Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

12 – 18 October 2015

Last week's central bank meetings offered no changes in monetary conditions. Poland's MPC left the reference rate at its historical low of 1.50% and confirmed that there was no room for noticeable modifications in its monetary policy. It also reiterated that there was no such room even after the current MPC's term will end. However, investor sentiment was positive last week as macro data releases and the tone of the FOMC minutes fuelled expectations that the Fed would not raise rates this year. The Polish zloty and its CEE peers firmed quite visibly on a weekly basis on rising appetite for risky assets. At the same time, investors decided to take profit on the debt markets globally following the strong rally that was triggered by September's weak non-farm payrolls data.

This week's calendar is filled with external and domestic events. Investors will focus on U.S. macro data and speeches by FOMC members, watching out for clues on the timing of the first rate hike by the Fed. Data from China (foreign trade and inflation) will also be eyed in the context of the Fed's monetary policy. Data about the euro zone's real economy (mainly industrial production for August) could also be interesting after a series of weak data from Germany. On the domestic side, we will get to see the balance of payments, the final September CPI reading, core inflation measures and labour market data. We believe that the August C/A could be the most important. Our forecast is above the market consensus and the numbers should confirm decent growth of Poland's economic activity. This release could, therefore, provide some support for the zloty, but room for its strengthening may, however, be limited by uncertainty ahead of Poland's parliamentary elections. Positive signs from the domestic real economy might cause the upward move on both the bond and IRS markets to continue.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (12 October)					
	US	Market holiday					
		TUESDAY (13 October)					
11:00	DE	ZEW index	Sep	pts	65.8	-	67.5
		WEDNESDAY (14 October)					
11:00	EZ	Industrial output	Aug	%MoM	-0.5	-	0.6
14:00	**PL**	**Current account**	**Aug**	**€m**	**-1 205**	**-767**	**-1 660**
14:00	**PL**	**Exports**	**Aug**	**€m**	**12 192**	**12 637**	**13 552**
14:00	**PL**	**Imports**	**Aug**	**€m**	**12 772**	**12 721**	**14 623**
14:00	**PL**	**Money supply**	**Sep**	**%YoY**	**7.6**	**7.7**	**7.3**
14:30	US	Retail sales	Sep	%MoM	0.2	-	0.2
20:00	US	Fed Beige Book					
		THURSDAY (15 October)					
14:00	**PL**	**CPI**	**Sep**	**%YoY**	**-**	**-0.8**	**-0.6**
14:30	US	CPI	Sep	%MoM	-0.2	-	-0.1
14:30	US	Initial jobless claims	week	k	-	-	263
16:00	US	Philly Fed index	Oct	pts	-2.0	-	-6.0
		FRIDAY (16 October)					
11:00	EZ	HICP	Sep	%YoY	-0.1	-	0.1
14:00	**PL**	**Wages in corporate sector**	**Sep**	**%YoY**	**3.5**	**3.3**	**3.4**
14:00	**PL**	**Employment in corporate sector**	**Sep**	**%YoY**	**1.0**	**1.0**	**1.0**
14:00	**PL**	**Core inflation**	**Sep**	**%YoY**	**0.4**	**0.5**	**0.4**
15:15	US	Industrial output	Sep	%MoM	-0.2	-	-0.4
16:00	US	Flash Michigan	Oct	pts	88.5	-	87.2

