Inflow of Ukrainians differentiates wage pressure

This week

- **The most important event this week will be the publication of data on industrial production and retail sales in Poland scheduled for Wednesday.** We forecast that output dynamics dropped to 5.6% YoY in September vs. 8.8% in August due to unfavourable calendar effects. In turn, the nominal retail sales growth rate rose, in our view, to 7.9% YoY in September vs. 7.6% in August, due to low base effects in some categories. We believe that if our forecasts materialize, the aggregate impact of the data may be slightly positive for PLN and yields on Polish bonds.
- **Significant data from the US will be released this week.** We expect industrial production to have increased by 0.1% MoM in September vs. a 0.9% decline in August, which will be consistent with business survey results. We expect that recovery in the US real estate market will be confirmed by data on housing starts (1210k in September vs. 1180k in August), building permits (1255k vs. 1272k), and existing home sales (5.26M vs. 5.35M). Business survey results will also be released this week. We expect that the Philadelphia FED Index rose to 25.1 pts vs. 23.8 pts in September. We believe that the aggregate impact of data on the US economy on the financial market to be limited.
- **Important data from China will be released on Thursday.** We expect that the economic growth rate rose to 1.8% QoQ in Q3 from 1.7% in Q2 (6.8% YoY vs. 6.9% in Q2). We believe that the monthly data will point to acceleration in the pace of economic activity in September. We forecast that industrial production increased by 6.8% YoY in September vs. 6.0% in August, retail sales rose by 10.5% YoY vs. 10.1%, and urban investments rose by 7.4% YoY vs. 7.8%. Data from China will not be market moving, we believe. Z. Xiaochuan, the Governor of the People's Bank of China, indicated today that the economic growth in China would accelerate to 7.0% YoY in H2 2017 from 6.9% in H1 2017. We believe that this statement will be positive for market sentiment, including for PLN.
- **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 20.0 pts in October vs. 17.0 pts in September. Thus, the index would rise to the highest level since May 2017.
- **Data on the Polish balance of payments in August was released today**. The current account deficit to dropped to EUR 100M in August vs. EUR 491M in July, which was mainly result of higher trade balance. The export dynamics decreased to 12.3% YoY in August vs. 12.4% in July, while import growth dropped to 7.6% YoY vs. 12.8%.
- **The September data on average wages and employment in the corporate sector in Poland will be released on Tuesday**. We forecast that employment dynamics dropped to 4.5% YoY from 4.6% in August. The lower growth rate was caused by high base effects (employment rose by 10.8k MoM in September 2016). In turn, the average wage dynamics rose to 6.9% YoY in September vs. 6.6% in August (the effect 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.
- **A review of Poland's rating by S&P is scheduled for Friday.** In April the agency left Poland's long-term rating unchanged at BBB+ with a stable outlook. In the justification for the decision S&P indicated that the stable outlook reflected a balance between the negative impact of the expansive fiscal policy (including higher social expenditure) on the rating and the expected relatively high economic growth rate. In mid-July, S&P indicated that changes in the judiciary proposed by PiS at the time (acts on the National Council of the Judiciary, Common Courts System, and Supreme Court) were a further confirmation of the agency's earlier opinion that institutional framework in Poland has weakened, undermining key institutions' ability to work as a check and balance on the government, which was responsible for Poland's rating downgrade in January 2016. We expect that the agency will affirm Poland's rating and its stable

outlook this week, as the latter two of the above-mentioned acts have since been vetoed by the President. In addition, the sound macroeconomic foundations of the Polish economy are a strong argument in favour of keeping Poland's credit rating unchanged. The agency's decision will be announced after the closing of the European markets, therefore the reaction of the FX market and the debt market will materialize no sooner than the following week.

