

WEEKLY ECONOMIC UPDATE

26 October – 1 November 2015

The ECB's rhetoric was the key market driver last week. The dovish comment by the ECB Governor, suggesting that further monetary easing was possible in December, weakened the euro, prompted a rally on the debt markets globally, and supported both the FX (in particular EM currencies, including the zloty) and equity markets. However, the zloty lost ground earlier in the week, with EURPLN rising temporarily to almost 4.30, the highest level since January 2015. This was, among others, caused by some controversial ideas launched by the opposition Law and Justice (PiS) party, which leads in opinion polls ahead of the elections. PiS said, for example, that it would appoint MPC members based on their willingness to cut rates or back some kind of an LTRO programme worth PLN350bn. The ECB's dovish rhetoric helped the zloty return below 4.25 per euro at the end of the week, confirming that global factors were still playing the key role on the market.

In this context, the last week of October should be very interesting, as we will get to see the outcome of Poland's general elections and the FOMC meeting. In our view, a decisive victory by PiS could trigger a rally on the short-end of the curves, on strengthening expectations of monetary policy easing in 2016. However, it could be negative for the zloty. We think that the announcement of the election results may not be able to put an end to the period of higher volatility as the FOMC makes its decision on rates and the U.S. 3Q advance GDP is released this week as well. The market gives clearly less than 10% odds for a hike this month and we think the Committee will not surprise. Thus, it is the statement that is likely to be crucial and that could spur more volatility in the market. Both the zloty and Poland's bonds would be supported by a dovish Fed rhetoric. Additionally, funds from the expected redemption of bonds and interest payments (worth cPLN27.3bn in total) will inflow onto the market at the beginning of the week. Higher market liquidity should support the T-bond auction planned for Thursday and improve market sentiment. Still, the upcoming bond auction and macro data releases abroad (Ifo for Germany, U.S. GDP for 3Q15) and in Poland (flash October CPI) will be in the background of the two key events.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (26 October)							
10:00	DE	Ifo index	Oct	pts	108.0	-	108.5
15:00	US	New home sales	Sep	k	545	-	552
TUESDAY (27 October)							
13:30	US	Durable goods orders	Sep	%MoM	-1.2	-	-2.3
15:00	US	Consumer confidence index	Oct	pts	102.4	-	103.0
WEDNESDAY (28 October)							
19:00	US	FOMC decision		%	0.0-0.25	-	0.0-0.25
THURSDAY (29 October)							
11:00	PL	Bond auction					
13:30	US	Initial jobless claims	week	k	-	-	259
13:30	US	Advance GDP	Q3	%QoQ	1.7	-	3.9
15:00	US	Pending home sales	Sep	%MoM	1.0	-	-1.4
FRIDAY (30 October)							
11:00	EZ	Flash HICP	Oct	%YoY	0.1	-	-0.1
13:30	US	Personal income	Sep	%MoM	0.2	-	0.3
13:30	US	Consumer spending	Sep	%MoM	0.2	-	0.4
14:00	PL	Flash CPI	Oct	%YoY	-0.6	-0.6	-0.8
14:00	PL	Inflation expectations	Oct	%YoY	-	-	0.2
15:00	US	Michigan index	Oct	pts	92.5	-	92.1

