WEEKLY ECONOMIC UPDATE

20 – 26 March 2017

Last week concluded with some improvement in the global market moods. There were two main culprits behind this development: 1) the Fed delivered a hike during its meeting in March, but was actually dovish suggesting that only two more rate increases may follow in 2017, 2) results of election in the Netherlands, as Geert Wilders' eurosceptic PVV party was beaten by Mark Rutte's liberal VVD. These two events decreased the investors' perception of uncertainty in 2017 and fueled demand for risky assets, at least for the time being. In Poland, we got to see some interesting numbers. CPI inflation surprised to the upside in February, suggesting that the market may become increasingly interested in speculating about rate hikes in Poland, maybe even as early as in 2017. Data on output and retail sales were visibly below expectations, suggesting that the optimism about pace of growth acceleration should be moderate.

This week is rather light as regards data releases. In Poland, Statistical Bulletin will be published on Thursday. This publication gives some important hints about the economic development, but is barely noticed by traders, so we are expecting no market reaction whatsoever. Some more interesting data: flash PMIs in Europe and US durable goods orders will be released on Friday and these may cause some market volatility. In general, it seems that the week will be quite calm and the trade can be stable, at least until Friday.

Economic calendar

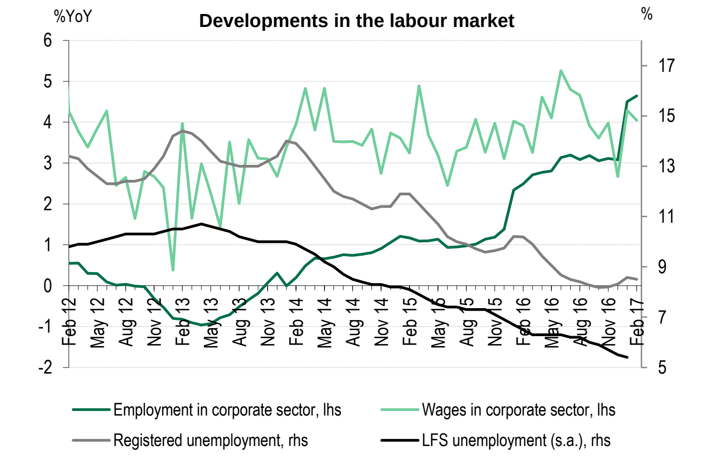
TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (20 March)					
		No important data					
		TUESDAY (21 March)					
		No important data					
		WEDNESDAY (22 March)					
15:00	US	Home sales	Mar	% m/m	-1.9	-	3.3
		THURSDAY (23 March)					
10:00	**PL**	**Unemployment rate**	**Feb**	**%**	**8.6**	**8.5**	**8.6**
12:00	**PL**	**T-bonds auction**					
13:30	US	Initial jobless claims	week	k	-	-	241
14:00	**PL**	**MPC minutes**					
15:00	US	New home sales	Feb	% m/m	0.9	-	3.7
		FRIDAY (24 March)					
9:30	DE	Flash PMI – manufacturing	Mar	pts	56.5	-	56.8
10:00	EZ	Flash PMI – manufacturing	Mar	pts	55.2	-	55.4
13:30	US	Durable goods orders	Feb	% m/m	1.0	-	2.0

Source: BZ WBK. Reuters. Bloomberg

ECONOMIC ANALYSIS DEPARTMENT:
al. Jana Pawła II 17, 00-854 Warszawa fax +48 22 586 83 40
email: ekonomia@bzwbk.pl Web site: http://www.bzwbk.pl
Piotr Bielski +48 22 534 18 87
Agnieszka Decewicz +48 22 534 18 86
Marcin Luziński +48 22 534 18 85
Marcin Sulewski +48 22 534 18 84

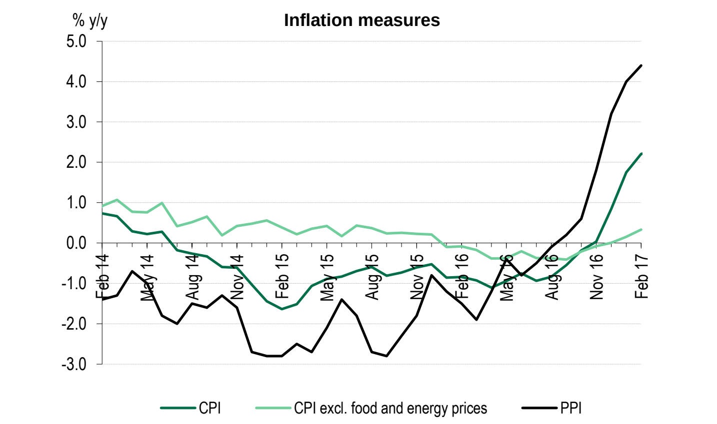
TREASURY SERVICES:
Poznań +48 61 856 5814/30
Warszawa +48 22 586 8320/38
Wrocław +48 71 369 9400

