MACROscope

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The growing price of recovery

Poland: Economic Outlook

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Executive Summary (macro)

This is yet another year on a forecasting rollercoaster: In just a few months we have moved from worries about the 3rd wave of Covid-19 and downward forecast revisions to re-opening economies, growing optimism and a rise of GDP forecasts, now back to increasing fears of the 4th wave; from an unusually cold April-May to a super-hot June; from NBP rate cut signals at the start of the year to rising rate hike expectations. The only area where the direction of forecasts has not changed, at least until recently, is inflation: CPI growth almost doubled since December's 2.4% y/y until May, with analysts' expectations for both 2021 and 2022 steadily moving up.

We believe the outlook for the Polish economy is optimistic, with GDP growth near 5% in 2021 and 2022. The country is likely to be among the first ones in Europe to return to the pre-pandemic output level, with GDP growth benefiting a lot from the global trade revival and manufacturing boom. The recovery of domestic demand started much earlier than we had anticipated and should continue, supported by healthy balance sheets of both firms and households. The EU's Recovery Fund should provide additional financing boost for investment soon. We like the idea that the next few years may resemble the "Roaring 20s" from the last century, as the economy and the society will try to recoup the pandemic losses.

That said, the pandemic is not over yet and the recent information suggests we should be prepared for the 4th wave of Covid-19 in autumn or even late summer, especially that the vaccine rollout in Poland has slowed and it may be difficult to reach herd immunity by the year-end. While it tames our appetite to lift this year's GDP forecast well above 5%, the lesson from the recent past suggests that the economic impact of every next wave of pandemic is diminishing. So, even if some sectors could feel the negative effects of restrictions again, the overall impact should be negligible… unless new virus mutations change the landscape completely.

The most important change in our forecasts since the previous quarterly report is not the upward GDP revision, in fact, but how we see the labour market and inflation outlook. The recent evidence shows that companies started hiring and wages accelerated already in the early stage of economic recovery. Continuation of economic expansion will likely push the labour demand even higher, with job vacancies rebounding quickly, generating mounting upward pressure on labour costs and increasing risk of wage-price loopback. Firms seem to be well prepared to cope with this wage pressure though, as their financial results are record-high.

CPI inflation peaked at 4.7% in May, it seems, but we think it will remain elevated for quite some time. We see growing evidence that the inflationary pressure is more stubborn and persistent than the central bank wants to admit. Our current forecast assumes CPI growth near 4% in both 2021 and 2022. In the environment of strong demand recovery, combined with tightening labour market and supply-side bottlenecks, inflation is unlikely to die of old age, we think. Taming inflation would require policy tightening. The cyclical fiscal adjustment (GG deficit from -7% of GDP in 2020 to -4% in 2021, according to our estimate) would help, but will not do all the job for the MPC so rate hikes will be justified.

We think the MPC has already started preparing the ground for potential policy normalisation. Please note that NBP president's rhetoric has changed notably in the last two months: the earlier pledges that rates will be unchanged "for long" or "until the end of the MPC term of office", QE will be live "forever", and thinking about policy tightening is "absurd" have been replaced by a new guidance: the NBP will not hesitate to hike when needed; rate hikes must be preceded by the end of QE, the tapering must take some time, preconditions for policy normalisation are forecasts showing high and persistent growth, high and persistent inflation – it must be reflected in the NBP projections (the November projection was marked as an important milestone). The ship has already started changing course, but it will simply take time to see the effects. We think we may reach the beginning of rate hikes cycle by November, assuming that the economic impact of the fourth wave of Covid-19 will be negligible.

Executive Summary (markets)

FX

We expect EURPLN at 4.51 at year end. Macroeconomic fundamentals are definitely positive: solid economic recovery, current account still in big surplus (near 3% of GDP), NBP likely to start policy tightening later this year. Our 3Q21E EURPLN forecast is higher at 4.58 because we reckon the monetary policy normalization in the US is one of the biggest challenges for the EM currencies in general and the zloty in particular. The August Jackson Hole Summit is an event around which investors might look less favourably toward the EM world. Santander forecasts EURUSD at 1.18 in 3Q2021E. Other risks for the zloty include: no change in the NBP policy, the increased number of the Covid-19 cases in Autumn which historically has lead to weaker zloty, or the contagion from the weaker forint if the EC threatens to withhold EU payments for Hungary due to rule of law violation.

FI

Global economic environment (in June both the ECB and Fed have revised up their GDP and inflation forecasts) are supportive for higher core market yields. Santander expects 10Y Bund yield at 0.0% and UST at 2.0% at the end of 2021. In the CEE3 region both MNB and CNB have already started the hiking cycle and market expectations of hikes are front-loaded (most of the hikes happen over the next 12 months). NBP has not started the cycle yet, markets expect majority of hikes in this cycle to happen in the year ending 24 months from now.

We forecast 2Y bond yields at 0.35% by the end of the year. The liquidity in the banking sector has increased again, weekly NBP bills auctions currently attract over PLN200bn. However it is the NBP main rate which is the main driver of the short term bonds. We expect 15bp hike later in the year bringing the main rate to 0.25%.

We forecast 10Y bond yields at 2.00% by the end of the year, the yield increase being driven predominantly by core market yields. We note a risk to a PL-DE spread widening (not our base case at the moment) as the monetary policy keeps normalizing.

In July c.PLN19.0bn comes back to the market in the form of coupon payments (PLN3.5bn) and redemption of the PS0721 bond. Over the short time horizon this should support the ASW especially on the front end of the curve. Later on the ASW should return to widening (normalization) trend. The Ministry of Finance issuance in 3Q21E is set at PLN4.0-13.0bn worth of bonds on outright sales, of which PLN 4.0-8.0bn on the outright auction on 23 July.

2021 Forecasts – what has changed

Indicator	Our view at the end of March 2021	Our view at the end of June 2021
GDP	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%.	Our worries about the 3rd wave of the pandemic proved unfounded: the economy started reviving faster and stronger than expected as soon as in 1Q21. The 4th Covid-19 wave is now a possibility, but we think it will also have negligible impact. GDP growth forecast currently at 5% for both 2021E and 2022E.
GDP breakdown	All assumptions [about reviving consumption, investments and exports] 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.	Instead of delayed recovery, we have seen much sooner revival of all demand components, investments in particular. We think they should continue contributing to fast economic growth in the following quarters.
Labour market	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.	Firms started hiring already at the start of the year and the labour market slack started diminishing much earlier than we had thought. Wage growth continues surprising to the upside.
Inflation	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.	CPI and core inflation went much higher than we had expected in 1H21 and we think they will remain elevated in 2H21 and 2022. Some components of current high inflation are transitory but they will be replaced by other, more fundamental conditions, resulting from a strong demand expansion and tighter labour market.
Monetary policy	We still believe that main interest rates will remain unchanged at least until mid-2022, when NBP governor’s term ends. NBP keeps favouring a weaker zloty and signalled more active QE management, but at least rate cuts are off the table.	We think the MPC policy is turning towards a more data-driven one and the central bank may start interest rate hikes already in November in reaction to a much more optimistic economic scenario. The next projections of the NBP will be key.
Fiscal policy	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.	A surprisingly strong macro scenario (higher GDP, higher inflation) will support fiscal revenues, allowing for a faster fiscal consolidation: we think GG deficit may drop to c.4% of GDP in 2021 from c.7% in 2020.
Fixed income market	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 the increased NBP’s QE and large redemptions in Q2.	Front-end bonds yields are likely to start increasing following the NBP hikes, despite the still abundant liquidity in the banking sector. Long-end bond yields will follow the core market yields higher with spread stable but with a risk of widening. July redemptions and coupon might keep ASW tight for another month after which the ASW should return to a widening (normalization) trend.
FX market	Short term outlook negative for PLN due to a mix of factors: high Covid-19 wave, more active NBP’s QE, uncertainty regarding FX loans. Some strengthening possible by the year-end, but returning to the pre-pandemic levels will take more time.	Strong macroeconomic fundamentals are supportive for the zloty. Main risks include Fed normalizing its monetary policy and Covid-19 case increases in the Autumn. The Supreme Court’s ruling on FX loans still remains the unknown, both as regards the timing and the verdict

Economy

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GDP outlook: Poland's outperformance continues

One quarter ago, we trimmed our GDP growth forecast for 2021 to 4.2% amid the rising 3rd Covid-19 wave, which quickly proved to be a wrong decision as the revival of the domestic demand started faster than expected, despite the uncertainty caused by the pandemic. Now, with the GDP forecast at 5.0% for both 2021 and 2022 (on par with market consensus), we are reluctant to lift it further, as the 4th wave is on the horizon. But the risks seem to be skewed to the upside, as the recent history has told us that every next pandemic wave has smaller economic implications.

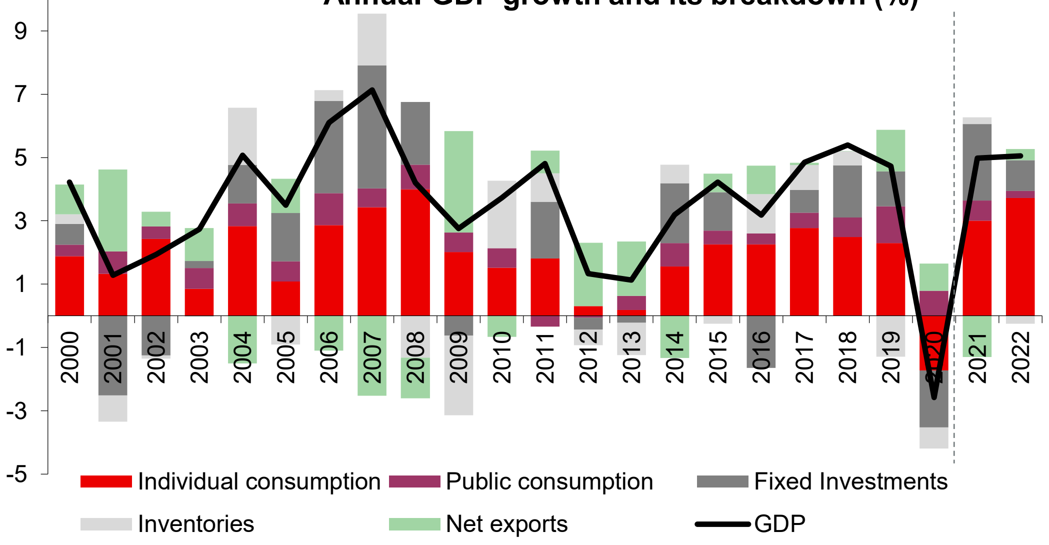
Poland remains one of the first countries in the EU that will return to the pre-pandemic output levels (already in mid-2021). Still, the return to pre-pandemic trend will take slightly more time. We estimate that Poland's real GDP may rise by c.7% between 2019 and 2022 (vs. c.10% in pre-covid forecast), which means ~1 year of GDP lost.

The most striking feature of 1Q GDP data was a sharp investment rebound (+18.2% q/q s.a.), which brought it back above the pre-pandemic level. Consumption recovery, albeit slower, started and should continue, supported by rising income and growing confidence. Foreign trade is also booming, in sync with the revival in global trade and manufacturing. So, all engines are already running and should continue supporting economic growth in 2021-22. We discuss the main components of the final demand in more detail on the following pages.

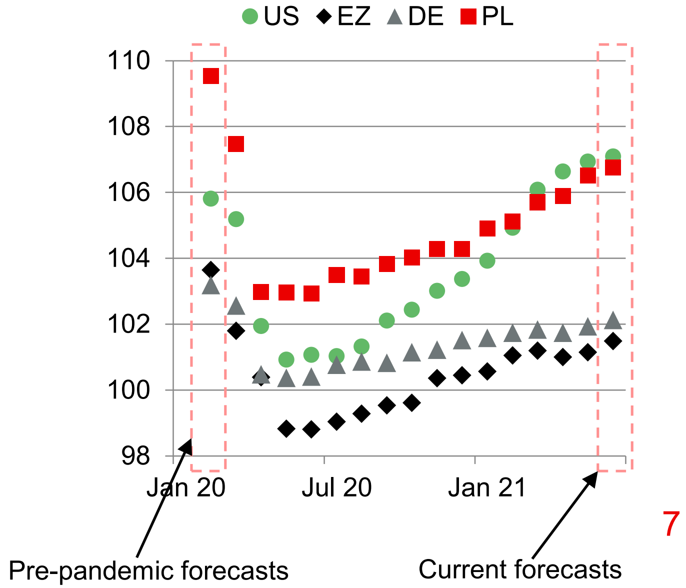
GDP growth forecasts according to Rzeczpospolita quarterly poll

	Mar/Apr 2021		Jun/Jul 2021	
	2021	**2022**	**2021**	**2022**
Median	**4.1**	**4.7**	**5.0**	**5.0**
Avg	4.0	4.7	4.9	4.9
Max	5.0	5.9	5.9	5.7
Min	1.8	3.4	3.8	3.5
SAN	**4.2**	**5.3**	**5.0**	**5.0**

Annual GDP growth and its breakdown (%)



GDP level expected in 2022 as compared to pre-Covid (2019=100), implied by Bloomberg consensus forecasts



Source: GUS, Rzeczpospolita, Bloomberg Santander

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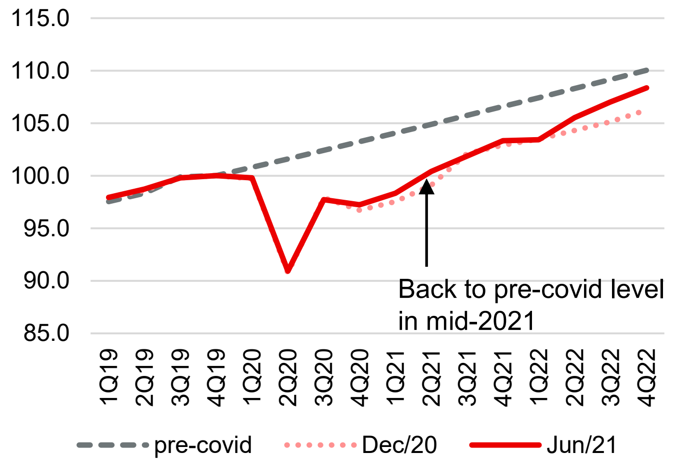
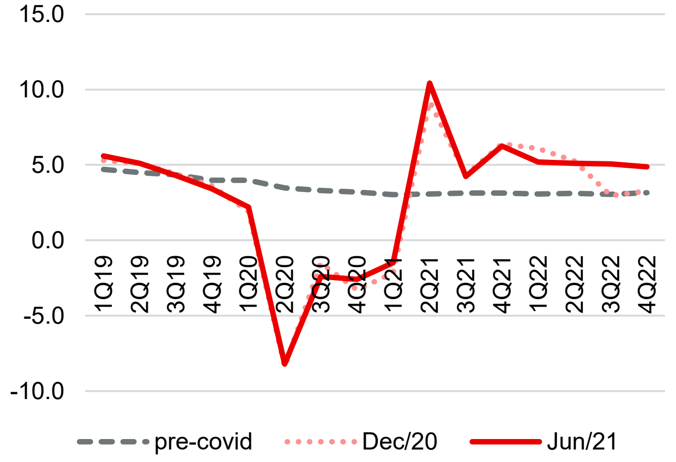
GDP outlook: recovery paths differ across sectors

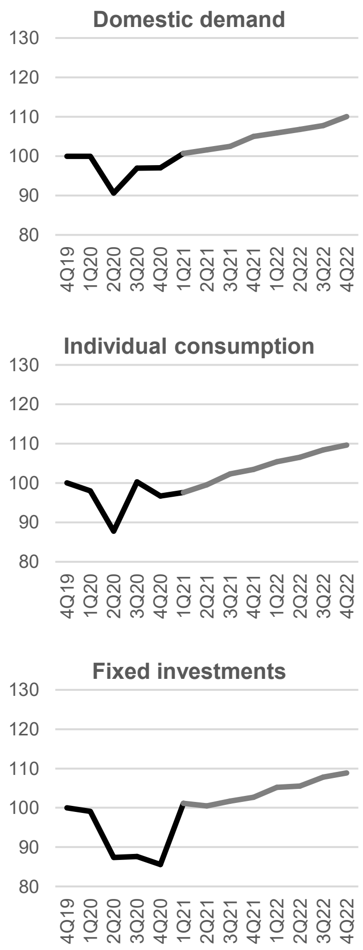
GDP forecast (4Q19=100, s.a.)



GDP growth forecast (% y/y)



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



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

Source: GUS, Santander

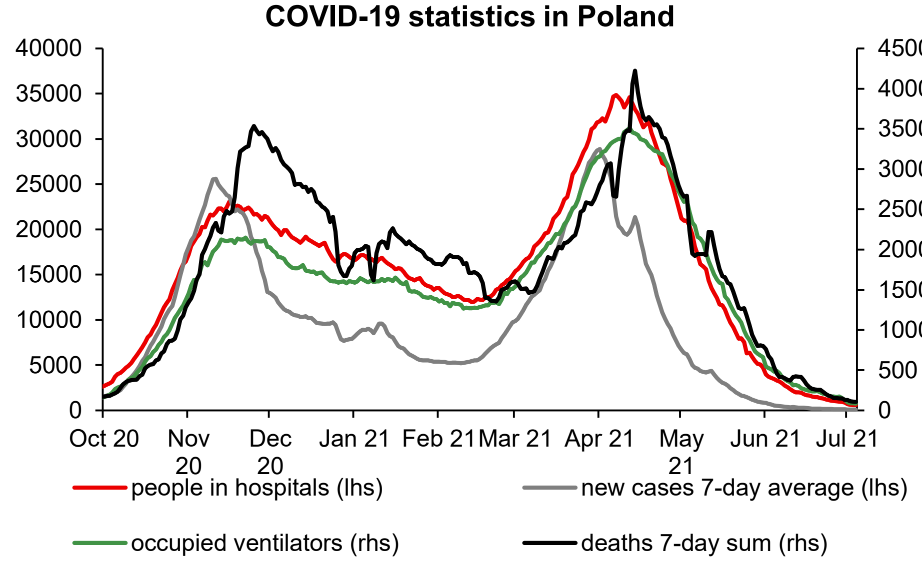
Covid update: another wave still possible

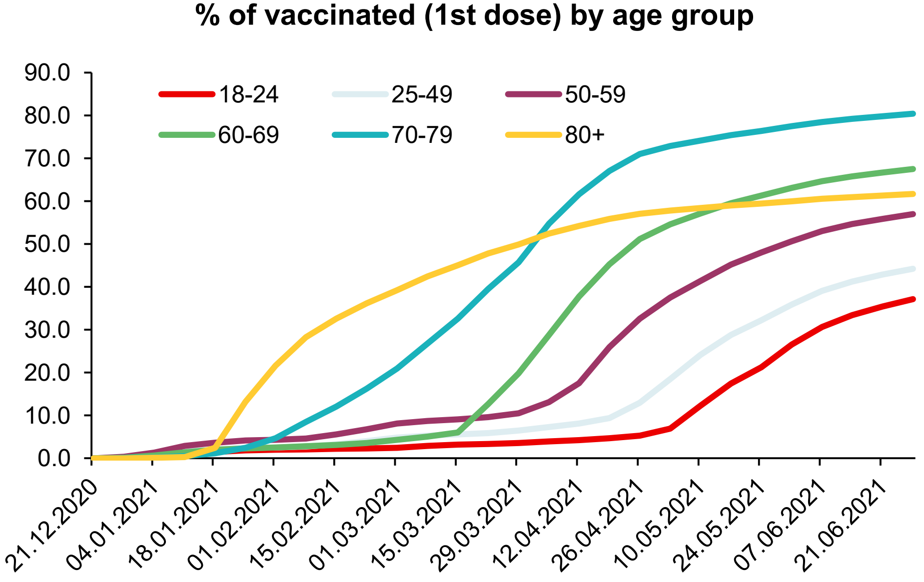
The Covid-19 epidemic has recently moderated in Poland with the third lowest count of daily new cases in the whole EU (after Romania and Malta). However, the appearance of new highly infectious variants means that **another wave cannot be ruled out.**

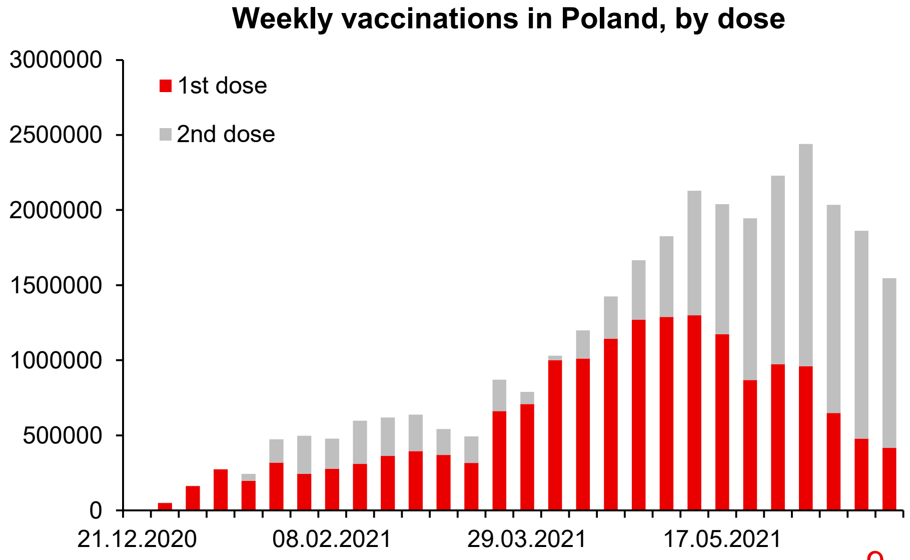
So far about 45% of the population have received at least one dose of vaccination and about 37% have been fully vaccinated. This is still markedly below herd immunity thresholds estimated at 60-70% (or even 90%+ for the new strains) so a strong rise in the number of infections and new restriction tightening remain a viable option.

