Bank Zachodni WBK
Grupa Santander

TRI-WEEKLY ECONOMIC UPDATE

21 December 2015 – 10 January 2016

Please be advised that today's Weekly Economic Update will be the last for 2015.
We will resume publication on January 8, 2016.
We wish our readers a happy Christmas and a prosperous New Year!

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		TUESDAY (22 December)					
14:30	US	GDP	Q3	%QoQ	1.9	-	3.9
16:00	US	Home sales	Nov	m	5.34	-	5.36
		WEDNESDAY (23 December)					
10:00	**PL**	**Unemployment rate**	**Nov**	**%**	**9.7**	**9.7**	**9.6**
14:30	US	Personal income / consumer spending	Nov	%MoM	0.2 / 0.3	-	0.4 / 0.1
14:30	US	Durable goods orders	Nov	%MoM	-0.2	-	2.9
16:00	US	New home sales	Nov	k	505	-	495
16:00	US	Michigan index	Dec	pts	92.0	-	91.3
		TUESDAY (29 December)					
16:00	US	Consumer confidence	Dec	pts	93.0	-	90.4
		MONDAY (4 January)					
2:45	CN	PMI – manufacturing	Dec	pts	-	-	48.6
9:00	**PL**	**PMI – manufacturing**	**Dec**	**pts**	**-**	**52.7**	**52.1**
9:55	DE	PMI – manufacturing	Dec	pts	-	-	52.9
10:00	EZ	PMI – manufacturing	Dec	pts	-	-	52.8
14:00	**PL**	**Flash CPI (to be confirmed)**	**Dec**	**%YoY**	**-0.4**	**-0.4**	**-0.6**
16:00	US	ISM – manufacturing	Dec	pts	49.5	-	48.6
		TUESDAY (5 January)					
11:00	EZ	Flash CPI	Dec	%YoY	-	-	0.1
		WEDNESDAY (6 January)					
	PL	**Market holiday**					
9:55	DE	PMI – services	Dec	pts	-	-	55.6
10:00	EZ	PMI – services	Dec	pts	-	-	54.2
14:15	US	ADP report	Dec	k	190	-	217
16:00	US	ISM – services	Dec	pts	56.0	-	55.9
20:00	US	FOMC minutes					
		THURSDAY (7 January)					
8:00	DE	Industrial orders	Nov	%MoM	-	-	1.8
11:00	**PL**	**Bond auction**					
14:30	US	Initial jobless claims	week	k	-	-	-
		FRIDAY (8 January)					
8:00	DE	Exports	Nov	%MoM	-	-	-1.3
14:30	US	Non-farm payrolls	Dec	k	200	-	211
14:30	US	Unemployment rate	Dec	%	5.0	-	5.0

Source: BZ WBK, Reuters, Bloomberg

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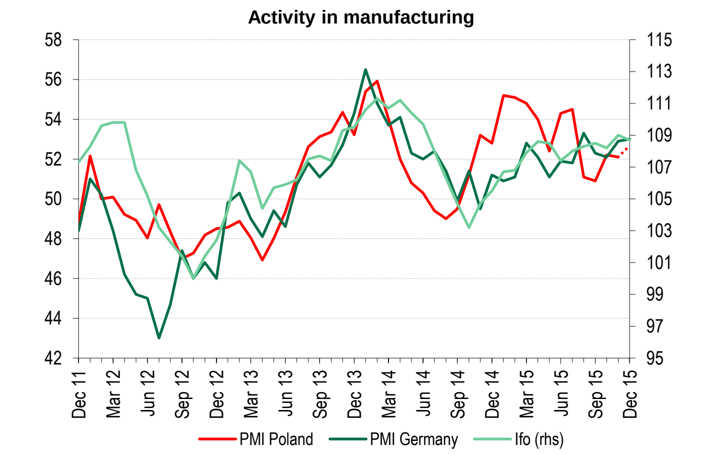
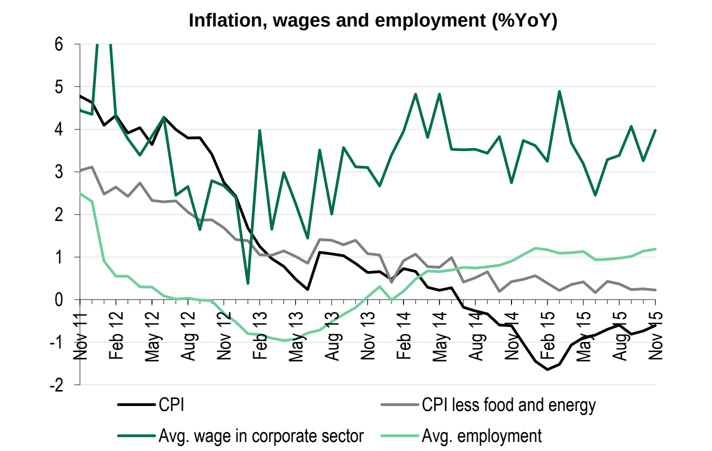
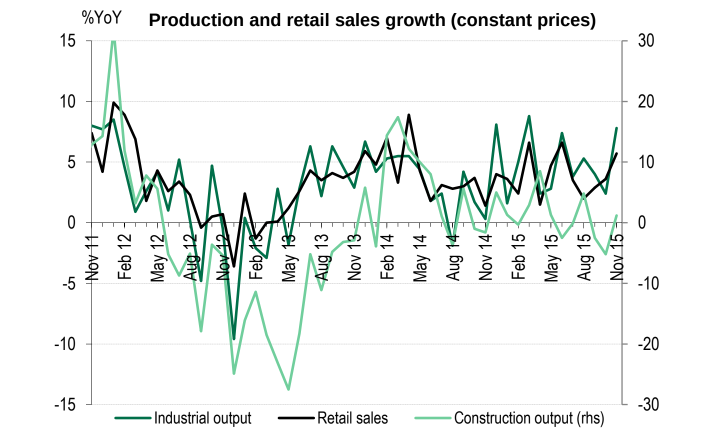
What's hot in the coming weeks – Few data releases in the holiday period



