Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

5 – 11 February 2018

Last week, we learned some decent Polish data. Flash 2017 GDP surprised to the upside implying 4Q17 GDP growth slightly above 5.0% y/y while the central bank's report showed that Polish companies were quite sanguine about their situation at the beginning of 2018. January manufacturing PMI index disappointed but remained well above 50pts signaling robust economic activity. These figures were accompanied by some dovish comments of Polish central bankers that weighed on the zloty and provided some support for bonds.

Globally, market sentiment deteriorated somewhat with stock indexes giving up part of their gains and bond yields surged as the FOMC statement sounded a bit more hawkish than in the previous month.

This week is rather light in terms of data releases and in our view the outcome of the Polish MPC meeting might have negative impact on the zloty. As far as bonds are concerned, it seems that sharp changes observed on the global market could dominate.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (5 February)					
02:45	CH	Caixin China PMI Services	Jan	pts	53.5	-	53.9
09:55	DE	Markit Germany Services PMI	Jan	pts	57.0	-	57.0
10:00	EZ	Eurozone Services PMI	Jan	pts	57.6	-	57.6
11:00	EZ	Retail Sales	Dec	% m/m	-1.0	-	1.5
16:00	US	ISM services	Jan	pts	56.45	-	56.0
		TUESDAY (6 February)					
08:00	DE	Factory Orders	Dec	% m/m	0.5	-	-0.4
09:00	CZ	Industrial Production	Dec	% y/y	3.3	-	8.5
		WEDNESDAY (7 February)					
	PL	**Poland Base Rate Announcement**		**%**	**1.50**	**1.50**	**1.50**
08:00	DE	Industrial Production SA	Dec	% m/m	-0.6	-	3.4
09:00	HU	Industrial Production SA	Dec	% y/y	5.1	-	3.4
		THURSDAY (8 February)					
08:00	DE	Exports SA	Dec	% m/m	-0.7	-	4.1
11:30	**PL**	**Bond Auction**					
14:30	US	Initial Jobless Claims	week	k	235	-	230
		FRIDAY (9 February)					
		No important events					

Source: BZ WBK, Reuters, Bloomberg

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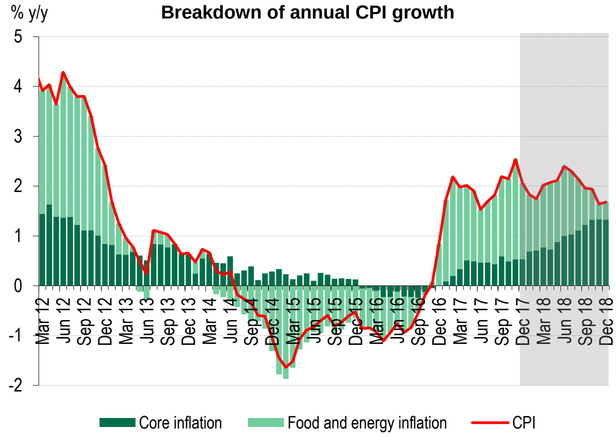
What's hot next week – Have we missed a change in MPC's rhetoric?

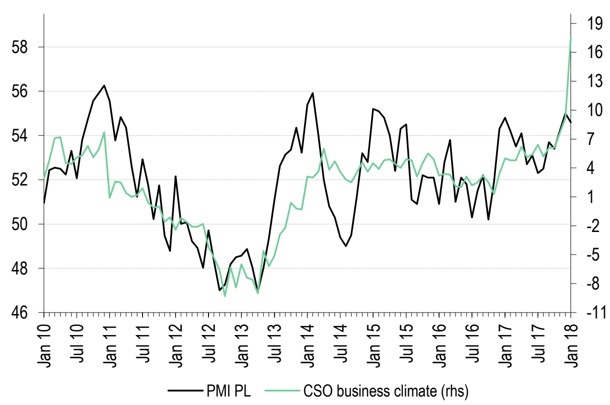
Breakdown of annual CPI growth



▪ Seemingly, there was a difference between the governor's attitude during the previous post-meeting press conferences and what he said in Davos. In our view, this week's MPC meeting will be an event that will clarify whether there was a change of bias of the governor or not. We think that his views remain dovish and he will stress the conditionality attached to his remarks about the possibility of a rate hike in 2019. Also, the January minutes were an expression of MPC dovishness and less pronounced stance of the hawkish minority. The governor should be accompanied on the 7-Feb press conference by Zubelewicz (who still seems to stick to his hawkish opinions) and Ancyparowicz or Osiatyński (both now considered moderate members, but in autumn of 2017 were seen as possible promoters of monetary tightening in 2018). Too little is still known about 4Q investment rebound to assume that it will influence the Council.

