

WEEKLY ECONOMIC UPDATE

4 – 10 April 2016

Market sentiment improved significantly last week thanks to relative pre-Easter calm. This stemmed from the dovish speech of Fed Chair Janet Yellen, who suggested that only gradual interest rate increases were likely in the years to come. As a result, appetite for risky assets, including Poland's, rose visibly. The zloty strengthened markedly against the main currencies, with USD/PLN reaching its lowest level since October 2015. Domestically, the flash CPI reading for March again showed deepening deflation, while PMI for Poland's manufacturing hit an eight-month high of 53.8pts due to faster growth of output, new orders, exports and employment. What is more, the flash general government deficit fell to 2.5% of GDP in 2015 (the lowest since 2007), which was also positive for the domestic assets.

This week, global central banks will likely continue to set market direction as both the Fed and the ECB will release their minutes. The zloty and the interest rate market could gain as both the FOMC and ECB should reaffirm their easing bias in monetary policy. On the other hand, this week will be filled with speeches of Fed members, which, as in the previous weeks, might set the market direction. As regards domestic events, Poland's MPC will decide on rates. The Council is widely expected to keep rates unchanged, and, in our view, its press conference will probably not bring any significant changes in rhetoric. Thursday's auction of OK1018 and DS0726 bonds will be closely watched, especially since the latest Ministry of Finance data showed that non-residents had increased in February their exposure to risk on the Polish interest rate curve by extending the duration of their portfolio. Market conditions are still favourable for tapping T-bonds.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (4 April)							
16:00	US	Factory orders	Feb	% m/m	-1.7	-	1.6
TUESDAY (5 April)							
8:00	DE	Industrial orders	Feb	% m/m	0.5	-	-0.1
9:55	DE	PMI – services	Mar	pts	55.5	-	55.3
10:00	EZ	PMI – services	Mar	pts	54.0	-	53.2
14:30	US	Trade balance	Feb	\$bn	-46.3	-	-45.7
16:00	US	ISM – services	Mar	pts	54.0	-	53.4
WEDNESDAY (6 April)							
	PL	MPC decision		%	1.5	1.5	1.5
8:00	DE	Industrial output	Feb	% m/m	-2.0	-	3.3
20:00	US	FOMC minutes	Mar				
THURSDAY (7 April)							
9:00	CZ	Industrial output	Feb	% y/y	5.3	-	1.0
11:30	PL	Bond auction					
13:30	EZ	ECB minutes					
14:30	US	Initial jobless claims	week	k	-	-	276
FRIDAY (8 April)							
8:00	DE	Exports	Feb	% m/m	0.1	-	-0.5
9:00	HU	CPI	Mar	% y/y	-	-	0.3
16:00	US	Wholesale inventories	Fed	% m/m	-0.3	-	0.3

Source: BZ WBK, Reuters, Bloomberg

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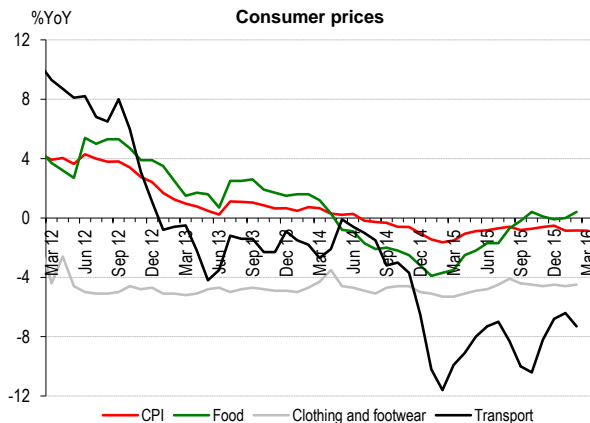
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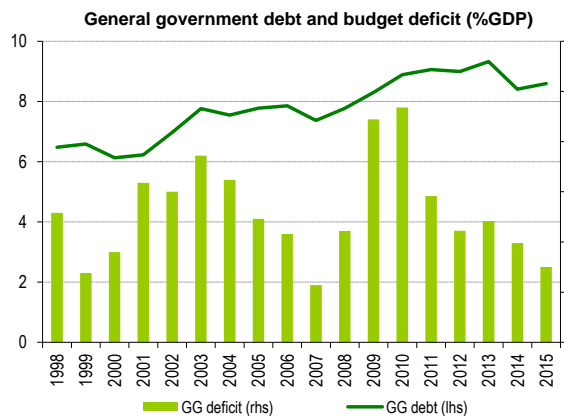
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What's hot this week – Global central banks more important than MPC

▪ Inflation surprised to the downside again (see below) but this does not change the monetary policy outlook, in our view. It seems that the new Monetary Policy Council (MPC) accepts CPI's deviation from the central bank's target until 2018 and wants to build its credibility on hawkish (more significant than needed) rhetoric. Thus, we do not expect the MPC to change rates at its upcoming meeting in April.

