MPC is going to introduce forward guidance

This week

- **In accordance with partial data (based on results from 99.97% of constituencies) communicated by the National Election Commission, A. Duda took 51.2% of the vote in the second round of the presidential election and R. Trzaskowski secured 48.79%**. The Head of the Commission, S. Marciniak, indicated that the addition of protocols from the missing constituencies will not affect the final result of the presidential election pointing to the victory of A. Duda. We believe that such result is neutral for PLN and yields on Polish bonds.
- **The most important event this week will be the meeting of the Monetary Policy Council scheduled for Wednesday**. The statement after the meeting will be of particular importance due to the publication of the preliminary results of the July macroeconomic projection. The GDP growth path will be significantly lowered in the July projection due to the forecast's markedly lower starting point. In turn, the inflation path is likely to run below the target in the monetary policy transmission horizon. In the statement the Council will point out the still high uncertainty about the macroeconomic conditions in the medium term. In sum, the projection is going to present an anti-inflation scenario with the Polish economy slowly regaining the equilibrium. It will thus be an argument in favour of further monetary easing. We expect the MPC to introduce forward guidance at its meeting this week, namely the announcement of keeping interest rates close to zero for an extended period of time (see below). The specific formula of the forward guidance, modeled after the one proposed by the ECB, is likely to point to the stabilization of interest rates or a possibility of further cuts. We believe that the materialization of our scenario after this week's meeting will be slightly negative for PLN and yields on Polish bonds.
- **Another important event this week will be the ECB meeting scheduled for Thursday.** We expect that the monetary policy parameters will be left unchanged. During the conference Ch. Lagarde is likely to emphasize that the ECB will follow the wait-and-see policy and needs time to assess the impact of the relaxation of the policy in recent months on the macroeconomic situation in the Eurozone. The ECB Governor will again emphasize that she is prepared to act if needed. We believe that it is highly likely that the ECB will increase the scale of its asset purchase programs (PEPP or its basic quantitative easing program) and will increase the limit on the amount of funds deposited in the ECB at 0.0% (so-called tiering) before the end of 2020. We believe that the conference after the ECB meeting will be neutral for the financial markets.
- **This week we will see some important data from China.** The market expects that the GDP increased by 2.5% YoY in Q2 vs. a 6.8% decrease in Q1 (+10.4% QoQ vs. -9.8% in Q1). In accordance with the market expectations, the June data will also point to the recovery of the economic activity in China. Industrial production increased by 4.7% YoY in June vs. a 4.4% increase in May, retail sales increased by 0.4% YoY in June vs. a 2.8% decrease in May, while urban investments rose to -0.3% YoY from 6.3% in May. In accordance with the consensus, the Chinese balance on trade dropped to USD 58.6bn in June vs. USD 62.9bn in May. At the same time, export dynamics rose to -1.4% YoY in June vs. -3.3% in May and import dynamics rose to -10.0% YoY vs. -16.7%. Data in line with the market expectations, pointing to further recovery of the Chinese economy, will be neutral for the financial markets. It is worth noting that the People's Bank of China, in the situation of sooner-than-expected recovery of economic activity in China, communicated last week that it would start to gradually withdraw the demand stimulating tools introduced due to the pandemic.
- **This week we will see some important data from the US reflecting the impact of the lifting of restrictions in some states on the economic activity**. We expect that nominal retail sales increased by 4.8% MoM in June vs. a 17.7% increase in May. We forecast that industrial production dynamics rose by 4.0% MoM in June vs. a 1.4% increase in May We expect that data on housing starts (1150k in June vs. 974k in May) and building permits (1277k vs. 1216k) will point to a slight increase in activity in the US real estate market. We expect that headline inflation rose to 0.5% YoY in June vs. 0.1% in May, due to higher dynamics of energy prices. The

preliminary University of Michigan Index will be released on Friday. We forecast that its value dropped to 77.0 pts in July vs. 78.1 pts in May due to households' concerns about the second wave of the epidemic in the US. We believe that the aggregate impact of data from the US economy on the financial markets will be limited.

