How long will the boom in construction last? (4)

This week

- **The most important event this week will be the publication of the flash estimate of GDP in Poland in Q3 scheduled for Tuesday.** We forecast that the GDP growth rate rose to 4.5% YoY from 3.9% in Q2. Conducive to faster GDP growth were higher contributions of investments and net exports. Lower contributions of inventories and consumption had an opposite impact. The publication of GDP data should not have a substantial impact on PLN or the yields on bonds.
- **Significant hard data on US economy will be released this week.** We expect that industrial production increased by 0.6% MoM in October vs. a 0.3% increase in September, which will be consistent with business surveys results. We forecast that that nominal retail sales dynamics dropped to -0.1% MoM in October from 0.6% in September, due to lower sales in the automotive branch and falling fuel prices. We expect that CPI inflation dropped to 2.0% YoY in October from 2.2% in September. We expect that the ongoing recovery in the US real estate market will be confirmed by data on housing starts (1170k in October vs. 1127k in September) and building permits (1250k vs. 1127k). Business survey results will also be released this week. We forecast that the NY Empire State Index dropped to 26.0 pts in November vs. 30.2 pts in October, while the Philadelphia FED Index dropped to 26.1 pts in November vs. 27.9 pts. We believe that the aggregate impact of data on the US economy on the financial market will be limited.
- **Important data from the Eurozone will be released this week.** The second estimate of the economic growth rate in the Eurozone will be released on Tuesday. We expect that it has not changed compared to the first estimate and amounted to 0.6% QoQ in Q3 vs. 0.7% in Q2. The growth structure has not been published. We believe that the source of lower GDP dynamics in Q3 were lower contributions of consumption and investments while higher contribution of inventories had an opposite impact. The quarterly economic growth rate in Germany will also be released on Tuesday. We believe that it has not changed compared to Q2 and amounted to 0.6%. ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany will also be released on Tuesday. The market expects that its value will increase to 20.0 pts in November vs. 17.6 pts in October. The publication of data on GDP in the Eurozone and Germany should not be market moving, we believe.
- **Data on the Chinese economy will be released on Tuesday.** According to the market consensus, the dynamics of industrial production dropped to 6.3% YoY in October from 6.6% in September, of urban investments to 7.4% vs. 7.5% in September**.** At the same time the market expects retail sales growth rate to have increased to 10.4% in October vs. 10.3% in September. Readings in line with the market expectations will support our forecast of GDP growth in China (6.7% in Q4 2017 vs. 6.8% in Q3, 6.8% in 2017 vs. 6.8% in 2016).
- **The October data on average wages and employment in the corporate sector in Poland will be released on Friday**. We forecast that employment dynamics dropped to 4.4% YoY from 4.5% in September. Slowdown of employment growth resulted from the fact that some people have exercised their right to receive pension following the lowering of the retirement age. In turn, the average wage dynamics rose to 6.1% YoY in October vs. 6.0% in September. Though important for the forecast of private consumption dynamics in Q4, the release of data on corporate wages and employment will be neutral for PLN and the debt market, we believe.
- **Data on the Polish balance of payments in September will be released today**. We expect the current account deficit to increase to EUR 131M vs. EUR 100M in August, mainly due to lower balance of transfers with the European Union. We forecast that export dynamics dropped to 10.3% YoY vs. 12.3% YoY in August, while import growth rate rose to 8.3% YoY vs. 7.6%. Conducive to lower import and export growth rate was the unfavourable difference in the number of working days. Our forecast is close to the market consensus (EUR -202M), therefore its materialization will be neutral for PLN and yields on Polish bonds.

- **Final data on the October inflation in Poland will also be released today.** We believe that the inflation rate will be in line with the flash estimate and thus will amount to 2.1% YoY vs. 2.2% in September. We expect that conducive to lower inflation were lower dynamics of fuel prices and lower core inflation. The publication of the inflation reading will be neutral for PLN and prices of Polish bonds.

