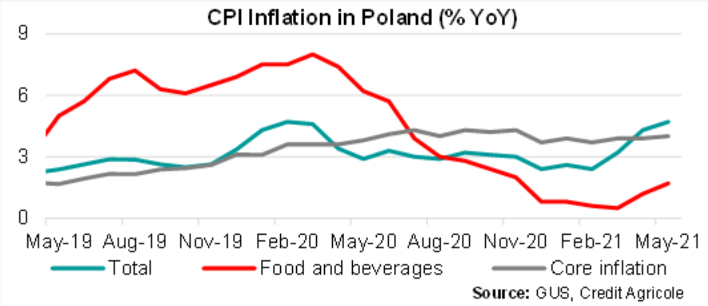
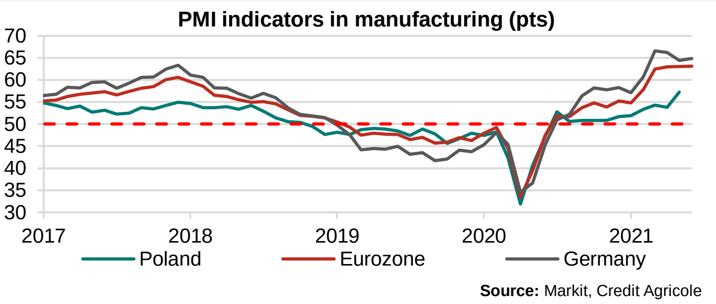
Will weakening inflation expectations drive inflation down?

This week

- **This week, important data from the US will be published.** The publication of labour market data is scheduled for Friday. We expect non-farm payroll to rise by 675k in June compared with an increase of 559k in May with a parallel reduction of the unemployment rate to 5.6% in June vs. 5.8% in May, a trend following from the progressing vaccine rollout and relaxation of restrictions in some states. Before Friday's publication, additional information on the labour market will be provided by the ADP report on employment in the private sector (the market expects an increase of 600k in June vs. 978k in May). Thursday will see the publication of the ISM manufacturing index. In our opinion, in June the index declined to 61.0 pts vs. 61.2 pts in May, a result consistent with the findings of regional business climate surveys. We forecast that the Conference Board consumer confidence index rose to 119.0 pts in June, up from 117.2 pts in May. We believe that the US data releases will be neutral for the financial markets.
- **On Wednesday, a preliminary estimate of HICP inflation in the Eurozone will be published.** We expect that annual inflation fell to 1.8-1.9% YoY in June vs. 2.0% in May, largely on the back of a slowdown in energy price growth and lower core inflation. Today, additional information on inflation in the Eurozone will be provided by the preliminary HICP inflation estimate in Germany. We forecast that it June it declined to 2.0% YoY vs. 2.4% in May. In our opinion, the release of Eurozone inflation data will be neutral for the zloty exchange rate and Polish bond prices.
- **This week, business climate surveys for Chinese manufacturing will be published.** We expect that the CFLP PMI index contracted to 50.8 pts in June vs. 51.0 points in May, while the Caixin PMI index fell to 51.8 points in June vs. 52.0 points in May. Thus, the data will point to a further slowdown in economic activity growth, a trend already signalled by the May data on industrial production, retail sales and fixed asset investment (see MACROmap of 21/06/2021). In our opinion, the Chinese data releases will be neutral for the financial markets.
- **On Wednesday, preliminary data on inflation in Poland will be published.** In our opinion, in June inflation fell to 4.4% YoY vs 4.7% in May. Both the slower growth of fuel prices and a drop in core inflation were conducive to slower price growth in June, with higher food prices having the opposite effect. Our forecast is below the market consensus (4.6%) and thus its materialisation would be slightly negative for the Polish zloty and the yields on Polish bond.



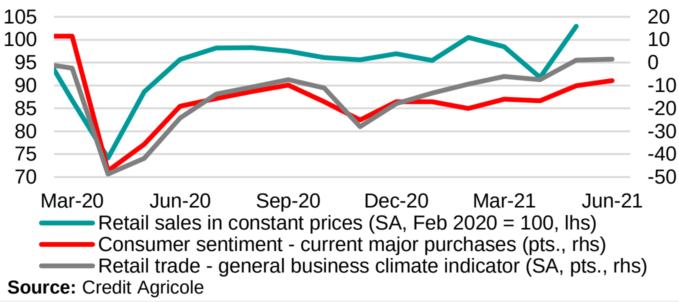
- **On Thursday, June data on the situation in industrial manufacturing in Poland will be published.** We expect that PMI declined to 56.0 pts, down from 57.2 points in May. Our forecast is supported by the slight deterioration in the economic situation recorded in the surveys of the Central Statistical Office (GUS). The data should be neutral for the PLN exchange rate and Polish bond prices.



