CRÉDIT AGRICOLE

MACRO MAP

Growth of house prices is about to slow down

This week

- **The most important event this week will be the reading of the flash February business sentiment indicators for major European economies scheduled for Friday.** We expect that the Composite PMI in the Eurozone decreased to 50.3 pts in February vs. 51.3 pts in January, thus marking the end of the stabilization of business climate observed in recent months. We believe that the index decrease resulted from the deterioration in Germany and France, due to the negative impact – through so-called supply chains - of the coronavirus outbreak in China on the economic activity within the single currency area. ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany will be released on Tuesday. The market expects that its value dropped to 20.4 pts in February from 26.7 pts in January. Our forecasts of business survey results in the Eurozone are below the consensus; therefore, their materialization will be slightly positive for PLN and the prices of Polish debt.
- **Another important event will be the Minutes of the January FOMC meeting planned to be released on Wednesday.** We believe that the text of the document will not provide any new information compared to the FED chairman's testimony to the Congress last week (see below). We expect it to repeat the view that the current FED monetary policy is adequate to ensure sustained increase in inflation, strong labour market and inflation reaching the target. The document is also likely to point to the coronavirus epidemic as a downside risk to the global economic outlook. We believe that the publication of the Minutes will be neutral for the financial markets.
- **Some important data from the US real estate market will be released this week.** We expect that the data on housing starts (1463k in January vs. 1608k in December), building permits (1434k vs. 1420k), and new home sales (5.45M vs. 5.54M) will signal stabilization of activity in the US real estate market. The publication of US data should not be market moving.
- **The January data on average wages and employment in the corporate sector in Poland will be released on Wednesday**. GUS will make the annual review of the number of people employed in microenterprises (companies employing less than 10 persons), which will result in a significant monthly increase in the number of people working in companies employing at least 10 persons. However the scale of the review is likely to be smaller from 2019. Consequently, we forecast that employment dynamics dropped to 1.8% YoY from 2.6% in December 2019. In turn, the average wage dynamics rose to 7.0% YoY in January vs. 6.2% in December, i.a. due to the increase of the minimum wage. Though important for the forecast of private consumption dynamics in Q1, the release of data on corporate wages and employment will be neutral for PLN and the debt market, we believe.
- **Data on the January industrial production in Poland will be released on Thursday.** We forecast that industrial production dynamics dropped to -1.6% YoY vs. 3.8% in December. Conducive to lower Industrial production dynamics were unfavourable calendar effects and the last year's high base effect. Our forecast is supported by the poor reading of Poland manufacturing PMI released at the beginning of the month. Our forecast of industrial production dynamics is lower from the market consensus (-0.1%); therefore, its materialization will be negative for PLN and yields on Polish bonds.
- **On Friday we will see the data on retail sales dynamics in Poland, which, in our view, dropped to 5.9% YoY in January vs. 7.5% in January**. Their decrease resulted from last year's high base effect, unfavourable difference in the number of working days, and deterioration of consumer sentiment. We believe that the materialization of our forecast, that is lower from the consensus (6.6%), will be slightly negative for PLN and yields on Polish bonds.

