Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

9 – 15 November 2015

Poland's Monetary Policy Council meeting was among the few events that did not surprise last week. The council kept rates on hold, despite the central bank's slightly lower CPI and GDP projections. October's PMI index surprised to the upside, rising to 52.2 points amid a rebound in new orders and production, while the flash CPI was below forecast, stabilising at -0.8%YoY. Abroad, Friday's much-better-than-expected nonfarm payrolls data were the main surprise. They sharply strengthened market expectations for an FOMC interest rate hike in December, especially that the Fed's chair, Janet Yellen, suggested a few days earlier that a hike was still on the cards.

Speculation about the Fed's policy outlook will probably remain the key market driver at the start of next week, especially since the data calendar is almost empty until Friday. Market activity is likely to be subdued also due to the fact that Wednesday is a public holiday in Poland and in the U.S. On Thursday, the Polish parliament holds its first post-election sitting and the current government will step down. The country's new cabinet will likely be sworn-in then as well. Investors will be eyeing news about the government's line-up, especially ministers who will be responsible for economic affairs. However, market reaction to the announcements should be limited, in our view, as long as the appointments are not extremely controversial. Friday will be packed with domestic data releases: flash GDP, final CPI, balance of payments, money supply. We expect GDP growth to stabilise at 3.3%YoY in 3Q15, which should be market-neutral. Investors are unlikely to get overly excited about the inflation data, unless it comes in different from the flash estimate. The balance of payments data may be slightly positive for the zloty, showing strong exports and a lower current account deficit.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (9 November)					
8:00	DE	Exports	Sep	%MoM	-	-	-5.2
9:00	CZ	CPI	Oct	%YoY	0.4	-	0.4
		TUESDAY (10 November)					
9:00	HU	CPI	Oct	%YoY	0.0	-	-0.4
		WEDNESDAY (11 November)					
	PL	**The Independence Day**					
		THURSDAY (12 November)					
11:00	EZ	Industrial output	Sep	%MoM	0.1	-	-0.5
13:00	**PL**	**First session of the Sejm**					
14:30	US	Initial jobless claims	week	k		-	276
		FRIDAY (13 November)					
8:00	DE	Flash GDP	Q4	%YoY	1.8	-	1.6
9:00	CZ	Flash GDP	Q4	%YoY	4.2	-	4.6
9:00	HU	Flash GDP	Q4	%YoY	2.3	-	2.7
10:00	**PL**	**Flash GDP**	**Q4**	**%YoY**	**3.3**	**3.3**	**3.3**
11:00	EZ	Flash GDP	Q4	%YoY	1.7	-	1.5
14:00	**PL**	**CPI**	**Oct**	**%YoY**	**-0.8**	**-0.8**	**-0.8**
14:00	**PL**	**Current account**	**Sep**	**€m**	**-418**	**-519**	**-864**
14:00	**PL**	**Exports**	**Sep**	**€m**	**14950**	**15446**	**12 764**
14:00	**PL**	**Imports**	**Sep**	**€m**	**14682**	**15000**	**12 855**
14:00	**PL**	**Money supply**	**Oct**	**%r/r**	**8.2**	**8.5**	**8.4**
14:30	US	Retail sales	Sep	%MoM	0.3	-	0.1
16:00	US	Flash Michigan	Nov	pts	91.0	-	90.0

Source: BZ WBK, Reuters, Bloomberg

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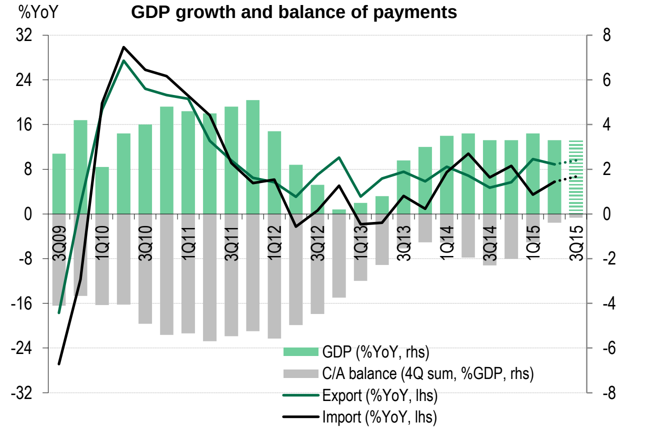
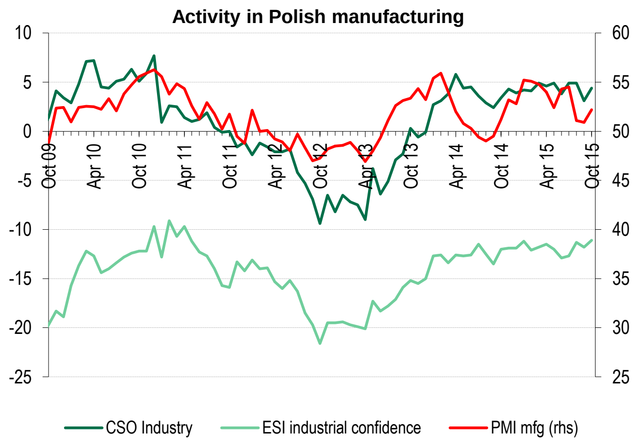
What's hot this week – Eventful Friday the 13th