Moreover, while the total vaccination rollout seems to remain strong, with about 2mn shots per week, the underlying data show a declining number of first vaccinations. Worryingly, the momentum is declining in all age groups. If this slowdown is caused by the unwillingness to get jabbed, we fear **it may be impossible to reach the herd immunity at all**. If we assume no further decay, and extrapolate vaccination momentum from the 26th week of the year, 70% mark of first-dose vaccination will not have been reached until November.

Polish health minister has already warned that, judging by the spread of the Delta variant in the UK, the next wave could hit Poland even before the end of summer holidays and the government will respond with restrictions, if necessary.







Source: ECDC, Michał Rogalski, Santander

External environment: optimism rising

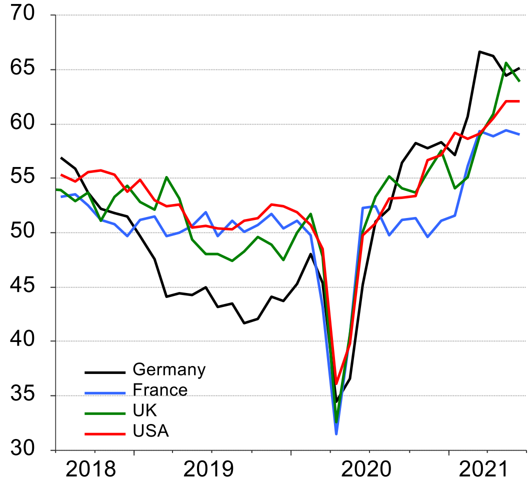
Compared to where things stood a quarter ago, we now have growing evidence from soft data of a revival in services sectors of major economies, not just their industries. PMIs in both manufacturing and services are at or near all-time highs, as the economies have opened up and demand was unchained.

The revival of international trade is proceeding even faster than the economic recovery and the pre-Covid trend has already been reached. This happens despite broadly reported disruptions in global supply chains and transportation, and by the way contradicts the popular hypotheses about post-pandemic de-globalisation.

Judging by current global growth forecasts, the US GDP will cross its pre-Covid trend line already in 2021, while the Eurozone GDP will be back to the pre-Covid level at the turn of 2021/2022 (the pre-Covid trend was pretty flat, so crossing it should not take much longer). Needless to say, another Covid wave might delay these important moments.

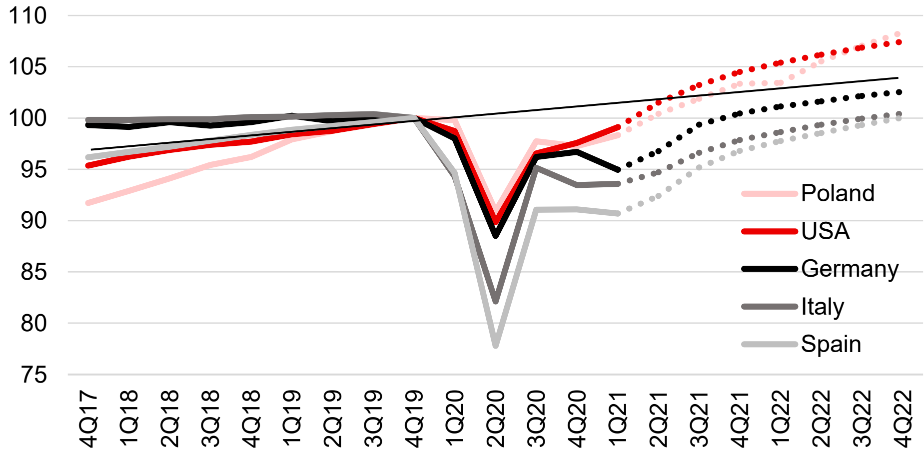
The global growth picture thus seems quite supportive for further economic rebound in Poland.

PMI manufacturing



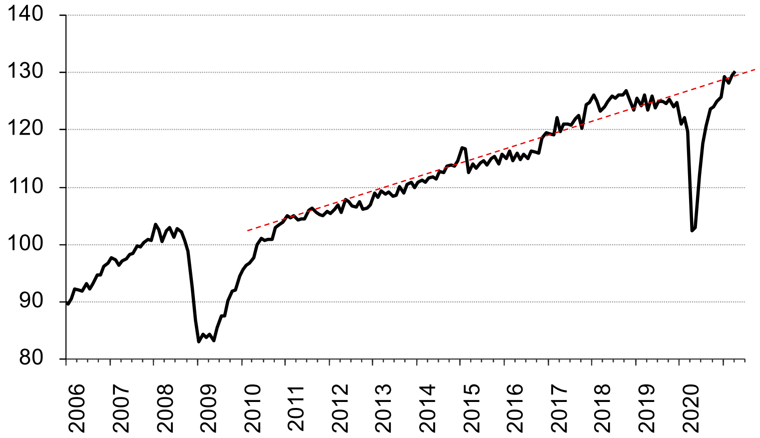
Source: Refinitiv Datastream, Santander

GDP growth trend (4Q19 = 100) and Bloomberg Consensus expectations plus Santander forecast for Poland



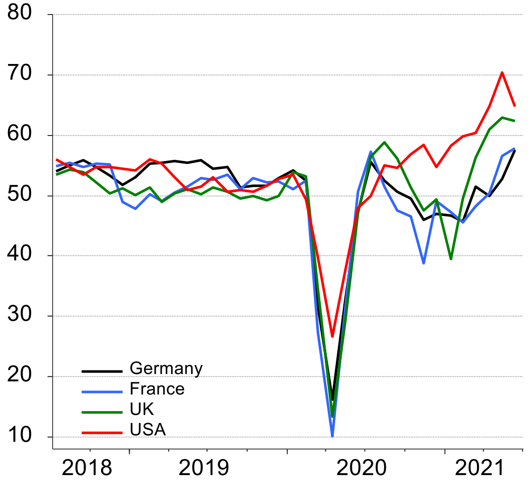
Source: Bloomberg, Santander

CPB World export volume index, 2010=100



Source: Refinitiv Datastream, Santander

PMI services



Source: Refinitiv Datastream, Santander

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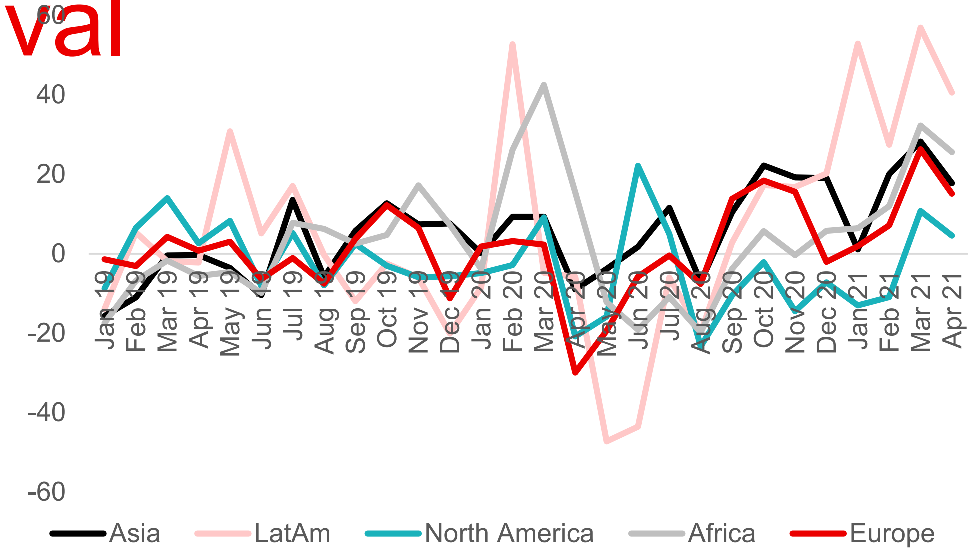
Foreign trade: broadening revival

Poland's exports to Europe (the continent receiving almost 90% of the total flow of goods) are now 20% above the average 2019 level. A weak start of the year was caused by front-loaded demand in 4Q20. The reopening of main trading partners' economies should keep exports much above the pre-Covid level and continue strengthening the role of intermediate goods in total export growth (at an earlier stage consumer durables were the key driver and still remain important).

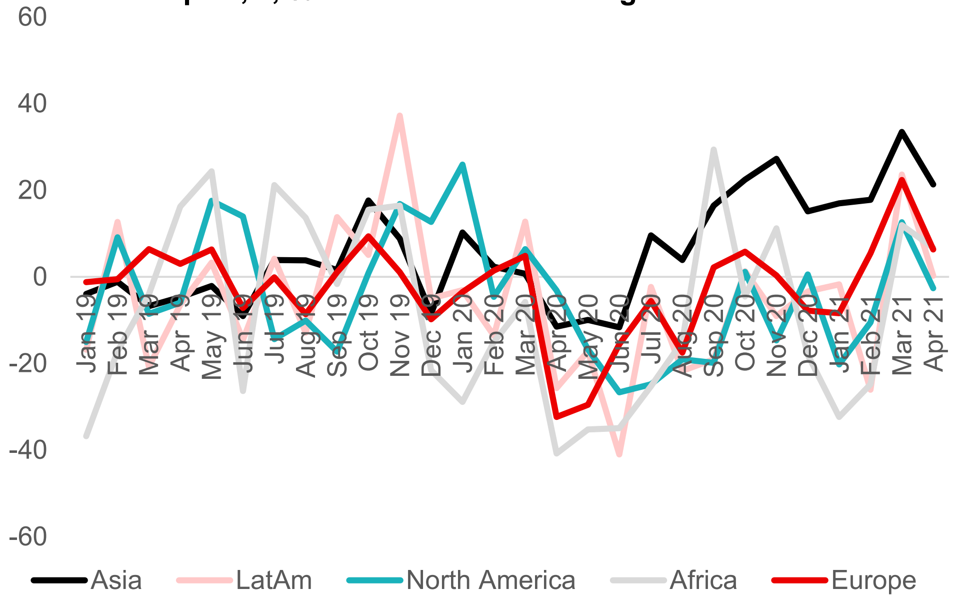
The export boost to LatAm is mostly about batteries (which added 35pp to export growth on average this year). This good is responsible for c.2pp of total export growth and its share increased to almost 3% from 1.2% in 2019. Also there is recently much re-exportation in Polish export statistics (seen e.g. in c.40% rise of telecom equipment exports while at the same time smartphones are one of key growth contributors on the imports side).

On the imports side there was a stunning rise of inflow of goods from China and Korea, possibly linked to the high freight costs and bottlenecks in sea transport. It is likely that much of this flow is shipped further to Europe instead of being utilised in Poland.

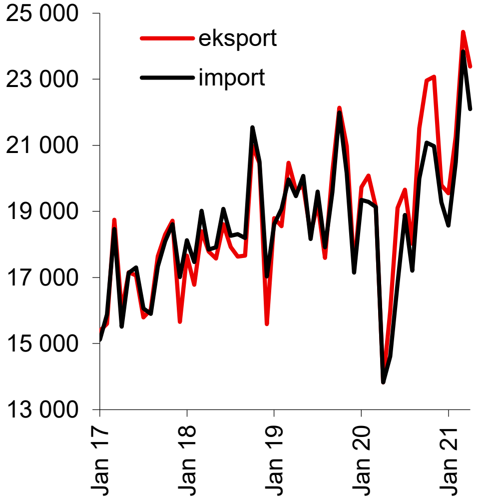
Export, €, % difference from average 2019 level



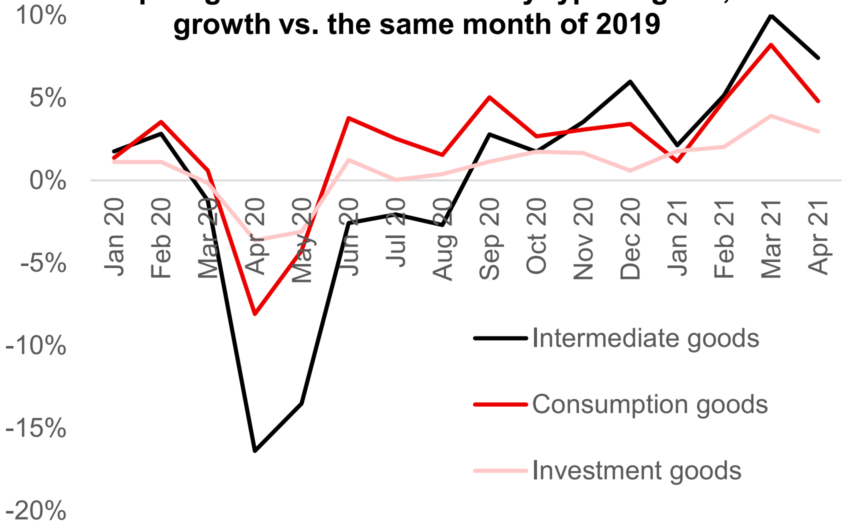
Import, €, % difference from average 2019 level



Export and import level, EURm



Export growth contributions by type of good, growth vs. the same month of 2019



Source: GUS, NBP, Eurostat Santander

Investments: rebound driven by companies…

Investment in 1Q21 increased by 1.3% y/y in real terms, surprising us markedly, as we were expecting that the investment remained deep under water. This made us revise our expectations for investment growth in 2021 to 14.5% y/y.

We do not yet have the full data breakdown, but it seems that the vigorous rebound from -15.4% in 4Q20 was mostly driven by companies. We have drawn that conclusion based on the following factors:

1) Data showed a rebound in investment of big companies (employing 50+) in 1Q21 to +4.6% y/y from -5.6% y/y.

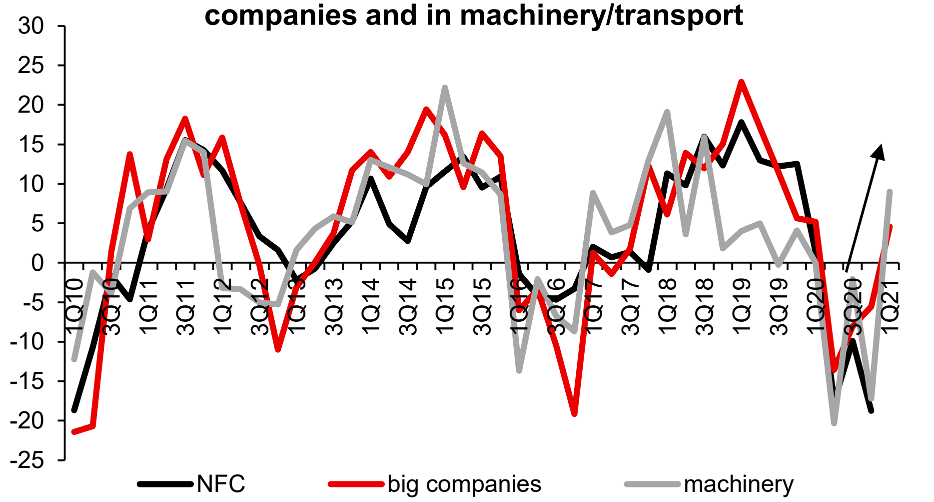
2) Local governments' investment declined by 19.3% y/y in 1Q21.

3) Asset breakdown showed a rise in investment in transport and machinery (+3.2% y/y in 1Q21 from -7.4% y/y in 4Q20) and this type of outlays is more correlated with companies' investment than with other categories.

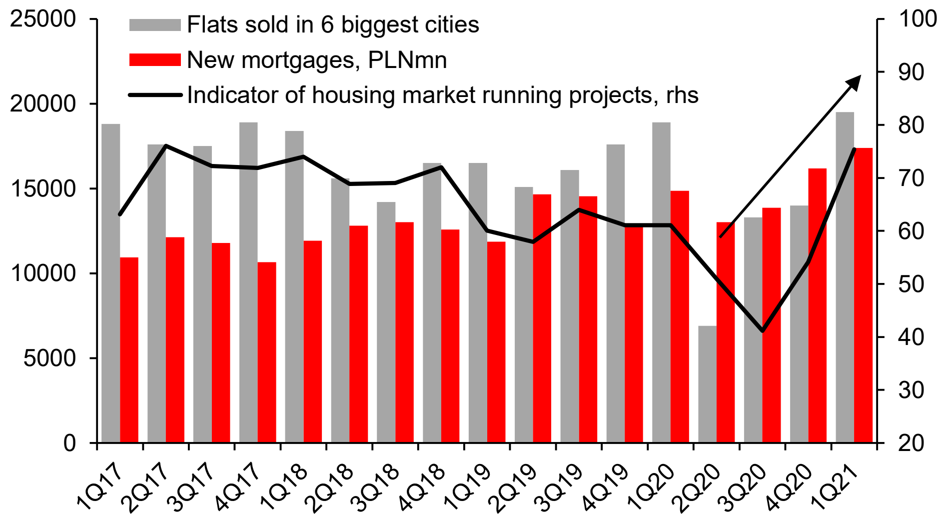
Earlier we claimed that the sound financial situation of companies means they will be able to turn into investment mode fast. While this call proved true, we were not expecting this to happen so fast, with the pandemic still holding a solid grip over the economy in 1Q21. Seemingly, the introduction of vaccines made companies feel confident enough to start preparing for the upcoming economic upturn. Strong data on leases in April and May suggest this is a permanent phenomenon, so we are expecting companies investment to be strong in 2021. This is the main source of the change in our forecast for 2021.

Households' investment (mostly dwellings) is also in an upswing, as confirmed by high volumes of flat and housing mortgage sales. In line with our view, activity of developers remains at high level, while positive labour market situation, low real interest rates and resumed inflow of immigrants will be supportive for the market in the upcoming quarters.

Investment in non-financial companies (NFC) vs investment in big companies and in machinery/transport



Housing market indicators



Source: GUS, Eurostat, NBP, JLL, Santander

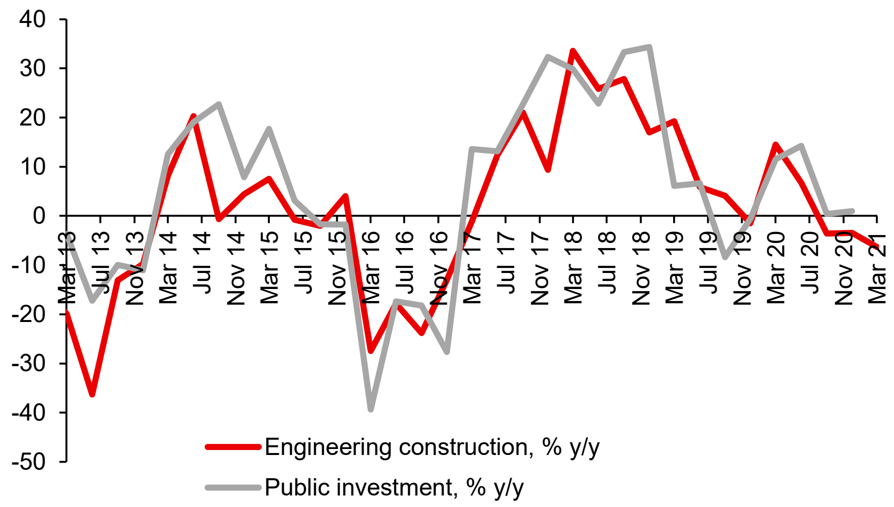
… With infrastructure likely to rebound soon

While investment in machinery and housing is already in an upswing, outlays in engineering infrastructure (highly correlated with public investment) are clearly lagging behind. This does not come as a surprise, as infrastructural projects are usually more complicated, more costly and take longer time to complete.

