

# 3-WEEKLY ECONOMIC UPDATE

22 December 2014 – 11 January 2015



Please be advised that today's Weekly Economic Update will be the last for 2014.

We will resume publication on January 9, 2015.

We wish our readers Merry Christmas and Happy New Year!

## Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE
				MARKET	BZWBK	
<b>MONDAY (22 December)</b>						
16:00	US	Home sales	Nov	m	5.23	- 5.26
<b>TUESDAY (23 December)</b>						
10:00	PL	Retail sales	Nov	%YoY	2.0	2.4 2.3
10:00	PL	Unemployment rate	Nov	%	11.4	11.4 11.3
14:30	US	Final GDP	Q3	%QoQ	4.3	- 4.6
15:55	US	Michigan sentiment index	Dec	pts	93.3	- 93.8
16:00	US	New home sales	Nov	k	460	- 458
<b>TUESDAY (30 December)</b>						
14:00	PL	Current account	Q3	€m	-1803	-1803 -553
16:00	US	Consumer confidence index	Dec	pts	92.5	- 88.7
<b>FRIDAY (2 January)</b>						
9:00	PL	PMI – manufacturing	Dec	pts	-	52.7 53.2
9:55/10	DE/EZ	PMI – manufacturing	Dec	pts	51.2/50.8	- 49.5/50.1
16:00	US	ISM – manufacturing	Dec	pts	57.5	- 58.7
<b>TUESDAY (6 January)</b>						
9:55/10	DE/EZ	PMI – services	Dec	pts	51.4/51.9	- 52.1/51.1
16:00	US	Industrial orders	Nov	%MoM	1.8	- -0.7
<b>WEDNESDAY (7 January)</b>						
11:00	EZ	Flash HICP	Dec	%YoY	0.0	- 0.3
14:15	US	ADP report	Dec	k	213	- 208
20:00	US	FOMC minutes	Dec			
<b>THURSDAY (8 January)</b>						
8:00	DE	Industrial orders	Nov	%MoM	-0.8	- 2.5
<b>FRIDAY (9 January)</b>						
8:00	DE	Exports	Nov	%MoM	-	- -0.5
14:30	US	Non-farm payrolls	Dec	k	232	- 321
14:30	US	Unemployment rate	Dec	%	5.7	- 5.8

