What will be the contribution of change in inventories to GDP growth in H2 2017 ?

This week

- **The most important event this week will be the FOMC meeting scheduled for Wednesday.** We expect that the target range for the Federal Reserve funds will be left at an unchanged level. We believe that the FED chair, J. Yellen, will announce this week that the reduction of the Federal Reserve balance sheet will start as from October. At the same time she is likely to emphasize that interest rate level will continue to be the main tool of the US monetary policy. Such decision will be consistent with earlier remarks of FED members. The September FOMC macroeconomic projection will be presented at the conference after the meeting. We expect that the unemployment rate and inflation profiles will be slightly lowered compared to the June projection. On the other hand GDP profile will be most likely revised upwards. The projection is also likely to indicate that the scale of the monetary tightening preferred by FED members in 2017 is 25 bp (no changes compared to the June projection) and in 2018 it is 50 bp (vs. 75 bp in the previous projection). Our scenario assuming no changes in the interest rate level at the meeting this week and announcement of the start of FED balance sheet reduction is in line with the market consensus. However, markets may show increased volatility during the conference after the FOMC meeting. The publication of the September FOMC macroeconomic projection (pointing to lower interest rate level in 2018) may contribute to a slight strengthening of PLN and a drop of yields on Polish bonds at the long end of the curve.
- **Another important event will be the publication of the results of the September business surveys for major European economies.** We expect that Composite PMI for the Eurozone dropped to 55.5 pts in September vs. 55.7 pts in August. In our view, the index decline resulted from a slight deterioration of business sentiment both in Germany and France. ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany will be released on Tuesday. We expect that its value will rise to 10.6 pts in September vs. 10.0 pts in August. We believe that the data will be neutral for PLN and prices of Polish bonds.
- **Significant hard data on US economy and business surveys results will also be released this week.** We expect that the sustainability of the recovery in the US real estate market will be confirmed by data on housing starts (1185k in August vs. 1155k in July), building permits (1220k vs. 1223k), and existing home sales (5.52M vs. 5.44M). The results of business surveys for manufacturing will also be released this week. We forecast that the Philadelphia FED Index dropped to 18.0 pts in September vs. 18.9 pts in August. We believe that the aggregate impact of data on the US economy on the financial market will be limited.
- **Data on industrial production and retails sales in Poland will be released on Thursday.** We forecast that industrial production dynamics rose to 6.7% YoY in August vs. 6.2% in July, due to the abatement of the unfavourable effect of holiday breaks in car factories. In turn, in our view, the nominal retail sales growth rate dropped to 5.8% YoY in August vs. 7.1% in July, due to the high base effects in some categories. We believe that if our forecasts materialize, the aggregate impact of the data will be slightly positive for PLN and yields on Polish bonds.
- **The August data on average wages and employment in the corporate sector in Poland will also be released today**. We forecast that employment dynamics rose to 4.6% YoY from 4.5% in July. The higher growth rate resulted from the low base effects (in August 2016 employment decreased by 1.3k MoM). In turn, the average wage dynamics rose to 5.7% YoY in August vs. 4.9% in July (the effect of changed timing of bonuses paid in mining). Though important for the forecast of private consumption dynamics in Q3, the release of data on corporate wages and employment will be neutral for PLN and the debt market, we believe.

