Good outlook for Polish exports

This week

- **Significant data from the US will be released this week.** We forecast that nominal retail sales dropped by 0.3% MoM in March vs. a 0.1% increase in February, due to lower sales dynamics in the automotive branch. The preliminary University of Michigan Index will be released on Thursday. We forecast that its value dropped to 96.3 pts in April vs. 96.9 pts in February. The aggregate impact of data from the US may be slightly positive for PLN and prices of the Polish debt.
- **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 rise to 13.3 pts in April vs. 12.8 pts in March.
- **Data on the Chinese balance of trade will be released on Thursday.** We expect that its balance decreased to USD 1.0bn in March vs. USD 44.6bn in February. We forecast that export dynamics recorded an increase to 8.1% YoY in March vs. -1.3% in February, while import dynamics dropped to 12.1% from 31.1%. The publication of data from China will be neutral for the markets, we believe.
- **Final data on the March inflation in Poland will be released on Tuesday.** We see a slight upside risk in relation to the flash estimate (2.0% YoY vs. 2.2% in February). In our view, the decline in inflation in March was mainly due to lower dynamics of food and fuel prices. Higher core inflation had an opposite effect. The reading should not be market moving
- **Data on the Polish balance of payments in February will be released on Thursday**. We expect the current account balance to drop to EUR -103M in February vs. EUR 2457M in January, which will be mainly due to lower balance of transfers with the EU. We forecast that export dynamics dropped to 5.4% YoY in February vs. 13.8% YoY in January, while import dynamics decreased to 6.9% YoY vs. 16.0%. Conducive to lower export and import dynamics was the effect of unfavourable difference in the number of working days. Our forecast of balance of payments is lower from the market consensus (EUR 57M) and its materialization would be conducive to PLN weakening.

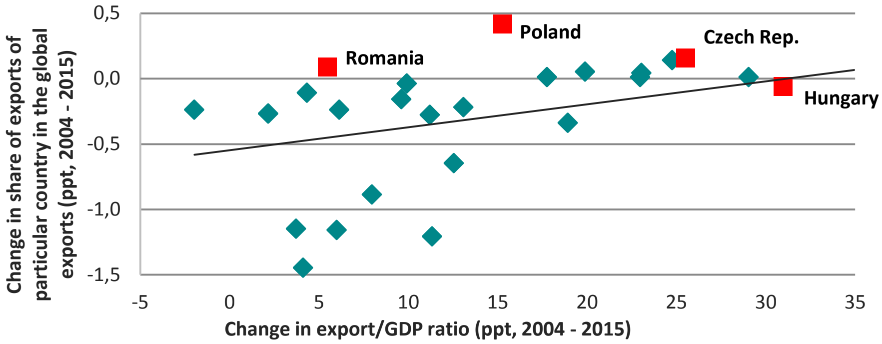
Last week

- **Numerous data from the US economy and business survey results were released last week.** Non-farm payrolls in the US rose by 98k in March vs. a 219k increase in February (revised downwards from 235k), running way below the market expectations (180k). The highest increase in employment was recorded in business services (+56.0k) while its sharpest decrease was recorded in retail trade (-29.7k). Unemployment rate dropped to 4.5% in February vs. 4.7% in January, running below the natural unemployment rate indicated by FOMC (4.7% - see MACROmap of 20/3/2017). The participation rate has not changed in March compared to February and stood at 63.0%. The annual dynamics of average hourly earnings dropped to 2.7% in March vs. 2.8% in February. We expect that the sustained improvement in the labour market in the coming months will be conducive to an increase in the annual wage growth. The results of business surveys in the US were also released last week. The ISM index for manufacturing decreased to 57.2 pts in March vs. 57.7 pts in February. The index decrease was due to lower values of three of its five sub-indices (output, new orders, and inventories). Higher sub-indices for employment and suppliers' delivery times had an opposite impact. The non-manufacturing ISM also recorded a decrease and amounted to 55.2pts in March vs. 57.6 pts in February. Conducive to the index decrease were lower values of three of its four sub-indices (business activity, new orders, and employment). Higher value of the sub-index concerning suppliers' delivery times had an opposite impact. The last week's readings from the US economy support our forecast, in which the annualized GDP growth rate in the US will drop to 1.3% in Q1 2017 vs.

