Gradual unfreezing of Polish manufacturing

This week

- **The most important event this week will be the ECB meeting scheduled for Thursday.** We expect interest rates to be maintained at the current level. We believe that the central bank will increase the scale of the ongoing Pandemic Emergency Purchase Program (PEPP) aimed at combating the negative impact of the COVID-19 epidemic on the Eurozone economy from EUR 750bn to EUR 1500bn and will extend its horizon until 2021 (now it is the end of 2020). Such decision will be supported by the ECB latest macroeconomic projection which will signal a marked deterioration of the macroeconomic outlook within the single currency area. The decision on extending the program at such scale has not been fully priced in by the markets; therefore, its materialization will be slightly positive for PLN vs EUR and the prices of Polish bonds.
- **This week we will see important data from the US.** Data from the labour market are scheduled to be released on Friday. Considering the still significant albeit decreasing number of unemployment benefit claims in recent weeks (see below), we expect non-farm payrolls to have decreased by 9M in May vs. a 20.5M decrease in April. Before the Friday's reading some additional information on the labour market will be provided by the ADP report on private sector employment (the market expects a decrease by 9.5M in May vs. a 20.2M decrease in April). The ISM index for manufacturing will be released today and in accordance with our forecast will rise to 43.0 pts in May vs. 41.5 pts in April. Slower decline in manufacturing activity has already been signaled earlier by regional business surveys. We expect that the publication of US data will not be market moving.
- **In recent days we have seen the May business survey results for China.** China Caixin manufacturing PMI rose to 50.7 pts in May vs. 49.4 pts in April, running above the market expectations (49.6 pts). The index increase resulted from higher contributions of 3 of its 5 sub-indices (for output, new orders and employment), while lower contributions of the sub-indices for suppliers' delivery times and inventories had opposite impact. Noteworthy in the data structure is the continuingly high rate of decline in new export orders. It shows that the Chinese manufacturing continues to be impacted by lower activity abroad due to the COVID-19 pandemic. On the other hand, CFLP PMI indicated a slight deterioration in Chinese manufacturing and dropped to 50.6 pts in May vs. 50.8 pts in April, running slightly below the market expectations (51.0 pts). We forecast that the GDP in China will increase by 2% YoY in 2020.
- **Polish manufacturing PMI has been released today.** The index increased to 40.6 pts in May vs. 31.9 pts in April, running above the market expectations (35.6 pts) and our forecast (35.0 pts). Coupled with the April's hard data, the business survey results pose a downside risk to our forecast of the GDP dynamics in Q2 (-8.4% YoY vs. 2.0% in Q1 – see below).

