Growth of food prices will slightly accelerate in 2019

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 unchanged. We believe that the NBP Governor, A. Glapiński, will repeat his opinion that interest rates will remain unchanged at least until the end of 2019. At the same time, the last week's preliminary data on December inflation in Poland (see below) may strengthen his view expressed the month before that rates will remain stable also in 2020. We believe that the statement after the Council meeting and the remarks of the NBP Governor during the conference will be neutral for PLN and yields on Polish bonds.
- **Another important event will be the FOMC meeting scheduled for Wednesday.** The markets will focus on FED members' in-depth analyses of outlook for global economic growth and increased volatility of financial markets in the context of future Federal Reserve policy. That is because the statement after the December FED meeting included a fragment saying that according to FOMC members risks to US economic outlook were roughly balanced, however they would closely monitor global economic and financial developments and assess their implications for the US economic outlook (see below). The publication of the Minutes is likely to be overshadowed by the last week's dovish address by the FED chair, J. Powell, who said that due to limited inflationary pressure, the Federal Reserve "will be patient" and would like to see further development of the economic situation in the US before deciding to further tighten the monetary policy. Consequently, we believe that the release of the Minutes will be neutral for financial markets.
- **Data on CPI inflation in the US will be released on Friday.** We believe that it dropped to -0.2% MoM in December vs. 0.0% in November (1.8% YoY in December vs. 2.2% in November), mainly due to lower dynamics of energy and fuel prices. At the same time we expect that core inflation in December has not changed compared to November and amounted to 0.2% MoM (2.2% YoY). We believe that the data will have a limited impact on PLN and prices of the Polish debt.
- **Data on new orders dynamics in German manufacturing have been released today and dropped to -1.0% MoM in November vs. 0.2% in October, running below the market expectations (-0.4%).** Their decrease resulted from lower dynamics of foreign orders and higher dynamics of domestic orders. Despite a monthly decline, the level of new orders in German manufacturing has stabilized in recent months. This week we will also see data on German industrial production and foreign trade. They will be crucial in the context of the numerous, weaker-than-expected business survey results for global economy (China, Eurozone, USA). The disappointing data on new orders in manufacturing suggest that data on industrial production and foreign trade are unlikely to surprise to the upside.

Last week

- **Non-farm payrolls in the US rose by 312k in December vs. a 176k increase in November (revised upwards from 155k), running clearly above the market expectations (increase by 178k).** The highest increase in employment was recorded in education and health service (+82.0k), hospitality and leisure (+55.0k), and business services (+43.0k), whereas employment in information activity has decreased (-1.0k). Unemployment rate rose to 3.9% in December vs. 3.7% in November, though staying way below the natural unemployment rate indicated by FOMC (4.4% - see below). It resulted from the fact that labour force increased faster from employment. In effect, the participation rate rose to 63.1% in December vs. 62.9% in November. The annual dynamics of average hourly earnings rose to 3.2% in December vs. 3.1% in November, thus returning to the October level (the highest value since April 2009). The hawkish impact of the data resulted in USD strengthening vs. EUR and, consequently, PLN weakening vs. USD. The results of business surveys in the US were also released last week. The ISM index for manufacturing decreased to 54.1 pts in December vs. 59.3 pts in November, running clearly below the market expectations (57.9 pts). The index decline resulted from lower values of all its five sub-indices (for new orders, output, employment, suppliers' delivery times, and inventories). Especially noteworthy in the data structure is the decrease in the new orders sub-index to the lowest level since August 2016 with a simultaneous increase in the sub-index for new export orders. This shows that the decline of the sub-index for total new orders resulted from weaker internal demand. December also saw a marked decrease in the sub-index for production backlogs which stood at 50 pts, namely the threshold dividing expansion from contraction of activity. This may suggest that given slower inflow of new orders, the companies were clearing production backlogs accumulated earlier. In recent months ISM stood slightly above 60 pts suggesting a very good, against the historical backdrop, situation in the US manufacturing. Thus, in our view, the December data should be treated with caution and the assessment of outlook for the US manufacturing should wait until the publication of business survey results for January. The last week's readings from the US economy support our forecast, in which the annualized US GDP growth rate will decrease to 2.7% in Q4 vs. 3.5% in Q3, though staying above the potential economic growth rate estimated by FED at slightly below 2%.