Source: BZ WBK, Reuters, Bloomberg

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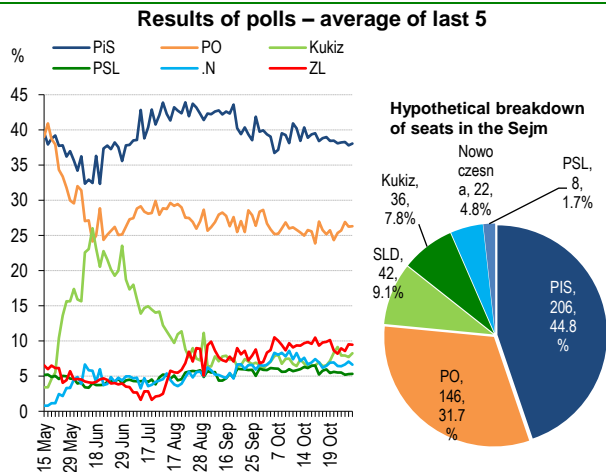
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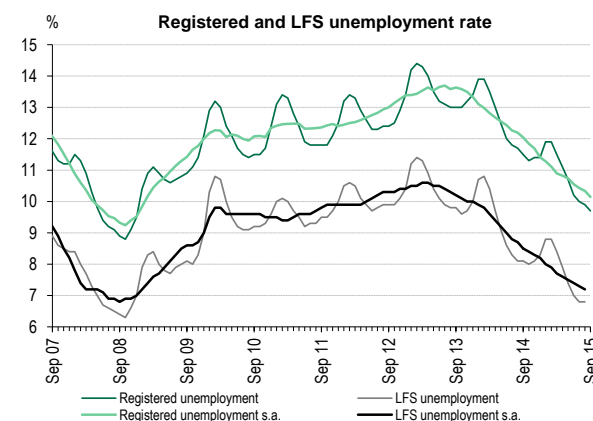
What's hot this week – Flash CPI and election results



Poland's election results will be the main domestic event of the week. Our analysis of the election's possible outcome (based on recent opinion polls) suggests that the likely winner, the opposition Law and Justice (PiS) party, might be slightly short of an outright majority (231 mandates). This will, of course, depend on the number of parties that will make it into the parliament. As many as five are close to the needed 5% or 8% threshold, according to the polls. Kukiz'15 is one of the small parties, which would be the most likely to support a PiS government. Detailed election results will probably be released on Monday evening.

We expect inflation to go up to -0.6%YoY in October, mainly due to rising food prices, which should post a positive growth rate in annual terms for the first time in more than a year. The following months are likely to show an even stronger upward correction in CPI: in our view, Poland's CPI will near 0% in November. Please note that food prices fell in 4Q14.

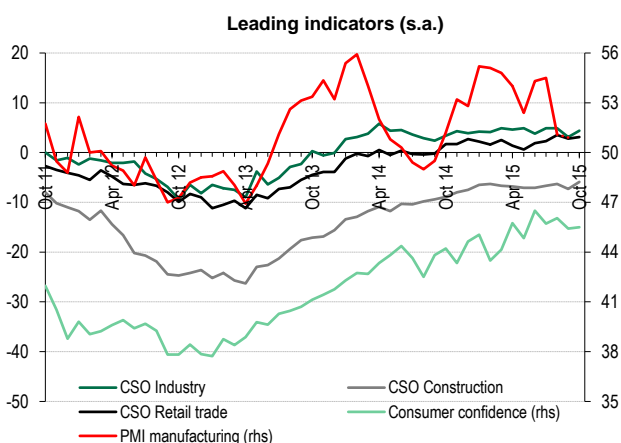
Last week in the economy – Unemployment rate down, sentiment up



Poland's registered unemployment rate fell in September to 9.7%, coming in lower than we had expected (9.8%) and below the Labour Ministry's forecast (9.9%). Our estimate of the seasonally-adjusted unemployment rate reached 10.1%, the lowest level since January 2009. The downward surprise in the unemployment rate was primarily due to the fact that the statistics office revised the number of the employment upwards, which lowered the entire unemployment rate path since December 2014. The statistics office does not reveal its employment estimates, but, according to our calculations, it went up by c150k, i.e. as much as 1%. These data are positive and show further improvement on the labour market. We expect the unemployment rate to fall further in the months to come.

Consumer confidence did not change much in October, with the index climbing by 0.5 percentage points in monthly terms. This number was positively affected by households' assessment of their financial situation, of the country's future economic conditions and possibility of major purchases. The leading indicator rose 0.3pp thanks to a better assessment of the country's future economic situation.

The statistics office's business climate indices improved in October in every single major sector, i.e. manufacturing, construction and trade. We look at this as major relief because there gauges had all slumped in September, raising worries about economic revival's durability and deceleration of economic growth at the end of 2015. Consumer confidence and economic sentiment data offer hope that consumer demand will remain strong, helping the economy stay on the 3%+ growth path.



