Subsequent signals of a soft patch in Polish manufacturing

This week

- **Significant data from the US will be released this week.** We forecast that total inflation rose to 2.5% YoY in April vs. 2.4% in March due to higher core inflation (2.2% YoY vs. 2.1% in March). The preliminary University of Michigan Index will be released on Friday. We forecast that it dropped to 98.5 pts in May vs. 98.8 pts in April. Conducive to the deterioration of households' sentiment was a decline in the US stock market. In our view, the aggregate impact of US readings will be neutral for PLN and prices of the Polish debt.
- **Data on the Chinese trade balance will be released on Tuesday**. We expect that it rose to USD 37.3bn in April vs. USD -5.0bn in March. We believe that the slowdown observed in March in Chinese manufacturing and exports was temporary. Thus, we forecast that export growth rate recorded an increase to 17.7% YoY in April vs. -2.7% in March, while import growth rate rose to 23.0% from 14.4%. The publication of data from China will be neutral for the markets, we believe.
- **Final data on the April inflation in Poland will be released on Friday.** We believe that inflation will not change compared to the flash estimate (1.6% YoY vs. 1.3% in February). The increase in April inflation occurred due to higher dynamics of food and fuel prices (see below). The publication of the data should not be market moving.
- **Data on new orders in German manufacturing has been released today.** Seasonally adjusted total orders decreased by 0.9% MoM in March vs. a 0.2% decrease in February. This has been a third month in a row of a seasonally-adjusted decrease in orders. Conducive to total orders decline was lower foreign demand (-2.8% MoM), while domestic orders have increased (1.5%). Consequently, the hard data from the German economy have confirmed the tendencies signaled by business surveys in recent months (see MACROmap of 30/4/2018), i.e. the slowdown in global trade. The data signal a downside risk to our forecast of economic growth in Germany (0.6% QoQ in Q1 and Q2).

Last week

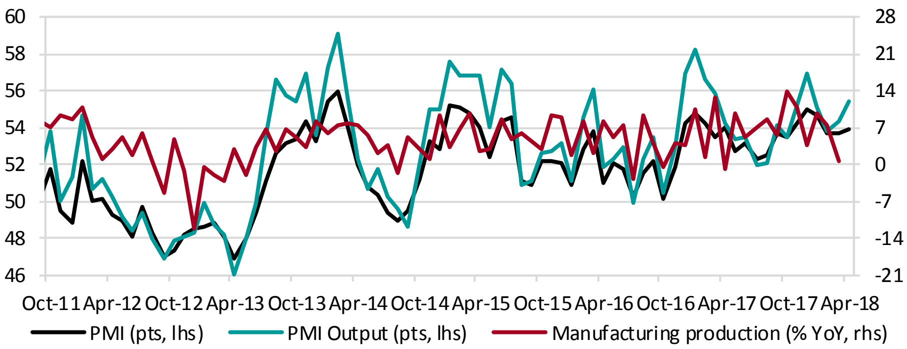
- **The most important event last week was FOMC meeting.** The target range for the Federal Reserve funds rate was left unchanged and amounts to [1.50%; 1.75%], which was in line with our expectations and the market consensus. The statement has not substantially changed compared to the one released after the March meeting. Despite the weaker-than-expected March US non-farm payrolls data, FOMC members maintained their positive view of the situation in the labour market, saying that "on the average" a strong increase in employment had continued in recent months. In the context of economic growth, FOMC members pointed out that the latest data pointed to a sharp increase in investments in Q1 with a simultaneous slowdown of consumption. According to the statement, FOMC members expect that inflation will stay close to the target (2%) in the medium term. In the short term FOMC members assess the risks to inflation as balanced. The text of the statement supports our scenario, in which FED will deliver three more interest rate hikes in 2018 (in June, September, and December, each time by 25bp).
- **Non-farm payrolls in the US rose by 164k in April vs. a 135k increase in March (revised upwards from 103k), running below the market expectations (increase by 192k).** The highest increase in employment was recorded in business services (+54.0k), education and health services (+31.0k), and manufacturing (+24.0k). On the other hand, employment decreased in wholesale trade (-9.8k) and in the public sector (-4.0k). Unemployment rate dropped to 3.9% in April from 4.1% in March, running below the natural unemployment rate indicated by FOMC (4.5% - see MACROmap of 26/3/2018). The participation rate dropped to 62.8% in April, due to the exit from the labour market of some of the so-far unemployed. Despite the slight decline in

