

# WEEKLY ECONOMIC UPDATE

## 8 – 14 January 2018

Market mood has been really optimistic over the last weeks, with rising risk appetite and stock market rallying. This wave pushed the zloty to 4.14 per euro, the lowest level since August 2015, and the CHFPLN exchange rate below 3.55 – the lowest level since January 2015. Polish CPI for December fell to 2.0% y/y under impact of high base effect, while PMI surprised to the upside, suggesting robust macro conditions. Global macro data were also positive.

This week the macro calendar is rather light; on Monday we will get to see European Commission's ESI indicators (likely to confirm sanguine moods) and on Wednesday the MPC meeting is to finish.. Moreover, the Sejm will work on draft budget for 2018. Another cabinet reshuffle was announced to be carried out soon after Three Kings' Day, but it seems not to happen until work on the budget is completed. There are some macro releases planned abroad, but of minor importance.

We do not expect much new from the Polish MPC. The rhetoric of the NBP governor will most likely stay very dovish, given that the recent macro readings have not induced him to change his view (drop of inflation, deceleration of wage growth). In general, we are expecting no new signals for the market, but at the same time we see that the current trends are running out of fuel. There is not much potential for the stronger zloty and longer-end bonds. Shorter end, on the other hand, can be supported by dovish MPC and buybacks scheduled for the end of the month.

### Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST			LAST
				MARKET	BZWBK	VALUE	
<b>MONDAY (8 January)</b>							
08:00	DE	Factory Orders	Nov	% m/m	-0.2	-	0.5
9:00	CZ	Industrial Output	Nov	% y/y	5.5	-	10.5
11:00	EZ	Retail Sales	Nov	% m/m	1.3	-	-1.1
<b>TUESDAY (9 January)</b>							
08:00	DE	Exports	Nov	% m/m	1.2	-	-0.3
08:00	DE	Industrial Production	Nov	% m/m	1.8	-	-1.4
11:00	EZ	Unemployment Rate	Nov	%	8.7	-	8.8
<b>WEDNESDAY (10 January)</b>							
	<b>PL</b>	<b>Poland Base Rate Announcement</b>		%	<b>1.50</b>	<b>1.50</b>	<b>1.50</b>
09:00	CZ	CPI	Nov	% y/y	2.4	-	2.6
09:00	CZ	GDP	3Q	% y/y	5.0	-	5.0
<b>THURSDAY (11 January)</b>							
11:00	EZ	Industrial Production	Nov	% m/m	0.7	-	0.2
14:30	US	Initial Jobless Claims	week	k	248	-	250
<b>FRIDAY (12 January)</b>							
9:00	HU	CPI	Dec	% y/y	2.2	-	2.5
14:30	US	CPI	Dec	% m/m	0.2	-	0.4
14:30	US	Retail Sales Advance	Dec	% m/m	0.3	-	0.8

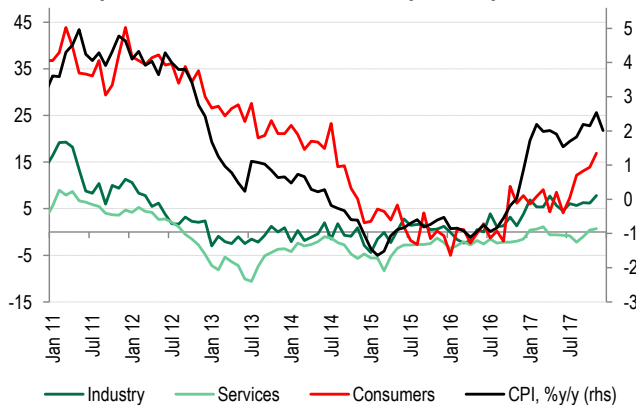
Source: BZ WBK, Reuters, Bloomberg

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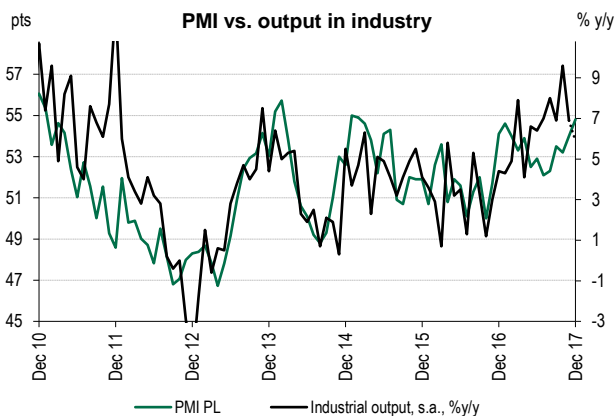
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**What's hot next week – MPC to stick to dovish tone****European Commission indicators: price expectations**

▪ MPC decision is due on Wednesday. We do not expect much new from the Council. The rhetoric of the NBP governor will most likely stay very dovish, given that the recent macro readings have not induced him to change his view (drop of inflation, deceleration of wage growth). At the press conference, we expect two hawks, Gatnar and Zubelewicz, to turn up, as the last time they accompanied the governor was Jul-17. We think their calls will not overshadow the governor's dovish main message.

