Trade war – a real threat to the Polish automotive branch?

This week

- **The most important event this week will be the release of the flash estimate of Polish GDP in Q2 scheduled for Tuesday.** We forecast that the GDP growth rate has not changed compared to Q1 and amounted to 5.2% YoY. Conducive to the acceleration of economic growth were higher contributions of net exports and investments. Lower contributions of inventories and consumption had an opposite impact. Our forecast is close to the consensus (5.1%), therefore its materialization will be neutral for PLN and yields on Polish bonds.
- **Subsequent GDP estimates for major European economies will be released on Tuesday.** We expect that, like in the first estimate, the quarterly GDP dynamics in the Eurozone stood at 0.3% in Q2 2016 vs. 0.4% in Q1. We forecast that the economic growth rate in Germany increased to 0.4% QoQ in Q2 vs. 0.3% in Q1. The last week's data from Germany (see below) pose a downside risk to our forecast. The release of GDP data for the Eurozone and Germany will not have any significant impact on PLN or the Polish debt market, we believe.
- **Some important data from China will be released on Tuesday.** The market expects that the monthly data will point to the stabilization of the annual economic growth rate in July. According to the consensus, industrial production increased by 6.3% YoY in July vs. 6.0% in June, retail sales rose by 9.0% YoY (same as in June), and urban investments dynamics have not changed in July compared to June and amounted to 6.0% YoY. In our view, the publication of data from China will not be market moving.
- **ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany will be released on Tuesday.** The market expects that its value rose to -19.1 pts in August vs. -24.7 pts in July. This will be the first index increase after the downward trend observed since February and caused i.a. by the publication of weaker-than-expected data from Germany and increasing market concerns about the negative impact of growing US protectionism on the economic situation in Germany.
- **Significant hard data on US economy and business survey results will be released this week.** We forecast that nominal retail sales increased by 0.1% MoM in July vs. a 0.5% increase in June, due to lower sales dynamics in the automotive branch. We forecast that industrial production rose to 0.4% MoM in July vs. a 0.6% increase in June, consistently with the relatively fast employment growth recorded in July in manufacturing (37k). After a temporary – in our view – significant slowdown in June, we expect acceleration in the growth of housing starts (1275k in July vs. 1173k in June) and building permits (1312k vs. 1273k) in July. Business survey results will also be released this week. We forecast that the NY Empire State Index dropped to 20.0 pts in August vs. 22.6 pts in July and Philadelphia FED Index decreased to 23.0 pts in August vs. 25.7 pts in July. We forecast that the preliminary University of Michigan Index (97.9 pts in July and August) will point to the stabilization of households' sentiment. We believe that the aggregate impact of data on the US economy on the financial market will be limited.
- **Data on the Polish balance of payments in June will be released today**. We expect the current account surplus to have increased to EUR 56M vs. EUR 42M in May, mainly due to higher balance of transfers between Poland and the EU. We forecast that export dynamics rose to 7.0% YoY in June vs. 2.7% in May, while import growth rate rose to 5.7% YoY vs. 1.7%. Although our forecast is substantially higher from the consensus (EUR -303M), its materialization will not have any significant impact on PLN.
- **Final data on the July inflation in Poland will be released on Tuesday.** We believe that inflation will not change compared to the flash estimate (2.0% YoY in July and June). Conducive to the increase in overall inflation were higher dynamics of fuel prices while lower dynamics of the prices of food and non-alcoholic beverages and core inflation had an opposite impact. The reading should not be market moving.
- **The July data on average wages and employment in the corporate sector in Poland will be released on Friday**. We forecast that employment dynamics dropped to 3.5% YoY in July from

3.7% in June, due to high base effects from the year before. In turn, the average wage dynamics rose to 7.8% YoY in July vs. 7.5% in June. Though important for the forecast of private consumption dynamics in Q3, the release of data on corporate wages and employment will be neutral for PLN and the debt market, we believe.

