The good streak in Polish manufacturing has ended

This week

- **The most 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 unchanged. Questions about the impact of the lower-than-expected November inflation reading on the monetary policy outlook in the nearest quarters may be raised during the conference. A. Glapiński will repeat his opinion that interest rates will remain unchanged at least until the end of 2019. However, the last week's inflation data might support the view he expressed a month ago that interest rates could remain stable also in 2020. The NBP Governor can also be expected to refer to the motion for interest rates cut that was filed at the November meeting. We believe that the statement after the Council meeting and the remarks of the NBP Governor during the conference may have a slightly negative impact on PLN and bond yields.
- **Data on business sentiment in Polish manufacturing have also been released today (see below).** Polish manufacturing PMI dropped to 49.5 pts in November vs. 50.4 pts in October, running significantly below the market consensus (50.4 pts) and our forecast (50.6 pts). Thus, the index stood below the 50 pts threshold diving expansion from contraction of activity. Conducive to the index decline were mainly lower values of the sub-indices for output and new orders. The average value of the PMI in October-November period (49.9 pts) stood significantly below its average value in Q3 (51.6 pts), which suggests a high likelihood of deceleration of economic growth in Q4 2018. We believe that the results of business surveys for Polish manufacturing released today are slightly negative for PLN and Polish bond yields.
- **Some important data from the US will also be released this week.** Data from the labour market will be released on Friday. We expect non-farm payrolls to have increased by 200k in November vs. 250k in October, with unemployment rate unchanged at 3.5%. 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 195k in November vs. 227k in October). Business survey results will also be released this week. The ISM index for manufacturing will be released today and we believe that it rose to 58.0 pts in November vs. 57.7 pts in October, consistent with the results of regional business surveys. We expect that the preliminary University of Michigan Index (97.0 pts vs. 97.5 pts) will point to a slight deterioration of households' sentiment in December. We believe that the US readings will be neutral for PLN and the prices of Polish bonds.
- **Business survey results for Chinese manufacturing have been released in recent days.** The CLFP PMI dropped to 50.0 pts in November vs. 50.2 pts in October, running below the market expectations (50.2 pts), while the Caixin PMI, released today, rose to 50.2 pts in November vs. 50.1 pts in October. The increase in Caixin PMI resulted from higher contributions of its sub-indices for inventories and total new orders. In turn, conducive to the index decrease were lower contributions of three of its five sub-indices (for output, employment, and suppliers' delivery times). Especially noteworthy in the data structure is the decrease in the new export orders sub-index to 47.7 pts in November vs. 48.8 pts in October. Its decrease results from the slowdown in global trade and the negative impact of the US-China trade war on the activity of the Chinese exporters. Interestingly, the total new orders sub-index rose to 50.9 pts in November vs. 50.4 pts in October, which means that the activity of the Chinese manufacturing in November was supported by stronger domestic demand. In subsequent months we expect further improvement of sentiment in China due to the 90-day truce in the US-China trade war (see below).

