Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

4 – 10 December 2017

The Polish MPC holds the last meeting of 2017, with the decision coming unusually on Tuesday. The recent news flow has definitely given the Council much to talk about. Only last week, we saw 3Q GDP growth beating expectations formed on the basis of an already higher-than-expected flash release, CPI unexpectedly hitting the 2.5% y/y target in November and PMI rising above 54 pts for the first time since April. However, the long-awaited recovery of fixed investments materialized at slower pace than expected, most likely with stagnation outside local governments. MPC hawks could get some tailwind and manage to tweak the statement a bit, but still they remain a minority. We might get the ultra-dovish E.Łon and one of the most hawkish members (K.Zubelewicz or E.Gatnar) accompanying the governor during the press conference. Apart from that, Fitch may release a rating review of Poland on Friday, most likely just to confirm the current A-/stable grade.

US non-farm payrolls and other data due this week as well as further news about US tax reform could lift the dollar. This could weigh on PLN, which refused to take advantage of the superb domestic publications. The MPC decision could trigger adjustment on the interest rate market if we learn about a motion to hike rates (yet, we think it is more likely in 1Q18). The sentiment on the bond market could be shaped by US data and politics, and in our view might act towards gradual rise of yields.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
			MONDAY (4 December)				
16:00	US	Durable Goods Orders	Oct	% m/m	0,0	-	-1.2
16:00	US	Factory Orders	Oct	% m/m	-0.35	-	1.4
			TUESDAY (5 December)				
	PL	**Poland Base Rate Announcement**		**%**	**1.5**	**1.5**	**1.5**
02:45	CH	Caixin China PMI Services	Nov	pts	-	-	51.2
09:55	DE	Markit Germany Services PMI	Nov	pts	-	-	54.9
10:00	EC	Eurozone Services PMI	Nov	pts	-	-	56.2
11:00	EC	GDP SA	3Q	% y/y	-	-	2.5
11:00	EZ	Retail Sales	Oct	% m/m	-	-	0.7
16:00	US	ISM services	Nov	pts	59.0	-	60.1
			WEDNESDAY (6 December)				
08:00	DE	Factory Orders	Oct	% m/m	-	-	1,0
14:15	US	ADP report	Nov	k	182	-	234
			THURSDAY (7 December)				
08:00	DE	Industrial Production SA	Oct	% m/m	-	-	-1.6
14:30	US	Initial Jobless Claims		k	240.0	-	238.
			FRIDAY (8 December)				
	PL	**Fitch rating review**					
08:00	DE	Exports SA	Oct	% m/m	-	-	-0.4
14:30	US	Change in Nonfarm Payrolls	Nov	k	205	-	261
14:30	US	Unemployment Rate	Nov	%	4.1	-	4.1
16:00	US	Michigan index	Dec	pts	98.5	-	98.5

