Business sentiment in the Eurozone breaks new records

This week

- **A meeting of the 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 stronger than expected inflation decrease in December and observed in recent weeks PLN strengthening and its impact on inflation outlook will be raised during the conference. In our view, the NBP Governor, A. Glapiński, will maintain his view that interest rates will remain unchanged until the end of 2018. We believe that the statement after the Council meeting and NBP Governor's remarks during the press conference will be slightly negative for PLN and yields on Polish bonds.
- **Significant data from the US will be released this week.** We expect CPI inflation to have dropped to 2.1% YoY in December vs. 2.2% in November, with a simultaneous stabilization of core inflation (1.7% YoY). In our view, inflation decreased due to lower dynamics of fuel prices. We forecast that nominal retail sales dropped to 0.5% MoM in December from 0.8% in November, due i.a. to lower fuel sales growth. Our forecasts are close to the market consensus, therefore we believe that the aggregate impact of US readings on the financial market to be limited.
- **Data on the Chinese balance of trade will be released on Thursday**. We expect that its balance dropped to USD 18.9bn in December vs. USD 40.2bn in November. We forecast that export growth dropped to 11.4% YoY in December vs. 12.3% in November, while import growth rose to 27.1% from 17.7%. The publication of data from China will be neutral for the markets, we believe.

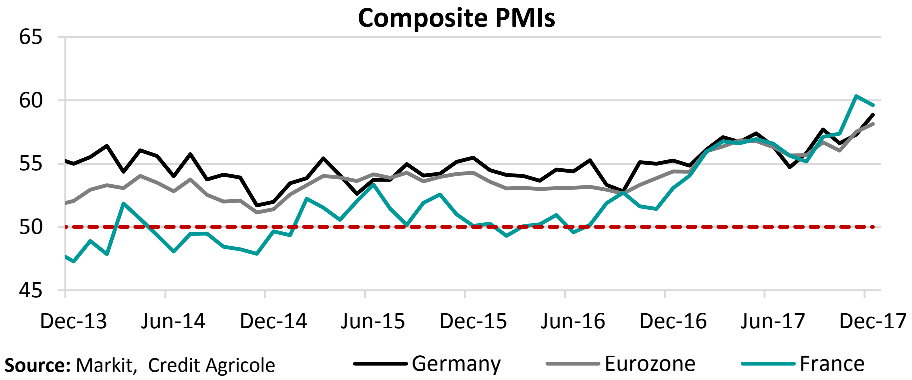
Last week

- **Poland manufacturing PMI rose to 55.0 pts in December vs. 54.2 pts in November, hitting the highest level since February 2015.** Conducive to the index increase were higher contributions of three of its five sub-indices (for output, employment, and new orders). Lower contributions of sub-indices for suppliers' delivery times and stocks of goods purchased had an opposite impact. Especially noteworthy in data structure is the increase in the employment sub-index, supported by growing capacity utilization. In our view the employment growth in the coming months will be increasingly limited by the growing difficulties of companies in finding skilled labour. This will be conducive to an increase in investments enabling to change production technology to a less labour consuming one and thus to increase productivity. This view is supported by the statement released together with the data in which the companies attributed good sentiment i.a. to "investments in more efficient equipment" (see MACROpulse of 2/1/2018). In Q4 2017, the average value of Poland manufacturing PMI amounted to 54.2 pts vs. 52.8 pts in Q3. This poses an upside risk to our forecast of economic growth in Q4 2017 (4.8% YoY vs. 4.9% in Q2).
- **According to the flash estimate, inflation in Poland dropped to 2.0% YoY in December vs. 2.5% in November leading to materialization of our scenario from the month before, in which inflation in November attained the inflation target only temporarily (see MACROmap of 4/12/2017).** We believe that conducive to decrease in inflation were lower dynamics of food and fuel prices. The final data on inflation will be released on 15 January. In subsequent months we expect further decrease in inflation due to lower growth rate of food and fuel prices. We thus maintain our monetary policy scenario which assumes first hike of NBP interest rates in July 2019.
- **The Minutes of the December FED meeting were released last week.** The description of the discussion after the meeting indicates that one of the reasons for the latest interest rates hike in the US were the expectations of the Federal Reserve members that the tax cuts adopted in December would accelerate the increase in inflation. At the same time, many FOMC members