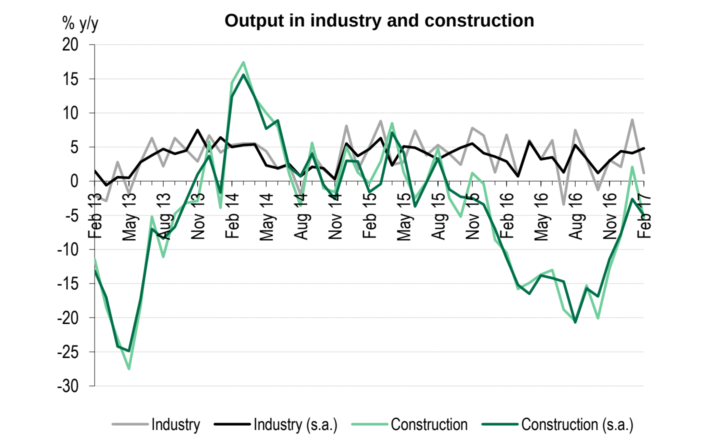
What's hot this week – Unemployment rate, leading indicators and MPC minutes



- We expect the unemployment rate to go down to 8.5% in February, in line with the Labour Ministry estimate, so a surprise is very unlikely, in our view. The data will confirm that the Polish labour market is still sizzling hot.
- Leading indicators will be the other important statistics of the week. Recently both business climate and consumer confidence indicators have been going up, suggesting an improving economic climate. We are expecting this trend to hold and to suggest acceleration of the GDP growth throughout 2017.
- MPC minutes may become a bit more interesting given that the inflation is approaching the target (2.5%) and this may cause a growing divergence between views of central bankers. In our view, interest rates will remain unchanged this year, but some analysts started to expect hikes as early as in 2017.

Last week in economy – Real activity below expectations, CPI surprised to the upside





- CPI inflation increased in February to 2.2% y/y from 1.7% y/y in January. The upward surprise was mainly in food prices which rose 1.0% m/m (the highest growth this month since 2000). This mainly stemmed from significant growth in prices of fresh vegetables. We are expecting a further slight rise in CPI. Even though it cannot be ruled out that inflation will temporarily reach 2.5% level, this is not our base scenario for now.
- Wage growth in corporate sector in February reached 4.0% y/y and employment growth 4.6% y/y. Demand for labour remains strong but the wage pressure is not growing. In our view, such situation cannot last forever and in the second half of the year we expect to see a slowdown in employment growth and a faster wage increase.
- Current account surplus in January reached the record level €2.5bn, which resulted mainly from big transfer of EU funds. Such good outcome is unlikely to repeat in next months. Export and import growth accelerated (to 13.8% and 16% y/y, respectively), partly due to calendar effect, and partly thanks to rising external and internal demand.
- Industrial output growth slowed in February to 1.2% y/y and construction output fell by 5.4% y/y. The results were weaker than in January and below market consensus. However, we should remember that slowdown versus January resulted mainly from the calendar effect. The data are not a reason for concern, in our view, but they suggest that we should not be overly optimistic about the outlook for Polish economic growth this year. Moreover, the retail sales growth (5.2% y/y in constant prices) also disappointed, signalling that the private consumption growth is stabilising at the start of the year, not accelerating further.

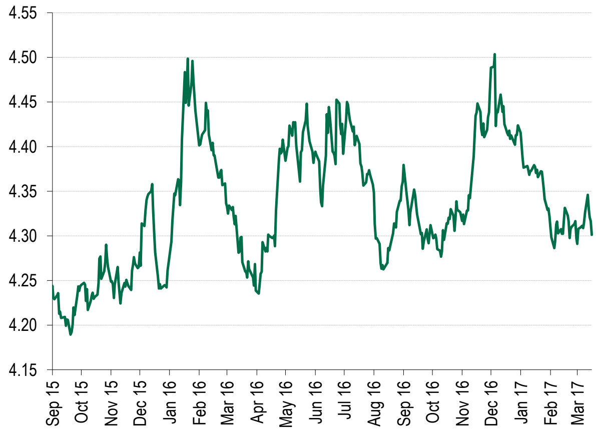
Quote of the week – No need to hike rates in the upcoming 12 months

