

WEEKLY ECONOMIC UPDATE

29 January – 4 February 2018

Global sentiment was quite positive last week, with equity markets posting further gains, EM currencies strengthening and debt prices falling. EURUSD climbed to 1.25, the highest level since December 2014 as the euro was supported by the ECB, which neither proved dovish nor changed its forward guidance policy. The dollar, on the other hand was undermined by comment of Steven Mnuchin, who endorsed a weaker currency, and by disappointing data on US GDP growth. In Poland, the zloty gained thanks to positive market moods and Adam Glapiński's comments, which were misinterpreted as hawkish (in our view).

This week we will get to see important data: final PMIs, non-farm payrolls and Polish GDP for 2017. Flash PMIs for Germany and Euro zone went down so the market will eye whether this change is confirmed. Weak data from Europe can potentially postpone tightening of the ECB policy. Polish annual GDP will help fine-tune forecasts for 4Q17, which are likely to show growth close to 5% y/y. FOMC meeting is another important event of the week. We are not expecting any crucial changes, yet this will be the last meeting chaired by Janet Yellen. Positive Polish macro data are likely to support domestic assets.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST	
				MARKET	BZWBK	VALUE	
MONDAY (29 January)							
14:30	US	Personal Spending	Dec	% m/m	0.5	-	0.6
14:30	US	Personal Income	Dec	% m/m	0.3	-	0.3
TUESDAY (30 January)							
10:00	PL	Flash GDP	2017	% y/y	4.5	4.5	2.9
11:00	EZ	GDP SA	4Q	% y/y	2.7	-	2.8
14:00	HU	Central Bank Rate Decision		%	0.9	-	0.9
16:00	US	Conference Board index	Jan	pts	123.1	-	122.1
WEDNESDAY (31 January)							
11:00	EZ	Flash HICP	Jan	% y/y	1.2	-	1.4
11:00	EZ	Unemployment Rate	Dec	%	8.7	-	8.7
14:15	US	ADP report	Jan	k	190	-	250
16:00	US	Pending Home Sales	Dec	% m/m	0.5	-	0.2
20:00	US	FOMC decision		%	1.25-1.50	-	1.25-1.50
THURSDAY (1 February)							
09:00	PL	Poland Manufacturing PMI	Jan	pts	55.2	55.4	55.0
09:55	DE	Germany Manufacturing PMI	Jan	pts	61.2	-	61.2
10:00	EZ	Eurozone Manufacturing PMI	Jan	pts	59.6	-	59.6
13:00	CZ	Central Bank Rate Decision			0.75	-	0.5
14:30	US	Initial Jobless Claims	week	k	235	-	233
16:00	US	ISM manufacturing	Jan	pts	58.9	-	59.7
FRIDAY (2 February)							
14:30	US	Change in Nonfarm Payrolls	Jan	k	188	-	148
14:30	US	Unemployment Rate	Jan	%	4.1	-	4.1
16:00	US	Michigan index	Jan	pts	95.0	-	94.4
16:00	US	Factory Orders	Dec	% m/m	0.5	-	1.3

Source: BZ WBK, Reuters, Bloomberg

ECONOMIC ANALYSIS DEPARTMENT:

al. Jana Pawła II 17, 00-854 Warszawa fax +48 22 586 83 40

email: ekonomia@bzwbk.pl

Web site: <http://www.bzwbk.pl>

Piotr Bielski +48 22 534 18 87

Marcin Luziński +48 22 534 18 85

Grzegorz Ogonek +48 22 534 19 23

Konrad Soszyński +48 22 534 18 86

Marcin Sulewski +48 22 534 18 84

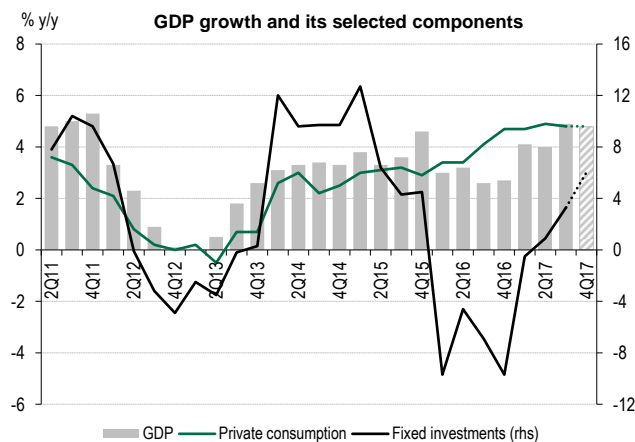
TREASURY SERVICES:

Poznań +48 61 856 5814/30

Warszawa +48 22 586 8320/38

Wrocław +48 71 369 9400

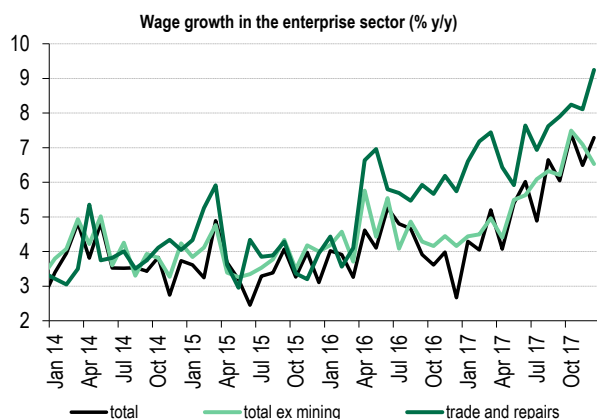
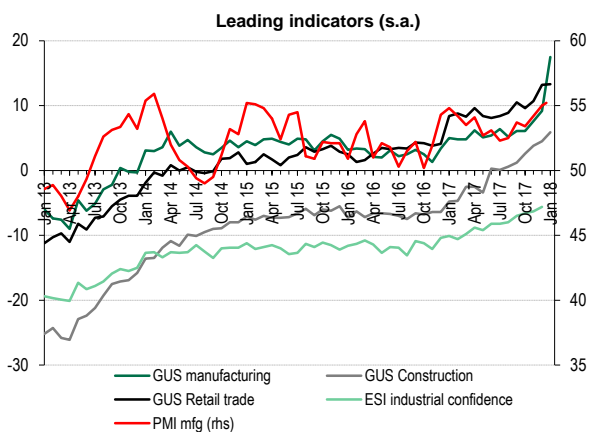
What's hot next week – Annual GDP and PMI



▪ Annual data on GDP growth will give us some information about economic performance in 4Q17. We are expecting the annual figure to show 4.5%, which will indicate 4Q17 result in 4.7-5.0% range. Fixed investment will be another important figure. Annual growth above 2.5% will suggest that the recovery in investment was gaining strength in the final quarter of 2017. Result above 3.5% is an indicator of a strong rebound. We are expecting the economic climate to stay positive in 2018 as well.

▪ GUS climate indicators (details below) suggest a spike in new orders with rising labour market pressure in January. German Ifo has climbed an all-time high at 117.6. On the other hand, manufacturing PMI in Germany and Eurozone fell. Thus, we are expecting PMI to go slightly further up in January 2018.

Last week in economy – Spike in business climate, wages boosted by mining



▪ Poland M3 money supply growth rose 4.6% y/y in December vs 4.5% y/y in November. Deposits continued the gradual slow down. Deposits of non-monetary financial institutions were an exception growing by PLN3bn m/m. Looking at loans, it is worth to note that the acceleration of consumption credits to 8% y/y and deceleration of mortgage loans to -1.5% y/y, the latter was mainly the effect of stronger zloty at the year-end. After adjusting for the FX effect, mortgages grew 3.5% y/y, like in the previous months. Current corporate loans accelerated to 8.4% y/y and investments loans to 12.6% y/y.

▪ In January 2018 the seasonally adjusted business climate indicators published by GUS improved in all economic sectors. Gains in manufacturing and hotels and restaurants were among the strongest in history. Index in manufacturing jumped from 9.2 to 17.5, its highest since April 2008, amid rebound in nearly all its components. High employment readings point to a very strong start of 2018 in terms of economic activity, despite building problems with labour shortage. We think that it implies strong growth of production in industry and construction in January.

