

Fragile recovery

Poland: Economic Outlook

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Index

■ Executive summary	p. 3
■ Forecasts review	p. 5
■ Economic activity	p. 7
■ Foreign trade	p. 14
■ Labour market	p. 15
■ Inflation	p. 19
■ Monetary policy	p. 21
■ Fiscal policy	p. 22
■ Financial markets	p. 23
■ Forecast table	p. 33
■ SECTORAL SUPPLEMENT	p. 37



Executive Summary (macro)

The third quarter that has just ended saw a vigorous rebound of economic activity, after a deep plunge in Q2, and as a result we have just moved our GDP estimate for Q3 up, to -3% y/y. However, the outlook for the upcoming quarters does not look any brighter, as the quickly rising tide of new Covid-19 cases threatens to slow the pace of economic recovery. Even if the government is quite reluctant to impose far-reaching restrictions or lockdowns, business activity may suffer from reduced output capacity, as the number of people in quarantine grows quickly, and/or from lower personal spending, as the second wave of pandemic may weigh on consumer confidence. That said, we do not expect to see the second wave of recession ahead, but rather a slowdown of the recovery process, especially in Q4. Overall, our forecasts for 2020 and 2021 remain roughly unchanged, at -3% and +4.8% respectively.

We see quite positive outlook for Polish exports and export-oriented manufacturing branches, which have suffered a lot in the early stage of the pandemic, but managed to recover very quickly and now seem to be enjoying a rapid expansion, possibly due to another episode of the "substitution effect" (Polish firms phasing out competition from the Western European markets during slowdowns/recessions due to high price competitiveness). See the [Sectoral supplement](#) for more evidence of this substitution effect from selected branches. Any sustained zloty depreciation should be helpful in this regard.

The labour market reaction to economic turmoil has been muted so far. The peak in unemployment rate is yet to be seen, but it is clear that it will be much smaller than anticipated at the early stage of the pandemic, as the large-scale government anti-crisis package has limited the collateral damage in the economy. That said, the consumer purchasing power will be reduced for quite some time as the firms' adjustment to the shock took its toll on real wage growth, which is unlikely to recover quickly.

While the disinflation in the developed Europe continues, Poland again diverged from the trend with CPI in September surprisingly rising to 3.2% y/y (and core inflation likely rebounding to 4.2%). We still believe that inflation will go down in the coming months and quarters, and will be well below the NBP target in 2021. The downward move will be driven by the subdued demand in the post-pandemic period, by the lower cost pressure, and also by the likely significant drop in food inflation, after China's ban on German pork exports will drag meat prices much lower.

The outlook for monetary policy remains unchanged: we think the main interest rates will remain "lower for longer", which means they are unlikely to change before the end of 2021, and possibly even further. First, as argued before, inflation will not exceed the target next year, we think. Secondly, even if it does, the main central banks in the developed world are now turning towards less hawkish approach, signalling potentially higher tolerance for temporarily higher inflation, and the NBP is likely to follow a similar approach, in our view. This is in contrast to some EM central banks (including Hungary) that have already turned to policy tightening in response to currency depreciation. We think that in case of the NBP there is a really long way before the currency weakness could trigger any nervous central bank response (in fact, this is what they were wishing for only a few months ago).



Executive Summary (markets)

FX

We perceive the recent global market mood deterioration as a temporary phenomenon. The economic activity data both in Poland and abroad are likely to show growth rate moderation but this should be not enough for the market to start to pricing-in a "W" recovery pattern. The number of new COVID-19 cases is likely to rise but introduction of a similar lockdown like in Spring on a global scale looks rather unlikely. At the same time, the market may start to price in that the central banks will ease monetary conditions to support economic activity which could prevent the risky assets from the sell-off like seen in March. That is why we keep our forecast of a stronger zloty at the year-end. The risk factor to this scenario are tensions between Armenia and Azerbaijan that could pressure currencies in our region. Also, few EM central banks became less dovish as of recently in order to support their currencies from weakening amid high inflation. The market could try to test how much these central banks could do to slow the currencies weakening.

FI

Third quarter was one of the least volatile ones in many years, both central bank rates and most yields remained unchanged or traded in a narrow horizontal ranges. In Poland, the abundant liquidity in the banking sector persists and makes us forecast government bond yields just slightly above zero in the final quarter of the year. Growing number of Covid-19 cases increases the risks to economic outlook. We expect no changes to NBP rates at least till the end of 2021 but for FRA contracts to trade below the 3M Wibor towards the end of the year. The percentage of foreign investors in Polish marketable bonds keeps decreasing and resides at the many-year lows. Polish banking sector and fixed income funds pick up the slack.

As for the issuance of bonds by the end of the year – MinFin announced one outright auction in December for up to PLN 5.0bn. We estimate BGK will use up all it's allowed PLN 100.0bn issuance limit which means additional PLN 18.0bn of issuance by EoY. PFR's program for large corporates worth PLN 15.0bn will be financed by bond issuance in the first half of October. We estimate the impact of the upcoming issuances on yields will not be insignificant (we expect 10Y bond yields at 1.50% at EoY) but the upside potential is limited by NBP's still running QE programme.



2020 Forecasts Review

Indicator	Our view at the end of June	Our view at the end of September
GDP	The dip in 2Q20 was lower than we thought three months ago, but the V-shaped trajectory still seems to be the baseline scenario (GDP -4% in 2020, +6% in 2021). It is supported by signals from recent data and record fiscal+monetary stimulus. The risk is lack of pandemic deceleration in Poland and new infections wave abroad .	Not only Q2 trough was shallower, but also the rebound in Q3 was stronger than anticipated, it seems. But the pace of revival is now clearly losing steam amid rising new wave of pandemic. GDP to drop -3% in 2020 and rise +4.8% in 2021.
GDP breakdown	Weakness of consumption and private investments will be partly offset by relative resilience of public spending and net exports improvement. Hope for decent export rebound in 2021 amid solid outlook for German economy (gigantic stimulus package), shortening of supply chains.	Export-oriented parts of the economy likely to be leading the rebound, with domestic demand subdued for quite some time.
Labour market	Many firms choosing reduction of worktime or/and salaries instead of job cuts. As we expected, the first wave of layoffs affected migrant workers, it seems. Overall, the households' income weakens significantly and the worst in the labour market is still ahead.	Unemployment rise much smaller than initially anticipated, as big government anti-crisis support prevented mass layoffs. Still, the households' income weakened substantially due to wage growth stagnation.
Inflation	Lower CPI so far resulted mainly from cheaper fuel and some goods. Services prices have pushed core inflation higher so far, but we still believe that it is just a matter of time before inflation drops below the target.	Inflation remains surprisingly persistent but we still expect it to go down in 2021 amid negative output gap and lower food prices. The decline will be slowed somehow by rising taxes and administrative fees.
Monetary policy	After cutting rates to almost zero, the MPC seems worried about small PLN reaction, which could herald bigger activity in this field. We think negative interest rates in Poland are at the very end of list of possible NBP's options.	Main interest rates still expected to stay "lower for longer". Worries about exchange rate not so relevant anymore, due to solid export rebound and the recent zloty depreciation.
Fiscal policy	We assume that government programmes will boost public spending by PLN115bn in total and we estimate GG deficit to exceed 10% of GDP this year.	Government officially planned GG deficit at 12% of GDP in 2020 and 6.2% in 2021, but the gap this year likely to be smaller (c.10%) as not all plans will be implemented.
Fixed income market	Short end of the curve very low amid pressure of rising excess liquidity in the banking sector. Yields at the long end kept in check by the NBP purchases, despite rising POLGBs supply after the summer.	Short end of the curve will remain close to zero (government bonds) or slightly below 3M Wibor (FRA contracts) as abundance of liquidity in the banking sector persists. Long end yields will gradually increase towards 1.50% at the end of the year as BGK and PFR will keep issuing bonds.
FX market	Zloty more likely to weaken than to strengthen due to: very low interest rates, spread of pandemic, signals from the MPC that the central bank would like to see bigger importance of FX channel in supporting the economy. Still possible increase of global risk aversion.	PLN weakening indeed materialised at the end of Q3 as global risk aversion surged but now we expect that the currency to regain ground before the year-end, as global sentiment stabilises and worries about rising Covid-19 cases subside.

Economy

1



Poland entered its first severe recession since early 90s.

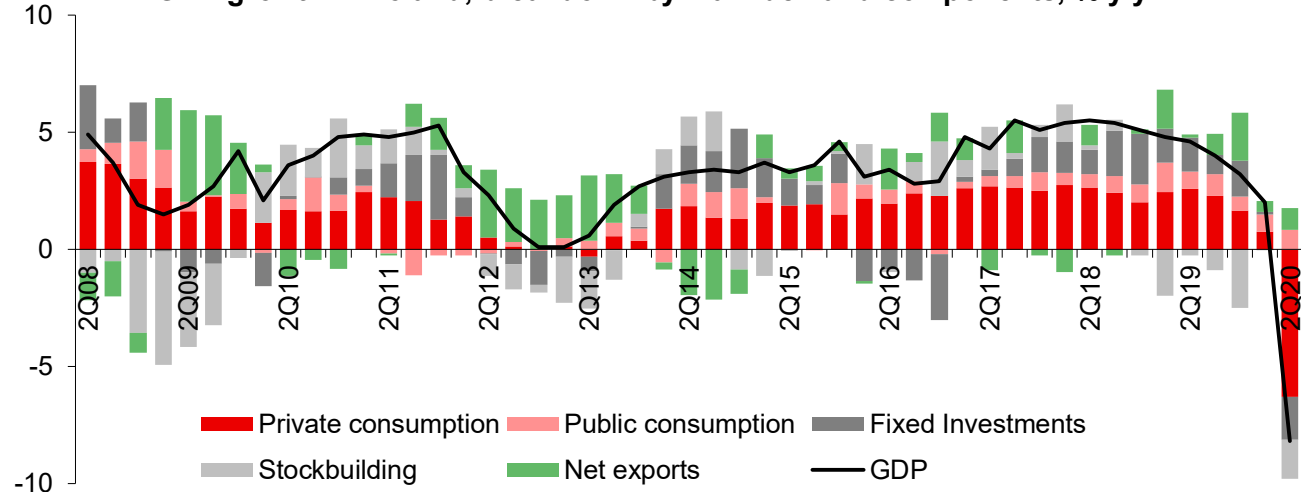
GDP data for 2Q20 have shown that the trough of the recession happened to be shallower than anticipated: GDP in Poland fell in 2Q20 by 8.2% y/y or 8.9% q/q after seasonal adjustment.

Although smaller than expected, the fall in GDP in Poland was the worst drop recorded since early 90s. Moreover, it was the second negative q/q reading in a row (-0.4% in 1Q20), so as a result in 2Q20 Poland fell into technical recession.

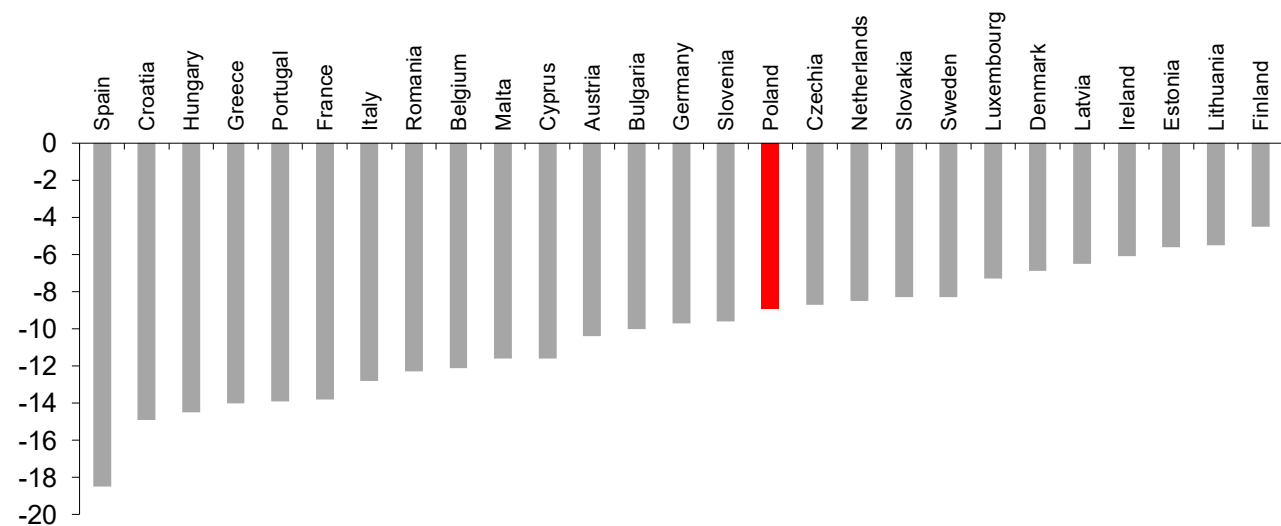
Both private consumption and investments fell by 10.9% y/y in 2Q. In case of consumption, this was the biggest drop since data is available (1996) and for investments since 2002. The drop of inventories also contributed negatively (-1.7pp off from the headline figure). On the other hand, public consumption proved supportive and even showed some improvement to 4.8% y/y. Net exports added 0.8pp to the GDP change since imports plummeted more than exports (-17.5% y/y and -14.5% y/y, respectively).

The depth of q/q GDP decline in 2Q20 placed Poland at 12th place among the 27 EU member states (where 1st = smallest decline). Half the EU countries recorded double-digit collapse of output, with Spain suffering the worst decline of 18.5% q/q.

GDP growth in Poland, breakdown by main demand components, % y/y



GDP in EU, % change Q/Q, 2Q20, seasonally-adjusted data



Source: GUS, Santander



Structure of the economy magnified the shock

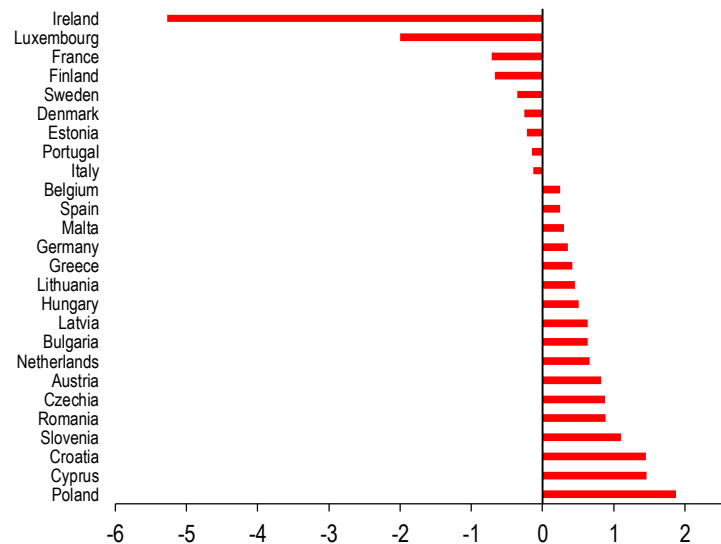
We suggested earlier that countries more reliant on tourism will suffer relatively more due to Covid-19. Hence, we argued that the small size of Poland's touristic sector means that Poland is less vulnerable to the shock. While countries with bigger HoReCa (Hotels-Restaurants-Catering) sectors did actually suffer more, we have found out that Poland's sectoral economic breakdown made it not less, but rather more vulnerable to the Covid-19 crisis.

We have summed growth rates of Poland's supply-side economic sectors (Eurostat's 10 sector breakdown) using weights of average sectoral economic breakdown of other EU countries. It turned out that Polish GDP would have fallen by 2 pp less if its sectoral composition was like the EU average. Similarly, if other EU countries had the same sectoral composition as Poland, decline in their GDP would have been deeper. That is because of Poland's high reliance on sectors that suffered relatively more: industry (24.6% of GDP in Poland, 19.2% in other countries) and on a broad sector consisting of trade, transport and HoReCa (26.4% in Poland, 18.4% in other countries). This negative effect stemming from the sectoral breakdown was the most considerable in Poland, as compared to other EU countries.

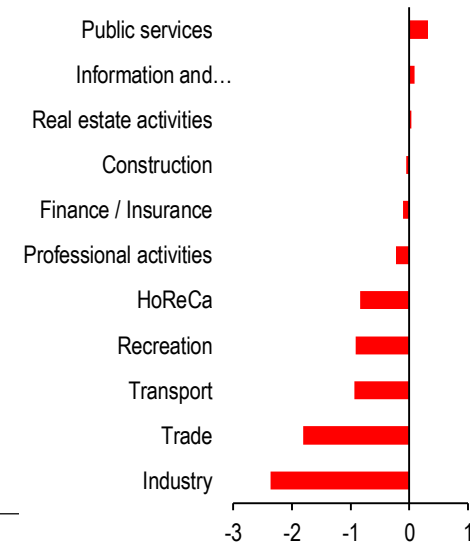
If we repeat this exercise for all EU countries and rank them by decline in Q2 GDP corrected for sectoral breakdown, Poland would come up 4th. This means that particular sectors were outperforming their EU peers.

Entertainment and recreation as well as financial services were hit markedly more than in other EU countries, and these were the only two sectors deviating from trend more than a median EU country. Other sectors did better than EU mean, with professional activities and public administration clearly outperforming.

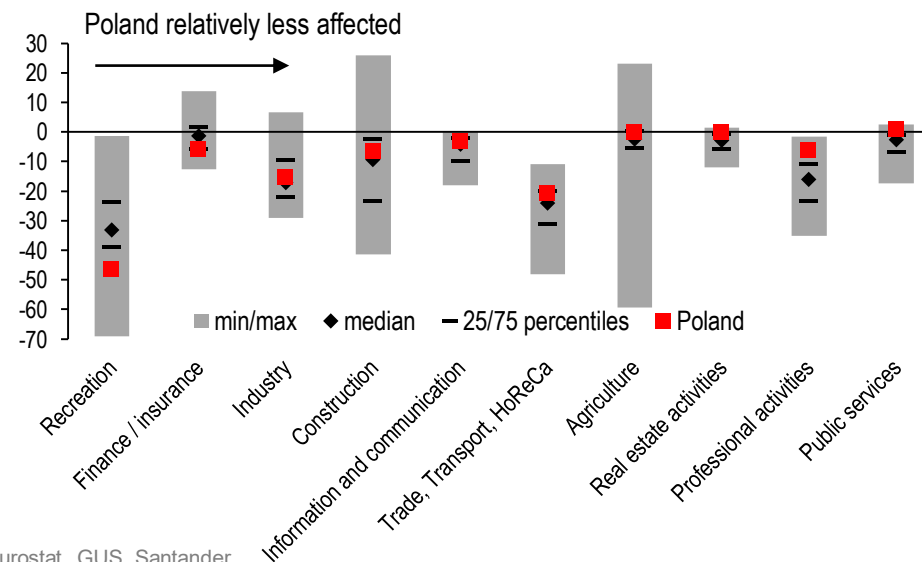
How would 2Q20 GDP growth change if a particular country's supply-side sectoral breakdown was like EU average



Contribution to Poland's GDP growth by sectors



Deviation of sector's value added vs trend in 2Q20, EU countries





Rebound in 3Q was significant

Industry, trade, transport, HoReCa and recreation were responsible for lion's share of decline in GDP in 2Q20. These sectors have deducted 6.8 percentage points from total value added (out of 6.9pp total). The recent data show that industry and trade recorded a fast V-shaped rebound, so given relatively high share of these sectors in Poland economy, 3Q rebound could be stronger than in other EU countries. We the five sectors mentioned above to deduct less than 1.5pp from 3Q20 GDP growth.

Industry: recorded a deep contraction in April, mostly in firms with high share of exports, producing durable consumer goods and investment goods. Quick rebound afterwards. The pace of rebound seems to have stalled in August.

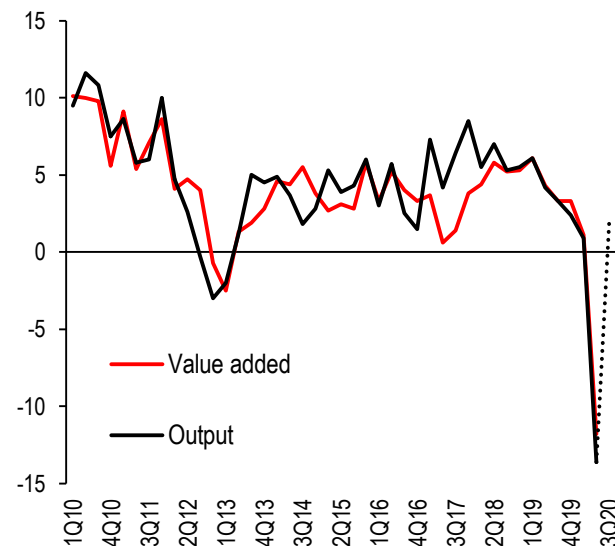
Trade: unlike in previous slowdowns now affected significantly by the lockdown. Retail trade rebounded quickly and strongly, but at least part of it was realisation of postponed demand. Temporarily surge in internet sales. Reduced consumers' purchasing power likely to weigh on demand in coming months.

Transport: lockdown has hit mostly passenger transport and – despite quick recovery – this sector remains subdued given restrictions in air travel and lower demand for business and private travels. Transport of goods did not suffer that much but also has not seen a major rebound.

