Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

20 – 26 February 2017

Last week was loaded with important macro releases. GDP readings for Europe were rather mixed, with Germany and the whole euro zone posting a rather disappointing result. On the other hand, Polish data surprised to the upside across the board, showing a very strong labour market, output, sales and exports. Even though there were some one-off statistical effects acting in favour of the data, in our view the underlying trend seems to gain steam. CPI inflation rose to 1.8% y/y, slightly above market expectations and clearly above expectations of the MPC members. In our view, speculation about rate hikes in 2017 may gain attention on the market.

This week there are no important domestic data releases, therefore the market will keep focusing on global releases and events, including European leading indicators for February (flash PMI, Ifo for Germany). These data should confirm positive growth outlook in the Euro zone, in our view. The key event might be FOMC minutes, and investors will be looking for confirmation of faster rate hike by Fed, suggested by Fed Chair Janet Yellen in her last testimony. Consequently, more hawkish FOMC minutes will put pressure on rising yields on core market, and as a result domestic yields can also go up. Situation in Greece will be in the foreground at the start of this week as on 20th February the Eurogroup will discuss the ongoing implementation of Greece's macroeconomic adjustment programme. This might negatively influence the global sentiment, putting some pressure on risky assets, including the Polish zloty.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (20 February)					
	US	Banking holiday					
16:00	EZ	Consumer confidence	Feb	pts	-4.8		-4.9
		TUESDAY (21 February)					
9:30	DE	Flash PMI	Feb	pts	56.2	-	56.4
10:00	EZ	Flash PMI	Feb	pts	55.0	-	55.2
		WEDNESDAY (22 February)					
10:00	DE	Ifo	Feb	pts	109.7	-	109.8
11:00	EZ	CPI	Jan	% y/y	1.8	-	1.8
16:00	US	Existing home sales	Jan	% m/m	1.1	-	-2.8
20:00	US	FOMC minutes	Feb				
		THURSDAY (23 February)					
8:00	DE	GDP	Q4	% y/y			1.2
10:00	**PL**	**Registered unemployment rate**	**Jan**	**%**	**8.7**	**8.6**	**8.3**
14:00	**PL**	**MPC minutes**					
14:30	US	Initial jobless claims	week	k			239
		FRIDAY (24 February)					
16:00	US	New home sales	I	% m/m	7.3		-10.4

Source: BZ WBK, Reuters, Bloomberg

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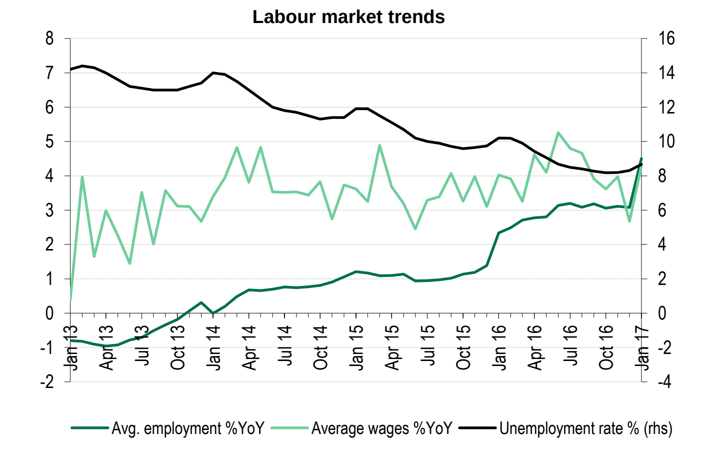
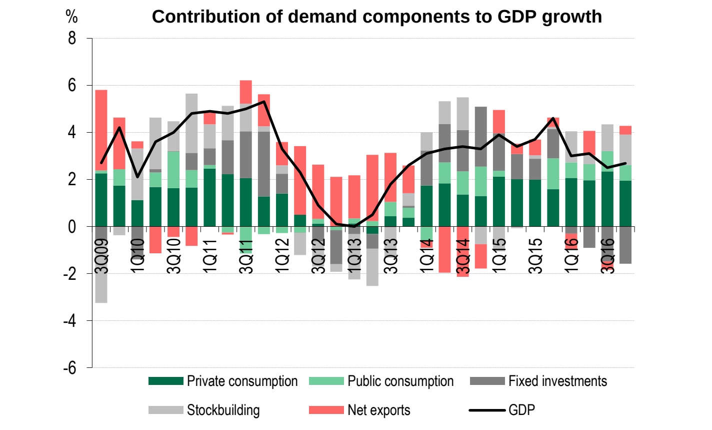
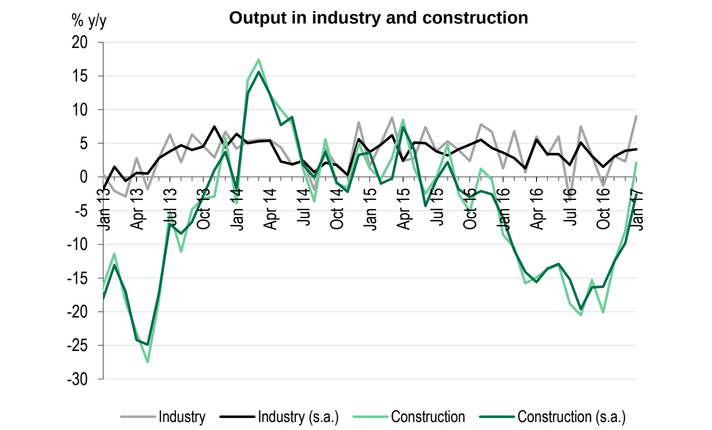
What's hot this week – Unemployment rate and Statistical Bulletin