- **This week we will see some important data from the US reflecting the impact of the lifting of restrictions in some states on the economic activity.** We expect that nominal retail sales rose to 8.0% MoM in May vs. a 16.4% decrease in April. We forecast that industrial production dynamics rose to 3.1% MoM in May vs. -11.2% in April. We expect that data on housing starts (1069k in May vs. 891k in April) and building permits (1215k vs. 1066k) will point to continuingly low activity in the US real estate market. We believe that the aggregate impact of data from the US economy on the financial markets will be limited.
- **ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany will be released on Tuesday**. The market expects that its value will decrease to 60.0 pts in July vs. 64.4 pts in June. The publication is likely to be neutral for the financial markets.
- **Data on the Polish balance of payments in May will be released on Tuesday**. We expect the current account balance to have increased to EUR 1243M vs. EUR 1163M in April. We forecast that export dynamics increased from -22.9% YoY in May to -29.2% in April, while import dynamics increased to -22.9% YoY from -28.2%. The increase in exports and imports will be consistent with the rebound in industrial production and retail sales recorded in May. In our view, the data on the balance of payments will be neutral for PLN and yields on Polish bonds.
- **Final data on the June inflation in Poland will be released on Wednesday.** The rate of inflation is likely to be in line with the flash estimate (3.3% YoY vs. 2.9% in May). Conducive to the inflation increase was higher core inflation and higher dynamics of fuel prices, while lower dynamics of food prices had opposite impact. The inflation reading will be neutral for PLN and the prices of Polish bonds.
- **The June data on average wages and employment in the corporate sector in Poland will be released on Friday**. We forecast that employment dynamics dropped to -4.0% YoY in June vs. -3.2% in May, due to the suspension of the recruitment process and redundancies amid the epidemic. We expect that the average wage dynamics rose to 1.6% YoY in June vs. 1.2% in May, due to severance payments for employees made redundant, resumption of work by persons previously affected by the lockdown, and low base effects. Though important for the forecast of private consumption dynamics in Q2, the release of data on corporate wages and employment will be neutral for PLN and the debt market, we believe.

Last week

- **Important data from the German economy were released last week**. Industrial production increased by 7.8% MoM in May vs. a 17.5% decrease in April, running below the market expectations (+10.0%). An increase in production was recorded in all the main categories (manufacturing, energy, and construction) and the sharpest increase in production took place in manufacturing which was affected the most by the effects of the pandemic in recent months. However it is worth emphasizing that despite a sharp increase in May the volume of production in the German manufacturing continues to be 20% lower from the pre-pandemic level. Data on new orders in German manufacturing were also released last week and rose by 10.4% MoM in May vs a 26.2% decrease in April, also running below the market expectations (+15.0%). The increase in orders resulted from both higher domestic and foreign orders from both inside and outside the Eurozone. Despite the increase recorded in May, orders in German manufacturing continue to stay at a level that is 30% lower than before the pandemic. Last week we also saw data on the German foreign trade, whose surplus rose to EUR 7.6bn in May vs. EUR 3.4bn in

April. An increase was recorded in both the dynamics of exports (9.0% MoM in May vs. -24.0% in April) and imports (3.5% vs. -16.6%) however both were below the market consensus (+13.8% and 12.0%, respectively), pointing to a slower-than-expected recovery in foreign trade. We forecast that the German GDP will decrease by 6.1% in 2020 vs. a 0.5% increase in 2019 and it will increase by 5.0% in 2021.

- **The non-manufacturing ISM in the US rose to 57.1 pts in June vs. 45.4 pts in May, running way above the market expectations (50.0 pts).** The index increase resulted from higher contributions of all 4 of its indices (for business activity, new orders, suppliers' delivery times, and employment). Nevertheless, it is worth pointing out that the employment sub-index is still markedly below the 50 pts threshold dividing expansion from contraction of activity. It means that employment in the US service sector continues to decrease although the pace of this decrease is slower than in previous months. This is consistent with the data on the number of unemployment benefit claims which last week amounted to 1314k vs. 1413k two weeks ago. A clear flattening of the downward trend in unemployment benefit claims shows that the redundancies continue and their scale is still considerable despite the reopening of the economy. The last week's data pose an upside risk to our scenario, in which the US GDP decreased in Q2 by -30.0% (in annualized terms) and in the whole 2020 it will decrease by 5.5% (see MACROmap of 1/6/2020). However, the second wave of the COVID-19 pandemic observed in the US poses a risk to the sustainability of the US economic recovery.