Last week

- **Last week, during the G20 summit, the US President D. Trump and the President of the Chinese People's Republic Xi Jinping declared a 90-day truce in the trade war with a view to resuming mutual negotiations.** It means that no new tariffs will be imposed in the next 90 days. Thus, the US will suspend the earlier planned rise in tariffs (from 10% to 25%) on USD 200bn worth of Chinese goods from 1 January 2019. On the other hand, China agreed to significantly increase imports from the US and to start negotiations on protection of intellectual property, fight against cyber theft, and lifting non-tariff trade barriers limiting imports from the US (i.a. of agricultural and energy commodities and industrial goods). Although the risk of further escalation of the trade war if no agreement is reached between the two countries still exists, the probability of the mitigation of the conflict has significantly increased, we believe. The agreement is conducive to a fall of USDCNY exchange rate and lower global risk aversion and, consequently, to the appreciation of PLN and lower yields on Polish bonds.
- **The Minutes of the November FOMC meeting were released last week.** In accordance with the Minutes, almost all FED members believe that further gradual monetary policy tightening in the US would be consistent with sustaining the Federal Reserve's objectives of maximum employment and price stability. The description of the discussion indicates that all FOMC members expect another interest rates hike fairly soon if incoming information on the labor market and inflation is in line with or stronger than their current expectations. The Minutes also included the information, in which FOMC members emphasize that FED policy is not on a preset course. At the same time, they are preparing for a change in the way of communicating their expectations concerning future Federal Reserve's policy. FOMC members wish to stop suggesting to the market participants that FED will continue the monetary policy tightening. In accordance with the Minutes, they plan to place greater emphasis on the evaluation of incoming data to make their policy more flexible. It is due to the fact that FED interest rates are getting increasingly closer to the equilibrium (the median FOMC members' expectations for the equilibrium rate in the September projection amounted to 3.0%), as mentioned by the FED Chairman, J. Powell, a day before the Minutes were published. His remark, suggesting a change in FED bias to a more dovish one and lower likelihood of further significant monetary tightening, have resulted in USD depreciation vs. EUR. The text of the Minutes supports our scenario, in which FED will hike interest rates again by 25 bp in December 2018. Nonetheless we see a substantial downside risk to our scenario, in which FED will hike interest rates by 100 bp in total in 2019. The scale of hikes in 2019 currently priced in by the market amounts to 50 bp.
- **Significant data from the US were released last week.** In accordance with the second estimate, the annualized US GDP growth rate has not changed compared to the first estimate and amounted to 3.5%. Revised downwards were the contributions of private consumption (2.45 pp in the second estimate vs. 2.69 pp in the first estimate), net exports (-1.91 pp vs. -1.78 pp), and government spending (0.44 pp vs. 0.56 pp), whose decline was offset by higher contributions of investments (0.25 pp vs. -0.04 pp) and inventories (2.27 pp vs. 2.07 pp). Thus, like in Q2, private consumption remained the main source of growth of the US GDP in Q3. Data on new home sales (544k in October vs. 597k in September) were also released last week and, combined with the data on building permits, housing starts, and existing home sales published two weeks ago (see MACROmap of 26/11/2018), point in total to the stabilization of activity in the US real estate market in October. The Conference Board Index was also released last week and decreased to 135.7 pts in November vs. 137.9 pts in October. The index decline resulted from a decrease in its sub-index for expectations while higher sub-index for the assessment of current situation had an opposite impact. We forecast that the annualized US GDP growth rate will decrease to 2.8% in Q4 vs. 3.5% in Q3, though staying above the potential economic growth

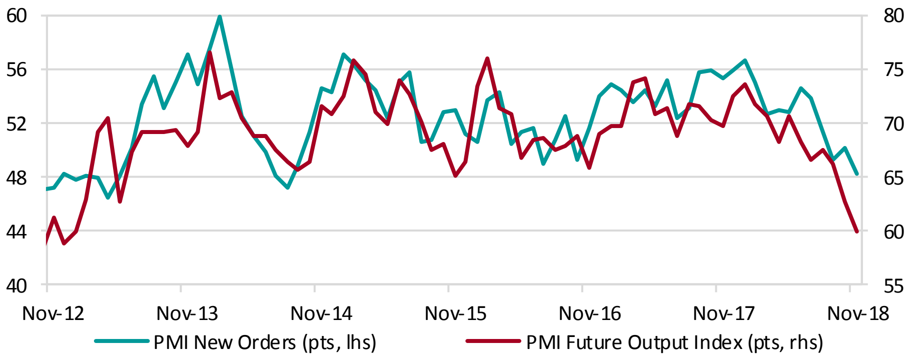
rate estimated by FED at slightly above 2%.

