Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

25 April – 1 May 2016

Global sentiment deteriorated at the end of last week, which was reflected mainly in falling equity indices and in weakening of some EM currencies, including the Polish zloty. Even though oil producers failed to reach an agreement on a production freeze, oil prices continued their upward trend, reaching this year's high. What is more, the ECB, as expected, left rates and its stimulus package unchanged from March and reassured that all instruments (including policy rates) would be used if needed. The ECB rhetoric was moderately dovish as the ECB sees inflation picking up in the second half of this year. In Poland, labour market data were strong in March, in particular employment, while the March production and retail sales data showed a surprising slowdown. Meanwhile, minutes from April's MPC meeting showed that the Council agreed that increased uncertainty regarding domestic and external developments also spoke in favour of stable interest rates. However, most Council members did not rule out the possibility of interest rate cuts in case of an economic slowdown in Poland and deepening deflation. All in all, the risk-off mode pushed EUR/PLN up to nearly 4.35 (its highest since February) and the 10Y bond yield above 3% (its highest since early March).

This week's calendar is quite rich with US events – numerous macro data and the FOMC decision on rates. Last month's statement was surprisingly dovish and was one of the factors behind risky assets' rally seen in the next few weeks that followed. The global market sentiment seems to have improved since then (stock indexes are higher) and so we do not expect any dovish surprise this time around that could support the Polish bonds and currency. This means that the US macro releases and how they are perceived in the context of their impact on monetary policy should play the main role. On the Polish macro data front, April flash CPI is due on Friday and we think that deflation deepened vs March. Should this actually by the case, the release could weigh on the zloty and support the front end of the Polish bond curve.

Economic calendar

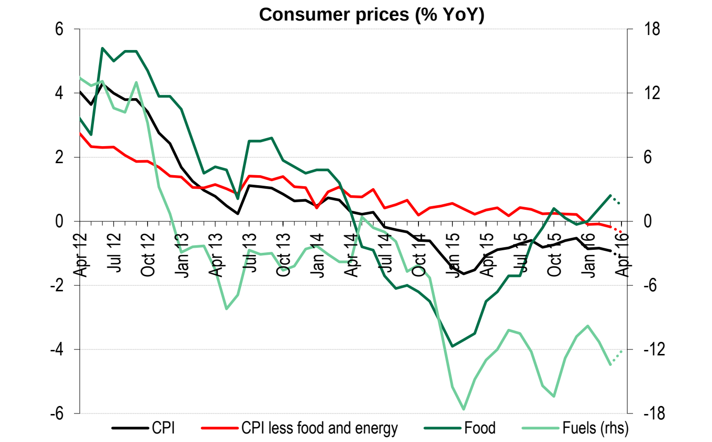
TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (25 April)					
10:00	**PL**	**Unemployment rate**	**Mar**	**%**	**10.0**	**10.0**	**10.3**
10:00	DE	Ifo index	Apr	pts	107.0	-	106.7
16:00	US	New home sales	Mar	k	522	-	512
		TUESDAY (26 April)					
14:00	HU	Central bank decision		%	1.05	-	1.20
14:30	US	Durable goods orders	Mar	% m/m	1.7	-	-3.0
16:00	US	Consumer confidence index	Apr	pts	96.0	-	96.2
		WEDNESDAY (27 April)					
16:00	US	Pending home sales	Mar	% m/m	0.1	-	3.5
20:00	US	FOMC decision		%	0.25-0.50	-	0.25-0.50
		THURSDAY (28 April)					
14:30	US	Advance GDP	Q1	% y/y	0.7	-	1.4
14:30	US	Initial jobless claims	week	k	-	-	247
		FRIDAY (29 April)					
11:00	EZ	Flash HICP	Apr	% y/y	-	-	-0.1
11:00	EZ	GDP	Q1	% q/q	0.4	-	0,3
14:00	**PL**	**Flash CPI**	**Apr**	**% y/y**	**-**	**-1.2**	**-0.9**
14:00	**PL**	**Inflation expectations**	**Apr**	**% y/y**	**0.2**	**0.2**	**0.2**
14:30	US	Personal income	Mar	% m/m	0.3	-	0.2
14:30	US	Consumer spending	Mar	% m/m	0.2	-	0.1
16:00	US	Michigan index	Apr	pts	90.2	-	89.7

