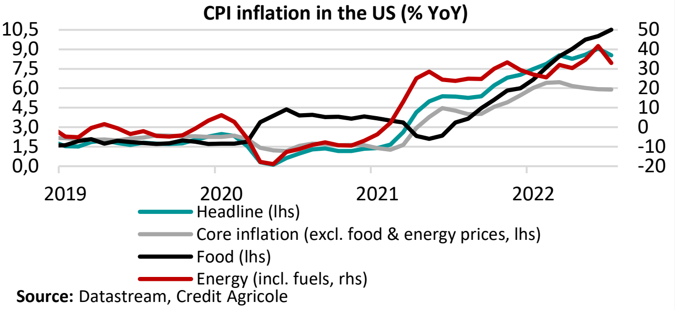
Will the NBP resume bond buying in 2023?

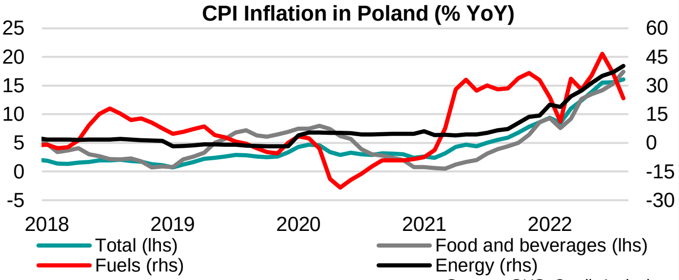
This week

- **This week, some important data on the US economy and business survey results will be released.** In our opinion, headline inflation fell to 8.1% YoY in August from 8.5% in July, driven down by a slower growth in energy prices. At the same time, we believe that core inflation in August rose to 6.1% YoY vs. 5.9% in July due to low base effects and continuing, strong inflation pressure. We expect the industrial production growth to have dropped to 0.2% MoM in August from 0.6% MoM in July, which will be consistent with manufacturing business survey results. We believe that, like in July, nominal retail sales volumes in August did not change. Results of business surveys from the US will also be released. A preliminary reading of the University of Michigan index will be released on Friday. We expect the households' sentiments to have improved (60.0 pts in September vs. 58.2 pts in August) with the prices of fuels falling continuously over the last couple of months. We believe that the overall impact of the data from the US economy on financial markets will be limited.



Source: Datastream, Credit Agricole

- **Some important data from China will be released on Friday.** The August data will suggest a slight acceleration of economic activity in China, but the pace of recovery was still being limited by electricity supply disruptions and local restrictions aiming to curb the spread of new COVID-19 infections. In our opinion, the industrial production growth accelerated to 4.0% YoY in August from 3.8% in July, while retail sales growth increased to 3.5% YoY vs. 2.7% in July. Furthermore, we expect the pace of the urban investments growth to have slowed down slightly (5.4% YoY in August vs. 5.7% in July) due to a decreased activity in the real property market. We expect that the release of data from China will be neutral for financial markets.
- **Final data on inflation in Poland for August will be released on Thursday.** We expect YoY price growth of 16.1% in August vs. 15.6% in July, in line with the flash estimate. Inflation was driven up by higher contributions of food prices, energy prices and core inflation. We believe that the release of inflation figures will be neutral for the PLN and yields on Polish bonds.



Source: GUS, Credit Agricole

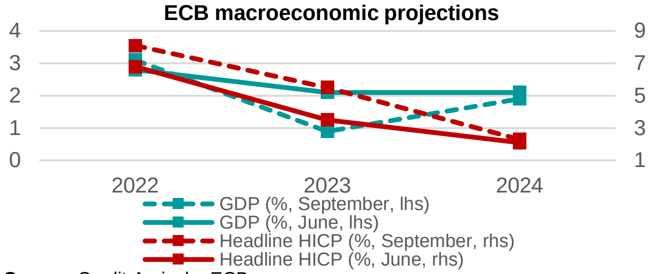
- **Data on Poland's balance of payments for July will be published this Tuesday.** We expect the current account balance deficit to have increased to EUR 2,229m from EUR 1,468m in June, driven primarily by a lower balance on trade in goods. We expect the exports growth rate to have dropped from 25.8% YoY in June to 22.7% in July, with the imports growth rate falling from 31.5% YoY to 26.6% due to the impact of unfavourable calendar effects. In our opinion, data on the balance of payments will be neutral for the PLN and yields on Polish bonds.