- **In accordance with the flash estimate, CPI inflation in Poland decreased to 1.2% YoY in November vs. 1.8% in October, running below our forecast equal to the market expectations (1.5%).** GUS has published partial data on the inflation structure with information on the rate of inflation in the categories “food and non-alcoholic beverages”, “energy”, and “fuels”. Conducive to the decrease in total inflation were lower dynamics of the prices of food and non-alcoholic beverages (0.7% YoY in November vs. 1.8% in October), fuels (10.5% YoY vs. 12.8%), and energy (1.1% YoY vs. 1.4%). The decrease in inflation resulted also from lower core inflation, which, in accordance with our estimates, dropped to 0.6% YoY in November vs. 0.9% in October. The flash inflation data pose a downside risk to our forecast, in which inflation will decrease to 1.8% YoY in Q4 vs. 2.0% in Q3 and in the whole 2018 will amount to 1.8% YoY vs. 2.0% in 2017. At the same time, combined with the sharp fall of oil prices recorded in recent weeks, the data signal a downside risk to our forecast of inflation in 2019 (2.2%). Final data on inflation will be released on 14 December.
- **GDP growth rate in Poland stood at 5.1% YoY in Q3 against 5.1% in Q2 and was in line with the flash estimate released earlier.** The stabilization of the GDP growth rate resulted from higher contributions of inventories (1.0 pp in Q3 vs. 0.0 pp in Q2) and investments (1.7 pp vs. 0.8 pp) as well as lower contributions of net exports (-0.9 pp vs. 0.9 pp) and private consumption (2.7 pp vs. 2.8 pp). The contribution of public consumption has not changed in Q3 compared to Q2 and amounted to 0.6 pp. In the structure of Q3 GDP, the strong acceleration of investment growth from 4.7% YoY in Q2 to 9.9% deserves special attention. We estimate that in Q3 the contribution of public investment to total investment growth significantly increased. We also do not rule out a higher contribution of housing investment to the total investment outlays. In our view, the fact which significantly boosted public investment growth in Q3 were higher local government investments in the period preceding the October local elections (see MACROpulse of 30/11/2018). The better-than-expected data on Q3 GDP signal a slight upside risk to our forecast of economic growth in 2018 (4.8%). We still expect that in subsequent quarters GDP growth will gradually decline at the back of the slowdown in employment conducive to slower consumption growth, short investment cycle in the corporate sector and the high base effect for public investments. We will present our revised macroeconomic scenario on 10/12/2018.
- **Investments of Polish enterprises employing at least 50 people increased by 13.3% YoY in Q3 vs. a 13.9% increase in Q2.** Their lower dynamics resulted from lower contributions of investments in services (by 0.9 pp) and mining (by 0.5 pp), while higher contributions of investments in construction (by 0.5 pp), manufacturing (by 0.4 pp), and in energy (by 0.3 pp) had an opposite impact. At the same time, like in in Q2, investments in services were the main source of growth of investments of 50+ companies in Q3. Considering the ownership structure of enterprises, investments of companies controlled by the public sector continued to be the main source of investments growth in Q3 (36.8% YoY in Q3 vs. 29.5% in Q2). Investments growth in Polish private companies have also slightly accelerated (5.4% vs. 4.0%), while the growth of investments of foreign private companies has visibly decelerated (6.1% vs. 12.1%). In subsequent quarters we expect a change in the structure of investments of 50+ companies and a higher contribution to their dynamics of domestic investments of private companies.
- **According to the flash estimate, inflation in the Eurozone dropped to 2.0% YoY in November vs. 2.2% in October, running below the market expectations (2.1%) and above our forecast (1.8%).** The decrease in inflation resulted from lower price dynamics in the categories “energy” and “services”. We expect that in subsequent quarters the annual inflation rate within the single currency area will remain within a downward trend and will amount to 1.1% 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 consistent with our scenario, in which the first hike of ECB interest rates (deposit rate) will take place in September 2019 and the main interest rate will be

hiked in December 2019. The market is now pricing a partial interest rate hike in the Eurozone (by 10 bp) in December 2019.

- **Ifo Index reflecting the sentiment among German managers representing the manufacturing, construction, trade, and services sectors, dropped to 102.0 pts in November vs. 102.9 pts in October.** The index decrease resulted from lower values of its sub-indices for both the assessment of the current situation and expectations. Deterioration was recorded in all the sectors covered by the survey (manufacturing, construction, trade, and services). Taking into consideration the inflowing results of business surveys for the German economy (see MACROmap of 26/11/2018), we see a downside risk to our forecast, in which in the whole 2018 the German GDP will increase by 1.9% vs. a 2.5% increase in 2017.

