Fitch's rating will not change for an extended period of time

This week

- **On Wednesday and Thursday, FED chair, J. Yellen, will present the semiannual monetary policy report to the Congress.** J. Yellen will present the Federal Reserve assessment of the US and global economic situation and the outlook for FED monetary policy. Particularly interesting in J. Yellen's testimony will be her answers to questions about the likely date of the next interest rate hike, FED balance sheet reduction plans, and the expected pace of monetary policy tightening by the Federal Reserve. Her remarks may contribute to increased volatility in the financial markets.
- **Significant data from the US will be released this week.** We forecast that industrial production increased by 0.4% MoM in June vs. no changes in May, which will be in line with business survey results. We also forecast that nominal retail sales increased by 0.1% MoM in June from -0.3% in May, due to higher sales dynamics in the automotive branch. The preliminary University of Michigan Index will be released on Friday. We forecast that its value dropped to 94.7 pts in July vs. 95.7 pts in June. We believe that the aggregate impact of data from the US economy on the financial markets will be limited.
- **Data on the Chinese balance of trade will be released on Thursday**. We expect that its balance rose to USD 42.1bn in June vs. USD 40.8bn in May. At the same time, we believe that export growth recorded an increase in June up to 11.4% YoY vs. 8.7% in May, while import growth rose to 20.0% from 14.8%. The publication of data from China will be neutral for the markets, we believe.
- **Data on the Polish balance of payments in May will be released on Friday**. We expect that the current account deficit increased to EUR 638M vs. EUR 275M in May, mainly due to lower trade balance. We forecast that export dynamics rose to 11.0% YoY in May vs. 0.6% in April, while import growth rate rose to 15.8% YoY vs. 3.4% Conducive to the increase in import and export growth rate was the effect of a favourable difference in the number of working days. Our balance of payments forecast is significantly below the market consensus (EUR 335M), therefore its materialization will be slightly negative for PLN.
- **Final data on the June inflation in Poland will be released tomorrow.** We expect that the rate of inflation has not changed compared to the flash estimate and thus has decreased compared to May (1.5% YoY vs. 1.9%). We believe that conducive to the decrease in inflation rate was lower dynamics of fuel prices. The publication of the inflation reading will be neutral for PLN and prices of Polish bonds.

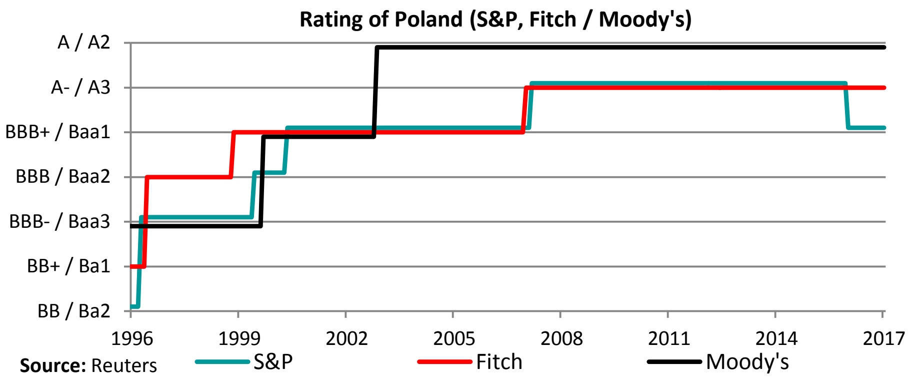
Last week

- **The Minutes of the June FOMC were released last week.** According to Minutes, FOMC members agree on the necessity of starting the process of FED balance sheet reduction. At the same time they differ as to the assessment of inflation outlook. Most FOMC members believe that the decrease in inflation recorded in recent months is temporary and that in the medium term it will run close to the FED target (2.0%). However, some FOMC members fear that the recent inflation decrease is permanent which reduces the probability of attaining the inflation target in the medium term. The text of the Minutes supports our forecast in which FED will start reducing its balance sheet in September 2017 and will hike interest rates by 25 bp in December 2017.
- **Numerous data from the US economy and business survey results were released last week.** Non-farm payrolls in the US rose by 222k in June vs. 157k in May (revised upwards from 138k). The highest increase in employment was recorded in education and health service (+45.0k), leisure and hospitality (+36k), business services (+35.0k), and the government sector (+35.0k). Employment decreased only in information services (-4.0k). Unemployment rate rose to 4.4% in

