Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

22 – 28 January 2018

The main feature of last week was a rise in bond yields on core markets which spread to other markets including Poland. The markets were caught by surprise with possible ECB's change of forward guidance mentioned in December minutes. EURUSD remained above 1.22, despite several attempts of ECB speakers to talk it down. The large set of data for Poland released last week did not make EURPLN move much. The economic activity figures like exports, imports, as well as and construction output were better than expected, while industrial production and especially retail sales fell short of expectations. Altogether, Polish December macro data support our 4.8% y/y forecast of 4Q GDP. Wages accelerated again above 7% y/y showing the build-up of labour market pressure. Still, we do not think the Monetary Policy Council will be impressed, given the dovish rhetoric of its last press conferences. We assume that the rise of core CPI in the course of 2018 will bring a rate hike back on the table.

This week, the market attention could turn to Europe: flash January PMIs and the ECB meeting, in particular. Minutes from the previous meeting sounded hawkish, signaling a possible introduction of a change in the bank's forward guidance already in early 2018, despite the fact that the ECB QE programme is to run until September, and this has been indirectly confirmed in many ECB members' remarks since then. The meeting can increase market volatility this week. Poland's macro calendar is rather light, most likely not providing any triggers for Polish assets and currency.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		TUESDAY (23 January)					
11:00	DE	ZEW Survey Current Situation	Jan	pts	-	-	89.3
14:00	**PL**	**Money Supply M3**	**Dec**	**% y/y**	**4.4**	**4.2**	**4.5**
		WEDNESDAY (24 January)					
09:30	DE	Flash Germany Manufacturing PMI	Jan	pts	-	-	63.3
09:30	DE	Flash Markit Germany Services PMI	Jan	pts	-	-	55.8
10:00	EZ	Flash Eurozone Manufacturing PMI	Jan	pts	-	-	60.6
10:00	EZ	Flash Eurozone Services PMI	Jan	pts	-	-	56.6
10:00	**PL**	**Unemployment Rate**	**Dec**	**%**	**6.5**	**6.6**	**6.5**
14:00	**PL**	**Stats Office business sentiment**	**Jan**	**pts**		**-**	
16:00	US	Existing Home Sales	Dec	% m/m	-2.32	-	5.6
		THURSDAY (25 January)					
	PL	**WZ0118 buyback (PLN8.6bn)**					
10:00	DE	IFO Business Climate	Jan	pts	-	-	117.2
13:45	EZ	ECB Main Refinancing Rate	Jan-18	%	-	-	0.0
16:00	US	New Home Sales	Dec	% m/m	-7.91	-	17.5
		FRIDAY (26 January)					
11:30	**PL**	**Bond Auction (PLN5-9bn)**					
14:30	US	Durable Goods Orders	Dec	% m/m	0.9	-	1.3
14:30	US	Advance GDP	4Q	% Q/Q	3.0	-	3.2