2.1% in Q4 2016.

- **The Minutes of the March FOMC meeting were released last week**. According to the Minutes, FOMC members assume that – providing the economic situation in the US develops in accordance with their expectations – there will be two more FED rate hikes before the end of the year. At the same time, the remarks of FED presidents, W. Dudley and P. Harker, after the March meeting indicate that FOMC members prefer a gradual pace of normalization of the monetary policy which, in our view, points to a low likelihood of interest rates hike in May. The Minutes also included records of the discussion on future policy of managing FED assets. FOMC anticipates passively shrinking (meaning phasing out reinvestment) its balance sheet before yearend. The text of the Minutes does not alter our scenario, in which FED will increase interest rates before the end of 2017 by 25bp (in September). Our expectations concerning future profile of FED interest rates are below market expectations and the profile presented in the macroeconomic projection of FOMC members (see MACROmap of 20/3/2017).
- **Poland manufacturing PMI dropped to 53.5 pts in March from 54.2 pts in February**. The index decrease was due to lower contributions of four of its five sub-indices (for employment, output, new orders, and inventories). Higher contribution of the sub-index for suppliers' delivery times had an opposite impact (see MACROmap of 3/4/2017). Especially noteworthy in the data structure is the continuation of a still relatively strong growth rate of new orders (including export orders), output, and employment. Similar value of the sub-indices for total new orders and for new export orders suggests that the growth of activity in Polish manufacturing is currently supported by both domestic and foreign demand. In the whole Q1, PMI rose to 54.2 pts vs. 52.1 pts in Q4 2016. This supports our forecast, in which the annual dynamics of the Polish GDP will increase to 3.6% in Q1 vs. 2.7% in Q4 2016.
- **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. Like in March, the Council indicated in its statement that due to fading effects of the past increase in global commodity prices, with only a gradual rise in domestic inflationary pressure stemming from improving domestic economic conditions, the risk of inflation persistently running above the target in the medium term was limited. During the press conference the NBP Governor Adam Glapiński repeated his view from the month before that interest rates were likely to stay unchanged until the end of 2018. The NBP Govenor also indicated that the PLN strengthening observed in recent weeks was anti-inflationary (see MACROpulse of 5/4/42017). The remarks of A. Glapiński support our forecast, in which the Council will decide to start the monetary tightening cycle in November 2018, increasing interest rates by 25 bp.
- **Numerous data from the German economy were also released last week**. The trade surplus rose to EUR 21.0M in February vs. EUR 18.9M in January. At the same time, export dynamics dropped to 0.8% MoM in February vs. 2.4% in January, while import dynamics dropped to -1.6% MoM vs. 2.8% in January. Data on orders in manufacturing were also released last week and rose by 3.4% MoM in February vs. a 6.8% decrease in January. The monthly dynamics of industrial production in February has not changed compared to January and amounted to 2.2%. Conducive to their stabilization was a decrease in the monthly output growth in manufacturing and its increase in construction and energy. The last week's data from the German economy support our forecast, in which the quarterly growth rate of the German GDP will rise to 0.5% in Q1 2016 vs. 0.4% in Q4 2016.

