Bank Zachodni WBK
Grupa Santander

# WEEKLY ECONOMIC UPDATE

## 24 – 30 November 2014

**Investors' optimism from the beginning of last week faded with the weaker-than-expected flash PMI readings for a number of countries, including China, Europe's biggest economies France and Germany, as well as the euro zone as a whole. The FOMC minutes were additionally quite neutral for the market. Consequently, fears over the global economic outlook came to light again, triggering a sell-off in the stock markets and the euro, and causing a strengthening in core debt. However, later into the week, the unexpected rate cut in China and the very promising Draghi's speech supported appetite for risky assets, including the Polish ones. On the domestic side, macro data were quite mixed (positive labour market figures and quite weak production data), yet central bankers' comments and minutes from the MPC's last meeting have revived hopes for monetary easing in coming months.**

**This week will bring the last set of macro data that may determine the central bank's next decision. Despite the fact that the calendar is filled with US data, investors will focus on the European flash HICP reading, the most important from the perspective of the ECB's QE launch. When it comes to Poland, investors will get to see retail sales and the 3Q GDP breakdown. These two releases could be an impulse that changes the balance of votes on the MPC already in December. However, if there is a rate cut, it will probably not be bigger than 25bp, in our view.**

### Economic calendar

| CZAS W-WA | COUNTRY | INDICATOR | PERIOD | | FORECAST MARKET | FORECAST BZWBK | LAST VALUE |
|---|---|---|---|---|---|---|---|
| | | **MONDAY (24 November)** | | | | | |
| 10:00 | DE | Ifo index | Nov | pts | 103.3 | - | 103.2 |
| | | **TUESDAY (25 November)** | | | | | |
| 8:00 | DE | GDP | Q3 | %YoY | 1.2 | - | 1.4 |
| **10:00** | **PL** | **Retail sales** | **Nov** | **%YoY** | **2.2** | **3.1** | **1.6** |
| **10:00** | **PL** | **Unemployment rate** | **Nov** | **%YoY** | **11.4** | **11.3** | **11.5** |
| 14:00 | HU | Central bank decision | | % | 2.1 | - | 2.1 |
| 14:30 | US | Preliminary GDP | Q3 | %YoY | 3.3 | - | 4.6 |
| 16:00 | US | Consumer confidence index | Nov | pts | 95.8 | - | 94.5 |
| | | **WEDNESDAY (26 November)** | | | | | |
| 14:30 | US | Durable goods orders | Oct | %MoM | -0.6 | - | -1.3 |
| 14:30 | US | Personal income | Oct | %MoM | 0.4 | - | 0.2 |
| 14:30 | US | Consumer spending | oct | %MoM | 0.3 | - | -0.2 |
| 14:30 | US | Initial jobless claims | week | k | | - | 291 |
| 15:55 | US | Michigan sentiment index | Nov | pts | 90.0 | - | 89.4 |
| 16:00 | US | Pending home sales | Oct | %MoM | 0.8 | - | 0.3 |
| 16:00 | US | New home sales | Oct | k | 470 | - | 467 |
| | | **THURSDAY (27 November)** | | | | | |
| | US | Market holiday | | | | | |
| | | **FRIDAY (28 November)** | | | | | |
| 9:00 | CZ | GDP | Q3 | %YoY | 2.3 | - | 2.5 |
| **10:00** | **PL** | **GDP** | **Q3** | **%YoY** | **3.3** | **3.3** | **3.5** |
| 11:00 | EZ | Flash HICP | Nov | %YoY | 0.3 | - | 0.4 |
| **14:00** | **PL** | **Inflation expectations** | **Nov** | **%YoY** | **-** | **-** | **0.2** |

