

WEEKLY ECONOMIC UPDATE

27 October – 2 November 2014

Markets have stabilised in the recent week on the back of investors' hopes that the main central banks will act if needed to stop market turmoil from spreading. Also, slightly better activity indicators from Europe helped to tame fears about depth of euro zone slowdown and resulting risk of return of sovereign crisis. Polish retail sales proved to be weaker than expected, but on the other hand labour market data and business climate surveys showed signs of improvement, suggesting that economic situation may be not as bad as feared.

Despite recent stabilisation of moods, we think it is too early to say that the risk aversion is gone for good, as we have still a number of risk factors in the air, and markets in the current state may react quite nervously to upcoming data and events. At the very start of the new week financial markets will have to digest a few important news: results of European banking sector stress tests and elections results from Ukraine (parliamentary) and Brazil (presidential). The two latter may be important mainly for Emerging Markets' assets. The key event of the week will be the FOMC meeting, however there are also other very important events in the agenda (including releases of German Ifo, US GDP, eurozone inflation), which may significantly affect market sentiment. Concerns about Ebola virus and geopolitical stability may also continue weighing on investors' moods.

Economic calendar

TIME W-WA	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (27 October)							
10:00	DE	Ifo index	Oct	pts	-		104.7
15:00	US	Pending home sales	Sep	%MoM	-		-1.0
TUESDAY (28 October)							
13:30	US	Durable goods orders	Sep	%MoM	-		-18.4
14:00	HU	Central bank decision		%	-		2.1
15:00	US	Consumer confidence index	Oct	pts	-		86.0
WEDNESDAY (29 October)							
19:00	US	FOMC decision					
THURSDAY (30 October)							
13:30	US	Advance GDP	Q3	%QoQ	-		4.6
13:30	US	Initial jobless claims	week	k	-		
FRIDAY (31 October)							
11:00	EZ	Flash HICP	Oct	%YoY	-		
13:30	US	Personal income	Sep	%MoM	-		0.3
13:30	US	Consumer spending	Sep	%MoM	-		0.5
14:00	PL	Inflation expectations	Oct	%YoY	-		0.2
14:55	US	Michigan index	Oct	pts	-		84.6

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>

Maciej Reluga (Chief Economist) +48 22 534 18 88

Piotr Bielski +48 22 534 18 87

Agnieszka Decewicz +48 22 534 18 86

Marcin Luziński +48 22 534 18 85

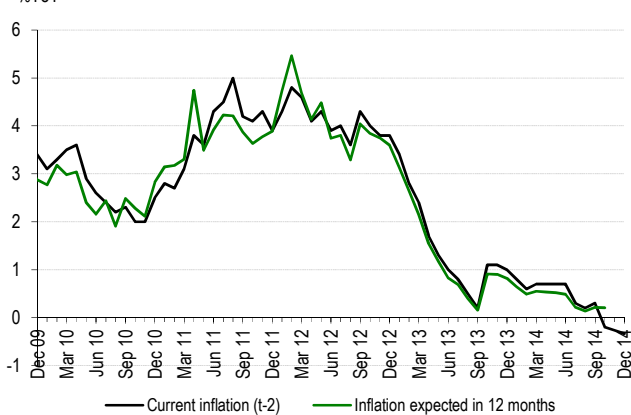
Marcin Sulewski +48 22 534 18 84

TREASURY SERVICES:

Poznań +48 61 856 5814/30

Warszawa +48 22 586 8320/38

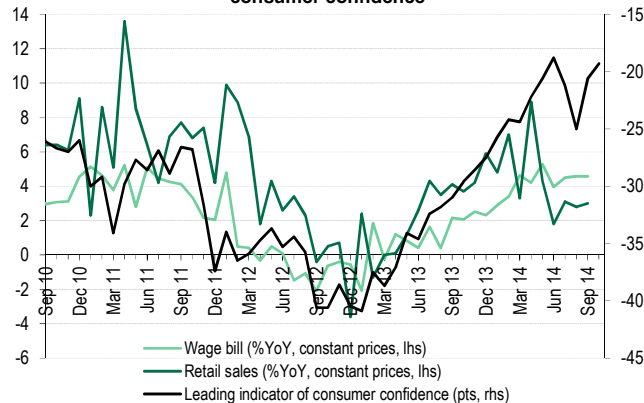
Wrocław +48 71 369 9400

What's hot this week – No data in Poland, but news from abroad will be important**Households' inflation expectations vs. current inflation**

▪ There are no key domestic data releases due next week. The only release, the highly adaptive households' inflationary expectations, is likely to remain at a very low level.