- The Ministry of Labour announced earlier that the registered unemployment rate rose slightly in November due to seasonal factors, so the official data release should be no surprise at all. The demand for labour remains strong, which should keep fuelling wage growth and ultimately private consumption.
- We predict flash CPI inflation to show -0.4%YoY in December, growing slightly mainly due to exceptionally low base effect. If the reading surprises on the downside again, rate cut expectations may strengthen, especially after the recent news about cuts in gas and electricity tariffs.
- PMI index for Polish manufacturing should inch up in December, according to our forecast, supported by rising economic activity in the euro area (most of business climate indicators were optimistic) and weak zloty, supporting Polish exporters. Recent data about industrial output confirmed that the underlying trend in Polish manufacturing remains strong.

Last week in the economy – Solid growth in economic activity, labour market in good shape





- CPI inflation reached -0.6% YoY in November, slightly below the flash estimate (-0.5% YoY). On monthly basis prices fell by 0.1%, mainly on the lower food (-0.4%) and slower growth of fuel prices (+1%). Core inflation excluding food and energy prices remained unchanged at 0.2% YoY. Consumer prices are growing slower than we were expecting and we think that deflation could persist at least until January. We still expect CPI growth to trend upwards next year, towards c1% YoY in December 2016.
- Employment in the corporate sector rose in November 1.2% YoY, in line with our forecast and above the market consensus (1.1% YoY). Wages rose 4.0% YoY in November, roughly in line with our and market expectations (3.8% YoY and 4.0% YoY, respectively). In monthly terms, employment rose by 9k and this is the highest increase for November since 2007, which confirms the strength of labour demand. Real wage bill rose 5.9% YoY. Robust growth of real incomes will continue to support the private consumption in the coming quarters.
- Industrial output rose in November by 7.8% YoY, above our forecast (6.2% YoY) and market consensus (5.7% YoY). Construction and assembly output added 1.2% YoY, while the market (and us) expected a drop in this sector. Retail sales also beat consensus and expanded by 5.7% YoY. In general, even though the readings were pushed up by one-off factors (e.g. calendar effect), they convey an optimistic message and support our forecast of robust economic growth in 4Q2015.
- Current account deficit fell sharply in October to €113m, mainly due to a sudden drop in imports (-2.8% YoY). Exports rose 3%YoY, roughly in line with expectations. We expect both export and import growth to accelerate, thanks to economic recovery in the euro zone and strong domestic demand.