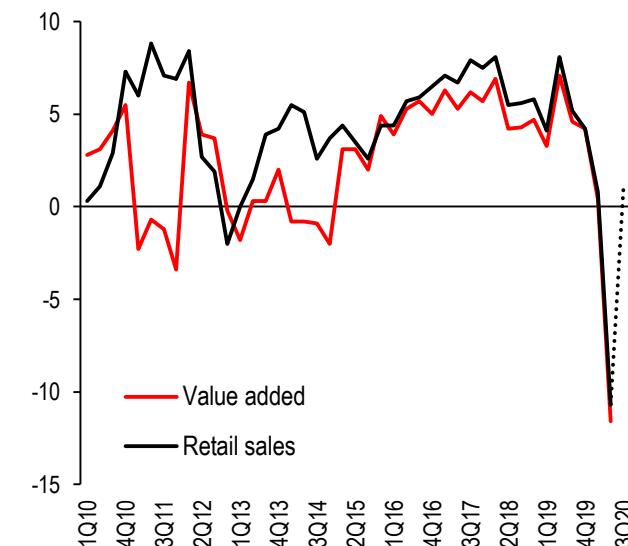
HoReCa: while our internal data on debit/credit card transactions suggest a normalisation since early July, data on touristic movement still show declines yet rebound is quite strong. Thus we are expecting this sector to remain deep below zero in 3Q20.

Recreation: data is scarce, so we are cautiously not assuming a major rebound.

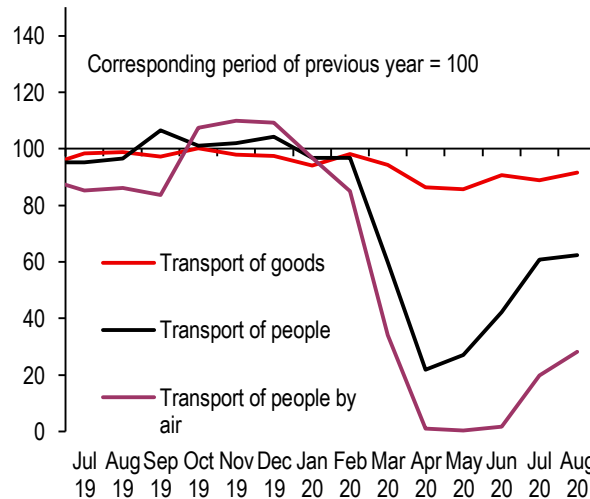
Industry: output vs value added, % y/y



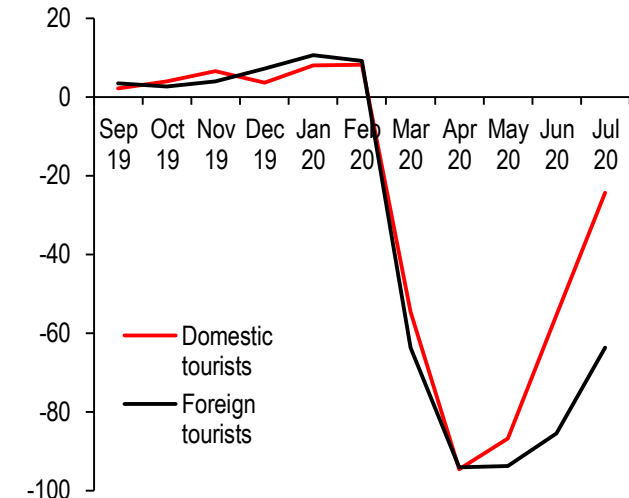
Trade: retail sales vs value added, % y/y



Transport of goods (tonnes) and people



Number of nights spent in Poland, % y/y





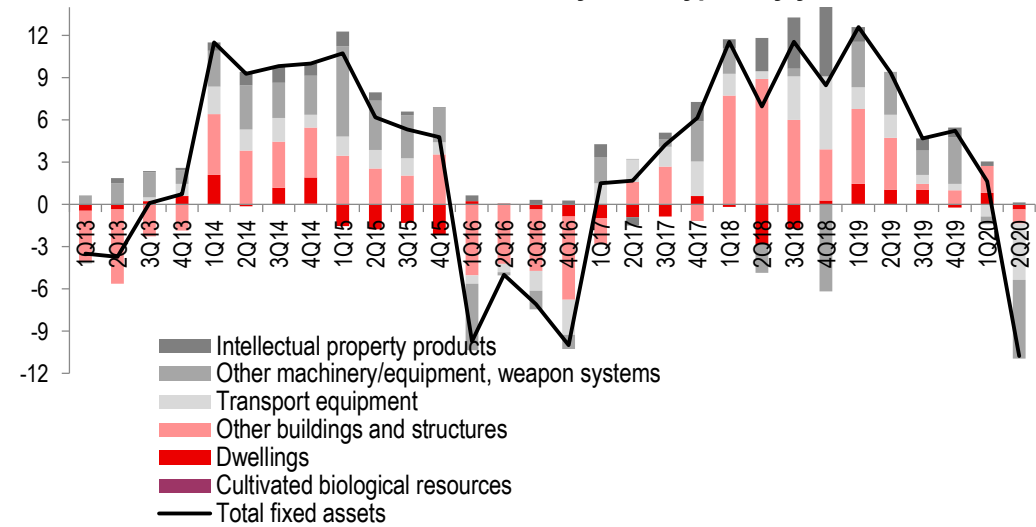
Construction to be a drag in 3Q

As regards other supply-side sectors, we expect them to show some improvement in y/y terms in 3Q20. There is however one notable exception: construction. Construction output clearly deteriorated in 3Q, so we would see this sector to become the main drag on growth and to deduct even 1 pp from total GDP growth.

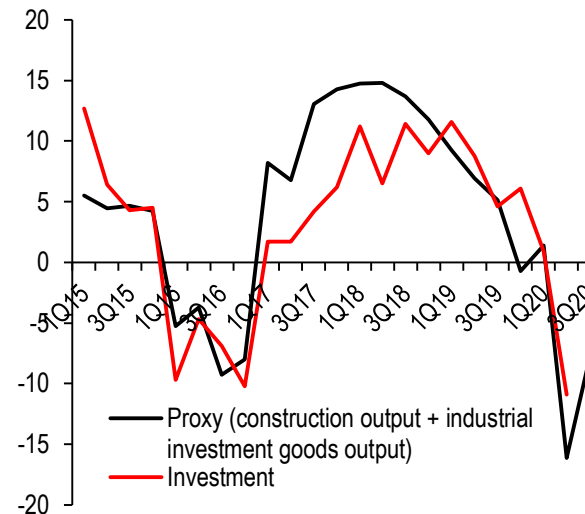
Declining construction output is also a bad omen for investment in 3Q. In 2Q the slide in total investment was driven mostly by falling outlays on transport and machines. And while this segment seems to have rebounded quite nicely in 3Q, as suggested by output of industrial investment goods, construction will drag it lower again.

Outlook for investment is grim. Companies are trying to optimise costs, with investment being one of the first victims. NBP indicator for companies' new and continued investment fell in 3Q20 to all-time lows. Moreover, lower tax incomes are likely to undermine budgets of local governments, so they are also likely to cut investment. There is some chance for an uptick in public investment given government's plans as well as EU Next Generation programme, but these are likely to take time to speed up.

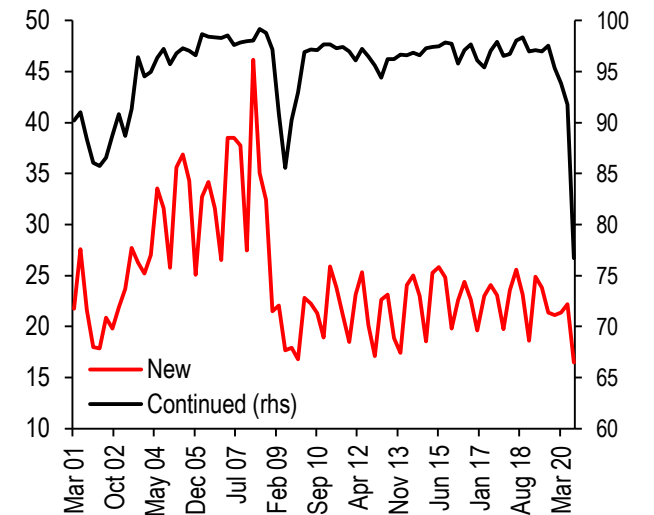
Investment breakdown by asset type, % y/y



Total investment and its proxy, % y/y



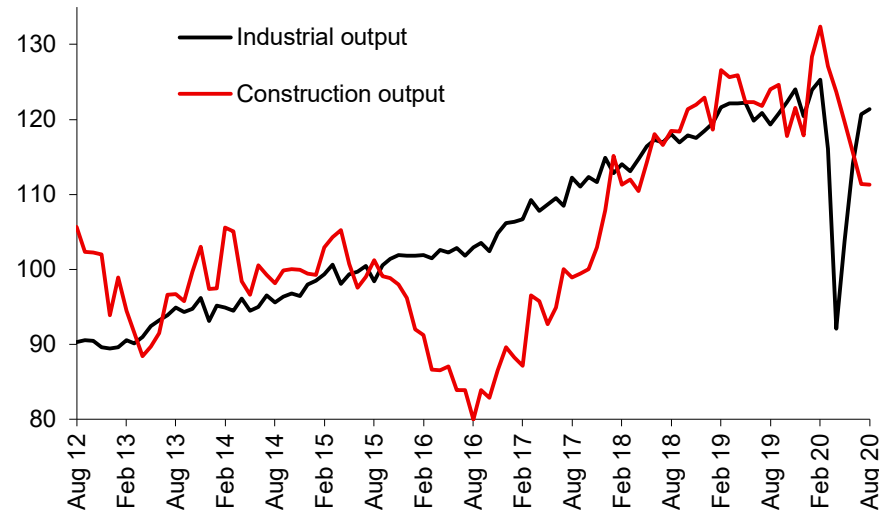
NBP investment indicator, pts



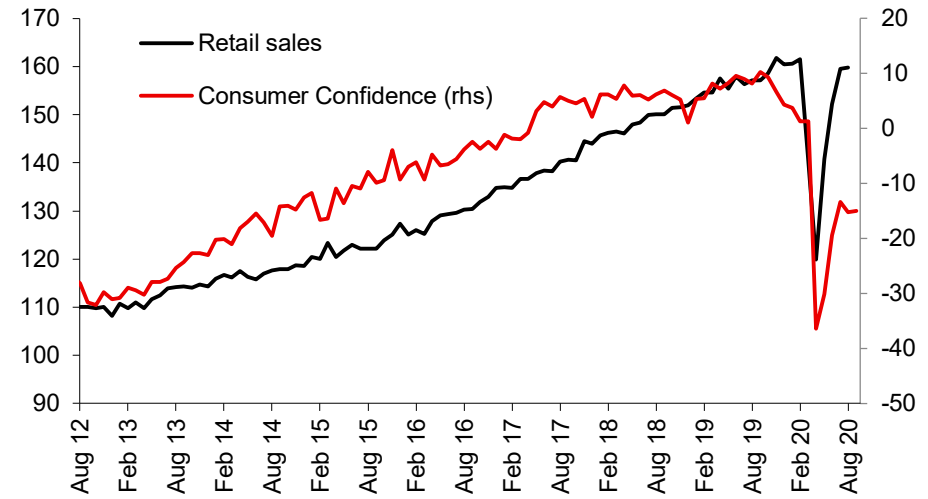


Quick (but uneven) rebound from the bottom

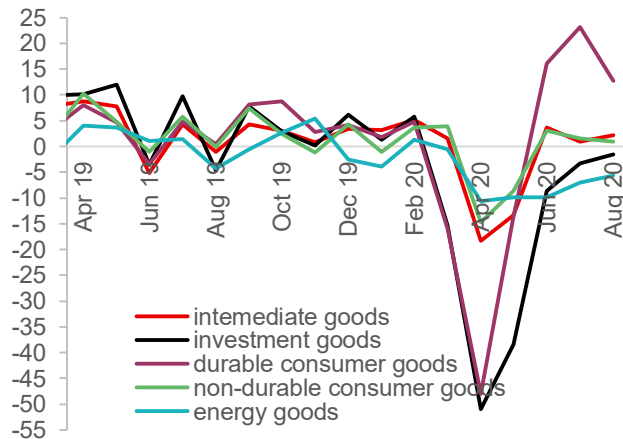
Output in industry and construction, 2015=100 (s.a.)



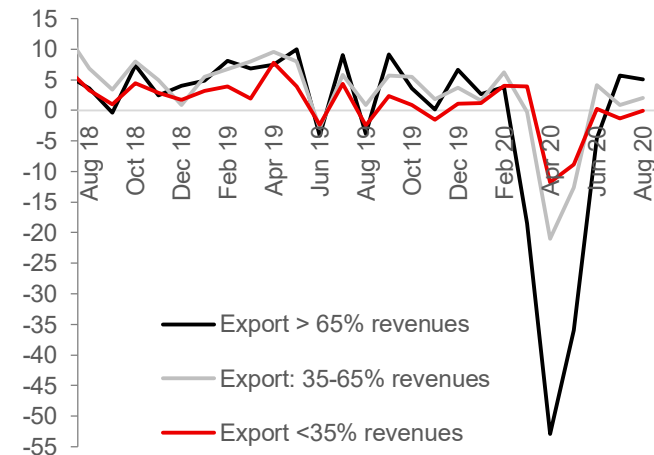
Retail sales and volume of retail trade, constant prices, 2015=100 (s.a.)



Production by main industrial groupings, %/y



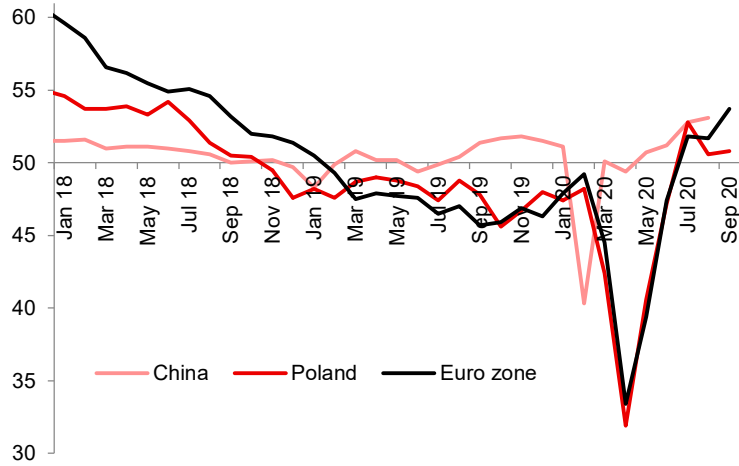
Manufacturing output, %/y, industries grouped by exposure to foreign demand





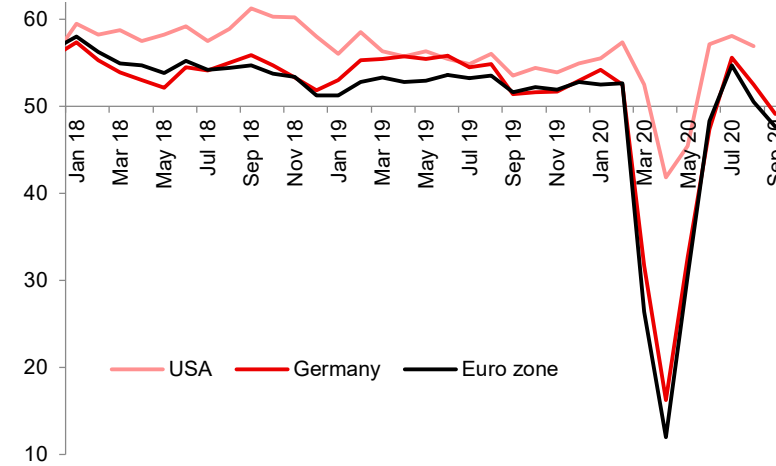
Leading indicators signal that recovery may slow

Manufacturing PMIs



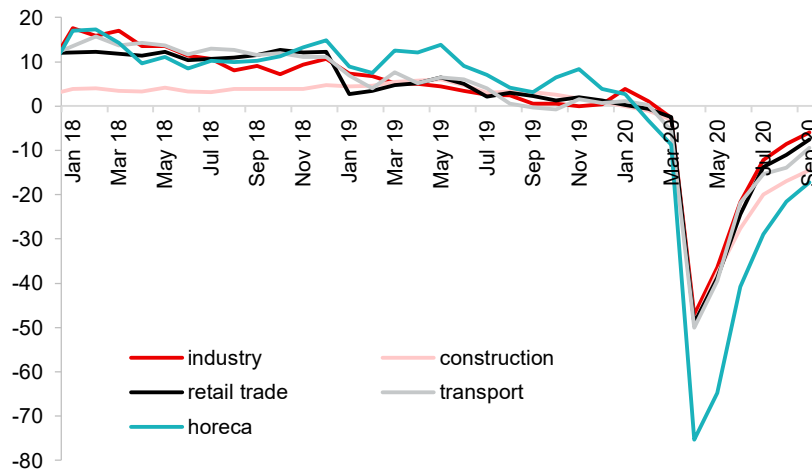
Source: Markit, Santander

Services PMIs



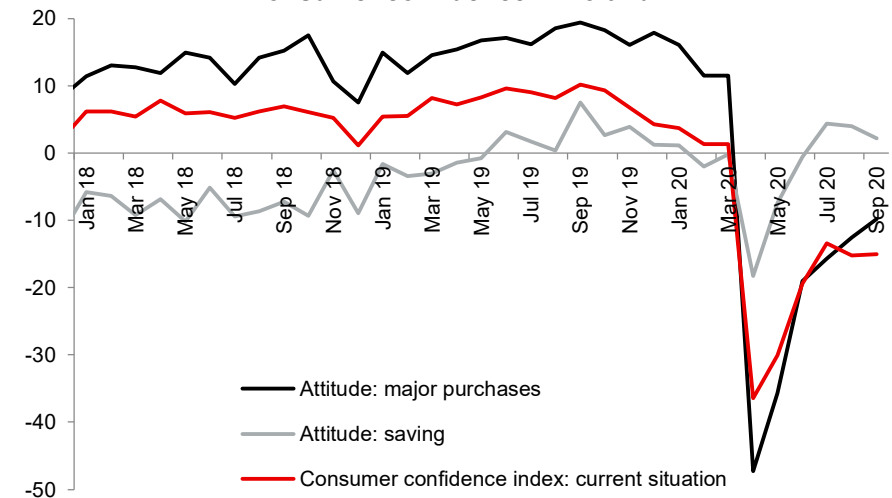
Source: Markit, Santander

Sectoral business sentiment indicators in Poland



Source: GUS, Santander

Consumer confidence in Poland



Source: GUS, Santander



Sentiment resilience to rising Covid-19 stats

With more knowledge and no element of surprise consumers, businesses and the government may refrain from tough measures applied "just in case". The restrictions that are now applied to selected regions only are less severe to economic activity.

We believe that rising daily infections (their impact on the behaviour of consumers and businesses, higher share of unavailable employees, plus the resulting restrictions) may flatten out the path of the rebound but should not send the economy into another trough.

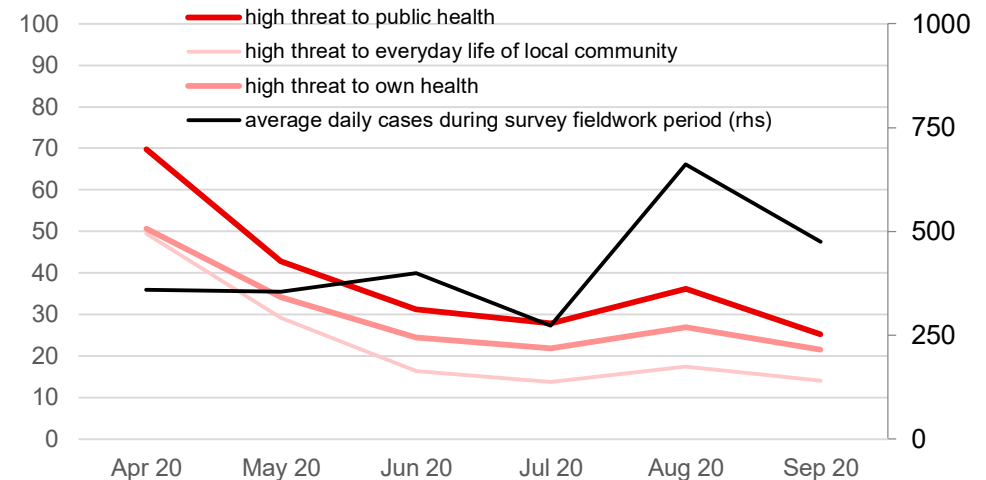
While the current wave of infections is much stronger in Poland than the initial one, consumer confidence is only lightly affected so far. Notice however that the last survey's fieldwork ended just before the serious outbreak in September.

The higher Covid-19 stats in early August affected consumers, but their response was negligible compared to the initial panic captured in some questions, like fears about own health and public health or influence of the pandemic on everyday life in one's neighbourhood.

August PMI report mentioned rising Covid-19 infections in Europe as one of the factors depressing industry's operating environment. However, GUS and ESI indexes kept rising at that time.

