MACROscope

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Vanishing point

Poland: Economic Outlook

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Executive Summary (macro)

A strong economic revival is still on the horizon, but is like a vanishing point – moving further away even as we travel in that direction. The third wave of the Covid-19 pandemic in Poland is in full swing and has already proven to be more severe than the previous one (yet still less deadly, hopefully thanks to the vaccination of the elderly population). The restrictions introduced so far by the government are a bit tougher than those seen in the autumn and winter but unless they prove to be "too little, too late" to tame the virus spread, they should not change the economic outlook drastically. A sharp pickup in GDP growth is still possible before the year end, in our view, but may be delayed vs. our previous forecast. **We lower our 2021 GDP growth forecast to 4.2%, but lift our estimate for 2022 to 5.1%** (page 12). Consensus forecasts for the European economy are moving in a similar direction (page 11).

We have argued for a long time that the situation across different parts of the economy may be very diversified, and the recent data confirm it. While the manufacturing sector is coping best, still operating at outputs well above the pre-pandemic level, and benefiting from the continuous rise of external demand, construction was hit by unfavourable weather at the start of the year, while retail trade and other services have suffered from the sweeping restrictions (p.13-16). Those trends are also reflected in labour market dualism: the detailed data show that under the surface of general labour market resilience in 2020 there were significant changes in both labour activity and employment (p.18-19). **We see evidence of building "hidden unemployment" (the flee to inactivity or to self-employment in agriculture), which may finally surface if the pandemic crisis lasts much longer.** On the other hand, it means there are probably reservoirs of easily available workforce for those sectors that would need it first, diminishing the risk of a rapid return to labour shortages and wage pressure accumulation once the economy gains momentum.

2020 ended with CPI dropping to 2.4% y/y, but in March inflation bounced back to 3.2%, partly due to higher fuel prices, but also, on our estimates, on the back of elevated core inflation. CPI growth may accelerate further in the coming months, to 4% by May. However, **core inflation should be on a downward trend throughout 2021, in our view**, amid the prolonged restrictions and stagnation of domestic demand (page 20). We see building upward risks for 2022 inflation.

In the last few months we have seen some interesting twists in the National Bank of Poland's communication style: signalling possible further interest rate cuts at the start of the year, quickly changed to the message that neither rate cuts nor hikes cannot be ruled out, then the statement about zero probability of rate hikes, at least until mid-2021, the pledge that NBP policy will follow the Fed´s and ECB's footsteps exactly, and finally the signal of a more pro-active approach to the QE programme. These twists have triggered volatility in market expectations for the policy outlook and in money market pricing. Our view is that **the most likely scenario for Polish monetary policy is interest rate stability at least until the middle of 2022, when there will be an election for a new NBP governor.** But at least the discussions about rate cuts in Poland have stopped for now. The zloty has weakened recently, underperforming other CEE currencies, which has been the NBP´s wish since mid-2020, so we think the central bank should be comfortable with the trend. (page 22)

Executive Summary (markets)

FX

EUR/PLN rose well above 4.60 in late March, which once again happened shortly after the new wave of Covid-19 hit Poland and the government introduced country-wide restrictions. It seems that the pandemic remains one of the key currency drivers. Other negative factors for the zloty include the generally negative sentiment towards EM currencies amid rising bond yields in the developed world and a stronger US dollar.

We are revising EUR/PLN forecasts higher mainly due to the major new wave of pandemic and the NBP's signal that it will boost its QE programme. The FX loans issue remains a risk factor and may introduce short-term volatility, but it remains uncertain when and how exactly it may play out. The Supreme Court ruling was postponed until 13 April. We still believe that by the end of the year the zloty may regain some of its strength, once the pandemic situation is under control and economic growth reaccelerates. (page 25)

FI

In Q1 the main driving force behind Polish yields were rising core market yields. Given expectations of no rate changes by NBP (front-end IRS) abundant liquidity in the banking sector (front-end bonds) and the increased amount of NBP QE (long-end bonds) it was only the long-end IRS that could freely move with core yields and as a result the 10Y ASW fell to -0.25% - the lowest in 20 years.

At the front-end of the curve we expect the situation to persist for another quarter (bond yields near zero, stable FRA up to mid-2022).

At the long-end of the curve, further rising core market yields and expectations of a GDP rebound in the 2H21E are likely to exert upward pressure on yields. The larger NBP QE, not so large government bond supply (given BGK Covid-19 bonds are likely to take up the slack – still up to PLN 26.0 bn more in 2021 possible) and large redemptions coming in April (PS0421) and May (PS0421) might help keep rising yields in check. We expect 10Y bond yields at 1.70% at the end of Q2 and at 1.90% at year end. (page 30)

2021 Forecasts – what has changed

Indicator	Our view in December 2020	Our view at the end of March 2021
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%.	Outlook for 2Q21-3Q21 worsened due to the third wave of the pandemic. Strong economic revival still likely before the year-end but may be delayed vs. previous forecast. 2021E average GDP growth lower, at 4.2%, but 2022E higher, at 5.1%.
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.	All assumptions still valid, however the pickup in consumption and investments will have to wait a bit longer until the pandemic threat diminishes and vaccine rollout gains the critical mass.
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.	Labour market remains quite robust in general, although the longer lasting restrictions may generate more job losses. Large internal differentiation: job cuts in some areas offset by new hiring in others, higher inactivity and surge in self-employment. Wage growth has been surprisingly strong to date.
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.	Inflation higher than we thought, mainly due to rising fuel prices. CPI may approach 4% again in May, but should descend towards 3% by the year-end. Core inflation should continue declining amid the prolonged stagnation of domestic demand, but we see building upward risks for 2022.
Monetary policy	Main interest 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.	We still believe that main interest rates will remain unchanged at least until mid-2022, when NBP governor's term ends. NBP keeps favouring weaker zloty and signalled more active QE management, but at least rate cuts are off the table.
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.	Very low visibility (due to the fact that the bulk of spending has been pushed out from the central budget) makes it difficult to track fiscal outlook in real time. We stick to the previous forecast of GG deficit at c.6% of GDP in 2021.
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.	NBP's pledge to keep rates unchanged for long and the abundant liquidity in the banking sector will keep front-end bond yields glued to zero. Long-end IRS will follow core market yield normalization (up) keeping long-end ASW negative. Long-end bonds will increase towards 1.90% by year-end but the rise will be kept in check by increased NBP QE and large redemptions in Q2.
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.	Short term outlook negative for PLN due to mix of factors: high Covid-19 wave, more active NBP's QE, uncertainty regarding FX loans. Some strengthening possible by the year-end, but return to pre-pandemic levels will take more time.

Economy

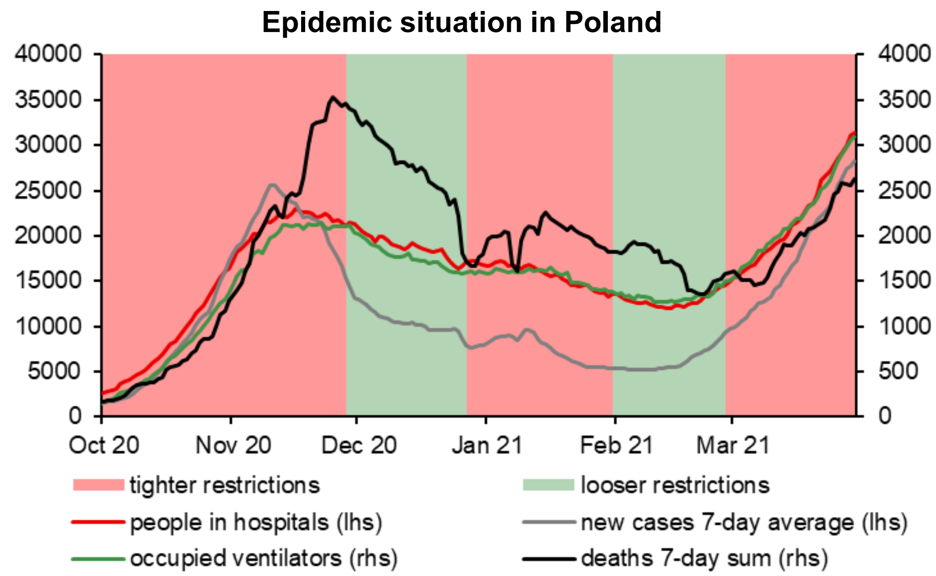
1

Covid-19: rising third wave

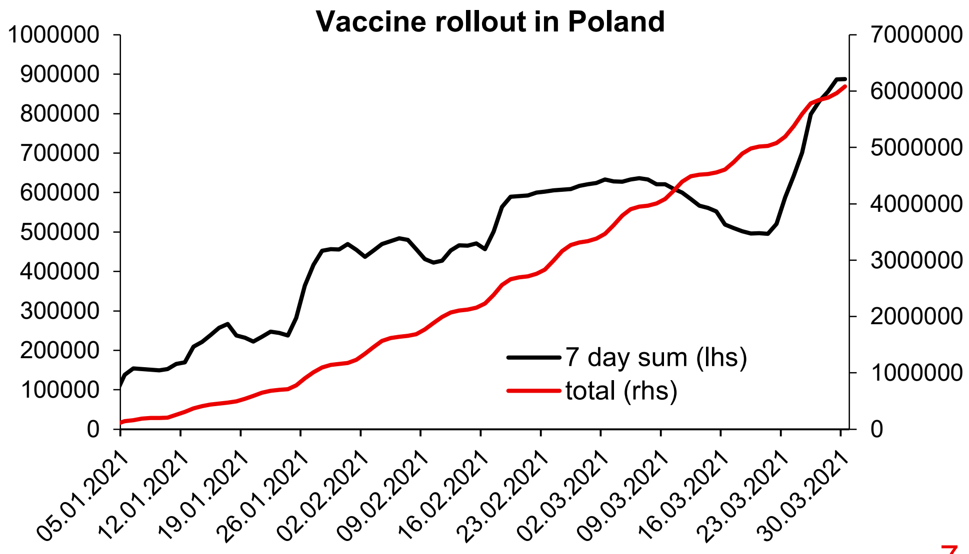
Third wave of Covid-19 is rising in Poland. New infections are going up sharply, and are already above peaks recorded in November. The number of people in hospitals and in ventilations are at all-time highs. The government responded with tighter restrictions – after loosening started on 1 February with reopening of shopping malls and cultural centres, on 27 February restrictions were reimposed in one voivodeship (out of 16) and in the entire country on 20 March. On 27 March the government ordered the closure of beauty salons and hairdressers as well as imposed stricter limits on number of people in shops.

Current [forecasts] indicate that a peak in infections is likely in early April. This is clearly an optimistic forecast, given that we are in late March already, but if we assume that the government will react similarly to the second wave, loosening of restrictions is possible in late April / early May. Since 1-3 May is a popular holiday period in Poland, we think the government will be keen to constrain travel during that time. Thus, it is unlikely that loosening will happen before the May holidays, in our view.

The vaccine rollout in Poland started in late December and has been gradually accelerating. In mid-March, the process slowed down due to negative news flow about the Astra Zeneca vaccine. But then a significant acceleration took place, bringing the 7-day sum to new high at 831k. So far, 6mn shots have been administered.



Source: Michał Rogalski, Santander



Source: Ministry of Health, Santander

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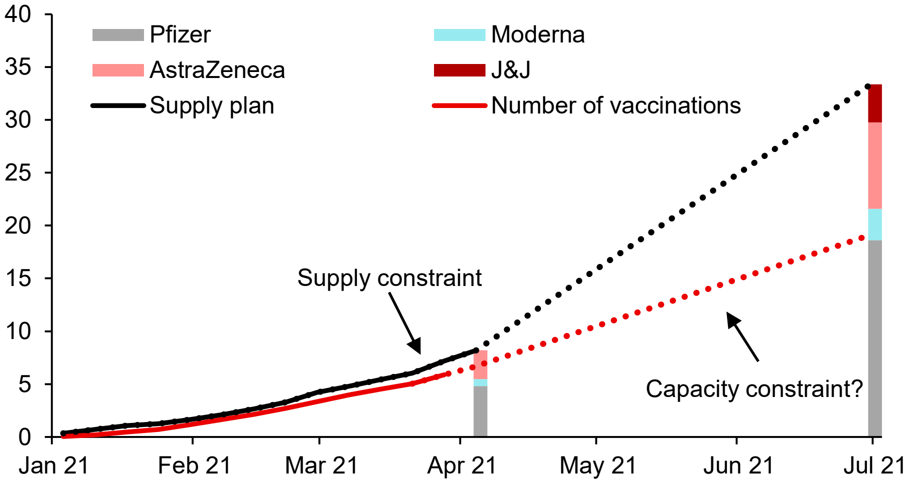
Covid-19: vaccination rollout constrained

The all-time high weekly vaccination number at 887k is slightly below capacity declared by the government for 2Q21 at 1mn/week (according to PM press conference on 30th March). The Prime Minister suggested that the government is aiming at 10mn/month capacity, but without giving any specific timeline. In 1Q21 the rollout was undermined by low supply of vaccines. According to the European Commission, deliveries are to speed up strongly in 2Q and this is when more will depend on the capacity.

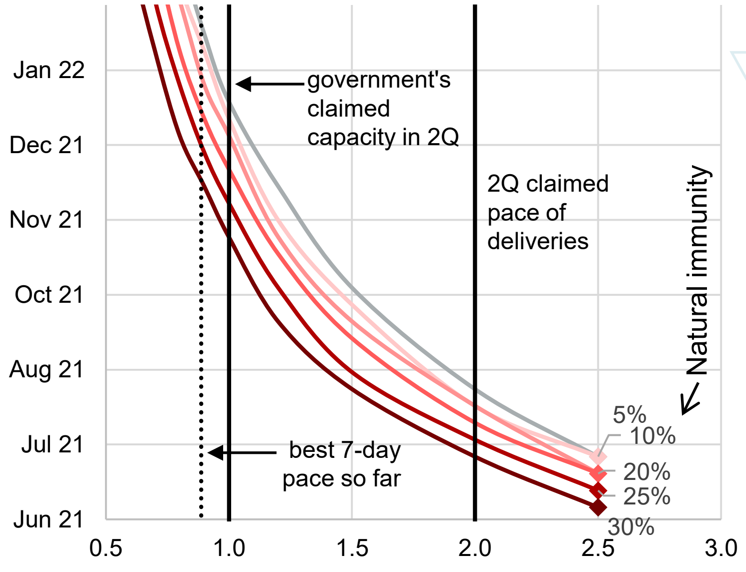
According to our simulations, reaching herd immunity is possible in 4Q21 if the current pace of vaccinations is continued. However, we think that immunity of the most vulnerable groups may be enough to avoid new lockdowns. According to our simulations, the 61+ age group could be potentially fully vaccinated by August 2021. If the government is able to speed up vaccinations to match 2Q21 supply, herd immunity could be reached in 3Q21.

Covid-19 vaccines rollout in Poland (mn doses)



Source: European Commission, Ministry of Health, Santander

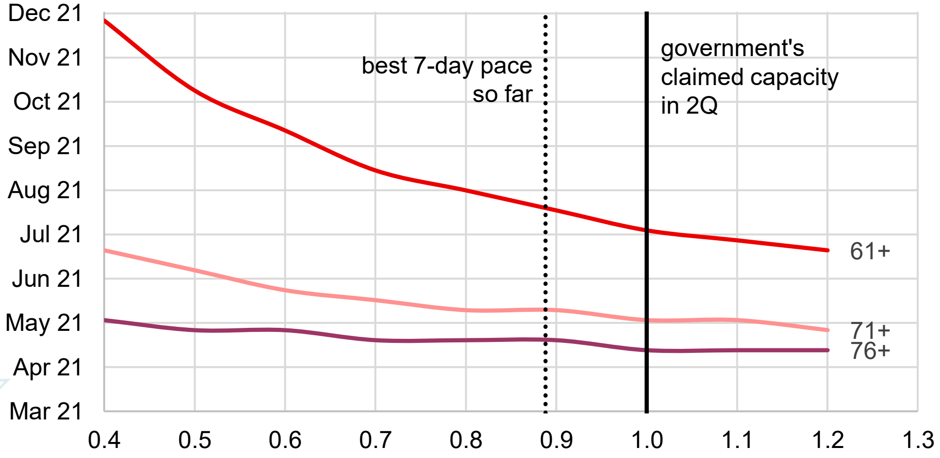
When do we reach herd immunity?



Source: Santander

Assumptions: vaccine effectiveness – 95% after two shots (15% of vaccines assumed to be one-shot J&J), immunity after vaccination: >1 year, R0 – 3.0 (67% immunity = herd immunity). Natural immunity = immunity acquired by people who recuperated from Covid-19

When an age group will be fully vaccinated?

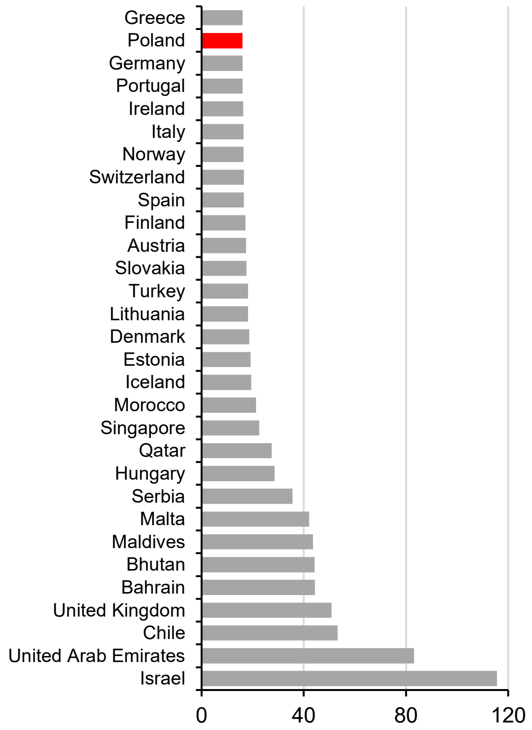


Assumptions: full capacity is directed towards shown age groups

Source: Santander

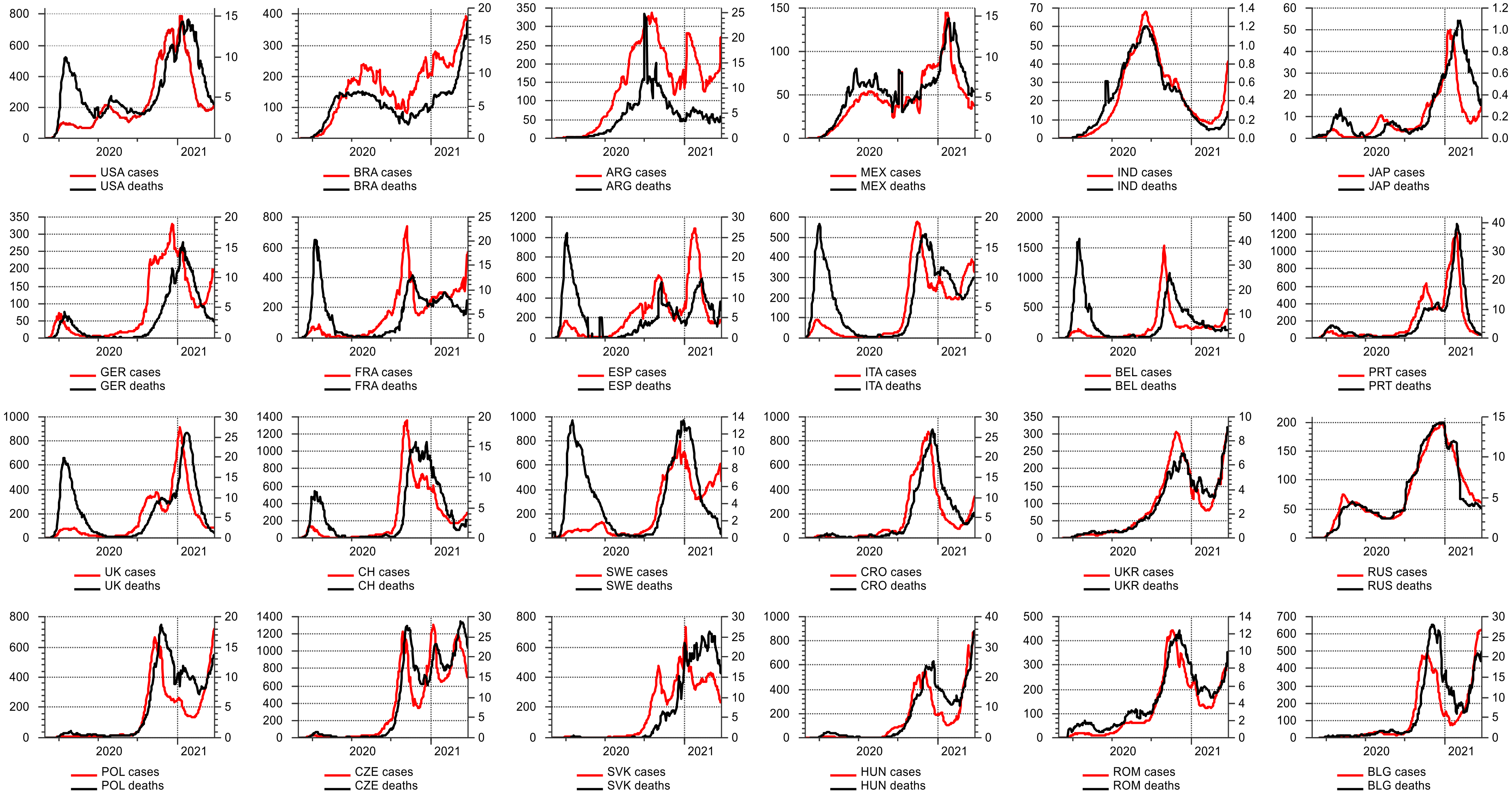
Covid-19: international context

Covid-19 vaccine administered per 100 people, March 30 2021



Source: ourworldindata.org

Covid-19: new confirmed cases (lhs) and deaths (rhs) per 1m, 7-day rolling average



Source: Refinitiv Datastream, Santander

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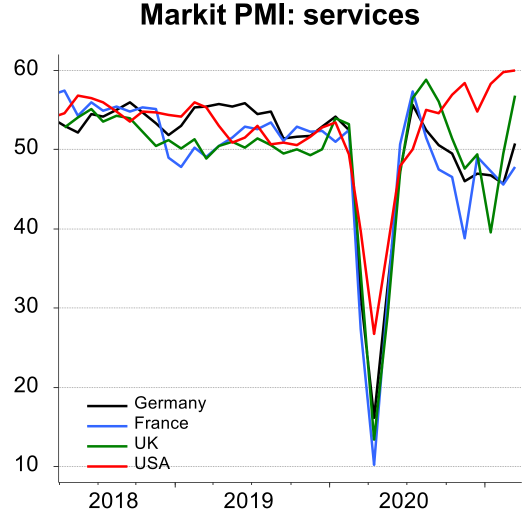
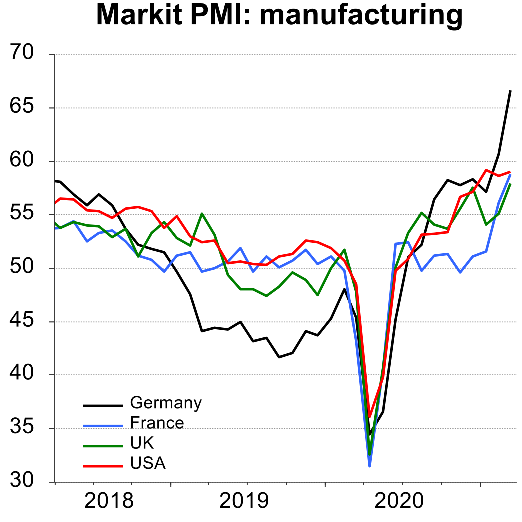
Global manufacturing and trade on the rise

Activity in global manufacturing continues rising, with Germany, Poland's biggest trading partner, leading the recovery in Europe. **It coincides with a sharp rebound in international trade in goods**. The index of global export volume has surged in January, returning not only to the pre-pandemic level but almost to the pre-pandemic trend. It is remarkable that the downturn in global trade was of similar magnitude, but much shorter than that seen during the Global Financial Crisis of 2009.

