

This week

- **The most important event this week will be the publication of preliminary data on June inflation in Poland, which in our view dropped to 1.7% YoY vs. 1.9% in May, scheduled for Friday.** Conducive to the CPI decline was lower dynamics of fuel prices. Our forecast is below the market consensus (1.9%). Therefore, its materialization will be slightly negative for PLN and yields on Polish bonds.
- **Flash estimate of HICP inflation in the Eurozone will also be released on Friday.** We expect that the annual inflation dropped to 1.2% YoY in June vs. 1.4% in May. The flash estimate of the June HICP inflation in Germany will be released on Thursday. Like in the case of the Eurozone, we expect its decline to 1.2% YoY vs. 1.4% in May. In both cases, conducive to the decline of the inflation indicator was lower core inflation. We expect that the publication of Eurozone inflation data will be slightly positive for PLN and Polish debt prices.
- **Significant hard data on US economy and business survey results will be released this week.** The final estimate of the US GDP in Q1 will be released on Thursday. We expect that the annualized economic growth rate has not changed compared to the second estimate and amounted to 1.2%. We forecast that the monthly dynamics of preliminary durable goods orders rose to -0.2% in May vs. -0.8% in April. The results of the June consumer sentiment survey will also be released in the US. We believe that both the upward-revised University of Michigan Index (95.0 pts vs. 97.1 pts in May) and the Conference Board Consumer Sentiment Index (115.0 pts vs. 117.9 pts) will signal a slight deterioration of households' sentiment in June. In our view, the aggregate impact of the US data will be neutral for the financial markets.
- **The June China manufacturing PMI according to CFLP will be released on Friday.** We expect that the indicator decreased slightly to 51.1 pts vs. 51.2 pts in May. We believe that the business survey results in China, pointing to stabilization of sentiment in manufacturing, will not be market moving.
- **Ifo Index reflecting the sentiment among German managers representing the manufacturing, construction, wholesale and retail trade sectors, will be released today.** We expect that the index value will increase to 115.1 pts in June from 114.6 pts in May. The decrease of the German PMI in June (see below) poses a downside risk to our forecast. The publication of Ifo index will be neutral for PLN and prices of Polish bonds, we believe.

Last week

- **Flash June business sentiment indicators (PMI) for major European economies were released last week.** PMI composite for the Eurozone dropped to 55.7 pts in June vs. 56.8 pts in May. The index decline was due to lower values of the indices both in France (55.3 pts in June vs. 56.9 pts in May) and in Germany (56.1 pts vs. 57.4 pts). Both economies recorded lower pace of activity growth in the services sector and decrease in the sub-index concerning output in manufacturing. A slight downturn was also recorded in the remaining Eurozone economies covered by the survey. Especially noteworthy in the structure of data concerning the situation in German manufacturing is the increase in the sub-index for total new orders, which signals a high probability of rebound in the growth of activity in German manufacturing in subsequent months. The average value of PMI composite for the Eurozone amounted to 56.4 pts in Q2 vs. 55.6 pts in Q1, which poses an upside risk to our forecast, in which the quarterly GDP growth rate in the Eurozone will decrease to 0.5% in Q2 vs. 0.6% in Q1.

