Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

24 – 30 October 2016

Recent data from the Polish economy confirmed our worries that GDP growth has probably slid below 3% y/y in the third quarter. Moreover, the statistical office has just informed that it had revised up GDP growth in 2015 (from 3.6% to 3.9%), which may imply that the slowdown in 2016 will be deeper than estimated earlier (effect of higher base). If the flash GDP data for 3Q16 – to be released in mid-November – show the pace of economic growth closer to 2.5% than 2.9%, market expectations for interest rate cuts may start reviving, especially that even before this release, the NBP will publish its new economic projections with paths of GDP and CPI likely to be revised down. Recently, we have seen signals from some MPC members suggesting that they may change their stance to less hawkish if economic data keep disappointing.

The calendar of data releases in Poland is almost empty this week – neither the registered unemployment rate nor the monthly Statistical Bulletin are news that could affect the market sentiment significantly. Investors will eye data publications and central bankers' comments abroad and if they imply higher probability of the Fed interest rate hike in December, both the zloty and the Polish bonds may weaken. Apart from the FOMC policy, other factors that may weigh on the Polish currency in the coming weeks include uncertainty ahead of the US elections, risk of hard Brexit, disappointing economic growth in Poland, works in the Sejm on lowering retirement age and on CHF loans issue (the Sejm has not rejected the costly Kukiz'15 proposal of loans conversion, but sent it to the Public Finance Committee). As regards the fixed income market, we expect the Polish yields to be trending up in the medium run, following core markets. However, short-term corrections (like the one in the recent few days) are possible, as in the world of ultra-low interest rates the yield of Polish 10Y bond at 3% may seem attractive to foreign players.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (24 October)					
9:30	GE	Flash PMI – manufacturing	Oct	pts	54.3	-	54.3
9:55	EZ	Flash PMI – manufacturing	Oct	pts	52.6	-	52.6
		TUESDAY (25 October)					
10:00	**PL**	**Unemployment rate**	**Sep**	**%**	**8.4**	**8.4**	**8.5**
10:00	GE	Ifo index	Oct	pts	109.6	-	109.5
14:00	HU	Central bank decision		%	0.90	-	0.90
16:00	US	Consumer confidence index	Oct	pts	101.0	-	104.1
		WEDNESDAY (26 October)					
16:00	US	New home sales	Sep	% m/m	-1.2	-	-7.6
		THURSDAY (27 October)					
14:30	US	Initial jobless claims	week	k	-	-	260
14:30	US	Durable goods orders	Sep	% m/m	0.1	-	0.1
16:00	US	Pending home sales	Sep	% m/m	1.2	-	-2.4
		FRIDAY (28 October)					
14:30	US	Advance GDP	Q2	% q/q	2.5	-	1.4
16:00	US	Michigan index	Oct	pts	88.1	-	91.2

Source: BZ WBK. Reuters. Bloomberg

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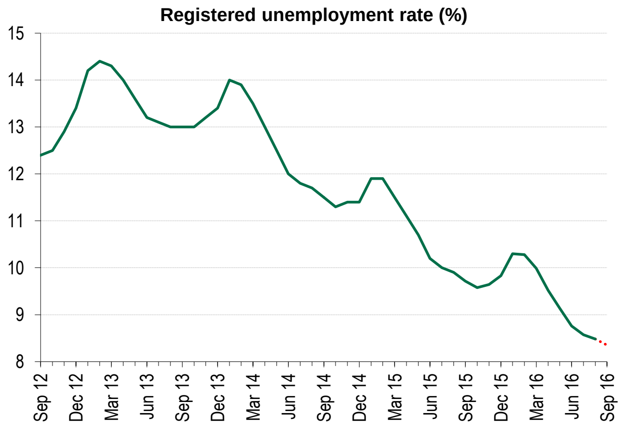
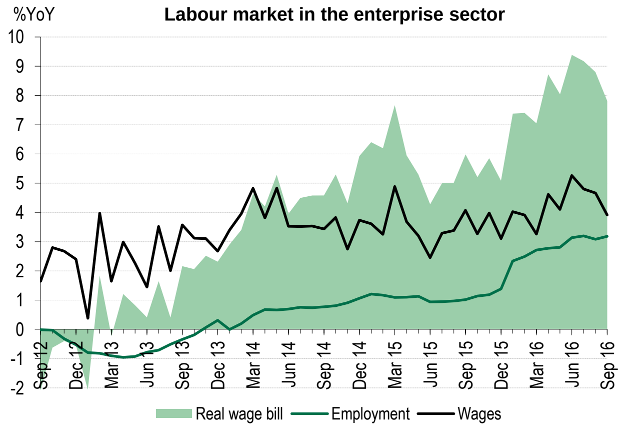
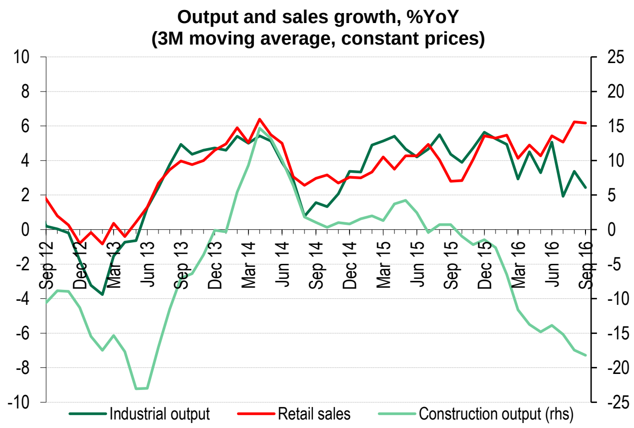
What's hot this week – Unemployment lower again



