Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

15 – 21 January 2018

Last week was full of important Polish and global events. In Poland, the long-awaited government reshuffle was announced. Many ministers were replaced but as there was no meaningful market reaction, investors seem not to perceive these changes as a factor that could be harmful for the public finances. The MPC left interest rates unchanged and the tone of the press conference was even more dovish than previously which supported Polish bonds amid global sell-off.

On the global market, volatility was driven by the media reporting that China could stop buying US bonds, solid euro zone macro data, hawkish tone of the ECB minutes and rising chances for a new German government. All these factors pushed EURUSD above 1.20 to its highest since early 2015 and triggered a sharp rise of yields worldwide.

This week, important US and Polish data are on the agenda. Friday's release of December industrial output which we expect to be slightly disappointing will join the dovish signals from the flash December CPI and MPC meeting possibly weighing on the zloty and supporting bonds. Given the recent EURUSD rally, we think there is bigger room for the exchange rate to fall after strong figures rather than for a rise in the case of disappointing readings.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
			MONDAY (15 January)				
14:00	**PL**	**CPI**	**Dec**	**% y/y**	**2.0**	**2.0**	**2.0**
14:00	**PL**	**Current Account Balance**	**Nov**	**€mn**	**693**	**880**	**575**
14:00	**PL**	**Exports**	**Nov**	**€mn**	**17 884**	**17 985**	**17 914**
14:00	**PL**	**Imports**	**Nov**	**€mn**	**17 289**	**17 377**	**17 317**
			TUESDAY (16 January)				
14:00	**PL**	**CPI Core**	**Dec**	**% y/y**	**0.8**	**0.8**	**0.9**
			WEDNESDAY (17 January)				
11:00	EZ	HICP	Dec	% y/y	1.4	-	1.4
14:00	**PL**	**Employment in corporate sector**	**Dec**	**% y/y**	**4.5**	**4.6**	**4.5**
14:00	**PL**	**Average Gross Wages**	**Dec**	**% y/y**	**6.9**	**7.5**	**6.5**
15:15	US	Industrial Production	Dec	% m/m	0.4	-	0.2
			THURSDAY (18 January)				
14:30	US	Initial Jobless Claims	weekly	k	245	-	261
14:30	US	Housing Starts	Dec	% m/m	-2.1	-	3.3
			FRIDAY (19 January)				
14:00	**PL**	**Sold Industrial Output**	**Dec**	**% y/y**	**2.8**	**2.2**	**9.1**
14:00	**PL**	**Construction Output**	**Dec**	**% y/y**	**10.1**	**10.2**	**19.8**
14:00	**PL**	**PPI**	**Dec**	**% y/y**	**0.6**	**0.6**	**1.8**
14:00	**PL**	**Retail Sales Real**	**Dec**	**% y/y**	**5.8**	**10.0**	**8.8**
16:00	US	Michigan index	Jan	pts	97.0	-	95.9