- We expect the registered unemployment rate to rise to 8.6% in January, from 8.3% in December (due to the seasonal factor). However, there is an upward risk for our forecast after the Labour Ministry showed its estimate of 8.7%. We are expecting this indicator to go further down in 2017 and to reach 7.4% at the year-end.
- The Statistical Bulletin will show detailed information on the wage and employment growth in January. We will get to know more about the surprising employment growth in January. We argued that in our view it was mostly triggered by contract transformation. According to the data, civil contracts are strongly widespread in administrative and supporting activities. So, a strong rise in that sector would confirm our claim.
- We will also get to know the business climate indicators for February, remembering they climbed strongly across the board in January.

Last week in economy – Recovery on its way





- GDP growth in 4Q16 accelerated to 2.7% y/y and was above our forecast and market consensus (both at 2.5% y/y). The positive surprise in the fourth quarter was primarily triggered by the shift in time of the government spending, which, according to our estimates, boosted GDP growth in 4Q16 by c0.7pp.
- The data on the economic activity in January were very good – growth in industrial production (9% y/y), construction output (2.1% y/y), as well as retail sales (9.6% y/y in constant prices) have clearly accelerated, exceeding market forecasts. Though the improvement may to a certain degree be attributed to the statistical effect (higher number of working days), it may also suggest that the economic recovery at the start of 2017 is stronger than we had previously expected. What is important is that the data suggest improvement in all the main growth components: consumption (retail sales), investments (construction) and exports (manufacturing).
- In January wages accelerated to 4.3% y/y, in line with the expectations, while employment rose by 4.5% y/y, beating by far the market and our forecasts. The sharp increase in employment was mostly caused by a larger number of surveyed entities; in January the Statistics Office is updating the pool of researched companies. We expect the employment growth to slow down in the months to come due to the drying up labour supply. Overall, the labour market situation remains good, which, in our opinion, should support private consumption growth in the coming quarters.
- In January CPI inflation rose to 1.8% y/y, from 0.8% in December, slightly above the expectations. We think the CPI may reach 2% y/y already in February, while core inflation will be rising much slower this year.

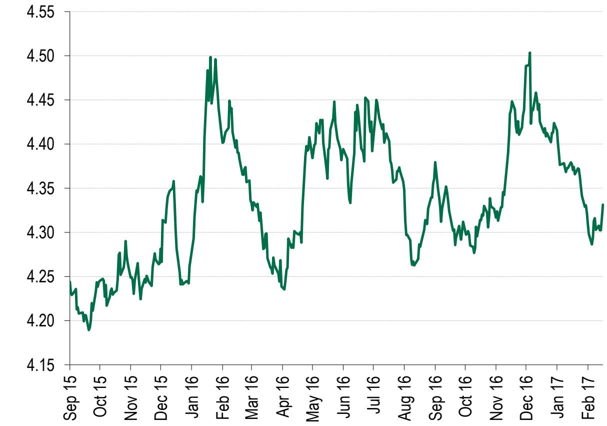
Quote of the week – No need for concern over inflation

Łukasz Hardt, MPC member, PAP, 13.02
No rate changes until end of the year is the most probable scenario. Inflation should not exceed 2.5%. Real interest rates are negative, but as long as we view is at temporary, it is not an argument to hike.
Kamil Zubelewicz, MPC member, PAP, 13.02
Possibility of a hike this year cannot be ruled out. We will see whether we are close to end of negative real interest rate period, or whether it will be longer.
Jerzy Żyżyński, MPC member, Reuters, 13.02
We are not expecting CPI to surpass 2.5%. If it does, we may consider hikes.
Grażyna Ancyparowicz, MPC member, Reuters, 15.02
Risk, of surpassing 2.5% is small, but if the upward trend holds, we will need some slight corrections of rates, before inflation reaches 3.5%.
Jerzy Kropiwnicki, MPC member, PAP, 13.02
There is no reason to worry about CPI at 1.8%. If upward inflation trend holds, then I would consider also data on GDP and unemployment when deciding on rates.

