Investments in Poland to recover later than in the region

This week

- **The results of business surveys for major European economies will be released on Tuesday.** We expect that PMI Composite for the Eurozone rose to 54.7 pts in January vs. 54.4 pts in December 2016. The index should increase given an improvement in Germany and a slight deterioration of sentiment in France. Ifo Index, reflecting the sentiment among German managers representing the manufacturing, construction, wholesale and retail trade sectors, will be released on Wednesday. We expect the index value to increase to 111.4 pts in January from 111.0 pts in December. Our forecasts concerning business survey results for major European economies are close to the consensus; therefore, the reading is likely to be neutral for PLN and prices of Polish bonds.
- **Significant data on US economy and business survey results will be released this week.** Preliminary December data on durable goods orders will be released on Friday. In our view, they increased by 7.0% MoM vs. a 4.5% decrease in November (i.a. the effect of higher orders in the Boeing company). The flash estimate of the US GDP in Q4 2016 will also be released on Friday. We expect that the annualized economic growth rate dropped to 2.1% vs. 3.5% in Q3 due to lower contributions of net exports and consumption. Data concerning the real estate market will also be released this week. We believe that new home sales rose to 604k in December vs. 592k in November, while existing home sales dropped to 5.50M vs. 5.61M. We expect that the final University of Michigan Index will point to stabilization of consumer sentiment in January (98.1 pts vs. 98.2 pts in December). We believe that the reading of durable goods orders will be conducive to a slight weakening of PLN and to lower prices of Polish bonds. Other US data should not be market moving.

Last week

- **Donald Trump delivered his inaugural address last week.** He maintained the promises from the election campaign that his administration will carry out protectionist economic policy. The promises of a significant increase in infrastructural investments were also repeated in the address. D. Trump’s remarks were of a general nature and failed to provide any new specific information on the future economic policy in the US. We expect that the scope of protectionist actions of the new government will be limited and the main effect of the launch of D. Trump’s economic program will be fiscal expansion (higher public investments and/or lower taxes). The expected by us changes in the US economic policy, leading to excessive demand in the economy, are consistent with our scenario, in which FED will increase interest rates by 50 bp in total in the whole 2017. D. Trump’s Friday address was neutral for global financial markets, we believe.
- **Industrial production in Poland rose by 2.3% YoY in December vs. a 3.3% increase in November**. We believe that last year the increase in production in some branches shifted from October to November, compared to the seasonal pattern from previous years. Consequently, a significant decline in the annual production growth was recorded in October and its stronger-than-expected increase was observed in November. After the abatement of this effect, the production growth rate returned in December to a level consistent with short-term trend (see MACROpulse of 19/1/2017). In the whole Q4, industrial production in Poland rose by 1.4% YoY vs. 2.3% in Q3. The construction and assembly production dropped by 8.0% YoY in December vs. a 12.8% decline in November. Seasonally-adjusted construction and assembly production rose by 2.5% MoM. The construction-and-assembly production increased despite the negative statistical effects and thus this increase is yet another signal of sustainable improvement in this branch. In the whole Q4, the construction-and-assembly production dropped to 13.2% YoY vs. a 18.1% decline in Q3. The data on industrial production and construction-and-assembly

production for Q4 pose a substantial upside risk to our scenario, in which economic growth will slow down to 1.7% YoY from 2.5% in Q3.

