MACROscope

Warsaw, 16 December 2020

Just wait for the spring to come

Poland: 2021 Outlook

Economic Analysis Department
Santander Bank Polska S.A.
ekonomia@santander.pl
+48 (22) 534 1887

Santander

Index

Executive Summary (macro)

Covid-19 was the main theme in 2020 and will remain the key topic also in 2021. Assumptions about how the pandemic develops are critical for predicting economic scenarios. While there are still many question marks (how quickly and effectively will the vaccine be distributed, how many people will volunteer to take the shot), **we think it is rational to assume that somewhere around mid-2021 the mass vaccination reaches the sufficient level to curb worries about potential next waves of the pandemic** (see pages 8-9).

So far, Poland has been coping with the crisis better than other European states (p. 10) and it seems that **once the Covid-19 threat is gone we will have big chance for a solid recovery, driven by the pent up demand, substitution effects and generous EU funding**. At the start of 2021 economic activity will still be subdued, as the coronavirus threat is likely to persist throughout the winter, but we expect to see a stronger revival in 2H21. **On the macro level, it would correspond to "Vu"-shaped recovery, with the second dip of recession shallower but longer than the first one, and GDP growth at +4.6% in 2021 vs. -3% in 2020** (p.13).

But the scenario would not be the same for all sectors. Manufacturing seems to be the least affected in this bout of pandemic and face the brightest outlook, amid international trade revival, while the HoReCa business and construction may struggle the most until they recover. (p.15) **See also the Sectoral Supplement (p.50) for a more detailed discussion of outlook for specific sectors of the Polish economy.**

The labour market reaction has been very mild to date and **even though the unemployment peak may still be ahead, it will remain low**. On the flip side, labour hoarding during the peak of the pandemic means little scope for employment jump when the economy accelerates, and wage pressure should be off the table for some time. (p. 22-23)

We consistently argue that **inflation rate in Poland should go down in 2021 below the official 2.5% target**, as a delayed consequence of the domestic demand contraction, but also a much lower cost pressure, decent corporate margins, high base effects and slowing food prices (p.25-27)

… Which should provide the central bank with a big comfort in **keeping interest rates unchanged, possibly even until the end of the current MPC's term of office** (early 2022). While some MPC members already started mentioning policy normalisation in 2021, such views are clearly in a minority. (p.29-30) What is likely to change is the size of the NBP's bond buying programme, which should be expanded accordingly with the size of government's next anti-crisis measures.

On the fiscal front, **General Government deficit is likely to be around 6% of GDP in 2021 (more or less in line with the government's budget plan), after 8-9% in 2020** (lower than assumed in the budget amendment). (p.31) Public debt should stabilise near 57% of GDP in Eurostat's methodology (thanks to higher nominal GDP growth next year), while its domestic measure (subject to the 60% of GDP constitutional limit) may be even below 50%, as most of the financing of anti-crisis programmes have been phased to state-run agencies, excluded from the indicator.

The agreement on the EU's Multiannual Financial Framework and the Recovery Programme has been reached at the December European Council, which means **Poland should benefit a lot from the substantial increase of the EU funding in 2021-2027** (allocation for Poland: EUR75bn in cohesion funds, EUR31bn agricultural funds and EUR64bn in EU Next Generation). According to our estimate, the Next Generation package alone is likely to add 4-5% to Polish GDP until 2025 with the peak impact on growth rates in 2022-2023. (p.32)

Executive Summary (markets)

FX

2020 brought a significant increase of volatility on the EM FX markets. In YTD terms, all of the main EM currencies depreciated vs the euro, and slightly less than a half of them strengthened vs the dollar. The zloty lost 3.8% vs the euro and gained 3.6% vs the USD which ranks the Polish currency 4th among its EM peers.

According to our forecasts, EURPLN returns in 2021 to 4.30, that is the middle of the 4.25-4.35 range in which it has been trading for the better time since mid-2018 until the Covid-19 crisis broke out. Key assumptions here are: positive global market mood persisting for at least a better part of the next year, avoidance of no-deal Brexit (the UK-EU trade deal reached in very early 2021 at the latest) and no resurfacing tensions between Poland and EU. (p.34-37)

FI

In 2020 bond yields declined following the core markets, and stabilized in the second half of the year. Polish bonds got very expensive on ASW basis.

In 2021 we expect 10Y bond yields to increase to 1.75% driven predominantly by the rise in the core market yields but also better than market consensus GDP growth which we expect as well non-negligible MinFin, BGK, PFR bond issuance. The falling CPI as well as NBP QE might stabilize the yields or even drive them la bit lower. Front end of the curve will remain stable with NBP on hold throughout the year. (p.38-41)

Percentage of foreigners in Polish bonds is historically low in general (17%), but some government bond series concentrated near 10Y tenor have higher share (40-50%) which makes them more vulnerable to the global sentiment. Similarly, BGK bonds are more vulnerable to a potential sell-off than the PFR ones. Polish bond yield curve is likely to become steeper as the growth recovers.

According to 2021 Budget Draft adjusted for the sum of purchases of bonds maturing in 2021 we estimate the MinFin net supply in 2021 at PLN40bn split into PLN15bn for fixed- and PLN25bn for floating coupon bonds. Most of the redemptions are concentrated in 1H 2021. (p.42-45)

2020 Forecasts in rearview mirror

Indicator	Our view in June 2020	Outcome
GDP	The dip in 2Q20 was lower than we had thought at the start of the pandemic, but the V-shaped trajectory still seems to be the baseline scenario (GDP -4% in 2020, +6% in 2021). It is supported by the signals from the recent data and record-high fiscal+monetary stimulus. The risk is that the pandemic does not decelerate in Poland and new infections wave bursts out abroad.	V-shaped scenario proved too optimistic as the next Covid-19 wave triggered the second (yet much smaller) contraction of economic activity in Q4, but both Q2 and Q3 were above the early forecasts and the overall GDP drop in 2020 is likely to be closer to -3% than -4% predicted in the mid-year.
GDP breakdown	Weakness of consumption and private investments will partly be offset by some relative resilience of public spending and net exports improvement. Hope for a decent export rebound in 2021 amid solid outlook for the German economy (gigantic stimulus package), shortening of supply chains.	Domestic demand and its main components proved even weaker than we had expected, which has been compensated partly by a massive improvement in net external balance, as export performed well and import slowed considerably.
Labour market	Many firms choose reduction of worktime or/and salaries instead of job cuts. As we had 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 yet to come.	The reaction of unemployment was even milder than we had thought. Wage growth decelerated, worsening of households' real purchasing power, but not as severely as we had expected.
Inflation	Lower CPI so far has resulted mainly from cheaper fuel and some goods. Also, services prices have pushed the core inflation higher so far, but we still believe that it is just a matter of time before inflation drops below the target.	Disinflation took place but was slower than we had expected.
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.	No surprise. Interest rates anchored at almost zero with no indication they can go any lower. NBP's activity on the FX market was not necessary as export outperformed while zloty did not appreciate further.
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.	Fiscal balance will probably be better, near 8-9% of GDP. Some of the unused funds will be utilised in the next government's support package.
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 even lower than we thought, long end slightly higher at the end of the year after hopes for 2021 recovery increased. Bond supply in fact was has dried out completely after the summer.
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. Increase of global risk aversion still possible.	Room for the zloty appreciation indeed proved limited, although on average in 2H20 the zloty was slightly stronger than we had expected in mid-year.

2021 Forecasts and main risks

Indicator	Our view (in a nutshell)	Main risks
GDP	After a still weak 1Q we expect to see stronger rebound of economic activity in 2H21, after mass vaccination removes worries about potential next waves of the pandemic. Quarterly y/y GDP growth pattern will be disrupted by base effects; annual average at 4.6%.	The key risk concerns the speed and range of the vaccination. If the herd immunity is not reached by autumn, we may be stuck in another round of Covid-19-related restrictions.
GDP breakdown	Consumption will be the strongest driver of revival, supported by a pent up demand, zero interest rates and limited labour market damage. Investments subdued for longer but to revive by the end of the year. Export will consistently be performing well but import rebound in 2H will make trade balance net negative for growth.	Consumption and investment rebound may be meagre until progress in fighting pandemic is sufficient. If it takes too long, the government's lifelines may be not enough to prevent a more lasting damage in terms of bankruptcies and unemployment.
Labour market	Unemployment rate is likely to peak in 1Q21, but will still be relatively low. Job hoarding during the crisis will prevent the labour demand jump once the economy accelerates. Wage pressure is off the table for some time, which implies limited real labour income growth for households.	If hopes for quick vaccination prove futile, firms may no longer be hoarding jobs and jump in unemployment is possible. On the flip side, stronger economic rebound and rise in labour inactivity could mean that labour shortage re-emerges as the challenge for firms sooner than we think.
Inflation	Inflation will get down towards 2% amid subdued demand, lower cost pressure on firms, falling food prices. There will be another round of hikes of administered fees and taxes slowing disinflation, but not preventing it as their scale will be lower than in 2020.	Our forecast is below market consensus and NBP projection and may not materialise if for some reason services prices fail to slow down. Big energy price hike and/or significant zloty depreciation could also push the CPI path higher.
Monetary policy	Main rates are likely to stay on hold until the end of the MPC term of office. Negative rates off the table. QE purchases to be extended in 1Q21 when the government launches its new round of anti-crisis measures.	The risk of negative rates seems very low, as even dovish central bank members see the downsides. In case of faster than expected economic rebound and persistent inflation, discussion about policy normalisation may intensify in 2H.
Fiscal policy	GG deficit is likely to be around 6% of GDP (as planned by the government), after 8-9% in 2020 (lower than planned). EU Budget approved, which secures large financing for Poland in 2021-27, supportive for economic growth.	Lower nominal economic growth and the delayed/ineffective vaccination proces seem the main risks for the state finances.
Fixed income market	Global and Polish economy will normalize in 2021 and so will long end yields. NBP won't change rates in 2021 but big % share of foreigners in 10Y bonds suggest that bear steepening is the most likely scenario for 2021. Yield increases will be limited by the ongoing QE program and falling inflation.	If the vaccine hopes are premature and the world output remains lower or even depressed for longer forcing central banks to act more (in the case of NBP it would probably mean more QE).
FX market	We expect the zloty to gain in 2021 and return towards 4.30 per euro by the year-end, the level that has served as a medium-term anchor for EURPLN before the pandemic broke out.	Main risk factors for the currency include higher global risk aversion, dollar appreciation, no-deal Brexit, disappointment with the speed of vaccination in Poland versus other countries.

Economy

1

Covid-19: wave-breaker on the horizon?

The first wave of the Covid-19 pandemic was mild in Poland. The government reacted quite early, imposing severe restrictions on social mobility and business. The result was a limited contagion (new daily Covid-19 cases in spring fluctuated around 10 per 1 million inhabitants, much lower than elsewhere in Europe), but still a severe loss of economic output in 2Q (see p.10).

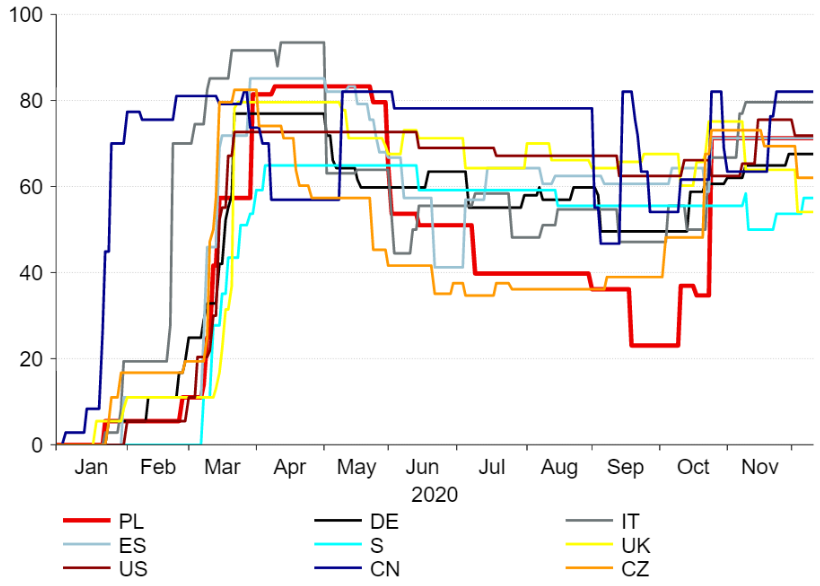
The situation in the second round of the pandemic was very different, as this time Poland happened to be one of the most affected in Europe in terms of new infections and deaths (new daily cases peaked in November at nearly 700 per 1m). Meanwhile, the new restrictions introduced by the government in autumn were more gradual, more selective and much less severe for most businesses than those imposed in the spring.

Currently the spread of pandemic has been contained again and the number of new cases dropped to levels that the government has indicated as thresholds for relaxing restrictions (yet it has also declared the relaxation is unlikely to start before the year-end).

It is too early to say that the threat is gone and we think that it is rational to assume that **we may still face the third wave of the Covid-19 pandemic in winter, before sufficiently large part of the population gets vaccinated against the coronavirus**.

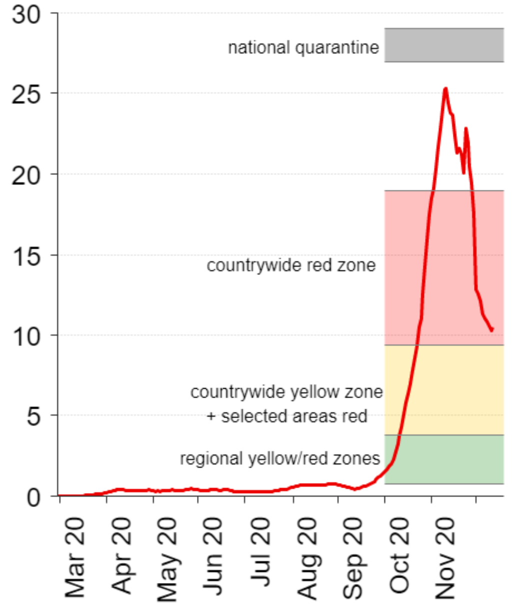
The story may change later in 2021. While there are still many question marks and implementation risks (how quick and effective the vaccination process will be), **we think it is rational to assume that somewhere around mid-2021 the mass vaccination reaches the sufficient level to reduce worries about next waves of Covid-19 so that life starts getting "back to normal"**.

Oxford University Stringency Index



Source: Refinitiv Datastream

Covid-19 in Poland: new daily cases (7d moving average) and the government's thresholds for relaxing restrictions



Source: Refinitiv Datastream, Santander Bank Polska

Government's guidance for relaxing pandemic restrictions:

National quarantine: leaving home: only for essential needs; cultural institutions: closed; public transport: 50% of seats / 30% total; churches: 1p/20m2; gatherings: max 5 people; weddings: banned; fairs, events: on-line; education: remote; shopping malls: only selected shops, 1p/20m2; hotels: only business travel; gastronomy: only take-away; hairdressers: closed; gyms, aquaparks: closed;

Red zone: leaving home: limits for youth <16y; cultural institutions: 25% audience; public transport: 50% of seats / 30% total; churches: 1p/15m2; gatherings: max 5 people; weddings: banned; fairs, events: on-line; education: classes 1-3 on-site; shopping malls: open, 1p/15m2; hotels: only business travel; gastronomy: only take-away; hairdressers: 1.5m distance; gyms, aquaparks: closed;

Yellow zone: leaving home: unrestricted; cultural institutions: 25% audience; public transport: 50% of seats / 30% total; churches: 1p/7m2; gatherings: max 25 people; weddings: max 50 people; fairs, events: on-line; education: hybrid; shopping malls: open, 1p/7m2; hotels: unrestricted; gastronomy: open 6:00-21:00; hairdressers: unrestricted; gyms, aquaparks: open, 1p/7m2 or 50% capacity;

Green zone: leaving home: unrestricted; cultural institutions: 50% audience; public transport: 100% of seats / 50% total; churches: 1p/4m2; gatherings: max 100 people; weddings: max 100 people; fairs, events: 1p/4m2; education: hybrid; shopping malls: unrestricted; hotels: unrestricted; gastronomy: unrestricted; hairdressers: unrestricted; gyms, aquaparks: open, 1p/7m2 or 50% capacity;

Covid-19: vaccination speed matters

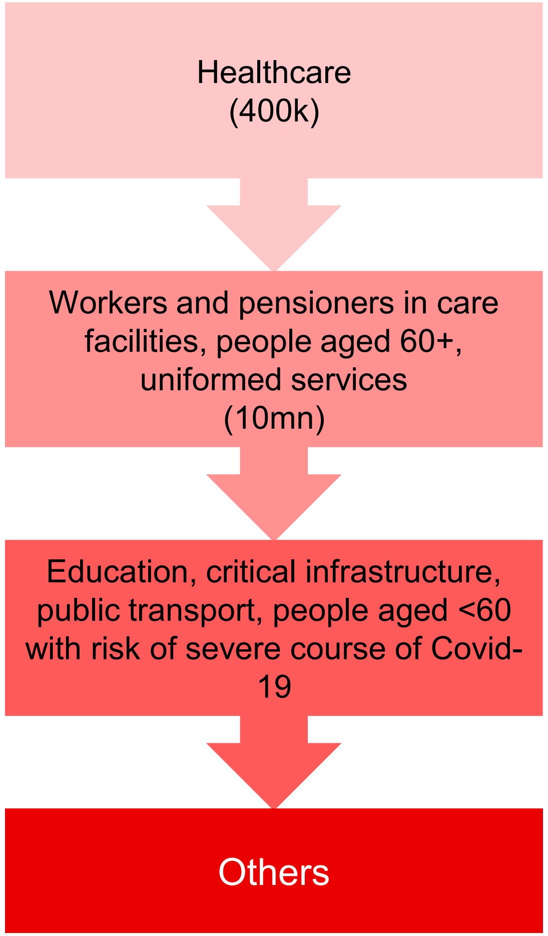
The government has presented its draft vaccination strategy outlining the assumed order of socio-economic groups eligible for vaccination. **The aim is to reach the herd immunity.**

The government is planning to finance the vaccination process and to distribute vaccines free of chargé. 62mn shots have already been booked. The process of qualifying medical points for vaccine distribution is underway. According to the spokesperson for the government, points qualified so far could service 3.4mn doses per month (850k per week). However, this number should be treated as tentative, as the process of qualifying vaccination points is underway.

According to our simulations, 850k shots per week could safeguard herd immunity in late 2021 / early 2022, depending on the levels of natural immunity (we think 10-15% is feasible) and on the length of vaccine-induced immunity (we assumed > 1 year). The number of vaccinations has to excceed 2mn per week to reach the target in 1H21.

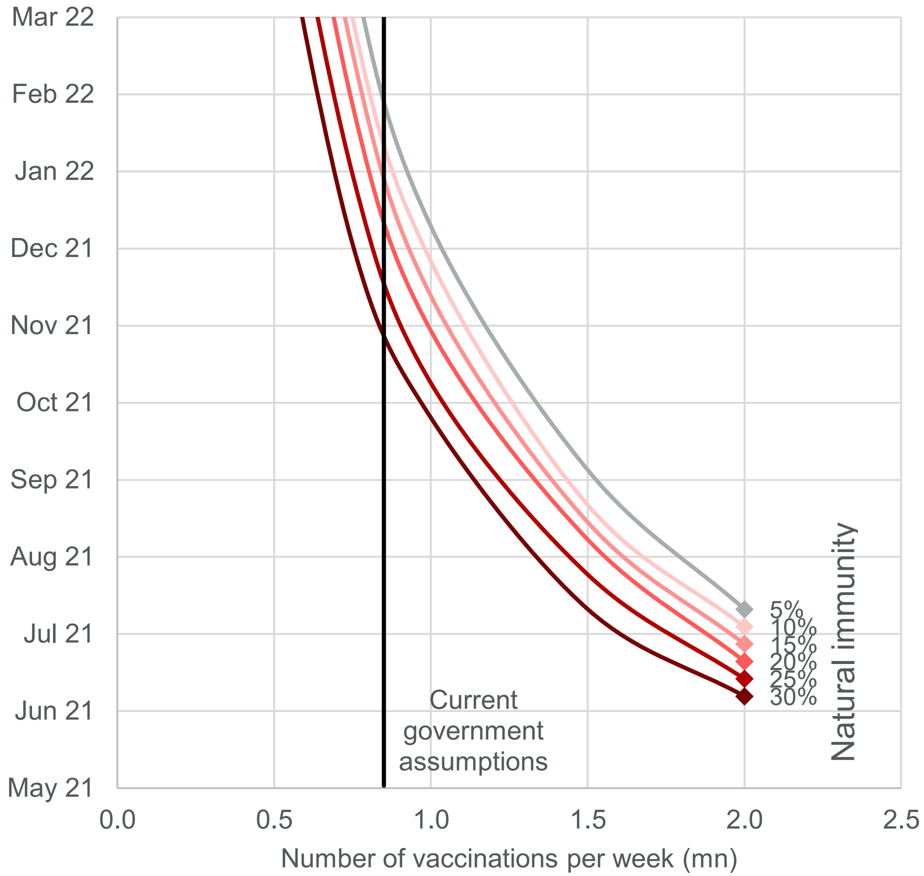
However, the expected pace of vaccinations is enough to vaccinate all the seniors by August/September. As this demographic group is the most vulnerable to Covid-19, we think that this will allow to avoid 2020-style lockdowns in 2H21.

Vaccination order according to government strategy



Source: Polish government

When can we reach herd immunity?



Assumptions: vaccine effectiveness – 95% after two shots, immunity after vaccination: >1 year, R0 – 2.5 (60% immunity = herd immunity), start of vaccinations: 1st February. Natural immunity = immunity acquired by people who recuperated from Covid-19

Source: Santander

The first wave: sharp drop, sharp rebound

The first wave of Covid-19 pandemic, triggering widespread country lockdowns and disruptions in supply chains, was devastating for European economies in 2Q. All countries recorded a sharp output drop in the spring, which – fortunately – was followed by a relatively rapid and vigorous rebound in the summer, after the lockdowns and restrictions were lifted.

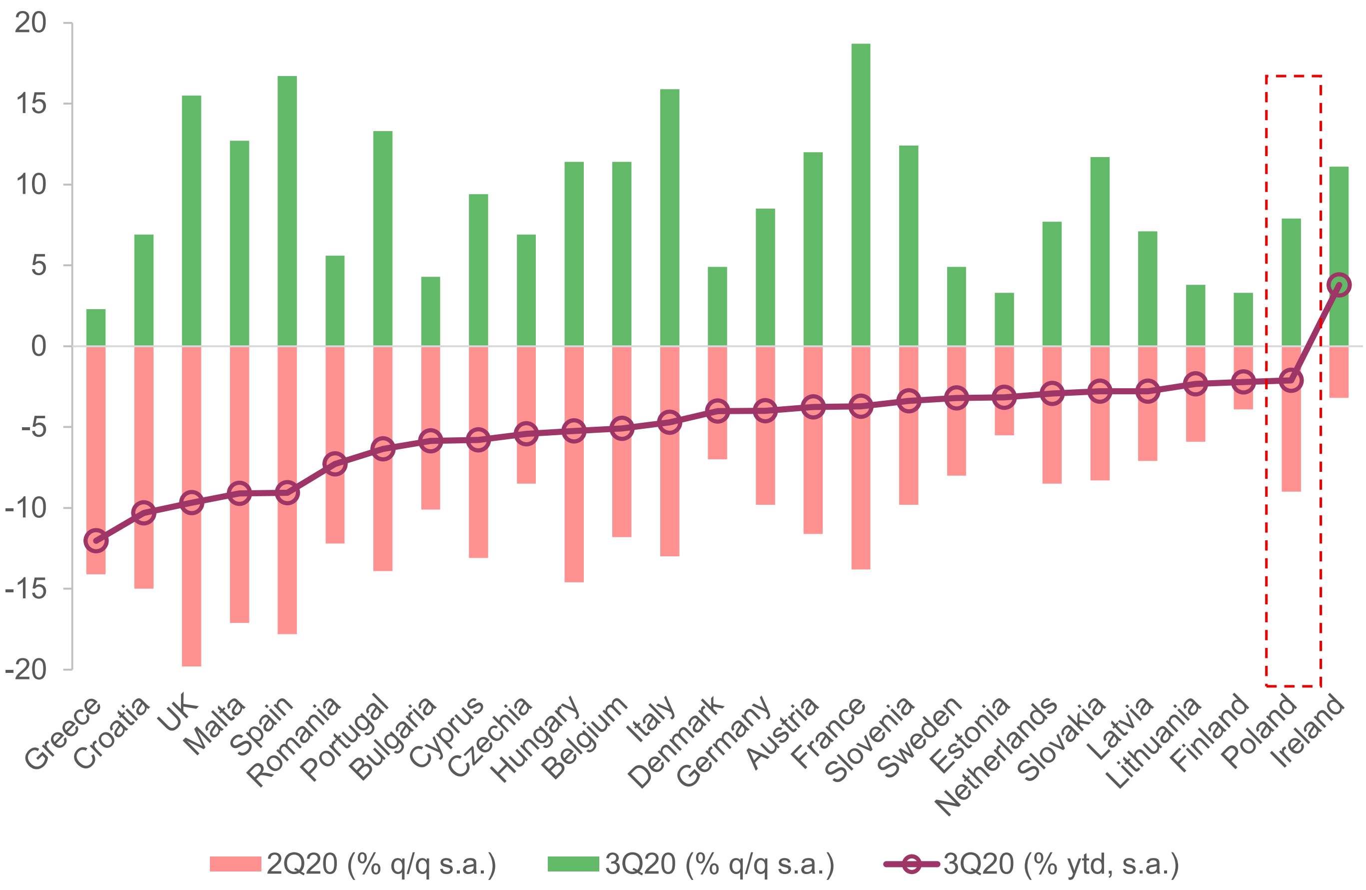
Poland was somewhere in the middle of EU27 group when it comes to the severity of GDP shock in 2Q alone, but if we look at cumulative performance in 1Q-3Q, it recorded the second best result among all the European countries.

Both 2Q and 3Q were not as bad for the economy as we had worried in the early stage of the pandemic, which is good news.

As we indicated in the earlier MACROscope, the structure of Polish economy has magnified the scale of shock in Q2: despite exceptionally low exposure to travel and tourism, Poland has relatively large reliance on industry (24.6% of GDP in Poland, 19.2% in other EU countries), which in Q2 was heavily affected by widespread restrictions.

However, such structure of the economy is likely to be helping us in the next wave(s) of pandemic, when manufacturing seems to be much less (if at all) affected (see next pages).

GDP change in 1Q-3Q 2020 - the impact of the first wave of Covid-19 pandemic



Source: Eurostat, Santander

Santander

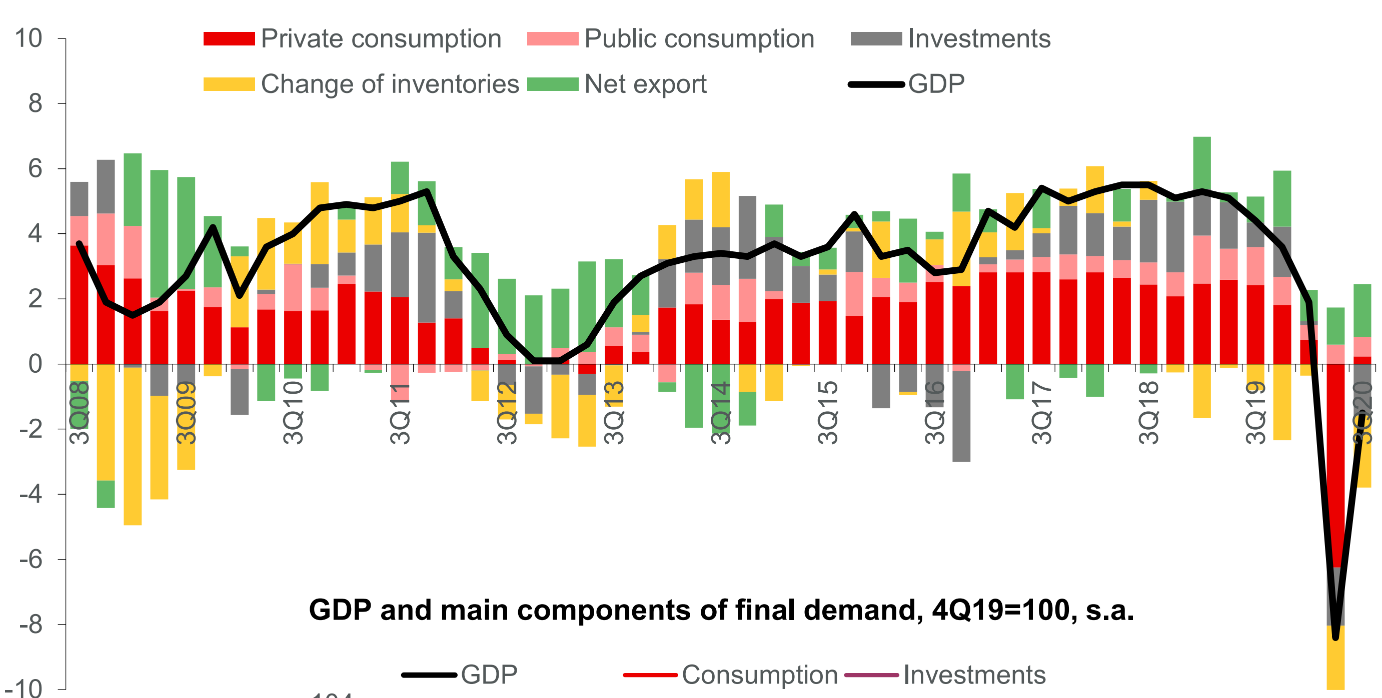
The first wave: broad-based demand disruption

The nature of the economic disruption in the worst-hit 2Q20 was unlike any other in the past. All main components of the final demand contracted sharply, as a result of the widespread restrictions on social mobility and business activity.