Last week

- **The Monetary Policy Council decided last week to raise interest rates once again.** The NBP reference rate rose from 6.50% to 6.75%. The 25bp rate hike was consistent with the market consensus and our forecast. The last week's hike was the lowest since the beginning of the current monetary policy tightening cycle in October 2021. In our opinion, the main reason why the monetary policy was tightened again was inflation, which continued to rise strongly in August and, in accordance with the flash estimate, reached 16.1% YoY comparing to 15.6% in July. The Council once again declared that its further decisions will depend on incoming information regarding perspectives for inflation and economic activity, including the impact of the Russian military aggression against Ukraine on the Polish economy. In our opinion, the press release suggests that last week's decision of the MPC should not be interpreted as ending the monetary policy tightening cycle, and the doors are still open for further interest rate hikes (see MACROpulse of 07/09/2022). During the press conference on Thursday, the NBP President A. Glapiński suggested that in October the MPC will either consider a 25bp hike or leave the rates as they are, and the decision will depend on the data that will be published in the nearest future. We expect the data to indicate that the economic growth is slowing down increasingly amidst persistent, high inflation, which will make the Council raise the interest rates once again by 25bp, and it will be the end of the monetary policy tightening cycle in Poland, with the reference rate reaching 7.00%. However, it might happen that the Council might make a one-month break in the interest rate hiking cycle, and then increase the rates by 25bp in November instead of October.

- **The ECB met last week, raising its interest rates by 75bp.** Consequently, the ECB's key interest rate currently stands at 1.25%, with the deposit rate reaching 0.75%. This means that the hike was consistent with our forecast and market expectations (see MACROmap of 05/09/2022). At the same time, the ECB communicated in its press release after the meeting that they expect to increase interest rates further over the next couple of meetings to dampen demand and guard against the risk of a persistent upward shift in inflation expectations. At the same time, future decisions on interest rates will continue to be data-dependent and follow a meeting-by-meeting approach. Furthermore, the ECB declared once again that they intend to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the date when the Governing Council started raising the key ECB interest rates and, in any case, for as long as necessary to maintain ample liquidity conditions and an appropriate monetary policy stance. As concerns the PEPP, the Governing Council similarly intends to reinvest the principal payments from maturing securities purchased under the programme until at least the end of 2024. Simultaneously, the ECB has lifted the 0% limit for interest rates on government deposits with national central banks. This decision is aimed at preventing the outflow of government deposits from national central banks. The ECB has also published its new macroeconomic projection. Inflation path has been revised significantly upwards, while the economic growth path was revised downwards. The ECB President Ch. Lagarde has emphasised many times that the last week's high rise of interest rates was frontloading, but nonetheless in her statements she has not ruled out further hikes of a similar scale. We expect the ECB to raise the rates three times this year, by a total of 150bp, and the hiking cycle will then come to an end with the deposit rate reaching 2.25%. At the same time, we believe there is a risk the ECB might start raising rates again in February 2023 if high inflation persists.

