Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

18 – 24 November 2013

Polish GDP growth accelerated in Q3 more than expected, while October's inflation surprised to the downside. GDP data positivley affected the zloty, while inflation figure supported IRS rates and debt. Our expectations about economic outlook and monetary policy did not change – GDP growth will be acccelerating gradually, while inflation will slowly rise. In due course, interest rates will remain unchanged until mid-2014, as the MPC suggested, but first hike is possible in Q3 2014.

In the course of this week, ten FOMC members are to deliver speeches, including eight voters. Apart from important data from the US economy, we are likely to hear ssuggestions about future Fed actions and their timing. Domestic interest rate market will see a clash of two forces – dovish rhetoric of the MPC members and hawkish data from industry. Last week, the GDP data surprised positively, and industrial output reading may also positively affect the zloty.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (18 November)					
		No important data releases					
		TUESDAY (19 November)					
11:00	DE	ZEW index	Nov	pts	30.8	-	29.7
14:00	**PL**	**Wages in corporate sector**	**Oct**	**%YoY**	**2.9**	**2.8**	**3.6**
14:00	**PL**	**Employment in corporate sector**	**Oct**	**%YoY**	**-0.2**	**-0.3**	**-0.3**
		WEDNESDAY (20 November)					
11:00	**PL**	**Bond switch auction**					
14:30	US	CPI	Oct	%MoM	0.0	-	0.2
14:30	US	Retail sales ex autos	Oct	%MoM	0.1	-	0.4
16:00	US	Home sales	Oct	m	5.16	-	5.29
20:00	US	FOMC minutes					
		THURSDAY (21 November)					
2:45	CN	Flash PMI – manufacturing	Nov	pts	50.8	-	50.9
9:28	DE	Flash PMI – manufacturing	Nov	pts	51.9	-	51.7
9:58	EZ	Flash PMI – manufacturing	Nov	pts	51.5	-	51.3
14:00	**PL**	**Industrial output**	**Oct**	**%YoY**	**4.4**	**6.6**	**6.1**
14:00	**PL**	**Construction and assembly output**	**Oct**	**%YoY**	**-5.5**	**-4.7**	**-4.8**
14:00	**PL**	**PPI**	**Oct**	**%YoY**	**-1.2**	**-1.2**	**-1.4**
14:00	**PL**	**MPC minutes**					
14:30	US	Initial jobless claims	week	k		-	339
16:00	US	Philly Fed index	Nov	pts	15.0	-	19.8
		FRIDAY (22 November)					
8:00	DE	GDP	Q3	%YoY	0.6	-	
10:00	DE	Ifo index	Nov	pts	107.7	-	107.4

Source: BZ WBK, Reuters, Bloomberg, Parkiet

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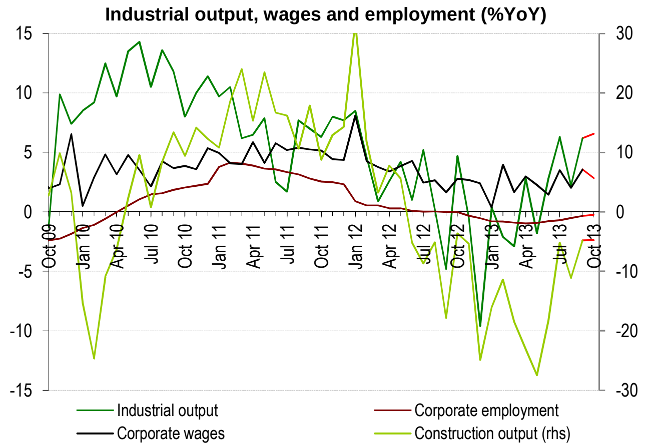
What's hot this week – More signals of economic recovery?



