Will higher interest rates strengthen USD?

This week

- **Important hard data from the US and business survey results will be released this week**. The final estimate of the US GDP in Q4 2017 will be released on Wednesday. We expect that the annualized economic growth rate will be revised upwards to 3.0% vs. 2.5% in the first estimate, due to higher contributions of private consumption and changes in inventories. The results of the March consumer sentiment survey results will also be released in the US. We believe that the Conference Board Consumer Confidence Index (131.8 pts vs. 130.8 pts in February), like the final University of Michigan Index (102 pts vs. 99.7 pts in February), will confirm the continuingly good households' sentiment. We expect that the publication of US data will be neutral for the financial markets.
- **The flash estimate of HICP inflation for Germany will be released on Thursday**. We expect that the annual inflation rate rose to 1.6-1.7% vs. 1.2% in February. Conducive to the increase in inflation is the shift of the Easter Holiday this year which has temporarily boosted core inflation. We expect that the data will not have any substantial impact on PLN or yields on bonds.

Last week

- **The most important event last week was the FOMC meeting.** The target range for the Federal Reserve funds was raised by 25 bp up to [1.50%; 1.75%] which was in line with our expectations and the market consensus. According to the statement, the hike is justified by the current and forecasted inflation profile and the situation in the labour market. New FOMC members' macroeconomic projections were presented at the conference after the meeting (see below). We expect that FED will hike interest rates additional three times in 2018 (in June, September, and December, each time by 25 pts).
- **Significant data from the US economy were released last week.** Durable goods orders rose by 3.1% MoM in February vs. a 3.5% decrease in January, mainly due to higher dynamics of orders for means of transport (the effect of increase in orders for aircrafts and parts). Excluding means of transport, the monthly growth rate of orders rose to 1.2% in February vs. -0.2% in January, due to higher dynamics of orders for machinery, electrical equipment, and metals. Especially noteworthy in the data structure is the increase in the annual dynamics of orders for non-military capital goods, excluding orders for aircrafts (8.0% in February vs. 6.2% in January), being the leading indicator for future investments. Data on new home sales (618k in February vs. 622k in January) and existing home sales (5.54M in February vs. 5.38M in January), pointing to continuingly high level of activity in the US real estate market, were also released last week. We forecast that the annualized US GDP growth rate will decrease to 2.0% in Q1 2018 vs. 3.0% in Q4 2017.
- **Flash March business sentiment indicators (PMI) for major European economies were released last week.** PMI composite for the Eurozone dropped to 55.3 pts in March vs. 57.1 pts in February, hitting the lowest level since January 2017. The index decline was due to lower values of the indicators for both Germany (55.4 pts in March vs. 57.6 pts in February) and France (56.2 pts vs. 57.3 pts). Both economies recorded lower sub-indices for business activity in services and output in manufacturing. Other Eurozone countries covered by the survey also recorded lower economic growth rate. According to Markit, the deterioration in March was partly due to unfavourable weather conditions in North Europe. Growing production backlogs, resulting i.a. from the delays in delivery chain as well as shortage of materials and skilled labour, also played an important role. Conducive to the deterioration in business sentiment was also lower export demand, resulting from strong EUR, and increase in political risk in the Eurozone, which has a negative impact in internal demand. In the whole Q1 2018, the composite PMI for the Eurozone dropped slightly to 57.3 pts vs. 57.6 pts in Q4 2017. This supports our forecast, in

which the quarterly GDP growth rate in the Eurozone will not change in Q1 compared to Q4 and will amount to 0.6%.

