

WEEKLY ECONOMIC UPDATE

26 February – 4 March 2018

Last week, global market sentiment remained unstable but volatility eased a bit after the recent jump. European economic activity data disappointed while the FOMC minutes sounded hawkish which contributed to lower EURUSD. In turn, stronger dollar weighed on the zloty. Polish bond yields eased slightly supported by trend on the global FI market and successful debt auction.

This week, important events are on the agenda. First, we will learn numerous US data, out of which the second estimate of the 4Q GDP, ISM and figures related to consumer confidence could be particularly important. On Monday, German CDU will decide whether to sign the coalition deal with SPD. On Wednesday, new Fed governor J. Powell will testify in the US Congress and investors will be looking for some guidance on monetary policy. This will be the final week before the Sunday Italian parliamentary elections. On the same day, SPD will vote on signing a coalition agreement with Merkel's CDU.

In Poland, we will see detailed 4Q17 GDP release and we see some down risk to this final number. We also expect some drop of Polish manufacturing PMI owing to slower economic activity in the euro zone (as indicated by recent data). We think the dollar may (still) weigh strongly on the zloty. Polish yields could rise slightly in reaction to the US data.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST			LAST
				MARKET	BZWBK	VALUE	
MONDAY (26 February)							
16:00	US	New Home Sales	Jan	% m/m	4.0	-	-9.3
TUESDAY (27 February)							
14:00	HU	Central Bank Rate Decision		%	0.9	-	0.9
14:30	US	Durable Goods Orders	Jan	% m/m	-2.0	-	2.8
16:00	US	Conference Board index	Feb	pts	126.0	-	125.4
WEDNESDAY (28 February)							
10:00	PL	GDP	4Q	% y/y	5.1	5.1	4.9
10:00	PL	Private Consumption	4Q	% y/y	-	5.0	4.8
10:00	PL	Investments	4Q	% y/y	-	11.8	3.3
11:00	EZ	Flash HICP	Feb	% y/y	-	-	1.3
14:30	US	Preliminary GDP	4Q	% q/q	2.5	-	2.6
16:00	US	Pending Home Sales	Jan	% m/m	0.5	-	0.5
THURSDAY (1 March)							
09:00	PL	PMI manufacturing	Feb	pts	-	54.1	54.6
09:55	DE	PMI manufacturing	Feb	pts	60.5	-	60.3
10:00	EZ	PMI manufacturing	Feb	pts	59.2	-	58.5
11:00	EZ	Unemployment Rate	Jan	%	-	-	8.7
14:30	US	Initial Jobless Claims	week	k	230	-	222
14:30	US	Personal Spending	Jan	% m/m	0.2	-	0.4
14:30	US	Personal Income	Jan	% m/m	0.2	-	0.4
16:00	US	ISM manufacturing	Feb	pts	58.6	-	59.1
FRIDAY (2 March)							
09:00	CZ	GDP SA	4Q	% y/y	-	-	5.1
16:00	US	Michigan index	Feb	pts	98.0	-	99.9