June vs.4.3% in May, staying below the natural unemployment rate indicated by FOMC (4.6% - see MACROmap of 19/6/2017). Its increase was mainly due to higher participation rate (up to 62.8% in June vs. 62.7% in May). The annual dynamics of average hourly earnings rose to 2.5% in June vs. 2.4% in May. We expect that the continuation of the improvement in the labour market in the coming months will contribute towards an increase in the annual wage dynamics. The results of business surveys were also released last week. The ISM index for manufacturing increased to 57.8 pts in June vs. 54.9 pts in May, hitting the highest level since August 2014. Conducive to the index increase were higher values of four of its five sub-indices (for output, new orders, suppliers' delivery times, and employment). Lower contribution of the inventories sub-index had an opposite impact. The non-manufacturing ISM also recorded an increase and rose to 57.4 pts in June vs. 56.9 pts in May. The index increase was due to higher contributions of three of its four sub-indices (new orders, suppliers' delivery times, and business activity). Lower contribution of the employment sub-index had an opposite impact. The last week's readings from the US economy support our forecast, in which the annualized US GDP growth rate will rise to 3.5% in Q2 vs. 1.4% in Q1.

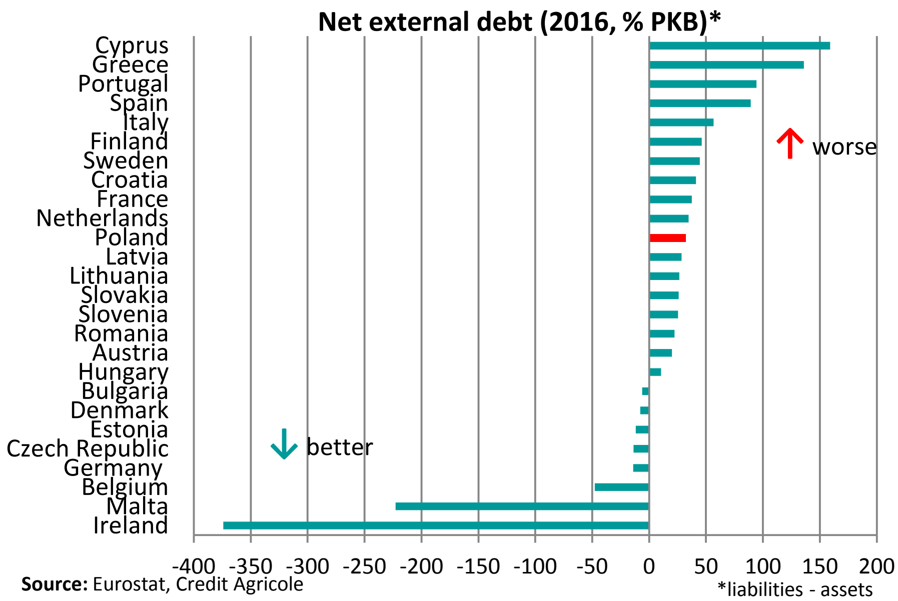
- **As we expected, the Monetary Policy Council left interest rates unchanged at its meeting last week (the reference rate amounts to 1.50%).** The MPC maintained the view that given the available data and forecasts, the current level of interest rates was conducive to keeping the Polish economy on the sustainable growth path and maintaining macroeconomic balance. Like in June, the Council indicated in its statement that due to fading effects of the past increase in global commodity prices, with only a gradual rise in domestic inflationary pressure stemming from improving domestic economic conditions, the risk of inflation persistently running above the target in the medium term was limited. The results of the July NBP inflation projection were presented during the press conference after the meeting. As we expected, the inflation path in 2017, forecasted in the July projection, has - compared to the March projection - been revised downwards and the GDP growth rate in 2017 has been raised. In accordance with the projection, inflation will continue to run below the MPC inflation target (2.5%) in 2017 and 2018, namely in the policy-relevant horizon, and will attain this target no sooner than in 2019 (see MACROpulse of 5/7/2017). At the conference after the meeting, the NBP Governor, A. Glapiński, repeated the view presented earlier that interest rates were highly likely to remain unchanged until the end of 2018. The results of the July macroeconomic projection and remarks of the NBP Governor support our scenario in which the Council will decide to start the monetary policy tightening cycle in November 2018, hiking interest rates by 25 bp.
- **Poland manufacturing PMI rose to 53.1 pts in June from 52.7 pts in May.** The improvement of sentiment resulted from higher contributions of four of its five indicators (for new orders, suppliers' delivery times, output, and stocks of purchases). A decrease in the employment sub-index had an opposite impact. Especially noteworthy in the data structure is an increase in the new orders sub-index with a simultaneous decrease in the sub-index for new export orders. It means that the reason for higher growth rate of orders in Polish manufacturing in June was the acceleration in domestic demand, while the increase in foreign demand slightly slowed down (see MACROpulse of 3/7/2017). The average PMI value in Q2 stood below the level of Q1 (53.3 pts vs. 54.2 pts). Thus, the data support our forecast, in which the dynamics of the Polish GDP will drop to 3.9% YoY in Q2 vs. 4.0% in Q1.
- **Important data from the German economy were released last week**. Industrial production rose by 0.4% MoM in May vs. 1.2% in April. Conducive to the decline in the monthly dynamics of industrial production was its lower growth rate in construction and energy. Data on orders in manufacturing were also released last week and rose by 1.0% in May vs. a 2.2% decrease in April. We forecast that the quarterly growth rate of the German GDP has not changed in Q2 compared to Q1 and amounted to 0.6%.