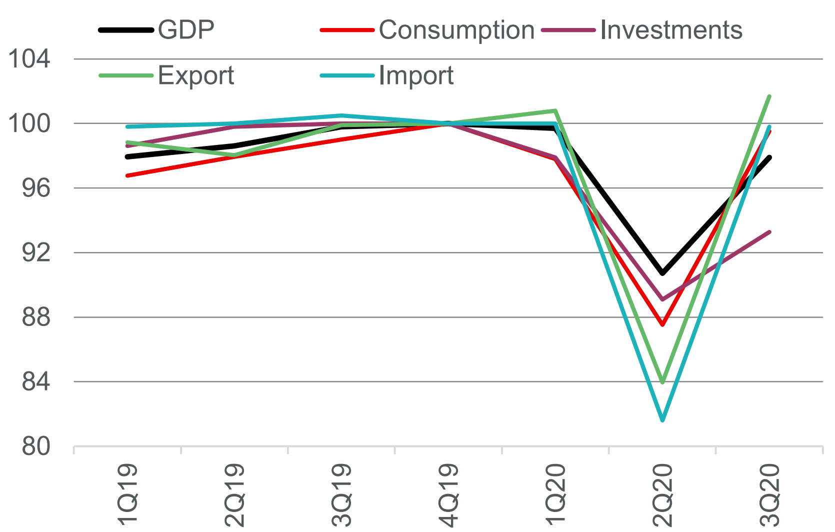
For the first time ever the private consumption, which usually tends to be smoothing the cycles, dropped more than the usually volatile fixed investments. Interestingly, the shock in external trade was even stronger than in the domestic demand, but – at the same time – much more short-lived.

The evidence to date shows that – contrary to some hypotheses at the start of the pandemic – **the pandemic did not trigger any substantial structural changes in consumer or firms' behaviour, that would have a long-lasing negative impact on economic growth**. Once the lockdowns have been lifted the pent up demand showed up and activity surged in most of areas (with exception to those which are still subject to some regulatory limitations)

Polish GDP, growth structure by demand components, % y/y



GDP and main components of final demand, 4Q19=100, s.a.



Source: GUS, Santander

Santander

The second wave: this time is different

As we wrote at the beginning, **even though the second wave of pandemic hit Poland much harder in terms of infection numbers, its economic impact seems to be much milder**. It resulted from a combination of factors:

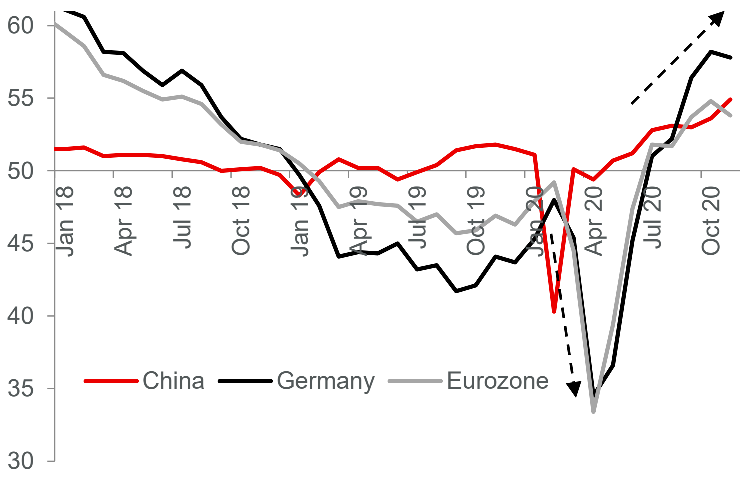
First of all, unlike in the spring, when a sudden stop in international trade took place, currently the trade channels and international supply chains seem largely unobstructed. Turnover in international trade and global export orders are quickly reviving, supported by strong demand from Asia (which has avoided the new wave of pandemic).

As a result, and also due to the fact that the restrictions imposed by governments are generally more selective and less severe, manufacturing sectors across Europe seem to be mostly unaffected and continue expansion. German industrial sector seems to be leading the way, which is good news for Poland, given this is our biggest trading partner (with almost 1/3 share in total exports).

Even in services, where renewed restrictions curbed activity again, the contraction is clearly smaller than in the spring.

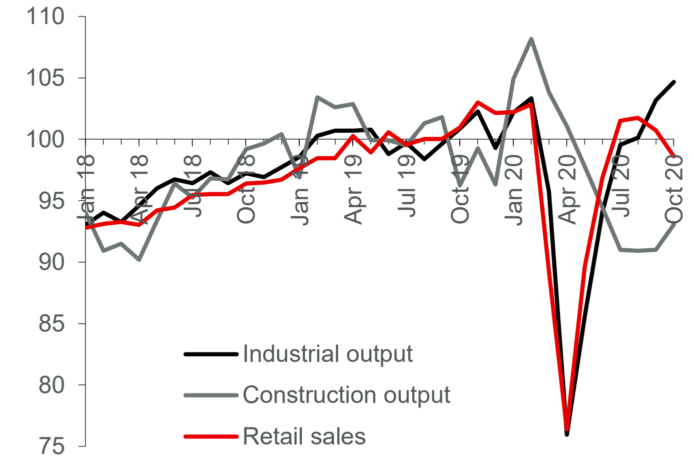
We think that **even if we face another wave of infections in 1Q21, the nature of the economic disruption should be similar to the current one, i.e. much milder and more contained than the one experienced in the spring**.

PMI in manufacturing



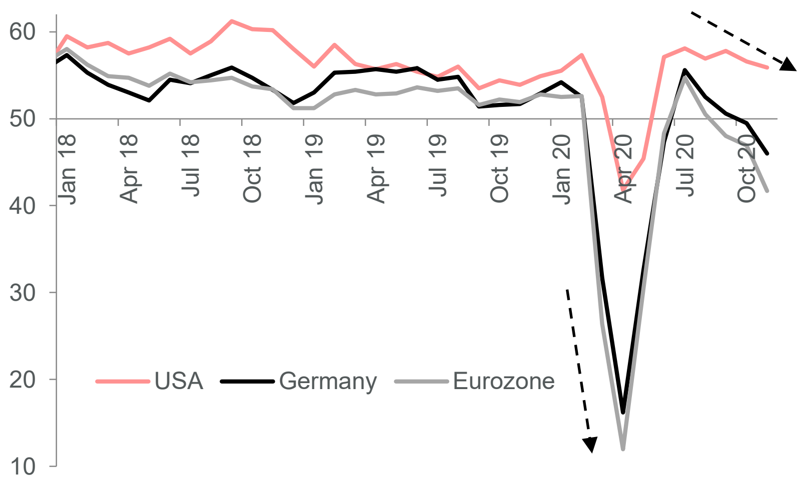
Source: IHS Markit, Santander

Poland: industrial and construction output, retail sales in constant prices, 2019=100 (s.a.)



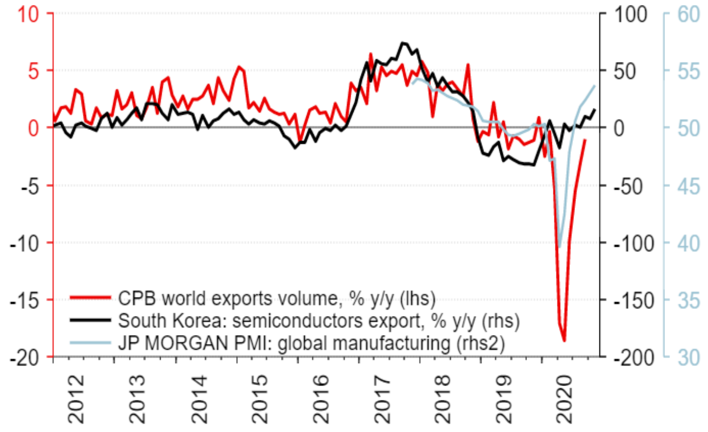
Source: GUS, Santander

PMI in services



Source: IHS Markit, Santander

Activity in international trade



Source: Refinitiv Datastream, Santander

GDP outlook: Vu-shaped scenario?

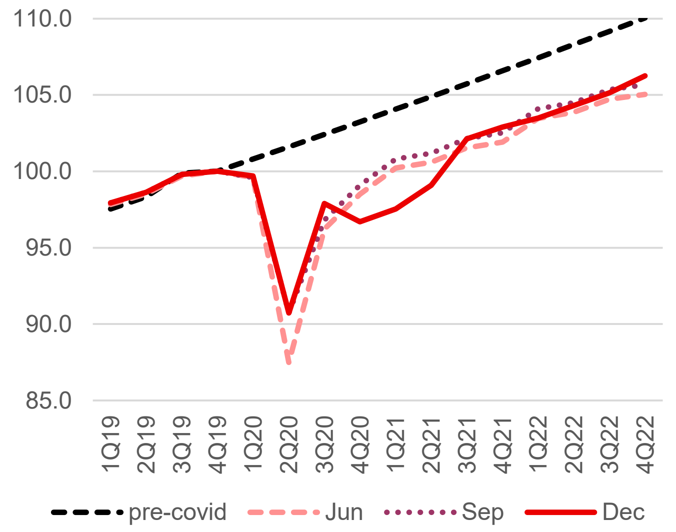
While earlier this year we were hoping for a V-shaped GDP scenario, the reality proved more complicated than that and hard to describe by a single letter. If we were to find a fancy acronym for the currently predicted scenario, it would be "Vu".

Right now we are in the middle of the second dip in this cycle, which should be shallower yet longer than the first one – in our view, the activity shall remain subdued also in 1Q21 as the pandemic threat is unlikely to disappear throughout the winter. Looking ahead, we expect to see a more significant rebound of economic activity in 2H21, after progress in mass vaccination removes worries about next waves of pandemic, unlocks the pent up demand and brings the economic activity back to the pre-pandemic levels.

We think that GDP growth next year may reach 4.6% on average (very close to 2019's 4.7%) and will be fuelled mainly by a solid rebound of domestic demand, private consumption in particular, with a bit delayed and weaker investment rebound. Net exports, while still in big surplus, will be negative for GDP growth despite solid export performance, as import revival would gain speed in 2H.

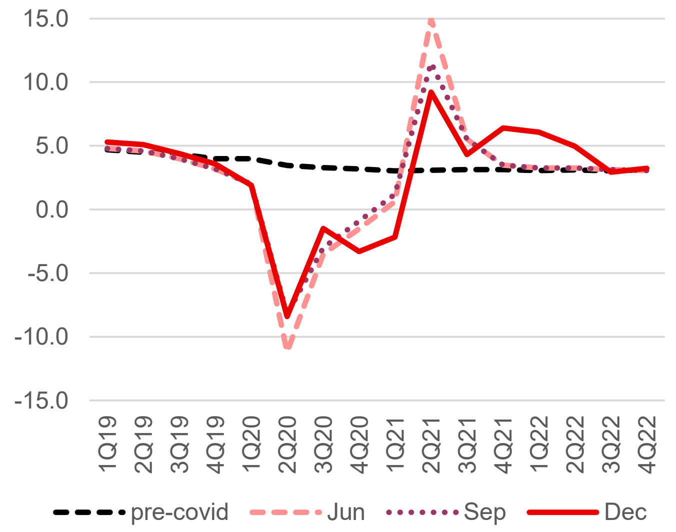
Given the extremely large fluctuations of output levels in recent (and coming) quarters, the year-on-year growth rates in 2021-22 will be subject to strong base effects and could be misleading. Therefore, we prefer to look at the (seasonally adjusted) output levels wherever possible, to properly assess the nature of the underlying trends.

GDP forecasts (4Q19=100 s.a.)



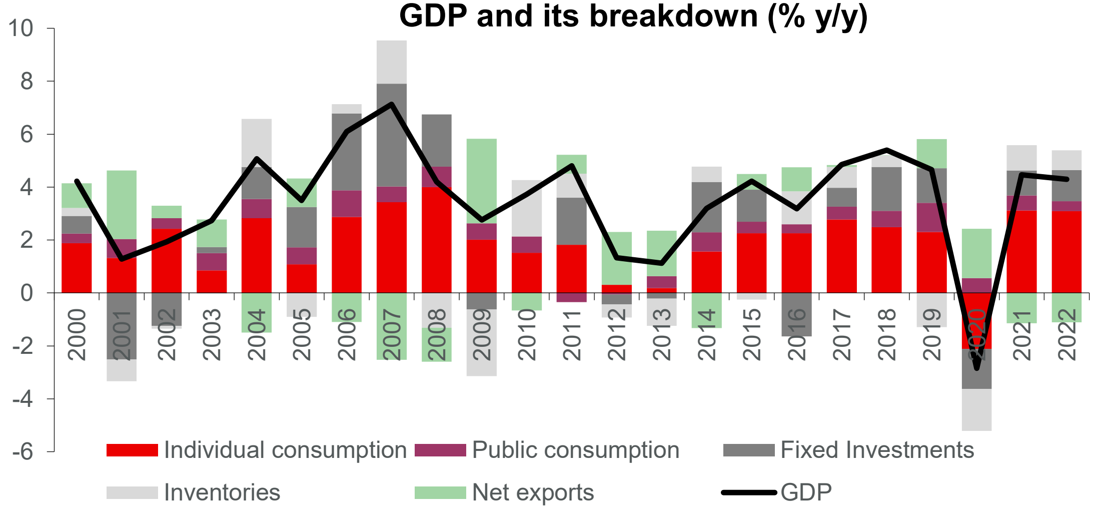
Source: Santander

GDP forecasts (% y/y)



Source: Santander

GDP and its breakdown (% y/y)



Source: GUS, Santander

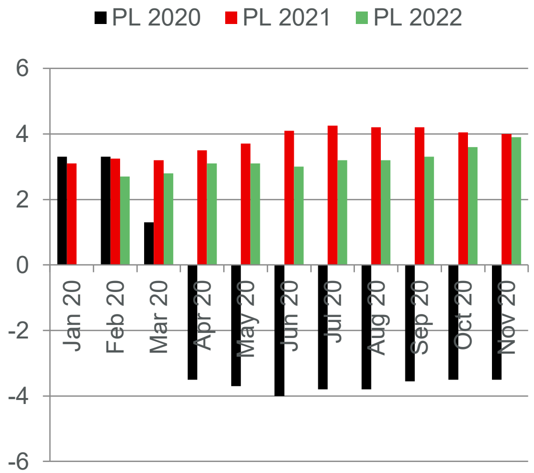
Santander

GDP outlook: our forecast vs others

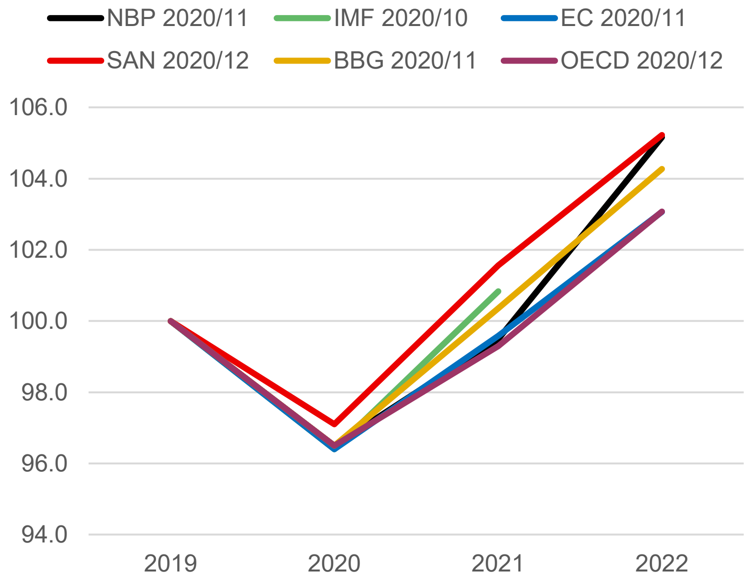
Economic forecasts have fluctuated over the recent months, in line with the changing newsflow. On one hand, the data about 2Q and 3Q surprised mostly to the upside; on the other hand the new, more severe wave of contagion in the autumn has lowered estimates for 4Q. Finally, the recent news about effective vaccines have raised optimism about the time needed to fight the virus. All in all, most of economic forecasts for Poland are currently more optimistic than they were in the middle of the year… at least if we look at the implied output level in 2020-22, rather than at the y/y growth rates.

Our forecast, which has been above market consensus for most of the time, still remains among the most optimistic, although in terms of the predicted level of output in 2021 it has barely changed since June.

GDP growth in Poland, median forecast Bloomberg

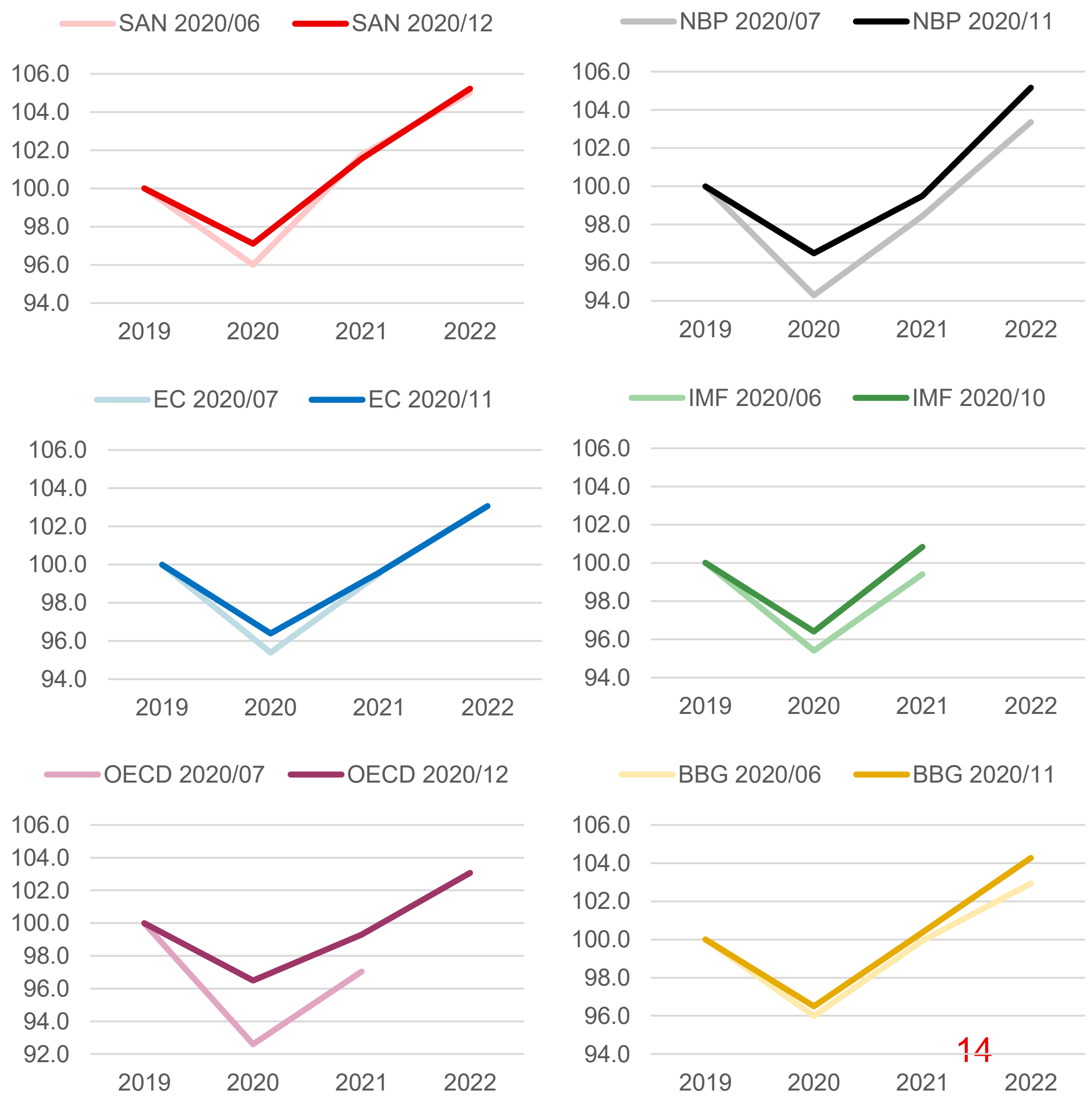


GDP forecasts for Poland, 2019=100



Sources: NBP, IMF, EC, OECD, Bloomberg, Santander

GDP forecasts for Poland, 2019=100



Santander

GDP breakdown: each sector has a different story

While the "Vu" scenario may apply to GDP on aggregate level, different parts of the economy have their own patterns, depending on their characteristic and vulnerability to pandemic restrictions. The charts on the right present how we see the outlook for different areas and sectors for the coming quarters:

Industry: V-shaped recovery, largely immune to 2nd wave of pandemic amid foreign trade expansion

Retail trade: Vu-shaped pattern as the second (shallower but longer) dip has been enforced by new restrictions (closing shops, distancing)

Transport, storage: V/Vu – passenger transport affected by restrictions similarly as retail trade, but commercial transport and logistics should benefit from growing international trade and e-commerce

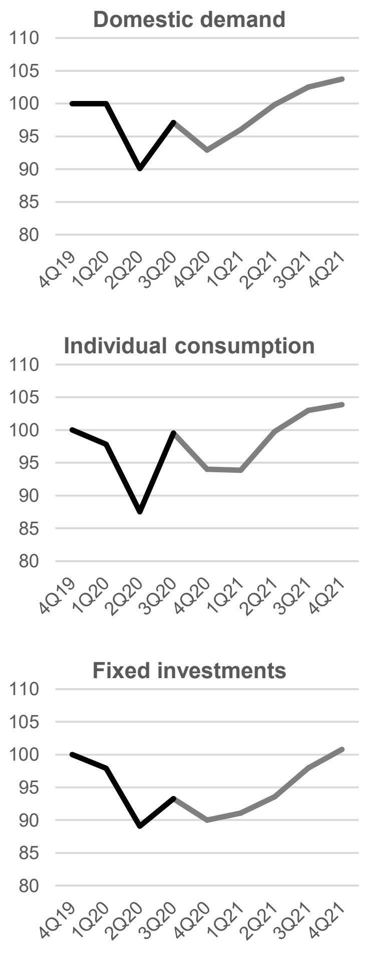
Accommodation and catering: proper W scenario with the second dip as severe as the first one (the winter season may be lost for the tourist business)

Construction: U-shaped pattern – the stagnation will be longer but recovery should start before 2021 ends

Finance: U – zero interest rates to stay for longer, which is a structural negative for the sector

ICT, professional and technical activities: either unaffected by the pandemic or even gaining on accelerated automation and digitalisation

Main demand components (4Q19=100, s.a.)



Source: GUS, Santander

Gross value added in main sectors (4Q19=100, s.a.)

(A) = Professional scientific and technical activities. Administrative and support service activities
(B) = Public administration and defence; compulsory social security. Education. Human health and social work activities

Note: See also the Sectoral supplement (p.50) for more detailed discussion of outlook for specific sectors of the Polish economy prepared by the Strategic Sectors Department

Foreign trade: vivid exports, sluggish imports

Export of goods surprised positively in 2020. This sector recovered faster in Poland than in European counterparts. Growth in consumer durables was particularily strong and Poland is one of their top suppliers to the EU (furniture, consumer electronics, automotive sector).

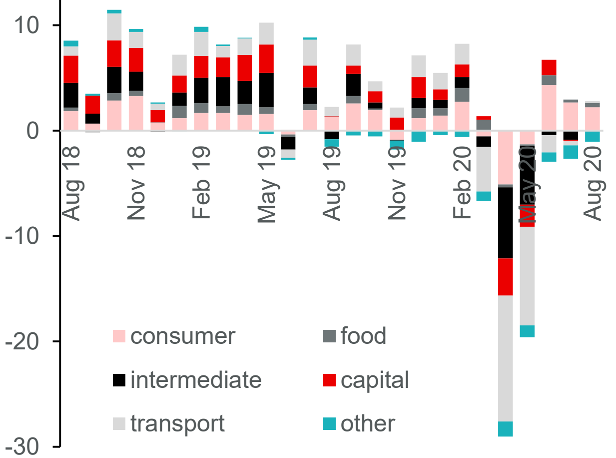
Consumer goods are already contributing more to total y/y exports growth than before the pandemic and are now the backbone of foreign sales with some support from food.

As global economy heads for a broader rebound in 2021, other goods categories of Polish exports should also boom (intermediate and capital goods) so far muted by lockdowns and economic uncertainty. Pandemic is also clearly preventing a recovery of turnover in international services trade.

Import recovered much slower than export to date. Energy commodities and transport equipment were behind this sluggishness. Decrease of social mobility means less demand for fuel, low price per barrel additionally reduced Poland's oil bill. A more stable economic environment is needed for the recovery of demand for cars from companies and households – we believe this should all come next year.

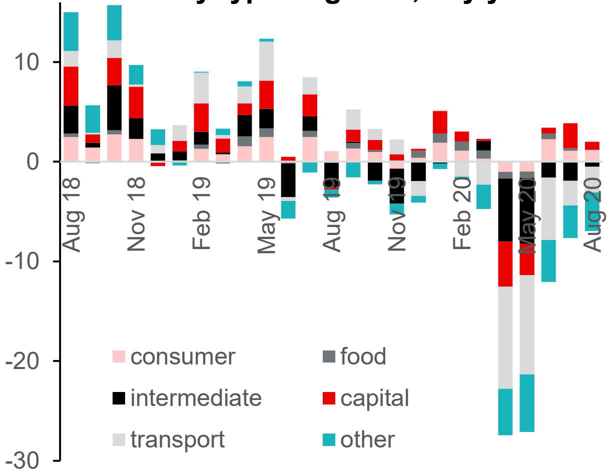
As a result, **post-pandemic return to normality should lead to more balanced C/A**, as goods imports finally start closing the gap to exports on stronger domestic demand. Before this happens we may see the streak of record high C/A surpluses continue – the 2nd Covid-19 wave is likely to weaken imports more than exports. The UK's Brexit preparations most likely created additional demand for Polish goods in late 2020.

Export growth contributions by type of goods, % y/y



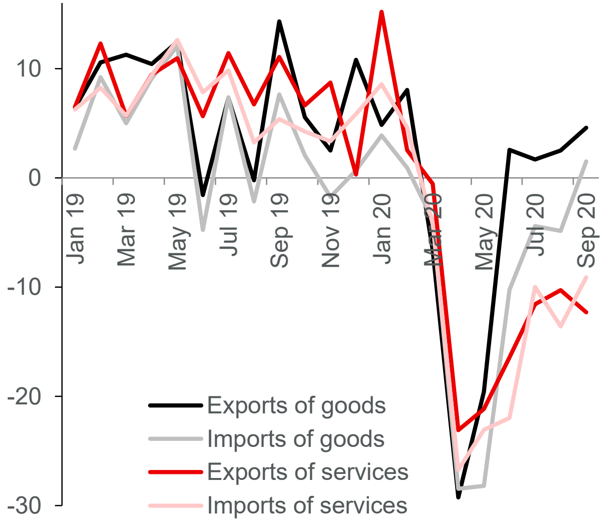
Source: Eurostat, Santander

Import growth contributions by type of goods, % y/y



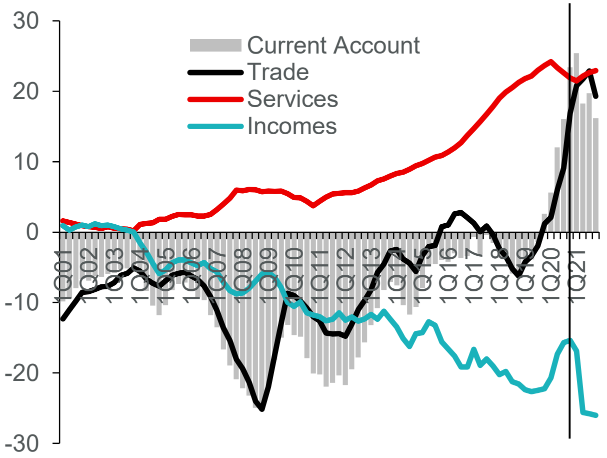
Source: Eurostat, Santander

Foreign trade, % y/y



Source: NBP, Santander

Current account breakdown 4Q sum, EURbn



Source: NBP, Santander

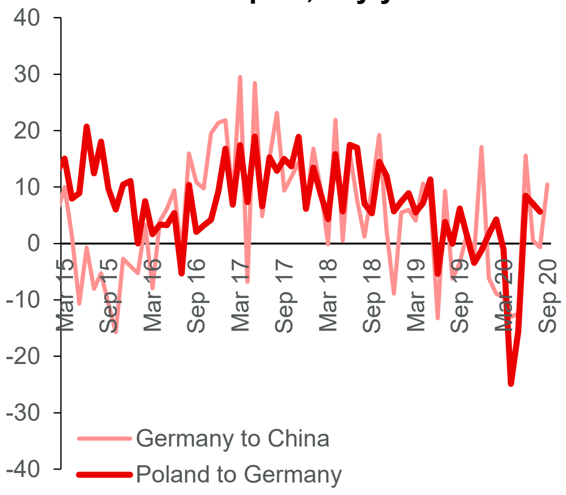
Foreign trade: global recovery and substitution

The expected growth in the eurozone goes up from -7.3% in 2020 to +4.6% in 2021 (Bloomberg consensus). This should secure further growth of Polish export even when base effect starts to reduce the contribution of consumer goods around the middle of next year. **Broad demand from Europe should be returning gradually in the course of 2021** as the pandemic is overcome with the help of mass vaccination.

Apart from the developing momentum of the European economy, we assume that Asia, already enjoying an economic rebound, will provide stable demand for Polish goods in 2021 (note the small decline in dispatch to Asia in spring, when trade with Europe and Americas collapsed). Much of this demand may also show up indirectly in the statistics via our trade link with Germany – note the co-movement of growth rates of export from Poland to Germany and from Germany to China in recent years.

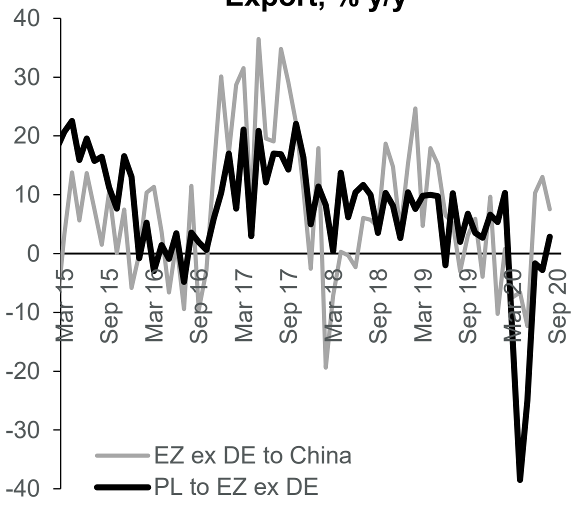
Like during the Global Financial Crisis (GFC), **Polish exporters manage now to grab a larger share of EU markets in the early stage of recovery**. We call this phenomenon a substitution effect, assuming it comes from elevated cost awareness of trade partners who now seek cheaper alternatives Poland can offer. While in the Jun-Aug'20 period total import of all EU countries was still falling y/y on average, in most of them import from Poland was already going up y/y, while in others it was falling less than total import (which is enough to make Polish exporters' market share rise).