- ✔ **Industrial production in Poland rose by 9.1% YoY in May vs. a 0.6% decrease in April.** The main reason for the sharp increase in production dynamics between April and May was a favourable difference in the number of working days. Especially noteworthy in the data structure is the high against the backdrop of other categories output dynamics in branches making goods used in the construction-assembly production. This signals a positive impact of the rebound in construction on the situation in manufacturing. The construction-assembly production rose by 8.4% YoY in May vs. a 4.3% YoY increase in April. Seasonally-adjusted construction production dropped by 3.2% MoM. The factor limiting annualized acceleration of production dynamics in May was lower growth rate (3.3% YoY vs. 14.0% in April) in the category "specialized construction activities". We expect that in subsequent months the assembly-construction production will show an upward trend due to the forecasted by us growing absorption of EU funds, significant increase in public outlays on infrastructure and recovery in residential construction (see MACROPulse of 20/6/2017). The data on industrial and assembly-construction production in the period April-May support our forecast of GDP growth in Q2 2017 (down to 3.9% YoY vs. 4.0% in Q1).
- ✔ **Retail sales in Poland rose in current prices by 8.4% YoY in May vs. 8.1% in April.** The sales in constant prices rose by 7.4% YoY in May vs. 6.7% in April. Conducive to higher annual sales growth in May was the abatement of weather anomalies observed in April 2017, which caused slowdown in sales dynamics in the categories: "textiles, clothing, footwear" and "motor vehicles, motorcycles and parts" in April. The calendar effects related to later Easter than last year had an opposite impact (see MACROPulse of 20/6/2017). The average retail sales dynamics between April and May amounted to 7.1% YoY vs. 7.5% in Q1, thus the last week's data are consistent with our scenario of decrease in private consumption growth rate to 4.2% YoY in Q2 vs. 4.7% YoY in Q1 2017.
- ✔ **Nominal wage dynamics in the Polish sector of enterprises rose to 5.4% YoY in May vs. 4.1% in April.** Conducive to higher wage growth in May were low base effects from the year before, i.a. in the categories "manufacture of coke and refined petroleum products" and "construction" (see MACROPulse of 19/6/2017). The annual employment dynamics dropped to 4.5% YoY in May vs. 4.6% in April. Consequently, the real wage fund dynamics (employment times average wages) in enterprises rose to 8.1% YoY in May vs. 6.7% in April. Employment growth in May was limited by the growing difficulties of companies in finding skilled labour. According to GUS business surveys, the share of manufacturing companies reporting such difficulties in Q2 has been the highest in the survey history. We expect a slight decrease of the annual employment growth in subsequent months as the improvement in the labour market will gradually slow down.

✔ Reducing the VAT gap to bring at least PLN 8bn of revenues

In May 2017, Deputy Prime Minister M. Morawiecki stated that improvement in the collection of tax on goods and services (VAT) might amount to ca. PLN 15-20bn in the current year. The Finance Ministry data on the execution of the state budget in 2017 point to a marked increase in VAT revenues. Between January and April, the revenues from this tax amounted to PLN 56.8bn and were by 33.5% higher than in the similar period of the previous year. Based on the estimates of the execution of the state budget for January-May released last week, we estimate that VAT revenues (approximated by revenues from indirect taxes and reduced by excise revenues) rose by 14.1% YoY in May. In the analysis below we are trying to answer the question to what extent reducing the VAT gap (the tightening of the tax system) was responsible for the increase in VAT revenues.

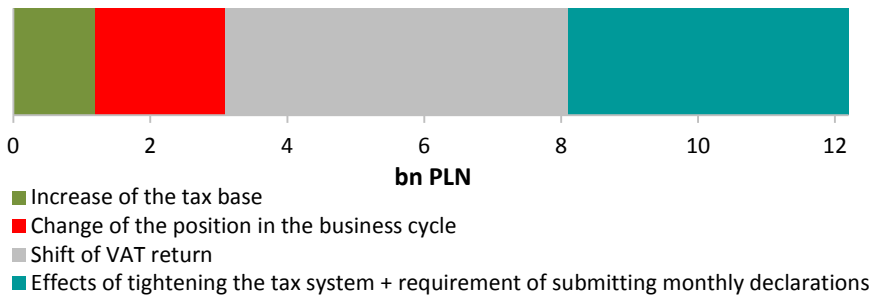
As a part of VAT tightening, several regulations, aimed at limiting VAT fraud and facilitating controls by tax authorities, were put in place. One of the administrative solutions is the introduction of so-called Standard Audit File constituting a system of controls of digital tax books data. The Standard Audit File has been binding on large businesses, keeping books in electronic form, from 1 July 2016, and on small and medium-size businesses (to a limited extent) from 1 January 2017. The tax law circumvention clause, introduced on 15 July 2016, allows officials to negate the tax benefits from actions which are only intended to reduce taxation, despite being legal. The so-called fuel package, concerning the licensing of trade in imported fuels and the methods of applying VAT on these fuels, was introduced on 1 August 2016. Other solutions, introduced as of 1 January 2017, include but are not limited to: clarification of conditions of a VAT payer deregistration and introduction of conditions for refusal to register a VAT payer, joint responsibility of the plenipotentiary registering a VAT payer for arrears in the payment of this tax, introduction of a requirement of submitting VAT declaration electronically (with some exceptions), imposition of new sanctions for inaccurate settlement of the tax or issuance of so-called empty invoices, as well as extension of so-called reversed VAT by i.a. some construction services. In addition, regulations, under which false VAT invoicing for high values will be punishable by imprisonment of even up to 25 years, were introduced on 1 March 2017.

