A dovish monetary tightening in the US

This week

- **March results of business surveys for major European economies will be released on Friday.** We expect that PMI Composite for the Eurozone dropped to 55.4 pts in March vs. 56.0 pts in February. The index declined amid slowdown of economic activity in France and stabilization of business climate in Germany. Our forecasts of business survey results for major European economies are below the consensus; therefore, their publication will be conducive to PLN appreciation and lower yields on Polish bonds.
- **US data will be released this week**. We forecast that new home sales rose to 567k in February vs. 555k in January, while existing home sales dropped to 5.56M vs. 5.69M. We expect that the February preliminary durable goods orders rose by 2.1% MoM vs. a 2.0% increase in January. Data from the US should not be market moving, we believe.
- **We have revised our forecast of inflation and scenario of monetary policy in Poland.** We expect that inflation will reach the local maximum in Q1 2017 and in subsequent quarters will gradually decrease to reach 1.6% in Q4. Conducive to higher inflation will be increasing core inflation resulting from growing cost pressure caused by moderate acceleration in wage growth and higher fuel prices. High base effects for food and fuel prices will have an opposite impact. We forecast that annual average inflation will run at 1.8% in 2017 (1.5% before the revision) and will decrease to 1.5% in 2018. We expect that in the conditions of inflation running significantly below the inflation target, the MPC will not decide to start the expected by us monetary policy tightening in 2018. Therefore, we have postponed the forecasted by us first interest rate hike to November 2018. We believe that the then published inflation projection will indicate increased probability of inflation exceeding the target in 2019, prompting Council members increase interest rates to 1.75%.

Last week

- **FOMC meeting was held last week.** The target range for Federal Reserve funds rate was increased by 25 bp to [0.75%; 1.00%], which was in line with our expectations and the market consensus. New macroeconomic projections of FOMC members were presented at a conference after the meeting (see below).
- **Numerous data from the US economy were released last week.** Industrial production in February has not changed compared to January when it dropped by 0.1%. The increase in monthly production growth compared to January was due to higher production growth rate in mining and utilities as well as its stabilization in manufacturing. At the same time, capacity utilization dropped to 75.4% in February vs. 75.5% in January. Data on nominal retail sales were also released last week. They rose by 0.1% MoM in February vs. a 0.6% increase in January. Excluding car sales, retail sales rose by 0.2% MoM in February vs. a 1.2% increase in January. Conducive to lower retail sales dynamics was lower sales growth rate in most of their categories. Data on the number of house starts (1288k in February vs. 1251k in January) and building permits (1213k vs. 1293) were also released last week and pointed to the continuation of the recovery in the US real estate market. The results of regional business surveys for US manufacturing were also released last week. The NY Empire State Index dropped to 16.4 pts in March vs. 18.7 pts in February and Philadelphia FED dropped to 32.8 pts vs. 43.3 pts. The significant decline in Philadelphia FED resulted from the high base effect of the month before, when the index reached the highest value since January 1984. The preliminary University of Michigan Index was also released last week and rose to 97.6 pts in March vs. 96.3 pts in February, suggesting a slight improvement in consumer sentiment. Conducive to the index increase were higher values of its sub-indices for both the assessment of the current situation and expectations. We forecast that the annualized GDP growth rate in the US will drop to 1.6%

in Q1 vs. 1.9% in Q4 2016.

