Bank Zachodni WBK
Grupa Santander

# WEEKLY ECONOMIC UPDATE

## 1 – 7 December 2014

**Last week the financial markets were mostly driven by expectations for a more dovish stance of the main central banks, given the weak macroeconomic data from the US and the euro zone. Hopes that the ECB could extend its asset purchases programme by corporate and sovereign bonds were strongly fuelled by the ECB governor Mario Draghi and the ECB deputy governor Vitor Constancio, bringing the 10Y Bund yield to an all-time low. This supported the Polish debt and currency. Moreover, OPEC's decision to keep oil production quotas unchanged triggered a slump in the price of oil, which reached its lowest level in three years. In Poland, the Q3 GDP growth breakdown came in with strong private consumption and fixed investments, suggesting that an interest rate cut in December is unlikely.**
**This week, the market will focus on the upcoming important data releases (PMI, NFP) and central bank decisions (Polish MPC, ECB). We expect the Polish rates to remain flat and think that the ECB will also stay on hold since it would rather wait for the second take-up of the TLTROs before extending its QE programme. Many Fed members are also due to speak and the market is likely to pay much attention to them, given the recently weaker data from the world's biggest economy.**

### Economic calendar

| TIME CET | COUNTRY | INDICATOR | PERIOD | | FORECAST MARKET | FORECAST BZWBK | LAST VALUE |
|---|---|---|---|---|---|---|---|
| | | **MONDAY (1 December)** | | | | | |
| 2:45 | CN | PMI – manufacturing | Nov | pts | 50.0 | - | 50.4 |
| **9:00** | **PL** | **PMI – manufacturing** | **Nov** | **pts** | **50.9** | **50.7** | **51.2** |
| 9:55 | DE | PMI – manufacturing | Nov | pts | 50.0 | - | 51.4 |
| 10:00 | EZ | PMI – manufacturing | Nov | pts | 50.4 | - | 50.6 |
| 16:00 | US | ISM – manufacturing | Nov | pts | 57.8 | | 59.0 |
| | | **TUESDAY (2 December)** | | | | | |
| | | No important data releases | | | | | |
| | | **WEDNESDAY (3 December)** | | | | | |
| | **PL** | **MPC decision** | | **%** | **2.0** | **2.0** | **2.0** |
| 9:00 | HU | GDP | Q3 | %YoY | 3.2 | - | 3.9 |
| 9:55 | DE | PMI – services | Nov | pts | 51.7 | - | 54.4 |
| 10:00 | EZ | PMI – services | Nov | pts | 51.3 | - | 52.3 |
| 11:00 | EZ | GDP | Q3 | %YoY | 0.8 | - | 0.8 |
| 14:15 | US | ADP report | Nov | k | 222 | - | 230 |
| 16:00 | US | ISM – services | Nov | pts | 57.5 | | 57.1 |
| 20:00 | US | Fed Beige Book | | | | | |
| | | **THURSDAY (4 December)** | | | | | |
| **11:00** | **PL** | **Bond switch auction** | | | | | |
| 13:45 | EZ | ECB decision | | % | 0.05 | - | 0.05 |
| 14:30 | US | Initial jobless claims | week | k | - | - | 313 |
| | | **FRIDAY (5 December)** | | | | | |
| 8:00 | DE | Industrial orders | Oct | %MoM | 0.4 | - | 0.8 |
| 14:30 | US | Non-farm payrolls | Nov | k | 225 | - | 214 |
| 14:30 | US | Unemployment rate | Nov | % | 5.8 | - | 5.8 |
| 16:00 | US | Industrial orders | Oct | %MoM | -0.2 | - | -0.6 |

