CRÉDIT AGRICOLE

MACRO MAP

Higher prices will not inflate the wage dynamics

This week

- **On Wednesday and Thursday, the FED chairman J. Powell will present a semi-annual monetary policy report to the Congress.** The investors will closely follow J. Powell's remarks about the outlook for economic growth, inflation, and interest rates. In our view, the FED chairman will mention low inflation pressure and the uncertainty about macroeconomic prospects and will emphasize that such economic situation justifies monetary easing in the nearest future. However, he will not give a specific date for interest rates cut (July or September). The markets are now pricing in the monetary easing at the July meeting by at least 25 bp. During J. Powell's testimony we may see increased volatility in the financial markets. The Minutes of the June FOMC meeting will also be published on Wednesday evening but we believe that they will not be market moving. Our baseline scenario assumes that FED will cut interest rates twice this year each time by 25 bp (in July and in September), anticipating a downturn in 2020. We see a risk that in the event of a marked improvement of the macroeconomic prospects signalled by information coming before the July meeting, the FOMC will postpone the monetary easing until September 2019.
- **Data on CPI inflation in the US will be released on Thursday.** We believe that CPI inflation dropped to 1.6% MoM in June from 1.8% in May, with core inflation stable at 2.0% YoY. We expect that the inflation reading will not significantly change the market expectations concerning the US monetary policy outlook and therefore will be neutral for the financial markets.
- **Data on the Chinese balance on trade will be released on Friday.** We expect it to have increased to USD 45.0bn in June vs. USD 41.7bn in May. In accordance with the consensus, the export growth rate dropped to -2.0% YoY in June from 1.1% in May, while import dynamics increased to -3.0% YoY from -8.5% in May. We believe that the publication of the data on the Chinese balance on trade will be overshadowed by the trade negotiations currently under way between the US and China and thus will be neutral for the financial markets.
- **Significant data from the German economy have been released this morning.** Industrial production increased by 0.3% MoM in May vs. a 0.2% decrease in April, running in line with market expectations. The increase in its monthly dynamics resulted from higher production dynamics in manufacturing and energy, while lower production dynamics in construction had an opposite impact. Data on balance on trade have also been released this morning and showed that export dynamics rose to 1.1% MoM in May vs. -3.4% in April, and import dynamics to -0.5% vs. -0.9%, with expectations at 0.5% and 0.3%, respectively. Consequently, the trade surplus rose to EUR 18.7bn in May vs. EUR 16.9bn in April. Data on orders in German manufacturing were released last week and dropped to 2.2% MoM in May vs. a 0.4% increase in April, running markedly below the market expectations (a decrease by 0.2%). The decrease in orders resulted from lower export orders while a slight increase in domestic orders had an opposite impact. In the case of foreign orders a decrease was reported both for orders from other countries of the Eurozone and from countries from outside the single currency area. The data on the German economy support our forecast in which the quarterly GDP dynamics in Germany will decrease to 0.2% in Q2 vs. 0.4% in Q1. We expect that in the whole 2019 the German economic growth rate will decrease to 0.7% YoY vs. 1.5% in 2018.

Last week

- **Some significant US data were released last week.** Non-farm payrolls in the US rose by 224k in June vs. a 74k increase in May (revised downwards from 75k), running clearly above the market expectations (an increase by 160k). The highest increase in employment was recorded in education and health service (+61.0k), business services (+51.0k), and leisure and hospitality

