Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

5 – 11 December 2016

Detailed GDP data for 3Q16 showed the deepening investment collapse and lower than expected effect of 500+ programme on private consumption. The data confirmed, in our view, that economic growth is likely to slow further and in 4Q it may be closer to 1% than 2% y/y. Manufacturing PMI rebounded in November, but we doubt it signals a recovery in Polish industry as all other business climate indicators for this sector declined. Meanwhile, flash CPI data showed that 28 month-long period of deflation has ended.

The result of the referendum in Italy may be the key factor for market sentiment at the start of the new week. The "No" vote is likely to trigger further rise of risk aversion and euro weakening amid worries about political turmoil in Italy, while the opposite scenario should provoke a rebound, at least in the short run. The ECB meeting is another important event, with investors focusing on the extension of QE programme. Given recent speculations about possible QE tapering, an extension of the programme beyond March 2017 should be a positive impulse for the market, in our view. The meeting of the Polish Monetary Policy Council will be probably overshadowed by events abroad. We do not expect any policy changes and expect the NBP governor to continue playing down the economic slowdown. However, other MPC members were a bit more dovish recently, and their comments during or after the conference may prove interesting. We will see even more weak data on economic growth in Poland in the coming month and eventually they may revive the market expectations for monetary easing in Poland.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (5 December)					
9:55	DE	PMI services	Nov	pts	55.0	-	54.2
10:00	EZ	PMI services	Nov	pts	54.1	-	52.8
16:00	US	ISM non-manufacturing	Nov	pts	55.2	-	54.8
		TUESDAY (6 December)					
8:00	DE	Industrial orders	Oct	% m/m	0.6	-	-0.6
11:00	EZ	GDP	Q3	% y/y	1.6	-	1.6
16:00	US	Industrial orders	Oct	% m/m	2.5	-	0.3
16:00	US	Durable goods orders	Oct	% m/m	0.7	-	4.8
		WEDNESDAY (7 December)					
	PL	**MPC decision**		**%**	**1.50**	**1.50**	**1.50**
8:00	DE	Industrial output	Oct	% m/m	0.8	-	-1.8
9:00	CZ	Industrial output	Oct	% m/m	0.5	-	2.7
		THURSDAY (8 December)					
9:00	HU	CPI	Nov	% y/y	-	-	1.0
13:45	EZ	ECB decision		%	0.00	-	0.00
14:30	US	Initial jobless claims	week	k	-	-	268
		FRIDAY (9 December)					
8:00	DE	Exports	Oct	% m/m	0.9	-	-0.7
9:00	CZ	CPI	Nov	% y/y	1.3	-	0.8
16:00	US	Flash Michigan	Dec	pts	94.1	-	93.8

Source: BZ WBK. Reuters. Bloomberg

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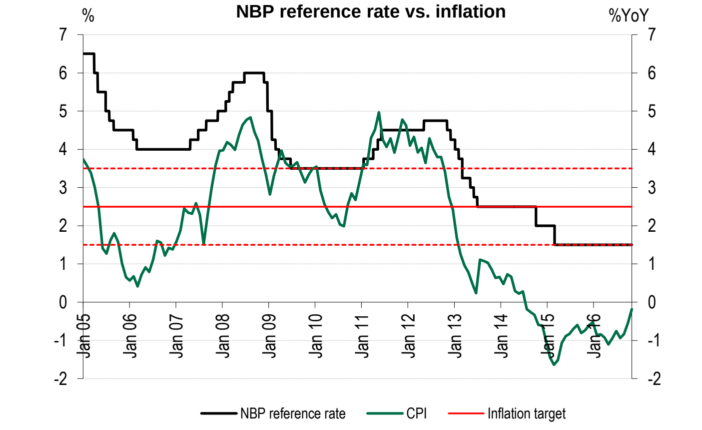
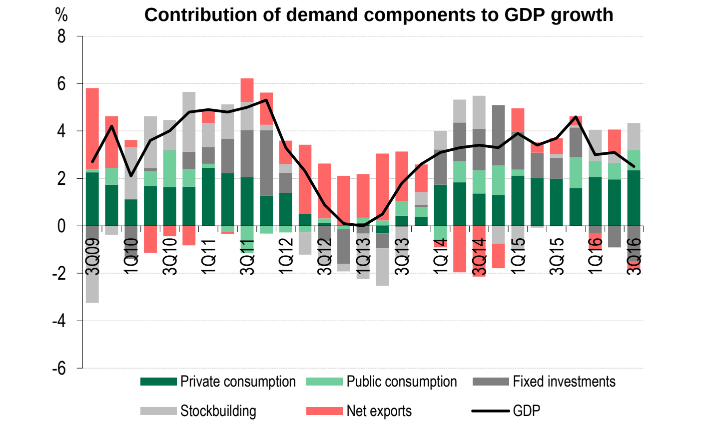
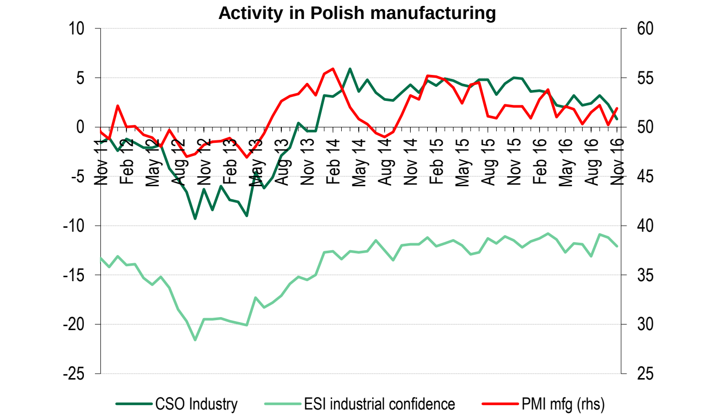
What's hot this week – Will MPC continue playing down the slowdown?



