

This week

- **The most important event this week will be the publication of the October business survey results for Polish manufacturing scheduled for Friday.** We expect that PMI dropped to 49.9 pts vs. 50.5 pts in September. The index decrease resulted from a significant deterioration of business sentiment in the Eurozone (see below). Thus, the index will fall below the 50.0 pts threshold dividing expansion from contraction of activity, for the first time since September 2014. The materialization of such scenario will be conducive to PLN weakening and lower yields on Polish bonds at the short end of the curve.
- **Important data from the US will also be released this week.** Data from the labour market will be released on Friday. We expect that the increase in non-farm payrolls amounted to 200k in October vs. 134k in September, with unemployment rate staying stable at 3.7%. 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 189k in October vs. 230k in September). Business survey results will also be released this week. The ISM index for manufacturing will be released on Thursday and, in our view, dropped to 59.3 pts in October vs. 59.8 pts in September, consistently with the results of regional business surveys. We expect that the Conference Board Consumer Confidence Index, like the University of Michigan Index (see below), will point to a slight deterioration of households' sentiment, standing at 137.0 pts vs. 138.4 pts in September. We believe that the publication of the US data will be neutral for PLN and prices of Polish bonds.
- **This week we will also see significant data from the Eurozone.** We expect that the quarterly GDP growth rate rose to 0.5% in Q3 2018 from 0.4% in Q2. A downside risk to our forecast is posed by the business survey results (PMI) for July-September. In addition, we forecast that HICP inflation rose to 2.2% in October vs. 2.1% in September. Lower dynamics of energy prices have been fully offset by higher core inflation. We believe that the materialization of our forecast of GDP in the Eurozone, being higher from the consensus (0.4%), will be conducive to a weakening of PLN and higher yields on Polish bonds, while the inflation reading is not likely to be market moving.
- **The October PMIs for Chinese manufacturing (Caixin and CFLP) will be released this week.** The market expects that CLFP decreased to 50.7 pts vs. 50.8 pts in September. In accordance with the market consensus, Caixin PMI is also expected to drop to 49.9 pts in October vs. 50.0 pts in September. The readings will be important from the perspective of assessing the impact of the trade war between China and the US on the economic situation in China. We believe that the business survey results in China will be negative for PLN.
- **Data on the October inflation in Poland will be released on Wednesday and, in our view, it decreased to 1.8% YoY vs. 1.9% in September.** We believe that lower growth rate of food and energy prices has been partly offset by a faster increase in fuel prices and core inflation. We believe that the publication will be neutral for PLN and yields on Polish bonds.

Last week

- **The ECB meeting was held last week.** The statement after the meeting retained the provision that the ECB expects "interest rates to remain at their present levels at least through the summer of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term" (so-called forward guidance). According to the statement, the ECB will continue the assets purchase until the end of December 2018 and anticipates to then end the purchases subject to the incoming inflation being in line with the ECB expectations. During the press conference after the meeting, the ECB Governor maintained his view that

the risks surrounding the Eurozone growth outlook were broadly balanced. Nevertheless, he pointed out that risks relating to protectionism, vulnerabilities in emerging markets and financial market volatility have gained more prominence recently. At the same time M. Draghi emphasized that the incoming data from the Eurozone pointed to “a weaker momentum, not a downturn”. However, M. Draghi pointed out that the macroeconomic scenario might be revised in the ECB December projection. We believe that the profiles of economic growth and inflation for 2018-2019 are likely to be revised downwards. At the same time, the ECB is likely to point out that the macroeconomic scenario is subject to downside risk. This may lead to a further weakening of expectations of interest rates hikes in the Eurozone. Last week the expectations of the first interest rates hike shifted from October 2019 to December 2019. We maintain our scenario, in which the ECB will hike the deposit rate by a total of 40bp in H2 2019 and the main interest rate by 25bp in Q4 2019.