(+33.0k). Employment decreased in retail trade (-7.6k) and mining and logging (-5.0k). Unemployment rate rose to 3.7% in June vs. 3.6% in May, running above the market expectations (3.6%) and markedly below the natural unemployment rate indicated by FOMC (4.2% - see MACROmap of 24/6/2019). The increase in the unemployment rate was largely due to an increase in the participation rate (62.9% in June vs. 62.8% in May). In other words, some so far economically passive persons entered the labour market in June but have not yet found employment. The annual dynamics of average hourly earnings have not changed in June compared to May and amounted to 3.1%, pointing to continuing low wage pressure in the US economy. The publication of better-than-expected US non-farm payroll data resulted in the USD appreciation vs. EUR. The results of business surveys in the US were also released last week. The ISM index for manufacturing decreased to 51.7 pts in June vs. 52.1 pts in May. Although the index proved better from the market expectations (51.0 pts) it stood at the lowest level since October 2016. The index decrease resulted from lower contributions of its sub-indices for new orders, suppliers' delivery times, and inventories, while higher contributions of the sub-indices for output and employment had an opposite impact. The non-manufacturing ISM also recorded a decrease (55.1 pts in June vs. 56.9 pts in May). It resulted from lower contributions of the sub-indices for employment, business activity, and new orders. A higher contribution of the sub-index for suppliers' delivery times had an opposite impact. The last week's readings from the US economy support our forecast, in which the annualized US GDP growth rate will decrease to 1.9% in Q2 vs. 3.1% in Q1, and will drop to 2.5% in the whole 2019 vs. 2.9% in 2018.

- **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 noted that the economic outlook remained favourable, and GDP growth would continue at a relatively high level in the coming years. The Council repeated the view that in the monetary policy transmission horizon inflation would remain close to the target (2.5% +/- 1 pp). The latest results of the NBP projection were presented at the conference after the meeting. As we expected, the inflation path in the 2019-2020 period, forecast in the July projection, was revised upwards compared to the March projection. It results from the projection that inflation in the 2019-2021 period will run close to the MPC inflation target. As we expected, the July projection upheld the downward trajectory of GDP growth rate in subsequent years but revised it upwards (see MACROpulse of 3/7/2019). At the conference after the MPC meeting, the NBP Governor A. Glapiński indicated that the latest projection supported the policy of leaving interest rates at the current level and in his view, they will remain stable until the end of 2021. Referring to the marked change in the stance of major central banks to a more dovish one, the NBP Governor said that the MPC was prepared for that. He emphasized at the same time that in Poland there was a room for impacting the macroeconomic situation through both monetary and fiscal policy if there was such need. The remarks of A. Glapiński and the results of the July inflation projection support our scenario, in which NBP interest rates will remain unchanged at least until the end of 2020.
- **Polish manufacturing PMI dropped to 48.4 pts in June vs. 48.8 pts in May, running below our forecast (49.0 pts) and the market expectations (48.9 pts).** Thus, the index has for eighth month running stayed below the 50 pts threshold diving expansion from contraction of activity. The PMI index decrease resulted from lower contributions of the sub-indices for new orders and current production. It is worth noting that the pace of the decrease in export orders has decelerated in June, meaning that responsible for faster decrease in total orders was the softening of domestic demand. Thus the June survey results have signaled some different tendencies compared to data compiled during the first five months of 2019 when the total number of new orders was decreasing slower from export orders. This is consistent with the improvement recorded in German manufacturing in June (see MACROmap of 24/6/2019).

Weaker demand has also contributed to an increase in the stocks of finished products at the fastest pace since February 1999. In addition to lower output and orders, pessimistic trends concerning the Polish manufacturing were also reflected by lower Indicator of Anticipated Production (in the next 12 months) which fell to the lowest level since December 2012. On the other hand, an optimistic signal coming from the survey is the first since January 2019 slight increase in employment. The average value of the PMI Index over the April-June period rose to 48.8 pts vs. 48.2 pts in Q1. The June PMI, coupled with the May data on construction-assembly production, signal a slight downside risk to our forecast of GDP growth in Q2 (5.0% YoY vs. 4.7% in Q1).

