Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

14 – 20 March 2016

Even though the European Central Bank did 'overdeliver' last Thursday announcing bigger scale of monetary easing than anticipated, the market reaction was far from enthusiastic and there was some profit taking on fixed income markets. Meanwhile, in Poland the situation was quite the opposite – after more hawkish than expected statement of the Monetary Policy Council, there was no significant correction, and yields remained low. We think, however, that the market should price-out expectations of interest rate cuts in Poland in the nearest months.

Central banks will remain in focus this week, with the US Fed, Bank of Japan and Bank of England holding their meetings. There will be many important data releases in Poland, which we expect to confirm solid economic activity and inflation slowly bottoming out. NBP's inflation report (Tuesday) and MPC minutes (Thursday) may also be important for expectations regarding monetary policy outlook in Poland.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (14 March)					
11:00	EZ	Industrial output	Jan	% m/m	1.7	-	-1.0
14:00	**PL**	**Money supply**	**Feb**	**% y/y**	**10.0**	**10.2**	**10.2**
		TUESDAY (15 March)					
9:00	CZ	Industrial output	Jan	% y/y	1.0	-	0.7
13:30	US	Retail sales	Feb	% m/m	-0.1	-	0.2
14:00	**PL**	**CPI**	**Feb**	**% y/y**	**-0.7**	**-0.6**	**-0.7**
14:00	**PL**	**Current account**	**Jan**	**€m**	**389**	**1398**	**-410**
14:00	**PL**	**Exports**	**Jan**	**€m**	**13733**	**13609**	**13 849**
14:00	**PL**	**Imports**	**Jan**	**€m**	**12872**	**12424**	**13 476**
		WEDNESDAY (16 March)					
13:30	US	House starts	Feb	k	1150	-	1099
13:30	US	Building permits	Feb	k	1200	-	1202
13:30	US	CPI	Feb	% m/m	-0.2	-	0.0
14:00	**PL**	**Wages in corporate sector**	**Feb**	**% y/y**	**3.9**	**4.3**	**4.0**
14:00	**PL**	**Employment in corporate sector**	**Feb**	**% y/y**	**2.4**	**2.4**	**2.3**
14:00	**PL**	**Core inflation**	**Feb**	**% y/y**	**0.1**	**0.1**	**-**
14:15	US	Industrial output	Feb	% m/m	-0.3	-	0.9
19:00	US	FOMC decision		%	0.25-0.50	-	0.25-0.50
		THURSDAY (17 March)					
11:00	EZ	HICP	Feb	% y/y	-0.2	-	0.3
13:30	US	Initial jobless claims	week	k	-266	-	259
13:30	US	Philly Fed index	Mar	pts	-1.7	-	-2.8
14:00	**PL**	**Industrial output**	**Feb**	**% y/y**	**5.5**	**5.3**	**1.4**
14:00	**PL**	**Construction and assembly output**	**Feb**	**% y/y**	**-5.5**	**-6.1**	**-8.6**
14:00	**PL**	**Real retail sales**	**Feb**	**% y/y**	**5.4**	**5.4**	**3.1**
14:00	**PL**	**PPI**	**Feb**	**% y/y**	**-1.3**	**-1.4**	**-1.2**
14:00	**PL**	**MPC minutes**					
		FRIDAY (18 March)					
15:00	US	Flash Michigan	Mar	pts	92.2	-	91.7

Source: BZ WBK, Reuters, Bloomberg

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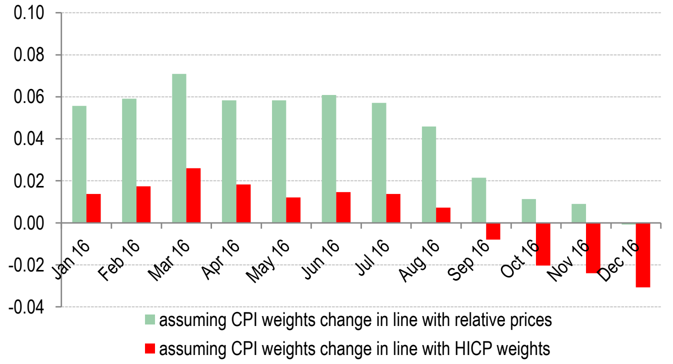
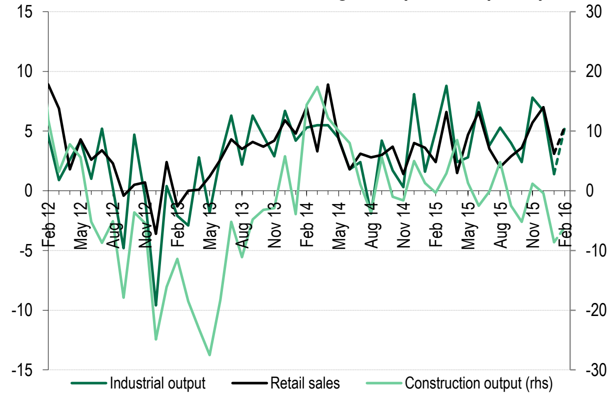
What's hot this week – Several important data and events