Source: BZ WBK, Reuters, Bloomberg

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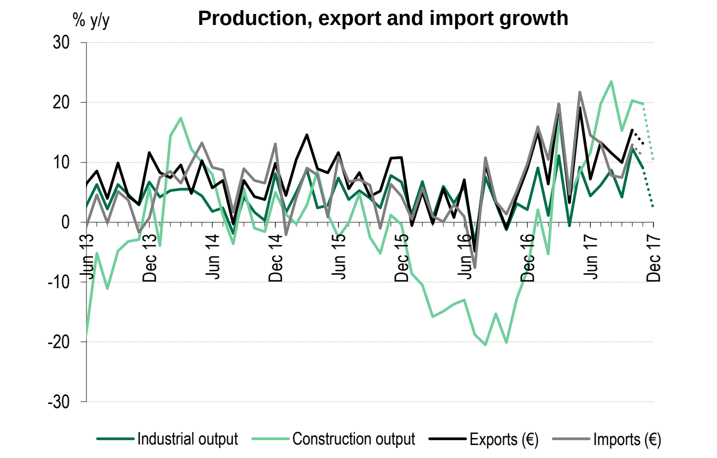
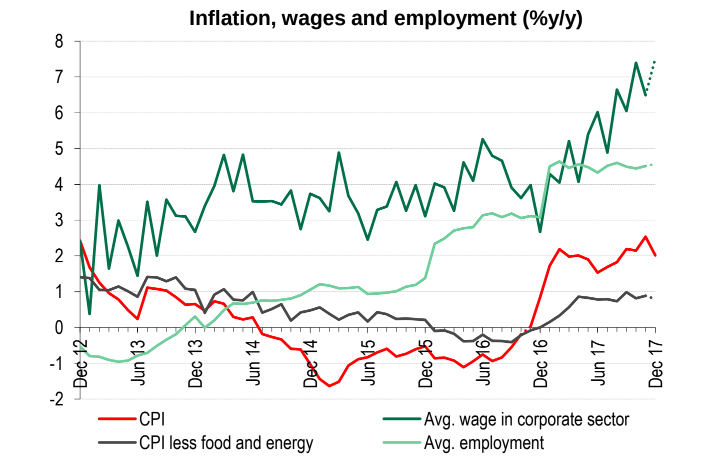
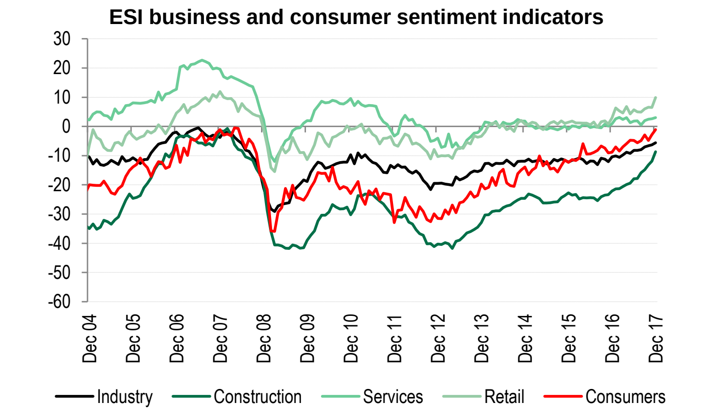
What's hot next week – CPI, output, wages and more





- The calendar is heavy this week. We will get a chance to see how various macroeconomic variables coped with base effects from December 2016 (when fuel prices boosted inflation and economic activity accelerated noticeably) and smaller number of working days y/y.
- We already know from the flash reading that CPI dropped from 2.5% y/y to 2%, but it is still important to check if core inflation decreased from 0.9% y/y to 0,8% as we estimated. Base effects may keep CPI subdued also in 1Q.
- We see industrial output at just 2.2% y/y, down from 9.1%, but such slowdown would be attributable almost entirely to the already mentioned statistical effects. In seasonally adjusted terms production could stay around 6-7% y/y. Producer prices may have sunk from 1.8% y/y to 0.6% further underlining the pullback of inflation, caused by base effect.
- We expect a 10.2% y/y growth of construction output in December. Construction activity surged in December 2016, with m/m growth at 34.8% vs an average for the Decembers of previous five years at 26.2%. However, we already know that construction output coped well with negative base effect in November, posting a result that beat consensus by a wide margin (19.8% y/y vs. 14% expected). Some decrease of the growth rate seems unavoidable, but we think the previous outcome confirms that there was accumulation of building and investment activity in 4Q, which should also be seen in GDP (a preliminary full-year result should be out by the end of January, from which 4Q can be deduced).
- We are quite bullish on retail sales in December due to the fact that consumer surveys suggest increased propensity to spend. We also have relatively high forecasts for wage growth (7.5% y/y, consensus 7.1%). Exports could have grown 13.2% y/y in November which should lead to a positive surprise in the whole current account balance.

