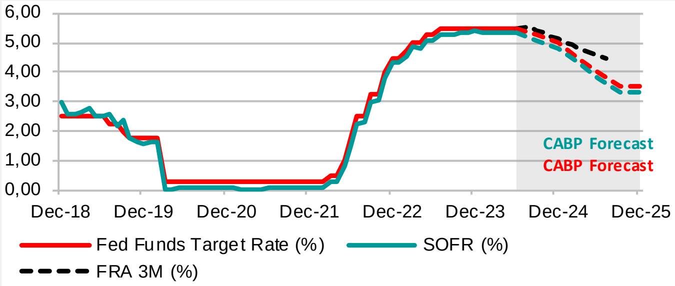
Large production capacity buffer hampers investment growth

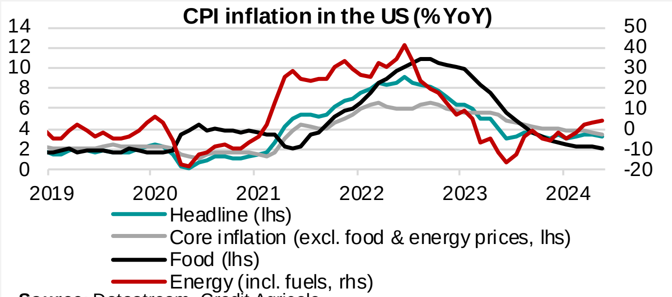
This week

- **The second round of the early French parliamentary elections was held on Sunday.** According to the final results, the New Popular Front won 182 seats in the 577-seat National Assembly, followed by President Emmanuel Macron's Ensemble alliance (168 seats), the National Rally (143 seats), and the Republicans (45 seats), with the remaining parties having 39 seats between them. None of the parties has an absolute majority (289 seats). We believe that the probability that the parties will manage to form a stable majority coalition in the National Assembly is low. In consequence, we believe that the election results entail a risk of a persisting deterioration in the fiscal position in the mid-term, and thus are slightly negative for EUR and PLN exchange rates.
- **On Tuesday, the Fed Chairman J. Powell will present the Fed's semi-annual monetary policy report to Congress.** Investors will be watching closely J. Powell's comments on prospects for economic growth, inflation, and interest rates. Of particular importance will be the Fed Chairman's comments about plans to ease monetary policy. J. Powell will probably note that inflationary pressures are easing. We expect him to reiterate that before making a decision to cut rates, the Fed must be sure that the fall in inflation is sustainable. Although we do not expect J. Powell to share any new information in the context of interest rates outlook, his appearance before Congress may add to volatility in financial markets.



Source: Refinitiv, Credit Agricole

- **Some important data from the US will be released this week.** We expect headline inflation to have fallen to 3.1% YoY in June from 3.3% in May, with core inflation remaining flat between May and June at 3.4% YoY. Thus, we believe that the inflation figures will signal a slow easing of inflationary pressures in the US. We expect the preliminary reading of the University of Michigan index to show a further deterioration in household sentiment (66.5 pts in July vs. 68.2 pts in June). In our opinion, this week's US data releases will be overshadowed by the Fed Chairman J. Powell' appearance before Congress (see above).



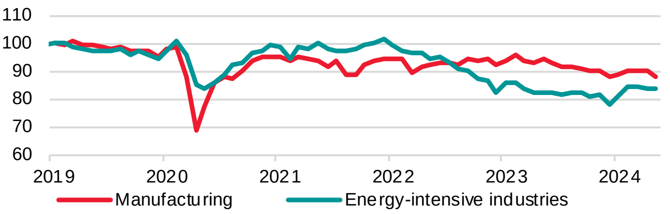
Source: Datastream, Credit Agricole

- **China's foreign trade figures will be released on Friday.** We forecast that China's trade balance grew to USD 83.3bn in June from USD 82.6bn in May. We expect export growth to have dropped to 5.6% YoY in June from 7.6% in May, and import growth to have dropped to 1.0% from 1.8%, showing a decline in China's foreign trade. We believe that data from China will be neutral for financial markets.