believe that the tax reform may positively impact the potential economic growth rate in the US. In our view, the inflation data coming in subsequent months will not be sufficient justification for the scale of the monetary tightening in 2018 expected in the December projection (by 75 bp – see MACROmap of 18/12/2017). Therefore we forecast that the scale of the interest rate hikes in 2018 will be lower from FOMC members' expectations and will amount to 50 bp.

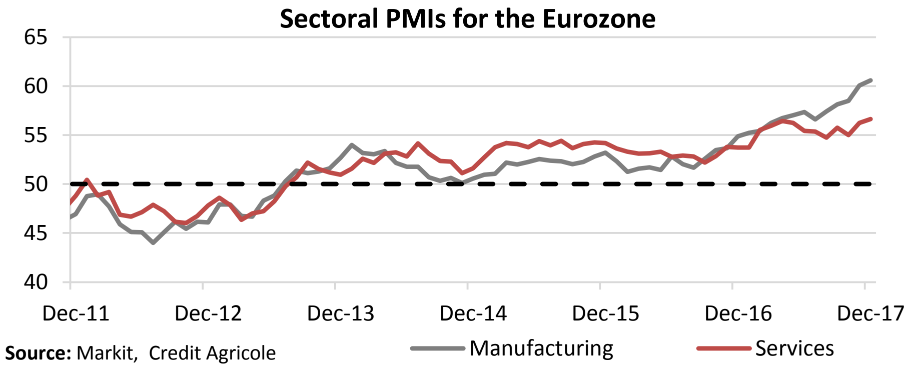
- **Numerous US hard data and business survey results were released last week.** Non-farm payrolls in the US rose by 148k in December vs. a 252k increase in November (revised upwards from 221k), running below the market expectations (up by 190k). The highest increase in employment was recorded in construction (+30.0k), leisure and hospitality (+29.0k), and education and health service (+28.0k). On the other hand, employment decreased in retail trade (-20.3k) and utilities (-0.9k). Unemployment rate in December has not changed compared to November and amounted to 4.1%, running clearly below the natural unemployment rate indicated by FOMC (4.6% - see MACROmap of 18/12/2017). The participation rate has not changed compared to November and amounted to 62.7%. The annual dynamics of average hourly earnings has increased and amounted to 2.5% in December vs. 2.4% in November. We expect that the annual wage growth will continue to increase as the situation in the labour market will improve further. The results of business surveys were also released last week. The ISM index for manufacturing increased to 59.7 pts in December vs. 58.2 pts in November. The index increase resulted from higher contributions of four of its five sub-indices (for new orders, output, stocks of goods purchased, and suppliers' delivery times). Lower contribution of the employment sub-index had an opposite impact. Especially noteworthy in the data structure is the sharp increase in the new orders sub-index (69.4 pts in December vs. 64.0 pts in November) to the highest level since January 2004. On the other hand, the non-manufacturing ISM recorded a decrease and dropped to 55.9 pts vs. 57.4 pts in November. Its decrease resulted from lower contributions of two of its four sub-indices (for business activity and new orders). Higher contributions of the sub-indices for employment and suppliers' delivery times had an opposite impact. The last week's readings from the US economy do not alter our forecast, in which the annualized US GDP growth rate decreased to 2.6% in Q4 vs. 3.3% in Q3.
- **According to the flash estimate, inflation in the Eurozone dropped to 1.4% YoY in December vs. 1.5% in November.** Conducive to the decrease in inflation was lower growth rate of energy prices. We forecast that inflation in the Eurozone dropped to 1.3% YoY in Q1 2018 vs. 1.4% in Q4 2017 due to further decrease in the dynamics of energy prices.
- **China Caixin manufacturing PMI rose to 51.5 pts in December vs. 50.8 pts in November**. The index increase resulted from higher contributions of four of its five sub-indices (for new orders, output, employment, and suppliers' delivery times). Lower sub-index for stocks of goods purchased had an opposite impact. Especially noteworthy in the data structure is the increase in the sub-index concerning new orders, including new export orders, which signals improvement of both internal and external demand. This supports our scenario assuming recovery in global trade in 2018. In the whole Q4, Caixin PMI dropped to 51.1 pts vs. 51.2 pts, running in line with our forecast of decrease in Chinese GDP dynamics to 6.7% in Q4 vs. 6.8% in Q3. We forecast that in the whole 2017, GDP in China will increase by 6.8% vs. a 6.7% increase in 2016.

