Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

26 March – 1 April 2018

Increase in interest rates by Fed was interpreted as a 'dovish hike,' which resulted in a severe drop of yields. Admittedly, Fed members raised their forecasts for the years 2019-20, but the median of expected hikes for 2018 stayed the same and the new Fed governor J. Powell sounded quite dovish during the press conference, which determined the reaction of investors. Bonds strengthened also due to the growing fears about the outlook for global economy on further actions in the trade war between the USA and China (US announcement of tariffs on Chinese goods, and signals that China is preparing a retaliatory move). At the same time, business sentiment indexes in Europe declining for the third month running confirmed that the peak of the business cycle is behind us and there is no outlook for stronger growth on the horizon.

In the last week ahead of Easter the number of economic publications will be limited. It is worth looking at German inflation, which may influence expectations about future ECB actions. If inflation in Europe continues to surprise on the downside, as do the weakening business sentiment indexes, then the expected time of monetary policy normalization by the ECB may be pushed forward. We are not expecting the MPC minutes to show any ground-breaking news, but only a statement that most MPC members, including the NBP president Adam Glapiński, interpreted the new NBP projection as an argument to keep rates unchanged. In our view, the MPC will be willing to wait with a change of monetary policy as long as inflation and wage growth remain low.

Investors' activity should fade during the pre-Easter week. The zloty remains weak and we do not expect this to change anytime soon. Any correction on the bond market should be mild and temporary. For now, there is no trigger for higher yields: risk for economic outlook is growing, inflation surprises to the downside and even Fed sounded dovish.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (26 March)					
		No important events					
		TUESDAY (27 March)					
11:00	EZ	ESI	Mar	pct.	113.3		114.1
11:30	**PL**	**Bond Auction**			-		
14:00	HU	Central Bank Rate Decision	Mar-18	%	0.9		0.9
16:00	US	Consumer Conference Board	Mar	pts	131.0		130.8
		WEDNESDAY (28 March)					
14:30	US	GDP Annualized	4Q	% Q/Q	2.65		2.5
16:00	US	Pending Home Sales	Feb	% m/m	2.0		-4.7
		THURSDAY (29 March)					
13:00	CZ	Central Bank Rate Decision	Mar-18		0.75		0.75
14:00	DE	HICP	Mar	% m/m	0.5		0.5
14:00	**PL**	**MPC minutes**	**Dec-17**		-		
14:30	US	Initial Jobless Claims	Mar-18	k	229.0		229.0
14:30	US	Personal Spending	Feb	% m/m	0.2		0.2
14:30	US	Personal Income	Feb	% m/m	0.4		0.4
16:00	US	Michigan index	Mar	pts	102.0		102.0
		FRIDAY (30 March)					
		No important events					

