

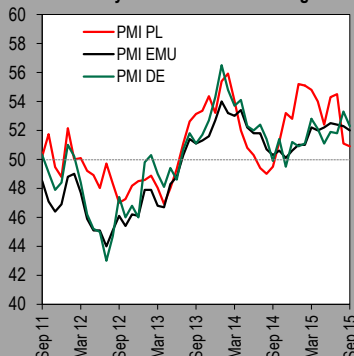
MACROscope

Polish Economy and Financial Markets

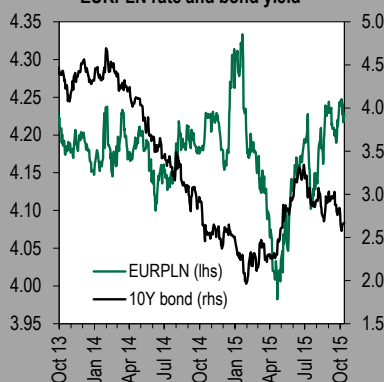
October 2015

A longer period of uncertainty?

Activity indices in manufacturing



EURPLN rate and bond yield



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ECONOMIC ANALYSIS DEPARTMENT:

al. Jana Pawła II 17, 00-854 Warszawa fax +48 22 5868340
 email: ekonomia@bzwbk.pl Website: skarb.bzwbk.pl
 Maciej Reluga (chief economist) +48 22 534 18 88
 Piotr Bielski +48 22 534 18 87
 Agnieszka Decewicz +48 22 534 18 86
 Marcin Luziński +48 22 534 18 85
 Marcin Sulewski +48 22 534 18 84

■ We see a strong resemblance between the current economic situation and the pattern of almost exactly a year ago: the PMI index is falling sharply, we have had some disappointing economic data (except for the labour market, which is doing fine), and external shocks are fuelling uncertainty about the global economic outlook (currently a slowdown in China and Emerging Markets, and a year ago Russian sanctions following the crisis in Ukraine). Even though the uncertainty and risk factors are likely to last longer (China, Volkswagen issue, Brazil, Greece, to name just a few), we believe that there are good reasons to expect the Polish economy to continue its healthy economic growth (c3.5% YoY in 2015-16), just as it did one year ago (details on p. 3-4).

■ Two weeks before the parliamentary elections the result seems highly uncertain and different opinion polls suggest different results, not to mention the fact that in past elections the polls were unreliable. Additionally, if there is no clear winner, the period of uncertainty may not end just a week or two after the election day, but may last until winter (or longer). On page 6 we present the timeline of procedural steps defined by the Constitution, together with the latest possible deadlines laid down by law.

■ Flash CPI data showed deflation deepening in September to -0.8% YoY, but we think this was only a temporary pause in the upward trend, which will push inflation above zero in November and towards 2% in 2016E. We still argue that, in these circumstances, there should be no need for Polish monetary policy to ease in 2016E, even though market speculation about possible rate cuts has been growing recently. This will probably continue, which may push domestic interest rates even lower. The long end of the domestic yield curve may obtain further support from falling yields on core markets, limited debt supply in October and a substantial inflow of money from bond redemptions and coupon payments. The scope for strengthening is limited, in our view, amid decent macro data and some investors may be willing to cut their exposure given electoral uncertainty. Until year-end, long-term yields are likely to rise, though an additional risk factor here concerns US monetary policy, as after September's meeting this uncertainty may last longer than previously thought.

■ EURPLN volatility dropped substantially in September and we now see a risk of a zloty depreciation vs the euro in the nearest days, given the uncertainty ahead of the October election and the Fed meeting. However, we think such a move would only be temporary. The Polish currency should regain strength at the end of this year, supported by the following factors: (1) a continuation of healthy economic growth; (2) rising inflation, which will reduce rate cut expectations; and (3) a US rate hike before the end of the year (limiting worries about global growth).

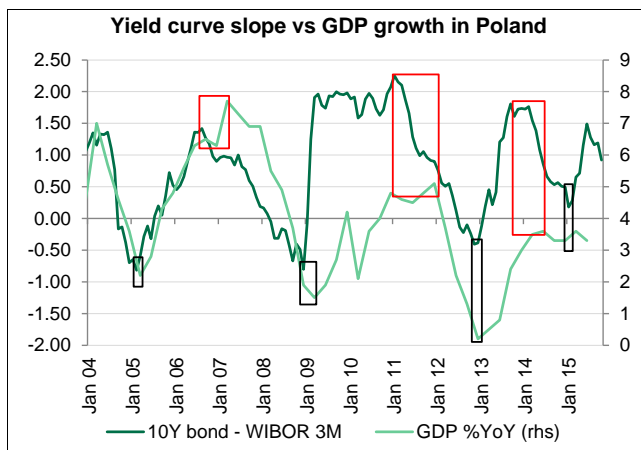
Financial market on October 12 2015:

NBP deposit rate	0.50	WIBOR 3M	1.73	EURPLN	4.2273
NBP reference rate	1.50	Yield on 2-year T-bond	1.70	USDPLN	3.7148
NBP lombard rate	2.50	Yield on 5-year T-bond	2.23	CHFPLN	3.8644

This report is based on information available until 12.10.2015.

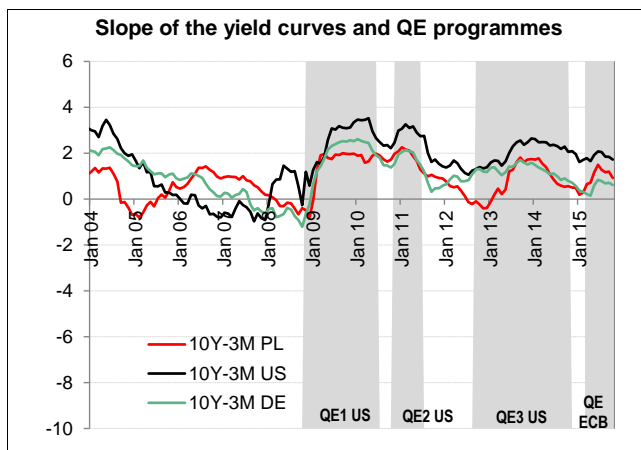
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Is the yield curve a good leading indicator in Poland?



Simple regression model – R² coefficient for different combinations of explanatory variable and its lag

Variable \ Lag	Bond 10Y - 2Y	Bond 10Y - WIBOR 3M	CSO index	PMI index	IRS 10Y-IRS 2Y
0	0.29	0.39	0.53	0.42	0.02
-1	0.39	0.57	0.49	0.44	0.19
-2	0.28	0.62	0.34	0.23	0.37
-3	0.12	0.46	0.15	0.12	0.39
-4	0.00	0.16	0.15	0.03	0.21



- The yield curve is often regarded as a good predictor of economic cycles and there is strong empirical evidence that the slope of the curve can be a reliable predictor of future economic activity in some countries, for example in the USA¹.

- Fluctuations in the Polish interest rate market in recent months, as well as growing uncertainty about the economic outlook, convinced us to look more closely at links between yield curves and the economic cycle in Poland, and to investigate what the current market conditions might tell us about the future economic situation.

- We decided to construct econometric models with the curve slope as an explanatory variable and economic growth as an endogenous variable. We experimented with various interest rate spread definitions, lags, samples and methodologies (linear regression, logit, VAR, regime-switching).

- Logit models proved to have very low predictive power², but VAR models confirmed that the curve slope does Granger cause economic growth. As regards simple regression³ the best results were obtained for the sample covering the period between 2010 Q1 and 2015 Q2, and for the slope defined as the spread between the yield of the 10Y bond and WIBOR 3M. This model had higher predictive power for future GDP growth in the last few years than popular economic climate indicators (the PMI or the CSO business climate indicator) – it was able to explain up to 62% of variations in GDP growth two quarters ahead. Meanwhile, the CSO index explained up to 53% of GDP changes and the PMI index up to 44%, but with lags of 0 and 1 quarters, respectively. However, the sample used for the regression was very short and once it was extended, the yield curve's predictive power dropped substantially, signalling the results were not robust.

- We also assumed that the slope-growth relation might not be linear, so we used a regime-switching model⁴, proving that changes in slope were more strongly connected to GDP during slowdowns.

- This seems to be in line with conclusions of detailed visual inspection of charts of the yield curve slope and the economic growth, which show, in our view, that the changes in the yield curve slope were leading the changes in economic growth only in periods of economic slowdowns, while in stages of recovery the curve was reacting to accelerating growth rather than predicting it. In particular, the slope usually reached its local minimum almost exactly in the same quarter as when GDP growth was at the bottom.

- The special case was the significant flattening of the yield curve at the end of 2014 and the start of this year. Although the curve has not inverted, the spread between the 10Y bond yield and WIBOR 3M plummeted sharply in this period, reaching its local low at 18bp in January 2015, and bouncing back quickly in the following months. This time, the change in the curve slope seemed to be a false signal, as it was not followed by a GDP slowdown, but rather by its stabilisation at a relatively high level (near 3.5%YoY). It is yet another factor challenging the findings of the linear regression – should they be valid, the Polish economy would have slowed down probably somewhere in mid-2014.