Source: BZ WBK, Reuters, Bloomberg

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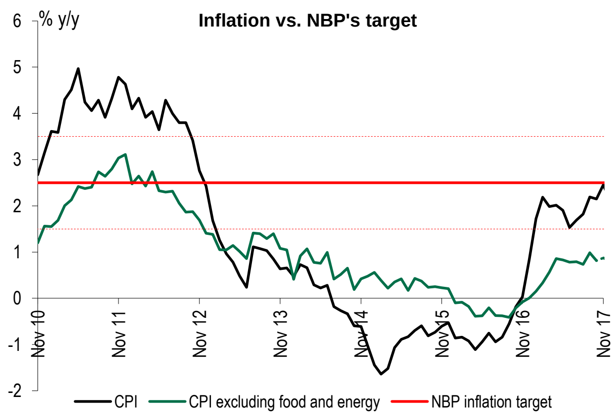
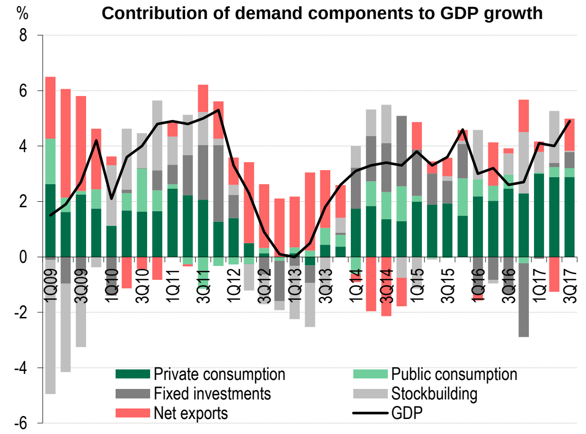
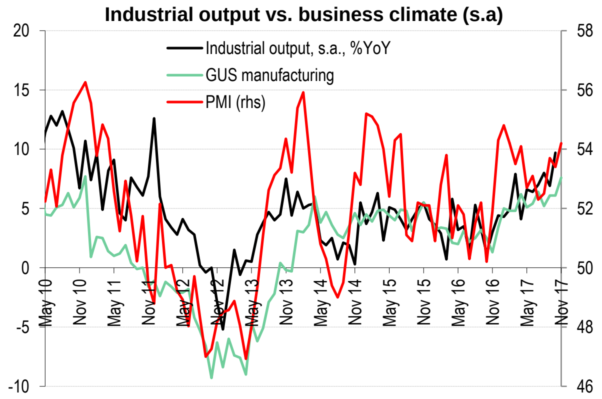
What's hot next week – Rates and Ratings



- December MPC meeting, unlike Fed's, is not supposed to bring monetary policy changes. And yet, the recent news flow has definitely given the Council much to talk about. There was a massive positive surprise in wage growth, CPI hit the target about a year earlier than indicated by the November NBP projection and 3Q GDP growth was a double upside surprise (both the flash and the final print came above expectations). On the other hand, investment growth - now one of the main topics of the MPC discussions - was still weak in 3Q (3.3% y/y), much below the NBP forecast of c6% y/y and the market consensus (4.5% y/y, we forecasted 4.4%). A motion to hike rates cannot be excluded now, but is more likely in 1Q.
- Fitch may review Polish rating on Friday. The agency did not change the grade/outlook in 2016 as others did on institutional risks and fiscal fears. Fitch has recently upgraded its macro forecasts for Poland. We expect stable assessment.

Last week in economy – Striking GDP growth, CPI on target





- Flash CPI rose to 2.5% y/y in November from 2.1% in October, reaching the official NBP target for the first time in five years. We estimate that the increase was driven mainly by prices of food (surge in prices of eggs and vegetables) and energy (petroleum and solid fuels). It seems likely that core inflation could have inched up as well, from 0.8% y/y to 0.9%. The data was a clear surprise for the market (Bloomberg consensus was 2.3%). We expect CPI growth to drop to 2.0% in December due to high base effect, but it should rise again in the next months, probably exceeding the official target in mid-2018. Core inflation should be also mounting gradually in 2018, driven by strong demand and growing labour costs.
- GDP growth in 3Q17 reached 4.9% y/y, above the flash estimate released two weeks ago (4.7%). Private consumption remained the main engine of expansion, rising 4.8% y/y, and the net exports surprised positively, adding 1.1pp to GDP growth. Meanwhile, the long-awaited recovery of fixed investments materialized at slower pace than expected, most likely with stagnation outside local governments. With the persisting weakness in investments and the capacity constraints reported in construction sector the investment recovery in the coming quarters may be weaker than we had anticipated. The good news is that the extremely supportive external environment (recovery in the euro zone) should boost Polish exports, while consumption growth should remain strong as well.
- Polish PMI rose to 54.2pts in November from 53.4, beating consensus (54.0). The upward move was driven by output subindex, highest since March. New orders and employment subindices went down a bit. PMI confirms that economic activity remained strong in 4Q17.

