What next with Poland's ratings?

This week

- **The most important event this week will be the Thursday's reading of the December industrial production and retail sales in Poland.** We forecast that industrial production dynamics dropped to 3.0% YoY in December vs. 3.3% in November. The higher-than-expected December publication of PMI poses a slight upside risk to our forecast. In turn, the nominal retail sales growth rate rose, in our view, to 6.9% YoY in December vs. 6.6% in November, due to higher Christmas spending than the year before, increase in retail prices, and improved consumer sentiment. We believe that the aggregate impact of the data will be slightly positive for PLN and yields on Polish bonds.
- **The ECB meeting will be held on Thursday.** In our view, it will not bring any changes in the Eurozone monetary policy. Questions about the future evolution of the ECB monetary policy in the context of the sharp December increase in inflation in the Eurozone (see MACROmap of 9/1/2017) may be raised at the press conference. PLN and the prices of the Polish debt may show increased volatility during the conference after the ECB meeting.
- **Important data from China will be released on Friday.** We expect that the economic growth rate has not changed in Q4 compared to Q3 and amounted to 6.7% YoY. In addition, other monthly data (industrial production, retail sales, and urban investments) will point, in total, to a slight acceleration in the pace of economic activity in December. Our forecast of GDP dynamics is equal to the market consensus; therefore, we expect that the aggregate impact of the above readings will be neutral for PLN.
- **Significant hard data on US economy and business survey results will also be released this week.** We expect industrial production to have increased by 0.9% MoM in December vs. a 0.4% decline in November, due to higher production growth in manufacturing. We expect that the data on housing starts (1164k in December vs 1090k in November) and building permits (1237k vs. 1212k) will confirm the recovery in the US real estate market. Mixed results of business surveys for manufacturing will also be released this week. We forecast that the NY Empire State Index dropped to 4.5 pts in January vs. 9.0 pts in December 2016, while Philadelphia Fed Index declined to 16.2 pts n January vs. 19.7 pts in December. We believe that the aggregate impact of data on the US economy on the financial market will be limited. The ceremony of the president-elect Donald Trump taking the oath of office will take place on Friday and will be followed by a traditional inaugural address. Donald Trump will deliver the address after the closing of the financial markets and its impact on the debt market and PLN, if any, will materialize in the following week.
- **ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany will be released on Tuesday.** The market expects that its value will increase to 18.8 pts in January vs. 13.8 pts in December 2016.
- **The December data on average wages and employment in the corporate sector in Poland will be released on Wednesday**. We forecast that employment dynamics dropped to 2.9% YoY in December vs. 3.1% in November. In turn, the average wage dynamics dropped to 3.7% YoY in December vs. 4.0% in November (the effect of lower bonuses paid in mining). The release of data on corporate wages and employment will confirm strong recovery in the labour market. The data will be neutral for PLN and the debt market, we believe.

Last week

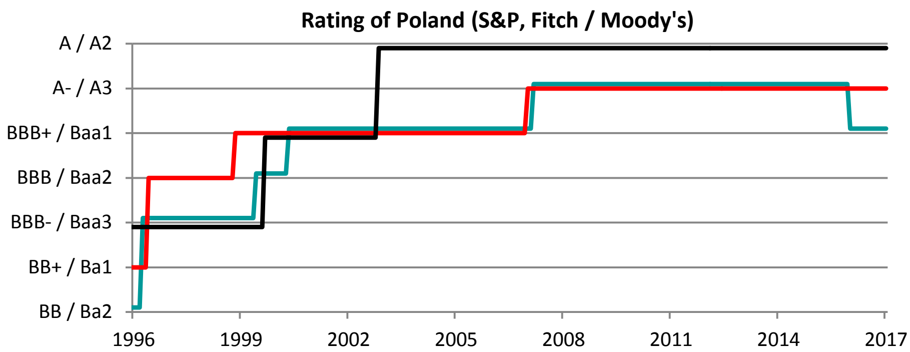
- **As we expected, the Monetary Policy Council left interest rates unchanged at its meeting last week (the reference rate amounts to 1.50%).** The bias of the Council's statement has not substantially changed compared to the December press release. The MPC maintained the view that given the available 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. In the Council's opinion, the GDP growth in Q4 2016 was probably subdued, however, in its view, monthly data signaled some improvement in economic activity over the recent past. The Council expressed the opinion that the fall in investment in Q4 was – like in Q3 – caused to a large extent by temporarily lower use of EU funds after the completion of the previous EU financial perspective. In addition, the Council emphasized that the increase in inflation had resulted mainly from factors beyond the direct impact of domestic monetary policy (see MACROpulse of 11/1/2017). During the press conference, Adam Glapiński expressed the view that the current parliamentary crisis in Poland would not have a substantial impact on the economic situation. He also believes that despite the anticipated significant increase in inflation, there are no reasons for changing interest rates in 2017. The remarks of A. Glapiński support our medium-term forecast of NBP rates, in which, due to inflation running close to the target and the expected by us solid economic growth, the Council will start the monetary tightening cycle in June 2018 and will increase interest rates in total by 50bp in 2018.

