Sharp increase in minimum wage supports the inflow of Ukrainians

This week

- **The most important event this week will be the signing of the "phase one" trade agreement between the US and China scheduled for this week**. According to the media reports the Chinese delegation will stay in Washington from Monday to Wednesday. D. Trump said that negotiations on further terms of the economic cooperation between the US and China would start as soon as the "first phase" agreement was signed. We maintain our scenario in which in subsequent months – despite the ongoing negotiations – there will be no further de-escalation of the conflict between these countries and a deeper agreement will not be reached. We think it is possible that after the presidential election in the US this year the conflict between the US and China may escalate again. Although already partly discounted by the investors, the signing of the agreement this week will be conducive to improved market sentiment, which will be positive for PLN
- **Important data from China will be released this week.** We expect that the economic growth rate rose to 6.2% YoY in Q4 vs. 6.0% in Q3 (1.4% QoQ vs. 1.5% in Q3). We believe that the monthly data will also point to slight acceleration in the annual growth rate of economic activity. We forecast that industrial production increased by 6.5% YoY in December vs. 6.2% in November, retail sales increased by 8.2% YoY vs. 8.0% in January, and urban investments dynamics have not changed in December compared to November and amounted to 5.2%. Data on the Chinese balance on trade will be released on Tuesday. We expect it to have increased to USD 66.6bn in December vs. USD 37.9bn in November with a simultaneous increase in exports and imports dynamics. Our forecast of economic growth rate in China is above the market consensus (6.0% YoY); therefore its materialization should be conducive to improved market sentiment, which will be positive for PLN.
- **Significant hard data from the US will be released this week.** We believe that industrial production decreased by 0.3% MoM in December vs. a 1.1% increase in November, consistently with lower employment recorded in manufacturing in December (see below). We forecast that nominal retail sales rose to 0.4% MoM in December vs. 0.2% in November, due to low base effects. We expect that headline inflation rose to 2.4% YoY in November vs. 2.1% in October, due to the stabilization of core inflation (2.3%), lower dynamics of food prices, and faster growth of energy prices. We expect that the stabilization in the US real estate market will be confirmed by data on housing starts (1372k in December vs. 1365k in November) and building permits (1460k vs. 1482k). The preliminary University of Michigan Index will be released on Friday. We forecast that its value has not changed in January compared to December and amounted to 99.3 pts. We believe that the publication of US data will be neutral for the financial markets.
- **Final data on the December inflation in Poland will be released on Wednesday.** We believe that the inflation rate will not change compared to the flash estimate (3.4% YoY vs. 2.6% in November). The data structure will confirm that the strong increase in headline inflation was mainly due to higher core inflation (see below). The clearly higher from our earlier expectations December inflation reading has made us revise the medium-term inflation scenario. In Q1 we expect further increase in headline inflation to 4.2% YoY which will largely result from the rise in electricity prices and the pro-inflationary impact of the sharp increase in the minimum wage with the beginning of 2020. In subsequent quarters inflation will be gradually decreasing due to high base effects and expiring shocks boosting food prices and thus on a yearly average it will amount to 2.9% in the whole 2020 vs. 2.3% in 2019. This week's inflation reading will be neutral for PLN and debt prices.
- **Data on the Polish balance of payments in November will be released today**. We expect the current account balance to drop to EUR -45M vs. EUR 529M in October, due to lower balance on goods. We forecast that export dynamics decreased to -0.7% YoY in November vs. 4.0% in October, while import growth rate dropped to -0.2% YoY vs. -0.1%. Conducive to lower import and export growth rate was the effect of an unfavourable difference in the number of working

days. The publication of data on the balance of payments will be neutral for PLN and yields on Polish bonds, we believe.