▪ Detailed information on wages showed that the December results (7.3% y/y) were pushed up by one-off payments in the mining sector, which contributed 1.3pp to the wages increase - the highest since February 2013. The growth in other sectors amounted, on average, to 6.5% y/y, which is less than in November (7.1% y/y). However, we believe that this slowdown does not imply a lower wage pressure, but rather is the outcome of the negative effect of business days, which reduced wages in sectors applying the piecework system more often (e.g. manufacturing). The growth of wages in trade is worth noting as it accelerated to 9.2% y/y and was the highest since mid-2008.

Quote of the week – No talk about interest rates in the MPC

Adam Glapiński, NBP president, PAP, 23 January

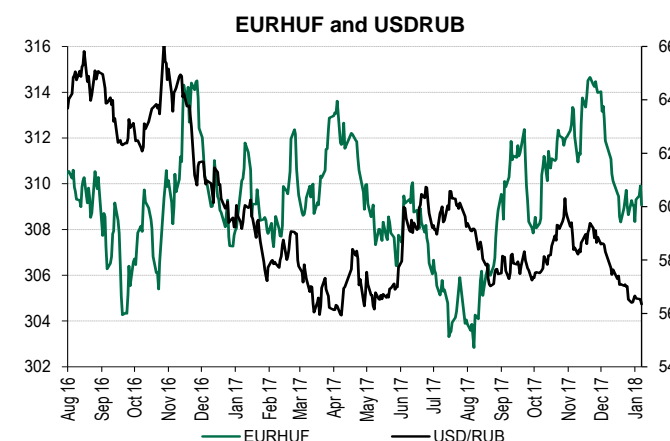
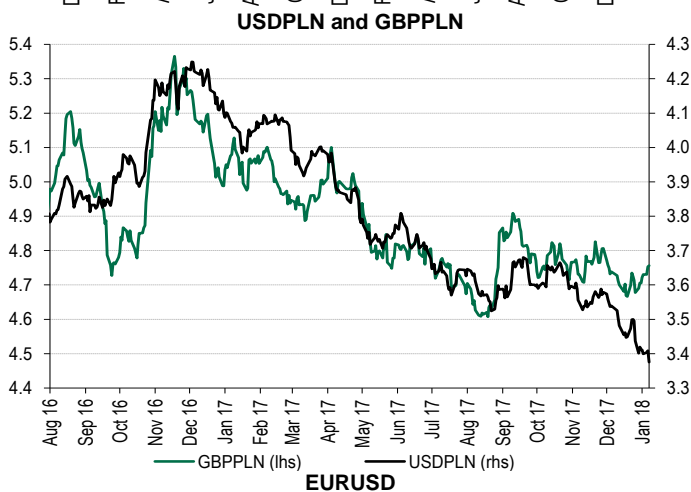
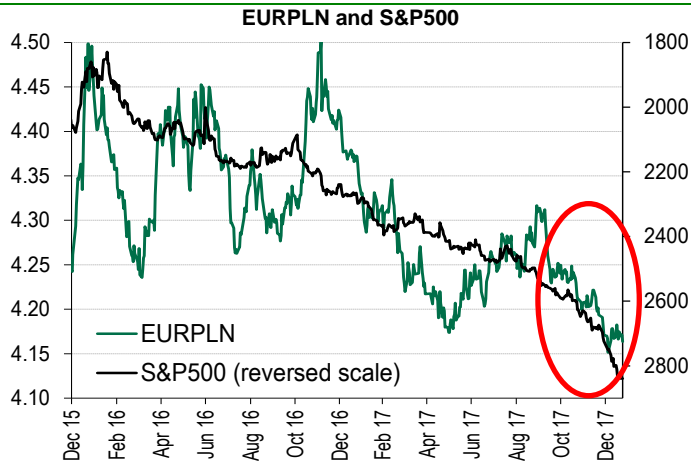
No one wants anything from the NBP. MPC members meet and talk about global poverty, global situation. But we are not talking about interest rates.

PAP, 24 January

I expect that rates will stay unchanged until end of 2018. If we hike in 2019, then it would be an effect of economic growth combined with a specific situation, e.g. too strong wage growth or some cost pressures like significant rise in oil prices. There are no internal reasons to hike rates. We will not hesitate to hike rates in a couple of quarters' time if there is such a necessity, and this is our plan.

