Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

19 – 25 February 2018

Last week, the global equity markets were licking wounds after the earlier sell-off. On the other hand, fixed income markets and the dollar did not see this sort of trend changes, both being still under selling pressure. The key figure of the week, US January inflation, came on the strong side, but was accompanied by poor retail sales and followed a day later by weak industrial output. As a result the market got more convinced that Fed could hike rates four times this year, but the three-hikes scenario is still the baseline. EURUSD set a new year-to-date high which together with a rebound on equities provided support for emerging currencies, including the zloty.

There was also plenty of domestic data, coming in line with our view that economic growth remained strong, wages and employment continued along the 2017 trends, confirming rising wage pressure, and with inflation getting softer in its first reading of 2018. Local markets were too busy adjusting to the external environment to pay attention to these releases.

This week we expect to see the zloty give back some gains and the global yields to correct lower. We are not sure if equities will find what it takes to continue to march higher. Flash PMI and Ifo may remind of the strong underlying macro story for Europe, but the recent sell-off was not based on doubts about economic prospects. The informal meeting of EU ex UK leaders should be watched as it could shed some light on the potential introduction of conditionality in the next EU budget, which is a big issue for Poland going beyond 2020.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
			MONDAY (19 February)				
			No important data releases				
			TUESDAY (20 February)				
10:00	**PL**	**Sold Industrial Output**	**Jan**	**% y/y**	**8.5**	**9.3**	**2.7**
10:00	**PL**	**Construction Output**	**Jan**	**% y/y**	**20.3**	**22.8**	**12.7**
10:00	**PL**	**PPI**	**Jan**	**% y/y**	**0.1**	**-0.2**	**0.3**
10:00	**PL**	**Retail Sales Real**	**Jan**	**% y/y**	**6.5**	**7.2**	**5.2**
11:00	DE	ZEW Survey Current Situation	Feb	pts	-	-	95.2
			WEDNESDAY (21 February)				
09:30	DE	Germany Manufacturing PMI	Feb	pts	60.5	-	61.1
09:30	DE	Markit Germany Services PMI	Feb	pts	57.0	-	57.3
10:00	EZ	Eurozone Manufacturing PMI	Feb	pts	59.3	-	59.6
10:00	EZ	Eurozone Services PMI	Feb	pts	57.6	-	58.0
16:00	US	Existing Home Sales	Jan	% m/m	0.7	-	-3.6
20:00	US	FOMC Meeting Minutes	Jan-18		-	-	0.0
			THURSDAY (22 February)				
10:00	DE	IFO Business Climate	Feb	pts	117.0	-	117.6
14:00	**PL**	**Money Supply M3**	**Jan**	**% y/y**	**4.8**	**4.8**	**4.6**
			FRIDAY (23 February)				
10:00	**PL**	**Unemployment Rate**	**Jan**	**%**	**6.9**	**6.9**	**6.6**
11:00	EZ	HICP	Jan	% y/y	1.3	-	1.3