- We think that recent changes in the slope of the yield curve were driven mainly by expectations for European QE, and less by domestic economic conditions. It is important to note that – contrary to earlier QE programmes in the USA – the quantitative easing in the euro zone was implemented when the area's (and in particularly Germany's) economy was already accelerating, not slowing.

- Currently, the domestic yield curve has started flattening again, but we think that once again this is mainly because of speculation about an extension of the ECB's QE programme (which we do not expect) and/or delay in Fed monetary tightening. We do not think it is a reliable signal of looming economic slowdown in Poland.

Source: CSO, Reuters, Bloomberg, BZ WBK.

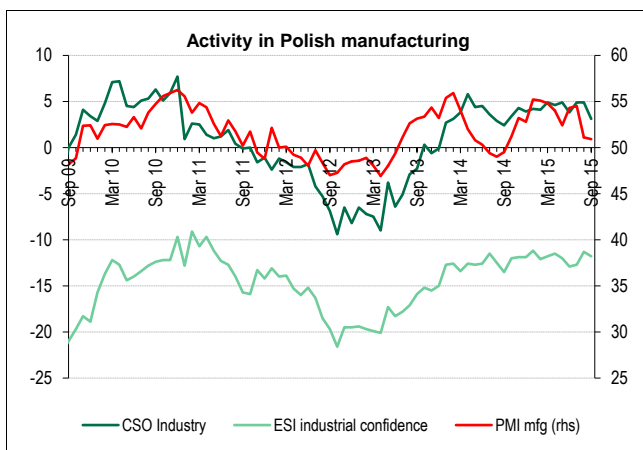
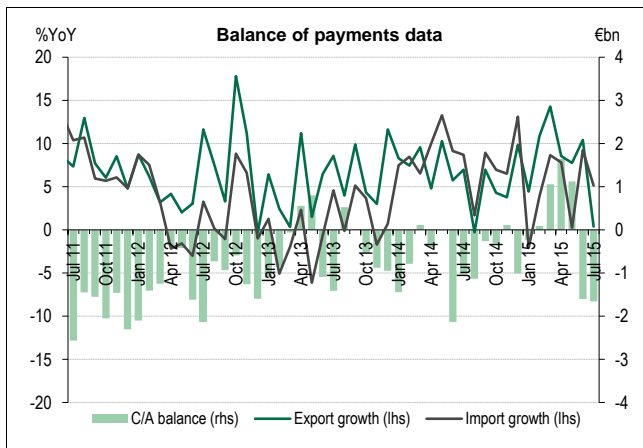
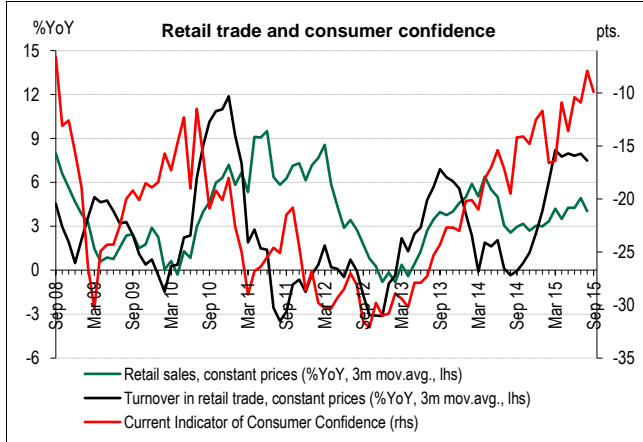
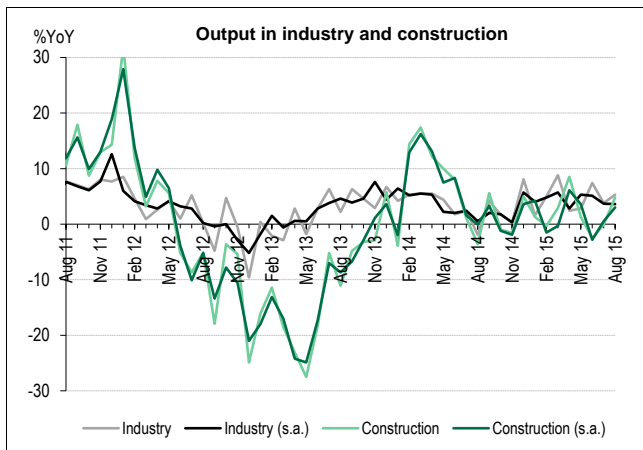
¹ Arturo Estrella & Frederic S. Mishkin, 1996. "The yield curve as a predictor of U.S. recessions," Current Issues in Economics and Finance, Federal Reserve Bank of New York, vol. 2(Jun).

² Our logit models explained a dummy variable, equal to 1 when the economic growth was slowing down at least two quarters in a row and by more than 0.5pp in total and equal to 0 in other cases.

³ With annual GDP growth rate as an endogenous variable.

⁴ Regime-switching models used change in GDP growth as an endogenous variable and change in curve slope as explanatory variable. There were two regimes with the same definition as in the case of logit model.

Economic update



Source: CSO, NBP, Markit, European Commission, BZ WBK.

Industry weakened (and not because of energy shortages)

Industrial output grew 5.3% YoY in August and proved rather disappointing. The pace of growth accelerated vs. July's 3.8% but this was mainly thanks to a positive working-day effect. According to the stats office, after the seasonal adjustment, industrial output growth reached 3.6% YoY, the lowest since April and below the average for the first seven months of the year (4.5% YoY).

In August, Poland faced the closure of some power stations due to a severe drought. However, total energy consumption rose noticeably in August—annual growth of energy production and supply reached 1% YoY vs. -2% YoY in July. According to PSE (company servicing energy transmission), the limitations in energy supply amounted to 55 GWh and we estimate the average consumption in the manufacturing sector at 5k GWh vs. total consumption at 13k GWh. This means that the energy shortage for manufacturing reached a maximum of 1% and, in our view, this is the maximum total drop in output due to the energy shutdown (it was probably even smaller, as companies were able to save energy on non-essential activities).

Retail sales also disappointed, possibly due to the weather

The increase in retail sales at constant prices in August amounted to 2.0% YoY (vs. 3.5% YoY in July), while sales in current prices decreased by 0.3% YoY (vs +1.2% YoY in the previous month). The outcome was significantly below consensus. Sales in the categories of clothing and footwear and furniture and electronics disappointed, in our opinion, the most. It is likely that – at least partly – this was a side effect of an exceptionally hot and dry summer, discouraging people from shopping in big shops, but encouraging sales in small shops (while on vacation). This was confirmed by data on retail trade turnover, covering also small shops, which continued to record strong growth at over 6% YoY.

Exports plummeted...

The current account balance in July reached -€1,660mn, which was the highest deficit in more than three years. The significant deterioration of the balance compared to June resulted from surprisingly weak exports (annual growth fell from c11% in June to nearly 1% in July). According to the NBP, weaker exports were partially due to sharp falls in sales of mobile phones. This was most likely an effect of the government's measures aimed at curbing tax evasion (introduction of a reverse charge on VAT on electronics in July). This, however, does not explain the whole slowdown, and we believe that the effect will be partly reversed in August.

