This week

- **The most important event this week will be the publication of data on the December industrial production in Poland scheduled for Friday.** We forecast that industrial production growth slowed down to 3.2% YoY vs. 4.7% in November. In our view, the December reading of industrial production will confirm the deterioration observed in this sector in recent months due to the slowdown in global trade. The significantly lower than expected Polish manufacturing PMI released at the beginning of the month poses a downside risk to our forecast. Our forecast of industrial production dynamics is below the market consensus (5,0%), therefore its materialization will be slightly negative for PLN and yields on Polish bonds.
- **The British parliament is expected to vote this week on the Brexit deal negotiated by T. May in November.** However, according to the latest reports, the vote may not take place and be postponed. We also do not rule out the scenario, in which the MPs will reject the a/m treaty this week. If this is the case, additional measures are likely to be taken to avoid Great Britain's uncontrolled exit from the EU (hard Brexit). In the coming days, the uncertainty about further developments concerning Brexit will be conducive to increased risk aversion and higher volatility of GBPPLN.
- **Some significant data from the US will be released this week.** We believe that industrial production increased by 0.2% MoM in December vs. a 0.6% increase in November, consistently with business survey results. We forecast that nominal retail sales growth dropped to 0.1% MoM in December vs. 0.2% in November, due to falling fuel prices. We expect that the slowdown in the US real estate market will be confirmed by data on housing starts (1251k in December vs. 1256k in November) and building permits (1287k vs. 1328k). Business survey results will also be released this week. We forecast that the NY Empire State Index rose to 12.0 pts in January from 10.9 pts in December 2015, in turn the Philadelphia FED Index rose to 10.5 pts in January vs. 9.1 pts in December. The preliminary University of Michigan Index will be released on Friday. We forecast that its value dropped to 97.0 pts in January vs. 98.3 pts in December).We believe that the US readings will be neutral for the financial markets.
- **Final data on the December inflation in Poland will be released on Tuesday.** We believe that the rate of inflation will not change compared to the flash estimate (1.1% YoY vs. 1.3% in November). In our view, conducive to the indicator decline was lower dynamics of prices of fuels and other energy and lower core inflation. Higher dynamics of prices of food and non-alcoholic beverages had an opposite impact. In our view, the reading of inflation will be neutral for PLN and the prices of Polish debt.
- **The December data on average wages and employment in the corporate sector in Poland will be released on Friday**. We forecast that employment dynamics dropped to 2.8% YoY vs. 3.0% in November, due to high base effects from the year before (in December 2017 employment rose by 17.2k MoM). We expect that average wage growth rose to 8.0% YoY in December vs. 7.7% in November. Though important for the forecast of private consumption dynamics in Q4, the release of data on corporate wages and employment will be neutral for PLN and the debt market, we believe.
- **Data on the Polish balance of payments in November will be released today**. We expect the current account deficit to increase to EUR 551M vs. EUR 457M in October, due to lower balance on trade and balance on transfers with the EU. We forecast that export dynamics dropped to 4.6% YoY in November vs. 10.2% in October, while import growth decreased to 8.5% YoY vs. 15.7%. Lower export and import growth resulted from the effect of unfavourable difference in the number of working days. Our forecast is close to the market consensus; therefore its materialization will be neutral for PLN.
- **According to data released today, the Chinese trade balance increased to USD 57.1bn in December vs. USD 44.7bn in November, running above the market expectations (USD 51.5bn)**. On the other hand, data on the Chinese export growth (-4.4% YoY in December vs.

5.4% in November, with expectations at 3.0%) and import growth (-7.6% YoY in December vs. 3.0% in November, with expectations at 5.0%) proved significantly weaker than forecasted. The data point to a weakening of both domestic and foreign demand. However, it should be noted that conducive to lower import dynamics was also the fall of oil prices. The data on passenger car sales which decreased by 15.8% YoY in December also indicate a marked weakening of Chinese domestic demand. In the whole 2018, passenger car sales decreased by 4.1%, marking their first decline in 28 years. The data on the Chines balance on trade, combined with the data on car sales, pose a downside risk to our forecast, in which the Chinese GDP growth rate will decrease to 6.4% in 2019 vs. 6.6% in 2018.

