WEEKLY ECONOMIC UPDATE

16 – 22 April 2018

In the coming days we will see next data from the Polish economy: core inflation, wages and employment, production in industry and construction. Full data about inflation confirmed that its drop in March to 1.3% y/y was driven mainly by core components and it is hard to point one main responsible sub-category, as declines were observed in several groups. It looks that the CPI inflation path in the coming months will be slightly lower than could be expected before the release. Core inflation has probably retreated to 0.7% y/y in March. In the coming months it is likely to increase, but may not reach 2% y/y before the year-end. Wage growth accelerated to 7% y/y in March, according to our forecast, despite unfavorable working days effect. It is the result of building imbalance between demand for labour and its supply, which is likely to grow even bigger in the coming months. It is hard to expect acceleration in employment growth, as the available labour force is depleting. Negative calendar effect will weaken production growth in March. But next months are likely to see higher growth rates again. While the peak cycle is already behind us, we still do not see a significant economic slowdown on the horizon.

Today in the evening S&P is scheduled to review Polish rating. We do not expect any change of either rating or its outlook, although the chances for the latter to be upgraded to positive rose recently amid Polish economic data, lower external imbalance and improvement of fiscal measures.

Should S&P surprise with the outlook upgrade, we may see even stronger zloty and lower bond yields after the weekend. On the other hand, no change could trigger profit taking after recent strengthening of Polish assets. Polish macro data are likely to be mixed – higher wages growth, lower output and core CPI – on balance they should not stop a profit taking on the debt market and slight zloty weakening.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (16 April)					
14:00	**PL**	**CPI Core**	**Mar**	**% y/y**	**0.7**	**0.7**	**0.8**
14:30	US	Retail Sales Advance	Mar	% m/m	0.4	-	-0.1
		TUESDAY (17 April)					
11:00	DE	ZEW Survey Current Situation	Apr	pts	86.0	-	90.7
14:30	US	Housing Starts	Mar	% m/m	2.7	-	-7.0
15:15	US	Industrial Production	Mar	% m/m	0.3	-	1.0
		WEDNESDAY (18 April)					
10:00	**PL**	**Employment in corporate sector**	**Mar**	**% y/y**	**3.7**	**3.7**	**3.7**
10:00	**PL**	**Average Gross Wages**	**Mar**	**% y/y**	**6.5**	**7.0**	**6.8**
11:00	EZ	HICP	Mar	% y/y	1.4	-	1.4
20:00	US	Beige Book				-	
		THURSDAY (19 April)					
10:00	**PL**	**Sold Industrial Output**	**Mar**	**% y/y**	**2.9**	**4.5**	**7.4**
10:00	**PL**	**Construction Output**	**Mar**	**% y/y**	**17.8**	**16.1**	**31.4**
10:00	**PL**	**PPI**	**Mar**	**% y/y**	**0.0**	**0.1**	**-0.2**
14:30	US	Initial Jobless Claims	Apr-18	k	230	-	233
		FRIDAY (20 April)					
		No important events					

