Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

9 – 15 April 2018

After a major surprise from lower inflation, investors' attention will be turned to the MPC decision on Wednesday. The MPC's rhetoric changed to much more dovish already in the previous months so the question is: can it be even more dovish now? Definitely, it is not going to get more hawkish, so the risk is one-sided, in our view. It should be noted that already before the March CPI release, the number of MPC members not ruling out that the next decision may be a rate cut and not a hike increased from one (E.Łon) to three (plus J.Kropiwnicki and J.Żyżyński). However, we do not expect the NBP Governor Glapiński to go that far to suggest rate cuts. Please recall that he was against policy easing in 2016, during the economic slowdown and prolonging deflation.

Friday the 13th will end up with the S&P rating review for Poland. There are no reasons to be feared, though, in fact, the question for now is how big the chances for rating improvement are. We expect the rating will remain unchanged (BBB+/A-2, outlook stable). Although some of the conditions pointed earlier by the S&P as supporting the rating improvement have materialized (low external imbalance, lower government debt and containment of interest expenses), but it is still too little to outweigh other risk factors (worries about demographic outlook, institutional uncertainty).

The issue number one abroad is trade wars and changes in market moods reflect the newsflow related to this subject. The US administration sends mixed signals: sometimes suggesting that it is possible to avoid new tariffs, and then threatening to escalate tariffs fight. It is hard to predict what kind of rhetoric will dominate in the coming days.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (9 April)					
08:00	DE	Exports SA	Feb	% m/m	-		-0.4
		TUESDAY (10 April)					
09:00	CZ	CPI	Mar	% y/y	1.7		1.8
09:00	HU	CPI	Mar	% y/y	-		1.9
		WEDNESDAY (11 April)					
	PL	**Poland Base Rate Announcement**		**%**	**1.50**	**1.50**	**1.50**
14:30	US	CPI	Mar	% m/m	0.0		0.2
20:00	US	FOMC Meeting Minutes	Mar-18		-		0.0
		THURSDAY (12 April)					
11:00	EZ	Industrial Production SA	Feb	% m/m	-		-1.0
14:30	US	Initial Jobless Claims		k	225		215
		FRIDAY (13 April)					
08:00	DE	HICP	Mar	% m/m	-		0.4
10:00	**PL**	**CPI**		**% y/y**	**1.3**	**1.3**	**1.4**
14:00	**PL**	**CPI Core**	**Mar**	**% y/y**	**-**	**0.6**	**0.8**
14:00	**PL**	**Current Account Balance**	**Feb**	**€mn**	**-412**	**-544**	**2 005**
14:00	**PL**	**Trade Balance**	**Feb**	**€mn**	**-468**	**-310**	**-204**
14:00	**PL**	**Exports**	**Feb**	**€mn**	**16 688**	**16 792**	**16 853**
14:00	**PL**	**Imports**	**Feb**	**€mn**	**17 221**	**17 102**	**17 057**
16:00	US	Michigan index	Apr	pts	101.0		101.4

Source: BZ WBK, Reuters, Bloomberg

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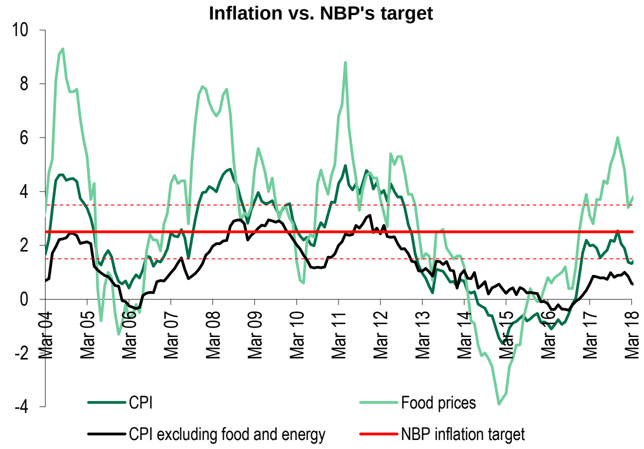
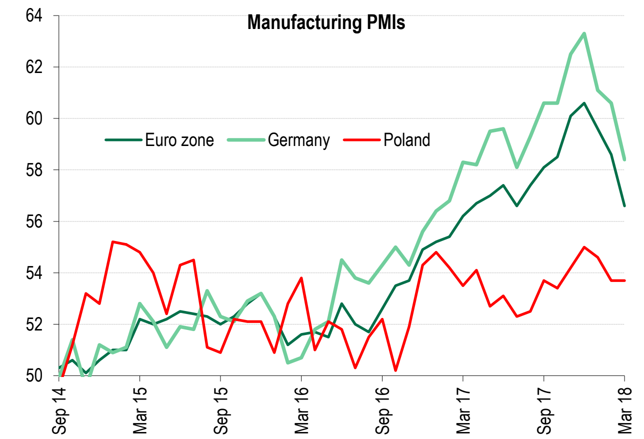
What's hot next week – MPC's 'I told You' moment

