Brexit will not disrupt Polish exports

This week

- **The most important event this week will be the publication of the June results of business surveys for major European economies scheduled for Friday.** We expect that PMI Composite for the Eurozone dropped to 56.6 pts in June vs. 56.8 pts in May. The index decrease occurred due to slight deterioration of sentiment in both Germany and France. Our forecasts of business survey results for Eurozone are running close to the consensus, thus their materialization will be neutral for PLN and yields on Polish bonds, we believe.
- **The data on the May industrial production and retail sales in Poland will be released on Tuesday.** We forecast that industrial production dynamics rose to 8.9% YoY in May vs. -0.6% in April. In turn, nominal retail sales growth rate in May did not change compared to April and amounted to 8.1% YoY. The growth of retail sales dynamics was limited by the abatement of favourable effect of Easter. Conducive to higher growth rate of industrial production was the statistical effect of a favourable difference in the number of working days. The publication of lower than expected Polish manufacturing PMI in May (see MACROmap of 1/6/2017) poses a downside risk to our forecast of industrial production. We believe that if our forecasts materialize, the aggregate impact of the data will be neutral for PLN and yields on Polish bonds.
- **The May data on average wages and employment in the corporate sector in Poland will be released today.** We forecast that employment dynamics did not change in May, compared to April and amounted to 4.6% YoY. In turn, the average wage dynamics rose to 4.7% YoY in May vs. 4.1% YoY in April, supported by the statistical effect of a favourable difference in the number of working days and sustained improvement of situation in the labour market. Though important for the forecast of private consumption dynamics in Q2, the release of data on corporate wages and employment will be neutral for PLN and the debt market, we believe.
- **Data on the US real estate market will be published this week.** We forecast that existing home sales decreased to 5.53M in May vs. 5.57M in April and new home sales increased to 575k in May vs. 569k in April, thus pointing to stabilization in activity in the US real estate market. In our view, the publication of the data will be neutral for financial markets.

Last week

- **FOMC meeting was held last week.** The target range for Federal Reserve funds rate was increased by 25 bp to [1.00%; 1.25%], which was in line with our expectations and the market consensus. According to the press release, the interest rates 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. Compared to the March projections, the forecast of economic growth rate in 2017 has been increased to 2.2% vs. 2.1%, while in 2018, 2019 and in the long term it remained unchanged (2.1%, 1.9% and 1.8%, respectively). The forecast of inflation in 2017 has been revised downwards to 1.6% from 1.9%, while in 2018, 2019 and in the long term will stabilize at the level of 2.0% (unchanged compared to the March projection). According to June projection, the unemployment rate as at the end of 2017 will amount to 4.3% vs 4.5% in the March projection and 4.2% as at the end of 2018 (4.5%) and 2019 (4.5%). Fed has lowered its estimate of natural unemployment rate from 4.7% to 4.6%. The profile of the interest rates of the federal funds rate (as expected by the FOMC members) has remained close to the level of the March projection. Currently, the median expectations concerning interest rates amounts to 1.4% as at the end of 2017 (1.4%), 2.1% as at the end of 2018 (2.1%), 2.9% as at the end of 2019 (3.0%) and 3.0% in the long term (3.0%). A document concerning FED's future asset management policy has also been published (Addendum to the Policy Normalization Principles and Plans). According to this document, FOMC members currently expect to begin implementing balance sheet normalization program this year, provided that the economy evolves broadly as anticipated. This program would gradually reduce the Federal Reserve's securities holdings by decreasing reinvestment of principal payments from those securities. For payments of principal that the Federal Reserve receives from maturing Treasury securities, the Committee anticipates that the cap will be USD 6bn per month initially and will increase in steps of USD 6bn at three-month intervals over 12 months until it reaches USD 30bn per month. In case of MBS (mortgage-backed-securities) the scheme is similar, but the aforementioned amounts equal to USD 4bn, USD 4bn and USD 30bn, respectively. The Committee also anticipates that the caps will remain in place once they reach their respective maximums so that the Federal Reserve's securities holdings will continue to decline in a gradual and predictable manner until the Committee judges that the Federal Reserve is holding no more securities than necessary to implement monetary policy efficiently and effectively. In our baseline scenario, we look for the FOMC to begin its balance sheet reduction program this fall, likely in September. In our view, FED would likely avoid hiking rates at the same time it launches its balance sheet reduction plan in order to assess the market impact. In effect, we expect that the next interest rates hike in US by 25bp to [1.25%; 1.50%] will be in December 2017. The scale of expected by us monetary policy normalization in US runs in line with the median of the FOMC-members-expected interest rates as at the end of 2017.

