Bank Zachodni WBK
Grupa Santander

# WEEKLY ECONOMIC UPDATE

## 8 – 14 December 2014

**November's manufacturing PMI for Poland was a big positive surprise and yet another signal that the economic growth slowdown towards the end of the year may be less severe than had been expected, despite the fact that the euro zone countries are still struggling with stagnation. After a series of positive data surprises it was quite irrational to expect an interest rate cut at the December's MPC meeting, so the Council's decision to leave its policy unchanged triggered no significant market reaction. In fact, the fixed income market recorded quite a significant correction during the week, although the initial move took place already before the MPC's decision (triggered by the high PMI and FinMin's announcement of its switch tender supply), with the yields' rise extending after the ECB meeting (disappointment with no QE announcement) and strong U.S. labour market data. Even though some analysts interpreted the MPC's last statement and press conference as quite hawkish, concluding that chances for another interest rate cut have fallen, we believe that the change in the statement rather signals that the door to another rate cut is open even a bit more widely. In our opinion, a slight interest rate cut in Poland remains likely in 1Q15 as upcoming macro data should point to a slower pace of economic growth at the end of this year. The MPC could decide to cut rates again even as early as in January, particularly if industrial output growth proves negative, which we forecast.**

**There are no bigger data releases in Poland this week and the calendar abroad is also very thin. As such, investors will await fresh comments of the central bankers and watch for any hints regarding the monetary policy outlook in Poland and abroad. The outcome of the second TLTRO take-up in the euro zone may affect market expectations on the scale for the ECB's QE and, if disappointing, the TLTRO results may strengthen the debt market. The zloty has the potential to gain further and any signals that odds for European QE are rising would definitely support this trend.**

### Economic calendar

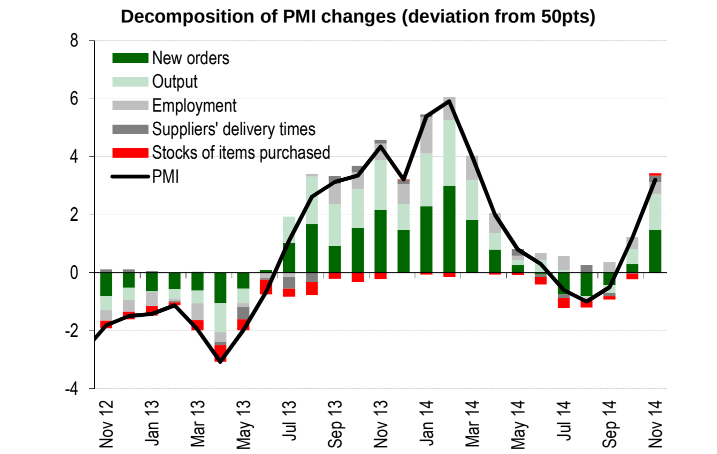
| TIME CET | COUNTRY | INDICATOR | PERIOD | | FORECAST MARKET | FORECAST BZWBK | LAST VALUE |
|---|---|---|---|---|---|---|---|
| | | **MONDAY (8 December)** | | | | | |
| 8:00 | DE | Industrial output | Oct | %MoM | 0.0 | - | 1.4 |
| 9:00 | CZ | Industrial output | Oct | %MoM | 4.0 | - | 8.3 |
| | | **TUESDAY (9 December)** | | | | | |
| 8:00 | DE | Exports | Oct | %MoM | - | - | 5.5 |
| 9:00 | CZ | CPI | Nov | %YoY | 0.7 | - | 0.7 |
| | | **WEDNESDAY (10 December)** | | | | | |
| | | No important data releases | | | | | |
| | | **THURSDAY (11 December)** | | | | | |
| 9:00 | HU | CPI | Nov | %YoY | -0.5 | - | -0.4 |
| 14:30 | US | Retail sales | Nov | %MoM | 0.3 | - | 0.3 |
| 14:30 | US | Initial jobless claims | week | k | - | - | 313 |
| | | **FRIDAY (12 December)** | | | | | |
| 11:00 | EZ | Industrial output | Oct | %MoM | 0.0 | - | 0.6 |
| **14:00** | **PL** | **Money supply** | **Nov** | **%YoY** | **7.9** | **7.9** | **7.7** |
| 15:55 | US | Flash Michigan | Dec | pts | 89.5 | - | 88.8 |

