Fast increase of orders in manufacturing with stagnation of employment

This week

- **The most important event this week will be the release of data from the US labour market.** We expect employment to have increased by 90k in September vs. a 156k increase in August, with unemployment rate down to 4.3% vs. 4.4% in August. The visibly lower - compared to August - increase in employment was largely due to the unfavourable effect of hurricanes Harvey and Irma on the economic activity in the US. 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 an increase by 135k in September vs. 237k in August). The results of US business survey will also be released today. We forecast that manufacturing ISM dropped to 58.0 pts in September vs. 58.8 pts in August, which will be in line with the results of regional business surveys. The publication of US readings should not be market moving.
- **A meeting of the Polish Monetary Policy Council will be held on Wednesday.** We expect that the MPC will decide to leave interest rates at an unchanged level. We believe that the issue of the higher-than-expected preliminary data on inflation in September is likely to be raised during the conference in the context of the monetary policy outlook. In our view, the NBP Governor, A. Glapiński, will repeat his view that interest rates will stay unchanged for an extended period of time. The press release after the Council meeting and NBP Governor's remarks during the conference is likely to contribute to a slight weakening of PLN and to a fall of yields on Polish bonds, we believe.
- **Data on business sentiment in Polish manufacturing have been released today.** PMI rose to 53.7 pts vs. 52.2 pts in August, running above our forecast (53.0 pts) and above the market expectations (53.2 pts). The average PMI in the July-September period (52.8 pts) stood at a slightly lower level than in Q2 (53.3 pts). Nevertheless, we see an upside risk to our forecast of GDP growth in Q3 (4.1% YoY vs. 3.9% in Q2), related to visibly higher from our expectations dynamics of industrial production in August (see MACROpulse of 19/9/2017).

Last week

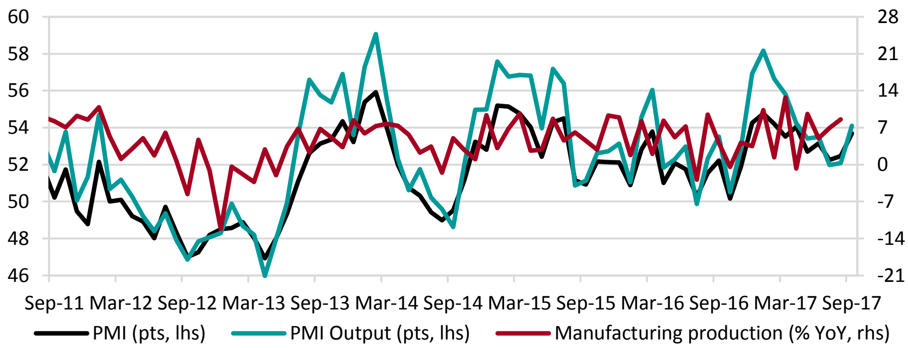
- **Last week President A. Duda presented his draft bills on the Supreme Court and the National Council of Judiciary (KRS).** The President's legislative initiative was preceded by his unexpected decision in July to veto both draft bills that had been passed by Sejm (see MACROmap of 31/7/2017). The key element of the President's proposal is the method of appointing KRS members. The KRS Law stipulates that 15 of 25 KRS members are the representatives of judicial circles. According to the President's proposal, they would be appointed by Sejm by a majority of three fifth of votes. Failing to obtain three fifth of votes, at the next stage each MP would be able to vote for one candidate only. According to the President, this would ensure a "multiparty appointment of KRS members". A part of the opposition and many lawyers found the proposed amendments unconstitutional as they assume that most KRS members would be appointed by politicians instead of judges. It is hard to tell at this stage whether the President's proposal will be accepted by Law and Justice. However, the judiciary reform in Poland is the leading project of the ruling party, therefore we expect that the President's initiative will be processed promptly. In our opinion, the possible adoption of the proposed amendments will open a new chapter of the dispute between the European Commission and the Polish government. Like in the case of amendments to the Constitutional Court Law, the Venice Committee may also get involved in the dispute. In the short term escalation of the dispute around the judiciary between the European Commission and Poland will be slightly negative for Poland's credit rating and PLN. Nevertheless, we expect that the stable macroeconomic fundamentals will support Poland's long-term rating. In the medium term, an increase in tensions between Poland and the European Union may result in deterioration of Poland's negotiating position in talks on the EU budget for the subsequent programming period (2021-2027). This may result in lower inflow of funds under the structural programmes to Poland, contributing to a lower rate of investments and slower long-term economic growth.

