WEEKLY ECONOMIC UPDATE

21 – 27 September 2015

Last week FOMC's decision was the most awaited event. Fed decided to keep rates unchanged and to lower economic forecasts, and the statement was quite dovish. The market reaction shows a mixed response to the announcement. Global debt market (including the Polish one) benefited significantly from the delay in lift-off, while equity markets fell as Fed's decision renewed concerns over the global economy. Last week we have also learnt more about the Polish economic activity. Recently published data, many of which were weaker than expected (exports, industrial output, retail sales), have generated a greater uncertainty regarding Poland's economic outlook in the second half of the year, but they do not clearly imply, in our view, a clear trend of economic slowdown. We think that continuation of the economic recovery in the euro zone and positive situation on the labour market should support slight acceleration of GDP growth in 2H15. The inflation data confirmed that the headline CPI is inching up and this gradual trend will be continued in the coming months, in our view.

This week investors' focus will be on external factors as in Poland there are no key data releases scheduled. In Europe leading indicators (flash PMI, Ifo) will be the most important. We think that these data might show further improvement, confirming that the euro zone economy is on the revival path. On the other hand, further signs of slowdown in Chinese economy could hurt EM currencies, including the Polish zloty. This weekend the Greek general elections will be held. In our view, the outcome of the elections should be rather neutral as the two parties that lead the polls (New Democracy and Syriza) support the EU's bailout package and the needed reforms.

Economic calendar

CZAS W-WA	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (21 September)					
16:00	US	Home sales	Aug	m	5.50	-	5.59
		TUESDAY (22 September)					
14:00	HU	Central bank decision		%	1.35	-	1.35
		WEDNESDAY (23 September)					
3:45	CN	Flash PMI-manufacturing	Sep	pts	47.6	-	
9:30	DE	Flash PMI- manufacturing	Sep	pts	52.8	-	53.3
10:00	EZ	Flash PMI- manufacturing	Sep	pts	52.0	-	52.3
10:00	**PL**	**Unemployment rate**	**Aug**	**%**	**10.0**	**10.0**	**10.1**
		THURSDAY (24 September)					
10:00	DE	Ifo index	Sep	pts	107.9	-	108.3
11:00	**PL**	**Bond auction**					
13:00	CZ	Central bank decision		%	0.05	-	0.05
14:30	US	Durable goods orders	Aug	%MoM	-2.1	-	2.2
14:30	US	Initial jobless claims	week	k	275	-	264
16:00	US	New home sales	Aug	k	515	-	507
		FRIDAY (25 September)					
14:30	US	Final GDP	Q2	%QoQ	3.7	-	0.6
16:00	US	Michigan index	Sep	pts	86.9	-	91.9