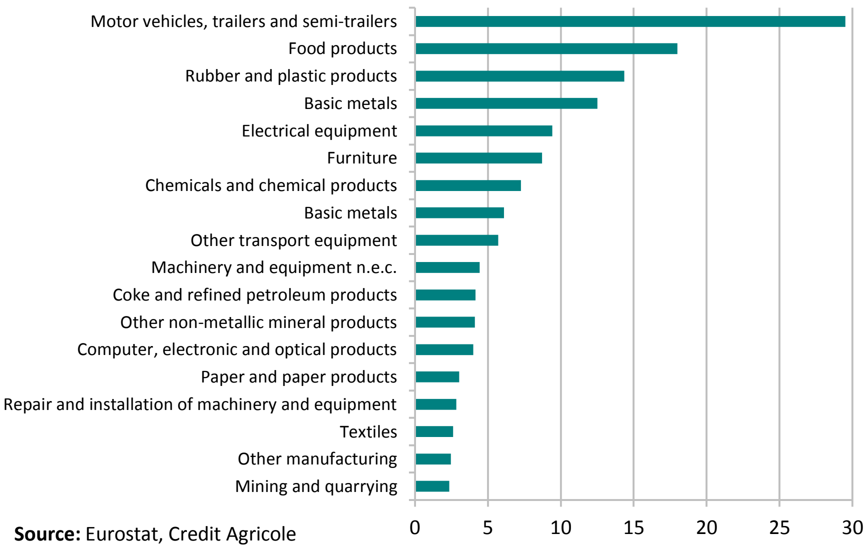
Good outlook for Polish exports



Source: World Bank, Credit Agricole, excluding Luxembourg

According to the World Bank data, the increase recorded between 2004 and 2015 in share of exports of goods and services in the global exports was the highest in Poland among the countries of the European Union (EU). Below we show which branches have contributed the most to Poland's success on the international scene, how the model of Polish exports growth has been evolving in recent years, and will present a short- and medium-term forecast of Poland's exports to the EU.

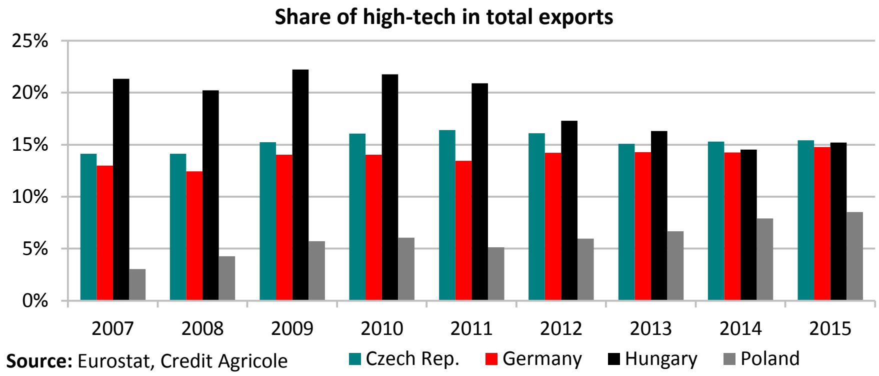
Increase in export sales (2010-2015, bn PLN)



Source: Eurostat, Credit Agricole

Due to the lack of comparable data (update of industrial activity classification from NACE Rev. 1.1 to NACE Rev. 2 in GUS statistics), a sectoral analysis of increase in exports over the full period since Poland's accession to the EU is not possible. Consequently, we have analyzed a shorter period – from 2010. The highest increase in export sales between 2010 and 2015 was recorded in Poland in the manufacturing branches dealing in the manufacture of: "motor vehicles, trailers and semitrailers" (PLN 29.5bn), "food products" (PLN 18.0bn), and "rubber and plastic products" (PLN 14.4bn). In the period 2010-H1 2016, the highest increase in share of exports in the sales revenue from products, materials and commodities was recorded in the categories: "computer, electronic and optical products" (21.1 pp), "other manufacturing" (18.1 pp), and "textiles" (11.1pp). In H1 2016, the highest increase in share of exports in the sales revenue from products, materials and commodities was recorded in the following sectors: "motor vehicles, trailers and semitrailers" (78.1%), "other transport equipment" (74.0%), and "computer, electronic and optical products" (72.0%).

