Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

17 – 23 April 2017

Last week was rather calm and investors were in a clear pre-Easter mood. However, the US president Donald Trump introduced some market volatility when he said that the dollar is too strong and interest rates should stay low. Moreover, there was some rise in geopolitical uncertainty after tensions in Syria, rocket tests in North Korea and bombings in Afghanistan. In Poland, we saw some interesting data on CPI and current account.

This week, on the other hand, has a huge potential to be interesting both as regards events in Poland and abroad. During the weekend, Turkey holds a constitutional referendum where it will decide on giving more power to president Erdogan. For us, the impact on the market of this event does not seem to be obvious, but there is a risk that volatility on the emerging markets could rise at the beginning of the week. French election is another important political event. In the recent days polls showed that candidates are running neck in neck so the uncertainty regarding the outcome might weigh on the risky assets. We will also get a large bunch of important macro data, especially PMI for Germany and the euro zone and US housing market data. As regards Poland, apart from some important data (industrial and construction output, retail sales, labour market), which will help fine-tune the GDP growth forecasts for 1Q17, on Friday the S&P may review its assessment of the Polish credit rating. We do not expect the S&P decision to have any breaking impact on the Polish market as domestic macro and fiscal performance has improved since the last review.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (17 April)					
		No important data releases					
		TUESDAY (18 April)					
14:30	US	House starts	Mar	k	1253	-	1288
14:30	US	Building permits	Mar	k	1250	-	1213
15:15	US	Industrial output	Mar	%	0.5	-	0.0
		WEDNESDAY (19 April)					
11:00	EZ	CPI	Mar	% y/y	1.5	-	2.0
14:00	**PL**	**Wages in corporate sector**	**Mar**	**% y/y**	**4.3**	**4.2**	**4.0**
14:00	**PL**	**Employment in corporate sector**	**Mar**	**% y/y**	**4.6**	**4.6**	**4.6**
20:00	US	Fed Beige Book					
		THURSDAY (20 April)					
14:00	**PL**	**Real retail sales**	**Mar**	**% y/y**	**6.6**	**7.0**	**5.2**
14:00	**PL**	**Industrial output**	**Mar**	**% y/y**	**7.4**	**8.7**	**1.2**
14:00	**PL**	**Construction and assembly output**	**Mar**	**% y/y**	**0.8**	**2.1**	**-5.4**
14:00	**PL**	**PPI**	**Mar**	**% y/y**	**4.6**	**4.6**	**4.4**
14:30	US	Initial jobless claims	week	k	-	-	234
14:30	US	Philly Fed index	Apr	pts	25.0	-	32.8
		FRIDAY (21 April)					
9:30	DE	Flash PMI – services	Apr	pts	55.5	-	55.6
9:30	DE	Flash PMI – manufacturing	Apr	pts	58.0	-	58.3
10:00	EZ	Flash PMI – services	Apr	pts	56.0	-	56.0
10:00	EZ	Flash PMI – manufacturing	Apr	pts	56.0	-	56.2
14:00	**PL**	**MPC minutes**					
16:00	US	Home sales	Mar	m	5.6	-	5.48

Source: BZ WBK, Reuters, Bloomberg

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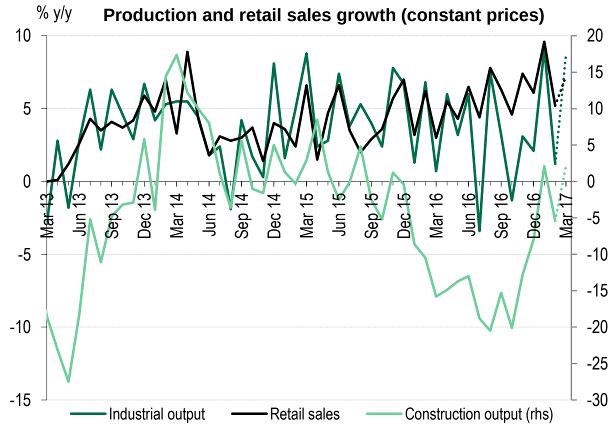
What's hot this week – Data on economic activity, labour market and PPI

