ECB bias is becoming increasingly dovish

This week

- **The most important event this week will be the reading of the April flash business sentiment indicators for major European economies scheduled for Thursday.** We expect that the Composite PMI for the Eurozone rose to 51.9 pts in April vs. 51.6 pts in March. Conducive to the index increase were the low base effects from the month before as well as the likely further improvement in Chinese manufacturing (increase in new orders, resulting in higher production in the German manufacturing). Geographically, the index increase resulted from the improvement of sentiment in both Germany and France. The business survey results will be particularly relevant for the assessment of the outlook for global trade. ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany will be released on Tuesday. We expect that its value increased to 7.0 pts in April from -3.6 pts in March. Our forecasts of business survey results for the Eurozone are close to the consensus; therefore, their materialization will be neutral for PLN and yields on Polish bonds.
- **Significant hard data on US economy and business survey results will be released this week.** We forecast that nominal retail sales increased by 1.0% MoM in March vs. a 0.2% decrease in February, due to higher sales in the automotive branch. We forecast that industrial production dynamics rose to 0.2% MoM in March vs. 0.0% in February, due to higher production growth in the category “utilities”. We expect that data concerning housing starts (1220k in March vs. 1162k in February) and building permits (1285k vs. 1291k) will point to stabilization in the US real estate market. Business survey results for manufacturing will also be released this week. We forecast that the Philadelphia FED dropped to 10.0 pts in April vs. 13.7 pts in March. The materialization of these forecasts will be consistent with our scenario, in which Q1 2019 will see a slight decline in the annualized GDP growth in the US down to 2.1% vs. 2.2% in Q4 2018. We believe that the aggregate impact of the data on the US economy will be limited.
- **Important data from China will be released on Wednesday.** We expect that the economic growth rate dropped to 6.3% in Q1 2019 vs. 6.4% (1.4% QoQ vs. 1.5% in Q4). Other monthly data will point in total to a slight acceleration of the annual growth rate of economic activity in March. We forecast that industrial production increased by 6.2% YoY in March vs. 5.3% in February, retail sales rose by 7.3% YoY vs. 8.2% in February, and urban investments rose by 6.3% YoY vs. 6.1% in February. In our view, the publication of data from China will be neutral for the financial markets.
- **The March data on average wages and employment in the corporate sector in Poland will be released on Wednesday**. We forecast that employment dynamics have not changed in March compared to February and amounted 2.9%. In turn, the average wage dynamics dropped, in our view, to 7.2% YoY in March vs. 7.6% in February, due to shifts in variable remuneration in mining. 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 March industrial production in Poland will be released on Thursday.** We forecast that industrial production growth slowed down to 4.3% YoY vs. 6.9% in February. Conducive to lower industrial production dynamics were unfavourable calendar effects and weaker foreign demand. We believe that the materialization of the forecast that is consistent with the market expectation will be neutral for PLN and yields on Polish bonds.
- **Another important event will be the review of Poland’s long-term rating by Moody’s scheduled for Friday**. The last review of the credit rating by Moody’s had been scheduled for October 2018 but the agency did not review Poland’s rating and did not publish a credit report at that time. Thus Poland’s rating was left at the existing level (A2 with a stable outlook). In its earlier reports the Agency was pointing to possible steady deterioration of the situation in public finance as conducive to Poland’s rating downgrade**.** We believe that, like S&P (see below), Moody’s will consider the government-proposed changes in the fiscal policy as

procyclical. Nevertheless, we expect that the rating and its outlook will remain unchanged. The agency's decision will be released after the closing of the European markets. The agency' decision, if in line with our expectations, will be neutral for PLN and yields on Polish bonds.