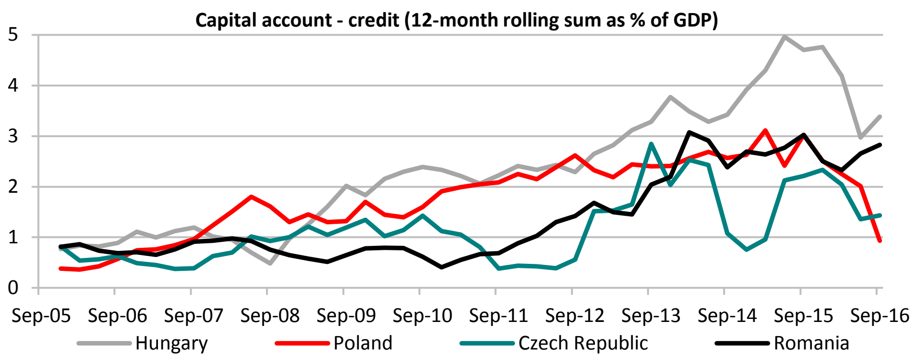
- **Nominal retail sales dropped to 6.4% YoY in December vs. a 6.6% increase in November**. The sales in constant prices rose by 6.1% YoY in December vs. 7.4% in November. Lower growth rate of retail sales occurred mainly due to lower dynamics of sales in the category "other" (down from -0.6% YoY in November to -8.4% in December). In the data, noteworthy is also the dynamics of prices of products included in retail sales which reached a positive level for the first time since March 2013 (see MACROpulse of 19/1/2017). In the whole Q4, real retails sales rose by 6.0% YoY vs. a 6.2% increase in Q3, which supports our forecast of stabilization of private consumption dynamics in Q4 vs. Q3 (3.9% YoY).
- **The ECB meeting was held last week.** As we expected, the existing monetary policy parameters were left unchanged. During the press conference after the meeting, the ECB Governor, M. Draghi, maintained dovish rhetoric, emphasizing that the December sharp increase in inflation in the Eurozone did not signal a significant increase in inflationary pressure as core inflation continued to stay low. The press release after the January meeting repeated the announcement that the expanded asset purchase program would last at least until December 2017. Our base scenario assumes that the ECB will extend the program until March 2018 and then will gradually taper the program until its termination in December 2018.
- **Numerous data from the US economy were released last week.** Industrial production growth increased to 0.8% MoM in December vs. -0.7% in November. Conducive to its increase was higher growth in all its branches (in manufacturing, mining, and utilities). Capacity utilization rose to 75.5% in December vs. 74.9% in November. Data on the number of house starts (1210k in December vs. 1212k in November) and building permits (1226k vs. 1102) were also released last week and pointed to the sustainability of the recovery in the US real estate market. The results of regional business sentiment surveys were also released for the US manufacturing. The NY Empire State Index dropped to 6.5 pts in January vs. 7.6 pts in December, while Philadelphia FED Index rose to 23.6 pts vs. 21.5 pts. The last week's data from the US economy do not alter our forecast, in which the annualized economic growth rate will amount to 2.1% in Q4 vs. 3.5% in Q3 (see below).
- **Numerous data on the Chinese economy were released last week.** The economic growth rate dropped to 1.7% QoQ in Q4 vs. 1.8% in Q3 (6.8% YoY in Q4 vs. 6.7% in Q3). December monthly data on industrial production (6.0% YoY in December vs. 6.2% in November), retail sales (10.9% vs. 10.8%), and urban investments (8.1% YoY vs. 8.3%) indicated a similar to the month before rate of growth of activity in the Chinese economy. In the whole 2016, GDP in China rose by 6.7% vs. a 6.5% increase in 2015, which was in line with our forecast. Its growth rate was consistent with the targeted GDP growth set by the Chinese government for 2016 at a level "6.5-7.0%". We believe that the economic growth rate in China will amount to 6.6% in 2017.
- **ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany rose to 16.6 pts in January vs. 13.8 pts in December, thus hitting the highest level since June 2016**. According to the press release, conducive to improved sentiment was the better-than-expected January reading of GDP in Germany for 2016 and the November industrial production in the Eurozone. We forecast that the growth rate of the German GDP will amount to 1.5% in 2017 vs. 1.9% in 2016.
- **Nominal wage dynamics in the Polish corporate sector dropped to 2.7% YoY in December vs. 4.0% in November**. In our view, one of the main factors conducive to its decline was changed timing of annual bonuses paid in the section "coal mining and quarrying", including in particular the payment in installments of the bonus marking St. Barbara's Day, being the sector's holiday, in Jastrzębska Spółka Węglowa (see MACROpulse of 18/1/2017). Corporate employment rose by 3.1% YoY in December. In effect, the real wage fund growth (employment times average wages) in enterprises dropped to 6.4% YoY in Q4 vs. 8.6% in Q3. The last week's data on corporate wages and employment confirm that the labour market in Poland is in the phase of

strong recovery. This is in line with our scenario, in which the labour market will reach equilibrium at the turn of 2017 and 2018 (see MACROmap of 12/12/2016).

