A pause in the tightening cycle in the Czech Republic

This week

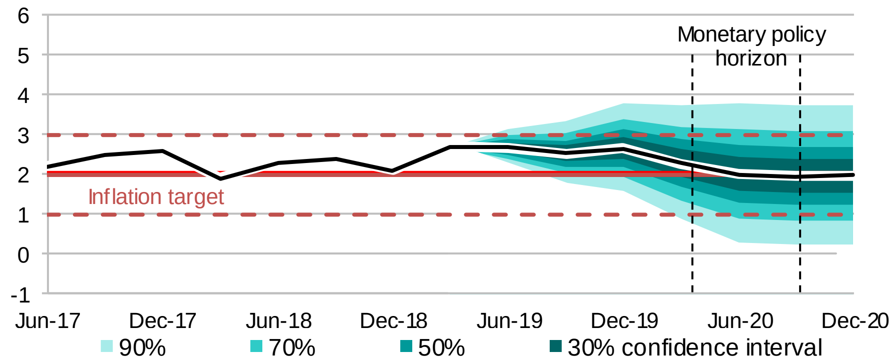
- **The most important event this week will be the meeting of the Monetary Policy Council scheduled for Wednesday**. We expect that the MPC will leave the interest rates unchanged. The issue of the marked increase of inflation in April in the context of its impact on the monetary policy outlook is likely to be raised during the conference. A. Glapiński will probably try to lower the market expectations of interest rate hikes in Poland. We believe that he will repeat his opinion that NBP interest rates will not change in 2019-2020 period. We believe that the tone of the press conference after the MPC meeting will be neutral for PLN and yields on Polish bonds.
- **Significant hard data on US economy and business survey results will be released this week.** We forecast that nominal retail sales increased by 0.2% MoM in April vs. a 1.6% increase in March, due to lower sales in the automotive branch. We forecast that industrial production dynamics rose to 0.0% MoM in April vs. -0.1% in March, consistently with the low growth of employment in manufacturing recorded in April (4k). We expect that data on housing starts (1185k in April vs. 1139k in March) and building permits (1282k vs. 1269k) will point to stabilization in the US real estate market. Business survey results will also be released this week. We forecast that the NY Empire State Index dropped to 9.0 pts in May vs. 10.1 pts in April, while the Philadelphia FED Index decreased to 9.0 pts in May vs. 8.5 pts in April. The preliminary University of Michigan Index will be released on Friday. We forecast that its value decreased to 96.5 pts in May vs. 97.2 pts in April. We believe that the aggregate impact of data on the US economy on the financial markets will be limited.
- **Important data from China will be released on Wednesday.** We expect that the monthly data will point to a slight slowdown of the annual economic activity growth rate in April, due to the last year's high base effects. We forecast that industrial production rose by 6.0% YoY in April vs. 8.7% in March, retail sales rose by 8.3% YoY vs. 8.7%, and urban investments rose by 6.6% YoY vs. 6.3% in March. In our view, the publication of data from China will be neutral for the financial markets.
- **The flash estimate of GDP in Poland in Q1 will be released on Wednesday.** We forecast that the GDP growth rate dropped to 4.4% YoY from 4.9% in Q4 2018. Conducive to slower GDP growth were lower contributions of investments and net exports. We believe that the GDP reading will be neutral for PLN and yields on Polish bonds.
- **Final data on the April inflation in Poland will be released on Wednesday.** We see a risk that the inflation rate will be revised downwards compared to the flash estimate (2.2% YoY vs. 1.7% in March). We believe that conducive to the indicator increase were higher dynamics of all its components (prices of food, fuels, energy and of goods and services included in the calculation of core inflation). The publication of the inflation data will be neutral for PLN and the prices of Polish bonds.

Last week

- **CPI inflation in the US decreased to 0.3% MoM in April vs. 0.4% in March (2.0% YoY in April vs. 1.9% in March), with market expectations at 0.4% MoM and 2.1% YoY, respectively.** Conducive to lower inflation in monthly terms were lower dynamics of energy and food prices. Core inflation has not changed in April compared to March and amounted to 0.1% (2.1% YoY in April vs. 2.0% in March), with market expectations at 0.2% MoM and 2.1% YoY, respectively. At the same time, the main source of inflation were higher dynamics of the prices of services, while the dynamics of the prices of goods have decreased. Such inflation structure raises doubts concerning the arguments presented by the FED chair, J. Powell, that the currently observed lower rate of inflation was temporary. In effect, after the publication of the weaker-form-the-market-consensus inflation data, the yields on US bonds decreased and USD depreciated vs. EUR. We maintain our scenario assuming the stabilization of interest rates in the US in 2019 and 2020.