- **An important event in recent weeks has been the December FOMC meeting.** As we expected, FED raised the target range for federal funds by 25bp to [2.25%; 2.50%]. At the same time, the statement repeated the view that risks to US economic outlook were roughly balanced. However a fragment was added that FED members would continue to closely monitor global economic and financial developments and assess their implications for the US economic outlook. At the same time, the Federal Reserve judges that gradual monetary easing will be consistent with sustained expansion of economic activity, strong labor market conditions, and inflation near the FED's symmetric objective (2% over the medium term). The December FOMC macroeconomic projection was presented after the meeting. The economic growth rate has been slightly revised downwards compared to the September projection. Currently, the median expectations for GDP growth rate amount to 3.0% in 2018 (3.1% in the September projection), 2.3% in 2019 (2.5%), 2.0% in 2020 (2.0%), 1.8% in 2021 (1.8%), and 1.9% in the long term (1.8%). The median expectations for core PCE inflation have slightly decreased compared to the September projection and amount to 1.9% in 2018 (2.0%), 2.0% in 2019 (2.1%), 2.0 in 2020 (2.1%), and 2.0% in 2021 (2.1%). Thus, the projection indicates that core inflation in the forecast relevant horizon will not exceed the FED inflation target. The unemployment path has not significantly changed. The median expectations amount now to 3.7% in Q4 2018 (3.7%), 3.5% in Q4 2019 (3.5%), 3.6% in Q4 2020 (3.5%), and 3.8% in Q4 2021 (3.7%). The natural unemployment rate estimated by FED has decreased compared to the September projection and amounts to 4.4% (4.5%). The median FOMC members' expectations concerning the level of interest rates have slightly decreased. In 2019 FED members expect a monetary policy tightening by 50bp (75bp), in 2020 by 25bp (25bp) and no hikes in 2021. Median long-term rate decreased to 2.75% (3.00%). Our forecast of interest rates in 2019 is consistent with the FOMC projection. We expect two hikes, each by 25bp (in Q2 and Q4 2019). We expect interest rates to stabilize in 2020. The market is currently not pricing in any rate hike in 2019. We therefore believe that data on US economy incoming in the next few months will be conducive to higher market expectations of further monetary tightening in the US and, consequently, will be negative for PLN and prices of the Polish debt.
- **The PMI index for Polish manufacturing decreased to 47.6 pts in December vs. 49.5 pts in November, hitting the lowest level since April 2013.** Thus, December was the second consecutive month in which the PMI index was below the 50-pts threshold, dividing expansion from contraction of activity. The decrease in the PMI index resulted from lower contributions of 3 out of its 5 components (for new orders, output and inventories). The higher contribution of components for employment and delivery times had the opposite effect. Especially noteworthy

in the data structure is the strongest since June 2009 decline in total new orders. New export orders have also decreased. It is worth noting that the component for total new orders has been below the component for new export orders for the first time since July 2017. This means that domestic orders have fallen more strongly than foreign orders. This in turn indicates that the decline in total orders in Polish manufacturing resulted not only from the weakening of external demand, but also domestic demand (see MACROpulse of 2/1/2019). The deterioration in Polish manufacturing in December was relatively strong compared to other economies covered by the survey. Deterioration at a similar scale was recorded in the Czech Republic, which suggests that it may result from slowdown in the automotive industry. The December data on industrial production and PMI for January will be crucial for the assessment of the reasons for the relatively strong deterioration in Polish manufacturing. In Q4 2018, the average value of the index was 49.2 pts vs. 51.6 pts in Q3, which supports our forecast of Polish GDP growth in Q4 2018 (4.5% YoY vs. 5.1% in Q3).

