How long will the boom in construction last?

This week

- **On Saturday, the Spanish Prime Minister, M. Rajoy, invoked Article 155 of the constitution and stated that he would curb the powers of the Catalan government and seize control over the region.** Regional elections in Catalonia will then be held within 6 months. M. Rajoy's proposal must still be passed by the Senate. Prime Minister Rajoy's party has a majority in the parliament's upper house; therefore, the said measures are likely to be implemented soon. The head of the Catalan government, C. Puidgement, said that he "cannot accept this attack" on the region's autonomy. The Saturday's events point to an increase in tension between Madrid and Catalonia which will be conducive to lower EURUSD rate, higher global risk aversion, and consequently, a slight weakening of PLN, we believe.
- **The most important event this week will be ECB meeting scheduled for Thursday.** In our view, the ECB will leave interest rates at an unchanged level. We believe that the ECB will decide to extend the time horizon of the expanded asset purchase program while starting its gradual tapering from January 2018. We allow two scenarios. First scenario: scale of purchase reduced from EUR 60bn down to EUR 40bn per month and the program extended by 6 months – "at least until June 2018". Second scenario: scale of purchase reduced down to EUR 30bn per month and the program extended by 9 months – "at least until September 2018". The first of the aforementioned scenarios is in line with the market consensus. During the conference we may see increased volatility of PLN and debt prices.
- **Another important event will be the publication of the October business survey results for major European economies.** We expect that Composite PMI for the Eurozone dropped to 56.5 pts in October vs. 56.7 pts in September. In our view, the index decline resulted from a slight deterioration in Germany and in France. Ifo Index, reflecting the sentiment among German managers representing the manufacturing, construction, wholesale and retail trade sectors, will also be released on Wednesday. We expect it to have increased to 115.5 pts in October vs. 115.2 pts in September. We believe that the data will be neutral for PLN and prices of Polish bonds.
- **Important hard data from the US and business survey results will be released this week**. The flash estimate of GDP in Q3 will be released on Friday. We expect that the annualized economic growth rate dropped to 2.6% vs. 3.1% in Q2 due to lower contributions of investments and consumption (impact of hurricanes). We forecast that monthly dynamics of preliminary durable goods orders dropped to 1.1% in September vs. 2.0% in August. Results of consumer sentiment surveys will also be released this week. We forecast that the final University of Michigan Index (98.0 pts in October vs. 95.1 pts in September and 101.1 pts in the flash estimate) will signal improvement in households' sentiment. The publication of US data will have a limited impact on the market, we believe.

Last week

- **As we expected, the rating agency Standard & Poor's affirmed Poland's long-term credit rating at BBB+ with stable outlook.** In the justification of the decision S&P indicated that it reflected the solid foundations of the Polish economy (i.a. low current account deficit, competitive wage levels, and high-quality human capital). At the same time, the agency pointed out a risk of the economy being overstimulated due to procyclical fiscal policy of the government, negative real interest rates, wage growth exceeding productivity growth, rising external demand, and inflow of EU funds. The agency indicated in its report that the declining working-age population would be one of the main risks to the situation in public finances and potential economic growth. The reduction of the retirement age intensifies this negative effect. According to S&P, a sharper than the agency currently expects deterioration in public finances or increased concerns about weakening of the independence of the central bank will be potentially negative for the rating. In turn, the rating could be upgraded if, contrary to S&P's expectations, Poland's current account deficit remains modest, public debt is permanently reduced and its service costs stabilize. A change in fiscal policy aimed at accommodating the effects of aging population or at increasing the potential economic growth rate in the long-term would also be positive for Poland's rating. In effect, considering the risks to Poland's credit rating outlined in S&P statement, we expect that S&P will not change Poland's rating and its stable outlook in the horizon of several quarters. The last week's decision of the agency is neutral for PLN and the debt market, we believe.