April, the US participation rate, continues to be relatively stable against the historical background. The annual dynamics of average hourly earnings have not changed in April compared to March and amounted to 2.6%. We expect that subsequent months will see further increase in wage growth amid improvement in the labour market. The ISM index for manufacturing was released last week and decreased to 57.3 pts in April vs. 59.3 pts in March. The index decrease resulted from lower contributions of four of its five sub-indices (for new orders, output, stocks of goods purchased, and employment). Higher value of the sub-index for suppliers' delivery times had an opposite impact. The growth rate of manufacturing activity in the US hit the lowest level since July 2017 – the surveyed companies reported that high capacity utilization limited the possibility of further acceleration in production. The non-manufacturing ISM also decreased in April and amounted to 56.8 pts vs. 58.6 pts in March. Its decrease resulted from lower contributions of three of its four sub-indices (for business activity in services, employment, and suppliers' delivery times). On the other hand, higher contribution of the new orders sub-index had an opposite impact. The last week's readings from the US economy pose a downside risk to our scenario, in which the annualized US GDP growth rate will rise to 3.1% in Q2 2018 vs. 2.1% in Q1.

- **According to the flash estimate, inflation in Poland rose to 1.6% YoY in April vs. 1.3% in March, running above our forecast equal to the market expectations (1.5%)**. GUS has released partial data on inflation structure with information on the price growth rate in the categories "food and non-alcoholic beverages", "energy", and "fuels". Conducive to the increase in total inflation were higher dynamics of prices of fuels (1.3% YoY in April vs. -2.3% in March) and food (4.0% YoY vs. 3.7% in March). A decrease in core inflation, which according to our estimates amounted to 0.5% YoY in April vs. 0.7% in March, had an opposite impact. The April data do not alter our forecast of average yearly inflation in 2018 (1.4% vs. 2.0% in 2017).
- **Polish manufacturing PMI rose to 53.9 pts in April vs. 53.7 pts in March (see below)**. The index stood slightly below its average value in Q1 (54.0 pts), which supports our forecast of the economic growth rate in Poland (4.3% YoY in Q2 vs. 4.7% in Q1).
- **According to the flash estimate the quarterly GDP growth rate in the Eurozone dropped to 0.4% in Q1 vs. 0.7% in Q4 2017, running in line with the market expectations and clearly below our forecast (0.6%).** The annual economic growth rate has also decreased and stood at 2.5% in Q1 vs. 2.8% in Q4 2017. The GDP data are a flash estimate and do not include its structure. The next GDP estimate for the Eurozone in Q1, including the growth rate in all the countries of the single currency area, will be released on 15 May and data on GDP structure will be released on 7 June. The weaker-than-we-expected data on GDP in Q1 pose a slight downside risk to our forecast of economic growth rate in the single currency area in the whole 2018 (2.4% vs. 2.5% in 2017).
- **According to the flash estimate, inflation for the Eurozone dropped to 1.2% YoY in April vs. 1.3% in March, running below our forecast equal to the market consensus (1.3%).** Conducive to the decrease in inflation were lower dynamics of prices of services. We expect that inflation will rise to 1.7% YoY in May due to the effects related to the shift of the date of Easter Holiday and to higher dynamics of fuel prices. In July, inflation in the Eurozone will reach the local maximum at 1.8% YoY. In our view, in subsequent quarters, the inflation rate in the single currency area will stay within a downward trend and will reach 1.4% in Q4 2019. We believe that core inflation in the Eurozone will not exceed 1.3% in the horizon of the next two years (vs. 0.7% in April and 1.1% in May). This supports our scenario, in which in June 2018 the ECB will extend the asset purchase program until December 2018, reducing its scale to EUR 15bn starting from September 2018. However, we do not rule out that high uncertainty about the currently observed slowdown of economic growth in the Eurozone may incline the ECB to postpone this decision until July.
- **China CFLP manufacturing PMI dropped to 51.4 pts in April vs. 51.5 pts in March.** On the other hand, the Caixin PMI recorded an increase, rising to 51.1 pts in April vs. 51.0 pts in March.

