Local government investments will boost GDP growth

This week

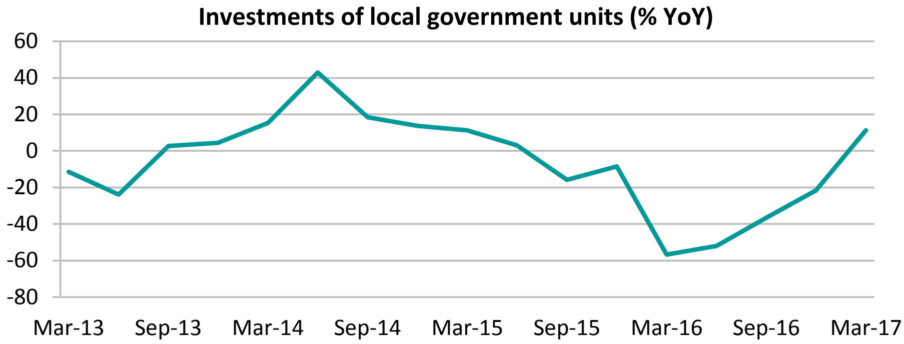
- **The most important event this week will be the ECB meeting scheduled for Thursday.** In our view, interest rates will be left unchanged. We believe that in the statement after the meeting the ECB will change its assessment of the risks surrounding the Eurozone's growth outlook, from "tilted to the downside, while moving towards a more balanced configuration" to "broadly balanced". In addition, we expect that the ECB will decide to change the forward guidance ("The Governing Council continues to expect the key ECB interest rates to remain at present or lower levels for an extended period of time, and well past the horizon of the net asset purchases.") by deleting the part on possible further interest rate cuts. The latest macroeconomic projection will also be presented at the conference after the meeting. We expect the inflation path to be revised downwards, and the expected GDP growth rate slightly upwards compared to the April projection. The expected by us change of the ECB bias to a more hawkish one will be conducive to a slight weakening of PLN and a fall of prices of the Polish debt.
- **A meeting of the Monetary Policy Council will be held on Wednesday.** We expect that the MPC will decide to leave interest rates at an unchanged level. The issue of the weaker-than-expected data on industrial production and construction-assembly production in April and lower from the consensus PMI in May is likely to be raised during the conference in the context of the monetary policy outlook. We believe that the NBP Governor, A. Glapiński, will repeat his view that interest rates will remain unchanged for an extended period. We believe that the press release after the Council meeting and NBP Governor's remarks during the conference will not substantially affect PLN or yields on Polish bonds.
- **Data on the Chinese balance of trade will be released on Thursday**. We expect that its balance rose to USD 49.8bn in May vs. USD 38.1bn in April. At the same time, we believe that export growth rate recorded a decline in May down to 6.8% YoY vs. 8.0% in April, while import growth rate dropped to 9.0% from 11.9%. The publication of data from China will be neutral for the markets, we believe.

Last week

- **In accordance with the final estimate, Polish GDP growth rate in Q1 amounted to 4.0% YoY vs. 2.5% in Q4 2016.** Conducive to the acceleration of GDP growth were higher contributions of investments (0.0 pp in Q1 vs. -2.8 pp in Q4), private consumption (3.0 pp vs. 2.2 pp), and public consumption (0.2 pp vs. 0.0 pp). Lower contributions of inventories (0.7 pp in Q1 vs. 2.3 pp in Q4) and net exports (0.1 pp vs. 0.8 pp) had an opposite impact. Thus, private consumption was the main source of Polish GDP growth in Q1 (see MACROpulse of 31/5/2017). The data support our scenario in which the slowdown of economic growth ended in Q4. We expect that GDP growth rate will run at a level close to 4.0% YoY in subsequent quarters of 2017. We will present an update of our forecasts for 2017-2018 on 12 June.
- **PMI index for Polish manufacturing dropped to 52.7 pts in May vs. 54.1 pts in April, hitting the lowest level since November 2016.** Despite the deterioration in May, Polish manufacturing PMI continues to run clearly above the 50 pts threshold dividing expansion from contraction of activity. The decline in PMI resulted from a decrease in the contributions of all its five components (for employment, new orders, suppliers' delivery times, output, and stocks of purchases), which shows that the deterioration of business sentiment in Polish manufacturing is wide ranging (see MACROpulse of 1/6/2017). Considering the sustained recovery in the German economy and the expected by us strong acceleration in public and corporate investments implemented with the use of EU funds in subsequent months, we believe that the deterioration of business sentiment in Polish manufacturing in May is temporary.