Quote of the week – Official candidates for the MPC to be known soon

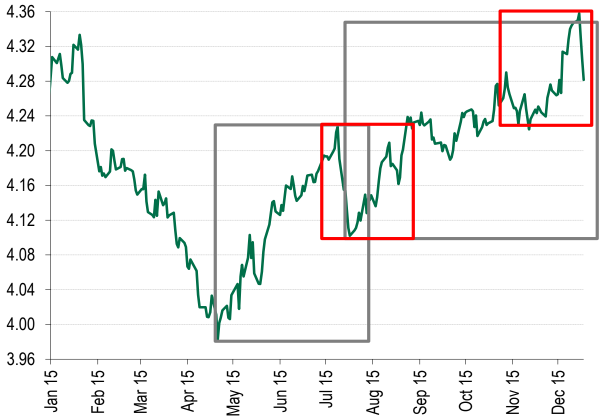
BloombergBusiness article, December 16, 2015

The following is a preliminary list of candidates being circulated by the party [PiS], which is still subject to changes, according to the people, who asked to remain unidentified to discuss private considerations: Jerzy Żyżynski (confirmed his candidacy); Grażyna Ancyparowicz (confirmed her candidacy), Małgorzata Iwanicz-Drozdowska, Agnieszka Alińska, Małgorzata Zaleska, Zbigniew Hockuba, Łukasz Hardt, Marek Chrzanowski, Jan Wojtyła, Michał Gabriel Wozniak, Eryk Łon, Elżbieta Ostrowska.

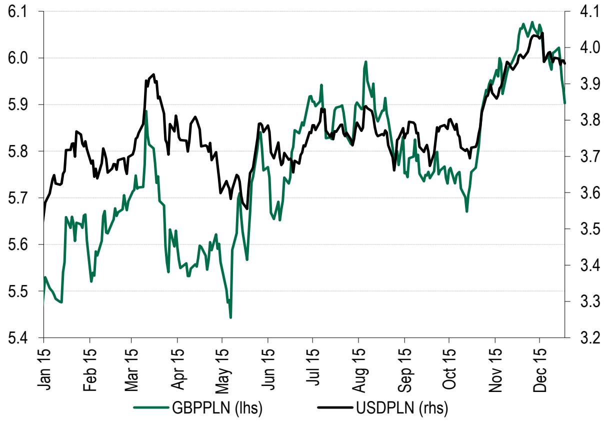
Last week BloombergBusiness presented an unofficial list of candidates for MPC positions (details on the left). Additionally, two other names were mentioned in the media as candidates of the Upper House (Senate): Eugeniusz Gatnar (currently NBP Board member) and Jerzy Kropiwnicki. At this stage, it is hard to guess which candidates have higher chances to be elected (3 by Sejm and 3 by Senate). This week, however, at least two names should be officially known, as according to the Sejm's regulations the deadline for proposals is 30 days ahead of expiring term of the previous member. Three Senate's names should follow the following week and the last person from Sejm might be known early 2016. First comments of official candidates will be the key to assess their monetary policy bias.

