Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

14 – 20 December 2015

Economic calendar

CZAS W-WA	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (14 December)					
11:00	EZ	Industrial output	Oct	%MoM	0.2	-	-0.3
14:00	**PL**	**Current account**	**Oct**	**€m**	**-605**	**-1214**	**-959**
14:00	**PL**	**Exports**	**Oct**	**€m**	**15450**	**15365**	**15 059**
14:00	**PL**	**Imports**	**Oct**	**€m**	**15629**	**15638**	**14 972**
14:00	**PL**	**Money supply**	**Nov**	**%YoY**	**9.3**	**9.4**	**9.2**
		TUESDAY (15 December)					
11:00	DE	ZEW index	Dec	pts	54.1	-	54.4
11:00	**PL**	**MPC press conference, summing up its term of office**					
14:00	**PL**	**CPI**	**Nov**	**%YoY**	**-0.5**	**-0.5**	**-0.7**
14:00	HU	Central bank decision		%	1.35	-	1.35
14:30	US	CPI	Nov	%MoM	0.2	-	0.2
		WEDNESDAY (16 December)					
9:30	DE	Flash PMI – manufacturing	Dec	pts	52.5	-	52.9
10:00	EZ	Flash PMI – manufacturing	Dec	pts	52.5	-	52.8
11:00	EZ	HICP	Nov	%YoY	0.1	-	0.1
13:00	CZ	Central bank decision		%	0.05	-	0.05
14:00	**PL**	**Wages in corporate sector**	**Nov**	**%YoY**	**3.9**	**3.8**	**3.3**
14:00	**PL**	**Employment in corporate sector**	**Nov**	**%YoY**	**1.1**	**1.2**	**1.1**
14:00	**PL**	**Core inflation**	**Nov**	**%YoY**	**0.3**	**0.3**	**0.3**
14:30	US	House starts	Nov	k	1140	-	1060
14:30	US	Building permits	Nov	k	1153	-	1161
15:15	US	Industrial output	Nov	%MoM	-0.1	-	-0.2
20:00	US	FOMC decision		%	0.50	0.50	0.25
		THURSDAY (17 December)					
10:00	DE	Ifo index	Dec	pts	108.9	-	109.0
14:00	**PL**	**Industrial output**	**Nov**	**%YoY**	**5.7**	**6.2**	**2.4**
14:00	**PL**	**Retail sales (constant prices)**	**Nov**	**%YoY**	**4.6**	**4.5**	**3.6**
14:00	**PL**	**Construction and assembly output**	**Nov**	**%YoY**	**-3.6**	**-7.8**	**-5.2**
14:00	**PL**	**PPI**	**Nov**	**%YoY**	**-1.9**	**-2.2**	**-2.3**
14:00	**PL**	**MPC minutes**					
14:30	US	Initial jobless claims	week	k		-	282
14:30	US	Philly Fed index	Dec	pts	1.5	-	1.9
		FRIDAY (18 December)					
		No important data releases					