Last week

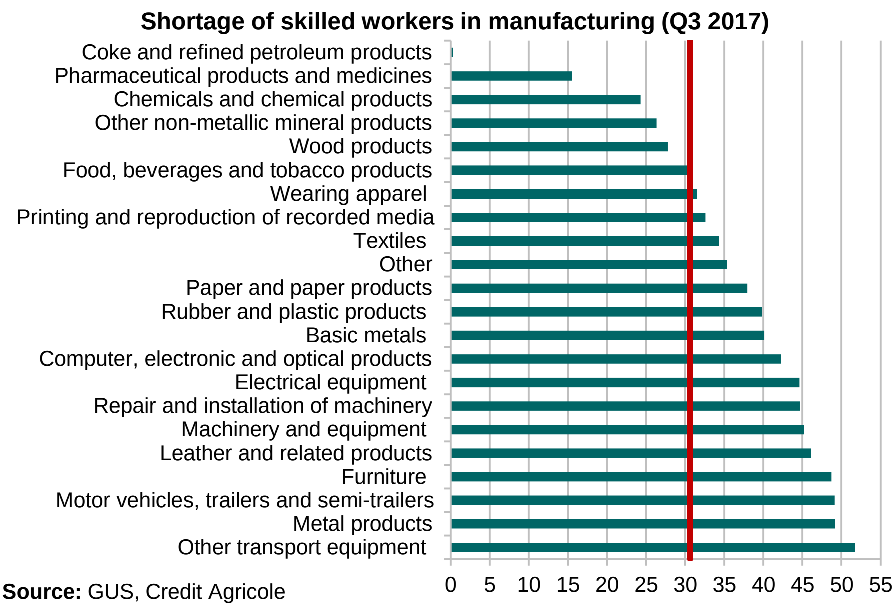
- **The Minutes of the September FOMC meeting were published last week.** The document indicated FED members' concerns about inflation returning to target in the medium term. Nonetheless, many of them support one more interest rate hike in 2017, providing the medium-term economic prospects in the US do not change substantially. This is in line with J. Yellen's statement from three weeks ago, in which she emphasized that the Federal Reserve should have continued the hikes despite the uncertain inflation outlook in the US (see MACROmap of 2/10/2017). The text of the Minutes does not alter our scenario that FED will hike interest rates by 25bp in December 2017. At the same time, FED members' concerns about inflation prospects support our view that the scale of interest rate hikes in 2018 will be lower from the median expectations presented in the September FOMC projection (75 bp) and will amount to 50 bp (see MACROmap of 25/9/2017).
- **US hard data and business survey results were released last week.** CPI inflation rose to 2.2% YoY in September vs. 1.9% in August (0.5% MoM vs. 0.4% MoM), running below the market expectations (2.3% YoY and 0.6% MoM, respectively). Conducive to higher inflation were higher dynamics of fuel prices related to hurricanes Harvey and Irma. Core inflation also ran below the market expectations and has not changed in September compared to August standing at 1.7% YoY (0.1% MoM in September vs. 0.2% MoM in August). The market expected it to stand at 1.8% YoY and 0.2% MoM, respectively. The publication of the data brought about a weakening of USD vs. EUR and a decline in yields on US bonds. Data on US retails sales were also released last week and increased by 1.6% MoM in September vs. a 0.1% decrease in August. Conducive to their higher monthly dynamics were higher sales in a majority of their sectors, due to the abatement of the unfavourable effect of Irma and Harvey hurricanes. Excluding cars, retail sales rose to 1.0% in September vs. a 0.5% increase in August. The University of Michigan Index indicated a strong improvement of consumer sentiment last week, increasing to 101.1 pts in October vs. 95.1 pts in September and hitting the highest level since January 2004. Conducive to the index increase were higher values of its sub-indices for both the assessment of the current situation and the expectations. The last week's data on the US economy do not alter our scenario in which the annualized US GDP growth rate will drop to 2.0% in Q3 vs. 3.1% in Q2.
- **CPI inflation in Poland has increased to 2.2% in September YoY vs. 1.8% in August, running in line with the flash estimate by GUS.** The increase in inflation in September was largely due to higher dynamics of food prices (see MACROpulse of 12/10/2017). Higher inflation also resulted from increased dynamics of prices of energy and higher core inflation, which amounted to 1.0% YoY in September vs. 0.7% YoY in August. The increase in core inflation occurred due i.a. to higher dynamics of prices in the category "communication", "recreation and culture", "other goods and services", and "health". Despite its visible increase in September, core inflation continues to be low, reflecting the still limited impact of the acceleration in wages observed in Poland on prices of consumer goods. The data on the September inflation signal an upside risk to our short-term forecast of CPI inflation; however, we expect that CPI inflation will slightly decrease in 2018 compared to 2017 and thus will stay below the MPC target. This is consistent with our scenario in which the MPC will leave interest rates unchanged until November 2018.
- **Significant data from the German economy were released last week**. The foreign trade surplus rose to EUR 21.6M in August vs. EUR 19.3M in July. Export dynamics rose by 3.1% MoM in

August vs. a 0.2% decline in July, while imports rose by 1.2% MoM in August vs. a 2.1% increase in July. The monthly dynamics of industrial production also increased and stood at 2.6% in August vs. -0.1% in July. Their increase resulted from higher output dynamics in energy and manufacturing, while their decline in construction had an opposite impact. The last week's data from the German economy support our scenario, in which the quarterly growth rate of the German GDP has not changed in Q3 compared to Q2 and amounted to 0.6%.