Source: BZ WBK, Reuters, Bloomberg

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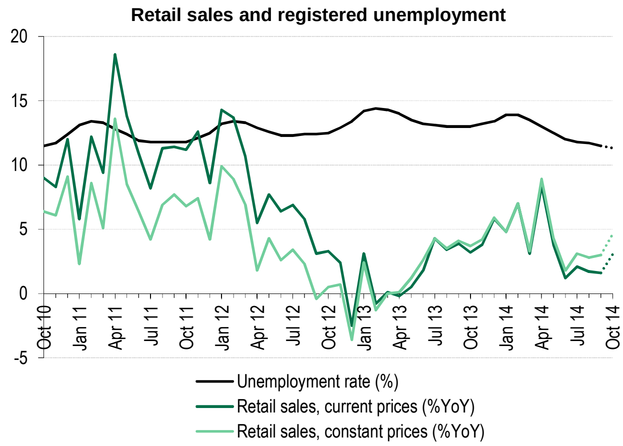
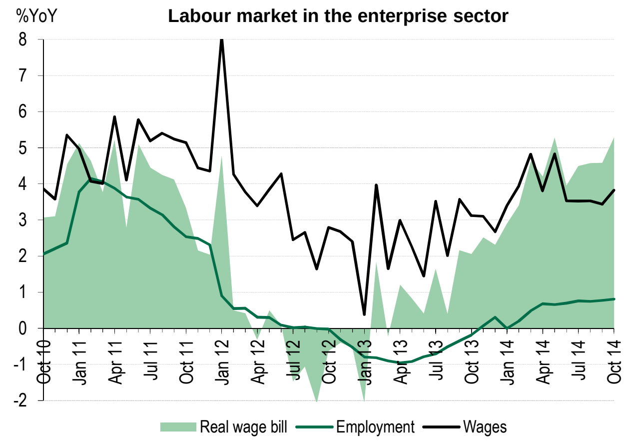
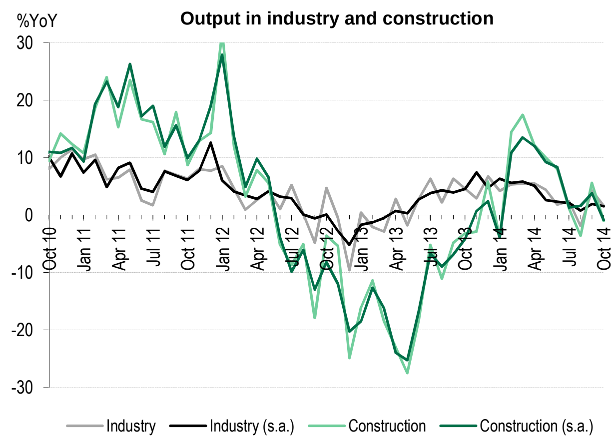
## What's hot this week – Q3 GDP breakdown, retail sales and unemployment rate




- The final data releases for October should be rather positive, in our view, with the registered unemployment rate sliding to 11.3% and retail sales showing a 3+ growth rate. We expect both to come in above the market consensus.
- A detailed breakdown of the 3Q GDP data will be released at the end of the week. The headline figure was above expectations, scaling back expectations for a rate cut in December. The structure of growth may also be important for the central bankers. We have a feeling that we may see a slight acceleration of private consumption and strong fixed investments. However, the level of uncertainty is high since we still do not know how the quarterly GDP breakdown has changed with the recent methodological change.
- In general, this week's data releases will be quite hawkish, in our view, which should diminish market expectations for a rate cut in December.

## Last week in the economy – Good labour market data, but industry and construction decelerated




- Average employment in the corporate sector increased in October by 0.8%YoY. The number of jobs rose by 7,000MoM, which is a quite good result for this part of the year. It looks like there is a clear revival in companies' demand for labour in the last few months.
- Average wage growth accelerated in October to 3.8%YoY. Salaries are growing despite a clear downward trend in CPI, which signals that companies may be facing increasing problems with finding skilled labour force.
- According to our estimates, real wage growth accelerated in October to 4.5%YoY, and growth of the real wage bill reached 5.3%YoY. In both cases, these were the biggest gains since January 2009. The rising purchasing power of households will keep supporting private consumption growth in the near term.
- Industrial production growth slowed in October to 1.6%YoY (and 1.5%YoY after seasonal adjustment). The data confirm that activity in the Polish industrial sector is slowing. The main source of a slowdown is worsening external demand and lower export orders. However, it has to be noted that among industrial branches recording the highest YoY production increases, there were still many export-oriented ones (for example, furniture 16.9%, computers and electronics 10.1%, machinery and tools 9.9%, electrical appliances 9%).
- Construction output fell in October by 1%YoY, clearly below forecasts, which also adds to our concerns about the slowing economy in the final part of the year. We were hoping to see a rebound, not only due to unusually good weather, but also thanks to higher investment activity in the private sector and higher municipal investments ahead of the local elections.
- PPI inflation showed -1.2%YoY in October and has been negative for 24 months in a row.

