Construction is bottoming out

This week

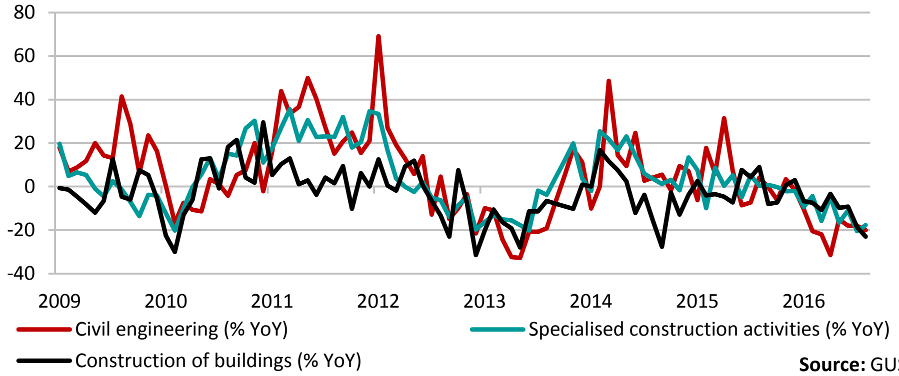
- **The most important event this week will be the publication of the Minutes of the September FOMC meeting.** The markets will focus on the FED members' in-depth analysis of short-term risks to the US economic growth, as the press release after the September's FOMC meeting included a provision that the significance of short-term risks to the US economy had decreased. Important for the markets will also be detailed information regarding the September FED macroeconomic projection, which pointed to a slower expected pace of normalization of the US monetary policy. We believe that the publication of the Minutes may be conducive to increased volatility in the financial markets.
- **Significant hard data on US economy and business survey results will be released this week.** We forecast that nominal retail sales rose by 0.7% MoM in September vs. a 0.3% decrease in August. The increase in nominal sales resulted from higher sales dynamics in the automotive branch and the rising fuel prices, we believe. We forecast that the preliminary University of Michigan index rose to 92.6 pts in October from 91.2 pts in September, pointing to improvement in households' sentiment. Our forecasts concerning US data are above the market consensus. Therefore, if they materialize, the aggregate impact of these data may be slightly negative for PLN and prices of Polish bonds.
- **Final data on the September inflation in Poland will be released on Tuesday.** We maintain our forecast in which inflation amounted to -0.4% YoY vs. -0.8% in August and the flash estimate at -0.5%. In our view, the increase in inflation rate was due to higher dynamics of fuel and energy prices and higher core inflation. If the indicator is revised upwards, the publication of the September inflation will be slightly positive for PLN and yields on Polish bonds.
- **ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany will be released on Tuesday.** In accordance with the consensus, its value will increase to 4.0 pts in October vs. 0.5 pts in September.
- **Data on the Chinese trade balance will be released on Thursday.** We expect its surplus to have decreased to USD 40.0bn in September vs. USD 52.1bn in August. We forecast that exports dynamics recorded a decline in September to -5.0% YoY vs. -2.8% in August, while imports dynamics rose to 6.7% from 1.5%. If our lower than the market consensus forecasts materialize, the data may be conducive to PLN weakening.
- **Data on the Polish balance of payments in August will be released on Friday**. We expect the current account deficit to decrease to EUR 615M in August vs. EUR 802M in July. We forecast that exports dynamics rose to 7.4 YoY in August vs. -4.8% in July, while import dynamics rose to 6.9% YoY vs. -7.3%. The simultaneous increase in imports and exports growth rates was caused by the effect of a favourable difference in the number of working days. The materialization of our forecast assuming lower from the consensus (EUR -331M) current account balance will not have a significant impact on PLN.

