Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

31 October – 6 November 2016

Last week investors' sentiment was mixed and fragile, depending on macro data releases. CEE currencies suffered from lower risk appetite and Hungarian central bank decision to ease its monetary policy. At the same time, debt market weakened globally as probability of Fed rate hikes this year increased visibly. As a result, EURPLN reached temporarily 4.345, while yield of Poland's 10Y benchmark rose temporarily above 3.15%. However, end of the week brought some rebound across all classes of assets.

This week's macro and events calendar abroad is heavy. It will include, among others, flash 3Q16 GDP growth in the euro zone, PMI indices, October's job report in the USA and central banks' meeting (BoJ, Fed, BoE). In our view, Fed outcome and non-farm payrolls are the key for market direction as they will influence FOMC decision in December. Fed is widely expected to keep interest rates unchanged this month, therefore investors will pay more attention to the statement. If FOMC sounds more hawkish, the global debt market can weaken gradually. This could also negatively influence the Polish zloty and other CEE currencies. All in all, we expect higher volatility on the financial markets after quite stable two previous weeks. As regards domestic factors, flash CPI and PMI are due this week. We expect further increase in the headline CPI as a result of growth in food and fuel prices. We think that also October's PMI for Poland may slightly rise. In our view, market response to domestic factors will be rather limited. At the start of the week liquidity on the Poland's market will be low as the financial market is closed on Tuesday, therefore Poland's assets could be more exposed to the global trends.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (31 October)					
11:00	EZ	Flash GDP	Q3	% y/y	1.6	-	1.6
11:00	EZ	Flash CPI	Oct	% y/y	0.5	-	0.4
13:30	US	Personal income	Sep	% m/m	0.4	-	0.2
13:30	US	Consumer spending	Sep	% m/m	0.4	-	0.0
14:00	**PL**	**Flash CPI**	**Oct**	**% y/y**	**-0.3**	**-0.3**	**-0.5**
		TUESDAY (1 November)					
	PL	**Market holiday**					
15:00	US	ISM – manufacturing	Oct	pts	51.7	-	51.5
		WEDNESDAY (2 November)					
9:00	**PL**	**PMI – manufacturing**	**Oct**	**pts**	**52.9**	**52.4**	**52.2**
9:55	GE	PMI – manufacturing	Oct	pts	55.1	-	54.3
10:00	EZ	PMI – manufacturing	Oct	pts	53.3	-	52.6
13:15	US	ADP report	Sep	k	165	-	154
19:00	US	FOMC decision		%	0.25-0.50	-	0.25-0.50
		THURSDAY (3 November)					
11:00	**PL**	**Switch auction**					
13:00	CZ	Central bank decision		%	0.05	-	0.05
13:30	US	Initial jobless claims	week	k	255	-	258
15:00	US	Industrial orders	Sep	% m/m	0.3	-	0.2
15:00	US	ISM – services	Oct	pts	56.0	-	57.1
		FRIDAY (4 November)					
13:30	US	Non-farm payrolls	Oct	k	175	-	156
13:30	US	Unemployment rate	Oct	%	4.9	-	5.0

