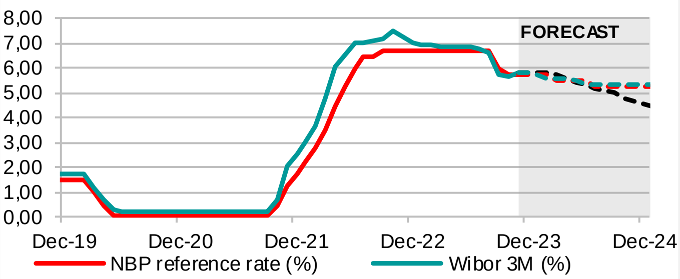
Will the Fed cut interest rates as early as March 2024?

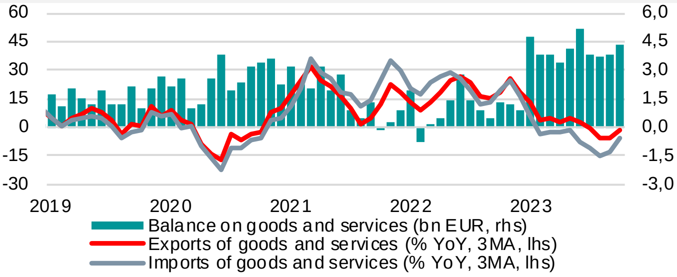
This week

- **The key event this week will be the MPC meeting planned for tomorrow.** We believe that interest rates will not change (current reference rate: 5.75%). The press release published after the December's MPC meeting supports our status quo forecast for the monetary policy. The MPC quoted there the uncertainty regarding future fiscal and regulatory policies and their impact on inflation as well as the adjustments to NBP interest rates made in the past months as the main reasons for stabilising the interest rates (see MACROpulse of 07/12/2023). Our scenario assumes that the first interest rate cut will take place in March 2024. This week will probably also see the NBP Governor's usual press conference, which can shed more light on Poland's monetary policy prospects. A decision to keep the rates unchanged would be consistent with market consensus, and thus it should have no impact on the PLN rate and yields on Polish bonds.



Source: Reuters, Credit Agricole

- **US inflation data will be released on Thursday.** We expect the headline inflation to have risen from 3.1% YoY in November to 3.3% in December, primarily as a result of last year's low base effects in the "energy" category. We estimate that the core inflation shrank to 3.9% YoY in December vs. 4.0% in November. Our forecasts are more less consistent with market consensus, so there will be no significant impact on the financial markets if they materialise.
- **Poland's balance of payments figures will be released on Thursday.** We expect the current account balance to have dropped to EUR 795m in November vs. EUR 2,036m in October, which will result from a lower balance on trade and primary income. We forecast that the exports dynamics dropped to 1.0% YoY in November vs. 1.6% in October while the imports growth accelerated from -8.4% YoY to -6.7%. Unfavourable calendar effects were driving the foreign trade down in November. Our current account balance forecast is markedly below the market consensus of EUR 1,878m, but in our opinion, there would be no material impact on the PLN and the yields on Polish bonds if it materialised.

