Fixed Income & Economics Daily

Wednesday, December 6, 2017

FX & RATES STRATEGY RESEARCH

Juan Miguel Arranz*
+5411-4341-1065
jarranz@santanderrio.com.ar

Marcin Sulewski*
48 22-534-1884
marcin.sulewski@bzwbk.pl

STRATEGY

- **ARGENTINA: Higher inflation, stronger peso and the postponement to April of the beginning of monetary cycle easing**
- **POLAND: Non-residents sold Polish bonds again**

ECONOMICS

- **POLAND: MPC immune to strong data**

ARGENTINA: Higher inflation, stronger peso and the postponement to April of the beginning of monetary cycle easing

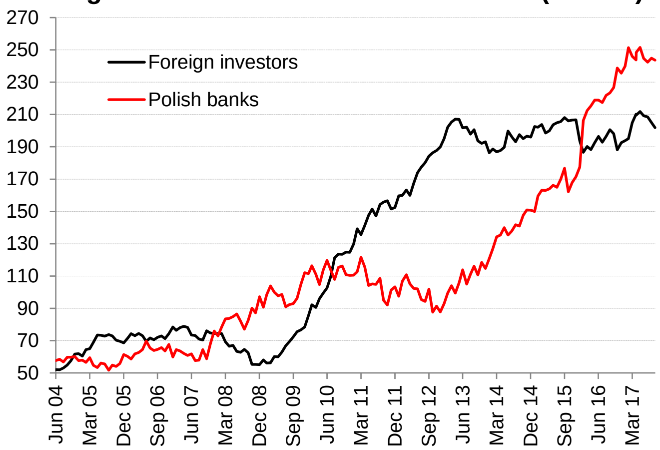
- Such as it is, this is the scenario now envisaged by REM's pollsters of economic forecasts.
- Economists polled in November's Central Bank survey raised inflationary forecasts, again. December 2017 annual expected inflation is now at 23.5% — 420 basis points higher than the 19.3% foreseen one year ago while December 2018 annual expected inflation was adjusted upward to 16.6% from the 14.0% foreseen 12 months ago.
- Economists' increasing annual gap forecasts as recorded in the last 12 months does not seem so impressive when compared with the widespread criticism Governor Sturzenegger is receiving from analysts and pundits through the local press.
- Although it is absolutely true that inflationary expectations are steadily diverging from the 17% and the 12% annual variation set as a goal by the Central Bank for 2017 and 2018, only a distrustful approach might argue that the battle against inflation was an easy task in a country with one of the highest inflation rates on earth, during the last one hundred years.
- Twelve-month inflation forecast to November 2018 was adjusted also upward to 17.5% or 0.2 percentage points above the 17.3% recorded in October.
- The dollar quotation is forecast to end at ARS17.8/USD in December and at ARS20.3/USD at the end of December 2018. Both quotations are lower than the ARS18.3/USD and the ARS20.8/USD projected in November 2016.
- Based on the above, while the inflation rate would be more difficult to abate, the expected appreciation of the local currency would also be higher than forecast 12 months ago. Interestingly, REM's poll, conducted by the Central Bank yesterday, confirmed their views of a deepening carry trade on a 12-month horizon.
- Last but not least, REM pollsters postponed the beginning of the monetary easing cycle to April from February, when the Central Bank Monetary Policy Rate would be compressed by 100 basis points to 27.75%. The MPR would end at 22% by December 2018, above the 21% projected in November.
- Expected growth rates were maintained for 2017 at 2.9%; 3.1% in 2018.
- The primary fiscal deficit for this year is expected to fall to minus ARS410 billion from minus ARS417 billion expected in October, narrower in 2018 at ARS408.8 billion from ARS412.3 billion.
- The peso recovered strength the day after the release of economic expectations; the pair closed at ARS17.2904/USD or 0.3% lower than Monday. Interestingly, the dollar quote has varied in a narrow range of ARS17.25 to ARS17.50 since mid-November.
- Seasonal FX demand is coming from dividend payments, hard currency loan cancellations and corporate dollar hoardings. Supply, in turn, continues to be led by financial rather than commercial flows, from which the recent quasi sovereign bond issuances such as Entre Ríos, Rio Negro and today La Rioja among others have dominated.
- The call money market captured renewed demand and transactions among triple A names are done at a 28.50% annual rate. The shortened Lebac, due on December 20, is showing a 29.90% increasing annual yield. Local investors are selling the shorter Central Bank paper in order to acquire longer Lebacs before the incoming last primary auction of the year on December 19, 2017.