Last week

- **As we expected, the Monetary Policy Council left interest rates unchanged at its last week's meeting (the reference rate amounts to 1.50%).** The MPC repeated the view that in the light of available data and forecasts the current level of interest rates was conducive to keeping the Polish economy on the sustainable growth path and maintaining macroeconomic stability. The MPC indicated in the statement that "taking into account the present information, including the results of the November projection, the Council judges that in the coming years inflation will run close to the inflation target". This means a slight change in the tone of the statement compared to the view the Council worded in October. The Council considered then that "the risk of inflation persistently running above the target in the medium term is limited". Such change is consistent with the results of the November projection (see below) which forecast a slightly higher inflation path in 2018-2019 compared to the July projection. According to the projection, inflation will slightly exceed the MPC inflation (2.5%) in 2019. At the meeting, the MPC decided to lower the rate of the mandatory reserve against funds obtained for at least two years from 3.5% to 0%. Present at the conference MPC member Ł. Hardt justified the decision by the need to align the burdens incurred by foreign and Polish entities due to the mandatory reserve requirement binding on banks. In our view the MPC decision has no material impact on the shape of the monetary policy. Interest on the mandatory reserve (1.35%) is similar to interest on NBP bills (1.50%) used by the NBP to absorb banking sector's liquidity. In addition, the percentage of deposits with maturity above two years in the deposits of domestic entities excluding central government institutions is low. This means that the change in the mandatory reserve requirement rate will not substantially affect the incomes of banks and interest on deposits with maturity above 2 years. The remarks of Council members at the conference after the meeting indicate that despite slightly increased inflation and GDP paths in the November inflation projection, MPC bias in monetary policy has not substantially changed compared to the one presented after the October meeting. At the same time, they support our forecast of NBP rates, in which, given a moderate wage pressure and inflation staying below the target, the MPC will leave interest rates unchanged until November 2018.
- **The surplus of the Chinese trade balance increased to USD 38.2bn in October vs. USD 28.6bn in September**. At the same time export dynamics dropped to 6.9% YoY in October vs. 8.1% in September while import dynamics dropped to 17.2% YoY in October vs. 18.6% in September. Last week's data from the Chinese economy is consistent with our scenario of recovery in global trade. The macroeconomic forecast of the European Commission published last week signals similar tendencies. According to this document, the volume of global trade (imports plus exports) will increase by 4.3% in 2017, by 4.1% in 2018 vs. a 2.4% increase in 2016.
- **The preliminary University of Michigan Index pointed to deterioration of consumer sentiment in the US, dropping to 97.8 pts in November vs. 100.7 pts in October.** Conducive to lower index were lower values of its sub-indices for both the assessment of the current situation and expectations. It was a correction after the index reached in October the highest level since January 2004. Thus, the results of consumer sentiment surveys do not alter our scenario in which the annualized GDP growth rate in the US will amount to 2.9% in Q4 2017 vs. 3.0% in Q3.

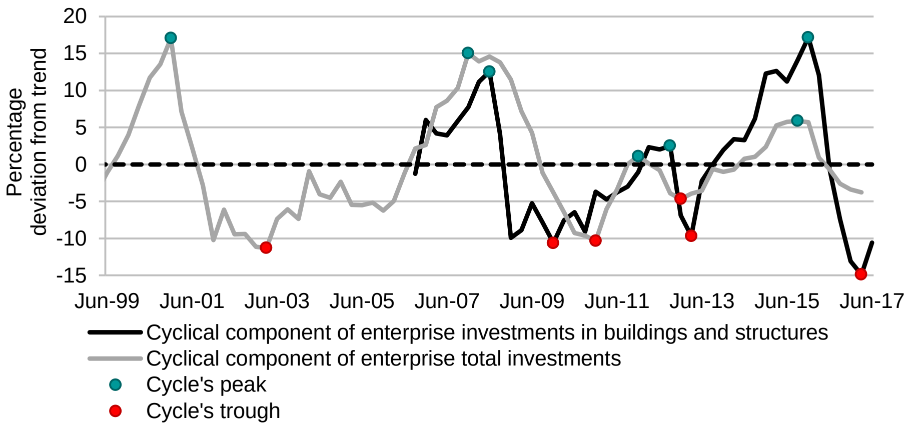
How long will the boom in construction last? (4)

Below we present the last part of our analysis of long-term prospects for construction. This report indicates the expected by us profile of corporate investments in buildings and structures. We have approached this subject from the point of view of the cyclicality of total fixed capital formation of companies.