- **ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany dropped to 5.1 pts in March vs. 17.8 pts in February, hitting the lowest level since September 2016**. According to the statement, the deterioration in sentiment was due to the survey participants' concerns about the negative impact of the growing US protectionism and the EUR appreciation vs. USD observed in recent months on the German exports. Ifo Index reflecting the sentiment among German managers representing the manufacturing, construction, wholesale and retail trade sectors was also released last week and dropped to 114.7 pts in March vs. 115.4 pts in February. The index decrease was due to its lower sub-indices concerning both the assessment of the current situation and expectations. Sector-wise, deterioration in sentiment was recorded in 2 of its 4 segments (manufacturing and retail trade), while the situation in construction improved. The assessment of situation in wholesale trade has not changed compared to February. We forecast that the quarterly GDP growth rate in the German economy will not change in Q1 compared to Q4 and will amount to 0.6%.
- **The dynamics of industrial production in Poland dropped to 7.4% YoY in February vs. 8.6% in January**. Seasonally-adjusted industrial production increased by 1.3% MoM in February. The value of production of the sectors of industry which recorded higher output in February in annual terms represented 83.2%.This shows that the recovery in manufacturing is wide ranging. Like in previous months, we saw a relatively fast increase in output both in segments with a considerable share of exports in sales ("machinery and equipment", "electrical equipment", and "furniture") and in segments connected with the construction sector ("other non-metallic mineral products", "metals", and "coke and refinery products"). It means that activity in Polish industry is supported by strong external demand and boom in domestic construction, in particular strong recovery in public infrastructural investments (see MACROpulse of 19/3/2018).The construction-assembly production growth rate dropped to 31.4% YoY in February vs. 34.7% in January. Conducive to slower production growth rate were the unfavourable weather conditions. Especially noteworthy in the data is the historically second fastest production growth in the segment "construction of civil engineering facilities". It shows that the construction-assembly production growth is boosted by outlays on public infrastructure (roads, railways, utilities). The production in this segment is additionally supported by temporarily increased investment activity of local government units due to the municipal elections scheduled for autumn. The data on industrial production and construction-assembly production – combined with the January data - pose a slight upside risk to our forecast of GDP growth rate in Q1 (4.7% YoY vs. 5.1% in Q4 2017).
- **Nominal retail sales in Poland increased by 7.9% YoY in February vs. 8.2% in January**. The real sales growth rate has not changed in February compared to January and amounted to 7.7%YoY. Conducive to higher dynamics of real retail sales were mainly higher sales in the category "solid, liquid and gaseous fuels", caused by unfavourable, compared to last year, weather conditions in February (severe frost), which boosted households' demand for heating fuels. On the other hand, unfavourable weather is likely to have adversely affected purchases in the category "motor vehicles, motorcycles, parts". Higher sales dynamics in the category "food, beverages and tobacco products" had a positive impact on retail sales growth (see MACROpulse of 21/3/2018). Between January and February 2018 the average growth rate of retail sales in constant prices amounted to 7.7% YoY vs. a 7.0% increase in Q4 2017, posing a slight upside risk to our forecast, in which the private consumption growth rate rose to 5.2% YoY in Q4 vs. 4.9% in Q4 2017.
- **In accordance with GUS data, the nominal dynamics of investments of companies employing at least 50 persons rose to 12.2% YoY in Q4 2017 vs. 1.7% in Q3**. Higher growth rate of fixed capital formation was wide ranging and resulted from higher contributions of investments in all

the sectors: manufacturing, energy, construction, services, and mining. However, the biggest contribution to increasing the investment dynamics between Q3 and Q4 was that of energy (up by 4.1 pp) and manufacturing (up by 3.3 pp). In the case of energy, the increase was related to low base effects from the year before. In turn, in the case of manufacturing, vital were investments in the segments which direct a significant part of production for exports (“manufacture of chemicals” and “manufacture of furniture”) and those related to the construction sector (“manufacture of other non-metallic mineral products”, “manufacture of metals”, “manufacture of metallic products”, and “manufacture of coke and refinery products”). In services, strong growth of investments was recorded in the transport category, most probably due to higher railway investments. In subsequent quarters we expect further recovery in corporate investments, supported by the inflow of EU funds and recovery in construction. Consequently, we forecast that investments dynamics will rise to 7.1% in 2018 vs. 5.2% in 2017.

