

# WEEKLY ECONOMIC UPDATE

## 6 – 12 March 2017

Last week, the market sentiment was quite good and investors were mostly focused on events in the USA. Donald Trump did not present any detailed actions in his speech, but he seemed to have moderated his stance on immigration, so generally his statement was positive for moods. Much changed on the US monetary policy front, as comments of FOMC members and quite positive data from the labour market boosted expectations of a rate hike already in March. At the end of the week, the money market saw 90% probability that rates will go up in March, versus 50% on Monday. Polish data came as no surprise, GDP growth and breakdown were in line with expectations, showing that public consumption was a major supporter. PMI index fell a bit, but in our view this was only a correction of previous strong growths.

This week we will get to see some important data abroad. As usual, non-farm payrolls are likely to gather much attention. However, Bureau of Labor Statistics is changing its methodology and revising historical data, so the market may take these numbers with a pinch of salt, and eye statistics on earnings instead. In Europe, German industrial orders and output are due for release and they will be important for the European and Polish economic outlook. The ECB will show its GDP and CPI projections during its decision-making meeting. Rates and QE parameters are broadly expected to stay flat, but economic outlook will be crucial for the ECB taper expectations. In the CEE region, Czech inflation may prove important as the Czech National Bank (CNB) is pondering on abandonment of its EURCZK floor at 27.0. In Poland, the MPC decision is the only important event. Polish central bankers will get to see the new inflation projection, which is very likely to show a considerably higher CPI path. The projection may challenge the MPC's claim that the CPI rise above 1.5% is temporary, but as you might remember, when last time the projection was not in line with the MPC view, they just downplayed the results. In our view, Polish assets will be influenced by foreign data and events this week.

### Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
<b>MONDAY (6 March)</b>							
16:00	US	Industrial orders	Jan	% m/m	1.0	-	1.3
<b>TUESDAY (7 March)</b>							
8:00	DE	Industrial orders	Jan	% m/m	-2.7	-	5.2
9:00	HU	GDP	Q4	% y/y	-	-	2.2
11:00	EZ	GDP	Q4	% y/y	1.7	-	1.8
<b>WEDNESDAY (8 March)</b>							
	<b>PL</b>	<b>MPC decision</b>		%	<b>1.50</b>	<b>1.50</b>	<b>1.50</b>
8:00	DE	Industrial output	Jan	% m/m	2.7	-	-3.0
9:00	HU	CPI	Feb	% y/y	2.7	-	2.3
14:15	US	ADP report	Feb	k	185	-	246
<b>THURSDAY (9 March)</b>							
9:00	CZ	CPI	Feb	% y/y	2.4	-	2.2
13:45	EZ	ECB decision		%	0.0	-	0.0
14:30	US	Initial jobless claims	week	k	-	-	
<b>FRIDAY (10 March)</b>							
8:00	DE	Exports	Jan	% m/m	2.0	-	-2.8
14:30	US	Non-farm payrolls	Feb	k	183	-	227
14:30	US	Unemployment rate	Feb	%	4.7	-	4.8

Source: BZ WBK, Reuters, Bloomberg

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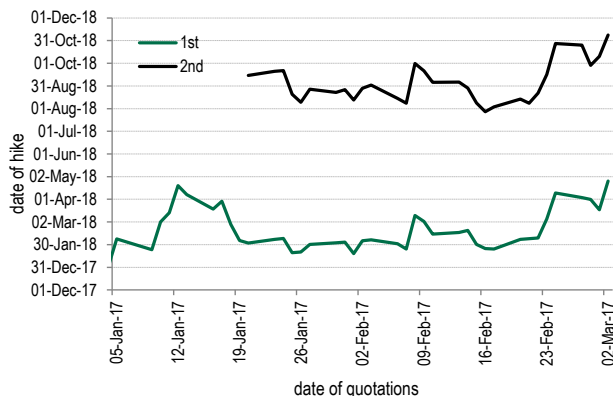
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## What's hot this week – MPC meeting with new projection