- Registered unemployment rate probably fell again in September, reaching 8.4%, its lowest level since the early 90s. The downward trend in unemployment in the recent months resulted from two factors: still solid companies' demand for new workers and gradually shrinking labour force. We think that this trend will continue in the coming months.
- The publication of a new monthly Statistical Bulletin from GUS is not likely to be a significant event for the market. Instead, investors may focus on data releases abroad, in particular flash PMI indicators in Europe, German Ifo index, and the first estimate of 3Q GDP growth in the USA.

Last week in economy – Industrial production and retail sales disappointed again





- Average wage growth in the corporate sector slowed in September to 3.9% y/y (down from 4.7% y/y in August and below the 4.5% market consensus), while employment growth accelerated to 3.2% y/y (up from 3.1% y/y in August and above the 3.1% consensus). It seems quite surprising that the pace of salary growth has decelerated, despite the unemployment rate having fallen to its all-time low and the highest pace of job creation since 2008. To some extent, it could be the result of the high base effect (the monthly wage increase in September 2015 was the highest in the last ten years) and less supportive calendar effect than in August. We think that in the coming months, wage pressure will mount due to the growing scarcity of the available workforce. Overall, the pace of labour income growth is still impressive – in September the average wage bill rose 7.8% y/y in constant prices – which should support the solid growth of private consumption.
- Industrial production in September rose 3.2% y/y, construction output fell 15.9% y/y, while retail sales rose 6.3% y/y (in constant prices). Despite a slight rebound in construction, we think that on balance the data were disappointing and confirmed that the GDP growth in 3Q16 was probably below 3% y/y. However, it has to be noted that the forecast error is bigger than usually, as the stat office informed earlier today about the upward revision of GDP growth in 2015, without providing the revised quarterly time series. Amid investment falling and export growth slowing down, private consumption is now the main engine of economic growth in Poland. However, its pace of growth also seems to be disappointing, in our view, taking into account solid growth of households' revenue (from both labour and family subsidies). We maintain the view that the next quarters are unlikely to see acceleration of economic growth above 3% y/y.

Quote of the week – Interest rate cut also possible

Eryk Łon, MPC member, 20 Oct, Nasz Dziennik

If it turns out that deflationary trends deepen and the pace of economic growth weakens, then, in my view, we could seriously consider interest rate cuts.

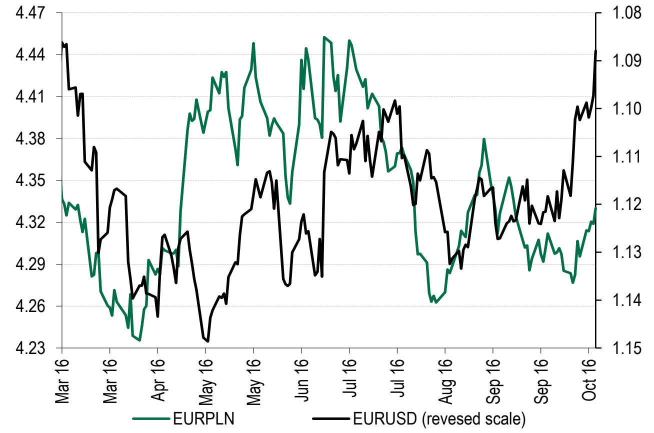
Łukasz Hardt, MPC member, 20 Oct, PAP

In my opinion, probability of interest rate hike next year has increased slightly. Interest rate cut is also possible in a situation of decelerating economic growth and CPI inflation hovering near zero. … Even if CPI inflation approaches the lower end of fluctuations band around target, i.e. to 1.5%, then for me it is not sufficient to decide about interest rate hike.