- **CPI inflation rose to 0.8% YoY in December vs. 0.0% in November**. The increase in CPI inflation was mainly due to higher dynamics of prices of fuel and food products, which raised inflation by 0.4 pp and 0.3 pp, respectively (see MACROpulse of 13/1/2017). Core inflation also recorded an increase to 0.0% YoY vs. -0.1% in November. We expect that due to the low base effects from the year before for fuel and energy price dynamics (electricity and gas price cuts in January 2016) and the electricity price rises introduced at the beginning of 2017, inflation will sharply increase to ca. 1.5-2.0% YoY in January. At the same time, we see an upside risk to our forecast of inflation in Q1 (1.5% YoY). In subsequent quarters of 2017, we expect a stabilization of CPI indicator within the range of 1.3-1.7% (1.5% on a yearly average). On the one hand, the closing of the output gap will be conducive to further increase in core inflation. On the other hand, the gradually abating low base effects for fuel prices will limit the increase in CPI indicator (see MACROmap of 12/12/2016).
- **The current account deficit dropped to EUR 427M in November from EUR 531M in October.** The slight increase in the current account balance was due to higher balances on goods and services (higher from October by EUR 230M and EUR 48M, respectively). Lower balance on secondary and primary income (lower from October by EUR 142M and EUR 32M, respectively) had an opposite impact. Export dynamics rose to 4.6% YoY in November vs. -2.3% in October, and imports dynamics rose to 6.4% YoY vs. 2.1%. Higher exports and imports growth rate was due to a favourable difference in the number of working days. The November data do not alter our forecast, in which the relation of cumulative current account balance for the last 4 quarters to GDP will decrease to -0.6% in Q4 vs. -0.5% in Q3.
- **Retail sales dynamics in the US rose by 0.6% MoM in December vs. 0.2% in November.** The acceleration in retail sales growth rate was mainly due to higher growth of car sales. Excluding car sales, retail sales rose by 0.2% MoM in December vs. a 0.3% increase in March. The preliminary University of Michigan Index was also released last week and decreased to 98.1 pts in January vs. 98.2 pts in December. The slight deterioration of consumer sentiment resulted from lower sub-index concerning expectations while improved assessment of current situation had an opposite impact. The last week's data from the US economy do not alter our forecast, in which the annualized GDP growth rate in the US amounted to 2.3% in Q4 vs. 3.4% in Q3.
- **Numerous data from the German economy were released last week**. GDP in Germany increased by 1.9% in 2016 vs. a 1.7% increase in 2015. Conducive to acceleration in economic growth were higher contributions of public consumption (0.8 ppt. in 2016 vs. 0.5 ppt. in 2015), investments (0.5 ppt. vs. 0.3 ppt.), and inventories (-0.4 ppt. vs. -0.5 ppt.), while lower contribution of net exports (-0.1 ppt. vs. 0.2 ppt.) had an opposite impact. The contribution of private consumption has not changed in 2016 compared to 2015 and amounted to 1.1 ppt., thus remaining the main source of growth of the German economy. Data on the German balance of trade were also released last week and its surplus rose to EUR 21.7M in November vs. EUR

20.6M in October. Import and export dynamics also recorded an increase (3.9% MoM in November vs. 0.5% in October and 3.5% vs. 1.2%, respectively). Data on industrial production were also released last week and its monthly growth rate dropped to 0.4% in November vs. 0.5% in October. The last week's data on the German GDP pose an upside risk to our forecast, in which the quarterly growth rate of the German GDP rose to 0.4% QoQ in Q4 vs. 0.2% in Q3 2016.