Source: BZ WBK, Reuters, Bloomberg

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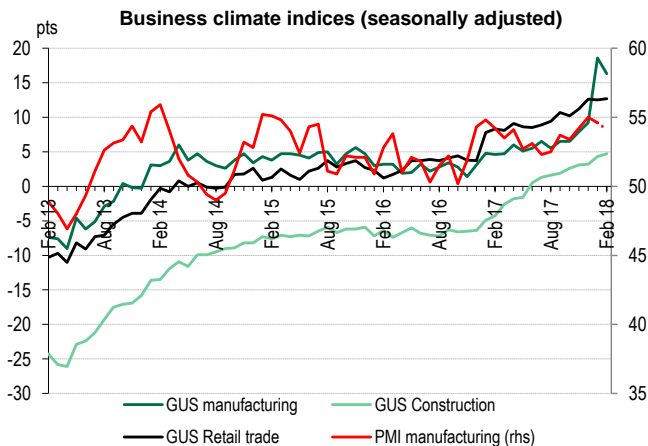
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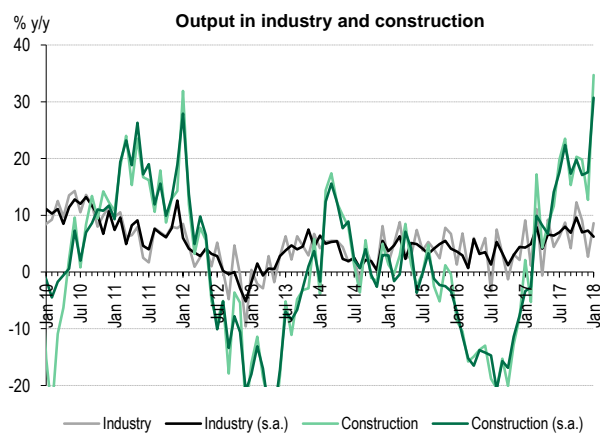
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What's hot next week – Investment surge: structure unknown; endangered PMI

▪ Detailed 4Q GDP data should confirm a rebound of investments. Economic growth might be lower than the flash reading of 5.1% y/y due to trade balance data. Private consumption probably grew by c5% y/y and investments by c12% y/y. Unfortunately, 4Q data on investments of companies will only come next month, and what matters is how much the private sector contributed to the investment surge.

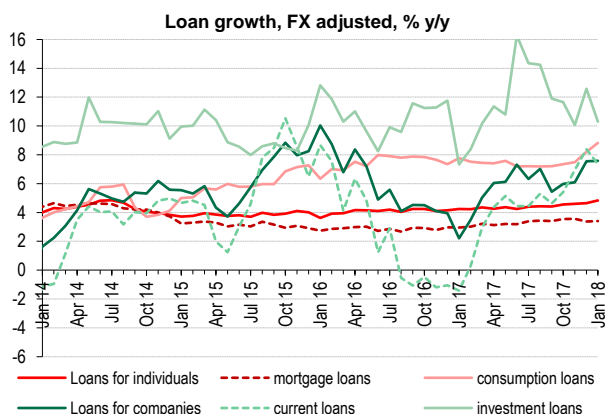
▪ The February PMI for Polish manufacturing seems at risk of extending the January decline. The European indices fell for a second time in a row and Polish Stats Office business sentiment indices were mixed instead of going for new records. What is more, seasonally adjusted growth of industrial output peaked in October and in January was the weakest in nine months. We expect the PMI to keep moving within the band seen since the start of 2015 and in February might drop from 54.6 pts to 54.1 pts.

Last week in economy – Building sector in great shape, industry slows down

▪ Industrial output rose 8.6% y/y in January, with seasonally adjusted data showing a slowdown to 6.2% y/y, the lowest print since April 2017. Construction sector surprised strongly to the upside, showing 34.7% y/y output rise (the strongest since 2007). Such sharp rebound was probably caused by a strong revival of investment activity. Retail sales rose 7.7% y/y in January. As we expected, an important factor behind this pickup was improvement in durable goods sales. The data support our expectations that the pace of GDP growth in 1Q18 remains close to 5% y/y.

▪ M3 growth accelerated to 4.8% y/y in January, in line with our forecast. Total deposits rose by 4.5% y/y and loans by 3.9% y/y. Household deposits kept on decelerating (3.9% y/y in January, the lowest in 12 years) and the tendency of switching term deposits into current deposits held on. Data corrected for FX changes suggest some acceleration of loans for private persons (4.8% y/y) and for companies (7.6% y/y). Interestingly, the higher growth of loans for firms was mostly due to a revival in real estate loans (9.1% y/y) amid some deceleration in current loans (7.3% y/y) and investment loans (10.3% y/y).

▪ Corporate wages calculated for all sectors excluding mining showed the same y/y growth rate as in October 2017 - the highest since 2009. The strongest wage acceleration was in 'hotels and restaurants' and 'administrative and support service activities' (both now above 10% y/y). Wages in services sector reached 7.5% y/y, the highest since January 2009. We expect further rise in the following months, and there is anecdotal evidence of pay raises among large companies. Rising labour costs will in our view contribute to the increase of core inflation.