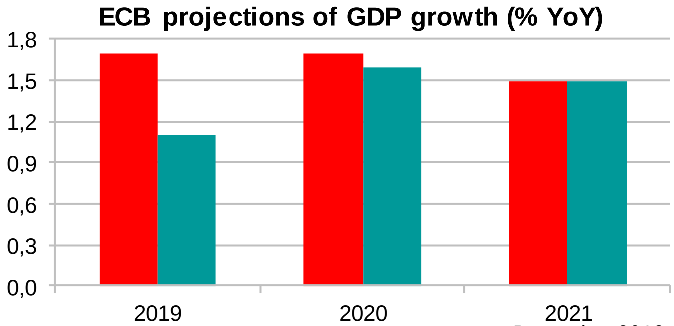
Last week

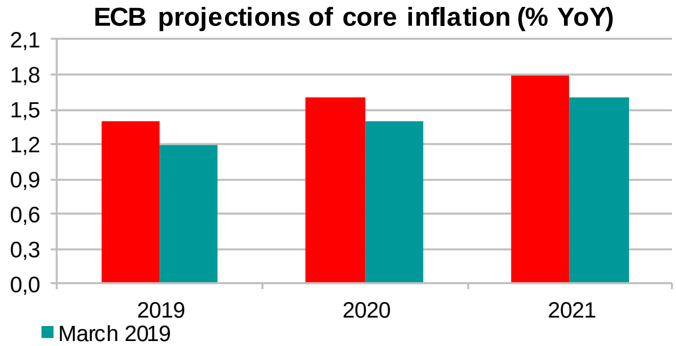
- **As we expected, S&P has affirmed Poland's long-term at A- with a stable outlook.** In the reasons for the decision, S&P pointed to sustainable economic growth, educated workforce, the EU membership, manageable levels of public and private debt, solid external metrics, and relatively deep domestic capital markets. According to the report, the rating could be raised if real income growth in Poland continued to outpace that of key trading partners without creating external imbalances or if the government posted budgetary surpluses, leading to a reduction in outstanding public debt in absolute terms. The rating could also be raised if the implementation of the Employee Equity Schemes (PPK) boosted private savings. At the same time the Agency pointed to possible significant deterioration of the situation in public finance or faster-than-expected wage growth (resulting in deterioration of competitiveness) as factors conducive to Poland's rating downgrade. The Agency believes that the government-proposed changes in the fiscal policy (so-called fiscal package) were procyclical and would result in higher public finance deficit. S&P has revised its forecast of the GG sector deficit in relation to GDP in 2020 from 2.0% to 2.6% and expects it to stay at this level in 2021 and 2022. We believe that the Agency will need several quarters to assess the results of the PPK. Consequently, we expect that the Agency will not change Poland's rating in the horizon of several quarters. In our view, the affirmation of Poland's credit rating by the Agency is neutral for PLN and bond yields.
- **The extraordinary summit of the European Council was held last week and decided to extend Brexit until 31 October 2019.** The condition of the extension is Great Britain's participation in the European Parliament election to be held between 23 and 26 May. Otherwise, Brexit will take place on 31 May 2019. At the same time, the statement after the summit emphasized that the Brexit deal was not renegotiable. In accordance with the summit decisions, the UK may leave the EU earlier than 31 October 2019 subject to approving T. May Brexit deal. The market's reaction to the summit results was limited. Our baseline scenario assumes that the UK will not leave the EU without a deal. Consequently, we maintain our scenario, in which as at the end of 2019 and 2020 GBPPLN will amount to 5.00 and 4.88, respectively.
- **The ECB meeting was held last week.** The statement after the meeting repeated the provision that the ECB expects "the interest rates to remain at their present levels at least through the end of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term". The tone of the conference after the ECB meeting last week confirmed the change in the central bank's bias that was signaled in March – a departure from the gradual normalization of the Eurozone monetary policy (implemented since June 2019) towards the possibility of its further easing (see below). We forecast that interest rates in the Eurozone will remain unchanged at least until the middle of 2021.
- **The Minutes of the March FOMC meeting were released last week.** As expected, the Minutes confirmed the change in the Federal Reserve's bias to more dovish. Especially noteworthy is the part saying that some FED members see significant uncertainty concerning the economic outlook and the situation in the financial markets. They also pointed out that the inflationary pressure in the US remained limited. At the same time some FED members mentioned that their views on the direction of changes in interest rates in the US may change with incoming data. The dovish tone of the Minutes supports our scenario assuming the stabilization of US interest rates in 2019 and 2020. The market is currently pricing in an interest rate cut by ca. 20bp in 2019.

