Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

27 February – 5 March 2017

Last week, the market was mostly affected by news from the main central banks (rather dovish Fed minutes and comments of ECB representatives) and by growing political uncertainty, especially by high support for Marine Le Pen in France. In Poland, we were provided with a large bunch of labour market data. Foreign macro data were quite optimistic, and increases in leading indicators for Germany and the euro zone were quite impressive.

This week is rather light as regards domestic data, so investors will focus on events abroad. We will get to see some interesting data on economic activity in the USA and the euro zone. Janet Yellen and Donald Trump are to speak, and this will probably boost market volatility. Moreover, the market will keep an eye on new election polls from the Netherlands and France. Polish data releases include February's PMI and 4Q16 GDP breakdown. In our view, public consumption growth in 4Q16 will be quite significant as regards the outlook for the upcoming quarters. Generally, the market behaviour in the last days was rather dubious, as stock markets were posting gains, suggesting a rising risk appetite but on the other hand, yields on the core markets fell markedly, suggesting an opposite. In our view, the same story may be repeated in the coming days, at least as long as the political uncertainty in Europe is in the fore.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (27 February)					
14:30	US	Durable goods orders	Jan	% m/m	1.6	-	-0.5
16:00	US	Pending home sales	Jan	% m/m	0.9	-	1.6
		TUESDAY (28 February)					
10:00	**PL**	**GDP**	**Q4**	**% y/y**	**2.7**	**2.7**	**2.5**
10:00	**PL**	**Private consumption**	**Q4**	**% y/y**	**4.4**	**4.0**	**3.9**
10:00	**PL**	**Fixed investment**	**Q4**	**% y/y**	**-5.1**	**-5.8**	**-7.7**
11:00	EZ	Flash HICP	Feb	% y/y	1.9	-	1.8
14:00	HU	Central bank decision		%	0.90	-	0.90
14:30	US	Preliminary GDP	Q4	% q/q	2.1	-	1.9
16:00	US	Consumer confidence index	Feb	pts	111.0	-	111.8
		WEDNESDAY (1 March)					
9:00	**PL**	**PMI – manufacturing**	**Feb**	**pts**	**-**	**55.1**	**54.8**
9:55	DE	PMI – manufacturing	Feb	pts	57.0		56.4
10:00	EZ	PMI – manufacturing	Feb	pts	55.5		55.2
14:30	US	Personal income	Jan	% m/m	0.3	-	0.3
14:30	US	Consumer spending	Jan	% m/m	0.3	-	0.5
16:00	US	ISM – manufacturing	Feb	pts	56.0	-	56.0
20:00	US	Fed Beige Book					
		THURSDAY (2 March)					
		No important data releases					
11:00	**PL**	**T-bond auction**					
		FRIDAY (3 March)					
9:00	CZ	GDP	Q4	% y/y	1.7	-	1.7
9:55	DE	PMI – services	Feb	pts	54.4	-	54.4
10:00	EZ	PMI – services	Feb	pts	55.6	-	55.6
16:00	US	ISM – services	Feb	pts	56.5	-	56.5

Source: BZ WBK, Reuters, Bloomberg

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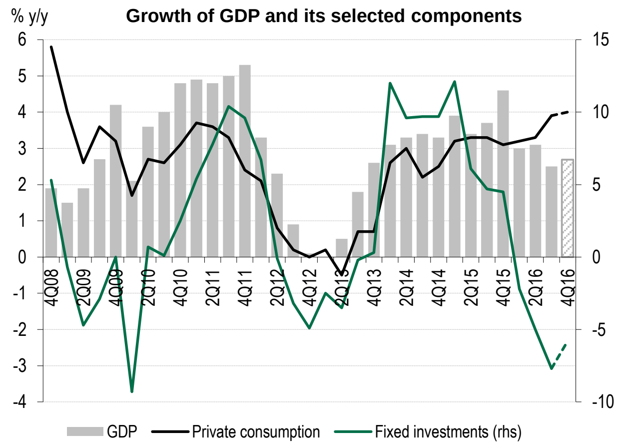
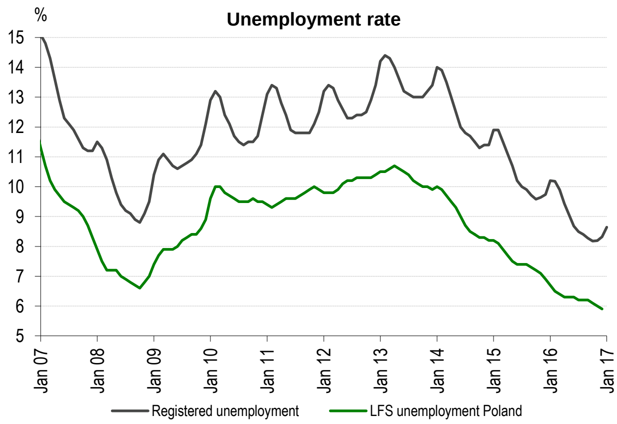
What's hot this week – GDP breakdown and PMI

