Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

10 – 16 April 2017

Dovish ECB was the main event of the week on the global market. Both central bank's minutes and words of the ECB president Mario Draghi undermined expectations for imminent policy normalisation in the euro zone and put a downward pressure on the market interest rates. In the CEE region, the Czech National Bank gathered most attention after its decision to abandon the 27.0-cap of EURCHF exchange rate. This move supported the Czech koruna, and proved supportive also for the zloty. Polish bond yields remained near local lows as the Polish MPC sounded dovish and the outlook for the domestic monetary policy has not changed at all. PMI index for Poland fell unexpectedly but still remains relatively high, pointing to the robust economic activity in manufacturing.

This week, there are no market-breaking events planned in Poland. The final March headline inflation should not differ much from the flash estimate and is likely to be neutral for the market. Current account is expected to have posted a deficit in February, and, as our forecast is below the consensus, the figure may put some slight negative pressure on the zloty. There are also only few important macro releases due abroad (in Germany and the US) and some of the FOMC members (including Janet Yellen) are expected to give a speech at the beginning of the week. The recent comments made by FOMC members were rather hawkish and market pricing for a June rate hike could intensify if the tone of US central bankers speeches is maintained. Market liquidity may me dampened in the pre-Easter period and this may potentially fuel the market volatility.

Economic calendar

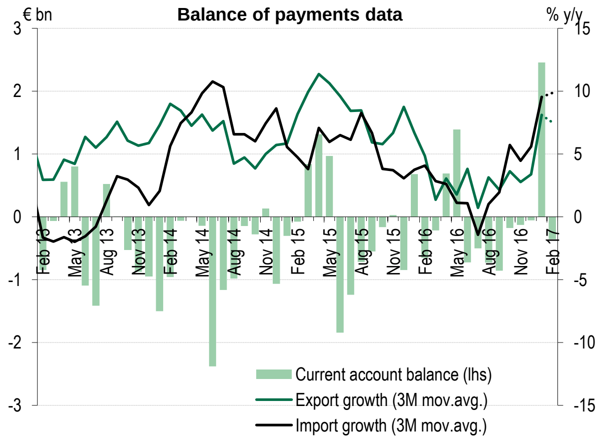
TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (10 April)					
9:00	CZ	CPI	Mar	% y/y	2.6	-	2.5
		TUESDAY (11 April)					
9:00	HU	CPI	Mar	% y/y	3.1	-	2.9
11:00	EZ	Industrial output	Feb	% y/y	2.0	-	0.6
11:00	DE	ZEW index	Apr	pts	-	-	77.3
14:00	**PL**	**CPI**	**Mar**	**% y/y**	**2.0**	**2.0**	**2.2**
		WEDNESDAY (12 April)					
14:00	**PL**	**Core inflation**	**Mar**	**% y/y**	**0.5**	**0.6**	**0.5**
		THURSDAY (13 April)					
14:00	**PL**	**Current account**	**Feb**	**€m**	**-100**	**-357**	**2457**
14:00	**PL**	**Exports**	**Feb**	**€m**	**15 356**	**15 064**	**14 976**
14:00	**PL**	**Imports**	**Feb**	**€m**	**15 300**	**15 300**	**14 751**
14:30	US	Initial jobless claims	week	k	-	-	234
16:00	US	Flash Michigan	Apr	pts	97.0	-	96.9
		FRIDAY (14 April)					
14:00	**PL**	**Money supply**	**Mar**	**% y/y**	**8.7**	**8.3**	**8.2**
14:30	US	CPI	Mar	% m/m	0.0	-	0.1
14:30	US	Retail sales	Mar	% m/m	0.0	-	0.1

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
Piotr Bielski +48 22 534 18 87
Marcin Luziński +48 22 534 18 85
Marcin Sulewski +48 22 534 18 84

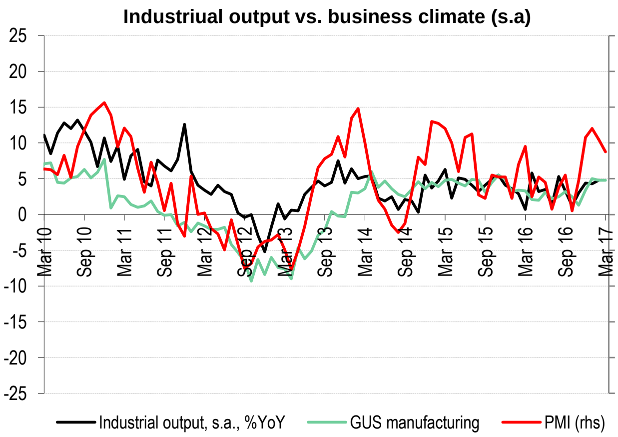
TREASURY SERVICES:
Poznań +48 61 856 5814/30
Warszawa +48 22 586 8320/38
Wrocław +48 71 369 9400

