Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

18 – 24 April 2016

Global sentiment was rather negative last week, weighing on EM currencies and debt, in spite of the Fed's Beige Book, which offered quite a positive view on the US economy and supported the US dollar. Data from China were also quite positive, mitigating worries about the Chinese economy. Polish assets suffered quite considerably due to global developments, nevertheless, but also from local factors. The European Parliament's resolution on and further escalation of the conflict around the Constitutional Tribunal did not reduce political risk. Moreover, macroeconomic data were not supportive either, with the current account balance significantly below expectations in February.

This week's calendar is quite rich with euro zone and US data. The EBC meeting and flash PMI will probably be the most important pieces of news. We do not expect any change in the ECB's monetary policy parameters in April, but weak data from the euro zone could awake expectations for further rate cuts in the monetary union. A few Fed members (Dudley, Rosengren, Kashkari) will speak at the start of the week and their comments may be important for the FOMC's monetary policy prospects. In Poland, a bunch of crucial data from the domestic economy are due (industrial output, retail sales, labour market). Our forecasts are above market expectations and we suppose these numbers will confirm that economic growth stayed robust in Poland at the end of 1Q2016. Positive macro fundamentals should be supportive of the Polish assets, but, in our view, the market is more concerned about fiscal policy and the perception of political risk, so news on these issues may be more important.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (18 April)					
14:00	**PL**	**Employment in enterprise sector**	**Mar**	**% y/y**	**2.5**	**2.6**	**2.5**
14:00	**PL**	**Wages in enterprise sector**	**Mar**	**% y/y**	**3.4**	**3.7**	**3.9**
		TUESDAY (19 April)					
10:00	**PL**	**Industrial production**	**Mar**	**% y/y**	**3.9**	**4.4**	**6.7**
10:00	**PL**	**Construction output**	**Mar**	**% y/y**	**-8.7**	**-12.8**	**-10.5**
10:00	**PL**	**Real retail sales**	**Mar**	**% y/y**	**5.8**	**6.8**	**6.2**
10:00	**PL**	**PPI**	**Mar**	**% y/y**	**-1.4**	**-1.3**	**-1.4**
11:00	DE	ZEW Index	Mar	pts	-	-	50.7
14:30	US	House starts	Mar	k	1165	-	1178
14:30	US	Building permits	Mar	k	1200	-	1177
		WEDNESDAY (20 April)					
16:00	US	Home sales	Mar	mn	5.25	-	5.08
		THURSDAY (21 April)					
13:45	EZ	EBC – interest rate decision	Apr	%	0.00	0.00	0.00
14:00	**PL**	**Minutes from April's MPC meeting**					
14:30	US	Philly Fed Index	Apr	% m/m	7	-	12.4
14:30	US	Initial jobless claims	week	k	-	-	253
		FRIDAY (22 April)					
9:30	DE	Flash PMI – manufacturing	Apr	pts	51	-	50.7
10:00	EZ	Flash PMI - manufacturing	Apr	pts	51.8	-	51.6

Source: BZ WBK, Reuters, Bloomberg

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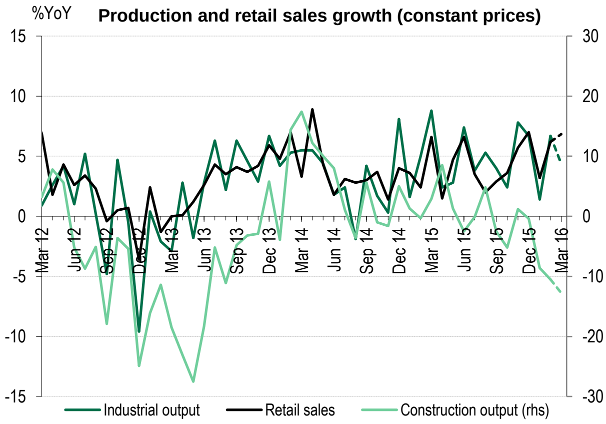
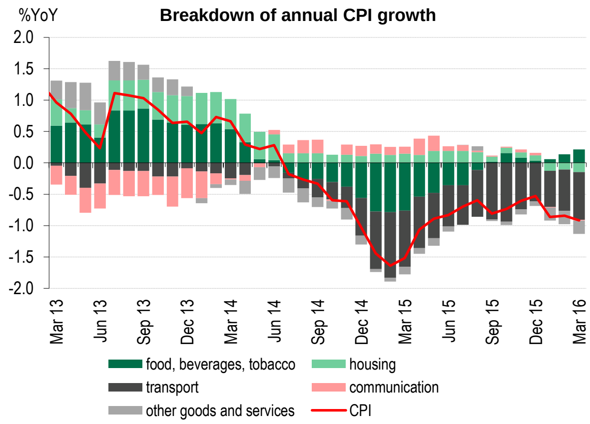
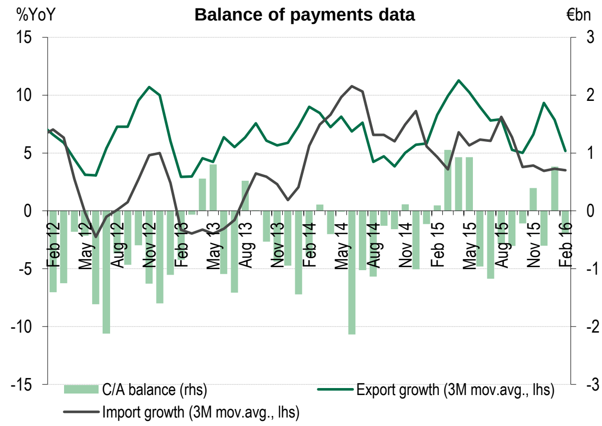
What's hot this week – Job market, industrial and construction output, retail sales



