Which branches will follow public investments ?

This week

- **On Tuesday and Wednesday, the FED chair, J. Yellen, will present the semiannual monetary policy report to the Congress.** In our view, it will be particularly important due to the increased uncertainty concerning the prospects of the economic policy of D. Trump administration. J. Yellen will present the Federal Reserve's assessment of the current US and global economic situation and prospects of the FED monetary policy. Of particular importance in J. Yellen's testimony will be her answers to questions concerning the likely date of the nexr interest rate hike and the expected pace of the monetary policy tightening by the Federal Reserve. We believe that the assessments worded by the FED chair will reflect the persisting uncertainty regarding the macroeconomic effects of the economic policy conducted by D. Trump administration and her remarks may contribute towards increased volatility in the financial markets.
- **Significant hard data on US economy and business survey results will be released this week.** We expect industrial production dynamics to have dropped to 0.1% MoM in January vs. 0.8% in December, due to lower production growth in "utilities" category (warm January effect). We forecast that nominal retail sales rose by 0.1% MoM in January vs. a 0.6% increase in December, due to lower sales dynamics in the automotive branch. The sustainability of the recovery in the US real estate market will be confirmed by relatively high numbers of building permits (1240k in January vs. 1228k in December) and house starts (1177k vs. 1226k). Business survey results will also be released in the US. In our view, Philadelphia FED Index dropped to 18.6 pts in February from 23.6 pts in January, while the NY Empire State Index likely rose to 7.5 pts from 6.5 pts in January. We believe that the aggregate impact of the data on the US economy on the financial market will be limited.
- **Subsequent GDP estimates for major European economies will be released on Tuesday.** We expect that, like in the first estimate, the quarterly GDP dynamics in the Eurozone stood at 0.5% in Q4 2016 vs. 0.4% in Q3. The economic growth rate in Germany probably increased to 0.5% QoQ vs. 0.2% in Q3. ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany will be released on the same day. The market expects that its value will drop to 15.0 pts in February vs. 16.6 pts in January. The release of GDP data for the Eurozone and Germany will not have a significant impact on PLN or the Polish debt market, we believe.
- **Data on the January inflation in Poland, which in our view rose to 1.6% YoY vs. 0.8% in December, will be released today.** In our view, the increase in inflation rate was due to higher dynamics of energy and fuel prices and higher core inflation. We expect that the publication of the inflation reading, lower than the market expectations (1.7%), will be slightly negative for PLN and yields on Polish bonds.
- **Data on the Polish balance of payments in December 2016 will be released today**. We expect the current account balance to increase to EUR 145M vs. EUR -427M in November 2016, mainly due to higher balance of transfers with the European Union. We forecast that export dynamics slightly dropped from 4.6% YoY in November to 4.5% in December, while import growth rate dropped from 6.4% YoY to 4.4%. In our view, data suggesting current account balance in December higher from the market expectations (PLN -726M) may be conducive to a strengthening of PLN.
- **The preliminary reading of GDP in Poland in Q4 2016 will be released on Tuesday.** We forecast that the GDP growth rate rose to 2.6% YoY from 2.5% in Q3 2016. Conducive to faster GDP growth were higher contributions of net exports and inventories (see MACROpulse of 31/1/2017). The GDP reading should not be market moving.
- **The January data on average wages and employment in the corporate sector in Poland will be released on Thursday**. GUS will make the annual revision of the number of people employed in microenterprises (companies employing less than 10 persons), which will result in a significant

monthly increase in the number of people working in companies employing at least 10 persons. We forecast that employment dynamics dropped to 2.9% YoY from 3.1% in December 2016. In turn, the average wage dynamics rose to 4.0% YoY in January vs. 2.7% in December, which was due i.a. to increase in minimum wages and the abatement of the effect of earlier payment of bonuses in mining. Though important for the forecast of private consumption dynamics in Q1, the release of data on corporate wages and employment will be neutral for PLN and the debt market, we believe.

- **Domestic data on the January industrial production and retail sales will be released on Friday.** We forecast that output dynamics rose to 7.6% YoY in January vs. 2.3% in December, while the nominal retail sales growth rate rose to 8.1% YoY vs. 6.4%. Both dynamics rose mainly due to the favourable difference in the number of working days. In addition, conducive to acceleration of industrial production was the abatement of the high base effect related to the completion of projects co-financed with EU funds from the 2007-2013 programming period towards the end of 2015. We believe that the aggregate impact of data release on industrial production and retail sales will be slightly negative for PLN and positive for the prices of the Polish debt.