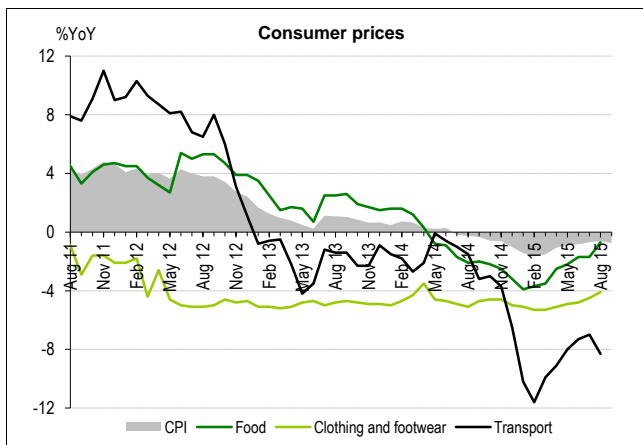
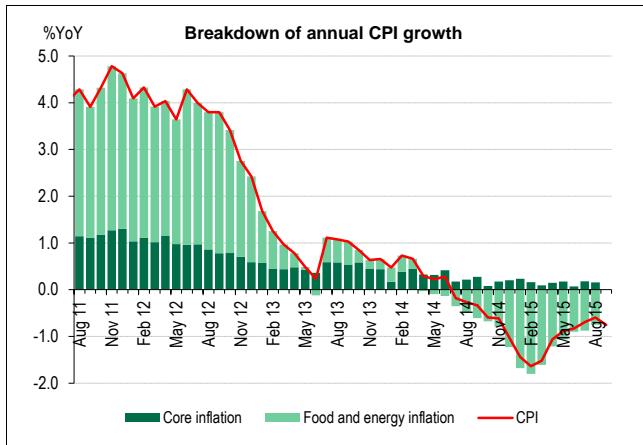
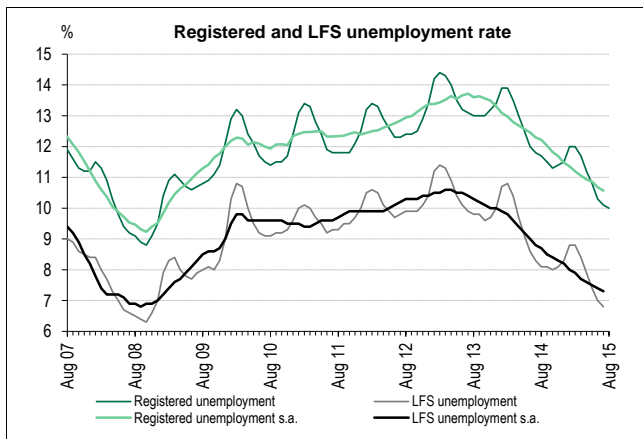
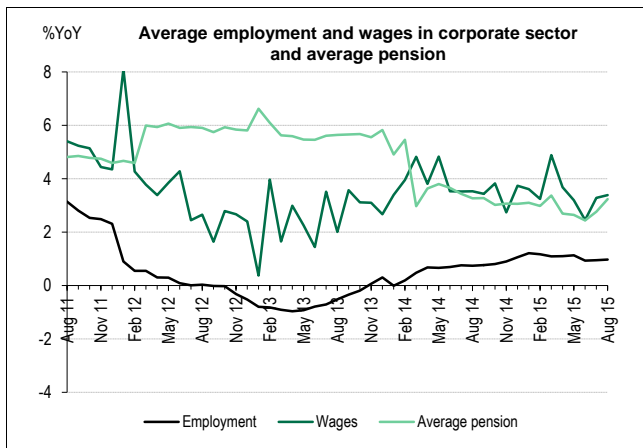
... and the PMI inched lower...

The PMI for Polish manufacturing disappointed for the second month in a row and dropped to 50.9pts in September (its lowest level for 12 months) from 51.1pts. The pace of output and order growth did not change much on a monthly basis but new export orders fell for the first time in 11 months. The latest weak PMI reading generates an additional uncertainty for Poland's manufacturing and general economic outlook. Other business climate indicators for September were not equally pessimistic, but also showed some deterioration of economic sentiment.

... but we remain optimistic yet cautious

In general, the last set of Polish macro data was quite weak. However, as argued above, some of this disappointment was due to one-off factors and we still think there are good reasons to expect the Polish economy to continue its healthy economic growth (c3.5% YoY in 2015-16), just as it did one year ago. The key issue for Poland is the outlook for the euro zone economy. Recent signals from abroad (weak data from Germany, VW scandal, data from China) are worrying, so the risk is skewed downwards, but we still believe the solid GDP growth in the euro zone should boost Polish exports in the coming quarters.

Economic update



Source: CSO, NBP, Eurostat, BZ WBK.

Labour market still growing stronger

- Average employment in the corporate sector rose 1.0% YoY in August, stronger than expected. On a monthly basis, employment in the corporate sector rose by 5k and this was the best result since 2007. We were rather sceptical as regards the room for a more substantial rise in employment and expected a slower pace of growth due to a contracting pool of available workers. Weak employment growth in 1H15 was in line with our call. Meanwhile, employment has been accelerating since July (which was also the best month for a couple of years). Note, however, that the improvement is being recorded basically in only one category – administrative and support service activities. Therefore, we still expect employment growth to stabilise and then even decelerate slightly in the coming months.

- Data on wages (3.4% YoY) did not bring much to the macroeconomic picture and only confirmed the positive tendencies of earlier months – wage growth is moderate, supporting a rise in household purchasing power. The wage bill in the corporate sector rose by 4.4% YoY in nominal terms and by 5.2% YoY in real terms in August.

- The registered unemployment rate fell in August to 10.0% and to 9.9% in September, according to data from the Labour Ministry (single-digits for the first time since 2008). The LFS seasonally adjusted unemployment rate fell to 7.2% in August and data for the previous months were revised downwards. The unemployment rate is now close to an all-time low of 6.8%, a level which we believe could be reached in late 2015 or early 2016.

- Labour market data confirm that the labour market is still in a good shape, which is positive for private consumption in 3Q.

CPI going up hesitantly

- CPI inflation rose in August to -0.6% YoY from -0.7% YoY in July, above market expectations. On a monthly basis, prices dropped 0.4%. The fall in deflation was driven mainly by a slower decline of food prices (-0.7% YoY vs. -1.7% YoY in July). This summer's drought could have put upward pressure on food prices. It seemed to us that it is still too early to see this effect on CPI data, but vegetable prices dropped only 5.9% MoM and fruit prices only 3.2% MoM, the smallest falls since August 2008 in both cases. According to the CSO flash estimate of inflation (the first release of its kind), the CPI declined to -0.8% YoY in September, stronger than expected. However, no further details about price developments in September are known.

- The drought should continue to have a positive impact on domestic inflation, but in our opinion its overall effect will be limited for at least two reasons. First, the increase in food prices should be curbed by higher (and relatively cheap) food imports. Remember global food prices are at multi-year lows. In August, the FAO Food Price Index registered the sharpest monthly decline since 2008 and dropped to the lowest level since early 2009. The decline results from ample supplies, a slump in energy prices and concern about an economic slowdown in China. Secondly, the impact of more expensive food on the CPI should be partly offset by less expensive fuel (prices at the pump fell c2.5% in August and around 5% in September) and a cut in gas tariffs in September. We still expect CPI inflation to reach +0.5% YoY in December (mainly due to an extremely low base) and then to continue its slow climb towards the target (low base + rebound in commodity prices + robust domestic demand).

- Core inflation excluding food and energy prices amounted to 0.4% YoY in August, while PPI inflation reached -2.7%YoY.

Monetary policy watch

Excerpts from the MPC's communiqué after its October meeting

Growth of global economic activity remains moderate. In the euro area, the recovery continues and the latest data point to stable GDP growth in this economy. Also in the United States, data indicate a further rise in economic activity. At the same time, in China economic conditions continue to deteriorate, while Russia and Brazil remain in recession. Therefore, concerns about the economic growth outlook in emerging market economies persist, which increases uncertainty about economic conditions worldwide.

Inflation abroad remains very low and in many countries it declined again, driven mainly by a renewed fall in commodity prices in recent months. In the euro area, price growth has turned negative again and the forecasts for the coming quarters have been revised downwards.

Against this background, the Federal Reserve and the ECB are keeping their interest rates close to zero. The ECB continues its asset purchase programme and has signalled an extension of this. At the same time, the Federal Reserve indicates a likely increase in interest rates. The uncertainty about the monetary policy of major central banks and concerns about the outlook for economic growth in emerging market economies are causing elevated volatility in global financial markets.

In Poland, stable economic growth continues, driven mainly by rising domestic demand, which is supported by favourable labour market developments, consumer confidence and the financial standing of enterprises, as well as by stable lending growth. Recently released economic activity indicators were lower than expected, but their decline will probably prove temporary.

In the Council's view, price growth will increase slowly in the coming quarters, supported by the expected closing of the output gap amid improving economic conditions in the euro area and favourable domestic labour market developments. At the same time, the persisting risk of stronger economic slowdown in emerging market economies, low commodity prices and weaker inflation outlook abroad result in increased uncertainty about the pace at which inflation will return to the target.

MPC not worried about the Polish economy

▪ The Monetary Policy Council (MPC) once again kept interest rates on hold in October (the reference rate at 1.5%). In line with what we had expected, the recent data releases (even though some of them were a bit disappointing) did not worsen the central bank's economic outlook and policymakers still anticipate inflation will rise, the pace of economic growth will remain stable and solid, and the output gap will gradually close.

▪ Interestingly, the two central bankers who will remain in office the longest (NBP governor Marek Belka until mid-2016 and MPC member Jerzy Osiatyński till the end of 2019) are clearly not eager to change rates, as the economic growth rate is healthy and close to its potential. Belka said clearly at the post-meeting press conference that there was no room for significant modifications in monetary policy and there should be no such room after the end of the current MPC term either. Meanwhile, Osiatyński (the most dovish member of the current Council) said he saw no rationale for more interest rate cuts as their effectiveness was very low. This is important news, as in an earlier interview Osiatyński was quoted as saying that the room for more monetary easing should be investigated. Now, he has apparently arrived at the conclusion that such a move would make little sense, despite ongoing uncertainty about the global economic outlook.

▪ We still think that it is very likely that monetary policy will remain unchanged not only until the end of the current Council's term, but also in 2016, amid stable GDP growth and inflation heading towards 2%. Interestingly, the market speculation about possible interest rate cuts in Poland intensified at the start of October, with FRAs fully pricing-in a 25bp cut in 6 months and c.60% odds for a 50bp rate cut in 9 months.