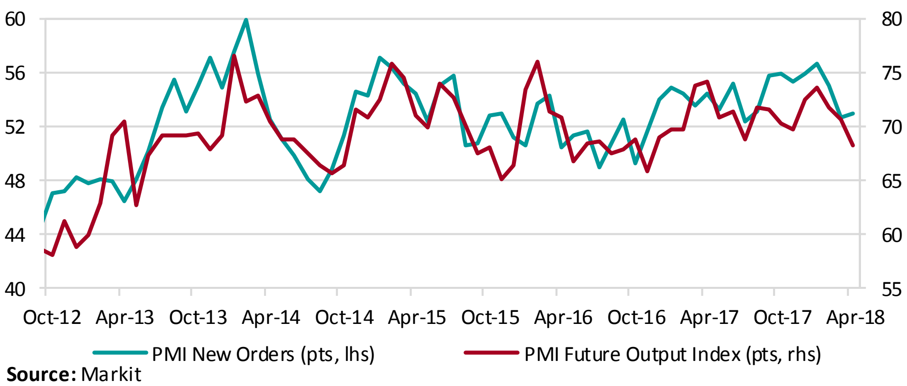
Conducive to the index increase were higher contributions of the sub-indices for employment and output. On the other hand, especially noteworthy is a sharp decrease in the sub-index for new export orders which fell below 50 pts, namely the threshold dividing contraction from expansion in this category. Export orders have been decreasing at the fastest rate since April 2016. This shows that the protectionist measures initiated by D. Trump have contributed to a marked deterioration in the prospects for foreign demand for goods manufactured in China. The business survey results for the Chinese manufacturing support our scenario of slowdown in global trade, which will adversely affect the economic activity in Poland in the coming quarters (see MACROmap of 30/4/2018).

Subsequent signals of a soft patch in Polish manufacturing



Source: Markit, GUS

The April data on business sentiment in Polish manufacturing were released last week. PMI rose to 53.9 pts in April vs. 53.7 pts in March, running above our forecast (52.9 pts) and market expectations (53.2 pts). Conducive to the index increase were mainly the higher values of sub-indices concerning total new orders and output. In addition, the sub-index concerning employment – which stood in April at a slightly lower level than in March - also signals good business sentiment. At first sight, the business survey results give an optimistic picture of Polish manufacturing at the beginning of Q2.

