Slight slowdown of Chinese economy

This week

- **The most important event this week was the today's reading of the April business survey results for major European economies.** The PMI Composite for the Eurozone stabilized at 55.2 pts amid weaker manufacturing and improved sentiment in services. Sentiment both in Germany and France improved. Ifo Index, reflecting the sentiment among German managers representing the manufacturing, construction, wholesale and services, will be released tomorrow. We expect it to decrease to 102.2 pts in April from 114.7 pts in March. The sharp decrease of the index will not reflect a deterioration of sentiment but only changes in the methodology of its calculation (a wider scope of services will be taken into account). Past index values calculated according to the new methodology will be released at the same time.
- **Another important event will be the ECB meeting scheduled for Thursday.** In our view, the monetary policy parameters will be left unchanged. On the other hand, journalists' questions and M. Draghi's answers will be crucial in the context of his Friday's dovish remark (see below). We expect that the conference after the meeting will be conducive to increased volatility of EUR, PLN, and prices of the Polish debt.
- **Significant hard data from the US and business survey results will be released this week**. The flash estimate of GDP in Q1 will be released on Friday. We expect that the annualized economic growth rate dropped to 1.7% vs. 2.9% in Q4 2017, due to lower contributions of private consumption and net exports. We forecast that new home sales decreased to 611k in March vs. 618k in February. We expect that the monthly dynamics of preliminary March durable goods orders dropped to 2.2% in March from 3.0% in February. The April US business survey results will also be released this week. We believe that the Conference Board Consumer Confidence Index (125.0 pts vs. 127.7 pts in March), like the upward revised final University of Michigan Index (98.3 pts vs. 101.4 pts in March), will point to a slight deterioration of households' sentiment. In our view, the aggregate impact of US data will be neutral for the financial markets.
- **In accordance with the GUS data released today, retail sales in enterprises employing more than 9 people increased in current prices by 9.2% YoY in March vs. a 7.9% increase in February, running markedly above the market consensus (8.2%) and our forecast (8.3%).** The sales growth rate in constant prices rose by 8.8% in March vs. 7.7% in February. For more details about this release please see MACROpulse of 23/04/2018.

Last week

- **Numerous hard data from the US and business survey results were released last week.** The monthly dynamics of industrial production dropped to 0.5% in March vs. 1.0% decline in February, due to lower production growth rate in mining and manufacturing. At the same time, capacity utilization dropped to 78.0% in March vs. 78.1% in February. Data on nominal retail sales were also released last week and increased to 0.6% in March vs. -0.1% in February, which resulted mainly from higher sales of cars. Excluding car sales, retail sales dynamics have not changed in March compared to February and amounted to 0.2% MoM. Sustained high activity in the US real estate market was reflected by data on building permits (1354k in March vs. 1321k in February) and housing starts (1319k vs. 1295k). Mixed signals concerning sentiment in manufacturing were given last week by NY Empire State Index (15.8 pts in April vs. 22.5 pts in March) and Philadelphia FED Index (23.2 pts in April vs. 22.3 pts in March). The last week's data on the US economy are consistent with our scenario, in which FED will hike interest rates three more times this year, each time by 25 bp (in June, September, and December).
- **ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany dropped to -8.2 pts in April vs. 5.1 pts in March, hitting the**

lowest level since November 2012. According to the statement, the deterioration of sentiment resulted from survey participants' concerns about the negative impact of the growing US protectionism on global trade and the aggravation of the geopolitical situation around Syria. Negative for the participants' sentiment were also the data which were released in recent months and which point to a slowdown of activity in the German economy. The deterioration of sentiment in Germany, being Poland's major trade partner, will have a negative impact on the growth rate of Polish exports in Q2 2018. Consequently, it poses a downside risk to our forecast, in which the dynamics of Polish exports will decrease to 6.5% YoY in Q2 vs. 7.5% in Q1. At the same time, it poses a downside risk to our forecast of the Polish GDP growth rate in Q2 (4.3% YoY in Q2 vs. 4.7% in Q1).