Investments in Poland to recover later than in the region

A sharp deepening decline in investments has been observed in Poland since the beginning of last year. The visible decline in the dynamics of fixed capital formation was frequently attributed to low absorption of EU funds at the beginning of the new programming period 2014-2020. To verify this hypothesis we have analyzed below the profile of investments in Poland against the backdrop of some other countries of the Central and Eastern Europe – Czech Republic, Hungary and Romania (hereinafter CEE-4).

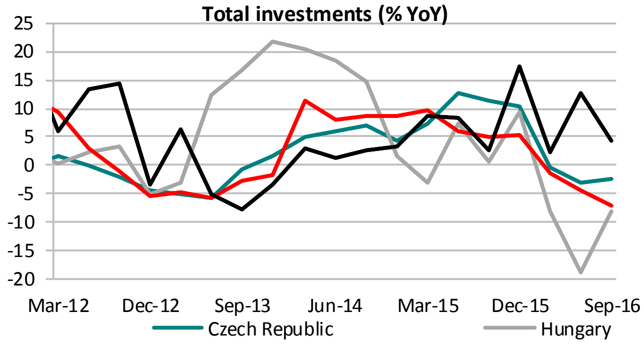
According to the originally binding regulations of the European Commission, the EU funds from the 2007-2013 programming period were to be utilized before the end of 2015. Considering the degree of allocation of the funds at the beginning of Q4 2015, there was a significant risk that, under the existing limitations, the available funds would not have been fully utilized and consequently would have been wasted. That is why solutions ensuring a flexible closing of programs in 2016 for member countries were agreed in consultation with the EC towards the end of 2015, guaranteeing optimal level of utilization of funds from the 2007-2013 programming period. This solution was especially beneficial for Romania. As at the end of December 2015, Romania has used only ca. 60% of funds available under operating programs while in the case of Poland and Hungary the absorption amounted to ca. 90% and for Czech Republic to 85%.

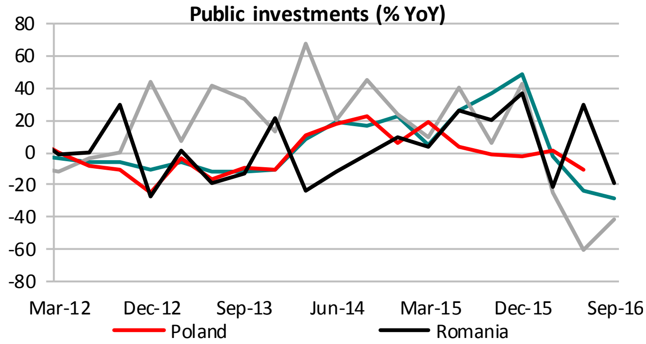


Source: Eurostat, Datastream, Credit Agricole

To assess the scale of the inflow of EU funds to CEE-4 countries, we have used the revenues (credit) in the capital account in the balance of payments. This item includes capital transfers of investment nature (for CEE-4 countries these are mainly incoming EU funds under structural and investment programs). From the beginning of 2016, in the case of Poland, Hungary and Czech Republic, a clear decline in capital account revenues in relation to GDP has been recorded (rolling sum for the last four quarters). On the other hand, in the case of Romania, which in 2016 continued to benefit largely from the funds from the previous programming period, no such decline has been observed. In addition, the absorption of EU funds under the 2007-2013 programming period clearly increased in Romania to ca. 75% as at the end of Q3 2016.

