Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

12 – 18 September 2016

Last week was quite volatile on the financial markets, with central banks' decisions reversing market direction. As expected, Poland's MPC kept the interest rates unchanged; however, the quite hawkish signals from the Council during the press conference put pressure on the domestic debt market after a visible rally in the first part of the week. While the market cooled down expectations for a rate hike by the FOMC later this month (after weaker data releases), the ECB disappointed, which caused an upward move in core yields affecting Poland's yields and IRS rates. Having reached almost 4.30 against the euro, the zloty saw a gradual moderate weakening in the second half of the week.

The start of the week will be (at least temporarily) affected by Moody's decision (to be announced on Friday, after market closes). We still think that Moody's will affirm Poland's rating, and this decision will be assets positive for Poland. However, if the rating is downgraded the reaction of the domestic financial market will be negative, though probably also temporary, as some investors may see higher yields as an attractive buying opportunity (particularly with the weaker zloty). Market attention will turn to macroeconomic data releases. We expect the final August CPI to confirm the flash figure of -0.8% y/y; information on exports performance in July may be important, in particular for the zloty. What is more, a bulk of the US macro data will be released in the second half of this week. This data will be in more focus than usual as investors are looking for some hints about the US economy performance after the surprisingly low August ISM surveys cooling down expectations for a rate hike later this month (now probability of such scenario is around 28%, down from 32% a week ago). In our view, there is still room for a decline in yields (even towards August's low), in particular on the long-end of the curves, if Moody's does not surprise negatively and the US macro data support the view that Fed keeps the rates unchanged later this month. This should also be a supportive factor for the zloty.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (12 September)					
14:00	**PL**	**CPI**	**Aug**	**% y/y**	**-0.8**	**-0.8**	**-0.9**
		TUESDAY (13 September)					
11:00	GE	ZEW index	Sep	pts	56.0	-	57.6
14:00	**PL**	**Current account**	**Jul**	**€m**	**-397**	**-367**	**-203**
14:00	**PL**	**Exports**	**Jul**	**€m**	**13 910**	**13 665**	**15 218**
14:00	**PL**	**Imports**	**Jul**	**€m**	**13 950**	**13 697**	**14 814**
14:00	**PL**	**Core inflation**	**Aug**	**% y/y**	**-0.4**	**-0.3**	**-0.4**
		WEDNESDAY (14 September)					
11:00	EZ	Industrial output	Aug	% y/y	-0.7	-	0.6
14:00	**PL**	**Money supply**	**Aug**	**% y/y**	**10.7**	**10.5**	**10.7**
		THURSDAY (15 September)					
11:00	EZ	HICP	Aug	% y/y	0.2	-	0.2
14:30	US	Retail sales	Aug	% m/m	-0.1	-	0.0
14:30	US	Initial jobless claims	week	k	-	-	259
14:30	US	Philly Fed index	Sep	pts	1.0	-	2.0
15:15	US	Industrial output	Aug	% m/m	-0.2	-	0.7
		FRIDAY (16 September)					
14:00	**PL**	**Wages in corporate sector**	**Aug**	**% y/y**	**5.0**	**4.4**	**4.8**
14:00	**PL**	**Employment in corporate sector**	**Aug**	**% y/y**	**3.2**	**3.3**	**3.2**
14:30	US	CPI	Aug	% m/m	0.1	-	0.0
16:00	US	Flash Michigan	Sep	pts	91.0	-	89.8

Source: BZ WBK. Reuters. Bloomberg

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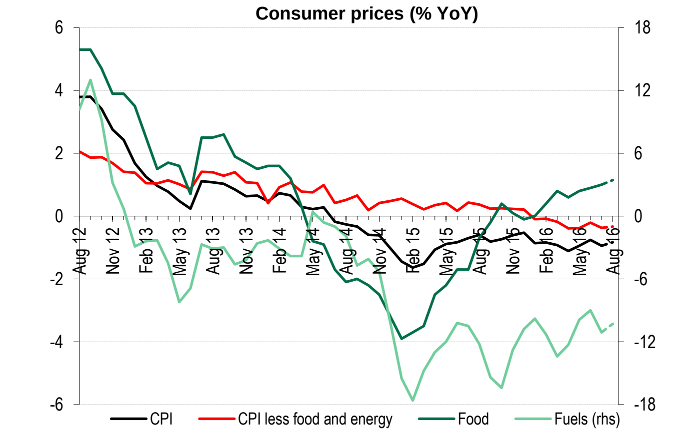
What's hot this week – CPI rebounding, export slowing