- **According to the flash estimate, CPI inflation in Poland dropped to 1.1% YoY in December vs. 1.3% in November, running in line with our forecast equal to the market consensus.** GUS has published partial data on inflation structure, including information about the rate of inflation in the categories “food and non-alcoholic beverages”, “energy”, and “fuels”. Conducive to decrease in total inflation were lower dynamics of prices of fuels (7.7% YoY vs. 10.6%) and energy (1.1% YoY vs. 1.2%) as well as lower core inflation which, in accordance with our estimates, decreased to 0.6% YoY vs. 0.7% in November. Higher growth rate of prices of food and non-alcoholic beverages (0.9% YoY in December vs. 0.7% in November) had an opposite impact. We forecast that inflation will decrease to 1.5% YoY in 2019 vs. 1.6% in 2018. Final data on inflation will be released on 15 January.
- **According to the flash estimate, inflation in the Eurozone dropped to 1.6% YoY in December vs. 1.9% in November, running in line with our expectations and below the market consensus.** The decrease in inflation resulted mainly from marked decline in the dynamics of energy prices (5.5% YoY in December vs. 9.1% in November). We expect that in subsequent quarters the annual inflation rate within the single currency area will be showing a downward trend and will amount to 0.8% YoY in Q4 2019. In addition, we forecast that core inflation in the Eurozone will not exceed 1.5% in the horizon of the next two years. This poses a downside risk to our scenario, in which the first hike of ECB interest rates (deposit rate) will take place in September 2019. The market is now pricing in the first interest rate hike in the Eurozone in March 2020.
- **China Caixin manufacturing PMI dropped to 49.7 pts in December vs. 50.2 pts in November**. It thus stood below the 50 pts threshold dividing expansion from contraction of activity for the first time since May 2017. The index decrease resulted from lower contributions of the sub-indices for new orders, inventories, and suppliers’ delivery times. Higher contributions of output and employment sub-indices had an opposite impact. Especially noteworthy in the data structure is a decrease in the sub-index concerning total new orders with a simultaneous increase in the sub-index for new export orders. This shows that conducive to lower sub-index for total new orders was weaker domestic demand. This view is supported by the latest message from Apple which has significantly revised its forecasts of Q1 2019 revenues, blaming weaker demand in China. Amid deterioration of internal demand outlook, the People’s Bank of China took subsequent steps last week aimed at stimulating lending by increasing the limits on loans for micro and small businesses from CNY 5bn to CNY 10bn and subsequent reduction of required reserves ratio by 100bp. The reduction of the mandatory reserve ratio will be divided into two equal parts: the first will take effect on 15 January and the second one on 25 January. Thus the ratio will hit the lowest level in 12 years. At the same time the Chinse government announced the strengthening of special economic zones to stimulate foreign trade and foreign investments. We believe that subsequent stimulus will be launched in the coming months in order to maintain a gradual slowdown of Chinese GDP. In effect we expect that in Q2 and Q3 2019, the People’s Bank of China will implement subsequent reductions of the mandatory

reserve ratio by 100bp in total. The main risk to our scenario is possible further escalation of protectionist measures in global trade.

Growth of food prices will slightly accelerate in 2019

As we expected, last year recorded a marked slowdown of the rate of growth of prices for food and non-alcoholic beverages which dropped to 2.6% YoY vs. 4.3% in 2017. Below we present our scenario of food prices in 2019.

We expect that conducive to higher dynamics of food prices in 2019 will be their increase in the category “bread and cereal products”, which this spring may reach the level of ca. 7% YoY. Further acceleration of price growth in this category will be supported by high prices of grains, due to last year’s drought in Europe and growing costs of labour. In H2 2019 we expect a gradual decrease in the dynamics of prices of breads and cereal products due to the forecast by us fall of grain prices and last year’s high base effects. That is because, assuming historically average agrometeorological conditions, the prices of grains will increase in annual terms. This increase will be additionally supported by a larger sown area resulting from improved profitability of cereal production. Nevertheless in the whole 2019 we expect that the dynamics of prices in the category “bread and cereal products” will increase to 5.9% vs. 3.9% in 2018.