- **The dynamics of industrial production in Poland dropped to 1.8% YoY in March vs. 7.4% in February.** The main factor behind the decrease in industrial production dynamics between February and March was an unfavourable difference in the number of working days. Especially noteworthy in the data is the slowdown of production in the export branches which most likely results from the slight deterioration in the German economy observed since January 2018 (see MACROpulse of 19/4/2018). The construction-assembly production growth dropped to 16.2% YoY in March vs. 31.4% in February. Conducive to slower production growth rate were the above-mentioned unfavourable calendar effects. The construction-assembly production growth was also hampered by high base effects from the year before (in March 2017 seasonally-adjusted production rose by 9.8% MoM). Seasonally-adjusted construction-assembly production dropped by 0.4% MoM in March 2018. We expect that in subsequent months the production will return to an upward trend, supported by growing absorption of EU funds, higher outlays on infrastructure, and further recovery in residential construction. In the whole Q1 the average dynamics of industrial production dropped to 5.6% vs. 8.2% in Q4 2017, while the dynamics of construction-assembly production rose to 26.1% vs. 17.1%. The acceleration in the construction-assembly production between Q4 2017 and Q1 2018 only partly offsets the negative impact of the slowdown in manufacturing on GDP.
- **Nominal wage dynamics in the Polish sector of enterprises dropped to 6.7% YoY in March from 6.8% in February**. The main factor behind lower annual wage dynamics was the previous year's high base effect related to the payment (unusually in March) of the second instalment of the annual bonus, the so-called 14th salary, in Katowicki Holding Węglowy (see MACROpulse of 18/4/2018). The unfavourable difference in the number of working days, lowering the wage growth of employees doing piecework, was also negative for the wage growth rate in March. On the other hand, salary increases in KGHM had an opposite impact. The annual employment growth has not changed in March compared to February and amounted to 3.7% YoY. In our view, the employment growth was boosted by gradual acceleration in real wage growth, which supports the return to the labour market of so-far professionally inactive persons, and by growing registered employment of immigrants from Ukraine. We estimate that the real wage growth in the corporate sector rate amounted on the average to 5.3% YoY in Q1 vs. 4.7% in Q4 2017. It supports our forecast of higher private consumption growth rate in Q1 2018 (5.2% YoY vs. 5.0% in Q4 2017).
- **Significant data on the Chinese economy were released last week.** The annual GDP growth rate has not changed in Q1 2018 vs. Q4 2017 and amounted to 6.8% (1.4% QoQ in Q1 vs. 1.6% in Q4, see below). The slowdown of activity in the Chinese economy in March was indicated by data on industrial production (6.0% YoY in March vs. 7.2% in February) and urban investments (7.5% YoY vs. 7.9%). On the other hand, the dynamics of retail sales recorded an increase (10.1% vs. 9.7%). The last week's data from the Chinese economy point to increasingly stronger symptoms of its slowdown (see below).
- **Last week the ECB Governor, M. Draghi, expressed the opinion that "it is possible that the Eurozone economy has reached the peak of its business cycle"**. He also voiced the conviction that further, significant monetary stimulation by the ECB was needed. He also pointed to the

necessity of further careful monitoring of the situation in the financial markets. M. Draghi indicated that prospects for inflation returning to the target in the medium term had improved. Despite that, in his view, prudence and patience was needed in monetary policy. The dovish tone of M. Draghi's remark has led to a weakening of EUR vs. USD and a slight decrease in yields on German bonds. At the same time, it poses a downside risk to our scenario, in which in June 2018 the ECB will extend the asset purchase program until December 2018, reducing its scale to EUR 15bn starting from September 2018. We maintain the view that the first hike of interest rates (deposit rate) will take place in September 2019 and the main interest rate will be hiked in December 2019.

