Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

23 – 29 November 2015

In her inaugural speech, Poland's new Prime Minister, Beata Szydło, listed the Law and Justice (PiS) government's top priorities and tasks for the first 100 days of the party's rule: (1) PLN500 monthly allowance per child, (2) lower retirement age, (3) higher tax- free income (PLN8000), (4) minimum hourly wage of PLN12. She also declared the government would act to boost investment growth by offering companies incentives and by introducing an LTRO-style lending programme by the central bank. Szydło added that she planned to cut CIT for smaller companies to 15%. Apart from the child allowance scheme (which is supposed to be launched in 1H16), implementation dates of the other proposals have not been specified and we suspect they will be delayed since the 2016 budget will already be stretched to the maximum. The PM said that higher budget spending would be financed by new, sector-specific taxes (most likely imposed on banks and supermarkets), higher dividend inflows, better value-added tax (VAT) collection and a slight rise of the budget deficit (PLN1-1.5bn). We think that it may be difficult to keep the general government deficit below 3% of GDP next year.

As the dust after the elections settles, we think that investors will tend focus on external factors in the near term. There are numerous data releases due abroad, which may affect expectations about the Fed's and ECB's policy outlook. On the domestic front, there is only one data release on the agenda – the registered unemployment rate, which is likely to be good news (we expect it to fall to 9.6%, its lowest since mid-2008), though probably neutral for the market. We think there is room for the zloty to appreciate in the short run thanks to positive global sentiment. We also see some scope for debt market strengthening, especially on dovish ECB rhetoric. However, room for a fall in yields is rather limited (especially on the belly and long end of the curve) due to the looming Fed rate hike and risk of a more expansive fiscal policy at home.

Economic calendar

CZAS W-WA	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (23 November)					
9:30	DE	Flash PMI-manufacturing	Nov	pts	51.8	-	52.1
10:00	EZ	Flash PMI-manufacturing	Nov	pts	52.2	-	52.3
16:00	US	Home sales	Oct	%MoM	-2.7	-	4.7
		TUESDAY (24 November)					
8:00	DE	GDP	Q3	%YoY	1.7	-	1.6
10:00	DE	Ifo index	Nov	pts	108.0	-	108.2
14:30	US	Preliminary GDP	Q3	%QoQ	2.0	-	3.9
16:00	US	Consumer confidence index	Nov	pts	99.2	-	97.6
		WEDNESDAY (25 November)					
10:00	**PL**	**Unemployment rate**	**Oct**	**%**	**9.6**	**9.6**	**9.7**
14:30	US	Personal income	Oct	%MoM	0.4	-	0.1
14:30	US	Consumer spending	Oct	%MoM	0.3	-	0.1
14:30	US	Durable goods orders	Oct	%MoM	1.5	-	-1.2
14:30	US	Initial jobless claims	week	k	-	-	271
16:00	US	New home sales	Oct	%MoM	6.8	-	-11.5
16:00	US	Michigan index	Nov	pts	93.0	-	93.1
		THURSDAY (26 November)					
	US	Market holiday					
		FRIDAY (27 November)					
9:00	CZ	Preliminary GDP	Q3	%YoY	-	-	4.6

Source: BZ WBK, Reuters, Bloomberg

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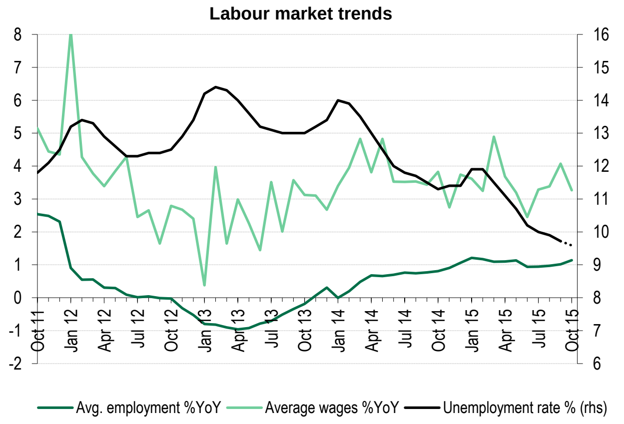
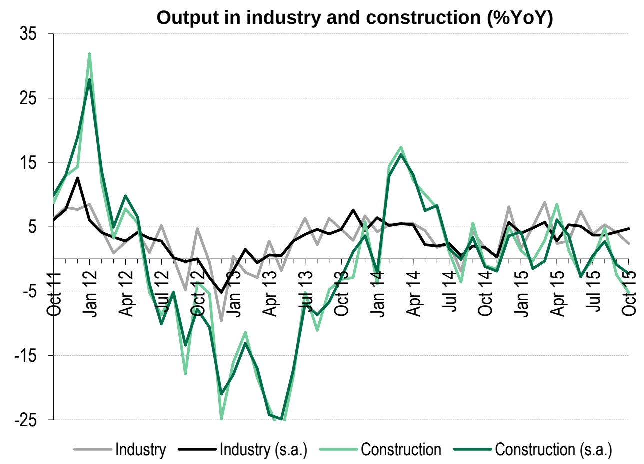
What's hot this week – Unemployment rate in free fall