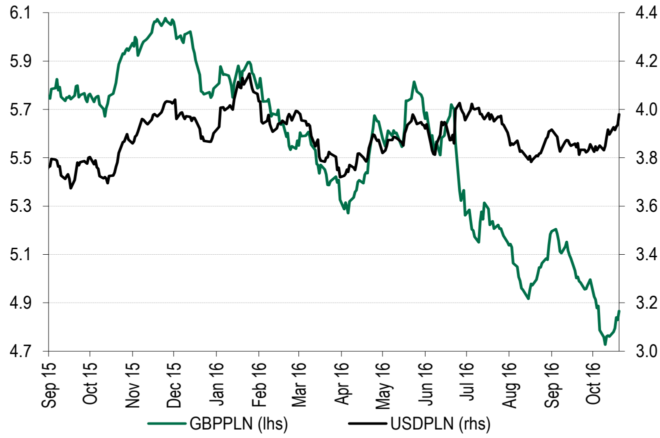
Recent comments made by the Monetary Policy Council members seem to suggest that some of them have become more concerned about possible economic slowdown in Poland (Łon and Hardt last week, Ancyparowicz a week earlier). Even though Hardt said that rate hike next year had become more likely, he admitted that CPI at 1.5% would not trigger such a move. Meanwhile, we see a diminishing risk that inflation will surge above 1.5% in 2017, but, instead, there is a growing probability that economic growth may disappoint further. Our base-case scenario still assumes stable interest rates until the end of 2017. However, if the next economic data show GDP growth much below 3% and inflation rebound lower than expected, market expectations for interest rate cuts in Poland may revive, in our view.

Foreign exchange market – Global factors key for the zloty

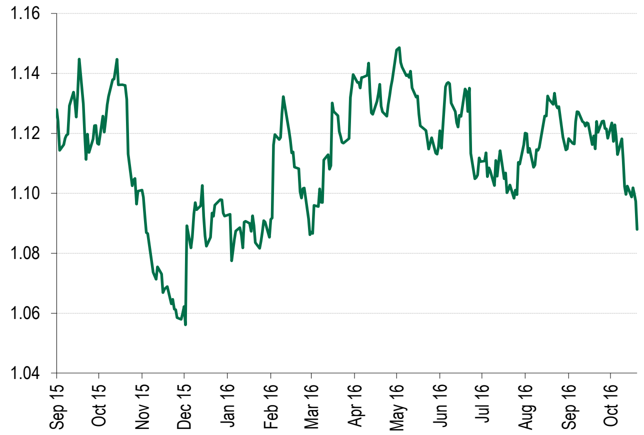
EURPLN and EURUSD



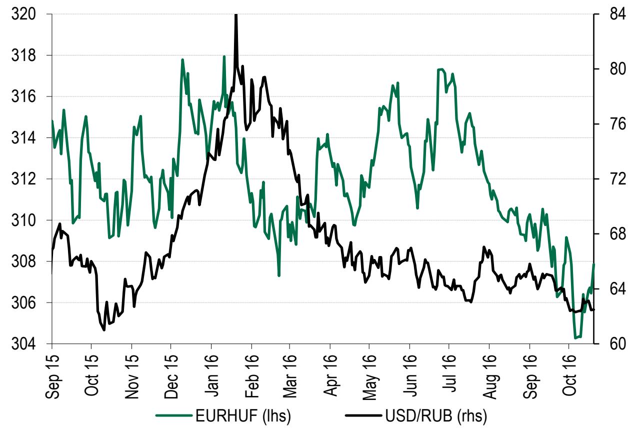
USDPLN and GBPPLN



EURUSD



EURHUF and USDRUB



Zloty underperforms EM peers

▪ Last five sessions saw zloty's depreciation vs the euro but the pace of weakening was slower than in the previous week. EUR/PLN rose temporarily to nearly 4.34 on the weak market sentiment after the weekend. USD/PLN skyrocketed to 3.98 from 3.91 as the dollar gained due to higher chances of a Fed rate hike and the outcome of the ECB meeting. The zloty depreciated also vs the British pound and Swiss franc. Since last Friday, the zloty has been the second weakest EM currency versus EUR, GBP, CHF and GBP.

