Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

14 – 20 November 2016

This week's agenda is full of important events and data releases. Flash 3Q GDP data will be the key publication in Poland. In our view, the message from the last MPC meeting suggested that if growth goes only slightly below 3% y/y, it may be not enough to change the monetary policy outlook. Other data are likely to confirm dissipating deflation and strong labour market.

Bond market weakened sharply after the US elections, mainly due to expectations that Trump's economic policies may trigger higher fiscal deficit and higher inflation. A correction after such strong selloff (at least temporary) is quite likely, but in our view, its timing is not certain . In the medium run, we still expect global bond yields to mount higher. The weakening of the zloty after Trump's victory was initially quite modest, but gained steam just before the long weekend. We see very little potential triggers for zloty appreciation in the near future, except for global moods improvement.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (14 November)					
11:00	EZ	Industrial output	Sep	% m/m	-	-	1.6
14:00	**PL**	**CPI**	**Oct**	**% y/y**	**-0.2**	**-0.2**	**-0.5**
14:00	**PL**	**Current account balance**	**Sep**	**€m**	**-605**	**-616**	**-1047**
14:00	**PL**	**Exports**	**Sep**	**€m**	**15680**	**15820**	**13750**
14:00	**PL**	**Imports**	**Sep**	**€m**	**15531**	**15889**	**14259**
14:00	**PL**	**Money supply M3**	**Oct**	**% y/y**	**9.0**	**8.8**	**9.3**
		TUESDAY (15 November)					
8:00	DE	Flash GDP	Q3	% y/y	-	-	1.8
9:00	HU	Flash GDP	Q3	% y/y	1.7	-	2.6
9:00	CZ	Flash GDP	Q3	% y/y	2.1	-	2.6
10:00	**PL**	**Flash GDP**	**Q3**	**% y/y**	**3.0**	**2.9**	**3.1**
11:00	DE	ZEW index	Nov	pts	-	-	59.5
11:00	EZ	GDP	Q3	% y/y	-	-	1.6
14:00	**PL**	**Core inflation**	**Oct**	**% y/y**	**-0.3**	**-0.4**	**-0.4**
14:30	US	Retail sales	Oct	% m/m	0.6	-	0.6
		WEDNESDAY (16 November)					
15:15	US	Industrial output	Oct	% m/m	0.2	-	0.1
		THURSDAY (17 November)					
11:00	**PL**	**Bond auction**					
11:00	EZ	HICP	Oct	% y/y	-	-	0.4
14:30	US	House starts	Oct	% m/m	10.7	-	-9.0
14:30	US	Building permits	Oct	% m/m	-2.9	-	6.3
14:30	US	CPI	Oct	% m/m	0.4	-	0.3
14:30	US	Philly Fed index	Nov	pts	8.0	-	9.7
14:30	US	Initial jobless claims	week	k	-	-	265
		FRIDAY (18 November)					
14:00	**PL**	**Wages in corporate sector**	**Oct**	**% y/y**	**4.2**	**4.2**	**3.9**
14:00	**PL**	**Employment in corporate sector**	**Oct**	**% y/y**	**3.1**	**3.1**	**3.2**

Source: BZ WBK. Reuters. Bloomberg

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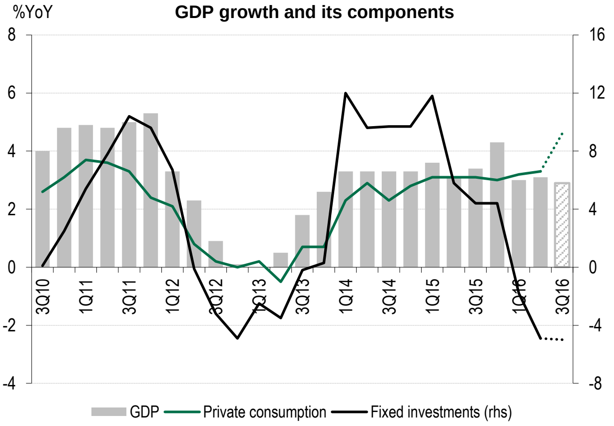
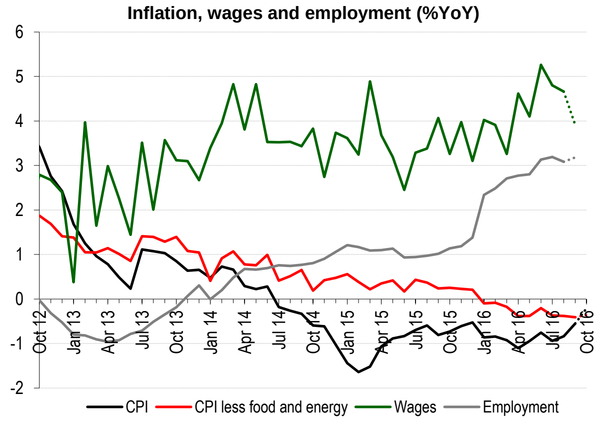
What's hot this week – Large bunch of important Polish data





