Delays in public investments will slow down economic growth

This week

- **The most important event this week will be the FOMC meeting scheduled for Wednesday.** We expect the Federal Reserve to maintain the status quo in the monetary policy. The remarks of some FED members lately suggested low likelihood of monetary tightening at the November meeting. We expect that the press release after the meeting will support our scenario in which the target range for the Federal Reserve funds will be increased by 25 bp in December 2016 to [0.50%; 0.75%]. The publication of the press release after FOMC meeting this week may contribute to a slight weakening of PLN and increase in yields on bonds at the long end of the curve, we believe.
- **Significant US data will be released this week.** Data from the labour market will be released on Friday. We expect that employment increased by 185k in October vs. 156k in September, while unemployment rate decreased to 4.9% from 5.0% in October. 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 186k in October vs. 154k in September). We forecast that the ISM index for manufacturing dropped to 51.3 pts in October vs. 51.5 pts in September, which will be consistent with mixed results of regional business surveys. We believe that non-farm payrolls reading may contribute to a slight weakening of PLN and drop of prices of Polish bonds. Other data from the US should not be market moving.
- **October China manufacturing PMIs (Caixin and CFLP) will be released on Tuesday.** We expect that Caixin PMI slightly rose to 50.4 pts vs. 50.1 pts in September, while CLFP PMI has not changed compared to September (50.4 pts). We expect that business survey results for China, pointing to stabilization of sentiment in manufacturing, will be neutral for the markets.
- **Data on business sentiment in Polish manufacturing will be released on Wednesday.** We expect that PMI rose to 52.9 pts vs. 52.2 pts in September. In our view, the higher growth rate of activity in manufacturing was due to the improvement in Germany and the Eurozone (see below). Our forecast is in line with the consensus; hence, its materialization will be neutral for PLN and yields on Polish bonds.
- **Significant data from the Eurozone was released today.** The GDP dynamics in the Eurozone have not changed in Q3 compared to Q2 and amounted to 0.3% QoQ (1.6% YoY). In our view, conducive to the slowdown of economic growth in annual terms was lower contribution of investments. In addition, the HICP inflation rose to 0.5% YoY in October vs. 0.4% in September.
- **Flash data on the October inflation in Poland will be released today. In our view, it rose to -0.3% YoY vs. -0.5% in September**. We believe that the increase in inflation rate was due to higher dynamics of fuel prices, while core inflation and the rate of food price rises remained stable compared to September. The data should be neutral for PLN and prices of Polish bonds.

Last week

- **Numerous hard data from the US economy and business survey results were released last week.** According to the first estimate, the annualized economic growth rate rose to 2.9% in Q3 vs. 1.4% in Q2. Higher GDP dynamics resulted from higher contributions of inventories (0.61 pp in Q3 vs. -1.16 pp in Q2), net exports (0.83 pp in Q3 vs. 0.18 pp in Q2), government expenditures (0.09 pp vs. -0.30 pp), and investments (-0.09 pp vs. -0.18 pp). Lower contribution of private consumption (1.47 pp in Q3 vs. 2.88 pp in Q2) had an opposite impact. Thus, the main driver of US GDP growth in Q3, like in Q2, was private consumption. Flash data on durable goods orders were also released last week and decreased by 0.1% MoM in September vs. a 0.3% increase in August. The decrease in the monthly orders dynamics between August and September was due to slower pace of orders in most branches, including orders for means of transport. Excluding means of transport, orders rose by 0.2% in September vs. a 0.1% increase in August. Especially noteworthy in data structure is the deepening of decline in orders for non-military capital goods excluding orders for aircrafts (-4.1% YoY in September vs. -2.6% in August), being a leading indicator of future investments. Data on new home sales were also released last week (593k in September vs. 575k in August), which, combined with the data on building permits, house starts, and existing home sales, released two weeks ago (see MACROmap of 24/10/2016), suggested continuation of the recovery in the US real estate market. The results of consumer sentiment surveys were also released last week. A deterioration of this sentiment was indicated by the Conference Board Index, which dropped to 98.6 pts in October vs. 103.5 pts in September. Its decline was due to lower sub-indices concerning both the assessment of current situation and expectations. The final University of Michigan Index also indicated a deterioration of consumer sentiment, dropping to 87.2 pts in October vs. 91.2 pts in September and 87.9 pts in the flash estimate. Like in the case of the Conference Board Index, its decline resulted from lower sub-indices concerning the assessment of current situation and expectations. The last week's data from the US economy do not alter our scenario in which the annualized economic growth rate will amount to 2.3 in Q4 (above potential growth rate) supporting arguments in favour of monetary tightening in the US.

