Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

11 – 17 April 2016

Last week the global investor sentiment deteriorated due to rather mixed data from the euro zone and from Germany as well as because of worrying information from the euro zone peripheries. Minutes of the FOMC meeting showed that supporters of more gradual hikes prevailed, underpinning market expectations that the next hike will be implemented in June at the earliest. As regards the ECB, minutes of its last meeting showed that the euro zone central bankers were discussing a deeper cut in rates but decided to save ammo for the future. In Poland, the MPC meeting was a non-event, with interest rates staying flat, but the Moody's warning that the constitutional crisis is credit negative sparked worries that this agency may downgrade Poland's credit outlook and/or rating in May (currently A2, stable). This, together with weaker global sentiments, weighed on the zloty and Polish bonds.

This week is not very rich in events abroad, with euro zone's HICP and industrial output being important in light of the last ECB minutes. US data may also prove interesting in context of the Fed monetary policy. Polish assets will most probably be more affected by domestic events: there are some data releases (CPI, current account, M3) on the agenda, but these will not be crucial, in our view. Fiscal policy will come to the fore, as the government will present its Convergence Programme Update before the Sejm's Finance Committee. The market will assess the credibility of the government's claims that it wants to keep the GG deficit below 3% of GDP. The issue of CHF-denominated loans may appear before the Financial Stability Committee meeting scheduled for 18 April and it may affect the PLN exchange rate.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (11 April)					
9:00	CZ	CPI	Mar	% y/y	0.4	-	0.5
14:00	**PL**	**CPI**	**Mar**	**% y/y**	**-0.8**	**-0.9**	**-0.8**
		TUESDAY (12 April)					
14:00	**PL**	**Core CPI excl. food and energy prices**	**Mar**	**% y/y**	**-0.1**	**0.0**	**-0.1**
14:30	US	Import prices	Mar	% m/m	1.0	-	-0.3
		WEDNESDAY (13 April)					
11:00	EZ	Industrial output sa	Feb	% m/m	-	-	2.1
14:00	**PL**	**Current account**	**Feb**	**€m**	**417**	**418**	**764**
14:00	**PL**	**Exports**	**Feb**	**€m**	**14338**	**14561**	**13275**
14:00	**PL**	**Imports**	**Feb**	**€m**	**13631**	**13741**	**12699**
14:30	US	Retail sales	Mar	% m/m	0.2	-	-0.1
20:00	US	Beige Book					
		THURSDAY (14 April)					
11:00	EZ	HICP	Mar	% y/y	-0.1	-	-0.2
14:00	**PL**	**Money supply M3**	**Mar**	**% y/y**	**9.7**	**9.8**	**10.0**
14:30	US	CPI	Mar	% m/m	0.2	-	-0.2
14:30	US	Initial jobless claims	week	k	-	-	267
		FRIDAY (15 April)					
15:15	US	Industrial output	Mar	% m/m	-0.1	-	-0.5
16:00	US	Flash Michigan	Apr	pts	92	-	91

Source: BZ WBK, Reuters, Bloomberg

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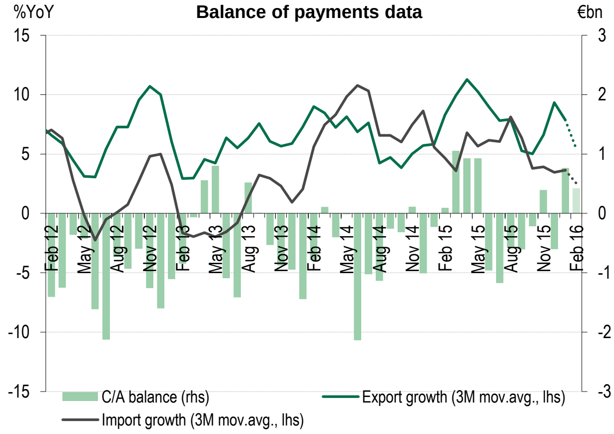
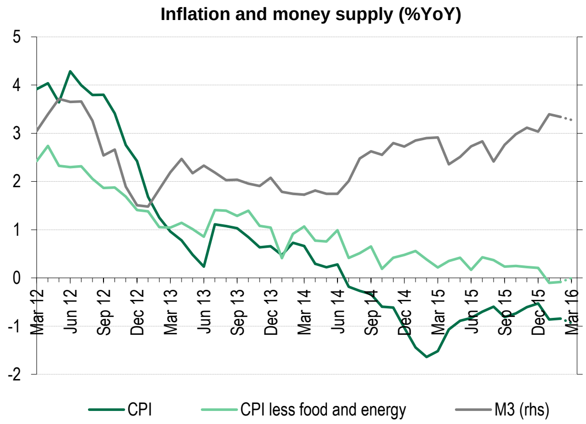
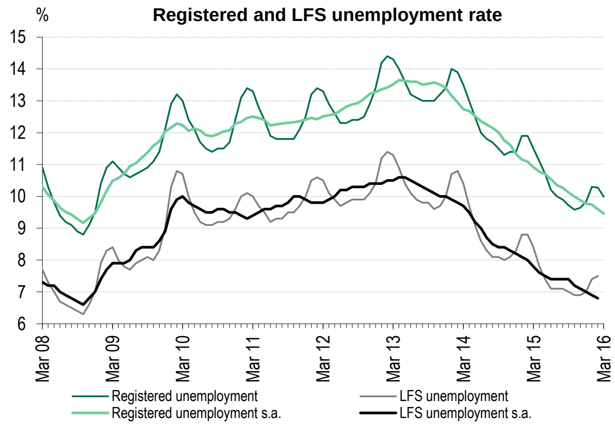
What's hot this week – Inflation, current account and money supply



