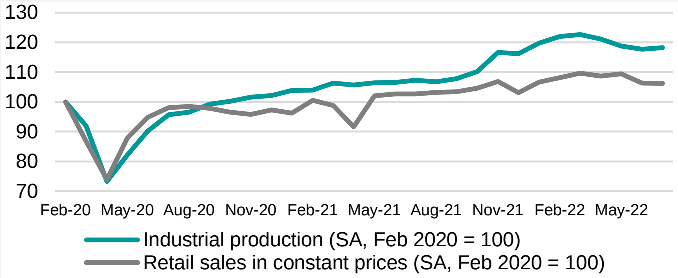
Agri-food sector makes money from cost shock

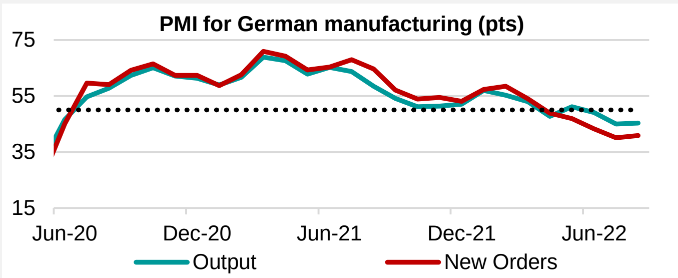
This week

- **The key event this week will the FOMC meeting planned for Wednesday.** We expect the Fed to go ahead with a 75bp rate hike, thus raising the target range for federal funds to [3.00%, 3.25%]. We believe that a rate hike of this size will be the Fed's response to higher than expected CPI inflation figures released last week (see below). The Fed will also release the latest economic projections by FOMC members. The market will focus on the FOMC members' median projection for US interest rates. We believe it will be higher than the June projection, indicating that the rate hike cycle will end in 2023 with the target range for federal funds at [4.25%, 4.50%], slightly above our revised scenario (see below). Our 75bp rate hike projection is in line with consensus, thus, if it proves correct, we do not expect it to have any material impact on the prices of assets. However the press conference following the FOMC meeting may add to volatility in financial markets.
- **Poland's industrial production figures for August will be released on Tuesday.** We forecast that growth in industrial production picked up to 11.5% YoY from 7.6% in July. Factors that account for acceleration in industrial production growth include favourable calendar effects and shifts in holiday breaks in the automotive industry. Our industrial production growth forecast is above market consensus (9.9%), and thus its materialization would be slightly positive for the PLN and yields on Polish bonds.



Source: GUS, Credit Agricole

- **Tuesday will also see the release of data on employment and average wages in Poland's business sector for August.** We forecast that growth in employment picked up to 2.5% YoY from 2.3% in July, as signalled earlier by business survey figures. At the same time, we expect average wage growth to have dropped to 13.8% YoY in August from 15.8% in July as a result of the absence of the effects of July bonus payments in, among others, mining, forestry, and the energy sector (see MACROpulse of 19/08/2022). We believe that the publication of data on employment and average wages in the business sector will be neutral for the PLN and the debt market.
- **Poland's retail sales figures will be released on Wednesday.** We expect that growth in retail sales dropped to 18.2% YoY in August from 18.4% in July. The drop in nominal sales growth was driven by falling fuel prices. Our retail sales growth forecast is below market consensus (20.0%), thus, its materialization may be slightly negative for the PLN and yields on Polish bonds.
- **Friday will see the publication of preliminary business survey results for key Eurozone economies**. The market expects a drop in the Eurozone's composite PMI to 48.2 pts in September from 48.9 pts in August. Further deterioration in the Eurozone's economy is driven by the global economy slowdown and by growing uncertainty due to soaring energy prices. Investors also expect a further drop in German manufacturing PMI, to 48.3 pts in September from 49.1 pts in August. The key information in the PMI report will be businesses' assessment of the gas shock impact on their operations. We believe that the release of Eurozone business survey results will be neutral for financial markets.