Source: BZ WBK, Reuters, Bloomberg

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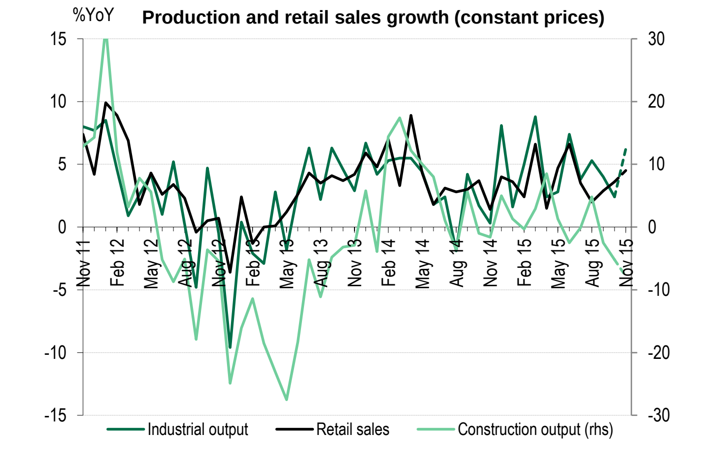
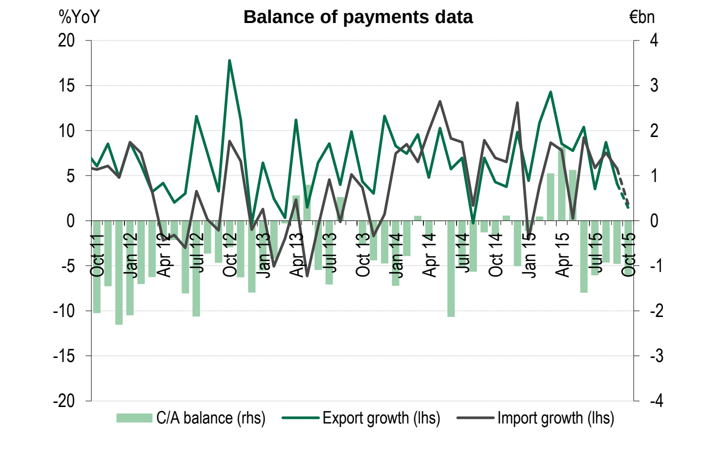
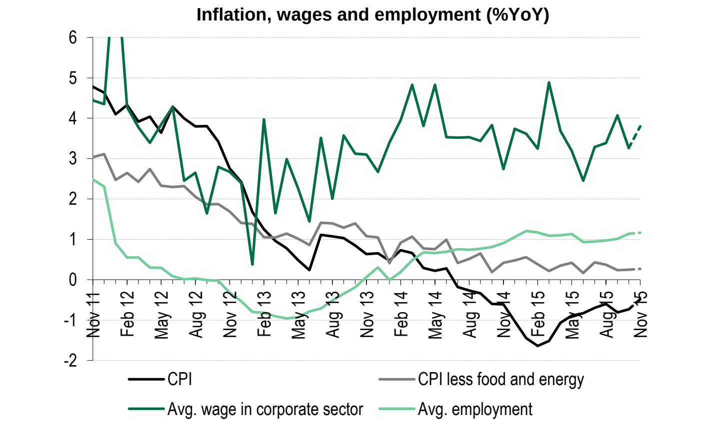
What's hot this week – A lot of important data







- This week will filled with domestic data releases. The market has been recently focused more on the Polish political scene than on macro releases due to wide expectations that the next MPC will be about politics, not data. However, several factors have recently undermined the market's faith in fast interest rate cuts: MPC's Adam Glapiński (seen as a strong candidate for the new NBP head) said that a rate cut would be negative for the financial sector and Jerzy Żyżyński (a possible MPC candidate) said that a 25bp cut would not have a significant effect, though would add to zloty depreciation. The seemingly deepening doubts about the interest rate outlook could raise the significance of the domestic data releases, in our view.
- Industrial and construction output figures, as well as retail sales in November, will be key for assessing economic developments. We believe that industrial output and retail sales will show a rebound (we are more optimistic than the market), confirming healthy levels of both domestic and foreign demand for Polish products (yet the rebound will be due to a positive working day effect). However, construction output will remain weak.
- We expect a wider current account deficit in October on the back of a weaker trade balance. Exports and imports should show a low annual growth rate due to a negative working day effect, but the underlying trend will remain robust, in our view. Data on foreign trade from the statistics office, released on Friday, point to an upside risk for our export forecasts. However, these numbers are released as year-to-date sum, so we cannot say for sure if exports in October were exceptionally strong or if data for the previous months were revised.
- Other data for November will be less important: CPI will probably fail to attract much attention as we already saw the flash reading. Still, we will see more details about the index's breakdown and this will be interesting, especially the developments in food prices, which we expect to be the main driver of CPI in 2016. Core inflation is likely to remain low.
- Labour market data will show a continuation of the current trends - moderate wage growth and strong job creation. We expect the same in case of the money supply data.
- PPI inflation was slightly higher in November, in our view. However, in monthly terms, producer prices were affected by lower commodity prices.
- The MPC's press conference, summing up its entire term's monetary policy, is not likely to be a ground-breaking event for the market. The FOMC decision will be the most important event of the week, as well as its press conference on Wednesday evening.

Quote of the week – 2016 deficit below 3%

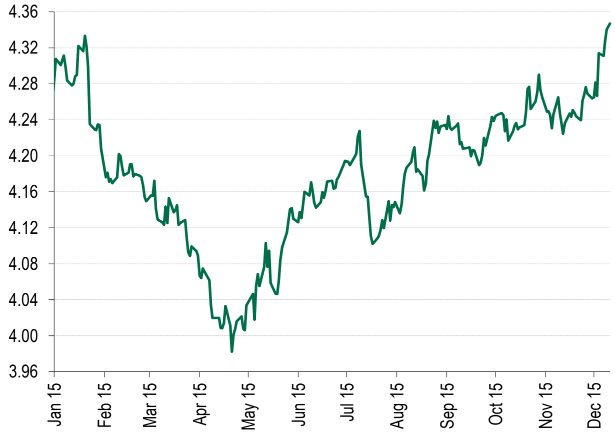
Leszek Skiba, deputy finance minister, 09.12.2015, PAP
We have a temporary widening of the general government deficit this year. The deficit will be below 3% in 2016. It is our intention for the European Commission to have no reservations.

