WEEKLY ECONOMIC UPDATE

12 – 18 February 2018

The last week brought a sharp spike in volatility on the global equity and debt markets. Stock indexes plummeted and bond yields jumped hitting the emerging market currencies, including the zloty. Just like we expected, the MPC confirmed its dovish rhetoric which added pressure on the Polish currency and prompted us to change our interest rate scenario: we decided to move the timing of the first 25bp rate hike from November 2018 to the beginning of 2019.

This week numerous Polish and US data will be released. On the domestic side, it seems that the January inflation could be most important release for the market. We expect CPI decelerated to 1.8% y/y while yet in November it was at its 2.5% y/y target. Such figure could strengthen the dovish message sent by the MPC and weigh on the zloty and support bonds.

Global trends will likely remain important drivers for Polish assets. Continuation of sell-off on the equity market may back the dollar, implying more negative pressure on the zloty.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (12 February)					
		No important events					
		TUESDAY (13 February)					
09:00	HU	CPI	Jan	% y/y	2.0	-	2.1
14:00	**PL**	**Current Account Balance**	**Dec**	**€mn**	**-500**	**15**	**233**
14:00	**PL**	**Trade Balance**	**Dec**	**€mn**	**-464**	**-200**	**109**
14:00	**PL**	**Exports**	**Dec**	**€mn**	**15950**	**15 802**	**18243**
14:00	**PL**	**Imports**	**Dec**	**€mn**	**16361**	**16 002**	**18134**
		WEDNESDAY (14 February)					
09:00	CZ	CPI	Jan	% y/y	2.2	-	2.4
09:00	HU	GDP	4Q	% y/y	4.2	-	3.9
10:00	**PL**	**GDP**	**4Q**	**% y/y**	**5.1**	**5.1**	**4.9**
11:00	EZ	GDP SA	4Q	% y/y	2.7	-	2.7
11:00	EZ	Industrial Production SA	Dec	% m/m	-0.2	-	1.0
14:30	US	CPI	Jan	% m/m	0.4	-	0.2
14:30	US	Retail Sales Advance	Jan	% m/m	0.3	-	0.4
		THURSDAY (15 February)					
10:00	**PL**	**CPI**	**Jan**	**% y/y**	**1.8**	**1.8**	**2.1**
14:30	US	Initial jobless claims	week	k	-	-	221
15:15	US	Industrial Production	Jan	% m/m	0.2	-	0.89
		FRIDAY (16 February)					
09:00	CZ	GDP SA	4Q	% y/y	1.0	-	5.0
10:00	**PL**	**Employment in corporate sector**	**Jan**	**% y/y**	**3.1**	**3.7**	**4.6**
10:00	**PL**	**Average Gross Wages**	**Jan**	**% y/y**	**6.9**	**7.3**	**7.3**
14:30	US	Housing Starts	Jan	% m/m	2.77	-	-8.2

