Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

2 – 8 April 2018

There are three important publications right after the Easter: general government debt and deficit for 2017, March's PMI and flash inflation. We are expecting the PMI to fall for the third time in a row, to 53.5pts, i.e. to the level recorded about half a year ago. In our view, flash CPI print will rise to 1.6% y/y. Still, as long as we are below 2% (and in our view this will happen for the better part of the year), interest rate hikes in Poland will remain a matter of distant future.

The zloty gained recently despite stronger dollar, possibly owing to information about rising chances for a compromise between Poland and the EU on rule of law. However, room for a further PLN appreciation seems limited. German and US bond yields were considerably down. Polish 10Y bond yields are trying to break 3.20%, an important technical support. A successful attempt can open the way to a further move down. Such a development could be backed by surprising low inflation in Poland or in the Euro zone. In the upcoming month, Polish bonds will be additionally underpinned by favourable supply/demand relation: the Ministry's offer will be limited, while banks and other financial institutions are likely to show high demand, as they are moving from floaters to fixed-coupon papers, and PLN15bn is flowing on the market from buybacks and interest payments.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (2 April)					
16:00	US	ISM manufacturing	Mar	pts	60.0		60.8
		TUESDAY (3 April)					
	DE	Retail Sales	Feb	% m/m	0.7		-1.0
09:00	**PL**	**Poland Manufacturing PMI**	**Mar**	**pts**	**-**	**53.5**	**53.7**
10:00	**PL**	**GG deficit**	**2017**	**% GDP**	**1.8**	**1.6**	**2.5**
09:55	DE	Germany Manufacturing PMI	Mar	pts	58.4		58.4
10:00	EZ	Eurozone Manufacturing PMI	Mar	pts	56.6		56.6
		WEDNESDAY (4 April)					
03:45	CN	Caixin China PMI Services	Mar	pts	54.55		54.2
10:00	**PL**	**CPI**	**Mar**	**% y/y**	**1.7**	**1.6**	**1.4**
11:00	EZ	Flash HICP	Mar	% y/y	1.4		1.2
11:00	EZ	Unemployment Rate	Feb	%	8.5		8.6
14:15	US	ADP report	Mar	k	205.0		234.7
16:00	US	Durable Goods Orders	Feb	% m/m	-		3.1
16:00	US	ISM services	Mar	pts	59.0		59.5
16:00	US	Factory Orders	Feb	% m/m	1.7		-1.4
		THURSDAY (5 April)					
08:00	DE	Factory Orders	Feb	% m/m	2.4		-3.9
09:55	DE	Markit Germany Services PMI	Mar	pts	54.2		54.2
10:00	EZ	Eurozone Services PMI	Mar	pts	55.0		55.0
11:00	EZ	Retail Sales	Feb	% m/m	0.3		-0.1
14:30	US	Initial Jobless Claims		k	230.0		229.0
		FRIDAY (6 April)					
08:00	DE	Industrial Production SA	Feb	% m/m	0.3		-0.1
14:30	US	Change in Nonfarm Payrolls	Mar	k	189.0		313.0
14:30	US	Unemployment Rate	Mar	%	4.0		4.1

