Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

28 November – 4 December 2016

Over the past week financial markets globally were vulnerable to macro data releases. Better than expected US macro reading pushed EURUSD towards a new low this year; however, the end of the week brought a rate increase. Meanwhile, the volatility on the CEE FX market was elevated, with EURPLN fluctuating between 4.40 and 4.44. The yields on Polish bonds, on the other hand, fell somewhat, following core market. The market response to the domestic releases was limited, though both production and retail sales in Poland disappointed and confirmed further slowdown in the economic activity in 4Q16.

This week macro calendar, both in Poland and abroad, is very heavy. In Poland, investors will learn about the final reading of 3Q16 GDP, flash CPI for November and PMI for the manufacturing sector. We expect some rebound in the PMI index, not so far from the neutral level of 50, and a continuation of the upward move in the headline CPI. In turn, GDP data should show the main drivers of Poland's economy for this and previous year following a revision by the Stats Office. However, global data, in particular non-farm payrolls in the US and the referendum in Italy, will overshadow the domestic events. Though the market has fully priced in the rate hike by Fed in December, the strong data from the USA may imply a faster monetary tightening in 2017. Consequently, it will have a negative influence on Poland's assets.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (28 November)					
		No important data releases					
		TUESDAY (29 November)					
14:30	US	Preliminary GDP	Q3	% q/q	3.0	-	1.4
16:00	US	Consumer confidence index	Nov	pts	101.2	-	98.6
		WEDNESDAY (30 November)					
10:00	**PL**	**GDP**	**Q3**	**% y/y**	**2.5**	**2.5**	**3.1**
10:00	**PL**	**Private consumption**	**Q3**	**% y/y**	**-**	**4.2**	**3.3**
10:00	**PL**	**Fixed investments**	**Q3**	**% y/y**	**-**	**-5.0**	**-4.9**
11:00	EZ	Flash HICP	Nov	% y/y	-	-	0.5
14:00	**PL**	**Flash CPI**	**Nov**	**% y/y**	**-**	**0.0**	**-0.2**
14:15	US	ADP report	Nov	k	160	-	147
14:30	US	Personal income	Oct	% m/m	0.4	-	0.3
14:30	US	Consumer spending	Oct	% m/m	0.5	-	0.5
16:00	US	Pending home sales	Oct	% m/m	0.2	-	1.5
20:00	US	Fed Beige Book					
		THURSDAY (1 December)					
9:00	**PL**	**PMI – manufacturing**	**Nov**	**pts**	**-**	**50.8**	**50.2**
9:55	GE	PMI – manufacturing	Nov	pts	54.4	-	55.0
10:00	EZ	PMI – manufacturing	Nov	pts	53.7	-	53.5
14:30	US	Initial jobless claims	week	k	-	-	251
16:00	US	ISM – manufacturing	Nov	pts	52.1	-	51.9
		FRIDAY (2 December)					
	PL	**S&P rating review**					
9:00	CZ	GDP	Q3	% y/y	1.9	-	2.6
14:30	US	Non-farm payrolls	Nov	k	180	-	161
14:30	US	Unemployment rate	Nov	%	4.9	-	4.9

