Bank Zachodni WBK
Grupa Santander

BI-WEEKLY ECONOMIC UPDATE

25 December 2017 – 7 January 2018

Please be advised that today's Weekly Economic Update will be the last for 2017.
We will resume publication on January 5, 2018.
We wish our readers a happy Christmas and a prosperous New Year!

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		WEDNESDAY (27 December)					
16:00	US	Conference Board index	Dec	pts	128	-	129
16:00	US	Pending Home Sales	Nov	% m/m	-0.75	-	3.5
		FRIDAY (29 December)					
14:30	US	Personal Income	Nov	% m/m	0.4	-	0.4
16:00	US	Michigan index	Dec	pts	97.2	-	96.8
16:00	US	New Home Sales	Nov	% m/m	-4.38	-	6.2
		TUESDAY (2 January)					
9:00	**PL**	**Poland Manufacturing PMI**	**Dec**	**pts**	**-**	**54.0**	**54.2**
9:55	DE	Germany Manufacturing PMI	Dec	pts	63.3	-	63.3
10:00	EZ	Eurozone Manufacturing PMI	Dec	pts	60.6	-	60.6
		WEDNESDAY (3 January)					
14:00	**PL**	**Flash CPI**	**Dec**	**% y/y**	**-**	**2.1**	**2.5**
16:00	US	ISM manufacturing	Dec	pts	57.95	-	58.2
20:00	US	FOMC Meeting Minutes					
		THURSDAY (4 January)					
3:45	CH	Caixin China PMI Services	Dec	pts	-	-	51.9
9:55	DE	Markit Germany Services PMI	Dec	pts	55.8	-	55.8
10:00	EZ	Eurozone Services PMI	Dec	pts	56.5	-	56.5
14:15	US	ADP report	Dec	k	185	-	190
		FRIDAY (5 January)					
11:00	EZ	Flash HICP	Dec	% y/y	1.5	-	1.5
14:30	US	Change in Nonfarm Payrolls	Dec	k	185	-	228
14:30	US	Unemployment Rate	Dec	%	4.0	-	4.1
16:00	US	ISM services	Dec	pts	57.4	-	57.4
16:00	US	Factory Orders	Nov	% m/m	1.5	-	-0.1

Source: BZ WBK. Reuters. Bloomberg

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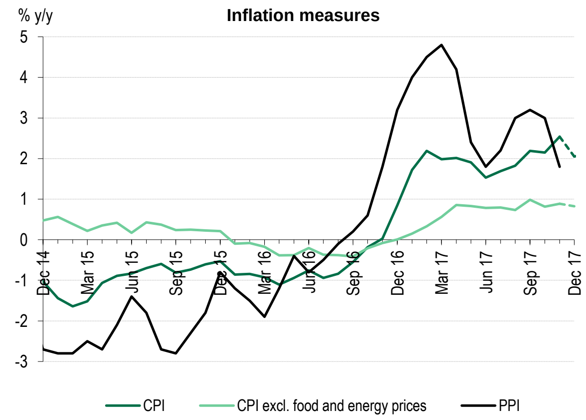
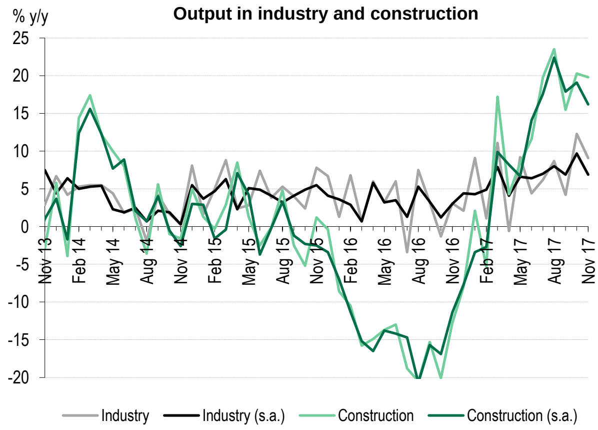
What's hot in the coming weeks – Decline in inflation, new PMI index



- We expect PMI in December to inch a bit down to 54.0 from 54.2. In our view, rise in some PMI components in November was excessive (output, stocks), so a small downward correction is possible. Still, PMI will be pointing to a positive economic climate in Poland.
- CPI inflation went down to 2.1% y/y in December from 2.5% y/y in November, in our view. This development was driven mostly by changes in fuel prices – Dec 16 saw a spike, while Dec 17 a decline, securing a strong base effect. Prices in core categories will be slowly climbing up. In 2018, we expect CPI to zigzag in 2-3% y/y range with strong changes in breakdown and major contribution of core inflation.
- We will also get to see revised data on balance of payments. We are expecting a relatively small deficit at €671mn in 3Q17.