Quote of the week – Deficit to reach PLN30bn

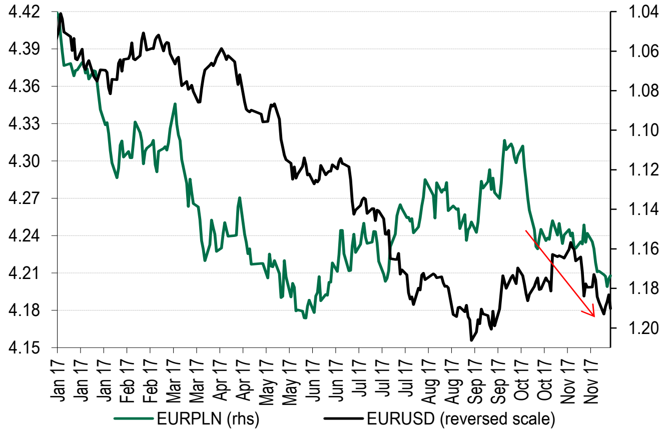
Teresa Czerwińska, deputy finance minister, PAP, 28 November

The usual rise in budget spending in the last months of the year as well as effects of two budget amendments and new acts worth more than PLN11bn will push the balance back into deficit in December. However, it will be much lower than the planned PLN59bn and will reach PLN30bn.

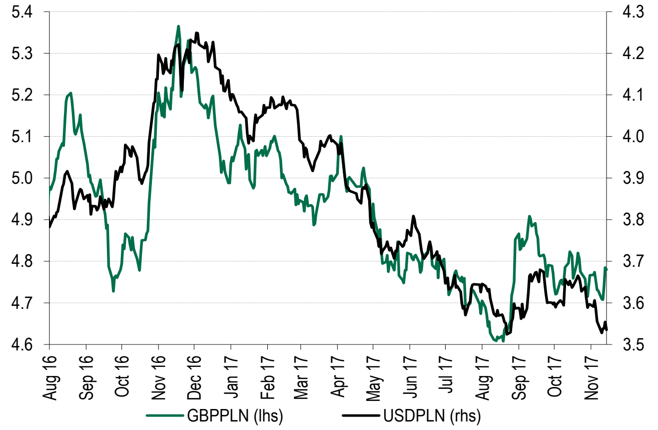
The Polish central budget was still in surplus (PLN2.7bn) after October. It was another month in a row with spending below/incomes above the plan. The positive labour market situation leads to much lower budget subsidies to the social security system (-19% y/y in YtD terms). Debt servicing costs are down c10% y/y. Growth rate of YtD VAT incomes slid to 22% y/y from 25%, but is likely to improve as the Ministry most likely will not frontload VAT returns at the end of the year (this move secured a strong fiscal start of 2017). Instead of VAT returns, the Ministry is likely to use another tool for deficit smoothing: a new budget amendment. Payment of one-off equivalent for coal benefit has actually worked this way, as 2017 budget was burdened to the benefit of the 2018 budget. It nevertheless seems that the Deputy Minister's claim may leave room for another amendment to allow larger expenditures in some areas thanks to the very comfortable budget position so far.