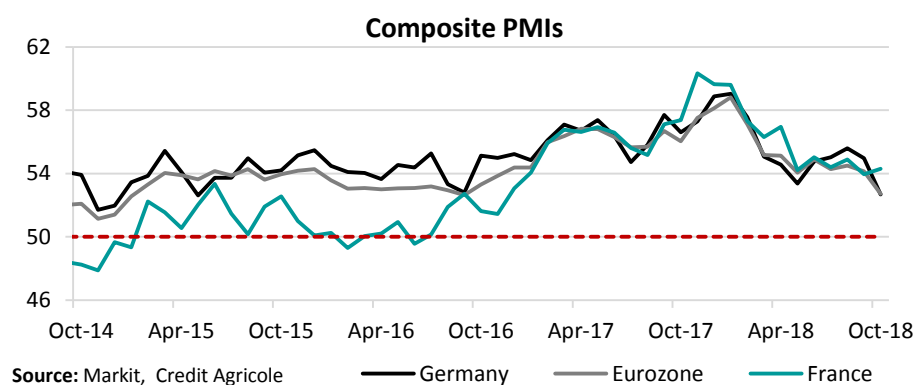
➤ **Significant data from the US economy were released last week.** In accordance with the first estimate, the annualized economic growth rate decreased to 3.5% in Q3 vs. 4.2% in Q2, which was slightly above the market expectations equal to our forecast (3.3%). Lower GDP dynamics resulted from lower contribution of net exports (-1.78 pp in Q3 vs. 1.22 pp in Q2) and investments (-0.04 pp vs. 1.10 pp), while higher contributions of inventories (2.07 pp vs. -1.17 pp), government spending (0.56 pp vs. 0.43 pp), and consumption (2.69 pp vs. 2.57 pp) had an opposite impact. Thus, like in Q2, private consumption was the main source of US GDP growth in Q3. Despite slower US GDP growth rate in Q3, it continues to stand above the potential estimated by FED at slightly below 2%. Preliminary data on durable goods orders were also released last week and increased by 0.8% MoM in September vs. a 4.6% increase in August. The decrease in their monthly dynamics resulted largely from slower growth of orders for non-military aircrafts and parts. Excluding means of transport, durable goods orders increased by 0.1% MoM vs. a 0.3% increase in August. Especially noteworthy in the data structure is a marked decline in the annual dynamics of orders for non-military capital goods, excluding orders for aircrafts (1.9% in September vs. 7.8% in August – the lowest dynamics since January 2017), being the leading indicator for future investments. Data on new home sales were also released last week (553k in September vs. 585k in August, with expectations at 625k), which, combined with data on new building permits, housing starts, and existing home sales, released two weeks ago, pointed to further slowdown in the US real estate market. The final University of Michigan Index was also released last week and dropped to 98.6 pts in October vs. 100.1 pts in September and 99.0 pts in the flash estimate. Conducive to its decline were lower values of its sub-indices for both the assessment of the current situation and expectations. The data published last week on the US economy support our scenario in which FED will hike interest rates by 25bp in 2018 and in 2019 the scale of US monetary policy tightening will amount to 100bp and will be 25 bp higher from that indicated in the latest FED projection. The market is currently pricing in two interest rate hikes in 2019.

➤ **Flash December business sentiment indicators (PMI) for major European economies were released last week.** Composite PMI (for manufacturing and services) for the Eurozone dropped to 54.2 pts in October vs. 54.1 pts in September, running below our forecast (53.8 pts) and the market expectations (53.9 pts). The PMI composite decline resulted from a decrease in its sub-index for output in manufacturing (to the lowest level since December 2014) and lower sub-index for business activity in services (lowest since October 2016). As a result, the value of the composite index for the Eurozone in October reached the lowest level since September 2016. In the whole Q3, the average value of PMI for the Eurozone amounted to 54.3 pts. Consequently, the October business survey results pose a downside risk to our forecast, in which the quarterly GDP growth rate in the Eurozone will not change in Q4 compared to Q3 and will amount to 0.5% (see below).

➤ **Ifo Index reflecting the sentiment among German managers representing the**

manufacturing, construction, trade, and services dropped to 102.8 pts in October vs. 103.7 pts in September. The index decrease resulted from lower values of its sub-indices concerning both the assessment of the current situation and expectations. Sector-wise, deterioration of sentiment was recorded in manufacturing, services, and trade, while the situation in construction improved. Considering the incoming business survey results for the German economy (see below), we see a downside risk to our forecast, in which the quarterly GDP growth rate in the German economy will not change in Q4 compared to Q3 and will amount to 0.5%.