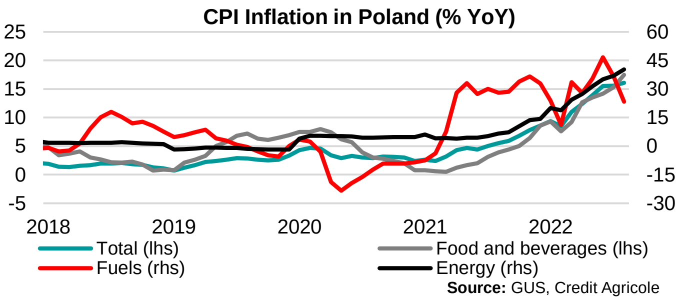


Source: Markit, Credit Agricole

- **Some important data from the US will be released this week.** We expect data on housing starts (1450k in August vs. 1446k in July), new building permits (1601k vs. 1685k) and existing home sales (4.67M vs. 4.81M) to confirm that the slowdown in the US hosing market seen in recent quarters continues. We believe that the publication of US data should not have a significant impact on financial markets.

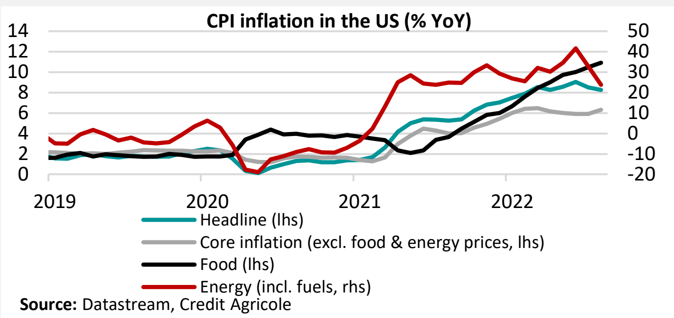
Last week

- **CPI inflation in Poland rose to 16,1% 16.1 YoY in August from 15.6, running in line with GUS's flash estimate.** Thus, inflation hit its highest level since March 1997, and had continued to run well above the upper band for deviations from the NBP's inflation target (3.5% YoY) for 17 months. The rise in inflation was driven by higher rises in the prices of food and non-alcoholic beverages (17.5% YoY in August vs. 15.3% in July), energy prices (40.3% vs. 37.0%), and by a rise in core inflation, which stood at 9.9% YoY in August vs. 9.3% in July (see MACROpulse of 15/09/2022). The rise was partially offset by a drop in fuel price growth, which fell to 23.3% from 36.8%. Last week's data is in line with our forecast that inflation will peak at 17.5% YoY in October and will continue to run above 16% until February 2023 (see MACROmap of 05/09/2022). We expect that incoming data, showing a deepening economic slowdown amidst persistently high inflation, will prompt the MPC to go ahead with one more interest rate hike, of 25bp, in October, which will end the monetary policy tightening cycle in Poland. However, we do not exclude the possibility of a scenario where the MPC pauses its interest rate hike cycle for a month, and then raises rates by 25bp in November instead of October (see MACROmap of 12/09/2022).



Source: GUS, Credit Agricole

- **Poland's current account balance fell to EUR -1,735m in July from EUR -1,468m in June, running above market expectations (EUR -1,850m) and our forecast (EUR -2,229m).** Thus, it was the 14th month in a row with Poland's current account deficit. The decline in the current account balance is accounted for by lower balances of trade in goods and in services (down by EUR 600m and EUR 276m, respectively, from June) partially offset by higher primary and secondary income balances (up by EUR 104m and EUR 508m, respectively, from June). At the same time, slower growth was seen both in exports (19.9% YoY in July vs. 25.8% in June) and in imports (23.5% vs. 31.5%), which to a large extent is accounted for by unfavourable calendar effects and a slowdown in global trade. The July figures are in line with our forecast showing that the cumulative current account balance for the last four quarters as a percentage of GDP will not change between Q2 and Q3 and will stand at -3.9% in Q3.
- **CPI inflation in the US dropped to 8.3% YoY in August from 8.5% in July, running above market expectations (8.1%).** The drop in inflation was largely driven by slower growth in food and energy prices. The drop was partially offset by soaring food prices and a rise in core inflation, to 6.3% YoY in August from 5.9% in July, above market expectations (6.1%). Thus, the data shows that the strong inflationary pressure in the US economy continues. Consequently, we have revised our US monetary policy