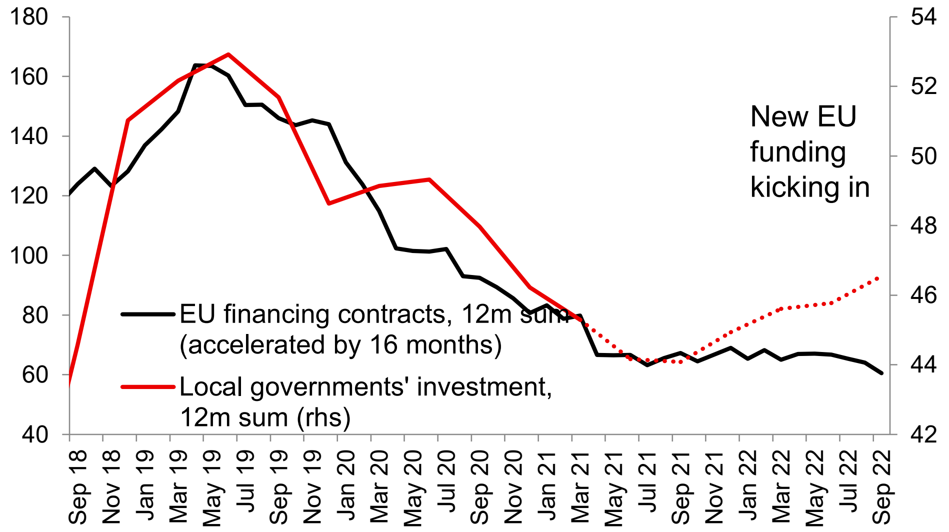
We do however believe that a rebound in this sector is also coming. On the one hand, activity of local governments is likely to remain muted in the upcoming quarters, as it is highly dependent on EU funds and the transition period between two EU frameworks is usually not favourable. Also most railroad construction tenders are planned for the end of the year. But on the other hand, order books in the construction sector are growing and the activity of GDDKiA (overseeing road investment) is increasing (PLN7.5bn signed contracts until early June).

We maintain our view that a recovery in this sector will gain strength at the end of 2021 and in 2022.

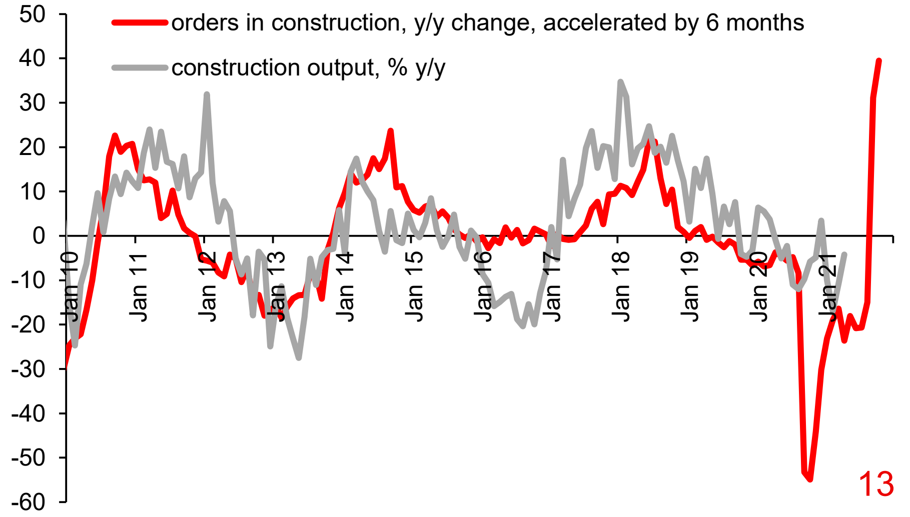
Public investment vs engineering construction



Signed contracts for EU 2014-2020 financing and investment in local governments, PLNbn



Construction – orders and output



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Source: GUS, Ministry of Finance, Ministry of EU Funds, Santander

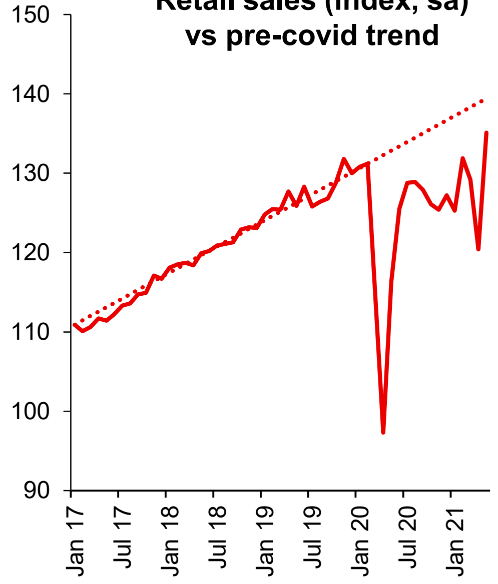
Consumption still with major upside

We think that consumption is likely to show two-digit growth rates soon, as it still remains muted and its normalisation versus incomes should be expected.

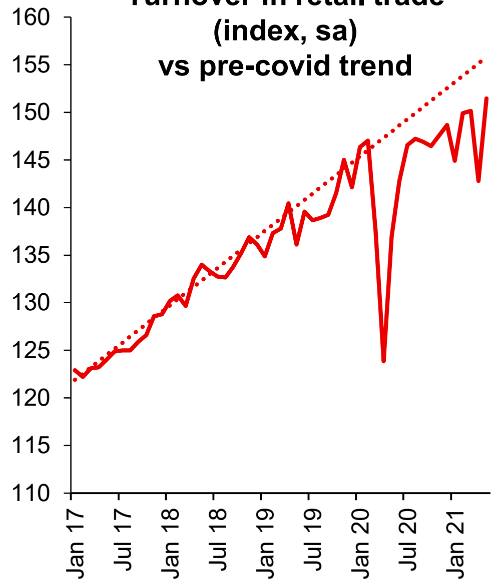
While some indicators, as industrial output, quickly returned to the pre-Covid trends, private consumption remains muted, with its monthly proxies (retail sales, retail trade turnover) visibly deviating from the trend. This deviation is particularly striking when we take into account the robust growth of households' incomes during the pandemic: private consumption as % of disposable incomes declined to unprecedented levels (or, to put it in other words, the saving rate rose markedly).

We see no reason for the saving rate to remain elevated for longer, and we are expecting it to return to its average level. This means there is a big upside for the consumption growth in the upcoming quarters, given a strong labour market and improving consumer assessment of the current financial situation and sentiment towards big-item purchases. While immediate normalisation would boost 2Q consumption by about 25%, we think this process will be gradual with a full return to trend in 1H22.

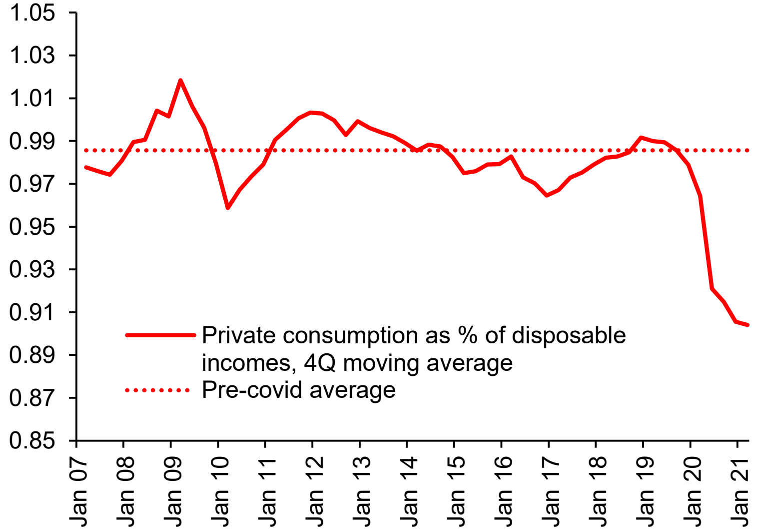
Retail sales (index, sa) vs pre-covid trend



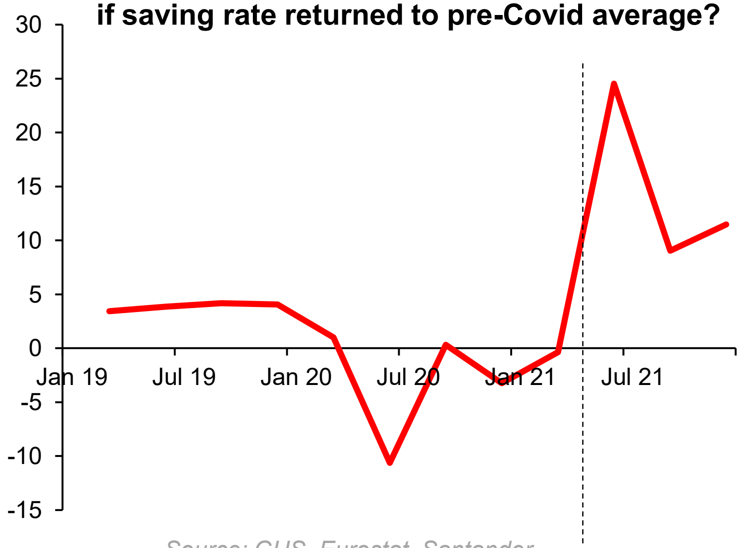
Turnover in retail trade (index, sa) vs pre-covid trend



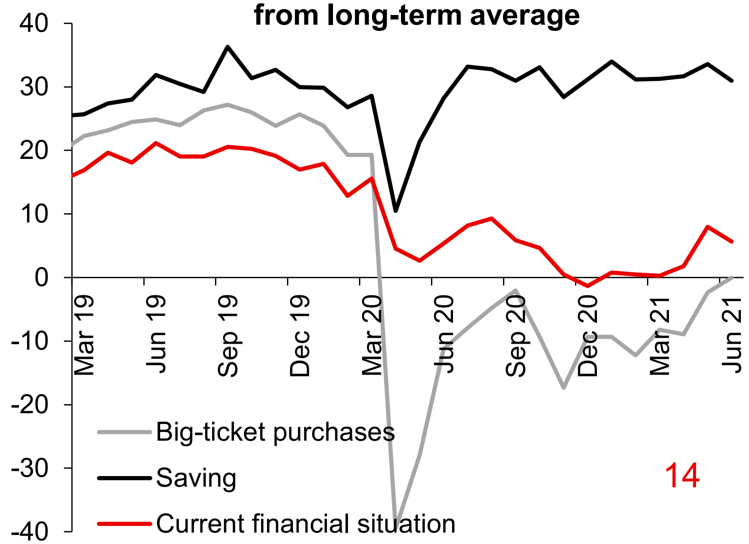
Private consumption as % of disposable incomes



What would happen with private consumption if saving rate returned to pre-Covid average?



Deviation of consumer confidence indicators from long-term average



Source: GUS, Eurostat, Santander

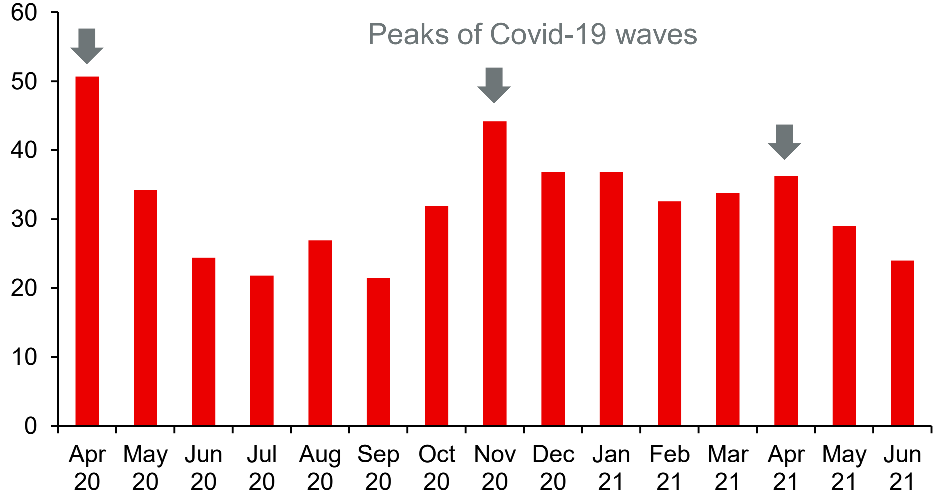
Consumers getting used to the pandemic

As stated at the previous page, we are expecting consumption to be normalising in the upcoming quarters. While the risk of another pandemic wave could postpone or undermine this process somewhat, in our view **the impact of lockdowns on consumption is generally declining with time.**

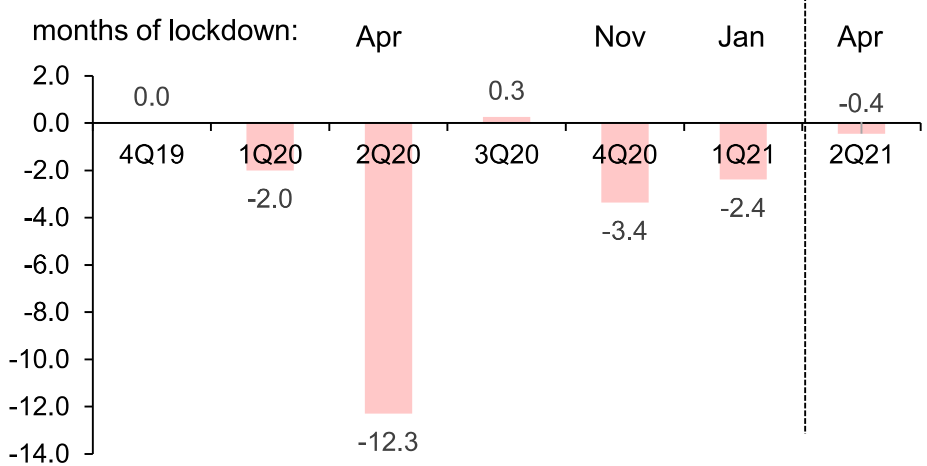
Every new wave of Covid-19 in Poland has been stronger in terms of the number of new cases, deaths and hospitalizations. And yet consumers were less and less often expressing high risk to one's health in consumer confidence surveys. We assume that people most concerned about the epidemic were eager to get vaccinated, so the average level of the perceived threat can fall even more during the next wave.

This decreasing concern is also visible in real data on mobility and private consumption. This means that the impact of lockdowns on actual consumption is declining as the populace is getting used to the pandemic environment.

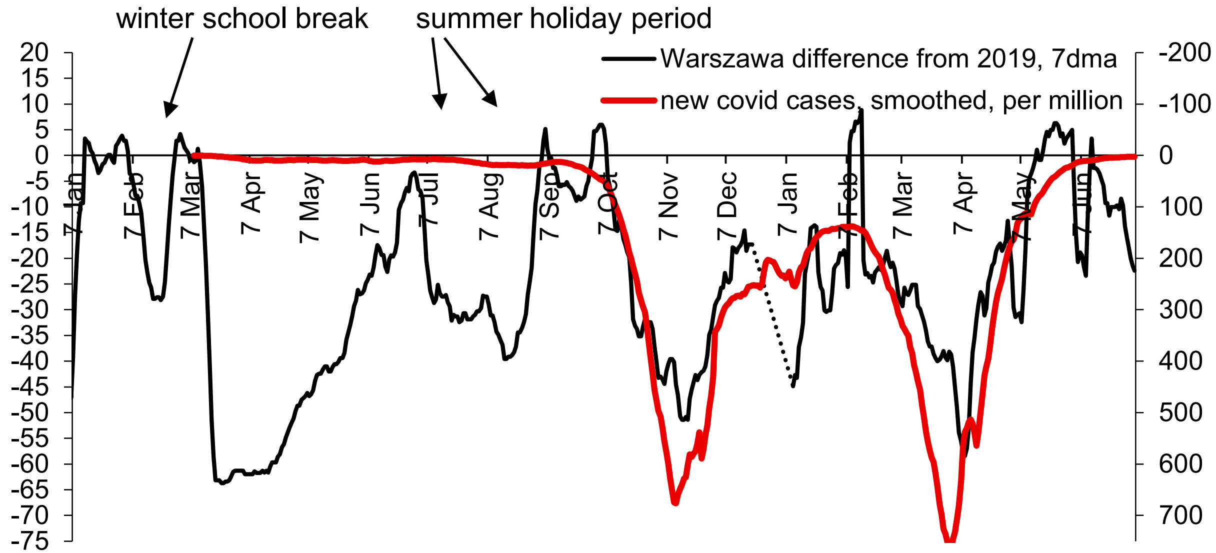
% of consumers viewing epidemic as major threat to their health



Private consumption: deviation from 4Q19 (s.a.)



Mobility in Warsaw vs new Covid-19 cases



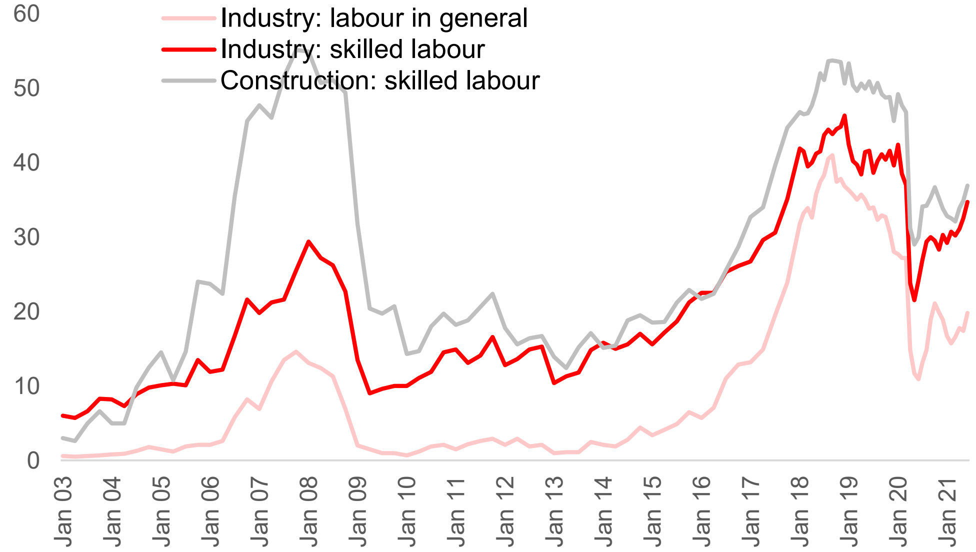
Source: GUS, TomTom, Santander

Labour market: firms hiring again

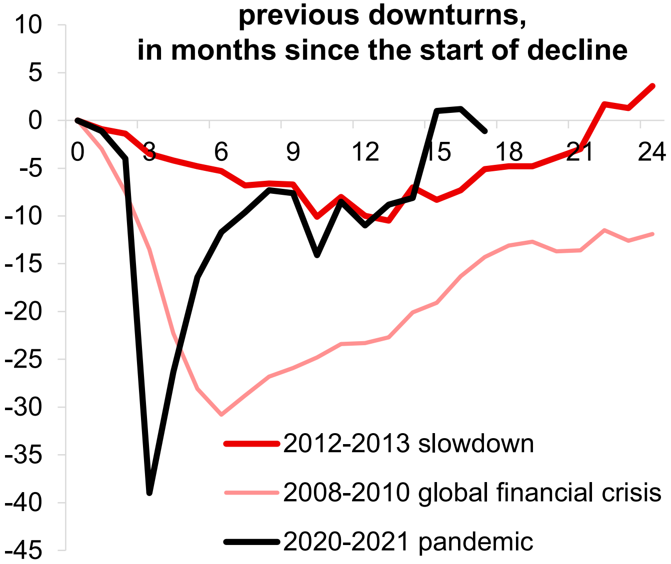
Business surveys show that firms have already started hiring and plan further employment rise amid the expected economic revival; this is seen across all company sizes. Vacancies are picking up again and shortage of skilled workers may return as an important challenge for companies sooner than expected.

These circumstances can lead to a rise of wage pressure. NBP signalled an increase of the pressure already in its April's Quick Monitoring report. At the same time solid financial situation of companies suggests they may show relatively low resistance against wage hike claims. Labour costs are still not considered as a painful obstacle to business expansion as in 2019.