Fitch's rating will not change for an extended period of time



Source: Reuters

As we expected, Fitch affirmed Poland's long-term credit rating at A- with a stable outlook. In the justification of the decision, Fitch indicated that the current rating reflected solid macroeconomic foundations of the Polish economy, including i.a. well-capitalized banking sector and public debt at a level similar to that of the countries with the same rating. At the same time, Fitch stressed the risk of a relatively high – against the backdrop of other countries – external debt of Poland.



Source: Eurostat, Credit Agricole
*liabilities - assets

The main tool Fitch uses in determining its ratings is an econometric model including 18 indicators concerning i.a. macroeconomic performance, public finance, external finances and structural factors. If determined only on the basis of this model, Poland's rating should stand at "A". However, due to a relatively high – against the backdrop of other countries with the same rating – net external debt in relation to GDP, the credit committee lowered the rating by one notch. In the EU there are two countries which have "A" rating – Malta (net external debt of -222.7% of GDP) and Ireland (-374.1% of GDP).

Fitch forecasts an increase in the public deficit in relation to GDP from 2.4% in 2016 to 2.6% in 2017, due to higher costs of related to the Family 500+ scheme (0.3% of GDP) and reduction of the retirement age (0.1% of GDP). At the same time, the agency believes that the said increased burden to the budget will be largely offset by higher revenue resulting from the economic recovery and the tightening of the tax system. In its scenario, Fitch forecasts fiscal tightening starting from 2018 (public deficit equal to 2.5% of GDP in 2018-2019). This means that the agency is probably assuming budget adjustments which in the coming years will offset the growing public expenditures related with the reduction of the retirement age (Fitch estimates their increase to 0.5% of GDP in 2018).

The agency forecasts that with economic growth rate staying slightly above 3.0% YoY and inflation converging to target (2.5%), the public debt in 2017 will not change compared to 2016 and will amount to 54.4% and will stabilize at a similar level in subsequent years. This scenario is consistent with the results of our simulations. The decrease in public debt will mainly result from the assumed by us strengthening of PLN being conducive to lower public debt after conversion to PLN. The main risk to this forecast is a possible depreciation of PLN resulting from increase in global risk aversion.

