Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

6 – 12 October 2014

Trends recently observed in the market continued in the past week. The zloty remained stable vs. the euro and continued to depreciate vs. the dollar as the latter was still gaining strength vs. the main and EM currencies. Polish bonds and IRS stayed low also due to the looming NBP rate cut. The European interest rate market continued to draw support from the expected inflow of fresh cash from the ECB. However, there came a correction after the ECB press conference, which failed to provide many details about the planned asset purchases programme. This clearly disappointed investors who had expected a more dovish rhetoric given the recently poor data form the euro zone. US jobless claims data released at the end of the week showed higher than expected reading for September and upward revision in August, which supported the dollar and renewed speculation about possible sooner interest rate hikes in the USA.

The economic calendar for the coming week is very light, but the decision of the Monetary Policy Council may cause some volatility in the Polish market as a 25bps rate cut, which we expect, may be somewhat disappointing for some. At the same time global investors shall focus on the US FOMC minutes and the numerous comments of the Committee members scheduled for the week, all of which could help assess the odds of a Fed rate hike before mid-2015.

Economic calendar

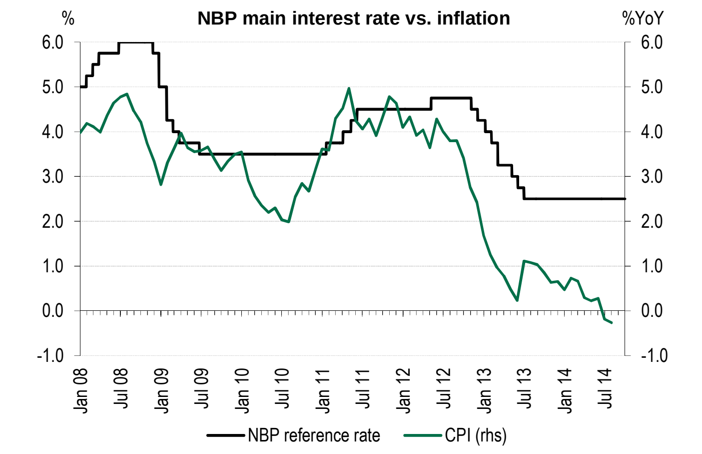
CZAS W-WA	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (6 October)					
8:00	DE	Industrial orders	Aug	%MoM	-2.3	-	4.6
		TUESDAY (7 October)					
8:00	DE	Industrial output	Aug	%MoM	-1.5	-	1.9
9:00	CZ	Industrial output	Aug	%YoY	0.7	-	8.6
		WEDNESDAY (8 October)					
	PL	**MPC decision**		**%**	**2.25**	**2.25**	**2.50**
20:00	US	FOMC minutes					
		THURSDAY (9 October)					
8:00	DE	Exports	Aug	%MoM	-6.0	-	4.8
9:00	CZ	CPI	Sep	%MoM	0.9	-	0.6
14:30	US	Initial jobless claims	week	k	-	-	287
		FRIDAY (10 October)					
9:00	HU	CPI	Sep	%YoY	-	-	0.2

Source: BZ WBK, Reuters, Bloomberg

ECONOMIC ANALYSIS DEPARTMENT:
ul. Marszałkowska 142. 00-061 Warszawa fax +48 22 586 83 40
email: ekonomia@bzwbk.pl Web site: http://www.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

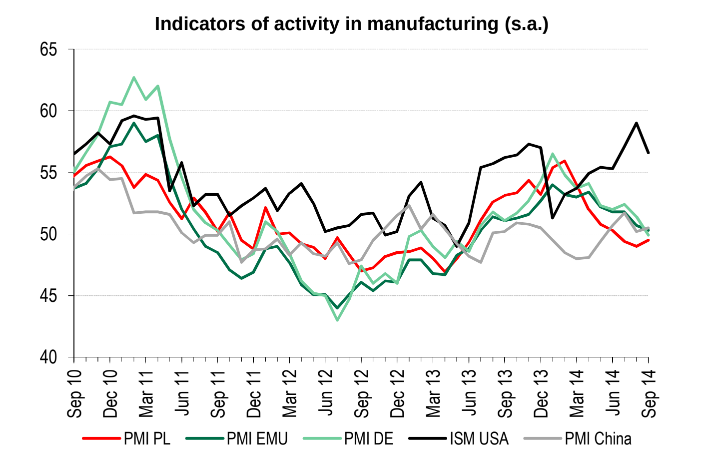
TREASURY SERVICES:
Poznań +48 61 856 5814/30
Warszawa +48 22 586 8320/38
Wrocław +48 71 369 9400