- **Numerous data from the US economy and business survey results were released last week.** Industrial production dynamics decreased to 0.0% MoM in May vs. 1.1% in April. Conducive to its decline was lower production growth in manufacturing and utilities, while its higher dynamics in mining had an opposite impact. Capacity utilization decreased to 76.6% in May vs. 76.7% in April. Data on the retail sales, which declined in May by 0.3% MoM vs. increase by 0.4% in April, was also released last week. The decrease in monthly retail sales dynamics occurred mostly due to lower growth rate of sales in most of its categories. Retail sales decreased by 0.3% in May vs. increase by 0.4% in April, excluding car sales. Last week, the data on housing starts (1092k in May vs. 1156k in April) and building permits (1168k vs. 1228k) was also released and indicated a slowdown of activity in US real estate market. The regional business survey results for US manufacturing, which indicated high level of activity, was also released last week. NY Empire State Index increased by 19.8 pts in June vs. -1.0 pts in May, while Philadelphia FED index decreased to 27.6 pts vs. 38.8 pts. The preliminary University of Michigan index was also released this week and decreased to 94.5 pts in June vs. 97.1 pts in May, indicating a deterioration of consumer sentiment in the US. Conducive to the index decline were lower sub-indices for expectations and the assessment of current situation. The last week's data from the US do not alter our forecast, in which the annualized GDP growth rate in the US will rise to 3.5% in Q2 vs. 1.2% in Q1.
- **CPI inflation in Poland decreased to 1.9% YoY in May vs. 2.0% in April.** Conducive to decrease in inflation were lower growth rate of fuel prices and core inflation, which declined to 0.8% YoY in May vs. 0.9% in April. Higher dynamics of food prices had an opposite impact. The data support our forecast, according to which the average inflation in Poland in H2 2017 will run at the level of ca. 1.9% - 2.0% YoY.
- **A current account deficit in Poland decreased to EUR 275M in April vs. a deficit of EUR 738M in March.** The improvement in the current account balance occurred due to higher balances on goods, services and secondary income (higher from March by EUR 304M, EUR 251M and EUR 3M, respectively), while the balance on primary income had an opposite impact (lower from March by EUR 95M). Exports dynamics decreased to 0.6% YoY in April vs. 14.9% in March, and imports dynamics dropped to 3.4% YoY vs. 18.9%. The lower growth rates of imports and exports were due to the statistical effect in the form of an unfavourable difference in the number of working days. We forecast, that the relation of cumulative current account balance

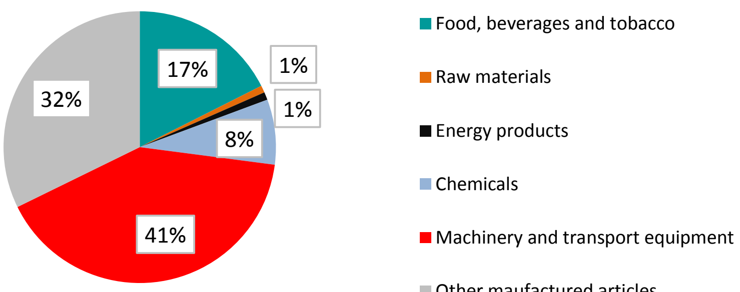
for the last 4 quarters to GDP will decrease to -0.1% in Q2 vs 0.0% in Q1.

