Slight slowdown of economic growth in the Eurozone

This week

- **The most important event this week will be the release of non-farm payrolls data in the US scheduled for Friday.** The markets expect that the employment increased by 195k in July vs. 222k in June, with unemployment rate falling down to 4.3% vs. 4.4% in June. Before the Friday's reading some additional information on the labour market will be provided by the ADP report on private sector employment (the markets expect an increase by 190k in July vs. 158k in June). US business survey results will also be released this week. We forecast that the ISM manufacturing index dropped to 56.9 pts in July vs. 57.4 pts in June, which will be in line with the regional business surveys. The publication of US data, consistent with the scenario of FED hiking interest rates by 25bp at the December meeting, should not be market moving.
- **Important data from the Eurozone will be released this week.** The flash estimate of HICP inflation – released today – stood at 1.3% YoY in July vs. 1.3% in June. We forecast that the quarterly GDP growth rate dropped to 0.5% in Q2 vs. 0.6% in Q1. The results of business surveys (PMI) for the Eurozone released in April-June period pose an upside risk to our forecast standing below the market consensus (0.6%). We believe that the publication of data from the Eurozone should not meet with a significant reaction of the financial markets.
- **Business survey results for Chinese manufacturing will be released this week.** CFLP PMI – released today – dropped to 51.4 pts in July vs. 51.7 pts in June. We expect that Caixin PMI also decreased only slightly to 50.3 pts vs. 50.4 pts in June. We believe that business survey results in China, pointing to a slight deterioration of sentiment in manufacturing, will be neutral for the markets.
- **July data on business sentiment in Polish manufacturing will be released on Tuesday.** We expect that PMI dropped to 53.0 pts from 53.1 pts in June. Conducive to a slight slowdown of economic growth in manufacturing was a deterioration of sentiment in Germany (see below). In turn, the results of GUS business surveys suggested a slight improvement of business sentiment. The publication of PMI is likely to be neutral for PLN and yields on Polish bonds.
- **Data on the July inflation in Poland was released today.** It increased to 1.7% YoY vs. 1.5% in June. We believe that higher inflation rate occured due to higher dynamics of food and fuel prices. In turn, core inflation has probably not changed in July compared to June and amounted to 0.8% YoY.

