WEEKLY ECONOMIC UPDATE

12 – 18 March 2018

MPC meeting was the main domestic event last week. The MPC kept monetary policy parameters unchanged, as expected, but surprised with adopting even more dovish bias than in the previous months. As a result, EURPLN jumped above 4.21 and bond yields plummeted. Global markets were driven by political news (US tariffs, possible USA-North Korea summit). The Italian general elections and the ECB meeting did not have long-lasting market influence.

The first part of the new week should be quite calm amid limited number of data releases. It could be a supportive environment for the zloty to gain slightly, provided that the general market sentiment does not deteriorate. Later in the week, the focus may start to shift towards the US where important data will be released less than a week before the FOMC decision.

In Poland, this week will be mostly about inflation. On Monday the NBP will release the new inflation projection and CPI data will be released on Thursday. Our CPI forecast for February is below the market consensus and if it proves correct, the surprise on the dovish side may weigh on the zloty and support bonds. However, the room for lower yields will be limited by last strong US nonfarm payrolls figure.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (12 March)					
		No important events					
		TUESDAY (13 March)					
13:30	US	CPI	Feb	% m/m	0.2	-	0.5
		WEDNESDAY (14 March)					
11:00	EZ	Industrial Production SA	Jan	% m/m	-	-	0.4
13:30	US	Retail Sales Advance	Feb	% m/m	0.3	-	-0.3
		THURSDAY (15 March)					
09:00	CZ	Industrial Production	Jan	% y/y	5.35	-	2.7
10:00	**PL**	**CPI**	**Feb**	**% y/y**	**1.8**	**1.6**	**1.9**
11:30	**PL**	**Bond Switch Auction**			**-**		
14:30	US	Initial Jobless Claims		k	220	-	231
		FRIDAY (16 March)					
10:00	**PL**	**Employment in corporate sector**	**Feb**	**% y/y**	**3.7**	**3.8**	**3.8**
10:00	**PL**	**Average Gross Wages**	**Feb**	**% y/y**	**7.2**	**7.5**	**7.3**
11:00	EZ	HICP	Feb	% y/y	-	-	1.2
13:30	US	Housing Starts	Feb	% m/m	-3.1	-	9.7
14:00	**PL**	**CPI Core**	**Feb**	**% y/y**	**1.0**	**1.0**	**0.9**
14:00	**PL**	**Current Account Balance**	**Jan**	**€mn**	**624**	**2 389**	**-1 152**
14:00	**PL**	**Trade Balance**	**Jan**	**€mn**	**-48**	**170**	**-1 268**
14:00	**PL**	**Exports**	**Jan**	**€mn**	**16 931**	**17 238**	**15 232**
14:00	**PL**	**Imports**	**Jan**	**€mn**	**17 152**	**17 068**	**16 500**
14:15	US	Industrial Production	Feb	% m/m	0.3	-	-0.1
15:00	US	Michigan index	Mar	pts	99.5	-	99.7