FRA-implied timing of rate hikes by the Polish MPC

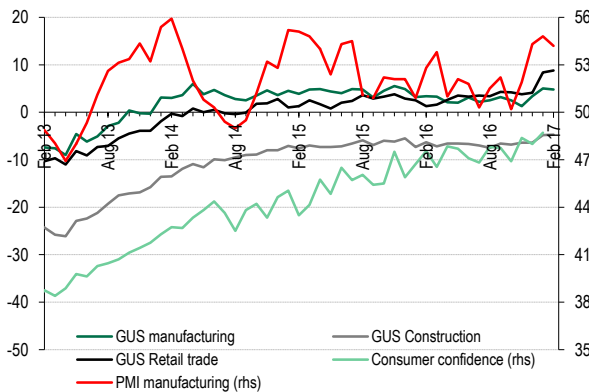


■ The MPC meeting is the only important domestic event of the week. We are expecting rates to stay flat, but this meeting will be important as the MPC members will get to see the latest inflation projection. It is very likely that the CPI path will go up as compared to the previous projection (1.3% y/y on average in 2017, 1.5% in 2018). The NBP projection may challenge the MPC's claim that the CPI rise above 1.5% is temporary, but please recall that last time the projection was not in line with the MPC view, so they just downplayed the results. Recently, some analysts started to expect rate hikes in Poland in 2017, but on the other hand, the FRA market postponed its pricing of the first hike until April/May 2018.

■ In our view the rise in inflation is not sufficient to make the MPC hike rates, as the NBP does not want to threaten the economic revival. We expect the first hike in 4Q2018.

## Last week in economy – GDP with no surprises, PMI a bit lower

Leading indicators (s.a.)

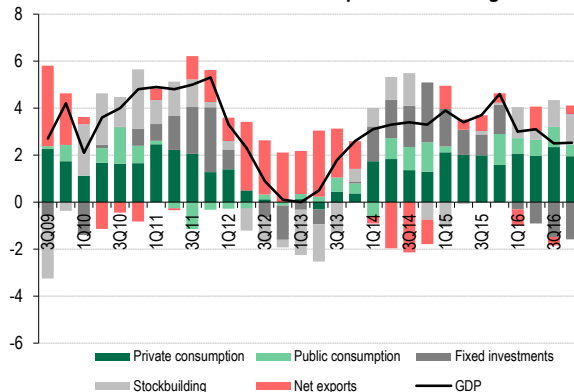


■ In February, the PMI Index for Polish manufacturing fell to 54.2pts from 54.8pts, mostly due to a lower reading of the output sub-index, while employment indicators were still on the rise, and the new orders sub-index was roughly flat. In our view, this move was only a correction of over-optimistic increases in the previous months and the indicator will be still suggesting improving business conditions in the months to come.

■ GDP growth accelerated to 2.7% y/y in 4Q16, in line with the flash reading. We stick to our previous opinion that 4Q16 data do not improve the outlook for 2017. The main source of positive surprise was the shift in time of government spending, which, according to our estimates, boosted GDP growth in 4Q16 even by c0.7pp. Thus, the 'underlying' GDP growth without this one-off effect was close to 2% y/y. Some recovery in investment (-5.8% y/y vs -7.7 in 3Q) is a positive factor. Supply-side data suggest it was driven mostly by construction, and further recovery in construction output in early 2017 suggests that investment was improving. Private consumption is likely to remain the main driver of the economic growth in Poland this year. In general, we assume a gradual acceleration of economic growth throughout 2017. The data do not change monetary policy outlook.

■ According to the LFS data, the seasonally-adjusted unemployment rate in Poland decreased in January to 5.4% from 5.5% in December 2016. Eurostat visibly revised the number of the unemployed for the last few months downwards, bringing it below one million for the first time in the history of the survey. Interestingly, the revised data mean that employment grew, while previous estimates pointed to stagnation. In January, employment growth was at c1.6% y/y.

