The Eurozone is getting closer to stagnation

This week

- **The most important event this week will be the FOMC meeting scheduled for Wednesday.** We expect that FED will cut the target range for the Federal Reserve funds rate by 25 bp down to [2.00%; 2.50%]. In our view, the conference after the meeting will take a dovish tone, consistent with the remarks of FED representatives in recent weeks. We believe that the FED Chairman, J. Powell, will draw attention to the relatively solid data coming recently from the US economy but will emphasize significant risk to the economic outlook in the US and globally. The markets will focus on information about the development of the US monetary policy in the next few months. J. Powell is likely to repeat his view that the central bank is prepared to act to sustain the economic recovery. Such remarks will aim at signaling to markets FOMC's readiness to further ease the monetary policy. Currently, the forward market is pricing in more than two cuts of FED interest rates (in total by 66 bp) by the end of 2019. We believe that the conference after the FOMC meeting will not provide any new information that would alter our scenario of the US monetary policy which assumes a cut by 25 bp in September 2019 and two more cuts in 2020. The interest rates cut by FOMC this week is in line with the market consensus and has been fully priced in by forward contracts. However, we believe that we may see increased volatility of financial markets during the FOMC conference.
- **Significant hard data from the US economy and business survey results will be released this week.** The publication of data from the labour market is scheduled for Friday. We expect the non-farm employment to have increased by 165k in July vs. 224k in June, with unemployment rate down to 3.6% from 3.7% in June. 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 153k in July vs. 102k in June). The ISM index for manufacturing will be released on Thursday and in accordance with our forecast will decrease to 51.3 pts in July vs. 51.7 pts in June. A slight index decrease has been signaled earlier by regional business sentiment surveys. We will also see the results of consumer sentiment surveys in July. We expect that both the Conference Board Index (125.0 pts vs. 121.5 pts in June) and the final University of Michigan Index (98.5 pts vs. 98.2 pts in June) will indicate improvement of consumer sentiment. In our view, the US readings will be overshadowed by FED decisions and will be neutral for the financial markets.
- **Some significant data from the Eurozone will be released this week.** We expect that the quarterly GDP dynamics decreased to 0.3% in Q2 from 0.4% in Q1. In addition, we forecast that HICP inflation dropped to 1.0% in July vs. 1.3% in June, due to lower dynamics of energy prices and lower core inflation. The materialization of our forecast of GDP in the Eurozone that is higher from the consensus (0.2%) may contribute to a slight weakening of PLN and higher yields on Polish bonds, while the inflation reading is not likely to be market moving.
- **The July PMIs for Chinese manufacturing (Caixin and CFLP) will be released this week**. We forecast that Caixin PMI slightly rose to 49.8 pts in July vs. 49.1 pts in June while CLFP PMI increased, in our opinion, to 49.5 pts vs. 49.4 pts in June. We believe that the indices staying below the 50 pts threshold (dividing expansion from contraction of activity) will signal the necessity of the Chinese government and the People's Bank of China of intensifying actions aimed at stimulating domestic demand. Our baseline scenario assumes fiscal and monetary easing in China in the nearest future (see MACROmap of 22/7/2019). We expect that the results of business surveys in China, pointing to the stabilization of sentiment in manufacturing, will be neutral for PLN and bond yields.
- **On Wednesday we will see flash reading of the July inflation in Poland which we believe decreased to 2.5% vs. 2.6% in June.** The decrease in inflation rate resulted from lower dynamics of fuel prices and higher core inflation. Our forecast is below the consensus (2.6%); therefore, its materialization will be slightly negative for PLN and yields on Polish bonds.
- **Data on business sentiment in Polish manufacturing will be released on Thursday.** We expect

that PMI dropped to 48.0 pts from 48.4 pts in June. Conducive to the index decrease was the deterioration in the Eurozone and Germany (see below). We believe that the PMI reading will be neutral for PLN and yields on Polish bonds.

