When will be the next interest rate hike in the Czech Republic?

This week

- **The most important event this week will be the publication of the Minutes of the September FOMC meeting scheduled for Wednesday.** The markets will focus on FED members' in-depth assessments of short- and medium-term prospects of the economic situation in the US (including mainly the expected inflation profile) and the likely date of interest rate hikes in 2018. The release of the Minutes may be conducive to increased volatility in the financial markets; however, they are unlikely to provide new information substantially altering our scenario of gradual normalization of the US monetary policy. Our base scenario assumes that FED will hike interest rates by 25bp at the December meeting.
- **Significant US data will be released this week.** We forecast that nominal retail sales rose to 2.0% MoM in September from a -0.2% in August, due to higher sales dynamics in the automotive branch. Business survey results will also be released this week. We expect that the preliminary University of Michigan Index rose to 95.5 pts in October vs. 95.1 pts in September. We believe that the aggregate impact of data on the US economy on the financial markets will be limited.
- **Data on the Chinese balance of trade will be released on Friday**. The market expects that its balance dropped to USD 39.5bn in September vs. USD 42.0bn in August. According to the market consensus export growth rose to 8.8% YoY in September vs. 5.5% in August, while import growth rose to 13.5% from 13.3%. The publication of data from China will be neutral for the markets, we believe.
- **Data on the September inflation in Poland will be released on Thursday.** We see a slight risk that inflation will be revised downwards to 2.1% YoY vs. 2.2% in the flash estimate published two weeks ago which will mean its marked increase compared to June (1.8%). In our view, the inflation rate increased due to higher dynamics of food prices and higher core inflation. We believe that the publication of the inflation reading will be neutral for PLN and prices of Polish bonds.