Slight slowdown of Chinese economy

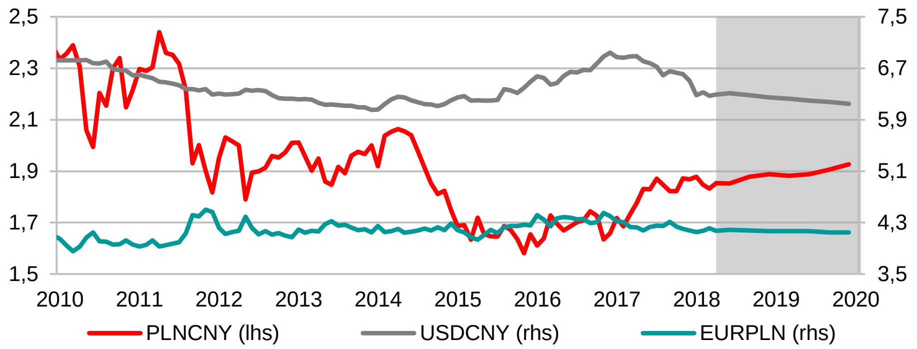
Source: Reuters, Credit Agricole

According to data released last week, the annual economic growth rate in China has not changed in Q1 2018 compared to Q4 2017 and amounted to 6.8%. The GDP growth structure pointed to further increase in the significance of services in creating added value and, on the demand side, to higher role of consumption amid decreasing contribution of investments. At first sight, the above-mentioned data give a positive picture of the Chinese economy. However, an in-depth analysis of recent publications points to growing symptoms of its slowdown.

Quarterly, seasonally-adjusted GDP growth rate dropped from 1.6% in Q4 2017 to 1.4% in Q1 2018, hitting the second lowest level in the history of the series. Stagnation trends were also signaled by the March data – industrial production dynamics dropped to 6.0% YoY vs. 7.2% in February, while urban investments growth rate dropped to 7.5% YoY vs. 7.9% in March. The March Caixin PMI for Chinese manufacturing also recorded a decline (51.0 pts vs. 51.6 pts in February). The situation in the labour market also looks less favourable than in recent quarters – the number of new jobs dropped in Q1 for the first time in two years (down by 1.2% YoY vs. a 2.8% increase in Q4 2017). In addition, the real disposable income growth declined to the slowest pace since 2016 (7.4% YoY in Q1 vs. 7.7% in Q4). A slowdown was also recorded for the activity in the real estate market (even faster YoY decline of the completed floor area of dwellings) and in lending. After the publication of weak economic data for Q1, the People's Bank of China (PBoC) lowered the required reserve ratio by 100bp. The PBoC indicated that such action was aimed at improving the liquidity situation of commercial banks and increasing lending in the segment of small and medium-size enterprises.

Especially noteworthy in the GDP data is the fact that the main factor behind the slowdown of economic growth in Q1 was the contribution of new exports which stood below zero (-0.6 pp vs. 0.6 pp) for the first time since Q4 2016. This is the effect of growing domestic demand and the strengthening of real effective rate of yuan. In the coming quarters, the protectionist measures initiated by D. Trump pose a substantial downside risk to the net exports' contribution to the Chinese GDP growth. D. Trump has informed recently that he is considering the imposition of additional tariffs on Chinese products whose imports amount to USD 100bn. In reaction to these words the Chinese administration announced that China would respond "immediately, decidedly, and without hesitation" should the US impose new tariffs. The aggravation of China's rhetoric may point to a higher likelihood of a customs war between these countries, however, in our opinion, this is rather negotiation tactic aimed at softening D. Trump's actions. In our baseline scenario we do not expect an open trade war between the USA and China. We estimate that even if China lost the whole export to the US that is subject to the now announced customs duties (goods worth USD 50bn), it would reduce their annual economic growth rate by only ca. 0.1 pp. In turn, the total trade exchange with the US boosted China's GDP dynamics in 2017 by 0.9 pp. Consequently, we believe that in the long term China will want to maintain good relations with the US (i.e. not to lead to a trade war) so as not to risk the loss of a bigger part of their exports to the US which could bring about a significant slowdown of economic growth.

We forecast that in subsequent quarters the dynamics of China's GDP will gradually decrease to 6.3% YoY in Q4 2019. The slowdown of growth will be related to further decline in the dynamics of investments resulting from the government measures reducing the China's leverage. Faster consumption growth will make up for slower growth of investments only to a limited extent because it will be simultaneously conducive to faster imports growth and lower contribution of net exports. The trajectory of GDP growth in subsequent quarters will be stabilized by PBoC actions consisting in the maintenance of an accommodative monetary policy.