Source: Datastream, Credit Agricole

scenario. Currently, we expect the Fed to raise interest rates by 75bp at its September meeting (previously we expected a 50bp hike). We expect a 50bp hike in November, a 25bp hike in December, and another 25bp hike in Q1 2023, which will be the end of the rate hike cycle. Thus, at the end of Q1 the target range for federal funds will be [4.00%, 4.25%]. Our new scenario expects a bigger interest rate disparity between the US and the Eurozone, which poses a risk to our forecast that the EURUSD rate will go up to 1.02 at the end of 2022.

- **Important data from the US was released last week.** Monthly industrial production growth decelerated to -0.2% in August from 0.5% in July, running below market expectations (0.2%). The decline in industrial production growth was due to lower production growth in all its main categories: manufacturing, mining and utilities. The usage of production capacities dropped to 80.0% in August vs. 80.2% in July. Data on retail sales was also released last week. It showed that its monthly nominal growth rate increased to 0.3% in August from -0.4% in July, running clearly above the market expectations (0.0%). Monthly growth of sales excluding cars dropped to -0.3% in August vs. 0.0% in July. Last week also saw the release of business survey results. The regional NY Empire State index (-1.5 pts in September vs. -31.3 pts in August) and the Philadelphia Fed (-9.9 pts vs. 6.2 pts) provided mixed signals from US manufacturing. On the other hand, the preliminary University of Michigan Index signalled a slight improvement of consumer sentiment, going up to 59.5 pts in September vs. 58.2 pts in August and running slightly above market consensus (60.0%). The increase in the index was due to higher index components for both the assessment of the current situation and expectations. Last week's data from the US economy supports our forecast that US GDP will expand by 1.7% in 2022 vs. 5.7% growth in 2021, and will grow by 0.5% in 2023 (see MACROmap of 12 September 2022).
- **Important data from China was released last week.** Data on industrial production (4.2% YoY in August vs. 3.8% in July), retail sales (5.4% vs. 2.7%), and urban investment (5.8% vs. 5.7%) show that growth in activity picked up markedly. At the same time, they were above market expectations (4.0%, 3.9% and 5.7% respectively). It is worth noting, however, that an important factor influencing the recorded increase in activity in the Chinese economy in August were the effects of a low base from a year ago, so it is still too early to interpret them as a signal of recovery. Therefore, taking into account the negative impact of the administrative restrictions related to the pandemic on economic activity in China, the disruptions in electricity supply recorded in the summer, as well as the persistently low activity in the Chinese property market (despite active state policy) as a result of a reduction in both demand and supply, we forecast that China's GDP growth will slow down to 3.0% (3.4% before revision) vs. 8.1% in 2021, and will reach 5.3% (unchanged) in 2023. As a result, we believe that China's economic growth target for 2022, which has been set at around 5.5%, will be difficult to achieve even under the active economic policies pursued by the Chinese government.

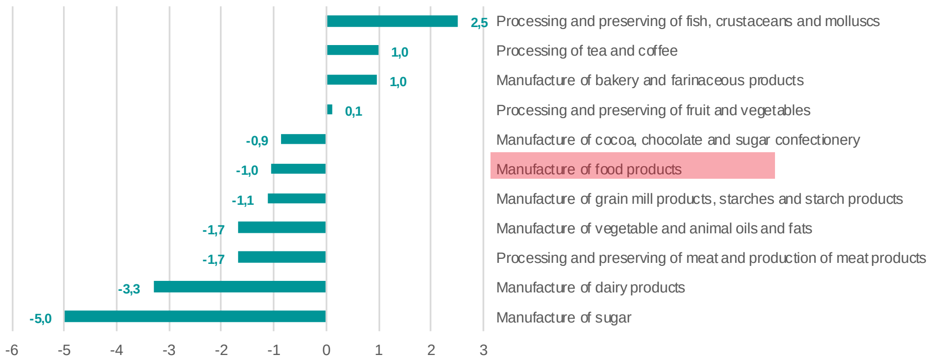
Agri-food sector makes money from cost shock