Last week in economy – Optimism still on the rise, government revamp



- Government reshuffle was quite profound, but does not necessarily mean a big change in policy. More emphasis was put on stimulating investments in the private sector and there is a chance for improving relations with the EU after personal changes.
- The Ministry of Labour said that in December the unemployment rate rose to 6.6% from 6.5%. The number of unemployed rose by 15.4k m/m – the smallest December's rise since 1994.
- All the European Commission's sectoral indices of economic sentiment rose in Poland in December. New orders and employment were particularly strong. Consumer inflation expectations rose for the sixth month running, getting to the highest level since mid-2014

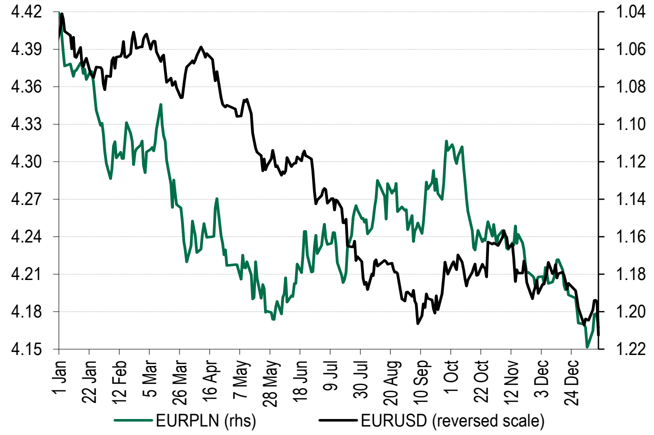
Quote of the week – We can use a term „wait and support"

Adam Glapiński, NBP governor, MPC press conference, 10 January
There are no reasons to raise Polish rates by the end of 2018. I am stunned by analysts' forecasts of rate hikes by the end of 2018. The period of stable rates may extend into 2019. We can use a term "wait and support" to describe our stance.
Eugeniusz Gatnar, MPC member, MPC press conference, 10 January
I used conditional mode when talking about a rate hike in 1Q18. Inflationary processes have lost strength. The decline of inflation has been deeper than we had expected, which makes me prefer to wait for March NBP staff projection. The perspective of CPI in 2.0-3.5% range would not worry me if its structure was unchanged.
Jerzy Kropiwnicki, MPC member, MPC press conference, 10 January
The labour market processes are moderate, wage growth is not keeping up with productivity growth.

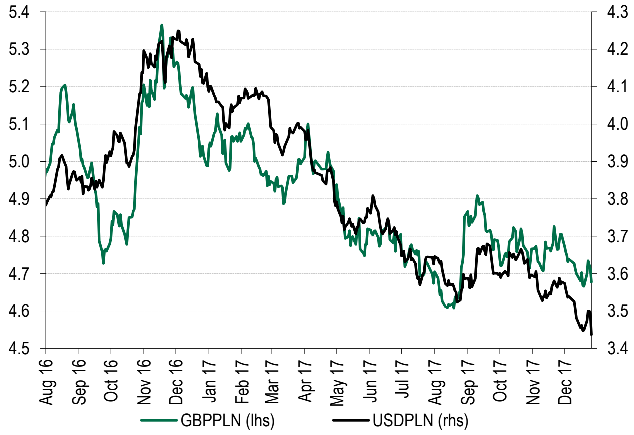
Monetary Policy Council kept interest rates unchanged, with the reference rate at 1.5%. The communiqué did not change significantly, with the most important part stating that inflation will remain close to the inflation target over the projection horizon, so the current level of interest rates is conducive to keeping the Polish economy on a sustainable growth path and maintaining macroeconomic stability. MPC's Eugeniusz Gatnar presented a rather dovish view, in contrast to his earlier rather hawkish remarks. Jerzy Kropiwnicki's remark on wage growth being slower than productivity growth contradicts the data. Obviously, the tone of the press conference was even more dovish than in the previous months. Inflation will be more core-driven in 2018, but its level should not give a reason to hurry with rate hikes.