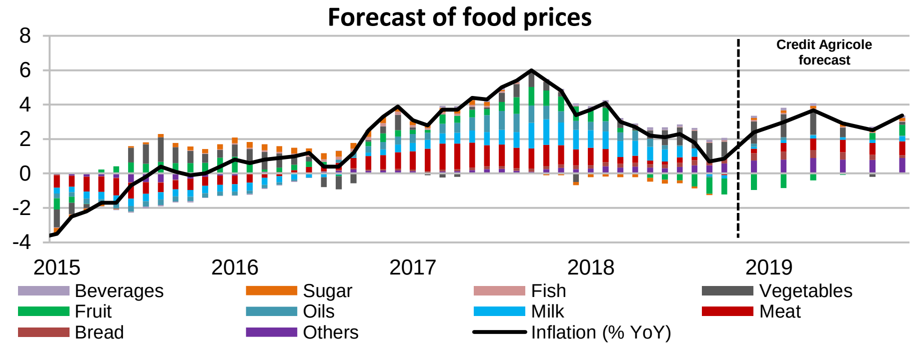
Higher inflation of food prices will also result from higher dynamics of the prices of vegetables (7.7% YoY in 2019 vs. 4.8% in 2018), largely caused by the last year’s poor harvest due to drought, which, combined with the last year’s low base effects, will support price rises in H1 2019. In a situation of historically average weather conditions in Poland in 2019, the growth of the prices of vegetables will markedly slow down in H2 2019.

We believe that the increase in food price inflation in 2019 will also be supported by slightly higher dynamics of the prices of meat (2.3% YoY vs. 1.8% in 2018), due to the stabilization of the dynamics of pork prices and further increase in the dynamics of prices of poultry meat. The main risk to our forecast is further spread of ASF worldwide. If ASF cases are recorded in subsequent countries of Western Europe, export restrictions will result in oversupply of pork in the EU and in a fall of its prices. In turn, possible marked decrease in the production of pork in China, due to ASF, may result in higher global prices of pork.

Higher dynamics of the prices of sugar may also contribute towards higher food prices. Although the oversupply of sugar continues in the global market and after a temporary increase towards the end of 2018 its prices resumed a downward trend, the last year’s low base effects will be conducive to higher dynamics of sugar prices.

On the other hand, the increase in the inflation of food prices will be limited by further decrease of dynamics in the categories “oils and fats” (1.3% YoY in 2019 vs. 7.4% in 2018) and “milk, cheeses, and eggs” (1.3% vs. 5.5%). We believe that it will result from the forecast by us further decrease in global prices of dairy products. Although recent months have brought a deterioration of agrometeorological conditions in New Zealand, being major exporter of dairy products, butter in particular, subsequent months are likely to see a marked recovery of production in the EU. In addition, in 2019 we assume further slowdown of demand for dairy products among their largest importers (i.a. China and Russia).

