Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

10 – 16 October 2016

Economic activity indexes for Europe continue to show decent performance despite the outlook for Brexit and this was reflected also in Polish September's PMI that surprised to the upside. US ISM manufacturing and services also beat expectations leading to the US dollar's appreciation and pushing rates up worldwide. The other factors driving yields up, also in Poland, was media speculation that the ECB could taper its QE program earlier than March 2017. The outcome of the Polish MPC meeting lacking any breaking information contrasted with the interesting news flow abroad. In our view, the only valuable thing was NBP's governor saying that rates will not be hiked in 2017 (which confirmed our base scenario).

This time only few important global data are on the agenda and they are rather unlikely to trigger any directional trend so investors might decide to take profit after the recent zloty's appreciation. At the same time, numerous central bankers will give a speech. The most recent opinion of the FOMC members were rather hawkish and we think this could persist if they are still on track to hike rates later this year. However, if the global market sentiment calms down a bit, Polish 10Y yield above 3% could attract investors' demand, so we think the room for higher market rates in Poland is rather limited for the time being. At the same time, investors will be looking for any hint from the ECB speakers if the central bank's plan regarding the asset purchase program has changed.

Economic calendar

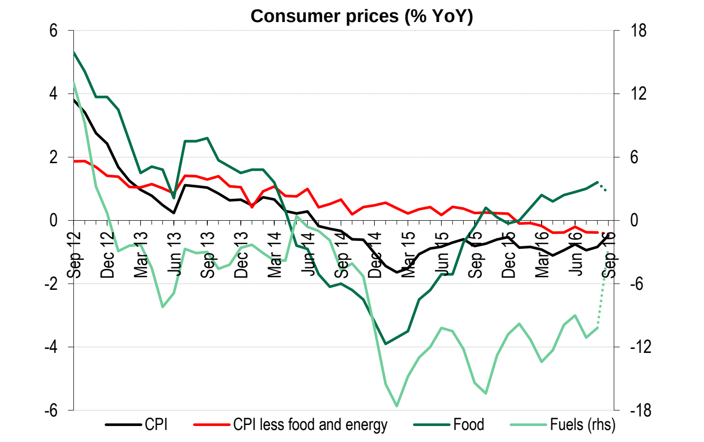
TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (10 October)					
8:00	GE	Exports	Aug	% m/m	2.2	-	-2.6
9:00	CZ	CPI	Sep	% y/y	0.6	-	0.6
		TUESDAY (11 October)					
9:00	HU	CPI	Sep	% y/y	0.6	-	-0.1
11:00	GE	ZEW index	Oct	pts.	2.0	-	0.5
14:00	**PL**	**CPI**	**Sep**	**% y/y**	**-0.5**	**-0.5**	**-0.5**
		WEDNESDAY (12 October)					
11:00	EZ	Industrial output	Aug	% m/m	0.7	-	-1.1
14:00	**PL**	**Core inflation**	**Sep**	**% y/y**	**-0.2**	**-0.4**	**-0.4**
20:00	US	FOMC minutes	Sep				
		THURSDAY (13 October)					
14:30	US	Initial jobless claims	week	k	-	-	249
		FRIDAY (14 October)					
14:00	**PL**	**Current account**	**Aug**	**€m**	**-318**	**-672**	**-802**
14:00	**PL**	**Exports**	**Aug**	**€m**	**13815**	**14089**	**13519**
14:00	**PL**	**Imports**	**Aug**	**€m**	**13754**	**14134**	**13832**
14:00	**PL**	**Money supply**	**Sep**	**% y/y**	**9.5**	**9.6**	**10.0**
14:30	US	Retail sales	Sep	% m/m	0.5	-	-0.1
16:00	US	Flash Michigan	Oct	pts.	92.0	-	91.2

Source: BZ WBK. Reuters. Bloomberg

ECONOMIC ANALYSIS DEPARTMENT:
al. Jana Pawła II 17, 00-854 Warszawa fax +48 22 586 83 40
email: ekonomia@bzwbk.pl Web site: http://www.bzwbk.pl
Maciej Reluga (Chief Economist) +48 22 534 18 88
Piotr Bielski +48 22 534 18 87
Agnieszka Decewicz +48 22 534 18 86
Marcin Luziński +48 22 534 18 85
Marcin Sulewski +48 22 534 18 84

TREASURY SERVICES:
Poznań +48 61 856 5814/30
Warszawa +48 22 586 8320/38
Wrocław +48 71 369 9400