- **The Caixin PMI for Chinese manufacturing dropped to 49.4 pts in June vs. 50.2 pts in May, running markedly below the market expectations (50.0 pts)**. At the same time, for the first time in four months, the index stood below the 50 pts threshold dividing expansion from contraction of activity. The index decrease resulted from lower contributions of four of its five sub-indices (for employment, new orders, output, and suppliers' delivery times) while higher contribution of the inventories sub-index had an opposite impact. Especially noteworthy in the data structure is the decrease in the sub-index for inventories, which for the first time since January stood below the 50 pts threshold. It signals that the measures taken by the Chinese government to stimulate internal demand have proved insufficient so far. The sub-index for new export orders also stood below the 50 pts threshold. According to the press release, its decrease was limited by higher orders from the US companies wishing to make it before the introduction of a subsequent tranche of US tariffs scheduled for July. The continuing decrease in activity in Chinese manufacturing was also indicated by the CFLP PMI published last week which has not changed in June compared to May and amounted to 49.4 pts, running below the market expectations. We maintain our forecast for economic growth in China (6.4% in 2019 and 6.0% in 2020). However, to achieve such GDP growth rate, the growth stimulus implemented by the Chinese government will have to increase. We believe that to this end measures will be taken to increase lending (stopping the process of deleveraging banks, reduction of interest rates), weaken CNY in line with the deterioration of the Chinese trade balance and fiscal policy will be eased more.

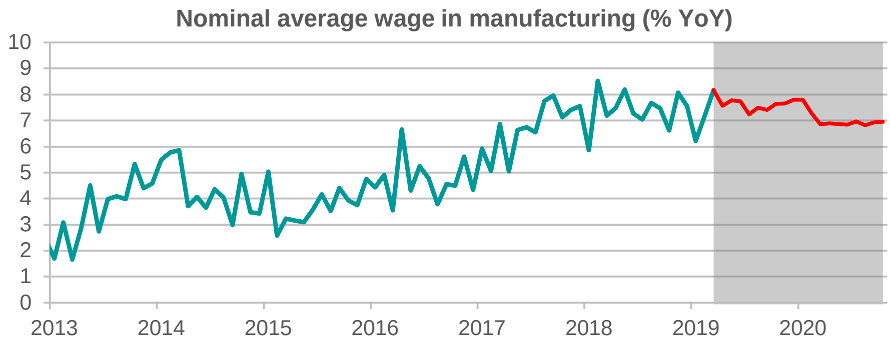
Higher prices will not inflate the wage dynamics

In recent weeks media have often discussed the issue of the fast – as perceived by consumers – growing prices in Poland. The issue of the price increases felt by households has also been raised during the last week's conference of the MPC. According to the NBP Governor they do not pose a threat to the stability of prices and do not require a reaction of the central bank. Below we have analyzed how the increase in inflation recorded in recent months was conducive to the intensification of the inflationary expectations of Poles and to increased pressure on wage increases.

According to NBP surveys, the inflationary expectations of Polish consumers are predominantly impacted by current inflation. On the other hand, the impact of the central bank's inflationary target on these expectations is negligent. In addition, the surveys suggest that the predominant factor impacting the inflationary expectations is the rate of changes of prices of goods that the households purchase most often (e.g. food) and not the total inflation. Such trends are reflected by the current price situation. The CPI inflation is at a moderate level. In June it reached a level of 2.6% YoY, i.e. was close to the NBP inflation target (2.5 ± 1 percentage point). In turn, the households' perception or price processes is now being shaped mainly by the fast increase in the prices of food (5.7% YoY in June), and in particular some of its representatives, e.g. the prices of vegetables (22.6% YoY in May) or pork (12.1% YoY).

Amid the currently observed low unemployment, employees may exert wage pressure (demand for higher wages) on the employers due to rising prices. Considering that total inflation has increased by nearly 2 ppt. since January 2019 and the annual dynamics of food prices in the similar period rose by nearly 5 ppt., we have analyzed whether the rise in consumer prices resulted in a faster increase in nominal wages. To single out this effect, we have built an econometric model, describing the dependence of wage dynamics in manufacturing companies on three factors – growth of labour productivity (long-term impact), deviation of unemployment rate from the trend representing the approximation of equilibrium unemployment (short-term factor, related to business cycle phase), and current inflation. As measure of inflation we have adopted the annual dynamics of food and fuel prices. These goods constitute a substantial part of consumer spending (ca. 30%) and are purchased relatively often. In consequence, changes in their prices relatively strongly influence the inflationary expectations of households. We have also tested the model specification, in which changes in prices were represented by total CPI inflation indicator but it has shown poorer predictive properties.

