Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

21 – 27 November 2016

Last week global market sentiment was weak and risk-off mode has continued. Flash data on GDP for 3Q16 has clearly disappointed as the Polish economic activity decelerated to a mere 2.5%YoY, which was the lowest reading in three years. The detailed data will be released at the end of November, so at this stage it is difficult to assess what was behind the slowdown. However, it is likely that the turn of 2016/17 will show even weaker GDP growth and the market may start speculating again about policy easing in future, especially that the last data have already revealed diverging views of the MPC members. Polish assets were under pressure over the past week, with EURPLN rising to 4.46 and yield of 10Y benchmark temporarily up to 3.75%. What is more, a bear steepening has continued on the debt market, with the front end of the curves outperforming other sectors.

This week macro calendar in Poland and abroad is quite heavy. In our view, investors will mainly focus on the US macro data releases and minutes from November's FOMC meeting. While December's hike by Fed is on the table, investors are worried that the scale of monetary tightening next year will be higher than previously expected. Therefore, the data will be considered through the lens of further monetary policy in the USA. Moreover, another set of Poland's data from real economy is due this week. Our forecasts are below market consensus, suggesting further slowdown in economic activity at the start of 4Q16. This data will be rather zloty negative in the short run, but we do not expect further significant zloty's depreciation against the euro later in the year. We still expect the front end of the curves to outperform other sectors, as the long end of the curve will be still affected by global factors. Consequently, the curves should remain steep in the upcoming days.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (21 November)					
14:00	**PL**	**Industrial output**	**Oct**	**% y/y**	**1.1**	**-0.1**	**3.2**
14:00	**PL**	**Real retail sales**	**Oct**	**% y/y**	**5.4**	**6.0**	**6.3**
14:00	**PL**	**Construction and assembly output**	**Oct**	**% y/y**	**-15.8**	**-17.1**	**-15.3**
14:00	**PL**	**PPI**	**Oct**	**% y/y**	**0.4**	**0.4**	**0.2**
		TUESDAY (22 November)					
14:00	HU	Central bank decision		%	0.90	-	0.90
16:00	US	Home sales	Oct	% m/m	-0.6	-	3.2
		WEDNESDAY (23 November)					
09:30	GE	Flash PMI – manufacturing	Nov	pts	54.7	-	55
10:00	EZ	Flash PMI – manufacturing	Nov	pts	53.2	-	53.5
14:30	US	Durable goods orders	Oct	% m/m	1.1	-	-0.3
14:30	US	Initial jobless claims	week	k	-	-	
16:00	US	New home sales	Oct	% m/m	-0.5	-	3.1
16:00	US	Michigan index	Nov	pts	91.6	-	87.2
20:00	US	FOMC minutes					
		THURSDAY (24 November)					
	US	Market holiday					
08:00	GE	GDP	Q3	% y/y	-	-	1.7
10:00	GE	Ifo index	Nov	pts	110.5	-	110.5
14:00	**PL**	**MPC minutes**					
		FRIDAY (25 November)					
10:00	**PL**	**Unemployment rate**	**Nov**	**%**	**8,2**	**8,2**	**8.3**

Source: BZ WBK. Reuters. Bloomberg

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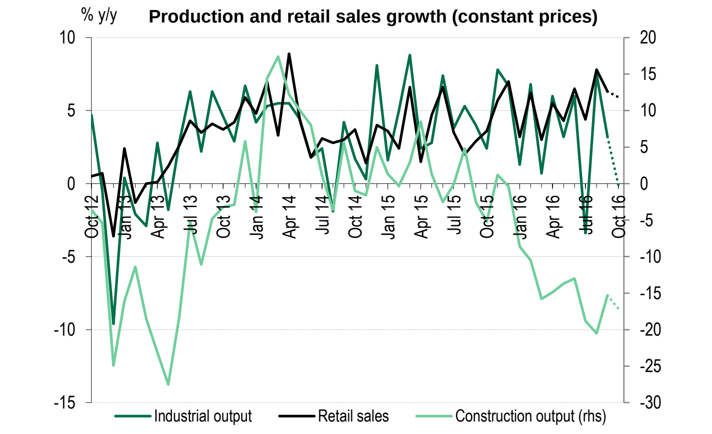
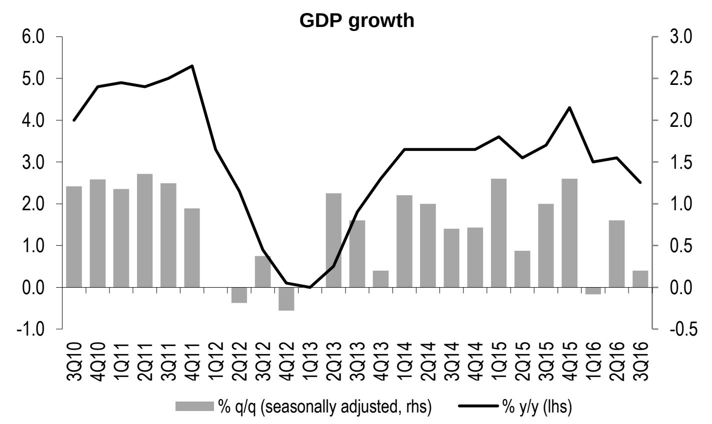
What's hot this week – Output in industry and construction, retail sales and unemployment

