

WEEKLY ECONOMIC UPDATE

3 – 9 April 2017

Polish zloty and bonds gained significantly last week, benefiting from higher risk appetite and inflow of money to emerging markets. We see a limited scope for continuation of this trend and we expect to see a profit taking at the start of April.

This week two important events on the Polish market will be PMI data and the Monetary Policy Council meeting. We expect the Polish manufacturing PMI to rise slightly in March, following the general moods improvement in Europe. However, it seems that in recent months the situation in manufacturing sector was better portrayed by other indicators, for example the business climate index from GUS. The latter has stabilised since January at the level consistent with c.5% y/y production growth (seasonally adjusted). The MPC decision on Wednesday is not likely to surprise. The main interest rates will remain unchanged, and the NBP President Adam Glapiński will most likely repeat a similar story as in the previous months – there are no reasons for interest rate hikes this year (or possibly even in 2018), as inflation surge at the start of the year was temporary and driven by exogenous factors. The flash CPI data for March have even reinforced this argumentation.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (3 April)							
9:00	PL	PMI – manufacturing	Mar	pts	54.6	54.7	54.2
9:55	DE	PMI – manufacturing	Mar	pts	58.3	-	56.8
10:00	EZ	PMI – manufacturing	Mar	pts	56.2	-	55.5
16:00	US	ISM – manufacturing	Mar	pts	57.0	-	57.7
TUESDAY (4 April)							
11:00	EZ	Retail sales	Feb	% y/y	0.8	-	1.2
14:30	US	Trade balance	Feb	\$bn	-46.5	-	-48.5
16:00	US	Industrial orders	Feb	% m/m	0.9	-	1.2
16:00	US	Durable goods orders	Feb	% m/m	-	-	1.7
WEDNESDAY (5 April)							
	PL	MPC decision		%	1.50	1.50	1.50
9:55	DE	PMI – services	Mar	pts	55.6	-	54.4
10:00	EZ	PMI – services	Mar	pts	56.5	-	55.6
14:15	US	ADP report	Mar	k	180	-	298
16:00	US	ISM – services	Mar	pts	57.0	-	57.6
20:00	US	FOMC minutes					
THURSDAY (6 April)							
8:00	DE	Industrial orders	Feb	% m/m	3.4	-	-7.4
9:00	CZ	Industrial output	Feb	% y/y	-	-	9.6
11:00	PL	Bond auction					
14:30	US	Initial jobless claims	week	k	-	-	258
FRIDAY (7 April)							
8:00	DE	Industrial output	Feb	% m/m	-0.3	-	2.8
8:00	DE	Exports	Feb	% m/m	-0.5	-	2.7
14:30	US	Non-farm payrolls	Mar	k	174	-	235
14:30	US	Unemployment rate	Mar	%	4.7	-	4.7

Source: BZ WBK. Reuters. Bloomberg

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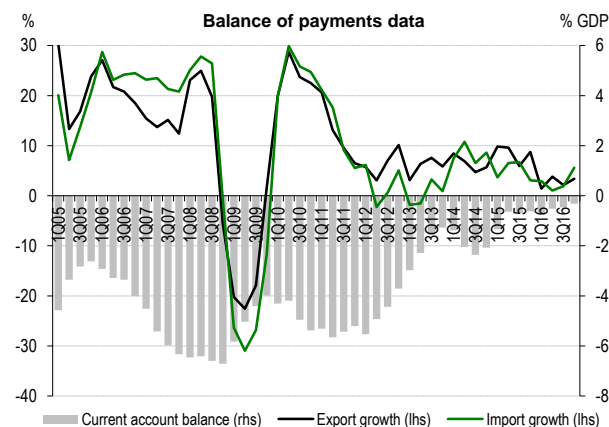
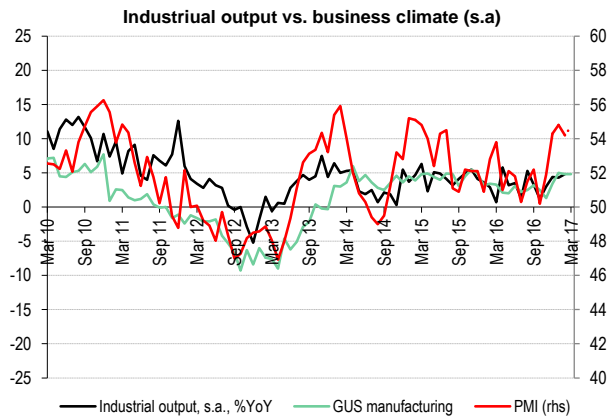
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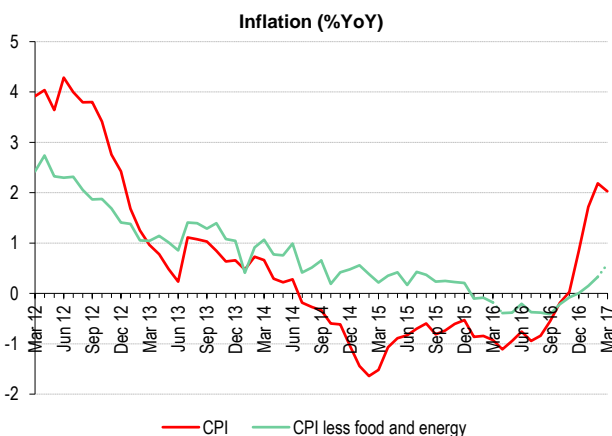
What's hot this week – Solid activity in manufacturing, MPC still dovish