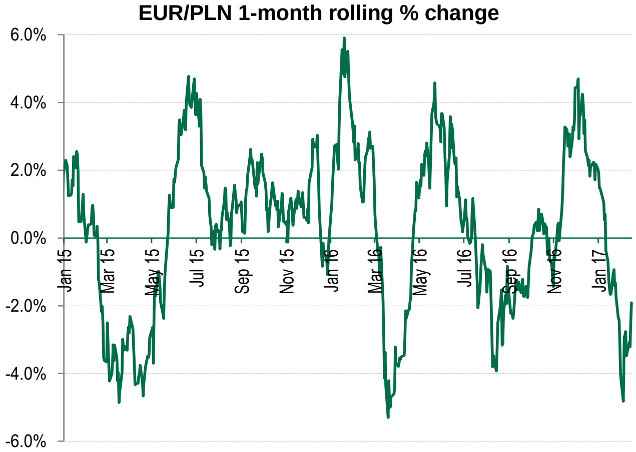
In our view, the pace of inflation pick-up at the start of this year has surprised the Polish MPC, even though some of the Council members are denying it. Moreover, we think that the MPC is underestimating the inflation's upward potential later this year. The central bankers currently believe that inflation will not top 2.5% and that even the CPI rise above 1.5% will be short-lived. While we agree on the former, the latter seems much less likely – we expect inflation to reach 2% already in February and to hover around this level for the better part of the year. This, in turn, is likely to trigger higher worries about breaching the target and higher divergence of views within the MPC. Zubelewicz and Hardt seem to be the most hawkish members, and they may be raising discussion about the need to tighten the policy, in our view, fuelling market speculation about rate hikes. Nevertheless, we think the majority of the MPC will keep interest rates unchanged this year.