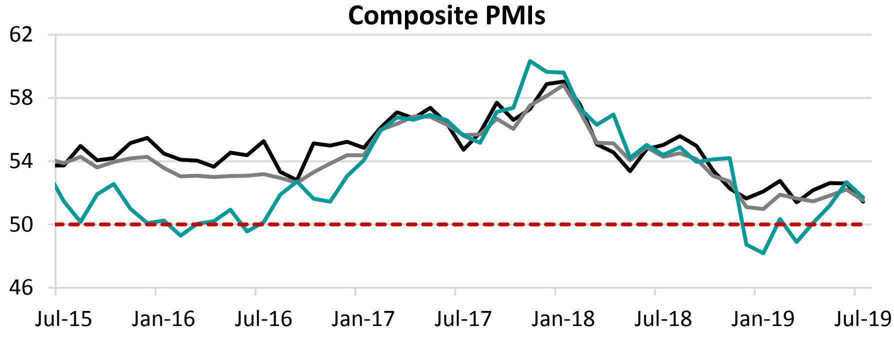
- **We have revised our macroeconomic forecast (see the table on page 7).** We expect that the GDP growth rate will amount to 4.4% YoY in 2019 (4.7% before the revision) and will amount to 3.8% in 2020 (no change compared to the previous forecast). The downward revision of the expected GDP growth rate in 2019 has been dictated mainly by the forecast's lower starting point, i.e. clearly lower than we had expected GDP dynamics in Q2 2019. The dynamics of industrial production and construction-assembly production (see MACROpulses of 18/7/2019 and 23/7/2019) stood significantly below our expectations in June, which made us lower our forecast of GDP growth rate in Q2 to 4.5% YoY from 5.0%. We believe that in July, as the unfavourable calendar effects and the negative impact of the heat wave will abate, the production growth will accelerate again. Nevertheless, the July results of business surveys (PMI) in Germany pointed to the deepening of the recession tendencies in manufacturing (see below). In our revised scenario we have factored in the risk of a marked deterioration of the economic situation in Poland's main trade partner, by lowering the forecasts of the dynamics of exports (and thus of GDP) in H2 2019. The scenario of the monetary policy in Poland and the EURPLN forecast have remained unchanged (see MACROmap of 10/6/2019).

Last week

- **The most important event last week was the ECB meeting.** As we expected, the monetary policy parameters in the Eurozone were left unchanged. In the statement after the meeting, the statement on the outlook for interest rates in the Eurozone (so-called forward guidance) was modified. It includes information that the ECB expects the interest rates to stay "at the present or lower level" at least until H1 2020 and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term. The ECB informed earlier that interest rates would remain "at the present level" at least until H1 2020. At the same time the statement included the information that the ECB would examine the possibilities of modifying or applying new tools of the monetary policy, i.a. the parameters of a new quantitative easing program or a tired deposit rate system. At the same time, the statement emphasized that the ECB was determined to keep inflation in line with the ECB inflation target (close but below 2%) and that it is treated as a symmetric target. Governor M. Draghi explained during the conference that it did not mean a change in the inflation target but was aimed at emphasizing the ECB determination in implementing its strategy. The tone of the statement and of the ECB Governor's remarks at the press conference proved to be less dovish than expected which led to EUR depreciation vs. USD. At the same time it supports our baseline scenario in which the ECB will cut the deposit rate by 10 bp in September to -0.50% and at the same time will introduce a 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.
- **In accordance with flash data, the composite PMI (for manufacturing and services sector) for the Eurozone dropped to 51.4 pts in July vs. 52.6 pts in June, running below our forecast (51.9 pts) and the market expectations (52.0 pts).** The composite index decline resulted from lower sub-indices for both output in manufacturing and business activity in services. In July PMI for the Eurozone stood below its average value of Q2 (52.2 pts) and thus the business survey results pose a downside risk to our forecast, in which the quarterly GDP growth rate in the Eurozone will not change in Q3 compared to Q2 and will amount to 0.3% (see below).