- **CPI inflation in the US rose to 0.4% MoM in March vs. 0.2% in February (1.9% YoY in March vs. 1.5% in February), with market expectations at 0.2% MoM and 1.8% YoY, respectively**. Conducive to higher inflation in monthly terms were higher dynamics of energy prices, while lower growth rate of food prices had an opposite impact. Core inflation has not changed in March compared to February and amounted to 0.1% (2.0% YoY in March vs. 2.1% in February), running below the market consensus (0.2% MoM and 2.1% YoY, respectively). The stabilization of core inflation points to the weakening of inflationary pressure despite a slight growth of wage pressure observed in recent months. This supports our scenario assuming the stabilization of interest rates in the US in 2019 and 2020 (see above). The preliminary University of Michigan Index was also released last week and dropped to 96.9 pts in April vs. 98.4 pts, due to its lower sub-index concerning the assessment of the current situation, while higher sub-index for expectations had an opposite impact. We forecast that the annualized US GDP growth rate will decrease to 2.0% in Q2 2019 vs. 2.1% in Q1.
- **The Chinese balance on trade increased to USD 32.6bn in March vs. USD 4.1bn in February, running significantly above the market expectations (USD 8.8bn)**. At the same time, export dynamics rose to 14.2% YoY in March vs. -20.8% in February and import dynamics dropped to -7.6% YoY vs. -5.2% , running above and below the market consensus (7.3% and -1.3%), respectively. The sharp increase in export dynamics resulted mainly from the abatement of the statistical effect related to the earlier than in 2018 date of the Chinese New Year, which increased the activity in foreign trade in January and significantly decreased it in February. For this reason, only the April data will enable a more thorough assessment of the situation in the Chinese foreign trade. Last week we also saw data on new credits which amounted to CNY 1690bn in March vs. CNY 886bn in February, with expectations at CNY 1200bn, which points to the first effects of the People's Bank of China policy aimed at stimulating internal demand through higher lending. We maintain our forecast that H1 2019 will see further slowdown of Chinese GDP growth which will reach its local minimum at 6.1% YoY in Q2 2019. In H2 2019 we forecast acceleration of economic growth and consequently in the whole 2019 the GDP dynamics in China will amount to 6.4% vs. 6.6% in 2018.
- **A deficit in current account of EUR 1 386M was recorded in Poland in February vs. a surplus of EUR 1 825M in January.** The deterioration in the current account balance resulted from lower balances on trade, services, primary income, and secondary income (lower from January by EUR 1037M, EUR 172M, EUR 1585M, and EUR 417M, respectively). Export dynamics rose to 10.0% YoY in February vs. 5.0% in January, and imports dynamics rose to 13.4% YoY vs. 4.9%, which largely resulted from the last year's low base effects. Higher exports dynamics were also supported by higher activity of the export-oriented branches of the Polish manufacturing in February (see MACROpulse of 20/3/2019). We forecast that the cumulative current account balance for the last 4 quarters in relation to GDP will decrease to -1.0% in Q1 vs. -0.7% in Q4 2018.

ECB bias is becoming increasingly dovish

The ECB meeting was held last week. The statement after the meeting repeated the provision that the ECB expects "the interest rates to remain at their present levels at least through the end of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term".





Source: ECB, Credit Agricole

It should be pointed out that in March the ECB revised its forecasts of economic growth rate and inflation in the Eurozone for 2019-2021 visibly downwards (see the chart). In accordance with the then presented projection the ECB inflation target will not be reached over the forecast period. At the meeting last week, the ECB Governor, M. Draghi, was even more pessimistic than in March about the macroeconomic outlook for the single currency area. Like other members of the Governing Council, he sees the slowdown of economic growth, including lower inflationary pressure. The ECB Governor also considers a scenario of recession in the Eurozone. However, for the time being he believes that the materialization of this risk is very unlikely. Nevertheless, he pointed out that the ECB was ready to act should the macroeconomic situation so require.