- At the start of the new month the focus will be, as usually, on the flash PMI/ISM indicators and the US labour market report. Other important events in the agenda include the FOMC minutes, speeches of several Fed representatives and data from Europe, including German production and exports. Summing up, there will be plenty of information that could affect the market expectations about the monetary policy outlook in the USA and euro zone.

- Flash PMIs in Europe surged in March, heating up expectations for economic revival. However, it is worth noting that the divergence between the confidence indicators and 'hard data' from Europe has been increasing recently, with the latter showing a less optimistic picture. Similar situation seems to be the case in Poland (see chart).

- We expect the Polish manufacturing PMI to rise slightly in March, following the general moods improvement in Europe. However, it seems that in recent months the situation in the manufacturing sector was better portrayed by other indicators, for example the business climate index from GUS. The latter has stabilised since January at the level consistent with c.5% y/y production growth (seasonally adjusted).

- The Monetary Policy Council decision on Wednesday is not likely to surprise. The main interest rates will remain unchanged, and the NBP President, Adam Glapiński, will most likely repeat a similar story as in the previous months – there are no reasons for interest rate hikes this year (or possibly even in 2018), as inflation surge at the start of the year was temporary and driven by exogenous factors. The flash CPI data for March have even reinforced this argumentation (details below).

Last week in economy – Inflation's upward trend halted

- Flash CPI inflation in March fell to 2.0% y/y, from 2.2% in February and was lower than expected (market consensus at 2.3%). We do not know the details yet but the usual suspect for the surprise is food prices, especially prices of vegetables, which surged early in the year and now started retreating. Apart from that, fuel prices and gas tariffs fell quite significantly in March, and probably there was still no signs of underlying price pressure. According to our current forecast, in April inflation may inch up to 2.1% y/y but since May it may be below 2% again. The data are strongly against expectations for rate hikes in Poland, and should be supportive for the short end of the yield curve.

- Current account deficit in 4Q16 was revised to €357mn from €1252mn. An upward correction was mostly applied to export of services and to export of goods, yet to a lesser extent. This revision posts some risk of upward revision of 4Q16 GDP.

