Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

13 – 19 March 2017

The zloty and Polish bonds held their ranges despite the dovish domestic MPC and somewhat hawkish ECB. Two crucial events to take place on Wednesday this week can spur volatility.

The Netherlands will hold parliamentary elections and so far the anti-euro party has a big support in the polls. Support is spread across many parties and it may be difficult to form a government, regardless of who wins. We think that the uncertainty surrounding European politics might be negative for the zloty.

Second, the FOMC will decide on the interest rates. The market has already priced-in the March 25bp hike so there should be no negative reaction on the EM market when it is delivered. However, we think that the balance of factors is rather negative for the zloty and its peers, at least in the short term.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (13 March)					
9:00	**PL**	**Inflation report**					
		TUESDAY (14 March)					
11:00	EZ	Industrial output	Jan	% m/m	1.7	-	-1.6
11:00	DE	ZEW index	Mar	pts	78.1	-	76.4
14:00	**PL**	**M3 money supply**	**Feb**	**% y/y**	**8.5**	**8.3**	**8.5**
14:00	**PL**	**CPI inflation**	**Feb**	**% y/y**	**2.1**	**2.0**	**1.8**
		WEDNESDAY (15 March)					
9:00	CZ	Industrial output	Jan	% y/y	7.8	-	2.7
13:30	US	CPI inflation	Feb	% m/m	0.0	-	0.6
13:30	US	Retail sales	Feb	% m/m	-0.1	-	0.4
14:00	**PL**	**Core inflation**	**Feb**	**% y/y**	**-**	**0.1**	**0.1**
19:00	US	FOMC decision		%	0.75-1.0	-	0.25-0.50
		THURSDAY (16 March)					
11:00	EZ	HICP	Feb	% y/y	2.0	-	1.8
13:30	US	House starts	Feb	k	1255	-	1246
13:30	US	Building permits	Feb	k	1253	-	1285
13:30	US	Initial jobless claims	Feb	k	-	-	243
13:30	US	Philadelphia Fed	Mar	pts	28	-	43.3
14:00	**PL**	**Current account**	**Jan**	**€mn**	**216**	**2079**	**-533**
14:00	**PL**	**Exports**	**Jan**	**€mn**	**15209**	**15195**	**14615**
14:00	**PL**	**Imports**	**Jan**	**€mn**	**14794**	**14841**	**14766**
14:00	**PL**	**Employment in corporate sector**	**Feb**	**% y/y**	**4.5**	**4.5**	**4.5**
14:00	**PL**	**Wages in corporate sector**	**Feb**	**% y/y**	**4.0**	**3.9**	**4.3**
		FRIDAY (17 March)					
14:00	**PL**	**Industrial output**	**Feb**	**% y/y**	**2.7**	**0.8**	**9.0**
14:00	**PL**	**Construction and assembly output**	**Feb**	**% y/y**	**-0.7**	**-3.5**	**2.1**
14:00	**PL**	**Retail sales**	**Feb**	**% y/y**	**7.1**	**7.1**	**9.6**
14:00	**PL**	**PPI**	**Feb**	**% y/y**	**4.6**	**4.6**	**4.1**

Source: BZ WBK. Reuters. Bloomberg

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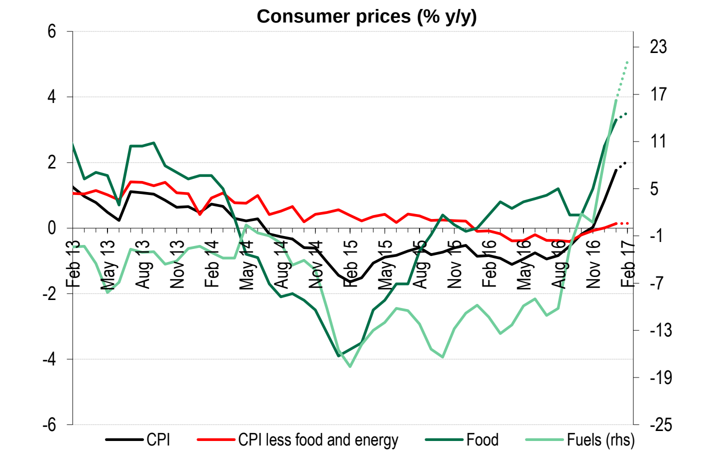
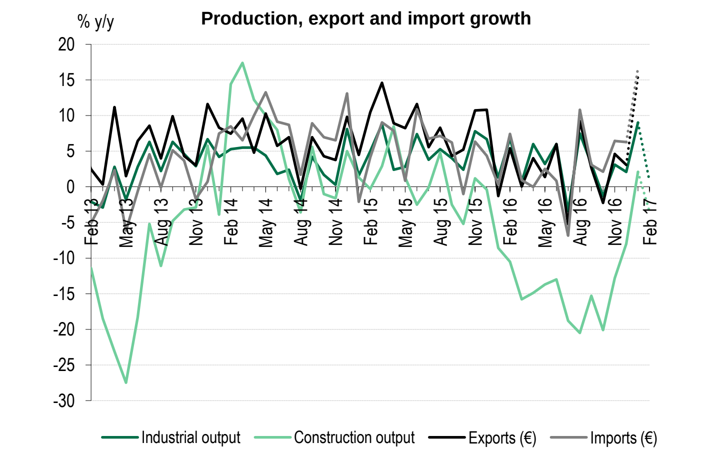
What's hot this week – Important Polish data





