Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

28 September – 4 October 2015

Last week's VW scandal further undermined the global market sentiment, which was already under pressure from worries about the world's economic outlook. Thus, even though the U.S. and euro zone's recent data releases were not that bad, risk aversion remained elevated and investors cautious. Data from Poland confirmed that its labour market was in very good shape in August and retail trade was growing at a healthy rate. The Eurostat unemployment data, due this week, should confirm, in our view, that the seasonally adjusted jobless rate continues to fall, approaching its all-time low, and that demand for new jobs is rising. Still, the CSO business climate indicators for Poland fell across all sectors in September, together with consumer confidence, and it will be interesting to see if other surveys to be released in the coming days will follow suit. We think the manufacturing PMI should rebound in September after posting a sharp slump in August. One day before the PMI, the European Commission will release its Economic Confidence Index, with correlates quite well with the Polish GDP, and, thus, should offer an interesting hint on Poland's economic activity in 3Q15 (although its significance for the market is limited).

Poland will release a flash CPI for the first time ever this week. We expect the inflation rate to have dropped slightly in September as rising food prices were offset by a slump in fuel prices and lower gas tariffs. A lower CPI (even though temporary, in our view) may additionally boost market speculations about possible interest rate cuts, driving the Polish bond yields even lower. Investors will stay focused on the global factors, especially data from the U.S. Any sign that the U.S. economy could be weakening, even slightly, would support the view that the first rate hikes should take place in early 2016. On the other hand, strong readings from the U.S. labour market may increase odds of a Fed lift-off this year and decrease risk aversion.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (28 September)					
14:30	US	Personal income	Aug	%MoM	0.4	-	0.4
14:30	US	Consumer spending	Aug	%MoM	0.3	-	0.3
16:00	US	Pending home sales	Aug	%MoM	0.4	-	0.5
		TUESDAY (29 September)					
16:00	US	Consumer confidence index	Sep	pts	96.0	-	101.5
		WEDNESDAY (30 September)					
9:00	CZ	GDP	Q2	%YoY	4.4	-	2.4
11:00	EZ	Flash HICP	Sep	%YoY	0.0	-	0.2
14:00	**PL**	**Flash CPI**	**Sep**	**%YoY**	**-0.6**	**-0.7**	**-0.6**
14:00	**PL**	**Current account**	**Q2**	**€m**	**-**	**1 505**	**1 648**
14:00	**PL**	**Inflation expectations**	**Sep**	**%YoY**	**-**	**-**	**0.2**
14:15	US	ADP report	Sep	k	188	-	190
		THURSDAY (1 October)					
3:45	CN	PMI – manufacturing	Sep	pts	47.0	-	47.3
9:00	**PL**	**PMI – manufacturing**	**Sep**	**pts**	**51.9**	**52.5**	**51.1**
9:55	DE	PMI – manufacturing	Sep	pts	52.5	-	53.3
10:00	EZ	PMI – manufacturing	Sep	pts	52.0	-	52.3
14:30	US	Initial jobless claims	week	k	-	-	267
16:00	US	ISM – manufacturing	Sep	pts	50.6	-	51.1
		FRIDAY (2 October)					
14:30	US	Non-farm payrolls	Sep	k	200	-	173
14:30	US	Unemployment rate	Sep	%	5.1	-	5.1