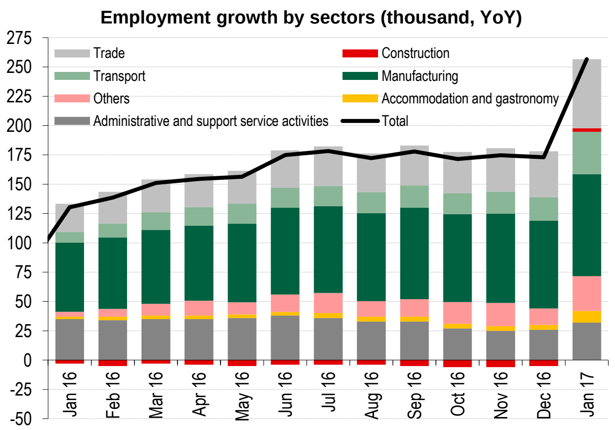


▪ We have already had quite precise estimates of 4Q16 growth breakdown, but the detailed data due for release this week will include some interesting information. In our view, the government decided to shift some spending from 2017 to 2016, thus boosting public consumption. We estimate that this move added about 0.7pp to GDP growth, but the exact data on public consumption growth will help assess the underlying trend better and fine-tune forecasts for the upcoming quarters. Private consumption, on the other hand, will help estimate how much households smoothed their spending and will give a hint about consumption patterns in 2017, especially in H2.

▪ We expect the PMI to go slightly up in February, following the German and euro zone indicators. On the other hand, Statistics Office's business climate for manufacturing went down, so we are not overly optimistic about the PMI.

Last week in economy – Bunch of labour market data





▪ In January, the registered unemployment rate in Poland rose to 8.6% from 8.3% in December in line with our projections. In our view, seasonally adjusted unemployment rate fell to 8.2% from 8.3%. The decline results mostly from a low number of new jobless claims accompanied by a relatively low number of newly employed and a high number of job offers. It should be emphasized that the data of Central Statistical Office of Poland were lower than the flash estimates of the Ministry of Labour (8.7%) which means that the Office has increased its estimated figures for the employed. Unfortunately, the data are not published, but according to our estimates, the upward adjustment must have been between 40k and 225k employees (which would mean a growth in the number of employed between 1.8% and 3.0% y/y in January).

▪ The data for 4Q2016 published as a part of Labour Force Survey (LFS) give some more insight into the labour market. The unemployment rate was 5.5%, which is the lowest level in the history of the survey, whereas the employment increased merely by 0.3% y/y. It should be noted that the employment in the agricultural sector decreased by 9.1% y/y (162k) while the employment in industry increased by 3.0% y/y (151k).

▪ Data about employment in corporate sector showed that the strongest increase took place in accommodation and catering (7.7% m/m) and in administrative and support service activities (6.1% m/m). In those sectors, as usual, there was a high share of people employed on civil law contracts, thus the data seem to confirm our hypothesis that very high employment growth in January partly resulted from the change of civil law contracts into regular contracts.

Quote of the week – Return to balanced economic growth is crucial

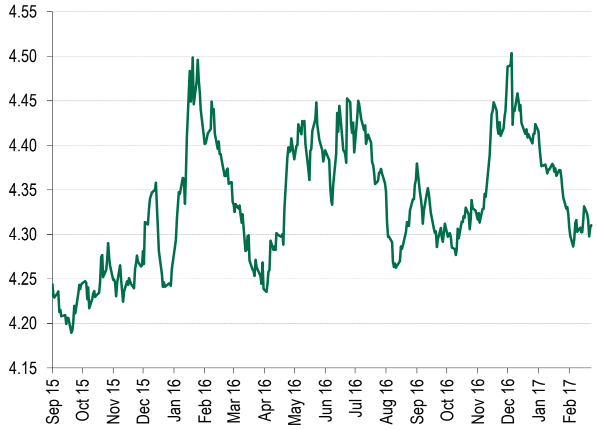
Rafał Sura, MPC member, PAP, 21.02

I do not view interest rate hike necessary in the upcoming quarters. Return to balanced economic growth is crucial right now. I would like the MPC to think about hikes, but not necessarily in 2017. There are no reasons to worry about a quick and persistent rebound in CPI, which would bring it above the target. Negative real interest rates are temporary