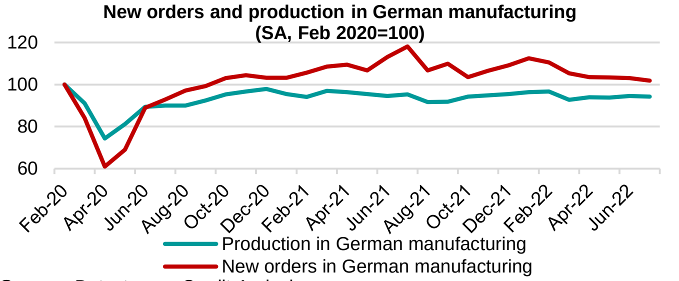
ECB macroeconomic projections



Source: Credit Agricole, ECB

- **Last week we also saw data on China's trade balance.** It fell in August to USD 79.4bn vs. USD 101.3bn in July, running significantly below market expectations (USD 93.0bn). At the same time, export growth rate dropped to 7.1% YoY in August vs. 18.0% in July, while import growth dropped to 0.3% YoY vs. 2.3%. The data indicates a marked slowdown in Chinese foreign trade activity as a result of the deteriorating outlook in the global economy. We forecast that China's GDP growth will slow to 3.4% in 2022 vs. 8.1% in 2021, and in 2023 it will reach 5.3%. As a result, we believe that China's economic growth target for 2022, which has been set at around 5.5%, will be difficult to achieve even under the active economic policies pursued by the Chinese government.

- **Some important data on German economy was released last week.** Industrial production declined by 0.3% MoM in July, compared to an increase of 0.8% in June, driven by lower growth in manufacturing, while higher production growth in construction and energy had the opposite effect. The growth of orders in manufacturing also slowed, to -1.1% MoM in July, vs. -0.3% in June. This marked the sixth consecutive month that orders declined. The higher rate of decline in orders was the result of slowing growth of domestic orders, while export orders growth accelerated. Taking into account the August PMI for German manufacturing, the decline in orders can be expected to continue in the coming months (see MACROmap of 29/08/2022). Last week's data, combined with business survey results, pose a significant downside risk to our forecast that Germany's quarterly GDP growth will increase to 0.3% in Q3 vs. 0.1% in Q2. Moreover, given the deteriorating supply situation in the European gas market, we see an increasing likelihood that the German economy will enter a recession in Q3.



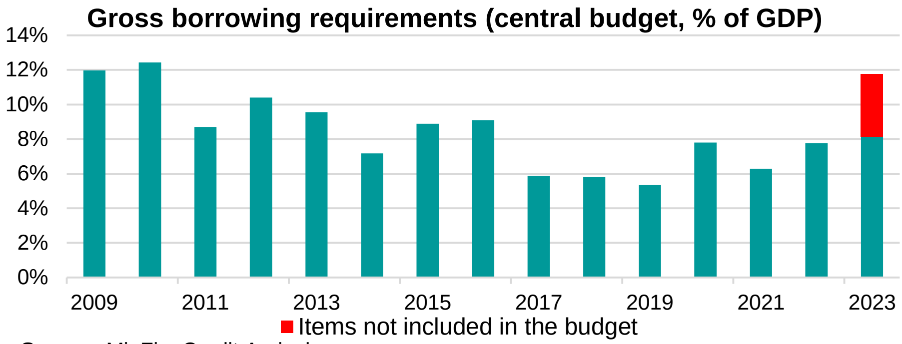
Source: Datastream, Credit Agricole

- **We have revised our path for US economic growth.** We now forecast that US GDP will expand by 1.7% (2.6% before the revision) in 2022, vs. 5.7% growth in 2021, and grow by 0.5% (1.5%) in 2023. The revision to our scenario was driven by a lower starting point, as well as deteriorating investment and private consumption prospects. Our new path for US economic growth, assuming a marked slowdown in 2023, is consistent with our Fed monetary policy scenario, under which the Federal Reserve will make three more interest rate hikes in 2022 (by 50bp in September, by 50bp in November and by 25bp in December), before ending the hiking cycle.

Will the NBP resume bond buying in 2023?