Foreign exchange market – Watch for Polish and US data

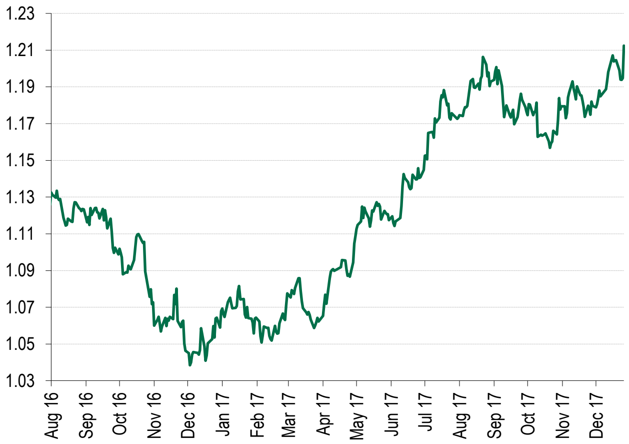
EURPLN and EURUSD



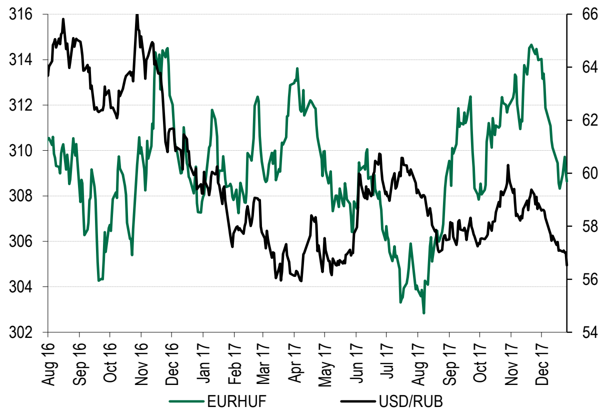
USDPLN and GBPPLN



EURUSD



EURHUF and USDRUB



Next Polish dovish data on horizon

- EURPLN rose after three consecutive weeks of a decline and the exchange rate rose temporarily above 4.19. There was no significant market reaction either to the Polish government reshuffle or to the outcome of the MPC meeting and it seems that it was the dollar's appreciation seen in the first part of the week that was the key factor pushing EURPLN up. USDPLN did not change on weekly basis as the rise to 3.52 was neutralized and the exchange rate returned to c3.43.
- Last week, the correlation between EURPLN and EURUSD remained strong and we assume this should hold in the weeks to come.
- This week, important US and Polish data are on the agenda. Our forecast of November C/A surplus is above consensus but this figure has recently lost importance and we think will not influence the market. On the other hand, Friday's release of industrial output which we expect to be slightly disappointing will join the dovish signals from the flash December CPI and MPC meeting potentially weighing on the zloty. Secondly, if the next US data look solid, the dollar may recover worldwide which could add pressure on the EM currencies, including the zloty.
- Last week, EURPLN tested the resistance at 4.19 and this is still the first level to watch.

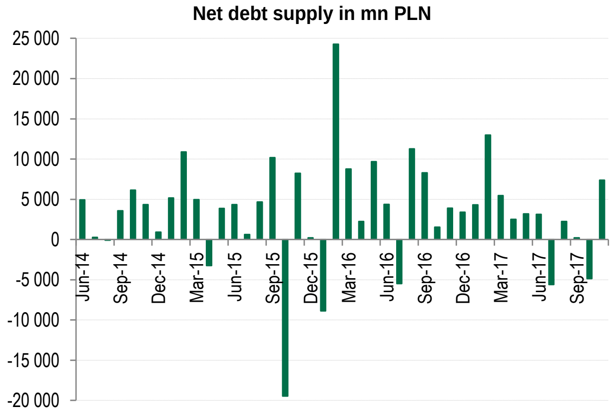
Euro strongest vs dollar since 2015

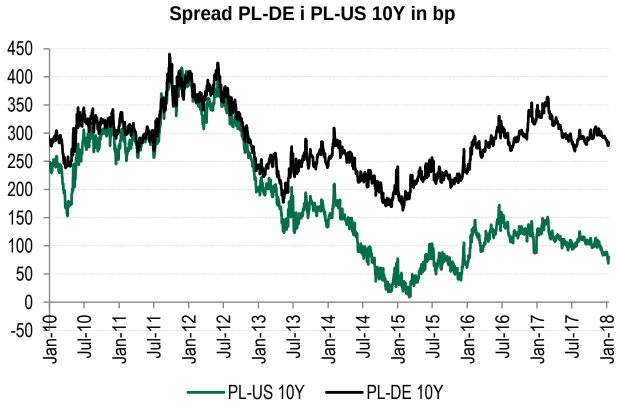
- EURUSD rose for the fourth week in a row. Solid euro zone macro data, the media talking about possible higher share of the euro in the China FX reserves, hawkish tone of the ECB minutes and rising chances that a new German government will finally be agreed pushed EURUSD to 1.213, its highest since early 2015.
- This week, the market attention could turn towards the US data. Given the recent EURUSD rally, we think there is bigger room for the exchange rate to fall after strong figures rather than for a rise in the case of a disappointing readings.