Business sentiment in the Eurozone breaks new records



Source: Markit, Credit Agricole

The Composite PMI in the Eurozone rose to 58.1 pts in December vs. 57.5 pts in November, hitting the highest level since February 2011. The increase in Composite PMI occurred due to an increase in both its sub-index for business activity in services and for output in manufacturing. In the Q4 2017, the average value of the Composite PMI for the Eurozone amounted to 57.2 pts vs. 56.0 pts in Q3. This supports our forecast, in which the quarterly GDP growth rate in the Eurozone rose to 0.7% in Q4 vs. 0.6% in Q3.



Source: Markit, Credit Agricole

Although improved sentiment in the Eurozone was recorded for both manufacturing and services, noteworthy is the continuing divergence in the growth rates of activity in these two sectors. The Eurozone manufacturing PMI in December hit the record high level in the survey history. The recovery in the Eurozone manufacturing is supported by ongoing sharp increase in internal and foreign orders. Increasingly stronger signals pointing to growing barriers related to insufficient capacities are also observed. Suppliers' delivery times in the Eurozone manufacturing in December have been the longest since May 2000, which shows that companies are falling behind in executing orders. This supports higher investments in increasing production capacities, including increase in employment. Consequently, the sub-index for employment in the Eurozone manufacturing has stayed at the record level attained in November (58.2 pts).

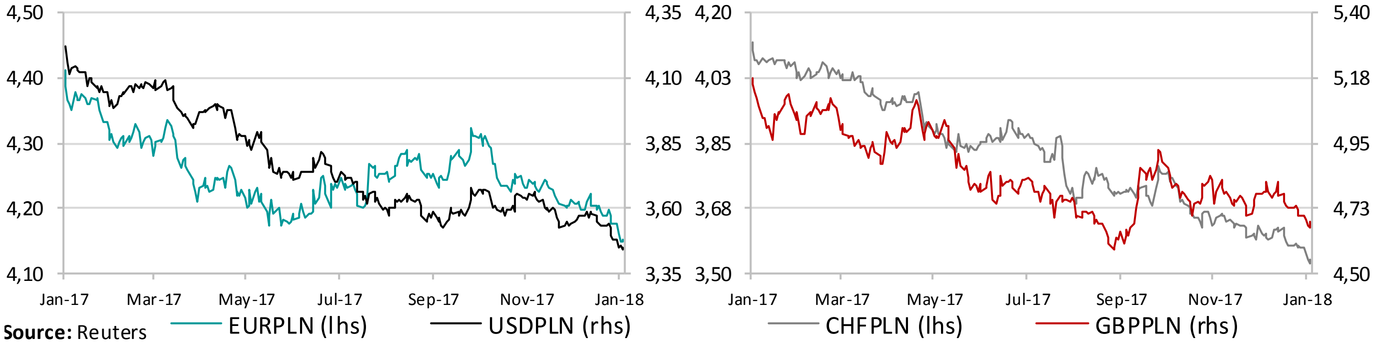
The improvement of sentiment in the Eurozone spanned wide geographically. The Composite PMI increased in Germany (58.9 pts in December vs. 57.3 pts in November), Italy (56.5 pts vs. 56.0 pts), and Spain (55.4 pts vs. 55.2 pts). The index decreased in France (59.6 pts vs. 56.0 pts). Nevertheless, its average value in Q4 stood at the highest level since Q3 2010, which poses an upside risk to our forecast, in which the quarterly dynamics of the French GDP has not changed in Q4 compared to Q3 and amounted to 0.5%.