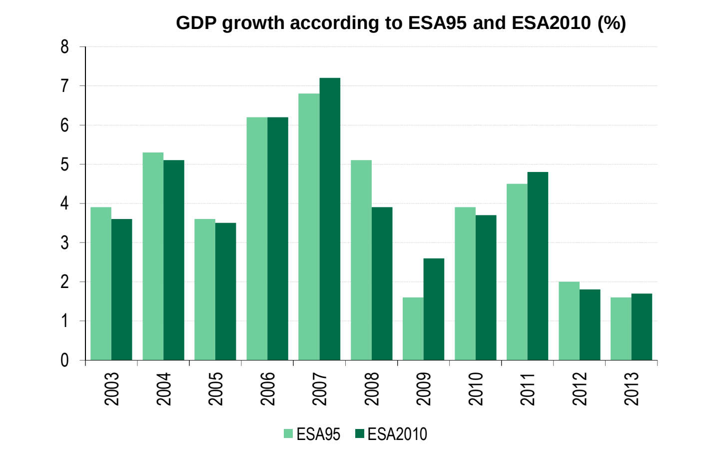
What's hot this week – Rates to go down but by how much?



- Although the economic calendar is nearly empty this week, the decision of the Polish Monetary Policy Council may introduce some volatility in the domestic market.
- The rate cut is a done deal given the recent opinions of the MPC members and the weak economic data. However, the scale of the reduction is uncertain. The cautious approach adopted by the central bank in September and the recent comments of its policymakers lead us to believe that a 25bps rate cut is more likely. According to Bloomberg, only four out of 22 surveyed analysts expect a 50bps cut. Meanwhile, the market seems to be pricing-in high odds of a 50bps cut, so a smaller reduction may be a disappointment that triggers a correction in the interest rate market. But this would probably be only short-lived, since the tone of the MPC press conference and its statement are likely to be quite dovish, re-fuelling hopes for more easing to come.

Last week in the economy – PMI slightly up, GDP and balance of payments revised





- Poland's manufacturing PMI improved to 49.5 points in September from 49.0 points in August, rising for the first time after six consecutive months of declines. Nevertheless, the gauge remained below a neutral level of 50 points in the whole 3Q. Improvement in the headline PMI figure was driven by a rise in employment that was stronger than in the previous month and a slower decline in new orders. It should also be noted that output fell at the fastest pace since May 2013. Companies reported that part of the slowdown was attributable to the Ukraine-Russia crisis. Recent manufacturing PMI readings confirm a visible slowdown in the Polish industrial sector. However, the index for September was clearly above market consensus, which seems to support our forecast for industrial output, which is also among the most optimistic on the market.
- Polish stat office released the first estimates of National Accounts complying with EU's new methodology ESA2010. The new figures for 2002-2013 include illegal activities, such as drugs trade, smuggling, and prostitution, but also other items, like spending on R&D or military equipment. After revision, nominal GDP in 2013 was increased by 1.6%, or PLN26.3bn, in which illegal activities added PLN13.3bn. Real GDP growth according to new methodology reached 1.7% in 2013, instead of 1.6%, so the difference was not substantial. Full set of revised data, including annual and quarterly series since 1995, will be available until the end of November.
- The methodological changes affected also balance of payments data. As a result, current account and trade balances for 2010-2014 were revised lower. In 2Q14, the current account balance was negative and reached -€553m, while earlier released monthly data for the April-June period suggested a surplus of €674m.

Quote of the week – A 50bps rate cut in October would be optimal

Jerzy Hausner, MPC member, Reuters, 29 September
There is always a question whether if we cut rates the economy would accelerate, as well as inflation.

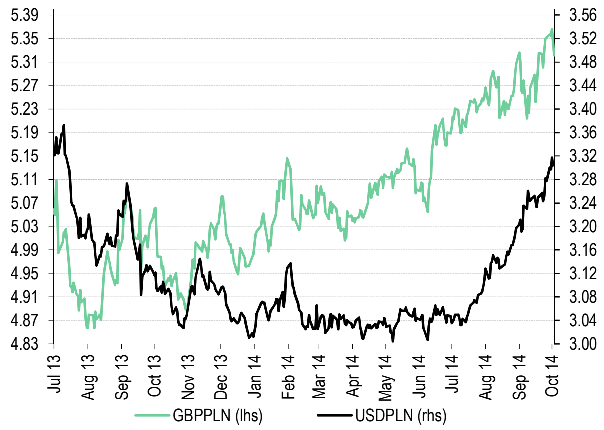
Elżbieta Chojna-Duch, MPC member, Reuters, 29 September
I believe that it would be optimal to lower rates by 50bps in October and later analyse the geopolitical situation and macroeconomic risks to assess if further cuts are needed. (…) I do not know on what basis the market is pricing in such scale of easing [100bps].

