# WEEKLY ECONOMIC UPDATE

## 5 – 11 March 2018

**Last week saw a positive start, with reassuring Fed report. Later, however, the new Fed chair Jerome Powell's testimony before the Congress was interpreted as hawkish, weighing on sentiments. Risk aversion was finally fuelled by Donald Trump's plans to introduce imports tariffs on steel and aluminum, raising concerns about outbreak of trade wars. Polish macro data were mixed: on one hand GDP growth was confirmed above 5% and the central budget recorded a strong start to 2018. On the other hand, PMI index went down, suggesting no further acceleration of y/y economic growth in 1Q18. The zloty was hit by the mood deterioration, while bonds strengthened.**

**This week is likely to provide a lot of emotions for investors. Elections in Italy will be held on 4 March. The populistic Five Star Movement is leading in polls, but is unlikely to form a coalition, so we may see a lengthy and unpredictable minority government formation process. In Germany, the SPD is holding an inner referendum whether to participate in the GroKo. Apart from politics, we will also see some news from the central banks: on Thursday the ECB is making decision on rates and US non-farm payrolls are due for release. In Poland, the MPC meeting is on the agenda. Polish central bankers will get to see the new inflation projection. In our view, the CPI path may be revised lower, so the already weak hawkish camp is likely to suffer another blow. The calendar is actually packed with important releases, such as German/Euro zone GDP, PMI for services, factory orders, export and industrial output or US ADP reports, Beige Book and durable goods orders. In general, market volatility is likely to go up.**

### Economic calendar

| TIME CET | COUNTRY | INDICATOR | PERIOD | | FORECAST MARKET | FORECAST BZWBK | LAST VALUE |
|---|---|---|---|---|---|---|---|
| | | **MONDAY (5 March)** | | | | | |
| 2:45 | CN | Caixin China PMI Services | Feb | pts | 54.25 | - | 54.7 |
| 9:55 | DE | Markit Germany Services PMI | Feb | pts | - | - | 55.3 |
| 10:00 | EZ | Eurozone Services PMI | Feb | pts | - | - | 56.7 |
| 11:00 | EZ | Retail Sales | Jan | % m/m | - | - | -1.1 |
| 16:00 | US | ISM services | Feb | pts | 58.5 | - | 59.9 |
| | | **TUESDAY (6 March)** | | | | | |
| 9:00 | HU | GDP | 4Q | % y/y | - | - | 4.4 |
| 16:00 | US | Durable Goods Orders | Jan | % m/m | -2.0 | - | -3.7 |
| 16:00 | US | Factory Orders | Jan | % m/m | -0.3 | - | 1.7 |
| | | **WEDNESDAY (7 March)** | | | | | |
| | **PL** | **Poland Base Rate Announcement** | | **%** | **1.5** | **1.5** | **1.5** |
| 9:00 | HU | Industrial Production SA | Jan | % y/y | - | - | 4.5 |
| 11:00 | EZ | GDP SA | 4Q | % y/y | - | - | 2.7 |
| 14:15 | US | ADP report | Feb | k | 180 | - | 233 |
| 20:00 | US | Beige Book | | | | | |
| | | **THURSDAY (8 March)** | | | | | |
| 8:00 | DE | Factory Orders | Jan | % m/m | - | - | 3.8 |
| 9:00 | HU | CPI | Feb | % y/y | - | - | 2.1 |
| 13:45 | EZ | ECB Main Refinancing Rate | | % | - | - | 0.0 |
| 14:30 | US | Initial Jobless Claims | week | k | 225 | - | 222 |
| | | **FRIDAY (9 March)** | | | | | |
| 8:00 | DE | Exports SA | Jan | % m/m | - | - | 0.0 |
| 8:00 | DE | Industrial Production SA | Jan | % m/m | - | - | -0.6 |
| 9:00 | CZ | CPI | Feb | % y/y | 1.9 | - | 2.2 |
| 14:30 | US | Change in Nonfarm Payrolls | Feb | k | 195 | - | 200 |
| 14:30 | US | Unemployment Rate | Feb | % | 4.0 | - | 4.1 |