- Poland's flash GDP for 3Q15 will be the key release of the week. We expect growth to stabilise at 3.3%YoY (in line with the consensus). It should be noted, however, that the forecast error is higher this time around, as the statistics office revised data for 2010-2014, but has not released the revised quarterly data yet.
- The CPI flash estimate showed deflation stabilising in October at -0.8%YoY (lower than expected) and we expect the final data to confirm this result. It will be interesting to see if it was mainly due to slower food price growth (cheap imports?) or other factors. Still, the market is unlikely to react to the release, unless the data deviates from the flash estimate.
- We expect the C/A balance to improve in September thanks to decent export growth. October's money supply data will confirm, in our view, that demand for loans form households and companies remains decent.

Last week in the economy – MPC on hold, solid activity in manufacturing



- Poland's manufacturing PMI surprised again, but this time on the positive side, by rising to 52.2 points in October (from 50.9 points in September). This was the biggest monthly improvement since June, mainly attributable to a rise in output and new orders. The latter was positively influenced by higher export orders, following the September contraction. At the same time, the October numbers showed that there was still no sign of inflation pressure: production costs fell at the fastest pace in two and a half years. Improvement in the headline PMI confirmed earlier signals from other business climate surveys (such as the European Commission's ESI or the statistics office's business climate index), which showed rising activity in manufacturing It also supports expectations that a decent pace of economic growth will be sustained in 4Q15, with GDP rising above 3%.
- The Monetary Policy Council left interest rates unchanged (the refi rate remains at 1.50%), as was widely expected. The text and tone of the statement did not change significantly from the previous month. The updated NBP projection, which showed (in line with earlier suggestions from central bank officials) slightly lower CPI and GDP projections (mainly for 2016, revisions for 2017 were only marginal), was the only new piece of information. Overall, the expected trends in inflation and economic growth did not change much. NBP governor Marek Belka stressed during the press conference that there was no justification for interest rate cuts.
- Following the clear victory of PiS in the parliamentary elections and the party's straightforward declarations that willingness to cut rates would be among the criteria used for choosing the central bank's new Monetary Policy Council members, we think that rates will be cut further, probably by 50bp in 1Q16.

Inflation and GDP projections in the subsequent *Inflation reports*

	GDP growth			
	Nov 14	Mar 15	Jul 15	Nov 15
2015	2.0÷3.7	2.7÷4.2	3.0÷4.3	2.9÷3.9
2016	1.9÷4.2	2.2÷4.4	2.3÷4.5	2.3÷4.3
2017	-	2.4÷4.6	2.5÷4.7	2.4÷4.6
	CPI inflation			
	Nov 14	Mar 15	Jul 15	Nov 15
2015	0.4÷1.7	-1.0÷0.0	-1.1÷-0.4	-0.9÷-0.8
2016	0.6÷2.3	-0.1÷1.8	0.7÷2.5	0.4÷1.8
2017	-	0.1÷2.2	0.5÷2.2	0.4÷2.5

Quote of the week – Labour market squeezing

Władysław Kosiniak-Kamysz, minister of labour and social policy, 6.11.2015, www.mpips.gov.pl

