Heavy weather for German manufacturing

This week

- **The most important event this week will be the FOMC meeting scheduled for Wednesday.** We expect FED to increase the target range for federal funds by 25 bp to [2.00%; 2.25%]. The September macroeconomic projection will be presented after the meeting. We believe that these forecasts will be particularly important for assessing the impact of expansive fiscal policy and further escalation of the US-China trade war on the US economy. We expect that the forecasted economic growth rate and inflation profile will be slightly revised upwards compared to the June projection. In addition, the projection is likely to indicate that core inflation at the turn of 2019 and 2020 will exceed the inflation target (2%). In turn, the unemployment rate profile will be revised downwards. In our view, the median FOMC members' expectations concerning the level of interest rates as at the end of 2018 (2.25%; 2.50%) will not change. However, we believe that the scale of interest rate hikes expected by FOMC members in 2019 will increase to 100 bp vs. 75 bp in the June projection, due to some FOMC members' concerns about the impact of the trade war and the resulting rise in the prices of imported goods on the inflation expectations. We also see a slight downside risk to the June interest rate profile in 2020, due to the assumed by us slowdown of GDP growth in the US in 2020 below the potential level, which will limit FED's propensity to monetary tightening. We believe that the publication of the FOMC projection pointing to a faster from the market expectations pace of the monetary policy tightening in 2019 will be slightly negative for PLN and the prices of Polish bonds.
- **Important data from the US will be released this week**. The final estimate of GDP in Q2 will be released on Thursday. We expect that the annualized economic growth rate will be slightly revised upwards to 4.3% vs. 4.2% in the second estimate, due to a higher contribution of consumption. Data on durable goods orders will also be released this week and, in our view, increased by 3.5% MoM in August vs. a 1.7% decrease in July, due to higher orders in the Boeing company. Data on new home sales (630k in August vs. 627k in July) will also be released this week, providing subsequent signals pointing to slower growth of activity in the US real estate market (see below). US business survey results will also be published. We expect that the Conference Board Consumer Confidence Index (131.0 pts in September vs. 133.4 pts in August), like the final University of Michigan Index (100.0 pts in September vs. 96.2 pts in August), will point to continuous good households' sentiment. In our view, the publication of US data will be overshadowed by the FED meeting scheduled for Wednesday and, therefore, should not be market moving.
- **Ifo Index reflecting the sentiment among German managers representing the manufacturing, construction, trade, and services sectors was released today.** It dropped to 103.7 pts in September from 103.8 pts in August. The deterioration of sentiment is consistent with the drop of the September PMI composite for Germany recorded last week. Data are neutral for the markets.
- **The flash estimate of HICP inflation for the Eurozone will be released on Friday**. We expect that the annual inflation rate has not changed in September compared to August and amounted to 2.0% YoY. At the same time, we assume that core inflation will stabilize at the August level (1.0% YoY). Some fragmentary information on inflation in the Eurozone will be provided earlier by the Thursday's publication of flash inflation in Germany where we also expect it to stabilize (1.9% in September and August). Our forecast is lower from the market consensus (2.1%); therefore, its materialization may be slightly positive for PLN and the prices of Polish bonds.
- **The September Caixin PMI for Chinese manufacturing will be released on Friday**. We expect it to drop to 50.4 pts in September vs. 50.6 pts in August, suggesting a slight decrease in the growth rate of activity in Chinese manufacturing, largely due to the negative impact of the US-China trade war on Chinese exports. We believe that the measures planned by the

Chinese government to stimulate domestic demand (i.a. higher tax allowance, lower corporate tax, increased lending, launch of new infrastructural investments, or tax preferences for export-oriented companies) will be reflected by business survey results no sooner than in Q2 2019. Our forecast is in line with the consensus; therefore, its materialization will be neutral for the financial markets.