- **According to the flash estimate, inflation in Poland rose to 2.2% yoY in September vs. 1.8% in August, running above the market expectations (+1.9%) and our forecast (2.0%).** We believe that the sharp increase in inflation was due to higher dynamics of food prices, of fruit prices in particular, and higher core inflation. The publication of data on visibly higher than expected inflation has contributed to the strengthening of PLN (see below). Final data on inflation, including its structure, will be released on 12 October.
- **Hard data from the US economy and business survey results were released last week**. According to the final estimate, the annualized GDP growth rate rose to 3.1% in Q2 vs. 3.0% in the second estimate. The slight upward revision resulted from higher contributions of inventories (0.12 pp in the final estimate vs. 0.02 pp in the second estimate) and government expenditures (-0.03 pp vs. -0.05 pp). Lower contributions of private consumption (2.24 pp vs. 2.28 pp) and investments (0.53 pp vs. 0.58 pp) had an opposite impact. The contribution of net exports has not changed and amounted to 0.21 pp. Thus the main source of the increase in the US GDP in Q2 was private consumption. Preliminary data on durable goods orders were also released last week and increased by 1.7% MoM vs. a 6.8% decrease in July, mainly due to higher dynamics of orders for means of transport (the effect of orders in the Boeing company). Excluding means of transport, durable goods orders rose by 0.2% MoM in August vs. a 0.8% increase in July. Especially noteworthy in the data structure is the continuing moderately high annual dynamics of orders for non-military capital goods, excluding orders for aircrafts (3.6% YoY in August vs. 4.1% in July), being a leading indicator for future investments. Data on new home sales (560k in August vs. 580k in July) were also released last week and indicated a slight decrease in activity in the US real estate market. The results of consumer sentiment surveys were also released last week. The Conference Board Index pointed to a slight deterioration of consumer sentiment, dropping to 119.8 pts in September vs. 120.4 pts in August. Its decrease resulted from lower sub-index for current situation while higher sub-index for expectations had an opposite impact. The final University of Michigan Index also pointed to a slight deterioration of consumer sentiment, dropping to 95.1 pts in September vs. 97.6 pts in August and 95.3 pts in flash estimate. The index decline resulted from its lower expectations sub-index while higher sub-index for current situation had an opposite impact. The last week's data on the US economy support our forecast, in which the annualized US GDP growth rate will decrease to 2.4% in Q3. This is consistent with our scenario, in which FED will hike interest rates by 25 bp in December 2017.
- **According to the flash estimate, inflation in the Eurozone has not changed in September compared to October and amounted to 1.5% YoY.** Inflation stabilized due to higher dynamics of food prices, offset by their decline for prices of energy and services. In the whole Q3 inflation has not changed compared to Q2 and stood at 1.5%. We expect that in 2017 the average inflation in the Eurozone will amount to 1.5%, which is in line with the ECB September projection (see MACROmap of 11/9/2017). We maintain our scenario in which the ECB will decide at its meeting in October to gradually taper the Expanded Asset Purchase Program staring from January 2018 extending it until June. The scale of purchase will also be reduced from EUR 60bn to EUR 40 bn per month. At the same time, we believe that the ECB will not hike interest rates sooner than H2 2019.
- **Ifo Index reflecting the sentiment among German managers representing the manufacturing, construction, wholesale and retail trade sectors, dropped to 115.2 pts in September vs. 115.7 pts in August.** Thus, the index stayed at a level close to the all-time high recorded in July (116.1 pts). The index decrease in September was due to its lower sub-indices concerning both the assessment of the current situation and expectations. Sector-wise, sentiment deteriorated in two of the four sectors (wholesale trade and manufacturing), while the situation in retail sales

and construction improved. We forecast that the quarterly GDP growth rate in Germany will drop to 0.5% in Q3 vs. 0.6% in Q2.

