Bank Zachodni WBK
Grupa Santander

# WEEKLY ECONOMIC UPDATE

## 16 – 22 November 2015

**Data released last week showed a slightly higher-than-expected GDP growth in 3Q15 (3.4%YoY), higher CPI inflation in October (-0.7%YoY) and disappointing exports in September (4.1%YoY). However, the economic outlook for the next quarters remains broadly unchanged, in our view, and we think that domestic data releases scheduled for the coming days will not change this. We expect economic growth to stabilise well above 3%YoY and inflation to keep trending upwards. At the same time, we still expect the new Monetary Policy Council to cut the main interest rate in 1Q15, as PiS officials keep repeating that there is still room for monetary easing and the party's candidates for new MPC are very likely to share this view.**

**The president designated Beata Szydło as the new PM and her cabinet may be sworn-in after the weekend. The new PM's inaugural speech will be key for assessing PiS's fiscal programme in practice. Two PiS nominations for economic positions in the cabinet should be perceived by the market as at least neutral and potentially confidence-building, as the names are well-known. The finance minister candidate already underscored the importance of stability in public finances and of keeping the budget deficit in check (possible minor deficit increase of PLN1-1.5bn) and we feel that at least some of the PiS election promises may be watered down. On the other hand, some controversial ideas are still in the air (modification of the fiscal spending rule, change of NBP's role, FX loan conversion, shortening of the retirement age) and may be a reason for investors to remain cautious. We think that the domestic market may remain under the influence of expectations for monetary policy decisions of the world's two major central banks, the U.S. Fed and the ECB.**

### Economic calendar

| TIME CET | COUNTRY | INDICATOR | PERIOD | | FORECAST | | LAST VALUE |
|---|---|---|---|---|---|---|---|
| | | | | | MARKET | BZWBK | |
| | | **MONDAY (16 November)** | | | | | |
| 11:00 | EZ | HICP | Oct | %YoY | 0.0 | - | 0.0 |
| **14:00** | **PL** | **Core inflation** | **Oct** | **%YoY** | **0.3** | **0.2** | **0.2** |
| | | **TUESDAY (17 November)** | | | | | |
| 11:00 | DE | ZEW index | Nov | pts | 54.5 | - | 55.2 |
| 14:00 | HU | Central bank decision | | % | 1.35 | - | 1.35 |
| 14:30 | US | CPI | Oct | %MoM | 0.2 | - | -0.2 |
| 15:15 | US | Industrial output | Oct | %MoM | 0.1 | - | -0.2 |
| | | **WEDNESDAY (18 November)** | | | | | |
| **14:00** | **PL** | **Wages in corporate sector** | **Oct** | **%YoY** | **3.6** | **3.6** | **4.1** |
| **14:00** | **PL** | **Employment in corporate sector** | **Oct** | **%YoY** | **1.0** | **1.0** | **1.0** |
| 14:30 | US | House starts | Oct | k | 1160 | - | 1206 |
| 14:30 | US | Building permits | Oct | k | 1140 | - | 1103 |
| 20:00 | US | FOMC minutes | | | | | |
| | | **THURSDAY (19 November)** | | | | | |
| **11:00** | **PL** | **Bond switch auction** | | | | | |
| **14:00** | **PL** | **Industrial output** | **Oct** | **%YoY** | **2.4** | **1.4** | **4.1** |
| **14:00** | **PL** | **Construction and assembly output** | **Oct** | **%YoY** | **-0.9** | **-3.5** | **-2.5** |
| **14:00** | **PL** | **Real retail sales** | **Oct** | **%YoY** | **3.0** | **3.2** | **2.9** |
| **14:00** | **PL** | **PPI** | **Oct** | **%YoY** | **-2.5** | **-2.4** | **-2.9** |
| **14:00** | **PL** | **MPC minutes** | | | | | |
| 14:30 | US | Initial jobless claims | week | k | | - | 276 |
| 14:30 | US | Philly Fed index | Nov | pts | 0.0 | - | -4.5 |
| | | **FRIDAY (20 November)** | | | | | |
| | | No important data releases | | | | | |