Last week

- **Numerous hard data and business survey results were released last week in the US.** As we expected, CPI inflation rose to 0.4% MoM in August vs. 0.1% in July (1.9% YoY in August vs. 1.8% in July), running above the market consensus (0.3% MoM and 1.8% YoY). Core inflation rose to 0.2% MoM in August vs. 0.1% in July (1.7% YoY in August and in July). The increase in inflation resulted mainly from higher dynamics of fuel prices caused by suspension of operations in some Texas refineries due to hurricane Harvey. The publication of better than the market consensus data led to a temporary strengthening of USD vs. EUR. Data on retails sales in the US were also released last week and decreased by 0.2% MoM in August vs. a 0.3% increase in July. The main factor behind lower retail sales was lower monthly growth rate of car sales. Excluding car sales, retail sales rose by 0.2% MoM vs. a 0.4% increase in July. Data on industrial production were also released last week and decreased by 0.9% MoM in August vs. a 0.4% increase in July, due to lower production growth in all its branches (manufacturing, mining, and utilities). Lower production growth was mainly the result of hurricane Harvey (see above). Capacity utilization dropped to 76.1% in August vs. 76.9% in July. Business survey results were also released last week. The NY Empire State Index dropped slightly to 24.4 pts in September vs. 25.2 pts in August. This index concerns business climate in New York State, therefore, its slight decline was not associated with hurricanes Harvey and Irma which affected Texas and Florida. The preliminary University of Michigan Index pointed to a slight deterioration of consumer sentiment, dropping to 95.3 pts in September vs. 96.8 pts in August. Conducive to the index decline was its lower sub-index for expectations, while opposite impact came from higher sub-index concerning the current situation. According to the statement, the deterioration of expectations reflects the concerns of some survey participants about the impact of Harvey and Irma hurricanes on the future economic situation. The last week's data pose a slight downside risk to our forecast, in which the annualized US GDP growth rate will decrease to 2.8% in Q3 vs. 3.0% in Q2.
- **Last week the European Commission (EC) has officially moved to the second step of infringement procedure against Poland.** The procedure was launched following the publication in the Polish Official Journal of the Law on the Ordinary Courts Composition. The EC referred to Poland's response to the allegations and decided to maintain its position that the published law was incompatible with the EU law (it issued so-called "reasoned opinion"). Thus Poland has one month to comply with the EC opinion. Otherwise, the EC may refer the case to the European Court of Justice which might result in imposition of financial penalties on Poland. Further procedures and an analysis of their possible short- and medium-term impact on the Polish economy has been presented in details in MACROmap of 7/8/2017. The EC statement coincided in time with the S&P conference on ratings in the countries of Central Europe. S&P stated that the Poland's current credit rating had already factored EC dispute with Poland. At the same time the Agency signaled an upside risk to its forecast of GDP growth in Poland in 2017 (3.6%) and indicated that the review of Poland's rating scheduled for 20 October might be a good opportunity for its revision. Right after the EC decision PLN slightly weakened.
- **According to final data, CPI inflation in August increased to 1.8% YoY vs. 1.7% in July, running in line with the flash estimate by GUS.** The increase in inflation (by 0.2 pp) was due to higher dynamics of fuel prices. Opposite impact came from lower core inflation, which dropped to 0.7% YoY in August vs. 0.8% in July. Conducive to its decline were i.a. lower price dynamics in the categories "communication", "recreation and culture", and "other goods and services" (see MACROpulse of 11/9/2017). The slight decline in core inflation is a sign of continuing lack of inflationary pressure in the economy. This supports our scenario in which the MPC will leave

interest rates unchanged until November 2018. We believe that the NBP inflation projection released in November 2018 will incline the MPC members to hike interest rates by 25 bp.

