

WEEKLY ECONOMIC UPDATE

19 – 25 March 2018

MPC Macro data to be released this week may disappoint slightly. Growth in production and retail sales is likely to slow amid lower number of working days and for the market it could be another factor reinforcing view that interest rate hikes will not come soon. The new Statistical Bulletin will help to answer questions about the structure of strong investments in 4Q17 and weaker wage growth in February. We will also see business climate indicators for March in Poland and in the euro zone. Last two months saw European confidence indices retreating from their local highs and they may continue doing so in March due to worries about US trade war escalation.

The event of the week abroad will be the FOMC meeting – the first one headed by the new president J.Powell. A 25bp rate hike is almost a done deal, and the key will be the Fed's communication, including the new economic forecasts and updated path of future interest rates (dot plot). Special attention should be turned on Fed's expectations about interest rates in 2019-20 and that is where we think a hawkish surprise for markets is possible.

On Friday evening Moody's is about to review Poland's rating. We think that both the rating and its outlook will remain unchanged, as strong economic fundamentals are neutralised by worries about the rule of law issue and the next EU budget.

Economic calendar

| TIME CET | COUNTRY | INDICATOR | PERIOD | FORECAST | | LAST | |
|-----------------------------|---------|-------------------------------|--------|----------|-------|-------|-------|
| | | | | MARKET | BZWBK | VALUE | |
| MONDAY (19 March) | | | | | | | |
| 10:00 | PL | Sold Industrial Output | Feb | % y/y | 8.4 | 6.7 | 8.6 |
| 10:00 | PL | Construction Output | Feb | % y/y | 28.7 | 28.1 | 34.7 |
| 10:00 | PL | PPI | Feb | % y/y | 0.1 | 0.16 | 0.2 |
| TUESDAY (20 March) | | | | | | | |
| 10:00 | PL | Retail Sales Real | Feb | % y/y | 7.7 | 7.4 | 7.7 |
| 11:00 | DE | ZEW Survey Current Situation | Mar | pts | 90.9 | - | 92.3 |
| WEDNESDAY (21 March) | | | | | | | |
| 10:00 | PL | Enterprises Financial Results | 2017 | | | | |
| 15:00 | US | Existing Home Sales | Feb | % m/m | 0.93 | - | -3.24 |
| 19:00 | US | FOMC decision | | % | 1.75 | - | 1.5 |
| THURSDAY (22 March) | | | | | | | |
| 9:30 | DE | Germany Manufacturing PMI | Mar | pts | 59.8 | - | 60.6 |
| 9:30 | DE | Markit Germany Services PMI | Mar | pts | 55.2 | - | 55.3 |
| 10:00 | DE | IFO Business Climate | Mar | pts | 114.6 | - | 115.4 |
| 10:00 | EZ | Eurozone Manufacturing PMI | Mar | pts | 58.2 | - | 58.6 |
| 10:00 | EZ | Eurozone Services PMI | Mar | pts | 56.0 | - | 56.2 |
| 13:30 | US | Initial Jobless Claims | week | k | 227.5 | - | 226.0 |
| 14:00 | PL | Money Supply M3 | Feb | % y/y | 5.0 | 5.1 | 4.8 |
| FRIDAY (23 March) | | | | | | | |
| 10:00 | PL | Rating Review Moodys | | | | | |
| 10:00 | PL | Unemployment Rate | Feb | % | 6.8 | 6.8 | 6.9 |
| 13:30 | US | Durable Goods Orders | Feb | % m/m | 1.6 | - | -3.6 |
| 15:00 | US | New Home Sales | Feb | % m/m | 4.55 | - | -7.8 |

