

WEEKLY ECONOMIC UPDATE

5 – 11 October 2015

Poland's data remain bitter-sweet. The manufacturing PMI for September disappointed miserably, by falling to nearly 50pts, but the LFS unemployment rate improved (to 7.2% after the seasonal correction), confirming that the positive trend in the labour market was not losing steam. The inflation drop in September was, according to the flash estimate, deeper than we had assumed, but we still think that this pause in the CPI's upward march was only temporary and that inflation would return above zero in November.

There are relatively few key data releases and events in the upcoming week. Several central banks hold their decision-making meetings (Australia, Japan, UK, Poland), but no changes in their monetary policies are expected. The Fed's minutes from September and speeches of several FOMC members may be much more important for investors, who will be looking for any hints about the timing of the first interest rate hike in USA. After the much lower-than-expected non-farm payroll figures, the expected timing of the Fed's lift-off was delayed further into 2016 and a strong impulse would be needed to change this. New data from Germany will be released (new orders, production, exports), but they will be for August, from before the VW scandal. So far, economic indicators for Germany have been quite good, however, the possible consequences of the VW emissions scandal pose huge uncertainty.

Poland's lower inflation and PMI, weak U.S. employment figures, worries about the impact of the VW scandal on the German economy – all these factors support further strengthening of the debt markets. The Polish market will probably be tracking this trend, unless global risk aversion rises dramatically. Speculations about interest rate cuts in Poland may intensify. EURPLN remains in a horizontal band of 4.18-4.26 and we expect it to stay there. Worries about the world's economic outlook and the worse-than-expected domestic data are not supportive for the zloty.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (5 October)							
9:55	DE	PMI – services	Sep	pts	54.3	-	54.9
10:00	EZ	PMI – services	Sep	pts	54.0	-	54.4
16:00	US	ISM – services	Sep	pts	58.0	-	59.0
TUESDAY (6 October)							
	PL	MPC decision		%	1.50	1.50	1.50
8:00	DE	Industrial orders	Aug	%MoM	0.4	-	-1.4
WEDNESDAY (7 October)							
8:00	DE	Industrial output	Aug	%MoM	0.2	-	0.7
9:00	CZ	Industrial output	Aug	%YoY	8.4	-	4.6
THURSDAY (8 October)							
8:00	DE	Exports	Aug	%MoM	-1.0	-	2.5
9:00	HU	CPI	Sep	%YoY	-	-	0.0
11:00	PL	Bond switch auction					
14:30	US	Initial jobless claims	week	k	-	-	277
20:00	US	FOMC minutes					
FRIDAY (9 October)							
9:00	CZ	CPI	Sep	%YoY	0.2	-	0.3

Source: BZ WBK, Reuters, Bloomberg

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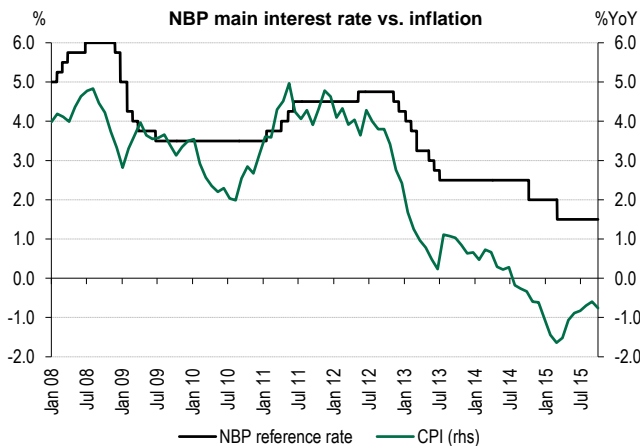
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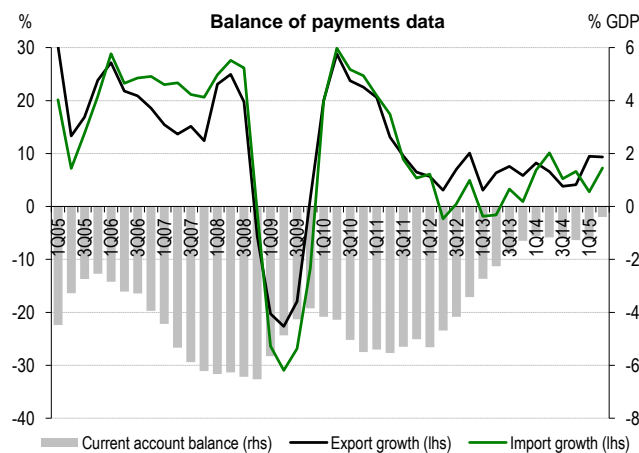
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What's hot this week – Polish MPC decision, FOMC minutes

