Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

18 – 24 December 2017

This week the zloty lost vs the euro amid dovish comments of Polish MPC members and shaky global market sentiment. Bond yields and IRS remained low also thanks to the “dovish rate hike” delivered by the FOMC. Changes on the Polish political scene did not have material impact on domestic assets.

Next week, we will learn about Polish November industrial output and retail sales data. Our forecasts are above the consensus but much of the positive news-flow from Poland seems to have already been priced by the FX market and the recent dovish comments of Polish central bankers should immunize domestic FI market against any positive surprises. Globally, we will get to see numerous US data but given that they will be released at the end of the next week, their market impact should be negligible.

On Wednesday, the European Commission may trigger the Article 7 of the EU Treaty against Poland. Its impact on the financial market should be temporary, as the risk of financial sanctions is still remote.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (18 December)					
11:00	EZ	HICP	Nov	% y/y	-	-	1.5
14:00	**PL**	**Employment in corporate sector**	**Nov**	**% y/y**	**4.4**	**4.3**	**4.4**
14:00	**PL**	**Average gross wages**	**Nov**	**% y/y**	**6.9**	**7.1**	**7.4**
		TUESDAY (19 December)					
10:00	DE	IFO Business Climate	Dec	pts	-	-	117.5
14:00	HU	Central Bank Rate Decision		%	0.9	-	0.9
14:00	**PL**	**Sold Industrial Output**	**Nov**	**% y/y**	**9.0**	**10.1**	**12.3**
14:00	**PL**	**Construction Output**	**Nov**	**% y/y**	**14.1**	**11.2**	**20.3**
14:00	**PL**	**PPI**	**Nov**	**% y/y**	**2.1**	**1.9**	**3.0**
14:00	**PL**	**Real Retail Sales**	**Nov**	**% y/y**	**6.4**	**7.2**	**7.1**
14:30	US	Housing Starts	Nov	% m/m	-3.1	-	13.7
		WEDNESDAY (20 December)					
16:00	US	Existing Home Sales	Nov	% m/m	0.73	-	2.05
		THURSDAY (21 December)					
13:00	CZ	Central Bank Rate Decision		%	0.50	-	0.50
14:00	**PL**	**MPC minutes**			**-**		
14:30	US	GDP Annualized	3Q	% q/q	3.3	-	3.3
14:30	US	Initial Jobless Claims		k	236.0	-	236.0
		FRIDAY (22 December)					
10:00	**PL**	**Unemployment Rate**	**Nov**	**%**	**6.5**	**6.6**	**6.6**
14:00	**PL**	**Money Supply M3**	**Nov**	**% y/y**	**-**	**4.6**	**5.7**
14:30	US	Durable Goods Orders	Nov	% m/m	1.6	-	-0.8
14:30	US	Personal Spending	Nov	% m/m	0.4	-	0.3
14:30	US	Personal Income	Nov	% m/m	0.4	-	0.4
16:00	US	Michigan index	Dec	pts	97.3	-	96.8
16:00	US	New Home Sales	Nov	% m/m	-5.11	-	6.2