Source: BZ WBK, Reuters, Bloomberg

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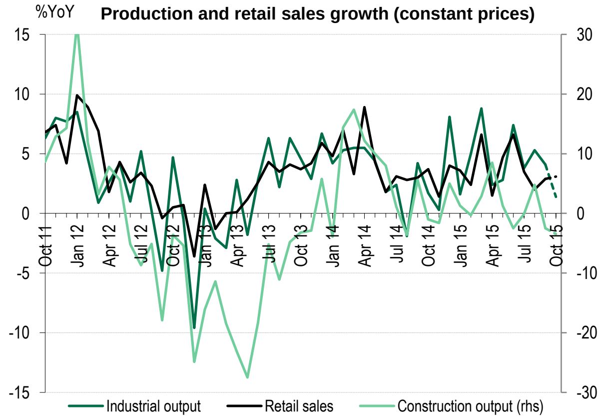
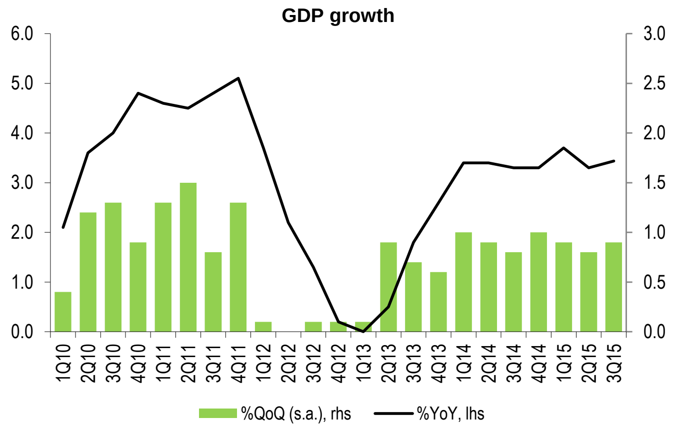
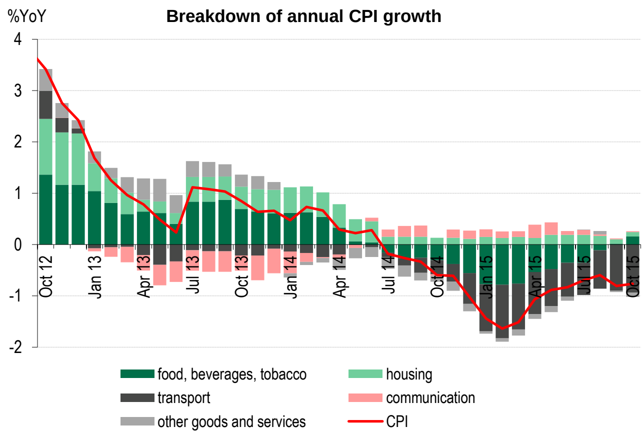
## What's hot this week – A bunch of important data




- We expect employment growth to remain at 1%YoY and wage growth to decelerate slightly to 3.6%YoY (4.4%YoY in real terms). The data should confirm that the labour market remains strong.
- Industrial production growth for October may not look overly impressive, mainly due to a lower number of working days. However, we think that the underlying trend should remain solid, showing a seasonally adjusted growth of over 4%YoY. Construction output growth is likely to remain negative.
- We expect retail sales in constant prices to rise by more than 3%YoY. Turnover in retail trade, including small shops, has been growing more than twice as fast in recent months.
- It is possible that the new Prime Minister will give her inaugural speech this week, shedding more light on the new government's economic programme.