Source: BZ WBK, Reuters, Bloomberg

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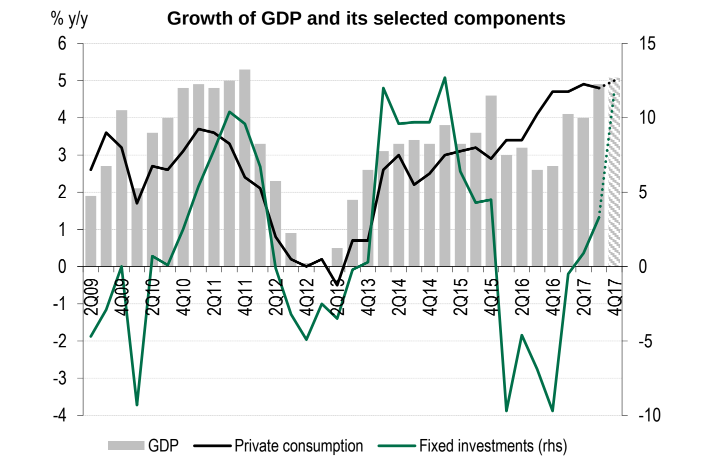
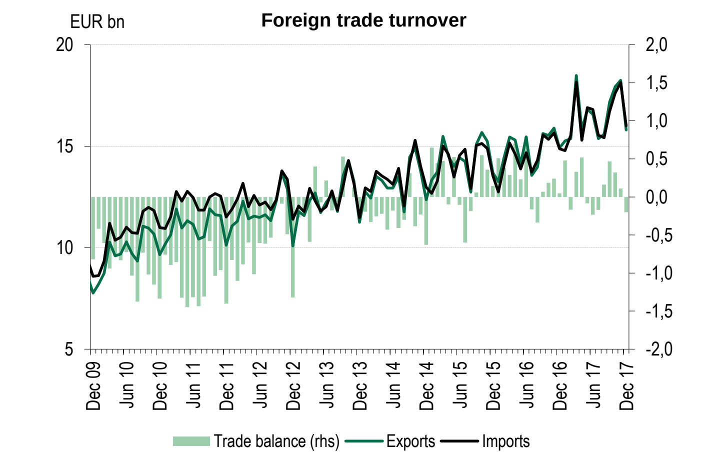
What's hot next week – Important data on schedule





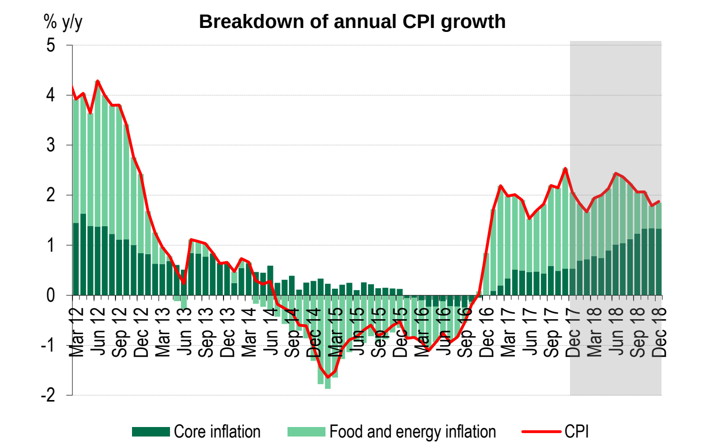
▪ January CPI is the most important statistic of the week. Our forecasts for January CPI suggest a further slide to 1.8% y/y from 2.1% y/y in December. In our view, January saw an unusually low growth in food prices due to downward tendencies in eggs and butter, earlier driven strongly up. CPI will also be dragged lower by high base effect in energy prices. Core inflation, on the other hand, most likely climbed to 1.1% y/y, the highest since 2014. In our view, inflation is likely to oscillate above 2.0% in the months to come and to temporarily hit 2.5% in mid-2018. We are expecting a further change in its breakdown: from food/energy driven to core driven (we expect core inflation at 2.0% at the end of 2018).

▪ Based on annual GDP data, we estimate 4Q GDP growth in 5.1-5.3% range. Based on stronger-than-expected GDP data and optimistic January surveys, we raised our 2018 GDP forecast to 4.3% from 4.0%, mostly in investment, but we stick to a decelerating path.

▪ We are expecting a balanced current account in December. Usually there is a deficit at the end of the year, but this time the Polish government paid a relatively low contribution to the EU budget (about €60mn vs €320mn on average in Jan-Nov). We are expecting a considerable slowdown of exports and imports vs November, but this will be mostly due to a lower number of working days. In general, strong business climate in the Euro zone will be supportive for demand for Polish products in the months to come.

▪ In January, the Statistics Office is revising the covered population of surveyed companies employing more than 9 people. In our view, the positive economic situation means that potentially many companies will enter the survey so we are likely to see a strong jump in employment statistics. As regards wages, we see a stabilisation at 7.3% y/y amid wage hikes in retail trade and a bit weaker working-day effect.

Last week in economy – MPC getting even more dovish



▪ The Monetary Policy Council kept the main interest rates unchanged, as broadly expected, with the reference rate at 1.5%. The official MPC communiqué remained almost the same as in the previous month, with key fragments saying that inflation should remain close to the central bank's target and that the current level of interest rates is supportive for keeping economy on the path of balanced growth and favourable for macroeconomic stability.

