Employment in manufacturing limited by the sharp increase in the minimum wage?

MACRO MAP

This week

- **The most important event this week will be the meeting of the Monetary Policy Council scheduled for Wednesday**. We expect that the MPC will leave interest rates unchanged. The issue of the impact of the stronger-than-expected slowdown of GDP growth in Q4 2019 with inflation running markedly above the target on the NBP monetary policy in the coming months is likely to be raised during the conference. We believe that A. Glapiński will repeat his view that interest rates will not change until the end of the current MPC term. We believe that the text of the statement after the Council meeting and remarks of the NBP Governor during the press conference will be neutral for PLN and yields on Polish bonds.
- **On Friday we will see important data from the US labour market.** We expect that non-farm payrolls amounted to 170k in January vs. 145k in December, with unemployment rate stable at 3.5%. 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 158k in January vs. 202k in December). The ISM index for manufacturing will also be released today. We expect it to have increased to 48.5 pts in January vs. 47.2 pts in December. However, a marked decrease in Chicago PMI in January signals a substantial downside risk to our forecast. If this risk materializes, we may see a slight increase in EURUSD and a decrease in EURPLN. In our view, other US readings this week will be neutral for the financial markets.
- **China Caixin manufacturing PMI that has been released today dropped to 51.1 pts in January vs. 51.5 pts in December, running slightly below the market expectations (51.3 pts).** Thus, despite a slight decrease in January, the index has for 6 months now stayed above 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 new orders, output, employment, and inventories), while higher sub-index for suppliers' delivery times had opposite impact. Especially noteworthy in the data structure is the sub-index for new export orders, which after three months is again below the 50 pts threshold, pointing to a weakening foreign demand for Chinese goods. It is worth noting that the Caixin PMI survey was carried out between 13 and 22 January, therefore its results reflect the outbreak of 2019-nCoV virus epidemic to a small extent. Last week we also saw CLFP PMI for Chinese manufacturing, which dropped to 50.0 pts in January vs. 50.2 pts in December, running in line with the market expectations. In the case of CFLP PMI responses were collected until 20 January. In view of the negative impact of the coronavirus epidemic on the economic activity in China, due to a temporary suspension or limitation of operations by many companies, we have decided to lower our forecast for Chinese GDP. We now expect that it will increase by 5.7% in 2020 vs. 6.1% in 2019 (we previously forecast a 6% increase in 2020). We expect increased risk aversion in the financial markets this week due to the spreading coronavirus epidemic. We believe that the market sentiment will improve only with reports that the spread of 2019-nCoV virus is slowing down. We expect that such scenario may materialize no sooner than in a few weeks' time. Data on the Chinese balance on trade will be released on Friday. We expect it to have increased to USD 51.0bn in January vs. USD 46.8bn in December, with a simultaneous sharp decrease in export and import dynamics (the effect of the Chinese New Year celebrations and 2019-nCoV virus epidemic). The data should not be market moving.
- **The results of business surveys for Polish manufacturing have been released today.** PMI dropped to 47.4 pts in January vs. 48.0 pts in December, running significantly below our forecast (48.5 pts) and the market consensus (48.3 pts). Thus, the index has for fifteen months in a row stayed below the 50 pts threshold dividing expansion from contraction of activity. The data are slightly negative for PLN and yields on Polish bonds (see below).