According to the results of international studies, investment cycles in advanced economies have gradually become shorter and shallower over the last decades. The shortening of the cycle occurs i.a. due to the increasing mobility of capital and popularization of information technologies. The increasing mobility of capital resulting from technical progress enables a faster implementation of investment projects than in the past. At the same time, the increasing percentage of advanced technologies in total fixed capital formation involves the necessity of replacement investments. These technologies are characterized by quite a short lifetime (they soon become outdated) and the necessity of updates, which contributes to the shortening of investment cycles.

In addition, in recent years the developed countries have experienced so-called secular stagnation. It is a situation in which the economic growth is lower than in the past despite an expansive fiscal and/or monetary policy (interest rates close to or below zero, quantitative easing programs). This stagnation is mainly due to the lack of new, substantial incentives for development, whose role in the past was played i.a. by rivalry during the Cold War or invention of the Internet. Besides, it is related i.a. to stricter credit requirements than before the crisis of 2008 as well as the fact that economic entities remain cautious after the global financial crisis and the debt crisis in the Eurozone. Secular stagnation is also reflected by shallower corporate investment cycles. Due to bigger uncertainty of enterprises concerning future business climate, the companies prefer to implement smaller investment projects, which results in lower amplitude of fluctuations of fixed capital outlays in recent years. At the same time, the intensifying regulation processes (e.g. in the banking sector) have a stagnating influence on the investment activity.

Data on total corporate investments in Poland confirm the trends observed globally. In order to derive cyclical fluctuations of corporate investments between 1999 and 2017 we have used econometric modelling. First, we computed the logarithm of seasonally adjusted and deflated by total investments, gross fixed capital formation of enterprises. Then, with the use of Hodrick-Prescott spectral filter we derived the trend for fixed capital formation. By subtracting the trend value from actual investment value, we obtained the percentage cyclical fluctuations of corporate investments in fixed assets.



Source: Eurostat, Pontinfo, GUS, Credit Agricole

The analysis has shown that three full corporate investment cycles occurred in Poland since 1999 and two incomplete cycles – a recovery cycle ending in Q4 2000 and a slowdown cycle starting from Q3 2015. Two characteristic features of these cycles are especially noteworthy. Firstly, the cycle's length (defined as the distance between two peaks) has shortened. The first of the cycles in the period under review lasted 28 quarter), the second 16 quarters, and the third 15 quarters.

Secondly, the amplitude of cyclical fluctuations (defined as a sum of relative absolute cycle peaks and bottoms variations from the trend) is decreasing over time. During the first cycle, it amounted to 28%, during the second one to 25% and during the third it amounted only to ca. 6%.

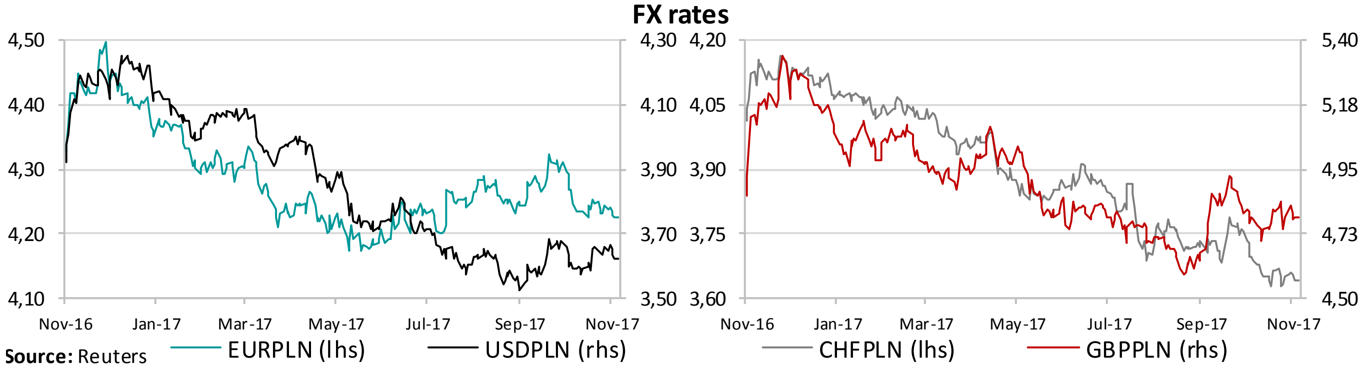
The need to precede an analysis of the cycle of corporate investments in buildings and structures by an analysis of the profile of cycle of corporate investments in fixed assets is dictated by data availability, as data on investments in buildings are available from 2006 only. A small number of observations may skew the results of econometric modelling and bias the conclusions concerning the cycle profile. However it can be observed that, for the period when data is available for both time series, the cycle of corporate investments in buildings and structures and the cycle of total corporate investments in fixed assets have similar profiles. This allows us to assume that the investment cycle in both sections was similar also between 1999 and 2006.

