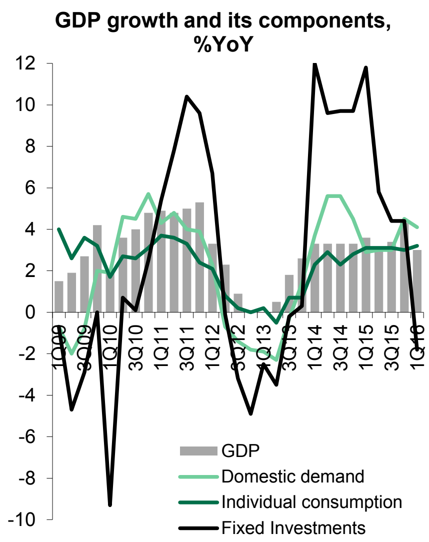
INSTANT COMMENT

31 May 2016

GDP slowdown mainly due to falling investments

GDP growth in 1Q16 reached 3.0% y/y, in line with flash estimate. The main source of a slowdown from 4.3% y/y in 4Q15 was drop of investments (-1.8% y/y) and negative net exports' contribution (-0.9 pp). Private consumption growth was stable at 3.2% y/y. We think GDP growth in the coming quarters should accelerate slightly, boosted by faster export growth (effect of solid economic growth in euro zone + competitive exchange rate), and in 2H16 by much higher private consumption (effect of 500+ child benefits programme). The biggest question mark concerns investments. It seems their drop in 1Q16 was mainly the effect of collapse of public investment spending and some rebound is possible before the end of the year if the absorption of EU support funds improves. So on average GDP growth in 2016 may be slightly below 3.5%, according to our forecast.

Inflation rate in May reached -1.0% y/y according to flash estimate. It is much below our forecast (-0.7% y/y). According to our observations prices of food and fuels rose in May, so such low CPI print probably implies a further drop of core inflation – possibly to the new record low -0.5% y/y.



GDP growth in 1Q16 reached 3.0% y/y, in line with flash estimate and versus 4.3% y/y in 4Q15. After seasonal adjustment, GDP fell by 0.1% q/q and rose by 2.6% y/y. This was the weakest GDP growth since 4Q13 and the slowdown was mainly due to a drop of investments (-1.8% y/y) and negative net exports' contribution (-0.9 pp). Consumption remained the main engine of growth in Q1.

Investment deducted 0.2 percentage points from the GDP growth. Lower fixed investment was primarily due to declining public outlays – according to Halina Dmochowska, acting president of the stat office, they fell by as much as 20% y/y. In our view, this is a result of the transition period between two EU financial frameworks and possibly also due to a slower decision process after the election amid staff exchange in public administration. However, even a 20% fall in public investment means that private outlays slowed down as well, according to our estimates. It was suggested by some indicaotrs, like NBP business conditions survey, which showed that companies are delaying their investment projects due to uncertainty about changes in legislation. Data from the big companies (employing at least 50 people) suggest that investment declined mostly in water supply, transport and warehousing as well as in energy production, thus in sectors connected to the public sector. On the other hand, investment in industrial manufacturing rose by 9% y/y. What is important, companies are still showing high demand for investment loans and for labour, so in our view this slowdown may be only temporary. Especially, as spending of EU funds may improve before the year-end.

Private consumption rose by 3.2% y/y, similary to previous quarters. Consumption was supported by favourable labour market situation, underpinning the households' purchasing power and their propensity to spend. We expect an acceleration of private consumption in H2 to 4-5% y/y due to the 500+ child benefit programme.

Exports and imports rose by 6.9% and 9.3% YoY respectively. The faster growth in imports led to the fall in the contribution of net exports into the economic growth. In Q1 2016, it was -0.9 pp vs -0.1% in Q4 2015. The growth rate of exports in Q1 was surprisingly slow considering the improvement of the economic standing of Poland's main trade partners. We expect the export growth to accelerate in the quarters to come provided that the market conditions in Europe continue to improve.