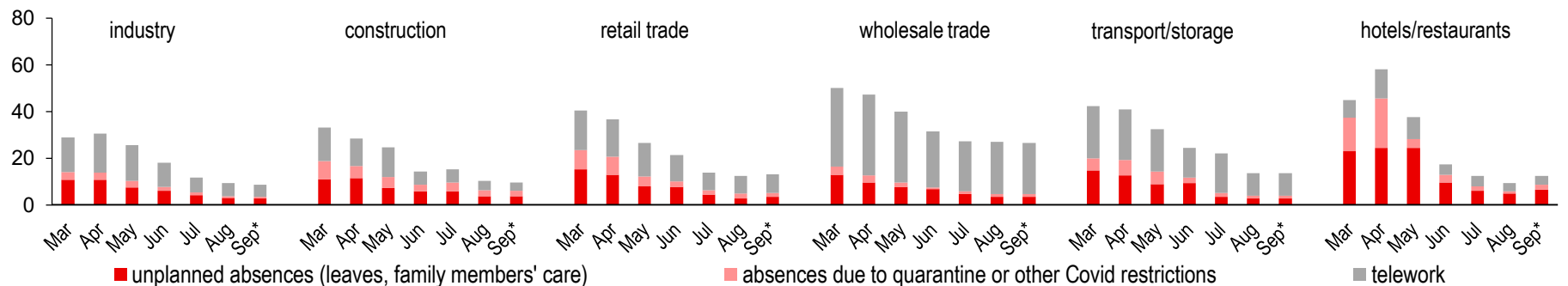
Notice that there is still no evidence that higher infections influenced labour availability.

Consumer opinions vs the spread of Covid-19



Source: NBP, Santander

Pandemic-related staff distortions, % of staff affected



* expected

Source: GUS, Santander



Foreign trade: sharp drop, sharp rebound

The pandemic resulted in a large improvement in external balance, led by record high surplus in trade of goods, with some correction in services trade surplus.

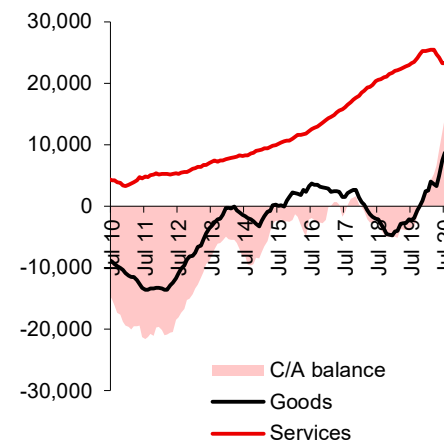
Both export and import growth collapsed in the first months by c.30% y/y, but export recovered much faster and in June-July was already growing c.3% y/y. Outlook for export growth remains positive and the gap vs import growth should remain open, helping drive Poland out of recession.

PMIs and ESI indicators are showing further recovery in European industry, which should translate to more demand for Polish goods. Also, usually in the recovery phase in Europe Polish exporters grab a larger chunk of EU markets (possibly due to offering cheaper substitutes to businesses and consumers) – Poland already benefitted from accumulated demand for consumer durables like furniture, IT and consumer electronics, or auto parts, among others. More on this in the [Sectoral supplement](#).

Resilience of German economy – Poland’s most important trade partner – proved vital for the recovery of Polish export. Polish sales to Germany started growing y/y already in June - for Italy and France it initially dropped much more and by July was still negative y/y. Germany is leading the European recovery boding well for Polish export.

Poland’s import decline was particularly deep in case of goods from Russia (oil, stealing c5pp from total y/y import growth) and this trade link is recovering sluggishly. On the other hand shipments from China and South Korea seem little affected by the pandemic with double-digit growth of capital goods from both, intermediate goods from Korea and consumer durables from China. In our view it is a sign that companies are willing to take advantage of the recovery rather than showing defensive approach.

12M cummulated balances in foreign trade, €mn



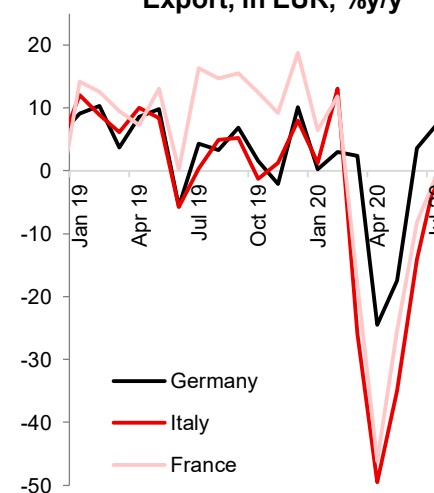
Source: NBP, Santander

Foreign trade, BoP data, in EUR, %/y



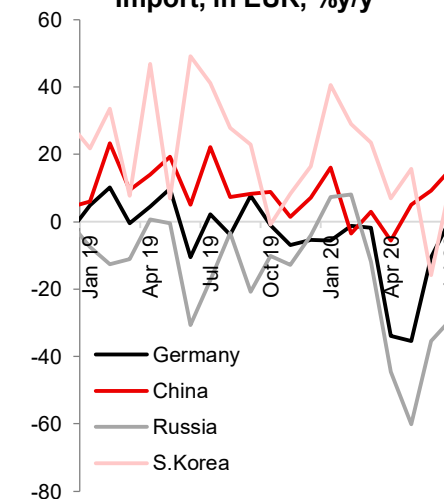
Source: NBP, Santander

Export, in EUR, %/y



Source: GUS, Santander

Import, in EUR, %/y



Source: GUS, Santander



Labour market avoided very negative scenarios

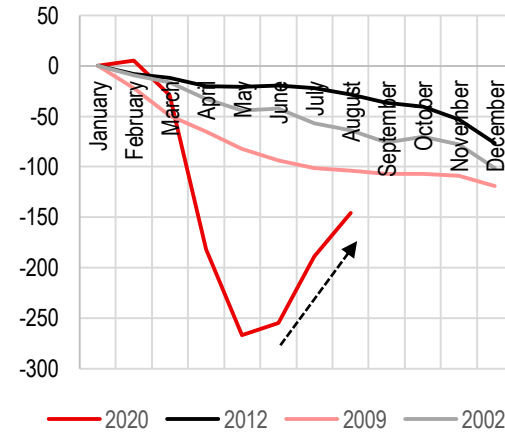
Average employment in companies fell, but according to our estimates only c. 1/3 of this decline reflected actual job cuts, the remaining part being the temporary reduction of working hours. Job cuts were more often in firms, which before pandemic were struggling with high labour costs and poor financial situation.

In June-July, average employment started rebounding (as working time was restored) but at the same time, number of jobs has continued declining.

The unemployment rise has been very mild to date, but the official data likely understate the actual situation and the full effect of pandemic on the labour market has not shown up yet. Still, the unemployment rate is unlikely to surge to double-digit levels.

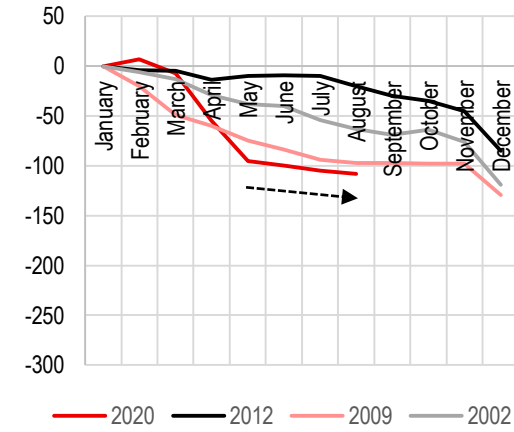
Limited scale of layoffs was at the expense of material slowdown in wages. As a result, consumers' purchasing power has been substantially reduced, and is likely to remain depressed in the coming quarters, as the shortage of labour is no longer as severe and companies remain in cost-cutting mode.

Average employment in corporate sector, difference from January in thousands



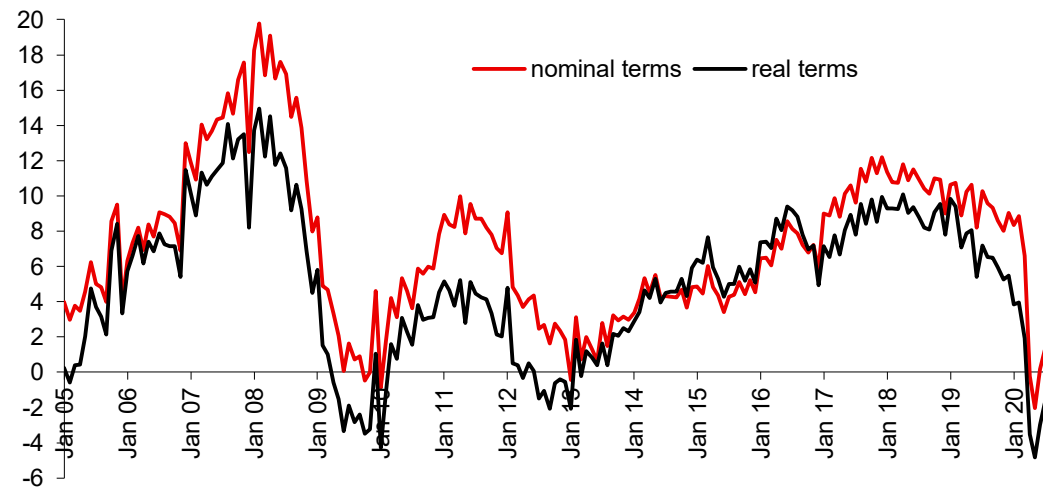
Source: GUS, Santander

Number of employed in corporate sector, difference from January in thousands



Source: GUS, Santander

Total wage bill in corporate sector, % y/y



Source: GUS, Santander



Unemployment rise in the pipeline

Registered unemployment rate is 6.1% (August) vs 5.5% in 1Q, LFS unemployment rate rose from 3% in 1Q to just 3.3% in 2Q. Is the labour market really so resilient?

Government support tools directed at shielding employment and household incomes, worth more than PLN100bn, allowed to avoid immediate mass bankruptcies and surge in unemployment. Their effect may soon wane though.

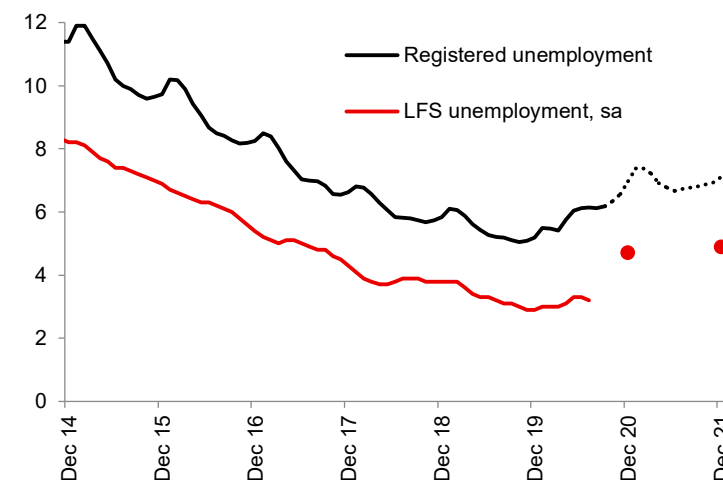
Most of the tools of the anti-crisis shield (support worth PLN40-50bn) had 3M window and were launched in 2Q, so a growing number of them is already expiring. Some labour contracts also had 3M notice period also delaying the response of unemployment. The financial shield (PLN60bn to micro-firms and SMEs) to preserve employment has a checkpoint in mid-2021, so it is still encouraging labour hoarding.

Some tools discouraged people from registering as unemployed before September 2020: the government introduced a special solidarity benefit available between June and August, which was higher than unemployment benefit and these two could not be collected together. At the same time, unemployment benefit was elevated from September on by 36%. Outflow of foreign workforce was also a stabiliser of the unemployment rate.

In LFS unemployment a methodological reason prevented a quick rise: people need to actively seek employment to be considered unemployed - the collapse of labour demand and lockdown reality most likely discouraged active search for work for some time (attributing to them inactive rather than unemployed status).

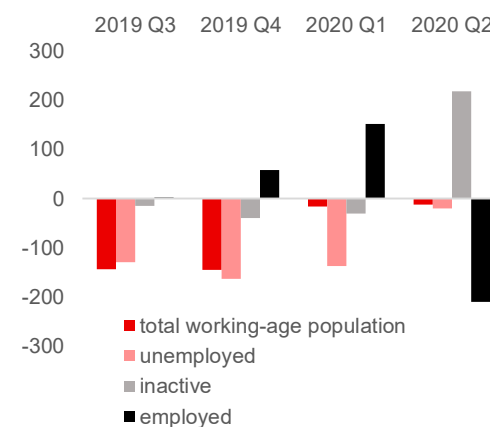
Labour demand indicators did recover to a large extent, but in our view not enough to prevent a rise of unemployment. We expect the LFS measure to go up to 4.7% still this year and 4.9% in Dec'21. Registered unemployment may reach 7% in Dec'20, peak at 7.4% in 1Q21 and end 2021 at 7.1%.

Unemployment rate response to the pandemic

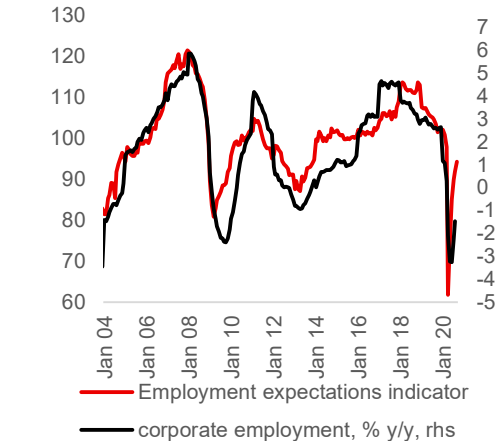


Source: GUS, Eurostat, Santander

LFS - labour market status change, y/y (k) ESI employment index vs employment



Source: GUS, Santander

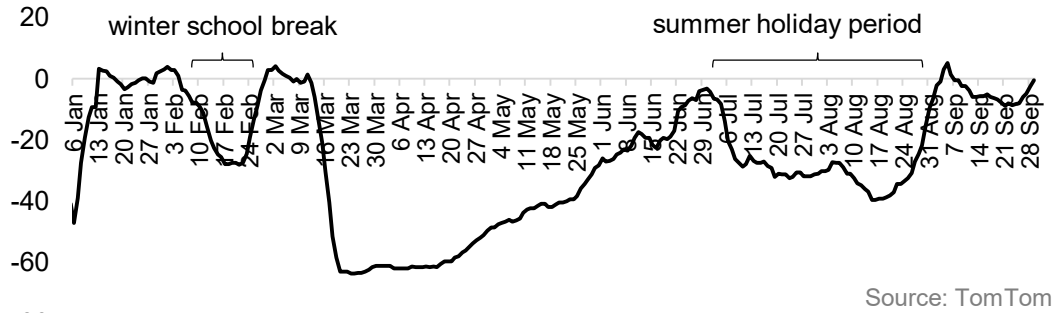


Source: GUS, European Commission, Santander

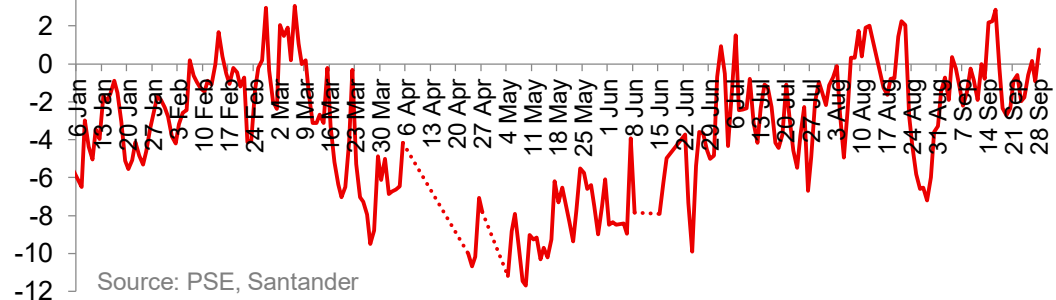


Live economic trackers: flattening out?

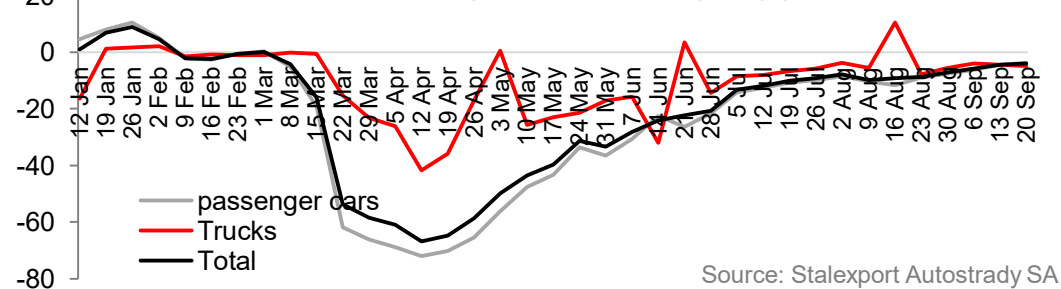
Tomtom road traffic index, Warsaw
(7d moving % deviation from 2019 average)



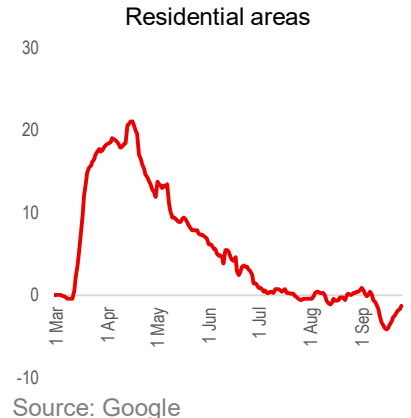
Daily electricity consumption, with day-of-week correction (% y/y)



Traffic intensity on A4 motorway, % y/y



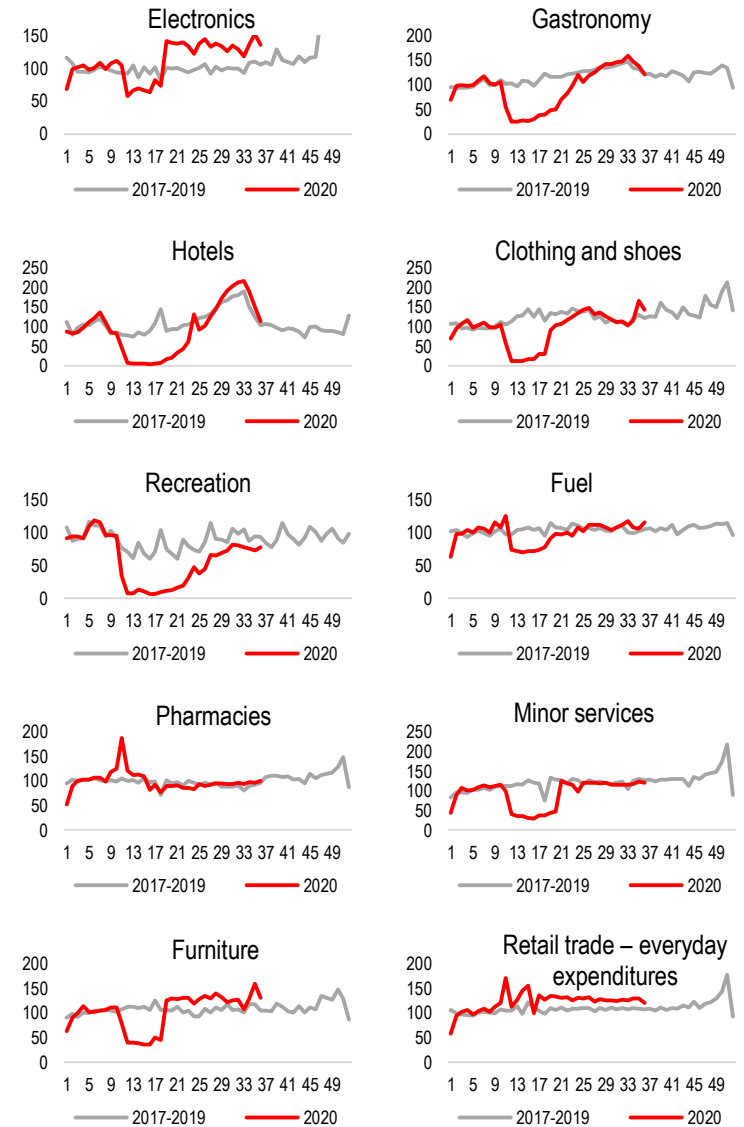
Google mobility report,
7d moving
deviation vs January



Workplaces



Credit card payments in selected categories
(first 10 weeks of the year = 100)



Source: Santander

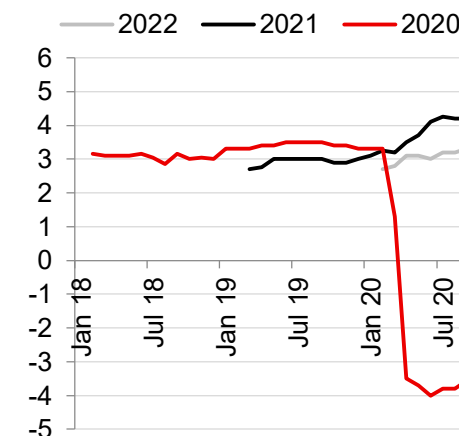




Why Poland may recover relatively quickly:

- ⚙️ Exceptionally small importance of sectors related with tourism and travel, relatively large share of industry and trade
- ⚙️ Very diversified, versatile economy; flexible entrepreneurs, able to exploit opportunities
- ⚙️ Price competitiveness => substitution effect
(Polish firms, as usually, phasing out competition from EU markets in difficult times)
- ⚙️ Lack of economic imbalances before the crisis
- ⚙️ Relatively large (vs GDP) anti-crisis measures, both from the government and the central bank
- ⚙️ Strong links with German economy, which potentially could be the leader of economic revival in Europe
- ⚙️ Shortening of global supply chains (Poland may strengthen its position of manufacturing hub in Europe)
- ⚙️ Potentially large allocation for Poland of funds from the new EU recovery package (the risk of substantial decline of EU funding for Poland in the next seven-year financial framework has disappeared after the budget deal agreed on the EU summit in July)

**Bloomberg consensus
for GDP growth in Poland:**



Dots represent current Santander forecasts
Source: Bloomberg, Santander



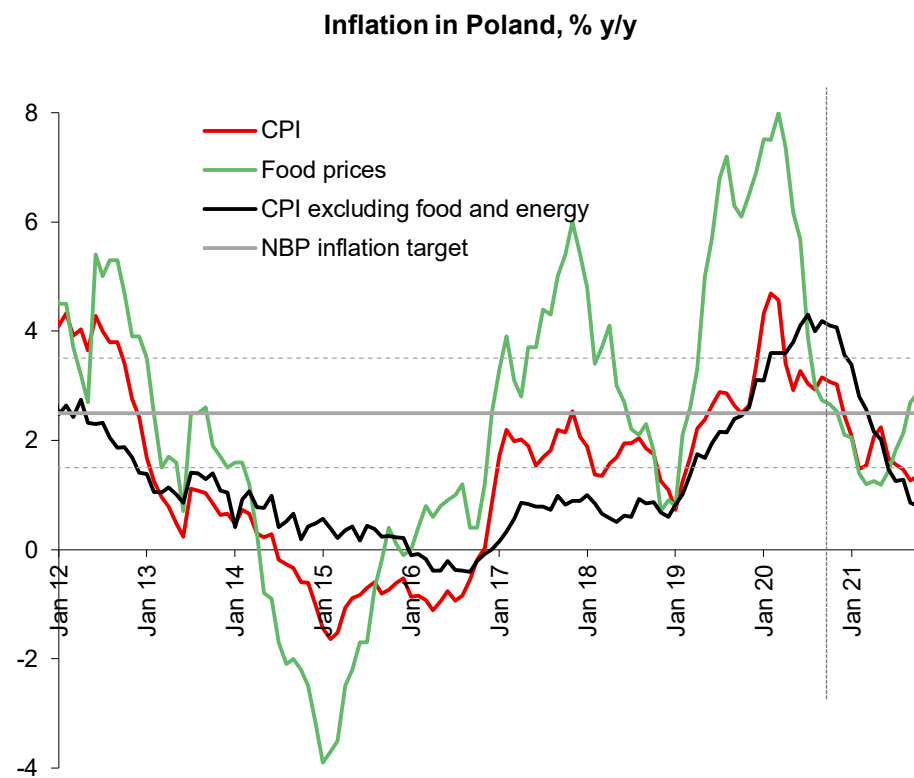
Disinflationary effect of Covid-19

The economic shock caused by Covid-19 pandemic will have eventually a disinflationary effect, in our view. In many countries inflation measures have initially declined, but then rebounded, due to temporary distortions (measurement problems, Covid-related charges). However, we believe that sooner or later the disinflation will prevail amid strongly negative output gaps.

Inflation in Poland remains at elevated level and we should be reaching the turning point about now - core inflation surged to 4.3% y/y in July, its 18-year high, but in August it decreased for the first time since Dec-18 and in September it probably remained below the peak.

Headline inflation should decrease in the coming quarters, likely below 2% y/y in 2021. For core CPI it may take more time to exhibit a downward trend – but in December it should already be at c.3.5% y/y and around the middle of 2021 it could even break below 1.5%.

Apart from slowing core inflation, CPI will be pushed lower by food prices, especially after the China's ban on German pork exports which is likely to trigger big drop in meat prices on European markets.



Source: GUS, NBP, Santander



The turnaround in services and imported inflation

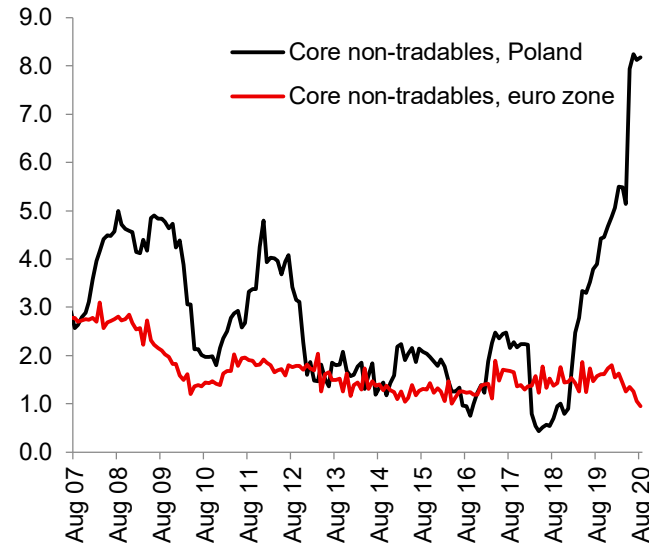
Polish services prices growth eased in August, but this was not a broad change yet. Transport services and package holidays did the trick while the growth rates of other service categories prices remained historically very high and not really decreasing.

Notice that this phenomenon of accelerated rise of services prices (or of the non-tradable part of core inflation) that occurred in Poland was not seen in the euro zone at all. Instead, services prices inflation was pretty much stable from March to June and started easing afterwards. In general, Polish inflation of non-tradables tends to eventually move back to the euro zone levels and obey its trend, albeit this may take some time and the current divergence is exceptional.

Sudden rush of euro zone tradable goods inflation from July dropped heavily only a month later, showing that the price pressure from abroad may now turn significantly negative. On the other hand, the recent PLN depreciation is acting in the other direction.

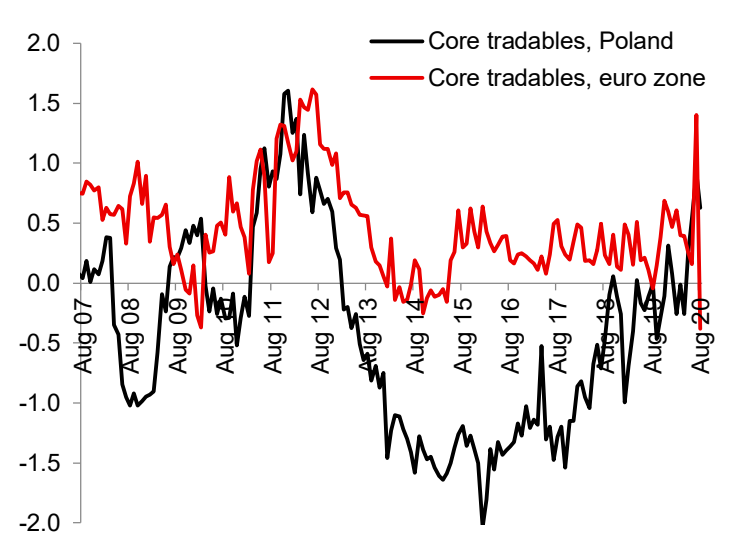
Broad-based declines in PPI also suggest heightened price competition in the environment of limited demand. PPI y/y growth declined in all 22 industries covered in Statistical Bulletin with 14 already below zero.

HICP Inflation in Poland vs euro zone, % y/y



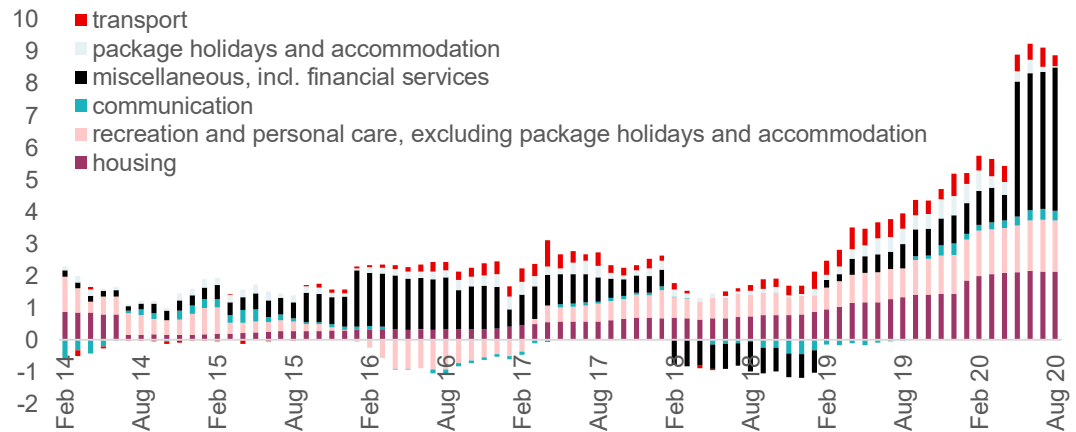
Source: Eurostat, Santander

HICP Inflation in Poland vs euro zone, % y/y



Source: Eurostat, Santander

Structure of HICP services Inflation in Poland, % y/y



Source: Eurostat, Santander



Monetary policy: interest rates lower for longer

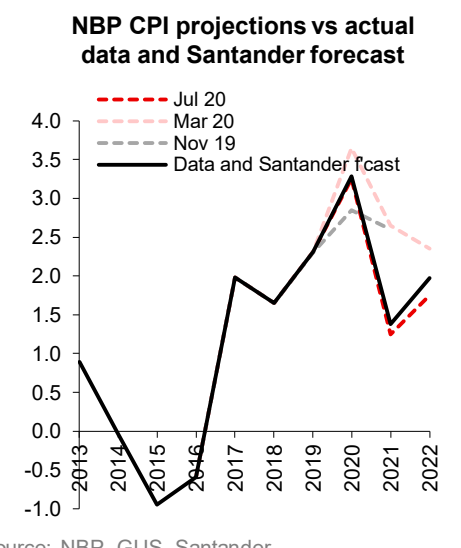
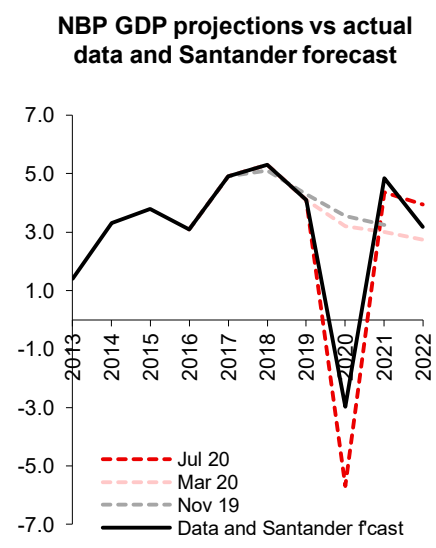
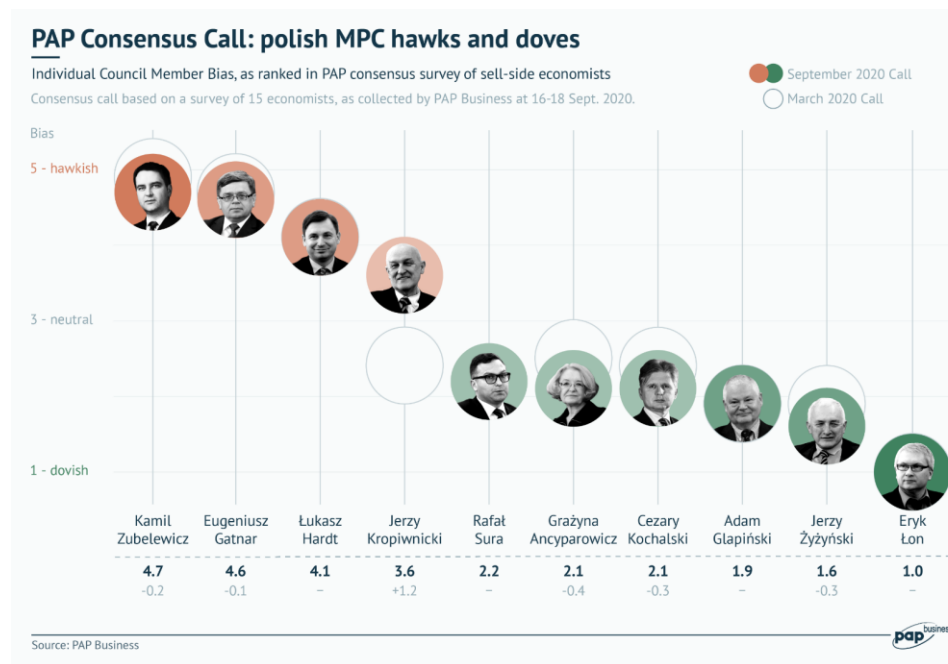
After busy Q2, next few months brought an absolute standstill in monetary policy in Poland. While the economy started getting back to life, the central bank seemingly remained in the peak-pandemic mode, holding only one-day MPC meetings and cancelling all post-meeting press conferences, so the communication with the market remained crippled.

The [Monetary Policy Guidelines for 2021](#) have not changed the central bank's strategy nor toolbox, only formally adding instruments used in 2020 (QE).

The recent comments of MPC members suggest a growing polarisation of views, with the majority of members centred around the NBP governor Glapiński supporting stabilisation of rates for a long time, perhaps even until their term of office (which we think is the most likely scenario), and minority calling for rates' normalisation already in 2021.

We think the MPC will not be concerned about the recent zloty depreciation, as this is exactly what they were wishing for in mid-year. The NBP research shows that the FX pass-through to inflation is quite small during economic slowdowns. And even if some effect materialises, we think the central bank's tolerance for temporary inflation's deviation from the target may be higher than before, similarly as in the case of US Fed.

From the current perspective it is clear that the NBP projections of GDP and inflation presented in July were overly pessimistic, but it is unlikely to change the MPC's policy outlook, in our view.



Source: NBP, GUS, Santander





Fiscal policy: large deficits in 2020-2021

The government approved the 2020 budget amendment and draft 2021 budget. The deficit limit for 2020 was lifted from 0 to PLN109.3bn, while the deficit in 2021 was planned at PLN82.3bn. We wrote more on 2020 budget [here](#) and on 2021 budget [here](#).

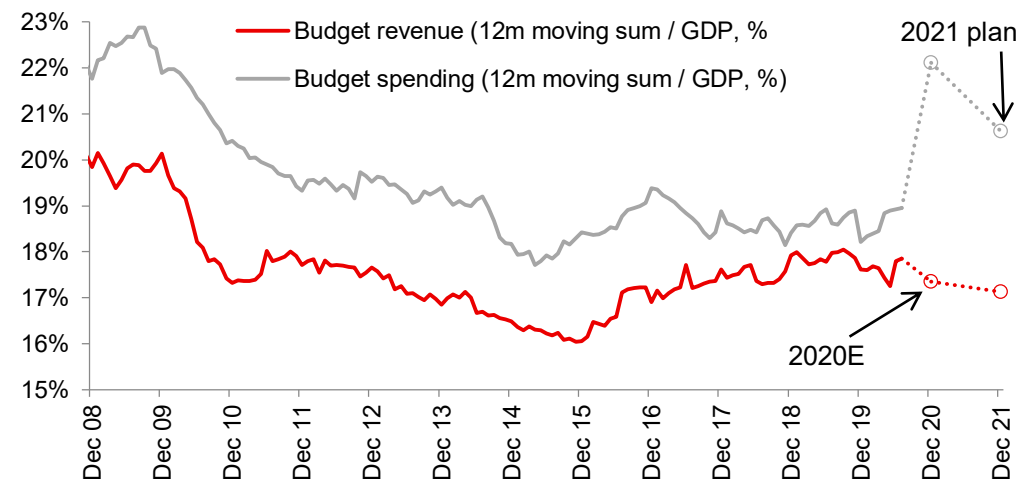
The deficits of the entire public sector according to EU standards (GG) are large: at 12% of GDP this year and 6% next year, and so are the borrowing needs (>PLN100bn net each year). However, until August the central budget deficit remained under control (PLN13.3bn), in our view PFR and BGK lifeline programmes will not be fully utilised (max 80% out of PLN200bn) and the government is unlikely to realise the investment spending plan (PLN12.1bn). Thus, we would not be surprised by a final 2020 deficit closer to 10% of GDP.

The lion's share of this year's debt issuance is already completed and taking into account the large structural overliquidity of the commercial banking sector, the existing QE programme, plus the sizeable FinMin's liquidity buffer (>PLN120bn), the government should meet no difficulty with financing.

The effect of high fiscal deficits will be an unprecedented spike in public debt: by almost 20 percentage points in two years, from 46.0% in 2019 to 61.9% in 2020 and 64.1% in 2021, according to government forecasts.

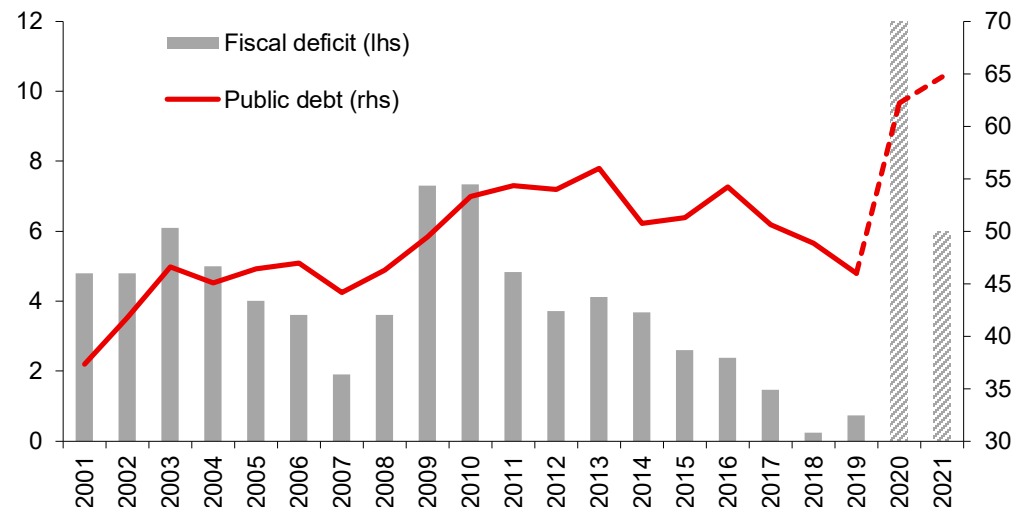
However, the rise of public debt according to Polish definition (not including some funds and agencies, like the PFR) will be less spectacular: from 43.6% of GDP in 2019 to 50.4% in 2020 and 52.7% in 2021. There is still much room to the constitutional limit of 60% to GDP.

Central budget incomes and spending in relation to GDP (12m moving sum, % of GDP)



Source: Finance Ministry, Santander

General government debt and deficit, % of GDP – government estimates



Source: Finance Ministry, Santander

Financial markets

A close-up photograph of a desk with financial documents. A silver pen lies diagonally across the papers. The documents feature various charts, including a line graph with a blue line and a bar chart with multi-colored bars. The background is softly blurred, showing more papers and a computer monitor.

2



FX market – EUR/PLN back to COVID peak

The zloty lost sharply in September owing to the global risk aversion.

Market mood deteriorated owing to rise of COVID-19 cases in some regions of the world (also in the CEE region) and macro data pointing to growth rate moderation.