- **Flash October business sentiment indicators (PMI) for major European economies were released last week**. PMI composite for the Eurozone rose to 53.7 pts in October vs. 52.6 pts in September. The index increase was due to higher value of the indicator in Germany (55.1 pts in October vs. 52.8 pts in September) and its decline in France (52.2 pts vs. 52.7 pts). The index increase in Germany was due to both higher activity in the services sector and increase in the sub-index concerning output in manufacturing. Especially noteworthy in the data structure is the acceleration in the employment growth in German manufacturing to the highest level since August 2011. In turn, the downturn in France resulted from lower activity in the services sector, while higher sub-index concerning output in manufacturing had an opposite impact. The October business survey results pose an upside 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 0.3%.
- **Ifo Index reflecting the sentiment among German managers representing the manufacturing, construction, wholesale and retail trade sectors, rose to 110.5 pts in October vs. 109.5 pts in September.** The index increase was due to higher sub-index concerning both the assessment of the current situation and expectations. Sector-wise, improved sentiment was recorded in two of the four sectors (manufacturing and construction). On the other hand, the situation in wholesale trade and in retail trade deteriorated. Combined with the last week's flash PMIs for Germany (see above), Ifo index poses an upside risk to our forecast, in which the quarterly German GDP growth rate will not change in Q4 compared to Q3 and will amount to 0.4%.

Delays in public investments will slow down economic growth

In the September forecast we markedly lowered the expected by us economic growth rate in 2016 (from 3.3% YoY to 2.9%; see MACROmap of 5/9/2016). In reasons for the revision we pointed i.a. to a deepening of the decline in investments in Q2 2016 and the expected by us only a slight increase in total investment growth in Q3, mainly due to a stronger than forecasted slowdown of public investments in Q2. In the September forecast, we expected public investments to gradually pick up (higher absorption of EU funds within the financial perspective 2014-2020), however, we believed that the annual growth rate of investment outlays allocated by the public sector would continue to be negative. Our scenario for H1 2017 assumed a positive growth rate of public investments resulting i.a. from higher absorption of EU funds and the boost in the form of low base effects. However, considering the recently released hard data and the trends signaled in business surveys, we see a substantial downside risk to the aforementioned scenario of public investments in the coming quarters. In the analysis below, we have benefited from the conclusions presented in NBP publications on the situation in enterprises – "Financial situation of the corporate sector in Q2 2016" and the "Quick Monitoring – October 2016".

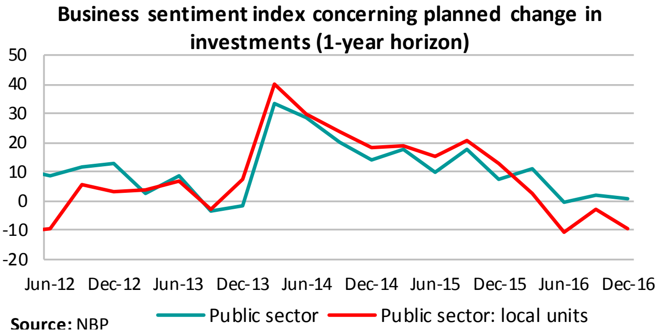
According to the report of the Ministry for Development, PLN 5.9bn were paid out until July 2016 under the perspective 2014-2020, i.e. only 1.9% of the quota available for the whole period. According to the Ministry for Development, the implementation of funds is delayed by a year in most operating programs and in the case of railway investments by two years. Problems with disbursement of the EU financing result i.a. from the European Commission-required implementation of the EU directives and the need to verify and update sector investment plans. For payments to be disbursed under the new financial perspective, plans harmonized with the EU laws must first be adopted. This problem is especially visible in the case of the railway sector and the water and sewage sector.