Last week

- **As we expected, the Monetary Policy Council left interest rates unchanged at the last week's meeting (the reference rate amounts to 1.50%).** 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 at a level close to the one observed in Q3 while the drop of investment in Q4 had probably been limited by an increased use of EU funds. In addition, in the press release a fragment was added that in the Council's opinion, bearing in mind the external and most probably temporary nature of factors behind the increase in price growth as well as low domestic demand pressure, the risk of inflation persistently running above the target in the medium term was low (see MACROpulse of 8/2/2017). During the press conference, the NBP Governor, Adam Glapiński, said that the MPC members agreed that "*wait-and-see*" approach was currently the best way of conducting monetary policy and he himself would be in favour of leaving NBP rates unchanged at the coming meetings. This means that the MPC is going to accept zero or slightly negative real interest rates for a longer period of time. The information from the meeting and the remarks of A. Glapiński support our medium-term forecast of NBP rates, in which the MPC will decide to start the monetary tightening cycle in June 2018 (interest rates hikes in 2018 will amount in total to 50bp).
- **The surplus of the Chinese balance of trade increased to USD 51.3bn in January vs. USD 40.8bn in December**. At the same time, export dynamics rose to 7.9% YoY in January vs. -6.1% in December (the highest level since February 2015), while import dynamics rose to 16.7% YoY vs. 3.1% (the highest level since April 2013). The sharp increase in import and export dynamics may be partly due to the positive statistical effect related to the New Lunar Year. Nevertheless, we believe that the data indicate improvement in internal and external demand. Thus, they support our scenario, in which subsequent quarters will see recovery in global trade.
- **Numerous data from the German economy were released last week**. The foreign trade surplus dropped to EUR 18.4M in December vs. EUR 18.7M in November. At the same time, export dynamics dropped to -3.3% in December vs. 3.9% in November, while import dynamics dropped to 0.0% MoM vs. 3.5%. The monthly dynamics of industrial production also recorded a decline and stood at -0.3% in December vs. 0.5% in November. Conducive to their decline were lower output dynamics in all its categories (manufacturing, energy, and construction). On the other hand, an increase was recorded for industrial orders, which rose by 5.2% MoM in December vs. a 3.6% decrease in November. We forecast that the German GDP will increase by 1.5% in 2017

vs. 1.9% in 2016.

- **The initial University of Michigan index decreased to 95.7 pts in February vs. 98.5 pts in January.** The index decline occured mainly due to a decrease in its sub-index concerning expectations while the sub-index concerning the assessment of current situation ran close to the January level. We forecast that the annualized US GDP growth rate will increase to 2.0% in Q1 2017 vs. 1.9% in Q4 2016.

Which branches will follow public investments ?

In 2017, we expect a significant recovery of public investments and higher fixed capital formation in companies controlled by the public sector, due to increasingly higher use of EU funds (see MACROmap of 12/12/2016). According to the available information, they will be mainly investments consisting in civil engineering constructions, in particular road, railway and utilities infrastructure (e.g. energy). The increase in these investments should contribute to higher outlays on fixed assets allocated by private companies connected to public investment cycle, as higher demand from the public sector, in the conditions of high degree of capacity utilization, will be conducive to higher investment expenditure of companies.

In order to analyze in which branches the investments will increase the most, we have studied the historical correlation between the construction-assembly production in the category “civil engineering” and the investments in companies employing at least 50 people in various sections of industry, services, and construction. In particular, we have analyzed the impact on corporate investments of production related to construction works in railways, road building, and utilities.

The highest correlation between corporate investments and public expenditure (correlation coefficient above 40%) can be seen in the categories directly or indirectly related to the support of construction projects. They are mainly: construction, manufacture of machinery and equipment (i.a. tools, industrial equipment), manufacture of electrical equipment (e.g. cables, lighting), chemical branch (e.g. paint, adhesives), and manufacture of metal products (e.g. metal structures) and other non-metallic mineral products (e.g. asphalt, cement, plaster). The scale of the correlation differs for the selected segments of infrastructural investments (roads, railway, and utilities). The relationships with private investments are not only simultaneous but also occur at a delay of one or two quarters (see the table).