Last week in economy – GDP - whopping finish of 2017

Business climate in manufacturing (s.a.)



GDP growth and its components (% y/y)

	2015	2016	2017	1Q17	2Q17	3Q17	*4Q17*
GDP	3.8	2.9	4.6	4.1	4.0	4.9	*5.1*
Domestic demand	3.3	2.2	4.7	3.9	5.5	3.9	*5.3*
Total consumption	2.8	3.4	4.2	3.7	4.2	4.1	*5.0*
Private consumption	3.0	3.9	4.8	4.7	4.9	4.8	*5.0*
Public consumption	2.4	1.7	2.6**	0.5	2.1	1.9	*5.0*
Gross accumulation	4.9	-1.9	6.4	5.1	11.6	3.3	*6.1*
Fixed investment	6.1	-7.9	5.4	-0.5	0.9	3.3	*11.8*
Net export *	0.6	0.7	0.1**	0.4	-1.3	1.1	*0.1*

* contribution to GDP growth (percentage points); ** BZ WBK estimate

▪ Full-year flash GDP data for Poland showed 2017 economic growth at 4.6%, beating market expectations and our forecast, both at 4.5%, up from 2.9% in 2016. Implied 4Q17 GDP growth is slightly above 5.0% y/y (assuming no revisions of 1-3Q data). Fixed investments most likely rose 11.8% y/y vs. 3.3% in 3Q and market consensus at 6-7%. Private consumption seems to have grown close to 5% y/y, which was expected.

▪ PMI for Polish manufacturing fell in January to 54.6pts from 55.0pts in December, below the consensus and our expectations. Still, the index remained above long-term average. Downward correction was due to fall in output and delivery times sub-indices, while new orders rose at the fastest pace in three years. On the other hand, the ESI indices for Poland in January showed strong improvement of mood in manufacturing and services (visible also in the Polish Stats Office indicators). We are expecting the PMI to stay above 50 for the months to come, as we are positive about the economic climate in Poland. However, considerable rises are unlikely, given that the manufacturing is close to its max capacity and is facing rising problems with hiring new staff.

▪ NBP Quick Monitoring from January 2018 showed that Polish companies were quite sanguine about their situation at the beginning of 2018, yet they are expecting some deterioration of their financial situation. A growing number of companies reported problems with finding workers and rising labor costs. Capacity utilization is very high, eg 70% of construction companies run close to maximum capacity, and dropping some orders is a frequent reaction. Firms also raised their forecasts for their own prices and the prices of raw materials. Companies are planning higher investments (mostly public companies and those utilizing the EU funds).

Quote of the week – I will not hesitate to change rates

Adam Glapiński, NBP president, DGP Daily, 29 January

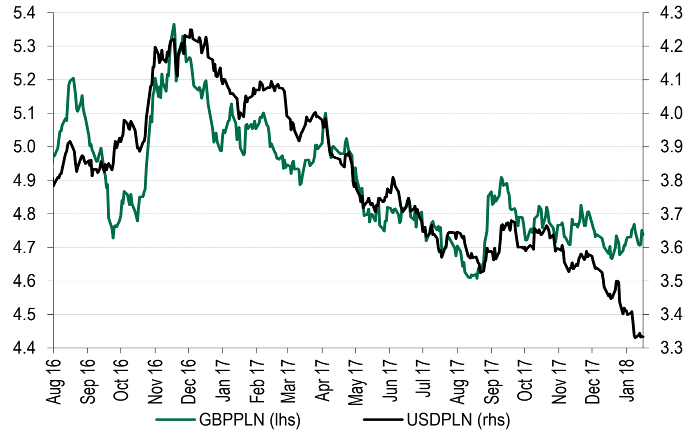
As a rule, I am not prejudiced against raising rates (…) I will not make firm statements about the next year. However, I would not be surprised if rates stayed in place even until mid-2019, as I would not be surprised if they needed to be raised. (…) If core inflation started rising much faster than our forecasts show, it would be a warning light for me. Stability is a virtue, but I will not hesitate to change rates, when it is necessary (…) The euro has strengthened recently which – despite strong economic momentum – made ECB even more reluctant to tighten monetary policy. We may function in a world of low interest rates for a long period of time.