- **We revised our forecast of the EURPLN rate upwards (see quarterly table).** The continued dovish attitude presented by the Monetary Policy Council (see MACROmap of 14/06/2021) will weaken market expectations towards the tightening of Poland's monetary policy. This tendency will be negative for the PLN exchange rate. Moreover, due to the slow vaccine rollout, we believe that the fourth wave of the pandemic in Q4 may be stronger than anticipated. We also do not rule out that at the end of this year the National Bank of Poland may become more active on the FX market. In summary, we expect the EURPLN rate to stand at 4.45 and 4.30 at the end of 2021 and 2022, respectively.

Last week

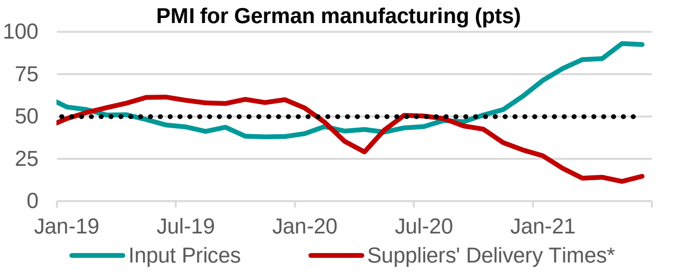
- **In May, Poland's industrial production expanded by 29.8% YoY vs. an increase of 44.5% in April.** The main driver of the strong reduction in the growth of industrial output between April and May was low base effects which were weaker than in April. Moreover, the statistical effect in form of an unfavourable difference in the number of working days was conducive to a decline in industrial production growth between April and May. Adjusted for seasonal factors, between April and May industrial output increased by 0.8%. We estimate that the level of industrial production in May was already by 7.1% higher than prior to the outbreak of the pandemic. The structure of the data indicates that export branches remain the main engines of industrial production growth in Poland. The growing output in export industries is supported by the current strong recovery in global trade, as well as Poland's upward shift in international supply chains (see MACROpulse of 21/06/2021). Construction-assembly production increased in May by 4.7% YoY vs. a 4.2% drop in April. The strong increase in the annual growth of construction-assembly production between April and May followed from a combination of last year's base effect favourable to production growth, statistical effects (unfavourable difference in the number of working days) and accelerated recovery in the construction sector (see MACROpulse of 22/06/2021). Although May marked the third consecutive month with a robust increase in construction activity, it is still well below pre-pandemic levels (by 6.4%). May data on construction-assembly production suggest that the boom in the construction sector is gaining momentum. Data on industrial production and construction-assembly production signal a slight upward risk to our forecast whereby Poland's GDP will expand by 11.2% YoY in Q2 vs. a 0.9% decline in Q1.
- **In May, Poland's retail sales grew by 19.1 YoY vs. a 25.7% surge in April.** In May, retail sales in constant prices increased by 13.9% YoY vs. a 21.1% spike in April. The main driver of the strong reduction in the growth of retail sales between April and May was low base effects which were weaker than in April. The recovery in trade activity recorded this May, related to the lifting of restrictions on sales in shopping centres and large-format furniture and DIY stores, was weaker than in May 2020. This is consistent with our scenario whereby in conditions of a major increase in the share of online sales and growing household mobility observed after the outbreak of the pandemic, pent-up demand has a limited impact on retail sales of goods (see MACROpulse of 22/06/2021). After accounting for seasonal factors, retail sales in constant prices in May was 3.0% higher in February 2020, i.e. a month in which the pandemic did not affect sales significantly. This May was thus the first month when retail sales was markedly higher than before the outbreak of the pandemic. Retail sales data represent an upward risk to our forecast whereby in Q2 consumption will expand by 11.2% YoY as compared with a 0.2% increase in Q1.