In the case of the railway sector, the general investment plan is specified in the Polish Railway Program (PRP). The PRP project was presented for public consultations and was supposed to be discussed in the Parliament late September/early October; however, its final update has not been adopted yet. Once the PRP has been adopted, it will still be necessary to develop detailed projects for specific investments. The developing of a project, issuing environmental decisions, and building permits takes 3 years, on average. The long preparation period risks slowing down investments between 2016 and 2017 and consequently accumulating construction between 2019 and 2020. The investments planned for 2016 are being currently implemented but these are mainly the uncompleted tasks postponed from the old EU programming period, while plans for 2017 have not been agreed yet.

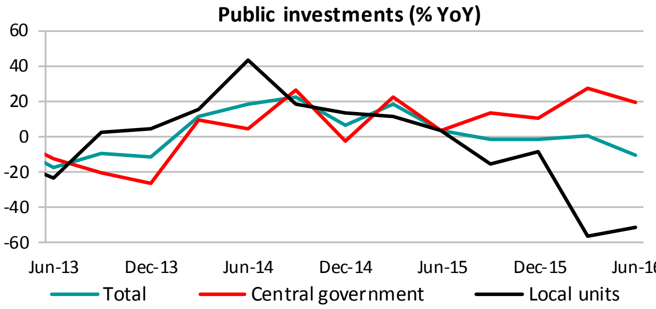
Also in the case of the water and sewage sector, the legislative delays – i.a. the unharmonized with the EU regulations Public Procurement Law and Water Law – prevented the start up of major investment projects. The former bill was amended with a delay of several months in June 2016 and the latter was adopted as late as in October. The lack of timely adoption of the said regulations (preventing disbursement of EU funds) has contributed to a visible decline in municipal investments, as a significant part of outlays for fixed assets in this sector is financed with the participation of EU funds.

The delays in the implementation of investments apply also to the energy sector where public ownership prevails. The decline in dynamics of outlays for fixed assets in Q1 2016 was of a statistical nature (high base effect related to the implementation of large projects in 2015). Nevertheless, the investment activity of enterprises in this sector is adversely affected by the currently falling prices of energy and the capital involvement in the restructuring of mining. The planned amendment to the Water Law and new tax burdens related to the possible increase in the nominal value of treasury-owned companies are additional risks to this sector's investments.

The factors outlined above have contributed to a decline in public investments in H1 2016 by 5.9% vs. a 2.1% increase in 2015. The decline in investments was especially marked in the case of local government units, which invest predominantly in i.a. the water and sewage sector. In H1 2016 these investments decreased by 53.6% YoY vs. a 6.8% decrease in 2015. According to the NBP business surveys ("Quick Monitoring" October 2016), the forecasts of public sector investments have deteriorated compared to H1 2016 – the enterprises declare further declines in outlays for fixed assets. In the light of the NBP business surveys, the rate of decline in investments of public companies, including the sector of local governments' enterprises, may be expected to stabilize in Q4 2016. Considering the above-presented time schedule of legislative works allowing to eliminate the difficulties in the EU financing of investments in the railway and water supply sectors, a clear increase in the absorption of EU funds will take place no sooner than in H1 2017, namely later than we had assumed in our September macroeconomic forecast (H2 2016).