- **At its last week's meeting the Czech National Bank (CNB) has left interest rates unchanged (two-week REPO rate amounts to 0.25%).** The decision has not been unanimous. Four members of the bank's board voted for leaving the rates at an unchanged level while 3 supported their hike. We see a significant upside risk to the inflation forecast presented by the CNB in the August projection, due to a fester than forecasted GDP growth in Q2 (4.7% YoY vs. 3.5% in the projection). A substantial factor is also a sharp increase in investment dynamics to a positive level (7.7% YoY), driven by growing absorption of EU funds. Consequently, the contribution of investments to economic growth amounted to 1.9 pp in Q2. We expect that in the coming quarters GDP dynamics running above the potential level will be conducive to growing difficulties in finding skilled labour, and consequently to an increase in wage pressure and inflationary pressure. EURCZK was stable in Q3 and the scale of its appreciation was limited by significant long currency positions opened in anticipation of CZK appreciation once floated in April 2017. In effect, the market reaction to interest rates hike in the Czech Republic in August was limited. EURCZK stabilization signals an upside risk to the inflation scenario in the August CNB projection as it assumed a moderate real-convergence-driven nominal appreciation of CZK. The last week's CNB meeting points in our view to an increased likelihood of 25bp hikes at the November meeting, and thus an upside risk to the expected by us short-term profile of CNB interest rates (according to our forecast the next hike will take place in February 2018).
- **Results of business surveys for the Chinese manufacturing were released last week.** China Caixin PMI dropped to 51.0 pts in September vs. 51.6 pts in August. Its decline resulted from lower contributions of three of its five sub-indices (for output, new orders, and inventories). Higher contributions of sub-indices for employment and suppliers' delivery times had an opposite impact. Especially noteworthy in the data structure are the suppliers' delivery times which in September were the longest since January 2017. According to the press release it was partly due to environmental controls which delay deliveries. On the other hand, PMI according to CFLP pointed to higher growth rate of activity in Chinese manufacturing, rising to 52.4 pts vs. 51.7 pts. Considering the hard data on the Chinese economy released in recent months (retail sales, industrial production, and urban investments), we expect that the GDP growth rate in China will drop to 6.8% in Q3 vs. 6.9% in Q2.

Fast increase of orders in manufacturing with stagnation of employment



Source: Markit, GUS

Business sentiment indicator for Polish manufacturing (PMI) rose to 53.7 pts vs. 52.5 pts in August, running above our forecast (53.0 pts) and market expectations (53.2 pts). Especially noteworthy in the structure of September PMIs is the fastest since February 2015 increase in total orders in Polish manufacturing. These orders were growing faster than export orders, signaling continuing fast increase in domestic demand. In our view, the stronger domestic demand for manufactured goods is related to the positive impact of the rebound in construction (resulting from acceleration in public investments implemented with the use of EU funds and increase in housing investments) on the manufacturing branches supplying goods used as an input for the assembly-construction production (see MACROpulse of 19/9/2017). In turn, the increase in new export orders in September (the highest growth rate since January 2017) was to a significant extent related to good business sentiment in the Eurozone manufacturing. Flash PMIs for the Eurozone (including Germany) pointed to improvement of sentiment in September and the factor behind the increase in activity was the continuing fast increase in total orders, including export orders, supported by recovery in global trade (see MACROmap of 25/9/2017).

The fast growth of new orders in Polish manufacturing was reflected by a significant increase in the output sub-index (up by 2.0 pts to 54.1 pts). However, PMI survey results point to growing barrier to increase of activity in manufacturing caused by rising difficulties of companies in finding skilled labour. In September, the employment sub-index amounted to 50.0 pts, hitting the lowest value since July 2013. The lack of new jobs in manufacturing has contributed to the sharpest increase in production backlogs since January 2015.