Last week

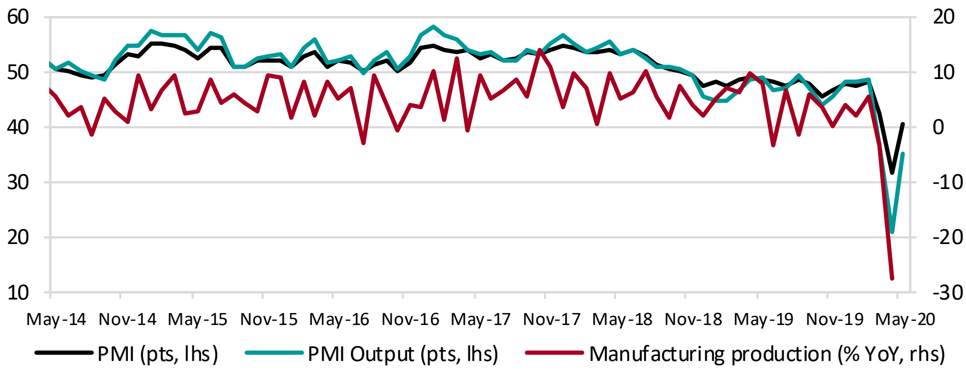
- **As we expected, the Monetary Policy Council decided last week to cut interest rates.** The NBP reference rate was reduced by 40 bps (from 0.50% down to 0.10%) and the lombard rate decreased by 50 bps (from 1.00% to 0.50%). According to the assessment presented in the press release after the meeting, the main reason for the cut was the continuing risk of inflation falling below the MPC inflation target in the monetary policy transmission horizon. According to the MPC, this risk is due to the outbreak of COVID-19 epidemic which contributed to a fall in global and Polish economic activity and to falling fuel prices. The Council believes that "the scale of the expected recovery could be curbed by uncertainty regarding the consequences of the pandemic, lower incomes and weaker sentiment of economic agents than in previous years". In the Council's opinion, monetary policy easing alleviates the fall in employment and deterioration of financial situation of enterprises, thus being conducive to quicker recovery after the abatement of the pandemic (see MACROpulse of 28/5/2020). In accordance with the statement, the NBP will continue to purchase treasury securities and government-guaranteed debt securities on the secondary market as part of structural open market operations. We expect the Council to wait with subsequent monetary policy decisions at least until autumn 2020. If there is a second wave of the COVID-19 pandemic, the Council may decide to take measures aimed at stimulating lending and demand similar to those taken in recent years by the central banks implementing monetary policy amid slightly positive or negative interest rates. We maintain our forecast in which the first interest rates hike will take place in July 2021.

- **In accordance with the flash estimate, CPI inflation in Poland dropped to 2.9% YoY in May vs. 3.4% in April, running below the market expectations equal to our forecast (3.0%)**. GUS has published partial data on the inflation structure, including information on the rate of inflation in the categories "food and non-alcoholic beverages", "energy", and "fuels". Conducive to the decrease in headline inflation were lower dynamics of the prices of food and non-alcoholic beverages (6.1% in May vs. 7.4% in April) and fuels (-23.4% YoY vs. -18.8%), while the dynamics of the prices of energy have not changed in May compared to April (5.2% YoY). In accordance with our estimates, core inflation rose to 3.8% YoY in May vs. 3.6% in April. We maintain our forecast, in which inflation will, on a yearly average, amount to 3.1% YoY vs. 2.3% in 2019. Final data on inflation will be released on 15 June.
- **The Polish GDP growth rate amounted to 2.0% YoY in Q1 vs. 3.2% in Q4 2019, running above the flash estimate released earlier (1.9%).** Slower GDP growth resulted from lower contributions of net exports (0.4 pp in Q1 vs. 2.0 pp in Q4), investments (0.1 pp vs. 1.5 pp), and private consumption (0.7 pp vs. 1.6 pp), while higher contributions of inventories (0.0 pp vs. -2.5 pp) and public consumption (0.8 pp vs. 0.6 pp) had opposite impact. Thus, the main source of GDP growth in Q1 was public consumption, while in previous quarters it was private consumption (see MACROpulse of 29/5/2020). It is worth noting that the structure of economic growth reflects a different reality from the one we are dealing with now, i.e. before the outbreak of the coronavirus epidemic. Thus, the tendencies it shows are of a limited predictive importance for subsequent quarters. The April data on retail sales, industrial production and construction-assembly production signal a downside risk to our forecast of economic growth in Q2 (-8.4% YoY) and in whole 2020 (-3.8%).
- **Nominal dynamics of investments in the Polish sector of enterprises employing at least 50 people decreased to 5.2% YoY in Q1 vs. 5.6% in Q4.** According to our estimates, it mainly resulted from lower dynamics of investments in the services (-0.7% YoY in Q1 vs. 1.3% in Q4), construction (0.2% vs. 1.4%), and mining (0.5% vs. 0.9%), while higher dynamics of investments in manufacturing (5.3% vs. 2.5%) and energy (-0.7% vs. -1.2%) had opposite impact. It is worth noting that the data on investments reflect a different reality from the one we are dealing with now, i.e. before the outbreak of the coronavirus epidemic. We forecast that total investments will decrease by 10.3% YoY in 2020 vs. a 6.9% increase in 2019.
- **According to the flash estimate, inflation in the Eurozone dropped to 0.1% YoY in May vs. 0.3% in April, running in line with the market consensus and above our forecast (0.0%).** The decrease in inflation resulted from lower dynamics of energy and food prices. We expect that in the coming months inflation will stand slightly above zero, in turn, in H2 2020 we will see a slight deflation in the Eurozone due to further decrease in core inflation. We forecast that HICP inflation will on a yearly average amount to 0.2% YoY in 2020 vs. 1.2% in 2019 and will increase to 0.5% in 2021.
- **Ifo Index reflecting the sentiment among German managers representing the manufacturing, construction, trade, and services rose to 79.5 pts in May vs. 74.2 pts in April, running slightly above the market expectations (78.3 pts).** The index increase resulted from its higher sub-index for expectations while the sub-index for the assessment of the current situation has further deteriorated. Sector-wise, improved sentiment was recorded in all the sectors covered