Source: BZ WBK. Reuters. Bloomberg

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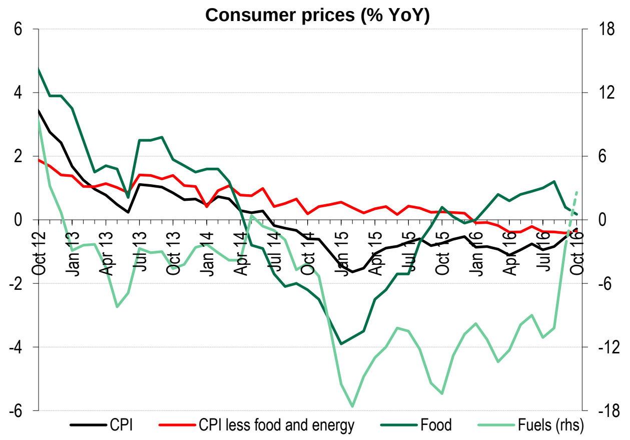
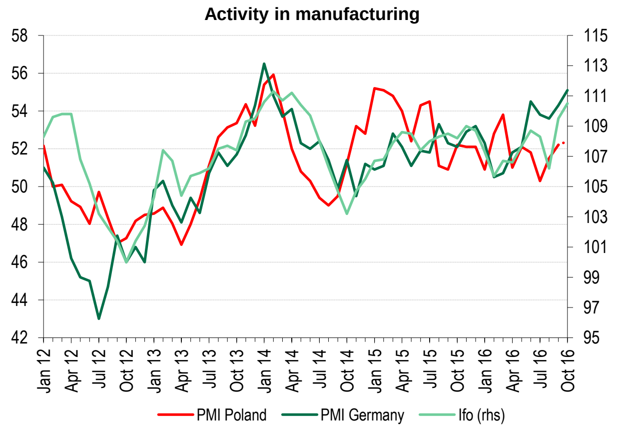
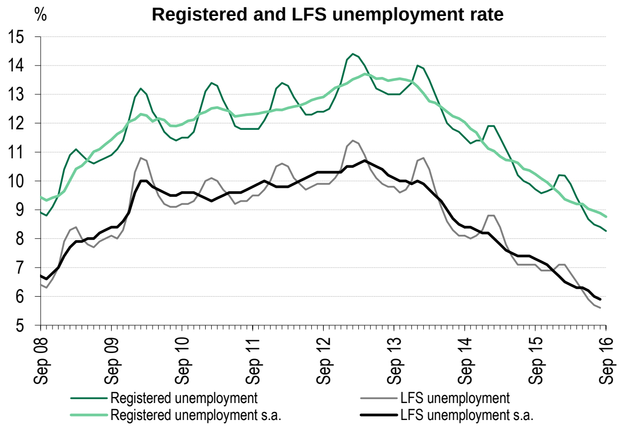
What's hot this week – Flash CPI and PMI



- We expect CPI to continue its upward trend in October and to reach -0.3% y/y, the highest level in two years. The upward momentum is generated mostly by fuel and food prices, with core inflation (excluding food and energy prices) most likely remaining flat at -0.4% y/y. In our view, it is probable that inflation will turn positive in December and then remain close to 1% y/y on average in 2017.
- In our view, PMI index for Polish manufacturing inched up in October following the improvement of these indices for Germany and the euro zone. However, the statistics office (GUS) index for manufacturing fell in October after a jump in September. Business climate in Germany remains crucial for prospects of Polish exports and industrial output.

Last week in economy – Unemployment rate and Statistical Bulletin





- The registered unemployment rate went down in September to 8.3% vs the consensus at 8.4%. A stronger decline was caused by the correction in the employment data (unemployment went down in 2015 and 2016). According to our estimates, employment was revised upwards by 150k or by c1%. We expect a further reduction of the unemployment rate (after a seasonal adjustment) in the forthcoming months although at a slower pace.
- Detailed data on employment in the corporate sector showed a continuation of growth in industrial manufacturing, trade, transport and administrative services. Trends in other sectors, especially mining, utilities and construction, remained weak.
- Output of investment goods advanced by 3.8% y/y in September 2016. In the whole Q3, investment goods output increased only by 2.2% y/y, which is the slowest growth this year. In our view, this suggests that investment in machinery and equipment may have slowed down in Q3.
- Maria Jeznach, the Head of National Accounts Department of the Statistical Office (GUS), said that it may be expected that GDP in Q3 will grow slower than 3.1% recorded in the first half of the year. In our view, Polish economy grew by 2.9% and according to Bloomberg survey we are below the consensus at 3.3%. Let us remind that recently GUS revised Poland's GDP growth in 2015 from 3.6% to 3.9%. This was mostly related to an upward change in exports to 7.7% y/y from 6.5% y/y previously. We do not know the quarterly breakdown yet, but generally this change created a higher base for this year's readings. Flash 3Q16 GDP data are due in mid-November.

Quote of the week – Interest rates are optimal

Eugeniusz Gatnar, MPC member, 26 Oct, Reuters

In my view, GDP growth in Q3 will reach 3.2%. Growth in Q4 will be similar – above 3% and 3.2% in the whole 2016. This makes me think about further stabilization of interest rates, but in my view the rates may go up in 2018. Currently, interest rates are at the optimal level.

Grzegorz Bierecki, member of Senate, 26 Oct, PAP

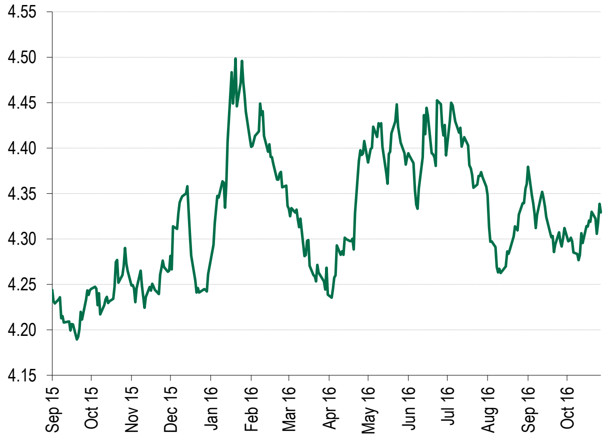
Rafał Sura is a candidate for the Monetary Policy Council suggested by PiS's senators.