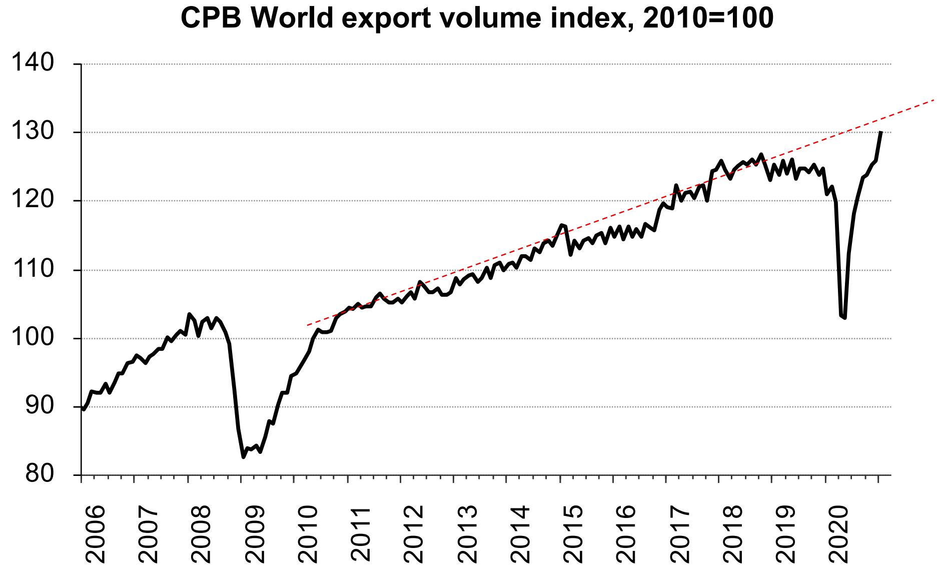
There are, however risk factors on the horizon, which could make further expansion more difficult. Producers report building problems with supply chains, including component shortages (e.g. semiconductors shortage already limiting automotive production in Europe) and delivery problems (containers shortage, and most recently the Suez Canal blockage).

Activity in services is increasingly dependent on vaccination progress – still depressed in most of Europe, picking up in USA and UK. While the vaccine rollout in the EU still remains disappointing, most European countries maintain their pledge to reach Covid-19 herd immunity by July, which gives hope that activity in services may revive more broadly in 3Q21.





Source: Refinitiv Datastream, Santander



Source: Refinitiv Datastream, Santander

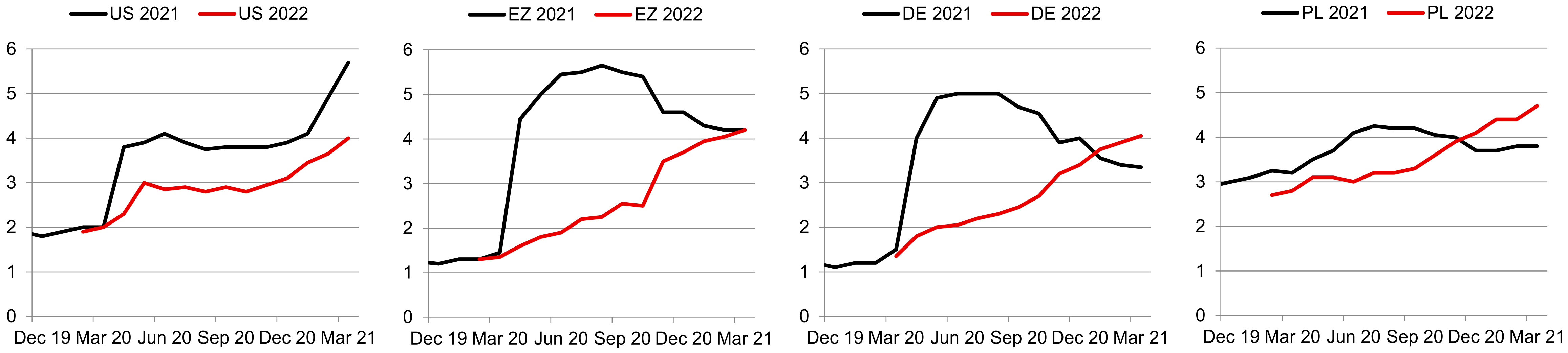
Growth momentum in Europe delayed?

The consensus forecasts for GDP growth in the USA are moving steadily up, buoyed by quite successful vaccination strategy of the Joe Biden's administration and implementation of the large fiscal stimulus package.

Meanwhile, **forecasts for Europe are gradually shifting the growth momentum from 2021 to 2022**. It is most likely caused by a combination of factors: the disappointing progress in vaccination, the looming third wave of coronavirus (already in full swing in CEE, still in the making in Western Europe), and doubts regarding the implementation of the EU Recovery Programme (concerns that the benefits may be delayed due to procedural issues and/or prolonging approval of the programme by the member states).

Predictions for Poland are moving in a similar direction as those for Europe: GDP consensus forecast for in 2022 already exceeded the one for 2021.

How GDP growth forecasts for USA, euro zone, Germany and Poland changed over time, according to Bloomberg consensus (%)



Source: Bloomberg, Santander

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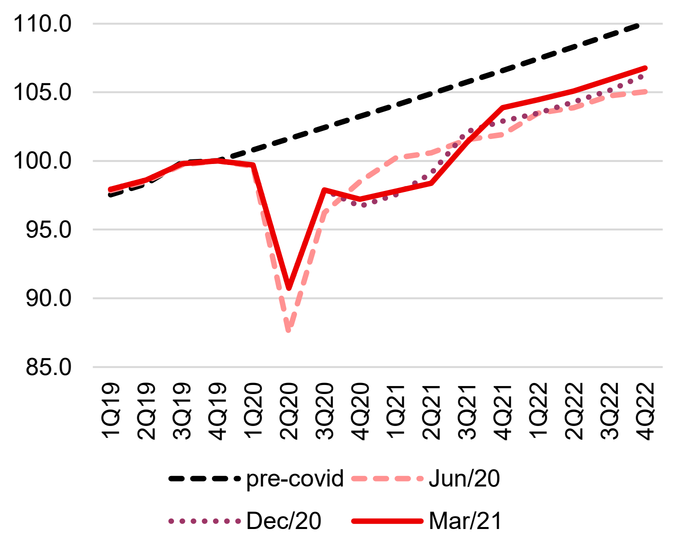
GDP outlook for Poland dimmed again by the virus

The third wave of Covid-19, resulting in renewed restrictions, plus still insufficient pace of vaccine rollout, has introduced additional uncertainty to GDP forecasts and justify, in our view, less optimistic predictions for this year. We still believe that the strong rebound of demand is just a matter of time, however recent events suggest it may take longer than we thought, so growth momentum may, indeed, be moving gradually towards 2022.

Our working assumption is that the current pandemic restrictions will be maintained at least until early May but hopefully will be the last ones needed in the cycle. In this scenario economic activity in 2Q21 will remain subdued but no more so than in 1Q (with seasonally adjusted q/q GDP growth slightly above zero), and in late summer or early autumn a stronger demand recovery may start. **Overall, Poland may end 2021 with GDP growth just above 4% and as one of the very few countries in EU with GDP already above the pre-pandemic level. Also, GDP growth in 2022 could exceed 5%.**

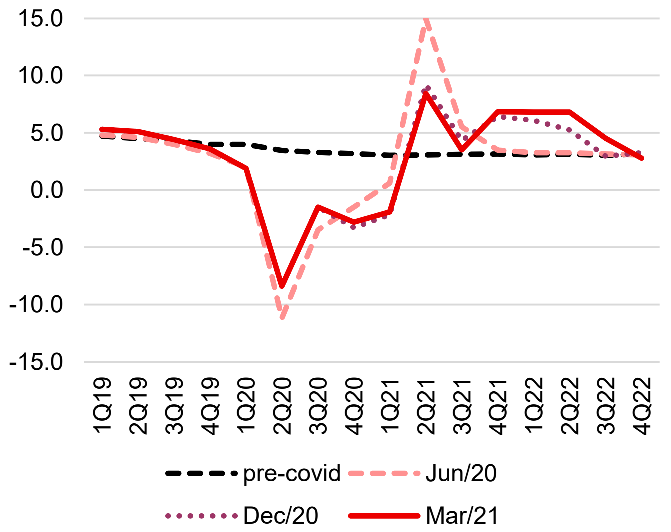
The risk factor is that the restrictions imposed by the government could prove to be "too little, too late" to tame the current wave of infections. If this is the case, we may see another drop in q/q GDP in Q2 and the slower revival in Q3. The result would be even lower GDP growth this year, but then possibly even higher in 2022.

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



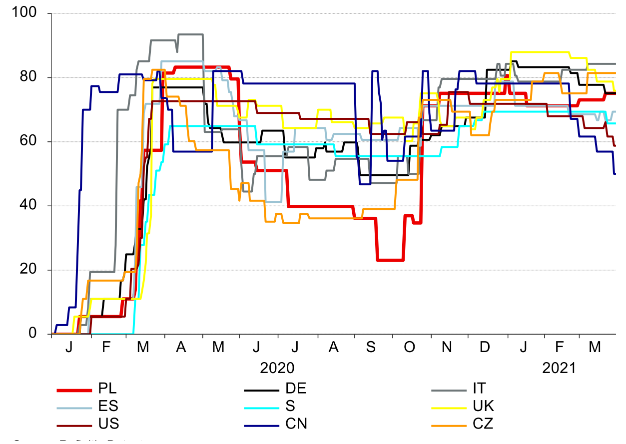
Source: Santander

GDP forecasts (% y/y)



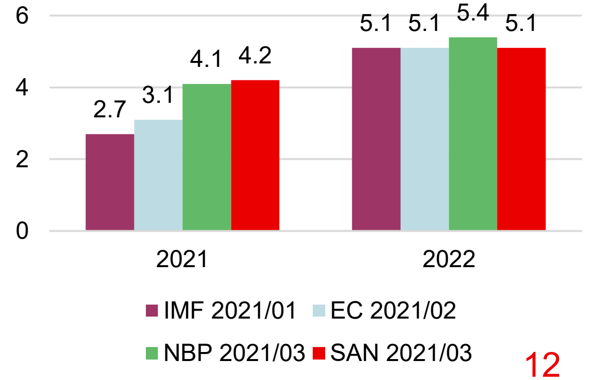
Source: Santander

Oxford stringency index



Source: Refinitiv Datastream, Santander

GDP growth forecasts for Poland (%)



Source: IMF, EC, NBP, Santander

Industry and exports: handicapped start to the year

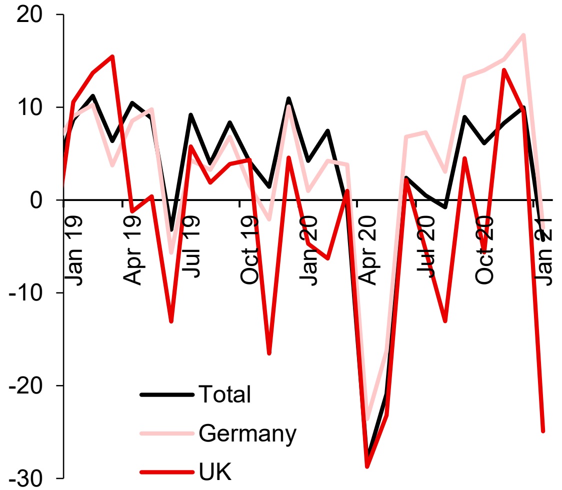
Early 2021 industrial output and export numbers left a feeling of disappointment compared to the late 2020 surge. There were good reasons for the pattern: stocking up before the end of the Brexit transition period (extra demand for industrial goods from abroad), the holiday period increasing propensity to buy big ticket items in demand during the pandemic, of which Poland is top European supplier (consumer durables), the end of German VAT rate reduction. Thus, **this early 2021 weakness of output should be transitory**.

The start of 2021 has also been difficult for Polish industry due to supply shortages (a global phenomenon) affecting business to a degree only seen before during the peak of the cycle in late 2007. This should also be a transitory negative factor for output, but note that the previous episodes of such shortages lead to production slowdowns.

An interesting point is that supply shortages have occurred in Poland amid huge rise (!) of imports from Asia and China in particular. Possibly Asian suppliers to Europe passed more of their goods via Silk Road when global sea freight capacity was limited.

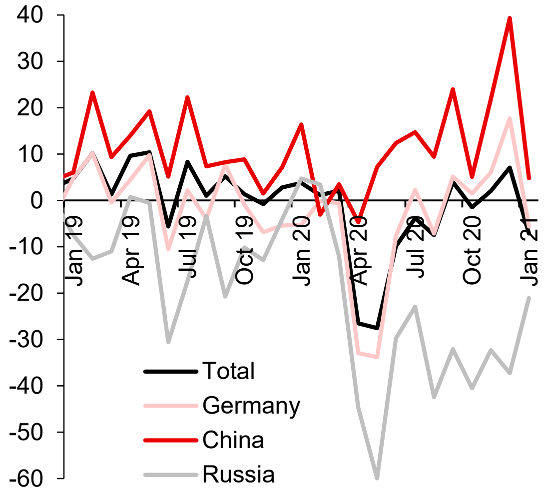
Imports from Russia have also been recovering of late (from -40% y/y in Dec'20 to -20% y/y in Jan'21). This means that Poland's huge 2020 trade surplus in goods, based on the greatly reduced value of imported commodities, may be shrinking in 2021.

Poland's export of goods, %y/y



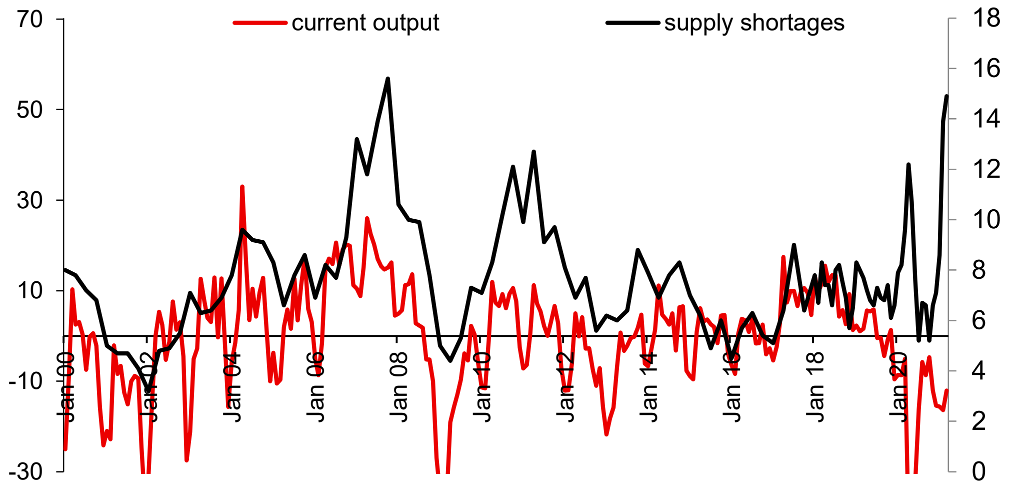
Source: GUS, Santander

Poland's import of goods, %y/y



Source: GUS, Santander

Business sentiment in industry, selected components



Source: GUS, Santander

Industry: durability of strong results

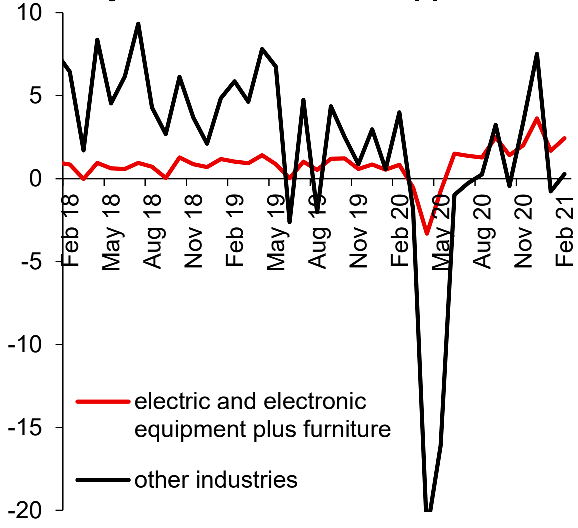
The success story of Polish industry in 2020 was based on the heightened demand for consumer durables due to the pandemic (more time spent at home). We are approaching a moment when base effects kick in to this category, which might deprive industry of the key contribution to output growth.

We are observing growing reluctance for major purchases in consumer surveys in Europe, which could mean that the demand for consumer durables may start to fade. On the other hand, the prolonged lockdowns are likely encouraging redecorating and people upgrading their consumer electronics and IT equipment, provided they still feel safe about their financial situation.

Industrial production is well diversified and able to switch to other branches as engines of growth as the business cycle progresses. We are already seeing sound results in intermediate goods, which historically has been well correlated with the performance of the European economy.

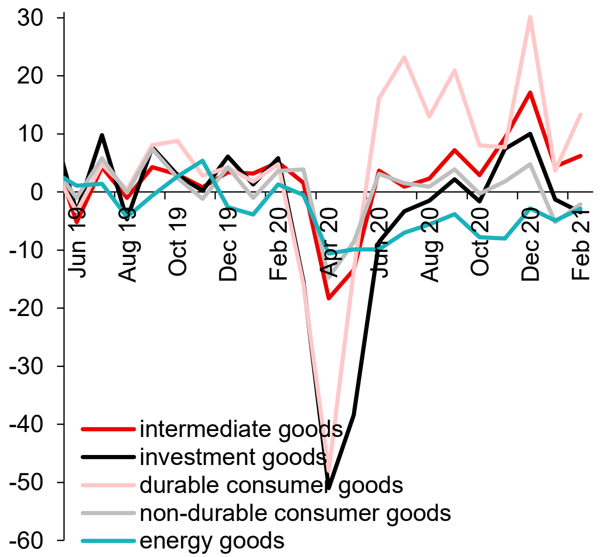
At a later stage of the cycle Polish investment goods providers should also start to contribute more to total output growth.

