Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

14 – 20 September 2015

This week's calendar is full of important data releases, but it seems that the market will be particularly waiting for the FOMC decision. The market is now pricing-in lower odds that the Fed will raise rates in September (below 50%) and many analysts have dropped their call for a September lift-off. We, however, think that a rate hike cannot be ruled out. We also think that if the Fed kept rates stable, EM currencies would gain amid a higher risk appetite. But even if there is a lift-off this month, the market could react positively if the accompanying statement suggested that further rate hikes would be slow to come and if the market took the decision as a sign of trust in economic recovery.

As regards the domestic data, we are more optimistic than most analysts on industrial output growth in August because we think that the temporary power shutdown mid-month had no significant negative impact on output. In general, decent data on production, sales and exports should increase investor optimism about Poland's economic outlook for 2H15.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (14 September)					
11:00	EZ	Industrial output	Jul	%MoM	0.2	-	-0.4
14:00	**PL**	**Current account**	**Jul**	**€m**	**-527**	**-527**	**-849**
14:00	**PL**	**Exports**	**Jul**	**€m**	**14317**	**14342**	**14 261**
14:00	**PL**	**Imports**	**Jul**	**€m**	**14212**	**14011**	**14 205**
14:00	**PL**	**Money supply**	**Aug**	**%YoY**	**8.0**	**8.0**	**8.6**
		TUESDAY (15 September)					
11:00	DE	ZEW index	Sep	pts	64.5	-	65.7
14:00	**PL**	**CPI**	**Aug**	**%YoY**	**-0.7**	**-0.8**	**-0.7**
14:30	US	Retail sales	Aug	%MoM	0.3	-	0.6
15:15	US	Industrial output	Aug	%MoM	-0.2	-	0.6
		WEDNESDAY (16 September)					
11:00	EZ	HICP	Aug	%YoY	0.2	-	0.2
14:00	**PL**	**Wages in corporate sector**	**Aug**	**%YoY**	**3.5**	**3.6**	**3.3**
14:00	**PL**	**Employment in corporate sector**	**Aug**	**%YoY**	**0.9**	**0.9**	**0.9**
14:00	**PL**	**Core inflation**	**Aug**	**%YoY**	**0.4**	**0.4**	**0.4**
14:30	US	CPI	Aug	%MoM	-0.1	-	0.1
		THURSDAY (17 September)					
14:00	**PL**	**MPC minutes**					
14:00	**PL**	**Industrial output**	**Aug**	**%YoY**	**6.2**	**7.1**	**3.8**
14:00	**PL**	**Retail sales**	**Aug**	**%YoY**	**3.5**	**4.0**	**1.2**
14:00	**PL**	**Construction and assembly output**	**Aug**	**%YoY**	**3.6**	**3.7**	**-0.1**
14:00	**PL**	**PPI**	**Aug**	**%YoY**	**-2.3**	**-1.9**	**-1.7**
14:30	US	Building permits	Aug	k	1150	-	1130
14:30	US	Initial jobless claims	week	k	1160	-	275
14:30	US	House starts	Aug	k	-	-	1206
16:00	US	Philly Fed index	Sep	pts	6.0	-	8.3
20:00	US	FOMC decision		%	0.0-0.25	-	0.0-0.25

Source: BZ WBK, Reuters, Bloomberg

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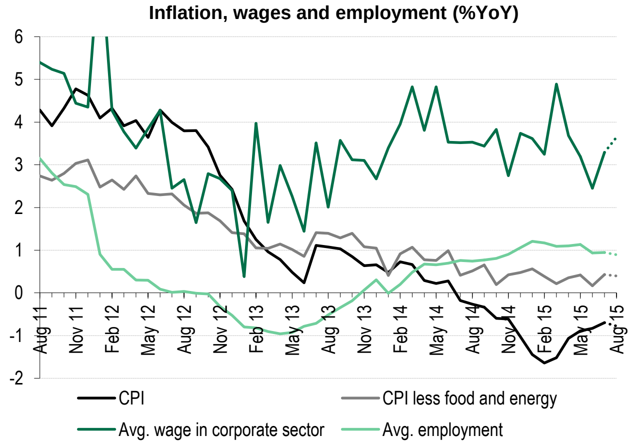
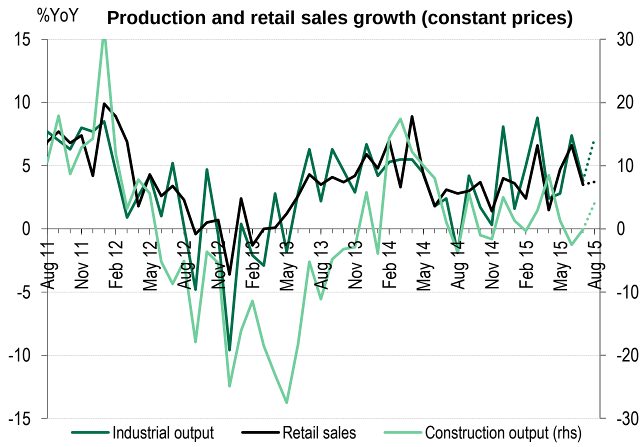
What's hot this week – Domestic macro data releases in the shadow of FOMC meeting