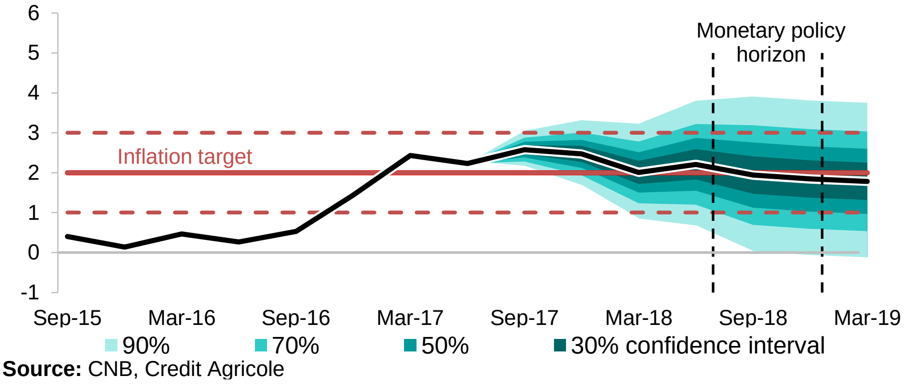
Last week

- **Numerous hard data and business survey results were released last week in the US.** Non-farm payrolls in the US dropped by 33k in September vs. a 169k increase in August (revised upwards from 156k), running below the market expectations (increase by 90k). The highest decrease in employment was recorded in leisure and hospitality (-111.0k), information services (-9.0k) and other services (-5.0k). The high decrease in employment in these sectors was caused by Irma and Harvey hurricanes. This view is additionally supported by the data on the number of people unable to work in September due to weather conditions, which stood at an all-time high level for September. Unemployment rate dropped to 4.2% in September vs. 4.4% in August, running markedly below the natural unemployment rate indicated by FOMC (4.6% - see MACROmap of 25/9/2017). The decline in unemployment rate resulted mainly from the decrease in the number of unemployed (-331k) with a simultaneous increase in the number of employed (+906k). It should be noted that unemployment rate is estimated in the US on the basis of the results of the second survey for households and not for companies as is the case for non-farm payrolls estimates. This explains the – usually temporary – differences between the two surveys results (employment decreased in the establishment data and increased in the household data). Consequently, the participation rate rose to 63.1% in September vs. 62.9% in August. The annual dynamics of average hourly earnings also rose and amounted to 2.9% in September vs. 2.7% in August. In our view, this resulted from the above-mentioned decrease in employment in leisure and hospitality where wages are relatively low compared to other sectors. Despite the fact that the published employment data were visibly weaker from the consensus, the expectations of a rate hike in the US at the December meeting and USD appreciation vs EUR have risen, mainly due to the higher wage growth rate. Results of business surveys in the US were also released last week. The manufacturing ISM Index rose to 60.8 pts in September vs. 58.8 pts in August, reaching the highest level since May 2004. The index increase resulted from higher contributions of four of its five sub-indices (for suppliers' delivery times, new orders, output, and employment). Lower contribution of the inventories sub-index had an opposite impact. Especially noteworthy in the data structure is the increase in the sub-index for suppliers' delivery times which reached the highest level since July 2004. Delivery times were longer due to Irma and Harvey hurricanes. Thus the strong increase in the manufacturing ISM Index in September resulted largely from temporary effects unrelated to improved business sentiment. The non-manufacturing ISM Index was also released last week and rose to 59.8 pts in September vs. 55.3 pts in August, hitting the highest level since August 2005. The index increase resulted from higher contributions of its sub-indices (for suppliers' delivery times, new orders, business activity, and employment). Like for the manufacturing ISM, the main source of the index increase were longer delivery times due to Irma and Harvey hurricanes. The last week's readings from the US economy pose a downside risk to our scenario, in which the annualized economic growth rate will drop to 2.0% in Q3 vs. 3.1% in Q2.

- **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. The Council indicated in its statement that in the following quarters inflation would remain moderate. At the same time, in the Council's opinion, the risk of inflation persistently running above the target in the medium term is limited (see MACROpulse of 4/10/2017). At the conference after the meeting, the NBP Governor, A. Glapiński, repeated the view presented earlier that NBP interest rates would most probably not change until the end of 2018. In his view, the increase in inflation recorded in August was temporary. A more hawkish view was taken by present at the conference G. Ancyparowicz who believes that there will be no need for revising the monetary policy in the next three to four quarters (i.e. until the middle of 2018). The remarks of the MPC members support our forecast of NBP rates, in which, given a moderate wage pressure and inflation staying below target, the MPC will leave interest rates unchanged until November 2018.
- **PMI for Polish manufacturing rose to 53.7 pts vs. 52.2 pts in August.** Conducive to the index increase were higher values of three of its five sub-indices (for new orders, output, and suppliers' delivery times). Lower sub-indices for employment and inventories had an opposite impact. Especially noteworthy in the structure of the September PMI is the continuing high increase in domestic demand (see MACROmap of 2/10/2017). The average PMI value in Q3 (52.8%) stood at a slightly lower level than in Q2 (53.3%). Nevertheless, we see an upside risk to our forecast of GDP growth in Q3 (4.1% YoY vs. 3.9% in Q2), due to visibly higher from our expectations dynamics of industrial production in August (see MACROpulse of 19/9/2017).

When will be the next interest rate hike in the Czech Republic?

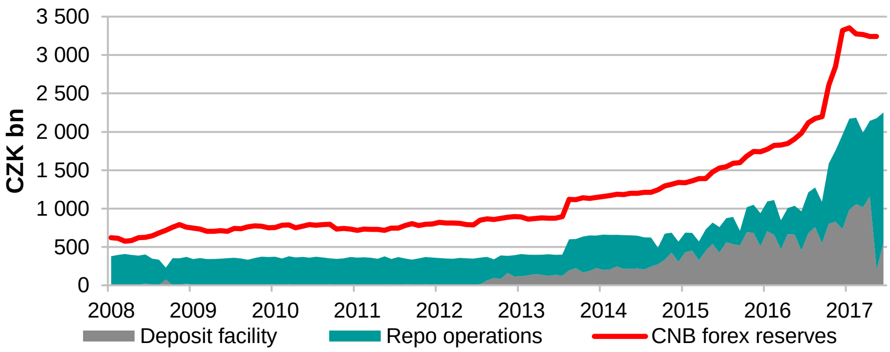
The Czech National Bank (CNB) has been the first central bank in the region which decided to hike interest rates in the recent years. After nearly five years of running a zero interest-rate policy, the CNB decided to hike the two-week REPO (hereinafter the interest rate) from 0.05% to 0.25% at the meeting in August. At the September meeting, the CNB left interest rates unchanged, however an increasing number of factors signal a growing probability of a hike in the coming months. Below we present our scenario regarding monetary policy in Czech Republic and CZK exchange rate.