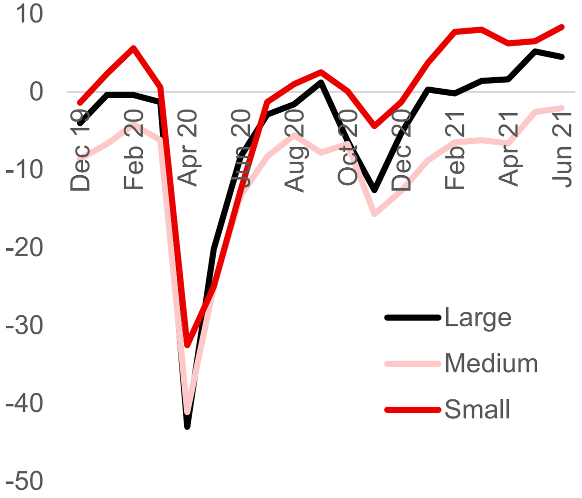
GUS Survey: Are labour shortages as an obstacle to business growth? %



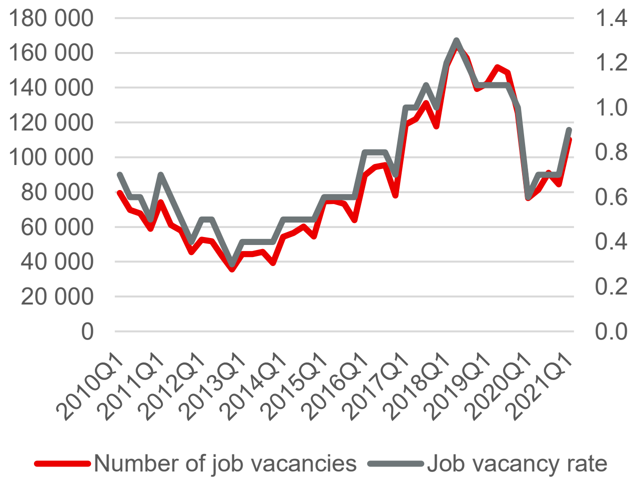
ESI, Poland: composite Employment Expectations Indicator, decline and recovery in previous downturns, in months since the start of decline



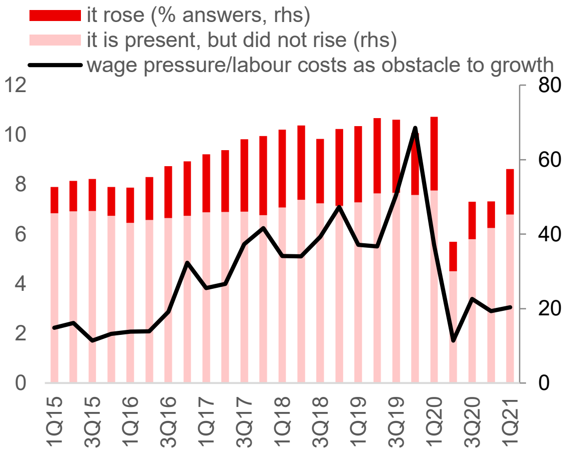
GUS Survey: Industry, employment expectations index by company size



Newly created jobs in quarter



Change of wage pressure vs. prev. quarter



Santander

Source: GUS, NBP, Eurostat, Santander

Labour market: the force awakens

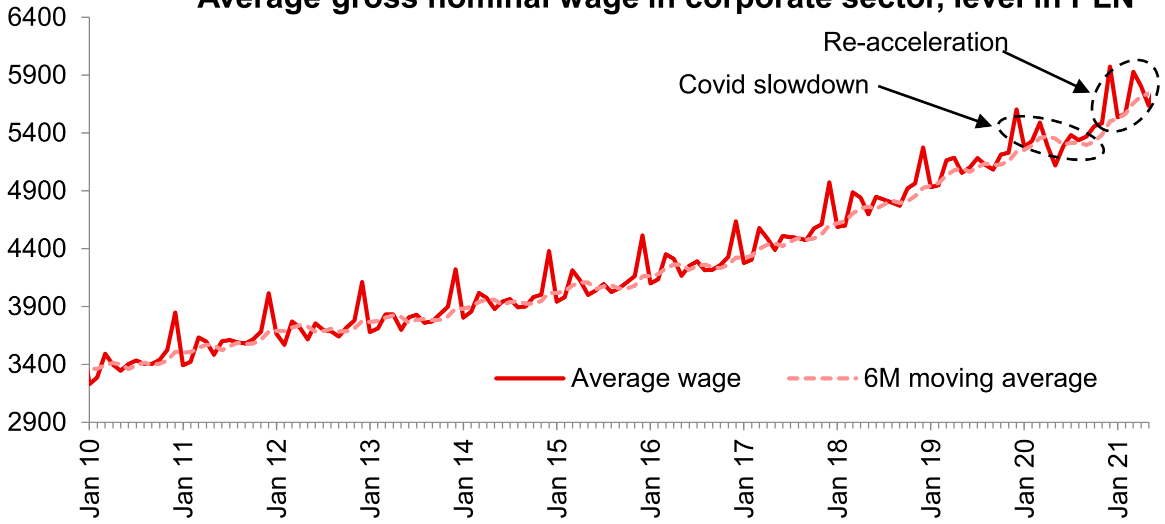
Upward trend in salaries slowed only for a while in 2020. Now wage levels started returning to the pre-pandemic trend.

Wages in total economy are rebounding faster than their most closely followed proxy – monthly data on average corporate sector wages.

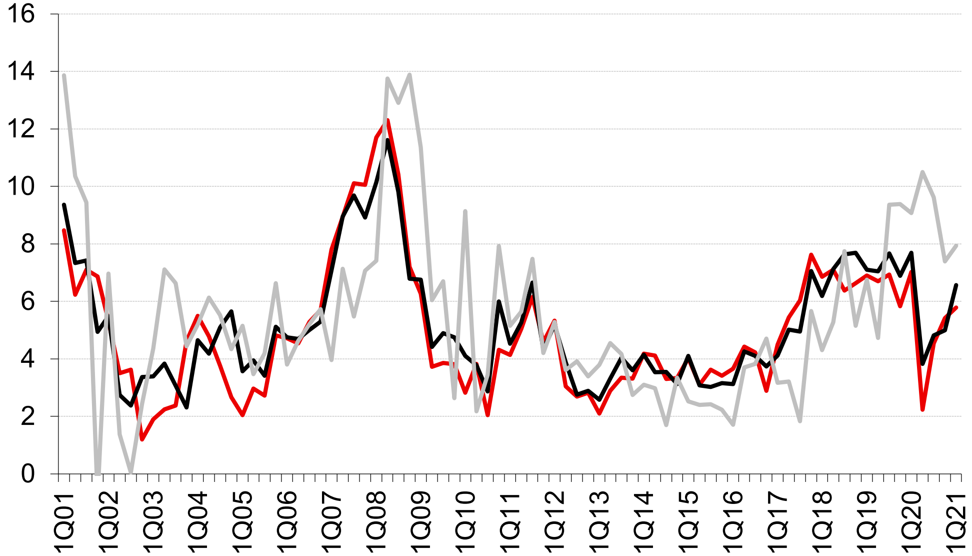
Real wage growth is also picking up. It took the labour market almost four years from the start of 2012-2013 slowdown to reach real wage growth of c.4% y/y (the current level, reached in a year). It failed at all to reach it after the global financial crisis before the next downturn came.

Given the above, what needs to be stressed is that the wage spike in 1H21 is not only the base effect.

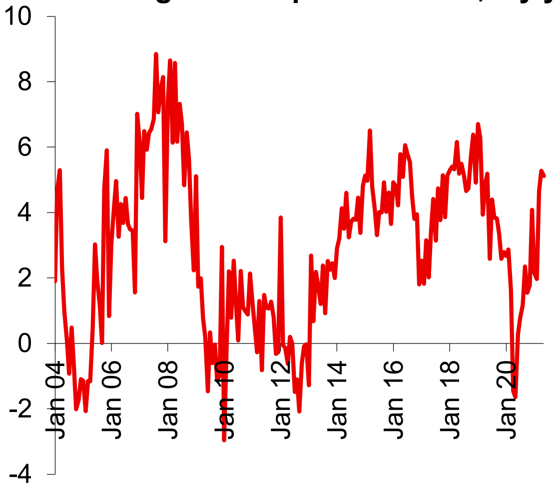
Average gross nominal wage in corporate sector, level in PLN



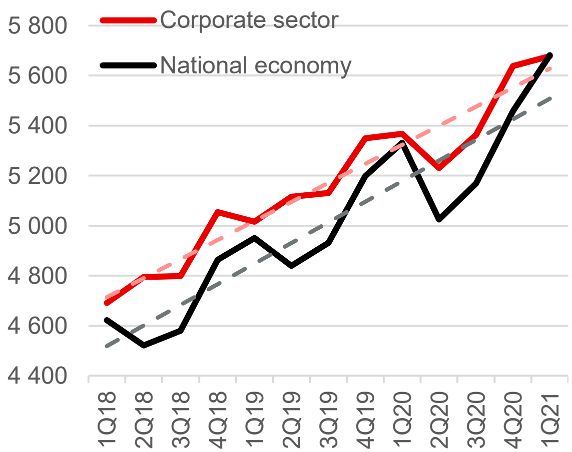
Average gross nominal wages, %y/y



Real wages in corporate sector, %y/y



Average wages, PLN



Santander

Source: GUS, NBP, Eurostat Santander

Inflation: something to worry about?

Inflation has been surprising to the upside in 2021, moving market consensus forecasts for 2021 and 2022 clearly upwards. So far, the Polish central bank has been observing this trend with big calm, arguing that the rise of inflation is transitory and does not require any monetary policy reaction. We noticed three main arguments used to justify the view that the current elevated inflation is nothing to worry about:

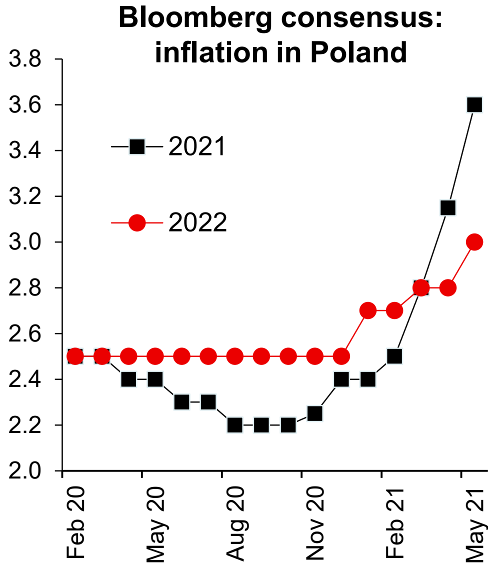
1. Inflation is higher due to base effects.
2. Even if prices are rising, it is a transitory effect (higher costs during the pandemic, bigger acceptance for price hikes during economy reopening) and growth will dissipate after the situation normalises.
3. Even if price growth is more persistent, it happens mainly/only in areas beyond the monetary policy influence.

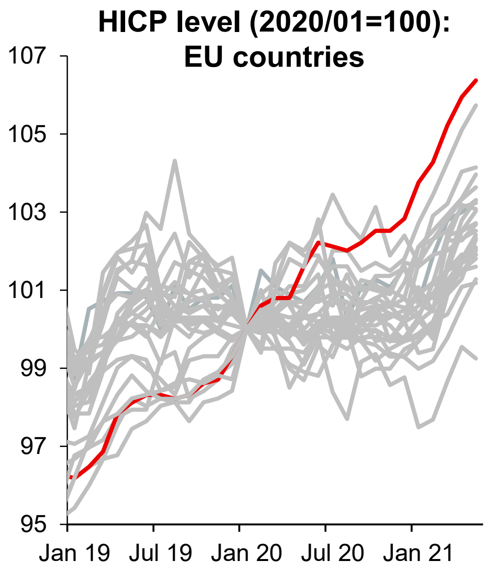
We think those arguments can be challenged, and in fact inflation will prove to be more broad-based and persistent than the central bank wants to admit.

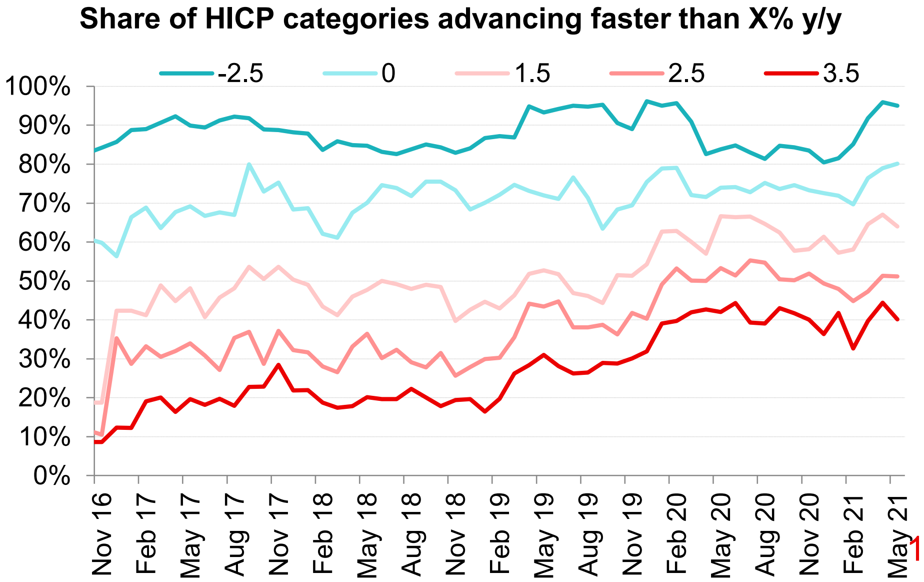
Base effect is clearly an economic buzzword of 2021. But it does not really apply to inflation rise in Poland, as prices did not go down much in 2020 (in contrast to many other countries), with only a few exemptions, fuels being the most important one. If you look at the price level, a strong upward momentum in 2021 is apparent (see top right-hand chart).

Some cost increases **are indeed transitory** and may discontinue (fuel, commodities), but others won't (food, energy prices; supply shortages in industry unlikely to disappear soon), plus other cost components will likely join when strong economic revival continues, consumption booms and labour market tightens. The list of price categories rising above 2.5% y/y is getting longer, which shows a broadening of the inflation trend (lower chart).

In reality it is not obvious which prices are **independent from the monetary policy**, as prices are generally strongly intertwined and are a function of demand and exchange rate, which clearly remain within scope of monetary policy (see the next page).







Source: Bloomberg, Eurostat, Santander

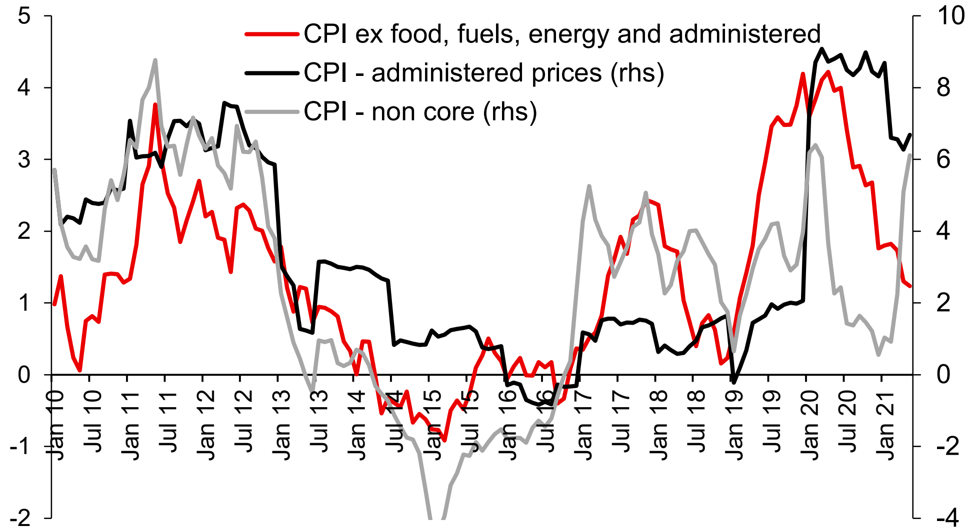
Inflation: beyond the MPC control?

One of the MPC arguments is that the CPI was driven by factors outside the scope of the monetary policy. We understand that these include administered prices, food and energy goods. We can however argue whether they are completely unaffected by the monetary policy, as they are under influence of aggregate demand, exchange rate and labour costs, which could actually be impacted by the MPC.

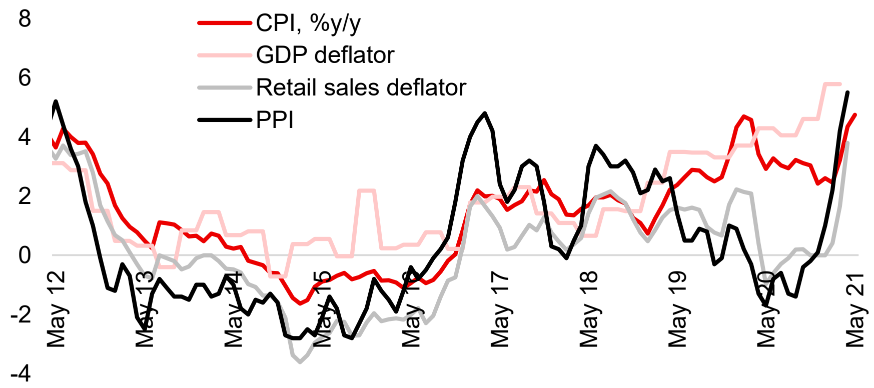
Our estimate of CPI ex food, fuel, energy and administered prices indeed has gone strongly down from peaks recorded in mid-2020. However, first: to arrive at such a measure, we had to exclude more than 50% of the CPI basket and in our view this is more cherry-picking than painting a reliable picture of inflationary pressures, especially given that virtually all broad inflation indicators are going strongly up. And second: if the MPC actually pays attention to such a measure, why didn't it react to its major spike in 2019?

Still, we think that even this measure is likely to rebound soon, as reopening of the economy and normalisation of demand, especially in recreation/culture and HoReCa is likely to support the price growth. Moreover, CPI ex food, fuels, energy and administered prices is strongly correlated with the (lagged) non-core part of the basket. The recent rise in non-core CPI elements should be filtering into other parts of the inflation basket over time, so it is likely that CPI would remain above target for longer tan MPC thinks.

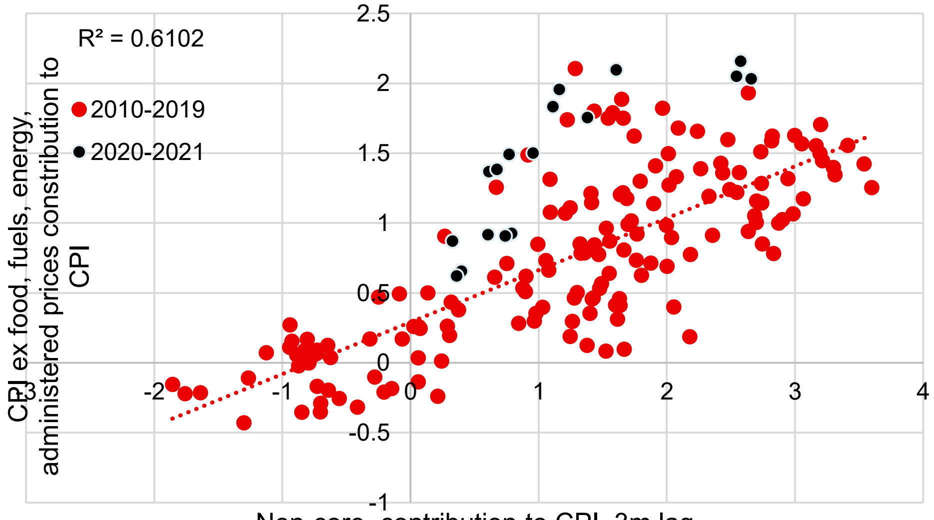
CPI breakdowns



Various measures of price changes in the economy, %y/y



Non core CPI vs CPI ex food, energy and administered prices



Source: GUS, NBP, Eurostat, Santander

Santander

Inflation: 4% to stay for longer

We think that the inflation rate will remain high in 2021 and 2022. The post-pandemic economic rebound is the main reason behind that.

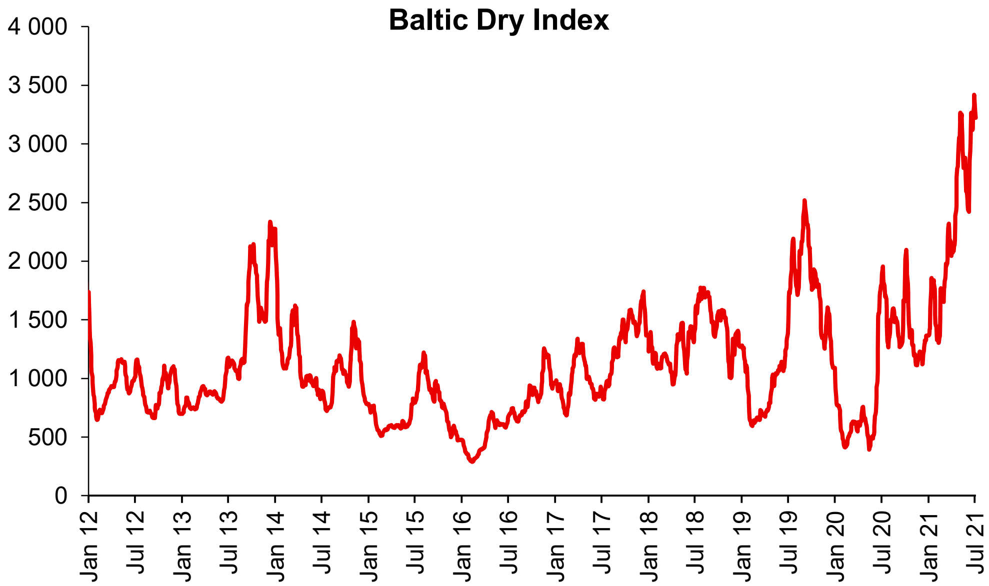
It is already visible that the global upward economic momentum is strongly driving prices of commodities, components and transport. Supply chains disruptions are even fuelling this trend. New economic stimuli that are only starting (European Union, USA) are likely to support the global demand even more, prolonging and strengthening the global price pressures.