Source: BZ WBK, Reuters, Bloomberg

ECONOMIC ANALYSIS DEPARTMENT:
al. Jana Pawła II 17, 00-854 Warszawa fax +48 22 586 83 40
email: ekonomia@bzwbk.pl Web site: http://www.bzwbk.pl
Maciej Reluga (Chief Economist) +48 22 534 18 88
Piotr Bielski +48 22 534 18 87
Agnieszka Decewicz +48 22 534 18 86
Marcin Luziński +48 22 534 18 85
Marcin Sulewski +48 22 534 18 84

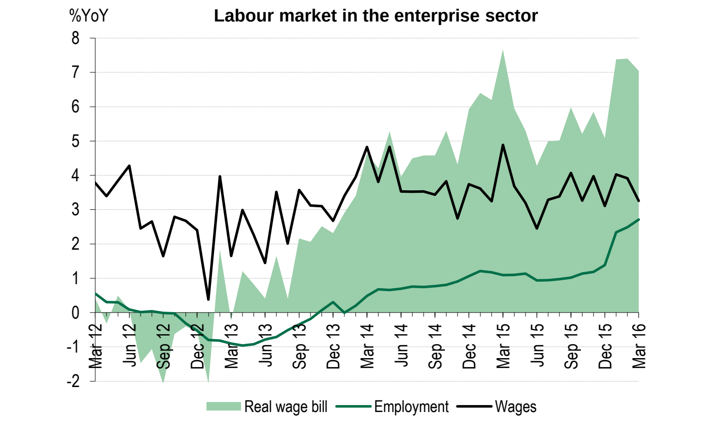
TREASURY SERVICES:
Poznań +48 61 856 5814/30
Warszawa +48 22 586 8320/38
Wrocław +48 71 369 9400

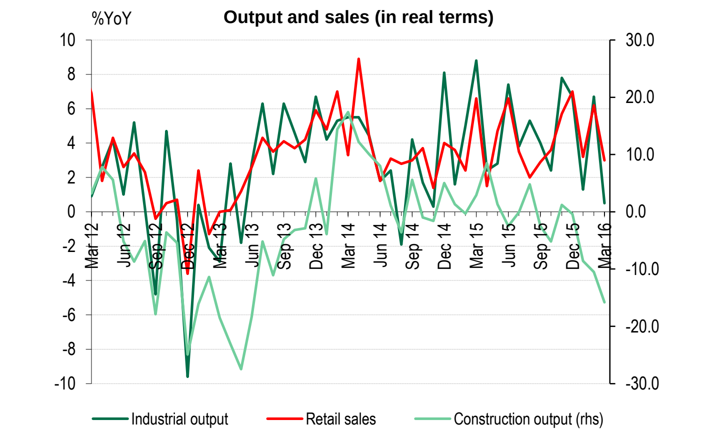
What's hot this week – Unemployment rate and flash CPI



- According to our estimates, Poland's registered unemployment rate in March fell to 10.0% from 10.3% in February, the lowest level in this month since 1991. Our forecast is supported by the Labour Ministry's estimate. We expect further declines in the unemployment rate in the upcoming months.
- We expect a decline of CPI in March to -1.2% y/y from -0.9% y/y. This will be mostly due to a cut in gas prices (by 5% m/m for households) and a high base effect in food prices. In our view, this will be this year's trough in CPI, which we expect to go up in the following months, turning positive in 4Q2016. Still, such a low reading (lowest since March 2015) may awake market expectations for a rate cut in Poland this year (the market currently sees quite a high probability of a rate cut in 6-9 months' time).