Source: BZ WBK, Reuters, Bloomberg

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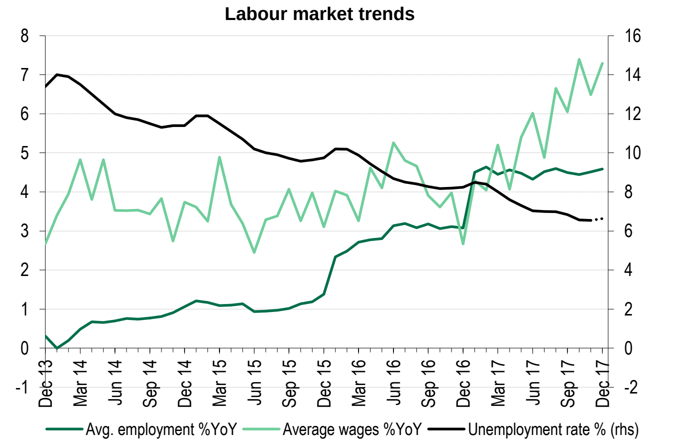
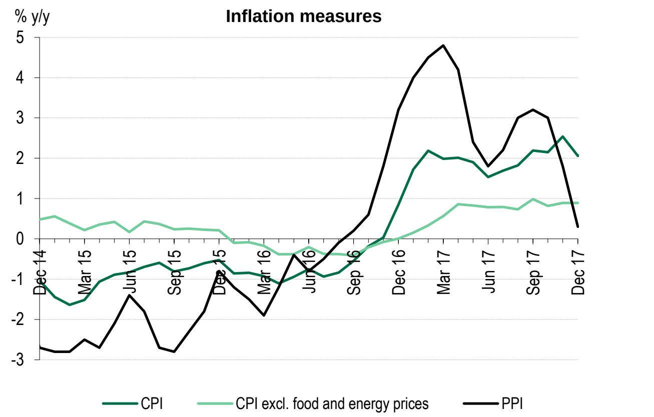
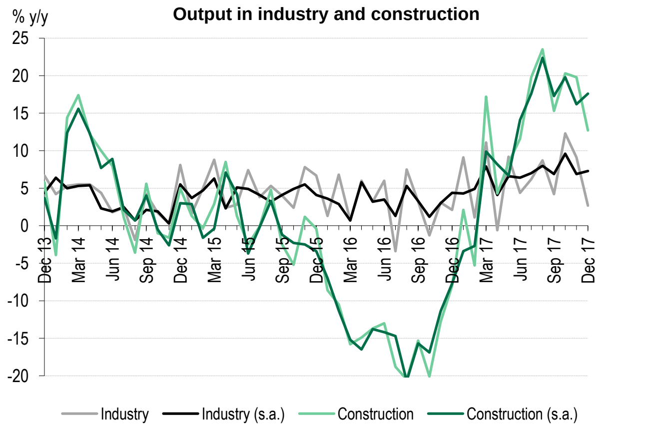
What's hot next week – Money supply, unemployment rate and business climate gauge



- Poland's macro calendar is rather light this week, with some interesting statistics, yet less watched by the market.
- M3 money growth is likely to show some deceleration in deposits and loans, mostly due to an FX effect. We are expecting money growth to accelerate in the upcoming quarters.
- In our view, the registered unemployment rate climbed to 6.6% in December. Most probably, rise in the number of the unemployed was the lowest this month since comparable data are available (early 90s) – thanks to strong labour demand and lower retirement age. Our forecasts is in line with data from the Labour Ministry, so a surprise is unlikely.
- We also expect Stats Office business climate indicators to show a further improvement of optimism. The monthly Statistical Bulletin will allow us to know more on strong labour market data released recently.

Last week in economy – December data confirm strong GDP growth in 4Q17





- Final reading of December CPI was at 2.1% y/y versus 2.0% in the flash release. Decline from November's 2.5% was due to high base effect in food and fuels. Core inflation excl. food and energy prices inched up to 0.9% y/y. In our view, inflation is likely to oscillate in 2.0-2.5% range in the months to come with a major change in its breakdown - from food/energy- to core-driven (we see core CPI at 2.0% at the end of 2018).
- Data on wages and employment for December beat expectations. Wage growth accelerated from 6.5% y/y to 7.3% and employment to 4.6% y/y from 4.5%. The acceleration in wages happened despite a lower number of working days y/y and is in line with our call that the tight labour market is generating a substantial wage pressure.
- C/A remained in surplus in November. Both exports and imports recorded a higher pace of y/y growth than expected, but it was the strength of the latter and its upward revision for October that was most surprising. The 12-month rolling C/A-to-GDP ratio set a new record high at 0.3% in November.
- Industrial output came in December at 2.7% y/y, lower than the market expected (3.5%) but slightly above our forecast (2.2%). Seasonally and working day adjusted output growth was 7.3% y/y, in line with 2H average confirming solid pace of expansion. Construction output surprised on the upside with 12.7% y/y vs 11.6% market consensus and our 10.2% call. It is a confirmation of accelerating investments in 4Q.
- Retail sales rose by 5.2% y/y in December, markedly slower than expected. In our view, sales slowed vs. November (8.8% y/y) mostly due to a negative working day effect (-2 days y/y). Slowdown in durable goods makes us think that many consumers advanced purchases (sell-offs in November).