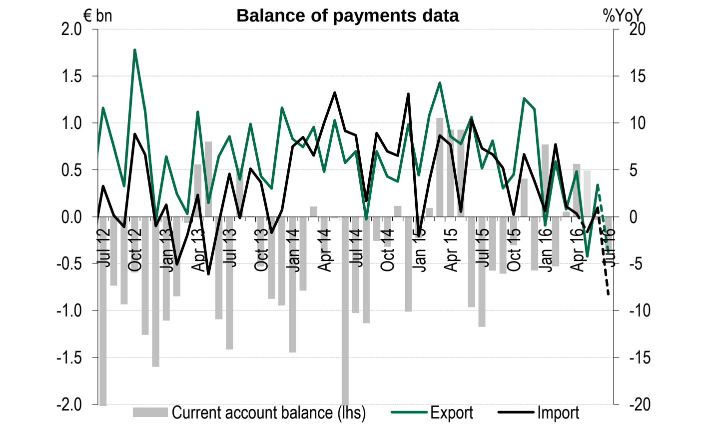


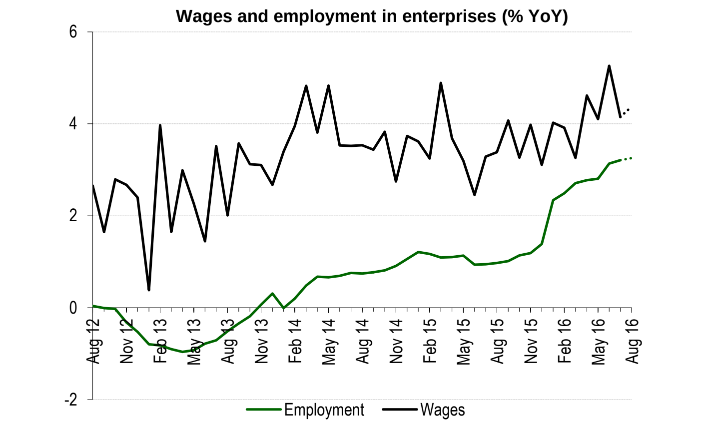
▪ Inflation data is not going to be the key release of the week, in our view. We think that the rebound in 12M CPI to -0.8% in August was only partly due to food prices, and thus the main core inflation measure also inched up, to -0.3% y/y. Next months will see a further move up, in our view.

▪ Balance of payments data for July will be the first gauge of Polish exports performance in 3Q16. We expect quite poor exports, after weak industrial output and disappointing German export data.

Data from the Polish labour market should confirm positive trends – solid employment growth and decent wage rise (albeit slower than in July due to the base effect), supportive for further acceleration of private consumption growth.

Last week in the economy – The MPC is not even thinking about rate cuts





▪ The Monetary Policy Council kept the interest rates unchanged in September. The statement after the meeting was similar to the previous one and the main piece reads: "current level of interest rates is conducive to keeping the Polish economy on the sustainable growth path and maintaining macroeconomic balance". Additionally, according to the MPC, the decline in investment was temporary (it was driven by EU funds absorption, investments should accelerate at the start of 2017); there is no inflationary pressure in the economy and the persisting deflation has not adversely affected decisions taken by the economic agents so far.

▪ It seems that the MPC still believes that 'wait and see' was the best policy option. Asked about the temptation to cut rates in order to accelerate growth, Glapiński rejected the idea and even started to talk about a scenario (though still quite distant) of policy tightening (if growth accelerates and CPI inflation increases towards 1.5%). We maintain our forecast that the official rate will remain stable in 2016-17.

▪ The MPC member Marek Chrzanowski resigned from his post for personal reasons. Chrzanowski was not in favour of further monetary easing – in the recent interview he argued that trying to boost economic growth with interest rate cuts could do more harm than good. Moreover, he suggested the MPC should rather consider rate hike instead of cut in the upcoming quarters. In his view, the financial sector stability (disadvantages of interest rates cuts could outweigh the benefits) was an important factor when making the decision.

▪ The Senate has three months to find the replacement for the MPC member in case of his dismissal. The candidates are not known yet, so it is hard to guess whether this will tilt the balance of votes significantly.