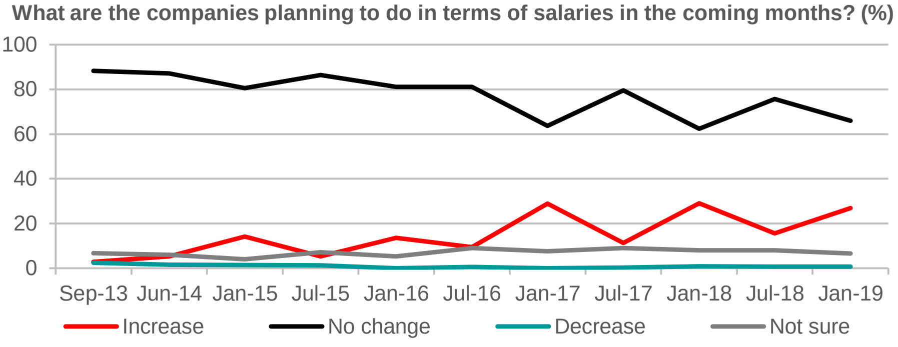
The results of the modeling have confirmed a statistically significant, positive influence of food and fuel price dynamics on the rate of wage growth in manufacturing. The increase in the annual indicator of fuel and food inflation by 1 percentage point results in a 0.3 ppt increase in wage dynamics. This means that between January and June 2019, the upward trend in manufacturing wages, measured by their annual smoothened dynamics, increased by ca. 1.1 ppt only as a result of higher inflationary expectations.



Source: GUS, Credit Agricole

We used the estimated model to forecast the wage dynamics in manufacturing. We forecast that by the end of 2019, due to the still high dynamics of food prices and the stabilization of fuel prices (simultaneous slowdown of production and employment growth), the average growth rate of nominal wages in manufacturing will have ranged between 7.2 and 7.8% YoY. In 2020, as the shocks boosting the food price dynamics will abate and the productivity growth in manufacturing will slow down, the wage dynamics will decrease on a yearly average to 7.1% vs. 7.5% in 2019.

In addition to the determinants included in the econometric model, the main factors limiting wage growth in the coming quarters will be the continuing low inflation in Poland's major trade partners (slowing down the increase in margins in the trade goods sector companies), launch of the Employee Equity Schemes (meaning an increase in non-wage labour costs), restructuring processes (investments implemented by companies to reduce labour intensity of production), and the government-announced abolition of the limit on annual base retirement and pension insurance contribution (so-called 30-fold) starting from 2020.

