Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

1 – 7 February 2016

The world's main central banks' monetary policy outlook is gradually becoming more dovish. Last week, the U.S. Fed kept interest rates unchanged, but its statement was interpreted as a bit softer. What is more, it was followed by weaker-than-expected data from the U.S. economy, putting a hike in March in question. Moreover, the Bank of Japan unexpectedly decided to cut interest rates below zero. It seems that the financial markets are getting more worried about global growth prospects, so prospects of more monetary easing make them more sanguine. A strong jump in oil prices, above 30$, was another big event of the week. The move was caused by alleged talks between Russia and OPEC about possible cuts to oil supply.

This week will be quite heavy with macro data releases. The U.S. non-farm payrolls should be key as they will likely affect the market's expectations about the pace of monetary policy normalisation. Personal income and spending, as well as the ISM business climate index, are among the other important U.S. numbers. As for the euro zone, we will get to see the final PMI surveys for January and these could offer signs about the pace of recovery in the euro zone. China's PMI may also prove important, given the market's worries about growth in this economy. In Poland, we will get to see the manufacturing PMI index, important for assessing the economic climate at the start of 2016, and outcome of the MPC meeting – with 5 new members. We do not expect any changes in the policy parameters yet, but the market will most probably pay a lot of attention to comments of the new central bankers as their views on monetary policy are rather obscure for the market players. If PLN continues to trim its losses, the deflation outlook keeps worsening and the main central banks keep tilting their policies towards a more dovish stance, we will not be able to exclude the possibility that the new MPC could start mulling interest rate cuts soon.

Economic calendar

CZAS W-WA	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (1 February)					
2:45	CN	PMI – manufacturing	Jan	pts	48.1	-	48.2
9:00	**PL**	**PMI – manufacturing**	**Jan**	**pts**	**51.8**	**51.9**	**52.1**
9:55	DE	PMI – manufacturing	Jan	pts	52.1	-	53.2
10:00	EZ	PMI – manufacturing	Jan	pts	52.3	-	53.2
14:30	US	Personal income	Dec	%MoM	0.2	-	0.3
14:30	US	Consumer spending	Dec	%MoM	0.1	-	0.3
16:00	US	ISM – manufacturing	Jan	pts	48.5	-	48.2
		TUESDAY (2 February)					
		No important data releases					
		WEDNESDAY (3 February)					
	PL	**MPC decision**		**%**	**1.50**	**1.50**	**1.50**
9:55	DE	PMI – services	Jan	pts	55.4	-	56.0
10:00	EZ	PMI – services	Jan	pts	53.6	-	54.2
14:15	US	ADP report	Jan	k	195	-	257
16:00	US	PMI – services	Jan	pts	55.3	-	55.3
		THURSDAY (4 February)					
11:00	**PL**	**Bond auction**					
13:00	CZ	Central bank decision		%	0.05	-	0.05
14:30	US	Initial jobless claims	week	k	-	-	278
16:00	US	Industrial orders	Dec	%MoM	-1.3	-	-0.2
		FRIDAY (5 February)					
14:30	US	Non-farm payrolls	Jan	k	200	-	292
14:30	US	Unemployment rate	Jan	%	5.0	-	5.0

Source: BZ WBK, Reuters, Bloomberg

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What's hot this week – First MPC meeting with new members

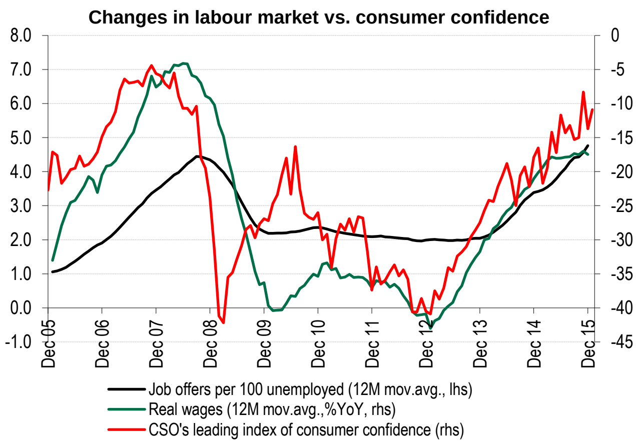
- We expect the Polish manufacturing PMI to drop slightly in January amid an uncertain global economic outlook and lower activity indicators in the euro zone. Alternative business climate measures in the industry offer no clear hint since the statistics office's business climate index fell, while the EC's ESI for manufacturing inched up in January.
- The first MPC meeting with 5 new members on board will surely attract market attention. We do not expect any policy changes at this stage, but if the zloty continues to trim its losses, the deflation outlook keeps worsening and the main central banks keep tilting their policies towards more a dovish bias, we would not exclude the possibility that the new MPC could start mulling interest rate cuts pretty soon. Please note that the tone of the MPC's statement was softened already in January by the outgoing Council members.