Contribution to total y/y output growth by selected industries, pp



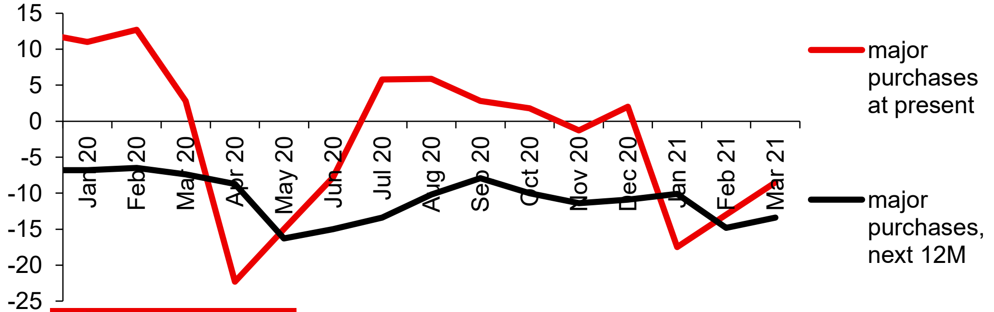
Source: GUS, Santander

Output by Main Industrial Groupings, %y/y



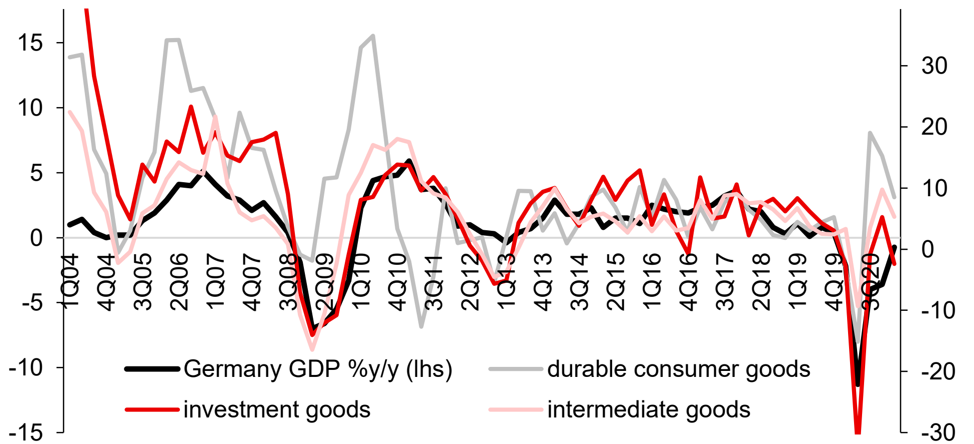
Source: GUS, Santander

ESI consumer confidence, Germany, major purchases indexes



Source: European Commission, Santander

Output by Main Industrial Groupings vs German GDP, %y/y



Source: GUS, Eurostat, Santander

Investment still undermined

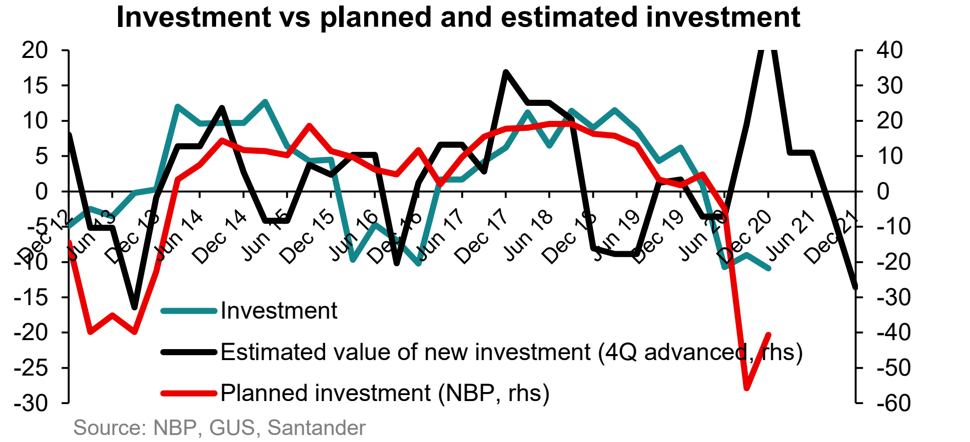
We have claimed in our 2021 outlook that investment growth will remain negative in 1H21 and then is likely to rebound strongly. We stick to that view although we have to acknowledge that risk for that forecast is skewed downwards. In our view investment is being withheld mostly due to negative pandemic outlook, while companies' finances remain quite healthy.

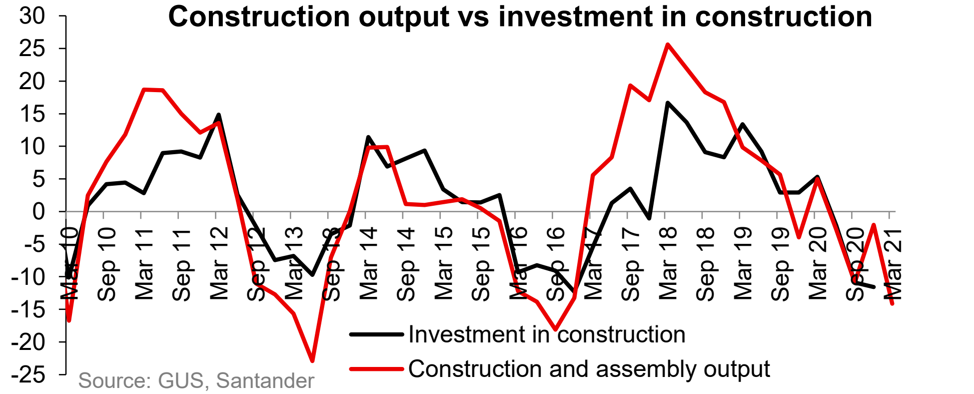
Uncertainty in the economy remains high, NBP indicator of planned investment remains depressed and estimated value of new investment tumbled in 4Q20 by almost 30% y/y. These measures suggest no imminent rebound.

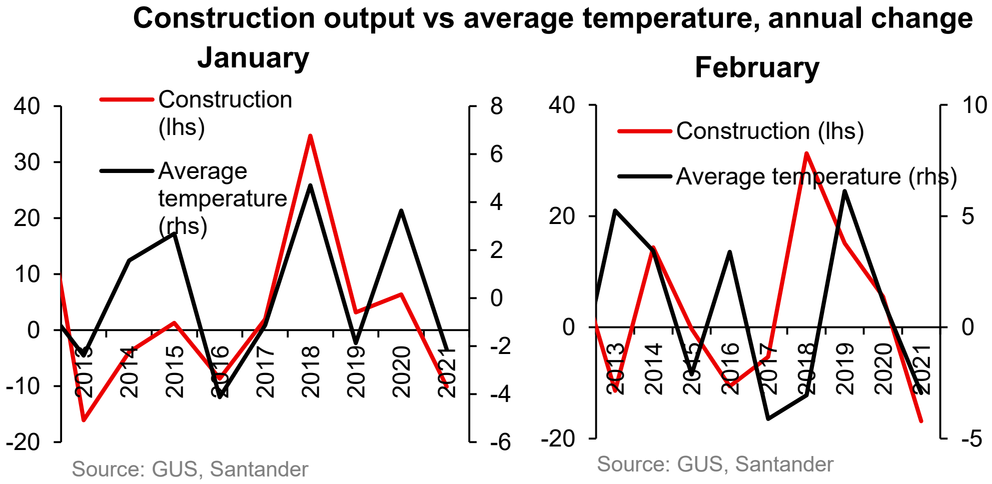
In 4Q20 the annual investment growth declined to -10.9% y/y from -9.0% in 3Q20. In asset breakdown, this slowdown was mostly caused by outlays on machinery and transport (-11.6% y/y versus -6.0% y/y in 3Q), while investment in construction did not recover and recorded -11.5% y/y vs -10.9% y/y in 3Q20.

While investment in construction and construction output are strongly correlated (see chart), in 4Q20 the construction output improved markedly vs 3Q20 (-11%) and declined by about 2% y/y. This improvement was mostly driven by housing and road construction.

In January and February results of construction were clearly disappointing showing deep declines in annual terms. This was partially to be blamed on severe weather conditions (see charts on the bottom right-hand side), but these numbers confirm another negative quarter for investment. We are expecting construction to return to positive growth rates in 2H21.







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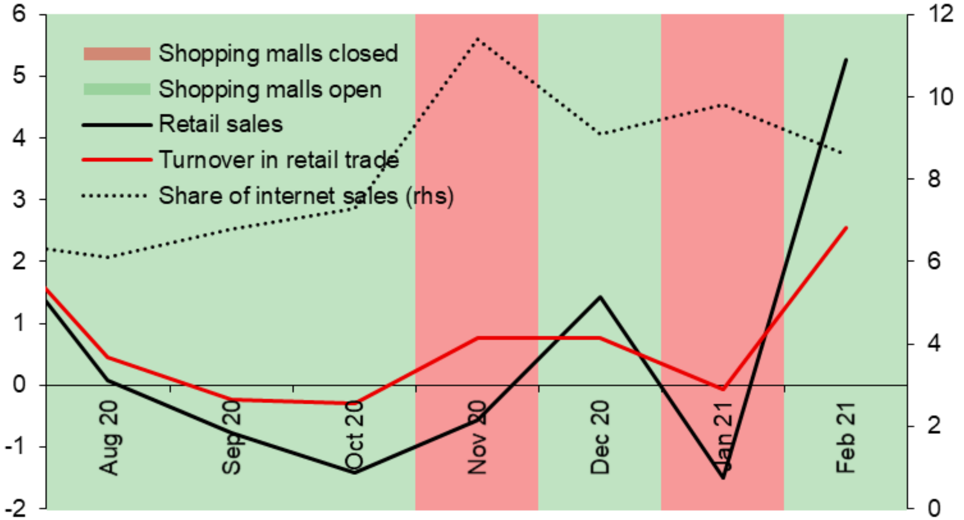
Consumption moving to the rhythm of restrictions

We think that restrictions, especially lockdowns of shopping malls, restaurants, hotels and beauty services, remain the main reason for the undermining of private consumption. The financial situation of households is sound, as we have shown on page 17. **Thus, we are expecting the consumption to normalise quickly after restrictions are lifted.** We are not expecting the so-called pent-up demand to be a major driver of consumption in 2021.

In the last few months, retail trade has been determined by whether shopping malls are opened or not. A reopening triggered immediate jumps in total sales, while lockdowns undermined total sales but supported internet sales. In 3Q20, when restrictions were loosened markedly and the number of infections was relatively low, private consumption managed to record a slightly positive growth in annual terms. These developments – in our view – set a benchmark for a potential rebound when the epidemic risk diminishes, which we think should be quick and strong.

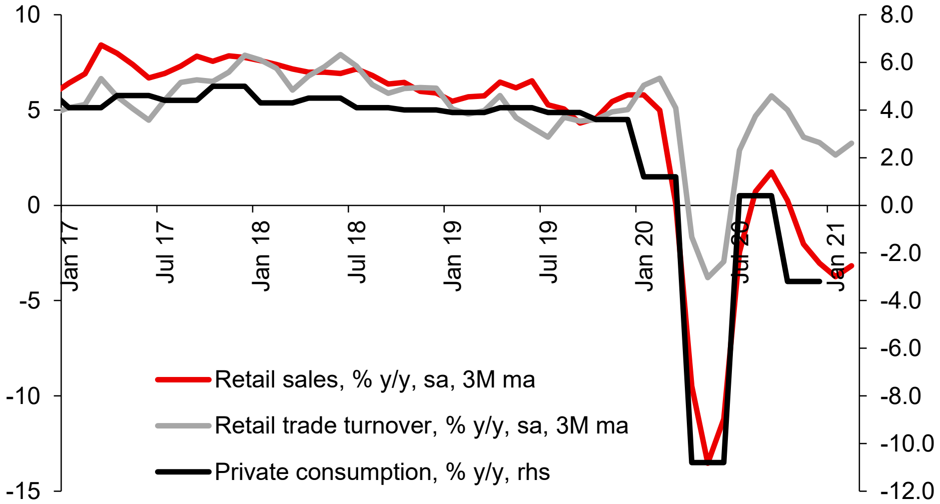
Despite the biggest economic crisis in years the financial standing of households has improved (page 17). That is why many economists (including us) have claimed that loosening of epidemic restrictions will unleash a so-called pent-up demand. This term means that consumers will buy more than usually in order to make up for the spending “lost” during the lockdown. However, our analysis of this phenomenon in 2020 showed that this type of demand was probably found only in a few limited spending categories. Thus, we think it is hard to expect that the pent-up demand could be a major factor behind rebound in GDP growth in 2021. Still, mare normalisation of sales will be enough to secure a hefty rise in private consumption.

Sales in retail trade (% m/m, s.a.) vs restrictions in shopping malls



Source: GUS, Santander

Consumption, retail sales and retail trade turnover, % y/y



Source: GUS, Santander

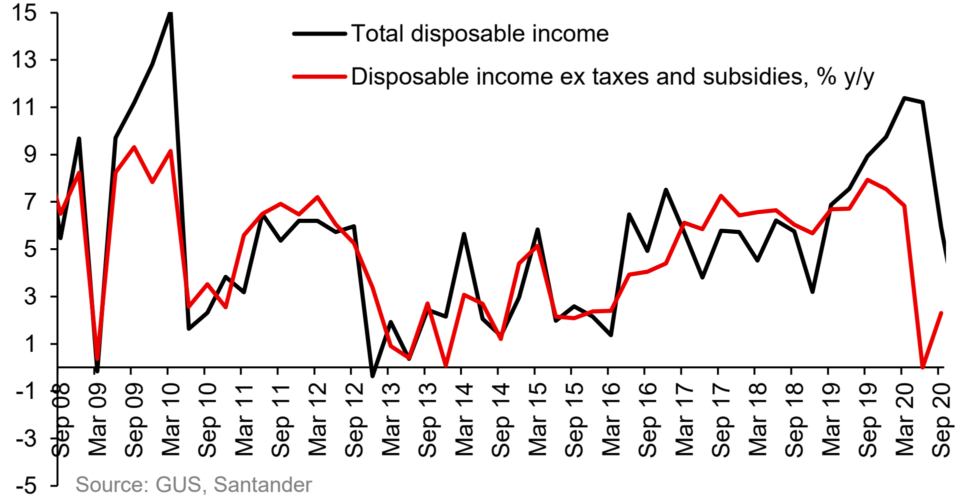
Santander

Incomes boosted by government aid

There are still no signs of any deterioration in the financial situation of households or companies. **In our view, healthy balance sheets will be a key factor behind a dynamic rebound as soon as pandemic lockdowns end.**

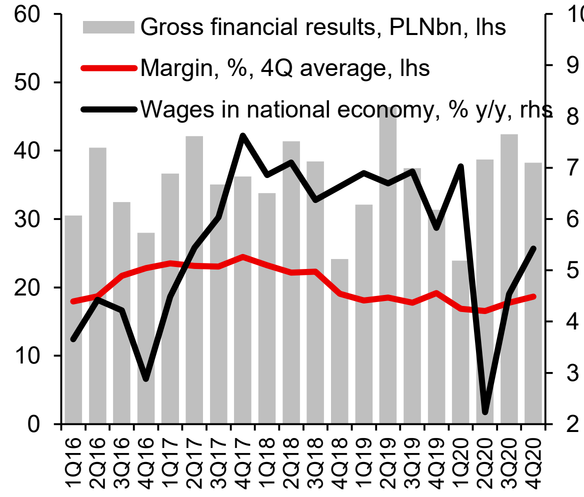
Financial assets of both sectors were improving at highest pace since post-GFC rebound in 2010. This could be mostly attributed to high incomes, which were boosted by the government help, especially in 2Q20, while 3Q20 saw some deceleration (plus lower spending). A slump in incomes is actually visible in data corrected for taxes, benefits and subsidies, but note that it was not deeper than in crises of 2008-2009 or 2012-2013. While detailed data on financial and non-financial accounts for 4Q20 are not available yet, statistics on wages and financial results in biggest firm suggest some improvement in incomes at the year-end.

Disposable incomes of households, % y/y



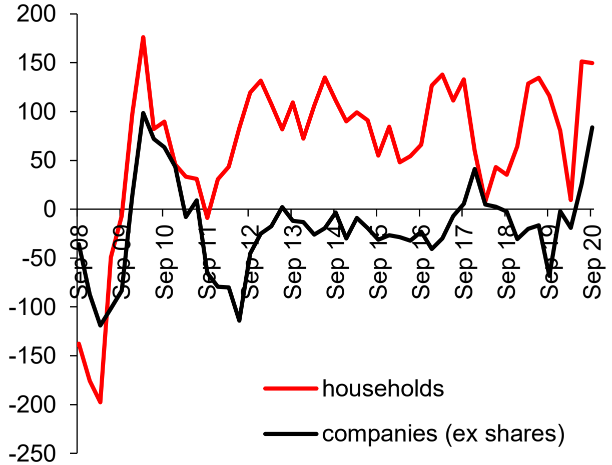
Source: GUS, Santander

Incomes of companies and employees



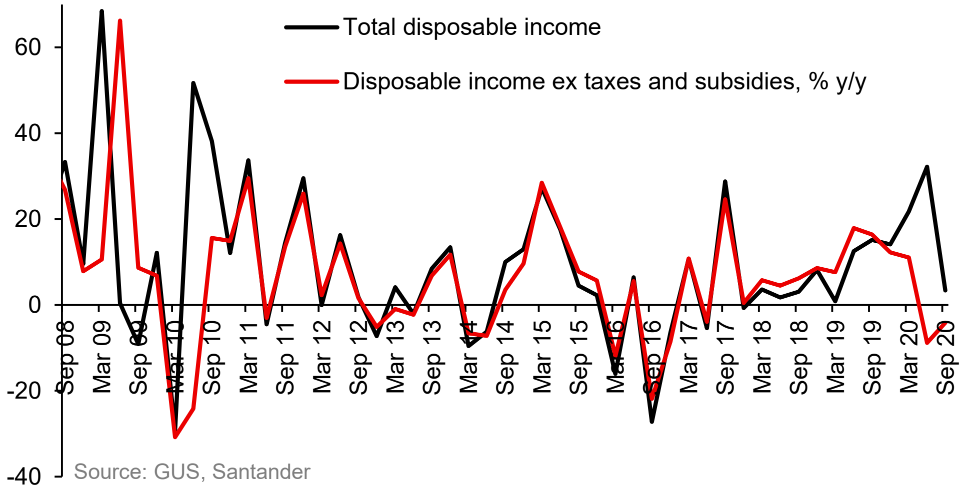
Source: GUS, Santander

Net financial assets – y/y change in PLNbn



Source: NBP, Santander

Disposable incomes of companies, % y/y



Source: GUS, Santander

Santander

Labour market: still calm on the surface

The labour market data still look very robust: the unemployment rate has been quite stable after only a modest rise in 2020 and wage growth remains surprisingly solid (seasonally adjusted real wages have been rising since September at the same average pace as in the last months before the pandemic), the average employment in corporate sector jumped strongly in February (albeit mainly in retail trade after weak January – probably due to reopening of shopping malls).

However, if we scratch the surface the picture starts looking more complex.

The demand for labour remained depressed in 4Q20. Net job creation at 37.6k was the weakest since the 2013 slowdown excluding the 2Q20 shock, down 29.2% y/y compared to -7.4% in 3Q20. Job creation growth was -20% y/y, worse than in 3Q20 (-16.4%). This could have improved in 1Q as employment components of business surveys went up in almost all industries, most services and all parts of trade.

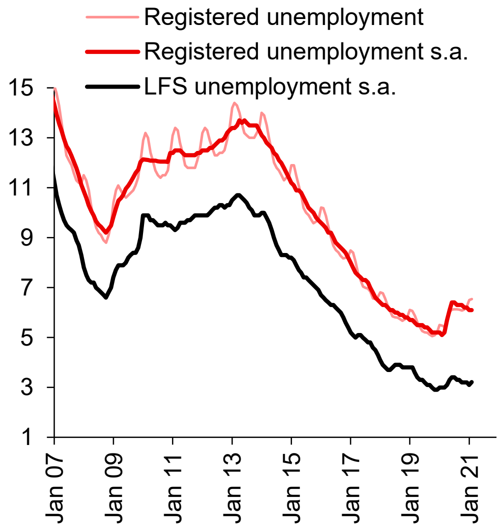
On the other hand, the trends in Google search suggest that the re-introduction of restrictions saw again some increase in Poles' questions regarding redundancies, unemployment registration and severance pay.

The government support focused on lowering labour costs is ongoing, albeit only to selected sectors, preventing some layoffs. This is making the registered unemployment rate somewhat unresponsive to the crisis. But if the restrictions last longer the companies' patience may be running out and more job cuts may follow.

As shown on the next page, the detailed Labour Force Survey data reveal that already in 2020 the actual trends in the labour market were less optimistic than suggested by the headline unemployment figures: we found some evidence of building "hidden unemployment" (a flee to labour inactivity or to self-employment in agriculture).

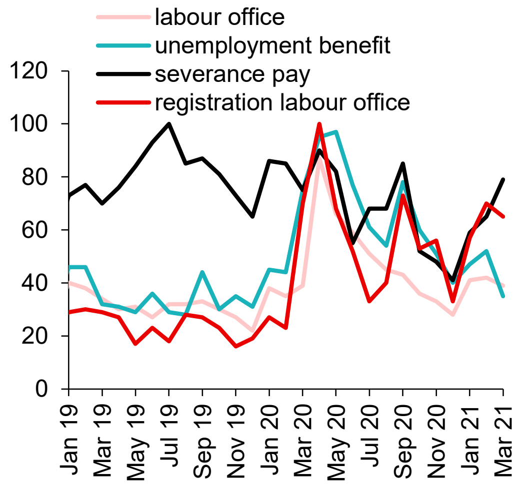
Migration flows also acted as a stabilizer of the unemployment rate since if foreigners lose jobs, they often return home instead of staying jobless in Poland. 2020 saw large fluctuations in the foreign workforce.