Source: BZ WBK, Reuters, Bloomberg

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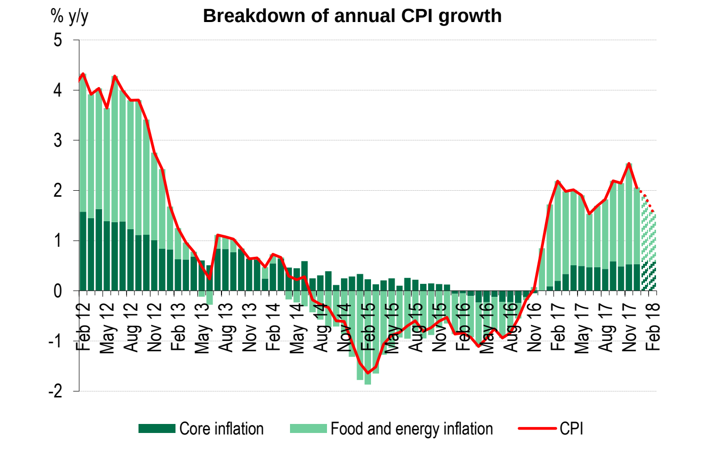
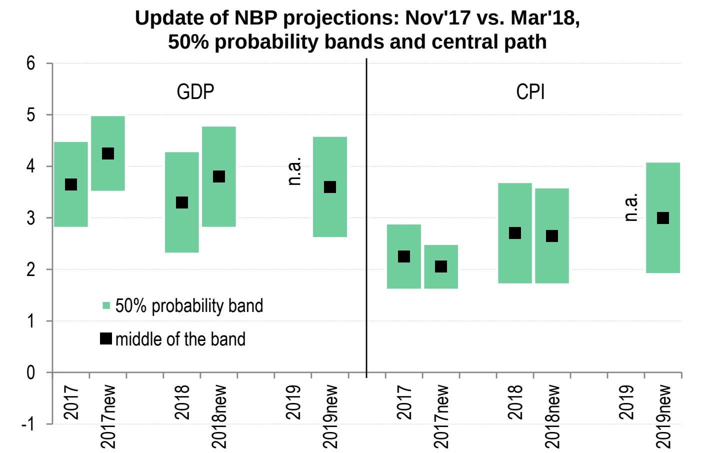
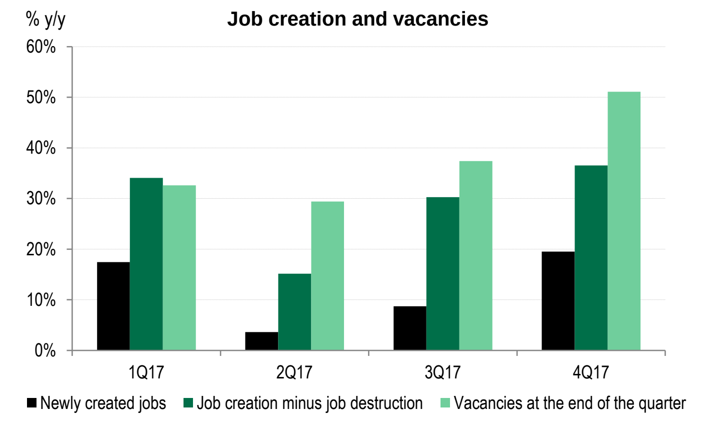
What's hot next week – Inflation, NBP projection and wages





- This week will be mostly about inflation with data for February released in Poland, the US and euro zone. On Monday, we will also get NBP inflation projection up to 2020.
- The Polish February CPI will be calculated using new weights and the January reading will be revised. This will allow for extraction of core inflation for both months. Our estimates show that CPI basket revision can marginally raise inflation, mostly at the start of the year (by +0.045 pp), but the effect will be too weak to change the trajectory.
- We forecast a decline of CPI in February from 1.9% y/y to 1.6%, strengthening the MPC's rhetoric that there are no reasons to consider rate hikes in foreseeable future. Core inflation can go the other way, from 0.9% y/y to 1% in February and further up, to c2% at the end of the year.
- The inflation report will provide details of the macroeconomic scenario envisaged by the NBP staff supporting the MPC. We already know that the central CPI path has been lowered from 2.25% y/y to 2,05% for 2018, and from 2,7% to 2,65% for 2019. 2020 was covered for the first time, and projected at 3% - not far enough from the 2.5% target to make the MPC worry, as the statement and the press conference has shown.
- Labour market data are likely yo confirm the solid growth of employment (3.8% y/y) and a further acceleration of wages (to 7.5% y/y from 7.3%) – as the labour shortages continue to haunt Polish companies.
- The C/A data for January will be a strong accent at the end of the working week. We expect a high surplus of cEUR2.4bn thanks to a substantial improvement in exports growth – accelerating from 2.1% y/y to 13% and restoring a trade balance surplus) and sizeable inflow of EU money. This would be the second highest monthly C/A balance since at least 1990.

Last week in economy – Vacancies up c50% y/y



- The Ministry of Labour estimates that in February the registered unemployment rate decreased to 6.8% from 6.9%. The ministry highlighted that on one hand labour participation was rising at an accelerated pace, while on the other the sudden deterioration of weather conditions had an adverse effect on the demand for seasonal work. In our view, there is still room for a decline of the registered unemployment rate, below 6% before the end of 1H18.
- The Stats Office's quarterly report on labour demand showed that the problem of labour shortages grew in 4Q17. The number of vacancies was 51.5% higher than in 4Q16, vs. +37.4% y/y in 3Q17 and +29.4% y/y in 2Q17. In our view, this fuels acceleration of wage growth in the enterprise sector, possibly to c10% y/y near the end of the year.