Last week in the economy – Strong GDP growth at the end of 2015

GDP growth and its components (%YoY)

	2014	2015	1Q15	2Q15	3Q15	4Q15
GDP	3.3	3.6	3.7	3.3	3.5	3.8**
Domestic demand	4.9	3.4	2.9	3.1	3.2	4.2**
Total consumption	3.1	3.2	3.2	2.9	2.9	3.6**
Private consumption	2.6	3.1	3.1	3.1	3.1	3.1**
Public consumption	4.9	3.5**	3.7	2.5	2.7	5.0**
Gross accumulation	12.6	4.2	1.1	4.0	4.0	5.6**
Fixed investment	9.8	6.1	11.5	6.1	4.6	5.0**
Net export *	-1.5	0.3	0.9	0.2	0.4	-0.4**

* contribution to GDP growth (percentage points); ** BZ WBK estimates



- Poland's GDP growth reached 3.6% in 2015, according to a flash estimate, fuelled by healthy private consumption, investments and exports. We forecast GDP growth to have accelerated to c.3.8%YoY in the final quarter of the year (or even slightly more). Private consumption growth remained stable, slightly above 3%YoY, while fixed investment growth even accelerated moderately, to c.5%YoY in the fourth quarter (6.1% on average in 2015). Export growth probably also remained robust in the final quarter of 2015, although we do not have detailed data yet. We still think that economic growth in Poland should remain stable in 2016, near 3.5%, still fuelled by the three main engines: consumption, investment and exports. While we see an upward risk to private consumption (which may be boosted not only by healthy labour income but also the new child benefits), there is a downward risk to investment growth and/or external demand due to the uncertain global growth outlook and higher political risk.
- The registered unemployment rate reached 9.8% in December, in line with expectations. 2015 ended with the lowest unemployment since 2008 and we expect it to fall further, though maybe at a slower rate due to the drying- up supply of workers. Detailed data continue to show a big number of people that are removed from the unemployment rolls due to taking up of a job - 119.9k in December vs. 108.1k one year earlier (the highest number since comparable data are available). Even though the scale of the Labour Ministry's intervention was stronger in December 2015, statistics on non-subsidised jobs were also better than one year ago - 94.8k vs. 88.0k in December 2014. This shows that companies' demand for labour is not weakening.

Quote of the week – Higher deficit to be a negative rating trigger

Arnaud Louis, Fitch analyst, PAP; 27.01

If we assume that the 3% cap holds, that growth remains stable, then public debt remains supportable as for this rating level. If we get a signal that the deficit will be higher [than the 3% cap], that will be a negative rating trigger. (...) We have heard of some rather extreme (FX mortgage) solutions .... rendering the banking sector incapable of supporting the economy anymore .... would be a clear negative for us.

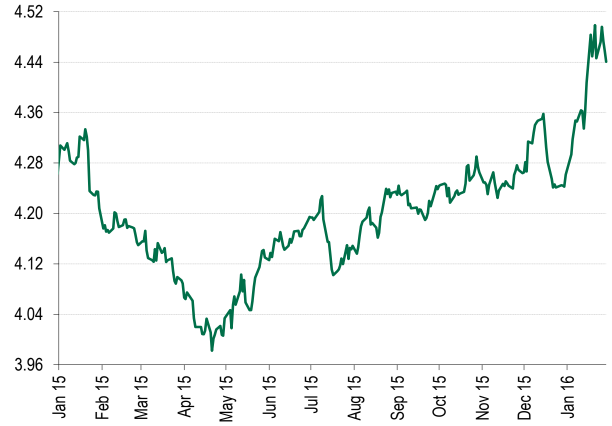
Sarah Carlson, Moody's analyst, Reuters; 27.01

At the current time, there are clearly some downside fiscal risks ... there are questions we have about how confidence will be able to evolve, but we take a look at the structural strengths and weaknesses of economies. For us, a really important structural strength for Poland is this really remarkably stable, resilient economic environment that has been able to survive quite significant tests in the recent past. (…) When we think about those institutions that are most relevant to creditworthiness -- things that will be important, that we look at -- are things like independence of central banking.