Source: BZ WBK, Reuters, Bloomberg

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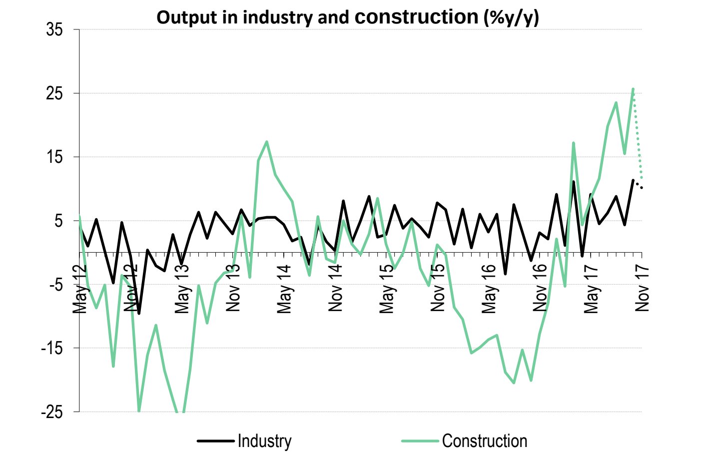
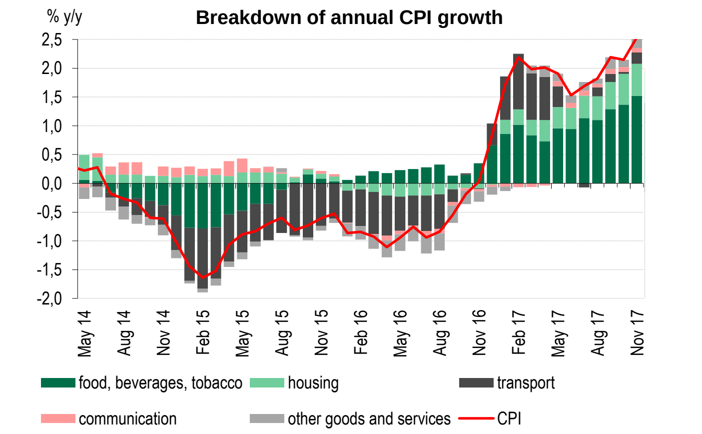
What's hot next week – Getting used to strong data

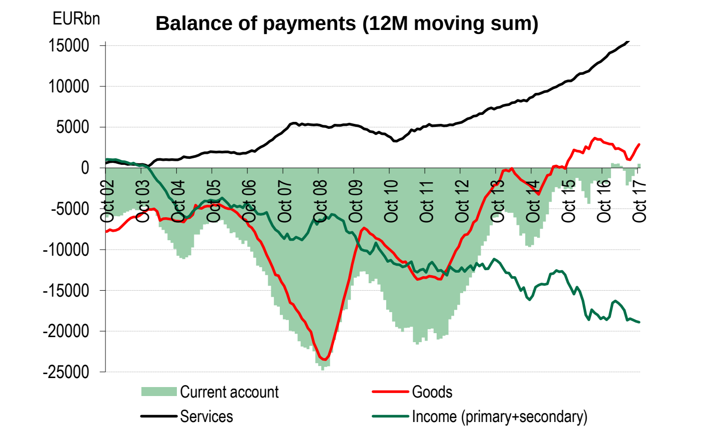


- Some of the macroeconomic data for November might suggest that we entered a period of stabilization at high levels. This results from the scale of positive surprise in October data (wage growth beat market forecasts by c1pp and output growth by 2.4pp).
- The labour market situation should lead to much higher wage growth than c7% y/y we see for November – possibly in the 8-10% range in the next months. We are relatively bearish on November construction output due to high base effect.
- MPC hawks were strangely silent since the last decision, which may suggest they now feel less comfortable about communicating their view. The MPC minutes will show whether they really stood down, or whether it was simply a coincidence that only members with views similar to the dovish NBP governor had the opportunity to speak to the media.

Last week in economy – CPI, welcome home!



- In November, inflation returned to the NBP target of 2.5% y/y after five years of wandering below this important level. CPI growth was based on rising prices of food (1% m/m, with eggs up 30% m/m). Core inflation inched up only slightly, to 0.9% y/y from 0.8% in October. We expect inflation to decrease in December to c2.0% y/y, and to rise gradually in the months to come, surpassing the target in mid-2018. Even though the inflation return to the target should be eyed by the MPC members, the CPI growth breakdown is not an argument for hawks. According to central bankers, monetary policy has a minimal influence on the food and fuel prices.
- October C/A surplus (€575mn) was above consensus (€210mn) and somewhat below our call (€720mn). Positive working day effect boosted exports to 15.4% y/y from 10.2% and imports to 12.9% y/y from 5.7%. Export growth was slightly disappointing given the strong October output growth.



- The government of PM Beata Szydło has been replaced with a new one, led by Mateusz Morawiecki. It already passed the parliamentary vote of confidence. There are hardly any personal changes – the former PM became a deputy-PM, minister without portfolio, while Morawiecki, already holding the position the finance minister and development minister, added premiership to his list of titles. The new PM's exposé did not include many details, new ideas or timeframes concerning the economic policy. The new Prime Minister pledged to continue the previous government's social programmes and to increase healthcare spending to 6% of GDP. Morawiecki named also a few big infrastructural projects he would like to carry out and stressed the need to build new roads. Interestingly, according to the Prime Minister, the state's role in the economy should be more pronounced, especially in industry, innovations and housing.