Quote of the week – No rate changes until the end of 2018, 2019, 2020.

Adam Glapiński, NBP governor, MPC press conf., Reuters, March 7

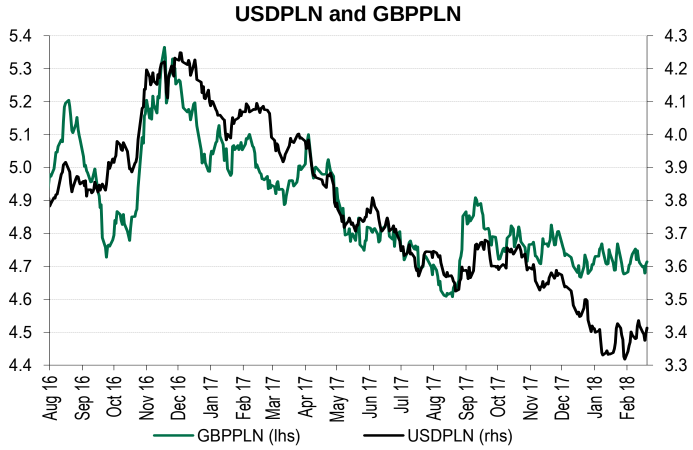
If data on which we are working do not change, then this year a rate hike seems totally unlikely. We will see how it is next year (...) but if at all, then (a rate hike could take place) somewhere near the end (of next year).

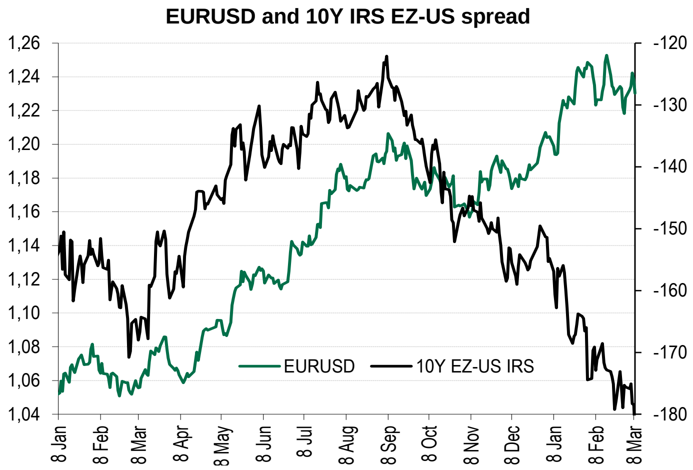
Honestly speaking, according to these forecasts, I do not see reasons to raise interest rates until the end of 2020. However, this is simply such a distant time that it is hard to say anything rational about it.

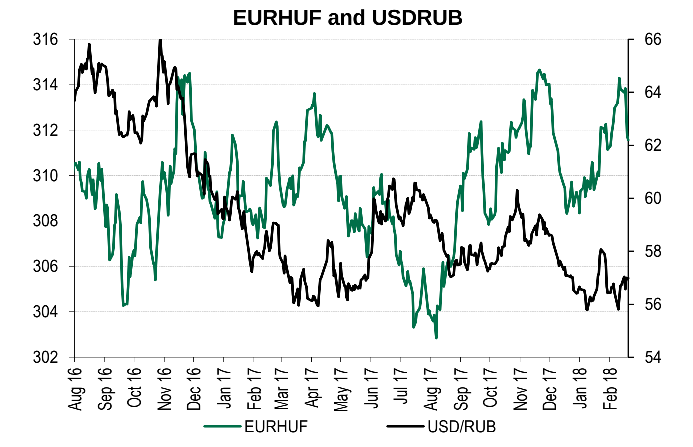
But if all these input data that we are operating on in the NECMOD [NBP's econometric model] materialise, then actually until the end of 2020 nothing will happen here because we would expect that we smoothly move into a situation where there would be motions filed in the MPC for a rate cut.

Interest rates were kept unchanged. The new NBP projections did not provoke any directional change of mind among the Council's members. Instead, the dovish camp received new arguments for keeping rates unchanged for long. The MPC press conference has reinforced further the dovish message sent by the Monetary Policy Council. NBP governor Adam Glapiński admitted that the new projections justify no rate hikes until the end of 2020, even if he was unwilling to state something reaching so far into the future. After such statements, we felt that the moment of monetary tightening moves even further away. However, we still believe that the MPC will start hiking interest rates earlier than suggested by the NBP governor, in mid-2019 at the earliest, and will be triggered by mounting inflationary and wage pressure and the start of interest rate hikes by the ECB.