Unemployment rate, %



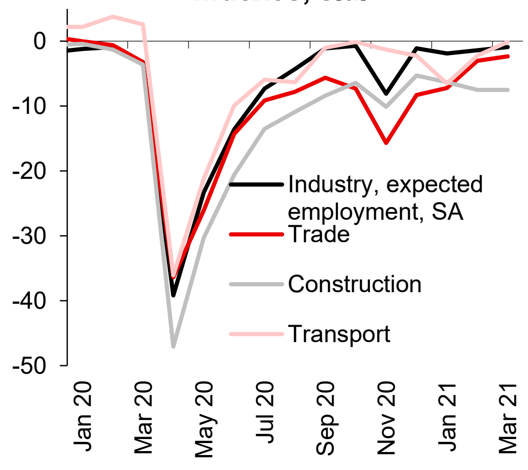
Source: GUS, Eurostat, Santander

Google search for selected labour market themes in Poland



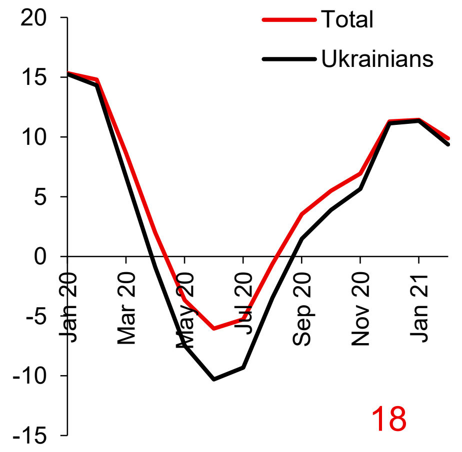
Source: Google, Santander

Employment expectations indexes, s.a.



Source: GUS, Santander

Foreigners registered in social security system, %y/y



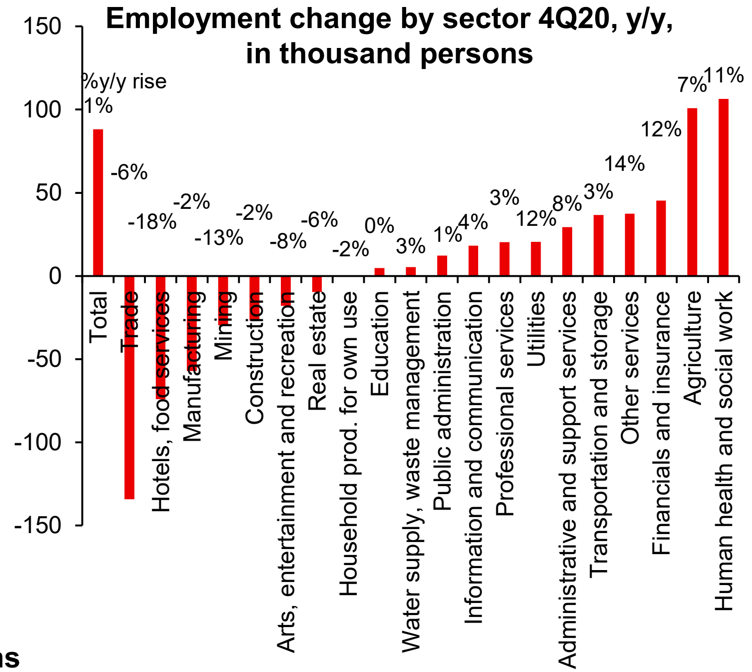
Source: ZUS, Santander

…but interesting changes beneath

Labour Force Survey* (LFS) data show that despite the stability of the headline labour market numbers in 2020, significant changes took place beneath, implying that the pandemic had bigger effect on employment than it would seem. We think there are several noteworthy trends to point out:

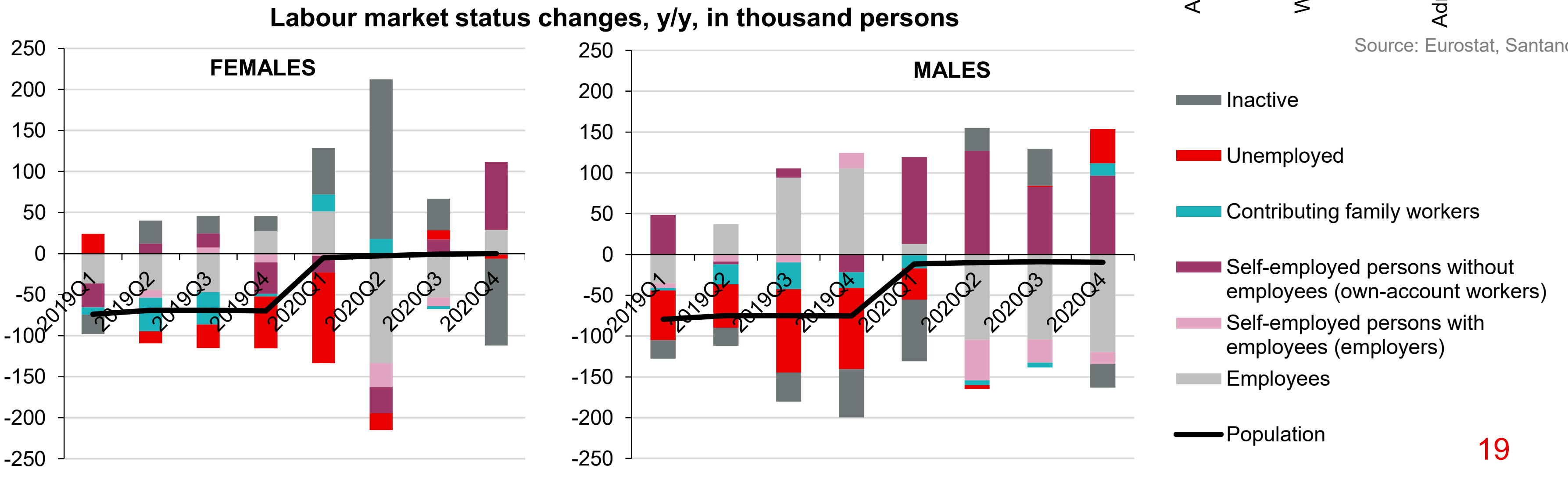
There was a visible shift from paid employment (-90k y/y in 4Q20) to self-employment (+179k in 4Q20). Interestingly, the vast majority of new self-employed appeared in agriculture (around 100k). We think that a large part of this move was people returning home to the countryside after losing paid jobs in urban areas, which we interpret as hidden unemployment. Earlier in the year, there was also a temporary rise in labour inactivity, which lowered unemployment rate fluctuations. Without those two factors, the LFS jobless rate could have been up to 1 percentage point higher in 2020.

The patterns in labour market status change during the pandemic were very different for men and women: men more often tended to escape to self-employment and their unemployment count has eventually increased. Women more often moved from paid employment to labour inactivity; the share moving to self-employment was smaller and unemployment has actually gone down. There was a particularly strong drop in activity among young women (<30y) and a notable rise for women >50y. For women, the biggest job cuts were in retail trade, the biggest employment rise in healthcare. Male employment fell most in manufacturing, rose most in agriculture & transport.



Source: Eurostat, Santander

Sectors cutting total jobs the most in 4Q20 were: manufacturing, car sales, retail trade, accommodation & restaurants, mining. At the same time sectors hiring a lot were: healthcare, agriculture, transport, IT, financial and insurance services.



Source: Eurostat, Santander

Source: Eurostat, Santander

* Please note that the Labour Force Survey does not cover short-term migrant workers.

Inflation: core vs. non-core divergence

In 2020 the main factor pushing up Polish inflation was the core inflation, mainly price of services, while the non-core component (i.e. costs of food, fuel and energy) was decelerating. In 2021 the situation may be just the opposite, we think.

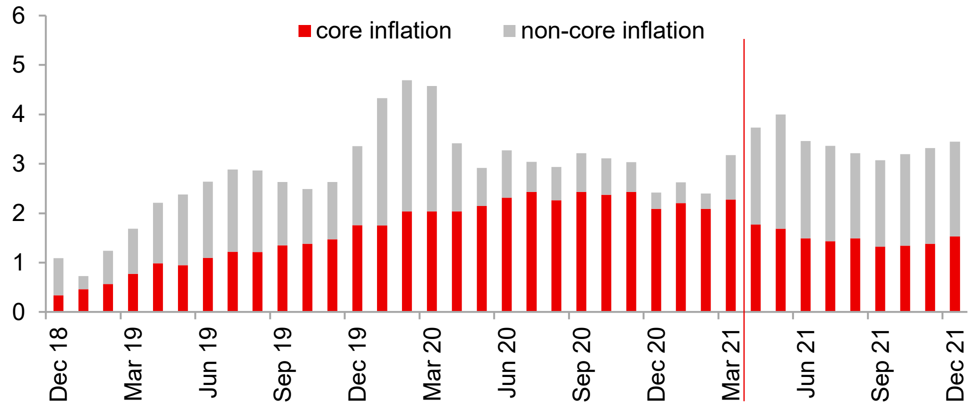
Despite surprisingly high flash CPI data for March, which according to our estimate imply core inflation rising to 4.0% y/y, the underlying inflationary pressure is unlikely to build further in the near term, in our view, as the domestic demand stagnation is prolonging due to the sweeping pandemic restrictions. As a consequence we still predict that **core inflation will trend downwards through most of this year**. What made us lift the 2021 inflation path were mainly the non-core components.

Oil price is the main reason we see CPI moving up, from lower-than-expected 2.4% in February to possibly around 4% y/y in May. In 2H21 CPI is likely to fall again with 2021 average close to 3.3%, we estimate.

Recent spike in global food prices (e.g. reflected by FAO indices) did not encourage us to change our food prices, because: firstly we have already expected rising momentum in most categories and secondly the correlation between FAO and food prices in Poland is not particularly strong.

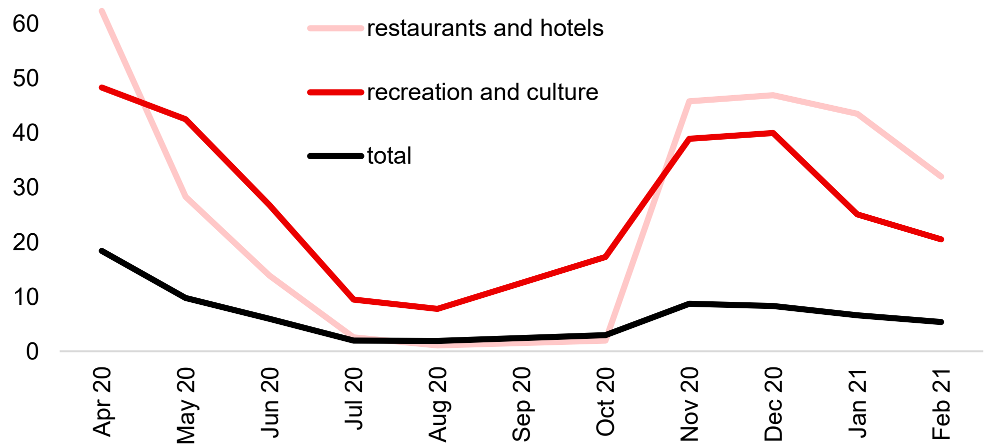
Last year there was a technical reason for high inflation persistence – high share of imputed prices in some categories. However this year the same factor (longer period of lockdowns than we previously assumed) may prevent a rapid increase of prices in these categories as ordinary seasonal patterns are usually used for price imputations. We believe that the removal of the ban on accommodation and entertainment services is likely to trigger a higher than usual adjustment of prices in these categories.

Structure of CPI inflation, %y/y



Source: GUS, Santander

Share of imputed prices: total and in most affected categories



Source: GUS, Santander

Core CPI: switch from services to goods

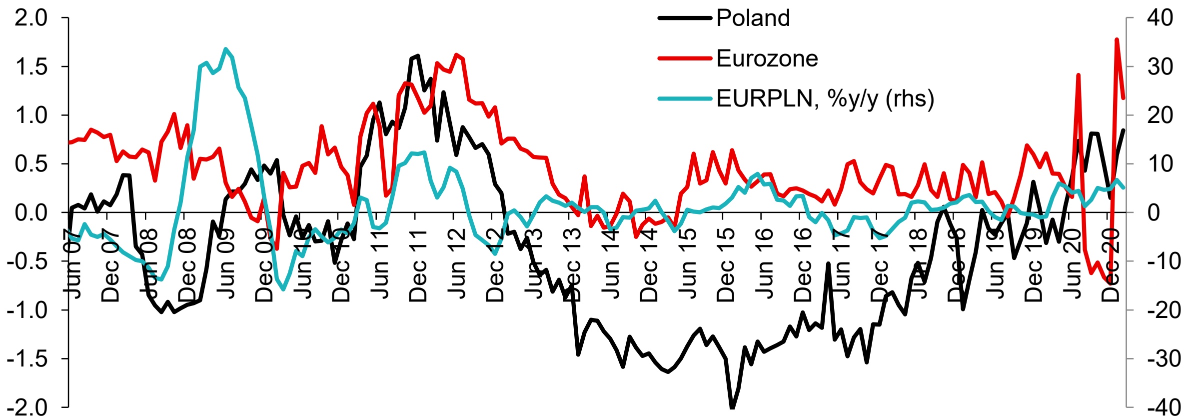
Demand conditions should allow for a gradual fall in core inflation this year. The possible delay in a rebound of GDP does not necessarily reduce core CPI more than we had previously thought.

Supply shortages and limited transport availability caused global cost pressure on firms, which they have been translating into their own prices. Polish PPI already hit 2% y/y in February vs. 0.1% in December (and our forecast for March sits at 4%), These factors are especially strong in industries that are also facing high demand due to the pandemic (consumer durables) which increases room for price growth.

CPI follows PPI signals in general, but in 2019-2020 the correlation broke down due to a fast rise of services inflation. It may be coming back now - **we expect some replacement of services inflation** (the downside turn has been getting broader across services categories, however March flash CPI print introduced uncertainty here) **with goods inflation** (up on shortages and Covid-ralated demand).

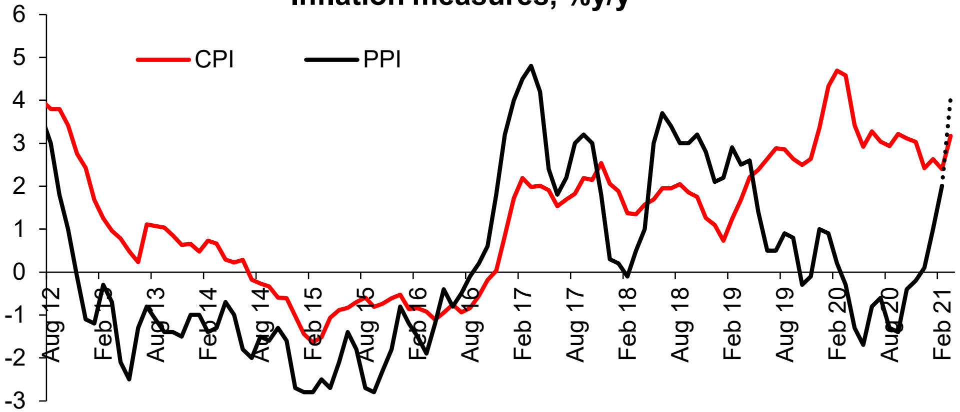
The EUR/PLN path for 2021 having moved higher, we also expect to import more inflation, especially given the rebound of the tradable part of core inflation in the Eurozone.

HICP inflation, core tradables component, %y/y



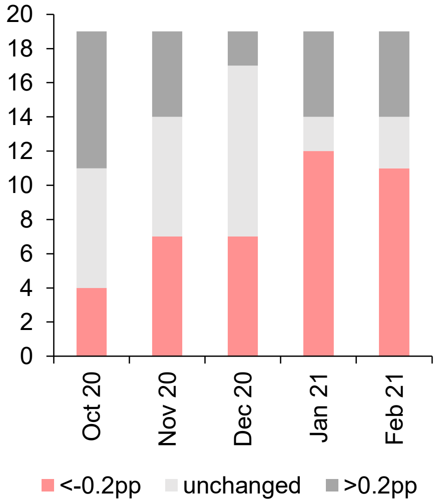
Source: Eurostat, Bloomberg, Santander

Inflation measures, %y/y



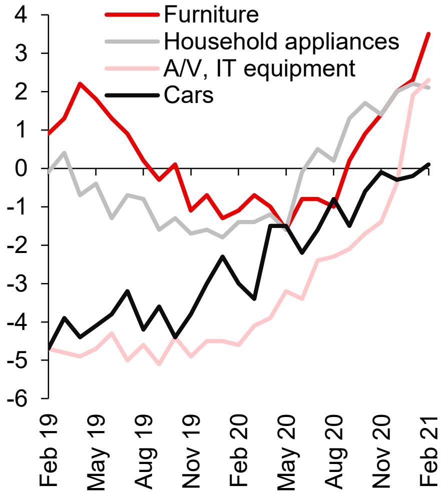
Source: GUS, Santander

Number of services categories by monthly change of y/y inflation



Source: GUS, Santander

CPI, inflation of selected goods, %y/y



Source: GUS, Santander

Monetary Policy: no rate hikes until mid-2022

Since the start of the Covid-19 pandemic, we have been complaining about the insufficient communication of the Polish central bank with the general public. The Monetary Policy Council has abandoned its post-meeting press conferences and the NBP governor (the most influential member of the panel) has been almost absent in the media, with his views on economic and policy outlook unknown.

The turn of 2020/21 saw a major breakthrough in this central bank's communication. While the MPC has remained in 'quiet mode', the NBP governor Adam Glapiński has become a frequent economic commentator. His public speeches and comments, including important hints regarding the policy outlook (see box), did have a significant impact on market expectations regarding future interest rate path, contributing to volatility in the Polish money market curve.

The big upward surprise in the March inflation data and further CPI rise in the coming months may reinforce market expectations for policy tightening.

A very interesting thing to watch will be how much patience will the NBP will have for any PLN depreciation. Given that this is what they were wishing for since mid-2020 and the zloty has been indeed surprisingly robust in real terms until recently (see p.26), it would be natural to assume that the tolerance for the adjustment should be quite large. However, we reckon that the MPC members' rhetoric (Glapiński, Łon) already seems a bit less dovish (no more signalling of rate cuts possibility), despite the economy being in new lockdowns, which earlier was pointed as a pre-condition for further policy easing.

Our view is still that **any discussions about monetary policy tightening seem very unlikely at least until mid-2022**, when the NBP head will undergo re-election for a potential second term. So, the current market pricing assuming quicker rate hikes seems overdone to us. However, if economic growth revives indeed, as we expect, and inflation continues rising, then the rate hike cycle may indeed start before the end of 2022.

Selected comments of NBP governor Adam Glapiński:

20/12/2020: The current level of interest rates – I want to make it very clear – must be described as adequate. And I think they will remain adequate for a long time.

29/12/2020: Current level of interest rates is adequate and is the best for the current situation. But in 1Q21 further rate cuts are possible. (…) For example, in case of the third wave of the pandemic, we may cut rates in 1Q21.

15/01/2021: I allow possibility of rate cuts and possibility of negative interest rates. Conditions: there would have to be radical deterioration of economic outlook. If there are no unexpected changes, interest rates will remain stable until the end of the MPC's and my term of office. There will be no interest rate hikes, there are no arguments for it.

05/02/2021: As I said before: the most likely scenario is no interest rate change at all. We do not rule out rate cuts. We do not rule out rate hikes if needed, just like we do not rule out rate cuts.

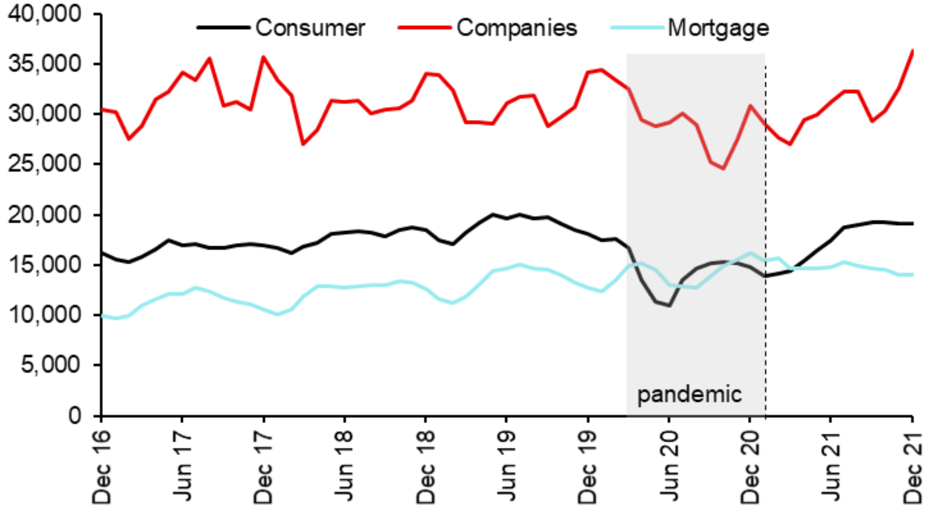
05/03/2021: The probability of interest rate hikes during the current MPC's tenure is zero… then a decimal point and then some number. Nothing suggests that interest rates could go up. If the (pandemic) shock deepens, we may return to rate cuts. If we were mulling rate hikes relying on forecasts for 2023, it would be a mistake. We will act exactly the same way as Fed and the ECB.

