First interest rates hike in Poland is moving further away

This week

- **The most important event this week will be the FOMC meeting scheduled for Wednesday.** We expect that FED will hike the target range for the Federal Reserve funds rate by 25 bp up to [1.50%; 1.75%] this week. The March FOMC macroeconomic projection will be presented after the meeting. We believe that these projections will be of special importance due to the changes in the US tax policy. We expect that the forecasted economic growth rate and core inflation profile will be raised compared to the December projection. In turn, the unemployment rate profile will be revised downwards. We see a risk (with the probability of materialization slightly above 50%) that the interest rates path will be revised upwards in the March projection. The projection is likely to indicate that the scale of monetary tightening preferred by FED members is 100 bp in 2018 (vs. 75 bp in the December projection) and 75 bp (vs. 50 bp) in 2019. In our view the amount of interest rates expected by FED members in the long term will remain unchanged at 2.75%. The market is now pricing in three hikes of FED interest rates (75 bp in total) until the end of 2018. We believe that the publication of the FOMC projection pointing to a pace of monetary policy tightening that is faster from market expectations will be negative for PLN and prices of Polish bonds.
- **Another important event will be Poland's long term rating review by Moody's scheduled for Friday.** The last rating review by Moody's was planned for September 2017 but the agency did did not publish a credit report then. Thus, Poland's rating was left at an unchanged level (A2 with a stable outlook). In May 2017, the agency changed the rating outlook form negative to stable. Moody's justified the change of the rating outlook by reduced risk of excessively expansive fiscal policy, as indicated by the fiscal deficit in 2016 which stood below the Agency's expectations. In reasons for the decision, Moody's also pointed to lower uncertainty concerning unorthodox government policies which helps to improve the investment climate. We expect that the agency will not change the rating or its outlook this week. The main arguments in favour of such decision will be the good execution of the budget in 2017 and solid foundations of the Polish economy. The agency's decision will be released after the closing of the European markets, therefore the reaction of the foreign exchange and debt markets will materialize no sooner than next week.
- **The March business survey results for major European economies will be released on Tuesday.** We expect that PMI Composite for the Eurozone dropped to 56.5 pts in March vs. 57.1 pts in February. The index decreased among the deceleration of economic activity growth in France and deterioration of sentiment in Germany. ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany will be released on Tuesday. We expect that it will drop to 14.5 pts in March vs. 17.8 pts in February. Ifo Index, reflecting the sentiment among German managers representing the manufacturing, construction, wholesale and retail trade sectors, will be released on Thursday. We expect that it dropped to 114.6 pts in March vs. 115.4 pts in February. Our forecasts concerning business survey results for major European economies are close to the consensus; therefore their publication will be neutral for PLN and prices of Polish bonds.
- **Data from the US will be released this week.** We forecast that new home sales rose to 625k in February vs. 593k in January and existing home sales dropped to 5.36M vs. 5.38M. We expect that preliminary data on the February durable goods orders will point to their increase by 2.5% MoM vs. a 3.6% decrease in January. In our view, the data from the US should not be market moving.
- **Data on the February industrial production in Poland will be released on Monday.** The business sentiment indicator (PMI) pointed to a slight deterioration in manufacturing in March. Therefore, we forecast that industrial production growth slowed down to 8.3% YoY vs. 8.6% in January. The materialization of our forecast will be neutral for PLN and yields on Polish bonds.

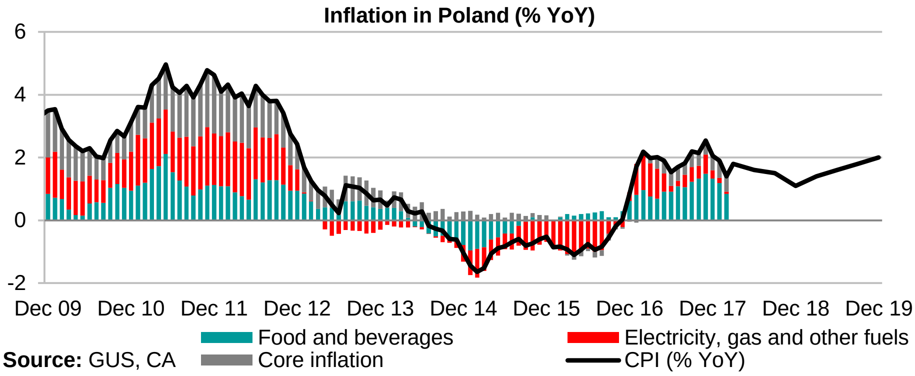
- **Data on retail sales in Poland will be released on Wednesday and in our view they rose by 8.0% YoY in February vs. 8.2% in January.** Conducive to their slower growth were the unfavourable weather conditions in February. In our view the data on sales will not be market moving.
- **We have revised our forecast of inflation and scenario of monetary policy in Poland.** We forecast that on a average in the whole 2018 inflation will stand at a level of 1.4% YoY (1.7% before the revision) and in 2019 will amount to 1.7% (previously 1.8%). The revision of the inflation forecast has also made us change the monetary policy scenario. We have shifted the forecast by us first interest rate hike to November 2019 (see below).