Last week

- **GDP in Poland rose by 4.0% in 2019 vs. 5.1% in 2018, running below our forecast (4.2%) that was in line with the market expectations**. Slower economic growth rate resulted from lower contribution of inventories (-0.8 pp in 2019 vs. 0.4 pp in 2018), private consumption (2.2 pp vs. 2.5 pp), and investments (1.4 pp vs. 1.6 pp), while higher contributions of net exports (0.4 pp vs. 0.0 pp) and public consumption (0.8 pp vs. 0.6 pp) had opposite impact. Thus, private consumption was the main source of economic growth in 2019 (see MACROpulse of 29/1/2020). Based on GUS data, we have estimated that real GDP growth rate stood at 2.9% YoY in Q4 2019 vs. 3.9% in Q3, which was a markedly slower pace from our expectations (3.5%). We estimate that conducive to slower GDP growth were lower contributions of net exports (-0.5 pp in Q4 vs. 0.8 pp in Q3), private consumption (1.7 pp vs. 2.2 pp), and inventories (-1.0 pp vs. -0.7 pp). Higher contribution of investments (1.8 pp vs. 0.8 pp) had opposite impact, while the contribution of government expenditure has not changed and amounted to 0.8 pp. Consequently, investments were the main source of economic growth in Q4 whereas in Q3 it was consumption. In our view, the marked acceleration of investments in Q4 resulted from intensified investment activity of enterprises in the modernization of existing fixed assets or increasing of production capacity and should not be attributed to public investments. The data on economic activity in Q4 pose a downside risk to our forecast of economic growth in 2020 (3.0%).
- **FOMC meeting was held last week.** In accordance with our expectations and the market consensus, FED left the target range for federal funds unchanged at [1.50%; 1.75%]. No substantial changes were introduced to the statement after the meeting. It repeated the view that FED's current monetary policy was adequate to ensure sustained increase in inflation, strong labour market, and inflation attaining the target. FED Chairman, J. Powell, said during the conference after the meeting that coronavirus was a risk to global economic outlook. J. Powell's dovish remark resulted in USD weakening vs. EUR. Our baseline scenario assumes that FED will cut interest rates by 25bp in Q2 2020 in reaction to the expected by us slowdown of economic growth.
- **Important data from the US were released this week**. In accordance with the first estimate, the annualized US GDP growth rate has not changed in Q4 compared to Q3 and amounted to 2.1%, running in line with the market expectations and slightly below our forecast (2.2%). The stabilization of the US GDP growth rate resulted from lower contributions of net exports (1.48 pp in Q4 vs. -0.14 pp in Q3), investments (0.01 pp vs. -0.14 pp), and government spending (0.47 pp vs. 0.30 pp) and from lower contributions of inventories (-1.09 pp vs. -0.03 pp) and private consumption (1.20 pp vs. 2.12 pp). Thus, net exports were the main source of US economic growth in Q4 whereas in Q3 it was private consumption. The situation where private consumption was not the main source of GDP growth was last seen in Q3 2013 – inventories were then the main factor behind GDP growth. Preliminary durable goods orders increased by 2.4% MoM in December vs. a 3.1% decrease in November, running significantly above the market expectations (0.5%). Excluding means of transport, the durable goods orders dynamics rose to -0.1% MoM -0.4% in November. Especially noteworthy in the data structure are higher dynamics of orders for non-military capital goods excluding aircrafts which amounted to 1.0% in December vs. 0.3% in November. This points to a high likelihood of slight acceleration in investments in the coming quarters. Last week we also saw data on new home sales (694k in December vs. 697k in November), which, coupled with last week's data on new building permits, housing starts, and existing home sales, confirmed increased activity in the US real estate market. The results of consumer sentiment surveys were also released last week. The Conference Board Index rose to 131.6 pts in January vs. 128.2 pts in December. The index increase resulted from higher values of its sub-indices for both the assessment of the current

situation and expectations. The final University of Michigan Index also indicated strong consumer sentiment and amounted to 99.8 pts in January vs. 99.3 pts in December and 99.1 pts in the flash estimate. The index slight increase resulted from its sub-index for expectations while lower sub-index for the assessment of the current situation had opposite impact. The last week's data on the US economy do not alter our scenario assuming a slowdown of the US GDP growth rate to 1.5% in Q2 and Q3 2020, largely due to the abatement of the positive effect of the fiscal stimulation, continuing high uncertainty limiting investment growth, as well as increasingly slow improvement in the labour market being conducive to lower consumption dynamics.