Source: BZ WBK, Reuters, Bloomberg

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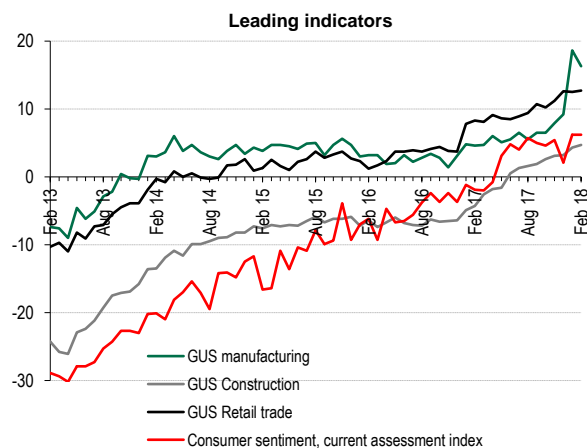
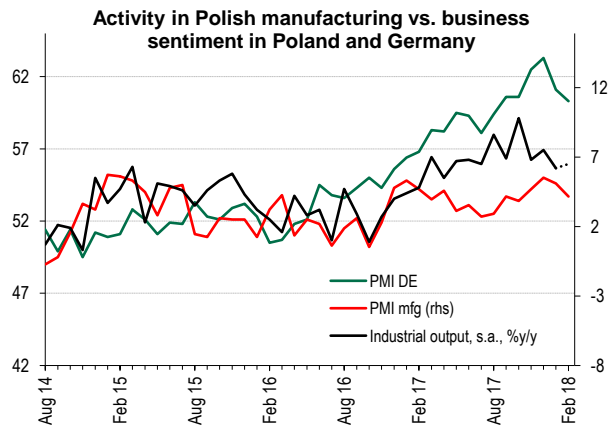
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What's hot next week – Something for everyone

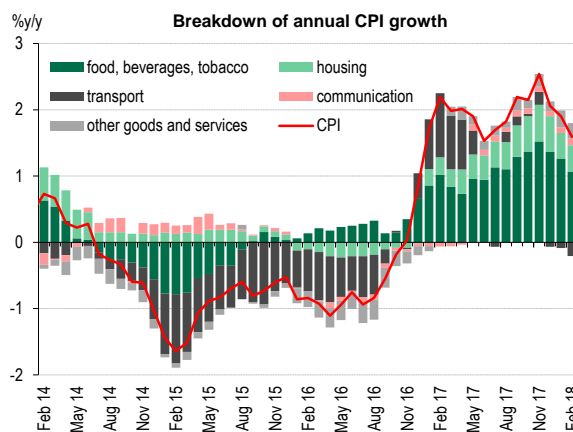
- There is something for everyone this week. There is the main set of economic activity numbers for February (output and retail sales) plus a more detailed look at what has happened recently in the economy thanks to a publication of the Statistical Bulletin. Among other things, the bulletin will contain additional breakdowns explaining the 11.3% y/y surge of investments in 4Q (as will a separate Stats Office publication on enterprise results due Wednesday). On the 'soft data' front, we will get the first consumer and business sentiment reports for March – the latter can give important insight, especially if flash PMIs from the euro zone and Germany in particular will show another, third-in-a-row decline.

- MPC minutes are also out this week, giving us broader background of the discussion the MPC had upon seeing the new NBP staff projection. They forecast lowered CPI path next to a higher GDP path and an output gap revised higher to 1.2% potential GDP in 2018 and rising to 1.8% by 2020.

- Another point in this week's agenda is the European Commission's deadline set for Poland. We are obliged to respond to the last batch of recommendations under the rule of law procedure. To our knowledge, legislative process went in the other direction since the EC formed the recommendations. Thus, even though a meeting of the PM and EC president seemed to have improved the relation, no conciliatory steps were taken by Poland. EU is not going to take any decisions on this date.

- Finally, Poland will also be evaluated by Moody's with a potential date of a sovereign rating revision this Friday. We think this event will not mean any changes for Polish rating or its outlook.

- However, the global background may easily overshadow domestic events with FOMC meeting in the calendar (together with refreshed dot plot and a press conference). The US might also announce a long list of new tariffs on Chinese goods, which could disturb the markets.

Last week in economy – Inflation collapsed, wages disappointed

- Inflation in February was only 1.4% y/y, down from 1.9% y/y. The consensus was 1.7-1.8%, we expected 1.6%. Food was the main culprit of the CPI slide - all items that were pushing inflation higher in 2017 subsided in early 2018. Services inflation went down from 2.8% y/y to 2.3% - despite growing labour costs due to tight labour market. Core inflation dropped to 0.8% y/y in Feb from 1.0% in January, we expected it to stay at 1%. It now seems much less likely that CPI could hit the 2.5% y/y inflation target this year. Instead it might remain below 2% for the better part of the year.