- **Numerous data from Chinese economy were released last week.** Dynamics of industrial production and retail sales did not changed in May compared to April and amounted to 6.5% YoY and 10.7% YoY, respectively, while growth rate of urban investments decreased to 8.6% YoY in May vs. 8.9% in April. The sustained high rate of economic activity in China supports our scenario of recovery in global trade.
- **ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany decreased to 18.6 pts in June vs. 20.6 pts in May.** According to the press release, a slight deterioration of sentiment occurred despite optimistic expectations regarding future economic situation. We forecast that the quarterly growth rate of the German GDP will not change in Q2 compared to Q1 and will amount to 0.6%.
- **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 of SNB was also presented. The inflation path was slightly revised downwards as compared to the March projection. In accordance with the June projection, inflation will run at 0.3% in 2017 (vs. 0.3% in the March projection), 0.3% in 2018 (0.4%) and 1.0% in 2019 (1.1%). The forecast of the Swiss that it will run at ca. 1.5% in 2017 GDP was maintained. The SNB decision is in line with our scenario for EURCHF and EURPLN, in which CHFPLN will amount to 3.75 as at the end of 2017 (see the quarterly table).

Brexit will not disrupt Polish exports

Our baseline scenario assumes that after Brexit and before a possible free trade agreement is signed between the UK and the EU countries, their trade relations will be defined by the rules resulting from the membership of the UK and of other EU countries in the WTO (see MACROmap of 15/5/2017). The analysis below focuses on the impact of the materialization of our scenario on the dynamics of Polish exports to the United Kingdom.

The commodity structure of Polish exports to the UK in 2016



Source: Eurostat, Credit Agricole

According to our baseline scenario, presented in detail in the MACROmap of 15/5/2017, the UK customs duties on Polish exports will be equal to the tariff rates currently applied by the EU to third countries. The amount of future average customs duties charged ad valorem (according to the value) in the respective categories of foreign trade was presented in detail in MACROmap of 22/5/2017. Considering the commodity structure of Polish exports to the UK, we estimate that the average amount of customs duties imposed on the Polish exports to this country will amount to 4.55%.

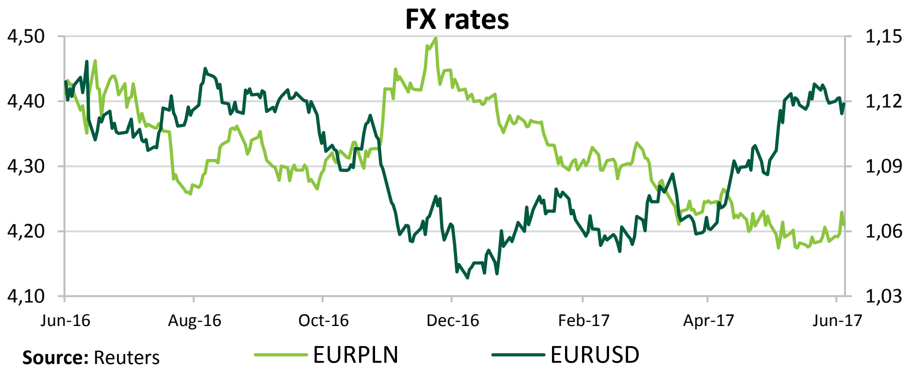
In order to estimate the impact of the customs duties to be imposed on Polish exports to the UK, at the first stage of our study, we created an econometric model which takes the Polish exports to the UK (adjusted with the Polish exports deflator) as a dependent variable. The array of economic independent variables in our model includes:

- **The annual dynamics of real PLNGBP rate lagged by two quarters**. A 1% increase in PLNGBP annual dynamics, ceteris paribus, leads after two quarters to a reduction of real dynamics of Polish exports to the UK by 0.29 pp. This variable is a proxy of changes in the price competitiveness of Polish exports to the UK, while the lag reflects a gradual process of prices adjusting to the changes in foreign exchange rates.
- **Change in the UK manufacturing PMI in annual terms** – a one-point increase in the UK manufacturing PMI in annual terms, ceteris paribus, leads to an increase in the real dynamics of Polish exports to the UK by 0.41 pp. This variable reflects economic fluctuations in the UK manufacturing, thus representing changes in demand on Polish exports.

Our analysis focuses only on separated impact of customs duties on Polish exports and disregards other potential Brexit-related effects, such as slowdown of economic growth in the United Kingdom, weaker GBP, higher transactional costs, return migration of Poles, or reorientation of Polish exports to other markets. The initial stage of the United Kingdom's negotiations with the European Union makes it impossible to make any reliable assumptions regarding these elements.

We assume that the imposition of customs duties on Polish exports to the UK will have a similar effect as the strengthening of PLN against GBP of a similar scale. Therefore, at the next stage of our study, using the econometric model described earlier, we assumed PLN appreciation vs. GBP equal to the estimated by us average amount of the customs duties that will be imposed on Polish exports to the UK according to our baseline scenario. With other conditions unchanged, we expect that the imposition of customs duties would lead to a decrease in the annual dynamics of Polish exports to this country by ca. 1.3 pp in the first year after their introduction. Thus, considering the percentage of the United Kingdom in the geographic structure of Polish exports, this impact on the dynamics of total Polish exports would be limited and would amount to under -0.1 pp. Consequently, it will have a negligible impact on the growth rate of the Polish GDP.

Business survey results in the Eurozone crucial for PLN

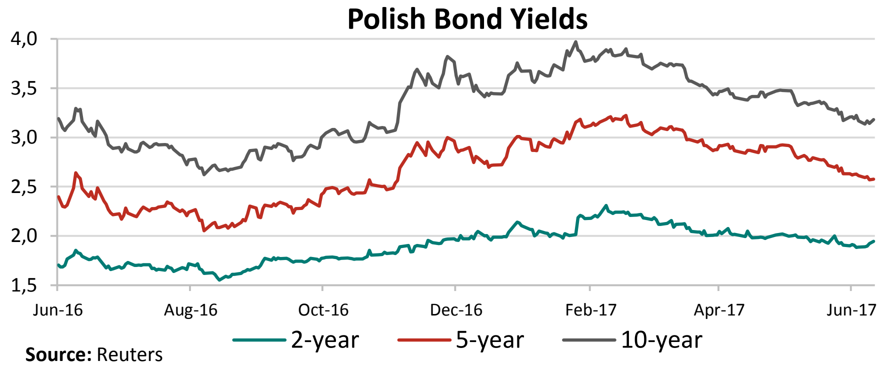


Source: Reuters

Last week EURPLN rate rose to 4.2100 (PLN weakening by 0.6%). In the first part of the week PLN was slightly depreciating in anticipation of, scheduled for Wednesday, FED decision concerning interest rates in US. On Wednesday, because of FOMC meeting, the volatility of Polish currency was higher. Despite the decision about interest rate hike running in line with market consensus, PLN and others emerging markets currencies have been significantly depreciating on Thursday, since the morning. Conducive to PLN weakening was also lower liquidity in the absence of Polish investors due to holiday in Poland. As a result, PLN closed on Thursday weaker by 0.8% against EUR than it closed on Wednesday. On Friday, there was a correction with a slight strengthening of PLN.

Crucial for PLN this week will be scheduled for Friday publication of business survey results for the Eurozone (PMI). If our close-to-market-consensus forecasts materialize, the data will be neutral for PLN. The numerous domestic data (industrial production, retail sales and corporate employment and average wages) will also have a limited impact on PLN. We believe that data on the US real estate market (existing home sales and new home sales) will also be neutral for Polish currency.