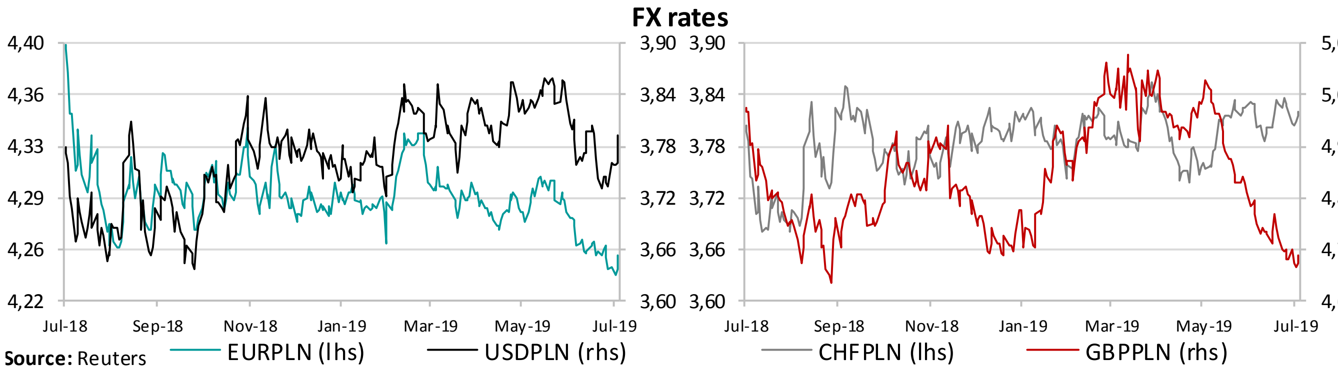


Source: Work Service, CA

The results of survey methodology studies also point to a limited potential for further acceleration in wage growth. According to "Labour Market Barometer" survey for Q1 2019, prepared by Work Service, the employers' propensity to raise wages is now the same as in 2017 and 2018 (see the chart). The percentage of employers who intend to increase wages for their employees next quarter amounts to ca. 27%. Similar conclusions concerning labour market tendencies can be drawn based on the NBP survey ("Quick Monitoring, April 2019"). The percentage of companies planning wage increases has decreased in Q2. The next issue of this survey will be released in mid-July. We assume that it will point to the continuation of the aforementioned tendencies.

The trends outlined above for wages in manufacturing support our forecast of wage dynamics in the national economy, assuming their drop to 7.5% in 2020 vs. 7.6% in 2019.

J. Powell's addresses may increase FX market volatility



Source: Reuters

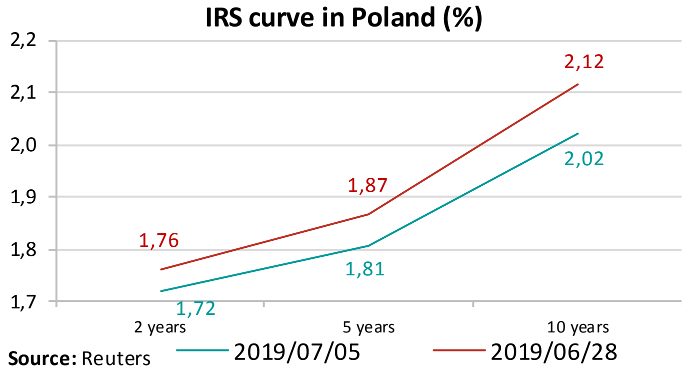
Last week, the EURPLN exchange rate rose to 4.2518 (PLN weakening by 0.2%). As we expected, the beginning of last week brought a slight strengthening of PLN due to lower global risk aversion in reaction to the decisions of the G-20 summit (see MACROmap of 1/7/2019). Further into the week we were observing low EURPLN volatility, compared to recent weeks, due to a scarce macroeconomic calendar as well as the Thursday's absence of the US investors (Independence Day in the US). The Wednesday's conference after the MPC meeting had no significant impact on PLN. Friday saw a slight weakening of PLN in reaction to lower-than-expected data on orders in German manufacturing. The better-from-the-consensus data from the US labour market released in the afternoon resulted in further depreciation of PLN.

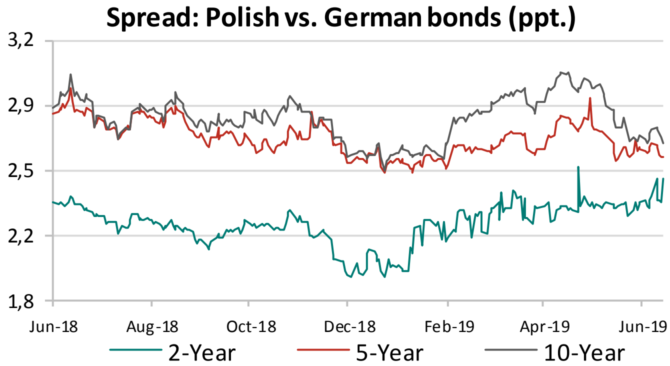
Especially noteworthy is also the last week's visible depreciation of PLN vs USD (by 1.6%). It resulted from the decrease in EURUSD recorded at the beginning of last week in reaction to the above-mentioned decisions of the G-20 summit which weakened the expectations of monetary easing in the US. Towards the end of the week an additional factor which deepened the decrease in EURUSD was the publication of better-than-expected data from the US labour market.