by the survey: manufacturing, construction, trade, and services, due to the gradual lifting of the restrictions imposed with a view to containing the spread of the COVID-19 pandemic. We forecast that the German GDP will decrease by 8.0% in 2020 vs. a 0.5% increase in 2019 and will increase by 6.1% in 2021.

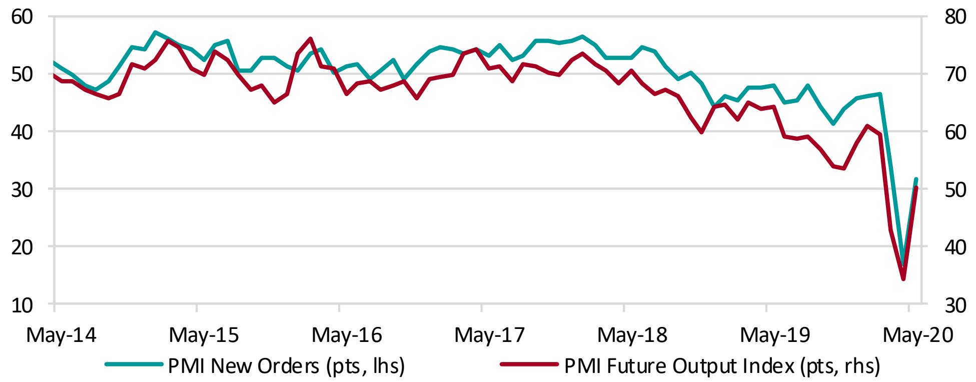
- **Significant data from the US were released last week.** The number of unemployment benefit claims amounted to 2123k last week vs. 2446k two weeks ago, pointing to a continuing high rate of employment decline in the US. Last week we also saw flash data on durable goods orders which decreased by 17.2% MoM in April vs. a 16.6% decrease in March. Excluding means of transport, the monthly dynamics of durable goods orders dropped to -7.4% in April vs. -1.7% in March. Last week we saw the second estimate of the US GDP in Q1, in which the annualized US GDP growth rate amounted to -5.0% vs. -4.8%. The downward revision resulted from lower contribution of inventories (-1.43 pp in the second estimate vs. -0.53 in the first estimate), while higher contributions of private consumption (-4.69 pp vs. -5.26 pp), government expenditure (0.15 pp vs. 0.13 pp), investments (-0.41 vs. -0.43 pp), and net exports (1.32 pp vs. 1.30 pp) had opposite impact. Thus, private consumption was the main source of the US GDP decrease. Last week we also saw data on new home sales (623k in April vs. 619k in March), which contrary to market expectations and unlike the data released in recent weeks did not point to a sharp decrease in activity in the US real estate market. The results of business surveys were also released last week. The Conference Board Index increased to 86.6 pts in May vs. 85.7 pts in April, suggesting a slight improvement of consumer sentiment. The index increase resulted from its higher sub-index for expectations while the sub-index for the assessment of the current situation has further deteriorated. A slight improvement of consumer sentiment was also suggested by the University of Michigan Index which rose to 72.3 pts in May vs. 71.8 pts in April and 73.7 pts in the flash estimate. Unlike the Conference Board Index the increase in the University of Michigan Index resulted from higher sub-index for the assessment of the current situation while the sub-index for expectations has decreased. We forecast that the annualized US GDP growth rate will drop to -30% in Q2 and will decrease by 5.5% in the whole of 2020. At the same time we expect that the unemployment rate in the US will reach its local maximum in Q2 exceeding 20% and in subsequent quarters it will gradually decrease to slightly below 10% at the end of 2020. Due to its negative impact on consumption, the marked deterioration in the labour market will be one of the main factors contributing to the GDP decline in 2020. We believe that in 2021 the US GDP will increase by 4.5% YoY and thus will stay below the levels from before the outbreak of the pandemic. This is in line with our scenario assuming that FED interest rates will stay close to zero at least until the end of 2021. At the same time, we believe that FED may start to control the level of the yield curve, treating it as a form of communicating its monetary policy outlook. Nonetheless, we do not expect FED to decide to introduce negative interest rates in the horizon of our forecast. We believe that it will use the so-far tools of its monetary policy.

