D. Trump's policy neutral for US interest rates path

This week

- **Data on the Chinese trade balance will be released on Wednesday.** We expect that it decreased to USD 38.9bn in July vs. USD 41.6bn in June. We forecast that export dynamics dropped to 6.5% YoY in July vs. 11.2% in June, while import dynamics decreased to 13.9% vs. 14.1%. The visible decrease in export dynamics ocurred largely due to the introduction by the US of higher import duties on some goods from China (see MACROmap of 18/6/2018). Our forecasts are close to the market consensus; therefore, their materialization will be neutral for PLN.
- **Data on US inflation will be released on Friday.** We forecast that overall inflation rose to 0.2% MoM in July vs. 0.1% in June (2.9% YoY in July and June). At the same time we expect core inflation to stabilize at 0.2% MoM (2.3% YoY). Our forecast is consistent with the market expectations; consequently, its materialization will not be market moving.
- **Numerous data from the German economy will be released this week**. Data on orders in manufacturing, released this morning, dropped by 4.0% MoM in June vs. a 2.6% increase in May, which was below the market expectations (-0.4%). In addition, the market expects a decrease in the dynamics of industrial production (-0.5% MoM in June vs. 2.6% in May) and stabilization of trade balance (EUR 20.2bn in June vs. EUR 20.3bn in May). Data on orders in manufacturing pose a substantial downside risk to market forecasts, as they indicate that the slowdown recorded in the German economy since the beginning of 2018 continues and its recovery signaled by the better-than-expected May data was only temporary. Thus the publication of subsequent, lower-than-expected data from the German economy may lead to a slight strengthening of PLN and higher prices of Polish bonds.

Last week

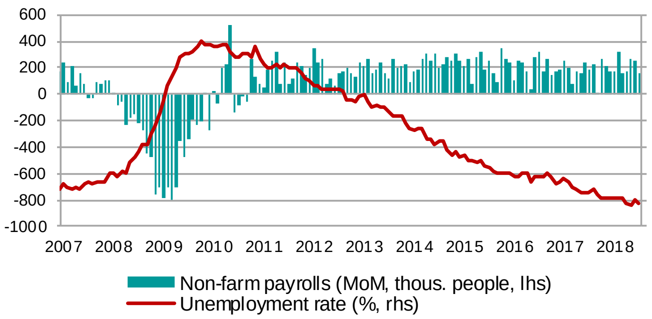
- **Non-farm payrolls in the US rose by 157k in July vs. a 248k increase in June (revised upwards from 213k), running below the market expectations (189k increase).** Consequently, directly after the data release, USD has slightly and temporarily weakened vs. EUR. The highest increase in employment was recorded in business services (+51.0k), leisure and hospitality (+40.0k), and manufacturing (+37.0k). On the other hand, the highest decrease in payrolls was recorded in the government sector (-13.0k), finance (-5.0k), and other services (-5.0k). The unemployment rate dropped to 3.9% in July from 4.0% in June, which was in line with market expectations. The unemployment rate is thus running below the natural unemployment rate indicated by FOMC (4.5% - see MACROmap of 18/6/2018). The participation rate has not changed in July compared to June and amounted to 62.9%. The annual dynamics of average hourly earnings has not changed either and amounted to 2.7%. We expect that subsequent months will see further increase in wage growth as the situation in the labour market will continue to improve. The results of business surveys in the US were also released last week. A slight improvement in consumer sentiment was recorded by the Conference Board Index which rose to 127.4 pts in July vs. 127.1 pts in June. Conducive to the index increase was higher value of its expectations sub-index while the decrease in the sub-index concerning the assessment of the current situation had an opposite impact. The ISM index for manufacturing recorded a decrease, dropping to 58.1 pts in July vs. 60.2 pts in June. The index decrease resulted from lower values of three of its five sub-indices (for suppliers' delivery times, output, and new orders). On the other hand, higher contributions of the sub-indices for inventories and employment had an opposite impact. The non-manufacturing ISM also recorded a decrease and dropped to 55.7 pts in July vs. 59.1pts in June, hitting the lowest level since August 2017. The index decrease resulted from lower contributions of its sub-indices for business activity, new orders, and suppliers' delivery times. Higher contribution of the employment sub-index had an opposite impact. We forecast that the annualized US GDP growth rate will decrease to 3.0% in Q3 vs. 4.1% in Q2.