- We do not expect the S&P to change Poland's rating or outlook this evening. In our view, the rating agency went well ahead of the curve in January. Currently, the factors that could affect the rating are the deteriorating GDP outlook and the retirement age cut approved by the government; other issues, however, like the CHF bill and fiscal stance are less negative than back in January.
- We expect the Polish MPC to keep rates on hold during its meeting in December. We still expect the NBP governor to play down the economic slowdown and say it is only temporary. However, other MPC members were a bit more dovish recently, and their comments during or after the conference may prove interesting. Weak data on the economic growth may revive market expectations for rate cuts in Poland.

Last week in economy – GDP may be below 2% y/y in Q4, end of deflation





- In 3Q16, GDP growth slowed to 2.5% y/y from 3.1% y/y in 2Q, in line with the flash estimate. Private consumption accelerated to 3.9% y/y from 3.3% in 2Q and contributed 2.3 percentage points to the GDP growth. The impact of the 500+ child benefit programme was positive, yet less considerable than expected. Investment plunged by as much as 7.7% y/y, highest since 2010. In general, the slump in investment is deeper and may last longer than expected. Net exports deducted 0.4 percentage point from the GDP growth, as exports expanded by 6.8% y/y and imports by 7.8% y/y. Export is weakening due to negative tendencies abroad (stagnation in global international trade). We expect this trend to persist , especially in 4Q16. It looks like 4Q16 might be rather closer to 1% than 2% y/y.
- According to the flash reading, CPI rose in November to 0.0% y/y, ending the 28-month period of deflation in Poland. It was caused mainly by statistical base effects, but we still don't see any signals of building underlying pressure on prices. CPI may inch slightly above zero in December, and in January it may jump to nearly 1% y/y.
- The PMI index for Polish manufacturing rebounded in November to 51.9pts from 50.2pts in October, exceeding market expectations. This move was driven by new orders, output and employment, while new export orders declined. Moreover, input prices rose at the fastest rate since 2012, mostly due to a weakening zloty and higher metal prices. For the last couple of months, the PMI index has been swinging up and down, but the moving average of the index remained in downward trend. Thus, we do not think that this jump in PMI in November suggests an imminent economic recovery.

Quote of the week – Acceleration of GDP growth in 4Q2016 … Not!

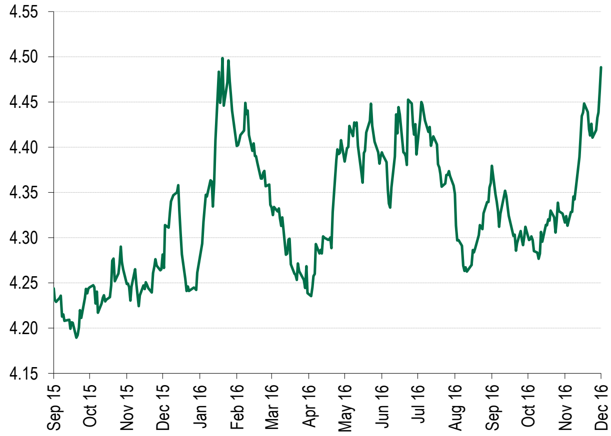
Mateusz Morawiecki, deputy PM, 29 Nov, Bloomberg
Poland's economic growth this year will be between 2.5 and 3 percent, in part due to significant slowdown around us.