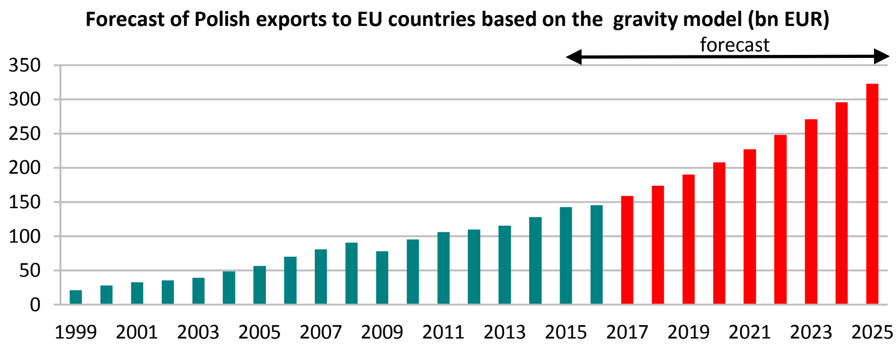
Good outlook for Polish exports



Source: Eurostat, Credit Agricole

One of the factors behind the fast increase in Polish exports since the accession to the EU has been the relatively low labour costs. According to Eurostat data, between 2004 and 2015, the hourly labour costs in the market sector in Poland amounted on the average to EUR 7.0 and were lower by 76.6% from Germany and by 69.4% from the EU average. They were also lower from other countries of the region – Hungary (by 7.1%) and the Czech Republic (by 20.7%). At that time, goods used in the production of final products (so-called intermediate goods) represented a dominant part of Polish exports. From 2007 a gradual change in the model of export growth has been observed in Poland. The share of intermediate goods in total exports has been decreasing while the share of high-tech has been growing. High-tech manufacturing exports include i.a. computer equipment, electronic equipment, pharmaceuticals, machinery and equipment, armaments, scientific instruments, and aerospace industry products. Despite a persistent upward trend, the share of Polish high-tech exports in Polish total exports was in 2015 still nearly twice lower than in Germany, the Czech Republic, and Hungary (8.5% vs. 15%). We believe that the upward trend in this segment will continue in subsequent years, being conducive to higher competitiveness of Polish exports and helping further increase in their value and their share in the global exports.

In the short term, foreign demand will be the main factor determining increase in Polish exports. We believe that subsequent months will see an intensification of recovery in global trade. This view is supported by business survey results for manufacturing, as high sub-indices were recorded in March for new export orders in the Eurozone (56.7 pts, highest since April 2011), Germany (58.9 pts, highest since May 2010), and the US (59.0 pts, highest since November 2013). This supports our forecast of increase in the exports growth rate in Poland from 8.4% in 2016 to 10.9% in 2017.