Source: BZ WBK, Reuters, Bloomberg

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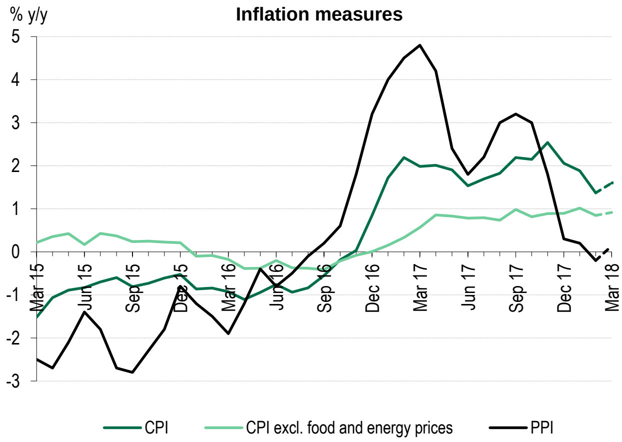
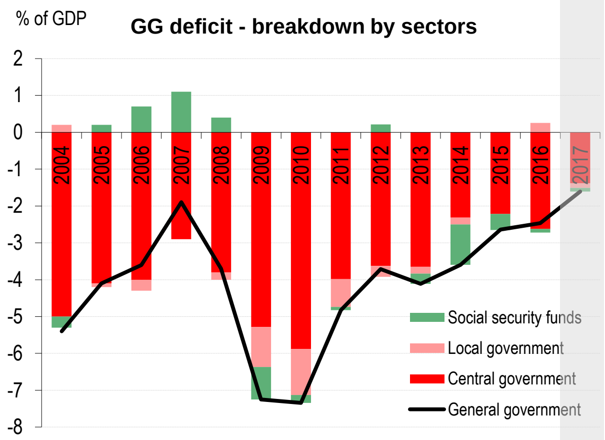
What's hot next week – CPI, GG deficit and PMI



- We are expecting CPI to inch up to 1.6% y/y in March from 1.4% in February. Upward march will be mostly due to higher annual growth of food prices, driven upwards by low base effect. Some downward pressure on CPI will be put by lower fuel and gas prices. We are also expecting the downward trend in communication prices to hold. Core CPI excluding food and energy prices will go up to 0.9% y/y from 0.8% y/y, in our view. We expect CPI to stay below 2% y/y in the months to come, with only temporary jumps above this mark. The relatively low CPI will support the MPC dovish rhetoric.
- In our view, in 2017 the general government deficit fell to 1.6% of GDP from 2.5% of GDP in 2016. This was the lowest deficit since comparable data have been available (1998).
- In our view, economic activity in Poland recorded its top performance at the turn of 2017 and 2018 and some slowdown is to come, so we see PMI for manufacturing a bit lower.

Last week in economy – ESI down, Moody's raised forecasts for Poland



- ESI indices showed some correction in sentiment in Poland in March. March was the weakest month this year in the overall sentiment index and the main sectoral indices (industry, services, consumers), but still much above the levels seen in 2017. Inflow of new business to industry remained close to all-time records. Building activity also weakened, shortage of labour was weighing on capacity a bit more than in February. Some sectors have already scaled down their employment expectations (construction, retail trade) while industry and services continue to believe it will be possible to fill vacancies in spite of the labour shortages in the economy. Consumers lost some of their confidence in future performance of the economy. Consumer inflation assessment and expectations dropped quite significantly, to the lowest level in 5 and 8 months, respectively.
- Moody's agency said risks to Polish rating of A2/neutral are balanced. Its analysts think an upgrade would require fiscal consolidation, improved balance of the social security system and institutional environment. A downgrade could come if fiscal position or investment climate deteriorated or if there were no structural reforms. The agency raised its forecast for Poland: GDP 2018 forecast from 3.5% to 4.3% and to 4.0% in 2019. The inflation forecast was revised from 2.2% to 2.7% for this year while CPI was projected at 3% in 2019. The deficit forecast was clearly reduced, from 2.7% to 1.8% of GDP this year. Next year it is forecasted at 2.3%, still far from the 3% threshold limiting the EU states. Despite such positive revisions, the agency assumes that the economy will be affected by workforce shortages, only partially counterbalanced by the inflow of immigrants and growing labour activity

Quote of the week – High chance for an agreement

Mateusz Morawiecki, Prime Minister, Reuters, wPolityce.pl March 27

Drafts regarding Poland's judicial system, recently proposed by the Law and Justice (PiS) party, have been received with great interest. There is a high chance for an agreement [with the European Commission] to be reached.