Source: BZ WBK, Reuters, Bloomberg

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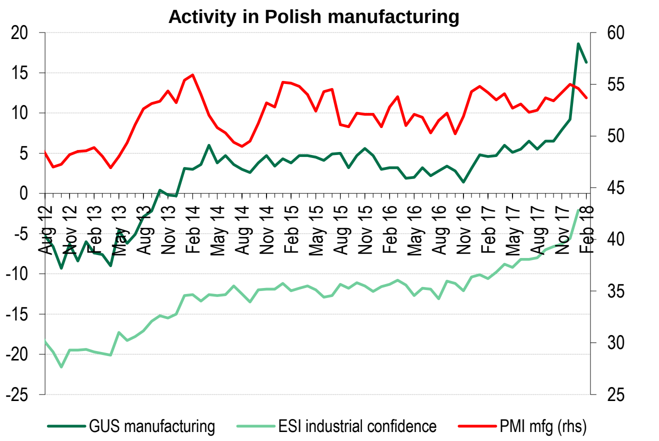
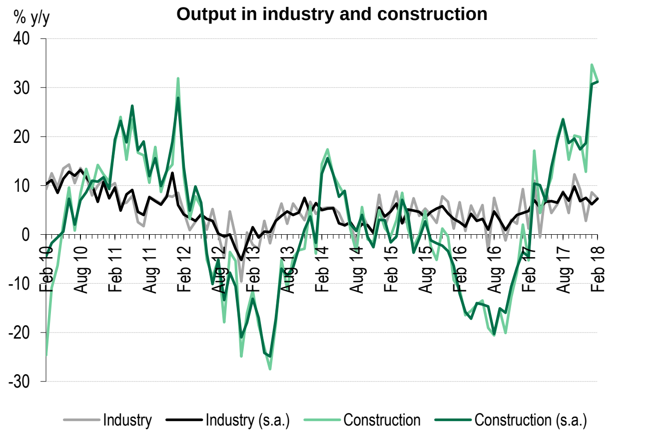
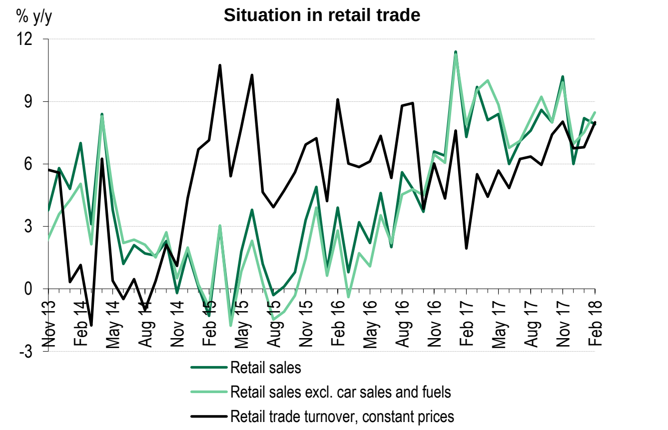
What's hot next week – Rating update, ESI and minutes



- There will not be many macro releases next week with the most important event still taking place this week. Today the Moody's rating agency is likely to release its update on Poland. We are not expecting any changes, yet it should be noted that the agency has recently downgraded Turkey on the back of institutional changes. Thus, we are curious how the agency will interpret the latest legislative changes in Poland.
- On Tuesday, we will get to see the European Commission's ESI indicators. The market does not pay much attention to these, but in our view they are quite a useful tool for economic forecasting. Given recent falls in virtually all major business climate indicators for Poland and major European economics, we are expecting the index to follow suit.
- We are not expecting the MPC minutes from the March meeting to change much as regards monetary policy outlook. Most likely, this will be the doves' song of triumph.

Last week in economy – Output and sales suggest GDP growth at c5%





- February's industrial output grew 7.4% y/y. Detailed data showed that the contribution of energy production was high probably owning to cold weather. Production of machinery and equipment, which is largely export-oriented, was very strong, growing 20.5% y/y. This, however, may suggest not only that external demand is strong, but also that investments are recovering in Poland.
- Construction output rose in February by 31.4% y/y. Civil engineering output rose 65% y/y, despite extremely low temperatures recorded for half of the month. This demonstrates the strength of demand before local government elections (planned for autumn) and stronger utilization of EU funds than last year. However, we still do not expect that the 30% plus pace of construction output growth will continue in the first two months of the year. In January and February, the level of activity is relatively low compared to the rest of the year, which makes it easier for the sector to achieve a high rate of growth. In the upcoming months, we believe construction output will likely be limited by the supply .
- Retail sales in constant prices rose in February by 7.7% y/y, unchanged versus January. February saw a slowdown in durable goods sales, especially cars – to 6.9% y/y from 17.9% y/y in January. The lower car growth rate was offset by higher growth of fuel sales, which accelerated to 8.8% y/y in February from 1.3% y/y in January. Fuel sales were boosted by a heavy freeze in late February. Retail sales data support our forecast of robust private consumption (up c5% y/y in 1Q18). In the upcoming months we expect retail sales growth to continue at high level, supported by high consumer confidence and a favorable labor market environment.