Source: NBP conferences

Loan growth remains muted

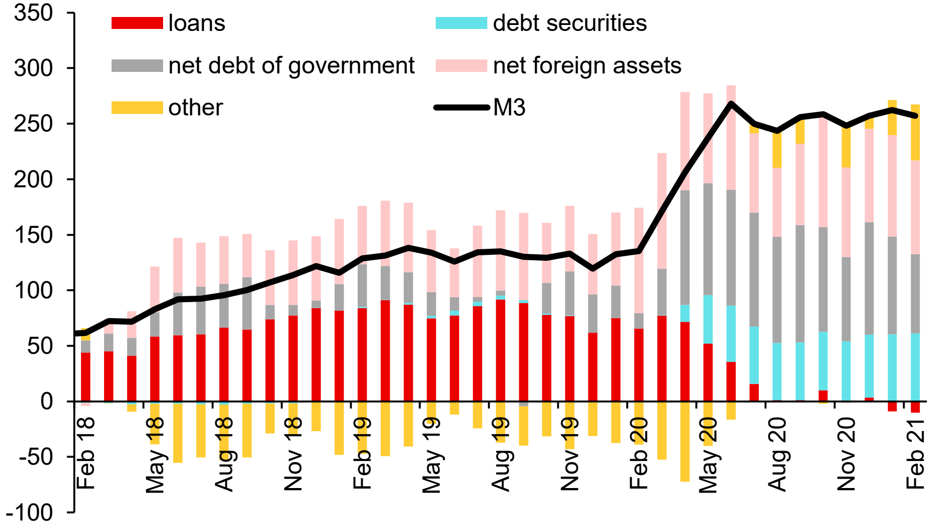
At the start of the year the loan market remained muted, with annual growth rate below zero and barely changed versus December. Growth rate of deposits decelerated slightly given lower money creation via government pandemic lifeline programmes. So far the loan and deposit markets are developing in line with our forecasts that the **annual loan growth will turn positive in 2021, fuelled by the rebound in economic activity (see the bottom right-hand chart), but should remain muted as long as pandemic restrictions remain in place**. We expect deposit growth will remain much stronger than the loan growth and is likely to stay close to 10% y/y throughout the year. The declining scale of government's financial programmes should help the loan and the deposit growth rate converge in the longer term.

Loan creation (3m sum, PLNmn)



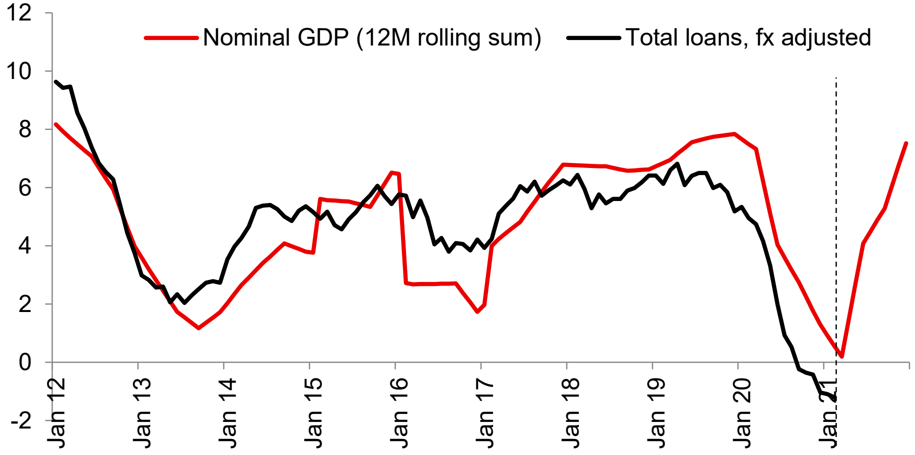
Source: NBP, Santander

M3 money supply and its creation factors, y/y change in PLNbn



Source: NBP, Santander

FX-adjusted value of loans, %y/y



Source: NBP, GUS, Santander

Financial markets

2

FX: EUR/PLN peaks whenever Covid-19 hits

EUR/PLN exceeded 4.60 in late March, once again shortly after the new wave of Covid-19 hit Poland and the introduction of country-wide restrictions. It seems that the pandemic remains one of the key currency drivers. Other negative factors for the zloty include the generally negative sentiment towards EM currencies amid rising bond yields in developed world and a stronger US dollar.

We have revised EUR/PLN forecasts higher for the coming quarters, as the short-term risks outweigh the positives, in our view.

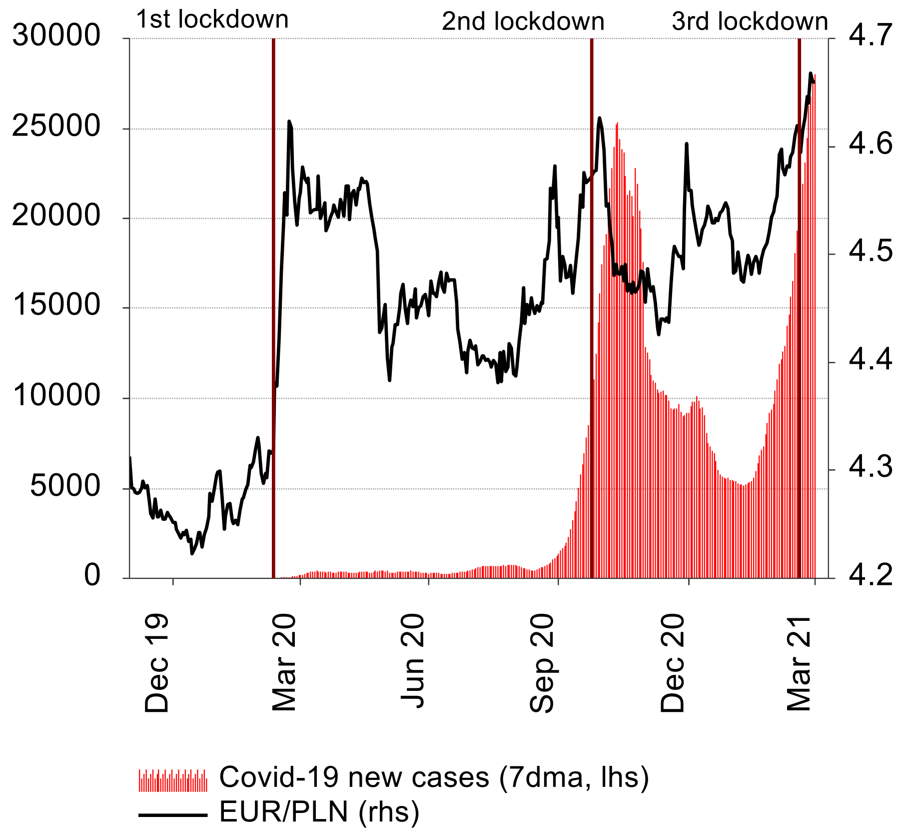
First of all, on the pandemic map of Europe, Poland´s current wave of coronavirus infections looks higher and longer than the previous ones, creating an even more severe strain on the healthcare system.

Secondly, the Polish central bank consistently favours a weaker currency. Its recent shift towards more pro-active QE programme management, the strong pledge to keep interest rates on hold at least until mid-2022, plus an open threat of possible FX interventions if zloty strengthens, create a firm floor for EURPLN, in our view.

Also, the uncertainty regarding the FX mortgage loans issue persists. The meeting of the Civil Chamber of the Supreme Court has been postponed from March 25 to April 13, as the head of the Court has been hospitalised. Whether the Chamber will indeed convene in April to discuss the FX mortgage issue remains unknown, as according to press information there are disagreements between the judges. The Supreme Court ruling may introduce short-term volatility but it remains uncertain when and how exactly it may play out.

We still believe that by the end of the year the zloty may regain some of its strength, once the pandemic is under control and economic growth reaccelerates. After all, Poland enjoys a large current account surplus (3.5% of GDP in 2020) and the economy may be more resilient than some others to the pandemic.

EURPLN and pandemic situation in Poland



Source: Refinitiv Datastream, Santander

Santander

FX: Has the zloty actually depreciated?

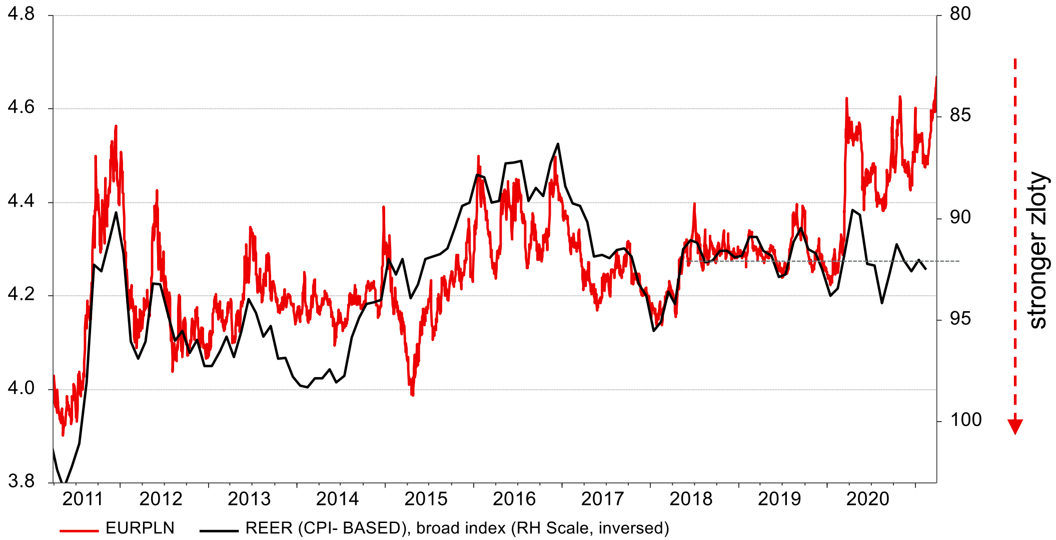
The EUR/PLN near 4.65, its highest level since March 2009, may suggest that the Polish currency is exceptionally weak. But we think it is interesting to note that the real effective exchange rate of the zloty (REER) tells a somewhat different story: **the zloty has barely moved in real terms vs. its pre-pandemic levels and in the last few months was slightly stronger than in 2018-2019** (upper chart). This was due to inflation in Poland in the last few quarters significantly outpacing inflation in our main trading partners (mainly the euro zone where inflation plummeted in 2020 in response to the pandemic, while in Poland it remained elevated).

So, the international competitiveness of Poland's foreign trade measured by REER has barely moved despite the EUR/PLN rise. And yet, it did not prevent rapid export expansion and the accumulation of a huge external trade surplus, marking a major deviation from the long-term relationship between the real effective exchange rate and the trade balance, visible in historical data from the last twenty years (lower chart).

It tells us two things: First, the large surplus in foreign trade is, at least to some extent, the transitory effect of pandemic disruption in domestic demand (and thus in imports), rather than only a reflection of improved external competitiveness. Once the restrictions are gone and life starts getting back to normal, such a big surplus is unlikely to persist.

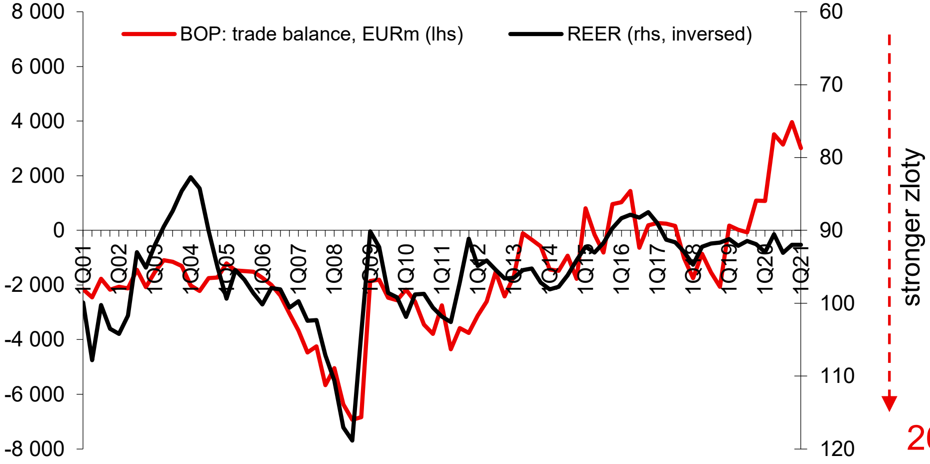
Second, it is hard to argue, in our view, that the Polish zloty is significantly undervalued. Instead, it seems close to its pre-pandemic equilibrium. We see potential for real appreciation in the medium run, once the economy reaccelerates sharply after the pandemic, as Poland is likely to benefit from shortening global supply chains and a boost in EU funding. But in the short run, we see more likelihood of a weaker, not stronger, zloty.

EURPLN vs real effective echange rate of the zloty



Source: Refinitiv Datastream, Santander

Trade balance vs real effective echange rate of the zloty



Source: NBP, BIS, Santander

Santander

FX: Where are the pain thresholds?

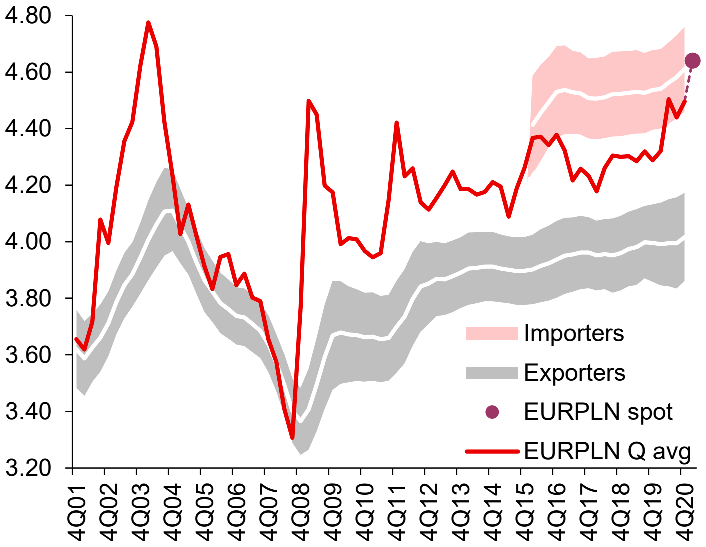
Judging by the quarterly NBP business survey results, **EURPLN and USDPLN** are far above the declared threshold levels for export profitability … but **very close to thresholds of import profitability** – and they are still depreciating.

The example of 2005-2008 PLN appreciation shows that the pain threshold of exporters adapted to the ongoing FX developments, but during the approach to and at the peak of the cycle. Can we assume that a similar adjustment will occur for importers and only a couple of quarters away from an expected economic rebound?

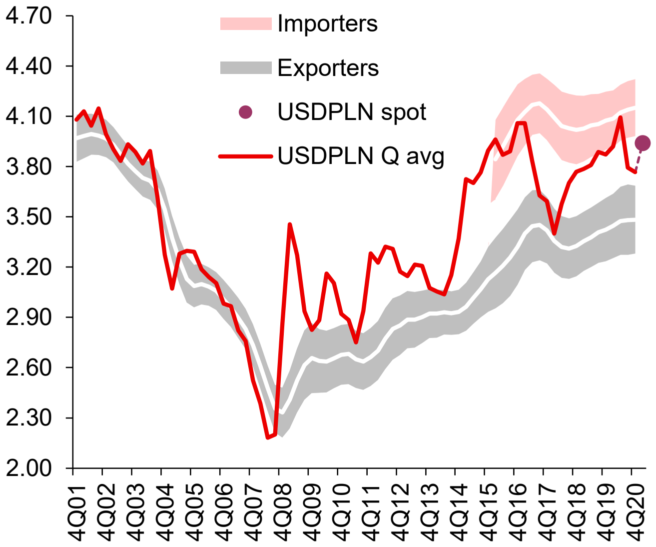
In our view further weakening of the zloty is more likely to cause a surge in import prices than a deterioration in import volumes. PPI prices are quite responsive to PLN swings, even when we take the oil component out of the picture.

Poland´s terms of trade have already come off the peak caused by the pandemic.

Foreign trade profitability thresholds +/-1/2 std.dev., based on NBP Quick Monitoring survey

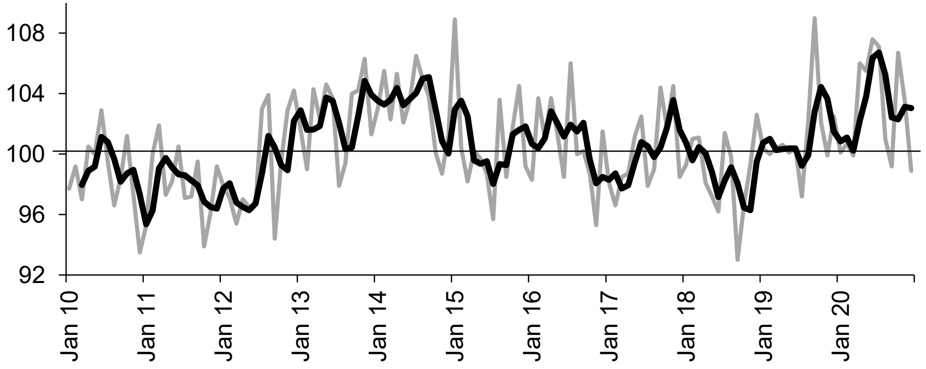


Source: NBP, Santander



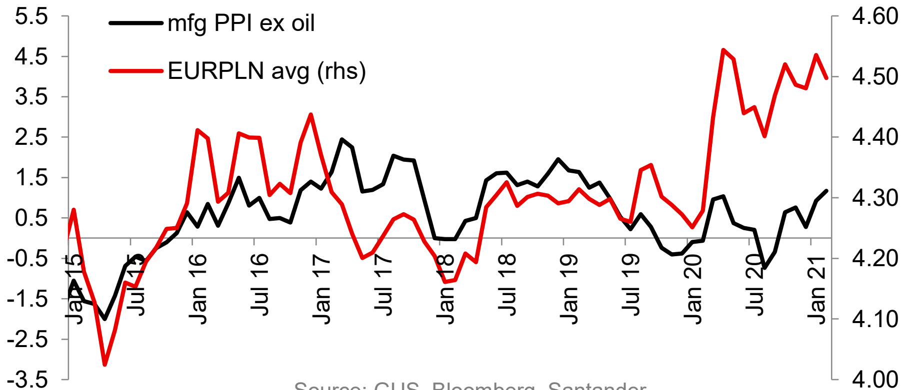
Source: NBP, Santander

Poland's terms of trade with 3M mov. avg.



Source: GUS, Santander

Producer prices vs exchange rate



Source: GUS, Bloomberg, Santander

FI market: 1Q2021 in retrospect (1)

The main driving force behind global yields in Q1 was rising US yields. Markets embraced the reflation trade in anticipation of President Joe Biden's c.$2.0trn fiscal stimulus package, on top of the dovish Fed and vaccination progress.

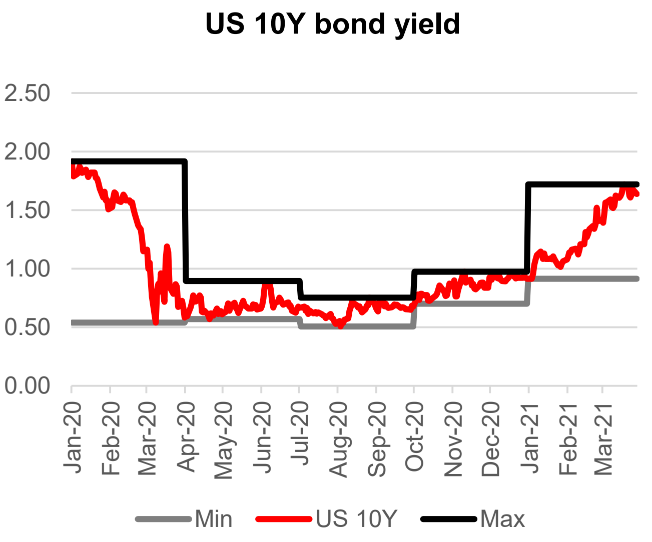
- **US 10Y bond yield** increased YTD by 75bp to c.1.70% (top-left chart). The quarterly yield range stood at 80bp.
- US government bond curve bear steepened (bottom-right) diverging significantly from the European bond curve steepness.

European yields were much better behaved because the fiscal stimulus in Europe was much smaller, and the ECB accelerated government bond purchases (within the PEPP) towards the end of the 1Q2021 to stem yield increases.

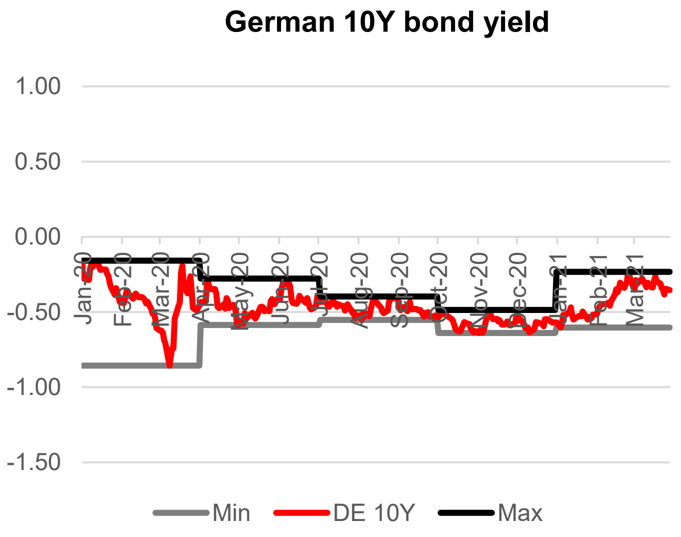
- **Germany 10Y bond yield** increased 25pb YTD to -0.30% (top-right). The quarterly range was 37bp.

In Poland, the bond yield curve was also well behaved because (1) it usually tracks the German yield curve more than the US one and (2) the NBP QE programme accelerated again in March (to PLN4bn/mth from PLN1bn/mth for the previous 6mth).