▪ This week will be heavy with domestic data releases, but the FOMC meeting will certainly be in the spotlight. It is still possible that the Fed will kick-start monetary tightening this this month despite the negative recommendation from both the IMF and the World Bank.

▪ At the beginning of the week, we will get to know the details of the July balance of payments. We expect to see improvement in the current account balance compared to June, mainly due to strong export growth (7%YoY) and muted rise in imports (2.4%YoY). Consequently, the trade surplus could increase to c€330mln from nearly €60mln in the previous month.

▪ We forecast that the consumer price index (CPI) fell in August -0.5%MoM and -0.8%YoY, mainly due to low food and fuel prices. Despite the severe drought, our estimates suggest that food prices fell in August -1.5%MoM, in line with the seasonal pattern. Meanwhile, fuel prices at the pump dropped -2.5%MoM. We expect core inflation excluding food and energy prices to stay at 0.4%YoY. We stick to our baseline scenario, which assumes a gradual rise in both the headline and core inflation in the upcoming months towards c+0.6%YoY and 1.1%YoY at the end of the year, respectively.

▪ In our view, data on the labour market should offer no surprises. We expect employment in the enterprise sector to rise 0.9%YoY and wages to accelerate slightly to 3.6%YoY.

▪ We are more optimistic than most analysts on industrial output growth in August because we think that the temporary power shutdown in mid-month (due to the drought) had no significant negative impact on output. We noticed that despite the shutdown, power consumption in August rose at the fastest pace YoY since 2011. As far as retail sales are concerned, we expect them to improve slightly in August. Decent production and sales data should increase investor optimism about Poland's economic outlook for 2H15.

Last week in the economy – Higher budget deficit in 2016

Main parameters of 2016 budget draft (PLNbn)

	2015 plan (1)	2015 E (2)	2016 plan (3)	change (3) / (2)
Total revenue	**297,198**	**291,423**	**296,879**	***1.9%***
Tax revenue	269,820	257,239	268,443	*4.4%*
VAT	124,262	121,000	128,370	*6.1%*
CIT	24,530	25,700	26,440	*2.9%*
PIT	44,390	44,843	46,700	*4.1%*
Non-tax revenue	25,830	32,636	26,699	*-18.2%*
Total spending	**343,278**	**337,478**	**351,499**	***4.2%***
Budget balance	**-46,080**	**-46,055**	**-54,620**	***18.6%***

▪ The government approved its preliminary budget draft for 2016, setting the deficit at PLN54.6bn (PLN8.5bn higher than this year's plan), revenues at PLN296.9bn (almost 2% higher than this year's predicted level) and spending at PLN351.5bn (up 4%).

▪ The 2016 budget draft is based on the assumption of 3.8% GDP and 1.7% inflation growth. While the latter is in line with our forecast, we are less optimistic on economic growth. Moreover, the budget's revenues include PLN3bn from this year's NBP profit, which seems to be risky since we expect zloty appreciation before year-end. The bigger deficit in 2016 (c3% of GDP) also reflects a departure from the government's fiscal consolidation path that was outlined in the Convergence Programme (which put the fiscal balance in 2016 at 2.3% of GDP). This is quite unfortunate because periods of decent economic growth should be used for fiscal consolidation, creating fiscal space for a potential reaction to more difficult times.