Gradual unfreezing of Polish manufacturing



Source: Markit. GUS

Polish manufacturing PMI has been released today. The index increased to 40.6 pts in May vs. 31.9 pts in April, running above the market expectations (35.6 pts) and our forecast (35.0 pts). The index structure reflects the resumption of operations by some companies after the lockdown in April and points to the first effects of the gradual easing of the administrative restrictions imposed to contain the spread of the epidemic. The output sub-index rose to 35.1 pts in May vs. 20.9 pts in April but still remains below the level recorded in March (36.6 pts). Today's business survey results support our forecast of increase in the industrial production dynamics to -20.0% YoY in May from -24.6% in April.

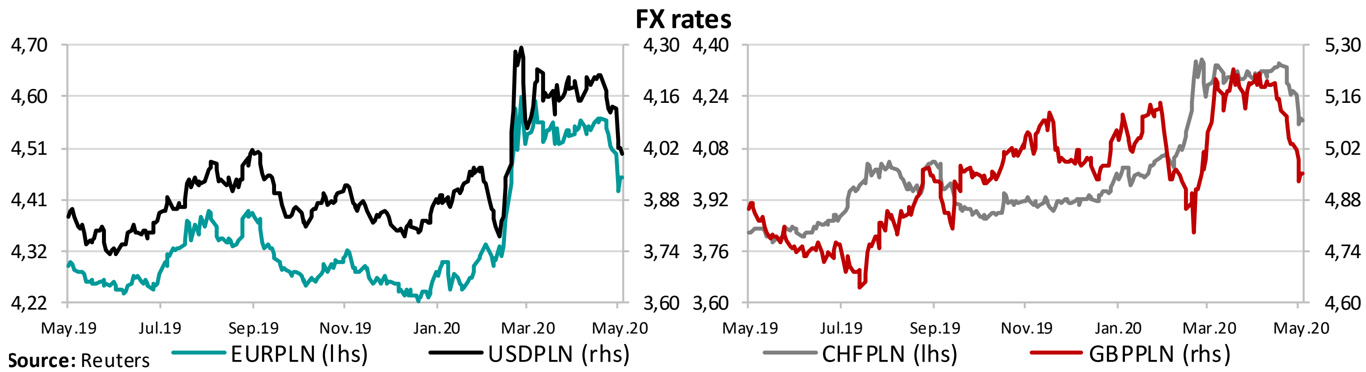


Source: Markit

Despite the slight improvement in May, the Polish manufacturing outlook continues to be bleak. Total new orders and new export orders decreased in May at a slower rate than in April however it has still been the second fastest decline rate in the survey history, i.e. since the middle of 1998. In May we continued to see the reduction of jobs, albeit to a smaller extent than in April. The indicator of future production (in the horizon of 12 months) increased in May to near 50 pts, which means that the number of companies which expect an increase in production and of those expecting a decrease in production during the year is similar.