- **We have revised our EURPLN forecast**. The expected by us slowdown of global and domestic economic growth, increased global risk aversion, and weaker expectations of interest rate hikes in Poland will be conducive to PLN depreciation vs EUR in H1 2019. Consequently, EURPLN will reach the local maximum of 4.33 as at the end of Q2 2019. The measures taken by the Chinese government and the People's Bank of China to stimulate domestic demand will contribute towards boosting global economic growth in H2 2019, which will result in the appreciation of PLN. We expect that EURPLN will amount to 4.25 as at the end of 2019 and to 4.15 as at the end of 2020. PLN will be supported by the expected by us tightening of the domestic monetary policy in 2020.

Last week

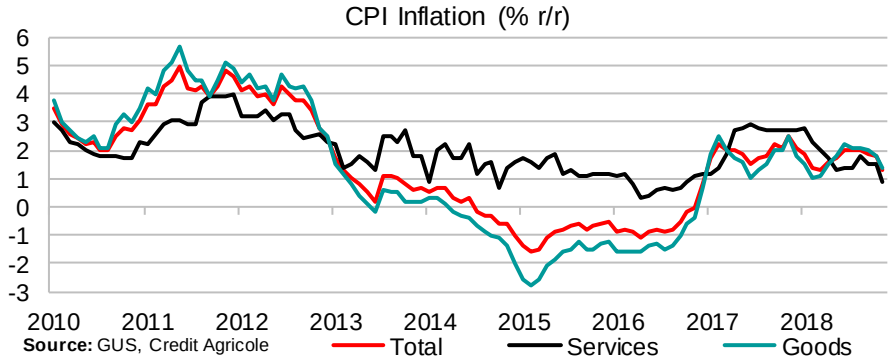
- **The most important event last week was the publication of the Minutes of the December FOMC meeting.** According to the document, many FOMC members believe that that due to limited inflationary pressure, the Federal Reserve may afford to "be patient" with regard to further policy firming. The Minutes also expanded on the fragment of the statement after the FED meeting, which said that the Federal Reserve judged that further gradual monetary tightening would be consistent with sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective over the medium term. According to the Minutes, "the gradual monetary tightening" means that taking current data into account, the scale of future interest rate hikes will be relatively limited. Considering the recent dovish remarks of FED representatives, including J. Powell's address two weeks ago (see MACROmap of 7/1/2019), the Minutes have not provided any new significant information on the US monetary policy outlook. The description of the discussions at the December FOMC meeting poses a substantial downside risk to our scenario of monetary policy in the US, in which we expect two hikes in 2019, each by 25bp (in Q2 and Q4). The market is currently not pricing in any interest rate hikes in 2019.
- **CPI inflation in the US dropped to -0.1% MoM in December vs. 0.0% in November (1.9% YoY in December vs. 2.2% in November), running in line with the market expectations**. The decrease in inflation resulted from lower dynamics of energy prices, while higher growth of food prices had an opposite impact. Core inflation in December has not changed compared to November and amounted to 0.2% MoM (2.2% YoY). The US non-manufacturing ISM Index was also released last week and decreased to 57.6 pts in December vs. 60.7 pts in November. The index decrease resulted from lower contributions of three of its four sub-indices (for business activity, suppliers' delivery times, and employment), while higher contribution of the new orders sub-index had an opposite impact. We forecast that the annualized US GDP growth rate dropped 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%.
- **As we expected, the Monetary Policy Council left interest rates unchanged at its meeting last week (the reference rate amounts to 1.50%).** In the statement after the meeting, the Council repeated the view that the current level of interest rates was conducive to keeping the Polish

