Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

8 – 14 February 2016

Central banks again were the most important market drivers last week. Very weak ISM, non-farm payrolls for January and words of the Fed's Dudley have almost erased expectations for a rate hike in March. These events have sent the EUR/USD exchange rate strongly up, triggering a verbal intervention from the ECB. In Poland, the MPC meeting produced a slightly more dovish statement, but, unfortunately, we did not have the chance to hear the new MPC members speaking. Based on the statement's wording, we assume that the NBP staff forecasts in March may prove very important for the central bankers and we still expect an interest rate cut. Poland's PMI strongly disappointed, falling to its lowest value in 16 months. Further falls of this index would be worrying, especially given the slightly weaker performance of other business climate indicators.

This week's macro calendar is rather light with foreign events. 4Q15 GDP for Germany and the euro zone will be the most interesting releases. Both are likely to confirm that economic recovery continued at the end of last year. The Chinese stock market will be closed for the entire week, so this risk factor will be temporarily off investor minds. Janet Yellen's may prove to be the most important event, given the market's weakening faith in a rate hike by the Fed in March. It is widely expected that Yellen will stick to the "wait and see" mode, so a hint that the FOMC is determined to hike may cause some serious moves on the markets. In Poland, we will get to see a bunch of crucial data, especially 4Q15 GDP and January's CPI. GDP is subject to lower uncertainty than usually as we have already seen data for the whole 2015. However, our estimate shows that this number may fall between 3.7 and 4.0%, so there might be an upward surprise (with the consensus at 3.8%). CPI will be important for the monetary policy prospects. Persistent deflation in 2016 may be a dovish argument.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (8 February)					
8:00	DE	Industrial output	Dec	%MoM	0.5	-	-0.3
9:00	CZ	Industrial output	Dec	%YoY	5.9	-	5.7
		TUESDAY (9 February)					
8:00	DE	Exports	Dec	%MoM	0.5	-	0.5
		WEDNESDAY (10 February)					
16:00	US	Public speech of Fed's Yellen					
		THURSDAY (11 February)					
9:00	HU	CPI	Jan	%YoY	1.2	-	0.9
14:30	US	Initial jobless claims	week	k	-	-	285
		FRIDAY (12 February)					
8:00	DE	Flash GDP	Q4	%YoY	-	-	1.8
9:00	HU	Flash GDP	Q4	%YoY	2.5	-	2.4
9:00	CZ	CPI	Jan	%YoY	0.5	-	0.1
10:00	**PL**	**Flash GDP**	**Q4**	**%YoY**	**3.8**	**3.8**	**3.5**
11:00	EZ	Industrial output	Dec	%YoY	0.3	-	1.1
11:00	EZ	Flash GDP	Q4	%YoY	-	-	1.6
14:00	**PL**	**CPI**	**Jan**	**%YoY**	**-0.5**	**-0.5**	**-0.5**
14:00	**PL**	**Current account**	**Dec**	**€m**	**-203**	**-1144**	**620**
14:00	**PL**	**Exports**	**Dec**	**€m**	**13 638**	**13 570**	**15 504**
14:00	**PL**	**Imports**	**Dec**	**€m**	**13 692**	**13 730**	**14 748**
14:00	**PL**	**Money supply**	**Jan**	**%YoY**	**9.4**	**9.4**	**9.1**
14:30	US	Retail sales	Jan	%MoM	0.1	-	-0.1
16:00	US	Flash Michigan	Feb	pts	92.5	-	92.0