- **The FOMC meeting was held last week.** The target range for Federal Reserve Funds rate has remained unchanged at [1.75%; 2.00%], running in line with our expectations and the market consensus. The statement has not changed significantly compared to the one released after the June meeting (see below). We maintain our scenario, in which FED will hike interest rates two more times in 2018 (in September and December) each time by 25bp.
- **In accordance with the flash estimate, CPI inflation in Poland has not changed in July compared to June and amounted to 2.0% YoY, running in line with market expectations and above our forecast (1.9%).** GUS has released partial data on inflation structure with information on inflation rate in the categories "food and non-alcoholic beverages", "energy", and "fuels". Conducive to higher overall inflation were higher dynamics of fuel prices (18.7% YoY in July vs. 15.2% in June), while lower dynamics of prices of food and non-alcoholic beverages (2.1% YoY in July vs. 2.7% in June) had an opposite impact. The dynamics of energy prices have not changed in July compared to June and amounted to 1.8% YoY. On this basis we estimate that core inflation decreased to 0.5% YoY in July vs. 0.6% in June. The July data do not alter our forecast of the average yearly inflation in 2018 (1.6% vs. 2.0% in 2017).
- **The Polish manufacturing PMI dropped to 52.9 pts in July vs. 54.2 pts June**. Conducive to the index decline were lower contributions of four of its five sub-indices (for employment, output, suppliers' delivery times, and new orders). Higher contribution of the sub-index for stocks of goods purchased had an opposite impact. An important reason for the decrease in the output sub-index and consequently in the overall index were holiday breaks in car factories. In our view, the structure of the July PMI shows that the short-term prospects for manufacturing activity continue to look optimistic (see MACROpulse of 1/8/2018). In effect, we expect sentiment in manufacturing to improve in August, which will be consistent with our forecast of economic growth in Q3 (4.8% YoY vs. 5.2% in Q2) and 5.0% in the whole 2018.
- **According to the flash estimate, inflation in the Eurozone rose to 2.1% YoY in July vs. 2.0% in June, running in line with our forecast equal to the market consensus**. The increase in inflation resulted mainly from higher dynamics of the prices of energy. We believe that inflation in the Eurozone has reached its local maximum in July. We expect that it will slightly decrease in August but will stay within the 1.8-2.0% until April 2019, due to high dynamics of fuel prices. In our view, in subsequent quarters, inflation rate within the single currency area will continue to show a downward trend and will reach 1.4% YoY in Q4 2019. In our opinion, core inflation in the Eurozone will not exceed 1.4% within the next two years. This is consistent with our scenario, in which the first hike of the ECB interest rates (deposit rate) will take place in September 2019 and the main interest rate will be hiked in December 2019.
- **In accordance with the flash estimate, the quarterly GDP growth rate in the Eurozone dropped to 0.3% in Q2 vs. 0.4% in Q1, running below the market expectations (0.4%) and well below our forecast (0.5%).** The annual economic growth rate has also decreased and amounted to 2.1% in Q2 vs. 2.5% in Q1. The GDP data are a flash estimate and do not include its structure. Subsequent estimate of GDP in Q2, including the growth rate in all the Eurozone countries, will be released on 14 August and the data on GDP structure on 7 September. Weaker-than-expected data on GDP in Q2 pose a downside risk to our forecast of economic growth in the single currency area in the whole 2018 (2.2% vs. 2.6% in 2017).
- **Business survey results for Chinese manufacturing were released last week.** CFLP PMI dropped to 51.2 pts in July vs. 51.5 pts in June, while Caixin PMI dropped to 50.8 pts in July vs. 51.0 pts in June). Especially noteworthy in the structure of Caixin PMI is further decrease in the sub-index concerning new export orders (48.4 pts in July vs. 48.8 pts in June), which since April has stood below the 50 pts threshold dividing expansion from contraction of activity. The decrease in new export orders in Chinese manufacturing is related to the introduction by the US of higher import duties on goods from China worth USD 34bn (see MACROmap of 18/6/2018). In reaction to the