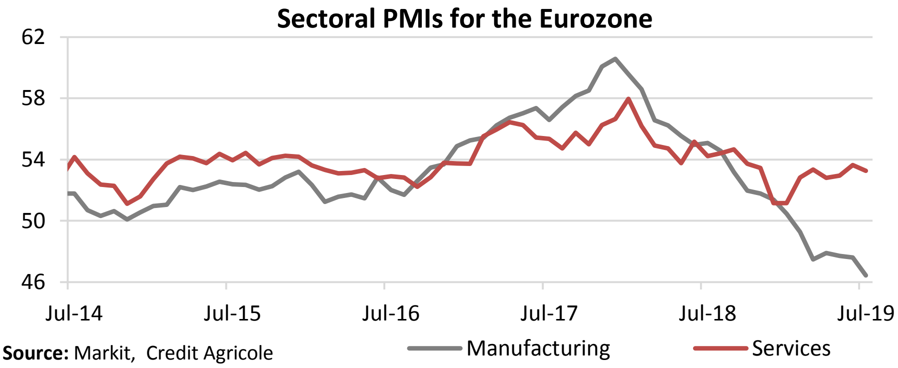
- **Ifo Index reflecting the sentiment among German managers representing the manufacturing, construction, wholesale and retail trade sectors, dropped to 95.7 pts in July vs. 97.5 pts in June, running visibly below the market expectations (97.0 pts).** The index resulted from lower sub-indices concerning both the assessment of the current situation and expectations. Sector-wise, the deterioration of sentiment was recorded in 3 of the 4 analyzed sectors (manufacturing, trade, and services), while the situation in construction has slightly improved. Coupled with the flash PMIs released last week, the data pose a downside risk to our forecast, in which the quarterly GDP growth rate in Germany will not change in Q3 compared to Q2 and will amount to 0.2%.
- **Significant data from the US were released last week.** In accordance with the flash estimate the annualized USD GDP growth rate dropped to 2.1% in Q2 vs. 3.1% in Q1. Lower GDP growth rate resulted from lower contributions of inventories (-0.86 pp in Q2 vs. 0.53 pp in Q1), net exports (-0.65 pp vs. 0.73 pp) and investments (-0.14 pp vs. 0.56 pp), while higher contributions of private consumption (2.85 pp vs. 0.78 pp) and government expenditures (0.85 pp vs. 0.50 pp) had an opposite impact. Thus the main source of US GDP growth in Q2 like in Q1 was private consumption. At the same time, it has recorded the highest dynamics since Q4 2017. Preliminary data on durable goods orders were also released last week. They increased by 2.0% MoM in June vs. a 2.3% decrease in May, running above the market expectations (0.7%). Excluding means of transport, the growth rate of durable goods orders rose to 1.2% in June vs. 0.5% in May. The annual dynamics of orders for non-military capital goods excluding orders for aircrafts rose to 2.0% in June vs. 1.2% in May, pointing to a likely acceleration in investments growth in subsequent months. Data on existing home sales (5.27M in June vs. 5.36M in May) and new home sales (646k in June vs. 604k in May) were also released last week, pointing to further slowdown in the US real estate market. The last week's data from the US support our scenario in which the annualized US GDP growth rate will decrease to 2.0% in Q3.
- **The construction-assembly production dynamics in Poland dropped to -0.7% YoY in June vs. 9.7% in May.** The sharp decline in the annual dynamics of production in June compared to May resulted from the statistical effect in the form of an unfavourable difference in the number of working days. Seasonally-adjusted construction-assembly production increased by 0.1% MoM in June. Although the construction activity will remain high in the coming quarters, we expect that the annual production dynamics will continue to show a downward trend, mainly due to the ending of the public investment cycle in public investments (including the end of local governments' investment peak – see MACROpulse of 23/7/2019). Such tendency will also be consistent with the expected by us profile of EU funds absorption within the current programming period (see MACROmap of 10/6/2019).

The Eurozone is getting closer to stagnation



Source: Markit, Credit Agricole

According to the flash data, the Composite PMI Index (for manufacturing and services) in the Eurozone dropped to 51.4 pts in July vs. 52.6 pts in June, running below our forecast (51.9 pts) and the market expectations (52.0 pts). The decline in the Composite PMI resulted from a decrease in its sub-indices for both output in manufacturing and business activity in services. In July, the PMI for the Eurozone stood slightly below its average value for Q2 (52.5 pts) and thus the business survey results pose a downside risk to our forecast, in which the quarterly GDP growth rate in the Eurozone will not change in Q3 compared to Q2 and will amount to 0.3%.