▪ The market is likely to focus on events abroad. Investors will eye US data, especially the first GDP reading for Q3 and the outcome of the FOMC meeting. The Fed members have recently seemed a bit more dovish and this week's releases are likely to affect expectations regarding the future monetary policy in the US. The German Ifo will also be important because forecasts for Germany have been recently revised down and the market is scrutinising every sign on the state of the euro zone's biggest economy.

▪ Geopolitics is still a concern, especially since there is a bigger presence of Russian or unidentified objects that appear in or around the countries in the Baltic Sea region. The Ebola virus is another factor that could potentially affect investor sentiment.

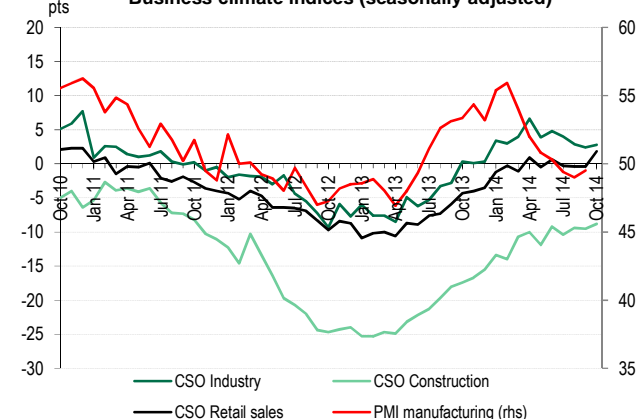
Last week in the economy – Labour market and business climate getting warmer**Retail sales, wage bill in corporate sector and consumer confidence**

▪ Retail sales growth disappointed in September by slowing to 1.6% y/y. The poor figure was mainly driven by weak performance in clothing and footwear, which might have been due to the exceptionally good weather last month that probably delayed the switch from summer to autumn clothes. Interestingly, the business climate index in retail trade improved significantly in October. This, together with the continuously positive situation on the labour market, bodes quite well for the private consumption outlook.

▪ Unemployment data indicate that positive labour market trends strengthened again, which should support private consumption in the second half of the year. On the other hand, one may worry how sustainable this improvement will be in the context of the decelerating external demand, which weakens the performance of the manufacturing sector. Data on employment in the corporate sector show that companies continue to hire, but demand for labour is fuelled by manufacturing. Employment in the corporate sector, excluding manufacturing, actually fell 0.1% y/y. The weakening manufacturing output could eventually translate into lower demand for labour.

▪ Business climate indicators, calculated by Poland's Central Statistics Office, improved in October in every major sector, including: manufacturing, construction, trade and transport. This comes after a few months of decline or stabilisation at best. Coupled with the pickup in the PMI indices in Germany and the euro zone, these factors suggest that the economic slowdown should not deepen any further.

▪ The CSO's estimate of capacity utilisation in the Polish economy rose to 77.6% in Q3, the highest level since 2008. Such high capacity use corresponded in the past with double-digit fixed investment growth. It, therefore, seems that Q3 was the third quarter in a row to show a surprisingly strong investment performance. This is also confirmed by the persistently high growth of investment loans and the fact that firms are hiring.

Business climate indices (seasonally adjusted)**Quote of the week** – We might have another move or moves by the end of the year

Andrzej Kaźmierczak, MPC member, 21.10, PAP

Of course, if deflation will be prolonged, we will not rule out further action. But we should not be impulsive.