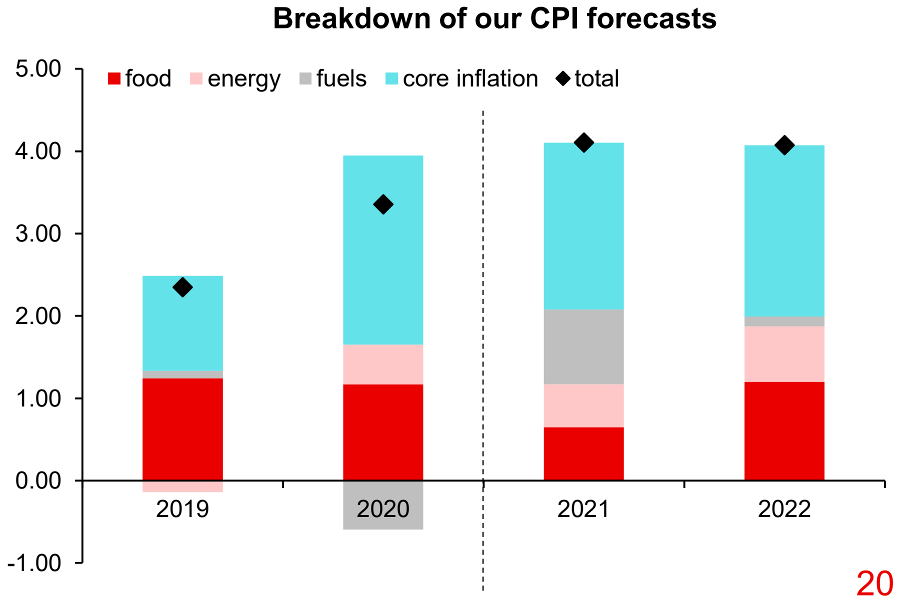
In Poland inflation will be additionally supported by healthy condition of the labour market consumers and companies, new fiscal programme („Polish Deal"), deeply negative interest rates, and possibly higher consumers' tolerance for price hikes after quarters of muted consumption.

The sound financial situation of companies could be among factors taming price growth, as firms have margins wide enough to accommodate cost increase, at least partly. However, the recent evidence shows that in the environment of strong demand this is not what is happening: the companies have enough pricing power to pass rising costs to customers and to final prices.

In our view, non-core elements will be responsible for about half of inflation in 2021 and 2022, with some change in composition: higher impact of food and energy (see next pages for more details) and lower of fuels in 2022. As for the core elements, we think that administered prices will play a less important role, but strong demand and still limited supply will be fuelling rise in market prices.

We are expecting CPI to oscillate around 4.5% in the rest of 2021 and average 4.1%. In 2022 CPI will be slowly declining below 4% at the year-end with average close to 4.0%.





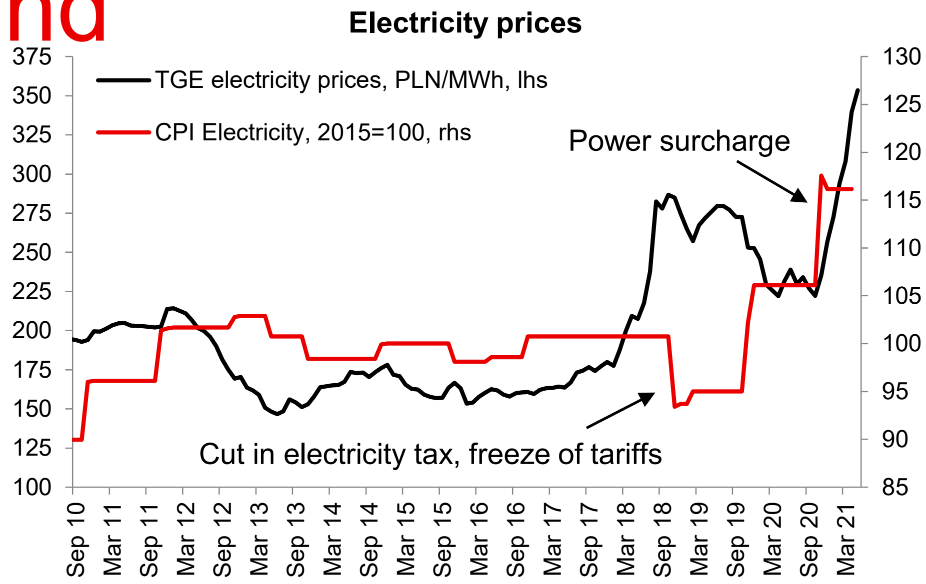
Santander

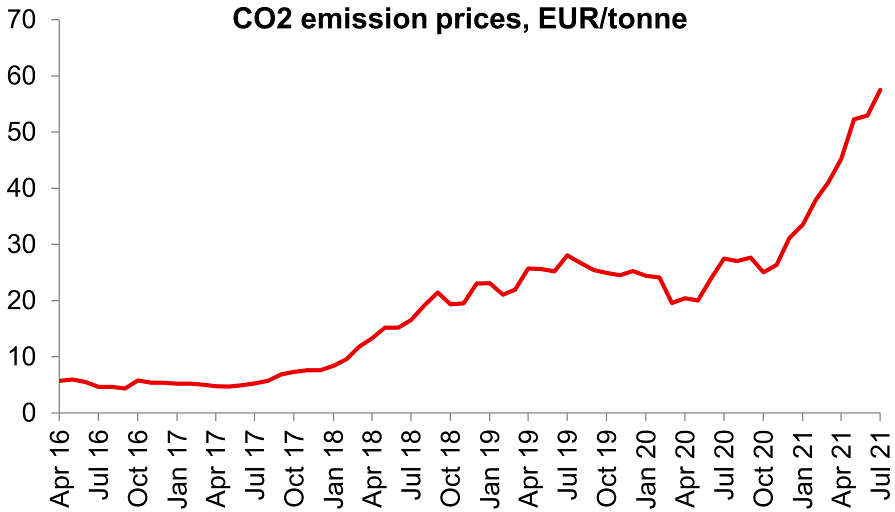
Source: GUS, Refinitiv, Santander

Energy prices on an upward trend

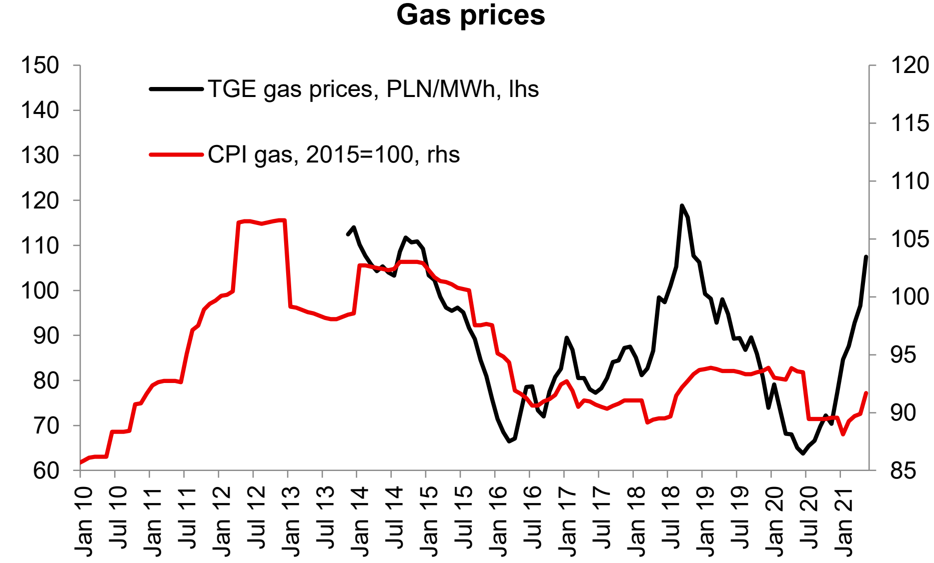
Market prices of energy have risen dynamically over the last few months and we think this is a persistent trend, especially in electricity, given Poland's coal-dependent energy mix and upward tendency of CO2 emission prices.

Electricity and gas prices for households depend not only on market prices of these commodities, but also on taxes, prices of distribution and decision of the market regulator (URE). This makes retail prices difficult to forecast, but the upward pressure is clearly visible, and upward correction of prices for households by 10-15% seems justified. Note that electricity prices for households have barely risen since 2017-2018 (if we account for non-commodity related changes in tariffs) when market prices were below 200 PLN/MWh as compared to current prices approaching 350 PLN/MWh. That having said, the regulator can simply ignore market prices (at least for some time), bowing to the political pressure, as it did in case of electricity in 2019 and gas in 2018.





Source: Ember, Santander



Source: TGE, GUS, Santander

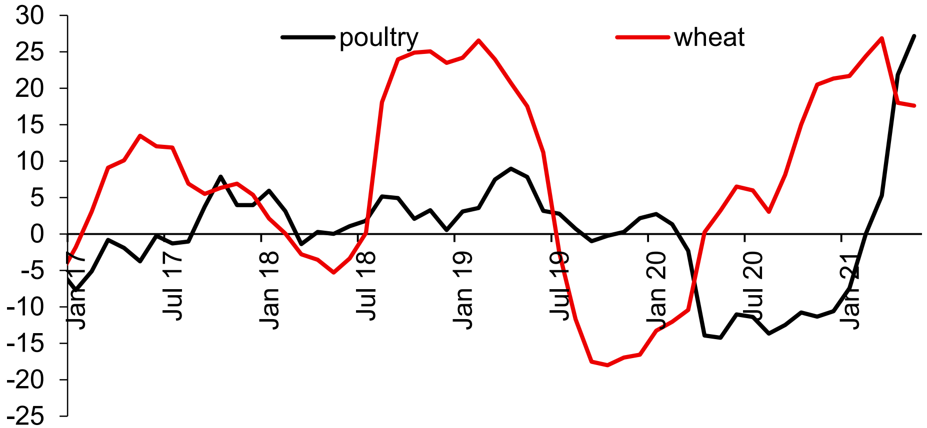
Food prices higher due to meat

In our Outlook 2021 we were expecting food prices to average 1.7% in 2021. We have revised this forecast to 2.3%.

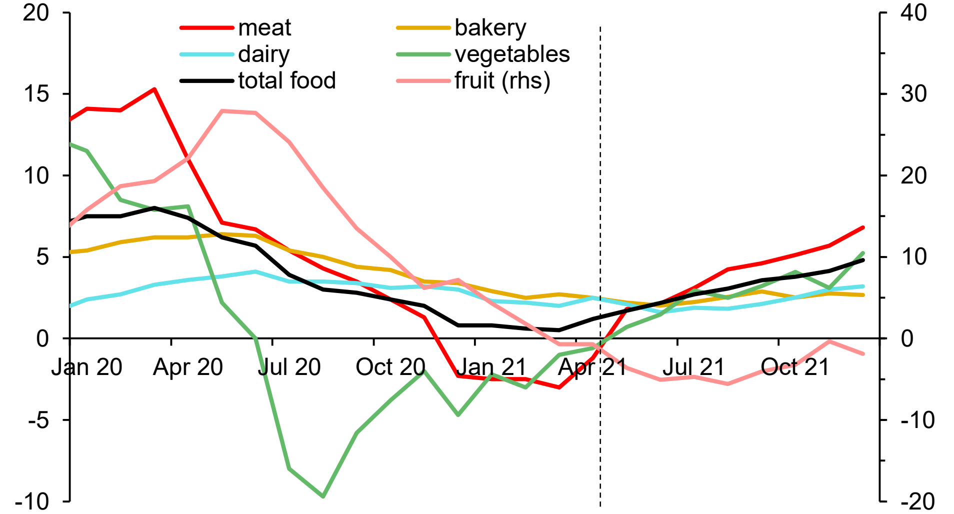
The upward revision was primarily caused by developments on the meat market. Higher fodder prices, external demand and supply limitations (outbreak of bird flu) caused that prices on the market rebounded faster and stronger than we had expected.

Other food categories seem to be developing in line with our expectations: grain and dairy prices are systematically going up, driven by strong demand and limited supply. Prices of fruit and vegetables remain muted thanks to strong crops in 2020. There were no major winter losses, so the cold and rainy spring (shorter vegetation and problems with chemical crop protection) did not have a significant impact on prices. However, first information about draughts are coming in, so we see some upward risk for prices in 2H21, while we do not revise our forecast higher yet.

Average procurement prices of selected major agricultural products, %y/y

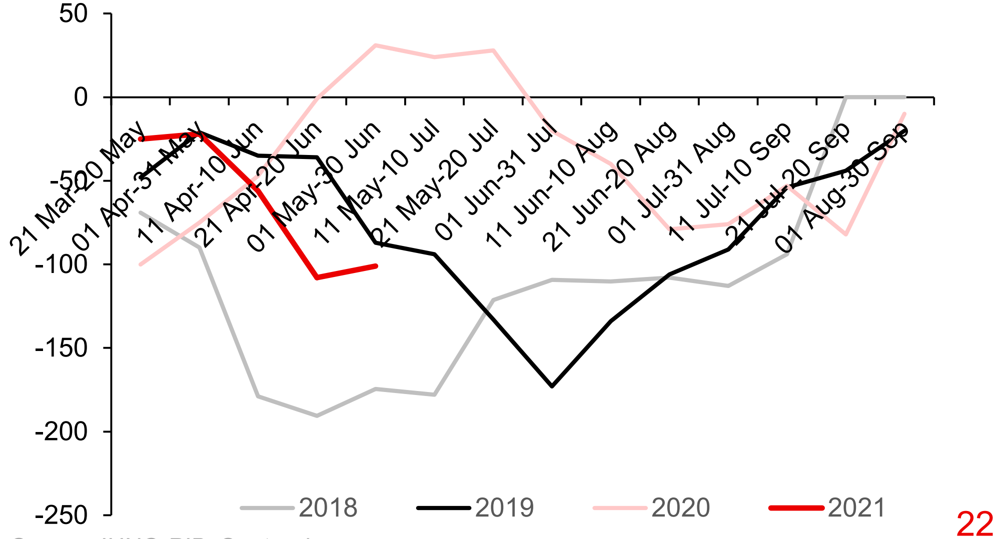


Food prices, % y/y



Source: GUS, Santander

Water Balance (difference between rain and evaporation), mm



Source: IUNG-PIB, Santander

Consumer inflation expectations - at ease?

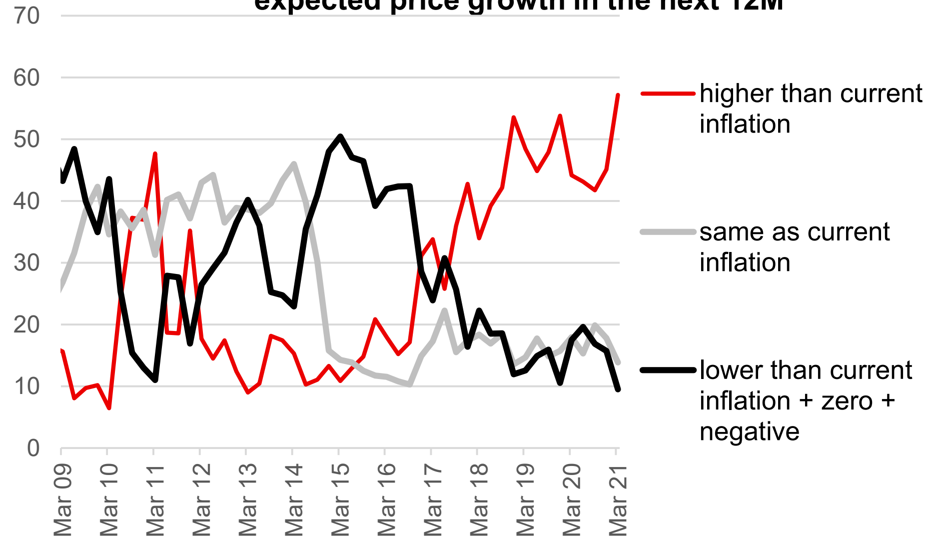
Companies see plenty of inflation in the pipeline. Only one in ten thinks prices could grow slower in the next 12M. Consumers' approach is more difficult to pinpoint as one measure is showing them as quite relaxed about the recent quick rise of inflation while the other signals distress. In theory, high consumer inflation expectations are one of key prerequisites for triggering second round effects.

GUS consumer inflation expectations index so far has not responded to the acceleration of inflation seen this year as if consumers assumed a transitory nature of the current CPI surge. Still, such attitude cannot hold long if inflation holds above 4% and historically there was always conversion of expectations towards current CPI (in situations when the expectations did not rise in advance of rising inflation).

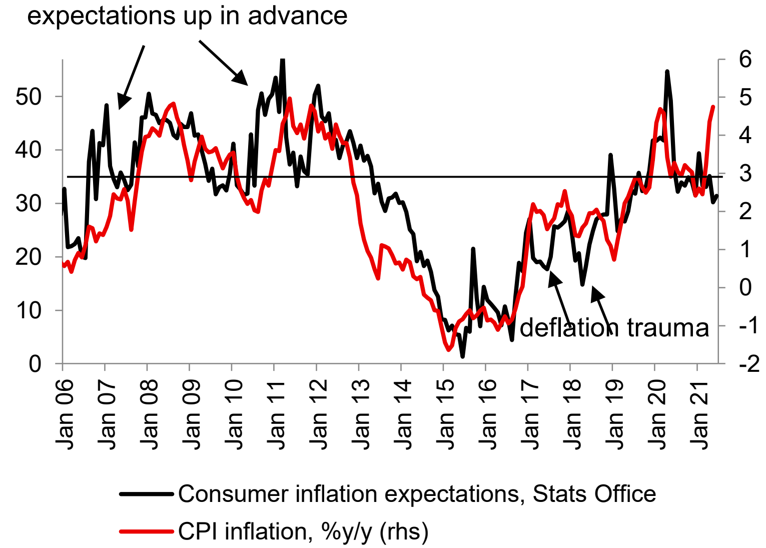
MPC's Eugeniusz Gatnar looked at the GUS measure from a different angle: it is by no means a soothing picture, as more and more people expect CPI to stabilise at high levels, which are way above the levels the NBP can tolerate. The measure is falling for technical reasons (because it is a dispersion index). He also said that the unpublished quantitative measure of inflation expectations is currently pointing at 13% (we do not have the data to assess how accurate this measure could be).

Also, an alternative measure, ESI, showed a more worrying picture. Only less than 18% think that in the next 12 months inflation will fall. The developments of the ESI indexes seemed harmless in April and May as the rise of current inflation perception was accompanied by some decline of future inflation index, but in June both measures went up.

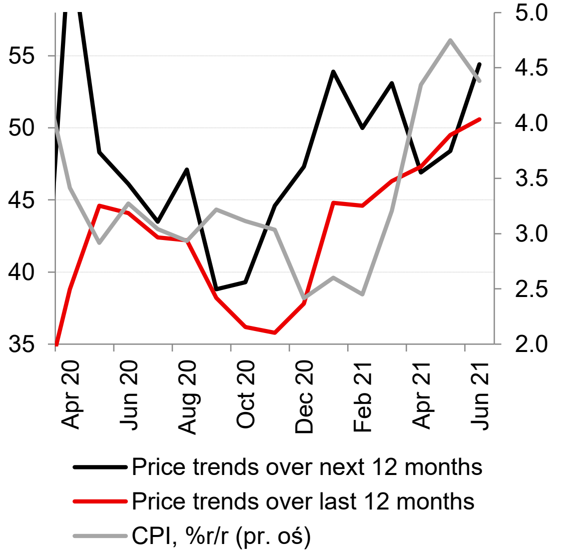
Business inflation expectations
expected price growth in the next 12M



Consume inflation expectations according to GUS



ESI consumer inflation expectations



Santander

Source: GUS, NBP, Eurostat European Commission, Santander

Risk of second round effects

Usually a strong negative supply side factor causes inflation but hurts real economy, so the rise in CPI finds it hard to turn into a wage-price spiral. This time the supply shock comes on top of a strong demand recovery. The Covid-19 crisis is different in this way that there was no phase of cheap labour, no period of severe unemployment that could make the unemployed lower their wage expectations.

Second round effects – which can turn a seemingly transitory inflation into a more lasting one – may be stronger in countries with tight labour markets (no slack) and where inflation hits really hard, leaving a sense of decreased purchasing power.

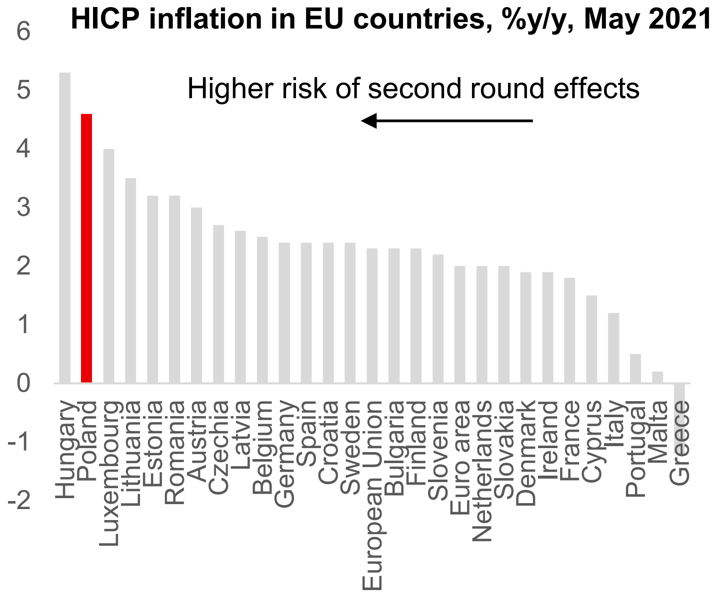
So, relatively speaking, Poland is at the very peak of the problem with one of the highest inflations and one of the lowest unemployment rates in the EU. This does not however prove that Poland will face second round effects.