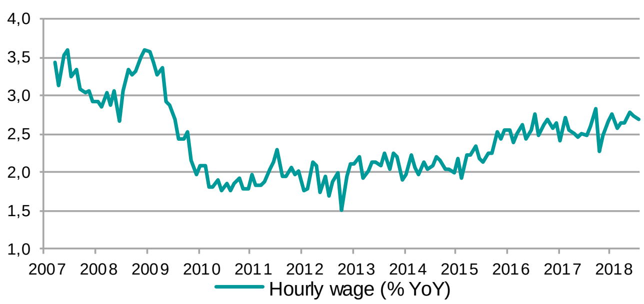
deterioration of foreign demand, the Chinese government announced the introduction of a package of measures stimulating the Chinese economy. One of its main assumptions will be the increase in lending in order to stimulate internal demand. This is consistent with the change observed in recent quarters in the structure of Chinese economic growth, where the significance of consumption is growing with a decreasing contribution of net exports. In the long term this will increase the resilience of the Chinese economy to external demand shocks, including the growing protectionism in global trade. Therefore, we maintain our forecast in which, despite the deterioration of export prospects, the dynamics of the Chinese GDP will decrease to 6.6% in 2018 vs. 6.9% in 2017. The main risk to our scenario is possible further escalation of protectionist measures in global trade.

D. Trump's policy neutral for US interest rates path

The most important event last week was the FOMC meeting. The target range for Federal Reserve funds rate has remained unchanged at [1.75%; 2.00%], which was in line with our expectations and the market consensus. The statement has not changed substantially compared to the one published after the June meeting. The FOMC's guidance was maintained, noting that "further gradual increases in the target range for the federal funds rate will be consistent with sustained expansion of economic activity, strong labour market conditions, and inflation near the Committee's symmetric 2 percent objective over the medium term". At the same time, the FED confirmed its view that risks to the economic outlook appeared roughly balanced. The most important change in the statement is the updated assessment of economic growth, taking into account the first GDP estimate for Q2, released two weeks ago (see MACROmap of 30/7/2018). FED's assessment emphasized the strong growth of investments and household spending recorded in Q2. The view concerning inflation prospects has also been amended in the statement which said that it would remain near 2 percent (earlier FED said only that it "moved close to 2 percent"). The assessment of the situation in the labour market has not changed significantly compared to the June statement. At the same time, the last week's data from the US labour market (see above) are consistent with the FED's view that the labour market has continued to strengthen.



Source: BLS, Datastream, Credit Agricole



Source: BLS, Datastream, Credit Agricole

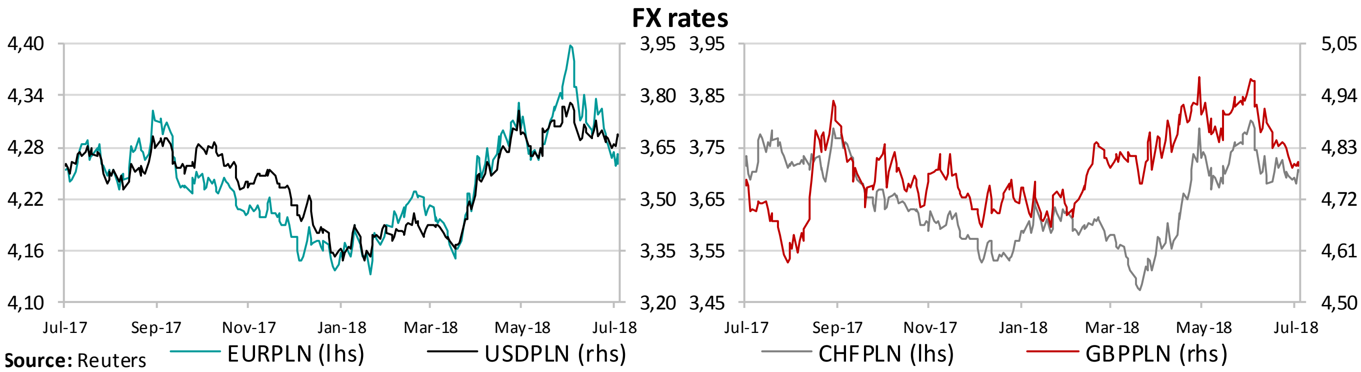
Although the statement has provided no new information about the US monetary policy outlook, the public discussion in the US concerning its prospects deserves particular attention. It raises two main issues: political independence of the Federal Reserve and potential impact of the Trump administration's policy on the US economic outlook and, consequently, on the FED policy.