▪ Monetary policy will most likely be the main theme of the week, with both the FOMC and ECB releasing their minutes and several Fed speakers on the agenda. Minutes from the FOMC's March meeting could offer some insight into what had stood behind the central bankers' decision to lower their interest rate hike expectations for 2016 from 4 to 2.

Last two weeks in the economy – GG deficit and CPI below expectations, PMI up

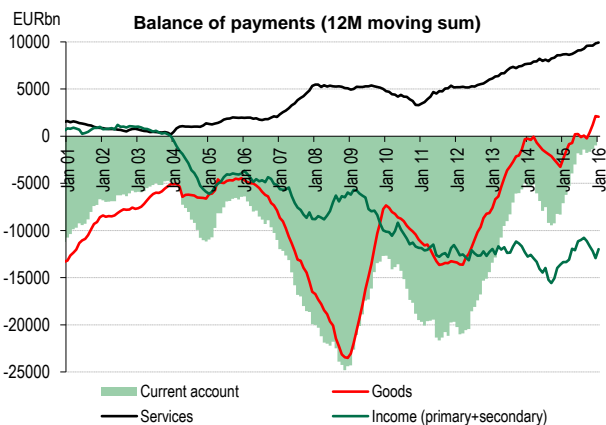
▪ Poland's general government deficit fell to 2.5% of GDP in 2015 vs 3.3% in 2014 (the lowest since 2007), while the general government debt rose to 51.5% of GDP in 2015 from 50.5% in 2014, according to a flash estimate of the statistics office. The deficit is lower than expected and data suggest that the local government and social security fund sectors posted a small surplus of about 0.1% of GDP. We expect a rise of the GG deficit to c3.0% in 2016.

▪ PMI reading for Poland's manufacturing surprised to the upside in March, hitting an eight-month high of 53.8pts. The better-than-expected outcome was mainly caused by faster growth of new orders. However, there were also increases in other important sub-indices: output and employment.

▪ CPI inflation surprised in March to the downside and was at -0.9% y/y vs -0.8% y/y in February and the consensus at -0.8% y/y. Detailed data will be released in mid-April.

▪ The registered unemployment rate was unchanged from January and stood at 10.3% in February. There was a large rise in the number of job offers (from 87k to 130k; 105k job offers were in the private sector, the most since June). We think that growing labour demand and shrinking pool of skilled workers may contribute to wage pressures in the near future.

▪ NBP's balance of payments data in 4Q2015 showed a slight revision of the previous monthly numbers, with higher imports and thus a higher current account deficit as well at €424mn. The entire 2015 ended with a €967mn C/A deficit, or 0.2% of GDP (the lowest level since comparable data are available). Poland's net international investment position was at -PLN260bn or 60.8% of GDP (the lowest level since 2011) vs 67.1% of GDP in 2014.