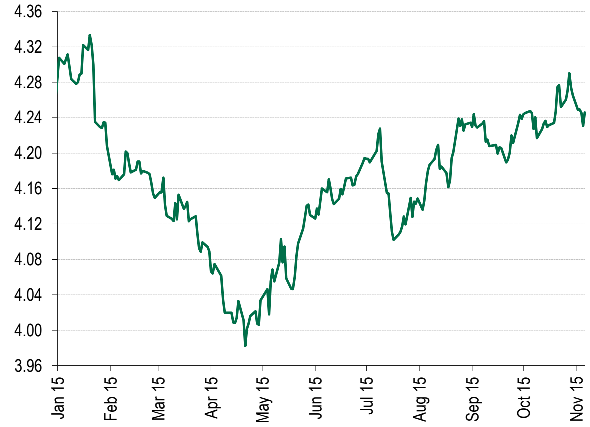
2015 has been a year of falling registered unemployment. A similar unemployment rate was recorded in December 2008, i.e. almost 7 years ago. The October's result confirmed the trend of stable labour market improvement.

It is very likely that unemployment rate at the end of the year will be in single digits.

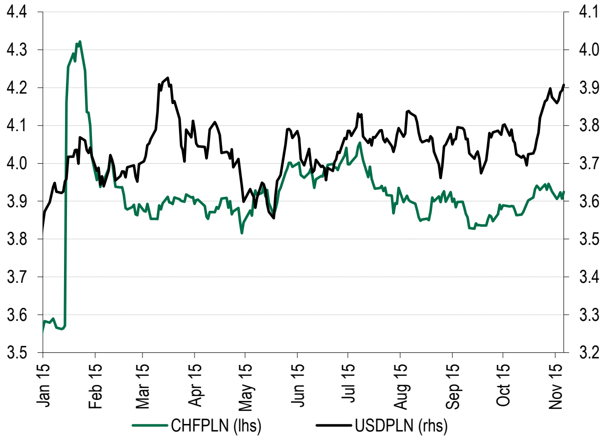
According to the Labour Ministry's estimates, the registered unemployment rate fell in October to 9.6%, in line with our forecast. We agree with Kosiniak-Kamysz that unemployment will continue to slide, but we expect this trend to be weakening ahead. Data for October shows that the number of free vacancies per 100 unemployed (12-month moving average) reached 4.4, rising to October's 2008 all-time high. Moreover, the number of people removed from the unemployment rolls due to taking up jobs is lower than one year ago. This means that despite the very high number of vacancies, the process of hiring is losing strength, indicating a demand-supply mismatch and a growing labour market squeeze, which is likely to translate into higher wage pressure, in our opinion.

Foreign exchange market – FOMC speakers and Polish issues in the spotlight

EUR/PLN

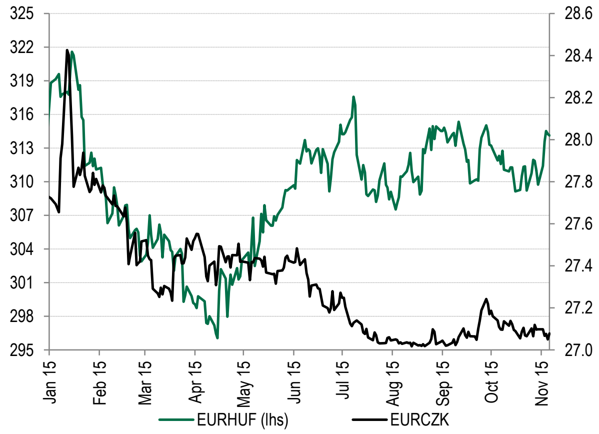


USD/PLN and CHF/PLN



EUR/USD

EUR/HUF and EUR/CZK



Zloty no longer depreciating vs. the euro

- EUR/PLN stayed below the 4.30 peak last week. It temporarily reached 4.22, but soon rebounded back close to 4.25 on strong U.S. nonfarm payrolls. The Polish currency continued to depreciate vs. the dollar – USD/PLN rose to c3.98 from 3.85 as EUR/USD plummeted.
- We think that the U.S. monetary policy outlook and Polish issues will be the main drivers for the zloty this week. Many FOMC members are due to speak in the coming days and their opinion will be particularly eyed after Friday's nonfarm payrolls. Odds for a December rate hike have risen to 70% from 50% on the US nonfarm payrolls, but this has failed to have a sustainable negative impact on the zloty so far. We have been claiming that monetary policy normalisation by the Fed could be seen as a vote of confidence in the U.S. economy, underpinning risky assets. Poland's internal issues pose, however, the main risk to a stronger zloty, in our view. Poland's flash 3Q GDP is out this week and the market may start pricing-in faster rate cuts if it proves disappointing, hitting the zloty. We do not think, however, that EUR/PLN could rise above 4.30 this week.