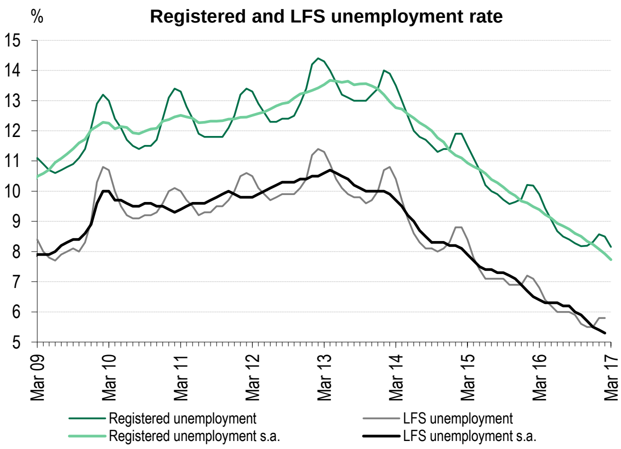
What's hot this week – Final CPI and current account



- Final data on CPI will most probably be not very interesting for the market, but we will get to know more details about the quite surprising decline of this gauge in March. In our view, fall of vegetable prices may be the main culprit, but we cannot rule out that other factors were also in play. We estimate core inflation excluding food and energy prices at 0.6% y/y, the highest level in over two years.
- Current account is likely to post a small deficit in February, as we have recorded a weak inflow of EU funds, which were the main factor behind big surplus in January. Both growth rates of exports and imports may be much lower than in January, mainly on the back of negative working day effect and low reading of industrial output.

Last week in economy – PMI slightly down, interest rates unchanged





- PMI index for Poland fell unexpectedly to 53.5pts in March from 54.2pts in February. The decline was driven by lower subindices of output, new orders and employment. The index fell for the second time in a row, but let us note that PMI is quite volatile and in the recent years it has not been the best predictor for the trends in the industrial output. We think this was also the case recently; the jump of PMI seen in the previous months looked overdone and, in our view, the actual economic trends in Polish manufacturing were much better represented by the business climate index released by the Statistical Office. The latter has been stable since January, indicating seasonally adjusted industrial output growth around 5% y/y. Despite the recent drop, the manufacturing PMI still remains relatively high, pointing to the robust economic activity in manufacturing.
- The Ministry of Labour released its estimates, showing that the unemployment rate fell to 8.2% in March from 8.5% in February. According to the Ministry, the number of the unemployed fell by 57.7k m/m. We have revised our forecast of the unemployment rate to 8.2%.
- The Monetary Policy Council kept the main interest rates on hold, with the reference rate still at 1.5%. As we expected, the rhetoric at the press conference was very similar as in the previous month. The official statement was almost the same as in March, emphasizing the limited risk of exceeding the inflation target in the medium run. The MPC predicted that inflation was likely to stabilize in the coming quarters, with fading impact of higher commodity prices and only a very gradual increase of internal inflationary pressure, despite record-low unemployment. To sum up, the Polish central bank has not surprised us at all. We maintain our view that the MPC will not hurry with monetary tightening and interest rate hikes are not likely to occur before the second half of 2018.

Quote of the week – Hikes are very unlikely in 2017

Adam Glapiński, NBP president, 05.04.2017, NBP conference

As we have said earlier, nothing has changed: inflation climbed pushed by rising commodity and vegetable prices. Supply factors made the oil prices stabilize, so inflation will slow down and anchor near 2%, also in 2018. All available information suggests that rates will stay flat until the end of 2017. We will see what happens in July. Hike in 2017 is completely unlikely, we will see what 2018 will bring, especially in 2H. In my view, there will be no reason for hike rates in 2018 as well.

