Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

22 – 28 August 2016

Last week started in rather weak moods due to the disappointing US macro data and companies quarterly earnings. However, later investors became more sanguine, which triggered a rebound on stock and commodity markets. FOMC minutes from the last meeting did not bring any new information about possible timing of the Fed's rate hike and US central bankers noted only that monetary policy normalisation will depend on the incoming macroeconomic data. As regards Poland, data from the labour market were again positive, but industrial output disappointed and fell by 3.4% y/y, thus amplifying expectations for rate cuts, raising worries about economic growth and hitting PLN.

There are a few important macro events this week. We will get to see the flash PMI for manufacturing in Germany and the euro zone and this will be a crucial hint about the pace of economic growth in Europe. The EU's policymakers will meet in Italy to discuss Brexit. Recently, this issue has receded into background, but still remains on cards, so the outcome of this meeting can generate some market volatility. Moreover, GDP data from Germany and the US are due for release. The US data will be assessed in light of the monetary policy normalization so they will be eyed by investors, who will most probably also pay much attention to Janet Yellen's speech in Jackson Hole. Currently, the market sees a fifty-fifty chance that rates in the US will go up this year. In general, this can be a week of high volatility. In Poland, only some less important macro data are due for release, so Polish assets will remain vulnerable to global moods.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (22 August)					
		No important data					
		TUESDAY (23 August)					
9:30	DE	Flash PMI – manufacturing	Aug	pts	53.7	-	53.8
10:00	EZ	Flash PMI – manufacturing	Aug	pts	52.0	-	54.4
14:00	HU	Central bank decision		%	0.90	-	0.90
16:00	US	New home sales	Jul	k	575	-	592
		WEDNESDAY (24 August)					
8:00	DE	GDP	Q2	% y/y	3.1	-	1.5
10:00	**PL**	**Unemployment rate**	**Jul**	**%**	**8.6**	**8.6**	**8.8**
16:00	US	Home sales	Jul	m	5.55	-	5.57
		THURSDAY (25 August)					
10:00	DE	Ifo	Aug	pts	108.5	-	108.3
14:30	US	Initial jobless claims	week	k	-	-	262
14:30	US	Durable goods orders	Jul	% m/m	3.5	-	-3.9
		FRIDAY (26 August)					
	US	Jackson Hole conference					
14:30	US	GDP	Q2	% y/y	1.2	-	0.8
16:00	US	Michigan index	Aug	pts	90.6	-	90.0

Source: BZ WBK. Reuters. Bloomberg

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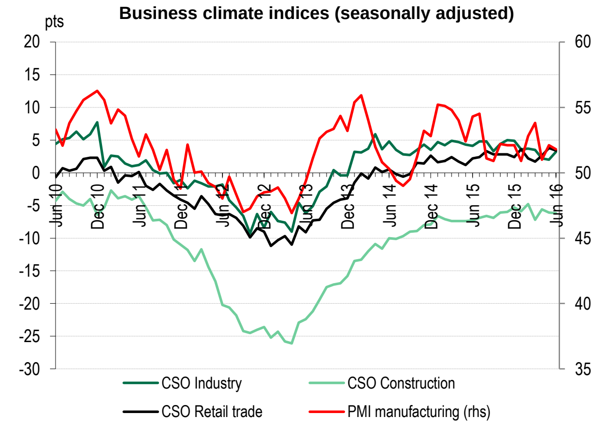
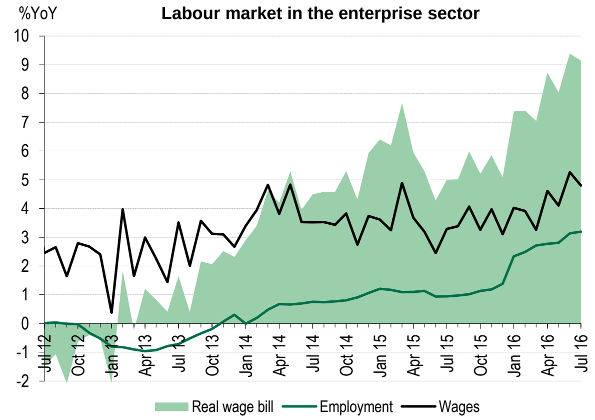
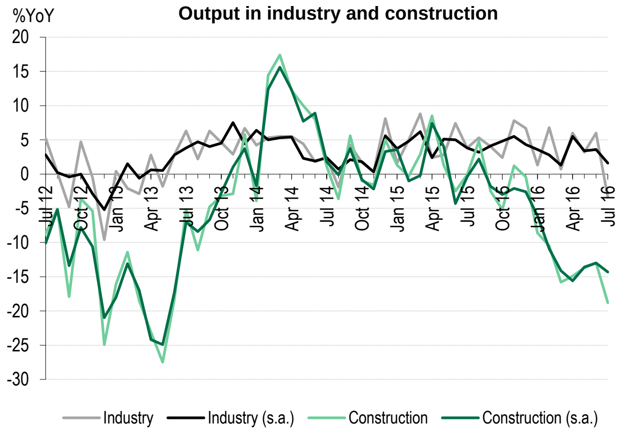
What's hot this week – Unemployment rate, business climate and financial results