- Flash 3Q16 GDP will be the most important figure of the week. In our view, economic growth decelerated to 2.9% y/y, mainly on the back of weaker exports and investment. On the other hand, we are expecting a stronger contribution of private consumption, which is likely to be underpinned by the 500+ programme. It should be noted, however, that a detailed breakdown of GDP growth will be released at the end of the month. In our view, such a deceleration will not be enough to make the MPC mull rate hikes unless there will be some evidence that the slowdown is persistent.
- We expect CPI to remain unchanged versus the flash estimate at -0.2% y/y. Core inflation may have remained flat at -0.4% y/y. According to our forecasts, CPI went up due to rising food and fuel prices. We will get to see whether the actual data will confirm our view. We expect positive price growth in December and CPI at about 1% y/y in 2017.
- In our view, current account deficit will narrow in September as compared to August. . This development will be mostly driven by lower trade deficit, while both exports and imports will decelerate in annual terms.
- M3 money supply growth most likely went down in October to 8.8% y/y from 9.3% y/y in September due to slower growth in deposits and cash in circulation.
- In our view, employment increased a bit in October, following the trends observed earlier. Wage growth is likely to rebound slightly versus September (3.9% y/y) due to salary increases in the retail trade. On the other hand, the negative working-day effect will exert a negative pressure on wage growth.

Last week in economy – MPC has not changed its course

	GDP growth			
	Nov 15	Mar 16	Jul 16	Nov 16
2016	2.3÷4.3	3.0÷4.5	2.6÷3.8	2.3÷3.4
2017	2.4÷4.6	2.6÷4.8	2.4÷4.5	2.6÷4.5
2018	-	2.1÷4.4	2.1÷4.3	2.2÷4.4
	CPI Inflation			
	Nov 15	Mar 16	Jul 16	Nov 16
2016	0.4÷1.8	-0.9÷0.2	-0.9÷-0.3	-0.7÷-0.6
2017	0.4÷2.5	0.2÷2.3	0.3÷2.2	0.5÷2.0
2018	-	0.4÷2.8	0.3÷2.6	0.3÷2.6

- The MPC left monetary policy unchanged, with the main reference rate still at 1.5%. The new NBP projection assumes that inflation path will be very similar to the one predicted in July, and GDP growth will be a bit lower in 2016 but slightly higher than predicted in July in the next two years.
- Adam Glapiński reiterated that he believes there would be no reason to change interest rates in 2017, unless GDP growth and inflation accelerate sharply (GDP growth at 3.6% and inflation at 1.5% would be no reason to hike rates, in his view). Other MPC members present at the press conference – J. Żyżyński and E. Łon (considered as relatively dovish) – confirmed that interest rates are currently at optimal level, as GDP growth is decent and inflation trending up.
- There are no significant changes in the Polish MPC's stance at this stage.

Quote of the week – No risk that EDP will be reintroduced

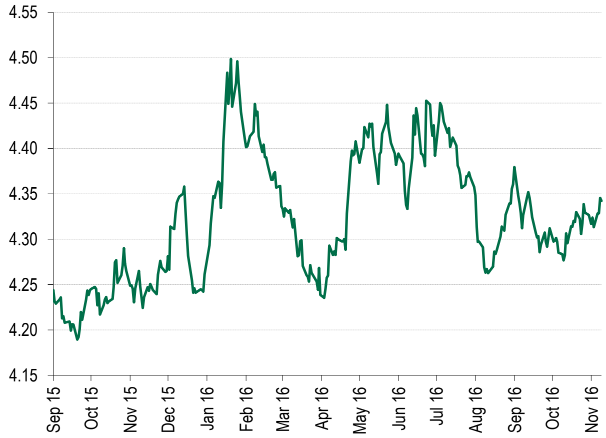
Mateusz Morawiecki, deputy prime minister, 9 Nov, PAP

Nominal realisation of the central budget is headed below PLN40bn. Tax receipts are more or less in line with this year's plan. (…) European Commission's forecast and actions aimed at improving tax collection show there is no risk that excessive deficit procedure will be reintroduced. Stable forecasts of potential GDP growth confirm that the European Commission is positive about Polish economic fundamentals.