In recent quarters, the agri-food sector has been facing intensifying cost pressures from rising prices of agricultural commodities and materials, energy, labour and interest costs on loans. The subject of the following analysis is to assess how the various sections of the Polish agri-food industry are coping with the strong increase in the costs of their activities. The extent to which firms in the agri-food sector manage to pass on rising costs down the chain carries valuable information from the point of view of the path of food prices in Poland and, consequently, the further development of inflation.

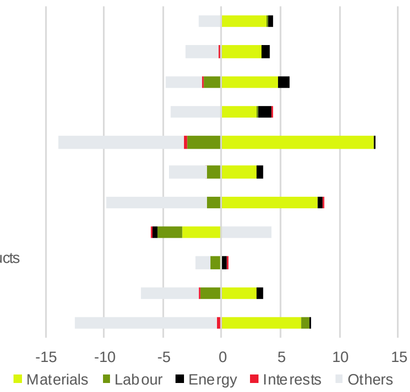
The cost pressures currently faced by agri-food businesses are mainly in four areas: materials, energy, labour and costs of interest on loans. Higher costs of materials are due not only to the recent strong increase in the prices of agricultural raw materials, but also to higher prices for packaging and chemicals used in production, the increase in which is the result of supply barriers related to, among other things, the gas crisis. Rising energy prices are linked to strong increases in the prices of energy commodities, as well as the prices of CO2 emission allowances. Increasing labour costs are driven by rising wage pressures in the Polish economy, which are supported by strong inflation growth amid a persistently tight labour market. Higher interest costs on loans, on the other hand, are the result of the cycle of interest rate hikes started by the MPC in October 2021.

Consequently, in our analysis, we used data from PONT Info for businesses with at least 10 employees, decomposing the increase in the share of total costs in revenues in individual sections of the agri-food industry, broken down into five areas: materials, energy, labour, costs of interest on loans and other. We have taken the average financial data of the analysed sections for the period 2015-2019 as a benchmark, so as to avoid the distorting effect of the COVID-19 pandemic on the results of our analysis. The interpretation of the results obtained is as follows: if the share of total costs in revenue remains unchanged or decreases, this means that businesses manage to pass on rising costs down the supply chain, including at the very end consumers. On the other hand, an increase in the share of total costs in revenue is tantamount to businesses being forced to reduce their margins amid limited opportunities to pass on rising costs down the supply chain.

Change in share of total costs in total revenues in major sections of agri-food industry (pp., H1 2022 vs. average for H1 in 2015-2019)



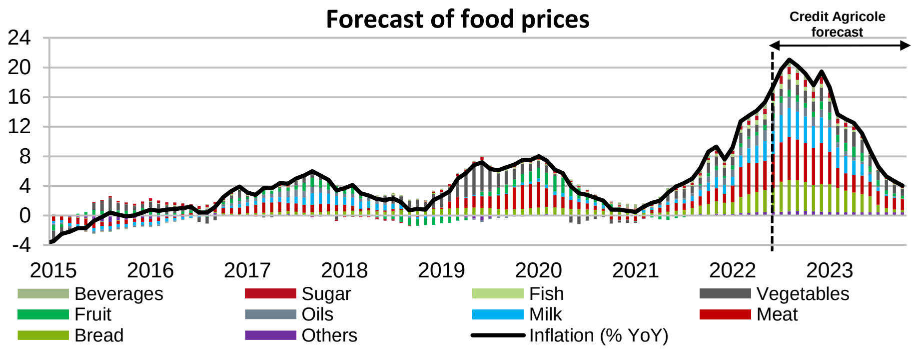
Breakdown of change in share of total costs in total revenues (pp.)