December data support our 4.8% y/y forecast of 4Q GDP.

Quote of the week – Arguments weakened with the slowdown of CPI

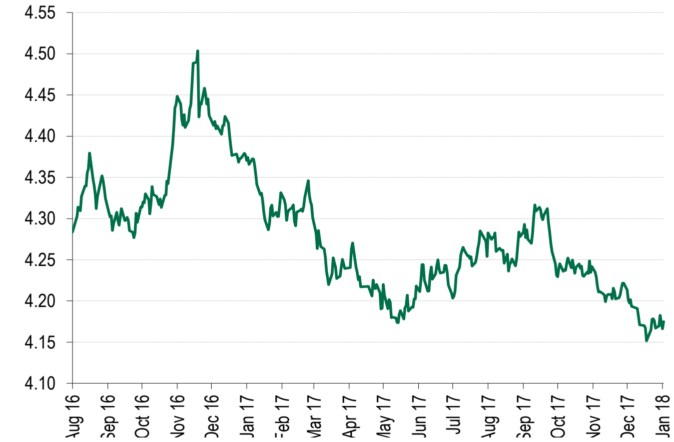
Grażyna Ancyparowicz, MPC member, Reuters, 17 January
If there are no signals that there is a robust credit activity and if all inflation triggers are either the result of the base effect or the result of independent factors (...) then it is very likely that throughout the year rates will be more or less at the level at which they are now.

Eugeniusz Gatnar, MPC member, Reuters, 17 January
My arguments supporting monetary tightening in the first quarter have weakened in connection with the inflation slowdown in December, which was deeper than I had expected. If March projection confirms a rise in inflation and weaker economic growth in 2019, then I would favour a rate hike sooner rather than later. However, if the March projection shows that GDP growth is not slowing and inflation is not accelerating, then I believe that one could wait for example until the next projection (in July) for a decision to raise rates.

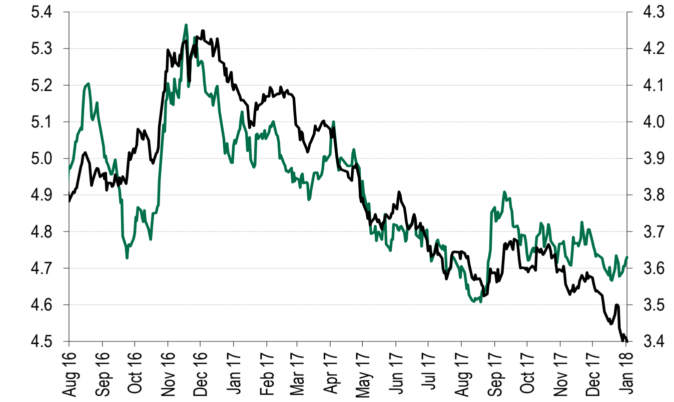
We think that with CPI likely to stay close but mostly below the 2.5% target this year the MPC may stick to 'wait–and-see' policy for long. While Eugeniusz Gatnar said during the last MPC press conference he could tolerate CPI outbreaks even above 3% y/y, it was under a condition that the structure of inflation stayed unchanged (ie with little input from core CPI categories). We assume that inflation will be more and more core-driven as the year progresses which should lead to the MPC hawks to become more vocal around the middle of the year and may again try to build a majority. If oil prices do not withdraw from 3-year highs they may try to affect the MPC's stance sooner. However, given the recent dovish rhetoric at press conferences only a larger set of positive data surprises later in the year might influence the Council's approach. We still think a rate hike will come in late 2018.