- **Significant data from the German economy were released last week**. Production dynamics rose to 0.5% MoM in March vs. 0.4% in February, running visibly above the market expectations (-0.5%). Their increase resulted from higher dynamics of production in the energy sector and manufacturing, while their decrease in construction had an opposite impact. Orders in German manufacturing also recorded an increase and rose by 0.6% in March vs. a decrease by 4.0% in February, though running below the market expectations (1.5%). The increase in total orders resulted from lower dynamics of domestic orders and higher dynamics of foreign orders. However, responsible for the increase in foreign orders were higher orders from other Eurozone countries, while orders from beyond the single currency area continued to decrease. In the light of the last week's data on the Chinese trade balance (see below), it points in our view to further slowdown of activity in global trade. This view is not altered by data on German foreign trade, showing that export dynamics rose to 1.5% MoM in March vs. -1.2% in February, while import dynamics rose to 0.4% MoM vs. -1.6%, with market expectations at -0.3% MoM and 0.5% MoM, respectively. Data on German economy pose an upside risk to our forecast, in which the quarterly GDP growth rate in Germany rose to 0.2% in Q1 2019 vs. 0.0% in Q4 2018. The data on GDP growth in Q1 will be released on Wednesday.
- **The Chinese balance on trade decreased to USD 13.8bn in April vs. USD 32.7bn in March, running significantly below the market expectations (USD 35.0bn).** At the same time, export dynamics dropped to -2.7% YoY in April vs. 14.2% in March, while import dynamics increased to 4.0% YoY vs. -7.6%, running respectively below and above the market (2.3% and -3.6%). The lower-than-expected dynamics of the Chinese exports signals further slowdown in global trade. In turn, higher import dynamics reflect, in our view, the first effects of the stimulation of internal demand implemented by the Chinese government. The data are consistent with our scenario assuming the acceleration of economic growth in China in H2 2019. Consequently, we forecast that in the whole 2019 the Chinese GDP dynamics will amount to 6.4% vs. 6.6% in 2018.
- **As announced two weeks ago, the US President, D. Trump, declared the imposition of a subsequent tranche of higher import tariffs on goods from China (up to 25% from 10%), this time of the total value of USD 200bn.** Increased tariffs cover a wide range of goods, i.a. furniture, car parts, many source materials, chemicals, and building materials. At the same time, D. Trump said that works were under way on the introduction of higher tariffs on the remaining imports from China. We expect that China will respond by introducing higher import tariffs on goods from the US worth USD 60bn. We estimate that, including the latest tranche of US tariffs, the trade war will decrease the dynamics of the Chinese GDP by 0.7 pp in 2019 and by 0.5 pp in 2020. Nonetheless, we maintain our forecast of economic growth in China (6.4% in 2019 and 6.0% in 2020). However, to achieve such GDP dynamics, the scale of the stimulation of growth implemented by the Chinese government will have to be increased. Despite the escalation of the trade war, we maintain our view that in H2 2019 China and the US will reach an agreement, though the likelihood of this scenario is lower now than before the Friday's decision of D. Trump to increase import tariffs on goods from China (we estimate that it amounts to 60%).

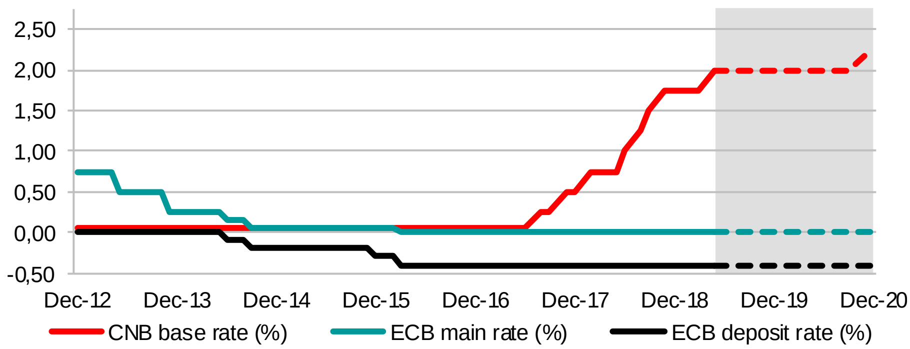
A pause in the tightening cycle in the Czech Republic



