Bank Zachodni WBK
Grupa Santander

BI-WEEKLY ECONOMIC UPDATE

21 March – 3 April 2016

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (21 March)					
15:00	US	Home sales	Feb	% m/m	-2.9	-	0.4
		TUESDAY (22 March)					
9:30	DE	Flash PMI – manufacturing	Mar	pts	50.8	-	50.5
10:00	EZ	Flash PMI – manufacturing	Mar	pts	51.4	-	51.2
10:00	DE	Ifo	Mar	pts	106.0	-	105.7
11:00	DE	ZEW index	Mar	pts	53.0	-	52.3
14:00	HU	Central bank decision		%	1.35	-	1.35
		WEDNESDAY (23 March)					
10:00	**PL**	**Unemployment rate**	**Feb**	**%**	**10.3**	**10.3**	**10.3**
15:00	US	New home sales	Feb	% m/m	3.2	-	-9.2
		THURSDAY (24 March)					
11:00	**PL**	**Bond switch auction**					
13:30	US	Initial jobless claims	week	k	268	-	265
13:30	US	Durable goods orders	Feb	% y/y	-2.7	-	4.7
		FRIDAY (25 March)					
13:30	US	GDP third estimate	Q4	% q/q	1.0	-	2.0
		MONDAY (28 March)					
14:30	US	Personal income	Feb	% m/m	0.1	-	0.5
14:30	US	Consumer spending	Feb	% m/m	0.1	-	0.5
16:00	US	Pending home sales	Feb	% m/m	-	-	-2.5
		TUESDAY (29 March)					
16:00	US	Consumer confidence index	Mar	pts	94.0	-	92.2
		WEDNESDAY (30 March)					
14:15	US	ADP report	Mar	k	190	-	214
		THURSDAY (31 March)					
11:00	EZ	Flash HICP	Mar	% y/y	-	-	-0.2
13:00	CZ	Central bank decision		%	0.05	-	0.05
14:00	**PL**	**Inflation expectations**	**Mar**	**% y/y**	**0.2**	**0.2**	**0.2**
14:30	US	Initial jobless claims	week	k	-	-	-
		FRIDAY (1 April)					
3:45	CN	PMI – manufacturing	Mar	pts	-	-	48.0
9:00	**PL**	**PMI – manufacturing**	**Mar**	**pts**	**-**	**53.0**	**52.8**
9:55	DE	PMI – manufacturing	Mar	pts	-	-	-
10:00	EZ	PMI – manufacturing	Mar	pts	-	-	-
14:30	US	Non-farm payrolls	Mar	k	191	-	242
16:00	US	Michigan index	Mar	pts	50	-	49.5
16:00	US	ISM manufacturing	Mar	pts	-	-	-

Source: BZ WBK, Reuters, Bloomberg

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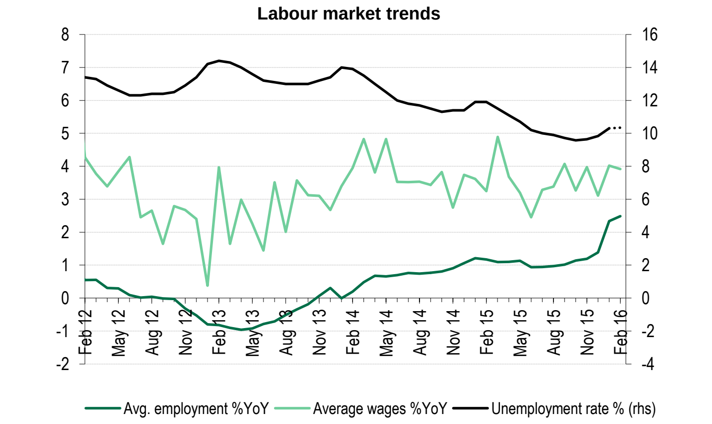
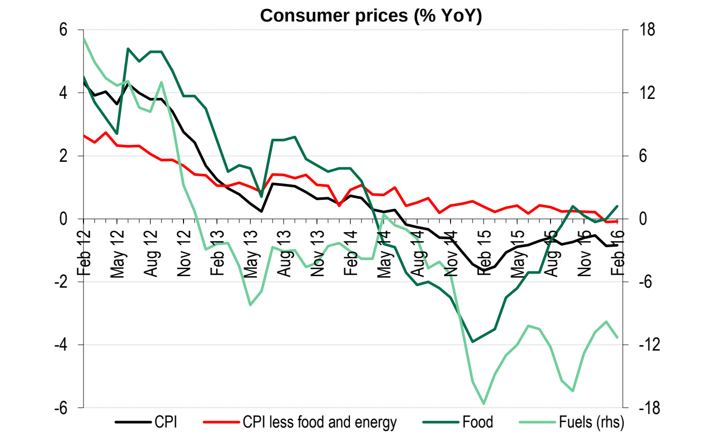
What's hot in next two weeks – The Easter is coming