Quote of the week – MPC candidates must be dovish

Henryk Kowalczyk, PiS MP, 21.10.2015, PAP

Yes, this [the MPC candidates' eagerness to cut rates] will be surely taken into account.

Open letter by current and former MPC members (Jan Czekaj, Dariusz Filar, Marian Noga, Andrzej Rzońca, Jan Winiecki, Andrzej Wojtyna, Anna Zielińska-Głębocka), 22.10.2015

Kowalczyk's declaration (...) is a symptom of acute irresponsibility and lack of competence. The constitution states that outstanding knowledge of finance is the only criterion in choosing the MPC member. Moreover, the NBP Act obliges the MPC members to vow to be neutral and to act in line with the NBP targets, with one major aim: ensuring price stability. Wishing that the new MPC members be ready to ease monetary policy is actually a wish of perjury.

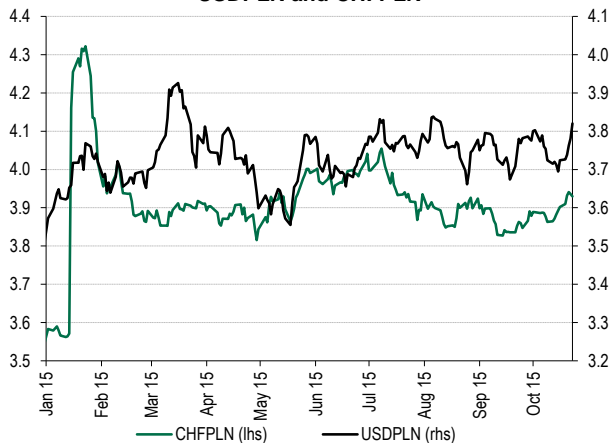
Kowalczyk's comments reveal that the main opposition party (which is tipped to win Sunday's election) plans to choose MPC members based on their willingness to cut rates and support the government's economic policy. First, this is a short-sighted approach based on the observation that inflation is low and the growth rate moderate. Second, as the MPC members noted in their letter, this would go against the Constitution that says that knowledge of finance is the main criterion. It should be up to the MPC members to decide whether they should support the government's economic policy or not. What is interesting is that we have the feeling that the two current MPC members that were appointed by PiS (Adam Glapiński and Andrzej Kaźmierczak) have suddenly become more dovish despite having voted against cuts 17 times in a row...

Foreign exchange market – Focus on Poland's elections and Fed

EURPLN



USDPLN and CHFPLN



EURUSD



USDRUB



Zloty weaker ahead of elections

▪ We were already suggesting a week and two weeks ago that volatility in the Polish FX market may rise which could have a temporary negative impact on the zloty. The last few days seemed to have confirmed our call. EUR/PLN jumped to c4.295, its highest since late January, on the back of higher odds for more monetary policy easing in Poland after the elections. The zloty soon recovered to 4.25 per euro thanks to the dovish signals from the ECB. Last week's high-low spread for EUR/PLN was the biggest since late August.

▪ The recent move in EUR/PLN indicates that the market has started to price in more aggressively a change of the government in Poland. We think some recovery is possible in the last week of October, after the general election takes place (in line with the rule: buy the rumours, sell the facts), but the scale of a decline is likely to depend on the outcome of the elections. We expect only a modest recovery if the PiS wins a majority in parliament. The scenario of the ruling Civic Platform and its coalition partner(s) winning enough votes to stay in power would be probably perceived as the most positive for the zloty.

▪ The scenario for more noticeable swings in the Polish FX market has materialized, but we think that this may not be the end of higher volatility as the FOMC is to decide on rates and the U.S. 3Q advance GDP is due this week. The market clearly gives less than 10% odds for a hike this month and we think the Committee will not surprise. Thus, it is the statement that is likely to be crucial and that could spur more volatility in the market.