Source: BZ WBK, Reuters, Bloomberg

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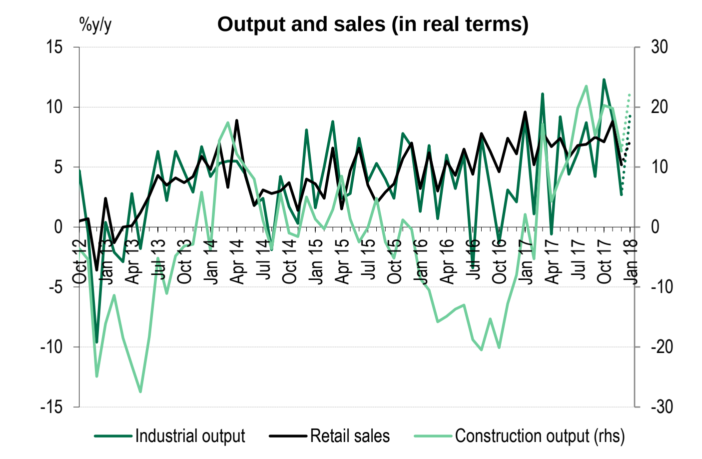
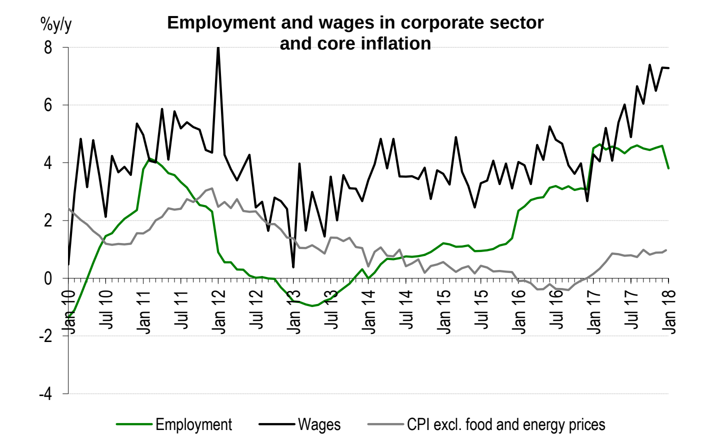
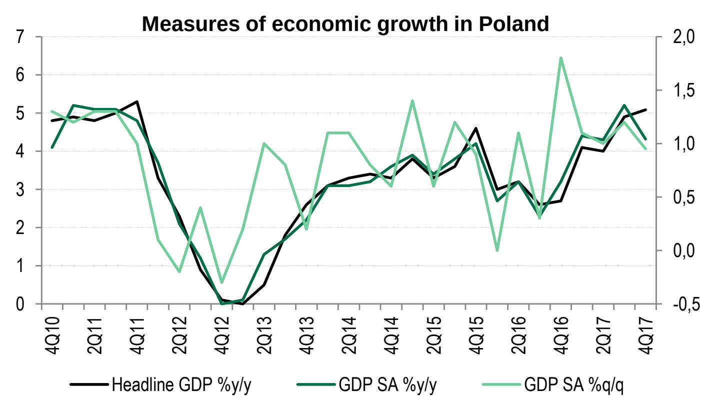
What's hot next week – Output and retail sales to shrug off December weakness



- This week, we will get data on economic activity in the first month of 1Q. As we wrote in our February MACROscope we expect the economy to keep running at about 5% y/y pace in 1Q, which would require the industrial output, construction output and retail sales data, all due Tuesday, to go back to the levels seen in October and November. These months had the same scale of working day effect as in January, while December offered much less worktime than a year earlier.
- Our industrial production forecast for January falls between 9.1% and 12.3% readings of the mentioned months, while construction output may even top 20.3% y/y from October thanks to unusually supportive weather conditions for this part of the year. Retail sales y/y growth may be however somewhat smaller due to an adverse base effect, but we are still above consensus with our 7.7% call as consumers in January might have made up for poor car purchases in December, and maintained extremely high level of optimism.

Last week in economy – GDP grew 5.1% y/y in 4Q, CPI goes below 2%





- Corporate employment in January at 3.8% y/y (vs. our 3.7% call and market expectations at 3.4%) and wage growth remaining at 7.3% (in line with our forecast, but higher than 6.9% consensus) should be treated as quite positive readings (in line with 2017 trends) The wage pressure has been increasing and employment has been staying at a decent level as the labour market is getting tighter.
- Polish inflation decreased in January from 2.1% y/y to 1.9%, in line with market expectations and slightly above our 1.8% forecast. Food prices rose by 1.1% m/m incl. alcohol and tobacco, we assumed 0.7% m/m. The release did not specify the fuel and energy price inflation so it is hard to get a precise estimate of core CPI. It likely went in January to the highest level since 2014, possibly to 1.0% instead of our earlier estimate of 1.1% y/y. CPI should stay close to 2% in the coming months, possibly rising to about 2.5% in the middle of the year only to drop back to c2% in late 2018.
- Flash GDP growth reading for 4Q17 was 5.1% y/y as we expected, vs. market consensus of 5.2%. Interestingly, in seasonally adjusted terms economic growth slowed to 4.3% in 4Q17 from 5.2% in 3Q17, after 1.0% q/q increase. It is still a very decent result, yet we do not fully understand what made the gap between seasonally adjusted and unadjusted GDP growth so large (highest since 2013). We see some risk that the final estimate of 4Q17 GDP growth could be revised slightly lower, as the data about foreign trade for December showed much higher than expected trade deficit. We still expect Polish economy to grow around 4.3% in 2018, due to extremely supportive external environment and strong domestic demand.

Quote of the week – Business as usual is not an option

Jean-Claude Juncker, European Commission (EC) President, EC, February 14

[Referring to February, 23 Informal Leaders' meeting to discuss EU budget priorities:] Let's first discuss about the Europe we want. Then, Member States must back their ambition up with the money to match. (…) we all need to understand that business as usual is not an option for this upcoming discussion.