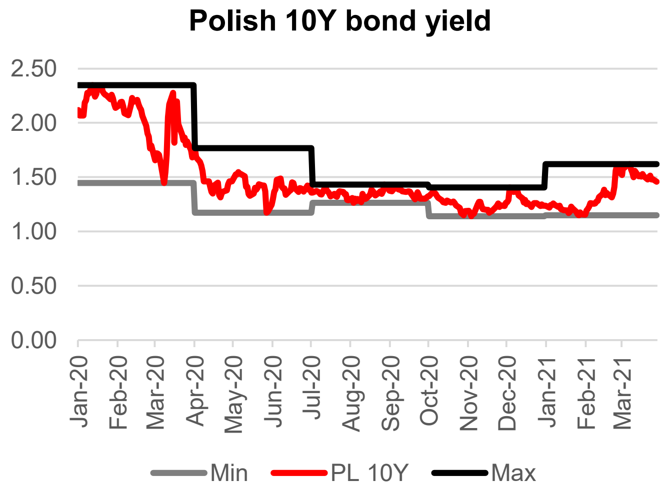
- **Polish 10Y bond yield** increased YTD 30pb to 1.55% (bottom-left). The quarterly range was 50bp.



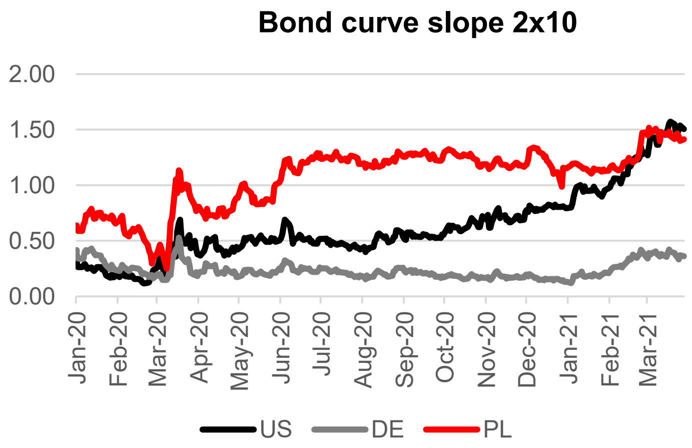
Source: Bloomberg, Santander



Source: Bloomberg, Santander



Source: Bloomberg, Santander



Source: Bloomberg, Santander

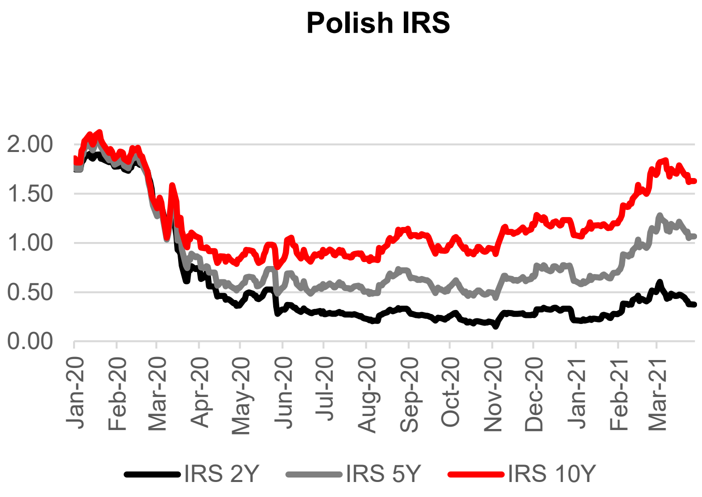
Santander

FI market: 1Q2021 in retrospect (2)

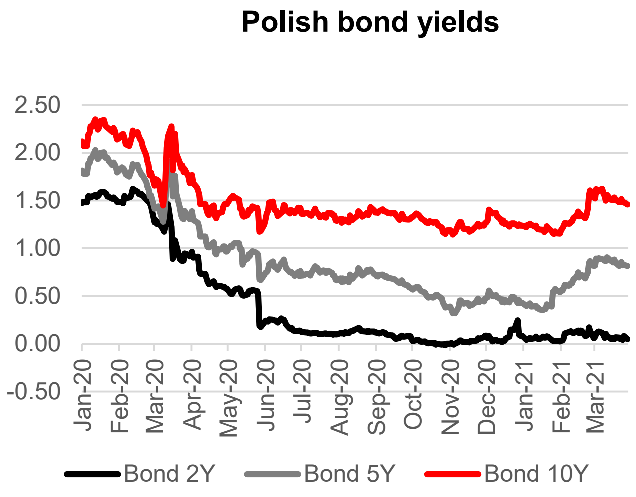
The four plots to the right show the behaviour of Polish yields in 2020 and Q1 2021.

As core yields have been rising:

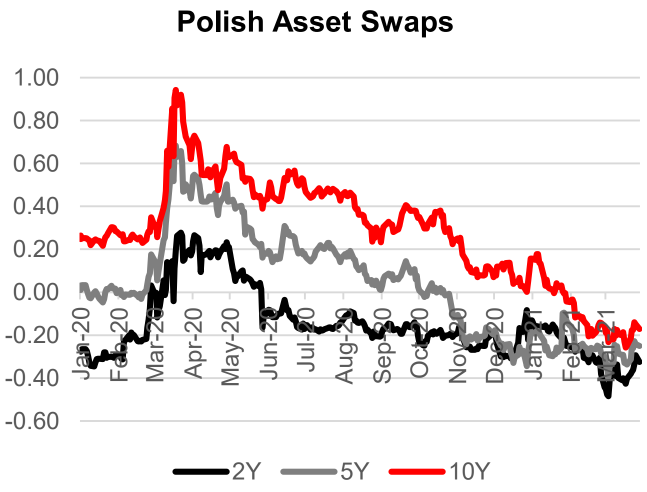
- It is only **long-dated IRS** (top-left) that were fully free to move alongside core market yields. This resulted in 10Y asset swaps flipping into negative territory at end of January and reaching -0.25% - the level last seen 20 years ago (in 2001).
- **Short-end IRS** (top-left) have temporarily increased with the paying flow in February and early March. But since then, have reversed the move as the more realistic view of the NBP took over. NBP is not going to change interest rates until at least mid-2022, in our opinion.
- **Short-end Polish government bonds** (top-right) were glued to the floor as abundant liquidity in the banking sector persists and if anything only increases.
- **Long-dated bonds** (top-right) were kept in check by the lack of increase in German yields, the symbolic increase in NBP QE at the end of the quarter and only a mediocre bond supply.
- In the context of rising global yields **we think that the Polish bonds are expensive on ASW spread** at -0.25% vs +20-+40bp before the pandemic.



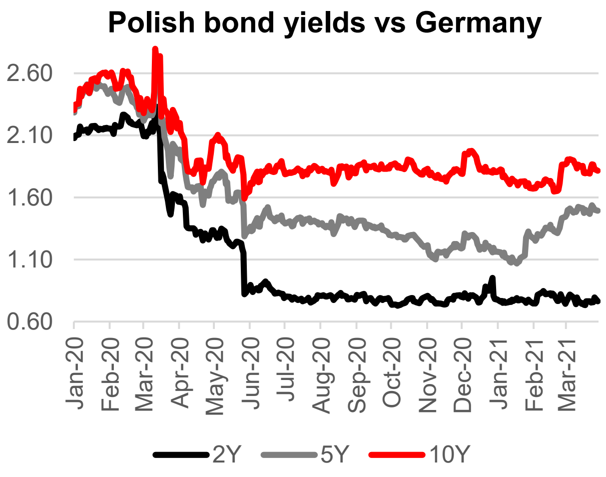
Source: Bloomberg, Santander



Source: Bloomberg, Santander



Source: Bloomberg, Santander



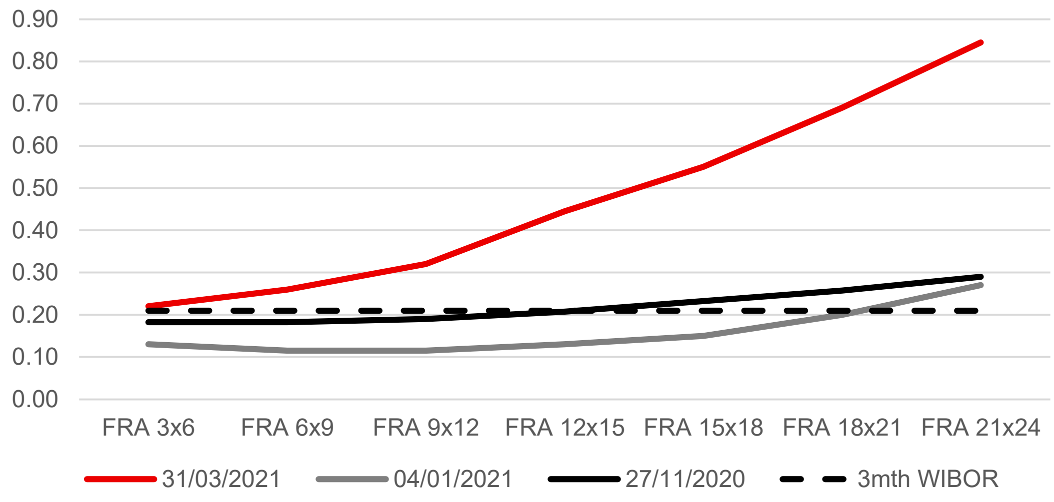
Source: Bloomberg, Santander

FI market: 2021 yield forecast (front end)

Our base case is still for **the NBP to keep rates on hold at 0.10% throughout 2021 and at least until mid-2022** (the end of Mr. Glapiński´s first term as NBP governor).

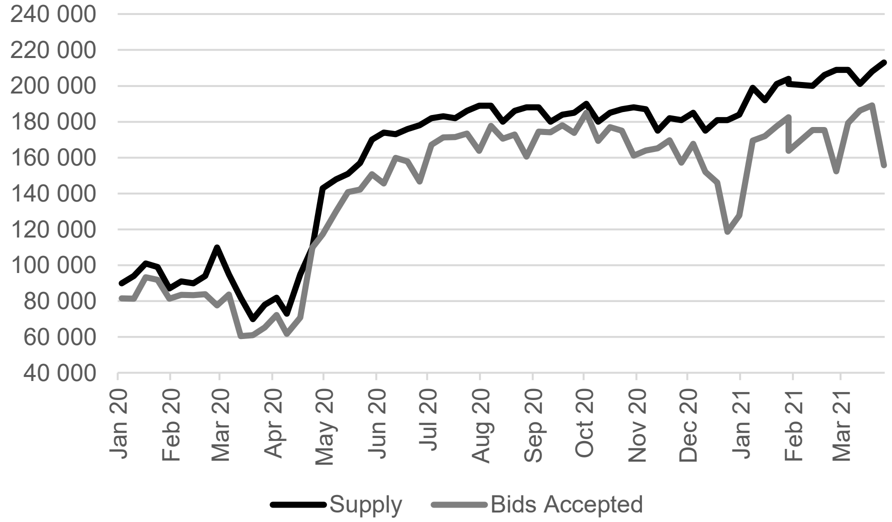
And this despite the fact that since our previous quarterly Macroscope, the market has been pricing both rate cuts (e.g. after Mr. Glapiński´s December comments) and rate hikes (more recently as the "reflation trade" has lifted rate expectations globally).

3M WIBOR vs FRA



Source: Bloomberg, Santander

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



Source: NBP, Santander

Banking sector liquidity as measured by 7-day NBP bill supply (left) if anything has increased further and is unlikely to decrease soon as the BGK and PFR programmes continue, albeit at a much slower pace.

- In 2021 the **BGK** has issued PLN 9bn (and at least another PLN 1bn in April) of a maximum of PLN 33bn scheduled for 2021.
- **PFR** program is much smaller in 2021 and is proceeding at a slow pace. PFR Head Pawel Borys said that PFR's financing needs have been met and that is why we do not expect significant PFR issuance in coming months.

In 2021 and in 2Q2021E particularly, **we expect short-end bond yields to remain just slightly above zero**, as in past quarters.

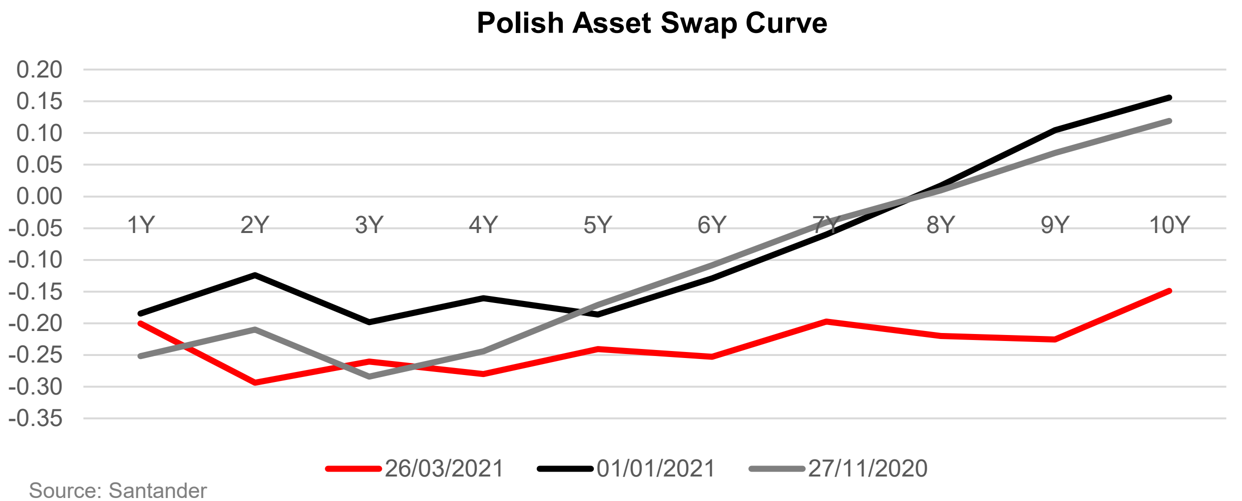
FI market: 2021 bond yield forecast (long end)

We expect the 10Y yield of Polish bonds to be 1.70% (vs 1.45% in November) at the end of 2Q2021E and 1.9% (vs 1.65% in November) at the end of 2021E. We increase our forecasts because:

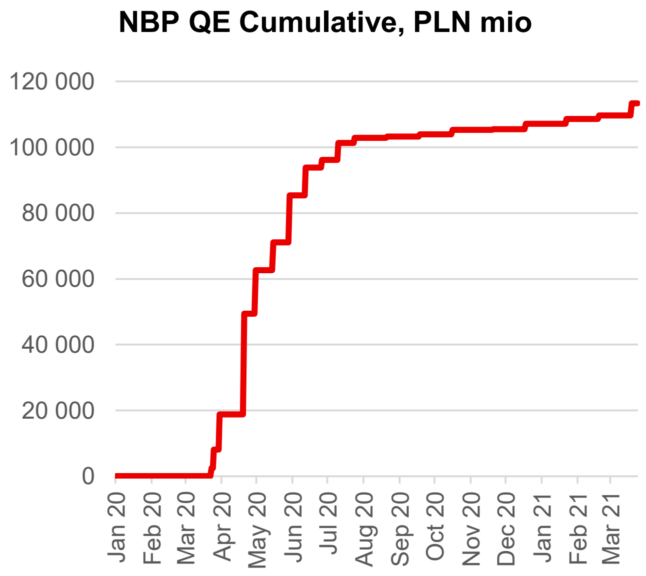
- **Core market yields** have been rising and we expect they will continue rising gradually towards the end of the year.
- **Polish GDP growth** is likely to improve towards the end of the year, (page 12) which would help to gradually normalize bond yields. CPI will rise further in the coming months, while core CPI should be declining, according to our forecast (page 20).
- **Changed EURPLN forecasts:** we do not expect the zloty to strengthen significantly towards the year end anymore.

There are factors limiting our desire to increase our yield forecast:

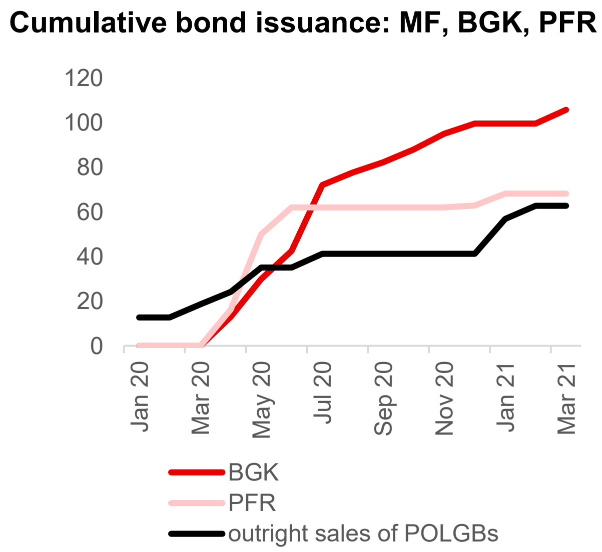
- YTD the 10Y ASW turned negative in January and is likely to remain negative for the foreseeable future (top chart)
- The majority of NBP QE purchases took place mid-2020 (bottom-left) and since then progressed at the slow pace of ~PLN 1.0bn/month. **In March NBP QE increased the auction purchase to ~PLN 4.0bn**, a largely symbolic move, but indicating that the NBP is watching rising bond yields closely and is likely to act if it deems yield rises excessive. The NBP asset purchase programme is open-ended.
- **The Bond supply is not significantly large** (bottom-right). If anything the BGK still has room to issue ~PLN 26.0bn this year, helping fund the government without the need to increase the POLGBs supply. In April the BGK will sell at least PLN 1.0bn of Covid-19 bonds.
- **Sizeable redemptions and coupon payments** (see next slide) are coming in Q2 which might flood the market with additional liquidity and enhance yield seeking behaviour further out on the yield curve.



Source: Santander



Source: Santander



Source: Santander

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2Q2021E Bond redemptions and coupon payments

As for PLN-denominated bonds, **pretty significant redemptions happen in 2Q2021E**:

- April (PLN 11.8 bn from PS0421)
- May (PLN 7.7 bn from OK0521)

On top of that, there is a total of PLN 4.6bn **coupon** payments paid:

- April (PLN 3.7 bn)
- May (PLN 0.9 bn)

As for FX bond **redemptions**:

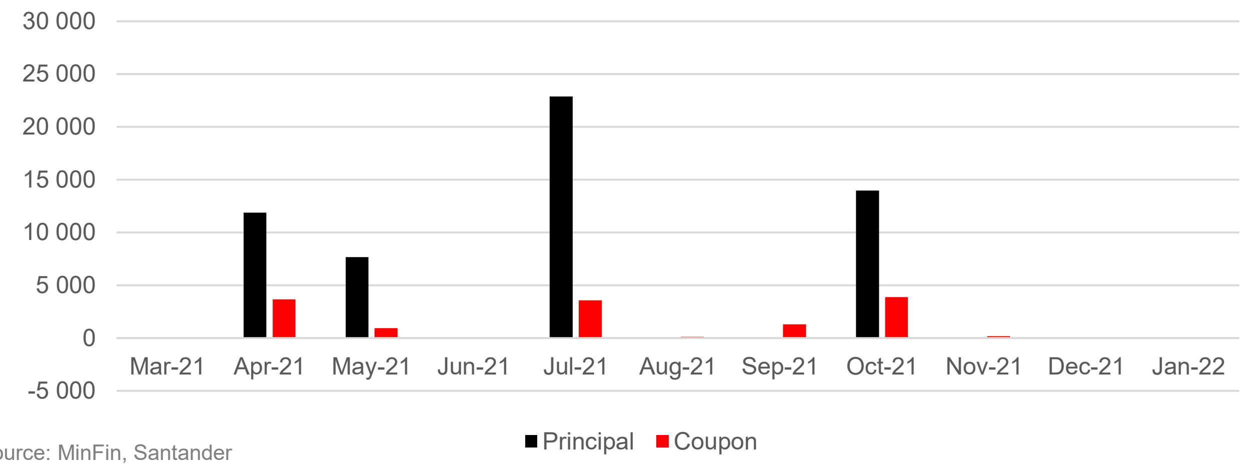
- April (PLN 6.8bn equivalent from USD 5.125%)

But rather modest FX bond **coupon** payments:

- April PLN 0.3 bn
- June PLN 0.1 bn

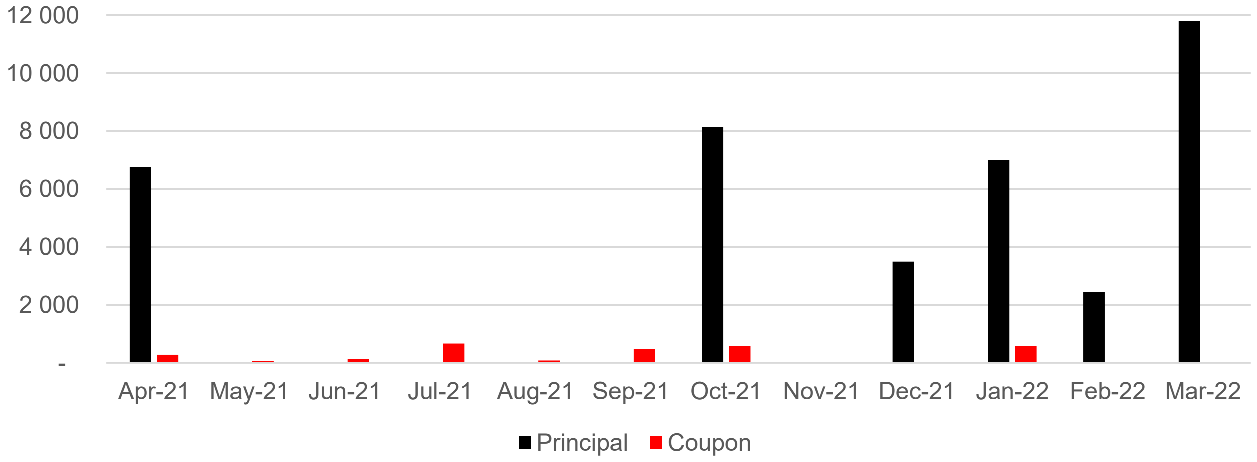
The "switch bonds" (PS0421, OK0521, PS0721, DS1021) are mostly owned by local banks and so far have been reluctantly sold to MinFin. This means that when they actually mature, and the BGK issues no more than PLN 1.0bn in April, the market might find itself in a situation of a lot of cash chasing bonds. This would exert a noticeable downward pressure on bond yields and asset swaps.