- This week we will get to see the registered unemployment rate in July. Most likely, the gauge fell to 8.6%, as suggested by the data from the Labour Ministry. We expect the unemployment rate to go down further in the upcoming months.
- The Polish Statistics Office will also release data on business climate indicators in August and financial results of non-financial enterprises in 2Q. Disappointing results of the industry (details below) and a fall of the PMI index generate a downward risk for business climate indicator for the industry. Recently, this measure has been rather robust. A move downwards may suggest a further weakening in the industrial sector. Data on financial results may shed more light on companies investment and employment potential.

Last week in the economy – Disappointing activity data at start of 3Q, but labour market remains strong





- Wages in the corporate sector grew in July by 4.8% y/y, less than in June (5.3% y/y), but above forecasts. On the other hand, employment in the corporate sector rose by 3.2% y/y in July, in line with our forecast and the market consensus. In monthly terms, employment reported an increase of 9k, the strongest rise since 2010. Data on employment show a constant strengthening of labour demand. Without the detailed structure of wage growth, it is difficult to judge whether the July's surprise once again resulted from the one-off effect (eg shifted payments of bonuses) or from a general increase in wages. We will revert to that after the Statistical Bulletin is released later this month. The favourable situation on the labour market will positively affect the private consumption in 3Q.
- Data on the economic activity at the start of 3Q were below our expectations (not to mention the market consensus). Industrial production was particularly disappointing, showing a decrease in annual terms (including the manufacturing sector), below all market forecasts. Although the figure was affected by the number of working days (minus two compared with July 2015), the seasonally adjusted annual growth of industrial production was at a mere 1.6% (a half of average growth in 1H16). Construction output was also below forecasts (sharp fall by c20% y/y) and retail sales growth in real terms were at 4.4% (5.4% consensus, 5.0% our forecast). We expect the data to improve in August, but the weak release supported our story of no GDP growth acceleration in 2H16. Recently, we revised our forecast for GDP (c3% y/y in 2016 and below 3% in 2017).
- In July, PPI inflation rose to -0.4% y/y as compared to -0.8% y/y in June (after revision).

Quote of the week – Motion for a rate cut may be filed after vacation

Jerzy Żyżyński, MPC member, 18 August, Reuters
I support some easing of monetary policy. Possibly, I can file such a motion after the vacation.

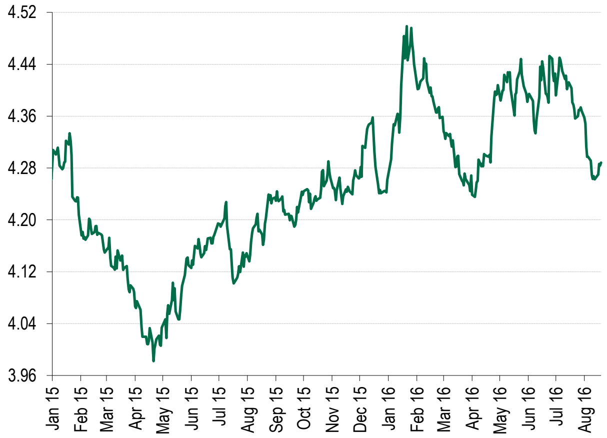
Eryk Łon, MPC member, 17 August, PAP
Last data on GDP growth postpone the first interest rate hike, but they were not dramatic enough to make us cut rates (…) If PMI falls considerably, then cuts may be voted.