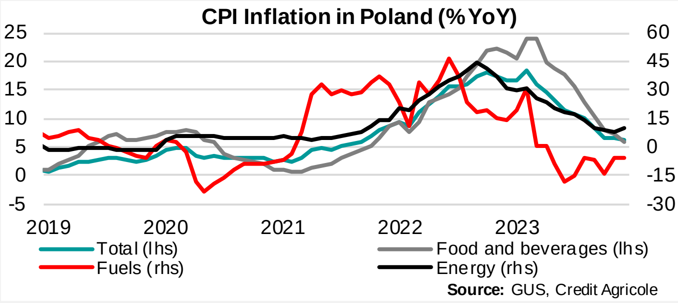


Source: NBP, Credit Agricole

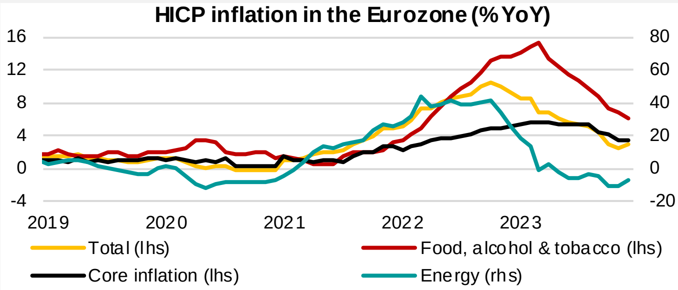
- **China's foreign trade figures will be released on Friday.** The market expects that China's trade balance went up from USD 68.4bn in November to USD 76.3bn in December. According to the market consensus, Chinese exports went up from 0.5% YoY in November to 1.6% in December, while imports grew from -0.6% YoY to 0.0%. A slowdown in activity reported by China's main trade partners remains the factor that curbs the Chinese foreign trade. Our conclusion is supported by the PMI data breakdown published two weeks ago, which showed a further decline in foreign orders (see MACROmap of 02/01/2024). We believe that data from China will be neutral for financial markets.
- **Industrial production data for Germany will be published this week.** The market consensus is that production in November did not change comparing to a 0.4% drop in October. Data on orders in the manufacturing sector have been released today. They show that the dynamics increased to 0.3% MoM in November vs. -3.8% in October. This means it was below the market consensus of 1.0%. The dynamics was driven up by a stronger (though figures were still negative) growth in export orders, while domestic orders growth went down. As regards the export

orders, the Eurozone orders fell again while the number of orders coming from non-EU countries went up. Foreign trade balance went up from EUR 17.7bn in October to EUR 20.4bn in November (the consensus stood at EUR 17.9bn). Both exports and imports growth accelerated between October and November (3.7% MoM vs. -0.4% and 1.9% MoM vs. -1.1%, respectively). We continue to believe that German foreign trade is still affected by the global economic slowdown. Inventories being adjusted to meet the demands of a less favourable situation are the factor that curbs the activity in global trade and affects the German industry. In our opinion, the data from Germany is neutral for financial markets.

Last week



- **In accordance with the flash estimate, the CPI inflation in Poland fell to 6.1% YoY in December vs. 6.6% in November, standing well below the market consensus, which was consistent with our forecast (6.4%).** GUS published partial data on the inflation structure, which contained information about price growth rates for the following categories: “food and non-alcoholic beverages”, “energy” and “fuels”. Inflation was driven down by a slower price growth in the “food and non-alcoholic beverages” (5.9% YoY in December vs. 7.3% YoY in November) and “fuels” (-6.0% vs. -5.7%) categories and by lower core inflation, which according to our estimates declined from 7.3% YoY in November to 7.0% in December. A stronger growth in the energy prices (9.8% vs. 7.9%) had the opposite impact on headline inflation. We believe there is a marked downside risk to our forecast, in which inflation is to fall to 3.3% YoY in Q1 and reach its local minimum at 2.4% in Q2. At the same time, the lower-than-expected inflation figures strongly support our scenario in which the MPC will cut the interest rates by 25bp in March 2024. However, if the procedure aimed at bringing the NBP Governor A. Glapiński before the State Tribunal is initiated, this will be a risk factor to our interest rate forecast.



