Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

2 – 8 May 2016

Several central bank meetings took place last week. Hungary's central bank cut rates by 15bp, as expected, but its statement was quite hawkish and the bank tried to curb market bets for further policy easing. The Fed and BoJ kept their interest rates unchanged, in line with expectations. However, the market was a bit surprised by a change in the Fed's statement and disappointed about the lack of further quantitative easing from BoJ, the reasons behind turning away from risky assets and falling stock prices. In Poland, President Andrzej Duda ensured that neither he nor the government would withdraw proposals of lowering the retirement age and raising tax-free income. What is more, government officials said they were monitoring the zloty weakening and, if needed, may use appropriate tools. This verbal intervention has proven quite ineffective so far. Despite deepening of deflation in April (flash CPI fell to -1.1% y/y from -0.9% y/y in March), the market's response to this release was subdued just before the long weekend. All in all, Poland's zloty and bonds stayed quite weak over the past week, underperforming most of their EM peers.

Market liquidity will be limited at the start of the coming week due to the long weekend – there is a market holiday in the UK on Monday and in Poland on Tuesday. Manufacturing PMI/ISM indices on Monday and US labour market data on Friday will likely be the most important data releases. We expect a slight decline in April's PMI, with muted market reaction as the index should remain well above the neutral level of 50 pts. We also do not expect any surprises from Poland's and the Czech central bank meetings. In case of the US nonfarm payroll data we think that a drop in yields in case of a disappointment may be smaller than their rise in case of a strong reading. In general, we expect a volatile period ahead for the Polish assets due to uncertainty about Moody's rating decision (May 13) and looming decisions on how the government plans to deal with the FX loans issue (president's next proposals due by June).

Economic calendar

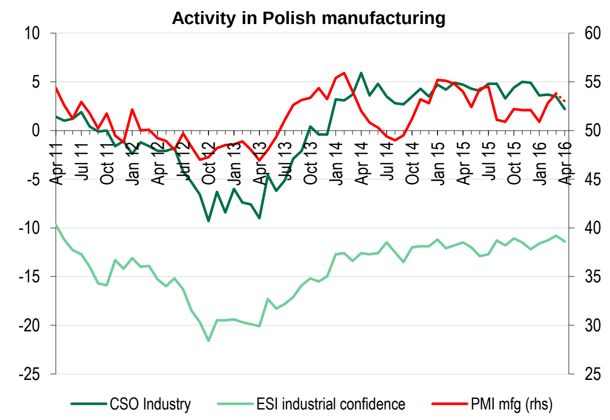
TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (2 May)					
	UK	Market holiday					
3:45	CN	PMI – manufacturing	Apr	pts	49.8	-	49.7
9:00	**PL**	**PMI – manufacturing**	**Apr**	**pts**	**53.0**	**53.0**	**53.8**
9:55	DE	PMI – manufacturing	Apr	pts	51.9	-	51.9
10:00	EZ	PMI – manufacturing	Apr	pts	51.5	-	51.5
16:00	US	ISM – manufacturing	Apr	pts	51.5	-	51.8
		TUESDAY (3 May)					
	PL	**Public holiday**					
		WEDNESDAY (4 May)					
9:55	DE	PMI – services	Apr	pts	54.6	-	54.6
10:00	EZ	PMI – services	Apr	pts	53.2	-	53.2
11:00	EZ	Retail sales	Mar	% y/y	2.7	-	2.4
14:15	US	ADP employment	Apr	k	198	-	200
16:00	US	ISM – services	Apr	pts	54.8	-	54.5
16:00	US	Factory orders	Mar	% m/m	0.7	-	-1.7
		THURSDAY (5 May)					
13:00	CZ	Central bank decision		%	-	-	0.05
14:30	US	Initial jobless claims	w/e	k	-	-	257
		FRIDAY (6 May)					
	PL	**MPC decision**		**%**	**1.50**	**1.50**	**1.50**
14:30	US	Non-farm payrolls	Apr	k	200	-	215
14:30	US	Unemployment rate	Apr	%	5.0	-	5.0