Last week

- **CPI inflation in Poland dropped to 1.4% YoY in February vs. 1.9% in January, running clearly below the market consensus (1.7%)**. Simultaneously, for the first time since December 2016, it stood below the lower bound of the inflation target tolerance band (2.5% +/- 1 pp.). Conducive to decrease in inflation were lower dynamics of food and non-alcoholic beverages prices and lower core inflation (0.8% YoY in February vs. 1.0% in January). The decrease in core inflation resulted from slower price growth in the categories "communication” and "recreation and culture”. Lower core inflation points to continuing lack of inflationary pressure in the Polish economy. GUS has also published revised weights in CPI inflation basket reflecting the structure of households' expenditures in 2017. Noteworthy in the new structure of weights in inflation basket is further increase in the share of expenditure on luxury goods (i.a. on restaurants and hotels), supported by further decrease in unemployment and very good households’ sentiment (see MACROpulse of 15/3/2018). The data on inflation made us revise our medium-term inflation profile and, consequently, the interest rates scenario (see below).
- **A surplus in current account of EUR 2005M was recorded in Poland in January vs. a deficit of EUR 1152M in December 2017.** At the same time, this has been the highest surplus since January 2017. The improvement in the current account balance was due to higher balances on primary income, trade, secondary income, and services (higher from December by EUR 1924M, EUR 1064M, EUR 125M, and EUR 44M, respectively). According to NBP statement, the balance on primary income increased largely due to higher inflow of EU funds within the framework of the Common Agricultural Policy. Export dynamics rose to 10.5% YoY in January vs. 2.1% in December, and imports dynamics rose to 15.4% YoY vs. 10.9%. Exports and imports growth increased due to the statistical effect in the form of a favourable difference in the number of working days. The last week’s data on the balance of payments do not alter our forecast, in which the relation of cumulative current account balance for the last 4 quarters to GDP will decrease to -0.1% in Q1 vs. 0.1% in Q4 2017.
- **Nominal wage dynamics in the Polish sector of enterprises dropped to 6.8% YoY in February from 7.3% in January.** Conducive to lower annual wage dynamics was the abatement of the January effect of the variable components of remuneration paid out mainly in manufacturing. The high base effects in the category "electricity, gas, steam and hot water supply” also had a negative impact on wage growth. The annual employment growth dropped to 3.7% YoY in February vs. 3.8% in January. Conducive to lower annual wage growth rate were the high base effects from the year before as well as very low, against historical background, temperatures which limited employment in construction companies (see MACROpulse of 16/3/2018). We estimate that the real wage growth rate amounted to 5.3% YoY in January-February period vs. 4.7% in Q4 2017. Combined with the expected by us acceleration in wage growth in March, it supports our forecast of higher private consumption growth in Q1 2018 (5.2% YoY vs. 4.9% in Q4 2017).