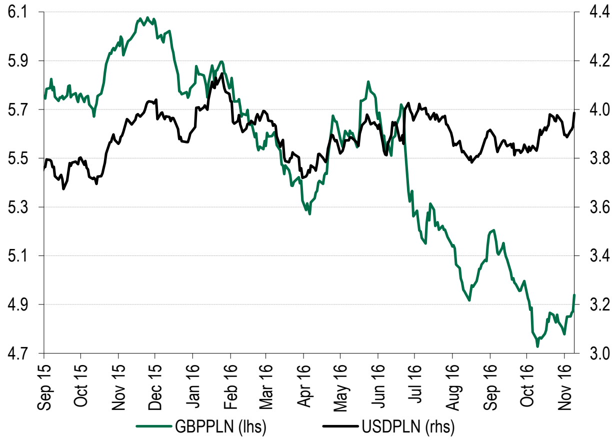
After 9 months of the year, the central budget deficit amounted to PLN20.6bn i.e. to 58% of the plan at PLN35.5bn. After September revenues are by 3.6% higher than planned in the budget act, while spending by 2.5% lower. Central budget deficit was assumed at PLN54.7bn, but we agree with Morawiecki that it may be lower and even fall in PLN35-40bn range. The European Commission expects general government deficit at 2.4% in 2016, 3.0% in 2017 and 3.1% in 2018 and such a level of deficit is unlikely to trigger the introduction of excessive deficit procedure. However, the structural deficit is expected to reach 2.8% in 2016, 3.1% in 2017 and 3.3% in 2018 – all 3 numbers are higher than in 2014 and 2015. This means that a more considerable slowdown will send the Polish deficit markedly above the 3% mark.