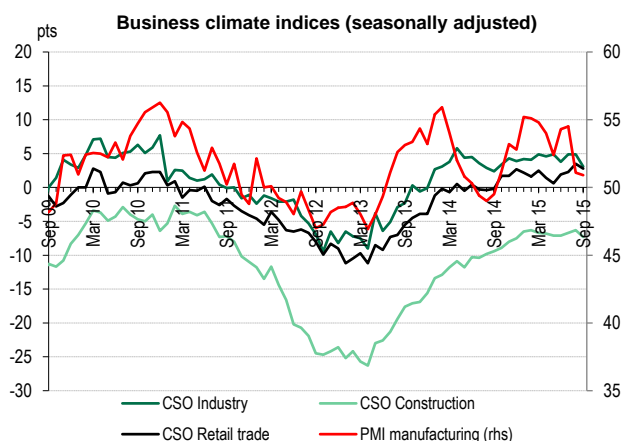


- The MPC policy meeting is the only important event in the domestic calendar this week. We expect rates to remain unchanged till the end of the current MPC's term and this is in line with the broader market expectations. The recently bearish data from the Polish economy (CPI, PMI) are unlikely to affect the rate decision, in our view.
- Foreign events will most probably come to the fore, with the release of the FOMC minutes from the September meeting being the most important. Policy normalisation in the U.S. is one of the main market drivers, so investors are likely to closely eye this event. Let us keep in mind that the FOMC decided not to hike rates in September, but most of the Committee members were in favour of raising rates before 2015 ends. The minutes could, therefore, shed more light on the exact timing of the possible Fed rate hike and better explain why the FOMC did not deliver it in September.

Last week in the economy – Lower CPI, PMI and unemployment



- The flash CPI estimate for September surprised to the downside as it showed inflation falling to -0.8% YoY from -0.6% YoY in August, more than we and the market had expected. However, this number does not change our expectation that inflation will rise later in the year.
- NBP released quarterly C/A data, which showed a significantly lower 2Q surplus than indicated by the earlier released monthly figures. The data also showed a considerable downward revision as far back as a few years into the past. This was mainly due to methodological changes, which included illegal goods like drugs and smuggling, which caused an upward revision of imports, and, thus, naturally a worse C/A.
- 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.



- Polish PMI disappointed for the second month in a row by falling to 50.9pts (its lowest level in 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 data also showed that Polish companies were benefitting from the lower commodity prices as production costs fell at the fastest pace since April 2014. There also seems to be no risk of inflation pressures. Weak PMI generates additional uncertainty about Poland's manufacturing and economic outlook. However, two things need to be considered in this context. First, economic activity indices for Germany and the euro zone remain healthy and we think it would be hard to imagine a sharp slowdown in Polish output and exports without a deceleration in the euro zone. Second, Poland's PMI has quite recently (e.g. in 2014) already suggested a slowdown, but no serious weakening in economic activity followed.

Quote of the week – Senseless to speculate on where Polish interest rate will go

Marek Belka, NBP governor, 30.09.2015, Bloomberg

Inflation in Poland will turn positive in November or December 2015. It is absolutely senseless to speculate where Polish interest rates will go. We don't expect anything dramatic [in economic growth] to happen.

Eiżbieta Chojna-Duch, MPC member, 30.09.2015, PAP

Given the current macro data, there are no reasons that would justify a change in interest rates. Inflation can turn positive at the start of 2016 rather than in 2015.

Andrzej Rzońca, MPC member, 28.09.2015, PAP

The next MPC will be challenged by strong external shocks. The MPC should, thus, consider normalising its monetary policy early enough, otherwise it could get the short end of the stick.

