Investment cycle in Poland will be short

This week

- **The most important event this week will be the meeting of the Monetary Policy Council scheduled for Wednesday.** We expect that the MPC will decide to leave interest rates at an unchanged level. We believe that the issues of the weaker-from-NBP-expectations data on investments in Q1 and the May inflation, which according to the flash estimate ran below the market expectations, will be raised during the conference. The data are important from the point of view of monetary policy outlook and they provide arguments in favour of maintaining stable interest rates for an extended period of time. In our view, the NBP Governor, A. Glapiński, will repeat his view that interest rates will remain unchanged at least until the end of 2019. The press release after the Council meeting and NBP Governor's remarks during the conference will be neutral for PLN and the prices of the Polish debt.
- **Data on the Chinese balance of trade will be released on Friday**. We expect that it rose to USD 39.0bn in May vs. USD 28.4bn in April. We forecast that export growth recorded an increase to 16.4% in May vs. 12.7% in April, while import growth rose to 22.1% from 21.5%. The publication of data from China will be neutral for the markets, we believe.
- **Information about subsequent protectionist measures undertaken by the United States will be a factor of potentially substantial and negative impact on market sentiment in the coming days.** Despite the recent remarks of the Treasury Secretary, Steven Mnuchin, who said that the trade war between the US and China had been suspended, the United States have announced the release on 15 June of a list of Chinese goods covered by the tariffs. Until the end of June, the administration will propose restrictions in Chinese investments in the US and controls limiting the access of Chinese companies to the US technologies. Last week, the administration also imposed customs duties on the import of steel (25%) and aluminum (10%) from Canada, Mexico, and the EU, which had been suspended for the duration of the negotiations. The EU and Canada can be expected to introduce retaliatory measures and impose customs duties on some goods imported from the US. Possible reaction of the US administration to such measures, for instance in the form of announcing the introduction of customs duties on passenger cars imported from the EU countries, will be negative for EUR and PLN.
- **The review of Poland's long-term rating by Fitch has been scheduled for Friday.** In December 2017, the Agency left Poland's long-term credit rating unchanged at A- with stable outlook. In the reasons for the decision Fitch indicated that the current rating reflected the sound macroeconomic fundamentals of the Polish economy, including a well-capitalized banking sector and public debt at a level similar to countries with the same rating. We believe that, due to the higher-than-expected GDP growth rate in recent quarters and good situation in public finance, the agency will change the tone of the statement to a more positive one. However, in the baseline scenario we expect that Fitch will affirm the so-far rating this week with stable outlook. Situation in public finances used to be indicated as a factor that might be a negative rather than positive risk for Poland's credit rating. In addition, in the case of Fitch, Poland's rating assigned only on the basis of an econometric model should be "A". However, due to a relatively high – against the background of other countries with such rating – net foreign debt in relation to GDP, the credit committee downgraded this rating by one notch. In December 2017, Fitch pointed out that reduction of net external debt supported by higher current account balance would have been conducive to upgrading Poland's credit rating. However, we believe that the surplus recorded in the current account in 2017 will not result in the rating upgrade or change of outlook. That is because, as at the end of 2017, net foreign debt in relation to GDP (29.6%) in Poland stood not only significantly above the median value for "A" rated countries but also above the values recorded in other "A-" rated countries: Lithuania (19.5%), Slovenia (22.2%), or Latvia (24.4%). What could incline Fitch to upgrade the outlook this week is the high economic growth rate in Q1 2018. The agency forecast in December 2017 that the GDP growth rate would amount to 3.6% YoY in 2018. Fitch were saying that the continuing high dynamics of

GDP, supporting Poland's convergence to other countries with "A" rating, posed an upside risk to credit rating. In effect, we do not rule out the scenario where Fitch will change the rating outlook this week from stable to positive. The agency's decision will be released after the closing of the European markets, therefore possible reaction of the FX market and the debt market will materialize no sooner than next week.