Last week

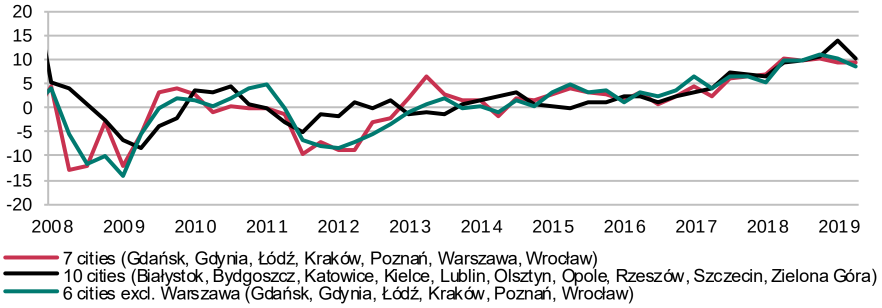
- **CPI inflation in Poland rose to 4.4% YoY in January vs. 3.4% in December 2019, running above the market consensus (4.1%) and slightly above our forecast (4.3%).** Thus, inflation has reached the highest level since December 2011 and exceeded the upper limit of band for deviations from the NBP inflation target. The data on January inflation are incomplete and of a preliminary nature due to the annual revision of weights in the inflation basket, which limits the possibility of drawing conclusions of their basis. Full data on the price increases in the respective categories in January and February 2020, including revised rate of inflation in January, will be published in March. According to the incomplete data published by GUS, conducive to the increase in inflation in January were higher dynamics of prices in the categories “food, non-alcoholic and alcoholic beverages and tobacco products”, “housing”, and “transport” (see MACROpulse of 14/2/2020). On the basis of the incomplete GUS data we estimate that core inflation continues to stay above 3.0% YoY. We believe that inflation will reach its local maximum at 4.2% YoY in Q1 2020, although last week’s data pose a slight risk to this forecast. We expect that inflation will be showing a weak downward trend in subsequent quarters, due to the forecasted by us decrease in the dynamics of the prices of food and non-alcoholic beverages and fuels as well as decreasing core inflation (see MACROmap of 10/2/2020). We forecast that in the whole 2020 inflation will amount to 3.2% YoY vs. 2.3% in 2019. Especially noteworthy in the context of the inflation reading are the last week’s remarks of MPC member G. Ancyparowicz, who said that interest rate hikes would have currently been a mistake and inflation would soon return near the upper target deviation limit, namely 3.5%. She emphasized at the same time that in further perspective interest rate hikes could have supported GDP growth in Poland. G. Ancyparowicz’s remark has not met with a market reaction. At the same time it is consistent with our scenario, in which NBP interest rates will remain at an unchanged level at least until the end of 2021.
- **The economic growth rate in Poland dropped to 3.1% YoY in Q4 2019 vs. 3.9% YoY in Q3**. It was thus running above the dynamics implied on the basis of the GDP data for the whole 2019 (2.9%, see MACROpulse of 29/1/2020). Seasonally adjusted quarterly GDP dynamics decreased to 0.2% in Q3 vs. 1.2% in Q2. The data published by GUS are a flash estimate and full data on GDP including information about its structure will be released towards the end of the month. The higher-than-we-expected dynamics in Q4 pose a slight upside risk to our forecast of economic growth in 2020 (2.7%). A more precise assessment of this risk will be possible after seeing the final data on GDP structure.
- **The surplus in the Polish current account surplus dropped to EUR 990M in December vs. EUR 1564M in November**. The decrease in the current account balance resulted from lower balance on trade, services, and secondary income (lower from November by EUR 669M, EUR 318M, and EUR 73M, respectively) while higher balance on primary income (up by EUR 486M) had opposite impact. Export dynamics rose to 10.6% YoY in December vs. -0.2% in November, while import growth rate rose to 0.8% vs. - 4.1%, largely due the statistical effect in the form of a favourable difference in the number of working days. We estimate that the cumulative current account balance for the last 4 quarters in relation to GDP has increased to 1.1% in Q4 vs. 0.2% in Q3, reaching the highest level in the history of the series. The record current account balance for the last 4 quarters in relation to GDP results from weakening imports (the effect of decelerating investments) and growing exports (mainly due to higher exports of services). The data pose a substantial upside risk to our forecast, in which the aforementioned relation will decrease to 0.1% at the end of 2020.
- **Flash data on GDP for major European economies were released last week.** Quarterly GDP dynamics in the Eurozone dropped to 0.1% in Q4 vs. 0.3% in Q3 (0.9% YoY in Q4 vs. 1.2% in Q3). Slower GDP growth rate within the single currency area resulted from lower GDP dynamics i.a.

in Germany (0.0% QoQ in Q4 vs. 0.2% in Q3), France (-0.1% vs. 0.3%), and Italy (-0.3% vs. 0.1%), while higher GDP dynamics i.a. in Spain (0.5% vs. 0.4%) had opposite impact. Detailed data including GDP structure will be released on 10 March. We forecast that that the GDP growth in the single currency area will not change compared to Q4 and will amount to 0.1% QoQ.