The last peak in the cycle of corporate investments in buildings and structures fell on Q4 2015. Based on the tendencies outlined above, subsequent peak in the cycle of corporate investments in buildings and structures can be expected to fall on the turn of 2018 and 2019. This means that in this period corporate gross fixed capital formation will be conducive the most to higher dynamics of the construction-assembly production.

Below we present three main conclusions from the analyses made in recent weeks on long-term prospects for the construction-assembly production:

- Assuming the profile of EU funds absorption will be similar to that during the 2007-2013 programming period, the peak of the rate of absorption during the 2014-2020 programming period is likely to fall on 2018.
- We expect that the peak of infrastructural investments growth rate will fall between 2017 and 2018.
- We believe that the terms of financing dwellings by means of a bank loan will remain favourable until the turn of 2018 and 2019. In subsequent quarters the demand growth rate will be limited by gradual hikes of interest rates and slower pace of improvement in the labour market.
- The demand for flats for rent will be stable in the coming years.
- Government programs for the housing market will contribute the most to higher construction-assembly production between 2018 and 2019. However it should be noted that government programs are much less significant from flat purchases in the primary market for satisfying housing needs or for rent.
- The peak of corporate investments in buildings and structures will fall on the turn of 2018 and 2019.
- The above factors indicate that the high growth rate of construction-assembly production will continue until the turn of 2018 and 2019. The GDP growth rate will show a similar profile.

Markets focus on data on GDP in Poland

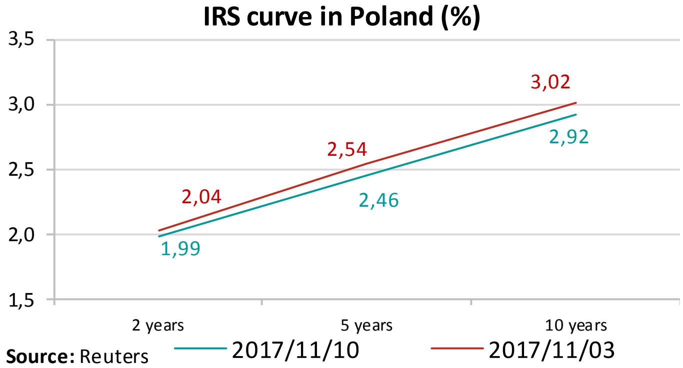


Source: Reuters

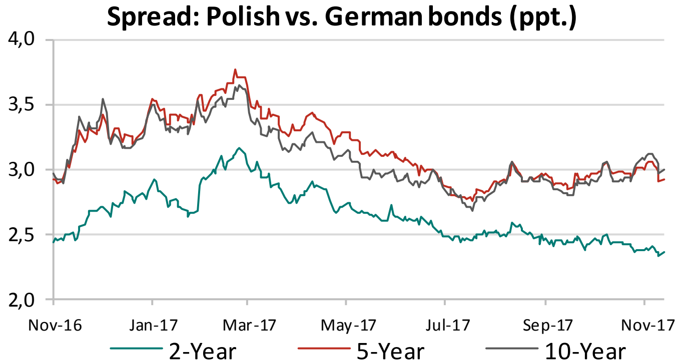
Last week EURPLN rate dropped to 4.2255 (PLN strengthening by 0.4%). Throughout the week, given a scarce macroeconomic calendar, PLN stayed within a weak upward trend. This tendency was distinct compared to the profile of other emerging markets' currencies, which were depreciating due to higher global risk aversion reflected by higher VIX index. The strengthening of PLN was supported by the results of the November MPC projection, in which GDP growth rate and inflation paths were revised upwards compared to the July report. Macroeconomic data from China and business survey results in the US had no significant impact on PLN profile. Last week PLN strongly appreciated vs USD due to PLN appreciation vs EUR given a simultaneous increase in EURUSD rate. USD depreciation vs EUR was related to the publication of the Senate's draft reform of US taxes which provides for tax reductions delayed by a year compared to the proposal of the House of Representatives.