- This will be a very interesting week in terms of Polish macro data. Apart from inflation, we will get to see data on the labour market, output, retail sales and balance of payments.
- CPI is likely to reach 2.0% y/y in February, and in the next months it may even exceed this level. The situation on food and fuel markets will determine how far inflation will go. However, the core inflation (NBP is due to release data for January and February) will be probably rising much more slowly this year, as there are still no signs of the underlying price pressure.
- Along with the CPI for February, the Statistics Office will release the revised CPI basket. In our view, this revision will have a very small impact on CPI: negative in the first half of the year, positive in the second. We expect to see the most considerable impact in December 2017, yet it will be equal to mere 0.03pp.
- Balance of payments data for January is likely to show a massive current account surplus, given very strong inflows of EU funds. According to the Ministry of Finance, current transfers from EU to Poland amounted to €2.2bn in January, vs average at €0.5bn monthly in 2016. We are also expecting a visible acceleration in exports and imports, given strong industrial output and positive working day effect.
- In February, the working day effect was negative and this will drag down results in industry, construction and retail trade. These statistics will be crucial in assessing the pace of economic revival in 1Q17.
- M3 money supply data may also prove a bit more interesting, as recently deposits were flowing out to stock market. Thus, we are expecting some deceleration in M3 growth rate.

Last week in economy – CPI projection higher but monetary policy unchanged

	GDP growth			
	Mar 16	Jul 16	Nov 16	Mar 17
2017	2.6÷4.8	2.4÷4.5	2.6÷4.5	3.4÷4.0
2018	2.1÷4.4	2.1÷4.3	2.2÷4.4	2.4÷4.5
2019	-	-	-	2.3÷4.4
	CPI Inflation			
	Mar 16	Jul 16	Nov 16	Mar 17
2017	0.2÷2.3	0.3÷2.2	0.5÷2.0	1.6÷2.5
2018	0.4÷2.8	0.3÷2.6	0.3÷2.6	0.9÷2.9
2019	-	-	-	1.2÷3.5

- As expected, the Monetary Policy Council kept interest rates unchanged. The reference rate remained at 1.5%.
- The tone of the MPC's official communique has not changed much and remained dovish, in line with our expectations, even though the new central bank projection showed an inflation path higher than its previous (November's) version. The mid-point of the CPI projection went up by 0.8pp in 2017 (to slightly above 2%) and by 0.5pp in 2018 (to 1.9%); the mid-point for 2019 is 2.4%. Thus, the new projection has challenged the Council's earlier view that inflation will go back below 1.5% relatively soon. On the other hand, the projection showed that in 2018, CPI is likely to stabilize instead of trending up further, and that reaching the 2.5% inflation target is still quite distant.

Quote of the week – Not worried about negative real interest rates

Adam Glapiński, NBP president, , Reuters, MPC
If current tendencies hold, then rates will remain unchanged until the year-end. There will be no reasons to hike rates – maybe even until the end of 2018 – but this is a distant future. Period of negative real interest rates is likely to be longer than expected previously. However, I see no reasons to be worried.