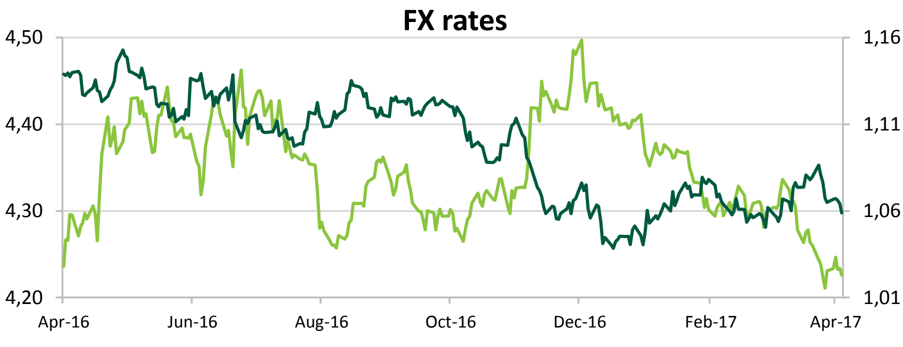


Source: Eurostat, Credit Agricole

One of the tools for evaluating potential level of exports in the long term is so-called gravity model. This concept was inspired by Newton's law of gravitation, which says that between any pair of objects there is an attracting force that increases proportionally to the products of their masses and decreases proportionally to the square of the distance between them. In the gravity model the value of trade between two countries increases proportionally to the products of their GDPs and decreases proportionally to the square of the distance between them. In order to estimate the potential value of exports we need to adopt some assumptions concerning the GDP growth rate in the two trading economies. Based on historical trends, we have assumed that the average annual nominal per capita GDP growth rate between 2017 and 2025 will amount to 6.0% in Poland and to 2.5% in the EU. Using the gravity model, we forecast that Polish exports of goods to the EU will increase from EUR 144.5bn in 2016 to EUR 332bn in 2015 (total increase by 122%, which means that the average exports growth rate in this period will amount to 9.3% YoY).

Our forecast is subject to several risks. Firstly, we have assumed that the average real GDP growth rate in Poland will, throughout the forecast period, stay close to the potential (3.0% per annum). Thus, our forecast does not address possible episodes of a strong deceleration of economic growth. Another risk is further disintegration trends in the European Union. Despite the fact that the United Kingdom is the second largest destination of Polish products, we believe that Brexit will not have a substantial negative impact on international trade. Potential exit of another large country from the EU (e.g. France) would contribute, in our view, to reducing the growth rate of Polish exports in the long term. The third risk is the protectionist tendencies observed globally. If the Trump administration decided to implement tools helping to limit US imports (e.g. higher customs duties), global trade would slow down and Polish exports growth would decrease.

Domestic balance of payments data negative for PLN

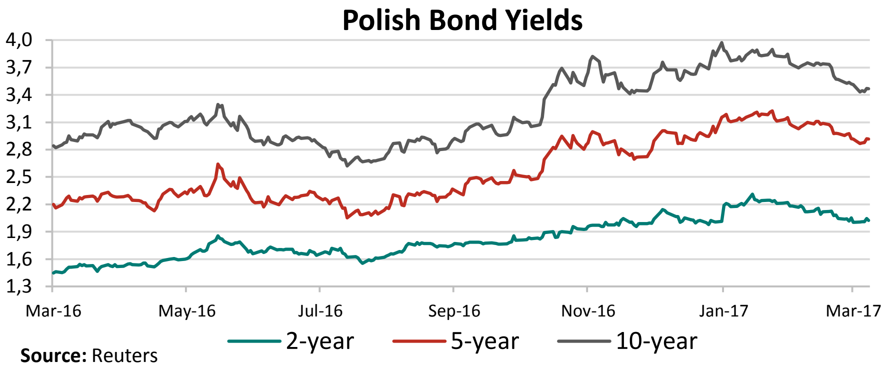


Source: Reuters

Last week, EURPLN rate dropped to 4.2258 (PLN strengthening by 0.1%). On Monday and Tuesday, PLN and other emerging currencies were depreciating due to some investors realizing profits, following their appreciation two weeks ago. On Wednesday PLN was making up for the losses from the first part of the week. The MPC meeting and the conference after the meeting were neutral for PLN. The publication of the Minutes of the March FOMC meeting also had a limited impact on PLN. Thursday afternoon saw PLN strengthening supported by the decision of the Czech National Bank to free the exchange rate of the Czech crown. On Friday PLN appreciation continued, boosted by weaker-than-expected data on non-farm payrolls in the US.

Crucial for PLN this week will be the US readings (preliminary University of Michigan Index and retail sales). If our lower-from-the-market-consensus forecasts materialize, the aggregate impact of the data may be slightly positive for PLN. The publication of domestic data on the balance of payments scheduled for Thursday may have an opposite impact. In our view, data on inflation in Poland will be neutral for PLN. Data on the balance of payment in China will also have a limited impact on PLN, we believe.