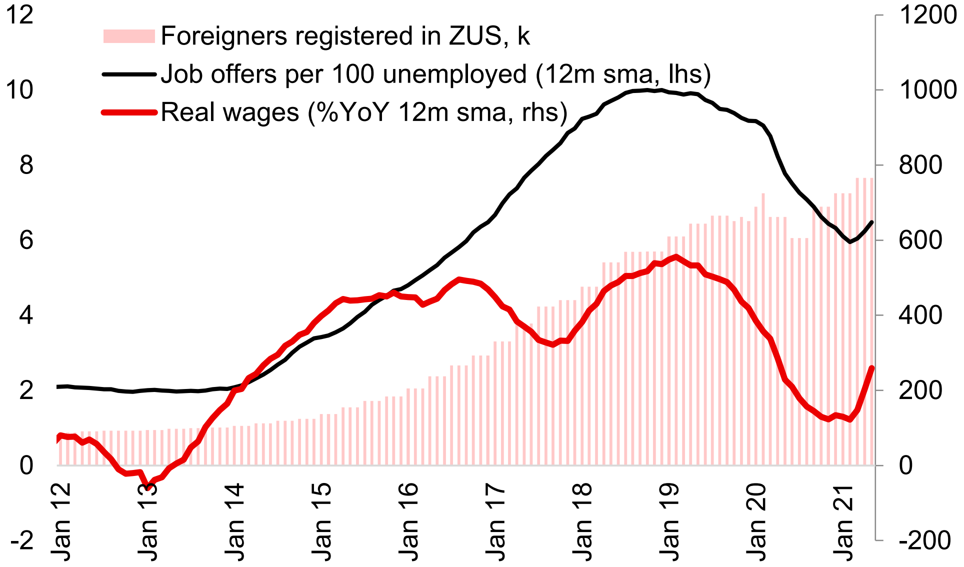
The mitigating factor could be the access to cheaper labour via migration (on the rise again in Poland). We believe it was the inflow of migrants that prevented real wages from fully responding to how tight the labour market was in 2018-2019.

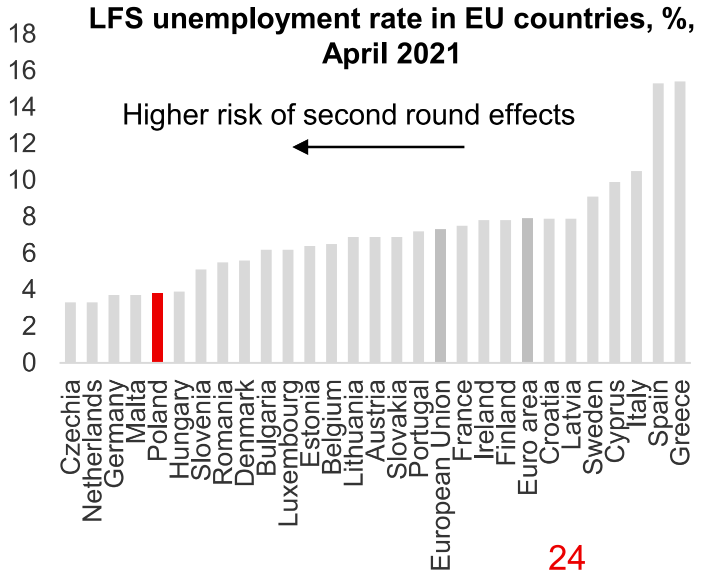
We should also bear in mind that the world's problem with inflation before the pandemic was that it was stubbornly low, impossible to be raised towards the targets. Economists explained it back then with secular trends like ageing.

Migration inflow seems to have already returned, but at the same time companies offering low-paid jobs (that were more often taken by migrants) like cleaning, security are signalling one of the highest gauges of labour shortages.

This means the inflow may be insufficient to prevent labour market tensions or that the foreigners' wage expectations have gone up. As a result the protection this factor offers against second round effects can be weaker than in 2018-2019.







Santander

Source: GUS, ZUS, Eurostat Santander

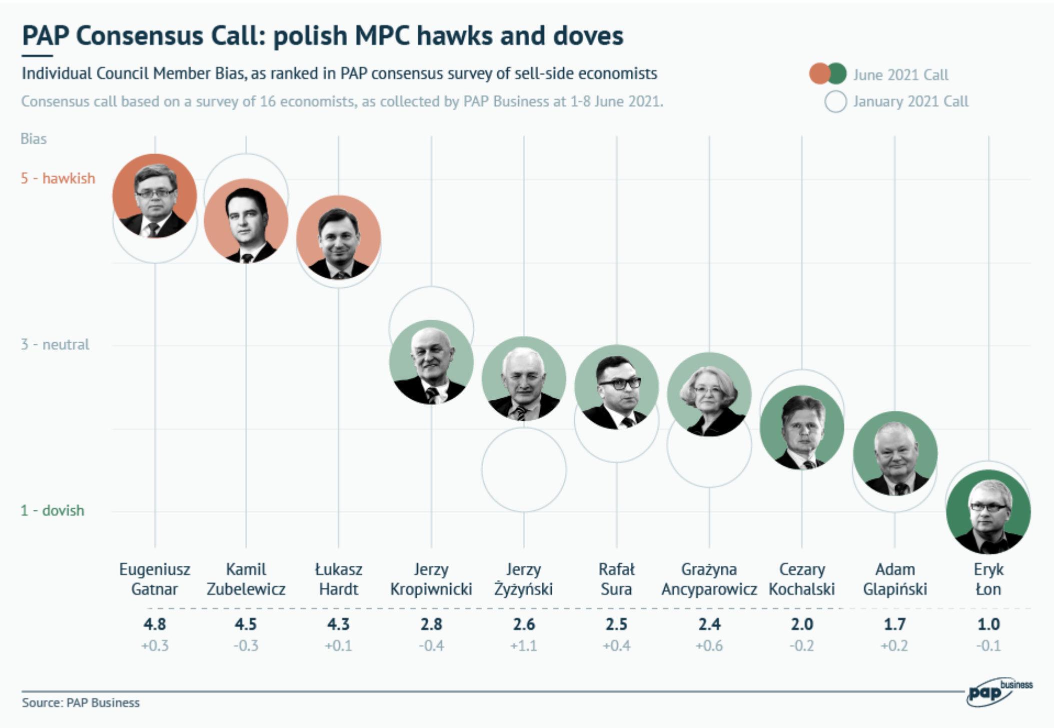
Monetary Policy: not as dovish as it seems?

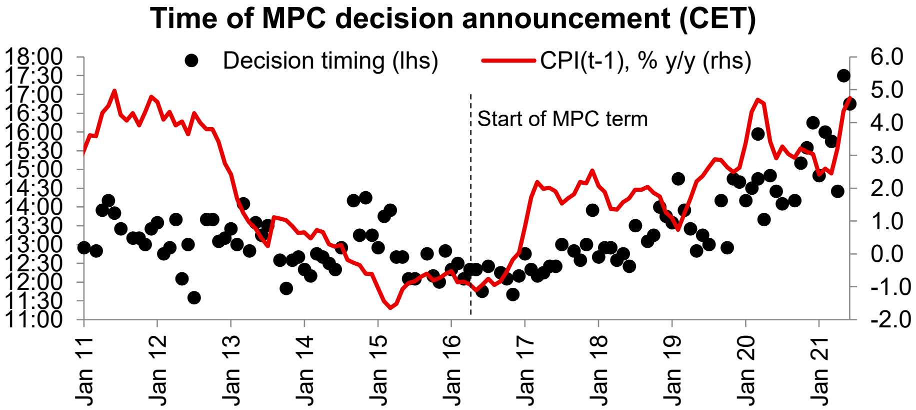
The official communication of the Polish central bank remains dovish, at least on the surface. In June the MPC statement and Mr. Glapiński at his conference stressed that elevated inflation results from factors beyond the monetary policy control and should be transitory, so it is too early to think about interest rate normalisation.

But at the same time, we notice a change in language used by the NBP Governor in the last two months, which can be interpreted as preparing ground for future policy normalisation if needed. Please note that earlier pledges that rates will be unchanged “for long” or “until the end of the MPC term of office”, QE will be live “forever”, and thinking about policy tightening is “absurd” have been replaced by a new guidance: the NBP will not hesitate to hike when needed; rate hikes must be preceded by the suspension of asset purchases programme; the QE tapering must take some time; preconditions for policy normalisation are forecasts showing high and persistent growth, high and persistent inflation – it must be reflected in the NBP projections (November projection was marked as a key milestone). In the recent FT article Glapiński for the first time mentioned that the first rate hike is possible even before the end of 2021.

We read this change in rhetoric as a hint from the central bank that the monetary policy will be in fact data-driven and determined by the macroeconomic scenario. At this point the central bank still sees no reason to change policy, and the most recent data about inflation drop in June will most likely reassure the MPC in its “wait and see” approach. But if strong economic revival continues and inflation remains elevated (which is our baseline scenario), then the consensus in the Council will be gradually changing. Judging by the time of MPC decision announcements, the discussions at the meetings have already gotten very intense.

We think that the first interest rate hike may take place in November, unless the new Covid-19 waver proves strong enough to damage economic outlook.





Source: PAP, NBP, Santander

Monetary Policy: (always) waiting for new projections

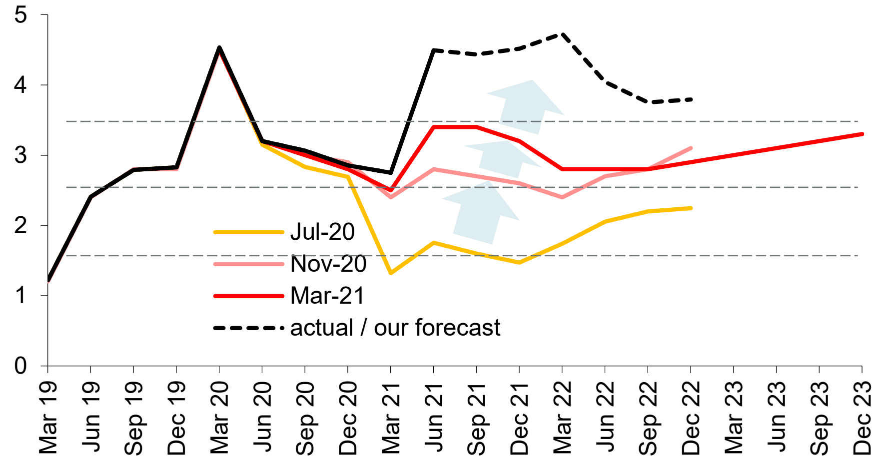
NBP Governor and several MPC members emphasised that next NBP projections will be key for making any monetary policy decisions. On one hand, we should take such declarations with a pinch of salt, as for the MPC it is always the next projection which is the most important, but once it gets released, it somehow loses the significance and the policymakers start eyeing the following update. This time, we already saw a guidance from the MPC that the nearest update of forecasts (in July) will not be as important as the one in November. To some extent it is understandable, as the uncertainty about the impact of potential 4th Covid wave will remain high until late autumn.

On the other hand, it seems quite likely that the new forecast updates will deliver more arguments to start policy normalisation. If we look at the evolution of NBP inflation forecasts in the last year, they have already gone up substantially and it is quite obvious that the next update(s) will be even higher, as the starting point is way above earlier assumptions, plus economic scenario looks even more optimistic (stronger GDP growth, stronger labour market, more accommodative policy mix).

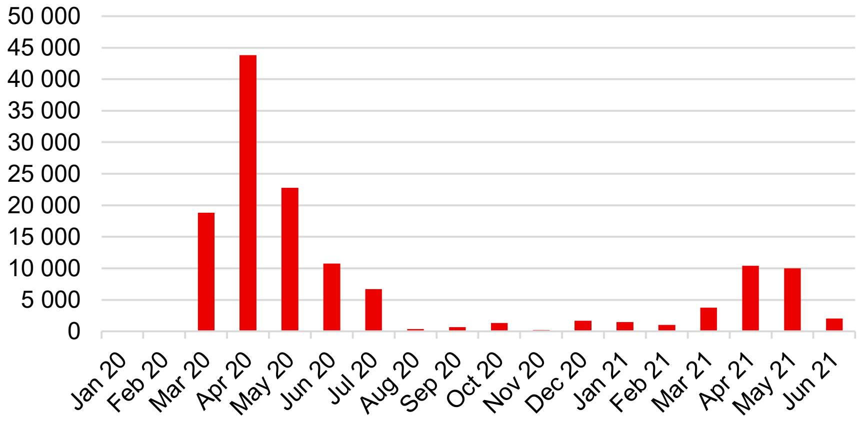
Already the last NBP projection in March has barely supported the MPC's claim that elevated inflation is transitory, as it was showing mild upward trend in both CPI and core inflation up to 3.5% by the end of 2023. Yet, the NBP Governor stressed that basing decisions on such distant outlook is wrong due to the great uncertainty surrounding forecast.

We think that July projection will not trigger any sudden policy adjustment from the MPC, but the central bank may continue slow preparations for a potential start of policy normalisation. Mr. Glapiński wrote recently in the article that the exit from the QE, which must precede rate hikes, should be "wisely spread over time". So, if we see continued reduction of the NBP asset purchases over the summer, it will be another hint that rate hikes may start before the year-end.

CPI according to NBP inflation projections



Value of NBP's asset purchases per month, PLNm



Santander

Source: NBP, GUS, Santander

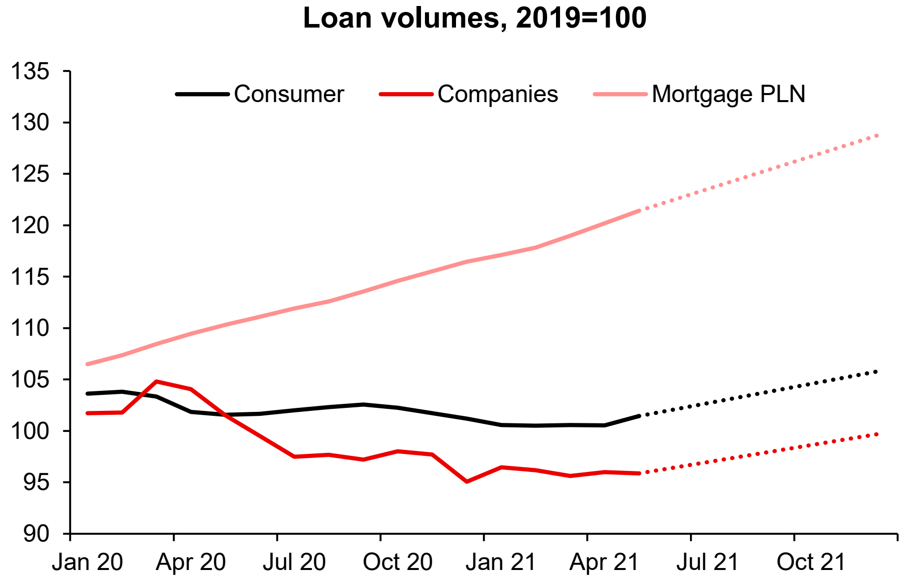
Loan market slowly waking up

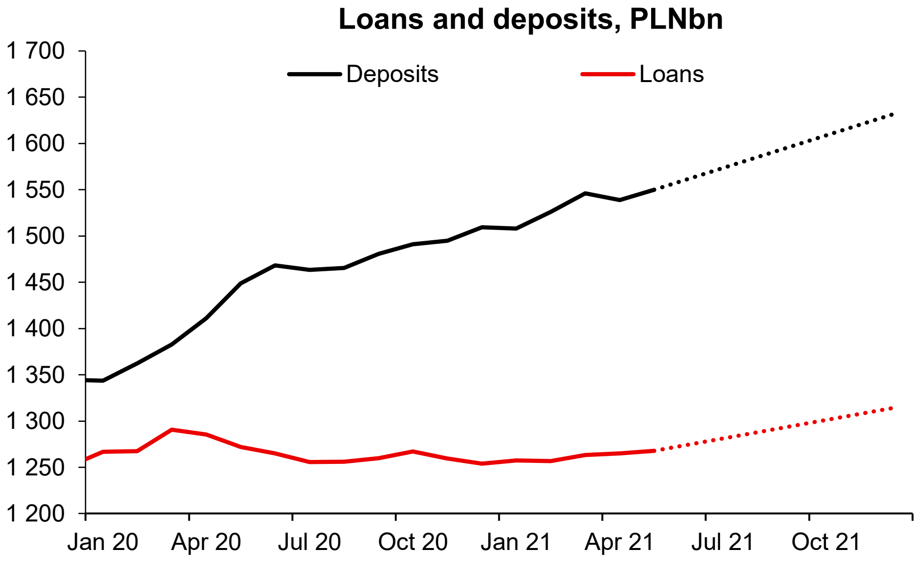
Housing market is in an upswing and generating high demand for mortgage loans. We are expecting this trend to stay, given low interest rates, strong labour market and inflow of immigrants.

May showed some rebound in consumer loans, together with restriction easing and stronger consumption and we are expecting this moment to mark a start of an upward trend.

So far, the banking system data show no rebound in companies' loans. At the same time, however, 2Q21 loan officer survey suggested that banks saw higher demand from companies for investment and M&A financing. Note that loan numbers did not rebound despite major revival in investment in 1Q21. In our view this happened mostly because companies use other financing sources, like own funds and leases. Thus, the impact of reviving investment on companies loans could be weaker in 2021 than usually, so we are not changing our loan forecasts following investment forecasts. Still, economic recovery and repayment of PFR loans should, in our view, finally translate into higher demand for bank financing.

Since the start of the pandemic, deposits were advancing at much faster rate than loans, given strong money creation through government channel. As government's support programmes are coming to an end, we are expecting the deposit growth to slow down, yet to remain slightly faster than in case of loans.





Source: NBP, Santander

Santander

Financial markets

2

Supportive conditions for higher core market yields

In June both ECB and Fed published fresh economic forecasts.

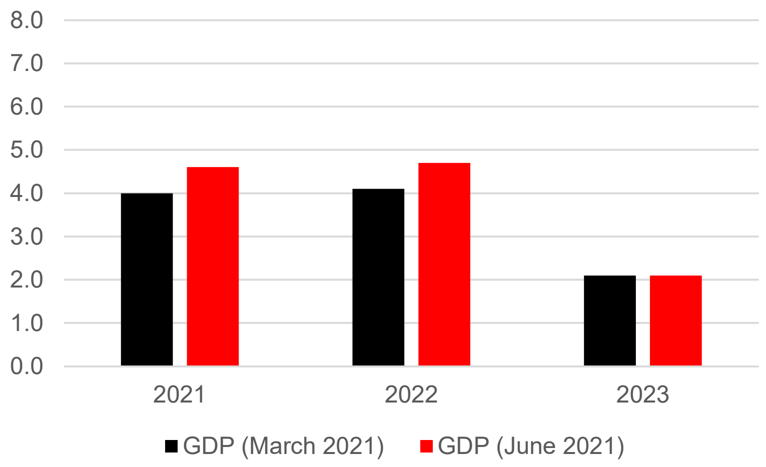
Growth forecasts in Eurozone were upgraded by 0.6pp both in 2021 and 2022. In the US only the 2021 GDP got upgraded by 0.5pp, the 2022 remained flat.

Inflation forecasts in the Eurozone were upgraded by +0.4pp in 2021 and +0.3pp in 2022. In the US the FED expects inflation now a full 1.0pp above the March forecast for the 2021 and pretty same for the 2022.

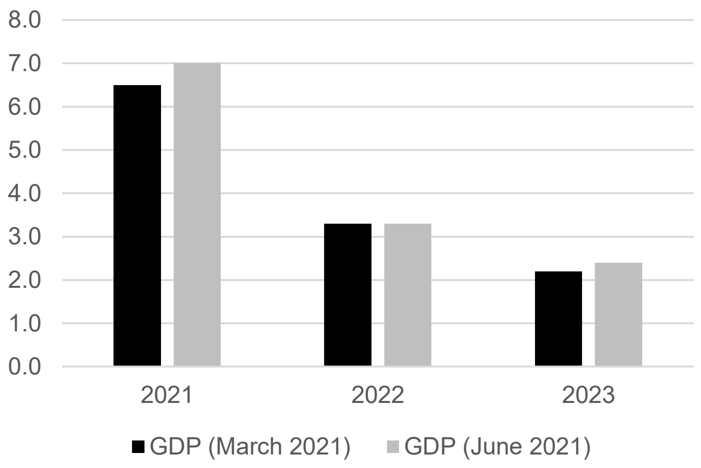
Rebounding growth and firming inflation in the Eurozone and US support core market yields which then support POLGB yields.