economy on a sustainable growth path and maintaining macroeconomic stability. The Council also emphasized that current information pointed to a relatively favourable outlook for economic siyuation in Poland, although a gradual slowing in GDP growth was expected in the years ahead. At the conference after the MPC meeting, A. Glapiński said that due to the adopted act on freeze of electricity prices and to the sharp decline in oil prices, inflation in the projection horizon could be expected to be significantly lower than anticipated in the November inflation projection and would run below the target (2.5%). The NBP Governor also said that interest rates might remain stable until the end of the MPC term of office, falling at the beginning of 2022. This is a change in A. Glapiński's attitude to even a more dovish one, because he was saying earlier that interest rates would remain unchanged until 2020. The NBP Governor informed that the Council was currently not debating any interest rate cuts. Noteworthy in this context is the opinion expressed by J. Żyżyński, who said that discussion on monetary policy easing, if any, would start no sooner than in 6 months' time. The text of the statement after the meeting and the NBP Governor's remarks are consistent with our scenario, in which NBP interest rates will remain unchanged until the end of 2019 and the first hike (by 25 bp) will take place in March 2020. Current market expectations point to first interest rate hike in 2021.

- **Important data from the German economy were released last week**. The dynamics of German industrial production dropped to -1.9% MoM in November vs. -0.8% in October, running clearly below the market expectations (+0.3%). Data on the December production for other economies of the Eurozone (France, Italy, and Spain) were also disappointing. The faster pace of decline in German industrial production resulted from lower output growth in manufacturing, construction, and energy. Industrial production in Germany has been showing a visible downward trend from May 2018 and in November reached the lowest value since January 2017. Thus, the data signal a high likelihood of the German economy entering technical recession. The visible slowdown of activity in German manufacturing is in line with data on German foreign trade, according to which export dynamics decreased to -0.4% MoM in November vs. 0.9% in October, and import dynamics dropped to -1.6% MoM vs. 0.8%. The relatively sharp decline in import dynamics signals a weakening of domestic demand in Germany. Data on new orders dynamics in German manufacturing were also released week and dropped to 1.0% MoM in November vs. 0.2% in October, running below the market expectations (-0.4%). Their decline resulted from lower dynamics of foreign orders and higher dynamics of domestic orders. However, recent months have seen the stabilization of orders in German manufacturing. We believe that the stagnation in German manufacturing may continue for several months before the effects of the stimulation of economic growth in China will be felt (see MACROmap of 7/1/2019). The last week's data on the German economy pose a downside risk to our forecast, in which the German GDP growth rate decreased to 1.5% vs. 2.2% in 2017.

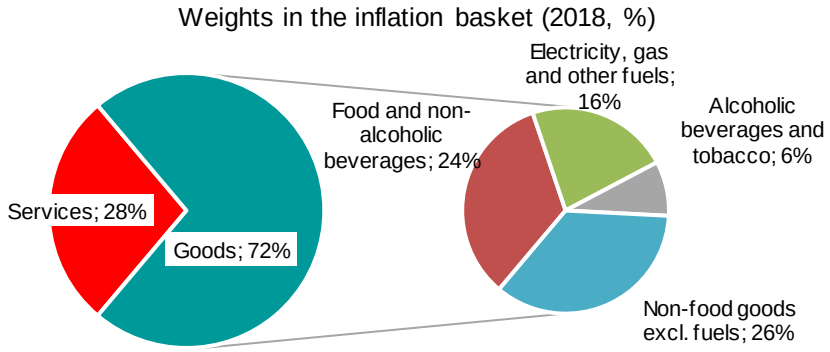
Rising prices of services as the main source of inflation

A decline in inflation has been observed in the Eurozone for two months now. According to the flash estimate, it dropped to 1.6% YoY in December vs. 1.9% in November. We expect that in the coming quarters the annual rate of inflation within the single currency area will continue to show a downward trend to reach 0.8% YoY in Q4 2019. The main factor behind slower price growth will be lower dynamics of energy prices, due to a relatively low level of global oil prices. In turn, core inflation is likely to slightly increase (1.1% YoY on a yearly average in 2019 vs. 1.0% in 2018), supported by declining unemployment in the Eurozone conducive to faster wage growth. The profile of core inflation in the Eurozone is an important factor from the point of view of assessing the prospects for price growth in Poland. Below is our forecast of inflation in Poland presented from a non-standard approach - broken down into goods and services.



