Domestic orders no longer offset the decrease in foreign demand

This week

- **Data on business sentiment in Polish manufacturing have been released today (see below).** PMI dropped to 50.5 pts in September vs. 51.4 pts in August, running significantly below the market consensus (51.5 pts) and our forecast (51.9 pts) thus hitting the lowest level since October 2016. The average value of the Polish PMI in July-September (51.6 pts) stood significantly below its average value in Q2 (53.8 pts), which supports our forecast of lower GDP growth rate in Q3 (4.4% YoY vs. 5.1% in Q2). We believe that the results of business surveys for Polish manufacturing are slightly negative for PLN and yields on Polish bonds.
- **The flash estimate of CPI inflation in Poland will be released today**. We expect that inflation rate dropped to 1.7% in September vs. 2.0% in August. We believe that conducive to a decrease in total inflation were lower dynamics of fuel and food prices. Conducive to lower dynamics of food prices in September were high base effects in the categories: “milk, cheeses, and eggs” (sharp increase in prices of eggs a year ago due to fipronil eggs contamination in Western Europe), “oils and fats” (record prices of butter a year ago) and fruit (failed harvest last year, record harvest this year). We expect that core inflation has not changed in September compared to August and amounted to 0.9% YoY. Our forecast is below the market consensus (1.9%) and thus its materialization will be conducive to weaker PLN and lower yields on Polish bonds.
- **Another important event this week will be the meeting of the Monetary Policy Council scheduled for Wednesday**. We expect that the MPC will decide to leave interest rates at an unchanged level. In our view, the tone of the statement and conference after the meeting will not change significantly compared to last month (see MACROpulse of 5/9/2018) and will focus on the relatively good prospects for the Polish economy. We believe that the NBP Governor, A. Glapiński, will repeat his view from the month before that interest rates will remain unchanged at least until the end of 2019. In the context of the latest remark of MPC member J. Kropiwnicki who suggested a possibility of the purchase of corporate bonds by the NBP, questions about the central bank possibly using unconventional tools in the monetary policy may be raised during the conference. According to J. Kropiwnicki, the purpose of this measure could be to support the fulfilment of allied commitments within NATO, e.g. through the purchase of bonds of armament companies. We believe that it was a concept illustrating a purely hypothetical scenario; hence, possible remarks at the conference concerning this issue should not have a substantial impact on the financial markets. In our view, the text of the statement after the Council meeting and the remarks of the NBP Governor during the conference will be neutral for PLN and prices of Polish debt.
- **This week we will also see important data from the US.** Data from the labour market will be released on Friday. We expect non-farm payrolls to have increased by 195k in September vs. 201k in August, with unemployment rate falling from 3.9% down to 3.8% in September. 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 184k in September vs. 163k in August). The ISM index for manufacturing will be released today and, in our view, dropped to 60.2 pts in September vs. 61.3 pts in August, due to last month’s high base effect (in August this indicator reached the highest level since May 2014). We believe that the US readings will be neutral for PLN and prices of Polish bonds.