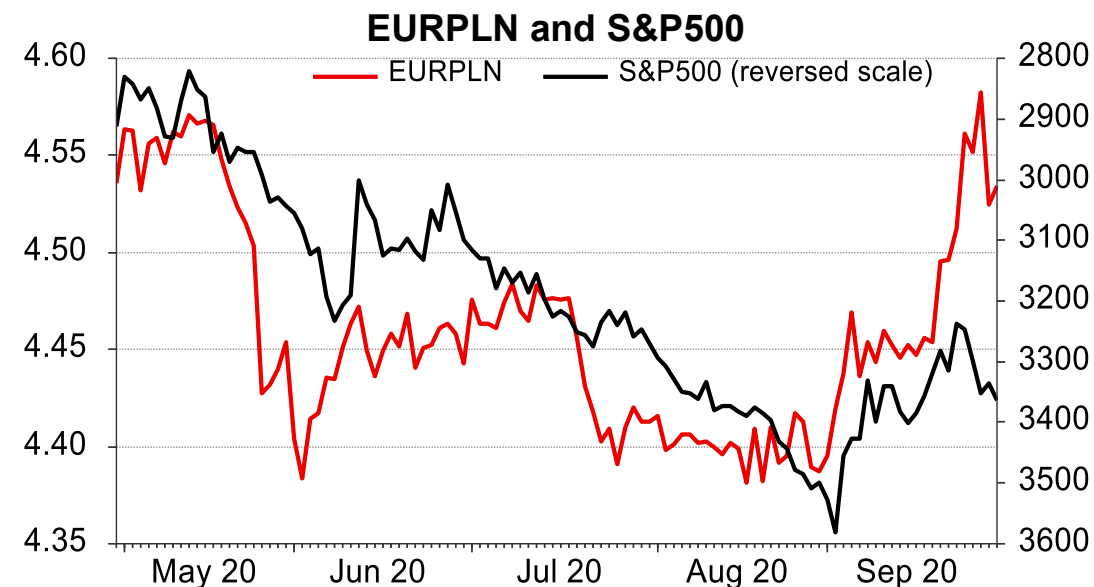
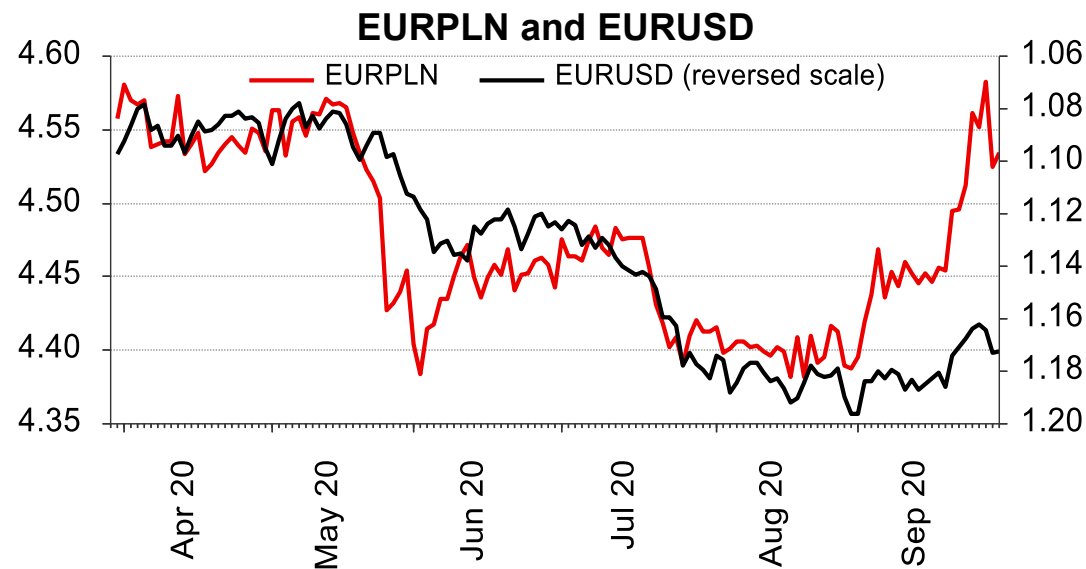
As a result, EUR/PLN jumped to 4.60, only slightly below its multi-month peak at c4.63 recorded during the March COVID-driven sell-off.

Looking at the EM FX universe, one may notice that the CEE currencies underperformed their LatAm and Asian peers in September.

Pace of a global economic revival could moderate amid rise of COVID-19 cases but we do not assume that lockdowns like to those announced in 1Q20 could be repeated.

Also, the current down move on the equity market is yet smaller than the previous corrections or paused above important support levels. Nevertheless, if it happen that stock indexes extend the current correction, we do not assume the wave of risk aversion could be larger than the one from March.

That is why we keep our view for stronger zloty at the year-end.

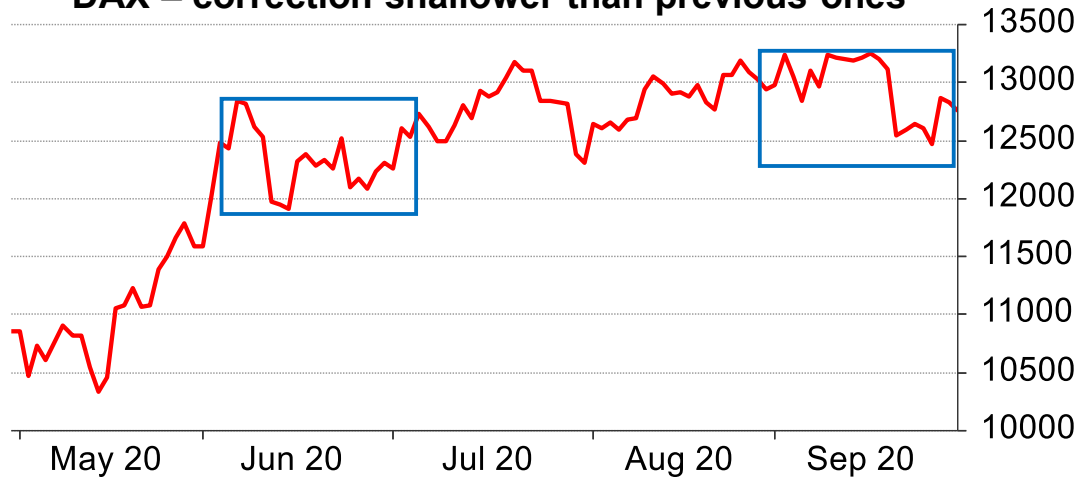


Source: Refinitiv Datastream, Santander Bank Polska



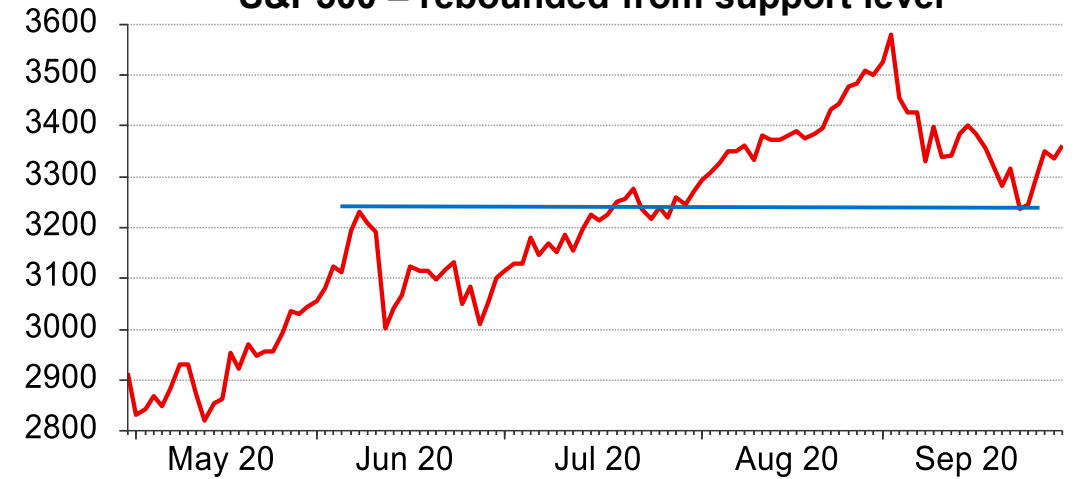
FX market – Only temporary mood deterioration

DAX – correction shallower than previous ones



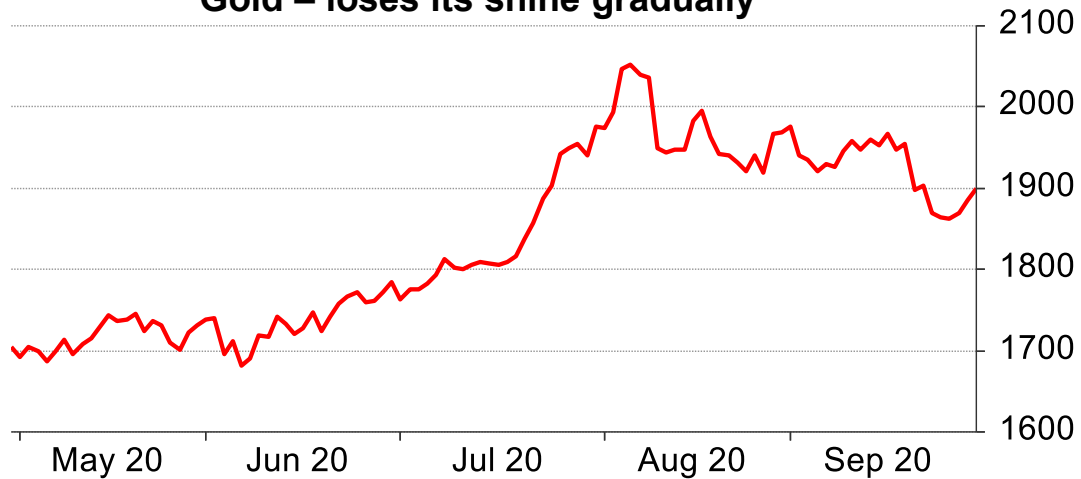
Source: Refinitiv Datastream, Santander Bank Polska

S&P500 – rebounded from support level



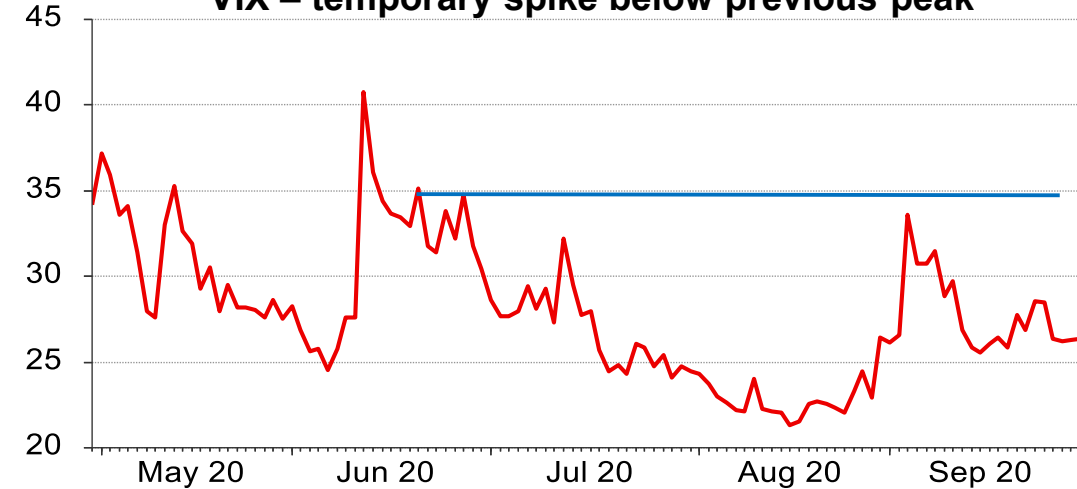
Source: Refinitiv Datastream, Santander Bank Polska

Gold – loses its shine gradually



Source: Refinitiv Datastream, Santander Bank Polska

VIX – temporary spike below previous peak



Source: Refinitiv Datastream, Santander Bank Polska



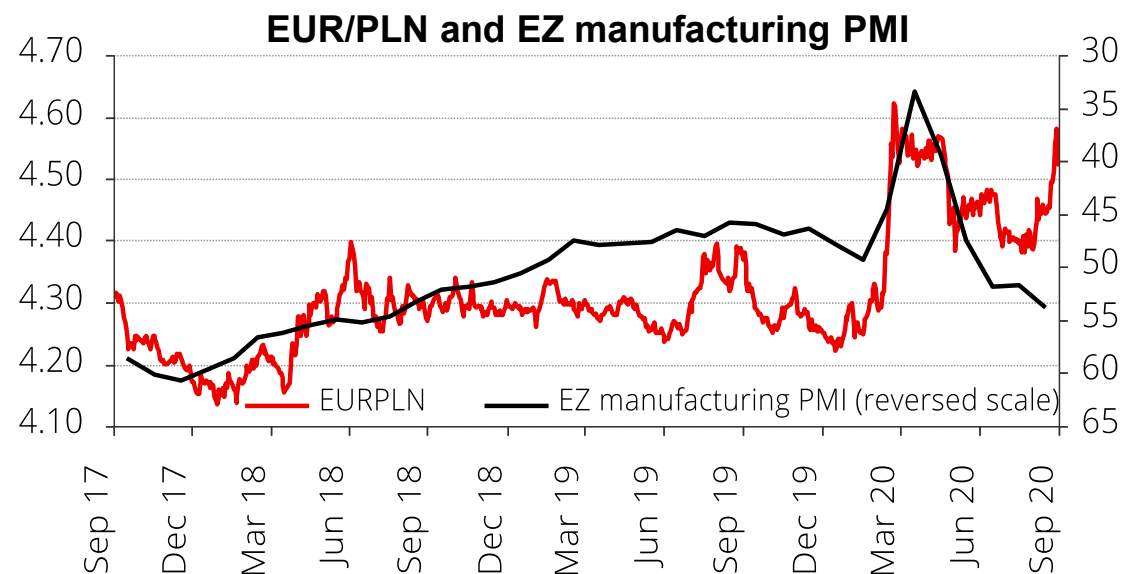
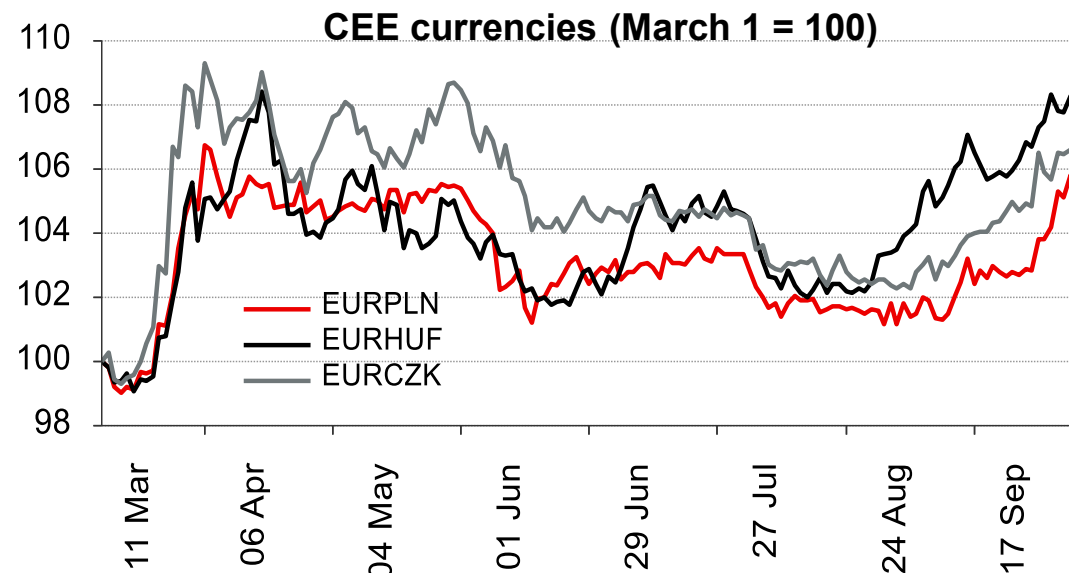
FX market – PLN weakening exaggerated

The zloty, koruna, forint, ruble and few of their EM peers are now close to lows seen in March during the peak of the coronavirus peak of risk aversion.

Although this is still not reflected in the stock indexes levels, the FX market might have started to price-in that the next wave of COVID-19 cases could have a meaningful impact on the global economic growth.

We do not think the current performance of the zloty and its EM peers is fair given the current and assumed by us performance of stock indexes (no further drop) and EUR/USD (back to 1.18 at the year-end). Rise of coronavirus cases could lead to return of social distancing measures and result in more cautious consumer activities, but growth rates shall not return to the bottom of the current cycle.

Recall that the sell-off in 1H20 was smaller than the one that took place in 2007/2008 although the current economic recession was more severe. In our view, less dramatic response was possible thanks to the nonstandard actions taken in the previous years by the central banks that taught the market that they will step in to help if needed.





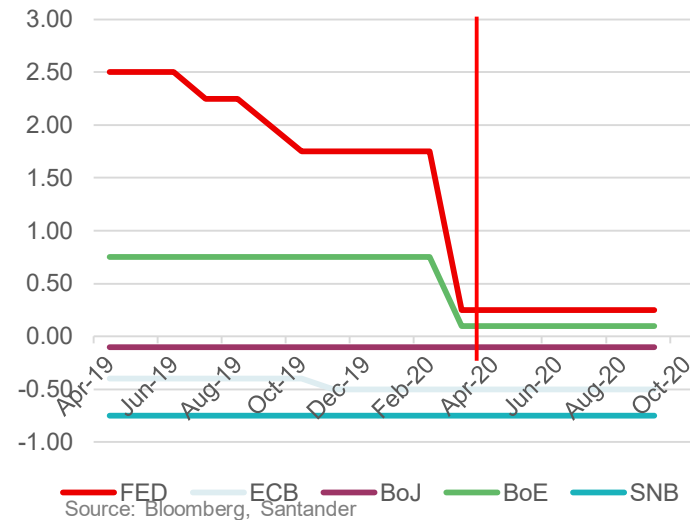
Central banks' rates have mostly stabilized in Q3...

Due to pandemic, in Q2 2020, global central banks cut rates abruptly and launched massive monetary stimuli. However in Q3 2020 central bank rates stabilized. In particular:

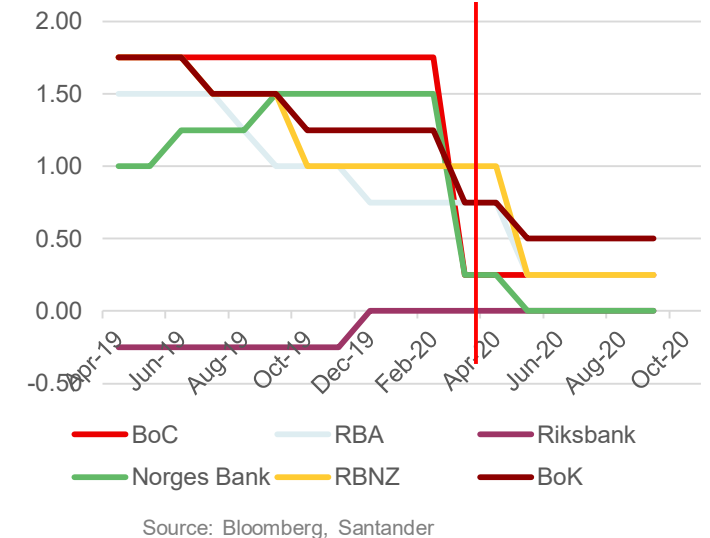
DM countries kept rates stable. However in light of heavily undershooting inflation rates (see bottom pictures) the central banks supported the economies via either special programmes:

- FED on its September meeting changed monetary policy strategy (as earlier suggested at the Jackson Hole summit) to explicit average inflation targeting (allowing inflation overshoots and effectively putting most focus within the reaction function towards the employment market)
- ECB launched the pandemic programme (PEPP) and beefed it up to EUR 1.3tn as of now, with another EUR 0.5tn possible in December 2020.
- BoE mentioned the possibility of negative rates.

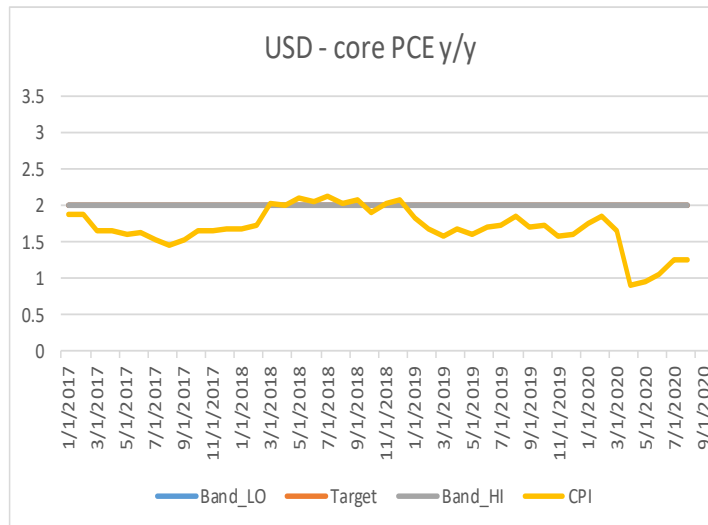
DM G5 – Interest Rates



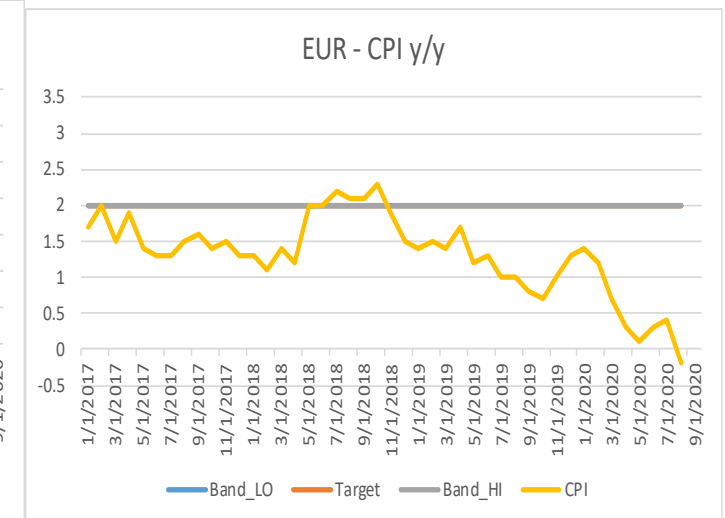
DM ex G5 – Interest Rates



USD - core PCE y/y



EUR - CPI y/y





...but some EM ones had to be careful due to CPI...

EM countries mostly kept rates stable. Except for the central banks of Mexico and Colombia who cut rates in the context of very poor economic outlook and Hungary which hiked (see below).