Today's business survey results point to continuing negative impact of the COVID-19 epidemic on Polish manufacturing activity. The average PMI value between April and May amounted to 36.2 pts vs. 46.0 pts in Q1. Coupled with the April's hard data, the business survey results pose a downside risk to our forecast of the GDP dynamics in Q2 (-8.4% YoY vs. 2.0% in Q1).

Marked appreciation of PLN supported by improvement in global sentiments



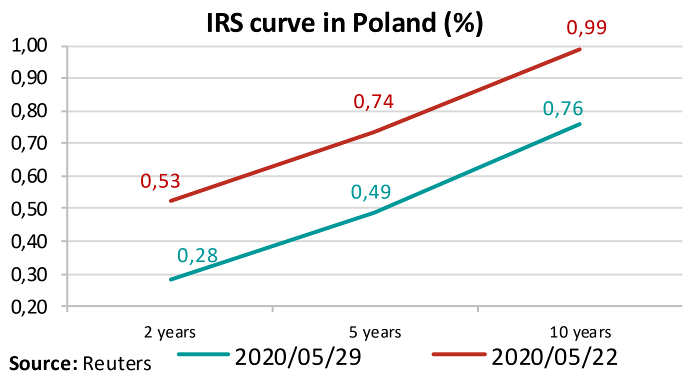
Source: Reuters

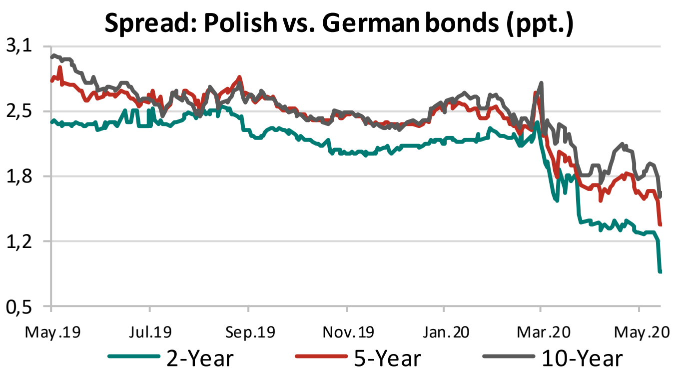
Last week, the EURPLN exchange rate dropped to 4.4522 (strengthening of PLN by 1.2%). Last week saw a marked appreciation of PLN and other emerging currencies, supported by improving global sentiment with the gradual unfreezing of activity in major economies. On Thursday PLN depreciated in reaction to the MPC's decision to reduce interest rates. Nonetheless, EURPLN remained clearly above the levels from the beginning of the week.

Due to lower risk aversion, last week saw the outflow of capital from so-called safe-havens and, consequently, the depreciation of USD and CHF. Thus, EURUSD rose last week to the highest level since March 2019.

The business survey results released this morning for Polish manufacturing are slightly positive for PLN. We expect that this week, like in the previous weeks, PLN will remain impacted by global sentiment related to the coronavirus pandemic. Crucial for the investors will be the information on the spread of the pandemic, especially in the context of the prospective lifting of administrative restrictions in major economies. This week of particular importance for PLN will be the ECB meeting scheduled for Thursday. We believe that it may contribute to the strengthening of PLN vs. EUR. Data from the US (non-farm payrolls, manufacturing ISM, number of unemployment benefit claims) will not have any significant impact on PLN.