Source: BZ WBK. Reuters. Bloomberg

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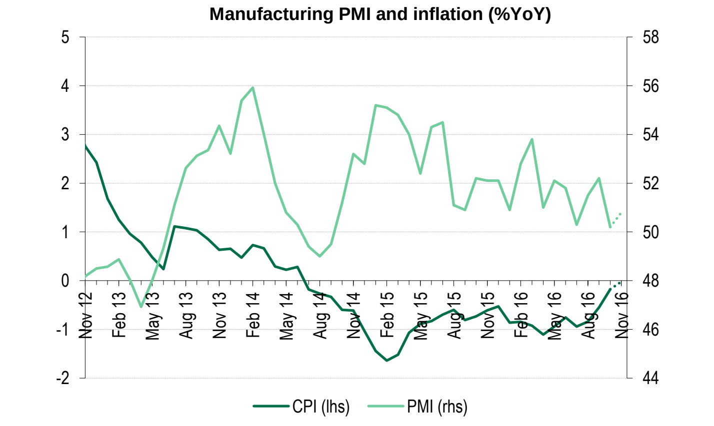
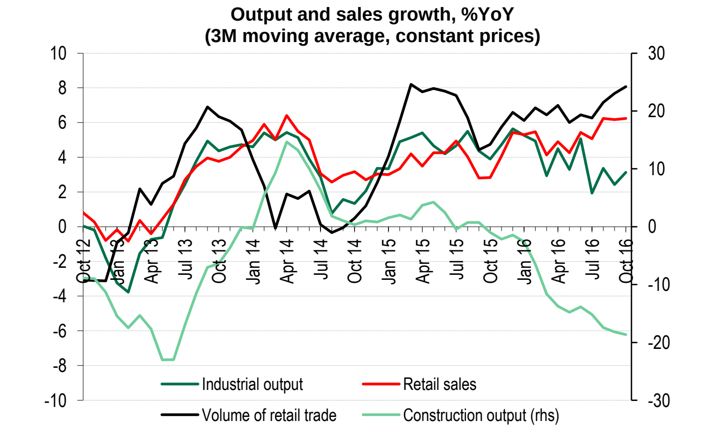
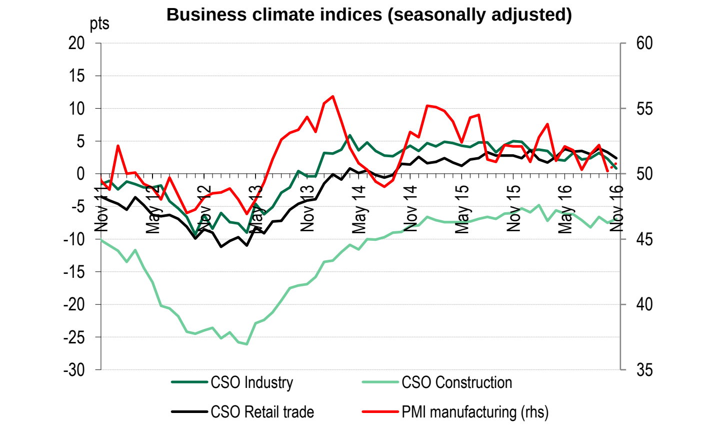
What's hot this week – CPI, PMI, GDP, S&P



- GDP growth slowed down to 2.5% y/y in 3Q16, according to flash estimate but it remains to be seen what was the growth breakdown. We suspect that the disappointing result was caused mainly by deeper investment slowdown, weaker than estimated improvement in private consumption (effect of 500+ programme) and revision of the data for 2015. It cannot be ruled out that two first quarters of 2016 will be revised as well.
- Flash CPI data will show growth at 0% y/y in November, in our view, ending the 28 month-long period of deflation. There are still no signs of inflationary pressure, though.
- We expect manufacturing PMI to rebound slightly in November to 50.8 after last month's strong drop to 50.2, but in general the index has been in downward trend recently.
- We do not expect the S&P to change Poland's rating or outlook.

Last week in economy – Growing evidence that GDP growth in Q4 may be below 2% y/y





- Industrial production fell by 1.3% y/y in October, which was way below forecasts. The seasonally adjusted growth in industrial production was at 1.3% y/y, as compared to above 3% in September or the average from the third quarter. Construction output also disappointed, falling by more than 20% y/y again. Even if October's lower output readings were under influence of lower number of working days, they show also some overall weakness of economic growth amid export and investments deceleration.
- Consumption is likely to remain the main driver of economic growth, but retail sales figure also disappointed in October, rising 4.6% y/y in constant prices. Weak car sales was the main factor behind the disappointing reading, as they fell by 2.5% y/y and this was the first negative growth in this category since February 2015.
- According to GUS survey, consumer confidence improved in November, reaching its multi-year high, which is a positive signal for consumption outlook. At the same time, business climate indicator in manufacturing fell sharply to its lowest since December 2013, signalling that the situation in the industrial sector is deteriorating.
- The data for big companies (employing more than 49 people) showed deepening of negative tendencies in investments – fall by 12% y/y in Q3 in real terms against -6% in Q2. Data from local governments also showed a deep slump in investment: -36.8% y/y in nominal terms in Q3 (vs -52.0% y/y in Q2).
- Registered unemployment rate fell in October to 8.2%, in line with labour ministry's forecast.

