Why is employment declining in small enterprises?

This week

- **Some important data from China have been released today.** The economic growth rate in China decreased to 6.2% YoY in Q2 vs. 6.4% in Q1 (1.6% QoQ in Q2 vs. 1.4% in Q1). Thus, the annual and quarterly GDP dynamics stood below (6.3% YoY) and above (1.5% YoY) the market expectations, respectively. On the other hand, the monthly data on industrial production (6.3% YoY in June vs. 5.0% in May, with expectations at 6.3%), retails sales (9.8% vs. 8.6%; 8.3%), and urban investments (5.8% vs. 5.6%; 5.5%) proved to be higher from the market consensus. Data for June may be pointing to the first effects of the stimulation of economic growth implemented by the Chinese government. This supports our scenario assuming an acceleration of economic growth in China in H2 2019. Consequently, we forecast that in the whole 2019 the dynamics of the Chinese GDP will amount to 6.4% vs. 6.6% in 2018.
- **Numerous hard data on the US economy and business survey results will be released this week.** We forecast that nominal retail sales dropped to 0.1% MoM in June from 0.5% in May, due to lower sales in the automotive branch and falling fuel prices. We expect industrial production to have decreased to 0.2% MoM in June vs. 0.4% in May, due to weather conditions limiting production in the category “utilities”. We expect that further slowdown in the US real estate market will be confirmed by data on housing starts (1268k in June vs. 1269k in May) and new building permits (1306k vs. 1299k). Business survey results will also be released this week in the US. Improvement in manufacturing will be indicated by Philadelphia FED Index which increased, in our view, to 5.0 pts in July vs. 0.3 pts in June and by the NY Empire State Index (up to 2.0 pts in July vs. -8.6 pts in June). We forecast that the preliminary University of Michigan Index rose to 98.5 pts in July vs. 98.2 pts in June. In our view, the aggregate impact of US data will not be market moving.
- **ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany will be released on Tuesday**. We expect that the index rose to -20.0 pts in July from -21.1 pts in June. Our forecast is in line with the consensus; therefore, its materialization will be neutral for PLN and the prices of Polish bonds.
- **Data on the Polish balance of payments in May will be released today**. We expect the current account balance to drop to EUR 572M in February vs. EUR 718M in April, mainly due to lower balance on trade. We forecast that export dynamics dropped to 9.0% YoY in May vs. 10.3% in April, while import growth rate dropped to 7.3% YoY vs. 8.7%. Although our forecast of the current account balance is above the market expectations (EUR 460M), we believe that the reading will not have any significant impact on PLN and yields on Polish bonds.
- **Final data on the June inflation in Poland was released today.** It run in line with the flash estimate (2.6% YoY vs. 2.4% in May). The increase in inflation resulted from higher dynamics of the prices of food and non-alcoholic beverages and core inflation. For more details please see today’s MACROpulse.
- **The June data on average wages and employment in the corporate sector in Poland will be released on Wednesday**. We forecast that employment dynamics dropped to 2.6% YoY in June from 2.7% in May, due to last year’s high base effects and growing supply-side barrier in the form of shortage of skilled labour. In turn, the average wage dynamics dropped, in our view, to 7.2% YoY in June vs. 7.7% in May, due to the shift of the payment of variable remuneration in certain branches. Though important for the forecast of private consumption dynamics in Q2, the release of data on corporate wages and employment will be neutral for PLN and the debt market, we believe.
- **Data on the June industrial production in Poland will be released on Thursday.** We forecast that industrial production growth slowed down to 2.0% YoY in vs. 7.7% in May. Conducive to the marked decrease in production dynamics were unfavourable calendar effects. Our forecast is in line with the market consensus; therefore, its materialization will be neutral for PLN and yields on Polish bonds.

- **On Friday we will see data on retails sales dynamics in Poland, which we believe dropped to 6.0% YoY in June vs. 7.3% in May.** Conducive to their decrease was an unfavourable difference in the number of working days. On the other hand, the sales were stabilized by good households' sentiment and payment of social transfers. Our forecast of retail sales dynamics is above the consensus (4.9%); therefore, its materialization will be slightly positive for PLN and yields on Polish bonds.