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 Luzziński +48 22 534 18 85

Marcin Sulewski +48 22 534 18 84

### TREASURY SERVICES:

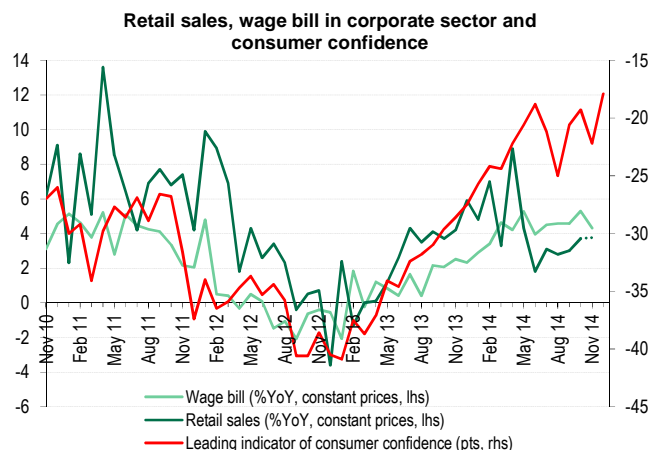
Poznań +48 61 856 5814/30

Warszawa +48 22 586 8320/38

Wrocław +48 71 369 9400

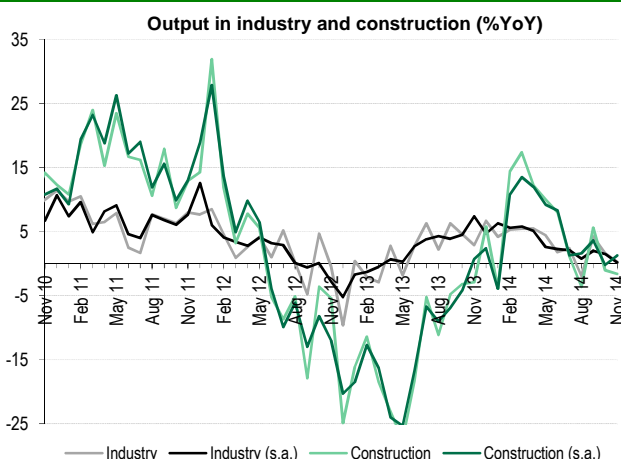
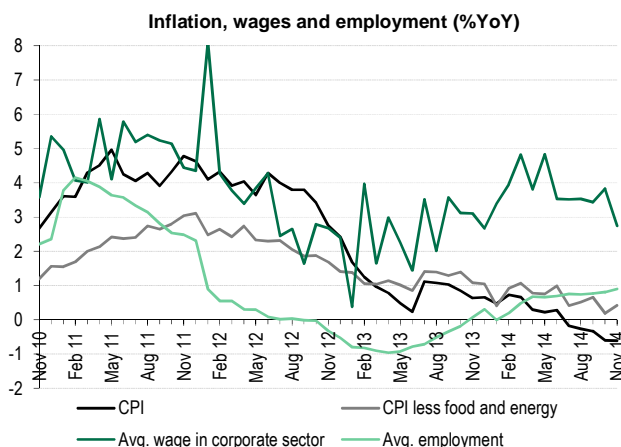


## What's hot in coming weeks – Couple of important indicators in the Holiday period



- In our view, the December PMI index will remain close to November's level. Its recent improvement shows that companies are growing more confident about the economic outlook, but we believe there is still not enough evidence of improvement in the euro zone to expect a bigger upward potential for this indicator.
- We expect the registered unemployment rate to inch up to 11.4% in November, in line with the Labour Ministry's forecast. This would only be a seasonal rise and data still point to further labour market improvement.
- Growth of retail sales in November was probably similar to the previous month's level. We expect retail sales to have grown by c4%YoY in real terms last month, which would suggest that private consumption growth is moderate in Q4.
- Quarterly current account data usually bring major revisions of past data, so they are likely to be closely eyed by the market.

## Last week in the economy – Price pressure still weak, industry decelerating but exports not bad



- CPI inflation remained at -0.6%YoY in November and we expect it to fall further, even to as low as -1%YoY in 1Q15, largely due to the continued slump in fuel prices (which have fallen c.5%MoM in December and are likely to drop even more). It seems highly likely to us that deflation is here to stay, at least until the middle of 2015, and maybe even until the end of 3Q15, something that could surprise the central bank. Core CPI without food and energy prices rose in November to 0.4%YoY from 0.2%YoY, while producer price inflation PPI fell to -1.6%YoY, partly due to the falling commodity prices in the global market.
- The current account balance reached -€435m in October and was lower than expected by the market. Exports and imports were higher than anticipated, which confirmed earlier signals from the CSO data. It is important to note that the latter suggested some revival of export growth to some euro zone countries, which may be good news for Poland's economic outlook.
- Employment in the corporate sector rose 0.9%YoY in November, while wages grew by 2.7%YoY, well below our own and market forecasts. The lower pace of wage growth might have been caused by the mining sector and we will be able to confirm this next week, when the statistics office releases more detailed data. Despite the slowdown in wages, we still perceive the situation on the labour market as positive.
- Industrial output decelerated to a mere 0.3%YoY in November, while construction and assembly output contracted by 1.6%YoY. Seasonally adjusted industrial output grew by 0.2%YoY, the slowest pace since May 2013.
- Last week's data generally confirmed that economic growth was slightly slowing down in the final quarter of 2014. This is in line with our scenario, in which we expect GDP growth to decelerate to a touch below 3% in 4Q14.

## Quote of the week – Deflation in the spring would signal rates' adjustment

**Jerzy Hausner, MPC member, 15 December, Wall Street Journal**

If it turned out deflation extends onto the spring, I would conclude the problem starts to be serious and it would be a signal for potential monetary adjustment.

**Jerzy Osiatyński, MPC member, 18 December, Wall Street Journal**

Today the problem is how to move to a faster growth track from a path of uncertain growth at around 3%. That would require actions aimed at supporting demand.