- **According to the flash estimate, inflation in the Eurozone rose to 1.4% YoY in January vs. 1.3% in December, running in line with the market consensus equal to our forecast.** The increase in inflation resulted mainly from higher dynamics of energy prices (1.8% YoY in January vs. 0.2% in December), while lower dynamics of the prices of services (1.5% vs. 1.8%) had opposite impact. We forecast that inflation in the Eurozone will be showing a downward trend in subsequent months to reach its local minimum at 0.9% 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, which, however, will not exceed 1.2% until the end of the year.
- **According to the flash estimate, the quarterly GDP dynamics in the Eurozone decreased to 0.1% in Q4 vs. 0.2% in Q3 (1.0% YoY in Q4 vs. 1.2% in Q3).** Last week we also saw flash GDP estimates for several Eurozone economies, i.a. for France (-0.1% QoQ in Q4 vs. 0.3% in Q3), Spain (0.5% vs. 0.4%), and Italy (-0.3% vs. 0.1%). Today's data on GDP in the Eurozone are a flash estimate and do not include its structure. Subsequent GDP estimate for the Eurozone, including the growth rate in all counties of the single currency area, will be released on 14 February and full data on GDP structure on 10 March.
- **Ifo Index reflecting the sentiment among German managers representing the manufacturing, construction, trade and services sectors, dropped to 95.9 pts in January vs. 96.3 pts in December, running below the market expectations (97.0 pts) and our forecast (96.4 pts).** The index decrease resulted from its lower sub-index for expectations while higher sub-index for the assessment of the current situation had opposite impact. Sector-wise, weaker sentiment was recorded in construction and services, while the situation in manufacturing and retail trade improved. Considering flash PMIs for Ger4many released two weeks ago (see MACROmap of 25/11/2019), we maintain our forecast, in which the quarterly growth rate of the German GDP will increase to 0.3% in Q1 vs. 0.1% in Q4.
- **The NBP Quick Monitoring was published last week.** The business survey results point to a significant deterioration of forecasts of financial situation and investment plans of companies. The data indicate that the expected slowdown in investments will be wide ranging and will affect both public and private companies. It is also worth pointing out that the structure of investments is changing – fewer companies wish to increase production capacity while interest in cost cutting projects keeps growing. The results suggest that more interested in cost cutting are companies with a higher percentage of employees with wages below the future minimum pay threshold. This is consistent with our view that subsequent months will see the stagnation of employment in the Polish sector of enterprises due to ongoing restricting processes resulting from growing costs of labour, including sharp increase in the minimum wage (see MACROpulse of 30/1/2020). At the same time, the survey results suggest no substantial impact of the high increase in the minimum pay on wage dynamics while wage pressure is staying at a stable level. In our view, it signals that the risk of second round effects is low. Coupled with the prospect of slower economic growth, it supports our forecast in which the NBP interest rates will not change at least until the end of 2021.

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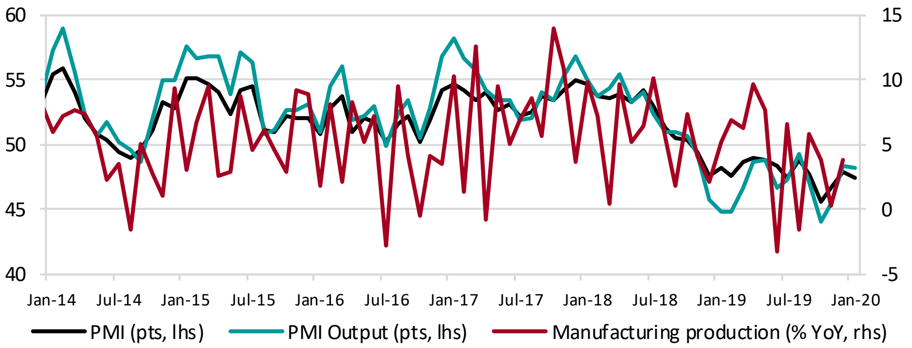
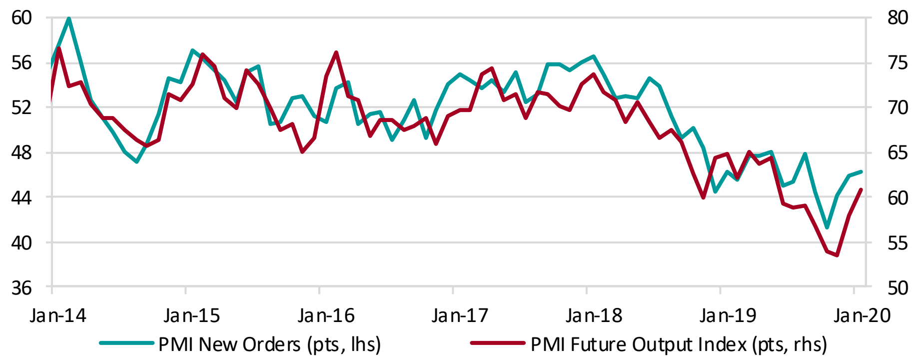


Source: Markit. GUS

Polish manufacturing PMI dropped to 47.4 pts in January vs. 48.0 pts in December, running significantly below our forecast (48.5 pts) and the market consensus (48.3 pts). Thus, the index has for fifteen months in a row stayed below the 50 pts threshold dividing expansion from contraction of activity.