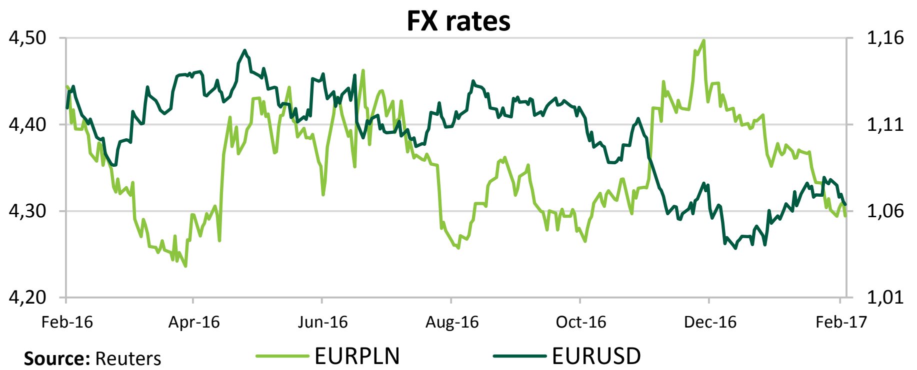
We believe that in 2017 the recovery in corporate investments caused by increase in public expenditure will be most pronounced in the said branches; however, it will not be limited only to these categories. There is a thesis in academic literature that in developing economies an increase in public investments, due to ‘crowding in’ effect, results in an increase in private investments (see MACROmap of 20/7/2015). In emerging economies, public investments are complementary to the investment activity of enterprises. Higher involvement of public resources increases the availability of infrastructure to enterprises, which increases return on private investments and is conducive to an increase in their dynamics. A positive correlation has been recorded in Poland in recent years between the dynamics of public outlays for fixed assets and the growth rate of corporate investments. This interdependence was weakened temporarily during the period of preparations to EURO 2012. Therefore, we believe that the ‘crowding in’ effect is also present in Poland.

The aforementioned results support our scenario in which the increase in the dynamics of public investments and companies controlled by the public sector will be conducive to higher corporate investment activity next year. This mechanism has been factored in in our forecast of total investment growth in 2017 (up to 5.3% YoY in 2017 vs. -5.5% in 2016).

Correlation coefficient			Construction-assembly production			
			Roads	Railways	Utilities	Civil engineering
Investment outlays	Construction	(t)	8,7%	11,3%	33,8%	39,2%
		(t+1)	1,5%	8,5%	**46,2%**	29,5%
		(t+2)	-17,1%	26,7%	**56,9%**	32,8%
	Manufacture of chemicals and chemical products	(t)	34,5%	**66,7%**	**57,4%**	**73,8%**
		(t+1)	18,1%	38,7%	**44,5%**	**45,2%**
		(t+2)	-1,1%	19,4%	**52,0%**	36,6%
	Manufacture of electrical equipment	(t)	-2,9%	30,0%	13,3%	17,9%
		(t+1)	16,0%	18,7%	7,3%	26,7%
		(t+2)	**54,7%**	**44,7%**	28,0%	**59,8%**
	Manufacture of machinery and equipment	(t)	29,1%	**41,2%**	27,5%	**55,0%**
		(t+1)	**42,8%**	**65,9%**	29,2%	**48,6%**
		(t+2)	31,1%	15,4%	23,2%	29,3%
	Manufacture of metal products	(t)	6,8%	31,9%	**48,5%**	36,4%
		(t+1)	-15,4%	16,9%	**50,4%**	31,6%
		(t+2)	-27,2%	-13,1%	10,6%	-8,0%
	Manufacture of other non-metallic mineral products	(t)	10,9%	3,1%	11,4%	24,1%
		(t+1)	17,4%	17,3%	22,1%	31,0%
		(t+2)	35,1%	**43,9%**	**47,1%**	**56,7%**