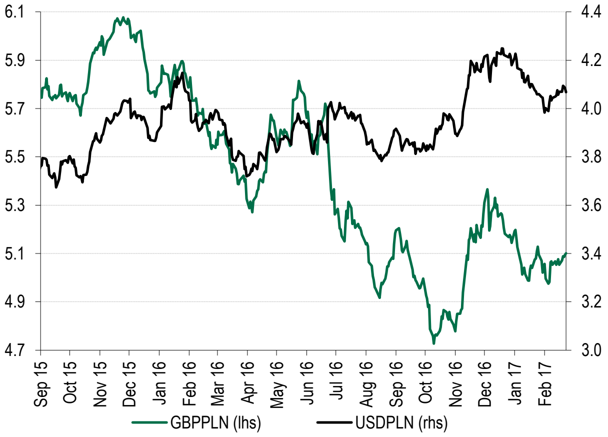
According to minutes from the February's MPC meeting, the central bankers expect to see the acceleration of economic growth in the coming quarters, mainly due to rebound in investments. Nevertheless, the growth is unlikely to exceed its potential level significantly, and the negative output gap should imply the lack of inflationary pressure. According to MPC members, inflation rise at the start of the year will be short-lived as it results mainly from higher prices of commodities. Some members suggested that if inflation proves to be higher than expected, then consideration of rate hikes may be justified in the coming quarters, and the important aspect will be the level of real interest rates. Still, the majority pointed to small probability of exceeding the inflation target, which implied that it was hard to define when interest rate hikes would be necessary. We still think that MPC members will be surprised by the scale of inflation increase this year, so the first group of MPC members may be growing.