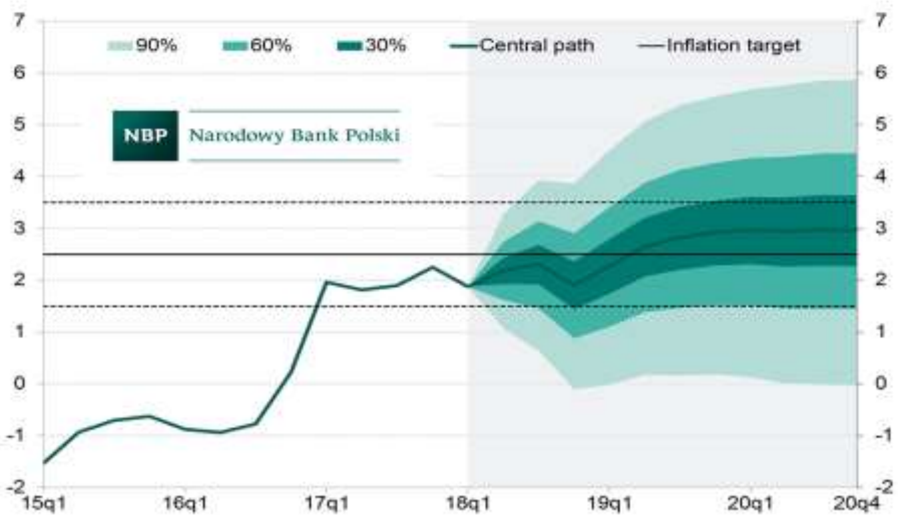
- **Significant data from the US economy were released last week.** CPI inflation dropped to 0.2% MoM in February vs. 0.5% in January (2.2% YoY in February vs. 2.1% in January). Its decrease resulted from lower growth rate of food and energy prices as well as lower core inflation which amounted to 0.2% MoM in February vs. 0.3% in January (1.8% YoY in January and February). The decrease in core inflation resulted i.a. from lower monthly growth rate of the prices of rental, health care, medication, education, and new vehicles. Despite a sharp decrease, the data were consistent with the investors' expectations and, consequently, had a limited impact on the financial market. Data on retail sales were also released last week and their nominal growth has not changed in February compared to January and amounted to -0.1% MoM**.** Excluding cars, nominal retail sales growth rose to 0.2% MoM in February vs. 0.1% in January, due to their higher growth i.a. in the categories "house and garden equipment" and "sports equipment". Data on industrial production were also released last week and increased by 1.1% MoM in February vs. a 0.3% decrease in January. The increase in monthly production growth resulted from its higher growth rate in mining and manufacturing, while its decrease in utilities had an opposite impact. Capacity utilization rose to 78.1% in February vs. 77.4% in January. A slight decrease in activity in the US real estate market was reflected by data on building permits (1298k in February vs. 1377k in January) and housing starts (1236k vs. 1329k). The results of business surveys were also released last week. The NY Empire State (up to 22.5 pts in March vs. 13.1 pts in February) and Philadelphia FED (down to 22.3 pts vs. 25.8 pts) indices brought mixed signals about the situation in manufacturing. On the other hand, the preliminary University of Michigan Index pointed to improvement in consumer sentiment, rising to 102.0 pts in March vs. 99.7 pts in February. Conducive to the index increase was its higher sub-index concerning the assessment of current situation, while lower sub-index concerning expectations had an opposite impact. The last week's data from the US economy do not alter our forecast, in which the annualized US GDP growth rate will drop to 2.2% in Q1 vs. 2.5% in Q4 2017.
- **Numerous data from China were released last week**. Higher growth rate of industrial production (7.2% YoY in February vs. 6.2% in January), retail sales (9.7% YoY in February vs. 9.4% in January), and urban investments (7.9% vs. 7.2%) point to continuing recovery in the Chinese economy. The last week's data support our forecast, in which the Chinese GDP will increase by 6.6% in 2018 vs. 6.8% in 2017. The growing protectionism in foreign trade on the part of the USA poses a downside risk to our forecast (see MACROmap of 5/3/2018).
- **The meeting of the Swiss National Bank (SNB) was held last week**. In accordance with the market expectations, the SNB has left the target range for LIBOR CHF 3M unchanged at [-1.25%; -0.25%] and the deposit rate at -0.75%. The provision in the statement saying that CHF continues to be high was left unchanged. In effect, it is necessary to maintain negative interest rates and be ready to intervene in the foreign exchange market if necessary. The latest SNB macroeconomic projection was presented at the conference after the meeting. The inflation path was revised downwards as compared to the December projection, mainly due to the CHF appreciation recorded in the last quarter. According to the March projection, inflation will amount to 0.5% in 2018 (vs. 0.7% in the December projection), 0.7% in 2018 (0.4%), 0.9% in 2019 (1.1%), and 1.9% in 2020. The projection also indicates that in Q3 2020 inflation will amount to 2.0%, slightly exceeding the SNB inflation target (below 2% a year). The SNB decision and the statement after the meeting are consistent with our EURCHF and EURPLN scenario, in which CHFPLN will amount to 3.45 as at the end of 2018.