Estimated impact of weights revision on CPI inflation rate (pp)



%YoY Production and retail sales growth (constant prices)



- As always this time of year, the statistics office will release its revised weights for the inflation basket along with CPI data for February and revised CPI for January. According to our estimates (based on the assumption that the structure of 2015 household expenditures changed in line with changes in the relative prices), the changed CPI weights may have a slightly positive impact on inflation in the first three quarters of 2016, though the effect could be even smaller than 0.1pp. A change of weights that is consistent with the HICP basket would have an even smaller effect, though this was not a good proxy for CPI weight revisions in the previous years.
- Our CPI forecast for February is -0.6% y/y, up from -0.7% y/y in January, but there is an asymmetric upward risk for both the figures (the result will depend on rounding effects). We estimate that core inflation excluding prices of food and energy was at 0.1% y/y in both January and February.
- We forecast a large current account surplus in January, which is much above market expectations, but we think that export and import growth had probably decelerated, following temporarily lower activity in industry and domestic demand.
- Other indicators to be released this week should confirm that there is a rebound in economic activity compared with January. Industrial production and retail sales should accelerate, according to our forecasts, partly boosted by a higher number of working days than in 2015. Employment and wage growth are also likely to show decent growth, confirming that demand for labour continues to be healthy.
- All those data releases may be overshadowed by the FOMC meeting on Wednesday evening and its impact on market expectations about the global economic outlook.

Last week in the economy – ECB overdelivered, unlike the MPC

Inflation and GDP projections in the subsequent *Inflation reports*

	GDP growth			
	Mar 15	Jul 15	Nov 15	Mar 16
2016	2.2÷4.4	2.3÷4.5	2.3÷4.3	3.0÷4.5
2017	2.4÷4.6	2.5÷4.7	2.4÷4.6	2.6÷4.8
2018	-	-	-	2.1÷4.4
	CPI inflation			
	Mar 15	Jul 15	Nov 15	Mar 16
2016	-0.1÷1.8	0.7÷2.5	0.4÷1.8	-0.9÷0.2
2017	0.1÷2.2	0.5÷2.6	0.4÷2.5	0.2÷2.3
2018	-	-	-	0.4÷2.8

- The Monetary Policy Council left interest rates unchanged, despite the fact that new projection showed a significantly lower inflation path as compared with the previous one. Mid-point of 12M CPI for 2016 was lowered by over 1pp, while for 2017 by 0.2pp. Inflation is not expected to reach the lower-end of band around the inflation target (of 2.5% +/-1pp) until the end of 2017. For 2018 mid-point of projection is at 1.6%.
- In our opinion, two factors, which might drive a policy change (rate cut) in future are: 1. a significant slowdown of the economy; 2. consequences of ECB's decision on the Polish market (stronger zloty, as this would revise further down inflation prospects). As we continue to expect a solid GDP growth (in line with projection) and we see rather limited room for further zloty appreciation, we therefore do not expect the MPC to change their stance in the following months.

Quote of the week – It's good to have some ammo

Marek Belka, NBP Governor, MPC conference, 11.03

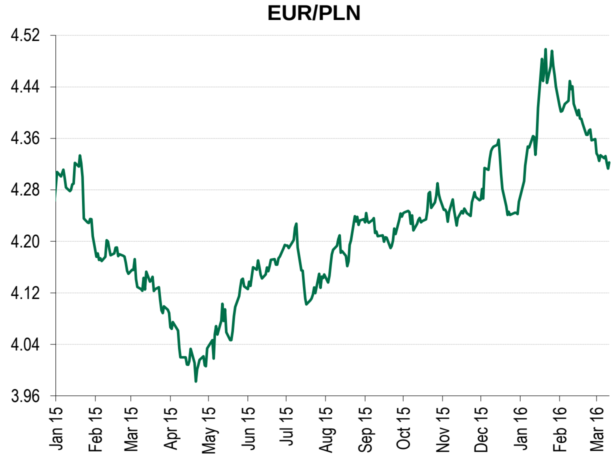
This stance, which you heard from me several months ago, still during the tenure of the 'old' council, is, I can say with a clear conscience, 100% maintained by the current MPC line-up.