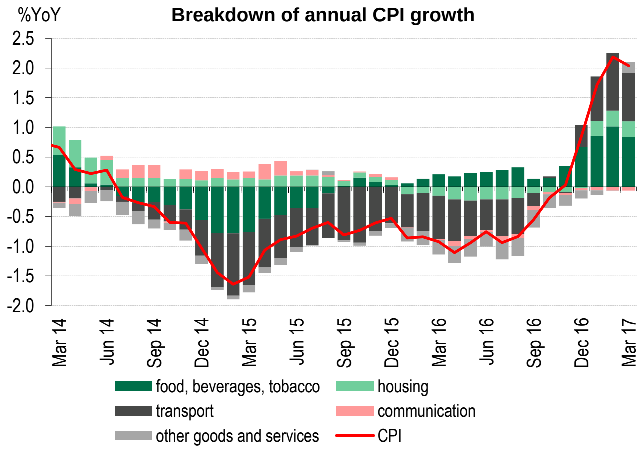


▪ This week, we will get to know final data from the Q1, helping to refine the GDP growth forecasts, which will be slightly above 3.0% y/y, in our view. Data on the economic activity (output in industry and construction, retail sales) will be markedly better than in February thanks to a positive working day effect. Retail sales will be slightly undermined by Easter effect, securing lower annual growth rates of sales in some sectors, especially in the food sector. Still, we expect real retail sales to grow by healthy 7.0% y/y.

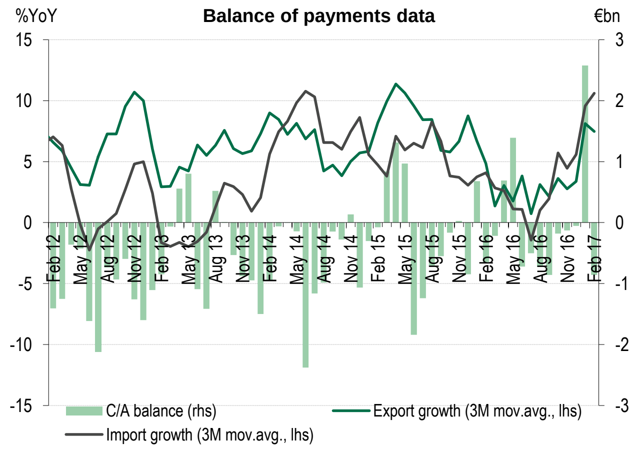
▪ Data from the labour market stayed strong in March and growth rates were close to these witnessed in February. Favourable labour market conditions were a strong supporter of private consumption in 1Q2017, which rose by about 4.0% y/y, according to our estimates.

▪ PPI inflation will go up, reaching the highest level in 5 years.

Last week in economy – CPI lower due to vegetable prices, C/A deficit above expectations



▪ CPI inflation reached 2.0% y/y in March, in line with the flash estimate. Prices dropped 0.1% m/m. As we suspected, the drop of inflation from February's 2.2% y/y resulted mainly from the lower food prices (-0.3% m/m), in particular vegetables, which went down by 5.4% m/m – the strongest drop in this month since at least 10 years. Thus, the data confirmed earlier hypotheses, according to which high prices of vegetables in January-February, triggered by severe winter in Southern Europe, were expected to retreat when Polish products started entering the market. Core inflation excluding food and energy amounted to 0.6% y/y. The figure turned out to be the highest since January 2015. We expect inflation to stay near 2% y/y in the months to come and ease to c1.5% y/y at the year-end due to the high base effect. Core inflation should continue to rise to c1.6-1.7% y/y in late 2017. Such inflation trends should warrant stable interest rates in Poland.



▪ In February, the current account deficit amounted to €860mn, above expectations. A significant change versus the high surplus in the previous month (€2.6bn) resulted primarily from a strong capital inflow in January within the frame of Common Agricultural Policy. Exports amounted to €15.044bn (+3.8% y/y) and imports reached €15.581bn (+9.1% y/y). Exports was exactly in line with our forecast and it decelerated due to the lower number of working days. Imports, however, was surprisingly high and this was the main factor responsible for above-forecast deficit. In our view, rise in imports reflects strength of the domestic demand and we cannot exclude that it was also driven by a rebound in investments (purchase of investment goods). We expect a robust exports in the months to come that should be driven by the economic revival in Poland's main trading partners. Imports may rise faster than exports which could deteriorate the C/A balance.