Last week

- **Some significant data on the US economy was released last week.** Non-farm payrolls rose by 206k in June vs. 218k in May (downward revision from 272k), running slightly above market expectations (190k). The strongest increases in employment were seen in education and health services (+82.0k), the government sector (+70.0k), and in construction (+27k), while declines were recorded in professional and business services (-17.0k), retail trade (-8.5k), and in manufacturing (-8.0k). Unemployment rose to 4.1% in June from 4.0% in May, running above market expectations (4.0%) and slightly above the natural unemployment rate estimated by the Fed (4.0%). At the same time, the labour force participation rate rose to 62.6% in June from 62.5%, but it still remains below the pre-Covid level (63.3%). Hourly wage growth dropped to 3.9% in June from 4.1%. The three-month moving average of hourly wage growth dropped, too, which we believe shows that wage pressures in the US economy are gradually easing. Last week also saw the release of business survey results. A slight deterioration in confidence was shown by the ISM manufacturing index, which fell to 48.5 pts in June from 48.7 pts in May, running below market expectations (49.1 pts). The fall in the index is accounted for by lower contributions from 3 out of its 5 components (output, employment and inventories), partially offset by higher contributions from new orders and delivery times. At the same time, the ISM services index dropped to 48.8 pts in June from 53.8 pts in May, well below market expectations (52.5 pts). The drop in the index is accounted for by lower contributions from all of its 4 components (business activity, new orders, employment, and delivery times). It is worth noting that the index fell below the 50-point mark for the first time since May 2020. At the same time, the business activity component dropped sharply, from 61.2 pts in May to 49.6 pts in June. We see downside risk to our scenario, which expects annualized US GDP growth to increase to 1.7% in Q2 from 1.4% in Q1, and US GDP to grow by 2.0% over the whole of 2024 compared with 2.5% for 2023.
- ***Minutes* of the June FOMC meeting were released last week.** The *Minutes* include a comment to the effect that although the FOMC member see signs that inflationary pressures are easing, they need greater confidence that inflation is moving sustainably toward its target before they can decide to cut rates. At the same time, a few FOMC members expressed concerns that keeping interest rates at elevated levels for too long may lead to a deterioration in the labour market. Currently, investors price in roughly two rate cuts in the US by the end of the year. Our scenario expects the Fed to cut rates by 25bp in July and by another 25bp in Q4. Such a forecast is supported by data that shows that activity in the US economy is gradually slowing down.
- **Some important data on German economy was released last week.** Industrial production shrank by 2.5% MoM in May compared to a 0.1% growth in April (upward revision from -0.1%), running markedly below the market expectations (+0.2%). Industrial production growth was driven down by a slower growth in the manufacturing and construction sectors, while an opposite impact came from a quicker growth in the energy sector. The strongest drops in production volumes were seen in the “electrical equipment” (-7.2%), “machinery and equipment” (-5.9%), “pharmaceutical products and medicines” (-5.4%), “vehicles, trailers and semi-trailers” (-5.2%), “computer, electronic and optical products” (-4.2%) and “furniture” (-3.7%) categories. Production in energy-intensive branches went slightly up (by 0.2% MoM), which resulted primarily from higher production

Production in manufacturing and energy-intensive industry branches in Germany (2019.01 = 100, SA)

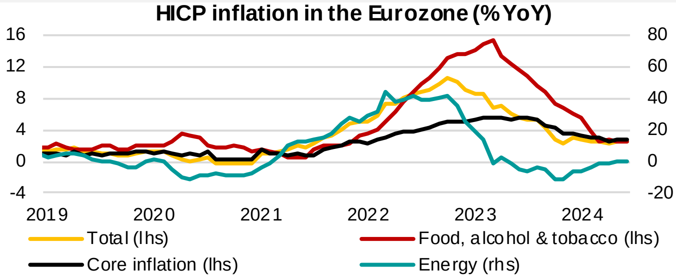


Source: Destatis, Credit Agricole

volumes in the chemical, and coke and oil processing sectors. However, it is worth noting that production volumes in energy-intensive branches are approx. 16% below the levels reported just before the outbreak of the war in Ukraine. Last week we also saw data on orders in manufacturing, which decreased in May to -1.6% from -0.6% in April (downward revision from -0.2%), printing markedly below market expectations (0.5%). The number of export orders fell while that of domestic orders went up. The decrease in the former stemmed from a marked decrease in orders from other Eurozone countries, while the number of orders from the countries outside the Eurozone increased. Today, we have seen the release of data on German foreign trade, whose balance went up from EUR 22.2bn in April to EUR 24.9bn in May, printing ahead of market expectations (EUR 21.1bn). At the same time, the exports growth slowed (-3.6% MoM in May vs. 1.7% MoM in April), the imports did the same (-6.6% vs. 1.2%), and both printed below market expectations (-1.9% and 1.0%, respectively). Consequently, the data is indicative of a marked slowdown in activity in the German foreign trade in May. We can see a downside risk to our forecast in which the quarterly GDP growth is to slow down from 0.2% in Q1 to 0.0% in Q2, and to accelerate by 0.1% in 2024 (vs. a 0.1% drop in 2023) and 1.1% in 2025.