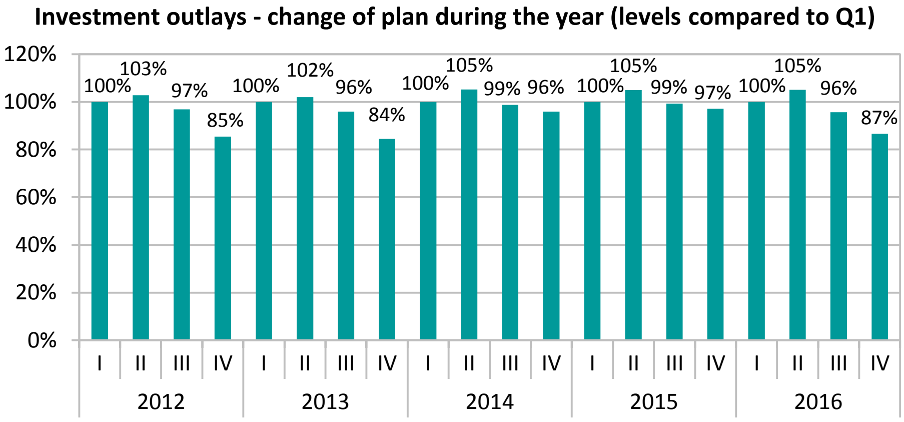
- **According to the flash estimate, inflation in Poland decreased to 1.9% YoY in May vs. 2.0% in April**. In our view, the decrease in inflation rate was due to lower dynamics of fuel prices. Higher dynamics of food prices and core inflation had an opposite impact. Final data on inflation including its structure will be published on 12 June.
- **Numerous data from the US economy and business survey results were released last week.** Non-farm payrolls rose by 138k in May vs. a 174k increase in April (revised downwards from 211k), running below the market expectation (185k). The highest increase in employment was recorded in education and health services (+47.0k), business services (+38.0k), and leisure and hospitality (+31.0k). Employment decreased to the highest extent in the public sector (-9.0k), retail trade (-6.1k), and wholesale trade (-2.1k).Unemployment rate dropped to 4.3% in May vs. 4.4% in April, thus running clearly below the natural unemployment rate indicated by FOMC (4.7% see MACROmap of 20/3/2017). Its decline occurred mainly due to a decrease in the participation rate down to 62.7% in May vs. 62.9% in April. The annual dynamics of average hourly earnings has not changed in May compared to April and amounted to 2.5% YoY. We expect that the continuation of the improvement in the US labour market in subsequent months will contribute towards an increase in the annual wage growth rate. The results of business surveys in the US were also released last week. The Conference Board Index dropped to 117.9 pts in May vs. 119.4 pts in April, pointing to a slight deterioration of consumer sentiment. On the other hand, the ISM index for manufacturing recorded a slight increase and rose to 54.9 pts in May vs. 54.8 pts in April. Conducive to the index increase were higher contributions of three of its five sub-indices (for new orders, employment and inventories). Lower contributions of output and suppliers' delivery times had an opposite impact. The last week's readings from the US economy do not change our scenario, in which FED will hike the federal funds rate by 25 bp at the June meeting.
- **According to the flash estimate, inflation in the Eurozone decreased to 1.4% YoY in May vs. 1.9% in April.** The decrease in inflation resulted from lower dynamics of energy and services which reduced inflation by 0.3 pp and 0.2 pp, respectively. Lower price dynamics in May occurred due to the abatement of the statistical effect related to Easter. The data support our scenario in which inflation in the Eurozone will decrease to 1.5% YoY in Q2 vs. 1.8% in Q1.
- **China Caixin manufacturing PMI dropped to 49.6 pts in May vs. 50.3 pts in April**. Thus it hit a level below the 50 pts threshold dividing expansion from contraction of activity for the first time since June 2016. The index decrease resulted from lower contributions of all its sub-indices (for output, new orders, employment, suppliers' delivery times, and stocks of goods purchased). We believe that the decrease in China manufacturing Caixin is temporary. This view is supported by the stabilization of business sentiment signaled by China manufacturing PMI according to CFLP, which has not changed in May compared to April and amounted to 51.2 pts.