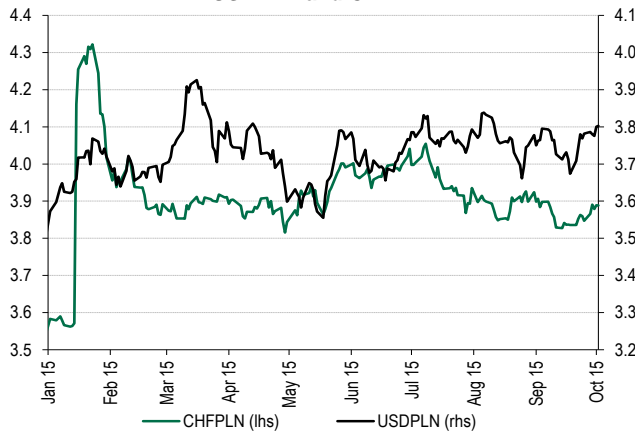
Marek Belka and Eiżbieta Chojna-Duch see no reason to change rates, given Poland's sound economic fundamentals and inflation expected to turn positive at the end of 2015 or start of 2016. This supports our forecast of flat interest rates in Poland in 2015 and in early 2016. There is some uncertainty regarding 2016 as we will then get a new MPC and no candidate names have yet been officially proposed. Andrzej Rzońca (one of the most hawkish members on the MPC) unveiled himself as the author of the idea of raising rates in a pre-emptive move, which would aim at creating more space to cut rates in the event of an external shock. This reasoning was presented in the MPC's last minutes, but – fortunately – it remains in stark minority.

Foreign exchange market – FOMC's minutes – more clues on future Fed policy?

EURPLN



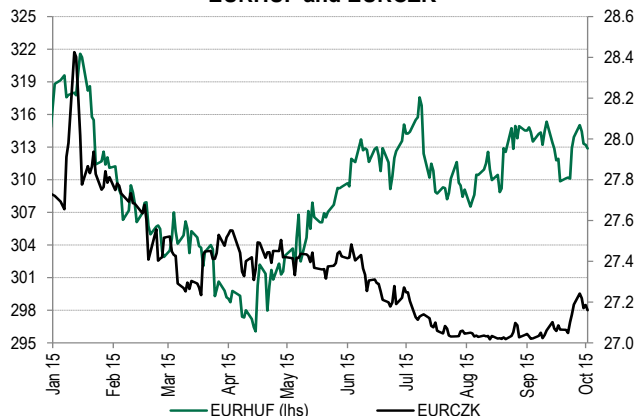
USDPLN and CHFPLN



EURUSD



EURHUF and EURCZK



EURPLN in a horizontal trend

▪ The Polish zloty weakened markedly over the past week. The domestic currency was under pressure from the lower September flash CPI, weaker-than-expected PMI for Poland's manufacturing sector and falling EURUSD. As a consequence, EURPLN rose temporarily above 4.25 to then stabilise slightly below that level ahead of the U.S. non-farm payrolls data. At the same time, USDPLN rose above 3.80, for the first time since early August. EURPLN returned above 4.25 after weaker than expected the US non-farm payrolls, while USDPLN shifted down towards 3.76.

▪ The third quarter of 2015 was not favorable for the zloty, which lost visibly against the British pound (by nearly 3% given the average rate in 2Q and 3Q), the euro (by 2.4%QoQ) and the U.S. dollar (by 1.7%QoQ). On the other hand, the zloty slightly firmed (0.6%) against the Swiss franc.

▪ This week is very light in domestic macro data releases. The MPC meeting scheduled for Tuesday will likely be uneventful as we expect the Council to leave its monetary policy unchanged. Investors will, therefore, be more focused on external factors affecting PLN, in particular macro data from Europe and the US. EURPLN did not change much on the U.S. labour market data release and remains within the 4.18-4.26 range. This trading range remains in place and we think that EURPLN is likely to stay in a horizontal trend for as long as the exchange rate does not break the abovementioned levels.