- We expect strong labour market data, as was the case in the previous months. We are even a bit more optimistic than the market, both on employment and wages.
- Industrial and construction output will likely decelerate against February, mainly on the back of a negative working day effect. Still, we expect the underlying trend in the industry to remain strong amid rises in manufacturing activity indices. Construction will continue its free fall, given the lacklustre growth of public investments.
- We expect strong retail sales in March, supported by the Easter holiday that was especially good for food sales. We are also quite optimistic about the other categories, such as data on car registrations that points to high car sales in March.

Last week in the economy – Inflation, balance of payments, money supply and GG deficit





- CPI in March was confirmed at -0.9% y/y in the final reading. In monthly terms, consumer prices rose 0.1%. Deepening of deflation in March was mostly due to price changes in the core categories and core inflation excluding food and energy prices slid to -0.2% y/y from -0.1% y/y in February. We expect the annual CPI growth to stay negative until 4Q2016 and to reach c0.5% y/y at the year-end. In our view, the prolonging deflation can encourage the MPC to cut interest rates, but only if there is a considerable deterioration of the growth outlook and significant zloty strengthening, which is not our base-case scenario.
- The current account balance in February was at a worse-than-expected €383m deficit (vs an expected surplus of over €400m). While exports were close to our forecast, growing nearly 5% y/y, there was a strong acceleration of imports (to 6.5% y/y), which was a big surprise. The negative income balance was also larger than we had estimated. We now expect export growth to accelerate further, supported by the euro zone's economic recovery. The import outlook should also improve, boosted by faster consumption growth in the nearest quarters. However, its growth may be limited by the relatively weak zloty and the generally lower import intensity of domestic demand. In general, net exports' contribution to GDP growth should be positive, at least in the first half of this year.
- M3 money supply expanded by 9.0% y/y vs 10.1% y/y in February. Slowdown in M3 growth was primarily due to a considerable drop in corporate deposits (by PLN4.6bn or 2% m/m), which may have been due to a big one-off transaction.
- The general government deficit was at 2.6% of GDP in 2015. We expect the GG deficit to rise towards 3% of GDP in 2016.

Quote of the week – A cut is desirable but would not serve a purpose in the nearest months

Grażyna Ancyparowicz, MPC member, PAP, 14.04
A rate cut may prove necessary if strong inflow of „hot money" will threaten financial stability. But this seems improbable.

Eryk Łon, MPC member, PAP, 11.04
Persistent deflation could make me support at least one motion for a rate cut this year.

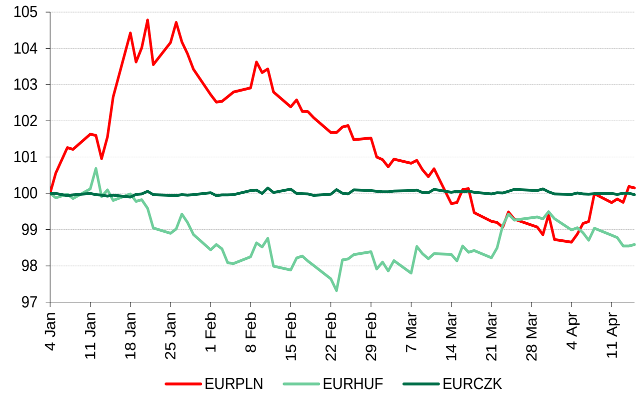
Jerzy Osiatyński, MPC member, PAP, 12.04
I do not mean to say that the MPC should hike rates in the upcoming months, but we should observe indicators that could make us more restrictive ahead of time. Or we should look for other economic policy tools that can contain wage pressure on prices.