Source: BZ WBK, Reuters, Bloomberg

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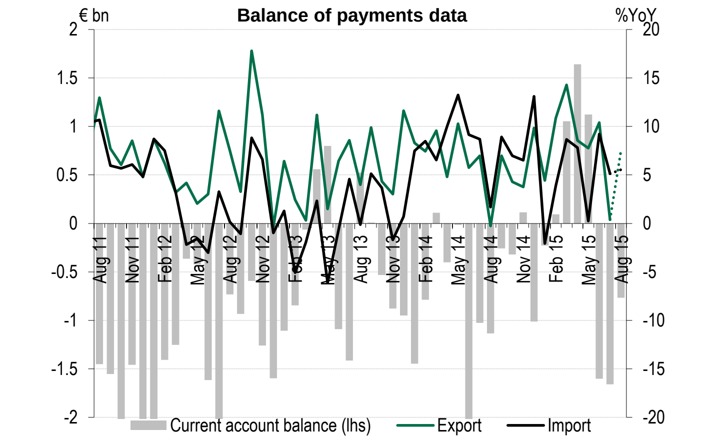
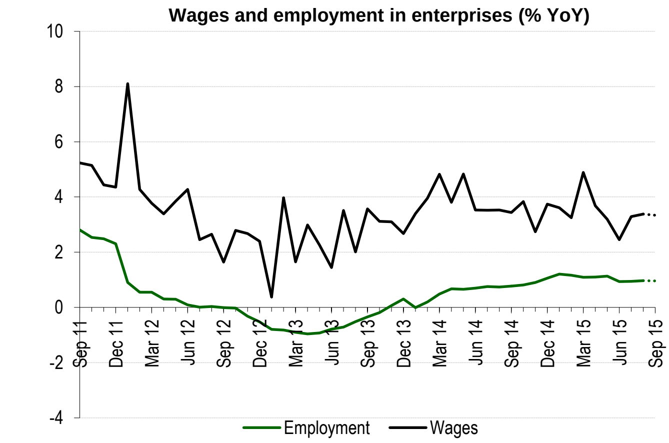
What's hot this week – Balance of payments more important than CPI?

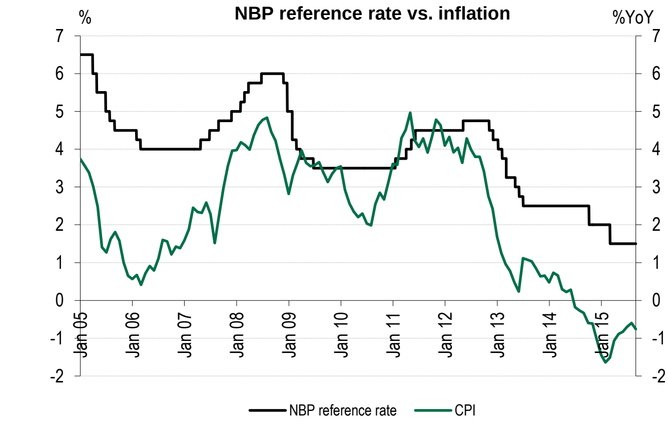


- We expect export growth to rebound in August, mainly due to a very low base effect. This means that the current account and trade deficits should be much smaller than in July. However, the reading is subject to a higher forecast error than usually since (1) the NBP has recently changed its methodology (e.g. by including illegal trade) and (2) changes in the VAT regime from July will continue to undermine mobile phone exports (though this is difficult to estimate). The recent disappointing data on German production and exports also raise uncertainty about the Polish trade data.
- CPI for September may be less important than it usually is because of the already known flash estimate at -0.8%YoY. So only a revision could cause a bigger market reaction. We see higher odds for an upward rather than a downward revision, if any. We expect core inflation excluding food and energy prices at 0.5%YoY, marginally up vs. August. We see CPI inflation approaching +0.5%YoY and core inflation reaching 1.0%YoY at the year-end.



- In our view, labour market data should stay strong in September, with employment growth at 1.0%YoY and wage growth at 3.3%YoY. August's employment surprised to the upside, but this was due to a jump in only one sector (administrative and support service activities) and we think that it was a one-off, unlikely to fuel additional acceleration later in the year. We actually even expect some deceleration given the fact that the market may be running out of workers.
- We expect the M3 money supply growth rate at 7.7% in September, which should, most probably, show acceleration of deposits and loans.
- In general, we expect the domestic data due for release this week to be less important than the publications and events abroad, which could affect market expectations about the timing of the Fed's rate hike and the global economic outlook.