PLN-denominated coupon payments and redemptions in 2021, PLNmn



Source: MinFin, Santander

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



Source: MinFin, Santander

Polish bonds foreign ownership – by bond series

End of January Ministry of Finance data shows that foreign ownership of Polish bonds **rebounded to 17.7%** from a historically low 17.1% - this is the average over all bond series.

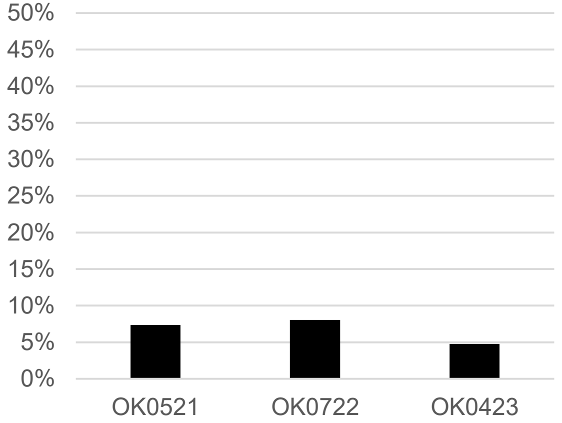
Foreigners own very few of the floating rate **WZ series** bonds (not pictured). As for fixed coupon bonds:

- **OK series** (tenors of 1Y – 3Y) foreigners own 5-8% depending on the series, have increased by 1.5-2.0pp m/m.
- **PS series** (tenors up to 5Y) foreigners own <20% except for the one that is maturing in April.
- **DS series** (tenors up to 10Y) foreigners own between 25-48% of each series. Here the DS0727 ownership is almost flat m/m and DS1029 slightly increased. But the DS1030 foreign ownership currently stands only at 35% (vs 47.2% as of end of October 2020, for example).
- **WS series** (tenors > 10Y) foreigners decreased their % share to below 40% of WS0428

Compared with November 2020, foreign ownership of longer dated fixed income bonds has diminished somewhat, but not enough to say that the risk of a significant impact of rising core market yields on the long end of the curve is now gone.

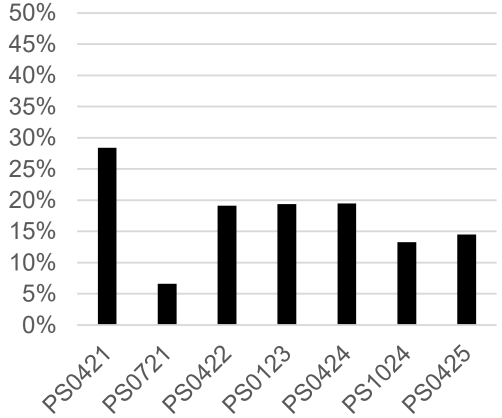
On the other hand, it is difficult to expect significant inflows into the Polish bond market given higher yields in the DM world. As a result **we expect foreign ownership of long dated fixed income bonds to gradually decline further in 2Q2021E.**

% Foreign ownership in POLGBs – OK series



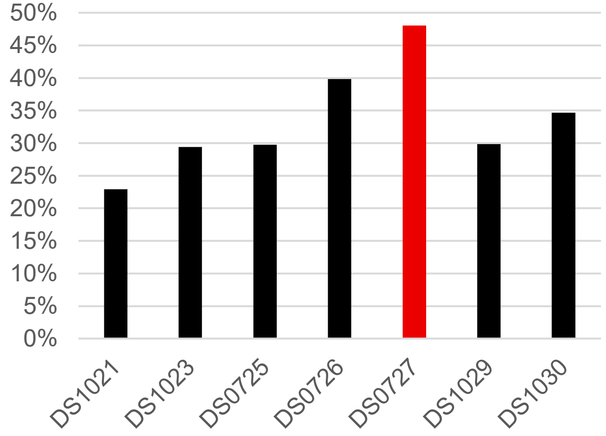
Source: MinFIn, Santander

% Foreign ownership in POLGBs – PS series



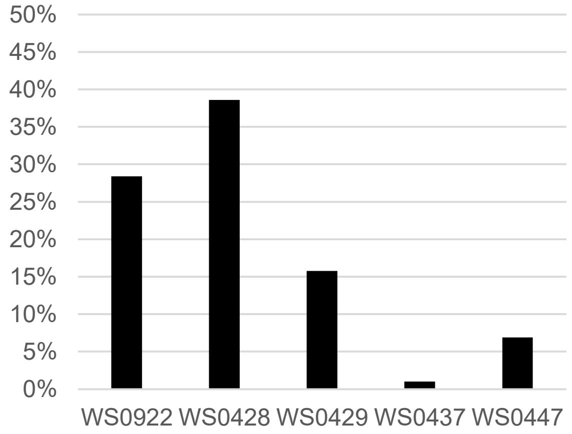
Source: Bloomberg, Santander

% Foreign ownership in POLGBs – DS series



Source: MinFin, Santander

% Foreign ownership in POLGBs – WS series



Source: MinFin, Santander

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Forecasts

3

Economic Forecasts

		2018	2019	2020	2021E	1Q20	2Q20	3Q20	4Q20	1Q21E	2Q21E	3Q21E	4Q21E
GDP	PLNbn	2,121.6	2,287.7	2,317.1	2,488.7	556.4	528.2	582.5	650.0	559.0	592.1	625.2	712.3
GDP	% y/y	5.4	4.5	-2.8	4.2	1.9	-8.4	-1.5	-2.8	-1.9	8.4	3.5	6.8
Domestic demand	% y/y	5.6	3.5	-3.9	4.0	1.0	-9.5	-3.2	-3.4	-3.4	7.8	4.0	7.3
Private consumption	% y/y	4.3	4.0	-3.0	3.3	1.2	-10.8	0.4	-3.2	-3.0	9.0	1.0	7.5
Fixed investment	% y/y	9.4	7.2	-8.5	5.3	0.9	-10.7	-9.0	-10.9	-8.0	5.0	5.0	12.0
Industrial output	% y/y	5.9	4.2	-1.1	11.0	0.9	-13.6	3.2	5.2	5.7	28.4	7.6	5.3
Construction output	% y/y	19.7	3.6	-3.5	-1.3	5.0	-2.8	-10.9	-2.0	-14.1	-7.4	2.3	8.0
Retail sales (real terms)	% y/y	6.5	5.1	-2.9	2.2	0.8	-10.7	1.0	-2.8	0.0	6.7	-2.8	4.9
Gross wages in national economy	% y/y	7.2	7.2	5.3	5.4	7.7	3.8	4.8	5.0	5.0	5.2	5.5	5.8
Employment in national economy	% y/y	2.6	2.2	-0.9	0.2	0.6	-1.7	-1.5	-1.0	-1.4	1.5	0.6	0.2
Unemployment rate *	%	5.8	5.2	6.2	6.2	5.4	6.1	6.1	6.2	6.5	6.0	6.0	6.2
Current account balance	EURmn	-6,518	2,611	18,289	17,610	4,623	5,527	3,237	4,902	5,497	5,839	3,087	3,188
Current account balance	% GDP	-1.3	0.5	3.5	3.2	1.0	2.1	2.8	3.5	3.7	3.7	3.6	3.2
General government balance (ESA 2010)	% GDP	-0.2	-0.7	-8.4	-5.9	-	-	-	-	-	-	-	-
CPI	% y/y	1.6	2.3	3.4	3.3	4.5	3.2	3.1	2.9	2.7	3.7	3.2	3.3
CPI *	% y/y	1.1	3.4	2.4	3.4	4.6	3.3	3.2	2.4	3.2	3.5	3.1	3.4
CPI excluding food and energy prices	% y/y	0.7	2.0	3.9	3.0	3.4	3.8	4.2	4.1	3.9	2.9	2.5	2.5

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

Source: GUS, NBP, Santander

Market Forecasts

		2018	2019	2020	2021E	1Q20	2Q20	3Q20	4Q20	1Q21	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	0.67	0.20	1.62	0.59	0.24	0.22	0.21	0.20	0.20	0.20
Yield on 2-year T-bonds	%	1.59	1.56	0.50	0.10	1.39	0.48	0.11	0.04	0.08	0.13	0.10	0.10
Yield on 5-year T-bonds	%	2.51	1.99	0.96	0.92	1.72	0.94	0.71	0.46	0.65	0.90	1.03	1.09
Yield on 10-year T-bonds	%	3.21	2.41	1.52	1.65	2.05	1.43	1.35	1.26	1.35	1.63	1.78	1.84
2-year IRS	%	1.92	1.74	0.62	0.40	1.53	0.43	0.27	0.26	0.37	0.42	0.40	0.40
5-year IRS	%	2.43	1.85	0.85	1.20	1.58	0.62	0.59	0.61	0.91	1.21	1.28	1.43
10-year IRS	%	2.89	2.05	1.15	1.75	1.67	0.89	0.96	1.08	1.11	1.84	1.98	2.06
EUR/PLN	PLN	4.26	4.30	4.44	4.55	4.32	4.50	4.44	4.50	4.54	4.61	4.55	4.48
USD/PLN	PLN	3.61	3.84	3.89	3.77	3.92	4.09	3.79	3.77	3.77	3.87	3.76	3.68
CHF/PLN	PLN	3.69	3.86	4.15	4.13	4.05	4.24	4.13	4.17	4.17	4.18	4.14	4.05
GBP/PLN	PLN	4.81	4.90	5.00	5.23	5.02	5.07	4.91	4.98	5.20	5.42	5.26	5.03

* 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 up to **31.03.2021** has been prepared by:

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MACROscope

Warsaw, 1 April 2021

Sectoral supplement

Strategic Sectors Department

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E-commerce growth fuels demand for packaging

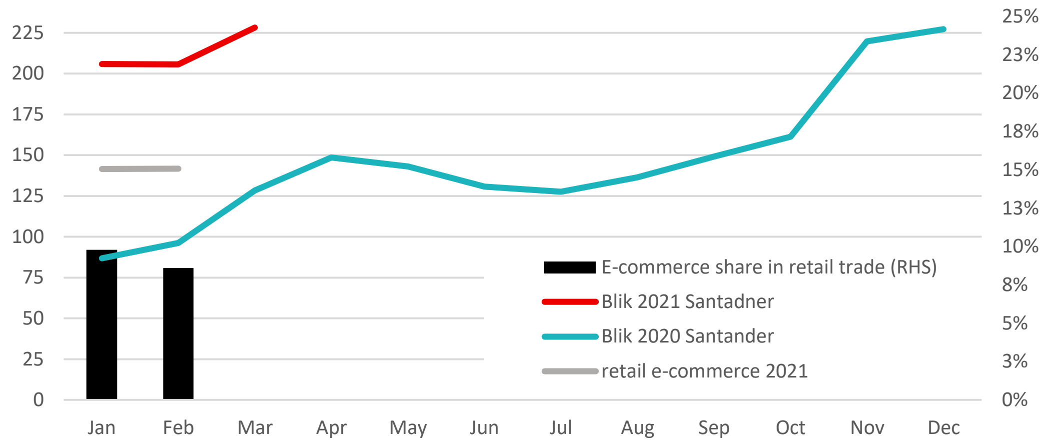
In March a year has passed since Covid-19 pandemic has hit Poland. There is a short list of sectors that benefitted from this situation, and surely e-commerce is on this list. We estimate that last year's turnover in e-commerce hit PLN70bn and noted 42% growth. In 2021 we see that e-commerce frenzy continues. Turnover in both January and February exceeded PLN6bln, and it took four months of 2020 to reach such a value. This translates into growth rate of as much as 56.8% y/y.

Based on dynamics of BLIK transactions (mobile payments) we see that tightening of restrictions in March has once more pushed consumers to spend their money on-line. Among main product categories, white goods remain the growth leader, with y/y change in turnover of almost 100%. Clothes are another category where we see dynamic turn to e-commerce, and growth rate of e-turnover over Jan-Feb period amounted to 49% y/y.

Continued growth of internet spending has its implication on many sectors. Apart from industries that sell consumer goods we see a very positive impact on the whole value chain of industries supporting e-commerce sales. Packaging producers are an excellent example. With an estimated value of sold production at almost PLN47bn it is of similar size to furniture industry, which is often called Polish export specialisation. Following results of this sector we can see how consumer behaviour has changed as pandemic progressed.

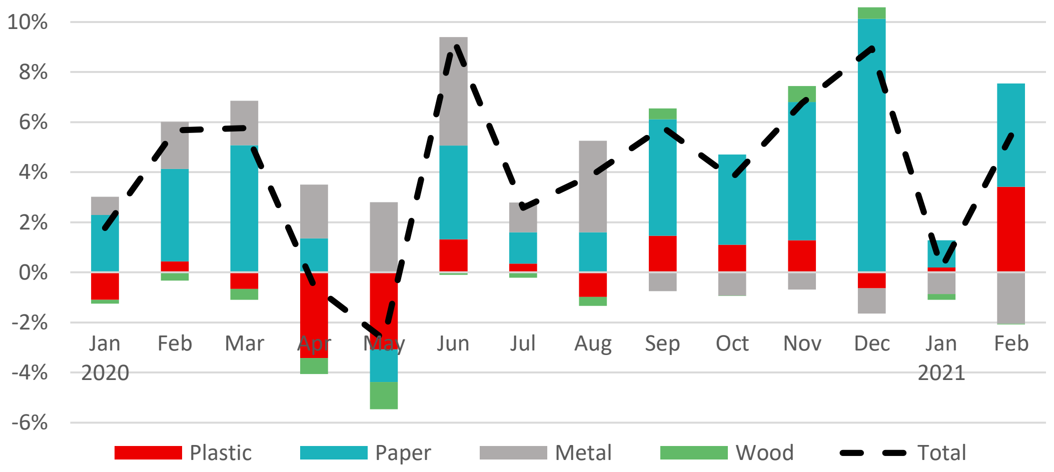
In 1H20 we saw consumers stockpiling before the first lockdown and this fuelled growth of canned food consumption, driving metal packaging production. In 2H20 the packaging market growth was driven by increased demand for paper and paperboard packaging for e-commerce sales. In the first months of 2021 we see growing sales of plastic packaging. This is mainly driven by extraordinary spike in prices of main plastics used in packaging production – in February we saw an increase of about 50% y/y, and almost 100% growth in March.

E-commerce sales index (12.2019 = 100)



Source: GUS, Santander

Annual change in packaging industry production



Source: GUS, Santander

Unstoppable transport

International transports carried out by Polish road carriers remained stable in 2020. Although the weight of freight they carried in all directions fell by 8.2%, the distance travelled on German toll roads by Polish trucks was unchanged compared to 2019. This result can be considered very good, given that the total kilometres charged to tolls in Germany fell by 1.3% and the leading carriers operating on German roads, with the exception of Lithuania, saw significant decreases.

Situation was similar at the beginning of the current year - in January-February, weight of freight transported by Polish carriers decreased by 9.2% y/y, but the number of toll kilometres driven by them on German roads decreased only by 0.4% y/y, while total kilometres charged to tolls in Germany were lower by 5.0% y/y.

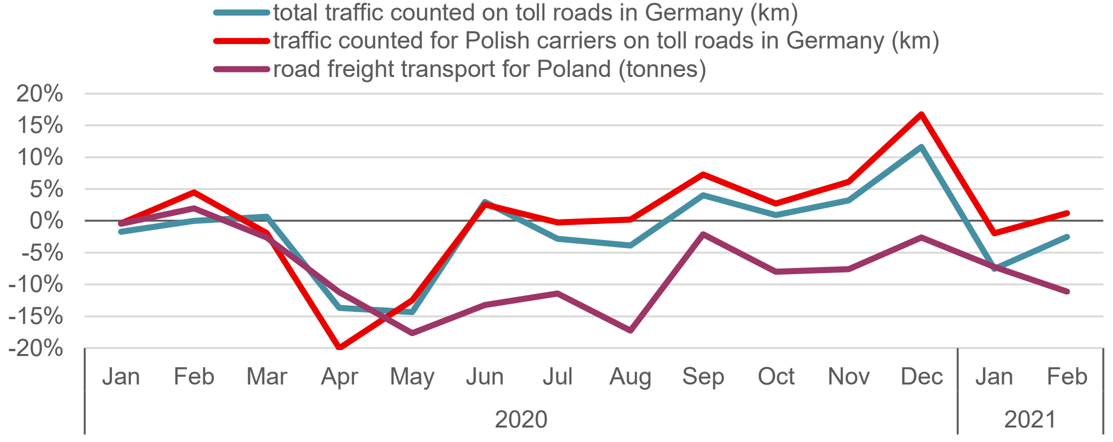
Stable situation in international transport resulted in no significant change in financial condition of carriers. Revenue, liquidity and debt in the first half of 2020 were similar to the previous year, but profitability increased, largely due to weak PLN and government support.

The pandemic was a period of increasing differences between large and small carriers, reflected in higher dynamics of revenues or number of vehicles in international traffic among the former.

At the end of 2020 and the beginning of this year, positive and growing dynamics of truck registrations by Polish carriers was visible. However, this is partly an effect of a low base. Declines in truck purchases had already started before the current crisis, i.e. as early as 2H2019, and the pandemic only exacerbated them.

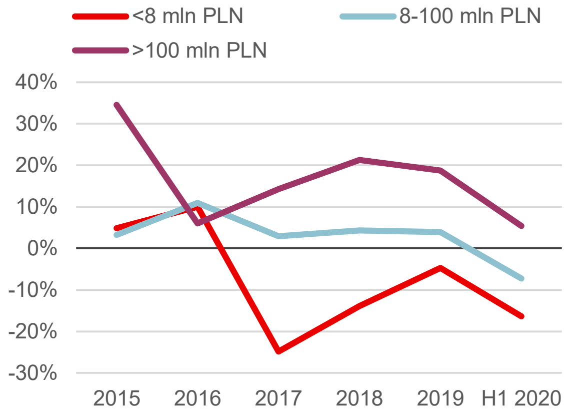
In view of the assumed GDP growth of Poland and the EU, we forecast an increase in tonne-kilometres of domestic road freight carriers by 4.5-6.7% in 2021.

Annual growth of road freight transport – Poland traffic and toll traffic in Germany



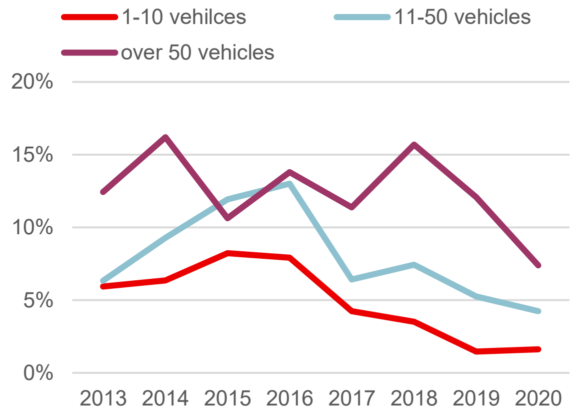
Source: GUS, BAG

y/y revenues of Polish carriers >9 employees by revenues



Source: PONT Info, Santander Bank Polska calc.

Vehicles of entities with international licences by number of vehicles (y/y)



Source: GITD, Santander Bank Polska calc.

Santander

Solid start of the year in furniture despite tougher restrictions

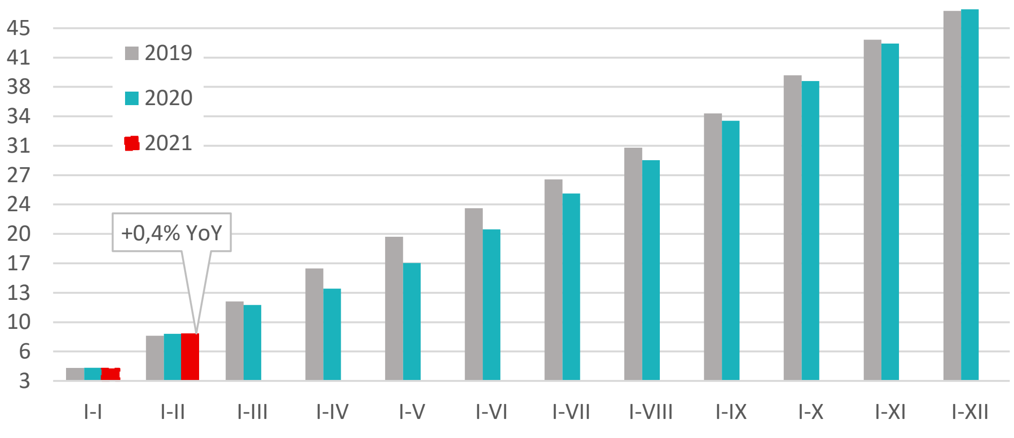
Furniture industry managed to finish last year with a marginal increase in sold production, which we view as quite positive given the pro-cyclical characteristic of this sector and decline of the Polish GDP of 2.8%.