Source: Credit Agricole

- **According to flash data, the composite PMI (for manufacturing and the services sector) in Eurozone increased in June to 59.2 pts vs. 57.1 pts in April, running above market expectations (58.7 pts) and below our forecast (59.1 pts).** Thus, for the fourth month running, the composite

Eurozone PMI was above the 50-point mark separating expansion from contraction, reaching its highest level since June 2006. The rise in the composite PMI followed from a marked increase in business activity in the services sector (the highest level of the component since August 2017) and accelerated manufacturing output growth. According to the relevant press release, similarly to the previous month, the strong improvement in the services sector was mainly driven by the continued easement of administrative restrictions and the gradual waning of the pandemic in Europe. In geographical terms, a robust economic improvement was recorded in Germany, France as well as other Eurozone countries covered by the study. As for trends in Germany, which are particularly important for Polish exports, the manufacturing PMI climbed to 64.9 pts in June compared with 64.4 pts in May. The expansion of the index followed from higher contributions from new orders and current production components, lower contributions from delivery times and stocks of purchases components, and the stabilization of employment components. In the data structure, particularly noteworthy is the slight decrease in indices for production backlogs and prices of semi-finished products and materials used in production, which was accompanied by smaller than in the month before increase in delivery times. This may suggest that supply-side barriers are starting to weaken, although they remain very high and limit the scale of recovery in German manufacturing. Last week's results of the economic climate survey in the Eurozone pose an upward risk for our scenario whereby the quarterly GDP growth in the Eurozone will increase to 1.1% in Q2 vs. a decline of 0.6% in Q1.



Source: Markit, Credit Agricole *the longer the lower the index value

- **The Ifo index, reflecting the sentiment of German businesses representing manufacturing, construction, trade and services sectors rose to 101.8 pts in June vs. 96.6 pts in May, a result exceeding the market consensus (100.0 points).** The growth of the index was attributable to the increase in its components for both the assesment of the current situation and business outlook. In sectoral terms, an improvement in the economic situation was recorded across all surveyed sectors: manufacturing, services, trade and construction. We see an upward risk for our forecast according to which the German GDP will rise by 1.3% QoQ in Q2 vs. a 1.8% contraction in Q1.
- **Last week, vital data regarding the US economy was published.** The number of new jobless claims dropped to 411k vs. 418k two weeks ago, running above market expectations (380k). In turn, the number of continued claims dropped from 3.5 million to 3.4 million. Thus, the data shows that while the situation on the US labour market is improving, the market is still far from equilibrium. Last week, data on new home sales (769k in May vs. 817k in April) and existing home sales (5.80 million vs. 5.85 million) was published, showing a decline in activity on the US real property market. Last week, the third estimate of US GDP was published, showing that the annualised rate of US GDP growth did not change compared with the second estimate and amounted to 6.4%. This was due to higher contributions from fixed investments (2.09 pp in the third estimate vs. 1.96 pp in the second estimate), inventories (-2.67 pp vs. -2.78 pp), private consumption (7.42 pp vs. 7.40 pp), lower contributions from net exports (-1.50 pp vs. -1.20 pp) and stabilization of government spending (1.02). Thus, the third estimate confirmed that the main source of US GDP growth in Q1 was private consumption, while in Q4 it was chiefly spurred by investments. Last week also saw the release of preliminary data on durable goods orders, which in May increased by 2.3% MoM vs. a 0.8% drop in April (upward revision from -1.3%), running below market expectations (2.7%). Excluding transportation, durable goods orders were down by 0.3% in May vs. 1.7% in April (upward revision from 1.0%). Thus, the volume of durable goods orders in the US in April was already by 9.7% higher than in February 2020, i.e. the last month without a strong impact of the pandemic on orders. In turn, the volume of orders for