- **The MPC member, E. Łon, gave an interview for the Polish Press Agency last week in which he said that a need of cutting interest rates by 50 bp might arise in the next few months**. Among the reasons for the cut he mentioned i.a. PLN strengthening, low dynamics of investments, relatively low interest rates in the region, and drop in commodity prices he expected. E. Łon also indicated that an intervention in the foreign currency market aimed at weakening PLN rate might be justified in the future. It should be noted that most MPC members do not share the view presented by E. Łon, and the NBP Governor, A. Glapiński, is himself of the opinion that interest rates will stay at the current level until the end of 2018 (see MACROpulse of 6/9/2017). Consequently, the last week's remarks of E. Łon are neutral for our short-term forecast of NBP interest rates.
- **Poland's current account deficit dropped to EUR 878M in July from EUR 932M in June.** The reduction of the current account deficit was due to higher balances on primary income, secondary income, and services (higher than in June by EUR 281M, EUR 52M, and EUR 41M, respectively), while lower balance on goods (down by EUR 320M compared to June) had an opposite impact. Export dynamics rose to 10.7% YoY in July vs. 8.7% in June, and imports dynamics dropped to 12.5% YoY vs. 15.0%. Conducive to higher exports and imports growth was the favourable difference in the number of working days. We forecast that the relation of the cumulative current account balance for the last 4 quarters to GDP will decrease to -0.7% in Q3 vs. -0.5% in Q2.
- **The meeting of the Swiss National Bank (SNB) was held last week.** As expected, the SNB left the target range for LIBOR CHF 3M unchanged at [-1.25%; -0.25%] and deposit rate at -0.75%. The provision on significant overvaluation of Swiss franc was deleted from the statement after the meeting and was replaced by a view that the depreciation of CHF observed in the last quarter enabled to "somewhat" decrease its significant overvaluation. Nonetheless, the SNB continues to believe that the CHF rate is high. Consequently, it repeated the promise to continue to be active in the currency market if needed. The latest macroeconomic projection was presented at the conference after the meeting. The inflation path was slightly revised upwards as compared to the June projection. In accordance with the September projection, inflation will run at 0.4% in 2017 (vs. 0.3% in the June projection), 0.4% in 2018 (0.3%), and 1.1% in 2019 (1.0%). On the other hand, the forecast of the Swiss GDP in 2017 was reduced to "slightly below 1.0%" vs. "ca 1.5%" in the June projection. The SNB decision is in line with our scenario for EURCHF and EURPLN, in which CHFPLN will amount to 3.59 as at the end of 2017 (see the quarterly table).
- **Numerous data from China were released last week**. Lower dynamics of industrial production (6.0% YoY in August vs. 6.4% in July), retail sales (10.1% YoY vs. 10.4%), and urban investments (7.8% vs. 8.3%) pointed to a wide range of slowdown of economic activity in the Chinese economy. At the same, the data proved to be visibly lower than the market expectations. They are also surprising in the context of the August PMIs indices for the Chinese manufacturing and services, which signaled a marked improvement. The slowdown recorded in August in China's economic growth is in line with our forecast in which the GDP growth rate in China will decrease to 6.8% in Q3 vs. 6.9% in Q2.

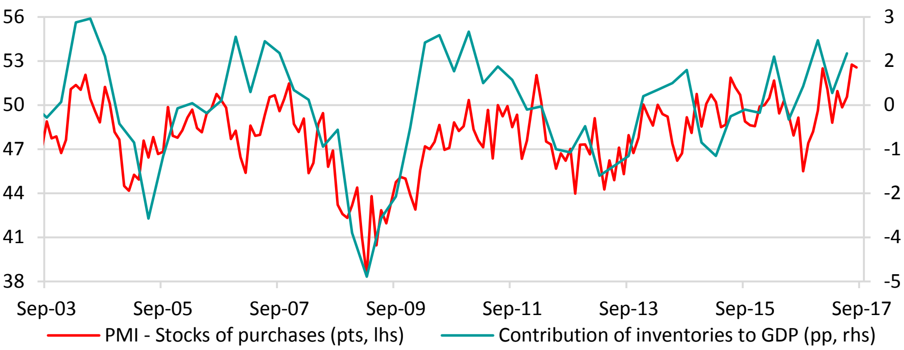
What will be the contribution of change in inventories to GDP growth in H2 2017?

According to GUS data, the main factor behind the acceleration in economic growth in Q2 was higher contribution of inventories. What is more, it has already been a fourth quarter running with a positive contribution of change in inventories to GDP growth rate. Therefore the question arises, whether we can soon expect a turning point in the inventories upward cycle.

Inventories can be divided depending on where they originated (producers' stocks and stocks in trade) and depending on level of processing (commodities and materials, work in progress, finished goods). In the case of this second classification, the levels at which they are kept in companies depend on the characteristics of the company. Based on these characteristics we can determine the so-called buffer level of inventories needed to maintain the continuity of production and sales. Despite the fact that such "optimum" level exists, historical data clearly show cyclicality of stocks. According to the theory of the economy, there are two reasons for their decline. The first one is a situation typical to the initial stage of economic recovery, when demand is satisfied not only with current production but also with inventories accumulated in previous periods. Companies are often not certain yet whether the recovery is sustainable, therefore they do not decide on bigger capacity utilization which allows them to liquidate some stocks. In the second case, inventories drop when companies, at the peak of an economic cycle, are not able to satisfy demand with current production level and have to utilize earlier accumulated stocks for that purpose.