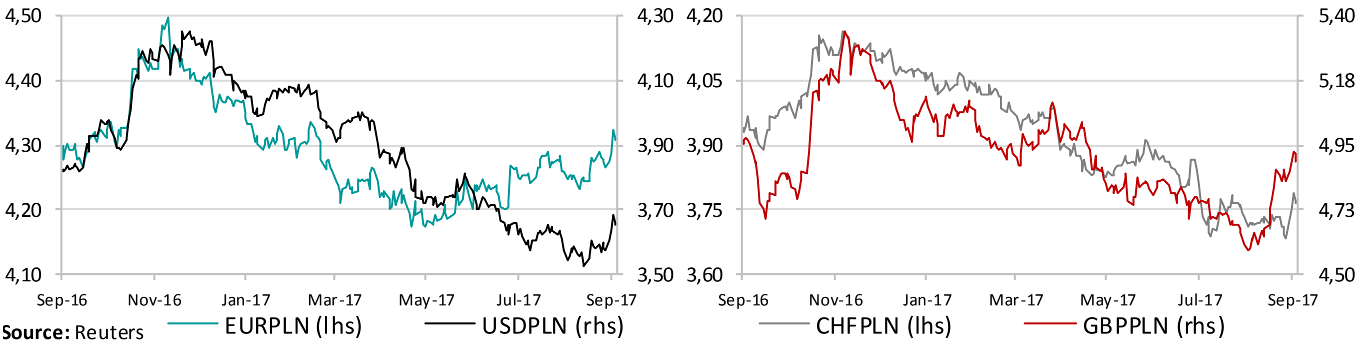
PMI survey results are in line with GUS business surveys, in which the percentage of companies reporting difficulties in finding skilled labour in Q3 was the highest in the survey history. At the same time they indicate that the continuing fast increase of demand in manufacturing with growing barrier in the form of stagnation in employment will be conducive to a decline in inventories and thus to a limited contribution of their growth to GDP dynamics in Q4. This view is supported by the results of the September PMIs, according to which producers were carrying out some orders through direct sale of their stocks.

The average PMI in the July-September period (52.8 pts) stood at a slightly lower level than in Q2 (53.3 pts). Nevertheless, we see an upside risk to our forecast of GDP growth in Q3 (4.1% YoY vs. 3.9% in Q2), related to visibly higher from our expectations dynamics of industrial production in August (see MACROpulse of 19/9/2017).

Today's data are slightly positive for PLN and yields on Polish bonds.

J. Yellen's hawkish remarks weakened PLN

FX rates



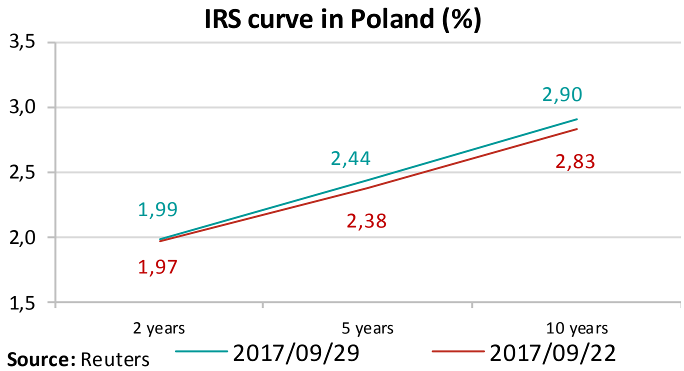
Source: Reuters

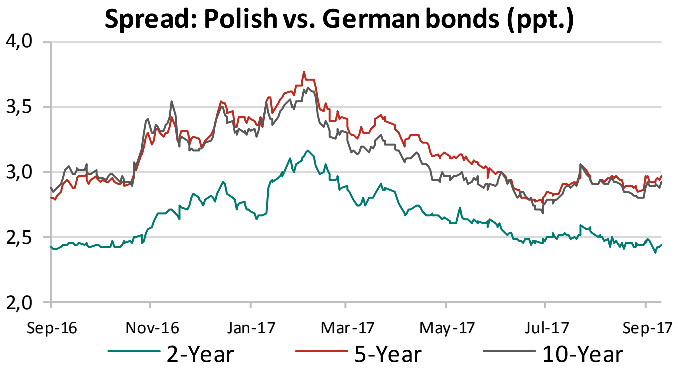
Last week EURPLN rate rose to 4.3079 (PLN weakening by 1.0%). Monday through Thursday a sharp weakening of PLN was observed. Consequently, EURPLN exceeded 4.33 on Thursday, hitting the highest level since March 2017. The main factor behind the weakening of PLN was the Tuesday's remark by the FED chair, J. Yellen, who emphasized that the Federal Reserve should continue hiking interest rates despite uncertain inflation outlook in the US. Thursday saw a correction. On Friday, PLN appreciation continued, supported by higher-than-expected preliminary data on domestic inflation in September.

Last week, PLN was strongly depreciating vs. USD, due to the above-mentioned PLN weakening vs. EUR, with a simultaneous fall of EURUSD.