Source: CNB, Credit Agricole

At the conference after the September meeting, the CNB Governor, J. Rusnok, informed that before deciding to hike interest rates again, the Board would like to see the November inflation projection and subsequent ECB decisions on monetary policy. We believe that the expected by us and by the financial markets ECB decision to start the tapering of the quantitative easing program in the coming months is unlikely to significantly change the conditions in the markets. Thus, the inflation projection will be the main factor determining future CNB decisions. We see a significant upside risk to the inflation projection presented by the CNB in the August projection (see the chart). We believe that the inflation profile will be revised upwards in November owing to two factors.

The first factor to increase inflation pressure is a faster than forecasted GDP growth in Q2 (4.7% YoY vs. 3.5% in the August projection). The sharp increase in investment dynamics to a positive level (7.7% YoY), driven by growing absorption of EU funds, is also an important factor. In effect, the contribution of investments to economic growth amounted to 1.9 pp in Q2. We expect that GDP growth running above the potential level will be conducive to growing difficulties in finding skilled labour in the coming quarters, and, consequently, to higher wage pressure and higher inflationary pressure. This view is supported by a high Czech manufacturing PMI (56.6 pts in September, highest since April 2017). Especially noteworthy in the structure of the September PMI is a sharp increase in total orders (including export orders), reflecting strong demand – both domestic and external. At the same time, despite a good demand outlook, the employment sub-index has dropped since June, signaling limitations to supply of labour.



Source: CNB, Credit Agricole

The second factor conducive to higher inflation profile in the November projection is the relative stabilization of EURCZK observed in Q3 despite the monetary tightening in August. The scale of CZK appreciation was limited by significant long CZK positions, opened due to the anticipated CZK appreciation after being "de-pegged" in April 2017. The amount of these positions can be estimated based on the sharp increase in excess liquidity in the banking sector (ca. EUR 40bn between December 2016 and April 2017, see the chart). EURCZK stabilization signals an upside risk to the inflation scenario in the August CNB projection because it assumed a moderate nominal appreciation of CZK, resulting from the process of real convergence.

Considering the factors outlined above, inflation in the November projection in the monetary policy horizon is likely to run close to the upper limit of the inflation target band (3.0%). Currently, the views of CNB members vary greatly. The decision on maintaining the status quo in monetary policy in September has not been unanimous. Four members of the CNB Board were in favour of leaving interest rates unchanged, while three members supported hikes. We believe that the November projection will prompt most members to vote for hiking interest rates by 25bp. We have therefore revised our scenario of the monetary policy outlook in the Czech Republic – we earlier assumed that the first hike would take place in February 2018. We also expect that the CNB Board will hike interest rates by subsequent 50 bp in 2018. Our scenario is supported by the remark of the CNB Governor at the conference after the September meeting, J. Rusnok, who stated that he can imagine a situation where interest rates would increase by more than 25bp in the next 6 months. The political situation in the Czech Republic (parliament election are in two weeks' time) does not alter our scenario. The polls point to the victory of ANO party led by A. Babiš. In our view, such result would mean the status quo in fiscal policy. A gradual monetary tightening in the Czech Republic will be conducive to a slight appreciation of CZK vs. EUR (EURCZK at 25.50 as at the end of 2018, see the table). Considering that we expect a stronger appreciation of PLN vs. EUR, PLNCZK will gradually increase towards 6.27 at the end of 2018.