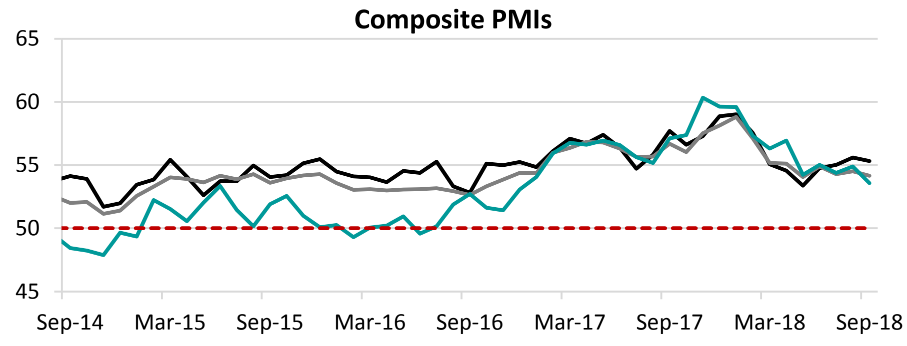
Last week

- **According to the flash data, the Composite PMI Index (for manufacturing and services) in the Eurozone dropped to 54.2 pts in September vs. 54.5 pts in August, running in line with our forecast and below the market expectations (54.4 pts).** The decline in PMI Composite resulted from its lower sub-index for output (down to the lowest level since September 2016) and higher sub-index for business activity in services. The average value of the Composite PMI for the Eurozone in the whole Q3 dropped to 54.3 pts vs. 54.7 pts in Q2, which poses a downside risk to our forecast, in which the quarterly GDP growth in the Eurozone will increase to 0.5% in Q3 vs. 0.4% in the Q2 (see below).
- **Hard data on the US economy and business survey results were released last week.** The number of housing starts rose to 1285k in August vs. 1174k in July, number of new building permits dropped to 1229k vs. 1303k (the lowest level since May 2017), while existing home sales have not changed in August compared to July and amounted to 5.34M. The sharp decrease in the number of new building permits points to a high likelihood of slowdown of activity in the US real estate market in subsequent months. On the one hand, it results from supply-side constraints related to higher construction costs, due to increasingly lower availability of labour and building plots as well as higher prices of timber (the result of higher tariffs on timber imported from Canada). On the other hand, demand-side constraints are increasingly visible in the market due to higher mortgage rates. The results of regional business surveys in manufacturing were also released last week. The NY Empire State Index suggested slight deterioration in manufacturing in the New York State, dropping to 19.0 pts in September vs. 25.6 pts in August. On the other hand, improved sentiment in manufacturing in the US Northeast was signalled by the Philadelphia FED Index, which rose to 22.9 pts in September vs. 11.9 pts in August. We forecast that the annualized growth rate of US GDP will decrease to 2.9% in Q3 vs. 4.3% in Q2 but will stay above the potential economic growth rate estimated by FED at a level slightly below 2%.
- **Industrial production dynamics in Poland dropped to 5.0% YoY in August vs. 10.3% in July**. The main factor behind the decrease in industrial production dynamics between July and August was an unfavourable difference in the number of working days and last year's high base effect. The structure of the August production data suggests the continuation of the wide range of recovery in branches with a sizeable percentage of exports in sales (see MACROpulse of 19/9/2018). The construction-assembly production dynamics increased to 20.0% YoY in August vs. 18.7% YoY in July. The production growth rate has increased despite the above-mentioned statistical effect in the form of an unfavourable difference in the number of working days and the last year's high base effect. The structure of data on construction-assembly production supports our view that the growth of public investments in the infrastructure peaked in Q1 2018. We expect that the investments growth rate will decrease in H2 2018 due to last year's high base effects and high capacity utilization in construction. The data on industrial production and construction-assembly production support our forecast of GDP growth rate in Q3 2018 (4.4% YoY vs. 5.1% in Q2).
- **Nominal retail sales in Poland increased by 9.0% YoY in August vs. a 9.3% increase in July**. The sales growth rate in constant prices dropped to 6.7% in August vs. 7.1% YoY in July. Lower real retail sales dynamics in August resulted from slower sales growth in the category "motor

vehicles, motorcycles, parts" (see MACROpulse of 21/9/2018). Noteworthy in the data structure is the marked acceleration in real sales growth in the category "furniture, radio, TV, and household appliances". Sales in this category are supported by households' high propensity to acquire durable goods, backed by the very good situation in the labour market and fast increase in lending in the segment of consumer loans. The August data on retail sales our forecast of consumption growth in Q3 (4.8% YoY vs. 4.9% in Q2).