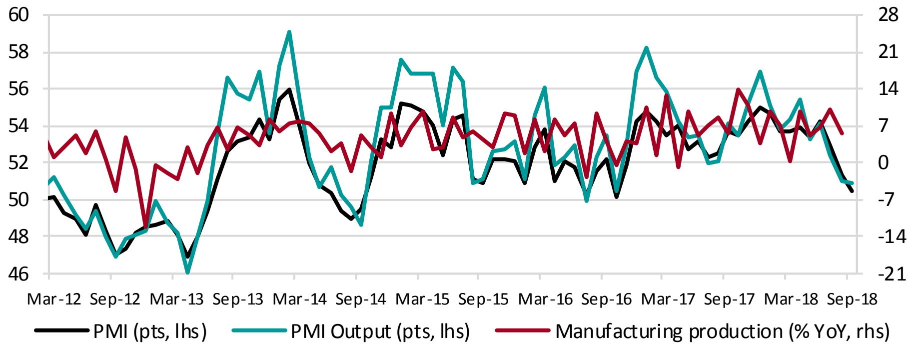
Last week

- **The FOMC meeting was held last week.** As we expected, the FED increased the target range for federal funds by 25 bp to [2.00%; 2.25%]. In the statement after the meeting the fragment saying that the stance of monetary policy remains accommodative, thereby supporting strong labor market conditions and a sustained return to 2 percent inflation was deleted. This change had been signalled in the August Minutes. However, the FED chairman, J. Powell, indicated during the conference after the meeting that deleting the aforementioned provision did not mean changes in the FED's expectations concerning the pace of the monetary tightening. The September FOMC macroeconomic projection was presented after the meeting. As we expected, the forecast economic growth rate was slightly revised upwards compared to the June projection. Now the median expectations concerning the GDP growth rate amount to 3.1% in 2018 (2.8% in the June projection), 2.5% in 2019 (2.4%), 2.0% in 2020 (2.0%), and 1.8% in 2021 and in the long term. The median expectations for core CPE inflation have not changed significantly compared to the June projection and amount to 2.0% in 2018 (2.0%), 2.0% in 2019 (2.1%), 2.1% in 2020, 2.1% in 2021, and 2.0% in the long term. Thus, the projection indicates that core inflation will slightly exceed the target at the turn of 2018 and 2019. The unemployment rate profile has not significantly changed either. The median expectations amount to 3.7% in Q4 2018 (3.6%), 3.5% in Q4 2019 (3.5%), 3.5% in Q4 2020 (3.5%), and to 3.7% in Q4 2021. The natural unemployment rate expected by the FED has not changed compared to the June projection and amounts to 4.5%. The median expectations of FOMC members concerning the interest rates level have not changed either. In 2018 the FED expect the monetary policy tightening by additional 25 bp, in 2019 by 75 bp, in 2020 by 25 bp and no hikes in 2021. Our scenario assumes a steeper interest rates profile in 2019 than that presented in the September projection. We believe that in 2019 FED will hike interest rates by 100 bp in total, due to higher inflation driven by higher prices of imported goods being a consequence of the trade war. We therefore expect that data coming from the US economy in subsequent months will point in total to a higher likelihood of a faster pace of the monetary tightening in the US, which will be negative for PLN and Polish debt prices.

Significant hard data from the US economy and business survey results were released last week. In accordance with the final estimate, the annualized US GDP growth rate amounted to 4.2% in Q2, and thus was in line with the previous estimate. The contribution of inventories was slightly revised downwards (-1.17 pp in the final estimate vs. -0.97 pp in the second estimate), which was offset by higher contributions of net exports (1.22 pp vs. 1.17 pp), investments (1.10 pp vs. 1.07 pp), consumption (2.57 pp vs. 2.55 pp), and government spending (0.43 pp vs. 0.41 pp). The final estimate has confirmed that private consumption was the main source of the US GDP growth in Q2, while in Q1 it was investments. Preliminary data on durable goods orders were also released last week and increased by 4.5% MoM in August vs. a 1.2% decrease in July, largely due to higher orders for non-military aircrafts and parts. Excluding means of transport, durable goods orders increased by 0.1% MoM vs. a 0.2% increase in July. Especially noteworthy in the data structure is a decline in the annual dynamics of orders for non-military capital goods excluding orders for aircrafts (7.5% in August vs. 8.7% in July), being the leading indicator for future investments. Data on new home sales were also released last week (629k in August vs. 608k in July). Considering the data on new building permits released two weeks ago (see MACROmap of 24/9/2018), we maintain our view that subsequent months will see a downturn in the US real estate market. On the one hand, it will result 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 consumer sentiment surveys were also released last week. The Conference Board Index rose to 138.4 pts in September vs. 134.7 pts in August, hitting the highest level since September 2000. The index increase resulted both from its higher sub-index concerning the assessment of current situation and expectations. The final University of Michigan Index has also pointed to marked improvement in consumer sentiment rising to 100.1 pts in September vs. 96.2 pts in August and 100.8 pts in the flash estimate. Its increase resulted from higher values of its sub-indices concerning both the assessment of current situation and expectations. We forecast that the annualized US GDP growth rate decreased to 3.0% in Q3 vs. 4.2% in Q2, though staying above the potential economic growth rate estimated by FED at a level slightly below 2%.