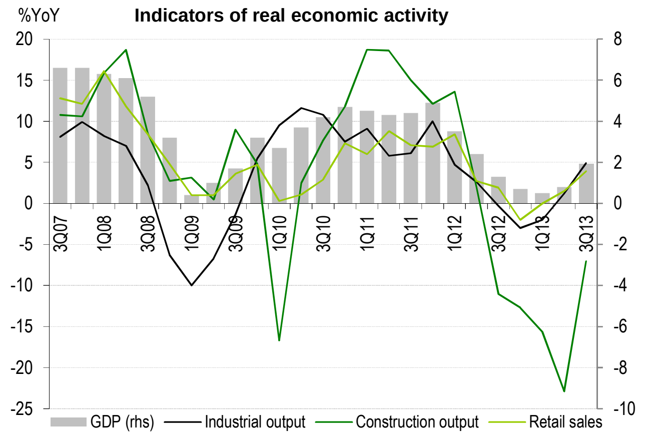
▪ We are expecting another bunch of positive data this week. In our view, these will confirm that the condition of Polish economy is improving further in Q4. According to our forecasts, employment increased slightly in monthly terms, for the fifth time in a row. Wage growth declined somewhat, but mainly due to temporary effect of high statistical base.

▪ CSO business climate indicators and PMI index are suggesting another strong month in Polish industry. We are expecting a robust reading of industrial production, clearly above market consensus. We are also more optimistic than the market as regards construction and assembly output.

▪ Similarly as last week, good data on economic activity will be accompanied by low inflation numbers (PPI below zero).

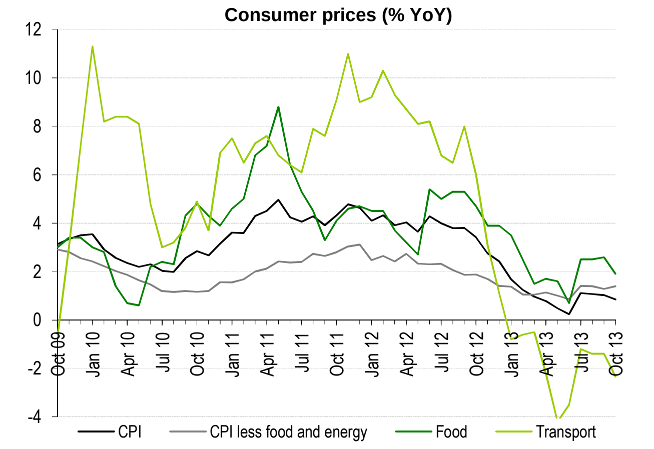
▪ Minutes of the MPC meeting may be interesting, as the MPC extended forward guidance until mid-2014, so we may see which arguments encouraged the Council to make such a decision.

Last week in the economy – Economy is accelerating, inflation under control



▪ GDP growth accelerated to 1.9%YoY in Q3, beating expectations and confirming that recovery of the domestic economy is gaining steam. Detailed growth breakdown is yet unknown, but according the CSO representatives a positive impact on the headline figure was provided by private consumption and improvement in investments.

▪ Current account deficit amounted to €1024m in September and was higher than expected, but lower than last year (hence, relation of 12M deficit to GDP fell to 2% in Q3, the lowest level since comparable data are available, i.e. 2001). Trade balance recorded an all-time high (almost €700m), while growth rate of exports surged to 8.1%YoY, still running considerably above growth rate of imports (3.2%YoY). In our view, these numbers confirm that exports still play the main role in economic recovery, but domestic demand begins to accelerate as well.



▪ October's headline inflation declined to 0.8%YoY, more than expected. Decline was mainly due to low food prices, while other categories surprised to the upside, so core inflation excluding food and energy prices increased to 1.4%YoY (while a stabilization was expected). We maintain our forecast of a gradual and slow rise in inflation in the upcoming months, to over 2% in the second half 2014.

▪ Flash data on money supply showed a slight deceleration in growth of deposits and loans in October. Annual growth rate of loans for companies returned close to zero at the beginning of Q4 after a slight acceleration recorded in the middle of the year. Loans for household slowed to 3.8%YoY. However, this deceleration was partly due to strengthening of the zloty against main currencies, which took place in October.