Foreign exchange market – Further room for zloty gains

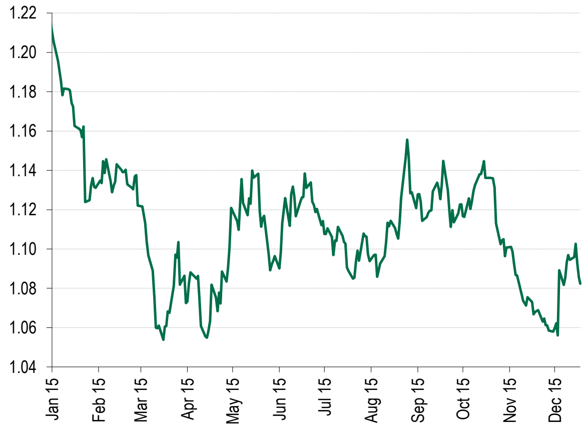
EUR/PLN



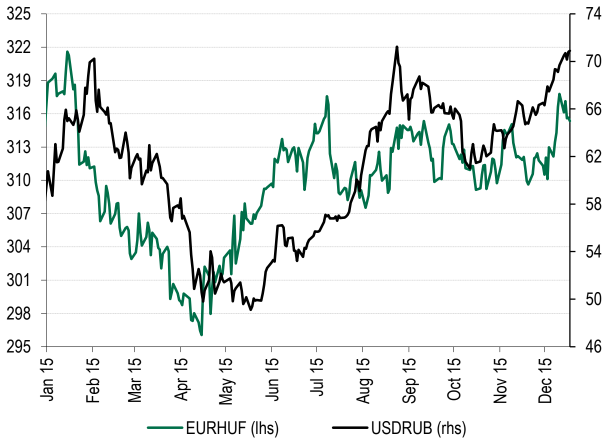
GBP/PLN and USD/PLN



EUR/USD



EUR/HUF and USD/RUB



Polish data and FOMC support the zloty

- Last week we wrote that investors might view the Fed's rate hike as a vote of confidence in the U.S. and global economy, providing support for the risky assets, including the zloty. Our suspicion proved correct and the FOMC managed to deliver a "dovish hike". Polish macro data were also very encouraging – October's C/A deficit was much lower than expected. November output and retail sales also surprised well to the upside. As a result, EUR/PLN fell to 4.27 from 4.37 after recording its biggest weekly drop since late January (when the zloty was boosted by the ECB decision to extend its asset purchase programme). Following this week's gains, the Polish currency neutralised all the losses suffered in early December on the disappointing ECB decision.
- The zloty's appreciation vs. the dollar was only temporary and USD/PLN returned to 3.95 after establishing a weekly low at 3.90. At the same time, GBP/PLN fell to 5.90 from 6.05 and CHF/PLN to 3.96 from 4.05.
- In the last six years, the zloty lost vs. the euro in the final month of the year only once – in December 2014 due to weak Polish data and expectations for more rate cuts by the Polish Monetary Policy Council. There are no more important domestic data due this year (and the most recent were really good) and the risk that more easing will take place in 1Q16 seems to have already been priced in in the previous weeks.
- Notice also that after the temporary rise to 4.37, the recent upside wave (developing since late July) and the one seen in late April-early July are nearly equal. This raises the odds that 4.37 could be a local peak for EUR/PLN. Following the same logic, should the exchange rate fall now in the same scale as it did in back July, EUR/PLN could reach c4.23 in the coming weeks. Nevertheless, we think that the year-end could be quite a good period for the zloty, though a higher political risk may limit room for its appreciation.

Dollar gains on Fed rate hike

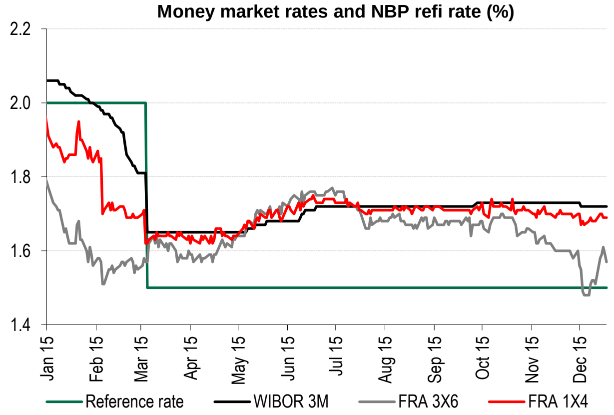
- After gaining for two consecutive weeks, the euro lost vs. the dollar. The U.S. currency benefited from the Fed rate hike and EUR/USD fell to 1.08 from c1.106.
- We expect the exchange rate to stay in a wide range of 1.05-1.11 until the next U.S. nonfarm payrolls (due in January) are released. They could help assess the pace and timing of the future rate hikes in the U.S.

Ruble remains under pressure from falling oil price

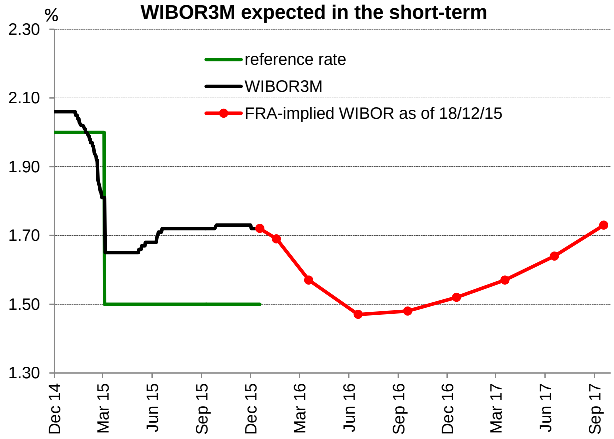
- The ruble depreciated for the fourth consecutive week vs. the dollar. USD/RUB rose above 71 on continuing decline of the Brent oil price that reached a fresh 2015 minimum and its lowest level since late 2008 at nearly 36$.
- At the same time, EUR/HUF fell to c314 from 318 and the forint managed to pare roughly half of its losses suffered in the previous week. The positive global market sentiment proved more important than remarks from the Hungarian central bank saying that more easing could be needed to support the economy.