The data on German industrial production that were published this morning and were in line with the expectations are neutral for PLN. Crucial for PLN this week will be the scheduled for Wednesday and

Thursday testimony to the Congress of the Chairman of the Federal Reserve, J. Powell, who will present a monetary policy report. We believe that during J. Powell's testimony we may see increased volatility on the foreign exchange market. In our view, the publication of the Minutes of the June FOMC meeting scheduled for Wednesday and the publication of data on US inflation scheduled for Thursday will be overshadowed by J. Powell's addresses and their impact on PLN will be limited. The publication of data on the Chinese balance on trade scheduled for Friday is also likely to be neutral for PLN.

Market focused on J. Powell's testimony to the Congress





Source: Reuters

Last week, 2-year IRS rates decreased to 1.72 (down by 4bp), 5-year rates to 1.81 (down by 6bp), and 10-year rates to 2.02 (down by 10bp). Monday through Friday saw a sharp decline in IRS rates across the curve, following the German market. Conducive to lower yields on core markets and IRS rates in Poland are the investors' growing expectations of monetary easing in the Eurozone. The Wednesday's conference after the MPC meeting had no substantial impact on the curve. Friday saw a partial correction and increase in IRS rates in reaction to the publication of better-than-expected data from the US labour market.

The today's data on German industrial production that were in line with the expectations had no substantial impact on IRS rates. This week the investors will focus on the testimony to the Congress of the FED Chairman J. Powell. Consequently, during his addresses we may see increased volatility of IRS rates. In our view, the publication of the Minutes of the June FOMC meeting scheduled for Wednesday and the publication of data on US inflation scheduled for Thursday will be overshadowed by J. Powell's addresses and are likely to be neutral for the market.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-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*	4,37	4,27	4,30	4,28	4,34	4,29	4,29	4,26	4,30	4,30	4,28	4,28	4,24	**4,26**
USDPLN*	3,74	3,66	3,71	3,69	3,84	3,79	3,74	3,72	3,79	3,84	3,82	3,83	3,73	**3,76**
CHFPLN*	3,78	3,69	3,83	3,75	3,80	3,79	3,81	3,74	3,79	3,85	3,75	3,83	3,82	**3,80**
CPI inflation (% YoY)	2,0	2,0	2,0	1,9	1,8	1,3	1,1	0,7	1,2	1,7	2,2	2,4	**2,6**	
Core inflation (% YoY)	0,6	0,6	0,9	0,8	0,9	0,7	0,6	0,8	1,0	1,4	1,7	1,7	**1,8**	
Industrial production (% YoY)	6,7	10,3	5,0	2,7	7,4	4,6	2,8	6,0	6,9	5,5	9,2	7,6	**2,0**	
PPI inflation (% YoY)	3,7	3,4	3,0	3,0	3,2	2,8	2,1	2,2	2,9	2,5	2,6	1,4	**1,2**	
Retail sales (% YoY)	10,3	9,3	9,0	5,6	9,7	8,2	4,7	6,6	6,5	3,1	13,6	7,3	**6,0**	
Corporate sector wages (% YoY)	7,5	7,2	6,8	6,7	7,6	7,7	6,1	7,5	7,6	5,7	7,1	7,7	**7,2**	
Employment (% YoY)	3,7	3,5	3,4	3,2	3,2	3,0	2,8	2,9	2,9	3,0	2,9	2,7	**2,6**	
Unemployment rate* (%)	5,8	5,8	5,8	5,7	5,7	5,7	5,8	6,1	6,1	5,9	5,6	5,4	**5,2**	
Current account (M EUR)	192	-754	-1005	-876	-482	-29	-1248	1825	-342	533	718	**572**		
Exports (% YoY EUR)	7,7	12,0	8,9	-1,5	13,2	7,6	2,3	5,0	10,0	7,9	10,3	**9,0**		
Imports (% YoY EUR)	9,4	12,4	14,0	4,2	18,0	9,1	2,3	4,9	7,8	1,4	8,7	**7,3**		