Recently, President Trump and some members of his administration have made comments that were critical of the Fed's policy of raising rates. In one of his interviews, D. Trump's economic advisor, L. Kudlov, expressed the hope that the FED under its new management understood that "more people working and faster economic growth do not cause inflation" hence they would raise interest rates slowly. In turn, D. Trump himself said earlier that monetary tightening hurt all that his administration had done in the US so far. The FED chairman, J. Powell, referred to these comments saying that FED did their work in a strictly nonpolitical way, based on detailed analysis. In our view, the Federal Reserve will not give in to political pressure. On the contrary, we see a risk that in order to emphasize their political independence, some FED members who so far showed dovish bias in monetary policy will become more hawkish.

From the point of view of US interest rates prospects, two issues are of particular importance in the policy run by D. Trump's administration: trade policy and fiscal policy. The minutes after the FOMC June meeting included a statement that most FOMC members believed that tariffs and restrictions in foreign trade might have a negative impact on business sentiment and investments in the US (see MACROmap of 9/7/2018). In turn, J. Powell during his testimony to the Congress said that possible increase in protectionism in global trade would be negative for the US economy (see MACROmap of 23/7/2018). In turn, an expansive fiscal policy consisting in higher government spending and lower taxes stimulates economic growth, as reflected by data on GDP in Q2. This was particularly visible in the case of private consumption dynamics which increased due to higher income tax threshold in the US. That is why we believe that risks to US economic outlook are balanced, which is in line with the FED's view. Thus, we maintain our scenario in which FED will hike interest rates two more times in 2018 (in September and December) each time by 25bp. More information about FOMC members' views on the prospects of the US monetary policy will be known upon the publication of the minutes of the FED August meeting.

The above analysis is based on the report by Michael Carrey (Crédit Agricole Corporate and Investment Bank): *No surprises in August FOMC statement. The minutes will be more interesting.*

FX market sentiment impacted by trade war escalation



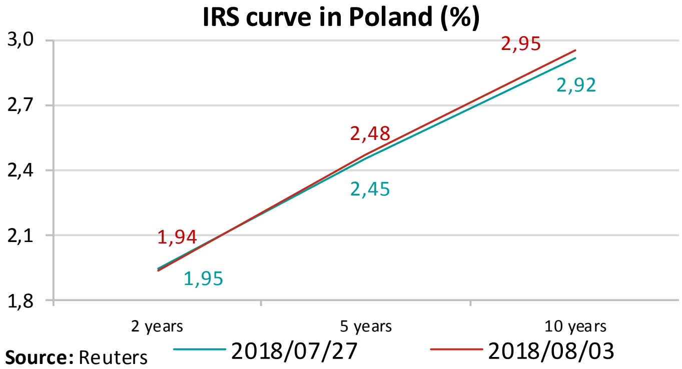
Source: Reuters

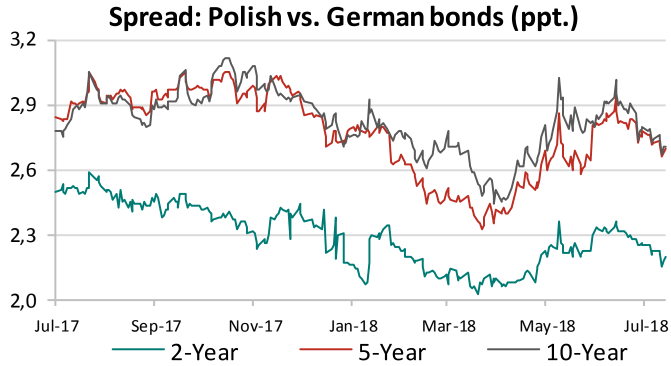
Last week, the EURPLN exchange rate dropped 4.2612 (PLN strengthening by 0.5%). Monday through Wednesday, EURPLN was staying within the downward trend started two weeks ago (see MACROmap of 30/7/2018). On Thursday, PLN weakened with increase in global risk aversion, reflected by higher VIX Index. The deterioration of market sentiment resulted from the stance of the Chinese government which announced to take retaliatory measures should the US threats of extending tariffs to USD 200bn of Chinese imports materialize. Friday saw a correction, supported by the decision of the People's Bank of China on introducing 20% reserve requirement for institutions selling forward contracts on Yuan. Thus, the profitability of speculations on Yuan weakening has decreased consequently leading to its strengthening, followed by the appreciation of other emerging currencies, including PLN. In effect on Friday afternoon, PLN made up for the Thursday losses. The Friday's data from the US labour market had a limited impact on PLN.

