

WEEKLY ECONOMIC UPDATE

12 – 18 December 2016

The Polish Monetary Policy Council signalled that it has not moved any closer to thinking about monetary easing, despite much weaker-than-expected data, and we think they will keep interest rates unchanged in 2017. Meanwhile, the ECB extended its QE programme until December 2017, trimming the scale of asset purchases to €60bn per month. ECB's Draghi tried to convince the markets the decision had nothing to do with QE tapering, and it seems he succeeded, as Bund yields fell after an initial spike.

Once the ECB meeting is over, the focus now moves to the FOMC meeting scheduled for Wednesday. A rate hike by 25bp is very likely, and seems to be fully priced-in. What is important right now is the outlook for the next year, changes in Fed's economic forecasts and its 'dot-plot.' It seems that the base-case scenario assumes two rate hikes in 2017. Any Fed's suggestion about possible stronger/faster tightening could trigger further selloff in world debt markets and EM currencies, while more dovish signals should result in the opposite reaction. We are not expecting a much more hawkish tone of the statement, and thus we see chances for a rebound of the zloty and bonds until the end of December. Another wave of correction is possible in January, under influence of very weak local data and rating agencies' decisions. Domestic data releases scheduled for this week should be market-neutral, in our view.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (12 December)							
14:00	PL	CPI	Nov	% y/y	0.0	0.0	-0.2
TUESDAY (13 December)							
11:00	GE	ZEW index	Dec	pts	59.0	-	58.8
14:00	PL	Core inflation	Nov	% y/y	-0.1	0.0	-0.2
WEDNESDAY (14 December)							
11:00	EZ	Industrial output	Oct	% m/m	0.2	-	-0.8
14:00	PL	Current account	Oct	€m	-751	-910	-999
14:00	PL	Exports	Oct	€m	15 368	15 190	15 312
14:00	PL	Imports	Oct	€m	15 487	15 336	15 512
14:00	PL	Money supply	Nov	% y/y	8.5	8.6	8.7
14:30	US	Retail sales	Nov	% m/m	0.3	-	0.8
15:15	US	Industrial output	Nov	% m/m	-0.3	-	0.0
20:00	US	FOMC decision		%	0.75	-	0.25-0.50
THURSDAY (15 December)							
9:55	GE	Flash PMI – manufacturing	Dec	pts	54.5	-	54.3
10:00	EZ	Flash PMI – manufacturing	Dec	pts	53.7	-	53.7
11:00	PL	Bond auction					
14:30	US	Initial jobless claims	week	k	256	-	258
14:30	US	CPI	Oct	% m/m	0.2	-	0.4
14:30	US	Philly Fed index	Dec	pts	9.0	-	7.6
FRIDAY (16 December)							
11:00	EZ	HICP	Nov	% y/y	0.6	-	0.5
14:00	PL	Wages in corporate sector	Nov	% y/y	3.9	3.4	3.6
14:00	PL	Employment in corporate sector	Nov	% y/y	3.0	3.0	3.1
14:30	US	House starts	Nov	k	1230	-	1323
14:30	US	Building permits	Nov	k	1240	-	1229