- **Last week, the FED Chairman, J. Powell, presented the half-yearly monetary policy report to the Congress**. As expected, he repeated in his statement that the Federal Reserve was closely following the risks of the coronavirus spread in China to the US economy. He said that the US economy will feel the consequences of the epidemic but it was too early to estimate the scale of this impact. At the same time J. Powell indicated that only a significant deterioration of the US economic outlook would have met with Federal Reserve's reaction in the form of adjustment of monetary policy parameters. J. Powell stated at the same time that if further monetary easing was necessary, FED was not considering the reduction of interest rates below zero but planned to use the tools it had used so far, thus suggesting a possible launch of a quantitative easing program. 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 in the US.
- **Last week we saw important data from the US economy.** CPI inflation rose to 2.5% YoY in January vs. 2.3% in December, running in line with market expectations. The main source of the increase in inflation in January was a higher growth rate of energy prices. Core inflation has not changed compared to December and amounted to 2.3%. Last week we also saw data on industrial production whose monthly dynamics rose to -0.3% vs. -0.4% in December. Conducive to their increase were higher output dynamics in utilities, while their decrease in manufacturing and mining had opposite impact. Capacity utilization decreased to 76.8% in January vs. 77.1% in December. Last week we also saw data on retail sales which increased by 0.3% MoM in January vs. a 0.2% increase in December. Excluding cars, the monthly retail sales dynamics dropped to 0.3% MoM in January vs. 0.6% in December. The preliminary University of Michigan Index was also released last week and rose to 100.9 pts in February vs. 99.8 pts in January, hitting the highest level since March 2018. The index increase resulted from higher sub-index for expectations while lower sub-index for the assessment of current situation had opposite impact. We forecast that the annualized US GDP growth rate will decrease to 1.6% in Q1 vs. 2.1% in Q4.
- **We have revised our forecast of EURUSD**. We now expect that EURUSD will amount to 1.13 at the end of 2020 and to 1.11 at the end of 2021. The main argument in favour of the expected EURUSD increase is the fact that its value is now below the so-called fair value (calculated based on fundamental factors). However, we have reduced the scale of the appreciation of EUR vs USD expected in the coming months, due to the deterioration of the economic outlook for the Eurozone. Assuming that D. Trump will win the presidential election in the US, 2021 may see a rebound of protectionism in global trade and increase in global risk aversion, which will support the appreciation of USD.

Growth of house prices is about to slow down

Average house transaction price in the primary market (% YoY)



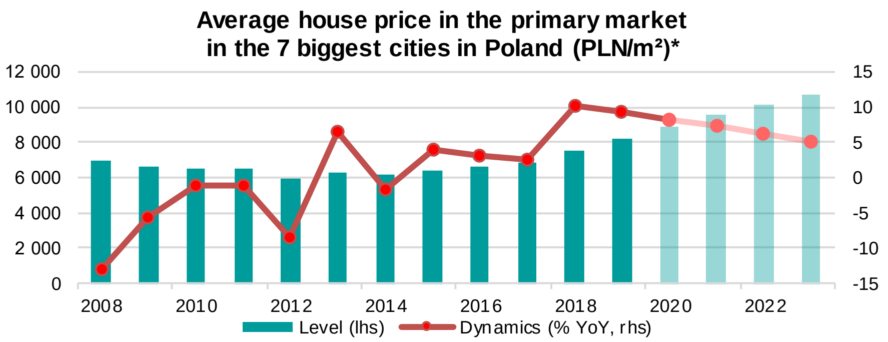
Source: NBP, Credit Agricole

The issue of the fast growth of real estate prices has been raised increasingly often in economic discourse in recent months. According to NBP data, the dynamics of transaction prices in the primary market have since Q4 2018 stayed at a level of ca. 10% YoY and been the highest since 2008 (see the chart). Many topics for discussion appear simultaneously in this context – i.a. impact of so-called investment purchases (for later rent) on the rise in prices, decreasing availability of dwellings for households (i.e. increasing house prices to wages ratio), growing households' expectations of further rises, as well as concerns about excessive rise in prices fuelled by speculative purchases that might lead to so-called price bubble. Below we present our forecast of dwelling prices in medium-term perspective.

Our analysis is based on NBP data on transaction prices of dwellings in the primary market averaged for the seven largest cities in Poland (Gdańsk, Gdynia, Łódź, Kraków, Poznań, Warsaw, and Wrocław). To prepare the forecast we have used an econometric model, in which the annual dynamics of dwelling prices depends on three variables:

- **Unemployment rate according to LFS,** which in the model represents the impact of changes in the households' housing demand on the profile of dwelling prices. The unemployment rate permits to simultaneously grasp many factors which determine the housing demand from the perspective of the situation in the labour market (changes in salaries, creditworthiness, concerns about loss of work, etc.). This variable has been used in the model with a one quarter lead, which means that it is the expectations concerning changes in the labour market (and thus the households' financial standing) that are very important in the context of the decision to buy a flat.
- **Value of cash purchases of dwellings**, which represents the impact of so-called investment demand (long-term investment of capital) on dwelling prices. We have used here the annual dynamics of the NBP-estimated cash demand for the purchase of developer dwellings in the aforementioned seven cities.
- **Households' expectations of the rise in dwelling prices.** According to the results of "The ING Financial Barometer" survey, more and more people believe that the prices of dwellings never fall. In the 2014-2018 period this opinion was shared by 34-38% of survey participants, while in the 2018-2019 period the percentage of those who gave a yes answer stood at ca. 50%. This variable reflects not only the Poles' propensity to buy a flat fearing further rise in prices but it is also supposed to reflect changes in the speculative demand (purchase of dwellings by short-term investors).

This model explains well the changes in transaction prices in the primary housing market (the model's data match amounts to ca. 80%). In order to prepare a forecast of dwelling prices we had to accept several assumptions concerning the evolution of the explanatory variables in the coming years. We expect that the unemployment rate will be showing a weak upward trend in the next few years (it will increase by 0.3 pp until the end of 2021 and by 1 pp until the end of 2023). This tendency will result i.a. from the expected by us slowdown of economic growth related to the cycle of the absorption of EU funds and the forecast by us decrease in employment (partly due to the sharp increase in the minimum wage). Amid deteriorating macroeconomic situation and decreasing level of savings, the growth of cash demand for dwellings can hardly be expected to stay at a two-digit rate. On the other hand, interest rates will remain unchanged in the coming years, which will support investments in dwellings as an alternative to low-interest-bearing bank deposits. To adopt the assumption that less and less Poles will expect that the "prices of dwellings never fall" will be consistent with the assumption of a decelerating demand of both households and long-term investors. Our forecast assumes that the percentage of survey participants who agree with this thesis will decrease to 40% in the horizon of 2023.

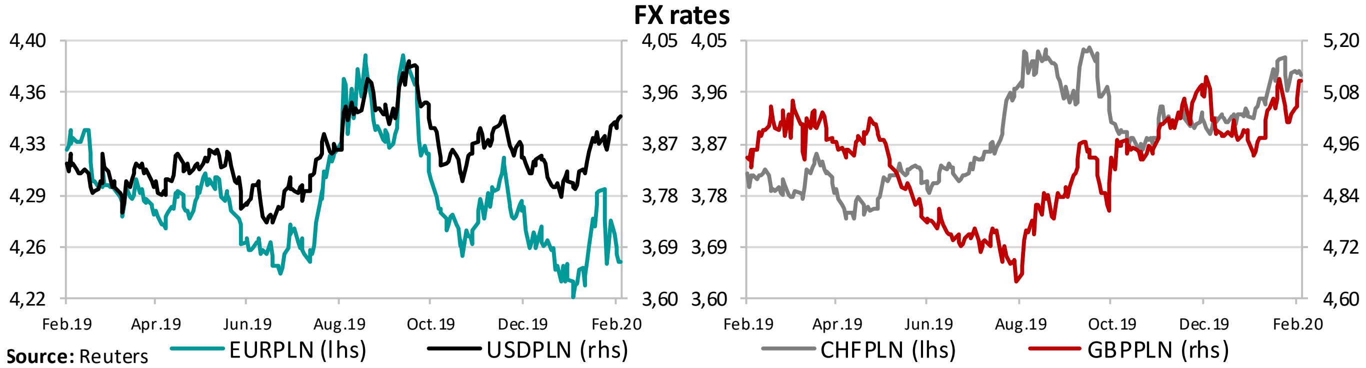


Source: NBP, Credit Agricole *forecast beyond 2019

In accordance with the above assumptions, we forecast that the growth rate of dwelling prices in the primary market will drop to 8.4% YoY in 2020 and in subsequent years will be showing a downward trend to reach a level of 5.0% in 2023. This means that the average transaction price in the aforementioned seven cities will increase from PLN 8.2k in Q4 2019 to PLN 10.7 at the end of 2023 (see the chart). It should be pointed out that this forecast is conditional and depends on the materialization of the scenario outlined above for the explanatory variables. The expected further albeit slower rise in dwelling prices will be supported not only by sustained demand but also by a limited supply of new dwellings due to developers' difficulties in acquiring new land for investments.