Eugeniusz Gatnar, MPC member, 13.03.2017, Reuters
Persistently negative interest rates would be an argument to hike rates still in 2017. However, for the time being, interest rates are only slightly negative, so we should wait at least until July and eye the inflation processes.
Grażyna Ancyparowicz, MPC member, 14.03.2017, PAP
Provided there are no extraordinary events, change in monetary policy bias can be considered no earlier than after the July projection.
Jerzy Osiatyński, MPC member, 15.03.2017, PAP
Until the end of 2017, inflation will be running around the 2.5% target. At the year-end CPI will go lower, to 1.6-1.7%.
Eryk Łon, MPC member, 16.03.2017, PAP
In my opinion, CPI is likely to run below the NBP's central projection. The risk of persistently exceeding the target in the upcoming two years is very low. There will be no need to hike rates in the upcoming 12 months.

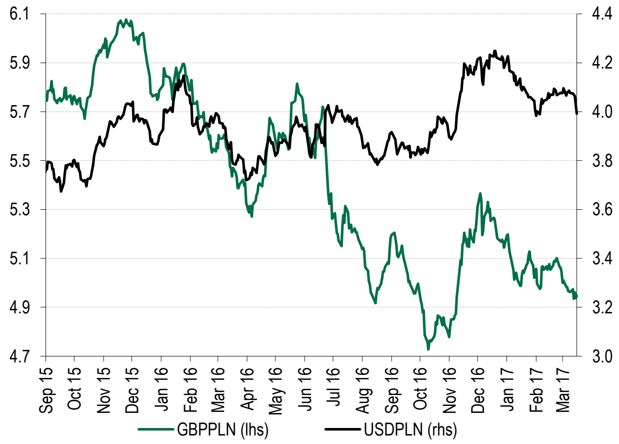
As we thought, the inflation's spike from the negative territory to around 2% made the MPC members comment more on the CPI. According to their rhetoric, real interest rates are negative, but this does not pose any threat or trigger negative effects for the economy. It seems that most MPC members think inflation will be below the NBP projections in 2017, so in our view there is still some room to surprise them and make change their rhetoric once more. Upon this background, the comment made by Eugeniusz Gatnar stands out as the most hawkish. Gatnar would consider hikes as early as in 2017 if the inflation stays high. We are not expecting hikes in 2017, as NBP president Adam Glapiński seems to be quite determined to keep interest rates flat this year. Moreover, the MPC will not wager threatening the still fragile economic growth.