▪ ESI indicators should confirm continued high optimism across the economy. We are interested in consumer inflation expectations which have recently been rising quite rapidly.

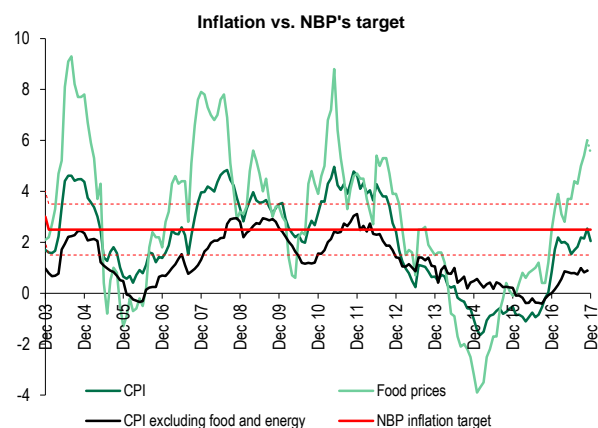
▪ This week Sejm is to make progress on the 2018 budget bill. The government reshuffle is expected to come once this legislative work has been completed.

**Last two weeks in economy – Business optimism and disinflation**

▪ Polish manufacturing PMI rose in December to 55.0, its highest level since February 2015. Companies reported a solid rise in output and new orders (with domestic orders outpacing external ones), as well as an acceleration in employment growth. The survey suggests that the Polish industry remains in very good shape, benefiting from economic revival in the euro zone and a strong local consumer market. Surprisingly, high PMI implies an upward risk to our sub-consensus forecast for December industrial output at 2.2% y/y (market expectations at 3.1% y/y).

▪ Inflation fell in December to 2.0% y/y from 2.5%, in line with our forecast (market consensus at 2.1%). The main reason behind the decrease was a high base effect in fuel prices, which rose sharply in Dec-16 and fell in Dec-17. Also, growth in food prices weakened slightly, according to our estimates. We think that the core CPI (excluding food and energy) somewhat dropped from 0.9% y/y to 0.8%. A full release is scheduled for January 15. According to our forecast, CPI is likely to remain near 2% y/y until Feb-18, after which it should climb above 2.5% in mid-year, and drop again toward 2.0% by December. Meanwhile, core inflation should be climbing gradually throughout the year, toward 2% y/y.

▪ In 3Q the current account surplus reached €112mn vs deficit at €799mn in 2Q. The improvement results from better-than-previously-reported performance of exports in 3Q (+12% y/y vs 11% y/y before the revision) and imports keeping its pace of growth. The scale of growth of revenues from services was revised up more than for expenditures (+5pp vs +3pp). The income balance was also revised higher. These data fit into the scenario of further gradual improvement in C/A amid strong external demand and moderate imports growth.