Source: BZ WBK, Reuters, Bloomberg

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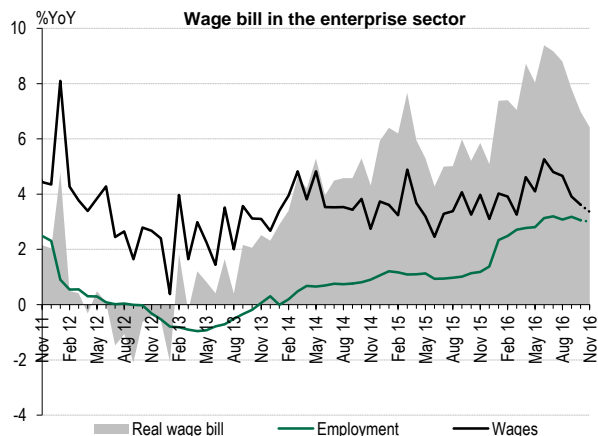
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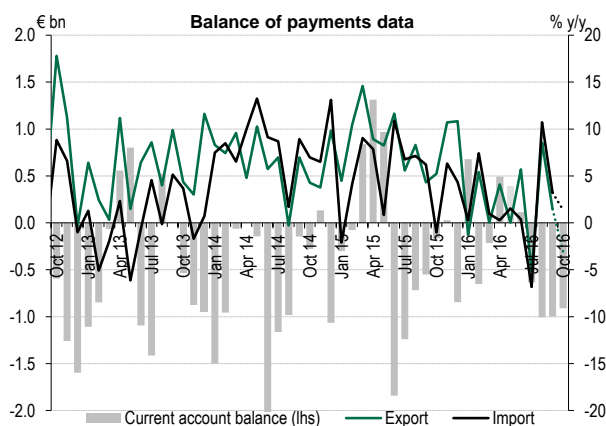
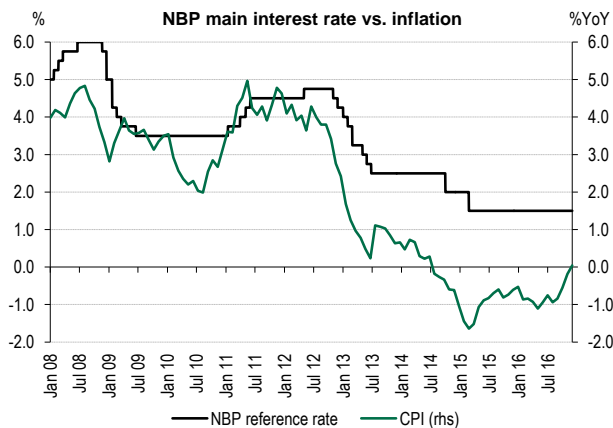
What's hot this week – Zero inflation, slowing exports

■ According to the flash reading, the CPI inflation rose in November to 0.0% y/y, ending the 28-month period of deflation in Poland. We expect the final reading to confirm this move. Core inflation also climbed to 0.0% y/y, in our view. Upward move of CPI was caused mainly by statistical base effects (prices of food and fuels that earlier dragged CPI down are no longer falling). CPI may inch more pronouncedly above zero in December, and in January it may jump to around 1% y/y. However, we are not expecting a sharp upward trend in CPI in the following months, but rather a slow increase towards 1.5% y/y at the end of 2017.

■ We expect the current account deficit in October to be roughly unchanged versus September. Growth rate of exports is likely to be negative and our forecast is supported by weak results of Polish industrial output as well as poor German exports. In general, we expect 4Q16 to be the weakest quarter of the year in terms of export growth, even despite strong support of the weakening zloty.

■ Wage growth decelerated a bit in November, in our view. This was due to weaker trends in mining and some base effects, but the underlying tendency remains quite positive, with probable upward effect of wage hikes in retail trade. We are still expecting wage growth to accelerate in the coming months. Employment growth is likely to decelerate to 3.0% y/y. In our view, the upward trend in employment is losing steam due to drying up supply of qualified workers.

■ M3 money supply growth remained roughly unchanged in November, according to our estimates.

**Last week in economy – MPC still optimistic about growth outlook**

■ The Monetary Policy Council left monetary policy in Poland unchanged, with the main reference rate at 1.5%. The Council admitted that GDP growth, after decelerating to 2.5% y/y in 3Q16, may slow down further in the final quarter of this year, but, at the same time, it reiterated that it expects the economic growth to accelerate next year. The NBP governor Adam Glapiński said he still believed that the key reason for economic slowdown was the low absorption of EU funds. He also said he remained an optimist and expected EU-funded investments to recover in 2Q17, which would be enough to speed up GDP growth.

■ The central bank moved any closer to mulling monetary easing, despite much-weaker-than-expected data about the 3Q GDP growth and worsening outlook for 4Q.

Quote of the week – No talk about cuts in one year horizon**Adam Glapiński, NBP president, 7 Dec, MPC conference**

We expect 4Q16 GDP growth to be below the level reported in 3Q. High base effect is working. Rebound in 2Q17 when absorption of EU funds accelerates.

I am optimistic, in my view only the EU means are a problem.

There is no reasons to think about cuts. Rates are at the lowest level ever, we have just said goodbye to deflation.

There will be no talk about cuts in one year horizon.