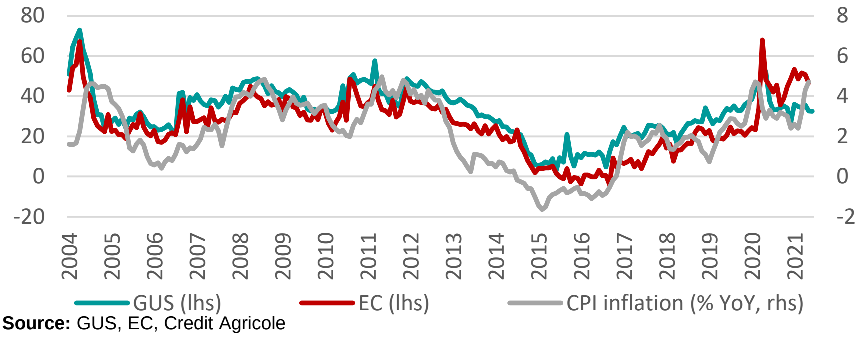
civilian capital goods, excluding aircraft, was already by 15.9% higher in April than in February 2020, indicative of robust prospects for a strong rebound in US investments in the coming months. Last week also saw the publication on PCE inflation, which increased in May to 3.9% YoY up from 3.6% in April, while core PCE inflation climbed to 3.4% YoY vs. 3.1%, which was in line with market expectations. PCE inflation growth was spurred by rising prices of energy, homes and real property rental rates, as well as such consumer goods as used cars. We expect PCE inflation to reach its local maximum of 4.5-5.0% until February 2022. Last week, the final University of Michigan index was also released with the index rising to 85.5 pts in June vs. 82.9 pts in May and 86.4 pts in the preliminary estimate. Consumer sentiment improved on the back of higher contribution from the expectations component with the assessment of the current situation having the opposite effect. Last week's data from the US economy do not change our scenario whereby the annualized GDP growth rate will reach its local maximum of 10.2% in Q2 and from Q3 2021 will follow along a downward trajectory. As a consequence, throughout 2021 the US GDP will expand by 6.5% compared to a 3.5% drop in 2020, to increase by 4.0% in 2022.

Will weakening inflation expectations drive inflation down?

In the recent months, Poland has seen spiking inflation, which in this May stood at 4.7% YoY, reaching its highest level since February 2020 (see MACROpulse of 15/06/2021). Media reports indicate that the high rate of price growth observed in the recent months is becoming more and more noticeable to consumers. The subject of the analysis below is the analysis of consumers' current inflation expectations and their implications for future inflation.

There are two main sources of data on household inflation expectations in Poland. The first is the GUS consumer market survey, which presents an index of expectations regarding changes in consumer prices over a 12-month horizon. The second source is an analogous expectations index developed by the European Commission (EC). In both cases, the index has the form of a balance and represents a weighted balance of the number of responses indicating that prices will rise more strongly or similarly to their current rise, and responses indicating that prices will not change or fall.

Expected change in consumer prices in the next 12 months (pts., SA)



Source: GUS, EC, Credit Agricole

Due to the fact that our analysis focuses on year-on-year inflation, which is free from seasonal fluctuations, at the very beginning we seasonally-adjusted the inflation expectations indices. There is quite a strong positive correlation between the seasonally-adjusted indices of inflation expectations calculated by GUS and the EC, and CPI inflation expressed on a year-on-year basis as in the case of both indicators it exceeds 0.7. In the next step of analysis, using econometric modelling, we examined the direction of the dependencies between the indices of inflation expectations and inflation. Granger causality tests indicate that the inflation expectations reported by GUS affect inflation, while the opposite relationship does not occur. In turn, in the case of inflation expectations reported by the EC, there is a two-way causality whereby inflation expectations affect inflation, just as inflation affects inflation expectations. It is worth noting, however, that the dependency whereby inflation expectations reported by the European Commission affect inflation is characterized by a markedly higher level of statistical significance than the inverse relationship. Thus, the results of our analysis suggest that inflation expectations in Poland are to a large extent rational, rather than adaptive. In other words, consumers do not form their expectations based on the latest inflation data, but in their forecasts account for factors that will affect inflation in the future, adjusting their expectations accordingly. Our conclusions are in opposition to the results of the NBP studies (2019) which show that current price growth is indicated as one of the main factors, in addition to the exchange rate, determining inflation expectations, which would signal their largely adaptive nature.

Perceived change in consumer prices over the last 12 months (pts., SA)