- **In accordance with the flash estimate, inflation in the Eurozone rose to 2.1% YoY in September vs. 2.0% in August, running in line with the market expectations and above our forecast (2.0%)**. The increase in inflation resulted from higher price dynamics in the categories: “food” and “energy”. We expect that in subsequent quarters the annual rate of inflation within the single currency area will range from 2.0% to 2.2%. In H2 2019 inflation will decrease supported by high base effects from the year before and will reach 1.4% YoY in Q4 2019. In addition, we forecast that core inflation in the Eurozone will not exceed 1.5% in the horizon of the next two years. This is in line with our scenario, in which the first hike of the ECB interest rates (deposit rate) will take place in September 2019 and the main interest rate will be hiked in December 2019.
- **Ifo Index reflecting the sentiment among German managers representing the manufacturing, construction, trade, and services, dropped to 103.7 pts in September vs. 103.9 pts in August.** The index decrease resulted from lower values of its sub-indices concerning both the assessment of the current situation and expectations. Sector-wise, deterioration was recorded only in manufacturing, while the situation in other sectors covered by the survey (trade, services, and construction) improved. The deterioration in Germany in September was signaled earlier by the PMI composite published two weeks ago (see MACROmap of 24/9/2018). Considering the incoming results of business surveys for the German economy, we see a downside risk to our forecast, in which the quarterly GDP growth rate in the German economy will not change in Q3 compared to Q2 and will amount to 0.5%
- **The results of business surveys for the Chinese manufacturing have been released recently.** The CFLP PMI dropped to 50.8 pts in September vs. 51.3 pts in August, while the Caixin PMI released yesterday dropped to 50.0 pts in September vs. 50.6 pts in August. The decrease in Caixin PMI resulted from lower contributions of all its five sub-indices (for output, new orders, employment, inventories, and suppliers’ delivery times). Especially noteworthy in the data structure is the decrease of the sub-index for new export orders to 47.6 pts in September vs. 48.8 pts in August, which is its lowest level since February 2016. Its decrease results from the slowdown in global trade and the negative impact of the trade war between the US and China on the activity of the Chinese exporters. We maintain our forecast that the dynamics of the Chinese GDP will decrease to 6.6% in 2018 vs. 6.9% in 2017. Our forecast is supported by the measures planned by the Chinese government to stimulate internal demand. They include i.a. higher tax allowance, lower corporate tax, increased lending, launch of new infrastructural investments, or tax preferences for export-oriented companies. In addition, the list of the stimulating measures continues to be extended. Nevertheless, we expect further deterioration of sentiment in China in subsequent quarters, and the first effects of the government policy in aid of stimulating economic growth are likely to be reflected by business survey results no sooner than in Q2 2019. The main risk to our scenario is possible further escalation of protectionist measures in global trade.

Domestic orders no longer offset the decrease in foreign demand



Source: Markit. GUS

Polish manufacturing PMI dropped to 50.5 pts in September vs. 51.4 pts in August, running significantly below our forecast (51.9 pts) and the market consensus (51.5 pts). In effect, the index hit the lowest level since October 2016 and stood only slightly above the threshold (50.0 pts) dividing expansion from contraction of activity.