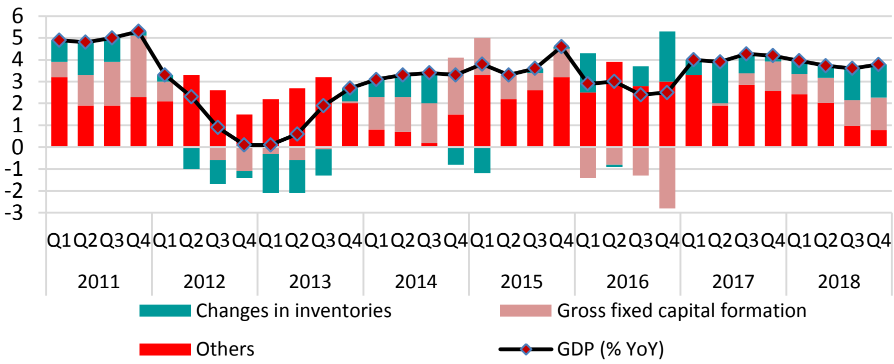
In turn, a situation where stocks grow appears when the amount of current production is higher from the demand. It is typical to the first stage of a slowdown, as companies are often unable to predict a sudden drop of demand for their products and at the beginning of a recovery when companies happen to overestimate its strength and produce too much. On the other hand, in some cases, companies, in anticipation of a recovery, increase the buffer of stocks of materials and semi-finished products in advance to be able to satisfy the future, often sharp surge in demand.

We believe that the two above mentioned factors have contributed in equal measure to the increase in the contribution of change in inventories to GDP in Q2. On the one hand, the macroeconomic conditions (i.e. demand) proved slightly worse from the market expectations. It was visible in particular in the case of a decline in investments of 50+ companies in annual terms. On the other hand, according to business surveys results, companies expect a recovery in subsequent quarters which made them increase stocks in Q2.



Source: Markit, GUS, Credit Agricole

To answer the question about the profile of the inventories contribution in Q3, we have used the results of business surveys prepared by Markit and by GUS. Historically, the contribution of inventories to GDP shows high correlation with PMI sub-index concerning stocks of purchases (linear correlation at 66.1%). The average value of this sub-index between July and August stood above Q2 average, thus suggesting a relatively robust pace of increase in inventories in Q3. In turn, the indicator of current stocks of finished goods in manufacturing prepared by GUS (correlation at 67.1%) has slightly decreased between July and August compared to Q2 average. Therefore the above business surveys do not provide a clear information as to the likely profile of the contribution of change in inventories to GDP in Q3.