The recent comments of the MPC members have slightly cooled market expectations for aggressive easing. The comment of Elżbieta Chojna-Duch was particularly striking. She said that she had no idea why the market was pricing-in rate cuts of as much as 100bps. This is interesting since over the past few weeks it has been her comments, among others, that fueled market expectations for deep rate cuts in Poland. We stick to our scenario of rate cuts totaling 75bps rate cut in 4Q, by 25bps each month, with just the risk of 50bps in October.

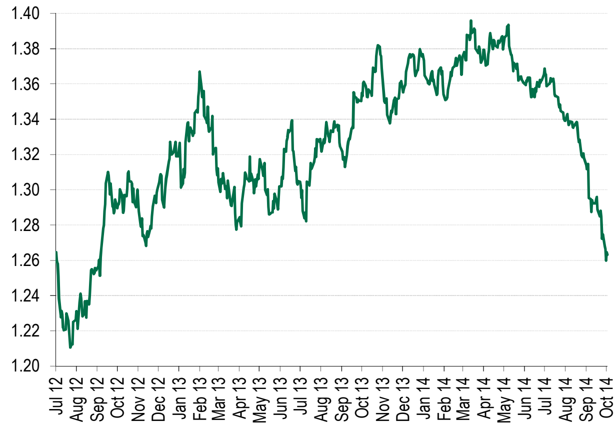
Foreign exchange market –EUR/PLN still waiting for an impulse

EURPLN

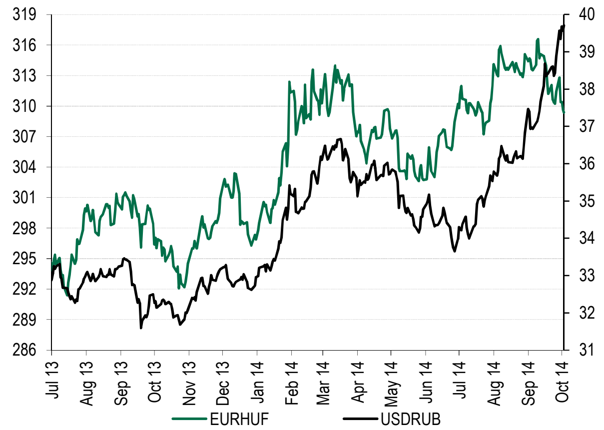
USDPLN and GBPPLN



EURUSD



EURHUF and EURCZK



The zloty stable vs. the euro and weaker vs. the dollar

- Low volatility in the EUR/PLN market continued last week and the exchange rate hovered near the lower end of the 4.17-4.23 range. It even tested it several times but these attempts proved unsuccessful. The zloty stabilised vs. the Swiss franc and recovered vs. the British pound, while continuing to depreciate vs. the dollar. USD/PLN broke the c3.30 peak from the past week and finished the week close to 3.34.
- EUR/PLN did not show any significant immediate reaction to the strong US nonfarm payrolls figure but started to rise at the very end of the session and ended the week above 4.18. Issues related to monetary policy are likely to drive the zloty this week. We expect the MPC to cut rates by 25bps only, which may be less than the market is hoping for. On the one hand, this should support the zloty given the smaller decrease of the interest rate disparity between Poland and the core markets. On the other, a cautious MPC decision may trigger a correction in the Polish debt market and this may weigh on the zloty. At the same time, emerging market currencies are likely to be under substantial impact from signals from the FOMC (release of minutes and speeches of the Committee's members are on the agenda).
- We expect EUR/PLN to remain below the 4.23 resistance in the coming week. If testing 4.17 finally proves successful, then the exchange rate could fall further towards 4.12. The trading range of EUR/PLN is narrowing, indicating a more noticeable move may be recorded soon.