Last week in economy – November data above expectations



- Polish industrial output rose in November by 9.1% y/y, slightly below expectations (market consensus at 9.6% y/y, our forecast at 10.1% y/y). Highest growth was recorded in export-oriented sectors as strong momentum in industry is driven by strong demand from Germany and the EU in general. We expect output to continue its upward trend in the months to come, given positive economic outlook for Europe. Construction rose by 19.8% y/y, much above the consensus at 14.1% y/y and our forecast at 11.2% y/y. Strong rebound in civil engineering (24.6% y/y) may be a proof of a further rebound in investments in 4Q17. Retail sales rose by 8.8% y/y, way above market expectations (6.4% y/y) and our forecast (7.1% y/y). The upward surprise was delivered by a spike in sales of durables: cars (15.9% y/y), electronic home appliances and furniture (14.8% y/y). The economic growth should remain rapid in the quarters to come, at c4.8% y/y in 4Q17 and 4.0% in 2018, driven by strong consumption, exports and recovering investment. Monthly data also support our forecast of accelerating consumption of durable goods.
- In November enterprise sector employment growth rose from 4.4% y/y to 4.5% (market expected 4.4%, versus us at 4.3%). The monthly increase of employment was the strongest among all Novembers since comparable data are available (1990!), which is quite striking given the currently tight labour market. Wage growth declined from 7.4% y/y to 6.5% y/y (market consensus and our forecast at 7.1% y/y), despite the same scale of the working day effect as in October. Such data correspond to the dovish tone of the last MPC meeting with the governor doubting the labour market situation is as severe (in terms of lack of spare capacity) as the 'soft indicators' may suggest. We expect that wage pressure will grow in the coming quarters, leading to acceleration of corporate wages.

Quote of the week – Clear risk of a serious breach of the rule of law in Poland

European Commission, 20 Dec

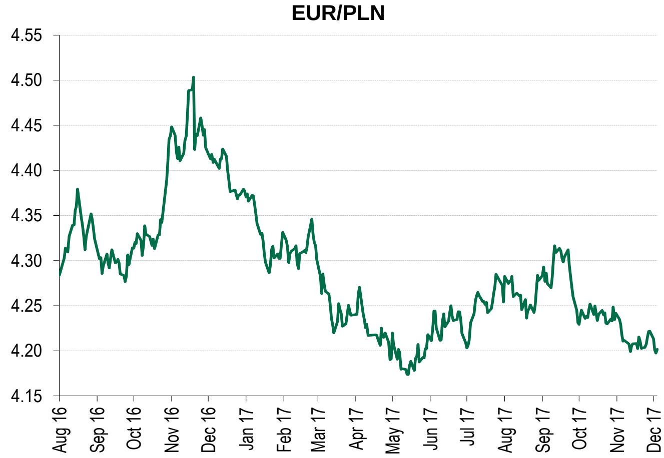
The Commission has today concluded that there is a clear risk of a serious breach of the rule of law in Poland. (…) The Commission has therefore proposed to the Council to adopt a decision under Article 7(1) of the Treaty on European Union.

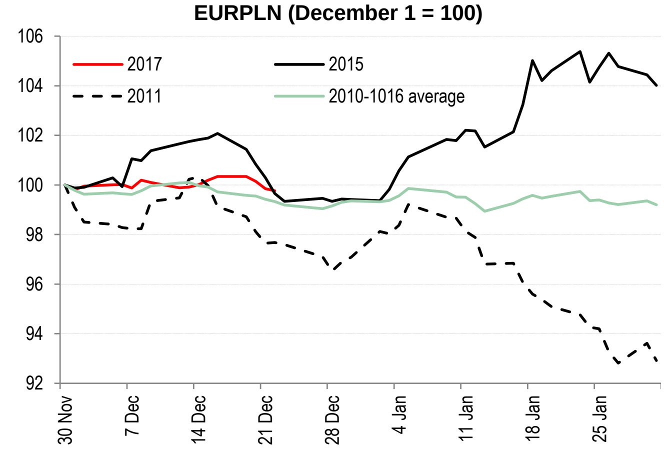
Jerzy Kwieciński, Deputy Development Minister, Bloomberg, 18 Dec