**Quote of the week – The EU is not a supermarket****Martin Schulz, SPD leader, PAP, 5 January**

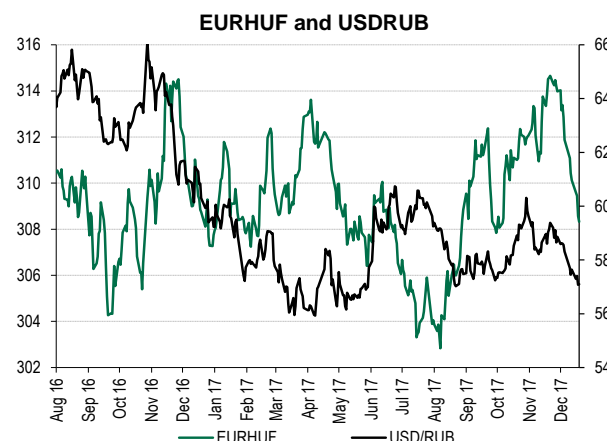
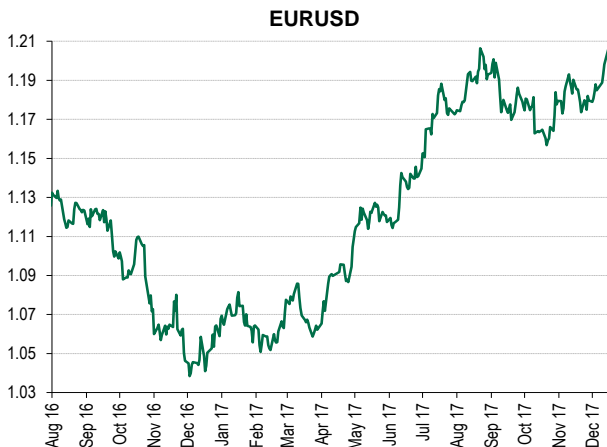
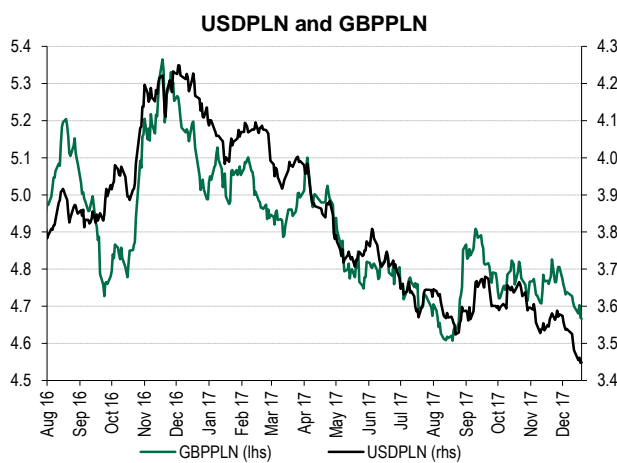
In the EU's future multi-year budgets, Germany cannot simply continue to contribute the usual sums, if beneficiary countries such as Hungary and Poland do not play a role in admitting refugees.

We are paying and bearing costs related to refugees, yet some countries are not admitting refugees - they are taking us for a ride.

The EU is a community of law and not a supermarket where everybody picks and chooses what they like.

Germany is getting closer to form a coalition government with SPD. The party's leader, Martin Schulz, has many times expressed negative opinions about Poland and Hungary's non-compliance with the EU refugee policy. This means that the German government to be formed may follow a tough line of politics vs the two countries which, in turn, increases the risk that the EU will include conditionality of payments in its next multi-year fiscal framework, after 2020. Given the current rule-of-law dispute of Poland and the European Commission, already leading to a recommendation of the latter to trigger Article 7.1 of the EU Treaty, this implies a growing risk of a significant reduction of financing that Poland would receive from the EU budget after 2020.

## Foreign exchange market – Zloty extends gains...



### ... but little room for further EURPLN drop

EURPLN stayed in the down trend at the turn of the year as the global market sentiment was very positive and demand for risky assets was high. Also, the media reported that the Ministry of Finance was active on the FX market selling euros in late 2017. As a result, EURPLN broke the May's bottom at 4.16 and temporarily fell to 4.14, its lowest since August 2015. The slightly below-consensus Poland flash December CPI did not have any material impact on the zloty. At the same time, USDPLN plummeted to 3.44 (its lowest since late 2014), GBPPLN reached 4.66 (last seen in September). CHFPLN dropped to 3.52 which means that the zloty has recovered all losses suffered vs the franc on 15 of January 2015 when the SNB abandoned 1.20 floor on the EURCHF market.

We think there is no big room for further zloty's appreciation. Technical analysis oscillators show EURPLN is oversold and implied volatilities are running at a multi-month lows. The 3M 25 delta risk reversal implied volatility is at the level last seen in late December 2015 (which is the lowest reading since 2008) and early 2016 showed a sharp rise of EURPLN to 4.50 from 4.20. We are not seeing any factor that could trigger such big move this time but this is yet another reason for us to stay cautious when betting for further zloty appreciation in the short term.

This week, the Polish MPC meets but we do not expect any change in the tone of communication, particularly given the last CPI data.

### EURUSD close to important level

EURUSD rose to 1.205, nearing the 2017 peak at c.1.21 vs 1.175 seen in mid-December. The euro was gaining thanks to strong European economic activity data and the dollar was hit by the situation on the US political scene and even solid data did not stop the EURUSD up trend.

The exchange rate approached the local resistance drawn by the 2017 peak and this week's events could determine if this level is broken or EURUSD returns into the range. Recent weeks showed that the mix of data and politics is driving the market. Next week, many FOMC members will speak and this could turn the market attention away from politics. If next US data is strong, the dollar may recover.