Last week

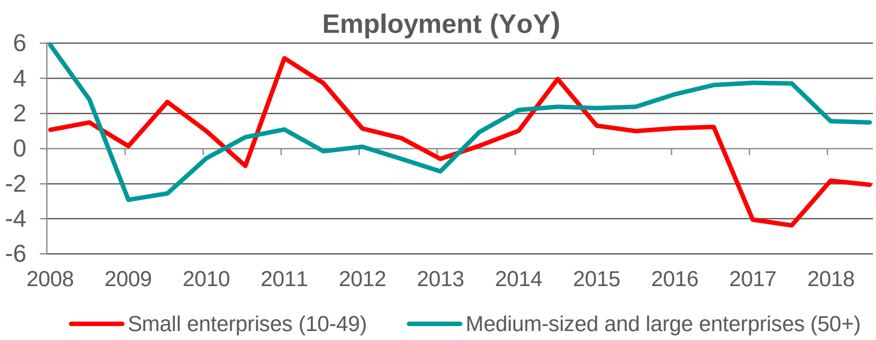
- **Last week the market was focusing on the testimony to the Congress of the FED Chairman, J. Powell, who presented a half-yearly report on the implementation of the US monetary policy.** He suggested in his address that the Federal Reserve was prepared to ease the US monetary policy anticipating future deterioration amid muted inflation pressures and did not intend to wait with that decision. J. Powell's dovish speech led to USD depreciation vs. EUR and lower yields on US bonds. The Minutes of the June FOMC meeting were also released last week. According to the Minutes, many members of the Federal Reserve believe that if the currently observed risks to the US economy persist (trade war escalation and prospect for economic slowdown amid continuing limited inflation pressure), monetary easing in the nearest future will be necessary. According to several FED members, such measures would help to mitigate the negative impact of possible future shocks in the US economy. A couple of members of the Federal Reserve were in favour of easing the monetary policy in June but some members said that there were no sufficient arguments yet supporting interest rate cuts and they preferred to wait for further information coming from the US economy. J. Powell's address and the text of the Minutes support our scenario, in which FED will cut interest rates twice this year each time by 25 bp (in July and September). However, we see a risk that in the event of a marked improvement of the macroeconomic prospects signalled by information coming before the July meeting, the FOMC will postpone the monetary easing until September 2019. The market is currently pricing in an interest rate cut by 31 bp at the July meeting.
- **CPI inflation in the US dropped to 1.6% YoY in June vs. 1.8% in May (0.1% MoM both in May and June), running in line with the market expectations**. The decrease in inflation in June resulted from lower dynamics of energy and food prices. Opposite impact had the increase in core inflation to 2.1% YoY in June vs. 2.0% in May (0.3% MoM in June vs. 0.1% in May), which ran above the market expectations (2.0%). The increase in core inflation in June resulted from higher dynamics of prices i.a. in the categories "clothing and footwear", "used cars", and "furniture". The data on inflation are consistent with our scenario of US interest rates (see above).
- **Significant data from the German economy were released last week**. Industrial production increased by 0.3% MoM in May vs. a 0.2% decrease in April, running in line with the market expectations. The increase in its monthly dynamics resulted from higher production dynamics in manufacturing and energy, while lower production dynamics in construction had an opposite impact. Last week we also saw data on the balance on trade, according to which export dynamics rose to 1.1% MoM in May vs. -3.4% in April, while import dynamics to -0.5% vs. -0.9%, with expectations at 0.5% and 0.3%, respectively. Consequently, the trade surplus rose to EUR 18.7bn in May vs. EUR 16.9bn in April. In turn, two weeks ago we saw data on orders in German manufacturing which dropped by 2.2% MoM in May vs. a 0.4% increase in April, running visibly below the market expectations (a decrease by 0.2%). The decline in orders resulted from lower export orders, while a slight increase in domestic orders had an opposite impact. In the case of foreign orders a decline was recorded both for orders from other Eurozone countries and from non-Eurozone countries. The data on the German economy support our forecast, in which the quarterly growth rate of the German GDP will decrease to 0.2% in Q2 vs. 0.4% in Q1. We expect

that in the whole 2019 the German economic growth rate will decrease to 0.7% YoY vs. 1.5% in 2018.