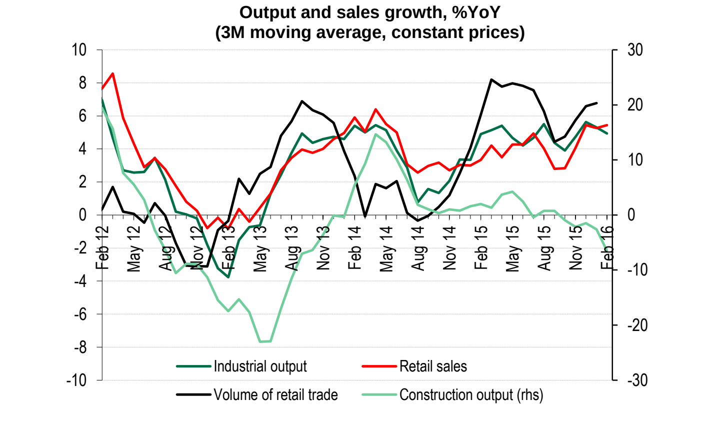


▪ The registered unemployment rate is the only major data release in Poland this week. According to the Labour Ministry's estimate, the rate remained stable in February, at 10.3% and with 1.66mn unemployed. The number of job offers was still on the rise (48% m/m and 33% y/y). Our forecast of the unemployment rate is in line with the ministry's numbers. We also see good chances for unemployment to fall below 9% in the summer.

▪ In the week after the Easter holiday, PMI data for March will be key. We expect the Polish manufacturing PMI to rise slightly further after its sharp rebound in February, which showed that economic activity remained healthy. PMIs for the other European economies will also be a crucial hint about the euro zone's economic outlook ahead (key for Polish export growth).

Last week in the economy – Inflation below, output and sales above forecasts





▪ Deflation once again proved lower than expected, reaching -0.8% y/y in February. Data for January were additionally revised down to -0.9% y/y, mainly due to changes in the CPI basket weights, while core inflation fell to -0.1% y/y in January-February (its lowest level since 2006). CPI inflation is likely to remain negative until the end of Q3.

▪ Employment growth accelerated in February to 2.5% y/y and wage growth decelerated to 3.9% y/y. In monthly terms, employment rose by 8.2k, making this the strongest February since 2011. February's labour market data show that at the start of 2016 wage pressures were moderate despite the strengthening demand for labour. We think that wage growth is likely to accelerate later this year and solid labour income growth will be favourable for private consumption.

▪ Industrial output data (6.7% y/y) and retail sales (6.2% y/y in constant prices) surprised to the upside in February, boosted by a calendar effect. However, seasonally adjusted production looks less impressive at a mere 3.0% y/y. Moreover, construction output is in a free fall (-10.5 y/y), which seems to reflect a slowdown in public investments.

▪ Current account balance data (€764mn) were above market expectations, but below our forecast. We were disappointed by the exports, yet their contraction in annual terms may have been partly due to calendar effects.

▪ On balance, it seems that economic activity in Poland remains decent, but GDP growth in 1Q16 is likely to slow down from the 3.9% y/y recorded in 4Q15. The worsening outlook for the global economy implies a risk of a slowdown in the Polish exports and production growth later this year. However, consumption growth will be boosted by strong labour income and generous child benefits that are to be launched in April.

Quote of the week – The MPC needs to have its umbrella ready

Jerzy Żyżyński, MPC member, Reuters, TVN24BiS, 18.03
I would reduce interest rates slightly, but the room is small. (A cut of 50bp) would have some impact. (…) We have to think if the central bank can engage in promoting economic growth. Maybe we should cut the Lombard rate.

Eryk Łon, MPC member, PAP, 17.03
I think an interest rate cut or keeping rates stable are now more likely moves than a hike. I do not rule out that in a few months there may be a need to promote investment (by lowering interest rates). External factors may decide whether interest rate cut is needed or not.