What's hot this week – CPI, balance of payments and M3 money supply

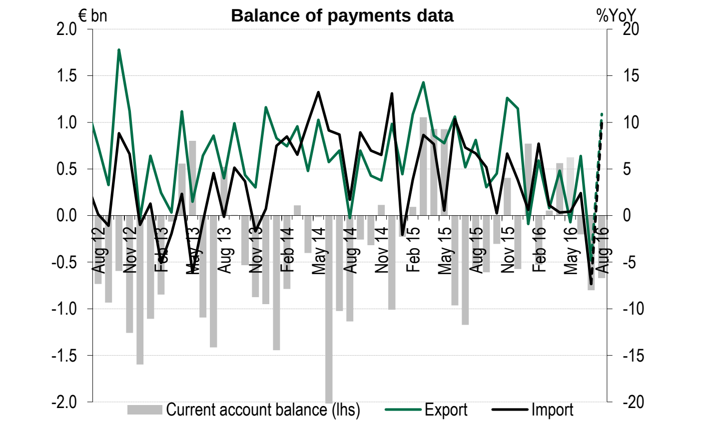


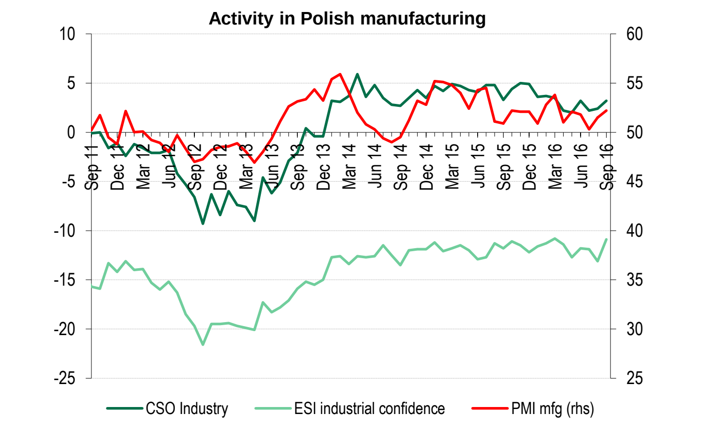
▪ We expect CPI in September to confirm the flash estimate at -0.5% y/y. We should bear in mind that this reading was subject to a higher uncertainty due to the introduction of free drugs for the elderly – this effect was difficult to estimate, and we are eager to see the actual data. We expect core CPI ro remain unchanged at -0.4% y/y in September.

▪ Data on balance of payments in August are likely to show a major rebound vs July on the back of the positive working day effect and good industrial output. Export is currently one of the key indicators to assess the pace of the economic growth in Poland. The recent rebound in PMI for Poland/Germany gives some hope that exports will not decelerate markedly.

▪ Data on M3 will be important in the light of the developments in deposits and loans; it may also help estimate the effects of the 500+ child benefit programme.

Last week in the economy – PMI up, rates flat





▪ PMI for the Polish manufacturing surprised as it went up to 52.2pts in September from 51.5pts in August. The rebound was driven mainly by output and new orders (particularly in export) that were rising at the fastest pace since March. Employment grew for the 38th month in a row, at a rate that was slowest for two years. PMI joined several other indexes that improved in September suggesting that Polish manufacturing might have performed quite well in the past month. However, we still see a risk that the GDP growth could be slightly below 3% in 3Q16 (flash estimate will be released in mid-November).

▪ The Monetary Policy Council kept interest rates unchanged, with the main reference rate still at 1.5%. The post-meeting statement was very similar to what we heard in September, and the NBP governor, Glapiński, started the press conference by saying that "nothing interesting is happening". He also reiterated that interest rates should remain on hold this year and in 2017 and, if there are no adverse developments, the next policy decision will be an interest rate hike (but not before 2018). Glapiński admitted that the economic growth in 2016 is slightly lower than expected, but he believes that in 2017 it will be 'excellent'. At the same time, inflation should be trending up (end of deflation in 2016). The biggest central bank's concern is the investment outlook, but according to Glapiński it is 'certain' that investments will rebound, the only question is whether it will be at the end of 2016 or in early 2017. Summing up, the message from the statement and the press conference was similar to what we heard in September – the MPC is not even thinking about monetary policy easing. We would need to see a very disappointing economic data to see reviving expectations for interest rate cuts, especially if the inflation rate is trending up.

Quote of the week – Marek Chrzanowski resigned… again

Marek Chrzanowski, MPC member, 6 October, PAP
My reasons [behind resignation] are purely personal. They are not connected to professional matters.