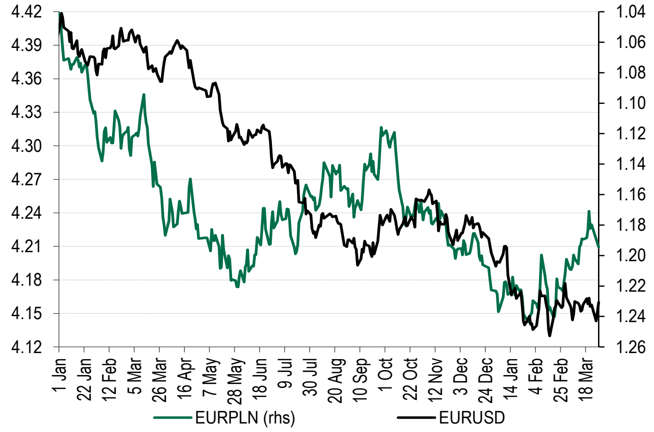
Jean-Claude Juncker, head of European Commission, TVN, March 23

I took the initiative of the Polish parliament with high sympathy.

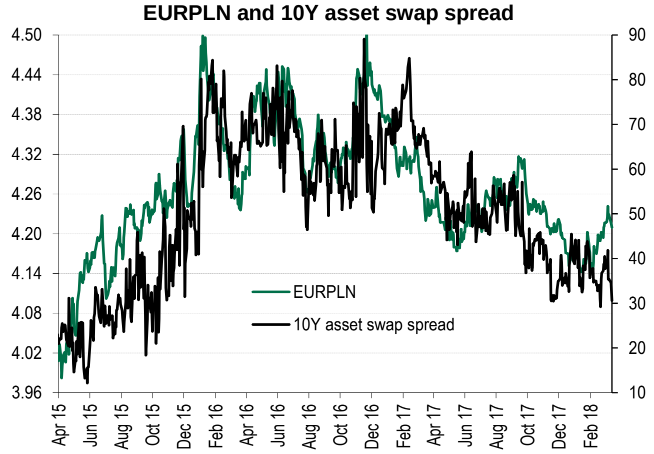
PM Mateusz Morawiecki said in an interview with wPolityce.pl that he sees high chance of reaching agreement with the European Commission on the rule of law issue. The ruling Law and Justice (PiS) has recently submitted amendments to judicial laws addressing some of the EC's recommendations: publication of the three unpublished sentences of the Constitutional Tribunal from 2016, and introduction of two-step consultations in the process of removal of heads and deputy heads of courts. If the EC welcomes those moves, saying that it is enough to lift the rule of law procedure, then the risk of cutting the EU funds for Poland would decrease, which should be positive for Polish assets. Note that head of the European Commission was positive about the proposed changes.

Foreign exchange market – Dollar and zloty in attack

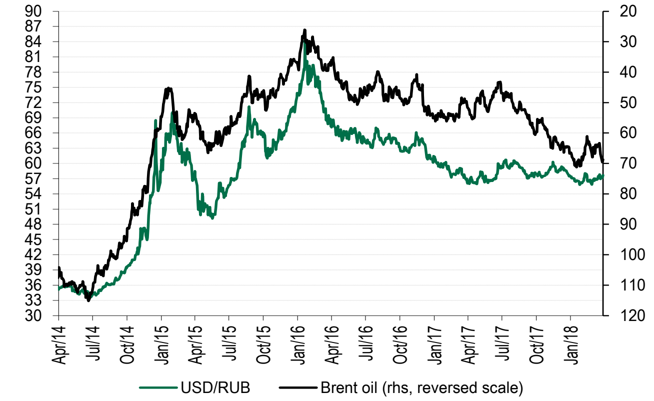
EURPLN and EURUSD



EURPLN and 10Y asset swap spread



USDRUB and Brent prices



Polish zloty recovering amid declining fears related to global trade

- The end of last week saw increases in EURPLN. The pressure on our currency came from the rising fears related to global trade, in view of the US plans to impose tariffs on Chinese exports. As a result, EURPLN started the week at 4.2330. Further into the week, the zloty strengthened, supported by improving sentiment for emerging markets' currencies. By midweek, EURPLN reached 4.2030, and rose slightly thereafter. USDPLN moved in the opposite direction during the week, climbing to 3.4230 on Thursday midday from 3.3910 on Monday afternoon. CHFPLN went down, following EURPLN (from 3.6070 to 3.5770), supported by the Swiss currency weakening against the euro. GBPPLN declined slightly (from 4.8250 to 4.8040), also on the back on the zloty strengthening against the euro.
- We believe that the prospects for a strengthening of the zloty are poor, and in any case it would only be temporary. We therefore reiterate that in the coming weeks the zloty will oscillate in the range of 4.21–4.22.