The good streak in Polish manufacturing has ended



Source: Markit

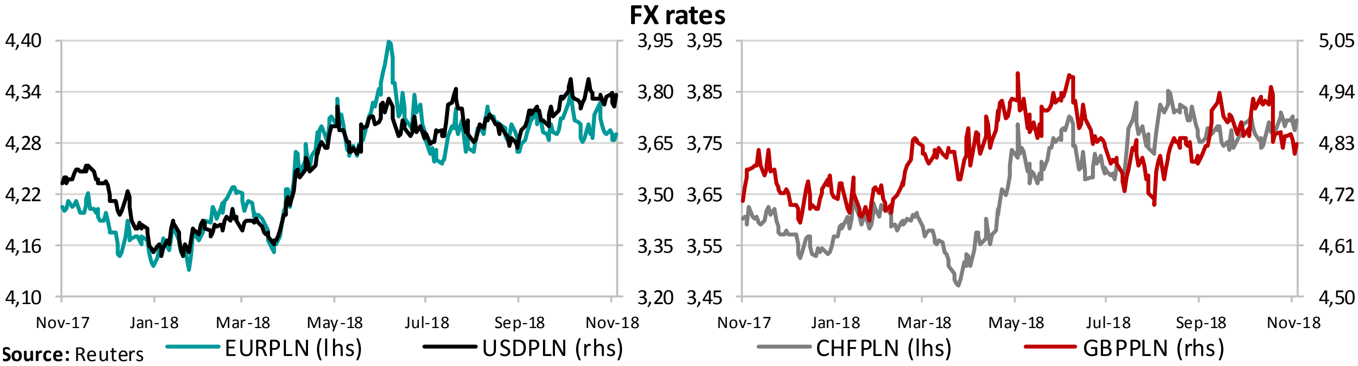
Polish manufacturing PMI dropped to 49.5 pts in November vs. 50.4 pts in October, running significantly below the market consensus (50.4 pts) and our forecast (50.6 pts). Thus, the index stood below the 50 pts threshold dividing expansion from contraction of activity and hit the lowest level since September 2014. Conducive to the index decline were mainly lower values of the sub-indices for output and total new orders.

The index structure shows that the buffer of accumulated production backlogs which supported production growth amid limited inflow of new orders in recent months has dried out. In effect, in November 2018 production decreased in monthly terms for the first time since July 2016. In the conditions of lower production, the companies were reducing employment for a second month in a row. The employment decrease was probably a resultant of the restructuring processes in some sectors and growing barrier in the form of shortage of skilled labour which is increasingly conducive to slower employment growth.

November recorded not only a decline in new export orders (resulting from the downturn in countries being Poland's major trade partners) but also lower inflow of total orders (suggesting weaker domestic demand). In addition, the Future Output Index (for the next 12 months) decreased in November to the lowest level since January 2013. According to Markit, the negative sentiment of companies concerning the future were attributed to small number of new orders, weaker forecasts for the German economy, and economic downturn. Considering the leading nature of the above indicators, the November data do not provide optimistic signals about the prospects for the growth of manufacturing activity.

The average value of the PMI in October-November period (49.9 pts) stood significantly below its average value in Q3 (51.6 pts), which suggests high likelihood of deceleration of economic growth in Q4 2018. We will present our revised macroeconomic scenario on 10/12/2018.

Polish manufacturing PMI negative for PLN



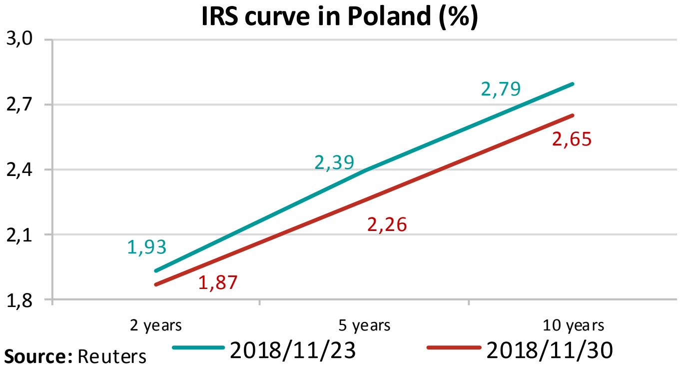
Source: Reuters

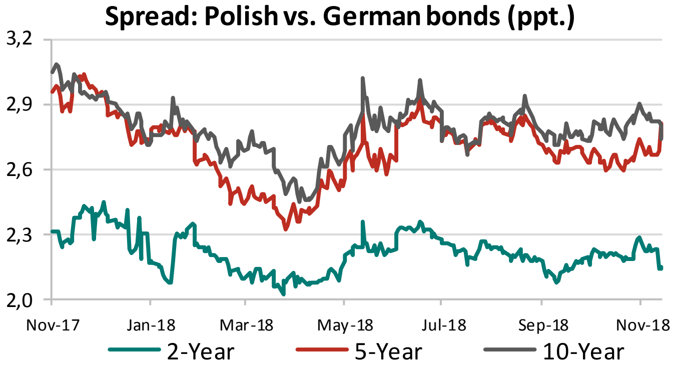
Last week, the EURPLN exchange rate amounted to 4.2911 (no change compared to the level from two weeks ago). Despite an eventful data and macroeconomic calendar (final data on GDP in Poland, flash data on inflation in Poland and the Eurozone, as well as FED Minutes), EURPLN showed low volatility compared to recent weeks, ranging from 4.28 to 4.30.

