Is Poland doomed to low inflation?

This week

- **The most important event this week will be the ECB meeting scheduled for Thursday.** In our view, the monetary policy parameters will be left unchanged – the current level of interest rates as well as forward guidance concerning their stable evolution in the future will be maintained. The latest macroeconomic projection will also be presented after the meeting. We expect that the economic growth rate and inflation profile will be revised downwards compared to the December projection. We believe that the conference tone will be dovish due to the deteriorating outlook for economic growth and limited inflationary pressure. No new plans concerning future monetary policy will be announced during the conference; however, the ECB Governor, M. Draghi, is likely to present a range of tools that can be implemented if the economic situation further deteriorates. M. Draghi's remarks will be consistent with our scenario assuming that in the coming months (most probably in April) the ECB will announce the launch of a subsequent TLTRO program. We expect to see increased volatility in the financial markets during the conference after the ECB meeting.
- **Another important event this week will be the meeting of the Monetary Policy Council scheduled for Wednesday**. We expect that the MPC will decide to leave interest rates at an unchanged level. At the same time, the results of the latest NBP projection will be presented during the meeting. It is unlikely to factor in the government-planned changes in the fiscal policy announced two weeks ago. We expect that the inflation path will be revised downwards compared to the November projection (no materialization of the assumed surge of energy prices) and the GDP growth rate will be revised upwards (due to the higher starting point of the forecast). The issue of the impact of the government-announced fiscal package on inflation and economic growth rate in the nearest quarters and the monetary policy will also be raised during the conference. We believe that A. Glapiński will try to lower the market expectations of interest rate hikes in Poland. His remarks will be more dovish from the views voiced by other MPC members last week (E. Gatnar, J. Żyżyński) who saw a possibility of monetary policy tightening due to the fiscal policy easing. We believe that the NBP Governor, A. Glapiński, will repeat his opinion that the NBP interest rates will not change between 2019 and 2020. In our view, the tone of the press conference will be slightly negative for PLN and positive for the prices of Polish bonds.
- **Important data from the US will be released this week.** The publication of data from the labour market is scheduled for Friday. We expect non-farm payrolls to have increased by 195k in February vs. 304k in January, with unemployment rate down to 3.8% from 4.0% in January. Before the Friday's reading some additional information on the labour market will be provided by the ADP report on private sector employment (the market expects an increase by 190k in February vs. 213k in January). We expect that further slowdown in the US real estate market will be confirmed by data on housing starts (1123k in January vs. 1078k in December), building permits (1299k vs. 1326k), and existing home sales (624k vs. 657k). We believe that the US readings will be neutral for the financial markets.
- **Data on the Chinese balance on trade will be released on Friday.** The market expects it to have decreased to USD 25.6bn in February vs. USD 39.2bn in January, with a simultaneous decrease in the exports and imports dynamics. The data will be relevant to the assessment of the sustainability and scale of the slowdown in global trade. However, we should bear in mind that they are affected by the statistical effect relating to the shift of the date of the Chinese New Year, which temporarily boosted foreign trade activity in January.