Quote of the week – 4Q16 will be still below 3%

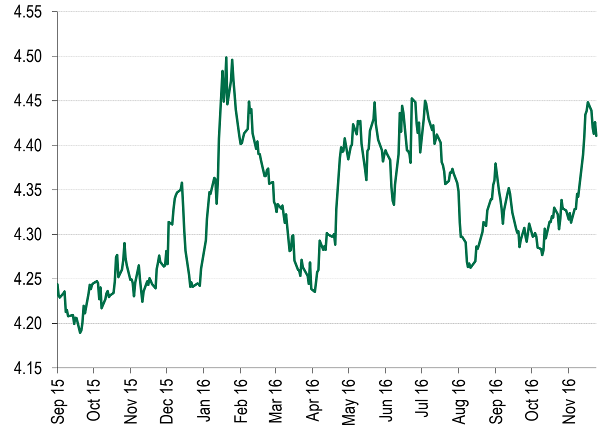
Mateusz Morawiecki, deputy PM, Minister of Economic Development and Finance, 24 Nov, PAP

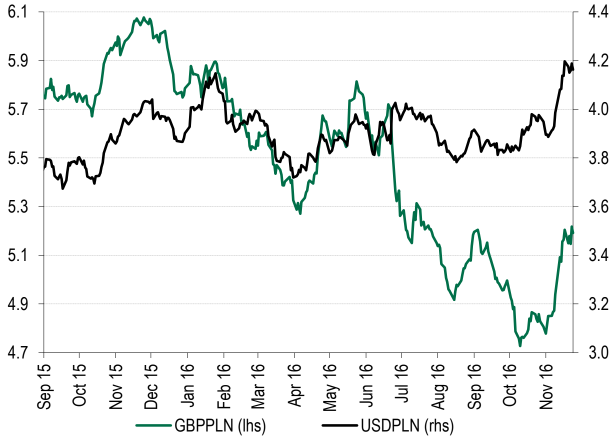
We are not considering yet the revision of 2017 budget macroassumptions. Of course I see the risks (for 2017 budget) but this year we have lower economic growth and lower deficit. There are risks threatening growth but there are also tax collection opportunities.

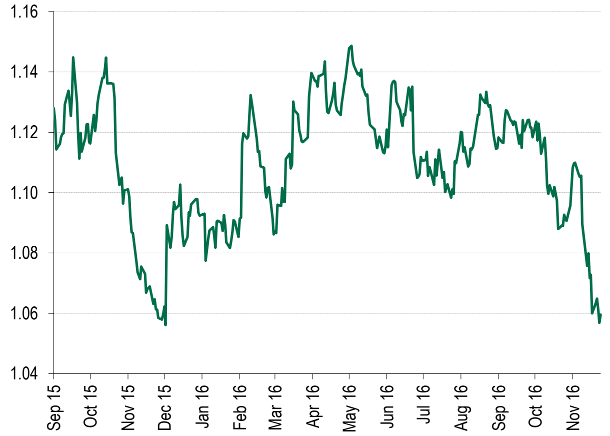
We are in the economic mini-cycle and due to the dependence on foreign investments 4Q16 will be still below 3% y/y, near 2.5%. But I see the upside potential starting from 2Q17; Looking at investment and production results, it may be above 3%.

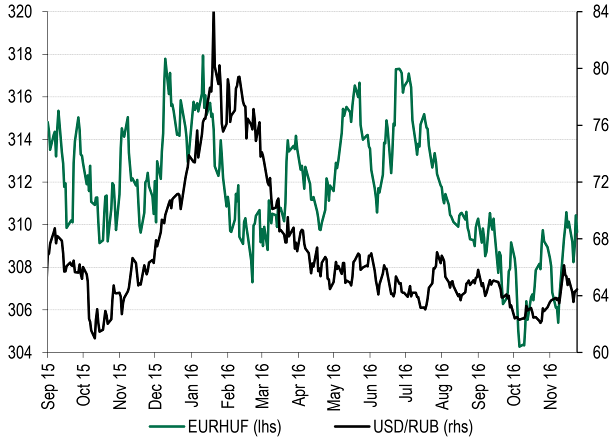
Deputy PM remains optimistic about Poland's economic growth outlook. We have to admit that we also expect the GDP growth to rebound in the future, but it seems more likely in the second half of 2017 rather than in the second quarter. Moreover, before a rebound takes place, we will probably see a further deceleration of growth. We will present more precise forecasts after the statistical office releases the revised quarterly GDP time series (publication on November 30). However, given the information that we already have it seems increasingly likely that GDP growth in 4Q16 could be not only below 3%, but below even 2% y/y.