- **Numerous data from the US economy were released last week.** Industrial production rose by 0.3% MoM in September vs. a 0.7% decline in August. Higher industrial production growth rate resulted from an increase in its monthly dynamics in all the categories (manufacturing, mining, and utilities). However, the dynamics of industrial production continued to be under the unfavourable impact of the hurricane Irma and Harvey. Capacity utilization rose to 76.0% in September vs. 75.8% in August. Aggregate data on building permits (1215k in September vs. 1272k in August), housing starts (1127k vs. 1183k), and existing home sales (5.39M vs. 5.35M) pointed to a slight decrease in activity in the US real estate market. The results of regional business surveys were also released last week. The NY Empire State Index rose to 30.2 pts in October vs. 24.4 pts in September (the highest level since October 2009) while the Philadelphia FED Index rose to 27.9 pts vs. 23.8 pts. We forecast that the annualized US GDP growth rate dropped to 2.6% in Q3 vs. 3.1% in Q2 (see above).
- **The dynamics of industrial production in Poland dropped to 4.3% YoY in September vs. 8.8% in August**. The main reason for the sharp decline in production growth rate between August and September was an unfavourable difference in the number of working days. Seasonally-adjusted industrial production decreased by 1.2% MoM in September. Like in the previous months, we saw a relatively fast increase in production both in segments with a considerable share of exports in sales and in segments connected with the construction sector (see MACROpulse of 18/10/2017). The construction-assembly production growth rate dropped to 15.5% YoY in September vs. 23.5% in August. Conducive to its decrease were the above-mentioned unfavourable calendar effects. Seasonally-adjusted construction production declined by 0.3% MoM. We believe that the decrease in the month-on-month seasonally-adjusted construction-assembly production is temporary and in the coming months production will again show an upward trend, boosted by growing absorption of EU funds, higher public outlays on infrastructure and continuing recovery in residential construction. In the whole Q3, the average dynamics of industrial production rose to 6.3% vs. 4.3% in Q2, while construction-assembly production dynamics rose to 19.4% vs. 8.4%. Therefore the data pose a clear upside risk to our forecast of GDP growth rate in Q3 2017 (up to 4.3% YoY vs. 3.9% YoY in Q2).
- **Nominal dynamics of retail sales in Poland increased to 8.6% YoY in September vs. 7.6% in August**. Real retail sales growth rose to 7.5% YoY in September vs. 6.9% in August. The acceleration in sales growth was mostly due to a seasonal increase in purchases of clothing and footwear from the autumn and winter collection, which occurred earlier this year due to exceptionally cold September (see MACROpulse of 18/10/2017). We expect that in the coming months the annual sales dynamics will gradually decrease due to last year's high base effect related to the disbursement of funds under the Family 500+ scheme. Lowering of the retirement age will be positive for retail sales growth in Q4. In the whole Q3, retail sales in constant prices rose by 7.1% vs. a 6.7% increase in Q2, which poses un upside risk to our forecast, in which private consumption growth rate dropped to 4.2% YoY in Q3 vs. 4.9% in Q2 2017.
- **Nominal wage dynamics in the Polish corporate sector dropped to 6.0% YoY in September vs. 6.6% in August**. Negative for the wage growth rate was the unfavourable difference in the number of working days, which reduced the growth rate of wages for piece work. Wage growth

rate slowed down in September despite bonuses paid in mining and pay rise in the segment "manufacture of coke and refined petroleum products" (see MACROpulse of 17/10/2017). The annual employment dynamics dropped to 4.5% in September vs. 4.6% in August. The high base effects from the year before were the factor behind lower employment growth rate. We estimate that real wage fund growth rate (employment times average wages) in enterprises amounted to 8.4% YoY in September vs. 9.6% in August. Consequently, in the whole Q3 it rose to 8.6% YoY vs. 7.9% in Q2. In subsequent quarters we expect deceleration of the improvement in the labour market and a slight decline in the annual employment dynamics. Given the continuing strong demand for labour, it will be conducive to a gradual increase in wage pressure in the Polish economy. We forecast that the wage growth rate in the national economy will increase to 5.2% YoY in 2017 vs. 3.8% in 2016 and will reach 6.5% in 2018.