Quote of the week – Poland should eliminate excessive deficit until 2015

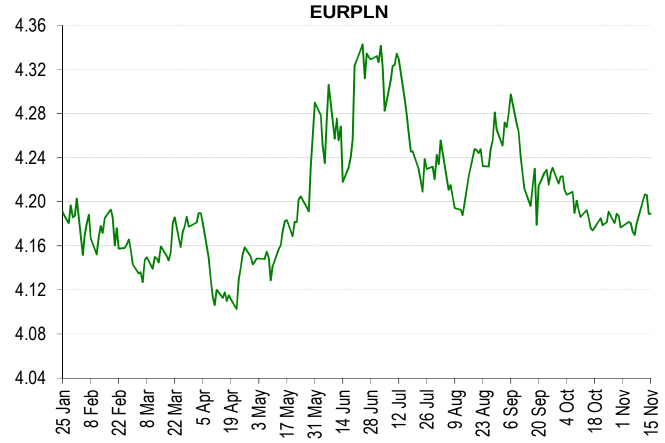
European Commission, Council recommendation with a view to bringing an end to the situation of an excessive government deficit in Poland, 15.11

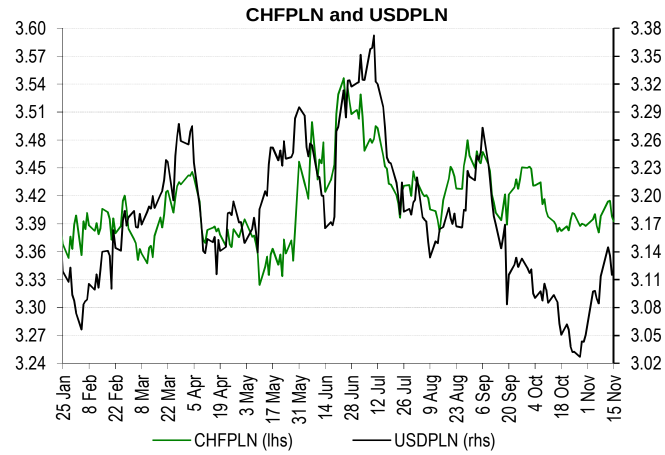
Poland should bring an end to the excessive deficit situation by 2015 in a credible and sustainable manner.

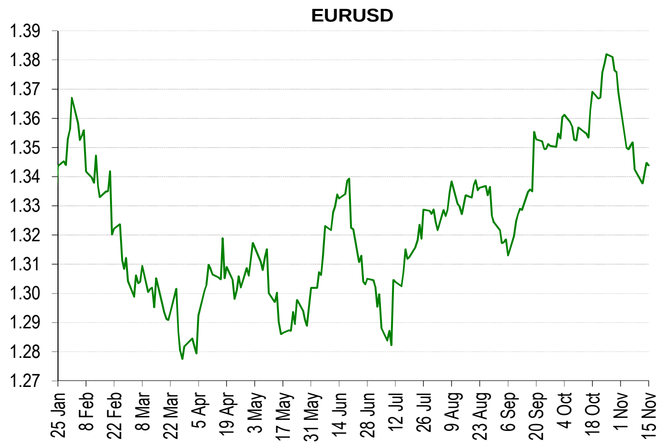
Poland should reach a headline deficit target of 4.8% of GDP in 2013, a deficit of 3.9% of GDP in 2014 and of 2.8% of GDP in 2015 (excluding the impact of the assets transfer of the pension reform). For 2014 this is consistent with an improvement of the structural balance of 1% of GDP and 1.2% of GDP for 2015, based on the Commission 2013 autumn forecast.

