Road fee will reduce consumers' purchasing power by more than PLN 4bn

This week

- **The most important event this week will be the ECB meeting scheduled for Thursday.** In our view, the interest rates will be left unchanged. We expect that the tone of the statement and conference after the meeting will point to further change in the ECB bias to neutral. We believe that the statement will include information about the improvement in economic outlook recorded in the Eurozone, which, in the ECB opinion, will positively impact inflation. The ECB is also likely to change the statement after the meeting by removing the part about the probability of possible increase in the monthly scale of asset purchases under the quantitative easing program. At the same time, M. Draghi will indicate that the ECB policy will continue to be accommodative for an extended period of time. We believe that the publication of the statement and the tone of the conference after the meeting will be conducive to a slight weakening of PLN and drop of prices of Polish debt.
- **Significant hard data on US economy and business survey results will also be released this week.** We expect that the ongoing recovery in the US real estate market will be confirmed by data on housing starts (1170k in June vs. 1092k in May) and building permits (1220k vs. 1168k). The results of business sentiment surveys for manufacturing will also be released this week. We forecast that the Philadelphia Fed Index rose to 30.0 pts in July vs. 27.6 pts in June, while the NY Empire State Index dropped to 16.0 pts in July vs. 19.8 pts in June. We believe that the aggregate impact of data on the US economy on the financial market will be limited.
- **ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany will be released this week.** The market expects that its value will drop to 18.0 pts in July vs. 18.6 pts in June.
- **The June data on average wages and employment in the corporate sector in Poland will be released on Tuesday**. We forecast that employment dynamics dropped to 4.3% YoY from 4.5% in May. In turn, the average wage dynamics dropped to 4.9% YoY in June vs. 5.4% in May. Though important for the forecast of private consumption dynamics in Q2, the release of data on corporate wages and employment will be neutral for PLN and the debt market, we believe.
- **Data on industrial production and retail sales in Poland will be released on Wednesday.** We forecast that output dynamics dropped to 4.3% YoY in June vs. 9.1% in May. In turn, the nominal retail sales growth rate dropped to 6.7% YoY in June vs. 8.4% in May, we believe. Conducive to the slower growth rates of the two indicators were mainly the unfavourable calendar effects. If the output and sales growth rates reach the levels we forecast, they will confirm the expected by us slowdown of economic growth in Q2. We believe that if our forecasts materialize, the aggregate impact of the data will be slightly positive for PLN and yields on Polish bonds.
- **Important data from Chine have been released today.** The economic growth rate rose to 1.7% QoQ in Q2 from 1.3% in Q1 (6.9% YoY vs. 6.9% in Q1). Other monthly data pointed to acceleration in the annual economic growth rate in June. Industrial production increased by 7.6% YoY in June vs. 6.5% in May, retail sales rose by 11.0% YoY vs. 10.7%, and urban investments growth rate has not changed compared to May and amounted to 8.6%. The data released today pose an upside risk to our forecast of GDP growth rate in China (6.7% in 2017). We believe that the solid data from China will be conducive to improvement in market sentiment this week and increase in risk appetite and thus to the strengthening of emerging currencies, including PLN.