Export, % y/y



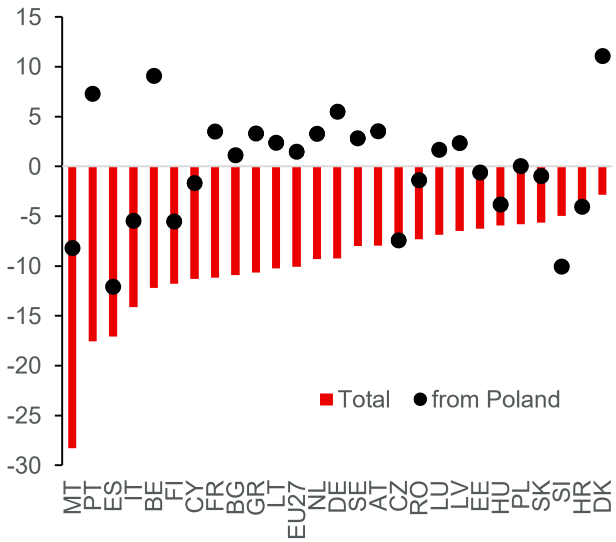
Source: GUS, Eurostat, Santander

Export, % y/y



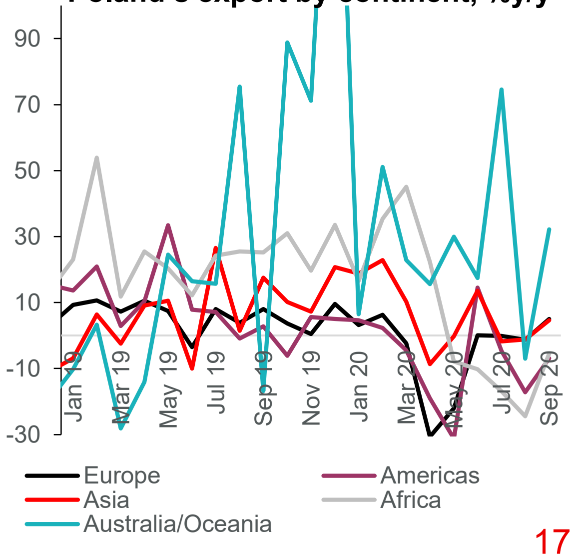
Source: Eurostat, Santander

Import of EU countries, Jun-Aug'20, %y/y



Source: GUS, Eurostat, Santander

Poland's export by continent, %y/y



Source: GUS, Eurostat, Santander

Industry: Poland in the pole position

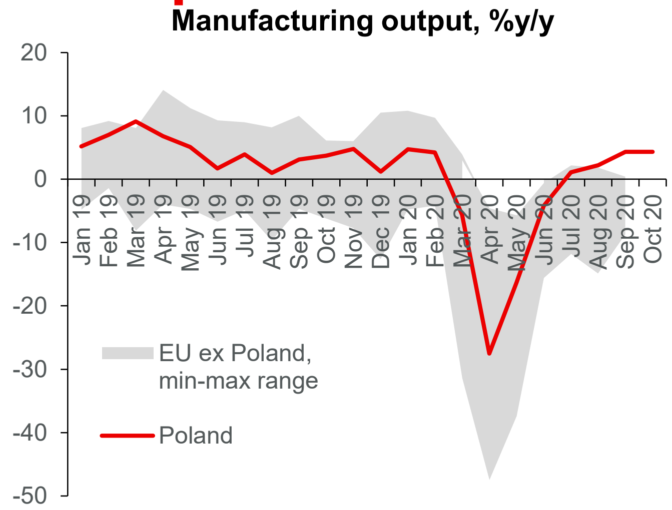
Polish industry re-booted faster after the spring lockdown than other EU countries. It was quite quick to reach positive y/y growth of output. Also, so far Poland is the only country with positive manufacturing output growth in all months since July. It looks like a good starting point for the economic recovery to take place in 2021.

The four largest eurozone economies are still struggling to lift their output in categories like furniture and consumer electronics above levels seen a year ago. In Poland these industries led the recovery.

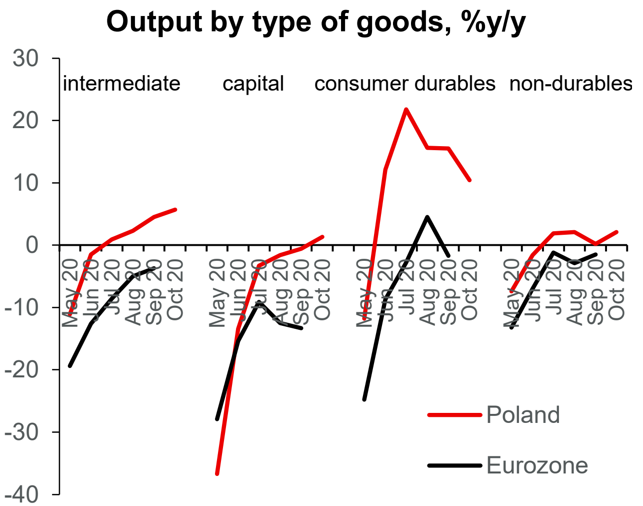
As the eurozone competitors are restoring their economic activity, even more demand for Polish intermediate and investment goods should follow – the categories which so far were regenerating relatively slower.

The vectors of the European recovery, as indicated by the priorities of the Next Generation EU program, are to be digital and green transition. **Poland is perfectly positioned to indirectly benefit from the program**, being one of the main suppliers of IT equipment, hybrid/electric car batteries and parts.

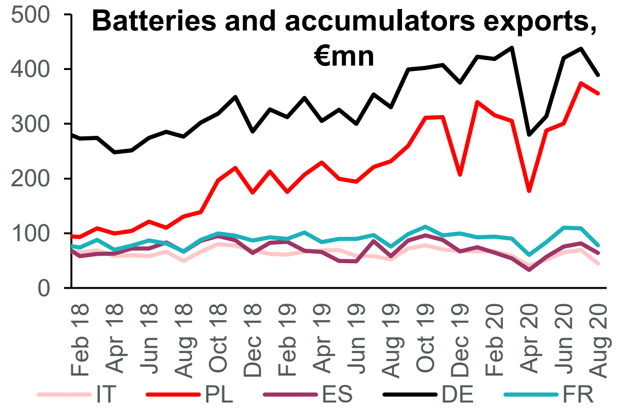
The battery business is still a small share of Poland's total exports (1.9% vs 0.5% two-three years ago), but with c50% y/y since May it is capable of significantly affecting the overall growth rate.

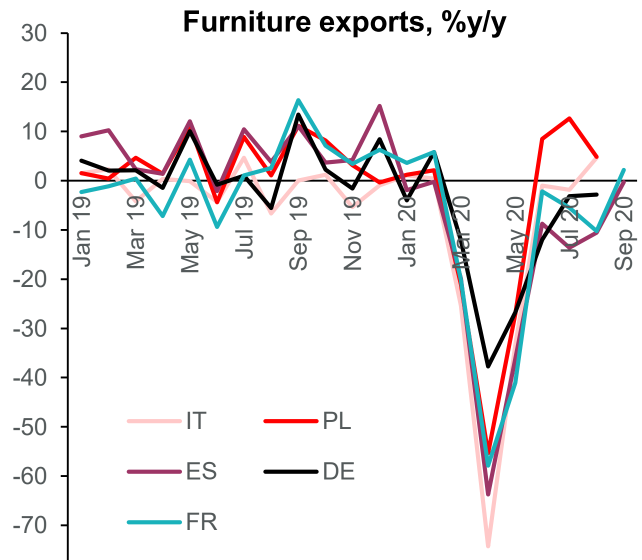


Source: Eurostat, Santander

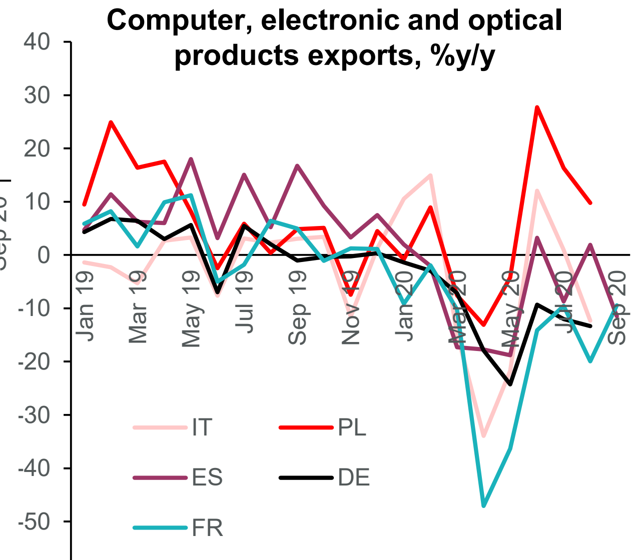


Source: Eurostat, Santander





Source: GUS, Santander



Source: Eurostat, Santander

Investments: to rebound strongly in 2H21…

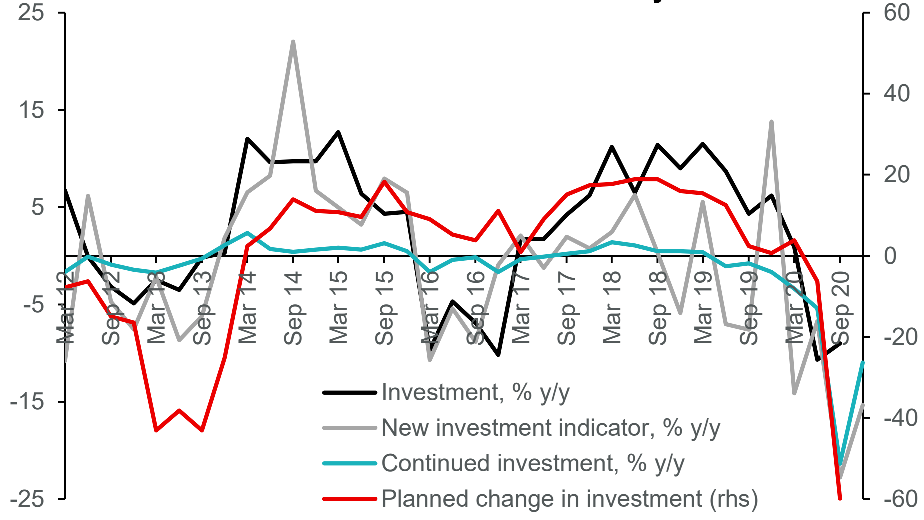
We are expecting investment in annual terms to remain in the negative territory at the start of 2021 and then to rebound to reach double-digit growth rates at the end of the year. Below and on the following page we are presenting our views on investment outlays in particular economic sectors.

Companies, representing about 55-60% of total investment recorded a disastrous drop in investment confidence, exceeding even declines seen during the GFC. However, confidence indicators tend to overreact and given still sound financial situation of Polish corporate sector (see [page 24]), we think that this sector is able to increase its investment activity relatively quickly. While we still have not seen complete data on corporate investment in 2Q and 3Q20, data from biggest companies (employing 50+ people) and data on investment breakdown by assets suggest that 3Q20 saw a rebound after a deep decline in 2Q20, supporting our faith in companies' ability to switch to investing mode relatively quickly. **Thus, while in our view the corporate investment activity went down again in 4Q20** due to the renewed lockdown, **we are expecting a moderate rebound in 1H21 and then an acceleration in 2H21 on the back of diminishing Covid-19 threat.**

Households investment, representing about 18-20% of the total, consists mostly of dwellings and we focus this sector in the paragraph. In 2Q20 home sales tumbled and prices went back a bit, while 3Q20 saw a rebound, also in prices. Revival of home sales and prices in 3Q20 is in our view a proof that households did not lose their appetite for new housing. While labour market lost pace a bit (but is in way better shape than feared), low interest rates securing cheap financing and encouraging to search for alternative investment as well as return of foreign workers (see page 23) are still factors suggesting a strong demand. Still, developers seem to be limiting supply, so while we are expecting **a strong and fast rebound, total household investment is likely to stay below 2019 level (in real terms).**

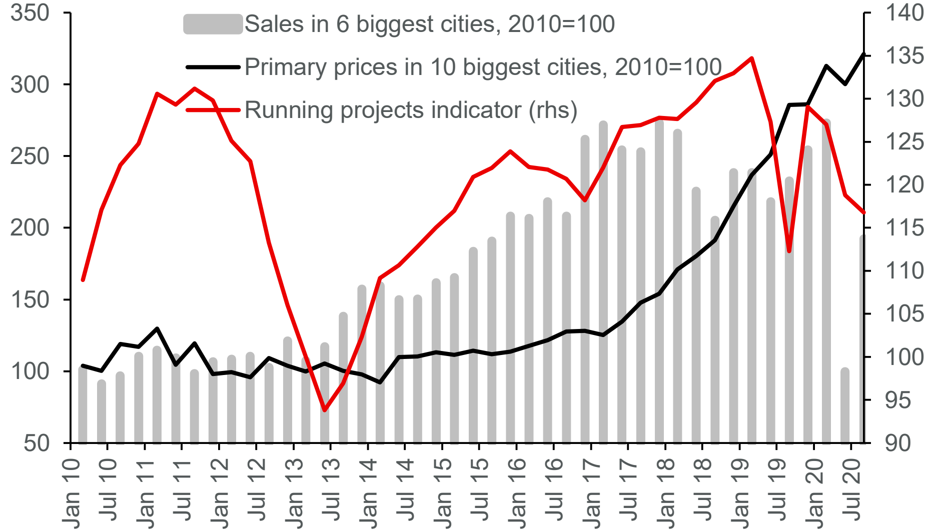
Santander

Investment and NBP investment activity indicators



Source: GUS, NBP, Santander

Housing market indicators



Source: JLL, NBP, GUS, Santander

… but more risks in the public sector

We are expecting the total general government investment activity to remain muted in 1H21 but to gather pace in 2H21, on the back of stronger road investment. That having said, the momentum will be weaker than in the private sector.

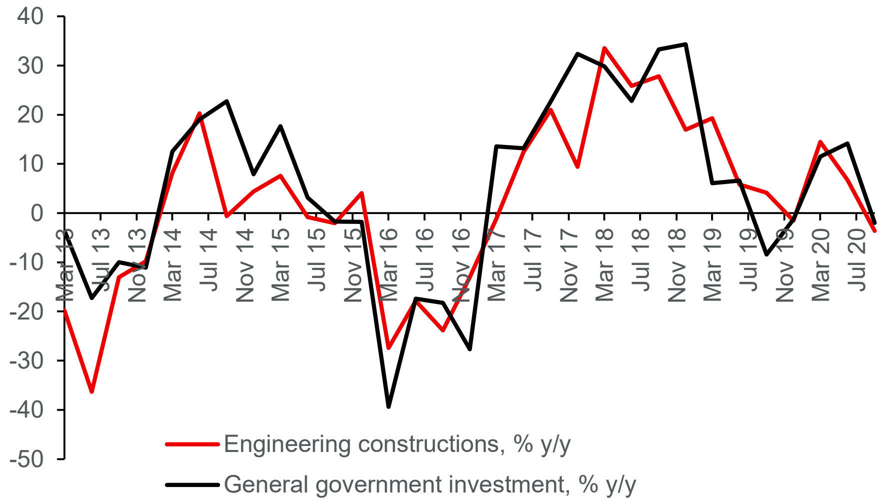
General government sector, representing about 25% of total investment is mostly correlated with outlays on civil engineering works (roads, railroad etc) and was a bright star of investment in 2Q20. However, this was in our view an effect of realisation of higher plans from 2019 and 2H20 is likely to show markedly worse results.

Local governments (accounting for about half of general government investment) plan a slight decline of investment outlays in 2021 and given high correlation between plans and actual spending, assumption of a some decline in this sector comes as an easy call.

As regards central sector, we are mostly interested in the activity of GDDKiA (agency for road investment) and PLK (Polish railways). GDDKiA presented ambitious plans for 2021 assuming road tenders worth cPLN20bn, as compared to PLN12.2bn for 2020 and PLN20.0bn for 2019. Note, however, that there is a long way from the public tender to the actual investment. Given that the current tender activity of this entity is rather low and total value of tenders finished over last few months is lower than in the corresponding period of 2019, we are expecting the road building activity to remain muted in 1H21 but to gather pace in 2H21.

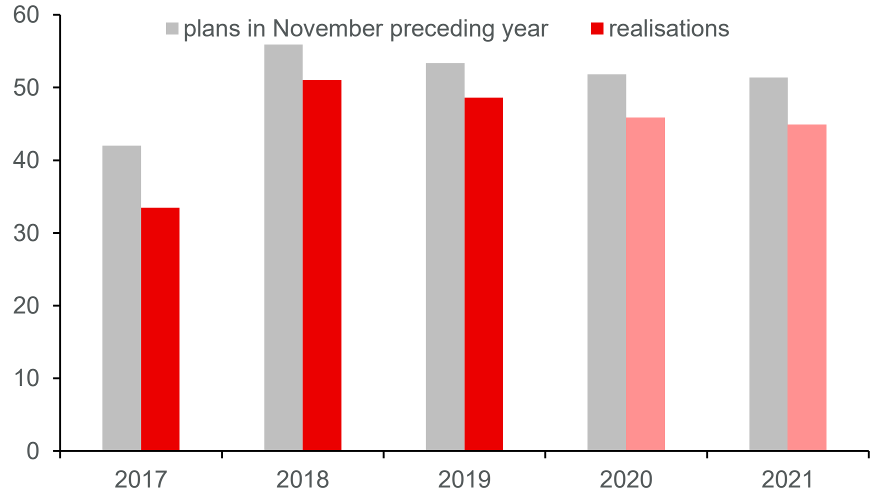
PLK also presented ambitious tender plans totalling PLN16.5bn in 2021. However, about 75% of tenders are planned for 2H21, so effects of the plan are more likely to be visible in 2022 and we are not very optimistic about railroad building activity in 2021.

GG investment vs civil engineering works



Source: Eurostat, GUS, Santander

Investment in local governments – plans vs realisations, PLNbn



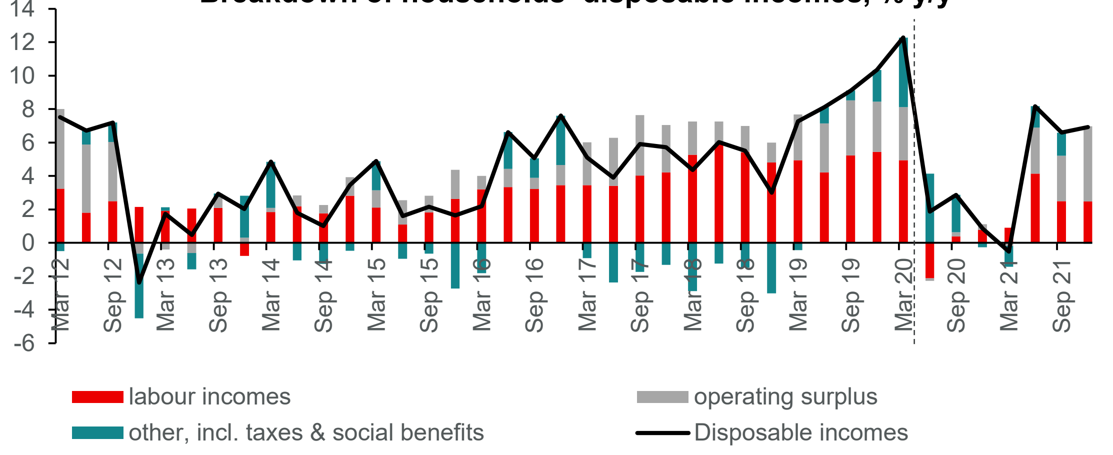
Source: Ministry of Finance, Santander

Consumption: wait for pent up demand to unleash

The pandemic caused a broken pattern in households' spending. Lockdown made it impossible to smooth consumption, hence there was pent up demand building. Consumers were forced - by the circumstances - to save**. The jump in saving rate should thus, in our view, step back in the course of 2021** on growing conviction the battle with the virus has been won (vaccinations and less restrictions). What is more, the robust labour market, another solid minimum wage hike (7.7%) and extra social transfers to retirees (13. and 14. pension) will provide a **decent income base for consumption in 2H21**.

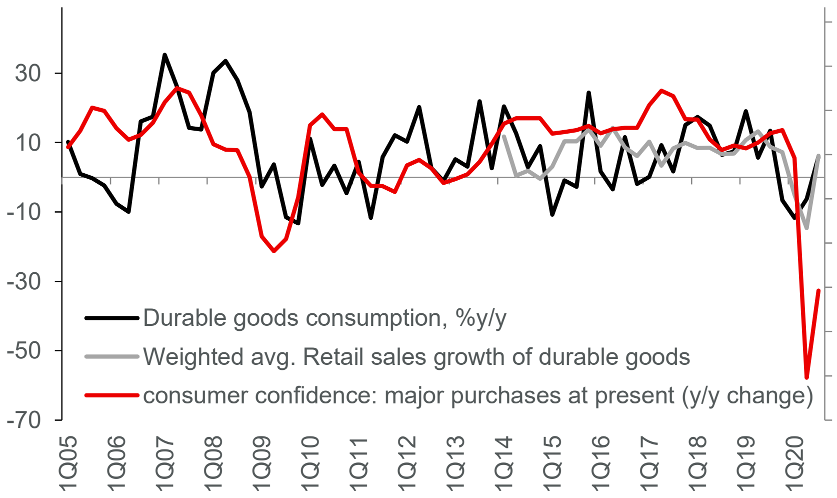
Economic uncertainty should theoretically discourage buying durables… which were booming in 2020 despite consumers' declarations of more caution (elevated saving index exceeded the collapsed major purchases index for the first time ever). What we find more important is that the index of assessment of own financial situation has descended moderately, to the long-term average while many other consumer confidence measures have set record lows. This also suggests **a solid rebound of consumption in 2021 on the back of the pent up demand instead of the currently declared precautionary saving**.

Breakdown of households' disposable incomes, % y/y



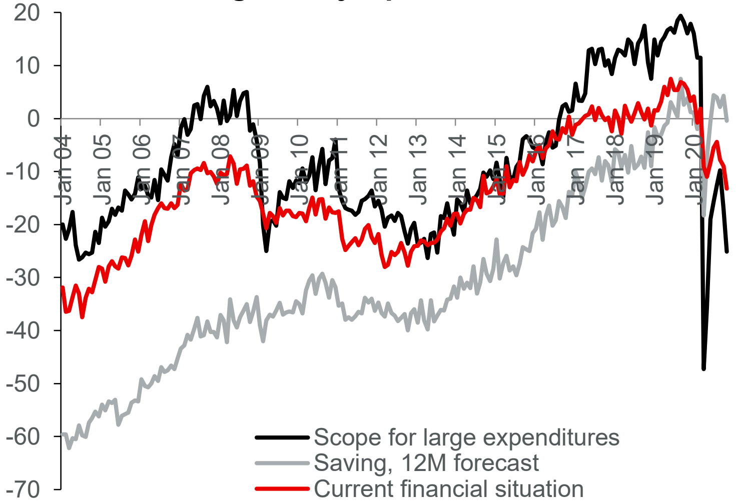
Source: Finance Ministry, Santander

Consumption of durable goods, %y/y



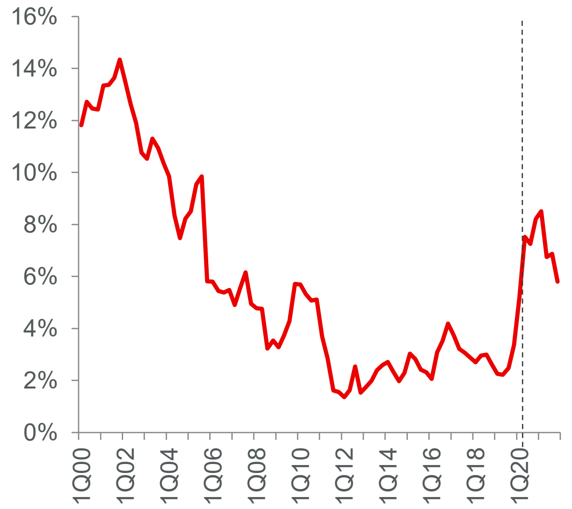
Source: GUS, Santander

Saving vs major purchases indexes



Source: NBP, Santander

Saving rate, %



Source: GUS, Santander

Labour market: robustness to last

Labour market proved surprisingly robust – thanks to government aid packages which encouraged labour hoarding and cutting worktime (as can be seen in average employment statistics) instead of jobs.

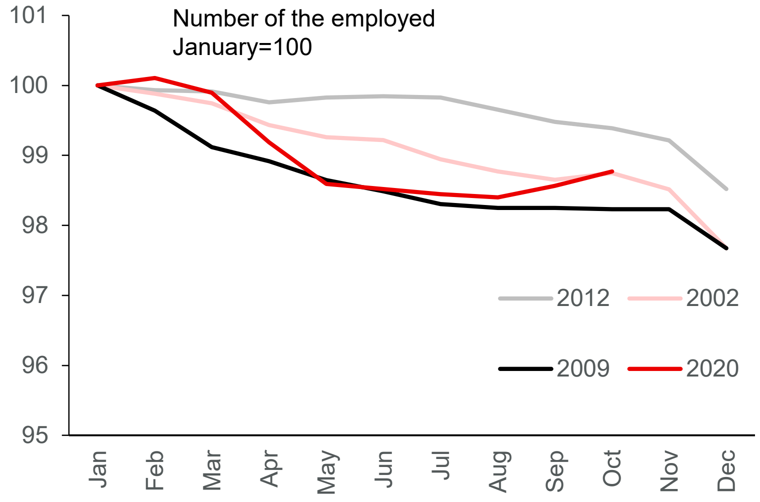
Conversion of a better part of the Financial Shield loan to a subsidy requires SMEs to keep staff level unchanged. **The Shield should stabilise the labour market still in 1H21** as the checkpoint will be in mid-2021. The benefit of labour hoarding may even increase for SMEs next year after the Shield 2.0 is launched (higher share of a loan to be potentially converted).

Labour market responded quickly to improved business climate in 3Q20: firms reduced their job shedding by 24% y/y, from +14.3% in 2Q.

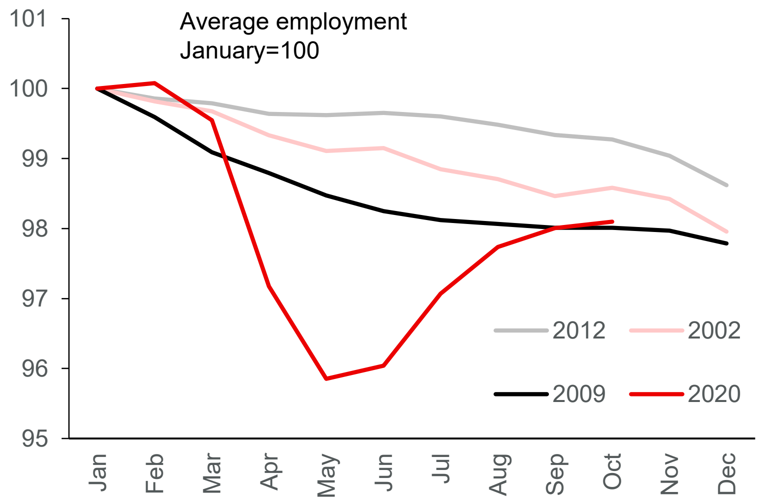
Employment headcount already started growing and fresh labour demand has been mentioned in recent PMI reports (to fill the gaps due to quarantines), despite the 2nd wave of pandemic.

We think, however, that the pickup in the number of jobs in 2021 will be in general rather limited – avoidance of large-scale redundancies during the peak pandemic means that firms have the capacity to cope with reviving demand without new hirings.