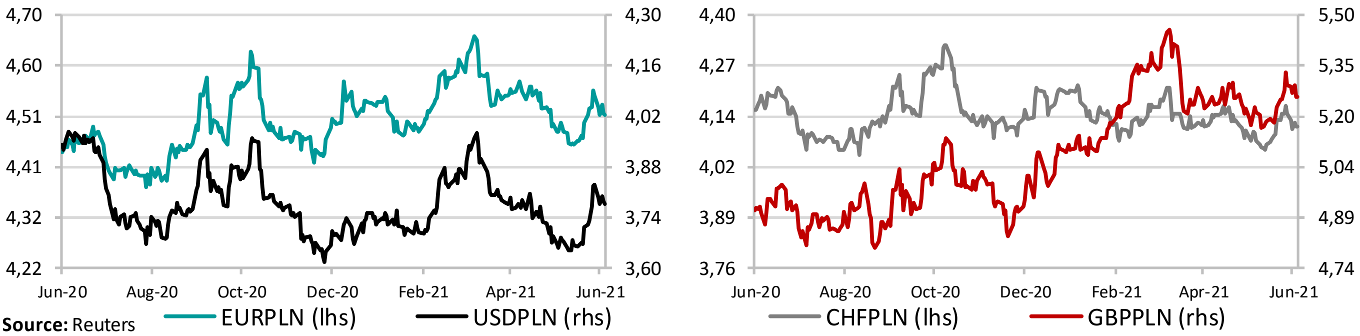
Source: EC, Credit Agricole

It is worth noting that despite the strong increase in inflation, in recent months there has been a slight decline in inflation expectations reported both by GUS and the EC. What is more, it occurred despite the fact that, in the perception of households, the rise in consumer prices clearly accelerated over the last 12 months. This suggests that inflation expectations are quite firmly anchored in Poland. This, in turn, signals a low likelihood of second-round effects (increased wage pressure related to rising inflation expectations).

The results of the above analysis support our assessment whereby inflation reached its local maximum this May and will decline in the following months, but nevertheless remain elevated (on average 4.5% YoY in H2 2021). On the one hand, we expect a decline in core inflation and fuel price growth and, on the other, we forecast an acceleration in the growth of food prices. In our opinion, from early 2022 inflation will follow along a slight downward trend. At the same time, even if our hypothesis about the high rationality of inflation expectations is not true, referencing the results of the NBP study, the decline in inflation together with the appreciation of the Polish zloty we forecast will drive inflation expectations down and prevent a ramp-up of inflationary pressure. Taking into account the press release after the last Monetary Policy Council meeting (MACROpulse of 09/06/2021), as well as dovish comments from NBP's Governor (see MACROmap of 14/06/2021), the above-mentioned inflation outlook supports our scenario whereby the MPC will not change interest rates until the end of 2022.

Preliminary domestic inflation data may weaken the Polish zloty

FX rates



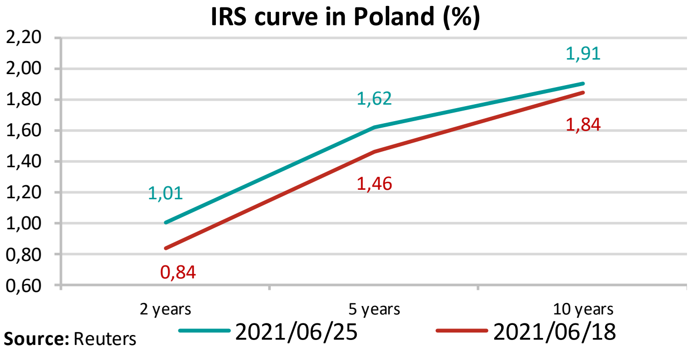
Source: Reuters

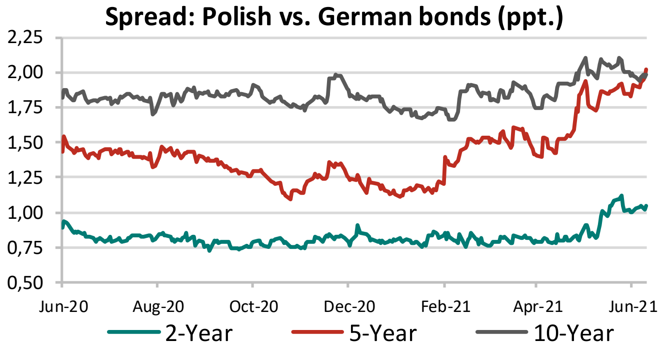
Last week, the EURPLN exchange rate fell to 4.5096 (appreciation of the zloty by 0.8%). Last week, the EURPLN rate followed along a gentle downward trajectory, supported by a decline in global risk aversion reflected by a drop in the VIX index. Publications of the results of business surveys in the Eurozone, as well as domestic data on industrial production and retail sales, had no significant impact on the market.

The decline in global risk aversion also supported the increase in the EURUSD rate. However, the Euro failed to recoup the losses from two weeks ago related to the hawkish tone of the FOMC meeting (see MACROmap of 21/06/2021).