Quote of the week – FX loan conversion bill to be scrapped

Małgorzata Kidawa-Błońska, Sejm Speaker, 9.09, PAP

The Sejm made many amendments and I think it will be very difficult to work them out in this parliament's term (…) I think it is unrealistic in this term.

Krystyna Skowrońska, head of Sejm's public finance committee, 10.09, PAP

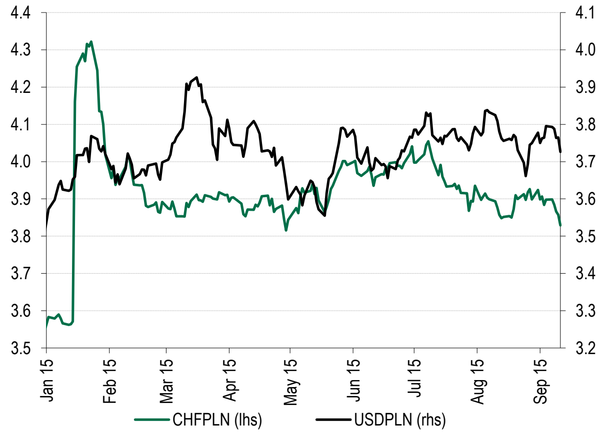
The public finance committee decided not to proceed on the Senate's version of the FX loan bill, which was to offer aid for Swiss franc borrowers, due to big controversies of constitutional nature.

It seems that, in line with our expectations, the Sejm will not continue work on the FX loan conversion bill before the elections, which means that the bill will be effectively scrapped (in line with the rule of discontinuity, unfinished bills expire when the parliament's term ends). For now, this lowers the risk that costly solutions for banks will be launched, which could also be negative for the FX market. However, it cannot be excluded that a new proposal to help the FX-indebted households will be presented to the parliament after the October elections. President Andrzej Duda's office already said it intended to work out a solution.

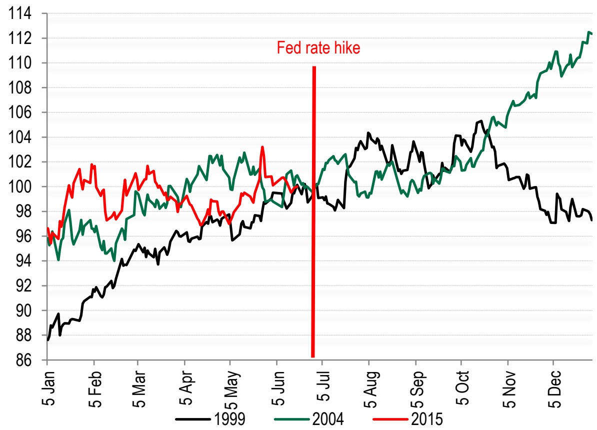
Foreign exchange market – Fed could support CEE currencies