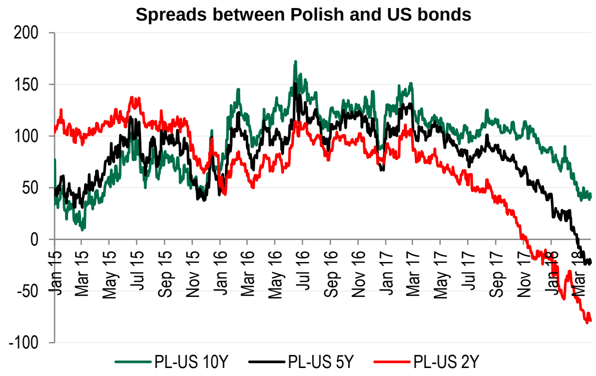
Weaker euro following PMI and US GDP data

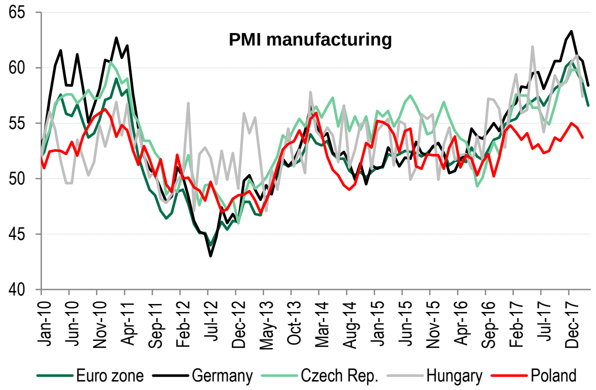
- The decline in EURUSD was accompanied by a weakening of the euro (EURUSD dropped from 1.2450 to 1.2310), largely in response to weaker-than-expected leading indicators from the Eurozone (ESI down from 114.1 to 112.6 points). The US dollar was additionally driven by the higher-than-expected final GDP reading for 4Q17 in the US (2.9% y/y, compared to the forecasted 2.7% y/y). Looking forward, we expect the US dollar to strengthen slightly against the euro in the coming weeks, with EURUSD declining below 1.2290. This scenario should be supported by slightly stronger US labour data and the continuing low leading indicators from Europe.

