Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

19 – 25 September 2016

Last week kicked off in a rather negative mood following disappointing news on the ECB monetary policy. Later, however, the moods cooled off as investors were positioning ahead of the Fed meeting. In Poland, the data were below expectations, with exports lower than expected, decelerated wage growth, and clearly disappointing employment figures.

The FOMC meeting is the main event of the week. Despite some hawkish data from the US, the market has generally lost faith in the rate hike in September. The question whether the Fed will hike rates this year and whether investors will be looking for any hint in this regard is still up in the air. Moreover, the US central bankers will show their dot chart reflecting their own expectations for interest rates. Last time these forecasts went considerably down. The Bank of Japan meeting may also gather attention, as recent rumours suggested that the Japanese monetary authority may be withdrawing from further easing. In Europe, flash PMI for manufacturing are due for release and these numbers will be important in the light of the last weak data from Germany (output, exports) as well as the ECB stance. In Poland, we will see important data on economic activity. We are quite optimistic about those numbers, so in our view, they may provide some support for the Polish assets, especially given the recent disappointing domestic statistics.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (19 September)					
14:00	**PL**	**Industrial output**	**Aug**	**% y/y**	**5.2**	**6.9**	**-3.4**
14:00	**PL**	**Construction and assembly output**	**Aug**	**% y/y**	**-13.7**	**-14.1**	**-18.8**
14:00	**PL**	**Retail sales (real)**	**Aug**	**% y/y**	**6.5**	**5.8**	**4.4**
14:00	**PL**	**PPI**	**Aug**	**% y/y**	**0.0**	**-0.4**	**-0.4**
		TUESDAY (20 September)					
14:00	HU	Central bank decision		%	0.90	-	0.90
14:30	US	House starts	Aug	% m/m	-1.6	-	2.1
14:30	US	Building permits	Aug	% m/m	2.3	-	-0.1
		WEDNESDAY (21 September)					
	JP	Bank of Japan		%	-0.1	-	-0.1
20:00	US	FOMC decision		%	0.25-0.50	-	0.25-0.50
		THURSDAY (22 September)					
11:30	**PL**	**Bond switch auction**					
14:00	**PL**	**MPC minutes**	**Aug**				
14:30	US	Initial jobless claims	week	k	-	-	260
16:00	EZ	Consumer confidence	Sep	pts	-8.1	-	-8.5
16:00	US	Home sales	Aug	% m/m	1.1	-	-3.2
		FRIDAY (23 September)					
9:30	DE	Flash PMI – manufacturing	Sep	pts	53.2	-	53.6
10:00	EZ	Flash PMI – manufacturing	Sep	pts	51.5	-	51.7
10:00	**PL**	**Registered unemployment rate**	**Aug**	**%**	**8.5**	**8.5**	**8.6**

Source: BZ WBK. Reuters. Bloomberg

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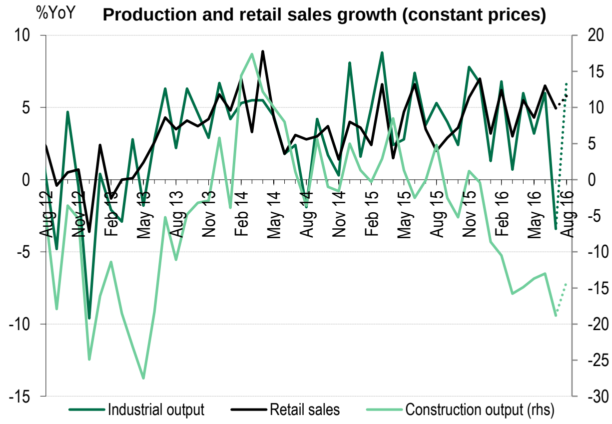
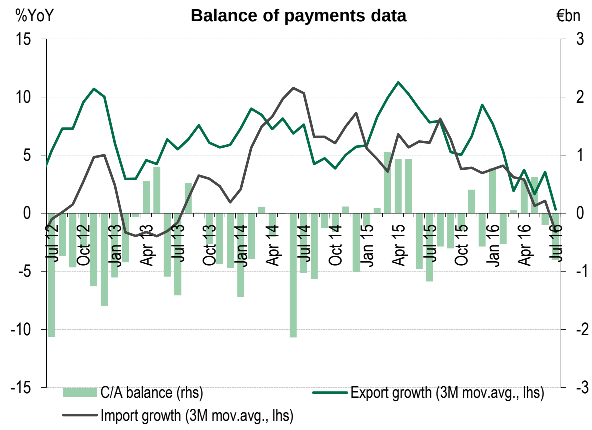
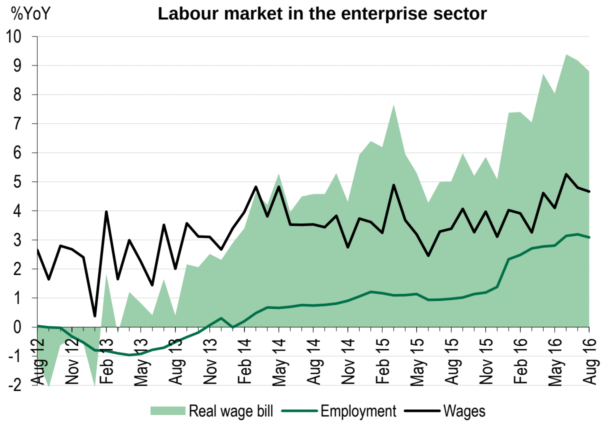
What's hot this week – Industrial and construction output, retail sales