Today's higher-than-expected PMI for Polish manufacturing is slightly positive for PLN. Crucial for PLN this week will be the data on non-farm payrolls in the US. If our forecast which is close to the market consensus materializes, their publication will have a limited impact on PLN. The tone of the conference after the Wednesday's MPC meeting is likely to be slightly negative for PLN.

MPC meeting negative for IRS rates





Source: Reuters

Last week the 2-year IRS rates rose to a level of 1.985 (up by 2 bp), of 5-year rates to a level of 2.435 (up by 6 bp), and of 10-year bonds to a level of 2.902 (up by 7 bp). Monday through Friday, IRS rates continued to increase across the curve. The factor conducive to higher IRS rates was the Tuesday's remark by J. Yellen who emphasized that that the Federal Reserve should continue hiking interest rates despite uncertain inflation outlook in the US. Friday saw a slight correction. The higher-than-expected data on inflation in Poland released Friday afternoon have contributed to an increase in IRS rates across the curve.

Today's higher-than-expected PMI for Polish manufacturing may support an increase in IRS rates. This week the Polish debt market will focus on the publication of data on non-farm payrolls in the US, scheduled for Friday. Our forecast does not differ significantly from the market consensus; therefore, its materialization will have a limited impact on IRS rates. The tone of the conference after the Wednesday's MPC meeting is likely to be slightly negative for IRS rates.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland														
Indicator	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17
NBP reference rate (%)	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	**1,50**
EURPLN*	4,29	4,31	4,45	4,40	4,32	4,31	4,23	4,23	4,18	4,23	4,25	4,25	4,31	**4,28**
USDPLN*	3,82	3,92	4,20	4,18	4,00	4,07	3,97	3,88	3,72	3,70	3,59	3,57	3,65	**3,61**
CHFPLN*	3,93	3,96	4,13	4,11	4,04	4,05	3,96	3,90	3,84	3,86	3,72	3,72	3,77	**3,73**
CPI inflation (% YoY)	-0,5	-0,2	0,0	0,8	1,7	2,2	2,0	2,0	1,9	1,5	1,7	1,8	**2,0**	
Core inflation (% YoY)	-0,4	-0,2	-0,1	0,0	0,2	0,3	0,6	0,9	0,8	0,8	0,8	0,7	**0,9**	
Industrial production (% YoY)	3,2	-1,3	3,2	2,2	9,1	1,1	11,0	-0,6	9,1	4,5	6,2	8,7	**5,6**	
PPI inflation (% YoY)	0,2	0,6	1,8	3,2	4,0	4,5	4,8	4,2	2,4	1,8	2,2	3,0	**3,2**	
Retail sales (% YoY)	4,8	3,7	6,6	6,4	11,4	7,3	9,7	8,1	8,4	6,0	7,1	7,6	**7,9**	
Corporate sector wages (% YoY)	3,9	3,6	4,0	2,7	4,3	4,0	5,2	4,1	5,4	6,0	4,9	6,6	**6,9**	
Employment (% YoY)	3,2	3,1	3,1	3,1	4,5	4,6	4,5	4,6	4,5	4,3	4,5	4,6	**4,5**	
Unemployment rate* (%)	8,3	8,2	8,2	8,3	8,6	8,5	8,1	7,7	7,4	7,1	7,1	7,0	**7,0**	
Current account (M EUR)	-858	172	99	-219	2342	-599	-529	-160	-298	-932	-878	**-427**		
Exports (% YoY EUR)	3,1	-0,6	5,7	5,1	14,3	5,7	15,1	1,4	16,2	8,7	10,7	**12,9**		
Imports (% YoY EUR)	3,5	3,6	6,3	7,1	16,0	8,9	16,8	3,3	21,4	15,0	12,5	**11,0**		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland											
Indicator	2017				2018				2016	2017	2018
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Gross Domestic Product (% YoY)	4,0	3,9	4,3	4,2	4,0	3,7	3,6	3,8	2,7	4,1	3,8
Private consumption (% YoY)	4,7	4,9	4,2	4,5	4,6	4,3	4,3	3,9	3,8	4,6	4,3
Gross fixed capital formation (% YoY)	-0,4	0,8	3,0	5,5	7,9	7,0	6,8	6,1	-7,8	3,0	6,7
Export - constant prices (% YoY)	8,3	2,8	8,0	10,0	8,0	7,7	6,8	5,5	9,0	7,3	7,0
Import - constant prices (% YoY)	8,7	6,1	9,0	11,6	10,6	10,0	10,4	8,3	8,9	8,9	9,8
GDP growth contributions: Private consumption (pp)	3,0	2,9	2,5	2,3	3,0	2,6	2,6	1,9	2,3	2,7	2,5
GDP growth contributions: Investments (pp)	0,0	0,1	0,5	1,3	0,9	1,1	1,2	1,5	-1,6	0,5	1,2
GDP growth contributions: Net exports (pp)	0,1	-1,5	-0,3	-0,4	-1,1	-0,8	-1,8	-1,3	0,3	-0,6	-1,2
Current account***	0,1	-0,5	-0,7	-1,2	-1,7	-1,5	-1,7	-2,0	-0,2	-1,2	-2,0
Unemployment rate (%)**	8,1	7,1	7,0	7,3	7,6	6,8	6,9	7,3	8,3	7,3	7,3
Non-agricultural employment (% YoY)	2,1	2,4	1,9	1,0	0,3	0,1	0,1	0,1	1,9	1,9	0,2
Wages in national economy (% YoY)	4,1	5,0	5,6	6,0	6,4	6,7	6,6	6,5	3,8	5,2	6,5
CPI Inflation (% YoY)*	2,0	1,8	1,9	1,8	1,5	1,9	1,6	1,5	-0,6	1,9	1,6
Wibor 3M (%)**	1,73	1,73	1,73	1,73	1,73	1,73	1,90	1,98	1,73	1,73	1,98
NBP reference rate (%)**	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,75	1,50	1,50	1,75
EURPLN**	4,23	4,23	4,31	4,16	4,15	4,12	4,10	4,07	4,40	4,16	4,07
USDPLN**	3,97	3,70	3,65	3,41	3,40	3,35	3,31	3,26	4,18	3,41	3,26