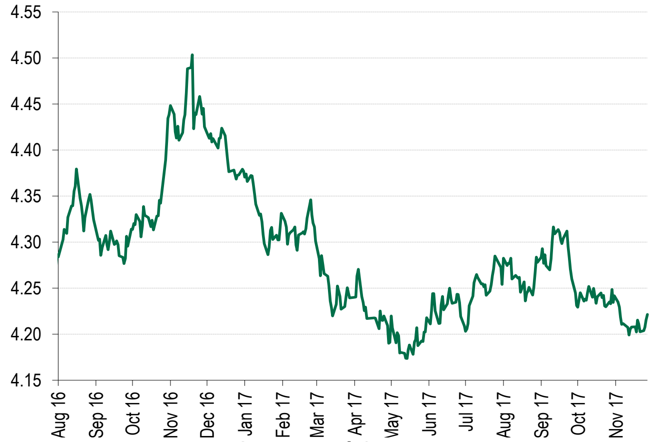
Quote of the week – Sole inflation is not that important

Grażyna Ancyparowicz, MPC member, Reuters, 13 December
The pick-up in inflation is caused by factors unrelated to monetary policy. Credit is rising at a very moderate pace. Cooling the economy in such conditions by raising rates seems highly inadvisable, especially if we are to support investment. I agree with governor Glapiński and the rate hike may be considered at the end of 2018 at the earliest.
Jerzy Żyżyński, MPC member, Reuters, December
There is no special threat. Core inflation is still low. The consumer inflation rate alone does not have so much significance. What is important is whether inflation results from excessive demand generated by credit. This is not the case. If we would be nearing the upper band of the inflation target (at 3.5%), one would have to consider what to do next.

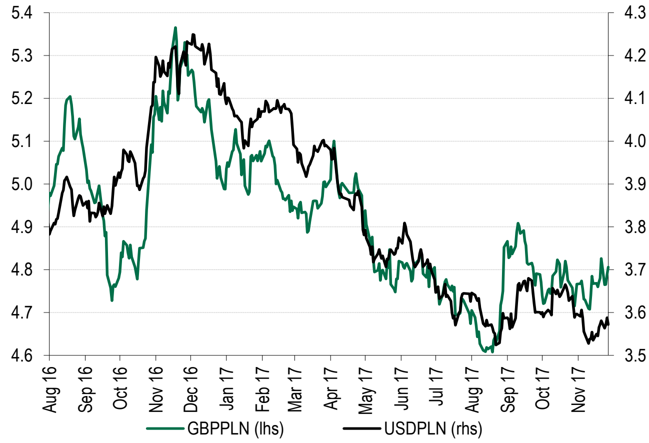
In our Instant comment to November CPI data we wrote that the rise of inflation to 2.5% target driven by non-core components (food, fuel, energy) could be a reason why the less hawkish MPC members may be still not too worried, as these factors are beyond impact of the monetary policy. Ancyparowicz's opinion confirms also that despite her earlier comments we should not place her in the hawkish camp that is for a rate hike in 2018. Ancyparowicz emphasized she was worried about poor investments performance and said that a clear revival of credit growth (including investment loans) could be argument for her to consider a rate hike. In her view, too early hike could be "deadly for the economy".