Foreign exchange market – Global factors key this week

EURPLN


USDPLN and GBPPLN


EURUSD


EURHUF and USDRUB


Zloty strengthening slightly

- As we had expected, volatility on the Polish FX market remained elevated over the past week. EURPLN approached 4.40 and USDPLN dropped nearly to 4.15, but none of them managed to break these levels. Consequently, downward move of rates was quickly reversed and EURPLN climbed towards 4.44, while USDPLN rose above 4.21 for a while. On a weekly basis zloty slightly gained against EUR, USD and CHF, while it remained more or less stable against GBP.
- The recent sessions have clearly shown that the zloty was very sensitive to global sentiment and the news from both the USA and Europe, which overshadowed the domestic data (industrial output, retail sales). This week situation will not change much. We believe that investors will mainly focus on the November's job report in the USA and macro data from Europe. Market players have fully priced in a rate hike by FOMC in December. However, they start worrying that stronger data from the USA may imply faster monetary tightening in 2017. All in all, the zloty's valuation will strongly depend on macro data abroad. What is more, PLN might be under pressure ahead of the referendum in Italy.
- This week another set of important domestic data will be published (3Q16 GDP, flash CPI, PMI index for November). This, together with the recently released data from real economy, should confirm further slowdown in the economic activity, even possibly below 2% in 4Q16. Therefore, renewed expectations for monetary easing after weak macro data might weigh on the zloty in the upcoming weeks. In turn, S&P will keep Poland's rating unchanged in our view and this should be neutral for PLN. Important levels for EURPLN are 4.38-4.40 and 4.46.

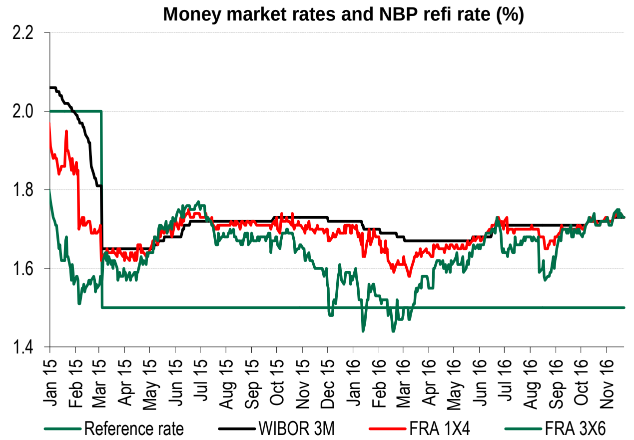
Upcoming events to keep pressure on euro

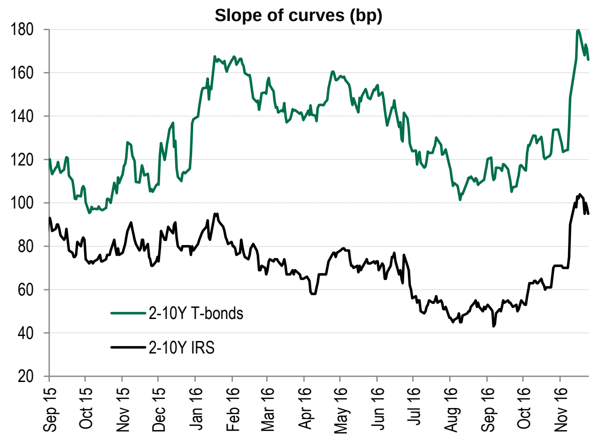
- Last week EURUSD reached this year's fresh low at 1.052. However, the US dollar appreciation trend (supported by strong macro data from the USA) was halted and EURUSD climbed to c1.06 at the end of the week.
- This week the macro calendar, in particular for the USA, is very heavy. Investors will translate macro data into the possible central banks' action in the upcoming month. Our expectations of the Fed's decision have not changed – we expect FOMC to deliver a rate hike by 25bp and such a decision is widely awaited. Uncertainty regarding the outcome of the referendum in Italy set on December, 4 will keep pressure on the euro in the upcoming week.