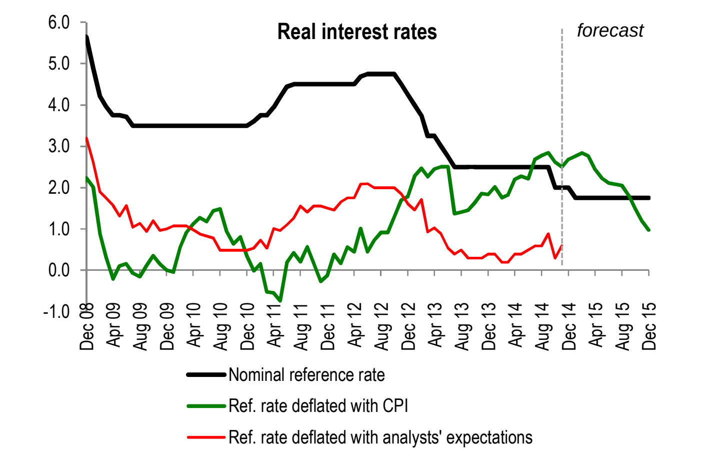
Source: BZ WBK, Reuters, Bloomberg

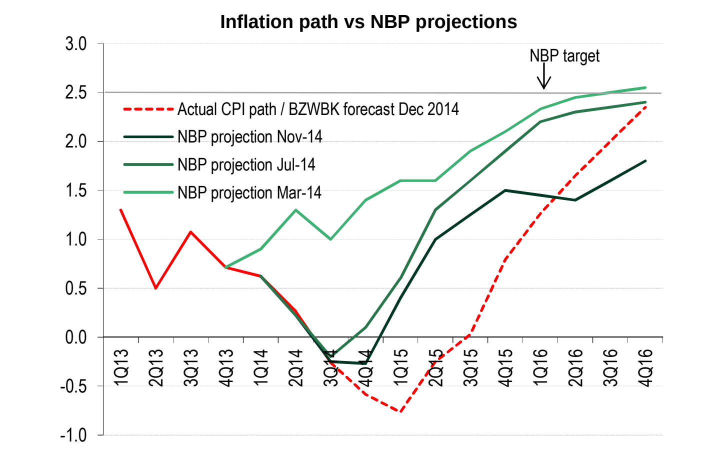
ECONOMIC ANALYSIS DEPARTMENT:
al. Jana Pawła II 17, 00-854 Warszawa fax +48 22 586 83 40
email: ekonomia@bzwbk.pl Web site: http://www.bzwbk.pl
Maciej Reluga (Chief Economist) +48 22 534 18 88
Piotr Bielski +48 22 534 18 87
Agnieszka Decewicz +48 22 534 18 86
Marcin Luziński +48 22 534 18 85
Marcin Sulewski +48 22 534 18 84

TREASURY SERVICES:
Poznań +48 61 856 5814/30
Warszawa +48 22 586 8320/38
Wrocław +48 71 369 9400

## **Last week in the economy** – Stronger PMI, MPC on hold, but more easing still possible




- The Polish manufacturing PMI index surged to 53.2pts November, the highest level since March. All its components were above the neutral mark for the first time since December 2010. New export orders rebounded significantly (with the sub-index above 50pts for the first time in seven months) and companies reported that they managed to enter new markets, mainly in Central and Eastern Europe. Improvement in orders supported output, in turn, which expanded in November at the fastest pace since March. The stronger economic activity also had a positive impact on employment, which grew for the 16th month in a row. At the same time, production costs and prices of sold goods did not change much. The strong PMI implies an upward risk to our industrial output forecast, although we still expect to see its growth below zero in November.
- The Monetary Policy Council did not surprise and kept interest rates unchanged in December. The main refinancing rate is still at 2.0%, the lombard rate at 3.0% and the deposit rate at 1.0%. Neither the MPC decision nor the press conference triggered a significant market reaction. Nevertheless, an interesting change took place in the final, key paragraph of the official statement.
- The MPC suggested last month that more rate cuts could follow if upcoming data would point to risks that the economic outlook could deteriorate. We already know that the latest data releases not only did not point to further deterioration, but in fact offered an improved outlook for economic growth. This month, however, the statement's final sentence said that more monetary policy easing could not be excluded should incoming data confirm economic growth was weakening and economic activity abroad remained subdued. This means that the prerequisite for a rate cut in Poland is no longer a deterioration of the outlook, but confirmation that domestic economic growth is decelerating and growth abroad remains weak.
- This is exactly what we expect since we forecast a slowdown of GDP growth in Poland to 2.8-2.9% YoY at the turn of 2014 and 2015. We also expect economic activity in the euro zone to remain weak in the coming two quarters. Additionally, CPI inflation will remain below zero probably for longer than we had previously thought (we see deflation until mid-2015, while Marek Belka did not rule out that it may last until February-March).
- Overall, we think that the change in the MPC statement is signalling that the door for a rate cut is open a bit more widely. In our opinion, a slight interest rate cut is still likely in 1Q15 as upcoming macro data should point to a slower pace of economic growth at the end of this year. It is possible that the MPC could decide to cut interest rates even in January, particularly if industrial output growth proves negative, in line with our forecast.