▪ Recent zloty's performance was in line with our expectations as we still think EUR/PLN could rise in the weeks to come due to below-consensus economic growth and uncertainty related to the global factors (Fed rate hike, US presidential elections).

▪ This week, a lot of foreign data is to be published and FOMC members are due to speak. Since August EUR/PLN has once again been negatively correlated with EUR/USD so we conclude that the zloty could depreciate further if this year's Fed rate hike becomes more likely. At the same time, we see that since September the zloty has been sensitive to trends prevailing on the European equity market, so any disappointing macro releases from Germany may negatively impact the Polish currency as they could translate into higher risk of slower domestic economic growth and higher probability of rate cuts.

EUR/USD below post-Brexit low

▪ EUR/USD plummeted below the post-Brexit low and broke 1.09 reaching its lowest since late February. The US dollar gained thanks to rising chances of a December Fed interest rate hike and a significant decline was seen also after the ECB meeting.

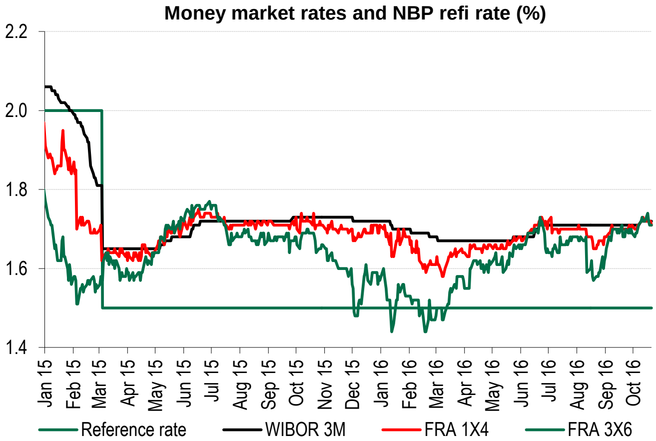
▪ Monetary policy issues shall continue to play the major role for EUR/USD this week as plenty of global macro data are on the agenda and numerous FOMC members will speak. US politics may also start attracting more attention as the presidential elections are getting closer. EUR/USD broke the post-Brexit bottom and the first resistance to watch now is at c1.08.

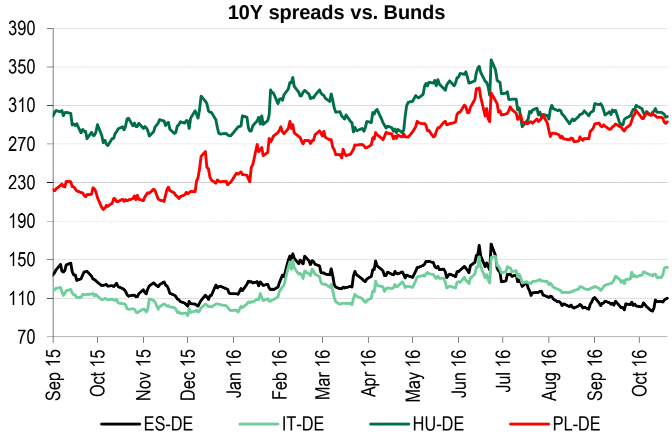
Forint under pressure, ruble stable

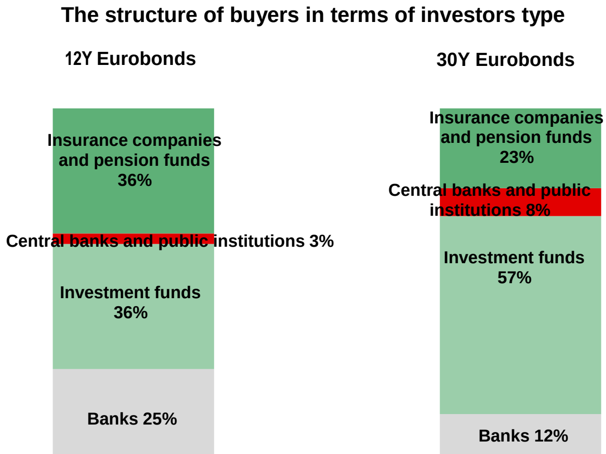
▪ Forint followed trends seen on the PLN market and has lost vs the euro for the second week in row with EUR/HUF reaching 308. At the same time, USD/RUB stabilized just above this year's bottom at just below 62.