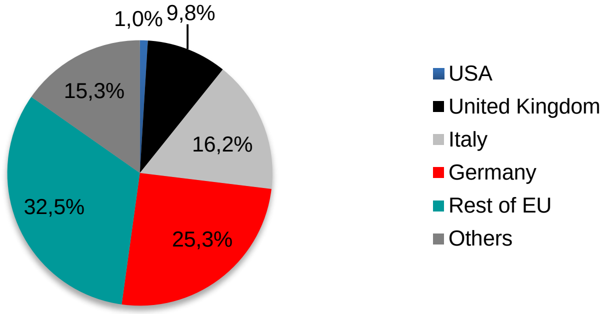
Last week

- **Some important data from the German economy were released last week**. The monthly dynamics of industrial production dropped to -0.9% in June vs. 2.4% in May, running below the market expectations (-0.5%). Its decline resulted from lower production dynamics in construction and manufacturing, while higher production dynamics in energy sector had an opposite impact. Orders in manufacturing also recorded a decline, dropping by 4.0% MoM in vs. a 2.6% increase in May, which was well below the market expectations (-0.4%). Data on the German trade balance were also released last week. It dropped to EUR 19.3bn in June vs. EUR 20.4bn in May, which also was below the market expectations (EUR 20.1bn). Its decrease took place amid lower dynamics of exports (0.0% MoM in June vs. 1.7% in May) and higher dynamics of imports (1.2% in June vs. 0.7% in May). The last week's data show that the slowdown of activity in the German economy, recorded since the beginning of the year, continues and its recovery signaled by the markedly better-than-expected May data was only temporary (see MACROmap of 9/7/2018). Thus, the last week's data pose a downside risk to our forecast, in which the quarterly growth rate of the German GDP rose to 0.4% in Q2 vs. 0.3% in Q1 (see above).
- **The Chinese trade balance decreased to USD 28.1bn in July vs. USD 41.5bn in June, running clearly below the market expectations (USD 39.3bn)**. On the other hand, data on the dynamics of Chinese exports (12.2% YoY in July vs. 11.2% in June, with expectations at 10.0%) and imports (27.3% YoY vs. 14.1%; 16.2%) proved better than expected. We believe that conducive to both higher exports and imports growth was the accelerated realisation of orders by some market participants before the imposition of the second tranche of import tariffs (USD 16bn) on China scheduled for the end of August. The recent remarks of both the US and Chinese representatives point, in our view, to the growing risk of escalation of trade war and extending increased tariffs to a majority of the mutual trade exchange between these countries (higher tariffs on Chinese exports to the US with total worth of USD 450bn and higher tariffs on the entire US exports to China). We currently assess the probability of the materialization of such scenario at 40%. We believe that the materialization of this scenario would lead to a decrease in the Chinese GDP by 0.1 percentage point in 2018, 0.8 pp in 2019, and 0.2 pp in 2020. However, in our view, this effect would be fully offset by the Chinese government's measures aimed at stimulating domestic demand (i.a. through expansive fiscal policy and stimulation of lending). Therefore, we maintain our forecast, in which the dynamics of the Chinese GDP will decrease to 6.6% in 2018 vs. 6.9% in 2017, to 6.4% in 2019, and to 6.0% in 2020.
- **CPI inflation in the US rose to 0.2% YoY in July vs. 0.1% in June (2.9% YoY in July and June), running in line with the market expectations**. Core inflation has not changed in July compared to June and amounted to 0.2% MoM (2.4% YoY in July vs. 2.3% in June), which was also in line with the market expectations. At the same time, it's worth noting that core inflation has reached in annual terms the highest level since September 2008, which points to growing inflationary pressure in the US economy. The last week's data are consistent with our scenario of two more interest rate hikes in the US before the end of 2018 (each by 25bp, in September and December).

Trade war – a real threat to the Polish automotive branch?

Media reports in recent months have focused extensively on growing protectionist tendencies in foreign trade between China and the US. Less attention has been paid to the risk of a potential trade war between the US and the European Union, signalized by the imposition of tariffs on exports of the European steel and aluminum to the US (at 25% and 10%, respectively). The said risk was visibly highlighted after D. Trump considered the introduction of 25% tariff on the EU exports of cars to the US. Such protectionist measures also affect Poland as in 2017 car production was responsible for 11% of the overall industrial production and exports of passenger cars and car components represented 4% of the Polish GDP. Below we present an analysis of the impact of possible tariff imposition on the situation in the Polish automotive branch and economic growth rate in Poland.