Contribution of demand components to GDP growth



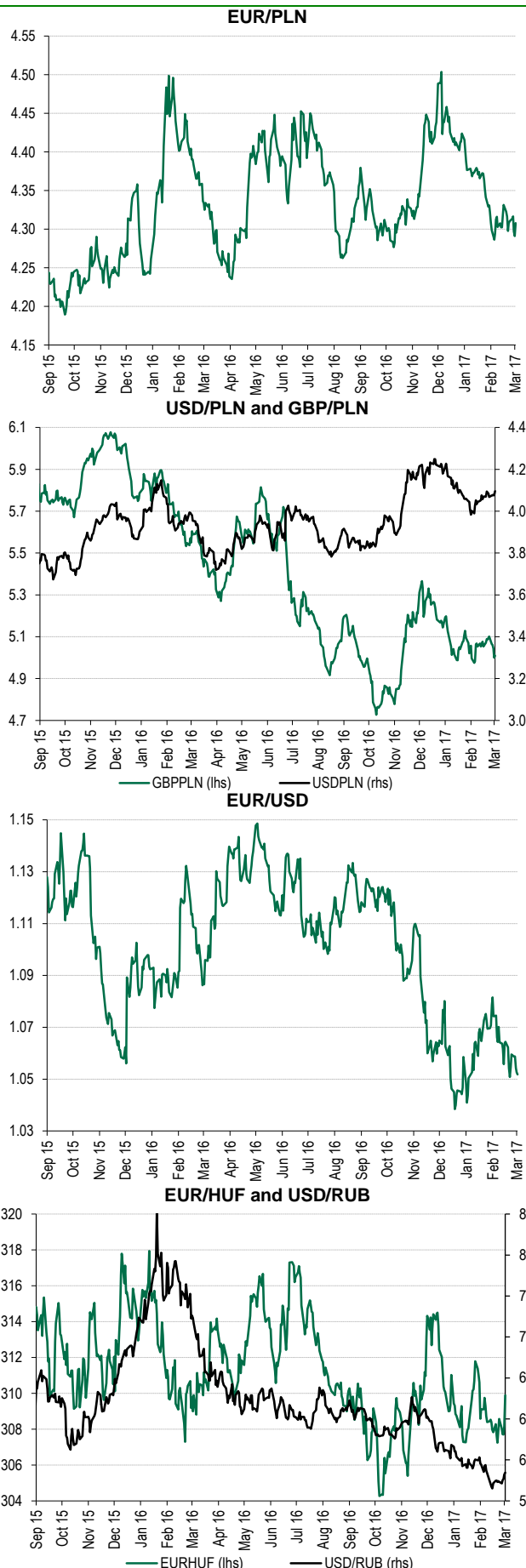
## Quote of the week – Keeping rates flat is optimal

**Eryk Łon, MPC member, 28 February 2017, Reuters, MPC**

Inflation pressure on consumer prices rose. We have to observe it. However, in general I think that the still low growth rate of investment justifies keeping rates unchanged for a longer time, at least 12 months. This is the optimal policy. Moreover, let me note that core inflation is relatively low, postponing the monetary policy tightening.

As we noted above, we are expecting the MPC to downplay higher inflation and focus on other arguments supporting the 'wait-and-see' mode. Comment of Eryk Łon suggests these may be: the still fragile economic growth, especially as regards investment, and relatively low core inflation. Moreover, we expect the MPC to argue that higher headline CPI is mostly due to commodity prices, so changes in rates will not affect the inflation rate anyway.

## Foreign exchange market – The US non-farm payrolls will set market direction



### EURPLN remains in consolidation channel

▪ Last week was mixed on the Polish FX market. Zloty as other CEE currencies followed situation on the global equity markets and the EURUSD changes, while domestic macro releases (4Q16 GDP structure, PMI for manufacturing) were in the shadow, with rather subdued impact on PLN. On a weekly basis, zloty gained mainly against British pound and Swiss franc and lost against the US dollar, while EURPLN was more or less stable.

▪ EURPLN trimmed nearly all gains from the first part of the week (the rate fell temporarily to c4.27 from c4.32 at the start of the week), and the rate returned to above 4.31 at the end of the week. However, EURPLN has continued its consolidation between 4.25-4.35, starting from early February. In the short run we see some room for EURPLN increase towards the upper boundary of fluctuation channel as a result of strong macro data from the US (mainly non-farm payrolls for February), which should confirm that rate hike by Fed is on the table this month. What is more, the upward move might be supported by political news from Europe, in particular taking into account the approaching elections in the Netherlands.

▪ All in all, we think that EURPLN may gradually increase, but the rate will not exceed the upper limit of fluctuation channel. As regards USDPLN, the rate will mirror EURUSD moves. Now USDPLN is close to resistance level of 4.10; the breaking of this level will open the room for further increase towards 4.13. In our view this week the MPC meeting will be rather neutral for the zloty.