- **The Chinese balance on trade increased to USD 51.0bn in June vs. USD 41.7bn in May, running above the market expectations (USD 44.7bn).** At the same time, export dynamics dropped to 1.3% YoY in June vs. 1.1% in May, while import dynamics increased to -7.3% YoY vs. -8.5%, running above and below the market consensus, respectively (-2.0% and -4.5%). The lower-than-expected dynamics of Chinese imports signal further slowdown of internal demand, despite the policy of its stimulation implemented by the Chinese government. We maintain our forecast for the economic growth in China (6.4% in 2019 and 6.0% in 2020). However, to achieve such GDP growth rate, the growth stimulus implemented by the Chinese government will have to increase. We believe that to this end measures will be taken to increase lending (stopping the process of deleveraging banks, reduction of interest rates), weaken CNY in line with the deterioration of the Chinese trade balance and fiscal policy will be eased more.

Why is employment declining in small enterprises?

According to GUS data, the employment growth rate in the enterprise sector went down to 2.7% YoY in May compared to 2.9% in April, which is below our forecast in line with the market consensus (2.9%). In MoM terms, employment went down by 12.2k people. Drop of employment is often seen in May, however, its scale was a negative surprise. The situation appeared particularly unfavourable in the context of the decline in employment recorded also in April. The decrease in the number of persons employed amid economic recovery is surprising. Below we are trying to find the reasons why.



Source: PONT Info, Credit Agricole

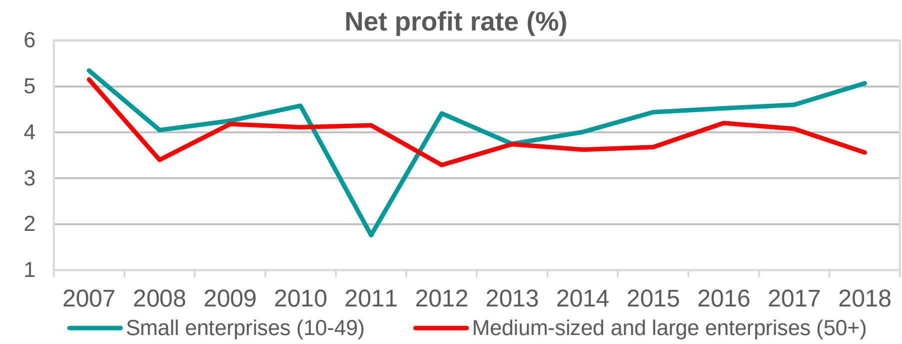
The said number of persons employed applies to entities employing more than 9 people in most sectors of the economy. The "enterprise sector" excludes i.a. the financial sector, public administration or education. Such presentation of data makes it impossible to analyze employment trends according to different classes of enterprise size. For this purpose we have used the data of the PONT Info base. The information in this data base is based on full, official GUS data included in F-01 reports completed by enterprises, representing the respective sectors of the economy. Thanks to this base we were able to follow changes in the number of persons employed in companies employing from 10 to 49 people (hereinafter small companies) and at least 50 people (hereinafter medium-sized and large companies). A disadvantage of this solution is that we do not have any information about the trends in 2019 (the latest information is from December 2018) and that data are available at semi-annual (instead at monthly) frequency.

Why is employment declining in small enterprises?

Source: PONT Info, Credit Agricole

It turns out that in the segment of small companies there has been a continuous decrease in the number of employees in YoY terms from the middle of 2017. On the other hand, in the companies employing at least 50 people a continuing increase in the number of persons employed was recorded, although it slowed down in 2018. It means that at the level of the whole enterprise sector, the decrease of employment in small companies was "masked" by the increase in the number of jobs in bigger entities. It was possible because medium-size and large companies are responsible for 86% of all employed persons. The availability of data prevents us from analyzing the trends in 2019. However, it may be assumed that as the supply-side barrier in the form of skilled labour shortage intensified, the employment growth in larger companies slowed down even more in 2019, which, with further reduction of the number of persons employed in small entities, has made the decrease in employment in the whole corporate sector more visible in recent months.