Last week

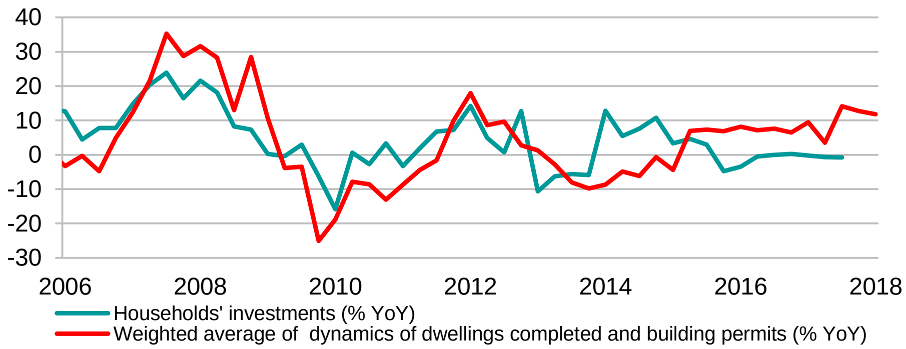
- **Non-farm payrolls in the US rose by 223k in May vs. a 159k increase in April (revised downwards from 164k), running above the market expectations (increase by 185k).** The highest increase in employment was recorded in education and health service (+39.0k), retail trade (+31.1k), and business services (+31.0k). Unemployment rate dropped to 3.8% in May from 3.9% in April, hitting the lowest level since April 2000, and clearly below the natural unemployment rate indicated by FOMC (4.5% - see MACROmap of 26/3/2018). The participation rate dropped to 62.7% in May vs. 62.8% in April, due to the exit from the labour market of some so-far unemployed persons. Despite the slight decrease in May, the participation rate in the US remains relatively stable against the historical background. The annual dynamics of average hourly earnings rose to 2.7% in May vs. 2.6% in April. We expect that subsequent months will record further increase in wage growth, as the situation in the US labour market will improve. According to the second estimate, the annualized US GDP growth rate amounted to 2.2% in Q1 vs. 2.3% in the first estimate. The downward revision resulted from lower contributions of inventories (down by 0.30 pp), net exports (down by 0.12 pp), and private consumption (down by 0.02 pp). A higher contribution of investments (up by 0.30 pp) had an opposite impact. The results of business surveys were also released last week. The ISM index for manufacturing increased to 58.7 pts in May vs. 57.3 pts in April. The index increase resulted from higher contributions of four of its five sub-indices (for new orders, output, suppliers' delivery times, and employment). A lower contribution of the inventories sub-index had an opposite impact. Especially noteworthy is the decrease in the sub-index concerning new export orders, which supports our scenario of slowdown in global trade. The Conference Board Consumer Confidence Index rose to 128.0 pts in May vs. 125.6 pts in April (the highest since February 2018). The index increase resulted from higher values of both its sub-indices for the assessment of the current situation and expectations. The last week's data from the US labour market support our scenario, in which FED will hike rates three more times (in total by 75 pts) before the end of 2018.
- **In accordance with the flash estimate, inflation in the Eurozone rose to 1.9% YoY in May vs. 1.2% in April, running above our forecast (1.8%) and the market consensus (1.6%).** Conducive to higher inflation were higher dynamics of prices of services, energy, and food. We expect that until November 2018, total inflation in the Eurozone will range between 1.9% and 2.0%, due to high dynamics of fuel prices. In our view, the inflation rate within the single currency area will show a downward trend in subsequent quarters to reach 1.4% in Q4 2019. In our view, core inflation will not exceed 1.4% (vs. 1.1% in May) within the next two years. The higher-than-expected May inflation does not alter 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. Yet, we do not rule out that the high uncertainty caused by the slowdown of economic growth observed recently in the Eurozone might incline the ECB to postpone this decision until July.
- **CFLP PMI for Chinese manufacturing rose to 51.9 pts in May vs. 51.4 pts in April**. On the other hand, Caixin PMI has not changed in May compared to April and amounted to 51.1 pts. The index stabilization resulted from higher contributions of the sub-indices concerning new orders, suppliers' delivery times, and output and lower contribution of the employment sub-index

