Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

3 – 9 October 2016

Moods on the financial markets were quite positive at the start of the week, thanks to the dovish FOMC and positive macroeconomic data from the euro zone and Germany. However, later optimism was undermined by worries about Deutsche Bank. Stocks of the biggest German banks tumbled after chancellor Angela Merkel ruled out state's help for this institution. Later, some investment funds decided to trim their exposure to the bank, fuelling additional worries that Deutsche may fail. In Poland, government reshuffle was the most awaited event of the week. The Finance Minister Paweł Szałamacha was replaced by Mateusz Morawiecki, who will now supervise two ministries – of development and finance. Although such a combination may lead to a policy dilemma (given strong pressure to boost economic growth), it seems that the government's pledge to keep deficit below 3% of GDP remains intact, so the change should be market neutral, in our view.

This week's calendar is quite heavy. Final PMI for the euro zone and Germany, as well as industrial output and orders in Germany will be important hints about the economic growth in Europe and also about export prospects for Poland. Data from the US, especially on the labour market, will affect expectations about US monetary policy. Investors currently price in a 50% chance that rates in the USA will go up in December. In Poland, we will get to see the PMI in manufacturing, which, in our view, will confirm that no GDP growth acceleration should be expected in Q3. MPC meeting will be most probably a non-event, with rates staying flat.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (3 October)					
9:00	**PL**	**PMI – manufacturing**	**Sep**	**pts**	**52.1**	**51.0**	**51.5**
9:55	GE	PMI – manufacturing	Sep	pts	54.3	-	53.6
10:00	EZ	PMI – manufacturing	Sep	pts	52.6	-	51.7
16:00	US	ISM – manufacturing	Sep	pts	50.2	-	49.4
		TUESDAY (4 October)					
		No important data releases					
		WEDNESDAY (5 October)					
	PL	**MPC decision**		**%**	**1.50**	**1.50**	**1.50**
9:55	GE	PMI – services	Sep	pts	50.6	-	51.7
10:00	EZ	PMI – services	Sep	pts	52.1	-	52.8
14:15	US	ADP report	Sep	k	160	-	177
16:00	US	Industrial orders	Aug	% m/m	-0.5	-	1.9
16:00	US	ISM – services	Sep	pts	53.0	-	51.4
		THURSDAY (6 October)					
8:00	GE	Industrial orders	Aug	% m/m	0.3	-	0.2
11:00	**PL**	**Bond auction**					
14:30	US	Initial jobless claims	week	k	-	-	254
		FRIDAY (7 October)					
8:00	GE	Industrial output	Aug	% m/m	0.9	-	-1.5
9:00	CZ	Industrial output	Aug	% y/y	8.3	-	-14.1
14:30	US	Non-farm payrolls	Sep	k	175	-	151
14:30	US	Unemployment rate	Sep	%	4.9	-	4.9

Source: BZ WBK. Reuters. Bloomberg

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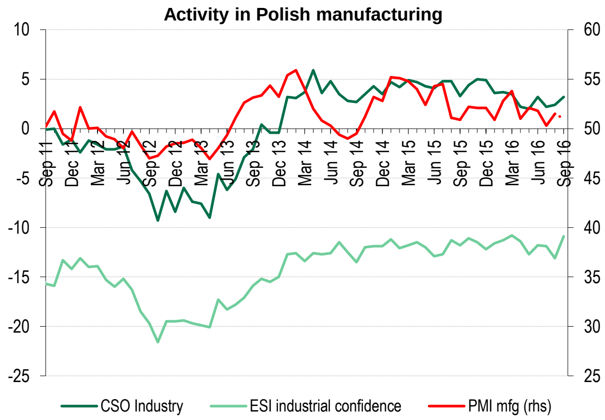
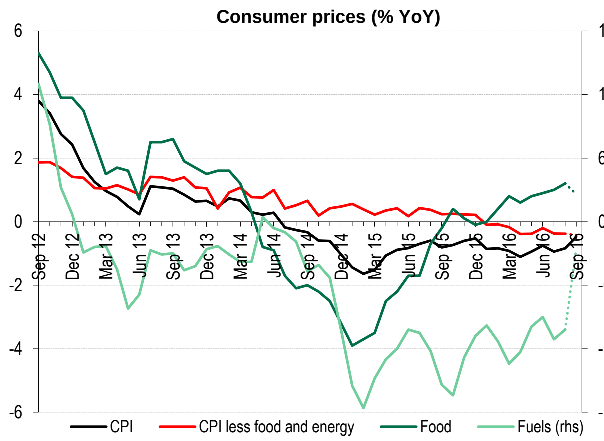
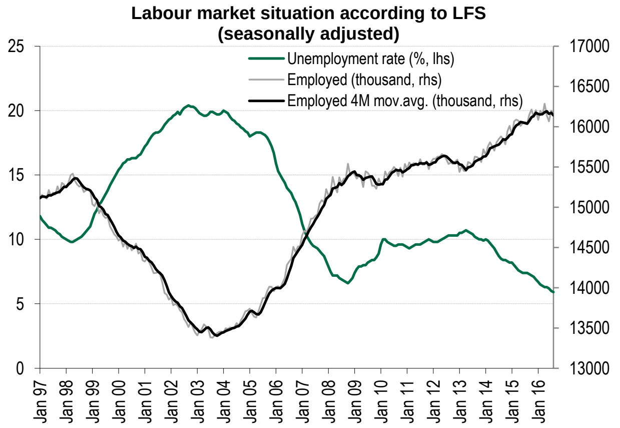
What's hot this week – PMI in manufacturing and MPC meeting