Source: BZ WBK, Reuters, Bloomberg

ECONOMIC ANALYSIS DEPARTMENT:
al. Jana Pawła II 17, 00-854 Warszawa fax +48 22 586 83 40
email: ekonomia@bzwbk.pl Web site: http://www.bzwbk.pl
Maciej Reluga (Chief Economist) +48 22 534 18 88
Piotr Bielski +48 22 534 18 87
Agnieszka Decewicz +48 22 534 18 86
Marcin Luziński +48 22 534 18 85
Marcin Sulewski +48 22 534 18 84

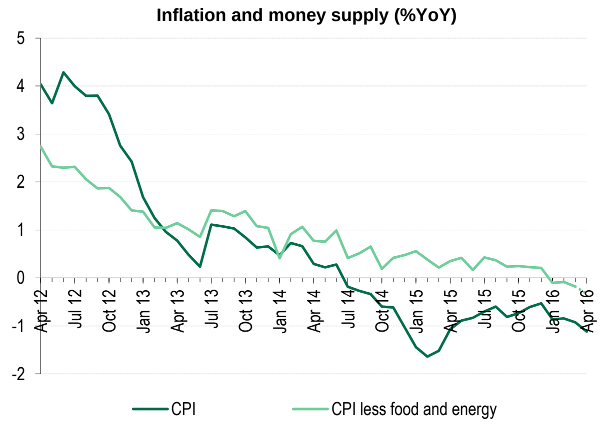
TREASURY SERVICES:
Poznań +48 61 856 5814/30
Warszawa +48 22 586 8320/38
Wrocław +48 71 369 9400

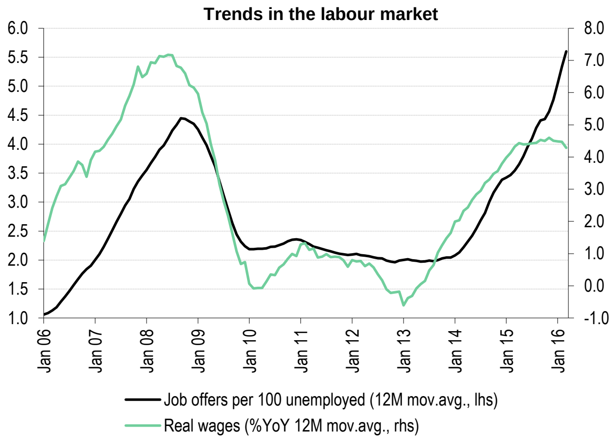
What's hot this week – PMI and MPC unlikely to surprise



- We expect a slight decline of Poland's manufacturing PMI in April (to 53.0) after two months of solid increases. Other leading indicators that have been published to date (GUS business climate or EC's ESI) showed slightly falling activity in manufacturing as well. Our forecast is in line with the market consensus, according to Bloomberg. If it proves correct, market reaction should be neutral, we think.
- We expect no surprise at all from the MPC meeting. The only unusual thing will probably be the fact that the decision will be made on Friday, not on Wednesday. Interest rates should remain on hold, in our view, and the tone of the MPC's statement should not change much from the one seen in March. Recent comments of the MPC members suggested clearly that they see no need for an interest rate reduction in the nearest months.