Source: GUS, Credit Agricole

Domestic data crucial for PLN

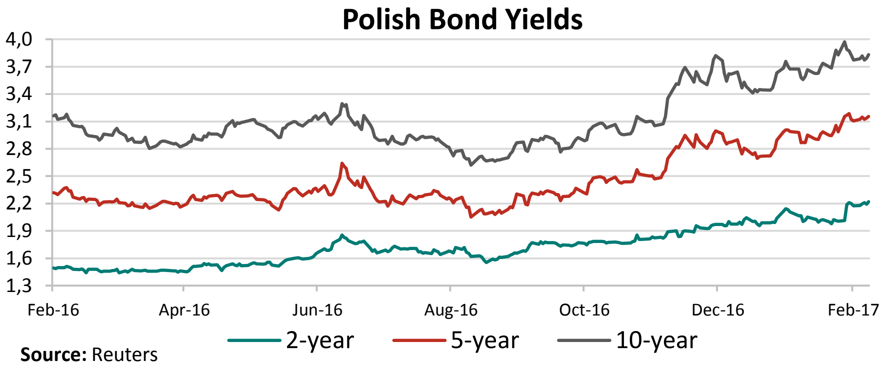


Source: Reuters

Last week EURPLN rate dropped to 4.2945 (PLN strengthening by 0.2%). At the beginning of last week, PLN strengthened to the highest level since October 2016, continuing the upward trend in which it has stayed from the beginning of 2017. In effect, on Monday and Tuesday, its rate was highly volatile, as investors were testing the level of 4.27 against EUR. On Wednesday and Thursday, PLN was relatively stable and the MPC meeting had a limited impact on the market. On Friday since morning, PLN and some emerging currencies were appreciating supported by the release of clearly better-than-expected data on the trade balance in China.

Crucial for PLN this week will be domestic data on the balance of payments and inflation (Monday) as well as industrial production and retail sales (Friday). We believe that balance of payments data will be positive for PLN. In turn, the aggregate impact of data on industrial production and retail sales, and inflation release will be negative for PLN. Other domestic data (corporate employment and average wages) will not have a substantial impact on PLN, we believe. On Tuesday and Wednesday, the FED chair, J. Yellen, will present a semiannual monetary policy report. We expect an increased volatility of PLN during J. Yellen's testimony. The aggregate impact of numerous data from the US (retail sales, industrial production, number of house starts, new building permits, as well as NY Empire State and Philadelphia FED Indices) on PLN will be limited. Data on GDP in the Eurozone, including Germany, will be neutral for PLN, we believe.

J. Yellen's testimony may increase volatility in the Polish debt market



Source: Reuters

Last week the yield of Polish 2-year benchmark bonds rose to a level of 2.22 (up by 4 bp), of 5-year bonds to a level of 3.155 (up by 5 bp), and of 10-year bonds to a level of 3.833 (up by 6 bp). Last week saw a relative stabilization of the Polish debt prices due to scarce macroeconomic calendar. The press release after the MPC meeting and the remarks of the NBP Governor, A. Glapiński, at the conference after the meeting had a limited impact on the Polish debt market. On Thursday and Friday, a slight increase in yields on Polish bonds, following US bonds, was visible at the long end of the curve. In our view, this was due to higher investors' expectations of rate hikes in the US. This view is supported by higher rates of US FRAs i.a. for 8x11 and 9x12 contracts.

This week the Polish debt market will focus on domestic data on industrial production and retail sales, and inflation. We expect that in total they will be conducive to lower yields on Polish bonds. Other domestic data (balance of payments, as well as corporate employment and average wages) will not have a substantial impact on the Polish debt market. On Tuesday and Wednesday, we expect an increased volatility of the Polish bond prices due to the testimony of the FED chair, J. Yellen. The aggregate impact of numerous data from the US (retail sales, industrial production, number of house starts, new building permits, as well as NY Empire State and Philadelphia FED Indices) on the Polish debt prices will be limited. Data on GDP in the Eurozone, including Germany, will also be neutral for yields on Polish bonds, we believe.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	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	Feb-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*	4,42	4,35	4,24	4,37	4,38	4,38	4,35	4,36	4,29	4,31	4,45	4,40	4,32	**4,29**
USDPLN*	4,08	4,00	3,73	3,81	3,94	3,94	3,90	3,91	3,82	3,92	4,20	4,18	4,00	**4,01**
CHFPLN*	3,98	4,00	3,87	3,97	3,96	4,04	4,02	3,97	3,93	3,96	4,13	4,11	4,04	**4,01**
CPI inflation (% YoY)	-0,9	-0,8	-0,9	-1,1	-0,9	-0,8	-0,9	-0,8	-0,5	-0,2	0,0	0,8	**1,6**	
Core inflation (% YoY)	-0,1	-0,1	-0,2	-0,4	-0,4	-0,2	-0,4	-0,4	-0,4	-0,2	-0,1	0,0	**0,2**	
Industrial production (% YoY)	1,4	6,8	0,7	5,9	3,2	6,0	-3,4	7,5	3,2	-1,3	3,2	2,4	**7,6**	
PPI inflation (% YoY)	-1,2	-1,5	-1,9	-1,2	-0,4	-0,8	-0,5	-0,1	0,2	0,6	1,8	3,0	**3,8**	
Retail sales (% YoY)	0,9	3,9	0,8	3,2	2,2	4,6	2,0	5,6	4,8	3,7	6,6	6,4	**8,1**	
Corporate sector wages (% YoY)	4,0	3,9	3,3	4,6	4,1	5,3	4,8	4,7	3,9	3,6	4,0	2,7	**4,0**	
Employment (% YoY)	2,3	2,5	2,7	2,8	2,8	3,1	3,2	3,1	3,2	3,1	3,1	3,1	**2,9**	
Unemployment rate* (%)	10,2	10,2	9,9	9,4	9,1	8,7	8,5	8,4	8,3	8,2	8,2	8,3	**8,7**	
Current account (M EUR)	679	-652	-217	691	1392	-723	-993	-739	-445	-531	-427	**145**		
Exports (% YoY EUR)	-1,3	5,4	0,0	4,0	1,4	6,0	-5,2	9,2	2,7	-2,3	4,6	**4,5**		
Imports (% YoY EUR)	0,3	7,4	0,9	0,0	2,5	0,8	-6,9	10,8	3,1	2,1	6,4	**4,4**		