Source: Markit, Credit Agricole

Especially noteworthy in the data are the deepening differences between the situation in manufacturing and in services. The difference between the PMI for services and the PMI for manufacturing reached in July the highest value since April 2009. Historically, these differences were short-lived, which, in our view, points to a high likelihood that the situation in services will soon deteriorate in the wake of weaker sentiment in manufacturing.

According to Markit statement, the main reason for the slowdown of economic growth in the Eurozone, both in manufacturing and services, is weaker external demand. Though the main impact channel here is the slowdown of foreign demand for goods, it is also accompanied by weaker demand for services, especially for manufacturing needs. Given a decrease in new orders, the companies, wishing not to reduce the production volumes, are clearing the production backlogs that accumulated earlier. This view is supported by lower sub-index for production backlogs. At the same time, the surveyed companies were voicing concerns about trade wars, deterioration of global economic outlook, and political tension, in particular the uncertainty about Brexit.

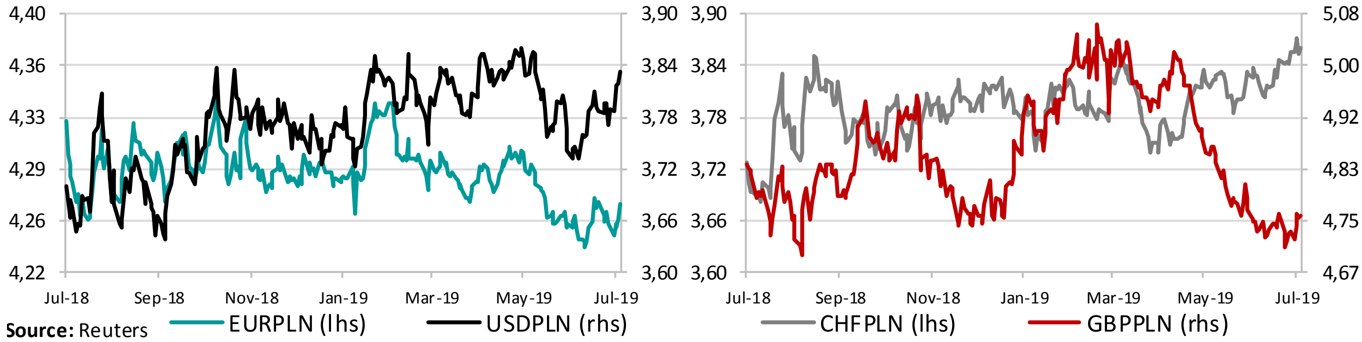
In geographic terms, deceleration of economic activity growth was recorded in Germany, in France, and the remaining Eurozone economies covered by the survey. Both in Germany and in France, the decrease in the composite PMIs resulted from lower sub-indices for output in manufacturing and business activity in services.

From the point of view of Polish exports, especially noteworthy in the data is a sharp decrease in the German manufacturing PMI down to 43.1 pts in July vs. 45.0 in June, reaching the lowest level since July 2012. The index decrease resulted from lower contributions of four of its five sub-indices: for employment, new orders, output, and inventories. Especially noteworthy in the PMI breakdown is a decrease in the sub-index for new export orders to the lowest level since April 2009. According to Markit, the deepening decline in orders in the German manufacturing results from weaker demand from China and the deceleration in the global automotive industry.

The signaled by the June PMI further slowdown of economic growth in the Eurozone, including Germany, supports our revised macroeconomic scenario for Poland, in which the GDP dynamics will decrease to 4.4% YoY in Q3 vs. 4.5% in Q2, and in the whole 2019 will decrease to 4.4% vs. 5.1% in 2018.