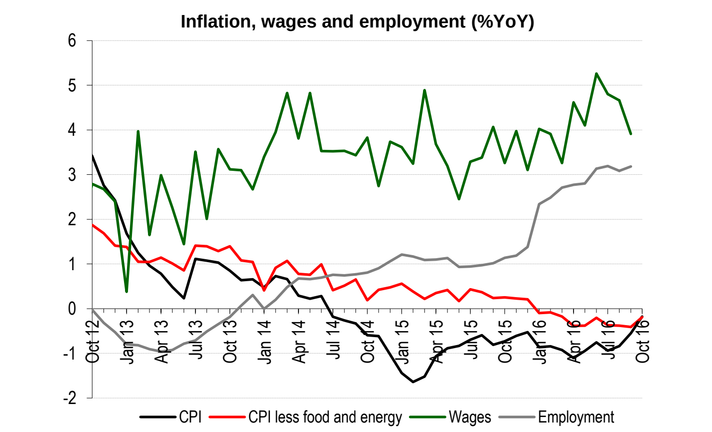


- According to our forecast, industrial output fell in annual terms in October. The generally paltry growth, undermined by slowdown in global trade, was additionally weakened by the negative working day effect. The rather uninspiring performance of leading indicators does not suggest any recovery in industry in the nearest future.
- The construction is still in dire straits, in our view, so we expect no rebound, at least in the upcoming months.
- PPI inflation is likely to go further up, in our view.
- As regards retail sales in October, we are expecting a slight deceleration versus September, but, in general, the quite robust growth will hold.
- We expect the registered unemployment rate to fall in 8.2% in October, in line with the Labour Ministry's projection.

Last week in economy – GDP growth lowest in three years



- GDP growth in 3Q16 reached 2.5% y/y, much below market consensus. We still do not know the breakdown of growth, but we suspect that three effects may be responsible for the lower-than-expected reading: (1) deeper fall in investments, (2) weaker-than-expected improvement in private consumption, despite new child subsidies, (3) revision of the data for 2015 (higher base effect). The higher base effect could have some importance, but it is not explaining the fact that the seasonally adjusted GDP growth reached 0.2% q/q in third quarter, after 0.8% in 2Q. Overall, this piece of news from the Polish economy suggests that the slowdown is more severe than expected. Moreover, 4Q may not be any better if private consumption and investments do not recover sharply. Probably another wave of downward revisions of GDP growth forecasts for Poland is coming.



- CPI inflation reached -0.2% y/y in October, in line with the flash estimate. CPI growth may turn positive in November, or December at the latest.
- C/A gap reached €999mn in September, more than expected. The surprise was mainly caused by weak exports, which expanded only by 1.5% y/y. Weak tendencies in global trade may continue to weigh on Polish exports.
- Employment growth in October amounted to 3.1% y/y, in line with forecasts. Wage growth decelerated to 3.6% y/y, the lowest pace since March. The situation in the labour market is quite puzzling, as the number of jobs has been growing quickly, despite the slowing output and investments, while wage pressure has remained very moderate, despite unemployment already at all-time lows and very common companies' complaints that it is virtually impossible to find new workers.

Quote of the week – Data may encourage the MPC to talk about rate cuts

Kamil Zubelewicz, MPC member, 15 Nov, Reuters

Growth slowdown in 3Q is not a reason to worry too much, but it needs a serious discussion.

Łukasz Hardt, MPC member, 15 Nov, Bloomberg

Cut is not very likely after the weaker data, but I never say never. On the other hand, I can see two reasons encouraging me to mull monetary tightening in the upcoming quarters.

Grażyna Ancyparowicz, MPC member, 15 Nov, PAP

Stabilization of rates is most probable. In the longer term – slow hikes.

Jerzy Żyżyński, MPC member, 15 Nov, PAP

These numbers might encourage the MPC to talk about rate cuts, even though there is not much room for easing.