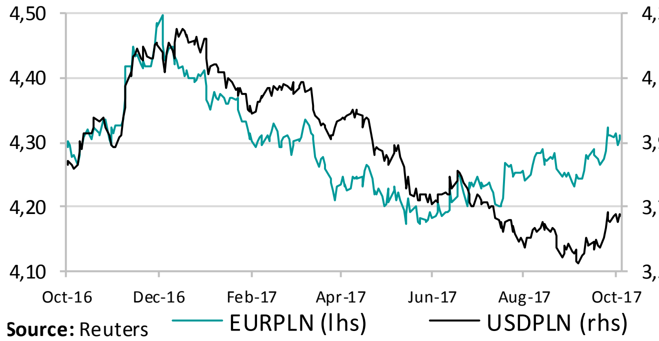
	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
CNB 2W repo rate (%)	0,05	0,05	0,25	**0,50**	**0,50**	**0,75**	**0,75**	**1,00**
EURCZK	27,02	26,11	25,97	**25,80**	**25,60**	**25,50**	**25,50**	**25,50**

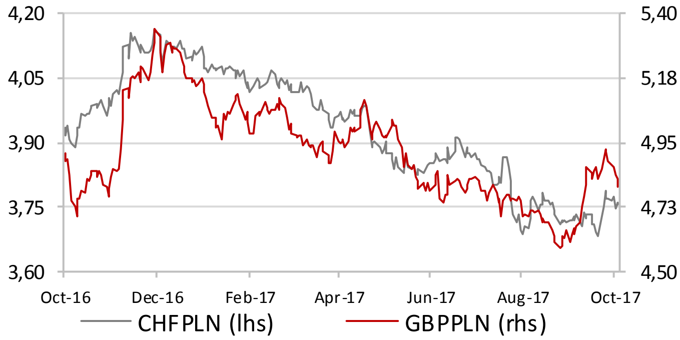
Source: Reuters, Credit Agricole

It should be pointed out that the case of the Czech Republic is exceptional for the region. Inflation in the Czech Republic is running currently (2.7% YoY in September) above the CNB target (2.0%). Due to the difficulties in finding skilled labour, there is a sharp increase in nominal wages (7.6% YoY in Q2). The CNB members have already started the normalization of the monetary policy and emphasize their intention to tighten it further. The above factors clearly set the Czech Republic apart from the macroeconomic situation in Poland. Therefore the expected by us monetary tightening in the Czech Republic does not alter our scenario assuming status quo in the NBP monetary policy until November 2018.