Last week

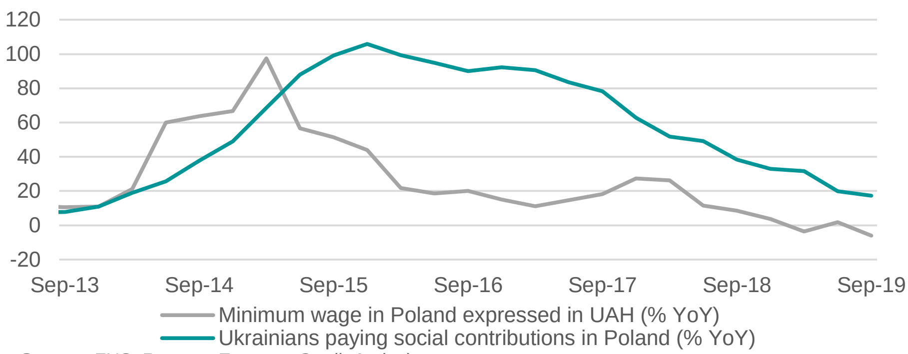
- **In accordance with the flash estimate, CPI inflation in Poland rose to 3.4% YoY in December vs. 2.6% in November, running clearly above the market expectations (2.9%) and our forecast (3.0%)**. GUS published partial data on the inflation structure, including information on the rate of inflation in the categories "food and non-alcoholic beverages", "energy", and "fuels". The increase in inflation resulted from higher dynamics of fuel prices (-0.2% YoY in December vs. -5.4% in November), food and non-alcoholic beverages (7.0% vs. 6.5% - probably the effect of the rise in pork prices), and higher core inflation, which, according to our estimates, rose to 3.2% YoY vs. 2.6% (the effect of growing cost pressure). The dynamics of energy prices have not changed compared to November and amounted to -1.8% YoY. Final data on inflation will be released on 15 January (see above). In accordance with our revised forecast (see above), we expect that on a yearly average inflation will stand at 2.9% in 2020 vs. 2.3% in 2019.
- **As we expected, the Monetary Policy Council left interest rates unchanged at the 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. Like in December 2019, the Council noted that the economic outlook remained favourable, and GDP growth, despite the expected decline, would continue at a relatively high level in the coming years. At the same time the Council pointed in its statement to continuing uncertainty about the scale and persistence of the slowdown abroad and its impact on domestic economic activity. Like the month before, the Council expects that inflation - after a temporary rise in 2020 Q1- will stay close to the target in the monetary policy transmission horizon. At the conference after the MPC meeting, the NBP Governor, A. Glapiński, repeated the view he had voiced earlier that interest rates would remain unchanged until the end of his term of office. He still believes that the first change in interest rates would be their reduction. Furthermore, he expressed an opinion that there was a low probability of a scenario in which the CPI inflation would exceed 4% in Q1 and remain elevated for a longer time. In his view, despite the surprisingly high flash inflation estimate (see above), inflation in Q1 would be only slightly above the inflation path from the November inflation projection (see MACROpulse of 9/1/2020). The MPC members present at the conference - Jerzy Żyżyński and Cezary Kochalski – emphasized that the December's increase in inflation and the expected further increase in inflation were of a supply-side nature, pointing that its reasons were beyond the reach of the central bank policy. The remarks of MPC members support our scenario, in which NBP interest rates will remain unchanged at least until the end of 2020 despite the expected increase in inflation in Q1 2020. The expected by us accommodative monetary policy of the ECB (another deposit rate cut, continuation of the quantitative easing program), and a significant slowdown of investment growth in the coming quarters, are consistent with this forecast.
- **Last week we saw important data from the US.** Non-farm payrolls rose by 145k in December vs. a 256k increase in November (revised downwards from 266k), running below the market expectations (+160k) and our forecast (+175k). The highest increase in employment was recorded in retail trade (+41.2k), leisure and hospitality (+40.0k), and education and health service (+36.0k). In turn, employment decreased in manufacturing (-12.0k), transport and warehousing (-10.4k), and mining and logging (-9.0k). Unemployment rate has not changed in December compared to November and amounted to 3.5%, thus staying significantly below the natural unemployment rate indicated by FOMC (4.1%).The participation rate has not changed either and amounted to 63.2% both in December and November. The annual dynamics of