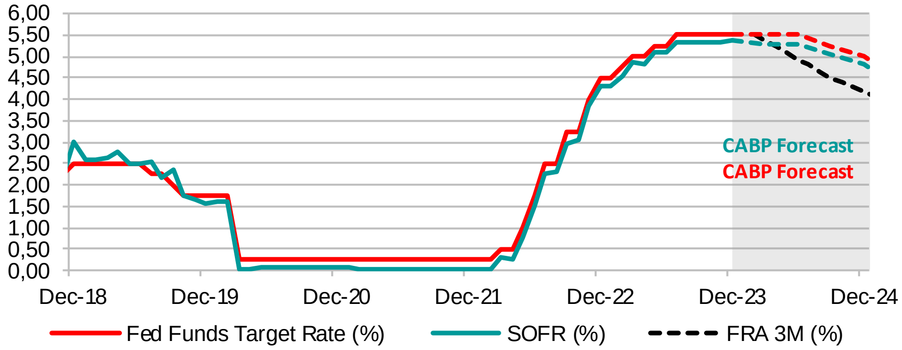
Source: Datastream, Credit Agricole

- **In accordance with the flash estimate, inflation in the Eurozone went up to 2.9% YoY in December vs. 2.4% in November, running slightly below the market consensus and our forecast (3.0%).** The downward trend in inflation was driven by lower food price growth (6.1% YoY in December compared to 6.9% in November) and lower core inflation (3.4% compared to 3.6%). On the other hand, the increase in the growth rate of the energy prices (-6.7% vs. -11.7%) related to the expiry of the effects of the high base of the previous year had an opposite effect. We expect the coming months to bring a further gradual decline in core inflation. We believe that the ECB will start the interest rate cut cycle as early as September 2024 and will make a total of three cuts of 25bp each (in September, October and December). Consequently, at the end of 2024, the refinancing rate will be 3.75% and the deposit rate 3.25%.
- **Some significant data on the US economy was released last week.** Improved sentiment in manufacturing was indicated by the ISM index, which increased to 47.4 pts in December from

46.7 pts in November, running above market expectations (47.1 pts). The increase in the index resulted from higher contributions of 3 out of its 5 components (employment, current output and delivery times), while lower contributions of new orders and inventories had the opposite effect. Particularly noteworthy in the data is the persistent decline in the input prices in manufacturing over the past eight months, which points to waning inflationary pressures in the goods market. On the other hand, the ISM index for services went down to 50.6 pts in December from 52.7 pts in November, running below market expectations (52.6 pts). It resulted from lower contributions of 3 out of its 4 components (employment, new orders and delivery times), while higher contribution of the business activity component had the opposite effect. Particularly noteworthy is the strong fall in the index for employment, which declined in December at the fastest rate since April 2020. In contrast to the ISM manufacturing index, the component for input prices is still well above the 50-point threshold, which reflects the continued increased inflationary pressures in the US services sector. We forecast the annualized US GDP growth to have slowed 0.8% in Q4 2023 from 5.2% in Q3 2023, and to reach 0.4% and 0.7% in Q1 and Q2 2024, respectively.

- **Last week, new information on the Fed's monetary policy outlook was provided by US non-farm payroll data, as well as the Minutes of the December FOMC meeting (see below).**

Will the Fed cut interest rates as early as March 2024?

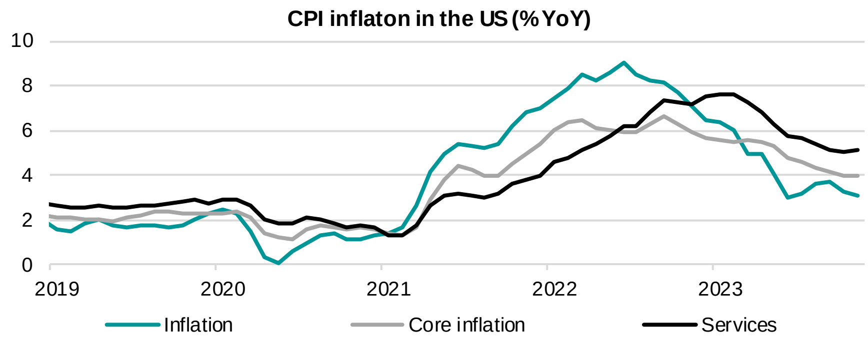


Source: Reuters, Credit Agricole

In recent weeks, there has been a strong increase in investor expectations of interest rate cuts in the US, reflected in FRA contracts. They are now pricing in a roughly 70% probability that the Fed will begin a cycle of interest rate cuts as early as March 2024. At the same time, FRA contracts are pricing in reductions of around 140bp in total by the end of 2024. In our baseline scenario, we assume that the first interest rate cut will not take place until July, with a total cut of 50bp in 2024. The subject of the analysis below is an assessment of the likelihood of the Fed easing monetary policy more rapidly (than in our scenario) in light of incoming information in recent weeks.