Santander forecasts Bund at 0.0% and UST at 2.0% at the end of 2021

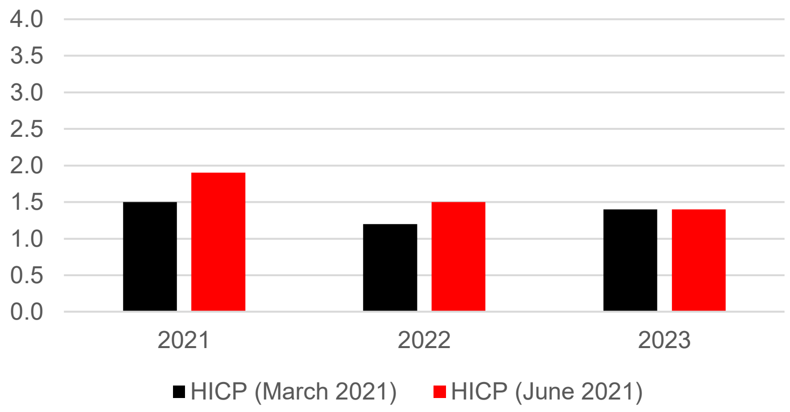
ECB GDP Forecasts in March and June 2021



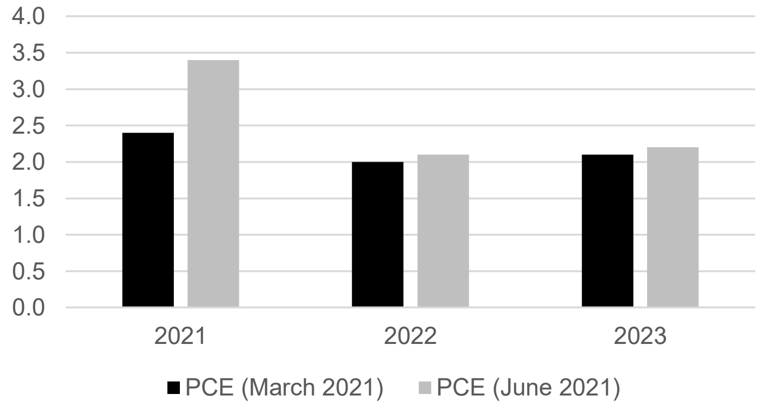
Fed GDP Forecasts in March and June 2021



ECB Inflation (HICP) Forecasts in March and June 2021



Fed Inflation (PCE) Forecasts in March and June 2021



Santander

Source: ECB, Fed, Santander

CEE3 regional context

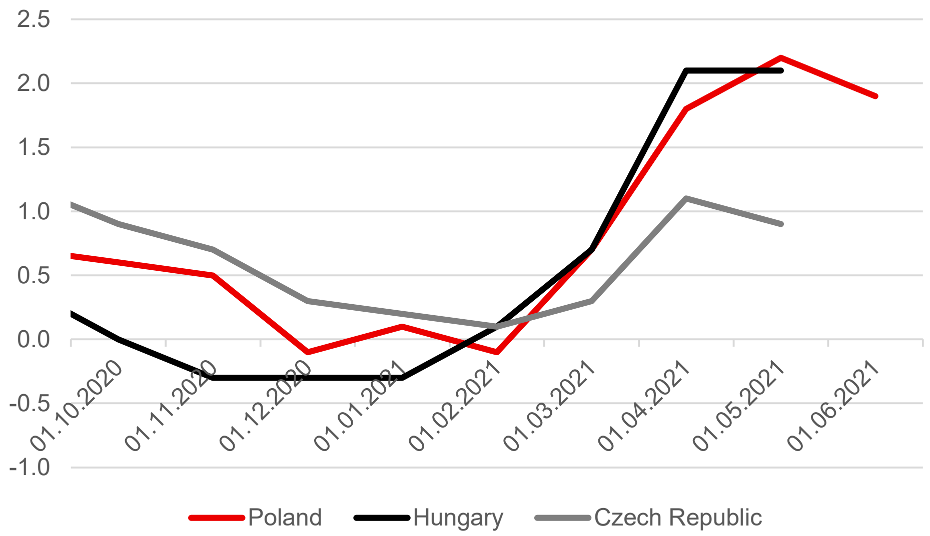
Reasoning from the amount of inflation overshoot over the respective central bank targets (top, left) one could say it is the NBP and MNB which were the most likely central banks to start the hiking cycle.

The NBP has not hiked yet however (top, right). While both MNB and CNB already have (by 0.30pp to 0.90% in Hungary and by 0.25pp to 0.50% in Czechia).

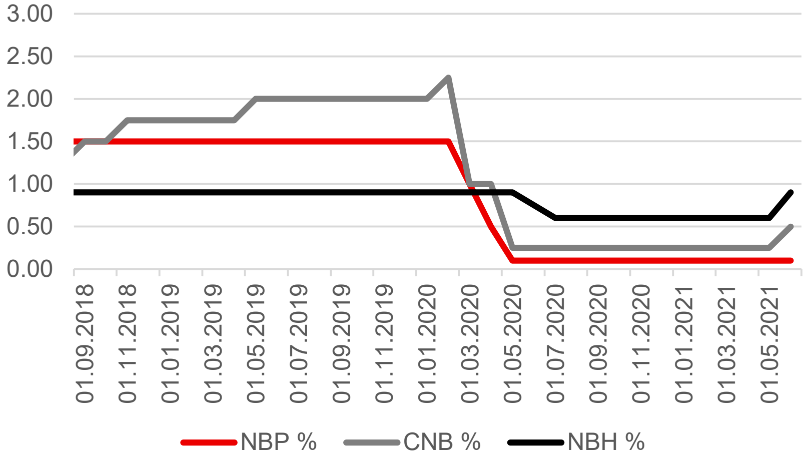
While both HUF and CZK have gained ~3% YTD vs the euro, PLN is stronger only by 1% (bottom, left). The PLN would probably catch up if the NBP started the hiking cycle now.

Swap markets expect (bottom, right) hikes frontloaded in Hungary and Czechia. In contrast, in Poland majority of hikes are expected only post mid-2022. **The hiking cycle in Poland will do start but later than in CEE peers, markets reckon.**

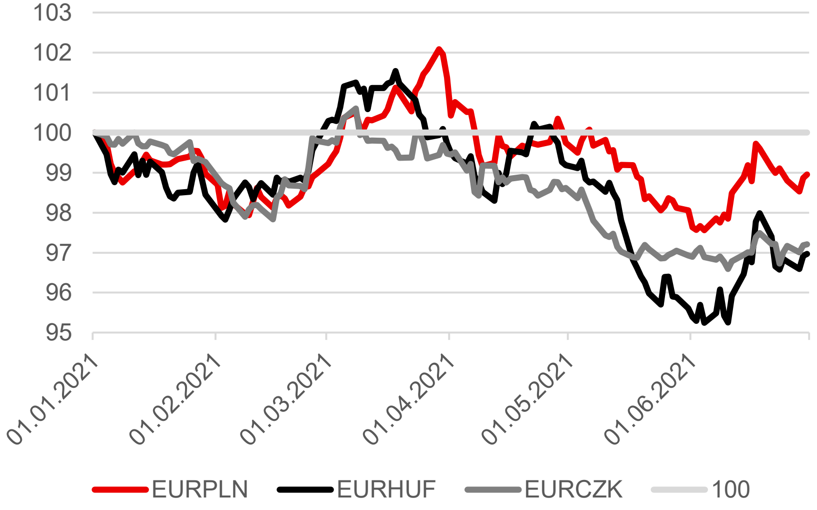
CPI overshoot vs respective central bank targets, pp



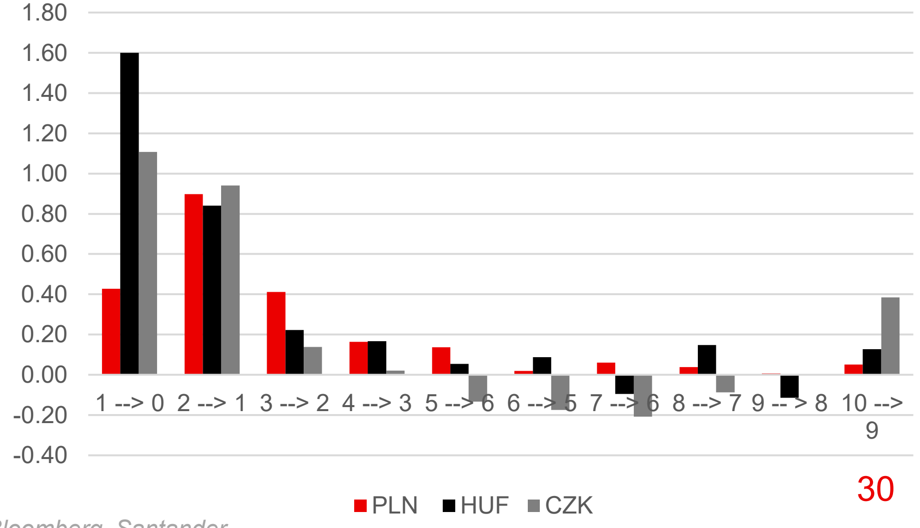
Central banks' main interest rates, %



CEE FX since the start of 2021 (=100)



Differences between adjacent 1Y Forward IRS, pp



Source: Bloomberg, Santander

Short-end yield curve forecast

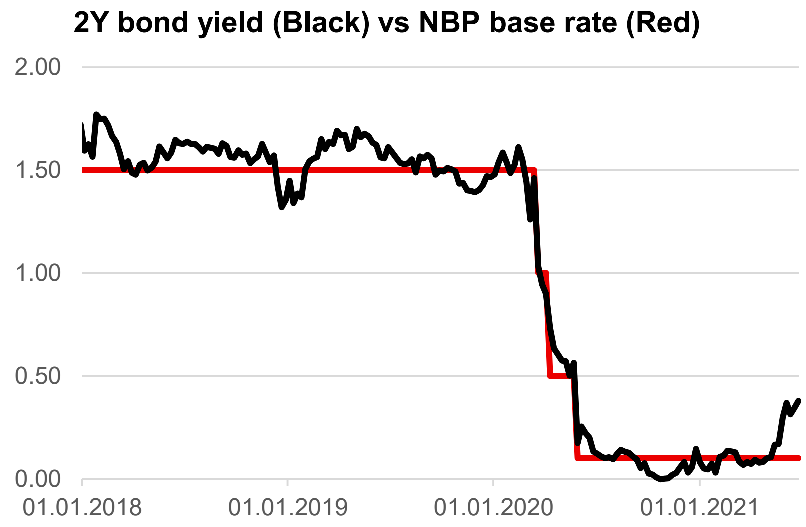
NBP base rate is the single most important factor determining short-end bond yields (top, left).

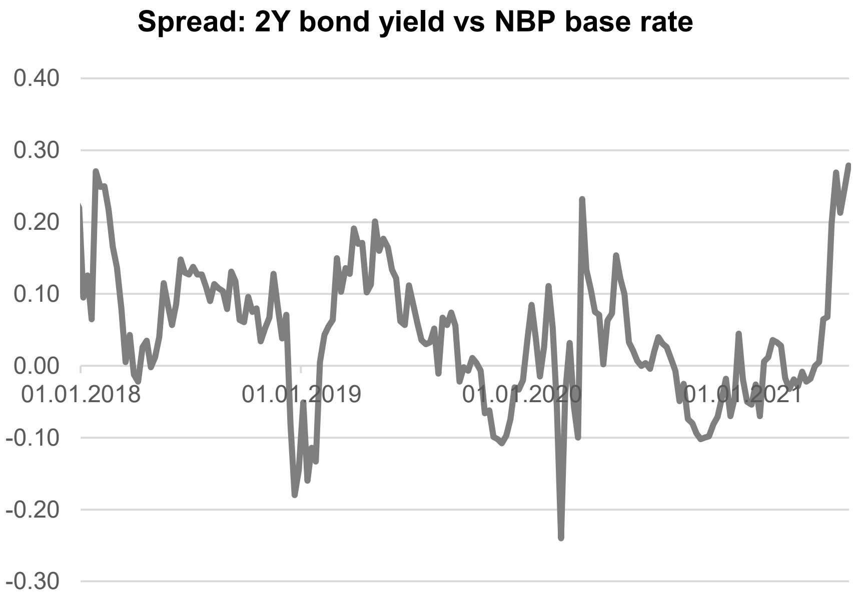
In recent years, 2Y bond yields traded mostly with a slight premium (top, right). On a weekly basis, the spread was at or above zero 76% of the time. The median of the spread stands at +7bp.

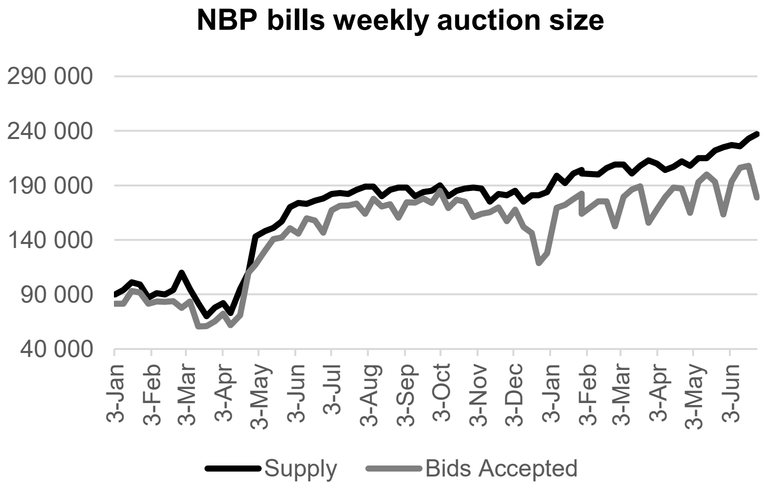
By the end of 2022 we expect a total of 90bp of hikes bringing the NBP rate to 1.00%. Hikes would likely be delivered on months of NBP Inflation Projections: November 2021, March 2022, July 2022, November 2022. The current market pricing as read from the FRA markets is shown on plot (bottom, right)

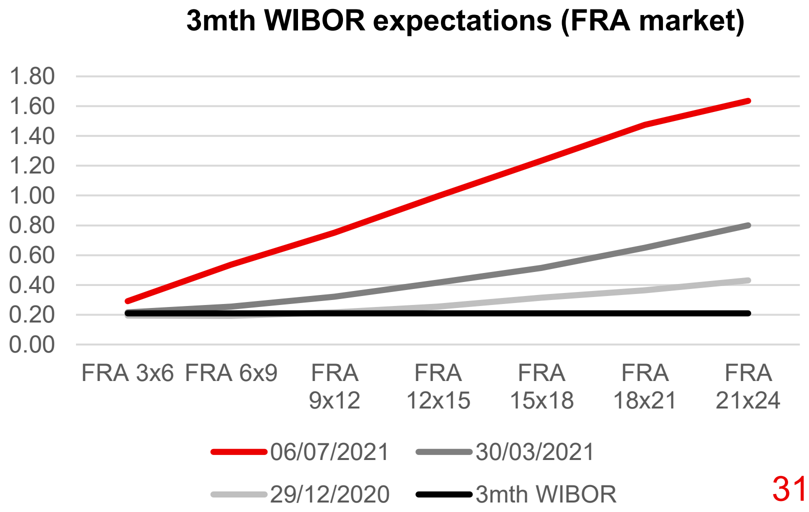
The second most important factor is the liquidity in the banking sector (bottom, left) which remain at the elevated levels and if anything even increases.

We expect 2Y bond yields at 0.20% at the end of 3Q21, at 0.35% at the end of the 4Q21 and at 1.10% at the end of 4Q22.









Santander

Source: Bloomberg, Santander

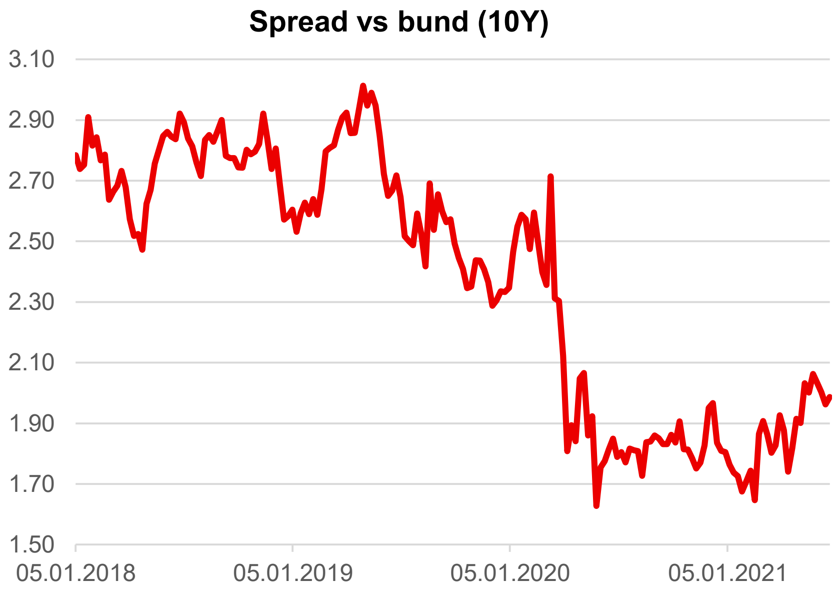
Lond-end yield curve forecast

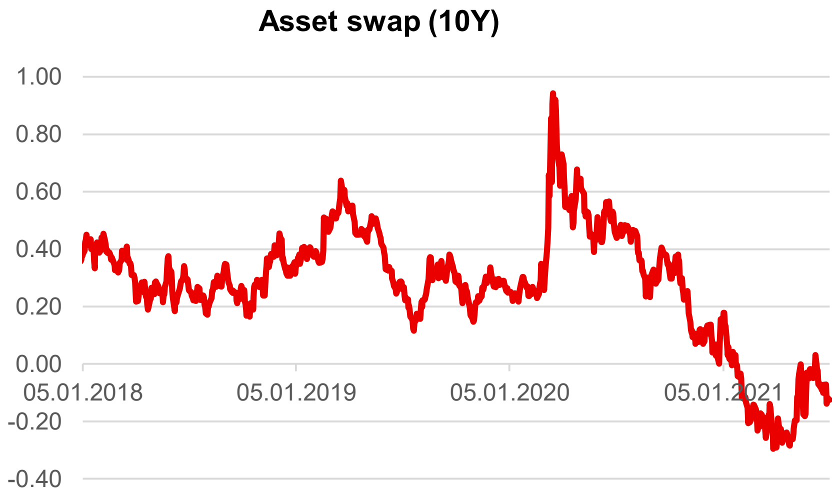
In our base case we expect the 10Y POLGB yields at 1.90% at end of 3Q21, 2.00% at the end of 4Q21 and 2.30% at the end of 4Q22.

The NBP hikes would result in a bear flattening of the yield curve – they mostly influence short-end of the yield curve. The long end of the bond curve rather follows the German Bund.

The Bund yields are likely to increase over time as both the economy and monetary policy normalize.

We note that the spread vs Bund remains compressed still (top, right), as is the asset swap (bottom, right). Were it to widen back to the pre-pandemic levels, the yields could increase even more.





Source: Bloomberg, Santander

Bond redemptions, coupons, foreign investors

In July there is a total of c.PLN19.0bn coming back to market in the form of coupons (PLN3.5bn) and a maturity of PS0721 bond on 25 July (PLN15.4bn).

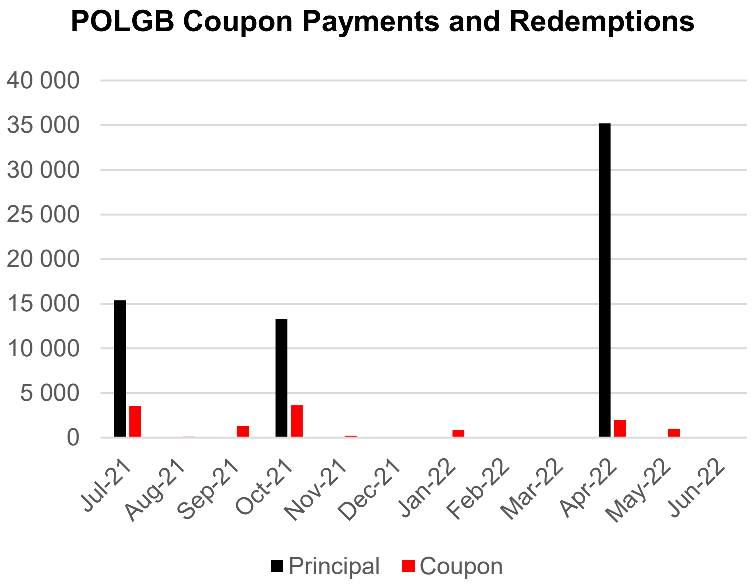
This fact should support bonds (especially short-term and belly) on the ASW basis through July. After which we expect ASW to return to gradual widening trend as the monetary policy normalization progresses. No significant redemptions of foreign currency denominated bonds happen in 3Q21E.