Local government investments will boost GDP growth



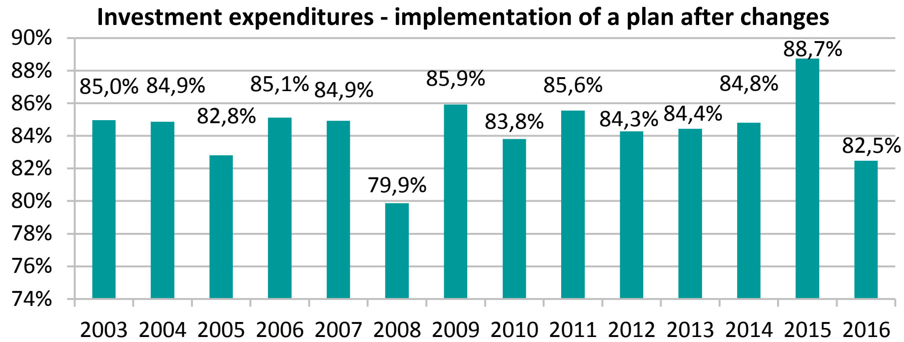
Source: Ministry of Finance, Credit Agricole

The Ministry of Finance release on the implementation of the budget of local government units (LGU) indicates that LGU investment expenditures increased in nominal terms by 11.2% YoY in Q1 2017 vs. a 21.7% decline in Q4 2016 and 34.4% in the whole 2016. Thus, they were one of the factors behind GDP growth acceleration in Q1 (see MACROpulse of 31/5/2017). The investment expenditures target for 2017 presented in this document (PLN 49.5bn) is also worthy of special notice. Its implementation would mean an increase in LGU fixed capital formation by 102.7% compared to 2016 level. Below we present the likelihood of the materialization of this scenario and its impact on GDP growth rate in 2017.



Source: Ministry of Finance, Credit Agricole

It should first be noted that, unlike the central budget, LGU spending plans are modified during the year. Based on the available data for 2012-2016, we have observed that the original target (published in Q1 report) for LGU investment expenditures is usually increased by 4% on the average in the Q2 report. And the plans presented as at the end of Q3 and Q4 were on the average lower by 3% and 10%, respectively, as compared to the original estimates. This means that the 2017 target is also likely to be revised downwards during the year. At the same time, we have not recorded any substantial impact of the political cycle on LGU budget revisions.

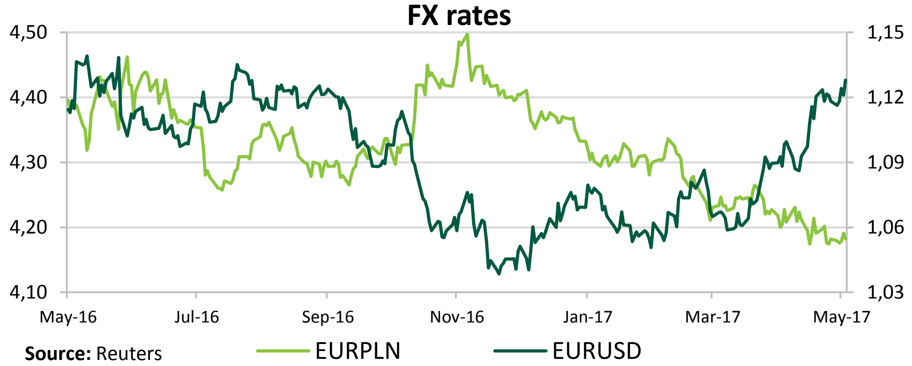


Source: Ministry of Finance, Credit Agricole

Another important issue to be taken into consideration when assessing the likelihood of budget execution this year is the historical implementation of investment expenditures. To this end, we have compared the final plans (at year end – after the above-described revisions) and the actual amount of expenditures, between 2003 and 2016. The assumed targets were not reached in any year. The actual expenditures were lower from the budget on the average by 15.5% (ranging between 11.3% and 20.1%). We have not observed any substantial impact of the political cycle on the degree of budget execution.

Taking into consideration the above-outlined factors, we assume that the plan of LGU investment expenditures for 2017 presented in the report after Q1 will be revised downwards during the year to ca. 90% of its original value and, in addition, the modified plan will be executed in 85%. Consequently, the real investment expenditures of LGUs will run at a level of ca. 77% of those provided for in the report published after Q1 (i.e. PLN 37.8bn). Consequently, LGU investment dynamics will be equal to 55.1% YoY in 2017. It is still a very high growth rate of fixed capital formation; however, it is nearly twice lower from the rate expected in the budget (102.7%). Considering the percentage of LGU investments in public investments (39.8%), total fixed capital formation (7.3%), and GDP (1.3%), their expected by us increase will contribute to increasing the dynamics of these indicators by 35.6 pp, 6.5 pp, and 1.2 pp, respectively, between 2016 and 2017. The materialization of this scenario poses an upside risk to our forecast of GDP growth rate in 2017 (3.8% YoY vs. 2.7% in 2016). We will present our updated forecasts for 2017-2018 on 12 June.