Last week in the economy – Inflation and unemployment still falling





- CPI fell in April to -1.1% y/y from -0.9% y/y in March, according to the stats office's flash estimate. We do not know the detailed data yet, but it seems that the drop was caused mainly by two factors: a cut of gas tariffs approved by the market regulator (retail gas prices for households fell c5% m/m) and a relatively high base effect in food prices. We expect the inflation rate to start picking up slowly in the coming months, but it is unlikely to rise above zero before 4Q16, in our view.
- Registered unemployment rate fell in March to 10.0%, the lowest level in this month since 1991, from 10.3% in February. We expect unemployment to fall further in the coming months.
- According to the Finance Ministry's data, the budget deficit amounted to PLN9.6bn after March, slightly above the initial plan (PLN9.3bn). Revenues reached PLN76.8bn (95% of the 1Q plan), while expenditures amounted to PLN86.4bn (96% of the plan). In March, VAT revenues were down 4% y/y and reached cPLN6bn. Income from the bank tax reached PLN364mn. It seems that budget revenues from the bank tax, retail tax and LTE will be short this year, by at least PLN1bn each. At this stage this does not seem to be a big threat to the budget as one-off income from the NBP profit will be higher than planned by cPLN5bn. However, if VAT revenues do not pick up significantly in the coming months, the finance ministry's comfort zone will shrink. For the time being we still do not see significant risks to this year's budget.

Quote of the week – The next move is more likely to be a rate hike

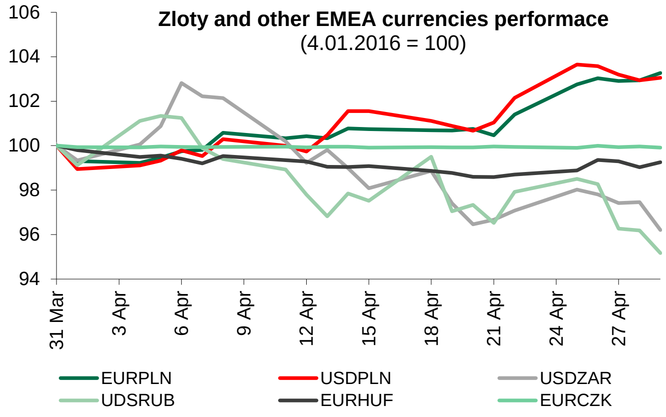
Marek Chrzanowski, MPC member, Reuters, 25.04
If we faced economic downturn or persistent deflation, then we could mull an interest rate cut. (…) This scenario, however, seems so remote that it's almost fiction. The next move is more likely to be a rate hike, but rather not too soon.

Kamil Zubelewicz, MPC member, Reuters, 27.04
All forecasts show that inflation will return to target with the current level of interest rates. So, if we cut rates today, we would be forced to raise them again. (…) If there is such discussion, I would opt for lowering of the inflation target.

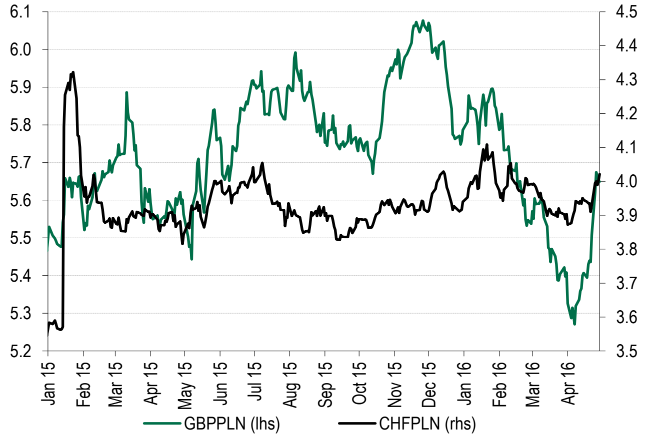
Eugeniusz Gatnar, MPC member, Reuters, 27.04
The current level of interest rates is optimal for the economy. When I think about factors that may cause softening of my stance, it is threats to economic growth. But I do not see such internal threats. The most likely scenario for rates is their stabilsation. Or perhaps, at some point of time, a change of bias in the opposite direction.

The most recent comments of the MPC members were quite hawkish, suggesting they see absolutely no need for monetary policy easing in Poland in the nearest months. Some of them even mentioned that for them a change in policy bias to a more restrictive stance or even considering rate hikes seem to be the more probable scenarios than interest rate cuts. Interestingly, according to minutes from the MPC's last meeting, most Council members "did not rule out the possibility of interest rate cuts in case of an economic slowdown in Poland and deepening deflation". Apparently, the central bankers are very confident about Poland's economic growth outlook, even despite signs of weakness in recent high-frequency data (production, retail sales). It seems that data about economic activity may be more important than inflation from the perspective of expectations about the MPC's future decisions.