In order to estimate the impact of the improved VAT collection on the amount of the state budget revenues from VAT, it is necessary to identify the tax base, namely the goods and services subject to taxation. We assumed that the amount of the tax base was approximately equal to the sum of private consumption, public consumption, and public investments. We should have also included households' investments in the tax base; however, the data concerning this indicator have not yet been revised in the Eurostat database (unlike public investments), which would lead to inconsistency with the remaining series. We then estimated the effective VAT rate, namely the percentage of the tax base received by the state budget. Our analysis shows that except for seasonal variations (± 0.5 pp depending on quarter), the effective VAT rate is a pro-cyclical variable, meaning that it increases with GDP dynamics and incomes earned by the society, which we believe may be due to growing percentage of expenditures on luxury goods in the households' basket and decreasing scope of grey economy in the upper phase of the business cycle.

Considering the interdependencies outlined above, we have built an econometric model in which effective VAT rate is explained by nominal dynamics of domestic demand, seasonal zero-one variables, and a binary variable representing the impact of the system tightening – it takes the value '1' in the period from Q1 2016 to Q1 2017. On the basis of this model we are able to decompose the difference between the amount of VAT revenues in Q1 2017 and Q1 2016 (PLN 12.2bn). In our analysis we are forced to disregard the information on revenues from the tax on goods and service for the period April-May because the national accounts data enabling to identify the tax base for this period are not yet available. In Q1 2017, the tax base increased by 6.4% compared to Q1 2016, which, with unchanged effective tax rate, would result in identical relative increase in VAT revenues (PLN 1.2bn). At the same time, Q1 2017 saw a sharp acceleration in the growth of domestic demand, which, according to the results of econometric modeling, contributed to a PLN 1.9bn increase in VAT revenues. This means that VAT revenues in Q1 2017 rose by PLN 3.1bn only as a result of economic growth.

According to the Finance Ministry's reply to a Parliamentary question, the actual VAT returns amounted to PLN 13.8bn in December 2016 and were higher by ca. PLN 5.0bn than in the same month of 2014 and 2015. We believe that this was the effect of the government action consisting in shifting VAT returns in order to smooth the public finance deficit profile, as such shift of VAT return is conducive to higher public deficit in 2016 and lower in 2017. This also means that VAT revenues were underestimated by ca. PLN 5bn in December 2016 and were overestimated by a similar amount in Q1, compared to a situation where such shift would not have taken place.

Breakdown of VAT revenue increase (Q1 2017 vs. Q1 2016)



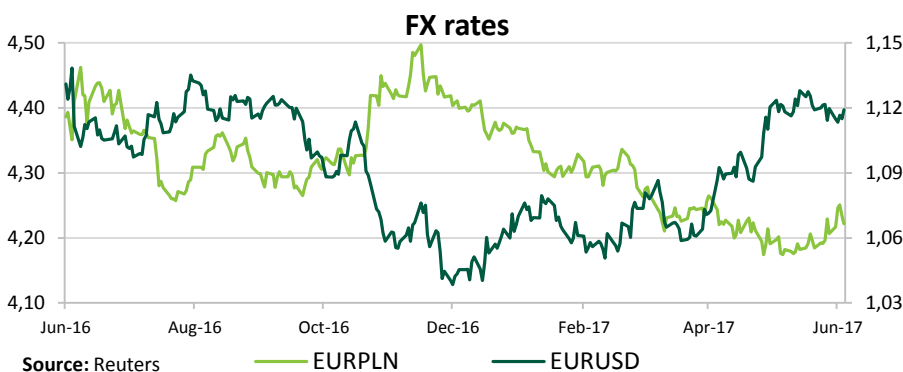
The above reasoning leads to a conclusion that PLN 8.1bn of the PLN 12.2bn of the VAT revenue increase in Q1 2017 compared to Q1 2016 can be attributed to the impact of factors unrelated to the government actions consisting in tax system tightening. The remaining PLN 4.1bn should be additionally adjusted by the impact of a new regulation, effective from

Source: Credit Agricole

January 2017, requiring that VAT declarations should be submitted monthly (instead of quarterly) by taxpayers whose sales in the previous year exceed an equivalent of EUR 1.2M. According to our calculations based on Pontinfo base, this requirement will be applicable to taxpayers who are responsible for a prevailing part of VAT paid (96%). This means that companies which in 2016 settled VAT for Q1 in full in April were forced to split this payment into February, March, and April in 2017. This leads to higher budget VAT revenues in Q1 2017 compared to 2016. It should however be noted that before this regulation was introduced a substantial part of companies had already been paying VAT monthly on a voluntary basis. This means that the impact of this factor was not significant.