## **Quote of the week** – Time to recap after the "communication disruption"

**Marek Belka, NBP President, 3 Dec, MPC conference**

The data we've seen over the last month are definitely improving, albeit just slightly, Poland's economic outlook. I find the structure of GDP growth to be the most important . If the Council decided to keep rates unchanged at the previous meeting taking note of the uncertainty over the economic outlook, its stance was certainly affirmed today.

I think that nothing bad happened to the economy (due to the lack of a rate cut). For sure what we had last month was a communication disruption. That's why today we decided to recap. Please note that we still see the possibility of further monetary easing and lower rates, though in a certain environment. We try to emphasise this today, what I had already said last month, in order not to surprise.

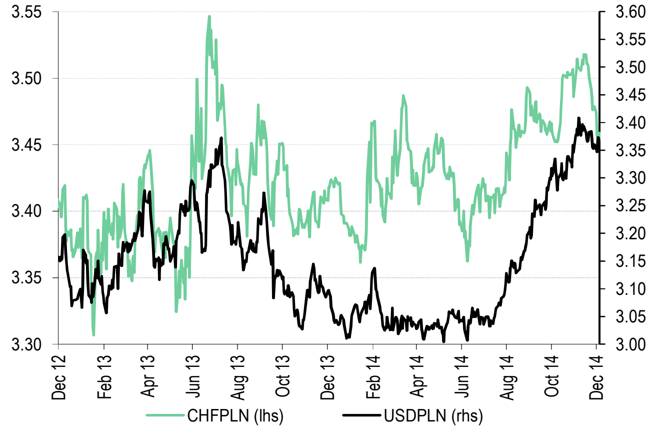
In the Council's opinion, GDP growth in Q4 will be similar to Q3, maybe slightly lower.

What is interesting, the NBP Governor admitted during the press conference that there was a problem last month, which he called a "communication disruption". The Council, therefore, decided to fix it this month, pointing out in the statement that further monetary policy easing was still possible in specific situations. We think these conditions could be met: there could be confirmation that domestic economic growth is decelerating and growth abroad remains weak. Therefore, if the Governor and the statement represent the view of the majority on the MPC (which we believe is the case), further easing is quite possible. Especially since Belka added that the MPC did not want to "surprise themselves". Hopefully, other members of the Council will not surprise the Governor either.

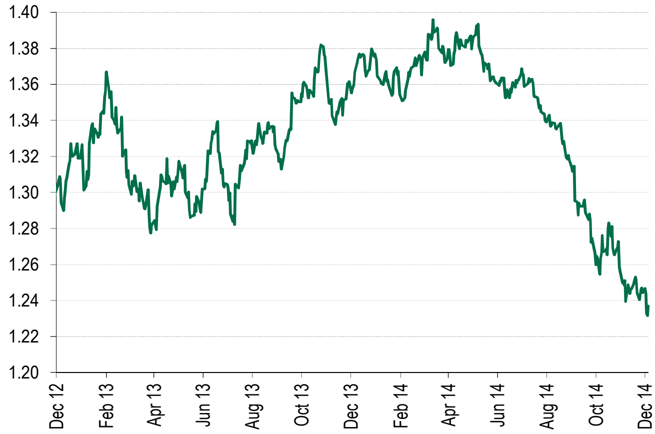
## **Foreign exchange market** – Room for further zloty strengthening