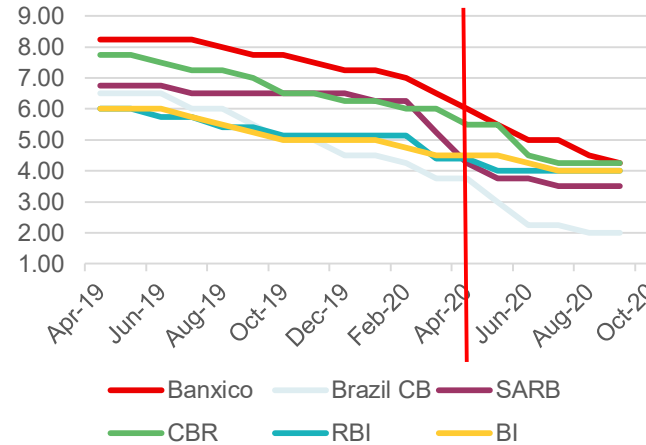
Many EM central banks have behaved more hawkish than it would be implied by the economic situation alone. The reason being mainly inflation rates which shoot up towards their upper target bands (see bottom pictures) due to weakening currencies:

- Russia. On 18 September, CBR kept rates on hold at 4.25% despite expectation by most economist of a 25bp cut.
- Turkey. On 24 September, CBT hike 200bp to 10.25% against market consensus of no change to rates.
- Hungary. On 22 September, NBH kept rates on hold at 0.60% however declined to launch additional easing tools. Just 2 days after the meeting NBH hiked 15bp to 0.75%
- Mexico. On 24 September, Banxico cut 25bp to 4.25% in line with expectations but less than 50bp cut expected by many other economists.

Given this EM CenBank behaviour we think EM FX is where the pain is.

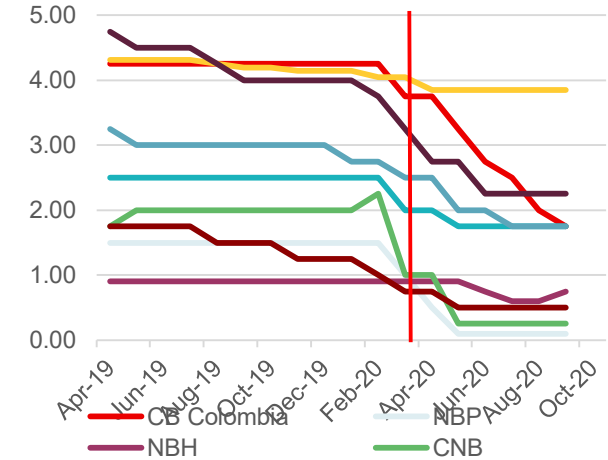
NBP does not have a problem with too high CPI yet however **PLN might be vulnerable to any global EM FX sell off.**

EM High Yielders – Interest Rates



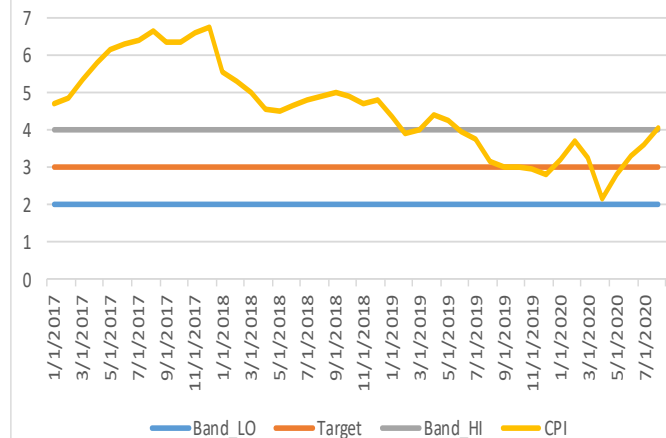
Source: Bloomberg, Santander

EM Low Yielders – Interest Rates



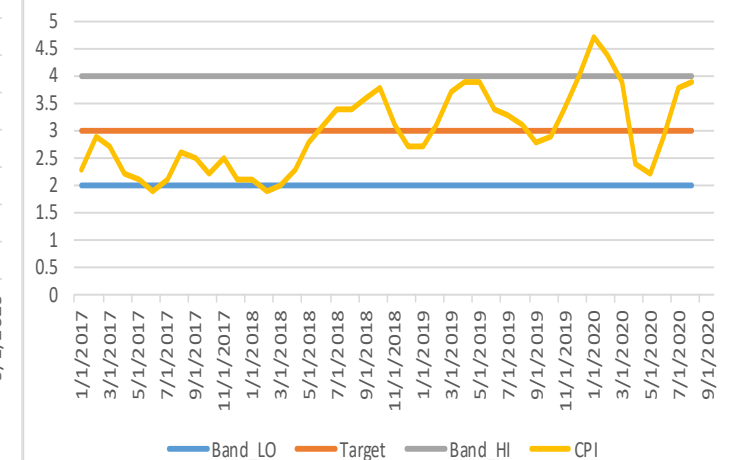
Source: Bloomberg, Santander

MXN - CPI y/y



Source: Bloomberg, Santander

HUF - CPI y/y



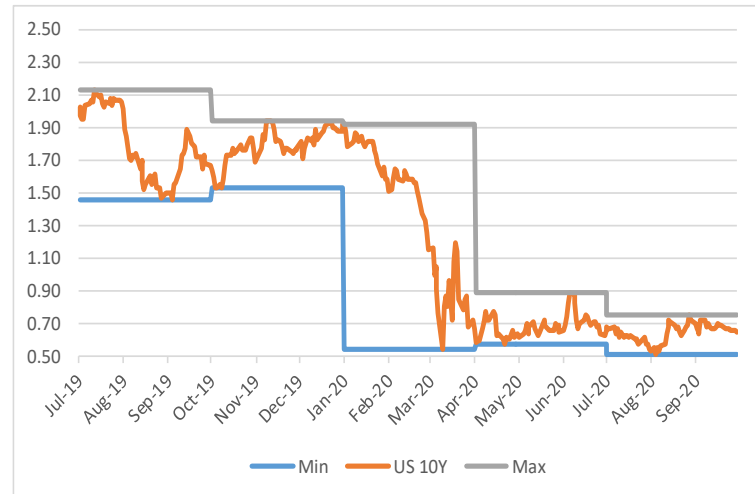
Source: Eurostat, Santander



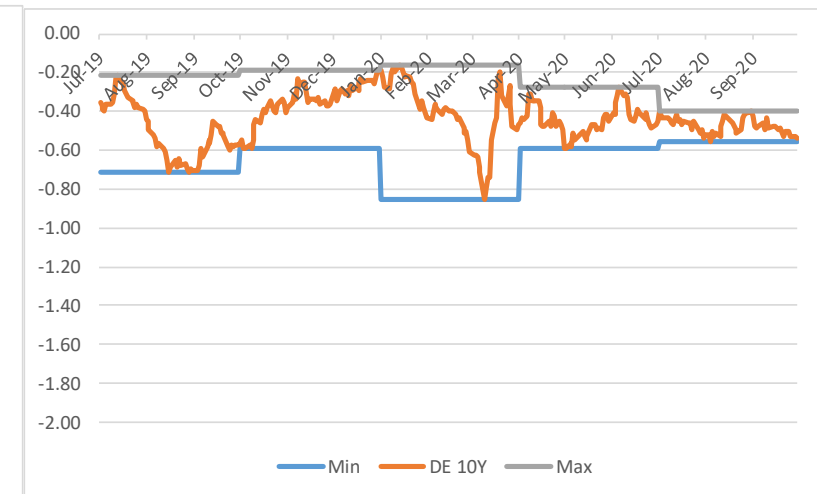
3Q 2020 saw historically low 10Y yield volatility

- In 3Q 2020, the range of the 10Y bond yields was one of **the lowest in many quarters**.
- In the **US** (T,L) the quarterly range at 25bp was just **18%** of the Q1 2020 range of 138bp.
- In **Germany** (T,R) the quarterly range at 16bp was just **23%** of the Q1 2020 range of 70bp.
- In **Poland** (B,R) the quarterly range at 17bp was just **18%** of the Q1 2020 range of 90bp.
- In **China** (B,L) the quarterly range at 30bp was **50%** of the Q1 2020 range of 61bp. This was mainly a function of relatively low 1Q 2020 volatility.
- The average level of yields was unchanged for almost 2 quarters in a row (2Q and 3Q 2020) in the US, Germany and Poland.
- The yields have however increased in China and this despite the inflow of foreign capital. **The 10Y China-US yield spread widened to a record ~250bp.**

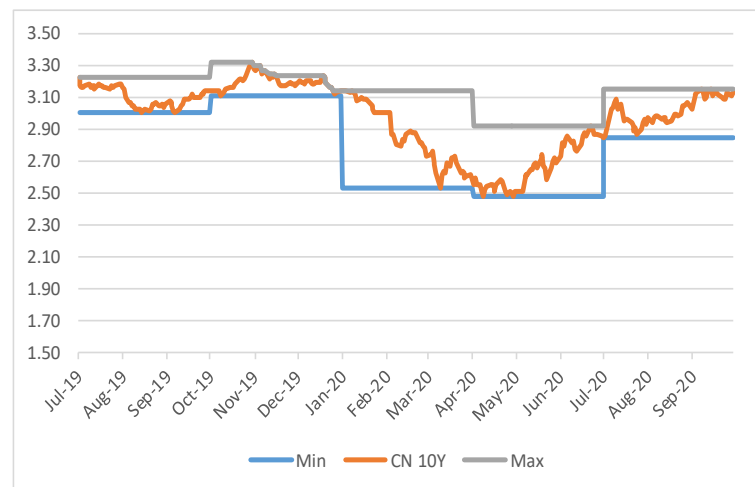
US 10Y Yield



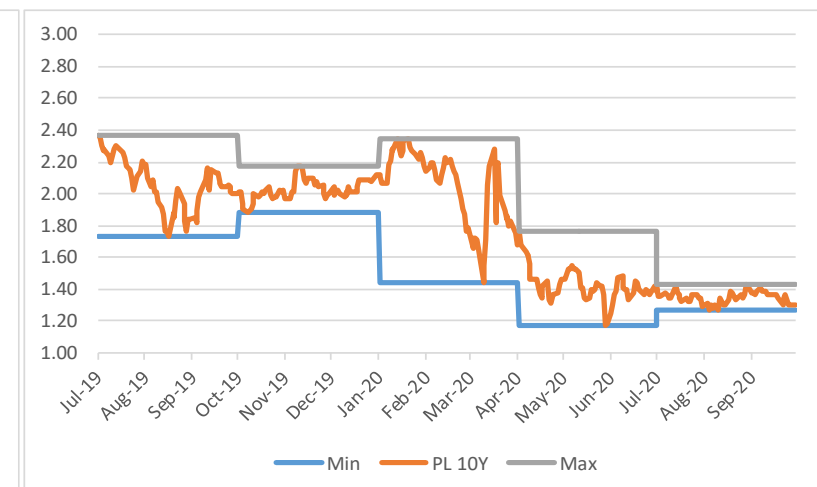
German 10Y Yield



China 10Y Yield



Polish 10Y Yield



Source: Bloomberg, Santander

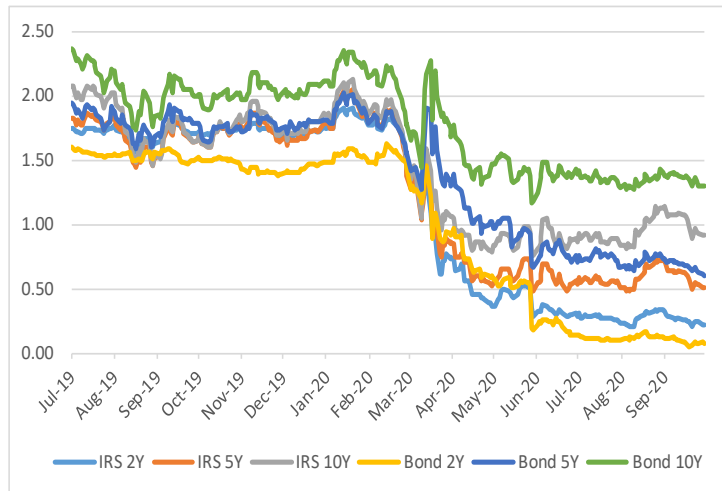
Source: Bloomberg, Santander



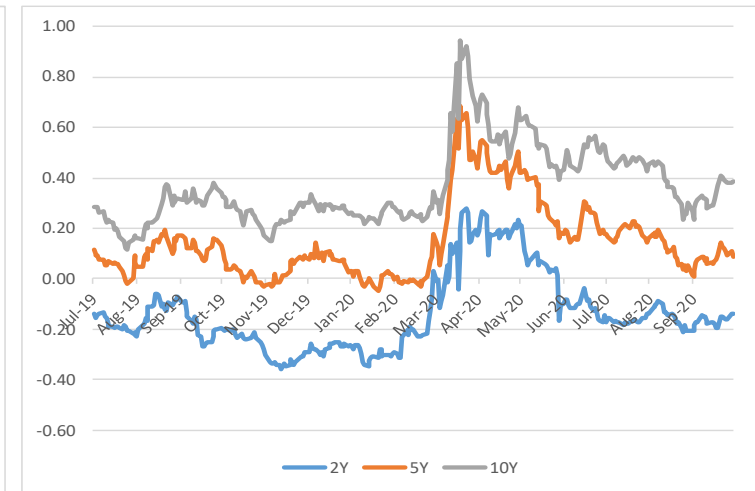
Polish yields in 3Q 2020 rear view mirror

- The four plots to the right describe the behaviour of Polish yields in the 3Q 2020 in the context of the whole past year.
- The **level of yields** (T,L), on average, remained at the 2Q 2020 levels with some local volatility (e.g. yield rises at the end of August due to optimism related to the Fed's change of monetary policy strategy towards average inflation targeting as announced at the Jackson Hole summit). 10Y bond closes the quarter at 1.30%.
- Polish **asset swaps** (T,R) normalized a bit more and their current levels are *de facto* indistinguishable from their pre-Covid-19 levels of late 2019 and early 2020.
- The **spreads of Polish bonds over the German ones** (B,L) have remained pretty stable with only exception a slight 10bp narrowing seen in the 5Y sector.
- Polish bond **yield curve 2x10 slope** (B,R) after having steepened in 2Q 2020 to ~120bp remains stable however at the elevated level. This stands in contrast to the 2x10 slopes of the US and German bond curves which remain stable at the low levels or even slightly flatten as in Germany.

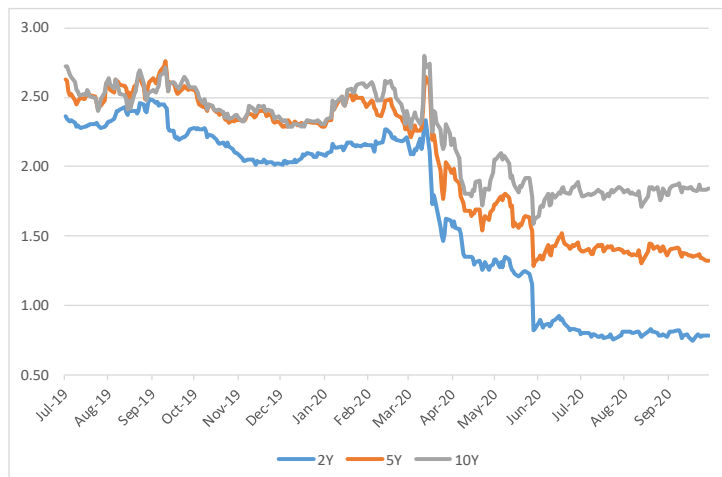
Polish IRS and bond yields: 2Y, 5Y, 10Y



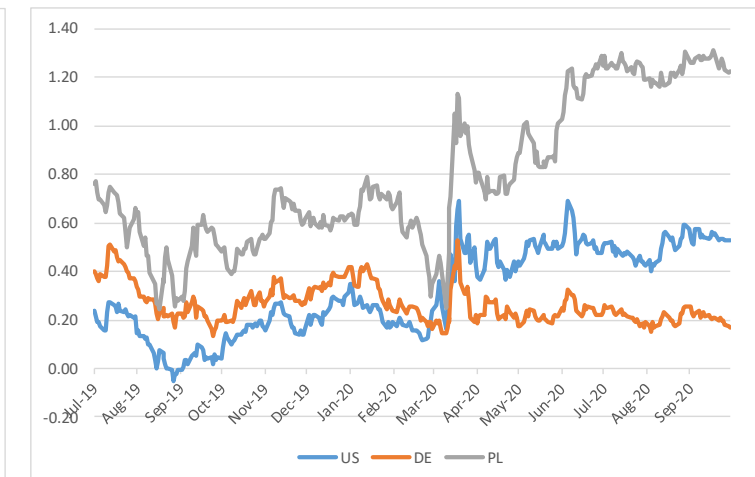
Polish asset swaps: 2Y, 5Y, 10Y



Polish bond yields vs Germany: 2Y, 5Y 10Y



Bond yield slope 2x10: US, Germany, Poland



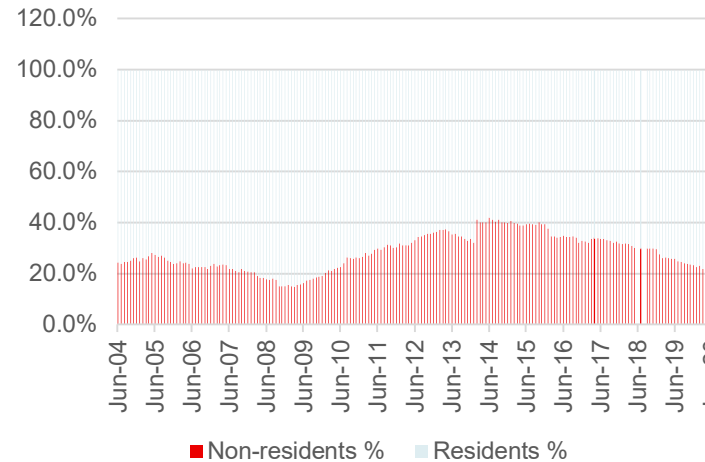


% share of foreign investors in POLGBs declines

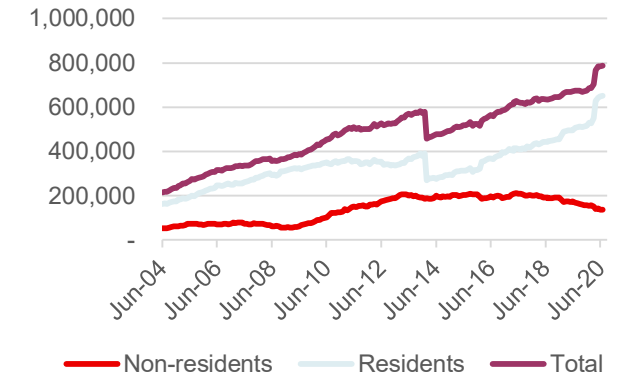
As far as 3Q 2020 is concerned Ministry of Finance published the data to and including July 2020:

- The **% share of foreign investors** (T,L) in POLGBs declined to 17.5% - the lowest level since 2009. The YTD decline amounts to 5.1pp already.
- The **ownership structure of POLGBs in PLN mio** (T,R) shows that the total outstanding amount of bonds is on the increase while most of the stock is being purchased locally. YTD the total outstanding amount of POLGBS increased by PLN 134bn.
- The **ownership structure of POLGBs by type of resident** (B,L) points clearly to the fact that most of the purchases of the bonds have been made by the banking sector. As of end of July the banking sector owns PLN 442.6bn worth of bonds, a YTD increase of PLN 137.7bn.
- Other bond technicals, like **redemption and coupon schedule** (B,R) point to relatively empty 4Q 2020 ahead.