- **The surplus of Chinese foreign trade balance decreased to USD 40.8bn in December vs. USD 44.6bn in November**. At the same time, export dynamics dropped to -6.1% YoY in December vs. 0.1% in November, while import dynamics rose to 3.1% YoY vs. 6.7%. Thus, the data confirmed the slowdown in foreign demand for Chinese goods, signaled earlier by business survey results for Chinese manufacturing (see MACROmap of 9/1/2016). The last week's data do not alter our forecast, in which GDP in China rose by 6.7% in 2016 vs. a 6.5% increase in 2015. Thus, its growth rate was consistent with the targeted GDP growth set by the Chinese government for 2016 at a level "6.5-7.0".

What next with Poland's ratings?



Source: Reuters

The update of Poland's long-term rating by Fitch and Moody's were planned to be released last Friday. However, Moody's did not revise Poland's rating and did not issue a credit report. Thus, Poland's rating was left at an unchanged level (A2 with negative outlook). A next rating assessment is planned for May 2017. Factors indicated by Moody's in earlier reports – i.e. lowering of retirement age contributing to deterioration in public finances, continued decline in investments, and crisis regarding the Constitutional Court – will pose a downside risk to Poland's credit rating at the time of its next assessment.

As we expected, Fitch rating agency left Poland's long-term rating unchanged at A- with stable outlook. In the justification of the decision, Fitch indicated that the current rating reflected the sound macroeconomic fundamentals of the Polish economy, including i.a. a well-capitalized banking sector and public debt at a similar level to other countries with the same rating. At the same time, Fitch highlighted a risk in the form of a relatively high – compared to other countries – Poland's net external debt.

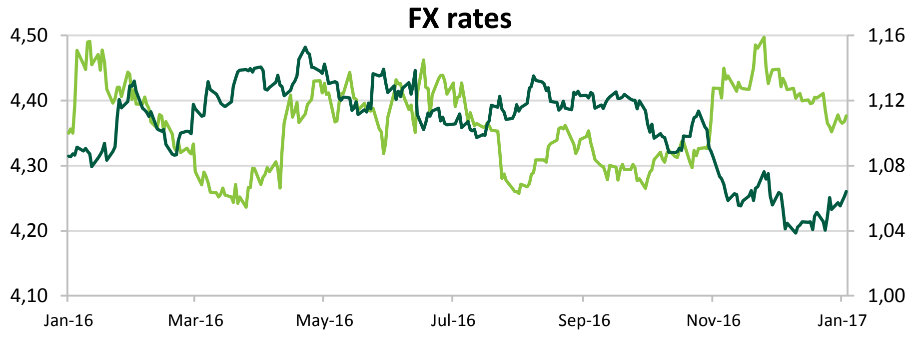
The press release emphasized that the government-proposed conversion of mortgage loans through banks reimbursing clients for the cost of foreign currency spreads they incurred was not a threat to financial stability. We believe that the implementation of the recommendation of the Financial Stability Committee on restructuring the mortgage loans portfolio that was presented last Friday should contribute to further improvement of the rating agency's assessment of the stability of the financial sector in Poland. The recommendation includes i.a. increasing risk weight for foreign currency mortgage loans and imposing a 3% systemic risk buffer when estimating capital requirement, and including foreign currency mortgage loan risk when calculating banks' contributions to the Bank Guarantee Fund.

In its press release, Fitch again pointed to lower predictability of economic policy in Poland and deterioration in political climate since October 2015. In the agency's view, such changes pose an upside risk to public debt profile and may adversely affect Poland's economic outlook. However, the agency expects that the government will not exceed the EU budget deficit criterion (3% of GDP threshold), fearing Poland's being covered again by excessive deficit procedure. In its base scenario, Fitch forecasts an increase in the public finance deficit in relation to GDP from 2.5% in 2016 to 3.0% in 2017, due to the abatement of one-off factors on the income side (LTE frequency auction) and increase in outlays on public investments co-financed with EU funds, due to their increasing absorption. In its scenario, Fitch assumed fiscal tightening starting from 2018 with economic growth rate staying slightly above 3.0% YoY. This means that the agency probably assumes budget adjustments, which will offset growing public expenditures in the coming years related to lowering of the retirement age. Fitch forecasts that in this scenario public debt will rise from 53.0% of GDP in 2016 to 54.6% in 2017 and will stabilize close to this level in subsequent years. The main risk to this forecast is a failure to tighten fiscal policy in the medium term, slower-than-expected economic growth rate, and PLN weakening, conducive to higher debt nominated in foreign currency.