**Quote of the week** – Watering down pre-election proposals?**Beata Szydło, Prime Minister, Polskie Radio, 31.03**

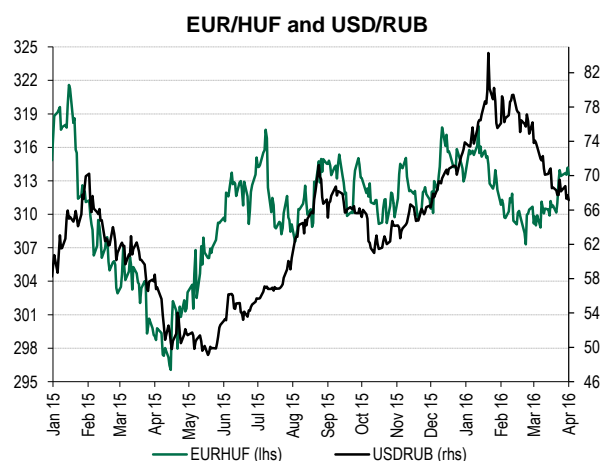
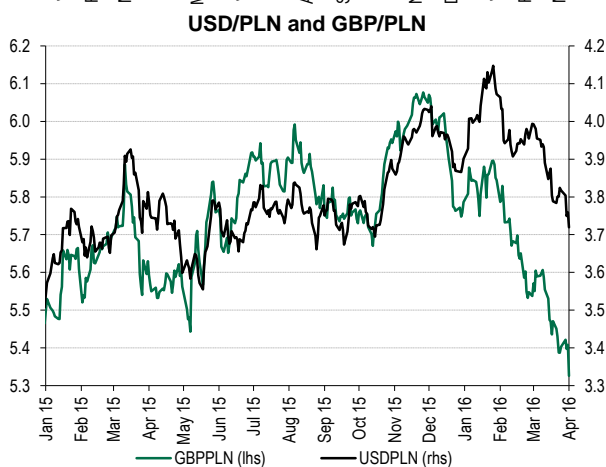
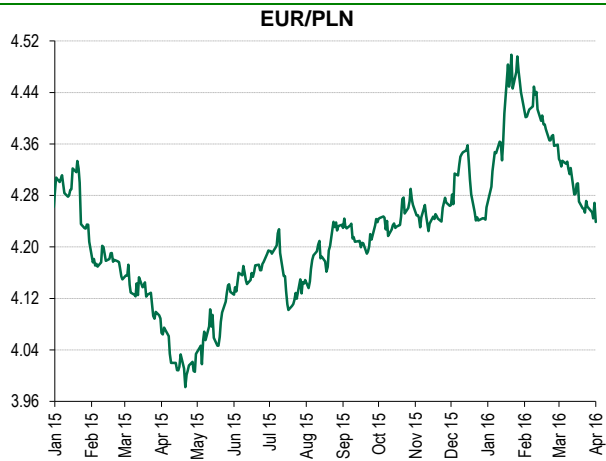
[The draft bill on lowering the retirement age] is already in the Sejm (Lower House of the Polish Parliament), the first reading took place and I think that soon the Sejm's commission will take a look at it. If the Sejm works on schedule, the draft bill should be approved after the holidays.

As far as the higher tax-free amount is concerned, we will probably spread its rise in time. I think that we should first increase the tax-free amount for people with the lowest income levels.

I would also like to find out what factors stood behind KNF's (Polish Financial Supervision Authority's) cost analysis and opinion [on the draft of the CHF loan conversion bill], as I think that it was probably too severe. I would like to hear the opinions of experts.

In April, the government will approve a new version of the Convergence Programme (CP). Higher economic growth (c4% in 2017-19, according to media reports) will make it easier (amid higher revenues) to assume that the deficit will not exceed 3% in the medium term. Still, for 2017 there is a gap to be covered – the govt will need to finance its full-year spending of 500+ programme amid no one-off revenues as in 2016. We estimate that to maintain the deficit at c3% of GDP, the additional fiscal adjustment of PLN12bn could be needed. We believe the Ministry of Finance will try to cover this in the new CP with an assumption of better tax collection (the required amount is 1/3 of the estimated VAT gap). As regards the higher tax-free income, Szydło clearly suggested that it would be introduced gradually (even over 5 years) and that it would be concentrated on low-income families. Lowering of the retirement age is the more risky idea and it has to be closely watched in the following months (whether the additional condition of the minimum number of years at work or paying contribution is introduced, which would water down the negative impact).

Foreign exchange market – Will the PLN appreciation be stopped?



Zloty gains vs euro, dollar, franc, pound...

▪ The zloty continued to benefit from the recently dovish signals from the global central banks (and the Polish MPC lagging behind) and some re-pricing of the local political risk. EUR/PLN reached its fresh 2016 low at just below 4.23 and this was already the fifth week in a row of its free-fall. March saw the biggest monthly drop of EUR/PLN since January 2015 (-2.25%). The zloty also firmed significantly vs the dollar with USD/PLN falling to 3.70, its lowest since mid-October (after the biggest monthly drop since July 2010). The Polish currency also took advantage of the pound's depreciation ahead of the "Brexit" referendum. GBP/PLN fell for the fourth consecutive week to reach 5.30, its lowest since December 2014.

▪ Dovish signals from central banks were one of the key factors fueling the zloty's recent appreciation, mainly from the Fed and its dovish statement from the March meeting. Fed's chair Janet Yellen also gave a dovish speech last week. There are only a few macro releases on the agenda in the coming days, but there will be plenty of occasions again to get more news from the central banks. Minutes from the last FOMC and ECB meetings are due and so investors will try to get better insight into what had convinced the US central bankers to drop two rate hikes this year and whether it is reasonable to expect more easing in the euro zone in the nearest future. Also, numerous FOMC members are due to speak and although most of them are non-voters, the market has recently showed that it was sensitive to their comments as well. Should the central banks' rhetoric remain dovish, EUR/PLN and USD/PLN could stay close to their recent lows.