Source: BZ WBK, Reuters, Bloomberg

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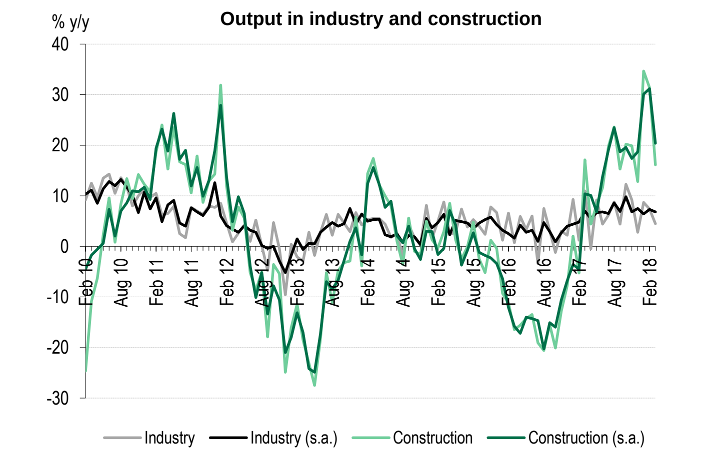
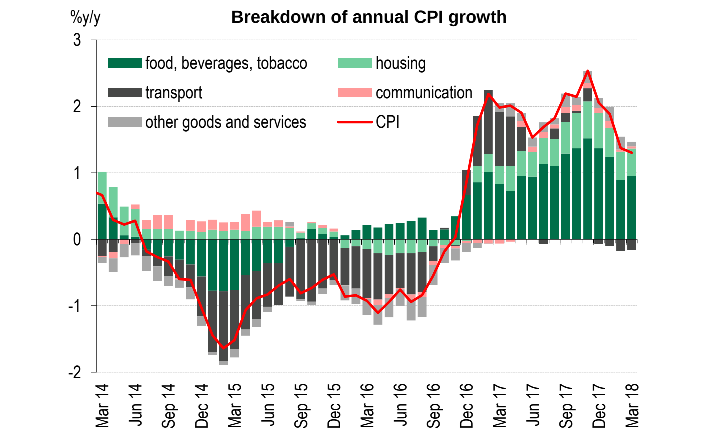
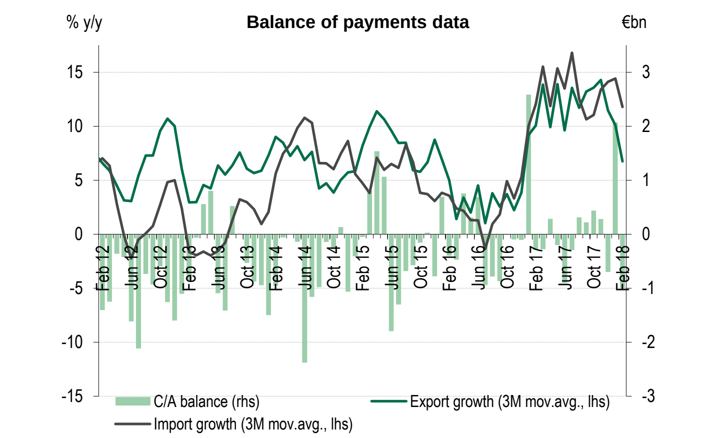
What's hot next week – Is this slowdown real?



- We pointed out in [our new MACROscope](), that in 1Q there were several nominal and soft indicators slowing down in the Polish economy (CPI, nominal value of public debt, PMI). This week gives us an opportunity to check if this slowdown also extended to real macroeconomic indicators.
- We think industrial output decelerated from 7.4% y/y to 4.5% in March, on working day differences and a negative Easter effect (accumulation of leaves and slower pace of work in the Easter holiday period). Filtering these effects out, our forecast means a similar level of activity as the average from Jan-Feb, market consensus assumes some real slowdown. Due to capacity constraints construction output is unlikely to continue growing by c30% y/y.
- Annual pace of corporate wages growth showed smooth acceleration in 1Q-3Q17 and steady pace since then, despite further signs of labour shortages. We think, the pace increased in March despite negative calendar effects.

Last week in economy – Weaker spine of inflation, export disappoints again





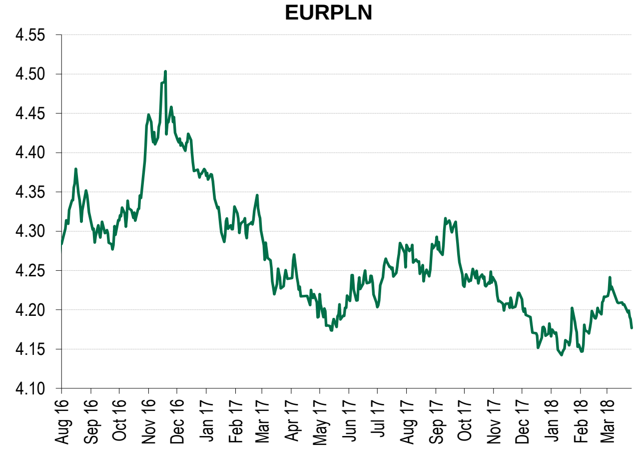
- March inflation fell to 1.3% y/y from 1.4% y/y in February, in line with the flash reading. The inflation was dragged further down by core categories, which showed a broad-based weakening. We estimate March core inflation ex food and energy at 0.65% y/y, the lowest level in a year (down from 0.84%). Weaker price tendencies in core categories suggest that the price growth may be weaker than expected in the months to come, supporting the MPC stance to keep rates unchanged. In our view, Polish CPI will accelerate to 2.2% y/y in June, fueled by high wage growth and tight labour market, only to retreat below 2% in 2H18 due to base effects in food and fuel. Core inflation should be mounting gradually, but may end this year slightly below 2% y/y.
- Labour Ministry informed that the registered unemployment rate fell to 6.6% from 6.8% (slightly less than we expected). The 33k decline in unemployment is the lowest for March in four years, yet business climate indicators show that demand for labour stays high. The remaining pool of the unemployed is small and so it may be unable to satiate the labour demand.
- February C/A deficit was worse than expected, above €1.0bn, we saw c€0.5bn. The downward surprise was caused by exports, rising a mere 5.7% y/y (vs 12% on average in 2017). Exports tend to negatively surprise recently, supporting our claim that business climate has peaked in 4Q17.
- Frans Timmermans, the Vice-President of the European Commission said it is too early to say if the row between Poland and EU on the rule of law can be ended and what will be the shape of the compromise. He said the EC will be closely monitoring Poland's actions and legislative changes to judge if they address the EC's concerns. He admitted that changes in Polish cabinet improved climate in Poland-EU relations. We should hear more from the EC this Tuesday.