- **Nominal wage dynamics in the sector of enterprises dropped to 6.8% YoY in August from 7.2% in July**. In our view, the main factor behind the lower wage dynamics in August 2018 was the last year's high base effect. This effect will abate in September 2018, which will be conducive to a visible acceleration in corporate wage growth in annual terms. The annual employment growth dropped to 3.4% YoY in August vs. 3.5% in July. The slowdown of employment growth resulted i.a. from the growing barrier in the form of shortage of skilled labour. We estimate that the real wage fund growth rate (employment times average wages) in enterprises dropped to 8.2% YoY in August vs. 8.8% in July and 9.5% in Q2. Thus, the real wage fund was growing in August at the slowest pace since July 2017. We expect that the factors which limit wage growth in enterprises in subsequent months will be the uncertainty about the date of the launch of the Employee Equity Scheme and the possible entry into force of the act lifting the limit on the annual basis for pension contributions (see MACROpulse of 18/9/2018).
- **The meeting of the Swiss National Bank (SNB) was held last week.** As expected, the SNB left the target range for LIBOR CHF 3M unchanged at [-1.25%; -0.25%] and deposit rate at -0.75%. The statement after the meeting indicated that CHF visibly appreciated since June 2018 and continues to be high. Consequently, it is necessary to maintain negative interest rates and readiness to currency interventions if needed. The latest macroeconomic projection was presented at the conference after the meeting. The inflation path was slightly revised downwards as compared to the June projection, mainly due to the CHF appreciation recorded in the last quarter. In accordance with the September projection, inflation will stand at 0.9% in 2018 (vs. 0.9% in the June projection), 0.8% in 2019 (0.9%), and 1.2% in 2020 (1.6%). The projection also indicates that in Q2 2021 inflation will amount to 2.0% YoY, thus slightly exceeding the SNB target (below 2% YoY). The projection increased the forecast of the Swiss GDP in 2018: 2.5-3.5% vs. ca. 2% in June projection, due to higher starting point after the upward revision of GDP data for previous quarters. The SNB decision and the statement after the meeting are consistent with our scenario for EURCHF and EURPLN, in which EURCHF will amount to 3.61 as at the end of 2018 to drop to 3.37 as at the end of 2019. The PLN appreciation vs. CHF will result from the expected by us decrease in EURPLN (4.29 and 4.15 as at the end of 2018 and 2019, respectively) and increase in EURCHF (1.19 and 1.28 as at the end of 2018 and 2019, respectively).

Heavy weather for German manufacturing



Source: Markit, Credit Agricole

According to the flash data, the Composite PMI Index (for manufacturing and services) in the Eurozone dropped to 54.2 pts in September vs. 54.5 pts in August, running in line with our forecast and below market expectations (54.4 pts). The decline in the Composite PMI resulted from its lower output sub-index (down to the lowest level since September 2016) and higher sub-index for business activity in services. The average value of the Composite PMI for the Eurozone in the whole Q3 dropped to 54.3 pts vs. 54.7 pts in Q2, which poses a downside risk to our forecast, in which the quarterly GDP growth in the Eurozone will increase to 0.5% in Q3 vs. 0.4% in the Q2.

Especially noteworthy in the data structure is the increasingly weaker outlook for the Eurozone manufacturing. So far, despite the slowdown in global trade observed from the beginning of 2018, it has continued to report relatively high activity due to the fact that amid slower increase in orders the companies were eliminating production backlogs by executing orders received earlier. However, this buffer is gradually running out, as reflected by the first since April 2015 decrease in the production backlogs indicator below the 50 pts threshold. Combined with the increasingly slower growth of new orders (51.4 pts in September vs. 54.7 pts in August – the lowest level since February 2015), including new export orders (50.0 pts vs. 52.0 pts – the lowest level since June 2013), it signals high likelihood of further decrease in the output sub-index in subsequent months.

In geographic terms, both Germany and France saw a deceleration of economic activity growth. The deterioration in Germany resulted from its lower sub-index for output in manufacturing and higher sub-index for business activity in services, while France recorded a decrease in both these sub-indices. On the other hand, a slightly higher pace of economic activity growth was recorded in the remaining Eurozone countries covered by the survey.