▪ We think, however, that room for more zloty gains may be limited as it seems that some crucial domestic issues may start to re-emerge. In particular, the CHF-denominated loan issue seems to still be alive. In recent weeks local media have reported a number of comments from government officials (including PM Beata Szydło and the chief of her chancellery), which questioned the quality of the Polish Financial Supervision Authority's (KNF) cost report and suggested that KNF will have to prepare another report. Also, the Financial Stability Committee is scheduled to meet on April 18 to discuss the issue. It seems, therefore, that work on the proposal (old or new) will continue and it is hard to guess when and what will be revealed.

Dollar pressured by Yellen

▪ EUR/USD jumped above 1.14, its highest level since mid-October 2015, on more dovish signals from the Fed, this time from Janet Yellen herself.

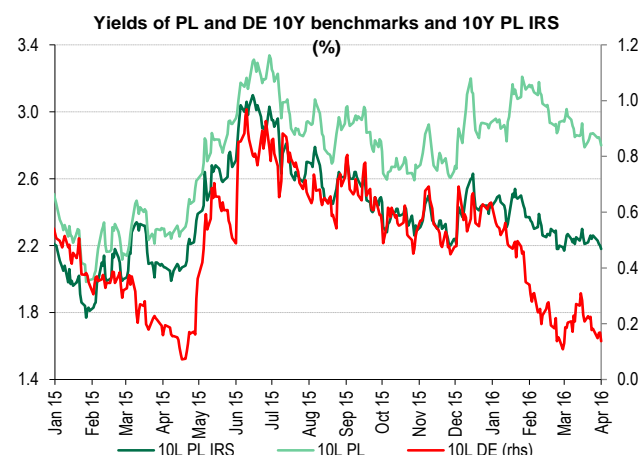
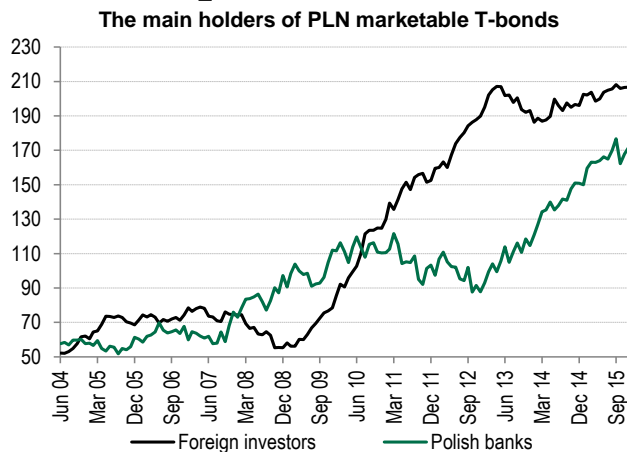
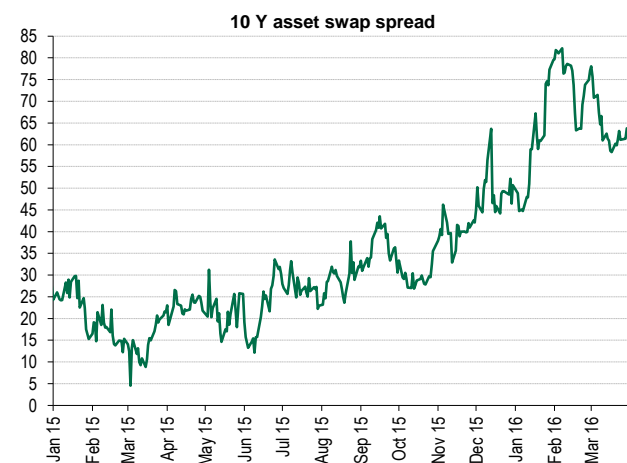
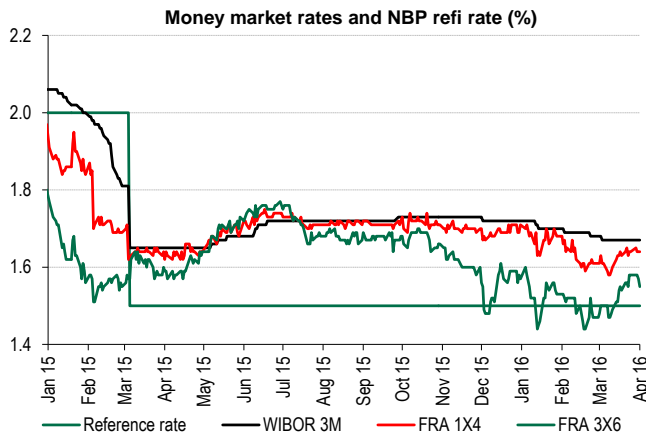
▪ This week, signals from the central banks are again likely to have the biggest impact on the exchange rate as the macro data release calendar is nearly empty. The exchange rate is getting closer to its 1.15-1.17 resistance area and we think that the ECB officials could soon try to talk the euro lower, preventing its further rise.