Last week in the economy – Strong labour market but disappointing activity





- In March, corporate employment grew 2.7% y/y, while wages were up 3.3% y/y. On a monthly basis, the number of workplaces in the corporate sector increased by as many as 15.5k, the best March result since 2007. We think that the slowdown in wage growth compared to February (3.9% y/y) mainly stemmed from a weaker working-day effect. We think that sound fundamentals of the Polish economy will continue to fuel demand for labour although the pace of employment growth may decelerate as the stock of qualified labour force is drying up.
- March retail sales (3% y/y in constant prices), industrial production (by 0.5% y/y) and construction (-15.8% y/y) strongly disappointed. It is hard to identify the source of this slowdown (though industry was partially dragged down by the weaker working-day effect and high base in mining) because the economy of both Poland's and the main trading partners seems to favour positive trends.
- GDP growth in 4Q15 was revised up to 4.3%, mainly due to higher public consumption. In our opinion, in the first quarters of 2016, economic growth is unlikely to stay above 4% y/y, while starting from 3Q2016, GDP growth will be supported by a significantly higher growth of private consumption.
- According to an unofficial version of the Convergence Programme, the pace of GDP growth is expected to accelerate from 3.8% this year to 4.1% in 2019. The GG deficit to GDP is expected to fall to 1.3% in 2019 (last year this target was assumed for 2018). Also, the public debt to GDP will run above the path expected in 2015 – above 50% in the forecast horizon. It will take longer to consolidate public finances because of the government's higher expenses, which will only by partly covered by higher tax collection.

Quote of the week – Final solution (for FX loan holders) will not be a cataclysm

Marek Belka, NBP president, Bloomberg, 18.04

The main reason [to cut rates] would be a significant weakening of economic growth in Poland. If credit stopped increasing or if there's a strange situation on the currency market, in either direction, then a wait-and-see strategy wouldn't be right. In 2017 budget policy may be looser. It's not recommended to cut rates in such instances.

Eryk Łon, MPC member, Nasz Dziennik 18.04

Risk of economic growth slowdown in Poland would be a reason to consider another rate cut. However, it seems that rates should not be changed soon.

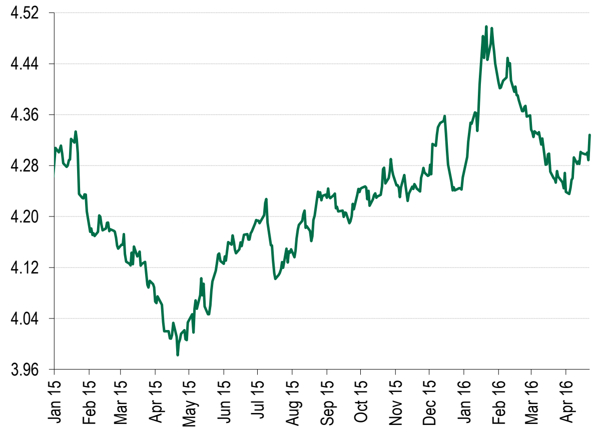
Adam Glapiński, NBP board member, Reuters, 20.04

FX mortgage loans are the biggest challenge. This issue should be solved as quickly as possible. I promise this will not be a cataclysm (…) all decision makers speak about stability of the banking sector.

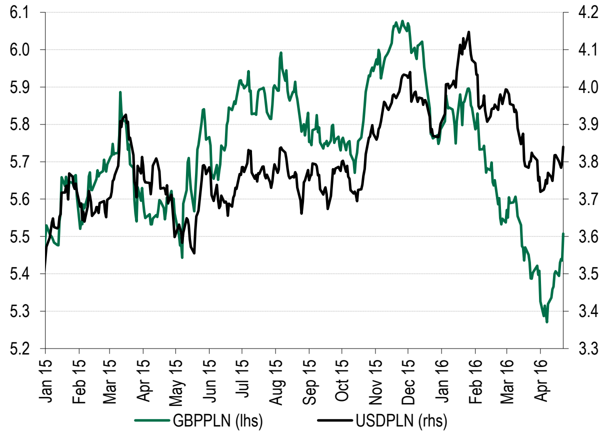
Minutes from the last MPC meeting and recent comments of the MPC members outline conditions for further rate cuts in Poland: slower growth, deeper deflation, a sudden stop in credit action or a considerable PLN appreciation. Deflation is still deepening (we expect -1.2% y/y in April), but, in our view, this is only temporary and CPI growth will turn positive at the year-end. As regards economic growth, we expect some slowdown against the very strong Q4 (4.3%), but it should not be significant (still above 3% y/y), thus not justifying further easing. We do not think that sharp PLN appreciation is very likely, given the continuously high political risk in Poland and the unresolved CHF loan issue. Credit growth should also remain quite solid, in our view. As Adam Glapiński, a likely candidate for NBP president, said, any solution of the CHF loan problem will respect financial stability. Thus, we do not think interest rate cuts are very likely.