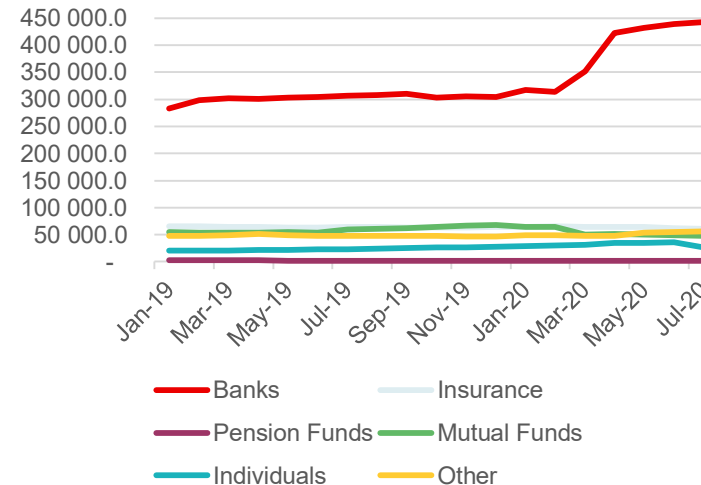
Ownership structure POLGBs, % of total



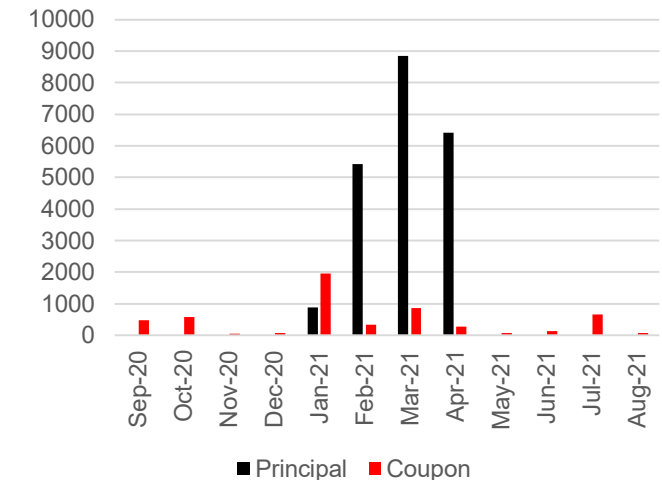
Ownership structure POLGBs, PLN mio



Ownership structure POLGBs – by type of resident, PLN mio



Redemptions and coupon payments

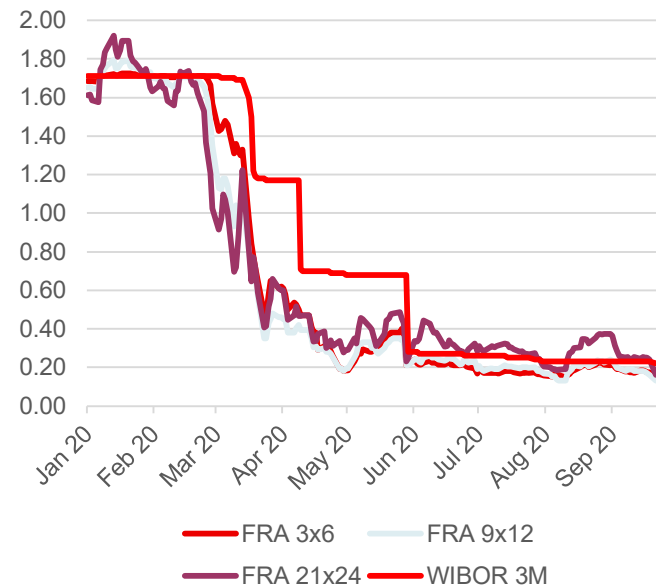




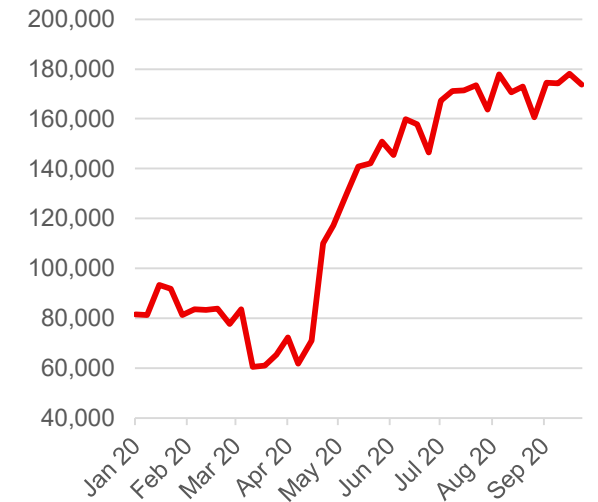
4Q 2020 yield forecasts

- We still expect the he NBP to keep rates unchanged at current 0.1% till the end of 2021. Currently 3M Wibor stands at 0.22% and is down 4bp QTD.
- **FRA markets** (T,L) currently remain below the 3M Wibor at ~0.16%, (for 3x6, 9x12 and 21x24 ones). The number of Covid-19 cases increases in Poland and Europe as the winter season nears worsening the economic outlook and dampening inflation. **Hence we expect the FRA market to remain below 3M Wibor over 4Q 2020.**
- Liquidity in the banking sector remains abundant and the **size of the weekly 7-day NBP bill auctions** (T,R) remains close to the record highs of PLN 180bn. The situation might remain in place in 4Q 2020 and impact **short-end bond yields which we expect to remain just slightly above zero.**
- Local demand for POLGBs comes predominantly from the banking sector but fixed income mutual funds also see a continuing inflows (B,R).
- On the **issuance** side, Ministry of Finance remains in a comfortable situation of decent >PLN 100bn liquidity cushion. MinFin will tap the market for up to PLN 5bn in December. BGK so far issued PLN 82.2bn out of maximum allowed PLN 100.0bn. We think BGK will issue the remaining PLN 18.0bn till EoY. PFR will need to finance another PLN 15.0bn as it launches a shield for large corporates. The issuance will likely occur in October. **Market impact from the issuance of BGK and PFR bonds should be noticeable but limited** as any surplus which will not be absorbed by the market will be absorbed by the NBP.
- We expect the 10Y yields to gradually increase towards 1.50% by EoY.

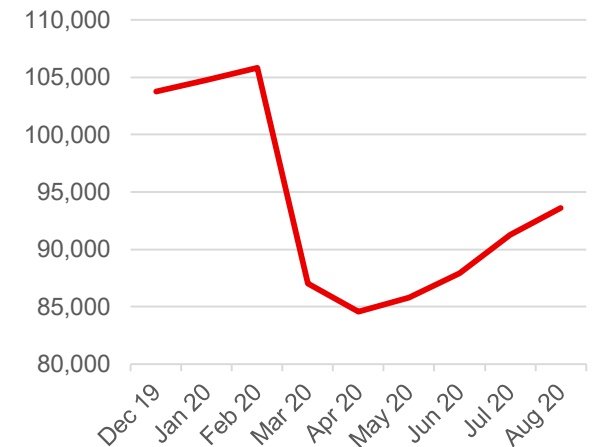
3M Wibor vs FRA



Size of the 7-day NBP bills weekly aucitons, PLN mio



Fixed income mutual funds AuM, PLN mio



Forecasts

3



Economic Forecasts

		2018	2019	2020E	2021E	1Q20	2Q20	3Q20E	4Q20E	1Q21E	2Q21E	3Q21E	4Q21E
GDP	PLNbn	2,120.5	2,273.6	2,288.2	2,404.4	552.2	524.9	572.9	638.2	555.0	573.1	603.9	672.4
GDP	% y/y	5.3	4.1	-3.0	4.8	2.0	-8.2	-3.0	-2.6	0.5	9.4	5.4	4.4
Domestic demand	% y/y	5.6	3.0	-3.6	5.3	1.7	-9.5	-3.8	-2.7	0.9	10.1	5.8	4.7
Private consumption	% y/y	4.2	3.9	-3.4	5.3	1.2	-10.9	-2.2	-2.0	1.0	12.0	5.0	4.0
Investment	% y/y	9.4	7.2	-7.2	5.4	0.9	-10.9	-8.0	-8.0	-5.0	9.0	9.0	6.0
Industrial output	% y/y	5.9	4.2	-2.0	7.3	0.9	-13.6	1.9	2.9	1.4	22.6	3.6	4.1
Construction output	% y/y	19.7	3.6	-6.6	1.9	5.0	-2.8	-12.8	-10.3	-11.1	-4.4	6.1	11.8
Retail sales (fixed prices)	% y/y	6.5	5.1	-3.1	4.7	0.8	-10.7	1.0	-2.6	1.6	13.3	-0.5	4.3
Gross wages in national economy	% y/y	7.2	7.2	5.0	4.6	7.7	3.8	4.4	4.3	3.2	6.4	4.2	4.6
Employment in national economy	% y/y	2.6	2.2	-0.9	0.7	0.6	-1.7	-1.3	-1.0	-1.4	2.4	1.1	0.7
Unemployment rate*	%	5.8	5.2	7.0	7.1	5.4	6.1	6.2	7.0	7.2	6.7	6.8	7.1
Current account	EURmn	-6,518	2,611	19,677	6,746	4,623	6,576	5,224	3,254	1,884	-2,219	4,029	3,052
Current account	% GDP	-1.3	0.5	3.8	1.2	1.1	2.3	3.4	3.8	3.3	1.5	1.3	1.2
General government balance (ESA 2010)	% GDP	-0.2	-0.7	-10.5	-6.0	-	-	-	-	-	-	-	-
CPI	% y/y	1.6	2.3	3.4	1.6	4.5	3.2	3.0	2.9	1.7	2.0	1.4	1.4
CPI *	% y/y	1.1	3.4	2.5	1.4	4.6	3.3	3.2	2.5	1.7	2.0	1.4	1.4
Core inflation	% y/y	0.7	2.0	3.8	1.7	3.4	3.8	4.2	3.9	2.9	1.9	1.1	0.8

* End of period; other variables – average in period



Market Forecasts

		2018	2019	2020E	2021E	1Q20	2Q20	3Q20	4Q20E	1Q21E	2Q21E	3Q21E	4Q21E
Reference rate *	%	1.50	1.50	0.10	0.10	1.00	0.10	0.10	0.10	0.10	0.10	0.10	0.10
WIBOR 3M	%	1.71	1.72	0.66	0.20	1.62	0.59	0.23	0.20	0.20	0.20	0.20	0.20
Yield on 2-year T-bonds	%	1.59	1.56	0.53	0.16	1.39	0.48	0.14	0.10	0.10	0.14	0.19	0.20
Yield on 5-year T-bonds	%	2.51	1.99	1.00	0.73	1.72	0.94	0.73	0.62	0.72	0.79	0.78	0.65
Yield on 10-year T-bonds	%	3.21	2.41	1.56	1.50	2.05	1.43	1.36	1.40	1.50	1.50	1.50	1.50
2-year IRS	%	1.92	1.74	0.63	0.34	1.53	0.43	0.28	0.28	0.31	0.35	0.35	0.35
5-year IRS	%	2.43	1.85	0.85	0.69	1.58	0.62	0.60	0.59	0.68	0.70	0.70	0.70
10-year IRS	%	2.89	2.05	1.11	1.09	1.67	0.89	0.95	0.93	1.05	1.10	1.10	1.10
EUR/PLN	PLN	4.26	4.30	4.42	4.32	4.32	4.50	4.44	4.43	4.35	4.33	4.30	4.30
USD/PLN	PLN	3.61	3.84	3.90	3.63	3.92	4.09	3.79	3.78	3.69	3.65	3.60	3.57
CHF/PLN	PLN	3.69	3.86	4.12	3.85	4.05	4.24	4.12	4.06	3.94	3.86	3.81	3.79
GBP/PLN	PLN	4.81	4.90	4.94	4.85	5.02	5.07	4.88	4.78	4.83	4.89	4.86	4.80

* End of period; other variables – average in period
All shaded areas represent Santander's estimates

Source: NBP, Bloomberg, Santander

This analysis is based on information available until **1.10.2020** has been prepared by:

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#2 BEST OVERALL FORECASTER - POLAND



#1 BEST OVERALL FORECASTER - POLAND



Sectoral supplement

Sectors that surprised positively

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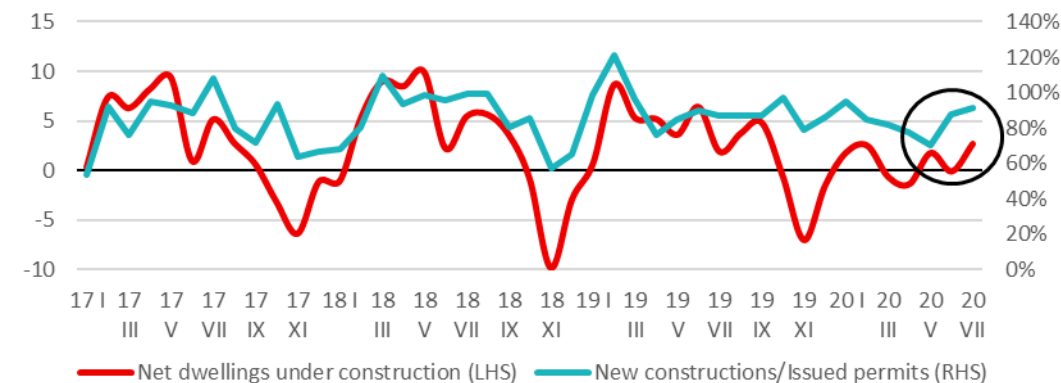
Housing market rebounds after quarantine

It seemed that COVID-19 pandemic would hit the housing market hard – from one day to another phones in sales offices went silent, rents for short term rentals dropped, and conversion of issued construction permits clearly weakened, which was supposed to precede a decline in new dwellings supply and an end to years of consecutive records in supply levels. It seemed like a natural consequence of consumers turning away from major purchases, and tightening supply from housing developers in order to avoid swinging the housing market into oversupply.

Yet supply cuts weren't as deep as it was expected. Fall in construction permits conversion was rather gradual and not as deep as typical seasonal variations seen between 4Q and 1Q. Most importantly, the indicator has quickly reversed the negative trend and returned to pre-pandemic levels in June. In July, number of completed dwellings noted a 40% YoY increase, August in turn saw the third highest number of dwellings under construction. Some 16,5 thousand dwellings which received construction permit during lockdown are awaiting construction. If 88% of them were to start construction works (average level from last 6 months before the pandemic) this year, then at year end the total number of dwellings under construction should fall not more than 0,5% YoY.

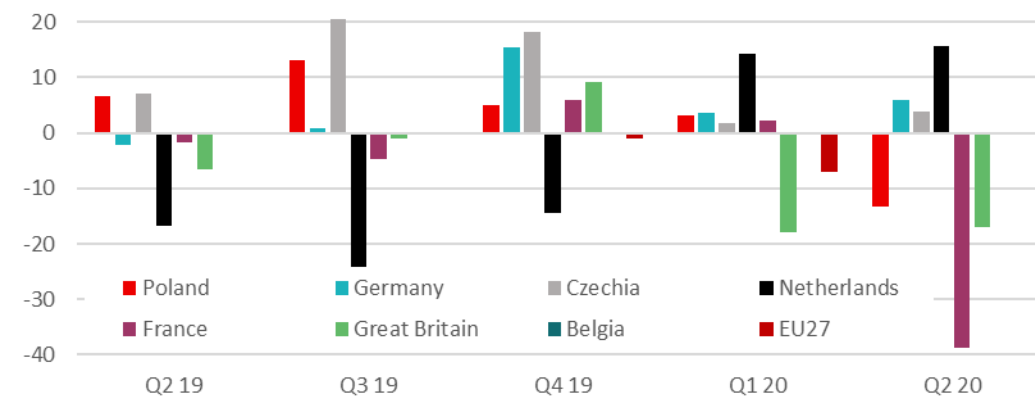
Supply of new dwellings on the EU market looks promising as well. In Germany, which is the single most important export market for Polish furniture and builders' joinery manufacturers, floor area of dwellings which received construction permit sustained a growth trend in each of the last 4 quarters. Countries such as France, or Italy, were among the hardest hit by the pandemic, which translated into slower recovery of export sales from April's tumble. As a result, these markets are losing their share in Polish export sales to the benefit of the Netherlands, Ukraine, or Luxembourg.

Net dwellings under construction*, construction permits conversion



Source: GUS, Santander calculations
*Balance of new dwellings under construction and completed dwellings

YoY change in construction permits volume on main export markets*



*Main export markets of Polish furniture and builders' joinery
Source: Eurostat, Santander calculations



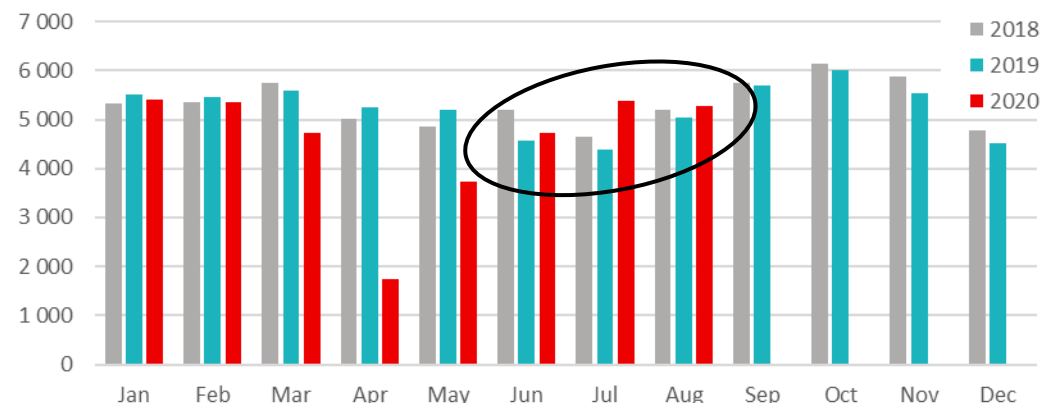
Polish furniture conquers the Netherlands

Furniture is not a first-need product – even though it’s not a secret, it’s a deciding factor for the pro-cyclical character of this market. Which is why market outlook in April looked very grim. Yet in spite of these expectations, Polish companies started going back on their feet very quickly. In second half of the year production volume remains higher YoY, and given that export sales account for the majority of sector’s sales, we expect it’s recovery path to follow suit. Given the above, we expect that at year end, sold production of Polish furniture manufacturers may be close to, or flattish compared to last year’s record high result.

We see a number of factors that resulted in such unexpectedly positive picture. Firstly, export sales to Germany, which accounts for almost 40% of all export sales of furniture, recorded a shallower decline compared to other major export markets. Rebound trajectory after bottoming out in April is also slightly above average for all export markets. But it wasn’t Germany alone that helped Polish furniture market regain its feet. Domestic orders were the second deciding factor. It took place only after major furniture retail chains reopened to long ques of consumers interested in home office furniture.

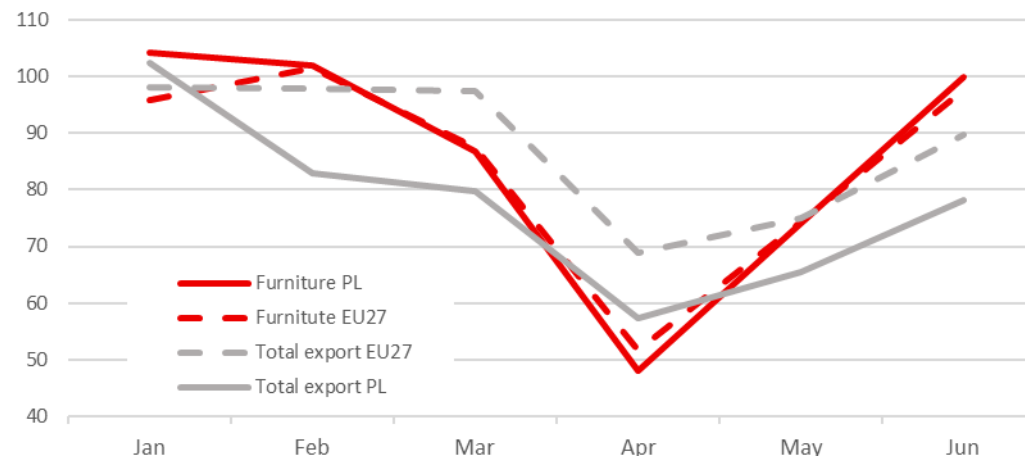
Thirdly, government strategies aimed at containing the spread of coronavirus lead to different consequences for particular markets, which lead to reshuffling among major export markets for Polish furniture. Most notably the Netherlands, where government restrictions were relatively less severe, became the third largest importer of Polish furniture. Export sales to this market were growing even before the pandemic thanks to increased activity in the Netherlands’ housing market. Even though export sales dropped YoY in March and April, the decrease was much shallower that average for all export markets. Sales to Sweden also followed a similar path. On the other hand, pandemic-hit French market noted a deep sales decline in April, and its recovery path is far below average. We observe similar scenario for Great Britain, or Italy. As a result, Polish furniture sales rebounds faster than EU-average for this sector.

Furniture production volume (thou pcs)



Source: GUS, Santander calculations

Export sales index* of furniture and goods in general



*100 = average monthly export sales in 2019

Source: Eurostat, Santander calculations



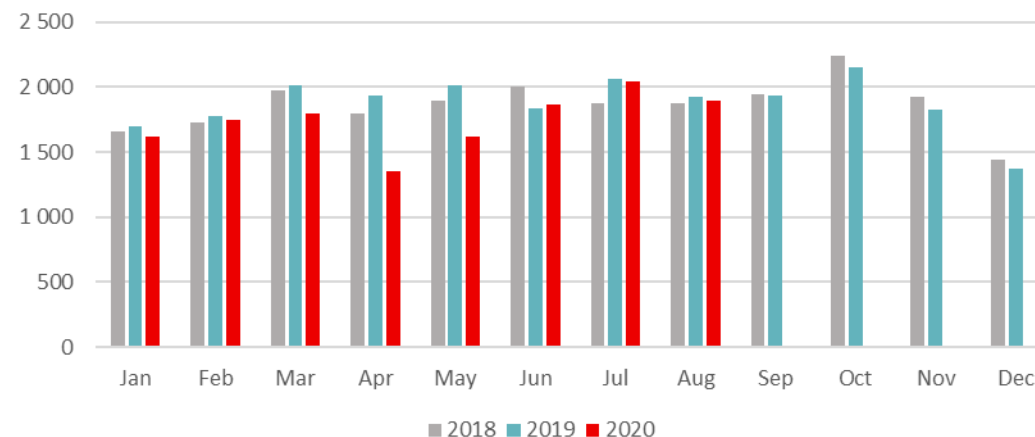
Builders' joinery sector opened to new markets

Because of relatively long life cycle of doors and windows, builders' joinery market growth depends on the primary, i.e. investment sales channel. Given the EU-wide rise of unemployment it was expected that builders' joinery manufacturers would be facing hard times. Yet Polish companies have largely stood their ground. In April alone production volume fell by „only” 30% YoY, which is a spectacular result given that, for example, furniture production volume fell by almost 70% in the same period. Under closer examination we see acceleration of trends visible before the pandemic. Production volumes fell the least in aluminium and plastic joinery segments, -11% and -20% YoY respectively.