- **The review of Poland’s long-term rating by Moody’s was scheduled for last Friday.** However, the agency did not review the rating and did not release a credit report. Thus Poland’s rating was left unchanged (A2 with a stable outlook)**.**

Will higher interest rates strengthen USD?

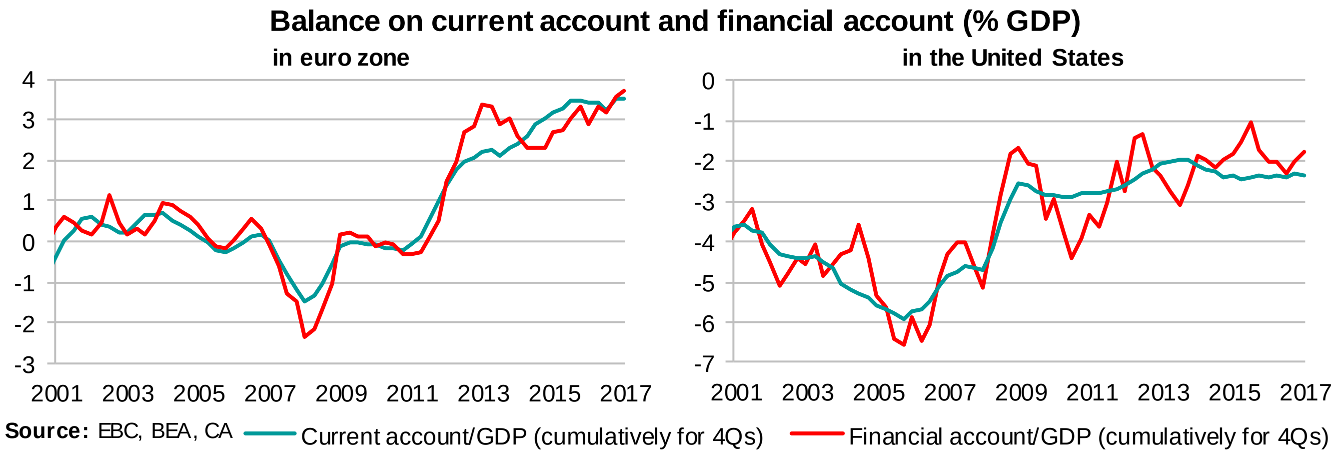
FOMC meeting was held last week. As we expected, FED raised the target range for the Federal Reserve funds rate by 25 bp up to [1.50%; 1.75%]. The March FED projections (see the table below) were also released together with the statement. Compared to the December projection, the expected economic growth rate was raised for 2018-2019 and was left unchanged for 2020 and the long term. The inflation projection was slightly raised for 2018 and 2020, while FED members’ expectations concerning 2019 and the long term did not change. In our view, the above revisions of the forecasts reflect the changes in the US tax policy (tax cuts for enterprises and households). Contrary to our expectations, the projection showed that the scale of the monetary policy tightening preferred by FED members in the whole 2019 was 75 bp (the same as in the December projection vs. the expected by us 100 bp). In 2019 FED expects three hikes (vs. the median pointing to a hike by 56 bp in the December projection) and subsequent two in 2020 (vs. 37 bp in the December projection). The amount of the interest rates forecast by FED members in the long term has been raised only slightly (by 10 bp) which probably signals that, in their opinion, the impact of the expensive fiscal policy on the economic growth rate and inflation will be limited in the long term. Despite the upward-revised interest rate profile in the FED projection, the market reacted to its publication by a weakening of USD vs. EUR. The EURUSD rate increased due to the fact that the analysts’ consensus pointed to a total of four rate hikes in 2018, while the FED projection was less hawkish and signaled only three hikes. Below we present the main factors affecting EURUSD in the medium term as well as our forecast.