- **In accordance with a flash estimate, inflation in the Eurozone went down to 2.5% in June vs. 2.6% in May, running in line with the market consensus and above our forecast (2.4%).** Inflation was driven down by a slower growth in the prices of energy (0.2% YoY in June vs. 0.3% in May) and food (2.5% vs. 2.6%). Core inflation did not change between May and June, and stood at 2.9% YoY. Particularly noteworthy about the data is that inflationary pressure is high and persistent in the case of the prices of services, but it has weakened when it comes to the prices of goods. We expect core inflation to fall gradually in the coming months. It will be falling very slowly, though, and will not reach the level of around 2% earlier than in Q2 2025.

HICP inflation in the Eurozone (% YoY)

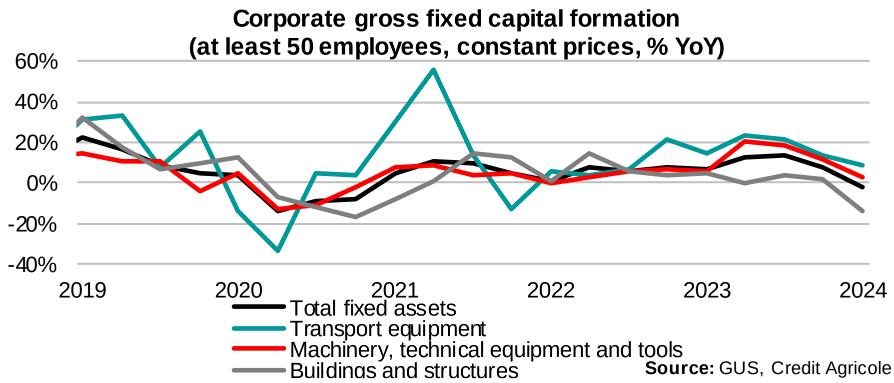


Source: Datastream, Credit Agricole

- **Last week, the Monetary Policy Council took a decision to keep interest rates unchanged (with the NBP reference rate standing at 5.75%).** The MPC's decision was consistent with market consensus and our forecast. The Council repeated that despite the observed economic recovery, demand and cost pressures in the Polish economy remained relatively low, which amidst weakened economic conditions and lower inflation pressure abroad curbed domestic inflation pressure. The Council's opinion regarding the future level of interest rates, which will depend on incoming information regarding prospects for inflation and economic activity was also repeated in the press release. The results of the July inflation projection were also released last week. The scenario presented in the projection is one of a marked acceleration of price growth in the quarters to come and inflation running well above the target until 2025. Such inflation profile will be seen together with economic growth acceleration in 2024-2025 followed by a strong slowdown of GDP growth in 2026 (see MACROpulse of 03/07/2024). It is worth noting that the NBP expects inflation in 2025 to be driven up primarily by a stronger growth in the prices of food and energy (in accordance with the comments on the projection, in 2025, the cap on energy prices for households will be lifted, the capacity fee will begin to apply again, and the regulated prices of the systemic heat will increase). NBP Governor A. Glapiński held his usual press conference last week as well. He said that inflation will rise again in the coming months due to the partial release of energy prices, and consequently "we can forget" about interest rate cuts. In his opinion, it will not be possible to make the first cuts earlier than in 2026. Consequently, we believe that both the press release published after the MPC meeting and the results of NBP's July projection of the inflation path strongly support our scenario of interest rate stabilisation in the quarters to come. We expect the first rate cut to take place in Q3 2025.

