Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

19 – 25 October 2015

Global sentiment improved quite visibly this past week as macro data releases from the U.S. reinforced market expectations that the Fed would not raise interest rates any time soon. At the same time, dovish comments from members of the ECB strengthened market hopes for QE extension in the euro zone. Poland's macro data also confirmed that export growth was quite robust and that there was a noticeable acceleration in company loans and deposits in September, suggesting that activity of Polish companies remains solid despite the uncertainty about the global economic outlook. What is more, the labour market remains strong, with the deepening of deflation in September only a temporary pause in the upward trend, in our view, which should push CPI growth towards +0.5%YoY in December. While Poland's bonds benefited from improving investor sentiment, the zloty moved sideways against the euro, awaiting an impulse.

This week's calendar is also quite busy, but we expect the domestic data to be overshadowed by global factors. Chinese macro data releases (including 3Q GDP) will likely set market direction at the start of the week. If the data surprise to the upside, concerns over global economic growth could fade. Better Chinese figures would also be supportive of the risky assets, including the Polish zloty and its CEE peers, while the debt market (including Poland's) might suffer. In fact, Polish bonds may suffer also if data from China are much weaker than expected because this would fuel global risk aversion. Still, any upward move in yields would be limited as the ECB's statement is likely to be dovish, suggesting there could be an increase and/or extension of the QE programme, if needed. Investors may also want to cut their exposure to Poland's assets just before the general election (on October 25). These factors might add volatility to the market, pushing yields/IRS rates up and weakening the zloty due to political uncertainty.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (19 October)					
4:00	CN	GDP	Q3	%YoY	6.8	-	7.0
4:00	CN	Industrial output	Sep	%YoY	6.0	-	6.1
4:00	CN	Retail sales	Sep	%YoY	10.8	-	10.8
14:00	**PL**	**Industrial output**	**Sep**	**%YoY**	**4.0**	**3.9**	**5.3**
14:00	**PL**	**Construction and assembly output**	**Sep**	**%YoY**	**1.2**	**1.4**	**4.8**
14:00	**PL**	**Real retail sales**	**Sep**	**%YoY**	**3.1**	**3.9**	**2.0**
14:00	**PL**	**PPI**	**Sep**	**%YoY**	**-2.8**	**-2.9**	**-2.7**
		TUESDAY (20 October)					
14:00	HU	Central bank decision		%	1.35	-	1.35
14:30	US	House starts	Sep	k	1142	-	1126
14:30	US	Building permits	Sep	k	1163	-	1170
		WEDNESDAY (21 October)					
		No important data releases					
		THURSDAY (22 October)					
13:45	EZ	ECB decision		%	0.05	0.05	0.05
14:00	**PL**	**MPC minutes**					
14:30	US	Initial jobless claims	week	k	-	-	255
16:00	US	Home sales	Sep	m	5.36	-	5.31
		FRIDAY (23 October)					
9:30	DE	Flash PMI – manufacturing	Oct	pts	51.9	-	52.3
10:00	EZ	Flash PMI – manufacturing	Oct	pts	51.8	-	52.0
10:00	**PL**	**Unemployment rate**	**Sep**	**%**	**9.9**	**9.8**	**10.0**