EURPLN

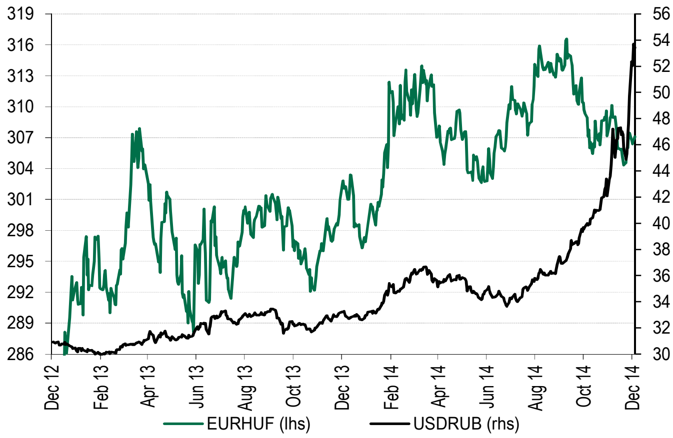
USDPLN and CHFPLN




EURUSD



EURHUF i USDRUB




### Zloty strongest against euro since July

- Poland's zloty strengthened quite noticeably over the past week, in line with our expectations. The better-than-expected PMI index and the lack of a rate cut by the MPC at its December meeting were the main drivers of its appreciation. EURPLN fell temporarily below 4.15, reaching the lowest level since July. However, its downward trend was halted by the ECB (which decided to wait with its QE programme announcement) and strong the US labour market data. As a consequence EURPLN increased above 4.16, while USDPLN towards 3.39 at the end of the week.
- In weekly terms the zloty also gained against the Swiss franc and the British pound by 0.6% and 0.2%, respectively, while it stayed more or less flat against the U.S. dollar.
- This coming week the zloty will remain under the influence of global factors, especially macro data releases from the euro zone and the U.S., as well as the results of the 2nd TLTRO, which might help the market gauge when the ECB may announce the QE programme. In our view, both macro data and the TLTRO's results should confirm the possibility of QE in the euro zone in 1Q15, supporting the zloty and other risky assets. Moreover, from the technical point of view, EURPLN broke its strong support at 4.16-4.17 and there is scope for further decline towards 4.12 in upcoming weeks.

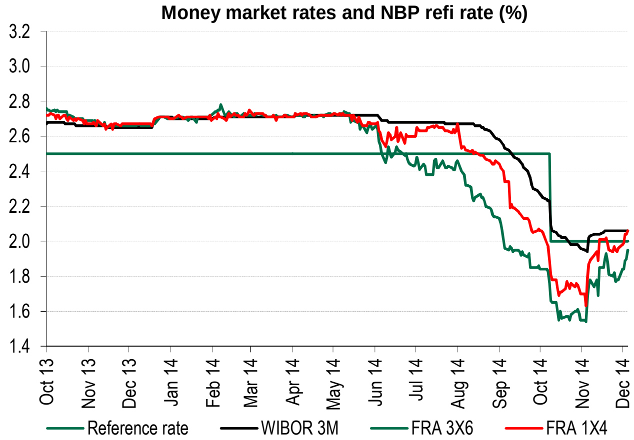
### Temporarily rebound of the euro after ECB

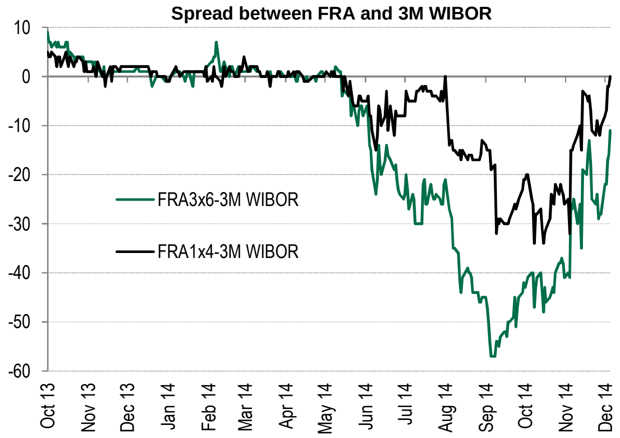
- The beginning of the week brought significant weakening of the euro as manufacturing PMIs for the biggest European economies were a bit worse than flash data had suggested. Consequently, EURUSD fell towards 1.23. The lack of the QE announcement in the euro zone by the ECB helped the euro to recover slightly, but the upward move was limited ahead of the U.S. labour market data release.
- The U.S. non-farm payrolls data pointed to improving conditions in the U.S. economy, pushing EURUSD again below 1.23 at the end of the week.
- This week may offer an impulse for further decline of EURUSD if results of the 2nd TLTRO disappoint. In such case, the ECB may have no other option but to expand its asset purchase programme at the beginning of 2015. Breaking the support level at 1.226-1.228 could open the door for further falls towards 1.20 in upcoming weeks.