EURPLN

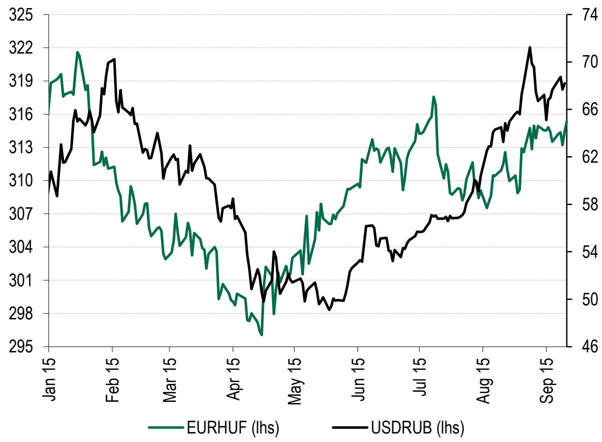
USDPLN and CHFPLN



EURUSD



EURHUF and USDRUB



FOMC crucial for the zloty…

- EUR/PLN was in its tightest weekly trading range since early July last week, hovering just above 4.20. Volatility was very low as investors were uncertain and cautious ahead of the FOMC decision. USD/PLN fell to 3.72 from 3.80 and CHF/PLN to 3.83 from 3.90 thanks to a higher EUR/USD and EUR/CHF. The zloty had pared roughly 80% of its losses suffered vs. the Swiss franc in mid-January.
- This week's calendar is full of important Polish and foreign data releases, but it seems that it is the FOMC decision that the market will be particularly waiting for. The market is now pricing-in odds of below 50% for a Fed rate hike and many analysts dropped their call for September's normalisation. But a no-hike-decision could still be a surprise to some. Interestingly, this week's decision will take place nearly exactly two years after the FOMC had decided to keep the monthly size of its QE3 bond purchases unchanged, while many had expected it to start its tapering back then. That decision was positively received by the market and risky assets gained in the months following.
- We think that if the Fed decides to postpone its rate hike, in line with calls from the IMF and the World Bank concerned about the global economy and the emerging markets, it could spur demand for risky assets as benefits from easy monetary policy could outweigh worries over global growth. On the other hand, the market could react positively even in case of a lift-off in September, if the accompanying statement suggested that the following rate hikes would be slow and if the market took the decision as a sign of trust in economic recovery. Please mind that according to the Financial Times, emerging markets central bankers have urged the Fed to raise rates sooner rather than later because they believe that this would end uncertainty and help markets recover.
- If the Fed makes a positive impact on the zloty, EUR/PLN may fall below 4.20 and near its local bottom from mid-August at 4.15.

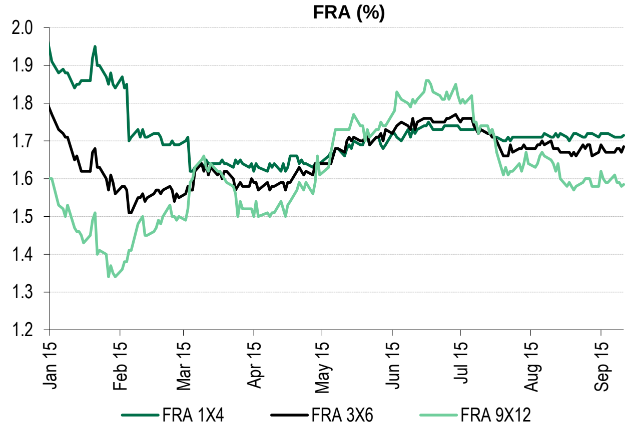
… and EUR/USD

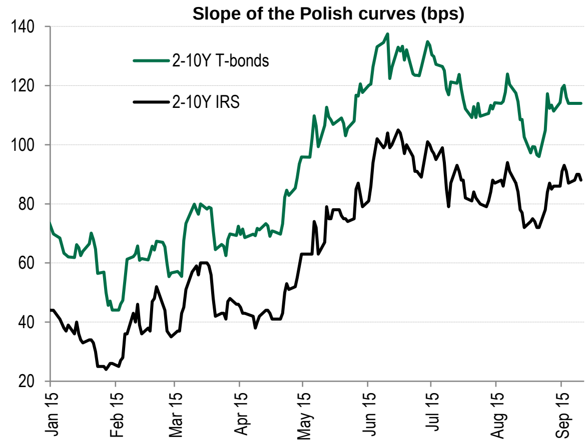
- The euro gained vs. the dollar last week and EUR/USD rose to 1.13 on market uncertainty ahead of the FOMC meeting.
- The third chart shows how EUR/USD moved for three months prior to and for six months after the first rate hike in the Fed's tightening cycle. We think that the 2004 case may shed some light on the current situation and direction that the exchange rate may follow in the coming months. In June 2004, the FOMC started its tightening cycle and interest rates rose from 1% to 5.25% just before the U.S. financial crisis. Meanwhile, the tightening cycle in the euro zone started in late 2005 and rates rose to 4.25% from 2% in the same period. The situation resembles, in our view, the current monetary policy expectations for both the U.S. and the euro zone quite well. The FOMC is expected to start raising rates already this year, with the ECB likely to stay put for the whole 2016. Past experience makes our current view of EUR/USD rising in the coming months not as controversial as one might think.