Thus, the tone of the conference after the ECB meeting last week has confirmed the change in the central bank's bias that was signaled in March – a departure from the gradual normalization of the Eurozone monetary policy (implemented since June 2019) towards the possibility of its further easing. The first of the elements easing the monetary policy is the planned launch of the third round of TLTRO. TLTRO consist in granting long-term loans to commercial banks to stimulate lending. Details on the terms of the new TLTRO series will be communicated at one of the forthcoming meetings (we expect that it will be in June). The rates to be applied in the new round will take into account a thorough assessment of the bank-based transmission channel of monetary policy as well as further developments in the economic outlook.

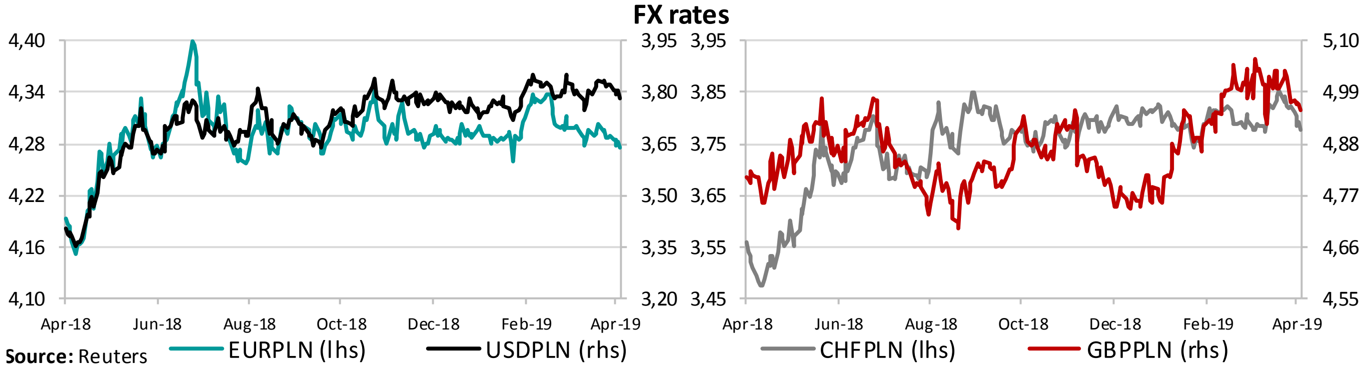
During the conference M. Draghi pointed out that the ECB would also consider whether the preservation of the favourable implications of negative interest rates for the economy required the mitigation of their possible side effects, if any, on bank intermediation. We believe that he referred to the possible introduction of a solution consisting in tiering the level of interest rates (in relation to negative deposit rate) on commercial banks' deposits at the central bank. However, M. Draghi pointed out that the Governing Council had not yet discussed the possible introduction of such solution. Asked if this measure, if implemented, would enable the ECB to maintain the deposit rate at a negative level for an extended period of time or to cut interest rates further, M. Draghi said it was currently difficult to link these two elements and that it would require a thorough analysis by the central bank.

Assuming that the possible implementation of a tiered deposit scheme for commercial banks' deposits at the central bank increases the effective deposit rate by 0.1 pp, the impact of such ECB measure on the result of the banking sector in the Eurozone will be limited. We estimate that it will result in increasing the total profits of commercial banks by ca. EUR 1.9bn (1.8% of net profit for 2017). This means that the effects of using such tool will have a limited impact on banks' capital and on lending. Therefore, such scheme will affect the macroeconomic conditions mainly through the monetary policy communication channels ("low/lower interest rates for an extended period of time"). However it should be pointed out that the ECB may achieve a similar result by modifying forward guidance.

The tone of the conference after the April ECB meeting supports our scenario of the monetary policy in the Eurozone (first hike no sooner than in the middle of 2021). We cannot rule out a scenario of further interest rate cuts in the Eurozone (in the event of the implementation of a tiered deposit scheme for commercial banks' deposits at the ECB). However under the current conditions further mitigation of the monetary policy in this way will have a limited impact on the economic growth and inflation in the Eurozone, we believe.