Aggregate impact of US data positive for prices of Polish debt



Source: Reuters

Last week the yield of Polish 2-year benchmark bonds rose to a level of 2.022 (up by 2 bp), of 5-year bonds have not changed compared to a level from two weeks ago and amounted to 2.915, and of 10-year bonds dropped to a level of 3.466 (down by 4 bp). Monday saw a rise in prices of the Polish debt, which was partly due to the publication of a lower-than-expected Poland's manufacturing PMI. Tuesday through Thursday, the increase in yields on Polish bonds occurred. In our view, this was due to lower activity of foreign investors and persistent high political risk in Europe in view of the approaching presidential election in France. On Thursday there was a debt auction, at which the Ministry of Finance sold PLN 5.0bn of 2-, 5-, 9-, and 10-year bonds with demand amounting to PLN 8.7bn. The auction had a limited impact on the yield curve. On Friday yields on Polish bonds decreased in reaction to weaker-than-expected data on non-farm payrolls in the US.

This week the Polish debt market will focus on US readings (preliminary University of Michigan Index and retail sales). We believe that their aggregate impact will be slightly negative for yields on Polish bonds. Domestic data on inflation and the balance of payments as well as other data from abroad (balance of payment in China) will be neutral for the prices of the Polish debt, we believe.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17	Apr-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*	4,24	4,37	4,38	4,38	4,35	4,36	4,29	4,31	4,45	4,40	4,32	4,31	4,23	**4,26**
USDPLN*	3,73	3,81	3,94	3,94	3,90	3,91	3,82	3,92	4,20	4,18	4,00	4,07	3,97	**4,01**
CHFPLN*	3,87	3,97	3,96	4,04	4,02	3,97	3,93	3,96	4,13	4,11	4,04	4,05	3,96	**3,99**
CPI inflation (% YoY)	-0,9	-1,1	-0,9	-0,8	-0,9	-0,8	-0,5	-0,2	0,0	0,8	1,7	2,2	**2,1**	
Core inflation (% YoY)	-0,2	-0,4	-0,4	-0,2	-0,4	-0,4	-0,4	-0,2	-0,1	0,0	0,2	0,3	**0,6**	
Industrial production (% YoY)	0,7	5,9	3,2	6,0	-3,4	7,5	3,2	-1,3	3,2	2,2	9,1	1,2	**7,1**	
PPI inflation (% YoY)	-1,9	-1,2	-0,4	-0,8	-0,5	-0,1	0,2	0,6	1,8	3,2	4,0	4,4	**4,7**	
Retail sales (% YoY)	0,8	3,2	2,2	4,6	2,0	5,6	4,8	3,7	6,6	6,4	11,4	7,3	**9,4**	
Corporate sector wages (% YoY)	3,3	4,6	4,1	5,3	4,8	4,7	3,9	3,6	4,0	2,7	4,3	4,0	**4,3**	
Employment (% YoY)	2,7	2,8	2,8	3,1	3,2	3,1	3,2	3,1	3,1	3,1	4,5	4,6	**4,5**	
Unemployment rate* (%)	9,9	9,4	9,1	8,7	8,5	8,4	8,3	8,2	8,2	8,3	8,6	8,5	**8,2**	
Current account (M EUR)	-217	691	1392	-723	-993	-739	-445	-531	-188	-533	2457	**-103**		
Exports (% YoY EUR)	0,0	4,0	1,4	6,0	-5,2	9,2	2,7	-2,3	4,7	6,7	13,8	**5,4**		
Imports (% YoY EUR)	0,9	0,0	2,5	0,8	-6,9	10,8	3,1	2,1	6,2	9,0	16,0	**6,9**		

