Bank Zachodni WBK
Grupa Santander

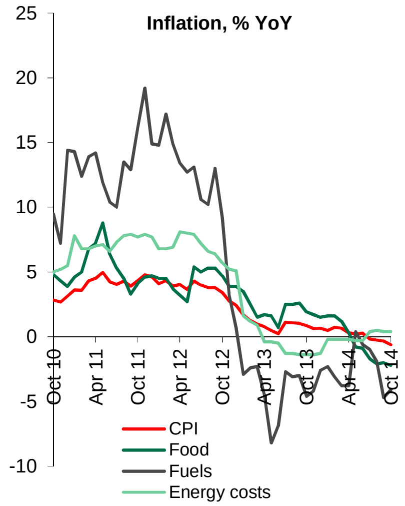
INSTANT COMMENT

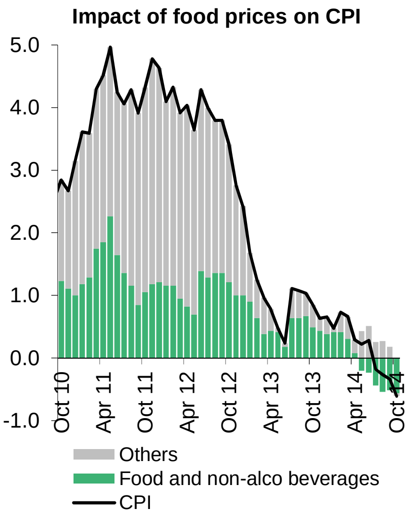
13 November 2014

Deflation can last longer than until the year-end

CPI fell more than expected in October, to the record low -0.6%YoY. While to large extent this decline is still determined by plummeting prices of food and fuel, there are completely no signs of building price pressures in other areas, and the inflation outlook remains benign. Core inflation excluding food and energy fell, according to our estimate, to 0.2%YoY, the lowest level in eight years. Deflation is here to stay at least until the end of 1Q15, in our view, which may change a bit assessment of economic situation for at least some MPC members. We think the data increase odds that the MPC will cut interest rates again at its nearest meeting in December, especially if next activity data prove to be uninspiring.

Balance of payments data for September showed that despite some rebound in export and import growth (driven mainly by working days effect), the trend growth is weakening, probably due to deteriorating economic activity in the euro zone.





Plunge in CPI deeper than expected

In October CPI fell by 0.6%YoY, which is not only below market consensus (-0.4%%YoY), but also below our forecast (-0.5%YoY). Deflation deepening to the new record low was still to a large extent due to situation on the food market, where prices – after a short pause in September – returned to a downward trend lasting since February 2014. In October prices of food and non-alcoholic beverages decreased by 0.2%MoM, which is an unusual phenomenon for this period. Our forecast, based among others on prices observed in local markets suggested a slight increase in this category. However, in general one should expect that food prices will continue to decline for some time, pushing the headline CPI down. This trend will result from global tendencies (FAO's global food price index is in declining for a number of months), food oversupply in Europe caused by good harvest and embargo imposed by Russia, as well as decrease in global prices of fuels (which are firmly correlated with food prices). In addition to food, prices of some other categories (health, transport, communication) were also lower than we predicted, which only in part was compensated by seasonal strong growth of prices of clothes and footwear (3.4%MoM). Crude oil and fuel prices keep declining, suggesting that this factor will also be acting in favour of CPI in the near future.

According to our estimates, core CPI excluding food and energy prices dropped in October to 0.2%YoY, the lowest level in eight years. However, we assume that core inflation will not stay at such low level in the coming months as both core and headline CPI dropped last month, among others, on the back of high base effect in communication prices (new tariffs were introduced by mobile operators in October last year) and this was followed by a drop of prices in this category in November 2013.

All in all, these data show a rather below-expectations inflation path (or deflation path, to be accurate). Annual CPI is likely to stay below zero longer than expected so far – our estimates show that positive CPI reading should be expected no sooner than in April 2015. Lack of any demand-side pressure supports this scenario.

Working days effect supported exports and imports in September

In September, exports reached €14.3bn (+5.5YoY) while imports €13.6bn (+5.8%YoY), slightly above market expectations (€14bn and €13.6bn, respectively) and our forecasts (€14.5bn and €13.7bn, respectively). The effect of higher number of working days in September had a positive impact on exports volumes (as well as on the industrial output), but data show that the upward trend decelerates – exports grew 3.5%YoY in 3Q vs.

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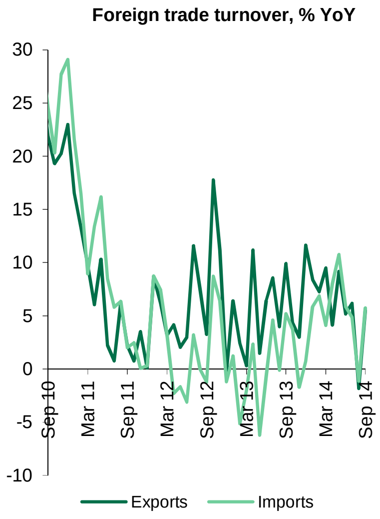

6.1%YoY in 2Q and 8.4%YoY in 1Q. This is the effect of lower economic activity in the euro zone, so sales of goods abroad may stay weak for the coming quarters. At the same time, imports will be supported by domestic internal demand and decent situation in the labour market, so we expect this category to accelerate in the nearest future. This together shall lead to smaller contribution of net exports into the GDP growth.

Balance of foreign trade showed a surplus worth €614m as well as balance of services worth €461m, while primary and secondary incomes deficit amounted to €1529m and €282m, respectively, which totalled to current account deficit at €235m. According to our forecast, aggregated 12-month current account balance in September reached -1.3% of GDP.