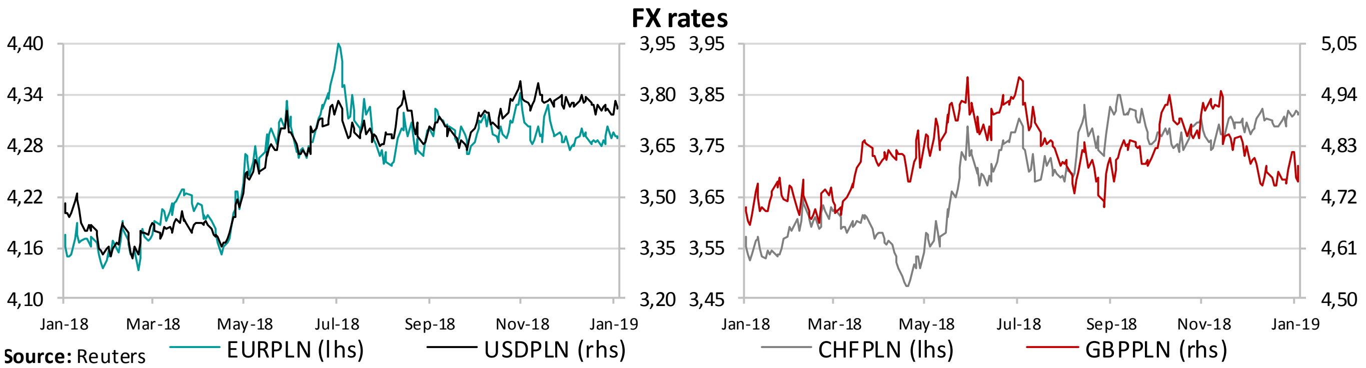
Conducive to a lower growth rate of food prices will also be lower dynamics of the prices of fruit (-3.9% YoY in 2019 vs. -0.2% in 2018). Due to the last year’s record harvest and high base effects of H1 2018, we forecast that their deflation will continue until Q3 2019. Assuming that this year's harvest is average against the historical backdrop, the rate of growth of fruit prices will markedly accelerate in Q4.



Source: Credit Agricole

Considering the outlook for prices in the respective agricultural markets, we forecast that the inflation of food prices in Poland will increase to 2.7% YoY in 2019 vs. 2.6% in 2018. The main risks to our scenario of food prices are agrometeorological conditions among the largest global producers and the implementation of a hard Brexit scenario which, due to export restrictions, may result in a temporary oversupply in the domestic market and, consequently, in a drop of prices. At the same time, we expect that CPI inflation will decrease to 1.5% in 2019 vs. 1.6% in 2018, due to higher dynamics of food prices, increase in core inflation, and lower dynamics of prices of fuels and energy.

Publication of FOMC Minutes crucial for PLN

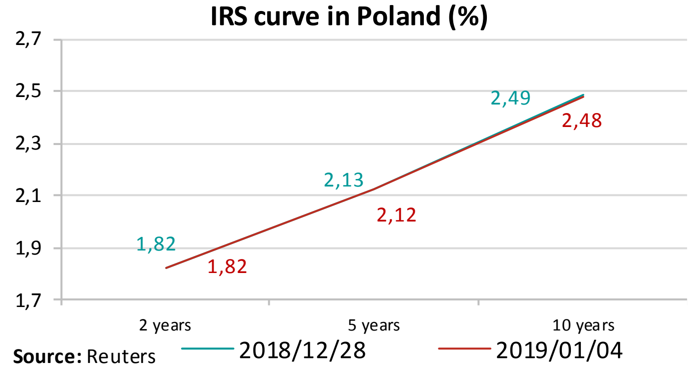


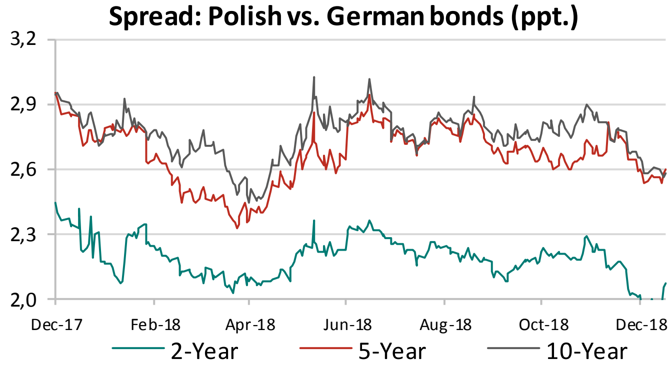
Source: Reuters

Last week, the EURPLN exchange rate dropped to 4.2878 (PLN strengthening by 0.3%). Throughout last week PLN was showing a relatively low volatility compared to recent weeks, ranging from 4.29 to 4.31, supported by holiday season and lower activity of investors. Tuesday's weaker-than-expected business survey results for Polish manufacturing were slightly negative for PLN. On Wednesday, PLN depreciation was supported by the deterioration of sentiment in the global financial market, largely due to concerns about the economic outlook in China. Friday's better-than-expected US non-farm payrolls reading had no substantial impact on EURPLN but resulted in a decrease in EURUSD and consequently in an increase in USDPLN. However, there was a correction in the afternoon due to the dovish address by the FED chair, J. Powell (see above).