- Employment in the corporate sector rose by 3.7% y/y slightly lower than we expected (3.8%). Wages rose by 6.8% y/y, below our expectations (7.5% y/y) and the previous print (7.3% y/y). It is possible that timing of bonus payment in mining distorted the data again (we assumed a disbursement in Feb).

Quote of the week – It would be good to keep rates unchanged as long as possible**Rafał Sura, MPC member, Reuters, March 15**

There is high chance that an intervention of the Council will not be necessary within the next 12M when it comes to interest rates. Looking farther ahead is too risky. ECB policy is an additional hint for us not to change rates.

Łukasz Hardt, MPC member, PAP, March 13

The probability of MPC reaction this year is lower than a couple of months ago. It depends what will happen to core inflation, labour market and investments.

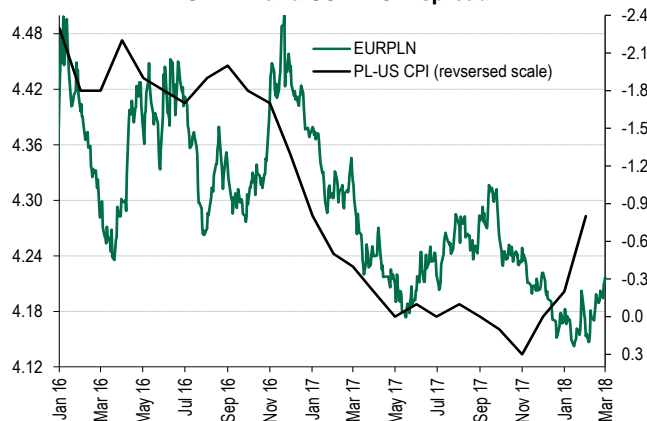
Grażyna Ancyparowicz, MPC member, PAP/Bloomberg, March 14

Given a significant disparity between Polish interest rates and the ECB's and other central banks, it is highly probable that we won't have to make any changes in borrowing costs this and next year. It would be good to keep them at the current level as long as possible.

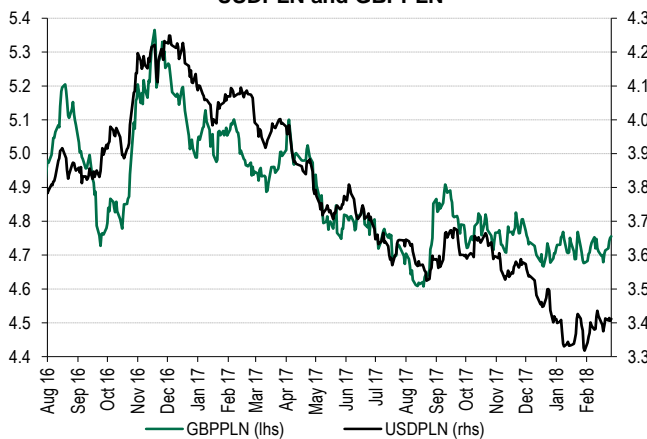
The MPC, faced with the lowered CPI projection, extended its 'wait-and-see' bias and will assess new economic data with caution. The recent quotes by members confirm this. The projection also assumed the nominal wage growth going no higher than the already achieved +7% y/y. It will possibly soothe those in the MPC who worry about risks to CPI from the tight labour market. Also, the much lower-than-expected February inflation supported the current MPC rhetoric that interest rates should stay unchanged not only this year but also in 2019, if economic situation would develop in line with the March projection. We expect the ECB will start lifting rates somewhere in the middle of 2019, which should persuade the MPC to back rate hikes in Poland in 4Q19.

Foreign exchange market – Risk for FOMC hawkish surprise

EURPLN and US-PL CPI spread



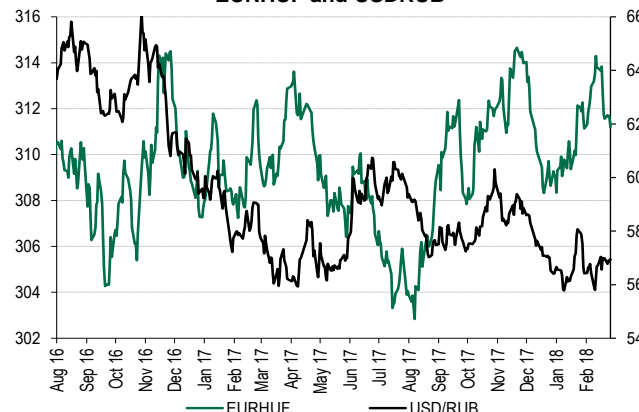
USDPLN and GBPPLN



EURUSD



EURHUF and USDRUB



EURPLN up after Polish CPI

▪ Last week, the zloty remained under pressure mainly owing to the downside surprise in Polish February CPI release. The global market sentiment was shaky amid political news from the US and also contributed to EURPLN's rise to 4.218, this year's fresh high.