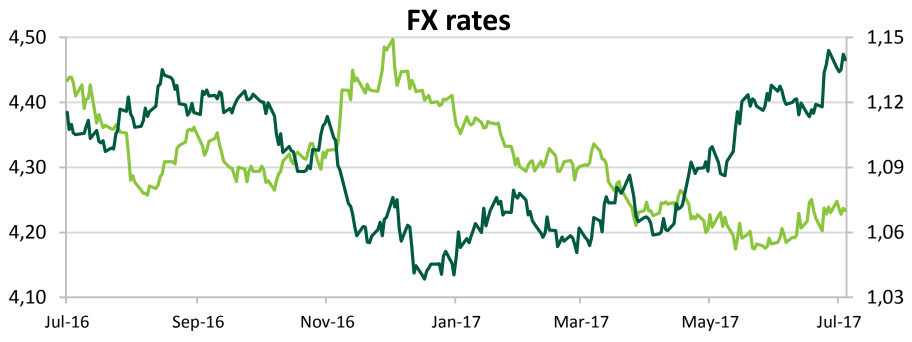
The agency statement indicates that the implementation of the currently discussed proposals of solving the problem of foreign currency mortgage loans (consisting of banks returning to clients the costs of currency spreads they had incurred, implementing solutions encouraging banks to restructure mortgage portfolios, and relaxing eligibility criteria to an existing fund financed by banks to support distressed borrowers) does not pose a threat to financial stability.

The agency has slightly weakened its bias in the context of deterioration of the political climate in Poland. It pointed to the easing of tensions in contacts with the European Union and lack of negative consequences resulting from the "rule of law" procedure. At the same time, the agency indicated that the potential tensions between Poland and the EU and Brexit might adversely affect the negotiations of the next EU budget, which might result in lower inflow of EU funds within the 2021-2027 programming period.

The stable rating outlook means that upside and downside risks to Poland's credit rating are balanced. According to Fitch, potentially negative for the rating will be the risk of exceeding the EU budget deficit threshold (3% of GDP) or lack of the expected fiscal tightening leading to the stabilization of public debt in relation to GDP in the medium term. Other risks are changes in the economic policy which might contribute to a deterioration of the investment climate, threaten macroeconomic stability, and deteriorate the outlook for economic growth. In turn, the rating could be upgraded should high economic growth rate be maintained supporting convergence to the A-rated countries and should external debt be reduced.

Considering the risks to the evaluation of Poland's credit rating, outlined in the Fitch's statement, we believe that in the horizon of several quarters the agency will not change Poland's rating and will maintain its stable outlook. On the other hand, we expect that in the coming years the government will shape fiscal policy so that the general government deficit does not exceed 3% of GDP which will stabilize Poland's rating. On the other hand, due to a significant difference in the average level of net external debt in the last three years as compared to other countries with A rating (34% against the median of 3% of GDP), the upgrading of Poland's credit rating is not likely.