Marek Chrzanowski, 17 August, PAP
Entrepreneurs' uncertainty about future economic conditions is affecting their investment decisions. Thus, I think that interest rate cuts would be ineffective in boosting economic growth.

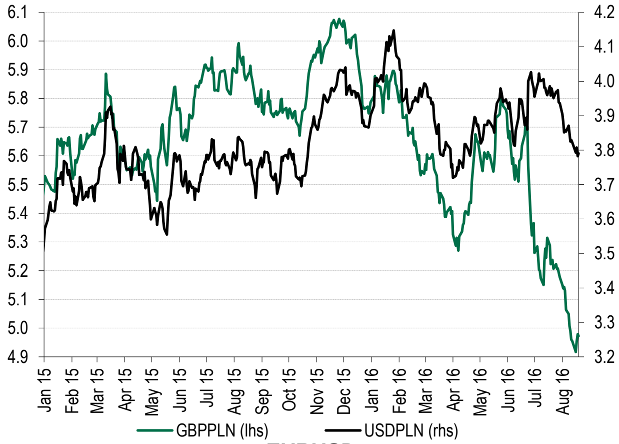
Weak data on industrial output encouraged Jerzy Żyżyński to mull an interest rate cut. He is the most dovish member of the MPC, so we are not surprised. However, the comment made by Eryk Łon shows that he may also think about cuts if PMI index goes down sharply. In our view, weak data on industrial output may have the same impact on Łon's view. Still, comments by other MPC members suggest they will not be too eager to support such a motion, so votes of Żyżyński and Łon are not enough. According to other central bankers, lower interest rates are unlikely to improve business climate and boost investment. We do not expect a cut, as long as GDP growth is above 3%. In our view, monetary policy easing in Poland is possible only given considerable deceleration of economic growth, but this is not our baseline scenario.

Foreign exchange market – Time to take profit after zloty's rally

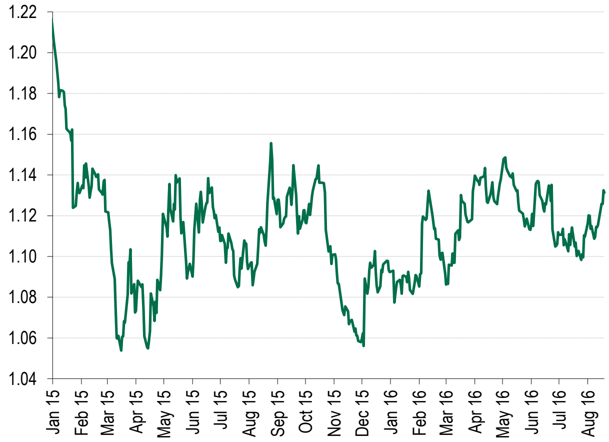
EURPLN



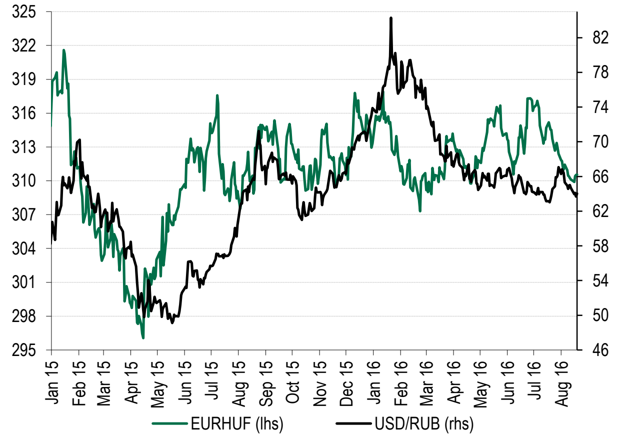
USDPLN and GBPPLN



EURUSD



EURHUF and USDRUB



Time to take profits

- Last week we pointed out that there was a limited room for the zloty's appreciation vs the euro and since then EUR/PLN has risen to 4.30 on the rather sour global market sentiment and disappointing Polish macro data. The zloty lost also vs the Swiss franc and vs the British pound (first weekly loss in four weeks). At the same time, the domestic currency gained slightly vs the dollar, as USD/PLN reached its fresh local low at 3.765.
- EUR/PLN has been testing 4.26 support for several days but did not manage to stay below this level for longer. Market pricing for a rate cut in Poland has strengthened sharply on the weaker-than-expected domestic economic activity data and we think that now a more persistent rebound in EUR/PLN might have started, as the zloty gave up more than a half of gains recorded upon the presentation of the President's CHF-loans relief bill.
- The past week showed that the Polish currency remains sensitive to the changes in the global market sentiment. Vital European and US data is on the agenda in the coming days and we think that given the recent zloty's significant gains, the Polish currency could now be more vulnerable to any below-consensus releases. First resistance to watch for EUR/PLN is at c4.33.