- **Parliamentary elections in the Netherlands were held last week**. According to preliminary results, the People's Party for Freedom and Democracy (VVD) won the elections obtaining 33 of the 150 seats in the parliament. The Eurosceptic Party for Freedom (PVV) came second with 20 seats. Thus, our scenario from the week before, in which PVV would not obtain majority in the parliament, has materialized. The results of the Dutch elections are positive to EURUSD and negative for EURPLN. The results of the May presidential elections in France will remain the main political risk to PLN in the coming weeks. A possible victory of M. Le Pen (this is not our base scenario) who supports i.a. France's exit from the Eurozone will be conducive to a sharp decrease of EURUSD and significant depreciation of PLN vs. EUR, USD, and CHF.
- **Industrial production in Poland rose by 1.2% YoY in February vs. a 9.0% increase in January**. The main reason for the sharp decrease in output growth between January and February was an unfavourable difference in the number of working days. Especially noteworthy in the structure of the February industrial production is a relatively high, against the backdrop of other categories, production growth in branches with a significant share of exports in the sales of products, trade goods and materials. These data are in line with our scenario, in which the recovery in the global trade will boost demand for Polish exports and increase manufacturing activity in 2017 (see MACROpulse of 17/3/2017). The construction-and-assembly production dropped by 5.4% YoY in February vs. a 2.0% YoY increase in January. The decline in the annual production growth was due to the above-mentioned difference in the number of working days and unfavourable weather conditions in February. We expect the construction-and-assembly production growth to increase in subsequent months due to the forecasted by us higher absorption of EU funds, significant increase in public outlays on infrastructure in 2017, and recovery in residential construction. Data on industrial production and construction-and-assembly production between January and February 2017 support our forecast of GDP growth in Q1 2017 (2.8% YoY in vs. 2.7% in Q4).
- **Retail sales in Poland rose in current prices by 7.3% YoY in February vs. 11.4% in January**. The sales in constant prices amounted to 5.2% YoY in February vs. 9.6% in January. The slowdown of sales growth in February was wide ranging which shows that it was mainly caused by unfavourable calendar effects. Taking into account the improving situation in the labour market, the expected by us stabilization of inflation, and the calendar effects, we believe that sales dynamics in constant prices will run at ca. 7% in March. Data on retail sales between January and February 2017 signal a slight upside risk to our forecast of private consumption (3.6% YoY vs. 4.2% YoY in Q4).
- **CPI inflation in Poland rose to 2.2% YoY in February vs. 1.7% in January**. The increase in inflation was due to higher dynamics of prices in the categories "fuels", "food and non-alcoholic", as well as core inflation which rose to 0.3% YoY in February vs. 0.2% in January. GUS also published revised weights in CPI inflation basket, reflecting the structure of household expenditures in 2016. Especially noteworthy in the new structure of weights in the inflation basket is a higher share of the categories "recreation and culture" and "restaurants and hotels", namely goods with a relatively high income elasticity of demand. The increase in weights in these categories indicates that the continuing recovery in the labour market last year and the positive impact of the Family 500+ scheme on consumption were conducive to higher consumption of luxury goods (see MACROpulse of 13/3/2017). The data on inflation in February suggest that conducive to increase in inflation in subsequent months will mainly be higher dynamics of food prices. We forecast that in the whole 2017 inflation will stay below the MPC inflation target on a yearly average (2.5% - see above).
- **A current account surplus of EUR 2457M was recorded in Poland in January vs. a deficit of EUR 533M in December**. The improvement in the current account balance was due to higher balances on primary income, secondary income, goods, and services (higher from December by EUR 1919M, EUR 526M, and EUR 376M, and EUR 169M, respectively). The sharp increase in the

balance on primary income resulted from the inflow of EU funds under the Common Agricultural Policy. Export dynamics rose to 13.8% YoY in January vs. 6.7% in December, and imports dynamics rose to 16.0% YoY vs. 9.0%. Higher exports and imports growth rate was due to the statistical effect in the form of a favourable difference in the number of working days. The data pose an upside risk to our forecast, in which the relation of cumulative current account balance for the last 4 quarters to GDP will decrease to -0.9% in Q1 2017 vs. -0.5% in Q4 2016.

- **The meeting of the Swiss National Bank (SNB) was held last week.** As expected, the SNB left the target range for LIBOR CHF 3M unchanged at [-1.25%; -0.25%] and deposit rate at -0.75%. The press release presented a view that Swiss franc continued to be significantly overvalued and the SNB would continue to be active in the currency market if needed. The latest macroeconomic projection was presented and the inflation path was slightly revised upwards as compared to the December projection. In accordance with the March projection, inflation will run at 0.3% in 2017 (vs. 0.1% in the December projection), 0.4% in 2018 (0.5%), and 1.1% in 2019. The forecast of the Swiss GDP was also maintained and it will run at ca. 1.5% in 2017. Considering the forecasted by us path of EURPLN (see the quarterly table) and EURCHF, we expect that CHFPLN will amount to 3.80 as at the end of 2017.
- **ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany rose to 12.8 pts in March vs. 10.4 pts in February**. According to the press release, the improvement of sentiment in March was limited by the uncertainty related to both the economic situation in Germany and the approaching elections in the EU countries which have the biggest influence on the pace of the European integration (i.a. the presidential elections in France and the parliamentary elections in Germany). We forecast that the GDP growth rate in Germany will rise to 0.5% QoQ in Q1 2017 vs. 0.4% in Q4 2016.
- **Numerous data from China were released last week**. Data on industrial production (6.3% YoY in February vs. 6.0% in January), retail sales (9.5% vs. 10.9%), and urban investments (8.9% vs. 8.1%) pointed to a similar growth rate of activity in the Chinese economy as in the month before. We forecast that in the whole 2017 GDP growth in China will amount to 6.6% on a yearly average vs. 6.7% in 2016 (see MACROmap of 13/3/2017).