Investments in Poland to recover later than in the region





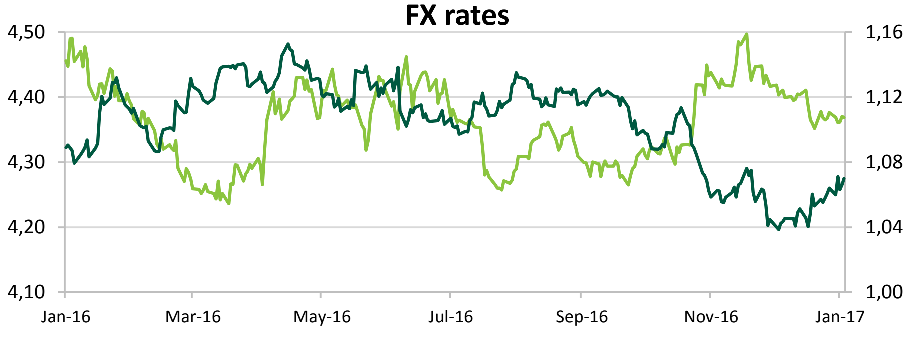
Source: Eurostat, Credit Agricole

Poland, Hungary and Czech Republic have recorded a decline in total investments in annual terms from the beginning of 2016, which occurred largely due to slower growth of fixed capital formation of the general government sector. The time consistent trend towards declining investments in three different countries shows that this phenomenon had a common cause in the form of smaller absorption of EU funds. This view is confirmed by the case of Romania which stands out positively against the backdrop of the other three countries. In the case of Romania, the growth rate of investments stayed clearly above zero between Q1 and Q3 2016. In addition, the decline in investment growth was stopped as early as in Q2 2016. In the case of Poland, an additional factor conducive to decline in public investments in 2016 was the political cycle in local governments. In 2016, local governments decided to limit fixed capital formation with a view to obtaining savings. We believe that the approaching local government elections in 2018 will encourage them to increase investments in H2 2017 and in the whole 2018.

It should be pointed out that in the case of Poland the scale of the decline in total investments in H1 2016 was similar as in Hungary and in Czech Republic. In turn, in Q3, this scale was reduced in Hungary and in Czech Republic while in Poland the decline in gross fixed capital formation deepened. This trend is consistent with the data on EU funds inflow in the capital account – in Q3 the absorption of the funds intensified in other countries of the region while in Poland the utilization of funds continued to stay low. This means that in Poland we were dealing with a delay in the implementation of funds in most operating programs as compared to Czech Republic and Hungary. Problems with the absorption of EU funds resulted i.a. from the implementation of the EU directives required by the European Commission and the necessary verification and updating of sector investment plans. The adoption of plans harmonized with the EU law was a condition of the disbursement of payments within the new programming period. This problem was especially visible in the case of i.a. railway sector and utilities sector (see MACROmap of 31/10/2016). In our view, the legislative delays occurred partly due to changes on the political scene after the parliamentary elections in October 2015.

We believe that the so-far difficulties in the utilization of EU funds and in the implementation of the operating programs and their negative impact on investment growth between Q1 and Q3 2016 do not threaten the expected by us economic recovery in 2017, as, according to the NBP data on the balance of payments, a clear increase in the inflow of funds in the capital account was recorded in November 2016 (EUR 942M vs EUR 33M in October). These data pose an upside risk to our forecast of increase in total investment growth up to -5.4% YoY in Q4 2016 from -7.7% in Q3. We believe that subsequent months will see an increasingly growing absorption of EU funds within the new programming period. Consequently, we forecast that the growth rate of total investments will run above zero in H1 2017 (see the quarterly table). Conducive to increase in fixed capital formation will also be higher investment activity of local governments in H2 2017 and in the whole 2018 (see above).

US data may weaken PLN

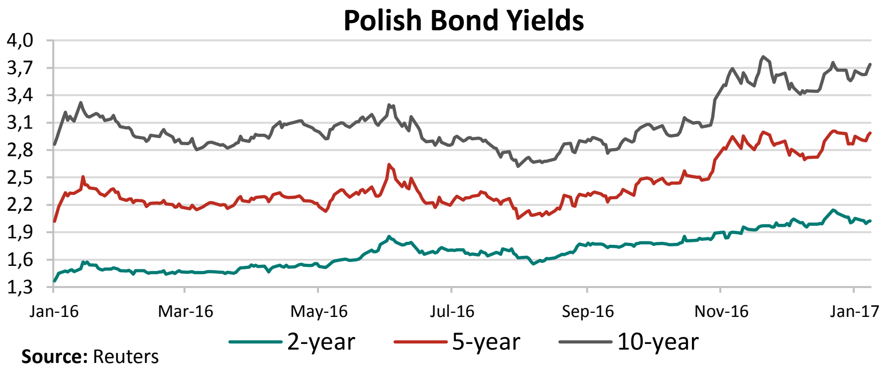


Source: Reuters

Last week EURPLN rate dropped to 4.3687 (PLN strengthening by 0.2%). Monday opening saw increased volatility of PLN and further into the day PLN strengthened. The appreciation of PLN was boosted by Fitch and Moody's decisions, published two weeks ago, on leaving Poland's rating unchanged. On Tuesday, PLN continued to appreciate, which was largely due to lower global risk aversion, reflected by lower VIX index. Wednesday saw a temporary depreciation of PLN. Due to no important events or macroeconomic readings on that day, its temporary depreciation was most likely of a transactional nature. This view is supported by the fact that it was recorded also for some other emerging currencies. On Thursday, due to the ECB meeting, PLN showed increased volatility. On Friday, PLN was stable and data on GDP in China release on Thursday to Friday night had a limited impact on the market.