which had an opposite impact. On the other hand, especially noteworthy is the continuing for two months now decrease in new export orders, which occurred despite the signaled in press releases temporary increase in demand from the US companies for Chinese goods due to the expected introduction of tariffs on imports from China. Consequently, the decrease in new orders in Chinese exports strongly supports our scenario of slowdown in global trade, which will adversely affect the economic activity in Poland in the coming quarters.

- **According to the flash estimate, inflation in Poland rose to 1.7% YoY in May vs. 1.3% in April, running below our forecast (1.8%) and the market expectations (1.9%)**. GUS published partial data on inflation structure, including information about inflation rate in the categories "food and non-alcoholic beverages", "energy", and "fuels". Conducive to higher headline inflation were higher dynamics of fuel prices (9.0% YoY in May vs. 1.4% in April). Lower dynamics of food prices (3.0% YoY vs. 4.1% in April) had an opposite impact. According to our estimates, core inflation amounted to 0.5-0.6% YoY in May vs. 0.6% in April. The April data pose an upside risk to our forecast of average yearly inflation in 2018 (1.4% vs. 2.0% in 2017).
- **The business sentiment indicator for Polish manufacturing (PMI) dropped to 53.3 pts in May vs. 53.9 pts April, running in line with the market expectations and slightly above our forecast (53.2 pts)**. As a result, it reached the lowest level since August 2017 (see MACROpulse of 1/6/2018). Conducive to the indicator decrease were lower values of the sub-indices for output and employment. Especially noteworthy in the data structure is the slight drop (sub-index below 50 pts) of new export orders. Polish manufacturing saw a decline in export orders already twice in the last three months. This trend is consistent with the slowdown in global trade recorded by business surveys abroad. The value of the Polish PMI in April-May period (53.6 pts) stood slightly below its average value in Q1 (54.0 pts), which supports our scenario of slower GDP growth in Q2 2018.
- **GDP growth rate in Poland stood at 5.2% YoY in Q1 vs. 4.9% in Q4 2017, running above the flash estimate released earlier (5.1%).** Seasonally adjusted GDP increased by 1.6% QoQ in Q1 vs. a 1.0% increase in Q4 (see MACROpulse of 30/5/2018). The main factor behind the acceleration of economic growth was higher contribution of change in inventories (1.9 pp vs. 0.1 pp in Q4 2017). Q2 saw a strong decrease in exports growth rate (down to 1.1% YoY in Q1 vs. 8.2% in Q4) which signals the weakening of foreign demand owing to a GDP slowdown in Poland's main trading partners (see MACROmap of 30/4/2018). Despite a simultaneous deceleration in imports (from 8.9% YoY in Q4 down to 3.3%), the contribution of net exports decreased by 1.2 pp in Q1 compared to Q4, which was the main factor hampering economic growth in Q1. The contribution of consumption to GDP growth rose to 3.0 pp in Q1 vs. 2.5 pp in Q4, hitting the highest level since Q4 2008. The factor which limited the scale of the acceleration of economic growth were investments. Their dynamics rose to 8.1% YoY vs. 5.4% YoY in Q4, however, due to decrease in the weight of fixed capital formation in GDP between Q4 and Q1, the contribution to GDP growth dropped by 0.5 pp. The data released last week support our scenario, in which Q1 2018 was the peak of the current economic cycle. In subsequent quarters we expect that the GDP growth rate will continue to be relatively high but will show a weak downward trend. The last week's data pose an upside risk to our forecast of yearly average GDP growth in 2018 (4.3% YoY in 2018 vs. 4.6% in 2017). We will present our revised medium-term macroeconomic scenario on 11 June.