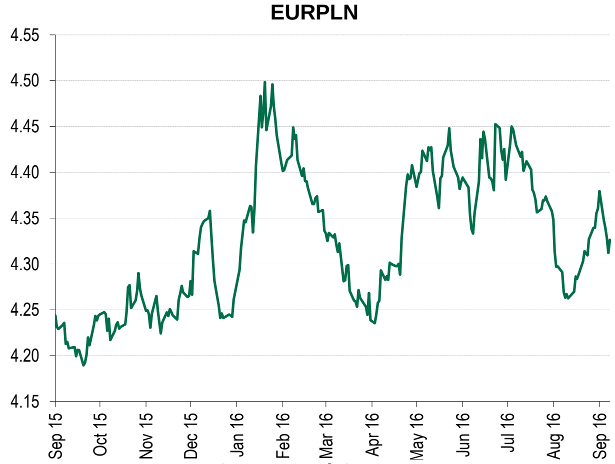
Quote of the week – Sorry… no news here

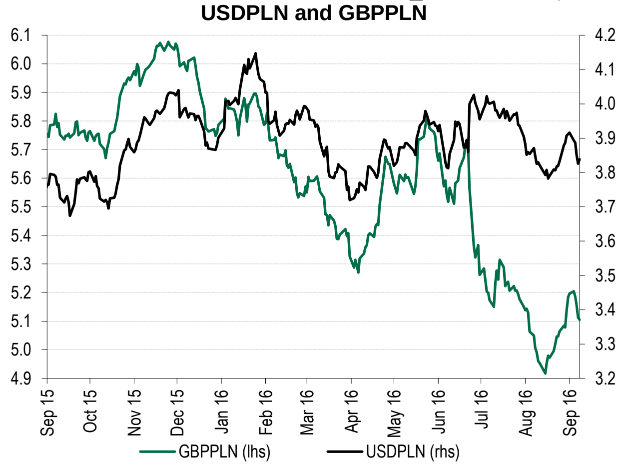
Adam Glapiński, NBP President, 7 September, PAP

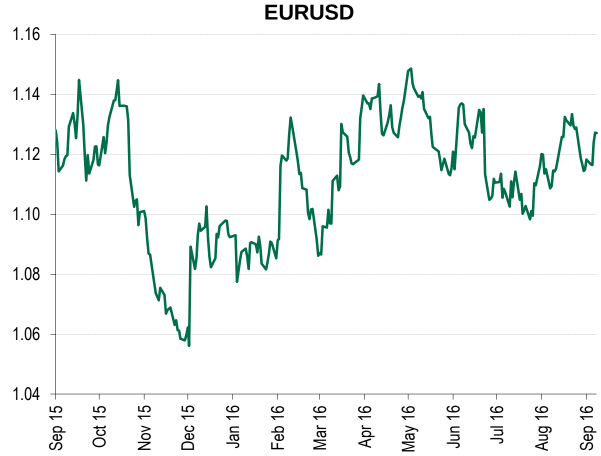
Economic results were improving in 2Q and this moves us towards future rate hikes. We might consider monetary easing, should the economic conditions worsen and growth decelerate, but there is no such need for the time being. I am not considering cuts, but I think that at some point of time, e.g. at the end of 2017, we can start the hiking cycle. There are no crucial changes in the monetary policy guidelines. But this does not mean we did not discuss them. The inflation target, which is not going to change, is a good indicator where we should go and what situation we consider positive. We were dreaming about the economic growth at 3.5-3.8% in 2016. Now we expect 3.1-3.3%.

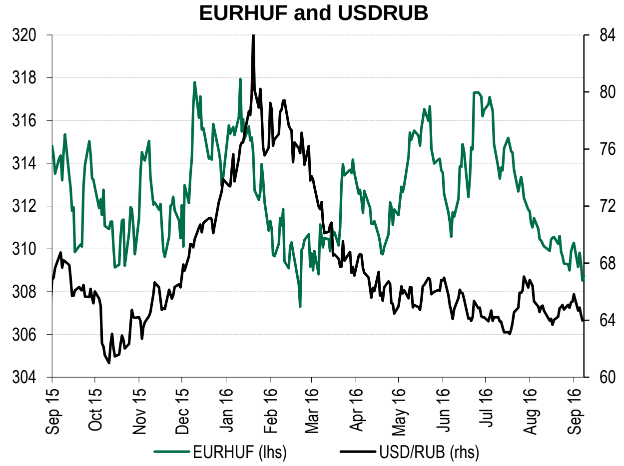
During the post-meeting press conference, NBP President, Adam Glapiński, said there was no interesting news regarding the monetary policy. Cuts are off cards, provided there is no sudden drop in the economic activity. Stable economic growth and rising inflation will argue eventual interest rate hikes. MPC members do not seem to be impressed by the latest reading on the weaker economic activity, perceiving it to be temporary. It was even commented that the economic statistics are improving, which suggests that the Polish central bankers remain optimistic about the economic outlook. The MPC's statement omitted the latest disappointing data from the industry (fall by 3.4% y/y in July), as well as the last week's data from Germany, which in our view, cast some doubt about the strength of GDP growth in Poland in the upcoming quarters.