- We expect PMI in Polish manufacturing to go down slightly in September. Other important business climate indices for Poland as well as the PMI for the euro zone and Germany went up, but in our view, the August's rebound (to 51.5 from 50.3) was a bit too strong, and a downward correction is probable. The PMI will remain at a level suggesting no acceleration of the economic growth. We expect the GDP growth in Q3 below 3% y/y.
- The MPC meeting in October will be a non-event, as interest rates are broadly expected to remain on hold. Let us remind you that recently the MPC approved the monetary policy guidelines for 2017, but the document contained no significant changes. The inflation target remained at 2.5% with ± 1 percentage point of accepted deviations, but the Council stressed their flexibility in reacting to inflation deviation from the target (to prevent financial system stability).

Last week in the economy – CPI higher, but below forecast again





- Polish inflation was lower than expected again, reaching -0.5% y/y in September. We don't know the details yet. There were three very strong low base effects that were pushing the inflation rate up this month: in the prices of fuel, recreation and electricity. Additionally, our estimates showed that both fuel and food prices rose quite considerably in September. But this could have been mitigated by the introduction of free pharmaceuticals for seniors, the effect that we have probably underestimated. Overall, inflation has started picking up (it was -0.8% y/y in August) and will probably keep climbing in the following months. CPI may turn positive in December, followed by a significant inflation spike (to c. 1% y/y) possible in January as a result of the price hikes accumulation at the start of the year and another low base effect.
- According to Labour Force Survey, the unemployment rate (seasonally adjusted) fell to 5.9% in August, hitting new record low level. At the same time, the data suggest that the positive trend in employment has faded away in the recent months.
- Paweł Szałamacha was dismissed from the post of Finance Minister. The Deputy Prime Minister, Mateusz Morawiecki, will be now supervising two ministries: Ministry of Finance and Ministry of Development. Moreover, he will chair the new Economic Committee of the government (KERM), which will be responsible for the economic policy coordination.
- The government's information centre informed that the draft 2017 budget approved on Wednesday included revenues higher by PLN1.1bn as compared to its earlier version and an increase in spending by a similar sum. We do not know the rationale for these changes, but in our view, the optimistic macro assumptions (GDP growth at 3.6%, our forecast at 2.9%) and European Commission's doubt about the trade tax imply that this is a risky move.

Quote of the week – We have higher appetite for growth

Beata Szydło, PM, 29 September, PAP, TVP Info

Deputy PM Morawiecki will have to think where to find money to invest in the Polish energy sector, how to solve the mining problems, what to do to keep energy prices flat. (…) We have higher expectations as regards budget revenues, pace of economic growth; those are the reasons why the Economic Committee is being established.

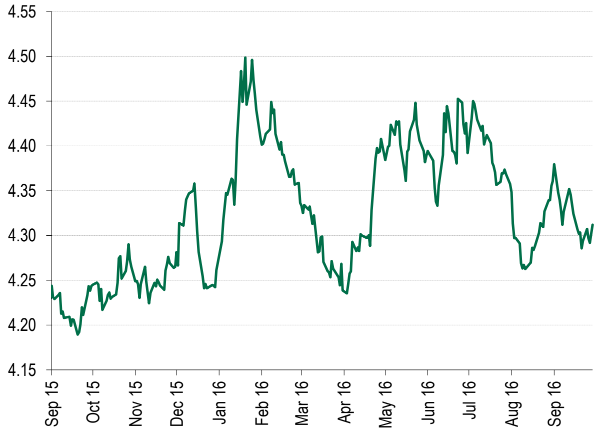
Mateusz Morawiecki, Minister of Finance and Development, 29 September, PAP

Obviously I want to secure stability of public finances. (…) The budget (for 2017) assumes deficit below 3% (…) and it is my pledge to fulfil PiS election promises without breaching this limit.