### USD gained as rate hike expectations strengthened

▪ The US dollar gained against the euro over last week as the comments from the FOMC members strengthened expectations for rate hike by Fed this month (probability of such decision increased to nearly 90%, up from 44% a week ago). EURUSD tested 1.05, but this level was not broken permanently as the rate reached 1.049 for a while. At the end of the week USD strengthening lost its pace ahead of Fed Chair Janet Yellen testimony late afternoon on Friday.

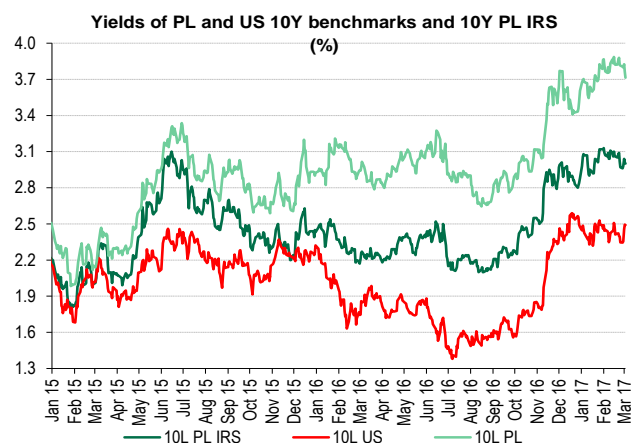
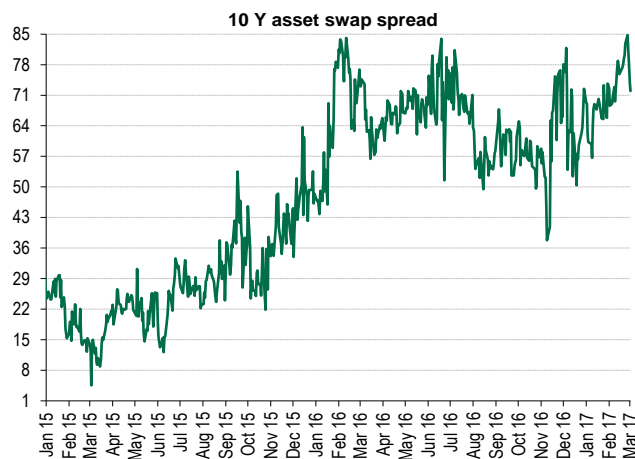
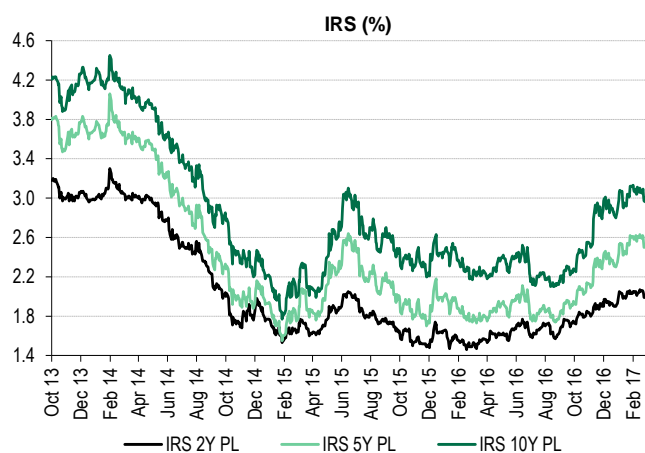
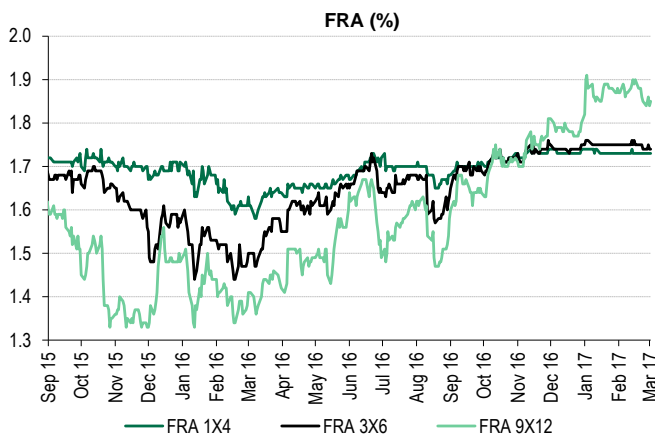
▪ This week investors will focus on ECB meeting and macro data releases in Europe and in the US. In our view, the ECB will confirm current loose monetary policy stance, keeping rates unchanged and its rhetoric. The key event will be the February job report in the US. While non-farm payrolls is broadly expected to be solid, we think that wages data will be in the spotlight and set the market direction in short term.