## Last week in the economy – Stable GDP growth, inflation slightly higher




- Inflation rose in October to -0.7%YoY, marginally above the -0.8% that was estimated initially. Food prices were the main culprit that drove CPI higher - they rose 0.4%MoM and 0.4%YoY (vs. -0.2%YoY in September). We estimate that the core CPI ex food and energy prices stayed unchanged in October at 0.2%YoY. We still expect inflation to rise in the coming months thanks to an exceptionally low base effect, higher food prices and more expensive fuels.
- The current account balance reached -€959mn with imports at €14.97bn (5.8%YoY) and exports at €15.06bn (4.1%YoY).
- The M3 money supply rose in October 9.2%YoY. This stemmed from further acceleration of cash in circulation - by 16.1%YoY (the strongest growth since March 2009).
- Flash GDP data reported a 3.4%YoY growth in 3Q15, slightly above our forecast and the market consensus at 3.3%YoY. Seasonally adjusted growth reached 0.9%QoQ, in line with our estimates. Data for 2013 and 2014 were revised downwards, with a particularly strong correction in 2013. The current estimate of GDP growth in 1Q13 amounts to 0.0%YoY, instead of 0.5%YoY, according to earlier calculations. Thus, it cannot be excluded that the revised quarterly data for 2010-12 (still due for release) will show that GDP growth was below zero at the end of 2012.
- The data point to economic growth stabilisation at above 3%YoY, starting from 1Q14. It is the longest period of such stabilisation since comparable quarterly data are available (i.e. since 1995). We think that economic growth should remain stable in the coming quarters, or may even accelerate slightly, supported by the still reasonably strong domestic demand and continuing economic recovery in the euro area. As a consequence, Poland's average GDP growth in 2015 may reach 3.5%, with 2016 not looking any worse.

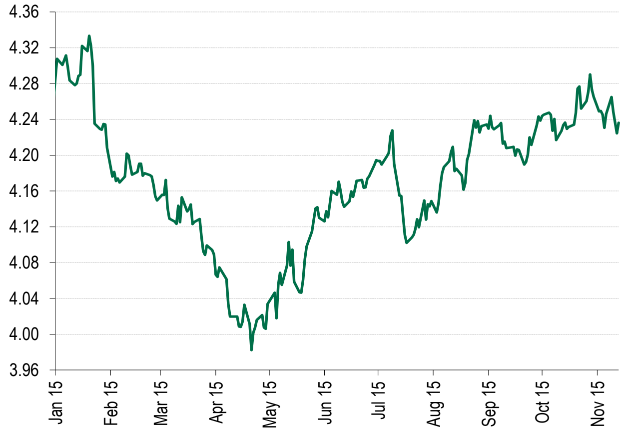
## Quote of the week – We will surely modify the spending rule

**Paweł Szałamacha, candidate for finance minister, 13.11.2015, PAP**
We have to quickly implement our child benefit project. This is a priority (…) At the same time, we will improve VAT collection (…) After increasing the deficit by PLN1.0-1.5bn, we will need PLN2.0-3.0bn from the bigger tax collection (…) In my view, exceeding of the 3% deficit to GDP threshold is not necessary in order to deliver our child benefit programme. (…) We will surely modify the spending rule in order to reach our top priority – the child benefit programme. (…) Changes to the tax-free income, demanded by the Constitutional Court, will be implemented in 2017.

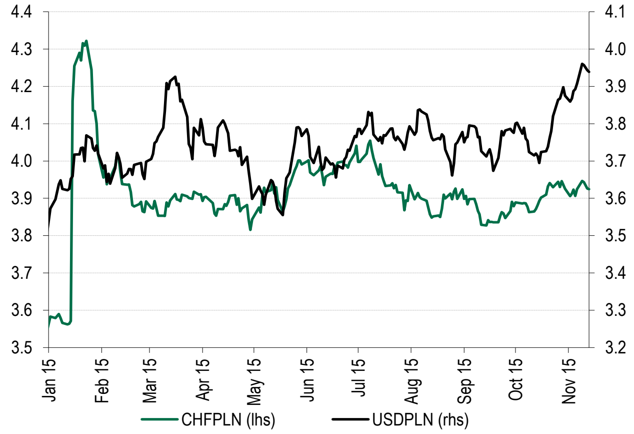
The new PM's inaugural speech will be key for assessing PiS's fiscal programme in practice. The first comments from the party's finance minister candidate underscored the importance of stability in public finances and of keeping the budget deficit in check (possible minor increase of PLN1-1.5bn). Child benefits will be the top priority, to be implemented in 2016. The project is to be financed with sector taxes (bank tax, most likely on assets, plus a tax on large-area stores), a slight increase of income from dividends and improved tax collection. PiS's second flagship project - higher tax-free income level - will probably be implemented later (in 2017). These plans imply some risk that the new government will raise the deficit (more significantly than Szałamacha suggested), if rapid improvement in tax collection fails to materialise. We are concerned about the declared modifications of the spending rule: the aim of this change would be to allow for higher spending, not to improve the rule, which seems to work properly.