Foreign exchange market – EURPLN slightly up

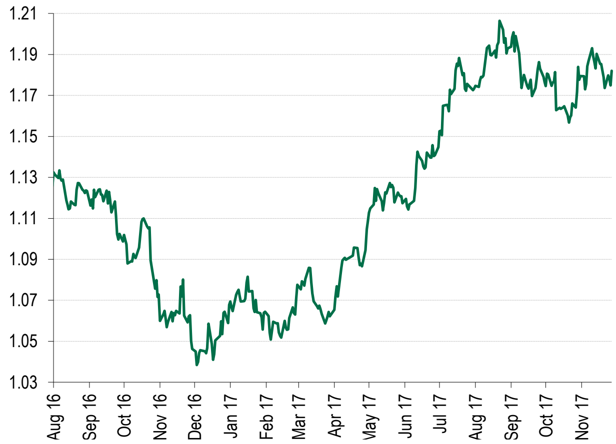
EURPLN



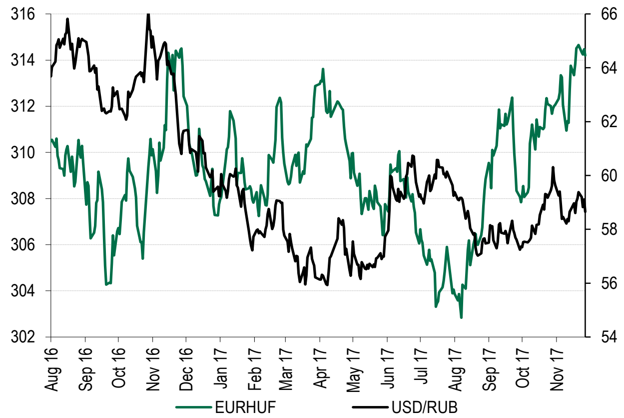
USDPLN and GBPPLN



EURUSD



EURHUF and USDRUB



The zloty slightly weaker vs the euro

- This week, the zloty gave up part of its recent gain. EURPLN rose above 4.22 in response to dovish comments of MPC members and mixed global market sentiment. USDPLN did not change much on a weekly basis while the exchange rate's volatility was similar to what we have seen recently. GBPPLN stayed near 4.78 while CHFPLN rose temporarily to 3.63 from 3.58. Contrary to our expectations, the market viewed the tone of the FOMC statement and press conference as not that hawkish but this did not help the zloty vs the euro.
- Next week, we will learn about Polish November industrial output and retail sales data. Our forecasts are somewhat above the consensus but like we have already claimed in the previous weeks, much of the positive news-flow from Poland looks to have already been priced. Thus, this week's releases should be rather market-neutral.
- The year-end is approaching and so liquidity on the Polish FX market is drying up gradually. On one hand, this may discourage investors from taking large positions. On the other hand, any surprising news could trigger bigger move. Looking back, since 2009 there have been only two cases where the high-low spread for the final two weeks of the year was higher than the average for two-week periods in whole year. Until now, this year's average for two-week high-low spread is at PLN0.06, still leaving some room for higher volatility to be observed until the remainder of the year.
- Important levels to watch are 4.22 (EURPLN has tested this area this week, next resistance at 4.25) and 4.187.

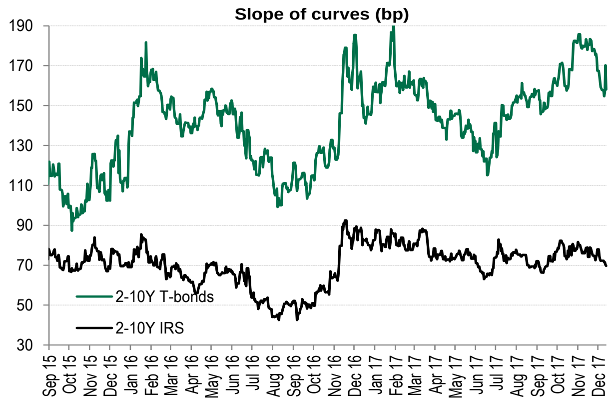
Dovish hike hit the dollar

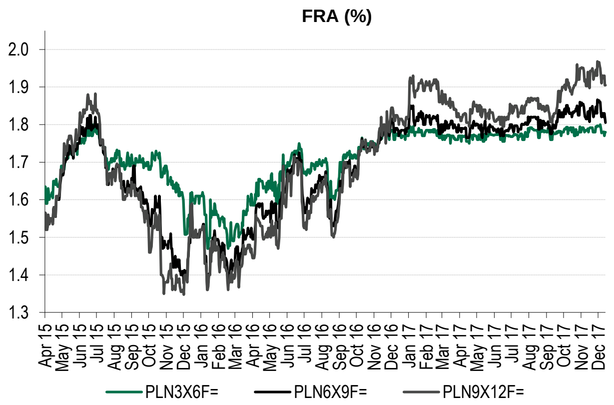
- The dollar lost vs the euro after two weeks of appreciation. The main trigger for EURUSD rise above 1.18 was a "dovish hike" delivered by the FOMC. The Fed GDP growth forecast for the US in 2018 was raised to 2.5% from 2.1%. At the same time, the FOMC members' expectations for inflation and interest rates remained roughly unchanged. The "dot-plot" showed that the FOMC members still anticipate three 25bp rate hikes in 2018 and two more in 2019 (unchanged vs the previous projections).
- Next week numerous US data is on the agenda but we think that the year-end period could curb investor's volatility.