*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	2,7	3,6	3,7	3,8	4,1	2,8	3,8	3,4
Private consumption (% YoY)		3,2	3,3	3,9	4,2	3,9	3,6	2,9	2,8	3,6	3,3	3,1
Gross fixed capital formation (% YoY)		-2,2	-5,0	-7,7	-5,8	0,5	4,0	6,8	8,7	-5,5	5,9	10,0
Export - constant prices (% YoY)		6,7	11,4	6,8	8,6	9,2	9,8	12,1	12,5	8,4	10,9	7,3
Import - constant prices (% YoY)		8,7	10,0	7,8	8,5	9,0	10,7	12,7	13,1	8,7	11,4	7,3
GDP growth contributions	Private consumption (pp)	2,0	1,9	2,3	2,1	2,5	2,1	1,7	1,4	2,1	1,9	1,8
	Investments (pp)	-0,3	-0,9	-1,4	-1,6	0,1	0,7	1,2	2,2	-1,1	1,1	1,8
	Net exports (pp)	-0,7	1,0	-0,3	0,3	0,5	0,1	0,0	0,1	0,1	0,2	-0,6
Current account***		-0,8	-0,5	-0,4	-0,3	-0,4	-0,5	-0,6	-0,7	-0,3	-0,7	-1,2
Unemployment rate (%)**		9,9	8,7	8,3	8,3	8,2	7,2	7,0	7,3	8,3	7,3	7,3
Non-agricultural employment (% YoY)		2,2	2,3	1,5	1,5	1,1	0,8	0,5	0,2	1,9	0,7	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	2,0	2,0	1,7	1,7	-0,6	1,8	1,5
Wibor 3M (%)**		1,67	1,71	1,71	1,73	1,73	1,73	1,73	1,73	1,73	1,73	1,98
NBP reference rate (%)**		1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,75
EURPLN**		4,24	4,38	4,29	4,40	4,23	4,33	4,23	4,18	4,40	4,18	4,07
USDPLN**		3,73	3,94	3,82	4,18	3,97	4,08	3,92	3,80	4,18	3,80	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 04/10/2017				
10:30	Eurozone	Sentix Index (pts)	Apr	20,7		21,0
		Tuesday 04/11/2017				
11:00	Germany	ZEW Economic Sentiment (pts)	Apr	12,8		14,0
11:00	Eurozone	Industrial production (% MoM)	Feb	0,9		0,0
14:00	**Poland**	**CPI (% YoY)**	**Feb**	**1,8**	**2,1**	**2,0**
		Wednesday 04/12/2017				
3:30	China	PPI (% YoY)	Mar	7,8	7,8	7,6
3:30	China	CPI (% YoY)	Mar	0,8	0,7	1,0
14:00	**Poland**	**Core inflation (% YoY)**	**Mar**	**0,3**	**0,6**	**0,5**
		Thursday 04/13/2017				
	China	Trade balance (bn USD)	Mar	-9,2	1,0	10,0
14:00	**Poland**	**Current account (M EUR)**	**Feb**	**2457**	**-103**	**57**
16:00	USA	Initial U. of Michigan Sentiment Index (pts)	Apr	96,9	96,3	96,6
		Friday 04/14/2017				
14:00	**Poland**	**M3 money supply (% YoY)**	**Mar**	**8,2**	**8,9**	**8,6**
14:30	USA	Retail sales (% MoM)	Mar	0,1	-0,3	-0,1
14:30	USA	CPI (% MoM)	Mar	0,1	-0,1	0,0
14:30	USA	Core CPI (% MoM)	Mar	0,2	0,2	0,2
16:00	USA	Business inventories (% MoM)	Feb	0,3	0,3	0,3

*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

** Reuters

Jakub BOROWSKI
Chief Economist
tel.: 22 573 18 40
jakub.borowski@credit-agricole.pl

Krystian JAWORSKI
Economist
tel.: 22 573 18 41
krystian.jaworski@credit-agricole.pl

Jakub OLIPRA
Economist
tel.: 22 573 18 42
jakub.olipra@credit-agricole.pl