Joinery sector was benefitting from a record growth streak of the housing construction on the Polish market. Relatively shallow decrease in new housing construction starts and quick rebound of construction permits conversion rate to pre-pandemic levels supported production volumes of joinery producers. But the biggest surprise might be sector's expansion on foreign markets, despite the fact that contrary to CEE region, we saw no increase in interest in major house improvements on Western markets but it didn't stand in joinery producers' way to increasing their share in EU's joinery export – from 25% before the pandemic to almost 27,5% in May. Export sales of builders' joinery in June was already 8% above last year's average.

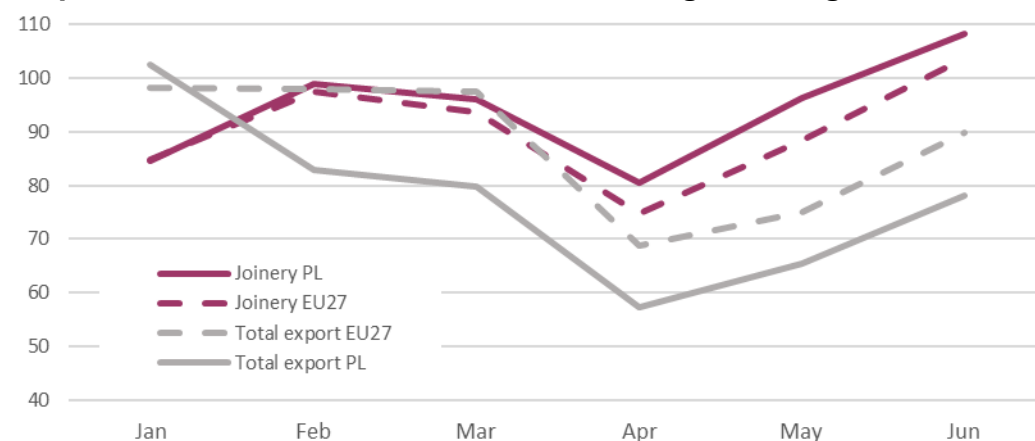
Reliable German import of Polish builder's joinery turned out be the major source of sales growth – Germany alone accounted for 28% of total export sales growth. Further 28% came from orders from Ireland, the Netherlands, and the USA. It is worth mentioning that Romania was also among growing sales destinations, at 12% sales growth YoY. Given that Romanian joinery manufacturers are considered to be very price competitive, expansion on this particular market must be quite an achievement.

Production volume of builders' joinery (thou pcs)



Source: GUS, Santander calculations

Export sales index* of doors, windows and goods in general



*100 = average monthly export sales in 2019

Source: Eurostat, Santander calculations



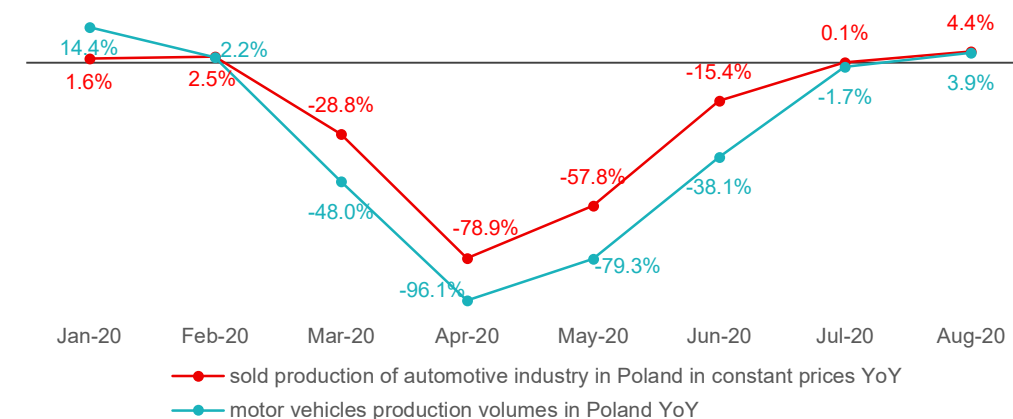
Automotive industry already on the rise

Dynamics of sold production of automotive industry in Poland was positive for second month in a row, and August's growth (4,4% YoY in constant prices) exceeded that of July (0,1% YoY). This growth stands in contrast to earlier assumptions, according to which the return to 2019 levels was to take place in a more distant perspective, and also slightly contrary to trends in Europe. Although dynamics of passenger car registrations and production volumes in Europe were improving, pace of recovery was lower than production in Poland and so far did not provide space for growth. In August there was even a correction of the trend and deepening of declines.

Data on automotive sold production value compared with motor vehicles production volumes leads to the conclusion that parts manufacturers have been less affected by the pandemic. Changes in volume of vehicle production came close to the dynamics of the industry sold production only in July and August, previously recording stronger declines. Parts manufacturers were certainly supported by the aftermarket segment, which was more stable than production for first assembly, as can be seen from good performance of parts distributors and maintenance service providers. The aftermarket parts market, in turn, was supported by also more stable imports of used cars.

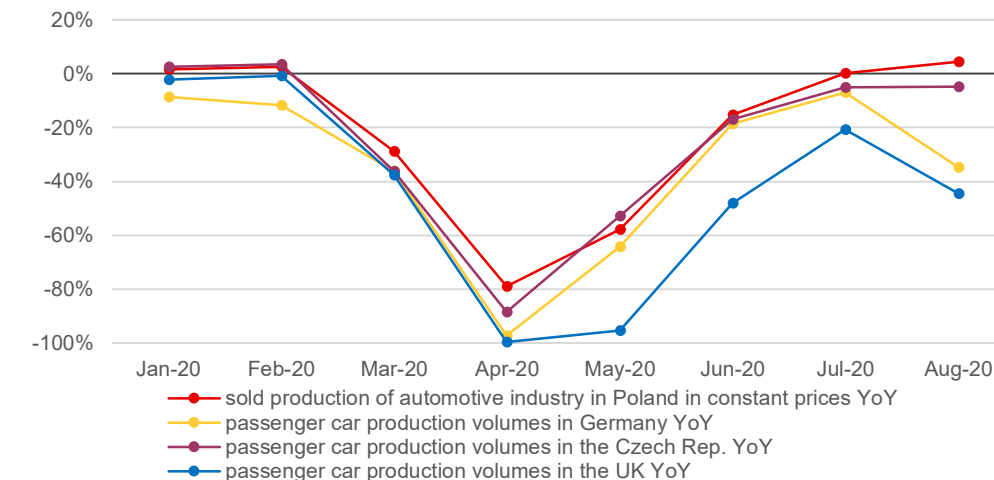
Permanent allocation of automotive logistics chains closer to production sites is a prospect for several years but there are many signs that automotive concerns are already increasing the share of orders to Polish suppliers, looking for opportunities to reduce costs in times of decreasing revenues and margins. According to a recent VDA survey, 2/3 of German parts suppliers had 50-75% of their production capacity filled. At that time, production of cars of major importers of Polish parts (Germany, the Czech Rep., the UK) continued to record declines YoY, with increasing sales of Polish parts suppliers. Parts producers from Germany are aware they are becoming less competitive. Even before the crisis 42% of respondents planned to relocate their production abroad, and more than 2/3 of them now intend to accelerate these plans. Therefore, our region, including Poland, has a chance to take over a significant part of production from Western Europe and supplies from Asia.

Production of the automotive industry in Poland



Source: GUS, Santander calculations

Production in Poland vs. production of major importers of Polish parts



Source: GUS, VDA, SAP, SMMT, Santander calculations



E-commerce drives warehouses supply

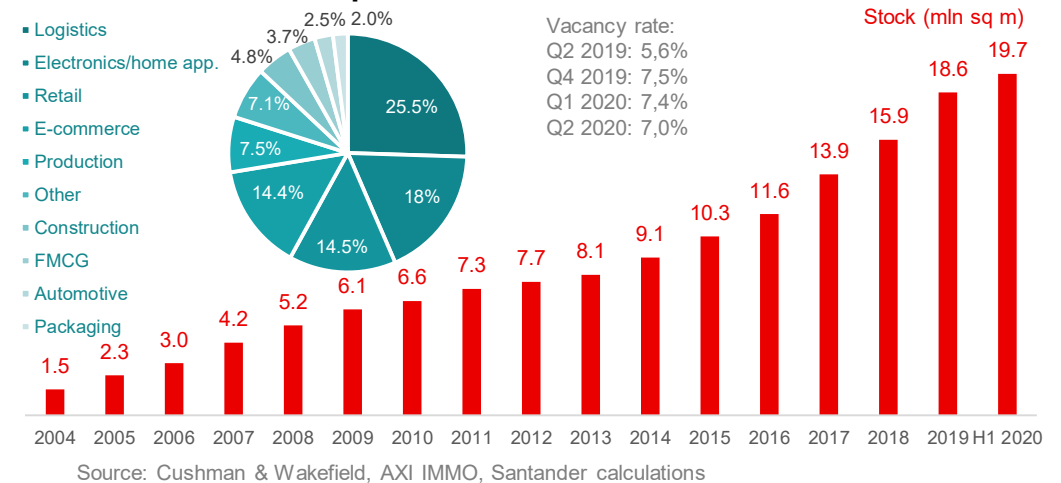
The first half of 2020 was another record period in terms of warehouse space supply in Poland. Stock increased to 19,7 million sq m, with another 1,9 million sq m under construction. Demand for new space amounted to 2,3 million sq m, which was 23% higher than the year before. New contracts and expansions accounted for 74% of total demand, and only 26% for renegotiations of contracts. It happened with the vacancy rate falling for the second consecutive quarter. These figures are evidence of a good situation of logistics. However, the pandemic has left its mark on the market. Part of demand for new space was generated by agreements signed on favourable terms, and also the number of speculative investments decreased.

There is increasing discussion about moving supply chains closer to production sites, i.e. from Asia to Europe, including Poland, which may create opportunities for logistics. Security of supply is becoming an increasingly important factor, even at the cost of higher production costs. A noticeable trend is the growing interest in small municipal warehouses, mainly for e-commerce purposes. Our country is strengthening its position as the logistics centre of the region, including for e-commerce purposes in neighbouring countries.

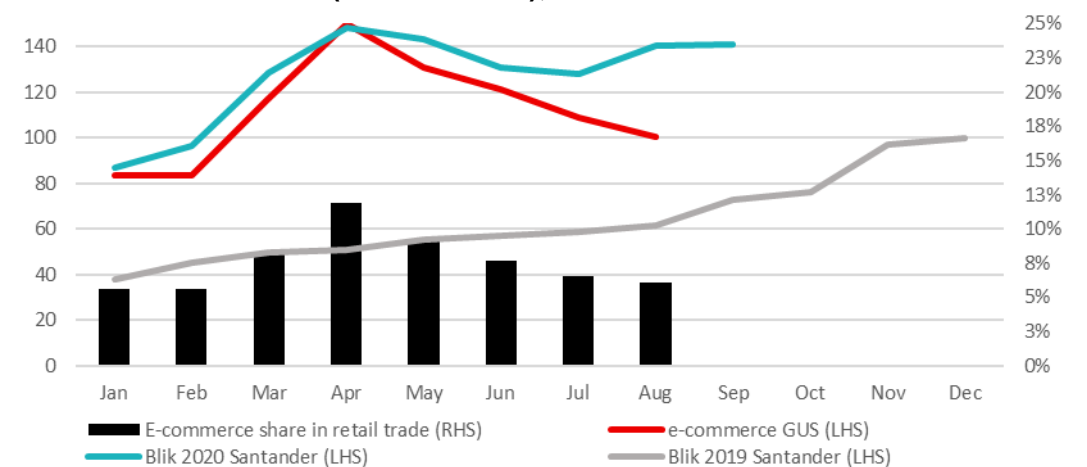
Growth of e-commerce sales may hardly be a surprise given that many traditional stores were closed, and people were reluctant to go out of their homes. But what was surprising was the scale of e-commerce growth. At its peak, the value of Internet transactions grew by over 140% YoY. Without proper warehouse and logistic resources such incredible growth wouldn't be possible.

In the second half of the year we see a gradual decrease in share of e-commerce in retail trade, mainly due to growth in food sales in brick-and-mortar stores. What is interesting is the fact that from July on we see diverging dynamics of payments data and official statistics. We expect that e-commerce sales may once more accelerate starting September, as people resume shopping after summer break, and gradually start preparing for Christmas. We expect that e-commerce growth in 2020 may close at over 100% YoY.

Stock of warehouse space in Poland



Internet sales index (12.2019=100), share of e-commerce in retail trade





Quick rebound of Polish food exports

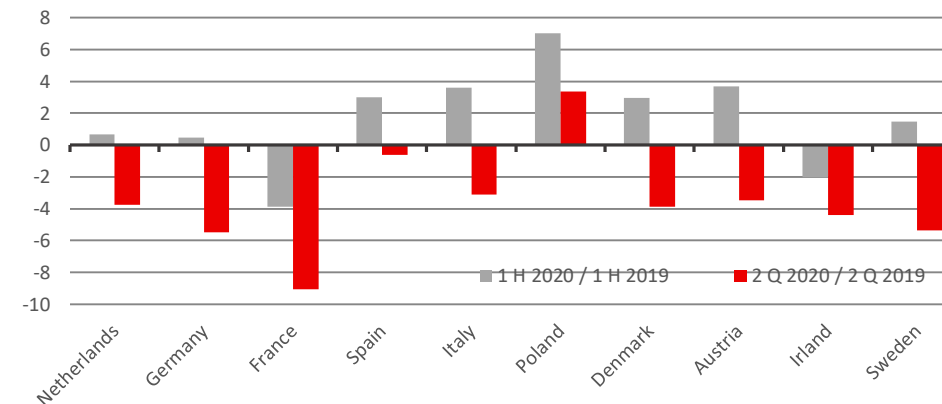
Polish food exports performed unexpectedly well during the lockdown period in the European Union and immediately after it. Although in April exports fell by 15% when compared to the high level in March but the value of exports was lower by only 3% in comparison to the same month in 2019. In May, foreign sales were slightly higher YoY (+ 1%). The acceleration took place in June, when the annual dynamics approached 13%.

Polish food industry returned to last year's levels of exports faster than the average for Polish economy. In addition, it also stands out positively against its competitors from other countries in the European Union. Among the TOP-10 food exporters in the EU, Poland is the only country whose value of foreign food sales was higher on an annual basis in the second quarter of this year. In period April-June the value of exports from Poland amounted to EUR 7,9 billion and was higher by 3,4% YoY. For comparison, in the indicated period, exports from the Netherlands were lower by 3,8%, from Germany by 5,5%, and from France by as much as 9,1%.

Poland stands out positively from the EU also in terms of exports throughout the first half of 2020. Total value of exports from Poland was higher by 7% YoY and it was the highest dynamic in the group of the largest exporters in the EU.

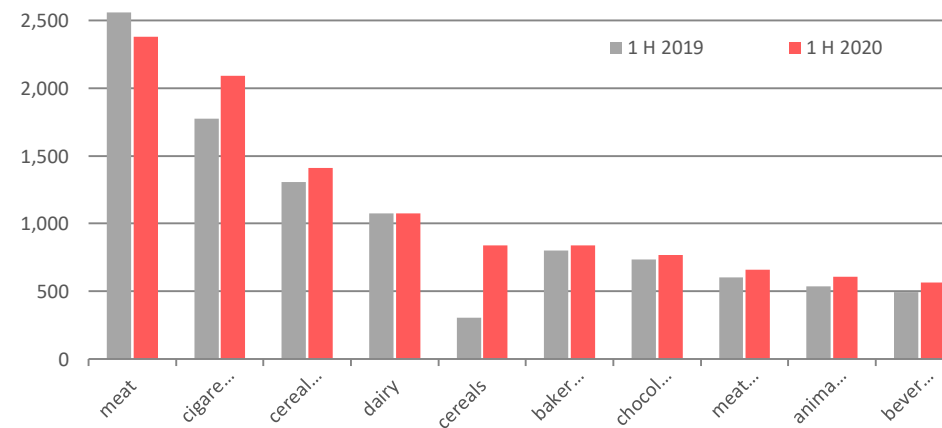
It is worth highlighting the high increase of foreign sales of cereals. Export of this category was higher by 173% YoY in 1H 2020. Increase was supported by uncertainty on the global market related to the COVID-19 pandemic (main global importers increased their purchases) and favourable exchange rate of PLN. Significant increase was also recorded in case of tobacco products (by 18%) - despite the EU ban on the sale of menthol cigarettes. High dynamics were also recorded in case of: cereal products (by 18%), beverages (by 14%), animal feed (by 13%) and meat products (by 10%).

Changes in export value of main EU food exporters (YoY, %)



Source: Eurostat, Santander calculations

Food export value, by main product groups (million EUR)



Source: Eurostat, Santander calculations



Lower domestic demand in August?

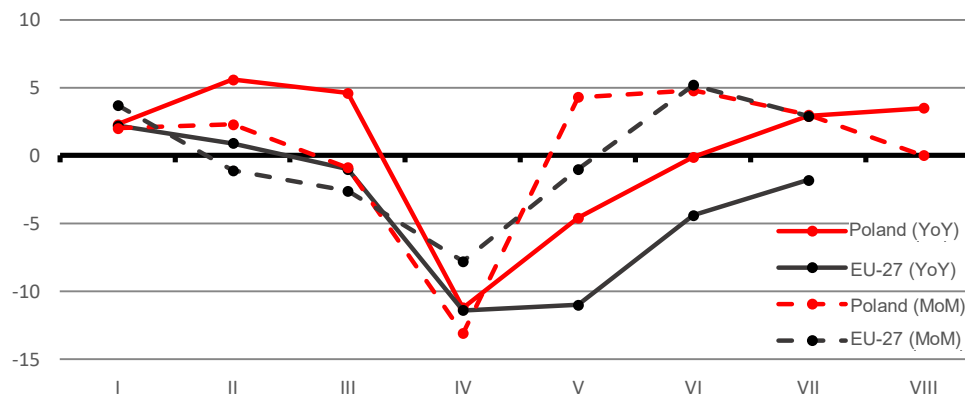
As a result of weakening demand, sold production of food industry (food products, beverages, tobacco products) declined strongly in April. Gradual increase was noted in the following months. As the seasonally adjusted Eurostat's index of sold production shows, sold production in medium and large food enterprises was increasing in May, June, and July. It is worth noting that while the fall in Poland in April was deeper than the EU-27 average, the growth dynamic in the next three months in Poland was higher than in other EU countries. In July, both in Poland and in the EU, a slowdown in growth dynamics was recorded. In turn, in August, the seasonally adjusted Eurostat's index indicated a stabilization for Poland at the level from July, while the seasonally unadjusted Polish CSO's (GUS) index showed a 4% decline in comparison to the previous month.

Importantly, despite the visible slowdown, sold production in Poland in July and August remained above the level of the corresponding months of 2019, which positively distinguished Poland among the EU countries.

The slight decline in Polish food retail sales value is worth noting. According to CSO's data, the monthly growth rate of retail food sales was negative in August and amounted to -0,2% (in current prices). Retail sales was also lower in annual terms (by 0,1%), which may be interesting, given the YoY increase in sold production. This may indicate a slightly weaker demand on the domestic market and higher sales from Poland to foreign markets. This strategy could be supported by stable and high food retail sales on the main EU markets and gradual recovery of turnover in the HoReCa segment in the EU.

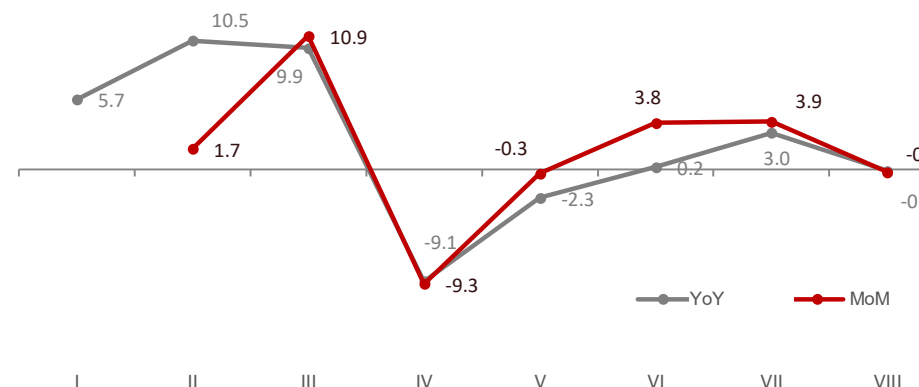
In the next months, turnover of Polish food industry should be supported by higher plant production. Currently, production of cereals, fruit, and vegetables is estimated to increase. On the other hand, the challenge for meat industry may be the possible deep fall in pork prices, related to the first ASF outbreaks in Germany.

Dynamic of sold production of the food industry in 2020 (%)



Source: Eurostat, Santander calculations

Dynamic of food retail in Poland (current prices, %)



Source: CSO, Santander calculations

This analysis is based on information available as of **30.09.2020** and has been prepared by:

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