Source: PONT Info, Credit Agricole

The data shows that as many as six of the 10 individual sections analysed have managed to reduce the share of total costs in revenue. This means that they have more than passed on rising costs down the supply chain, thus increasing their margins. Interestingly, this observation is also true for aggregated data for food processing as a whole. The best situation is in the 'manufacture of sugar, 'manufacture of dairy products' and ‘processing and preserving meat and production of meat products' sections. In contrast, the strongest increases in the share of total costs in revenue were seen in the 'processing and preserving fish, crustaceans and molluscs', 'processing of tea and coffee’ and 'manufacture of bakery and farinaceous products’ sections, which means that in these categories, cost shocks are forcing businesses to cut margins. At the same time, an analysis of the cost structure shows that the biggest problem business are currently facing is primarily the rising cost of materials and, to a lesser extent, energy. It is worth noting that costs of labour and interest tend to increase more slowly than revenues and, as a consequence, their share of revenues decreases. Thus, contrary to popular opinion, these are not currently cost categories that significantly determine the change in profitability of businesses in the agri-food industry.

Analysis of the data leads to the conclusion that sections producing basic foodstuffs with relatively low price elasticity of demand, such as sugar, dairy products, meat, oils and fats or flour, have been able to more than pass on rising costs down the supply chain. The exception to this is the 'manufacture of bakery and farinaceous products' section, where there was a moderate increase in the share of total costs in revenue. Analysis of the data at a higher level of detail shows that bakeries and pastry shops had the greatest problem in passing on rising costs down the supply chain, while pasta manufacturers significantly reduced the share of total costs in revenue. The market for bakery and pastry products is characterised by a much lower level of concentration than the pasta market. Thus, the data suggests that the lower the market concentration, and consequently the higher the competition and weaker the bargaining position of the market players, the more difficult it is for businesses to raise the prices of their products.

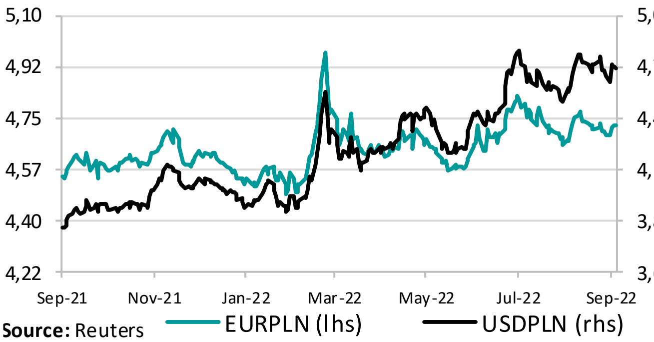


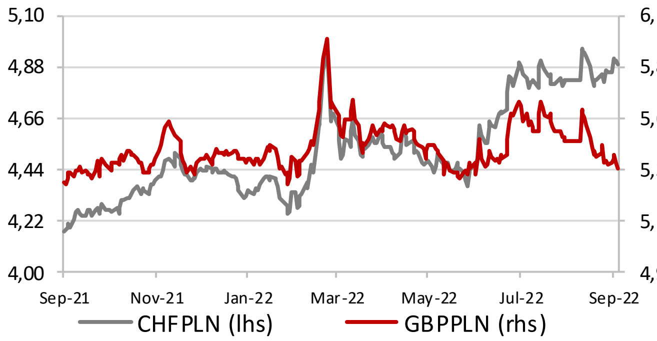
Source: Credit Agricole

We believe that high cost pressure will continue in the coming quarters. This will be primarily due to further increase in energy prices that we expect. We also see a risk of an increase in the price of inputs used in the agri-food industry, whose production depends on the availability of gas. On the other hand, the decline in the prices of basic agricultural commodities, which we expect (see AGROmap of 19/09/2022), will have an opposite effect. Consequently, we believe that the next few months will see further increases in food and soft drinks prices as a result of agri-food businesses passing on rising production costs down the supply chain. This is consistent with our scenario that food price growth will reach its local maximum in October 2022, exceeding 20% YoY, after which it will follow a mild downward trend, assuming that the anti-inflation shield is maintained until the end of 2023. As a result, total inflation will increase to 14.2% YoY in 2022, compared to 5.1% in 2021, and then fall to 9.0% in 2023. The main upward risk factor for our forecast is the risk of gas shortages in Europe in the coming months. The materialisation of this risk will act to increase food prices through higher prices for fertilisers and chemicals used in food processing and, in an extreme scenario, their limited availability.