The most important event in the foreign exchange market was the statement by the FED Chair, J. Powell, who said that US interest rates were currently only slightly below the equilibrium level. The market received this remark as dovish which led to EUR depreciation vs. USD. Noteworthy is also the last week's depreciation of GBP vs. EUR, due to investors' concerns as to whether T. May would succeed in obtaining the support of the British parliament for the negotiated agreement on Brexit terms. Consequently, PLN appreciated vs. GBP last week (by 0.3%).

The beginning of the week may bring PLN appreciation due to lower risk aversion after truce in the USA-China trade war was declared during the G20 summit (see above). Today's results of business surveys for Polish manufacturing are slightly negative for PLN. In turn, the Caixin PMI published last night for Chinese manufacturing is neutral for PLN. The MPC meeting scheduled for Wednesday may be slightly negative for PLN. The investors will also focus on US non-farm payroll data. However, if our forecast that is close to the market expectations materializes, the data will not be market moving. Other US data (Manufacturing ISM and preliminary University of Michigan Index) will also be neutral for PLN, we believe.

Market focused on the MPC meeting





Source: Reuters

Last week, 2-year IRS rates decreased to 1.87 (down by 6bp), 5-year rates to 2.26 (down by 13bp), and 10-year rates to 2.65 (down by 14bp). Last week saw a decline in IRS rates across the curve, due to the publication of lower-than-expected domestic inflation data and further decrease in the uncertainty in the Polish market caused by the KNF crisis. The decrease in IRS rates was also supported by lower bond yields in the core markets (in the US and Germany) resulting from the last week's dovish remark by J. Powell (see above). On Thursday there was a debt exchange auction at which the Finance Ministry repurchased PLN 6.7bn of bonds maturing in 2019 and sold PLN 7.0bn of 3-, 6-, and 10-year bonds, with demand amounting to PLN 7.6bn. The auction had no significant impact on IRS rates.

The beginning of the week may see a decrease in IRS rates due to the trade truce between the US and China declared during the G20 summit (see above). The Polish manufacturing PMI released today is slightly negative for IRS rates. Crucial for IRS rates this week will be the MPC meeting scheduled for Wednesday which may contribute to their slight decrease. In our view, the US non-farm payrolls reading scheduled for Friday will have a limited impact on the curve. Other data from the US economy (manufacturing ISM and preliminary University of Michigan Index) will also be neutral for IRS rates.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland														
Indicator	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-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*	4,20	4,18	4,15	4,17	4,21	4,24	4,31	4,37	4,27	4,30	4,28	4,34	4,29	**4,29**
USDPLN*	3,53	3,48	3,34	3,42	3,42	3,51	3,69	3,74	3,66	3,71	3,69	3,84	3,79	**3,61**
CHFPLN*	3,59	3,57	3,59	3,62	3,58	3,54	3,74	3,78	3,69	3,83	3,75	3,80	3,79	**3,67**
CPI inflation (% YoY)	2,5	2,1	1,9	1,4	1,3	1,6	1,7	2,0	2,0	2,0	1,9	1,8	**1,5**	
Core inflation (% YoY)	0,9	0,9	1,0	0,8	0,7	0,6	0,5	0,6	0,6	0,9	0,8	0,9	**0,9**	
Industrial production (% YoY)	9,2	2,8	8,6	7,3	1,7	9,3	5,2	6,7	10,3	5,0	2,7	7,3	**4,5**	
PPI inflation (% YoY)	1,8	0,3	0,2	-0,1	0,5	1,0	3,0	3,7	3,4	3,0	3,0	3,2	**3,3**	
Retail sales (% YoY)	10,2	6,0	8,2	7,9	9,2	4,6	7,6	10,3	9,3	9,0	5,6	9,7	**8,0**	
Corporate sector wages (% YoY)	6,5	7,3	7,3	6,8	6,7	7,8	7,0	7,5	7,2	6,8	6,7	7,6	**7,1**	
Employment (% YoY)	4,5	4,6	3,8	3,7	3,7	3,7	3,7	3,7	3,5	3,4	3,2	3,2	**3,0**	
Unemployment rate* (%)	6,5	6,6	6,8	6,8	6,6	6,3	6,1	5,8	5,8	5,8	5,7	5,7	**5,7**	
Current account (M EUR)	95	-1354	2289	-792	-914	291	495	-200	-750	-582	-547	**-131**		
Exports (% YoY EUR)	17,7	4,8	15,5	6,6	-4,4	9,1	1,1	6,2	9,2	7,2	0,3	**8,8**		
Imports (% YoY EUR)	17,8	13,2	19,0	9,5	0,3	12,4	1,4	7,9	10,3	11,3	5,4	**10,8**		