... while some members would even consider rate hikes

▪ According to the minutes of the September MPC meeting, "certain Council members were of the opinion that in the coming months it could be justified to consider raising interest rates" due to the increased risk of strong external shocks. The argument behind this proposal was that the central bank should tighten policy while economic growth was strong to "increase room for monetary easing in the event of negative shocks".

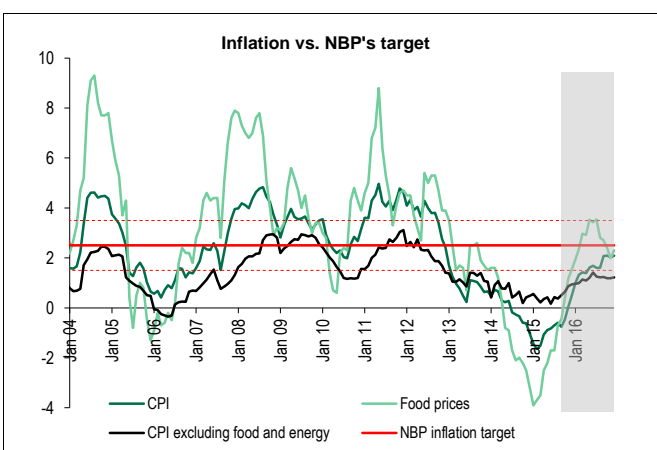
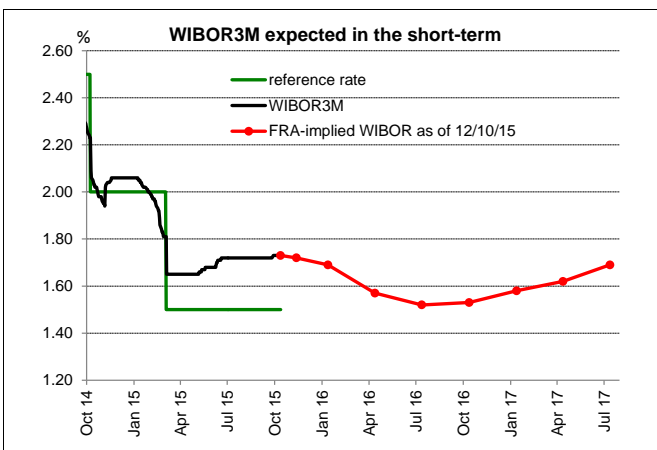
▪ "Certain members" most likely means only one person – Andrzej Rzońca – who unveiled himself as the supporter of such an idea in one of the later interviews. Fortunately, such a view does not have wider support in the Council, and we think that a much better way to prepare the economy for possible external shocks is to keep interest rates on hold at a low level.

No changes in monetary policy guidelines

▪ The monetary policy guidelines for 2016 approved by the Monetary Policy Council included no important changes in monetary policy framework or the toolbox.

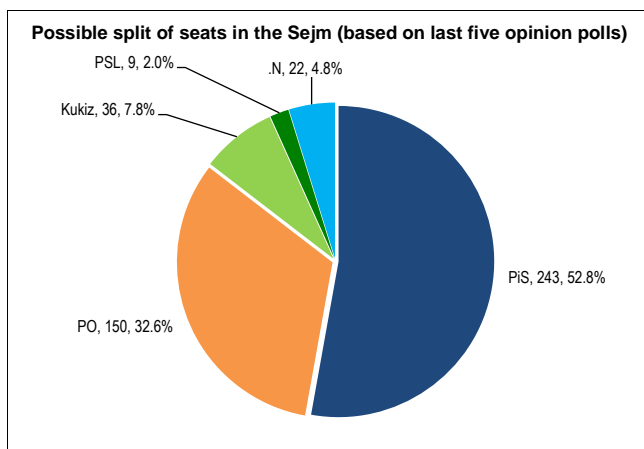
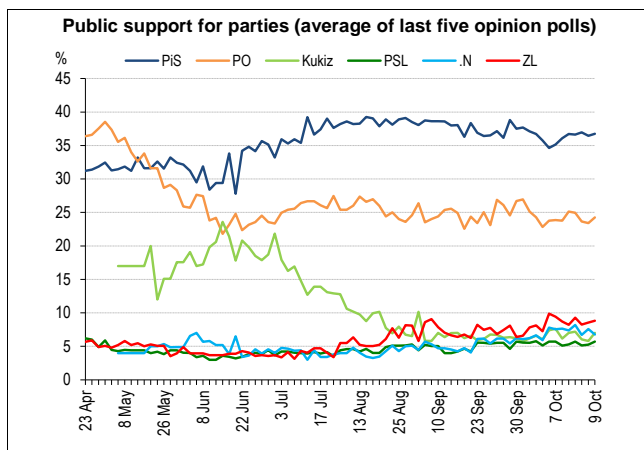
▪ The inflation target remains unchanged (despite earlier comments by some MPC members that a change in the target could be worth considering) and the other components of the monetary policy strategy have also been maintained.

▪ The MPC will still allow inflation to deviate from the target should this result from actions aimed at maintaining long-term macroeconomic stability. The Council will still take the stability of the financial system into consideration.



Sources: NBP, Reuters, BZ WBK.

Fiscal policy watch



Post-election timeline – procedural steps after election determined by the Polish Constitution

Deadline	Procedural step
Oct 25	Election day
↓	+ max 30 days
Nov 24	The first session of Parliament
↓	+ max 14 days
Dec 8	The President appoints the government – 1 st attempt
↓	+ max 14 days
Dec 22	Sejm's vote of confidence (requires absolute majority of votes)
↓ if unsuccessful	+ max 14 days
Jan 05	Sejm appoints the government – 2 nd attempt (requires absolute majority of votes)
↓ if unsuccessful	+ max 14 days
Jan 19	The President appoints the government – 3 rd attempt
↓	+ max 14 days
Feb 02	Sejm's vote of confidence (requires simple majority of votes)
↓ if unsuccessful	
Feb 02	The President calls early elections
↓	+ max 45 days
Mar 18	New elections

Source: opinion polls, Ministry of Finance, Reuters, BZ WBK.

Uncertainty regarding election results still high...

- Last month we said it was unclear who would run the country after October's general election. The last few weeks have not made the situation easier to predict. The conservative Law and Justice party (PiS) still leads opinion polls, but a few polls showed its lead over the ruling Civic Platform (PO) has been narrowing, while support for minor opposition parties has been rising. There is a big question mark over whether one party (PiS) will secure more than 50% of the seats in the lower chamber of parliament and rule alone.
- The average results from the latest 5 opinion polls conducted by different companies and their implications for the distribution of seats in parliament are shown in the charts alongside.

....and (theoretically) may last till winter (or longer)...

- It should be noted that – unless the latter scenario materialises and one party secures more than half of the seats in the Sejm – the political uncertainty after the elections may last quite a while.
- If the PiS fails to get a majority of seats in the Sejm, it would have to seek coalition partner(s), which may be difficult, in our view, if for example the Kukiz movement does not enter Parliament. In such a scenario, one cannot exclude that eventually the government will be created by a coalition of Civic Platform (PO) and smaller parties, with PiS remaining the biggest opposition group in parliament. However, it may take some time to form a government. The table on the left present the timeline of procedural steps defined by the Constitution, together with the latest possible deadlines according to law. In reality, procedures may be faster, depending on political decisions. For example, the President will probably call the first session of the new parliament much earlier than 30 days after the elections.

- Polish law allows three attempts to form a government. In a first step, the Prime Minister and his government are appointed by the President. Usually, the mission to form a cabinet is handed to the candidate of the strongest party in the new parliament (probably PiS, if opinion polls are correct). The government has two weeks to win a vote of confidence in the Sejm, and it must be approved by an absolute majority, i.e. more than 50% of votes. If the vote of confidence is rejected, the Sejm has two weeks to propose an alternative government – theoretically it could be comprised of a coalition of parties not involving the strongest party in Parliament. If the second attempt is also unsuccessful, the President has the initiative again, and this time a simple majority of votes is enough to approve the government, so the condition is less restrictive. If all three steps are unsuccessful, the President has to call new elections. In the meantime, the government appointed by the President in the third step runs the country.