Domestic data on production and retail sales of key importance for the PLN

FX rates





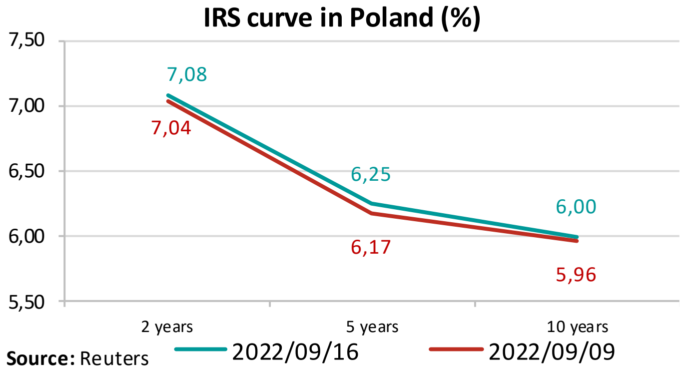
Source: Reuters

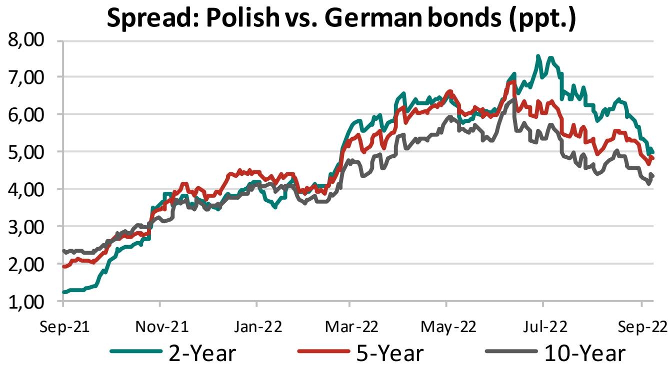
Last week, the EURPLN rate increased to 4.7234 (the PLN weakened by 0.6%). Last week saw a weakening of the PLN as a result of increased global risk aversion, reflected in the rise of the VIX index. The source of the deterioration in market sentiment was the publication of higher-than-market-consensus US inflation data, which raised expectations among some investors for a larger scale of interest rate hikes by the Fed.

The publication of the aforementioned US inflation data last week also contributed to a strengthening of the USD against the EUR. Given our revised Fed monetary policy scenario of greater interest rate disparity between the US and the Eurozone, we see downside risk to our scenario of a mild rise in EURUSD in the coming months to 1.02 by the end of 2022.

This week, domestic industrial production data (Tuesday) will be in the spotlight; it may contribute to a slight strengthening of the PLN while retail sales data in Poland (Wednesday) may have the opposite effect. The FOMC meeting scheduled for Wednesday may increase PLN volatility. We believe that other publications from the Polish and global economies will not have a significant impact on the PLN. Information influencing the assessment of the risk of production disruptions as a result of the gas shock in Europe, which could significantly weaken the growth prospects in the Eurozone and Poland, will remain an important determinant for the PLN.

FOMC meeting in the spotlight





Source: Reuters

Last week, 2-year IRS rates increased to 7.08 (up by 4bp), 5-year rates to 6.25 (up by 8bp) and 10-year ones to 6.00 (up by 4bp). Last week saw a rise in IRS rates, particularly visible at the short end of the curve, following core markets. What contributed to this was the publication of higher-than-market-consensus US inflation data, which intensified expectations among some investors for a larger scale of interest rate hikes by the Fed. On Friday, IRS rates corrected and fell.