Despite the PLN strengthening vs. EUR last week, PLN has weakened vs. USD (by 0.2%) and CHF (by 0.2%), due to a fall of EURUSD and EURCHF rates. On the other hand, PLN appreciated vs. GBP (by 0.5%), due to an increase in EURGBP rate. The GBP weakening vs. EUR resulted from the dovish remarks of the Governor of the Bank of England, M. Carney, during the last week's conference after the BoE meeting. Although the Bank of England raised rates by 25bp, as expected, M. Carney said during the conference after the meeting that the monetary policy "needs to walk not run", which has led to GBP weakening. Carney's Friday remark that there was an "uncomfortably high" risk of the materialization of hard Brexit scenario was also negative for GBP.

Crucial for PLN this week will be the US inflation reading scheduled for Friday. However, we believe that it will be neutral for PLN. The publication of data on Chinese balance on trade, scheduled for Wednesday, will also have a limited impact on PLN. On the other hand, the aggregate impact of data from Germany (industrial production, orders in manufacturing, and balance on trade) may be slightly positive for PLN.

Holiday mood in IRS market





Source: Reuters

Last week, 2-year IRS rates decreased to 1.94 (down by 1bp), 5-year rates rose to 2.48 (up by 3bp), and 10-year rose to 2.95 (up by 3bp). Last week, the market showed very low liquidity, due to the holiday period which limited IRS volatility. A slight increase in IRS rates at the centre and at the long end of the curve resulted from transactional factors. This view is supported by a decrease in the spread between IRS rates and yields on Polish bonds at the centre and at the long end of the curve.