Marek Belka, NBP president, 22.10, Financial Times

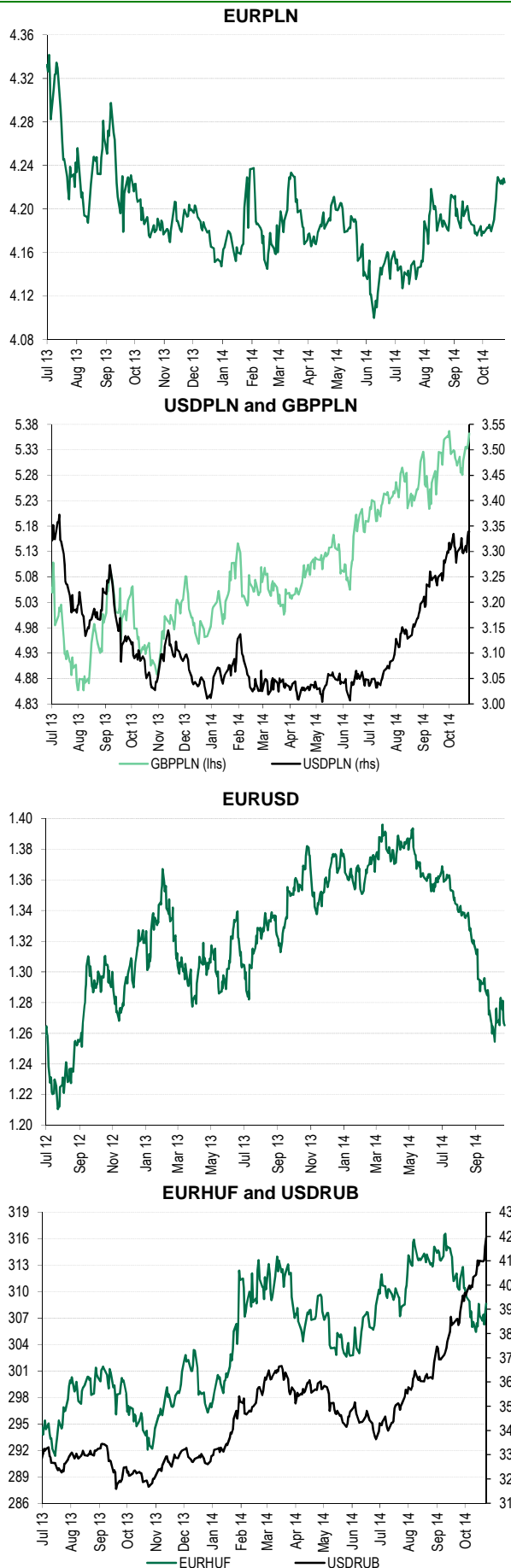
We want to concentrate our moves in a very short time. No promise, but we might have another move or moves in the rest of the year.

Jerzy Hausner, MPC member, 24.10, Bloomberg

When asked if rates should be cut further, I reply: no. But I don't rule it out, if current forecasts become subject to significant changes. (...) The probability of maintaining interest rates at current levels is greater than that of reducing them.

Minutes from the October MPC meeting showed that the adjustment of the NBP interest rates should be rather quick and "significant". The question whether the move by 50bps delivered in October was strong enough to be called "significant". We think that the new economic projection of the central bank (which the MPC will get to see at the November meeting) will show a significantly lower CPI and GDP path. The recent comments of NBP deputy head A.Raczko seem to support this view. This will justify a continuation of monetary easing. We now expect a 25bps rate cut in November and believe that policymakers will not shut the door to cuts in the future, though only if the economic situation gets worse than what was presented in the projection.

Foreign exchange market – Key events ahead



EUR/PLN stable again but for how long?

▪ Last week, which followed the noticeable rise in the EUR/PLN volatility, was rather calm and the exchange-rate stayed in the 4.21-4.24 range. The majority of the emerging currencies gained vs. the euro, but lost against the dollar despite the rebound in the global stock markets and the general stabilisation of sentiment. USD/PLN temporarily climbed to nearly 3.36 (just above the local peak from the first week of October) from c3.26.

▪ The FOMC decision will be the key event in the coming week. It is due on Wednesday and it is widely expected that the size of the QE3 programme will be cut to zero. But because there have been some dovish signals from the FOMC recently and some mixed US data releases, investors now seem to be less certain that the Committee will actually deliver a hawkish message. If the statement addresses many concerns over the recent data and the risk for the global (and thus) US economic outlook, investors may start to price in that the Fed rate hikes will come later rather than sooner. Of course, the message will be even stronger if the size of QE3 stays unchanged at \$15bn per month. This, together with hopes for more action from the ECB (e.g. corporate bond buying as rumoured last week) may support risky assets.

▪ Notice, however, that the EM currencies failed to perform much better last week despite the stabilisation (or even some improvement) in the global market sentiment. There are several risk factors for the EM assets that may explain this: elections in Ukraine and Brazil this weekend and the geopolitical tensions in the Baltic Sea region.

▪ Important levels for EUR/PLN are at 4.20 and 4.26.