Source: BZ WBK, Reuters, Bloomberg

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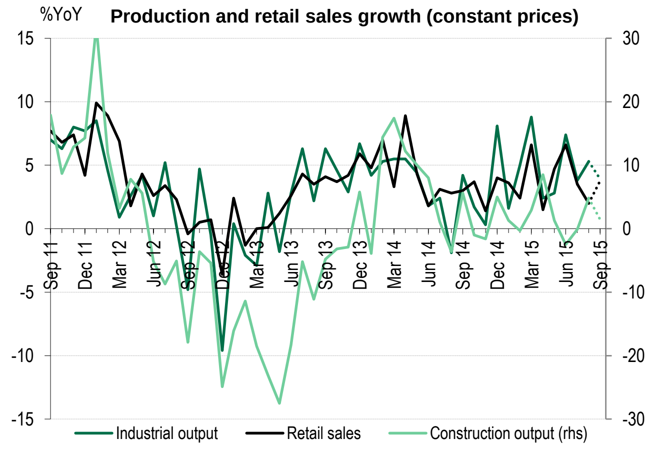
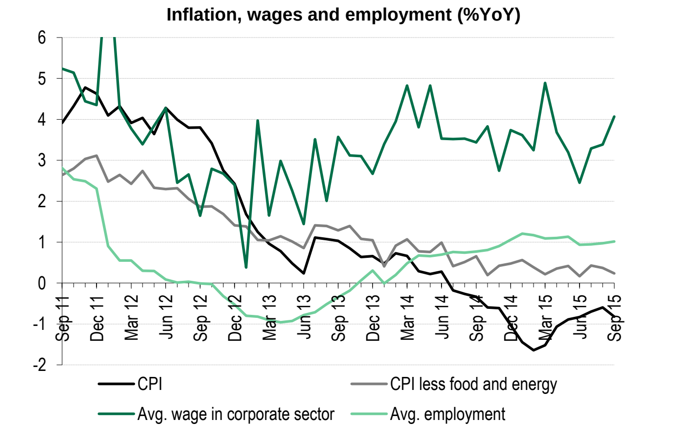
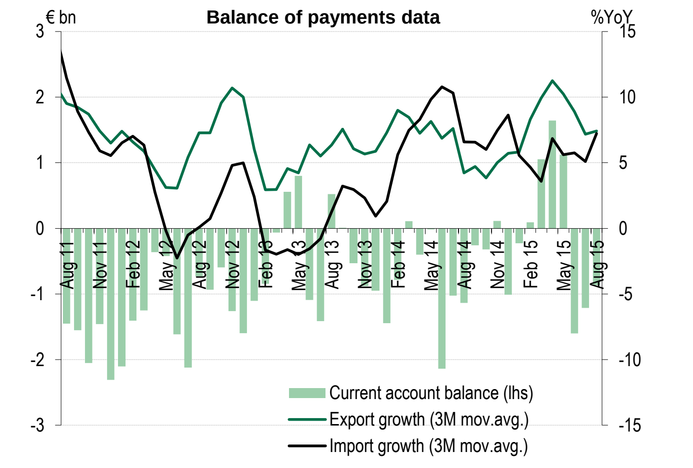
What's hot this week – Last data before elections



- Production data for September should not be particularly strong, in our view, showing a moderate slowdown vs. August. This time around, in contrast to August, the annual growth rates will not be affected by a working-day effect. But it will probably still be too early for the data to show a significant impact from the VW scandal, even though the business climate indicators had already worsened in September. The range of the market forecasts is wide – between -4% and +6%YoY for construction and 2.7-5.1%YoY for industrial output.
- Retail sales data should offer more optimism, showing a moderate rebound, supported by growth in household income, and confirming that consumer demand remains solid.
- The jobless rate fell to 9.9% in September, according to the Labour Ministry's estimate. We do not rule out the possibility that it even reached 9.8%, as the Ministry tends to overestimate the number of the unemployed.

Last week in the economy – Exports and wages accelerating





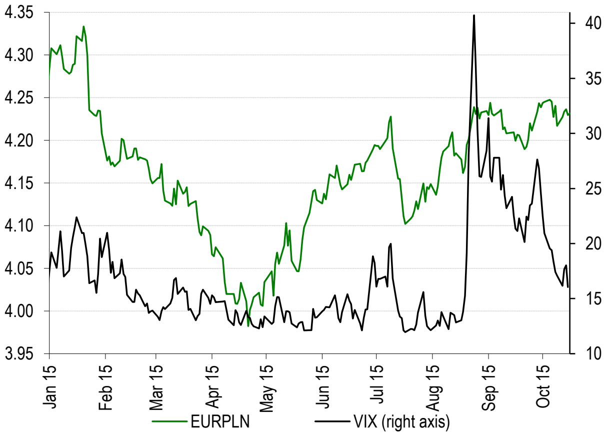
- CPI growth eased in September to -0.8%YoY, in line with the flash estimate. A cut in gas tariffs, introduction of free school books for children and much cheaper fuels were the three main factors pushing inflation lower. The first two will not happen again in the following months, while fuel prices, though still falling, are doing so at a slower pace. Food prices rose 0.6% MoM in September, faster than we had expected, and we think this trend will likely be maintained. This, together with a very low base, should push inflation higher in the coming months.
- The current account balance amounted to -€864mn in August and was much better than the market had expected. Export and import growth also surprised to the upside as both rebounded after dropping temporarily in July. At the same time, the NBP revised the July numbers up. We still expect that the euro zone's healthy economic growth will translate into strong growth of Polish exports in the coming quarters, which, in turn, would help maintain the pace of GDP growth well above 3% YoY. The CSO data on foreign trade also confirmed that Polish export growth to our biggest trading partners accelerated in August again. In Germany's case, it was, according to our estimate, at almost 17%YoY, at its highest since March 2011.
- Average employment in the corporate sector rose 1.0% YoY in September, in line with expectations, while the average wage growth accelerated to 4.1% YoY, well above the forecasts. The total wage bill rose 6% YoY in constant prices. Persistently strong demand for workers amid diminishing stock of available employees should lead to higher wage pressure and this in turn is likely to keep private consumption strong (supporting the GDP) and push inflation up in the coming quarters.
- September saw a noticeable acceleration in companies' loans and deposits. It seems that firms are still enjoying high earning growth and are not slowing investment activity.