- **The foreign trade surplus in China decreased to USD 28.5bn in September vs. USD 41.9bn in August**. Export dynamics rose to 8.1% YoY in September vs. 5.6% in August, while import dynamics rose to 18.7% YoY in September vs. 13.5% in August, which was visibly above the market expectations (the market expected import dynamics at 13.5%). The significant increase in import dynamics points to stronger internal demand in the Chinese economy, i.e. in construction. In our view, it may have also occurred due to companies "front loading" supplies ahead of a week-long national holiday in early October. Lower surplus in the Chinese balance on trade supports our forecast, in which the GDP growth rate in China will decrease to 6.8% YoY in Q3 vs. 6.9% in Q2 (see above).

Inflow of Ukrainians differentiates wage pressure

In MACROmap of 24/7/2017 we analyzed the wage growth pressures in different branches of manufacturing. We noticed then that the main factor behind faster wage growth rate were growing difficulties of companies in finding skilled workers. The varying degrees of these difficulties observed in respective manufacturing branches allow to explain the differentiation of the wage dynamics between them. We believe that the strong inflow of Ukrainians to our country observed in recent years is conducive to reducing the said difficulties. Below we present selected channels of the impact of foreigners' inflow to Poland on the situation in the domestic labour market.



Source: GUS, Credit Agricole

According to GUS business surveys, the percentage of companies declaring a barrier in the form of shortage of skilled workers in Q3 was the highest in survey history. The average share for manufacturing amounted to 30.6%. An analysis by respective sectors shows that for most sectors percentage exceeded this value. On the other hand the average value is mainly reduced by two sectors "manufacture of coke and refined petroleum products" (only 0.2% of these firms declare such difficulties) and "manufacture of basic pharmaceutical products and pharmaceutical preparations" (15.5%).

To estimate the number of Ukrainians working in Polish manufacturing we have used the data of the Ministry of Labour and Social Policy on the number of declarations of the intention to employ a foreigner. Such declaration is one of the forms of obtaining a work permit in Poland by foreigners staying legally within the territory of the Republic of Poland. It is designed for citizens of 6 countries: Armenia, Belarus, Georgia, Moldavia, Russia, and Ukraine. Compared to other forms (employment permit, temporary residence and employment permit) the procedure of obtaining it is significantly simplified. In the case of employment permits, applications have to be submitted to the relevant province governor and a labour market test must be performed to check if a Polish or other EU citizen can be employed at the position. A foreigner can obtain employment permit only if the employer's requirements cannot be met by persons registered with the Employment Office. In the case of declarations of the intention to employ a foreigner, the prospective employer registers the declaration with a district employment office which finishes the procedure of obtaining it.

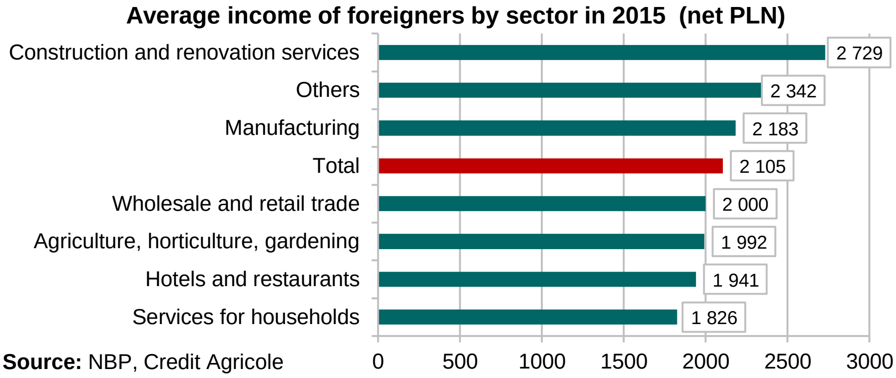
In 2015, 2016, and H1 2017, a total of 344.7k such declarations were issued on employment of foreigners in manufacturing only. Details concerning specifically the number of Ukrainians in respective branches are not known, therefore for the purpose of the analysis we identify Ukrainians with all foreigners (they are responsible for more than 95% of declarations). A declaration of the intention to employ a foreigner entitles to legal employment for a period of maximum 6 months within consecutive 12 months. The period of working can be used either continuously (full 6 months) or in several shorter periods, however the total employment period cannot exceed the time limit. If an employer wants to employ a foreigner for a period longer than 6 months, after a 3-month period of the foreigner's working for him, he can apply for an employment period without the need of a labour market test being performed.