Source: BZ WBK, Reuters, Bloomberg

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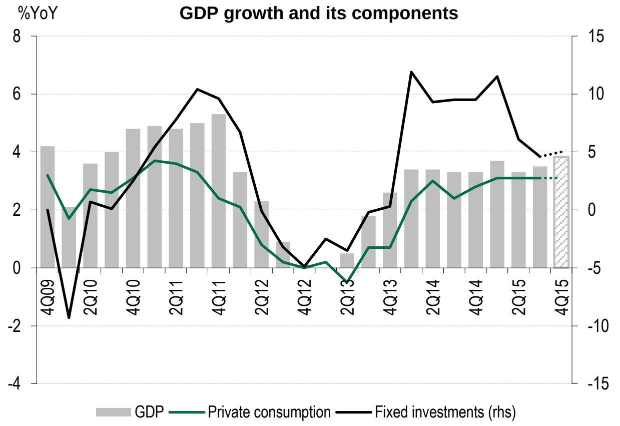
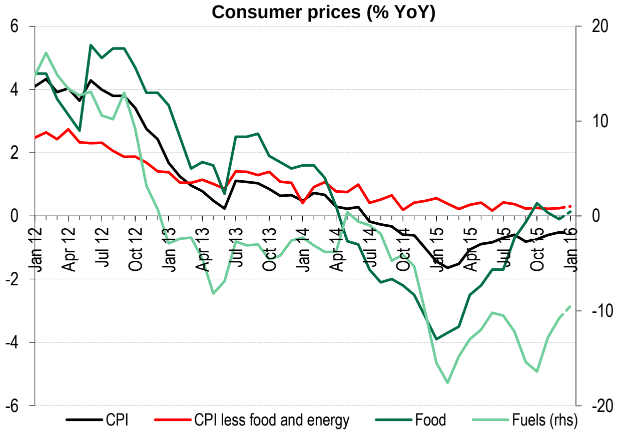
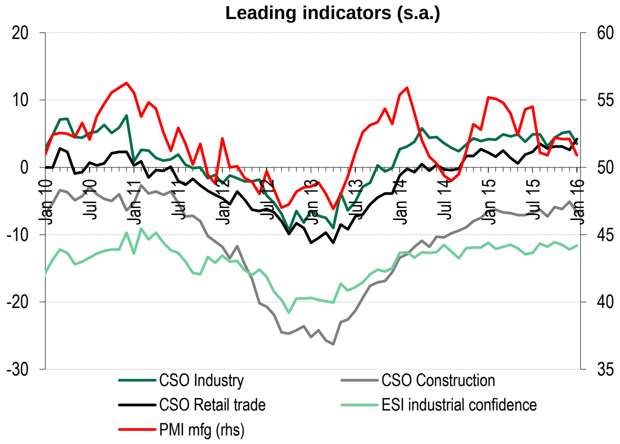
What's hot this week – Flash GDP for Q4, CPI and balance of payments





- This week's domestic macro calendar is heavy with important releases, which cumulate at the end of the week. We will get to see the flash GDP growth for 4Q15. Real economy data in December reaffirmed that Poland's general economic activity was growing quickly at the end of 2015, supported by both solid external demand (fuelling industrial production and exports) and accelerating household spending (thanks to solid growth in labour income). The flash 2015 GDP data also suggested that economic activity accelerated to 3.8% YoY or more in the fourth quarter.
- In January, the headline CPI stayed at -0.5% YoY (unchanged from the previous month), with the fall in prices at 0.2% MoM. On a monthly basis, both energy and fuel prices should continue to decline, while we expect modest growth of food prices (by c1%).
- We forecast a substantial rise in the current account deficit in December due to a significant widening of the gap of both the primary and secondary incomes. This was mainly caused by high payments to the EU budget, with the current inflows from the EU at a very low level. We also expect some deterioration in the trade balance, though also a persistently strong export growth (by 9.8% YoY) and a moderate rise of imports (by 5.7% YoY).
- We expect the M3 money supply to grow 9.4% YoY in January.
- This week, on February 9, the Sejm's Public Finance Committee will hold hearings of MPC candidates - Henryk Wnorowski, a candidate proposed by the governing party PiS, and former Finance Minister Mateusz Szczurek proposed by opposition party PO. Probably also this week, the Sejm will vote on the candidates and, in line with the previous pattern, it will likely approve the PiS candidate.

Last week in the economy – PMI below expectations, rates flat



- Poland's January manufacturing PMI index fell unexpectedly to 50.9pt from 52.1pt and reached its lowest level in 16 months. Weaker output growth was the main culprit (the worst result in five months), also new orders (mainly domestic as foreign orders were rising faster). On the positive side, employment continues to grow. The survey confirmed that there was still no inflation pressure on the horizon. Overall, January's numbers pointed to a deceleration in economic activity at the beginning of the year.
- As expected, Poland's Monetary Policy Council kept rates unchanged at its February meeting. The Council was less optimistic about a rise in CPI in the upcoming months, striking a bit more dovish tone. In our view, the MPC did not give any clear hints about the likely outcome of the March meeting, thus leaving its policy options open, so it can digest the upcoming CPI and GDP projections.