We see an upside risk to our forecast if the households' expectations of further rise in dwelling prices do not start to subside or if the macroeconomic situation proves better than expected. We also see a risk related to the growing popularity of so-called flipping, namely short-term investments consisting in buying flats for renovation and their quick re-sale at a profit. However, such activities focus on the secondary market and in our model such transactions are reflected by the variable representing "cash demand". In addition, it is worth pointing out that historically prices in the primary market were a leading indicator to prices of dwellings in the secondary market. That is why we expect that the slowdown in the price growth expected by us in the horizon of several years will materialize in both segments of the housing market.

Flash PMIs in the Eurozone may strengthen PLN



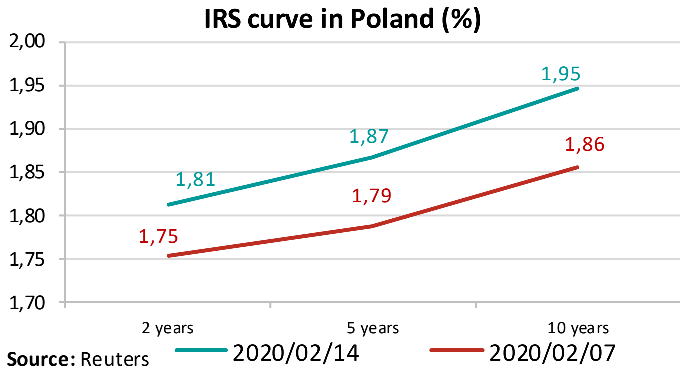
Source: Reuters

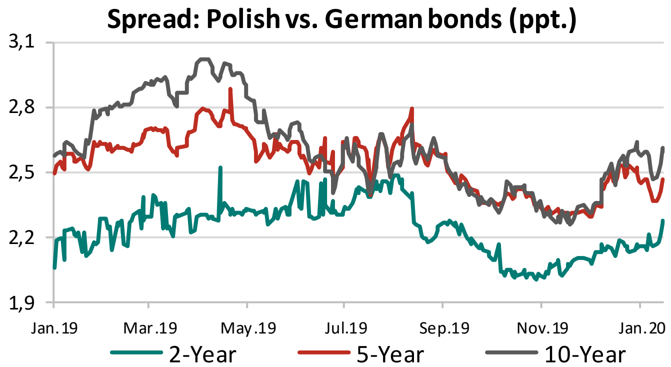
Last week, the EURPLN exchange rate dropped to 4.2457 (strengthening of PLN by 0.7%). Throughout last week we saw a slight strengthening of PLN, due to a decrease in the global risk aversion, reflected by lower VIX index. Higher demand for risk assets was supported by lower uncertainty about the coronavirus epidemic, pointing to a decreasing pace at which it was spreading. Domestic higher-than-expected data on inflation and GDP had no substantial impact on PLN.

Last week also saw further a weakening of EUR vs. USD. Lower EURUSD is supported by investors' concerns about the prospects of economic growth within the single currency area. For the same reason EUR was also depreciating vs. CHF and GBP.

Crucial for PLN this week will be the publication of flash PMIs for major Eurozone economies. We believe that if our lower-from-the-consensus forecasts materialize, the data may contribute towards PLN strengthening. On the other hand, domestic data on industrial production and retail sales may be negative for PLN. Other data from Poland (employment and average wages in the corporate sector) and the US (number of housing starts, building permits, and existing home sales) should not have any substantial impact on PLN. The FOMC Minutes are also likely to be neutral for PLN. Positive for PLN this week may be the incoming media reports pointing to a slowdown in the spread of coronavirus.

Business survey results in the Eurozone crucial for the market





Source: Reuters

Last week, 2-year IRS rates increased to 1.81 (up by 6bp), 5-year rates to 1.87 (up by 8bp), and 10-year rates to 1.95 (up by 9bp). The first part of the week saw an increase in IRS rates following core markets, largely due to a decrease in the global risk aversion related to the coronavirus epidemic. However, an upward revision of the number of cases resulting from the changed method of their calculation announced in China has led to a partial correction. Further into the week, IRS rates increase was supported by the incoming regional data pointing to a higher-than-expected inflation. On Friday after the publication of domestic data on inflation and GDP, there was a correction and IRS rates decreased because some investors decided to realize profits.