Jerzy Żyżyński, MPC member, Bloomberg, 11.04
I still think a cut is desirable. I don't think that passing a motion for a cut would be possible or would serve a purpose in the nearest months.

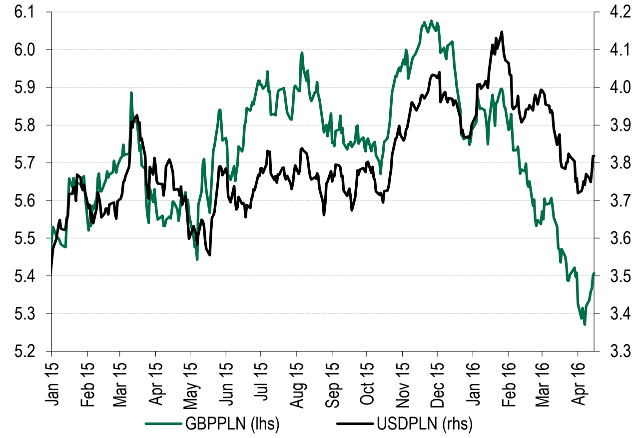
There is some divergence among the new MPC members. J. Osiatyński started to mull hikes. In his view, a rise in unit labour costs may be an important signal to tighten monetary policy. However, Osiatyński sees some room for a cut, provided that financial stability remains intact and wage growth is contained. Strong inflow of portfolio capital due to interest rate disparity would encourage G. Ancyparowicz to vote for a cut, but she herself sees this as rather improbable. E. Łon thinks that prolonging deflation is an argument to ease policy and he is a supporter of non-standard instruments in monetary policy. J. Żyżyński supports a cut, but would like to wait. Generally, all four members see some reason to ease monetary policy, with Osiatyński and Ancyparowicz being rather hawkish and Łon and Żyżyński dovish. The prevailing opinion is that the MPC should wait and see the effects of the government's expansionary fiscal policy. That supports our forecast of no rate change this year.

Foreign exchange market – Poland's fundamentals to support zloty

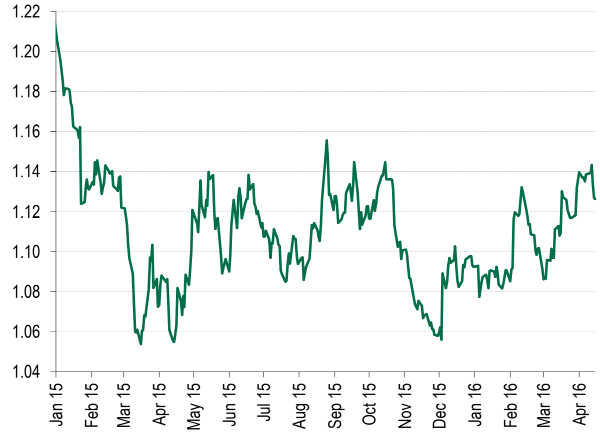
Zloty and other CEE peers (4 Jan 2016 = 100)