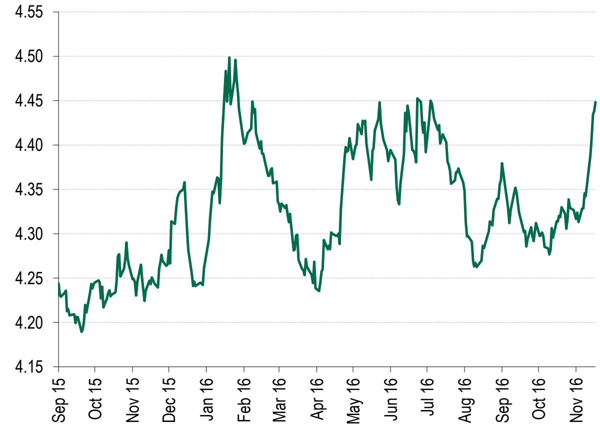
Jerzy Kropiwnicki, MPC member, 15 Nov, PAP

GDP data are no reason to change the monetary policy.

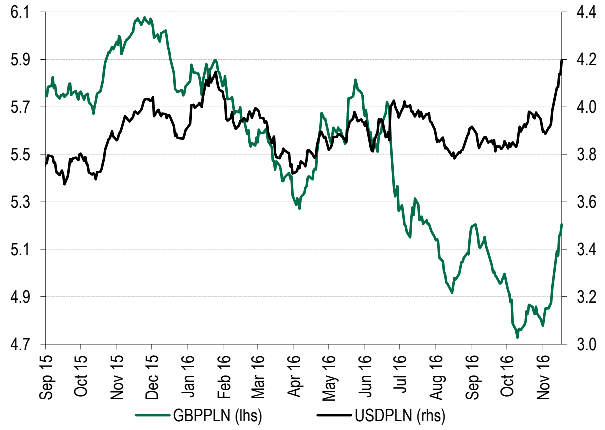
Recent data on 3Q GDP growth triggered a visible divergence in views of the MPC members. Jerzy Żyżyński, Kamil Zubelewicz and Łukasz Hardt suggested that weak data may be an argument to start a discussion about possible rate cuts (yet monetary policy easing is not very probable), while Jerzy Kropiwnicki and Grażyna Ancyparowicz were more hawkish and saw no reasons to modify policy parameters. In our view, it is highly probable that weak economic data will continue to follow, so we would expect some change in the MPC rhetoric, which is likely to fuel market expectations for rate cuts in Poland. On 16 November, the Polish Senate appointed Rafał Sura as new MPC member. Sura said that he supports the wait-and-see approach in monetary policy and currently there is no need for any nonconventional measures.