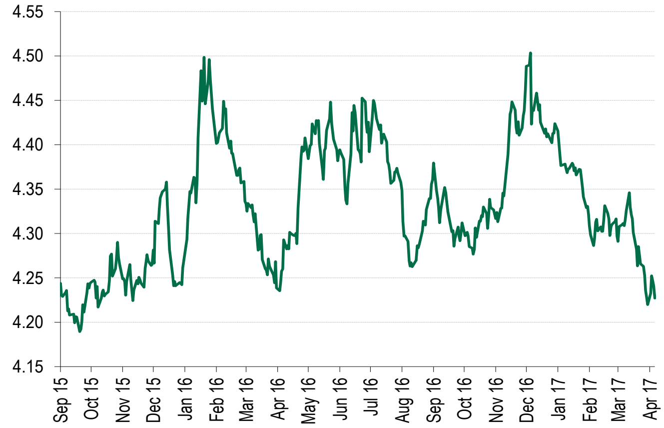
Rafał Sura, MPC member, 05.04.2017, NBP conference

March inflation supports our 'wait and see' mode. Provided there are no shocks in the upcoming quarters, inflation will be below 2% at the year-end. Negative real interest rates are a new phenomenon in Poland and its effects are not clear. We will observe its impact on the economy.

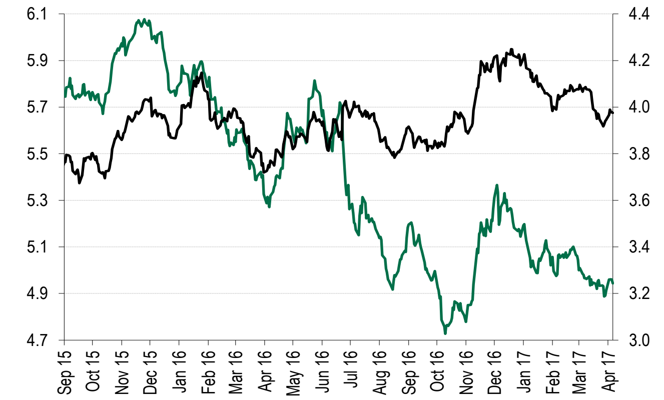
During the NBP conference, the NBP head Adam Glapiński said that the recent data confirmed the economic scenario predicted by the MPC was correct. In his view, inflation rate should decrease slightly in the coming months and is likely to stabilize near 2% y/y later this year and also in 2018. Glapiński added that he was not worried at all about the consequences of negative real interest rates and he did not expect to see any increase in wage pressure in Poland. The NBP President said that he believed that interest rate hike in 2017 was completely unlikely. Glapiński did not rule out a policy tightening in 2H18, but in his view, such move will not be needed in 2018. Rafał Sura did not say much on monetary policy perspectives, apart from the fact he supported the "wait-and-see" mode. Currently the market prices in one hike in Poland in 2018, in September.