MPC is going to introduce forward guidance

The key event this week will be the meeting of the Monetary Policy Council scheduled for Wednesday. The statement after the meeting will be of particular importance due to the publication of the preliminary results of the July macroeconomic projection. They will be the first NBP forecasts to fully reflect the impact of the COVID-19 epidemic on the economic conditions in Poland. The March projection had assumed that the course of the epidemic would be milder from what it actually was. We believe that the projection results will be crucial for the MPC decisions concerning the monetary policy parameters.

GDP growth path will be significantly lowered in the July projection due to the forecast's visibly lower starting point. In this context, the NBP expectations concerning the impact of the epidemic on the respective components of the GDP will also be important. In turn, the inflation path is likely to run below the target in the monetary policy transmission horizon. The surprising increase in inflation in June, via high base effects, will be conducive to lower inflation next year. In the statement the Council will point out the still high uncertainty about the macroeconomic conditions in the medium term (fears of a second wave of the epidemic, deterioration of investment climate, no clear information about the scale of the improvement in the global economic outlook, etc). In sum, the projection is going to present an anti-inflation scenario with the Polish economy slowly regaining the equilibrium. It will thus be an argument in favour of further relaxation of the monetary policy.

To predict monetary policy decisions has become quite a challenge in recent months. The inflow of information from the MPC has been visibly curtailed. There was no customary press conference after some recent MPC meetings and the Council members' statements for the press have also become less frequent than usual. In addition, an asymmetry of information has appeared recently between the analysts and the NBP. The results of the NBP business surveys (so-called Quick Monitoring) scheduled for publication in April and July 2020 have not been released. Thus, unlike the MPC, we do not have precise information about the impact of the COVID-19 epidemic on the corporate investment climate or on the expectations of companies concerning the future value of outlays on fixed assets. GUS has not published lately any survey results in this respect – we only have some general information about the financial standing of companies. Therefore, it is hard to assess how the dynamically changing macroeconomic situation affects the monetary policy outlook in Poland.

We believe that three documents published recently by the NBP are particularly important for making scenarios concerning the shape of the monetary policy – the statement after the June MPC meeting, Minutes of the May meeting, and June financial stability report. Especially noteworthy in the first document is the fragment added by Council about the impact of the changes in zloty exchange rate on the pace of the economic recovery. In the Council's opinion, this pace can be mitigated by "*the lack of visible zloty exchange rate adjustment to the global pandemic shock and to the monetary policy easing by NBP*". The quotation points to the Council's concern about the fact that the exchange rate channel in the monetary policy transmission mechanism is inefficient. A consequence of inefficient exchange rate channel is a smaller (albeit positive) impact of the so-far interest rate cuts on demand and inflation. In our view, the language used by the Council does not signal a higher likelihood of a foreign exchange intervention aimed at a sustained weakening of PLN; however, it indicates the need of further relaxation of the monetary policy (see MACROpulse of 16/6/2020).

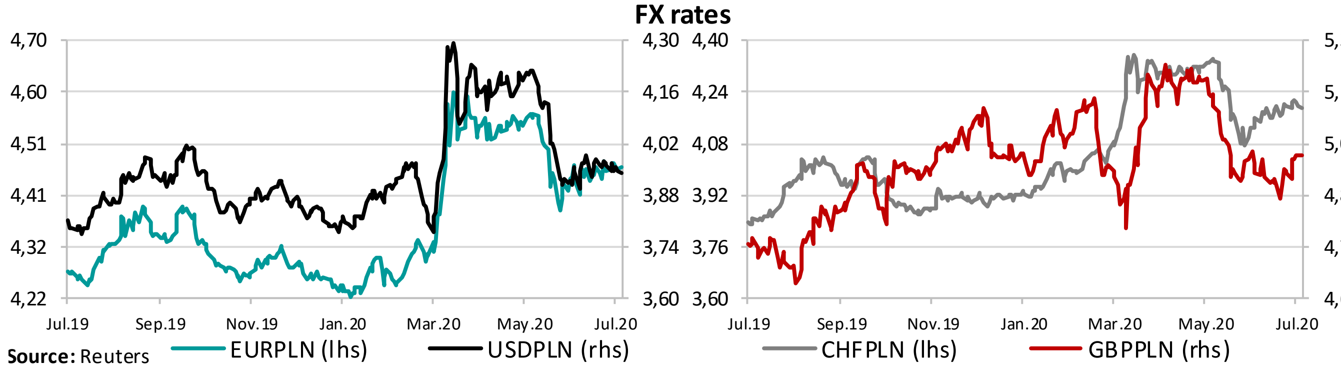
In the Minutes of the May meeting there appears a theme of interest rate cuts in the context of the banking sector stability. The MPC members were pointing out that lower credit service costs would mitigate the negative impact of the pandemic on the financial situation of households and companies. In effect, rate cuts contribute towards limiting the scale of companies' insolvency and lowering the increase in unemployment and the resulting secondary effects of the pandemic. The conclusion of most MPC members was that the rate cut would improve the country's medium-term economic outlook and – through its positive impact on the borrowers' financial standing – would enhance the stability of the financial sector.