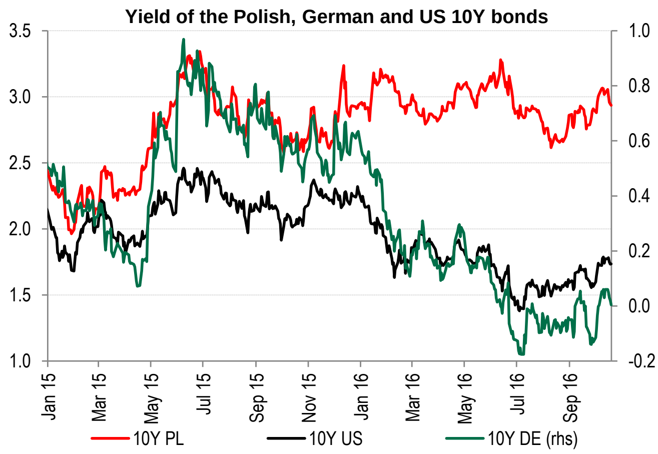
▪ This week, Hungarian central bank announces its decision on the interest rates. Last month MNB left rates unchanged but cut the value of cash banks can park on deposits. We think this week MNB will stay on hold and global events should be the main driver for EUR/HUF. In the previous week, the exchange rate broke out of the horizontal trend observed since 2Q15 and in the context of technical analysis, this suggests that the forint should remain strong. At the same time, we do not see much appreciation potential for the ruble given the looming Fed rate hike, risk of a correction of oil prices after the recent rally and US/EU politicians talking about extending economic sanctions on Russia. The Russian central bank will probably leave interest rates unchanged this week (in line with its recent rhetoric) and this should be a non-event for the market.

Interest rate market – Core market sets direction









Yield of the 10Y benchmark again below 3%

▪ Poland's interest rate market strengthened visibly over the past week. Both IRS rates and yields fell 1-10bp on a weekly basis, following the global trends. Domestic debt market also gained following the information on successful Eurobonds issue (details below) as this may imply lowering supply of zloty-denominated debt. Domestic macro data releases were more or less neutral for investors. Market response to the ECB's outcome was muted as the bank kept its monetary policy unchanged and directed investors' attention to the December meeting, when new macro forecasts will be released. All in all, the yield of 10Y benchmark dropped below 3% for the first time in two weeks.

▪ Both IRS and bond yields curves flattened visibly as the belly and the long end of the curve benefited the most from strengthening of the core debt market. At the same time, the front end of the curve rebounded only somewhat. Furthermore, both asset swap spread for 10Y sector tightened gradually as T-bonds market gained more than IRS. At the same time, risk premium set by spread over Germany bonds also narrowed towards 290bp.

▪ On the money market, WIBOR rates 1M and 12M increased by 1bp, while other rates remained unchanged. At the same time, FRA rates decreased slightly following situation on the IRS market. Investors keep their expectations for a virtually stable rates in the next 21 months.

Intense week on primary debt market

▪ Last week was quite intense for the Polish primary market. Poland successfully launched bonds denominated in euro, tapping 12Y and 30Y worth €750m and €500m, respectively. The shorter bond was priced 48bp above the swap curve (which implies yield 1.058%), while the longer one 120bp above swap curve (yield 2.122%). Deputy finance minister, Piotr Nowak, said that the ministry wanted to use opportunity of good market sentiment and low yields to pre-finance the 2017 gross borrowing needs, and to protect itself from potential rise of uncertainty due to situation in the USA.

▪ At the last October's auction on domestic market, the Ministry of Finance sold floaters (WZ0121 and WZ1122) and a new 5Y benchmark PS0422 worth PLN9.94bn in total. Recorded demand was solid and amounted to PLN12.2bn (more than the upper limit of offer worth PLN10bn). Auction yield of the 5Y bond PS0422 reached the level of 2.499%.

Global factors remain key issue

▪ This week's domestic macro calendar is light as only the registered unemployment rate will be released. This data is neutral for the market players. In our view, end of the week may bring lower domestic investors' activity ahead of national holiday on November, 1st.

▪ Investors will focus on the global factors, both macro data releases (in particular 3Q GDP data in the USA, flash PMI indices for the Euro zone countries) and speeches of central bankers from ECB and Fed. We think that data from the USA should support market expectations for a rate hike by Fed in December (now market sees 68% probability of such decision). It will mean higher volatility on the belly and the long end of the curves and, as a result, we cannot rule out some profit taking after recent strengthening.

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