Source: BZ WBK, Reuters, Bloomberg


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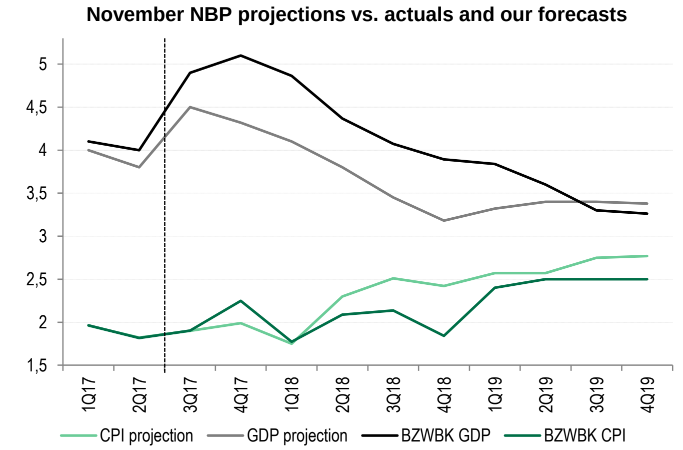
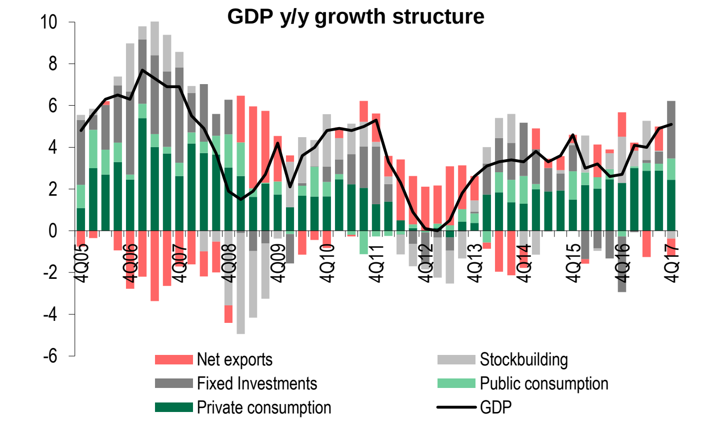
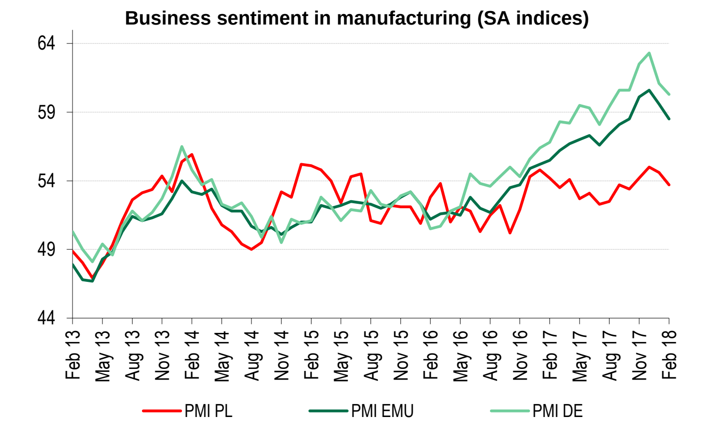
## **What's hot next week** – MPC to read a dovish message from the new projection




- The MPC meets this week and will receive an NBP inflation projection update. This is a moment when potentially the Council could rethink some of its views, but this time the new paths of CPI and GDP might lead most members to a conclusion that what governor Adam Glapiński currently communicates is the optimal approach given the NBP's macroeconomic outlook. The governor claims lack of reasons to hike rates at least until 1Q19, and that suggesting how monetary policy should look later is wrong due to economic uncertainty.
- The projected CPI path saw a significant upward revision in November, and yet it did not influence the Council much. This time a downside adjustment seems more likely, but most of the hawks have already moderated their views so there should be no signs of the MPC becoming more dovish now.
- GDP in 3-4Q broke above the NBP projection, but the MPC rhetoric has already focused on the slowdown to come.

## **Last week in economy** – Investment rebound confirmed, PMI fell again




- GDP growth in 4Q17 was confirmed at 5.1% y/y, up from 4.9% in 3Q. We finally saw a strong rebound of fixed investments, which recorded 11.3% y/y in 4Q vs. 3.3% in the previous quarter. Net exports were much weaker than we had expected due to a rebound of imports, but at the same time inventory changes had a much smaller negative contribution than we had estimated. Private consumption grew by 4.9% y/y, similar to the previous quarters of 2017. We expect the GDP growth to stay close to 5% y/y also in 1Q, given the maintained very high consumer and business optimism (despite PMI decline).
- The European Commission's ESI index for the Polish economy rose in February to 112.0 pts from 111.7 pts. A slight decline was only seen for industry (from -2.1 pts to -2.8 pts, but still near the 10-year high set a month earlier). Meanwhile, consumer confidence index set a new all-time record.
- PMI for Poland's manufacturing fell to 53.7pts in February from 54.6pts in January. This was the second slide in a row, bringing the PMI to level recorded in October 2017. The index was dragged lower by a weaker growth of all main components: new orders, output and employment. Still, the average PMI for January and February is the same as for 4Q.
- The central budget saw a surplus of PLN8.6bn in January, which is the best start to a year since comparable data have been available (1995). Revenues were down 5% y/y. PIT revenues added 13.7% y/y, CIT +11.4% y/y, but VAT surprised to the downside (-17.1% y/y) – because of one-off effects like delays in payments due to the recovery in investment in 4Q17. Spending, was down 12% y/y, most likely due to a pull-forward of some spending to December (e.g. subsidies to the Social Security Fund).