The analyzed number of declarations of the intention to employ a foreigner does not represent a precise number of foreigners employed, because if a foreigner works for several employers during the permitted period, one person will be issued several declarations. Therefore, by dividing the number of declarations issued by employment in a specific category we obtain only an approximate percentage of Ukrainians in the total number of employees. The chart compares the GUS index concerning barrier to operation in the form of shortage of skilled workers in Q3 against the total number of declarations of the intention to employ a foreigner issued between 2015 and H1 2017, presented as a percentage of the average number of persons employed in the respective branch in H1 2017 (hereinafter: percentage of foreigners). Each point corresponds to one manufacturing branch. The chart presents only branches where the percentage of foreigners exceeds 3%. Both variables show a moderate negative correlation (-42%). Such correlation indicates that the inflow of Ukrainians to Poland limits the difficulties of companies in finding skilled labour.

Impact of foreigners' employment on shortage of skilled workers in manufacturing*

Source: MPiPS, Credit Agricole

* in industries with share of foreigners in total employment >3%



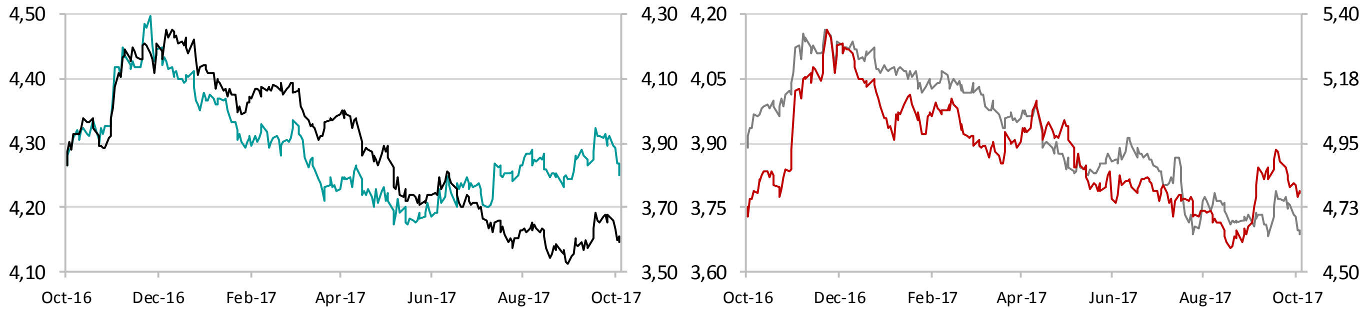
Source: NBP, Credit Agricole

Consequently, the inflow of foreigners is also conducive to limiting the wage growth in Polish manufacturing. Employers registering the declarations in 2016 only in 20% of cases declared the intention to employ foreigners under an employment contract (this percentage rose by 4.8 pp compared to 2015). This means that immigrants are still only to a limited extent factored in the wage and employment statistics (as they only cover people employed under employment contract). However, the presence of Ukrainians in the labour market is conducive to slower wage growth of other employees. According to the results of the survey "Citizens of Ukraine working in Poland", carried out by the NBP in 2015 on a group of Ukrainian citizens working in the Warsaw metropolitan area, they were earning PLN 2105 net per month. Therefore, foreigners were earning slightly less from the median earnings in the Polish national economy in 2014 (PLN 2360 net). It can be expected that similar disproportion between the wages of Poles and foreigners can still be observed now.

We expect that the inflow of Ukrainians to Poland will continue to stay at a high level in the coming quarters. Therefore, the factors outlined above support our scenario, in which the wage growth rate in the national economy will increase from 3.8% YoY in 2016 to 5.2% in 2017 and 6.5% in 2018.