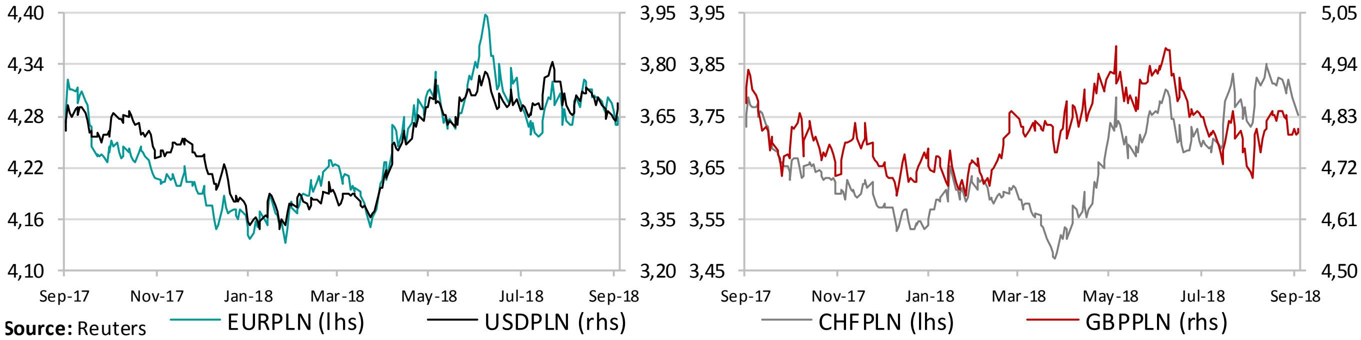
Especially noteworthy is the even stronger than last month decline in the new export orders in MoM terms. The pace of this decline was the fastest since July 2014. We believe that the decrease in foreign demand was related to the slowdown in global trade observed in recent months, which was limiting exports in the Eurozone, including Germany. This view is supported by the downward tendency recorded from the beginning of 2018 in export orders in German manufacturing. We believe that the protectionist measures implemented in recent months in global trade did not have any substantial impact on the exports of goods from Poland.

Unlike August, which recorded a quite fast increase in domestic demand, September also saw a decline in total new orders. In addition, the Future Output Indicator (for the coming 12 months) decreased in September to the lowest level since November 2016. Considering the leading nature of the two indicators, the September data do not provide optimistic signals about the prospects for the growth of manufacturing activity.

Despite a decline in orders, output growth rate was stable (sub-index at 50.9 pts in September vs. 51.0 pts in August). We believe that the companies were using production capacities to reduce production backlogs and increase the stocks of final products – as confirmed by the index structure. The average value of the Polish PMI between July and September (51.6 pts) stood significantly below its average value in Q2 (53.8 pts), which supports our forecast of GDP dynamics in Q3 (4.4% YoY vs. 5.1% in Q2). In subsequent months the increase in manufacturing activity will be limited by the slowdown in foreign trade but the acceleration in domestic demand (supported by faster increase in investments) will partly offset this negative trend.