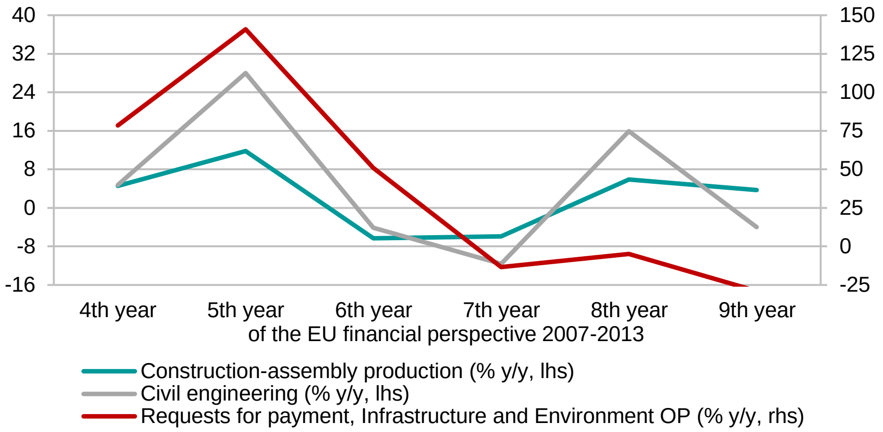
- **ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany rose to 17.6 pts in October vs. 17.0 pts in September**. According to the press release, the improvement in sentiment was supported by solid data coming in the recent months from the Eurozone, which increased survey participants' expectations of normalization of the ECB monetary policy. We forecast that the German GDP growth rate will drop to 0.5% in Q4 vs. 0.6% in Q3.
- **Numerous data from China were released last week**. The annual GDP growth rate dropped to 6.8% in Q3 vs. 6.9% in Q2 (1.7% QoQ both in Q2 and Q3). Noteworthy is the structure of Chinse growth where private consumption plays an increasingly important role. The contribution of consumption to growth rose to 4.5 pp in Q3 vs. 4.4 pp in Q2, while the contribution of investments has not changed and amounted to 2.3 pp. This is the effect of the measures taken by the Chinese government to change the model of growth based on investments to a consumption-based model. The continuing high growth rate of activity in the Chinese economy last week was also reflected by data on industrial production (6.6% in September vs. 6.0% in August), retail sales (10.3% vs. 10.1%), and urban investments (7.5% vs. 7.8%). We expect that the GDP growth rate in China will decrease to 6.7% YoY in Q4 and in the whole 2017 it will increase to 6.8% vs. 6.7% in 2016. An upside risk to our forecast is posed by the statement of the Governor of the People's Bank of China, Zhou Xiaochuan that the GDP growth rate in China will rise to 7.0% in H2 2017 (it would mean that the economic growth rate would exceed 7.0% in Q4 2017).
- **MPC members J. Kropiwnicki and J. Osiatyński spoke last week about the outlook for the monetary policy in Poland.** J. Kropiwnicki said he did not expect any changes in the monetary policy parameters at least until the middle of next year. However, he pointed out that the evolution of wage pressure posed a risk to that view. At the same time he emphasized that one should have waited with the assessment of that risk until the publication of the November NBP projection and factored in the inflation and wage growth data coming in subsequent months. Therefore a visible change can be observed in recent weeks in J. Kropiwnicki's views because in his remarks of 18 September he expressed the view that he saw no reason for interest rate hikes in the next two years. Change in bias to a more hawkish one can also be observed in the case of J. Osiatyński. He said that if wage pressure continued it was not ruled out that the MPC would have to decide to hike interest rates sooner than Q4 2018. In July J. Osiatyński was suggesting that such decision was possible "before the end of 2018". Despite some MPC members changing bias to a more hawkish one, we maintain our scenario that the MPC will leave interest rates unchanged until November 2018. We believe that inflation will continue to run below the NBP target in 2018, largely due to the expected by us marked decrease in the dynamics of food prices (i.a. in the categories "oils and fats", "milk, cheese, eggs", "fruit", and "meat"), stabilization of oil prices, and strengthening of PLN. At the same time we believe that increase in core inflation will be limited by asymmetric wage pressure. Wages will increase mainly in the non-traded goods sector while in the traded goods sector their increase will be limited by strong competition pressure, which reduces the possibilities of increasing the prices

of products to offset increased costs of labour.

How long will the boom in construction last?

The macroeconomic data coming in recent months as well as business survey results point to an ongoing recovery in construction. The annual seasonally-adjusted dynamics of construction-assembly production stood in August 2017 at the highest level since January 2012, namely since the construction boom related to EURO 2012. Short- and medium-term outlook for construction in Poland is favourable. We believe that increase in the construction-assembly production will be supported by growing absorption of EU funds, higher public expenditure on infrastructure, and continuation of recovery in residential construction. This view is supported i.a. by further increase in GUS business sentiment indicator concerning the order-book in construction, which in September reached the highest level since 2008. However more important from the point of view of medium-term outlook for economic growth is the profile of activity in Polish construction in the horizon of several years as well as answer to the question how long the currently observed boom in this sector will last. The analysis below is first in a series of reports on long-term prospects for construction. Next ones will be presented in subsequent MACROmaps.

The growth rate of assembly-construction production, especially in the segment of civil engineering, is determined mostly by the pace of absorption of EU funds. Out of the respective operational programs, funds on construction projects are allocated to the largest extent under the program Infrastructure and Environment. During the previous programming period in 2010-2015, the dynamics of the value of request for payment submitted under this operational program showed high correlation with the growth rate of total construction-assembly production (49%) and production in the civil engineering segment (67%).