Foreign exchange market – CEE currencies benefited from global mood improvement

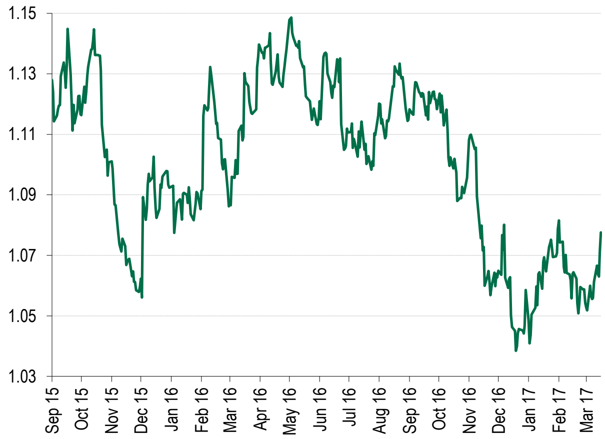
EUR/PLN



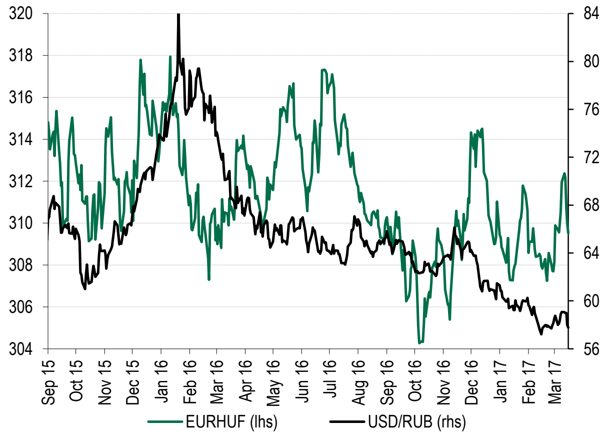
USD/PLN and GBP/PLN



EUR/USD



EUR/HUF and USD/RUB



Zloty stronger thanks to external and domestic factors

- Last week was favourable for the zloty, but also other CEE peers. Zloty gained visibly against the main currencies, with EURPLN falling below 4.29, and USDPLN dropping below 4.00, the lowest since early-February in both cases. This mainly stemmed from dovish Fed hike and the Dutch election results. Consequently, investors reduced their concerns about quick rate hikes in the USA and fuelled some optimism in Europe ahead of further elections scheduled for 2017: in France (April-May) and in Germany (August-September). What is more, the zloty also benefited from favourable January balance of payments data, which showed huge C/A surplus.
- Despite significant changes in EURPLN, the rate has been remaining in consolidation channel between 4.25-4.35 since early February. This week macro calendar is very light and only flash leading indicators from Europe will be released in the second half of the week. From the technical point of view, there are continuing signals for upward correction in the upcoming weeks; however, we do not see any strong reason for EURPLN growing above the upper boundary of the range. As regards USDPLN, the rate is likely to mirror EURUSD moves.

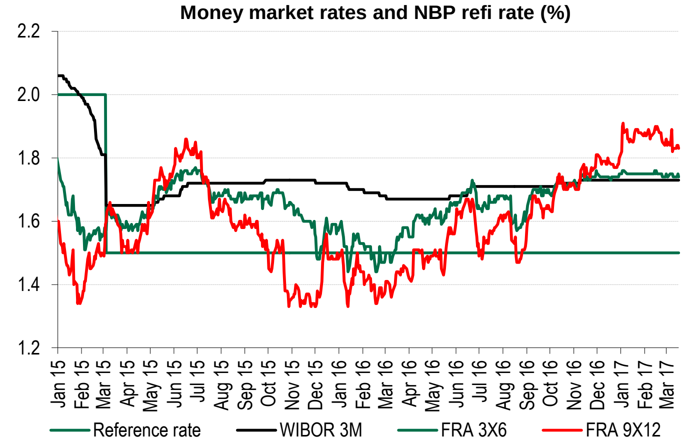
EUR stronger after Fed meeting and Dutch election

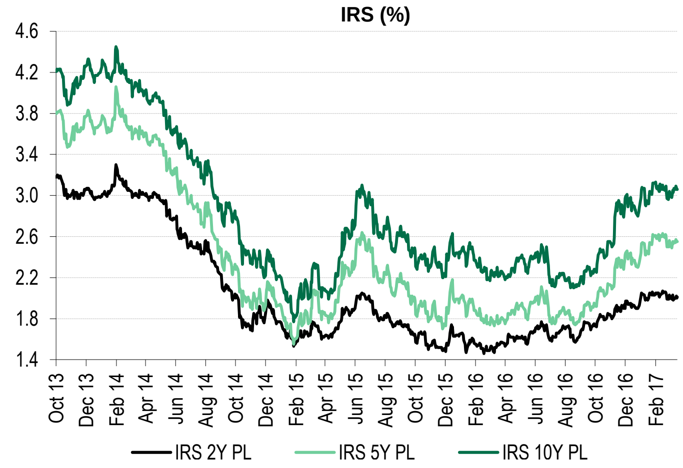
- EURUSD increased significantly in response to the Fed dovish rate hike and the Dutch general election result. Contrary to market expectations, Fed announced a gradual monetary tightening cycle (only 3 hikes this year instead of 4 predicted by the market). In the meantime, the ECB member Ewald Nowotny suggested that rate hikes by the ECB may be on the way. Hence, EURUSD increased for a while towards 1.08, not so far from this year's high at 1.083 reached at the start of February. Last week brought also significant changes in EURGBP. GBP gained markedly in post-BoE trading as one of the members voted for an immediate rate hike. This renews expectations that BoE may start monetary tightening earlier than previously expected.
- Investors' mood is very fragile and strongly dependent on news flow about monetary policy outlook and political situation in Europe, in particular survey poll from France. We think that volatility on EURUSD may be quite high. This week investors will focus on flash PMI for European countries. Further signals of economic revival should keep EURUSD above 1.07 in a short-run. What is more, this week a number of Fed members (including Fed's Chair Janet Yellen) will speak and their rhetoric may influence market sentiment in the short run.