**Jan Winięcki, MPC member, 16 December, Reuters**

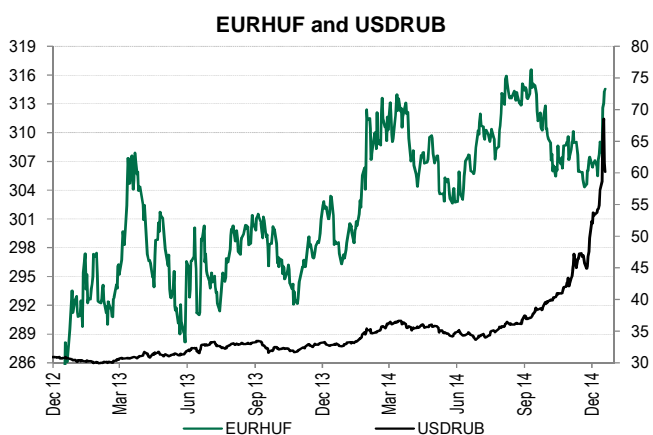
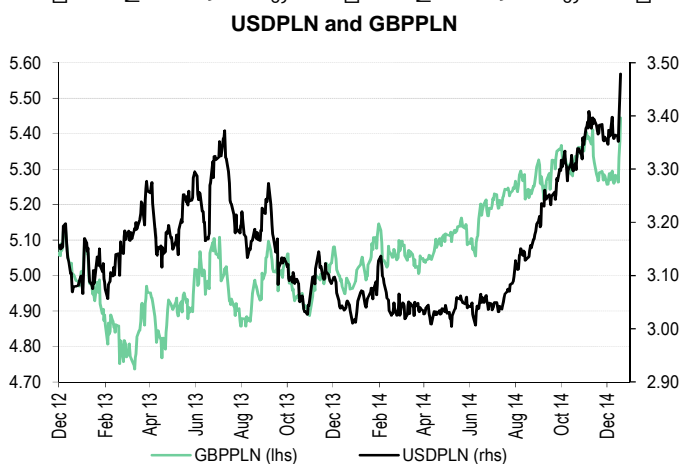
Price growth between -1 and +1% will be present in upcoming 5-10 years, so I will not change my stance even if deflation extends into spring.

**Elżbieta Chojna-Duch, MPC member, 19 December, PAP**

Weakening of the zloty can be treated as a substitute of interest rate cuts, provided that it is persistent and not a two-day event. And it will be persistent as long as the ruble is weak.

Results of the MPC vote in November confirmed that Elżbieta Chojna-Duch was the one who withdrew her support for rate cuts, becoming responsible for the stop in monetary policy easing. The zloty's recent depreciation may make her even more convinced that further rate cuts are not necessary at the moment, so we think she may not re-join the dovish camp quickly. On the other hand, Jerzy Hausner's last comment (and he has recently been against rate cuts) seemed dovish. He said he would treat deflation in the spring as an argument to ease monetary policy further. We stick to our view that rates will be cut one more time by 25bp in 1Q15 (as the scale and persistence of deflation will surprise the MPC a lot), but given the recent developments, the cut is more likely to come in February-March than January.

## Foreign exchange market – The Polish zloty may recover slightly at the end of the year



### Zloty at its weakest

▪ The end of the year has brought plenty of volatility, especially in the emerging world. The zloty not only suffered from the sharp depreciation of the Russian ruble, but also from the dovish domestic macro data. The zloty continued to weaken even despite some rebound on the RUB. EURPLN increased temporarily to slightly above 4.28 (the highest level since September 2013), reaching this year's maximum. At the same time, the Polish currency deepened its losses against the U.S. dollar (USDPLN increased above 3.48, the highest since June 2012) due to the significant EURUSD decline.

▪ While the zloty usually tends to appreciate in December, the situation is totally different this time around. The currency's performance up to now suggests that it may be the worst December since 2008. In the last week, the zloty was one of the weakest currencies in the emerging market universe, losing 3.5% vs. the U.S. dollar and 3% vs. the British pound. It also lost the most against these two currencies since the beginning of this year (by nearly 13% and slightly more than 8%, respectively).

▪ The turn of the year should bring lower liquidity and weaker investor activity, which could boost market volatility. Relatively strong retail sales data (our forecast is well above the market's) might offer the domestic currency some relief despite the fact that, from a technical point of view, an upward move of EURPLN is more probable than a downward move in the coming weeks. The key resistance levels are at 4.287 and then at 4.313, while the important support level is at 4.227.