The Friday's inaugural address of D. Trump (see above) should not have any substantial impact on PLN, we believe. Important for PLN will be the Friday's preliminary data on durable goods orders in the US, which, if our higher-from-the-consensus forecast materializes, it will be conducive to PLN depreciation. The aggregate impact of other data from the US (flash GDP in Q4, existing home sales, new home sales, final University of Michigan Index) on PLN will be limited, we believe. In our view, today's PMI readings for major European economies and the Wednesday's Ifo index for Germany will also be neutral for PLN.

Polish debt market focuses on US data



Source: Reuters

Last week the yield of Polish 2-year benchmark bonds dropped to a level of 2.025 (down by 3 bp), of 5-year bonds rose to a level of 2.985 (up by 4 bp), and of 10-year bonds rose to a level of 3.739 (up by 7 bp). On Monday, Polish bonds opened lower than they closed on Friday, which was due to Fitch and Moody's decisions, published two weeks ago, on leaving Poland's rating unchanged. Further into the week, a weak upward trend continued for Polish bonds especially visible in the middle and at the long end of the curve following core markets (US and Germany). In our view, this was related to the market expectations of the Friday's inaugural address of the US President, D. Trump.

The Friday's inaugural address of D. Trump (see above) should not have any substantial impact on the prices of Polish bonds, we believe. The Polish debt market will focus on the Friday's preliminary data on durable goods orders in the US, which, if our higher-from-the-consensus forecast materializes, may be positive for yields on Polish bonds. Other data from the US (flash GDP in Q4, existing home sales, new home sales, final University of Michigan Index) will not have a significant impact on the Polish debt market, we believe. Today's PMI readings for major European economies and the Wednesday's Ifo index for Germany will also be neutral for the prices of Polish bonds.

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	**4,37**
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	**4,07**
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	**4,07**
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	2,3	
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	3,0	
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	6,4	
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	2,7	
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	3,1	
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
GDP growth contributions: Investments (pp)	-0,3	-0,9	-1,4	-1,5	-0,1	0,2	1,1	2,1	-1,0	0,9	1,8
GDP growth contributions: 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	FORECAST* CONSENSUS**
		Tuesday 01/24/2017				
9:30	Germany	Flash Manufacturing PMI (pts)	Jan	55,6	55,4	55,4
10:00	Eurozone	Flash Services PMI (pts)	Jan	53,7	53,9	53,9
10:00	Eurozone	Flash Manufacturing PMI (pts)	Jan	54,9	55,2	54,8
10:00	Eurozone	Flash Composite PMI (pts)	Jan	54,4	54,7	54,5
15:45	USA	Flash Manufacturing PMI (pts)	Jan	54,3		54,5
16:00	USA	Existing home sales (M MoM)	Dec	5,61	5,50	5,50
16:00	USA	Richmond Fed Index	Jan	8,0		
		Wednesday 01/25/2017				
10:00	**Poland**	**Registered unemplyment rate (%)**	**Dec**	**8,2**	**8,3**	**8,3**
10:00	Germany	Ifo busienss climate (pts)	Jan	111,0	111,4	111,2
		Thursday 01/26/2017				
16:00	USA	New home sales (k)	Dec	592	604	586
		Friday 01/27/2017				
10:00	Eurozone	M3 money supply (% MoM)	Dec	4,8		4,9
14:30	USA	Preliminary estimate of GDP (% YoY)	Q4	3,5	2,1	2,2
14:30	USA	Durable goods orders (% MoM)	Dec	-4,5	7,0	2,6
16:00	USA	Final U. of Michigan Sentiment Index (pts)	Jan	98,1	98,1	98,1

*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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