Source: Markit

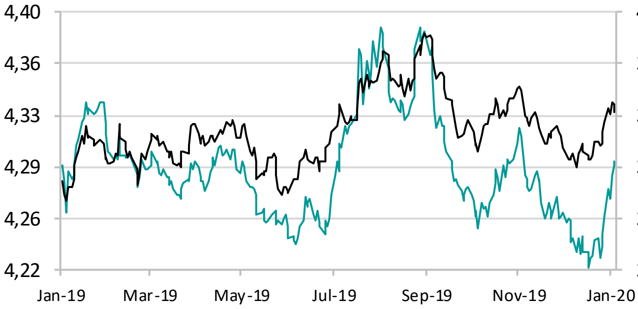
The data structure causes certain concern in the context of growth prospects for the manufacturing activity. The sub-index for employment dropped to 46.5 pts in January from 48.9 pts in December. This means that in January employment in manufacturing recorded the sharpest decline since October 2009. However, it should be pointed out that a significant reduction of jobs took place amid a stabilizing pace of the decrease in new orders and output. In addition, the Expected Production Indicator (in the horizon of 12 months) stood in January at the highest level since May 2019. Thus, the significant reduction of employment can hardly be attributed to the deterioration of the demand outlook. We are therefore proposing a hypothesis that the factor which has partly contributed to the decrease in employment indicated by companies was the sharp increase in the minimum wage with the beginning of 2020 (see MACROmaps of 21/10/2019 and 28/10/2019).

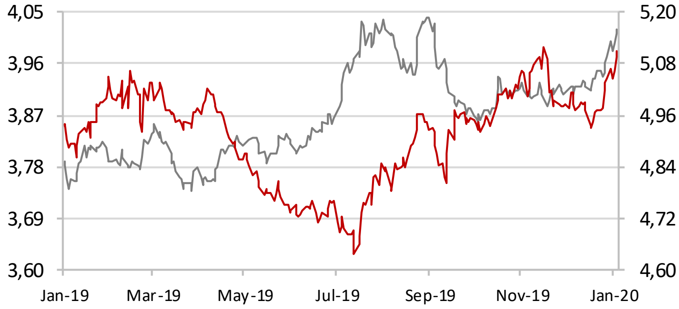
Recent months saw companies clearing their production backlogs amid a decrease in new orders. This was a factor which stabilized current production. In January production backlogs were decreasing at the slowest rate since October 2018, which might signal that the outstanding orders buffer is exhausted and the decline in current production is highly likely to deepen in subsequent months. This scenario is supported by a continuing decline in new export orders that was recorded in January.

Despite improved assessments concerning expected production, we believe that in subsequent quarters the decline in public investments and slowdown in global trade, including in automotive branch, will limit the scale of activity in Polish manufacturing. We will present our revised macroeconomic scenario in the next MACROmap.

Foreign exchange market continues to be impacted by 2019-nCoV epidemic

FX rates





Source: Reuters

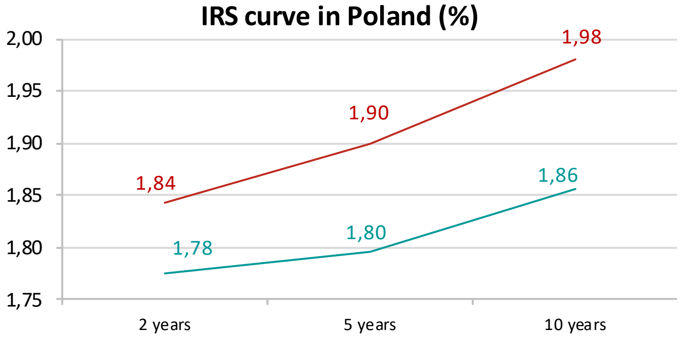
Last week, the EURPLN exchange rate rose to 4.2962 (PLN weakening by 0.9%). Throughout last week, PLN and other emerging currencies were depreciating due to increased global risk aversion resulting from the investors' concerns about the impact of the spreading coronavirus on the global economy. Consequently, EURPLN rose to the highest level since early December 2019. Domestic GDP reading had no substantial impact on the market.