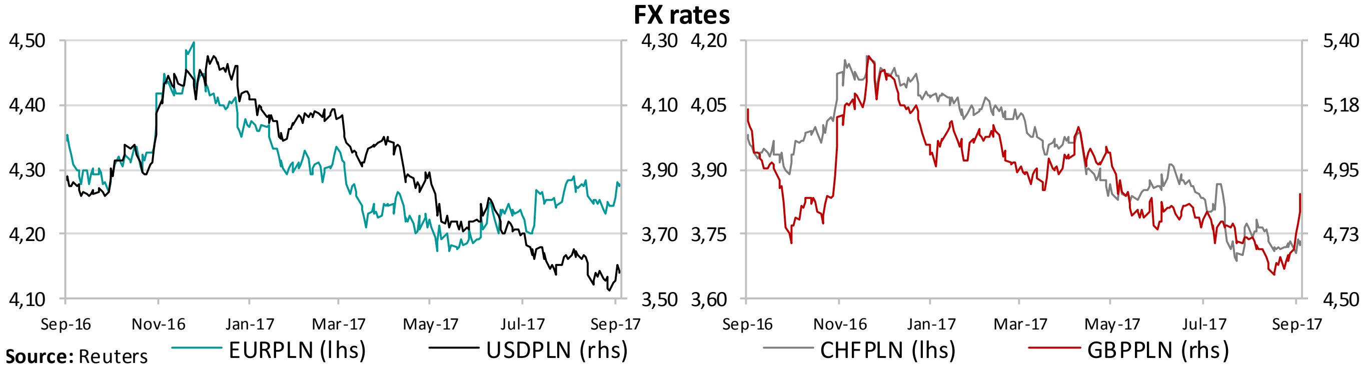


Source: GUS, Credit Agricole

We believe that the key factor determining the contribution of change in inventories to GDP in H2 2017 will be the high base effects from the year before. In Q3 2016 inventories increased by 1.9% of GDP and in Q4 2016 by 2.7% of GDP. These have been the highest increases recorded in these quarters since 2007-2008. Inventories are hardly likely to increase again so much in relation to GDP in Q3 and Q4 2017. However, we believe that the negative effect of their lower contribution to GDP growth will be more than set off by higher growth of the remaining GDP elements. This view is in line with our forecast, in which GDP growth rate will increase to 4.2% YoY in H2 2017 vs. 3.9% in H1.

Poland's dispute with European Commission negative for PLN

FX rates

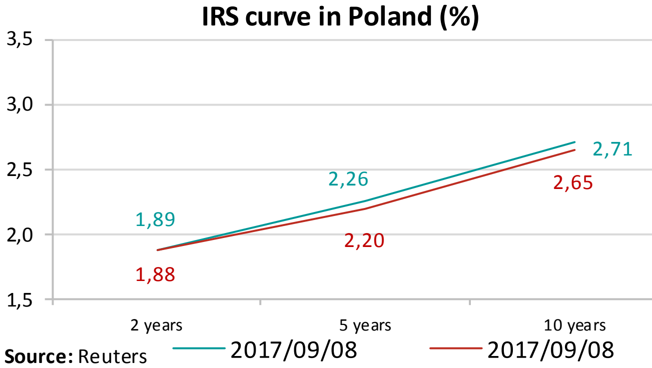


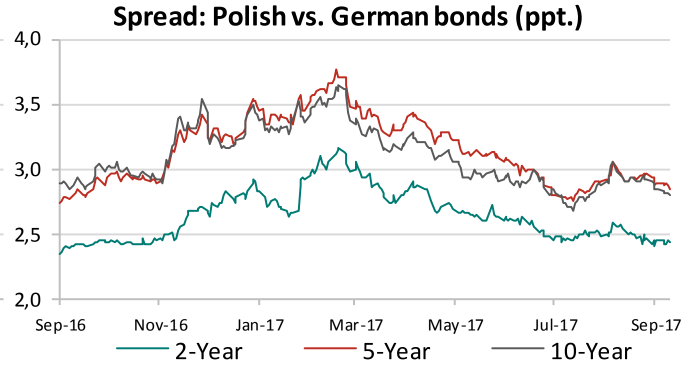
Source: Reuters

Last week EURPLN rate rose to 4.2778 (PLN weakening by 0.8%). The most important event for PLN last week was the statement of the European Commission that second step in infringement procedure against Poland had been launched (see above). In effect, PLN weakening was observed on Tuesday and Wednesday. Especially noteworthy is PLN strong depreciation observed last week vs. GBP (by 4.1%). It occurred largely due to a sharp decrease in EURGPB rate after the Thursday's meeting of the Bank of England which signaled that, owing to growing inflationary pressure, monetary tightening cycle may start in the UK in the coming months.

Crucial for PLN this week will be the FOMC meeting scheduled for Wednesday which may contribute to an increased volatility of PLN. At the same time, the publication of new FOMC economic projections may slightly strengthen PLN. In our view, data on industrial production and retail sales in Poland will also be positive for PLN. Other domestic data (corporate wages and employment), data from the US real estate market, and business survey results for the Eurozone will be neutral for PLN, we believe.