POLAND: Non-residents sold Polish bonds again

- The Ministry of Finance released data showing that October was the fourth month in a row in which foreign investors were selling Polish PLN marketable bonds. The outflow reached almost PLN3.2bn and was only slightly lower than in September (PLN3.45). As a result, non-residents' holdings bonds fell to c. PLN202bn, the lowest level since February. The biggest sellers of Polish bonds among non-residents were commercial banks (-PLN6.8bn) and the biggest buyers were central banks (+PLN7.5bn).

- Polish commercial banks reduced the bond portfolio by PLN1.15bn.

Holdings of Polish PLN marketable bonds (PLNbn)



Source: Ministry of Finance, BZ WBK.

CEE ECONOMICS

POLAND

ECONOMICS

MPC Immune to Strong Data

Piotr Bielski*
+4822-534-1887
piotr.bielski@bzwbk.pl

The Monetary Policy Council kept the main interest rates unchanged, with the reference rate at 1.5%. The MPC also decided to reduce interest on the mandatory reserve to 0.5% (from 1.35%), with effect from 1 January 2018.

The latter decision will increase the NBP profit (at the expense of commercial bank profits) by around PLN350m per year, according to our estimates. It is the second month in a row when the central bank adjusts its reserve requirement policy – in November, they have cut the required reserve ratio on funds with maturity of at least two-years to 0% (from current 3.5%) – effective March 2018. The NBP president explained at the press conference that the decision was of a technical nature and – together with the last month's tweak to the reserve ratio – is aimed at supporting growth of long-term deposits (with maturity >2Y). We think that those moves do not change the overall course of monetary policy.

The official MPC communique was relatively soft. The Council acknowledged that inflation's rise to 2.5% in November was fueled mainly by the prices of food and energy, while core inflation remained low. They also wrote that wage growth in the total economy remained stable in 3Q and unit labor costs even decelerated despite higher wages in the corporate sector. The MPC maintained its assessment that the current level of interest rates supports well-balanced economic growth and macroeconomic stability.

The post-meeting press conference was even softer. Adam Glapinski repeated his claim that interest rates should remain on hold until the end of 2018. In his view, the recent data did not challenge this opinion, but even confirmed it – wage pressure is not rising but even (in his view) decreasing, core inflation remains low, growth of unit labor costs decelerated. Moreover, the central bank estimated that investment growth (excluding the energy sector) rose 6.9% y/y in 3Q17, which they see as a satisfactory result. Glapinski was accompanied by Eryk Lon (extremely dovish) and Rafal Sura (moderately dovish), and both MPC members confirmed his assessment that there is no need for monetary policy adjustment.

In sum, the official statement and the press conference confirmed that the President, Adam Glapinski, still firmly controls the majority in the rate-setting panel, with no desire to change the monetary policy stance in the foreseeable future. However, we suspect that the recent strong data releases could have deepened the divisions in the MPC. The announcement of the decision (13:55CET) was unusually late (latest since March 2015, when the MPC cut rates by 50bps) and we suspected that it could have resulted from more heated discussion about the monetary policy outlook. President Glapinski did not confirm this assessment, but we guess that more hawkish Council members will be more vocal in expressing their concerns in the coming weeks. But, of course, to see a significant change in the balance of votes would require much more hard arguments from economic data. For now, we assume that the first interest rate hike is still likely in the final quarter of 2018.