Foreign exchange market – Horizontal trend may continue

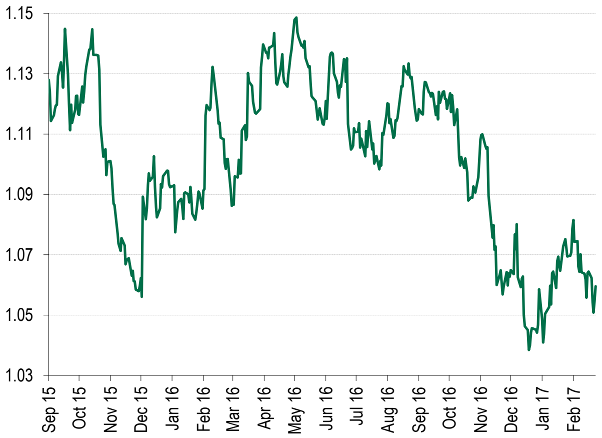
EUR/PLN



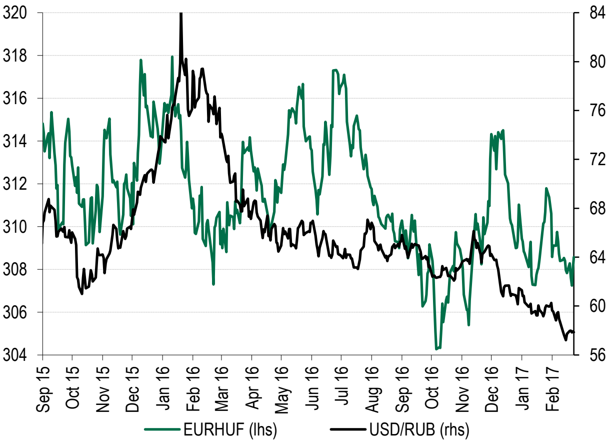
USD/PLN and GBP/PLN



EUR/USD



EUR/HUF and USD/RUB



Zloty gained a bit in weekly terms

- Last week, Polish zloty strengthened visibly against the euro, with EURPLN declining temporarily to 4.286, its lowest level since early February. This mainly stemmed from higher appetite for risky assets, reflected in growing equity market indices. However, the rate quickly returned to 4.31 due to concerns about French election. More significant changes were noted for USDPLN – the rate sharply climbed to 4.10 (its highest in one month period) as a result EURUSD drop to 1.05. The move was only short-lived and USDPLN dropped again near 4.06. On a weekly basis, zloty gained against the euro and Swiss franc, while lost against the US dollar and British pound.
- Situation on the EURPLN chart did not change much. The rate has anchored around the mid of fluctuation channel between 4.25-4.35. Currently, the zloty valuation is quite stable as two tendencies dominate on the market. On the one hand, there is a clear risk-on mode implied by strong equity markets (in which in USA equity indices reached a fresh historical maximum). On the other hand, political risk in Europe is growing and it is mainly associated with the elections scheduled for 2017. We think that horizontal trend should dominate on the market.
- This week, domestic macro calendar is very light as we will only get some more details about Poland's GDP growth in 4Q16 and PMI manufacturing index for February. In our view, these data will have a slight impact on PLN.

Profit taking on the US dollar

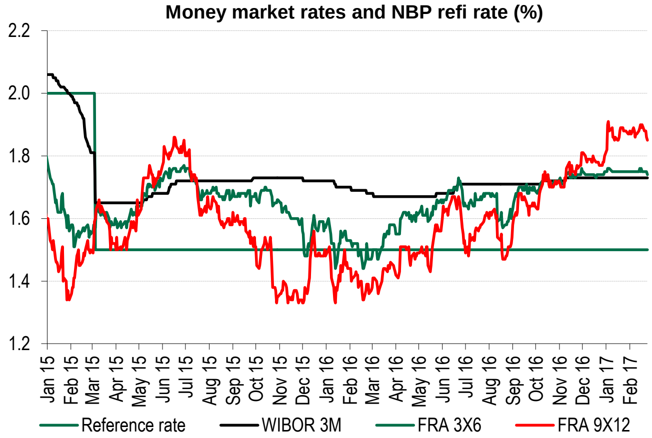
- Last week, EURUSD fell to 1.05 (down from 1.63), its lowest level since early January, backed on hawkish comments from Fed members. However, FOMC minutes from February signalled no rush to hike rates and this fueled profit taking. Consequently, EURUSD returned to 1.06 at the end of the week.
- This week, macro calendar is quite heavy. Market will concentrate on the February PMIs in Europe and flash HICP in the Euro zone. As regards the USA, the most important releases are February ISM surveys and data from real economy (durable goods orders and personal spending as well as income report, both for January). In our view both data from Europe and USA should confirm quite solid fundamentals. On the other hand, uncertainty about the election outcome, especially in France, might put some pressure on EUR, keeping EURUSD between 1.04-1.08.

CEE currencies moved sideways

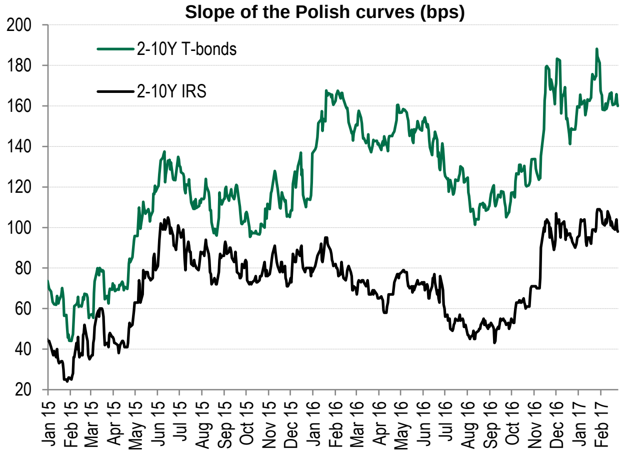
- CEE currencies, similarly to the Polish zloty, moved sideways last week. Higher inflation performance in Czechia renewed expectations for an earlier exit from the EURCZK floor, adding to intraday high volatility. EURHUF inched slightly higher over the week with the rate increasing to 308.5, up from 307.5 at the start of the week. However, it is still within consolidation channel between 306-310. At the same time, Russian ruble benefited from higher oil prices. As a result USDRUB fell to 57.2 for a while, but it ended the week slightly above 58.
- This week, global factors remain crucial for HUF valuation as, in our view, market response to Hungarian central bank decision (it is broadly expected to keep rates unchanged) will be muted. The Russian ruble will remain under influence of oil prices changes.