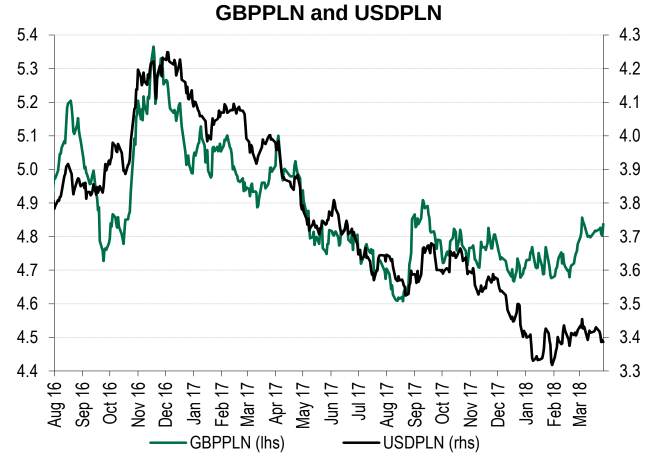
Quote of the week – It's all like a dream

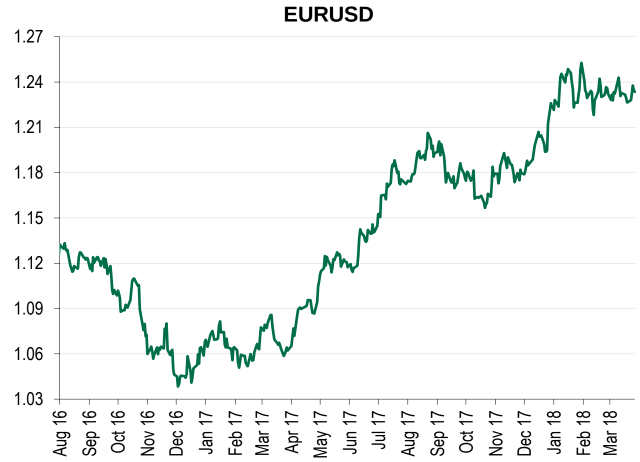
Adam Glapiński, NBP head, MPC press conference, April 11
Inflation was even lower than our forecast. This has not influenced my view nor the view of many of my colleagues. But some members have modified their positions as they had [earlier] thought they saw seeds of higher inflation, especially from the labor market; now it has all disappeared. The whole time, we were waiting for the moment when rates would have to be raised. And currently this period is pushed back so much that there's no reasons to think about this. Perhaps the moment will come when a move in the other direction will be warranted. I extend the time horizon when I do not see reasons for rate changes to two years. We have good economic growth and we don't have inflation or inflation even declines (…) It's all like a dream. (…) but by no means will that last forever.

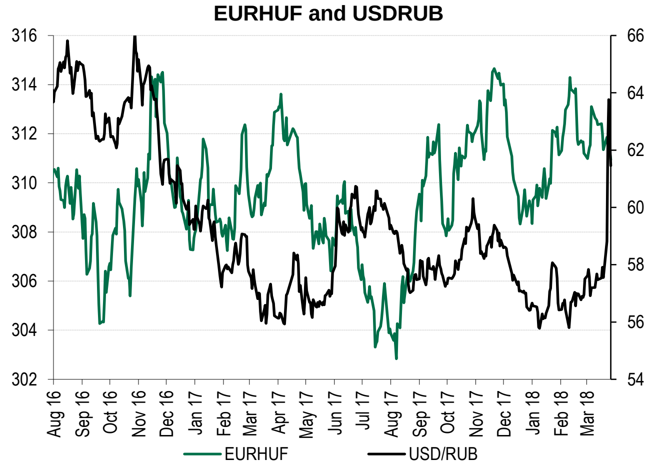
Polish MPC kept interest rates on hold, as expected (reference rate at 1.50%). The official statement remained very similar in tone to the previous one, but the press conference was even more dovish than before. NBP Governor Adam Glapiński said the timing of possible interest rate changes moved even further away (he would see rates flat for two years from now on) and even those MPC members who earlier saw risk for inflation from the tightening labour market now changed their view. At the same time, Glapiński downplayed suggestions that the next MPC decision could be a rate cut (other tools would be used in need of stimulus). We still think that the MPC will keep rates stable until the very late 2019, and the next decision will be a rate hike.