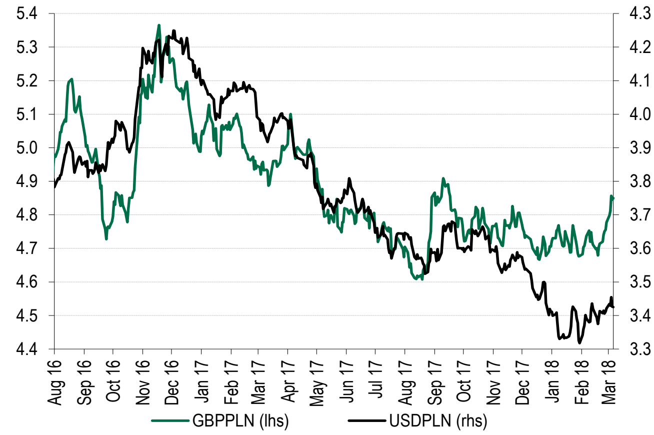
Quote of the week – Sailing calm waters until 2020 seems risky

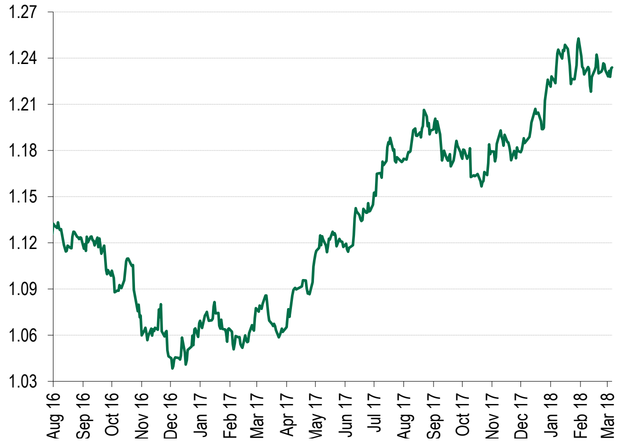
Eugeniusz Gatnar, MPC member, PAP, March 20
I would like to be forward looking. In my view, the second half of the year is a good time to hike rates. Hike would be justified by higher inflation pressure.
Jerzy Kropiwnicki, MPC member, PAP, March 16
It is good that the current MPC has no inclinations to make decision based on models or to succumb to pressure from analysts, who are connected to various business groups. Lower economic growth with no inflation pressure are likely to create a lower rates environment.
Jerzy Żyżyński, MPC member, Reuters, March 22
I agree with Glapiński. I think that we have no reasons to change interest rates because the economy is stable and it is growing. I do not exclude this [that the next move will be a cut]. The central bank can tighten policy only if there is excessive pressure from (the expansion of) credit, which is not the case now.
Jerzy Osiatyński, MPC member, Reuters, March 19
For some time, entrepreneurs can accept profitability falling due to rising unit labour costs. But at some point of time this has to end. The view that we will be sailing calm waters until 2020 seems risky to me.

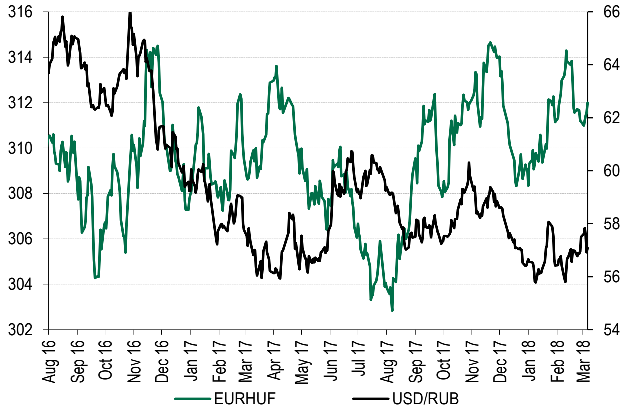
Recent weeks, with more lower CPI NBP projection, lower inflation and weaker wage growth were a triumph of dovish central bankers lead by Adam Glapiński. Jerzy Żyżyński and Jerzy Kropiwnicki want rates to remain unchanged in the upcoming quarters and are satisfied with the stable monetary policy. They even stated that interest rate cut may be the next move in the monetary policy. Jerzy Osiatyński believes that CPI may be a bit higher than in the NBP projection and wants to remain cautious, but does not mention any need to hike rates. Eugeniusz Gatnar is the last man standing in the hawkish camp, expecting wage growth to become double-digit, core inflation to hit 4% in 2019-2020 and claiming that rates should go up this year already. In our view, the upcoming months will not change the monetary policy landscape. Even with wage growth going up, inflation will remain rather low, dismissing any hawkish arguments.