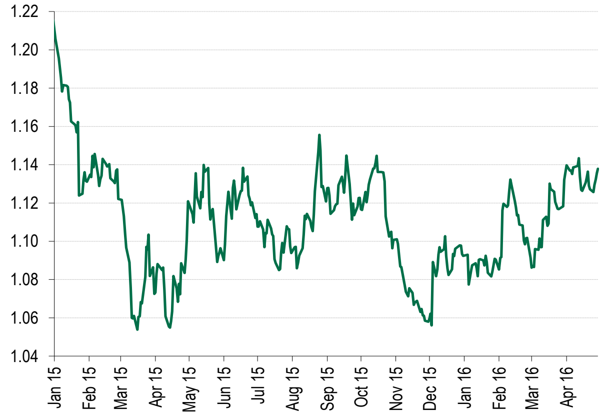
Foreign exchange market – High volatility ahead



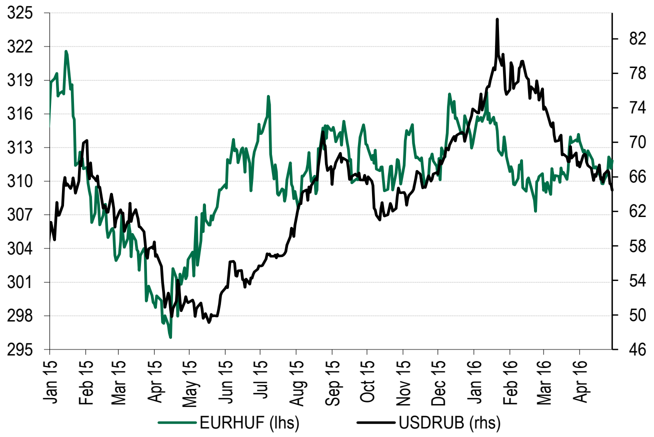
CHF/PLN and GBP/PLN



EUR/USD



EUR/HUF and USD/RUB



Zloty remains under pressure

▪ As we expected, room for zloty gains was limited last week. EUR/PLN was quite volatile as we saw 4.427 at the start of the week, then 4.369, and after that the rate ended the week above 4.40. Next to the sour global market sentiment, the Polish currency is burdened by negative domestic factors, including, among others, selling of domestic debt by foreign investors, worries about a new proposal of FX loan conversion and the approaching Moody's decision on Poland's credit rating. On a weekly basis, the zloty lost against all the main currencies, the most against the British pound (2.6%) and the Swiss franc (2.3%).

▪ In April, the zloty was the weakest currency among the EM universe after quite the favourable March. EUR/PLN ended the month at a level above 4.40, close to the level from early February and despite verbal interventions by deputy finance minister Piotr Nowak and then PM Beata Szydło. What is more, the spread between the level of EUR/PLN at the end of month and the month's average was 0.10, the highest since May 2013. This is due mainly to the domestic factors (in particular the FX-loan conversion), which have raised the risk premium for Poland's assets. In our view, the upcoming domestic macro releases (April PMI for manufacturing) and the MPC decision on rate (rates on hold) should be rather neutral for the zloty. However, global macro data, mainly the non-farm payrolls in the US, will be key. All in all, in our view, the zloty remains more and more sensitive to the global risk sentiment and may benefit less from external easing than other markets in the region. Thus, despite having constructive macro views, we expect a volatile period ahead. We uphold our stance that in May the zloty will likely remain weak. The support levels for EUR/PLN are at 4.35 and then at 4.32, while the resistance levels are at 4.43 and the next at 4.47.