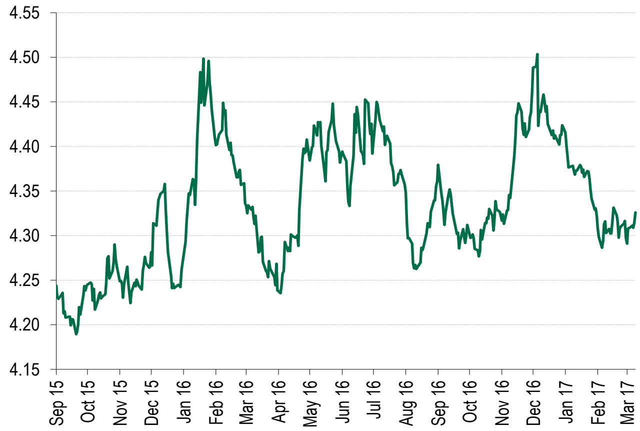
Eugeniusz Gatnar, MPC member
Inflation path went higher, but I am not worried. I would have been with inflation above 2.5%.

Łukasz Hardt, MPC member
Real interest rates will remain negative for longer, maybe even until 2019. I will be eyeing If this development will be deepening.

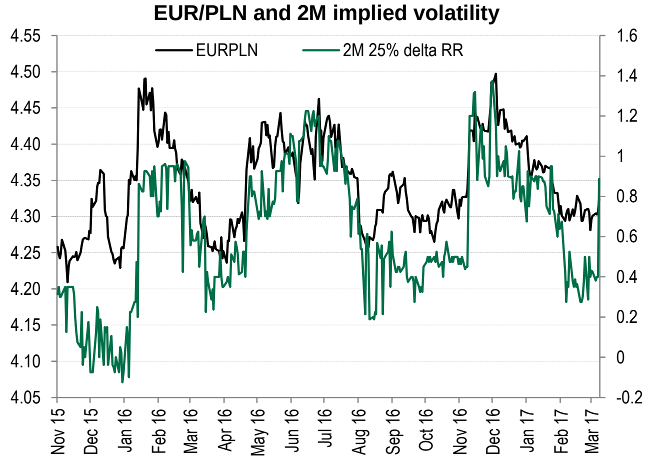
The MPC members present at the press conference (Hardt, Gatnar) said they were not worried that the period of negative real interest rates will be longer than earlier expected. The NBP Governor Adam Glapiński repeated several times his earlier pledge that he saw no reasons to change interest rates until the end of this year. Moreover, he even added that if situation evolves in line with the current NBP's projection, he would see no reason to tighten monetary policy also in 2018. In general, we think that both the official communique and the comments presented during the press conference have clearly confirmed that the Polish central bank is not going to hurry with the monetary policy tightening, unless we see a really dramatic change in the inflation environment. We think that the first interest rate hike should not take place earlier than in late 2018.