Temporary decrease of worktime and labour hoarding

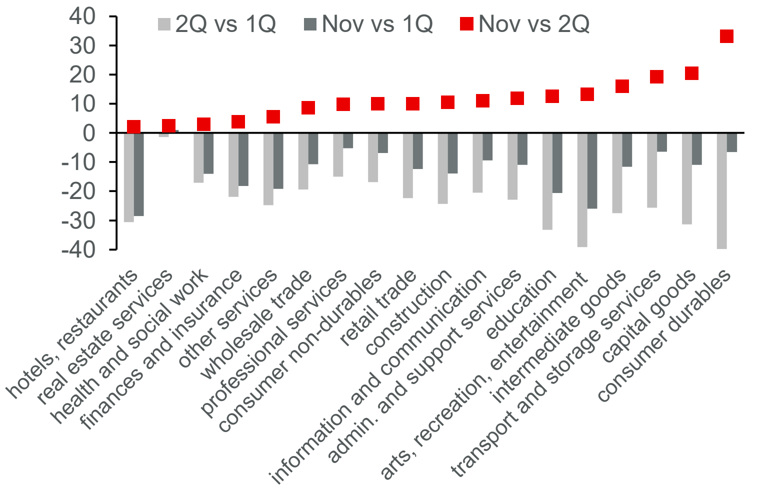


Source: GUS, Santander



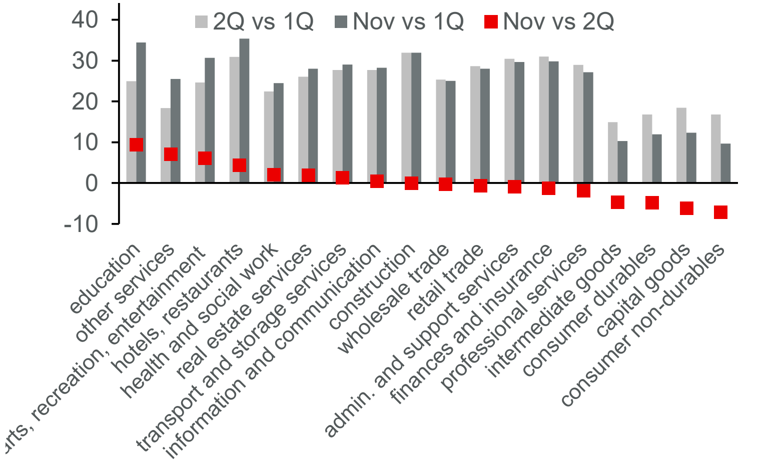
Source: GUS, Santander

Business climate: changes of employment indexes



Source: GUS, Santander

Business climate: changes of econ. environment uncertainty indexes



Source: GUS, Santander

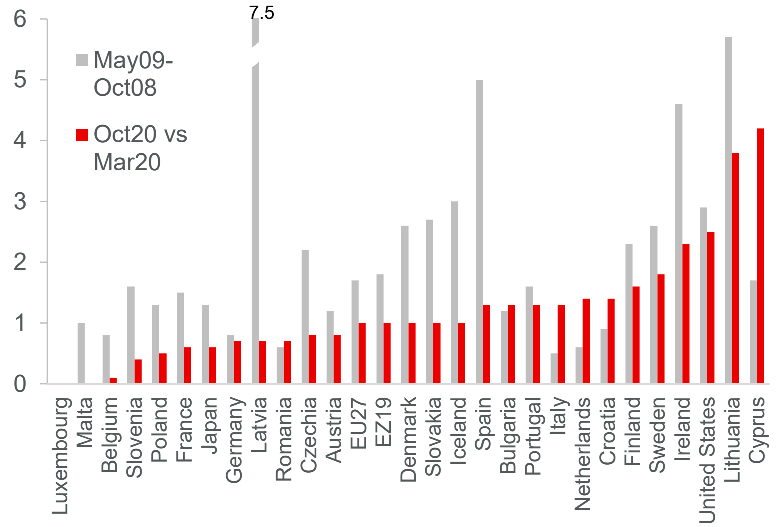
Labour market: mild reaction to date

The reaction of unemployment to the pandemic crisis has been very limited to date – the number of unemployed registered in labour offices in October was 180k higher y/y, while according to the Labour Force Survey (LFS) unemployment went up 90k y/y. It can be explained by a few factors: (1) Labour hoarding by firms and limited jobs reduction, mentioned on the previous page. (2) The fact that large part of those who actually lost jobs escaped to inactivity, instead of boosting unemployment rolls (see the bottom-right chart). (3) Migrant workers were among the first to suffer from job losses and some of them temporarily returned home. Social security data show, however, that this outflow has been already reversed by September (bottom-left).

The peak of unemployment rate may be still ahead, but it is unlikely to be much above the current levels, in our view. Once the economy revives in 2H21, the jobless rate should stabilise at still moderately low level.

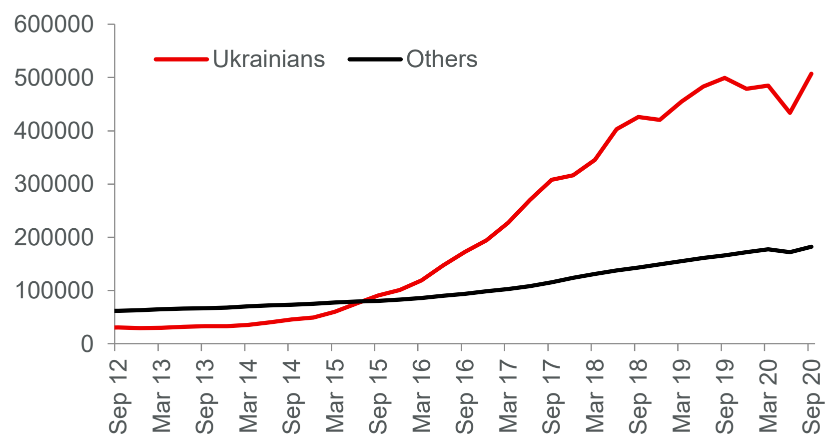
The relatively small labour market reaction to the current economic shock is not only Poland's characteristic but quite broad phenomenon (upper-right chart), resulting from the record fast and record big state interventions aimed at avoiding collateral damage from the pandemic.

Change in LFS unemployment rates by country: Covid-19 crisis vs GFC (first 8 months)



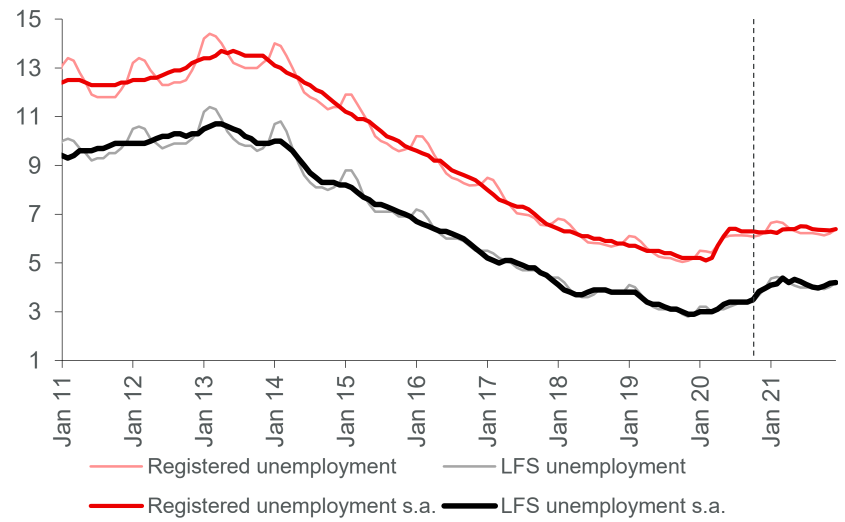
Source: Eurostat, Santander

Non-resident workers registered in social security (ZUS)



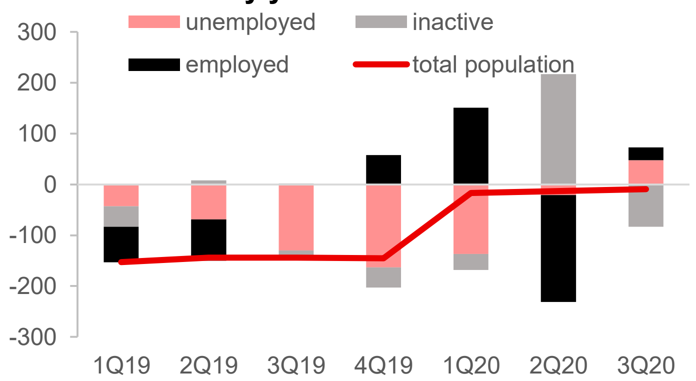
Source: ZUS, Santander

Unemployment rate, %



Source: GUS, Eurostat, Santander

Change in labour market status according to LFS, y/y thousands

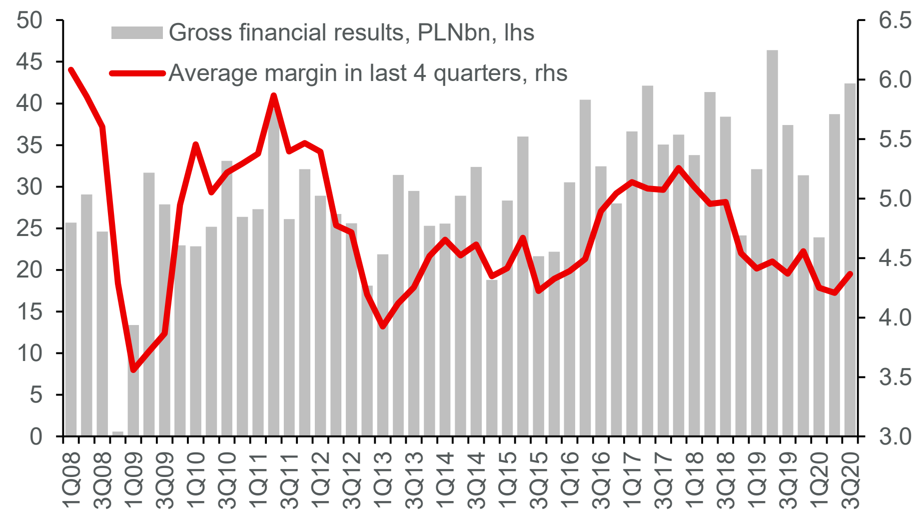


Source: GUS, Santander

Corporate sector: fairly unscathed

Financial results of companies show that the sector did not suffer much from the pandemic. While data show some rising variation (more companies recording higher losses), the average is going up. The biggest companies (employing 50 and more people) witnessed some decline in results and margins in 2Q20, but it was only a petty glitch compared to what happened during the GFC in 4Q08 and in the following quarters. 3Q20 showed a strong rebound and improvement in gross financial results in annual terms. Financial data of SMEs employing 10-49 people showed their financial results and margins improved in annual terms even in 1H20. We do not have data from the smallest companies, but the REGON database showing their total count (dominated by sole proprietorships) revealed a major decline in March and April, which was more than offset in the months to come.

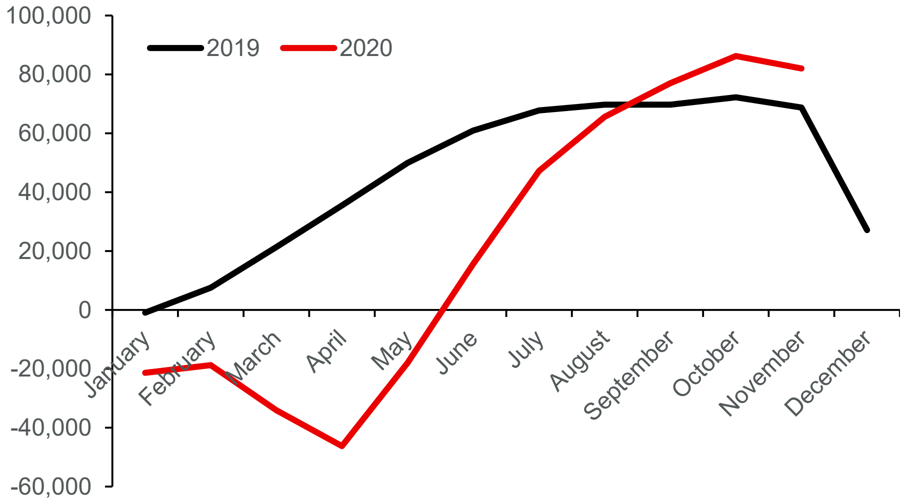
Financial results of companies employing 50 and more



Source: GUS, Santander

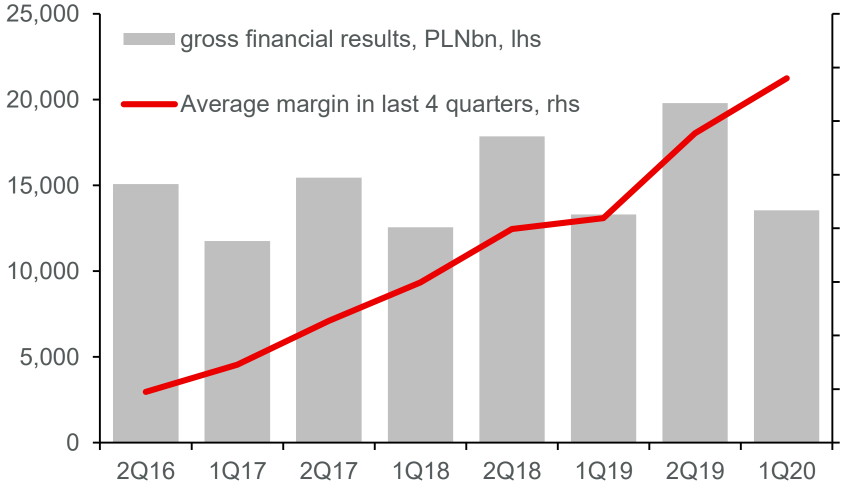
Quite good financial results mean that the sector will be able to turn to the investment mode quite quickly and will not be eager to lay off staff. The government's lifeline programmes surely can take some credit, but it requires more research to state its impact numerically.

Cumulated ytd net registrations of companies in REGON



Source: GUS, Santander

Financial results of companies employing 10-49



Source: GUS, Santander

Santander

Inflation: to go down in 2021…

We are expecting CPI inflation to go down to 2.3% in 2021 from 3.4% expected in 2020. Lower momentum of food prices will be the main factor dragging inflation down and we discuss this issue on the following page. Growth rates in other categories will also go down, in our view, mostly due to still strongly negative output gaps in Poland and globally. There will be, however, several administrative factors contributing positively to CPI in 2021:

1) Introduction of power surcharge in electricity bills (+6% to electricity prices, +0.25pp to total inflation).

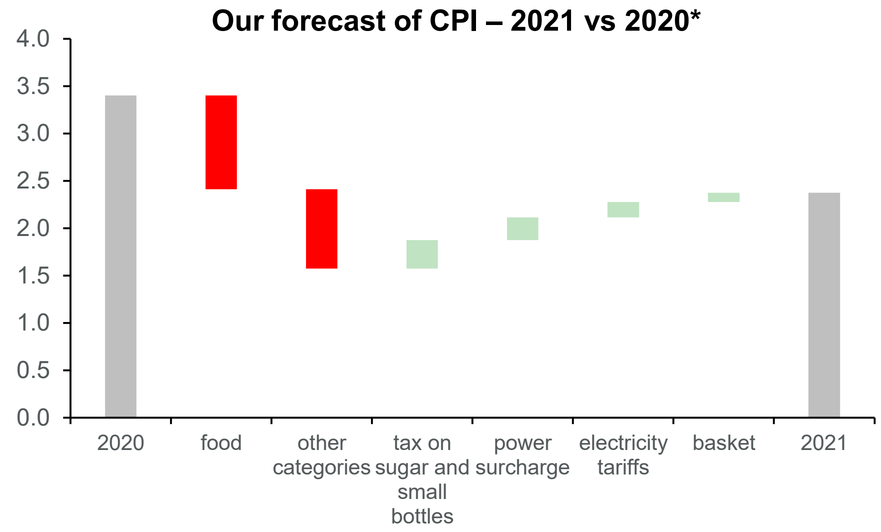
2) Hike of electricity tariffs (+3%, +0.1pp to CPI)

3) Introduction of tax on sugar drinks and alcohols in small bottles (+0.3pp to CPI)

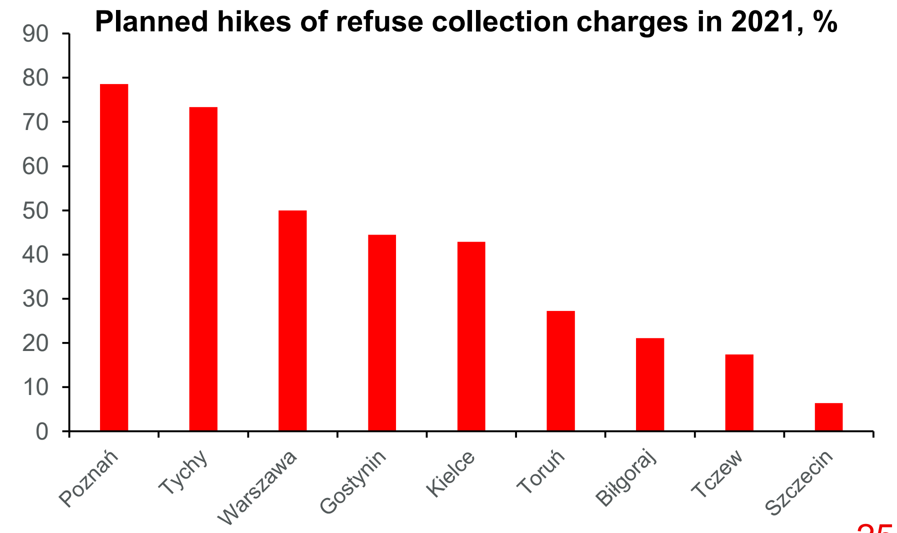
4) Further rise of refuse collection prices, many local taxes and TV/radio tax (+0.1pp to CPI)

5) Recalculation of CPI basket. While usually this procedure does not affect CPI markedly, this time the epidemic really shook the consumer demand and its breakdown. Thus, basket changes can be a bit more significant, provided that GUS is not going to account for these epidemic-induced temporary swings. We are expecting an increase in weights of food and housing costs and a decline in others. Note however there will be also major refurbishments within categories, e.g. with culture and recreation witnessing a decline in cinema or theatre services, but increase in TV subscriptions or recreational durables. We estimate this change to add 0.1pp to CPI.

Risks to our forecasts seem fairly balanced. If vaccination process is not smooth and further lockdowns are introduced, there could be a stronger downward pressure on prices. On the other hand, if the economic rebound is stronger than expected, companies could be more eager to rebuild their margins and to raise prices.



Source: GUS, Santander * green = positive contribution, red = negative contribution



Source: Santander

… mostly because of food prices

We are expecting the food prices to rise by 1.7% in 2021 versus 4.8% in 2020, deducting about 1.0pp from CPI. This will mostly stem from developments in meat and vegetable/fruit prices.

Meat prices fell dynamically in 2020, mostly due to limited demand resulting from lockdown of HoReCa (impact mostly on gourmet meats like beef) and export limitations due to the ASF outbreak in Germany (pork) or bird flu (poultry), faced with oversupply in meat production. We are expecting this factors to carry into 1H21. In 2H21, supply is likely to be reduced and demand to return with falling Covid-19 risks and this should allow meat prices to recover. On average meat prices could be somewhat below 2020 level, though.

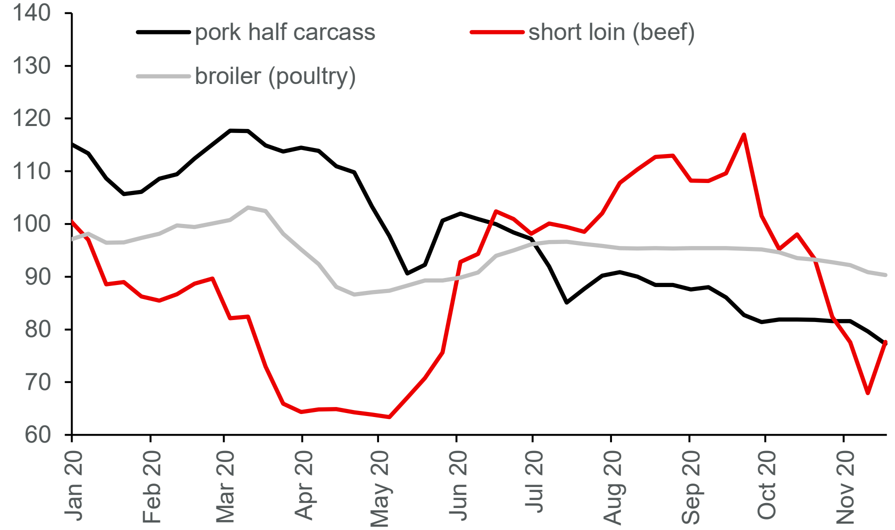
Output of **vegetables and fruit** was quite decent in 2020 and this will put a cap on prices in these categories, at least in 1H21. We have found a quite strong correlation between domestic output and change in prices until April next year. In 2H21, the 2021 weather conditions will be key and we see some upward risk here, given the increasing occurrence of droughts.

Grain prices went up, given limited supply (lower wheat output in the EU, and grain output in the Ukraine) and strong demand (surge in animal output in China) and we are expecting this process to continue in 2021, affecting bakery prices.

Dairy product prices declined during the pandemic but then were gradually rising. We are expecting this trend to continue in 2021. Economic rebound should be supportive for dairy consumption, so the upward momentum is likely to gather pace in 2H21.

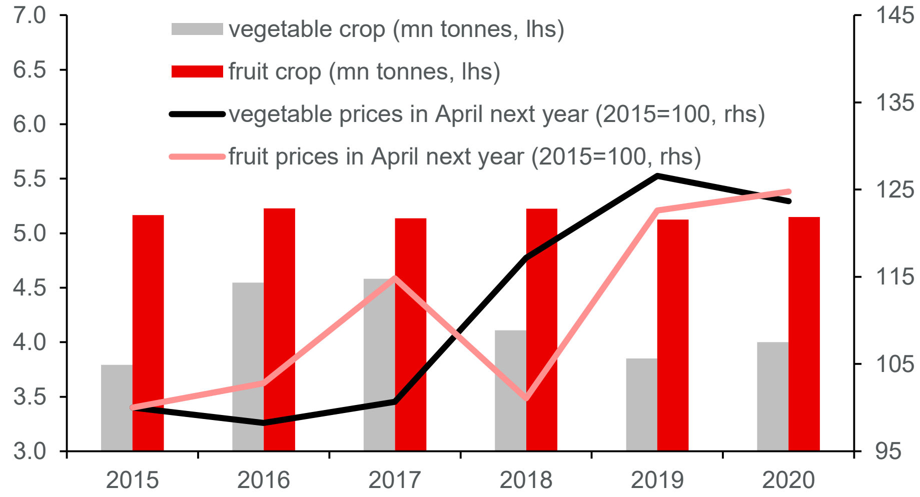
.

Prices of meat, 2019=100



Source: Agriculture Ministry, Santander

Vegetable and fruit output and prices



Source: GUS, Santander

Santander

Inflation: closing the gaps

In 2020 the Polish inflation behaved way different than its eurozone counterpart, climbing even more and staying stubbornly high during the pandemic. Polish consumer inflation also detached from the path of PPI. **There are several such gaps and all seem to indicate that CPI wandered too far up. We believe downside adjustment should come next year**.

Part of the Poland-eurozone gap was caused by discretionary decisions rather than market forces. Unlike in the eurozone, administered prices growth skyrocketed in Poland and will not totally fade in 2021, but at least this gap will narrow.

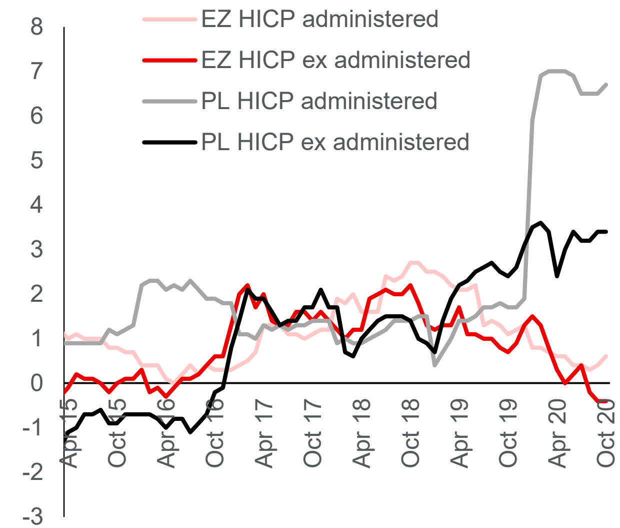
Another gap can be spotted in HICP ex administered prices. Services prices inflation was building up in 2019 on high labour costs. The pandemic acccelerated the process in Poland but dampened the eurozone counterpart. Note that the Polish one tends to follow the trend set by the eurozone one, temporarily pushing higher (and rarely below the latter). Energy price hike and moderate wage growth in 2021 (labour hoarding may delay wage pressure during economic rebound, productivity needs to recover first) may lead to still positive, but less striking growth of services prices in Poland.

There is a tight co-movement of the non-core part of inflation in Poland and the eurozone. A gap appeared during the Global Financial Crisis, due to heavy depreciation of the zloty. This explanation will work only partially for the current gap. We think the Polish carbon-based electricity generation (relatively expensive due to CO2 permits) may make it difficult for the gap to close entirely.

Historically, PPI inflation worked as a leading indicator for consumer prices inflation. The gap is already quite wide, signalling limited cost pressure on companies to raise own prices. The solid level of profit margins seems to confirm this.

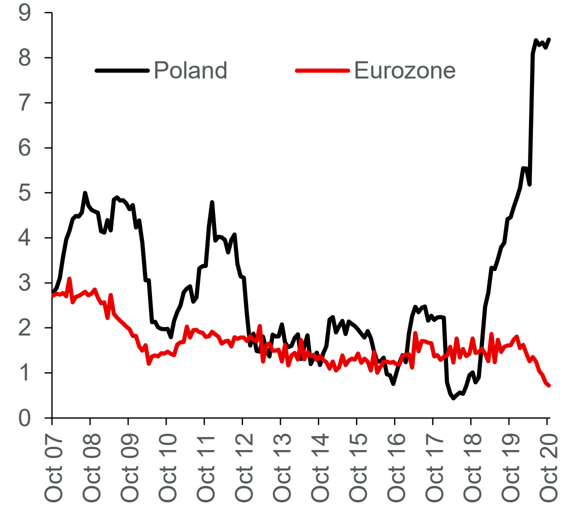
Santander

Administered prices, %y/y



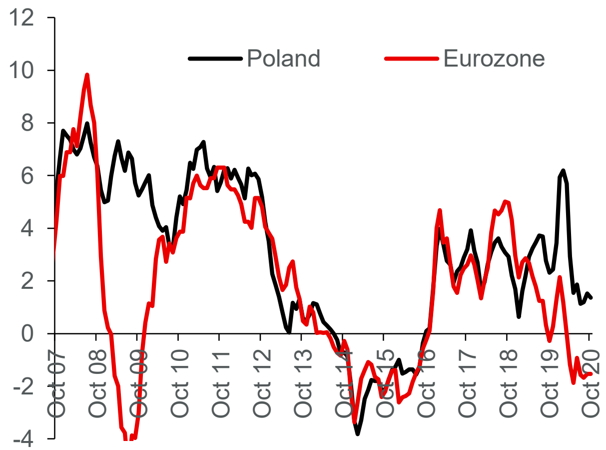
Source: Eurostat, Santander

HICP core inflation non-tradable part, %y/y



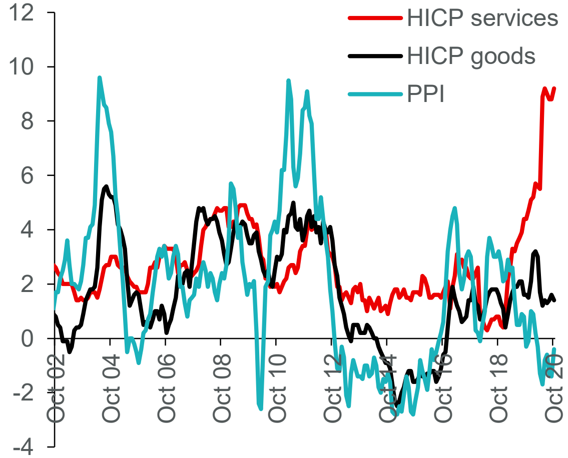
Source: Eurostat, Santander

HICP non-core inflation, %y/y



Source: Eurostat, Santander

PPI vs consumer inflation categories, %y/y



Source: Eurostat, GUS, Santander

Loans to rebound slowly

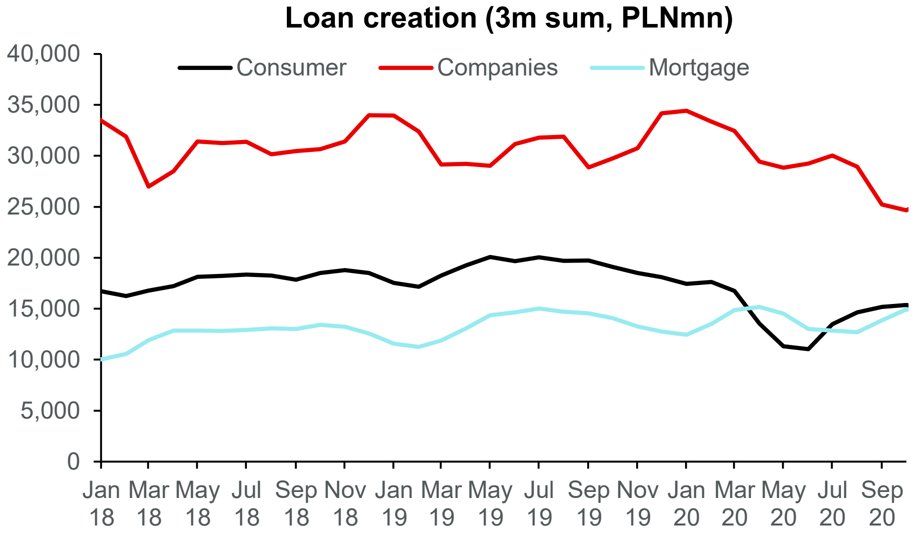
We are expecting annual loan growth to turn positive in 2021, but to remain muted. In our view, the deposit growth will remain way stronger and is likely to stay close to 10% y/y throughout the year.

Covid-19 epidemic has strongly hit loans sales in Poland, mostly through the demand channel. Mortgage loans suffered only slightly and we think that the demand for housing will stay strong. Sales of consumer loans rebounded quickly but remained below pre-pandemic level. It is likely to dip again due to renewed lockdown, but we are expecting a rebound in 2021 together with the stronger consumption. Demand from companies was hit not only by the pandemic, but also by the PFR financial help, which has crowded out loans. The second bout of PFR help, starting in January, will dent loan demand again. Lower investment activity will also undermine companies' demand for loans.

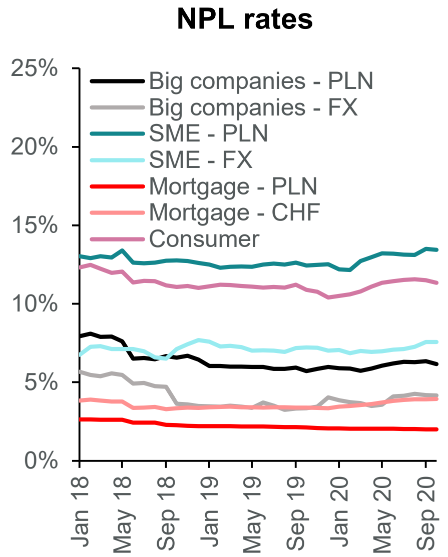
Despite rather muted loan growth, we are expecting deposits to record relatively high growth rates, given additional money creation from epidemic help programmes, high public deficit and expected banks' demand for government bonds.

NPL rates went a bit up, with most considerable rise in CHF mortgage loans in relative terms and in SME PLN loans in absolute terms. These moves were however not significant with total NPL rate at 6.9% in October versus 6.6% in February. There was though some major rise in loan under observation, especially in corporate loans. According to NBP, at the end of 1H20 a total of 12.3% loans for companies and 8.4% of loans for households were suspended. After the first wave of pandemic, rise in NPL was limited by loan moratoria.