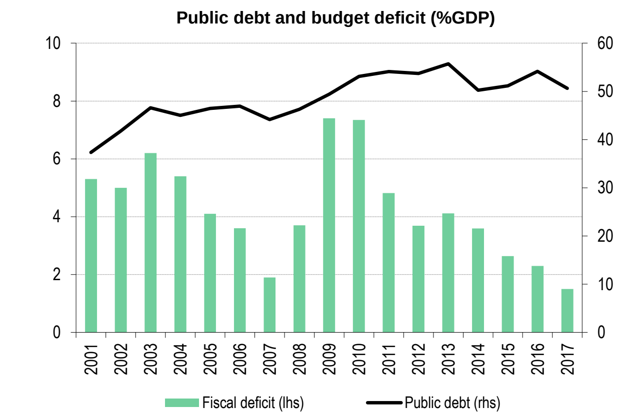


▪ The MPC meets this week. We do not think the statement requires any changes given what we have recently learned about the economy. The focus at the press conference will be on CPI. Inflation unexpectedly sneaked below the +/-1pp range around the NBP target in February and March. Headline and core CPI already dipped below the March NBP projection, published less than a month ago. The governor might simply repeat that as far ahead as one could rationally look rates should stay unchanged, and what has recently happened to CPI just shows the high uncertainty the MPC has to deal with. Any references to rate cuts now seem unlikely: the MPC did not want to cut rates further in 2016 when deflation lingered and GDP growth was much weaker. Still, we now have 3 members instead of 1 who do not exclude that the next move could be a rate cut.

▪ We think the S&P will keep the Polish rating and outlook unchanged on April 13.

Last week in economy – Tiny inflation, record-low GG deficit





▪ Polish inflation unexpectedly declined in February, from 1.4% y/y to 1.3%. Market consensus was 1.6-1.7% and we expected 1.6%. This is the second big negative deviation from consensus in a row. Core inflation most likely dropped to 0.6% y/y from 0.8%, while a rise to 0.9% was expected and goes against our view that the measure of price trends should increase due to the tensions on the labour market. We do not know the exact source of this surprise, but we direct our suspicion towards financial services (Eurostat showed a considerable drop in this category in February in HICP) and clothing/footwear. The latter usually rises in March, but this time the effect may have been distorted by the long winter, which delayed the introduction of new spring collections to the boutiques. Additionally, the Statistics Office introduced a methodological change in this category. This release was another trigger to lower this year's forecasted CPI path. We now feel it may be hard for CPI to return to 2% y/y this year.

▪ Polish PMI stayed at 53.7 pts in March, beating consensus; there was no third decline in a row. The report mentions the decrease in the new orders component to the lowest level since July 2017 and no growth of foreign orders vs. February. The purchasing activity sub-index also decreased in March (the lowest in 16 months). Current output and expected output remained strong and employment rose at the fastest pace in almost a year. The March PMI signals it will be hard for the economy to maintain 5% GDP growth in the coming quarters.

▪ The general government deficit for 2017 was estimated at 1.5% of GDP vs 2.3% in 2016, the lowest level since comparable data have been available (1995). This was driven by strong growth of tax revenues, due to strong consumption and improved tax collection, low debt servicing and social security costs. We expect the 2018 GG deficit at 2% of GDP.