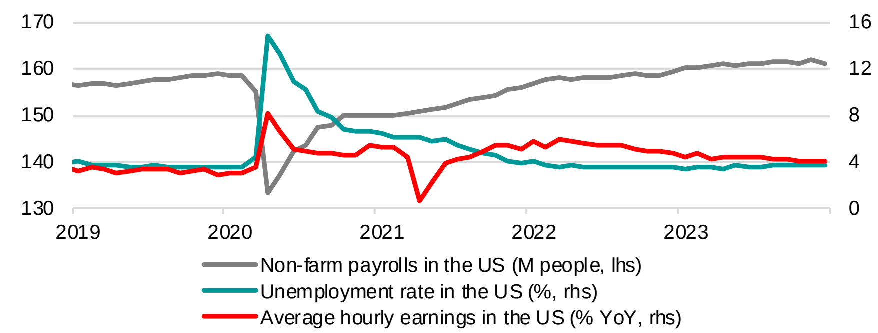
The source of the strong increase in expectations for interest rate cuts in the US was the publication of the December FOMC projection, as well as Fed Chairman J. Powell's statements at the press conference following the meeting. The median expectation for the Federal Reserve funds rate at the end of 2024 suggested reductions of a total of 75bp in 2024 (50bp in the September projection) and 100bp in 2025 (125bp). Thus, although the scale of interest rate cuts expected by FOMC members over the next two years is unchanged compared to the September projection, the results of the December projection indicate that a significant part of the monetary easing will take place in 2024. This was perceived by investors as a dovish signal, leading to a marked weakening of the USD against the EUR and a strong decline in US bond yields. PCE inflation forecasts for 2023-2024 were revised downwards in December (to 3.2% and 2.4%, respectively, vs. 3.7% and 2.6% in the September projection), while there was no change for the projected unemployment rate over the said period. During the press conference, Federal Reserve chief J. Powell suggested that the Fed had most likely already completed the interest rate hike cycle. He also said that FOMC members are "thinking about discussing" interest rate cuts, although the discussion itself has not yet begun (see MACROmap of 18.12.2023).

The tone of the December FOMC projection and J. Powell's statements were tempered quite significantly by the Minutes of the December FOMC meeting published last week. According to the transcript of the discussion, the majority of FOMC members want interest rates to be kept high for "some more time". They believe that it would be appropriate for monetary policy to remain restrictive until inflation starts to move clearly towards the Fed's inflation target. However, it is worth noting that the publication of the Minutes had only a moderate positive impact on the USD and US bond prices.



Source: Datastream, Credit Agricole

Recent incoming data indicates a gradual weakening of inflationary pressures in the US. Nevertheless, the focus remains on the 'services' category, which is characterised by a fairly high inertia and continues to see historically high rates of price increases. At the same time, the monthly price growth rate in this category continues to be above the seasonal pattern. At the same time, we are dealing with weakening household inflation expectations. The median for expected inflation at a 1-year horizon published with the University of Michigan index fell to 3.1% YoY in December, compared with 4.5% in November, and reached its lowest level since March 2021 (see MACROmap of 11/12/2023).