Increasingly weaker business sentiment in the Eurozone



According to the flash data, the Composite PMI Index (for manufacturing and services) in the Eurozone dropped to 54.2 pts in October vs. 54.1 pts in September, running significantly below our forecast (53.8 pts) and the market expectations (53.9 pts). The decline in the Composite PMI resulted from its lower output sub-index in manufacturing

(down to the lowest level since December 2014) and lower sub-index for business activity in services (lowest since October 2016). In effect, the value of the composite index for the Eurozone in October reached the lowest level since September 2016. In the whole Q3, the average value of PMI for the Eurozone amounted to 54.3 pts and thus the October business survey results pose a downside risk to our forecast, in which the quarterly GDP growth rate in the Eurozone will not change in Q4 compared to Q3 and will amount to 0.5% (see below).

Especially noteworthy in the data structure is the increasingly weaker outlook for the Eurozone manufacturing. For the first time in 4 years, a decline in monthly terms has been observed in total new orders and the decline in new export orders has been the sharpest in 5 years. In addition, the Future Output Index (for the coming 12 months) decreased in October to the lowest level since December 2012. Considering the leading nature of the a/m indicators, the October data are not optimistic for the prospects of activity growth in the Eurozone manufacturing. Amid limited inflow of new orders, the slowdown in output was limited for a second month in a row by the implementation of production backlogs.

In geographic terms, a deceleration of economic activity growth was recorded in Germany while France recorded an improvement. Improved sentiment in France resulted from lower sub-index for output in manufacturing and higher sub-index for business activity in services, while Germany recorded a decrease in both these sub-indices. Other Eurozone economies covered by the survey (excluding France and Germany) saw further downturn – the indicators concerning current and expected production have dropped to the lowest levels in five years.

The situation in German manufacturing industry is particularly relevant to the assessment of Poland's future economic outlook. The PMI index for the German manufacturing decreased to 52.3 pts in

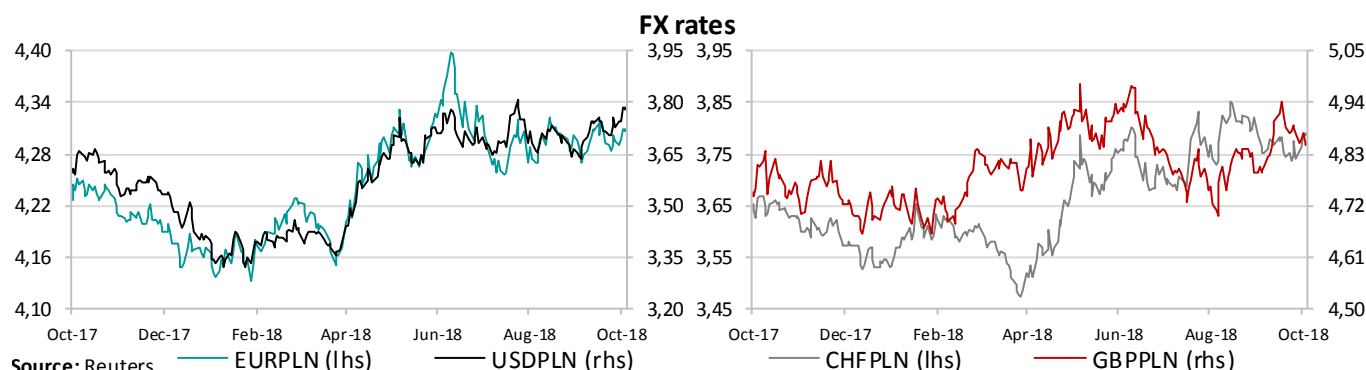
October vs. 53.7 pts in September. The PMI decline resulted from lower contributions of all its 5 sub-indices (for employment, output, new orders, suppliers' delivery times, and inventories). Similarly as in the case of data for the entire Eurozone, a decline was recorded for production backlogs, new export orders, and total new orders. The surveyed companies were pointing out a lower number of orders from counterparties in the automotive industry.

Lower number of new 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 the continuingly strong internal demand in the German economy. We expect that the slowdown in global trade, reflected by the October data, will continue until the end of 2018. We believe that in H1 2019 it will recover due to rebound in global investments. This supports our forecast 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.

The business survey results for the Eurozone pose a downside risk to the activity in Polish manufacturing to be reflected by a lower Polish PMI in October. It is possible that the index will fall below the 50 pts threshold dividing expansion from contraction of activity. The materialization of such scenario would be conducive to PLN depreciation and lower yields on Polish bonds at the short end of the curve (see above).