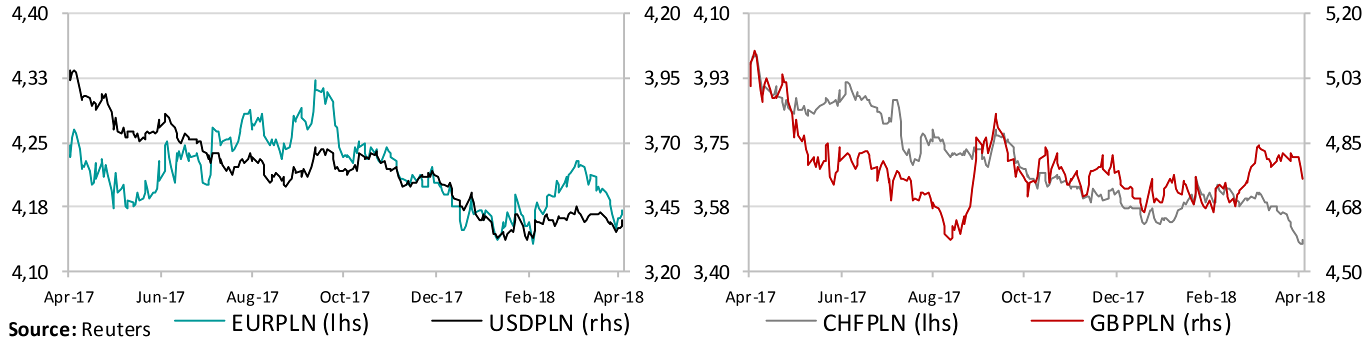
Source: Reuters, Credit Agricole

The PBoC Governor, Yi Gang, indicated that the central bank had no intention of taking measures aimed at yuan weakening in order to mitigate the negative impact of the US protectionist actions on the Chinese economy. We expect that in the coming quarters the yuan rate vs. USD will stay within a weak upward trend – we forecast that USDCNY rate will decrease to 6.25 as at the end of 2018 and to 6.15 as at the end of 2019. Conducive to yuan strengthening will be the continuing inflow of portfolio capital to China. Barclays announced in March that Chinese bonds would be added to its indices, which supported demand for the Chinese debt. We believe that in the coming quarters a similar decision will be taken also by other investment funds. The scale of the CNY appreciation will be limited by the expected by us slowdown of economic growth in China. In effect, considering the forecast by us USDPLN rate (see the quarterly table), we expect that PLNCNY will stay within an upward trend reaching up to 1.93 as at the end of 2019.

In the above analysis we have used the reports of D. Kowalczyk (Crédit Agricole Corporate and Investment Bank): *China-US trade-war risk rises as Beijing steps up retaliation against Washington's tariffs* and *China: PBoC cuts banks' required reserve ratio as growth momentum eases*.

Business survey results may strengthen PLN

FX rates



Source: Reuters

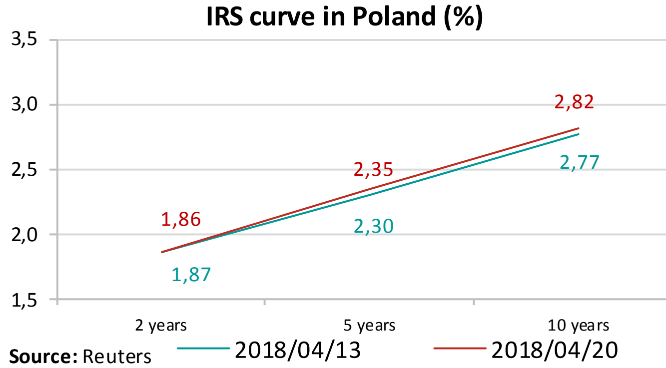
Last week EURPLN rate rose to 4.1710 (PLN weakening by 0.1%). The S&P decision to affirm Poland's existing rating and change its outlook from stable to positive, published two weeks ago, had a limited impact on PLN. Throughout last week we observed a weak depreciation of PLN and other currencies of the region related to lower risk appetite reflected by higher VIX index. Increase in risk aversion was supported by the incoming subsequent signals pointing to growing risk of slowdown in the global economy (ZEW index for Germany and hard data for China). Domestic data on employment and average wages and industrial production had no significant impact on PLN.