The NBP president Adam Glapiński said at the conference in Davos that the MPC members do not discuss interest rates at all during the Council meetings. We guess it was an exaggeration, but it seems to accurately show the NBP governor's belief that there is absolutely no need to change interest rates in Poland in the coming quarters. Glapiński's next comment about possible hikes in 2019 may seem a bit contradictory, and was interpreted as hawkish by investors, but in our view it was not. Especially as compared to market expectations, pricing-in the first hike in January 2019 and the second - in July 2019. We are however surprised by NBP president's argumentation, suggesting that wage growth is not an internal factor. We think that accelerating wage growth and mounting core inflation will finally convince the central bank to lift interest rates at the turn of 2018 and 2019.

Foreign exchange market – Attention turns to the US



EURPLN following EURUSD and stocks

- Last week, the zloty gained vs the euro and dollar and lost vs the pound and franc. EURPLN fell to c4.14 (testing the 2018 bottom) thanks to hawkish comment of NBP governor, rising EURUSD and positive global market sentiment. At the same time, USDPLN dropped to 3.31, its lowest since October 2014.

- The recent weeks showed that rising EURUSD and positive trends on the equity markets are the main drivers of EURPLN. So far, c25% of companies from the S&P500 index reported 4Q17 earning with c75% of them showing higher EPS than expected. Unsurprisingly, US equity indexes are holding firm close to their all-time-highs and the trend on that market may be still one of the core factors influencing EURPLN.

- This week, we will learn important US data, including January nonfarm payrolls, and the FOMC will decide on the interest rates. Like we write below, we find EURUSD overbought and expect the exchange rate correct down in the weeks to come.

- As regards Polish data, we think they could show positive picture of the domestic economy. We would not be surprised if flash 2017 GDP surprised to the upside and the January PMI may follow the upside trend like the other economic sentiment indexes released this week. Thus, Polish data may generate down pressure on EURPLN if the global mood remains positive.

EURUSD up for sixth week in a row

- The passing week is likely to be the sixth in a row of rising EURUSD. The main factors driving the exchange rate above 1.25 in the recent days were politicians' comments and the outcome of the ECB meeting.

- The ECB did not change the monetary policy parameters and its forward guidance. A new message was that changes on the currency market triggered uncertainty about medium-term inflation prospects. It seems that after significant appreciation of the euro witnessed during recent weeks, the market expected a more explicit reference to the situation on the currency market. In effect, only a reserved remark combined with the still positive economic outlook pushed EURUSD up. US Treasury Secretary Steven Mnuchin said that weak dollar is good for the US economy.

- This week, we will learn the US January labour market report and the FOMC will decide on the interest rates. EURUSD is rising for already six weeks in a row and since early November the exchange rate fell in only three weeks. The 6-week and 12-week EURUSD % changes have reached the levels that in the past coincided with the pause/correction in the ongoing trend. We find EURUSD overbought and think the dollar could recover in the coming weeks.

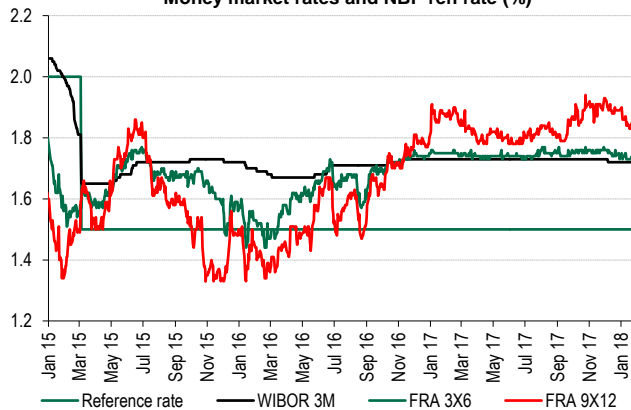
Czech elections and Hungarian central bank decision

- The second round of the Czech presidential elections will take place in the final weekend of January. President M.Zeman is fighting in a tight race for a reelection with J.Drahos. Outcome of voting is likely to have major implications for A.Babis, whose minority government lost confidence vote and has been given more time to find a coalition partner. Zeman says he will again call Babis for the PM office while Drahos will oppose his candidacy. Drahos victory could complicate formation of the Czech new government. Political events may overshadow the next interest rate hike that the market expects to be delivered this week.