Focus on data from the US labour market

FX rates



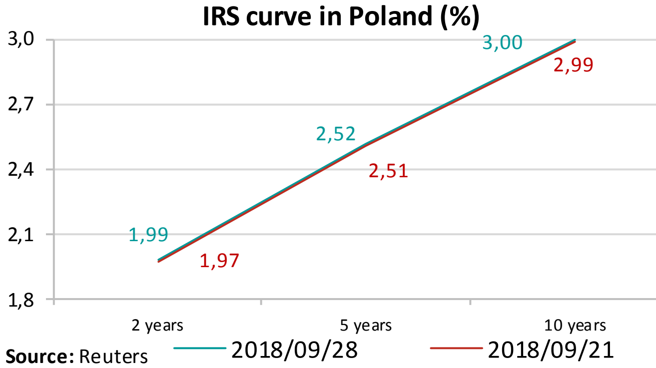
Source: Reuters

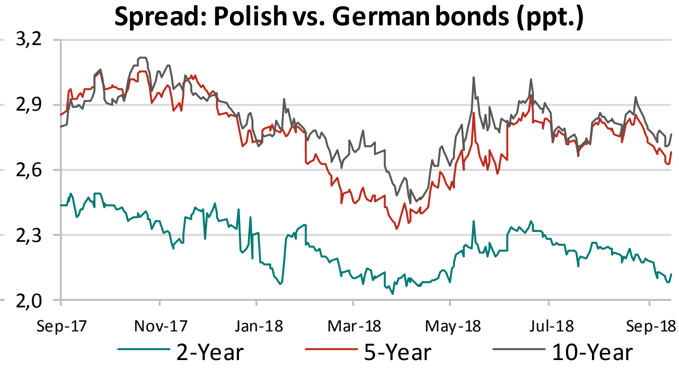
Last week, the EURPLN exchange rate dropped to 4.2785 (PLN strengthening by 0.6%). Monday through Thursday, EURPLN was within a downward trend. Other emerging currencies were also appreciating (i.a. HUF and TRY) which shows that PLN appreciation resulted from higher demand for risk assets. FED meeting had no substantial impact on PLN. Friday saw a partial correction; however, PLN remained visibly below the levels from the beginning of the week.

Despite the marked appreciation of PLN vs EUR, PLN weakened last week vs. USD (-0.6%) and GBP (-0.3%), due to lower EURUSD and EURGBP. EUR weakening vs USD was supported by increasing interest rates disparity between FED and ECB rates. In turn, GBP strengthening vs. EUR resulted from partial correction after its sharp depreciation two weeks ago caused by higher concerns about Brexit.

The results of business surveys for Polish manufacturing (PMI) released today are slightly negative for PLN. The scheduled for today publication of the flash estimate of inflation in Poland may be negative for PLN, as it is likely to indicate a stronger-from-market-expectations decrease in price dynamics. Crucial for PLN this week will be the data on non-farm payrolls in the US. However, if our forecast that is close to the market consensus materializes, they are likely to be neutral for PLN. Other US data (manufacturing ISM) and the MPC meeting will also have a limited impact on PLN.

MPC meeting neutral for the markets





Source: Reuters

Last week, 2-year IRS rates increased to 1.99 (up by 1bp), 5-year rates to 2.51 (up by 1bp), and 10-year rate to 3.00 (up by 1bp). IRS rates slightly increased across the curve following the German market. On Thursday, conducive to higher IRS rates were the higher-than-expected data on inflation in Germany. Flash data on inflation in the Eurozone, released on Friday, were in line with the market consensus, which brought about a slight correction and a decrease in IRS rates. FED meeting was neutral for the market.