### EURUSD hits this year's low

▪ The beginning of the week was favourable for the single currency as macro data for the euro zone (especially for Germany) came in better than expected. EURUSD broke 1.25 and set the December's maximum at 1.257. But dovish signals from the ECB and the hawkish message of the Fed pushed the rate towards its local minimum at 1.225.

▪ Switzerland was also in the centre of attention. The Swiss National Bank decided to introduce negative interest rates and to keep the EURCHF floor at 1.20, triggering a weakening of the Swiss franc vs. the euro.

▪ The combination of looming Fed rate hikes, strong U.S. economy and high expectations for an extension of the ECB's asset purchase programme points to a lower EURUSD in the medium term. Breaking the support of 1.226 would open the door to further decline towards 1.20. But, in our view, such move could take pace in 1H15.

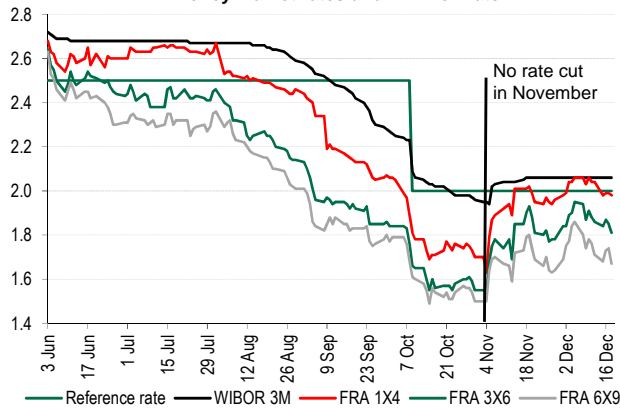
### Russian meltdown

▪ Last week brought a rapid deterioration of the global sentiment, especially in the CEE region. USDRUB surged to a new all-time high of 80 from 60. The aggressive rate hike by the Russian central bank (by 650bp to 17%) helped RUB only for a while, but, at the end of the week, the currency managed to recoup some of its losses thanks to stabilising oil prices and the central bank's intervention on the market. At the same time, the CEE currencies were under significant pressure from worries about possible spill-over effects. Among the CEE countries, the forint lost the most and it did not benefit from the ruble's rebound. EURHUF increased above 316 at the end of the week (slightly lower than this year's maximum at 317.5).

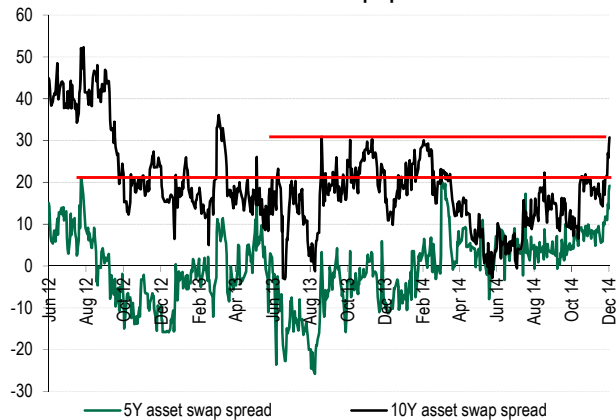
▪ RUB has lost almost 45% year-to-date. Despite its slight rebound, the currency remains sensitive to changes in oil prices and news from the Russian economy. The turn of the year could be difficult for the Hungarian forint. Technical analysis signals further forint weakening against the euro – EURHUF may test its peak from September.