Source: BZ WBK, Reuters, Bloomberg

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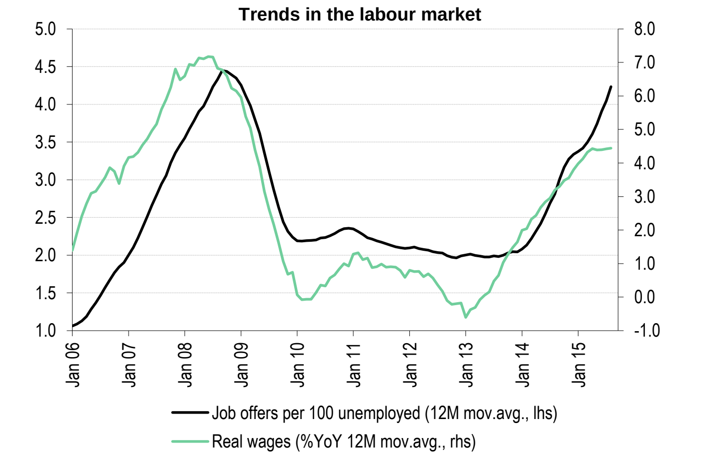
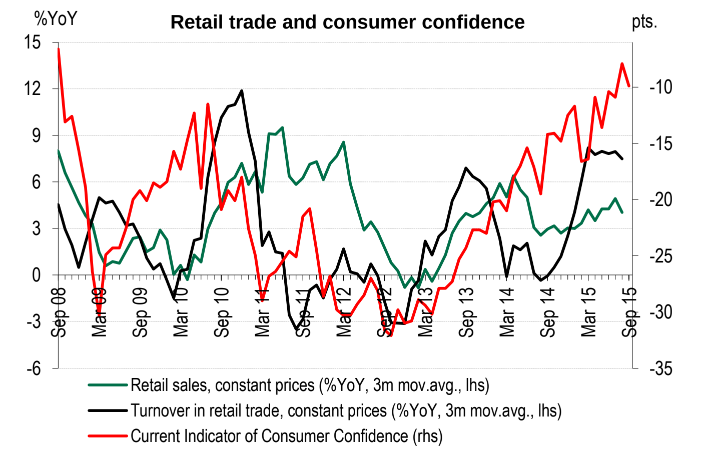
What's hot this week – Flash CPI, final PMIs

▪ Poland will release a flash CPI for the first time ever this week. We expect the inflation rate to have dropped slightly in September (to -0.7%YoY) as rising food prices (fuelled by a drought) were offset by a slump in fuel prices (which fell 5%MoM, according to our estimate) and lower gas tariffs (which were more than 4% lower for retail clients).

▪ We think that the Polish manufacturing PMI rebounded in September and that its deterioration in August was probably exacerbated by temporary power shutdowns. EU's business activity is still decent, which (together with the quite weak zloty) should support sentiment in the Polish industry. According to the CSO, the inflow of new orders rose in August by 7.6% YoY (the fastest since end-2014), mainly due to a rebound in export orders (11.2% YoY). On the other hand, the CSO manufacturing climate index fell in September to a one-year low. It is not, however, a good PMI predictor.

Last week in the economy – Solid labour market and retail sales





▪ The registered unemployment rate fell in August to 10%. The number of the unemployed fell to 1.56 million, the lowest level since late 2008 (and c.290k lower than last year). At the same time, the number of new job offers reached 119k and was more than 26% higher than last year. The data confirm, in our view, that the situation on the labour market keeps improving and it seems very likely that the unemployment rate could drop in September to a single-digit level.

▪ We think that Eurostat's unemployment data (based on the Labour Force Survey), to be released on Wednesday, should confirm these positive trends on the labour market.

▪ The ratio of the number of job offers to the number of the unemployed has been growing steadily for a number of months, and, in our view, should trigger a growing pressure on real wages. This, in turn, will support healthy growth of consumption demand and further improvement in consumer confidence, which should continue to improve in the coming months despite the slight drop in September.

▪ The volume of retail trade (which, in contrast to retail sales, includes data from small shops but omits car sales) rose in August by 6.3% YoY in constant prices (versus 5.8% YoY in July). Thus, the data failed to confirm a clear slowdown, which affected retail sales (2% YoY in constant prices in August, versus 3.5% YoY in July). In our view, this seems to confirm that the weaker retail sales reading was probably caused by the exceptionally good weather at the peak of the summer holiday season – people travelled, causing a temporary decline in big shopping malls' sales, while the overall trade volume remained decent.

Quote of the week – A step towards better Poland (not!)

Andrzej Duda, Poland's President, 21.09.2015, PAP

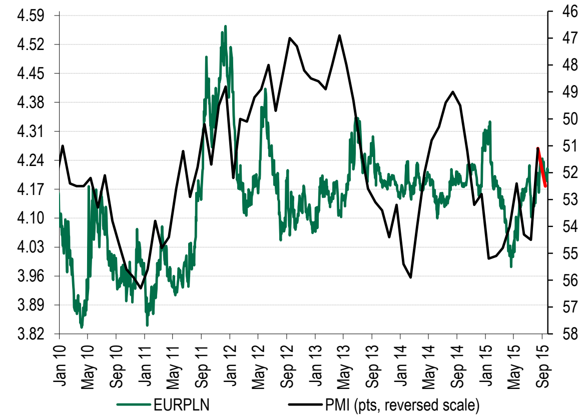
This bill reverses the retirement age back to 60 for women and 65 for men. I believe this is a step towards better Poland.