Business survey results in the Eurozone crucial for PLN

FX rates



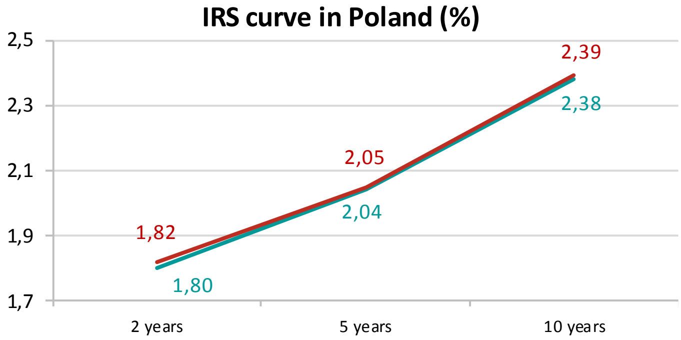
Source: Reuters

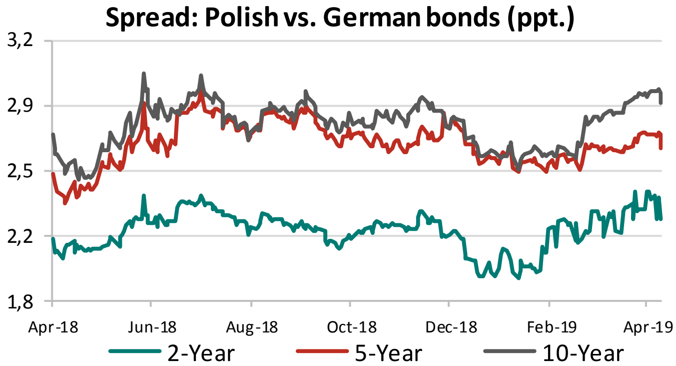
Last week, the EURPLN exchange rate dropped to 4.2758 (PLN strengthening by 0.3%). The first part of the week saw a weak appreciation of PLN in anticipation of the scheduled-for-Wednesday ECB meeting and the publication of the Minutes of the March FED meeting. The tone of the conference after the ECB meeting proved to be more dovish than expected, which resulted in further appreciation of PLN. Thursday saw a slight correct but on Friday PLN continued to appreciate, supported by a decline in global risk aversion. The Friday's S&P decision concerning the update of Poland's rating was announced after the closing of the European markets; therefore, it had no impact on PLN.

Last week EURUSD showed increased volatility. Wednesday saw its depreciation in reaction to a dovish tone of the press conference after the ECB meeting. On the other hand, early Friday morning saw a marked appreciation of EUR vs. USD, supported by increased transactional demand following the acquisition of a major European financial institution by an Asian investor. The European Council summit decisions concerning Brexit had a limited impact on EURGBP.

The affirmation by S&P of Poland's rating and its outlook is neutral for PLN. Crucial for PLN this week will be the results of business surveys (flash PMIs for the Eurozone and ZEW for Germany). However, if our forecasts that are close to the market consensus materialize, the data will not have any substantial impact on PLN. Numerous data from the US (industrial production, retail sales, housing starts, new building permits and Philadelphia FED) and data from China (GDP, industrial production, retail sales, urban investments) are also likely to be neutral for PLN. We believe that the scheduled for this week domestic readings of corporate wages and employment, and industrial production will not have any substantial impact on PLN. The Friday's update of Poland's rating by Moody's will be announced after the closing of the European markets; therefore, its impact on PLN will materialize no sooner than next week.

S&P report is neutral for IRS rates





Source: Reuters

Last week, 2-year IRS rates increased to 1.82 (up by 2bp), 5-year rates to 2.05 (up by 1bp), and 10-year rates to 2.39 (up by 1bp). Monday through Thursday, IRS rates were stable. The ECB meeting, publication of the Minutes of the March FED meeting, and the decisions of the European Council summit concerning Brexit had no substantial impact on the curve. Friday saw a slight increase in IRS rates following the German market. The Friday's S&P decision concerning the update of Poland's rating was announced after the closing of the European markets; therefore, it had no impact on the yield curve.