Foreign exchange market – High volatility persists

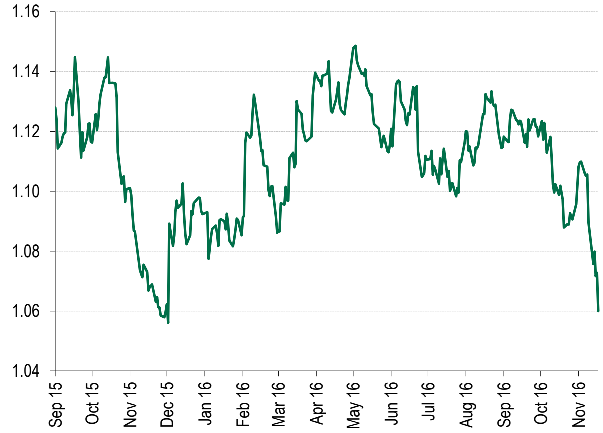
EURPLN



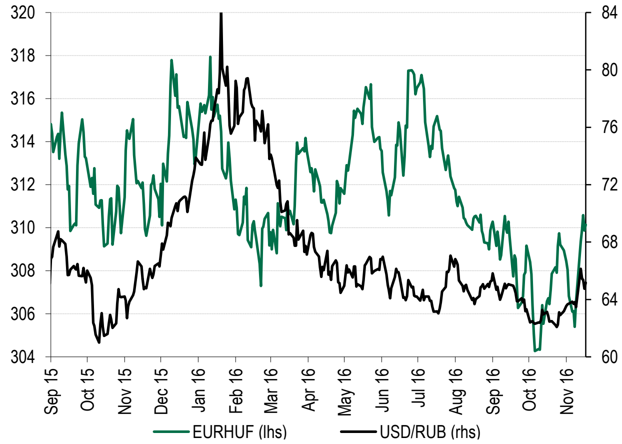
USDPLN and GBPPLN



EURUSD



EURHUF and USDRUB



Zloty's free fall vs dollar

- Last week the zloty depreciated vs the euro, Swiss franc and pound, but the biggest move was recorded for USD/PLN that jumped from 4.08 to 4.20 (its highest since 2H2002). At the same time, EUR/PLN advanced to 4.46 from 4.40, reaching its highest since July.
- All the main EM currencies have depreciated vs the dollar since the US elections with the zloty underperforming its CEE peers which was reflected by its 6.3% loss (vs -5.3% for the forint and -1.8% for ruble). The zloty lost also the most vs the euro in the CEE region. Next to the renewed weakening wave from abroad, internal issues might have generated an additional pressure on the Polish currency – much weaker than expected flash 3Q GDP and lowering the retirement age.
- In the previous reports, we were outlining our negative outlook for the zloty until the end of the year on numerous occasions and our forecast for December (4.40) has materialized already in mid-November. We do not expect the zloty's depreciation vs the euro to continue later in the year but both external factors (December Fed interest rate hike) and internal issues (economic growth below expectations) should limit the scope for the zloty's recovery. For USD/PLN, developments on the EUR/USD market will be crucial.

EUR/USD nearing crucial support

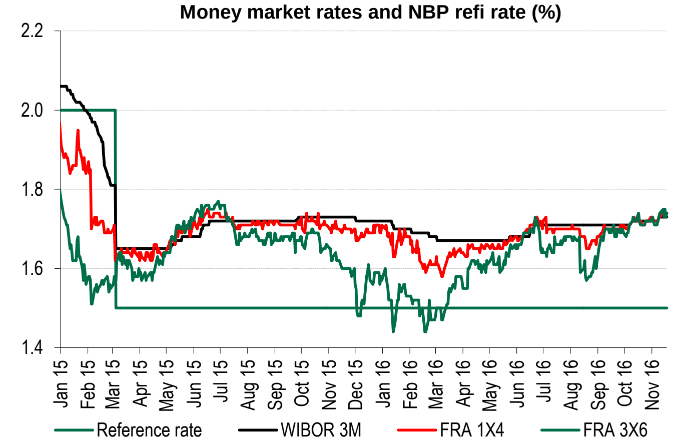
- EUR/USD continued the downside momentum triggered by the outcome of the US Presidential elections and fell for the second week in a row. As a result, the exchange rate broke this year's bottom at c1.07 and reached 1.058, nearing the local bottom from December 2015. Last time EUR/USD fell for nine consecutive sessions in August 2003. If it declines at the end of the week, it will be the longest falling streak since the data have been available (1992 at Reuters).
- This free fall clearly shows the strength of the trend, but one should bear in mind that the exchange rate is nearing 1.045, the 2015 low when the market was expecting that EUR/USD was heading for a parity and the lower band of the trading range in which EUR/USD had been hovering for roughly two years. Breaking this level would be an important event. Last week the dollar was supported by the US data and more releases from the world's biggest economy are on the agenda in the coming days. The EUR/USD performance in the coming weeks may set direction for the months to come.

Forint weaker, ruble stronger

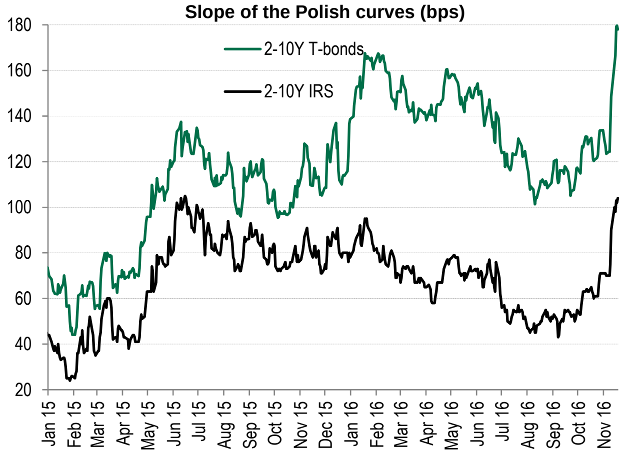
- At the beginning of the week, EUR/HUF rose to 311 from 309 and then stabilized below this level. USD/RUB corrected after the jump seen in the previous week and fell temporarily to 64.2 from 66 due to some rebound in oil price.
- This week Hungarian central bank is announcing its decision on the interest rates. The bank has recently suggested that monetary policy could be even more relaxed if needed, but we think this month Hungarian central bankers will stay on hold. The global market sentiment shall remain the core driver for the forint and ruble.