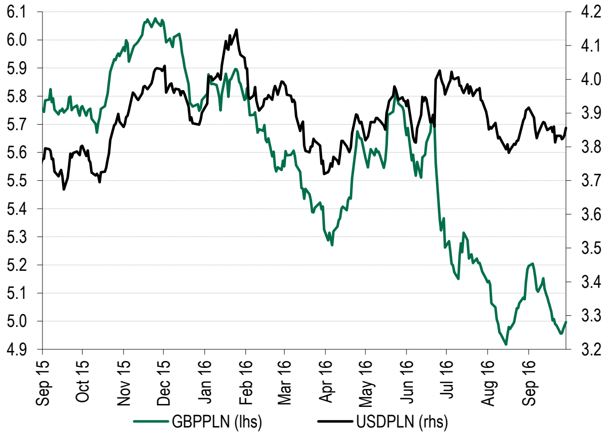
The change in the government implies a significant boost of Morawiecki's powers in the government, but it also means he is fully responsible for the economic policies. PM Szydło underscored the government has a bigger appetite for budget revenues and economic growth. This creates a challenge for the new super-minster as there seems to be an intrinsic conflict between guarding fiscal discipline and boosting economic growth, especially at times when the economic activity is disappointing (in our view, GDP growth may slow below 3% in 3Q16, instead of accelerating) and the external environment is not supportive. Nevertheless, we assume the government's pledge to keep fiscal deficit below 3% of GDP will remain intact – it was explicitly confirmed by minister Morawiecki – so the change in the government should in fact be market-neutral.

Foreign exchange market – Focus will return to the US macro data

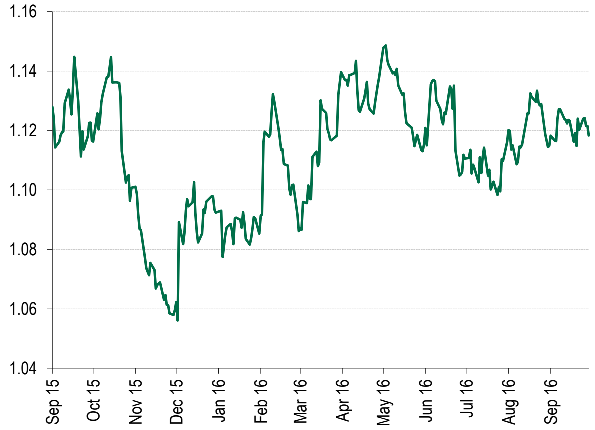
EURPLN



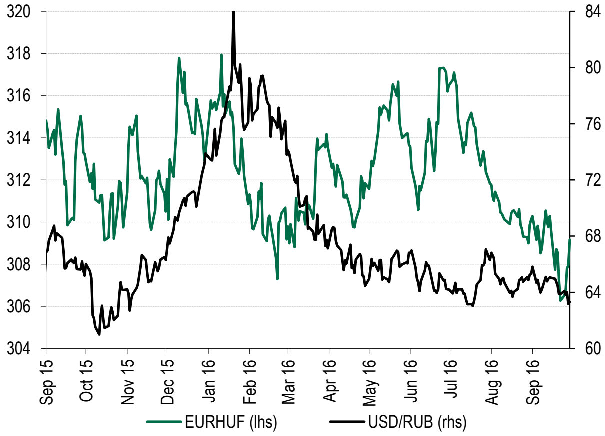
USDPLN and GBPPLN



EURUSD



EURHUF and USDRUB



Zloty weaker due to risk-averse mood

- Last week was quite volatile on the FX market. In the first part of the week, the zloty gained markedly against the main currencies, with EUR/PLN reaching 4.27, lowest since mid-August. However, the zloty weakened somewhat following the government reshuffle late on Wednesday, and as a result of worsened investor moods globally (sparked by fears Deutsche Bank problems might roil the global financial sector). As a result, EUR/PLN increased to nearly 4.32 (highest since mid-September), but closed the month around 4.30. Risk-off mode pushed USD/PLN towards 3.86 for a while due to the EUR/USD decrease as investors shift capital towards safe-haven assets.
- This week's agenda was full of economic releases in Poland and abroad, as well as important events. Small decrease in the leading indicators (we expect PMI for Poland's manufacturing to fall slightly) might be zloty negative. On the other hand, the quite hawkish MPC's rhetoric should balance that out. Global factors, including the US labour market data, will also be the key issues for investors this week. In our view, the market reaction to the weaker non-farm payrolls will be more significant. It could trigger a slight rebound of the zloty. Ahead of that release, we expect EUR/PLN to move sideways in the range of 4.27-4.36, keeping closer to the mid-level of the fluctuation channel. However, the rate is likely to move towards the higher boundary of the rage in the upcoming weeks.