## **Foreign exchange market –** Global factors likely to remain the key drivers

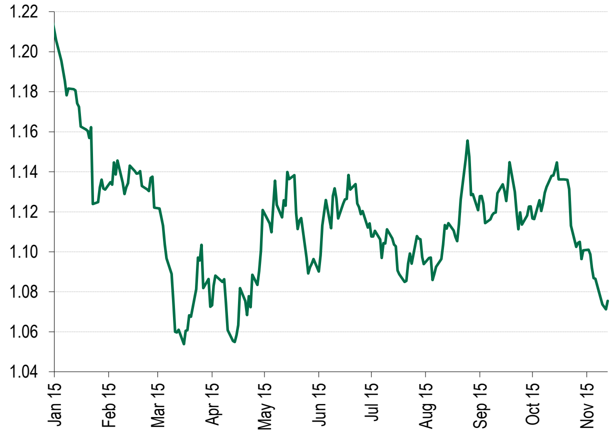
EUR/PLN



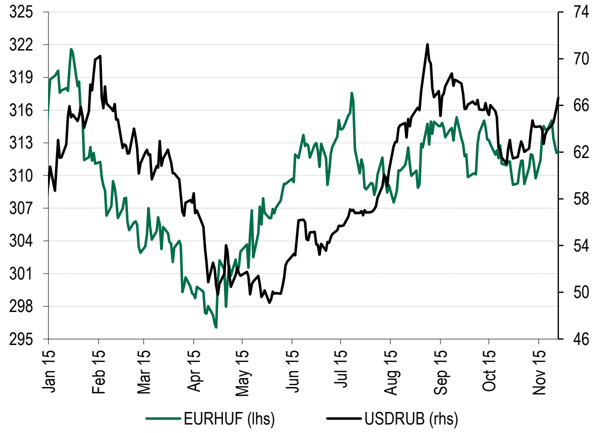

USD/PLN and CHF/PLN




EUR/USD




EUR/HUF and USD/RUB




### Zloty trading sideways at high intraday volatility

- The first part of the previous week brought zloty's strengthening. Amid the absence of Polish investors on Wednesday, the domestic currency gained further versus the euro and the dollar – EURPLN fell to 4.205 (to the lowest level since mid-September) and USDPLN below 3.91. The zloty was underpinned by quite a positive market sentiment and lower liquidity on the Polish market. However, this was only a short-term move as investors took profit at the end of the week. As a result, EURPLN returned towards 4.24, while USDPLN rose to 3.95. On the other hand, the zloty lost markedly against the British pound (over 1% on a weekly basis) due to EURGBP's decline to 0.704, the lowest level since mid-August.
- The EURPLN chart did not change much over the past week. Despite the positive surprise by Poland's flash 3Q15 GDP data, EURPLN returned above 4.24 due a deteriorating global sentiment. This week will be filled with many domestic and external events. Taking into account the fact that the zloty is more vulnerable to external factors, the domestic macro releases and political news flow will likely be overshadowed this week. The FOMC minutes will be key this week, which, in a short term, may impact market expectations for a December lift-off. In our view, EURPLN may hover in a wide range of 4.20-4.30, staying slightly below the middle of the fluctuation band.

