Trade wars will not stop the Chinese dragon

This week

- **The most important event this week will be the ECB meeting scheduled for Thursday.** In our opinion, the monetary policy parameters will be left unchanged; however, the conference after the meeting will take a dovish tone. In our view, the ECB Governor, M. Draghi, will signal that the monetary policy in the Eurozone will be eased in the coming months but no specific measures will be indicated. We believe that due to the continuing uncertainty about the outlook for economic growth in the Eurozone and globally, the ECB will not decide to ease the monetary policy at the July meeting and will wait until September. The results of the latest macroeconomic projection will have been known then. The conference this week is also likely to raise the issue of possible changes in the ECB inflation target, suggested by the unofficial information obtained by Bloomberg. If M. Draghi confirms the speculations that the ECB inflation target could be increased or a symmetric corridor of permissible deviations from the target would be defined, we may see EUR weakening vs. USD, appreciation of PLN vs. EUR, and higher prices of the Polish debt during and after the conference. In our baseline scenario we expect that the ECB will cut the deposit rate by 10bp to -0.50% in September while introducing tiered deposit rate system. In addition, the ECB will then decide to launch a next round of the quantitative easing program (QE2) with the monthly purchase scale at EUR 50bn. In our view, this program will be launched at the beginning of 2020 and will last 18 months.
- **Another important event this week will be the reading of the July results of business surveys for major European economies scheduled for Wednesday.** We expect that the Composite PMI for the Eurozone dropped to 51.9 pts in July from 52.2 pts in June. The index decreased given deterioration in both Germany and France. Ifo Index, reflecting the sentiment among German managers representing the manufacturing, construction, trade and service sectors, will be released on Tuesday. We expect that it will stay unchanged in July compared to June and will amount to 97.4 pts. The results of business surveys will be especially important in the context of assessing the prospects for the slowdown of economic growth observed in recent months within the single currency area and the trends in global trade. Our forecasts of business survey results for major European economies are close to the consensus; therefore, their publication is likely to be neutral for PLN and the prices of Polish bonds.
- **This week we will see important hard data from the US economy.** On Friday, the flash estimate of GDP in the Q2 will be published. We expect that the annualized rate of economic growth has decreased to 2.1% against 3.1% in Q1, due to lower contributions of investments, changes in inventories, and next exports. We forecast that preliminary orders for durable goods increased by 0.6% in June vs. a 1.3% decrease in May due to a higher number of orders in the "transport" category. We expect that the continuation of the slowdown in the US real estate market will be confirmed by data on new home sales (657k in June vs. 658k in May) and existing home sales (5.35M in June vs. 5.34M in May). We believe that the US readings will be neutral for the financial markets.
- **Data on construction-assembly production will be released on Tuesday.** We forecast that production dynamics dropped to 3.0% YoY in June vs. 9.6% in May. Conducive to the decrease in its dynamics were unfavourable calendar effects and deterioration of sentiment in construction companies signalled by GUS business surveys. Our forecast is below the market expectations (3.8%); however, its materialization will be neutral for PLN and yields on Polish bonds, we believe.

Last week

- **CPI inflation in Poland increased to 2.6% YoY in June vs. 2.4% in May.** Thus, inflation has exceeded the NBP inflation target (2.5 ± 1 percentage point) and reached the highest level since

November 2012. The inflation growth was driven by higher dynamics of the prices of food (largely the effect of increasing prices of vegetables) and higher core inflation (1.9% YoY vs. 1.7%). The increase in core inflation was wide ranging, which, in our view, points to growing cost pressure in the Polish economy (see MACROpulse of 15/7/2019). On the other hand, conducive to a decrease in headline inflation were lower dynamics of the prices of fuels (3.0% YoY in June vs. 4.1% in May) and energy (-0.9% YoY in June vs. -0.8% in May). In accordance with our forecast, in the next quarters we will see a continuing gradual inflation growth driven by a stronger increase in the prices of food and higher core inflation (see MACROmap of 10/6/2019). We believe that inflation will reach its local peak at 3.0% YoY in Q1 2020. Consequently, we expect the price growth rate for 2019 to increase to 2.2% YoY vs. 1.6% in 2018, and then to decline slightly to 2.0% in 2020. This goes in line with our scenario, in which interest rates in Poland will remain stable at least until the end of 2020.