Statement of the Development Ministry, 30 Nov
The Development Ministry has assessed that in 4Q2016 the economic growth should accelerate slightly, mostly due to faster growth of private consumption. Investment will also recover gradually, and its rate of decline should slow down in 4Q2016, also due to expected higher absorption of means from the new EU perspective.

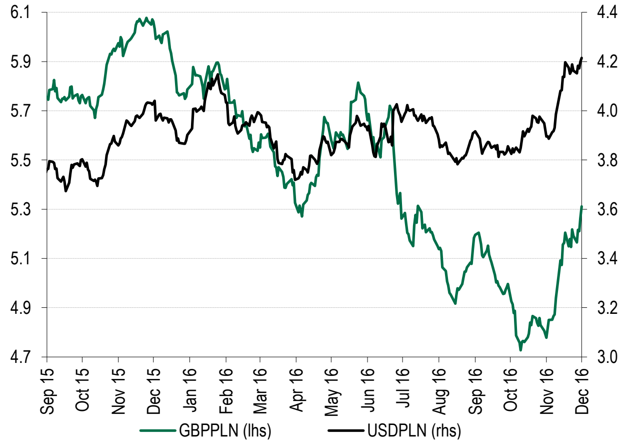
PM Morawiecki still remains optimistic about growth in 2016, claiming that both the entire year and 4Q results will be above 2.5%. As we stated above, 4Q growth is likely to be closer to 1% than 2%. As regards the whole year, it may be close to 2.5%, but with risk skewed downwards. Surely, Morawiecki's forecast is way above the market forecasts (2% avg according to Parkiet poll). As regards 2017 GDP growth, it looks like there is a chance for V-shaped recovery, assuming that fixed investments (mostly connected with EU funds) will show a significant recovery. However, the GDP growth rate for the next year as a whole should stay below 3% (even if 4Q17 might be above). This has been our forecast since mid-2016 (though with a different quarterly profile) and we think that market consensus is likely to converge to sub-3% growth rate forecast soon.