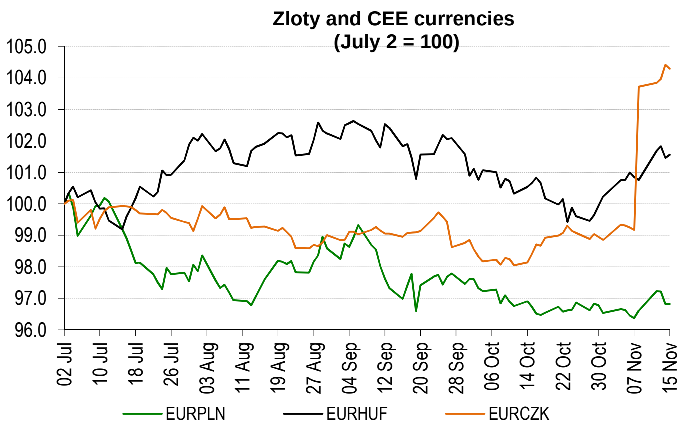
According to recent forecast of the European Commission, the General Government balance in Poland is predicted at -4.8% of GDP in 2013, +4.6% in 2014 and -3.3% in 2015. After excluding impact of OFE overhaul, the results for 2014-2015 are at -4.2% and -3.9% of GDP, correspondingly. In EC's opinion Poland should be reducing the deficit faster (to -3.9% and -2.8% of GDP, respectively), in order to quit the excessive deficit procedure in 2015. In our view, it is quite unlikely that we will see such pace of fiscal consolidation in 2015, which is an election year (the government officially predicts 2015 deficit at 3.of GDP).

Foreign exchange market – Under strong influence of upcoming macro data from the US









Domestic macro data supported the zloty

- Last week zloty appreciated gradually against the main currencies, after relatively considerable weakening on Monday, when domestic market was closed (EURPLN temporary increased towards 4.22). Releases of macroeconomic data (mainly better than expected 3Q GDP reading), but also dovish signals from Fed were supportive factors for the zloty. Consequently, EURPLN returned below 4.20, however, remaining slightly above local minimum around 4.175.
- Situation on USDPLN was more volatile. On Monday the exchange rate temporary increased slightly above 3.15, as a consequence of EURUSD decline. In the following days zloty gained against the US dollar, but USDPLN has remained above 3.10 (this level was broken after weaker than expected industrial output reading in the US). Zloty also slightly appreciated against the CHF (by 0.2% in weekly term), while against the GBP zloty was more or less stable.
- This week another set of bullish data from Polish economy will be released. We think that upcoming macro data should confirm the strong opening of Q4, showing continuation and even slight acceleration of economic revival. Consequently, these data should bring another impulse for zloty appreciation. Currently, the short-term support for the EUSPLN is at 4.175 (next, more important is at 4.15), while resistance level is at 4.227.

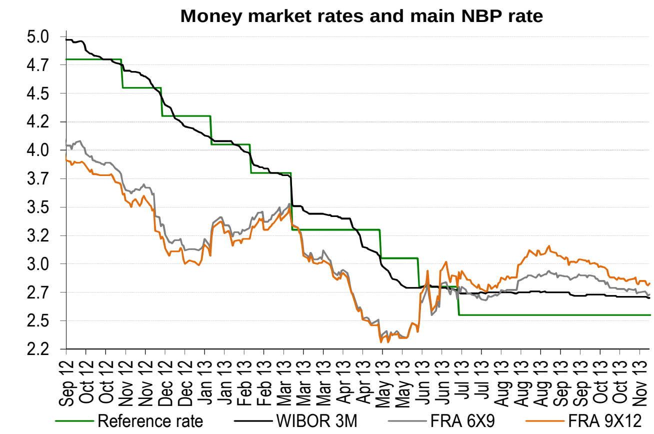
The euro strongly depends on the US macro data