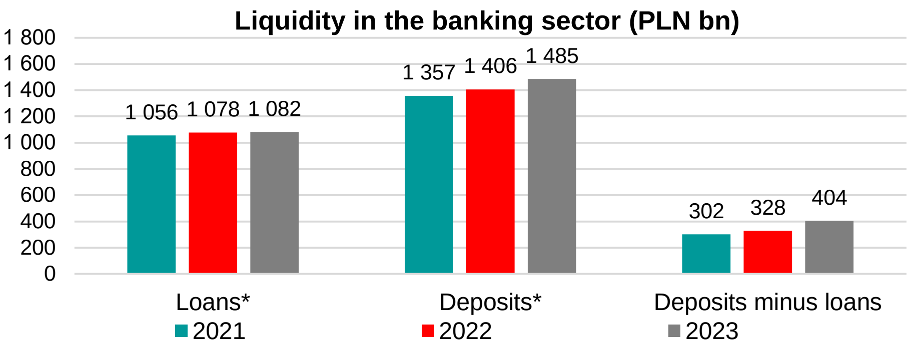
Two weeks ago, the budget bill for 2023 was presented. The amount of revenues for the state budget is PLN 604.4bn, and expenditures have been set at PLN 669.4bn. Thus, the planned deficit of the state budget for 2023 amounts to PLN 65.0bn. Below we present important information in the context of financing the budget for 2023, i.e. the so-called borrowing needs.

The gross borrowing needs of the state budget are the amount that is needed to finance the state budget deficit and the budget of European funds, the state budget's outgoings (including repayment of loans) and the redemption of bonds issued in previous years that mature in a given year. According to the budget bill, the gross borrowing needs of the state budget will amount to PLN 269.6bn in 2023. As a proportion of GDP, they will amount to 8.1% and will be the highest since 2016. It is worth noting, however, that the draft budget does not take into account certain expenditures, the probability of materialization of which in 2023 is, in our opinion, significant. Thus, the actual borrowing needs of the state budget are likely to be significantly higher than the amount assumed in the bill.



Source: MinFin, Credit Agricole

First, the draft budget does not provide for an extension of the Anti-Inflation Shield to 2023. We believe that such a scenario is unlikely. If the Shield is terminated in 2022, the average annual inflation rate in 2023 would exceed 10%, which would be a difficult scenario for the government given the parliamentary elections. According to NBP estimates, the cost of extending the Shield to 2023 is PLN 33.4bn. Secondly, we believe that as a part of the election campaign, the government will decide to grant the 14th and 15th pensions in 2023 (the budget includes the so-called '13th pension' only) and to valorize benefits under the Family 500+ program to PLN 700 per child. Such measures would entail an increase in budget expenditures by PLN 23bn and PLN 15bn, respectively. Alternatively, we expect the government to increase other expenditures (including social ones) on a scale similar to the cost of the 14th and 15th pensions and the 40% valorization of the 500+ benefit. Third, in an environment of high energy prices, the government is likely to decide to freeze electricity and gas prices for households, which would entail additional budget expenditures equal to PLN 23bn and PLN 13bn, respectively (according to government analyses accessed by Dziennik Gazeta Prawna). Combined with the coal allowance (PLN 11.5bn), the cost of such shielding measures would reach a total of about PLN 47bn in 2023. It is difficult to clearly predict whether the aforementioned measures will actually be implemented, or whether the government will make simultaneous savings in other areas of the budget. Nevertheless, taking fully into account the above-mentioned additional measures, gross borrowing needs would increase by PLN 120bn vs. the figure presented in the budget bill, and would amount to PLN 389.4bn. In relation to GDP (11.7%), they would be the largest since 2010, which thus raises the question of the government's ability to finance them.



Source: NBP, Credit Agricole *non-financial corporations and households

We believe that domestic banks will be an important buyer of government-issued bonds. Amid the slowdown in economic growth (and decline in lending) as well as rapid deposit growth (driven by nominal wage growth and relatively high interest rates) that we expect, liquidity in the banking sector will increase markedly in 2023. Excess liquidity, in simple terms defined as the excess of deposits of households and non-financial firms over loans granted to them, will increase in our view by about PLN 75bn in 2023 compared to 2022. Due to the design of the bank tax (no tax on bonds), a large part of these funds will be used to purchase Polish debt, in our opinion. The second source of financing borrowing needs may be available funds accumulated in budget accounts. We estimate that the government's liquidity cushion is about PLN 15bn. Part of the financing may be obtained from foreign investors, although the level is difficult to predict.