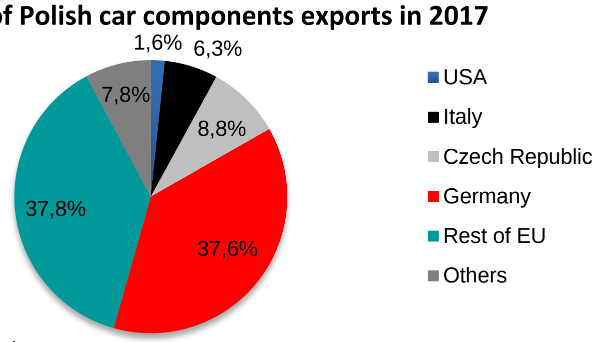
Breakdown of Polish passenger cars exports in 2017



Source: Eurostat, Credit Agricole

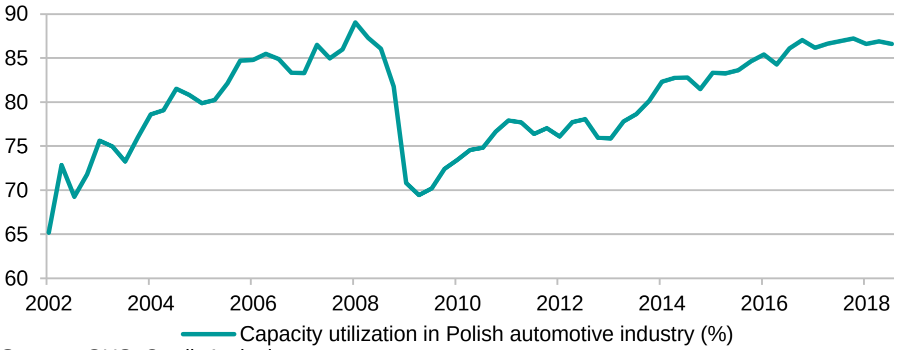
The impact of higher US tariffs on the Polish automotive branch can be divided into direct and indirect one. The direct impact consists in lower exports of passenger cars from Poland to the US, due to their higher prices after the imposition of said tariffs. Even the materialization of an extremely pessimistic scenario, namely the loss of all the orders coming from the US, would have a limited negative impact on the dynamics of exports of the Polish car industry. This is due to the fact that the US is the destination for only 1% of cars exports from Poland. The majority of cars manufactured in Poland (85%) is directed to the European Union.

Breakdown of Polish car components exports in 2017



Source: Eurostat, Credit Agricole

In turn, the indirect impact of possible introduction of tariffs on the Polish automotive industry is more difficult to assess. Poland may be affected by lower US demand for passenger cars manufactured in other EU countries being, as the supplier of car components, a significant element of the European supply chain. Hence, lower US demand for European cars will result in lower demand for car parts manufactured in Poland. Lower number of orders coming from the US to Germany may prove particularly important as Germany is responsible for more than 50% of the passenger car exports from the EU to the US. This would have a negative impact on Polish exports growth, Germany being the destination for 40% of car parts and components exported from Poland, which represent 1% of the Polish GDP.



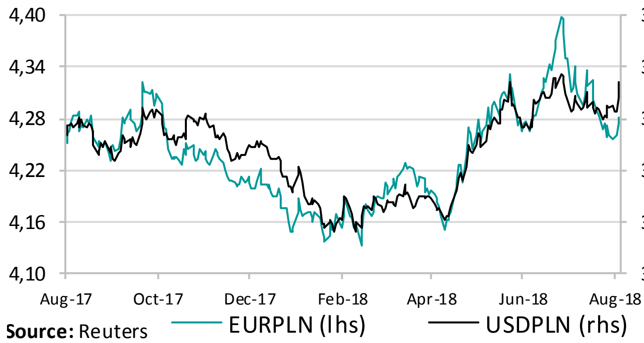
Source: GUS, Credit Agricole

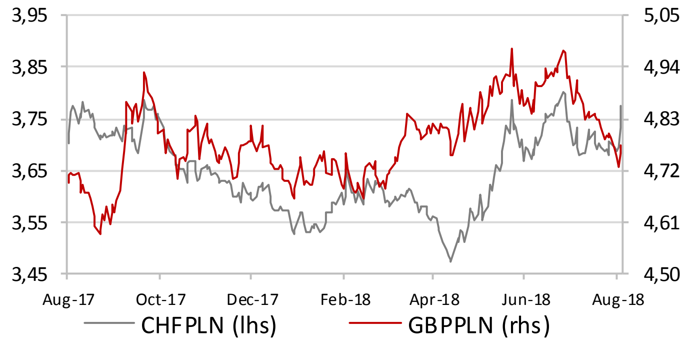
However, we believe that the negative impact of the introduction of US tariffs on cars will be lower than the above mentioned 1 percentage point due to three factors. Firstly, the US is the recipient of only 7.5% of the German and 10.9% of the EU car exports. In addition, we believe that there is a significant possibility of geographic reorientation of these exports in the event of lower demand for these products in the US market. Secondly, Polish car industry has considerable backlogs in the implementation of orders, as shown by 10-year high capacity utilization (amounting to 87% in Q3 2018, see the chart). For this reason, even if the demand for parts manufactured in Poland drops rapidly, in the extreme case where all US orders for cars manufactured in EU are lost, the production capacity of Polish factories would still be utilized for several more months. In effect, the impact of the demand shock would be spread over time and at the same time would be smaller in scale. Thirdly, car production is an import-intensive industry, which means that lower exports from Poland would also entail lower import of resources, which would limit the negative impact on the trade balance and GDP growth rate in the coming quarters.