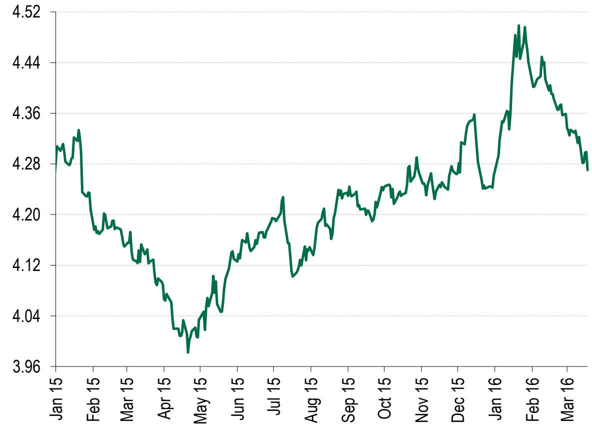
Eugeniusz Gatnar, MPC member, PAP, 17.03
Current interest rates are working well. This instrument can still be used. Some kind of economic slowdown could be a reason to change MPC stance. But nothing like this seems to be on the horizon. Current interest rate is at optimal level.

Łukasz Hardt, MPC member, PAP, 18.03
Stable path of interest rates is currently most probable. We are already close to zero lower bound. We need to save ammo in case something unexpected happens. We need to have an umbrella ready, even if the sun is shining.

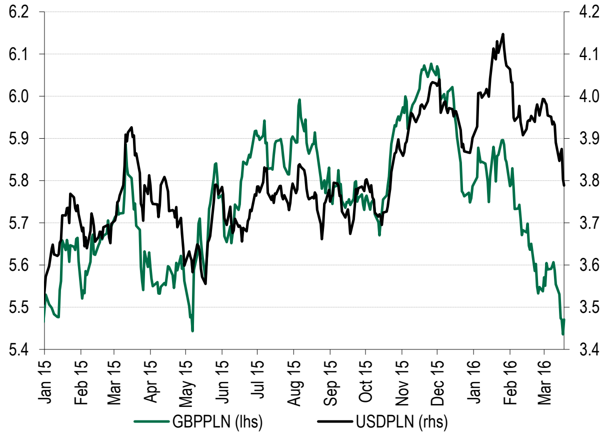
The lower house of parliament Sejm has just filled the last remaining vacancy on the Monetary Policy Council, appointing PiS deputy Jerzy Żyżyński to the Council. We think that Żyżyński is going to be the most dovish of the Council's members, which his recent comments seem to confirm (there is room for a small rate reduction). The other MPC members continue to argue that the current level of interest rates is adequate for now. It is interesting that the MPC members' recent comments suggest quite clearly that the pace of economic growth, not the inflation outlook, is the key argument in the central bank's current reaction function. Thus, we guess that prolonging deflation would not trigger monetary policy easing as long as the GDP growth outlook remains decent. The probability of interest rate cuts will, therefore, probably rise if the European economy starts slowing more significantly, which would also worsen Poland's growth outlook.