Last week

- **FED chair, J. Yellen, presented the semi-annual monetary policy report to the Congress last week.** In her remarks, she pointed to deterioration in the US inflation outlook, which suggests taking a cautious approach in further normalization of FED monetary policy. However, she indicated that in her view the decrease in inflation occurred partly due to transitory factors and it was too early to expect that it would not reach the target in the medium term. J. Yellen emphasized, at the same time, that FED was prepared to adjust its policy in a situation of high likelihood of inflation running persistently below the target (2.0%). Therefore, we believe that, in case of lack of signals of improved outlook for core inflation, the assumed by us 3 interest rate hikes in 2018, signaled also by the median expectations of FOMC members in the June inflation projection (see MACROmap of 19/6/2017), will likely not materialise. J. Yellen's remarks do not alter our scenario, in which FED will start to reduce its balance-sheet this September and will hike interest rates by 25 bp in December 2017.
- **Numerous data from the US economy were released last week.** Industrial production dynamics rose to 0.4% MoM in June vs. a 0.1% in May. Its increase occurred due to higher production growth rate in manufacturing, while lower production growth rate in mining and media supply had an opposite impact. Production capacity rose to 76.6% in June vs. 76.4% in May. Data on retail sales were also released last week and dropped by 0.2% MoM in June vs. a 0.1% decrease in May. Excluding car sales, retail sales dropped by 0.2% MoM in June vs. a 0.3% decrease in May. The preliminary University of Michigan Index pointed to a deterioration of consumer sentiment and dropped to 93.1 pts in July vs. 95.1 pts in June. The index decrease resulted from its lower sub-index concerning expectations while higher sub-index for the assessment of current situation had an opposite impact. The last week's data from the US economy do not alter our forecast, in which the annualized GDP growth rate in the US will rise to 3.5% in Q2 vs. 1.4% in Q1.
- **CPI inflation in June decreased to 1.5% YoY vs. 1.9% in May.** The drop in inflation (by 0.4 pp) was due to lower dynamics of prices in the category "transport". The main factor behind lower growth rate of prices in this category was lower fuel prices (see MACROpulse of 11/7/2017). Core inflation did not change in June compared to May and amounted to 0.8% YoY. The data pose a downside risk to our forecast, in which in two subsequent quarters average inflation in Poland will run at level of ca. 1.9%-2.0% YoY. However, conducive to increase in inflation is the introduction of a new road fee announced by the government (see below).
- **The current account deficit in Poland rose to EUR 179M in May from EUR 160M in April.** The decrease in the current account balance resulted from lower balances on goods and secondary income (lower from April by EUR 411M and EUR 35M, respectively), while higher balances on services and primary income (higher from April by EUR 218M and EUR 209M, respectively) had an opposite impact. Export dynamics rose to 14.5% YoY in May vs. 1.4% in April, and import dynamics rose to 19.1% YoY vs. 3.3%. Higher exports and imports growth occurred mainly due to the statistical effect in the form of a favourable difference in the number of working days. We forecast that the relation of cumulative current account balance for the last 4 quarters to GDP will decrease to -0.1% in Q2 vs. 0.1% in Q1.
- **The foreign trade surplus rose to EUR 20.3M in May vs. EUR 19.8M in April.** At the same time, export dynamics rose to 1.4% MoM in May vs. 0.9% in April, while the monthly import growth rate has not changed compared to April and amounted to 1.2%. We forecast that the quarterly growth rate of the German GDP has not changed in Q2 compared to Q1 and amounted to 0.6%.
- **The foreign trade balance of China increased to USD 42.8bn in June vs. USD 40.8bn in May.** At the same time export dynamics recorded an increase to 11.3% YoY in June vs. 8.7% in May and import dynamics rose to 17.2 from 14.8%. Higher import and export growth rates reflects the

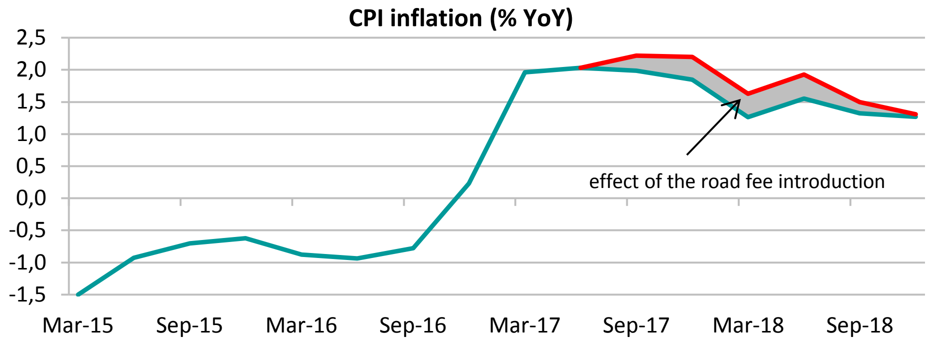
changing structure of GDP growth in China, which to an increasingly higher extent is based on total consumption while the significance of investments is diminishing. The relatively high, against historical backdrop, growth rate of Chinese imports and exports supports our forecast of recovery in global trade.