The affirmation by S&P of Poland's rating and its outlook is neutral for IRS rates. This week the market will focus on the results of business surveys (flash PMIs for the Eurozone and ZEW for Germany). However, we believe that these data will not have any substantial impact on IRS rates. In our view, numerous data from the US (industrial production, retail sales, housing starts, new building permits and Philadelphia FED) and data from China (GDP, industrial production, retail sales, urban investments) will also be neutral for the curve. The domestic readings of corporate wages and employment, and industrial production will also have a limited impact on IRS rates. The Friday's update of Poland's rating by Moody's will be announced after the closing of the European markets; therefore, it its impact on IRS rates will materialize no sooner than next week.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19
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*	4,21	4,24	4,31	4,37	4,27	4,30	4,28	4,34	4,29	4,29	4,26	4,30	4,30	4,31
USDPLN*	3,42	3,51	3,69	3,74	3,66	3,71	3,69	3,84	3,79	3,74	3,72	3,79	3,84	3,82
CHFPLN*	3,58	3,54	3,74	3,78	3,69	3,83	3,75	3,80	3,79	3,81	3,74	3,79	3,85	3,84
CPI inflation (% YoY)	1,3	1,6	1,7	2,0	2,0	2,0	1,9	1,8	1,3	1,1	0,7	1,2	1,5	
Core inflation (% YoY)	0,7	0,6	0,5	0,6	0,6	0,9	0,8	0,9	0,7	0,6	0,8	1,0	1,1	
Industrial production (% YoY)	1,7	9,3	5,2	6,7	10,3	5,0	2,7	7,4	4,6	2,8	6,0	6,9	4,3	
PPI inflation (% YoY)	0,5	1,0	3,0	3,7	3,4	3,0	3,0	3,2	2,8	2,1	2,2	2,9	2,6	
Retail sales (% YoY)	9,2	4,6	7,6	10,3	9,3	9,0	5,6	9,7	8,2	4,7	6,6	6,5	3,9	
Corporate sector wages (% YoY)	6,7	7,8	7,0	7,5	7,2	6,8	6,7	7,6	7,7	6,1	7,5	7,6	7,2	
Employment (% YoY)	3,7	3,7	3,7	3,7	3,5	3,4	3,2	3,2	3,0	2,8	2,9	2,9	2,9	
Unemployment rate* (%)	6,6	6,3	6,1	5,8	5,8	5,8	5,7	5,7	5,7	5,8	6,1	6,1	5,9	
Current account (M EUR)	-925	-34	236	192	-754	-1005	-876	-482	-29	-1248	1825	-1386		
Exports (% YoY EUR)	-2,8	10,4	1,5	7,7	12,0	8,9	-1,5	13,2	7,6	2,3	5,0	10,0		
Imports (% YoY EUR)	2,6	15,0	4,1	9,4	12,4	14,0	4,2	18,0	9,1	2,3	4,9	13,4		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland

Indicator	2019				2020				2018	2019	2020
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Gross Domestic Product (% YoY)	4,3	4,5	4,3	4,2	4,0	3,9	3,7	3,6	5,1	4,3	3,8
Private consumption (% YoY)	4,8	5,5	4,4	4,3	4,4	3,5	3,7	3,6	4,6	4,7	3,8
Gross fixed capital formation (% YoY)	8,5	5,8	5,2	5,0	4,7	4,9	4,8	5,0	7,3	5,8	4,8
Export - constant prices (% YoY)	7,0	5,7	6,4	6,1	7,8	8,4	8,6	8,4	6,2	6,3	8,3
Import - constant prices (% YoY)	8,3	8,7	6,8	6,9	6,4	8,0	8,1	8,3	7,0	7,7	7,7
GDP growth contributions: Private consumption (pp)	3,1	3,3	2,6	2,2	2,8	2,1	2,2	1,8	2,7	2,8	2,2
GDP growth contributions: Investments (pp)	1,0	0,9	0,9	1,2	0,6	0,8	0,9	1,2	1,3	1,0	0,9
GDP growth contributions: Net exports (pp)	-0,4	-1,3	0,0	-0,2	1,0	0,5	0,5	0,3	-0,2	-0,5	0,6
Current account (% of GDP)***	-1,0	-1,4	-1,0	-1,0	-1,1	-1,2	-1,2	-1,2	-0,7	-1,0	-1,2
Unemployment rate (%)**	5,9	5,5	5,7	5,8	5,9	5,5	5,7	5,8	5,8	5,8	5,8
Non-agricultural employment (% YoY)	0,4	0,4	0,4	0,3	0,2	0,2	0,2	0,3	0,9	0,4	0,2
Wages in national economy (% YoY)	8,2	7,7	7,2	7,1	7,4	7,1	6,6	6,8	7,2	7,6	7,0
CPI Inflation (% YoY)*	1,2	1,5	1,6	1,7	2,0	1,9	2,1	2,2	1,6	1,5	2,0
Wibor 3M (%)**	1,72	1,72	1,72	1,80	1,97	1,97	2,14	2,22	1,72	1,80	2,22
NBP reference rate (%)**	1,50	1,50	1,50	1,50	1,75	1,75	1,75	2,00	1,50	1,50	2,00
EURPLN**	4,30	4,33	4,29	4,25	4,23	4,21	4,19	4,15	4,29	4,25	4,15
USDPLN**	3,84	3,80	3,70	3,60	3,53	3,48	3,41	3,32	3,74	3,60	3,32