Last week in the economy – Interest rates unchanged



- The Monetary Policy Council once again kept interest rates on hold (the reference rate remains at 1.5%). In line with what we had expected, the recent data did not change the central bank's economic outlook and the NBP still expects inflation to rise and the pace of economic growth to remain stable and solid (with the output gap gradually closing).
- The central bank's governor, Marek Belka, said that there was no room for noticeable monetary policy modifications and that there should be no such room once the current MPC's term ends either. The most dovish Council member, Jerzy Osiatyński (the only member to stay on the council next year) suggested that he did not see a reason to cut rates since effectiveness of such a move would be very low.
- In our view it is very likely for the monetary policy to remain unchanged until the end of the current Council's term.

Quote of the week – Effectiveness of rate cuts would be low

Marek Belka, NBP governor, 06.10.2015, MPC conference
Let us first see the new MPC's makeup, but I do not think that monetary policy would be modified significantly. We are not guided by monthly data, we look at a longer horizon; the GDP forecast is quite stable – and we will see the new forecast next month. The external situation is the main source of uncertainty about growth in Poland.

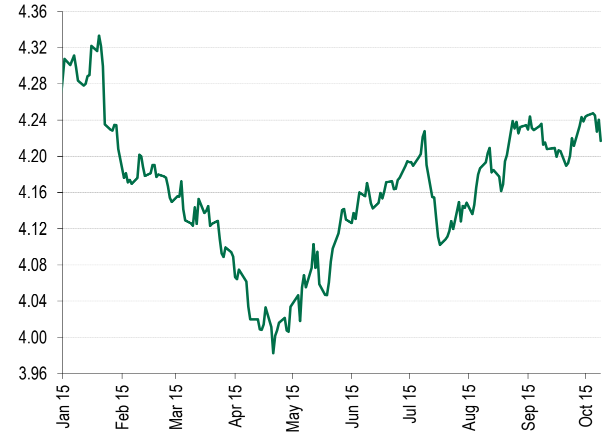
Jerzy Osiatyński, MPC member, 06.10.2015, MPC conference
The growth path is stable, with an upward rather than downward outlook. The only uncertainty concerns public consumption (new EU funds' absorption). Effectiveness [of monetary policy moves] would be low, so reasons for cutting rates are dubious.

Anna Zielińska-Głębocka, MPC member, 06.10.2015, MPC conference
Our monetary policy has not caused any imbalances, so it was effective.

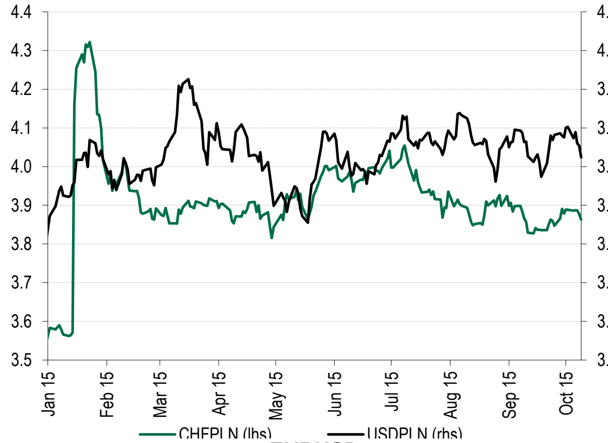
The two MPC members, who will remain in office the longest (Belka until mid-2016 and Osiatyński till the end of 2019) are clearly not eager to change rates, as the economic growth rate is healthy and close to its potential. At the same time, they expect inflation to rise. We share this view and guess that Belka and Osiatynski would not back lower rates in 2016, which are currently priced-in by the market. However, they point out there is uncertainty about the external environment, so we think only a massive shock from abroad (like economic slowdown in China) could make them change their minds. Nevertheless, we still know nothing about the possible candidates for the new MPC and it is their views that will be crucial for the bank's monetary policy.