FOMC and stress tests' results in the spotlight

▪ Speculations that the ECB may enlarge the scope of its asset purchase programme by also buying corporate debt from 2015 have put pressure on the euro. Investors are also concerned about the outcome of the European banks' stress tests (due on Sunday). Consequently, the EUR/USD dropped from 1.284 to nearly 1.26.

▪ Sunday's results of the stress tests may determine the start of the week on the EUR/USD market. However, we think that the fluctuations should not be overly high as investors will be awaiting the Wednesday's FOMC decision. The recently poor European macro data strengthened worries that the economic slowdown may spread further. That said, investors are now less certain that the Fed will hike rates sooner than in mid-2015.

▪ Crucial levels for EUR/USD are at 1.26 (next support at 1.25) and 1.29.

USD/RUB at 42, strong depreciation of the koruna

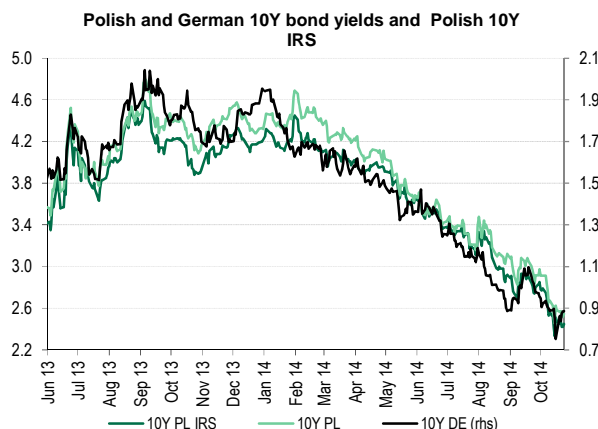
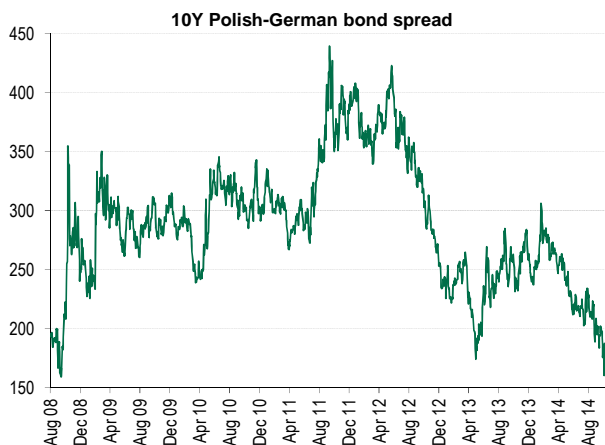
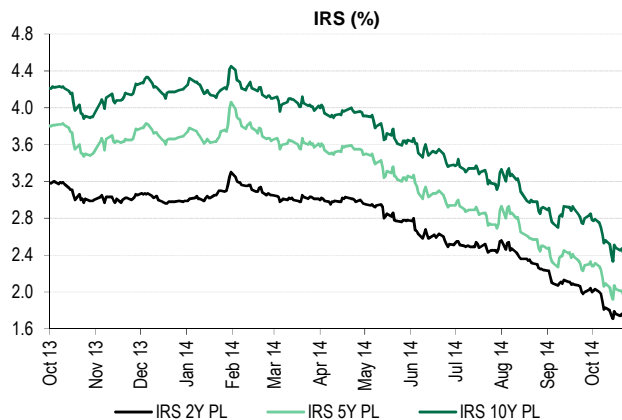
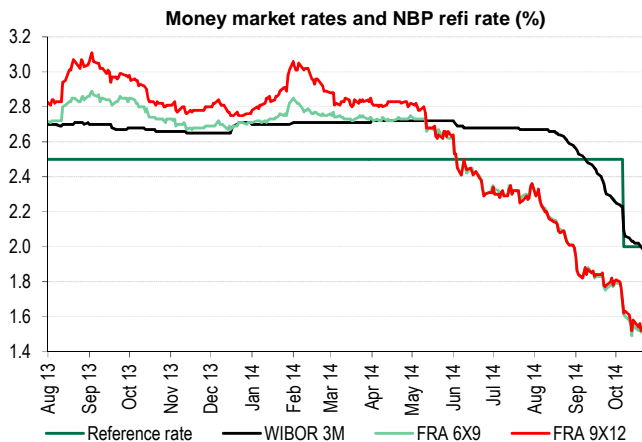
▪ The ruble, forint and the Czech koruna depreciated last week. The EUR/CZK recorded its biggest weekly open-close spread since November 2013, when the CNB established the floor at 27.0.