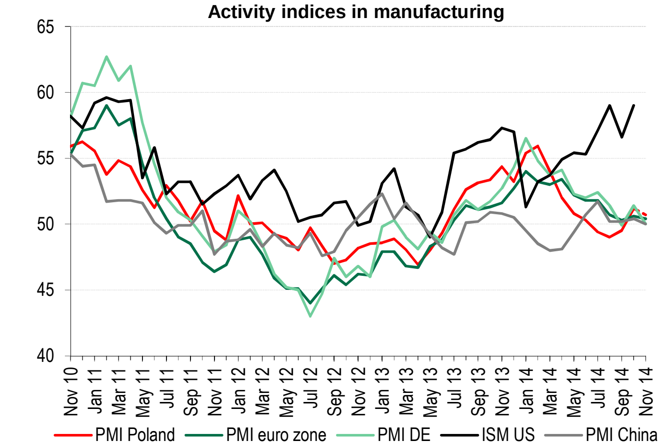
Source: BZ WBK, Reuters, Bloomberg

ECONOMIC ANALYSIS DEPARTMENT:
al. Jana Pawła II 17, 00-854 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** – PMI and MPC meeting

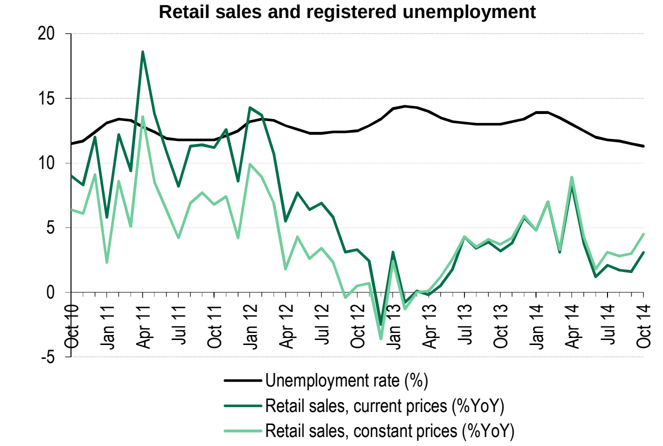
Activity indices in manufacturing



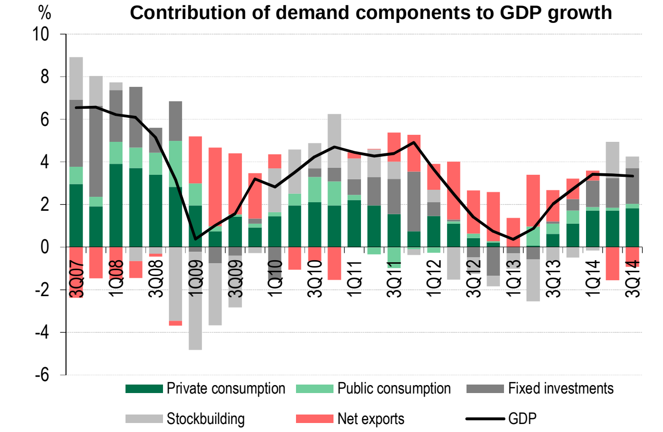

- In our view, the Polish manufacturing PMI index inched down to 50.7 in November, in line with the corresponding indices for Germany and the euro. We think that the October's surge to 51.2 was overly optimistic given the weak economic sentiment in the euro zone and generally worldwide, so a downward correction is now possible.
- We expect the MPC to keep interest rates unchanged in December, with the reference rate staying at 2.00%. The recent set of macroeconomic data was rather positive, especially data on GDP growth and its breakdown (see details below) and this is likely to discourage the MPC from any moves at its upcoming meeting. Still, some members of the MPC are determined to continue to ease monetary policy, and even though some others are hesitant, we do not rule out one more cut in early 2015.