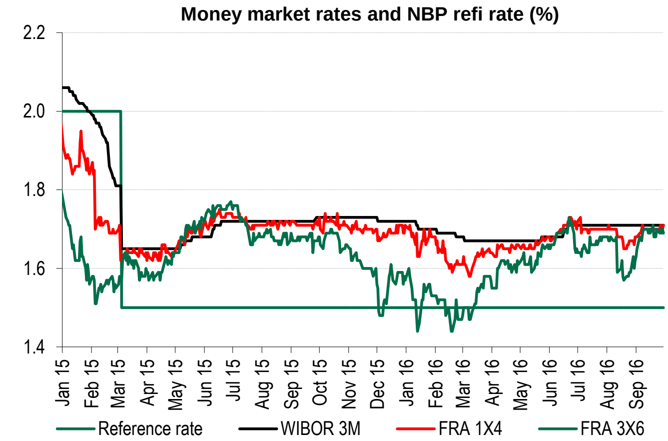
EUR/USD around 1.12 ahead of the US macro data

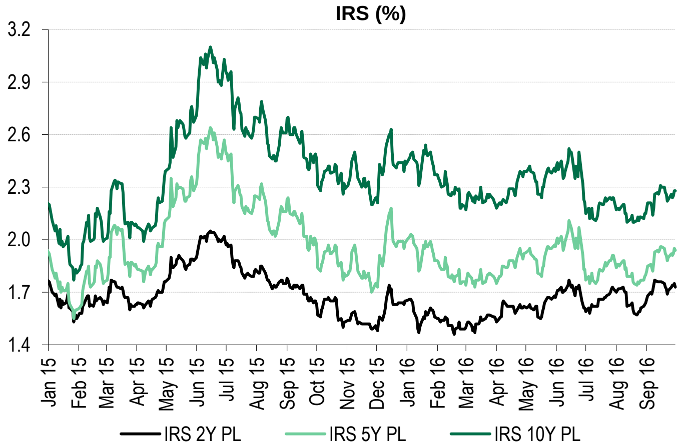
- EUR/USD went temporarily up to 1.128 amid the increased risk aversion. This resulted from the better than expected macro data releases from Germany and the uncertainty prior to US presidential debate. However, the US dollar gained significantly at the end of the week, trimming nearly all the earlier losses. This stemmed from a higher demand for safe haven assets (including the US dollar).
- This week investors' focus will return onto the US macro data releases (mainly ISM index and September's job report). Strong data from the US economy should support our view that Fed will hike rates in December. This, together with prolonged risk averse mode, could result in EUR/USD decline even towards support level around 1.11.

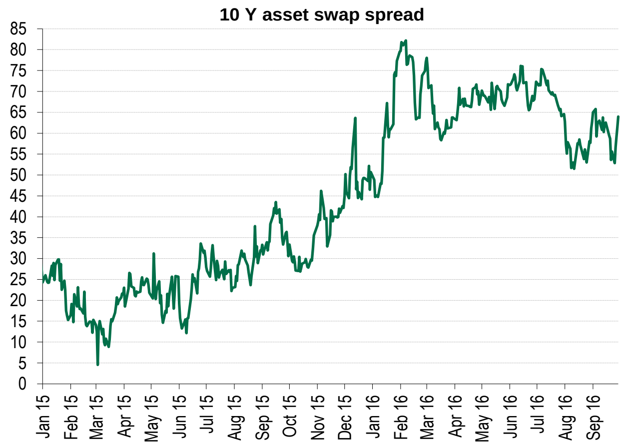
Mixed picture on the CEE FX market

- The performance of the other CEE currencies was mixed over the past week. While RUB and CZK were more or less stable in weekly terms, the Hungarian forint led the losses due to the risk-off mode and in the wake of the referendum on the EU's migrant quotas to be held on 2 October. As a result EUR/HUF increased towards 310, hitting the highest level in the last two weeks. Decline in oil prices negatively affected USD/RUB at the end of the week, the rate remained below the level from a week ago.
- This week, the global factors will remain the largest determinants for the CEE currencies. PMI readings for both Hungary and Russia are the most volatile indices, therefore their impact on HUF and RUB might be muted. However, at the start of the week, HUF will be under impact of the referendum results. If the Hungarian migrant quota referendum surprises with a high 'No' vote, HUF should continue to depreciate. What is more, the US data, in particular the September's job report, will be also crucial for HUF valuation in the short run. As regards RUB, oil prices are still crucial for USD/RUB and the important levels for the rate are 63 and 67.