In general, the composition of GDP growth for Q1 looks rather bleak – out of the three drivers of the economic growth in the previous quarters (consumption, investments, export),

ECONOMIC ANALYSIS DEPARTMENT:

al. Jana Pawła II 17, 00-854, Warszawa fax +48 22 586 83 40

email: ekonomia@bzwbk.pl Web site: http://www.bzwbk.pl

Maciej Reluga (Chief Economist) +48 22 534 18 88

Piotr Bielski +48 22 534 18 87

Agnieszka Decewicz +48 22 534 18 86

Marcin Luziński +48 22 534 18 85

Marcin Sulewski +48 22 534 18 84

TREASURY SERVICES:

Poznań +48 61 856 5814/30

Warszawa +48 22 586 8320/38

Wrocław +48 71 369 9400

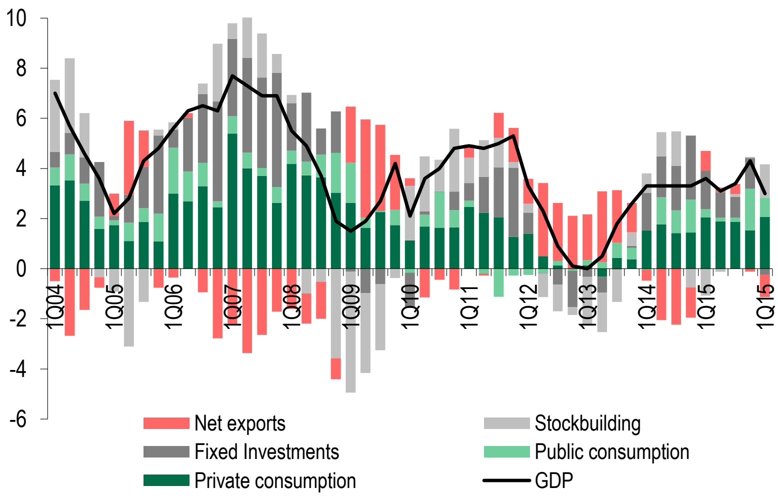
only one remains – private consumption. We expect its role to grow even further in H2, as the 500+ programme will trigger larger household spending, which will boost the GDP growth rate for the four next quarters. We also predict the export growth to rebound, since the European data indicate a quite solid economic growth in euro zone, which should in our opinion result in the inflow of orders for the Polish industry (especially given the PLN rate, which ensures high competitiveness). Investments are still very much up in the air. Nevertheless, we assume that their growth will steadily recover in the following quarters, partly due to more effective use of EU funds. All in all, we expect the GDP growth rate to accelerate gradually until the end of the year and reach the average of approx. 3.5% for the entire 2016.

GDP growth and its components (%YoY)

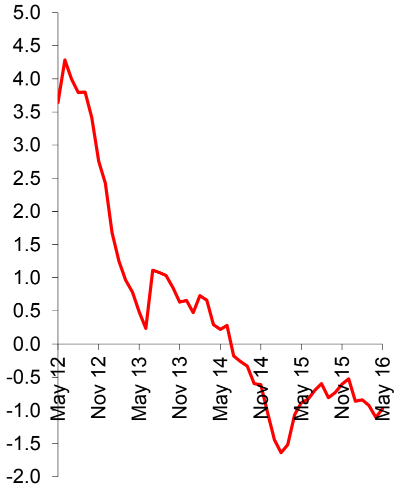
	2013	2014	2015	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16
GDP	1.3	3.3	3.6	3.3	3.3	3.6	3.1	3.4	4.3	3.0
Domestic demand	-0.7	4.9	3.4	5.6	4.5	2.9	3.0	3.0	4.5	4.1
Total consumption	0.7	2.9	3.1	2.8	3.8	2.8	2.5	2.6	4.5	3.4
Private consumption	0.2	2.6	3.1	2.3	2.8	3.1	3.1	3.1	3.0	3.2
Public consumption	2.2	4.7	3.4	5.1	7.2	1.8	0.8	0.9	8.7	4.4
Gross accumulation	-5.8	12.8	4.5	18.2	6.5	3.4	4.9	4.8	4.5	8.1
Fixed investment	-1.1	10.0	5.8	9.7	9.7	11.8	5.8	4.4	4.4	-1.8
Net export *	2.0	-1.5	0.3	-2.2	-1.2	0.8	0.2	0.4	-0.1	-0.9

* contribution to GDP growth (percentage points);

GDP growth and its main components (% YoY)



CPI, % YoY



Inflation below expectations again

CPI inflation was at -1.0% y/y in May versus our forecast at -0.7% y/y and Bloomberg market consensus at -0.9% y/y. Our estimates show that fuel prices rose considerably in May (5% m/m) and food prices climbed moderately. This suggest that the low reading was caused by falling prices in other categories. Thus, we are likely to see core inflation decreasing to a new record low of -0.5% y/y. Recent comments of MPC members reveal that the economic growth is more important for them than the prolonging deflation, so we are expecting the MPC's propensity to cut rates to stay low in the nearest months, provided there are no new signals of economic slowdown.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Rates Area, Economic Analysis Department, al. Jana Pawła II 17, 00-854, Warsaw, Poland, phone +48 22 534 18 88, email ekonomia@bzwbk.pl, http://www.bzwbk.pl.