Foreign exchange market – Zloty has remained under pressure

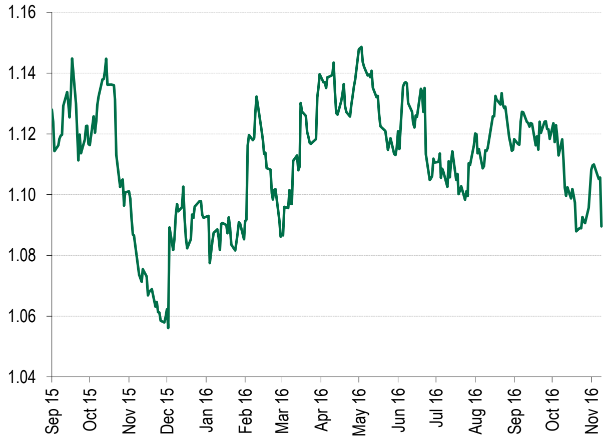
EURPLN



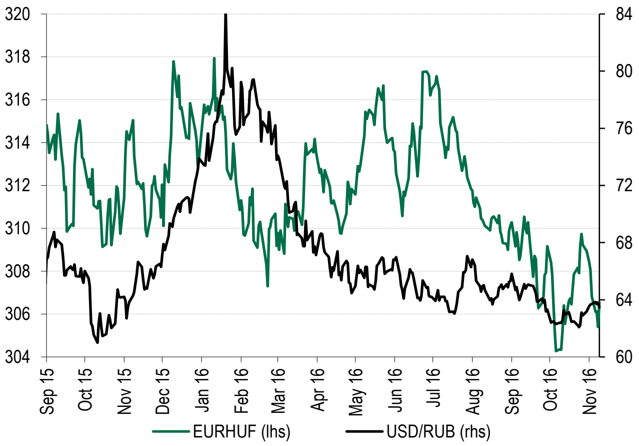
USDPLN and GBPPLN



EURUSD



EURHUF and USDRUB



Zloty suffered from the Trump's victory

- Last week, the key event on the Polish FX market was the US presidential election. In previous weekly report, we pointed out that volatility on the Polish FX market could rise, leading to zloty's weakening and it seems that this scenario has started materializing. Zloty lost in reaction to the Trump's victory, but its weakening was different depending on the main currency. While EURPLN rose temporarily to nearly 4.36, CHFPLN climbed above 4.06 for the first time since mid-July and GBPPLN rose above 5.00, its highest since the end of September. USDPLN was also very volatile, however firstly the rate fell sharply to nearly 3.84 and then increased sharply above 4.00 (for the first time since June). Market response to the MPC decision to keep interest rates unchanged was neutral as such decision was expected.
- The Polish zloty was the second weakest, after the Mexican peso, currency among the EM universe, staying under pressure of increasing probability that Fed will hike rates in December (above 80% chance according to Bloomberg). However, this weakening was quite benign as compared to Mexican currency. The zloty remained quite volatile before the long weekend in Poland, with EURPLN rising above the resistance level of 4.36.
- This week's domestic macro calendar is heavy as a bulk of data will be released, including September's balance of payments, inflation data (headline and core), and flash GDP for 3Q16. In our view, the last data will be the most important; our forecast at 2.9% y/y is slightly below market consensus of 3%. We think that only significant disappointment of this reading may affect the zloty as only in this case, the MPC will be more willing to change its approach to economic outlook. Otherwise, it will confirm the status quo in Polish monetary policy, bringing an impulse to some rebound after recent losses. Also the US macro data, which are due this week, may bring some revival for the zloty if data disappoint. Important levels for EURPLN are 4.39 and 4.30.

The US dollar strengthened after the elections

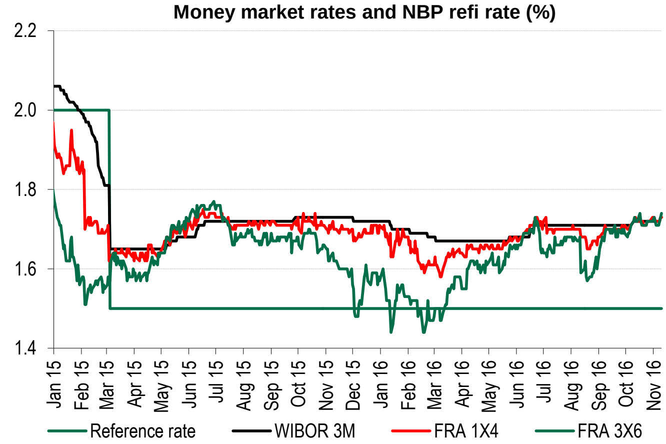
- The US dollar weakened significantly in the first reaction to the outcome of the US presidential elections and a sharp decline in probability that Fed will hike rate in December. As a result, EURUSD rose towards 1.13, the highest since late August. However, the upward move was only short-lived and it quickly reversed as market players shifted their attention to Fed's monetary policy. Investors still price-in a rate hike by 25 bp in December and this supports the US dollar. EURUSD fell to 1.088 for a while and then stabilized around 1.09.
- This week's calendar of macro data from both Europe and the USA is quite heavy. In our view, weaker than expected outcome from the US macro data may bring impulse to some correction on the US dollar after significant strengthening.

HUF and RUB weakened somewhat after the US elections

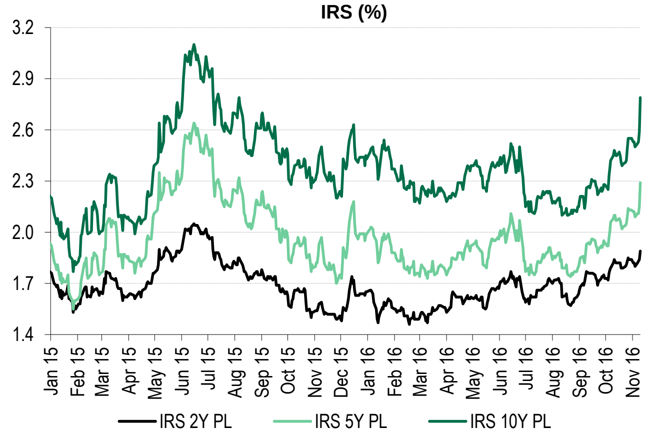
- CEE currencies response to the Trump's victory in the US presidential elections was muted. After an initial sell-off in forint, ruble and koruna, they recovered very quickly. However, the Hungarian forint, similarly to the Polish zloty, stayed under pressure, with EURHUF growing towards 308.
- This week, investors will focus not only on macro data releases abroad (mainly data from the USA), but also on domestic data in each CEE countries, in particular flash GDP growth for 3Q16. We think that the recently released PMI data for Hungary, Czechia and Russia should support quite strong economic activity in all countries. If flash GDP data confirm it, we expect some rebound in CEE currencies.