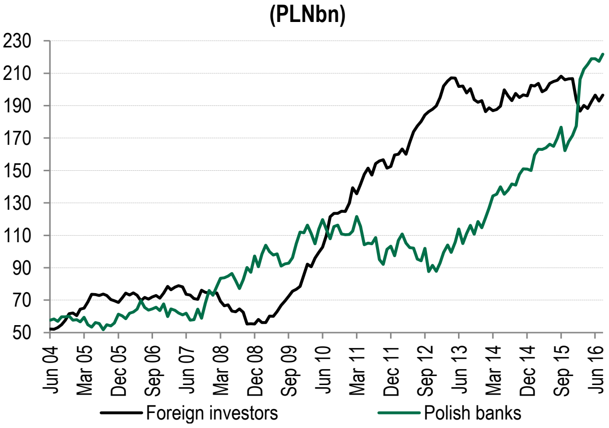
Interest rate market – Little room for rates to rise







Polish PLN, marketable bonds held by domestic banks and non-residents (PLNbn)



Polish and global factors push rates up

- Last week the Polish rates rose significantly, this is particularly true of the bond yields that were underperforming their European peers. The main factors pushing IRS/yields up were the decent US data, uncertainty related to the Polish government reshuffle, comment of the MPC's Hardt saying he still saw no room for a rate cut and flash September CPI that rose noticeably. The 10Y Bund spread rose above 300bp for the first time since mid-July.
- As a result, the 2Y IRS rose 2bp to 1.73%, the 5Y and 10Y rates climbed 4-5bp to c1.95% and nearly 2.30%, respectively. The asset swap spread winded 6-8bp for the 5Y and 10Y tenors. Both bond and IRS curves steepened, mainly in the 2-10 and 2-5 segments.
- FRAs followed the IRS and the market still does not price in any changes in NBP rates in the coming 21 months. 1-12M WIBOR rates did not change last week.

Polish banks and non-residents buy Polish bonds

- The Finance Ministry announced its plans to issue bonds for PLN14-28bn in 4Q16 at 3-4 standard auctions and 1-2 switch auctions. In October, the ministry wants to auction bonds worth PLN8-16bn. On Thursday, the ministry will offer OK1018 and DS0727 for the total amount of PLN3-6bn. The deputy finance minister said that c91% of this year's borrowing needs were covered at the end of 3Q.
- According to the most recent data released by the Finance Ministry, in August, non-residents bought PLN3.6bn of Polish marketable PLN bonds (in nominal terms), virtually neutralizing the July's outflow. Mutual funds were the most active on the non-resident's side increasing their holdings by PLN1.6bn. At the same time, commercial and central banks reduced their exposure slightly, by PLN406mn and PLN128mn, respectively. Geographically, the entities from the euro zone and North America were the most active buyers (+PLN1.1bn each), while investors from Asia (excluding Middle East) were selling the Polish debt (-PLN400mn).
- Polish banks also proved keen to buy debt, with a purchase worth PLN4.4bn, and their portfolio hitting afresh the all-time high at PLN221.7bn, after the biggest nominal monthly increase since March.

Little room for rates to rise

- The US September nonfarm payrolls and manufacturing ISM are on the agenda this week and together with speeches of the FOMC members should attract most of the market attention. The market is not fully pricing in a December Fed rate hike (it sees c50% for a 25bp hike, according to Bloomberg) but in our view, the fact that it will happen sooner rather than later makes the market more sensitive to the below-consensus data releases than to readings showing robust performance of the US economy.
- Polish rates rose last week with the 10Y benchmark bond yield breaking 2.90% and approaching a 2.95-3.0% resistance limiting scope for a rise already since mid-July. We think that Polish yields at or near 3% might be perceived as an attractive asset in the world of ultra-low interest rates and so we think there is a limited room for the Polish yields/IRS to rise, at least for the time being. However, this could only be the case if the global market sentiment does not deteriorate sharply due to, for example, worries about the German banking sector.

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