Quote of the week – The MPC should not overreact to incoming data

Jerzy Osiatyński, MPC member, 31.03.2017, Bloomberg

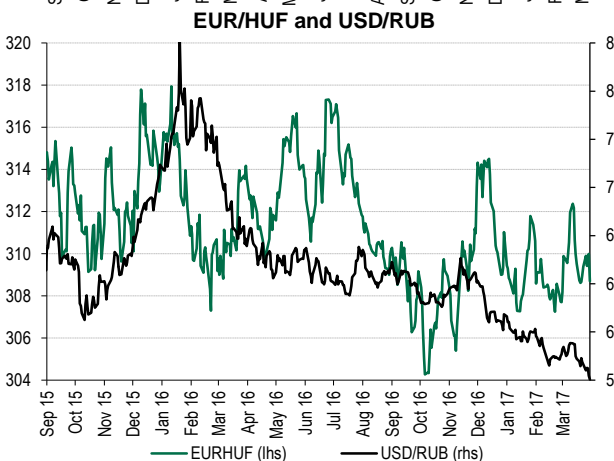
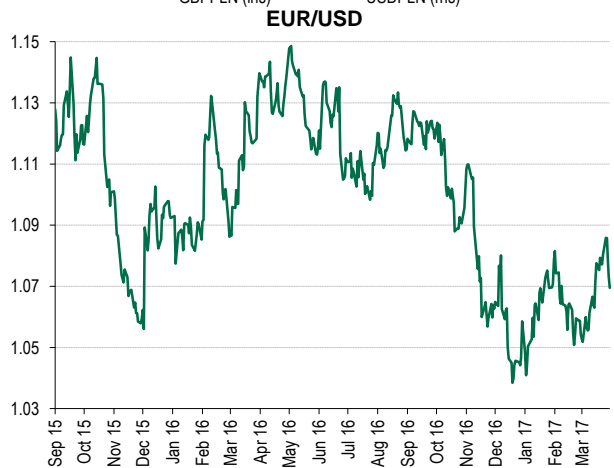
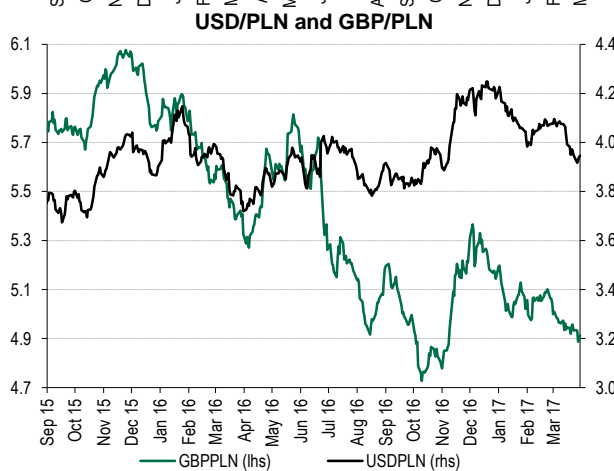
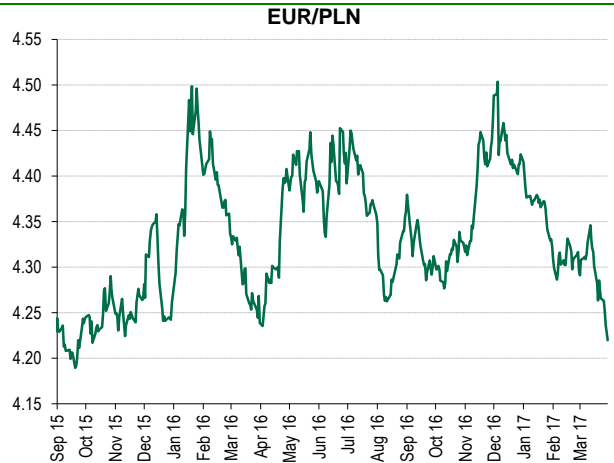
The NBP has no monopoly on fighting inflation. If one wants to have lower inflation, the government should compromise with social partners on wage growth, and market regulators should defend competition as it's socially less painful than monetary tightening.

Even if inflation exceeds the target by 0.1-0.2 percentage point in the middle of 2017, it will slow to 1.6-1.7 percent by year-end. The possibility that oil will slip in the near future will help keep inflation just below 2.5 percent in 2018.

Overreacting to that data comes in the form of pressure on policy makers, who are urged to drop their bias and move to raising rates. Oil prices, however, have, in the meantime, stabilized and their impact on our inflation will fade away month after month. So far so good, and the future looks even better.

The MPC member, Jerzy Osiatyński, said in an interview for Bloomberg that he supports keeping interest rates unchanged for longer. In his view, the MPC should not overreact to monthly inflation data, as these are under impact of temporary external factors and there is still no deeper inflationary pressure. According to the MPC member, monetary policy tightening would be very painful for the economic growth and employment and interest rate hike would be needed only if the government and social groups did not find the way to limit the wage pressure. This comment is generally in line with the views of most other MPC members, and supports our forecast that rates will stay flat in 2017.

Foreign exchange market – Is it time for correction?



Zloty hit a new minimum this year vs euro

▪ Last week, the Polish zloty gained significantly vs main currencies, with EUR/PLN reaching its new 2017 low, at nearly 4.21 (its lowest since November 2015). This mainly stemmed from the continued positive global sentiment and capital inflows on the emerging markets. USD/PLN fell to 3.89 for a while (its lowest since November 2016) thanks to a significant increase of EUR/USD. However, the rate quickly returned towards 3.95 as a result of the US dollar strengthening at the end of the week.