I hope that this bill will be approved already in this parliament's term. (…) If not, I will not give up and the bill will be submitted in the next parliament's term, when there will be a new ruling coalition.

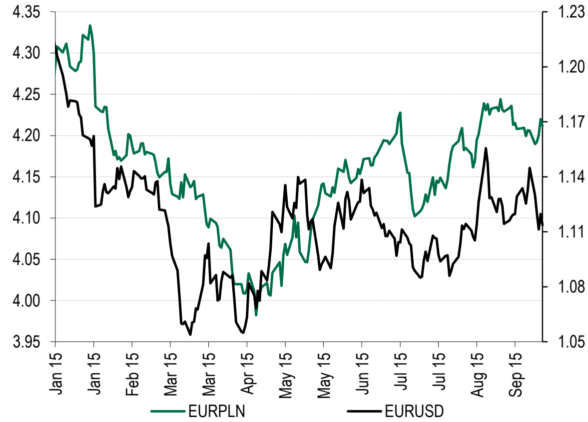
The President proposed a bill that lowers the retirement age back to 65 years for men and 60 for women. Contrary to earlier speculations, the bill does not introduce a minimum number of years that a person must pay pension contributions to be eligible retirement. We think this is a very bad idea, which, if implemented, would be very costly for the economy. And not only because of the short-term costs for the budget (we estimate that the bill's introduction at the start of 2016 would increase the number of pensioners by 300k and would cost the budget c.PLN10bn annually), but, more importantly, because it could impede Poland's long-term economic growth potential, exacerbating problems with its declining working age population. The unemployment rate is already near its all-time low and companies are struggling to find skilled employees. These problems would only grow in time due to the demographic trends.

Foreign exchange market – Will U.S. data trigger higher volatility?

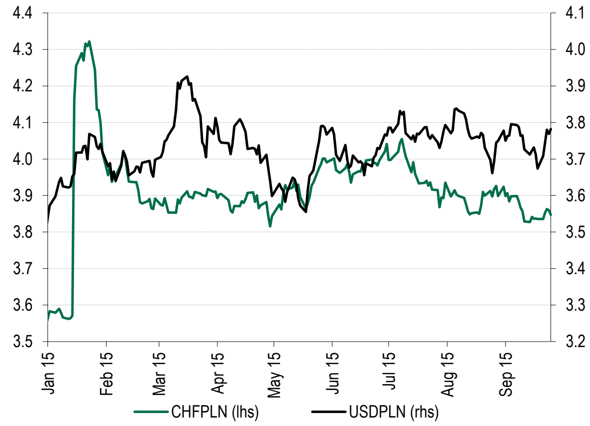
EURPLN and Polish PMI



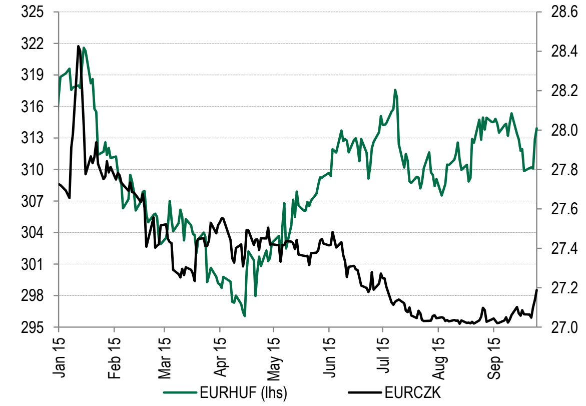
EURPLN and EURUSD



USDPLN and CHFPLN



EURHUF and EURCZK



Zloty slightly weaker vs. euro and dollar

- The zloty has now lost more than half its gains vs. the euro since mid-August. EUR/PLN rose temporarily above 4.23 from 4.18 on lower risk appetite fueled by the Volkswagen scandal. The Polish unit also lost vs. the dollar – rising to 3.78 from 3.75.
- If EURP/PLN stays within the 4.18-4.26 range until Wednesday, September's high-low spread will be the lowest monthly spread since November 2014. EUR/PLN was even more volatile in the June-August period. Other CEE currencies and EUR/USD are also recording their monthly ranges at multi-month lows. It seems that uncertainty about the timing of the Fed's rate hike may be curbing volatility. What is more, uncertainty about the outcome of Poland's parliamentary elections could be weighing on the zloty.
- We think that the U.S. nonfarm payrolls data due this week may trigger a bit higher market volatility. EUR/PLN and EUR/USD are trending in the same direction this year and when U.S. data are strong – bringing the Fed's rate hike seemingly closer and supporting the dollar vs. the euro – the zloty gains vs. the single currency on diminishing worries about the global economy. We expect to see a rebound in Poland's PMI in September, which could improve sentiment after the rather disappointing macro data of late. September's high (4.26) and low (4.18) are the important levels for EURPLN.