## Interest rate market – Asset swap spreads close to important resistance

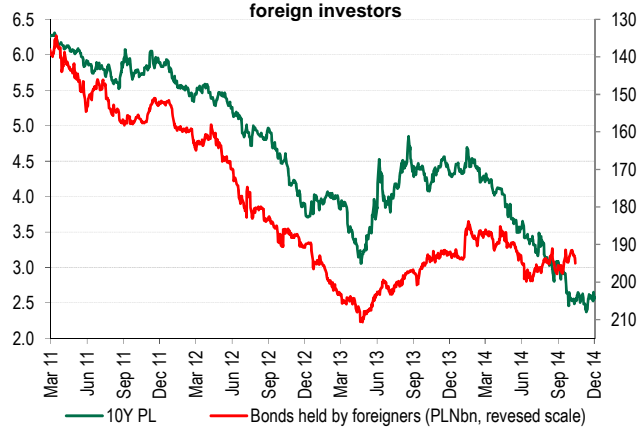
Money market rates and NBP refi rate



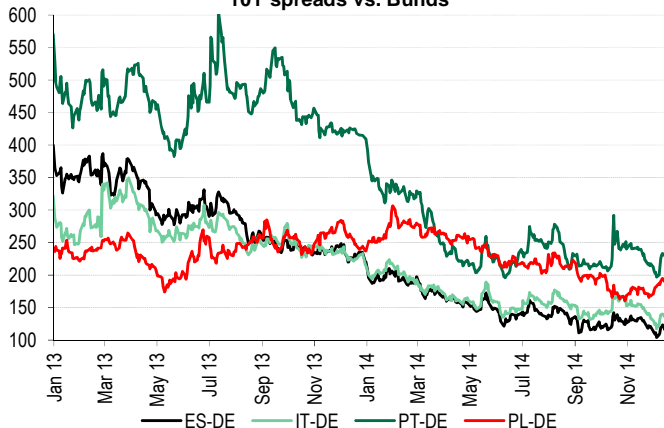
5Y and 10Y asset swap spreads



Yield of the 10Y benchmark and holdings of Polish bonds by the foreign investors



10Y spreads vs. Bunds



### WIBOR stable, FRA expects more cuts

■ 12M WIBOR remained stable for the second week in a row. This past week was also the fourth consecutive week when the 1-9M WIBORs were flat. These rates ended their downward trend and became stable shortly after the MPC failed to deliver a rate cut in November.

■ The FRA market, however, continues to anticipate more interest rate cuts and it is pricing-in a 25bp reduction in 3-months' time. It also sees an 80% probability of rates being 50bp lower in 9-months' time.

■ We expect WIBOR to resume its downward path in early 2015 due to hopes for more monetary policy easing in 1Q15. Still, the trend may not resume as early as in January because as we think the MPC is likely to keep rates unchanged at its first meeting next year. This, however, should not be a big surprise for the market.

### Polish asset swaps on the rise

■ The past week was very volatile on the Polish bond and IRS markets. The 10Y yield ended flat on weekly basis and 5Y and 2Y dropped by 2bp and 6bp, respectively. Meanwhile, the IRS curve moved down by 9-10bp. As a result, the Polish 5Y and 10Y asset swap spreads (which have been widening since around mid-December) reached their highest levels since March – c.20bp and c.30bp, respectively. Both are currently near their resistance levels. This seems to also reflect the growing worries about a possible contagion from Russia.

■ There were also big intraday changes recorded on the German Bunds, which, on the one hand, were caused by risk aversion due to Russia-related worries, but, on the other, were due to pressure from the more hawkish tone of the FOMC statement.

■ We expect the Polish PMI to slightly fall in December, following three months of a sharp increase. However, we do not think that this data will be weak enough to fuel expectations for a rate cut in January. Our November retail sales' forecast is well above the consensus, which we think could offer the MPC yet another argument why it should not hurry with further monetary easing (especially that the consumer confidence indicator surged in December, pointing to an improving consumption outlook). However, it seems that changes in the perceived sovereign risk may be more important for the Polish fixed-income market in the near term than expectations for the monetary policy outlook. Investors may, therefore, focus on news from Russia, trying to assess the risk of a spillover, among others.

■ Meanwhile, strong hopes that the ECB will extend its measures should support demand for Polish debt in the coming weeks. The third chart clearly shows that foreigners' activity in the Polish bond market has a noticeable impact on the domestic debt. Yields are currently somewhat above the all-time lows and this offers room for strengthening. Also, when we look at the spreads vs. Bunds, Polish bonds look more attractive than their Spanish, Italian or Portuguese counterparts. Nevertheless, the coming weeks may be decisive for the direction that the asset swap spreads may take.

■ The Polish market fought off pressure from the more hawkish FOMC rhetoric and so we think that the U.S. monetary policy will not be an issue for the Polish FI market at the turn of the year.

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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](mailto:ekonomia@bzwbk.pl), <http://www.bzwbk.pl>.