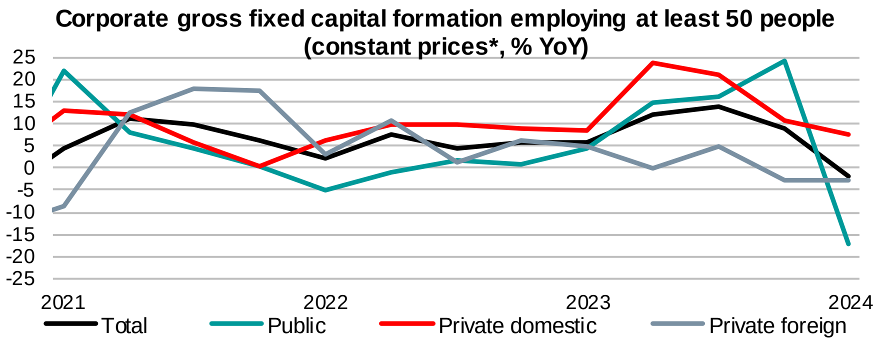
Large production capacity buffer hampers investment growth

In accordance with the data published by Statistics Poland, real investments carried out by companies employing at least 50 people shrank by 2.2% YoY in Q1 comparing to a 7.9% growth, which represented their slowest growth since Q4 2020. Below we will analyse the current trends and medium-term prospects for investments.



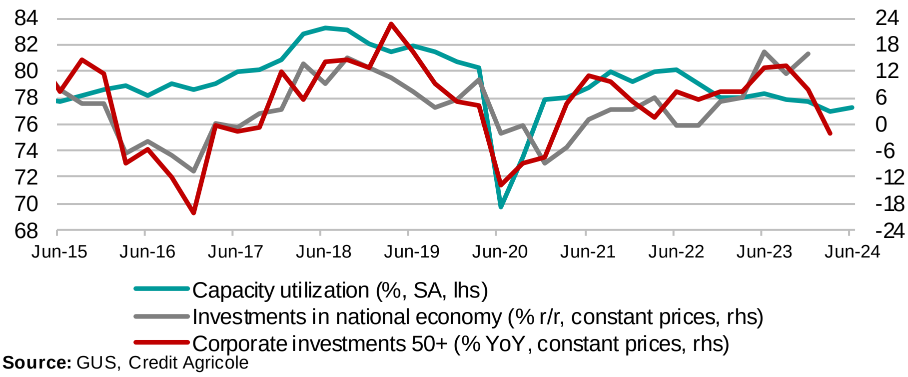
Source: GUS, Credit Agricole

It is definitely worth noting a broad-based slowdown of capital expenditure growth in Q1, which stems from the investment data breakdown. Expressed in terms of constant prices, the growth slowed down in both “buildings and structures” (-14.2% YoY vs. +2.0% in Q4) and “machinery, technical equipment and tools” (2.8% vs. 11.3%) and “transport equipment” (8.7% vs. 13.5%) categories.



Source: PONT Info, Credit Agricole *adjusted using deflator of total corporate investments 50+

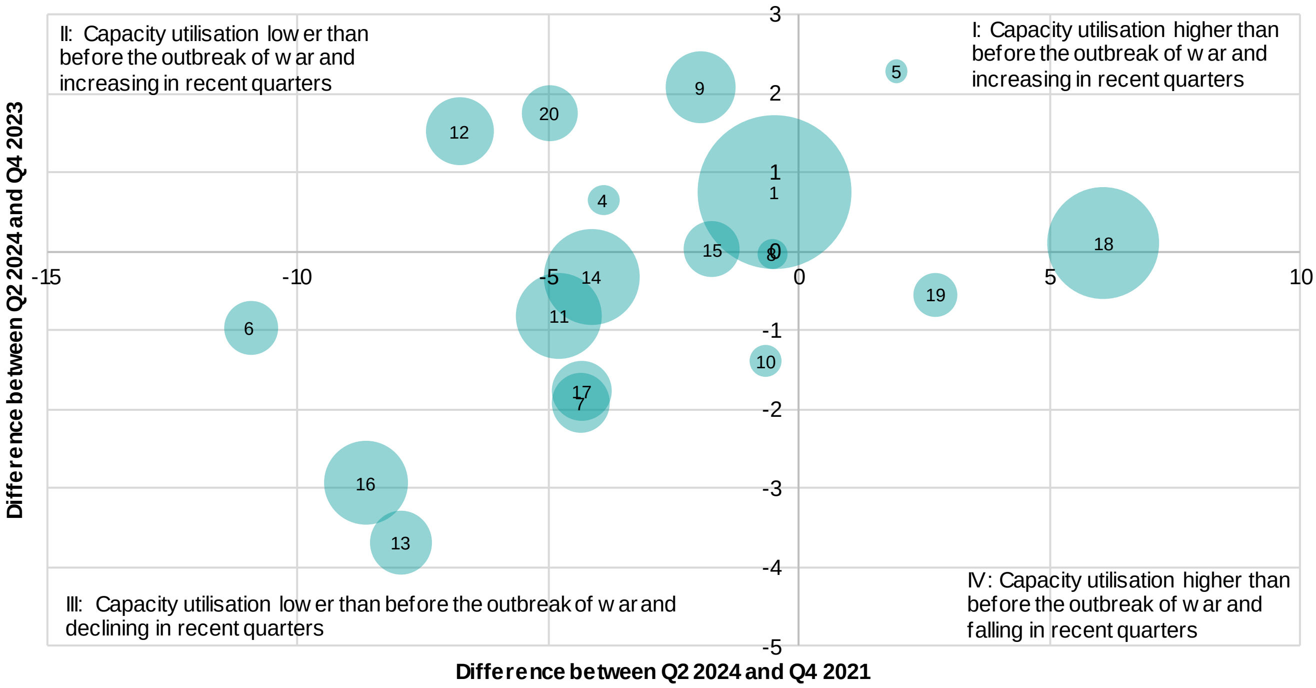
A broad-based slowdown of investment growth expressed in real terms can also be seen when data is broken down by enterprise ownership forms. In accordance with the data provided by PONT Info, investment growth expressed in constant prices slowed down in the enterprises with a dominant share of the public sector (-17.1% in Q1 vs. 24.1% in Q4), domestic private companies (7.5% vs. 10.8%) and foreign private companies (-2.8% vs. -2.6%). Such a marked slowdown in investments carried out by the enterprises with a dominant share of the public sector arises from a reduced absorption of EU funds in the pause between financial perspectives for 2014-2020 and 2021-2027 (see MACROmap of 18/03/2024).