Foreign exchange market – Waiting for the trigger

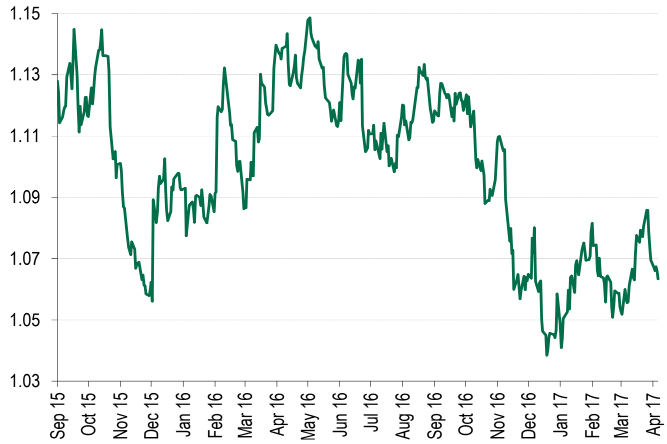
EUR/PLN



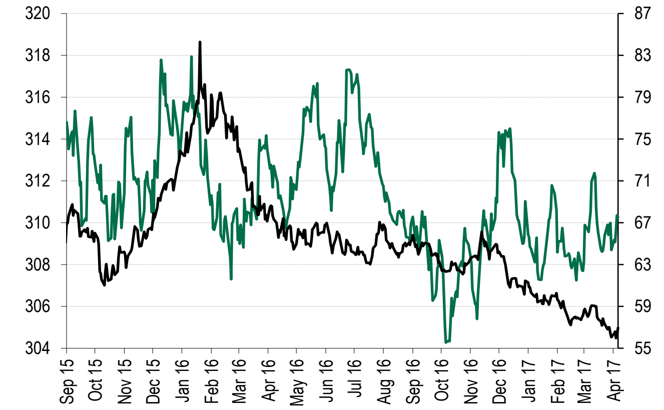
USD/PLN and GBP/PLN



EUR/USD



EUR/HUF and USD/RUB



Stabilization after rally

- Last week, EUR/PLN stayed above this year's low at c.4.21 reached in late March. We were expecting that the beginning of the new quarter may bring some profit taking from the zloty's recent gains and in early April the Polish currency has at least stopped to appreciate. The main factors weighing slightly on the zloty were the below-consensus March figures for the flash CPI and manufacturing PMI while the appreciation of the Czech koruna (details at the bottom of the page) helped the zloty to pare part of earlier losses. USD/PLN remained fairly stable last week hovering around 3.97.
- The zloty's 1Q17 appreciation versus the euro has been the best quarterly performance of the Polish currency since 1Q15. It is also worth noting that the last time EUR/PLN fell for the two quarters in a row was in 2013. Also, France holds presidential elections in April and the investors' attention could again start to turn to the European politics. These are some reasons why we expect that EUR/PLN could rise in the nearest future.
- This week we will learn the February C/A data. Our forecast assumes current account deficit well below consensus and in our view such figure may weigh at least slightly on the zloty. Global market sentiment shall also influence the zloty with the equities performance in reaction to the German and US data being, in our view, key for the Polish currency.

Awaiting trigger

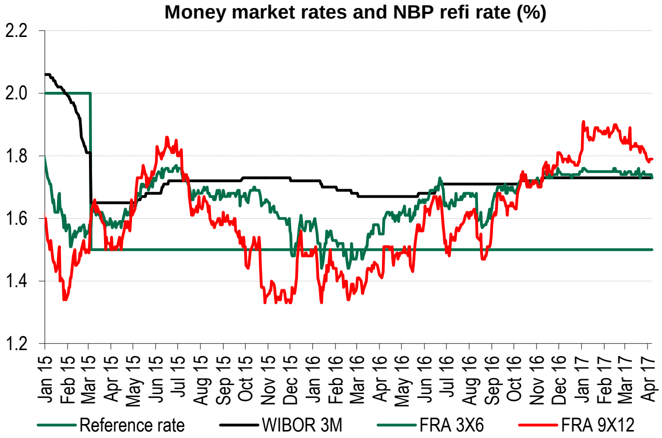
- After a significant plunge recorded in the previous week, EUR/USD continued the trend but at a clearly slower pace. Before the US monthly non-farm payrolls data were released, weekly high-low range for EUR/USD was the lowest since March 1986 (Reuters data). This was despite the surprisingly dovish signals from the ECB suggesting that there are no plans to change the forward guidance soon. The US nonfarm payrolls was very weak, but the unemployment rate fell to its lowest for nearly 10 years which supported the dollar, but the scale of move was not very big.
- The market is clearly waiting for a trigger that could initiate some more sustainable trend. We do not think that such low volatility could persist this week as well and we would expect EUR/USD to show higher degree of sensitivity to the coming macro data than in the previous days.

CNB abandons EUR/CZK floor

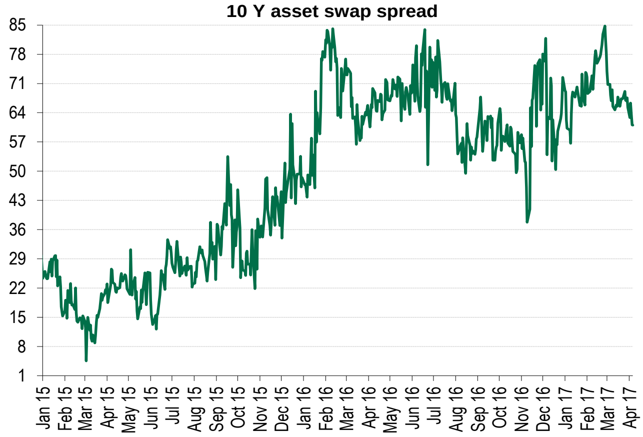
- The main event that affected the CEE market last week was the decision of the Czech National Bank (CNB) to abandon the EUR/CZK floor at 27.0 introduced in November 2013. The CNB has been alluding to such a decision for a long time, indicating that the withdrawal of the limit could be expected in mid-2017. However, following the March meeting, the central bank announced that such a decision could be taken at any point in time. The market was surprised and, in response to the announcement, EUR/CZK plunged to ca. 26.55. Jiri Rusnok, the governor of the CNB, said that the bank is ready to take measures to curb the exchange rate fluctuations. However, he also added that the bank would not take any steps in the first days after the decision in order to enable the exchange rate to find a new level of market equilibrium.
- The forint and the ruble lost last week. EUR/HUF rose despite rising BUX stock index. USD/RUB rose after three weeks in a row of decline which was largely due to higher tensions in Syria.