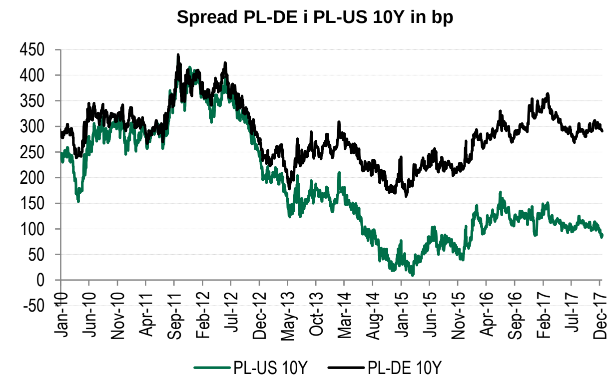
Mixed performance of CEE currencies

- The Czech koruna lost vs the euro with EURCZK rising to 25.68 nearing the local peak at just below 25.7. The koruna is giving up its gains amid still high uncertainty whether the Czech central bank will raise rates third time this year next week.
- The ruble gained vs the dollar amid "dovish-hike" in the US and despite lower oil price this week. This Friday the central bank of Russia is expected to cut interest rates. Dovish rhetoric of the central bank was one of the factors weighing on the ruble in the previous weeks.
- Hungarian forint stabilized vs the euro after seven consecutive weeks of depreciation. EURHUF stayed below its highest level since late 2016 at just above 315 but we expect the exchange rate to resume the upside trend after a short correction. Next week, the Hungarian central bank meets and could pressure the forint it dovish rhetoric is maintained.

Interest rate market – Bad news is good news, good is no news







Last week

- Over the last week, yields shifted down by 1-6 pb across the curve. The 10Y yield decreased by 1 bp, while the weekly volatility on this segment of the curve was 2-3 bp. In the 2Y-5Y segment, we also observed yields decrease, most of it on the belly. The IRS rates witnessed a parallel shift downwards by 3-4 bp. These changes took place when the US treasuries curve returned to the level from the end of the previous week after the higher volatility period and the German curve was moved up. The Wednesday's dovish Fed rate hike, as well as Thursday's ECB conference, were ignored by the investors on the domestic market.

The market will calm before Christmas

- In the week before Christmas, we do not expect bigger changes on the domestic interest rates market. On the core markets, a few important data are due for release: Euro zone HICP, housing market, durable goods orders and US Michigan consumer confidence Index. However, most of these statistics will not be crucial for the interest rate market investors. The most important for the next Fed decisions will be personal income and spending data, but the time of release (on Fridays afternoon, before the Christmas weekend) means that debt market players will be not able to digest these data. On the European front, some changes could be triggered by Ifo data release (which is scheduled on Tuesday). Nonetheless, only the disappointing data reading (it is not a base scenario for us) could drag the yield curve down. We think that any positive surprise will be ignored by market players. We anticipate the same reaction for domestic data (industrial production, retail sales – both we forecasting above market consensus). Only strong disappointing domestic data could help domestic bonds and push the IRS rates down. The reaction of investors after the last MPC conference, however, suggests that they believed the NBP governor that he is determined to keep rates at current levels by the end of the year regardless of the data flowing down, and the MPC will not oppose this.

Bond auction could push the short end up

- As a consequence, we think that 5Y-10Y yields and IRS rates will stay at the current level. Only the short end of the curve could be pulled up by 2-3 pb as a consequence of the scheduled for 15 December switch auction. Until the end of the year, we do not expect any important changes except the last two days before the end of the year where the investors could try to reshape the market picture and debt pricing and try to take benefit from the low liquidity at the end of the year.

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 87, email ekonomia@bzwbk.pl