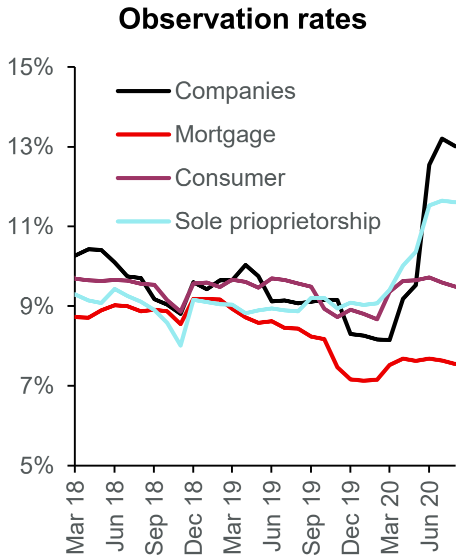
NBP assessed that the Covid-19 did not threaten the financial system stability in Poland despite rising NPL rates and falling revenues. There is also low credit crunch risk.



Source: NBP, Santander



Source: NBP, Santander



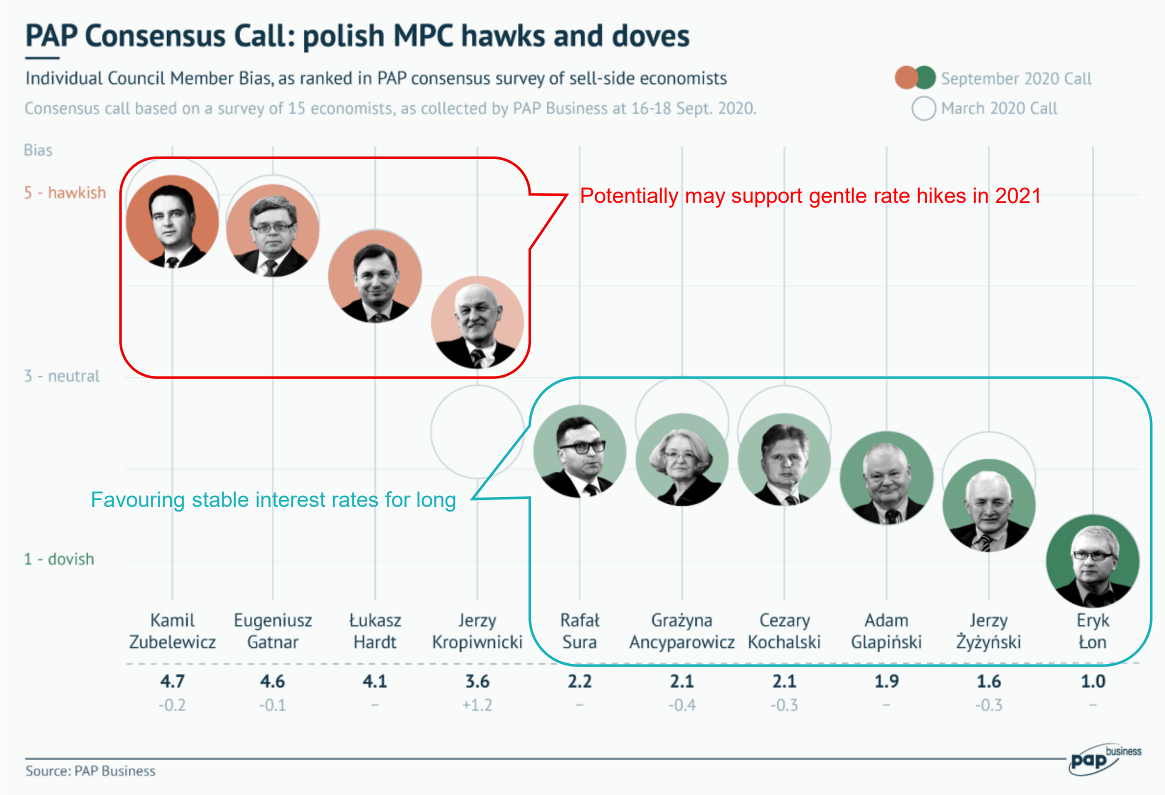
Source: NBP, Santander

Monetary Policy: all we need is patience

By slashing the main reference rate by 140bp to nearly zero in 2Q20 in response to the first wave of Covid-19, the Monetary Policy Council has basically reached its limits, at least on conventional policy response front. Judging by numerous comments and press interviews of central bank officials, **if there is one thing that virtually all the MPC members agree on, it is the assessment that going towards negative interest rates territory is not a viable option, even if economic situation deteriorates much further** (according to some of them, it could be even against Polish law). Thus, further interest rate cuts in Poland are clearly off the table.

Instead, once the economy starts getting back on its feet, the discussion about the policy normalisation may start, it seems. While three or four MPC members have already signalled potential support for gentle rate hikes in 2021, the vast majority seems to share the strong view that any rush should be avoided. **We expect the NBP interest rates to remain on hold at least until the end of the current MPC's term of office** (most members end their term at the very start of 2022 – see the table on the right). Lower inflation (below the 2.5% target in 2021, according to our forecast) should provide the central bank lots of comfort in keeping this view. And even if it doesn't, the NBP is likely to take cue from the main central banks abroad, which have declared bigger tolerance for temporarily higher inflation after the pandemic shock.

The shape of monetary policy after 2021 will be dependent on the pace of economic normalisation and will be designed by the new set of policymakers (only the NBP Governor may be re-appointed for the second term). We think it is much too early to make strong bets what it will bring to the table. But our best guess is that a more "hawkish" rate-setting panel is quite unlikely (unless there is a major political reshuffle in the parliament by then).



Ends term:	20 Feb 2022	25 Jan 2022	20 Feb 2022	21 Jan 2022	16 Nov 2022	9 Feb 2022	21 Dec 2025	21 Jun 2022	30 Mar 2022	9 Feb 2022
Appointed by:	President	Senate	President	Senate	Senate	Sejm	President	Sejm *	Sejm	Sejm

Source: PAP, NBP, Santander

* designated by the President

Santander

Monetary Policy: communication breakdown

Since the very start of Covid-19 pandemic the NBP is running an interesting experiment on the importance (or lack thereof) of central bank's communication. Since March the MPC cancelled all the post-meeting press conferences, the bank introduced several last-minute (unexplained) changes of the meetings calendar, the central bank governor – the most influential person in the Council – avoids any live interaction with economic journalists, market participants or general public. Moreover, the MPC decision announcements started drifting quickly towards very late hours.

In our view none of those changes serve well for the quality of central bank's communication, its transparency and clarity, which – according to substantial body of economic literature – should be at the heart of modern monetary policy strategies, especially those based on direct inflation targeting. Still, the NBP does not seem to be concerned, and according to the just-released [meetings calendar](), it is not planning to restore the MPC press conferences even in 2021. Will it eventually matter? Maybe not, if the monetary policy is going to be indeed idle for long. But if for some reason the central bank decides for any change, then signalling and steering market expectations may be way more difficult with such track record of broken communication.

The length of the official MPC press releases has increased by c.40% after the pandemic started, but it is hard to argue they tell us more about the central bank's reaction function. The language of the communiques has unsurprisingly evolved towards even more dovish, with even smaller emphasis put on inflation than before (see the word cloud). A new element introduced since mid-year was the expression of worry that the economic recovery could be slowed by insufficient currency depreciation, which seems to reflect NBP's tolerance for weaker zloty. Yet, it was not followed by any more decisive interventions.

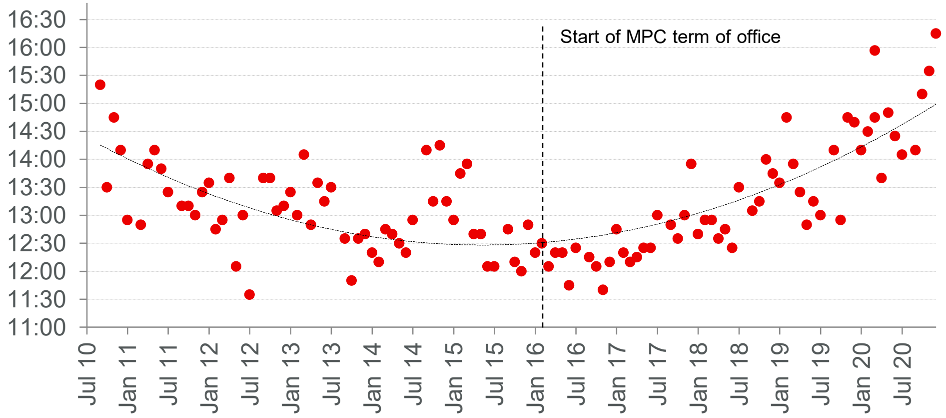
Word clouds of MPC official press releases :

April-December 2019

April-December 2020

Source: wordart.com, Santander

Hour of MPC decision announcement:



Source: Santander

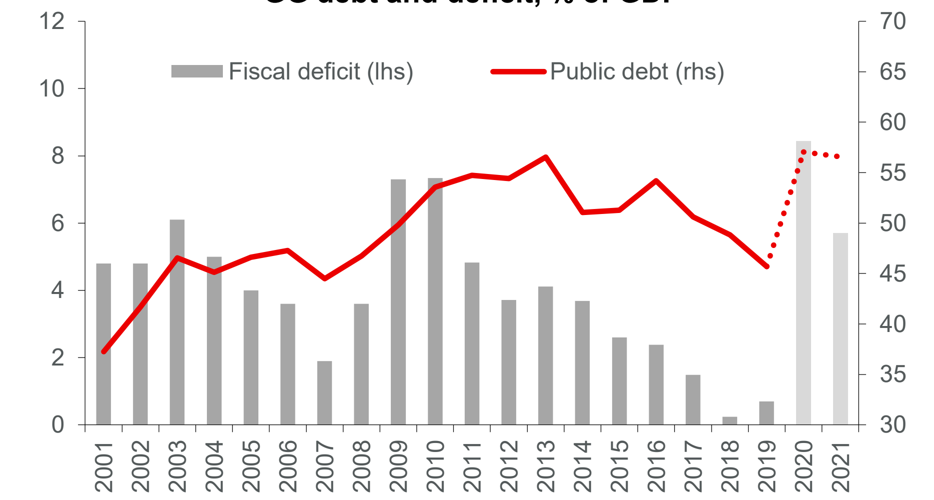
Fiscal policy: deficit below expectations?

We stick to our forecast that 2020 GG deficit will be lower than 12% of GDP expected by the government and will fall in 8-9% range (all-time high). Our forecast for 2021 deficit sits at c6% of GDP. The 2020 GG budget was burdened by massive costs of Covid-19 lifeline, which we estimate at cPLN150bn in total. The pandemic impact on other budget categories, especially incomes, was negative, but weaker than expected initially. Also, the government did not realise the investment programme announced in early stages of the pandemic, in line with our call. Much depends on Eurostat's interpretation of transfers from the central government to social security funds (about PLN40bn) planned for the year-end. As they are meant to cover 2021 spending, we assume it will be booked by the Eurostat in 2021. This is why we are expecting the 2020 deficit to be lower than planned. New bout of PFR help is a negative factor for 2021 deficit, but in our view it offsets possible higher revenues, lower spending in other categories and lower deficit of local governments

Central budget has performed pretty well in 2020. While we stated on numerous occasions that epidemic-related spending was pushed outside the budget, incomes look pretty good. In October, year-to-date VAT and CIT incomes were close to 0% y/y, PIT declined by 5% y/y and excise duties by 1.6% y/y. These numbers are likely to deteriorate somewhat in 4Q20, but given their robust performance so far, we are expecting no major fall. While deficit was at only PLN12bn in October, in our view it is likely to jump towards PLN100bn in December, as the government will book subsidies for FUS (social security fund) earmarked for 2021, as we explained it in our comments to 2020 and 2021 budget bills.

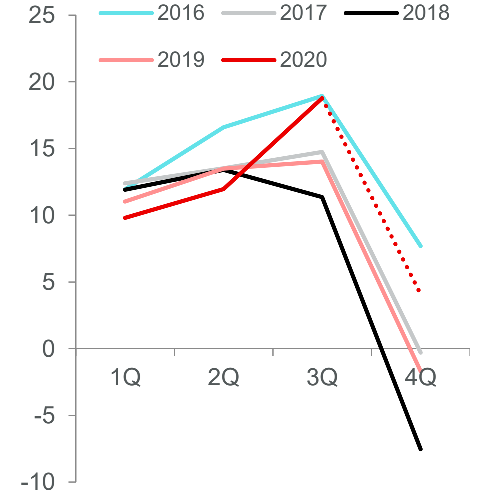
In 2020 local governments did not see a deterioration in their budgets. Their total surplus amounted to PLN18.8bn after 3Q20 as compared to PLN14.0bn after 3Q19. We are expecting the year-end results to be close to zero. Until 3Q20 incomes from PIT, a major chunk of local government budgets (about 20%) fell by 5.4% y/y, but this was more than offset by government subsidies (+21% y/y), so their total incomes improved by 10.5% y/y. For 2021 local governments planned a small deficit, but over the last few years the actual realisation was regularly better than planned.

GG debt and deficit, % of GDP



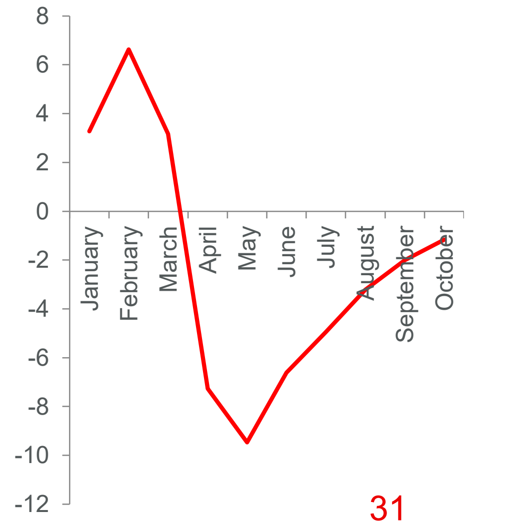
Source: Eurostat, GUS, Santander

Ytd deficit in local governments, PLNbn



Source: Miniistry of Finance, Santander

Ytd growth rate of central budget tax revenues, % y/y



Source: Miniistry of Finance, Santander

Santander

EU budget: big funding boost

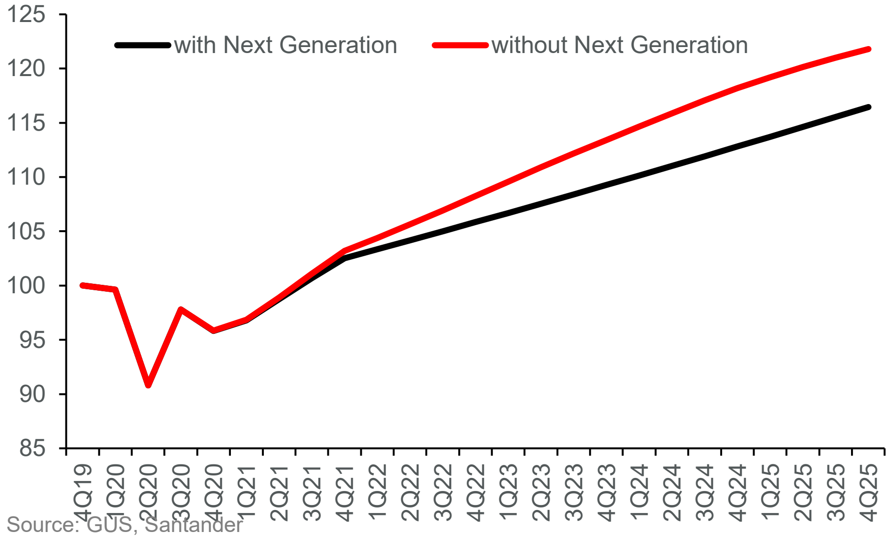
EU Multiannual Financial Framework 2021-2027 is the most generous EU budget for Poland so far and possibly the last one of that size. The European Commission has earmarked for Poland: EUR75bn in cohesion funds, EUR31bn agricultural funds and EUR64bn in EU Next Generation (in current prices). Part of the EU Next Generation fund will be reassessed in 2022 to take into account post-pandemic state of economies. For Poland, this part is worth about EUR6.0bn.

Higher EU funds in the 2021-2027 will support Poland's economic growth in the upcoming years and postpone the outlook for declining financing for Poland that was flagged as a medium-period risk. According to our estimates, the Next Generation programme is likely to add 4-5% to Polish GDP until 2025 with peak impact on growth rates in 2022-2023.

The agreement on the EU Budget has been reached at the December European Council summit, despite Poland and Hungary warned earlier they may block the bill if there is no withdrawal of European Parliament's resolution introducing new mechanism linking EU money to respect for rule of law criteria. The conditionality has not been removed, but instead accompanied by political declarations delaying the implementation of its already watered down version. Thus, in practice the risk that Poland loses some of the EU funding because of the rule of law concerns is not big.

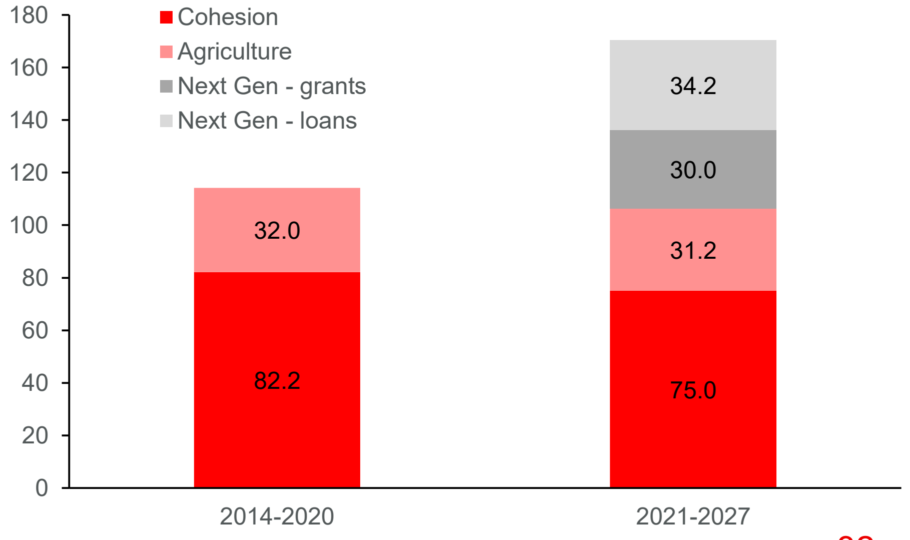
In Poland EU funds are mostly spent on road and railway infrastructure, environmental issues and on support for B+R+I activities in companies. The new EU budget is slightly more biased towards environment that the previous ones.

Poland's GDP with and without EU Next Generation (our estimate)



Source: GUS, Santander

EU funds earmarked for Poland in EU budgets, EURbn (current prices)



Source: European Commission, Santander

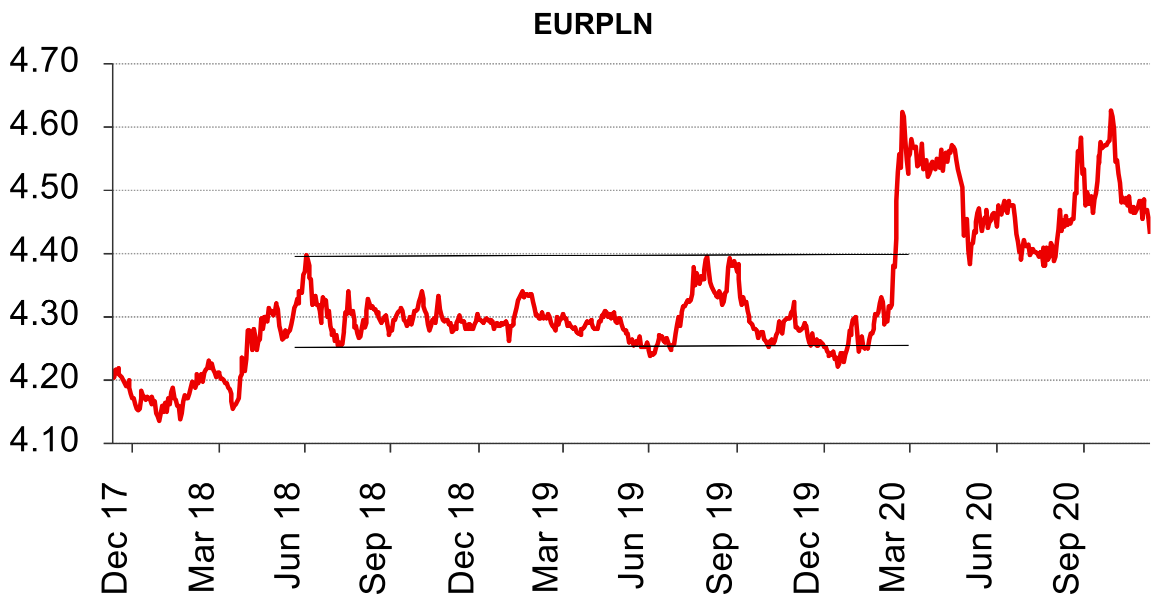
Financial markets

2

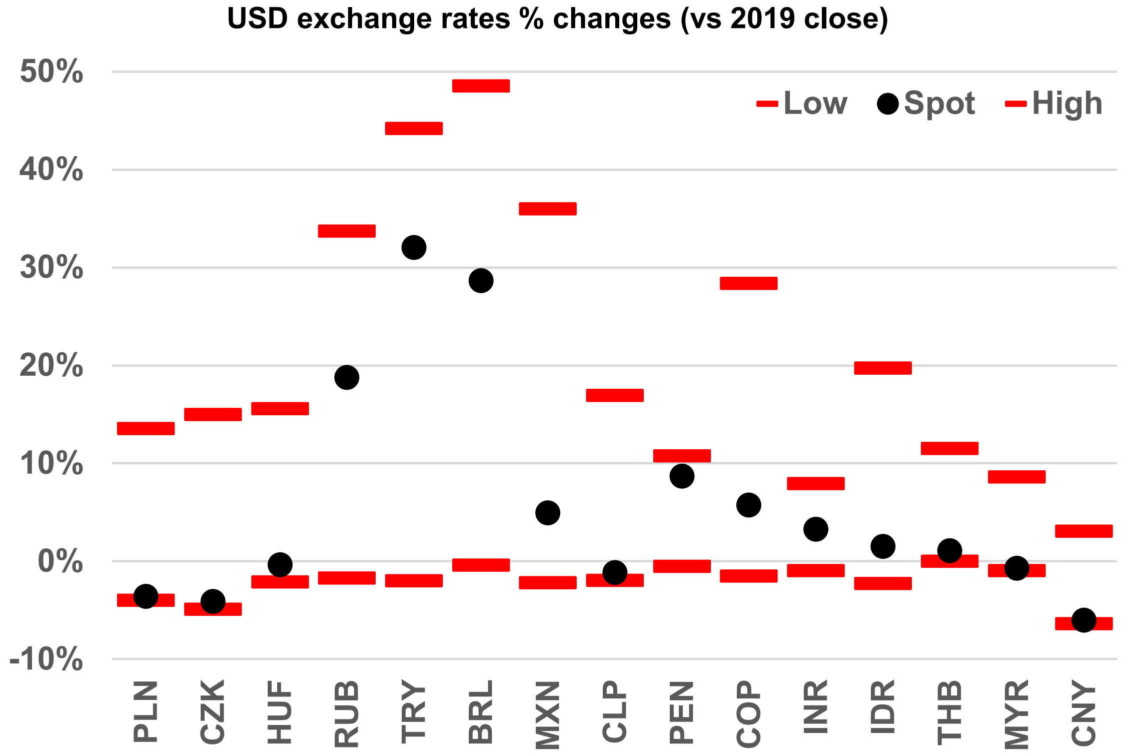
FX market: volatile 2020

2020 brought a significant increase of volatility on the EM FX market. Versus the dollar, the CEE exchange rates recorded the widest annual % high-low spreads for 3-4 years, most of the LatAm for 5 years (for MXN even since 2008 US financial crisis).

In YTD terms, all of the main EM currencies depreciated vs the euro, and slightly less than a half of them strengthened vs the dollar. The zloty lost 3.8% vs the EUR and gained 3.6% vs the USD which gives the Polish currency 4th place among EM peers.



Source: Refinitiv Datastream, Santander Bank Polska



Source: Refinitiv, Santander Bank Polska

Santander

FX market: back to the past?

According to our 2021 forecasts, **EURPLN returns to 4.30, that is the middle of the 4.25-4.35 range** in which it has been trading for the better time since mid-2018 until the Covid-crisis broke out. Key assumptions here are **positive global market mood** persisting for at least a better part of the next year, **avoidance of no-deal Brexit** (the UK-EU trade deal reached in very early 2021 at the latest) and **no resurfacing tensions between Poland and EU**.

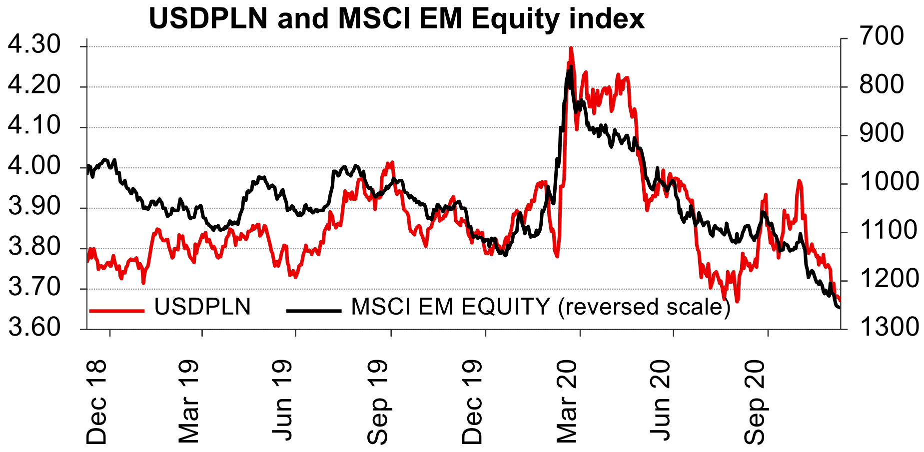
Why do we see EURPLN returning to only the middle of the range? The table on the next page gives a general summary of Poland macro/market current and expected performance vs its EM peers. What we see is that there seems to be no particular reason why investors should favour the zloty vs the other EM currencies that would result in a material change on the EURPLN chart. Actually, in the short-term the zloty could be even underweighted given the negative interest rates and unattractive carry vs EM peers.

MAIN ASSUMPTIONS

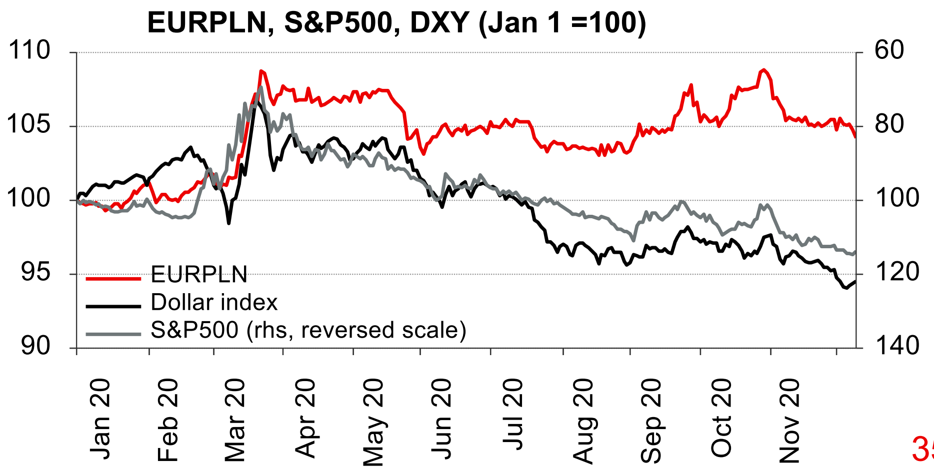
- Global and Polish economic activity picks up amid easing restrictions.
- Highly accommodative monetary policy of the main global central banks provides fuel for economic recovery.
- Weak dollar should support the EM currencies.
- Further improvement of Polish C/A balance as % of GDP (until early 2021, then only a slight correction with still relatively big external surplus).
- Stable interest rates in Poland.

RISK FACTORS

- No trade deal between the UK and EU.
- Slow pace of vaccination distribution in Poland that may result in economic restrictions being in place longer than in the other CEE countries.
- Low real interest rates in Poland compared to the CEE and EM peers. Hardly any chances for a rate hike in 2021.



Source: Refinitiv Datastream, Santander Bank Polska



Source: Refinitiv Datastream, Santander Bank Polska

FX market: fundamental factors (1)

The below table contains factors often mentioned in literature as important for the currencies performance. We divided them into those important in the longer-term and those most watched in the shorter term horizon. We show how they differ across different currencies from different geographies and pick three out- and underperformers to get an idea which currencies could be favored by investors.