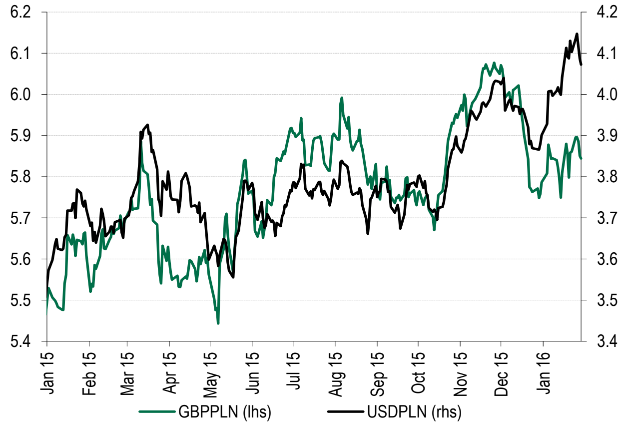
We think that the comments of Moody's and Fitch's analysts suggest that these agencies do not currently mull a cut of Poland's credit rating. But they list factors, which will most likely trigger a downward credit action. These are: 1) threats to NBP's independence, 2) increase of the GG deficit above 3% of GDP, 3) blows against the banking sector, e.g. due to the FX loan conversion. As for the first factor, we do not see any actions in that direction yet and we do not expect any. As for the second, the government claims it is determined to stick to the 3% target. However, if 3% becomes the mid-term target, as suggested by the government's officials (replacing the 1% target), the risk of exceeding this mark during a slowdown would be major. As for the third, the president has presented his bill, which, if implemented, would generate huge losses for the banking sector. But the future of this bill is unclear and its impact on the banking sector may fade during work on the regulations.

Foreign exchange market – Global sentiment key for market direction

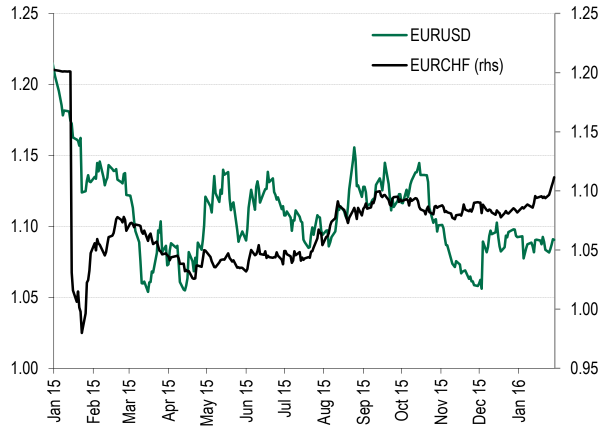
EUR/PLN



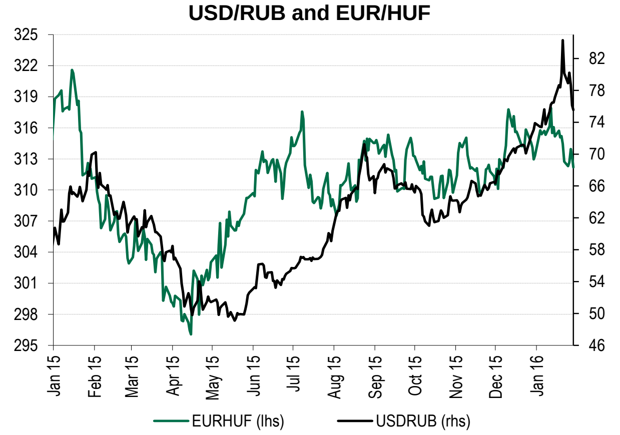
GBP/PLN and USD/PLN



EUR/USD and EURCHF



USD/RUB and EUR/HUF



EURPLN below local minimum

- In line with our expectations, central bank decisions helped the zloty rebound in the second half of the week after a very volatile start. On the one hand, the probability of a March rate hike by the Fed has fallen markedly as the FOMC statement sounded a touch more dovish than the previous one. On the other hand, Bank of Japan joined the easing camp and surprised markets by introducing negative interest rates of -0.10%. EURPLN fell below its local minimum of 4.44 in response to these decisions. Improvement of the global sentiment also helped CHFPLN fall below 4.00, for the first time since the start of 2016.
- This week's calendar of macro releases and events is quite heavy. Domestic events (manufacturing PMI, the MPC meeting) will unlikely be surprising as political uncertainty in Poland might be slightly weighing on the managers' mood and, consequently, on the survey. At the same time, the MPC is widely expected to keep its monetary conditions unchanged. We, therefore, expect these events to be overshadowed by external events. Investors will likely focus on data from China and the U.S., which could affect the Fed's decision on rates in March. Any sign that the Chinese economy is losing momentum further and relatively weak data from the U.S. labour market could cool down expectations for quick hikes by the Fed, which would underpin appetite for the risky assets. As a result, we do not rule out a fall of EURPLN towards 4.38.