We perceive the DGP interview with Adam Glapiński as more balanced expression of the governor's views, but ultimately still something that does not put him as a proponent of tighter monetary policy. The circumstances of the interview (World Economic Forum in Davos) required an opinion formulated in a different way than the live commentary of the governor during MPC press conferences – highlighting more the openness to adapt to unexpected changes in economic situation, and the ability to consider various possible scenarios for the economy by the Council. A thing to note from the interview is the reference to core CPI outlook. We think some members have lower tolerance to an acceleration of this measure and as it moves towards 2% y/y in 2018 they will voice their concerns and at some point will want to vote for a rate hike.

Foreign exchange market – Local factors key for zloty

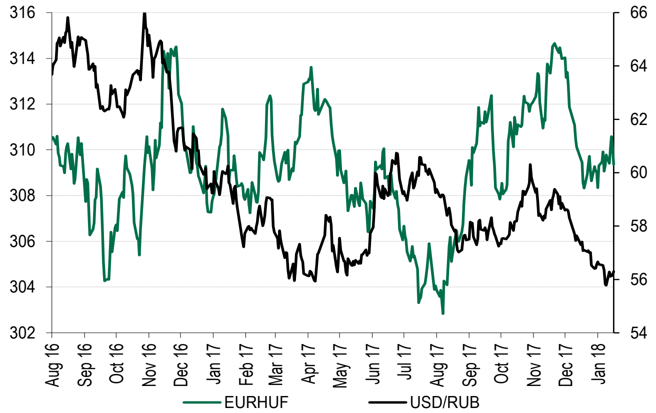
EURPLN

USDPLN and GBPPLN



EURUSD

EURHUF and USDRUB



Looking at local factors

- It seems that internal events had the biggest impact on the zloty in the passing week and EURPLN rose to 4.16 after falling to 4.13 on previous Friday. Profit taking from recent appreciation of the Polish currency was fueled by dovish comments of some MPC members and tone of the Council's last meeting minutes, below-consensus manufacturing PMI and weaker sentiment on the global equity market. At the same time, USDPLN stayed a touch above the multi-year low hovering around 3.33. CHFPLN rose for the third week in a row, approaching 3.60.
- We think Polish factors may continue to play important role on the domestic FX market. MPC holds a meeting this week. Although we do not expect any changes in rates, the outcome of the meeting could be interesting given the recent comments of NBP's head Adam Glapiński. Some market participants have received his recent interview as rather hawkish while in our view the tone of the statement and press conference will be rather dovish. Should this be the case, the zloty may weaken on the central banker's comments, as it did last week.
- Last week, we pointed out that trends on the equity markets are important for EURPLN and since then, the upside momentum of stock indexes has somewhat lost steam. If the pause in the rally continues, profit taking from zloty appreciation may intensify.

EURUSD near multi-year peak

- In the recent days, EURUSD stayed in the previous week's trading range hovering just below a multi-year peak at c1.254. The euro was supported by still decent PMIs while the dollar was pressured by some weaker-than-expected US data. UST yields reached their highest levels for a several years but this did not manage to support the dollar.
- The coming week is rather light in terms of data releases but numerous FOMC members will speak. However, the majority of them do not have currently a voting right in the Committee.
- We think the EURUSD rally is overdone given the looming March Fed rate hike. No important data publications are on the agenda this week and we think this could encourage investors to take part of profits from the exchange rate jump.

Koruna stronger after rate hike

- EURCZK stayed in the down trend as the Czech central bank raised interest rates by 25bp, main refi rate to 0.75%. Czech central bank head, Jiri Rusok, said after the meeting that one more hike this year is likely which looked fairly dovish given the FRA market pricing one 25bp hike in the next three months and a total of 75bp in the next 12 months. It seems there is a little room for stronger koruna in the short term, particularly given the political deadlock.
- EURHUF and USDRUB did not change much on weekly basis.