Despite an eventful macroeconomic calendar, we believe that this week's readings will not have a significant impact on PLN, as our forecasts of both domestic (inflation, balance of payments, GDP, corporate wages and employment) and foreign (industrial production, retail sales, business survey results in the US, GDP for the Eurozone and Germany) indicators are close to the market expectations.

Limited impact of macroeconomic data on IRS rates



Source: Reuters



Last week the 2-year IRS rates dropped to a level of 1.9851 (down by 5 bp), of 5-year rates to a level of 2.455 (down by 8 bp), and of 10-year bonds dropped to a level of 2.92 (down by 10 bp). At the beginning of the week, IRS rates were falling down following core markets trends. On Thursday there was an exchange auction at which the Ministry of Finance sold PLN 8.1bn of 3-, 5-, 6-, 10-, and 11-year bonds and redeemed bonds maturing in 2018. The successful – in the markets' opinion – debt auction was conducive to a further fall of IRS rates.

Our forecasts of major macroeconomic variables this week are in line with the market consensus (see the calendar). Thus the materialization of our forecasts should be neutral for IRS rates this week.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	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	Nov-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*	4,31	4,45	4,40	4,32	4,31	4,23	4,23	4,18	4,23	4,25	4,25	4,31	4,24	**4,22**
USDPLN*	3,92	4,20	4,18	4,00	4,07	3,97	3,88	3,72	3,70	3,59	3,57	3,65	3,64	**3,58**
CHFPLN*	3,96	4,13	4,11	4,04	4,05	3,96	3,90	3,84	3,86	3,72	3,72	3,77	3,65	**3,64**
CPI inflation (% YoY)	-0,2	0,0	0,8	1,7	2,2	2,0	2,0	1,9	1,5	1,7	1,8	2,2	**2,1**	
Core inflation (% YoY)	-0,2	-0,1	0,0	0,2	0,3	0,6	0,9	0,8	0,8	0,8	0,7	1,0	**0,9**	
Industrial production (% YoY)	-1,3	3,2	2,2	9,1	1,1	11,0	-0,6	9,1	4,5	6,2	8,7	4,3	**10,5**	
PPI inflation (% YoY)	0,6	1,8	3,2	4,0	4,5	4,8	4,2	2,4	1,8	2,2	3,0	3,1	**2,9**	
Retail sales (% YoY)	3,7	6,6	6,4	11,4	7,3	9,7	8,1	8,4	6,0	7,1	7,6	8,6	**8,5**	
Corporate sector wages (% YoY)	3,6	4,0	2,7	4,3	4,0	5,2	4,1	5,4	6,0	4,9	6,6	6,0	**6,1**	
Employment (% YoY)	3,1	3,1	3,1	4,5	4,6	4,5	4,6	4,5	4,3	4,5	4,6	4,5	**4,4**	
Unemployment rate* (%)	8,2	8,2	8,2	8,5	8,4	8,0	7,6	7,3	7,0	7,0	7,0	6,8	**6,6**	
Current account (M EUR)	-14	-97	-106	2548	-514	-405	459	-297	-1114	-491	-100	**-131**		
Exports (% YoY EUR)	-1,0	4,3	9,0	15,1	6,4	19,7	2,5	18,5	6,5	12,4	12,3	**10,3**		
Imports (% YoY EUR)	1,3	5,2	9,8	16,0	10,5	19,8	3,8	20,4	13,0	12,8	7,6	**8,3**		