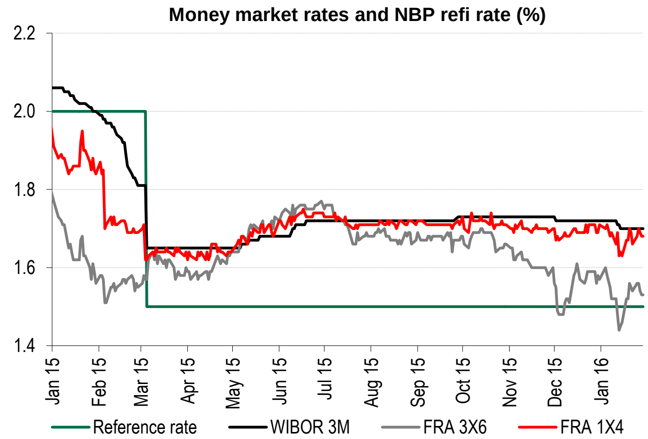
EURUSD remains in narrow range

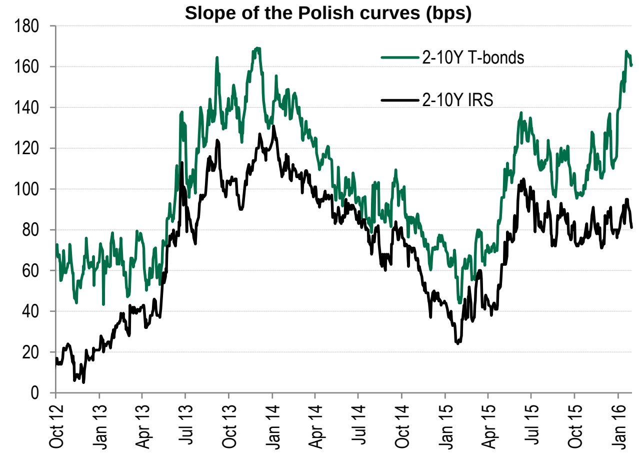
- Last week brought a gradual rise in EURUSD, which increased above 1.09 (from 1.08 at the start of the week), supported by the central banks' decisions. The euro performed well thanks to weak macro data from the U.S., which trimmed expectations of a near-term rate hike by the FOMC. Meanwhile, EURCHF went up to 1.108, the highest level since January 2015, when the central bank in Switzerland (SNB) stopped defending the rate at 1.20. There are rumours that this could be the doing of SNB's interventions.
- EURUSD was little changed over the past week, moving sideways between 1.08 and 1.10. In our view, the upcoming macro data from both Europe and the U.S. will reaffirm the recently observed trends. Strong signals of further improvement in European economic activity (which PMI indices should show) will keep EURUSD moves to the upside for the time being.