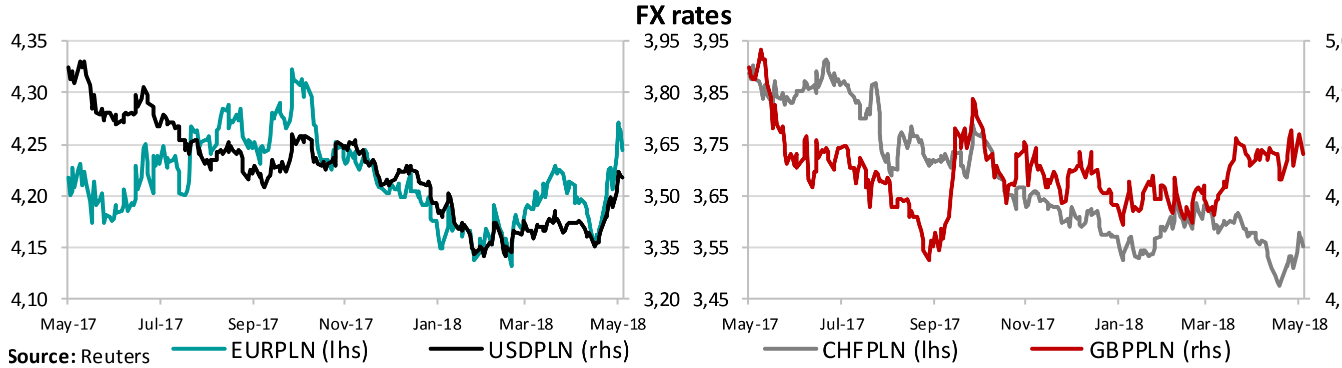


Source: Markit

However, in the data we see several risks which might threaten the sustainability of the recovery in Polish manufacturing. A decrease in production backlogs was recorded in April, for the first time since December 2017. It does not have to unambiguously indicate a downturn, however, such phenomenon may signal that the demand for goods offered by the Polish manufacturing is weakening. This view is supported by the decrease in the sub-index concerning the purchasing activity of enterprises to the lowest level since November 2016. In addition, the Future Output Index – reflecting the managers' expectations concerning production in the next 12 months - recorded a decline in April for a third consecutive month and, consequently, hit the lowest level since November 2016.

What's more, the deterioration in manufacturing was wide ranging geographically – in April, PMIs recorded a decline in the Czech Republic, Hungary, Germany, and the Eurozone. The business survey results support our scenario, in which the nearest months will see a slight slowdown of global economic growth. For the time being, such tendencies were not reflected by the Polish PMI sub-index concerning new export orders (it rose to 51.6 pts in April from 49.9 pts in March). However, we believe that the deterioration in global sentiment will contribute towards a decline in Polish exports dynamics in subsequent months (see MACROmap of 30/5/2018). The value of the Polish PMI stood in April slightly below its average for Q1 (54.0 pts), which supports our forecast of the economic growth rate in Poland (4.3% YoY in Q2 vs. 4.7% in Q1).

PLN depreciation during long weekend



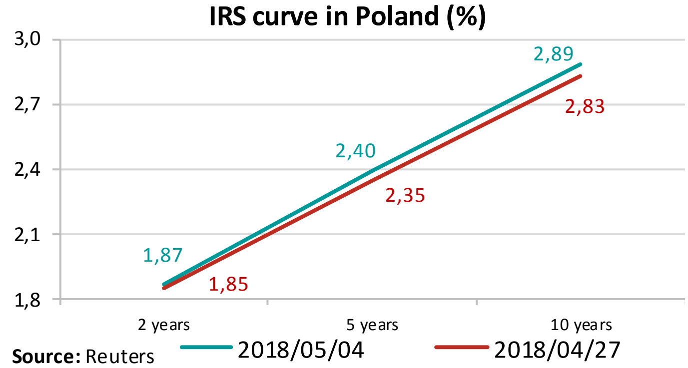
Source: Reuters

Last week EURPLN rate rose to 4.2388 (PLN weakening by 0.8%). On Monday and Tuesday, given low market liquidity due to long weekend, PLN visibly depreciated vs. EUR. The depreciation of PLN was not stopped even by the statement of E. Gatnar, MPC member, in which he did not rule out the necessity of interest rate hikes this year. From Wednesday through Thursday, EURPLN was relatively stable and stood around 4.27. The publication of domestic data (PMI and preliminary inflation) and the statement after the FOMC meeting had no substantial impact on PLN. On Friday, with the return of domestic investors, PLN strengthening could be observed. The PLN appreciation was also supported by the weaker-than-expected data from the US labour market.