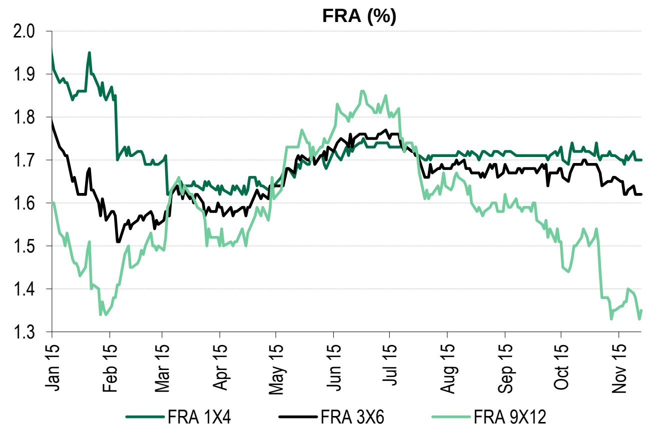
### EURUSD vulnerable to monetary policy signals

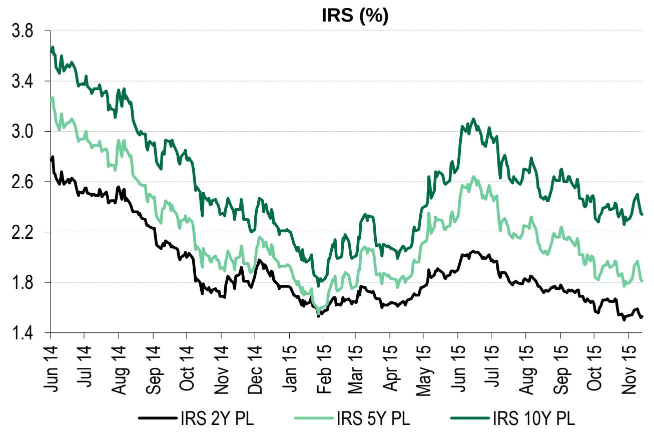
- EURUSD confirmed last week that it was still vulnerable to the "monetary policy divergence trade". EURUSD initially fell to 1.067, reaching a fresh local minimum. The U.S. dollar continued to benefit from the rising probability of a December rate hike in the U.S., while the euro was still under pressure from expectations of further monetary easing by the ECB as early as next month. However, EURUSD bounced back above 1.08 due to a lack of new actionable signs from either Fed's Yellen or ECB's Draghi. But it was only short-lived and the rate ended the week at around 1.075.
- This week is heavy with European and the U.S. macro data releases and events. In our view, the inflation figures and FOMC minutes will be the most important, possibly affecting future monetary policies by both the Fed and ECB. We expect EURUSD to stay range-bound in the short term, with relatively high intraday volatility. However, the growing odds of a December rate hike by the Fed might push EURUSD towards its March minimum of 1.045.

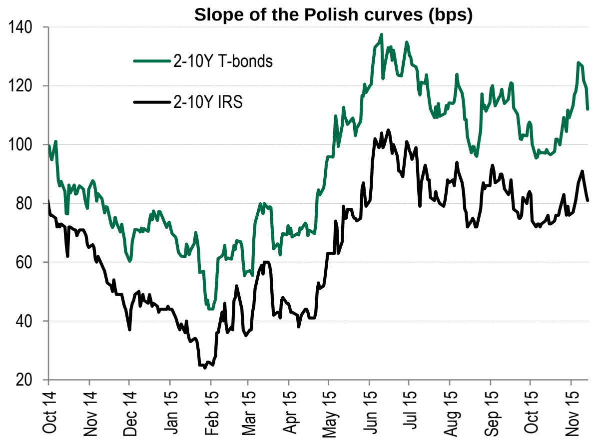
### Global sentiment to drive CEE currencies