- **The dynamics of industrial production in Poland dropped to -2.7% YoY in June vs. 7.7% in May.** The sharp decrease in the annual dynamics of industrial production in June compared to May resulted from the statistical effect in the form of an unfavourable difference in the number of working days. We believe that production may also have been negatively impacted by the record high air temperatures recorded in June resulting i.a. in lower productivity and shorter working times. The decline in production was wide ranging and was recorded in categories representing 76% of industrial production value. It is worth noting here that industries which recorded positive annual production dynamics in June included branches with a large percentage of exports in sales. This is consistent with the June business survey results for Germany and the Eurozone (PMI) which pointed to weaker recession tendencies in manufacturing in countries being Poland’s main trading partners. We believe that as the negative effects abate, the dynamics of industrial production in Poland will markedly increase again in July. The data on June industrial production in Poland pose a downside risk to our forecast for GDP growth in Q2 2019 (5.0% YoY) and in the entire 2019 (4.7%).
- **Retail sales in Poland increased in current prices by 5.3% YoY in June vs. a 7.3% increase in May**. The sales dynamics in constant prices decreased to 3.7% in June vs. 5.6% in May. The slowdown of retail sales in June was wide ranging which, in our view, should be attributed to the statistical effect in the form of an unfavourable difference in the number of working days (see MACROpulse of 19/7/2019). Conducive to the slowdown of real retail sales dynamics were also the last year’s high base effects in the category “motor vehicles, motorcycles, parts”. On the other hand, higher dynamics in the category “textile, clothing, footwear”, which largely resulted from the postponement of shopping for summer clothing and footwear from May to June, due to extremely cold May, had an opposite impact. We expect that - as the calendar effects abate - the retail sales growth rate will remain high in the coming months, supported by strong labour market, optimism of consumers, and payment of social transfers. The average retail sales dynamics in constant prices rose to 7.1% YoY in Q2 vs. 4.5% in Q1. Today’s data support our forecast, in which the growth rate of private consumption rose to 5.0% YoY in Q2 vs. 3.9% in Q1. The data on retail sales support our forecast in which the growth rate of private consumption will increase to 5.0% YoY in Q2 vs. 3.9% in Q1.
- **Nominal wage dynamics in the Polish corporate sector amounted to 5.3% YoY in June vs. 7.7% in May.** The sharp decrease in the annual wage dynamics in June compared to May resulted from the statistical effect in the form of an unfavourable difference in the number of working days. In our view, a factor decelerating the wage dynamics in June was also a decreasing wage pressure in enterprises signaled by the results of the NBP business survey (see MACROpulse of 17/7/2019). The employment growth rate in the enterprise sector rose to 2.8% YoY in June vs. 2.7% in May. In MoM terms, employment increased by 13.6k. The marked increase of employment in June was due to a low base effect from April and May. We expect the trend towards increase in employment to continue into subsequent months. However it will weaken due to the persistent barrier in the form of shortage of skilled labour. We estimate that the real

wage fund growth rate in enterprises dropped to 5.5% YoY in June (the lowest level since December 2016) from 8.1% in May. Consequently, the real wage fund increased by 7.1% YoY in Q2 vs. 8.8% in Q1. We believe that the probability of a strong acceleration of wage growth in H2 2019 is low. The wage growth potential in the coming quarters will be limited by continuously low inflation in Poland's major trade partners, launch of the Employee Equity Schemes and expected removal of the cap on annual income subject to social security contributions (so-called 30-fold) starting from 2020, and investments implemented by companies to reduce labour intensity of production (increase in productivity).

