

WEEKLY ECONOMIC UPDATE

27 March – 2 April 2017

Last week global moods improved visibly as the poor performance of Marine Le Pen in the French presidential debate was the catalyst for an increase in demand for risky assets. Fed members' speeches confirmed that FOMC would continue the monetary tightening, hiking rates three times this year (or even more, according to Williams). These had muted the impact on the market. While investors decided to take profit on the equity markets, the CEE currencies and debt gained markedly, EUR/PLN reached its fresh 2017 low at 4.256 and the yield of 10Y benchmark fell to 3.55%, its lowest since mid-January. Domestic debt market also benefited from the favourable auction results, which increased completion of the 2017 gross borrowing needs towards 53%.

This week will be quite heavy in external events, including macro data from Europe and USA, speeches from Fed members, including the Fed Chair, Janet Yellen, and central bank meetings in Czechia and Hungary. All these factors can add up to market volatility. What is more, the market will also monitor the political situation in the USA as Obamacare is on the agenda in the Congress and it will be the test for Trump's administration ability to implement reforms suggested during the presidential election campaign. As regards Poland, only flash March CPI is due later this week. Our forecast at 2.2% y/y (the same as in February) should be positive for the market, as some analysts warned earlier that inflation may hit the 2.5% target in March. All in all, domestic bonds should remain quite strong, supporting by window-dressing at the quarter end. We also foresee the zloty to keep its gains, but the risk of correction after significant strengthening increases.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (27 March)							
10:00	DE	Ifo index	Mar	pts	110.8	-	111
TUESDAY (28 March)							
14:00	HU	Central bank decision		%	0.90	-	0.90
16:00	US	Consumer confidence index	Mar	pts	113	-	114.8
WEDNESDAY (29 March)							
16:00	US	Pending home sales	Feb	% m/m	2.4	-	-2.8
THURSDAY (30 March)							
13:00	CZ	Central bank decision		%	0.05	-	0.05
14:30	US	Initial jobless claims	week	k	-	-	258
14:30	US	GDP third estimate	4Q	%	2.0	-	1.9
FRIDAY (31 March)							
9:00	CZ	GDP	4Q	% y/y	1.7	-	1.9
11:00	EZ	Flash HICP	Mar	% y/y	1.8	-	2.0
14:00	PL	Flash CPI	Mar	% y/y	-	2.2	2.2
14:30	US	Personal income	Feb	% m/m	0.4	-	0.4
14:30	US	Consumer spending	Feb	% m/m	0.2	-	0.2
16:00	US	Michigan index	Mar	pts	98	-	97.6

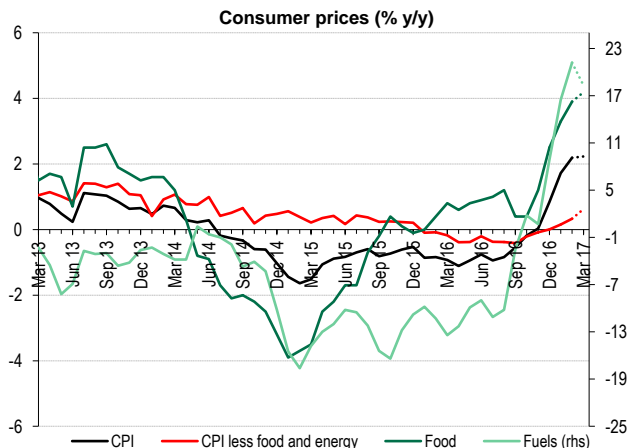
Source: BZ WBK, Reuters, Bloomberg

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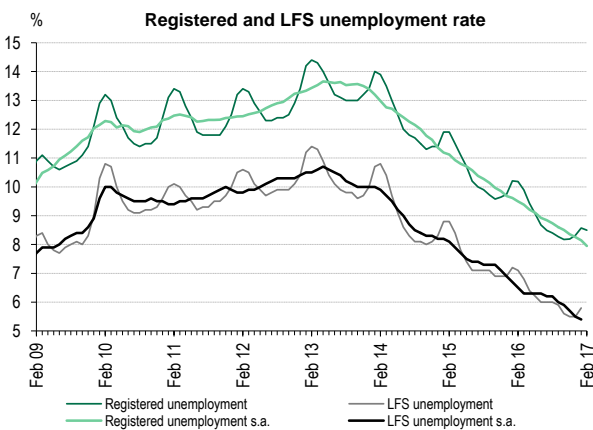
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What's hot this week – CPI to stay flat

▪ We expect March's inflation to remain at 2.2% y/y, unchanged versus February. Despite the flat headline number, there are different tendencies among particular categories. According to our estimates, gas and fuel prices went down in March, but this move was offset by the rising prices of food (especially poultry) and tobacco, as well as by low base effect in recreation and culture (prices of television services went strongly down in March 2016). Also, we expect the core inflation, excluding food and energy prices, to go up noticeably, to 0.6% y/y, from 0.3% y/y in February, in our view.