Source: BZ WBK, Reuters, Bloomberg

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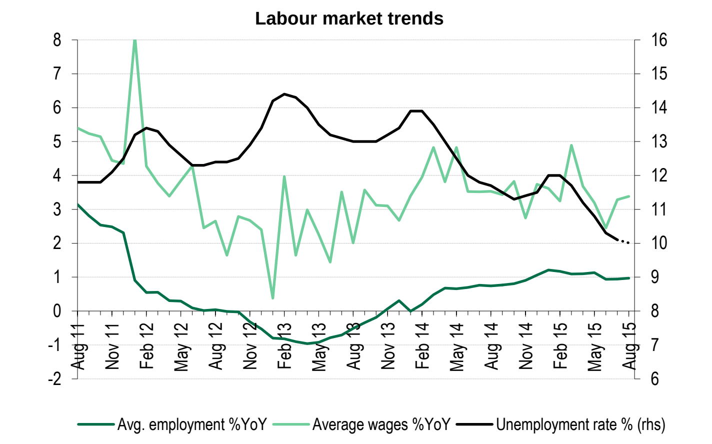
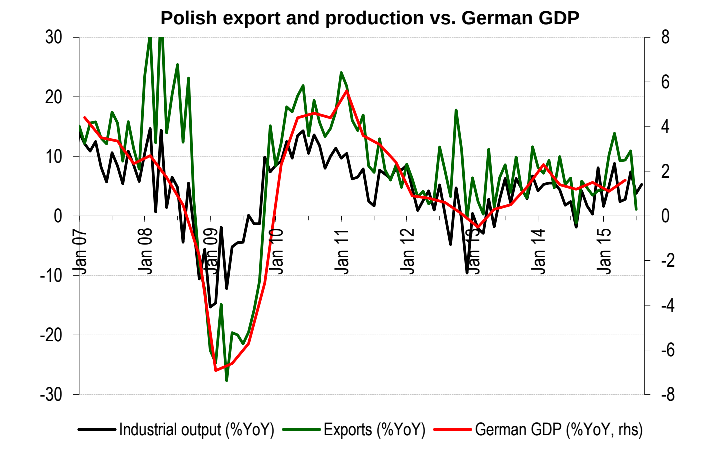
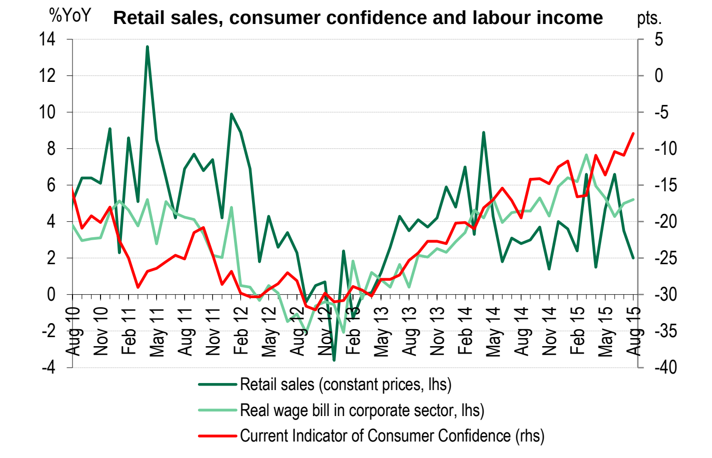
What's hot this week – Unemployment and flash PMIs



- We expect Poland's unemployment rate to slightly fall in August to 10.0% from 10.1% in July, in line with the Labour Ministry's data. In our view, the unemployment rate is likely to drop below 10% in the months to come, but it may return to the 10% level at the year-end (seasonal effect). It would be nevertheless the lowest unemployment rate in December since 2008. The continuing improvement on the labour market should keep supporting the solid growth of private consumption.
- The statistics office will release data on trade turnover in August. These data also cover small shops and it is interesting if these numbers will confirm the weak picture drawn by the retail sales data.
- September's flash PMIs for the EZ and DE will be important in the context of the weaker Polish exports and industrial output data (see below). But as long as the euro zone's economy sticks to its recovery path, Poland's growth should remain robust.

Last week in the economy – Weaker data on output, sales and exports, labour market in good shape





Trade deficit on weaker exports

- The weakening of exports (1%YoY) and robust imports (6.9%YoY) in July caused the first trade deficit this year (-€1.1bn) and a strong rise in the C/A deficit (€1.7bn). The euro zone's recovery, which we expect, should be supportive of the Polish exports, but the risk of temporary border controls in some of the EU countries poses a threat to these forecasts.

Inflation and employment above forecasts

- CPI inflation in August reached -0.6%YoY versus -0.7% in July, mainly on the back of a smaller decline of food prices (-0.7%YoY vs. -1.7%YoY in July). The drought is likely to push food prices up, however, the strength of this effect will, in our view, be moderated by cheap food imports and lower fuel prices.
- Average employment in the corporate sector rose 1.0%YoY in August, while wages rose 3.4%YoY. On a monthly basis, employment in the corporate sector rose by 5k and this was the best result since 2007. This, however, may be a one-off.

Weak industry, construction not too bad

- Industrial output grew 5.3%YoY in August, below forecasts, and its acceleration vs. July's 3.8% was mainly caused by a working day effect. It is possible that the inflow of new orders is losing strength (this was suggested by the recent PMI survey). If so, this would be negative for the economic growth prospects in the upcoming quarters. However, we do not find strong arguments to back this scenario since the euro zone's growth remains solid.
- Construction surprised to the upside in August, showing a rise of output of 4.8%YoY (strongest since April).

Hot summer bad for stores?

- Retail sales at constant prices rose 2.0%YoY in August (vs. 3.5%YoY in July), significantly below expectations. Sales of clothes and footwear, as well as furniture and electronics, disappointed. It is possible that this was a side effect of the exceptionally hot and dry summer.