The rating's stable outlook means that upside and downside risks to Poland's credit rating are balanced. According to Fitch, potentially negative for the rating will be the risk of exceeding the EU criterion for budget deficit (3% of GDP threshold) or lack of the fiscal tightening expected by the agency in order to stabilize public debt in relation to GDP in the medium term. Another risk is changes in economic policy, which could contribute to deterioration of investment climate and may threaten macroeconomic stability and prospects for economic growth. On the other hand, the rating could be upgraded, should high economic growth rate be maintained, boosting convergence to countries with A rating, and should net external debt decrease.

We expect that in the coming years the government will conduct the fiscal policy in such a way as to ensure that the general government deficit does not exceed 3% of GDP. According to the results of our simulations, in the conditions of moderate recovery and inflation running close to target, we should see stabilization or slight decrease in public debt in relation to GDP starting from 2017. To a great extent, it will result from the assumed by us strengthening of PLN conducive to a decrease of foreign debt expressed in PLN. Therefore, if the macroeconomic assumptions expected by us in the base scenario materialize, fiscal policy aiming at maintaining the public deficit equal to 3% of GDP would not pose a risk to the stability of public finance in medium term. However, it will not lead to a significant decrease in public debt in relation to GDP, which would give Poland a safety margin in public finances in the event of a significant multiyear deterioration of economic situation. At the same time, due to a stronger inflow of EU funds within the new programming period, we should see a decrease in net external debt in relation to GDP. Fitch forecasts its decrease from 31.4% of GDP in 2016 to 28.6% in 2018. In result, considering the risk factors to Poland's rating outlined in Fitch's report, we expect that Fitch will not change Poland's rating and will maintain its stable outlook in the horizon of several quarters.

Polish data may strengthen PLN

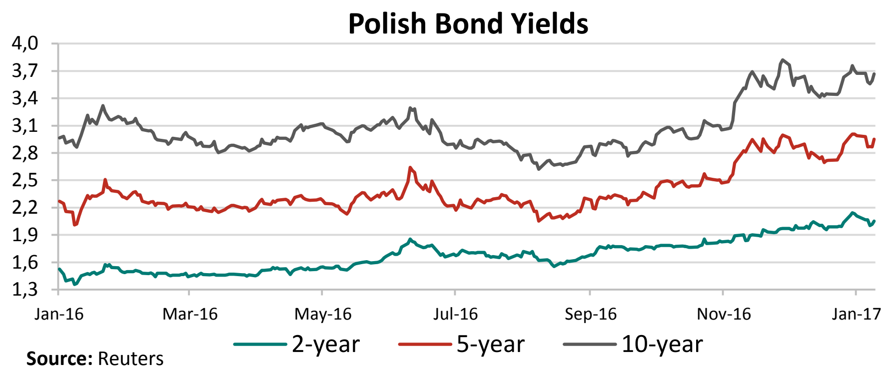


Source: Reuters

Last week EURPLN rate rose to 4.3766 (PLN weakening by 0.6%). From Monday morning, PLN and other currencies of the region were depreciating. Considering that no important macroeconomic data were released on that day, it was likely a correction after the appreciation of emerging currencies which continued for the last two weeks (see MACROmap of 9/12/2016). At the Tuesday opening, PLN partly made up for the losses from the previous day and its rate remained stable until the end of the week, oscillating around 4.37 to EUR, supported by scarce macroeconomic calendar. Friday afternoon saw increased volatility of PLN, due to uncertainty related to the evening update of Poland's rating by Moody's and Fitch (see above).

The Friday's decisions of Fitch and Moody's rating agencies on leaving Poland's rating unchanged were in line with market expectations and therefore will not materially affect PLN, we believe. Crucial for PLN this week will be the Thursday's domestic data on industrial production and retail sales. If our forecasts materialize, the aggregate impact of the data will be slightly positive for PLN. In our view, the Thursday's ECB meeting will also be important for PLN, being conducive to its increased volatility. Other domestic data (corporate wages and employment), data from the US (industrial production, housing starts, building permits, as well as Philadelphia Fed and NY Empire State Indices), and data from China (GDP in Q4, retail sales, industrial production, urban investments) will not be market moving, we believe. The possible impact of D. Trump's Friday inaugural address on PLN will materialize next week (see above).