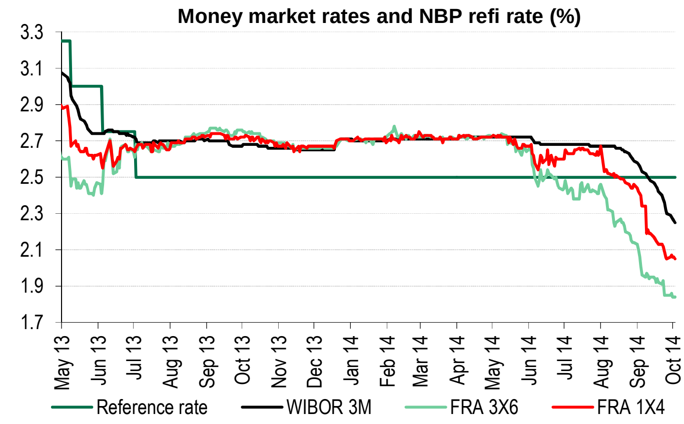
Third week in a row of falling EUR/USD

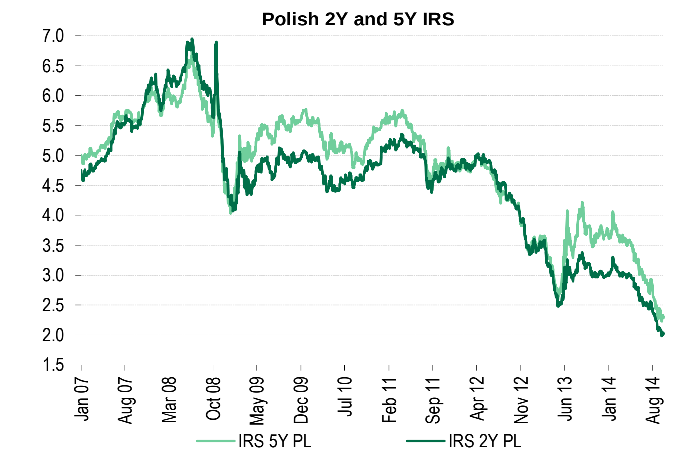
- The dollar continued to appreciate vs. the main currencies, including the euro, yen and pound. EUR/USD managed to break the crucial 1.266 level that we indicated last week thanks to rather poor data from the euro zone and strong expectations for Fed rate hikes that were fuelled by the surprisingly positive US nonfarm payrolls data. Consequently, EUR/USD was close to 1.252 at the end of the week, its lowest since September 2012. This was the third consecutive week of falling EUR/USD.
- Many FOMC members are due to give a speech this week and their comments may be particularly interesting given the latest data from the US labour market.
- From the technical analysis point of view, breaking 1.266 opened the door for further plunge - even towards 1.245.

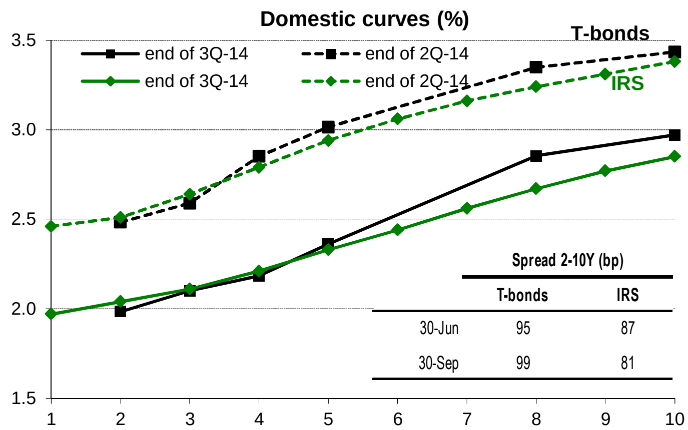
Fresh record low on the ruble, forint gains slightly