Foreign exchange market – Global factors remain key

EUR/PLN

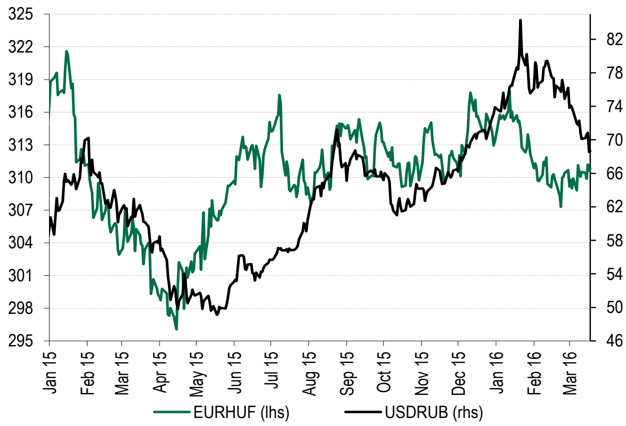


USD/PLN and GBP/PLN



EUR/USD

EUR/HUF and USD/RUB



Zloty firms on ECB and Fed decisions

- Poland's zloty continued to gain last week due to the dovish stance of the FOMC on Wednesday, with the domestic factors (mixed macro data releases) more or less neutral for the domestic currency. While EUR/PLN fell slightly below 4.27 at the end of the week, USD/PLN hit its lowest level since October 2015 at nearly 3.78. On a weekly basis, the zloty gained markedly against the US dollar (by 2.6%) and the British pound (by 1.5%).
- The Financial Supervision Authority (KNF) presented its estimate of losses that Polish banks would incur if President Andrzej Duda's proposal on FX mortgage loan conversion would be implemented. KNF's estimate (at almost PLN67bn) should, in our view, reduce the probability that the president's proposal will get approved, though discussion about the final shape of the proposal will likely continue, making it impossible for the uncertainty to disappear completely. And it is a risk factor for the zloty in the medium term.
- The Polish zloty is currently quite strong against the euro, with the EUR/PLN rate close to the lower end of the 4.25-4.35 fluctuation range. We do not rule out the possibility of higher volatility in response to the upcoming macro data releases from both Europe and the US, in particular the flash PMI indices for the euro zone countries. Lower-than-expected readings could encourage investors to take profit. What is more, market liquidity will likely fall at the end of the week due to the Easter holiday, which may also add to the market volatility if data prove surprising. All in all, we expect the aforementioned fluctuation channel to remain intact for the EUR/PLN rate in the upcoming weeks/months.

Dovish Fed pushes EUR/USD above 1.13

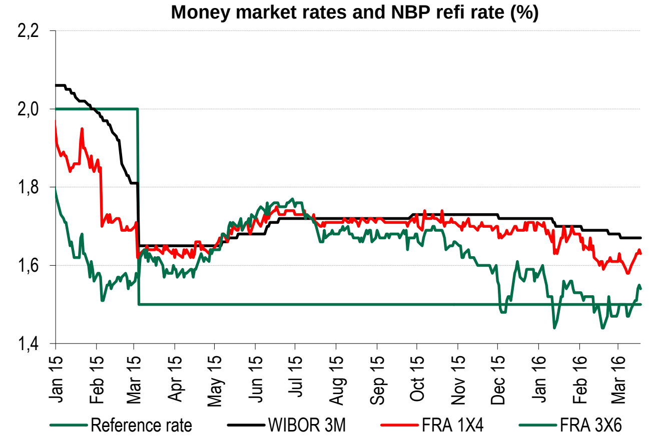
- The US dollar weakened significantly over the past week as the Fed surprisingly scaled back its forecast to only two rate hikes this year, down from four in December. As a result, EUR/USD rose to nearly 1.135 (not so far from this year's top from February). However, this move was only short-lived and the rate returned below 1.13 at the end of the week.
- There are some important macro data releases (including flash manufacturing PMIs for the euro zone countries, Ifo and ZEW indices for Germany and important data from the US) and speeches of Fed members on the agenda this week. If the leading indicators will signal a slowdown in the euro zone's economic activity, investors might renew their expectations for further ECB support. As a consequence, the euro could weaken somewhat against the main currencies, with EUR/USD heading south.

Rouble the strongest since December 2015

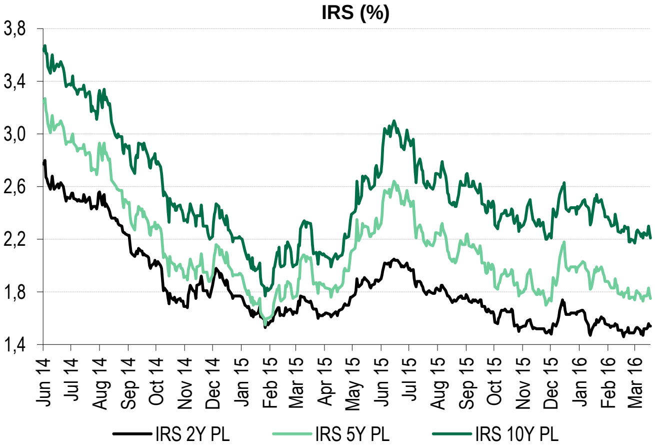
- The Hungarian forint and the Czech koruna were more or less stable on a weekly basis, but intraday volatility was quite high. At the same time, the Russian rouble firmed against the US dollar due to rising Brent prices (over $42/bbl) and the Russian central bank's decision to keep its monetary policy unchanged. As a result, USD/RUB fell below 68, for the first time since December 2015.
- Global factors will remain the main drivers for the CEE market this week. Signals of a slowdown in the euro zone (by flash PMI readings) might have a negative impact on investor sentiment. On the side of the domestic factors, the Hungarian central bank (NBH) meeting will be watched closely. In our view, NBH should keep its monetary policy stable, preparing the ground for further conventional and/or unconventional easing. Stable rates in Hungary should be moderately supportive for the forint.