- We expect industrial output to rebound considerably in August, among other factors thanks to a positive working day effect, after a very disappointing result in July. July's slump was partly triggered by the calendar effect, but probably also by the external demand (weak German production and exports). If the August data prove lower than expected again, worries about the Polish economic growth in 2H16 may strengthen.
- In our view, the rebound in construction output in August was not significant, but the next months should see a gradual further improvement, which may herald gradual pickup in investment.
- Retail sales data have shown no clear signs of impact of the 500+ programme so far. We expect the next data to reflect some improvement, especially that households' deposits and cash in circulation were weak in August, which may be a harbinger of higher personal spending.

Last week in the economy – Disappointing data from the Polish economy





- CPI inflation rose in August to -0.8% y/y, up from -0.9% y/y in July. Prices fell 0.2% in monthly terms. Overall, The August CPI does not shed any new light on the price trends in Poland and should be the reason for the MPC to keep interest rates unchanged. Slight rise in inflation was driven by higher food prices, as well as by higher prices of insurance. Core inflation excluding food and energy prices remained unchanged at -0.4% y/y. We expect the inflation to continue rising gradually and reach the positive territory in December.
- The current account deficit reached €802mn in July, more than we and the market expected. The biggest surprise for us was lower exports and higher imports. In annual terms, exports contracted 4.8% and this was the worst result since 2009. Deceleration in exports was an easy call given the poor performance of industrial output in July and disappointing German exports. Still, the slowdown was even sharper than we had supposed and this makes us doubt if Polish exports could do well in the months to come.
- In August, employment in the corporate sector rose by 3.1% y/y versus expectations at 3.2% y/y, while wages in the same sector rose 4.7% y/y, below market consensus. In monthly terms, employment fell by 1 thousand, which was a big disappointment. We have been warning about possible deceleration of job creation for quite some time, pointing to the depleting reservoirs of available workforce. It is still too early to say for sure whether our warnings will materialize or turn out to be just temporary. As regards wages, the annual growth decelerated despite the positive effect of the number of working days (which was negative in July) supporting our call that wages growth in June-July were distorted by the bonus payments in some sectors.

Quote of the week – Deficit not exceeding 30% of plan

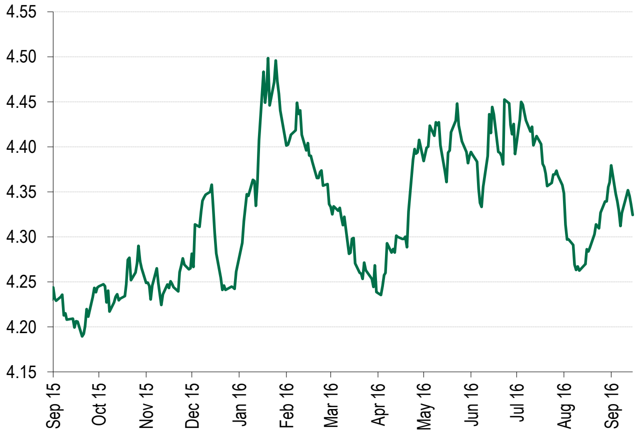
Paweł Szałamacha, finance minister, 13 and 14 September, PAP

The budget deficit did not exceed 30% of the plan after 8 months. Budget revenues amounted to PLN214bn after 8 months. (…) As regards the taxes next year, we are not planning many changes. We may discuss the retail trade tax due to the feedback from the European Commission.