Crucial for PLN this week will be the publication of the Minutes of the December FOMC meeting. However, it will be overshadowed by the last week's address by the FED chair, J. Powell, and will be neutral for PLN. We believe that the publication of data on US inflation and the MPC meeting will not be market moving.

Market focused on Minutes of December FED meeting





Source: Reuters

Last week, 2-year IRS rates have not changed compared to the level from two weeks ago and amounted to 1.82, 5-year rates dropped to 2.12 (down by 1bp), and 10-year rates to 2.48 (down by 1bp). Wednesday saw a sharp decrease in IRS rates across the curve following the publication of weaker-than-expected business survey results for Polish manufacturing. Friday saw a correction, supported by better-than-expected data from the US labour market.

This week the market will focus on the release of the Minutes of the December FOMC meeting scheduled for Wednesday. However, we believe that it will have a limited impact on IRS rates. The publication of data on US inflation and the MPC meeting is likely to be neutral for the curve.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland														
Indicator	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19
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	4,15	4,17	4,21	4,24	4,31	4,37	4,27	4,30	4,28	4,34	4,29	4,29	4,28
USDPLN*	3,48	3,34	3,42	3,42	3,51	3,69	3,74	3,66	3,71	3,69	3,84	3,79	3,74	3,75
CHFPLN*	3,57	3,59	3,62	3,58	3,54	3,74	3,78	3,69	3,83	3,75	3,80	3,79	3,81	3,83
CPI inflation (% YoY)	2,1	1,9	1,4	1,3	1,6	1,7	2,0	2,0	2,0	1,9	1,8	1,5	1,3	
Core inflation (% YoY)	0,9	1,0	0,8	0,7	0,6	0,5	0,6	0,6	0,9	0,8	0,9	0,9	0,7	
Industrial production (% YoY)	2,8	8,6	7,3	1,7	9,3	5,2	6,7	10,3	5,0	2,7	7,3	4,5	3,2	
PPI inflation (% YoY)	0,3	0,2	-0,1	0,5	1,0	3,0	3,7	3,4	3,0	3,0	3,2	3,3	2,8	
Retail sales (% YoY)	6,0	8,2	7,9	9,2	4,6	7,6	10,3	9,3	9,0	5,6	9,7	8,0	8,1	
Corporate sector wages (% YoY)	7,3	7,3	6,8	6,7	7,8	7,0	7,5	7,2	6,8	6,7	7,6	7,1	8,0	
Employment (% YoY)	4,6	3,8	3,7	3,7	3,7	3,7	3,7	3,5	3,4	3,2	3,2	3,0	2,8	
Unemployment rate* (%)	6,6	6,8	6,8	6,6	6,3	6,1	5,8	5,8	5,8	5,7	5,7	5,7	5,8	
Current account (M EUR)	-1354	2289	-792	-914	291	495	-200	-750	-582	-547	-457	-551		
Exports (% YoY EUR)	4,8	15,5	6,6	-4,4	9,1	1,1	6,2	9,2	7,2	0,3	10,2	4,6		
Imports (% YoY EUR)	13,2	19,0	9,5	0,3	12,4	1,4	7,9	10,3	11,3	5,4	15,7	8,5		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland												
Indicator		2018				2019				2018	2019	2020
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Gross Domestic Product (% YoY)		5,3	5,1	5,1	4,5	3,7	3,6	3,2	2,9	5,0	3,3	3,2
Private consumption (% YoY)		4,7	4,9	4,5	4,4	4,2	3,5	3,4	3,3	4,6	3,6	3,0
Gross fixed capital formation (% YoY)		8,2	4,7	9,9	9,3	8,1	6,7	4,4	3,6	8,3	5,2	4,2
Export - constant prices (% YoY)		3,4	7,6	4,9	4,4	4,7	4,7	4,9	5,4	5,1	4,9	4,5
Import - constant prices (% YoY)		5,5	6,5	6,9	6,5	5,7	5,6	6,3	5,8	6,4	5,9	6,0
GDP growth contributions	Private consumption (pp)	3,0	2,8	2,7	2,2	2,7	2,0	2,0	1,6	2,7	2,1	1,7
	Investments (pp)	1,0	0,8	1,7	2,3	1,0	1,1	0,8	0,9	1,5	1,0	0,8
	Net exports (pp)	-1,0	0,9	-0,9	-0,9	-0,4	-0,3	-0,6	-0,1	-0,5	-0,3	-0,6
Current account (% of GDP)***		-0,2	0,0	-0,4	-0,7	-1,0	-1,0	-1,0	-0,9	-0,7	-0,9	-0,8
Unemployment rate (%)**		6,6	5,8	5,7	5,8	6,1	5,6	5,7	5,8	5,8	5,8	5,8
Non-agricultural employment (% YoY)		1,4	1,0	1,1	0,8	0,4	0,4	0,4	0,4	1,1	0,4	0,1
Wages in national economy (% YoY)		6,2	7,1	7,6	7,3	7,5	7,2	6,9	6,2	7,1	7,0	5,5
CPI Inflation (% YoY)*		1,5	1,7	2,0	1,4	1,6	1,6	1,2	1,4	1,6	1,5	2,0
Wibor 3M (%)**		1,70	1,70	1,72	1,72	1,72	1,72	1,72	1,80	1,72	1,80	2,30
NBP reference rate (%)**		1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	2,00
EURPLN**		4,21	4,37	4,28	4,29	4,27	4,25	4,20	4,15	4,29	4,15	4,07
USDPLN**		3,42	3,74	3,69	3,76	3,71	3,57	3,44	3,35	3,76	3,35	3,16