Considering the factors outlined above, the introduction of tariffs on the automotive branch exports from the EU to the US would have a limited negative impact on Poland's economic growth rate. We estimate this impact at ca. 0.1-0.2 pp in the horizon of one year. Nevertheless, the latest remarks from D. Trump point to increased likelihood of growing protectionist tendencies in global trade in the coming quarters and rising downside risk to global GDP growth. The escalation of the trade war, namely the introduction by the US of further tariffs against China and the EU and retaliation by the counterparties, would lead to slower GDP growth in Poland's main trading partners and thus also slower GDP growth in Poland. Therefore, further development of the trade conflict poses a visible downside risk to the forecast by us Polish GDP growth rate (5.0% YoY in 2018 and 3.7% in 2019, see MACROmap of 30/7/2018). However, a full-blown trade war is not our baseline scenario.

Global sentiment negative for the PLN

FX rates



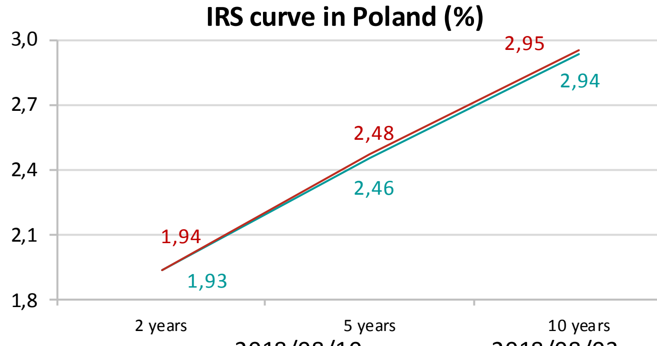


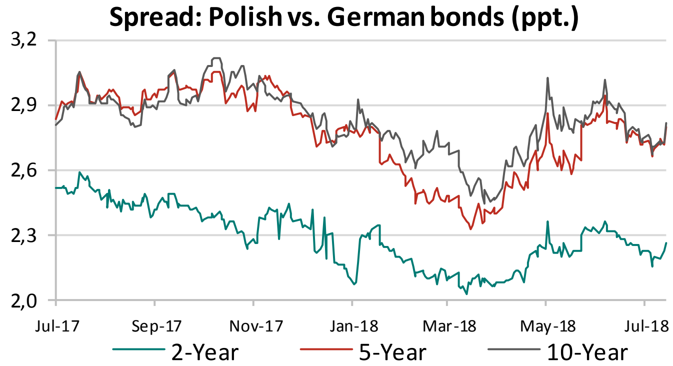
Source: Reuters

Last week, the EURPLN exchange rate rose 4.2820 (PLN weakening by 0.5%). The reason for PLN weakening was increase in global risk aversion. Lower appetite for risk assets was encouraged by growing concerns about further escalation of the trade war between the US and China. The increase in risk aversion was also supported by a diplomatic crisis between the US and Russia, after the US accused Russia of having used chemical weapons to attack the former Russian spy S. Skripal and threatened to impose sanctions, including i.a. downgrade of diplomatic relations, suspension of Aeroflot flights to the US, and/or lowering trade exchange. On the other hand, the Prime Minister of Russia, D. Medvedev, said that possible imposition of US sanctions on the Russian banking sector would be received as a declaration of trade war. Negative for market sentiment was also the growing currency crisis in Turkey and press reports that the ECB was concerned about excessive exposure of some European banks to Turkey. In effect, last week, Thursday and Friday especially, saw outflow of capital to so-called safe havens. Consequently, PLN was visibly depreciating also against USD (by 1.9%) and CHF (by 1.9%). On the other hand, PLN appreciated vs. GBP (by 0.3%), which was visibly depreciating last week vs. EUR with increasing likelihood of the materialization of the scenario where the United Kingdom will not manage to negotiate a trade deal with the EU in time for Brexit (so-called hard Brexit).