Source: CNB, Credit Agricole

As we expected (see MACROmap of 18/3/2019), the Czech National Bank (CNB) has increased the two-week repo rate by 25bp to 2.00%. The main argument for the hike was the sustained inflationary pressure. In April, CPI inflation amounted to 3.0% YoY, running along the upper limit of the tolerance band for the CNB inflation target (2.0 ± 1.0% YoY). The decrease of risk in the Czech Republic's external environment (i.a. the delay of Brexit) has also increased the room for maneuver for the CNB. It has now been the eighth interest rate hike in the current cycle of the monetary policy tightening. Below we present our scenario concerning the outlook for the monetary policy in the Czech Republic and our forecast of EURCZK and PLNCZK.

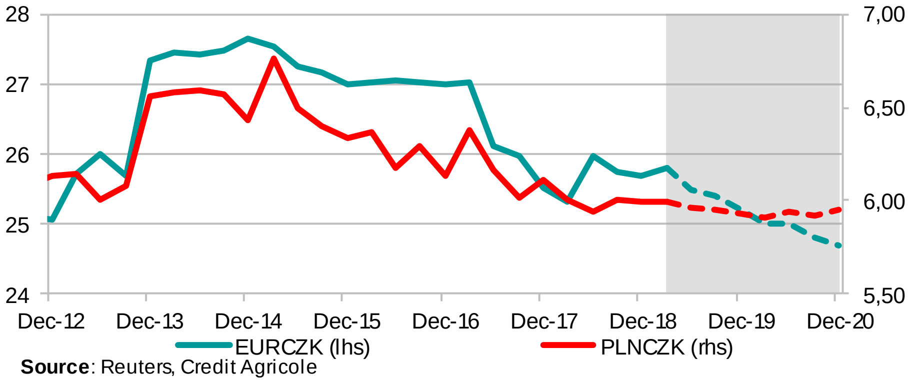
After the May meeting of the central bank, the stance of the CNB representatives has changed to markedly more dovish – they now expect the stabilization of interest rates until the middle of 2020. Such forward guidance was not only expressed in their remarks but was also included in the statement after the meeting. The forecast of the two-week repo rate presented in the May report on inflation still implies a slight (by a dozen or so pb) tightening of the monetary policy in Q2 2019, followed by its easing (the decrease of the rate to 1.83% as at the end of 2020). We believe that such scenario (resulting from econometric modelling) is extremely unlikely, as frequent changes of interest rates would be conducive to lower credibility of the CNB. In addition, during the conference, the CNB Governor explained that the further slight increase in the two-week repo rate presented in the projection should not be understood as the announcement of further hikes and that the stabilization of interest rate is forecast for an extended period of time.



Source: Reuters, Credit Agricole

According to the statement, the main factor justifying the leaving of domestic interest rates at an unchanged level is the negative level of interest rates in the Eurozone. The CNB believes that the ECB will start the normalization of the monetary policy in 2020, thus limiting the rate of CZK appreciation due to a diminishing interest rate divergence between the Czech Republic and the Eurozone. This assumption differs from our scenario of the monetary policy in the Eurozone – we believe that the first hike of the ECB interest rates will take place no sooner than in the middle of 2021. This means that the scale of CZK appreciation in 2020 is likely to be higher from the CNB expectations, which limits the need for the monetary policy tightening delivered in a conventional way. That is why our baseline scenario forecasts that the CNB will hike interest rates no sooner than in Q4 2020.

An argument in favour of a later (than the horizon of stable interest rates indicated in the forward guidance) interest rate hike in the Czech Republic are also our expectations concerning the economic growth rate and inflation in the Eurozone. We believe that both variables will stand in 2020 and 2021 at a lower level than that forecast in the CNB May projection. In addition, the global economic outlook is subject to uncertainty due to lower likelihood of the US and China reaching an agreement soon. Nevertheless, assuming, in accordance with our baseline scenario, that the currently observed slowdown in global trade is temporary and H2 2019 will see acceleration in global economic growth, the tightening of the monetary policy by the CNB in Q4 2020 would not pose a risk to the sustainability of the economic recovery in the Czech Republic.