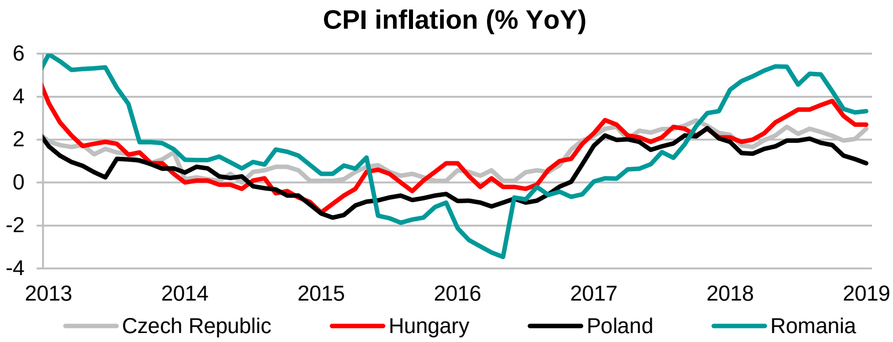
Last week

- **The Polish GDP growth rate decreased to 4.9% YoY in Q4 2018 vs. 5.1% in Q3 (0.5% QoQ in Q4 vs. 1.6% in Q3), running in line with the flash estimate released by GUS.** The decrease in GDP dynamics resulted from lower contribution of inventories (0.0pp in Q4 vs. 1.0pp in Q3) and private consumption (2.2pp vs. 2.7pp). Higher contributions of net exports (0.2pp in Q4 vs. -0.9pp) and public consumption (0.8pp vs. 0.6pp) had an opposite impact. The contribution of investments has not changed compared to Q3 and amounted to 1.7 pp. Thus, like in Q3, the main source of Polish GDP growth in Q4 was private consumption. In the context of a downturn abroad, most surprising in the structure of GDP for Q4 is the acceleration in exports. This may suggest growing competitive advantages of Polish enterprises abroad. Such view is supported by data on international trade in goods whose scale of the slowdown in exports in Poland in Q4 was the smallest among the countries of the region (see MACROpulse of 28/2/2019). The data on GDP in Q4 do not alter our view of the outlook for economic growth in 2019. On the other hand, significant changes planned by the government in fiscal policy (see MACROmap of 25/2/2019) pose a substantial upside risk to our forecast of economic growth in 2019 (3.3% vs. 5.1% in 2018). In the next MACROmap we will present our revised macroeconomic scenario taking into account the impact of the aforementioned fiscal package.
- **Polish manufacturing PMI dropped to 47.6 pts in February vs. 48.2 pts January, running below the market expectations (48.0 pts).** Thus, the index has now for four months in a row been running below the 50 pts threshold dividing expansion from contraction of activity. The index decrease resulted from lower contributions of two of its five sub-indices (for new orders and employment). Higher contribution of the sub-index for suppliers' delivery times had an opposite impact. The contributions of output and inventories have remained unchanged. February recorded subsequent increase in the sub-index for stocks of finished goods, which rose at the fastest pace since February 1999. Combined with further fast decline in production backlogs and lower indicator reflecting the expectations concerning production in horizon, this signals that the increase in stocks resulted from the surprisingly sharp decline in demand (see MACROpulse of 1/3/2019). Business survey results for Polish manufacturing support our forecast, in which industrial production growth slowed down to 3.5% YoY in February from 6.1% in January.
- **China Caixin manufacturing PMI rose to 48.9 pts in February vs. 48.3 pts in January, running above the market expectations (48.5 pts).** Nevertheless, February has been 3rd month in a row when the index stood below the 50 pts threshold dividing expansion from contraction of activity. The index increase resulted from higher contributions of four of its five sub-indices (for new orders, output, inventories, and supply delivery times). Lower contribution of the employment sub-index had an opposite impact. Noteworthy in the data structure is the sharp increase in the sub-index for total new orders, which after two months of declines rose above 50 pts. This was accompanied by a decline in new export orders. Thus, the increase in total new orders in Chines manufacturing in February resulted from stronger domestic demand. This may point to the first effects of the fiscal stimulation carried out by the Chinese government, including higher infrastructural investments. On the other hand, CFLP PMI indicated downturn in Chinese manufacturing, by dropping to 49.2 pts in February vs. 49.5 pts in January. The first signs of improvement in Chinese manufacturing combined with the growing probability of de-escalation in the US-China trade war support our forecast, in which in the whole 2019 the GDP dynamics in China will amount to 6.4% vs. 6.6% in 2018.
- **Last week, FED Chairman J. Powell presented the semi-annual monetary policy report to the Congress**. In his testimony he repeated the view that the Federal Reserve could afford to be “patient” when taking decisions on the amount of interest rates. J. Powell justified that conservative approach i.a. by increased volatility in the financial markets, slowdown of global

economic growth, uncertainty about Brexit, ongoing negotiations between the US and China, as well limited inflationary pressure in the US economy. J. Powell's remarks do not alter our scenario, in which the Federal Reserve will hike interest rates by 25bp in 2019 (in Q3). We believe that the argument in favour of interest rate hike will be the expected by us stabilization of situation in global economy in H1 2019 and lower political uncertainty (de-escalation of trade war, clarification of the Brexit issue). Currently the market is not pricing in any interest rate cut in the US in 2019.