Foreign exchange market – Little room for zloty gains

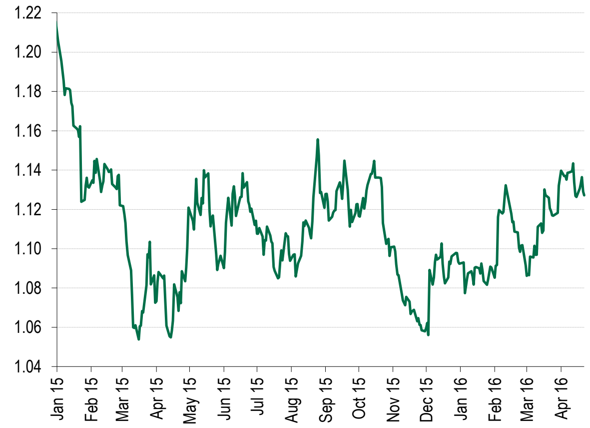
EUR/PLN



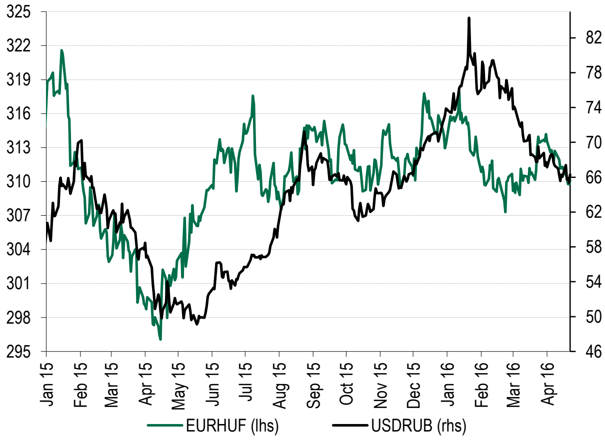
USD/PLN and GBP/PLN



EUR/USD



EUR/HUF and USD/RUB



Little room for zloty gains

- The zloty remained weak and continued to weaken vs the euro, dollar and pound, a trend triggered earlier this month by, among others, Moody's warning on the impact of the political situation in Poland on the sovereign rating. EUR/PLN rose last week to 4.35, its highest since mid-March, also on the rather volatile global market sentiment, significant weakening of the Polish bonds, clearly disappointing domestic economic activity data. And despite dovish signals from the ECB. USD/PLN rose to 3.87 and GBP/PLN to 5.57. In the past week, the zloty was the worst performing EM currency vs the euro, dollar, pound and franc.
- Numerous crucial US data (including the advance 1Q GDP estimate) is on the agenda this week. The FOMC is also to announce its interest rate decision. Last month's statement was surprisingly dovish and was one of the factors behind EURPLN's free-fall seen in the next few weeks that followed. The global market sentiment seems to have improved since then (stock indexes are higher) and so we do not expect any dovish surprise this time around that could support the Polish currency. This means that the US macro releases and how they are perceived in the context of their impact on monetary policy should play the main role.
- The month is nearing its end and we think it is worth noting that the zloty firmed against the euro in May only twice in the last 10 years: in 2008 (when risky assets were rallying worldwide a few months before the US financial crisis) and in 2014 (on expected monetary policy easing in the euro zone). The average monthly percentage EUR/PLN rise in May for the last 10 years was c2.3%. We do not think the sentiment in the equity market is strong enough to provide sufficient support for the zloty and the ECB is likely to refrain from taking more action in the short-term. This is why we think there is limited room for the zloty to gain in the nearest future.