Interest rate market – 10Y bond yield above 3.30%

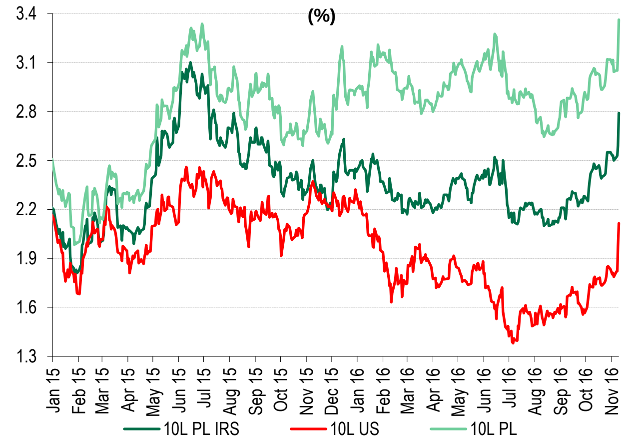
Money market rates and NBP refi rate (%)



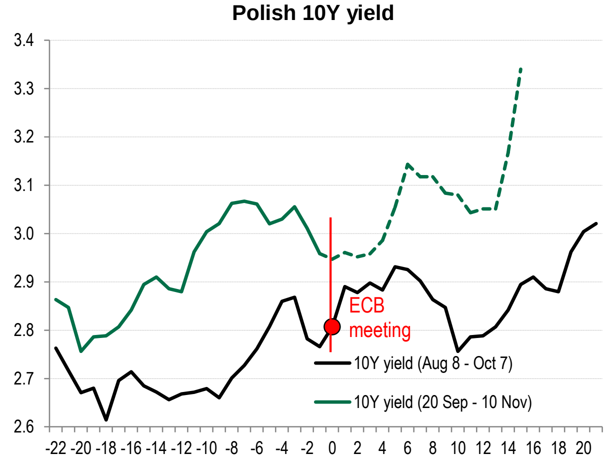
IRS (%)



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



Polish 10Y yield



Rates jump on Trump's victory

- Unsurprisingly, the outcome of the US presidential elections was the main event last week. Surprisingly, Donald Trump won against Hillary Clinton contrary to expectations, shocking investors and triggering sharp swings on the global market. The first reaction of bonds was calm but soon investors started to price in rise of the fiscal deficit in the US and faster Fed rate hikes amid higher economic growth and inflation. This pushed market rates sharply up across the board with Polish 10Y bond yield rising to c3.35% (slightly above the June 2016 peak and highest since June 2015) and the respective IRS to 2.79% (highest since July 2015). Last week, we suggested that Polish debt may weaken if Trump wins but the PL-DE spread should not rise. While the former proved correct, Polish 10Y bond clearly underperformed its German peer and the spread rose to 306bp from 290bp. The asset swap spread increased only slightly holding near 55bp. One should notice that relatively low liquidity on the Polish market was an important factor that exaggerated the scale of domestic debt weakening.
- FRAs rose, though clearly less than IRS. 3-9M WIBORs rose 1bp on a weekly basis.

Will US data provide support?

- This week, Poland's flash 3Q GDP is on the agenda. We and the market expect further slowdown and bonds might regain some ground this proves correct. However, it should be noted that the stat office has revised GPD for 2015 (without showing which quarters have been revised) so the uncertainty related to this week's release is even higher than usually. We expect final CPI to confirm the flash release. Labour market data should also be rather market neutral.
- Numerous US data are due to be released this week. After a temporary doubt in December Fed rate hike, the market is now again pricing c80% chance for a 25bp adjustment next month. Consequently, we think that the investors' reaction to these data should be larger if they disappoint rather than when they surprise to the upside.
- It should be noted that the Polish 10Y bond yield continues to follow the pattern we presented in mid-October on the occasion of the looming ECB's decision. Surprisingly, not only the direction, but also the timing match the path. Should this hold, some mild recovery should be expected in the days to come and then, the upside trend shall resume.
- The bond auction is planned for Thursday and we think that the Finance Ministry may sell PS0422 (it was not offered on the switch auction earlier this month). Last week, yield of this bond rose above 2.85%, which has been its highest since its first issuance in late October. The Ministry of Finance is in a comfortable situation as this year's borrowing needs are already covered (even if we assume that this year's budget deficit will be in line with the plan, while actually it may be lower) and the next year's needs are pre-financed in c5%, according to our calculations. That is why we do not exclude that the second November's auction will be cancelled.

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