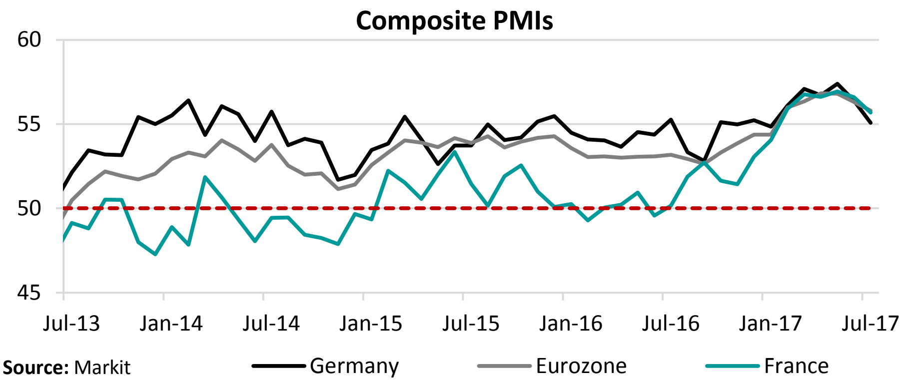
Last week

- **Composite PMI for the Eurozone dropped to 55.8 pts in July vs. 56.3 pts in June.** The PMI composite index decline occurred due to the stabilization of its services activity sub-index and a decrease in the sub-index concerning output in manufacturing (see below).
- **FOMC meeting was held last week.** As we expected, the target range for the Federal Reserve funds was left at an unchanged level [1.00%; 1.25%]. According to the statement, FOMC members expect FED to start the process of reducing its balance-sheet total "relatively soon". This means a change compared to the June statement, where FED members were promising to start the process "this year". The statement also pointed out the drop of inflation recorded in recent months in the US and the fact that it was currently running below the target (2%). Nonetheless, in accordance with the recent testimony to the Congress of FED Chair, J. Yellen, it is too early to expect inflation not to reach the target in the medium term (see MACROmap of 17/7/2017). The press release after the last week's FOMC meeting supports our scenario, in which FED will start to reduce its balance-sheet in September 2017 and will hike interest rates by 25bp in December 2017.
- **Numerous hard data on US economy and business survey results were released last week.** According to the preliminary estimate, the annualized US GDP growth rate rose to 2.6% in Q2

vs. 1.2% in Q1. Higher GDP dynamics resulted from larger contributions of inventories (-0.02 pp in Q2 vs. -1.46 pp in Q1), private consumption (1.93 pp vs. 1.32 pp), and government expenditures (0.12 pp vs. -0.11 pp). Lower contributions of investments (0.36 pp vs. 1.27 pp) and net exports (0.18 pp vs. 0.22 pp) had an opposite impact. Thus, private consumption was the main source of US GDP growth in Q2. Data on durable goods orders were also released last week. They increased by 6.5% MoM in June vs. a 0.1% decrease in May, which was mainly due to higher growth of orders for means of transport. Excluding transportation, durable goods orders rose by 0.2% MoM in June vs. a 0.6% increase in May. Especially noteworthy in the data structure is the increase in orders for non-military capital goods excluding orders for aircrafts (5.6% YoY in June vs. 5.0% in May), being a leading indicator for future investments. These orders increased in year-on-year terms for a fifth month in a row. The sustainability of the recovery in the US real estate market was suggested by data on existing home sales (5.52M in June vs. 5.62M in May) and new home sales (610k in June vs. 605k in May). The results of consumer sentiment surveys were also released last week. The Conference Board Consumer Confidence Index rose from 117.3 pts in June to 121.1 pts in July (the highest level since March 2017), which resulted both from increase in the sub-index for the assessment of the current situation and expectations. The final University of Michigan Index also indicated improvement in consumer sentiment and dropped to 93.4 pts in July vs. 95.1 pts in June and 93.1 pts in the initial reading. Conducive to the index decline was decrease in its sub-index for expectations while increase of the sub-index for the assessment of the current situation had an opposite impact. We forecast that the annualized US GDP growth rate will decrease to 2.4% in Q3.