From the point of view of future business climate in Poland, especially noteworthy is the situation in German manufacturing. The German manufacturing PMI rose to 63.3 pts in December vs. 62.5 pts in November, hitting the highest level in the survey history. Its increase resulted from higher contributions of four of its five sub-indices (for output, new orders, stocks of goods purchased, and suppliers' delivery times). The decrease in the employment sub-index had an opposite impact. Especially noteworthy in the in the data structure is the increase in the sub-indices for new orders (64.2 pts in December vs. 63.7 pts in November) and new export orders (63.2 pts vs. 63.0 pts) to the highest level since March 2010. The acceleration in the inflow of new orders allows to expect that the high level of activity in German manufacturing will continue into subsequent months.

The marked improvement in the Eurozone manufacturing, in Germany in particular, is conducive to stronger demand for goods manufactured in Poland and used in the production of final goods (so-called intermediate goods). This poses an upside risk to our forecast assuming a slight decrease in the dynamics of Polish exports in Q4 (7.5% YoY vs. 7.6% in Q3). At the same time, the growing demand for intermediate goods made in Poland in the conditions of high capacity utilization supports higher fixed capital formation in Polish manufacturing. This is in line with our forecast of higher investment growth rate in Q4 (6.9% YoY vs. 3.3% in Q3).

MPC meeting slightly negative for PLN

FX rates



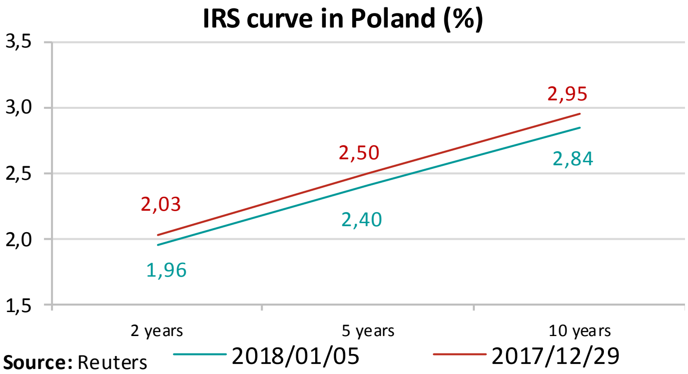
Source: Reuters

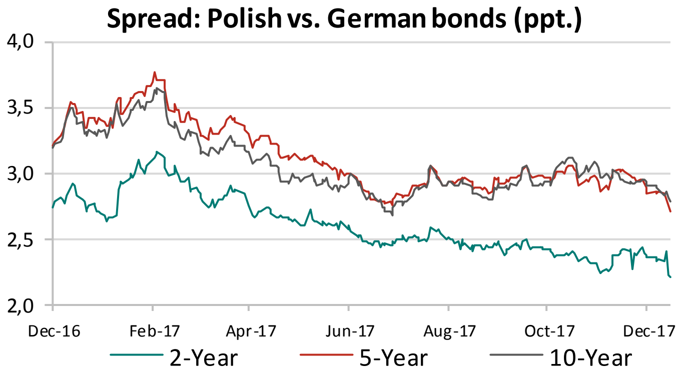
Last week EURPLN rate dropped to 4.1521 (PLN strengthening by 0.6%). Last week PLN was staying within a weak upward trend. PLN strengthening was related to a decrease in global risk aversion reflected by lower VIX index. The publication of lower-than-expected domestic inflation data had a limited impact on PLN. Friday saw a slight correction. The release of data from the US labour market led to a temporary increase in PLN volatility.