Foreign exchange market – Italian referendum and ECB in the spotlight

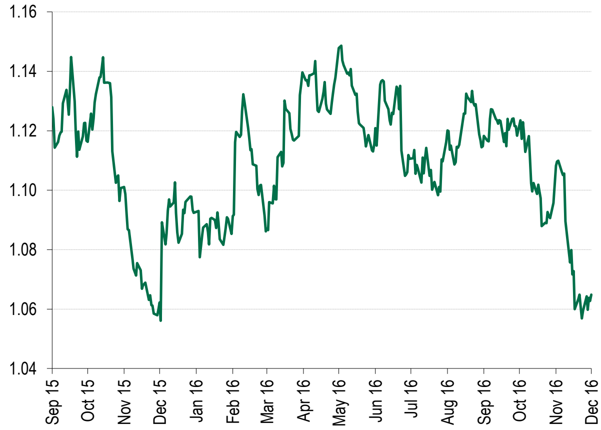
EUR/PLN



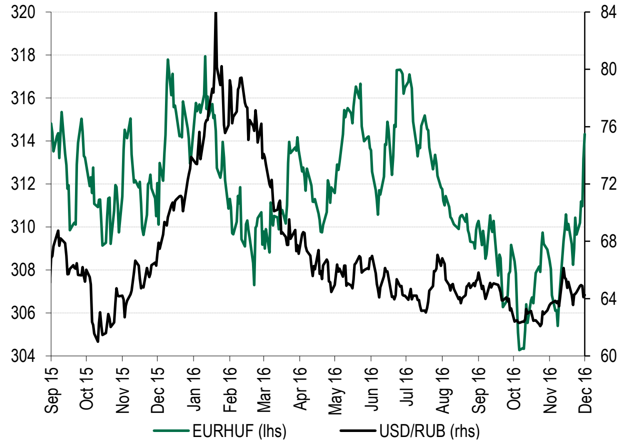
USD/PLN and GBP/PLN



EUR/USD



EUR/HUF and USD/RUB



Volatility rises again and hits the zloty

- Since the beginning of the past week, the zloty was under pressure vs main currencies. Robust US data strengthening expectation for the Fed rate hikes, uncertainty ahead of the Italian referendum and significant sell-off of Polish bonds were the main factors driving the zloty weaker. As a result, EUR/PLN, USD/PLN, CHF/PLN and GBP/PLN rose above their local peaks from mid-November reached during the first upside wave triggered after the US presidential elections. The zloty depreciated to nearly 4.50 per euro, 4.22 per dollar, 4.18 per Swiss franc and 5.34 per pound.
- Volatility on the Polish market increased again after two weeks of stabilization and we think this could persist in the coming days. Italian referendum is due to be held on Sunday and this issue has attracted much of the market's attention. Should "no" win, the next wave of risk aversion could spur worldwide as investors could start pricing more political turmoil in Italy and likely stronger negative pressure on the Italian banking sector. Recall, however, that previous big events that took place earlier this year (UK voting for Brexit, Donald Trump winning US presidential elections) triggered only a very-short term turbulence on the FX market. If "yes" wins this weekend in Italy, a noticeable relief and recovery of risky assets could take place.
- The next important event this week will be the ECB decision on its asset purchase program. We think it will be announced that the program will last longer than March 2017 but its scale of extension could be disappointing for the market. If this is the case, risky assets could give up part of the earlier gains.
- Key levels to watch for EUR/PLN are 4.50 (next resistance at 4.54) and 4.46 (next support at 4.40).

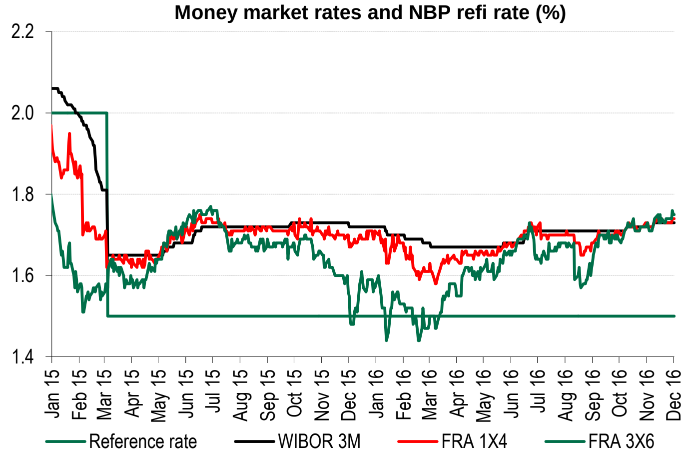
EUR/USD still in a range waiting for the trigger

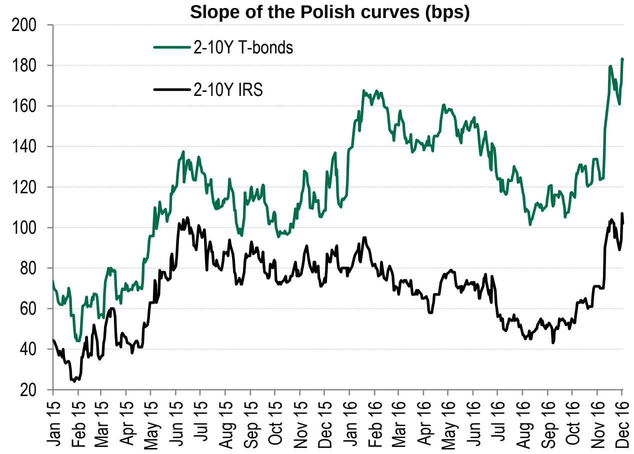
- EUR/USD remained stable around 1.06 for the second week in a row. The US data was very sound, but this was not enough to fuel further US dollar's appreciation as the market was waiting for the Italian referendum.
- We think that market reaction to the Sunday's Italian voting will be straightforward. If "no" wins, EUR/USD is likely to resume its downward move while "yes" could boost the euro. The next positive factor for the single currency could be the outcome of the ECB meeting, in our view.
- EUR/USD is still hovering just above the 1Q15 low, at 1.045, and the next weeks may determine the direction for the market for the months to come.