- This week we will get to see updated inflation data: the statistics office will release revised CPI for March (we expect no change versus the flash estimate at -0.9% y/y) and the NBP will release core inflation (we expect 0.0% y/y). CPI is currently a less important figure than usual for the markets, as deflation has no effect on the MPC's stance. We expect inflation to remain negative until 3Q/4Q 2016.
- We expect a slightly lower C/A surplus in February. The trade balance will most probably improve versus January, but this will be offset by stronger income outflows. Still, in annual terms, the C/A balance will improve and may reach a surplus of 0.1% of GDP – for the first time since the mid-90s.
- M3 money supply growth slowed down in March, in our view, partially on the back of PLN strengthening, which lowered the value of the FX-denominated deposits.

Last two weeks in the economy – Rates flat, unemployment rate lowest in 25 years





- The Monetary Policy Council's decision to keep rates on hold was in line with expectations and the statement did not bring any new elements. As the NBP Governor Marek Belka stated during the press conference, the Council did not get any closer to a rate cut. As we wrote after the March meeting, if the new projection would not persuade the Council, it would be hard to expect a change in opinion in the following months. The decision was probably unanimous, which was confirmed by the very early hour of the announcement. Belka said that the Council was currently quite unanimous in its views (which does not mean this will continue, as economic background might be different). The Council accepts a significant divergence of inflation from the target, treats the target very flexibly (which is in line with Monetary Policy Guidelines). It was even stated that given the fact that the main aim of the MPC (price stability) has been maintained, the Council can also focus on stability of the financial sector. It was emphasised that GDP growth remains strong (although 1Q16 slightly below 4Q15), and that the labour market and wage bill dynamics were very good. Most of the risks for growth are external and a materialisation of those could be a trigger for rate changes. What is interesting is that Belka said that the possibility of adjusting rates more significantly in one shot (not in a sequence) was one of the MPC's discussion topics. Still, this was purely theoretical at this stage and the bottom line after the MPC meeting is: do not expect a rate cut in Poland in the next few months.
- The registered unemployment rate fell in March to 10.0%, which was the lowest reading for this month since 1991, according to the Labour Ministry estimate. Data on job offers showed that demand for labour remains strong, so further declines in the unemployment rate are very probable in the months to come.

Quote of the week – I will not recommend lower VAT rates in 2017

Paweł Szałamacha, minister of finance, DGP, 08.04

Most likely, there will be no return to lower VAT rates in 2017. I will not recommend such a change. First, we have to rebuild tax revenues. We will not do it in a few months' time.

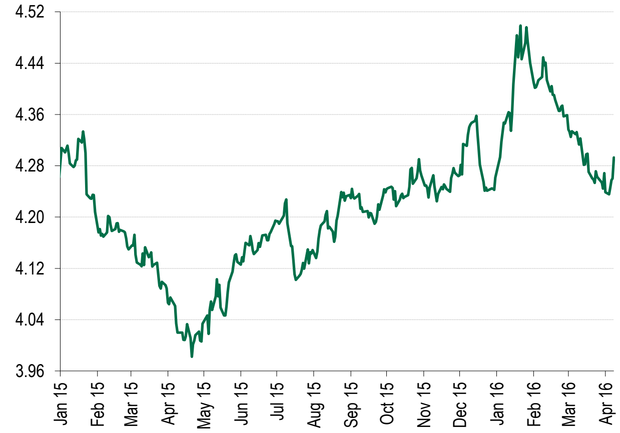
PAP, 07.04

Our priority for 2016 and the following years in to reduce the VAT gap, which was estimated by the EU at 26% of the VAT liability. The average for the EU is at 15%. I would like to reach this target in three years' time. In nominal values, this means a reduction from the current €10bn to €5.5-5.8bn. This is a realistic target that I would like to reach.