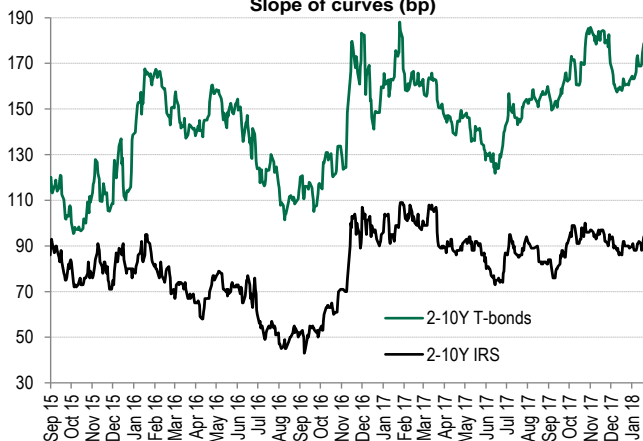
- On Tuesday, the Hungarian central bank will decide on the interest rates. Recent forint appreciation could encourage the central bankers to adopt somewhat more dovish tone, in our view.

Interest rate market – Watch for the Polish and US data

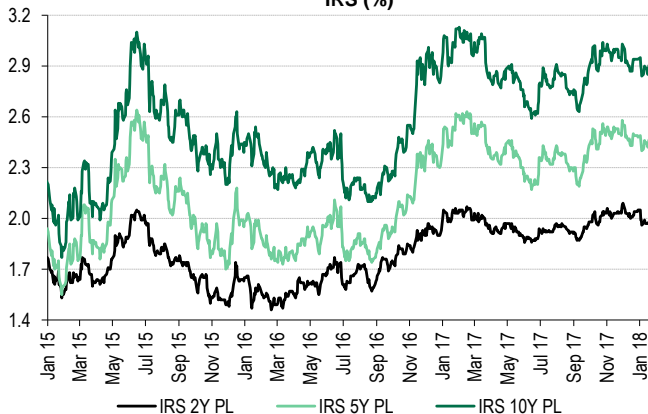
Money market rates and NBP refi rate (%)



Slope of curves (bp)



IRS (%)



ECB pushed market rates up

Over the last week, we have observed a massive sell-off of the 5-10Y bonds (yields rose by 7-9bp) and some repricing on the short end of the curve (2Y bond yields drop by 3bp). Simultaneously the IRS curve increased by 15bp in the 5-10Y segment and 6bp on the short end. These changes were stimulated by expectations for ECB conferences and by ECB conferences rhetoric. Investors interpreted the tone as not dovish enough, after the last week's strong euro appreciation against the US dollar.

Auction

On Friday's auction, the Ministry of Finance sold bonds for cPLN7bn, of which 47% was floating-coupon bonds, WZ1122 and WZ0528. The highest bid/cover ratio has the zero-coupon OK07720 bonds (1.7) and floating-rates WZ0528 bonds (1.6). The bid/cover ratio for auction was 1.5, while in the previous auction it was 2.3.

PMI and GDP in spotlight

In our opinion, this week release of non-farm payrolls data as well as domestic PMI reading for January and flash GDP reading (for 2017) will be crucial for bond market.

We think that domestic data will surprise on the positive side and GDP data will show higher-than-expected private consumption growth, while the PMI data could indicate strong increase in new orders. Implementation of such a scenario may point to a risk of further depreciation of the 5-10L segment. Moreover, US data should not turn out worse than the consensus. The FOMC meeting, scheduled for Wednesday, should not affect the bond market (this will be the last meeting before the Fed chair change from Janet Yellen to Jerome Powell).

We are less pessimistic in terms of the front end of the curve. Some room for discount is possible in reaction to the expected increase of PMI reading (suggesting persistent tensions on the labour market). Yields uplift will likely be supported by debt volume refill by Friday's auction (bn7PLN), after the Thursday WZ0118 buyback (bn8.6PLN). However, low level of Polonia O/N rates and the rising share of current deposits in the banking sector should prove an effective brake for too aggressive upshift of the yields on the short end of the curve.

In the few-week perspective, we believe that the bond market sell-off will continue, the strongest on the 5-10Y segment. This scenario will likely be supported by higher-than-in-January net debt supply and the mood on the global market. The short end of the curve is likely to remain on a relatively low level, where the low Polonia rates show overliquidity in the sector.

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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