Quote of the week – Rates should remain stable

Minutes from the September's MPC meeting, 17.09.2015

Certain Council members were of the opinion that in the coming months it could be justified to consider raising interest rates. In their opinion, such a scenario was supported by the prospect of increased price growth amidst probable further improvement in economic conditions. In their opinion, an interest rate hike should also be considered due to the increased risk of strong external shocks, since this would increase room for monetary easing in the event of negative shocks.

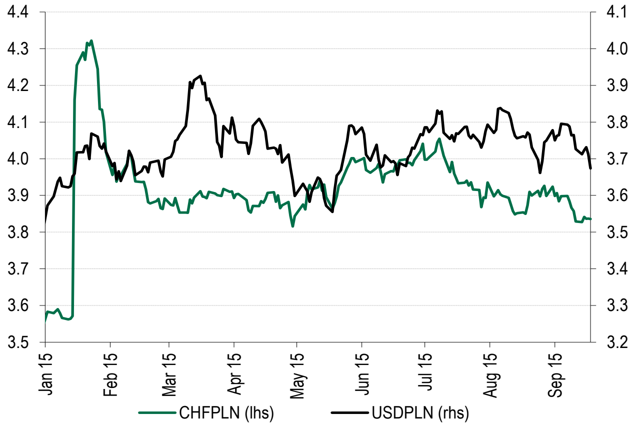
The majority of Council members pointed out that due to the possibility of a stronger economic slowdown in China and renewed fall in commodity prices, uncertainty regarding economic activity and price developments in Poland had increased and the balance of risks for economic growth and inflation had shifted downwards. These members assessed that the most likely scenario was a stabilisation of interest rates.

The MPC acknowledged the downward risk to the GDP and CPI forecasts, but the Council do not see a need to adjust rates downwards. It is quite clear that most MPC members want to keep rates unchanged until the end of the MPC's current term and a significant shock would be needed (changing the forecasted GDP/CPI path) to change this view. However, in the minutes, the MPC's member(s) proposed a rate hike. Yes, it is weird, we admit. But the justification is even trickier (see comment on the left). It goes as follows: we have strong growth and there is a risk of a strong external shock - by hiking rates we create more space to cut them in the event of sudden deterioration of the economic conditions. Well, is it not better to just keep rates on hold (at a low level) to address this balance of risks?

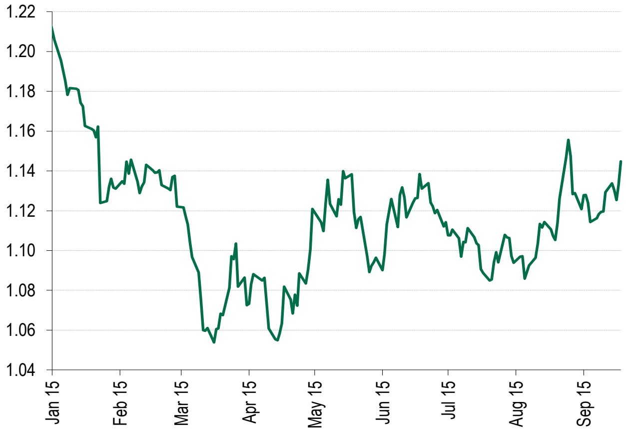
Foreign exchange market – Muted market reaction to Fed's decision