A similar assessment was also presented in the June financial system stability report. The NBP pointed out there that the public financial support for companies launched in reaction to the COVID-19 shock together with the monetary easing, including through lower interest rates, limited the negative consequences of the pandemic for borrowers, thus mitigating credit losses in banks and the negative impact on the sector's stability.

The information presented above shows that concerns about the banking sector stability used by some MPC members as an argument against further interest rate cuts have now lost their importance. We believe that amid inflation running below the target in medium term and low investment activity of enterprises (as the results of the NBP July projection will confirm), the MPC will continue an accommodative monetary policy for a longer time. We expect the MPC to introduce forward guidance at its meeting this week, namely the announcement of keeping interest rates close to zero for an extended period of time. The specific formula of the forward guidance, modeled after the one proposed by the ECB, is likely to signal the stabilization of interest rates or a possibility of further cuts.

We maintain the view that further monetary easing will be unconventional. We do not rule out that the range of the NBP potential instruments will include negative interest rates but we do not believe that they will be introduced as early as in July. We expect that the Council will wait with the decision on the use of further unconventional tools at least until autumn 2020. If there is a second wave of the COVID-19 epidemic and accompanying it increase in uncertainty and deterioration of business climate, the Council might decide to take measures aimed at stimulating lending and demand similar to those taken in recent years by the central banks conducting monetary policy amid interest rates close to zero (see MACROmap of 8//6/2020). We maintain our forecast in which the first interest rate hike will take place in November 2022.

Second wave of COVID-19 in the US negative for USD

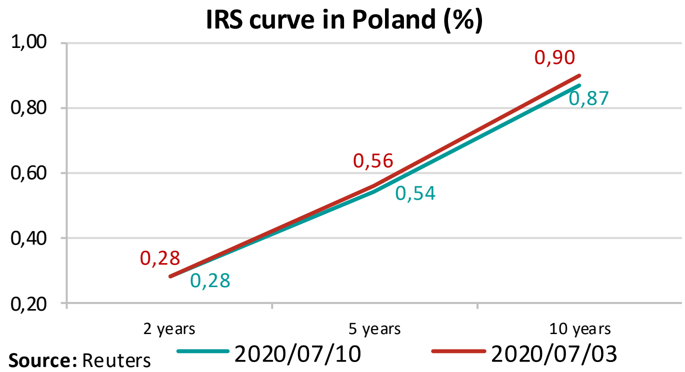


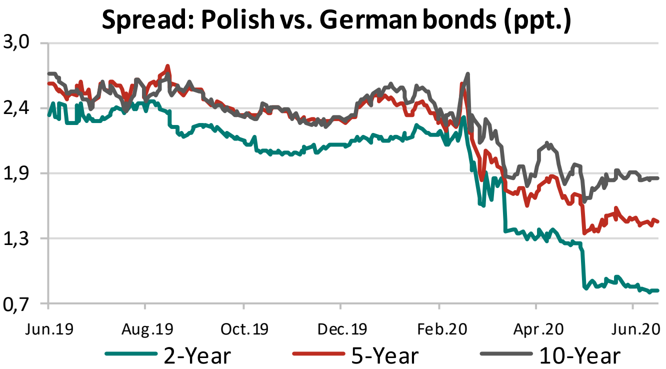
Source: Reuters

Last week, the EURPLN exchange rate amounted 4.4599 (no change compared to two weeks ago). In the first part of the week EURPLN was showing a weak upward trend, in the wake of higher risk aversion. Lower demand for risk assets was supported by investors' growing concerns about the economic consequences of the second wave of COVID-19 pandemic observed now in the US. This view is supported by the USD depreciation vs EUR recorded last week. At the same time, the FX market volatility was limited by a scarce macroeconomic calendar. Towards the end of the week there was a correction and slight appreciation of PLN.