The beginning of the week saw a weak decline in EURUSD. However, the slightly dovish tone of the Wednesday's conference after the FOMC meeting resulted in the trend reversal and USD depreciation vs. EUR. Weaker-than-expected data on GDP for the Eurozone were not market moving.

The business survey results released this morning (Caixin PMI for Chinese manufacturing and Polish manufacturing PMI) are slightly negative for PLN. Crucial for PLN this week will be the publication of data from the US labour market. However our forecast of US employment growth is close to the market consensus and therefore we believe that its materialization will not have any substantial impact on PLN. On the other hand, today's publication of US manufacturing ISM may result in a slight appreciation of PLN. In our view, data on the Chinese balance on trade and the MPC meeting will be neutral for PLN. At the same time, the foreign exchange market can be expected to be impacted by increased risk aversion due to the spread of coronavirus.

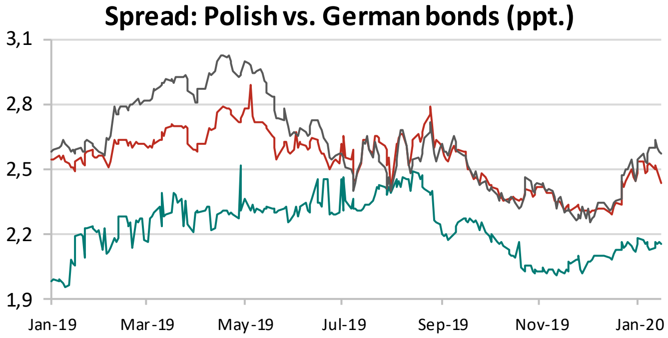
Data from the US labour market crucial for IRS rates

IRS curve in Poland (%)



Source: Reuters

Spread: Polish vs. German bonds (ppt.)



Last week, 2-year IRS rates decreased to 1.84 (down by 6bp), 5-year rates to 2.10 (down by 10bps), and 10-year rates to 1.98 (down by 12bps). Throughout the previous week, a drop in IRS rates was observed across the curve following the core markets. The decrease in IRS rates was supported by growing investors' concerns about the impact of 2019-nCoV epidemic on global economic outlook. The publication of weaker-than-expected domestic data on GDP had no substantial impact on the curve.

Today's results of business surveys for Polish manufacturing are slightly negative for IRS. This week the market will focus on data on non-farm payrolls in the US. However, we do not expect them to have any significant impact on IRS. On the other hand, today's publication of the manufacturing ISM may contribute to a slight decrease in IRS rates. In our view, the MPC meeting will be neutral for the curve. At the same time, IRS rates can be expected to remain impacted by increased risk aversion due to the spread of coronavirus.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	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	Feb-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*	4,26	4,30	4,30	4,28	4,28	4,24	4,29	4,38	4,37	4,26	4,31	4,26	4,30	**4,27**
USDPLN*	3,72	3,79	3,84	3,82	3,83	3,73	3,87	3,98	4,01	3,82	3,91	3,79	3,88	**3,85**
CHFPLN*	3,74	3,79	3,85	3,75	3,83	3,82	3,90	4,02	4,02	3,87	3,91	3,92	4,02	**3,92**
CPI inflation (% YoY)	0,7	1,2	1,7	2,2	2,4	2,6	2,9	2,9	2,6	2,5	2,6	3,4	**4,3**	
Core inflation (% YoY)	0,8	1,0	1,4	1,7	1,7	1,9	2,2	2,2	2,4	2,4	2,6	3,1	**3,3**	
Industrial production (% YoY)	6,0	6,9	5,5	9,2	7,6	-2,6	5,8	-1,5	5,5	3,7	1,5	3,8	**-1,6**	
PPI inflation (% YoY)	2,2	2,9	2,5	2,6	1,4	0,5	0,5	0,9	0,8	-0,3	-0,1	1,0	**1,2**	
Retail sales (% YoY)	6,6	6,5	3,1	13,6	7,3	5,3	7,4	6,0	5,3	5,4	5,9	7,5	**5,9**	
Corporate sector wages (% YoY)	7,5	7,6	5,7	7,1	7,7	5,3	7,4	6,8	6,6	5,9	5,3	6,2	**7,0**	
Employment (% YoY)	2,9	2,9	3,0	2,9	2,7	2,8	2,7	2,6	2,6	2,5	2,6	2,6	**1,8**	
Unemployment rate* (%)	6,1	6,1	5,9	5,6	5,4	5,3	5,2	5,2	5,1	5,0	5,1	5,2	**5,5**	
Current account (M EUR)	2529	-630	217	542	430	-114	-915	-246	962	573	1457	**-571**		
Exports (% YoY EUR)	5,9	10,5	7,8	9,6	11,5	-2,6	5,9	-1,8	13,5	3,8	-1,0	**5,6**		
Imports (% YoY EUR)	2,1	8,4	2,8	8,0	11,1	-5,4	6,9	-3,4	6,4	-0,2	-4,6	**4,1**		