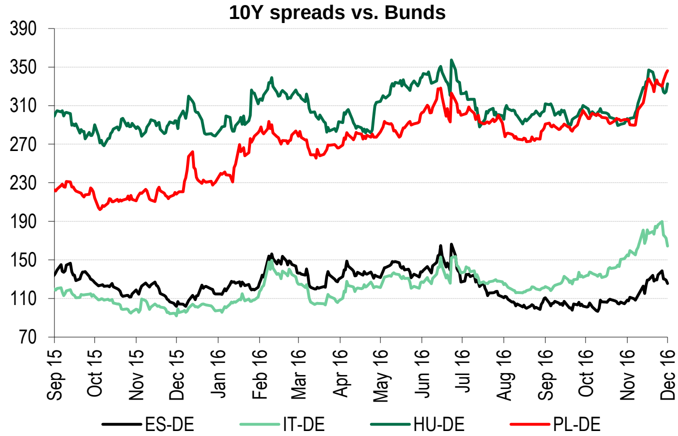
Risk aversion hits forint, ruble slightly stronger vs USD

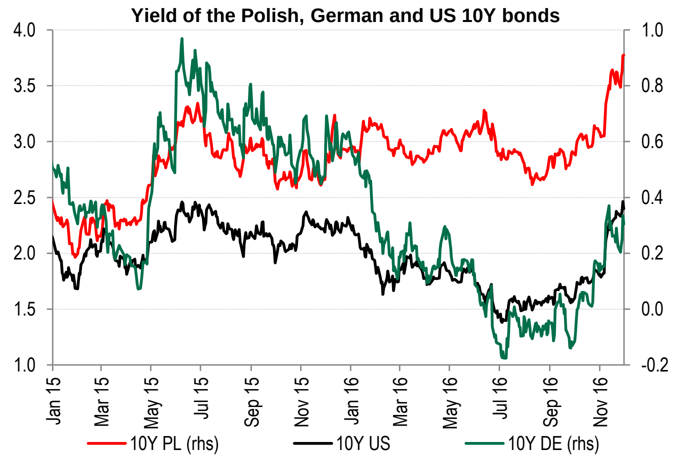
- The Forint also suffered last week amid an elevated risk aversion with EUR/HUF rising above 314 (its highest since late July) from below 310. At the same time, USD/RUB stayed near 64.5. OPEC finally agreed to cut oil output but so far this has had only a temporary positive impact on the ruble.
- Hungarian GDP and CPI data is on the agenda this week. The Hungarian central bank (MNB) is in the easing mode and if the coming data look dovish, they could hit the forint as the market may start to price in more monetary policy easing to be delivered by the MNB soon.

Interest rate market – ECB may push rates up









High volatility hits bonds again

- Last week brought another wave of sharp sell-off on the global debt market, hitting particularly the 10Y tenor, so the start of December was highly volatile after the quiet end of November. This happened for a number of reasons, including the strong US macro data fuelling expectations of higher rates, the upcoming referendum in Italy and some speculations about a possible tapering of ECB's QE programme. Consequently, the yield of 10Y Bund increased temporarily to 0.37%, while the yield of 10Y UST climbed above 2.45%. The domestic market also suffered from the global mood deterioration, with yield of 10Y surging c15bp to 3.80%, above the local peak reached during the first upside wave that started after the U.S. presidential elections (at 3.75%). At the same time, 10Y IRS rate reached its fresh high of 2.98% this year.
- Risk premium for Polish assets increased markedly over the past week. Poland's bond underperformed Bunds, and as a result the 10Y spread PL-DE widened to c. 350bp, the highest level since September 2012. Moreover, both bond yield and IRS curves steepened visibly, with the 2-10Y spread widening above 180bp for T-bonds and above 105bp for IRS.
- According to the Ministry of Finance, in October non-residents sold Polish PLN-denominated marketable bonds for nearly PLN2.5bn in nominal terms versus the end of September. Consequently, nominal value of foreign investors' portfolio fell to PLN198.1bn. The PLN7.7bn outflow from foreign mutual funds was the highest. Geographically, institutions from North America sold PLN7.2bn worth of Polish bonds in October. At the same time, Polish banks purchased debt for nearly PLN3.5bn, increasing their portfolio to PLN226.7bn, the highest level in history again.
- On money market, 1-12M WIBORs remained stable, while FRAs grew significantly, with the biggest move on the long end. The market has started to fully price-in a 25bp hike in the next 15 months.

Heavy week ahead

- Although the US presidential elections took place already three weeks ago, global interest rate market is still very shaky with Polish IRS/yields also witnessing high intraday volatility. We think this could continue in the days to come as next big events are on the agenda – Italian referendum on Sunday and the ECB decision on Thursday.
- It seems that Polish market reaction to the results of the weekend voting will be straightforward – "no" could generate more upside pressure on IRS/yields driving the PL-DE spread even higher while "yes" might trigger some recovery.
- We think that the ECB decision to extend its QE programme beyond March 2017 could be a positive impulse for the market, even if the size of the move would not be significant.
- The MPC is likely to keep its rhetoric unchanged which shall not influence the Polish market significantly.

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