Especially noteworthy is the last week's PLN strengthening vs. GBP (by 1.2%). It resulted from the marked depreciation of GBP vs. EUR, supported by the publication of weaker-than-expected data on inflation in the United Kingdom as well as a dovish remark of the Governor of the Bank of England, M. Carney, who weakened the investors' expectations of interest rate hike in May. In turn, Friday saw a marked weakening of EUR vs. USD, and, consequently, PLN vs. USD in reaction to the dovish remark by the ECB Governor, M. Draghi (see below).

Crucial for PLN this week will be the publication of Ifo index for Germany. If our lower-from-the-market-consensus forecasts materialize, these data may be slightly positive for PLN. We believe that the ECB meeting may be conducive to increased volatility of PLN. In our view, the aggregate impact of data from the US (first estimate of GDP in Q1, preliminary durable goods orders, Conference Board Index, new home sales, and existing home sales) on PLN will be limited.

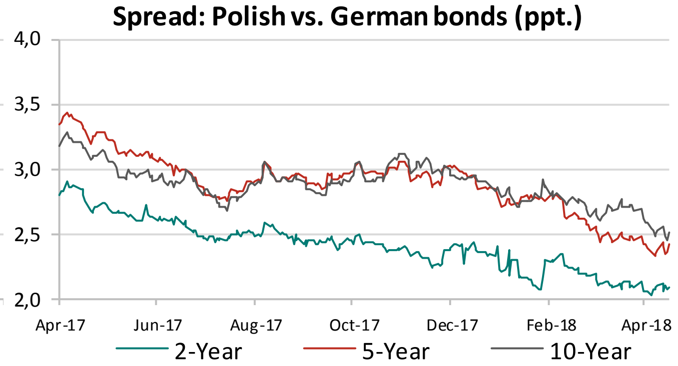
IRS rates increase following the German market

IRS curve in Poland (%)



Source: Reuters

Spread: Polish vs. German bonds (ppt.)



Last week the 2-year IRS rates have not changed compared to the level from two weeks ago and amounted to 1.86, 5-year rates rose to a level of 2.35 (up by 5 bp), and 10-year rates to a level of 2.82

(up by 5 bp). The S&P decision to affirm Poland's existing rating and change its outlook from stable to positive, published on Friday two weeks ago, had no significant impact on IRS rates, which were rising last week, following the German market. The continuing relatively low liquidity in the domestic market did not support IRS volatility, either. Domestic data on industrial production as well as employment and average wages in the Polish corporate sector had no significant impact on the curve. The Friday's dovish remark of M. Draghi (see above) had a limited impact on IRS rates.