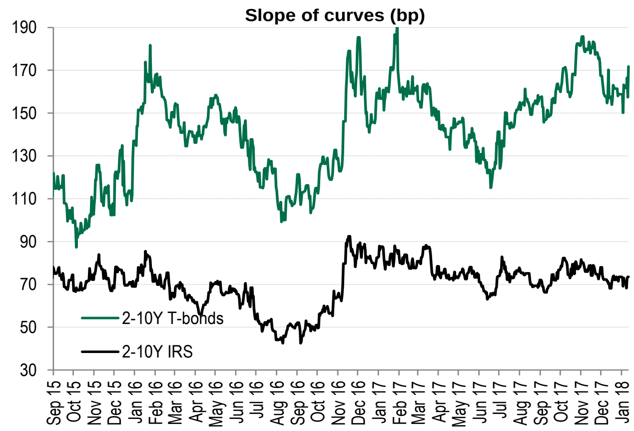
Koruna and forint stable, ruble stronger vs dollar

- EURCZK and EURHUF did not move much while USDRUB plummeted below the September's bottom at 56.7, reaching 56.5, its lowest since June. The ruble gained vs the dollar on rising oil prices and higher EURUSD.
- This week, there will be no important macro data releases in Hungary and Czechia while in Russia we will get to know CPI and foreign trade numbers. However, it seems that the trend on the commodity market and dollar performance will be key for the USDRUB direction. 2017 bottom at c55.66 is a crucial level.

Interest rate market – BoJ and ECB pushed the curves up







Central banks pushed the yields up

- Last week, we observed rising yields on the global and domestic debt market. The most of the upward move was a reaction to the information from the central banks. Early last week, the Bank of Japan (BoJ) decided to reduce the scale of bond purchases. In the second part of the week, the hawkish tone of ECB minutes pushed the core and domestic yields up. As a result, the US and Germany 10Y bond yields increased by 7bp. The domestic yields curve move was slightly higher: 10bp in the 5-10Y segment. The short end did not react (the upward shift was 2bp), which is a result of ultra-dovish tone on MPC conference.

The domestic curve should be under downward pressure

- In this week, we expect domestic yield curve to be under downward pressure, stronger on the belly and the short end of the curve. This move will be fuelled by expected series of weaker than November domestic macro data and investors will be focused on inflation. The December's CPI data should confirm that core inflation in December remained low. In our opinion, the industrial production data, whose release is scheduled for the second part of the week, will not encourage domestic debt sell-off. According to our forecasts, the industrial production y/y % SA decelerated in December to 2.2% (vs 2.8% median forecast). Moreover, part of investors may be under the illusion of industrial production dynamics drop from 9.1% y/y in November to c2.0% y/y in December. Most of this drop was due to differences in the number of working days, however, for less aware investors it could be a signal not to take quite seriously the S&P remarks that Polish economy is close to overheating. At the same time, the retail sales data release will be scheduled, but this reading will rather not be so friendly to the domestic bonds. Our forecast for December's retail sales in nominal terms (10.0% y/y) clearly exceeds the median forecasts (5.8% y/y).

The long end stay higher

- We still think that the short end of the curve will be supported by planned limited net bonds supply in the second part of this month. According to the Ministry of Finance, at the auction planned for the end of January, the maximum supply will be PLN9bn, vs. PLN8.6bn worth of redemptions scheduled for January. Nevertheless, we reckon that the long end of the curve will remain under the upward pressure, due to the high level of core markets yield. In our opinion, the core market yields will continue their upside trend, after the series of good reading macro data from Europe as well as series of hawkish signals sent by the European and Asian central banks.

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