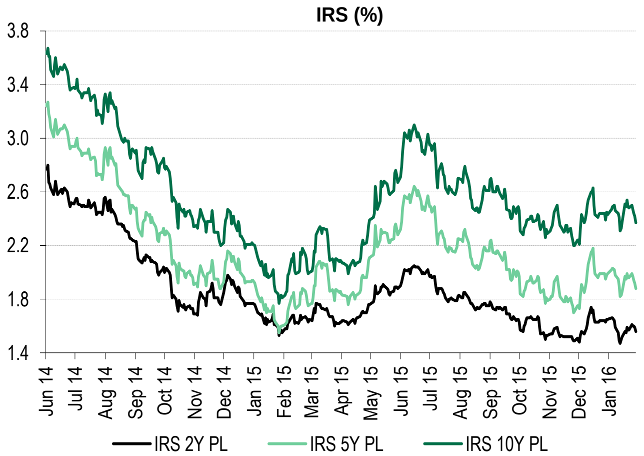
RUB rebounds on rising oil prices

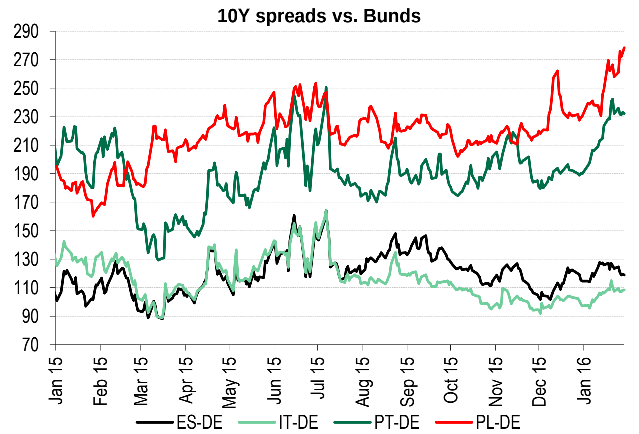
- The Hungarian forint, similarly to the zloty, was quite volatile this past week. EURHUF rose to nearly 315 as the Hungarian central bank said it may ease its monetary policy further if needed. However, at the end of the week, the rate fell to nearly 311 on the decision of the Bank of Japan. The Russian ruble also rebounded on rising oil prices thanks to indications from Russia that it was willing to meet with OPEC next month. As a result, USDRUB temporarily reached 75 as the Russian central bank kept the official rates unchanged.
- Volatility on the CEE region's FX markets remains quite high. With the global sentiment still key for investors. The falling probability of quick rate hikes in the U.S. should be supportive for the CEE currencies in the short term. As regards CZK, the CNB meeting could be the key event this week. In our view, the CNB will keep its monetary conditions stable, underpinning EURCZK's horizontal trend.

Interest rate market – U.S. data and auction in the spotlight









Bonds return to pre-downgrade levels

- ECB's dovish rhetoric and more monetary policy easing from the Bank of Japan underpinned Poland's bonds, helping them recover all losses that they suffered in mid-January after the S&P's downgrade. IRS followed suit and fell 5-10bp on the belly and long end only just last week. The 2Y IRS ended the week at c1.55% (roughly unchanged on a weekly basis), the 5Y was at around 1.90% and the 10Y close to 2.40%. Both curves became less steep, but, for the bonds, the 2-10 spread is still near its multiyear peak (160-170bp).
- At the first bond auction after the S&P downgrade, the Finance Ministry sold WZ0120 for PLN2.7bn, WZ0126 for PLN2.0bn and the new 2Y bond OK1018 for PLN3.4bn. The ministry's total supply was slightly above the upper range of the original supply plan (PLN5-8bn), but, in our view, this auction is not a good proxy of foreign investors' perception of the Polish assets as the main holders of the floaters on offer were domestic banks and mutual funds. According to the Finance Ministry, c30% of this year's gross borrowing needs are now covered.

U.S. data and auction in the spotlight

- FOMC left interest rates unchanged last week and said that macro data would be key for "determining the timing and size of future adjustments to the target range for the federal funds rate". Monthly U.S. nonfarm payrolls are on the agenda this week and it seems the story will be straightforward. The market currently sees only 14% odds for a Fed rate hike in March and, if the number surprises well to the upside, core bonds may weaken. Since the December rate hike by the Fed, yields of the 10Y Treasuries and Bunds fell c30bp. Given the market's current pricing for the next hikes we think that the market's positive reaction to a weak number could be smaller than to a strong release. For a few days after the downgrade, the 10Y PL-DE spread stabilised showing a positive link between the Polish and German long-term bonds. We think that developments on the core markets will have most impact on the belly and long end of the Polish bond and IRS curve this week.
- We expect Poland's MPC to keep rates unchanged in February. The meeting will be attended by five new members and so we hope that the statement and press conference will provide hints on the likelihood of rate cuts in the coming months. Last month's statement was already a bit dovish, in our view, and this week we shall see if the change in the line-up had any impact on the MPC's communication with the market.
- As we mentioned above, we do not believe that the last bond auction reflected the impact of the recent downgrade on foreign investors' attitude. This week, the Finance Ministry will again try to raise cash and OK1018 and DS0726 will be offered. This 10Y benchmark pared roughly all of its losses suffered after S&P's downgrade. According to the most recent data, at the end of December, non-residents held c40% of the DS0726 outstanding (with the mutual funds being the biggest foreign holder of this bond) and we think that this week's auction will be a real test for non-resident demand for the Polish bonds following the downgrade.

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