▪ The central bank is signaling clearly that interest rate hikes before the end of 2018 are becoming less and less likely and even hawkish MPC members' views are converging to those presented by Glapiński. We think that CPI zig-zagging in a horizontal trend below the 2.5% target for the better part of this year will give the MPC argument good enough to keep monetary policy on hold until the very end of 2018.

Quote of the week – Lower chances for rate hikes in 2018

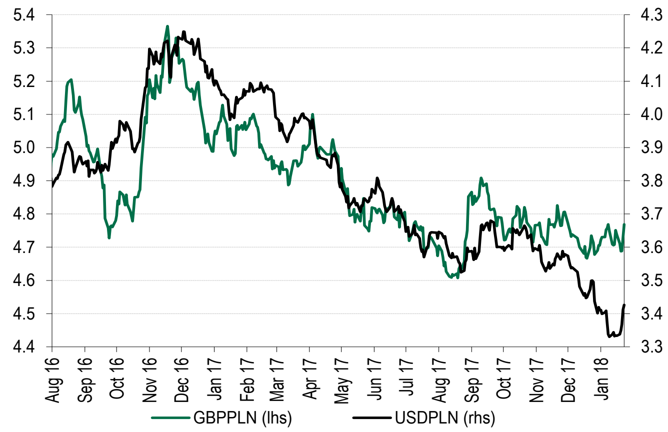
Adam Glapiński, NBP president, post-meeting conference, 7 Feb
My last comments were overinterpreted. I avoid speaking about monetary outlook in 2019, as it is too distant. For the time being, it is best to say that rates will stay on hold until end of 2018.. When I was talking about 2019, I was sarcastic.

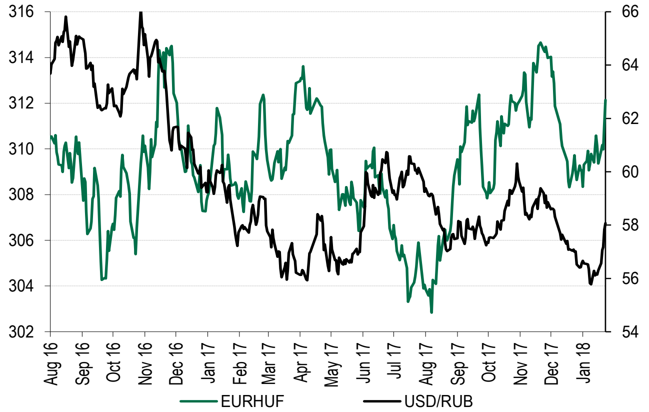
Jerzy Osiatyński, MPC member, post-meeting conference, 7 Feb
Investment in the private sector should translate into higher labour productivity, and this, in turn, should lower the risk of wage growth outpacing the productivity growth, so I feel safer.

Łukasz Hardt, MPC member, post-meeting conference, 7 Feb
In my opinion, the probability of no-change scenario until the end of 2018 is higher than earlier.

Seemingly, there was a difference between the NBP Governor Adam Glapiński's attitude during the previous post-meeting press conferences and what he said in an interview from Davos. The February meeting confirmed, however, our view that his views remained dovish. While he initially stressed that it was too early to talk credibly about next year, later on he admitted that he still saw a chance for stable rates in 1H19. The MPC reaction to strong investment rebound in 4Q (12% y/y implied by full-year data) was interesting. While the need to support muted investments was earlier one of the key arguments to justify the dovish stance, now the likely rebound in corporate investments was seen as a factor limiting worries about the wage pressure, thus also supporting a dovish approach. The hawkish camp seems now in disarray due to the recent decline of headline inflation and stable core CPI.