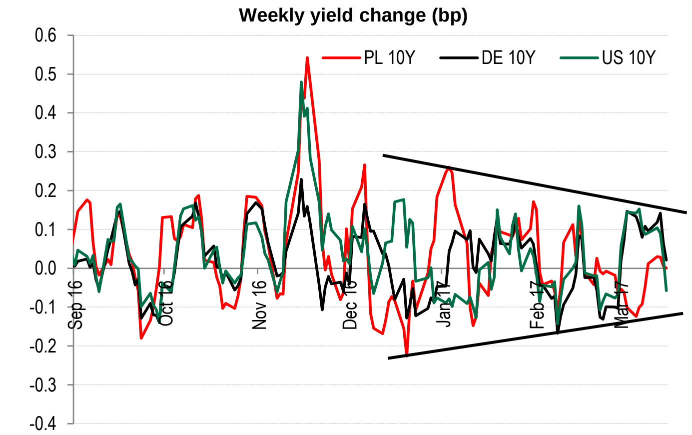
Forint and ruble gain in post-Fed trading

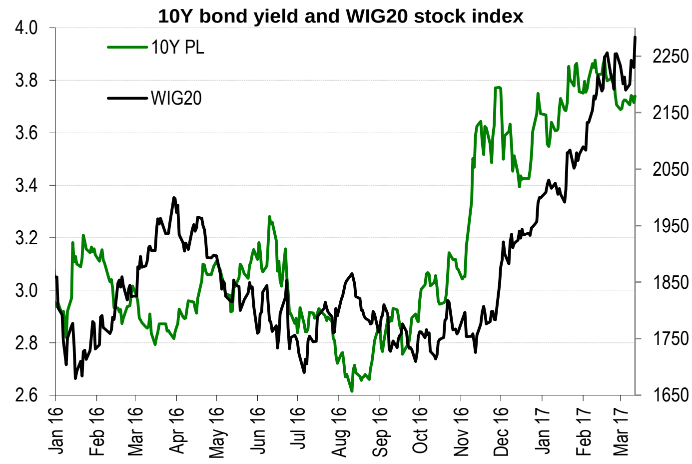
- Both forint and ruble benefited from global sentiment improvement after Fed and the Dutch election results. Consequently, EURHUF fell below 309 at the end of the week, while USDRUB stabilised around 57.8, supported by rebound in oil prices and comments from the Russian central bank.
- In our view, external factors will be crucial for CEE currencies, in particular for the Hungarian forint. As regards USDRUB, the rate will be under influence the outcome of the Russian central bank outcome, which this time will discuss a potential rate cut.

Interest rate market – Still awaiting trigger









IRS/yields still in range

- "Dovish" Fed rate hike and Dutch elections results when the anti-euro party did not win provided only slight and short-lived support for the Polish FI market. Bond yields and IRS remained roughly stable on weekly basis: the 2Y IRS remained close to 2%, 5Y rate did not move much from 2.55% and the 10Y IRS is still near 3.05%. Slopes of the curves, asset swap spreads and spread vs Bund did not change much either.
- FRAs closed fairly flat on weekly basis and some volatility was seen only in the case of longer rates which might have occurred because of the inflation surprise in Poland. 1-12M WIBORs did not change.

Poland taps foreign bond market

- The Ministry of Finance issued 10Y and 20Y euro-denominated bonds for €1.5bn (including €1bn from the 10Y bond sale). Bonds were priced at 1.471% and 2.198%, respectively. In the case of 20Y bond, this was the reopening of issuance and now the total nominal value of this bond outstanding is €2bn. Buyers at the auction were mainly from Germany, Austria and the UK. Under the entity criteria, mutual and pension funds, as well as insurance companies dominated.

Still awaiting trigger

- In our previous reports, we have highlighted subdued volatility persisting on the EUR/PLN market and the last few weeks have clearly showed that this is also the case for the FI market.
- The third chart shows the 1-week bps change for PL, DE and US 10Y bond yields. We can see pretty clearly that the core markets have also witnessed a period of falling intra-week volatility (the same is observed for 1-month bps changes).
- Hopes for more fiscal stimulus in the US after Donald Trump won presidential elections hit the bonds but boosted equities. The fourth chart shows that Polish 10Y bond yields and WSE WIG20 index have been moving pretty closely for the last couple of months. Equities look a bit stretched after the recent rally, in our view, and the next global data on economic activity may need to surprise much to the upside to keep stock prices (and yields) high.
- This week's calendar does not contain many important data, but just after the weekend numerous FOMC members will give a speech. The Fed's "dot chart" did not change significantly vs December so comments made by US central bankers should not shed new light on the outlook for the Fed monetary policy.
- We think that the coming week may again be pretty boring on the global and Polish FI market unless a correction on the equity market starts amid no fresh impulse that could boost stock prices.

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