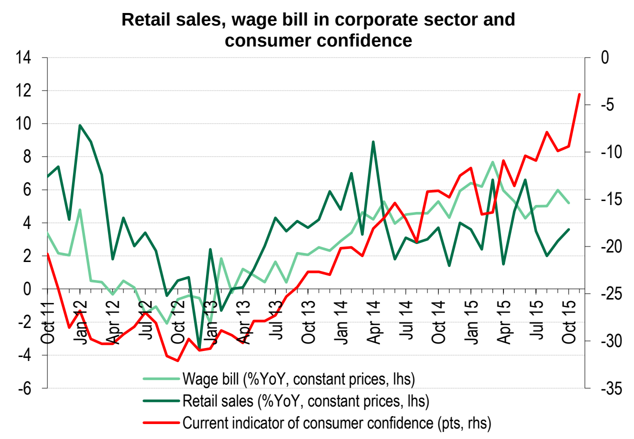


▪ According to the Labour Ministry's estimate, the registered unemployment rate fell to 9.6% in October, the lowest level since mid-2008, and we think that the statistics office will confirm this number.

▪ This is a very good level, taking into account the seasonal cycle. The ministry's data for October suggests that the number of free vacancies per 100 unemployed was at an all-time high. At the same time, the number of people who found a job and so were removed from the unemployment rolls is lower than a 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 we expect to translate into higher wage pressure.

Last week in the economy – Positive numbers from the labour market, industry and retail sales





▪ The pace of employment growth in the corporate sector accelerated in October to 1.1% YoY from 1.0% YoY, while wage growth decelerated to 3.3% YoY from 4.1% YoY. On a monthly basis, the number of jobs rose by 14k in October, the most since 2007. In our view, wages decelerated mainly due to a negative working-days' effect that influenced those who are employed on the basis of piecework. Demand for labour remains strong and job creation has been strengthening over the last few months.

▪ Consumer confidence index went strongly up in November to the highest level since mid-2008, both as regards the current and the leading indicator. According to our estimates based on the statistics office data, seasonally adjusted business climate indices for manufacturing, construction and trade also improved in November.

▪ Industrial output rose 2.4% YoY in October, versus 4.1% YoY rate one month earlier, mainly due to less working days. In seasonally adjusted terms, output rose 4.7% YoY, above YtD average at 4.4% YoY. What is more, retail sales data surprised to the upside by coming in at 3.6% YoY in real terms, while the construction and assembly output numbers disappointed once again, contracting 5.2% YoY, much more than expected.

▪ We believe that data point to a decent pace of economic growth in Poland at the start of 4Q15. Healthy growth of disposable income and retail sales – together with positive consumer confidence – support our forecasts for sound private consumption in the remainder of 2015 and in 2016. Positive performance of the industry is also an optimistic signal for export growth, employment and investment in Q4.

▪ PPI inflation rose to -2.3% YoY in October, while core inflation excluding food and energy prices reached 0.3%YoY.