We expect that the main factor shaping EURUSD rate in the coming quarters will be the continuing inflow of capital to the Eurozone. Recent years have seen increasing surpluses in the current account and in the financial account within the single currency area (in 2017 they amounted to 3.5% and 3.7% of GDP, respectively). In turn, in the US, a relatively stable deficit at a level of ca. 2% of GDP has been observed for both accounts. We expect that the above divergence in capital flows will be maintained in the coming quarters, contributing towards an increase in the EUR equilibrium rate vs. USD.

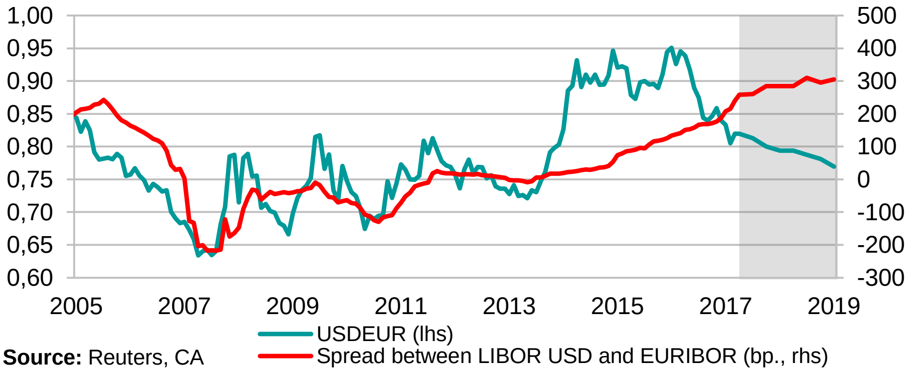
March Economic Projections of FRB Members & Reserve Bank Presidents*				
Indicator	**2018**	**2019**	**2020**	**Longer Run**
Target federal funds rate				
March Projection	2.1%	2.9%	3.4%	2.9%
December Projection	2.1%	2.7%	3.1%	2.8%
Credit Agricole Projection	**2.375%**	**3.125%**		**2.75%**
Change in real GDP				
March Projection	2.7%	2.4%	2.0%	1.8%
December Projection	2.5%	2.1%	2.0%	1.8%
Credit Agricole Projection	**2.9%**	**2.5%**	**1.8%**	**1.8%**
Unemployment rate - Q4 Average				
March Projection	3.8%	3.6%	3.6%	4.5%
December Projection	3.9%	3.9%	4.0%	4.6%
Credit Agricole Projection	**3.7%**	**3.4%**	**3.5%**	**4.5%**
Core PCE inflation				
March Projection	2.0%	2.1%	2.1%	
December Projection	1.9%	2.0%	2.0%	
Credit Agricole Projection	**2.0%**	**2.2%**	**2.3%**	

Source: Federal Reserve Board and Credit Agricole.
Projections of change in real GDP and core PCE are from the fourth quarter of the previous year to the fourth quarter of the year indicated. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Projections for the target federal funds rate are the value of midpoint of the target range that is the median of individual forecasts of FOMC members at the end of year.

Another factor conducive to USD weakening vs. EUR will be the expansive fiscal policy of the US. We believe that the fiscal impulse in the US will contribute to a temporary acceleration in economic growth but will not bring the effect of a sustainable increase in productivity. The materialization of such scenario may increase market concerns about the increase of so-called twin deficits in the US – higher deficit in current account caused by increase in the budget deficit. In addition, we believe that D. Trump's protectionist policy will not markedly reduce the US trade deficit (i.a. due to retaliatory tariffs imposed by other countries). The previous episodes of "trade wars" (the conflict between the US and Japan in the nineties or customs duties on imports of steel imposed in 2002) failed to decrease external imbalances in the US. We believe that we will see a similar situation in the coming quarters.



Will higher interest rates strengthen USD?