Foreign exchange market – Politics play market









Zloty strongest since February vs euro

- EURPLN fell third week in a row, reaching 4.17 amid positive global market sentiment, hopes for a soon end of conflict with the EC and investors pricing higher chances for a Polish rating outlook upgrade by S&P. The zloty gained also vs the dollar and franc but depreciated vs pound.
- The 1Q18 has passed and, according to Bloomberg, slightly less than a half of the major EM currencies gained vs the euro and only several lost vs the dollar. In our 2018 Outlook, we claimed that it could be difficult for the zloty to gain this year after it appreciated much in 2017 and became expensive vs its EM peers. Looking at 1Q18 best performers, all but one in Top10 vs the euro lost in 2017, suggesting that our guess that there may be a capital shift from 2017 outperformers to underperformers might be correct. In 2017, the zloty gained c5% vs the euro and ended the 1Q18 with a 0.66% loss.
- On April 13, the S&P's rating review for Poland is scheduled. Since their last review, domestic fiscal and economic picture has improved noticeably. We do not expect a change in rating or outlook but the chances for the latter are non-negligible. If it happens, the zloty could gain at least for some time. Also, our forecasts for March industrial output wages are above the consensus which could provide some short-term boost for the zloty. First support for EURPLN to watch is at c4.16.

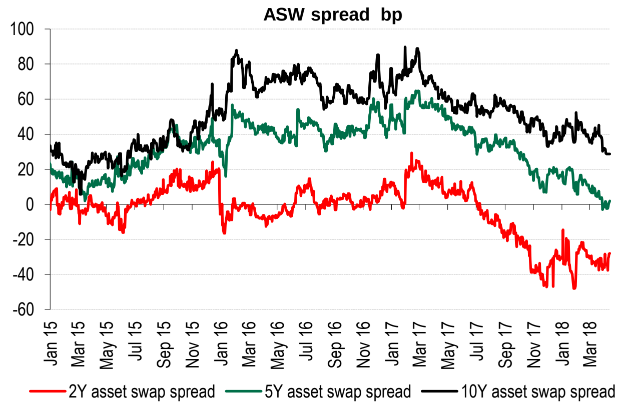
EURUSD still stable

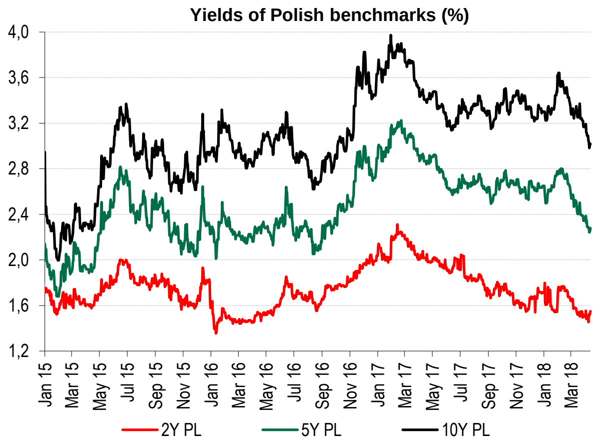
- EURUSD remained in the horizontal trend observed since the beginning of the year, fluctuating around 1.23.
- Looking only at the open/close prices, the exchange rate has been holding within the range from the second week of February. Periods of low volatility are followed by sharp swings and we expect that soon some bigger move could start. In the short-term, we assume EURUSD may stay fairly stable while later in the year the euro could resume the appreciation trend.
- This week, numerous US data are on the agenda. The most recent readings looked rather dovish and pushed EURUSD up away from 1.22 support. We do not expect the upcoming data to trigger any persistent trend. More likely, volatility may rise due to next political comments regarding situation in the Middle East.