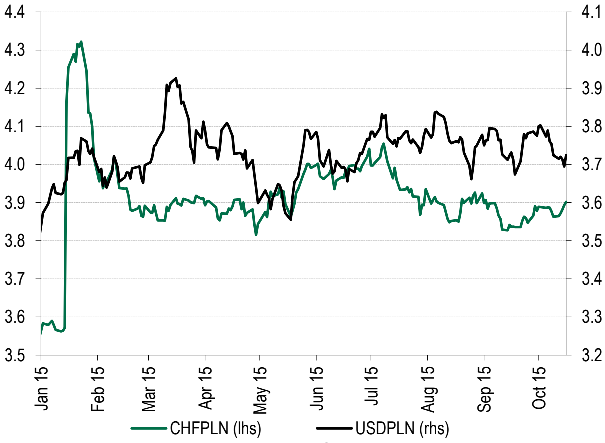
Quote of the week – Deflation to give way

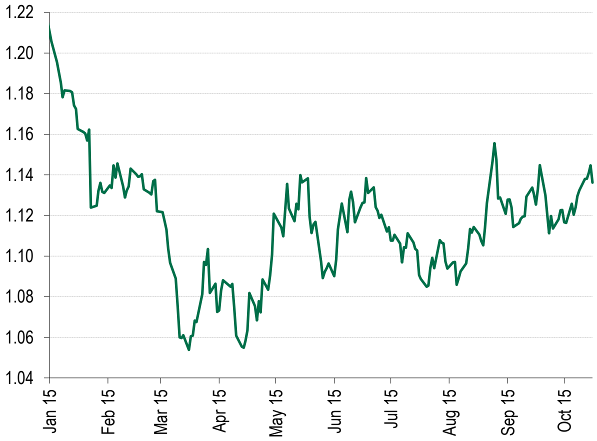
Mateusz Szczurek, finance minister, 15.10.2015, PAP
We expect deflation to end at the turn of November and December. We expect CPI to rise to 0.4% or higher. This will mainly be due to improvement on the labour market. This is a slow return of inflation to the central bank's target, but the trend will be more visible in 2016.
Elżbieta Chojna-Duch, MPC member, 15.10.2015, PAP
Deflation will give way. At the turn of the year CPI should be positive. The Council maintains its earlier stance that there are no sufficient reasons to tighten or to relax monetary policy.
Andrzej Kaźmierczak, MPC member, 16.10.2015, PAP
According to the forecasts that we have recently received, CPI will be above zero in December and reach its peak, in the nearest months, possibly in February – maybe at 1.2%. Later, inflation may drop slightly. However, this does not justify a change to the current monetary policy. (…) Interest rate changes will be the next MPC's job.

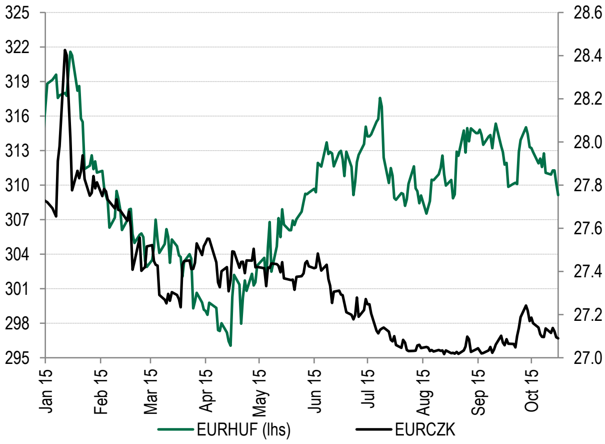
It seems that it is a consensus view right now that the inflation rate will turn positive before the end of this year. According to our forecasts, CPI will be very close to zero already in November, but it will depend largely on food and fuel prices whether it will cross the threshold at this point already or in December. Still, as Szczurek said, the inflation's upward trend should be even clearer in 2016, supported not only by the very low base and a reversing trend in food and energy prices, but also by improvement on the labour market and healthy domestic demand. Thus, inflation should approach 2% in 2016, in our view.