Sharp decline in IRS rates in reaction to the MPC's decision to cut interest rates





Source: Reuters

Last week, 2-year IRS rates dropped to 0.28 (down by 25bps), 5-year rates to 0.49 (down by 25bps), and 10-year rates to 0.76 (down by 23bps). Last week saw a marked decrease in IRS rates across the curve in reaction to the MPC's decision to reduce interest rates. The macroeconomic readings and other market developments remained overshadowed by the MPC's decision.

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The Polish manufacturing PMI released this morning is slightly positive for IRS rates. The ECB meeting scheduled for Thursday may contribute towards a decrease in IRS rates this week. Data from the US (non-farm payrolls, manufacturing ISM, number of unemployment benefit claims) will be neutral for the curve, we believe.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	May.19	Jun.19	Jul.19	Aug.19	Sep.19	Oct.19	Nov.19	Dec.19	Jan.20	Feb.20	Mar.20	Apr.20	May.20	Jun.20
NBP reference rate (%)	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,00	0,50	0,10	**0,10**
EURPLN*	4,28	4,24	4,29	4,38	4,37	4,26	4,31	4,26	4,30	4,33	4,55	4,54	4,44	**4,44**
USDPLN*	3,83	3,73	3,87	3,98	4,01	3,82	3,91	3,79	3,87	3,92	4,13	4,15	4,00	**4,07**
CHFPLN*	3,83	3,82	3,90	4,02	4,02	3,87	3,91	3,92	4,02	4,06	4,29	4,30	4,16	**4,19**
CPI inflation (% YoY)	2,4	2,6	2,9	2,9	2,6	2,5	2,6	3,4	4,3	4,7	4,6	3,4	**3,0**	
Core inflation (% YoY)	1,7	1,9	2,2	2,2	2,4	2,4	2,6	3,1	3,1	3,6	3,6	3,6	**3,5**	
Industrial production (% YoY)	7,6	-2,6	5,8	-1,5	5,5	3,7	1,5	3,8	1,1	4,8	-2,4	-24,6	**-20,0**	
PPI inflation (% YoY)	1,4	0,5	0,5	0,9	0,8	-0,3	-0,1	1,0	0,9	0,2	-0,3	-1,3	**-1,5**	
Retail sales (% YoY)	7,3	5,3	7,4	6,0	5,3	5,4	5,9	7,5	5,7	9,6	-7,0	-22,6	**-18,5**	
Corporate sector wages (% YoY)	7,7	5,3	7,4	6,8	6,6	5,9	5,3	6,2	7,1	7,7	6,3	1,9	**2,4**	
Employment (% YoY)	2,7	2,8	2,7	2,6	2,6	2,5	2,6	2,6	1,1	1,1	0,3	-2,1	**-2,7**	
Unemployment rate* (%)	5,4	5,3	5,2	5,2	5,1	5,0	5,1	5,2	5,5	5,5	5,4	5,8	**6,3**	
Current account (M EUR)	-227	10	-824	-820	846	442	1412	366	2348	878	2438	**2196**		
Exports (% YoY EUR)	11,5	-2,4	6,4	-1,2	13,0	4,0	0,8	9,0	3,6	7,5	-7,5	**-32,3**		
Imports (% YoY EUR)	11,5	-5,3	6,7	-3,0	6,2	0,3	-3,5	-0,7	2,4	0,6	-4,5	**-30,4**		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland

Indicator	2020				2021				2019	2020	2021
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Gross Domestic Product (% YoY)	2,0	-8,4	-3,1	-5,3	-0,2	5,5	3,7	3,5	4,1	-3,8	3,0
Private consumption (% YoY)	1,2	-15,0	-5,1	-2,0	2,1	8,1	4,3	3,7	3,9	-5,1	4,2
Gross fixed capital formation (% YoY)	0,9	-7,0	-12,2	-16,5	-5,4	3,4	4,8	5,4	7,2	-10,3	2,5
Export - constant prices (% YoY)	0,6	-6,3	-2,3	-1,1	2,0	4,5	4,0	4,1	4,7	-2,1	3,6
Import - constant prices (% YoY)	-0,2	-7,0	-5,4	1,0	4,5	5,0	3,4	3,5	2,7	-2,8	4,0
GDP growth contributions Private consumption (pp)	0,7	-8,7	-3,0	-1,0	1,3	4,4	2,5	1,9	2,2	-2,9	2,3
Investments (pp)	0,1	-1,2	-2,2	-4,2	-0,7	0,6	0,8	1,2	1,3	-1,9	0,4
Net exports (pp)	0,4	0,0	1,5	-1,0	-1,2	0,0	0,5	0,5	1,2	0,3	0,0
Current account (% of GDP)***	1,3	1,2	1,1	0,2	-0,1	-0,1	0,0	0,1	0,5	0,2	0,1
Unemployment rate (%)**	5,4	8,2	8,6	8,0	7,8	6,2	5,5	6,1	5,2	8,0	6,1
Non-agricultural employment (% YoY)	0,7	-2,5	-3,1	-2,0	-0,9	3,2	2,9	2,2	0,3	-1,7	1,8
Wages in national economy (% YoY)	7,7	5,9	3,6	2,9	3,0	3,6	4,3	4,9	7,2	5,0	4,0
CPI Inflation (% YoY)*	4,5	2,6	2,1	3,2	2,1	3,7	3,3	1,8	2,3	3,1	2,7
Wibor 3M (%)**	1,17	0,30	0,30	0,30	0,30	0,53	0,70	0,78	1,71	0,30	0,78
NBP reference rate (%)**	1,00	0,10	0,10	0,10	0,10	0,10	0,50	0,50	1,50	0,10	0,50
EURPLN**	4,55	4,44	4,40	4,37	4,36	4,35	4,34	4,33	4,26	4,37	4,33
USDPLN**	4,13	4,07	4,00	3,94	3,93	3,95	3,95	3,94	3,79	3,94	3,94

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
		Monday 06/01/2020				
3:45	China	Caixin Manufacturing PMI (pts)	May	50,2	49,6	49,6
9:00	**Poland**	**Manufacturing PMI (pts)**	**May**	**31,9**	**35,0**	**35,6**
9:55	Germany	Final Manufacturing PMI (pts)	May	36,8	36,8	36,8
10:00	Eurozone	Final Manufacturing PMI (pts)	May	39,5	39,5	39,5
15:45	USA	Flash Manufacturing PMI (pts)	May	39,8		
16:00	USA	ISM Manufacturing PMI (pts)	May	41,5	43,0	43,5
		Wednesday 06/03/2020				
10:00	Eurozone	Services PMI (pts)	May	28,7	28,7	28,7
10:00	Eurozone	Final Composite PMI (pts)	May	30,5	30,5	30,5
11:00	Eurozone	Unemployment rate (%)	Apr	7,4		8,2
11:00	Eurozone	PPI (% YoY)	Apr	-2,8		-4,0
14:15	USA	ADP employment report (k)	May	-20236		-9500
16:00	USA	Factory orders (% MoM)	Apr	-10,3		-12,4
16:00	USA	ISM Non-Manufacturing Index (pts)	May	41,8	44,0	43,0
		Thursday 06/04/2020				
11:00	Eurozone	Retail sales (% MoM)	Apr	-11,2		-15,0
13:45	Eurozone	EBC rate decision (%)	Jun	0,00	0,00	0,00
14:30	USA	Initial jobless claims (k)	w/e	2438		2100
		Friday 06/05/2020				
8:00	Germany	New industrial orders (% MoM)	Apr	-15,6		-20,0
14:30	USA	Unemployment rate (%)	May	14,7	20,5	19,6
14:30	USA	Non-farm payrolls (k MoM)	May	-20500	-9000	-10000

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

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