average hourly earnings dropped to 2.9% in December vs. 3.1% in November, hitting the lowest level since July 2018. This points to continuingly low wage pressure in the US economy despite growing employment and persistently very low unemployment. The results of business surveys in the US were also released last week. Non-manufacturing ISM index increased to 55.0 pts in December vs. 53.9 pts in November, running above market expectations (54.5 pts). The index increase resulted from higher contributions of its sub-indices for business activity and suppliers' delivery times, while lower contributions of the sub-indices for new orders and employment had opposite impact. The last week's data do not alter our forecast, in which the annualized US GDP growth rate decreased to 1.7% in Q4 vs. 1.9% in Q3. In subsequent quarters we expect it to decrease further to 1.5% in Q2 and Q3 2020, largely due to the abatement of the positive effect of fiscal stimulation, continuing high uncertainty limiting investment dynamics as well as increasingly slow improvement in the labour market, being conducive to lower consumption growth.

- **According to the flash estimate, inflation in the Eurozone rose to 1.3% YoY in December vs. 1.0% in November, running in line with the market consensus equal to our forecast.** The increase in inflation resulted mainly from higher dynamics of energy prices (0.2% YoY in December vs. -3.2% in November). We expect inflation to increase further to 1.4% in January and February, thereafter show a downward trend and reach its local minimum at 1.0% in June. The decrease in inflation in H1 2020 will result from lower dynamics of energy prices. In H2 2020 we forecast a slight increase in inflation but it will not exceed a level of 1.2% until the end of the year.
- **Last week we saw some important data from the German economy**. Industrial production rose by 1.1% MoM in November vs. a 1.0% decrease in October, running above the market expectations (0.7%). The increase in its monthly dynamics resulted mainly from a sharp increase in the dynamics of production of capital goods (2.4% MoM in November vs. -4.2% in October), while lower dynamics of production of intermediate and consumer goods had opposite impact. Despite the increase in November, the production of capital goods continues to show a clear downward trend, suggesting that the German companies are limiting investments. Sector-wise, construction and manufacturing recorded an increase in production dynamics, while energy saw their sharp decline. On the other hand, data on orders in German manufacturing proved visibly lower from the consensus, decreasing by 1.3% YoY in November vs. a 0.2% increase in October, while the market expected them to increase by 0.3%. The sharp decrease in orders dynamics resulted from a lower growth rate of foreign orders, while the dynamics of domestic orders have increased. In foreign orders, both orders from the Eurozone and from countries outside the single currency area have decreased. Last week we also saw data on the German balance on trade which decreased to EUR 18.3bn in November vs. EUR 20.4bn in October. At the same time, the dynamics of German exports dropped to -2.3% MoM in November vs. 1.5% in October, while import dynamics dropped to -0.5% vs. 0.5%. The last week's data from the German economy, coupled with the decrease in German composite PMI recorded in Q4 2019, pose a significant downside risk to our forecast, in which the quarterly growth rate of the German GDP has not changed in Q4 compared to Q3 and amounted to 0.1%.

Sharp increase in minimum wage supports the inflow of Ukrainians

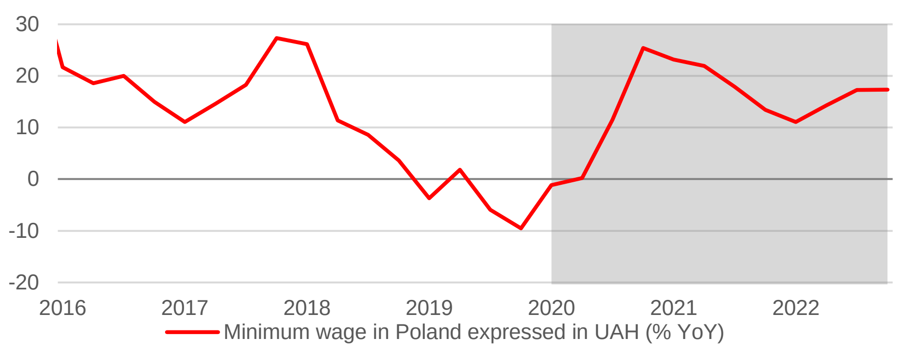
In accordance with ZUS data, nearly half a million Ukrainians were paying social contributions in Poland at the end of Q3 2019. The number of employees form Ukraine who were paying the contributions has been growing since 2013 but in recent quarters their inflow was gradually slowing down (see the chart below), partly due to high base effects. In the 2014-2015 period, the number of immigrants from Ukraine was growing at a rate of several dozen percent per year. These dynamics were impossible to maintain in the long term. In addition, the economic situation of Ukraine has significantly improved in the meantime. The 2014-2015 period saw deep recession there while now the economic growth rate stands at 3-4% YoY, reducing the propensity of Ukrainian citizens to seek employment abroad. We believe that there is yet another important factor determining the scale of the inflow of economic migration from Ukraine – the profile of migrants' earnings in Poland converted into Ukrainian hryvnia (UAH). In the analysis below we are presenting the trends in this respect and evaluate how the expected changes in wages in Poland will impact the inflow of Ukrainians.