Foreign exchange market – Attention may turn to Fed







Zloty weakest this year vs euro

- Last week, EURPLN jumped temporarily to 4.215 and, just like we expected, the trigger for this move was the outcome of the MPC meeting that was even more dovish than recently. At the same time, USDPLN remained near 3.40, GBPPLN stayed flat close to 4.69 and CHFPLN fell to 3.58 from 3.64.
- The first part of the new week should be quite calm amid limited number of data releases. The zloty has recently lost pretty noticeably and if the global market does not deteriorate, the Polish currency might recover at least part of recent losses.
- On Thursday, the stat office will release Poland February CPI. Our forecast is below the market consensus and if it proves correct, the surprise on the dovish side may weigh on the zloty. Additionally, in our view, there is an upside risk for the upside revision of January figure (as it will be recalculated according to the new basket weights), implying that the monthly drop of the y/y change would be even bigger than many had expected.
- Globally, this will be the last week before the FOMC decision and on Friday we will learn important US data. These releases could switch market attention towards the likely Fed rate hike which, in turn, might negatively influence emerging currencies that, in general, have gained so far this year vs the dollar.
- We still think there is a limited room for the zloty to recover and EURPLN should stay above 4.16 in the weeks to come.

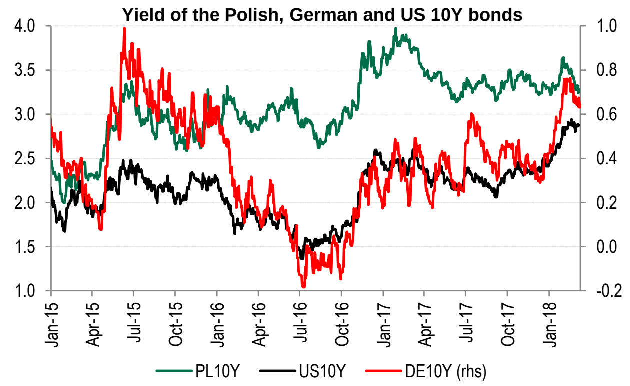
EURUSD driven by politics

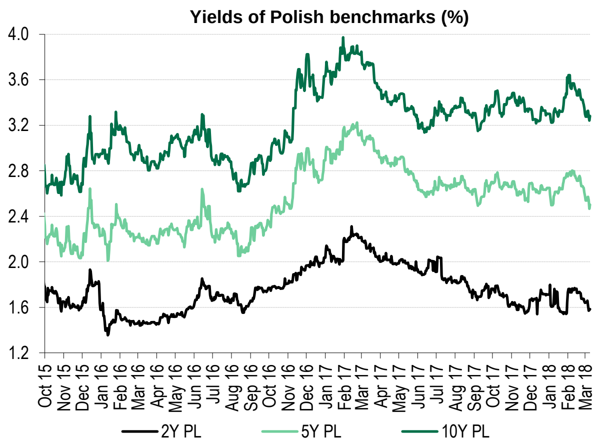
- Last week, politics was the main driver for EURUSD. First, the exchange rate was on the rise as the dollar was pressured by Donald Trump idea to impose tariffs on steel and aluminum. However, later in the week the greenback recovered after the information that the US president plans to meet with the North Korea leader. On weekly basis, the situation did not change much and EURUSD remained around 1.245.
- In our view, this week the market attention could turn to the upcoming FOMC decision. We think that EURUSD is too high, given the divergence between the ECB and Fed monetary policy. The EZ-US 10Y IRS spread implies that EURUSD should be somewhat lower and we expect the exchange rate to move down. This could be particularly the case as there is a chance that political tensions could ease, at least in the short term.
- We think EURUSD might test 1.22 support again in the days to come.