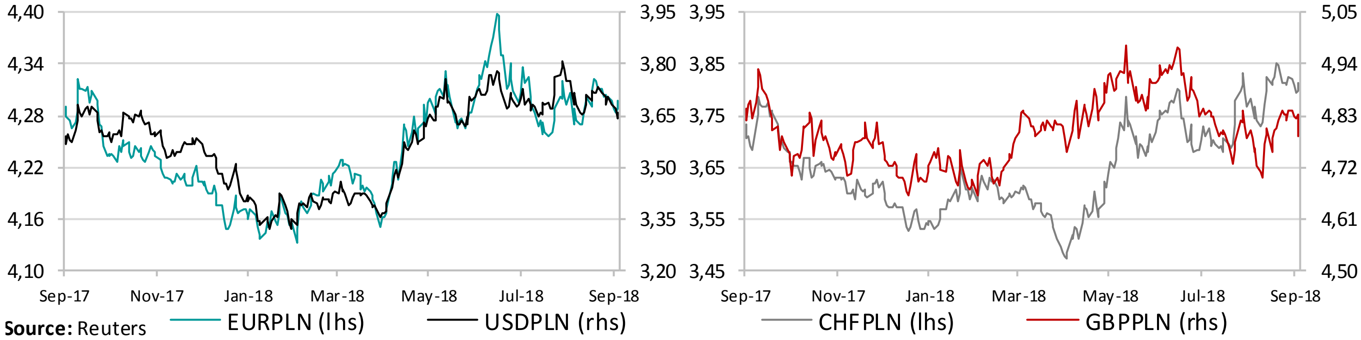
The current situation in German manufacturing industry is particularly relevant to the assessment of Poland's future economic outlook. The PMI index for the German manufacturing sector decreased to 53.7 pts in September vs. 55.9 pts in August. This slowdown resulted from lower contributions of 4 out of its 5 sub-indices (for employment, output, new orders, and suppliers' delivery times), while higher contribution of the inventories sub-index had an opposite impact. Similarly as in the case of data for the entire Eurozone, the production backlogs indicator dropped below the 50 pts threshold. The decrease below the 50 pts threshold was also recorded for the new export orders sub-index (the lowest level since June 2013).

Slower growth of export orders in German manufacturing signals high likelihood of weaker demand for goods manufactured in Poland and used in the production of final goods (intermediate goods). However, this effect will be limited by continuing strong internal demand in the German economy.

We expect that the slowdown in global trade will continue until the end of 2018. We believe that in H1 2019 it will recover due to rebound in global investments. This supports the forecast by us profile of Polish exports growth which will reach its local minimum in Q1 2019 and will amount to 3.7% YoY to later increase to 4.8% in Q4 2019.

New FED projections might weaken PLN

FX rates



Source: Reuters

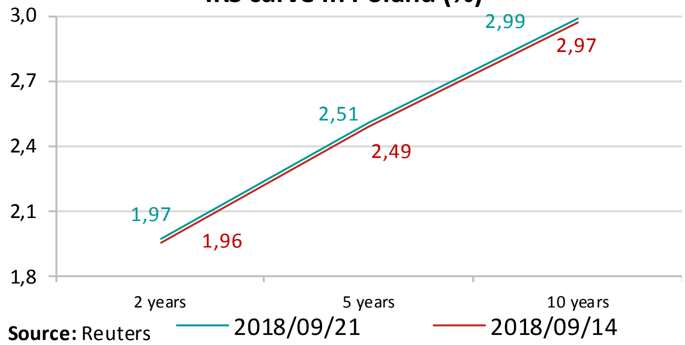
Last week, the EURPLN exchange rate dropped to 4.2971 (PLN strengthening by 0.1%). Monday through Wednesday EURPLN showed a downward trend, supported by lower global risk aversion. Higher risk appetite was supported by lower uncertainty in the market after the US President, D. Trump, announced on Monday the decision expected by the investors on introducing higher tariffs on imports from China, this time on goods worth USD 200bn in total. On Thursday and Friday PLN was depreciating. On Friday its depreciation resulted mainly from a decrease in EURUSD after the publication of lower-than-expected business survey results for the Eurozone.

A marked appreciation of PLN vs. GBP (by 1.1%) was also recorded last week. It resulted from a significant increase in EURGBP on Friday after the British Prime Minister, Theresa May, announced a stalemate in the Brexit negotiations.