First interest rates hike in Poland is moving further away



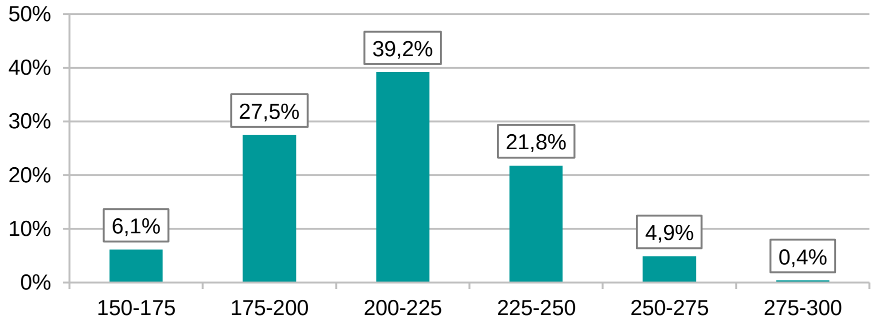
Source: GUS, CA

We have revised our forecast of inflation and scenario of monetary policy in Poland. The February inflation published last week ran significantly below our expectations (1.4% YoY vs. 1.9% in January, see MACROpulse of 15/3/2018). The most surprising were lower dynamics of the prices of food and non-alcoholic beverages (3.4% YoY in February vs. 4.8% in January) and lower core inflation (0.8% YoY vs. 1.0% in January). The lower starting point made us revise downwards the whole forecast path of inflation in 2018. We expect that in subsequent months conducive to decrease in inflation will be lower dynamics of the prices of food and non-alcoholic beverages which will stand slightly below zero in Q4. The forecast by us increase in core inflation, resulting from the growing cost pressure related to moderate acceleration in wage growth, will have an opposite impact. In addition, until July 2018, the increase in inflation will be supported by the low base effects from the year before in the category "fuels". Consequently, we believe that in H1 2018 CPI inflation will run at an average level of 1.6% YoY and will later decrease to 1.1% in Q4 2018. We forecast that the average yearly price dynamics in 2019 will amount to 1.7% vs. 1.4% in 2018.



The revision of the inflation forecast made us also change the scenario of the monetary policy. At the conference after the March Council meeting, the NBP Governor, A. Glapiński repeated the view presented in recent months that NBP interest rates should stay at the current level until the end of 2018 (a hike in 2018 is "unlikely"). The NBP Governor presented a surprising opinion that – if the scenario outlined in the March projection materializes – the NBP interest rates should remain at the current level until the end of 2020. However, it should be pointed out that our forecast of inflation is significantly below the path presented in the NBP projection (1.4% in 2018 vs. 2.1% according to NBP and 1.7% in 2019 vs. 2.7% in the projection). Consequently we have shifted the forecasted by us first interest rate hike from July to November 2019. This means that the first interest rate hike will take place slightly later after the expected by us first hike of the deposit rate in the Eurozone (September 2019).

Probability of FED funds rate range in December 2018 priced in by the market (bp.)