Release of FOMC Minutes may increase PLN volatility

FX rates



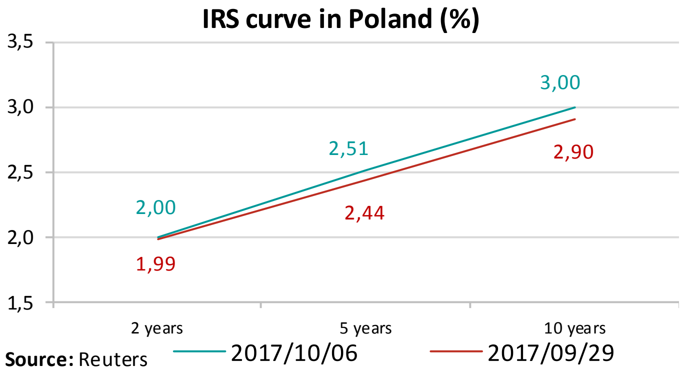


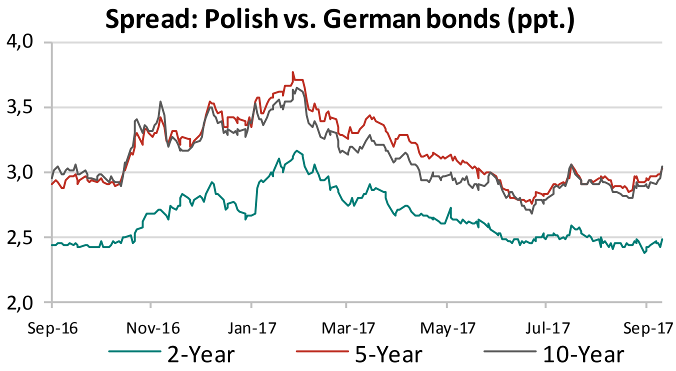
Source: Reuters

Last week EURPLN rate dropped to 4.3097 (PLN strengthening by 0.1%). In the first part of the week, EURPLN rate showed low volatility, due to a scarce macroeconomic calendar. On Wednesday, PLN was appreciating, like other emerging currencies, as investors started worrying that a candidate with a less hawkish bias than assumed earlier would be appointed as FED chair. On Thursday and Friday, PLN stabilized at a level slightly above 4.30 vs. EUR. The data from the US labour market released on Friday were negative for PLN. Last week PLN significantly appreciated vs. GBP (by 1.9%) due to the increase in EURGBP rate supported by the address of the British prime Minister, T. May. It raised concerns among some investors as to whether she was the right person to head the government with the approaching Brexit negotiations and a simultaneous decline in the support for the Conservative Party.

Crucial for PLN this week will be the release of the Minutes of the September FOMC meeting scheduled for Wednesday. We believe that it may contribute to increased volatility of PLN. The aggregate impact of data from the US (retails sales and the preliminary University of Michigan Index) on PLN will be limited, we believe. In our view, the data on the balance of trade in China and final domestic data on inflation will also be neutral for PLN.

IRS rates increase following German bonds





Source: Reuters

Last week the 2-year IRS rates rose to a level of 2.00 (up by 1 bp), of 5-year IRS rates a level of 2.51 (up by 7 bp), and of 10-year IRS rates to a level of 2.995 (up by 9 bp). Last week IRS rates sharply increased across the curve, following German bonds. The dovish tone of the press conference after the MPC meeting brought about a temporary slight correction on Wednesday. The debt exchange auction on Thursday at which the Finance Ministry redeemed PLN 6.6bn of bonds maturing in 2018 and sold PLN 6.8bn of 2-, 5-, 6-, 9-, and 10-year bonds had no substantial impact on the yield curve. The US non-farm payroll data release on Friday intensified investors' expectations of FED interest rate hikes in December and, consequently, contributed to higher IRS rates.

This week the Polish debt market will focus on the release of the Minutes of the September FOMC meeting scheduled for Wednesday. We believe that it may contribute to increased volatility of IRS rates. Data from the US (retails sales and the preliminary University of Michigan Index) and final data on inflation will not have a substantial impact on the Polish debt market, we believe.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-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*	4,29	4,31	4,45	4,40	4,32	4,31	4,23	4,23	4,18	4,23	4,25	4,25	4,31	**4,28**
USDPLN*	3,82	3,92	4,20	4,18	4,00	4,07	3,97	3,88	3,72	3,70	3,59	3,57	3,65	**3,61**
CHFPLN*	3,93	3,96	4,13	4,11	4,04	4,05	3,96	3,90	3,84	3,86	3,72	3,72	3,77	**3,73**
CPI inflation (% YoY)	-0,5	-0,2	0,0	0,8	1,7	2,2	2,0	2,0	1,9	1,5	1,7	1,8	**2,1**	
Core inflation (% YoY)	-0,4	-0,2	-0,1	0,0	0,2	0,3	0,6	0,9	0,8	0,8	0,8	0,7	**0,9**	
Industrial production (% YoY)	3,2	-1,3	3,2	2,2	9,1	1,1	11,0	-0,6	9,1	4,5	6,2	8,7	**5,6**	
PPI inflation (% YoY)	0,2	0,6	1,8	3,2	4,0	4,5	4,8	4,2	2,4	1,8	2,2	3,0	**3,2**	
Retail sales (% YoY)	4,8	3,7	6,6	6,4	11,4	7,3	9,7	8,1	8,4	6,0	7,1	7,6	**7,9**	
Corporate sector wages (% YoY)	3,9	3,6	4,0	2,7	4,3	4,0	5,2	4,1	5,4	6,0	4,9	6,6	**6,9**	
Employment (% YoY)	3,2	3,1	3,1	3,1	4,5	4,6	4,5	4,6	4,5	4,3	4,5	4,6	**4,5**	
Unemployment rate* (%)	8,3	8,2	8,2	8,3	8,6	8,5	8,1	7,7	7,4	7,1	7,1	7,0	**7,0**	
Current account (M EUR)	-858	172	99	-219	2342	-599	-529	-160	-298	-932	-878	**-427**		
Exports (% YoY EUR)	3,1	-0,6	5,7	5,1	14,3	5,7	15,1	1,4	16,2	8,7	10,7	**12,9**		
Imports (% YoY EUR)	3,5	3,6	6,3	7,1	16,0	8,9	16,8	3,3	21,4	15,0	12,5	**11,0**		