## Quote of the week – There is room to cut interest rates

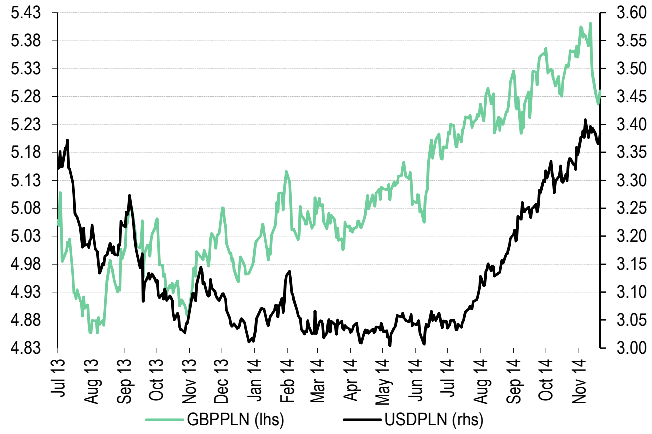
**Jerzy Osiatyński, 21 November 2014, Reuters**
There is room to cut interest rates. Even despite the recent data showing that GDP growth was higher than expected. All inflation forecasts, including core inflation, suggest that price growth will be considerably below the 2.5%-target at least until the end of 2016. Under these circumstances, we should look at monetary policy from the perspective of the MPC's secondary target, which is supporting economic growth.
**Marek Belka, 20 November 2014, Wall Street Journal**
I have always said the Monetary Policy Council should carry out policies aimed at fulfilling the inflation target. There is still room to cut interest rates.
**Anna Zielińska-Głębocka, 20 November 2014, PAP**
We should not allow the deflationary trend to become persistent.

Last week there were a few comments, which all came from the MPC's doves. It seems these policymakers are not changing their bias and are likely to support monetary policy easing also in December, despite the few better-than-expected data releases. Some members clearly have a huge appetite for cuts: minutes from the November MPC meeting revealed that there were three rate-cut motions submitted: -100bp, -50bp, -25bp, none of which gathered enough support. This shows that the Council is deeply divided. We are still expecting more monetary easing in Poland, but it is really hard to guess whether the balance of votes on the MPC will change already in December. We still have a few data releases before the next meeting and they may determine the MPC's decision. But, if there is a rate cut, it will not be bigger than -25bps, in our view.

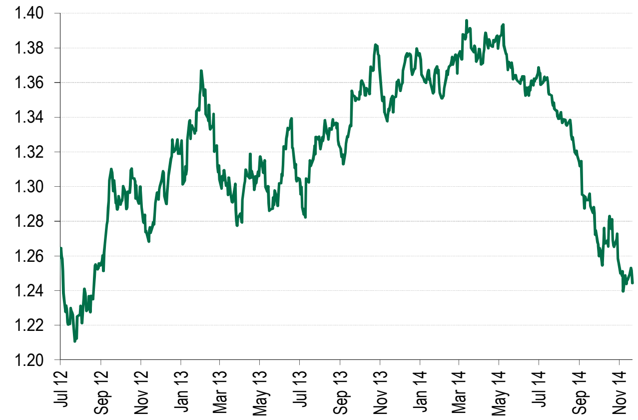
## **Foreign exchange market** – Promise of QE supports CEE currencies

EURPLN

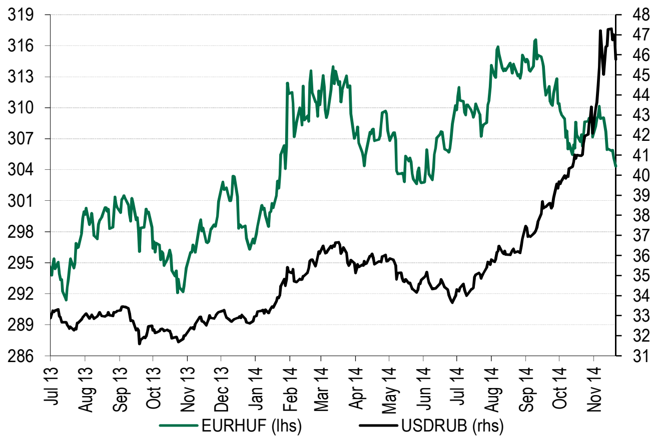
USDPLN and GBPPLN




EURUSD



EURHUF and USDRUB




### Polish zloty stronger and stronger

- The Polish zloty firmed against the main currencies over the past week despite the renewed expectations for interest rate cuts in the coming months. The slightly better domestic macro data and the strengthening belief in in the euro zone's QE programme on the back of weaker European data were the main drivers of the zloty's appreciation. Consequently, the EUR/PLN fell below the support at 4.20 during Friday's session and reached 4.19 (the lowest level since mid-October). In weekly terms, the USD/PLN was more vulnerable due to the EUR/USD changes. The USD/PLN returned to its upward trend at the end of the week (after declining temporarily to 3.346) thanks to the sharp fall of the EUR/USD.
- EUR/PLN broke important support at 4.20 last week. In our opinion, the domestic macro data (retail sales, GDP breakdown), which will be released this week may support the zloty further – particularly the sales release (our forecast is clearly above the market consensus). Thus, these data coupled with the continuously strong expectations for a QE programme in the euro zone, could push EUR/PLN towards 4.18 in the coming days.