- **On Monday the President of Poland, Andrzej Duda, vetoed the bill on the Supreme Court as well as the bill on the National Council of the Judiciary**. The former bill provided for the retirement of all current Supreme Court judges except those chosen by the justice minister, whereas the latter would give Parliament the right to elect most of the judges of the National Council of the Judiciary, which would nominate future candidates for the president to appoint to the Supreme Court. These measures sparked massive protests across the country and rising pressure on President Duda to veto both initiatives. Opposition parties, representatives of academia and NGOs, as well as many legal experts, viewed these bills as unconstitutional. Furthermore, if adopted, the bills would likely be perceived by the European Commission as a threat to the rule of law. This, in turn, could result in financial sanctions being imposed on Poland, increased domestic political tensions, a deterioration of the business climate, a dent in Poland's standing in negotiations related to the next EU program period, significant downside risk to its sovereign ratings, a government bond sell-off and PLN depreciation. The PLN depreciation against EUR and HUF observed last week signalled that investors have assigned rising probability to this sequence of events. Therefore, in the very short run the President's decision to veto both acts is slightly bond- and PLN-positive. President Duda has announced that he will launch far-reaching consultations and will present his own bills on the Supreme Court and the National Council of the Judiciary within two months. At this stage it is difficult to assess whether the new bills will be approved by the ruling Law and Justice (L&J) party, which holds an absolute majority in both chambers of the Parliament. In the meantime, one possible scenario is L&J overruling the presidential veto with the help of Kukiz15 party – so far the party least opposed to L&J – three small caucuses and independent members of parliament. However, Kukiz15 has already declared that it supports the President's motion, and we view the scenario of it collaborating with L&J as unlikely. Our baseline scenario assumes no qualified majority in the lower house of the Parliament to reject the veto (3/5) and L&J adopting a wait-and-see strategy. At this juncture it is hard to predict whether the President's final proposal will be accepted by L&J. If not, tensions between the ruling party and the President may rise, evoking speculation regarding snap elections. Given the experience of 2007 – when the decision of Jaroslaw Kaczynski, L&J's leader, to call early parliamentary elections resulted in defeat and power passing to Civic Platform and Polish Peasants Party for eight years – we believe that this radical solution will not be enacted. Nevertheless, last Monday's veto seems to mark the beginning of a new chapter in Polish politics, in which the thus-far close cooperation between Jaroslaw Kaczynski and Andrzej Duda may become less harmonious. As a corollary, in the coming months our short-term EUR/PLN profile will be vulnerable to elevated domestic political uncertainty. This view is supported by the EC proceedings started on Saturday against Poland concerning violation of member state's obligations. Following the publication of the bill on common courts of law in the Journal of Laws, the EC called upon Poland to remedy the violation. The main EC objection concerning the bill refers to sex discrimination due to the introduction of different retirement age for women (60 years) and men (65 years) holding office as judges. According to the EC, such provision is in conflict with Article 157 of the Treaty on the Functioning of the European Union and the directive on gender equality in employment. The EC also voiced a concern that the right of the justice minister to extend the term of office of judges who have reached the retirement age and to dismiss and appoint court presidents might undermine the independence of Polish courts. The Saturday's decision of the EC will pose a downside risk to PLN rate and the prices of the Polish debt this week.

Slight slowdown of economic growth in the Eurozone



Source: Markit

The Composite PMI (for manufacturing and services) in the Eurozone decreased to 55.8 pts in July from 56.3 pts in June. Nonetheless, the indicator is only slightly below its six-year high recorded in April and May (56.8 pts). The decline in Composite PMI occurred due to the stabilization of its sub-index for business activity in services and decrease of the sub-index for output in manufacturing.

Geographically, a lower growth rate of economic activity was recorded both in Germany and in France. The deterioration in the two economies resulted both from lower sub-index concerning output in manufacturing and lower sub-index concerning activity in services. On the other hand, an improvement of sentiment was recorded in the remaining Eurozone countries included in the survey – the monthly economic growth rate hit the second highest level in the last decade.

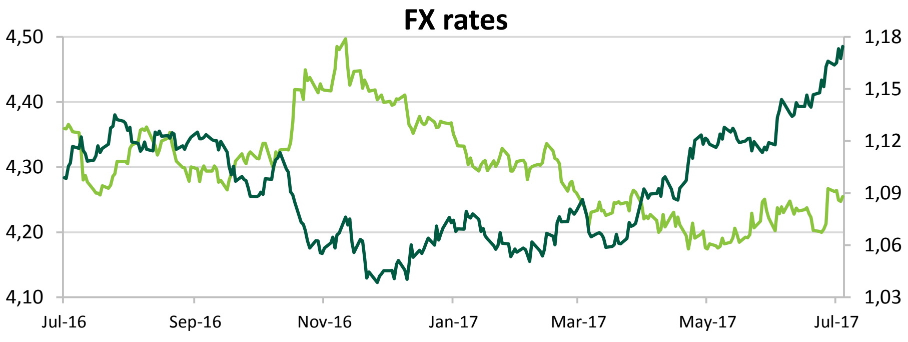
We believe that the decline in Composite PMI is temporary and does not signal any permanent downward trends in the Eurozone. Our view is supported by the sustained high employment growth rate (54.3 pts in July vs. 54.4 pts in June), reflecting optimism concerning future economic climate in the Eurozone. Similar conclusions may be drawn from the indicator of future (in the horizon of 12 months) output, as it continues to stay at a high – against the historical backdrop – level. The July results of business surveys support our forecast of a slight decline in GDP growth rate in the Eurozone to 0.4% QoQ in Q3 vs. 0.5% in Q2.