We expect that the aggregate impact of the readings of numerous domestic data scheduled for this week (balance of payments, final inflation, flash GDP for Q2, employment and average wages in the corporate sector) on PLN will be limited. We believe that data from the US (retail sales, industrial production, new building permits, housing starts, NY Empire State, Philadelphia FED, and preliminary University of Michigan indices), China (retail sales, industrial production, urban investments), and the Eurozone (GDP in the Eurozone, GDP in Germany) will also be neutral for PLN.

IRS resilient to sharp increase in risk aversion





Source: Reuters

Last week, 2-year IRS rates decreased to 1.93 (down by 1bp), 5-year to 2.46 (down by 2bps), and 10-year to 2.94 (down by 1bp). Throughout the previous week, low liquidity related to holiday period was continuing and limited IRS volatility. Monday through Thursday saw a slight decrease in IRS rates across the curve, following the German market. This decrease was hampered by increase in risk aversion and consequently higher spread between yields on the Polish and the German bonds. IRS rates rose slightly only on Friday with a particular increase in risk aversion on the market. However, they remained below the levels from the beginning of the week.

We believe that the aggregate impact of numerous Polish readings (final inflation, flash GDP, employment and average wages in the corporate sector, balance of payments) on IRS rates will be limited. Data from the US (retail sales, industrial production, new building permits, housing starts, NY Empire State, Philadelphia FED, and preliminary University of Michigan indices) and from the Eurozone (GDP in the Eurozone, GDP in Germany, ZEW index for Germany) will also be neutral for 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	**3,67**
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	**3,69**
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	**2,0**	
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	**0,5**	
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
Investments (pp)	0,9	1,4	1,6	2,2	0,6	0,6	0,4	0,5	0,6	1,5	0,6
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	7,1	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	FORECAST* CONSENSUS**
		Monday 08/13/2018				
14:00	**Poland**	**Current account (M EUR)**	**Jun**	**42**	**56**	**-303**
		Tuesday 08/14/2018				
4:00	China	Retail sales (% YoY)	Jul	9,0		9,0
4:00	China	Industrial production (% YoY)	Jul	6,0		6,3
4:00	China	Urban investments (% YoY)	Jul	6,0		6,0
8:00	Germany	Preliminary GDP (% QoQ)	Q2	0,3	0,4	0,4
10:00	**Poland**	**CPI (% YoY)**	**Jul**	**2,0**	**2,0**	**2,0**
10:00	**Poland**	**Flash GDP (% YoY)**	**Q2**	**5,2**	**5,2**	**5,1**
11:00	Eurozone	Preliminary GDP (% QoQ)	Q2	0,0	0,3	0,3
11:00	Eurozone	GDP flash estimate (% YoY)	Q2	0,0	2,1	2,1
11:00	Germany	ZEW Economic Sentiment (pts)	Aug	-24,7		-20,0
		Wednesday 08/15/2018				
14:30	USA	Retail sales (% MoM)	Jul	0,5	0,1	0,1
14:30	USA	NY Fed Manufacturing Index (pts)	Aug	22,6	20,0	20,0
15:15	USA	Industrial production (% MoM)	Jul	0,6	0,4	0,3
15:15	USA	Capacity utilization (%)	Jul	78,0	78,3	78,2
16:00	USA	Business inventories (% MoM)	Jun	0,4		0,1
		Thursday 08/16/2018				
14:00	**Poland**	**Core inflation (% YoY)**	**Jul**	**0,6**	**0,5**	**0,6**
14:30	USA	Initial jobless claims (k)	w/e	213		216
14:30	USA	Housing starts (k MoM)	Jul	1173	1275	1260
14:30	USA	Building permits (k)	Jul	1292	1275	1306
14:30	USA	Philadelphia Fed Index (pts)	Aug	25,7	23,0	22,0
		Friday 08/17/2018				
10:00	**Poland**	**Employment (% YoY)**	**Jul**	**3,7**	**3,5**	**3,6**
10:00	**Poland**	**Corporate sector wages (% YoY)**	**Jul**	**7,5**	**7,8**	**7,6**
11:00	Eurozone	HICP (% YoY)	Jul	2,1	2,1	2,1
16:00	USA	Initial U. of Michigan Sentiment Index (pts)	Aug	97,9	97,9	97,9

*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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