Source: GUS, Credit Agricole

Usually, inflation structure is reported broken down into food and non-alcoholic beverages, fuels, energy, and other components of the inflation basket, namely so-called core inflation. Another method of analyzing inflation in Poland is to divide it into goods and services. Below we present price trends for these two groups of products.



Source: GUS, Credit Agricole

Expenditures on services represent only 28% of the inflation basket. The remaining 72% of household spending is for the purchase of goods. Goods include food and non-alcoholic beverages (24% of the entire basket), fuels and other energy (16%), alcohol beverages and tobacco products (6%), and other products (hereinafter: non-food goods excluding energy, 26%).

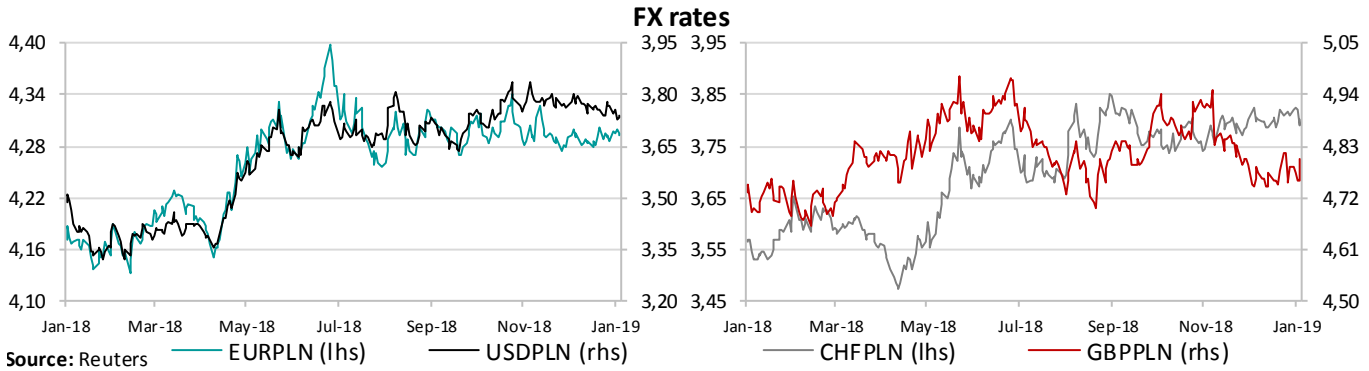
The prices of food and fuels are significantly impacted by foreign factors – prices of agricultural commodities, oil prices, PLN rate (research shows that the impact of PLN rate on inflation has markedly declined in recent years). We have presented our scenario in this respect in MACROmaps of 10/12/2018 and 7/1/2019. We forecast that food price inflation in Poland will increase to 2.7% YoY in 2019 vs. 2.6% in 2018, while the dynamics of fuel prices will decrease to -2.2% YoY from 8.0% in 2018.

Non-food goods excluding energy are so-called tradeable goods. According to the law of one price, identical goods should sell for the same price domestically and abroad (accurate to transactional costs, including costs of transport and taxation). Otherwise, it would be profitable to import goods at lower prices from abroad. To model the pace of changes in these prices, we have worked on an econometric model which uses core inflation in the Eurozone and wage dynamics in Polish manufacturing as explanatory variables. The outcome of the impact of slightly higher core inflation in the Eurozone and gradual slowdown of nominal wage growth (see MACROmap of 10/12/2018) will be a slight increase in the dynamics of prices of non-food products excluding energy (from -0.5% YoY in 2018 to -0.2% YoY). Slight decrease in prices is consistent with considerable competition observed in the tradeable goods sector, supported by progressing globalization. Such conditions limit the companies' ability to increase the prices of their products.

On the other hand, services are non-tradable products. Their prices are determined mainly by the cost of labour. That is why in the model explaining the growth of prices of services we have used the dynamics of wages in services. In theory, the prices of non-traded goods are not subject to competitive pressure from abroad. However, it has turned out that core inflation in the Eurozone has a statistically substantial impact on the evolution of the prices of services in Poland. This is explained by the fact that due to technological development an increasing part of services can be outsourced abroad. Consequently, some services cease to be "pure" non-tradeable goods. Based on our model, we forecast that the average yearly growth of prices of services in 2019 will stay at a similar level as the one recorded in 2018 (1.8% YoY).