*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	4,5	4,2	4,0	3,7	3,6	3,8	2,9	4,1	3,8
Private consumption (% YoY)	4,7	4,9	4,7	4,7	4,6	4,3	4,3	3,9	3,9	4,7	4,3
Gross fixed capital formation (% YoY)	-0,4	0,8	3,7	5,9	7,9	7,0	6,8	6,1	-7,9	3,2	6,7
Export - constant prices (% YoY)	8,3	2,8	8,0	9,5	8,0	7,7	6,8	5,5	8,8	7,1	7,0
Import - constant prices (% YoY)	8,7	6,1	9,0	11,6	10,6	10,0	10,4	8,3	7,9	8,9	9,8
GDP growth contributions – Private consumption (pp)	3,0	2,9	2,8	2,4	3,0	2,6	2,6	1,9	2,9	2,8	2,5
GDP growth contributions – Investments (pp)	0,0	0,1	0,6	1,4	0,9	1,1	1,2	1,5	-2,1	0,5	1,2
GDP growth contributions – Net exports (pp)	0,1	-1,5	-0,3	-0,6	-1,1	-0,8	-1,8	-1,3	0,9	-0,6	-1,2
Current account***	0,1	-0,5	0,0	-1,2	-1,7	-1,5	-1,7	-2,0	-0,3	-1,2	-2,0
Unemployment rate (%)**	8,0	7,0	6,8	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	4,9	6,0	6,4	6,7	6,6	6,5	3,8	5,0	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	3,50	3,49	3,40	3,33	3,26	4,18	3,50	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 11/13/2017				
14:00	**Poland**	**CPI (% YoY)**	**Oct**	**2,1**	**2,1**	**2,1**
14:00	**Poland**	**Current account (M EUR)**	**Sep**	**-100**	**-131**	**-202**
		Tuesday 11/14/2017				
3:00	China	Retail sales (% YoY)	Oct	10,3		10,4
3:00	China	Industrial production (% YoY)	Oct	6,6		6,3
3:00	China	Urban investments (% YoY)	Oct	7,5		7,4
8:00	Germany	Preliminary GDP (% QoQ)	Q3	0,6	0,6	0,6
10:00	**Poland**	**GDP (% YoY)**	**Q3**	**3,9**	**4,5**	**4,5**
11:00	Eurozone	Preliminary GDP (% QoQ)	Q3	0,6	0,6	0,6
11:00	Germany	ZEW Economic Sentiment (pts)	Nov	17,6		20,0
14:00	**Poland**	**Core inflation (% YoY)**	**Oct**	**1,0**	**0,9**	**0,9**
		Wednesday 11/15/2017				
14:30	USA	CPI (% MoM)	Oct	0,5	0,1	0,1
14:30	USA	Core CPI (% MoM)	Oct	0,1	0,2	0,2
14:30	USA	Retail sales (% MoM)	Oct	1,6	-0,1	0,0
14:30	USA	NY Fed Manufacturing Index (pts)	Nov	30,2	26,0	26,0
16:00	USA	Business inventories (% MoM)	Sep	0,7		0,1
		Thursday 11/16/2017				
11:00	Eurozone	HICP (% YoY)	Oct	1,4	1,4	1,4
14:30	USA	Philadelphia Fed Index (pts)	Nov	27,9	26,1	24,1
15:15	USA	Industrial production (% MoM)	Oct	0,3	0,6	0,5
15:15	USA	Capacity utilization (%)	Oct	76,0	76,4	76,3
		Friday 11/17/2017				
10:00	Eurozone	Current account (bn EUR)	Sep	33,3		
14:00	**Poland**	**Employment (% YoY)**	**Oct**	**4,5**	**4,4**	**4,4**
14:00	**Poland**	**Corporate sector wages (% YoY)**	**Oct**	**6,0**	**6,1**	**6,4**
14:30	USA	Housing starts (k MoM)	Oct	1127	1170	1180
14:30	USA	Building permits (k)	Oct	1225	1250	1243

*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

** Parkiet

MACRO MAP

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