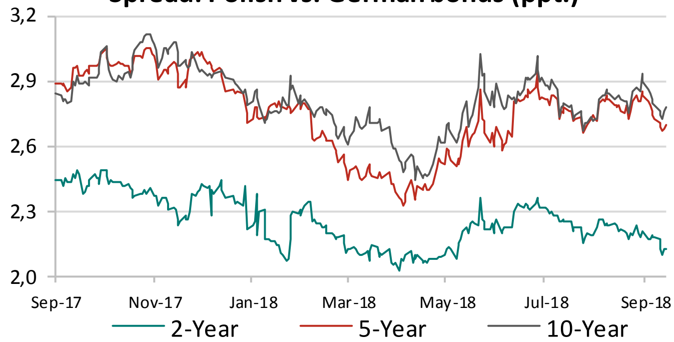
This week the investors will focus on the FED meeting scheduled for Wednesday. We believe that the publication of the FOMC's new macroeconomic projections may lead to a slight weakening of PLN. In our view, the numerous data from the US (final data on GDP, durable goods orders, new home sales, Conference Board Index, and final University of Michigan Index) will be overshadowed by the Fed meeting and will be neutral for PLN. On the other hand, the publication of flash data on inflation in the Eurozone, scheduled for Friday, may be positive for PLN. The results of business surveys in China (Caixin PMI) will be neutral for PLN.

Market focused on FED meeting

IRS curve in Poland (%)



Spread: Polish vs. German bonds (ppt.)



Source: Reuters

Last week, 2-year IRS rates increased to 1.97 (up by 2bp), 5-year rates to 2.51 (up by 2bps), and 10-year rates to 2.99 (up by 2bps). Throughout the previous week, IRS rates were showing low volatility, supported by low liquidity in the market. Friday saw an increase in spread between the Polish and German bonds, due to lower yields on German bonds following the publication of weaker-than-expected business survey results for the Eurozone, while the prices of Polish bonds remained stable.

This week the market will focus on FED meeting. We believe that the publication of the latest FOMC projections may lead to an increase in IRS rates at the long end of the yield curve. In our view the publication of flash data on inflation in the Eurozone will have an opposite impact. Other data from the US (final data on GDP, durable goods orders, new home sales, Conference Board Index, and final University of Michigan Index) will be neutral for the market, we believe.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-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*	4,25	4,31	4,24	4,20	4,18	4,15	4,17	4,21	4,24	4,31	4,37	4,27	4,30	**4,31**
USDPLN*	3,57	3,65	3,64	3,53	3,48	3,34	3,42	3,42	3,51	3,69	3,74	3,66	3,71	**3,65**
CHFPLN*	3,72	3,77	3,65	3,59	3,57	3,59	3,62	3,58	3,54	3,74	3,78	3,69	3,83	**3,68**
CPI inflation (% YoY)	1,8	2,2	2,1	2,5	2,1	1,9	1,4	1,3	1,6	1,7	2,0	2,0	2,0	
Core inflation (% YoY)	0,7	1,0	0,8	0,9	0,9	1,0	0,8	0,7	0,6	0,5	0,6	0,6	0,9	
Industrial production (% YoY)	8,9	4,3	12,4	9,2	2,8	8,6	7,3	1,7	9,3	5,2	6,7	10,3	5,0	
PPI inflation (% YoY)	3,0	3,2	3,0	1,8	0,3	0,2	-0,1	0,5	1,0	3,0	3,7	3,4	3,0	
Retail sales (% YoY)	7,6	8,6	8,0	10,2	6,0	8,2	7,9	9,2	4,6	7,6	10,3	9,3	9,0	
Corporate sector wages (% YoY)	6,6	6,0	7,4	6,5	7,3	7,3	6,8	6,7	7,8	7,0	7,5	7,2	6,8	
Employment (% YoY)	4,6	4,5	4,4	4,5	4,6	3,8	3,7	3,7	3,7	3,7	3,7	3,5	3,4	
Unemployment rate* (%)	7,0	6,8	6,6	6,5	6,6	6,9	6,8	6,6	6,3	6,1	5,9	5,9	**5,9**	
Current account (M EUR)	311	218	206	54	-847	1955	-782	-785	-90	169	-240	-809		
Exports (% YoY EUR)	13,4	11,5	15,8	15,5	2,6	12,1	5,9	-1,6	8,9	2,7	9,0	9,8		
Imports (% YoY EUR)	8,7	8,9	15,4	15,9	10,9	16,7	8,1	1,4	11,1	1,5	10,2	11,6		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland

Indicator		2018				2019				2017	2018	2019
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Gross Domestic Product (% YoY)		5,2	5,1	4,4	4,5	3,7	3,5	3,4	3,3	4,6	4,8	3,5
Private consumption (% YoY)		4,8	4,9	4,8	4,7	4,4	3,9	3,7	3,6	4,8	4,8	3,9
Gross fixed capital formation (% YoY)		8,1	4,5	8,0	8,5	6,2	4,4	3,4	2,9	3,4	7,5	3,9
Export - constant prices (% YoY)		1,1	6,9	5,8	4,8	3,7	5,0	5,3	4,8	8,2	4,7	4,7
Import - constant prices (% YoY)		3,5	6,5	7,3	5,9	5,3	6,4	6,1	5,3	8,7	5,8	5,8
GDP growth contributions	Private consumption (pp)	3,0	2,9	2,8	2,3	2,8	2,3	2,2	1,8	2,7	2,8	2,3
	Investments (pp)	0,9	0,7	1,4	2,1	0,8	0,7	0,6	0,7	0,6	1,4	0,7
	Net exports (pp)	-1,2	0,5	-0,5	-0,4	-0,7	-0,5	-0,3	-0,2	0,1	-0,5	-0,4
Current account (% of GDP)***		-0,2	0,0	-0,4	-0,7	-1,0	-0,9	-0,7	-0,7	0,2	-0,7	-0,7
Unemployment rate (%)**		6,6	5,9	5,8	5,9	6,2	5,8	5,8	5,9	6,6	5,9	5,9
Non-agricultural employment (% YoY)		1,4	1,0	0,8	0,6	0,4	0,4	0,4	0,4	1,9	0,9	0,4
Wages in national economy (% YoY)		6,2	7,1	7,3	6,9	7,3	6,7	6,2	6,3	5,3	6,9	6,6
CPI Inflation (% YoY)*		1,5	1,7	1,9	1,4	1,6	1,6	1,3	1,4	2,0	1,6	1,5
Wibor 3M (%)**		1,70	1,70	1,70	1,70	1,70	1,70	1,70	1,78	1,72	1,70	1,78
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
EURPLN**		4,21	4,37	4,31	4,29	4,27	4,25	4,20	4,15	4,18	4,29	4,15
USDPLN**		3,42	3,74	3,65	3,55	3,47	3,40	3,28	3,19	3,48	3,55	3,19

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST* CA	FORECAST* CONSENSUS**
		Monday 09/24/2018				
10:00	Germany	Ifo busienss climate (pts)	Sep	103,8	103,0	103,2
14:00	**Poland**	**M3 money supply (% YoY)**	**Aug**	**7,3**	**7,6**	**7,5**
		Tuesday 09/25/2018				
10:00	**Poland**	**Registered unemplyment rate (%)**	**Aug**	**5,9**	**5,9**	**5,9**
15:00	USA	Case-Shiller Index (% MoM)	Jul	0,1		0,2
16:00	USA	Richmond Fed Index	Sep	24,0		
16:00	USA	Consumer Confidence Index	Sep	133,4	131,0	132,0
		Wednesday 09/26/2018				
16:00	USA	New home sales (k)	Aug	627		634
20:00	USA	FOMC meeting (%)	Sep	2,00	2,25	2,25
		Thursday 09/27/2018				
10:00	Eurozone	M3 money supply (% MoM)	Aug	4,0		3,9
11:00	Eurozone	Business Climate Indicator (pts)	Sep	1,22		1,19
14:00	Germany	Preliminary HICP (% YoY)	Sep	1,9	1,9	1,9
14:30	USA	Initial jobless claims (k)	w/e	201		210
14:30	USA	Final GDP (% YoY)	Q2	4,2	4,3	4,2
14:30	USA	Durable goods orders (% MoM)	Aug	-1,7	3,5	1,8
		Friday 09/28/2018				
3:45	China	Caixin Manufacturing PMI (pts)	Sep	50,2	50,4	50,4
11:00	Eurozone	Preliminary HICP (% YoY)	Sep	2,0	2,0	2,1
14:30	USA	Real private consumption (% MoM)	Aug	0,2		
15:45	USA	Chicago PMI (pts)	Sep	63,6		62,4
16:00	USA	Final U. of Michigan Sentiment Index (pts)	Sep	100,8	100,0	100,6

*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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