## **Last week in the economy –** Positive GDP figures, further improvement in the labour market

Retail sales and registered unemployment




Contribution of demand components to GDP growth




- Retail sales' growth accelerated in October to 2.3%YoY. Car sales disappointed by rising only 9.8%MoM, half the speed suggested by data on new car registrations. Meanwhile, retail sales in other areas grew roughly in line with expectations. According to our estimate, retail sales growth, excluding autos and fuels, accelerated to 5.1%YoY, the highest level since May 2014.
- Unemployment fell to 11.3%, showing the biggest decline of the number of unemployed in October since 2007. Positive trends are likely to continue.
- GDP growth in 3Q14 reached 3.3%YoY vs. 3.5%YoY in 2Q, with the seasonally adjusted growth accelerating to 0.9% from 0.7% in 2Q. Private consumption accelerated in 3Q to 3.2%YoY (fastest rise since 2Q11). Investment growth surprised, accelerating in 3Q to 9.9%YoY, from the already decent 8.7%YoY in 2Q. Net exports' contribution to GDP growth was negative and reached -1.6pp (vs -1.9pp in 2Q).
- The GDP data confirmed the strength of domestic demand, which is mitigating the negative impact of the slowing external demand on the Polish economic growth. Apparently, neither entrepreneurs nor consumers were afraid of the deteriorating business climate abroad; the former kept expanding, probably anticipating that the slowdown in the euro zone would be short-lived, while the latter kept spending money as their purchasing power is rising thanks to the booming labour market and falling prices. This may continue for a while, implying that GDP growth in the nearest quarters will probably be higher than we had assumed earlier. However, domestic demand will not be able to keep the economy growing if it is the only engine running. Thus, a revival of external demand (from the euro zone in particular) is crucial for maintaining GDP growth in the medium run.

## **Quote of the week –** Some members want to wait

**Jerzy Hausner, MPC member, 25 November 2014, Reuters**

I think that the current level of interest rate is adequate. I am not ready to support a shift from moderately positive real rates to very low interest rates.

**Marek Belka, NBP governor, 24 November 2014, Reuters**

I fear the zloty strengthening versus the euro. This can weigh on recovery in enterprises. We may take this factor into account while discussing the monetary policy outlook. Some members want more cuts, some do not want them, some others would like to wait. It is hard to say what happens. In my view, there is still room for cuts.

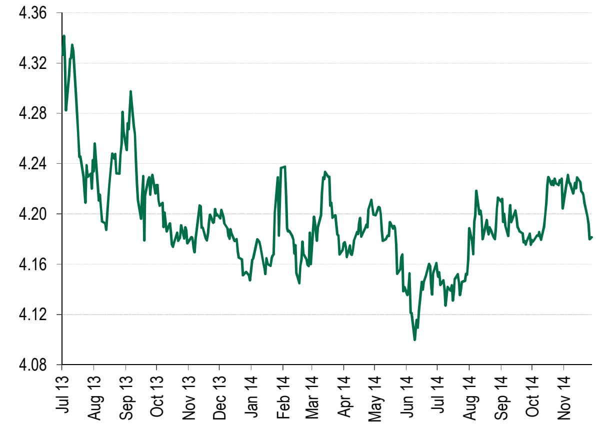
**Elżbieta Chojna-Duch, MPC member, 26 November 2014, PAP**

Domestic data on retail sales or industrial output are not a reason for concern, especially the labour market situation. The GDP breakdown in Q3 will be important (…) There is still some room to ease monetary policy.

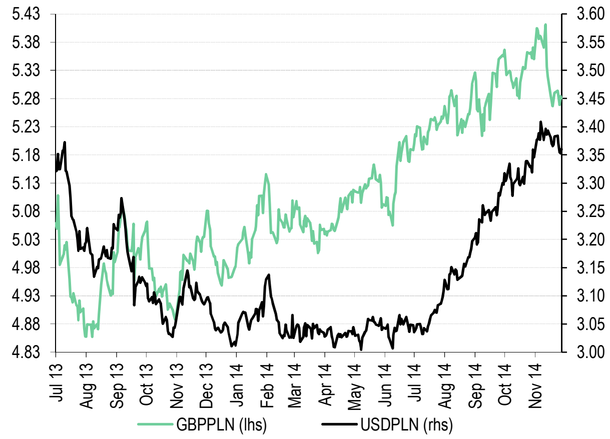
Detailed results of the MPC vote in October confirmed our guess that a cut by 50bp was supported by M. Belka, A. Bratkowski, E. Chojna-Duch, J. Osiatyński and A. Zielińska-Głębocka. Other members do not want cuts and are quite stable in their views, so views of these five doves are crucial for the time being. E. Chojna-Duch is probably the one who "wanted to wait" in November. Overall, she still sees room for interest rate cuts. If the GDP breakdown for Q3 (strong growth in investment and moderate consumption acceleration) was important for her, we should not see any easing in December. Chojna-Duch is also concerned about the external environment, so if economic data on the euro zone and Germany shows further deterioration, she may be encouraged to support cuts again.