Foreign exchange market – Zloty and CEE peers supported by delayed U.S. rate hikes

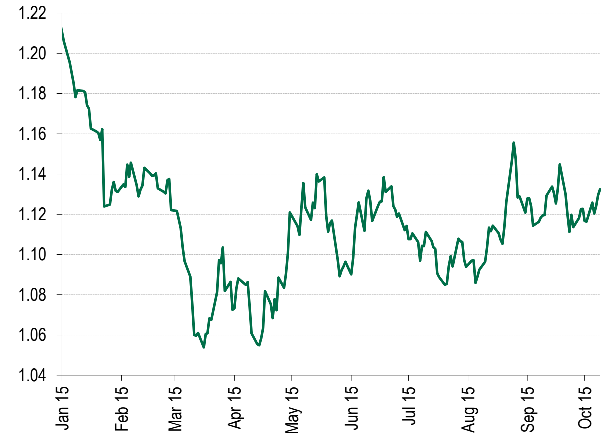
EURPLN



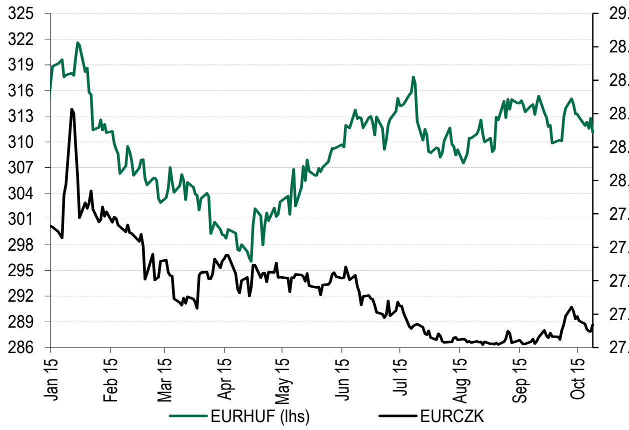
USDPLN and CHFPLN



EURUSD



EURHUF and EURCZK



Zloty still stable

- There were no breaking changes on the Polish FX market last week and just like we had expected, EUR/PLN stayed within the 4.18-4.26 range, hovering close to the upper boundary. However, the end of the week brought some strengthening of the zloty as the FOMC minutes suggested that the Fed would be in no rush to hike rates. As a result, EUR/PLN fell temporarily below 4.21, the strongest level this month. On a weekly basis, the domestic currency strengthened vs. other major currencies, by the most against the US dollar (by 2.1%).
- September's high-low spread for EUR/PLN at cPLN0.08 was the smallest monthly spread since November 2014. As we wrote two weeks ago, the zloty's CEE peers and EUR/USD are also recording monthly ranges at multi-month lows. Periods of low volatility quite often end very abruptly and usually precede a drop in demand for riskier assets. It is hard to guess when volatility will rise substantially again, but uncertainty ahead of Poland's general election (October 25) and before the FOMC meeting (October 28) may be the trigger. However, we think that even if the zloty depreciated sharply vs. the euro in the near future, this would only be temporary.
- There are important U.S. data on the agenda this week. Some FOMC members are also due to speak in public. This means that market anticipations of the timing of the Fed's first rate hike could be the main driver of the global market mood. Turning to Polish data, we think that the August C/A could be the most important. Our forecast is above the market consensus and so we expect this release to provide some support for the zloty, particularly after the disappointing July numbers. Room for strengthening may, however, be limited by uncertainty ahead of the Polish parliamentary elections.

EUR/USD touch higher despite weak data from Germany

- This week's EUR/USD trading range was the narrowest since December 2014 and the exchange rate stayed close to 1.117-1.135 despite a series of disappointing German macro data releases. Room for euro depreciation might have been limited by the last U.S. monthly non-farm payrolls that delayed the Fed's rate hike and weighed on the dollar. The FOMC minutes, reaffirming the dovish tone of the Fed, pushed EUR/USD towards the upper limit of the range.
- We expect volatility to rise this week as several important U.S. data are due and many FOMC members are to speak in public. After the last U.S. labour data release, the market began to expect the first Fed rate hike farther down the road and it now sees only 8% odds for a hike this month. The U.S. data would have to be really strong to change this, but if this is not the case in the coming days, then we think the Fed will hold fire in October in order not to spook the market. In this scenario, EUR/USD is likely to stay above 1.108 and there will be still more bias to the upside.