Foreign exchange market – Beware of March 15

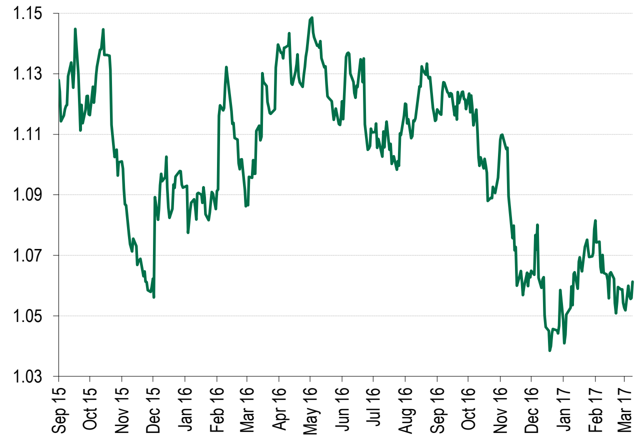
EUR/PLN



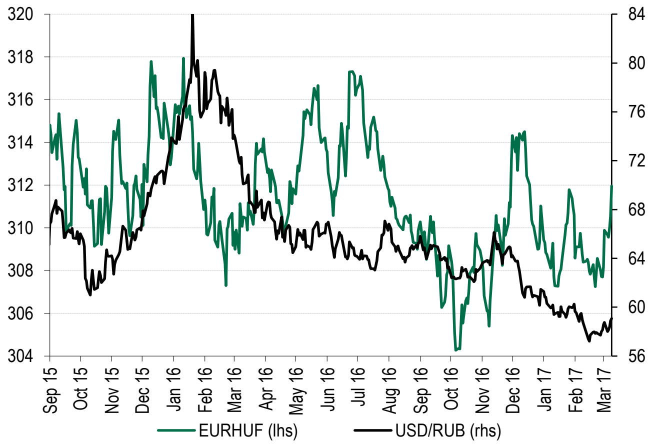
EUR/PLN and 2M implied volatility



EUR/USD



EUR/HUF and USD/RUB



Internal and external factors hit the zloty

- Volatile global market sentiment, dovish message from the Polish MPC and somewhat hawkish tone of the ECB weighed on the zloty. EUR/PLN was on the rise every single day past week and the exchange rate neared the upper band of the 4.25-4.34 range where it has remained since early February.
- In our previous reports we pointed out that the zloty's appreciation had been too excessive. Now, after a month of stabilization, we would like to point out that the 1M and 2M implied volatilities have reached their local bottoms (see the second chart). The past experience shows that the spikes in volatility which occurred from these levels have been accompanied by zloty's depreciation. Note that periods of volatility staying low were rather short and it appears that the abovementioned rise has already started and the EUR/PLN might follow soon.
- Two crucial events will take place this week on Wednesday. The Netherlands will hold parliamentary elections and so far the anti-euro party has a big support in the polls. We think that the uncertainty surrounding European politics might encourage investors to take profit after the recent equities rally which could be negative for the zloty. Second, the FOMC will decide on the interest rates. According to Bloomberg, the market has already priced-in the March 25bp hike so there should be no negative reaction on the EM market when it is delivered. Still, despite the recent pretty fast rise in inflation, Polish MPC does not seem to hurry with the interest rate hikes that could be supportive for the domestic currency and we think that the balance of factors is rather negative for the zloty, at least in the short term.

EUR/USD stable waiting for important events

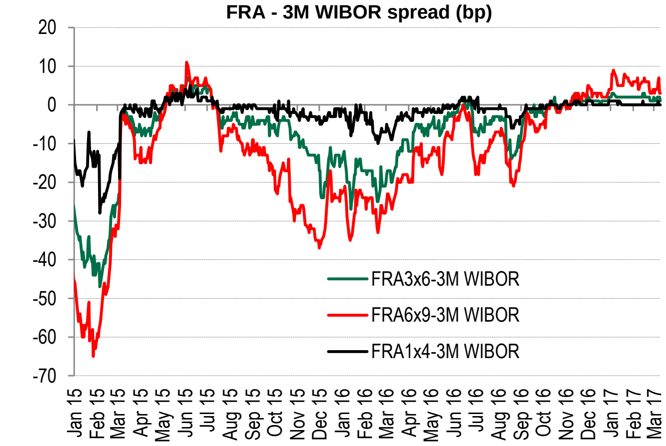
- EUR/USD remained in a horizontal trend ranging 1.05-1.065 despite sound US data, less dovish than expected rhetoric of the ECB and mixed German figures.
- The Dutch elections and the FOMC decision on rates are key events for EUR/USD in the short-term. The market has already priced-in the March 25bp Fed rate hike (and two more later in the year) so delivery should not boost the dollar and EUR/USD could rise amid global profit-taking. However, the scale of any potential increase could be limited by the results of Dutch elections. Currently, polls show that support is spread across many parties and it may be difficult to form a government, regardless of who wins.

Forint and ruble under pressure

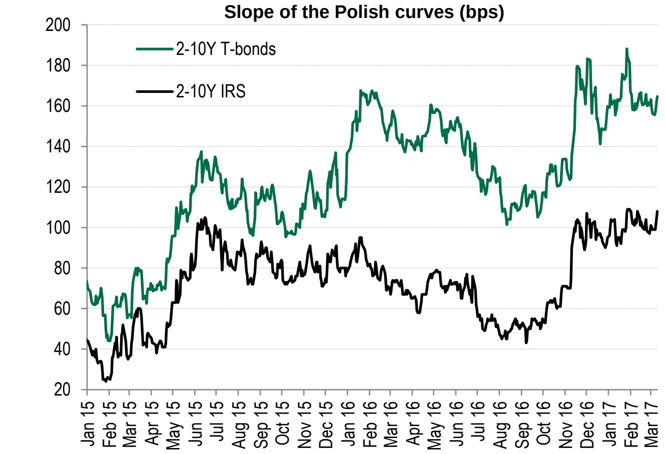
- Both forint and ruble lost last week amid mixed market mood and falling commodity prices – EUR/HUF rose to 312 from 308 while USD/RUB jumped to 59.5 from 58.
- We think both currencies, just like the zloty, are likely to be under pressure in the short term.