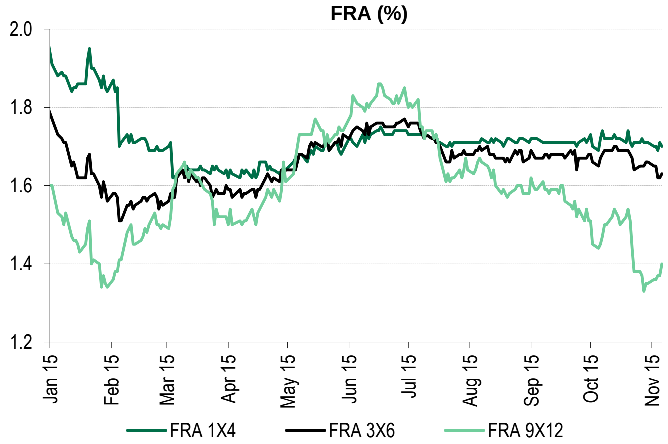
U.S. data boost dollar

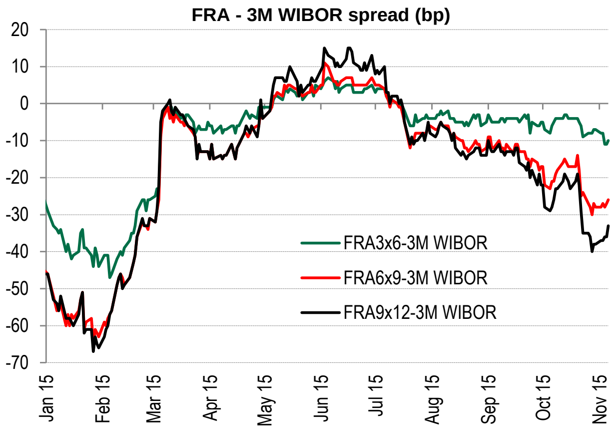
- EUR/USD reached c1.07, its lowest since late April, mainly on the exceptionally strong U.S. nonfarm payrolls data, but also on the hawkish signals from the Fed and a dovish ECB.
- This week will be rather thin as far as macro releases are concerned, but plenty of FOMC members are due to speak. Given the latest set of U.S. nonfarm payrolls, their comments will likely be followed very closely. EUR/USD's drop below 1.08 opens the door for testing of this year's low at 1.045.

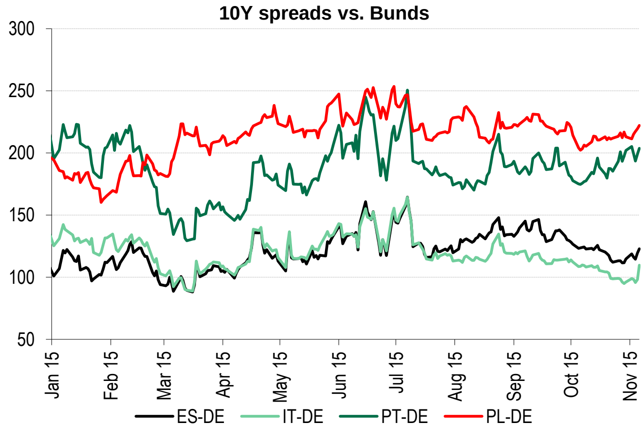
EUR/CZK floor to stay for longer, more easing in Hungary