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
		Monday 01/07/2019				
8:00	Germany	New industrial orders (% MoM)	Nov	0,3		-0,4
10:30	Eurozone	Sentix Index (pts)	Jan	-0,3		-2,8
11:00	Eurozone	Retail sales (% MoM)	Nov	0,3		0,1
16:00	USA	ISM Non-Manufacturing Index (pts)	Dec	60,7	58,5	59,1
16:00	USA	Factory orders (% MoM)	Nov	-2,1	0,2	0,3
		Tuesday 01/08/2019				
8:00	Germany	Industrial production (% MoM)	Nov	-0,5		0,3
11:00	Eurozone	Business Climate Indicator (pts)	Dec	1,09		0,99
		Wednesday 01/09/2019				
8:00	Germany	Trade balance (bn EUR)	Nov	17,3		18,0
11:00	Eurozone	Unemployment rate (%)	Nov	8,1		8,1
20:00	USA	FOMC Minutes	Dec			
	Poland	**NBP rate decision (%)**	**Jan**	**1,50**	**1,50**	**1,50**
		Thursday 01/10/2019				
2:30	China	PPI (% YoY)	Dec	2,7		1,6
2:30	China	CPI (% YoY)	Dec	2,2		2,1
14:30	USA	Initial jobless claims (k)	w/e	231		225
16:00	USA	Wholesale inventories (% MoM)	Nov	0,0		0,5
16:00	USA	Wholesale sales (% MoM)	Nov	-0,2		
		Friday 01/11/2019				
14:30	USA	CPI (% MoM)	Dec	0,0	-0,2	-0,1
14:30	USA	Core CPI (% MoM)	Dec	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

Jakub BOROWSKI
Chief Economist
tel.: 22 573 18 40
jakub.borowski@credit-agricole.pl

Krystian JAWORSKI
Senior Economist
tel.: 22 573 18 41
krystian.jaworski@credit-agricole.pl

Jakub OLIPRA
Economist
tel.: 22 573 18 42
jakub.olipra@credit-agricole.pl