Domestic data positive for PLN

FX rates



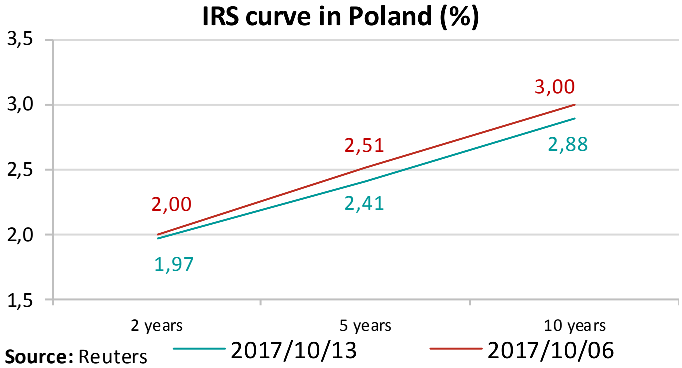
Source: Reuters

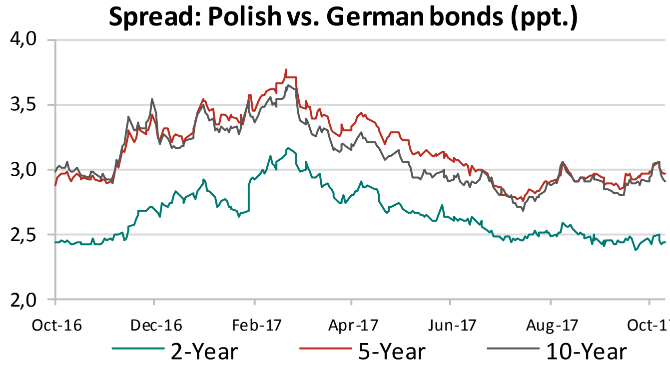
Last week EURPLN rate dropped to 4.2528 (PLN strengthening by 1.3%). Throughout last week PLN was appreciating together with other currencies of the region. This was largely due to decrease in global risk aversion reflected by lower VIX index. Positive for PLN was also stabilization of the political situation in Spain related to the postponement of the declaration of Catalonian independence and thus alleviation of tension between Madrid and Catalonia as well as a slightly dovish bias of the Minutes of the September FOMC meeting. Last week PLN was also strengthening against other main currencies and its appreciation was especially visible in the case of USD. It was supported by a simultaneous increase in EURUSD rate due to a slight reduction of the market expectations of rate hikes in December.

Crucial for PLN this week will be domestic data on industrial production and retail sales. If our forecasts materialize, the data may contribute to a slight strengthening of PLN, we believe. Data on Polish corporate wages and employment should not be market moving. The publication of numerous US data (industrial production, housing starts, new building permits, existing home sales, as well as Philadelphia

FED index) and data from China (GDP in Q3, retails sales, industrial production, and urban investments) will not have any significant impact on PLN. We believe that today's statement by the Governor of the People's Bank of China, assuming acceleration of economic growth rate in China in H2 2017 (see above) will be positive for market sentiment, including for PLN. Important for PLN will be the review of Poland's rating by S&P scheduled for Friday. However the agency's decision will be released after the closing of the European markets, therefore the reaction of the FX market to this decision will materialize no sooner than next week.

Correction on the Polish debt market





Source: Reuters

Last week 2-year IRS rates dropped to a level of 1.970 (down by 3 bp), of 5-year rates to a level of 2.412 (down by 10 bp), and of 10-year rates to a level of 2.884 (down by 11 bp). The first part of the week saw a decrease in IRS rates across the curve, as the prices of Polish bonds reached attractive levels which supported a correction. As of Wednesday, conducive to further decrease in IRS rates were lower yields in the German market. On Friday, the decrease in IRS rates was additionally deepened by weaker-than-expected data on inflation in the US.