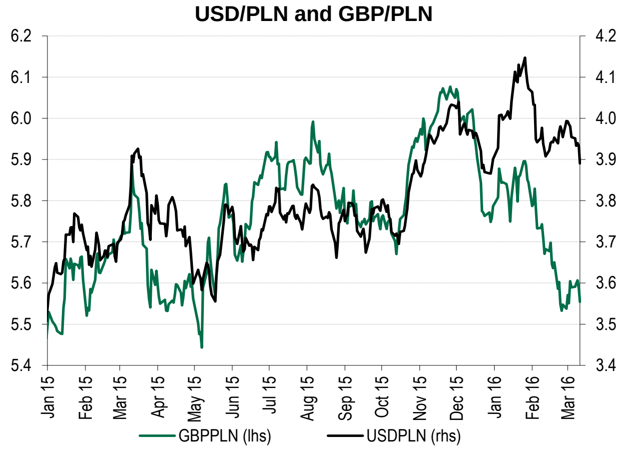
Certain risks are intensifying. You can't rule out even crisis conditions in the global market. In such times, it's good to have some ammo. It's good to have interest rates from which one can react quickly to a weak economy or sudden slowdown. (…) Rate stabilization is most likely.

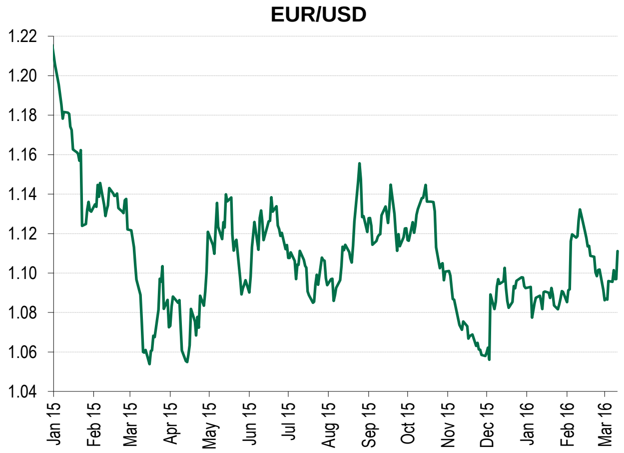
A cut of reserve requirement was not considered – it makes sense only when banking sector is not overliquid.

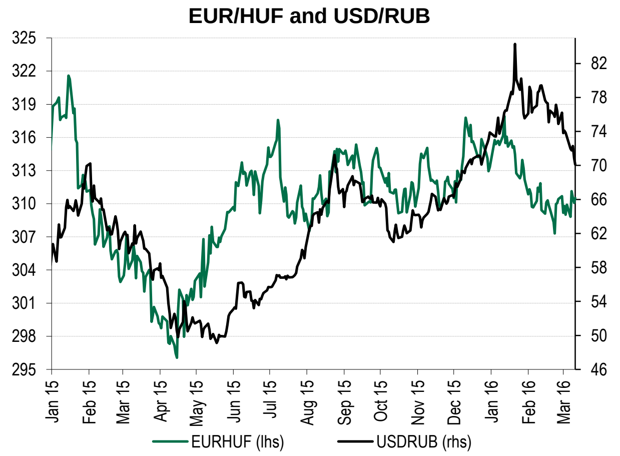
Despite the fact that the new inflation projection does not foresee inflation's return to the target before 2018, the NBP Governor Marek Belka confirmed during the MPC press conference the continuation of direct inflation targeting strategy in Poland. He also said that the central bank should have some ammo left to be able to react if there is a sudden economic slowdown. We are not convinced by this argument – if the MPC fears a global shock, it should act pre-emptively, especially given low inflation, justifying downward move in rates. MPC governor mentioned also that most central banks miss their inflationary targets. However, this is not a good excuse for Polish central bankers to do nothing, as most other central banks are actively trying to reach their targets.