Quote of the week – Wait-and-see also in 2018

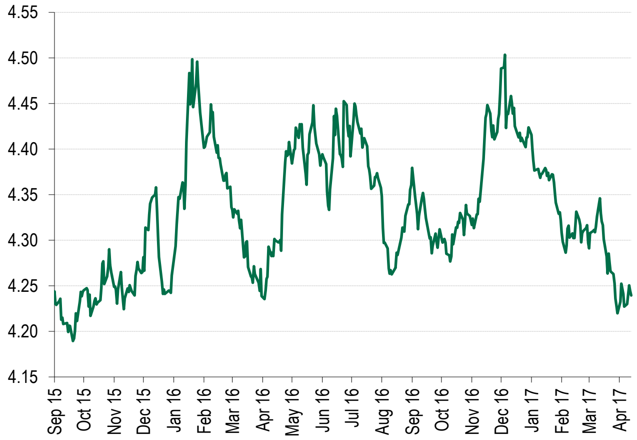
Rafał Sura, MPC member, 11 April 2017, PAP
I believe that inflation will be below 2% at the year-end. If CPI stays within this range, there will be no reason for hike rates in 2017 or in 1Q2018. We are analyzing the inflation development, so July projection will be crucial, as it will show CPI path for 2018 and 2019.

Grażyna Ancyparowicz, MPC member, 13 April 2017, PAP
I cannot rule out that wait-and-see mode will continue by 1H2018 or longer. July projection will be key in determining sources and momentum of inflation. Rates should go up, if wage growth persistently overshoots growth of productivity and will be accompanied by rising investment.

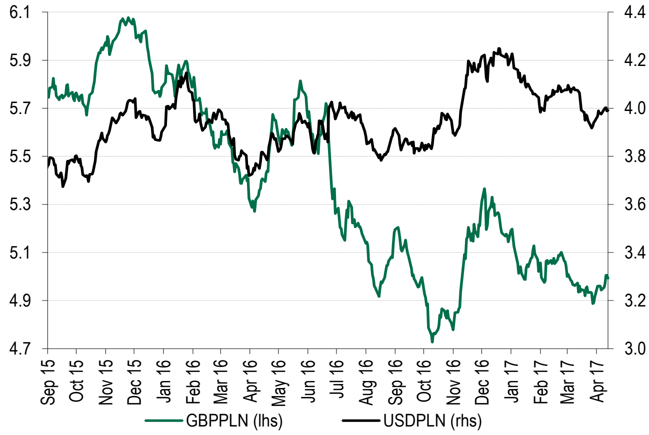
Last week's comments of MPC members were dovish, in line with views of most other central bankers in Poland. Both Ancyparowicz and Sura want to pursue the wait-and-see policy in 2017 and 2018 and they are waiting for the July CPI projection. As long as the inflation stays close to 2% y/y (and this is our base scenario for 2017), they will be unwilling to change rates. In general, these comments support our view that rates will remain unchanged by the end of 2018.