### CEE currencies under pressure

▪ Last week CEE currencies weakened somewhat, in particular the Russian ruble. This mainly stemmed from some global mood deceleration as expectations for the March rate hike by Fed strengthened significantly. What is more, RUB suffered also from falling oil prices, while HUF from the Hungarian central bank readiness to ease monetary policy further if needed. Consequently, USDRUB increased to nearly 59 for a while, and EURHUF climbed to nearly 310.

▪ This week CEE currencies will be under impact of external factors, in particular the US macro data. However, investors' focus might move towards the Czech koruna as CPI data are due this week. This release will be important for the timing of the CNB's exit from EURCZK floor. Despite significant increase in the headline CPI, core inflation is relatively low and thus we think that the CNB is likely to opt to take some time and to observe the inflation trend in the coming months, keeping the EURCZK floor until mid-2017.

## Interest rate market – Central banks and US data in the spotlight



### IRS up, yields down

▪ Last week, Polish asset swaps narrowed as bonds proved exceptionally strong while the IRS followed the global trend of rising market rates amid rather strong US macro data and some hawkish comments of the FOMC members. As a result, the 2Y IRS rose above 2%, the 5Y rate rose further above 2.50% and the 10Y IRS returned to above 3%.

▪ At the same time, FRA curve did not change much on weekly basis and 1-12M WIBORs stayed flat.

### Non-residents buy Polish debt, successful bond auction

▪ Poland's Ministry of Finance informed that in January foreign investors purchased PLN-denominated bonds worth PLN1.2bn, increasing their portfolio to PLN193.8bn. Like in the previous months, the demand focused on the 5Y and 10Y benchmarks – nonresidents purchased more than PLN2bn of DS0727 (and at the end of January held 42% of this bond outstanding) and PLN1.4bn of PS0422.

▪ Within this group of investors, the mutual funds were the most active (+PLN2.45bn), while the commercial banks and the central banks reduced their holdings (by PLN1.2bn and PLN484mn, respectively). In terms of geographical breakdown, Polish bonds were bought by investors from the euro zone (+PLN1.9bn) and Asia (+PLN1.34bn), while European players, outside the euro zone sold Poland's assets by PLN833mn.

▪ At the same time, Polish commercial banks purchased domestic bonds worth PLN4.4bn, increasing their portfolio to a fresh record high of cPLN240bn. In January Poland's mutual funds sold T-bonds worth cPLN1bn.

▪ The switching auction was successful, the Ministry of Finance purchased the debt maturing in 2017 for PLN 4.77bn and sold bonds for PLN 5.24bn. The demand again focused on the long end – the Ministry gained PLN 2.24bn only from the sale of DS0727.

### Central banks and US data in the spotlight

▪ This week market attention will focus on the central banks and US monthly job report.

▪ Polish MPC is broadly expected to leave the interest rates flat and in our view the Council is likely to play down the probable upside revision of the inflation path in the updated economic forecasts. If this is the case, the market reaction should be muted. Since the last MPC meeting, FRAs moved marginally down – postponing the market-priced first NBP rate hike – and we think this week there will be no reason for a major change in monetary policy outlook.

▪ The belly and long end of the curves are likely to be more under the impact of the outcome of the ECB meeting and the US monthly job report with the latter likely being more important for the market.

▪ Sound US macro data and hawkish comments from the FOMC members have boosted market pricing for the Fed March 25bp rate hike to 90% from just c30% in early February, according to Bloomberg. The hike in March is virtually priced in so it seems that the market reaction will be bigger to the below-consensus figure rather to a positive surprise.

▪ The correlation between Polish and core markets has faded recently but we think that domestic IRS/yields will not ignore the global trends fuelled by such big events.

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