Quote of the week – Accord possible

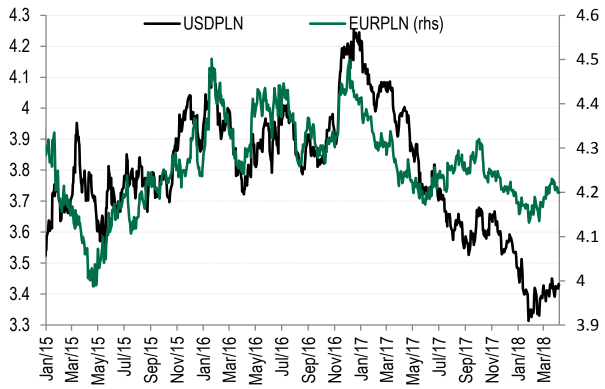
Jarosław Kaczyński, Law and Justice leader, Gazeta Polska, 4 April

I assess chances that the spat with the European Commission will end at 80%. According to the information I have, an accord is possible. We want to change the law in line with the EC recommendations. It is required in the light of the need to normalise the situation.

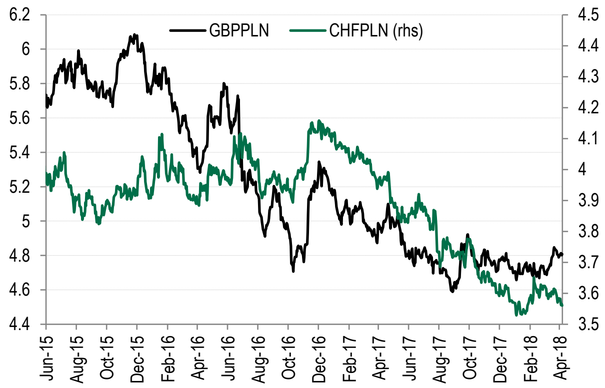
More signals from the ruling Law and Justice (PiS) that it wants to end the rule-of-law conflict with the European Commission. We described the judicial steps taken by Poland in the previous edition of our Weekly Economic Update. An accord could have material impact on Polish currency and assets (potentially, accessibility of future EU funds is at stake). It might also change the balance of risks in the view of rating agencies. S&P might issue a report on April, 13. We note however that, while the agency downgraded Poland in Jan-16 on institutional concerns, its recent opinions have focused on net government debt level, response to ageing to secure future budgets, and long term potential growth.