## **Quote of the week –** No reasons to expect a CPI 'ketchup effect'

**Piotr Szpunar, Head of NBP Economic Analysis Department, Bloomberg, February 27**

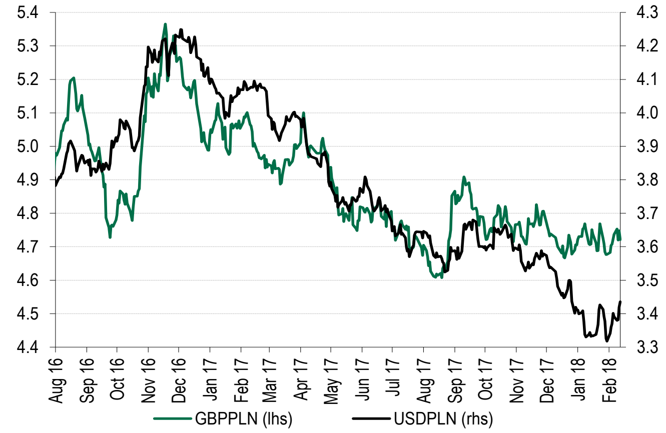
There are no reasons to expect that our inflation is under threat of a 'ketchup effect' [Wage pressure is like shaking the ketchup bottle, with no inflation coming out – but at some time, when wage pressure is strong enough, inflation may come out in a rush]. Expectations that wage growth will speed up to double digits and become the main inflation trigger later this year -- not only is that not our base scenario, but we even consider that as highly unlikely. From now on, demand for labor is to weaken rather than to increase. Inflation is low across the world [helping] Polish inflation to stay limited. It will continue to act this way.

The new head of the NBP research department, Piotr Szpunar has given an interview at the time when most of the work for the March projection update was (most likely) done. His macro outlook seems quite bearish for CPI. He questions the common view among market analysts that tight labour market will be a strong inflationary factor this year. A we see it: historically the response of core CPI to wage acceleration occurred with a couple of quarters of delay, explaining why we have not seen this effect yet. Szpunar claims inflation should stay limited, which might be a hint that the path will be lowered vs. the previous November update where core CPI sped up to almost 3% y/y by 4Q19 and CPI stayed above 2.5% target throughout 2019. The last projection had core CPI at c1.6% in 1Q18, but a 1% outcome is more likely – even if it does not lead to the short end of CPI path being corrected lower, it will add to the dovish flavor of the update.

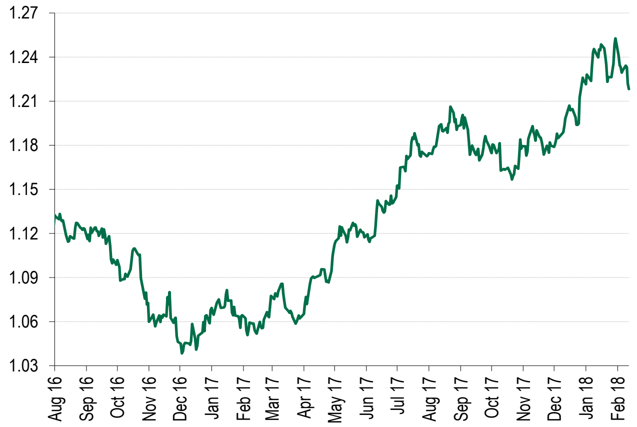
## **Foreign exchange market –** Strong dollar pressures zloty