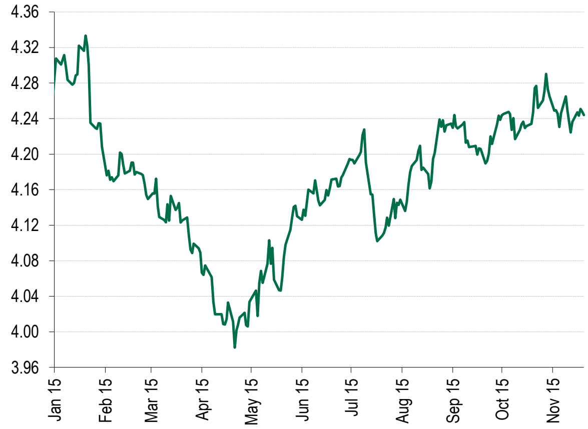
Quote of the week – Government priorities for the first hundred days

Beata Szydło, Prime Minister, 18.11.2015, www.premier.gov.pl
I want to focus on issues we shall tackle during the first one hundred days of our government. Firstly, granting the PLN 500 per child benefit (starting from the second child), and in families with lower incomes - from the first child. A child is not a cost, it is an investment. Secondly, lowering the retirement age to sixty years for women and sixty-five years for men. Thirdly, increasing the tax-free allowance to PLN 8,000. Fourthly, providing free medicines for the elderly over 75. Fifthly, increasing the minimum hourly wage in Poland to PLN 12.

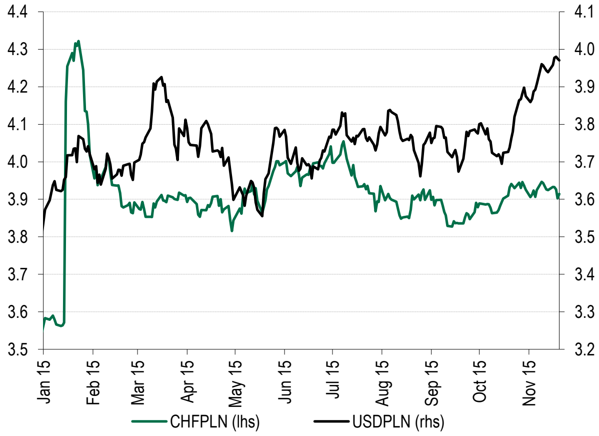
PM Beata Szydło's inaugural speech did not include any new economic proposals. But we do know now which policy proposals the government plans to enact in the first 100 days of its rule. These include the most costly projects, such as child benefits (PLN15-20bn), higher tax-free allowance (c15bn) and lower retirement age (PLN5-10bn). However, despite the planned fast government approval, some of these laws will only come into force beyond 2016 (with the child benefits the top priority, to be implemented probably in 1Q16), if the government does not want to raise the budget deficit by more than PLN1.0-1.5bn, something it had already announced earlier. We think it could be difficult to keep the general government deficit below 3% of the GDP, given that it may be hard to achieve growth in budget revenues as high as planned by the new government.