*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	2,9	3,3	3,2	2,7	2,7	4,0	3,0	3,3
Private consumption (% YoY)		3,9	4,4	3,9	3,4	3,4	3,6	3,4	3,0	3,9	3,3	3,0
Gross fixed capital formation (% YoY)		12,2	9,1	4,7	7,2	3,1	1,9	1,5	1,7	7,8	1,9	5,0
Export - constant prices (% YoY)		7,3	3,2	5,0	4,2	4,2	4,1	4,2	4,4	5,1	4,2	5,3
Import - constant prices (% YoY)		6,0	3,1	3,9	4,5	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	1,7	2,1	2,1	2,0	1,5	2,2	1,9	1,7
	Investments (pp)	1,5	1,5	0,8	1,8	0,4	0,3	0,3	0,4	1,4	0,3	0,9
	Net exports (pp)	1,0	0,2	0,8	-0,5	0,5	0,5	0,6	0,8	0,4	0,6	0,6
Current account (% of GDP)***		-0,6	-0,4	0,2	0,6	0,4	0,3	0,2	0,1	0,6	0,1	-0,2
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	FORECAST* CONSENSUS**
		Monday 02/03/2020				
2:45	China	Caixin Manufacturing PMI (pts)	Jan	50,2	51,7	51,3
9:00	**Poland**	**Manufacturing PMI (pts)**	**Jan**	**48,0**	**48,5**	**48,3**
9:55	Germany	Final Manufacturing PMI (pts)	Jan	45,2	45,2	45,2
10:00	Eurozone	Final Manufacturing PMI (pts)	Jan	47,8	47,8	47,8
15:45	USA	Flash Manufacturing PMI (pts)	Jan	51,7		
16:00	USA	ISM Manufacturing PMI (pts)	Jan	47,2	48,5	48,5
		Tuesday 02/04/2020				
11:00	Eurozone	PPI (% YoY)	Dec	-1,4		-0,7
16:00	USA	Factory orders (% MoM)	Dec	-0,7	1,0	1,1
		Wednesday 02/05/2020				
10:00	Eurozone	Services PMI (pts)	Jan	52,2	52,2	52,2
10:00	Eurozone	Final Composite PMI (pts)	Jan	50,9	50,9	50,9
11:00	Eurozone	Retail sales (% MoM)	Dec	1,0		-0,4
14:15	USA	ADP employment report (k)	Jan	202		158
16:00	USA	ISM Non-Manufacturing Index (pts)	Jan	55,0	54,8	55,2
	Poland	**NBP rate decision (%)**	**Feb**	**1,50**	**1,50**	**1,50**
		Thursday 02/06/2020				
8:00	Germany	New industrial orders (% MoM)	Dec	-1,3		0,6
14:30	USA	Initial jobless claims (k)	w/e	216		215
		Friday 02/07/2020				
8:00	Germany	Industrial production (% MoM)	Dec	1,1		-0,2
8:00	Germany	Trade balance (bn EUR)	Dec	18,3		18,2
14:30	USA	Unemployment rate (%)	Jan	3,5	3,5	3,5
14:30	USA	Non-farm payrolls (k MoM)	Jan	145	170	165
16:00	USA	Wholesale inventories (% MoM)	Dec	-0,1		0,1
16:00	USA	Wholesale sales (% MoM)	Dec	1,5		
	China	Trade balance (bn USD)	Jan	46,8	51,0	

*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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