**Quote of the week** – There is still fear of deflation**Eugeniusz Gatnar, MPC member, Bloomberg, February 19**

If inflation tops the target in 2H18, on the back of a strong impetus from wages, the council should consider a reaction this year, to anticipate what is to happen in 2019. We shouldn't be lulled to sleep in a comfort zone created by current data.

Łukasz Hardt, MPC member, PAP/Bloomberg, February 19

[Rate hikes this year] have become less probable as core inflation, including services' prices, turned out lower than I had expected.

Kamil Zubelewicz, MPC member, Reuters, February 23

There is still fear of deflation regardless of its sources and a relatively high tolerance for inflation, even in the face of the possibility of temporary inflation at four percent. I still think that by the end of 2019 it will not be possible to build a majority in the MPC for rate hikes.

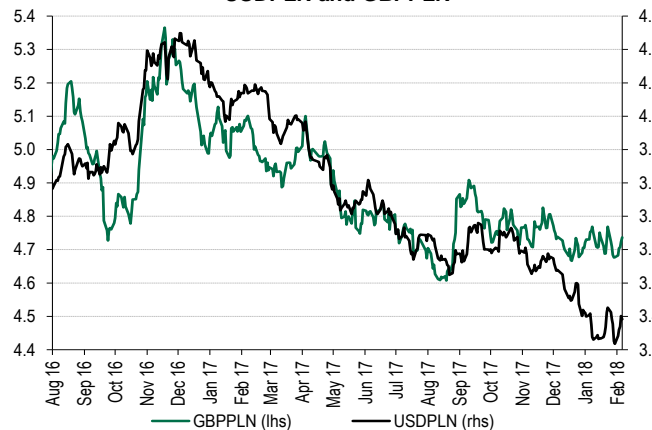
NBP February minutes seemed a bit more dovish than the previous document. The paragraph where the hawks placed their argument, was halved, and it no longer lists conditions that would warrant a rate hike apart from a quite general reference to a potential rapid rise of inflationary pressure. The members stated that core inflation in 4Q was lower than envisaged in the NBP projections (0.87% y/y average vs. just above 1% in the November projection) despite stronger-than-expected GDP growth, which suggests that inflationary pressure is still limited. In separate interviews, Ł. Hardt signaled reduced chances for a rate hike this year and K. Zubelewicz does not believe it could even be delivered in 2019. We think the Council will keep rates on hold at least until 1Q19. We expect CPI to be mostly zigzagging below the target, preventing a tilt of the Council to the hawkish side.

Foreign exchange market – US data and politics in spotlight

EURPLN



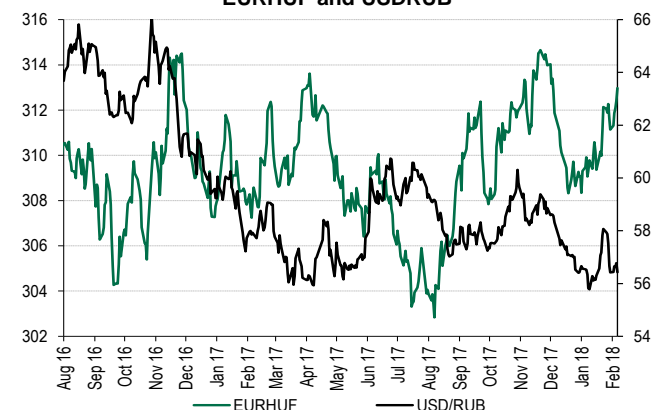
USDPLN and GBPPLN



EURUSD



EURHUF and USDRUB



Zloty hit by stronger dollar

▪ Last week, EURPLN neared 4.19 amid poor global market sentiment and hawkish tone of the FOMC minutes. USDPLN rebounded from the multi-year low at below 3,31 and reached nearly 3.42. The Polish currency depreciated also vs the pound (to 4.73 from 4.68) and the franc (to 3.63 from 3.58).