Investment cycle in Poland will be short

According to data on GDP in Poland released last week, the dynamics of total investments rose to 8.1% YoY in Q1 vs. 5.4% YoY in Q4. A correct assessment of investment activity trends in the coming quarters is a crucial factor affecting the accuracy of forecast of economic growth rate. Below we present our short-term scenario of gross fixed capital formation broken down into three main segments: households' investments, corporate investments, and public investments.

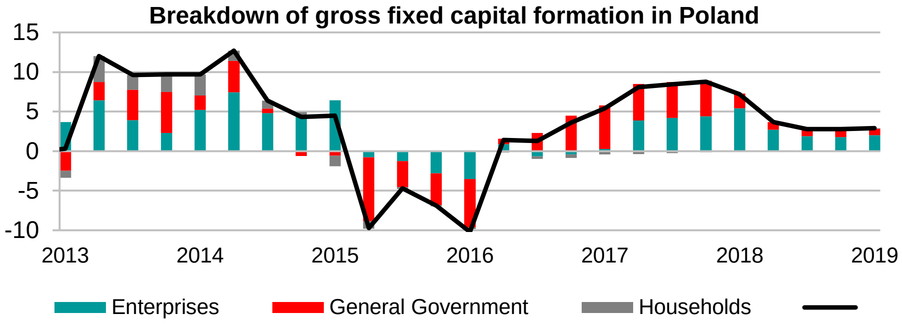


Source: Eurostat, GUS, Credit Agricole * weights respectively 20% and 80%

The key source of information about households' investment outlays are data on building permits issued and number of completed dwellings. Based on such data for January-March, we estimate that the dynamics of households' investments in Q1 have not substantially changed compared to recent quarters and continued to run close to zero. We believe that 2018-2019 will see a weak trend for an increase in the dynamics of households' outlays for fixed assets. Demand for new homes will be supported by good situation in the labour market and purchase of flats for rent (as an alternative source of investments, given low return on bank deposits).

Fixed capital formation of enterprises in general show different trends than investments of 50+ companies. Unlike for large companies (surge in nominal dynamics from 1.7% in Q3 2017 to 12.2% in Q4 followed by a decline to 6.1% in Q1 2018) the rebound in investments of total enterprises takes a milder course. We expect that in the coming months the barrier in the form of high capacity utilization will be the main factor inclining companies to increase investment outlays. On the other hand, corporate investments will be limited by growing difficulties in finding skilled labour. We believe that the recovery in the investment activity will peak at the turn of 2018 and 2019. The tendencies outlined above are consistent with the results of the NBP business surveys ("Quick Monitoring", April 2018). According to the report results, in companies controlled by the public sector, all the elements of the assessment of investment activity continue to strongly improve; in turn, in private companies, investment activity scores remain positive and stable.