EUR/USD sharply up after weak the US non-farm payrolls

▪ EURUSD rose towards 1.128 at the beginning of the week and then fell temporarily to 1.114 as the non-farm payrolls data release was approaching. USD trimmed most of its earlier losses caused by the negative reading of the September flash HICP in the euro zone. Investors also believe that the stable sentiment is raising the chances for a rate hike in the U.S. The US labour market data disappointed and the prospects of Fed hiking in 2015 continue to fade. As a consequence EURUSD increased above 1.13.

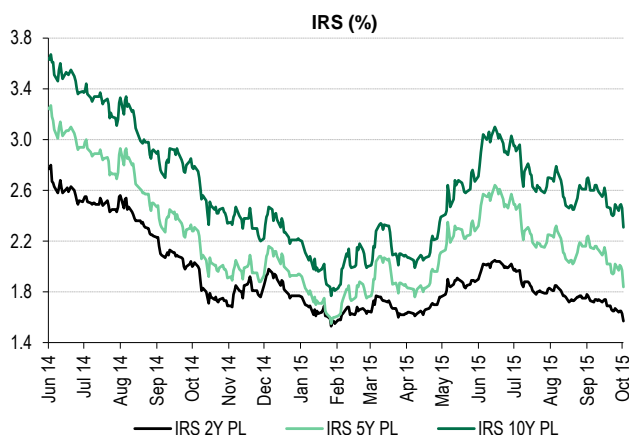
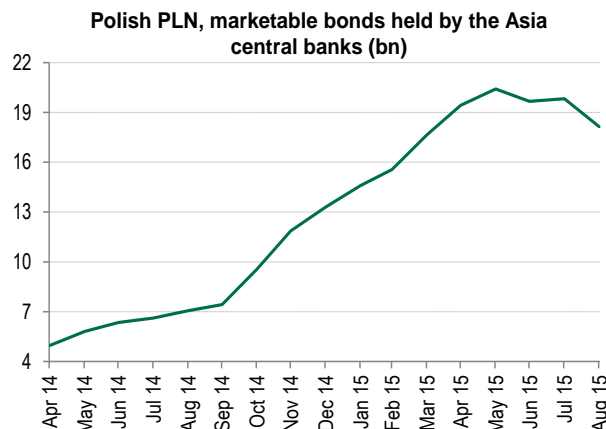
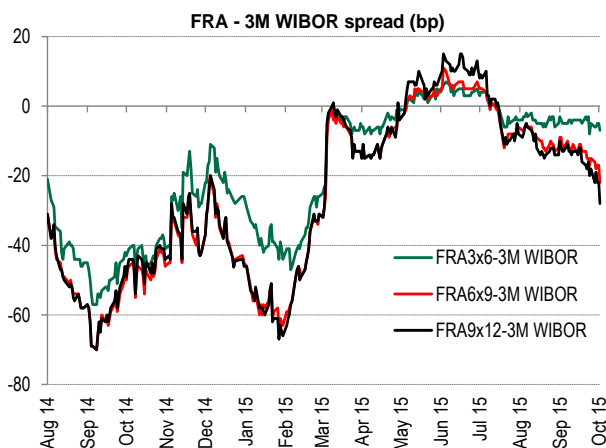
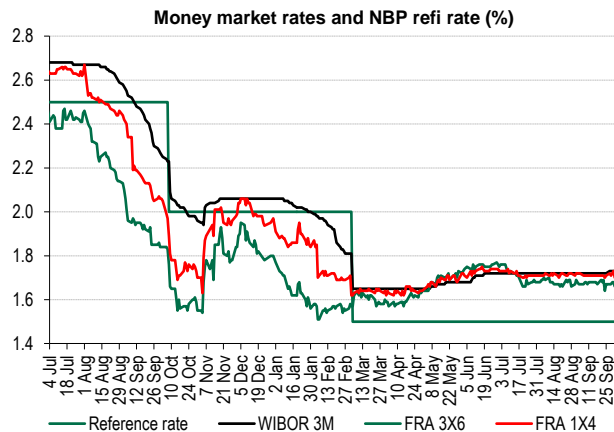
▪ This week investors will again look for any sign of further action by the Fed. In this case, minutes from FOMC's September meeting may shed some light on the situation. Return to speculation on monetary policy normalisation by the Fed later this year (after FOMC's members speeches later this week) should push EURUSD towards its last week's minimum (1.114), especially if the European macro data (PMI for services and the PMI composite) will show a gradual weakening of economic activity.