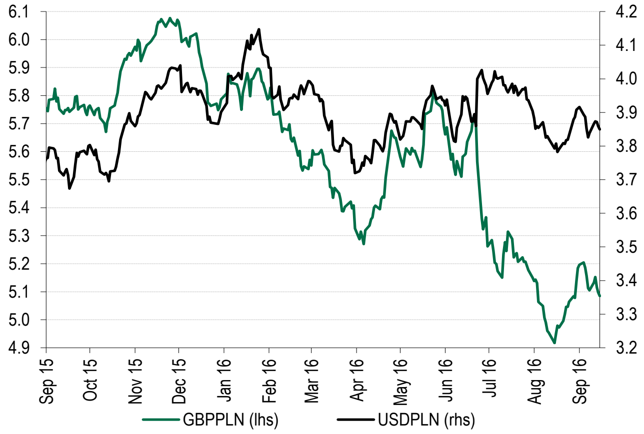
According to Paweł Szałamacha, the budget revenues reached PLN214bn in the Jan-Aug period, which means that in August alone a rise by 14% y/y was recorded, clearly a very good result. However, no detailed data have been released yet, so we cannot say more on this growth breakdown. We estimate that spending has been realized in about 98% after August, so revenues are trending above and spending below the plan. In our view, it is highly probable that the central budget deficit will be below PLN50bn this year and even a result below PLN45bn cannot be ruled out (vs plan at PLN54.7bn). Szałamacha also said that the government may consider taking this opportunity and move some spending from 2017 to 2016. We guess that such a move is being mulled in order to limit the risk of the 2017 deficit going above 3% of GDP.