Henryk Kowalczyk, chief of PM's standing committee, 11.12.2015, PAP
We are finishing work on the 2016 budget. Let me assure you that the deficit will not rise above 3% of GDP. We are below this limit and will keep the spending rule, yet slightly modified. The government will work on the draft budget together with an amendment on Tuesday.

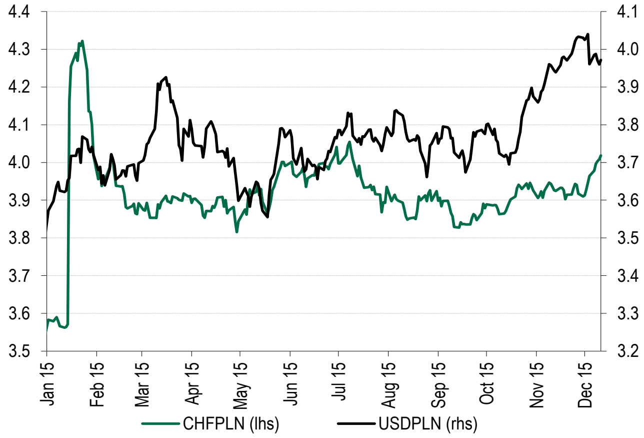
Government officials stick to their declaration that the GG deficit in 2016 will not exceed 3% of GDP, i.e. about PLN55bn, which is the same as the current central budget deficit that was set by the previous last government. In our view this is possible, provided that new expenditures will be watered-down or delayed (e.g. PLN500 per child is planned for Q2) or assuming there are extraordinary revenue sources, such as the LTE auction (PLN9bn) or a higher-than-expected NBP profit. However, one-off revenues will not finance permanent spending plans in the longer perspective, increasing the upward risk for the deficit in the medium term. Moreover, the new government is not really trustworthy as far as keeping the deficit in check is concerned, given its decisions to ease the spending rule, which gave them cPLN15bn (1% of GDP) room for extra spending in 2016 alone.

Foreign exchange market – CEE currencies weaker ahead of FOMC

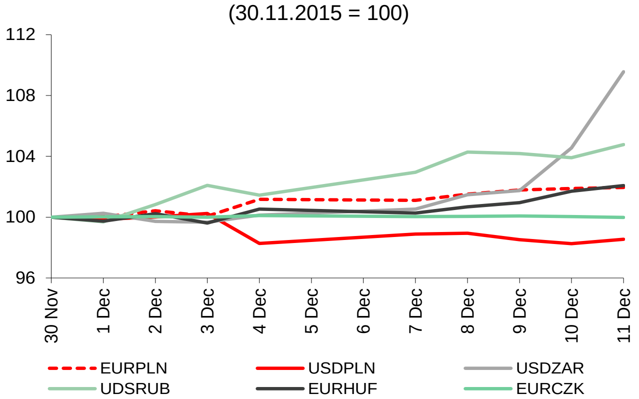
EUR/PLN



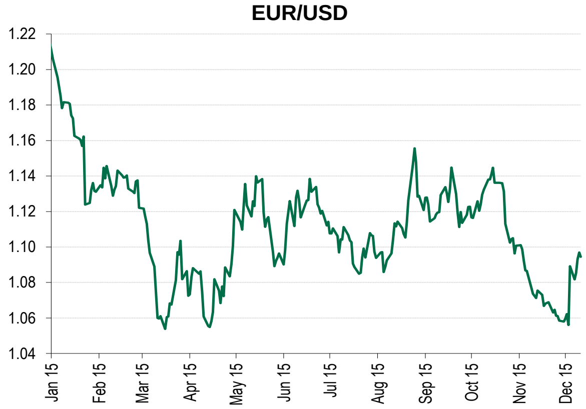
CHF/PLN and USD/PLN



Zloty and other EMEA currencies performace
(30.11.2015 = 100)



EUR/USD



Zloty under strong pressure …

- The zloty weakened markedly against the main currencies over the past week. Its depreciation was caused by both global (such as renewed worries about China, expectations on Fed lift-off) and domestic factors (such as concerns about the fiscal policy outlook, bank tax). Consequently, EURPLN rose above 4.35 at the end of the week, the highest level since the end of 2014. The zloty also lost visibly against the Swiss franc over the past week, with CHFPLN rising above 4.0, for the first time since July.
- This week is filled with domestic macro data releases, including C/A, industrial output, retail sales. In our view, these monthly data should confirm that economic activity remains decent in Poland, underpinning the zloty. However, the FOMC decision will likely have a strong influence over the zloty. We think that the Fed's rate hike may be interpreted as a vote of confidence in the U.S. and global economy, providing support for the risky assets, including the zloty. We, therefore, expect some rebound in the domestic currency after its significant weakening in the previous weeks. However, room for zloty strengthening is limited due to domestic political risk.