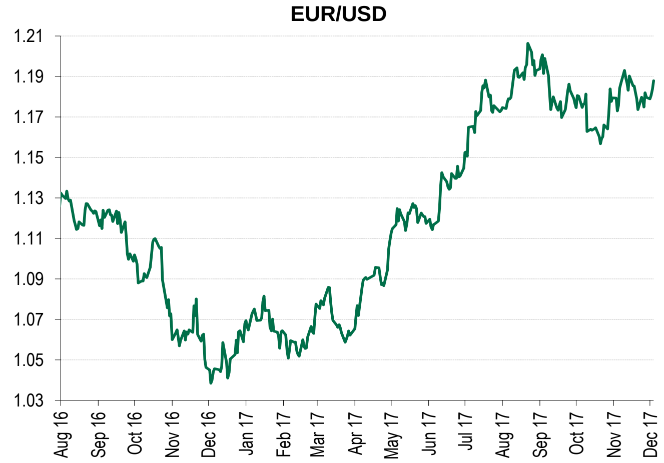
The dispute with the EU has so far has had no impact on the current financing programme, though I'd lie if I told you that tension helps the relationship. Brexit can definitely have a negative impact, especially if it leads to a financial gap with no plan by member states to cover that. The tensions do impact discussions on the funding in the next programme. But we're opposing adding new preconditions to funding, including linking funds with rule of law as suggested by the commission.

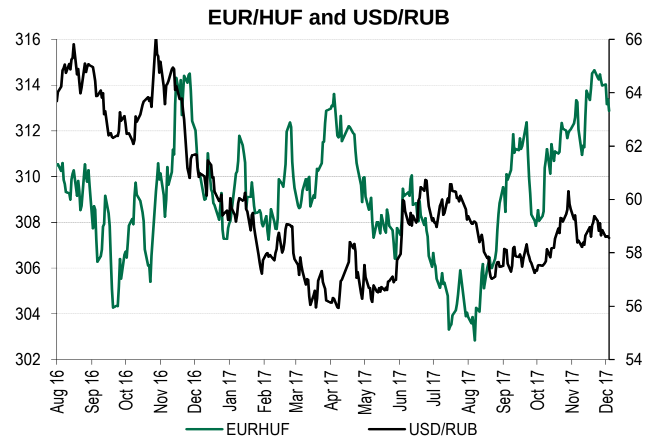
The European Commission recommended the EU Council to trigger the Article 7 of the EU Treaty against Poland. This is the first time ever the pressure of the EU institutions directed at a single country went that far. It still does not imply sanctions (which are described in Article 7(2)), but is a step in this direction. Sanctions still seem to be quite unlikely, in our view, as the next step (serious and persistent breach of EU rules) requires a unanimous vote by member states (ex Poland). It seems that veto could come from Hungary (a country which might seek reciprocal protection from Poland in its arguments with the EU). The Hungarian deputy PM Zsolt Semjen said after the EC decision that action against Poland is unacceptable and his government will be against introducing sanctions.

Foreign exchange market – Data to show direction at the turn of the year









CPI may push EURPLN up

- Unsurprisingly, this week has not brought any meaningful changes on the Polish FX market. In line with what we had expected, solid domestic economic activity data failed to move EURPLN and the exchange rate is still in the horizontal trend hovering near 4.20. Decision of the European Commission to launch the procedure in Article 7 of the EU Treaty triggered only a marginal and temporary reaction. USDPLN declined to 3.52 from 3.58 thanks to a higher EURUSD. The zloty gained also to the British pound (GBPPLN fell to 4.72 from 4.82) and the Swiss franc (to 3.58 from 3.63).
- Since 2010, looking at the EUR/PLN performance at the turn of the year, we do not find a clear pattern. What we may say is that the very beginning of the new year could see a slightly weaker zloty. However, there is no clear indication where the exchange rate could move later in January.
- In early 2018 we will learn Polish flash December CPI. Our forecast assumes that we could see some down move from the 2.5% y/y reached in November. Such a figure, together with dovish outcome of the last MPC press conference and no hawkish comments since then, could weigh on the zloty, in our view. However, we think EURPLN may stay in the 4.19-4.23 range at the turn of the year.