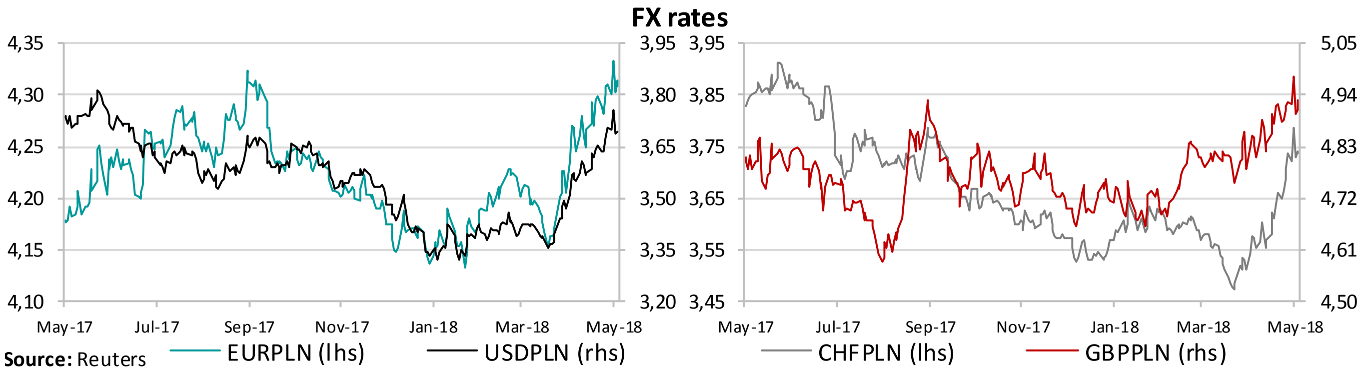
Based on the data on construction-assembly production, we estimate that the dynamics of public investments in infrastructure peaked in Q1 2018 (see MACROpulse of 21/5/2018). This is signaled by the decrease in dynamics in April in the segment "construction of civil engineering" to the lowest level since December 2017. In subsequent quarters public investments will be supported by the absorption of EU funds and by the political cycle (the approaching local and parliamentary elections). However, due to the last year's high base effects and supply-side constraints (shortage of skilled labour), the dynamics of public investments will gradually decrease.



Source: Eurostat, GUS, Credit Agricole

Considering the tendencies outlined above in the three segments of gross outlays on fixed assets, we see a moderate potential for further acceleration in total investments growth (see the chart). Until the end of 2018, the dynamics of total investments will range from 7% to 9% YoY. Starting from Q4 2018 it will show a downward trend to reach ca. 3% in Q4 2019. In effect, the average yearly investments growth rate will amount to 8.0% in 2018 and to 3.0% in 2019. We will present our revised medium-term macroeconomic scenario, accounting for the expected investment profile presented above, on 11 June.

PLN rate dictated by Italy



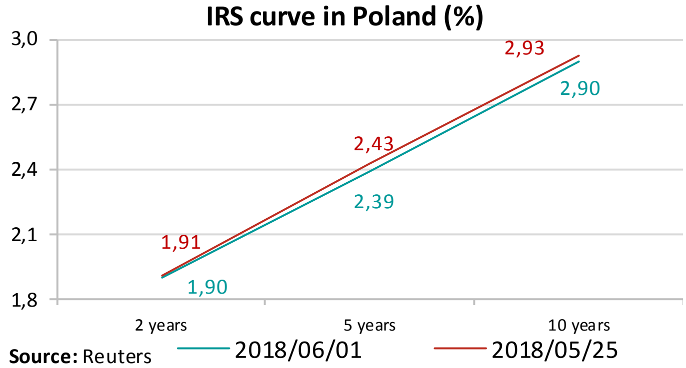
Source: Reuters

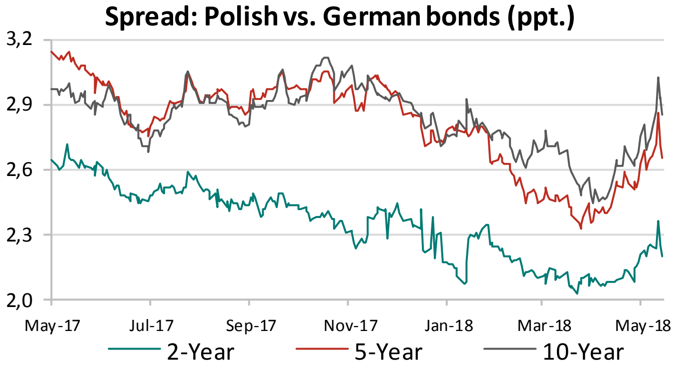
Last week EURPLN rate dropped to 4.3090 (PLN strengthening by 0.1%). On Monday, PLN appreciated vs EUR, as investors positively reacted to the information about Italian President's veto against the appointment of the finance minister being an avowed opponent of Italy's membership in the Eurozone. As we expected, Tuesday saw increased risk aversion, due to concerns that snap elections in Italy will lead to increased support for populist parties. As a result, PLN significantly depreciated vs. EUR. Then, until the end of the week, PLN was showing an upward trend due to the information that the 5 Star Movement will retry to form a government with the extreme right-wing Northern League. The scale of PLN appreciation was limited by weaker-than-expected data on inflation in Poland, higher-from-the-consensus inflation in the Eurozone, and the imposition by D. Trump of tariffs on steel and aluminum.