Interest rate market – Higher volatility in a busy week

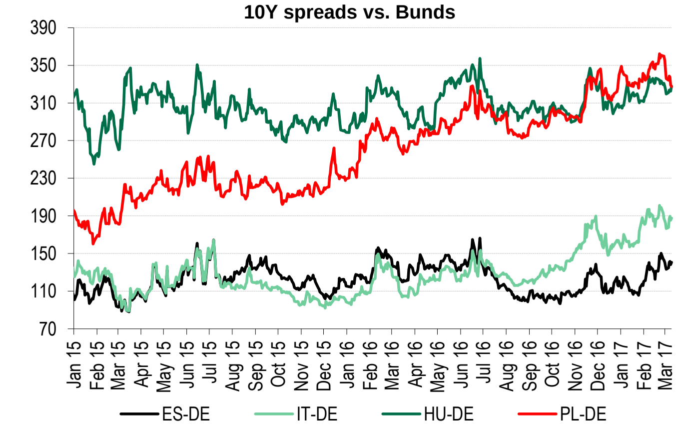
FRA - 3M WIBOR spread (bp)



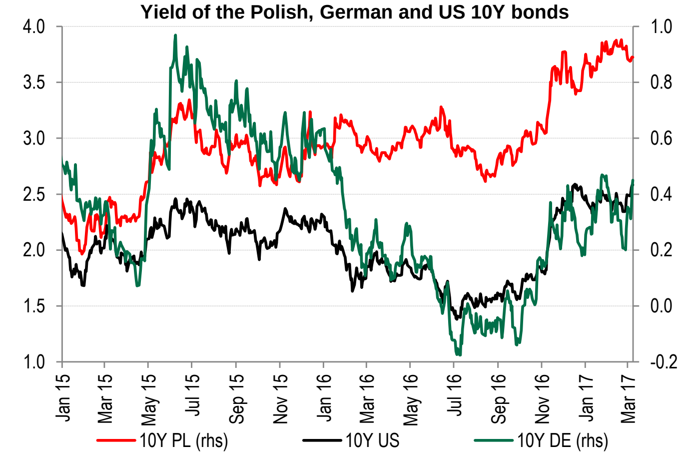
Slope of the Polish curves (bps)



10Y spreads vs. Bunds



Yield of the Polish, German and US 10Y bonds



Moderate increase in Polish yields after ECB's outcome

- Last week Polish assets followed changes on the core market. Interestingly, Polish market gained more than the core market at the start of the week and lost less in the second half of the week. The yield of the 10Y benchmark temporarily fell to 3.68% (its lowest level since late January) and then grew to 3.75%. Despite quite dovish rhetoric of the MPC, domestic bonds trimmed part of earlier gains and the upward move gradually intensified after the ECB press conference, when the yield of 10Y Bund grew above 0.45%, the highest since the end of January.
- Both IRS and yield curves shifted up over the past week. A bear steepener developed on both markets as the long end of the curves suffered the most. The 2-10Y spread widened to c165bp for T-bonds and to c107bp for IRS. What is more, T-bonds market performed better than IRS, and as a consequence, asset swap spread narrowed somewhat on weekly basis. In the meantime, Polish bonds outperformed the core market and as a result spread over Bunds for 10Y tightened markedly to c330bp, the lowest since January.
- On the money market, last week FRA curve shifted down, while WIBORs remained stable. The MPC declaration to keep rates unchanged at least until the end of 2017 allowed investors to scale down their expectations of interest rate path for upcoming months. The date of the first rate hike by 25bp by the MPC moved towards June 2018 from April/May 2018 expected earlier.

Fed meeting in the spotlight

- This week will be abundant in domestic macro data releases and important events abroad (the Dutch election in Europe and rate-setting FOMC meeting in the USA, both on March 15). In our view, economic activity in Poland in February was slightly weaker as compared to the previous month (the majority of our forecasts is slightly below the market consensus), confirming that the MPC should not be in a hurry to normalize monetary policy. Furthermore, the increase in the headline CPI towards 2% y/y will not be a surprise and market response might be subdued taking into account the latest MPC comment that inflation growth resulted from higher global commodity prices, i.e. factors beyond the direct impact of domestic monetary policy. Given all the aforementioned factors, we think that the front end of the curves should anchor close to the current levels.

The belly and the long end of the curves will remain more vulnerable to external factors, including macro data releases abroad, the election in the Netherlands and FOMC decision, which can increase market volatility. In our view, Fed decision on rates will be the key event in this busy week. It is broadly expected that Fed will hike rates by 25bp, so market response to such a decision might be limited. We think that only the lack of monetary tightening by FOMC will bring significant market reaction on the debt market, causing visible yields' decline globally, including the Polish assets. However, this might be only short-lived if political risk in Europe rises after the results of the Dutch election.

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 88, email ekonomia@bzwbk.pl