Last week

- **Non-farm payrolls in the US rose by 156k in September vs. a 167k increase in August (revised upwards from 151k), running below the market expectations (175k).** The highest increase in employment was recorded in professional and business services (+67.0k), education and health services (+29.0k), and construction (+23.0k). Employment decreased in manufacturing (-13.0k), the government sector (-11.0k), and transportation and warehousing (-9.0k). Unemployment rate increased compared to August and amounted to 5.0% vs. 4.9% in August, running above the natural unemployment rate indicated by the FOMC (4.8% - see MACROmap of 26/9/2016). The increase in unemployment rate was due to the inflow into the labour market of people who so far have been outside the labour force. This was reflected by an increase in participation rate to 62.9% in September vs. 62.8% in August. The annual dynamics of average hourly earnings rose to 2.6% in September vs. 2.4% in August. We expect that in the coming months the increase in wage growth will be continued, as the labour market will be approaching equilibrium. The results of business surveys in the US were also released last week. The ISM index for manufacturing increased to 51.5 pts in September vs. 49.4 pts in August, thus running above the 50 pts threshold dividing expansion from contraction of activity. Especially noteworthy in the data structure is a sharp increase in the sub-index concerning new orders (55.1 pts vs. 49.1 pts). This shows that the orders decline in August was temporary. Non-manufacturing ISM was also released last week and rose to 57.1 pts in September vs. 51.4 pts in August, hitting the highest level since October 2015. The index increase resulted from higher values of 3 out of 4 its sub-indices (business activity, new orders, and employment). A lower contribution of the sub-index concerning deliveries had an opposite impact. The last week's readings from the US economy (in particular, increase in hourly wages, increase in labour market participation, upward revision of employment in August, and improvement in consumer sentiment) support our forecast, in which FED will increase the target range for the Federal Reserve funds in December 2016 by 25 bp to [0.50%; 0.75%].

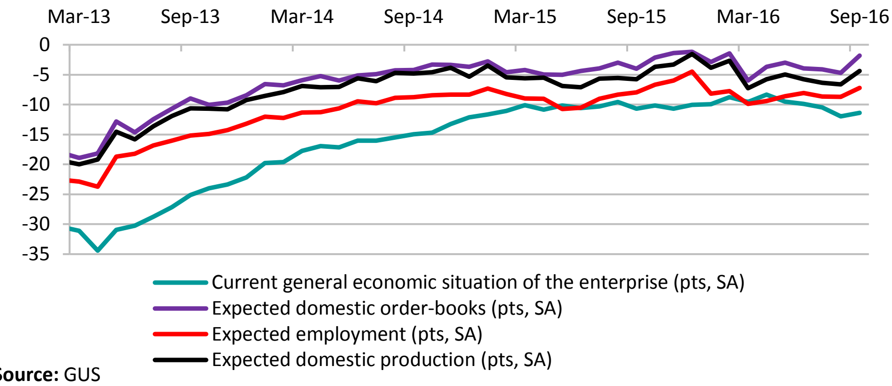
- **As we expected, at the last week's meeting, the Monetary Policy Council left interest rates unchanged (the reference rate amounts to 1.50%).** The bias of the Council's statement has not substantially changed compared to the September statement. The MPC maintained the view that given the available data and forecasts, the current level of interest rates was conducive to keeping the Polish economy on the sustainable growth path and maintaining macroeconomic balance. During the press conference, the NBP Governor, A. Glapiński, informed that, despite the expected increase in inflation to a positive level next year, in his view, the most likely scenario was currently the stabilization of interest rates in 2017 and start of interest rate hike cycle in 2018 (see MACROpulse of 5/10/2016). A. Glapiński's remark suggests a downside risk to our forecast of NBP rates in 2017. However, we maintain the view that the expected by us acceleration of economic growth in H1 2017, combined with increase in inflation to visibly positive levels and real NBP reference rate drop to a level close to zero, will make the MPC start a monetary tightening cycle in July 2017 and increase the NBP reference rate by 50bp in total in 2017. The main risk to our forecast continues to be the likely prolongation by the ECB of the expanded asset purchase program.
- **Data from the German economy were released last week**. Orders in manufacturing rose by 1.0% MoM in August vs. a 0.3% increase in July, while industrial production rose by 2.5% vs. a -1.5% decline. The increase in industrial production was due to higher output growth rate in manufacturing, while lower dynamics of production in construction and energy had an opposite impact. We forecast that the quarterly growth rate of the German GDP will not change in Q4 compared to Q3 and will amount to 0.4%.