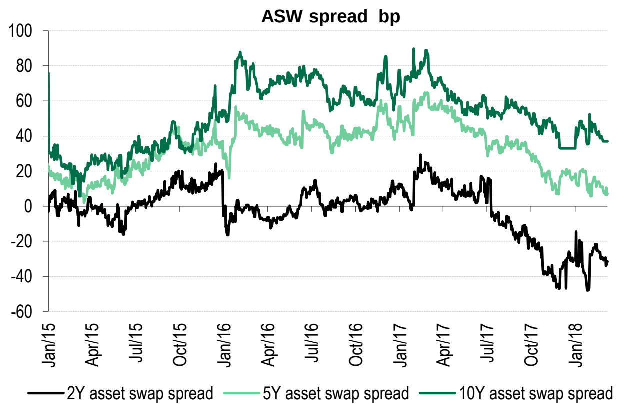
Forint gains, koruna and ruble flat

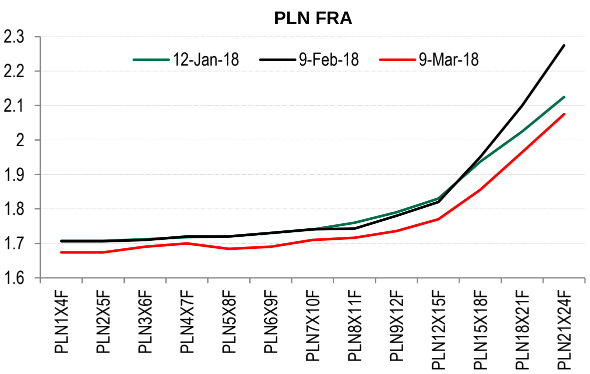
- Last week, the koruna and ruble remained fairly stable, with EURCZK and USDRUB rising marginally. The Czech currency was under slight pressure of lower-than-expected February CPI figure (1.8% y/y) that fell below the central bank target and market consensus (2.0% y/y). At the same time, the forint gained noticeably vs the euro and EURHUF neared 311. Hungarian forint was boosted by the above-forecasts data on the retail sales and industrial output and jump of Budapest stock index.

Interest rate market – Looking for inflation









NBP and ECB pushes the curve down

- Last week was dominated by domestic bonds yields slide. The yields drop occurred across the curve, however, it remained firm only in the belly and the front end of the curve. As a result, compared to the previous Friday, the curve decreased by 4-6 bps. in the 2-5Y segment and by 1bp. on the long end (at the same time the US curve lifted up and the German one fell). Those moves were fueled by EBC and NBP conferences (dovish and ultra-dovish, respectively) as well as by the market worries about the negative impact of the US president decision (to imposing tariffs on steel -25% and aluminum-10%) on the global trade. Moreover, the return of international investors to the domestic debt market helped to push yield curve down.

CPI on the spotlight

- This week, crucial event for the debt market will be domestic and US CPI data release and switch auction. We do not see real risk for overshooting the consensus by US inflation data release. We believe that domestic February CPI (our forecast is 1.6% y/y) will be below the market estimates (1.8% y/y), owing to slower growth of food prices on the m/m basis and fuel prices m/m reduction. The realization of this scenario would confirm the NBP governor's suggestions expressed at the last MPC conference that interest rates could remain unchanged until 2020. We do not believe that this effect will be neutralized by the reading of domestic wages and employment data, where the reading of wage dynamic below the market estimates is possible.
- The above-mentioned factors should improve domestic treasury bonds valuations. However, we think that after last week's rally, this data will at best serve to reduce the profit taking-related pressure. The switch auction (scheduled on Wednesday) may have a positive impact on the domestic sovereign bonds. We expect significant demand for the belly and the short end of the curve (and as usual for floating coupons WZ series bonds), as a consequence of a low level of debt supply on the March regular auction (bn3-5PLN).

Fed lurks around the corner

- On the debt market, FOMC conference on new interest rates paths will take the center stage in the coming week (for the first time attended by the newly appointed FED Chair, Jerome Powell). We expect the upward pressures on the yields before the conference (as a consequence of expected "dot plot" move up). However, the conference will probably disappoint investors with "over-inflated expectations" on hawkish Fed statement. As a consequence, we expect downward pressures on domestic yields to reverse.

Switch auction

- The switch auction offer will include OK0720, PS0123, WZ0524, WS0428, WZ0528 (possibly also WS and IZ bonds) in the switch of PS0418 (outstanding amount of bn14.6 PLN), PS0718 (bn18.7PLN) and OK1018 (bn19.7PLN).

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