Foreign exchange market – Zloty ignores Polish data

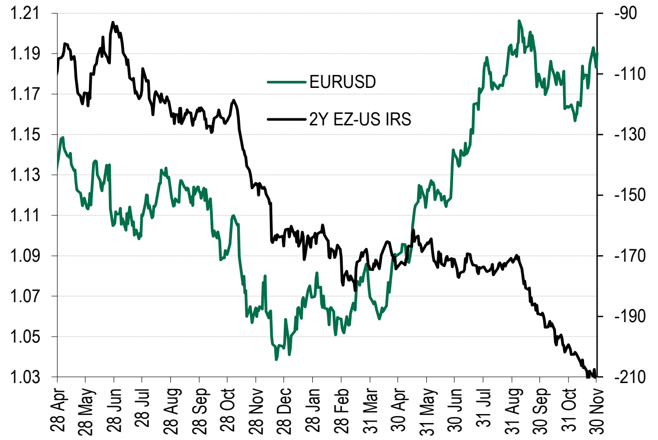
EURPLN and EURUSD



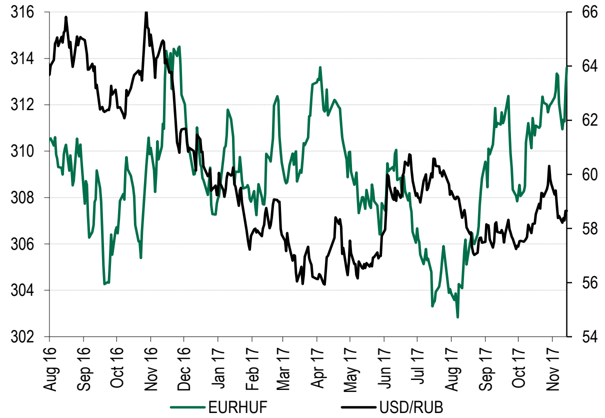
USDPLN and GBPPLN



EURUSD and 2Y US-EZ IRS spread



EURHUF and USDRUB



Zloty eyeing US data

- EURPLN started and ended the last week above 4.20 and the drop below 4.19 (likely triggered by stop-loss orders amid low liquidity) proved very short-lived. In line with what we had written last time, there was no sustainable market reaction to Polish macro releases showing higher-than-expected headline 3Q GDP and flash November CPI. USDPLN stayed in a wide 3.51-3.56 range, GBPPLN increased to 4.79 from 4.68 while CHFPLN eased below 3.60.
- The first chart shows that correlation between EURPLN and EURUSD rose in the recent weeks. This week, we will learn important data from the US and EURUSD reaction to these releases might have an impact on the zloty vs the euro.
- This week the MPC announces its decision on interest rates. Councils' members did not comment on data showing inflation hitting the target and headline GDP growth higher than flash estimate. Regardless of the post-meeting statement tone and outcome of the press conference, we do not expect the MPC meeting to have any material impact on the zloty as the recent hawkish data were ignored by the market.

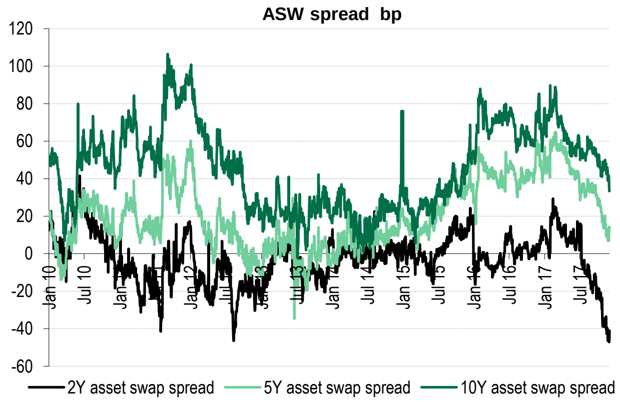
EURUSD in a range

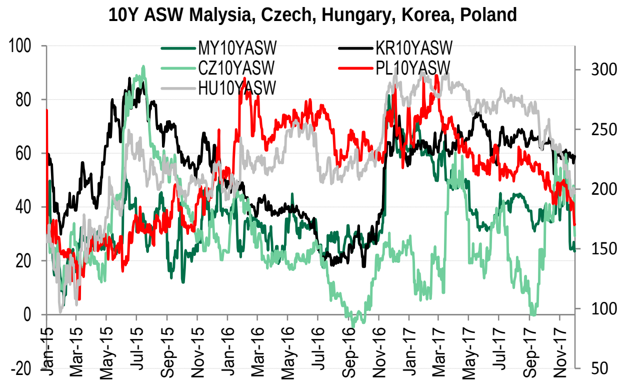
- EURUSD stayed in the horizontal trend hovering around 1.19. The dollar was gaining in the first part of the week amid strong US macro data. However, the currency did not manage to keep gains due to the signals suggesting that there is still no final decision on the tax reform.
- The US interest rate market has already priced-in December 25bp Fed rate hike. However, EURUSD has been rising and has departed from the 2Y US-EU IRS spread. We think this shows there is room for stronger dollar if the next US data are better than expected.