When estimating additional VAT revenues resulting from the tightening, one should also address the fact that the model does not fully match empirical data (model error). This error amounts to ca. PLN 7bn for the whole year. Considering the scale of this error, and being directed by the principle of conservative estimate, we have concluded that a downward deviation from the forecast amount of additional VAT revenues resulting from the tax system tightening is more likely now. Consequently, we estimate that additional revenues resulting from improved VAT tax collection in 2017 will amount to 8-15bn PLN. Hence, reaching the lower limit of the target indicated by M. Morawiecki is likely. Our estimates may change after the publication of the report on VAT revenues execution for the period January-June and of the national accounts data enabling to identify the tax base in Q2.

Domestic data on inflation negative for PLN



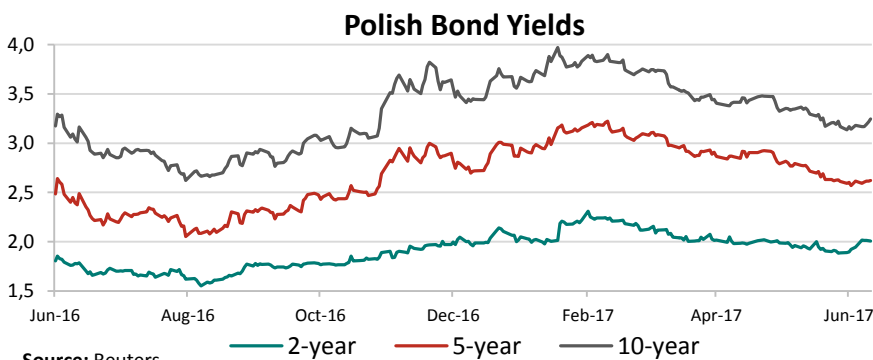
Source: Reuters

Last week EURPLN rate rose to 4.2218 (PLN weakening by 0.4%). Monday through Wednesday saw a slight weakening of PLN. The depreciation of PLN was supported by investors' expectations of an interest rates hike in the US and a drop of fuel prices. Domestic data on industrial production and retail sales had a limited impact on PLN. On Thursday, the trend reversed,

global risk aversion reflected by VIX index decreased, and PLN strengthened. The appreciation of PLN was also supported by weaker-than-expected results of business surveys in the Eurozone (PMI) released on Friday.

Crucial for PLN this week will be the flash data on domestic inflation, which, if our forecast materializes, may be conducive to its weakening. On the other hand, we believe that the publication of flash data on inflation in Germany and the Eurozone will be slightly positive for PLN. We expect that the US data will not be market moving. The publication of the business survey results for manufacturing in China (PMI) and Germany (Ifo) will also be neutral for PLN, we believe.

 **Flash data on June inflation in the Eurozone positive for debt**



Source: Reuters

Last week the yield of Polish 2-year benchmark bonds rose to a level of 2.007 (up by 6 bp), of 5-year bonds have not changed and amounted to 2.621, and of 10-year bonds rose to a level of 3.246 (up by 7 bp). From Tuesday, yields on Polish bonds were increasing in the center and at the long end of the curve. In turn, the debt prices at the short end of the yield curve

continued to be relatively stable. Conducive to higher yields on bonds were markets' expectations of monetary tightening in the US and increased risk aversion reflected by a bigger spread vs. yields on core markets. On Thursday, the Finance Ministry held a debt swap auction at which it redeemed PLN 4.16bn of bonds maturing in 2017 and 2018 with demand amounting to PLN 5.16bn, selling PLN 4.03bn of 2-, 5-, 9-, and 10-year bonds. The auction was not market moving.

This week the Polish debt market will focus on flash data on inflation in Poland. If our forecast materializes, we expect an increase in the prices of Polish bonds. The publication of flash data on the June inflation in the Eurozone may also have a positive impact on the prices of the Polish debt. We expect that the publication of the data from the US, as well as Ifo index and PMI index in China will be neutral for the local bond market.