Günther Oettinger, Budget Commissioner, Bloomberg, February 13

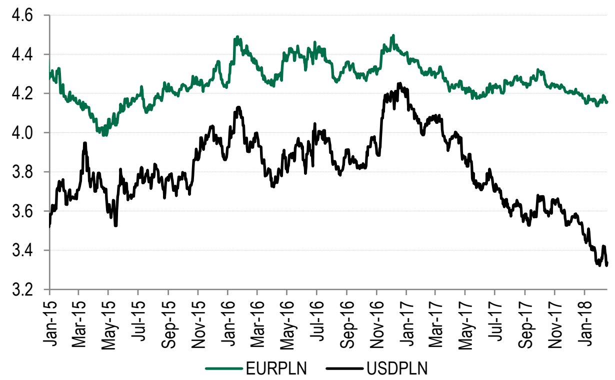
If the heads of governments give us the mandate, [linking subsidies to member states to compliance with rule-of-law criteria] will be part of our proposal. Poland and Hungary know that if they aren't behaving cooperatively, if they don't stick to rule-of-law, the readiness to fill up the EU budget will decline. Therefore I expect concessions on the political level between the member states, and I'm glad the European Council is discussing the EU budget framework for the first time in a few days.

The European Commission prepared numerous scenarios of multiannual financial frameworks beyond 2020 and released them ahead of the first informal meeting of the European Council to discuss key aspects of the next EU budget. These scenarios are supposed to help EU leaders decide on the direction for the budget, particularly how to balance it after the UK leaves the EU and whether the benefits paid from the budget should be linked to the compliance with common EU values (the so-called conditionality issue). The latter is important for Poland being in conflict with the EU under the Rule-of-Law Procedure. Informal summit will be convened to make such directional decisions on February, 23.

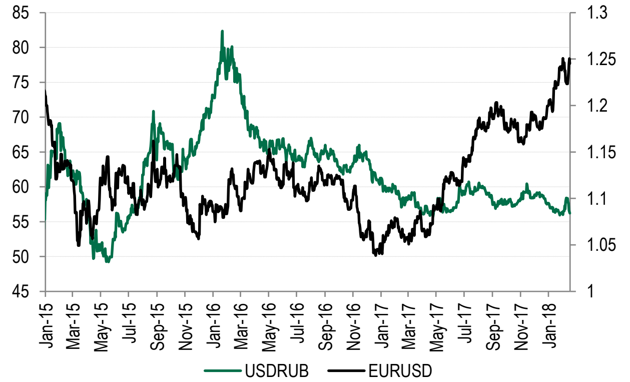
The EU commissioner for budget and human resources, Günther Oettinger, said that the legislative process for introducing conditionality rules has already started, and that further efforts will depend on the scale of support gained from the leaders of member states.