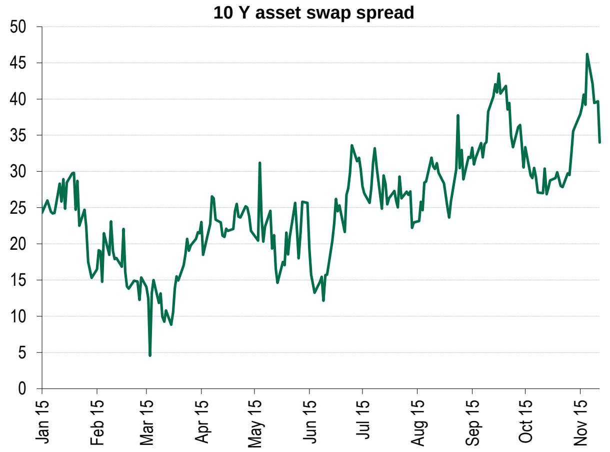
- The CEE region's FX markets were mixed over the past week. Both the Hungarian forint and the Russian ruble underperformed the Czech koruna. RUB lost mainly due to a fall in oil prices and comments from the Russian central bank officials, while HUF weakened as a result of a slowdown in 3Q15 GDP growth. What is more, the forint did not benefit from ratings agency Moody's decision to upgrade the country's sovereign rating outlook to positive from stable.
- This week investors will focus on the global factors. Strengthening expectations of a rate hike in the U.S. might put some pressure on the region's currencies. In Hungary, the central bank's (NBH) meeting will be the key event. It is broadly expected that the NBH will keep interest rates unchanged. However, the central bank might release further details on its new Growth Supporting Programme and this information could weight on HUF.

## **Interest rate market** – ECB speakers more important than U.S. data?




### Bonds recover on strong U.S. nonfarm payrolls

- Monetary policy remained the main driver for the Polish and global debt markets. At the beginning of the week, yields and IRS continued their upside move triggered by the exceptionally strong U.S. nonfarm payrolls. However, dovish signals from the ECB that emerged soon afterwards supporting the market and, in the following days, the IRS and yields fell below levels seen before the strong U.S. labour market numbers. On a weekly basis, Poland's yields fell 7-25bp and the IRS 5-15bp.
- Expectations for more easing in the euro zone pushed Poland's longer FRAs down. The 6x9 FRA and the longer rates fell 5bp. The market is still pricing in only one 25bp cut within 6 months, while, in our view, the NBP rates will be cut by 50bp in 1Q16. That is why we see room for lower FRAs.

### ECB speakers more important than U.S. data?

- Plenty of data releases are scheduled this week – mainly from Poland and the U.S. However, there are also some ECB member speeches on the agenda and we think that they may be even more relevant for the Polish FI market.
- In September, the 10Y asset swap spread broke the long-term 40bp resistance and rose to 48bp, its highest since September 2012. After some correction, the spread was again close to 48bp just before the last U.S. nonfarm payrolls and fell to nearly 33bp last week. We think that the asset swap spread could continue falling if the ECB board members sounded dovish enough to support expectations for more monetary easing in December and U.S. data did not surprise too much to the upside. The last dovish signals from the central bank pushed the 10Y IRS down 16bp, while the long-term bonds gained as much as c25bp. The strong U.S. nonfarm payrolls pushed the 10Y IRS up by 10bp, while the 10Y yield rose only 13bp, a move that had a smaller impact on the asset swap spread.
- Both the IRS and bond curves flattened slightly last week and we think this could continue in the coming days if the positive impact of the ECB's comments dominate the U.S. data. Our forecasts for the Polish October industrial and construction output are well below the consensus and expectations for rate cuts in Poland may strengthen should they materialise. Still, changes on the short end are likely to be smaller than on the long ends.
- On Tuesday, the Finance Ministry will announce bonds to be repurchased and offered at a switch auction. Since the standard auction that was held in late October, the belly of the curve gained c6bp, while the 2Y and 10Y yields did not change much. We think the Finance Ministry might want to take advantage of the long-term yield's drop seen last week and could offer 5Y and 10Y benchmarks.

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