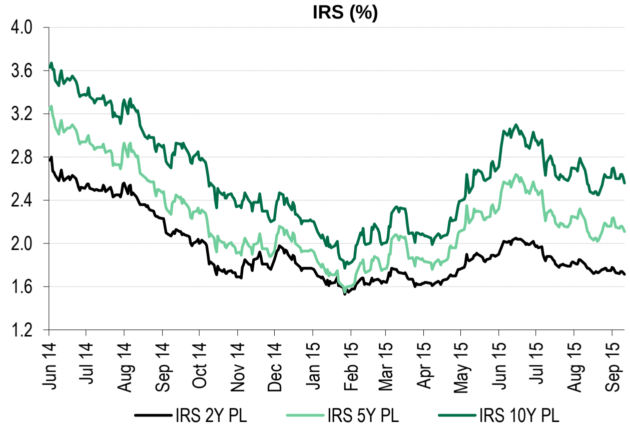
CEE currencies stable ahead of the FOMC decision

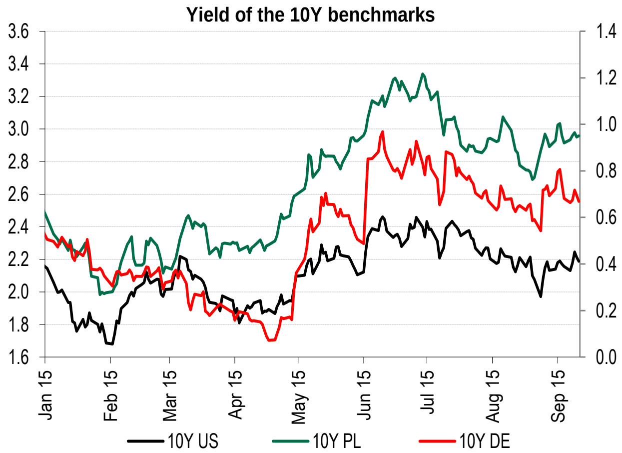
- The other CEE currencies were roughly stable this past week with EUR/HUF and USD/RUB hovering at elevated levels and EUR/CZK still flirting with the 27 floor. The head of the Czech central bank said that the bank would not abandon its current FX policy – that it was keeping EURCZK above 27 until mid-2016. He added that the floor could be in place for longer if CPI remained below expectations.
- It seems that the FOMC decision will be the main driver for the CEE region's currencies in the coming days and could determine their direction for the nearest weeks or even months.

Interest rate market – Fed to set market direction









No big changes ahead of the FOMC

- IRS stayed roughly stable and the bond curve moved 1-6bp up on a weekly basis. Concerns about Poland's higher budget deficit next year may have caused the higher debt market yields. The bond curve steepened slightly, while the 10Y asset swap spread remained close to 33bp. At the same time, the FRA curve dropped 1-3bp and so the market's pricing of the expected changes in the Polish monetary policy did not change much.
- Poland's Ministry of Finance launched long-term bonds – a WZ0126 floater and a new fixed coupon DS0726 – worth PLN3.02bn in total. Demand stood at cPLN2.4bn for the DS0726 (and the bond was priced at 3.066%) and cPLN1.4bn for the WZ0126 bond. The auction was not very successful as bids (in particular for the new DS) were relatively low compared with the ministry's previous auctions. This points to a quite fragile investor sentiment due to the approaching FOMC meeting and reflects fears about the prospects of a bigger debt supply next year (due to the higher 2016 budget deficit plan). This auction helped the ministry cover c86% of its 2015 borrowing needs.

Fed to set market direction

- This week is heavy with domestic and external events, but, in our view, the FOMC decision (due Thursday) will be in the most important, possibly overshadowing the domestic macro data releases. We believe that a rate hike by the Fed in September (which still cannot be excluded, in our view) could trigger a wave of rising yields across the global fixed-income markets. First, because investors began to bet that monetary policy normalisation could start later due to the recent turmoil in China. Second, because the lift-off in September would be a vote of confidence in the strength of the U.S. economy and may thus weaken investors' worries about the world's economic outlook. However, should the Fed's statement cool market expectations for further hikes, the market's overall reaction could be muted.
- If the Fed leaves rates unchanged in September, fixed-income markets should strengthen across the globe. This could also affect the Polish market, although we think there is risk that Polish bonds could underperform the core markets in such scenario because a no-change decision by the Fed could spur concerns about global growth and lead to an elevated risk aversion, which could hit Polish assets just like it did in late August.
- We think that macro data for August will confirm that Poland's economic growth remains healthy and faces no inflation pressure. Most of our forecasts (CPI, core inflation, retail sales) are close to market expectations, so their impact on the market should be rather neutral. On the other hand, we are more optimistic than the market on industrial production and this data could add some volatility.

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.