Interest rate market – The 10Y spread over Bund at the highest level since 2012

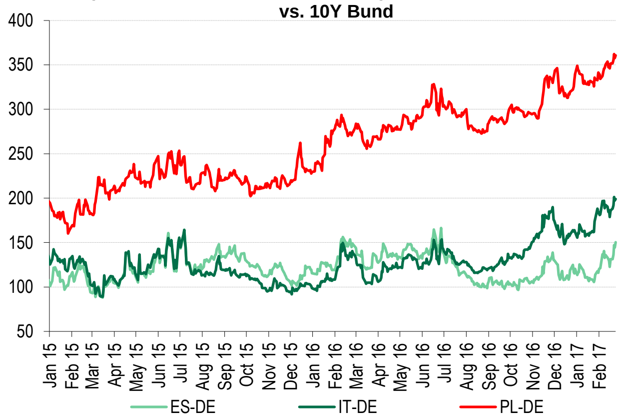
Money market rates and NBP refi rate (%)



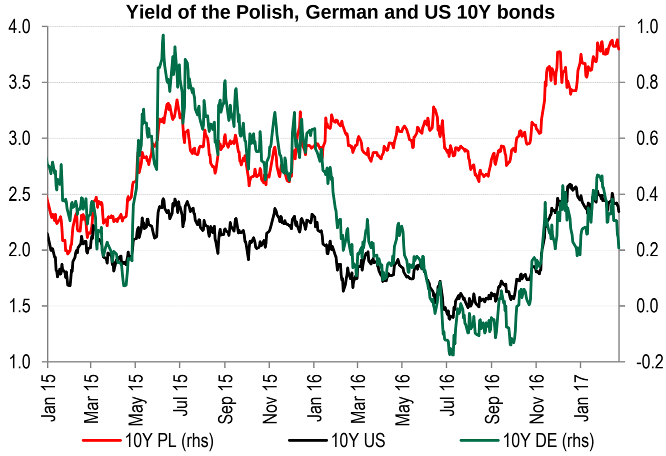
Slope of the Polish curves (bps)



Spread of 10Y Polish, Italian and Spanish 10Y benchmarks vs. 10Y Bund



Yield of the Polish, German and US 10Y bonds



IRS rates significantly down

- Last week, Polish bond market did not benefit from significant decline in yields on the core market (with the yield of German 10Y benchmark declining towards 0.20% at the end of week). The yield of 10Y Polish benchmark temporarily increased to 3.88% before FOMC minutes release, and then fell again to 3.82% and stayed close to this level until the end of the week as Fed suggested that it was in no hurry to hike rates. At the same time, IRS rates dropped more visibly, with 10Y IRS rate dropping below 3%, for the first time since mid-January.
- Over the past week, long term bonds/IRS rates were most volatile. Therefore, the slope of the curves reflected investors' mood, but on weekly basis the 2-10Y spread did not change much and amounted to c160bp for T-bonds and 99bp for IRS. Moreover, IRS market outperformed T-bonds, and consequently, asset swap spread widened markedly. In the meantime, spread over Bund for 10Y sector has continued growing and reached 360bp at the end of the week, its highest since 2012.
- On the money market, WIBORs were stable, while FRA inched slightly lower. Nevertheless, the market is still pricing-in a monetary tightening by the MPC in 12-month horizon.

Auction and macro data in the spotlight

- Global factors have remained crucial for Poland's market direction. Domestic assets suffer from increasing probability that Fed will continue its tightening cycle. Therefore, investors will still look for some insight from the US macro data. Fed hike in March is possible but is definitely not certain, so any news that support such scenario might result in some profit taking on core markets after recent significant strengthening. As regards domestic data, we still expect quite strong outcome from real economy (detailed GDP data for 4Q16, February PMI). Both factors mentioned above suggest that the room for bond strengthening is limited. In our view, the front end of the curves will be more or less stable, while the long end will remain more volatile.
- Political risk in Europe is growing in particular given increasing support for Marine Le Pen in France. This should keep wider spread over Bunds not only for periphery countries, but also for Polish bonds.
- This week, Poland's Ministry of Finance will present its issuance plan for March. After February, gross borrowing needs for 2017 have been financed in c43%, while the 1Q17 issuance plan is implemented in 78%. This means that T-bonds offer for March should not be higher than PLN8bn. Moreover, the first auction in March is planned on Thursday (March, 2). The results of the recent auction showed solid demand despite that the supply of Polish securities prevails on the domestic secondary market We think that we may witness the same situation also at this auction.

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