Attention shifts from ECB to Fed

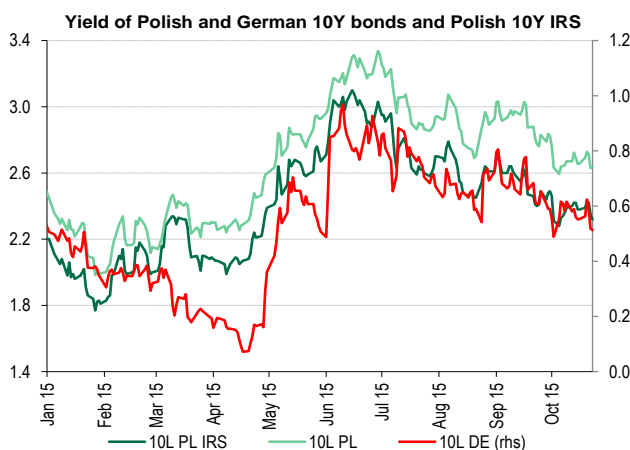
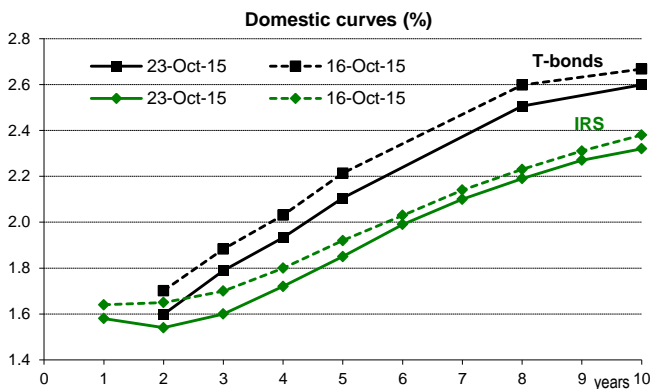
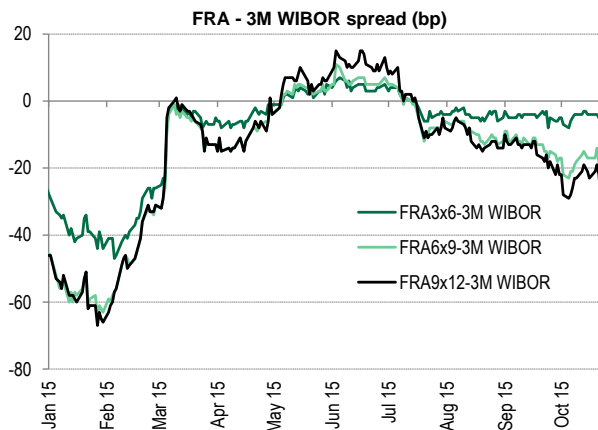
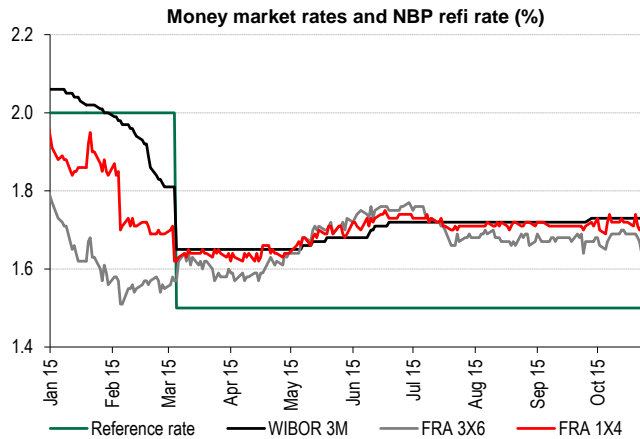
▪ The main driver for EUR/USD last week was the rhetoric of the ECB that fuelled expectations that more easing was likely in December. The euro suffered as the exchange rate fell sharply to c1.102 below the September's low and to its lowest since mid-August.