This week, the publication of domestic industrial production data (Tuesday) will be crucial for the IRS rates; it may contribute to an increase in IRS rates at the short end of the curve. The publication of national retail sales data (Wednesday) may have the opposite effect. We believe that the FOMC meeting scheduled for Wednesday may increase IRS rates volatility. Data releases from the Polish and global economies planned for this week will not have a significant impact on the IRS, in our opinion. Information influencing the assessment of the risk of production disruptions as a result of the gas shock in Europe, which could significantly weaken the growth prospects in the Eurozone and Poland, will remain an important factor shaping the curve.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland														
Indicator	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22
NBP reference rate (%)	0,10	0,10	0,50	1,25	1,75	2,25	2,75	3,50	4,50	5,25	6,00	6,50	6,50	6,75
EURPLN*	4,52	4,60	4,60	4,65	4,58	4,58	4,69	4,64	4,67	4,58	4,70	4,73	4,72	**4,77**
USDPLN*	3,83	3,98	3,98	4,10	4,03	4,08	4,18	4,19	4,43	4,27	4,48	4,63	4,70	**4,72**
CHFPLN*	4,18	4,27	4,35	4,47	4,42	4,40	4,56	4,54	4,55	4,45	4,69	4,86	4,80	**4,92**
CPI inflation (% YoY)	5,5	5,9	6,8	7,8	8,6	9,4	8,5	11,0	12,4	13,9	15,5	15,6	16,1	
Core inflation (% YoY)	3,9	4,2	4,5	4,7	5,3	6,1	6,7	6,9	7,7	8,5	9,1	9,3	9,9	
Industrial production (% YoY)	13,1	8,7	7,6	14,9	16,3	18,0	17,3	15,4	12,3	14,9	10,4	7,7	**11,5**	
PPI inflation (% YoY)	9,6	10,3	12,0	13,6	14,4	16,1	16,1	21,9	24,1	24,7	25,6	24,9	**24,4**	
Retail sales (% YoY)	10,7	11,1	14,4	21,2	16,9	20,0	16,5	22,0	33,4	23,6	19,9	18,4	**18,2**	
Corporate sector wages (% YoY)	9,5	8,7	8,4	9,8	11,2	9,5	11,7	12,4	14,1	13,5	13,0	15,8	**13,8**	
Employment (% YoY)	0,9	0,6	0,5	0,7	0,5	2,3	2,2	2,4	2,8	2,4	2,2	2,3	**2,5**	
Unemployment rate* (%)	5,8	5,6	5,5	5,4	5,4	5,5	5,5	5,4	5,2	5,1	4,9	4,9	**4,9**	
Current account (M EUR)	-527	-1817	-1368	-1269	-2685	-1046	-3787	-4010	-3476	-1485	-1468	-1735		
Exports (% YoY EUR)	23,9	9,4	8,9	7,4	26,6	19,9	11,2	18,7	7,9	27,2	25,8	19,9		
Imports (% YoY EUR)	33,6	22,4	24,2	23,9	35,1	35,0	22,1	38,2	24,5	36,4	31,5	23,5		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland												
Indicator	2022				2023				2021	2022	2023
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Gross Domestic Product (% YoY)	8,5	5,5	0,6	0,2	-0,3	0,8	2,9	3,9	5,9	3,4	1,9
Private consumption (% YoY)	6,6	6,4	0,0	0,5	1,0	1,5	0,7	1,3	6,1	3,3	1,1
Gross fixed capital formation (% YoY)	4,3	7,1	1,2	0,2	-0,7	-0,3	3,0	3,8	3,8	2,6	1,8
Export - constant prices (% YoY)	2,0	5,2	4,5	3,5	1,8	0,5	2,9	4,5	11,8	3,8	2,4
Import - constant prices (% YoY)	8,8	7,8	2,2	1,1	0,7	-1,3	5,1	7,0	15,9	4,7	2,7
GDP growth contributions: Private consumption (pp)	3,9	3,6	0,0	0,2	0,6	0,9	0,4	0,7	3,4	1,8	0,6
GDP growth contributions: Investments (pp)	0,6	1,1	0,2	0,0	-0,1	0,0	0,5	0,8	0,7	0,4	0,3
GDP growth contributions: Net exports (pp)	-3,8	-1,2	1,4	1,4	0,7	1,2	-1,2	-1,3	-1,2	-0,3	-0,1
Current account (% of GDP)***	-2,8	-3,9	-3,9	-4,0	-3,8	-3,4	-3,7	-4,3	-0,7	-4,0	-4,3
Unemployment rate (%)**	5,4	4,9	4,7	5,0	5,3	5,0	4,7	5,0	5,4	5,0	5,0
Non-agricultural employment (% YoY)	2,3	0,6	2,0	2,2	2,2	1,2	0,7	0,3	1,8	1,8	1,1
Wages in national economy (% YoY)	9,7	11,8	10,3	10,2	10,0	8,3	7,5	6,9	8,9	10,5	8,2
CPI Inflation (% YoY)*	9,6	13,9	16,2	17,0	14,6	9,9	7,1	4,4	5,1	14,2	9,0
Wibor 3M (%)**	4,77	7,05	7,13	7,13	7,13	7,13	6,63	6,01	2,54	7,13	6,01
NBP reference rate (%)**	3,50	6,00	6,75	7,00	7,00	7,00	7,00	6,25	1,75	7,00	6,25
EURPLN**	4,64	4,70	4,77	4,75	4,75	4,73	4,70	4,65	4,58	4,75	4,65
USDPLN**	4,19	4,48	4,72	4,66	4,61	4,50	4,39	4,23	4,03	4,66	4,23