- **Last week Sejm adopted changes in the functioning of the National Council of the Judiciary (Krajowa Rada Sądownictwa - KRS) and of the common courts system.** The bills were passed by the Senate unamended and were directed to the President for signature. The adopted changes assume i.a. the establishment of two chambers within the KRS and the termination of the term of office of its present members (judges) after 30 days of the entry into force of the amendment. New Council members will be appointed by the Sejm for a four-year term. KRS members have so far been appointed by the judicial circles. The amendment also provides for the derogation from the principle of appointment of the presidents of district courts by the president of the appeal court, under the procedure of the General Assembly of Judges opining on the candidate, in favour of their appointment by the Minister of Justice. Changes in the method of the appointment of KRS members and of presidents of the appeal and regional courts pose a risk of the Judiciary losing independence from the legislative and executive powers. In reaction to the adopted changes, the Head of the European Commission, Jean-Claude Juncker, announced that the Commission would discuss this week the rule of law in Poland. We believe that, in reaction to the changes introduced in the functioning of the administration of justice, in the short term the EC will not take any actions that could substantially affect the prospects for economic growth in Poland, PLN rate or prices of the Polish debt. The absence of market reaction to the adopted changes may signal that investors do not see them as a significant threat to the investment climate in Poland and treat the EC reaction and protests of the opposition against the changes as yet another development in the political dispute in Poland. In our view, the adopted acts are slightly negative for Poland's credit rating; however, they are not likely to bring about changes in Poland's rating by major agencies. Firstly, the last week's amendments will be taken into account in the rule of law indices – hence in the assessment of the rating – with a considerable delay. Secondly, the agencies are likely to indicate the difficult to assess impact on the investment climate in Poland. However, we see a risk that, at the next revision, Standard & Poor's will again change the outlook for Poland's rating to "negative". Our view is supported by the remark of F. Winnekens, the agency analyst in charge of Poland's rating revision, in today's Dziennik Gazeta Prawna daily, who said that the proposed amendments were yet another confirmation of the agency's earlier opinion on the weakening of the institutions and deterioration in the functioning of the check and balances mechanisms which had influenced Poland's rating downgrade in January 2016.

Road fee will reduce consumers' purchasing power by more than PLN 4bn

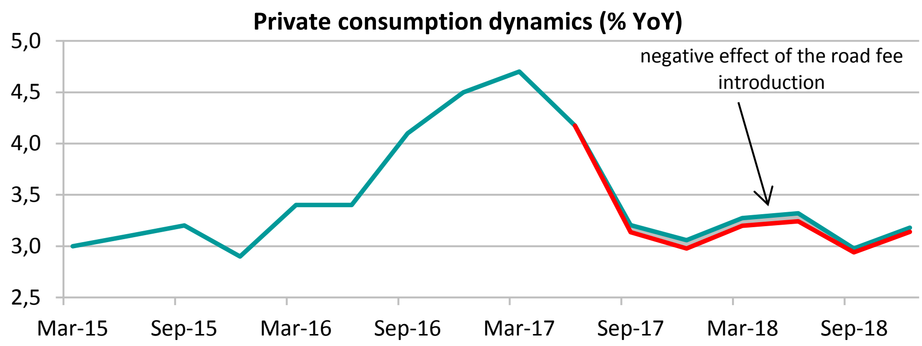
The Parliament is currently working on establishing a so-called Local Government Road Fund (Fundusz Dróg Samorządowych - FDS), with the mission to co-finance the building and rebuilding of county and municipal roads and bridges along province roads. According to the justification to the draft bill, its introduction will positively impact regional development by improving the availability of the communication infrastructure and thus conditions for business activity. FDS will operate along the same lines as the National Road Fund. The main source of FDS financing will be a so-called road fee, consisting in the introduction of a 20 grosz rate to be added to the price of one liter of motor fuel and gas used as fuel in vehicles with the internal combustion engines. In accordance with the government estimates, the establishment of such fee should guarantee revenue at a level of ca. PLN 4-5bn per year. For comparison, they represent one-fifth of the budget expenditures related with the operation of the Family 500+ Scheme (PLN 24-25bn in 2018) and half of the costs resulting from the reduction of

the retirement age (PLN 10.2bn). The road fee proceeds will be divided fifty-fifty into the FDS revenues and the National Road Fund revenues. The analysis below presents the expected by us impact of the new road fee on selected macroeconomic indicators in Poland. We are considering two scenarios: the base scenario, in line with our quarterly macroeconomic forecast (MACROmap of 12/6/2017), and an alternative scenario, factoring in the effects of the introduction of the road fee.