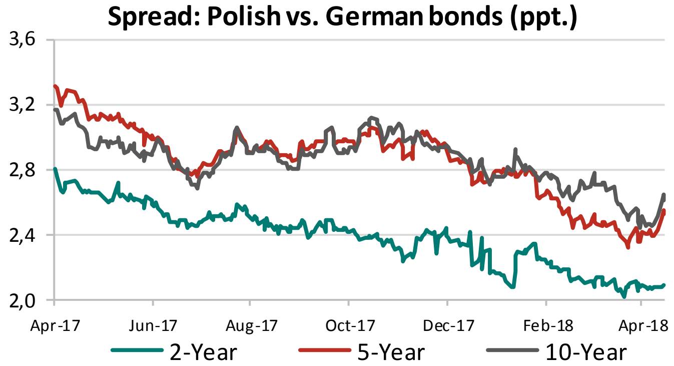
Last week PLN was also depreciating vs. USD. This resulted from the above-mentioned increase in EURPLN rate with a simultaneous further decrease in EURUSD rate, which has been staying within a downward trend for several weeks. USD appreciation vs. EUR was supported by the outflow of capital from the US caused by interest rates disparity. In effect, last week, USDPLN hit the highest level since December 2017.

The macroeconomic calendar this week is exceptionally scarce. We believe that data from Poland (final inflation), the US (inflation, preliminary University of Michigan Index), and China (trade balance) will have a limited impact on PLN.

Scarce macroeconomic calendar will support the stabilization of IRS rates



Source: Reuters



Last week Polish 2-year IRS rate rose to a level of 1.867 (up by 1 bp), of 5-year IRS rate to a level of 2.395 (up by 5 bp), and of 10-year IRS rate to a level of 2.886 (up by 6 bp). Throughout the week, IRS rates were staying within a weak upward trend. This tendency was supported by several factors: low activity of domestic investors and higher-from-the-consensus reading of inflation in Poland.

The macroeconomic calendar this week is exceptionally scarce. We believe that data from Poland (final inflation), the US (inflation, preliminary University of Michigan Index), and China (trade balance) will have a limited impact on IRS rates, which will support their stabilization.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-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*	4,23	4,18	4,23	4,25	4,25	4,31	4,24	4,20	4,18	4,15	4,17	4,21	4,24	**4,20**
USDPLN*	3,88	3,72	3,70	3,59	3,57	3,65	3,64	3,53	3,48	3,34	3,42	3,42	3,51	**3,48**
CHFPLN*	3,90	3,84	3,86	3,72	3,72	3,77	3,65	3,59	3,57	3,59	3,62	3,58	3,54	**3,53**
CPI inflation (% YoY)	2,0	1,9	1,5	1,7	1,8	2,2	2,1	2,5	2,1	1,9	1,4	1,3	**1,6**	
Core inflation (% YoY)	0,9	0,8	0,8	0,8	0,7	1,0	0,8	0,9	0,9	1,0	0,8	0,7	**0,6**	
Industrial production (% YoY)	-0,5	9,3	4,4	6,3	8,9	4,3	12,4	9,2	2,8	8,6	7,3	1,9	**7,8**	
PPI inflation (% YoY)	4,2	2,4	1,8	2,2	3,0	3,2	3,0	1,8	0,3	0,2	-0,1	0,3	**0,7**	
Retail sales (% YoY)	8,1	8,4	6,0	7,1	7,6	8,6	8,0	10,2	6,0	8,2	7,9	9,2	**8,2**	
Corporate sector wages (% YoY)	4,1	5,4	6,0	4,9	6,6	6,0	7,4	6,5	7,3	7,3	6,8	6,7	**7,1**	
Employment (% YoY)	4,6	4,5	4,3	4,5	4,6	4,5	4,4	4,5	4,6	3,8	3,7	3,7	**3,7**	
Unemployment rate* (%)	7,6	7,3	7,0	7,0	7,0	6,8	6,6	6,5	6,6	6,9	6,8	6,6	**6,2**	
Current account (M EUR)	284	-202	-902	-296	311	218	436	278	-699	2072	-1017	**-620**		
Exports (% YoY EUR)	3,3	19,1	7,2	15,0	13,4	11,5	15,8	15,5	2,6	11,7	5,7	**-1,1**		
Imports (% YoY EUR)	5,0	21,5	14,3	14,6	8,7	8,9	15,4	15,9	10,9	16,3	8,3	**2,1**		