Source: ZUS, Reuters, Eurostat, Credit Agricole

Precise time series for Ukrainians' earnings in Poland are not known (only periodical surveys are made in this respect), that is why we have accepted the minimum wage as their measure. This assumption seems appropriate considering that a large part of migrants do jobs that do not require high skills. The minimum wage was then converted into Ukrainian hryvnia at PLNUAH exchange rate. This measure enables us to assess the attractiveness of economic migration from the perspective of Ukrainians staying in Poland temporarily and transferring a significant part of their income abroad. In recent years the annual growth rate of the nominal minimum wage in Poland in UAH was showing high correlation with the annual dynamics of Ukrainians paying social contributions.

The visibly decreasing in recent quarters dynamics of minimum wage in Poland expressed in UAH resulted mainly from PLNUAH fluctuations. UAH appreciated vs. PLN by 9.2% in 2018 and by additional 18.6% in 2019. Thus, the appreciation of UAH has ceteris paribus contributed to a decrease in the wages received by the Ukrainians in Poland by nearly 30%, which may have significantly limited the scale of the immigrants' inflow. The key issue in the coming quarters is the answer to the question how the planned increase in minimum wage will affect the economic migration to Poland.



Source: Reuters, Eurostat, Credit Agricole

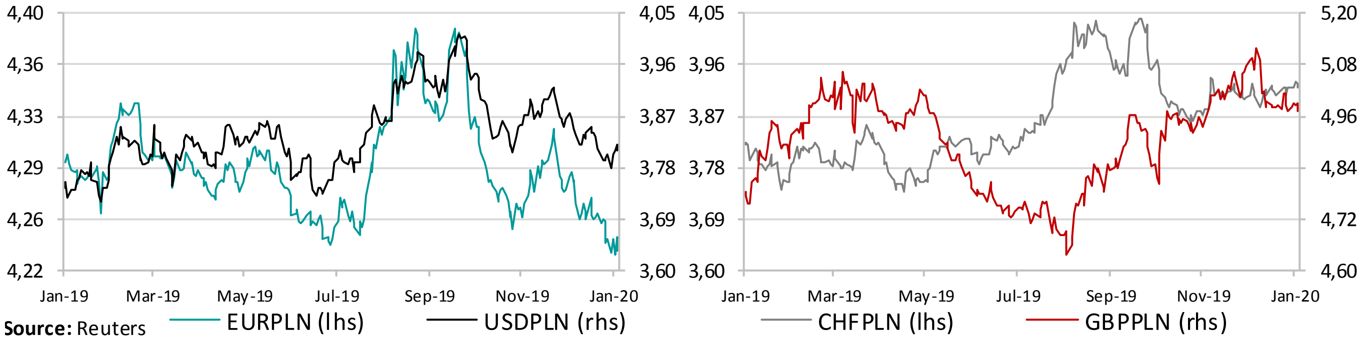
We believe that PiS announcement setting the target for the minimum wage at PLN 4000 at the end of 2023 will not be met, as such sharp increase in minimum wage would be conducive to a decrease in employment (see MACROmaps of 21/10/2019 and 28/10/2019) and would meet with strong opposition from the employers.