Source: NBP

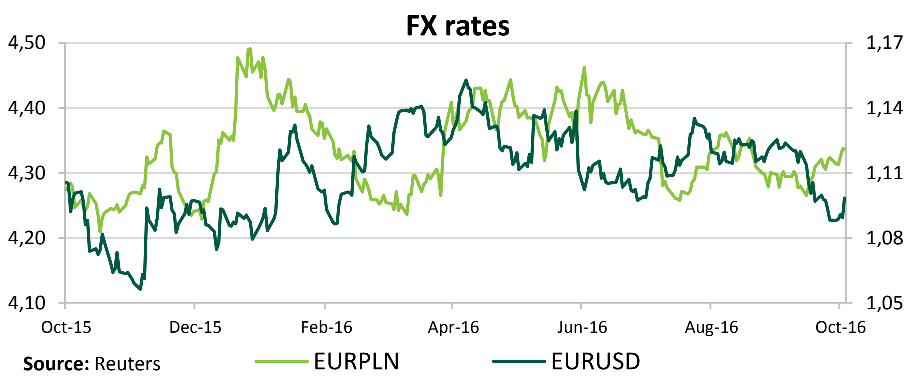


Source: Eurostat, Ministry of Finance, Credit Agricole

Factors that could contribute to a faster recovery in public investments include i.a. the works on the simplification of the management of EU funds, carried out by the Ministry for Development. The Ministry is planning to appoint a beneficiary's spokesman, whose mission will be to influence the process of utilization of EU funds and implementation of operating programs. Such position is to be created in every institution managing EU funds, including the marshal's offices. In addition, a team for simplifying the system of EU funds management is to be created. Investment processes in the railway sector are to be facilitated also by the amendment to the Railway Transport Act, adopted in August. The changes in the Act are aimed at accelerating works related to the preparation and implementation of railway infrastructural investments. On the other hand, investments in energy may be boosted by the creation of so-called power market. This project assumes the creation of a system where producers of energy are to be paid not only for the generated and sold energy but also for staying ready to generate energy. Power capacity would be contracted in advance every four years, which is supposed to encourage maintenance of the existing generation capacities and boost investments in building new power blocks. The Ministry of Energy assumes that draft act will have been ready by the end of this year and will take effect in 2017. However, it is difficult to assess the extent to which these actions will contribute towards acceleration in public investments.

Considering the above-outlined factors affecting the dynamics of public outlays for fixed assets, we believe that the risk to our forecast of total investments growth rate is asymmetrical downwards – the path forecasted below is more likely to materialize. Thus, in the next forecasting round (at the beginning of December) we are likely to revise total investments growth rate downwards in H2 2016 and in 2017. This modification will directly result in lowering the forecasted GDP growth rate in this period.

FED and US data may weaken PLN

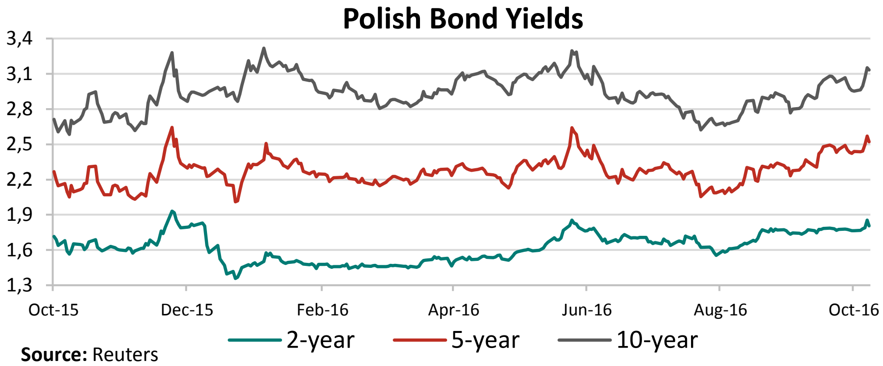


Source: Reuters

Last week EURPLN rate rose to 4.3360 (PLN weakening by 0.3%). Monday saw appreciation of PLN, despite the release of better-than-expected PMIs for major European economies. Tuesday through Friday, PLN and other currencies of the region were depreciating together with increase in global risk aversion, reflected by higher VIX index. In our view, the decrease in demand for risky assets resulted from growing expectations of normalization of the US monetary policy and political risk related to the approaching presidential elections in that country. This view is supported by the increase in yields on US bonds continuing since Tuesday across the curve. The first estimate of the US GDP in Q3, which was released on Friday and proved higher than expected by the market, had a limited impact on PLN.

Important for PLN this week will be the data on non-farm payrolls in the US. If our higher-from-the-market-consensus forecast materializes, we expect that they will be conducive to a slight weakening of PLN. The text of the press release after the Wednesday's FED meeting may also be conducive to a slight weakening of PLN. If our forecasts materialize, the reading of ISM for the US manufacturing, domestic data (flash estimate of inflation, PMI) and business survey results in China should not have a substantial impact on PLN.

Possible further increase in yields



Source: Reuters

Last week the yield of Polish 2-year benchmark bonds rose to a level of 1.806 (up by 4 bp), of 5-year bonds to a level of 2.522 (up by 8 bp), and of 10-year bonds to a level of 3.134 (up by 18 bp). Monday through Friday, yields on Polish bonds were increasing across the curve, following the core markets. We believe that it was due to the increase in global risk aversion, reflected by higher VIX index. In our view, it resulted from growing expectations of normalization of the US monetary policy and political risk related to the approaching presidential elections in that country. On Friday before noon there was a correction, however the afternoon's higher-than-expected data on the US GDP were conducive to a continuation of increase in yields on Polish bonds, visible especially at the long end of the curve.