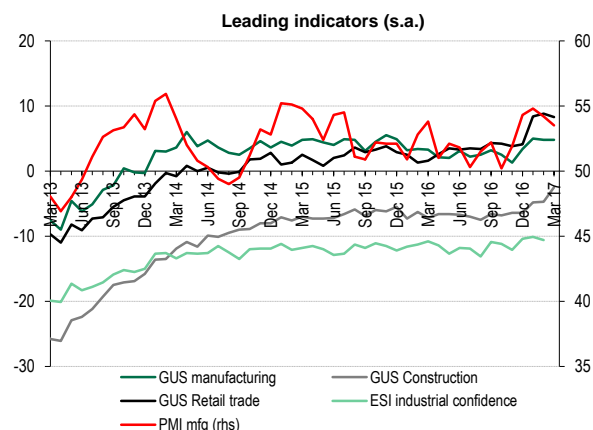
▪ In our view, CPI will remain close to 2.0% y/y in months to come and will temporarily go lower in December due to base effect.

Last week in economy – Signs of recovery in investment

▪ In January and February, output of investment goods increased by a total of 9.0% y/y vs. -0.8% y/y in 4Q and 3.5% y/y for the entire 2016. It is a sign that investments in machinery and transport equipment rebounded in early 2017, which increased chances for a positive increase in total investments as early as in 1Q. However, the level of that climb will be curbed by the high base effect, which is attributable to the fact that in 1Q 2016, investments in machines and transport equipment were supported by military expenditure, which, in our opinion, are not fully factored in the industrial output data.

▪ Registered unemployment dropped to 8.5% in February, as expected by the Ministry of Labour. The number of unemployed persons fell by almost 14k over a month (best February result since 2008). The number of new job offers remained steady at a high level. Over the past 12 months, there have been approximately 7 vacancies per 100 unemployed persons, the most since comparable data became available. Tighter labour market conditions will put pressure on accelerating pay rises in the coming months.

▪ In March, the second straight deterioration in consumer sentiment has been observed. Both current and leading indicators for the consumer confidence index have dropped. Deterioration pertains mainly to the assessment of the current economic situation in Poland, future financial standing of households and possibilities of future savings. Both indices stayed, however, at a relatively high level. Polish Statistics Office has also published the March business climate indicators. The industry index was stable, while the construction indicator improved substantially and the retail indicator weakened slightly.

**Quote of the week – Rate hike in 2017 cannot be ruled out**

Eugeniusz Gatnar, MPC member, 22.03.2017, PAP

Rate hikes in 2017 cannot be ruled out, if the economic growth confirms the optimistic forecasts. Inflation is likely to exceed 2.5% this year and stay above this level until end of 2019. It is difficult to tolerate negative real interest rates in Poland.

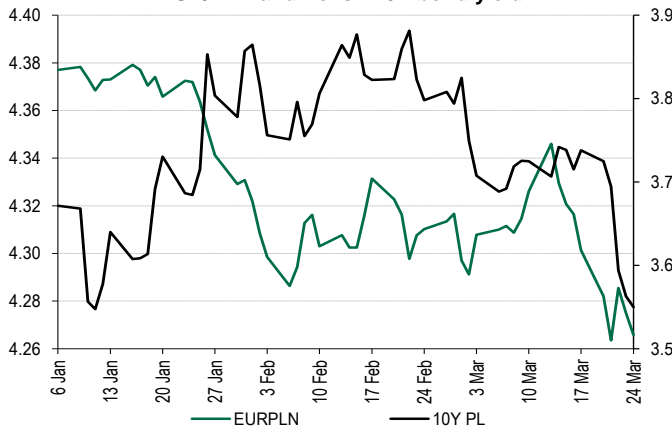
Jerzy Kropiwnicki, MPC member, 20.03 and 23.03.2017, PAP, ISBNews

I am not expecting the inflation target to be surpassed in the upcoming 12 months, so rates will remain unchanged, in my view. Negative real interest rates are not affecting the economic negatively for the time being, but negative effects can show up at the year-end (...) I see no possibility to change monetary policy in 2017. In my view, monetary policy is rather unable to support the economy.