		LONG-TERM HORIZON		MEDIUM-TERM HORIZON				SHORT-TERM HORIZON			
		GDP per capita (k USD)	Public debt (% of GDP)	C/A (% of GDP) 1)	Change in % y/y GDP growth rate (pp) 2)	Expected change in % y/y GDP growth rate (pp) 3)	Sovereign rating 4)	Real interst rate (pp) 5)	10Y sovereign bond yield	Vol adjusted carry trade (bps) 6)	Import coverage ratio 7)
CEE	PLN	15.0	45	2.7%	-4	-1	A-	-3	1.31	-6	189%
	CZK	20.1	30	2.4%	-3	0	AA-	-2	1.32	2	399%
	HUF	15.0	65	-0.9%	-6	-1	BBB	-2	2.26	76	176%
	RUB	9.9	14	2.4%	-5	1	BBB-	0	5.84	381	702%
	TRY	9.2	-	-2.4%	2	-6	BB-	1	12.88	1160	73%
LatAm	BRL	8.6	74	-2.0%	-4	2.1	BB-	-2	7.34	354	869%
	MXN	9.8	47	1.3%	-6	2.5	BBB	1	5.45	364	183%
	CLP	13.9	28	0.1%	-9	6.2	A+	1	2.99	31	260%
	PEN	6.7	27	-0.1%	-6	12.7	BBB+	-2	3.67	54	802%
	COP	6.4	52	-2.5%	-10	6.7	BBB-	0	4.98	209	513%
Asia	INR	2.0	47	0.4%	-11	19.8	BBB-	-3	5.95	358	545%
	IDR	3.9	35	-1.1%	-6	2.8	BBB	2	6.16	440	359%
	THB	6.6	34	6.4%	-4	3.9	BBB+	1	1.26	35	503%
	MYR	11.4	52	3.1%	-3	2.0	A-	3	2.76	164	252%
	CNY	9.9	38	0.0%	12	14.0	A+	4	3.31	267	554%

Source: Refinitiv, Santander Bank Polska

- Top three outperformers

- Top three underperformers

1) 4Q sum of C/A divided by 4Q sum of GDP (both in USD)
2) GDP(t)-GDP(t-2), pp
3) GDP(t+2)-GDP(t), GDP(t+2) from Oxford Economics
4) Mid among Moody's, Fitch and S&P (S&P notation)
5) Main central bank rate minus current annual inflation
6) 2Y (3Y for HU and whole Asia) bond yield spread vs UST multiplied by (100 minus 1M ATM VOL for EM currency)
7) Sum of 3-month USD imports divided by USD FX reserves

Santander

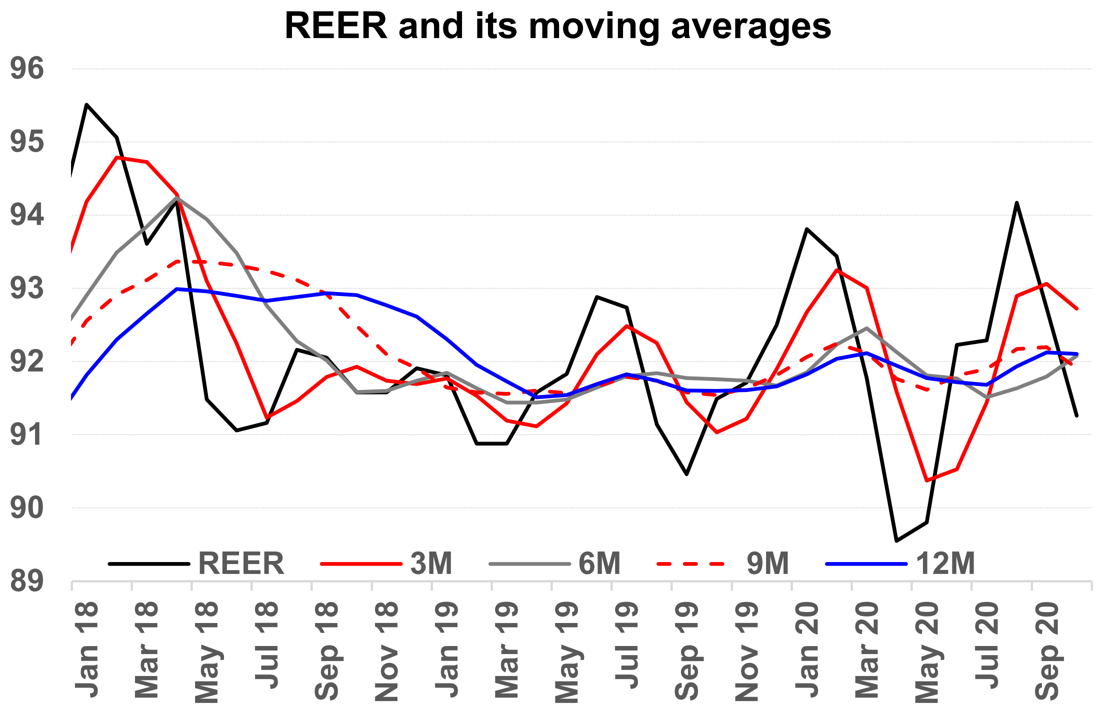
FX market: fundamental factors (2)

Zloty's underperformance in the short-term factors and slight undervaluation in REER terms (vs moving average) seem to be coherent, though the current undervaluation is above-average. Regarding the mid- and long-term factors Poland does not look to be above- or below-average, so there **should be no extra bonus or penalty for the zloty** from the fundamental side in the coming months. The above-average undervaluation in terms of REER could be at least reduced thanks to the general risk-on mood we expect to dominate in 2021. On the other hand, according to the IIF model of EM FX fair values, PLN is c.11% undervalued vs fundamentals.

Looking at the other EM currencies, the Indonesian rupiah (IDR) has strong short-term fundamentals and is undervalued in REER terms (also when comparing the current deviation to the average).

		REER vs moving average				Jan13-Oct20 average deviation			
		3M	6M	9M	12M	3M	6M	9M	12M
CEE	PLN	-1.6%	-0.9%	-0.7%	-0.9%	-0.1%	-0.1%	-0.2%	-0.3%
	CZK	-2.1%	-1.3%	-1.1%	-1.5%	0.0%	0.1%	0.1%	0.2%
	HUF	-1.5%	-1.7%	-1.5%	-2.1%	-0.2%	-0.3%	-0.5%	-0.8%
	RUB	-2.3%	-7.0%	-8.4%	-11.2%	-0.5%	-1.0%	-1.6%	-2.1%
	TRY	-3.1%	-8.2%	-11.4%	-14.1%	-0.7%	-1.6%	-2.4%	-3.1%
LatAm	BRL	-2.1%	-4.0%	-8.1%	-13.3%	-0.6%	-1.4%	-2.0%	-2.6%
	MXN	2.2%	4.0%	3.1%	-0.3%	-0.3%	-0.9%	-1.4%	-1.9%
	CLP	-0.7%	-0.7%	0.8%	0.6%	-0.2%	-0.6%	-0.8%	-1.2%
	PEN	-1.1%	-3.9%	-4.7%	-4.8%	-0.1%	-0.1%	0.0%	0.1%
	COP	-1.7%	-3.7%	-4.1%	-5.9%	-0.4%	-1.0%	-1.6%	-2.2%
Asia	INR	1.3%	2.3%	2.6%	2.2%	0.1%	0.3%	0.6%	0.9%
	IDR	-0.4%	-2.8%	-2.7%	-3.6%	-0.1%	-0.2%	-0.3%	-0.1%
	THB	-0.5%	-1.0%	-0.9%	-2.1%	0.0%	0.0%	0.1%	0.3%
	MYR	-0.3%	0.2%	-0.2%	-1.2%	-0.2%	-0.5%	-0.7%	-1.0%
	CNY	1.0%	1.8%	1.0%	1.3%	0.1%	0.2%	0.3%	0.4%

Source: Bank for International Settlements, Santander Bank Polska
Minus means current REER is below its moving average – proxy for the currency undervaluation
Plus means current REER is above its moving average – proxy for the currency overvaluation



Source: Santander Bank Polska; AOP

Santander

FI market: 2020 in retrospective (1)

Over 2020, 10Y bond yields in the core markets declined and Polish bond yields followed suit:

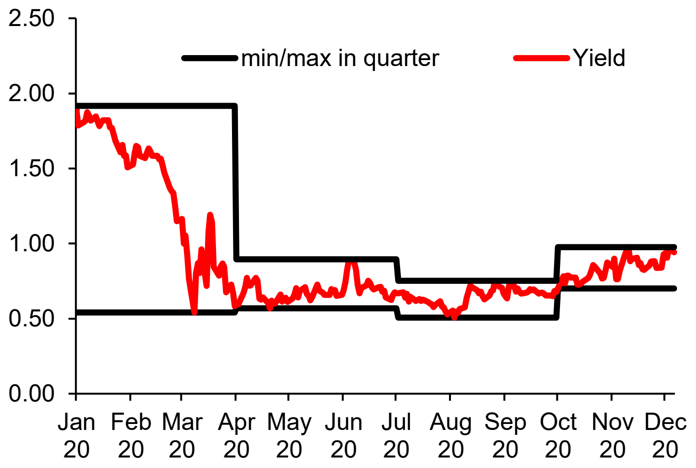
- US 10Y down 95bp to 0.95% (T-L)*
- Germany 10Y down 60bp to -0.60% (T-R),
- Polish 10Y down 70bp to 1.40% (B-R).

What's interesting, the Chinese 10Y yields actually increased 15bp to 3.30% (B-L).

The highest yield volatility (as measured by quarterly high-low yield ranges) was, not surprisingly, the highest in the Q1 2020 when the pandemic began and some of the central banks (Fed, NBP) cut rates.

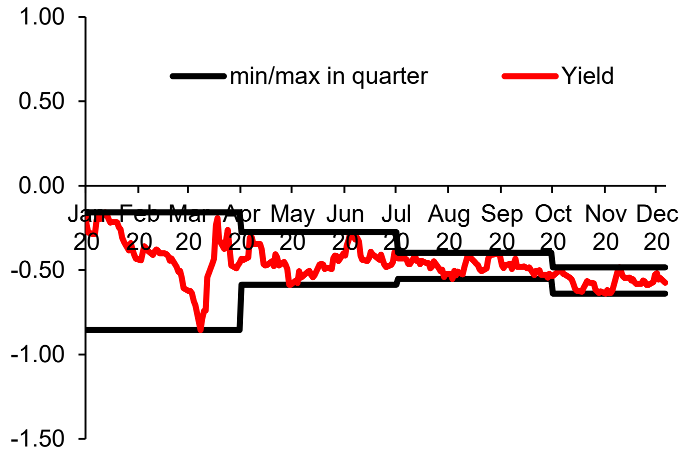
Later in the year the volatility declined and since then has remained subdued as central banks' QE programs keep yields in check while the uncertainty regarding the economic outlook remains still at an elevated level.

US 10Y bond yield



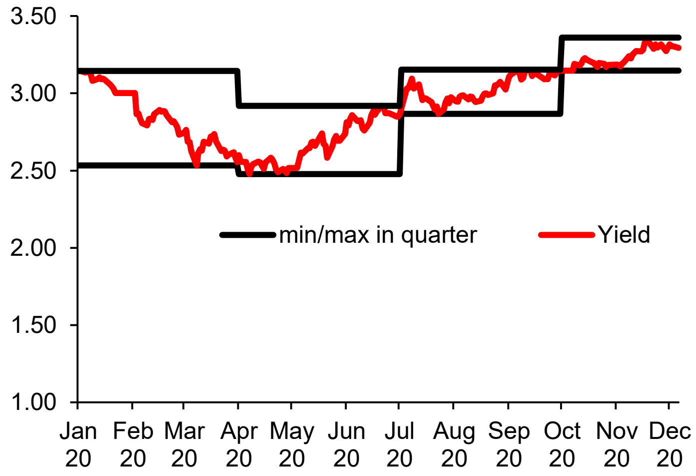
Source: Bloomberg, Santander

German 10Y bond yield



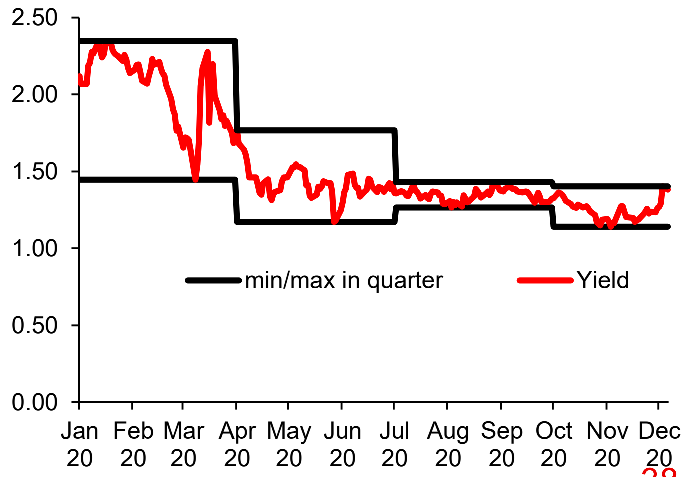
Source: Bloomberg, Santander

China 10Y bond yield



Source: Bloomberg, Santander

Polish 10Y bond yield



Source: Bloomberg, Santander

* T-L = top-left
T-R = top-right
B-L = bottom-left
B-L = bottom, right

Santander

FI market: 2020 in retrospecive (2)

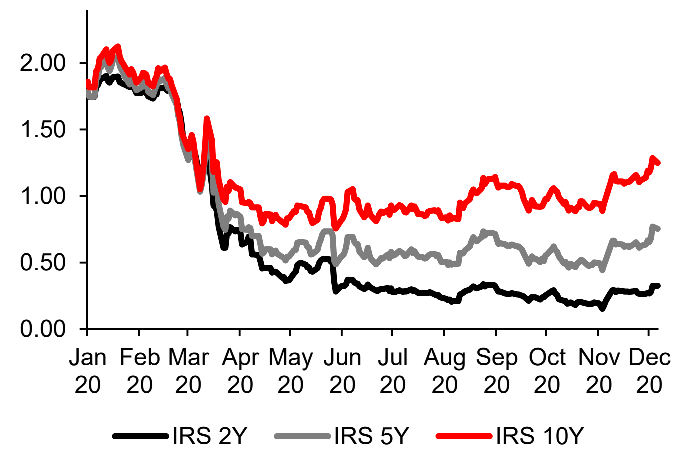
The four plots to the right describe the behaviour of Polish yields in the 2020

The **level of IRS** (T-L) and **bond yields** (T-R), declined in the direct aftermath of the pandemic in the spring. Since then the 2Y tenor remained low and anchored while the belly traded horizontally to slightly lower (especially for bonds) while the long end marched slowly higher, especially toward the end of the 2020 year after the vaccine news.

Polish **asset swaps** (B-L) narrowed in the H1 2020 and then narrowed even more in the September-October period as the increasing number of Covid-19 cases in Poland drove expectations higher of a further stimulus (incl. QE which drowns short and belly bonds in liquidity). Only after the vaccine news appeared have the long end and belly ASW started to normalise. **We note, however, that POLGBs are still very expensive on ASW basis.**

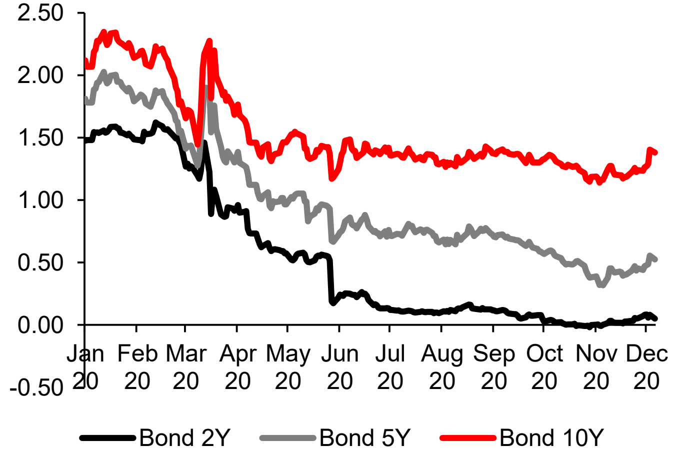
The **spreads of Polish bonds over the German counterparts** (B-R) have been compressing for the whole year partly driven by NBP rate cuts and BGK and PFR programs partially financed by NBP which increased liquidity and yield seeking behaviour of investors. Only in December 2020 the spreads started to widen again after the Polish and Hungarian governments threatened to veto the EU budget and the Recovery Fund.

Polish IRS



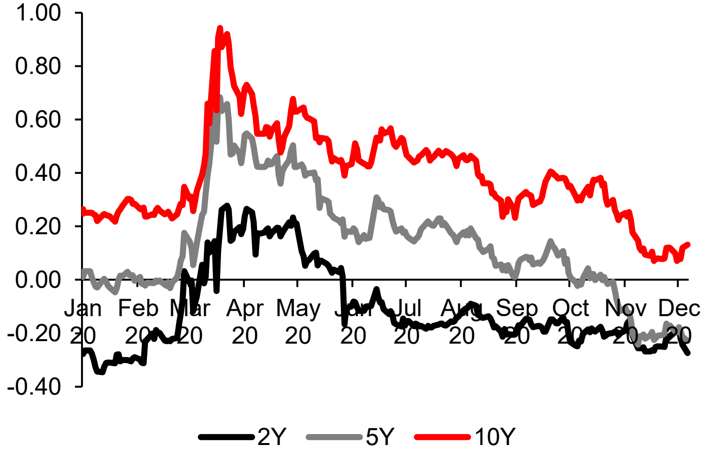
Source: Bloomberg, Santander

Polish bond yields



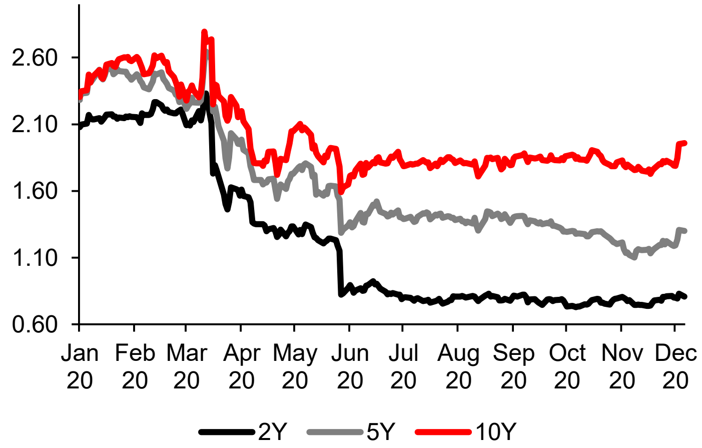
Source: Bloomberg, Santander

Polish Asset Swaps



Source: Bloomberg, Santander

Polish bond yields vs Germany



Source: Bloomberg, Santander

Santander

FI market: 2021 bond yield forecast (long end)

We expect the 10Y yield of Polish bonds at 1.75% at the end of 2021 (vs current 1.40%) with main contributions coming from:

NBP QE (yield negative). NBP's asset purchase program is open-ended (no precommitted size). Might help cap yield rise if needed.

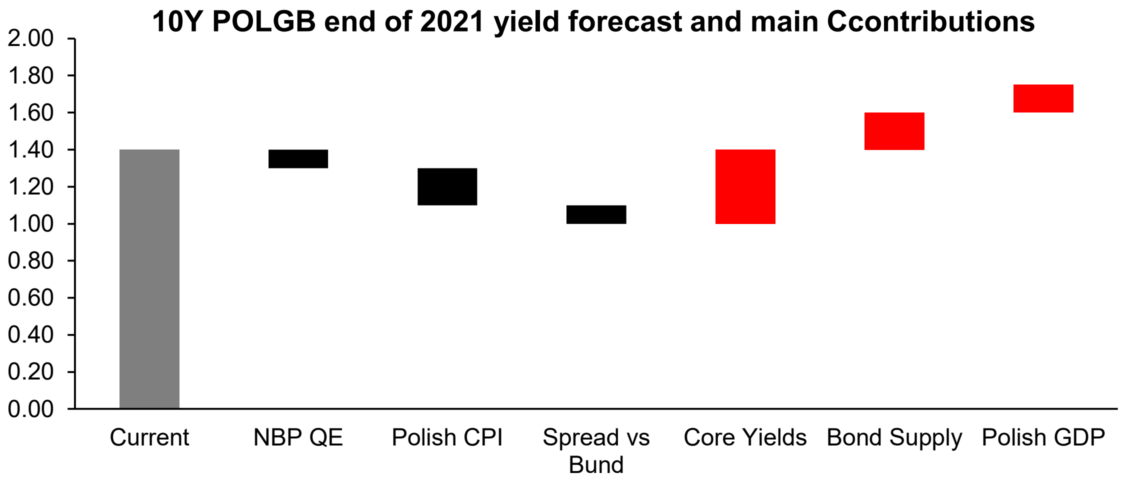
Polish CPI (yield negative, B-L). Base effects kick in in 2021 and the headline CPI risks printing below 2.0% in September 2021. Core CPI, usually correlated with output gap, will drop below 1.5% by the end of 2021. See pages 26-29 for more details.

Spread vs Bund (yield negative). As growth outlook improves in Europe so will the perception of sovereign credit risks and this should lead to further tightening of spreads vs German bonds.

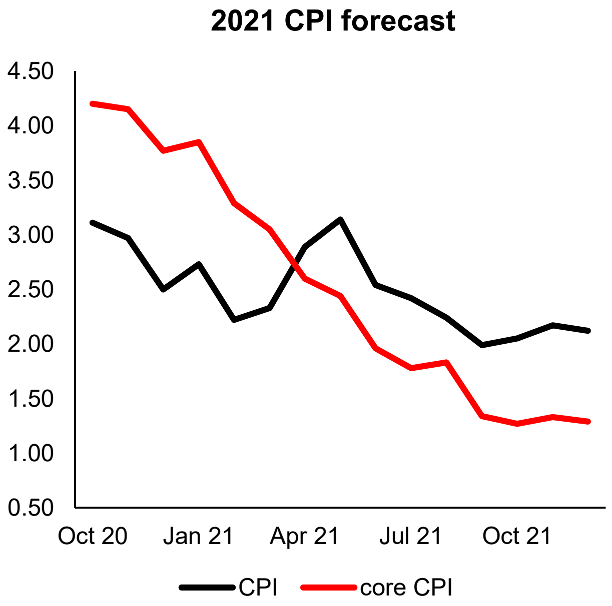
Core yields (yield positive, B-R). Our house view is that bond yields in the core markets should gradually increase over the course of 2021.

Bond supply (yield positive). BGK issuance is still PLN14bn off target (of PLN 112bn) while the PFR is likely to issue up to PLN35bn. Additionally, Ministry of Finance should start issue bonds again with net issuance of the order of PLN40bn (as indicated in September in first 2021 Budget Act draft and adjusted for the 4Q switch auction results).

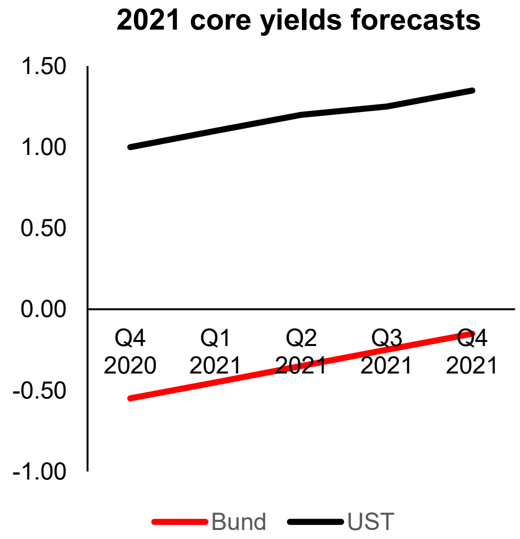
Polish GDP. We are more optimistic on GDP growth in Poland than market consensus (4.6% vs 3.9%) and hence, if we are proven right, this would naturally mean to higher yields in the long end of the curve. See pages 13-21 for more details.



Source: Santander



Source: Santander



Source: Santander

FI market: 2021 bond yield forecast (front end)

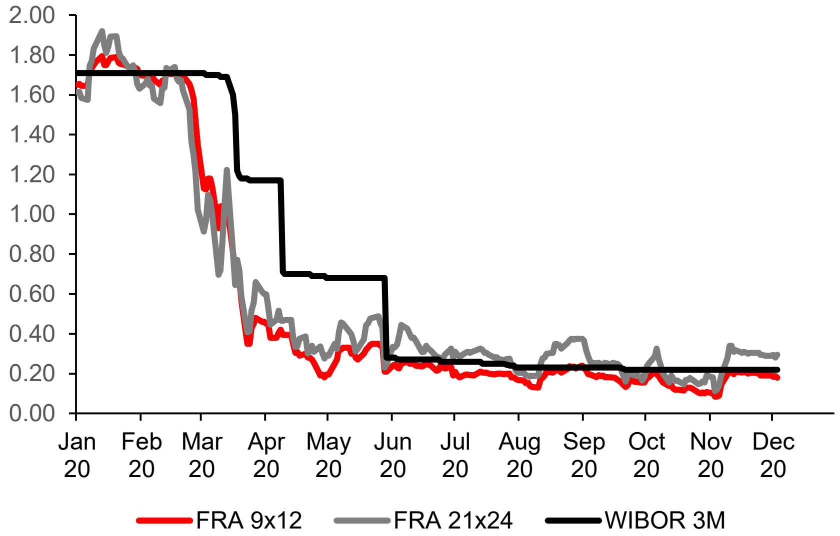
Our base case is for the NBP to keep rates on hold at 0.10% throughout the 2021.

The 3M Wibor has stabilised at 0.22% in the last quarter (T-R) and in our opinion is very unlikely to move lower from here.

FRA contracts for late 2021 (e.g. 9x12) trade with 2bp premium to the 3M Wibor. However the longer ones (e.g less liquid 21x24) at 0.40% point to market pricing of hikes for the late 2022 (next MPC).

We think that as the growth normalisation occurs throughout the globe and in Poland we find it increasingly convincing to **pay 9x12 FRA on dips**. If no hikes occur the trade will deliver zero returns. If normalisation is fast and markets notice, then there is upside.

3M Wibor vs FRA



Source: Bloomberg, Santander

Size of the 7-day NBP bills weekly auctions, PLNmn

Source: NBP, Santander

Banking sector liquidity as measured by 7-day NBP bills supply (B-L) has levelled off.

But is unlikely to decrease soon: corporate and retail deposits are high and if anything the BGK and PFR programs will be continued in early 2021 providing further supply of liquidity.

There is increased Corporate Bond issuance going on (ca PLN 10bn in Q4 2020) which is driving investor interest however the amounts are too small to significantly impact liquidity in the system.

That is why we expect **short-end bond yields to remain just slightly above zero,** as in the past quarter.

Santander

Polish bonds ownership breakdown

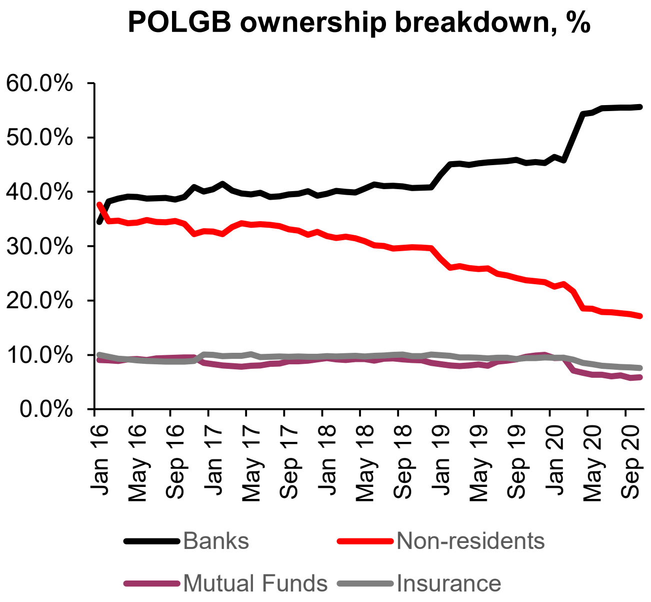
Ministry of Finance published the data including October 2020:

The **% share of foreign investors** (T,L) in POLGBs keeps declining. At the end of October it declined to 17.1% - the lowest level since 2009. Full 2020 decline stands at 6.2pp. **Polish banks** take up the slack, they currently own 55.6% of bonds, a YTD increase of 10.3pp.

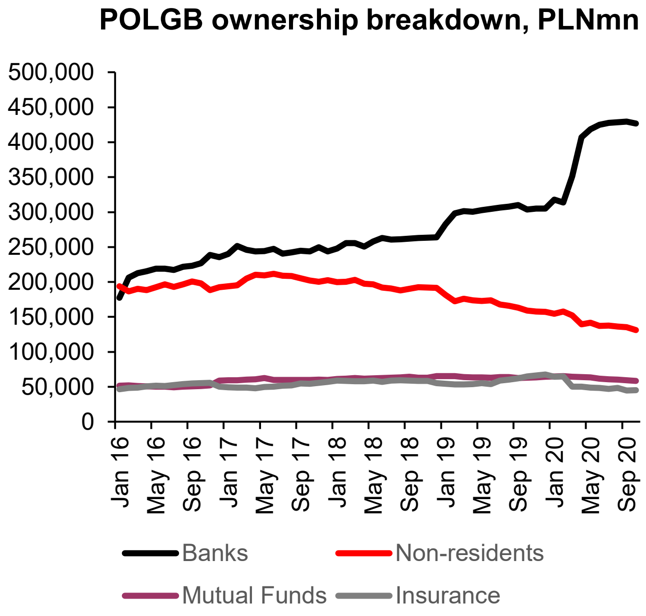
The **ownership structure of POLGBs** (T,R) shows that the notional of Polish banks holdings actually fell to PLN426.8bn in October from PLN429.6bn in September. Foreigners hold a record low PLN131.3bn. The holdings of Polish **insurance funds** keeps declining as well – at PLN58.2bn is lowest since 2016.

Data from IZFiA (Polish association of fund managers) (B,L) points clearly to the fact that the outflows from the mutual funds which took place in direct aftermath of the Spring sell-off **have not recovered in full** (still PLN10bn to go). Which is strange given almost zero deposit rates customer currently receive in banks.

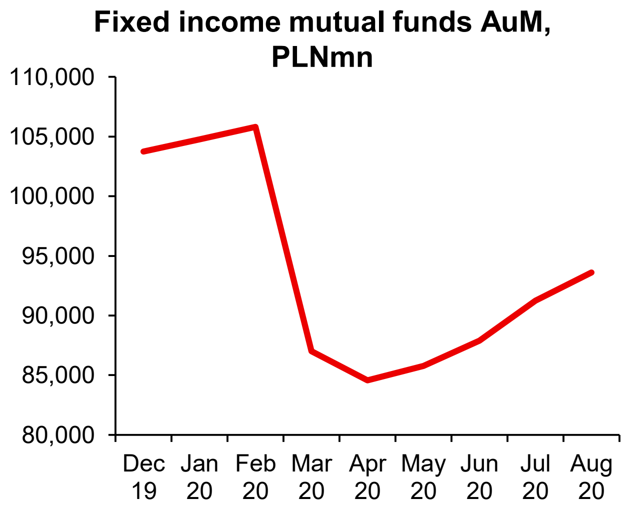
The newly launched **PPK pension program** has not matched expectations in the first year of its operation and hence **is unlikely to support POLGBs in a significant manner**. According to IZFiA only PLN1.8bn went into the program till and including October 2020 (B,R). The bonds constitute 20-90% of the PPK money pot, depending on the fund's target date.