*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	2,6	2,8	2,5	3,3	4,1	2,8	3,3	3,2
Private consumption (% YoY)		3,2	3,3	3,9	4,0	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	-5,8	0,0	1,6	6,8	8,7	-5,5	5,3	10,0
Export - constant prices (% YoY)		6,7	11,4	6,8	6,0	6,9	9,2	12,1	12,5	7,5	10,2	7,3
Import - constant prices (% YoY)		8,7	10,0	7,8	5,5	8,0	10,7	13,0	13,1	7,8	11,2	9,0
GDP growth contributions	Private consumption (pp)	2,0	1,9	2,3	2,0	2,3	2,1	1,7	1,4	2,1	1,9	1,7
	Investments (pp)	-0,3	-0,9	-1,4	-1,6	0,0	0,3	1,2	2,2	-1,1	1,0	1,8
	Net exports (pp)	-0,7	1,0	-0,3	0,4	-0,3	-0,2	-0,1	0,2	0,1	-0,1	-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	3,7	4,1	4,4	4,6	4,8	3,8	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	4,14	4,16	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**
		Monday 02/13/2017				
14:00	**Poland**	**CPI (% YoY)**	**Jan**	**0,8**	**1,6**	**1,7**
14:00	**Poland**	**Current account (M EUR)**	**Dec**	**-427**	**145**	**-726**
		Tuesday 02/14/2017				
2:30	China	PPI (% YoY)	Jan	5,5	7,2	6,3
2:30	China	CPI (% YoY)	Jan	2,1	2,1	2,4
8:00	Germany	Preliminary GDP (% QoQ)	Q4	0,2	0,5	0,5
10:00	**Poland**	**GDP (% YoY)**	**Q4**	**2,5**	**2,6**	**2,6**
11:00	Germany	ZEW Economic Sentiment (pts)	Feb	16,6		15,0
11:00	Eurozone	Preliminary GDP (% QoQ)	Q4	0,5	0,5	0,5
14:00	**Poland**	**M3 money supply (% YoY)**	**Jan**	**9,6**	**9,2**	**9,2**
		Wednesday 02/15/2017				
14:30	USA	Retail sales (% MoM)	Jan	0,6	0,1	0,1
14:30	USA	NY Fed Manufacturing Index (pts)	Feb	6,5	7,5	7,0
14:30	USA	CPI (% MoM)	Jan	0,3	0,3	0,3
14:30	USA	Core CPI (% MoM)	Jan	0,2	0,2	0,2
15:15	USA	Industrial production (% MoM)	Jan	0,8	0,1	0,0
15:15	USA	Capacity utilization (%)	Jan	75,5	75,5	75,5
		Thursday 02/16/2017				
14:00	**Poland**	**Employment (% YoY)**	**Jan**	**3,1**	**2,9**	**2,8**
14:00	**Poland**	**Corporate sector wages (% YoY)**	**Jan**	**2,7**	**4,0**	**4,3**
14:30	USA	Philadelphia Fed Index (pts)	Feb	23,6	18,6	18,0
14:30	USA	Housing starts (k MoM)	Jan	1226	1177	1222
14:30	USA	Building permits (k)	Jan	1228	1240	1230
		Friday 02/17/2017				
14:00	**Poland**	**Retail sales (% YoY)**	**Jan**	**6,4**	**8,1**	**7,7**
14:00	**Poland**	**PPI (% YoY)**	**Jan**	**3,0**	**3,8**	**3,7**
14:00	**Poland**	**Industrial production (% YoY)**	**Jan**	**2,3**	**7,6**	**8,1**

*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

** Reuters

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