Domestic balance of payments data negative for PLN

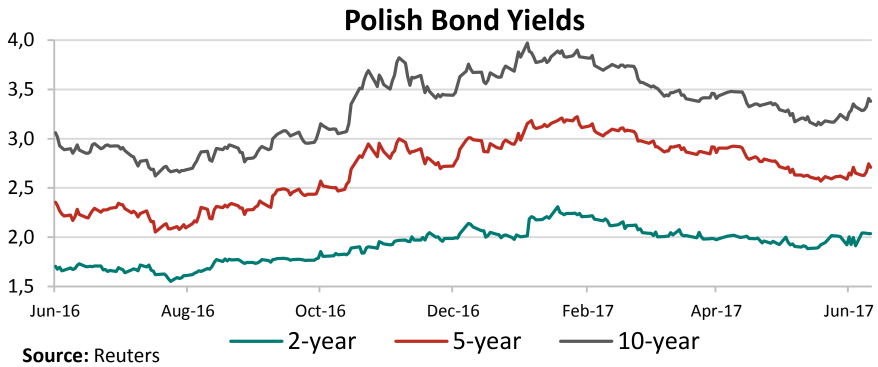


Source: Reuters

Last week EURPLN rate rose to 4.2358 (PLN weakening by 0.1%). On Monday, PLN was depreciating, supported by the publication of a higher-than-expected US manufacturing ISM. On Tuesday and Wednesday, PLN showed increased volatility in anticipation of the Minutes of the FOMC June meeting. The MPC meeting and the press conference presenting the latest NBP macroeconomic projections had no significant impact on PLN. The Minutes released on Wednesday evening were not market moving. On Thursday, PLN was depreciating since morning but the publication of a weaker-than-expected ADP report in the US reversed the trend. On Friday, PLN was relatively stable and oscillated around 4.23 vs. EUR, while higher-than-expected US non-farm payrolls data had no substantial impact on its rate. Fitch's decision on leaving Poland's existing rating and its stable outlook was released after the closing of the European markets. Thus, it had no impact on PLN.

We believe that the decision of Fitch on leaving Poland's existing rating and its stable outlook, released last Friday, is neutral for PLN. Crucial for PLN this week will be J. Yellen's testimony to the Congress, scheduled for Wednesday and Thursday. We believe that her remarks may be conducive to increased volatility of PLN rate. In our view, the publication of numerous US data (retails sales, industrial production, preliminary University of Michigan Index) will be overshadowed by J. Yellen's testimony and their aggregate impact on PLN will be limited. On the other hand, important for PLN will be the publication of domestic data on the balance of payments which may lead to its depreciation, we believe. In our view, data on inflation in Poland and data on the balance on trade in China will be neutral for PLN.

J. Yellen's testimony crucial for the Polish debt market



Source: Reuters

Last week the yield of Polish 2-year benchmark bonds rose to a level of 2.035 (up by 12 bp), of 5-year bonds to a level of 2.727 (up by 7 bp), and of 10-year bonds to a level of 3.38 (up by 5 bp). Monday through Thursday, the prices of Polish bonds were stable. The MPC meeting and FOMC Minutes had limited impact on the market. Thursday saw a visible increase in yields on Polish bonds following German bonds. This may have been due to increased uncertainty resulting from the G-20 summit in Hamburg and the related visit of the US President D. Trump to Europe. The US non-farm payrolls data released on Friday had a limited impact on the prices of Polish bonds. Fitch's decision on leaving Poland's existing rating and its stable outlook was released after the closing of the Polish debt market.