Especially noteworthy is the last week's PLN strengthening vs. CHF. On Wednesday, CHFPLN reached the lowest level since 15 January 2015, when CHF had significantly appreciated following the SNB decision to float it against EUR. This occurred due to CHF weakening vs. EUR in recent months, following a decrease in the global risk aversion as well as a relatively high rate of PLN vs. EUR.

The most important event for PLN this week will be the MPC meeting. We believe that the statement after the Council meeting and NBP Governor's remarks during the press conference will be slightly negative for PLN. US data (retail sales and inflation) should not have a significant impact on PLN.

Polish debt market focused on MPC meeting





Source: Reuters

Last week the yield of Polish 2-year benchmark bonds dropped to a level of 1.96 (down by 7 bp), of 5-year bonds to a level of 2.40 (down by 10 bp), and of 10-year bonds dropped to a level of 2.84 (down by 11 bp). Last week saw a decline in IRS rates across the curve. Conducive to their decrease was the increase in global risk aversion, as indicated by a significant decrease in spread between the Polish and the German bonds. The decrease in IRS rates was also supported by the publication of lower-than-expected domestic inflation data. On Thursday debt auctions (main and supplementary one) took place at which the Finance Ministry sold PLN 6bn of 2-, 5-, 6-, and 10-year bonds with demand amounting to PLN 13.8bn. The successful debt auction contributed to a decrease in IRS rates.

This week the Polish debt market will focus on the MPC meeting scheduled for Wednesday. In our view, the statement after the Council meeting and NBP Governor’s remarks during the press conference may lead to a decrease in IRS rates at the short end of the curve. We believe that the aggregate impact of US data (retail sales and inflation) on IRS rates will be limited.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland														
Indicator	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18
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*	4,40	4,32	4,31	4,23	4,23	4,18	4,23	4,25	4,25	4,31	4,24	4,20	4,18	**4,17**
USDPLN*	4,18	4,00	4,07	3,97	3,88	3,72	3,70	3,59	3,57	3,65	3,64	3,53	3,48	**3,53**
CHFPLN*	4,11	4,04	4,05	3,96	3,90	3,84	3,86	3,72	3,72	3,77	3,65	3,59	3,57	**3,56**
CPI inflation (% YoY)	0,8	1,7	2,2	2,0	2,0	1,9	1,5	1,7	1,8	2,2	2,1	2,5	**2,1**	
Core inflation (% YoY)	0,0	0,2	0,3	0,6	0,9	0,8	0,8	0,8	0,7	1,0	0,8	0,9	**0,9**	
Industrial production (% YoY)	2,2	9,1	1,1	11,0	-0,6	9,1	4,5	6,2	8,7	4,3	12,3	9,0	**2,9**	
PPI inflation (% YoY)	3,2	4,0	4,5	4,8	4,2	2,4	1,8	2,2	3,0	3,2	3,0	1,8	**0,7**	
Retail sales (% YoY)	6,4	11,4	7,3	9,7	8,1	8,4	6,0	7,1	7,6	8,6	8,0	10,2	**9,0**	
Corporate sector wages (% YoY)	2,7	4,3	4,0	5,2	4,1	5,4	6,0	4,9	6,6	6,0	7,4	6,5	**7,2**	
Employment (% YoY)	3,1	4,5	4,6	4,5	4,6	4,5	4,3	4,5	4,6	4,5	4,4	4,5	**4,5**	
Unemployment rate* (%)	8,2	8,5	8,4	8,0	7,6	7,3	7,0	7,0	7,0	6,8	6,6	6,5	**6,6**	
Current account (M EUR)	-106	2548	-514	-405	350	-264	-892	-203	189	120	575	**556**		
Exports (% YoY EUR)	9,0	15,1	6,4	19,7	3,2	19,2	7,2	13,3	11,5	10,0	15,4	**12,6**		
Imports (% YoY EUR)	9,8	16,0	10,5	19,8	4,6	21,7	14,5	13,2	7,8	7,5	12,9	**11,5**		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland													
Indicator		2017				2018				2017	2018	2019
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Gross Domestic Product (% YoY)		4,1	4,0	4,9	4,8	4,2	3,9	3,6	3,6	4,5	3,8	3,3
Private consumption (% YoY)		4,7	4,9	4,8	4,3	4,2	3,9	3,5	3,8	4,7	3,9	3,0
Gross fixed capital formation (% YoY)		-0,5	0,9	3,3	6,9	8,6	7,2	7,2	6,6	3,6	7,2	5,0
Export - constant prices (% YoY)		9,6	3,1	7,6	7,5	5,6	6,5	6,6	6,2	7,0	6,2	5,0
Import - constant prices (% YoY)		9,7	6,0	5,7	6,9	6,4	7,1	7,2	8,2	7,1	7,2	6,0
GDP growth contributions	Private consumption (pp)	2,9	2,9	2,9	2,1	2,7	2,3	2,1	1,9	2,7	2,3	1,8
	Investments (pp)	0,0	0,1	0,6	1,7	1,0	1,2	1,2	1,6	0,6	1,4	0,9
	Net exports (pp)	0,4	-1,3	1,1	0,6	-0,2	0,0	0,0	-0,7	0,2	-0,2	-0,3
Current account***		0,1	-0,4	0,0	-0,5	-0,8	-0,4	-0,1	-0,5	-0,5	-0,5	-0,7
Unemployment rate (%)**		8,0	7,0	6,8	6,6	6,7	6,1	6,2	6,5	6,6	6,5	6,5
Non-agricultural employment (% YoY)		2,1	2,4	1,8	1,6	1,2	0,7	0,4	0,3	2,0	0,6	0,0
Wages in national economy (% YoY)		4,1	5,0	4,9	5,9	6,8	5,8	6,1	6,8	5,0	6,4	6,5
CPI Inflation (% YoY)*		2,0	1,8	1,9	2,3	1,8	1,9	2,0	1,2	2,0	1,7	2,0
Wibor 3M (%)**		1,73	1,73	1,73	1,72	1,73	1,73	1,73	1,73	1,72	1,73	1,98
NBP reference rate (%)**		1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,75
EURPLN**		4,23	4,23	4,31	4,18	4,17	4,14	4,12	4,10	4,18	4,10	4,15
USDPLN**		3,97	3,70	3,65	3,48	3,53	3,45	3,38	3,33	3,48	3,33	3,27