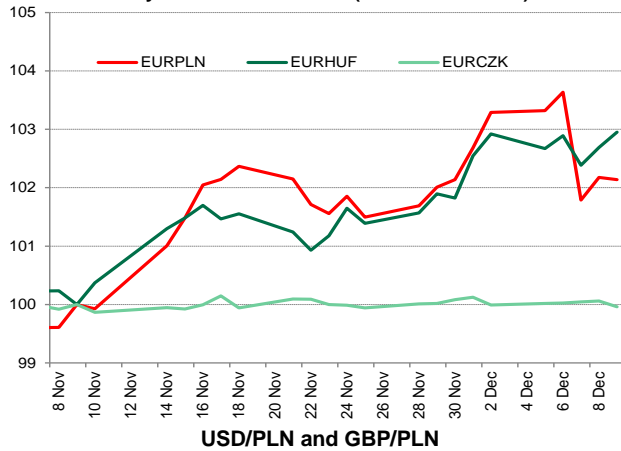
Jerzy Kropiwnicki, MPC member, 7 Dec, MPC conference

In 2H17 the positive effect of the "Mieszkanie+" programme (cheap housing) should be visible.

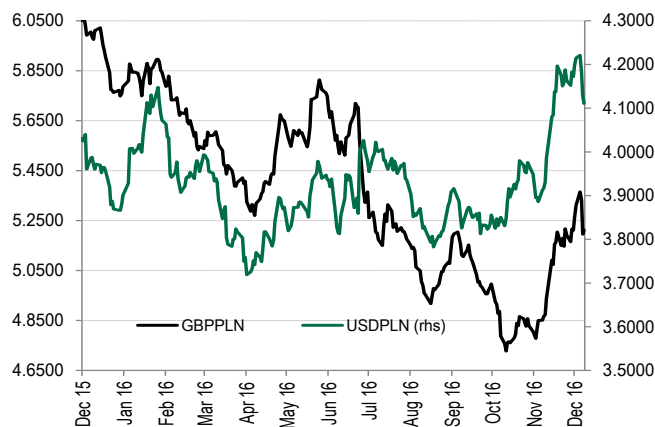
Glapiński strongly emphasized that there is absolutely no reason to think about interest rate cuts in Poland and in his opinion there would be no such discussion in the central bank in the coming year. NBP governor suggested that there are no significant differences of opinions on that matter within the MPC. Lower interest rates are not needed, in his view, and, what is more, there are no reasons to believe that they would be effective in propping up economic growth and investments. Another argument to avoid lowering rates is the situation of smaller banks, as such move would complicate their life even further, and the central bank has to take care of the financial system stability. On the other hand, NBP head made it clear that there would neither be conditions for mulling interest rate hikes in 2017.

Foreign exchange market – Fed's forward guidance crucial for investors

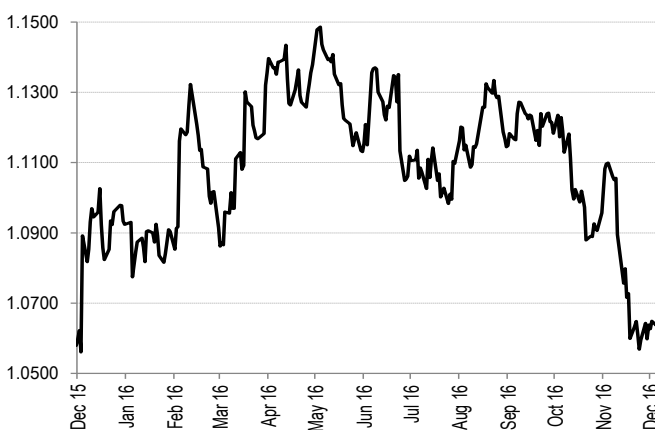
Zloty and CEE currencies (8 November = 100)



USD/PLN and GBP/PLN



EUR/USD



USDRUB



Elevated volatility remains on the market

Volatility on the Polish FX market remained elevated over the past week, in line with our expectations. The zloty, similarly to other EM currencies, weakened significantly after the Italian referendum and strong macro data from the USA, despite the unexpected S&P's decision about raising Poland's rating outlook to neutral. As a result, EURPLN increased towards 4.50, while USDPLN reached nearly 4.20. Rebound on Poland's debt market helped the zloty to trim part of the earlier losses, with EURPLN dropping to 4.42 for a while. This resulted mainly from the global mood improvement ahead of the ECB meeting and Polish yields decline. In the first reaction to the ECB's decision, zloty lost against the main currencies, but then strengthened somewhat, and ended the week around 4.45. Meanwhile, USDPLN increased above 4.22 due to the EURUSD decline. On weekly basis, the zloty outperformed other CEE peers, recovering after its recent sharp depreciation. The zloty gained on average 1% against the main currencies.