Foreign exchange market – Risk aversion hits zloty and backs dollar

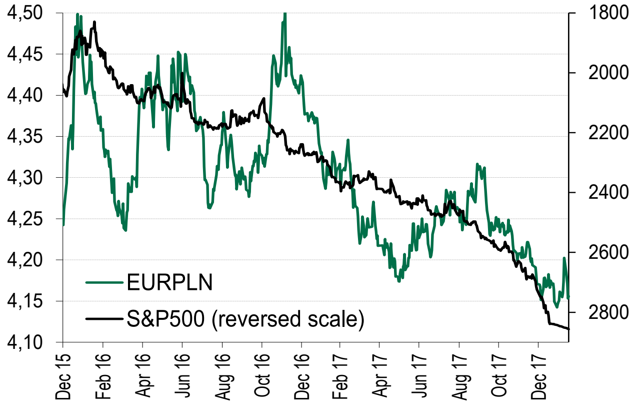
EURPLN and USDPLN



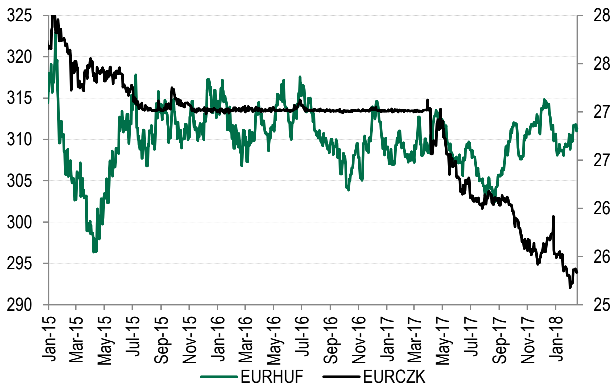
EURUSD and USDRUB



EURPLN and S&P500



EURHUF and EURCZK



Zloty rebound

- EURPLN was falling over the last week, following the stock market rebounds. In the second part of the week, some deceleration of PLN gains occurred after the US inflation data release (surprise on the positive side). However, the PLN strengthening against EUR was stopped by the US retail sales data (negative surprise) and industrial production data (below consensus). As a result, EURPLN slid to 4.1560 at the end of the week from the 4.1700 at the beginning. The zloty also gained against other main currencies: GBPPLN dropped to 4.6870 from 4.7240, CHFPLN shifted down to 3.6010 from 3.6360, while the USDPLN slid to 3.3380 from 3.3910 (returning to the level seen at the end of the previous week). PLN ignored the Polish inflation data (which showed the short-term downward trend of inflation y/y growth), labour market statistics as well as flash 4Q GDP data.
- This week, we will get to see the flash European PMI data reading for February and domestic industrial data for January. In our opinion, the data will not affect the PLN. We gather that the situation on the stock markets will remain crucial for the zloty valuation. Given that we expect a downward pressure on equities, the zloty may depreciate. At the end of the week, we expect some EURPLN increase to 4.17 and USDPLN move to 3.36.

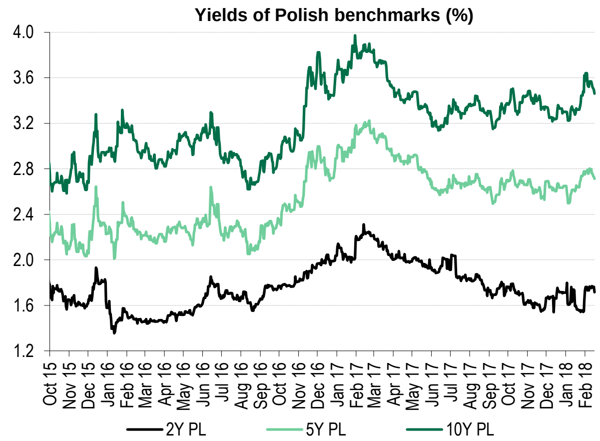
Dollar hit by data on retail sales and industrial output

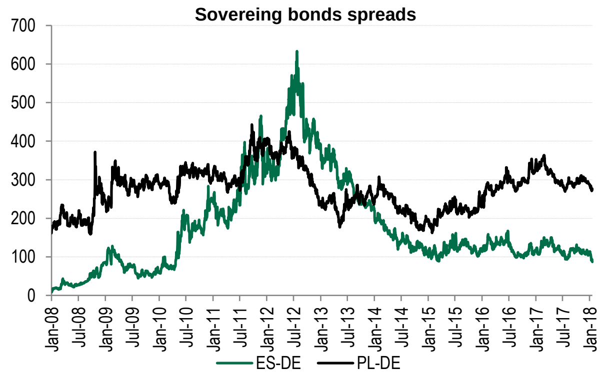
- Last week, the EURUSD upward march was continued thanks to weaker-than-expected US January's retail sales data (-0.3% m/m vs. +0.2% forecasts) and industrial production data (-0.1% m/m vs. +0.2% m/m forecasts). The upward move was slowed by higher-than-expected US inflation print (+0.5% m/m vs. +0.3% m/m forecasted). At the end of the week, EURUSD surged to 1.2440 from 1.2250 at the beginning.
- This week, we are expecting EURUSD to go down, supported by weaker results of equity markets, which are very likely to suffer a correction after last week's strong rebound. PMI numbers from Europe should not affect EURUSD.