This week, flash inflation data from Poland will be of key importance for the zloty. If our forecast, which is lower than the market consensus, materializes the data may lead to a weakening of the Polish currency. Other data from Poland (flash manufacturing PMI), as well from the USA (non-farm payrolls, ISM index for manufacturing, Conference Board index), the Eurozone (flash inflation) and China (CFLP and Caixin PMI indexes for manufacturing) will, in our opinion, not have a major bearing on the PLN exchange rate.

Flash domestic inflation data in the market spotlight





Source: Reuters

Last week, 2-year IRS rates increased to 1.01 (up by 17 bps), 5-year to 1.62 (up by 16 bps), and 10-year to 1.91 (down by 7 bps). Last week saw a continued spike in IRS rates across the curve, following the core markets. This was a continuation of the upward trend related to rising investor expectations of a monetary tightening in the US. On Thursday, the Ministry of Finance conducted a debt switching auction where for PLN 3.9bn it repurchased bonds maturing in 2021 and 2021 and sold bonds with 2-, 5-, 9- and 10-year maturities for PLN 4.1bn. The auction had no significant impact on the curve. Domestic data release on industrial production and retail sales also had no significant impact on the curve

This week, the market will focus on the publication of flash data on inflation in Poland, which may contribute to a decline in IRS rates. Other data from Poland (flash manufacturing PMI), as well from the USA (non-farm payrolls, ISM index for manufacturing, Conference Board index), the Eurozone (flash inflation) and China (CFLP and Caixin manufacturing PMI) will, in our opinion, be neutral for the curve.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland														
Indicator	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21
NBP reference rate (%)	0,10	0,10	0,10	0,10	0,10	0,10	0,10	0,10	0,10	0,10	0,10	0,10	0,10	**0,10**
EURPLN*	4,44	4,44	4,41	4,40	4,53	4,60	4,47	4,55	4,52	4,52	4,63	4,56	4,48	**4,51**
USDPLN*	4,00	3,95	3,74	3,68	3,86	3,95	3,75	3,73	3,72	3,74	3,95	3,79	3,66	**3,77**
CHFPLN*	4,16	4,17	4,10	4,07	4,21	4,32	4,13	4,21	4,18	4,11	4,18	4,15	4,07	**4,12**
CPI inflation (% YoY)	2,9	3,3	3,0	2,9	3,2	3,1	3,0	2,4	2,6	2,4	3,2	4,3	**4,7**	
Core inflation (% YoY)	3,8	4,1	4,3	4,0	4,3	4,2	4,3	3,7	3,9	3,7	3,9	3,9	**4,0**	
Industrial production (% YoY)	-16,8	0,5	1,1	1,5	5,7	1,0	5,4	11,1	0,7	2,5	18,6	44,4	**27,0**	
PPI inflation (% YoY)	-1,7	-0,8	-0,6	-1,3	-1,4	-0,4	-0,2	0,1	1,0	2,2	4,2	5,3	**6,2**	
Retail sales (% YoY)	-8,6	-1,9	2,7	0,4	2,7	-2,1	-5,3	-0,8	-6,0	-2,7	17,1	25,7	**16,0**	
Corporate sector wages (% YoY)	1,2	3,6	3,8	4,1	5,6	4,7	4,9	6,6	4,8	4,5	8,0	9,9	**10,0**	
Employment (% YoY)	-3,2	-3,3	-2,3	-1,5	-1,2	-1,0	-1,2	-1,0	-2,0	-1,7	-1,3	0,9	**2,5**	
Unemployment rate* (%)	6,0	6,1	6,1	6,1	6,1	6,1	6,1	6,2	6,5	6,5	6,4	6,3	**6,1**	
Current account (M EUR)	1556	3333	650	1273	1330	2307	1956	477	3341	1585	938	**2560**		
Exports (% YoY EUR)	-19,2	4,3	2,2	2,4	6,6	3,7	10,0	14,6	-0,9	5,9	27,7	**69,4**		
Imports (% YoY EUR)	-27,3	-7,4	-3,6	-4,0	2,1	-4,2	4,1	12,4	-4,0	6,2	24,6	**55,2**		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland											
Indicator	2020				2021				2020	2021	2022
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Gross Domestic Product (% YoY)	2,0	-8,3	-1,7	-2,7	-0,9	11,2	4,9	6,1	-2,7	5,3	4,9
Private consumption (% YoY)	1,2	-10,8	0,4	-3,2	0,2	11,2	3,8	4,5	-3,0	4,7	4,5
Gross fixed capital formation (% YoY)	1,7	-9,8	-8,2	-15,4	1,3	7,7	6,1	11,8	-9,6	7,6	8,4
Export - constant prices (% YoY)	2,7	-13,7	2,3	7,6	5,7	14,1	8,5	9,3	-0,2	9,2	8,3
Import - constant prices (% YoY)	0,8	-16,6	-0,3	8,2	10,0	9,1	6,7	8,0	-1,9	8,4	8,9
GDP growth contributions: Private consumption (pp)	0,7	-6,2	0,2	-1,7	0,1	6,2	2,2	2,2	-1,7	2,6	2,5
Investments (pp)	0,2	-1,6	-1,4	-3,9	0,2	1,2	1,0	2,5	-1,8	1,3	1,4
Net exports (pp)	1,1	0,8	1,4	0,1	-1,9	3,3	1,5	1,3	0,8	1,0	0,0
Current account (% of GDP)***	1,1	2,2	2,9	3,5	3,7	3,5	3,2	3,1	3,5	3,1	2,5
Unemployment rate (%)**	5,4	6,1	6,1	6,2	6,4	5,7	5,6	5,6	6,2	5,6	5,1
Non-agricultural employment (% YoY)	0,7	-1,8	-0,7	0,0	0,0	1,8	0,9	0,7	-0,5	0,9	0,4
Wages in national economy (% YoY)	7,7	3,8	4,8	5,0	6,6	7,0	6,5	6,3	5,3	6,6	5,8
CPI Inflation (% YoY)*	4,5	3,2	3,0	2,8	2,7	4,5	4,5	4,5	3,4	4,1	3,0
Wibor 3M (%)**	1,17	0,26	0,22	0,21	0,21	0,21	0,21	0,21	0,21	0,21	0,26
NBP reference rate (%)**	1,00	0,10	0,10	0,10	0,10	0,10	0,10	0,10	0,10	0,10	0,10
EURPLN**	4,55	4,44	4,53	4,55	4,63	4,51	4,45	4,45	4,55	4,45	4,30
USDPLN**	4,13	3,95	3,86	3,73	3,95	3,77	3,71	3,71	3,73	3,71	3,47