Construction is bottoming out



Source: GUS

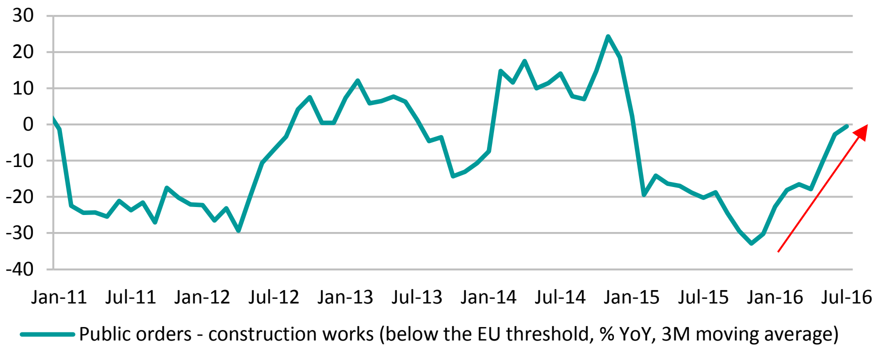
The construction and assembly production dropped by 20.5% YoY in August vs. a 18.8% decline in July. The deepening of production drop was greatly surprising in the context of strong support for production in a form of favourable calendar effects (see MACROpulse of 19/9/2016). Seasonally-adjusted construction and assembly production fell by 5.5% MoM. The contraction of activity in construction has been visible for several quarters – the construction and assembly production growth has been within a downward trend since H2 2015. This year the rate of output growth slowdown deepened. The lowest business activity is in the category "civil engineering facilities", whose dynamics this year has been, on the average, below the remaining two categories of construction and assembly production (“specialized construction activities” and “construction of buildings”, see the chart). This is consistent with the slowdown in public investments, recorded in H1 2016, related to limited absorption of EU funds at the beginning of the new financial perspective 2014-2020. Below we present short- and medium-term trends in this sector, based on business survey results and other factors reflecting the situation in this business.



Source: GUS

Business surveys prepared by GUS since the beginning of 2016 pointed to a deterioration of sentiment in construction (see the chart), which is consistent with the incoming data on production in this sector. However, this trend reversed in September, as a slight improvement was recorded in the assessment of general current economic situation of construction companies. In addition, in the case of expectations of enterprises, the improvement was more visible and covered a wide range of indicators – i.a. future growth rate of production, employment, and orders in construction. Business sentiment indicators reflecting these areas rose in September to the highest levels, since February 2016, December 2015, and February 2016, respectively. Considering the leading nature of these indices, the results of GUS business surveys may be expected to signal a reversal of trend in construction and indicate improvement in the horizon of several months.

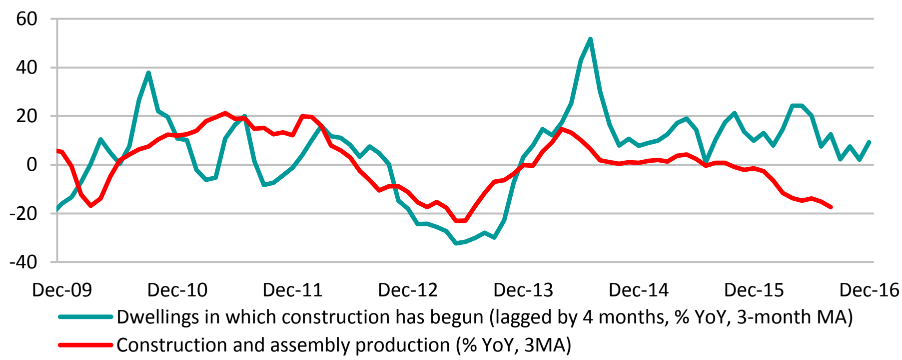
Construction is bottoming out



Source: UZP

The expected by us recovery in construction is supported by data on public orders. The amounts of EU thresholds, namely amounts on which the obligation of applying a stricter procedure and sending announcements to the Official Journal of the European Union depends is ca. PLN 22M for construction works. The three-month moving average of annual growth of orders for construction works with the value below the EU threshold has stood below zero since February 2015. However, a marked upward trend for this growth has been visible since 2015 and it may be expected to exceed zero in the coming months. The expected growth of public orders is consistent with the profile of financial expenditures (mainly capital expenditure) presented in the Multiannual Financial Forecast (MFF) of local government units (LGU). According to this document, released in August 2016, LGU financial expenditures are to decrease by 4.6% YoY in 2016 and increase by 1.4% in 2017. The decline in expenditures this year results from low absorption of EU funds (see above).