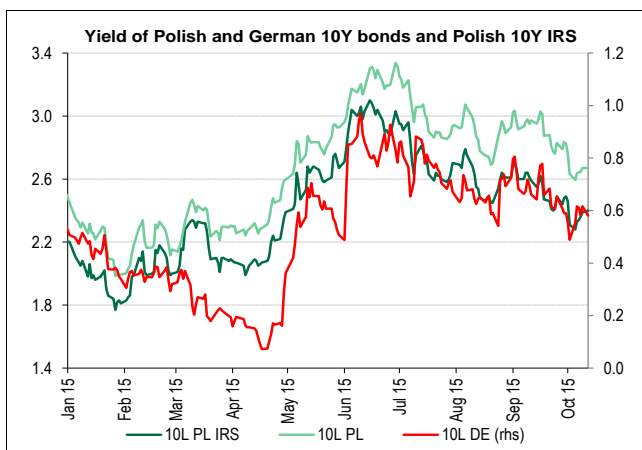
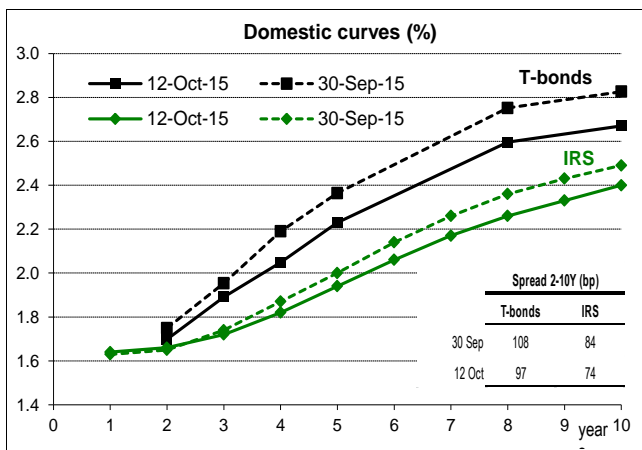
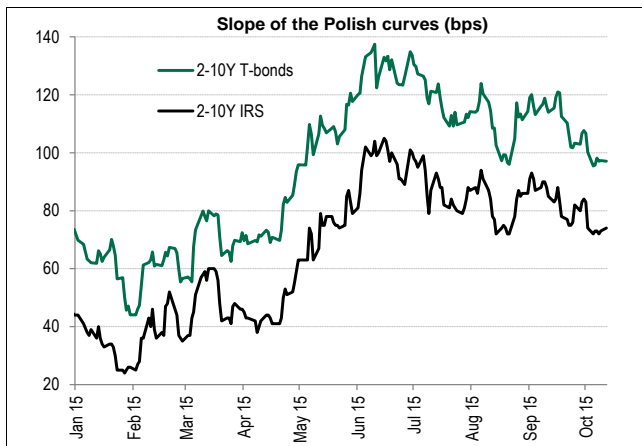
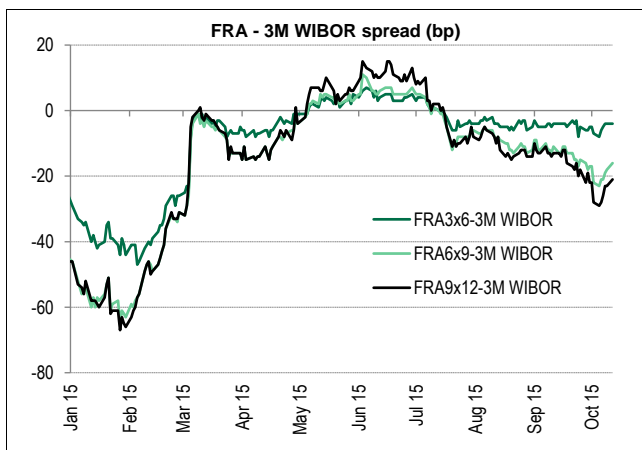
- Two weeks before the elections the bottom line is: the result seems highly uncertain (especially given differences between the polls and results in some previous elections) and the period of uncertainty may not end just a week or two after the election day.

... and the same applies to prospects for economic policy

- In the meantime, parties continue to promise a lot in the election campaign. The leader in the polls (PiS) has 3 main ideas: allowances for children, higher tax-free income and earlier retirement. The official proposal as regards the latter was recently presented by the President, but will not go through the current parliament. We do not think costly proposals will be included in the 2016 budget (if the PiS forms a cabinet) because of: 1. insufficient time; 2. no room in the budget on the spending side (the current government used 100% of the spending rule cap); 3. no additional revenues (PiS assumes higher effectiveness of tax collection).

- The issue of possible help for CHF-borrowers has receded into the background recently. Also, the details about the banking tax were not disclosed by the opposition party.

Interest rate market



Source: Finance Ministry, Reuters, Bloomberg, BZ WBK.

Strong rally due to delay in interest rate hikes by FOMC

Poland's interest rate market, like core and peripheral euro zone markets, benefited from the FOMC's decision to keep rates unchanged and from its dovish rhetoric after the September meeting. The decline in yields and IRS rates deepened quite visibly early October as the US non-farm payroll data were a big disappointment, suggesting that the FOMC would delay the start of its monetary policy normalization. As a result, the yield of the 10Y benchmark declined temporarily to 2.57%, its lowest since April 2015.

The 2-10Y spread narrowed noticeably in early October as the bull flattener developed on both markets. The spread over Bunds in the 10Y sector also narrowed visibly, temporarily reaching c200bp, the lowest level since end-March.

On the money market, FRAs fell significantly on strengthening expectations of a more significant monetary policy adjustment (rate cuts of 50bp). The less dovish than expected MPC rhetoric during the press conference (Mr Belka said that there is no room for a noticeable modification in the monetary policy) and upward correction of IRS caused FRAs to rise across the board. As a consequence, the probability of further monetary easing declined and the market now sees almost 80% odds of a 25bp cut in 6 months' time, nearly fully pricing in a 25bp rate cut in 9 months' time (FRA6x9 at 1.55% and FRA9x12 at 1.50%).

Poland has started to pre-finance 2016 borrowing needs

Early October was very busy on the primary market. Poland's Ministry of Finance tapped a new 6Y Eurobond (maturing 14 October 2021) worth €1.75bn (amid demand exceeding €2.5bn). The bonds were priced 45bp above the average swap rate, which implied a yield of 0.94%, the lowest in the history of Poland's issues on the euro market.

The Ministry was also active on the domestic debt market. It sold the new 5Y PS0421 bonds worth PLN3.14bn with a yield of 2.29% and the 10Y benchmark DS0726 worth PLN2.5bn with a yield of 2.78% (slightly above the level of the secondary market before the auction).

All in all, we think that the Ministry will complete this year's issuance target at the end of October. The switch tenders and foreign issuance in 4Q15 should allow it to cover c20% of 2016 gross borrowing needs (PLN180bn).

General election and FOMC meeting in the spotlight

Yields and IRS rates increased slightly due to profit-taking after a strong rally in early October. In upcoming weeks a lot of important domestic and external events could influence the market direction. In our view, domestic macro data due later this month should be decent and some investors may want to cut their exposure just before the general election (25 October). These factors might add volatility to the market and push yields/IRS rates up due to political uncertainty.

However, in our view, domestic factors are overshadowed by the main central bank meetings of the ECB and FOMC. ECB is expected to increase and/or extend its QE programme. This could be suggested by the Governor Mario Draghi, who is ready to use all the instruments if warranted. We also expect the Fed to keep its monetary policy unchanged this month. Still dovish monetary bias by the main central banks should be supportive for core markets and consequently Polish assets. Given these factors, we think that an increase in domestic yields and IRS rates will be rather limited and a modest decline towards this month's minimum levels is very likely in the short term. We think that limited debt supply in October, plus a substantial inflow of money from bond redemptions and coupon payments should be also supportive of domestic debt.

Given our expectations that the Fed will start normalising its monetary policy in the coming months, and taking into account the likely rebound in Poland's headline inflation and GDP growth in upcoming quarters, we still expect higher yields/IRS rates at the end of the year.

Foreign exchange market



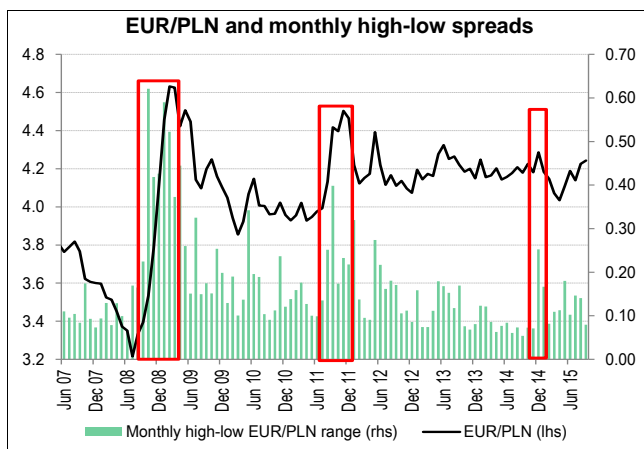
EUR/PLN waiting for a boost

▪ The Fed's decision to leave interest rates unchanged in September, worries about global economic growth and the scandal in the German automotive industry did not manage to trigger breaking changes in the Polish and CEE FX markets. September's high-low spread for EUR/PLN at cPLN0.08 was the smallest monthly spread since November 2014. The cPLN0.15 spread for USD/PLN was the smallest since February 2015, and the PLN0.14 for GBP/PLN since August 2014. The zloty's CEE peers and EUR/USD also recorded monthly ranges at multi-month lows.