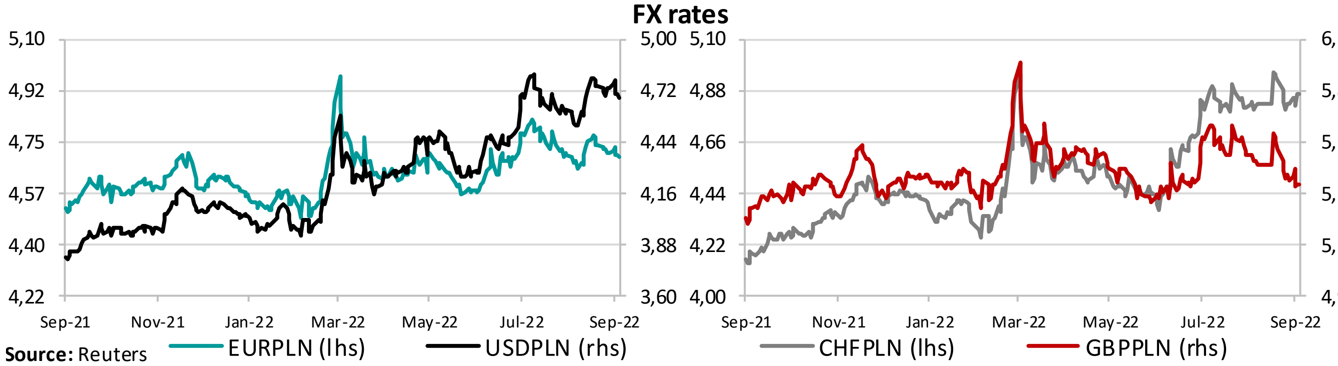
At the same time, one should remember that the borrowing needs of the general government sector are not limited to the borrowing needs of the state budget (the so-called central budget) discussed above. In addition, it is also necessary to provide financing for local government units and financial obligations incurred via funds at the Bank Gospodarstwa Krajowego (BGK) included in this sector. These include the

National Road Fund, the COVID-19 Response Fund, the Aid Fund and the Armed Forces Support Fund, among others. The specific borrowing needs of these entities have not yet been made public. However, they can be estimated based on the change in the difference between the government institutions and local government units' debt and the state public debt. According to the budget bill, the debt of other institutions included in the general government sector will increase by PLN 85bn between 2022 and 2023. In our opinion, it's the borrowing needs of the aforementioned funds that are primarily responsible for this debt increase. This PLN 85bn, in other words, is the approximate value of the so-called net borrowing needs, i.e. gross borrowing needs after excluding the redemption of bonds maturing in 2023. Using the Long-Term Financial Forecast of Local Government Units, we assume that the total gross borrowing needs of BGK funds and local government units will be PLN 95bn in 2023.

In assessing the domestic banking sector's ability to finance government and local government borrowing needs, it is crucial to look at net borrowing needs. Debt maturing next year will simply be rolled over. We estimate that net borrowing needs of the general government sector will amount to PLN 312.3bn in 2023 (PLN 107.5bn planned under the central budget and PLN 85bn under BGK and local government funds, and PLN 119.8bn due to expected by us government actions not included in the budget), or 9.4% of GDP. Even in a conservative estimate, assuming that the 14th and 15th pensions are not granted and the 500+ benefit is not validated, the net borrowing needs of the general government will be PLN 273bn (8.2% of GDP) in 2023. This amount represents more than three times our estimate of the increase in excess liquidity in the banking sector (PLN 75bn), which could be used to buy bonds. The government's issue of bonds could additionally be financed by funds placed so far by banks in NBP money bills (about PLN 200bn). However, we believe that the potential for such a transfer of funds is limited due to significant interest rate risk (NBP money bills are 7 days deposits, while bonds usually have maturities of several years). As a result, the government could opt to issue treasury bills with short maturities (less than a year) to increase the attractiveness of such securities compared with NBP money bills.