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
		Monday 10/02/2017				
9:00	**Poland**	**Manufacturing PMI (pts)**	**Sep**	**52,5**	**53,0**	**53,2**
9:55	Germany	Final Manufacturing PMI (pts)	Sep	60,6	60,6	60,6
10:00	Eurozone	Final Manufacturing PMI (pts)	Sep	58,2	58,2	58,2
11:00	Eurozone	Unemployment rate (%)	Aug	9,1		9,0
15:45	USA	Flash Manufacturing PMI (pts)	Sep	53,0	53,0	
16:00	USA	ISM Manufacturing PMI (pts)	Sep	58,8	58,0	58,0
		Tuesday 10/03/2017				
11:00	Eurozone	PPI (% YoY)	Aug	2,0		2,3
		Wednesday 10/04/2017				
10:00	Eurozone	Services PMI (pts)	Sep	55,6	55,6	55,6
10:00	Eurozone	Final Composite PMI (pts)	Sep	56,7	56,7	56,7
14:15	USA	ADP employment report (k)	Sep	237		135
16:00	USA	ISM Non-Manufacturing Index (pts)	Sep	55,3	55,6	55,4
	Poland	**NBP rate decision (%)**	**Oct**	**1,50**	**1,50**	**1,50**
		Thursday 10/05/2017				
16:00	USA	Factory orders (% MoM)	Aug	-3,3	1,3	1,0
		Friday 10/06/2017				
8:00	Germany	New industrial orders (% MoM)	Aug	-0,7		0,7
14:30	USA	Unemployment rate (%)	Sep	4,4	4,3	4,4
14:30	USA	Non-farm payrolls (k MoM)	Sep	156	90	98
16:00	USA	Wholesale inventories (% MoM)	Aug	0,0		0,3
16:00	USA	Wholesale sales (% MoM)	Aug	-0,1		0,2

*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

Jakub BOROWSKI
Chief Economist
tel.: 22 573 18 40
jakub.borowski@credit-agricole.pl

Krystian JAWORSKI
Senior Economist
tel.: 22 573 18 41
krystian.jaworski@credit-agricole.pl

Jakub OLIPRA
Economist
tel.: 22 573 18 42
jakub.olipra@credit-agricole.pl