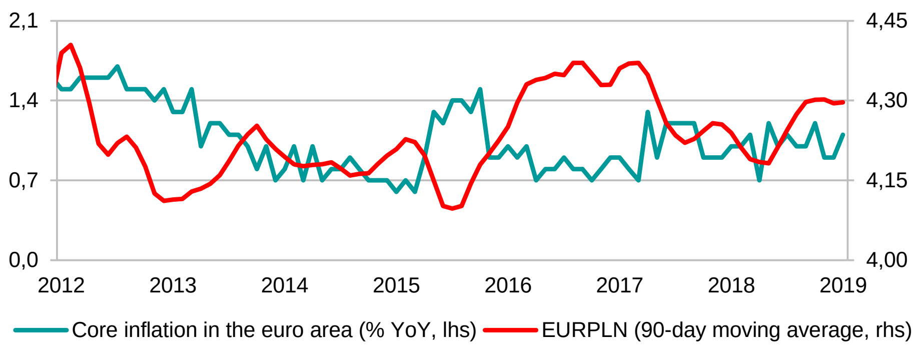
- **Important data from the US economy were released last week.** In accordance with the first estimate, the annualized US GDP growth rate dropped to 2.6% in Q4 2018 vs. 3.4% in Q3, running slightly above the market expectations (2.3%). Its decrease resulted from lower contributions of inventories (0.13pp in Q4 vs. 2.33pp in Q3), private consumption (1.92 pp vs. 2.37pp) and government expenditure (0.07pp vs. 0.44pp). Higher contributions of net exports (-0.22pp vs. -1.99pp) and investments (0.69pp vs. 0.21pp) had an opposite impact. Thus, like in Q3, private consumption was the main driver of US GDP growth in Q4. Last week we also saw outstanding data on building permits (1326k in December vs. 1322k in November) and housing starts (1078k in December vs. 1214k in November) which sent mixed signals from the US real estate market. The results of business surveys were also released last week. The Conference Board Index pointed to improvement in consumer sentiment, rising to 131.4 pts in February vs. 121.7 pts in January. Its increase resulted from higher values of its sub-indices for both the assessment of the current situation and expectations. The University of Michigan Index also indicated improvement in consumer sentiment, rising to 93.8 pts in February vs. 91.2 pts in January and 95.5 pts in the flash estimate. Its increase resulted from higher value of the sub-index for expectations while lower sub-index for the assessment of the current situation had an opposite impact. The ISM Index signaled deterioration in manufacturing and dropped to 54.2 pts in February vs. 56.6 pts in January, running below the market expectations (55.5 pts). Its decrease resulted from lower contributions of four of its five sub-indices (for output, new orders, employment, and supplier's delivery times). The last week's data from the US do not alter our forecast, in which the annualized US GDP growth rate will decrease to 1.7% in Q1 2019.
- **According to the flash estimate, inflation in the Eurozone rose to 1.5% YoY in February vs. 1.4% in January, running in line with the market expectations.** The increase in inflation resulted from higher dynamics of food and energy prices, while their decrease in services had an opposite impact. We expect that in April inflation in the Eurozone will reach its local maximum at 1.7% YoY and in subsequent quarters will show a downward trend dropping to 1.0% in Q4 2019. In addition, we forecast that core inflation in the Eurozone will not exceed 1.4% 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 and the main interest rate will be hiked in December 2019. The market is now pricing in the first interest rate hike in the Eurozone (by 10bp) in Q2 2019.

Is Poland doomed to low inflation?