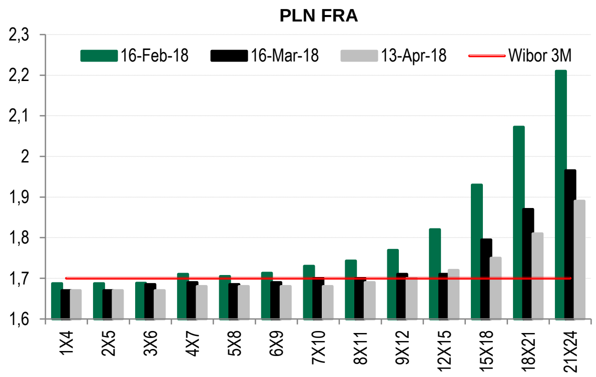
Political issues drive ruble

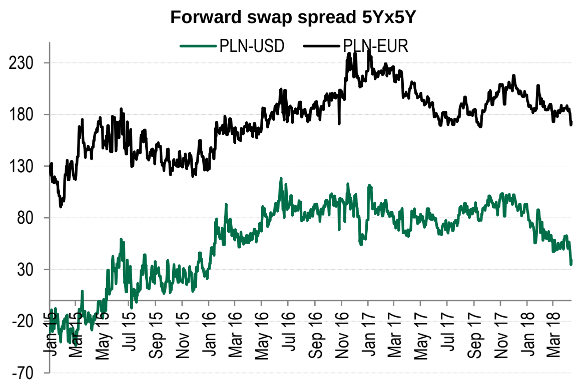
- Elsewhere in the CEE region, the biggest rise in volatility was observed on the ruble market. Since the very beginning of the week, the currency was under pressure of information that the US imposed new sanctions on Russia. As a result, USDRUB skyrocketed to 65.05 from 58.09. Later in the week, the ruble managed to neutralize roughly half of these losses as the US president softened his tone on the possible military intervention in Syria. It appears that geopolitical issues could be the main driver for the ruble in the nearest future.
- According to most recent results of Hungarian parliamentary elections, the ruling Fidesz party won 3rd time in a row gaining 133 seats in 199 seat parliament. There has been no persistent reaction of the forint so far.

Interest rate market – Bonds over bend









Yields return to autumn 2016 levels

- The Over the last week, the domestic yield curve touched the local low. The strong yield falls led the yields of bonds (2.98% - 10Y and 2.24% - 5Y) to the level last reported in September 2016, that is before the series of TV debates between Trump and Clinton. Simultaneously, the asset swap spreads (ASW) narrowed massively: ASW10Y to 26bp last seen in July 2015, ASW5Y to -3bp last seen at the turn of 2013 and 2014.
- The biggest surprise was a massive fall of spreads over the US Treasuries, i.e. +18pb in the 10Y segment, - 42pb in the 5Y segment and – 82pb in the 2Y segment. Spread over the US Treasuries decreased below the level last seen in the 2006-2007 when the GDP in Poland was rising by 6-7% and debt – to-GDP ratio decreased to 44.2% (2007) from 47.2% (2006). Currently, debt-to-GDP ratio decreased from 54.2% (4Q16) to 50.6% (4Q17).
- In the second part of the week, yields of domestic bonds moved slightly up by 2-3bp, following the core bonds market.

Bond market ready for price down

- We This week we expect slight sell-off (driven by profit-taking) of domestic debt, after the rally over the last three weeks. In our opinion, information about maintaining the rating (and outlook) of Polish debt by S&P (the communique is expected on April 13 evening) will be a trigger for this move. We thought that the comment to rating revision (if the former appears) will contain a positive assessment of the Polish economy and fiscal stance. If such a thing happens, there may be a temporary delay to start profit-taking, however no more than one or two days. We think that our profit-taking scenario will be supported by industrial production data (scheduled for Thursday), where we expect release above the market median forecast. As a consequence, we believe that yields will go up by 7-10bp in the 5-10Y segment, while the short end will remain stable. The core inflation data (entered into the calendar for Monday) will not affect the domestic bond market.
- In the next four or five weeks, we anticipate the yields of Polish bonds to remain at elevated levels. However, we still think that geopolitical uncertainty will be a break for more aggressive sell-off of domestic debt. We believe that Polish fiscal data (we expect further series of solid information) will support the domestic bond market. Good fiscal data should result in announcements about limiting the supply of debt in the coming months.

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