In our view, the results of the second round of the presidential election are neutral for PLN. 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 second wave of infections and new outbreaks in the US. The market will also focus on the MPC meeting which may contribute to PLN weakening. In our view, the ECB meeting will not have any significant impact on the market. We believe that data from the US (retail sales, industrial production, inflation, housing starts, building permits, preliminary University of Michigan Index), Germany (ZEW Index), Poland (inflation, balance of payments, corporate employment and average wages), and China (GDP, retails sales, industrial production, urban investments) will be neutral for PLN.

Election results neutral for IRS rates





Source: Reuters

Last week, 2-year IRS rates have not changed compared to two weeks ago and amounted to 28 bps, 5-year rates decreased to 0.54 (down by 2bps), and 10-year rates to 0.87 (down by 3bps). Last week IRS rates were relatively stable, supported by scarce macroeconomic calendar. Last week the NBP bought the securities of the Ministry of Finance, PFR, and BGK issued to provide funding under the financial shield and the COVID-19 fund with the total value of PLN 5.2bn. The operation had a limited impact on the curve. So far the NBP has purchased securities totalling PLN 101.3bn. The statement by the PFR

President, P. Borys, who said that ultimately the scale of the PFR bond issue to provide financing for the COVID-19 might be lower by PLN 10-15bn from the originally envisaged PLN 100bn was also neutral for IRS rates.

In our view, the results of the second round of the presidential election are neutral for the curve. This week the market will focus on the information about the second wave of infections and new outbreaks in the US. We believe that the MPC meeting may lead to lower IRS rates. On the other hand, the ECB meeting will be neutral for the market. Data from the US (retail sales, industrial production, inflation, housing starts, building permits, preliminary University of Michigan Index), Germany (ZEW Index), China (GDP, retails sales, industrial production, urban investments), and Poland (inflation, balance of payments, corporate employment and average wages) will also have a limited impact on IRS rates.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	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	Jul.20
NBP reference rate (%)	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	**0,10**
EURPLN*	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	**4,46**
USDPLN*	3,73	3,87	3,98	4,01	3,82	3,91	3,79	3,87	3,92	4,13	4,15	4,00	3,95	**3,98**
CHFPLN*	3,82	3,90	4,02	4,02	3,87	3,91	3,92	4,02	4,06	4,29	4,30	4,16	4,17	**4,18**
CPI inflation (% YoY)	2,6	2,9	2,9	2,6	2,5	2,6	3,4	4,3	4,7	4,6	3,4	2,9	**3,3**	
Core inflation (% YoY)	1,9	2,2	2,2	2,4	2,4	2,6	3,1	3,1	3,6	3,6	3,6	3,8	**4,1**	
Industrial production (% YoY)	-2,6	5,8	-1,5	5,5	3,7	1,5	3,8	1,1	4,8	-2,4	-24,6	-16,9	**-7,5**	
PPI inflation (% YoY)	0,5	0,5	0,9	0,8	-0,3	-0,1	1,0	0,9	0,2	-0,3	-1,4	-1,5	**-1,0**	
Retail sales (% YoY)	5,3	7,4	6,0	5,3	5,4	5,9	7,5	5,7	9,6	-7,0	-22,6	-8,6	**-2,5**	
Corporate sector wages (% YoY)	5,3	7,4	6,8	6,6	5,9	5,3	6,2	7,1	7,7	6,3	1,9	1,2	**1,6**	
Employment (% YoY)	2,8	2,7	2,6	2,6	2,5	2,6	2,6	1,1	1,1	0,3	-2,1	-3,2	**-4,0**	
Unemployment rate* (%)	5,3	5,2	5,2	5,1	5,0	5,1	5,2	5,5	5,5	5,4	5,8	6,0	**6,3**	
Current account (M EUR)	10	-824	-820	846	442	1412	366	2348	878	2438	1163	**1243**		
Exports (% YoY EUR)	-2,4	6,4	-1,2	13,0	4,0	0,8	9,0	3,6	7,5	-7,5	-29,2	**-22,9**		
Imports (% YoY EUR)	-5,3	6,7	-3,0	6,2	0,3	-3,5	-0,7	2,4	0,6	-4,5	-28,2	**-22,9**		