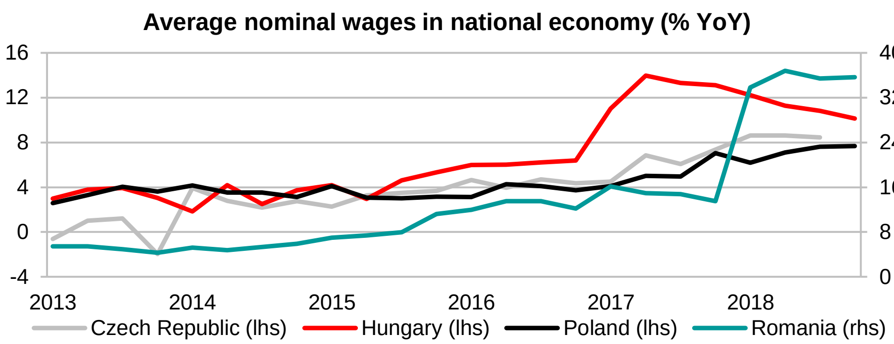
Source: Datastream, Credit Agricole

Inflation in Poland, compared to other countries of the region, is currently at a relatively low level. The rate of inflation has since the turn of 2017 and 2018 stayed below the levels recorded in the Czech Republic, Romania and Hungary (see the chart). Especially puzzling is the marked difference between the level of core inflation in Poland and in the aforementioned countries. Below we present the reasons for this and our forecast of inflation in Poland in the coming quarters.



Source: Eurostat, Reuters, Credit Agricole

In our view, there are several reasons for the slow growth of prices in Poland. First one is low import inflation. Recent years have seen low inflationary pressure within the single currency area. Core inflation in the Eurozone usually ranged between 0.5 and 1.5% YoY, namely below the ECB inflation target. In addition, EURPLN was not subject to considerable fluctuations in recent years, which supported the stabilization of import prices denominated in PLN. The above factors were also present in other countries of the region; therefore, they are not an element differentiating individual economies.



Source: Datastream, Credit Agricole

What distinguishes Poland from the Czech Republic, Romania and Hungary is the situation in the labour market. The wage dynamics in Poland is at a markedly lower level (see the chart). The faster growth of wages in the region occurred partly due to the economic policy carried out in the said countries – significant increase in minimum wage, pay rises for public sector employee, reduction of employers' contributions (in Romania and Hungary – giving more room for rises in the private sector). The second element limiting wage increases in Poland compared to other countries of the region is a relatively high inflow of economic immigrants compared to the number of the employed. The inflow of Ukrainians to Poland amid growing difficulties of enterprises in finding skilled labour was conducive to limited wage pressure.

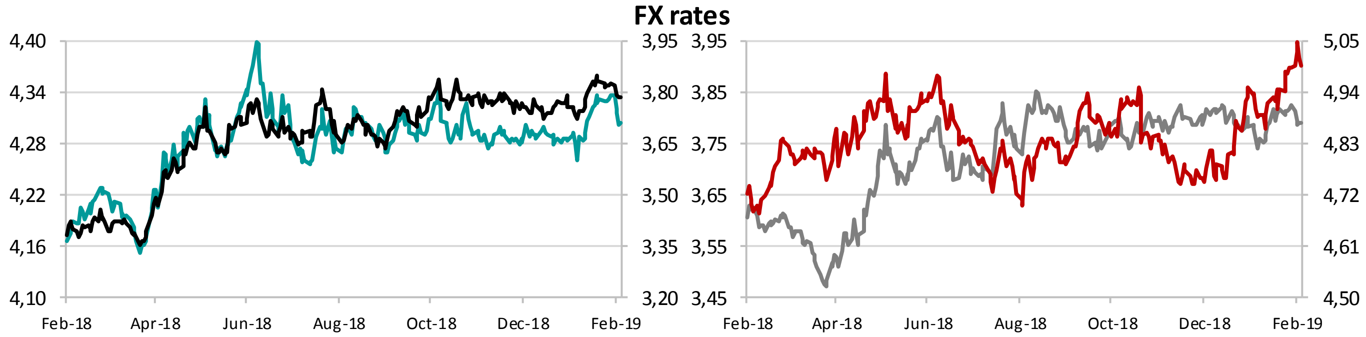
In addition, Polish employees show low propensity to changing jobs – the percentage of employees searching for a different main or additional job has showed a downward trend in the past 10 years and currently amounts to 1%. This trend results mainly from the long period of time needed to find new employment. The labour market researchers signal that this is due to relatively poorly developed professional consultancy and employment services. These conditions also limit wage pressure.