Considering the above-outlined impact of the evolution of prices of respective groups of goods and services, we expect that CPI inflation will decrease to 1.5% in 2019 vs. 1.6% in 2018. This is consistent with our forecast, prepared with the use of "standard" approach, in which inflation is a resultant of the expected dynamics of the prices of food, fuels, and energy and of core inflation (por. MACROmap of 10.12.2018).

Dovish signals from FED negative for USD



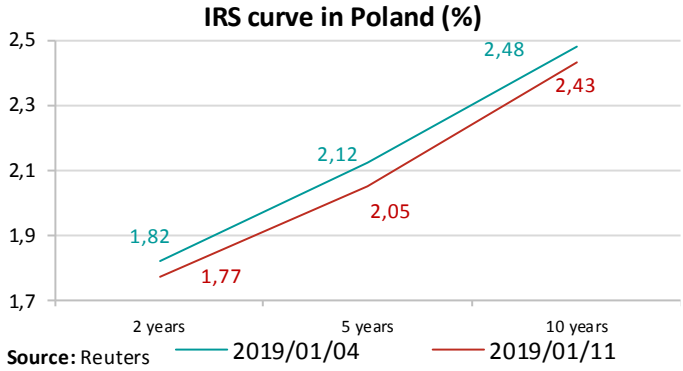
Source: Reuters

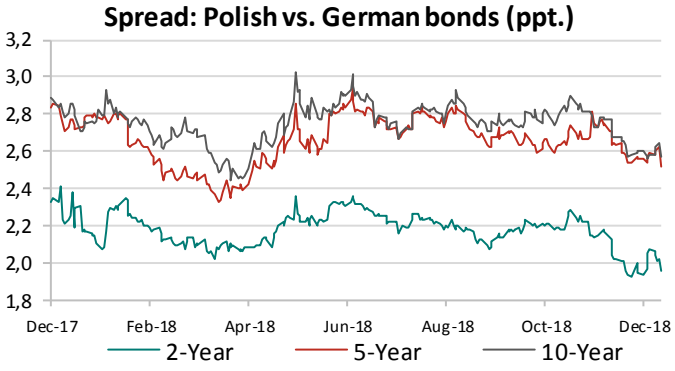
Last week, the EURPLN exchange rate rose 4.2921 (PLN weakening by 0.1%). Throughout last week EURPLN was relatively stable compared to recent weeks and ranged from 4.29 to 4.31, partly due to scarce macroeconomic calendar. Important for PLN was the Tuesday's weaker-than-expected reading of German industrial production, which resulted in its temporary depreciation. Thursday morning also saw PLN weakening, supported by the dovish tone of the press conference after the Wednesday's MPC meeting. However, later into the day there was a correction, supported by the decrease in global risk aversion, reflected by VIX index. Its decline was supported by the dovish tone of the Minutes of the December FED meeting released on Wednesday evening.

Last week also saw USD weakening vs EUR, after the Federal Reserve representative, R. Bostic said that interest rate cuts were possible if economic outlook deteriorated in the US. In effect, PLN strengthened vs. USD by 0.7% last week. Friday also saw GBP appreciation vs. EUR, due to media reports that the UK might try to postpone Brexit. Consequently, last week saw PLN weakening vs. GBP (by 0.4%).

Crucial for PLN this week will be the data on domestic industrial production. If our lower-from-the-market-consensus forecast materializes, they may be conducive to PLN weakening. In our view, other domestic data (final inflation, core inflation, corporate wage and employment, and balance of payments) will not have any substantial impact on PLN. We believe that the numerous data from the US (industrial production, retail sales, NY Empire State, Philadelphia FED and preliminary University of Michigan indices) will also be neutral for PLN. In the coming days the uncertainty about further developments concerning Brexit (see above) will be conducive to increased risk aversion and higher volatility of GBPPLN.