▪ Looking at recent developments from the perspective of technical analysis, breaking of the September's low should open the door for more falls in EUR/USD. However, it seems that strong currency is a hot potato that the ECB and Fed are trying not to hold on to for too long and so we think that the FOMC will try not to provide additional fuel for the dollar this week. It seems that only strong U.S. data could push EUR/USD noticeably below 1.10.

Ruble strong enough for the central bank?

▪ Since late August, when EM currencies started to recover after the Chinese stock market rout, the ruble has clearly outperformed vs. its peers with an almost 12% gain vs. the dollar, according to Bloomberg. The Chilean peso, the next strongest performer, gained less than 10%. The ruble's gains fuel speculation about when the Russian central bank could restart its foreign currency purchase programme, aimed at replenishing FX reserves. The central bank governor, Elvira Nabiullina, said that when the volatility lessens, purchases may be resumed, but there is no hurry to increase the current cUSD370bn reserves. She added that there has been no decision taken so far to restart FX purchases. However, the market is speculating that the decision could take place at the central bank meeting on October 30 and this could slow the ruble's appreciation or even trigger some profit taking.

Interest rate market – Front end well supported by rate cut expectations



Dovish ECB prompts global debt market rally

▪ The ECB meeting was the key event last week. Draghi's dovish comments, suggesting that the ECB's monetary policy stimulus would be re-examined in December, prompted a rally on the debt markets globally, including Poland. From the domestic side, PiS's declaration that the party would select candidates for the MPC based on their propensity to cut rates also supported the downward trend in yields/rates, in particular on the front-end of the curves. However, the end of the week brought some profit-taking, but it proved to be only short-lived despite the approaching general election in Poland.

▪ On a weekly basis, both curves moved down by 4-11 bp, with the biggest fall in the yields/IRS rates on the short-end. As a result, the curves slightly steepened, with the 2-10Y spread widening slightly above 100 bp for T-bonds, for the first time since the end of September. However, core and periphery assets benefitted from the dovish ECB the most, so the spread over Bunds tightened more significantly than was the case of the Polish 10Y sector (which remained slightly above 210 bp).

▪ FRA rates also fell markedly on PiS's suggestion that NBP rates could be lower after the elections. The market is currently pricing-in a 25 bp cut in 6 months and it sees nearly 70% odds for a 50 bp cut in total in 9 months' time.

Election results, FOMC and auction in the spotlight

▪ This week's calendar is full of important events, including Poland's election, the FOMC meeting, a domestic auction and macro data releases. The outcome of the elections will be, however, the most crucial. Recent polls clearly point to imminent changes on the political scene in Poland with PiS seemingly heading for a victory in Sunday's parliamentary election. The currently ruling party, the Civic Platform (PO), is likely to become the biggest opposition party. A victory by PiS could trigger a rally on the short-end of the curves amid rising odds for monetary policy easing in 2016.

▪ Strengthening on the belly- and long-end of the curves will likely be limited as global factors might overshadow the domestic events. In our view, the FOMC meeting will not bring any changes in monetary policy, as is broadly expected. The Fed's statement will, therefore, be crucial since it could offer clues on the direction of the U.S. monetary policy in the coming months. We think that the start of monetary normalisation by the FOMC before the end of the year is still likely, however, the Fed's rhetoric in October should remain dovish. Given the prospects of further easing by the ECB and the risk that the Fed could further delay its lift-off, the core markets should remain relatively strong. This should also be a supportive factor for Poland's bonds. Despite this, we do not exclude the possibility of elevated volatility on the market due to uncertainty about Poland's new government formation.

▪ This week's market liquidity will probably rise significantly due to the redemption of DS1015 bonds and interest payments worth cPLN27.3bn in total. These funds will flow onto the market on Monday, but they could be partly allocated through T-bonds that will be offered at Thursday's auction. Poland's Ministry of Finance plans to offer T-bonds on Thursday (29 October), but the offer will depend on market conditions – the Ministry will say whether the auction will be held or not two days before the potential auction. It is 4Q15 issuance plan, the ministry said it would offer bonds worth PLN5-10bn on October 29 or November 5.

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