A dovish monetary tightening in the US

FOMC meeting was held last week. The target range for the Federal Reserve funds rate was increased by 25 bp to [0.75%; 1.00%], which was in line with our expectations and the market consensus. A vote against this decision was cast by N. Kashkar, the President of Minneapolis FED, who was in favour of keeping rates at an unchanged level. According to the press release, the hike is justified by the current and expected inflation and the perspectives of the situation in the labour market.

New macroeconomic projections of FOMC members were presented at a conference after the meeting and have not substantially changed compared to the December projection. The forecast of economic growth rate in 2018 has increased to 2.1% vs. 2.0% and of core inflation in 2017 has been revised upwards to 1.9% from 1.8%. At the same time FED decreased its estimate of natural unemployment rate to 4.7% vs. 4.8% in the December projection. Other macroeconomic projections have remained unchanged (see the table). The profile of the FOMC-members-expected interest rates of the federal funds rate has also remained largely unchanged. The median expectations concerning interest rates as at the end of 2017 amounts to 1.375%, 2.125% as at the end of 2018, 3.00% as at the end of 2019 (revised upwards from 2.875% in the December projection) and to 3.00% in the long term.

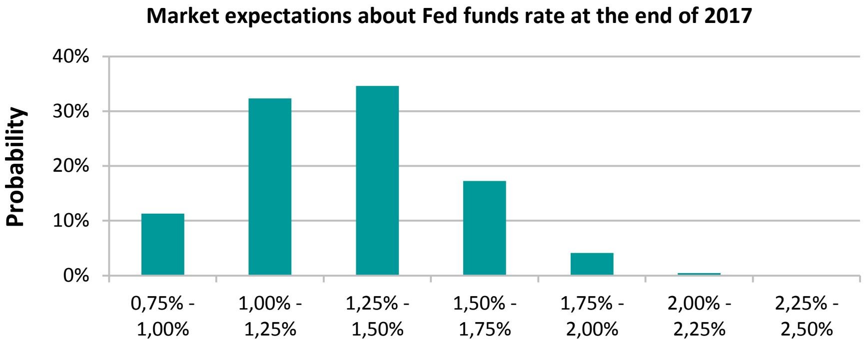
Despite the interest rates hike at the last week's meeting and the increase in the FOMC-members-expected level of interest rates in 2019, the bias of the conference after the meeting was interpreted by the markets as dovish – the EURUSD rate recorded an increase and yields on 10-year US bonds have dropped. Such market reaction resulted from changes in the FED press release, which included a reference to the symmetry of the Federal Reserve inflation target (2.0%). At the press conference, the FED Chair, J. Yellen, indicated that it was possible that inflation would deviate from the target, which should not be treated as the maximum inflation level acceptable by FED. This means that FOMC will be inclined to tolerate a temporary overshooting of the target, which will not force them to react by necessarily tightening the monetary policy soon. During the conference, the FED chair also emphasized that FED's assessment of the US economic outlook had not changed since the December meeting. In the context of fiscal policy, she indicated that she did not want to give a premature opinion on changes planned by the Trump administration and their impact on the prospects for the US monetary policy.