This week, the Polish debt market will focus on domestic data on industrial production and retail sales. We believe that they may contribute to an increase in IRS rates at the short end of the curve. Other domestic data (balance of payments and average wage and employment in the corporate sector) will not have a substantial impact on IRS rates. Numerous data from the US (industrial production, housing starts, new building permits, existing home sales, as well as Philadelphia FED index) will also be neutral for the Polish debt market, we believe. Important for IRS rates will be the review of Poland's rating by S&P scheduled for Friday. However it will be released after the closing of the European markets, therefore its impact on IRS rates, if any, will materialize no sooner than next week.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland														
Indicator	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	Oct-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*	4,29	4,31	4,45	4,40	4,32	4,31	4,23	4,23	4,18	4,23	4,25	4,25	4,31	**4,28**
USDPLN*	3,82	3,92	4,20	4,18	4,00	4,07	3,97	3,88	3,72	3,70	3,59	3,57	3,65	**3,61**
CHFPLN*	3,93	3,96	4,13	4,11	4,04	4,05	3,96	3,90	3,84	3,86	3,72	3,72	3,77	**3,73**
CPI inflation (% YoY)	-0,5	-0,2	0,0	0,8	1,7	2,2	2,0	2,0	1,9	1,5	1,7	1,8	2,2	
Core inflation (% YoY)	-0,4	-0,2	-0,1	0,0	0,2	0,3	0,6	0,9	0,8	0,8	0,8	0,7	1,0	
Industrial production (% YoY)	3,2	-1,3	3,2	2,2	9,1	1,1	11,0	-0,6	9,1	4,5	6,2	8,7	**5,6**	
PPI inflation (% YoY)	0,2	0,6	1,8	3,2	4,0	4,5	4,8	4,2	2,4	1,8	2,2	3,0	**3,2**	
Retail sales (% YoY)	4,8	3,7	6,6	6,4	11,4	7,3	9,7	8,1	8,4	6,0	7,1	7,6	**7,9**	
Corporate sector wages (% YoY)	3,9	3,6	4,0	2,7	4,3	4,0	5,2	4,1	5,4	6,0	4,9	6,6	**6,9**	
Employment (% YoY)	3,2	3,1	3,1	3,1	4,5	4,6	4,5	4,6	4,5	4,3	4,5	4,6	**4,5**	
Unemployment rate* (%)	8,3	8,2	8,2	8,3	8,6	8,5	8,1	7,7	7,4	7,1	7,1	7,0	**7,0**	
Current account (M EUR)	-858	172	99	-219	2342	-599	-529	-160	-298	-932	-878	**-427**		
Exports (% YoY EUR)	3,1	-0,6	5,7	5,1	14,3	5,7	15,1	1,4	16,2	8,7	10,7	**12,9**		
Imports (% YoY EUR)	3,5	3,6	6,3	7,1	16,0	8,9	16,8	3,3	21,4	15,0	12,5	**11,0**		

*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	4,31	4,16	4,15	4,12	4,10	4,07	4,40	4,16	4,07
USDPLN**	3,97	3,70	3,65	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 10/16/2017				
3:30	China	PPI (% YoY)	Sep	6,3	7,3	6,3
3:30	China	CPI (% YoY)	Sep	1,8	1,6	1,6
14:00	**Poland**	**Current account (M EUR)**	**Aug**	**-878**	**-427**	**-622**
14:30	USA	NY Fed Manufacturing Index (pts)	Oct	24,4	23,0	20,5
		Tuesday 10/17/2017				
11:00	Germany	ZEW Economic Sentiment (pts)	Oct	17,0		20,0
12:00	Eurozone	HICP (% YoY)	Sep	1,5	1,5	1,5
14:00	**Poland**	**Employment (% YoY)**	**Sep**	**4,6**	**4,5**	**4,6**
14:00	**Poland**	**Corporate sector wages (% YoY)**	**Sep**	**6,6**	**6,9**	**6,2**
15:15	USA	Industrial production (% MoM)	Sep	-0,9	0,1	0,2
15:15	USA	Capacity utilization (%)	Sep	76,1	76,1	76,2
		Wednesday 10/18/2017				
14:00	**Poland**	**Retail sales (% YoY)**	**Sep**	**7,6**	**7,9**	**7,9**
14:00	**Poland**	**PPI (% YoY)**	**Sep**	**3,0**	**3,2**	**3,1**
14:00	**Poland**	**Industrial production (% YoY)**	**Sep**	**8,8**	**5,6**	**5,2**
14:30	USA	Housing starts (k MoM)	Sep	1180	1210	1180
14:30	USA	Building permits (k)	Sep	1272	1255	1250
		Thursday 10/19/2017				
4:00	China	GDP (% YoY)	Q3	6,9	6,8	6,8
4:00	China	Retail sales (% YoY)	Sep	10,1	10,5	10,2
4:00	China	Industrial production (% YoY)	Sep	6,0	7,4	6,2
4:00	China	Urban investments (% YoY)	Sep	7,8	6,8	7,7
14:00	**Poland**	**MPC Minutes**	**Oct**			
14:30	USA	Initial jobless claims (k)	w/e	243		245
14:30	USA	Philadelphia Fed Index (pts)	Oct	23,8	25,1	23,7
		Friday 10/20/2017				
10:00	Eurozone	Current account (bn EUR)	Aug	25,1		
16:00	USA	Existing home sales (M MoM)	Sep	5,35	5,26	5,30

*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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