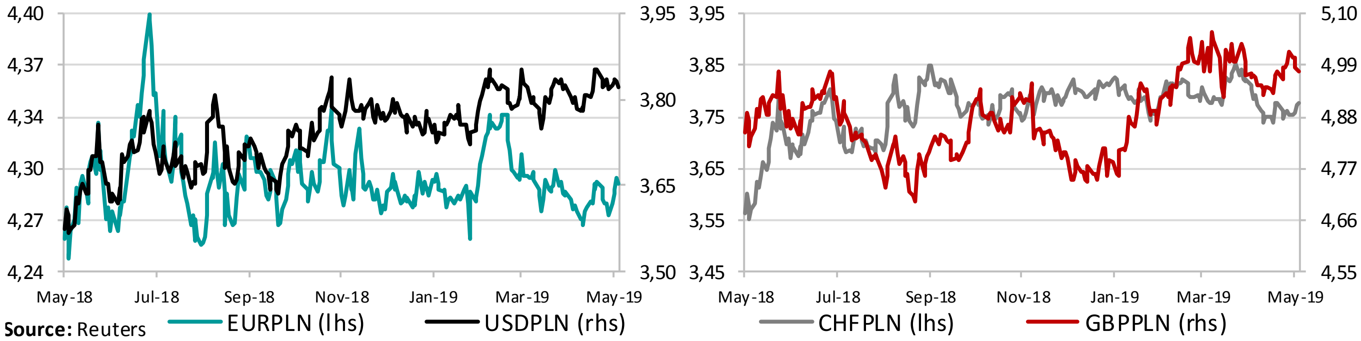


Source: Reuters, Credit Agricole

We maintain our forecast that the continuing divergence of interest rates between the Czech Republic and the Eurozone will be conducive to a slight appreciation of CZK vs. EUR (EURCZK amounting to 25.20 as at the end of 2019 and to 24.7 as at the end of 2020). The scale of the CZK appreciation will be limited by the significant long currency positions, opened in anticipation of the CZK appreciation after the removal of the EUR/CZK floor in April 2017. Considering the expected by us EURPLN profile (see the quarterly table), we forecast that PLNCZK will amount to 5.93 as at the end of 2019 and to 5.95 as at the end of 2020.

Data on Polish GDP neutral for PLN

FX rates



Source: Reuters

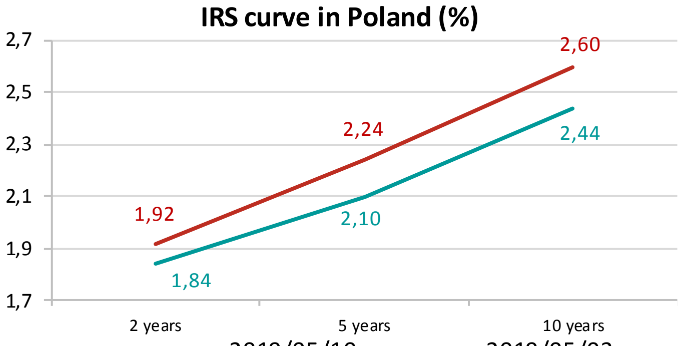
Last week, the EURPLN exchange rate rose 4.2948 (PLN weakening by 0.5%). Monday through Friday PLN was depreciating due to increased risk aversion reflected by higher VIX Index. Lower appetite for risk resulted from the uncertainty as to whether President D. Trump would act on his announcement from two weeks ago and introduce higher import tariffs on a subsequent tranche of goods from China. Although D. Trump's Friday decision on the imposition of tariffs lowered the uncertainty and decreased global risk aversion, EURPLN has stayed at higher levels.

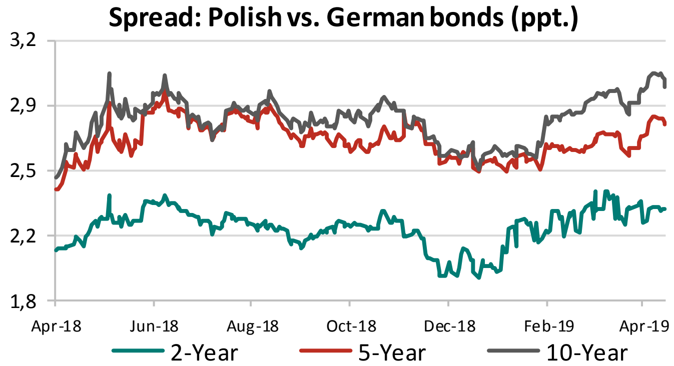
The escalation of the US-China trade war, coupled with the dovish impact of data on the US CPI inflation (see above), supported an increase in EURUSD. Last week EUR was also appreciating vs. GBP, due to the deadlock in Brexit talks between the ruling Conservative Party and the Labour Party, being the major opposition party.