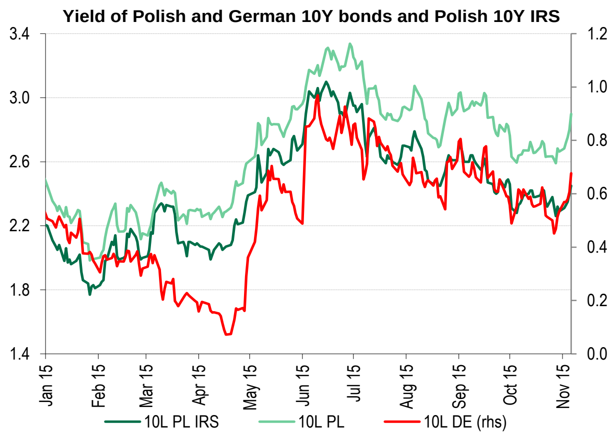
- The Czech central bank kept its monetary policy parameters intact. The bank only slightly revised its GDP and CPI forecasts and so it still expects economic growth at just below 3% in 2017 and 2018 vs. 4.7% this year. It sees inflation remaining close to 2% in the next two years. However, the bank forecasts the return of CPI to target on the basis of its assumption that EUR/CZK floor will be dropped in early 2017. The CB currently intends to keep its FX regime intact at least until mid-2016, but its head, Miroslav Singer, said that an extension to 2017 has already been discussed. The market did not react to this rhetoric. It seems investors find it more important that the central bank is not considering raising the floor and that it simply prefers to prolong the current currency floor.
- The past week was the worst for the forint vs. the euro since late September, with EUR/HUF rising to 314 from 310. The outlook for more monetary policy easing was the main drag for the currency. First, a member of the MNB's financial stability department said that the central bank could continue its monetary easing in the coming years, which could have a negative impact on the forint. Later, the central bank announced that it would extend its monetary stimulus programme until 2016 (Lending for Growth scheme, which PiS plans to copy in Poland). Its value is supposed to reach HUF600bn. Banks participating in the programme will be obliged to boost their loan stock to small and medium businesses.

Interest rate market – Fed policy to set debt market direction









Curves getting steeper

- Money market rates did not change much over the past week. WIBOR rates were stable, while FRAs inched slightly higher (except for the 3x6 rate, which was 4 bp lower on a weekly basis) due to rising IRS rates. Nevertheless, expectations for further monetary easing in early 2016 persist. The market is now fully pricing-in a 25 bp cut in 6 months' time and it sees over 70% odds of a 50 bp reduction on a nine-month horizon.
- Last week brought quite a visible rise in the T-bond yields and IRS rates, as well as on the core markets. On a weekly basis, both curves moved 5-24 bp up across the board. Poland's assets saw some further selling pressure (especially on the long end of the curves) as investors took hawkish comments by Fed Chair Janet Yellen as a sign that a December rate hike was very likely. On the other hand, the market did not react to domestic events (flash CPI release, MPC's comments on rates). Much stronger than expected the US non-farm payrolls pushed yields up globally (with yield of 10Y Bund rising near 0.70%). As a consequence yield of Poland's 10Y benchmark increased above 2.90% (the highest level since mid-September).
- The long end of the curves underperformed the front end and, as a consequence, both steepened markedly, with the 2-10Y spread widening temporarily above 120 bp for the T-bonds and over 80 bp for the IRS. What is more, the spread over Bunds slightly widened, climbing above 220 bp (the highest level since mid-September) In case of the peripheral debt and for the 10Y sector, it climbed above 220 bp
- Poland's Ministry of Finance confirmed that the 2015 gross borrowing requirements had been fully met at the end of October. The Ministry has now already started pre-financing of next year's borrowing needs (mainly through switch tenders). We still believe that Poland may be able to cover 20%-30% of its 2016 gross borrowing needs (PLN180bn) by the end of 2015.

Fed members' comments and macro data in spotlight

- Investors mood will remain under influence of strong the US labour market data at the beginning of the week due to lack important events. However, we remain still bullish on the front end of the curves as pricing-in of monetary easing in 2016 could turn more dovish in the upcoming weeks. The spread to WIBOR for the 2Y sector still suggests there is room for yields to go lower, especially since leaving deflation behind will be a slower process than we had previously expected. Nevertheless, we stick to our view that CPI inflation will return to positive territory at the end of the year. We also believe that the 5Y sector could benefit from the strengthening expectations of rate cuts.
- The long end of the curves remains more vulnerable to signs from the world's key central banks, which means that investors are likely to pay attention to Fed members' speeches that are due this week. In our view, a rate hike in December is still on the table and any news or macro data strengthening this scenario would push the domestic yields of the long-matured instruments up.
- On the domestic front, Poland's macro data releases (CPI, flash 3Q GDP, current account balance) will, in our view, be rather neutral for the market as our forecasts are close to market consensus. However, investors will closely watch Poland's political scene, especially the new government appointments. The announcement of the new finance minister may potentially trigger some volatility if it raises investors' doubts about his expertise. The growing risk of significant fiscal policy easing could have a negative impact on the valuation of Poland's assets, keeping the yields/IRS rates in the 10Y sector at elevated levels.

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