EURPLN

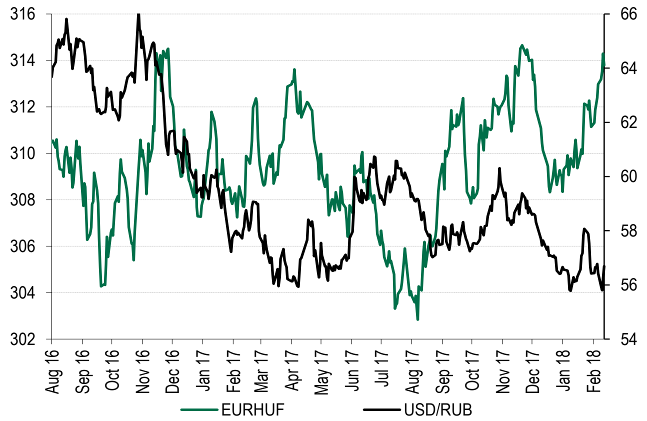
USDPLN and GBPPLN




EURUSD



EURHUF and USDRUB




### Zloty hit by stronger dollar

- EURPLN rose for the second week in a row and the exchange rate approached the local peak at 4.20. The zloty was pressured by dollar appreciation and shaky global market sentiment. At the same time, USDPLN jumped temporarily to 3.45 from 3.37, nearing its 2018 peak. The Polish currency also lost slightly vs the franc and gained vs the pound.
- The recent weeks have shown that the zloty's performance is strongly linked to EURUSD trends and global market sentiment. This week some important events are on the agenda (ECB decision, US monthly job report) and are likely to drive the Polish currency.
- Next to the external factors, the zloty may be under the impact of the outcome of the MPC meeting. The Council members will have the updated CPI and GDP forecasts at their disposal. We think that the inflation path could be revised lower which might strengthen the dovish rhetoric of the MPC, weighing on the zloty.
- Important levels to watch for EURPLN are resistance area at 4.19-4.20 and support at 4.163 (next one at 4.145).

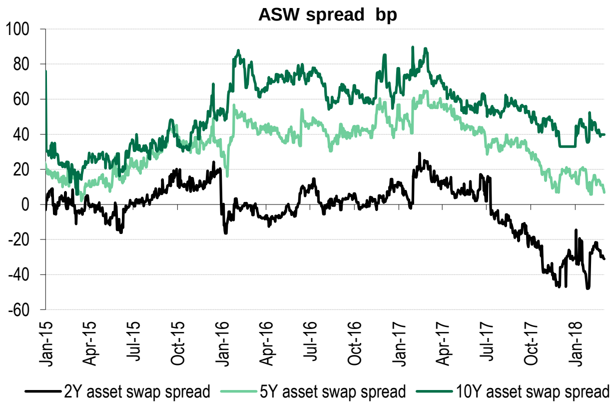
### Next important events on agenda

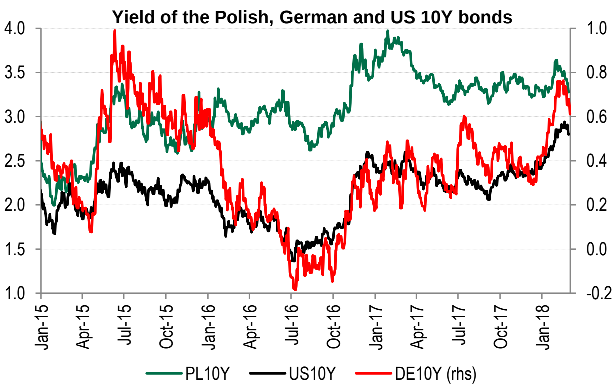
- EURUSD was on the downside for the better part of the week amid strong US consumer confidence index, hawkish remarks of the new Fed governor and higher demand for safe assets amid unstable global market sentiment. The exchange rate broke 1.22 support but Donald Trump idea to impose tariffs on some goods hit the greenback and EURUSD jumped above 1.23.
- US factors appeared to be important drivers for the market in the recent days. This should not change this week, when we will see monthly job report and Fed Beige Book.
- On Thursday, the ECB holds a meeting. In our view, pause in the EURUSD upside trend might have calmed the central bankers and so the exchange rate may not be given much attention during the press conference. Nevertheless, the most recent European data showed some slowdown in economic growth which may encourage the ECB to adopt somewhat more cautious view for the coming quarters.
- After the weekend, the market may be under the impact of Italian general elections results. We elaborated more on this issue in our previous weekly report.
- We are still of the opinion that EURUSD may fall in the weeks to come. If the exchange rate breaks 1.22, the next support levels to watch are at 1.21 and 1.19.