▪ The recent weeks have shown that internal issues related to the outlook for the monetary policy are crucial for the zloty. In our view, the global context of inflation trends could also become important. This week the FOMC decides on the interest rates and its new governor, J. Powell, will hold his first conference where he will present the updated economic forecasts. We see risk for a hawkish surprise after the meeting. The market is now pricing three 25bp rate hikes for this year (the scenario that has been maintained as the most likely by the FOMC in their December dot plot). However, the issue could be next year – currently there is no strong consensus among the FOMC members how many rate hikes may be needed in 2019 and even a few changes in opinion could result in the upside shift for the median for the next year. Also, if inflation forecasts are revised up and/or new Fed governor sounds hawkish, there could be a pressure on the EM currencies, including the zloty.

▪ This week on Monday and Tuesday, more Polish data will be released. Our forecasts for February industrial output and retail sales are slightly below market consensus and thus these releases should fit the dovish tone of the last MPC press conference and CPI data. As a result, we think these figures may help EURPLN to stay above 4.20 in the weeks to come.

▪ On Friday 23 March, Moody's may release an update of the Polish rating but we do not expect any change in outlook and credit grade so this event should be market-neutral.

▪ The first support for EURPLN to watch is at 4.19, next at 4.16. Resistance is at 4.225 (December's peak).

EURUSD waiting for trigger

▪ Last week's EURUSD high-low spread was the lowest since early January despite more changes on the US political scene and amid mixed US data. Investors' activity might have been reduced by the looming March FOMC meeting.

▪ We think the outcome of the US central bankers' meeting may trigger at least some short-term volatility in the market. As we have written above, there is a risk of a hawkish surprise as the FOMC members expectations for 2018 and 2019 rate hikes will be scrutinized by investors. We sustain our view that EURUSD may test 1.22 support again in the nearest future.

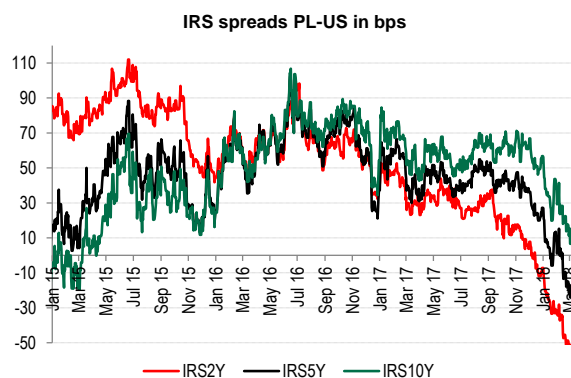
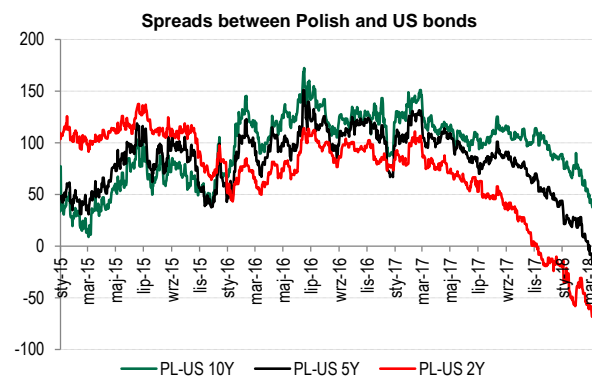
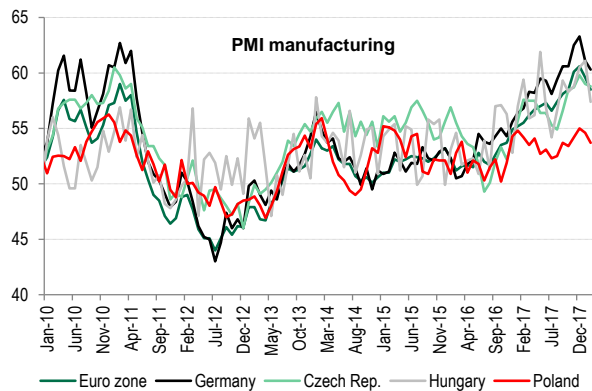
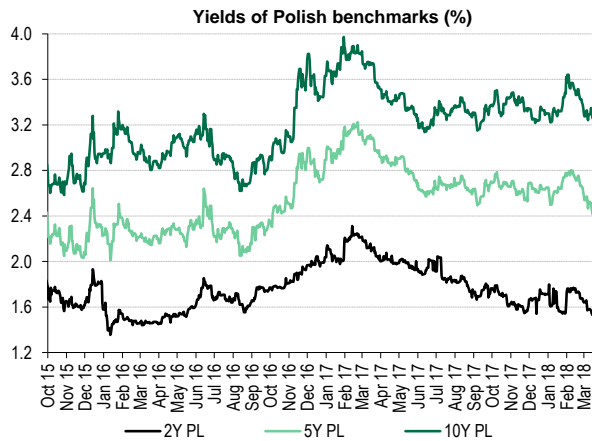
Koruna gains on hike hopes, ruble waits for CBR decision