Foreign exchange market – Pre-Easter low volatility period

EURPLN


USDPLN and GBPPLN


EURUSD


EURHUF and USDRUB


EURPLN still high despite dovish FOMC

- EURPLN stayed in the upside trend but the pace of zloty depreciation was slower than in the previous weeks. Although the FOMC raised its median expected rates for 2019 and 2020, the market focused on the short-term perspective (still three hikes printed on the dot plot for 2018) and the market viewed the message as dovish instead of hawkish. On the other hand, the zloty did not benefit much from the outcome of the FOMC meeting as the global market sentiment deteriorated sharply, owing to worries over global trade. EURPLN ended the week near 4.22 after it first climbed to new 2018 high at above 4.24. USDPLN held in the horizontal trend around 3.425. The zloty lost slightly vs the franc (CHFPLN rose to 3.62 from 3.59) and quite substantially versus the pound (GBPPLN jumped to 4.86 from 4.78) after the UK and EU agreed on the key points of the transition period, i.e. the first stage of Brexit.
- The pre-Easter week is pretty light in terms of economic data releases and the market volatility should remain subdued.
- Investors focused on the dovish side of the FOMC meeting. This week, some US data will be released that might turn the market attention towards the hawkish message if they surprise to the upside.
- We maintain our view that we do not see big potential for the zloty to resume its appreciation trend and EURPLN shall stay above 4.20 in the weeks to come.

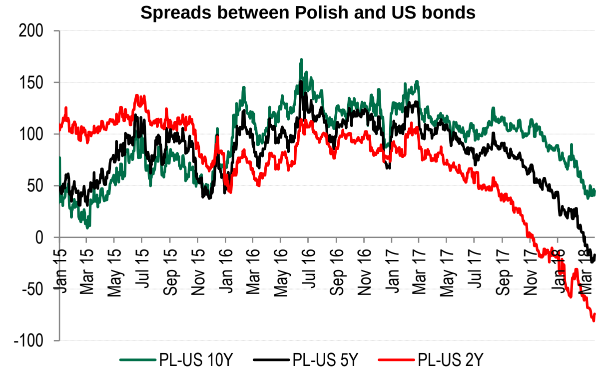
EURUSD still waiting for trigger

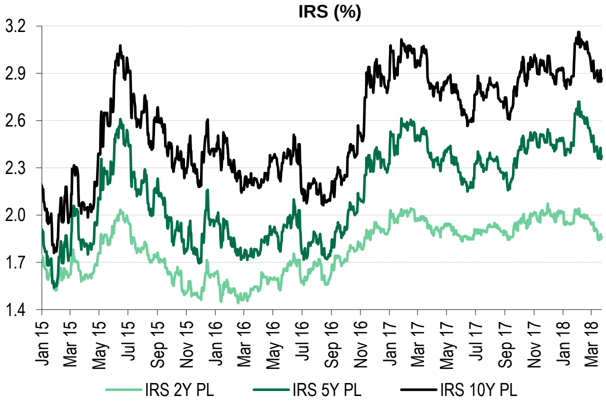
- Outcome of the FOMC meeting, poor European economic data and new political news did not manage to push EURUSD out of the 1.22-1.25 range. Last week's high-low spread was even a touch smaller than previously.
- We do not expect EURUSD to leave the abovementioned range in the coming days. There will be some important US data released this week but the looming Easter holiday should limit investors activity.