Foreign exchange market – Zloty could gain ahead

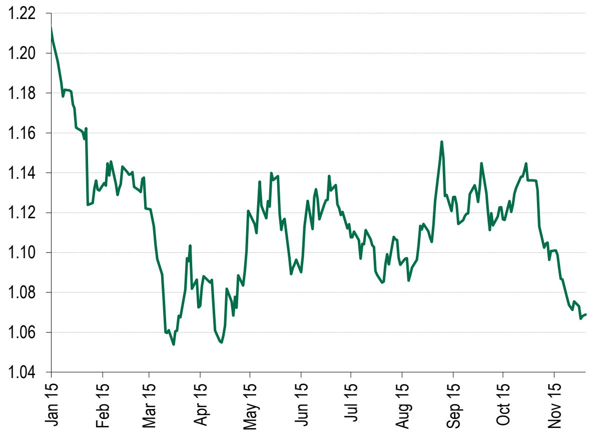
EUR/PLN



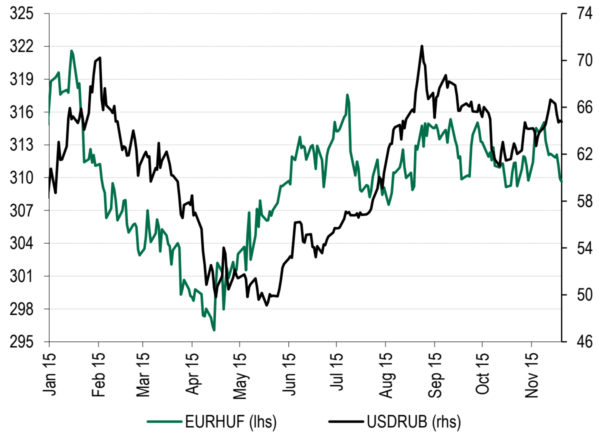
USD/PLN and CHF/PLN



EUR/USD



EUR/HUF and USD/RUB



PLN stable vs. EUR, weaker vs. USD and GBP

- After the somewhat higher volatility seen in mid-November, EUR/PLN stabilised at around 4.245 of late, comfortably within the previous week's trading range. The zloty temporarily weakened above 4.26 per euro after PM Beata Szydło said that the central bank's mandate could be expanded to include an LTRO-type programme. But this was only temporary and the zloty soon recovered thanks to the improving global market sentiment.
- At the same time, USD/PLN trended slightly up and neared 4.0, its highest since May 2004. An even more significant move was seen on GBP/PLN, which rose above 6.06, its highest since July 2005, breaking its multi-year resistance at c6.0.
- The zloty's appreciation against the euro came to a stop in the previous week, exactly on the 100-day moving average, with EUR/PLN rebounding from c.4.205 afterwards. On the other hand, it is worth noting that the upside wave that started in the previous week is similar in size to the one seen at the beginning of the month. This offers hope that the zloty could gain slightly vs. the euro in the coming days. Now that PM Szydło already gave her inaugural speech, Polish politics should be in the shadow of the global macro data. Just like we have been saying, the zloty no longer suffers when U.S. numbers raise odds for a Fed rate hike. At the same time, should the data be soft, pointing to a longer period of low rates in the U.S., risky assets worldwide could draw support. The support level for EUR/PLN is now at c4.21, the resistance at 4.265 (at 4.28 next).

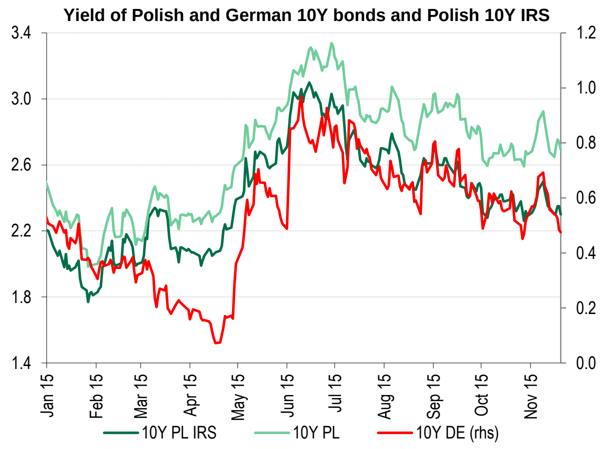
EUR/USD still driven by monetary policy

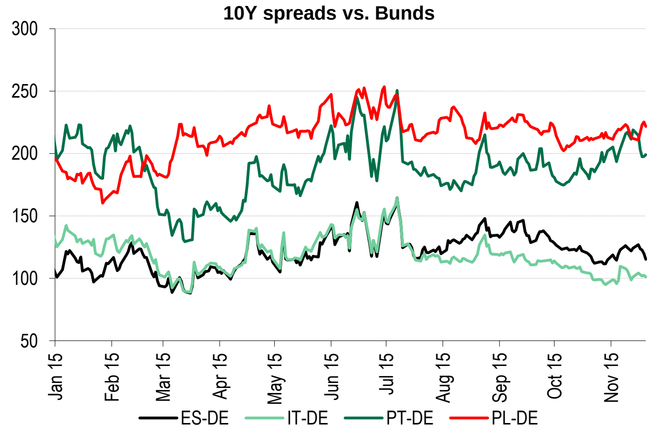
- The dollar gained slightly vs. the euro last week and EUR/USD temporarily fell to nearly 1.06. The single currency was still under pressure from the euro zone's monetary policy easing outlook.
- According to market pricing, the odds for a December rate hike by the Fed are at c70% and we believe this to be quite high. Plenty of U.S. data are on the agenda this coming week and we think that monetary policy issues will remain the core drivers of EUR/USD. We think, however, that the U.S. data would need to be very strong to be able to push EUR/USD significantly lower since the market has basically already priced in the December hike.