*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)	4,7	5,0	4,6	4,6	4,2	3,8	3,7	3,4	5,1	4,7	3,8
Private consumption (% YoY)	3,9	5,0	4,4	4,0	3,7	3,6	3,5	3,4	4,5	4,3	3,6
Gross fixed capital formation (% YoY)	12,6	10,8	8,1	6,6	4,8	4,9	5,2	4,8	8,7	8,8	4,9
Export - constant prices (% YoY)	5,9	5,3	6,0	6,0	5,4	5,4	5,4	6,3	6,3	5,8	5,6
Import - constant prices (% YoY)	5,0	7,2	8,3	7,7	6,9	6,7	6,2	6,3	7,1	7,1	6,5
GDP growth contributions: Private consumption (pp)	2,4	2,9	2,6	2,0	2,3	2,1	2,1	1,7	2,6	2,5	2,0
Investments (pp)	1,6	1,7	1,5	1,6	0,6	0,8	1,0	1,2	1,5	1,7	0,9
Net exports (pp)	0,7	-0,8	-1,0	-0,7	-0,6	-0,5	-0,2	0,2	-0,2	-0,5	-0,3
Current account (% of GDP)***	-0,4	-0,6	-0,5	-0,6	-1,0	-1,1	-1,1	-1,0	-0,7	-0,6	-1,0
Unemployment rate (%)**	5,9	5,2	5,4	5,7	5,8	5,1	5,3	5,6	5,8	5,7	5,6
Non-agricultural employment (% YoY)	0,0	0,2	0,2	0,1	0,1	0,1	0,1	0,1	0,9	0,1	0,1
Wages in national economy (% YoY)	7,1	7,6	7,8	7,7	7,7	7,7	7,3	7,1	7,2	7,6	7,5
CPI Inflation (% YoY)*	1,2	2,4	2,6	2,6	3,0	2,0	1,5	1,5	1,6	2,2	2,0
Wibor 3M (%)**	1,72	1,72	1,72	1,72	1,72	1,72	1,72	1,72	1,72	1,72	1,72
NBP reference rate (%)**	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50
EURPLN**	4,30	4,25	4,28	4,28	4,28	4,28	4,25	4,23	4,29	4,28	4,23
USDPLN**	3,84	3,73	3,82	3,75	3,69	3,63	3,54	3,50	3,74	3,75	3,50

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
		Monday 07/08/2019				
8:00	Germany	Industrial production (% MoM)	May	-1,9		0,3
8:00	Germany	Trade balance (bn EUR)	May	17,0		17,0
10:30	Eurozone	Sentix Index (pts)	Jul	-3,3		0,1
		Wednesday 07/10/2019				
3:30	China	PPI (% YoY)	Jun	0,6	0,0	0,2
3:30	China	CPI (% YoY)	Jun	2,7	2,6	2,7
14:30	USA	Initial jobless claims (k)	w/e	221		
16:00	USA	Wholesale inventories (% MoM)	May	0,4		0,4
16:00	USA	Wholesale sales (% MoM)	May	-0,4		
20:00	USA	FOMC Minutes	Jun			
		Thursday 07/11/2019				
14:30	USA	CPI (% MoM)	Jun	0,1	0,0	0,0
14:30	USA	Core CPI (% MoM)	Jun	0,1	0,2	0,2
		Friday 07/12/2019				
	China	Trade balance (bn USD)	Jun	41,7		45,0
11:00	Eurozone	Industrial production (% MoM)	May	-0,5		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

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