MPC meeting neutral for PLN

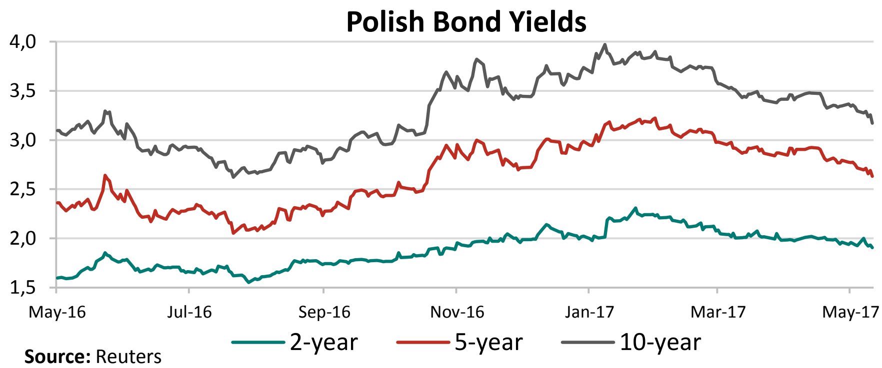


Source: Reuters

Last week EURPLN rate has not changed compared to the level from two weeks ago and amounted to 4.1824. Monday through Wednesday PLN was stable, supported by scarce macroeconomic calendar. On Wednesday, PLN depreciated in reaction to a lower-than-expected flash estimate of inflation in Poland. On Thursday it continued to depreciate supported by the publication of weaker-than-expected results of business surveys for the Polish manufacturing and clearly higher-from-the-consensus data on the US labour data and the ADP report. The Friday's publication of lower-than-expected data on non-farm payrolls in the US resulted in a slight appreciation of PLN.

The most important event for PLN this week will be the ECB meeting scheduled for Thursday. The expected by us change of the ECB bias to a more hawkish one will be conducive to a slight weakening of PLN, we believe. In our view, the MPC meeting and data on the Chinese balance of trade will be neutral for PLN.

The Polish debt market focused on the ECB meeting



Source: Reuters

Last week the yield of Polish 2-year benchmark bonds dropped to a level of 1.908 (down by 2 bp), of 5-year bonds to a level of 2.633 (down by 8 bp), and of 10-year bonds to a level of 3.173 (down by 12 bp). On Monday and Tuesday the prices of the Polish debt showed low volatility due to scarce macroeconomic calendar. Wednesday saw a decline in yields on Polish bond visible at the center and long end of the yield curve. The increase in prices of the Polish debt was supported by lower-from-the-market-consensus publication of the flash estimate of inflation in Poland and the announcement by the Finance Ministry of a lower-than-expected supply at the debt auction scheduled for 9 June. On Thursday, the yields on Polish bonds were stable. The Friday's reading of lower-than-expected data on non-farm payrolls in the US contributed to a decrease in yields on Polish bonds.

This week the Polish debt market will focus on the ECB meeting scheduled for Thursday. The expected by us change of the ECB bias to a more hawkish one will be negative for the prices of the Polish bonds. Other events (MPC meeting, publication of data on the Chinese balance of trade) will not meet with a significant reaction of the Polish debt market, we believe.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-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*	4,38	4,38	4,35	4,36	4,29	4,31	4,45	4,40	4,32	4,31	4,23	4,23	4,18	**4,17**
USDPLN*	3,94	3,94	3,90	3,91	3,82	3,92	4,20	4,18	4,00	4,07	3,97	3,88	3,72	**3,72**
CHFPLN*	3,96	4,04	4,02	3,97	3,93	3,96	4,13	4,11	4,04	4,05	3,96	3,90	3,84	**3,86**
CPI inflation (% YoY)	-0,9	-0,8	-0,9	-0,8	-0,5	-0,2	0,0	0,8	1,7	2,2	2,0	2,0	**2,0**	
Core inflation (% YoY)	-0,4	-0,2	-0,4	-0,4	-0,4	-0,2	-0,1	0,0	0,2	0,3	0,6	0,9	**0,6**	
Industrial production (% YoY)	3,2	6,0	-3,4	7,5	3,2	-1,3	3,2	2,2	9,1	1,1	11,0	-0,6	**8,9**	
PPI inflation (% YoY)	-0,4	-0,8	-0,5	-0,1	0,2	0,6	1,8	3,2	4,0	4,5	4,8	4,3	**3,4**	
Retail sales (% YoY)	2,2	4,6	2,0	5,6	4,8	3,7	6,6	6,4	11,4	7,3	9,7	8,1	**8,1**	
Corporate sector wages (% YoY)	4,1	5,3	4,8	4,7	3,9	3,6	4,0	2,7	4,3	4,0	5,2	4,1	**4,7**	
Employment (% YoY)	2,8	3,1	3,2	3,1	3,2	3,1	3,1	3,1	4,5	4,6	4,5	4,6	**4,6**	
Unemployment rate* (%)	9,1	8,7	8,5	8,4	8,3	8,2	8,2	8,3	8,6	8,5	8,1	7,7	**7,3**	
Current account (M EUR)	1392	-723	-503	-729	-858	-179	-128	-56	2576	-825	-738	**-764**		
Exports (% YoY EUR)	1,4	6,0	-5,3	9,3	3,1	-0,5	5,8	5,2	13,9	4,9	14,9	**1,7**		
Imports (% YoY EUR)	2,5	0,8	-7,3	10,7	3,5	3,6	6,3	7,1	16,1	9,9	18,9	**8,2**		