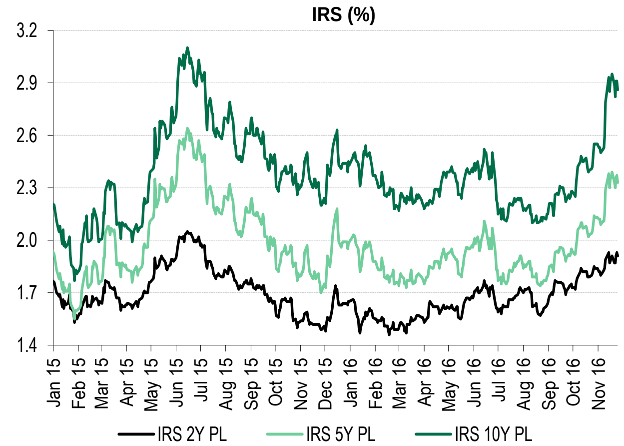
Forint trims losses after MBH decision

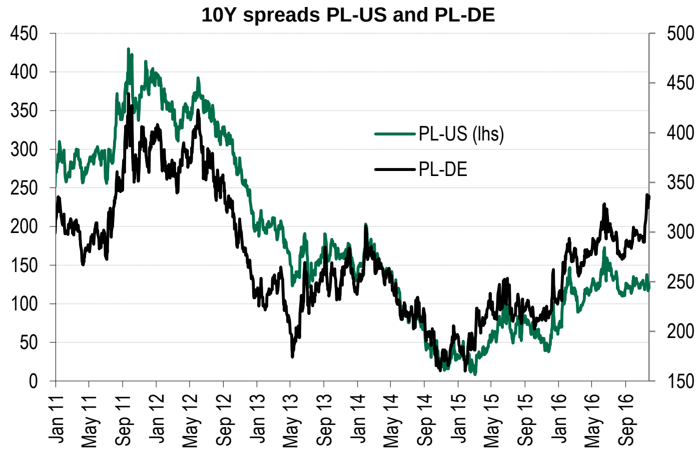
- Last week the Hungarian forint lost the ground after the central bank's (MNB) decision to cut the overnight lending rate by 10bp to 0.90% and decided to do another 15bp cut in one-week lending rate to 0.90%. This decision surprised the market and pushed EURHUF above 310 from c307.5. At the end of the week, forint slightly gained and EURHUF fell towards 309. The Russian ruble was also under pressure from declining oil prices. As a result, USDRUB increased temporarily to 65. At the same time, the Czech koruna was quite immune to global sentiment changes.
- This week forint, similarly to PLN, will stay under influence of global factors, in particular macro data in the USA and the referendum in Italy. These data may shadow release of the PMI index for Hungary, which is typically characterized by high volatility. At the same time, RUB valuation will be influenced by the OPEC decision on oil production. Russian macro data (inflation, PMI) due this week will be rather neutral for RUB.

Interest rate market – Treasuries more important than Bunds









Rates volatile in a range

- IRS and bonds' yields ended the week near the levels seen last Friday, but while the upside trend has paused, the intraday volatility remained high. External factors, such as the US data that were particularly providing volatility, continued to be the main driver for the Polish interest rate market. At the end of this week, the 10Y IRS was near 2.90%, the 5Y around 2.40% and the 2Y rate close to 1.90%. The bond curve flattened a bit as the short end lost slightly while the long end was a bit lower than a week ago.
- 1-12M WIBOR rates stayed unchanged on weekly basis.

Treasuries more important than Bunds

- According to Bloomberg, the market has already priced in the Fed's December rate hike. Still, the strong US data released recently continued to generate some upside pressure on rates. We think the impact of these numbers may be magnified by Donald Trump's victory in the US presidential elections (and his plans to boost the US economic growth) and now the market is taking the Fed rate hike in December as a deal-done and is pricing the next hikes that may take place in 2017. That is why the coming US data may also drive the market with the second estimate of 3Q GDP and November's payrolls being the most awaited.
- Having said that, please note that considering the period since the US presidential elections, the correlation between the 10Y Polish bond and Treasury is 95% while the respective figure for Bund is below 80%. In October, the figures were exactly the opposite which clearly shows that developments on the US market might have become more important for the Polish bonds. According to the Finance Ministry data, the US investors are the biggest holders of Polish bonds under the country criteria with nearly PLN29bn in nominal terms of PLN marketable bonds held at the end of September (and rising gradually after the sell-off after the S&P's January's Polish rating downgrade).
- The belly and long end of the curve should remain sensitive to the global trends while the short-term rates could remain, in our view, rather stable. The headline GDP number should not deviate from the flash estimate and we think the detailed data might show that it was the contraction in investments that weighed the most on the final number. If the other components remain robust, this could be good news. However, the 2Y yield/IRS has already been on the rise since the beginning of the year and the GDP data could be not enough to push short-term rates up given the rather gloomy economic outlook.
- We think Polish PMI rebounded in November and this could be the first positive signal from the high-frequency data for a long time. However, we do not think this could push short-term rates up either.
- In our opinion, S&P will leave Polish rating unchanged at BBB+ with negative outlook.

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 88, email ekonomia@bzwbk.pl