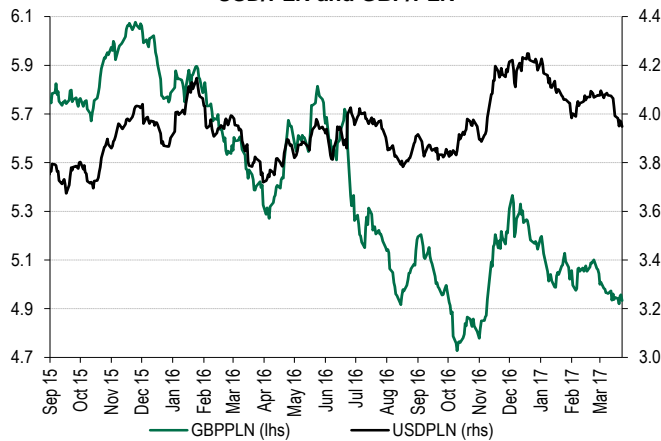
Minutes from the last MPC meeting confirmed that the most likely scenario for the monetary policy in Poland is keeping the NBP rates stable in the next quarters. The document included a bit longer discussion about the interest rate outlook than in the previous months. One should notice that while in February all of the Council members were supporting no changes in interest rates, in March it was "majority" of them. This may signal growing worries among the MPC members; and Eugeniusz Gatnar seems to be a good example of that. Only two weeks ago we was quite sure that CPI will return to 1.5% soon. Now he sees inflation above 2.5% until end of 2019 (sic!) and does not rule out hiking rates as early as 2017. On the other hand, Jerzy Kropiwnicki said he does not see any reason for a rate hike this year. In his view, rate hikes could stifle the economic growth that in his opinion could reach 3.7-3.9% this year.

Foreign exchange market – Attention turns to the US

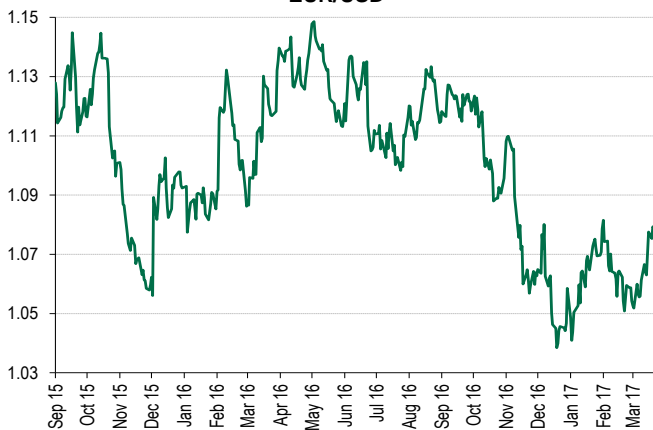
EUR/PLN and Polish 10Y bond yield



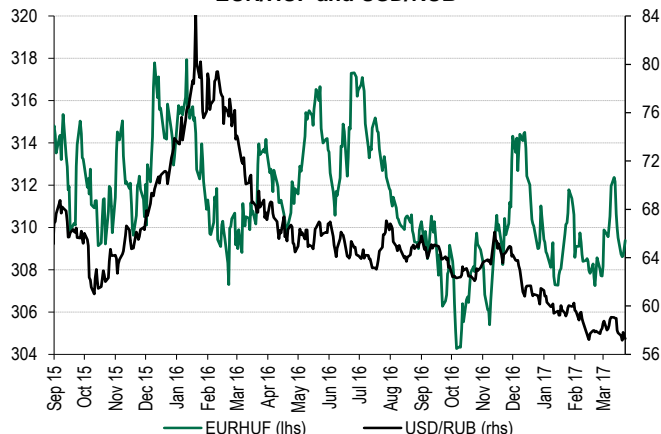
USD/PLN and GBP/PLN



EUR/USD



EUR/HUF and USD/RUB



Bonds and stocks key for zloty

▪ Last week, the zloty gained slightly vs main currencies with EUR/PLN reaching its fresh 2017 low at 4.256. Still, the pace of appreciation was clearly slower than in the previous week. The Polish currency benefited from the quite positive sentiment persisting on the global market amid lower worries about the European politics.

▪ Since February, EUR/PLN is following trends observed on the Polish bond market. We think domestic debt may remain strong at least until the end of the week/month/quarter, which could stabilize the zloty near the current levels. However, we also see a high correlation between EUR/PLN and the WSE WIG20 stock index. Should market doubts over the ability of the new US president to deliver his campaign promises strengthen, equities could resume the downside correction, which in turn is likely to weigh on the risky assets, including the zloty.