The recent sessions have clearly shown that global factors are the most important for the zloty's valuation. This week global macro and events calendar is heavy, with FOMC meeting as the key issue. Monetary tightening by Fed is widely expected; therefore, investors will focus on new CPI and GDP projections and new dot plots, looking for some hints of further Fed's monetary outlook. The quite cautious Fed rhetoric about Fed rate path in the upcoming months should be supportive for the zloty. What is more, EURPLN's chart suggests that room for further increase is rather limited and downward trend of the rate is more likely by the end of 2016. Important levels for EURPLN are 4.50 and 4.40. In the meantime, volatility on the USDPLN may remain high, depending on EURUSD direction after the FOMC meeting.

EURUSD below 1.06 ahead of December's Fed meeting

Last week the situation on the EURUSD was mixed, with the highest range of fluctuation since the announcement of US elections results. Initially, EURUSD increased to nearly 1.075 (up from 1.05) and then stabilised near 1.07 ahead of the ECB meeting. The first reaction to the ECB's decision brought a sharp increase to 1.087, but then the rate fell below 1.06 at the end of the week. We also noted high volatility on the sterling with GBP weakening against the main currencies after weak UK macro data and increased Brexit risk.

We think that EURUSD might fall gradually even towards December's low of 1.05, waiting for the Fed meeting. The market is well prepared for FOMC rate hike by 25bp, but tail risks in terms of the Fed forward guidance remain. Consequently, FOMC rhetoric and forecasts will be crucial for the market direction. In our view, EURUSD could return towards 1.07 if Fed remains quite cautious about further monetary tightening.

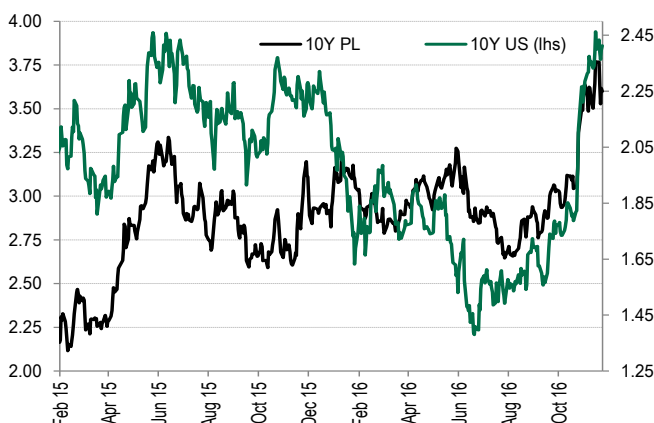
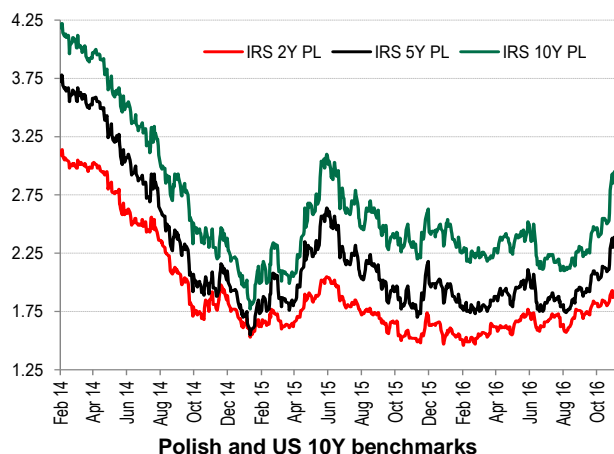
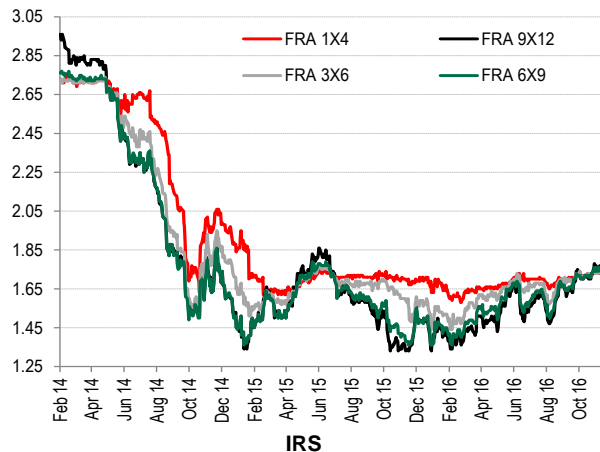
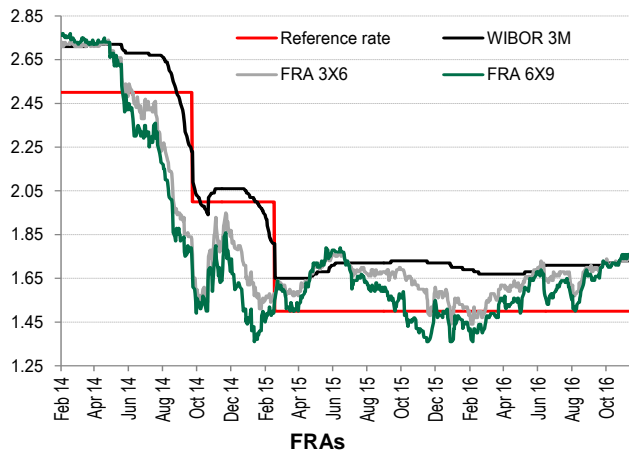
Gradual rebound among CEE currencies