EUR/USD up, but correction very likely

▪ Last week brought a EUR/USD rise towards 1.14. USD's weakening was driven by the Fed's lack of commitment to a June hike as suggested by April's statement and weak US activity data. The 1Q16 GDP data in the US showed the slowest rate of expansion in two years. At the same time, the first estimate for Euro zone's GDP growth in 1Q16 was better than expected (1.6% y/y vs 1.4% y/y).

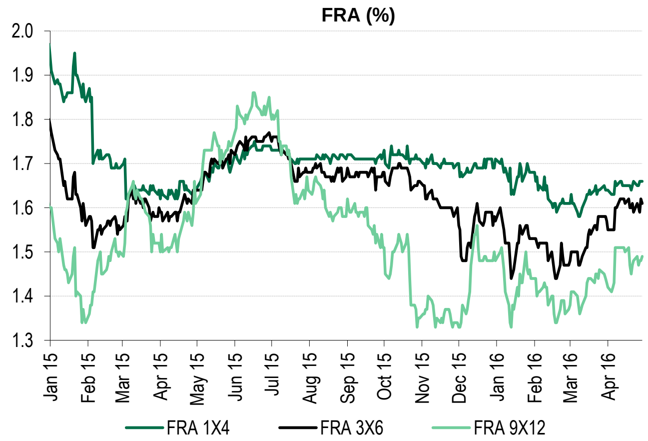
▪ This week, the market will focus on important data in both Europe (including final PMI manufacturing data) and US (labour market data). After the euro's quite significant strengthening in the last two weeks, we think that the potential for a correction on EUR/USD is growing, in particular if the US labour market data show further strengthening.

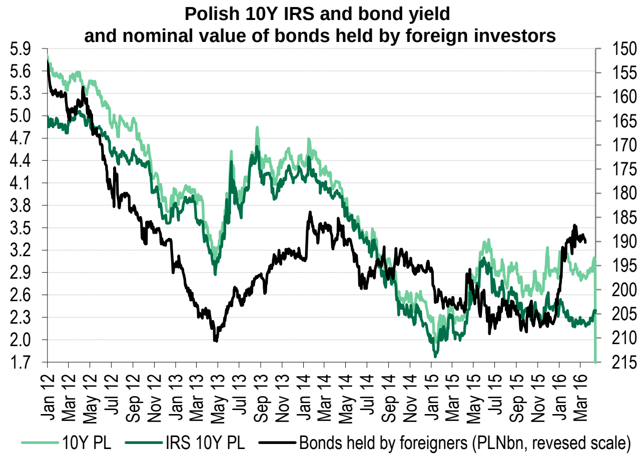
April PMIs in focus, CNB in line with expectations

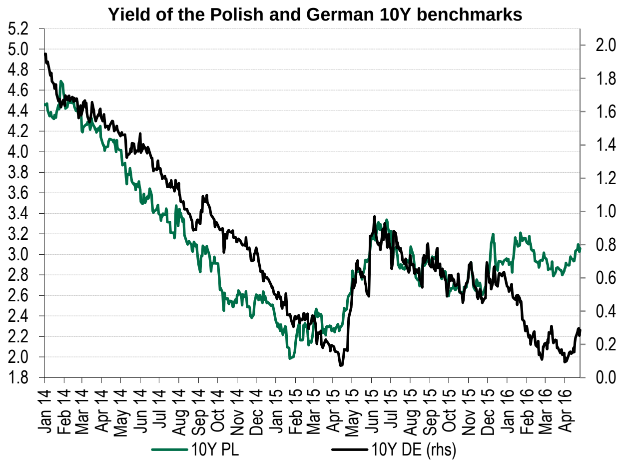
▪ Both EUR/HUF and EUR/CZK were quite stable on a weekly basis, while USD/RUB fell visibly due to rising oil prices (to over USD48/bbl). The outcome of central bank meetings in Hungary (MNB) and Russia (CBR) was in line with expectations. In Hungary rates were cut by 15bp, while in Russia they stayed unchanged. MNB's less dovish rhetoric put some pressure on HUF, with EUR/HUF going towards 313 at the end of week.