… along with its CEE and EM peers

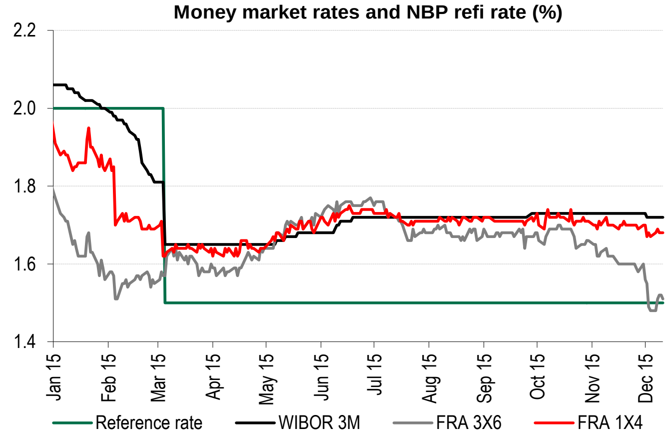
- Emerging market currencies, also in the CEE region, remain under strong pressure, which intensified after the ECB's decision in December. However, the Czech koruna and Poland's zloty outperformed other CEE currencies. The Russian ruble was one of the worst among the EM peers. Its sharp weakening against the main currencies was mainly caused by further falls in crude prices. As a result, USDRUB climbed to almost 70. At the same time, EURHUF rose to nearly 318 at the end of the week due to worries that the Hungarian central bank could announce some unconventional measures to push the yield of long-term T-bonds lower and stimulate economic growth.
- EM currencies, including CEE, will likely remain under pressure due to the approaching FOMC meeting. However, country-specific factors, such as the Hungarian central bank meeting or crude price performance, will set the direction for HUF and RUB, respectively.

EURUSD still above 1.09

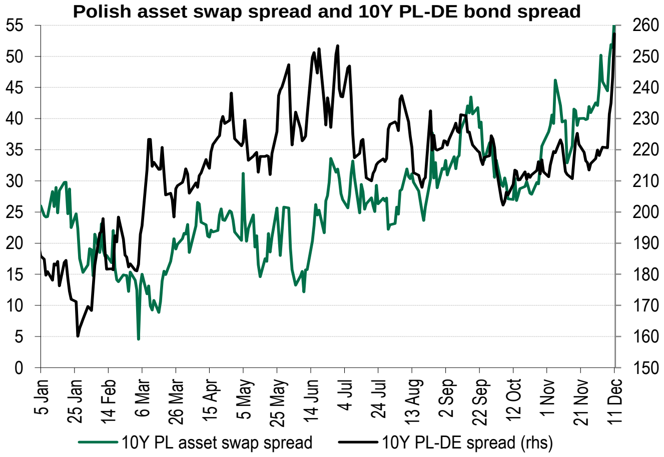
- EURUSD continues its upward move, initiated by the ECB's December decision. For the first time since early November, the rate reached 1.104 due to falls in oil prices and equities. However, this was only a short-lived move and EURUSD quickly returned below 1.10. What is more, U.S. macro data were mixed and did not help the U.S. dollar rebound visibly.
- EUR/USD is still holding onto its post-ECB gains and remains above 1.09, but additional gains still appear to be capped as much by the ECB rhetoric as by the economic or FOMC backdrop. This week's macro calendar is heavy with important releases from both Europe (ZEW and Ifo indices for Germany, flash PMI for the manufacturing sector in the euro zone countries) and the U.S. (CPI, data from the real-estate market). However, in our view, the FOMC meeting will be the key event of the week. It is broadly expected that the Fed will start its monetary policy normalisation this month (the probability of such a scenario increased to nearly 80%) for the first time in more than nine years. Awaiting the Fed's decision, EURUSD should fluctuate in its recent range of 1.08 – 1.11. The market's reaction to the decision will depend on the FOMC wording about the pace and scale of its monetary tightening cycle. In the short run, we see some room for a EURUSD decline towards 1.05.