Euro continues to gain

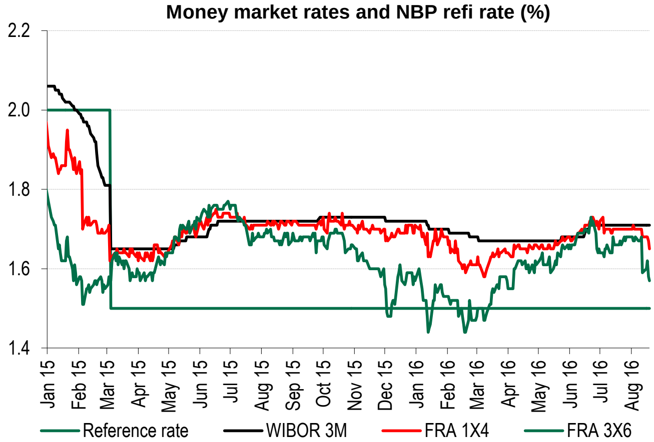
- EUR/USD climbed for the second week in a row to reach 1.136 due to somewhat disappointing US data released at the beginning of the week.
- The exchange rate has been rising already since mid-July and so the euro has already recovered nearly all losses suffered in reaction to the announcement of the British referendum. This is despite the recent strong US labour market data.
- The issue of the Fed's monetary policy could attract more market attention this week as the US data releases are on the agenda and the Jackson Hole conference begins. The market still sees only slightly less than 50% chances for a Fed rate hike this year and perhaps more hawkish signals are needed to support the dollar.

Forint loses, ruble gains

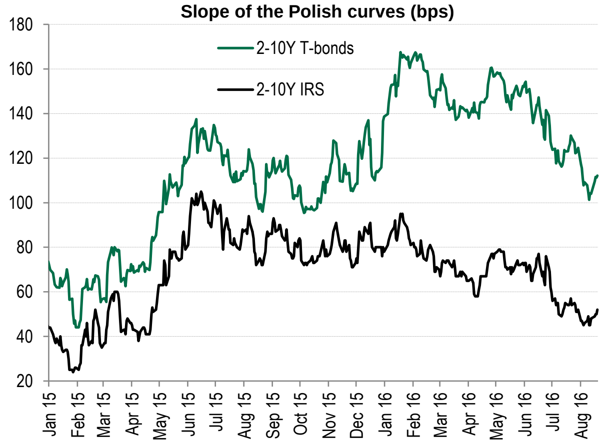
- EUR/HUF followed EUR/PLN last week as the forint gave up part of the recent gains vs the euro and lost on value for the first time in four weeks – the exchange rate rebounded above 310.
- Rising Brent oil price helped the ruble last week and USD/RUB fell for the third week in a row, reaching temporarily 63.36. In our view, however, the scope for further appreciation of the Russian currency is limited. Alongside the purely macro factors, the ruble could be hit by concerns about the next phase of the Russia-Ukraine military conflict. The media have recently focused on the situation at the Ukraine border where the Russian army is gathering more and more military hardware. In response to these actions, Ukraine's President, Poroshenko, announced the highest level of combat readiness. Rising geopolitical tensions may add to the pressure on the ruble, as they were the main driver for the USD/RUB's moves back in 2014/2015.