▪ Situation on EUR/PLN changed significantly over the past week as the Polish zloty outperformed other CEE peers and fell well below the lower boundary of the consolidation channel of 4.25-4.35. The zloty's appreciation vs the euro was fairly strong, therefore the risk of correction in the upcoming days/weeks increases. In the short run release of the March PMI index for the Polish manufacturing should keep the zloty strong. But, any signals from the USA that Fed might speed up its monetary tightening after strong macro data and hawkish rhetoric from Fed's members might push EUR/PLN up.

▪ In our view, in the short term important levels for EUR/PLN are 4.20 and 4.25.

Profit taking pushed EUR/USD down

▪ Start of the week brought a significant increase in EUR/USD. The rate rose slightly above 1.09 on Monday (this year's top and its highest since the first half of November 2016). The upside move was fueled by a decrease in investors' optimism as regards chances for implementing promised fiscal and tax reforms by Trump's administration and better than expected German data. However, strong macro data from the USA triggered EUR correction in the second part of the week, with EUR/USD declining below 1.07.

▪ This week macro calendar for Europe and USA is quite heavy. Investors will learn, among others, leading indicators (PMIs in Europe and ISM in USA) and the US non-farm payrolls. We believe that US macro data (in particular March job report) together with Fed minutes should shed light on the Fed's next moves. Increased concerns that Fed might speed up its monetary policy should keep EUR/USD below 1.07 in the upcoming days/weeks.

CEE currencies quite strong at the end of 1Q

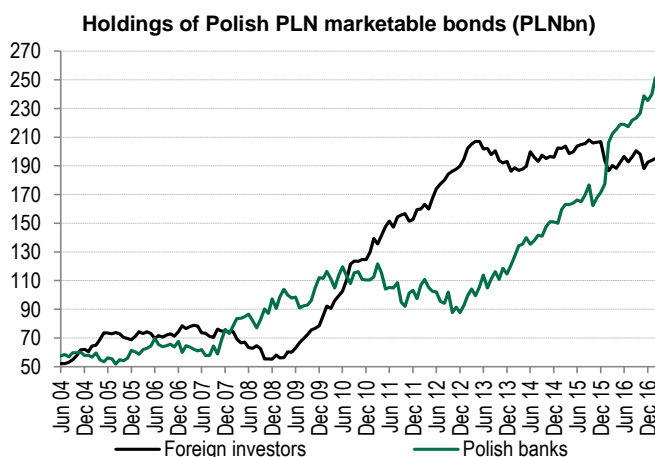
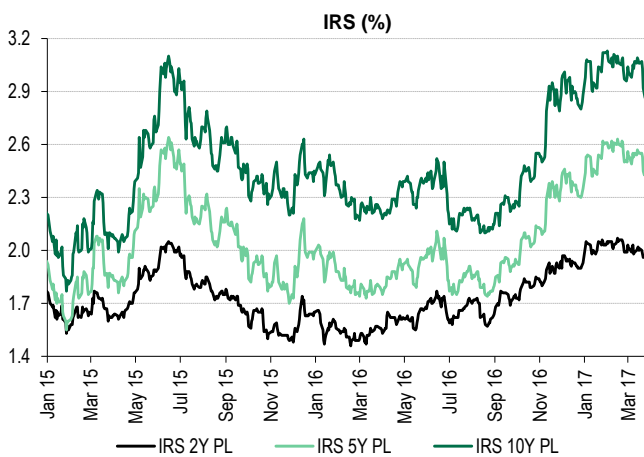
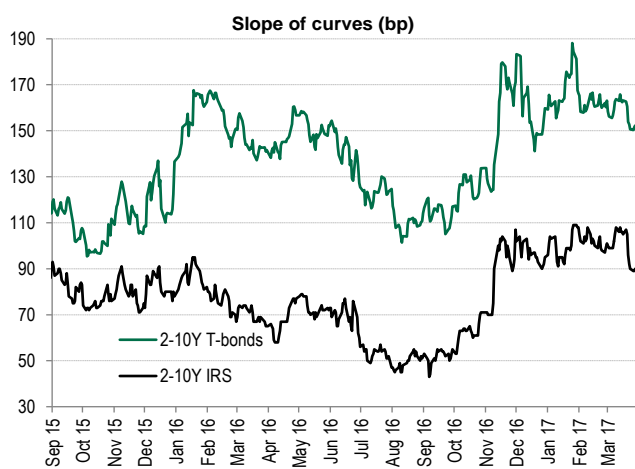
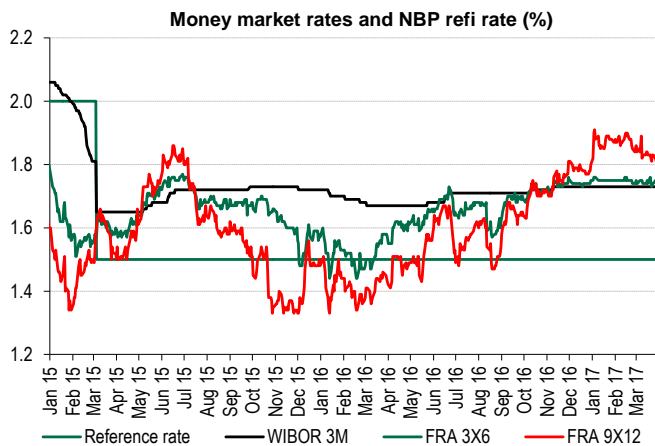
▪ Last week central bank meetings in Hungary (MNB) and Czechia (CNB) were in the spotlight. As expected, MNB kept its monetary policy unchanged, but the bank reiterated that it was ready to ease monetary policy further if needed. As a result EUR/HUF rose to 310 for a while. But it was only short lived as the rate fell towards 308 at the end of the week.