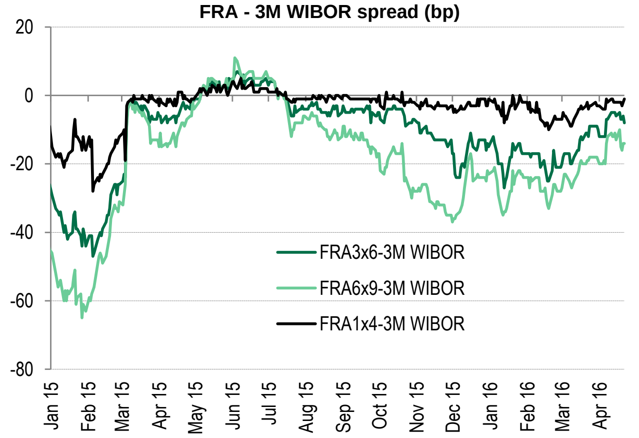
US data key for EUR/USD

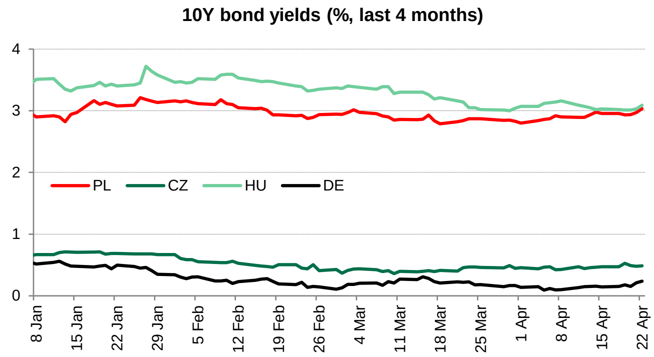
- The past week was rather quiet for EUR/USD despite numerous US data releases and the somewhat dovish outcome of the ECB meeting. The exchange rate stayed close to 1.13 and within the previous week's trading range.
- As mentioned above, we do not think the FOMC could surprise again by coming through more dovish and so the outcome of the meeting should be at least dollar-neutral. The US data will be key for EUR/USD this week, in our view.
- Each downward correction ahead in the upside trend that has been in place since early March is bigger than the previous one and this suggests that it could be difficult for the euro to continue to gain vs the dollar.