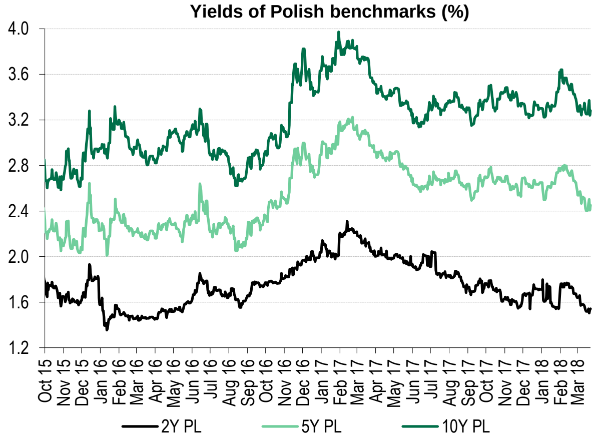
MNB and CNB will decide on rates

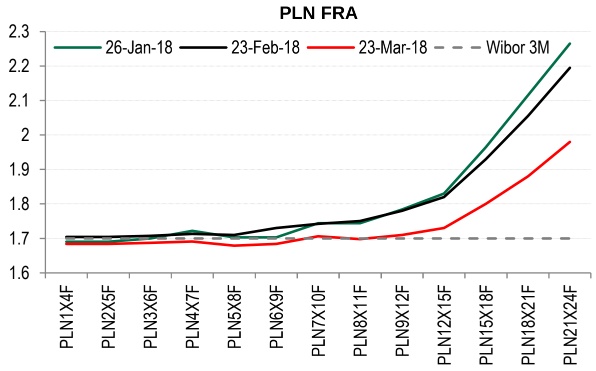
- EURHUF and USDRUB witnessed the biggest changes elsewhere in the CEE region. The forint was under pressure of sour global market sentiment and EURHUF surged to 313 from 310. Dollar weakening after the FOMC decision pushed USDRUB down to 56.8 from 58 seen at the beginning of the week. Additional support for the ruble was provided by rising prices of oil.
- This week, the Hungarian (MNB) and Czech (CNB) central bank will decide on the interest rates.
- We do not expect the MNB to change parameters in monetary policy. The bank will likely repeat it is ready to take additional steps if needed but this should not come as any surprise for the market.
- As regards the CNB, the market is pricing one more 25bp rate hike to be delivered later this year and this is in line with the central bankers' rhetoric. Thus, the only market sensitive information would be that central bankers consider hiking in the first half of the year rather than in 2H18. If this is the case, the koruna might gain vs the euro.

Interest rate market – Dovish Fed pushes yields down









Bonds on roller caster

- The bond market was very volatile over the last week. The domestic bonds were following the core market trends. However, the scale of changes of domestic yields was substantially higher. The domestic bonds were also influenced by domestic data (weaker industrial production, retail sales, and PPI), which temporarily supported the Polish debt in the first part of the week. On the w/w basis, yields rose by 2-4bp across the curve, after reporting the first growth and touching the highest level in the month (before the FOMC conference). In the second part of the week, yields fell rapidly, after the investors were surprised by not sufficiently hawkish tone of the Fed conference (markets expected strong hawkish signal).

Domestic debt to be immune to US data

- This This week we expect the publication of NBP minutes, US personal spending and income data release, as well as consumer confidence data (Conference Board and the University of Michigan). Moreover, on Tuesday (exceptionally due to Easter) regular bonds auction will be held. We believe that events mentioned above will have a rather positive influence Polish bonds. However, the temporary profit-taking is possible in the first part of week (before the auction). In the next weeks' perspectives, we expect weaker next Polish PMI reading, which is likely a support for the Polish sovereign bonds.
- The US personal spending and income data will likely be strong. However, the last European data (flash PMI) show that European manufacturing sector loses the momentum (which is influenced by EUR strengthening and trade wars fears). Therefore, we think that the US data will be roughly ignored by the domestic bonds, which are strongly connected with European bond market. Similarly, we do not expect any strong influence of Consumer Confidence Indices release (University of Michigan and Conference Board).
- We believe that NBP minutes publication will not influence the domestic debt market. In our opinion (and also priced in by FRA contracts), the last domestic inflation data (CPI fall to 1.4% y/y in February from 1.9% y/y in January) confirmed the NBP governor's suggestions expressed at the last MPC conference that interest rates could remain unchanged in the long run.

Auction

- On the regular auction scheduled for Tuesday, Ministry of Finance announced sales of PLN3bn bonds series OK0720, PS0123, WZ0524, WS0428 and WZ0528. In our opinion, the auction will be successful, due to the lower level of debt supply and expected strong demand of foreign investors. We believe that domestic investors will stay interested in floating-coupon and 2-5Y segment bond (short end will be under the influence of buy-back of PS0418 bonds, expected at the end of April).

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 87, email ekonomia@bzwbk.pl