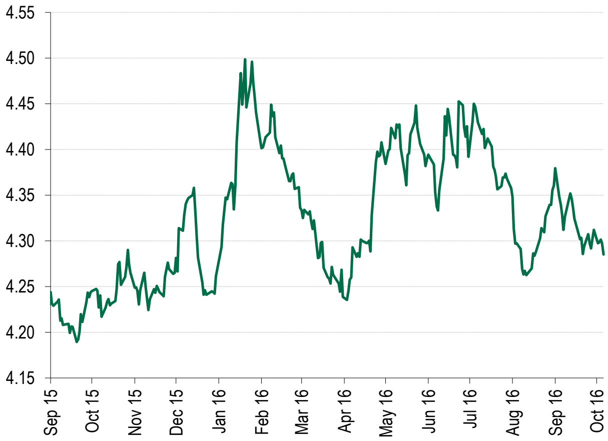
Adam Glapiński, NBP governor, 5 October, MPC conference

Soon the role of the banking regulator will be vested in NBP.

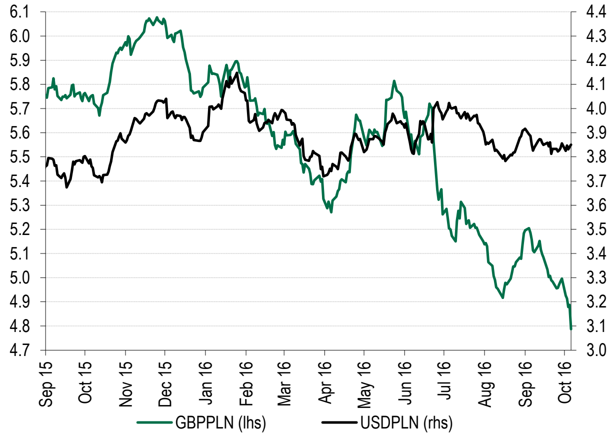
Marek Chrzanowski again filed in his resignation from the MPC due to personal reasons, only a couple of days after he had withdrawn his first resignation. On Thursday the Polish Senate dismissed Chrzanowski. According to the Head of the Senate Chancellery, Jakub Kowalski, the 14-day term for proposing new candidates may start on Monday and the final choice could be made at the turn of November/December. In our view, a change in the MPC's line-up will not influence the Polish monetary policy. The term of office of the KNF (Polish Financial Supervision Authority) Chairman, Andrzej Jakubiak, ends this week, so soon we may hear the names of potential successors. On the other hand, soon the KNF may disappear and the NBP may take over as banking regulator.