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
		Monday 01/08/2018				
8:00	Germany	New industrial orders (% MoM)	Nov	0,5		0,5
10:30	Eurozone	Sentix Index (pts)	Jan	31,1		31,2
11:00	Eurozone	Business Climate Indicator (pts)	Dec	1,49		1,51
11:00	Eurozone	Retail sales (% MoM)	Nov	-1,1		1,3
		Tuesday 01/09/2018				
8:00	Germany	Industrial production (% MoM)	Nov	-1,4		1,8
8:00	Germany	Trade balance (bn EUR)	Nov	19,9		21,0
11:00	Eurozone	Unemployment rate (%)	Nov	8,8		8,7
		Wednesday 01/10/2018				
2:30	China	PPI (% YoY)	Dec	5,8	4,8	4,8
2:30	China	CPI (% YoY)	Dec	1,7	1,6	1,9
16:00	USA	Wholesale inventories (% MoM)	Nov	0,7		0,7
16:00	USA	Wholesale sales (% MoM)	Nov	0,7		
	Poland	**NBP rate decision (%)**	**Jan**	**1,50**	**1,50**	**1,50**
		Thursday 01/11/2018				
11:00	Eurozone	Industrial production (% MoM)	Nov	0,2		0,8
		Friday 01/12/2018				
	China	Trade balance (bn USD)	Dec	40,2	18,9	37,0
14:30	USA	CPI (% MoM)	Dec	0,4	0,1	0,2
14:30	USA	Core CPI (% MoM)	Dec	0,1	0,2	0,2
14:30	USA	Retail sales (% MoM)	Dec	0,8	0,5	0,4
16:00	USA	Business inventories (% MoM)	Nov	-0,1		0,3

*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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