▪ The recent Czech inflation data was below the consensus and investors could be speculating that the CNB will finally have to lift the floor.

▪ USD/RUB stayed in the upward trend for the seventh week in a row and reached 42. The ruble continues to be under pressure from the deteriorating outlook for the Russian economy and worries about a possible rating downgrade.

The Hungarian central bank holds its meeting this week. It announced a few months ago that it was ending its easing cycle and investors will try to judge whether the central bank's assessment of the situation has changed given the further deterioration in the economic activity in Europe of late.

Interest rate market – Fed may set direction for fixed income market

**WIBOR keeps falling, IRS and bond yields also down**

- The WIBOR rates remained in their downward trend and fell 3-4bps on a weekly basis and by a total of 23-32bps (with the 1M rate falling the most) since the October decision of the MPC. The FRA market is currently pricing-in a fall in the 3M WIBOR by c25bps in one month's time and by almost another 50bps in the next 3 months.

- The past week in the fixed income market was much less volatile than the previous. The IRS curve moved down by 4-7bps, while the bond curve by 2-7bps, with the biggest decline on the short end. These slight changes were coherent with the roughly stable Bunds (some marginal yields' increase) and no major changes in the EUR/PLN rate. The market reacted significantly neither to the Polish weaker-than-expected retail sales nor the MPC members' comments. Currently, the 2Y IRS is near its all-time low 1.72%, the 5Y rate is at 1.96%, c5bps above its record low, and the 10Y IRS at 2.42%, c10bps above the all-time low.

- The debt auction was quite successful. The Ministry of Finance sold bonds worth PLN6.1bn (above the upper limit of the plan) amid demand at over PLN9.6bn. The Ministry sold OK0716 for PLN2.3bn and PS0719 for PLN3.8bn. Yields at the auction were slightly above the secondary market levels.

- Thanks to strengthening of the Polish market and some weakening of the core markets, the 10Y spread vs. the German long-term benchmark dropped by c10bps to c163bps. This is the lowest level since September, 2008. At the same time, the 10Y spreads for the Spanish and Italian bonds are slightly above their lowest levels since 2010 and 2011, respectively, which were reached several weeks ago. The Polish spread is roughly equal to the Italian spread and c35bps higher than the Spanish spread.

FOMC in the spotlight

- Global market sentiment has recently been the key driver for the Polish bonds and IRS. This week, changes in market expectations for decisions of the major central banks may play the key role.

- On Sunday, we will see the outcome of the European banks' stress tests. There have been some rumours about the number of institutions, which failed the examination and if the final results prove worse than anticipated, then hopes for the ECB to expand its asset buying programme by including corporate bonds may strengthen.

- It seems, however, that the FOMC is the most awaited event this week. Investors will eye any clue on whether the Committee has grown any more worried over the US economic outlooks since its last meeting, especially given the sluggish growth in the euro zone. Any signals that the FOMC members' assessment of the situation has deteriorated may revive investors' expectations that the monetary policy bias will not change significantly at least until mid-2015, thus providing support for the global fixed income assets.

This publication has been prepared by Bank Zachodni WBK S.A. for information purposes only. It is not an offer or solicitation for the purchase or sale of any financial instrument. Information presented in the publication is not an investment advice. All reasonable care has been taken to ensure that the information contained herein is not untrue or misleading. But no representation is made as to its accuracy or completeness. No reliance should be placed on it and no liability is accepted for any loss arising from reliance on it. Forecasts or data related to the past do not guarantee future prices of financial instruments or financial results. Bank Zachodni WBK S.A., its affiliates and any of its or their officers may be interested in any transactions, securities or commodities referred to herein. Bank Zachodni WBK S.A. or its affiliates may perform services for or solicit business from any company referred to herein. This publication is not intended for the use of private investors. Clients should contact analysts at and execute transactions through a Bank Zachodni WBK S.A. entity in their home jurisdiction unless governing law permits otherwise. Copyright and database rights protection exists in this publication.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Rates Area, Economic Analysis Department, Al. Jana Pawła II 17, 01-854 Warsaw, Poland, phone +48 22 534 18 88, email ekonomia@bzwbk.pl, <http://www.bzwbk.pl>.