Foreign exchange market – Waiting for the ECB

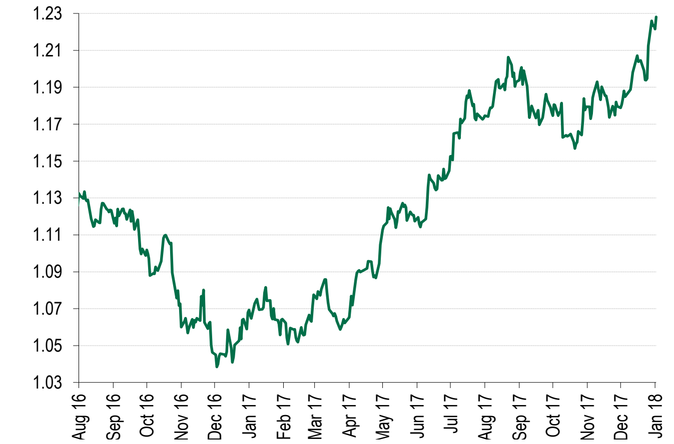
EURPLN



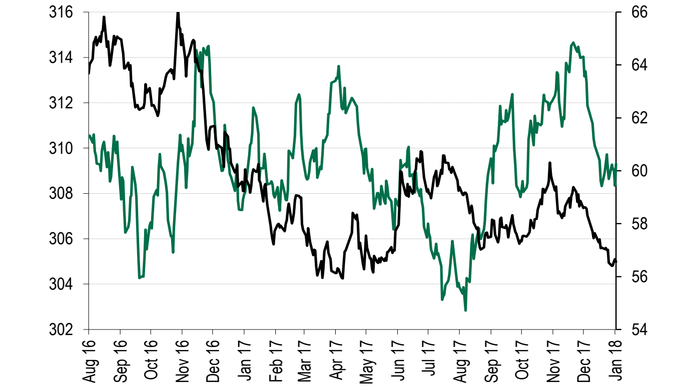
USDPLN and GBPPLN



EURUSD



EURHUF and USDRUB



EURPLN follows EURUSD

- Last week, EURPLN did not move much and was hovering around 4.17. Polish macro data was a mixed bag – lower C/A surplus and better-than-expected labour market figures. Global market mood was pretty positive but the dollar's appreciation prevented the zloty from benefiting from higher risk appetite. At the same time, USDPLN fell for a fifth week in a row but the pace of decline was smaller than in the previous weeks. GBPPLN and CHFPLN did not move much.
- This week, the market attention could turn to the European events: flash January PMIs and the ECB meeting.
- Tone of the minutes from the ECB December meeting was rather hawkish but this did not hit the CEE currencies and the EURPLN correlation with EURUSD proved more important. Like we elaborate below, we think that the outcome of the ECB meeting might push EURUSD down which may imply upside pressure on EURPLN under the assumption that correlation holds.
- Internally, there seems to be no events that could influence the zloty this week.

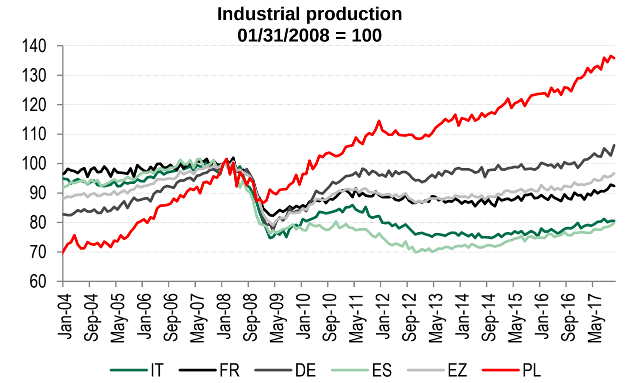
ECB may talk EURUSD down

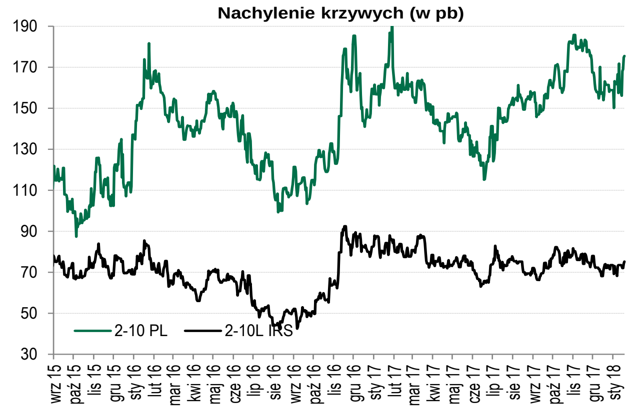
- EURUSD broke 1.23 on news about progress in the German coalition talks and comments of several ECB members. The euro did not keep its gains as next euro zone central bankers talked the currency down saying that it influences inflation. As a result, EURUSD ended the week close to 1.22.
- The last week's verbal attempts to stop euro appreciation make us think that the tone of the statement and remarks during the press conference would not be too hawkish. As a result, the outcome of the ECB meeting might hit the euro vs the dollar. Also, the manufacturing PMI indexes for Germany and the euro zone are now at their all-time high and much of that improvement has already been priced in by the market. Thus, any down correction – that should not surprise after such robust performance seen in the previous months – may be a trigger for down move of EURUSD. In our view, drop of the exchange rate might be bigger in the case of below-consensus reading than potential jump when data surprise to the upside.