Source: Credit Agricole

For the purpose of our analysis, we have assumed that the aforementioned changes will enter into force with effect from August 2017. We assume that the road fee will be transferred in full to consumers through an increase of fuel prices. Considering that the rate, presented in the draft bill, will be increased by VAT, the road fee will raise the price per liter of any fuel (gasoline, diesel fuel, gas) by ca. 25 grosz. Given the current level of fuel prices and assuming that the structure of their consumption will be as in the inflation basket, this means an effective increase in fuel prices by ca. 6%. Last year, the cost of fuel for private means of transport represented 4.83% of total household expenditures. Thus, the direct inflation impulse resulting from road fee introduction will materialize as a 0.3 pp increase in total price dynamics within the horizon of 12 months from the adoption of the bill, as compared to the base scenario. However, we should bear in mind that higher fuel prices contribute to increase in household spending not only in a direct way but also result in higher operating costs of enterprises (i.a. due to higher costs of transport). These costs are to a large extent transferred to consumers in final prices of goods and services. In order to estimate the overall price effects of the road fee introduction, we have used our econometric model, based on which we prepare our quarterly forecasts. It factors in the above-mentioned interdependencies in an equation describing core inflation (fuel price growth rate delayed by one quarter is one of the variables that explains it). Based on our simulations, indirect effects of the road fee introduction will contribute to increasing the core inflation path by ca. 0.1 pts, as compared to the base scenario. Consequently, the aggregate impact of direct and indirect effects will contribute to increasing the total price growth rate by ca. 0.4 pp within the horizon of one year from the adoption, as compared to the base scenario. The secondary price effects related to the road fee rate adjustment (by inflation rate) in coming years will have a negligent impact on the price growth rate in Poland.

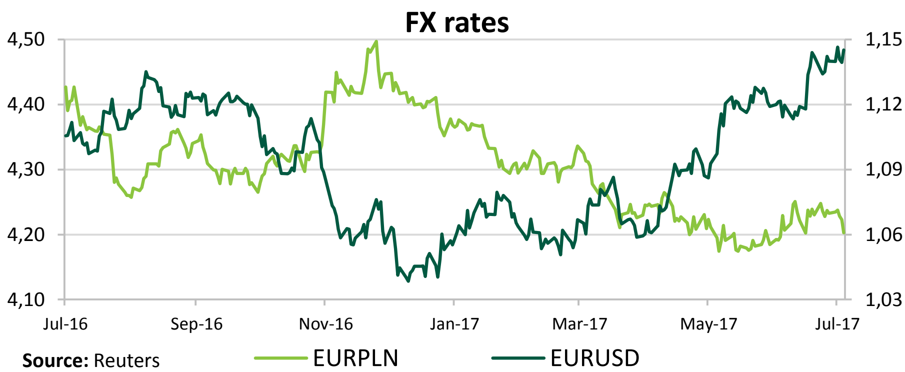


Source: Credit Agricole

Higher fuel prices are not only conducive to increase in inflation but also impact the real economy. The price rise outlined above will contribute – with other conditions unchanged – to a decrease in real wages and, consequently, also to a decrease in the purchasing power of households by ca. 0.4%, namely ca. PLN 4.5bn. The results of the simulation with the use of our quarterly model indicate that real drop in consumption will be lower than it would result from direct consideration of the inflation impulse presented above. Firstly, the rise in prices will contribute to increasing the wage pressure, which will be conducive to an increase in nominal wage dynamics by ca. 0.1 pp, as compared to the base scenario. Thus, real wage dynamics will decrease by only 0.3 pp in the horizon of one year from introducing the fee. Secondly, changes in wages are not mirrored precisely by changes in private consumption. In accordance with the theory of the economy, households tend to smooth out the level of their consumption over time. They mitigate negative income shocks by utilizing accumulated savings or taking credits. The structure of our model factors in such consumer behavior. In effect, taking into account the increase in nominal wages and the private consumption smoothing, the introduction of the road fee will contribute to a decrease in real private consumption dynamics by 0.1 pts in one-year horizon. This means that real private consumption will decrease by ca. PLN 1.1bn, as compared to the base scenario.

The introduction of road fee is conducive to raising the inflation path presented in our June forecast, in which inflation in Poland will run at a level of ca. 1.9% - 2.0% YoY in H2 2017. At the same time, the June inflation data released last week (see MACROpulse of 11/7/2017) pose a downside risk to our forecast. We believe that the aggregate effect of these two factors will be neutral to our inflation forecast presented in the base scenario. Consequently, the negative impact of the inflation impulse on real private consumption dynamics will be negligible. The main risk to our assumptions is the difficulty in estimating the extent to which fuel producers will include the road fee in the final price of fuel. There is a possible scenario where the fuel concerns owned by the State Treasury (PKN Orlen, Lotos) will follow a strategy aimed at permanently increasing market share. To this end, they may delay the increases in fuel prices or introduce them gradually. In such scenario, the impact of the road fee on increase in inflation will be proportionately lower and more spread over time.