Polish data neutral for the debt market



Source: Reuters

Last week the yield of Polish 2-year benchmark bonds increased to a level of 1.946 (up by 1 bp), of 5-year bonds decreased to a level of 2.577 (down by 4 bp), and of 10-year bonds increased to a level of 3.18 (up by 1 bp). The prices of Polish debt were stable on Monday and Tuesday. Following German and US bonds, there was a drop of yields on Polish bonds on Wednesday, visible in the middle and at the long end of the curve, as some investors expected that new macroeconomic projection of FED would indicate slower pace of US monetary policy normalization. On Thursday, the trading in the Polish debt market was suspended due to holiday. The correction and slight drop in prices of Polish debt was observed on Friday.

This week the Polish debt market will focus on the release of the business survey results for Eurozone, scheduled for Friday. If our close-to-market-consensus forecasts materialize, the data impact on the prices of Polish bonds will be limited. Neutral for Polish debt market will also be, in our view, the domestic data (industrial production, retail sales and commercial employment and average wages), as well as data on the US real estate market (existing home sales and new home sales).

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland														
Indicator	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-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*	4,38	4,38	4,35	4,36	4,29	4,31	4,45	4,40	4,32	4,31	4,23	4,23	4,18	**4,20**
USDPLN*	3,94	3,94	3,90	3,91	3,82	3,92	4,20	4,18	4,00	4,07	3,97	3,88	3,72	**3,75**
CHFPLN*	3,96	4,04	4,02	3,97	3,93	3,96	4,13	4,11	4,04	4,05	3,96	3,90	3,84	**3,89**
CPI inflation (% YoY)	-0,9	-0,8	-0,9	-0,8	-0,5	-0,2	0,0	0,8	1,7	2,2	2,0	2,0	1,9	
Core inflation (% YoY)	-0,4	-0,2	-0,4	-0,4	-0,4	-0,2	-0,1	0,0	0,2	0,3	0,6	0,9	0,8	
Industrial production (% YoY)	3,2	6,0	-3,4	7,5	3,2	-1,3	3,2	2,2	9,1	1,1	11,0	-0,6	**8,9**	
PPI inflation (% YoY)	-0,4	-0,8	-0,5	-0,1	0,2	0,6	1,8	3,2	4,0	4,5	4,8	4,3	**3,4**	
Retail sales (% YoY)	2,2	4,6	2,0	5,6	4,8	3,7	6,6	6,4	11,4	7,3	9,7	8,1	**8,1**	
Corporate sector wages (% YoY)	4,1	5,3	4,8	4,7	3,9	3,6	4,0	2,7	4,3	4,0	5,2	4,1	**4,7**	
Employment (% YoY)	2,8	3,1	3,2	3,1	3,2	3,1	3,1	3,1	4,5	4,6	4,5	4,6	**4,6**	
Unemployment rate* (%)	9,1	8,7	8,5	8,4	8,3	8,2	8,2	8,3	8,6	8,5	8,1	7,7	**7,3**	
Current account (M EUR)	1392	-723	-503	-729	-858	-179	-128	-56	2576	-825	-738	-275		
Exports (% YoY EUR)	1,4	6,0	-5,3	9,3	3,1	-0,5	5,8	5,2	13,9	4,9	14,9	0,6		
Imports (% YoY EUR)	2,5	0,8	-7,3	10,7	3,5	3,6	6,3	7,1	16,1	9,9	18,9	3,4		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland											
Indicator	2017				2018				2016	2017	2018
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Gross Domestic Product (% YoY)	4,0	3,9	4,1	4,1	3,4	3,8	3,6	3,9	2,7	4,0	3,7
Private consumption (% YoY)	4,7	4,2	3,2	3,1	3,3	3,3	3,0	3,2	3,8	3,8	3,2
Gross fixed capital formation (% YoY)	-0,4	3,9	6,1	8,2	8,8	6,8	5,2	4,1	-7,9	5,4	5,7
Export - constant prices (% YoY)	8,3	8,5	9,6	10,1	8,1	7,2	8,8	8,9	9,0	9,1	8,3
Import - constant prices (% YoY)	8,7	9,4	10,6	11,7	10,1	9,1	8,1	7,9	8,9	10,1	8,8
GDP growth contributions: Private consumption (pp)	3,0	2,5	1,9	1,5	2,1	2,0	1,8	1,6	2,3	2,2	1,8
GDP growth contributions: Investments (pp)	0,0	0,6	1,1	2,0	1,0	1,1	0,9	1,0	-1,6	1,0	1,0
GDP growth contributions: Net exports (pp)	0,1	0,0	-0,2	-0,4	-0,7	-0,6	0,6	0,7	0,3	-0,2	0,0
Current account***	0,0	-0,1	-0,1	-0,5	-1,1	-1,3	-1,2	-1,0	-0,3	-0,5	-1,0
Unemployment rate (%)**	8,1	7,1	7,0	7,3	7,6	6,8	7,0	7,3	8,3	7,3	7,3
Non-agricultural employment (% YoY)	2,1	1,5	1,3	0,6	0,2	0,0	0,0	0,0	1,9	1,4	0,0
Wages in national economy (% YoY)	4,1	4,4	4,9	4,6	4,9	5,2	5,4	5,5	3,8	4,5	5,2
CPI Inflation (% YoY)*	2,0	2,0	2,0	1,9	1,3	1,6	1,3	1,3	-0,6	2,0	1,4
Wibor 3M (%)**	1,73	1,73	1,73	1,73	1,73	1,73	1,90	1,98	1,73	1,73	1,98
NBP reference rate (%)**	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,75	1,50	1,50	1,75
EURPLN**	4,23	4,20	4,18	4,16	4,15	4,12	4,10	4,07	4,40	4,16	4,07
USDPLN**	3,97	3,75	3,80	3,71	3,71	3,61	3,50	3,45	4,18	3,71	3,45