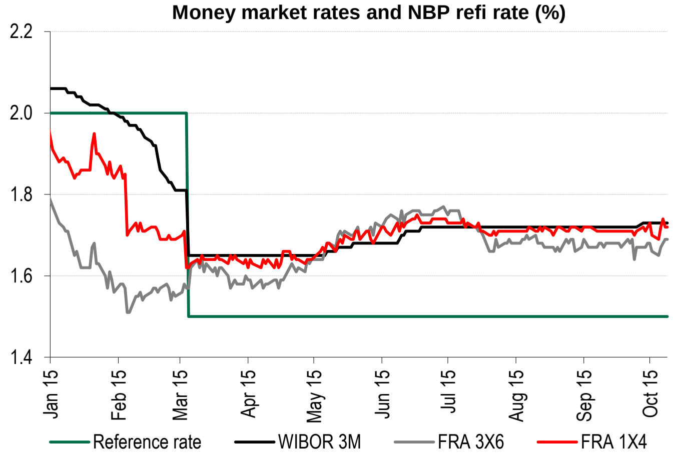
CEE currencies moderately stronger

- CEE currencies firmed moderately as the dovish tone of the FOMC minutes fuelled expectations that the Fed may not raise rates this year. The forint was also supported by strong demand from foreign investors for Hungarian bonds. Consequently, EUR/HUF fell towards 310, the lowest level since mid-September. Meantime, the Russian rouble benefited from rising oil prices as the market ignored news of the Russian military campaign in Syria.

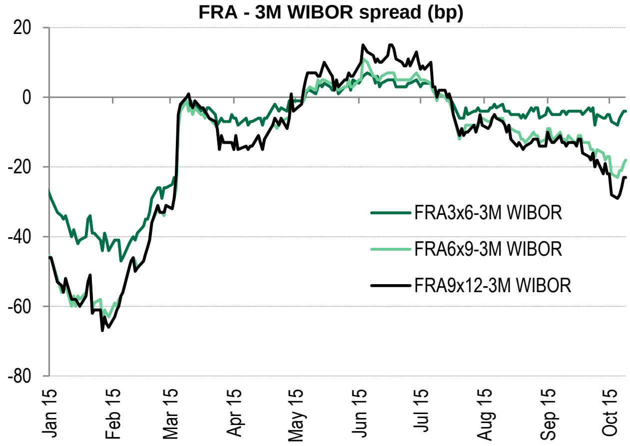
CEE currencies will remain vulnerable to the upcoming global events, especially macro data releases from the U.S.. Further signs that the Fed could delay the first hike should be supportive for the riskier assets, including the region's currencies.

Interest rate market – Yields slightly up due to decent macro data and approaching general elections

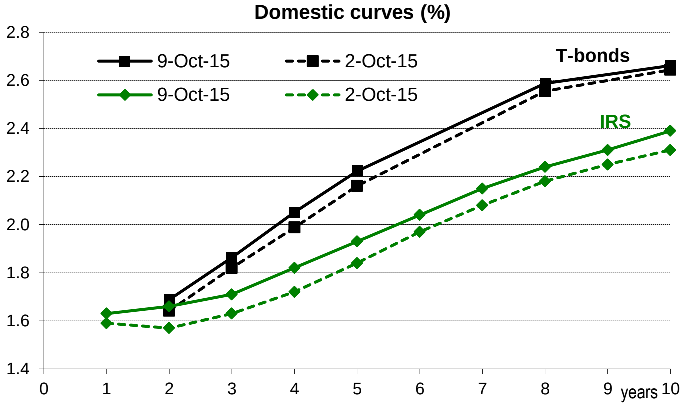
Money market rates and NBP refi rate (%)