We believe that the decision of Fitch on leaving Poland's existing rating and its stable outlook, released last Friday, is neutral for the prices of Polish bonds. This week, the Polish debt market will focus on J. Yellen's testimony to the Congress, scheduled for Wednesday and Thursday. We believe that her remarks may be conducive to increased volatility of the prices of the Polish debt. In our view, the aggregate impact of numerous US data (retails sales, industrial production, preliminary University of Michigan Index) on the Polish debt market will be limited. Domestic data on the balance of payments and inflation and data on the Chinese balance on trade will be neutral for the prices of Polish bonds.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	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	Jul-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	4,35	4,36	4,29	4,31	4,45	4,40	4,32	4,31	4,23	4,23	4,18	4,23	4,21
USDPLN*	3,94	3,90	3,91	3,82	3,92	4,20	4,18	4,00	4,07	3,97	3,88	3,72	3,70	3,72
CHFPLN*	4,04	4,02	3,97	3,93	3,96	4,13	4,11	4,04	4,05	3,96	3,90	3,84	3,86	3,85
CPI inflation (% YoY)	-0,8	-0,9	-0,8	-0,5	-0,2	0,0	0,8	1,7	2,2	2,0	2,0	1,9	1,7	
Core inflation (% YoY)	-0,2	-0,4	-0,4	-0,4	-0,2	-0,1	0,0	0,2	0,3	0,6	0,9	0,8	0,9	
Industrial production (% YoY)	6,0	-3,4	7,5	3,2	-1,3	3,2	2,2	9,1	1,1	11,0	-0,6	9,1	4,3	
PPI inflation (% YoY)	-0,8	-0,5	-0,1	0,2	0,6	1,8	3,2	4,0	4,5	4,8	4,2	2,5	2,2	
Retail sales (% YoY)	4,6	2,0	5,6	4,8	3,7	6,6	6,4	11,4	7,3	9,7	8,1	8,4	6,7	
Corporate sector wages (% YoY)	5,3	4,8	4,7	3,9	3,6	4,0	2,7	4,3	4,0	5,2	4,1	5,4	4,9	
Employment (% YoY)	3,1	3,2	3,1	3,2	3,1	3,1	3,1	4,5	4,6	4,5	4,6	4,5	4,3	
Unemployment rate* (%)	8,7	8,5	8,4	8,3	8,2	8,2	8,3	8,6	8,5	8,1	7,7	7,4	7,1	
Current account (M EUR)	-723	-503	-729	-858	-179	-128	-56	2576	-825	-738	-275	-638		
Exports (% YoY EUR)	6,0	-5,3	9,3	3,1	-0,5	5,8	5,2	13,9	4,9	14,9	0,6	11,0		
Imports (% YoY EUR)	0,8	-7,3	10,7	3,5	3,6	6,3	7,1	16,1	9,9	18,9	3,4	15,8		

*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
	Investments (pp)	0,0	0,6	1,1	2,0	1,0	1,1	0,9	1,0	-1,6	1,0	1,0
	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***		0,1	-0,1	-0,1	-0,5	-1,1	-1,3	-1,2	-1,0	-0,2	-0,5	-1,0
Unemployment rate (%)**		8,1	7,1	7,0	7,3	7,6	6,8	6,6	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	1,8	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	4,23	4,18	4,16	4,15	4,12	4,10	4,07	4,40	4,16	4,07
USDPLN**		3,97	3,70	3,77	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	CONSENSUS**
		Monday 07/10/2017				
3:30	China	PPI (% YoY)	Jun	5,5	5,5	5,5
3:30	China	CPI (% YoY)	Jun	1,5	1,9	1,5
8:00	Germany	Trade balance (bn EUR)	May	19,8		20,3
10:30	Eurozone	Sentix Index (pts)	Jul	28,4		28,4
		Tuesday 07/11/2017				
14:00	**Poland**	**CPI (% YoY)**	**June**	**1,9**	**1,7**	**1,7**
16:00	USA	Wholesale inventories (% MoM)	May	0,3		0,3
16:00	USA	Wholesale sales (% MoM)	May	-0,4		
		Wednesday 07/12/2017				
11:00	Eurozone	Industrial production (% MoM)	May	0,5		0,6
14:00	**Poland**	**Core inflation (% YoY)**	**Jun**	**0,8**	**0,9**	**0,8**
		Thursday 07/13/2017				
	China	Trade balance (bn USD)	Jun	40,8	42,1	42,4
14:30	USA	Initial jobless claims (k)	w/e	244		245
		Friday 07/14/2017				
14:00	**Poland**	**Current account (M EUR)**	**May**	**-275**	**-638**	**335**
14:30	USA	Retail sales (% MoM)	Jun	-0,3	0,1	0,1
14:30	USA	CPI (% MoM)	Jun	-0,1	0,0	0,1
14:30	USA	Core CPI (% MoM)	Jun	0,1	0,2	0,2
15:15	USA	Industrial production (% MoM)	Jun	0,0	0,4	0,3
15:15	USA	Capacity utilization (%)	Jun	76,6	76,8	76,7
16:00	USA	Business inventories (% MoM)	May	-0,2		0,3
16:00	USA	Initial U. of Michigan Sentiment Index (pts)	Jul	95,1	94,7	95,0

*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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