

Fixed Income & Economics Daily

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FX & RATES STRATEGY RESEARCH

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STRATEGY

- **ARGENTINA: One-year yield curve of Lebac & Letes bills will be split into two parts**

ECONOMICS

- **POLAND: Foreign Trade Below Expectations in January**
- **POLAND: NBP Inflation Report**

ARGENTINA: One-year yield curve of Lebac & Letes will be split; Lebacs will reign in the short end while Treasury Letes will prevail in the longer part of the curve

- After several government controversies through which
 1. Local insurance companies were banned from investing any fund in Lebacs
 2. In December, Lebacs for non-resident holders were levied a 5% income tax, or the equivalent of 130 basis points
 3. The Central Bank's interest rate recalibration generates confusion among investors
- The Ministry of Finance and the monetary authority seem to have reached a fair agreement.
- The Central Bank will concentrate most Lebac issuances in short-end paper; the four shorter Lebacs are already capturing 85% of the AR\$1.253bn total stock.
- The five longest ones instead would be offered in primary auctions at less attractive lower rates. These are currently capturing only 15% of the remaining stock of Lebacs.
- Meanwhile, the Republic will start issuing local currency Letes – presumably no shorter than 180 days – at rates that will allow the government to build up a decent amount of shorter-term public debt (up to one year) in the months to come.
- At the same time, they will avoid any competition with money already sterilized by the Central Bank.
- The Ministry of Finance's announcement to issue 182-day Peso-denominated Letes at a 2.06% monthly nominal capitalized rate – which implies a 27.7% effective rate – is equivalent to the current 25.8% secondary market return for September 19 Lebacs.
- Such equivalence provides support for the above assumptions of an agreement among the economic team's policy makers.
- Recall that in December, the Ministry of Finance issued local currency Letes twice that month, with tenors set between 91 to 273 days. Those auctions allowed the Republic to collect more than AR\$46 bn pesos.
- Local insurance companies' restriction from acquiring Lebacs was crucial for December 15 and December 22's successful issuances, while cut-off rates, well below that of comparable Lebac paper, set a limit on the Republic's desire to build up short-term government debt.
- Net/net: The Central Bank and the Ministry of Finance have finally solved their competition for short-term funds, channeling existing and futures resources through differentiation of returns rather than compulsory government measures.
- Keeping in mind the negative slope of the yield curve, the Central Bank will maintain its concentration of the Lebac stock in the short end (less than 180 days) of the curve while the Treasury will remain concentrated in the longer part, i.e. the rest of the curve.
- Wednesday's cut-off price for the 182-day peso Lete should be above par in order to offer a return to non-resident investors equal to or below September Lebacs minus the tax yield for non-resident investors (no less than 24.5% annual return).

IMPORTANT DISCLOSURES/CERTIFICATIONS ARE ATTACHED.

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CEE ECONOMICS

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Foreign Trade Below Expectations in January

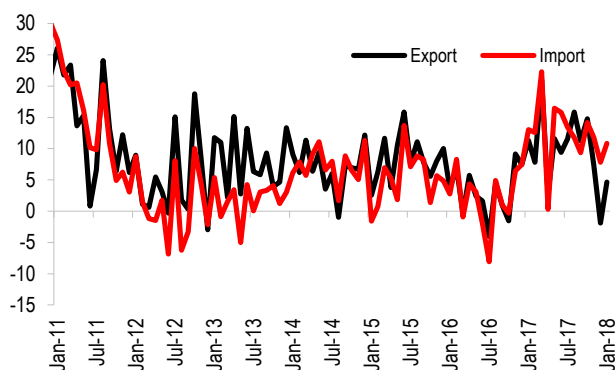
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Central Statistics Office data on foreign trade in January 2018 showed exports at €16.5bn (+4.8% y/y) and imports at €17.0bn (+10.9% y/y). **These numbers suggest that foreign trade was visibly weaker than we had expected.** Given the recent disappointing release of January's German export data, we are reducing our forecast for NBP data on exports, imports and current account (to €1.9bn from €2.4bn). Recall that exports surprised to the downside in December as well. **The positive economic climate in the Euro zone is generally supportive of demand for Polish goods, so we see the weakness in Polish exports as temporary.**

Poland's Exports and Imports, % y/y



Source: Poland Central Statistics Office, BZ WBK.



POLAND

ECONOMICS

NBP Inflation Report

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The March NBP staff projection was created under the assumption of higher global growth than in the November round. The projected path of Polish GDP was raised. In particular, **the forecast for investments was raised** by 1pp, to 8.6%, in 2018 and by 1.3pp, to 6.3%, in 2019, which was justified by high demand, high capacity utilization and very low inventories of finished goods. The revision came in spite of a negative surprise for 2017 results (actual investments came in below the NBP's November forecast). **The forecast for private consumption was increased** by 0.4pp in 2018-2019 due to higher than previously estimated wage growth and strong consumer optimism. **As a result, the output gap for 2018 was revised higher, from 0.7% of potential GDP to 1.2%, and in the following years the gap is forecast to grow to +1.7% and +1.8%.**

As for the labor market, employment is projected to grow in each year of the forecast thanks to rising labor participation rates (at least as long as the expansionary phase of the business cycle continues), and the growth of nominal wages is forecast to rise no higher than the already achieved +7% y/y.

Despite the higher forecast for GDP, output gap, and wage growth, the inflation projection has been lowered vs. the November forecast. According to NBP analysts, this is due in part to the absence of an energy price hike at the beginning of 2018, which was assumed in the previous projection, but was primarily driven by the reduction of the forecast for core inflation. The authors of the analysis attribute this to **a lower sensitivity of domestic prices to economic activity** and by the appreciation of the zloty, which reduces import prices. The NBP directors stressed that this issue is a widely observed phenomenon among developed economies and in the CEE.

The weaker response of inflation to real economic developments has yet to receive a proper diagnosis by economists. This is why **we believe that the MPC, faced with the March projection, will be willing to extend its 'wait-and-see' period** and will assess new economic data with caution.



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