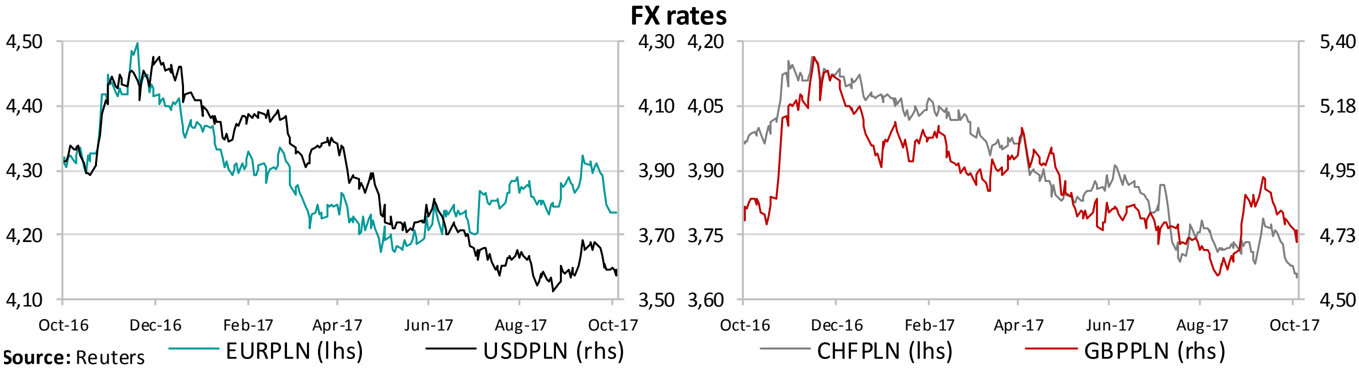


Source: Portal Funduszy Europejskich, GUS, Credit Agricole

The absorption of funds within the 2007-2013 programming period (see the chart) shows that the peak dynamics of the value of the requests for payment under Infrastructure and Environment operational program fell on 2011, namely on the fifth year of that programming period. We believe that the absorption of funds within the current programming period will have a similar profile. Our view is supported by data on the percentage of EU funds used (under Infrastructure and Environment program) as at the end of September 2017, which is at a similar level as at the same moment of the previous programming period. This means that the pace of EU funds absorption is likely to be the fastest in 2018 (the fifth year of 2014-2020 programming period). This supports our scenario in which the dynamics of public investments and construction-assembly production will increase in 2018 compared to 2017. At the same time the boom in infrastructural investments can be expected to end at the turn of 2018 and 2019. The factors outlined above support our forecast assuming acceleration in total investments growth to 6.7% in 2018 from 3.0% in 2017.

The main risk to our forecast may be delays in the implementation of investment projects. In addition, it is hard to unequivocally state if the profile of EU funds utilization within the current programming period will be similar to that within 2007-2013 programming period due to the preparations to EURO 2012 taking place then.

CHFPLN at the lowest since 2015, focus on ECB



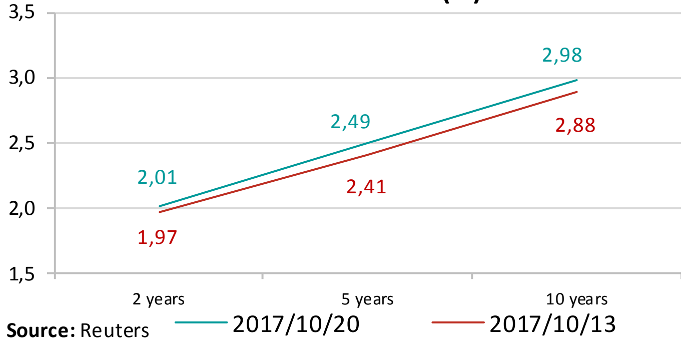
Source: Reuters

Last week EURPLN rate dropped to 4.2342 (PLN strengthening by 0.3%). On Monday PLN continued the appreciation from two weeks ago, supported by better-than-expected data on the balance of payments in Poland. From Tuesday to Friday its rate was stable and oscillated around 4.32 to EUR. On Thursday its increased volatility was supported by an increase in tension between Madrid and Catalonia, due to the announcements of the Spanish government concerning the suspension of Catalonia's autonomy should it proclaim independence. On Friday PLN was slightly depreciating temporarily returning close the levels at which it opened on Monday. The S&P decision to affirm Poland's rating at BBB+ and its stable outlook was announced after the closing of the European markets, therefore it had no impact on PLN. Last week PLN was appreciating vs. CHF due to increase in EURCHF in anticipation of the ECB meeting scheduled for Thursday. Consequently, CHFPLN fell to the lowest level since 15 January 2015, when CHF significantly appreciated following the SNB decision to float its rate against EUR (see MACROmap of 19/1/2015).