- **The surplus in the current account in Poland rose to EUR 1 006M in May vs. EUR 720M in April.** The improvement in the current account balance was due to higher balances on services, primary income, and secondary income (higher from April by EUR 214M, EUR 120M, and EUR 135M, respectively), while lower balance on trade (down by EUR 183M compared to April) had an opposite impact. Export dynamics rose 13.3% YoY in May vs. 10.1% in April, and imports dynamics rose to 11.2% YoY vs. 8.5%. The data pose an upside risk to our forecast, in which the relation of cumulative current account balance for the last 4 quarters to GDP will increase to -0.6% in 2019 from -0.7% in 2018.
- **Significant hard data on US economy and business survey results were released last week.** Industrial production dynamics decreased to 0.0% MoM in June vs. 0.4% in May, running slightly below the market expectations (0.1%). The decrease resulted from lower production dynamics in utilities while higher production growth rate in manufacturing has an opposite impact. Capacity utilization dropped to 77.9% in June vs. 78.1% in May. On the other hand, retail sales dynamics have not changed and amounted to 0.4% MoM both in May and in June, running above the market expectations (0.1%). Excluding car sales, nominal retail sales dynamics also amounted to 0.4% both in June and in May. Data on building permits (1220k in June vs. 1299k in May) and housing starts (1253k vs. 1265k) were also released last week and pointed to further deterioration in the US real estate market. Last week we also saw business survey results. The NY Empire State Index (4.3pts in July vs. -8.6 pts in June) and Philadelphia FED (21.8 pts in July vs. 0.3 pts in June) recorded an increase pointing to improvement in manufacturing in the New York State and in Pennsylvania, New Jersey and Delaware region, respectively. A slight improvement in consumer sentiment was signaled by the preliminary University of Michigan Index which rose to 98.4 pts in July vs. 98.2 pts in June, running slightly below the market consensus (98.5 pts). The index increase resulted from a higher sub-index for expectations while the sub-index for the assessment of the current situation has decreased. Our baseline scenario assumes that this year FED will cut interest rates twice each time by 25 bp (in July and in September). In the context of the last week's generally solid data from the US economy, we however see the risk that FOMC will wait with easing the monetary policy until September 2019. The market is currently pricing in a rate cut by 36bp at the July meeting.
- **ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany dropped to -24,5 pts in July vs. -21.1 pts in May, running below the market expectations (-22.3 pts)**. According to the statement, the deterioration of sentiment resulted from the continuing uncertainty in the German export branches, geopolitical tension about Iran, negative impact of the US-China trade war on the global economic outlook as well as no progress in the negotiations concerning the final shape of Brexit. We forecast that the German GDP growth rate will not change in Q3 compared to Q2 and will amount to 0.2%.

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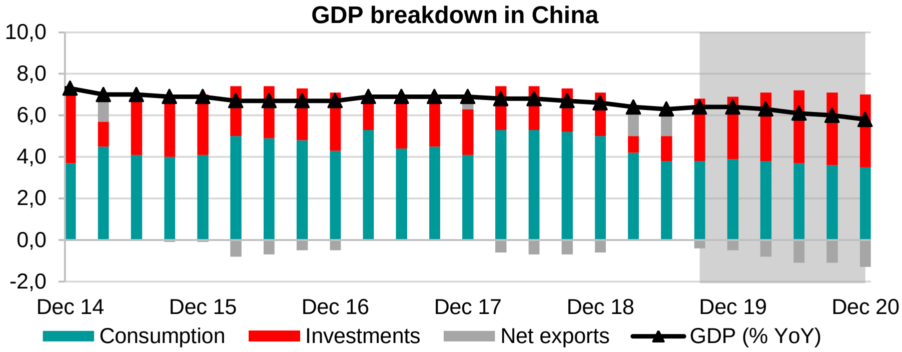
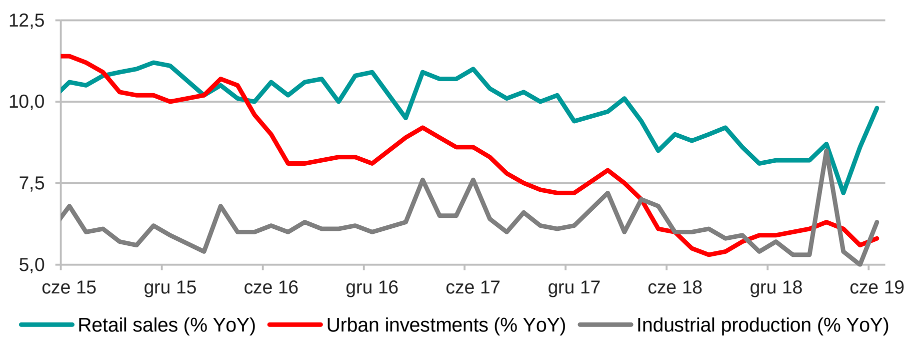