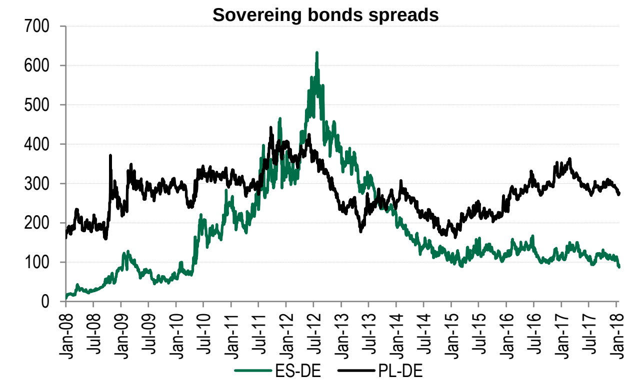
Koruna gains on rate hikes outlook

- Elsewhere in the CEE region, forint remained stable vs the euro, ruble lost slightly vs the dollar as the US currency gained on the global market and oil prices stopped rising. At the same time, koruna gained vs the euro with EURCZK falling to 25.36, breaking the 2017 bottom and reaching its lowest since March 2013. The koruna ignored the widely expected event of the new minority government losing the confidence vote and was boosted by a hawkish comment of Czech central bank member Vojtech Benda saying faster rate hikes are likely.

Interest rate market – Waiting for the new forward guidance







Yield curve stepper following core markets

▪ Over the last week, we observed the depreciation of belly and the long end of the curve and the downward shift of the short end of the curve. The 5y-10Y bonds segment sell-off was fueled by core bonds market, where the yield was rising (it worth to stress that at the same time we saw the price increase of Eurozone periphery bonds). In the case of the front end of the curve, the fall was a reaction to the expected this week WZ018 bonds buyback.

ECB in the spotlight

▪ This week the market players will be focused on the ECB conference. The investors expects that ECB the shows direction for the next moves of central bank, after the last remarks of its representatives. At the end of the week the investors will be focused on the bonds redemptions and bonds auction.

▪ In the last week ECB published December minutes, where the central bank suggested that the communication language would need to evolve gradually, tuned to the improving macroeconomics situation. Moreover the some central bank representatives, which suggested, that on the January meeting central bank could change the forward guidance language to the less dovish.

▪ In our view, this time we may face the same situation like in September when rising EURUSD pushed the ECB to soften the tone at the press conference in order to neutralize the hawkish statement. Thus, we think that high yields could fall after the ECB meeting on the euro zone market helping Polish debt to recover as well (mainly on the long end).

Bond auction

▪ On Thursday the Ministry will buyback WZ0118 bonds for PLN8.61bn. On Friday, the second regular bond auction will take place when debt for PLN5-9bn will be issued. The Ministry intends to sell zero-coupon OK0720, fixed-coupon PS0123 and WS0428 as well as WZ1122 and WZ0528 floaters. The Ministry said it could add WS and IZ (inflation-linked) bond series. We think that WS bonds will constitute c50% of total bond issuance.

▪ At the end of the week, the bond auction and buyback will take place. The net effect of these operations should not exceed +PLN0.4bn of bond issuance on the market (under assumption that the Ministry of Finance will stick to the plan of not issuing more than PLN9bn bonds at the regular auction). As a result, we expect yields to move down along the curve, mainly on the short end and the belly.

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