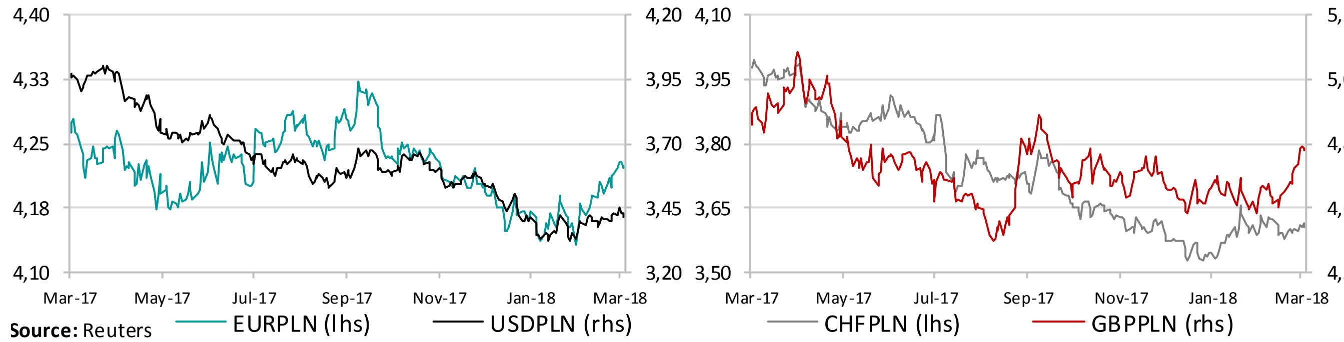


Source: Reuters, CA

On the other hand, in the coming quarters USD will be supported by the growing disparity of interest rates between USD and the Eurozone. We expect that by the end of 2019 FED will have hiked interest rates by 150 bp. In the same period, the ECB will have hiked the deposit rate by 30 bp and the main interest rate by 15 bp. The growing rates disparity will be conducive to EURUSD diverging downwards from the equilibrium rate. However, we believe that the over-all result of higher equilibrium rate of EUR vs. USD (due to the inflow of capital to the Eurozone) and the downward divergence of the EURUSD rate due to so-called "carry trade" transactions (resulting from the disparity of interest rates) will be the strengthening of EUR vs. USD. Consequently, we forecast that EURUSD will increase to 1.26 as at the end of 2018 and to 1.30 as at the end of 2019 (see the chart).