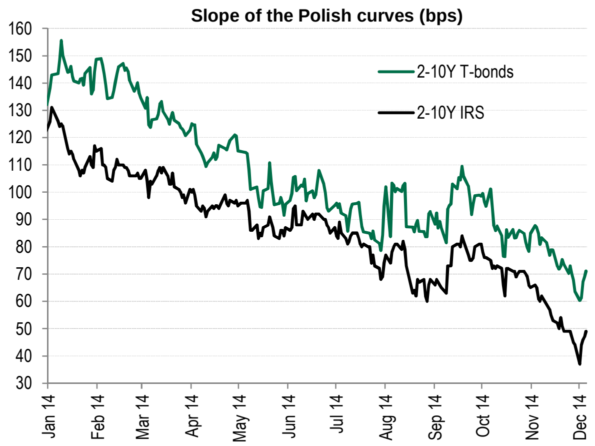
### Russian ruble keeps sinking

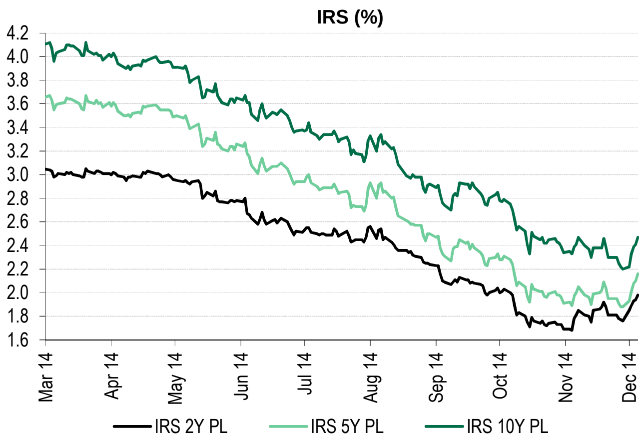
- Last week the Russian ruble remained the weakest currency in the EM universe. USDRUB surged well above 50, temporarily approaching 55. Speculation that the central bank would intervene helped the ruble rebound slightly. At the same time, the Hungarian forint and the Czech koruna slightly firmed against the euro. However, weaker-than-expected industrial output in Hungary pushed EURHUF rate again towards 307 at the end of week.
- This week investors will focus on data from the local markets, CPI for November, in particular. Prospects of a further decline in the headline figures (due to a drop in fuel prices) for both Hungary and the Czech Republic may weight on their currencies. When it comes to the, pressure from both weak macro data and declining oil prices will stabilise USDRUB at an elevated level.

## **Interest rate market** – Calm week ahead?




### PMI and Finance Ministry pushed rates up

- Short-term interest rates surged last week after the Polish PMI index showed a noticeable increase in November, despite the drop in indexes for Germany and euro zone. This release has affected market expectations on the monetary policy outlook not only for December but also for the coming months. The FRA market is currently pricing-in no more than a 25bp cut in 9-months' time, while back in mid- and late-November it was discounting even an 80% probability of a 50bp cut on this horizon. Since market expectations had changed already before the MPC meeting, the central bank's decision to keep rates on hold failed to trigger any market reaction.
- Positive data from Poland also pushed the short ends of the IRS and bond curves up – by 22bp and 15bp on a weekly basis, respectively. At the same time, the belly and long ends of both curves also increased, mainly triggered by news from the Finance Ministry that it would offer 5Y and 10Y benchmarks at Thursday's switch tender. At the end of the week, there was further correction , this time on the back of very strong data from the U.S. labour market. Yields and IRS in the 5Y and 10Y tenors rose roughly 24-27bp. Thus, there was also some correction in the flattening trend that has been observed recently.
- At the switch bond auction, the Ministry of Finance sold bonds worth PLN4.8bn. PLN1.6bn was raised from selling DS0725, slightly more than PLN2bn came from PS0719 and nearly PLN1.2bn from WZ0124. We estimate that slightly more than 20% of next year's borrowing needs had already been covered after this auction.

### Calm week ahead?

- There are no bigger data releases in Poland this week and the calendar abroad is also very thin. As such, investors will await fresh comments of the central bankers and watch for any hints regarding the monetary policy outlook in Poland and abroad. The outcome of the second TLTRO take-up in the euro zone may affect market expectations on the scale for the ECB's QE and, if disappointing, the TLTRO results may strengthen the debt market. In general, we expect that the interest rate market should remain roughly stable, awaiting more significant impulses.
- As the end of the year approaches, liquidity in the Polish fixed-income market usually dries up significantly. In the previous years, the final weeks of December were usually also characterized by a slightly lower volatility of yields, especially in the 5Y-10Y segment.
- However, we still believe that Polish bonds could pare at least some of their recent losses before the end of 2014. Our forecasts for CPI and industrial output growth are clearly below consensus and we think that the coming monthly releases will confirm that economic growth in Poland is slowing slightly below 3% in 4Q14. This should revive expectations for at least one more NBP rate cut. FRA1x4 and FRA3x6 are not pricing-in any rate cuts and so we see room for a decline in these rates since we expect that the MPC will cut rates by 25bp, possibly as early as in January.
- The ECB governor has also clearly indicated that more easing in the euro zone is likely in early 2015 and this should also keep rates low in the coming weeks.

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](http://www.bzwbk.pl).