Foreign exchange market – Risk aversion hits zloty and backs dollar





EURPLN jumps to 4.20

- EURPLN rose for the second week in a row owing to mix of Polish and global factors. Equities plummeted worldwide and at some point bonds also joined the trend weighing on the EM currencies. Internally, the MPC rhetoric sounded dovish, as we expected, and this also added some pressure on the zloty. Also, Bank of England said it might need to hike interest rates earlier than expected which boosted the pound and was an additional factor pushing GBPPLN up to nearly 4.78. At the same time, CHFPLN jumped above 3.65 from 3.56 and UDSPLN to 3.43 from 3.34. EURPLN rose above 4.20 and the upside move developing since late January is now the biggest correction in the down trend observed since October.
- This week we will learn some Polish data with the flash 4Q GDP and January CPI likely being the most important. Total 2017 GDP figure released in the previous week implied that in the final quarter of last year economy was likely growing at a pace above 5%. However, it should come as no surprise to anyone. At the same time, January CPI will, in our view, show a deceleration to below 2% while yet in November inflation was at the 2.5% target. We think that this release may strengthen the dovish message sent by the MPC.
- This week we will also see numerous US data. Correlation between EURPLN and USDPLN is still significant and so these releases might influence the zloty through EURUSD channel.
- EURPLN broke resistance at 4.19 and from this point of view door for further rise to 4.22 are opened.

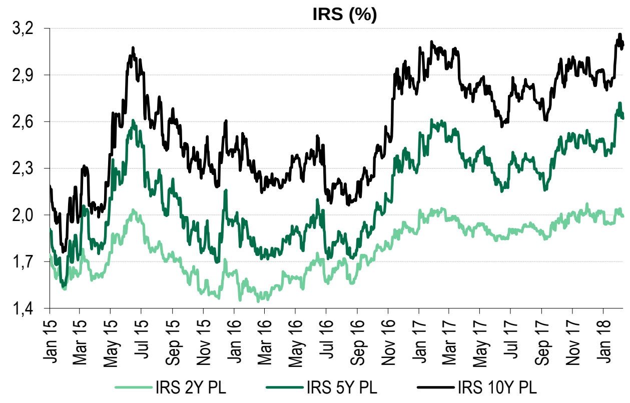
Dollar gains vs euro

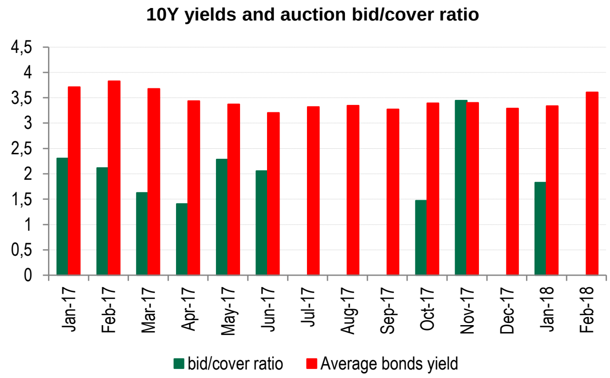
- EURUSD terminated the series of seven consecutive weeks of a rise and fell to 1.22 as demand for safe assets rose amid elevated risk aversion.
- This week's calendar is full of US economic activity releases that could trigger a sustainable move. We think the EURUSD rally seen in the previous weeks is overdone and we expect the dollar to recover. This could be the case if the risk aversion persists on the global market and the US data are good.