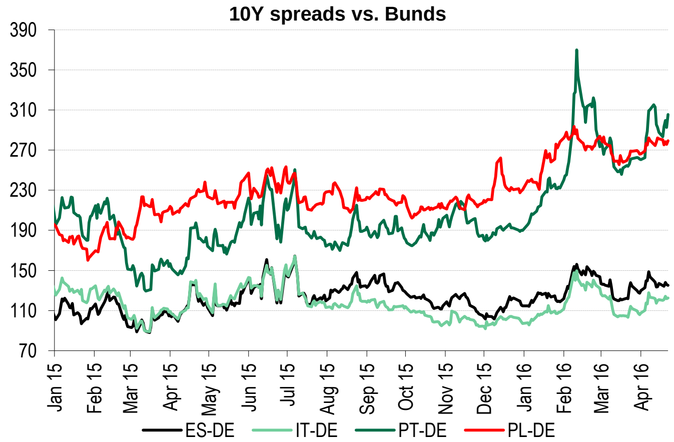
MNB, CBR should not surprise

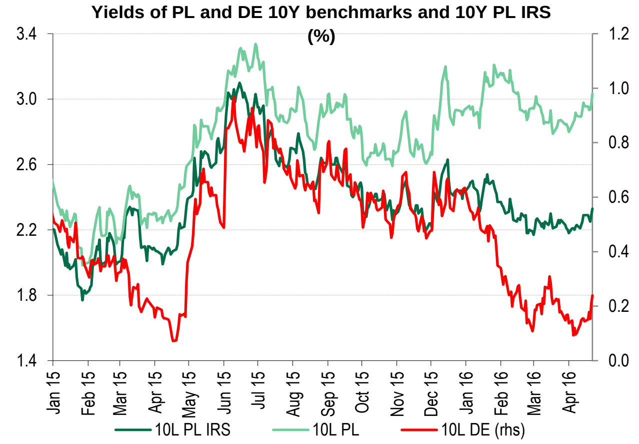
- The forint continued to appreciate vs the euro despite the outlook for more rate cuts by the Hungarian central bank (MNB). EURHUF eased temporarily last week to nearly 308, its lowest since mid-March. The MNB will announce its rate decision this week and the market expects a 15bp cut.
- The rising oil price continued to support the ruble, pushing USD/RUB to its fresh 2016 low at 64.6, its lowest since late November 2015. Russia's central bank will also decide on rates this week (on Friday). The main rate is currently at 11% and the market does not expect any change this week. The economic and inflation trends are key for CBR and these are highly dependent on the commodity market. In March, the bank expected a 1.3-1.5% contraction, assuming the average oil price at US$30bbl. In April, the bank's analysts said it could be c1% if oil stays close to its current levels.

Interest rate market – Some revival ahead?









Interest rate market under pressure

- Poland's interest rate market suffered on noticeable rises of yields on both core and peripheral debt last week. The German 10Y benchmark yield jumped almost 9bp on a weekly basis, its highest level in more than a month. As a consequence, the Polish 10Y benchmark yield tested 3% at the end of the week (its highest level since early March) due to weak macro data and despite favourable auction results.
- Poland's Ministry of Finance successfully launched floaters (WZ0120, WZ0126) and 5Y benchmark PS0721. The total sale amounted to PLN8.5bn (including top-up), more than the maximum level on offer (PLN8bn). Funds from the PS0416 redemption and interest payments (cPLN16.4bn in total) supported bids, mainly for PS0721. All in all, after April's auctions, Poland has covered more than 60% of the 2016 gross borrowing needs.
- Tracking trends on the core markets, the Polish T-bond and IRS curves steepened somewhat as the long end of the curves underperformed the front end. At the same risk, the premium fell markedly as the Polish 10Y benchmark spread over the Bund narrowed to nearly 275pb, similarly to other CEE peers.
- As regards the money market, WIBORs remained unchanged, while FRAs dropped gradually, in particular on much weaker-than-expected industrial output and retail sales data. Market expectations for rate cuts slightly strengthened as investors now see an 80% chance (vs c60% at the start of the week) that rates will fall by 25 bp in nine months' time.

Heavy week of key events for bonds

- This week is filled with important events globally (central bank meetings in Hungary and USA) and domestically (bank tax payment, May's issuance plan), as well as macro data releases (including first estimates of GDP growth for the euro zone and USA, flash CPI in Poland). As was the case in the previous months, the Fed meeting will take centre stage. However, in our view, the FOMC rhetoric is unlikely to differ significantly compared with the March meeting. Notwithstanding, a still dovish outcome of the Fed meeting could be a supportive factor for bonds globally, but only in the short term. Following the meeting, important data, including GDP in the US, will be released, which might affect investors' view on further monetary policy in the US.
- This will be the last week of the month, so we expect higher volatility on the market due to the banking tax payment. Similarly to the previous month, there could be significant changes in the very short WIBOR rates and POLONIA. We could also see more activity, though mainly on the front end of the bond curve ahead of the tax payment.
- The statistics office will release flash CPI data for April this week. We expect deflation to deepen again, increasing the real yields of Poland's assets. This data could, therefore, lead to some revival on the Polish interest rate market, especially on the front end of the curves and after the quite significant weakening a week ago.
- Poland's Ministry of Finance will present its issuance plan for May. In our view, the ministry might offer bonds worth up to PLN8bn at two regular auctions. We expect the ministry to take a flexible approach to the supply and offer bonds also taking into account the fact that it has already met quite a significant amount of the government's borrowing needs for the year.

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.