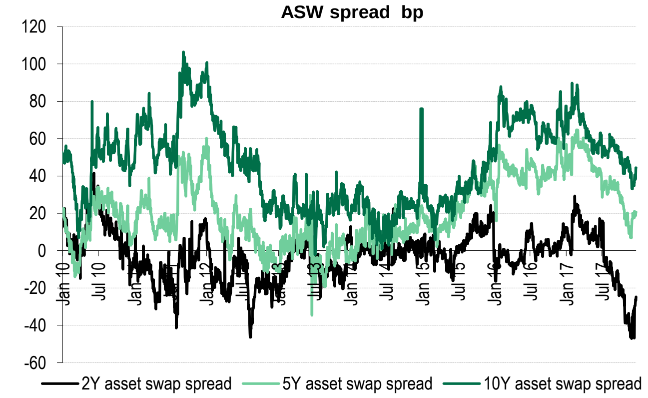
ISM could push EURUSD down

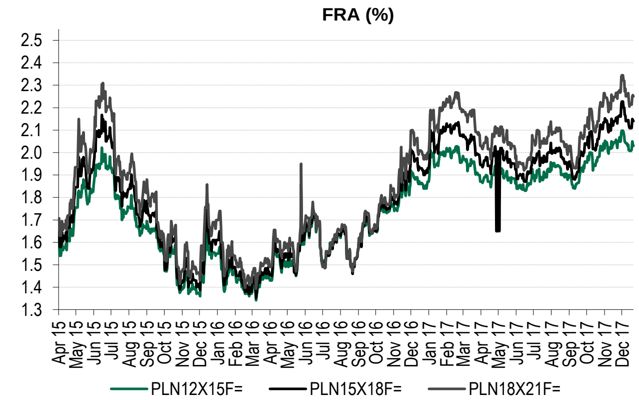
- EURUSD neared 1.19 from 1.173 thanks to hawkish remarks of the ECB central bankers and despite the approval of the long-awaited US tax bill. Taking a broader look, the exchange rate stayed in the horizontal trend observed since late November.
- We do not think the final week of the year could bring any material changes on the market. In early January we will get to know the US manufacturing ISM index. The December FOMC “dot plot” showed that the US central bankers sustained their forecasts for a three 25bp rate hikes in 2018. However, the interest rate market is currently not pricing such a scenario and if the next US data are strong, the dollar could gain early next year.

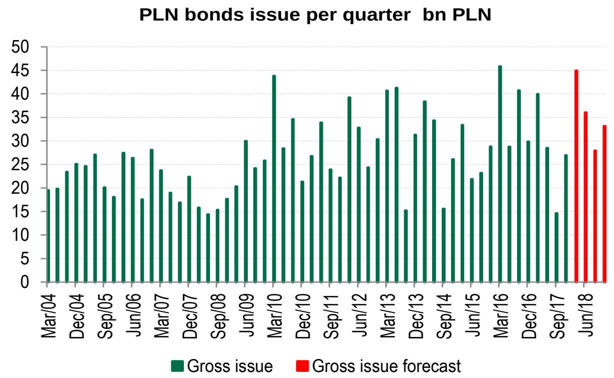
Interest rates flat in Hungary and Czechia

- The forint is likely to gain vs the euro after eight consecutive weeks of depreciation as EURHUF fell to 312 from 314 in the recent days. The Hungarian central bank left interest rates unchanged this week repeating that accommodative monetary policy is needed for inflation to reach its target in mid-2019. The central bank left its CPI forecasts unchanged for 2018 and 2019 (at 2.5% and 2.9%, respectively) and raised its GDP estimates for 2018 to 3.9% from 3.7%.
- EURCZK was stable close to its local peak waiting for a Czech central bank (CNB) decision on rates. The most recent comments of central bankers were mixed and the market has lost faith that third rate hike will be delivered this year. Indeed, the CNB decided to leave rates unchanged citing the strong koruna as a reason for a pause in tightening cycle. The outcome of the meeting did not have much impact on the Czech currency.
- Russian ruble did not move much vs the dollar and USDRUB stayed near 58.75.

Interest rate market – The higher supply at the beginning of the year







Core markets and EC pushed the yields up

▪ Over the last week the yields increased across the curve. The strongest move was observed on the long end (12bp) and short end of the curve (8bp). On the belly the move was the smallest (6bp). This process was accompanied by asset swap spread widening corresponding to roughly half of the increase in yields. This move was reflected by 2-5bp upshift on the longer end (+12M) of the FRA curve.

▪ The 2/3 of yields increases in Poland was fueled by core market sell-off. The rest of the curve upshift was triggered by EC decision to launch against Poland Article 7 of European Treaty.

Expected short-term stabilisation

▪ The end of 2017 should be relatively stable on the debt market. As usual, low liquidity at the end of the year may support temporary, but strong prices changes due to the window dressing process. We expect some debt strengthening at the end of the year, the stronger one on the long end of the curve. Simultaneously, we think that the IRS rates will remain stable. These changes will be supported by expectations for inflation (we expect flash December reading at 2.1% and stabilization of core inflation) as well as anticipated by us core bonds market rebound.

▪ We expect that at the beginning of the year the domestic debt market will be under mild negative pressure affected by high PMI reading (our forecast is 54.0).

Higher debt supply on the horizon

▪ As In the longer horizon, we anticipate further gradual yield rise, more noticeable on the long end amid higher (than in 4Q17) debt supply at auctions in 1Q18. The front end of the curve should drop a little from current levels, driven mainly by redemption of WZ0118 floating-bonds planned for the end of January (cPLN8bn). We do not expect meaningful changes on the long end and the belly of the IRS curve, while the short end should decreases marginally.

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