Polish debt market focuses on domestic data



Source: Reuters

Last week the yield of Polish 2-year benchmark bonds dropped to a level of 2.051 (down by 5 bp), of 5-year bonds dropped to a level of 2.949 (down by 4 bp), and of 10-year bonds has not changed compared to the level from two weeks ago and amounted to 3.668. Monday through Wednesday, a decline in yields on Polish bonds across the curve was observed, following the US bonds. In our view, the decline in yields on US bonds may have occurred partly due to no information from D. Trump concerning future fiscal policy of his administration, which weakened the expectations of higher economic growth rate and inflation in the US and, consequently, sooner normalization of the monetary policy by FED. On Thursday, the trend reversed, which may have been partly due to increased uncertainty in the domestic debt market caused by the Friday evening update of Poland's rating by moody's and Fitch.

The Friday's decisions of Fitch and Moody's rating agencies on leaving Poland's rating unchanged were in line with market expectations and therefore their impact on the prices of the Polish debt will be limited, we believe. In our view, this week the Polish debt market will focus on Thursday's domestic data on retail sales and industrial production, whose aggregate impact will be positive for yields on Polish bonds. On Thursday, we also expect increased volatility of the prices of the Polish debt due to the ECB meeting. Other data from the Polish economy (corporate wages and employment), like data from the US (industrial production, housing starts, building permits, as well as Philadelphia Fed and NY Empire State Indices) will be neutral for the Polish debt market, we believe. The possible impact of D. Trump's inaugural address scheduled for Friday on yields on Polish bonds will materialize next week (see above).

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17
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*	4,26	4,42	4,35	4,24	4,37	4,38	4,38	4,35	4,36	4,29	4,31	4,45	4,40	**4,44**
USDPLN*	3,92	4,08	4,00	3,73	3,81	3,94	3,94	3,90	3,91	3,82	3,92	4,20	4,18	**4,23**
CHFPLN*	3,91	3,98	4,00	3,87	3,97	3,96	4,04	4,02	3,97	3,93	3,96	4,13	4,11	**4,14**
CPI inflation (% YoY)	-0,5	-0,9	-0,8	-0,9	-1,1	-0,9	-0,8	-0,9	-0,8	-0,5	-0,2	0,0	0,8	
Core inflation (% YoY)	0,2	-0,1	-0,1	-0,2	-0,4	-0,4	-0,2	-0,4	-0,4	-0,4	-0,2	-0,1	**0,0**	
Industrial production (% YoY)	6,7	1,4	6,8	0,7	5,9	3,2	6,0	-3,4	7,5	3,2	-1,3	3,3	**3,0**	
PPI inflation (% YoY)	-0,8	-1,2	-1,5	-1,9	-1,2	-0,4	-0,8	-0,5	-0,1	0,2	0,6	1,7	**2,5**	
Retail sales (% YoY)	4,9	0,9	3,9	0,8	3,2	2,2	4,6	2,0	5,6	4,8	3,7	6,6	**6,9**	
Corporate sector wages (% YoY)	3,1	4,0	3,9	3,3	4,6	4,1	5,3	4,8	4,7	3,9	3,6	4,0	**3,7**	
Employment (% YoY)	1,4	2,3	2,5	2,7	2,8	2,8	3,1	3,2	3,1	3,2	3,1	3,1	**2,9**	
Unemployment rate* (%)	9,7	10,2	10,2	9,9	9,4	9,1	8,7	8,5	8,4	8,3	8,2	8,2	**8,3**	
Current account (M EUR)	-846	679	-652	-217	691	1392	-723	-993	-739	-445	-531	-427		
Exports (% YoY EUR)	10,8	-1,3	5,4	0,0	4,0	1,4	6,0	-5,2	9,2	2,7	-2,3	4,6		
Imports (% YoY EUR)	4,4	0,3	7,4	0,9	0,0	2,5	0,8	-6,9	10,8	3,1	2,1	6,4		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland

Indicator		2016				2017				2016	2017	2018
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Gross Domestic Product (% YoY)		3,0	3,1	2,5	1,7	2,6	2,4	3,0	3,9	2,5	3,0	3,2
Private consumption (% YoY)		3,2	3,3	3,9	3,9	3,6	3,6	2,9	2,8	3,6	3,2	2,9
Gross fixed capital formation (% YoY)		-2,2	-5,0	-7,7	-5,4	-1,0	1,3	6,1	8,2	-5,3	4,8	10,0
Export - constant prices (% YoY)		6,7	11,4	6,8	4,5	6,7	9,1	11,8	11,7	7,3	9,9	7,3
Import - constant prices (% YoY)		8,7	10,0	7,8	5,4	8,0	10,7	13,0	13,1	7,9	11,2	9,0
GDP growth contributions	Private consumption (pp)	2,0	1,9	2,3	1,9	2,3	2,1	1,7	1,4	2,1	1,9	1,7
	Investments (pp)	-0,3	-0,9	-1,4	-1,5	-0,1	0,2	1,1	2,1	-1,0	0,9	1,8
	Net exports (pp)	-0,7	1,0	-0,3	-0,3	-0,4	-0,3	-0,3	-0,1	-0,1	-0,3	-0,6
Current account***		-0,8	-0,5	-0,5	-0,6	-0,9	-1,0	-1,1	-1,0	-0,6	-1,0	-1,5
Unemployment rate (%)**		9,9	8,7	8,3	8,3	8,8	7,9	7,8	8,1	8,3	8,1	8,1
Non-agricultural employment (% YoY)		2,2	2,3	1,5	1,3	0,6	0,4	0,2	0,1	1,8	0,3	0,0
Wages in national economy (% YoY)		3,1	4,3	4,1	4,4	4,5	4,6	4,6	4,5	4,0	4,5	4,8
CPI Inflation (% YoY)*		-0,9	-0,9	-0,8	0,2	1,5	1,7	1,3	1,6	-0,6	1,5	2,3
Wibor 3M (%)**		1,67	1,71	1,71	1,73	1,73	1,73	1,73	1,73	1,73	1,73	2,23
NBP reference rate (%)**		1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	2,00
EURPLN**		4,24	4,38	4,29	4,40	4,35	4,33	4,23	4,18	4,40	4,18	4,07
USDPLN**		3,73	3,94	3,82	4,18	4,10	4,12	4,03	3,87	4,18	3,87	3,51

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
		Monday 01/16/2017				
14:00	**Poland**	**Core inflation (% YoY)**	**Dec**	**-0,1**	**0,0**	**0,0**
		Tuesday 01/17/2017				
11:00	Germany	ZEW Economic Sentiment (pts)	Jan	13,8		18,3
14:30	USA	NY Fed Manufacturing Index (pts)	Jan	9,0	16,2	9,0
		Wednesday 01/18/2017				
11:00	Eurozone	HICP (% YoY)	Dec	1,1		1,1
14:00	**Poland**	**Employment (% YoY)**	**Dec**	**3,1**	**2,9**	**3,1**
14:00	**Poland**	**Corporate sector wages (% YoY)**	**Dec**	**4,0**	**3,7**	**4,0**
14:30	USA	CPI (% MoM)	Dec	0,2	0,3	0,3
14:30	USA	Core CPI (% MoM)	Dec	0,2	0,2	0,2
15:15	USA	Industrial production (% MoM)	Dec	-0,4	0,9	0,6
15:15	USA	Capacity utilization (%)	Dec	75,0	75,6	75,4
		Thursday 01/19/2017				
10:00	Eurozone	Current account (bn EUR)	Nov	28,4		
13:45	Eurozone	EBC rate decision (%)	Jan	0,00	0,00	0,00
14:00	**Poland**	**Industrial production (% YoY)**	**Dec**	**3,3**	**3,0**	**1,8**
14:00	**Poland**	**Retail sales (% YoY)**	**Dec**	**6,6**	**6,9**	**6,1**
14:00	**Poland**	**PPI (% YoY)**	**Dec**	**1,7**	**2,5**	**2,6**
14:30	USA	Philadelphia Fed Index (pts)	Jan	21,5	16,2	16,0
14:30	USA	Housing starts (k MoM)	Dec	1090	1164	1190
14:30	USA	Building permits (k)	Dec	1212	1237	1225
		Friday 01/20/2017				
:	China	GDP (% YoY)	Q4	6,7	6,7	6,7
:	China	Retail sales (% YoY)	Dec	10,8	10,9	10,7
:	China	Industrial production (% YoY)	Dec	6,2	6,1	6,1
:	China	Urban investments (% YoY)	Dec	8,3	8,5	8,3

*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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