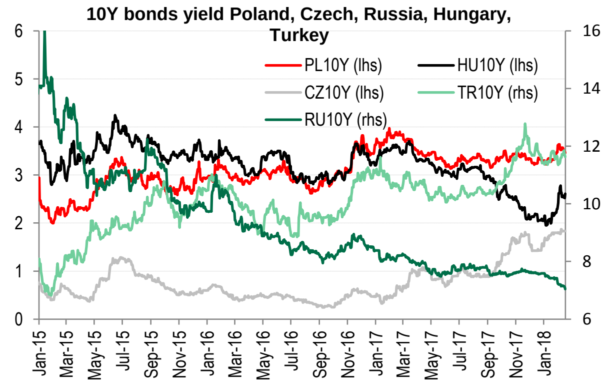
CEE recovery on the strong data

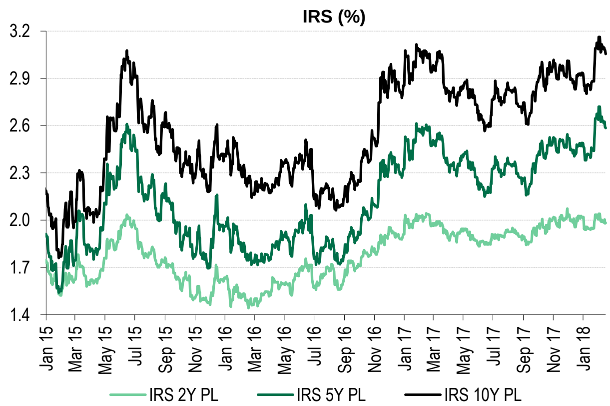
- Other CEE currencies lost at the beginning of the week following the equity market sell-off. However, later in the week the CEE FX market regained strength. Only the Czech koruna was quite sluggish, moving in 25.3-25.4 range. The ruble and the forint were boosted by better-than-expected economic data. In Hungary, 4Q17 GDP rose by 1.3% q/q versus expectations at 1.1% and in Russia January industrial output rose by 2.9% m/m vs forecasts at 0.5%. This dragged EURHUF down to 311.40 from 311.90 with a temporary spike to 313.20. USDRUB slid to 56.40 from 58.70 with a most considerable move on Wednesday (to 56.70 from 57.70) after release of industrial output statistics.
- Russian statistics on incomes and retail sales are due for release this week. These numbers are expected to point to a further moderate recovery in the Russian economy. This, combined with a bit higher oil prices, will be supportive for the ruble. In Czechia and Hungary the macro calendar is light, and this should stabilise their currencies.

Interest rate market – PMI and stocks help the debt









Polish bonds reinforced by weak US data

- Last week was marked by strengthening of Polish and CEE bonds market, despite the still unstable core bond market. The Polish bonds gained marginally in the 2Y segment, where the yields fell by 1-2 bp, while the yield curve in the 5-10Y segment dropped significantly by 6-8 bp. The IRS rates were following a slightly different route, the IRS curve slid by 2 bp across the curve. This move was triggered by the release of core markets data, where the weaker-than-expected US retail sales release and industrial production data positively affected CEE debt markets. The Polish inflation data release was ignored by the market players.

European PMI will be pushing the curve down

- This week, we expect some improvement in the global and domestic debt market. On the domestic market, we anticipate strengthening in the 4-10Y segment and stabilization on the short end. At the same time, we are waiting for some correction on the IRS market, the stronger one on the front end of the curve. This scenario will be likely supported by the macro data releases scheduled for the next week. Especially the European manufacturing PMI data, where we expect some data deterioration, supporting our scenario. Simultaneously, we expect the services sector flash PMI indices to remain at the higher level, which should potentially limit the expected downward pressure on yields and rates. Moreover, we expect that there will be a return to downward trends in the stock markets after upward correction last week. Moreover, we think that lower crude oil prices (in PLN and EUR), after the two weeks of sell-off should positively impact the European bonds market.

Domestic data will be ignored

- On the domestic front, the industrial production data and retail sales data release were scheduled for this week. We reckon that this information will confirm the high level of activity in the Polish economy. However, considering the MPC are strongly devoted to keep interest rates flat, we do not think that these data could have any impact on the domestic debt market. In our opinion, the PPI reading (where we expect a negative number) could positively affect the domestic bond market, but the real effect will be limited.

Auction

- For the Thursday's auction, the Ministry of Finance (MoF) is planning to sell PLN3-6bn. At the auction, they will offer zero-coupon OK0720 bonds, fixed-coupon PS0123, and WS0428 bonds as well as floating-coupon WZ0524 and WZ0528 bonds (and possibly WS or IZ –inflation-linked series bonds). The final offer and the supply will be announced 2 days in advance. In our view, WZ floaters will make up even 50% of the sold bonds. In our opinion, the auction will be neutral for the market.

Additional information is available on request. Please contact Bank Zachodni WBK S.A., Economic Analysis Department, al. Jana Pawła II 17, 00-854 Warsaw, Poland, phone +48 22 534 18 87, email ekonomia@bzwbk.pl