Source: Reuters, Credit Agricole

According to data released last week, the GDP growth rate in China dropped to 6.2% YoY in Q2 vs. 6.4% in Q1. It thus stood below the market expectations (6.3% YoY). The GDP growth structure pointed to the stabilization of the services contribution to creating added value and to lower contribution of industry. On the demand side, overall consumption was exceptionally weak, with dynamics dropping from 7.8% in Q1 to 6.4% in Q2 and being the lowest in 6 quarters. Partly to blame is private consumption whose dynamics decreased from 5.8% YoY in Q1 to 5.4% YoY in Q2 and reached the second lowest growth rate in history. On the other hand, the contribution of net exports to GDP growth continued to be relatively high (1.3 pp in Q2 vs. 1.5 pp in Q1) – the effect of a drop of imports given a slight increase in exports. The increase in investments has been the only factor accelerating economic growth. The contribution of gross capital formation amounted to 1.2 pp in Q2 vs. 0.8% in Q1. At first sight, the above-mentioned data present a pessimistic picture of the Chinese economy. However, an in-depth analysis of recent publications signals more optimistic tendencies.

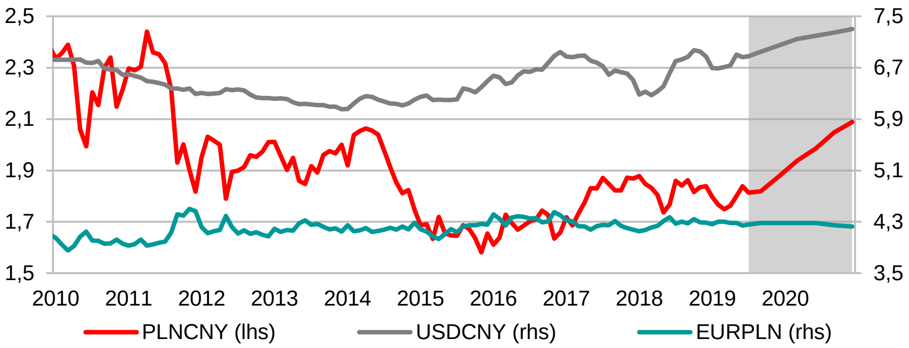


Source: Reuters

Firstly, GDP growth in Q2 was in line with the target set by the Chinese government (6.0% - 6.5%) and the average GDP growth in H1 2019 was in the upper half of this bracket. Furthermore, the quarterly, seasonally-adjusted GDP growth rate has been the highest since Q3 2018 and amounted to 1.6% YoY vs. 1.4% in Q1. In addition, higher from the market consensus were monthly data for industrial production (6.3% YoY in June vs. 5.0% in May with expectations at 6.3%), retail sales (9.8% vs. 8.6%; 8.3%), and urban investments (5.8% vs. 5.6%; 5.5%). Improvement was also recorded in urban employment (which rose in June for the first time in seven months) and in lending (up to 9.3% YoY in June vs. 5.4% YoY in May, attaining the highest result from April 2017). We believe that the June data point to the end of stagnation tendencies in the Chinese economy and such trend correction points with high probability to the acceleration of economic growth in Q3.

A significant downside risk to the economic growth rate in China in the coming quarters will be the further development of so-called trade wars. We believe that after the G-20 summit in Osaka, only a temporary de-escalation of the US-China trade conflict has been observed. We expect that the current negotiations will not bring any favourable results in the perspective of several months, which will point to a decreasing likelihood of consensus being reached soon. We believe that in Q4 2019 the US-China conflict will escalate again and D. Trump will decide to impose 25% tariffs on all goods imported from China. We estimate that if such scenario materializes, the economic conflict with the US will be conducive to the annual growth rate in Chine decreasing by 1.1 pp in 2019 and by 1.8 pp in 2020.

We support our forecast that economic growth in China will amount to 6.4% YoY in 2019 vs. 6.6% in 2018 and will decrease to 6.0% in 2020. However, to achieve the forecast by us economic growth rate, the growth stimulus implemented by the Chinese government will have to increase. We believe that to this end the People's Bank of China will take measures to increase lending (stopping the process of deleveraging banks, reduction of interest rates), and will allow CNY depreciation in line with the deterioration of the Chinese trade balance. The fiscal policy will also be more expansionary.