It should be noted that currently we are dealing with the longest from at least 2008 episode of decrease of employment in small companies. In addition, as the number of jobs decreases, we see a simultaneous decline in the number of entities in this segment. The decreasing number of small enterprises is a sign of either numerous bankruptcies, which is not confirmed by business surveys on financial situation of companies (see below) or of changes in companies' size resulting in their transfer to the category with a smaller (<10) or bigger (50+) number of employees.



Source: PONT Info, Credit Agricole

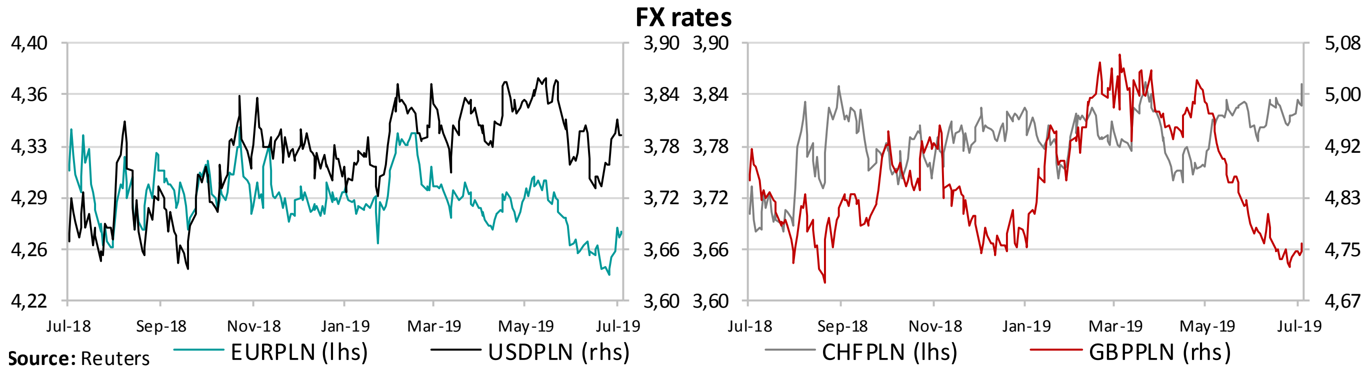
The PONT data indicate that from the middle of 2017 a slight increase in the average number of employees per small company has been observed. Considering that it was a period of economic recovery, it may be assumed that the decline in the number of small entities results from their fast expansion and the fact that they were increasing employment and consequently dropped out from the sample of 10-49 employees and were classified to the segment of companies employing at least 50 persons. The hypothesis of the positive impact of economic recovery on the operations of small companies is also confirmed by data on improving profitability of small businesses. In the 2016-2018 period, the percentage of small profitable companies rose by 1.4 pp up to 80.8%. Improved productivity of small enterprises is also visible in the profile of net profit rate (net profit divided by total revenues). For small companies it has been showing an upward trend continuously from 2013 and in 2018 was markedly higher than for larger companies (5.1% vs. 3.6%).

However, the decrease in the number of units could also have resulted from consolidation operations, namely acquisitions by larger entities. In such cases restructuring occurs which usually results in a decrease of employment. We should bear in mind however that small companies are mainly family businesses whose owners are usually disinclined to sell their operations. That is why we assume that fusions between small companies, if any, are also at a small scale. Therefore, we believe that the main factor conducive to the decline in employment in small companies is the expansion of their activity (including employment) resulting in the transfer of companies to the segment with bigger employment (at least 50 employees).

It should be pointed out that against the backdrop of the aforementioned favourable trends we can also see other, less favourable tendencies that may be conducive to a decline in employment. Firstly, the average wage in small companies stood in 2018 at a level that was lower by 14% compared to companies employing at least 50 people. Amid low unemployment this difference supports a natural flow of labour force from smaller to bigger enterprises. Secondly, a large number of small companies complain about payment backlogs. They emphasize that problems with delayed payments force them to limit investments and eventually – limit wages and reduce employment. However, GUS business surveys signal that problems with payment delays or financial standing of small companies have not significantly deteriorated recently. In addition, payment delays are decreasing amid fast economic growth and therefore should not now be attributed the main responsibility for the decrease of employment in small companies.