*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)		2,9	3,0	2,4	2,5	4,0	3,7	3,7	4,1	2,7	3,8	3,4
Private consumption (% YoY)		3,4	3,4	4,1	4,5	4,7	3,6	2,9	2,8	3,8	3,5	3,1
Gross fixed capital formation (% YoY)		-9,8	-4,5	-6,7	-9,8	-0,4	4,0	6,8	8,7	-7,9	5,8	10,0
Export - constant prices (% YoY)		7,1	11,8	7,8	9,3	8,3	8,7	12,1	11,9	9,0	10,3	7,3
Import - constant prices (% YoY)		8,7	10,1	8,7	8,2	8,7	9,7	12,7	13,1	8,9	11,1	7,3
GDP growth contributions	Private consumption (pp)	2,2	2,0	2,5	2,2	3,0	2,1	1,7	1,4	2,3	2,0	1,8
	Investments (pp)	-1,4	-0,8	-1,3	-2,8	0,0	0,7	1,2	2,1	-1,6	1,0	1,8
	Net exports (pp)	-0,5	1,2	-0,3	0,8	0,1	0,0	0,0	-0,2	0,3	0,0	-0,6
Current account***		-0,8	-0,5	-0,4	-0,3	0,0	-0,5	-0,6	-0,7	-0,3	-0,7	-1,2
Unemployment rate (%)**		9,9	8,7	8,3	8,3	8,1	7,2	7,0	7,3	8,3	7,3	7,3
Non-agricultural employment (% YoY)		2,2	2,3	1,5	1,5	2,1	0,8	0,5	0,2	1,9	0,9	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	4,17	4,23	4,18	4,40	4,18	4,07
USDPLN**		3,73	3,94	3,82	4,18	3,97	3,72	3,85	3,73	4,18	3,73	3,45

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST* CA	FORECAST* CONSENSUS**
		Monday 06/05/2017				
10:00	Eurozone	Services PMI (pts)	May	56,2	56,2	56,2
10:00	Eurozone	Final Composite PMI (pts)	May	56,8	56,8	56,8
16:00	USA	ISM Non-Manufacturing Index (pts)	May	57,5	57,0	57,0
16:00	USA	Factory orders (% MoM)	Apr	0,5	-0,1	-0,2
		Tuesday 06/06/2017				
10:30	Eurozone	Sentix Index (pts)	Jun	27,4		27,5
11:00	Eurozone	Retail sales (% MoM)	Apr	0,3		0,2
		Wednesday 06/07/2017				
8:00	Germany	New industrial orders (% MoM)	Apr	1,0		-0,4
11:00	Eurozone	Revised GDP (% QoQ)	Q1	0,5	0,5	0,5
11:00	Eurozone	Final GDP (% YoY)	Q1	1,7		1,7
	Poland	**NBP rate decision (%)**	**Jun**	**1,50**	**1,50**	**1,50**
		Thursday 06/08/2017				
	China	Trade balance (bn USD)	May	38,1	49,8	
8:00	Germany	Industrial production (% MoM)	Apr	-0,4		0,5
13:45	Eurozone	EBC rate decision (%)	Jun	0,00	0,00	0,00
		Friday 06/09/2017				
3:30	China	PPI (% YoY)	May	6,4	6,2	
3:30	China	CPI (% YoY)	May	1,2	1,2	
8:00	Germany	Trade balance (bn EUR)	Apr	19,6		20,5
16:00	USA	Wholesale inventories (% MoM)	Apr	-0,3		0,2
16:00	USA	Wholesale sales (% MoM)	Apr	0,0		

*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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