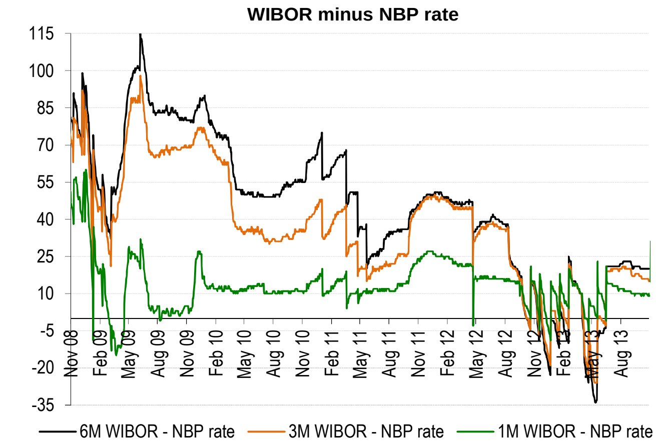
- Last week brought some rebound of EURUSD after sharp decline due to much better than expected October's non-farm payrolls data in the US. The exchange rate increased above 1.34, supported by mainly statement from the Fed chairman nominee before the US Senate Banking Commission. Janet Yellen said that the US economy should accelerate to allow the central bank to start tightening of monetary policy. This comment of the next Fed governor awoke hopes that the US central bank may postpone QE3 tapering until later that currently expected (1Q2014).
- This week investors focus on another macro data from the American economy, which will be interpreted as future FOMC actions. What is more, minutes from October's FOMC meeting might bring more signals or suggestions about upcoming Fed's monetary policy, which will impact investors' mood on EURUSD. Crucial support is at around 1.33, while resistance level is at 1.35.

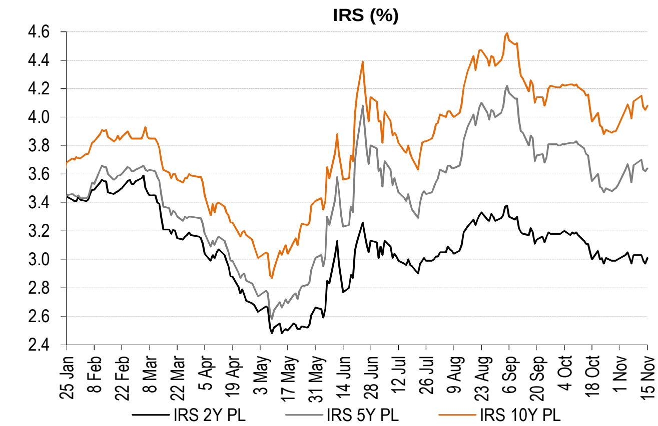
CEE currencies under strong impact of macro data

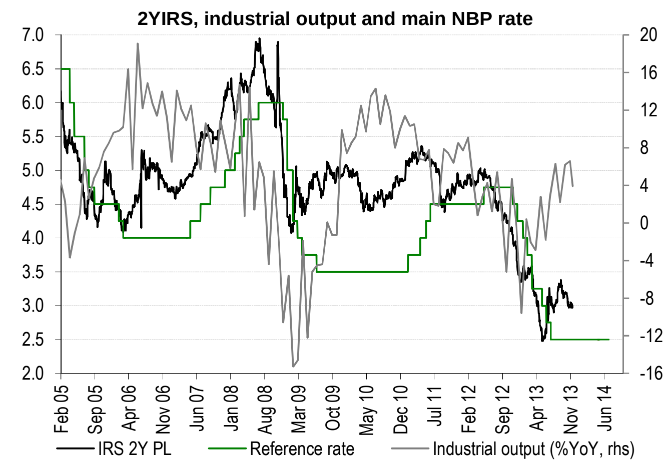
- Last week the Czech koruna has continued depreciation trend against the euro. It came, among others factors, from the CNB governor's comment that currently the central bank wants to keep EURCZK at 27.0 during the next 18 months, and from weaker than expected Q3 GDP data (unexpectedly, GDP contracted by 1.6%YoY, after one quarter improvement). As a result EURCZK increased temporary above 27.20.
- Situation on the HUF was also volatile. Information that Moody's might revise downward rating for Hungary if government in Budapest takes actions which will weigh on the banks financial condition caused EURHUF increase to 298.5. However, better than expected Q3 GDP figure together with low inflation rate resulted in forint appreciation towards 297 against the euro. However, despite relatively stable global mood, EURHUF again shifted up above 298.
- This week global factors will shadow domestic ones (lack of important macroeconomic readings). Further improvement of global mood should support emerging market currencies, in which CZK and HUF. But Czech koruna might remain under pressure of central bank's interventions, which were confirmed by the CNB's minutes.