Foreign exchange market – Zloty under impact of global factors (and elections?)









Waiting for an impulse

- Poland's zloty moved sideways last week, trading in quite a narrow range of 4.212-4.242 against the euro. The currency failed to benefit from the decent domestic macro data (including a significant rebound in exports), but reacted instead to data releases abroad. However, the impact was more evident on USDPLN, which reacted quickly to global sentiment changes, which were reflected in EURUSD movements. EURUSD's sharp increase towards 1.15 caused a temporary fall in USDPLN to 3.674 (the lowest level since the end of August) and then a rise to slightly above 3.73 on the back of EURUSD's decline.
- EURPLN's chart did not change much over the past week, though corrections that follow upward moves are becoming shallower, suggesting that the market is waiting for an impulse. This week is heavy with domestic and external events, though we expect the domestic data to be likely overshadowed by important news from China (including GDP for 3Q2015), which should set market direction at the beginning of the week. U.S. data on the real-estate market and flash PMI indices for the euro zone countries that are due later in the week will also be important because they will be looked at in the context of the ECB's and Fed's future monetary policies. Despite the expected dovish rhetoric by the ECB and, in our view, a quite mixed set of macro data from the U.S. (supporting the market view that the Fed will not hurry with rate hikes), we expect higher volatility on the FX market ahead of Poland's general elections on October 25.

USD close to 7-week low vs. euro

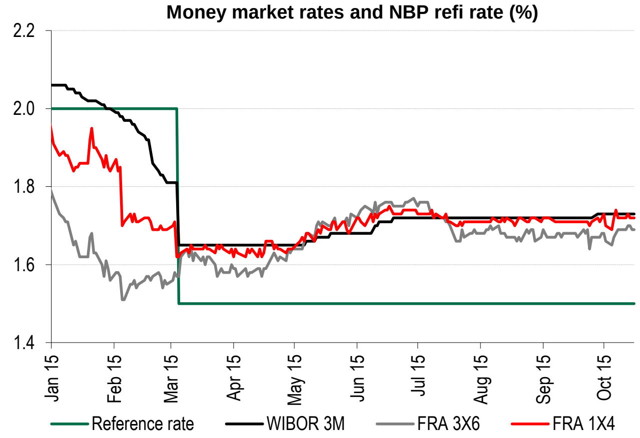
- The U.S. dollar weakened quite visibly over the past week, temporarily hitting its weakest level against the euro in 7 weeks. EURUSD rose to nearly 1.15 (not that far from its August peak of 1.17) on a series of weak data from the U.S., which were interpreted as going against quick rate hikes by the FOMC. As a consequence, the probability of a December rate hike fell below 30%. However, dovish comments by an ECB member helped the U.S. dollar recover and EURUSD fell towards 1.13 at the end of the week.
- We expect EURUSD to stay in its horizontal trend this week as factors backing upward and downward moves seem to balance each other out. We think that the U.S. macro data from the real-estate market will be rather mixed, likely reaffirming the investor view that the Fed will start hiking rates in 2016. This would offer the U.S dollar less support. On the other hand, the ECB (on October 22) should confirm its readiness for further monetary easing, which might trim the euro's earlier gains. 1.108 and 1.17 remain to be the important levels for EURUSD.

CEE currencies move sideways

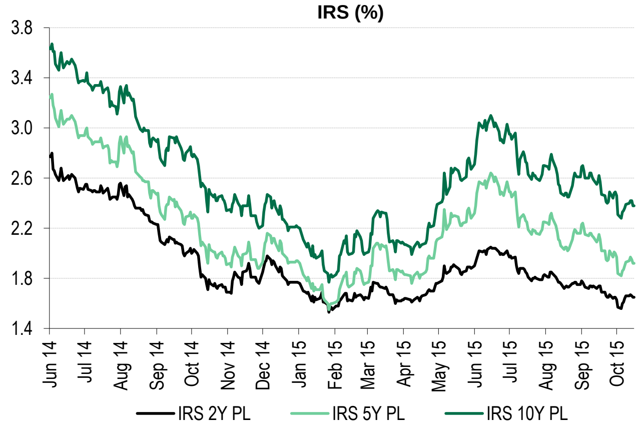
- CEE currencies, just like Poland's zloty, were quite volatile. The start of the week brought some weakening, but then the region's currencies rebounded, tracking improvement in the global sentiment. On a weekly basis, the forint gained 0.6% against the euro, while the Czech koruna and the Russian rouble gained only 0.2%.
- We expect the CEE region's currencies to move sideways this week, with global factors remaining their key drivers, in particular the ECB meeting. In our view, the still dovish rhetoric of the ECB should be supportive for HUF, CZK and RUB. The NBH meeting will rather be a non-event for HUF as we expect the central bank to keep its monetary policy unchanged.