Quote of the week – EC expects Poland's GG deficit at 3.4% of GDP in 2017

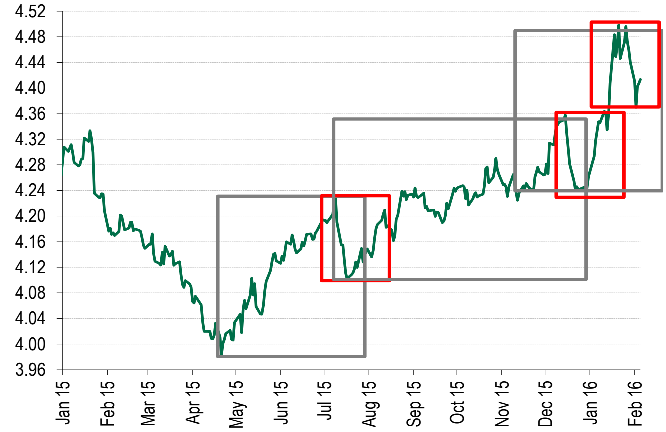
Finance Ministry's comment to EC forecasts; 04.02

The newest European Commission forecasts point to a risk that the reference deficit level will be exceeded in 2017 (3.4% of GDP), which is due to the EC's assumption of a no-policy-change scenario. The EU has taken into account the full-year impact of the 500+ child benefit programme, no one-off revenues from the LTE auction and a cut in the VAT rates. But it did not include actions strengthening the revenue side (…) thanks to restored tax flows and a more effective tax collection.

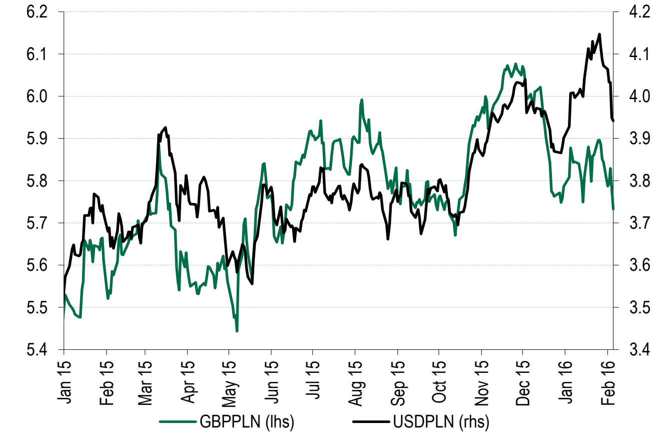
The European Commission expects the Polish GG deficit to reach 3.4% of GDP in 2017. The Polish Ministry of Finance was a bit sceptical about this forecast, suggesting that the Commission's "no-policy-change" assumption omits important budgetary revenues from improved tax collection. We agree that such actions may be positive for the budet. However, the Ministry did not mention the implementation of other election promises that will work towards a higher deficit, like the higher tax-free income and lower retirement age. In our view, these could amount to at least 1% of GDP and this gap will be difficult to cover with improved tax collection. Still, the Finance Ministry claims it is committed to the 3% deficit-to-GDP threshold. Let us keep in mind that this is an important issue for the rating agencies.

Foreign exchange market – EUR/PLN stops, EUR/USD jumps

EUR/PLN

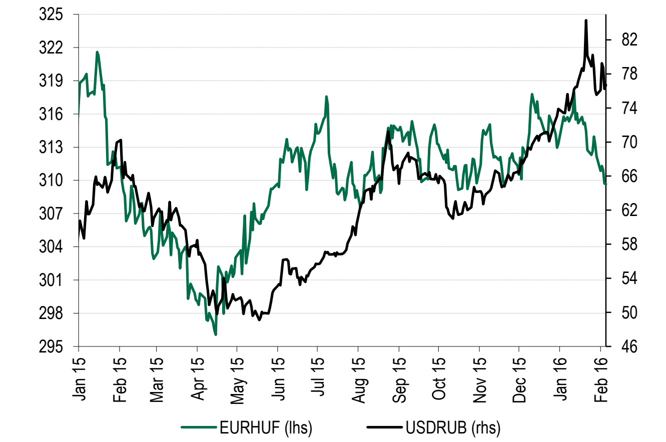


GBP/PLN and USD/PLN



EUR/USD

USD/RUB and EUR/HUF



Third time lucky?

▪ The zloty gained temporarily to 4.37 per euro last week, recovering all the losses it had suffered after S&P's downgrade. The currency started the month very well and, for a while, was even the second strongest EM currency vs. the euro and the dollar. However, at the end of the week, EUR/PLN corrected to c.4.40. Higher EUR/USD supported the zloty versus the greenback and USD/PLN fell temporarily to 3.93, its lowest since early January.