CONTACTS / IMPORTANT DISCLOSURES

Macro Research			
Maciej Reluga*	Head Macro, Rates & FX Strategy – CEE	maciej.reluga@bzwbk.pl	48-22-534-1888
Sergio Galván*	Economist – Argentina	sgalvan@santanderrio.com.ar	54-11-4341-1728
Maurício Molan*	Economist – Brazil	mmolan@santander.com.br	5511-3012-5724
Juan Pablo Cabrera*	Economist – Chile	jcabrera@santander.cl	562-2320-3778
Diana Ayala	Economist - Colombia	diana.ayala@santander.us	212-350-0979
David Franco*	Economist – Mexico	dafranco@santander.com.mx	5255 5269-1932
Tatiana Pinheiro*	Economist – Peru	tatiana.pinheiro@santander.com.br	5511-3012-5179
Piotr Bielski*	Economist – Poland	piotr.bielski@bzwbk.pl	48-22-534-1888
Marcela Bensión*	Economist – Uruguay	mbension@santander.com.uy	5982-1747-5537
Fixed Income Research			
Diana Ayala	Macro, Rates & FX Strategy – Latin America	diana.ayala@santander.us	212-407-0979
Juan Miguel Arranz*	Chief Rates & FX Strategist – Argentina	jarranz@santanderrio.com.ar	5411-4341-1065
Juan Pablo Cabrera*	Chief Rates & FX Strategist – Chile	jcabrera@santander.cl	562-2320-3778
Aaron Holsberg	Head of Credit Research	aholsberg@santander.us	212-407-0978
Equity Research			
Christian Audi	Head LatAm Equity Research	caudi@santander.us	212-350-3991
Andres Soto	Head, Andean	asoto@santander.us	212-407-0976
Walter Chiarvesio*	Head, Argentina	wchiarvesio@santanderrio.com.ar	5411-4341-1564
Valder Nogueira*	Head, Brazil	jvalder@santander.com.br	5511-3012-5747
Pedro Balcao Reis*	Head, Mexico	pbalcao@santander.com.mx	5255-5269-2264

Electronic Media	
Bloomberg	SIEQ <GO>
Reuters	Pages SISEMA through SISEMZ

This report has been prepared by Santander Investment Securities Inc. ("SIS"; SIS is a subsidiary of Santander Holdings USA, Inc. which is wholly owned by Banco Santander, S.A. "Santander"), on behalf of itself and its affiliates (collectively, Grupo Santander) and is provided for information purposes only. This document must not be considered as an offer to sell or a solicitation of an offer to buy any relevant securities (i.e., securities mentioned herein or of the same issuer and/or options, warrants, or rights with respect to or interests in any such securities). Any decision by the recipient to buy or to sell should be based on publicly available information on the related security and, where appropriate, should take into account the content of the related prospectus filed with and available from the entity governing the related market and the company issuing the security. This report is issued in Spain by Santander Investment Bolsa, Sociedad de Valores, S.A. (“Santander Investment Bolsa”), and in the United Kingdom by Banco Santander, S.A., London Branch. Santander London is authorized by the Bank of Spain. This report is not being issued to private customers. SIS, Santander London and Santander Investment Bolsa are members of Grupo Santander.

ANALYST CERTIFICATION: The following analysts hereby certify that their views about the companies and their securities discussed in this report are accurately expressed, that their recommendations reflect solely and exclusively their personal opinions, and that such opinions were prepared in an independent and autonomous manner, including as regards the institution to which they are linked, and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report, since their compensation and the compensation system applying to Grupo Santander and any of its affiliates is not pegged to the pricing of any of the securities issued by the companies evaluated in the report, or to the income arising from the businesses and financial transactions carried out by Grupo Santander and any of its affiliates: Juan Miguel Arranz*.

*Employed by a non-US affiliate of Santander Investment Securities Inc. and not registered/qualified as a research analyst under FINRA rules, and is not an associated person of the member firm, and, therefore, may not be subject to the FINRA Rule 2242 and Incorporated NYSE Rule 472 restrictions on communications with a subject company, public appearances, and trading securities held by a research analyst account.

The information contained herein has been compiled from sources believed to be reliable, but, although all reasonable care has been taken to ensure that the information contained herein is not untrue or misleading, we make no representation that it is accurate or complete and it should not be relied upon as such. All opinions and estimates included herein constitute our judgment as at the date of this report and are subject to change without notice.

Any U.S. recipient of this report (other than a registered broker-dealer or a bank acting in a broker-dealer capacity) that would like to effect any transaction in any security discussed herein should contact and place orders in the United States with SIS, which, without in any way limiting the foregoing, accepts responsibility (solely for purposes of and within the meaning of Rule 15a-6 under the U.S. Securities Exchange Act of 1934) for this report and its dissemination in the United States.

Santander