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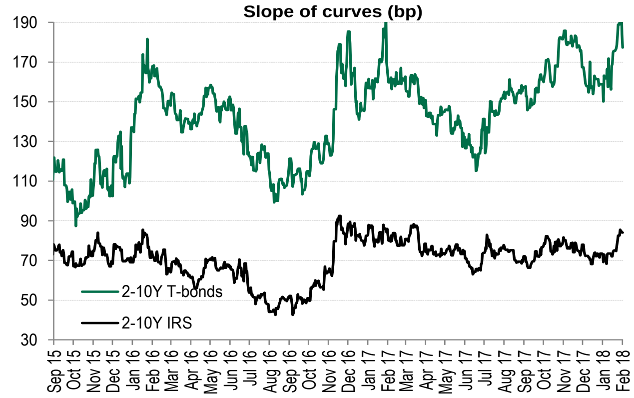
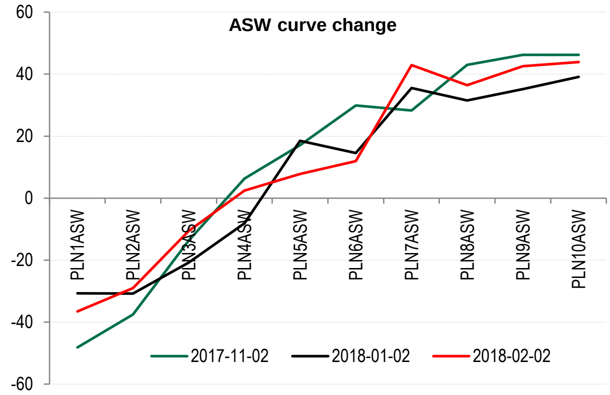
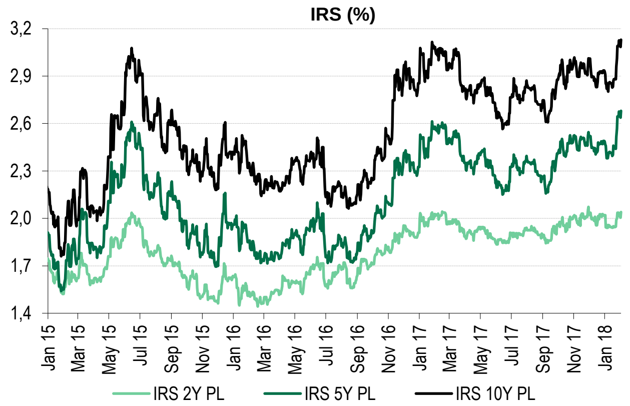
Interest rate market – Central banks fuel sell-off







Domestic longer yields rose fueled by the core markets

- Last week was marked by rising yields on the core and domestic debt markets. The yields were rising fueled by investors responses to the core central banks meeting (ECB and FED) and US labour market data release. This process was focused on the long and the middle part of the curves. On the domestic market, the scale of the upward move was clearly smaller than on the core markets. For example, the yield of Polish 10Y bonds rose by 8 bp, compared to Bunds with 11 bp upward move and US treasuries with 13 bp upward move. At the end of the week, the Bank of Japan decision decrease yields by buying the longer yields helped to calm the market.

Higher net supply will push the yields up

- This week on the bonds market, players will be focused on the MPC conference (on Wednesday) and regular debt auction (on Thursday). Awaiting the MPC conferences could generate risk for gradual yield increases on the belly and the front end of the curve. Investors have been wondering for some time if the recent interview of NBP governor Adam Glapiński does not mean shift towards hawks (read more in the economy section). Moreover, the higher net debt supply in February (PLN6-12bn vs. PLN4.5bn in January) will exert the upward pressure on the yields. The upward yield trend on the core debt markets, can also negatively influence Polish debt market. In our opinion, even in the case of the dovish tone of MPC conference investors will stay on their position that growing inflation pressures as a result of labour market shortage and faster wages growth will push the IRS rates up. As a consequence, we expect further asset swap spread (ASW) decreases, the stronger on the long end of the ASW curve.

Auction

- In The Ministry of Finance informed that for the 8 February the regular bonds auction was scheduled The planned supply is PLN3-6bn. MF plan to sell OK0720, PS0123, WS0428, WZ1122 and WZ0528 bonds.

We expect yield gains correction on the long end

- We In the longer horizon, we expect the yields increases corrections (thanks to lower January's CPI number release), the stronger on the long end of the curve. We think that the increases of the yields of the core market accompanying Euro periphery drop of bonds yield show that the part of the core debt increase was a result of the reduction of "safe haven" effect. Moreover, we still maintain the view that overliquidity of the Polish banking sector, expressing itself in a low level of Polonia rates should support higher interest in Polish debt by domestic banks and non-banking financial institutions.

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