Market focuses on domestic data on industrial production





Source: Reuters

Last week, 2-year IRS rates decreased to 1.77 (down by 5bp), 5-year rates to 2.05 (down by 7bp), and 10-year rates to 2.43 (down by 5bp). Monday saw a decrease in IRS rates, following the German market, due to the publication of weaker-than-expected data on orders in German manufacturing. Subsequent days saw an increase in IRS rates because investors were selling bonds, increasing liquidity before the debt auction scheduled for Thursday. At the auction, the Finance Ministry sold PLN 6.0bn of 2-, 5-, and 9-year bonds with demand amounting to PLN 12.5bn. The high demand at the auction was conducive to a decline in IRS rates. The dovish tone of the conference after the MPC meeting was also conducive to their decrease.

This week the market will focus on data on domestic industrial production. We believe that they may contribute to a decrease in IRS rates at the short end of the curve. In our view, other domestic data (final inflation, core inflation, corporate wage and employment, and balance of payments) will be neutral for the curve. We believe that the numerous data from the US (industrial production, retail sales, NY Empire State, Philadelphia FED and preliminary University of Michigan indices) will also have a limited impact on IRS rates.

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	**4,29**
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	**3,74**
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	**3,76**
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	1,3	**1,1**	
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	0,7	**0,6**	
Industrial production (% YoY)	2,8	8,6	7,3	1,7	9,3	5,2	6,7	10,3	5,0	2,7	7,4	4,6	**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	2,7	**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	8,2	**8,9**	
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	7,7	**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	4,30	4,33	4,29	4,25	4,29	4,25	4,15
USDPLN**		3,42	3,74	3,69	3,74	3,74	3,64	3,52	3,43	3,74	3,43	3,22

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
		Monday 01/14/2019				
	China	Trade balance (bn USD)	Dec	44,7	47,2	51,5
11:00	Eurozone	Industrial production (% MoM)	Nov	0,2		-1,3
14:00	**Poland**	**Current account (M EUR)**	**Nov**	**-457**	**-551**	**-482**
		Tuesday 01/15/2019				
9:00	Germany	Preliminary GDP (% YoY)	2018	2,2	1,5	1,5
10:00	**Poland**	**CPI (% YoY)**	**Dec**	**1,2**	**1,1**	**1,1**
14:30	USA	NY Fed Manufacturing Index (pts)	Jan	10,9		12,0
		Wednesday 01/16/2019				
14:00	**Poland**	**Core inflation (% YoY)**	**Dec**	**0,7**	**0,6**	**0,7**
14:30	USA	Retail sales (% MoM)	Dec	0,2	0,1	0,2
16:00	USA	Business inventories (% MoM)	Nov	0,6		0,3
		Thursday 01/17/2019				
11:00	Eurozone	HICP (% YoY)	Dec	1,6	1,6	1,6
14:30	USA	Housing starts (k MoM)	Dec	1256	1251	1261
14:30	USA	Building permits (k)	Dec	1328	1287	1290
14:30	USA	Philadelphia Fed Index (pts)	Jan	9,4	10,5	11,0
		Friday 01/18/2019				
10:00	**Poland**	**Employment (% YoY)**	**Dec**	**3,0**	**2,8**	**2,8**
10:00	**Poland**	**Corporate sector wages (% YoY)**	**Dec**	**7,7**	**8,0**	**7,3**
10:00	**Poland**	**Industrial production (% YoY)**	**Dec**	**4,7**	**3,2**	**5,0**
10:00	**Poland**	**PPI (% YoY)**	**Dec**	**2,7**	**2,8**	**2,6**
10:00	Eurozone	Current account (bn EUR)	Nov	23,0		
15:15	USA	Industrial production (% MoM)	Dec	0,6	0,2	0,3
15:15	USA	Capacity utilization (%)	Dec	78,5	78,5	78,6
16:00	USA	Initial U. of Michigan Sentiment Index (pts)	Jan	98,3	97,0	97,0

*The forecasts of macroeconomic indicators for Poland were prepared by Credit Agricole Bank Polska S.A. The forecasts of foreign indicators were prepared by Crédit Agricole Corporate and Investment Bank
** Reuters

MACRO MAP

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