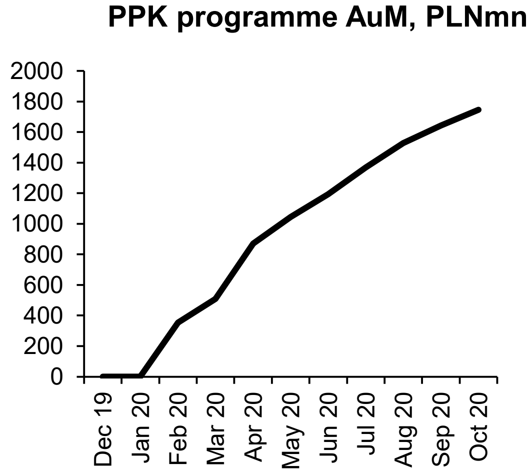
Source: MinFin, Santander



Source: MinFin, Santander



Source: IZFiA, Santander



Source: IZFiA, Santander

Santander

Polish bonds foreign ownership – by bond series

A more detailed look into the Ministry of Finance data on foreign ownership of Polish bonds reveals interesting structure: despite the fact that that the overall number of foreign ownership stands at **historically low 17.1%** - this is just the average over all bond series.

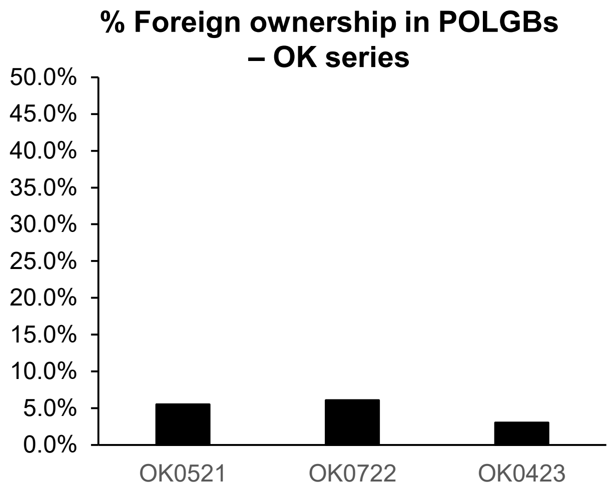
Foreigners barely own any floating rate **WZ series** bonds (not pictured). As for fixed coupon bonds:

- **OK series** (tenors of 1Y – 3Y) foreigners own 5%
- **PS series** (tenors up to 5Y) foreigners own <20%
- **DS series** (tenors up to 10Y) foreigners own between 25-50% of each series.
- **WS series** (tenors > 10Y) foreigners own over 40% of WS0428

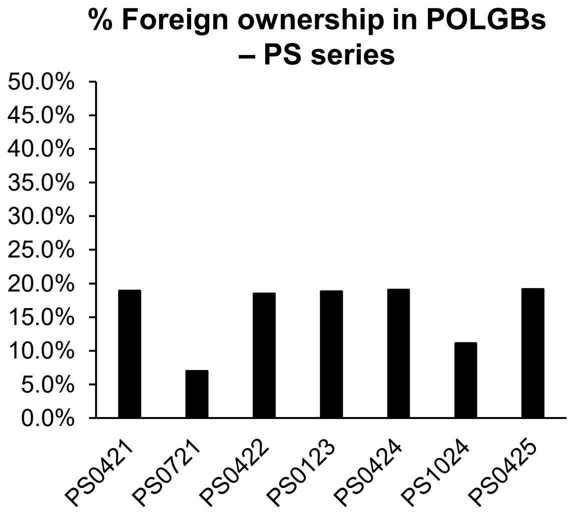
What we find interesting is that three bond series concentrated around the 10Y tenors (DS0727, WS0428 and DS1030) have **foreign ownership of over 40%**.

The possible impact on yields is straightforward: **the 10Y sector is the most vulnerable to a global rates sell-off, while that risk on the belly of the curve is less pronounced while on the front end is outright negligible**.

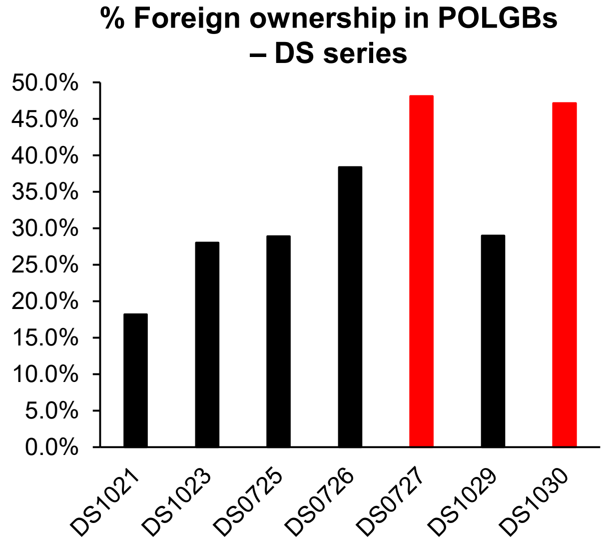
As a result, in a global yields growth environment the **most likely scenario for the Polish bond yield curve is for it to bear steepen.**



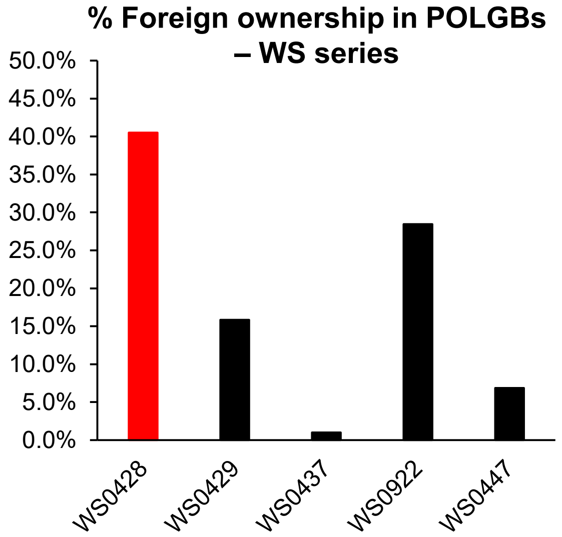
Source: MinFIn, Santander



Source: Bloomberg, Santander



Source: MinFin, Santander



Source: MinFin, Santander

Santander

2021 Bond redemptions and issuance

2021 will be decent both in coupon payments and redemptions.

As for **coupon payments:**

- For PLN-denominated bonds a total of **PLN13.6bn of coupons** will be paid with major payments concentrated in April (PLN3.7bn), July (PLN3.6bn) and October (PLN2.9bn).
- For bonds denominated in other currencies a total of **equivalent of PLN5.5bn of coupons** should be paid with majority in January (PLN2.0bn, mostly from EUR-denominated bonds) and in March (PLN1.0bn from both USD- and EUR-denominated bonds).

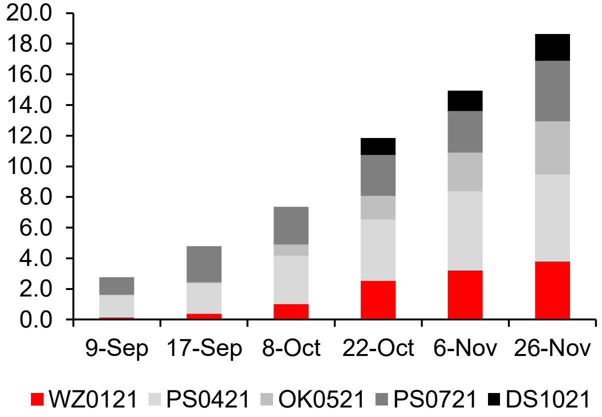
As for **redemptions**:

- A total of **PLN78bn of redemptions** in 2021 for PLN-denominated bonds. They are concentrated around April (PLN16.0bn from PS0421), May (PLN12.3bn from OK0521), July (PLN30.0bn from OK0721) and October (PLN14.0bn from DS1021).
- FX bonds also **mature in PLN29bn**, mostly in March (EUR 4.0% in PLN9.0bn), April (USD 5.125% in PLN6.4bn) and October (EUR 0.875%) in PLN7.8bn.

As of the date of writing the schedule of MinFin issuance for 2021 has still not been published so only rough estimates are available.

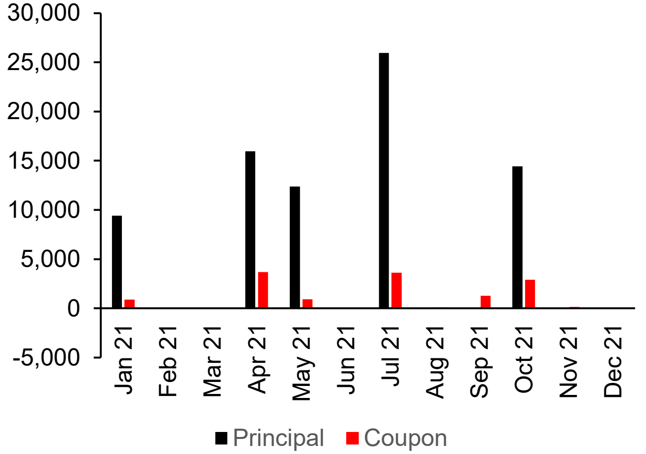
Based on the September Draft 2021 Budget (B-L) and the switch auctions carried in last 4 month of 2020 (T-L), **we estimate the net 2021 issuance in PLN-denominated bonds at PLN ~40.0bn split into PLN 15.0bn fixed and PLN 25.0bn floating notes.**

MinFin purchases of bond maturing in 2021 since the September's budget draft, PLNbn



Source: MinFin, Santander

PLN-denominated coupon payments and redemptions in 2021, PLNmn



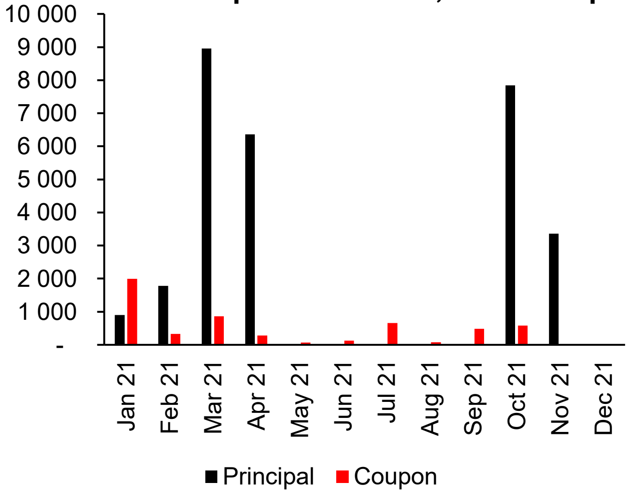
Source: Bloomberg, Santander

Planned debt issuance according to 2021 budget draft, as of September (PLNbn)

	2021 plan		
	Net	Redemptions	Gross
T-bills	9 116	10 846	19 962
POLGBs (fixed coupon)	31 960	82 370	114 330
POLGBs (floating coupon)	30 462	12 888	43 350
POLGBs (retail/savings)	6 244	8 756	15 000
Total	77 782	114 860	192 642

Source: MinFin, Santander

FX-denominated coupon payments and redemptions in 2021, PLNmn equiv



Source: Bloomberg, Santander

Santander

BGK and PFR bonds ownership, NBP QE

NBP has so far purchased a total of **PLN105.5bn** worth of bonds. Of which PLN53.0bn of government bonds and PLN52.4bn of non-government bonds (BGK and PFR).

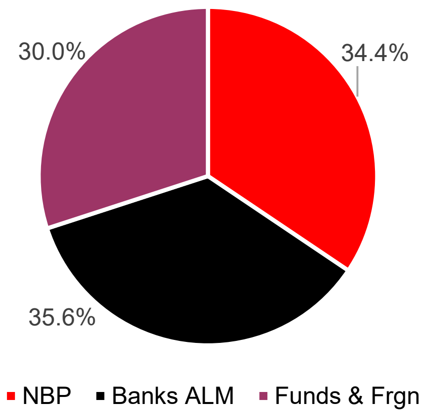
NBP owns **PLN33.5bn BGK** bonds (34.4% of issuance, T-L) and **PLN18.9bn of PFR** bonds (30.2% of issuance, T-R). The % ownership differs by bond series however (B-L).

Mutual funds and foreign investors own much more of BGK bonds (30.0%) than PFR bonds (8.8%) hence in case of liquidation it is **BGK bonds which are more vulnerable to a sell-off.**

NBP QE is open-ended (there is no predetermined amount of any bond to be bought). NBP QE is likely to be kept in place regardless of the growth outlook scenario:

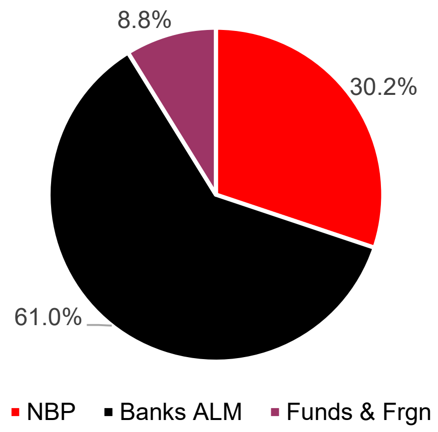
- in case of *growth outlook deterioration* NBP QE might be used to help finance another emergency funding programs (bonds issued both by the Ministry of Finance and/or BGK, PFR)
- In case of *growth outlook improvement* NBP QE might be used at some point to control the long end of the yield curve so that higher yields do not tighten funding conditions. The steepness of the Polish bond yield curve is pretty well behaved at the moment, however further steepening of the core market yield curves might put additional pressure on the local curve (B-R).

% Ownership breakdown of BGK Bonds



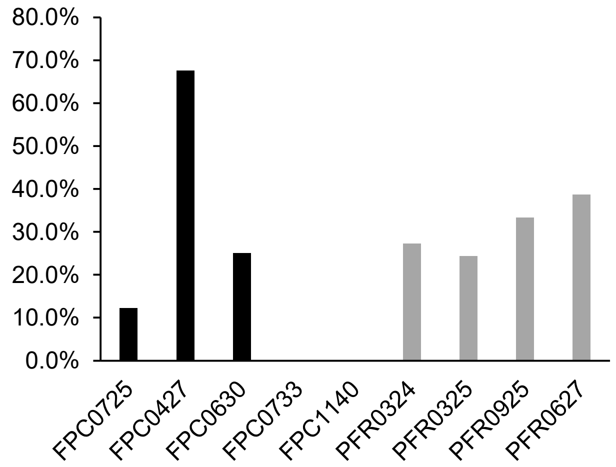
Source: NBP, Bloomberg, Santander

% Ownership breakdown of PFR Bonds



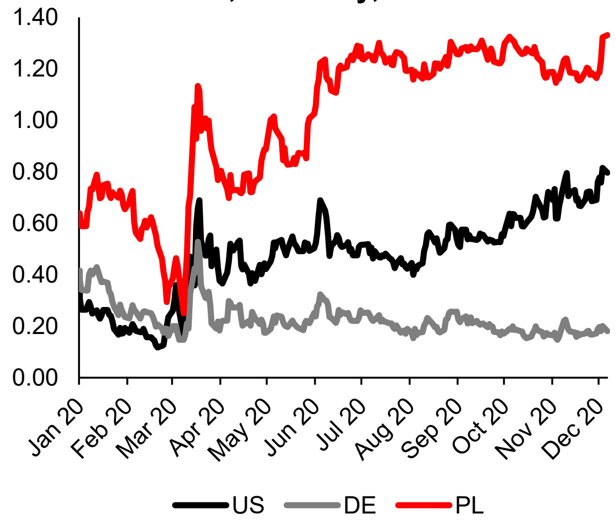
Source: NBP, Bloomberg, Santander

NBP % ownership breakdown of BGK (FPC) and PFR bonds by series



Source: NBP, Santander

2x10 bond yield steepness in US, Germany, Poland



Source: Bloomberg, Santander

Forecasts

3

Economic Forecasts

		2018	2019E	2020E	2021E	1Q20E	2Q20E	3Q20E	4Q20E	1Q21E	2Q21E	3Q21E	4Q21E
GDP	PLNbn	2,121.6	2,287.7	2,309.0	2,497.9	556.4	528.2	582.5	641.9	564.2	601.5	629.2	703.0
GDP	% y/y	5.4	4.5	-2.9	4.6	1.9	-8.4	-1.5	-3.3	-2.2	9.2	4.3	6.4
Domestic demand	% y/y	5.6	3.5	-4.9	6.1	1.0	-9.5	-3.2	-7.1	-4.0	10.8	5.6	11.6
Private consumption	% y/y	4.3	4.0	-3.7	5.6	1.2	-10.8	0.4	-6.0	-4.0	14.0	3.5	10.5
Fixed investment	% y/y	9.4	7.2	-8.1	5.5	0.9	-10.7	-9.0	-10.0	-7.0	5.0	5.0	12.0
Industrial output	% y/y	5.9	4.2	-1.5	9.0	0.9	-13.6	3.2	4.0	3.6	25.1	4.8	5.1
Construction output	% y/y	19.7	3.6	-4.7	-1.6	5.0	-2.8	-10.9	-6.1	-13.3	-6.9	3.2	5.6
Retail sales (real terms)	% y/y	6.5	5.1	-3.9	6.9	0.8	-10.7	1.0	-6.2	-2.0	16.0	3.7	9.7
Gross wages in national economy	% y/y	7.2	7.2	5.2	4.1	7.7	3.8	4.8	4.7	3.0	5.8	3.6	3.8
Employment in national economy	% y/y	2.6	2.2	-1.0	0.2	0.6	-1.7	-1.5	-1.2	-1.4	1.5	0.6	0.3
Unemployment rate *	%	5.8	5.2	6.3	6.4	5.4	6.1	6.1	6.3	6.6	6.2	6.2	6.4
Current account balance	EURmn	-6,518	2,611	23,393	16,161	4,623	6,576	3,359	8,835	6,641	-559	4,826	5,253
Current account balance	% GDP	-1.3	0.5	4.5	2.8	1.0	2.3	3.0	4.5	4.9	3.4	3.6	2.8
General government balance (ESA 2010)	% GDP	-0.2	-0.7	-8.4	-5.9	-	-	-	-	-	-	-	-
CPI	% y/y	1.6	2.3	3.4	2.3	4.5	3.2	3.1	2.9	2.4	2.8	2.1	2.0
CPI *	% y/y	1.1	3.4	2.5	2.0	4.6	3.3	3.2	2.5	2.4	2.8	2.1	2.0
CPI excluding food and energy prices	% y/y	0.7	2.0	3.9	2.2	3.4	3.8	4.2	4.0	3.4	2.3	1.6	1.3

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

Source: GUS, NBP, Santander

Market Forecasts

		2018	2019E	2020E	2021E	1Q20E	2Q20E	3Q20E	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	0.24	0.21	0.20	0.20	0.20	0.20
Yield on 2-year T-bonds	%	1.59	1.56	0.50	0.15	1.39	0.48	0.11	0.02	0.06	0.14	0.19	0.20
Yield on 5-year T-bonds	%	2.51	1.99	0.96	0.61	1.72	0.94	0.71	0.45	0.52	0.59	0.64	0.71
Yield on 10-year T-bonds	%	3.21	2.41	1.52	1.50	2.05	1.43	1.35	1.25	1.35	1.44	1.55	1.64
2-year IRS	%	1.92	1.74	0.62	0.31	1.53	0.43	0.27	0.23	0.24	0.29	0.34	0.35
5-year IRS	%	2.43	1.85	0.84	0.66	1.58	0.62	0.59	0.57	0.59	0.64	0.69	0.70
10-year IRS	%	2.89	2.05	1.14	1.09	1.67	0.89	0.96	1.04	1.06	1.10	1.10	1.10
EUR/PLN	PLN	4.26	4.30	4.44	4.38	4.32	4.50	4.44	4.50	4.48	4.40	4.33	4.30
USD/PLN	PLN	3.61	3.84	3.90	3.63	3.92	4.09	3.79	3.79	3.74	3.67	3.59	3.54
CHF/PLN	PLN	3.69	3.86	4.15	3.90	4.05	4.24	4.13	4.17	4.07	3.93	3.83	3.79
GBP/PLN	PLN	4.81	4.90	5.00	4.88	5.02	5.07	4.91	5.01	5.00	4.92	4.83	4.78

* 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 **11.12.2020** has been prepared by:

ECONOMIC ANALYSIS DEPARTMENT
SANTANDER BANK POLSKA S.A.
al. Jana Pawła II 17, 00-854 Warszawa
email: ekonomia@santander.pl
Web site: https://www.santander.pl/en/economic-analysis

Maciej Reluga, Chief Economist, CFO	22 534 18 88
Piotr Bielski, Director	22 534 18 87
Marcin Luziński, Economist	22 534 18 85
Grzegorz Ogonek, Economist	22 534 19 23
Wojciech Mazurkiewicz, Economist	22 534 18 86
Marcin Sulewski, Economist, CFA	22 534 18 84

MACROscope

Warsaw, 16 December 2020

Sectoral supplement

Poland: 2021 Outlook

Strategic Sectors Department

Santander Bank Polska S.A.
sektory@santander.pl

Santander

Mixed outlook for residential construction market

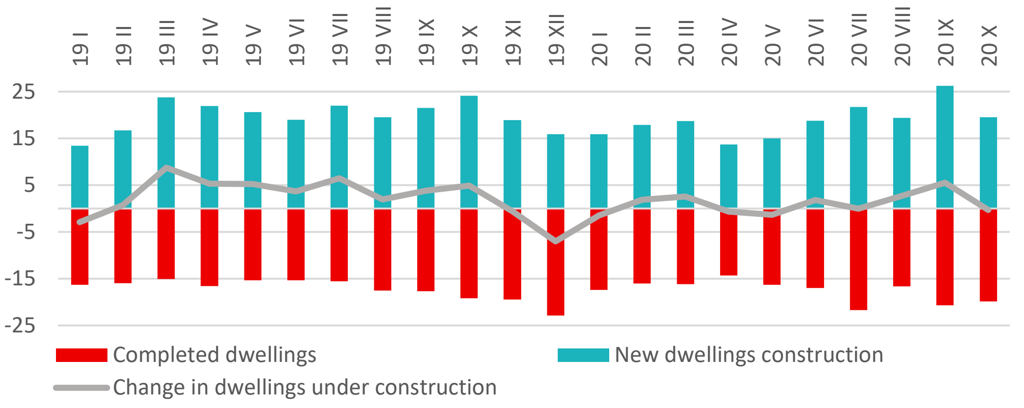
Construction activity in residential buildings enters seasonal slowdown at the end of the year. Developers push to complete as many dwellings as possible before the end of the year, with rebound in new construction coming in March/April. This year, it was during this period that we had April's lockdown, which significantly curbed seasonal rebound in number of dwellings under construction.

Decelerating supply of new housing constructions is accompanied by decelerating construction costs (construction services and materials) – official data for Poland and EU27 show that in 2Q20 average cost remained at higher level y/y but based on prices reported by construction crews there was decelerating momentum in prices in 3Q and 4Q, which may result in stabilisation at a relatively high level at year end. We expect that number of dwellings under construction will close this year with a -0.2% to -0.5% y/y drop, resulting from weak new construction starts in October after record-breaking September, which shows limited realisation of delayed demand from lockdown period. Still, we view this as a good result.

Taking into consideration record low levels of backlogs in buildings construction in 2Q and 3Q20 we expect that negative trend in new dwellings construction will continue in 1Q21 and perhaps even 2Q21. In the second half of the year, based on expected general improvement in economic situation and perspective of containing the pandemic, we expect to see growth in new dwellings construction. As a result, number of dwellings under construction at the end of 2021 could be around this year's level.

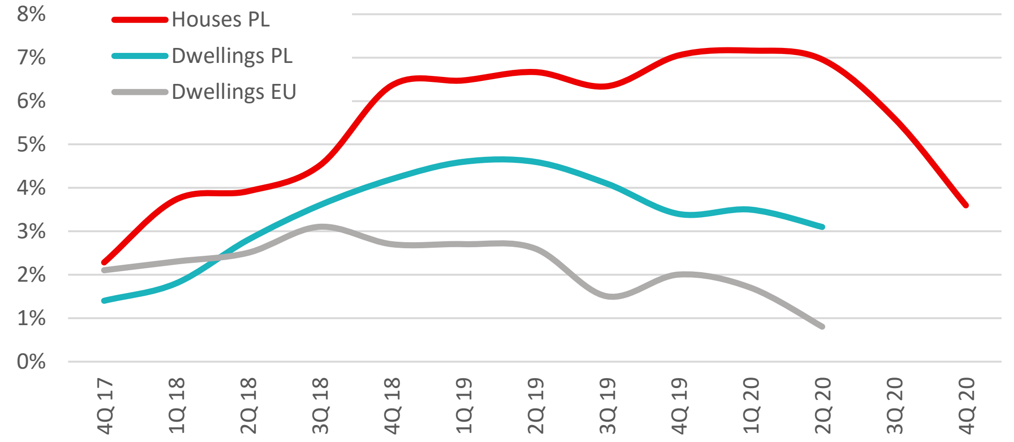
Situation in buildings construction on important export markets is mixed. In Germany 3Q20 showed the first decline in floor area of buildings that received construction permit at -1.2% y/y, after four quarters of consecutive growth. In the Netherlands, which were responsible for significant part of this year's growth in builder's joinery and furniture export, 3Q20 brought an 18% increase in permitted floor area. Sustaining new buildings supply on these markets should be positive for Polish export of construction and furnishing goods in 2021.

New dwellings under construction, completed dwellings, change in dwellings under construcion (thousands)



Source: GUS, Santander calculations

y/y change in construction costs of residential buildings



Source: Eurostat, Wielkiebudowanie.pl, Santander calculations

Santander

Domestic market outpaces export growth

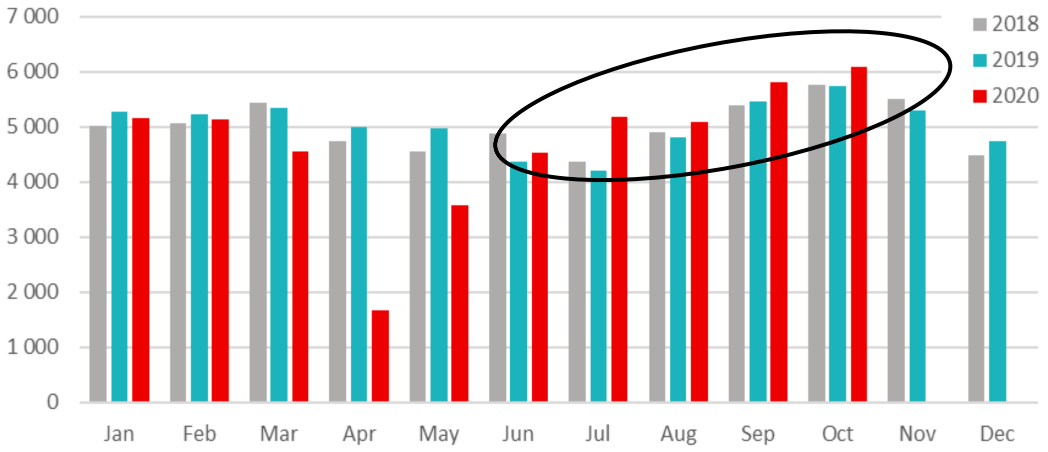
Furniture production was among the hardest hit sectors of manufacturing given the pro-cyclical nature of this market. Nevertheless, Polish furniture manufacturers are systematically recovering from April lockdown, both in domestic and export sales, with the latter responsible for the majority of sales.

Yet in spite of dominant share of export in sold production of furniture, it was domestic market that grew faster after the very tough break of 1Q/2Q20. After eight months of 2020, value of furniture export remained 8.9% lower y/y, while sold production of the furniture industry was only 4.8% y/y lower. This means that in case of furniture, domestic demand picked up even faster than export sales did. What plays an important role in this is the possibility of no-deal Brexit. Even though there are continued talks between officials, companies are already directing their sales to other markets in order to avoid uncertainty and risk. Since Great Britain was the 3rd largest importer of Polish furniture in 2019, this puts significant downward pressure on furniture export growth this year.

Stronger domestic furniture demand may also be the result of less stringent Covid-19 related restrictions. From June to October restrictions in Poland were eased by a larger margin than EU-average, according to Oxford University's Stringency Index. Nevertheless, domestic market's potential is insufficient to fully cover losses from April-May period. What is more, card payments data show that furniture sales plummeted by around 60% y/y in November due to second lockdown. Given the above, we expect that sold production of furniture industry will end this year at around 2% decline y/y.

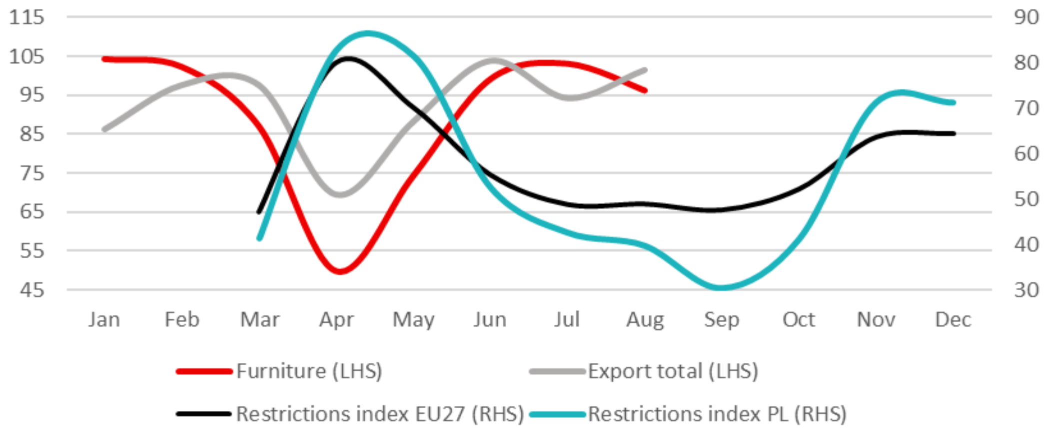
Next year should bring growth rates of sold furniture production in the range of around 7-10% y/y given very low base of 2Q20. Growth structure should move more towards export markets. Key indicators to look for will be economic situation in Germany, the largest importer of Polish furniture overall, and in the Netherlands, the market with the highest import growth this year (+EUR17mn/+4.1% y/y after 8 months of 2020).