PMI for Polish manufacturing may weaken PLN

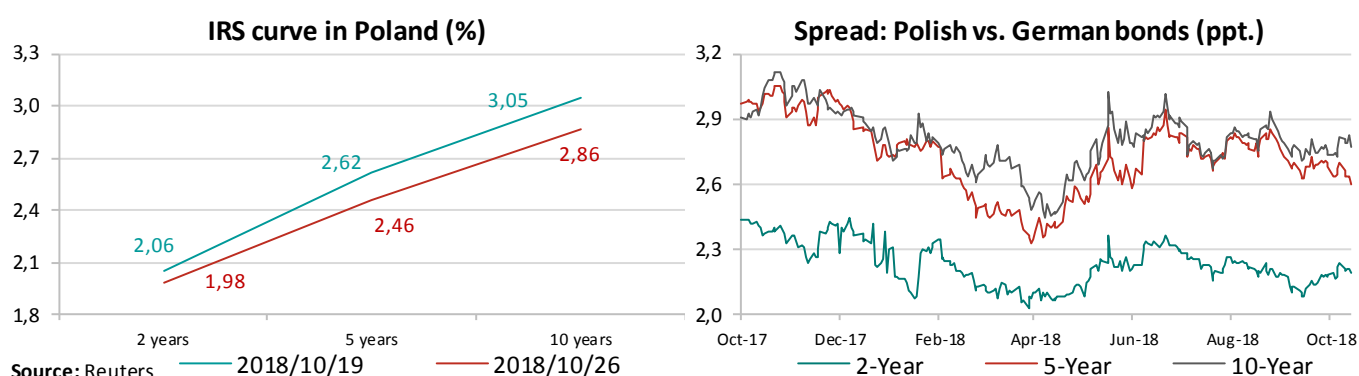


Last week, the EURPLN exchange rate rose 4.3077 (PLN weakening by 0.3%). Throughout last week EURPLN remained within a weak upward trend, supported by an increase in global risk aversion, i.a. due to growing political risk in Italy. PLN was depreciating the strongest on Wednesday, largely due to the publication of clearly weaker than expected business survey results for the Eurozone (see above). This was an untypical reaction, as weaker data from the Eurozone, pointing to increased likelihood of continuation of accommodative monetary policy within the single currency area, should be positive for PLN.

The publication of lower than expected PMI indices in the Eurozone was also conducive to a decrease in EURUSD and EURCHF. Consequently, last week PLN also depreciated against USD (by 1.4%) and CHF (by 1.2%). On the other hand, PLN appreciated versus GBP (by 0.5%), due to continued increase in EURUSD. Conducive to further GBP weakening versus EUR is the impasse in Brexit talks and, in particular, no agreement concerning the future functioning of the border between Ireland and Northern Ireland forming a part of the United Kingdom.

Crucial for PLN this week will be the publication of business survey results for Polish manufacturing (PMI) scheduled for Friday. If our lower than the market consensus forecast materializes, they may contribute to PLN weakening. The publication of flash GDP data for the Eurozone may also be negative for PLN. Conducive to PLN depreciation may also be the publication of Caixin PMI for Chinese manufacturing scheduled for Thursday. Data on inflation in Poland and the Eurozone, like data from the US (non-farm payrolls, Conference Board and manufacturing ISM Index) and other data from China (CFLP PMI for manufacturing) will not have a significant impact on the market, we believe.

The market focuses on GDP data for the Eurozone



Last week, 2-year IRS rates decreased to 1.98 (down by 8bp), 5-year rates to 2.46 (down by 16bp), and 10-year rates to 2.86 (down by 19bp). On Monday, IRS rates were showing low volatility. Tuesday to Friday, strong decline was observed in IRS rates across the curve, following the German market. The decline in IRS rates was supported by weaker than expected business survey results in the Eurozone released on Wednesday. The ECB meeting had no substantial impact on the market. A debt auction was held on Friday at which the Finance Ministry sold PLN 10.0bn of 2-, 6-, and 10-year bonds with demand amounting to PLN 31.22bn. The successful auction contributed to a decline in IRS rates. The exceptionally high demand resulted from increased ZUS purchases as part of the management of the Demographic Result Fund as well as increased market liquidity, i.a. due to the concentration of coupon payments in October and maturing bonds issued for the National Road Fund.