From the point of view of future business climate in Poland, noteworthy is the situation in German manufacturing. The German manufacturing PMI dropped to 58.3 pts in July vs. 59.6 pts in June. In the index structure noteworthy is the decrease in the sub-index for new orders (58.7 pts in July vs. 61.7 pts in June), accompanied by increase in the sub-index for new export orders (59.2 pts in July vs. 58.5 pts in June). Higher sub-index for new export orders supports our scenario of recovery in global trade.

Additional information on the situation in German economy was also provided last week by the Ifo Index reflecting the sentiment among German managers representing the manufacturing, construction, wholesale and retail trade sectors which rose to 116.6 pts in July vs. 115.2 pts in June, thus hitting the highest level in the survey history. The index increase resulted from higher values of its sub-indices concerning both the assessment of the current situation and expectations. Sector-wise, improved sentiment was recorded in three of the four sectors (manufacturing, construction and wholesale trade) while in retail trade it deteriorated.

The increase in export orders in the German manufacturing signals a high likelihood of higher demand for goods manufactured in Poland and used in the production of final goods (so-called intermediate goods). This supports our forecast in which the annual dynamics of Polish exports will increase to 9.6% in Q3 vs. 8.5% in Q2. We expect that in Q4 the annual exports dynamics will increase further to a two-digit level (see below).

Decision of the European Commission negative for PLN

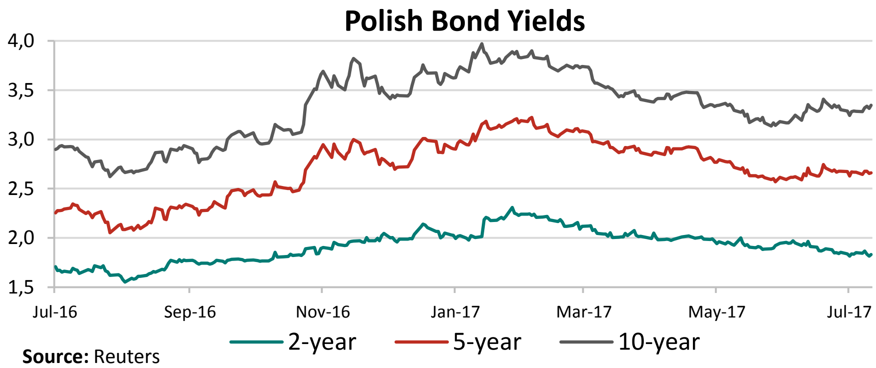


Source: Reuters

Last week EURPLN rate dropped to 4.2550 (PLN strengthening by 0.3%). The most important event last week was the decision of President A. Duda to veto the bill on the Supreme Court and the bill on the National Council of the Judiciary. In reaction to the President's announcement, PLN temporarily strengthened. However, in the following days PLN returned to levels similar to those at which it opened on Monday and was showing increased volatility due to the elevated political risk in Poland (see above).

The most important event for PLN this week will be the publication of data on non-farm payrolls in the US scheduled for Friday. However, if our close-to-the-market-consensus forecast materializes, the data will be neutral for PLN. Other data from the US (manufacturing ISM), Eurozone (GDP), and business survey results for Chinese manufacturing will also have a limited impact on the market. If our forecasts materialize, Polish manufacturing PMI will be neutral for PLN. The Saturday's decision of the EC to start proceedings against Poland concerning violation of member state's obligations (see above) will be conducive to PLN weakening this week.

Polish debt market focused on non-farm payrolls in the US



Source: Reuters

Last week the yield of Polish 2-year benchmark bonds dropped to a level of 1.831 (down by 2 bp), of 5-year bonds dropped to a level of 2.662 (down by 1 bp), and of 10-year bonds rose to a level of 3.347 (up by 6 bp). On Monday, the prices of the Polish debt rose in reaction to President A. Duda's decision to veto the bill on the Supreme Court and the bill on the National Council of the Judiciary. However, further into the week, an increase in yields on Polish bonds was observed, especially at the centre and at the long end of the curve, due to elevated political risk in Poland (see above). Changes in global risk aversion had a limited impact on the Polish debt market.