We therefore expect that after an increase by 15.6% to PLN 2600 gross in 2020, the minimum wage will increase by 10% (to PLN 2860) at the beginning of 2021 and by 7% (to PLN 3060) at the beginning of 2022. At the same time, we forecast a gradual weakening of UAH vs. USD between 2020 and 2022, due to a deepening current account deficit in Ukraine. Considering our forecast of USDPLN (see the quarterly table), we expect that UAH will start depreciating again vs. PLN in 2020 – by a total of 22.7% in the horizon of three years compared to the level as at the end of 2019. We expect PLNUAH to amount to 6.79 at the end of 2020, to 7.00 at the end of 2021, and to 7.68 at the end of 2022 vs. 6.25 at the end of 2019. In the coming years the minimum wage in Poland expressed in UAH will therefore be increasing – in year-on-year terms – at a two-digit pace (see the chart).

The expected by us tendencies, both the minimum wage increase and UAH depreciation vs. PLN, will contribute towards reversing the unfavourable, from the point of view of the inflow of economic migration, trend in Ukrainians' earnings in Poland. This will limit the forecasted by us decrease in non-agricultural employment resulting from the planned sharp increase in minimum wage in the coming years. The risks to our scenario are the expected by us fast (by several dozen percent per year) increase in the nominal wages in Ukraine and the opening of the labour market in Germany.

Data from China positive for the PLN

FX rates



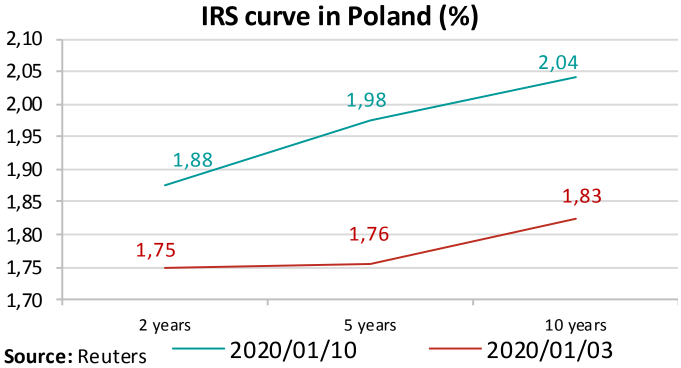
Source: Reuters

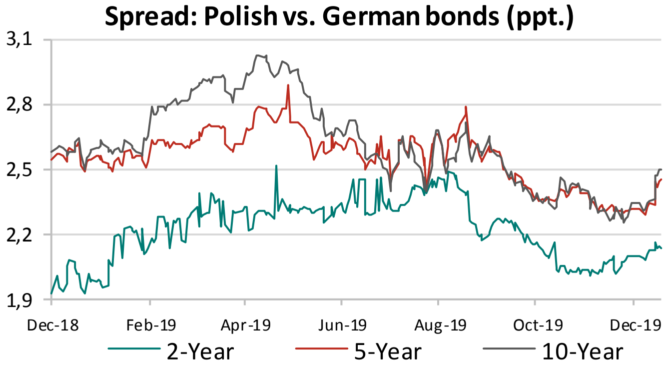
Last week, the EURPLN exchange rate dropped to 4.2342 (strengthening of PLN by 0.2%). The last week's slight appreciation of PLN resulted from a decrease in global risk aversion reflected by lower VIX index. Higher demand for risky assets resulted from a lower – in the investors' opinion – likelihood of further escalation of the conflict between the US and Iran. The publication of clearly-higher-than-expected domestic data on inflation had no significant impact on PLN. In turn, the slight appreciation of PLN was supported by the publication of weaker-than-expected data from the US labour market.

Despite the decrease in global risk aversion, EUR depreciated further vs. USD last week. This may have partly resulted from the publication of weak data from the German economy, pointing to a deterioration of the economic outlook for the Eurozone.

In our view, the appreciation of PLN this week will be supported by improved global sentiment resulting from the planned for this week signing of the first phase agreement between the US and China. PLN strengthening will also be supported by the publication of data from China (GDP, industrial production, retail sales, urban investments). Domestic data on inflation and the balance of payments as well as numerous data from the US (industrial production, retail sales, inflation, number of housing starts, new building permits, and preliminary University of Michigan Index) will not have any significant impact on PLN, we believe.