Foreign exchange market – FOMC will set the direction

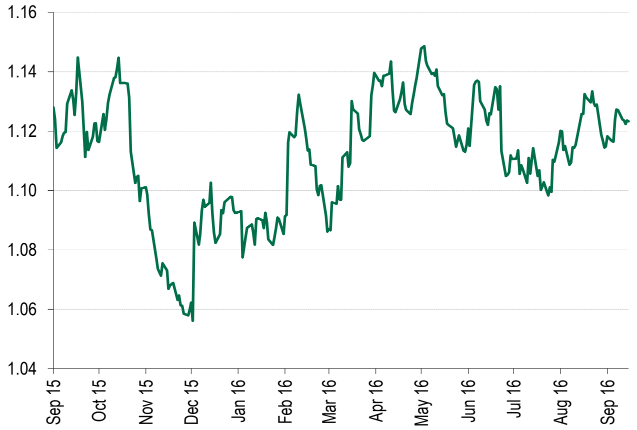
EURPLN



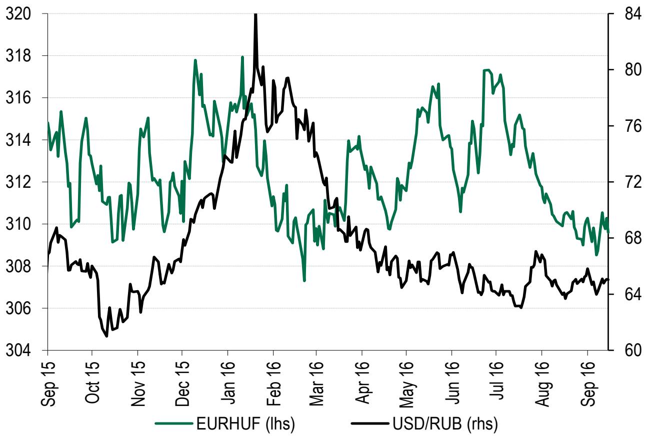
USDPLN and GBPPLN



EURUSD



EURHUF and USDRUB



Zloty waiting for an impulse

- Last week, the zloty stabilized slightly with EUR/PLN hovering around 4.34 and USD/PLN remaining near 3.86. There were no meaningful triggers in the market and last week, the narrowest trading range in September was noted for EUR/PLN.
- Lower volatility might have been caused by the pending FOMC's decision. The market is not pricing in a rate hike to be announced this week, which is in line with our base case scenario, so the decision should not initiate any significant move in the market. The statement from the meeting should have larger impact as it will show the FOMC members' assessment of the most recent US data that was somewhat mixed(poor ISM, strong Philly Fed, decent initial jobless claims, only slightly weaker retail sales and industrial output). It is worth recalling that zloty's depreciation noted since mid-August has been partially fuelled by the increased probability of the Fed rate hike this year amid some hawkish comments made by the Committee's members. More evidence suggesting that the FOMC will lift rates this year (which is not fully priced in by the market either) could hit the Polish currency once again.
- As far as the Polish data is concerned, we think that August industrial output and retail sales will improve significantly vs. July data. Our forecasts for the output is above the consensus, whereas in the case of retail sales, we are less optimistic than the market. We think, however, that the output data should attract more market attention and the Polish data could be net slightly positive for the zloty this week. We think that EUR/PLN could break 4.30, but this could be only for a while. Resistance levels to watch are 4.36 and c4.40.

Volatility goes down ahead of the FOMC

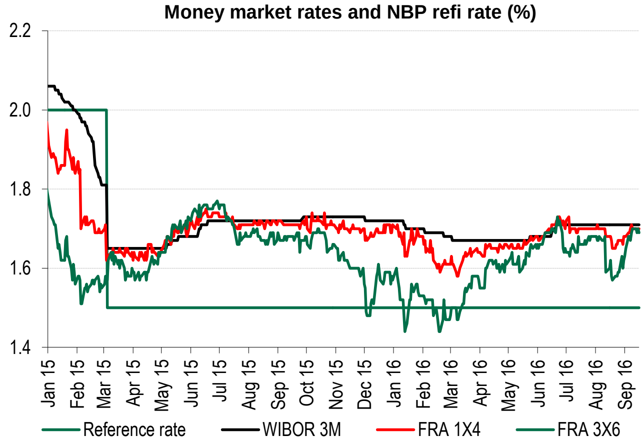
- Volatility on the EUR/USD market has also faded and the exchange rate spent the whole week within the previous Friday's trading range (1.12-1.128) and the last week's high-low spread was the lowest since August 2014. Apparently, such narrow trading range was triggered by investors awaiting the Wednesday's decision on the Fed rates.
- As mentioned above, both we and the market do not expect a change in rates so the statement will be the key. Statistically, periods of lower volatility are followed by more dynamic moves and so we expect more noticeable changes in EUR/USD this week in reaction to the FOMC statement.

CBR cuts rates, MNB will not follow

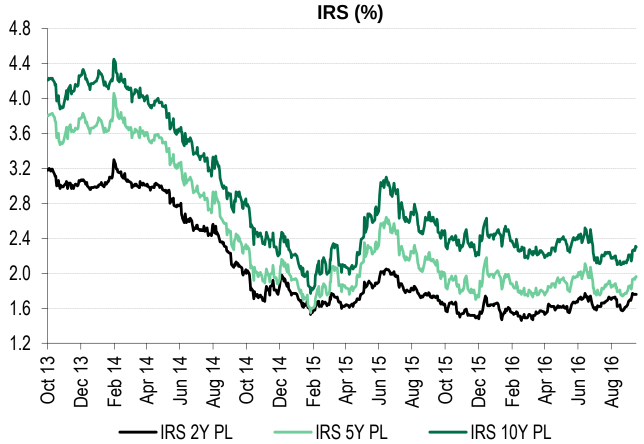
- Both EUR/HUF and USD/RUB did not move much from the levels seen last week – the former remained near 310, while the latter around 65.
- The Russian central bank (CBR) cut interest rates by 50bp to 10%, in line with the consensus. The bank said there will be no more easing this year and more cuts may take place in 1H17 should inflation decline and the risk for the meeting bank's 4% inflation target at the end of the next year not rise.
- The Hungarian central bank (MNB) holds a meeting this week but no change in the monetary parameters is expected and so it is the FOMC decision that should have the main impact on the forint this week.