Source: GUS, Credit Agricole

We believe that investment activity is significantly curbed by low utilisation of production capacities. Our conclusion is supported by data published by Statistics Poland, which shows that seasonally-adjusted utilisation of production capacities in the manufacturing sector, which currently stands at approx. 77.2%, has been following a clear downward trend over the last couple of quarters. This means that nowadays the enterprises do not need to take efforts to overcome a barrier resulting from a high level of utilisation of production capacities, which was the main capital expenditure increase driver for the enterprises in the past.

The analysis of the levels of capacity utilisation in the individual categories of the manufacturing sector is important for the assessment of investment activity acceleration prospects. To this end, we have compared changes in seasonally-adjusted level of capacity utilisation, analysing two horizons, namely a medium-term (Q4 2021 - May 2024) and a short-term one (Q4 2023 – Q2 2024). We used this approach last week, too, analysing production trends in the individual categories of the Polish manufacturing sector (see MACROmap of 01/07/2024). This way we could see how production capacities were used in the individual branches of the manufacturing sector after the outbreak of war in Ukraine and whether or not there have been any changes in utilisation trends. The results of our calculations are presented in the chart below.



Source: GUS, Credit Agricole
1 - Food products, beverages, tobacco products, 4 – Textiles, 5 - Wearing apparel, 6 - Wood and of products of wood and cork, 7 - Paper and paper products, 8 - Printing and reproduction of recorded media, 9 - Chemicals and chemical products, 10 - Basic pharmaceutical products and pharmaceutical preparations, 11 - Rubber and plastic products, 12 - Other non-metallic mineral products, 13 - Basic metals, 14 - Fabricated metal products, except machinery and equipment, 15 - Computer, electronic and optical products, 16 - Electrical equipment, 17 - Machinery and equipment n.e.c., 18 - Motor vehicles, trailers and semi-trailers, 19 - Other transport equipment, 20 - Furniture

*the size of the circles reflects the weight of the category in the total manufacturing output sold

The chart should be interpreted as follows: If the circle representing a given category is in the first quarter, this means that the capacity utilisation in that category in Q2 2024 was higher than it had been at the moment the war broke out in Ukraine, and that it was growing over the last couple of months. Those categories are marked by the brightest outlook as regards investments aimed at increasing the production capacity. They include “wearing apparel” and “vehicles, trailers and semi-trailers”, which together represent approx. 12.2% of the volume of production sold in the Polish manufacturing sector. Taking into consideration the recovery that we expect to take place in the automotive industry in relation to companies such as Mercedes, Audi, VW, Porsche or BMW launching new car models (see, for example, MACROmaps of 20/05/2024 and 27/05/2024), we believe that the capacity utilisation in the “vehicles, trailers and semi-trailers” category will keep on increasing in the quarters to come.