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST* CA	FORECAST* CONSENSUS**
		Monday 06/19/2017				
14:00	**Poland**	**Employment (% YoY)**	**May**	**4,6**	**4,6**	**4,6**
14:00	**Poland**	**Corporate sector wages (% YoY)**	**May**	**4,1**	**4,7**	**4,9**
		Tuesday 06/20/2017				
10:00	Eurozone	Current account (bn EUR)	Apr	34,1		
14:00	**Poland**	**Retail sales (% YoY)**	**May**	**8,1**	**8,1**	**9,1**
14:00	**Poland**	**PPI (% YoY)**	**May**	**4,3**	**3,4**	**2,9**
14:00	**Poland**	**Industrial production (% YoY)**	**May**	**-0,6**	**8,9**	**8,6**
		Wednesday 06/21/2017				
16:00	USA	Existing home sales (M MoM)	May	5,57	5,53	5,55
		Thursday 06/22/2017				
14:00	**Poland**	**MPC Minutes**	**Jun**			
16:00	Eurozone	Consumer Confidence Index (pts)	Jun	-3,3	-2,8	-3,0
		Friday 06/23/2017				
9:30	Germany	Flash Manufacturing PMI (pts)	Jun	59,5	58,5	59,0
10:00	Eurozone	Flash Services PMI (pts)	Jun	56,3	56,3	56,2
10:00	Eurozone	Flash Manufacturing PMI (pts)	Jun	57,0	56,3	56,8
10:00	Eurozone	Flash Composite PMI (pts)	Jun	56,8	56,6	56,7
15:45	USA	Flash Manufacturing PMI (pts)	Jun	52,7		53,0
16:00	USA	New home sales (k)	May	569	575	600

*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

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