March Economic Projections of FRB Members & Reserve Bank Presidents

Indicator	2017	2018	2019	Longer Run
Target federal funds rate				
March Projection	1,375%	2,125%	3,00%	3,00%
December Projection	1,375%	2,125%	2,875%	3,00%
CA-CIB	[1,00 - 1,25%]	[2,00 - 2,25%]		2,75%
Change in real GDP				
March Projection	2,1%	2,1%	1,9%	1,8%
December Projection	2,1%	2,0%	1,9%	1,8%
CA-CIB	2,2%	2,5%		1,8%
Unemployment rate - Q4 Average				
March Projection	4,5%	4,5%	4,5%	4,7%
December Projection	4,5%	4,5%	4,5%	4,8%
CA-CIB	4,4%	4,1%		4,8%
Core PCE inflation				
March Projection	1,9%	2,0%	2,0%	
December Projection	1,8%	2,0%	2,0%	
CA-CIB	2,0%	2,1%		

Source: Federal Reserve Board and Crédit Agricole Corporate and Investment Bank.
Projections of change in real GDP and core PCE are from the fourth quarter of the previous year to the fourth quarter of the year indicated. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Projections for the target federal funds rate (range midpoint) are at the end of year. Figures present the median of individual forecasts of FOMC members.

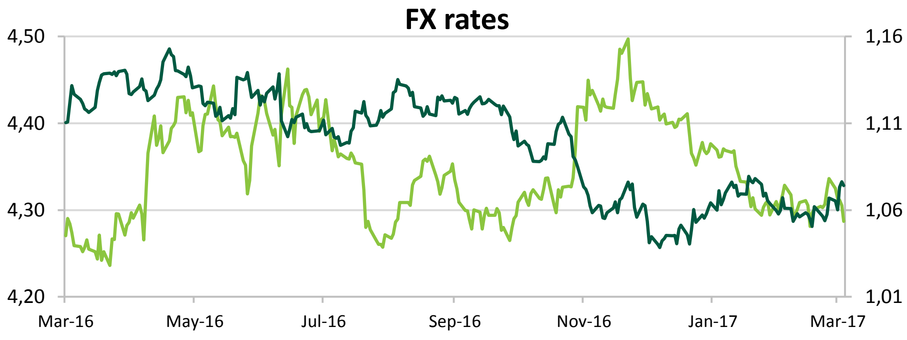
We believe that the expectations of economic agents (observed in business survey results) and FED members (presented in the March projection) concerning the positive impact of the policy of the Trump administration on economic growth in the medium term are not over optimistic. In our view, the House and the Senate will only support such proposals of reducing taxes or increasing outlays on infrastructure which will have a limited negative impact on the balance of the federal budget (the budget deficit amounted to 3.2% of GDP in 2016). Consequently, in the coming months, economic entities will revise downwards their expectations concerning the scale of the fiscal expansion which may contribute to lower assessment of business sentiment in the corporate sector and deterioration in the demand outlook. The high likelihood of the materialization of this scenario is an argument in favour of decreasing in subsequent projections the FOMC-members-expected scale of rate hikes in 2017.



Source: Bloomberg

Our base scenario assumes that until the end of 2017 FED will hike interest rates by 25 bp (in September). Our expectations concerning the future profile of FED interest rates are below the market expectations. The FRA market is currently pricing in the scale of interest rates hikes until the end of 2017 at ca. 43 bp. This means that, if our scenario assuming less hawkish FED bias in the monetary policy materializes, H2 2017 will see a decrease in the market-expected scale of interest rate hikes in the US, higher EURUSD rate, and PLN strengthening both against EUR and – at a larger scale – against USD, which is in line with our quarterly forecast of USDPLN (see the quarterly table).

PMIs for the Eurozone slightly positive for PLN

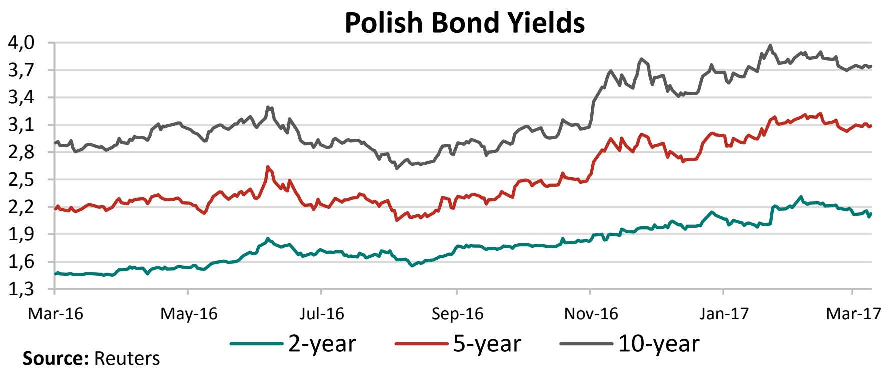


Source: Reuters

Last week EURPLN rate dropped to 4.2871 (PLN strengthening by 1.1%). Throughout last week, PLN and other emerging currencies (i.a. Hungarian forint, Russian ruble, and Turkish lira) were within an upward trend. Their strengthening was helped by less-hawkish-than-expected bias of the conference after the FOMC meeting (see above) as well as the preliminary results of the Dutch elections, pointing to a victory of the People's Party for Freedom and Democracy (see above). The publication of numerous domestic data (inflation, balance of payments, corporate wages and employment, industrial production, and retail sales) had a limited impact on PLN.