Another element which slows down inflation (not only in Poland) is the growing globalization contributing to a long-range decline in enterprises' margins. According to scientific research, this tendency is related to the position of Polish companies in the global value chains (GVC) and them being more oriented towards foreign markets. The growing globalization is also becoming increasingly important for the prices of services. According to the traditional approach, services represent so-called non-tradable goods. The main factor which determines their prices are costs of labour and in theory they are not subject to foreign competitive pressure. Nevertheless, due to technological progress, an increasingly bigger share of services can be outsourced abroad. Consequently, some services stop being "pure" non-tradable goods and growing competitive pressure can be observed also in this segment of enterprises. These tendencies are responsible for the fact that a decrease in the unemployment rate now causes a smaller rise in prices than two decades ago, resulting in the so-called flattening of the Philips' curve. Limited possibilities of companies to transfer higher costs to consumers are reflected by the NBP business surveys ("Quick Monitoring, January 2019"), in which 59% of companies fear the outflow of customers to competition or lower demand if they increased the prices of their products.

We believe that the anti-inflationary impact of the situation in the Polish labour market will become smaller in the coming quarters, contributing towards gradual increase in inflation. According to the latest data, the inflow of Ukrainians to Poland has slowed down. In addition, there is a significant risk of the outflow of immigrants to Germany in 2020, due to changes in the German migration law. Such tendencies, given the difficulties in finding skilled labour, will be conducive to a faster increase in wages in Poland. In addition, the NBP business surveys indicate a significant increase in wage pressure in Q1 2019. The above factors will be conducive to increased cost pressure in enterprises. At the same time, the possibility of a further decrease in enterprises' margins is limited, which means that growing costs of labour will be transferred to customers through increases in prices of finished goods. Higher prices of waste disposal and the forecasted by us increase in core inflation in the Eurozone in 2020 will also contribute towards the rise of consumer prices in Poland.

Another important factor conducive to increase in the demand pressure in Poland, thus in inflation, will be the government-announced easing of fiscal policy. Due to considerable uncertainty as to the fiscal package, the impact of the changes in fiscal policy on the rate of inflation is difficult to assess now. The factors outlined above support our forecast assuming increase in inflation up to 2.0% in 2020 from 1.5% in 2019. The way in which GUS will factor the rise in electricity prices in the CPI index is the source of uncertainty for our scenario.