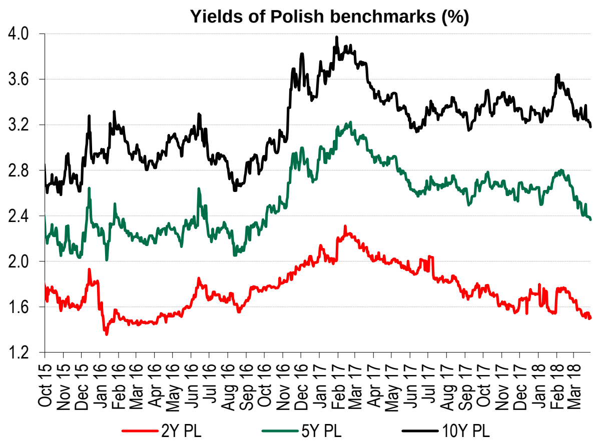
No change in MNB and CNB rates

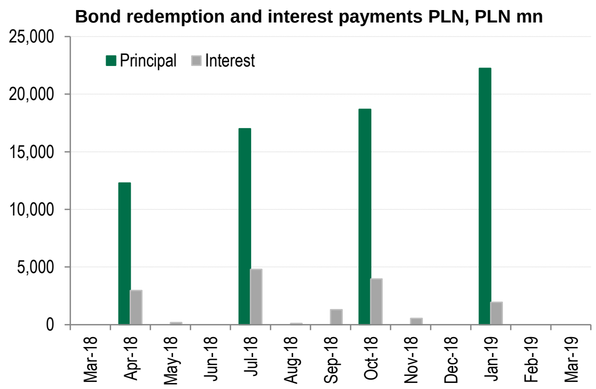
- Last week EURCZK returned to 25.37 (after hitting 25.48 on Wednesday) in response to the central bank's decision to keep the policy rates unchanged and to hold off any hikes at least until the end of 2018 (adopting the "wait and see" approach). The declines in EURCZK recorded at the end of last year should be partly covered by profit taking. Regarding EURHUF, it recorded a temporary rise from 312.20 to 313.10 followed by a decline to about 312.20; these movements were driven by fears of a trade war between the US and the rest of the world. The decisions of the Hungarian central bank to keep the rates at the current level and to continue deploying non-standard monetary policy measures to support the accommodative monetary conditions have not affected the Hungarian currency. For the coming week we expect the EURHUF to weaken slightly on the back of worse industrial production data.
- USDRUB kept climbing up the whole week, supported by the declining oil prices and the tensions caused by the diplomatic crisis related to the expulsion of Russian diplomats. As a result, USDRUB rose from 57.10 to 57.50. We expect it to stabilise in the coming week.

Interest rate market – Lower inflation strengthens bonds









Eurozone inflation data pushed yields down

- Over the last week, the domestic yield curve has moved down by 3-6bp, more visibly on the long end. The scale of the downward shift in the 5-10Y segment was close to the changes observed in the US curve and smaller than the German ones. The long end of the IRS curve decreased on a scale similar to the long end of the yield curve. The curves were pushed down by the core market behaviour and Eurozone inflation data.

Limited supply will support domestic bonds

- We think that the post-Easter week on the debt market will be dominated by Polish and European PMI data and domestic flash inflation data. At the end of the week, market players will concentrate on the US non-farm payrolls data. There is a switch auction planned in the domestic calendar. The low debt supply in April (PLN4-8bn on one regular auction scheduled for 27 April, vs. total debt supply in April'17 at PLN7.9bn) should support the bonds valuation. Total bond supply in 2Q18 at PLN15-25bn on 3-5 auctions is planned to be similar to 2Q2017 (PLN20bn). In our view, this information will not undermine the market mood.

- As regards the final PMI data release, we do not expect a positive surprise. Firstly, because of the lower level of foreign orders in the flash PMI data (in our opinion due to the stronger euro). Secondly, the ESI indices show that companies are less optimistic about further demand and assessment of new orders (also due to the stronger euro). Consequently, the likelihood of an upward revision is lower. Moreover, the domestic flash CPI data will rather not surprise us on the positive side and even if it does, we believe this will be neutralized by lower Eurozone inflation. As a result, in the first half of the week, the sentiment for the debt market should remain strong. A certain risk is related to the opening of a new quarter (Monday-Tuesday). It may mean a small and temporary sell-off in the 8-10Y segment (after window dressing at the end of 1Q18).

Non-farm payrolls data will not affect Polish debt market

- In the late week investors will focus on the US labour market data. In our opinion, the non-farm payrolls reading will be slightly above expectations (185K), which may negatively affect the US treasuries. However, we do not expect a significant negative impact on the Polish treasuries. In one or two weeks, we expect the downward pressure on the Polish yields to continue. Further data release from Europe and Poland (we do not anticipate any surprise on the positive side) as well as upcoming bond redemptions and interest payments at the end of April (in total, slightly above PLN15bn) will probably positively influence the Polish debt market.

Switch auction

- The switch tender scheduled for 5 April will include sales of OK0720, PS0123, WZ0524, WS0428, WZ0528, versus purchases of PS0418, PS0717 and OK1018.

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 87, email ekonomia@bzwbk.pl