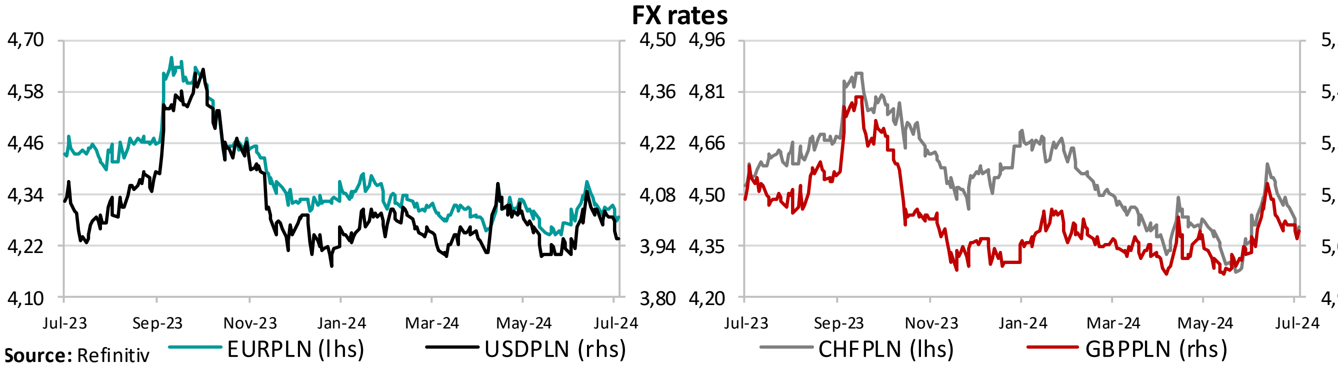
If the circle representing a given category is in the second quarter, this means that the capacity utilisation in that category in Q2 2024 was lower than it had been at the moment the war broke out in Ukraine, but it was growing over the last couple of months. In other words, those are categories with potential for the first quarter, which would be conducive to an increase in expenditures aimed at increasing their production capacities, provided that the favourable trends continue and the demand starts to grow. This group includes “food, beverage and tobacco products”, “textiles”, “chemicals and chemical products”, “other non-metallic mineral products”, “computer, electronic and optical products” and “furniture”. Together they represent approx. 38.2% of the volume of the production sold in the Polish manufacturing sector.

The third quarter shows the categories where the capacity utilisation in Q2 2024 was below the levels observed before the outbreak of war in Ukraine, and declined over the last couple of quarters. Those are categories where the likelihood of new major investments is low due to the production capacity buffer, which is large and growing. This group includes “products of wood, cork, straw and wicker”, “paper and paper products”, “printing and reproduction of recorded media”, “pharmaceutical products”, “rubber and plastic products”, “basic metals”, “fabricated metal products, except machinery and equipment”, “electrical equipment” and “machinery and equipment”, i.e. 9 out of 18 categories under analysis. Those categories represent 38.0% of the volume of production sold in the manufacturing sector.

The fourth quarter, in turn, comprises the categories in which the capacity utilisation in Q2 printed above the levels recorded at the moment of the outbreak of war in Ukraine, but nonetheless was falling over the last couple of quarters. Only one category, namely “other transport equipment” can be found in that quarter. It represents 1.8% of the value of the production sold in the Polish manufacturing sector.

The results of our analysis show that the outlook for investments is still poor for a half of the analysed categories. Given their relatively high share in the volume of production sold in the Polish manufacturing sector, it will curb the companies’ investments in the quarters to come, and will lead to a slowdown of investment growth in general. It is consistent with our forecast of a strong slowdown of investment growth in Poland, from 13.1% YoY in 2023 to -0.3% in 2024.