Foreign exchange market – Waiting for central banks' speakers

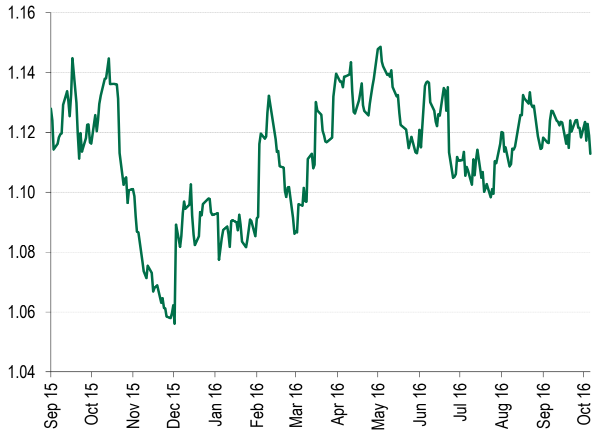
EURPLN



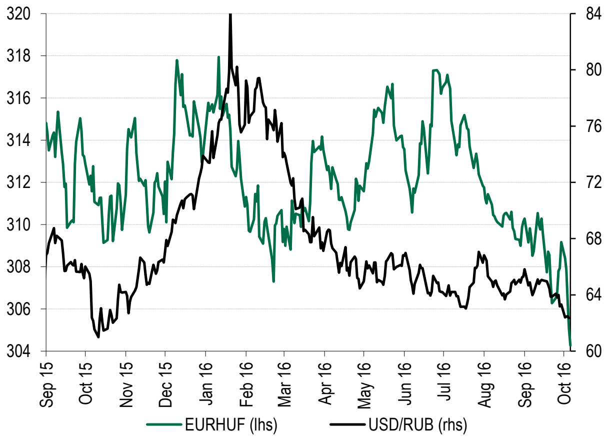
USDPLN and GBPPLN



EURUSD



EURHUF and USDRUB



EUR/PLN near local bottom

- For the better part of the past week EUR/PLN has been trading near 4.30 and only in its final stage the exchange rate fell temporarily to the local bottom at 4.27. At the same time, USD/PLN rose slightly to 3.85 amid lower EUR/USD.
- The zloty has stabilized after the September's rally and we think the time for a more persistent correction is nearing. This time only few global data are on the agenda and they are rather unlikely to trigger any directional trend so investors might decide to take profit after the recent moves. At the same time, numerous central bankers will give a speech. The most recent opinion of the FOMC members were rather hawkish and we think this could persist if they are still on track to hike rates later this year.
- The US non-farm payrolls could decide where the zloty will end the week. The market is looking for an improvement vs the somewhat disappointing August number and if the data are strong, then the CEE currencies could be under pressure.
- We think that some support for the Polish currency could be provided by the August balance of payments. Our forecast for the C/A deficit is slightly above market consensus, but in our view the trade deficit will fall substantially vs July which may be positively received by the market.

More volatility for EUR/USD ahead?

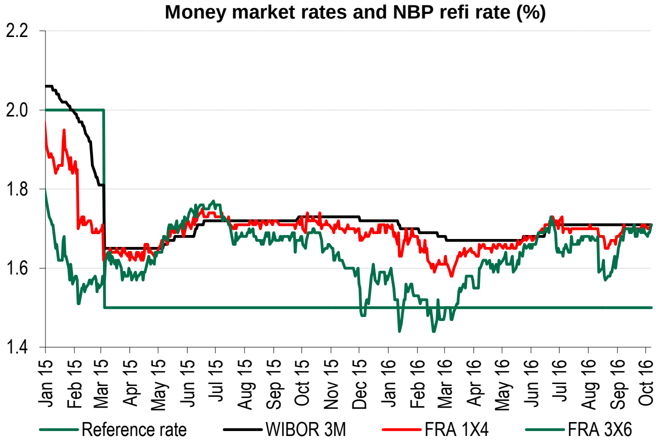
- At the end of the past week EUR/USD was testing the lower boundary of the 1.112-1.135 horizontal trend amid decent US ISM data released earlier in the week and Bloomberg speculating that the ECB could taper its QE program earlier than March 2017. The US non-farm payroll could determine if this attempt to go lower will be successful.
- The EUR/USD volatility has declined after the Brexit vote and now the market is waiting for another trigger that could initiate significant and persistent trend. FOMC and ECB members will give a speech this week so the volatility could rise at last in the short term. We expect FOMC hawkish rhetoric to continue which should be USD-positive. At the same time, investors will be looking for any hint from the ECB speakers if the central bank's plan regarding the asset purchase program has changed.
- Important levels for EUR/USD below 1.112: 1.105 (August bottom) and 1.095 (lowest level in July).

HUF and RUB strongest this year

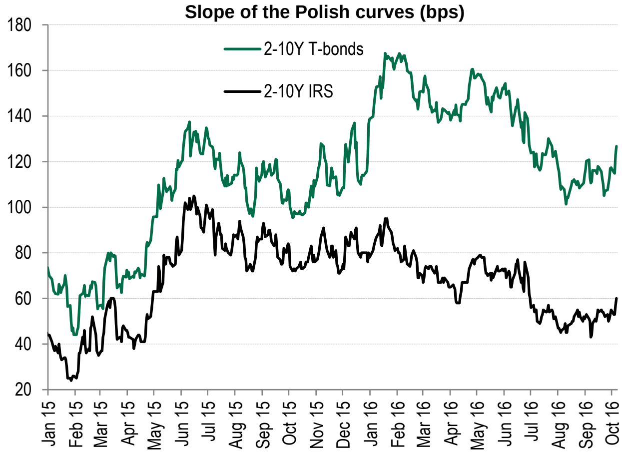
- Both Hungarian forint and Russian ruble outperformed the zloty last week as EUR/HUF and USD/RUB reached their fresh 2016 lows at 303 and 62 respectively. The ruble was benefiting from rising oil prices.
- CEE inflation data will be released this week. Hungarian CPI has been below zero for already four months and now investors expect its return into the positive territory in annual terms. We think that even if inflation surprises to the downside, this does not have to be HUF-negative. In late September, the Hungarian central bank eased the monetary policy injecting more liquidity into the system which had a positive impact on bonds and might have also supported the forint.