▪ All in all, in our view, in the short term there is still high risk for profit taking after the recent zloty's appreciation.

French politics support euro

▪ The euro gained vs the dollar for the fourth consecutive week and EUR/USD rose slightly above 1.08 nearing its local peak from early February. The main driver of the upside trend was the debate ahead of the French presidential elections where Marine Le Pen had not done well in the observers' view. As a result, lower market's concern about anti-euro fraction winning the elections boosted the single currency at the beginning of the week. Later on, the upside trend slowed down and only the surprisingly strong flash PMIs helped EUR/USD to end the week near the weekly peak.

▪ This week market attention is likely to shift to the US where many of crucial data are on the agenda and numerous FOMC members will give a speech.

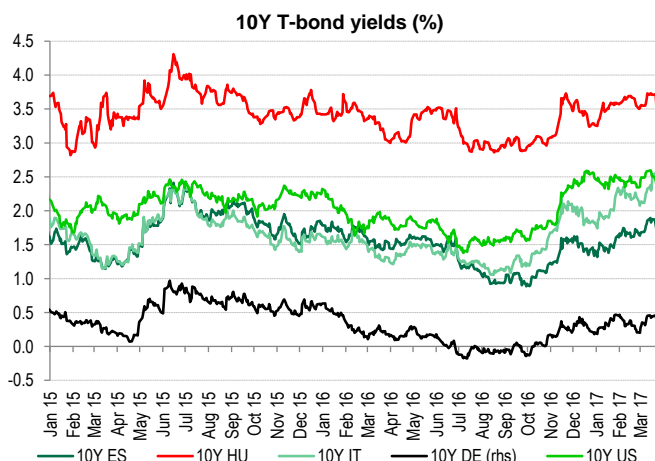
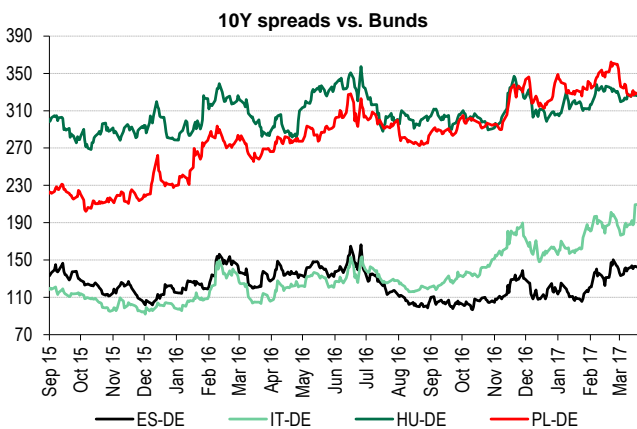
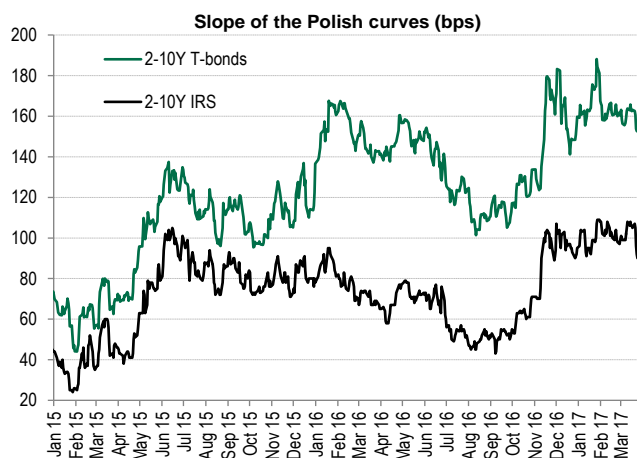
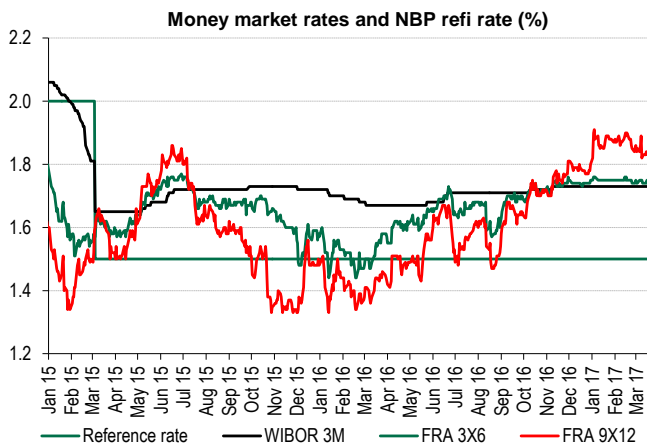
▪ EUR/USD has neared the first important resistance at 1.083 (the February's peak) and in our view a strong impulse may be needed to push the exchange rate higher.