Foreign exchange market – Zloty stronger thanks to better fiscal data

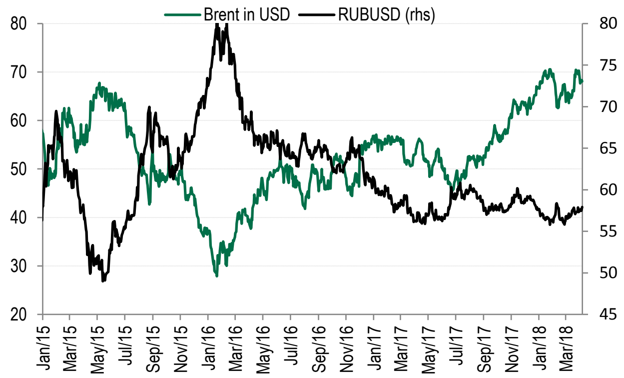
EURPLN and EURUSD

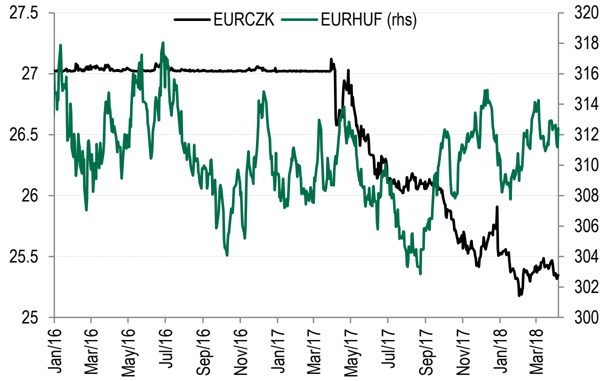


GBPPLN and CHFPLN



USDRUB and Brent prices





Zloty increased despite the low inflation reading

- Last week we observed gradually EURPLN decrease after the slight increases at the end of the previous week. As a result, EURPLN moved down to 4.1970 on Thursday from 4.2170 at the beginning of the week. On the way touching 4.1930, in a response to the drop in EURUSD to 1.2260. Over the most part of the week, USDPLN oscillated between 3.4100-3.4280, without the clear trend. Among the data that temporarily influenced the EURPLN, it is worth paying attention to March's CPI flash, whose low reading affected EURPLN and pushed it temporarily up to 4.2110. CHFPLN gradually declined, which was partly a consequence of the slight appreciation of the zloty to the euro, and in part the weakening of the Swiss franc against the euro (in reaction to negative surprise with the leading indicators of KOF and PMI). As a result, CHFPLN dropped on Thursday to 3.5660 from 3.5870 at the beginning of the week. GBPPL increased, mainly owing to GBP growth against EUR (as a reaction to good manufacturing PMI data), which translated into GBPPLN increase to 4,8180 from 4,8040.

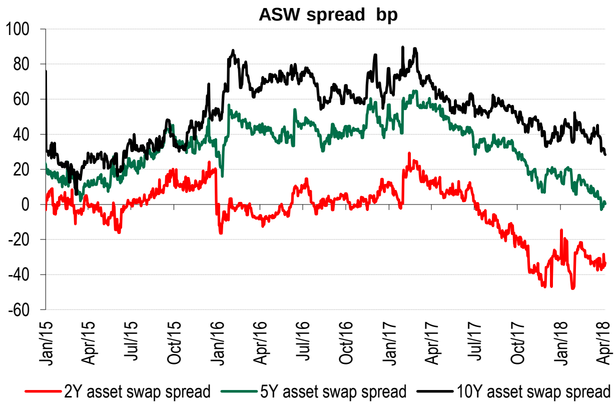
Fiscal data improvement pushed CEE currencies up

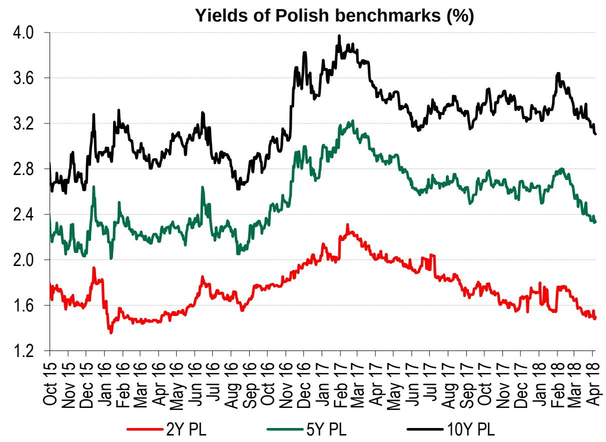
- EURUCZK dropped gradually over the week as a result of final GDP data for 4Q17 (5.5% y/y vs 5.2% y/y -estimates) as well as a strong budget surplus in 2017 (+1,6%GDP). As a result, EURCZK was pushed down to 25.33 on Thursday from 25.40 at the beginning of the week.
- EURHUF also fell (to 311.30 from 312.60) as a result of investors reactions to information about relatively low increase in government deficit (by 0,3 pp to 2,0% GDP) in 2017. Lower PMI reading in March from the Czech Republic and Hungary did not impress investors. USDRUB fluctuated between 57.20 and 57.90 without the clear trend, following changes in oil prices.

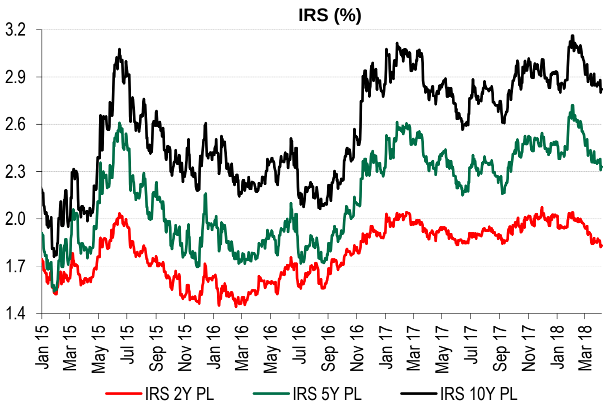
Expected EURPLN stabilisation and USDPLN rise