The Saturday's decision of the Spanish Prime Minister to suspend the autonomy of Catalonia will be conducive to lower EURUSD rate, increase in global risk aversion, and, consequently, a weakening of PLN, we believe. The most important for PLN this week will be the ECB meeting scheduled for Thursday. The expected by us ECB decision to start the tapering of the quantitative easing program is in line with the market consensus (reduction of monthly scale of purchases to EUR 40M and simultaneous extension of the program horizon by 6 months); however, we may see increased volatility of PLN during the conference after the meeting. Important for PLN this week will also be the publication of the results of business surveys for major European economies (PMI, Ifo for Germany). If our forecasts materialize, the impact of data on PLN will be limited. Neutral for PLN will also be the numerous data from the US economy (flash estimate of GDP in Q3, preliminary durable goods orders, and final University of Michigan Index).

Markets focused on ECB meeting

IRS curve in Poland (%)



Spread: Polish vs. German bonds (ppt.)

Source: Reuters

Last week the 2-year IRS rates rose to a level of 2.009 (up by 4 bp), 5-year rates to a level of 2.491 (up by 8 bp), and 10-year rates to a level of 2.979 (up by 10 bp). Last week IRS rates rose following the German debt market. The increase in rates was related to the investors' expectations of the Thursday's ECB meeting. The market expects that ECB will take decision on gradual tapering of the Expanded Asset Purchase Program. The S&P decision to affirm Poland's rating at BBB+ and its stable outlook was announced after the closing of the Polish debt market, therefore it had no impact on IRS rates.

This week the Polish debt market will focus on the ECB meeting scheduled for Thursday. Although the expected by us ECB decision to start the tapering of the quantitative easing program is in line with the market consensus (reduction of monthly scale of purchases to EUR 40M and simultaneous extension of the program horizon by 6 months), we believe that it may lead to increased volatility of IRS rates. We expect that the results of business surveys for major European economies (PMI, Ifo for Germany) and numerous data from the US economy (flash estimate of GDP in Q3, preliminary durable goods orders, and final University of Michigan Index) will not have any substantial impact on IRS rates.

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	4,3	
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	3,1	
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	8,6	
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	6,0	
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)	-874	-14	-97	-106	2548	-514	-405	459	-297	-1114	-491	-100		
Exports (% YoY EUR)	3,5	-1,0	4,3	9,0	15,1	6,4	19,7	2,5	18,5	6,5	12,4	12,3		
Imports (% YoY EUR)	3,5	1,3	5,2	9,8	16,0	10,5	19,8	3,8	20,4	13,0	12,8	7,6		

*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	CONSENSUS**
		Monday 10/23/2017				
14:00	**Poland**	**M3 money supply (% YoY)**	**Sep**	**5,5**	**5,6**	**5,6**
16:00	Eurozone	Consumer Confidence Index (pts)	Oct	-1,2		-1,1
		Tuesday 10/24/2017				
9:30	Germany	Flash Manufacturing PMI (pts)	Oct	60,6	60,0	60,0
10:00	**Poland**	**Registered unemplyment rate (%)**	**Sep**	**7,0**	**7,0**	**6,9**
11:00	Eurozone	Flash Services PMI (pts)	Oct	55,8	55,7	55,7
11:00	Eurozone	Flash Manufacturing PMI (pts)	Oct	58,1	57,2	57,8
11:00	Eurozone	Flash Composite PMI (pts)	Oct	56,7	56,5	56,5
15:45	USA	Flash Manufacturing PMI (pts)	Oct	53,1		53,6
16:00	USA	Richmond Fed Index	Oct	19,0		
		Wednesday 10/25/2017				
10:00	Germany	Ifo busienss climate (pts)	Oct	115,2	115,5	115,2
14:30	USA	Durable goods orders (% MoM)	Sep	2,0	1,1	1,0
16:00	USA	New home sales (k)	Sep	560	545	555
		Thursday 10/26/2017				
11:00	Eurozone	M3 money supply (% MoM)	Sep	5,0		5,0
13:45	Eurozone	EBC rate decision (%)	Oct	0,00	0,00	0,00
		Friday 10/27/2017				
14:30	USA	Preliminary estimate of GDP (% YoY)	Q3	3,1	2,6	2,6
16:00	USA	Final U. of Michigan Sentiment Index (pts)	Oct	101,1	98,0	100,8

*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

Jakub BOROWSKI
Chief Economist
tel.: 22 573 18 40
jakub.borowski@credit-agricole.pl

Krystian JAWORSKI
Senior Economist
tel.: 22 573 18 41
krystian.jaworski@credit-agricole.pl

Jakub OLIPRA
Economist
tel.: 22 573 18 42
jakub.olipra@credit-agricole.pl