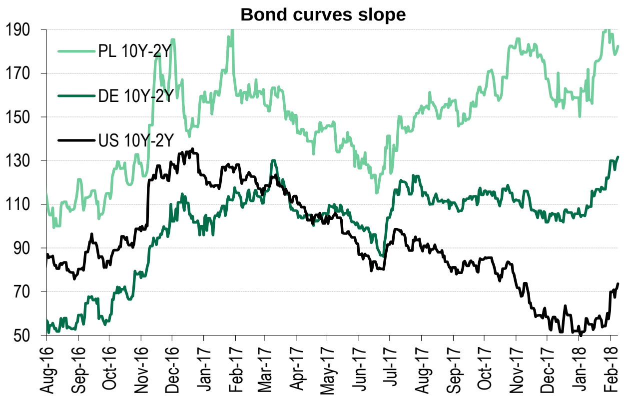
CEE currencies under pressure

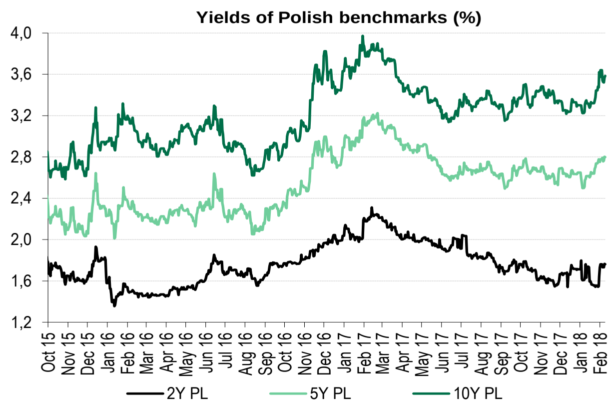
- The other CEE currencies also suffered from the global sell-off on the equity market. EURHUF jumped to 312.5 from 309, USDRUB to 58.5 from 56.5 and EURCZK to 25.38 from 25.12.
- Russian central bank cut interest rates by 25bp taking the main rate to 7.50%. Inflation is at 2.2%, holding below the 4% target and the central bank said this may allow for easing monetary policy further this year. This week's decision had no impact on the ruble.
- This week Czech and Hungarian inflation numbers will be published. In Czechia, inflation is holding above the 2% target and the market is expecting it neared that level in January. The Czech FRA market is pricing 25bp hike to be delivered in next three months and the central bank head said after the January 25bp hike that one more could be delivered later this year. Given this cautious rhetoric and market pricing, we think that inflation data might weigh on the koruna in the short term.

Interest rate market – Core markets will be key









BoE adds fuel to sell-off

- Last week, we observed the core markets and domestic bonds sell-off. Investors were afraid of faster-than-formerly-expected tightening of the monetary policy by the main central banks. This fear was strengthened after the Bank of England press conference, where the governor signaled that interest rates could now rise faster and to a greater extent than previously expected. As a result, the domestic yield curve was lifted up by 2-5 bp, mainly on the belly. However, the upward shift on the long end of the domestic curve was smaller than on the long end of the Treasuries curve and the Bund curve.

Auction

- Thursday’s bond auction was relatively successful given the adverse market conditions. The Ministry of Finance sold debt for PLN5bn (at the upper end of the planned supply) amid total demand at PLN8.65bn. The bid/cover ratio reached 1.7 vs 1.5 at the previous auction and 2.1 on average in 2017. WZ1122 and PS0123 attracted the biggest interest. The Ministry informed that after the auction it has covered 43% of this year’s gross borrowing needs.

Core markets to keep long end high

- This week, Polish debt market is likely to remain under the impact of global factors. In our view, yields of domestic and core bonds are likely to stay at a high level owing to, among others, US economic activity data. Retail sales, inflation and income figures should be of particular importance as in the market’s view they could confirm concerns expressed by several FOMC members that CPI could rise in the months to come, weighing on bonds. Expectations for these releases may thus strengthen the upside pressure on Polish bond yields in the 5-10Y segment in the first part of the week.

Domestic data should help the belly

- Polish data that will be released in the second half of the week should be debt-supportive. In our view, 4Q GDP figure should not hit bonds, particularly given the fact that the total 2017 result allowed for fairly accurate, in our view, estimate of growth in the final quarter of the past year. It seems that inflation data could be key. We expect CPI decelerated in January to 1.8% y/y which could be a good reason for the MPC to keep its rhetoric of no need for rate changes. As a result, we think that yields up to 5Y could ease somewhat from current high levels. In the case of the short end, we expect stabilization as the liquidity situation on the Polish market appears to be the main driver of that segment. As far as the long end is concerned, yields may stay high given the situation on the global debt market. Turning to the IRS curve, we expect Polish data to push the front end and the belly down while the long end may stay high.

- In the horizon over the next week we expect gradual stabilization of the core markets and, as a consequence, the appearance of the pressure to lower domestic curve in the 5-10Y segment..

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