▪ The first chart shows the zloty's appreciation came to a halt when EURPLN fell almost proportionally to its previous two downward corrections. We have been highlighting the fact that we do not see much room for the zloty to gain in the short term and this past week showed that EUR/PLN may stay at an elevated level if the global market sentiment fails to improve significantly and overshadow, at least partially, some of the negative internal factors. Odds for a Fed rate hike have been gradually falling in the last few weeks and this was not helpful for the zloty as concerns about China played the main role. The market is likely to focus this week on Yellen's speech and her assessment of the U.S. economic outlook. This seems to be most important event this week, but we do not think it could push EUR/PLN out of the 4.36-4.51 range.

Lower odds for Fed rate hikes push EUR/USD higher

▪ U.S. data releases were a mixed bag last week. Investors mostly focused on the below-consensus ISM indexes and William Dudley's comment. The New York Fed's president said that "financial conditions are considerably tighter than they were at the time of the December meeting," when the FOMC raised rates. It seems that this comment was key for EUR/USD breaking the 1.10 resistance and rising above 1.12, its fresh 2016 peak and highest level since October.

▪ The market now sees hardly any chance for more rate hikes in the U.S. this year (less than a 30% probability for a 25bp rise until June, less than 50% until December). This may change this week when the Fed's Yellen will speak in the U.S. parliament, which we expect to be the most watched event by investors globally this week. We think though that even if the odds for further rate hikes fell further, the strength of this factor on the EURUSD upside would be rather diminishing. Also, the ECB officials could try to talk the euro down, so there is a chance for some correction for the exchange rate this week. At the same time, EUR/USD's stabilisation had ended after the rate's significant jump above 1.10 and there seems to be a bias now rather to the upside in the medium term. 1.135 is the next important resistance level.

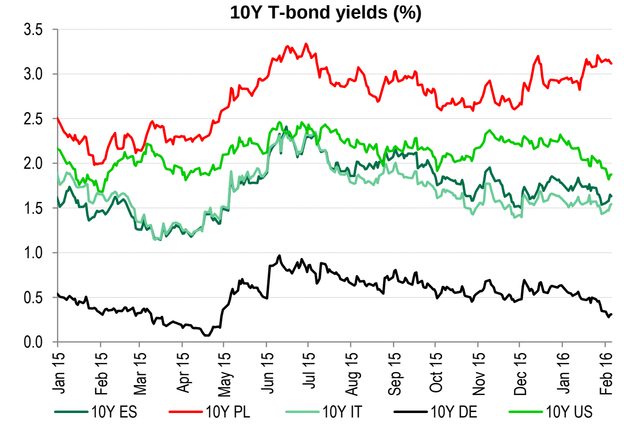
Forint continues to firm

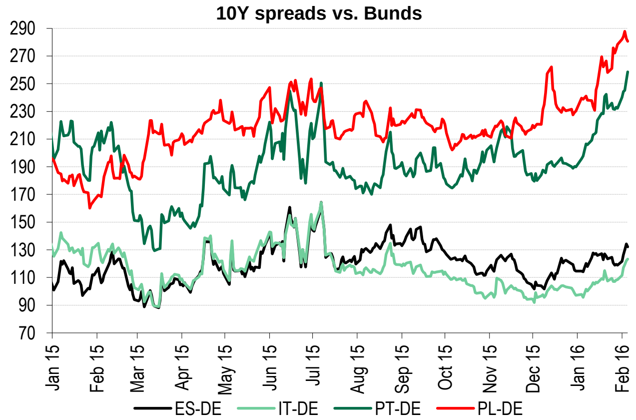
▪ The ruble stayed strong as Brent stabilised somewhere above its multi-year low with USD/RUB hovering around 77.5.

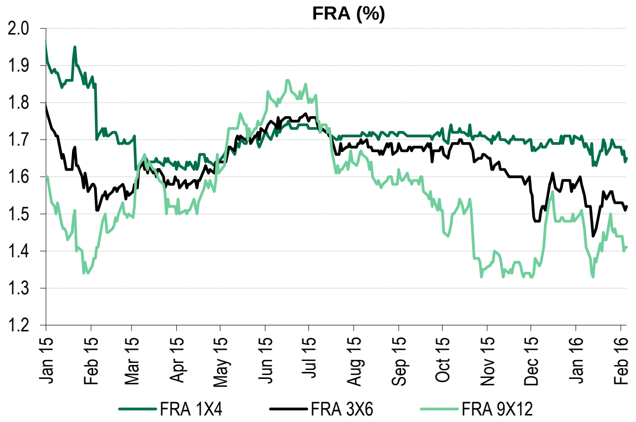
▪ The forint gained for the fourth week in a row vs. the euro and EUR/HUF fell to 309 (its lowest since late November) from 312. The Hungarian currency is benefiting from the somewhat more stable global market sentiment (thanks to the ECB and BoJ) and perhaps, to some extent, Poland's downgrade.