The result of the elections in France slightly negative for the PLN

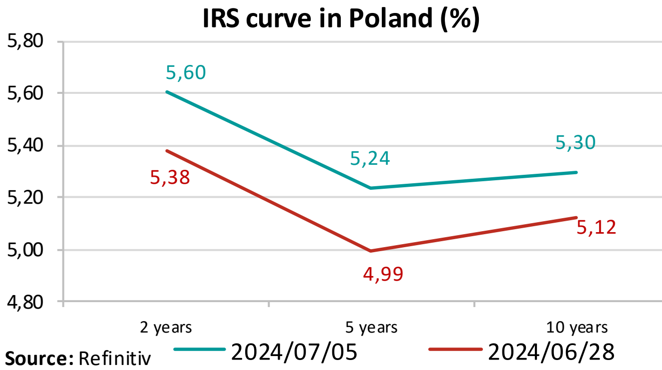


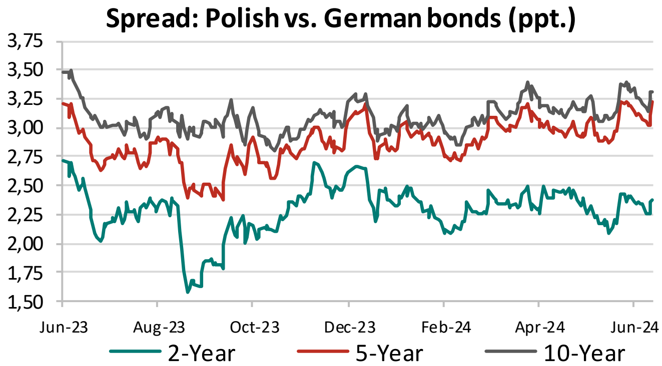
Source: Refinitiv

Last week, the EURPLN rate dropped to 4.2872 (the PLN strengthened by 0.4%). Last week, the EURPLN followed a downward trend as the EURUSD was rising. The USD weakened against the EUR due to increasing expectations concerning interest rate cuts in the US, which were driven up by lower-than-consensus business sentiment data for the US economy. US non-farm payroll data released on Friday did not have any significant impact on the currency market.

In our opinion, the result of the elections in France is slightly negative for the PLN. Turning to the week ahead, the Federal Reserve Chairman J. Powell's speech before the Congress, which is scheduled for Tuesday, will be of key importance for the PLN as it may be conducive to its increased volatility. We expect the publications from the global economy planned for this week to be neutral for the PLN.

Hawkish tone of the NBP Governor's press conference drives the IRS rates up





Source: Refinitiv

Last week, 2-year IRS rates increased to 5.60 (up by 22bp), 5-year rates to 5.24 (up by 25bp) and 10-year ones to 5.30 (up by 18bp). IRS rates went markedly up last week in response to the hawkish tone of the NBP Governor A. Glapiński's press conference, with A. Glapiński saying the interest rates could be cut no earlier than in 2026 (see above). As regards the core markets, the yields on bonds fell in reaction to interest rate cut expectations in the US. Consequently, the spread between the Polish and German bonds increased.

This week, the spotlights will be turned on the Federal Reserve Chairman J. Powell's speech before the Congress, which is scheduled for Tuesday and can be conducive to an increased volatility of the IRS rates. In our opinion, data releases from the global economy scheduled for this week will be neutral for the curve.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24	Feb-24	Mar-24	Apr-24	May-24	Jun-24	Jul-24
NBP reference rate (%)	6,75	6,75	6,75	6,00	5,75	5,75	5,75	5,75	5,75	5,75	5,75	5,75	5,75	5,75
EURPLN*	4,43	4,40	4,47	4,63	4,45	4,35	4,33	4,32	4,31	4,29	4,33	4,27	4,30	**4,30**
USDPLN*	4,06	4,00	4,12	4,37	4,21	4,00	3,93	4,00	3,99	3,97	4,06	3,94	4,02	**4,03**
CHFPLN*	4,52	4,59	4,66	4,78	4,62	4,56	4,64	4,64	4,52	4,40	4,41	4,36	4,47	**4,47**
CPI inflation (% YoY)	11,5	10,8	10,1	8,2	6,6	6,6	6,2	3,7	2,8	2,0	2,4	2,5	**2,5**	
Core inflation (% YoY)	11,1	10,6	10,0	8,4	8,0	7,3	6,9	6,2	5,4	4,6	4,1	3,8	**3,8**	
Industrial production (% YoY)	-1,6	-2,7	-2,2	-3,3	2,0	-0,3	-3,5	3,0	3,2	-5,7	7,8	-1,7	**-2,5**	
PPI inflation (% YoY)	0,3	-2,1	-2,9	-2,7	-4,2	-5,1	-6,9	-10,6	-10,0	-9,9	-8,5	-7,0	**-6,5**	
Retail sales (% YoY)	2,1	2,1	3,1	3,6	4,8	2,6	0,5	4,6	6,7	6,0	4,3	5,4	**5,7**	
Corporate sector wages (% YoY)	11,9	10,4	11,9	10,3	12,8	11,8	9,6	12,8	12,9	12,0	11,3	11,4	**11,2**	
Employment (% YoY)	0,2	0,1	0,0	0,0	-0,1	-0,2	-0,1	-0,2	-0,2	-0,2	-0,4	-0,5	**-0,5**	
Unemployment rate* (%)	5,1	5,0	5,0	5,0	5,0	5,0	5,1	5,4	5,4	5,3	5,1	5,0	**4,9**	
Current account (M EUR)	4087	55	587	1184	2151	1352	199	1742	511	325	-241	**-769**		
Exports (% YoY EUR)	4,3	0,2	-2,1	-4,0	2,1	-2,0	-6,2	-4,5	0,5	-9,5	5,5	**-7,3**		
Imports (% YoY EUR)	-5,0	-6,4	-10,9	-13,8	-7,1	-7,2	-10,6	-5,3	0,9	-8,3	5,7	**-1,4**		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland

Indicator	2024				2025				2023	2024	2025
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Gross Domestic Product (% YoY)	2,0	2,5	3,3	3,5	4,2	4,4	4,6	4,8	0,2	2,8	4,6
Private consumption (% YoY)	4,6	5,1	4,1	3,5	2,9	2,5	2,4	2,2	-1,0	4,3	2,6
Gross fixed capital formation (% YoY)	-1,8	0,1	0,9	-0,4	8,7	9,4	10,5	11,7	13,1	-0,3	10,4
Export - constant prices (% YoY)	0,5	1,0	3,5	6,5	7,3	5,7	4,3	7,1	3,4	2,8	6,3
Import - constant prices (% YoY)	-0,1	2,3	9,1	9,2	8,9	7,3	5,4	7,3	-2,0	5,0	7,6
GDP growth contributions: Private consumption (pp)	2,7	2,9	2,4	1,7	1,8	1,5	1,4	1,1	-0,5	2,4	1,5
GDP growth contributions: Investments (pp)	-0,2	0,0	0,1	-0,1	1,1	1,5	1,7	2,7	2,1	0,0	1,8
GDP growth contributions: Net exports (pp)	0,4	-0,6	-2,6	-1,0	-0,4	-0,4	-0,4	0,2	3,3	-1,0	-0,3
Current account (% of GDP)***	1,2	1,0	0,9	0,8	0,8	0,7	0,6	0,6	1,6	0,8	0,6
Unemployment rate (%)**	5,3	4,9	4,8	4,9	5,2	4,8	4,7	4,8	5,1	4,9	4,8
Non-agricultural employment (% YoY)	-0,2	-0,2	-0,2	-0,3	-0,4	-0,5	-0,5	-0,5	0,8	-0,2	-0,5
Wages in national economy (% YoY)	14,4	15,5	14,8	15,0	10,1	8,3	7,1	6,5	12,8	14,9	8,0
CPI Inflation (% YoY)*	2,8	2,5	4,6	5,1	5,5	5,1	3,5	3,4	11,6	3,8	4,4
Wibor 3M (%)**	5,88	5,85	5,88	5,88	5,88	5,63	5,51	5,38	5,88	5,88	5,38
NBP reference rate (%)**	5,75	5,75	5,75	5,75	5,75	5,75	5,50	5,25	5,75	5,75	5,25
EURPLN**	4,29	4,30	4,26	4,24	4,23	4,22	4,21	4,20	4,33	4,24	4,20
USDPLN**	3,97	4,02	4,02	4,04	3,95	3,87	3,83	3,75	3,93	4,04	3,75

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
		Monday 07/08/2024				
8:00	Germany	Trade balance (bn EUR)	May	22,1		21,2
10:30	Eurozone	Sentix Index (pts)	Jul	0,3		0,0
		Wednesday 07/10/2024				
3:30	China	PPI (% YoY)	Jun	-1,4		-0,8
3:30	China	CPI (% YoY)	Jun	0,3		0,4
16:00	USA	Wholesale inventories (% MoM)	May	0,6		
16:00	USA	Wholesale sales (% MoM)	May	0,1		
		Thursday 07/11/2024				
14:30	USA	CPI (% MoM)	Jun	0,0	0,1	0,1
14:30	USA	Core CPI (% MoM)	Jun	0,2	0,2	0,2
		Friday 07/12/2024				
16:00	USA	Initial U. of Michigan Sentiment Index (pts)	Jul	68,2	76,5	68,5
	China	Trade balance (bn USD)	Jun	82,6	83,3	85,2

*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

MACRO MAP

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