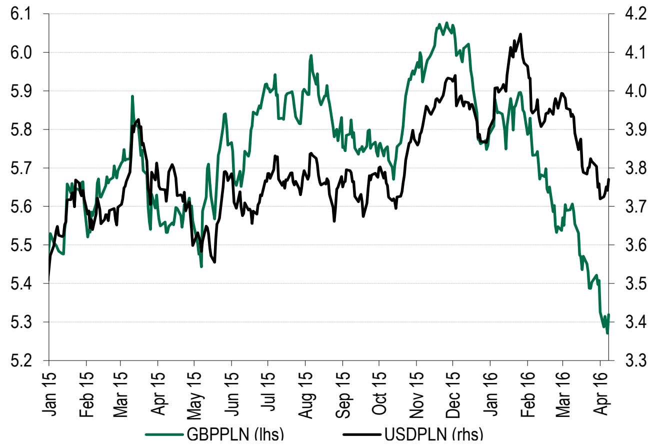
The Finance Ministry needs an additional PLN12bn in revenues to prevent the 2017 central budget deficit from rising, according to our estimates. Improvement in tax collection is the Ministry's priority and it is planning to raise an additional PLN15-20bn in three years' time thanks to these actions. This translates into about PLN5bn a year (assuming flat time distribution, which is rather unlikely, as the Ministry will need some time to reach full effectiveness of its actions). Additionally, the Ministry seems to be planning to cancel the VAT cut in 2017, which may bring additional PLN5bn in revenues, in our view. These two measures, if successful, may almost cover the gap in 2017. On April 13, the government will present the Convergence Programme Update in the Sejm's Finance Committee and expect more details to come.

Foreign exchange market – Pressure on the zloty continues

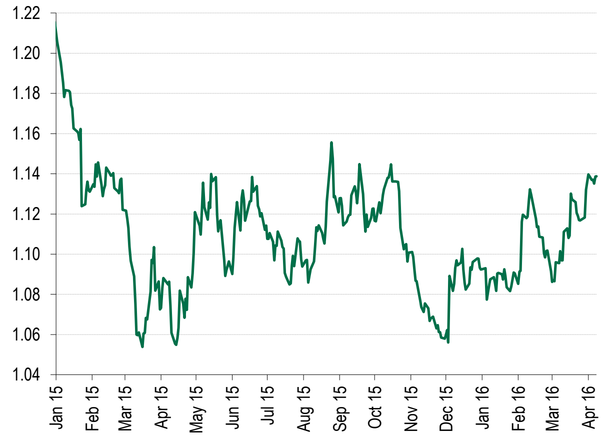
EUR/PLN



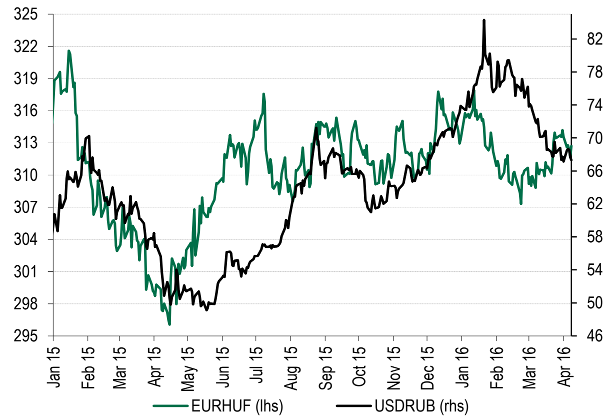
USD/PLN and GBP/PLN



EUR/USD



EUR/HUF and USD/RUB



Profit taking after significant rally

▪ Poland's zloty lost against the main currencies over the past week due to the risk off sentiment globally. However, zloty's weakening also resulted from domestic factors, as last week Moody's warned that the crisis around the Constitutional Court is credit negative. As a consequence EUR/PLN temporarily increased above 4.30, the highest level since early March, up from local minimum at 4.227 at the start of the week. At the same time USD/PLN increased towards 3.78, up from 3.71.