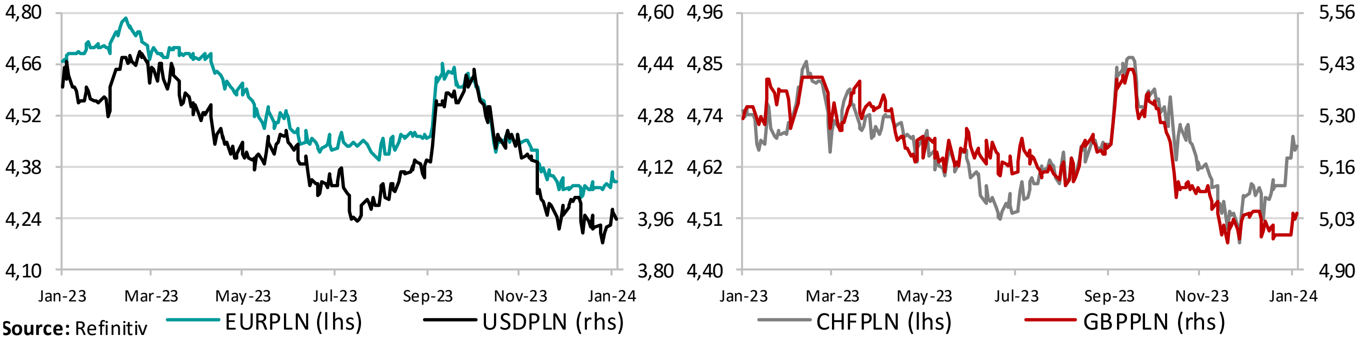
Source: Datastream, Credit Agricole

Another important data from the point of view of the monetary policy outlook in the US is the non-farm payroll data released last week, which increased by 216k in December, compared to an increase of 173k in November (downward revision from 199k) and was above market expectations (180k). The strongest increases in employment were seen in education and health services (+74.0k), the government sector (+52.0k), and leisure and hospitality (+40k). In contrast, the largest decreases in employment occurred in transport and storage (-22.6k), mining and logging (-1.0k) and the 'other services' category (-1.0k). The unemployment rate in December was unchanged compared to November at 3.7%, slightly below market expectations (3.8%). Thus, it still remains below the natural rate of unemployment, estimated by the Fed at 4.0%. On the other hand, the labour force participation rate dropped to 62.5% in December from 62.8% in November. At the same time, average hourly earnings growth increased slightly in December to 4.1% YoY, compared to 4.0% in November. However, it is worth noting that its 3-month moving average is in a mild downward trend, which we believe is indicative of weakening wage pressures in the US economy.

Given the information incoming in recent weeks, we see downside risk to our US interest rate forecast of a first cut in July 2024, with a total cut of 50bp in 2024. Nonetheless, we believe that the probability of an interest rate cut as early as March 2024 is low and that the total scale of rate cuts of around 140bp in 2024, as priced by FRA contracts, is too high in light of the still stubbornly elevated core inflation and the continued good labour market situation. We also see upside risk to our EURUSD forecast of 1.05 at the end of 2024, and consequently downside risk to our USDPLN forecast at the end of 2024 (4.15).

NBP Governor’s press conference in the spotlight

FX rates



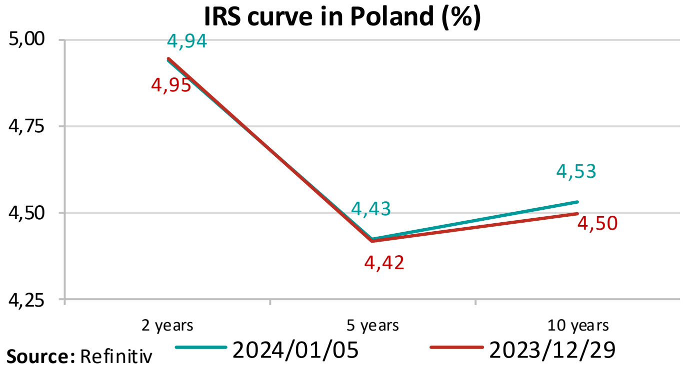
Source: Refinitiv

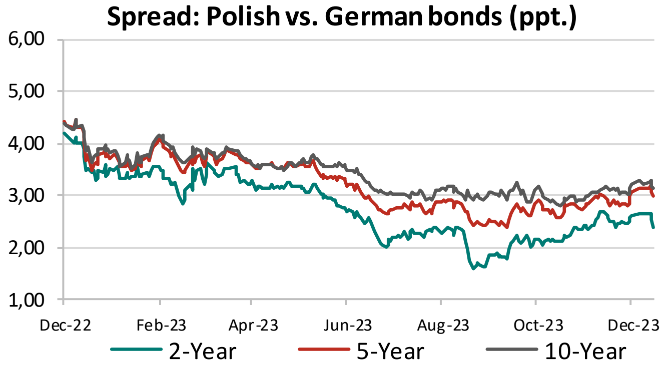
Last week, the EURPLN rate increased to 4.3422 (the PLN weakened by 0.2%). The first part of the week saw a marked decline in the EURPLN, a correction after its rise two weeks ago. The PLN weakened on Friday, helped by the publication of lower-than-expected domestic inflation data. Indeed, the data led to an increase in expectations of interest rate cuts in Poland, which was reflected in a drop in FRA rates.