## **Foreign exchange market** –Zloty may appreciate further

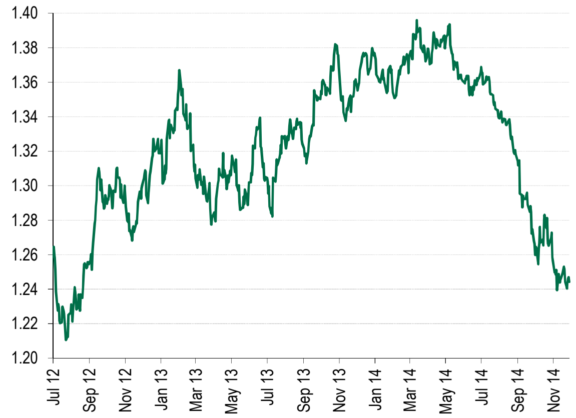
EURPLN



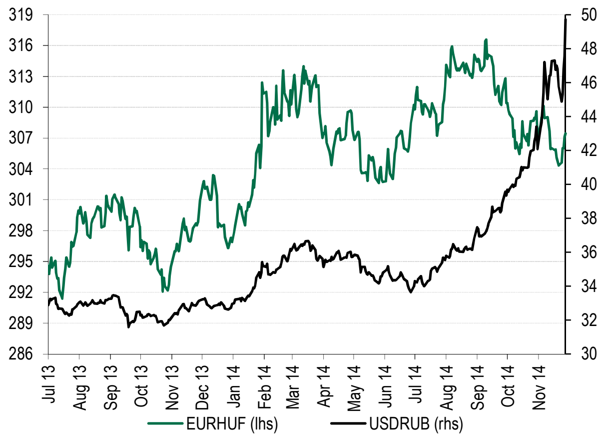

USDPLN and GBPPLN




EURUSD




EURHUF and USDRUB




### Zloty strongest since October and may appreciate further

- As we had expected, after breaching the vital support at 4.20 against euro in the previous week, the zloty continued to appreciate and EUR/PLN reached temporarily even 4.17, its lowest since early October. The zloty was benefiting from hopes for more ECB easing, decent domestic macro data and inconclusive comments of the Polish MPC members that diminished, in the market's view, odds for a December rate cut.
- Events in the coming days could decide whether EUR/PLN breaks the next support area at 4.16-4.17 (September lows) or rebounds back towards 4.20. The MPC's decision to keep interest rates on hold for the second straight month should be supportive for the currency, while the November manufacturing PMI, due on Monday, should be neutral, in our view, showing a slight decrease after the solid October gain. On the other hand, we do not expect the ECB to announce an extension of the asset purchase programme already at its December meeting and this might weigh on the risky assets.
- If EUR/PLN manages to break 4.16-4.17, then the next target is at 4.12. Resistance is at 4.20-4.21.