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
		Tuesday 06/29/2021				
11:00	Eurozone	Business Climate Indicator (pts)	Jun	1,50		
14:00	Germany	Preliminary HICP (% YoY)	Jun	2,0	2,0	2,1
15:00	USA	Case-Shiller Index (% MoM)	Apr	1,6		1,7
16:00	USA	Consumer Confidence Index	Jun	117,2	119,0	119,0
		Wednesday 06/30/2021				
3:00	China	Caixin Manufacturing PMI (pts)	Jun	51,0	50,8	50,8
10:00	**Poland**	**Flash CPI (% YoY)**	**Jun**	**4,7**	**4,4**	**4,6**
11:00	Eurozone	Preliminary HICP (% YoY)	Jun	2,0	1,8	1,9
14:15	USA	ADP employment report (k)	Jun	978		600
15:45	USA	Chicago PMI (pts)	Jun	75,2		70,0
		Thursday 07/01/2021				
3:45	China	Caixin Manufacturing PMI (pts)	Jun	50,2	51,8	51,8
9:00	**Poland**	**Manufacturing PMI (pts)**	**Jun**	**57,2**	**56,0**	**57,0**
9:55	Germany	Final Manufacturing PMI (pts)	Jun	64,9	64,9	64,9
10:00	Eurozone	Final Manufacturing PMI (pts)	Jun	63,1	63,1	63,1
11:00	Eurozone	Unemployment rate (%)	May	8,0		8,0
15:45	USA	Flash Manufacturing PMI (pts)	Jun	62,6		
16:00	USA	ISM Manufacturing PMI (pts)	Jun	61,2	61,0	61,0
		Friday 07/02/2021				
11:00	Eurozone	PPI (% YoY)	May	7,6		9,5
14:30	USA	Unemployment rate (%)	Jun	5,8	5,6	5,7
14:30	USA	Non-farm payrolls (k MoM)	Jun	559	675	675
16:00	USA	Factory orders (% MoM)	May	-0,6	1,7	1,5

*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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