Foreign exchange market – Higher volatility follows ECB









Higher volatility follows ECB

- The past week was pretty volatile for EUR/PLN, but the currency ended it at levels similar to previous Friday. The zloty was first gaining on hopes for more ECB easing, with the actual announcement leading to some profit taking and EUR/PLN rising temporarily to 4.34 from 4.28. At the same time, USD/PLN fell for the second week in a row reaching nearly 3.85, its lowest since late December.
- We expect Poland's macro data due this week to be supportive for the zloty – industrial output is likely to show noticeable improvement and the current account balance should be much better than the market anticipates.
- We do not expect the FOMC to sound excessively hawkish but confident enough to sustain expectations for decent economic growth in the US and worldwide. As a result, this should be quite positive for the global risk appetite. At the same time, we still think it could be difficult for the zloty to maintain its pace of appreciation later this month. One of the uncertainty factors that could limit the scope for currency strengthening is the expectation for the next decisions on the issue how to deal with the FX loans. Before the end of March the Financial Supervisory Authority (KNF) is expected to present its estimates how costly for banks will be the president's proposal. Investors will wait for any guidance about possible future shape of the solution.

Another central bank event in the spotlight

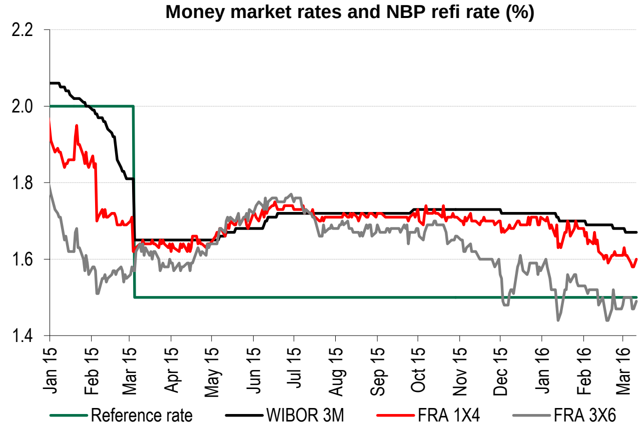
- The past week's high-low spread for EUR/USD was the widest since early February and Thursday's gap was the biggest since December 3, when the European Central Bank disappointed the market with its decision on that day.
- The central bank decision was the biggest market driver last week and the case might be similar in the days ahead. The FOMC will announce its decision on rates on Wednesday and neither we nor the market expect policy changes this time around. According to Bloomberg, chances for rate hikes in 2H16 have risen significantly in the last few weeks on strong US macro data, but the probability of a rate hike in March has fallen to nearly zero. Nevertheless, the tone of the statement could shed some light about whether the Fed's next hikes could take place rather in mid-2016 or at the very end of the year. We also do not expect Yellen's remarks and the Fed's statement to be dovish. If this is the case, then the dollar could recoup at least some of its recent losses.

Ruble gains ahead of central bank decision

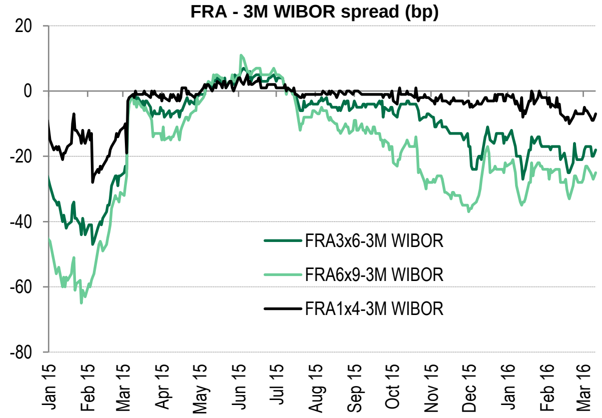
- The Russian ruble continued to appreciate amid the rising Brent price (USD/RUB fell below 70, its lowest since late December), while the Hungarian forint gave up its previous week's gains (EUR/HUF rose to above 311 from 307.5).
- The Russian central bank is to make its rate decision on Friday. The RCB's rhetoric has become more hawkish of late, but we think rates will remain unchanged this month. The oil price rose noticeably since late February, but, at the same time, the ruble gained vs the dollar, limiting the upside impact of higher commodity prices on inflation.