This week the market will focus on the US inflation reading scheduled for Friday. However, we believe that it will not have any substantial impact on IRS rates. On the other hand, data from Germany (industrial production, balance on trade) which, due to today's reading of orders in manufacturing, are likely to prove lower from the market expectations (see above) may contribute to a slight decrease in IRS rates.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland														
Indicator	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-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*	4,25	4,25	4,31	4,24	4,20	4,18	4,15	4,17	4,21	4,24	4,31	4,37	4,27	**4,28**
USDPLN*	3,59	3,57	3,65	3,64	3,53	3,48	3,34	3,42	3,42	3,51	3,69	3,74	3,66	**3,65**
CHFPLN*	3,72	3,72	3,77	3,65	3,59	3,57	3,59	3,62	3,58	3,54	3,74	3,78	3,69	**3,67**
CPI inflation (% YoY)	1,7	1,8	2,2	2,1	2,5	2,1	1,9	1,4	1,3	1,6	1,7	2,0	**1,9**	
Core inflation (% YoY)	0,8	0,7	1,0	0,8	0,9	0,9	1,0	0,8	0,7	0,6	0,5	0,6	**0,7**	
Industrial production (% YoY)	6,3	8,9	4,3	12,4	9,2	2,8	8,6	7,3	1,7	9,3	5,2	6,8	**11,2**	
PPI inflation (% YoY)	2,2	3,0	3,2	3,0	1,8	0,3	0,2	-0,1	0,5	1,0	3,0	3,7	**3,6**	
Retail sales (% YoY)	7,1	7,6	8,6	8,0	10,2	6,0	8,2	7,9	9,2	4,6	7,6	10,3	**9,6**	
Corporate sector wages (% YoY)	4,9	6,6	6,0	7,4	6,5	7,3	7,3	6,8	6,7	7,8	7,0	7,5	**7,8**	
Employment (% YoY)	4,5	4,6	4,5	4,4	4,5	4,6	3,8	3,7	3,7	3,7	3,7	3,7	**3,5**	
Unemployment rate* (%)	7,0	7,0	6,8	6,6	6,5	6,6	6,9	6,8	6,6	6,3	6,1	5,9	**5,9**	
Current account (M EUR)	-296	311	218	206	54	-847	1955	-782	-785	-90	42	**56**		
Exports (% YoY EUR)	15,0	13,4	11,5	15,8	15,5	2,6	12,1	5,9	-1,6	8,9	2,7	**7,0**		
Imports (% YoY EUR)	14,6	8,7	8,9	15,4	15,9	10,9	16,7	8,1	1,4	11,1	1,7	**5,7**		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland												
Indicator	2018				2019				2017	2018	2019
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Gross Domestic Product (% YoY)	5,2	5,2	4,8	4,7	4,4	3,8	3,3	3,0	4,6	5,0	3,7
Private consumption (% YoY)	4,8	4,6	4,6	4,5	4,0	3,5	3,6	3,4	4,8	4,6	3,7
Gross fixed capital formation (% YoY)	8,1	8,6	9,4	9,1	4,9	3,4	2,5	2,1	3,4	8,9	3,2
Export - constant prices (% YoY)	1,1	6,0	5,5	4,7	7,0	5,5	5,3	4,9	8,2	4,3	5,7
Import - constant prices (% YoY)	3,5	4,0	4,5	5,3	6,2	5,8	5,4	5,1	8,7	4,3	5,7
GDP growth contributions: Private consumption (pp)	3,0	2,7	2,7	2,3	2,6	2,1	2,1	1,7	2,7	2,7	2,1
GDP growth contributions: Investments (pp)	0,9	1,4	1,6	2,2	0,6	0,6	0,4	0,5	0,6	1,5	0,6
GDP growth contributions: Net exports (pp)	-1,2	1,3	0,8	-0,1	0,6	0,1	0,2	0,0	0,1	0,2	0,2
Current account (% of GDP)***	-0,2	0,0	-0,1	-0,6	-0,9	-0,9	-0,8	-0,9	0,2	-0,6	-0,9
Unemployment rate (%)**	6,6	5,9	5,7	6,0	6,4	5,9	5,7	6,0	6,6	6,0	6,0
Non-agricultural employment (% YoY)	1,4	1,2	1,0	0,8	0,5	0,3	0,2	0,1	1,9	1,1	0,3
Wages in national economy (% YoY)	6,2	7,4	7,0	7,1	7,6	7,0	6,7	6,6	5,3	6,9	7,0
CPI Inflation (% YoY)*	1,5	1,7	1,9	1,1	1,3	1,3	1,2	1,5	2,0	1,6	1,3
Wibor 3M (%)**	1,70	1,70	1,70	1,70	1,70	1,70	1,70	1,78	1,72	1,70	1,78
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
EURPLN**	4,21	4,37	4,27	4,24	4,23	4,20	4,18	4,15	4,18	4,24	4,15
USDPLN**	3,42	3,74	3,62	3,50	3,44	3,36	3,27	3,19	3,48	3,50	3,19

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
		Monday 08/06/2018				
8:00	Germany	New industrial orders (% MoM)	Jun	2,6		-0,4
10:30	Eurozone	Sentix Index (pts)	Aug	12,1		13,5
		Tuesday 08/07/2018				
8:00	Germany	Industrial production (% MoM)	Jun	2,6		-0,5
8:00	Germany	Trade balance (bn EUR)	Jun	20,3		20,1
		Wednesday 08/08/2018				
	China	Trade balance (bn USD)	Jul	41,6	38,9	38,8
		Thursday 08/09/2018				
3:30	China	PPI (% YoY)	Jul	4,7	4,6	4,4
3:30	China	CPI (% YoY)	Jul	1,9	1,6	2,0
14:30	USA	Initial jobless claims (k)	w/e	218		220
16:00	USA	Wholesale inventories (% MoM)	Jun	0,0		
16:00	USA	Wholesale sales (% MoM)	Jun	2,5		
		Friday 08/10/2018				
14:30	USA	CPI (% MoM)	Jul	0,1	0,2	0,2
14:30	USA	Core CPI (% MoM)	Jul	0,2	0,2	0,2

*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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