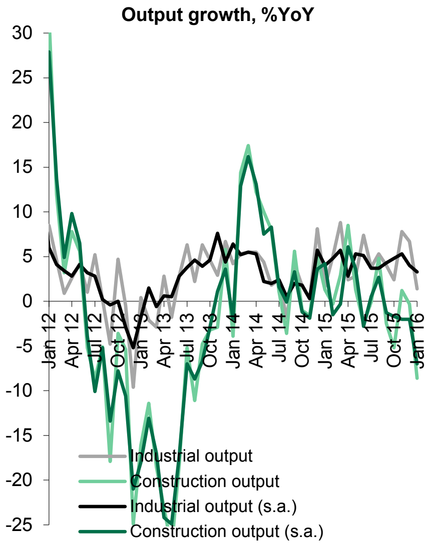
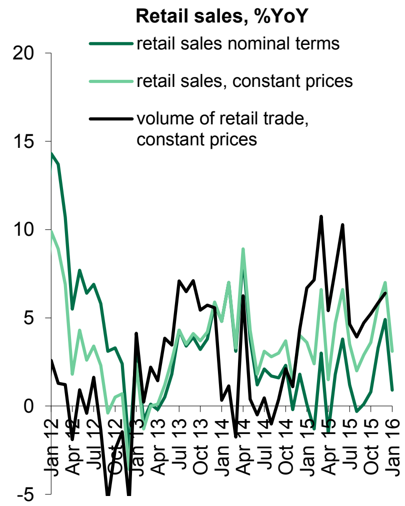
INSTANT COMMENT

17 February 2016

Output and sales below expectations

Pace of growth of industrial output decelerated in January to 1.4% YoY from 6.8% YoY in December 2015, construction output to -8.6% YoY from -0.3% YoY and retail sales to 3.1% YoY from 7.0% YoY. As regards industry, activity in this sector has been negatively affected by lower number of working days than a year ago but even after adjusting for this effect January's data show some deceleration. Data from construction and retail sales were also disappointing, but in our view these may have been distorted by one-off factors. In our view it is premature to conclude a persistent deterioration of the economic activity outlook after that release. As long economic growth remains sound in Germany and the whole UE, orders for the domestic industry could continue to rise. Additionally, the very positive labour market situation and government's 500+ programme will support acceleration of consumer demand. Still, January's data are dovish.





Slowdown in industry, downturn in costruction

Pace of growth of industrial output decelerated in January to 1.4% YoY from 6.8% YoY in December 2015. This was well below market consensus (2.9% YoY), but quite close to our estimate (1.7% YoY). One should remember that activity in industry has been negatively affected by lower number of working days than a year ago but even after adjusting for this effect January's data show some deceleration. According to the stat office, industrial output grew 3.3% YoY after seasonal adjustment, its slowest for 10 months, but in our view it is premature to conclude a persistent deterioration of the economic activity outlook after that release. As long economic growth remains sound in Germany and the whole UE, orders for the domestic industry could continue to rise, particularly given the current level of the exchange rate making our manufacturers even more competitive. We expect industrial output to accelerate in the months to come (particularly in February where there will be a positive impact of the working days effect).

Decline of construction and assembly output by 8.6% YoY (by 7.0% YoY after seasonal adjustment) was a major negative surprise. Supposedly, this may have been due to worse weather conditions, but we cannot rule out that the ongoing slowdown in public investment (visible in data since mid-2015) is one of the culprits as well. As a result of this contraction, output in construction (after seasonal adjustment) returned to mid-2013 level.

Retail sales below expectations

January's retail sales were considerably weaker than expected and rose by 3.1% YoY in real terms (we expected 6.9% YoY, market 5.2% YoY) and by 0.9% YoY in nominal terms. We were especially wrong about car sales, which fell by 26.7% MoM (and rose by 4.6% YoY versus 19.7% YoY in December), i.e. by about 10 percentage points more than in 2015 and 2014. Sales of press and books were also disappointing (6.5% YoY versus 25.0% YoY in December) and the same can be said about household appliances (5.5% YoY versus 10.1% YoY in December). On the other hand, acceleration was recorded in sales of clothing and footwear (20.5% YoY versus 13.9% YoY in December) and medicines (6.8% YoY versus 2.9% YoY). The statistics office again reshuffled food and other retail sales categories, and after two months returned to the previous classification. Thus, food sales growth jumped to 2.9% YoY from -6.0% YoY and other retail sales fell to 1.4% YoY from 33.5% YoY. According to our estimates, total sales in these two categories reached 2.4% YoY in January versus 5.4% YoY in December.

We do not see any reason for sharp weakening of retail sales and so we think that for some reasons consumers could have switched some purchases to December from January and

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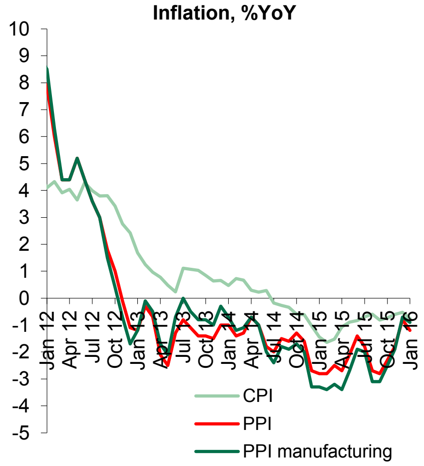

this could explain strong end of 2015 (+7% YoY, highest growth since April 2014) and poor beginning of 2016. The next months will be the key to verify this thesis. We think that robust labour market and launching the child benefit programme since April will be a solid support for the private consumption this year.

Deepening declines in producer prices in January

In January, producer prices fell by 0.5% as compared to December, which translated into an annual decline in prices of 1.2% (after a drop of 0.8%YoY in December 2015). PPI inflation reading was lower than the market (-0.7%YoY) and our (-0.5%YoY) forecasts, which resulted from a further decline in commodity prices on the international market. January's weakening of the zloty against the major currencies did not affect producer prices this month. On a monthly basis the largest decline in prices was recorded for mining and quarrying (by 3.9%), while prices in manufacturing decreased by 0.3%, including the most fall in manufacture of coke and refined petroleum products (by 8.3%).

Deflation in producer prices remained more than three years, and this situation will not change in the coming months. However, we expect producer prices to increase gradually and to be slightly above zero at the end of the year.