▪ Correlation of EURPLN and EURUSD remained significant and we think the dollar performance may remain core driver of the zloty. In the days to come, numerous US data will be released and the first weekend of March will see Italian general elections. All this could drive EURUSD (details below) influencing the zloty as well.

▪ In Poland, the stat office will release detailed 4Q17 GPD data. As we wrote after the flash figures, we see some risk of the final estimate being revised down, as the data about foreign trade for December showed much higher-than-expected trade deficit. As a result, Poland Wednesday's data could disappoint, weighing slightly on the zloty.

▪ Important levels to watch for EURPLN are resistance area at 4.19-4.20 and support at 4.145 (next one at 4.13).

US data and politics in spotlight

▪ EURUSD fell, owing to hawkish FOMC minutes and below-consensus European economic activity data. The exchange rate fell temporarily below 1.23 but stayed within 1.22-1.255 range observed since mid-January. The coming days could bring somewhat higher volatility, in our view.

▪ This week's calendar is full of the US economic releases, out of which the second estimate of the 4Q GDP, ISM and figures related to consumer confidence could be particularly important.

▪ This will be the final week before the Italian parliamentary elections. The recent polls have shown that the Five Star Movement has the biggest support (c28%) but, potentially, coalition of Berlusconi's Forza Italia and some smaller parties could score c40%. It seems that high support for the ruling Democratic Party would be the best for the euro but the coalition they could form may now count for c30% of votes, according to the last polls.

▪ On the same day, SPD will vote on signing a coalition agreement with Merkel's CDU. Announcement of the agreement provided support for the euro and now we will see if this was not a premature reaction.

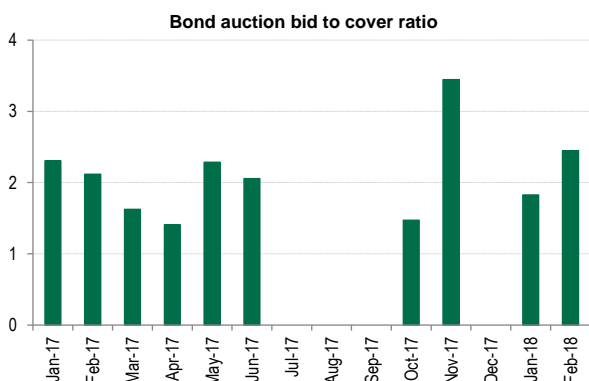
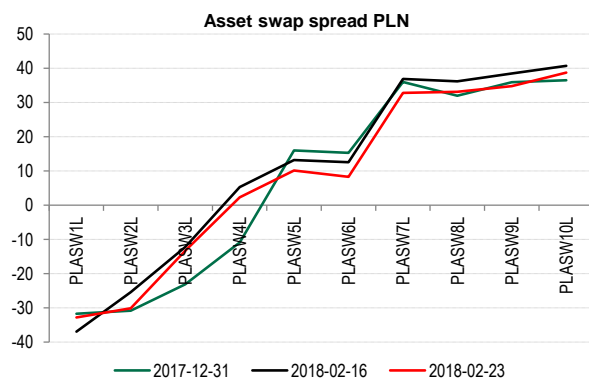
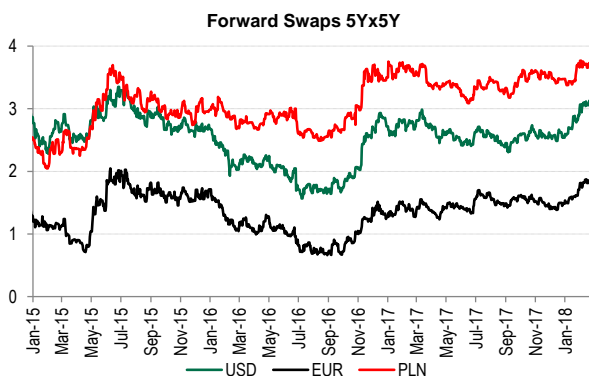
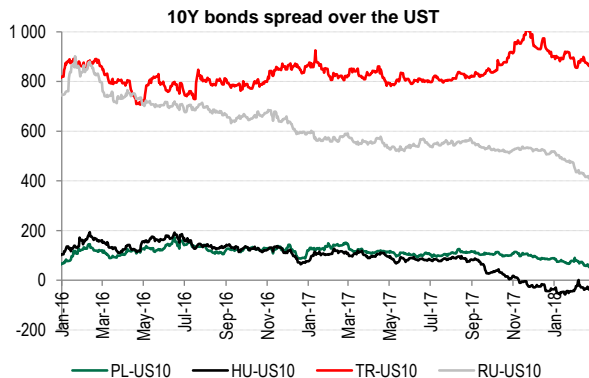
▪ We think that recent weaker-than-expected euro zone data, looming March Fed rate hike and uncertainty ahead of the Italian elections could push EURUSD lower in the short-term.