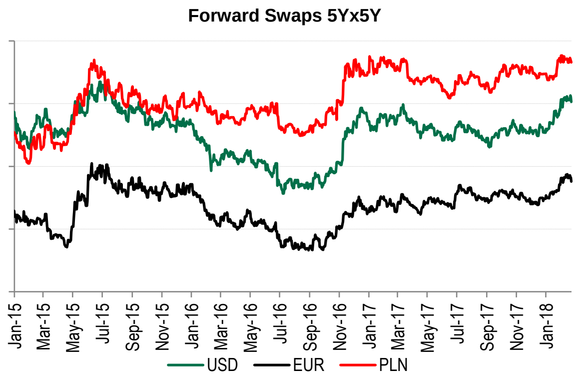
### CEE currencies weaker amid risk aversion

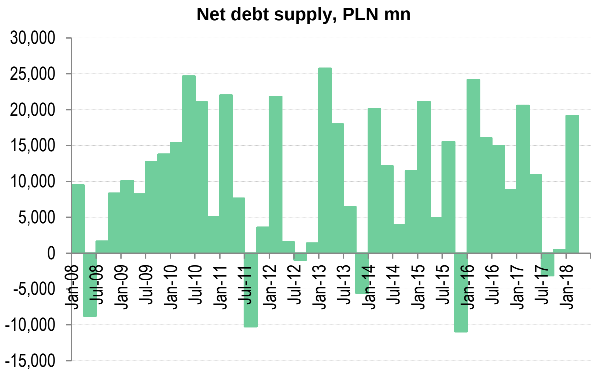
- The other CEE currencies also lost amid dollar appreciation and lower demand for risky assets. EURCZK neared 25.45 vs 25.35 last week, EURHUF touched 314.4 (establishing its new 2018 peak) vs. 312.8 seen last Friday, while USDRUB jumped to 56.62 from 55.53.
- This week, we will see Czech and Hungarian February CPI. In both cases, recent months showed inflation falling after a significant rise in 2017. Czech central bank is in the hiking mode while in Hungary the bias in monetary policy is still on the dovish side. We think that inflation figures could have a bigger impact on the koruna – recent comments of the CNB governor were rather reserved as regards the pace of monetary policy tightening and the Friday's release could give some clue if the next hike will be delivered sooner or later.

## Interest rate market – Focus on USA




### The budget results supports domestic bonds

- The domestic bonds yields were decreasing over last week. The yields of domestic bonds (across the curve) decreased driven by information of the low level of debt supply in March, strong budget and slowing down of core markets bonds sell-off. Thus, the domestic yield curve was lowering by 10-15 bp on the 5-10Y segment (reached the level seen in mid-January) and by 3 bp on the 2Y segment. It is worth noting that the move on the core markets was substantially smaller (and in the case of 2Y UST we observed some rise in yields). Simultaneously we observed ASW spread compression and appearance of the negative spread between POLGB5Y and UST5Y.

### Waiting for ECB and US labour market

- This week the US non-farm payrolls data and ECB press conference will be crucial for the long end of the domestic yield curve. The Polish MPC press conference is not likely to be a big thing for the long end of Polish T-bonds. In our opinion, the ECB conference (Thursday) will be slightly positive for the Polish bonds market. However, the last released industrial sector data were a little weaker than the previous one, the services sector data remained strong (ESI) and will likely remain so (PMI). This data set, in combination with stronger weaker EUR, will potentially help to maintain rather positive tone of the ECB conference (from bonds holders' point of view), and as a consequence will positively influence for Polish T-bonds.
- In the up-to-4Y segment the key information will concern lower debt supply in March, strong budget data for January and high liquidity in the domestic financial sector. It should support creating good mood to maintain yields of bonds on the lowered level.
- Wednesday's ADP report release, as well as Beige Book presentation before the Congress, will be a risk factor for the 5-10Y domestic bond segment. The report and the data will possibly confirm bright picture of US economy and, as a consequence, will temporarily negatively affect 5-10Y bonds.
- Later this week, we will see strong US non-farm payrolls data release (Friday). We anticipate that these data will negatively affect US debt market, which will likely trigger profit taking in the 5-10Y segment (after the last week rally) and temporarily will push the prices down. We believe that lower debt supply, over-liquidity in the domestic financial sector as well as scheduled for the end of April bond buy-back (PLN14.6bn) will help to maintain the yields on the lower level in the 2-5Y segment. However, in the longer horizon it is possible that the long end will also be beneficiary of this information.

### Auction plan

- The Ministry of Finance announced that in March it will hold only one regular auction (27 March) with a supply of PLN3-5bn (which means lower debt supply in 1Q18 by PLN6.8bn comparing to 1Q17). The offer will include OK0720, PS0123, WZ0524, WS0428, WZ0528 (possibly also WS and IZ bonds). As usual, we expect significant demand for the WZ series (floating coupon) bonds. 15 March will see a switch auction with the same set of bonds to buy.

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