CPI releases in CEE in the spotlight

▪ The Hungarian forint and the Czech koruna firmed moderately over the past week on the back of the relatively good macro data releases for both countries, including the PMI indices for the manufacturing sectors. At the same time, USDRUB was more or less stable for most of the week, while the end of the week brought its rise to nearly 66.6 after weaker the U.S. labour market data. The market did not react significantly to news about the Russian airstrikes in Syria.

▪ Global factors are likely to determine the CEE currencies this week, but domestic data in each of the countries, especially the CPI readings, could also leave their mark. It is broadly expected that the headline CPI in the Czech Republic and Hungary will gradually fall, which means that this increased risk of deflation could weigh on the HUF and the CZK. As regard Russia, the headline CPI is expected to rise in September, which could add some volatility to the market at the beginning of the week.

Interest rate market – Rates could stay low

**More gains on both local and global factors**

- Polish bonds and IRS have been very sensitive to the global market sentiment, with a tendency to gain at times of lower demand for riskier assets. They also drew support from the below-consensus flash inflation estimates for Poland and the euro zone, as well as the very disappointing U.S. nonfarm payrolls. On a weekly basis, the 2Y IRS fell 10bp to 1.57%, the 5Y by 18bp to 1.84% and the 10Y by 18bp to 2.31%.

Asian central banks are selling Polish debt

- The Finance Ministry released data on Poland's PLN, marketable bond holders, which showed that domestic banks were responsible for the biggest monthly change in August – they bought debt worth PLN5bn and the nominal value of their portfolio reached an all-time high of nearly PLN170bn. This was the domestic banks' biggest buying spree since February. It is also worth noting that they mostly concentrated on the PS series. Foreign investor holdings rose by merely PLN0.7bn to PLN205.6bn in the same period, but there were noticeable shifts in the specific portfolios within this group. Foreign banks purchased PLN2.7bn, while the omnibus accounts added nearly PLN1.5bn. At the same time, central banks disposed of PLN1.8bn worth of bonds, with mutual funds selling PLN1.6bn. With respect to the foreign central banks, Asian banks were responsible for the selling of a total of PLN1.7bn. Data on the central bank holdings has been available since April 2014. In this period, Asian CBs sold Polish bonds only in two of the months, with August being the most intense. The nominal value of this group's portfolio is now the lowest since March 2015 and stands at PLN18.1bn. Considering the geographical breakdown, the central banks' reduction constituted 85% of the total selling seen from Asia. At the same time, investors from the euro zone bought bonds for nearly PLN2.0bn.

- The Finance Ministry said it was planning one standard auction in Q4, which should take place at the end of October or at the start of November. The value of the offered bonds will amount to PLN5-10bn. The ministry will also hold three switch auctions, with the first scheduled for October 8. It also plans foreign issues and loans from international institutions (€0.9-1.1bn). The head of the Finance Ministry's Debt Department, Piotr Marczak, said that the ministry has so far covered 93% of this year's borrowing needs.

Rates should stay low

- There has been more disappointing Polish data released since the MPC's last meeting, but recent comments of some of the Council's members suggest they are not really getting more concerned about economic growth. We think that this week's MPC meeting will probably be a non-event, with the Council acknowledging the weaker data, but likely reiterating that the current situation required no rate cuts. FRAs are pricing in more easing next year and this is probably due to expectations that the next Council will be biased on the dovish side. We think that rate cut speculations are likely to continue in the nearest weeks, but, in our view, Poland's sound economic growth and rising CPI will not justify rate cuts in 2016.

- The FOMC minutes and comments of the Committee's members that are scheduled for this week may be far more important for the Polish market, particularly given the last poor U.S. nonfarm payrolls data. Investors will eye more information on the discussion that the Fed held at its meeting in September, when it left rates unchanged, trying to assess when the Fed rates could go up. The PLN 2Y, 5Y and 10Y IRS are hovering close to their lowest levels since May and we think that they could also stay low in the next few weeks amid the rate cut speculations in Poland and the rather more distant Fed rate hike.

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