This week the market will focus on the results of business surveys for major European economies (PMIs and Ifo index. On the other hand, the numerous data from the US (first estimate of GDP in Q1, preliminary durable goods orders, Conference Board Index, new home sales, and existing home sales) will have a limited impact on the curve.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	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	Apr-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*	4,23	4,23	4,18	4,23	4,25	4,25	4,31	4,24	4,20	4,18	4,15	4,17	4,21	**4,17**
USDPLN*	3,97	3,88	3,72	3,70	3,59	3,57	3,65	3,64	3,53	3,48	3,34	3,42	3,42	**3,39**
CHFPLN*	3,96	3,90	3,84	3,86	3,72	3,72	3,77	3,65	3,59	3,57	3,59	3,62	3,58	**3,54**
CPI inflation (% YoY)	2,0	2,0	1,9	1,5	1,7	1,8	2,2	2,1	2,5	2,1	1,9	1,4	1,3	
Core inflation (% YoY)	0,6	0,9	0,8	0,8	0,8	0,7	1,0	0,8	0,9	0,9	1,0	0,8	0,7	
Industrial production (% YoY)	11,0	-0,5	9,3	4,4	6,3	8,9	4,3	12,4	9,2	2,8	8,6	7,4	1,8	
PPI inflation (% YoY)	4,8	4,2	2,4	1,8	2,2	3,0	3,2	3,0	1,8	0,3	0,2	-0,1	0,3	
Retail sales (% YoY)	9,7	8,1	8,4	6,0	7,1	7,6	8,6	8,0	10,2	6,0	8,2	7,9	**8,3**	
Corporate sector wages (% YoY)	5,2	4,1	5,4	6,0	4,9	6,6	6,0	7,4	6,5	7,3	7,3	6,8	6,7	
Employment (% YoY)	4,5	4,6	4,5	4,3	4,5	4,6	4,5	4,4	4,5	4,6	3,8	3,7	3,7	
Unemployment rate* (%)	8,0	7,6	7,3	7,0	7,0	7,0	6,8	6,6	6,5	6,6	6,9	6,8	**6,5**	
Current account (M EUR)	-280	284	-202	-902	-296	311	218	436	278	-699	2072	-1017		
Exports (% YoY EUR)	19,7	3,3	19,1	7,2	15,0	13,4	11,5	15,8	15,5	2,6	11,7	5,7		
Imports (% YoY EUR)	19,7	5,0	21,5	14,3	14,6	8,7	8,9	15,4	15,9	10,9	16,3	8,3		

*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	4,1	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
	Investments (pp)	0,0	0,1	0,6	2,8	1,1	1,5	1,3	1,2	1,0	1,3	0,6
	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 (% of GDP)***		0,2	-0,4	0,3	0,3	-0,1	-0,1	-0,4	-0,4	0,3	-0,4	-0,6
Unemployment rate (%)**		8,0	7,0	6,8	6,6	6,5	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	1,5	1,5	1,6	1,1	2,0	1,4	1,7
Wibor 3M (%)**		1,73	1,73	1,73	1,72	1,70	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	4,21	4,19	4,18	4,17	4,18	4,17	4,15
USDPLN**		3,97	3,70	3,65	3,48	3,42	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**
		Monday 04/23/2018				
9:30	Germany	Flash Manufacturing PMI (pts)	Apr	58,2	56,9	57,5
10:00	**Poland**	**Retail sales (% YoY)**	**Mar**	**7,9**	**8,3**	**8,2**
10:00	Eurozone	Flash Services PMI (pts)	Apr	54,9	54,7	54,6
10:00	Eurozone	Flash Manufacturing PMI (pts)	Apr	56,6	55,8	56,1
10:00	Eurozone	Flash Composite PMI (pts)	Apr	55,2	54,9	54,9
15:45	USA	Flash Manufacturing PMI (pts)	Apr	55,6		55,0
16:00	USA	Existing home sales (M MoM)	Mar	5,54	5,56	5,55
		Tuesday 04/24/2018				
10:00	Germany	Ifo busienss climate (pts)	Apr	114,7	102,2	102,6
14:00	**Poland**	**M3 money supply (% YoY)**	**Mar**	**4,9**	**5,2**	**5,3**
15:00	USA	Case-Shiller Index (% MoM)	Feb	0,8		0,7
16:00	USA	New home sales (k)	Mar	618	611	630
16:00	USA	Richmond Fed Index	Apr	15,0		
16:00	USA	Consumer Confidence Index	Apr	127,7	125,0	126,0
		Wednesday 04/25/2018				
10:00	**Poland**	**Registered unemplyment rate (%)**	**Mar**	**6,8**	**6,5**	**6,6**
		Thursday 04/26/2018				
13:45	Eurozone	EBC rate decision (%)	Apr	0,00	0,00	0,00
14:30	USA	Durable goods orders (% MoM)	Mar	3,0	2,2	1,4
		Friday 04/27/2018				
11:00	Eurozone	Business Climate Indicator (pts)	Apr	1,34		1,27
14:00	**Poland**	**MPC Minutes**	**Apr**			
14:30	USA	Preliminary estimate of GDP (% YoY)	Q1	2,9	1,7	2,0
16:00	USA	Final U. of Michigan Sentiment Index (pts)	Apr	97,8	98,3	98,0

*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

MACRO MAP

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