In order to assess the impact of issuing debt securities by the government, local governments and the BGK on the development of bond yields, it is necessary to look at their total supply (new issues plus the rollover of debt maturing in 2023), or in other words, the general government's gross borrowing needs. We estimate that they will amount to PLN 484.4bn in 2023 (14.6% of GDP), comprising new issues of PLN 312.3bn and the redemption of maturing bonds in the amount of PLN 172.1bn. The strong increase in the supply of bonds in 2023, which we expect, will act to increase their yields. Even when part of these needs are financed (prefinanced) in 2022, the upward pressure on yields in 2023 will remain high. Such a trend will also be supported by the monetary tightening we expect from the major central banks, primarily the Fed and the ECB (see above). In our view, in the event of a significant increase in yields, it is possible that the NBP will resume buying Treasury securities and debt securities guaranteed by the Treasury on the secondary market as part of structural open market operations. Such an action will have the effect of lowering bond yields and stabilizing the market for debt instruments, which may contribute to increased demand for Treasury bonds from foreign investors. The market conditions outlined above will be conducive to increased volatility of the PLN.

PLN exchange rate influenced by gas market situation



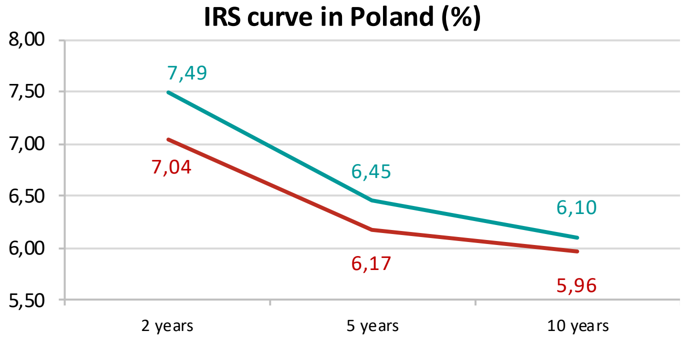
Source: Reuters

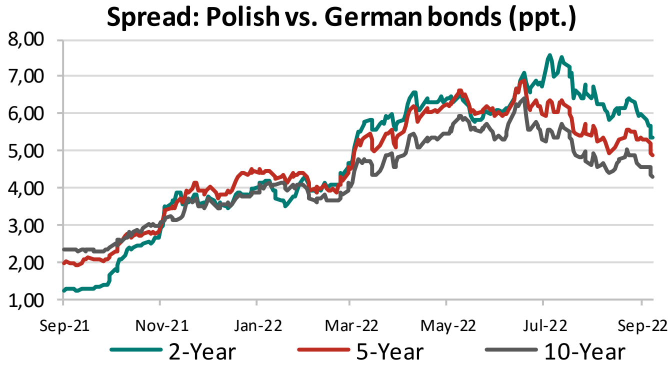
Last week, the EURPLN rate dropped to 4.7024 (the PLN strengthened by 0.2%). Throughout last week, the EURPLN exchange rate followed a mild downward trend. What contributed to the strengthening of the PLN was a reduction in global risk aversion, which was reflected in a decline in the VIX index. The meetings of the MPC and the ECB did not have a significant impact on the PLN.

Last week also saw a slight strengthening of the EUR against the USD, helped by the ECB's decision to raise interest rates, which reduced the interest rate disparity between the US and the Eurozone. In the months ahead, we expect the EURUSD to continue its gentle rise to 1.02 by the end of 2022.

We believe that the publications of data from the Polish and global economies scheduled for this week will not have a significant impact on the PLN, and the main determinant of the PLN's exchange rate will remain information affecting the assessment of the risk of a gas shock in Europe, which may significantly weaken the prospects for economic growth in the Eurozone and Poland.