Interest rate market – Rate cuts expectations renewed after weak macro data

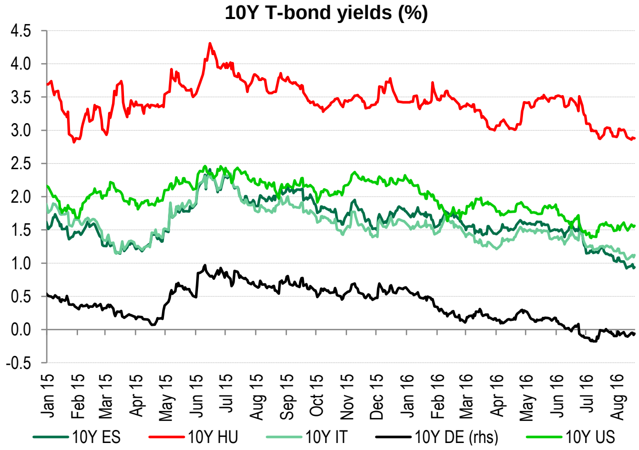
Money market rates and NBP refi rate (%)



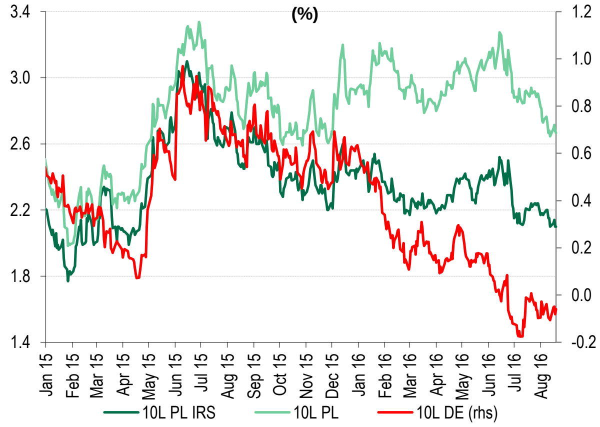
Slope of the Polish curves (bps)



10Y T-bond yields (%)



Yields of PL and DE 10Y benchmarks and 10Y PL IRS (%)



Rates inched lower after weak macro data

- The situation on the domestic interest rate market was mixed last week. Initially, yields/IRS rates increased markedly after the hawkish comments by the FOMC members, who suggested a rate hike was possible even in September, and information about a T-bond offer at the Thursday's auction. As a result, the 10Y benchmark yield increased temporarily towards 2.75%. However, much-weaker-than-expected macro data releases (mainly on the industrial output) and favourable auction results (see below) helped the market to revive visibly. What is more, the strengthening on both the core and peripheral debt markets after quite dovish FOMC minutes was also supportive for the Poland's curves. However, at the end of the week yields across the board were slightly higher, compared to the end of the previous week, while the IRS rates were somewhat below those levels.
- Both yields and IRS curves gradually steepened as weaker-than-expected economic activity data (industrial output, retail sales) and a still dovish comment made by the MPC's Żyżyński renewed expectations for monetary easing in the coming months. The FRA market clearly shows that investors see an 80% chance of a 25bp rate cutting the 6month horizon. Consequently, the front end outperformed most sectors. What is more, the 10Y asset swap spread widened towards 60bp, while the spread vs the Bund did not change much, remaining near 275bp.
- Poland's Ministry of Finance successfully launched 2Y OK1018, 5Y PS0721 and 10Y DS0726 benchmark worth PLN7.95bn, only slightly lower than the upper offer (PLN8.0bn). The 5Y benchmark PS0721 was in high demand. The auction yields were slightly above the levels observed on the secondary market just before the tender. We estimate that following the auction, this year's borrowing needs are covered in more than 80%.

Global factors are key

- This week, the domestic macro data releases and events calendar is nearly empty. In our view, the registered unemployment rate is neutral for the market. Therefore, investors will focus on the global macro data releases; in particular, lots of US macro data are due this week. The recent FOMC minutes confirmed that the Fed wanted to wait for another set of data to be released before taking further action. Thus, stronger-than-expected figures from the US economy may trigger profit taking on the core markets after quite a strong rally in the recent days. Consequently, domestic assets may also suffer from higher core yields. What is more, the key event for investors will be the Fed's governor testimony in the Jackson Hole on Friday (26 August). This may bring more hints about the Fed's outlook on both economic growth and inflation, which will translate into monetary policy action later this year. Rising risk of continued rate hiking cycle by the Fed later this year (we still see FOMC to hike rate by 25bp in December) may push yields up in the coming months globally, in particular on the long end of the curves.
- In the short run, there is still (limited) room for further decline in the yields/IRS rates as a result of stronger expectations on rate cuts. However, the front end of the curves should continue to outperform other sectors.

Additional information is available on request. Please contact Bank Zachodni WBK S.A., 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.