Polish debt market focused on FED





Source: Reuters

Last week the 2-year IRS rates have not changed and amounted to 1.885, 5-year rates rose to a level of 2.255 (up by 5 bp), and 10-year bonds to a level of 2.705 (up by 6 bp). IRS rates continued to increase across the curve last week following the core markets. In the first part of the week, IRS rates increase was also supported by higher supply of bonds from some investors who were selling bonds to increase their liquidity before the Thursday's debt exchange auction. At the debt auction, the Finance Ministry redeemed PLN 6.6bn of bonds maturing in 2017 and 2018, selling PLN 6.8bn of 2-, 5-, 6-, and 10-year bonds, with demand amounting to PLN 9.1bn. The auction led to a slight temporary increase in IRS rates.

This week the Polish debt market will focus on the FOMC meeting, scheduled for Wednesday, which may support higher volatility of IRS rates. The publication of the new FOMC economic projection may lead in our view to their decline at the long end of the curve. On the other hand, the publication of data on industrial production and retail sales in Poland may contribute to an increase in IRS rates. Domestic data on corporate wages and employment, business survey results for major European economies, and data from the US real estate market will not have a substantial impact on the Polish debt market, we believe.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland														
Indicator	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-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*	4,36	4,29	4,31	4,45	4,40	4,32	4,31	4,23	4,23	4,18	4,23	4,25	4,25	**4,23**
USDPLN*	3,91	3,82	3,92	4,20	4,18	4,00	4,07	3,97	3,88	3,72	3,70	3,59	3,57	**3,55**
CHFPLN*	3,97	3,93	3,96	4,13	4,11	4,04	4,05	3,96	3,90	3,84	3,86	3,72	3,72	**3,68**
CPI inflation (% YoY)	-0,8	-0,5	-0,2	0,0	0,8	1,7	2,2	2,0	2,0	1,9	1,5	1,7	1,8	
Core inflation (% YoY)	-0,4	-0,4	-0,2	-0,1	0,0	0,2	0,3	0,6	0,9	0,8	0,8	0,8	0,7	
Industrial production (% YoY)	7,5	3,2	-1,3	3,2	2,2	9,1	1,1	11,0	-0,6	9,1	4,5	6,3	**6,7**	
PPI inflation (% YoY)	-0,1	0,2	0,6	1,8	3,2	4,0	4,5	4,8	4,2	2,4	1,8	2,2	**2,8**	
Retail sales (% YoY)	5,6	4,8	3,7	6,6	6,4	11,4	7,3	9,7	8,1	8,4	6,0	7,1	**5,8**	
Corporate sector wages (% YoY)	4,7	3,9	3,6	4,0	2,7	4,3	4,0	5,2	4,1	5,4	6,0	4,9	**5,7**	
Employment (% YoY)	3,1	3,2	3,1	3,1	3,1	4,5	4,6	4,5	4,6	4,5	4,3	4,5	**4,6**	
Unemployment rate* (%)	8,4	8,3	8,2	8,2	8,3	8,6	8,5	8,1	7,7	7,4	7,1	7,1	**7,0**	
Current account (M EUR)	-729	-858	172	99	-219	2342	-599	-529	-160	-298	-932	-878		
Exports (% YoY EUR)	9,3	3,1	-0,6	5,7	5,1	14,3	5,7	15,1	1,4	16,2	8,7	10,7		
Imports (% YoY EUR)	10,7	3,5	3,6	6,3	7,1	16,0	8,9	16,8	3,3	21,4	15,0	12,5		