Dovish tone of the conference after MPC meeting may weaken PLN



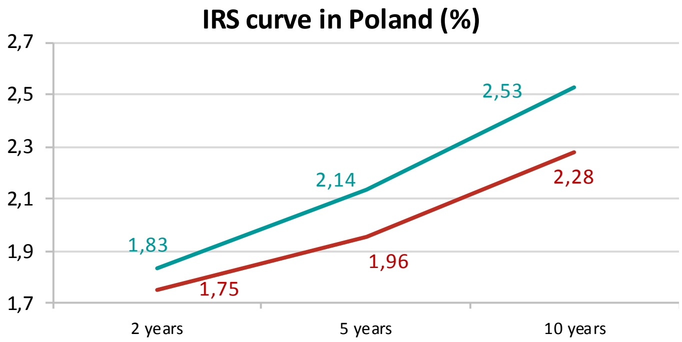
Source: Reuters

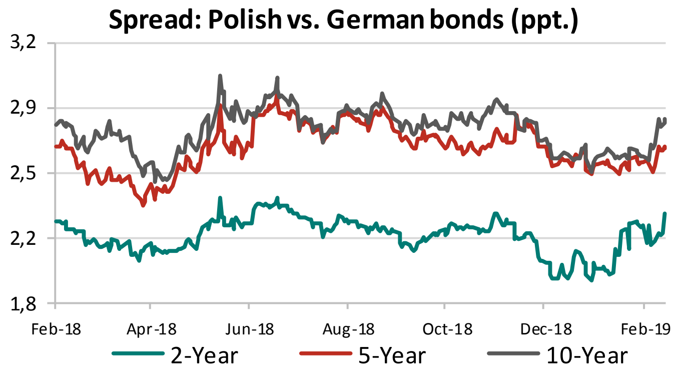
Last week, the EURPLN exchange rate dropped to 4.3045 (PLN strengthening by 0.8%). On Monday, EURPLN was stable and oscillated around 4.33. Tuesday through Thursday saw the appreciation of PLN and other currencies of the region, due to lower risk aversion reflected by lower VIX index. Higher appetite for risk assets may have been supported by investors' growing expectations of de-escalation of the US-China trade war. On Friday PLN slightly weakened, to a certain extent due to the publication of a weaker-than-expected PMI for Polish manufacturing.

Due to the reasons for the last week's appreciation of PLN which was caused by lower global risk aversion, PLN also appreciated vs. USD (by 1.0%) and CHF (by 0.9%). On the other hand, PLN depreciated vs. GBP (by 0.1%), due to lower EURGBP. The appreciation of GBP vs. EUR is supported by growing market expectations of the postponement of Brexit.

Crucial for PLN this week will be the MPC meeting scheduled for Wednesday. We believe that it may result in the depreciation of PLN. On Thursday increased volatility of PLN may be supported by the ECB meeting. The US readings scheduled for this week (non-farm payrolls, number of housing starts, new building permits and existing home sales) will not have any significant impact on PLN, we believe.

Increased market volatility due to ECB meeting





Source: Reuters

Last week, 2-year IRS rates increased to 1.83 (up by 8bp), 5-year rates to 2.14 (down up 10bp), and 10-year rates to 2.53 (down by 25bp). As we expected, the beginning of last week saw a sharp increase in IRS rates across the curve in reaction to the fiscal package which was announced two weeks by the Law and Justice and lowered market expectations of interest rate cuts in Poland (see MACROmap of 25/2/2019). At the same time we saw an increase in spread between the Polish and the German bonds. Further into week, the increase in yields in the core markets (in Germany and the USA), supported by lower global risk aversion, was an additional factor conducive to higher IRS rates.

This week all eyes will be on the Wednesday's MPC meeting. We believe that its tone may contribute towards lower IRS rates. On Thursday, IRS rates may be more volatile due to the ECB meeting. The US readings scheduled for this week (non-farm payrolls, number of housing starts, new building permits and existing home sales) will be neutral for the curve, we believe.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-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*	4,17	4,21	4,24	4,31	4,37	4,27	4,30	4,28	4,34	4,29	4,29	4,26	4,30	**4,30**
USDPLN*	3,42	3,42	3,51	3,69	3,74	3,66	3,71	3,69	3,84	3,79	3,74	3,72	3,79	**3,74**
CHFPLN*	3,62	3,58	3,54	3,74	3,78	3,69	3,83	3,75	3,80	3,79	3,81	3,74	3,79	**3,74**
CPI inflation (% YoY)	1,4	1,3	1,6	1,7	2,0	2,0	2,0	1,9	1,8	1,3	1,1	0,9	**1,1**	
Core inflation (% YoY)	0,8	0,7	0,6	0,5	0,6	0,6	0,9	0,8	0,9	0,7	0,6	**1,0**	**1,0**	
Industrial production (% YoY)	7,3	1,7	9,3	5,2	6,7	10,3	5,0	2,7	7,4	4,6	2,8	6,1	**3,5**	
PPI inflation (% YoY)	-0,1	0,5	1,0	3,0	3,7	3,4	3,0	3,0	3,2	2,8	2,1	2,2	**2,4**	
Retail sales (% YoY)	7,9	9,2	4,6	7,6	10,3	9,3	9,0	5,6	9,7	8,2	4,7	6,6	**6,8**	
Corporate sector wages (% YoY)	6,8	6,7	7,8	7,0	7,5	7,2	6,8	6,7	7,6	7,7	6,1	7,5	**7,2**	
Employment (% YoY)	3,7	3,7	3,7	3,7	3,7	3,5	3,4	3,2	3,2	3,0	2,8	2,9	**2,9**	
Unemployment rate* (%)	6,8	6,6	6,3	6,1	5,8	5,8	5,8	5,7	5,7	5,7	5,8	6,1	**6,1**	
Current account (M EUR)	-792	-914	263	297	112	-994	-681	-858	-471	-240	-1400	**1617**		
Exports (% YoY EUR)	6,6	-4,4	9,9	1,4	7,0	8,4	7,3	0,0	12,1	7,2	2,3	**6,2**		
Imports (% YoY EUR)	9,5	0,3	13,6	2,9	8,7	10,0	11,2	5,4	17,5	10,0	3,0	**6,4**		