Interest rate market – Waiting for central banks

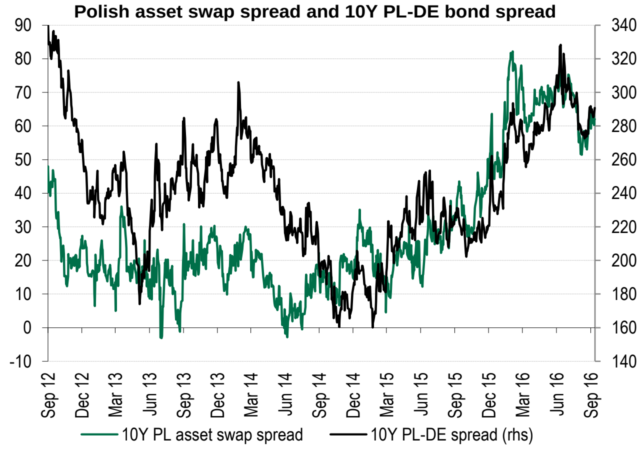
Money market rates and NBP refi rate (%)



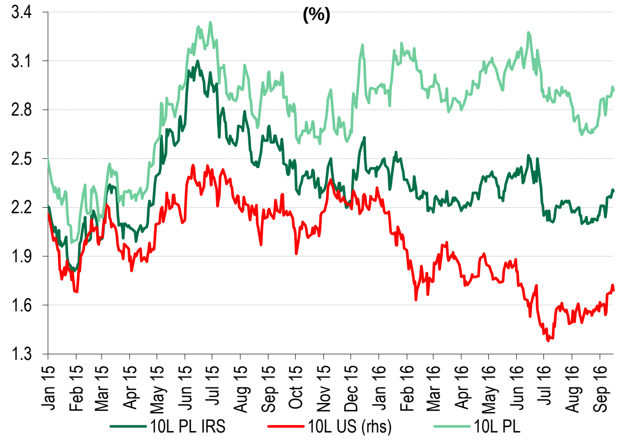
IRS (%)



Polish asset swap spread and 10Y PL-DE bond spread



Yields of PL and US 10Y benchmarks and 10Y PL IRS (%)



Polish IRS/yields stable…

- Last week, the Polish IRS and bond yields held near their local peaks with some higher volatility seen only at the very end of the week when, as a result, the 2Y IRS was near 1.75%, the 5Y rate around 1.95% and the 10Y IRS near but still below 2.30%.
- FRAs did not move much as well and the market still does not price in any change in the NBP interest rates in the next 21 months. 1-12M WIBORs remained stable.

…awaiting Fed and BoJ

- There was no meaningful market reaction to the Moody's decision to leave Poland's rating and outlook unchanged and now the investors' attention is likely to shift to global factors, as the FOMC and BoJ meetings are approaching.
- The one-month correlation between the Polish 10Y IRS/yield and the 10Y Treasury is above 80%, making the domestic FI market quite exposed to the Wednesday's FOMC decision. We do not expect the Fed rates to be lifted already this week and this should not surprise investors. The tone of the statement is likely to be crucial and rates may rise worldwide (pushing them up also in Poland) should hawkish rhetoric from the FOMC members be maintained. The other factor, next to the hawkish signals from the Fed driving Polish market rates up in the last weeks, was the Bank of Japan's reluctancy to take bolder action towards the monetary policy easing. BoJ will announce its decision on Tuesday and the market consensus shows investors are not expecting any change neither in the interest rates nor in the size of the asset purchase programme. However, the BoJ has been rumoured it could change the structure of its purchases in order to push the long-term rates higher and if these speculations are confirmed, Polish long end may be higher before the FOMC decision.
- At the same time, we think that the scope of the weakening of Polish bonds is limited and if the 10Y yield nears 3%, it could be utilized for purchases in the world of the ultra-low interest rates.

Switch auction to start pre-financing process

- On Thursday, the Finance Ministry will hold a bond switch auction. The Ministry has not declared yet which bonds it will offer but these will not be the same as those offered at the beginning of the month (OK1018, WZ1122, DS0726). This means that the chances for offering the 5Y benchmark PS0721 are pretty high. The most recent data show that at the end of July non-residents held 37% (PLN7bn) of PS0721 outstanding at that time and had been accumulating this bond in the earlier months.
- This week's auction will start pre-financing of the 2017 requirements. The ministry expects to cover c20% of its 2017 gross borrowing needs by the end of this year, which, in our view, seems realistic.

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