Interest rate market – Awaiting Fed's response

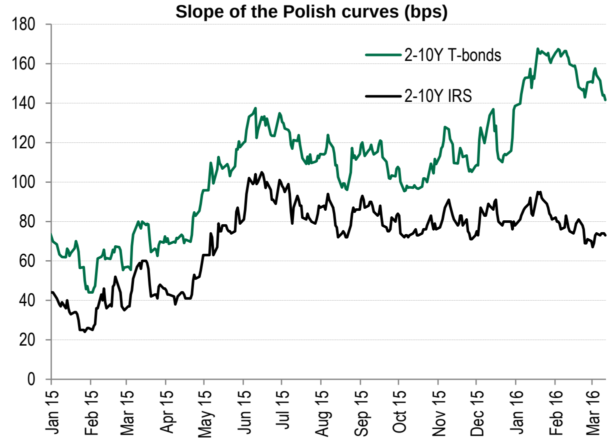
Money market rates and NBP refi rate (%)



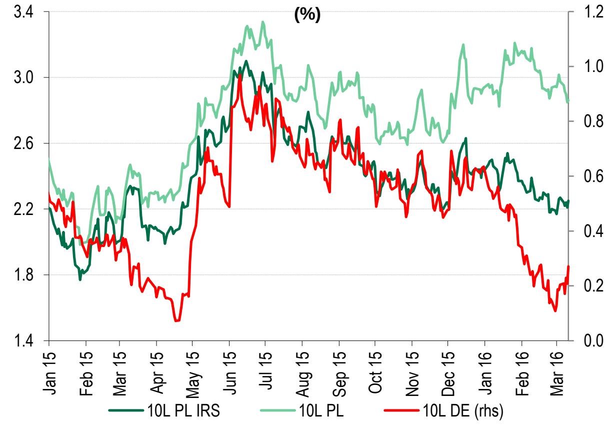
FRA - 3M WIBOR spread (bp)



Slope of the Polish curves (bps)



Yields of PL and DE 10Y benchmarks and 10Y PL IRS (%)



Rally ahead of central bank meetings

- The central bank meetings (ECB, Poland's MPC) were last week's key events. Poland's yields and IRS rates fell a bit ahead of the meetings, tracking trends on the core markets fuelled by expectations that the ECB would ease its monetary policy quite aggressively. But unlike in December, the ECB not only met, but also exceeded market expectations. The initial response on bonds was positive globally. But some profit taking appeared already during the press conference because the ECB's governor Mario Draghi played down chances of further rate cuts, saying that with the current outlook, the ECB expected rates to remain at their current levels ahead. This caused the 10Y Bund yield to grow slightly above 0.30%, the highest level since early February. Consequently, Polish bonds came under gradual pressure as well. The decision of Poland's MPC to keep rates unchanged (as expected) did not have a significant impact on the domestic interest rate market. On a weekly basis, yields and the IRS rates were 1-12bp lower across the board.
- Bonds performed better than IRS, which caused the asset swap spreads for the 10Y sector to tighten markedly. What is more, the yield curve flattened visibly thanks to the belly and long ends outperforming the short end. The risk premium on the domestic bonds also fell, as reflected in the tightening spread over the Bunds for the 10Y sector (slightly below 260bp, down from c280bp at the end of the previous week).
- The money market was little changed last week. WIBORs remained flat, while FRAs fell slightly ahead of the MPC decision. The decision to keep rates stable was in line with the market consensus. However, the market continues to price in further monetary easing in the months to come (FRA6x9 at 1.42%).

Fed and domestic macro data key

- This week's calendar is quite heavy with macro data releases and events. The FOMC meeting could be the key event and is likely to set market direction in the coming days/weeks. It is broadly expected that the Fed will keep rates unchanged, though investors would like to have more clarity about the timing of the next move from the statement (including new macro and long-term interest rate forecasts) and remarks of the Federal Reserve Chair Janet Yellen. Investors have slightly raised their expectations for a rate hike in 2H16E on a series of good US macro data. However, dovish rhetoric might have a positive impact on bonds as was the case after the December meeting.
- Apart from the FOMC, investors will closely monitor domestic macro data releases, including inflation (CPI, PPI) and data from the real economy (corporate employment and wages, industrial output, retail sales). We expect some revival in production and retail sales after the weak January numbers. What is more, CPI inflation should rise a bit in February (to -0.6% YoY from -0.7% YoY in January). In sum, Poland's upcoming macro data releases could reaffirm that economic growth remains quite decent and that there is no inflationary pressure.
- While the market expectations on further monetary easing by the MPC may weaken, in our view, the short end of the bond curve should remain supported by the impact of bank tax (creating incentive for banks to move money from NBP bills to short-term Treasuries). The belly and the long end of the curves will remain under the influence of global factors, making the Fed's decision and macro data abroad key. We still see room for further spread tightening over Bunds for Poland's 10Y sector, especially if the risk-on mode will dominate the market after the ECB and Fed decisions.

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