Furniture production volume (thousands units)



Source: GUS, Santander calculations

Restrictions stringency index*, export of furniture and total goods index**



*Average monthly value of government restrictions stringency index of University of Oxford
**100 = average monthly export sales in 2019
Source: Eurostat, Oxford University, Santander calculations

Improving resilience of joinery manufacturers

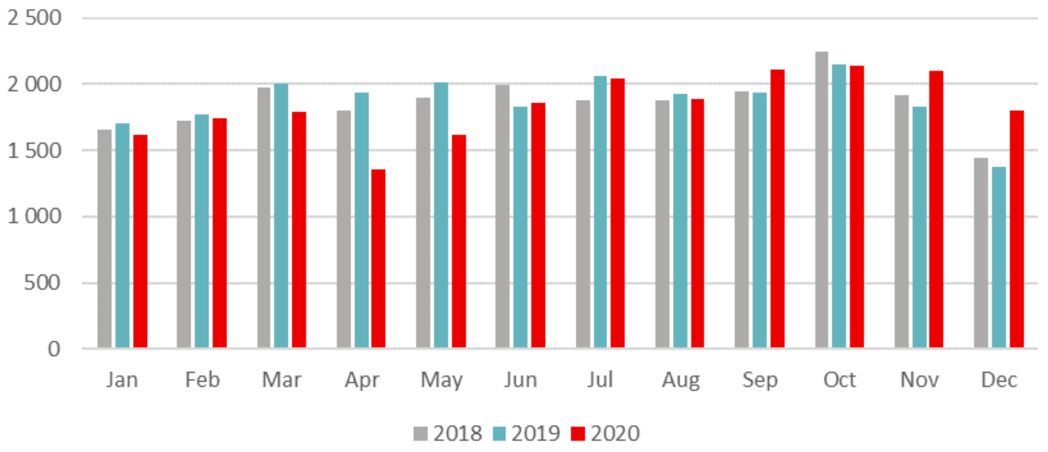
10 months into 2020, builders' joinery production volume is lower by 5% y/y, resulting mostly from lower production volume of joinery of wood. It is a continuation of a trend present on this market well before the pandemic – growing importance of PVC and aluminium joinery and declining role of Great Britain in export of Polish joinery (back in 2018 the UK was the largest importer of wooden windows and frames).

Value of Polish joinery export was already at last year's level after 8 months. Foreign sales rebounded significantly faster than export of goods in total, which remains 5% lower y/y. Among main markets most responsible for this positive result are Germany (28% of this year's export growth), the Netherlands (9%), Ireland (9%), and, what is very important, the USA (8%).

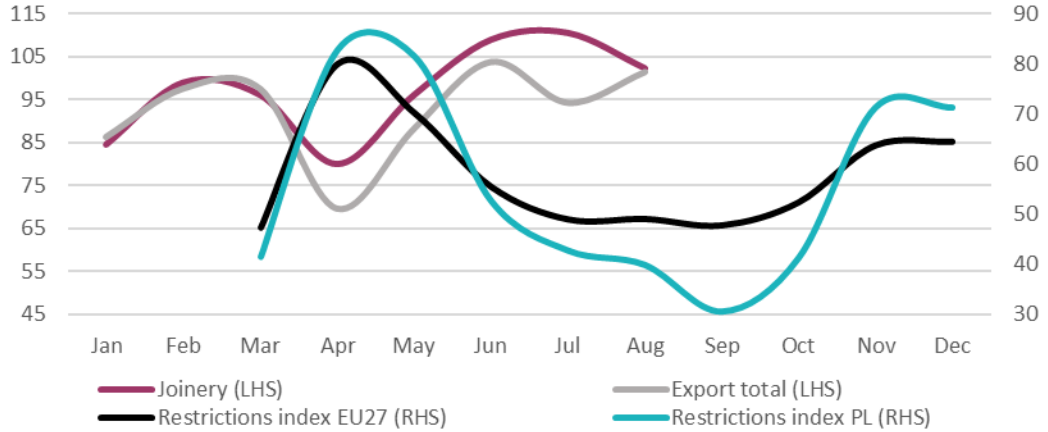
What draws attention are the last two of the above mentioned markets. Sales growth to Ireland amounted to 53% y/y, the USA noted a 25% increase y/y. In case of the former, sales are visibly correlated to the level of uncertainty around Brexit deal talks between London and Brussels. What is more, up to 2Q20 Irish market was noting double digit growth of floor area in residential buildings with construction permit in four preceding quarters. In case of the USA, sales growth along with increasing position among importers of Polish joinery shows how Polish joinery manufacturers expand beyond the EU market, where they compete on high quality but also relatively low production costs.

Expansion beyond EU improves Polish joinery manufacturers' resilience to changing economic situation. Even though the Covid-19 pandemic has hit global growth it did not bring the demand for construction and furnishing materials to zero. Thanks to high competitiveness Polish joinery companies should be able to increase sales in spite of weaker demand. We expect that Polish joinery sector will close 2020 at 4% y/y drop in production volume and a 3% y/y increase in export value. As a result, the share of export in sold production may cross the 60% threshold. Next year we expect further acceleration of export value at a rate of ≥5%.

Production volume of builders' joinery (thousands units)



Restrictions* vs export sales of doors, windows and goods in general**



* Average monthly value of government restrictions stringency index of University of Oxford
** Average monthly export sales in 2019 = 100

Source: Eurostat, Oxford University, Santander calculations

Automotive market will remain below 2019

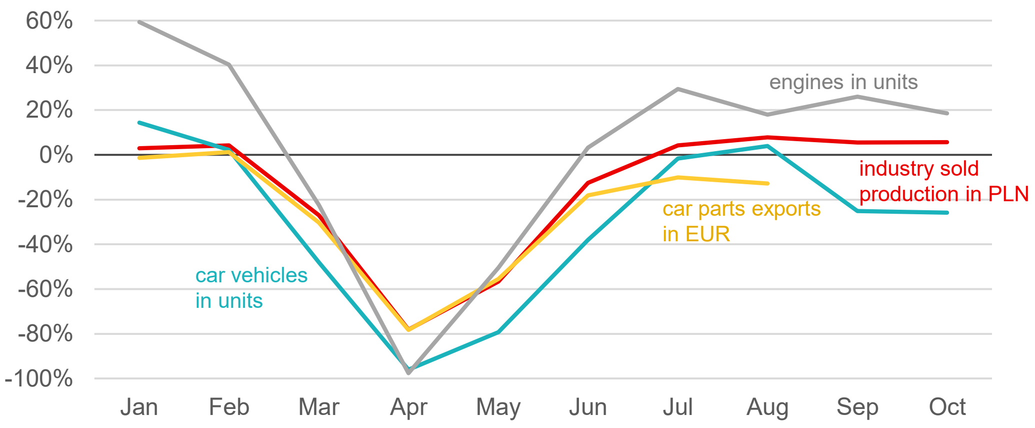
Sold production of the Polish automotive industry in the second half of 2020 (July-October) recorded a 5.7% y/y increase. Taking into account a decrease in the volume of production of car vehicles at that time by 15% y/y, this increase is mainly attributed to car parts manufacturers. It was supported by demand from main importers of domestic car parts (Germany, Czechia, Spain), where production of passenger cars was recovering. It is also worth noting that engines production increased by 23% y/y in this period.

Expected growth of the EU economy in 2021 will not allow it to return to the level of 2019. It is also not to be expected from the automotive sector. Passenger car registrations in the EU are expected to rise 16-17% (LMC Automotive, ACEA/IHS Markit), which would still mean a 13-14% decline vs 2019 level. Our forecasts for domestic parts manufacturers are slightly more optimistic, i.e. a 5-10% drop in revenue compared to 2019. Their cost/price advantage during the crisis has gained importance. Car companies should look for savings when sales fall and when they incur high expenditures on new technologies. Furthermore, support for the production of parts should continue to be provided by an anti-cyclical aftermarket.

We expect that domestic economic growth assumed for 2021 will not ensure a return of passenger car sales volumes to pre-crisis levels. Uncertain economic situation and continuation of the pandemic will be the main factors hindering demand. Recovery of car sales may also be constrained by a further increase in car prices, which is very likely due to falling margins and investments of car companies in alternative drives, as well as, since 2021, payment of penalties for exceeding emissions standards for cars sold by a given company.

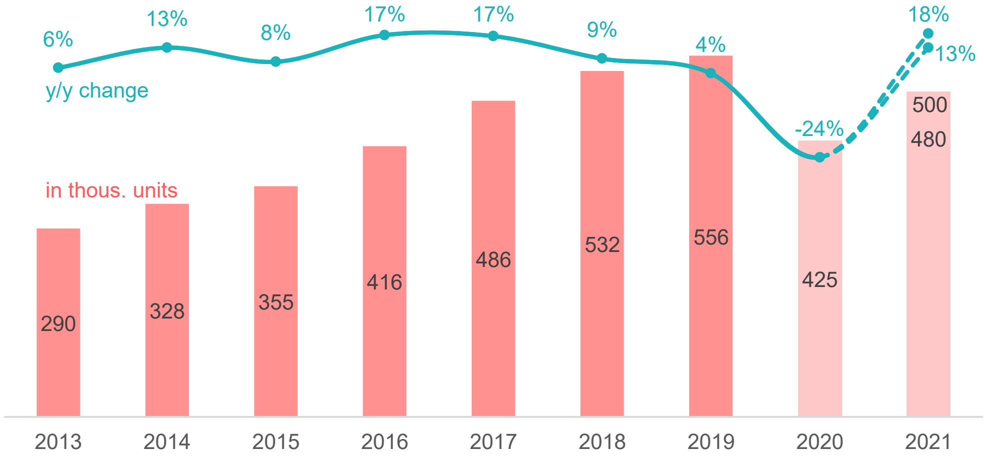
Until November, drops in the number of registrations of new passenger cars in Poland (-25% y/y) were slightly smaller than in Western Europe (-26% y/y). In 2021, the relative performance should be similar. We expect the volumes to increase by 13-18%, which would result in a 10-14% decrease from 2019.

Growth of automotive production in Poland in 2020.



Source: GUS, Eurostat

New passenger car registration volumes in Poland



Source: PZPM, Santander

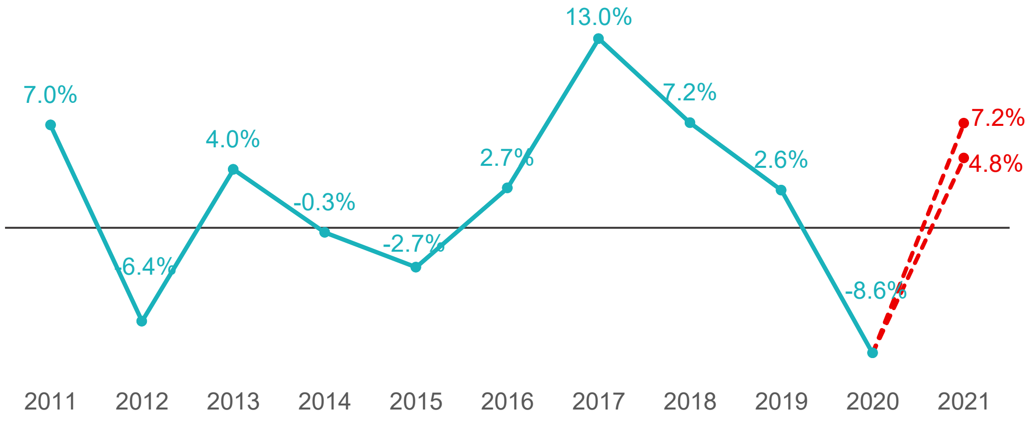
Exports and Internet will be fuel for transportation

We assume that road freight transport in tonne-kilometres carried out by Polish carriers will be 8.6% lower in 2020. In 2021, we forecast growth of 4.8-7.2%, which will mean a 2-4% decrease relative to 2019.

2/3 of transport work done by domestic carriers is international, so the main factor determining demand will be the economic situation and trade in the EU and Poland. Polish export to the EU countries, which since June has been growing y/y (data available until August), should still be an opportunity. In 2019, Polish carriers were leading in total and international road freight transport in the EU, but their competitiveness in relation to local carriers from Western European countries has slightly decreased due to increased costs related to the first regulations of the Mobility Package that came into force in August this year. Much will depend on the pace and degree of their adaptation to the new regulations. It has to be assumed that the aggressive expansion of competitors from Central and Eastern Europe, such as Lithuania and Romania, will continue.

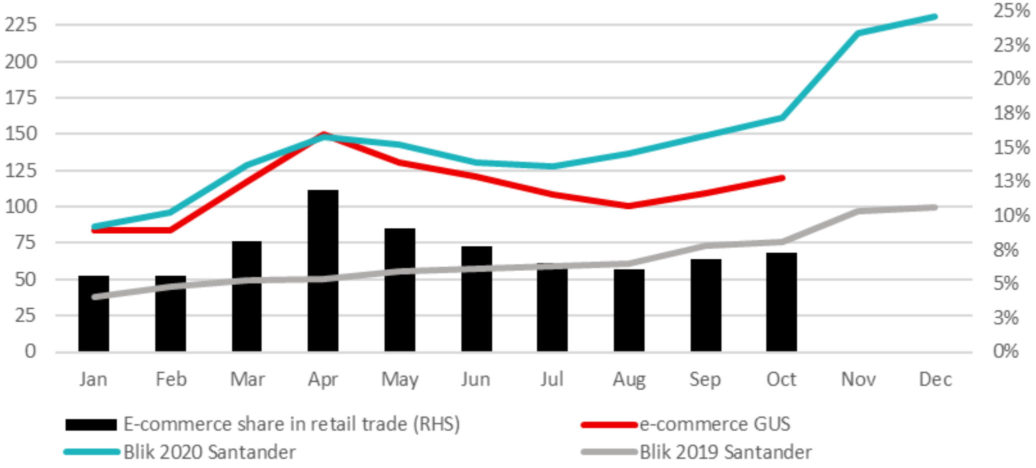
Moving on to the situation on the domestic market, we see that even though retail sales was still 2.5% lower y/y after 10 months, e-commerce sales continue to grow significantly, which should result in corresponding growth in volume of parcel deliveries. According to Santander Bank Polska payments data, in November e-commerce sales showed a 120% y/y growth, with data for the first week of December showing a 130% y/y growth. Even though payments data were quite well correlated to GUS data on e-commerce in the first half of the year, in following months it started to increasingly outpace official growth rates. Based on statistics for the Polish retail sales sector we estimate that e-commerce sales have grown some 47% y/y so far. Share of e-commerce in retail trade grew from 5.4% (last year's average) to about 7.4%. We expect that Christmas shopping will further push this to 7.8% for the year in total.

Growth of Polish road freight transport (tonne-kilometres)



Source: GUS, Santander Bank Polska

Internet sales index*, share of e-commerce in retail trade



100 = retail Internet sales in 12.2019
Source: GUS, Santander, Santander calculations

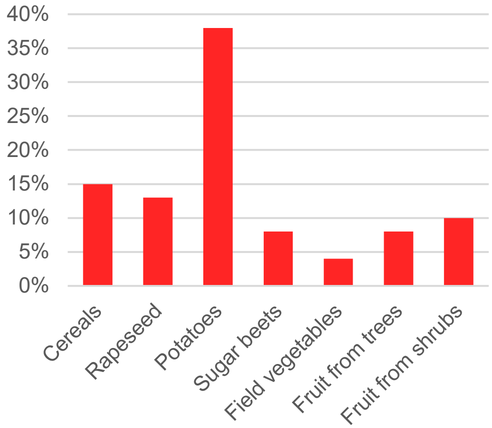
Domestic raw material is an advantage of the food industry

The first wave of Covid-19 showed how access to the local raw material base was an important advantage of the domestic food industry. Thanks to this, supply of raw materials produced by Polish agriculture remained a stable element of food industry's business environment, in a period of many new challenges. Dynamics of agricultural production are an important determinant of changes in food production.

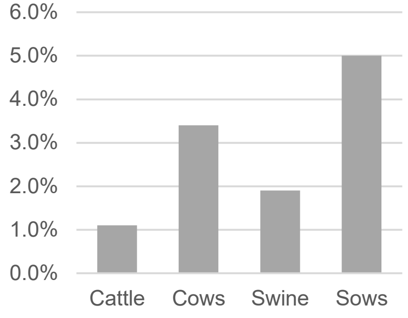
In 2020/21 season, food industry will benefit from this year's higher plant production in Poland. According to the assessments of experts from GUS, cereal and rapeseed harvests in this year are higher by 15% and 13% y/y, respectively. Potatoes production increased by 38% in comparison to 2019. Increase in sugar beet is expected to be 8%. Production of field vegetables is higher by 4% y/y. Harvests of fruit from trees and shrubs are higher by 8% and 10% y/y, respectively.

In livestock production, the situation is very mixed. On the one hand, domestic livestock survey, carried out in mid-2020, indicated a further increase in the domestic cattle and pig herds – in comparison to December 2019, positive dynamics were recorded in almost all technological groups of livestock. In practice, this meant potential for production growth in the future. Poultry production was also increasing at the same time. However, strong drops in prices of meat and livestock this year changed these expectations in the case of some livestock production. In November, the average purchase price of pigs was lower by 30% y/y. In case of turkeys, negative growth was 29%. In turn, the purchase prices of chickens for fattening were lower by 4% when compared to low level of the same month of the previous year. Reduction in prices and a significant deterioration in the profitability of pigs and poultry farming will probably be reflected in reduction of domestic livestock production potential in the second half of 2020. It will also have negative impact on meat production in Poland in 2021. Milk producers and manufacturers will enter 2021 in better moods. The dairy industry benefits from high foreign demand, incl. China, which supports domestic prices.

Production growth of the main plant raw materials (y/y)

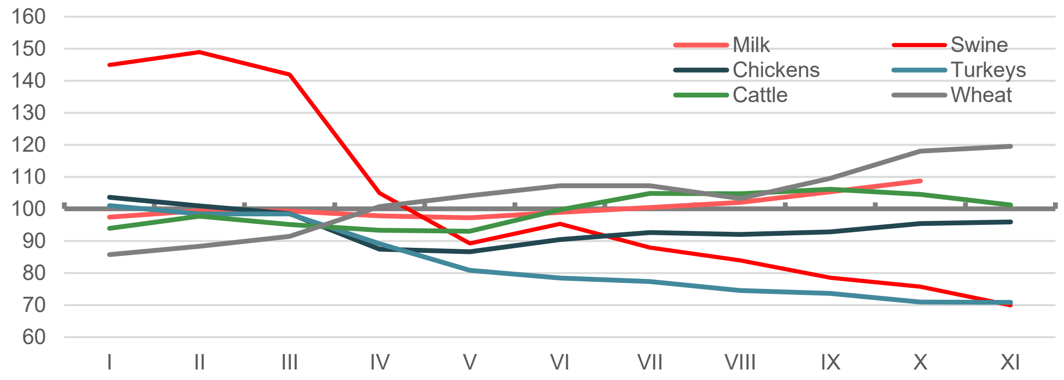


Change in the number of livestock (VI 2020, y/y)



Source: GUS, Santander calculations

Growth of purchase prices of agricultural raw materials in 2020 (y/y)



Source: Polish Ministry of Agriculture, GUS, Santander calculations

Santander

Is the food industry becoming increasingly resistant to shocks?

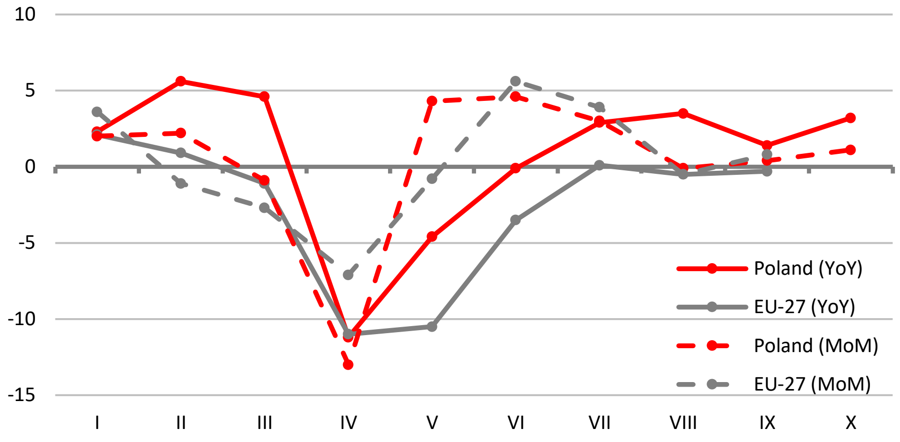
The impact of the second wave of the pandemic is felt by food companies, but it should be emphasized that the barriers of current operations are fewer than during the first wave. On the one hand, restrictions once more affected the HoReCa sector, which is an important customer for the domestic food production industry. On the other hand, most processing plants, trade in other EU countries and international transport operate without significant obstacles.

The data on the growth rate of food industry's sold output in the EU indicate a weaker negative impact than during the first wave of Covid-19. According to Eurostat estimates, in October, when restrictions in economic and social life in Poland and other EU countries returned, sold production of the domestic food industry increased by 1.1% in comparison to September. At the same time, it remained above the level from the corresponding month of 2019 (+ 3.2%).

Also, soft indicators show higher optimism than during the first wave. GUS business tendency survey shows that assessment regarding the current and expected portfolio of domestic and foreign orders in Polish food industry worsened in November, but the balance of answers was much higher than in April and May. Similar results are shown by business climate studies carried out in other EU countries, including main export markets for Polish food. This gives hope that the negative impact of further Covid-19 waves will be much lower than during the first one.

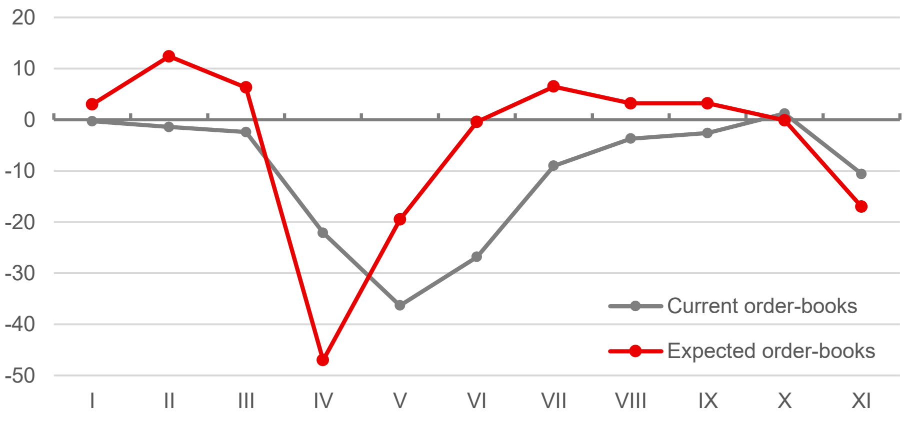
One of the drivers of the food industry remain, despite the pandemic, exports. After three quarters, the value of foreign sales of Polish food exceeded EUR25bn, which means an increase by 6.7% in annual terms. Polish foreign food sales was supported by weaker PLN. Throughout 2020, exports may reach another record level, exceeding EUR33bn (+5.5%). A no-deal Brexit remains a risk factor for the export performance in the next year. The UK is one of the most important foreign recipients of Polish food.

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



Source: Eurostat, Santander calculations

Business tendency survey in food industry (balance of answers)



Source: GUS, Santander calculations

This analysis is based on information available as of **11.12.2020** and has been prepared by:

STRATEGIC SECTORS DEPARTMENT
al. Jana Pawła II 17, 00-854 Warszawa
E-mail: sektory@santander.pl
Sectoral approach resources: www.santander.pl/korporacje/rozwiazania-sektorowe

Sector analyses:

Grzegorz Rykaczewski	agriculture, food industry	+48 512 765 647
Maciej Nałęcz	industry, services	+48 665 615 384
Radosław Pelc	automotive, transport, logistics	+48 887 845 708

Business contact:

Bartosz Toczony	director	+48 693 220 698
Martyna Dziubak	automotive, transport, logistics	+48 727 570 319
Renata Dutkiewicz	food industry, cosmetics	+48 607 083 699
Małgorzata Nesterowicz	services and family businesses	+48 695 201 053
Kamil Mikołajczyk	industry	+48 661 381 827

IMPORTANT DISCLOSURES

This report has been prepared by Santander Bank Polska S.A. and is provided for information purposes only. Santander Bank Polska S.A. is registered in Poland and is authorised and regulated by The Polish Financial Supervision Authority.

This report is issued in Poland by Santander Bank Polska S.A., in Spain by Banco Santander, S.A., under the supervision of the CNMV and in the United Kingdom by Banco Santander, S.A., London Branch (“Santander London”). Santander London is registered in the UK (with FRN 136261) and subject to limited regulation by the FCA and PRA. Santander Bank Polska S.A., Banco Santander, S.A. and Santander London are members of Grupo Santander. A list of authorised legal entities within Grupo Santander is available upon request.

This material constitutes “investment research” for the purposes of the Markets in Financial Instruments Directive and as such contains an objective or independent explanation of the matters contained in the material. Any recommendations contained in this document must not be relied upon as investment advice based on the recipient’s personal circumstances. The information and opinions contained in this report have been obtained from, or are based on, public sources believed to be reliable, but no representation or warranty, express or implied, is made that such information is accurate, complete or up to date and it should not be relied upon as such. Furthermore, this report does not constitute a prospectus or other offering document or an offer or solicitation to buy or sell any securities or other investment. Information and opinions contained in the report are published for the assistance of recipients, but are not to be relied upon as authoritative or taken in substitution for the exercise of judgement by any recipient, are subject to change without notice and not intended to provide the sole basis of any evaluation of the instruments discussed herein.

Any reference to past performance should not be taken as an indication of future performance. This report is for the use of intended recipients only and may not be reproduced (in whole or in part) or delivered or transmitted to any other person without the prior written consent of Santander Bank Polska S.A..

Investors should seek financial advice regarding the appropriateness of investing in financial instruments and implementing investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realised. Any decision to purchase or subscribe for securities in any offering must be based solely on existing public information on such security or the information in the prospectus or other offering document issued in connection with such offering, and not on this report.

The material in this research report is general information intended for recipients who understand the risks associated with investment. It does not take into account whether an investment, course of action, or associated risks are suitable for the recipient. Furthermore, this document is intended to be used by market professionals (eligible counterparties and professional clients but not retail clients). Retail clients must not rely on this document.

To the fullest extent permitted by law, no Santander Group company accepts any liability whatsoever (including in negligence) for any direct or consequential loss arising from any use of or reliance on material contained in this report. All estimates and opinions included in this report are made as of the date of this report. Unless otherwise indicated in this report there is no intention to update this report.

Santander Bank Polska S.A. and its legal affiliates may make a market in, or may, as principal or agent, buy or sell securities of the issuers mentioned in this report or derivatives thereon. Santander Bank Polska S.A. and its legal affiliates may have a financial interest in the issuers mentioned in this report, including a long or short position in their securities and/or options, futures or other derivative instruments based thereon, or vice versa.

Santander Bank Polska S.A. and its legal affiliates may receive or intend to seek compensation for investment banking services in the next three months from or in relation to an issuer mentioned in this report. Any issuer mentioned in this report may have been provided with sections of this report prior to its publication in order to verify its factual accuracy.

Santander Bank Polska S.A. and/or a company in the Santander Group is a market maker or a liquidity provider for EUR/PLN.

Santander Bank Polska S.A. and/or a company of the Santander Group has been lead or co-lead manager over the previous 12 months in a publicly disclosed offer of or on financial instruments issued by the Polish Ministry of Finance or Ministry of Treasury.

Santander Bank Polska S.A. and/or a company in the Santander Group expects to receive or intends to seek compensation for investment banking services from the Polish Ministry of Finance or Ministry of Treasury in the next three months.

ADDITIONAL INFORMATION

Santander Bank Polska S.A. or any of its affiliates, salespeople, traders and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, Santander Bank Polska S.A. or any of its affiliates' trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein.

No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

Investment research issued by Santander Bank Polska S.A. is prepared in accordance with the Santander Group policies for managing conflicts of interest. In relation to the production of investment research, Santander Bank Polska S.A. and its affiliates have internal rules of conduct that contain, among other things, procedures to prevent conflicts of interest including Chinese Walls and, where appropriate, establishing specific restrictions on research activity. Information concerning the management of conflicts of interest and the internal rules of conduct are available on request from Santander Bank Polska S.A..

COUNTRY & REGION SPECIFIC DISCLOSURES

Poland (PL): This publication has been prepared by Santander Bank Polska S.A. for information purposes only and it is not an offer or solicitation for the purchase or sale of any financial instrument. All reasonable care has been taken to ensure that the information contained herein is not untrue or misleading. But no representation is made as to its accuracy or completeness. No reliance should be placed on it and no liability is accepted for any loss arising from reliance on it. Information presented in the publication is not an investment advice. Resulting from the purchase or sale of financial instrument, additional costs, including taxes, that are not payable to or through Santander Bank Polska S.A., can arise to the purchasing or selling party. Rates used for calculation can differ from market levels or can be inconsistent with financial calculation of any market participant. Conditions presented in the publication are subject to change. Examples presented in the publication is for information purposes only and shall be treated only as a base for further discussion.

U.K. and European Economic Area (EEA): Unless specified to the contrary, issued and approved for distribution in the U.K. and the EEA by Banco Santander, S.A. Investment research issued by Banco Santander, S.A. has been prepared in accordance with Grupo Santander's policies for managing conflicts of interest arising as a result of publication and distribution of investment research. Many European regulators require that a firm establish, implement and maintain such a policy. This report has been issued in the U.K. only to persons of a kind described in Article 19 (5), 38, 47 and 49 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (all such persons being referred to as "relevant persons"). This document must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is only regarded as being provided to professional investors (or equivalent) in their home jurisdiction.

Thank You.

Our purpose is to help people and business prosper.

Our culture is based on believing that everything we do should be:

Simple Personal Fair

Santander

MEMBER OF
Dow Jones Sustainability Indices
In Collaboration with RobecoSAM

FTSE4Good