*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)	4,4	4,0	5,2	4,9	4,7	4,3	4,2	3,9	4,6	4,3	3,0
Private consumption (% YoY)	4,5	4,9	4,7	5,0	5,4	4,4	4,3	4,2	4,8	4,6	3,6
Gross fixed capital formation (% YoY)	1,4	1,3	3,6	5,4	6,5	6,0	5,5	5,0	3,4	5,6	3,1
Export - constant prices (% YoY)	11,2	4,5	9,2	8,2	7,5	6,5	6,6	6,0	8,2	6,6	5,0
Import - constant prices (% YoY)	11,1	8,0	7,0	8,9	8,1	7,8	7,5	7,0	8,7	7,6	6,0
GDP growth contributions: Private consumption (pp)	2,8	2,9	2,8	2,5	3,5	2,6	2,6	2,1	2,7	2,7	2,1
Investments (pp)	0,2	0,2	0,6	1,4	0,8	1,0	0,9	1,2	0,6	1,0	0,6
Net exports (pp)	0,5	-1,5	1,3	0,0	0,0	-0,4	-0,2	-0,3	0,1	-0,2	-0,3
Current account (% of GDP)***	0,2	-0,4	0,3	0,3	-0,1	-0,1	-0,4	-0,4	0,3	-0,4	-0,6
Unemployment rate (%)**	8,0	7,0	6,8	6,6	6,6	6,0	6,2	6,5	6,6	6,5	6,5
Non-agricultural employment (% YoY)	2,1	2,4	1,8	1,3	1,2	0,7	0,4	0,3	1,9	0,6	0,2
Wages in national economy (% YoY)	4,1	5,0	4,9	7,1	6,8	6,1	6,4	6,8	5,3	6,5	6,5
CPI Inflation (% YoY)*	2,0	1,8	1,9	2,3	1,5	1,5	1,6	1,1	2,0	1,4	1,7
Wibor 3M (%)**	1,73	1,73	1,73	1,72	1,70	1,70	1,70	1,70	1,72	1,70	1,95
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	4,21	4,19	4,18	4,17	4,18	4,17	4,15
USDPLN**	3,97	3,70	3,65	3,48	3,42	3,41	3,34	3,31	3,48	3,31	3,19

* quarterly average

** end of period

***cumulative for the last 4 quarters

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
		Monday 05/07/2018				
8:00	Germany	New industrial orders (% MoM)	Mar	0,3		0,5
10:30	Eurozone	Sentix Index (pts)	May	19,6		21,1
		Tuesday 05/08/2018				
	China	Trade balance (bn USD)	Apr	-5,0	37,3	24,7
8:00	Germany	Industrial production (% MoM)	Mar	-1,6		0,8
8:00	Germany	Trade balance (bn EUR)	Mar	19,2		20,0
		Wednesday 05/09/2018				
16:00	USA	Wholesale inventories (% MoM)	Mar	0,5		0,5
16:00	USA	Wholesale sales (% MoM)	Mar	1,0		0,6
		Thursday 05/10/2018				
3:30	China	PPI (% YoY)	Apr	3,1	3,3	3,5
3:30	China	CPI (% YoY)	Apr	2,1	2,0	1,9
13:00	UK	BOE rate decision (%)	May	0,50	0,50	0,50
14:30	USA	CPI (% MoM)	Apr	-0,1	0,3	0,3
14:30	USA	Core CPI (% MoM)	Apr	0,2	0,2	0,2
		Friday 05/11/2018				
16:00	USA	Initial U. of Michigan Sentiment Index (pts)	May	98,8	98,5	98,5

*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

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