*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	4,9	3,7	3,6	3,2	2,9	5,1	3,3	3,2
Private consumption (% YoY)		4,7	4,9	4,5	4,3	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	6,7	8,1	6,7	4,4	3,6	7,3	5,2	4,2
Export - constant prices (% YoY)		3,4	7,6	4,9	8,9	4,7	4,7	4,9	5,4	6,2	4,9	4,5
Import - constant prices (% YoY)		5,5	6,5	6,9	9,0	5,7	5,6	6,3	5,8	7,0	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	1,7	1,0	1,1	0,8	0,9	1,3	1,0	0,8
	Net exports (pp)	-1,0	0,9	-0,9	0,2	-0,4	-0,3	-0,6	-0,1	-0,2	-0,3	-0,6
Current account (% of GDP)***		-0,2	0,0	-0,5	-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	0,0	0,4	0,4	0,4	0,4	0,9	0,4	0,1
Wages in national economy (% YoY)		6,2	7,1	7,6	7,7	7,5	7,2	6,9	6,2	7,2	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	3,73	3,64	3,54	3,74	3,54	3,24

* quarterly average

** end of period

***cumulative for the last 4 quarters

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST* CA	CONSENSUS**
		Monday 03/04/2019				
10:30	Eurozone	Sentix Index (pts)	Mar	-3,7		-3,2
11:00	Eurozone	PPI (% YoY)	Jan	3,0		2,9
		Tuesday 03/05/2019				
10:00	Eurozone	Services PMI (pts)	Feb	52,3	52,3	52,3
10:00	Eurozone	Final Composite PMI (pts)	Feb	51,4	51,4	51,4
11:00	Eurozone	Retail sales (% MoM)	Jan	-1,6		1,0
16:00	USA	New home sales (k)	Dec	657		593
16:00	USA	ISM Non-Manufacturing Index (pts)	Feb	56,7	57,0	57,2
		Wednesday 03/06/2019				
14:15	USA	ADP employment report (k)	Feb	213		190
	Poland	**NBP rate decision (%)**	**Mar**	**1,50**	**1,50**	**1,50**
		Thursday 03/07/2019				
11:00	Eurozone	Final GDP (% YoY)	Q4	1,2		1,2
11:00	Eurozone	Revised GDP (% QoQ)	Q4	0,2	0,2	0,2
11:00	Eurozone	Employment (% YoY)	Q4	1,2		1,2
13:45	Eurozone	EBC rate decision (%)	Mar	0,00	0,00	0,00
14:30	USA	Initial jobless claims (k)	w/e	225		225
		Friday 03/08/2019				
	China	Trade balance (bn USD)	Feb	39,2		25,6
8:00	Germany	New industrial orders (% MoM)	Jan	-1,6		0,4
14:30	USA	Unemployment rate (%)	Feb	4,0	3,8	3,9
14:30	USA	Non-farm payrolls (k MoM)	Feb	304	195	185
14:30	USA	Housing starts (k MoM)	Jan	1078	1123	1180
14:30	USA	Building permits (k)	Jan	0	1299	1297

*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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