The growing barrier in the form of shortage of skilled labour supports our scenario assuming a gradual decrease in employment dynamics in the national economy in subsequent quarters. At the same time we believe that further flow of employees from small companies to larger entities will be observed. Consequently, we expect that MoM decreases of employment in the whole sector of enterprises is a phenomenon that may appear from time to time but is not a sign of any negative tendencies.

Data from China slightly positive for the PLN

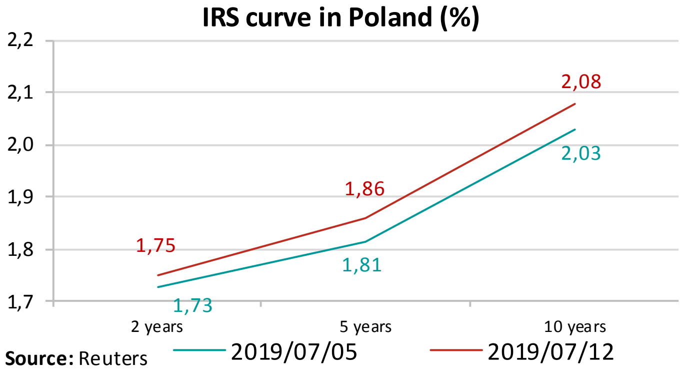


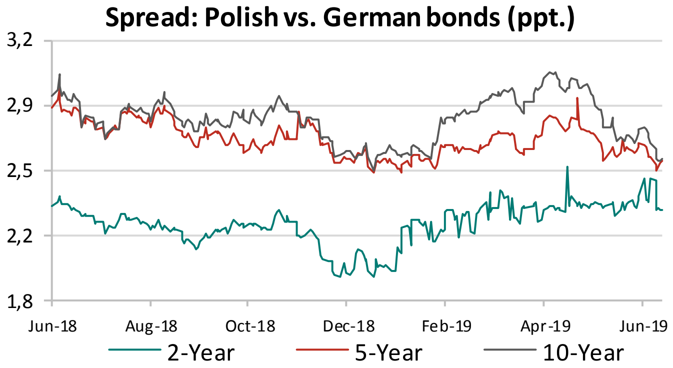
Source: Reuters

Last week, EURPLN exchange rate rose to 4.2678 (PLN weakening by 0.4%). The beginning of last week brought the depreciation of PLN and of other currencies of the region. It resulted from lower market expectations of monetary easing in the US after the published two weeks ago clearly better-than-from-the-market-consensus data on non-farm payrolls in the US (see MACROmap of 8/7/2019). Wednesday saw a slight correction and a slight strengthening of PLN in reaction to a dovish tone of the testimony of the FED Chairman, J. Powell, to the Congress. Thursday and Friday saw PLN stabilization supported by scarce macroeconomic calendar. Due to the increase in global risk aversion recorded in the first part of the week, PLN was also depreciating vs other major currencies. Despite an increase in the appetite for risky assets towards the end of the week, PLN has failed to make up for earlier losses. In effect, last week PLN depreciated vs USD (by 0.1%), CHF (by 1.0%), and GBP (by 0.4%).

Today's better-than-expected data from China are slightly positive for PLN. Crucial for PLN this week will be the publication of data on retail sales in Poland, which may contribute to its slight appreciation. In our view, other data from Poland (industrial production, average wage and employment in the Polish corporate sector, balance of payments) will have a limited impact on PLN. We believe that numerous US readings scheduled for this week (retail sales, industrial production, number of housing starts, new building permits, preliminary University of Michigan Index, as well as NY Empire State and Philadelphia FED Indices) as well as ZEW Index for Germany will also be neutral for PLN.