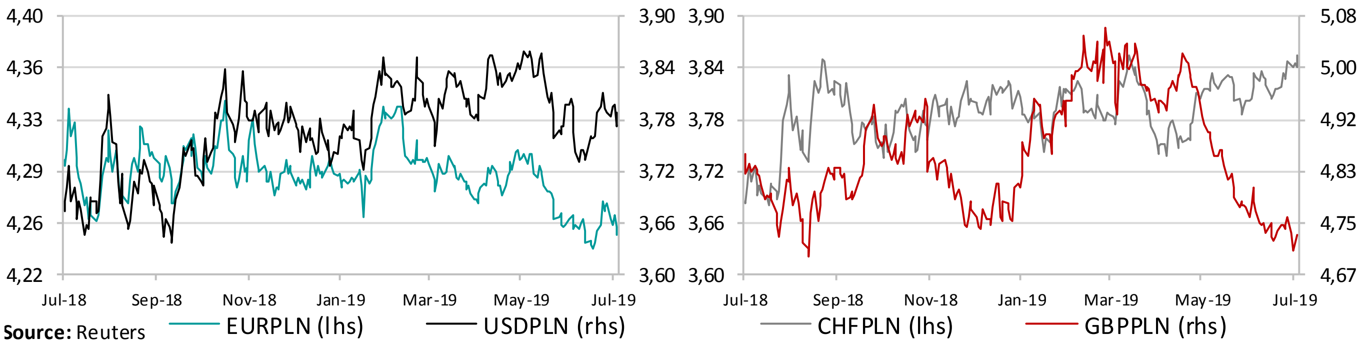
Source: Reuters, Credit Agricole

The assessment of the influence of the macroeconomic conditions in China on the situation in Poland should factor in the evolution of the PLN rate against yuan. The PLNCNY rate is a resultant of the two factors: the PBoC foreign exchange rate policy (affecting the USDCNY rate) and the evolution of the USDPLN rate. We expect that due to the observed slowdown of economic growth and the expected easing of monetary policy by the PBoC, the USDCNY rate will increase from the current level of 6.88 to 7.05 in Q4 2019 to reach 7.30 as at the end of 2020. Considering our USDPLN rate forecast (see the quarterly table), we expect that yuan will depreciate against PLN. We forecast an increase of PLNCNY from the current level of 1.82 to 1.88 as at the end of Q4 2019 and its further increase to 2.09 as at the end of 2020.

China is a destination of only 1.0% of Polish exports. The slowdown in China may adversely affect the situation of enterprises exporting their goods to China but will have a negligible effect on the economic growth rate in Poland. More tangible will be the indirect impact through the deterioration in Poland's major trade partners (e.g. in Germany). These effects may be particularly visible in the automotive industry. However, we should emphasize that the aggregate impact of the deterioration in China will not play a dominant role in the expected by us deceleration of economic growth in Poland (4.7% YoY in 2019 and 3.8% in 2020). Much more important will be the forecast by us lower growth rates of domestic consumption and investments.

The ECB meeting may contribute to PLN appreciation

FX rates



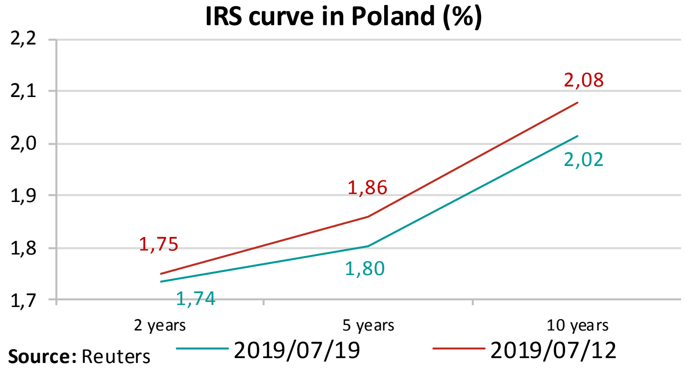
Source: Reuters

Last week, the EURPLN exchange rate dropped to 4.2475 (appreciation of PLN by 0.5%). The beginning of last week brought a correction and PLN strengthening after its depreciation recorded two weeks ago (see MACROmap of 15/7/2019). The appreciation of PLN was supported by the Monday's better-than-expected readings of industrial production, retails sales and urban investments in China and balance of payments in Poland. On Wednesday, PLN started depreciating due to a temporary increase in global risk aversion. Lower appetite for risk assets resulted i.a. from raising concerns about further escalation of the US-China trade war after the US President D. Trump said that "he can impose further tariffs on goods imported from China if he so wishes". Thursday saw a correction and PLN strengthening. The weaker-than-expected domestic data on industrial production had a limited impact on PLN. On Friday EURPLN was relatively stable and domestic retail sales reading was not market moving.