Last week PLN was mainly shaped by changes in global risk aversion. Thus, USDPLN, CHFPLN, and GBPPLN followed EURPLN. A slight strengthening of PLN was recorded for each of these rates across the week.

The macroeconomic calendar is exceptionally scarce this week. This week crucial for PLN will be the MPC meeting scheduled for Wednesday. We believe that the tone of the conference after the meeting will not substantially affect PLN. Data on the balance of payments from China will not be market moving, we believe. The Friday's review of Poland's rating by Fitch will be released after the closing of the European markets, therefore its impact on PLN will materialize no sooner than next week. On the other hand, negative for PLN might be subsequent information about protectionist measures taken by the United States.

Rating review neutral for IRS rates





Source: Reuters

Last week the 2-year IRS rates dropped to a level of 1.9025 (down by 1 bp), 5-year rates to a level of 2.39 (down by 3 bp), and 10-year rates to a level of 2.8975 (down by 3 bp). Due to a holiday in the US and UK, IRS rates were relatively stable on Monday. On Tuesday, with increase in political risk in Italy, IRS rates showed increased volatility. Then, until the end of the week, with increase in risk appetite (see above), IRS rates were showing a weak upward trend.

This week, the scarce macroeconomic calendar will support the stabilization of IRS rates. We believe that the conference after the MPC meeting, data from China (balance on trade), as well as the coming reports about subsequent protectionist measures taken by the US will have a limited impact on IRS rates. The Friday's review of Poland's rating by Fitch will be released after the closing of the European markets, therefore its impact on IRS rates will materialize no sooner than next week.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-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*	4,18	4,23	4,25	4,25	4,31	4,24	4,20	4,18	4,15	4,17	4,21	4,24	4,31	**4,30**
USDPLN*	3,72	3,70	3,59	3,57	3,65	3,64	3,53	3,48	3,34	3,42	3,42	3,51	3,69	**3,64**
CHFPLN*	3,84	3,86	3,72	3,72	3,77	3,65	3,59	3,57	3,59	3,62	3,58	3,54	3,74	**3,71**
CPI inflation (% YoY)	1,9	1,5	1,7	1,8	2,2	2,1	2,5	2,1	1,9	1,4	1,3	1,6	**1,6**	
Core inflation (% YoY)	0,8	0,8	0,8	0,7	1,0	0,8	0,9	0,9	1,0	0,8	0,7	0,6	**0,6**	
Industrial production (% YoY)	9,3	4,4	6,3	8,9	4,3	12,4	9,2	2,8	8,6	7,3	1,7	9,2	**9,3**	
PPI inflation (% YoY)	2,4	1,8	2,2	3,0	3,2	3,0	1,8	0,3	0,2	-0,1	0,5	1,1	**1,1**	
Retail sales (% YoY)	8,4	6,0	7,1	7,6	8,6	8,0	10,2	6,0	8,2	7,9	9,2	4,6	**4,6**	
Corporate sector wages (% YoY)	5,4	6,0	4,9	6,6	6,0	7,4	6,5	7,3	7,3	6,8	6,7	7,8	**7,8**	
Employment (% YoY)	4,5	4,3	4,5	4,6	4,5	4,4	4,5	4,6	3,8	3,7	3,7	3,7	**3,8**	
Unemployment rate* (%)	7,3	7,0	7,0	7,0	6,8	6,6	6,5	6,6	6,9	6,8	6,6	6,3	**6,3**	
Current account (M EUR)	-202	-902	-296	311	218	436	278	-699	2072	-972	-982	**-81**		
Exports (% YoY EUR)	19,1	7,2	15,0	13,4	11,5	15,8	15,5	2,6	11,7	5,5	-2,0	**9,7**		
Imports (% YoY EUR)	21,5	14,3	14,6	8,7	8,9	15,4	15,9	10,9	16,3	8,3	1,6	**11,6**		