Foreign exchange market – Global data crucial after Moody's









Global data crucial after Moody's

- Last week, the zloty was the 5th best performing EM currency vs the euro and the dollar. EUR/PLN fell to 4.30 from 4.36 on hopes that Moody's will not cut Poland's rating, as well as thanks to the positive global market sentiment supported by lower chances for a fast Fed's rate hike (on the below-consensus US nonfarm payrolls released last Friday). The zloty's appreciation trend halted after the ECB decision to leave the monetary policy parameters unchanged. This disappointed investors and EUR/PLN rebounded to c4.33.
- At the end of the week, Moody's may announce its decision on Poland's rating and its outlook (currently at A2, negative). We think that any positive reaction to the no-change in rating and outlook decision (which is our base scenario) could only be temporary and the zloty will not gain any more in the weeks to come.
- Nevertheless, the beginning of the week should be under the impact of the Moody's decision. In the next days, however, the global events should gain attention as important data from Germany and the US are due. Also, a few FOMC members will give a speech in the first part of the week.
- Numerous Polish data is on the agenda this week, but they are less important for the market. The final August inflation should not differ much from the flash estimate, our forecast for C/A deficit is near the consensus (although weak exports volumes could generate some negative pressure on the zloty) and labour market numbers have hardly ever been a market driver. Support at 4.30 and resistance near 4.36 (next at 4.40) are important levels to watch for EUR/PLN.

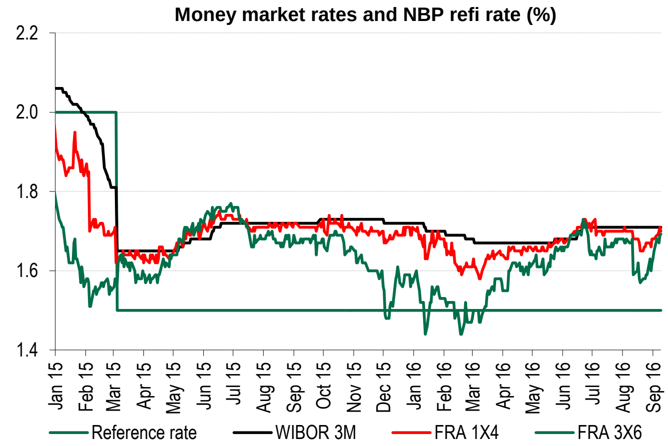
ECB and US data support euro

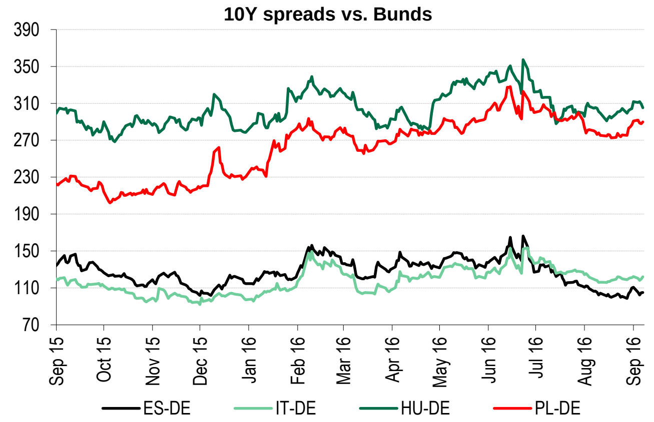
- The euro gained vs the dollar thanks to the very weak US ISM for services and no monetary policy easing announced by the ECB. As a result, EUR/USD climbed above 1.13 to its fresh September's high.
- Chances for the Fed's rate hike to come still this year fell on the last US data hitting the dollar. Important data from the world's biggest economy is on the agenda in the coming days and a few FOMC members will give a speech early in the week, so the issue of the Fed's monetary policy could again come into the spotlight. After the last ECB decision, we see limited room for the dollar to gain and EUR/USD should hold above 1.112 in the days to come. Important resistance is at c1.135.