Interest rate market – Polish assets still sensitive to global trends

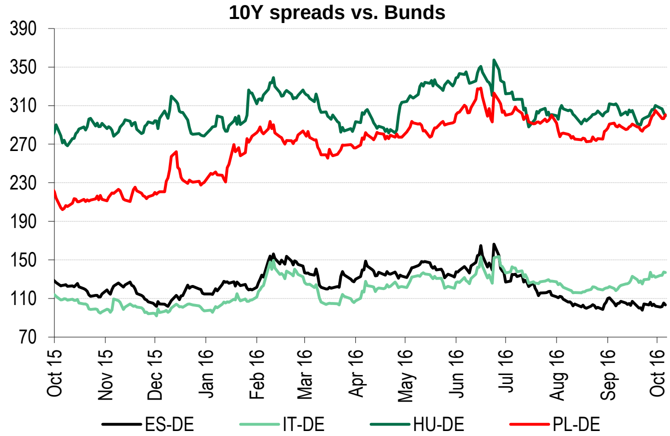
Money market rates and NBP refi rate (%)



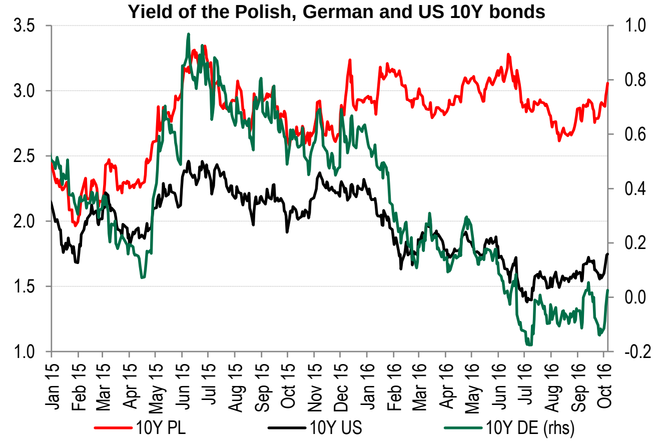
Slope of the Polish curves (bps)



10Y spreads vs. Bunds



Yield of the Polish, German and US 10Y bonds



Weaker Polish debt market due to global trends

- Last week the, Polish IRs rates and yields rose significantly, following global trends. This mainly resulted from investors' concerns that ECB could be tapering its QE programme. The upward trend of yields/rates strengthened after quite strong US macro data, which increased probability of rate hike by Fed till year-end (slightly above 63%) and the outcome from Poland's MPC. Favourable auction results (details below) helped the market to rebound for a while, but the mood quickly returned to quite negative. As a result the yield of 10Y benchmark increased above 3% and 10Y IRS rate rose above 2.40%, both for the first time since the end of June.
- In the first week of October, the belly and the long end of the curves suffered the most from global mood deterioration, while the front end was more or less stable. As a results both IRS and yields curves steepened visibly, with the 2-10Y spread rising to nearly 130bp for T-bonds and to c60bp for IRS. Meantime, risk premia for Poland's assets has remained quite high, with the spread over Bunds for 10Y sector oscillating around 300bp.
- The first bond auction in October was favourable for the Polish Ministry of Finance. The recorded demand totalled nearly PLN10bn, well above the maximum level of the offer (PLN6bn) and mainly concentrated on a new 10Y benchmark, DS0727. All in all, the ministry tapped bonds worth PLN6.8 in total on both regular and top-up auctions. We estimate that after the yesterday's auction 94% of this year's borrowing needs are covered.
- On the money market, FRAs increased markedly, following upward move in IRS. The market still does not price in any changes in NBP rates in the coming months as suggested by the MPC. At the same time WIBORs did not change over the past week.

Global factors in the spotlight

- This week is quite busy in terms of domestic (inflation rate, balance of payment and M3) and foreign (CEE inflation, some data from the Euro zone and USA) macro data releases and events (mainly FOMC minutes). In our view, the final inflation rate reading for September will be rather neutral for domestic market as we expect the reading to confirm the flash number of -0.5% y/y. This, together with the core inflation figures close to historical low, should support the front end of the curves close to the current levels.
- Recent changes in both yields and IRS rates clearly show that Polish interest rate market is very sensitive to the global trends. The US September job report could trigger significant moves on the core market, and thus in Poland. In our view, the market reaction could be asymmetric – weakening after the positive surprise could be smaller than gains after the disappointing number. What is more, this week FOMC minutes and comments from the Fed members will be closely watched by investors. In our view, any signs, which may boost expectations for Fed interest rate hikes later this year will result in pushing up yields in core debt markets. The latter factors may justify a gradual rise in yield of the 10Y benchmark and a further steepening of the curves.
- The yield of the 10Y benchmark is now slightly above 3%. We think that this level is still attractive for investors hunting for yields. Therefore, any sentiment improvement on the core market will quickly translate into a reverse trend on the Polish assets.

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