Foreign exchange market – PLN volatility could rise soon

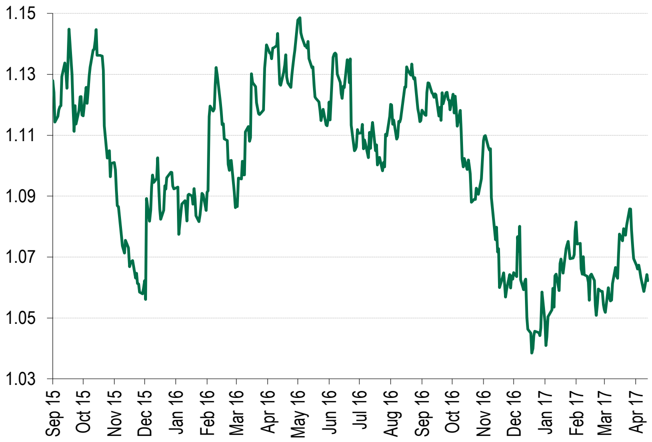
EUR/PLN



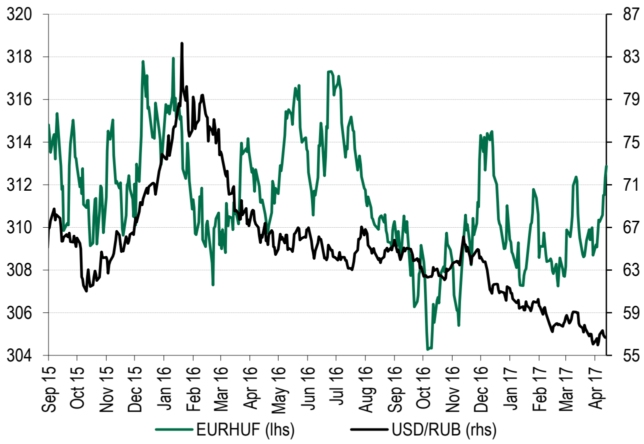
USD/PLN and GBP/PLN



EUR/USD



EUR/HUF and USD/RUB



PLN volatility could rise soon

- Last week on the Polish FX market was pretty calm given no important macro releases and limited investors' activity before Easter. EUR/PLN rose after four consecutive weeks of a decline on the profit taking after recent appreciation of the zloty and bigger than expected Polish C/A deficit in February. As a result, EUR/PLN rose above 4.24 but remained within the previous week's trading range. At the same time, USD/PLN stayed in the 3.97-4.01 horizontal trend.
- Since late March, EUR/PLN weekly trading range has been lower in each consecutive week. On the emerging markets, periods of lower volatility usually precede some bigger moves and if this pattern continues, we may see some bigger moves on the market soon.
- This week will be the last before the French presidential elections. In the recent days polls showed that candidates are running neck in neck so the uncertainty regarding the outcome might weigh on the risky assets.
- This weekend Turkey holds a constitutional referendum where it will decide on giving much more power to president Erdogan. For us, the impact on the market of this event does not seem to be obvious. On the one hand, giving the power to the president might concern investors viewing this as a risk factor weighing on the country's credibility. On the other hand, centralization could reduce the risk of another attempt of remove the president from the office (at least in the short term), which should be positive for the Turkish assets and there may be no adverse reaction on the emerging markets either.
- Our forecasts for Polish retail sales and industrial output are above the consensus which could potentially boost the zloty. However, the recent EUR/PLN's free-fall was partly driven by improving economic outlook and market pricing for a faster economic growth. That is why the positive impact of the Polish macro data on the zloty could be limited.
- On Friday the S&P may review its assessment of the Polish credit rating. We do not expect this event to have any breaking impact on the Polish market as domestic macro and fiscal performance has improved since the last review.

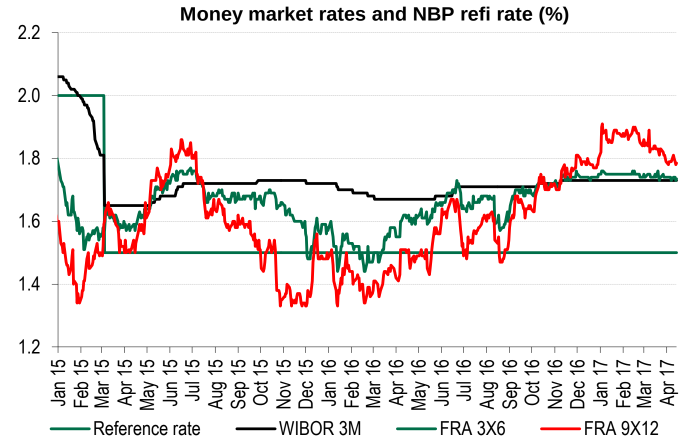
EUR/USD still in a horizontal trend

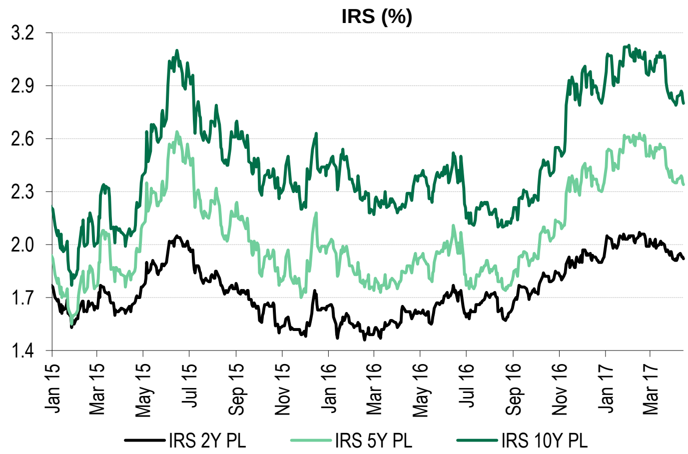
- In our last report we outlined that last week's high-low range for EUR/USD was the lowest since March 1986 (Reuters data). We suggested that such low volatility would rather not hold long but in the last five sessions the trading range was only slightly wider than in the previous week. EUR/USD rose after two consecutive weeks of decline and the greenback was hit by Donald Trump saying that the dollar is too strong. As a result, EUR/USD jumped temporarily to above 1.067.
- This week numerous US data are on the agenda and some FOMC members will speak, but the market attention may focus on the news from France ahead of the presidential elections. We think there is a limited room for the euro to gain as long as uncertainty regarding the results of the first round persists.