▪ Elsewhere in the CEE region, the koruna and forint gained slightly vs the euro while the ruble lost vs the dollar.

▪ The Czech currency may have been supported by central bankers' comments that boosted expectations for a 25bp rate hike to be delivered on March 29.

▪ On Friday, the Russian central bank will decide on the interest rates. Consensus expected a 25bp cut of the main rate to 7.25%, as the inflation rate is continuing its down trend and reached 2.2% y/y in February, its all-time low. Russian central bank has recently said it may turn to neutral stance in the monetary policy. However, the easing cycle in the recent months does not seem to have much negative impact on the ruble and so we think the dollar performance and commodity prices will remain the core drivers for USDRUB.

Interest rate market – Between Fed and European data

**Low inflation helped bonds**

Yields were decreasing last week. In mid-week, the yields were pushed down by Polish CPI data release, which surprised on the downside by 0.3 pp. In the second part of the week, we observed temporary profit-taking, and afterwards the bond market was again reporting gains. As a result, the bond yield curve slid by 5-6bp on the short and long end, while the belly decreased by 10bp. The IRS curve slid slightly less. On the switch auction, the Ministry of Finance sold and bought bonds for PLN5.2bn and PLN5.1bn, respectively.

Expected weaker European data

This week, the domestic debt market will be dominated by release of the domestic (industrial production, retail sales) and Europe data (PMI, Ifo, ZEW). Moreover, investors will listen carefully to the FOMC conferences, where the new Fed chairman, Jerome Powell, will have his debut.

In our opinion, the industrial production y/y (we expect data 1.7pp below the market forecasts) and retail sales y/y reading (our forecast is 0.3pp below market consensus) should support domestic bonds. We believe that European leading indicators (ZEW, Ifo, PMI - the release is scheduled for Thursday) will be below the previous ones and see some risk that readings may be below the market forecasts. We think that concerns about the trade war could negatively weigh on the PMI and Ifo reading. As a consequence, we expect downward yield pressures in the 2-5Y segment to continue.

Fed as potential risk factor for long end

In our opinion, Tuesday FOMC conference (we anticipate rate hike to 1.5-1.75%) will be an important factor for the long end of the curve. Expectations on rate hike should push the domestic curve slightly up (the market expects a hawkish tone). We believe that hawkish tone of the conference will negatively and temporarily affect long end of the domestic curve. If the conference has a neutral or moderately dovish tone, we believe that it will have a positive impact on 10Y bonds. However, even if the FOMC conference has hawkish tone, we think that in the w/w terms the yield curve will drop. In our opinion, Moody's sovereign debt revision, scheduled for the end of the week, will be neutral for the Polish bonds. In the longer horizon, we expect the downward yield pressure to continue, especially in the 2-5Y. The debt will be supported by PS0418 bonds buy-back and waiting for the Polish and European PMI's data release.

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