Interest rate market – Fed speakers and macro data in the spotlight

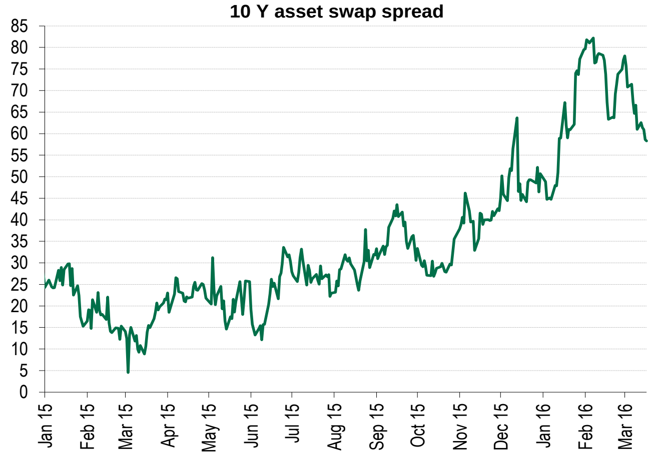
Money market rates and NBP refi rate (%)



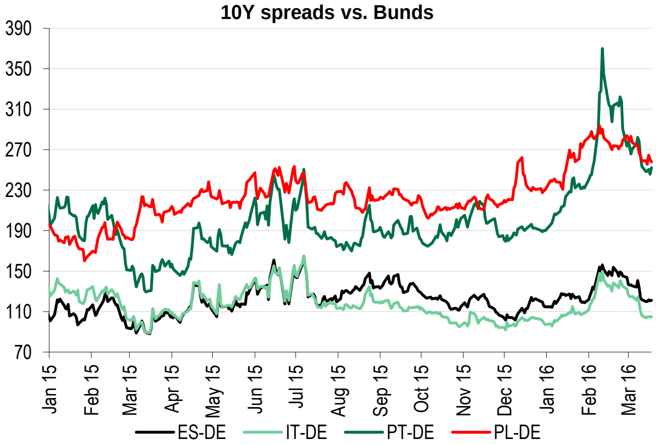
IRS (%)



10 Y asset swap spread



10Y spreads vs. Bunds



Dovish Fed drags rates down

- The past week was the second in a row when a central bank meeting outcome had the biggest impact on the FI market. The FOMC statement sounded surprisingly dovish and this had a positive impact on the global bonds. Polish debt also benefited from the worldwide rally with the 10Y benchmark yield falling to c2.80%. At the same time, the IRS lagged behind and the not-too-dovish rhetoric of the Polish MPC and decent domestic macro data pushed the 2Y IRS up 5bp to 1.55%. The 5Y IRS ended the week at around 1.75% and the 10Y close to 2.20%.
- WIBOR stayed unchanged while FRAs rose 4-7bp.

Fed speakers and macro data in the spotlight

- Central banks released vital signals in the last two weeks, which drove yields down in Poland and abroad particularly. The ECB extended its monetary policy easing, while the FOMC had reduced the number of the expected rate hikes this year. Important US and euro zone data are due this week and there are numerous Fed speakers (although all but one are non-voters) on the agenda. Considering the recent EUR/USD developments, the US central bankers will probably try not to sound too hawkish, with rather cautious and dovish remarks more likely given the outcome of the Committee's last meeting. If this proves correct, Europe's yields/IRS should remain low and shall not generate any upside pressure on the Polish rates.
- A correction to follow the recent rally also seems unlikely in case European economic activity data disappoint again. Manufacturing PMIs for Germany and the euro zone are on the downside this year, painting a rather gloomy European economic growth outlook, which underpins demand for safe assets. It seems that only a significant rebound of indexes could ease concerns and push the yields/IRS up.
- At the same time, the recently decent Polish macro data and comments of the MPC members could continue to generate upside pressure on FRAs. Before the MPC's March meeting, the market was pricing in a full 25bp cut in six months' time. Investors have now delayed their expectations to 12 months from now. We think there is still room for the FRAs to rise.
- The Finance Ministry holds a bond switch auction this week. It is set to repurchase PS0416, OK0716 and PS1016 bonds. The most recent data show that non-residents held at the end of January 40% of the bonds to be repurchased. We think that this week the Ministry could offer five-year PS0421 bonds (as the 2Y and 10Y benchmarks have already been offered this month) and maybe a floater. At the end of January, foreign investors had only 25% of this bond outstanding, while domestic banks held c54% of it. Given the above, we think that the success of this week's auction may depend mainly on the Polish investors. Deputy finance minister, Piotr Nowak, said that this year's borrowing needs are now covered in 44%.

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