De-escalation of the US-China conflict may support an increase in IRS rates





Source: Reuters

Last week, 2-year IRS rates increased to 1.88 (up by 13bp), 5-year rates to 1.98 (up by 22bp), and 10-year rates to 2.04 (up by 21bp). On Monday, the volatility of IRS rates was limited due to holiday. Tuesday through Friday saw a sharp increase in IRS rates across the curve, following the core markets. It was supported by improved investors' sentiment, due to lower risk of further escalation of the conflict between the US and Iran. This view is supported by lower VIX index. Nonetheless, the spread between the Polish and German bonds continued to be high. The domestic clearly-higher-than-expected data on inflation were overshadowed by global sentiment. On Thursday, there was also a debt exchange auction at which the Ministry of Finance sold PLN 5.0bn of 2-, 4-, 5-, 10-, and 27-year bonds with demand amounting to PLN 7.2bn. The auction had a limited impact on the curve.

This week the decrease in IRS rates will be supported by improved global sentiment resulting from the planned for this week signing of the first phase agreement between the US and China. We believe that the publication of data from Poland (inflation, balance of payments), China (GDP, industrial production, retail sales, urban investments), and the US (industrial production, retail sales, inflation, number of housing starts, new building permits, and preliminary University of Michigan Index) will be neutral for the curve.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19	Jan-20
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*	4,29	4,26	4,30	4,30	4,28	4,28	4,24	4,29	4,38	4,37	4,26	4,31	4,26	**4,27**
USDPLN*	3,74	3,72	3,79	3,84	3,82	3,83	3,73	3,87	3,98	4,01	3,82	3,91	3,79	**3,81**
CHFPLN*	3,81	3,74	3,79	3,85	3,75	3,83	3,82	3,90	4,02	4,02	3,87	3,91	3,92	**3,90**
CPI inflation (% YoY)	1,1	0,7	1,2	1,7	2,2	2,4	2,6	2,9	2,9	2,6	2,5	2,6	**3,0**	
Core inflation (% YoY)	0,6	0,8	1,0	1,4	1,7	1,7	1,9	2,2	2,2	2,4	2,4	2,6	**3,2**	
Industrial production (% YoY)	2,8	6,0	6,9	5,5	9,2	7,6	-2,6	5,8	-1,5	5,5	3,7	1,5	**6,8**	
PPI inflation (% YoY)	2,1	2,2	2,9	2,5	2,6	1,4	0,5	0,5	0,9	0,8	-0,3	-0,1	**0,6**	
Retail sales (% YoY)	4,7	6,6	6,5	3,1	13,6	7,3	5,3	7,4	6,0	5,3	5,4	5,9	**8,2**	
Corporate sector wages (% YoY)	6,1	7,5	7,6	5,7	7,1	7,7	5,3	7,4	6,8	6,6	5,9	5,3	**6,1**	
Employment (% YoY)	2,8	2,9	2,9	3,0	2,9	2,7	2,8	2,7	2,6	2,6	2,5	2,6	**2,6**	
Unemployment rate* (%)	5,8	6,1	6,1	5,9	5,6	5,4	5,3	5,2	5,2	5,1	5,0	5,1	**5,2**	
Current account (M EUR)	-1528	2529	-630	217	357	379	-310	-797	-659	172	529	**-45**		
Exports (% YoY EUR)	-0,5	5,9	10,5	7,8	9,4	11,6	-3,1	7,7	-0,1	9,3	4,0	**-0,7**		
Imports (% YoY EUR)	0,2	2,1	8,4	2,8	7,7	10,1	-4,7	8,4	-2,5	4,3	-0,1	**-0,2**		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland

Indicator	2019				2020				2019	2020	2021
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Gross Domestic Product (% YoY)	4,8	4,6	3,9	3,5	3,3	3,2	2,7	2,7	4,2	3,0	3,3
Private consumption (% YoY)	3,9	4,4	3,9	3,8	3,4	3,6	3,4	3,0	4,0	3,3	3,0
Gross fixed capital formation (% YoY)	12,2	9,1	4,7	2,7	3,1	1,9	1,5	1,7	6,0	1,9	5,0
Export - constant prices (% YoY)	7,3	3,2	5,0	4,9	4,2	4,1	4,2	4,4	5,1	4,2	4,5
Import - constant prices (% YoY)	6,0	3,1	3,9	3,9	3,6	3,5	3,3	3,0	4,2	3,4	4,0
GDP growth contributions: Private consumption (pp)	2,5	2,5	2,2	1,9	2,1	2,1	2,0	1,5	2,3	1,9	1,7
GDP growth contributions: Investments (pp)	1,5	1,5	0,8	0,7	0,4	0,3	0,3	0,4	1,1	0,3	0,9
GDP growth contributions: Net exports (pp)	1,0	0,2	0,8	0,7	0,5	0,5	0,6	0,8	0,6	0,6	0,2
Current account (% of GDP)***	-0,6	-0,4	-0,1	0,0	-0,2	-0,4	-0,5	-0,6	0,0	-0,6	-1,0
Unemployment rate (%)**	5,9	5,3	5,1	5,2	5,5	5,0	5,0	5,3	5,2	5,3	5,5
Non-agricultural employment (% YoY)	0,0	0,2	0,5	0,1	-0,1	-0,1	-0,2	-0,3	0,2	-0,2	-0,5
Wages in national economy (% YoY)	7,1	7,0	7,7	7,0	7,5	7,6	7,4	7,0	7,2	7,4	6,0
CPI Inflation (% YoY)*	1,2	2,4	2,8	2,8	4,2	3,1	2,4	2,1	2,3	2,9	2,0
Wibor 3M (%)**	1,72	1,72	1,72	1,71	1,71	1,71	1,71	1,71	1,71	1,71	1,71
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	4,37	4,26	4,29	4,29	4,29	4,29	4,26	4,29	4,25
USDPLN**	3,84	3,73	4,01	3,79	3,83	3,73	3,64	3,70	3,79	3,70	3,76

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
		Monday 01/13/2020				
14:00	**Poland**	**Current account (M EUR)**	**Nov**	**529**	**-45**	**500**
		Tuesday 01/14/2020				
14:30	USA	CPI (% MoM)	Dec	0,3	0,3	0,3
14:30	USA	Core CPI (% MoM)	Dec	0,2	0,2	0,2
	China	Trade balance (bn USD)	Dec	37,9	66,6	48,0
		Wednesday 01/15/2020				
10:00	**Poland**	**CPI (% YoY)**	**Dec**	**2,6**	**3,0**	**2,9**
10:00	Germany	Preliminary GDP (% YoY)	2019	1,5	0,6	0,6
11:00	Eurozone	Industrial production (% MoM)	Nov	-0,5		0,3
14:30	USA	NY Fed Manufacturing Index (pts)	Jan	3,5	4,0	3,5
		Thursday 01/16/2020				
14:00	**Poland**	**Core inflation (% YoY)**	**Dec**	**2,6**	**2,7**	**3,2**
14:30	USA	Retail sales (% MoM)	Dec	0,2	0,4	0,3
14:30	USA	Philadelphia Fed Index (pts)	Jan	0,3	4,4	3,9
16:00	USA	Business inventories (% MoM)	Nov	0,2		-0,1
		Friday 01/17/2020				
3:00	China	GDP (% YoY)	Q4	6,0	6,2	6,0
3:00	China	Retail sales (% YoY)	Dec	8,0	8,2	7,8
3:00	China	Industrial production (% YoY)	Dec	6,2	6,5	5,9
3:00	China	Urban investments (% YoY)	Dec	5,2	5,2	5,2
10:00	Eurozone	Current account (bn EUR)	Nov	32,4		
11:00	Eurozone	HICP (% YoY)	Dec	1,3	1,3	1,3
14:30	USA	Housing starts (k MoM)	Dec	1365	1372	1372
14:30	USA	Building permits (k)	Dec	1474	1460	1469
15:15	USA	Industrial production (% MoM)	Dec	1,1	-0,3	0,0
15:15	USA	Capacity utilization (%)	Dec	77,3		77,2
16:00	USA	Initial U. of Michigan Sentiment Index (pts)	Jan	99,3	99,3	99,3

*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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