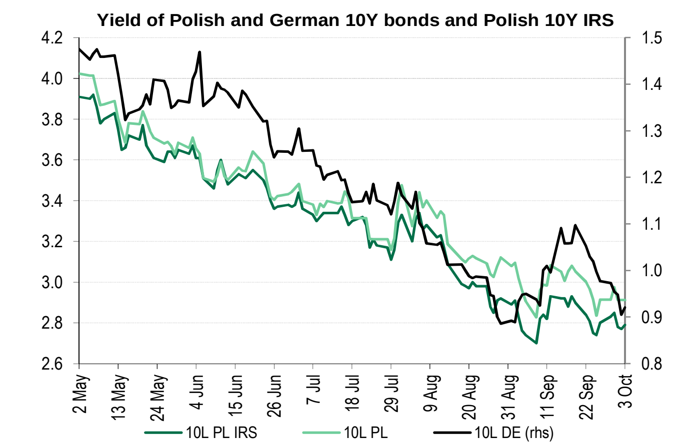
- The Hungarian forint gained slightly vs. the euro (EUR/HUF dropped to 309 from 313), the Czech koruna remained stable vs. the euro (EUR/CZK around 27.5), while Russian ruble reached a fresh all-time low vs. the dollar (USD/RUB surged over 39.9). The forint, just like the zloty, continued to benefit from hopes for additional liquidity from the ECB to flow into the market, while the ruble was still under pressure from the deteriorating Russian economic outlook.
- Inflation data are due this week in Hungary and the Czech Republic. Deflation ended in Hungary a couple of months ago, helping the currency to recover from losses suffered when the central bank was cutting rates. The outlook for price growth has now improved and this should not change much this week. Czech inflation has also rebounded recently, but the pace of the rebound may still be a concern for the central bankers. If CPI disappoints this week, then speculation for lifting the 27.0 floor may strengthen and weigh on the koruna.

Interest rate market – A short-lived correction (after a 25bps cut) is very likely









WIBOR rates lower and lower

- The domestic money market rates have continued their downward trend, but the scale of the decline was smaller than in the previous weeks. This is due to comments of some MPC members (Hausner, Chojna-Duch), who tried to cool expectations for deeper rate cuts. In weekly terms, the WIBOR rates fell 5-6bps across the board (vs. 7-13bps falls a week ago).
- FRAs were more or less stable over the last days after declining significantly in the previous weeks. The market currently expects the WIBOR 3M to slightly drop below 1.80% in six months' time. It means that the FRA is pricing-in cuts of more than 75bps till the end of 1Q 2015.
- Markets will be focused on the MPC meeting this week, especially since some investors are betting on a more aggressive cut (by 50bps). Therefore, a small step (by 25bps) may result in a short-lived correction (even if only intra-day). However, we still expect the WIBOR rates to decline till the end of the year, with the 3M rate falling towards 1.90%, due to gradual monetary easing, weak macro data and a prolonged period of below-zero inflation.

Some rebound after correction at the end of 3Q

- The end of September brought an upward correction on the domestic T-bonds and IRS, but it was only short-lived as the bond yields and the IRS rates quickly returned to their downward path at the start of the new month. It seems that the most important driver of these changes was the strengthening of the Bund market – the 10Y German bond yield plunged slightly below 0.9% after the weaker-than-expected final manufacturing PMI index for Germany. However, bond yields rose on the core markets after the disappointing ECB message (Draghi's message did not sound as dovish as many had hoped) and strong US non-farm payrolls for September. This gradually pressured the domestic debt market.
- Summing up the third quarter, it was a favourable period for Polish assets. Yields dropped 45-65bps, while the IRS rates were 47-61bps down, with the 5Y instruments benefitting the most. Consequently, the 2-5Y spreads narrowed quite significantly, while the 5-10Y spread widened somewhat.
- At the switch tender, the Finance Ministry sold long-term bonds worth PLN3.7bn, buying back securities maturing next year (WZ0115 and PS0415). The recorded bids amounted to PLN 4.4 bn and mainly concentrated on the offered floating rate T-bonds. The Ministry launched WZ0124 worth PLN1.9bn, DS0725 worth PLN1.5bn, with the average yield at c3.00% and WS0428 worth PLN0.3bn at 3.16%. Prices at the auction were in line with those on the secondary market.

The MPC's rate decision the most important for the market

- The MPC meeting will be the key event this week. We think that a rate cut by 25bps at this nearest MPC meeting may bring a correction again. In our opinion, however, it will only be short-lived (even if only intra-day) as the central bank's statement is likely to point to further easing anyway.
- We think there is still room for further declines in the yields/IRS rates in the coming weeks, supported by the anticipated accommodative ECB policy that will extend the search for yield to help shrink risk premiums, by the anticipation of lower MPC rates further ahead, and by the continuously uninspiring economic data.
- The long end of the curves will remain more vulnerable to the core markets as many of the Fed members will have their speeches. Notwithstanding, the 3% yield level for the 10Y benchmark should effectively stop its upward move. We think that this level could attract demand from foreign investors as the looming abundance of cheap liquidity in the euro zone favours yield hunting and domestic bonds still look more attractive.

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.