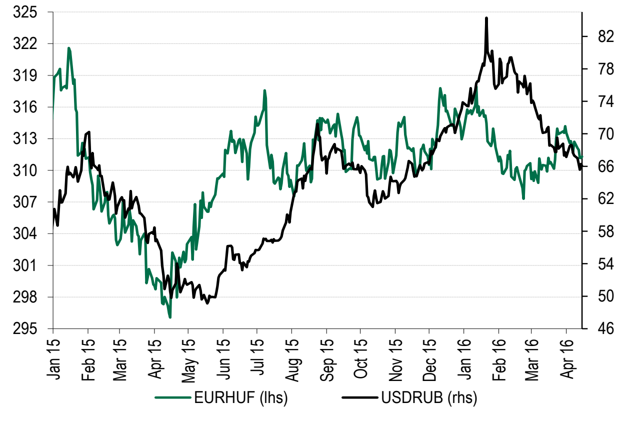
USD/PLN and GBP/PLN



EUR/USD



EUR/HUF and USD/RUB



Zloty near one month high at 4.30 vs euro

- Poland's zloty remained under pressure last week, as we had expected. EUR/PLN hit a one month high close to 4.31 on political risks, but also slightly weaker-than-predicted C/A data. The zloty lost ground against the US dollar in particular, which was due to a EUR/USD decline. USD/PLN climbed temporarily towards 3.835, the highest level since late March. On a weekly basis, the zloty also lost 1.7% against the British pound and was more or less stable against the Swiss franc.
- The zloty has been underperforming its CEE peers in April as investors are taking profit after a long period of PLN rally and political risks are rising quite considerably in Poland.. On the other hand, Poland's fundamentals are still supportive despite February's C/A data, which were slightly disappointed. Crucial real economy data are due this week, including industrial output and retail sales. Our forecasts are above market consensus, which means we could expect some revival of the zloty in the short run. In our view, the ECB meeting's outcome, reaffirming the bank's dovish rhetoric might also be supportive. In the mid to long term, we expect the zloty to stay under pressure, mainly from internal factors, such as a looming ratings downgrade. What is more, the FX loan conversion bill is still pending and it is likely to weigh on the zloty in the upcoming weeks as the President's Chancellery is to present an amended proposal of the bill at the turn of May and June. Given this, we think EUR/PLN could move sideways, in a range of 4.25-4.35, in the coming weeks.

EUR/USD near lower bound of fluctuation channel

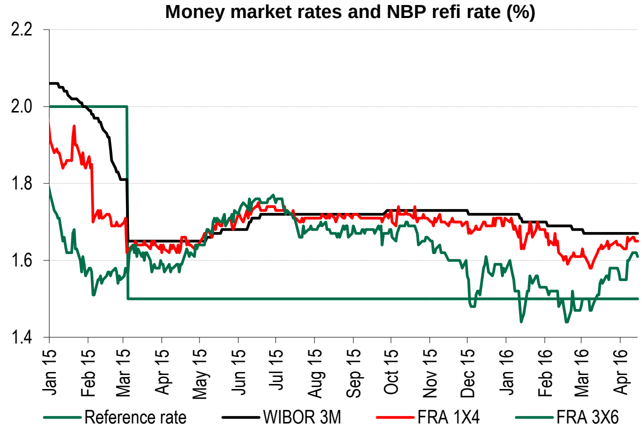
- The US dollar strengthened visibly last week, with EUR/USD shifting down towards the lower bound of the fluctuation channel between 1.12 and 1.16. This was caused by quite hawkish macro data and statements from some Fed members.
- Some important macro data from the euro zone and the US will be releases this week. Any negative piece of news from the euro zone could renew expectations of further rate cuts, which should imply a weaker EUR. In this light, the outcome of the ECB meeting might be key. We think that EUR/USD will stay near the lower boundary of the fluctuation channel of 1.12-1.16 in the short run. The European currency might also be under pressure from rising political risks.

CEE currencies slightly stronger

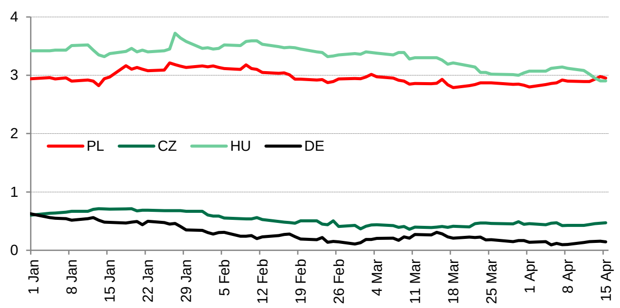
- CEE currencies remained quite strong over the past week as there was no negative impact from internal factors. Both HUF and CZK were quite immune to the mixed global environment. On a weekly basis, EUR/HUF fell from c313 to slightly below 311 at the end of the week, supported by strong foreign demand for government bonds. It is worth noting that HUF/PLN temporarily reached 1.382, the highest level since mid-March. At the same time, USD/RUB reached its local minimum at nearly 65 due to a quite significant rise in Brent prices. However, at the end of the week, the rate rose again to 66 ahead of the Doha meeting.
- Global factors will dominate the CEE market this week as there are no important domestic issues in the pipeline. The world's major oil producers will meet in Doha this weekend to discuss a potential production freeze. The outcome of the meeting will set market direction for oil prices and, as a result, also for USD/RUB.