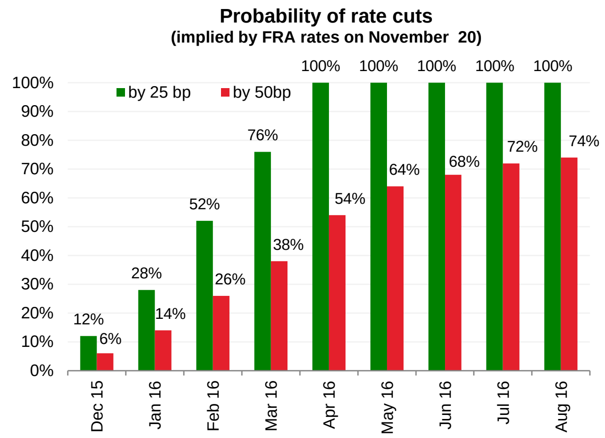
Stronger forint and ruble

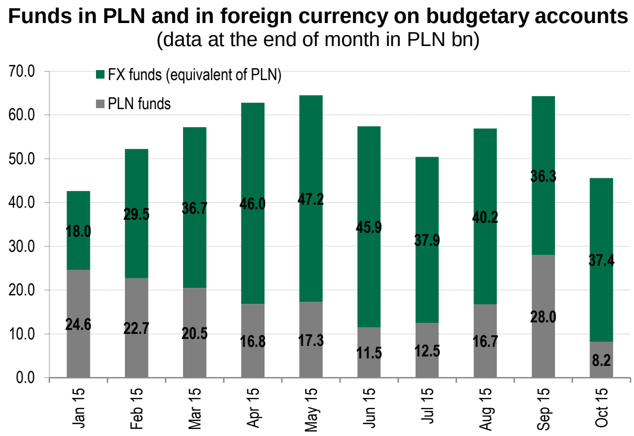
- The forint gained vs. the euro for the second week in a row with EUR/HUF falling below 309 from 312, its lowest since late October. The Hungarian currency was supported by the central bank's decision to leave rates unchanged and absence of hints that more monetary policy easing could be needed. Also, at the end of the week, the forint gained on rumours that ratings agency Fitch could raise Hungary's rating.
- The ruble's four consecutive weeks of depreciation vs. the dollar came to an end, with USD/RUB falling to 64.3 from 67.0. The exchange rate stayed, however, within the previous week's trading range.

Interest rate market – Monetary policy remains key









Mixed sentiment on domestic FI market

- The domestic interest rate market was mixed last week. Bonds and IRS, tracking core markets, firmed at the start of the week to quickly return to an upward move due to released details about Thursday's auction and the Polish PM's inaugural speech, among others. At the very end of the week, Polish debt has strengthened again.
- On a weekly basis, the yield curve shifted up, with the belly and the long end of the curve losing the most. As a result, the 2-10Y spread widened over the past week. At the same time, weekly changes in the IRS rates were rather muted. Consequently, the asset swap spread for all the sectors widened markedly on a weekly basis, with the 10Y sector spread now below 40 bp. Moreover, the widening spread over Bunds (which reached temporarily 225 bp for 10Y, the highest level since the end of September) implies a rising risk premium for Poland's bonds.
- Poland's Ministry of Finance successfully tapped fixed-rate PS0421 and DS1026 bonds and WZ0120 floaters worth a total of PLN8.3bn at switch auction. Despite the mixed market environment, the auction's prices were close to those on the secondary market. It is worth noting that through switch auctions, the ministry has lowered, by nearly PLN11bn, its redemptions of the PLN-denominated debt in 2016.

External events and buy-back auction in the spotlight

- The central bank's monetary policy remains the main driver for the debt market. FRAs are currently pricing-in over 60% chance of rate cuts of 50 bp in 6 months' time, which is close to our expectations that the new MPC will likely cut rates by 50 bp in 1Q16. We, therefore, see some room for a gradual fall on the front end of the curves in the upcoming weeks. However, the outlook for this week's possible market-movers is rather light with no important events and domestic macro data releases on the agenda that could possibly change the market view on rates. This is why we think that the short ends of the curves are likely to oscillate near their current levels.
- The belly and the long ends of the curves might be more vulnerable to external factors, including macro data releases in Europe and in the U.S., that could shed more light on the future monetary policies of the ECB and Fed. In our view, there is still room for some short-term strengthening on the long end of the curve (which should be supported mainly by the ECB's monetary easing in December). In the medium term, we still see higher yields of the longer maturing bonds/IRS rates as we expect further improvement of Poland's economic fundamentals (decent GDP growth, rising inflation) and rising yields on the core markets.
- Poland's Ministry of Finance plans to redeem this week up to €1bn in eurobonds maturing in February 2016. This would amount to 22% of the total FX redemptions (both bonds and credit) in 2016, which had a nominal value of €4.6bn. The operation would pose no problem since the ministry's foreign currency funds stood PLN37.4bn at the end of October.

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.