Interest rate market – What is more important – hawkish data or dovish MPC rhetoric?









Money market still stable

- On weekly basis only 3M WIBOR – out of 1-12M range – changed. It terminated the series of staying unchanged for 13 sessions and declined by 1bp. Meanwhile, 6M rate is at 2.70% for already 19 sessions, one year at 2.75% for 37 sessions. Data showing ongoing economic recovery seem to be overshadowed by MPC declaration on stable interest rates in quarters to come. This suggests that the room for an increase of money market rates is limited in the short term (FRA does not expect any rebound for next 6 months, only in 9-month time prices in a ca. 10bp increase). Current MPC has already proven that it is sensitive to current macro data and thus we expect that in the following months – together with decent macro data – WIBOR rates will rise faster than market currently prices in.

Low inflation drags IRS down

- After a quite visible surge of IRS and bond yields seen at the end of the previous week (and at the beginning of the past week) triggered by surprisingly strong US nonfarm payrolls, recent days brought some recovery on the domestic interest rate market. Amid strengthening on the core debt markets and lower than expected Polish inflation IRS and bond yields retreated to levels seen on the day of the MPC meeting. 2Y IRS declined by 3bp from the local peak established at the beginning of the past week (to 3%) while 5Y and 10Y rates by 8-9bp to 3.62% and 4.05%, respectively. At the end of the week 2Y rate was c.40bp, 5Y by 60bp and 10Y by 50bp lower than in early September after the government announced first draft of changes in OFE. Yields of bonds also declined but less than IRS.

Dovish rhetoric of the MPC vs. hawkish macro data

- Data on October's industrial output are due to be released this week and our forecast is above market consensus. Consequently, two forces will clash this week – hawkish data with MPC's declaration on stable NBP rates at least until mid-2014.
- MPC promised that interest rate will stay unchanged at least until mid-2014 (and according to some members even longer). On the other hand, comments of Council's members indicate that they expect rather subdued growth and lower inflation than we do. The market surely remembers that this MPC is sensitive to current macro data and thus if next data surprise to the upside – just like recent did – may influence market expectations. However, the scale of move after industrial data may be constrained by last data on low CPI.
- IRS and bond yields declined last week also due to strengthening recorded on the core debt markets. This week plenty of data from Europe (flash PMI) and US (retail sales, among others) is due to be released that may have an impact on German debt. Additionally, minutes from the last FOMC meeting will be released and many Council's members will give speech. Thus, this week may be rich of adjustment of market expectations regarding future actions of the US central bank.
- This week the Ministry of Finance will carry out one of two bond switch auctions scheduled for the remainder of the year. It will buyback OK0114/PS0414 bonds and will offer 10Y benchmark DS1023 and bond of WS/WZ/IZ series – depending on market conditions. Data of the Ministry show that in May the foreign investors held 62.5% of total DS1023 outstanding, while at the end of September this was 50.5%. In this period of time the Ministry issued additional c.PLN2bn of this benchmark wile foreigners reduced their holdings by PLN1bn. Thus, data show some withdrawal of foreign investors from this security. However, this 10Y bond was eagerly purchased by insurance companies in September.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Rates Area, Economic Analysis Department, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone +48 22 534 18 88, email ekonomia@bzwbk.pl, http://www.bzwbk.pl.