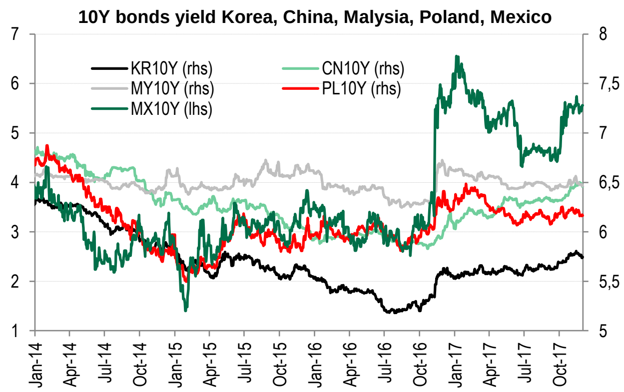
Koruna and forint weaker, ruble stable

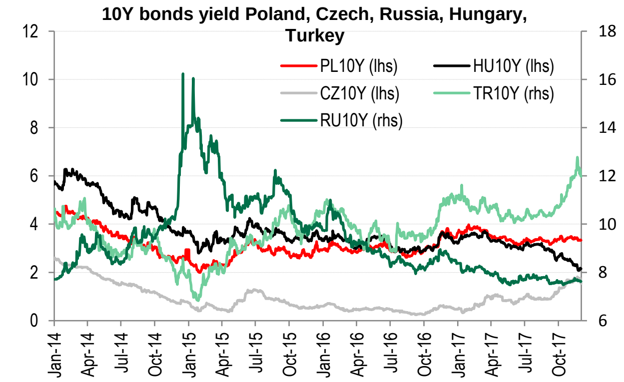
- Czech koruna gave up part of its recent gains vs the euro with EURCZK rising to 25.55 from 25.4. At the same time, the forint depreciated vs the euro third week in a row as EURHUF rose above 313 nearing its November peak. The Hungarian currency is still under pressure of the last central bank decision to ease monetary policy further. USDRUB did not move much and remained around 58.5 holding slightly above its November bottom at 58.
- Last week, we wrote that we see limited room for stronger ruble vs the euro in the short term and we keep this view. As regards the forint, dovish bias of the central bank could weigh on the Hungarian currency preventing EURHUF from deeper decline. We think that koruna could also give up part of its recent gains vs the euro as the December hike is still not certain and the market has been pricing in 25bp hike in the final month of the year aggressively.

Interest rate market – ASW spreads lower









Profit taking is looming

▪ This week, we expect small sell-off of domestic bonds. We anticipate the stronger move on the front-end of the curve, where investors will not be ready to accept so low yields in the face of rising inflation. The long end of the curve may suffer owing to the expected continuation of US tax reform story. This week, we will learn numerous US data and we think that monthly job report may look strong. In our opinion, the debt sell-off will likely not break 3-4 bp. This move will likely be accompanied by a similar upward move of 10Y ASW spread. The downtrend of the CEE region credit risk observed since autumn suggests that the upward move will likely be temporary.

10YASW on the 2-year low

▪ Domestic asset swap spread was decreasing in the 10Y segment. The 10YASW downshift was supported by surprisingly high GDP reading for 3Q17, high flash CPI reading for November and further upward PMI index move. As a result, 10YASW spread dropped to 33 bp from 42 bp across the week (the Czech ASW spread decreased to 29 bp from 45 bp over the same period), the lowest level since November 2015. At the same time, we observed an uphill in the 2YASW curve segment. In our opinion, the short end upward shift was a consequence of rising fears of faster than a previously expected increase in interest rates, after the November flash CPI reading. The ASW10Y spread compression was accompanied by a marginal upward move of the yield curve (c3bp).

Drop of CEE credit risk price

▪ In our opinion, relatively small yields upward move was a consequence of solid domestic data, which suggested the decrease of credit risk price and positive CEE markets credit trends. Across the last week, most of CEE region 10YASW spreads and 10Y bond yields were falling (Hungary was one exception). Investors ignored the rise of yields of the US Treasuries and Bunds seen in the second half of the week.

FRA market

▪ The FRA rates in the +12M segment rose by 3-4 bp across the last week, pricing the first rate hike in the 4Q18 and next hike in the 2Q19.

Ministry of Finance

▪ Ministry of Finance (MoF) said that currently it financed 13,5% of next year borrowing needs. The foreign investors cut their bonds holding by PLN3.2bn in October. MoF does not plan to offer bonds at regular tender in December, but they announced one switch auction (15 December). On the switch action, MF planned to offer zero-coupon OK0720, fix-coupon PS0123, DS0727 and floating-coupon WZ1122, WZ0528 bonds.

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