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST* CA	FORECAST* CONSENSUS**
		Tuesday 09/20/2022				
10:00	**Poland**	**Employment (% YoY)**	**Aug**	**2,3**	**2,5**	**2,4**
10:00	**Poland**	**Corporate sector wages (% YoY)**	**Aug**	**15,8**	**13,8**	**13,5**
10:00	**Poland**	**PPI (% YoY)**	**Aug**	**24,9**	**24,4**	**24,5**
10:00	**Poland**	**Industrial production (% YoY)**	**Aug**	**7,6**	**11,5**	**9,9**
11:00	Eurozone	Current account (bn EUR)	Jul	4,2		
14:30	USA	Housing starts (k MoM)	Aug	1446	1450	1440
14:30	USA	Building permits (k)	Aug	1685	1601	1610
		Wednesday 09/21/2022				
10:00	**Poland**	**Retail sales (% YoY)**	**Aug**	**18,4**	**18,2**	**20,0**
16:00	USA	Existing home sales (M MoM)	Aug	4,81	4,67	4,70
20:00	USA	FOMC meeting (%)	Sep	2,50	3,25	3,25
		Thursday 09/22/2022				
9:30	Switzerland	SNB rate decision %)	Q3	-0,25		0,50
13:00	UK	BOE rate decision (%)	Sep	1,75		2,25
14:00	**Poland**	**M3 money supply (% YoY)**	**Aug**	**6,2**	**6,4**	**6,1**
16:00	Eurozone	Consumer Confidence Index (pts)	Sep	-24,9		-26,0
		Friday 09/23/2022				
9:30	Germany	Flash Manufacturing PMI (pts)	Sep	49,1		48,3
10:00	Eurozone	Flash Services PMI (pts)	Sep	49,8		49,1
10:00	Eurozone	Flash Manufacturing PMI (pts)	Sep	49,6		48,8
10:00	Eurozone	Flash Composite PMI (pts)	Sep	48,9		48,2
10:00	**Poland**	**Registered unemplyment rate (%)**	**Aug**	**4,9**	**4,9**	**4,9**
15:45	USA	Flash Manufacturing PMI (pts)	Sep	51,5		51,2

*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

Jakub BOROWSKI
Chief Economist
tel.: 22 573 18 40
jakub.borowski@credit-agricole.pl

Krystian JAWORSKI
Senior Economist
tel.: 22 573 18 41
krystian.jaworski@credit-agricole.pl

Jakub OLIPRA
Senior Economist
tel.: 22 573 18 42
jakub.olipra@credit-agricole.pl