▪ Situation on the zloty changed quite visibly over the past week. Some investors decided to take profit after quite long period of zloty's strengthening. Zloty gained nearly 5% against the euro since January (when EUR/PLN reached this year's high near 4.50). EUR/PLN easily broke the resistance level at 4.286 and now it is close to a 150-DMA near 4.30. This week domestic macro calendar is quite light, with balance of payment data as the key. In our view data should confirm strong growth of exports as we expect quite significant trade surplus. While fundamentals are still supportive, the zloty could remain under pressure of uncertainty about CHF-loans conversion and perspectives of rating downgrade. All in all, in our view EUR/PLN might move sideways between 4.28-4.33.

EUR/USD moves sideways

▪ Last week EUR/USD was quite volatile. FOMC minutes that showed a deeply split Fed drove the EUR/USD rate above 1.145 for a short while. On the other hand, hawkish comments from some Fed's members, suggesting earlier rate hikes than market is pricing-in, pushed EUR/USD down to nearly 1.13. All in all, on weekly basis EUR/USD was more or less stable, with the rate slightly below 1.14. What is more, safe haven flows strengthened the Japanese yen (to nearly 108 against the US dollar for a while).

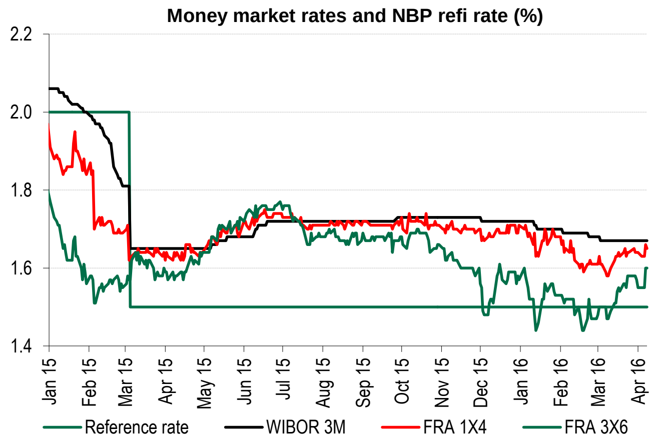
▪ This week macro calendar is rather light, with inflation data for the US and the euro zone as the most crucial for the market. The CPI outcome will help investors to guess further steps of ECB and Fed in monetary policy. Lower than expected CPI reading in the euro zone might renew expectations on further monetary easing by the ECB (which is not our baseline scenario), pushing EUR/USD down towards 1.13 or even lower. In our view, EUR/USD should remain within the 1.12-1.14 range, awaiting new impulses that will shape its developments in the later part of the quarter.

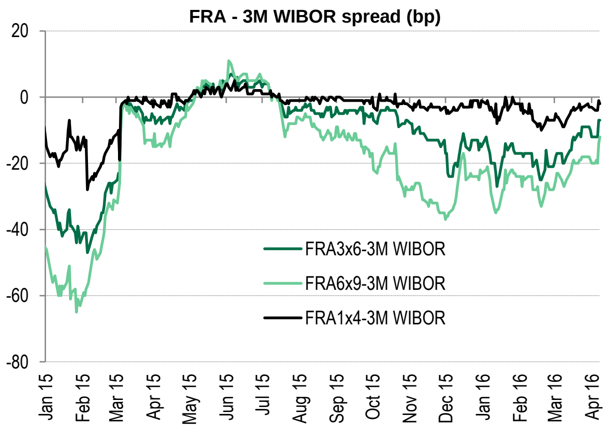
CEE currencies also under pressure

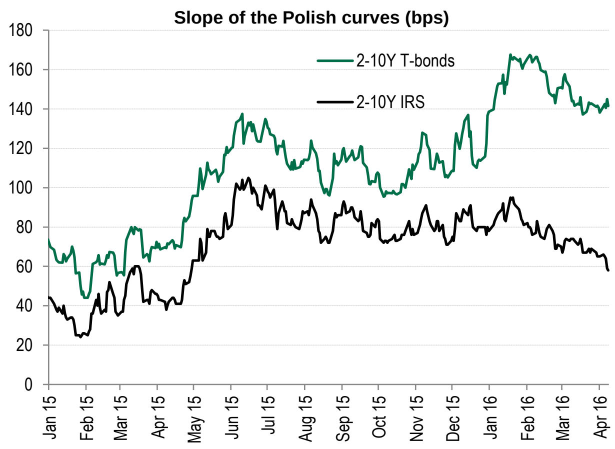
▪ CEE currencies were also under pressure, however their weakening was lower as compared to the losses on the PLN. The Hungarian forint lost the ground due to lower than expected CPI reading for March (-0.2% y/y vs expected 0.1% y/y). This strengthened expectations for further monetary easing later this month. As a result EUR/HUF increased over 312. At the same time, the Russian ruble was vulnerable to changes in oil prices. Increase in oil prices towards $41/bbl keeps USD/RUB in a narrow range of 67.1-69.5.