### Euro recovers slightly vs. the dollar

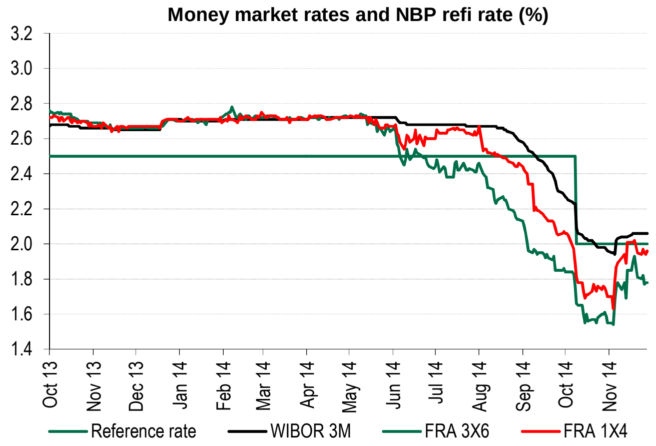
- The euro appreciated slightly vs. the dollar in the past week as US data was rather poor and undermined expectations for prompt rate hikes by the Fed. However, the potential for a EUR/USD rebound was limited by the more dovish comments from the ECB. The exchange rate rose to 1.253 from 1.236 to finally pull back to 1.246.
- It seems that monetary policy of the main central banks will be the key factor for EUR/USD this week. Many Fed members are due to speak and the US monthly nonfarm payrolls will be released. The recent macro data from the world's biggest economy was not impressive and investors may be sensitive to US central bankers' comments and the monthly labour market data, if it fits this disappointing trend. Noticeable volatility may also be provided by the ECB since the recent comments of its officials and poor macro data fuelled expectations that the asset purchase programme could be extended as soon as in December. We, however, are of the opinion that the central bank will rather wait for the second take-up of the TLTROs before extending the scale of the monetary policy stimulus.
- As long as it is difficult to work out the net effect of the US nonfarm payrolls data and the FOMC members' comments on EUR/USD, we think that the outcome of the ECB's meeting may support the euro, at least in the short run. Also, the Swiss referendum on rising the gold share in the central bank's reserves is likely to be unsuccessful (as recent polls show) and this might push EUR/CHF higher, giving an upward impulse also for EUR/USD.

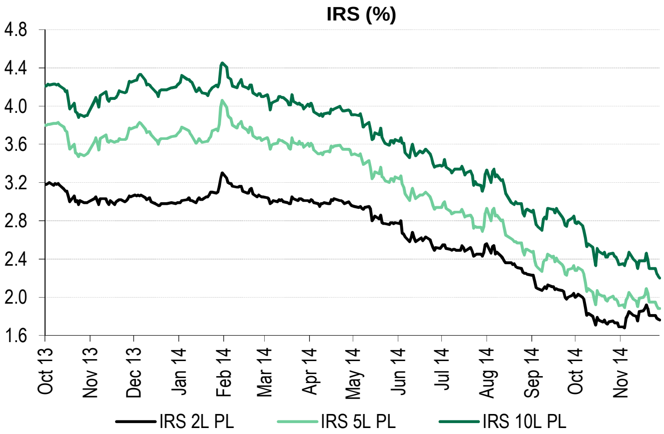
### Ruble and forint depreciate

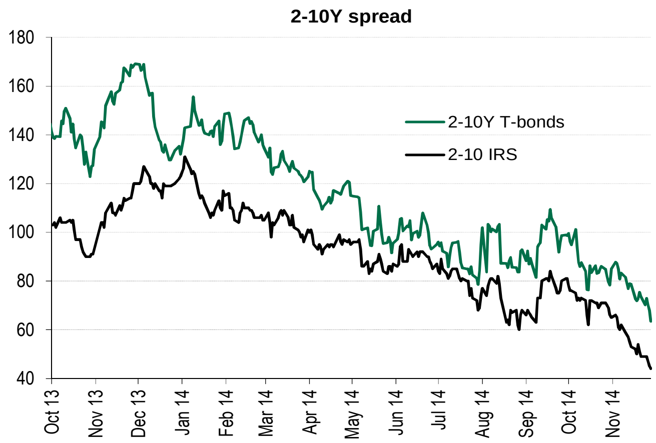
USD/RUB up-trend resumed last week after two weeks of stabilisation. The trend of falling oil prices intensified after OPEC's decision to leave the output level unchanged and this hit the ruble – the exchange rate broke the previous peak of 48.6 and reached a fresh all-time high at above 49.8.