▪ Periods of low volatility quite often end very abruptly and usually precede a drop in demand for riskier assets. In the last 20 years EUR/PLN has recorded a monthly drop only 9 out of 32 times when the monthly low-high spread was above PLN0.25. It is hard to guess when volatility will rise substantially again, but the uncertainty before Poland's general election (October 25) and before the FOMC meeting (October 28) may be the triggers.

▪ However, we think that even if the zloty depreciates sharply vs. the euro in the near future, this may only be temporary. A significant rebound is possible in the last week of October, after the general election takes place (in line with the well-known rule: buy the rumours, sell the facts).

▪ In the coming months, we expect the zloty to strengthen, supported by decent GDP growth, rising inflation (which would curb speculation about rate cuts), and our expectations of a Fed hike before year end (which would be a sign of the Fed's faith in global economic growth). However, due to prolonging stabilization at a high level we revise EUR/PLN forecasts upwards slightly.

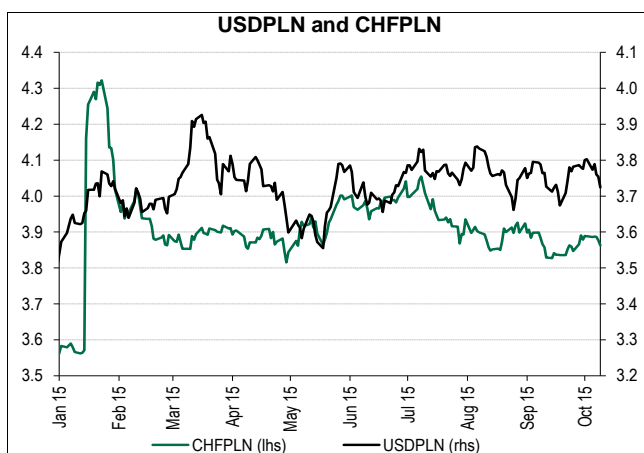


EUR/USD still moving sideways

▪ In September, EUR/USD stayed in the horizontal trend hovering just above c1.11. The monthly high-low spread was the lowest since February despite the FOMC's decision on rates, poor German macro data and the "VW scandal". The rate rose towards 1.14 after the monthly non-farm payroll data were much lower than expected.

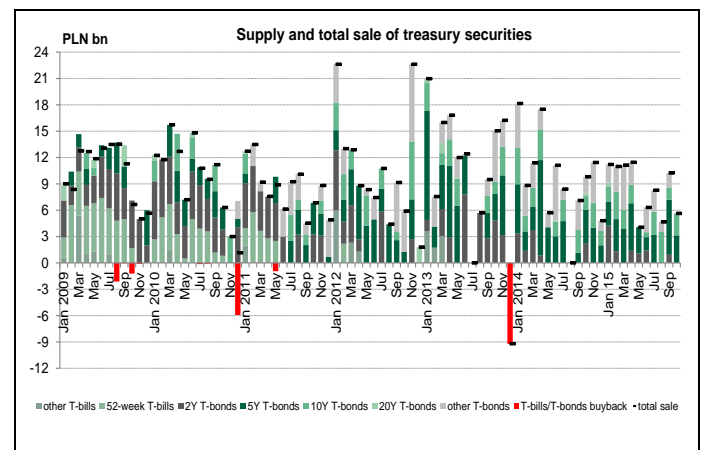
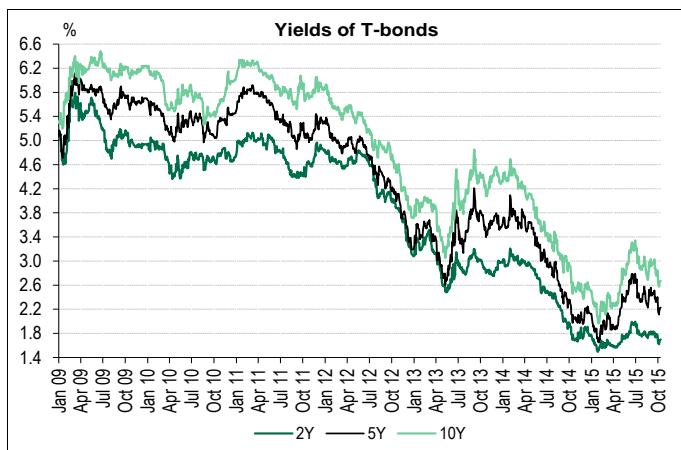
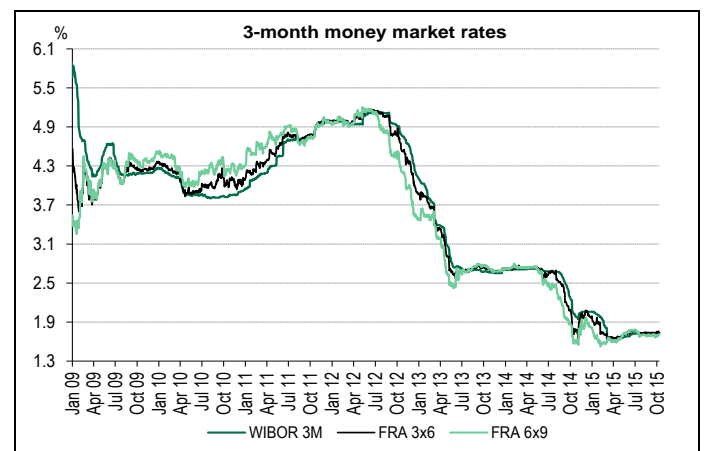
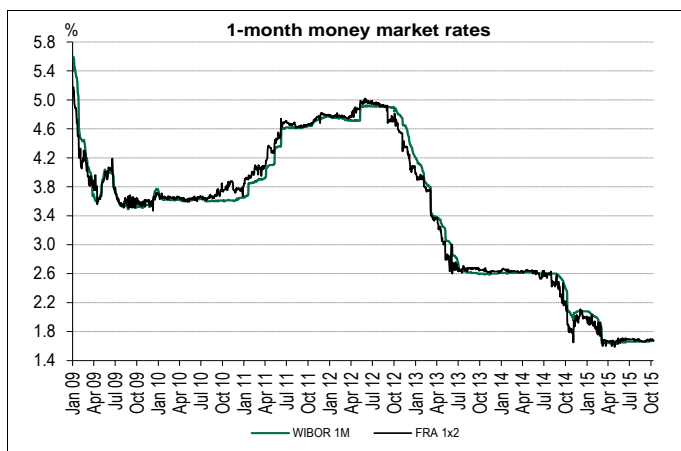
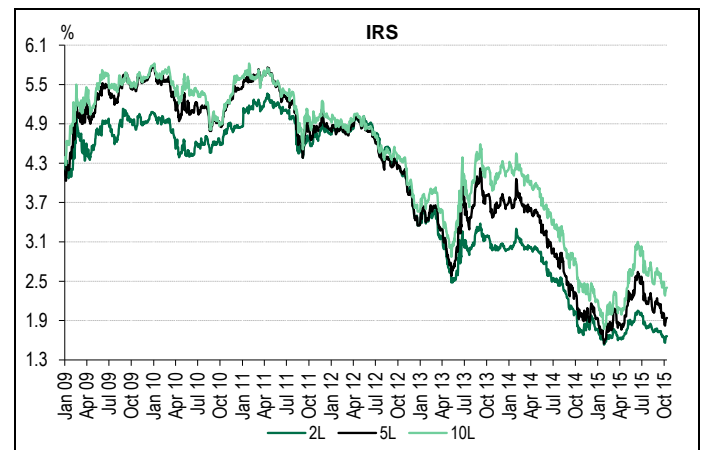
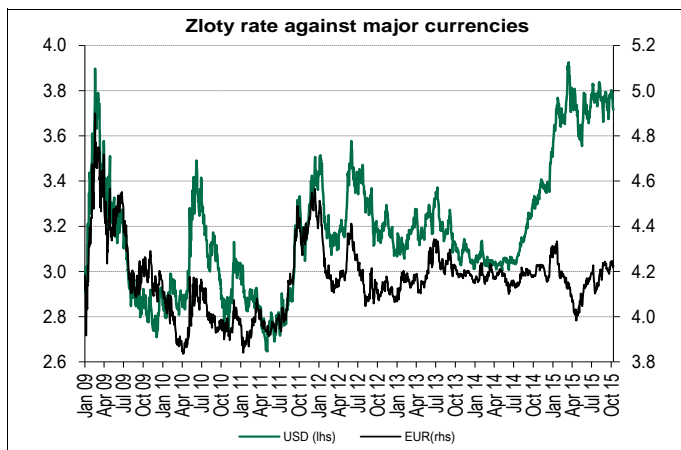
▪ After the latest disappointing U.S. labour data release, the market began to expect the first Fed rate hike further down the road and it now sees only 8% odds of a hike this month. The U.S. data would have to be really strong to change this, but if this is not the case, then we think the Fed will hold fire in October in order not to spook the market. In this scenario, EUR/USD is likely to stay above 1.108.