Interest rate market – More factors needed to keep market strong

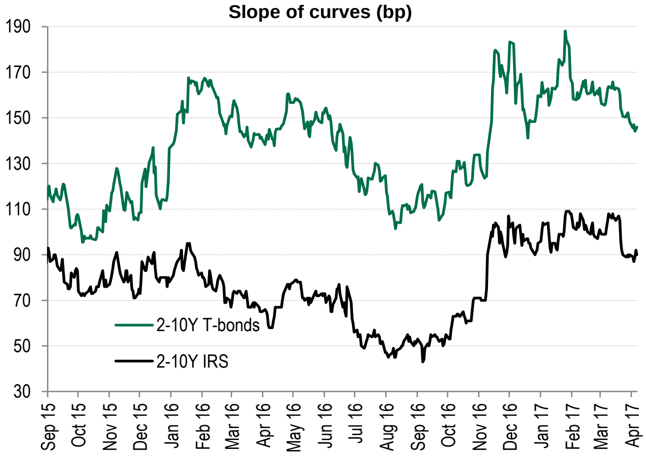
Money market rates and NBP refi rate (%)



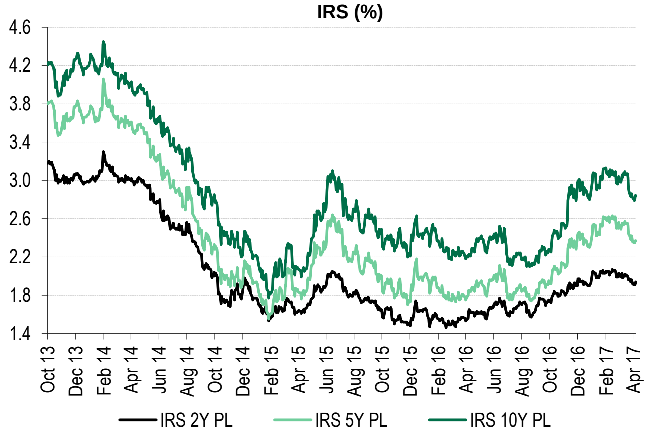
10 Y asset swap spread



Slope of curves (bp)



IRS (%)



Rates stable at the beginning of a quarter

- IRS and bond yields did not change much on weekly basis and settled just above the recent lows reached in the previous week. Just as we expected, MPC's rhetoric was dovish but this did not have much impact on the FRAs as the very short end of the curve adjusted after the surprisingly low flash March CPI figure released just a few days before the MPC meeting. Investors seem to have factored in the recent inflation figure and the dovish rhetoric of the MPC. According to FRA rates the market sees first 25bp rate hike in 18 months, which is now in line with our base scenario.

Gross borrowing needs covered in 56%

- The last week's bond auction was pretty successful as the Ministry of Finance sold bonds for PLN5bn, at the upper band of the planned supply and demand at PLN8.7bn. Just like at the previous auction, the biggest amounts were raised from 5Y and 10Y benchmarks, PS0422 and DS0727 (PLN1.4bn and PLN1.7bn, respectively). The Ministry announced that after the auction this year's gross borrowing needs have been covered in 56%.

More factors needed to keep market strong

- This week, there are no market-breaking events planned in Poland. The final March headline inflation should not differ much from the flash estimate and the Tuesday's release is likely to be neutral for the IRS/yields while the other Polish figures shall not be vital for the FI market.
- There are also only few important macro releases planned to be published abroad (in Germany and US) and some of the FOMC members (including Janet Yellen) are expected to give a speech at the beginning of the week.
- As we mentioned last week, since the beginning of 2015, the 10Y yields have never fallen for the two consecutive quarters. Polish 2Y, 5Y and 10Y bond yields are now holding at or near their 2017 lows and after the recent dovish inflation data and the MPC rhetoric (that failed to trigger any persistent downward move) may simply need more supportive factors to at least stay at the current levels. We think that there is little chance of any of them to emerge this week.
- The recent comments made by FOMC members were rather hawkish and, according to Bloomberg, the market currently sees c65% probability of a 25bp Fed rate hike in June. As long as the June rate raise is our base-case scenario, we anticipate the upside pressure on the global yields start to arise which should also influence the Polish market. For the time being, at the end of this week, the 10Y UST yield was testing important support at c.2.30% and the nearing US macro data and FOMC members comments may determine the direction at least in the short-term.

Additional information is available on request. Please contact Bank Zachodni WBK S.A., Economic Analysis Department, al. Jana Pawła II 17, 00-854 Warsaw, Poland, phone +48 22 534 18 87, email ekonomia@bzwbk.pl