Interest rate market – Spreads may widen

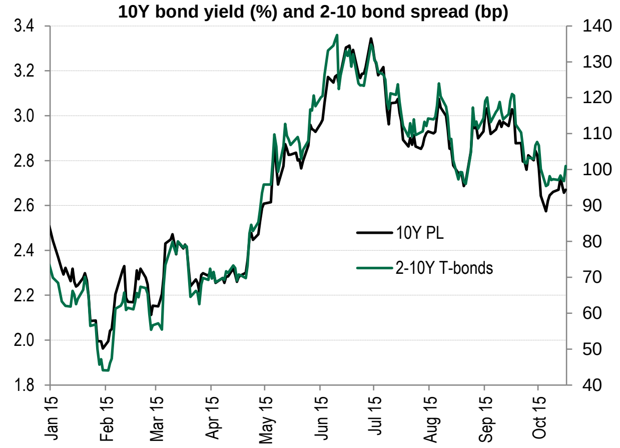
Money market rates and NBP refi rate (%)



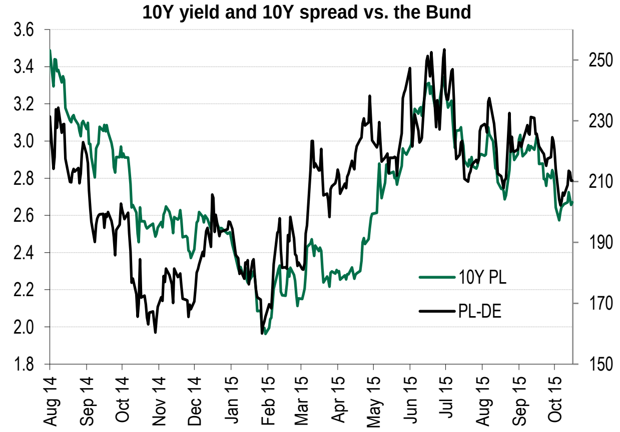
IRS (%)



10Y bond yield (%) and 2-10 bond spread (bp)



10Y yield and 10Y spread vs. the Bund



Market little changed

- There was some volatility on the Polish FI market in the last few days but, on a weekly basis, no significant changes were recorded. Domestic data were largely ignored.
- IRS stayed slightly above the local lows from early October and the 2Y rate remains close to 1.65%. The 5Y is now somewhere above 1.90%, with the 10Y at around 2.40%.

Bonds could be under pressure…

- This week's calendar has plenty of important data on the agenda. We think that Poland's debt could be under pressure in the first part of the week due to Chinese data releases. If these surprise to the upside, concerns about global economic growth could fade and investors could warm up to riskier assets, rather than debt. We believe that Polish bonds could weaken even if the Chinese data disappoint because they could trigger another wave of panic in the global market. This in turn could cause the domestic debt to suffer if risk aversion rose above a critical level.
- We think that bonds could at least partly recover later in the week. Ewald Nowotny from the ECB said last week that more action was needed to push inflation towards its target and we think that the ECB's president, Mario Draghi, could also sound dovish at the ECB press conference this week.
- U.S. data, to be released just one week ahead of the FOMC decision on rates, will be dissected by investors from the perspective of the Fed's monetary policy. The market sees less than 5% odds for a hike this month and c30% for a hike in December. It would, therefore, be difficult to expect that the incoming U.S. data could change the consensus, at least for October. Nevertheless, data from the world's biggest economy is likely to add volatility this week.
- Important Polish data are due this week, but our forecasts are close to the consensus, which means that we do not expect them to have a meaningful impact on the domestic interest rate market.

… and spreads may rise

- The short ends of the IRS and bond curves are well anchored and any changes in the slope this year have mainly been driven by changes in the belly and long ends. Since we believe that the 5Y and 10Y tenors could weaken this week, at least temporarily, the curves may stop flattening.
- We think that the 10Y PL-DE bond spread could also rebound farther away from the local low at nearly 200bp reached two weeks ago. In our view, Germany's bonds could perform better if demand for debt proved lower. Uncertainty ahead of Poland's parliamentary elections on October 25 is an additional factor that could weigh on the Polish debt. We think that some investors may want to cut their exposure ahead of this event and that even unimpressive flows (size wise) could be meaningful due to the likely subdued liquidity.

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.