The results of business surveys for Polish manufacturing (PMI) released today are slightly negative for IRS rates. In our view, the scheduled for today publication of the flash estimate of domestic inflation, which, if our forecast materializes, will prove lower from the market expectations, may contribute to a decrease in IRS rates at the short end of the curve. We believe that data from the US (non-farm payrolls, manufacturing ISM) and the MPC meeting will also have a limited impact on the curve.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland														
Indicator	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	Oct-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*	4,31	4,24	4,20	4,18	4,15	4,17	4,21	4,24	4,31	4,37	4,27	4,30	4,28	**4,28**
USDPLN*	3,65	3,64	3,53	3,48	3,34	3,42	3,42	3,51	3,69	3,74	3,66	3,71	3,69	**3,66**
CHFPLN*	3,77	3,65	3,59	3,57	3,59	3,62	3,58	3,54	3,74	3,78	3,69	3,83	3,75	**3,74**
CPI inflation (% YoY)	2,2	2,1	2,5	2,1	1,9	1,4	1,3	1,6	1,7	2,0	2,0	2,0	**1,7**	
Core inflation (% YoY)	1,0	0,8	0,9	0,9	1,0	0,8	0,7	0,6	0,5	0,6	0,6	0,9	**0,9**	
Industrial production (% YoY)	4,3	12,4	9,2	2,8	8,6	7,3	1,7	9,3	5,2	6,7	10,3	5,0	**4,5**	
PPI inflation (% YoY)	3,2	3,0	1,8	0,3	0,2	-0,1	0,5	1,0	3,0	3,7	3,4	3,0	**2,8**	
Retail sales (% YoY)	8,6	8,0	10,2	6,0	8,2	7,9	9,2	4,6	7,6	10,3	9,3	9,0	**8,2**	
Corporate sector wages (% YoY)	6,0	7,4	6,5	7,3	7,3	6,8	6,7	7,8	7,0	7,5	7,2	6,8	**7,1**	
Employment (% YoY)	4,5	4,4	4,5	4,6	3,8	3,7	3,7	3,7	3,7	3,7	3,5	3,4	**3,4**	
Unemployment rate* (%)	6,8	6,6	6,5	6,6	6,9	6,8	6,6	6,3	6,1	5,9	5,9	5,8	**5,8**	
Current account (M EUR)	218	206	54	-847	1955	-782	-785	-90	169	-240	-809	**-783**		
Exports (% YoY EUR)	11,5	15,8	15,5	2,6	12,1	5,9	-1,6	8,9	2,7	9,0	9,8	**5,2**		
Imports (% YoY EUR)	8,9	15,4	15,9	10,9	16,7	8,1	1,4	11,1	1,5	10,2	11,6	**10,0**		

*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
GDP growth contributions: Investments (pp)	0,9	0,7	1,4	2,1	0,8	0,7	0,6	0,7	0,6	1,4	0,7
GDP growth contributions: 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	1,72	1,72	1,72	1,72	1,72	1,80	1,72	1,72	1,80
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	4,28	4,29	4,27	4,25	4,20	4,15	4,18	4,29	4,15
USDPLN**	3,42	3,74	3,69	3,61	3,53	3,46	3,36	3,27	3,48	3,61	3,27

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST* CA	FORECAST* CONSENSUS**
		Monday 10/01/2018				
9:00	**Poland**	**Manufacturing PMI (pts)**	**Sep**	**51,4**	**51,9**	**51,5**
9:55	Germany	Final Manufacturing PMI (pts)	Sep	53,7	53,7	53,7
10:00	**Poland**	**CPI (% YoY)**	**Sep**	**2,0**	**1,7**	**1,9**
10:00	Eurozone	Final Manufacturing PMI (pts)	Sep	53,3	53,3	53,3
11:00	Eurozone	Unemployment rate (%)	Aug	8,2		8,2
15:45	USA	Flash Manufacturing PMI (pts)	Sep	55,6		
16:00	USA	ISM Manufacturing PMI (pts)	Sep	61,3	60,2	60,3
		Tuesday 10/02/2018				
11:00	Eurozone	PPI (% YoY)	Aug	4,0		3,8
		Wednesday 10/03/2018				
10:00	Eurozone	Services PMI (pts)	Sep	54,7	54,7	54,7
10:00	Eurozone	Final Composite PMI (pts)	Sep	54,2	54,2	54,2
11:00	Eurozone	Retail sales (% MoM)	Aug	-0,2		0,2
14:15	USA	ADP employment report (k)	Sep	163		185
16:00	USA	ISM Non-Manufacturing Index (pts)	Sep	58,5	58,0	58,1
	Poland	**NBP rate decision (%)**	**Oct**	**1,50**	**1,50**	
		Thursday 10/04/2018				
16:00	USA	Factory orders (% MoM)	Aug	-0,8	2,0	2,1
		Friday 10/05/2018				
8:00	Germany	New industrial orders (% MoM)	Aug	-0,9		0,3
14:30	USA	Unemployment rate (%)	Sep	3,9	3,8	3,8
14:30	USA	Non-farm payrolls (k MoM)	Sep	201	195	185

*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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