The USD strengthened against the EUR last week, helped by the hawkish tone of the Minutes from the December FOMC meeting. Friday’s publication of US labour market data led to a further strengthening of the USD.

This week's usual NBP Governor's press conference may be important for the PLN. However, we do not expect it to have a significant impact on the exchange rate of the Polish currency. We believe that other data releases from the Polish and global economies scheduled for this week will be neutral for the PLN.

Domestic inflation data led to drop in IRS rates





Source: Refinitiv

Last week the 2-year IRS rates decreased to 4.94 (down by 1bp), 5-year rates increased to 4.43 (up by 1bp), and 10-year rates increased to 4.53 (up by 3bp). The beginning of last week saw an increase in IRS rates following the core markets. The rise in bond yields in the core markets was supported by a lowering of expectations of interest rate cuts by the major central banks, helped in part by the hawkish tone of the December FOMC meeting. IRS rates fell on Friday (by around 9bp for 2-year IRS rates) in response to the publication of lower-than-expected domestic inflation data. A debt auction at which the Ministry of Finance sold securities with 2-, 5- and 10-year maturities for a total of PLN 8.0bn against a demand of PLN 15.7bn also contributed to lower IRS rates.

The usual press conference by NBP Governor A. Glapinski will be crucial for IRS rates this week. However, we do not believe it will have a significant impact on the curve. In our opinion, other data releases from the Polish and global economies scheduled for this week will be neutral for the IRS rates.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland														
Indicator	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24
NBP reference rate (%)	6,75	6,75	6,75	6,75	6,75	6,75	6,75	6,75	6,75	6,00	5,75	5,75	5,75	**5,75**
EURPLN*	4,69	4,71	4,70	4,68	4,59	4,53	4,43	4,40	4,47	4,63	4,45	4,35	4,33	**4,36**
USDPLN*	4,38	4,33	4,45	4,31	4,16	4,23	4,06	4,00	4,12	4,37	4,21	4,00	3,93	**3,98**
CHFPLN*	4,72	4,70	4,72	4,71	4,66	4,64	4,52	4,59	4,66	4,78	4,62	4,56	4,64	**4,63**
CPI inflation (% YoY)	16,6	16,6	18,4	16,1	14,7	13,0	11,5	10,8	10,1	8,2	6,6	6,6	**6,1**	
Core inflation (% YoY)	11,5	11,7	12,0	12,3	12,2	11,5	11,1	10,6	10,0	8,4	8,0	7,3	**7,0**	
Industrial production (% YoY)	0,9	1,8	-1,0	-3,1	-6,0	-2,8	-1,1	-2,3	-1,9	-3,3	1,9	-0,7	**-5,0**	
PPI inflation (% YoY)	20,5	20,1	18,2	10,3	6,2	2,8	0,3	-2,1	-2,9	-2,7	-4,2	-4,7	**-5,7**	
Retail sales (% YoY)	15,5	15,1	10,8	4,8	3,4	1,8	2,1	2,1	3,1	3,6	4,8	2,6	**5,2**	
Corporate sector wages (% YoY)	10,3	13,5	13,6	12,6	12,1	12,2	11,9	10,4	11,9	10,3	12,8	11,8	**12,4**	
Employment (% YoY)	2,2	1,1	0,8	0,5	0,4	0,4	0,2	0,1	0,0	0,0	-0,1	-0,2	**-0,2**	
Unemployment rate* (%)	5,2	5,5	5,6	5,4	5,3	5,1	5,1	5,0	5,0	5,0	5,0	5,0	**5,1**	
Current account (M EUR)	-1722	2246	1467	1372	-330	491	1049	-62	-299	394	2036	**795**		
Exports (% YoY EUR)	11,6	19,2	14,8	16,1	1,5	3,8	3,5	0,2	-2,3	-4,3	1,6	**1,0**		
Imports (% YoY EUR)	14,6	10,4	-1,6	3,3	-9,8	-5,3	-6,0	-7,3	-11,9	-14,8	-8,4	**-6,7**		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland													
	Indicator	2023				2024				2022	2023	2024
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
	Gross Domestic Product (% YoY)	-0,3	-0,6	0,5	1,9	2,3	2,6	2,9	3,3	5,3	0,5	2,8
	Private consumption (% YoY)	-2,0	-2,8	0,8	2,3	2,5	3,0	3,3	3,5	5,2	-0,4	3,1
	Gross fixed capital formation (% YoY)	6,8	10,5	7,2	7,3	5,3	1,9	2,6	2,0	4,9	7,9	2,7
	Export - constant prices (% YoY)	3,8	-3,2	-11,0	2,3	3,9	5,0	4,3	4,5	6,7	-2,1	4,4
	Import - constant prices (% YoY)	-3,2	-6,8	-20,3	3,7	4,6	5,6	6,0	5,5	6,8	-6,6	5,4
GDP growth contributions	Private consumption (pp)	-1,3	-1,6	0,5	1,2	1,5	1,7	1,9	1,8	2,9	-0,2	1,7
	Investments (pp)	0,9	1,5	1,2	1,6	0,7	0,3	0,5	0,5	0,8	1,3	0,5
	Net exports (pp)	4,6	2,1	5,9	-0,8	-0,1	0,0	-0,5	-0,6	0,2	2,7	-0,3
	Current account (% of GDP)***	-0,7	-0,1	0,6	0,8	1,0	0,5	-0,3	-1,0	-2,4	0,8	-1,0
	Unemployment rate (%)**	5,4	5,1	5,0	5,1	5,2	4,9	4,8	5,0	5,2	5,1	5,0
	Non-agricultural employment (% YoY)	1,5	1,1	1,4	0,7	0,0	-0,5	-0,6	-1,0	0,6	1,2	-0,5
	Wages in national economy (% YoY)	14,3	13,8	11,0	9,9	9,5	8,6	8,8	9,0	12,1	12,2	9,0
	CPI Inflation (% YoY)*	17,0	13,1	9,7	6,4	3,3	2,4	4,3	4,2	14,3	11,6	3,5
	Wibor 3M (%)**	6,89	6,90	5,77	5,88	5,63	5,38	5,38	5,38	7,02	5,88	5,38
	NBP reference rate (%)**	6,75	6,75	6,00	5,75	5,50	5,50	5,25	5,25	6,75	5,75	5,25
	EURPLN**	4,68	4,43	4,63	4,33	4,42	4,40	4,38	4,36	4,69	4,33	4,36
	USDPLN**	4,31	4,06	4,37	3,93	4,09	4,11	4,13	4,15	4,38	3,93	4,15