It is worth noting that the increase in investments in 2017 is in conflict with the surplus in the local government sub-sector planned for 2017 in the Budget Act (0.2% of GDP). In addition, the LGU MFF forecasts a deficit in the local government sub-sector amounting to 0.1% of GDP in 2017. We believe that the scenario presented in MFF is more likely to materialize than the one presented in the Budget Act. The LGU investment profile presented in MFF and the increasing dynamics of public orders for construction works will boost construction and assembly production in the horizon of several quarters.

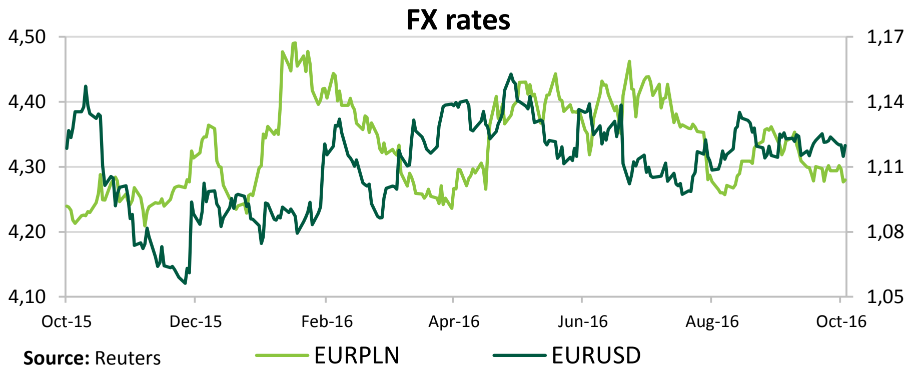


Source: GUS

We also expect residential construction to boost construction activity. Historically, data on residential construction in progress signaled changes in construction and assembly production ca. four months in advance. Since the beginning of 2016, this dependence has weakened, as mainly lower infrastructural investments were responsible for a decline in construction and assembly production. Nevertheless, the three-month moving average of growth of residential construction in progress rose to 9.2% YoY in August vs. 2.2% in May. Considering the large scale of the indicator increase and its leading nature for activity in construction, we expect that in subsequent months residential construction will continue to partly offset the collapse in infrastructural investments.

Taking the above factors into account, we believe that construction and assembly production reached the bottom in August. Despite the negative calendar effects in September, we forecast that the improvement observed in construction will help to stabilize the annual production growth in this sector (-20.5% YoY), which will gradually increase in the coming months. Nevertheless, we also expect that the annual dynamics of capital expenditure allocated by the public sector as well as the construction and assembly production dynamics will continue to be negative until the end of 2016. In H1 2017, together with the continuing recovery in residential construction and increasing absorption of EU funds within the new perspective, the production will accelerate. A downside risk to our forecast is further possible delays in the announcement and execution of public tenders (mostly concerning road and railway infrastructure) which occurred in the last few months.

Foreign data will be conducive to PLN weakening

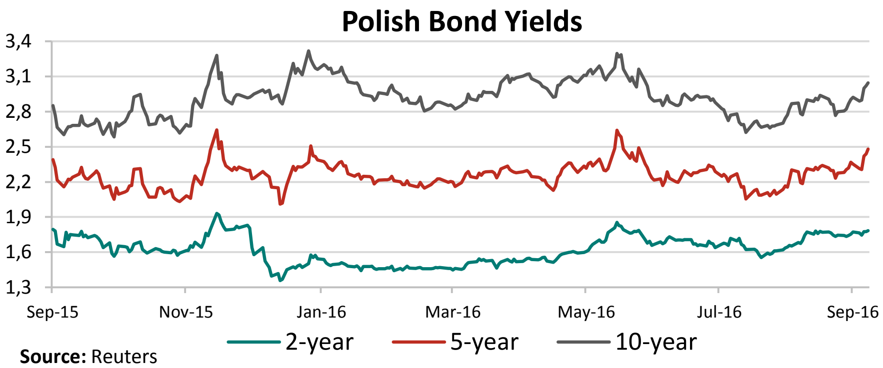


Source: Reuters

Last week EURPLN rate fell down to 4.2800 (PLN strengthening by 0.3%). On Monday, PLN rate was stable. Tuesday saw a weakening of PLN together with an increase in global risk aversion, reflected by VIX index. However, on Wednesday, global risk appetite increased which was conducive to a strengthening of PLN and other emerging markets currencies. From Friday morning, PLN was slightly depreciating in anticipation of data on non-farm payrolls in the US. These proved weaker from the market expectations; however, their structure pointing to higher wage pressure and increase in labour market participation rate has limited the data positive impact on PLN.