Foreign exchange market – Waiting for more US data

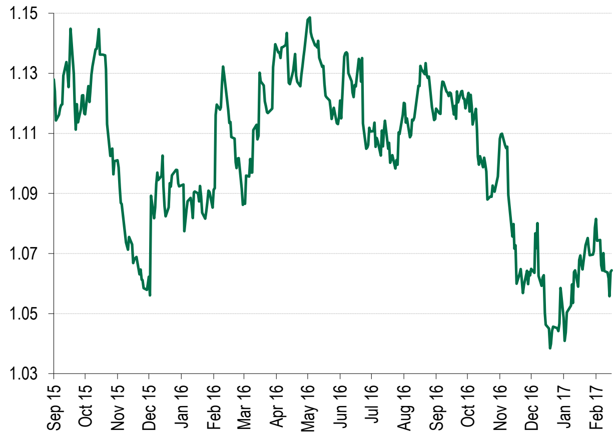
EUR/PLN



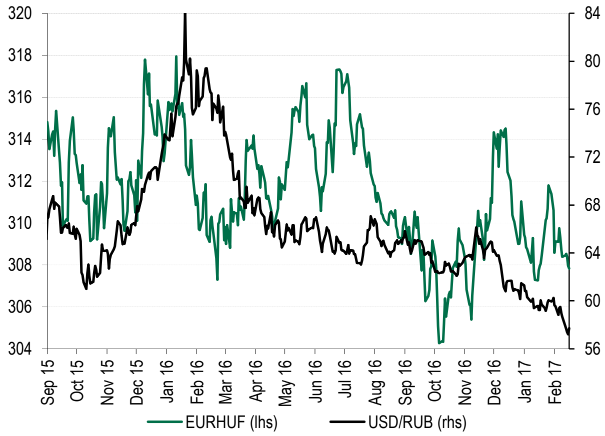
EUR/PLN 1-month rolling % change



EUR/USD



EUR/HUF and USD/RUB



Polish data with little support for the zloty

- Last week, the Polish currency lost vs the euro, dollar, Swiss franc and British pound. The scale of the zloty's depreciation was limited but the direction was in line with our call from the last week when we suggested that it may be tough for EUR/PLN to continue the downside move. Polish better-than-expected flash 4Q GDP provided only temporary support for the zloty, while strong January's industrial output and retail sales were ignored by the market. EURPLN rose to 4.33 from c4.28, USDPLN rebounded temporarily to 4.08 from 4.04, CHFPLN rose to 4.05 from 4.03, GBPPLN touched 5.10 but in the end it returned to 5.04.
- The past week was full of important data releases and numerous FOMC members comments that failed to move the market noticeably. We still think that the zloty is likely to give up more of its recent gains vs the euro. The second chart shows that EUR/PLN's 1-month rolling percentage change has reached levels considered extreme given the past experience. This suggests that market's pricing for an economic recovery may have been exaggerated and now more positive impulses might be needed for the zloty to continue its appreciation trend or, at least, to help keep the recent gains.
- Global sentiment should be key next week but we think that the Polish currency is rather more likely to respond to poor numbers rather to the good ones.

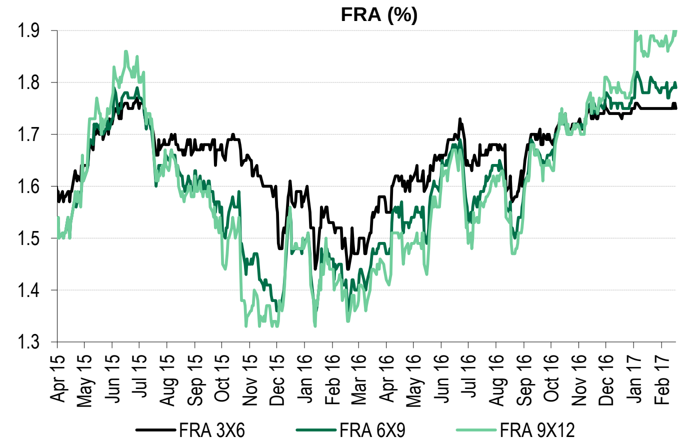
US data supported the dollar

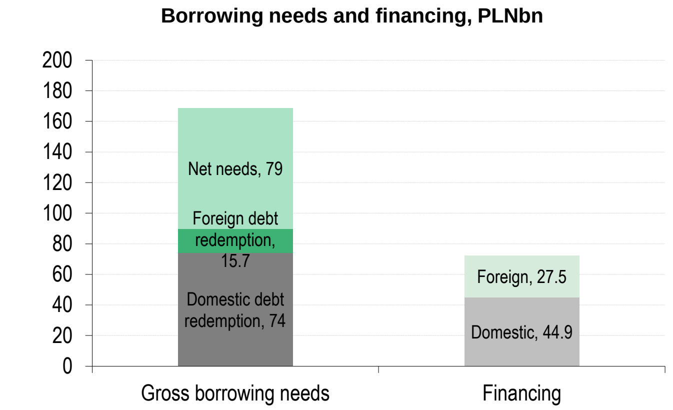
- EURUSD was falling since the beginning of the week amid sound US data but when it reached 1.052 the downside move stopped and investors decided to take profit from the dollar's appreciation pushing the exchange rate to 1.065 at the end of the week.
- Last week, the US macro data proved an important driver for EURUSD and the coming days will bring some more US figures as well as the next comments of the FOMC members. According to Bloomberg, the market is currently pricing 34% probability for a 25bp Fed rate hike in March vs 28% last week. Should the next US data also beat expectations, there is still room for a stronger dollar after the January's EURUSD rally to 1.08 from 1.035. The local bottom at 1.052 is the first support to watch.