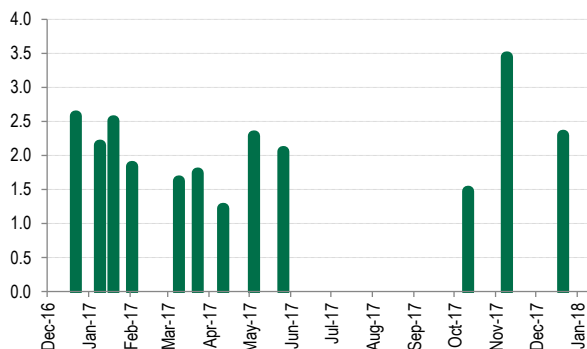
### CEE currencies strong at turn of year

Forint benefited from the positive global market sentiment and EURHUF plummeted to 308 from 315. Rising oil prices and weaker dollar helped USDRUB to fall to c56.8 from 58.5. EURCZK was pretty volatile at the year-end but this was the result of commercial bank's activity related to their balance sheet management.

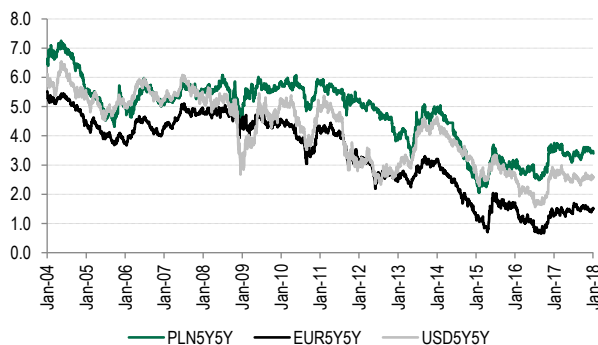
This week we will learn Hungarian and Czech December CPI, but in our view these releases are rather unlikely to trigger sustainable move. No rate hike in Czechia in December is widely perceived as a pause in the tightening cycle and the Hungarian central bank is not signaling it could change its dovish bias anytime soon.

## Interest rate market – Debt gains after good auction

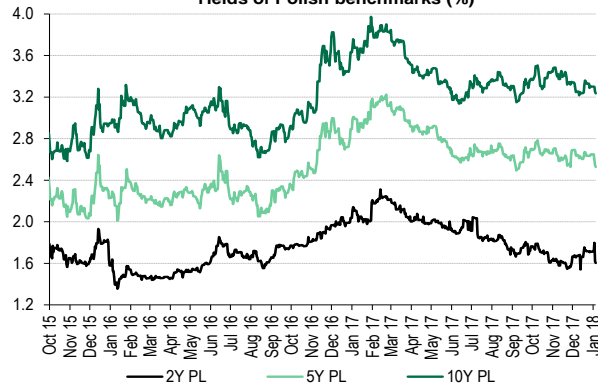
Bid to Cover ratio on the regular bond auction



Forward swaps 5Yx5Y



Yields of Polish benchmarks (%)



### Strong demand pushes curve down

▪ Last week we observed domestic bonds market strengthening. The first signal for the debt price improvement was generated by December flash CPI reading (2.0%/y, vs. expected 2.1% and previous 2.5% release). At the end of the week, the domestic bonds rally was fueled by good results (and strong demand) of regular debt auction. At Thursday's auction, Ministry of Finance sold bonds worth PLN5bn at the regular auction and PLN1bn in a top-up tender. Bid-to-cover ratio (b2c) was at 2.3 (vs 3.4 at previous auctions). WZ1122 (sold PLN1.08bn) and WZ0528 (sold PLN0.64bn) were bid stronger than other papers, with b2c at 3.0 and 2.5, respectively. Among the fixed rate bonds, PS0123 was the most wanted (b2c 2.3) and was sold at PLN1.48bn.

### MPC likely to support bonds

▪ In This week we expect the strengthening of the Polish debt to continue across the yield curve. Strong demand at the last auction suggested good perspectives for the Polish T-bonds. Some risk for this scenario is connected with Germany industrial production data and US inflation data due next week.

▪ MPC conference scheduled for this Tuesday should support the domestic bonds market. We think that at the conference, NBP will point out their determination to hold the interest rates at the current level at least up to 4Q18 (as we saw it at the December press conference). The last December inflation data should help NBP governor to justify this statement. Also, the global debt market should not affect the Polish bonds negatively. Data release from the core markets scheduled for this week will likely surprise on the positive side. However, the core market bonds behavior suggested that investors did not see too much room for tangible yield increase. Last months have shown that that series of strong releases of leading indicators as well as solid labour market data from both sides of the Ocean did have not led to a durable depreciation of 10Y US and Germany T-bonds.

### Looming redemption limits room for sell-off

▪ High debt prices provoke profit taking. Despite that, we believe that the expected-in-late-January redemption of PLN8.6bn WZ0118 bonds, mainly held by domestic banks, will encourage them to fill-up their position in floating-rate bonds and fixed-coupon bonds with maturity up to 5Y in the next weeks. This should strongly limit room for bond price decrease.

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