MPC member Eugeniusz Gatnar said that in his opinion the current level of NBP interest rates is optimal and should not be changed. He thinks that interest rate cuts would not stimulate economy, but could be negative for the banking sector stability and could contribute to speculative bubbles. Gatnar added that the next interest rate move should be a rate hike, but in 2018. However, Gatnar remains quite optimistic about the economic growth. We think that Polish economy will not grow faster than 3% y/y in the nearest quarters, which may be a negative surprise for Gatnar and other MPC members.

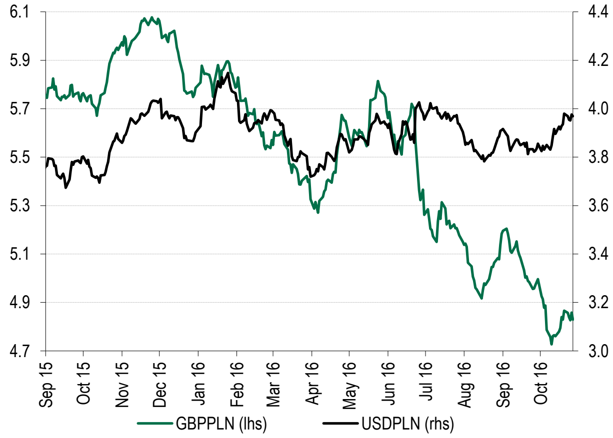
Rafał Sura will be the candidate for the MPC to replace Marek Chrzanowski. Sura holds PhD in legal sciences and specializes in financial and administration law. Just like the majority of the Council members, he does not have any experience in monetary policy and would be the sole non-economist in the MPC. We do not think that if Sura is elected, his views will influence the outlook for the monetary policy.