Hungarian forint underperformed other CEE peers as EURHUF increased to 315, the highest level since July. At the same time, the Russian ruble strengthened somewhat, supported by rising Brent oil prices, with USDRUB falling to 62.9 for a while and ended the week slightly above 63.1.

In our view, HUF, RUB and CZK will remain under influence of global factors, mainly the Fed meeting. From the local side, Russian central bank will hold its meeting on Friday (16 Dec). We think that the central bank will keep interest rates unchanged and this should be rather neutral for USDRUB.

Interest rate market – 25bp rate hike but what next?

NBP rate and money market rates



Bullish flattener on the bond market

▪ The result of Italian referendum had only short-term adverse impact on the global market and stronger hopes for more monetary policy stimulus from the ECB pushed yields down. Although the central bank seems to have disappointed bond players (yields rose noticeably on the global market after the decision), Polish debt gained on weekly basis with the sharp yield's decline on the belly and long end, flattening the curve.

▪ At the end of the week, the 2Y IRS was near 1.95% (-3bp on weekly basis), the 5Y rate reached 2.42% (-2bp), and the 10Y IRS was at 2.96% (-3bp). As the IRS curve was less volatile than the bond curve, the asset swap spread narrowed to 64bp from 78bp for 10Y.

▪ 1-12M WIBORs remained stable on weekly basis.

FOMC to set direction

▪ This week, numerous Polish data are on the agenda but it is the FOMC decision that is very likely to be the main event. The U.S. central bank is widely expected to hike rates by 25bp and this should be already priced-in. In September, the median of the Committee members' interest rate forecasts for end-2017 fell to 1.13% from 1.63% and for end-2018 to 1.88% from 2.38%. The market is already pricing in a c50bp hike next year, which is our base-case scenario, so it seems that there could be a bigger reaction if FOMC sounds more dovish than hawkish this week.

▪ We have already pointed to the high correlation between the Polish 10Y benchmark and its respective U.S. peer persisting since the U.S. presidential elections. In our view, the global market reaction to the FOMC decision will be key for at least the short-term trend of Polish debt.

▪ On Thursday, the Ministry of Finance will hold a bond switch auction. The Ministry will repurchase WZ0117, PS0417 and DS1017. According to the recent data, at the end of October, non-residents held PLN13.2bn and Polish banks PLN25.8bn of bonds planned for repurchase. Given this significant difference and the fact that there are only two OK series outstanding after OK1016 maturity and Polish banks tendency to switch their holdings to the short-term debt, we think that the Ministry of Finance could offer new OK bond. Offering short-term WZ would also be in line with the Ministry's rhetoric, saying that short-term bonds might be offered at this switch auction.

▪ Final CPI for November should not deviate from the flash estimate so this figure is likely to be market-neutral. The other Polish macro data – October C/A and November employment and wages – should be of less significance as well.

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