Interest rate market – Polish bonds underperform CEE peers

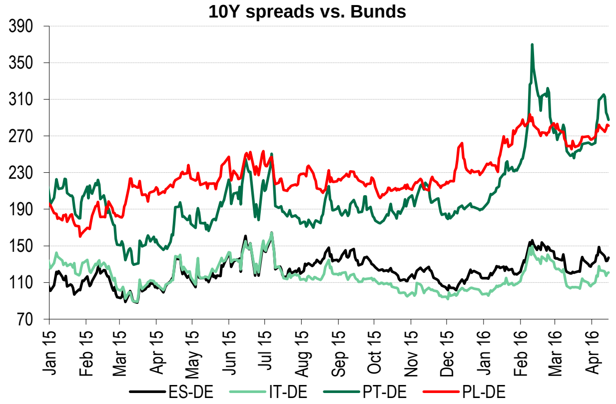
Money market rates and NBP refi rate (%)



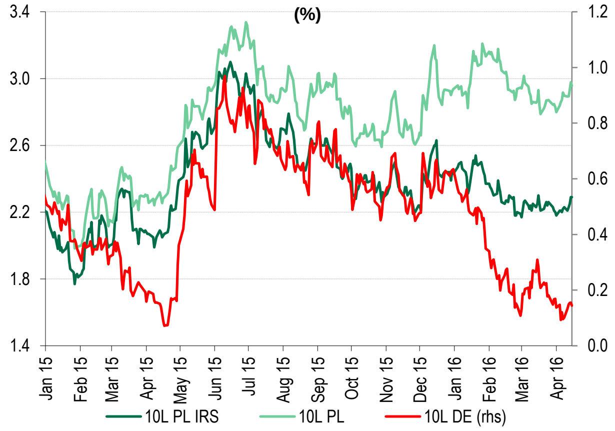
10Y bond yields (%, last 4 months)



10Y spreads vs. Bunds



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



Poland's yields higher than Hungary's

- Poland's interest rate market suffered last week on persistently high domestic political risks and higher yields on the core markets. As a result, the 10Y benchmark yield grew temporarily above 2.96%, but ended the week around 2.95%. Both the T-bond and IRS curves steepened over the past week as the belly and long end underperformed the short end. What is more, the spread over Bunds for the 10Y sector widened visibly, growing again above 280bp.
- Interestingly, in the last part of the week, Hungary's junk-rated yields fell below Poland's for the first time since 2002. We think this was caused by, among others, the interest rate differential as the Hungarian central bank is expected to continue to ease its monetary easing even later this month, while Poland's MPC has refused to cut rates further.
- On the other hand, Poland's Ministry of Finance successfully reopened the issue of 20Y EUR bonds. The sales value was set at €750m with demand at €1.1bn. The total nominal value of this bond issue equals €1.5bn. The bonds were priced at 125bp above the average swap rate, i.e. at 2.275%. We estimate that the government's borrowing needs have already been financed in 58% so far this year Deputy Finance Minister, Piotr Nowak, said that the ministry had already met its FX needs for this year, so no more issues on the USD and EUR markets were on the agenda. He did not, however, rule out such a possibility entirely. Meetings on a "panda" bond issue with investors in China have been scheduled for mid-April. The pilot value of the "panda" bond issue is expected to reach about $300-500m.
- As regards the money market, WIBOR rates remained flat, while the 3x6 and 6x9 FRA rates rose 2bp in weekly terms. The market upholds its view that there is a c60% chance rates will fall by 25bp in the next nine months.

ECB meeting key

- This week's domestic macro calendar is rich with the main real economy indicators due for release. We expect the upcoming Polish data releases to reaffirm that economic growth remains healthy (our forecasts for industrial output and retail sales are above market expectations), which could continue to generate upside pressure on FRAs.
- Turning to the interest rate market, the front end of the curves is well anchored and we expect rather range trading in the upcoming weeks. On the belly and long ends of the curves, domestic fundamentals could be overshadowed by global events, especially the outcome of the ECB meeting. In our view, efforts by the ECB to prop up inflation should support debt markets in the coming weeks.
- That said, we still see some room for a gradual decline in bond yields/IRS rates in the short run after quite quick and deep weakening in the previous days. We believe the current yield levels to be attractive as the strategy of hunting for yield supports domestic curves. However, the rebound could be limited as investors are waiting for Moody's to decide on Poland's ratings on May 13.

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.