Crucial for PLN this week will be the publication of domestic data on GDP. However, we believe that they will not have any substantial impact on PLN. The MCP meeting will also be neutral for PLN. We believe that numerous data from the US (retail sales, industrial production, number of housing starts, new building permits, NY Empire State Index, Philadelphia FED Index, preliminary University of Michigan

Index) and China (industrial production, retail sales, urban investments) will also have a limited impact on PLN.

Market focused on the MPC meeting





Source: Reuters

Last week, 2-year IRS rates decreased to 1.842 (down by 7bp), 5-year rates to 2.098 (down by 14bp), and 10-year rates to 2.435 (down by 16bp). The beginning of last week brought a marked correction of IRS rates which rose significantly two weeks ago, after the publication of higher-than-expected flash data on domestic inflation (see MACROmap of 6/5/2019). The correction was also reflected by lower spread between the Polish and German bonds. Subsequent days saw a further decrease in IRS rates following the German market. On Thursday, the Ministry of Finance held a debt exchange auction at which it repurchased bonds maturing in 2019 and 2020 and sold PLN 4.1bn of 2-, 5-, 9-, and 10-year bonds with demand amounting to PLN 5.8bn. The auction had no significant impact on the market.

This week the market will focus on the MPC meeting, though, in our view, it will have a limited impact on IRS rates. Domestic data on GDP, numerous data from the US (retail sales, industrial production, number of housing starts, new building permits, NY Empire State Index, Philadelphia FED Index, preliminary University of Michigan Index) are also likely to be neutral for the market.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-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*	4,24	4,31	4,37	4,27	4,30	4,28	4,34	4,29	4,29	4,26	4,30	4,30	4,28	**4,28**
USDPLN*	3,51	3,69	3,74	3,66	3,71	3,69	3,84	3,79	3,74	3,72	3,79	3,84	3,82	**3,79**
CHFPLN*	3,54	3,74	3,78	3,69	3,83	3,75	3,80	3,79	3,81	3,74	3,79	3,85	3,75	**3,75**
CPI inflation (% YoY)	1,6	1,7	2,0	2,0	2,0	1,9	1,8	1,3	1,1	0,7	1,2	1,7	**1,9**	
Core inflation (% YoY)	0,6	0,5	0,6	0,6	0,9	0,8	0,9	0,7	0,6	0,8	1,0	1,4	**1,5**	
Industrial production (% YoY)	9,3	5,2	6,7	10,3	5,0	2,7	7,4	4,6	2,8	6,0	6,9	5,5	**9,0**	
PPI inflation (% YoY)	1,0	3,0	3,7	3,4	3,0	3,0	3,2	2,8	2,1	2,2	2,9	2,5	**2,3**	
Retail sales (% YoY)	4,6	7,6	10,3	9,3	9,0	5,6	9,7	8,2	4,7	6,6	6,5	3,1	**10,0**	
Corporate sector wages (% YoY)	7,8	7,0	7,5	7,2	6,8	6,7	7,6	7,7	6,1	7,5	7,6	5,7	**6,7**	
Employment (% YoY)	3,7	3,7	3,7	3,5	3,4	3,2	3,2	3,0	2,8	2,9	2,9	3,0	**3,0**	
Unemployment rate* (%)	6,3	6,1	5,8	5,8	5,8	5,7	5,7	5,7	5,8	6,1	6,1	5,9	**5,6**	
Current account (M EUR)	-34	236	192	-754	-1005	-876	-482	-29	-1248	1825	-1386	**-1088**		
Exports (% YoY EUR)	10,4	1,5	7,7	12,0	8,9	-1,5	13,2	7,6	2,3	5,0	10,0	**9,1**		
Imports (% YoY EUR)	15,0	4,1	9,4	12,4	14,0	4,2	18,0	9,1	2,3	4,9	13,4	**12,4**		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland

	Indicator	2019				2020				2018	2019	2020
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
	Gross Domestic Product (% YoY)	4,4	4,5	4,3	4,2	4,0	3,9	3,7	3,6	5,1	4,3	3,8
	Private consumption (% YoY)	4,5	5,5	4,4	4,3	4,4	3,5	3,7	3,6	4,5	4,7	3,8
	Gross fixed capital formation (% YoY)	7,0	5,8	5,2	5,0	4,7	4,9	4,8	5,0	8,7	5,8	4,8
	Export - constant prices (% YoY)	7,0	5,7	6,4	6,1	7,8	8,4	8,6	8,4	6,3	6,3	8,3
	Import - constant prices (% YoY)	8,3	8,7	6,8	6,9	6,4	8,0	8,1	8,3	7,1	7,7	7,7
GDP growth contributions	Private consumption (pp)	3,1	3,3	2,6	2,2	2,8	2,1	2,2	1,8	2,6	2,8	2,2
	Investments (pp)	1,0	0,9	0,9	1,2	0,6	0,8	0,9	1,2	1,5	1,0	0,9
	Net exports (pp)	-0,4	-1,3	0,0	-0,2	1,0	0,5	0,5	0,3	-0,2	-0,5	0,6
	Current account (% of GDP)***	-1,0	-1,4	-1,0	-1,0	-1,1	-1,2	-1,2	-1,2	-0,7	-1,0	-1,2
	Unemployment rate (%)**	5,9	5,5	5,7	5,8	5,9	5,5	5,7	5,8	5,8	5,8	5,8
	Non-agricultural employment (% YoY)	0,4	0,4	0,4	0,3	0,2	0,2	0,2	0,3	0,9	0,4	0,2
	Wages in national economy (% YoY)	8,2	7,7	7,2	7,1	7,4	7,1	6,6	6,8	7,2	7,6	7,0
	CPI Inflation (% YoY)*	1,2	2,4	2,5	2,3	2,8	1,7	1,5	1,6	1,6	2,1	1,9
	Wibor 3M (%)**	1,72	1,72	1,72	1,80	1,97	1,97	2,14	2,22	1,72	1,80	2,22
	NBP reference rate (%)**	1,50	1,50	1,50	1,50	1,75	1,75	1,75	2,00	1,50	1,50	2,00
	EURPLN**	4,30	4,28	4,27	4,25	4,23	4,21	4,19	4,15	4,29	4,25	4,15
	USDPLN**	3,84	3,75	3,68	3,60	3,53	3,48	3,41	3,32	3,74	3,60	3,32

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
		Tuesday 05/14/2019				
11:00	Eurozone	Industrial production (% MoM)	Mar	-0,2		-0,3
11:00	Germany	ZEW Economic Sentiment (pts)	May	3,1		5,0
		Wednesday 05/15/2019				
4:00	China	Retail sales (% YoY)	Apr	8,7	8,3	8,6
4:00	China	Industrial production (% YoY)	Apr	8,5	6,0	6,5
4:00	China	Urban investments (% YoY)	Apr	6,3	6,6	6,3
8:00	Germany	Preliminary GDP (% QoQ)	Q1	0,0	0,2	0,4
10:00	**Poland**	**CPI (% YoY)**	**Apr**	**1,7**	**1,9**	**1,8**
10:00	**Poland**	**Flash GDP (% YoY)**	**Q1**	**4,9**	**4,9**	**4,5**
11:00	Eurozone	Preliminary GDP (% QoQ)	Q1	0,4	0,4	0,4
11:00	Eurozone	GDP flash estimate (% YoY)	Q1	1,2	1,2	1,2
14:30	USA	NY Fed Manufacturing Index (pts)	May	10,1	9,0	8,5
14:30	USA	Retail sales (% MoM)	Apr	1,6	0,2	0,3
15:15	USA	Industrial production (% MoM)	Apr	-0,1	0,0	0,1
15:15	USA	Capacity utilization (%)	Apr	78,8		78,8
16:00	USA	Business inventories (% MoM)	Mar	0,3		0,0
	Poland	**NBP rate decision (%)**	**May**	**1,50**	**1,50**	**1,50**
		Thursday 05/16/2019				
14:00	**Poland**	**Core inflation (% YoY)**	**Apr**	**1,4**	**1,5**	**1,6**
14:30	USA	Philadelphia Fed Index (pts)	May	8,5	9,0	9,5
14:30	USA	Housing starts (k MoM)	Apr	1139	1185	1200
14:30	USA	Building permits (k)	Apr	1288	1139	1290
		Friday 05/17/2019				
11:00	Eurozone	HICP (% YoY)	Apr	1,7	1,7	1,7
16:00	USA	Initial U. of Michigan Sentiment Index (pts)	May	97,2	96,5	97,5

*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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