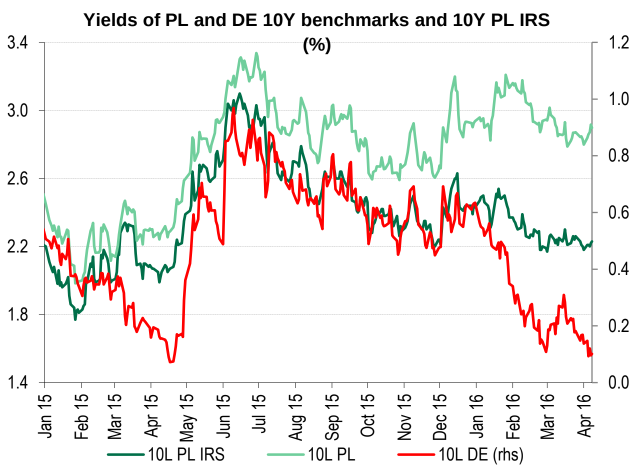
▪ This week global sentiment and country-specific factors (including March CPI in the Czech Republic) will drive market. Rising risk of deflation in the Czech Republic might push EUR/CZK to even below 27, which would probably launch central bank's intervention on the FX market. In our view, further rally on oil prices might push USD/RUB towards strong resistance level 66.

Interest rate market – Global sentiment the most important









Poland's yields up due to risk off mode

- Poland's domestic interest rate market suffered from global sentiment deterioration and sell-off on the periphery debt market. Negative sentiment could also result from the effect of warning by Moody's about possible credit downgrade and changes in investors' portfolio before the Thursday's auction. As a result yield of 10Y benchmark increased to nearly 2.95% for a while, the highest level since early March. However, end of the week brought gradual revival on the market, which pushed yield of 10Y down to 2.90%.
- Ministry of Finance had no problems with selling debt at the first auction this month. It sold a total PLN6.4bn (supply was within the PLN 3-6bn range), including OK1018 (PLN 1.8bn) and DS0726 (PLN 4.6bn). Investors purchased offered T-bonds with yields close to the level on secondary market at 1.558% and 2.896% respectively. According to deputy Finance Minister Piotr Nowak, after the last week's auction this year's borrowing needs have been covered in 56%.
- On weekly basis both IRS and T-bond curves shifted up by 4-12 bp across the curves. While T-bond curve steepened gradually as the long end underperformed the front end (2-10Y spread widened over 140bp), IRS curve flattened with 2-10Y spread narrowing as the front end of the curve grew by 12bp. The risk premium also increased as can reflected in the rise of the spread to the Bund to more than 280bp.
- On the money market WIBORs remained unchanged, while FRAs and IRS increased as the MPC keeps rather hawkish rhetoric. In line with our expectations, FRA market once again scaled back their expectations on further monetary easing. Now investors see a 70% chance rates will fall 25bp in the next nine months, while it priced-in a full rate cut in this period at the start of the week.

Global sentiment is still the key

- This week's domestic macro calendar is quite light with the headline and core CPI releases as the key. In our view, the final CPI reading for March should be close to the flash number at -0.9% y/y. This outcome might be neutral for the debt market. On the other hand CPI readings in the euro zone and in USA might be closely watch by investors as this numbers might determine further monetary policy by ECB and Fed. This could influence domestic asset valuation in the short run. Renewed expectations for more easing from the ECB should be supportive factor for bond market globally, including the Poland's one.
- In our view, situation in the euro zone periphery might be crucial for Poland's debt market direction. After significant weakening over the past week we see some room for revival. However, persisting risk averse mode together with further negative news flow from the euro zone periphery might keep domestic yields at elevated level. As a result spread over Bund could remain wide.
- Investors will also closely watch the issue of the Updated Convergence Programme. We do not expect any negative surprises – the Ministry of Finance confirms its determination to keep the general government deficit below/close to 3% of GDP, which should be positive for the market players. Still, a full assessment of credibility o government's plans will be possible only when the next year's budget will be planned.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Rates Area, Economic Analysis Department, al. Jana Pawła II 17, 00-854 Warsaw, Poland, phone +48 22 534 18 88, email ekonomia@bzwbk.pl, http://www.bzwbk.pl.