### EUR/USD shifts down as door to QE wide open

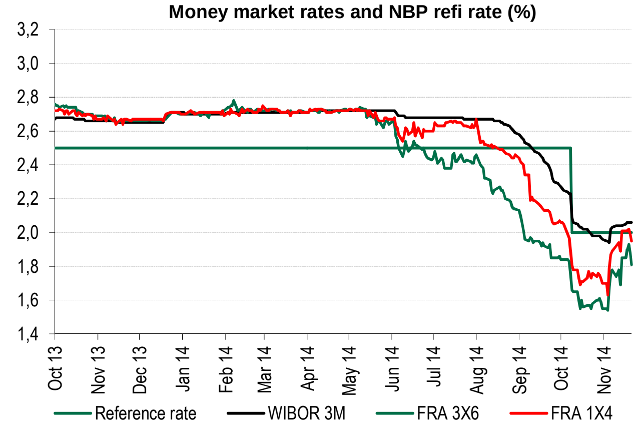
- The euro trimmed some of its loses from the beginning of last week after Germany's ZEW gave investors a reason to be more optimistic about growth prospects in the euro zone. However, new data from the global economy (flash PMI readings for the euro zone's and China's manufacturing sectors) were not so optimistic and investors decided to take profit on the euro (after which the EURUSD reached 1.257). Draghi's speech on Friday highlighted that the door was now wide open for possible QE as recovery was waning. This caused a deeper decline in the EURUSD (towards 1.24).
- This coming week's flash HICP release for the euro zone, next to data from the US, will be the key event since the inflation outlook is the most important issue from the perspective of implementing of the QE programme by the ECB. A lower-than-expected reading could, therefore, push the EURUSD even below 1.24.

### Russia's ruble rebounds strongly

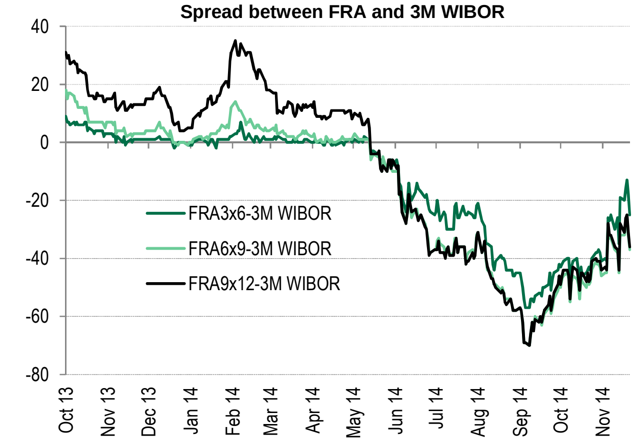
- This passing week, the situation on the Hungarian forint, the Czech koruna and the Russian ruble was mixed. The latter gained the most across the EM universe over the past week (3.4% against the euro and 4.6% against the US dollar) thanks to the rise in oil prices and strong demand for the ruble from the domestic taxpayers. The better sentiment also helped other currencies rebound, though their gains were more muted.
- Local events could be more important for the FX market this coming week. The lack of a rate cut in Hungary (despite the further fall in the headline CPI) should support the forint. From the perspective of technical analysis, the EURHUF may continue its downward trend towards 300 in the upcoming weeks after breaking the crucial support at 305 last week. At the same time, we expect to see a horizontal trend on the EURCZK in the upcoming week as the 3Q GDP breakdown should confirm there is only a gradual deterioration of domestic demand.

## **Interest rate market** – Short-end and belly of the curves may remain under pressure

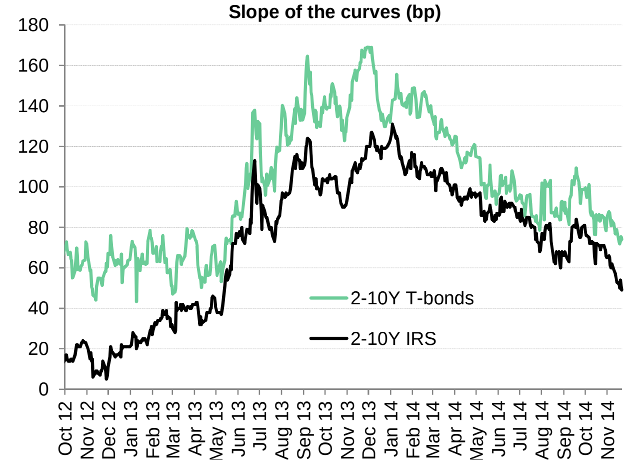
**Money market rates and NBP refi rate (%)**