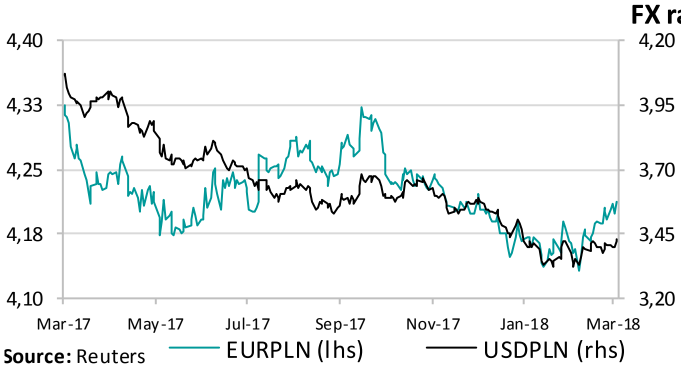


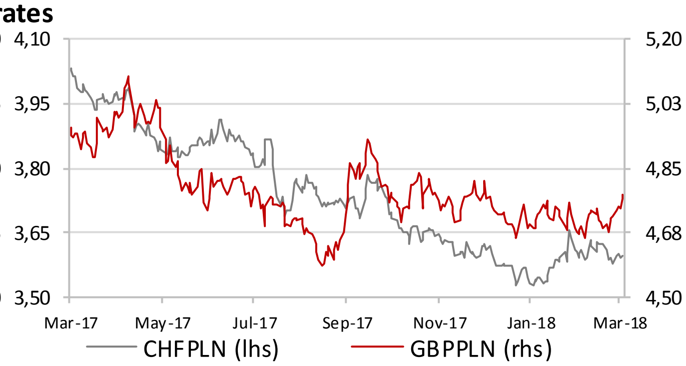
Source: Bloomberg (16/3/2018), Credit Agricole

The FRA market is currently pricing in the first interest rate hike in Poland at the turn of Q2 and Q3 2019. We believe that in the coming weeks the market expectations will be gradually converging to our scenario. This tendency will be conducive to PLN weakening vs. EUR. Another factor conducive to PLN weakening is the lower likelihood of further monetary easing by the ECB, signaled after the March ECB meeting (see MACROmap of 12/3/2018). The third factor conducive to PLN weakening in the short term may be changes in market expectations concerning the monetary policy in the US. The forward contracts market is now pricing in three hikes of FED interest rates (75 bp in total) until the end of 2018. Our base scenario also assumes 3 interest rate hikes in 2018 each by 25 bp (in March, in June, and in September). However, we assess the probability of FED signaling 4 hikes in 2018 in the March projection as slightly higher than 50%. If this risk materializes, the intensification of market expectations of a faster pace of the monetary policy tightening in the US will have a negative impact on PLN. The main uncertainty to our forecast of interest rates in the US is how FED members will evaluate the impact of the expansive fiscal policy of the Trump administration on the economic growth rate and inflation in the US. Considering the factors outlined above, we see an upside risk to our forecast of PLN rate (EURPLN at 4.10 as at the end of 2018).

FOMC meeting negative for PLN

FX rates





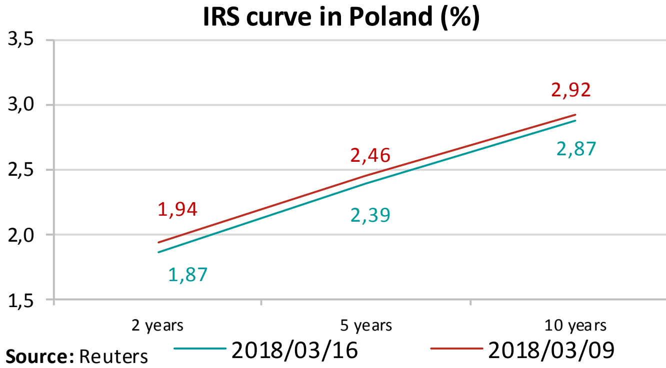
Source: Reuters

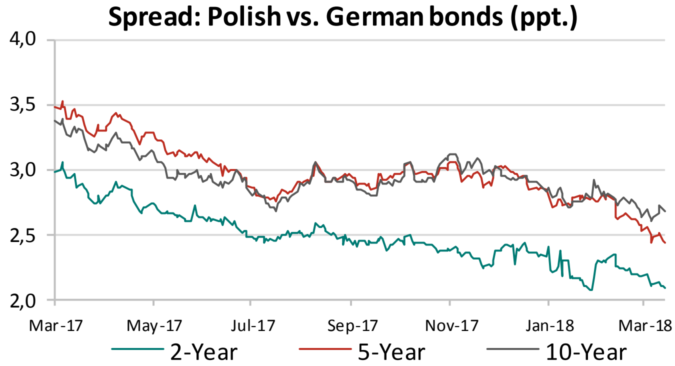
Last week EURPLN rate rose to 4.2132 (PLN weakening by 0.5%). Monday through Wednesday PLN was depreciating among an increase in global risk aversion reflected by higher VIX index. On Wednesday, PLN reached levels attractive for investors, which contributed to a correction. However, the clearly lower-than-expected data on domestic inflation released on Thursday resulted in EURPLN increasing again and staying around 4.21 until the end of the week. Better-than-expected data on the Polish balance of payments had a limited impact on the market. PLN was also depreciating against other major currencies last week: USD (by 0.6%), CHF (by 0.5%), and GBP (by 1.2%).