*end of period

Forecasts of the quarterly macroeconomic indicators

Indicator		2017				2018				2016	2017	2018
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Gross Domestic Product (% YoY)		4,0	3,9	4,3	4,2	4,0	3,7	3,6	3,8	2,7	4,1	3,8
Private consumption (% YoY)		4,7	4,9	4,2	4,5	4,6	4,3	4,3	3,9	3,8	4,6	4,3
Gross fixed capital formation (% YoY)		-0,4	0,8	3,0	5,5	7,9	7,0	6,8	6,1	-7,8	3,0	6,7
Export - constant prices (% YoY)		8,3	2,8	8,0	10,0	8,0	7,7	6,8	5,5	9,0	7,3	7,0
Import - constant prices (% YoY)		8,7	6,1	9,0	11,6	10,6	10,0	10,4	8,3	8,9	8,9	9,8
GDP growth contributions	Private consumption (pp)	3,0	2,9	2,5	2,3	3,0	2,6	2,6	1,9	2,3	2,7	2,5
	Investments (pp)	0,0	0,1	0,5	1,3	0,9	1,1	1,2	1,5	-1,6	0,5	1,2
	Net exports (pp)	0,1	-1,5	-0,3	-0,4	-1,1	-0,8	-1,8	-1,3	0,3	-0,6	-1,2
Current account***		0,1	-0,5	-0,7	-1,2	-1,7	-1,5	-1,7	-2,0	-0,2	-1,2	-2,0
Unemployment rate (%)**		8,1	7,1	7,0	7,3	7,6	6,8	6,9	7,3	8,3	7,3	7,3
Non-agricultural employment (% YoY)		2,1	2,4	1,9	1,0	0,3	0,1	0,1	0,1	1,9	1,9	0,2
Wages in national economy (% YoY)		4,1	5,0	5,6	6,0	6,4	6,7	6,6	6,5	3,8	5,2	6,5
CPI Inflation (% YoY)*		2,0	1,8	1,9	1,8	1,5	1,9	1,6	1,5	-0,6	1,9	1,6
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	4,31	4,16	4,15	4,12	4,10	4,07	4,40	4,16	4,07
USDPLN**		3,97	3,70	3,65	3,41	3,40	3,35	3,31	3,26	4,18	3,41	3,26

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST* CA	FORECAST* CONSENSUS**
		Monday 10/09/2017				
8:00	Germany	Industrial production (% MoM)	Aug	0,0		0,7
10:30	Eurozone	Sentix Index (pts)	Oct	28,2		28,5
		Tuesday 10/10/2017				
8:00	Germany	Trade balance (bn EUR)	Aug	19,5		20,3
		Wednesday 10/11/2017				
20:00	USA	FOMC Minutes	Sep			
		Thursday 10/12/2017				
12:00	Eurozone	Industrial production (% MoM)	Aug	0,1		0,5
14:00	**Poland**	**CPI (% YoY)**	**Sep**	**2,2**	**2,1**	
		Friday 10/13/2017				
	China	Trade balance (bn USD)	Sep	42,0		39,5
14:00	**Poland**	**Core inflation (% YoY)**	**Sep**	**0,7**	**0,9**	
14:30	USA	CPI (% MoM)	Sep	0,4	0,6	0,6
14:30	USA	Core CPI (% MoM)	Sep	0,2	0,2	0,2
14:30	USA	Retail sales (% MoM)	Sep	-0,2	2,0	1,6
16:00	USA	Business inventories (% MoM)	Aug	0,2		0,7
16:00	USA	Initial U. of Michigan Sentiment Index (pts)	Oct	95,1	95,5	95,1

*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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