Domestic inflation data may weaken PLN

FX rates



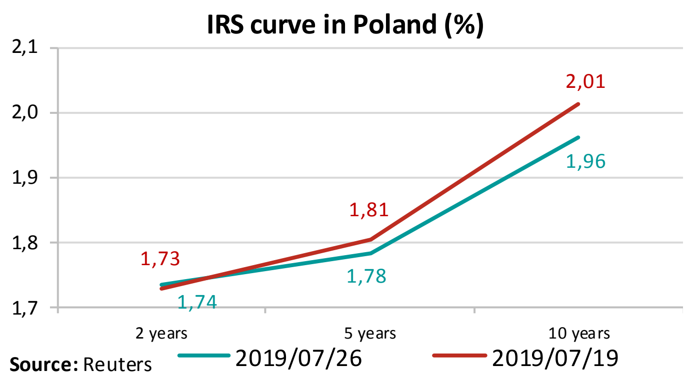
Source: Reuters

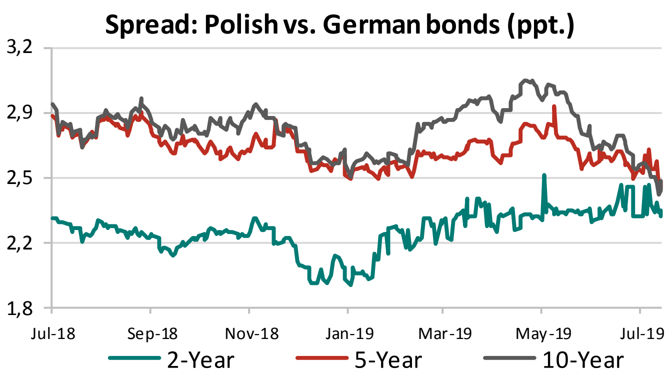
Last week, the EURPLN exchange rate rose 4.2672 (PLN weakening by 0.4%). At the beginning of the week, PLN and other currencies of the region were slightly depreciating. Wednesday saw a slight correction after the publication of markedly weaker-than-expected business survey results for major Eurozone economies, which intensified the investors' expectations of the ECB monetary policy easing. The tone of the Thursday's ECB meeting and M. Draghi remarks proved to be less dovish from the investors' expectations, resulting in the depreciation of PLN. On Friday, PLN depreciated further, supported by the publication of better-than-expected data on the US GDP.

Last week also recorded USD appreciation vs. EUR. Although the less-dovish-than-expected tone of the conference after the ECB meeting resulted in an increase in EURUSD, its scale was not big enough to offset the EUR depreciation from the first part of the week due to growing investors' expectations of monetary easing by the ECB. Consequently, last week also saw PLN depreciation vs. USD.

Crucial for PLN this week will be the FOMC meeting. The FX market may be highly volatile during the press conference. The publications of domestic inflation and GDP in the Eurozone may contribute towards PLN weakening. The publication of Polish manufacturing PMI, flash data on inflation in the Eurozone, Chinese manufacturing PMIs (Caixin and CLFP), and numerous data from the US (non-farm payrolls, Conference Board Index, final University of Michigan Index, and manufacturing ISM) will not have any significant impact on PLN, we believe.

The market focuses on the FOMC meeting





Source: Reuters

Last week, 2-year IRS rates increased to 1.74 (up by 1bp), 5-year rates dropped to 1.78 (down by 3bp), and 10-year rates to 1.96 (down by 5 bp). Monday through Thursday saw a decrease in IRS rates across the curve following the German market. Conducive to lower yields on German bonds were growing investors' expectations of monetary easing by the ECB, additionally supported by the publication of weaker-than-expected business survey results for the Eurozone. The tone of the Thursday's ECB meeting proved to be less dovish from the investors' expectations, which resulted in an increase of IRS rates across the curve. On Friday there were debt auctions at which the Finance Ministry sold PLN 7.9bn of 5-, 6-, and 10-year bonds with demand amounting to PLN 10.8bn. The auction resulted in a decrease in IRS rates. The publication of better-than-expected data on the US GDP had an opposite impact.

This week the market will focus on the FOMC meeting. We believe that the tone of the meeting may be conducive to increased volatility of IRS rates. The publications of domestic inflation may contribute towards a decrease of IRS rates. The flash estimate of GDP in the Eurozone may have an opposite impact. The publication of Polish manufacturing PMI, flash data on inflation in the Eurozone, and numerous data from the US (non-farm payrolls, Conference Board Index, final University of Michigan Index, and manufacturing ISM) will be neutral for the curve, we believe.