This week the market will focus on the publication of flash GDP data for the Eurozone scheduled for Wednesday. If our higher from the market consensus forecast materializes, the data may be conducive to higher IRS rates. The publication of business survey results for Polish manufacturing (PMI), scheduled for Friday, may contribute to a decrease in IRS rates. Data on inflation in Poland and the Eurozone, as well as data from the US (non-farm payrolls, Conference Board and manufacturing ISM Index) will not have a significant impact on the curve, we believe.

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	3,76
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	3,73
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	1,9	
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	0,8	
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	2,8	
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	2,9	
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	5,6	
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	6,7	
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	3,2	
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	5,7	
Current account (M EUR)	21	-13	95	-1354	2289	-792	-914	291	495	-200	-750	-549		
Exports (% YoY EUR)	12,9	17,8	17,7	4,8	15,5	6,6	-4,4	9,1	1,1	6,2	9,2	7,4		
Imports (% YoY EUR)	10,6	16,9	17,8	13,2	19,0	9,5	0,3	12,4	1,4	7,9	10,3	11,2		

*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	4,8	4,8	3,5
Private consumption (% YoY)	4,8	4,9	4,8	4,7	4,4	3,9	3,7	3,6	4,9	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	3,9	7,5	3,9
Export - constant prices (% YoY)	1,1	6,9	5,8	4,8	3,7	5,0	5,3	4,8	9,5	4,7	4,7
Import - constant prices (% YoY)	3,5	6,5	7,3	5,9	5,3	6,4	6,1	5,3	10,0	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	2,8	2,3
	Investments (pp)	0,9	0,7	1,4	2,1	0,8	0,7	0,6	0,7	0,7	1,4
	Net exports (pp)	-1,2	0,5	-0,5	-0,4	-0,7	-0,5	-0,3	-0,2	0,1	-0,5
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	5,8	5,7	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	2,0	1,8	2,4	2,4	2,2	2,0	2,0	1,7	2,2
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	CONSENSUS**
Monday 10/29/2018						
13:30	USA	Real private consumption (% MoM)	Sep	0,2		
Tuesday 10/30/2018						
11:00	Eurozone	Preliminary GDP (% QoQ)	Q3	0,4	0,5	0,4
11:00	Eurozone	Business Climate Indicator (pts)	Oct	1,21		1,14
14:00	USA	Case-Shiller Index (% MoM)	Aug	0,1		0,1
14:00	Germany	Preliminary HICP (% YoY)	Oct	2,2	2,4	2,4
15:00	USA	Consumer Confidence Index	Oct	138,4	137,0	135,8
Wednesday 10/31/2018						
2:00	China	Caixin Manufacturing PMI (pts)	Oct	50,8		50,7
10:00	Poland	CPI (% YoY)	Oct	1,9	1,8	1,9
11:00	Eurozone	Preliminary HICP (% YoY)	Oct	2,1	2,2	2,2
11:00	Eurozone	Unemployment rate (%)	Sep	8,1		8,1
13:15	USA	ADP employment report (k)	Oct	230		189
14:45	USA	Chicago PMI (pts)	Oct	60,4		60,4
Thursday 11/01/2018						
2:45	China	Caixin Manufacturing PMI (pts)	Oct	50,2		49,9
13:00	UK	BOE rate decision (%)	Nov	0,75	0,75	0,75
14:45	USA	Flash Manufacturing PMI (pts)	Oct	55,9		
15:00	USA	ISM Manufacturing PMI (pts)	Oct	59,8	59,3	59,0
Friday 11/02/2018						
9:00	Poland	Manufacturing PMI (pts)	Oct	50,5	49,9	50,2
9:55	Germany	Final Manufacturing PMI (pts)	Oct	52,3	52,3	52,3
10:00	Eurozone	Final Manufacturing PMI (pts)	Oct	52,1	52,1	52,1
13:30	USA	Unemployment rate (%)	Oct	3,7	3,7	3,7
13:30	USA	Non-farm payrolls (k MoM)	Oct	134	200	190
15:00	USA	Factory orders (% MoM)	Sep	2,3	0,7	0,4

*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