Market expectations for further interest rate hikes in Poland weaken





Source: Reuters

Last week the 2-year IRS rates decreased to 7.04 (down by 45bp), 5-year rates to 6.17 (down by 28bp), and 10-year rates to 5.96 (down by 14bp). Last week saw a decline in IRS rates visible especially at the short end of the curve. What contributed to the decline was the weakening expectations of some investors for further interest rate hikes in Poland, linked to deteriorating economic growth prospects. This assessment is supported by a marked reduction in FRA contract quotes (by about 40bp in the case of FRA 3x6).

Data releases from the Polish and global economies planned for this week will not have a significant impact on the IRS, in our opinion. Information affecting the assessment of the risk of a gas shock in Europe will remain an important factor shaping the curve as it may significantly weaken the prospects for economic growth in the Eurozone and Poland.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland														
Indicator	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22
NBP reference rate (%)	0,10	0,10	0,50	1,25	1,75	2,25	2,75	3,50	4,50	5,25	6,00	6,50	6,50	6,75
EURPLN*	4,52	4,60	4,60	4,65	4,58	4,58	4,69	4,64	4,67	4,58	4,70	4,73	4,72	**4,77**
USDPLN*	3,83	3,98	3,98	4,10	4,03	4,08	4,18	4,19	4,43	4,27	4,48	4,63	4,70	**4,72**
CHFPLN*	4,18	4,27	4,35	4,47	4,42	4,40	4,56	4,54	4,55	4,45	4,69	4,86	4,80	**4,92**
CPI inflation (% YoY)	5,5	5,9	6,8	7,8	8,6	9,4	8,5	11,0	12,4	13,9	15,5	15,6	**15,2**	
Core inflation (% YoY)	3,9	4,2	4,5	4,7	5,3	6,1	6,7	6,9	7,7	8,5	9,1	9,3	**9,5**	
Industrial production (% YoY)	13,1	8,7	7,6	14,9	16,3	18,0	17,3	15,4	12,3	14,9	10,4	7,7	**11,5**	
PPI inflation (% YoY)	9,6	10,3	12,0	13,6	14,4	16,1	16,1	21,9	24,1	24,7	25,6	24,9	**24,4**	
Retail sales (% YoY)	10,7	11,1	14,4	21,2	16,9	20,0	16,5	22,0	33,4	23,6	19,9	18,4	**18,2**	
Corporate sector wages (% YoY)	9,5	8,7	8,4	9,8	11,2	9,5	11,7	12,4	14,1	13,5	13,0	15,8	**13,8**	
Employment (% YoY)	0,9	0,6	0,5	0,7	0,5	2,3	2,2	2,4	2,8	2,4	2,2	2,3	**2,5**	
Unemployment rate* (%)	5,8	5,6	5,5	5,4	5,4	5,5	5,5	5,4	5,2	5,1	4,9	4,9	**4,9**	
Current account (M EUR)	-527	-1817	-1368	-1269	-2685	-1046	-3787	-4010	-3476	-1485	-1468	**-2229**		
Exports (% YoY EUR)	23,9	9,4	8,9	7,4	26,6	19,9	11,2	18,7	7,9	27,2	25,8	**22,7**		
Imports (% YoY EUR)	33,6	22,4	24,2	23,9	35,1	35,0	22,1	38,2	24,5	36,4	31,5	**26,6**		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland											
Indicator	2022				2023				2021	2022	2023
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Gross Domestic Product (% YoY)	8,5	5,5	0,6	0,2	-0,3	0,8	2,9	3,9	5,9	3,4	1,9
Private consumption (% YoY)	6,6	6,4	0,0	0,5	1,0	1,5	0,7	1,3	6,1	3,3	1,1
Gross fixed capital formation (% YoY)	4,3	7,1	1,2	0,2	-0,7	-0,3	3,0	3,8	3,8	2,6	1,8
Export - constant prices (% YoY)	2,0	5,2	4,5	3,5	1,8	0,5	2,9	4,5	11,8	3,8	2,4
Import - constant prices (% YoY)	8,8	7,8	2,2	1,1	0,7	-1,3	5,1	7,0	15,9	4,7	2,7
GDP growth contributions: Private consumption (pp)	3,9	3,6	0,0	0,2	0,6	0,9	0,4	0,7	3,4	1,8	0,6
GDP growth contributions: Investments (pp)	0,6	1,1	0,2	0,0	-0,1	0,0	0,5	0,8	0,7	0,4	0,3
GDP growth contributions: Net exports (pp)	-3,8	-1,2	1,4	1,4	0,7	1,2	-1,2	-1,3	-1,2	-0,3	-0,1
Current account (% of GDP)***	-2,8	-3,9	-3,9	-4,0	-3,8	-3,4	-3,7	-4,3	-0,7	-4,0	-4,3
Unemployment rate (%)**	5,4	4,9	4,7	5,0	5,3	5,0	4,7	5,0	5,4	5,0	5,0
Non-agricultural employment (% YoY)	2,3	0,6	2,0	2,2	2,2	1,2	0,7	0,3	1,8	1,8	1,1
Wages in national economy (% YoY)	9,7	11,8	10,3	10,2	10,0	8,3	7,5	6,9	8,9	10,5	8,2
CPI Inflation (% YoY)*	9,6	13,9	16,2	17,0	14,6	9,9	7,1	4,4	5,1	14,2	9,0
Wibor 3M (%)**	4,77	7,05	7,13	7,13	7,13	7,13	6,63	6,01	2,54	7,13	6,01
NBP reference rate (%)**	3,50	6,00	6,75	7,00	7,00	7,00	7,00	6,25	1,75	7,00	6,25
EURPLN**	4,64	4,70	4,77	4,75	4,75	4,73	4,70	4,65	4,58	4,75	4,65
USDPLN**	4,19	4,48	4,72	4,66	4,61	4,50	4,39	4,23	4,03	4,66	4,23