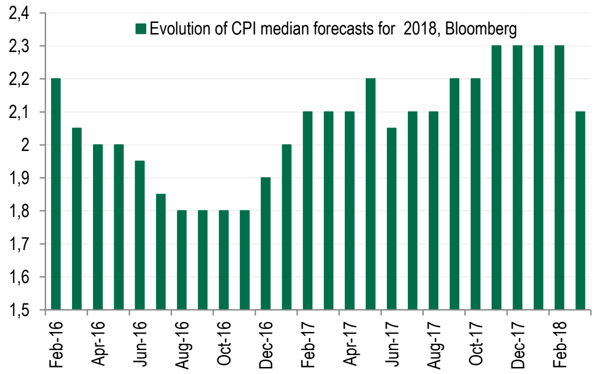
- Last Next week the investors on currency market will focus on the MPC conference, the final reading of inflation data in Poland and Europe and University of Michigan consumer confidence data. Market players will concentrate less on the minutes of the Fed meeting on March 18. We believe that in a response to the surprisingly low domestic inflation readings in March, the MPC will confirm the willingness to leave interest rates on the current level for a longer period. In our opinion, it may slightly negatively affect the zloty. The final reading of domestic inflation data and inflation reading for Eurozone as well as data about US consumer confidence are not likely to have a greater impact on EURPLN. In the case of the USDPLN rate, we expect a slight increase in response to growing trade tensions between the US and China.

Interest rate market – Yields decrease fuelled by lower inflation









Eurozone inflation data pushed yields down

- The MPC conference will be the key event for the domestic debt market this week. We believe that the MPC conference tone will be neutral or dovish. In our opinion, regardless of the conference rhetoric, it is hard to expect a negative impact on the debt market. The rest of the week data will likely have a moderate impact on the debt market. We believe that the US inflation data may somehow influence the US Treasuries, but the Polish treasuries will stay insulate. The Eurozone industrial production (we expect a slightly lower reading) will likely have a positive impact on the domestic debt, however on a moderate scale. The final reading of domestic CPI data due on 13 April remains the element of uncertainty. However, in our opinion, even if it turned out that the fall in inflation in March to 1.3% was caused by one-off effects, the scale of inflation surprise to the downside (1.3% y/y vs. 1.6-1.7% y/y, according to estimates) will prevail. The revision of the Polish debt rating announced for 13 April should not have a major impact on the domestic bond market.

Downward pressures to be maintained thanks to bond buy-back and low supply

- We At the end of the month, we expect the downward pressures on the yields to be maintained (more persistent in the 5-10Y segment), mostly thanks to the PS0418 bond redemptions (PLN11.5bn principal) scheduled for 25 April. This scenario will be supported by limited debt supply on the auction (planned for 27 April) and the "supply gap" which results from the difference between the auction and buy-back dates.

Low inflation supported debt

- In Over the last week, the yields of domestic bonds have decreased. The downshift of the curve was fueled mainly by decrease of debt to GDP ratio in 2017 (to 50.6 %) and lower-than-expected March inflation reading. As a result, the domestic curve moved down by 1bp in the 2Y segment, by 1bp in the 5Y segment and by 6bp in the 10Y segment. The IRS curve was shifted down by 1bp, 1bp and 5bp, respectively. It translated into asset swap spread (ASW) compression to 26bp for 10Y ASW (last seen in October 2015), -3bp for 5Y ASW (last seen in June 2014) and the rise of 2Y ASW to – 37bp. Investors were not impressed by the switch auction, at which the Ministry of Finance sold PLN3bn bonds.
- According to Finance Ministry data, the general government debt fell to 50.6% of GDP in 2017 (see chart on 2 page) from 54.1% in 2016 thanks to low fiscal deficit, high nominal growth of GDP (6.7% - the highest since 2011) and stronger zloty. In 2018, debt-to-GDP ratio could go to c50%.

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