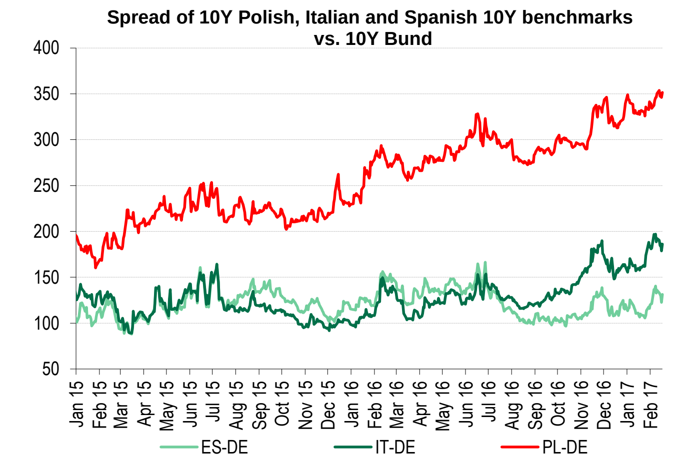
Volatile rubel, stable forint

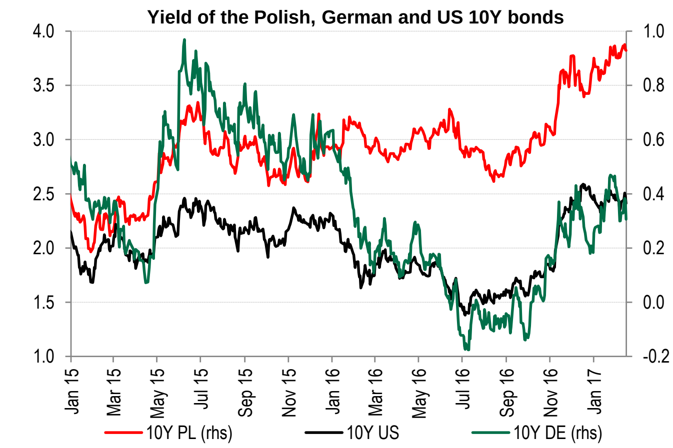
- The first part of the past week was pretty good for the rubel vs the dollar as USDRUB fell to the fresh 2017 low at 56.64 (and its lowest since July 2015) amid slight decline in oil prices. However, the ruble's appreciation proved short-lived (it rose back above 58) after the Russian economy minister said he discussed the recent ruble appreciation with president Putin. Already in the past months Russian government officials had been suggesting that ruble was getting too strong which had a negative effect on the economy. In January the Russian Ministry of Finance decided to start FX purchases to restore its reserves which was interpreted by the market as an action aimed at halting the USDRUB down trend.
- Last week, EURHUF was hovering within a 307-309 range. The Hungarian flash 4Q GDP estimate was much weaker than expected (1.6% y/y vs 2.0% y/y) but did not have any persistent negative impact on the forint.

Interest rate market – Global factors still crucial









Domestic yields lower at the end of the week

- Last week, Polish interest rate market was strongly dependent on investors' mood on the core market. Initially, increase in yields of both German and US bonds (with 10Y UST growing temporarily above 2.50%) spilled over into higher domestic yields and IRS rates (with yield of 10Y benchmark reaching 3.88%, its highest level since the beginning of February). This stemmed mainly from hawkish rhetoric of Fed Chair Yellen testimony, in which she suggested that FOMC may tighten monetary policy in the upcoming months. However, end of the week brought some strengthening on debt market globally, with Polish 10Y benchmark testing 3.80%. Favourable domestic auction results were an additional factor supporting domestic assets (details below).
- FRAs increased visibly over the past week. This stemmed mainly from better than expected domestic macro data releases and hawkish comments from Mr Zubelewicz from MPC who stated that interest rate hike in 2017 cannot be ruled out, but only 'if something really worrying happens'. Consequently, FRA curve steepened visibly as compared to the previous week, and market now is fully pricing-in rate hike by 25bps in 12 months horizon.
- Poland's Ministry of Finance successfully launched T-bonds on Thursday's auction, selling papers worth cPLN7bn. Recorded demand amounted to nearly PLN13bn and concentrated mainly on medium and long term bonds (offer of 5Y, 10Y and 30Y benchmarks attracted 66% of total demand). It is noteworthy that investors (mainly insurance companies, in our view) submitted solid demand on a new 30Y benchmark WS0447, whose sale reached PLN2.11bn or 30% of total sale. Deputy finance minister, Piotr Nowak, said that this year's borrowing needs were covered in 43% and bond issues might be lower in the months to come.

Investors' eyes still on the core market

- This week's calendar is not tight in Poland, therefore investors will keep focusing on global factors. We think that FOMC minutes release may be most crucial. This can bring some signals how fast FOMC will hike rates this year taking into account Fed Chair testimony last week. Increasing chance for earlier monetary tightening by Fed may bring impulse to take profit on core markets after quite significant strengthening at the end of last week. This will put pressure on domestic curves, in particular on the belly and long end. Taking into account current market circumstances, we think that the yield of 10Y benchmark will stay in the range of 3.75-3.90%, oscillating closer to the mid of the fluctuation channel. Risk premia might stay elevated (now spread over Bund for 10Y is around 350bps) as Polish assets did not fully benefit from global mood improvement.
- The front end of the curve will be still under influence of domestic factors. Macro data releases for January (including CPI, industrial output, retail sales) surprised the market to the upside, confirming that economic activity in Poland is solid at the start of the year. These data caused short-lived upward move in yield of 2Y benchmark. In the absence of new data, short end may be sensitive to new MPC members comments.

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