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
		Monday 01/08/2024				
8:00	Germany	Trade balance (bn EUR)	Nov	17,8		17,9
8:00	Germany	New industrial orders (% MoM)	Nov	-3,7		0,6
10:30	Eurozone	Sentix Index (pts)	Jan	-16,8		-15,5
11:00	Eurozone	Unemployment rate (%)	Nov	6,5		6,5
11:00	Eurozone	Retail sales (% MoM)	Nov	0,1		0,0
		Tuesday 01/09/2024				
8:00	Germany	Industrial production (% MoM)	Nov	-0,4		0,2
	Poland	**NBP rate decision (%)**	**Jan**	**5,75**	**5,75**	**5,75**
		Wednesday 01/10/2024				
16:00	USA	Wholesale inventories (% MoM)	Nov	-0,2		0,0
16:00	USA	Wholesale sales (% MoM)	Nov	-1,3		
		Thursday 01/11/2024				
14:30	USA	CPI (% MoM)	Dec	0,1	0,2	0,2
14:30	USA	Core CPI (% MoM)	Dec	0,3	0,2	0,2
		Friday 01/12/2024				
2:30	China	PPI (% YoY)	Dec	-3,0		
2:30	China	CPI (% YoY)	Dec	-0,5		
14:00	**Poland**	**Current account (M EUR)**	**Nov**	**2036**	**795**	**1878**
	China	Trade balance (bn USD)	Dec	68,4		76,2

*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
** Refinitiv

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