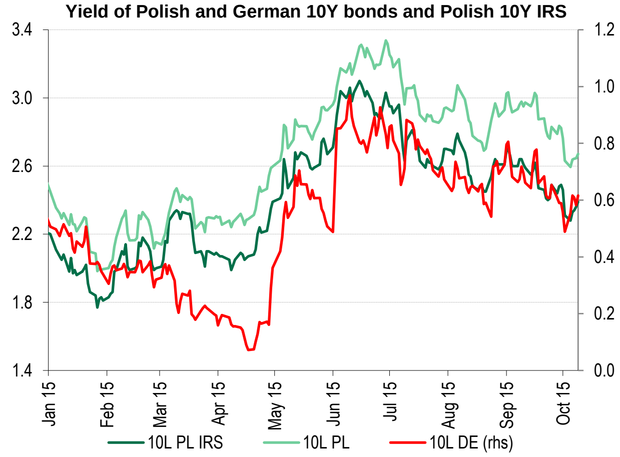
FRA - 3M WIBOR spread (bp)



Domestic curves (%)



Yield of Polish and German 10Y bonds and Polish 10Y IRS



Minor profit-taking after significant rally

- Poland's interest rate market initially strengthened, supported by the US. non-farm payrolls data on Friday. As a result, the 10Y benchmark yield fell temporary to 2.57%, for the first time since April. However, the less dovish than had been expected MPC rhetoric and news that the Ministry of Finance would offer long-term bonds at its Thursday's auction caused some profit-taking in the next few days. As a result, yields and IRS rates were anchored not that far from their local minimums.
- On a weekly basis, both curves moved slightly up, with the front-end of the yield curve underperforming the belly and the long-end. As a result, the 2-10Y spread slightly narrowed, dropping below 100 bp. At the same time, the IRS curve moved parallel, keeping the 2-10Y spread more or less stable (slightly below 74 bp). What is more, the spread vs. the Bund narrowed visibly, declining to nearly 200 bp, for the first time since end-March.
- On the money market, FRAs fell significantly on strengthening expectations of a more significant monetary policy adjustment (rate cuts by 50 bp). The less dovish (than expected) MPC rhetoric and upward correction on the IRS caused FRAs to rise across the board. As a consequence, probability of further monetary easing fell and the market now sees almost 80% odds of a 25 bp cut in 6 months' time, nearly fully pricing-in a 25bp rate cut in 9 months' time (FRA6x9 at 1.55% and FRA9x12 at 1.50%).

Busy week on the primary market …

- It was a busy week on the primary market. In line with the 4Q issuance plan, Poland's Ministry of Finance successfully placed 6Y eurobonds (maturing 14.10.2021) worth €1.75bn (amid demand exceeding €2.5bn). The bonds were priced 45bp above the average swap rate, which implied a yield of 0.94%, the lowest in the history of Poland's issues on the euro market. According to the ministry, banks had the biggest share in demand (38%), while investment funds came in second (35%), followed by central banks and public institutions (20%). The statement underscored that the nominal value of bonds purchased by the central banks and public institutions was the highest in the history of Poland's foreign debt placements. The value of yesterday's issue amounts to c.40% of foreign currency borrowing needs for 2016.
- Results of the switch tender were also favourable as the Ministry tapped new 5Y bonds PS0421 worth PLN3.14bn with a yield of 2.29% and the 10Y benchmark DS0726 worth PLN2.5bn with a yield of 2.78% (slightly above the level at the secondary market before the auction).

… and ahead of important macro data releases

- This week is heavy with important domestic and external events. On the domestic side, investors will focus on the macro data releases, including the balance of payments and the final September CPI. In our view, trade data will be crucial for the market's sentiment. We expect quite a decent growth level in exports (after the weak July numbers), confirming a still healthy rise in economic activity. Positive signs from the real economy might cause the correction on the interest rate market to continue. On the other hand, the final CPI reading will be rather neutral for the market as we expect it to be close to the flash number.
- As in the previous week, external factors will likely be key for market direction this week as well. We expect macro data due this week, in particular data from the U.S., to confirm that the Fed will postpone its monetary policy normalisation until December. This should support bonds. However, data from China might add some volatility. The approaching general election in Poland might also increase volatility as some investors might want to cut their exposure.

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.