*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)		4,4	4,0	5,2	4,9	5,2	4,3	4,2	3,9	4,6	4,3	3,0
Private consumption (% YoY)		4,5	4,9	4,7	5,0	4,8	4,4	4,3	4,2	4,8	4,6	3,6
Gross fixed capital formation (% YoY)		1,4	1,3	3,6	5,4	8,1	6,0	5,5	5,0	3,4	5,6	3,1
Export - constant prices (% YoY)		11,2	4,5	9,2	8,2	1,1	6,5	6,6	6,0	8,2	6,6	5,0
Import - constant prices (% YoY)		11,1	8,0	7,0	8,9	3,5	7,8	7,5	7,0	8,7	7,6	6,0
GDP growth contributions	Private consumption (pp)	2,8	2,9	2,8	2,5	3,0	2,6	2,6	2,1	2,7	2,7	2,1
	Investments (pp)	0,2	0,2	0,6	1,4	0,9	1,0	0,9	1,2	0,6	1,0	0,6
	Net exports (pp)	0,5	-1,5	1,3	0,0	-1,2	-0,4	-0,2	-0,3	0,1	-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	6,6	6,0	6,2	6,5	6,6	6,5	6,5
Non-agricultural employment (% YoY)		2,1	2,4	1,8	1,3	1,4	0,7	0,4	0,3	1,9	0,7	0,2
Wages in national economy (% YoY)		4,1	5,0	4,9	7,1	6,2	6,1	6,4	6,3	5,3	6,2	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	1,70	1,70	1,70	1,72	1,70	1,95
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	4,30	4,27	4,24	4,18	4,24	4,15
USDPLN**		3,97	3,70	3,65	3,48	3,42	3,64	3,50	3,37	3,48	3,37	3,19

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST* CA	FORECAST* CONSENSUS**
		Monday 06/04/2018				
10:30	Eurozone	Sentix Index (pts)	Jun	19,2		18,4
11:00	Eurozone	PPI (% YoY)	Apr	2,1		2,4
16:00	USA	Factory orders (% MoM)	Apr	1,6	-0,2	-0,6
		Tuesday 06/05/2018				
10:00	Eurozone	Services PMI (pts)	May	53,9	53,9	53,9
10:00	Eurozone	Final Composite PMI (pts)	May	54,1	54,1	54,1
11:00	Eurozone	Retail sales (% MoM)	Apr	0,1		0,5
16:00	USA	ISM Non-Manufacturing Index (pts)	May	56,8	58,0	57,6
		Wednesday 06/06/2018				
	Poland	**NBP rate decision (%)**	**Jun**	**1,50**	**1,50**	**1,50**
		Thursday 06/07/2018				
8:00	Germany	New industrial orders (% MoM)	Apr	-0,9		0,7
11:00	Eurozone	Final GDP (% YoY)	Q1	2,5	2,5	2,5
11:00	Eurozone	Revised GDP (% QoQ)	Q1	0,4	0,4	0,4
		Friday 06/08/2018				
	China	Trade balance (bn USD)	May	28,8	39,0	
8:00	Germany	Industrial production (% MoM)	Apr	1,0		0,2
8:00	Germany	Trade balance (bn EUR)	Apr	22,0		20,5
16:00	USA	Wholesale inventories (% MoM)	Apr	0,0		0,3
16:00	USA	Wholesale sales (% MoM)	Apr	0,3		

*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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