Foreign exchange market – Central banks' meeting and macro data in the spotlight

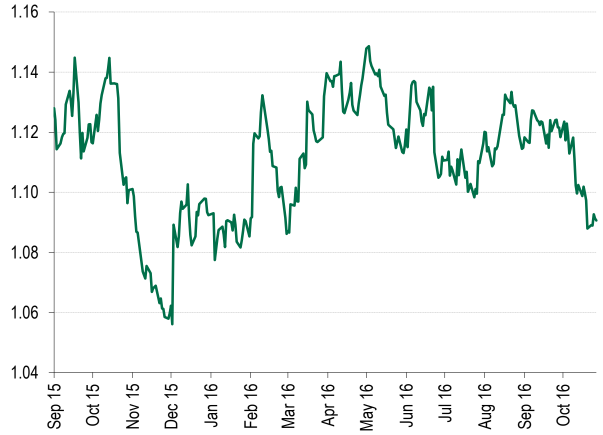
EURPLN



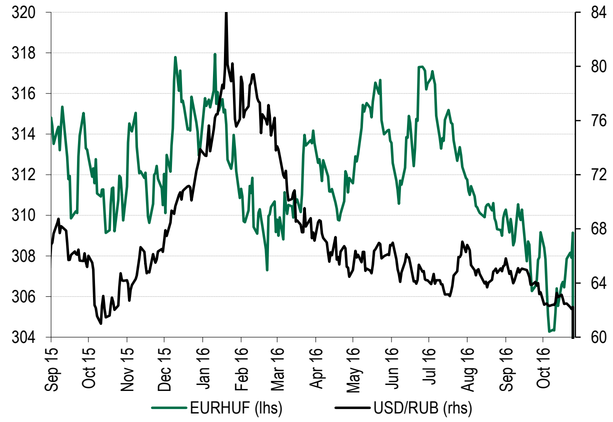
USDPLN and GBPPLN



EURUSD



EURHUF and USDRUB



Zloty could recover somewhat

- Last week, EURPLN was in the range of 4.30-4.35. Initially, EURPLN fell towards the lower boundary of the fluctuation channel and then it increased to nearly 4.345 (its highest level since early September). The zloty's weakening stemmed from decreasing risk appetite and situation on the FX market in Hungary. Zloty, following the Hungarian forint, weakened visibly in response to the Hungarian central bank decision (more details below). On a weekly basis, Polish zloty was among the EM countries which underperformed most noticeably against the euro, the US dollar and the Swiss franc. However, the zloty gained slightly against the British pound.
- This week, in our view, volatility on the zloty can increase after two weeks of EURPLN moving in sideways. It will mainly depend on the macro data abroad (in particular from the USA) and the outcome of FOMC's November meeting. We do not exclude that the zloty might rebound somewhat if the US macro data disappoint. However, the zloty's strengthening will be limited as higher volatility returns on the market at the end of the week ahead of the US presidential election on November, 8. We still expect EURPLN to rise later in the year.
- As regards domestic data, investors will draw their attention to PMI index for Polish manufacturing. We expect the October's index to remain more or less stable. Consequently, the release will be rather neutral.

EURUSD increased only gradually

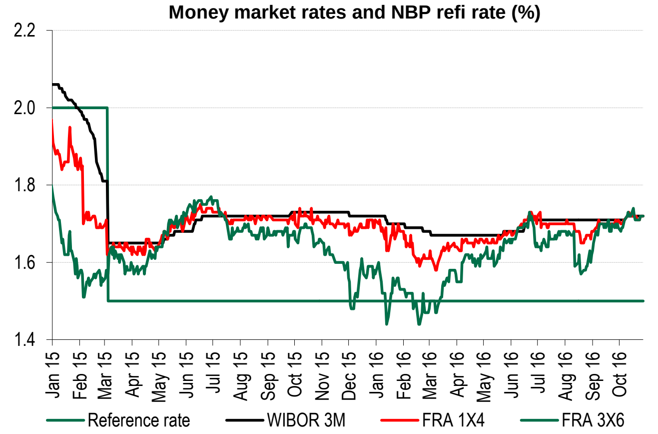
- The euro gained somewhat against the US dollar over the past week after the recent weakening. However, the scale of the move was not significant as EURUSD rose temporarily to 1.095. At the same time, GBP weakened against both the euro and the US dollar as Northern Ireland court rejected challenges to the Brexit process, removing the least obstacle to PM Theresa May's plan to begin severing ties with the European Union by the end of March.
- This week macro and events calendars are quite heavy. The main focus will be on central bank meetings (BoJ, Fed, BoE) and job report in the USA. In our view, central banks will keep their monetary policy unchanged this week. However, we think that FOMC statement could suggest a rate hike in December, in line with the expectations. This, together with October's job report in the USA, may add to market volatility. In our view, the more hawkish FOMC outcome, the greater strengthening of the US dollar.

Global factors in the spotlight

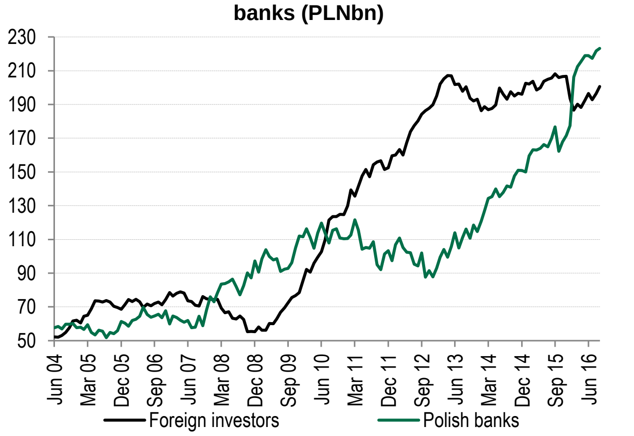
- Last week, both HUF and RUB were under influence of central banks' outcome. The Hungarian central bank decided to lower lending rate by 10bp, to 1.05% and to cut the reserve requirement ratio from 2% to 1%, while keeping the main rate unchanged at 0.90%. The MNB rhetoric had negative impact on the forint – EURHUF rose above 309, up from 307.8 at the end of previous week. As expected, the Russian central bank kept its monetary policy unchanged (the base rate remained at 10%). The Russian ruble lost against the US dollar, with USDRUB increasing temporarily above 63 due to oil prices decline.
- This week global factors will be the key for both HUF and RUB. FOMC outcome should set HUF direction in the short run. On the other hand, RUB will be still under the influence of oil prices. Today OPEC and non-OPEC experts start production-cap discussions, which will end during the weekend. Results will be crucial for USDRUB.

Interest rate market – Time for a correction?