Crucial for PLN this week will be data from the US (retail sales, preliminary University of Michigan index). If our higher than the market consensus forecasts materialize, the aggregate impact of the data from the US economy may be negative for PLN. Data on the Chinese trade balance, which we believe will prove weaker from the market expectations, may be conducive to PLN weakening. On the other hand, final data on domestic inflation, which we believe will be revised upwards in relation to the flash estimate, may contribute to PLN strengthening. The Wednesday release of the Minutes of the September FOMC meeting will contribute to increase volatility in the markets, we believe.

The Polish debt market focuses on US data



Source: Reuters

Last week the yield of Polish 2-year benchmark bonds rose to a level of 1.783 (up by 1 bp), of 5-year bonds to a level of 2.479 (up by 13 bp), and of 10-year bonds to a level of 3.045 (up by 12 bp). On Monday, the prices of the Polish debt were stable. Tuesday through Friday, yields on Polish bonds continued to increase, following core markets, which was related to higher market expectations of further normalization of the US monetary policy (the likelihood of rate hike in December, estimated based on forward contracts, amounts now to ca. 60%). On Thursday, there were two debt auctions (main and supplementary one), at which the Ministry of Finance sold PLN 6.8bn of 2- and 11-year bonds with demand amounting to PLN 10.4bn. The Friday's weaker than expected data on US non-farm payrolls were conducive to a slight rise in prices of Polish bonds across the curve.

This week, the Polish debt market will focus on US data (retail sales, preliminary University of Michigan index). We believe that they will be higher from market expectations and their aggregate impact may be positive for yields on Polish bonds. The forecasted by us upward revision of final data on inflation in Poland may have a similar impact, especially at the short end of the yield curve. The Wednesday release of the Minutes of the September FOMC meeting may contribute to increased volatility in the Polish debt market.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	Sep-15	Oct-15	Nov-15	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16
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	4,25	4,27	4,26	4,42	4,35	4,24	4,37	4,38	4,38	4,35	4,36	4,29	**4,30**
USDPLN*	3,80	3,86	4,04	3,92	4,08	4,00	3,73	3,81	3,94	3,94	3,90	3,91	3,82	**3,86**
CHFPLN*	3,90	3,91	3,93	3,91	3,98	4,00	3,87	3,97	3,96	4,04	4,02	3,97	3,93	**3,97**
CPI inflation (% YoY)	-0,8	-0,7	-0,6	-0,5	-0,9	-0,8	-0,9	-1,1	-0,9	-0,8	-0,9	-0,8	**-0,4**	
Core inflation (% YoY)	0,2	0,3	0,2	0,2	-0,1	-0,1	-0,2	-0,4	-0,4	-0,2	-0,4	-0,4	**-0,2**	
Industrial production (% YoY)	4,0	2,4	7,8	6,7	1,4	6,8	0,7	5,9	3,2	6,0	-3,4	7,4	**2,8**	
PPI inflation (% YoY)	-2,8	-2,3	-1,8	-0,8	-1,2	-1,5	-1,9	-1,2	-0,4	-0,8	-0,5	-0,1	**0,1**	
Retail sales (% YoY)	0,1	0,8	3,3	4,9	0,9	3,9	0,8	3,2	2,2	4,6	2,0	5,6	**6,7**	
Corporate sector wages (% YoY)	4,1	3,3	4,0	3,1	4,0	3,9	3,3	4,6	4,1	5,3	4,8	4,7	**4,4**	
Employment (% YoY)	1,0	1,1	1,2	1,4	2,3	2,5	2,7	2,8	2,8	3,1	3,2	3,1	**3,1**	
Unemployment rate* (%)	9,7	9,6	9,6	9,8	10,3	10,3	10,0	9,5	9,1	8,8	8,6	8,5	**8,4**	
Current account (M EUR)	-608	-305	405	-573	771	-529	54	563	624	-203	-802	**-615**		
Exports (% YoY EUR)	3,0	4,5	12,6	11,5	-0,9	5,9	0,8	4,8	-0,7	6,4	-4,8	**7,4**		
Imports (% YoY EUR)	5,2	0,2	6,7	3,8	0,6	7,7	1,1	0,3	0,4	2,4	-7,3	**6,9**		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland

	Indicator	2016 Q1	2016 Q2	2016 Q3	2016 Q4	2017 Q1	2017 Q2	2017 Q3	2017 Q4	2015	2016	2017
	Gross Domestic Product (% YoY)	3,0	3,1	2,8	2,9	3,3	3,5	3,3	3,9	3,6	2,9	3,5
	Private consumption (% YoY)	3,2	3,3	4,0	4,0	4,0	3,7	3,0	3,1	3,1	3,6	3,4
	Gross fixed capital formation (% YoY)	-1,8	-4,9	-3,4	-1,5	3,0	4,4	5,1	5,2	5,8	-2,7	4,7
	Export - constant prices (% YoY)	6,9	10,9	6,6	6,6	7,2	7,0	6,1	7,0	6,8	7,7	6,8
	Import - constant prices (% YoY)	9,3	9,9	6,0	6,1	6,9	6,3	6,6	7,3	6,3	7,8	6,8
GDP growth contributions	Private consumption (pp)	2,0	1,9	2,4	1,9	2,6	2,2	1,8	1,5	1,8	2,1	2,0
	Investments (pp)	-0,2	-0,9	-0,7	-0,4	0,4	0,7	0,9	1,4	1,1	-0,5	0,9
	Net exports (pp)	-0,9	0,8	0,4	0,4	0,4	0,6	-0,1	0,2	0,3	0,2	0,3
	Current account***	-0,8	-0,6	-0,4	-0,5	-0,4	-0,5	-0,4	-0,6	-0,6	-0,5	-0,6
	Unemployment rate (%)**	10,0	8,8	8,4	8,4	8,9	8,0	7,9	8,4	9,8	8,4	8,4
	Non-agricultural employment (% YoY)	2,2	2,3	2,6	1,9	1,4	1,0	0,5	0,0	1,4	2,2	0,7
	Wages in national economy (% YoY)	3,1	4,3	5,0	5,3	5,3	5,1	5,0	4,9	3,3	4,4	5,1
	CPI Inflation (% YoY)*	-0,9	-0,9	-0,7	0,3	1,8	2,0	1,7	1,6	-0,9	-0,6	1,8
	Wibor 3M (%)**	1,67	1,71	1,71	1,71	1,71	1,96	2,13	2,21	1,72	1,71	2,21
	NBP reference rate (%)**	1,50	1,50	1,50	1,50	1,50	1,50	1,75	2,00	1,50	1,50	2,00
	EURPLN**	4,24	4,38	4,29	4,30	4,30	4,20	4,20	4,15	4,26	4,30	4,15
	USDPLN**	3,73	3,94	3,82	3,91	3,91	3,75	3,72	3,61	3,92	3,91	3,61

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST* CA	FORECAST* CONSENSUS**
		Monday 10/10/2016				
8:00	Germany	Trade balance (bn EUR)	Aug	19,4		20,0
10:30	Eurozone	Sentix Index (pts)	Oct	5,6		6,3
		Tuesday 10/11/2016				
11:00	Germany	ZEW Economic Sentiment (pts)	Oct	0,5		4,0
14:00	**Poland**	**CPI (% YoY)**	**Sep**	**-0,8**	**-0,4**	**-0,4**
		Wednesday 10/12/2016				
11:00	Eurozone	Industrial production (% MoM)	Aug	-1,1		1,2
14:00	**Poland**	**Core inflation (% YoY)**	**Sep**	**-0,4**	**-0,2**	**-0,2**
20:00	USA	FOMC Minutes	Sep			
		Thursday 10/13/2016				
	China	Trade balance (bn USD)	Sep	52,1	40,0	53,0
		Friday 10/14/2016				
3:30	China	PPI (% YoY)	Sep	-0,8	0,1	-0,3
3:30	China	CPI (% YoY)	Sep	1,3	1,7	1,6
14:00	**Poland**	**Current account (M EUR)**	**Aug**	**-802**	**-615**	**-331**
14:00	**Poland**	**M3 money supply (% YoY)**	**Sep**	**10,0**	**9,3**	**9,5**
14:30	USA	Retail sales (% MoM)	Sep	-0,3	0,7	0,6
16:00	USA	Business inventories (% MoM)	Aug	0,0		0,2
16:00	USA	Initial U. of Michigan Sentiment Index (pts)	Oct	91,2	92,6	92,0

*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

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