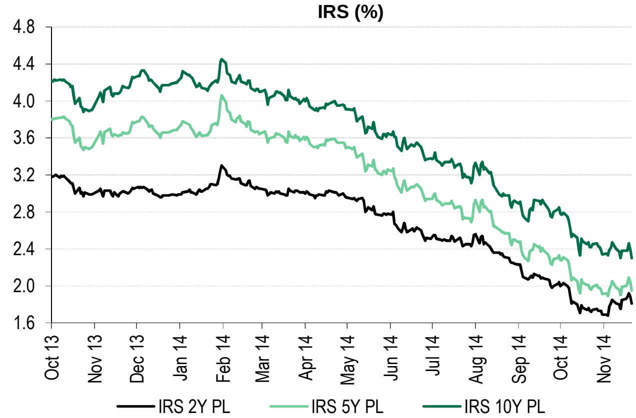

**Spread between FRA and 3M WIBOR**




**Slope of the curves (bp)**




**IRS (%)**




### WIBOR gently up, high volatility in IRS and bonds

- The 1-12M WIBOR rates rose 2bp last week and FRAs moved down slightly, with the biggest move recorded at the end of the week. The FRA market is currently pricing-in no NBP rate cut in December (1x4 rate is close to 2%) and not even a full, 25bp cut in the next 3 months. A full 25bp cut is priced-in in 6 month horizon. Looking at our scenario (we expect one more cut of 25bp), we think that the FRA1x4 has the potential to fall over the next 1-2 months. At the same time, we do not see much room for a decline in the FRA6x9 or FRA9x12.
- The past week was quite volatile in the Polish IRS and bond markets, mainly due to global events. First, rates surged on the hawkish minutes of the Bank of England, though this move was soon more than reversed by the disappointing flash manufacturing PMIs for France, Germany and whole euro zone. At the same time, Mario Draghi gave a very dovish speech, which underpinned hopes for more imminent easing from the ECB. At the end of the week, China's interest rate cut gave another strong impulse for the market to strengthen. That said, Poland's data proved less important. The bond and IRS curves dropped 5-10bp on a weekly basis, while trade volumes in the bond market were thin the whole week.
- The switch auction was quite successful and the Ministry of Finance sold debt worth almost PLN7bn (over PLN4bn in PS0719 and PLN2.9bn in the floating WZ0119 ). The Ministry bought back WZ0115 worth PLN5.9bn, PS0415 worth PLN1.1bn and OK0715 worth PLN67mn.

### Bearish flattener may continue

- The Polish curves have been flattening since the MPC's November decision to keep interest rates unchanged. The 2-10 spreads narrowed by 12-14bp to 75bp for bonds and to 50bp for the IRS. The 5-10 spreads narrowed by c10bp to 45bp for bonds and to 35bp for the IRS. The short ends and the belly of the curves appeared quite vulnerable to the smaller chance of further interest rate cuts following the MPC's latest decision and the better-than-expected GDP data.
- We think that the 2Y and 5Y tenors may continue to be under pressure this week due to the more upbeat Polish macro data. Our forecast for the November retail sales is clearly above the market consensus, which is likely to join the recent set of positive news from Poland. If our estimate proves right, the short end and the belly of the two curves could suffer more. We therefore think that a more bearish flattener could be seen in the coming days.
- GDP data will also be looked at closely, especially the main drivers of growth in Q3 and if there will a revision of the strong flash estimate. We think that strong investments and consumption could make this release look even more optimistic, strengthening arguments that limit – in some MPC members' view – room for more rate cuts in Poland.
- However, please keep in mind that the recent MPC members' comments confirmed that the Council's doves still see room for more monetary easing, regardless of the slightly better data of late. For some of them, room for rate cuts is probably still substantial, shown by the fact that there was a motion to cut rates by 100 bp in November. While such a large scale of easing seems unlikely, hopes that incoming data could change the balance of votes towards a smaller cut may limit the potential for a sharp upward move in the 2Y, 5Y IRS and bond yields.
- The chance that many of the numerous US macro data releases may surprise to the upside is another risk factor that may limit the potential for the bearish flattener this week. Strengthening of expectations for rate hikes in the US may push the core – and thus the domestic – curves up in all the tenors.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Rates Area, Economic Analysis Department, Al. Jana Pawła II 17, 00-854 Warsaw, Poland, phone +48 22 534 18 88, email ekonomia@bzwbk.pl, http://www.bzwbk.pl.