Crucial for PLN this week will be the FOMC meeting scheduled for Wednesday. Although the March hike of interest rates in the US has already been discounted by the market, we believe that the publication of the new FOMC economic projection will be negative for PLN. Data from the US (existing home sales, new home sales, preliminary durable goods orders) and business survey results for major European economies (flash PMIs as well as Ifo and ZEW indices for Germany) will have a limited impact on PLN. Domestic data on retail sales and industrial production will also be neutral for PLN. The

Friday’s update of Poland’s rating by Moody’s will be released after the closing of the European markets, therefore its impact on PLN will materialize no sooner than next week.

IRS rates decreased in reaction to domestic data on inflation





Source: Reuters

Last week the 2-year IRS rates dropped to a level of 1.868 (down by 7 bp), 5-year rates to a level of 2.385 (down by 7 bp), and 10-year rates to a level of 2.872 (down by 4 bp). Last week saw a sharp decrease in IRS rates across the curve in reaction to the lower-than-expected data on domestic inflation released on Thursday. A successful debt swap auction at which the Ministry of Finance redeemed PLN 5.24bn of 2-, 5-,6-, and 10-year bonds maturing this year, with demand amounting to PLN 7.9bn has also contributed to lower IRS rates.

This week the market will focus on the FOMC meeting scheduled for Wednesday. We believe that the March FOMC projection published at the conference after the meeting will have a hawkish bias. Thus it will be conducive to higher IRS rates. Data from the US (existing home sales, new home sales, preliminary durable goods orders) and business survey results for major European economies (flash PMIs as well as Ifo and ZEW indices for Germany) will be neutral for IRS rates, we believe. Domestic data on retail sales and industrial production will also have a limited impact on the market. The Friday’s update of Poland’s rating by Moody’s will be released after the closing of the European markets, therefore its impact on the Polish debt market will materialize no sooner than next week.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	Feb-17	Mar-17	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18
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*	4,31	4,23	4,23	4,18	4,23	4,25	4,25	4,31	4,24	4,20	4,18	4,15	4,17	**4,17**
USDPLN*	4,07	3,97	3,88	3,72	3,70	3,59	3,57	3,65	3,64	3,53	3,48	3,34	3,42	**3,42**
CHFPLN*	4,05	3,96	3,90	3,84	3,86	3,72	3,72	3,77	3,65	3,59	3,57	3,59	3,62	**3,56**
CPI inflation (% YoY)	2,2	2,0	2,0	1,9	1,5	1,7	1,8	2,2	2,1	2,5	2,1	1,9	1,4	
Core inflation (% YoY)	0,3	0,6	0,9	0,8	0,8	0,8	0,7	1,0	0,8	0,9	0,9	1,0	0,8	
Industrial production (% YoY)	1,2	11,0	-0,5	9,3	4,4	6,3	8,9	4,3	12,4	9,2	2,8	8,6	**8,3**	
PPI inflation (% YoY)	4,5	4,8	4,2	2,4	1,8	2,2	3,0	3,2	3,0	1,8	0,3	0,2	**0,4**	
Retail sales (% YoY)	7,3	9,7	8,1	8,4	6,0	7,1	7,6	8,6	8,0	10,2	6,0	8,2	**8,0**	
Corporate sector wages (% YoY)	4,0	5,2	4,1	5,4	6,0	4,9	6,6	6,0	7,4	6,5	7,3	7,3	6,8	
Employment (% YoY)	4,6	4,5	4,6	4,5	4,3	4,5	4,6	4,5	4,4	4,5	4,6	3,8	3,7	
Unemployment rate* (%)	8,4	8,0	7,6	7,3	7,0	7,0	7,0	6,8	6,6	6,5	6,6	6,9	**6,9**	
Current account (M EUR)	-514	-405	350	-264	-892	-203	189	120	297	272	-1152	-1152		
Exports (% YoY EUR)	6,4	19,7	3,2	19,2	7,2	13,3	11,5	10,0	15,5	14,9	2,1	2,1		
Imports (% YoY EUR)	10,5	19,8	4,6	21,7	14,5	13,2	7,8	7,5	14,8	15,7	10,9	10,9		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland

Indicator		2017				2018				2017	2018	2019
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Gross Domestic Product (% YoY)		4,1	4,0	4,9	5,1	4,7	4,3	4,2	3,9	4,6	4,3	3,0
Private consumption (% YoY)		4,7	4,9	4,8	4,9	5,2	4,2	4,1	4,3	4,8	4,4	3,6
Gross fixed capital formation (% YoY)		-0,5	0,9	3,3	11,3	9,2	9,5	7,6	4,7	5,2	7,1	3,1
Export - constant prices (% YoY)		9,6	3,1	7,6	6,8	7,5	6,5	6,6	6,0	6,7	6,6	5,0
Import - constant prices (% YoY)		9,7	6,0	5,7	9,2	8,1	7,8	7,5	7,0	7,7	7,6	6,0
GDP growth contributions	Private consumption (pp)	2,9	2,9	2,9	2,5	3,4	2,5	2,4	2,1	2,8	2,6	2,1
	Investments (pp)	0,0	0,1	0,6	2,8	1,1	1,5	1,3	1,2	1,0	1,3	0,6
	Net exports (pp)	0,4	-1,3	1,1	-0,8	0,0	-0,4	-0,2	-0,3	-0,2	-0,2	-0,3
Current account***		0,1	-0,4	0,2	0,1	-0,1	-0,1	-0,4	-0,4	0,1	-0,4	-0,6
Unemployment rate (%)**		8,0	7,0	6,8	6,6	6,6	6,0	6,2	6,5	6,6	6,5	6,5
Non-agricultural employment (% YoY)		2,1	2,4	1,8	1,3	1,2	0,7	0,4	0,3	1,9	0,6	0,2
Wages in national economy (% YoY)		4,1	5,0	4,9	7,1	6,8	6,1	6,4	6,8	5,3	6,5	6,5
CPI Inflation (% YoY)*		2,0	1,8	1,9	2,3	1,6	1,6	1,5	1,1	2,0	1,4	1,7
Wibor 3M (%)**		1,73	1,73	1,73	1,72	1,72	1,72	1,72	1,72	1,72	1,72	1,97
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**		4,23	4,23	4,31	4,18	4,17	4,14	4,12	4,10	4,18	4,10	4,15
USDPLN**		3,97	3,70	3,65	3,48	3,42	3,37	3,30	3,25	3,48	3,25	3,19

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST* CA	FORECAST* CONSENSUS**
		Monday 03/19/2018				
10:00	**Poland**	**PPI (% YoY)**	**Feb**	**0,2**	**0,4**	**0,2**
10:00	**Poland**	**Industrial production (% YoY)**	**Feb**	**8,6**	**8,3**	**8,1**
		Tuesday 03/20/2018				
11:00	Germany	ZEW Economic Sentiment (pts)	Mar	17,8	14,5	13,0
16:00	Eurozone	Consumer Confidence Index (pts)	Mar	0,1	0,1	0,0
		Wednesday 03/21/2018				
10:00	**Poland**	**Retail sales (% YoY)**	**Feb**	**8,2**	**8,0**	**8,0**
15:00	USA	Existing home sales (M MoM)	Feb	5,38	5,36	5,40
19:00	USA	FOMC meeting (%)	Mar	0,25	1,75	0,25
		Thursday 03/22/2018				
9:00	Eurozone	Current account (bn EUR)	Jan	29,9		
9:30	Germany	Flash Manufacturing PMI (pts)	Mar	60,6	59,3	59,8
10:00	Eurozone	Flash Services PMI (pts)	Mar	56,2	55,7	56,0
10:00	Eurozone	Flash Manufacturing PMI (pts)	Mar	58,6	57,6	58,1
10:00	Eurozone	Flash Composite PMI (pts)	Mar	57,1	56,5	56,8
10:00	Germany	Ifo busienss climate (pts)	Mar	115,4	114,6	114,7
13:00	UK	BOE rate decision (%)	Mar	0,50	0,50	0,50
14:00	**Poland**	**M3 money supply (% YoY)**	**Feb**	**4,8**	**5,0**	**5,0**
14:45	USA	Flash Manufacturing PMI (pts)	Mar	55,3		55,5
		Friday 03/23/2018				
10:00	**Poland**	**Registered unemplyment rate (%)**	**Feb**	**6,9**	**6,9**	**6,8**
13:30	USA	Durable goods orders (% MoM)	Feb	0,0	2,5	1,6
15:00	USA	New home sales (k)	Feb	593	625	620

*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

MACRO MAP

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