Forint weaker, koruna and ruble stable

▪ No important news emerged elsewhere in the CEE region. EURHUF followed EURPLN rising amid strong dollar and high risk aversion and jumped to 313.2. EURCZK remain stable at around 25.32 and USDRUB stayed near 56.4.

▪ This week, the Hungarian central bank will decide on the interest rates. We do not expect any changes in monetary policy to be announced as the forint is weak, Hungarian bond yields are holding low and inflation is still close to 2%.

Interest rate market – Focus on the debt supply

**Domestic bonds rally**

▪ Last week the domestic bond yields, as well as part of emerging European bonds (Russian, Turkish, Hungarian) were decreasing. The domestic debt price improvement coincided with US debt yield increases (as a reaction to the Fed minutes) and decreases of German debt yields. As a result, Polish yield curve slid by 4-6 pb over the week. The IRS curve slid down slightly less, which translated into an asset swap spread compression. Yield decreases were supported by weaker-than-expected Eurozone PMI data release. At the same time, the solid Polish retail sales and industrial production releases did not affect negatively the domestic debt. However, the biggest yields and rates slide was triggered by the Ministry of Finance (MoF) statement to cut bond supply (to PLN3-4bn from PLN5-6bn) on the Thursday auction. The next move was triggered by successful auction results. It is worth noting that last week the spread of 5Y POLGB over the 5Y UST approached zero.

Cutting supply will support bonds

▪ This Early this week we expect the domestic yields and rates decrease to continue. The downward move will likely be supported by announcement of the MoF March auction plan scheduled for the end of the month. We think that MoF will reiterate the declaration that debt supply will be limited in the upcoming months. As a consequence, we believe that the downward pressure on the yield will remain in place at least until Wednesday. The PMI data (where we expect slight deterioration) is also likely to help the domestic bonds. The end of the week will be less favourable for the bond market in the 5-10Y segment. We anticipate a solid reading of January US personal income and spending, robust GDP data, and the final Michigan Index release which will likely push US rates and yields up. As a consequence, we expect temporary rebound of Polish bond yield. The risk for this scenario will be new Fed chairman J. Powell testimony in Congress, scheduled for Tuesday. In our opinion, European policy events (election in Italy and voting for acceptations the German government agreement) scheduled for this week will not affect the Polish debt market.

▪ In the next weeks' perspectives, we believe the domestic bonds yield and rates will get back to downward trend, thanks to the lower-than-formerly-planned debt supply in the next months. The risk for this scenario will be the Fed meeting, expected in 2H of March, and, potentially, interest rates hike.

Auction

▪ On the auction, Ministry of Finance sold PLN4,9bn bonds (PLN0.9bn at the top-up tender). Average bid-to-cover ratio (b2c) was 3.26., the most popular were WZ0528 bonds (b2c=3.7), which represented 56.8% of sales. On the auction, MoF sold also 30Y bonds, with 3.76% yield (10Y 3.43%). Ministry informed that they financed 46% of 2018 borrowing needs.

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