US data neutral for PLN

FX rates



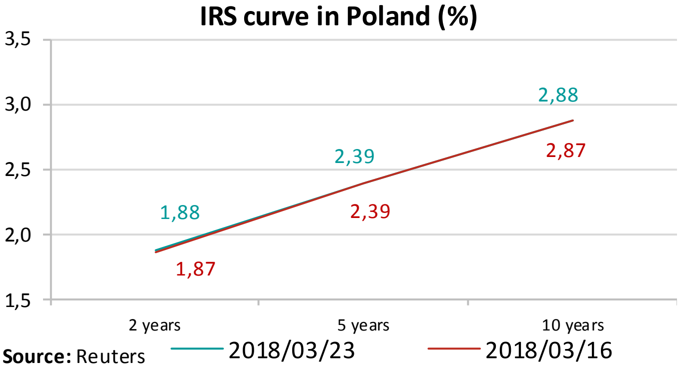
Source: Reuters

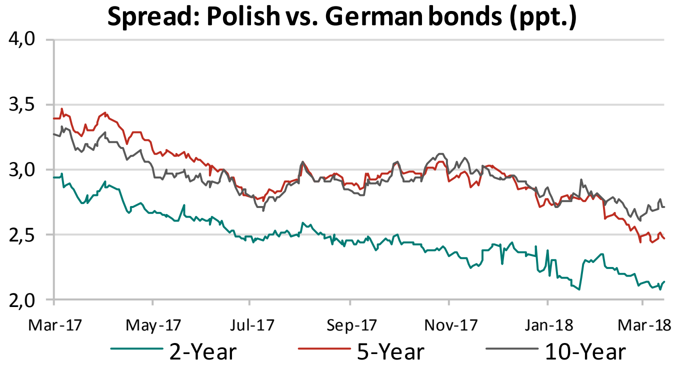
Last week EURPLN rate rose to 4.2237 (PLN weakening by 0.2%). Monday through Wednesday, PLN was depreciating in anticipation of the Wednesday's FOMC meeting. Domestic data on industrial production and retail sales had a limited impact on the market. Wednesday afternoon saw a correction which also continued on Thursday, supported by the less-hawkish-than-expected tone of the FOMC projection. On Friday, PLN was again depreciating as global risk aversion increased after the Chinese government announced the plans of imposing duties on import of US products in reaction to the US duties on import of steel and aluminum (see MACROmap of 5/3/2018).

Last week PLN was visibly depreciating vs. GBP (by 1.0%). This resulted from the decrease in EURGBP rate after it was reported that the UK and the EU had reached an agreement on the transition period before Brexit.

On Friday the Moody's did not review Poland's rating and did not release a credit report, which is neutral for PLN. Important for PLN this week will be the data from the US (final estimate of GDP in Q4, Conference Board Index, and final University of Michigan Index). However, we believe that their aggregate impact on PLN will be limited. Flash data on inflation in Germany will also be neutral for PLN.

Less-hawkish-than-expected FED projection lowered IRS rates





Source: Reuters

Last week the 2-year IRS rates rose to a level of 1.880 (up by 1 bp), 5-year rates to a level of 2.385 (unchanged compared to the level from before two weeks), and 10-year rates rose to a level of 2.877 (up by 1 bp). In the first part of the week an increase in IRS rates was observed across the curve in anticipation of the publication of the latest economic projection after the Wednesday's FOMC meeting. It proved to be less hawkish than expected. In effect, Thursday saw a decrease in IRS rates across the curve to the level from the beginning of the week. On Friday IRS rates were relatively stable.

On Friday Moody's did not review Poland's rating and did not release a credit report, which is neutral for IRS rates. This week the market will focus on the data from the US (final estimate of GDP in Q4, Conference Board Index, and final University of Michigan Index). However, we believe that they will not have any significant impact on IRS rates. Flash data on inflation in Germany will also be neutral for the market.

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	4,20
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	3,44
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	3,59
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	7,4	
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	-0,2	
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	7,9	
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	6,8	
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
GDP growth contributions: Investments (pp)	0,0	0,1	0,6	2,8	1,1	1,5	1,3	1,2	1,0	1,3	0,6
GDP growth contributions: 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	4,20	4,19	4,18	4,17	4,18	4,17	4,15
USDPLN**	3,97	3,70	3,65	3,48	3,44	3,41	3,34	3,31	3,48	3,31	3,19

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
		Tuesday 03/27/2018				
10:00	Eurozone	M3 money supply (% MoM)	Feb	4,6		4,6
11:00	Eurozone	Business Climate Indicator (pts)	Mar	1,48		1,40
15:00	USA	Case-Shiller Index (% MoM)	Jan	0,6		0,6
16:00	USA	Richmond Fed Index	Mar	28,0		
16:00	USA	Consumer Confidence Index	Mar	130,8	131,8	131,0
		Wednesday 03/28/2018				
14:30	USA	Final GDP (% YoY)	Q4	2,5	3,0	2,6
		Thursday 03/29/2018				
14:00	Germany	Preliminary HICP (% YoY)	Mar	1,2	1,6	1,6
14:30	USA	Real private consumption (% MoM)	Feb	-0,1		
15:45	USA	Chicago PMI (pts)	Mar	61,9		62,0
16:00	USA	Final U. of Michigan Sentiment Index (pts)	Mar	102,0	102,0	102,0

*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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