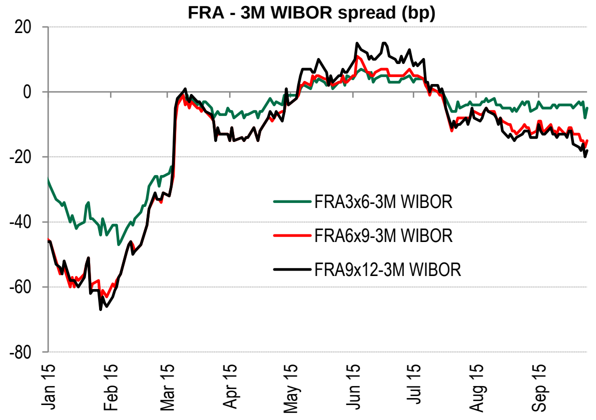
EUR/USD close to local low

- EUR/USD was hovering above September's 1.108 low in the past week. The euro was gaining during the risk aversion waves on the global market, but room for appreciation was limited by Janet Yellen's hawkish comment.
- The U.S. monthly labour market data are due this week. The previous release was a mixed bag as the rise in nonfarm payrolls disappointed, but there was a substantial upward revision of the July number. The unemployment rate fell and hourly earnings rose more than anticipated. Despite the poor August nonfarm payrolls, the FOMC said in September, after it had left rates unchanged, that "the labour market continued to improve, with solid job gains". We think that should the monthly number of the new nonfarm payrolls stay close to 200k in September, the dollar could gain and EUR/USD could test 1.108-1.10. The next support at 1.085-1.08.

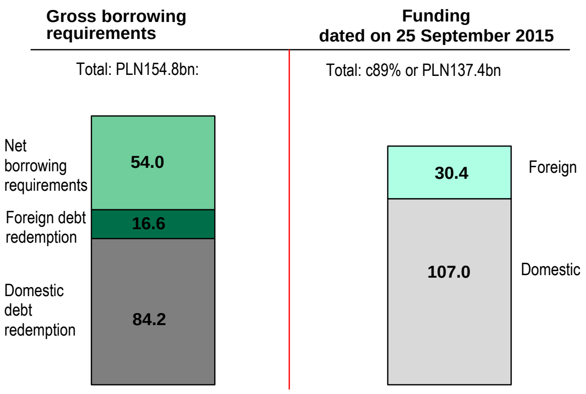
Koruna, forint weaker after CB meetings

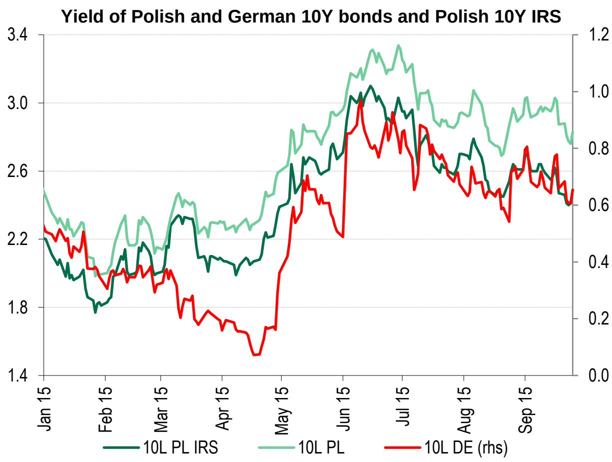
- The Czech central bank left rates unchanged and the governor said the bank had discussed extending the EUR/CZK floor in time but that no decisions were taken so far as there was still much time to consider such a move. The current floor is to stay until mid-2016. Singer also said the bank discussed negative interest rates, but agreed that the current situation and economic outlook did not justify them this month. EUR/CZK jumped temporarily to 27.3 (its highest since early July) and, thanks to the dovish hints from the central bank and global risk aversion, the weekly jump was the highest since mid-March.
- Hungary's central bank also left rates unchanged, as expected. The new central bank's forecasts assume that the 3% inflation target will not be reached before 2017, so interest rates are likely to stay low for longer than previously expected. Two days after this decision, the Hungarian central bank moved the interest rate corridor around its refi rate cutting its deposit and credit rates by 25bp. This decision is expected to provide more incentive for commercial banks to buy Hungarian government debt. Bonds reacted positively to the move, but the forint obviously did not like it – EUR/HUF rose to 315 from 311.