*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)		5,3	5,1	5,1	4,5	3,7	3,5	3,4	3,3	4,8	4,8	3,5
Private consumption (% YoY)		4,7	4,9	4,5	4,7	4,4	3,9	3,7	3,6	4,9	4,8	3,9
Gross fixed capital formation (% YoY)		8,2	4,7	9,9	8,5	6,2	4,4	3,4	2,9	3,9	7,5	3,9
Export - constant prices (% YoY)		3,4	7,6	4,9	4,8	3,7	5,0	5,3	4,8	9,5	4,7	4,7
Import - constant prices (% YoY)		5,5	6,5	6,9	5,9	5,3	6,4	6,1	5,3	10,0	5,8	5,8
GDP growth contributions	Private consumption (pp)	3,0	2,8	2,7	2,3	2,8	2,3	2,2	1,8	2,8	2,8	2,3
	Investments (pp)	1,0	0,8	1,7	2,1	0,8	0,7	0,6	0,7	0,7	1,4	0,7
	Net exports (pp)	-1,0	0,9	-0,9	-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	5,8	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	1,1	0,6	0,4	0,4	0,4	0,4	1,9	1,0	0,4
Wages in national economy (% YoY)		6,2	7,1	7,6	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	1,8	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

Our revised forecasts for 2018-2019 (shaded area) will be released on 10/12/2018.

* quarterly average

** end of period

***cumulative for the last 4 quarters

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
		Monday 12/03/2018				
2:45	China	Caixin Manufacturing PMI (pts)	Nov	50,2	50,1	50,0
9:00	**Poland**	**Manufacturing PMI (pts)**	**Nov**	**50,4**	**50,6**	**50,4**
9:55	Germany	Final Manufacturing PMI (pts)	Nov	51,6	51,6	51,6
10:00	Eurozone	Final Manufacturing PMI (pts)	Nov	51,5	51,5	51,5
15:45	USA	Flash Manufacturing PMI (pts)	Nov	55,4		
16:00	USA	ISM Manufacturing PMI (pts)	Nov	57,7	58,0	57,5
		Tuesday 12/04/2018				
11:00	Eurozone	PPI (% YoY)	Oct	4,5		4,5
		Wednesday 12/05/2018				
10:00	Eurozone	Services PMI (pts)	Nov	53,1	53,1	53,1
10:00	Eurozone	Final Composite PMI (pts)	Nov	52,4	52,4	52,4
11:00	Eurozone	Retail sales (% MoM)	Oct	0,0		0,2
14:15	USA	ADP employment report (k)	Nov	227		195
16:00	USA	ISM Non-Manufacturing Index (pts)	Nov	60,3	59,7	59,1
	Poland	**NBP rate decision (%)**	**Dec**	**1,50**	**1,50**	**1,50**
		Thursday 12/06/2018				
8:00	Germany	New industrial orders (% MoM)	Oct	0,3		-0,4
16:00	USA	Factory orders (% MoM)	Oct	0,7	-1,9	-2,0
		Friday 12/07/2018				
8:00	Germany	Industrial production (% MoM)	Oct	0,2		0,3
11:00	Eurozone	Final GDP (% YoY)	Q3	1,7	1,7	1,7
11:00	Eurozone	Revised GDP (% QoQ)	Q3	0,2	0,2	0,2
11:00	Eurozone	Employment (% YoY)	Q3	1,3		
14:30	USA	Unemployment rate (%)	Nov	3,7	3,7	3,7
14:30	USA	Non-farm payrolls (k MoM)	Nov	250	215	200
16:00	USA	Wholesale inventories (% MoM)	Oct	0,7		0,7
16:00	USA	Wholesale sales (% MoM)	Oct	0,2		0,3
16:00	USA	Initial U. of Michigan Sentiment Index (pts)	Dec	97,5	97,5	97,0

*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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