Market focuses on data on Polish retail sales





Source: Reuters

Last week, 2-year IRS rates increased to 1.75 (up by 2bp), 5-year rates to 1.86 (up by 5bp), and 10-year rates to 2.08 (up by 5bp). The beginning of this week saw the stabilization of IRS rates supported by scarce macroeconomic calendar. Wednesday morning saw an increase in IRS rates across the curve, in anticipation of the FED Chairman J. Powell's testimony to the Congress. A dovish tone of J. Powell's address resulted in a correction and temporary decrease in IRS rates. However, on Thursday and Friday IRS rates resumed an upward trend following the core markets. On Thursday there was a debt exchange auction at which the Ministry of Finance repurchased bonds maturing in 2019 and 2020 and sold PLN 4.7bn of 2-, 5-, 6-, and 10-year bonds with demand amounting to PLN 6.1bn. The auction had a limited impact on the curve.

This week the market will focus on domestic data on retail sales. If our higher-from-the-market-consensus forecast materializes, the data may result in an increase in IRS rates. In our view, other data from Poland (industrial production, average wage and employment in the Polish corporate sector, balance of payments) will not have any significant impact on the curve. The numerous US data (retail sales, industrial production, number of housing starts, new building permits, preliminary University of Michigan Index, as well as NY Empire State and Philadelphia FED Indices) as well as ZEW Index for Germany will also be neutral for IRS rates, we believe.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland														
Indicator	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19
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*	4,37	4,27	4,30	4,28	4,34	4,29	4,29	4,26	4,30	4,30	4,28	4,28	4,24	4,26
USDPLN*	3,74	3,66	3,71	3,69	3,84	3,79	3,74	3,72	3,79	3,84	3,82	3,83	3,73	3,76
CHFPLN*	3,78	3,69	3,83	3,75	3,80	3,79	3,81	3,74	3,79	3,85	3,75	3,83	3,82	3,80
CPI inflation (% YoY)	2,0	2,0	2,0	1,9	1,8	1,3	1,1	0,7	1,2	1,7	2,2	2,4	2,6	
Core inflation (% YoY)	0,6	0,6	0,9	0,8	0,9	0,7	0,6	0,8	1,0	1,4	1,7	1,7	1,9	
Industrial production (% YoY)	6,7	10,3	5,0	2,7	7,4	4,6	2,8	6,0	6,9	5,5	9,2	7,6	2,0	
PPI inflation (% YoY)	3,7	3,4	3,0	3,0	3,2	2,8	2,1	2,2	2,9	2,5	2,6	1,4	1,2	
Retail sales (% YoY)	10,3	9,3	9,0	5,6	9,7	8,2	4,7	6,6	6,5	3,1	13,6	7,3	6,0	
Corporate sector wages (% YoY)	7,5	7,2	6,8	6,7	7,6	7,7	6,1	7,5	7,6	5,7	7,1	7,7	7,2	
Employment (% YoY)	3,7	3,5	3,4	3,2	3,2	3,0	2,8	2,9	2,9	3,0	2,9	2,7	2,6	
Unemployment rate* (%)	5,8	5,8	5,8	5,7	5,7	5,7	5,8	6,1	6,1	5,9	5,6	5,4	5,2	
Current account (M EUR)	192	-754	-1005	-876	-482	-29	-1248	1825	-342	533	718	572		
Exports (% YoY EUR)	7,7	12,0	8,9	-1,5	13,2	7,6	2,3	5,0	10,0	7,9	10,3	9,0		
Imports (% YoY EUR)	9,4	12,4	14,0	4,2	18,0	9,1	2,3	4,9	7,8	1,4	8,7	7,3		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland												
Indicator		2019				2020				2018	2019	2020
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Gross Domestic Product (% YoY)		4,7	5,0	4,6	4,6	4,2	3,8	3,7	3,4	5,1	4,7	3,8
Private consumption (% YoY)		3,9	5,0	4,4	4,0	3,7	3,6	3,5	3,4	4,5	4,3	3,6
Gross fixed capital formation (% YoY)		12,6	10,8	8,1	6,6	4,8	4,9	5,2	4,8	8,7	8,8	4,9
Export - constant prices (% YoY)		5,9	5,3	6,0	6,0	5,4	5,4	5,4	6,3	6,3	5,8	5,6
Import - constant prices (% YoY)		5,0	7,2	8,3	7,7	6,9	6,7	6,2	6,3	7,1	7,1	6,5
GDP growth contributions	Private consumption (pp)	2,4	2,9	2,6	2,0	2,3	2,1	2,1	1,7	2,6	2,5	2,0
	Investments (pp)	1,6	1,7	1,5	1,6	0,6	0,8	1,0	1,2	1,5	1,7	0,9
	Net exports (pp)	0,7	-0,8	-1,0	-0,7	-0,6	-0,5	-0,2	0,2	-0,2	-0,5	-0,3
Current account (% of GDP)***		-0,4	-0,6	-0,5	-0,6	-1,0	-1,1	-1,1	-1,0	-0,7	-0,6	-1,0
Unemployment rate (%)**		5,9	5,2	5,4	5,7	5,8	5,1	5,3	5,6	5,8	5,7	5,6
Non-agricultural employment (% YoY)		0,0	0,2	0,2	0,1	0,1	0,1	0,1	0,1	0,9	0,1	0,1
Wages in national economy (% YoY)		7,1	7,6	7,8	7,7	7,7	7,7	7,3	7,1	7,2	7,6	7,5
CPI Inflation (% YoY)*		1,2	2,4	2,6	2,6	3,0	2,0	1,5	1,5	1,6	2,2	2,0
Wibor 3M (%)**		1,72	1,72	1,72	1,72	1,72	1,72	1,72	1,72	1,72	1,72	1,72
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
EURPLN**		4,30	4,25	4,28	4,28	4,28	4,28	4,25	4,23	4,29	4,28	4,23
USDPLN**		3,84	3,73	3,82	3,75	3,69	3,63	3,54	3,50	3,74	3,75	3,50