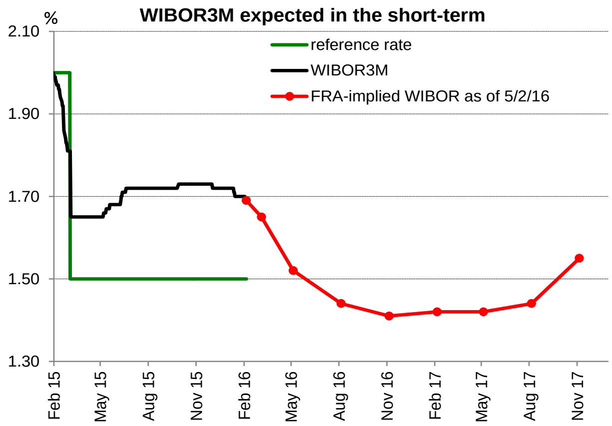
▪ CEE CPI data is on the agenda this week. Hungary's inflation has been trending up since January 2015 and we do not think it could hit the forint even if it surprised to the downside this week.

Interest rate market – Time to take profit?









Core market, auction support Polish debt

▪ The domestic interest rate market firmed markedly over the past week. Bonds benefited from investor sentiment improvement and strong demand for core debt. The 10Y Bund yield fell to nearly 0.25%, the lowest level since April 2015. At the same time, the U.S. Treasuries gained on a series of weaker macro data (ISM, jobless claims, factory orders, durable goods orders), with the 10Y UST benchmark falling to 1.84%, the lowest since February 2015. The domestic debt market was also supported by favorable auction results. All in all, Poland's 10Y yield ended the week at c3.10% (the lowest level since mid-January), down from nearly 3.20% at the start of the week.

▪ On a weekly basis, both the t-bond and IRS curves were down 2-7bp and 3-8bp, respectively. The yield curve remains quite steep (with the 2-10Y spread at 164bp, close to the level noted a week ago), with the IRS curve slightly flattened and the 2-10Y spread narrowing towards 75bp. What is more, the spread to the 10Y Bund rose above 280bp, which shows that investors look for a high premium due to political uncertainty.

▪ Poland's Ministry of Finance successfully launched 2Y OK1018 and 10Y DS0726 bonds. The ministry issued debt worth PLN9.0bn in total (at both regular and top-up tenders, more than the upper band of the originally planned offer). Demand was solid and reached nearly PLN15bn at both auctions (including over PLN3bn at the top-up). Healthy demand for the 10Y benchmark confirms that the rating downgrade did not have a significant impact on investor demand for Polish debt from non-residents. We estimate that after Thursday's auction, this year's gross borrowing needs are covered in c36%.

▪ The money market was little changed this past week. WIBOR 1M and 3M fell 1bp on a weekly basis, while other rates remained stable. At the same time, FRAs inched gradually down, by 1-7bp across the board. Despite this, the market is upholding its expectations that monetary policy will remain unchanged.

Eyes on domestic factors

▪ This week Poland's interest rate market should be under the influence of domestic factors as there are no important events or macro releases due abroad. Among the macro data (flash GDP for 4Q15, headline CPI, M3, CA balance) due this week, GDP and inflation will be the most crucial. Our forecasts for the 4Q15 GDP (3.8%YoY) and the headline inflation figure (-0.5%YoY) are in line with the market consensus. However, a stronger-than-expected 4Q15 GDP reading (closer to 4%) could cool down expectations for a quick rate cut. The FRA market is pricing-in a rate cut of 25bp in a six-month horizon.

▪ Looking at external factors, we think that only the Fed governor Janet Yellen's speech will attract investor attention. On Wednesday and Thursday, Yellen will testify in Congress on the semi-annual report on monetary policy. We expect a "wait-and-see stance" to be the most likely approach, according to the latest macroeconomic data. Any clear hint about the likely outcome of the March FOMC meeting would strongly affect the debt market globally, including Poland's. We expect an asymmetric market reaction in response to this outcome. There is a bigger scope for a yield/rate increase if the Fed's governor suggests quicker rate hikes (than the market expects) than there is room for further strengthening if Yellen suggests a "wait-and-see" stance. Recent gains on the Polish debt market were quite strong, we, therefore, do not rule out some profit-taking in the week to come.

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