Forint down, ruble up

▪ Elsewhere in the CEE region, the forint remained under pressure from the Hungarian central bank's recent decision to cut interest rates (including the depo rate below zero). EUR/HUF rose temporarily above the previous week's peak and neared 315, its highest since late January.

▪ The Brent price is still close to its recent high, hovering around 40\$/bbl. This allowed the ruble to gain slightly vs the dollar with USD/RUB falling temporarily below 67, its lowest since early December 2015.

Interest rate market – Central banks to continue to drive markets



Yields up before Easter, then down again

- The interest rate market was mixed over the past two weeks. IRS rates were more or less stable, while T-bond yields rose noticeably as some investors took profit ahead of the Easter holiday. Bonds recovered slightly afterwards, tracking the core market. Flash CPI readings for March and the 2015 general government deficit slightly supported the domestic curves. Meanwhile, the bond market failed to respond to the government's bond supply plans for 2Q16.

- Poland's both IRS and T-bond curves steepened gradually as their long ends underperformed the front ends. What is more, yields rose more substantially than the IRS rates and, as a result, the asset swap spread widened to nearly 65bp for the 10Y sector. We also noted that Poland had underperformed other CEE countries and the euro zone's peripheral peers. As a consequence, the spread over Bunds widened to 270bp for a while, ending the week slightly below this level.

- The last two weeks brought no significant changes on the money market. WIBORs were more or less stable, while FRAs rose gradually. The market scaled back its expectations for further monetary easing, however, it still prices in a rate cut of 25bp in 12 months' time.

Poland covers over 50% of its target for 2016

- Poland successfully placed bonds on both the domestic and international markets. The Ministry of Finance sold bonds (PS0721 and floaters) worth PLN8.6bn at a switch auction. It also priced a 10-year USD-denominated benchmark bond with a maturity set for April 6, 2016. The nominal amount of the issue amounts to USD1.75bn (vs recorded demand at USD3.6bn). The Ministry has covered 52% of the 2016 gross borrowing needs by now.

- Poland's issuance plan for 2Q16 is quite moderate. The Ministry plans five-six regular auctions with the supply at PLN20-30bn in total. In April alone, the T-bond offer will reach PLN7-15bn. Assuming that it will tap the market for the maximum value of the offered bonds in 2Q16 (PLN30bn), we predict that this year's target will have been covered in c70%.

- The latest Ministry of Finance data about the main holders of marketable T-bonds showed that, in nominal terms, non-residents trimmed their holdings in February by PLN7bn to PLN186.5bn (the lowest level since January 2014). However, the selling was concentrated at the short end of the curve (bonds maturing in 2016-2017), while foreign investors used the opportunity to increase the duration of their portfolio by rising their holdings in medium- and long-term bonds (mainly PS0421 and DS0726). Overall, their exposure to risk on the Polish interest rate curve rose in February.

Central banks and auction take centre stage

- This week's domestic macro calendar is light, so investors will focus on the central banks (Poland's MPC meeting, the FOMC and ECB minutes) and the domestic T-bond auction. It is widely expected that the Council will keep interest rates unchanged. The press conference might also be a non-event. The same day, the FOMC will release its minutes from the March meeting. This outcome might be key and could set the market direction in short run if the FOMC upholds its dovish rhetoric.

- At the start of the week, we will get to see the final bond offer for Thursday's auction. Initially, the Ministry planned to offer OK1018 and DS0726 for a total of PLN3-6bn. We think that the Ministry is unlikely to face any problems selling the bonds. Current market conditions (expansionary ECB policy, dovish Fed) should support the auction results.

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