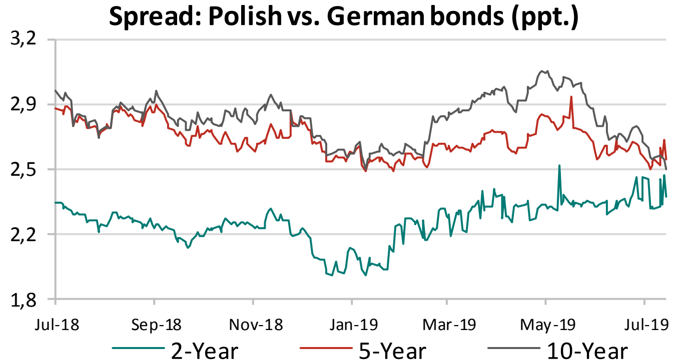
Especially noteworthy last week is also the increased volatility of EURUSD. On Thursday, FOMC member J. Williams voiced the opinion that FED should take anticipative measures to avoid too low inflation which led to USD depreciation vs EUR. The Federal Reserve in New York explained later that J. Williams' remark referred to academic research, which resulted in a correction and decrease in the EURUSD exchange rate.

This week we may see PLN strengthening in reaction to the ECB meeting (see above). We believe that the publications of business survey results for major European economies scheduled for this week (flash PMIs for the Eurozone and Ifo index for Germany), of US data (existing home sales, new home sales, flash GDP estimate) and of domestic data on construction-assembly production will be neutral for PLN.

Market focuses on the ECB meeting



Source: Reuters



Last week, 2-year IRS rates decreased to 1.74 (down by 1bp), 5-year rates to 2.80 (down by 6bp), and 10-year rates to 2.02 (down by 6bp). Monday through Friday saw a slight decrease in IRS rates across the curve following the core markets. Conducive to lower yields on German and US bonds were the growing expectations of investors of monetary easing by the ECB and FED. Numerous domestic readings had a limited impact on the market.

This week the market will focus on the ECB meeting, which may contribute to a decrease in IRS rates. In our view, the publications of business survey results for major European economies (flash PMIs for the Eurozone and Ifo index for Germany), of US data (existing home sales, new home sales, flash GDP estimate) and of domestic data on construction-assembly production will not have any substantial impact on the curve.

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	**4,25**
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	1,9	
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	-2,7	
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	0,6	
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	5,3	
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	5,3	
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	2,8	
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	-405	343	-1126	2438	-718	116	720	1006		
Exports (% YoY EUR)	7,7	12,0	8,9	-1,5	13,2	8,1	1,7	5,4	9,9	7,8	10,1	13,3		
Imports (% YoY EUR)	9,4	12,4	14,0	4,2	18,1	9,2	2,2	1,6	7,8	2,6	8,5	11,2		

*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	-0,1	-0,4	-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	4,24	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**
		Tuesday 07/23/2019				
10:00	**Poland**	**Registered unemplyment rate (%)**	**Jun**	**5,4**	**5,2**	**5,3**
16:00	Eurozone	Consumer Confidence Index (pts)	Jul	-7,2		-7,2
16:00	USA	Existing home sales (M MoM)	Jun	5,34	5,35	5,33
16:00	USA	Richmond Fed Index	Jul	3,0		
		Wednesday 07/24/2019				
9:30	Germany	Flash Manufacturing PMI (pts)	Jul	45,0	44,8	45,2
10:00	Eurozone	Flash Services PMI (pts)	Jul	53,6	53,3	53,3
10:00	Eurozone	Flash Manufacturing PMI (pts)	Jul	47,6	47,5	47,7
10:00	Eurozone	Flash Composite PMI (pts)	Jul	52,2	51,9	52,1
10:00	Eurozone	M3 money supply (% MoM)	Jun	4,8		4,7
15:45	USA	Flash Manufacturing PMI (pts)	Jul	50,6		51,5
16:00	USA	New home sales (k)	Jun	626		659
		Thursday 07/25/2019				
10:00	Germany	Ifo busiensss climate (pts)	Jul	97,4	97,4	97,0
13:45	Eurozone	EBC rate decision (%)	Jul	0,00	0,00	0,00
14:30	USA	Initial jobless claims (k)	w/e	216		215
14:30	USA	Durable goods orders (% MoM)	Jun	-1,3		0,8
		Friday 07/26/2019				
14:30	USA	Preliminary estimate of GDP (% YoY)	Q2	3,1	2,1	1,8

*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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