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST* CA	FORECAST* CONSENSUS**
		Monday 04/15/2019				
10:00	**Poland**	**CPI (% YoY)**	**Apr**	**1,7**	**1,5**	**1,5**
14:30	USA	NY Fed Manufacturing Index (pts)	Apr	3,7	9,0	7,0
		Tuesday 04/16/2019				
11:00	Germany	ZEW Economic Sentiment (pts)	Apr	-3,6	7,0	1,0
14:00	**Poland**	**Core inflation (% YoY)**	**Mar**	**1,0**	**1,1**	**1,3**
15:15	USA	Industrial production (% MoM)	Mar	0,1	0,2	0,3
15:15	USA	Capacity utilization (%)	Mar	78,2	79,1	79,2
		Wednesday 04/17/2019				
4:00	China	GDP (% YoY)	Q1	6,4	6,3	6,3
4:00	China	Retail sales (% YoY)	Mar	8,2	7,3	8,4
4:00	China	Industrial production (% YoY)	Mar	5,3	6,2	5,9
4:00	China	Urban investments (% YoY)	Mar	6,1	6,3	6,3
10:00	**Poland**	**Employment (% YoY)**	**Mar**	**2,9**	**2,9**	**2,9**
10:00	**Poland**	**Corporate sector wages (% YoY)**	**Mar**	**7,6**	**7,2**	**7,2**
11:00	Eurozone	HICP (% YoY)	Mar	1,4	1,4	1,4
		Thursday 04/18/2019				
9:30	Germany	Flash Manufacturing PMI (pts)	Apr	44,1	45,0	45,0
10:00	**Poland**	**Industrial production (% YoY)**	**Mar**	**6,9**	**4,3**	**4,2**
10:00	**Poland**	**PPI (% YoY)**	**Mar**	**2,9**	**2,6**	**2,6**
10:00	Eurozone	Flash Services PMI (pts)	Apr	53,3	53,3	53,1
10:00	Eurozone	Flash Manufacturing PMI (pts)	Apr	47,5	48,0	48,0
10:00	Eurozone	Flash Composite PMI (pts)	Apr	51,6	51,9	51,7
14:00	**Poland**	**MPC Minutes**	**Apr**			
14:30	USA	Retail sales (% MoM)	Mar	-0,2	1,0	0,8
14:30	USA	Philadelphia Fed Index (pts)	Apr	13,7	10,0	10,3
		Friday 04/19/2019				
14:30	USA	Housing starts (k MoM)	Mar	1162	1220	1240
14:30	USA	Building permits (k)	Mar	1291	1285	1300

*The forecasts of macroeconomic indicators for Poland were prepared by Credit Agricole Bank Polska S.A. The forecasts of foreign indicators were prepared by Crédit Agricole Corporate and Investment Bank
** Reuters

MACRO MAP

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