Forint under pressure, ruble stable

▪ The forint has clearly underperformed its CEE peers as it lost vs the euro (EHURHUF rose to 309.5 from 308). There were no macro data released in Hungary last week but the member of the central bank's board (MNB), Bianka Parragh, said that she does not see any inflation pressure that could limit the scope for action in the monetary policy. The MNB continues to claim that more easing could be implemented if needed while inflation in Hungary reached 2.9% y/y in February, its highest since January 2013 (vs roughly zero in August 2016). Leaving open door for more easing amid a clear jump in inflation might have weighed on the forint last week. MNB meets this week and its rhetoric could have a material impact on the forint.

▪ The ruble ended the week near last Friday's closing after only a temporary depreciation vs the dollar. Unexpectedly, the Russian central bank cut its main interest rate to 9.75% from 10% and said that more gradual cuts are likely in 2Q and 3Q. The bank acknowledged that risk of inflation missing the target has abated while the economic growth is stronger than expected. The decision was fairly neutral for the ruble.

Interest rate market – Horizontal trend is likely



Yields/IRS rates dropped visibly

▪ Last week was favourable for the interest rate market globally, in particular for peripheral and CEE countries. Both yields and IRS rates fell significantly across the board, with the highest decline on long end of the curves. There were several factors supporting the downward trend in yields/IRS rates, and they included among others, equity indices decline and some concerns over Trump's planned fiscal reform. In addition, favourable auction results (details below) also helped the Polish debt market to strengthen. As a result, the yield of 10Y benchmark reached 3.55%, its lowest since mid-January.

▪ Spread over Bund and the US Treasuries for 10Y sector narrowed significantly and reached 315bp (lowest since late December) and 115bp, respectively. In the meantime, bull flattener developed on both T-bond and IRS markets as the long end of the curved outperformed other sectors. Consequently, the 2-10Y spread narrowed towards 150bp for T-bonds and to 90bp for IRS.

▪ On the money market, FRA rates for longer tenors dropped visibly. Consequently, investors slightly scaled back their expectations on the interest rate path. Now investors see a c60% chance (down from nearly 75% at the end of previous week) for a rate hike by 25bp in a 12-month horizon.

Poland issuance above 50% completion mark

▪ The last March auction was successful as Poland's Ministry of Finance launched T-bonds (OK0419, PS0422, DS0727 WZ1122 and WZ0126) worth cPLN5.0bn in total (at the upper end of the planned offer) amid the demand at cPLN8.1bn. Similarly, as at the previous auctions, the bonds from the long end of the curve enjoyed the biggest demand of investors. The sale of PS0422 and DS0727 accounted for 71% of total sale.

▪ The Ministry of Finance informed that after the auction, this year's borrowing needs are covered in 52.6%.

Risks are balanced, supporting sideways move

▪ This week domestic macro calendar is light as only flash March inflation rate will be released on March, 31. In our view, the headline CPI might be flat at 2.2% y/y (similarly to February's figure) and materialisation of our scenario should be positive for the market, in particular that as some analysts warned earlier that inflation may hit the 2.5% target in March.

▪ External factors will be also closely watched by market players as we learn, among others, about the inflation data in the Euro zone or GDP data in USA. These together with speeches from Fed members, including the Fed Chair Janet Yellen can add to the market volatility. What is more, market will also monitor political situation in the USA as Obamacare is on the agenda in the Congress and it will be the test for Trump's administration ability to implement reforms suggested during the presidential election campaign.

▪ At the end of the week, Poland's Ministry of Finance will inform about its issuance plan for 2Q17. Given the current level of the 2017 gross borrowing needs completion we expect the ministry to decrease the offer towards cPLN30bn as compared the 1Q17 sale (nearly PLN40bn), with the highest offer in April. This mainly stems from quite huge inflows on the market as a result of PS0417 redemption (PLN11.5bn) and coupon payments (PLN3.5bn in total).

▪ Summing up, risk factors mentioned above are balanced. We expect debt market to remain quite strong, supporting by window-dressing at the end of quarter. Therefore, we expect both yields and IRS rates to move sideways this week.

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