Interest rate market – Little room for rates to fall

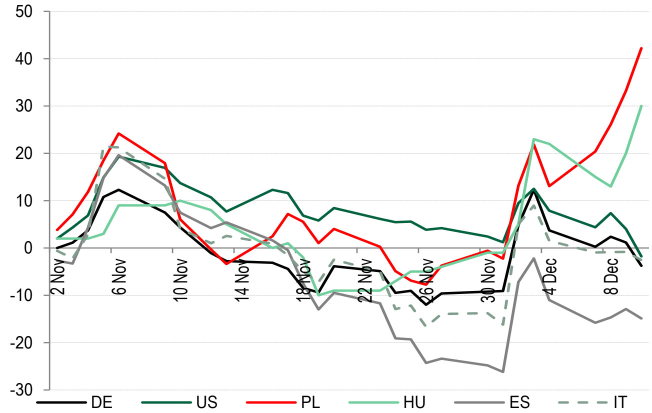
Money market rates and NBP refi rate (%)



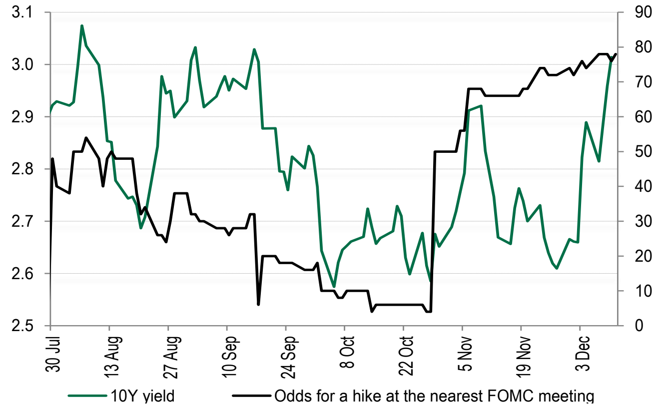
Polish asset swap spread and 10Y PL-DE bond spread



Bond yield change since November 2 (bp)



Polish 10Y yield and probability for the 25bp hike at the nearest Fed meeting



Internal and external factors pushing rates higher…

- Poland's interest rate market was clearly underperforming core debt last week. The bond curve moved 15-22bp higher as part of its post-ECB reaction, as well as on the looming debt auction and risk of more fiscal easing by the new government. The 2Y IRS rose 10bp to c1.65%, its highest since late October, the 5Y was up by 15bp to nearly 2.10%, and the 10Y was 11bp higher and above 2.50% (the highest since mid-September for the last two).
- The 10Y spread vs. Bunds jumped above 250bp, its highest since April 2014 as the Polish 10Y yields rose above 3.10%. Also, the 10Y Polish asset swap spread rose and reached c60bp, its highest since May 2012.
- The switch auction was quite successful. The Finance Ministry sold bonds for nearly PLN6.7bn. Nearly half of the cash was raised from PS0421 (PLN3.1bn). Investors also bought PLN2.6bn of OK0717 and PLN1.0bn of DS0726.

… with rather little odds for the trend to reverse

- The previous monetary policy tightening cycle in the U.S. was started by Alan Greenspan in June 2004 and the last rate hike was delivered in June 2006 when the Federal Reserved was governed by Ben Bernanke. Since then, an unprecedented scale of monetary policy easing was launched worldwide. Given the long time that has passed since the Fed's last rate hike and the current monetary environment, we find it rather useless to look for any analogies on how the market could react when the FOMC lifts rates this week.
- Odds for a hike are high (c80%), but we think that even when delivered, there will be room for some initially positive reaction on the part of the risky assets and thus some debt weakening worldwide. As we have been suggesting recently, investors could view the rate hike as a quasi "vote of confidence" in the U.S. and global economy and, as such, could prove supportive for the risky assets.
- The overall market reaction to the FOMC decision will surely also depend on the "dot chart" showing FOMC member's forecasts of interest rates and Janet Yellen's press conference. We think that the Committee will try to avoid triggering any excess volatility on the markets and so, if the core yields rise, the scale of the move would not be significant.
- Polish bonds have recently been underperforming the core debt market and their CEE peers. We expect Polish politics to continue pressuring the debt market in the coming days as the lower house of the Polish parliament is expected to discuss fiscal issues – the 2015 budget and possibly also the budget for 2016, bank tax.
- On the domestic macro data front, our industrial output forecast is above the consensus and could pressure the front of the curves together with some recently surprisingly not overly dovish comments of the MPC members and their potential replacements.
- Overall, we think that the Polish IRS/yields are rather unlikely to end the coming week below this week's closing.

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.