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	4,20
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	3,77
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	3,87
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	1,9	
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	0,8	
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	9,1	
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	2,5	
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	8,4	
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	5,4	
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	4,5	
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	-275		
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	0,6		
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	3,4		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland												
Indicator	2017				2018				2016	2017	2018	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
Gross Domestic Product (% YoY)	4,0	3,9	4,1	4,1	3,4	3,8	3,6	3,9	2,7	4,0	3,7	
Private consumption (% YoY)	4,7	4,2	3,2	3,1	3,3	3,3	3,0	3,2	3,8	3,8	3,2	
Gross fixed capital formation (% YoY)	-0,4	3,9	6,1	8,2	8,8	6,8	5,2	4,1	-7,9	5,4	5,7	
Export - constant prices (% YoY)	8,3	8,5	9,6	10,1	8,1	7,2	8,8	8,9	9,0	9,1	8,3	
Import - constant prices (% YoY)	8,7	9,4	10,6	11,7	10,1	9,1	8,1	7,9	8,9	10,1	8,8	
GDP growth contributions	Private consumption (pp)	3,0	2,5	1,9	1,5	2,1	2,0	1,8	1,6	2,3	2,2	1,8
	Investments (pp)	0,0	0,6	1,1	2,0	1,0	1,1	0,9	1,0	-1,6	1,0	1,0
	Net exports (pp)	0,1	0,0	-0,2	-0,4	-0,7	-0,6	0,6	0,7	0,3	-0,2	0,0
Current account***	0,0	-0,1	-0,1	-0,5	-1,1	-1,3	-1,2	-1,0	-0,3	-0,5	-1,0	
Unemployment rate (%)**	8,1	7,1	7,0	7,3	7,6	6,8	7,0	7,3	8,3	7,3	7,3	
Non-agricultural employment (% YoY)	2,1	1,5	1,3	0,6	0,2	0,0	0,0	0,0	1,9	1,4	0,0	
Wages in national economy (% YoY)	4,1	4,4	4,9	4,6	4,9	5,2	5,4	5,5	3,8	4,5	5,2	
CPI Inflation (% YoY)*	2,0	2,0	2,0	1,9	1,3	1,6	1,3	1,3	-0,6	2,0	1,4	
Wibor 3M (%)**	1,73	1,73	1,73	1,73	1,73	1,73	1,90	1,98	1,73	1,73	1,98	
NBP reference rate (%)**	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,75	1,50	1,50	1,75	
EURPLN**	4,23	4,20	4,18	4,16	4,15	4,12	4,10	4,07	4,40	4,16	4,07	
USDPLN**	3,97	3,77	3,77	3,71	3,71	3,61	3,50	3,45	4,18	3,71	3,45	

* quarterly average

** end of period

***cumulative for the last 4 quarters

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
Monday 06/26/2017						
10:00	Germany	Ifo business climate (pts)	Jun	114,6	115,1	114,4
10:00	Poland	Registered unemployment rate (%)	May	7,7	7,3	7,4
14:30	USA	Durable goods orders (% MoM)	May	-0,8	-0,2	-0,6
Tuesday 06/27/2017						
15:00	USA	Case-Shiller Index (% MoM)	Apr	0,9		0,5
16:00	USA	Richmond Fed Index	Jun	1,0		
16:00	USA	Consumer Confidence Index	Jun	117,9	115,0	116,0
Wednesday 06/28/2017						
10:00	Eurozone	M3 money supply (% MoM)	May	4,9		5,0
Thursday 06/29/2017						
11:00	Eurozone	Business Climate Indicator (pts)	Jun	0,90		0,96
14:00	Germany	Preliminary HICP (% YoY)	Jun	1,4	1,20	1,30
14:30	USA	Final GDP (% YoY)	Q1	1,2	1,2	1,2
14:30	USA	Initial jobless claims (k)	w/e	241		240
Friday 06/30/2017						
3:00	China	Caixin Manufacturing PMI (pts)	Jun	51,2	51,1	51,0
11:00	Eurozone	Preliminary HICP (% YoY)	Jun	1,4	1,2	1,2
14:00	Poland	Flash CPI (% YoY)	Jun	1,9	1,7	1,9
14:30	USA	Real private consumption (% MoM)	May	0,2		
15:45	USA	Chicago PMI (pts)	Jun	59,4		58,0
16:00	USA	Final U. of Michigan Sentiment Index (pts)	Jun	94,5	95,0	94,5

*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