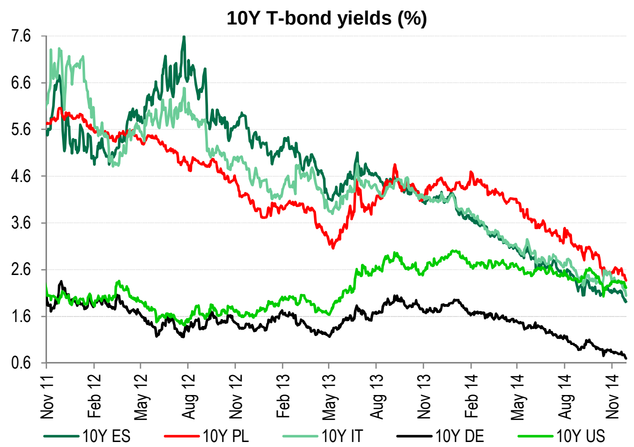
- The Hungarian central bank left interest rates unchanged, as expected. However, the market is starting to notice the risk that the easing cycle may be renewed given the adverse impact that the weaker growth in the euro zone may have on the Hungarian economy. This weighed on the forint in the past week and pushed EUR/HUF above 307, back above the crucial support at 305 that the exchange rate had broken in the previous week.

## **Interest rate market** – No rate cut by the MPC may trigger profit taking




### Money market rates may stabilise in the coming week

- WIBOR rates were stable over the past week, while FRAs remained more vulnerable to the macro data releases. FRAs fell for most of the week due to the positive market sentiment, but they shifted up at the end of the week as expectations for a rate cut in December faded on the healthy 3Q GDP breakdown. Notwithstanding, FRAs were still lower than at the end of the previous week.
- The FRA market is currently pricing-in a rate cut of 25bp in 3 months' time and a total of 50bp in a 6 month horizon. We think that lack of a rate cut in December would not surprise the market, keeping money rates stable ahead of more macro data releases later in December. It is worth noting that the turn of the year usually brings a bit higher cost of capital, therefore, we do not exclude some gradual increase in WIBORs in upcoming weeks.

### IRS and T-bond yields reached fresh record-lows

- The domestic FI market strengthened quite considerably last week. Both IRS and T-bonds rallied due to further strengthening on the core and peripheral debt markets as expectations for QE in the euro zone increased considerably. Consequently, the IRS rates / T-bond yields reached fresh record-lows, with the yield of the 10Y benchmark falling temporarily to 2.36%. However, the strong 3Q GDP breakdown halted the downward move at the end of the week. As a result, some investors decided to take profit, trimming the earlier gains on the FI market.
- Last week, the domestic curves shifted down by 3-9bp for IRS and by 1-9bp for T-bonds. A bull flattener strategy developed on both markets over the past week as the long end of the curves gained the most. The 2-10Y spreads continued to narrow, reaching the lowest level since mid-May 2013.
- Poland's Finance Ministry announced that it will hold a single switch auction on December 4, in line with its issuance plan for 4Q 2014. The Ministry is seeking to redeem floating rate WZ0115T-bonds and fixed-rate PS0415 and OK0715 bonds. The offer of T-bonds at this auction will depend on market conditions, but, in our view, it might be T-bonds from the mid- and long-end of the curve and floaters, i.e. the WZ series. The offer will be announced at the beginning of the week (on December 2).

### Central banks' meetings and auction are the key events

- This week investors will focus on central banks' meetings, awaiting new information on the monetary policy outlook in Poland and start of QE in the euro zone. In our view, the MPC's decision to keep rates on hold in December could trigger profit-taking in the FI market in the short run, especially at the short end of the curves. Later during the month, however, yields may go down again on the back of new economic data releases (we still expect CPI to be very low and a significant drop in production).
- Considering the long end of the curves, the ECB meeting and the auction will be the most crucial. The strong belief in QE by the ECB helped both core and peripheral debt to strengthen, with the yield of the 10Y benchmark declining to 0.70% for Germany, below 1% for France and slightly below 1.90% for Spain. Further downward move on the core market may stabilise valuation of the domestic assets near their current levels. At the same time, favourable results of the bond auction could also be a supportive factor (as in November) for the domestic curve.

Bank Zachodni WBK
Grupa Santander



Additional information is available on request. Please contact Bank Zachodni WBK S.A. Rates Area, Economic Analysis Department, Al. Jana Pawła II 17, 00-854 Warsaw, Poland, phone +48 22 534 18 88, email ekonomia@bzwbk.pl, http://www.bzwbk.pl.