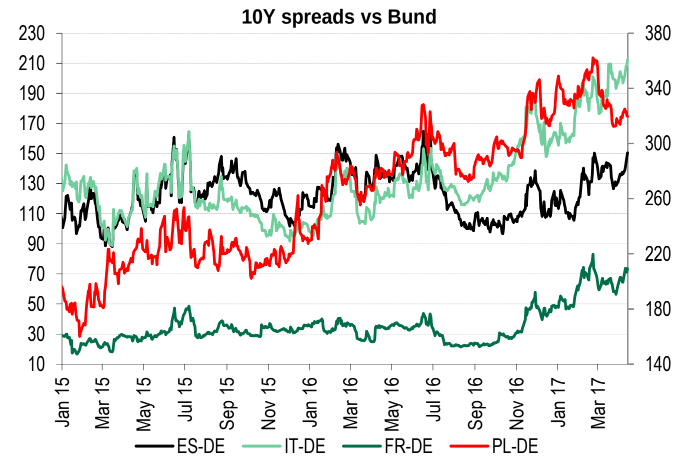
Koruna and forint weaker

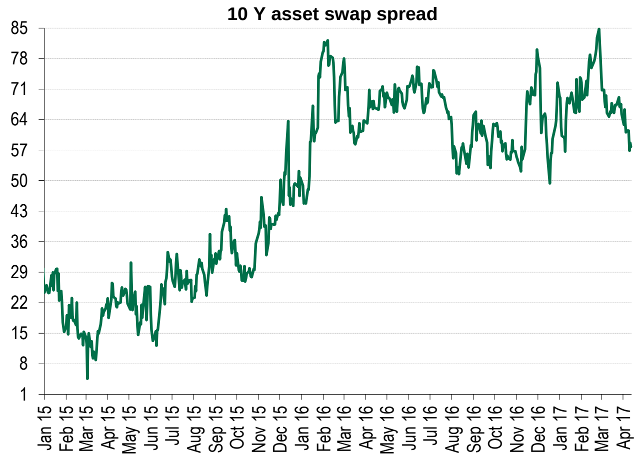
- Last week, EUR/CZK rebounded from 26.5 to 26.75 reversing more than 1/3 of the plunge recorded after last week the Czech central bank abandoned the floor. EUR/HUF rose to 312.5 partly on the much below-forecast March CPI figure.

Interest rate market – Politics in the spotlight









Yields down amid low liquidity

- Lower investors' activity on pre-Easter basis and President Trump's wish to keep interest rates low in the US pushed yields down worldwide last week. The Polish 10Y bond yield neared 3.38% (-Xbp on weekly basis) while 10Y Bund reached 0.175% (-Xbp) and 10Y UST 2.23% (-Xbp). At the same time, Polish IRS rates remained flat leading to narrowing of the asset swap spread; 5Y spread declined by 2bp to 51bp, and 10Y – by 3bp to 59bp.

Politics key in the coming week

- We think Polish bonds could be under pressure next week as the French presidential elections are looming and this could encourage investors to take profit from recent noticeable drop in yields. The uncertain result of the first round of presidential elections on next Sunday and the risk of a good result of Marine Le Pen can lead to increased volatility.
- Market does not seem to discount the risk of Marine Le Pen victory. The 10Y FR-DE bond yield spread rose c25bp since the beginning of the year while the respective spreads for Italy, Spain or Netherlands increased by c50bp, 31bp and 10bp, respectively. Also the CDS market does not show any higher risk for France leaving the EU – 5Y USD French CDS fell 6bp since the beginning of the year, pretty much the same as for Germany, Italy or Spain. French CAC40 equity index is nearly 4% up since January, more than +2.8% for the Italian stock index and not that much less than 5.5% for the German DAX.
- Current polls show that candidates are running neck in neck. Standings for the first round (as per 13 April) are as follows: Macron: 24%, Le Pen: 22%, Fillon: 20% and Melenchon: 19%. Polls for the second round do not give Marine Le Pen much chance for a final victory. In our view, if her result in the first round is much better than expected, then markets can become nervous and Bunds might gain, which is likely to weigh on the Polish bonds. As a result, the 10Y PL-DE spread could rise. The Polish 10Y asset swap spread has approached its 50bp support and we think this level will not be broken should bonds come under pressure due to French politics.
- There are some important macro data releases on the agenda this week (US real estate market, flash April PMIs in the euro zone). Also, some of the FOMC members and ECB Board members are expected to give a speech at the beginning of the week. The recent comments made by FOMC members were rather hawkish. Janet Yellen suggested this week that the Fed interest rate hikes should be neither too slow, nor too fast. The market perceived her comments as coherent with the recent central bank rhetoric suggesting gradual rate hikes.
- Poland rating review by the S&P should be at least neutral for the market as macro and fiscal measures now look better than during the last re-assessment.

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