EURPLN

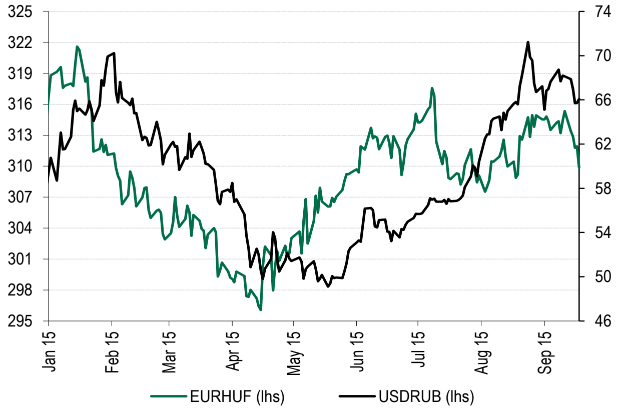
USDPLN and CHFPLN



EURUSD



EURHUF and USDRUB



Zloty remains near 4.20 against the euro

- The zloty was quite stable last week – enjoying the lowest spread between its weekly high and low since the end of June. Neither the lower-than-expected domestic industrial output and retail sales data nor the FOMC's decision to keep rates stable triggered significant fluctuations and the zloty stayed close to 4.20 against the euro.
- The zloty gained the most against the U.S. dollar (1.4%) over the past week. USDPLN temporarily fell slightly below 3.67 (four-week minimum) due to a significant EURUSD rise. As regards the other main currencies, the zloty slightly lost against the Swiss franc (0.2% on a weekly basis) and gained a touch vs. the British pound (0.2%).
- EURPLN did not change much after the FOMC meeting. As we had expected in our previous Weekly Economic Update, investor concerns over the global economy strengthened after the Fed decided not to raise rates and offered a rather dovish message.
- There will be no key readings from Poland this week, so investors will rather focus on global events, especially data on the U.S. economy and flash PMI readings for China and the euro zone countries. Further signs of a slowdown in China could result in weaker EM currencies, including Poland's zloty. If this scenario were to materialise, it could push EURPLN towards its September maximum (4.2575).

U.S. dollar hits 4-week low against the euro after Fed

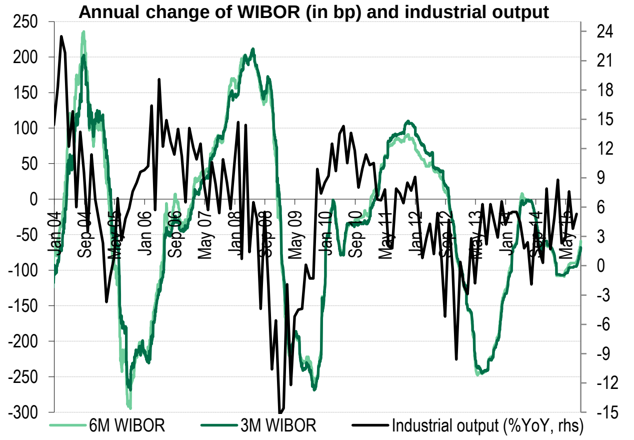
- EURUSD was quite stable ahead of the FOMC meeting. Macro data releases from Europe and USA only had a minor impact on investor sentiment. The FOMC decided to keep interest rate unchanged and cut its economic forecasts. What is more, the statement that followed the decision was unexpectedly dovish. All in all, EURUSD rose significantly, temporarily reaching 1.146 (its highest level in four weeks).
- This week investors will likely stay under the influence of the Fed's decision (in particular at the beginning of the week) and macro data releases in Europe and the U.S. In our view, the outcome of the Greek elections should be rather neutral as the two parties that lead the polls (New Democracy and Syriza) support the EU's bailout package and the needed reforms. We believe that signals of further revival of the European economy, suggested by flash PMIs, should be another supportive factor for the euro. All in all, we do not exclude the possibility that EURUSD could rise towards its maximum level of 1.17 from back in August.

Central banks' meetings in CEE

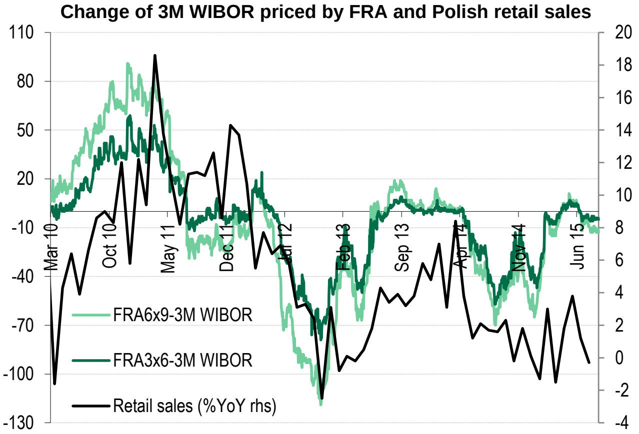
- The CEE region's currencies gained last week due to country-specific factors. Both HUF and RUB benefited the most, with EURHUF and USDRUB falling to their lowest levels since mid-August. EURHUF fell below 310, while USDRUB temporarily reached 64.8 (due to gradual increase in oil prices). After FOMC decision HUF continued to gain as investors were expecting the S&P to increase Hungary's rating outlook to positive, while RUB trimmed part of earlier gains due to profit taking. At the same time, EURCZK shifted towards 27.04 (more or less stable in weekly basis).
- The coming week's central bank meetings in Hungary and the Czech Republic will be in the spotlight. While the NBH meeting will rather be a non-event, the Czech central bank could offer more details about its monetary policy in case of renewed worries over the risk of deflation (CPI in August fell to 0.3%YoY).