▪ In our view, there is still more bias to the upside and we still expect the exchange rate to rise to 1.16 at the end of the year. The risk to our scenario is the market's concern about global growth that could fuel speculation about the ECB extending its asset purchase program amid lower economic activity and inflation staying below the target for longer. However, should worries about the global economy strengthen, the FOMC is likely to delay its rate hike further (meaning less support for the dollar) and the potential for EUR/USD decline should also be limited.



Sources: Reuters, Bloomberg, BZ WBK.

Market monitor



Treasury bond auctions in 2014/2015 (PLN mn)

month	date	First auction			date	Second auction			Switch auction		
		T-bonds	offer	offer		T-bonds	offer	offer	date	T-bonds	offer
October '14	23.10	OK0716/PS0719	2000-6000	6062.1					2.10	WZ0115/PS0415	WZ0124/DS0725/WS0428
November	6.11	WZ/DS/WS	2000-4000	4495.7					20.11	WZ0115/PS0415/OK0715	WZ0119/PS0719
December									18.12	WZ0115/PS0415/OK0715	PS0719/WZ0124/DS0725
January '15	15.01	WZ/DS/WS	3000-5000	4198.5	22.01	OK0717/PS0420	5000-7000	7005.2			
February	5.02	WZ/DS/WS	3000-5000	5980.0	12.02	OK0717/PS0420	3000-5000	5000.0			
March	5.03	USD20150716/ USD20151019**	up to \$500m	\$400.6m	12.03	WZ0124/DS0725/WS0428	3000-4000	4639.0	26.03	PS0415/OK0715/DS1015	WZ0120/PS0420
April	9.04	WZ0124/DS0725	2500-4500	3788.0	23.04	OK0717/WZ0120/PS0420	5000-7000	7654.3			
May	7.05	OK/WZ	3000-5000	Call off	21.05	OK0717/PS0420	2000-4000	4056.0			
June	11.06	OK0717/WZ0120	2000-4000	4236.5					25.06	OK0715/DS1015	PS0420/DS0725
Julv	9.07	WZ0120/WZ0124	1000-2000	2430.3	23.07	PS0420/DS0725	3000-6000	5852.7			
August	6.08	DS0725/WZ0126	1000-4000	4655.9							
September	10.09	WZ0126/DS0726	2000-4000	3019.0	24.09	OK0717/PS0420	4000-6000	7214.0			
October	29.10	To be announced	5000-10000						8.10	DS1015/OK0116	PS0421/DS0726

* with supplementary auction, ** buy-back auction, *** demand/sale.

Source: MoF, Reuters, BZ WBK.

Economic calendar

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
12	13 DE: ZEW index (Oct)	14 PL: Balance of payments (Aug) PL: Money supply (Sep) EZ: Industrial output (Aug) US: Retail sales (Sep) US: Fed Beige Book	15 PL: CPI (Sep) US: CPI (Sep) US: Philly Fed index (Oct)	16 PL: Core inflation (Sep) PL: Wages and employment (Sep) EZ: HICP (Sep) US: Industrial output (Sep) US: Flash Michigan (Oct)
19 PL: Industrial output (Sep) PL: PPI (Sep) PL: Retail sales (Sep)	20 HU: Central bank decision US: House starts (Sep) US: Building permits (Sep)	21	22 PL: MPC minutes EZ: ECB decision US: Home sales (Sep)	23 PL: Unemployment rate (Sep) CN: Flash PMI – manufacturing (Oct) DE: Flash PMI – manufacturing (Oct) EZ: Flash PMI – manufacturing (Oct)
26 DE: Ifo index (Oct) US: New home sales (Sep)	27 US: Consumer confidence index (Oct) US: Durable goods orders (Sep)	28 US: Decyzja FOMC	29 US: Advance GDP (Q3) US: Pending home sales (Sep)	30 PL: Flash CPI (Oct) PL: Inflation expectations (Oct) EZ: Flash HICP (Oct) US: Personal income (Sep) US: Consumer spending (Sep) US: Michigan index (Oct)
2 November PL: PMI – manufacturing (Oct) CN: PMI – manufacturing (Oct) DE: PMI – manufacturing (Oct) EZ: PMI – manufacturing (Oct) US: ISM – manufacturing (Oct)	3 US: Industrial orders (Sep)	4 PL: MPC decision DE: PMI – services (Oct) EZ: PMI – services (Oct) US: ISM – services (Oct) US: ADP report (Oct)	5 DE: Industrial orders (Sep) CZ: Central bank decision	6 DE: Industrial output (Sep) CZ: Industrial output (Sep) US: Non-farm payrolls (Oct) US: Unemployment rate (Oct)
9 DE: Exports (Sep) CZ: CPI (Oct)	10 HU: CPI (Oct)	11 PL: The Independence Day	12 EZ: Industrial output (Sep)	13 PL, DE, CZ, HU, EZ: Flash GDP (Q3) PL: CPI (Sep) PL: Balance of payments (Sep) PL: Money supply (Oct) US: Retail sales (Oct) US: Flash Michigan (Nov)
16 PL: Core inflation (Oct) EZ: HICP (Oct)	17 DE: ZEW index (Nov) HU: Central bank decision US: CPI (Oct) US: Industrial output (Oct)	18 PL: Wages and employment (Oct) US: House starts (Oct) US: Building permits (Oct) US: FOMC minutes	19 PL: MPC minutes PL: Industrial output (Oct) PL: PPI (Oct) PL: Retail sales (Oct) US: Philly Fed index (Nov)	20

Source: CSO, NBP, Bloomberg

Calendar of MPC meetings and data releases for 2015

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
ECB meeting	22	-	5	15	-	3	16	-	3	22	-	3
MPC meeting	13-14	3-4	3-4	14-15	5-6	2-3	7-8	-	1-2	5-6	3-4	1-2
MPC minutes	22	19	19	23	21	18	-	20	17	22	19	17
Flash GDP*		13			15			14			13	
GDP*	-	27	-	-	29	-	-	28	-	-	30	-
CPI	15	13 ^a	13 ^b	15	14	15	15	13	15	15	13	15
Core inflation	16	-	16	16	15	16	16	14	16	16	16	16
PPI	21	18	18	20	20	18	17	19	17	19	19	17
Industrial output	21	18	18	20	20	18	17	19	17	19	19	17
Retail sales	27	18	18	20	20	18	17	19	17	19	19	17
Gross wages, employment	20	17	17	17	19	17	16	18	16	16	19	16
Foreign trade	about 50 working days after reported period											
Balance of payments*			31			30			30			30
Balance of payments	13	13	16	13	15	15	14	13	14	14	13	14
Money supply	14	13	13	14	14	12	14	13	14	14	13	14

* quarterly data. a preliminary data for January. b January and February.
Source: CSO, NBP