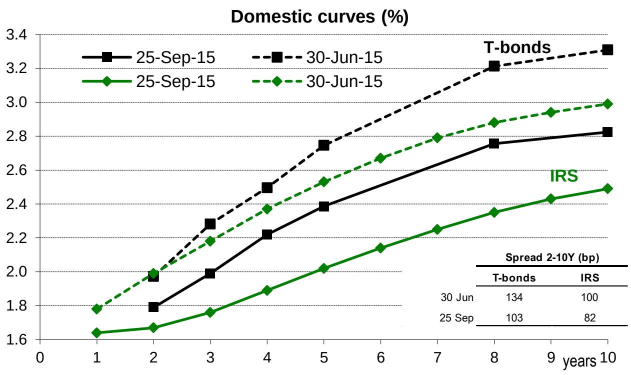
Interest rate market – Lower CPI, uncertain growth outlook may support bonds



The 2015 gross borrowing needs and its financing







Correction after strong rally

- Poland's bonds gained for most of last week. The downward trend was supported, among others, by further decline in yields on the core debt markets as investors were betting that the Fed would start its rate hikes in 1Q 2016. The market also drew support from a successful domestic debt auction. However, the end of the week brought a correction spurred by a speech of the Fed's governor. Janet Yellen reiterated that a rise in the Fed's rates was still very likely later this year, though economic surprises could cause a delay. As a consequence, the 10Y benchmark yield climbed temporarily to 2.84%, up from nearly 2.75% (September's minimum level).
- Domestic T-bonds performed better than IRS this past week and, as a consequence, the asset swap spread narrowed quite visibly, in particular on the 10Y sector. In weekly terms, both curves flattened with their long-ends benefitting the most from the situation on the core markets.
- Money market rates also fell significantly over the past week. Expectations for another rate cut by the MPC strengthened and the market currently sees the odds for a 25 bps rate cut in 6 months' time at nearly 70%.
- Poland's Ministry of Finance successfully launched short- and medium-term bonds on the primary market. It sold OK0717 and PS0420 bonds worth PLN7.1bn in total (at both the regular and top-up tenders). The recorded bids mainly focused on the 5Y benchmark (demand exceeded PLN13bn in total) and, in our view, were generated mostly by foreign investors. Consequently, the PS0420 paper was purchased at a higher price than on the secondary market. We estimate that the Finance Ministry has now covered 89% of its 2015 gross borrowing needs.

Issue plan, macro data in spotlight

- This week is relatively heavy with macro data releases, including Poland's first flash CPI, PMI indicators and non-farm payrolls data in USA. In our view, a slightly lower flash CPI for September may additionally fuel market speculation about interest rate cuts, driving bond yields even lower (at least in the short run). We think PMI should be less relevant for the market and that its rebound, after the sharp slump in August, is unlikely to trigger a major reaction. Investors will stay focused on the global factors, especially data from the U.S. Any sign that the U.S. economy could be weakening, even slightly, would support the view that the first rate hikes should take place in early 2016. In such a case, further strengthening of the core market would also support Poland's debt and could push yields down towards their minimum levels from September. On the other hand, strong readings from the U.S. labour market may trigger a notable correction if the market believes that the Fed's lift-off is realistic this year.
- This week investors will get to see the 4Q 2015 bond issue plan, including details about October's offer. In our view, supply at the October-December auctions will be high as the Ministry plans to end financing this year's borrowing needs at the end of next month, which we think is realistic. Auction results in the upcoming months will likely be supported by significant inflows from the DS1015 redemption (PLN22.4bn) and interest payments from October's series of PS and DS worth of PLN7.72bn in total. High supply in the last quarter of 2015 could limit the room for deeper falls in yields.
- The end of 3Q15 could favour the "window dressing" effect on the Polish debt market. We, therefore, think that the current correction should not be deep. Yields and IRS rates are now 15 – 60 bp lower than at the end of June.

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.