Crucial for PLN this week will be the release of business survey results for major European economies (PMI) scheduled for Friday. If our lower-from-the-market-consensus forecasts materialize, the data may be conducive to a slight appreciation of PLN. We expect that data from the US (existing home sales, new home sales, and preliminary durable goods orders) will be neutral for PLN.

Polish debt market focused on PMI readings



Source: Reuters

Last week the yield of Polish 2-year benchmark bonds have not changed compared to the level from two weeks ago and amounted to 2.124, of 5-year bonds dropped to a level of 3.086 (down by 1 bp), and of 10-year bonds dropped to a level of 3.741 (down by 1 bp). In the first part of the week, the prices of the Polish debt were stable across the curve. On Thursday, yields on Polish bonds at the centre and at the long end of the curve were lower than they closed on Wednesday, which resulted from a less hawkish than expected bias of the conference after the FOMC meeting. Conducive to higher prices of the Polish debt were also the results of the Dutch parliamentary elections pointing to a victory of the people's Party for Freedom and Democracy (see above). The publication of numerous domestic data (inflation, balance of payments, corporate wages and employment, industrial production, and retail sales) was neutral for the Polish debt market.

This week the Polish debt market will focus on the release of business survey results for major European economies (PMI) scheduled for Friday. We expect that PMIs will run slightly below the market expectations and thus may be conducive to a slight increase in prices of the Polish debt. The release of data from the US (existing home sales, new home sales, and preliminary durable goods orders) will likely have a limited impact on yields on Polish bonds.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	Feb-16	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17
NBP reference rate (%)	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50
EURPLN*	4,35	4,24	4,37	4,38	4,38	4,35	4,36	4,29	4,31	4,45	4,40	4,32	4,31	**4,35**
USDPLN*	4,00	3,73	3,81	3,94	3,94	3,90	3,91	3,82	3,92	4,20	4,18	4,00	4,07	**4,14**
CHFPLN*	4,00	3,87	3,97	3,96	4,04	4,02	3,97	3,93	3,96	4,13	4,11	4,04	4,05	**4,07**
CPI inflation (% YoY)	-0,8	-0,9	-1,1	-0,9	-0,8	-0,9	-0,8	-0,5	-0,2	0,0	0,8	1,7	2,2	
Core inflation (% YoY)	-0,1	-0,2	-0,4	-0,4	-0,2	-0,4	-0,4	-0,4	-0,2	-0,1	0,0	0,2	0,3	
Industrial production (% YoY)	6,8	0,7	5,9	3,2	6,0	-3,4	7,5	3,2	-1,3	3,2	2,2	9,0	1,2	
PPI inflation (% YoY)	-1,5	-1,9	-1,2	-0,4	-0,8	-0,5	-0,1	0,2	0,6	1,8	3,2	4,1	4,4	
Retail sales (% YoY)	3,9	0,8	3,2	2,2	4,6	2,0	5,6	4,8	3,7	6,6	6,4	11,4	7,3	
Corporate sector wages (% YoY)	3,9	3,3	4,6	4,1	5,3	4,8	4,7	3,9	3,6	4,0	2,7	4,3	4,0	
Employment (% YoY)	2,5	2,7	2,8	2,8	3,1	3,2	3,1	3,2	3,1	3,1	3,1	4,5	4,6	
Unemployment rate* (%)	10,2	9,9	9,4	9,1	8,7	8,5	8,4	8,3	8,2	8,2	8,3	8,6	**8,6**	
Current account (M EUR)	-652	-217	691	1392	-723	-993	-739	-445	-531	-188	-533	2457		
Exports (% YoY EUR)	5,4	0,0	4,0	1,4	6,0	-5,2	9,2	2,7	-2,3	4,7	6,7	13,8		
Imports (% YoY EUR)	7,4	0,9	0,0	2,5	0,8	-6,9	10,8	3,1	2,1	6,2	9,0	16,0		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland

	Indicator	2016				2017				2016	2017	2018
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
	Gross Domestic Product (% YoY)	3,0	3,1	2,5	2,7	2,8	2,5	3,3	4,1	2,8	3,3	3,2
	Private consumption (% YoY)	3,2	3,3	3,9	4,2	3,6	3,6	2,9	2,8	3,6	3,2	2,9
	Gross fixed capital formation (% YoY)	-2,2	-5,0	-7,7	-5,8	0,0	1,6	6,8	8,7	-5,5	5,3	10,0
	Export - constant prices (% YoY)	6,7	11,4	6,8	8,6	8,8	9,2	12,1	12,5	8,4	10,2	7,3
	Import - constant prices (% YoY)	8,7	10,0	7,8	8,5	8,9	10,7	13,0	13,1	8,7	11,2	9,0
GDP growth contributions	Private consumption (pp)	2,0	1,9	2,3	2,1	2,3	2,1	1,7	1,4	2,1	1,9	1,7
	Investments (pp)	-0,3	-0,9	-1,4	-1,6	0,0	0,3	1,2	2,2	-1,1	1,0	1,8
	Net exports (pp)	-0,7	1,0	-0,3	0,3	-0,3	-0,2	-0,1	0,2	0,1	-0,1	-0,6
	Current account***	-0,8	-0,5	-0,5	-0,5	-0,9	-1,0	-1,1	-1,0	-0,5	-1,0	-1,5
	Unemployment rate (%)**	9,9	8,7	8,3	8,3	8,3	7,2	7,1	7,7	8,3	7,7	7,7
	Non-agricultural employment (% YoY)	2,2	2,3	1,5	1,5	0,6	0,4	0,2	0,1	1,9	0,3	0,0
	Wages in national economy (% YoY)	3,1	4,3	4,1	3,7	4,1	4,4	4,6	4,8	3,8	4,5	4,8
	CPI Inflation (% YoY)*	-0,9	-0,9	-0,8	0,2	2,0	1,9	1,7	1,6	-0,6	1,8	1,5
	Wibor 3M (%)**	1,67	1,71	1,71	1,73	1,73	1,73	1,73	1,73	1,73	1,73	1,98
	NBP reference rate (%)**	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,75
	EURPLN**	4,24	4,38	4,29	4,40	4,35	4,33	4,23	4,18	4,40	4,18	4,07
	USDPLN**	3,73	3,94	3,82	4,18	4,14	4,16	4,03	3,87	4,18	3,87	3,51

* quarterly average
** end of period
***cumulative for the last 4 quarters

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
		Monday 03/20/2017				
11:00	Eurozone	Wages (% YoY)	Q4	1,6		
		Wednesday 03/22/2017				
10:00	Eurozone	Current account (bn EUR)	Jan	31,0		
15:00	USA	Existing home sales (M MoM)	Feb	5,69	5,56	5,54
		Thursday 03/23/2017				
10:00	**Poland**	**Registered unemplyment rate (%)**	**Feb**	**8,6**	**8,6**	**8,6**
13:30	USA	Initial jobless claims (k)	w/e	243		240
15:00	USA	New home sales (k)	Feb	555	567	566
16:00	Eurozone	Consumer Confidence Index (pts)	Feb	-4,9		-5,8
		Friday 03/24/2017				
9:30	Germany	Flash Manufacturing PMI (pts)	Mar	56,8	56,3	56,5
10:00	Eurozone	Flash Services PMI (pts)	Mar	55,5	55,0	55,3
10:00	Eurozone	Flash Manufacturing PMI (pts)	Mar	55,4	55,1	55,4
10:00	Eurozone	Flash Composite PMI (pts)	Mar	56,0	55,4	55,8
13:30	USA	Durable goods orders (% MoM)	Feb	2,0	2,1	1,2
15:45	USA	Flash Manufacturing PMI (pts)	Mar	54,2		54,5

*The forecasts of macroeconomic indicators for Poland were prepared by Credit Agricole Bank Polska S.A. The forecasts of foreign indicators were prepared by Crédit Agricole Corporate and Investment Bank
** Reuters

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