Interest rate market – Fed may keep rates low

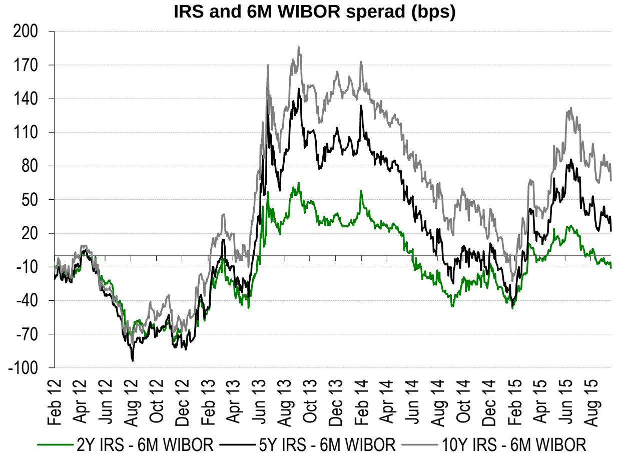
Annual change of WIBOR (in bp) and industrial output



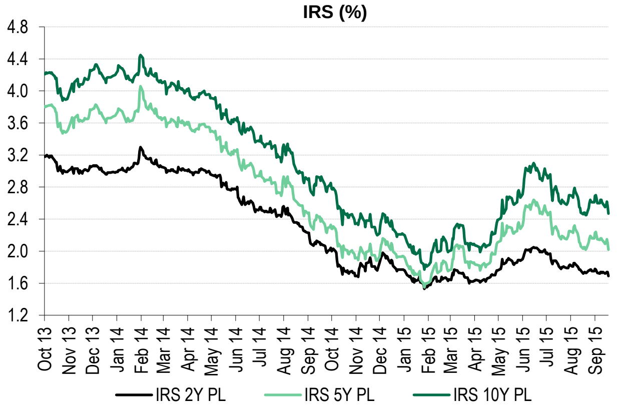
Change of 3M WIBOR priced by FRA and Polish retail sales



IRS and 6M WIBOR sperad (bps)



IRS (%)



Fed pushed rates down…

- Poland's FI market was roughly stable for the better part of the week as investors awaited the outcome of the FOMC meeting. The Fed's decision to leave rates unchanged and its quite dovish statement triggered – just like we had expected – a sharp drop in rates worldwide. Poland's debt was outperforming and this might have been due to the clearly below-consensus data released earlier in the week, which neutralized the negative effects of the growing worries about global growth.
- On a weekly basis, the bond curve fell 8-10bp and the IRS 5-12bp, on their long ends the most.
- There was also a noticeable drop on the longer FRAs. The dovish outcome of the FOMC meeting, as well as Poland's weak macro data, further strengthened market expectations for more easing by the MPC (raising the probability of a 25bp cut in 9-12 months at 60% from 50%). Furthermore, the market not does not expect a rate hike in the next 21 months (vs. 65% odds for a 25bp hike just before the FOMC's decision).

… and its rhetoric could continue to support the Polish market

- Last week offered the Polish interest rate market a substantial amount of information on the domestic economy and U.S. monetary policy. We could say that both the internal and external factors combined into a rather coherent, dovish message, which may continue to support Polish debt, at least at the start of the week. Some FOMC members are also due to speak this week (including Janet Yellen) and it is hard to expect that they could change their minds over the weekend and make very hawkish comments.
- Greece's parliamentary elections are scheduled for the weekend, but we do not expect this factor to weigh on the global market sentiment.
- However, we see a risk of some profit-taking this week on the short-end and belly of the curve. On Tuesday, the Finance Ministry will announce its bond offer for Thursday's auction. Earlier this month, the Ministry sold long-term debt and so it could now issue short- and mid-term series. As regards the belly, the Ministry could offer a new 5Y fixed coupon benchmark or an on-the-run mid-term floater (like WZ0120). According to the initial plan, the auction's total supply should amount to PLN2-6bn.
- As regards global data, flash manufacturing PMIs and U.S. macro data could trigger some volatility on the long ends of the curves. Fed's Yellen stressed that the shaky global market sentiment was one of the factors that prevented the FOMC from raising rates this month and so the important figures due in the coming days may initiate noticeable swings in investor sentiment.

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.