First months of 2021 brought further improvement. In January sold production was down by 2.5% y/y but after accounting for difference in working days, it grew by a solid 7.7% y/y. In turn, February brought growth of „only" 3,5% y/y, which in our view results from strict restrictions in place on main export markets since the end of last year. It is worth noting that we see growth in sold production compared to pre-pandemic months of last year.

Furniture export value in 2020 was down by 3.8%. In terms of value, the largest decrease was on the German market but it turned out significantly smaller that in 1H20. This was not the case for British, French, or Czech markets. Among EU markets, the Netherlands experienced the highest growth in furniture export from Poland.

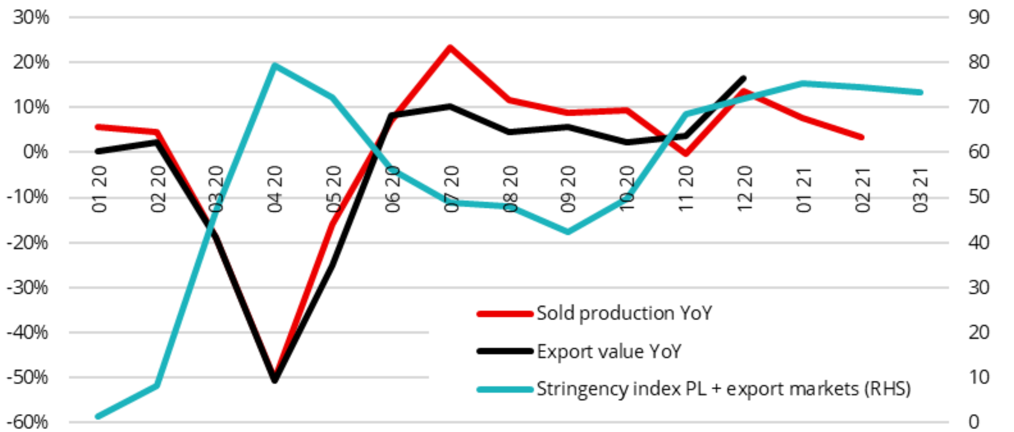
Tight government restrictions remain in place on main export markets – shops are partially closed, on some markets consumers need to make a prior appointment, click&collect purchases are also available. On the single most important export market, Germany, the government resigned from closing all shops during the Easter weekend, which could have been a hit for the furniture industry in Poland. In the Netherlands, which had significant share among markets on which furniture exports increased last year, restrictions are very gradually eased. Great Britain, which remained the 3rd largest importer of furniture from Poland, plans to loosen restrictions in April. In spite of closure of furniture shops in Poland, we expect that 4-6% growth rate of sold production of the furniture industry is still possible in 2021.

Sold production of the furniture industry (PLNbn)



Source: GUS, Santander calculations

Annual change in sold production, export of furniture; Goverment restrictions stringency index*



* Monthly average of daily values of government restrictions stringency index of Oxford University

Source: Eurostat; Oxford University, Santander calculations

Santander

Builders' joinery expands on foreign markets

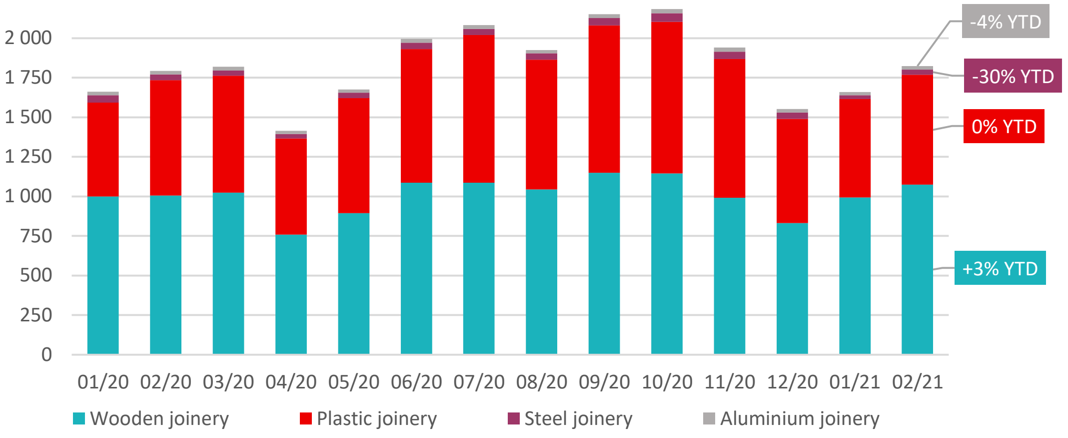
Production volume of builders' joinery in 2020 contracted by 4%, in line with our expectations. In December alone, production volume grew by as much as 13.3% y/y, which was last year's record for this industry. First months of 2021 brought a further increase at 0.9% y/y due to higher production of wooden and windows of wood, and PVC windows.

Builders' joinery export value grew last year by 4.2%, above our expectations of 3%. More that 50% of this growth came from increased sales of PVC windows, and further 18% came from aluminium joinery. Both of these segments increased their share in export structure, PVC windows' share grew from 47% of export in 2019 to 49% in 2020. Aluminium joinery grew from 13% to 14% in 2020. It is worth noting that since the second wave of restrictions, export value of builders' joinery seems positively correlated with the level of restrictions, in contrast to the first wave which brought deep decline. This can be interpreted as shifts in supply chains, or simply expansion of Polish exporters on the EU market.

Germany was the most important market in terms of both export sales value and y/y growth. Together with France and the Netherlands, it accounted for almost 60% of shipments in terms of value. It is also important to note that the USA, Canada, and Mexico accounted for 8.2% of last year's growth. As a result, we expect that share of export in builders joinery production increased to as much as 60%.

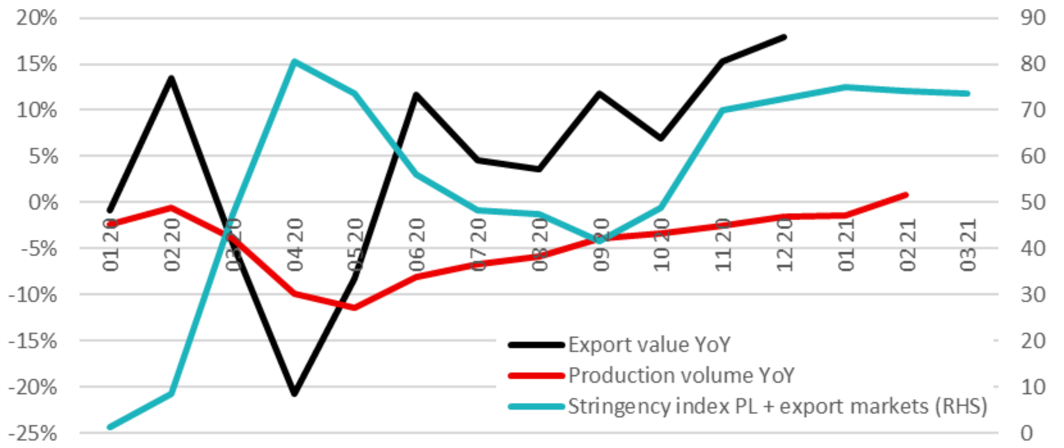
Back on the domestic market, even though in February we saw record high number of sold dwellings, the number of dwelling under construction did not decline significantly, thanks to equally strong impulse of new constructions. It could be that investors expect that restrictions caused by the pandemic will cease before the dwellings are completed, which could also result in equally strong from home improvement segment. This would significantly boost sales of builders' joinery manufacturers.

Production volume of builders' joinery (thousand pieces)



Source: GUS, Santander calculations

Annual change in sold production, export of builders' joinery; Goverment restrictions stringency index*



* Monthly average of daily values of government restrictions stringency index of Oxford University
Source: Eurostat, Oxford University; Santander calculations

Weaker than expected year start in automotive

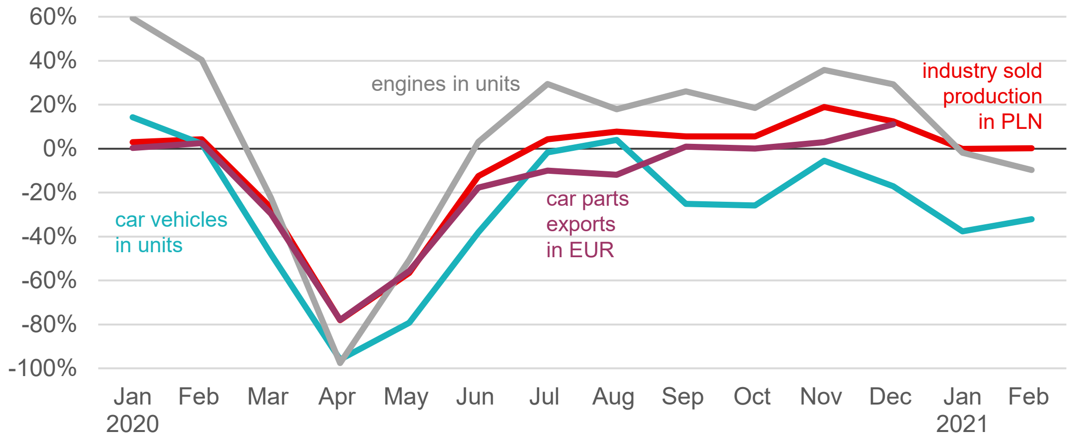
The beginning of 2021 in automotive production turned out to be weaker than expected. Demand in Europe continued to fall, with registrations in January-February down 23.1% y/y. The USA (-8.4% in light vehicles) and China (+73%, although a very low base from last year) performed better. An additional factor limiting production was semiconductor supply problems, which may also be seen in the coming months.

After a successful autumn and positive dynamics at the end of 2020, since the beginning of this year we see declines in the production of passenger cars in main importers of Poland-produced car parts, i.e. the Czech Republic, the UK and Spain. Also the leading importer, i.e. Germany, saw declines despite its stronger exports to China or the United States, which reported a more stable demand than Europe.

Against this background, the domestic automotive industry overall is still performing well, having maintained value of sold production at last year's level. Moreover, production volumes of both motor vehicles and engines fell in January and February, so the entire sector's output manager unchanged in annual terms thanks to production of automotive parts and components. Certainly, sales of parts were supported by a stable aftermarket segment, as can be seen in the good results of the leading domestic distributors, and export of parts also started to grow at the end of the year.

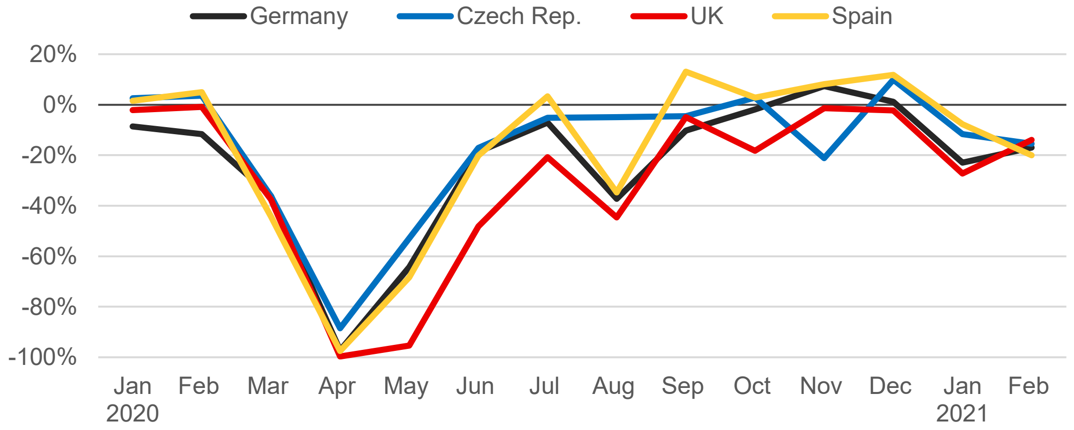
Previous forecasts of 10-13%* growth in light vehicle sales in Europe in 2021 may be revised downwards if the situation does not start to improve in the upcoming months. In the long term, Europe is not expected to return to 2019 production volumes until 2023 at the earliest. This is the view of analysts**, but so is the forecast of domestic parts manufacturers, most of whom expect a recovery to take place between 2022 and 2023***. Similar schedule is predicted for the USA, while China could break through 2019 levels as early as 2021.

Annual growth of automotive production in Poland in 2020 and 2021



Source: GUS, Eurostat

Annual growth of passenger car production in countries - major importers of car parts produced in Poland



Source: VDA, SAP, SMMT, ANFAC

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* Moody's, S&P, VDA, LMC Automotive
** Moody's, S&P
*** AutomotiveSuppliers.pl

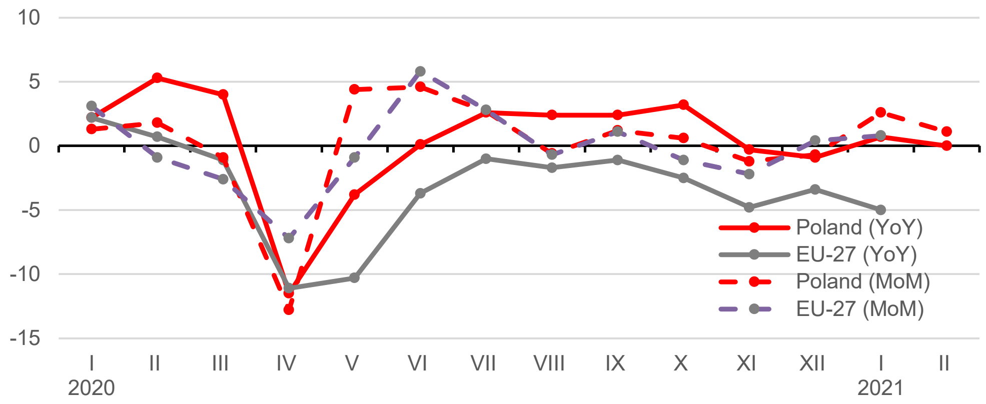
Increase in food industry production

Despite the uncertainty related to successive waves of pandemic, the situation of domestic food industry was quite stable in the first months of this year. As shown by the seasonally and calendar adjusted Eurostat data, total value of sold production (food products, beverages and tobacco products) in medium and large companies increased in January and February by 2.6% and 1.1% m/m, respectively. In turn, compared to the corresponding periods of 2020 (calendar adjusted data), dynamic in January was positive and amounted to 0.7%, while in February the production volume remained at the previous year level. In this area the domestic food industry stood out positively compared to the European Union. As shown by preliminary data, in January the average monthly growth in the EU-27 was lower than registered in Poland (0.8% vs 2.6% in Poland). In annual terms there was a 5% decrease.

In the main category, i.e. food products, value of sold production of domestic industry was higher in annual terms both in January and February. The situation in beverage industry was worse, though. In January, production value was lower by 8.2% y/y, and in February lower by 7.1% y/y. In case of tobacco products in January a strong m/m increase was recorded, which allowed for a positive y/y growth (+1,2%). However, in February the value decreased both m/m and y/y (-11 %).

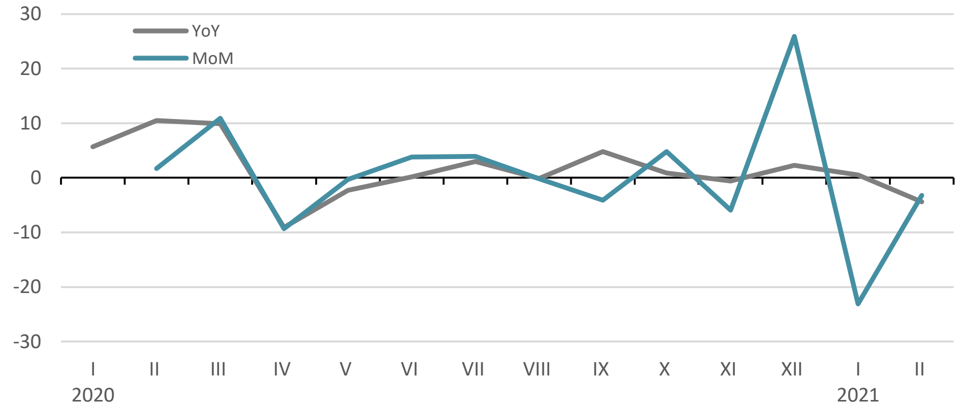
In January, domestic demand underpinned the food industry production. Although retail sales of food decreased after Christmas, its level remained higher than in the previous year. According to the Central Statistical Office (GUS) data, annual sales dynamic in current prices in January amounted to +0,5%, despite one trading day less y/y. In turn, a decline in retail food trade was recorded in February. The value of sales decreased by 3,2% m/m, which means a deeper decline than the average recorded in indicated month in the last decade. As a result, annual dynamic was also negative.

Growth of sold production of food industry (%)



Source: Eurostat, Santander calculations

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



Source: GUS, Santander calculations

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Lower food export in January

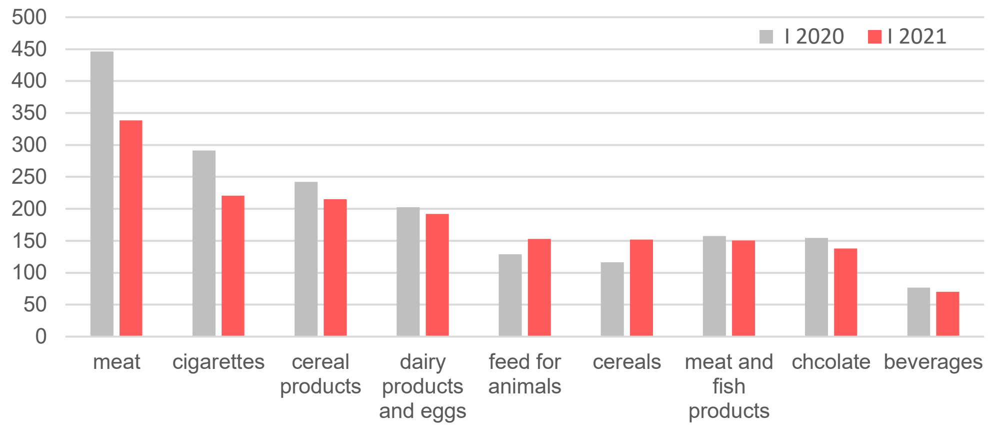
In 2020, Polish food export set a new record, despite difficult conditions of the pandemic. According to preliminary data, total value of foreign sales amounted to EUR34bn, which means an increase of 7%.

However, the beginning of 2021 brought a significant drop in export. The value of food export in January amounted to EUR2.4bn and was lower by 9% compared to the corresponding period of 2020. For comparison, in April 2020, i.e. during the first lockdown in the EU, export was lower only by 1.2% y/y. Foreign sales of most major categories fell in January. Very high, 24% y/y declines were recorded for the two most important assortments: unprocessed meat and tobacco products. Foreign sales of cereal and chocolate products were 11% lower than in the previous year. Export of beverages decreased by 9%. In turn, an increase was recorded in case of cereals (by 31%) and animal feed (by 19%).

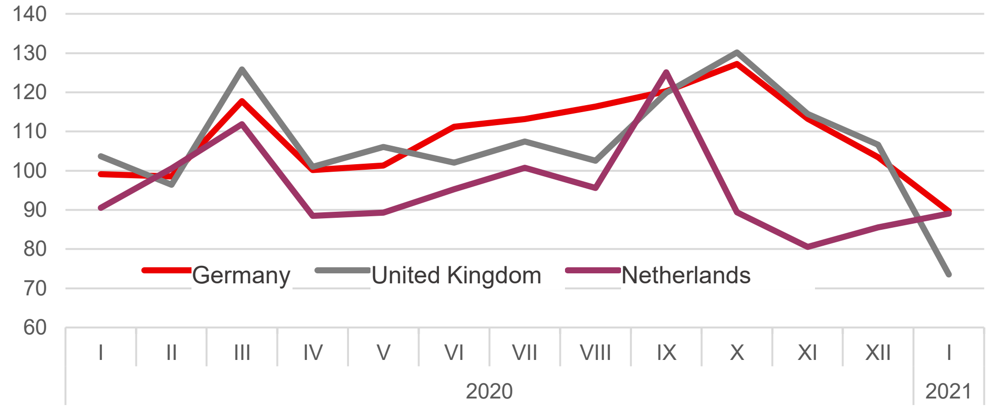
Export results in January were significantly affected by, among others, drop in sales to the United Kingdom, which was the second largest foreign recipient of Polish food in recent years. In January, the value of sales to the British market amounted to EUR172mn and was lower by 30% y/y. High drops - reaching 20-30% - were also recorded in sales from other EU countries to the United Kingdom, incl. from France, Spain and Ireland. On the one hand, this could be a result of strong increase in British food stocks at the end of 2020, for fear of no-deal Brexit. However, on the other hand, it may also be the result of new formalities in EU-UK trade, which are no longer under intra-EU terms.

In the coming months, the pandemic will remain the main risk factor for the food industry, both in terms of the potential of the domestic market and export. If epidemic situation improves too slowly, food companies will not be able to use some of the potential of spring and summer months.

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



Poland's food export, bymain foreign markets (av. monthly value in 2019 = 100)



Source: GUS, Santander calculations

This analysis is based on information available as of **30.03.2021** and has been prepared by:

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