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST* CA	FORECAST* CONSENSUS**
		Tuesday 09/13/2022				
11:00	Germany	ZEW Economic Sentiment (pts)	Sep	-55,3		-60,0
14:00	**Poland**	**Current account (M EUR)**	**Jul**	**-1468**	**-2229**	**-1759**
14:30	USA	CPI (% MoM)	Aug	0,0	0,0	-0,1
14:30	USA	Core CPI (% MoM)	Aug	0,3	0,4	0,3
		Wednesday 09/14/2022				
11:00	Eurozone	Industrial production (% MoM)	Jul	0,7		-0,8
		Thursday 09/15/2022				
10:00	**Poland**	**CPI (% YoY)**	**Aug**	**15,6**	**16,1**	**16,1**
11:00	Eurozone	Wages (% YoY)	Q2	2,7		
14:30	USA	NY Fed Manufacturing Index (pts)	Sep	-31,3		-15,3
14:30	USA	Retail sales (% MoM)	Aug	0,0	0,0	0,0
14:30	USA	Philadelphia Fed Index (pts)	Sep	6,2		3,5
15:15	USA	Industrial production (% MoM)	Aug	0,6	0,2	0,2
15:15	USA	Capacity utilization (%)	Aug	80,3		80,3
16:00	USA	Business inventories (% MoM)	Jul	1,4		0,8
		Friday 09/16/2022				
4:00	China	Industrial production (% YoY)	Aug	3,8	4,0	4,0
4:00	China	Retail sales (% YoY)	Aug	2,7	3,5	4,0
4:00	China	Urban investments (% YoY)	Aug	5,7	5,4	5,6
11:00	Eurozone	HICP (% YoY)	Aug	9,1	9,1	9,1
14:00	**Poland**	**Core inflation (% YoY)**	**Aug**	**9,3**	**9,9**	**9,9**
16:00	USA	Initial U. of Michigan Sentiment Index (pts)	Sep	58,2	60,0	59,8

*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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