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

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST* CA	FORECAST* CONSENSUS**
		Monday 07/15/2019				
4:00	China	GDP (% YoY)	Q2	6,4	6,2	6,2
4:00	China	Retail sales (% YoY)	Jun	8,6		8,3
4:00	China	Industrial production (% YoY)	Jun	5,0		5,2
4:00	China	Urban investments (% YoY)	Jun	5,6		5,5
10:00	**Poland**	**CPI (% YoY)**	**Jul**	**2,6**	**2,6**	**2,6**
12:00	**Poland**	**Current account (M EUR)**	**May**	**718**	**572**	**460**
14:30	USA	NY Fed Manufacturing Index (pts)	Jul	-8,6	2,0	0,5
		Tuesday 07/16/2019				
11:00	Germany	ZEW Economic Sentiment (pts)	Jul	-21,1	-20,0	-20,0
14:00	**Poland**	**Core inflation (% YoY)**	**Jun**	**1,7**	**1,9**	**1,9**
14:30	USA	Retail sales (% MoM)	Jun	0,5	0,1	0,2
15:15	USA	Industrial production (% MoM)	Jun	0,4	0,2	0,1
		Wednesday 07/17/2019				
10:00	**Poland**	**Employment (% YoY)**	**Jun**	**2,7**	**2,6**	**2,6**
10:00	**Poland**	**Corporate sector wages (% YoY)**	**Jun**	**7,7**	**7,2**	**7,0**
11:00	Eurozone	HICP (% YoY)	Jun	1,2	1,2	1,2
14:30	USA	Housing starts (k MoM)	Jun	1269	1268	1260
14:30	USA	Building permits (k)	Jun	1299	1306	1298
		Thursday 07/18/2019				
10:00	**Poland**	**Industrial production (% YoY)**	**Jun**	**7,7**	**2,0**	**2,0**
10:00	**Poland**	**PPI (% YoY)**	**Jun**	**1,4**	**1,2**	**0,7**
14:30	USA	Philadelphia Fed Index (pts)	Jul	0,3	5,0	5,0
		Friday 07/19/2019				
10:00	**Poland**	**Retail sales (% YoY)**	**Jun**	**7,3**	**6,0**	**4,9**
16:00	USA	Initial U. of Michigan Sentiment Index (pts)	Jul	98,2	98,5	98,4

*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