This week the market will focus on the publication of flash PMIs for major Eurozone economies, which, in our view, may contribute towards a decrease in IRS rates. The publication of domestic data on industrial production and retail sales may have similar impact. Other data from Poland (employment and average wages in the corporate sector) and the US (number of housing starts, building permits, and existing home sales) will be neutral for IRS rates, we believe. In our view, the FOMC Minutes release scheduled for Wednesday should not have any substantial impact on IRS rates. An increase in IRS rates this week may be supported by the incoming media reports pointing to a slowdown in 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	3,87	**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	**3,97**
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	4,4	
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	1564	990		
Exports (% YoY EUR)	5,9	10,5	7,8	9,6	11,5	-2,6	5,9	-1,8	13,5	3,8	-0,2	10,6		
Imports (% YoY EUR)	2,1	8,4	2,8	8,0	11,1	-5,4	6,9	-3,4	6,4	-0,2	-4,1	0,8		

*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	3,1	3,0	2,9	2,7	2,4	4,0	2,7	3,3
Private consumption (% YoY)		3,9	4,4	3,9	3,4	3,4	3,3	3,1	3,0	3,9	3,2	2,8
Gross fixed capital formation (% YoY)		12,2	9,1	4,7	7,2	3,9	2,2	0,8	-1,8	7,8	0,7	3,5
Export - constant prices (% YoY)		7,3	3,2	5,0	4,0	3,5	3,6	4,2	4,4	4,8	3,9	5,0
Import - constant prices (% YoY)		6,0	3,1	3,9	5,2	3,8	3,4	2,9	2,3	4,5	3,1	4,0
GDP growth contributions	Private consumption (pp)	2,5	2,5	2,2	1,7	2,1	1,9	1,8	1,5	2,2	1,8	1,6
	Investments (pp)	1,5	1,5	0,8	1,8	0,5	0,4	0,1	-0,5	1,4	0,1	0,6
	Net exports (pp)	1,0	0,2	0,8	-0,5	0,0	0,3	0,8	1,2	0,4	0,6	0,8
Current account (% of GDP)***		-0,6	-0,4	0,2	1,1	0,4	0,3	0,2	0,1	1,1	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	6,9	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	3,4	2,8	2,5	2,3	3,2	1,6
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	3,90	3,83	3,76	3,80	3,79	3,80	3,83

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST* CA	FORECAST* CONSENSUS**
		Tuesday 02/18/2020				
11:00	Germany	ZEW Economic Sentiment (pts)	Feb	26,7		21,2
14:30	USA	NY Fed Manufacturing Index (pts)	Feb	4,8		5,0
		Wednesday 02/19/2020				
10:00	Eurozone	Current account (bn EUR)	Dec	33,9		
10:00	**Poland**	**Employment (% YoY)**	**Jan**	**2,6**	**1,8**	**2,0**
10:00	**Poland**	**Corporate sector wages (% YoY)**	**Jan**	**6,2**	**7,0**	**6,7**
14:30	USA	Housing starts (k MoM)	Jan	1608	1463	1434
14:30	USA	Building permits (k)	Jan	1420	1434	1447
20:00	USA	FOMC Minutes	Jan			
		Thursday 02/20/2020				
10:00	**Poland**	**Industrial production (% YoY)**	**Jan**	**3,8**	**-1,6**	**-0,1**
10:00	**Poland**	**PPI (% YoY)**	**Jan**	**1,0**	**1,2**	**0,8**
14:00	**Poland**	**MPC Minutes**	**Feb**			
14:30	USA	Philadelphia Fed Index (pts)	Feb	17,0		12,0
16:00	Eurozone	Consumer Confidence Index (pts)	Feb	-8,1		-8,0
		Friday 02/21/2020				
9:30	Germany	Flash Manufacturing PMI (pts)	Feb	45,3	44,8	44,8
10:00	**Poland**	**Retail sales (% YoY)**	**Jan**	**7,5**	**5,9**	**6,6**
10:00	Eurozone	Flash Services PMI (pts)	Feb	52,5	51,8	52,2
10:00	Eurozone	Flash Manufacturing PMI (pts)	Feb	47,9	46,0	47,5
10:00	Eurozone	Flash Composite PMI (pts)	Feb	51,3	50,3	51,0
11:00	Eurozone	HICP (% YoY)	Jan	1,4	1,4	1,4
15:45	USA	Flash Manufacturing PMI (pts)	Feb	51,9		51,4
16:00	USA	Existing home sales (M MoM)	Jan	5,54	5,45	5,48

*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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