Interest rate market – 10Y sector still affected by global factors

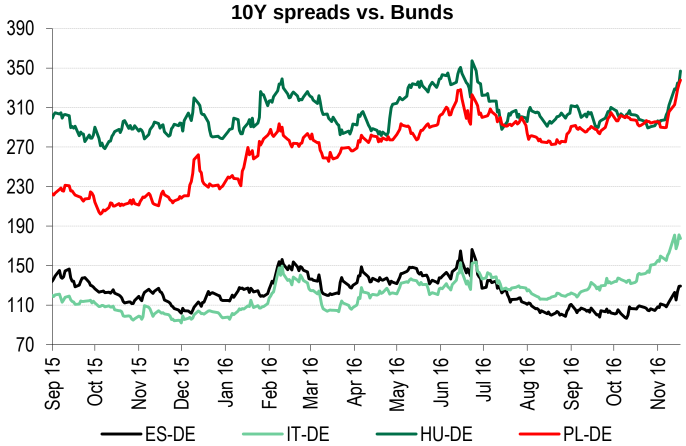
Money market rates and NBP refi rate (%)



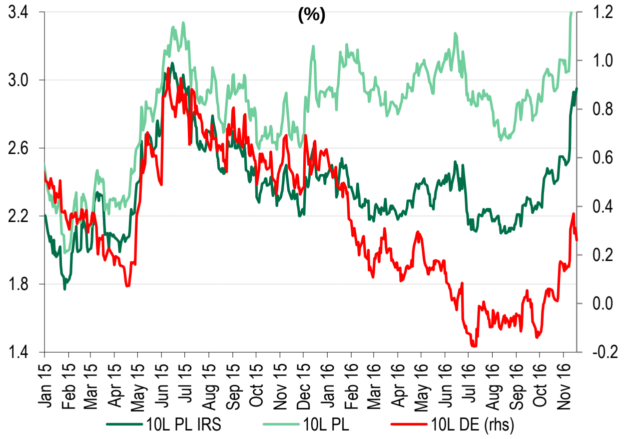
Slope of the Polish curves (bps)



10Y spreads vs. Bunds



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



Yields up, curves steeper

▪ Last week global debt markets weakened significantly, following upward move after Trump's victory in the US presidential election. This also stemmed from Fed Chair Janet Yellen's testimony which confirmed that FOMC is likely to hike rates by 25bp in December; currently, the market sees a 96% chance for such scenario, according to Bloomberg. What is more, poor auction results (details below) also put pressure on domestic debt. Consequently, the yield of the Polish 10Y benchmark increased temporarily to 3.75%, its highest since May 2014. At the same time, the 10Y IRS rate rose above 3% for the first time since mid-2015.

▪ Bear steepening has continued on the debt market. As a result, the 2-10Y spread widened significantly to nearly 190bp for T-bonds and towards 110bp for IRS. Risk premia also continued to widen, with the spread over the 10Y Bunds increasing over 330bp for the first time since 2012 and the CDS 5Y for Poland rising to 84bp.

▪ At the last auction this month, Poland's Ministry of Finance sold PS0422, WZ1122 and WS0126 worth PLN3.65bn as compared to the demand at PLN5.5bn. The 5Y fixed-coupon bond accounted for the lion's share of sales. Auction results were rather poor – the total issue was only slightly above the lower offer limit, while demand was only slightly above the upper offer limit. The ministry announced that it covered already 100% of the 2016 gross borrowing needs after the budget amendment. However, taking into account our assumption that this year's budget deficit will be lower by cPLN10bn than the target, we believe that the ministry has continued its pre-financing process.

▪ As regards money market, WIBORs remained stable over the past week, while the FRA rates increased across the board by 1-10bp. The market slightly scaled back its expectations for monetary tightening by Poland's MPC, fully pricing in a 25 bp in the next two years, while at the end of the previous week it expected a hike by 50bp (in total) during this time.

Investors' mood still fragile

▪ Recent days have clearly shown that investors' mood globally is very fragile and sentiment can quickly change from positive to negative. We see the recent sell-off as exaggerated, but it is impossible to say where it will stop. This week investors will focus on macro data releases abroad, in particular in the USA. While December's hike by Fed is on the table, investors are worried that the scale of monetary tightening next year will be higher than the previously expected. Therefore, investors will consider macro data from the USA through the lens of further monetary policy by FOMC. This together with minutes from the FOMC November's meeting will be crucial for the market in the upcoming days. All in all, volatility on the long end of the curves should remain elevated.

▪ Moreover, another set of important domestic macro data is due this week. In our view, data from real economy (industrial output, retail sales) could be quite weak at the start of 4Q16. This should support the front end of the curves in the short run. Thus, the front end of the curve should still outperform the belly and the long end, keeping the curves steep in the upcoming days.

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