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	**4,27**
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	**3,84**
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	**3,87**
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	5,3	
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**	**4,5**	**4,4**	**4,2**	**4,2**	**3,9**	**3,7**	**3,5**	**5,1**	**4,4**	**3,8**
Private consumption (% YoY)	**3,9**	**5,0**	**4,5**	**4,0**	**3,7**	**3,6**	**3,5**	**3,4**	**4,5**	**4,3**	**3,6**
Gross fixed capital formation (% YoY)	**12,6**	**8,9**	**8,1**	**6,9**	**4,8**	**4,9**	**5,2**	**4,8**	**8,7**	**8,5**	**4,9**
Export - constant prices (% YoY)	**5,9**	**6,0**	**5,0**	**4,9**	**5,0**	**5,2**	**5,2**	**5,0**	**6,3**	**5,4**	**5,1**
Import - constant prices (% YoY)	**5,0**	**6,2**	**7,5**	**7,2**	**6,9**	**6,7**	**6,2**	**6,3**	**7,1**	**6,5**	**6,5**
GDP growth contributions: **Private consumption (pp)**	**2,4**	**2,9**	**2,7**	**2,0**	**2,3**	**2,1**	**2,1**	**1,7**	**2,6**	**2,5**	**2,1**
GDP growth contributions: **Investments (pp)**	**1,6**	**1,4**	**1,4**	**1,7**	**0,6**	**0,8**	**1,0**	**1,2**	**1,5**	**1,5**	**0,9**
GDP growth contributions: **Net exports (pp)**	**0,7**	**0,2**	**-1,1**	**-1,0**	**-0,8**	**-0,6**	**-0,4**	**-0,6**	**-0,2**	**-0,4**	**-0,6**
Current account (% of GDP)***	**-0,4**	**-0,1**	**-0,3**	**-0,4**	**-0,5**	**-0,6**	**-0,8**	**-0,8**	**-0,7**	**-0,4**	**-0,8**
Unemployment rate (%)**	**5,9**	**5,3**	**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**	**2,4**	**2,4**	**2,9**	**1,9**	**1,8**	**1,6**	**1,6**	**2,1**	**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 07/30/2019				
11:00	Eurozone	Business Climate Indicator (pts)	Jul	0,17		0,11
14:00	Germany	Preliminary HICP (% YoY)	Jul	1,3	1,1	1,3
14:30	USA	Real private consumption (% MoM)	Jun	0,2		
15:00	USA	Case-Shiller Index (% MoM)	May	0,0		
16:00	USA	Consumer Confidence Index	Jul	121,5	125,0	125,0
		Wednesday 07/31/2019				
3:00	China	Caixin Manufacturing PMI (pts)	Jul	49,4	49,5	49,6
10:00	**Poland**	**CPI (% YoY)**	**Jul**	**2,6**	**2,6**	**2,5**
11:00	Eurozone	Preliminary GDP (% QoQ)	Q2	0,4	0,3	0,2
11:00	Eurozone	Preliminary HICP (% YoY)	Jul	1,3	1,0	1,1
11:00	Eurozone	Unemployment rate (%)	Jun	7,5		7,5
14:15	USA	ADP employment report (k)	Jul	102		150
15:45	USA	Chicago PMI (pts)	Jul	49,7		51,0
20:00	USA	FOMC meeting (%)	Jul	2,50	2,25	2,25
		Thursday 08/01/2019				
3:45	China	Caixin Manufacturing PMI (pts)	Jul	50,2	49,8	49,6
9:00	**Poland**	**Manufacturing PMI (pts)**	**Jul**	**48,4**	**48,0**	**47,9**
9:55	Germany	Final Manufacturing PMI (pts)	Jul	43,1	43,1	43,1
10:00	Eurozone	Final Manufacturing PMI (pts)	Jul	46,4	46,4	46,4
13:00	UK	BOE rate decision (%)	Aug	0,75	0,75	0,75
15:45	USA	Flash Manufacturing PMI (pts)	Jul	50,0		
16:00	USA	ISM Manufacturing PMI (pts)	Jul	51,7	51,3	52,0
		Friday 08/02/2019				
14:30	USA	Unemployment rate (%)	Jul	3,7	3,6	3,7
14:30	USA	Non-farm payrolls (k MoM)	Jul	224	165	170
16:00	USA	Final U. of Michigan Sentiment Index (pts)	Jul	98,4	98,5	98,4
16:00	USA	Factory orders (% MoM)	Jun	-0,7	0,6	0,8

*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

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