Interest rate market – There is still room for downward adjustment

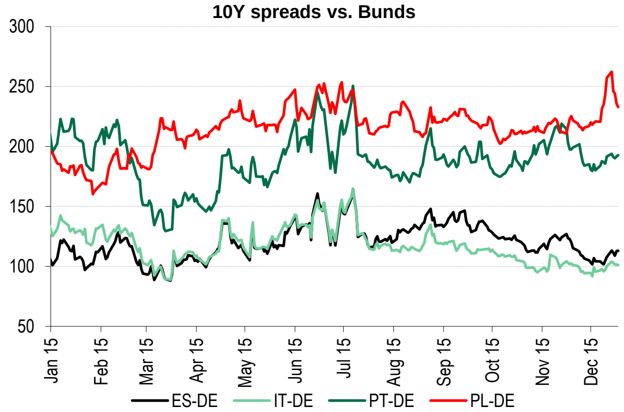
Money market rates and NBP refi rate (%)



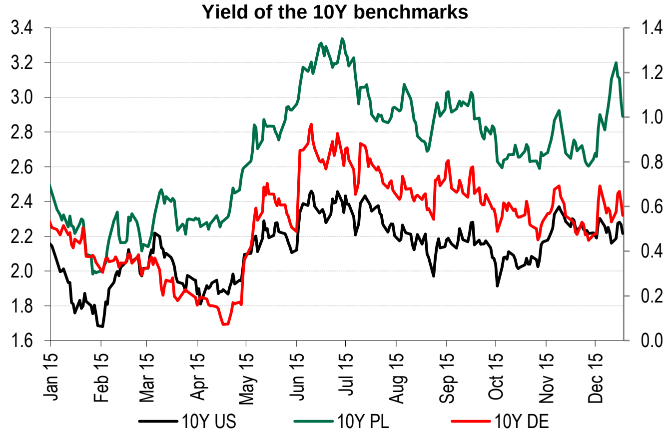
WIBOR3M expected in the short-term



10Y spreads vs. Bunds



Yield of the 10Y benchmarks



Yields/IRS rates inched lower on Fed

- FOMC decision was the key event of the past week. As widely expected, Fed delivered a hike by 25 bp for the first time since June 2006, ending the seven-year period of near-zero interest rates. Bond market globally positively reacted to "the dovish hike". Poland's interest rate market benefited from strengthening on core market and as a result yield of 10Y benchmark fell to 2.90%, down from local peak at nearly 3.25% at the beginning of the week.
- On weekly basis T-bond yields benefited more than IRS from investors' mood improvement. What is more, the belly and the long end of the curves outperformed the front end and both curves flattened as a result. The front end of the curves was under pressure of comments by the MPC members (Glapiński, Osiatyński) and some unofficial candidates to a new Council, which cooled down market expectations for rate cuts in early 2016. Moreover, spread over Bunds also tightened visibly and fell below 240 bp for 10Y sector (down from over 260 bp at the start of the week).
- FRA market also trimmed earlier losses on Fed due to decline in IRS rates. However, market scaled back its expectations for further monetary easing in Poland. Currently, investors see more than 50% odds of a 25bp reduction on a three-month horizon, but do not expect a rate cut by 50bp anymore. At the same time, WIBORs were more or less stable (only 9M rate fell by 1 bp).

Low liquidity at the turn of the year

- In our opinion, money market rates should remain stable in coming weeks. FRAs could be more vulnerable to news flow about a short list of candidates to a new MPC. Renewed expectations for more cuts early 2016 might again push FRA rates down. Therefore flash CPI, which will be released at the beginning of January together with the recently released information about lower energy and gas prices should help the FRA market to strengthen.
- The front end of the curves was under pressure in last days as investors scaled back their expectations for monetary easing in Poland in early 2016. We think that more cuts (c50 bp in 1Q16) are still likely and these expectations might intensify at the beginning of the next year. Therefore, we still see room for the front end of the curves to adjust downwards.
- FOMC's rhetoric after December's meeting clearly suggests that further rate hikes would only come slowly and will depend on macro and other factors like oil prices outlook or global economy performance. As a result we expect three hikes in 2016. In our view, it creates lower pressure on higher UST yields and consequently on Bunds. As a result, increase in domestic yields (mainly on the long end of curves) should be more muted, with the next non-farm payrolls data in the US as a key for market direction at the start of 2016. Until this time we expect yields/IRS rates to move sideways. However, volatility of the market might remain high as liquidity of the market declines due to the Christmas holidays and year-end.
- The end of 4Q15 and year-end could favour the "window dressing" effect on the Polish debt market. We, therefore, think that the turn of the year could bring downward pressure across the board. Yields are now 7 bp higher than at the end of September on the long-end of curves, while the front end of the curve is close to the level observed a quarter ago.

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