*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	4,3	4,2	4,0	3,7	3,6	3,8	2,7	4,1	3,8
Private consumption (% YoY)	4,7	4,9	4,2	4,5	4,6	4,3	4,3	3,9	3,8	4,6	4,3
Gross fixed capital formation (% YoY)	-0,4	0,8	3,0	5,5	7,9	7,0	6,8	6,1	-7,8	3,0	6,7
Export - constant prices (% YoY)	8,3	2,8	8,0	10,0	8,0	7,7	6,8	5,5	9,0	7,3	7,0
Import - constant prices (% YoY)	8,7	6,1	9,0	11,6	10,6	10,0	10,4	8,3	8,9	8,9	9,8
GDP growth contributions: Private consumption (pp)	3,0	2,9	2,5	2,3	3,0	2,6	2,6	1,9	2,3	2,7	2,5
GDP growth contributions: Investments (pp)	0,0	0,1	0,5	1,3	0,9	1,1	1,2	1,5	-1,6	0,5	1,2
GDP growth contributions: Net exports (pp)	0,1	-1,5	-0,3	-0,4	-1,1	-0,8	-1,8	-1,3	0,3	-0,6	-1,2
Current account***	0,1	-0,5	-0,7	-1,2	-1,7	-1,5	-1,7	-2,0	-0,2	-1,2	-2,0
Unemployment rate (%)**	8,1	7,1	7,0	7,3	7,6	6,8	6,9	7,3	8,3	7,3	7,3
Non-agricultural employment (% YoY)	2,1	2,4	1,9	1,0	0,3	0,1	0,1	0,1	1,9	1,9	0,2
Wages in national economy (% YoY)	4,1	5,0	5,6	6,0	6,4	6,7	6,6	6,5	3,8	5,2	6,5
CPI Inflation (% YoY)*	2,0	1,8	1,9	1,8	1,5	1,9	1,6	1,5	-0,6	1,9	1,6
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	4,23	4,16	4,15	4,12	4,10	4,07	4,40	4,16	4,07
USDPLN**	3,97	3,70	3,55	3,41	3,40	3,35	3,31	3,26	4,18	3,41	3,26

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST* CA	FORECAST* CONSENSUS**
		Monday 09/18/2017				
11:00	Eurozone	HICP (% YoY)	Aug	1,5	1,5	1,5
14:00	**Poland**	**Employment (% YoY)**	**Aug**	**4,5**	**4,6**	**4,6**
14:00	**Poland**	**Corporate sector wages (% YoY)**	**Aug**	**4,9**	**5,7**	**5,7**
		Tuesday 09/19/2017				
10:00	Eurozone	Current account (bn EUR)	Jul	21,2		
11:00	Germany	ZEW Economic Sentiment (pts)	Sep	10,0	10,6	12,5
14:00	**Poland**	**Retail sales (% YoY)**	**Aug**	**7,1**	**5,8**	**7,2**
14:00	**Poland**	**PPI (% YoY)**	**Aug**	**2,2**	**2,8**	**2,9**
14:00	**Poland**	**Industrial production (% YoY)**	**Aug**	**6,2**	**6,7**	**6,0**
14:30	USA	Housing starts (k MoM)	Aug	1155	1185	1175
14:30	USA	Building permits (k)	Aug	1230	1220	1220
		Wednesday 09/20/2017				
16:00	USA	Existing home sales (M MoM)	Aug	5,44	5,52	5,45
20:00	USA	FOMC meeting (%)	Sep	1,25	1,25	1,25
		Thursday 09/21/2017				
14:00	**Poland**	**MPC Minutes**	**Sep**			
14:30	USA	Philadelphia Fed Index (pts)	Sep	18,9	18,0	17,2
16:00	Eurozone	Consumer Confidence Index (pts)	Sep	-1,5		-1,5
		Friday 09/22/2017				
9:30	Germany	Flash Manufacturing PMI (pts)	Sep	59,3	58,8	59,0
10:00	Eurozone	Flash Services PMI (pts)	Sep	54,7	54,6	54,8
10:00	Eurozone	Flash Manufacturing PMI (pts)	Sep	57,4	56,8	57,2
10:00	Eurozone	Flash Composite PMI (pts)	Sep	55,7	55,5	55,6
14:00	**Poland**	**M3 money supply (% YoY)**	**Aug**	**5,0**	**5,4**	**5,3**
15:45	USA	Flash Manufacturing PMI (pts)	Sep	52,8		53,0

*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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