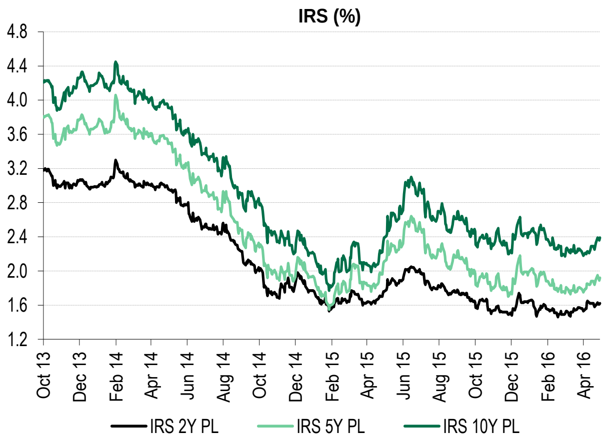
▪ CEE FX markets will remain under the influence of global factors, as well as country specific data and events this week (including PMI readings, oil price performance and the Czech central bank meeting). We expect quite a volatile period ahead.

Interest rate market – US data in the spotlight









Rates rise, nonresidents buy Polish bonds

▪ Polish assets were clearly under pressure last week and this was also the case of bonds. Yields and IRS rose significantly mainly in the belly and long ends of the curves – the 10Y benchmark yield rose temporarily to 3.10%, while the 5Y and 10Y IRS jumped to 1.95% and c2.40%, respectively, their highest since late January/early February.

▪ MPC members Chrzanowski, Zubelewicz and Gatnar spoke on the central bank's monetary policy and said that stable interest rates were the most likely scenario for the coming months. However, their views failed to trigger any noticeable reaction on FRAs and the market still prices-in a c55% probability of a 25bp cut in 6 months and c80% in 9-12 months.

▪ The Finance Ministry said it would offer bonds worth a total of PLN4-11bn in May. At the standard auction on May 5, it plans to offer 2Y and 10Y benchmarks (OK1018 and DS0726) for PLN2-5bn. Its offer on May 26 (when it plans to sell bonds worth PLN2-6bn) will depend on the market conditions, but the ministry will not offer bonds that it had sold earlier in May.

▪ According to the most recent data released by the Finance Ministry, in March foreign investors purchased Polish, PLN, marketable bonds for PLN3.6bn after an outflow of more than PLN20bn in January-February. At the end of 1Q, the nominal value of their portfolio stood at cPLN190bn. Nonresidents remained focused on the mid- and long-term benchmarks and the biggest monthly purchase was recorded for DS0726 (+PLN4.7bn to over PLN10bn, 59% of this bond outstanding). As regards other investors' groups, Polish banks continued to accumulate Polish bonds and, in March, they bought debt for PLN6.2bn. The nominal value of their portfolio rose to a fresh all-time high at PLN212bn.

US data in the spotlight

▪ US data is likely to drive the market this week with April's manufacturing ISM and the monthly employment report the most awaited numbers. According to Bloomberg, investors do not expect the Fed to hike rates until December, so if the data surprise to the upside, the market's reaction may be more significant than in case of a disappointment. The third chart shows that 10Y Polish-German bonds' spread widened after the January's S&P decision and stayed high due to internal issues (CHF mortgages, concerns about rating downgrades). Although correlation with the core market has recently increased, we think that Polish yields/IRS may rise when the Bunds weaken, while it may be difficult for them to fall when yields decline abroad.

▪ On the domestic side, we do not expect April's manufacturing to surprise and we do not expect any meaningful change in the MPC's rhetoric. Nevertheless, issues, such as conversion of FX mortgages or looming rating updates – are still on the agenda and could continue to limit the yields/IRS downside potential. The European Commission may publish its spring edition of economic forecasts. This is rather unlikely to have any direct impact on the market, but may show whether the EC believes Poland's Convergence Programme from late April to be reliable.

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.