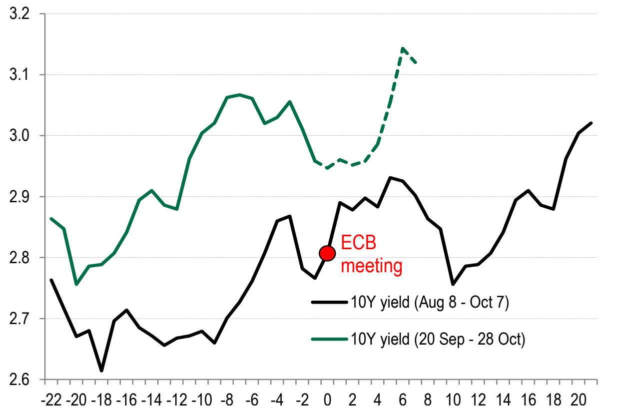
Money market rates and NBP refi rate (%)



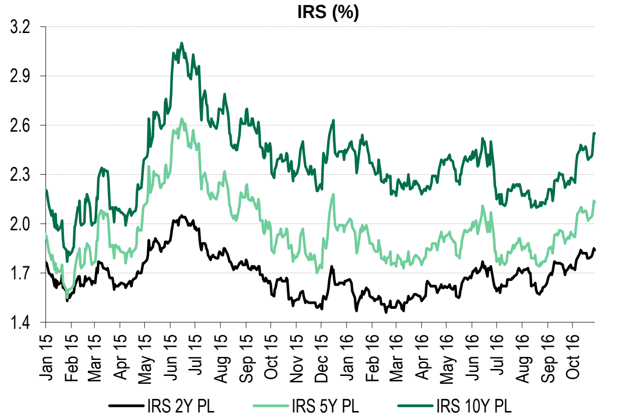
Polish. PLN, marketable bonds held by nonresidents and Polish banks (PLNbn)



Polish 10Y benchmark yield



IRS (%)



High volatility on the global market

- Last week, the global debt market was under pressure as chances for Fed rate hike in 2016 increased. Significant sell-off abroad had taken its toll also on the Polish market, where the 10Y benchmark yield skyrocketed temporarily to 3.15%, its highest since late June. The IRS curve also moved sharply up on weekly basis – the 10Y rate jumped 15bp to 2.55%, the 5Y IRS went up by 10bp to 2.15% and 2Y rate rose 5bp to 1.85%. It is worth noticing that Polish bonds were not underperforming their peers and the 10Y spread vs the Bund remained roughly stable near 295bp. Also, Polish curves steepened following the global trend.
- Developments on the IRS market influenced FRAs as well, where the longest rates rose 10bp. 1-12M WIBORs did not change on weekly basis.

Non-residents' bond holdings above PLN200bn again

- According to the most recent data released by the Ministry of Finance, in September, non-residents purchased Polish, PLN-denominated debt for PLN4.1bn in nominal terms (the largest monthly increase since May) and the nominal value of their portfolio had risen above PLN200bn for the first time since December 2015 (the subsequent decline was triggered by the S&P's rating downgrade). Within this group, the biggest buying was recorded for mutual funds (PLN1.2bn) and commercial banks (PLN915mn). Polish commercial banks bought PLN1.5bn of Polish debt.
- The Ministry of Finance informed that it will offer OK1018/IZ0823/DS0727 bonds on the switch auction planned for November 3. During the standard auction on November 17, the Ministry will offer debt for PLN3-7bn and the market conditions will determine which bonds will be offered. Deputy Finance Minister said that 100% of the this year's borrowing needs were covered.

Time for a correction?

- Two weeks ago, we showed that Polish 10Y yield had been following the trend we saw one month before the September's ECB meeting. Back then, we concluded that we expect Polish market rates to rise later during the year and this has recently been proven correct. When we update the chart, we see that if the yield was supposed to continue to follow the pattern, some debt recovery might emerge soon. Perhaps this has already started on Friday and foreign investors will be eager to take advantage from recent weakening of Polish bonds and the 10Y yield rising to 3.15%.
- Polish flash October CPI and manufacturing PMI are on the agenda this week, but we think that the FOMC decision and the US monthly job report will be the key factors driving Polish rates. Our base scenario assumes no rate hike this week, but if the FOMC members want to tighten monetary policy this year the statement should sound more hawkish than the previous one. If this is the case, the global rates might rise, although the room for an increase looks to be limited as the market is now pricing over 70% chances for a 25bp Fed rate hike in December (according to Bloomberg) and the ECB said it would not end its asset purchase program abruptly.
- There is a market holiday on Tuesday so lower liquidity may persist during the whole week making Polish IRS/yields even more exposed to the global trends.

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