Domestic data on industrial production positive for PLN

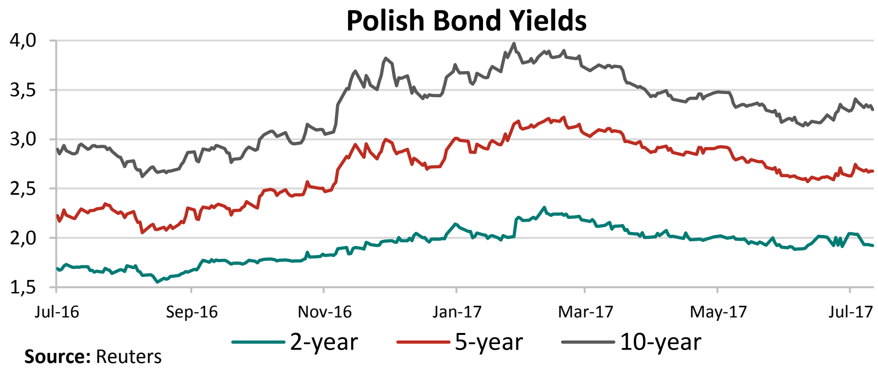


Source: Reuters

Last week EURPLN rate dropped to 4.2030 (PLN strengthening by 0.7%). Throughout the week, PLN and other currencies of the region were within an upward trend, following the decrease in global risk aversion. Conducive to their strengthening were also the dovish remarks of FED chair, J. Yellen, before the Congress, which indicated an increased likelihood of a slower-from-the-market-expectations pace of the monetary policy normalization in the US in 2018. Domestic data on inflation and the balance of payments were neutral for PLN.

We believe that today's solid readings from China will be conducive to improvement in market sentiment this week and increase in risk appetite and thus to the strengthening of the emerging currencies, including PLN. Crucial for PLN this week will be the ECB meeting, scheduled for Thursday. The expected by us change in ECB bias to more neutral will be conducive to a slight weakening of PLN. Important for PLN will also be the publication of domestic data on industrial production and retail sales, scheduled for Wednesday. We believe that, if our forecasts materialize, the aggregate impact of the data will be slightly positive for PLN. Other domestic data (employment and average wages in the corporate sector) and US data (housing starts, building permits, Philadelphia FED and NY Empire State Indices) will not be market moving.

Polish debt market focuses on the ECB meeting



Source: Reuters

Last week the yield of Polish 2-year benchmark bonds dropped to a level of 1.924 (down by 11 bp), of 5-year bonds to a level of 2.676 (down by 3 bp), and of 10-year bonds to a level of 3.303 (down by 8 bp). At the opening on Monday, the prices of the Polish debt were going up, following the German bonds. This was a correction after a sharp decline in their prices two weeks ago (see MACROmap of 10/7/2017). At the opening on Tuesday, the yields on Polish bonds increased, partly due to higher uncertainty in the market, in anticipation of the testimony of FED chair, J. Yellen, to the Congress. Her dovish remarks further into the week were conducive to increase in appetite for risk assets and, consequently, to lower yields on Polish bonds. Domestic data on inflation and the balance of payments were not market moving.