This week, the Polish debt market will focus on data from the US labour market. They may be conducive to an increase in yield on Polish bonds, we believe. The text of the press release after the Wednesday's FED meeting may also be conducive to a slight increase in yields at the other end of the curve. We believe that the reading of ISM for the US manufacturing and domestic data (flash estimate of inflation, PMI) will not be market moving.

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	**4,34**
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	**3,95**
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	**3,99**
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	8,3	
Current account (M EUR)	-550	-165	28	-846	679	-652	-217	492	389	113	-635	-1047		
Exports (% YoY EUR)	4,3	5,2	10,7	10,8	-1,3	5,4	0,0	4,1	0,0	5,7	-5,1	8,0		
Imports (% YoY EUR)	6,2	-1,0	6,3	4,4	0,3	7,4	0,9	0,3	1,5	0,4	-6,8	10,4		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland

Indicator	2016				2017				2015	2016	2017
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Gross Domestic Product (% YoY)	3,0	3,1	2,8	2,9	3,3	3,5	3,3	3,9	3,9	2,9	3,5
Private consumption (% YoY)	3,2	3,3	4,0	4,0	4,0	3,7	3,0	3,1	3,2	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	6,1	-2,7	4,7
Export - constant prices (% YoY)	6,9	10,9	6,6	6,6	7,2	7,0	6,1	7,0	7,7	7,7	6,8
Import - constant prices (% YoY)	9,3	9,9	6,0	6,1	6,9	6,3	6,6	7,3	6,6	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
GDP growth contributions: Investments (pp)	-0,2	-0,9	-0,7	-0,4	0,4	0,7	0,9	1,4	1,2	-0,5	0,9
GDP growth contributions: Net exports (pp)	-0,9	0,8	0,4	0,4	0,4	0,6	-0,1	0,2	0,8	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	-0,8	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 10/31/2016				
11:00	Eurozone	Preliminary GDP (% QoQ)	Q3	0,3	0,3	0,3
11:00	Eurozone	Preliminary HICP (% YoY)	Oct	0,4	0,5	0,5
13:30	USA	Real private consumption (% MoM)	Sep	-0,1		
14:00	**Poland**	**Flash CPI (% YoY)**	**Oct**	**-0,5**	**-0,3**	**-0,3**
14:45	USA	Chicago PMI (pts)	Oct	54,2		54,0
		Tuesday 11/01/2016				
2:00	China	NBS Manufacturing PMI (pts)	Oct	50,4	50,4	50
2:45	China	Caixin Manufacturing PMI (pts)	Oct	50,2	50,4	50
14:45	USA	Flash Manufacturing PMI (pts)	Oct	53,2	53,2	
15:00	USA	ISM Manufacturing PMI (pts)	Oct	51,5	51,3	51,7
		Wednesday 11/02/2016				
9:00	**Poland**	**Manufacturing PMI (pts)**	**Oct**	**52,2**	**52,9**	**52,9**
9:55	Germany	Final Manufacturing PMI (pts)	Oct	55,1	55,1	55,1
10:00	Eurozone	Final Manufacturing PMI (pts)	Oct	53,3	53,3	53,3
13:15	USA	ADP employment report (k)	Oct	154		165
19:00	USA	FOMC meeting (%)	Nov	0,25	0,25	0,25
		Thursday 11/03/2016				
11:00	Eurozone	Unemployment rate (%)	Sep	10,1		10,0
13:00	UK	BOE rate decision (%)	Nov	0,25	0,25	0,25
14:30	USA	Initial jobless claims (k)	w/e	260		260
15:00	USA	Factory orders (% MoM)	Sep	0,2	0,1	0,2
15:00	USA	ISM Non-Manufacturing Index (pts)	Oct	57,1	56,0	56,0
		Friday 11/04/2016				
10:00	Eurozone	Services PMI (pts)	Oct	53,5	53,5	53,5
10:00	Eurozone	Final Composite PMI (pts)	Oct	53,7	53,7	53,7
11:00	Eurozone	PPI (% YoY)	Sep	-2,1		-1,8
13:30	USA	Unemployment rate (%)	Oct	5,0	4,9	4,9
13:30	USA	Non-farm payrolls (k MoM)	Oct	156	185	175

*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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