*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	-10,5	-4,0	-2,5	-0,2	6,2	3,7	3,5	4,1	-3,8	3,2
Private consumption (% YoY)	1,2	-15,0	-3,1	0,0	2,1	8,1	4,3	3,7	3,9	-4,2	4,4
Gross fixed capital formation (% YoY)	0,9	-7,0	-12,2	-14,0	-5,4	5,1	5,4	5,9	7,2	-9,6	3,5
Export - constant prices (% YoY)	0,6	-11,0	-5,1	-3,1	2,0	5,1	4,2	4,1	4,7	-4,6	3,8
Import - constant prices (% YoY)	-0,2	-8,0	-7,4	-2,8	4,5	5,0	3,4	3,5	2,7	-4,6	4,1
GDP growth contributions: Private consumption (pp)	0,7	-8,7	-1,8	0,0	1,3	4,4	2,5	1,9	2,2	-2,4	2,5
GDP growth contributions: Investments (pp)	0,1	-1,2	-2,2	-3,5	-0,7	0,9	0,9	1,3	1,3	-1,8	0,6
GDP growth contributions: Net exports (pp)	0,4	-2,1	0,9	-0,3	-1,2	0,2	0,7	0,5	1,2	-0,3	0,1
Current account (% of GDP)***	1,3	1,2	0,8	0,5	0,2	0,1	0,2	0,2	0,5	0,5	0,2
Unemployment rate (%)**	5,4	6,3	6,5	7,5	7,3	6,1	5,5	6,1	5,2	7,5	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	2,3	3,2	3,4	2,7	3,2	2,9	3,0	7,2	4,1	3,0
CPI Inflation (% YoY)*	4,5	3,2	3,0	3,5	2,2	2,9	2,2	1,5	2,3	3,6	2,2
Wibor 3M (%)**	1,17	0,26	0,26	0,26	0,26	0,26	0,26	0,26	1,71	0,26	0,26
NBP reference rate (%)**	1,00	0,10	0,10	0,10	0,10	0,10	0,10	0,10	1,50	0,10	0,10
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	3,95	3,86	3,80	3,79	3,82	3,84	3,83	3,79	3,80	3,83

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST* CA	FORECAST* CONSENSUS**
		Tuesday 07/14/2020				
11:00	Eurozone	Industrial production (% MoM)	May	-17,1		15,0
11:00	Germany	ZEW Economic Sentiment (pts)	Jul	63,4		60,0
14:00	**Poland**	**Current account (M EUR)**	**May**	**1163**	**1243**	**817**
14:30	USA	CPI (% MoM)	Jun	-0,1	0,4	0,5
14:30	USA	Core CPI (% MoM)	Jun	-0,1	0,2	0,1
	China	Trade balance (bn USD)	Jun	62,9		58,6
		Wednesday 07/15/2020				
10:00	**Poland**	**CPI (% YoY)**	**Jul**	**3,3**	**3,3**	**3,3**
14:30	USA	NY Fed Manufacturing Index (pts)	Jul	-0,2		10,0
15:15	USA	Industrial production (% MoM)	Jun	1,4	4,0	4,4
15:15	USA	Capacity utilization (%)	Jun	64,8		67,7
		Thursday 07/16/2020				
4:00	China	GDP (% YoY)	Q2	-6,8		2,1
4:00	China	Retail sales (% YoY)	Jun	-2,8		0,4
4:00	China	Industrial production (% YoY)	Jun	4,4		4,7
4:00	China	Urban investments (% YoY)	Jun	-6,3		-3,2
13:45	Eurozone	EBC rate decision (%)	Jul	0,00	0,00	0,00
14:00	**Poland**	**Core inflation (% YoY)**	**Jun**	**3,8**	**4,1**	**4,1**
14:30	USA	Retail sales (% MoM)	Jun	17,7	4,8	5,0
14:30	USA	Philadelphia Fed Index (pts)	Jul	27,5		20,0
16:00	USA	Business inventories (% MoM)	May	-1,3		-2,3
		Friday 07/17/2020				
10:00	**Poland**	**Employment (% YoY)**	**Jun**	**-3,2**	**-4,0**	**-3,9**
10:00	**Poland**	**Corporate sector wages (% YoY)**	**Jun**	**1,2**	**1,6**	**1,4**
11:00	Eurozone	HICP (% YoY)	Jun	0,3		0,3
14:30	USA	Housing starts (k MoM)	Jun	974	1150	1169
14:30	USA	Building permits (k)	Jun	1216	1277	1295
16:00	USA	Initial U. of Michigan Sentiment Index (pts)	Jul	78,1	77,0	79,0

*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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