This week the Polish debt market will focus on the ECB meeting, scheduled for Thursday. The expected by us change in the ECB bias to more neutral will be negative for the prices of Polish bonds, we believe. The publication of domestic data on inflation and retail sales, scheduled for Wednesday, may also contribute to a drop of prices of the Polish debt. Other domestic data (employment and average wages in the corporate sector) and US data (housing starts, building permits, Philadelphia FED and NY Empire State Indices) will be neutral for the Polish debt market, we believe.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	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	Jul-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	4,35	4,36	4,29	4,31	4,45	4,40	4,32	4,31	4,23	4,23	4,18	4,23	**4,21**
USDPLN*	3,94	3,90	3,91	3,82	3,92	4,20	4,18	4,00	4,07	3,97	3,88	3,72	3,70	**3,72**
CHFPLN*	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	**3,85**
CPI inflation (% YoY)	-0,8	-0,9	-0,8	-0,5	-0,2	0,0	0,8	1,7	2,2	2,0	2,0	1,9	1,5	
Core inflation (% YoY)	-0,2	-0,4	-0,4	-0,4	-0,2	-0,1	0,0	0,2	0,3	0,6	0,9	0,8	0,8	
Industrial production (% YoY)	6,0	-3,4	7,5	3,2	-1,3	3,2	2,2	9,1	1,1	11,0	-0,6	9,1	**4,3**	
PPI inflation (% YoY)	-0,8	-0,5	-0,1	0,2	0,6	1,8	3,2	4,0	4,5	4,8	4,2	2,5	**2,2**	
Retail sales (% YoY)	4,6	2,0	5,6	4,8	3,7	6,6	6,4	11,4	7,3	9,7	8,1	8,4	**6,7**	
Corporate sector wages (% YoY)	5,3	4,8	4,7	3,9	3,6	4,0	2,7	4,3	4,0	5,2	4,1	5,4	**4,9**	
Employment (% YoY)	3,1	3,2	3,1	3,2	3,1	3,1	3,1	4,5	4,6	4,5	4,6	4,5	**4,3**	
Unemployment rate* (%)	8,7	8,5	8,4	8,3	8,2	8,2	8,3	8,6	8,5	8,1	7,7	7,4	**7,1**	
Current account (M EUR)	-723	-503	-729	-858	172	99	-219	2342	-599	-529	-160	-179		
Exports (% YoY EUR)	6,0	-5,3	9,3	3,1	-0,6	5,7	5,1	14,3	5,7	15,1	1,4	14,5		
Imports (% YoY EUR)	0,8	-7,3	10,7	3,5	3,6	6,3	7,1	16,0	8,9	16,8	3,3	19,1		

*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
GDP growth contributions: Investments (pp)	0,0	0,6	1,1	2,0	1,0	1,1	0,9	1,0	-1,6	1,0	1,0
GDP growth contributions: 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***	0,1	-0,1	-0,1	-0,5	-1,1	-1,3	-1,2	-1,0	-0,2	-0,5	-1,0
Unemployment rate (%)**	8,1	7,1	7,0	7,3	7,6	6,8	6,6	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	1,8	2,0	1,9	1,3	1,6	1,3	1,3	-0,6	1,9	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	4,23	4,18	4,16	4,15	4,12	4,10	4,07	4,40	4,16	4,07
USDPLN**	3,97	3,70	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	FORECAST* CONSENSUS**
		Monday 07/17/2017				
4:00	China	Retail sales (% YoY)	Jun	10,7	10,4	10,6
4:00	China	Industrial production (% YoY)	Jun	6,5	6,7	6,5
4:00	China	Urban investments (% YoY)	Jun	8,6	8,6	8,5
11:00	Eurozone	HICP (% YoY)	Jun	1,3	1,3	1,3
14:30	USA	NY Fed Manufacturing Index (pts)	Jul	19,8	16,0	15,0
:	China	GDP (% YoY)	Q2	6,9	6,8	6,8
		Tuesday 07/18/2017				
11:00	Germany	ZEW Economic Sentiment (pts)	Jul	18,6		18,0
14:00	**Poland**	**Employment (% YoY)**	**Jun**	**4,5**	**4,3**	**4,3**
14:00	**Poland**	**Corporate sector wages (% YoY)**	**Jun**	**5,4**	**4,9**	**5,0**
		Wednesday 07/19/2017				
14:00	**Poland**	**Retail sales (% YoY)**	**Jun**	**8,4**	**6,7**	**6,9**
14:00	**Poland**	**PPI (% YoY)**	**Jun**	**2,5**	**2,2**	**2,2**
14:00	**Poland**	**Industrial production (% YoY)**	**Jun**	**9,1**	**4,3**	**3,8**
14:30	USA	Housing starts (k MoM)	Jun	1092	1170	1150
14:30	USA	Building permits (k)	Jun	1168	1220	1200
		Thursday 07/20/2017				
10:00	Eurozone	Current account (bn EUR)	May	22,0		
13:45	Eurozone	EBC rate decision (%)	Jul	0,00	0,00	0,00
14:30	USA	Initial jobless claims (k)	w/e	248		245
14:30	USA	Philadelphia Fed Index (pts)	Jul	27,6	30,0	24,7
16:00	Eurozone	Consumer Confidence Index (pts)	Jul	-1,3		-1,1
		Friday 07/21/2017				
14:00	**Poland**	**M3 money supply (% YoY)**	**Jun**	**6,2**	**6,1**	**6,0**

*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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