▪ The CNB decided to leave interest rate unchanged and to keep its EUR/CZK floor in place. However, the central bank modified its strategy towards this target, namely it abandoned the declaration to repeal the threshold in mid-2017, which means that it can be done at any point now. As a result, EUR/CZK increased to 27.23 for a while, but ended the week around 27.06.

▪ In the meantime, USD/RUB mirrored changes on oil prices. The Russian rouble strengthened at the end of the week as oil prices grew by 6% on weekly basis.

▪ In our view, some correction among CEE currencies is likely after significant strengthening in recent week. The impulse may come from external factors, in particular, the US macro data.

Interest rate market – Time to take profit

**Bonds still strong**

- Last week, the IRS and bond yields continued the downside trend though at a clearly slower pace. Dovish signals from the ECB and lower than expected inflation readings from Europe were supporting the global bonds with yields on the EMs falling more than on the core markets. The Polish 10Y bond yield neared 3.50%. At the same time, the 2Y IRS remained stable close to 1.95%, the 5Y rate fell to 2.40% (its lowest since mid-January) and the 10Y IRS declined slightly below 2.85% (its lowest since late December).

- 1-12M WIBORs did not change while FRAs remained flat.

Five auctions in 2Q, Polish banks accumulate bonds

- The Ministry of Finance announced that in 2Q17 it plans to offer bonds worth PLN20-30bn at five auctions. On April 6 the Ministry will offer OK0419/PS0422/WZ1122/WZ0126/DS0727 for the total amount of PLN3-5bn. The Ministry does not plan to issue T-bills in 2Q17.

- According to the data released by the Ministry of Finance, in February Polish PLN-denominated marketable debt increased by PLN13bn out of which PLN11.5bn was bought by the Polish banks. As a result, the nominal value of their portfolio rose above PLN251bn. Non-residents purchased PLN1.3bn of the Polish bonds and at the end of February the nominal value of their portfolio stood at PLN195bn (highest since October 2016). Within this group, mutual funds purchased bonds for PLN2.2bn, commercial banks increased their holdings by PLN645mn while the stock on the omnibus accounts fell by PLN2bn and central banks (mainly from Asia and Middle East) reduced holdings for PLN900mn. Under the geographical criteria, euro zone countries and the entities from the US were the biggest buyers.

Time to take profit

- Polish bonds ended the quarter with a gain. Note that since the beginning of 2015 there has never been the case of the 10Y yields falling for the two consecutive quarters. In 2013-14 the 10Y benchmark was gaining for six quarters in a row but this was when the market was first expecting and later the MPC started to deliver rate cuts. Obviously, now the market pricing is quite the other way round.

- The most recent US data were pretty robust but according to Bloomberg, the market sees c50% chances for a Fed rate hike in June. We find this rather low given the recent FOMC members saying that three or four 25bp hikes could be delivered in total this year. If the next US figures are strong, an upside pressure on global yields could emerge. The 10Y bond yield neared its first support at just below 3.50% (January's bottom) and we think it now could rise to c3.60%.

- While the new quarter may start with some profit taking after the recent rally on the belly and long end of the curve, the short-term rates should stay firm, at least this week, as the MPC is likely to continue its dovish rhetoric after the Friday's flash March CPI data.

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