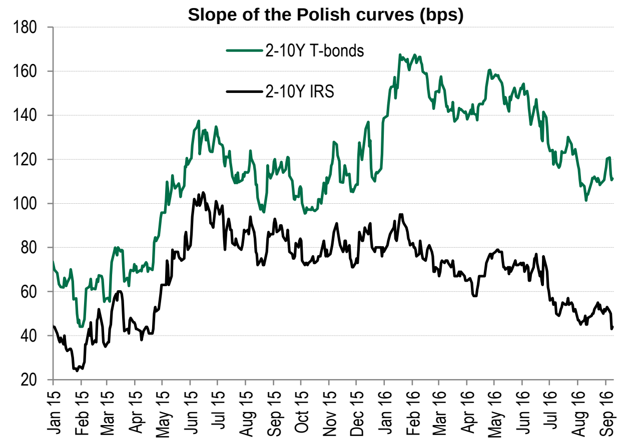
Ruble stable awaiting decision on rates

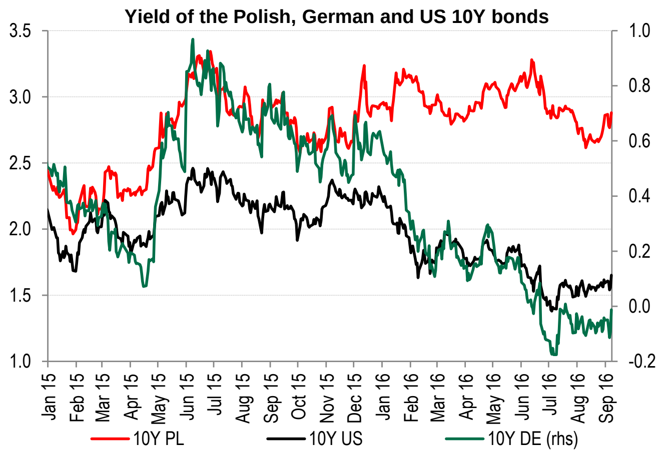
- Last week, EUR/HUF declined temporarily below 308, while USDRUB stayed near 64.
- The Central Bank of Russia (CBR) will decide on the interest rates on Friday and the market expects a 50bp cut to 10%. In July, the CBR left the interest rates unchanged. The bank said more monetary policy easing was likely if inflation continued to decline in line with its expectations. August's annual CPI eased to 6.9% from 7.2%. The central bank still expects to reach its 4% target by the end of the next year, which is likely to support more monetary easing. Also, numerous comments have emerged in the last months, suggesting that the ruble has been too strong and this could also justify more rate cuts.

Interest rate market – Very volatile rates market









Poland's MPC and ECB put pressure on the market

- The situation on the Polish debt market was mixed last week. The week started with a weakening on the bond market, following the mood from the previous week when bonds suffered due to speculations that Moody's may cut the Poland's credit rating (after comments from the deputy PM). Although later during the week we saw a significant strengthening, the bond yields and IRS rates have gradually increased again as the Polish MPC was more hawkish than expected and the ECB disappointed (increase in yields on the core markets). Effectively, the belly and the long end of the curves went back down for a while to the level observed before the previous auction and at the end of the week the 10Y yield was 2bp higher as compared to a week ago. At the same time, the yields and IRS rates from the front end of the curves shifted up as the MPC suggested that next (though distant) move in rates would be a hike.
- Measures of country-specific risks (asset swap spreads or spreads vs German bunds) decreased last week, with the spread over Bunds for the 10Y sector tightening to c290bp. What is more, both the yield and IRS curves flattened quite markedly as the long-term instruments outperformed the short-term ones. After the ECB's decision, Polish curves corrected the earlier flattening and on the last two days of the week a mild steepening was recorded amid weakening on the belly and the long end stronger than on the short end.
- On the money market, the FRA rates increased significantly, while the WIBORs remained stable. The FRA rise was a reaction to the hawkish signals from the MPC. Consequently, investors scaled back their expectations for monetary easing in Poland, seeing official rates to be unchanged in the next two years.

Moody's decision and macro data key events

- The start of the week will be (at least temporarily) affected by the Moody's decision (announcement on Friday, after the market closes). We still think that Moody's will affirm Poland's rating, and such a decision would be bond-positive. However, in case of a rating downgrade, a negative reaction of bonds should also be temporary, as some investors may see higher yields as an attractive buying opportunity (particularly with the weaker zloty). A similar scenario was reported in January when S&P decreased the rating.
- The first set of the domestic macro data is due this week. However, the market's reaction to these releases will be rather subdued as we think that the final reading of the August's CPI will confirm the flash figure at -0.8% y/y. On top of that, while the data from the labour market (employment and wages in the enterprise sector) or the M3 money supply are right now market-neutral, but the July's balance of payment (in particular exports performance) may attract the attention of investors and increase the market volatility.
- All in all, Polish bond market dynamics in the last days has proved that investors used bond weakening for purchases. In our view, there is still room for a decline in yields (even towards the August's low), in particular on the long-end of the curves, if the US macro data which are due this week support the view that the Fed keeps rates unchanged later this month. A rebound may be less pronounced in the case of short-term securities, as the hawkish signals from the MPC on the September's meeting will limit market expectations for monetary policy easing in Poland, in our view.

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