Economic data and forecasts for Poland

Monthly economic indicators

		Sep14	Oct14	Nov 14	Dec 14	Jan 15	Feb 15	Mar 15	Apr 15	May 15E	Jun 15	Jul 15	Aug 15	Sep 15E	Oct 15E
PMI	pts	49.5	51.2	53.2	52.8	55.2	55.1	54.8	54.0	52.4	54.3	54.5	51.1	50.9	52.5
Industrial production	% YoY	4.2	1.7	0.3	8.1	1.6	5.0	8.8	2.4	2.8	7.4	3.8	5.3	3.9	1.3
Construction production	% YoY	5.6	-1.0	-1.6	5.0	1.3	-0.3	2.9	8.5	1.3	-2.5	-0.1	4.8	1.4	3.2
Retail sales ^a	% YoY	1.6	2.3	-0.2	1.8	0.1	-1.3	3.0	-1.5	1.8	3.8	1.2	-0.3	1.4	2.2
Unemployment rate	%	11.5	11.3	11.4	11.5	12.0	12.0	11.7	11.2	10.8	10.3	10.1	10.0	9.8	9.7
Gross wages in corporate sector	% YoY	3.4	3.8	2.7	3.7	3.6	3.2	4.9	3.7	3.2	2.5	3.3	3.4	3.3	2.8
Employment in corporate sector	% YoY	0.8	0.8	0.9	1.1	1.2	1.2	1.1	1.1	1.1	0.9	0.9	1.0	1.0	0.9
Exports (€)	% YoY	7.0	4.3	3.8	9.8	4.4	10.9	14.3	8.5	7.8	10.4	0.4	7.5	9.6	10.0
Imports (€)	% YoY	8.9	7.0	6.5	13.1	-2.1	3.9	8.7	7.8	0.3	9.2	5.1	5.5	6.7	8.0
Trade balance	EUR mn	313	-384	-231	-629	639	526	485	-142	539	-47	-1,071	-84	753	-117
Current account balance	EUR mn	-258	-319	114	-1,011	-228	93	1,054	1,642	1,124	-1,602	-1,660	-767	-261	-713
Current account balance	% GDP	-2.3	-2.2	-2.0	-2.0	-1.7	-1.5	-1.3	-0.8	-0.5	-0.4	-0.5	-0.4	-0.4	-0.5
Budget deficit (cumulative)	PLN bn	-22.4	-27.2	-24.8	-29.8	-0.6	-11.3	-16.7	-16.7	-19.6	-26.1	-26.6	-25.9	-34.6	-39.8
Budget deficit (cumulative)	% of FY plan	47.1	57.4	52.1	62.7	1.3	24.6	36.2	36.2	42.6	56.7	57.7	56.1	75.1	86.4
CPI	% YoY	-0.3	-0.6	-0.6	-1.0	-1.4	-1.6	-1.5	-1.1	-0.9	-0.8	-0.7	-0.6	-0.8	-0.5
CPI excluding food and energy	% YoY	0.7	0.2	0.4	0.5	0.6	0.4	0.2	0.4	0.4	0.2	0.4	0.4	0.5	0.6
PPI	% YoY	-1.6	-1.3	-1.6	-2.7	-2.8	-2.8	-2.5	-2.7	-2.1	-1.4	-1.8	-2.7	-2.9	-2.3
Broad money (M3)	% YoY	7.9	7.7	8.4	8.2	8.6	8.7	8.9	7.2	7.6	8.3	8.6	7.3	7.7	7.8
Deposits	%YoY	8.1	8.4	9.0	9.0	9.1	9.0	9.2	7.8	7.8	8.7	8.8	7.7	8.2	8.3
Loans	%YoY	5.2	6.5	6.8	7.2	8.0	7.7	7.8	6.4	7.7	7.9	7.9	7.6	8.0	7.8
EUR/PLN	PLN	4.19	4.21	4.21	4.21	4.28	4.18	4.13	4.02	4.08	4.16	4.15	4.19	4.22	4.22
USD/PLN	PLN	3.25	3.32	3.38	3.42	3.68	3.68	3.81	3.73	3.66	3.71	3.78	3.77	3.75	3.73
CHF/PLN	PLN	3.47	3.48	3.50	3.50	3.96	3.93	3.89	3.88	3.93	3.98	3.96	3.89	3.86	3.85
Reference rate ^b	%	2.50	2.00	2.00	2.00	2.00	2.00	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
3M WIBOR	%	2.45	2.07	2.03	2.06	2.03	1.92	1.67	1.65	1.67	1.70	1.72	1.72	1.72	1.73
Yield on 2-year T-bonds	%	2.02	1.77	1.78	1.84	1.60	1.60	1.62	1.60	1.74	1.91	1.82	1.79	1.79	1.71
Yield on 5-year T-bonds	%	2.40	2.12	2.04	2.16	1.82	1.88	1.99	1.98	2.38	2.68	2.45	2.40	2.43	2.22
Yield on 10-year T-bonds	%	2.98	2.63	2.54	2.55	2.21	2.20	2.32	2.36	2.83	3.20	3.00	2.88	2.91	2.75

Note: ^a in nominal terms, ^b at the end of the period.

Source: CSO, NBP, Finance Ministry, BZ WBK estimates.

Quarterly and annual economic indicators

		2013	2014	2015E	2016E	1Q15	2Q15	3Q15E	4Q15E	1Q16E	2Q16E	3Q16E	4Q16E
GDP	PLN bn	1,662.1	1,728.7	1,794.4	1,886.8	417.8	433.8	443.1	499.7	438.1	457.5	465.2	526.1
GDP	% YoY	1.7	3.4	3.5	3.5	3.6	3.3	3.4	3.5	3.1	3.6	3.6	3.6
Domestic demand	% YoY	0.2	4.9	3.3	3.5	2.6	3.3	3.3	3.7	3.3	3.6	3.5	3.7
Private consumption	% YoY	1.1	3.1	3.2	3.2	3.1	3.0	3.3	3.3	3.3	3.2	3.1	3.1
Fixed investments	% YoY	0.9	9.2	7.0	6.0	11.4	6.4	6.2	6.0	6.0	6.0	6.0	6.0
Industrial production	% YoY	2.3	3.4	4.5	4.9	5.3	3.9	4.3	4.4	3.8	5.7	5.5	4.7
Construction production	% YoY	-10.3	4.3	2.0	4.0	1.4	1.9	2.0	2.5	3.7	5.8	4.1	2.9
Retail sales ^a	% YoY	2.6	3.1	1.4	5.3	0.7	1.4	0.9	2.6	3.3	3.4	6.5	7.5
Unemployment rate ^b	%	13.4	11.5	10.0	9.2	11.7	10.3	9.8	10.0	10.3	9.3	9.0	9.2
Gross wages in the national economy ^a	% YoY	3.4	3.6	3.4	4.9	4.1	3.1	3.1	3.3	3.2	5.1	5.7	5.5
Employment in the national economy	% YoY	-1.1	0.2	0.7	0.6	0.8	0.8	0.6	0.5	0.5	0.6	0.7	0.7
Exports (€)	% YoY	5.7	6.4	9.6	10.7	9.8	8.9	9.6	10.0	11.0	11.0	10.5	10.3
Imports (€)	% YoY	0.2	8.3	6.0	10.8	3.5	5.7	6.7	8.0	10.0	11.0	11.0	11.0
Trade balance	EUR mn	-335	-3,255	2,206	2,324	1,651	350	729	-524	2,241	389	592	-898
Current account balance	EUR mn	-5,031	-8,303	-1,032	-246	900	1,110	-1,557	-1,485	1,462	1,033	-1,452	-1,289
Current account balance	% GDP	-1.3	-2.0	-0.2	-0.1	-1.3	-0.4	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1
General government balance	% GDP	-4.0	-3.2	-2.7	-2.9	-	-	-	-	-	-	-	-
CPI	% YoY	0.9	0.0	-0.8	1.7	-1.5	-0.9	-0.7	0.0	1.2	1.6	1.8	2.1
CPI ^b	% YoY	0.7	-1.0	0.5	2.1	-1.5	-0.8	-0.8	0.5	1.4	1.7	2.1	2.1
CPI excluding food and energy	% YoY	1.2	0.6	0.5	1.2	0.4	0.3	0.4	0.8	1.0	1.2	1.2	1.2
PPI	% YoY	-1.3	-1.5	-2.2	-1.4	-2.7	-2.1	-2.5	-1.7	-1.5	-1.9	-1.3	-0.7
Broad money (M3) ^b	% oY	6.2	8.2	8.0	7.8	8.9	8.3	7.7	8.0	7.9	7.9	7.8	7.8
Deposits ^b	%YoY	6.6	9.0	7.3	8.1	9.2	8.7	8.2	7.3	7.5	7.7	7.9	8.1
Loans ^b	%YoY	3.5	7.2	6.5	5.5	7.8	7.9	8.0	6.5	6.3	6.0	5.7	5.5
EUR/PLN	PLN	4.20	4.18	4.17	4.11	4.20	4.09	4.19	4.19	4.13	4.11	4.10	4.10
USD/PLN	PLN	3.16	3.15	3.71	3.46	3.72	3.70	3.77	3.65	3.51	3.47	3.43	3.42
CHF/PLN	PLN	3.41	3.45	3.89	3.56	3.93	3.93	3.90	3.81	3.73	3.63	3.50	3.39
Reference rate ^b	%	2.50	2.00	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
3M WIBOR	%	3.02	2.52	1.75	1.75	1.87	1.67	1.72	1.73	1.74	1.75	1.75	1.75
Yield on 2-year T-bonds	%	2.98	2.46	1.72	2.00	1.61	1.75	1.80	1.72	1.82	1.95	2.07	2.17
Yield on 5-year T-bonds	%	3.46	2.96	2.25	2.68	1.90	2.35	2.43	2.31	2.54	2.63	2.72	2.82
Yield on 10-year T-bonds	%	4.04	3.49	2.70	3.42	2.24	2.79	2.93	2.84	3.17	3.35	3.50	3.65

Note: ^a in nominal terms, ^b at the end of period. Source: CSO, NBP, Finance Ministry, BZ WBK estimates.

This analysis is based on information available until 12.10.2015 has been prepared by:

ECONOMIC ANALYSIS DEPARTMENT

Al. Jana Pawła II 17, 00-854 Warszawa fax +48 22 586 83 40

Email: ekonomia@bzwbk.pl Web site (including Economic Service page): <http://www.skarb.bzwbk.pl>

Maciej Reluga* – Chief Economist

tel. +48 22 5341888. Email: maciej.reluga@bzwbk.pl

Piotr Bielski* +48 22 534 18 87

Agnieszka Decewicz* +48 22 534 18 86

Marcin Luziński* +48 22 534 18 85

Marcin Sulewski* +48 22 534 18 84

TREASURY SERVICES DEPARTMENT

Poznań

pl. Gen. W. Andersa 5
61-894 Poznań

tel. +48 61 856 58 14/30

fax +48 61 856 44 56

Warszawa

al. Jana Pawła II 17
00-854 Warszawa

tel. +48 22 586 83 20/38

fax +48 22 586 83 40

Wrocław

ul. Rynek 9/11
50-950 Wrocław

tel. +48 71 369 94 00

fax +48 71 370 26 22

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