This week the Polish debt market will focus on the publication of data on non-farm payrolls in the US, scheduled for Friday. If our close-to-the-market-consensus forecast materializes, we do not expect it to substantially affect the prices of Polish bonds. The manufacturing ISM in the US and data from the Eurozone (GDP) will also be neutral for the Polish debt market. We expect that domestic data (manufacturing PMI) will also have a limited impact on the Polish debt market. In our view, the Saturday's decision of the EC to start proceedings against Poland concerning violation of member state's obligations (see above) is credit negative and will be conductive to increase in yields on 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	**4,25**
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	**3,62**
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	**3,74**
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	1,5	
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	0,8	
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	4,5	
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	2,4	1,8	
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	6,0	
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	6,0	
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	172	99	-219	2342	-599	-529	-160	-179		
Exports (% YoY EUR)	6,0	-5,3	9,3	3,1	-0,6	5,7	5,1	14,3	5,7	15,1	1,4	14,5		
Imports (% YoY EUR)	0,8	-7,3	10,7	3,5	3,6	6,3	7,1	16,0	8,9	16,8	3,3	19,1		

*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	3,57	3,53	3,52	3,46	3,42	3,36	4,18	3,53	3,36

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
		Monday 07/31/2017				
3:00	China	Caixin Manufacturing PMI (pts)	Jul	51,7	51,6	51,6
11:00	Eurozone	Preliminary HICP (% YoY)	Jul	1,3	1,3	1,3
11:00	Eurozone	Unemployment rate (%)	Jun	9,3		9,2
14:00	**Poland**	**Flash CPI (% YoY)**	**Jul**	**1,5**	**1,6**	**1,6**
15:45	USA	Chicago PMI (pts)	Jul	65,7		61,3
		Tuesday 08/01/2017				
3:45	China	Caixin Manufacturing PMI (pts)	Jul	50,2	50,3	50,4
9:00	**Poland**	**Manufacturing PMI (pts)**	**Jul**	**53,1**	**53,0**	**53,3**
9:55	Germany	Final Manufacturing PMI (pts)	Jul	58,3	58,3	58,3
10:00	Eurozone	Final Manufacturing PMI (pts)	Jul	56,8	56,8	56,8
11:00	Eurozone	Preliminary GDP (% QoQ)	Q2	0,6	0,5	0,6
14:30	USA	Real private consumption (% MoM)	Jun	0,1		
15:45	USA	Flash Manufacturing PMI (pts)	Jul	53,2	53,2	
16:00	USA	ISM Manufacturing PMI (pts)	Jul	57,8	56,5	56,5
		Wednesday 08/02/2017				
11:00	Eurozone	PPI (% YoY)	Jun	3,3		2,4
14:15	USA	ADP employment report (k)	Jul	158		190
		Thursday 08/03/2017				
10:00	Eurozone	Services PMI (pts)	Jul	55,4	55,4	55,4
10:00	Eurozone	Final Composite PMI (pts)	Jul	55,8	55,8	55,8
11:00	Eurozone	Retail sales (% MoM)	Jun	0,4		0,2
13:00	UK	BOE rate decision (%)	Jul	0,25		
14:30	USA	Initial jobless claims (k)	w/e	233		240
16:00	USA	Factory orders (% MoM)	Jun	-0,8	2,7	2,7
16:00	USA	ISM Non-Manufacturing Index (pts)	Jul	57,4	56,9	57,0
		Friday 08/04/2017				
8:00	Germany	New industrial orders (% MoM)	Jun	1,0		0,8
14:30	USA	Unemployment rate (%)	Jul	4,4	4,3	4,3
14:30	USA	Non-farm payrolls (k MoM)	Jul	222	195	187

*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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