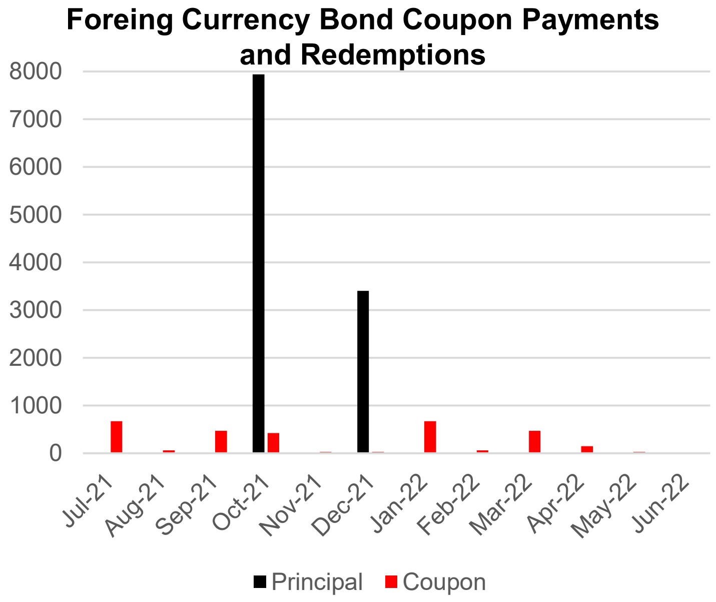
Ministry of Finance announced that in 3Q21E it would sell PLN4.0-13.0bn worth of bonds on outright sales, of which PLN4.0-8.0bn would happen on the outright auction on 23 July. On top of that there is a switch auction scheduled for 9 July. Ministry of Finance has financed over 70% of financing needs for the current year.

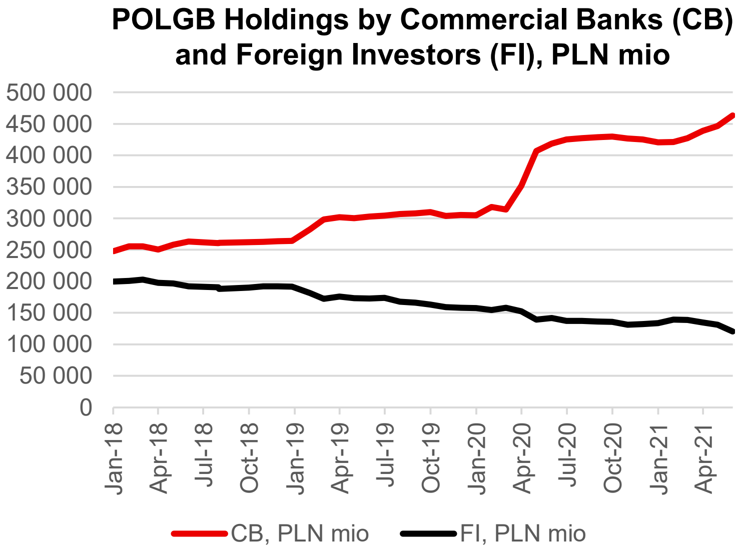
NBP purchase auction takes place on 16 July.

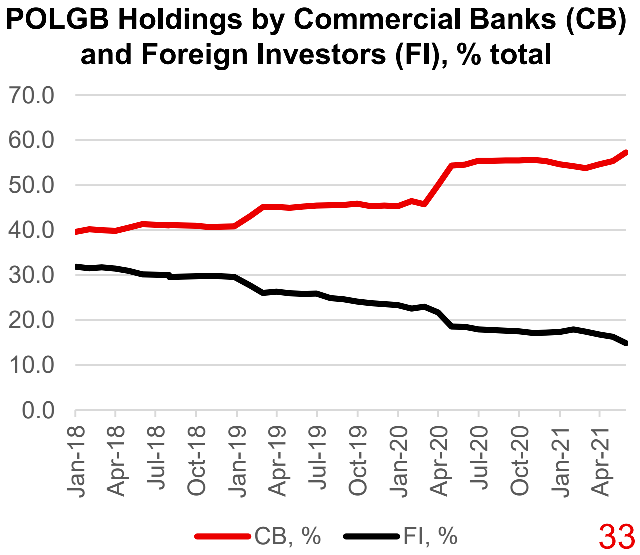
BGK increased the upper limit of issuance of its bonds for the 2021 year to PLN39.7bn from PLN33.2bn (of which PLN24.8bn have already been issued). The demand for the bonds has been weaker of late hence it might be difficult to place the extra amount.

The downward trend in the POLGB holdings of foreign investors continues. In May the % share of POLGBs they hold fell to 14.9% down from 16.3% a month earlier and 17.4% at the end of 2020.









Source: Bloomberg, Finance Ministry, Santander

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FX forecast and risks

We see EURPLN at 4.58 at the end of 3Q21 and 4.51 at the end of 4Q21.

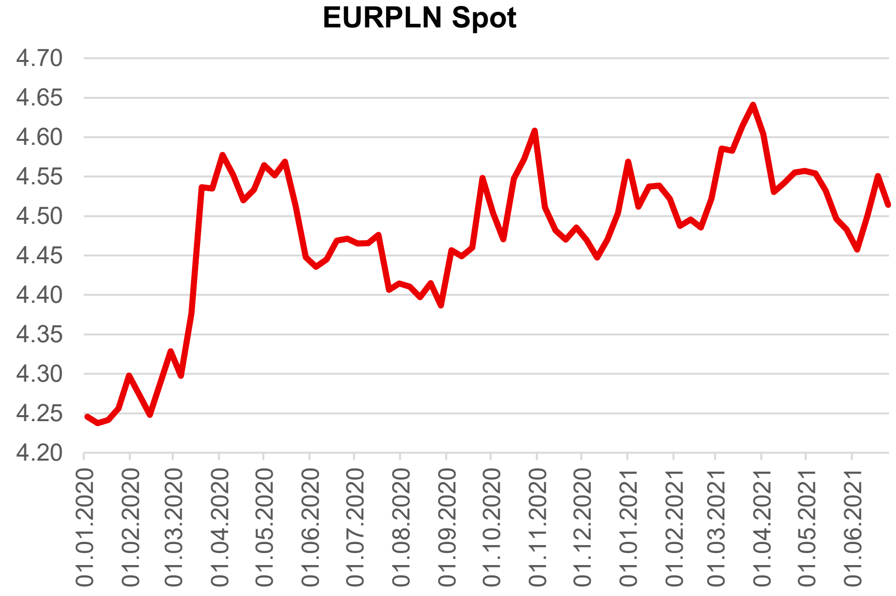
The macro fundamentals of the PLN are definitely positive: the economic recovery is solid, the current account remains in big surplus (near 3% GDP), NBP is likely to start a hiking cycle this year (although had it started the cycle in June as MNB and CNB, the PLN would probably be even stronger).

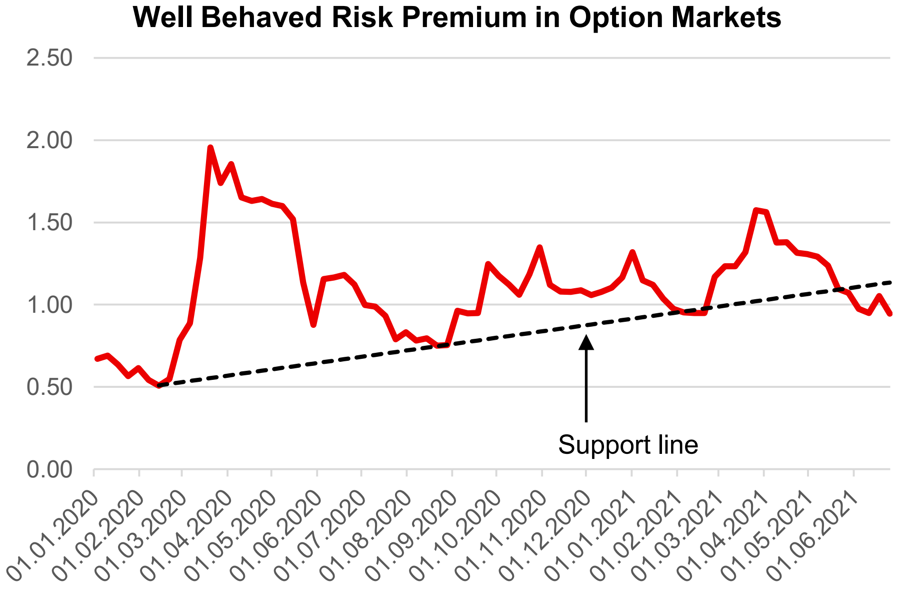
Our 3Q21E EURPLN forecast at 4.58 is higher than the current spot level because we reckon the monetary policy normalization in the US is one of the biggest challenges for the EM currencies in general and the zloty in particular. The August Jackson Hole Summit is an event around which investors might look less favourably toward the EM world. Santander forecasts EURUSD at 1.18 in 3Q2021E.

The Supreme Court's Civil Chamber has postponed the meeting on the FX loans without a precise deadline, asking several institutions for their opinions on the matter. According to the Court's First President, the next session is planned in September. The ruling still remains the unknown, it seems, both as regards the timing and the verdict.

The main risks to the PLN include:

- **No change in the NBP policy**. It may turn out that in contrast to what we expect, the NBP may neither end QE nor start a hiking cycle, plus it may repeat FX interventions at the end of the year again (as it did in December 2020), beefing up the NBP's PnL.
- The increased number of **Covid-19 cases in Autumn**. Historically, the higher the number of Covid-19 cases the weaker the PLN.
- **Contagion risks from weaker forint** if Brussels withholds (or at least threatens to do so) payments of EU money for Hungary on the basis of breaking the rule-of-law.





Source: BloombergSantander

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Forecasts

3

Economic Forecasts

		2019	2020	2021E	2022E	1Q21	2Q21E	3Q21E	4Q21E	1Q21E	2Q21E	3Q21E	4Q21E
GDP	PLNbn	2,287.7	2,323.9	2,582.8	2,790.2	585.2	625.0	641.7	730.9	640.6	673.7	691.5	784.4
GDP	% y/y	4.7	-2.7	5.0	5.0	-0.9	10.4	4.2	6.3	5.2	5.1	5.1	4.9
Domestic demand	% y/y	3.6	-3.7	6.7	5.0	1.0	12.1	5.8	8.2	5.2	5.2	5.1	4.8
Private consumption	% y/y	4.0	-3.0	5.4	6.7	0.2	13.5	2.0	7.0	8.0	7.0	6.0	6.0
Fixed investment	% y/y	6.1	-9.7	14.5	5.5	1.3	15.0	16.0	20.0	4.0	5.0	6.0	6.0
Industrial output	% y/y	4.2	-1.1	12.5	9.2	7.8	30.1	9.2	6.6	6.5	7.5	11.2	11.2
Construction output	% y/y	3.6	-3.5	5.3	6.1	-12.5	2.7	12.7	11.9	12.3	3.4	5.0	6.1
Retail sales (real terms)	% y/y	5.1	-3.0	7.2	4.3	1.2	13.7	4.0	9.7	9.0	5.9	2.0	1.2
Gross wages in national economy	% y/y	7.2	5.3	8.3	7.1	6.6	9.3	8.6	8.6	8.0	7.2	6.5	6.8
Employment in national economy	% y/y	2.2	-1.0	0.4	2.4	-1.4	1.5	0.9	0.7	2.4	2.6	2.4	2.4
Unemployment rate *	%	5.2	6.2	6.1	5.9	6.4	6.0	5.9	6.1	6.2	5.7	5.7	5.9
Current account balance	EURmn	2,611	18,105	13,980	7,703	2,948	5,704	2,582	2,745	665	4,322	1,469	1,247
Current account balance	% GDP	0.5	3.5	2.5	2.2	3.1	3.0	2.8	2.5	2.0	1.7	1.5	1.2
General government balance (ESA 2010)	% GDP	-0.7	-7.0	-4.0	-3.5	-	-	-	-	-	-	-	-
CPI	% y/y	2.3	3.4	4.0	4.1	2.8	4.5	4.4	4.5	4.7	4.0	3.8	3.8
CPI *	% y/y	3.4	2.4	4.6	3.8	3.2	4.4	4.3	4.6	4.5	4.0	3.7	3.8
CPI excluding food and energy prices	% y/y	2.0	3.9	3.6	3.7	3.8	3.8	3.4	3.3	3.6	3.4	3.7	3.9

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

Source: GUS, NBP, Santander

Market Forecasts

		2019	2020	2021E	2022E	1Q21	2Q21	3Q21E	4Q21E	1Q21E	2Q21E	3Q21E	4Q21E
Reference rate *	%	1.50	0.10	0.25	1.00	0.10	0.10	0.10	0.25	0.50	0.75	1.00	1.00
WIBOR 3M	%	1.72	0.67	0.26	0.93	0.21	0.21	0.24	0.39	0.61	0.83	1.09	1.19
Yield on 2-year T-bonds	%	1.56	0.50	0.20	0.76	0.08	0.20	0.26	0.28	0.44	0.58	0.97	1.06
Yield on 5-year T-bonds	%	1.99	0.96	1.12	1.55	0.65	1.10	1.33	1.40	1.45	1.52	1.60	1.65
Yield on 10-year T-bonds	%	2.41	1.52	1.69	2.15	1.35	1.73	1.76	1.93	2.08	2.13	2.17	2.22
2-year IRS	%	1.74	0.62	0.67	1.05	0.37	0.71	0.80	0.80	0.83	0.98	1.13	1.25
5-year IRS	%	1.85	0.85	1.34	1.61	0.91	1.42	1.49	1.54	1.59	1.60	1.60	1.65
10-year IRS	%	2.05	1.15	1.82	2.19	1.45	1.87	1.94	2.00	2.17	2.20	2.20	2.20
EUR/PLN	PLN	4.30	4.44	4.54	4.49	4.54	4.53	4.55	4.55	4.51	4.50	4.49	4.47
USD/PLN	PLN	3.84	3.89	3.80	3.68	3.77	3.76	3.85	3.84	3.75	3.70	3.66	3.60
CHF/PLN	PLN	3.86	4.15	4.14	3.85	4.17	4.13	4.14	4.11	3.92	3.88	3.83	3.79
GBP/PLN	PLN	4.90	4.99	5.24	4.95	5.20	5.25	5.30	5.22	5.06	4.99	4.93	4.81

* 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 **5.07.2021** has been prepared by:

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MACROscope

Warsaw, 7 July, 2021

Sectoral supplement

Strategic Sectors Department

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E-commerce growth to slow down – but how much?

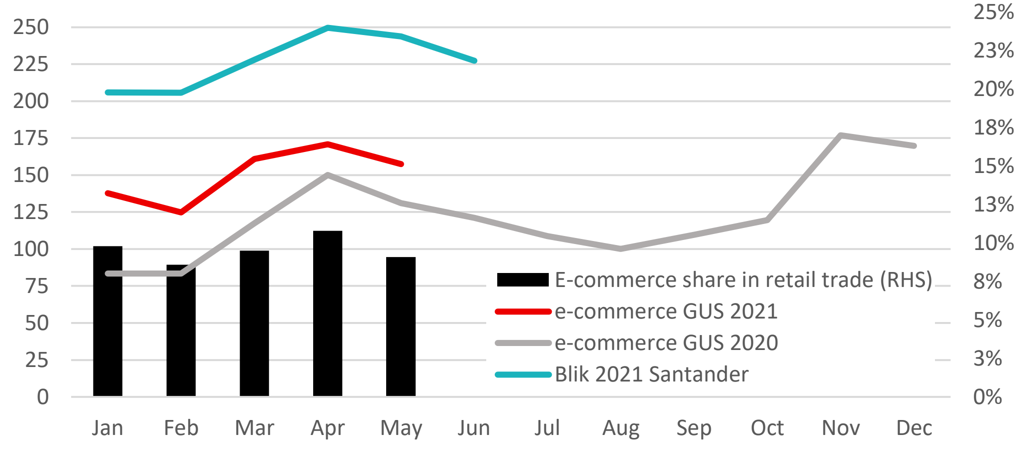
Since May most of pandemic restrictions which changed consumption patterns are gone from public life. This will slow down Internet sales growth, but it won't stop it entirely. After growing by as much as 42% last year, we expect that figures for this year will reach 24-28% y/y growth, which means PLN17 to 20 bn additional spending in the Internet. Our scenario assumes that significant portion of this growth was realised back in 1Q21 due to lingering restrictions and growth will resume in the last quarter, due to seasonality and Christmas shopping.

According to our estimates B2C internet sales grew in Jan-May 21 by some 33% y/y. Peak was reached in April, much like last year due to the introduction of the first lockdown. As a result, the share of e-commerce in retail sales has almost doubled compared to pre-pandemic levels. According to GUS data, e-sales in May were lower on a m/m basis, and internet payments of Santander's clients suggests that this trend was continued in June, due to the start of holiday season. Data for consecutive months probably will not bring any significant changes. What will be most important is the last quarter – we expect that after coming back to „normal" life consumer will not turn their backs on e-commerce and we will reach another sales record, even if November and December will not bring tightening of restrictions compared to present level.

Analysing e-commerce data in detail we see that there remains a „pandemic" pattern with sales of white goods, electronics and home furnishings being the largest category, coming in slightly ahead of sales of clothes. We see, however, that the distance between the two is gradually decreasing, which is the result of intensified social contacts, gradual resignation from remote work, and holiday season preparations.

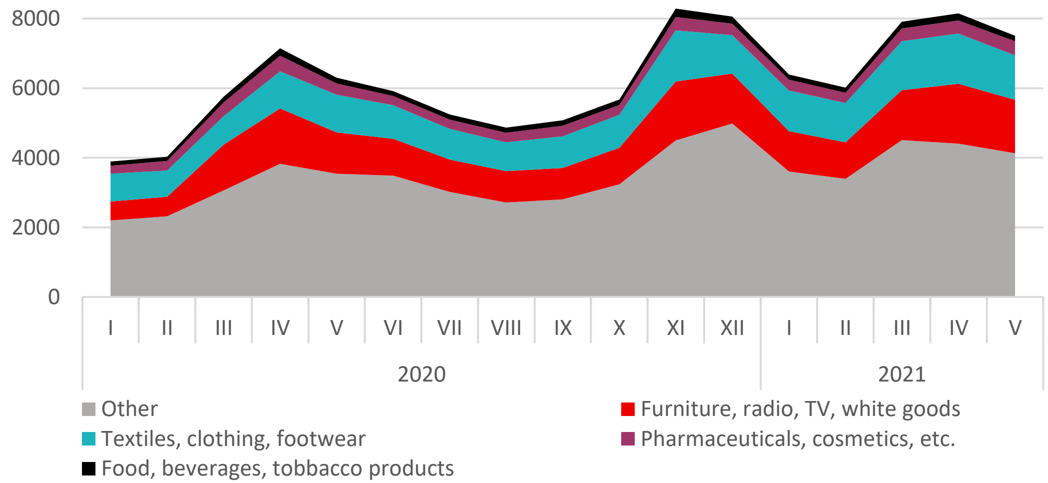
In case of B2B e-commerce, we expect that growth will accelerate this year, in contrast to our forecast for B2C e-commerce. Sales growth might reach as high as 40% this year. We cover this topic in greater detail in our dedicated report available here.

Retail Internet sales index (12.2019 = 100)



Source: GUS, Santander

E-commerce sales by category (PLN mn)



Source: GUS, Santander

Packaging industry growing at long unseen pace

According to our estimates, sold production of packaging industry noted double digit growth figures for April and May, which translates into 8-9% growth YTD. In the months to come we expect that growth rate will lose some of its impetus due to holiday season, but starting from September we may see double digit growth once more. If we assume that packaging industry will sustain at least 8% growth on average this year, then sold production for 2021 may reach as much as PLN51bn.

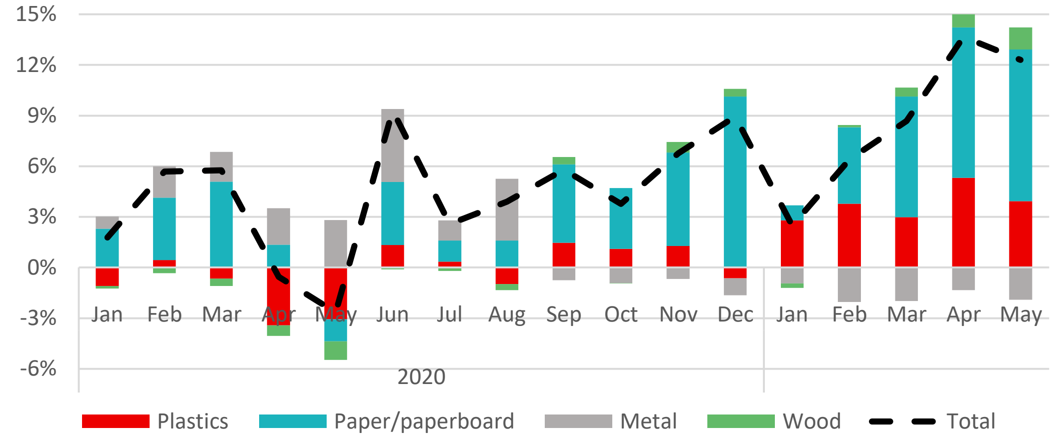
An important change that we see this year is a significantly increased role of plastic packaging, fuelled not only by increased demand, but also a rapid increase of prices caused by production costs growth. What is more, this trend is present in the whole packaging industry, but in case of plastic packaging, responsible for about 35% of industry's sales, this translates into accelerated growth of the whole sector.

Between November and July this year, an index representing average price of plastics used in the packaging industry rose by ~107%, while in July alone price growth amounted to 126% in annual terms.

What is more, we see that prices of papers used in the packaging industry are rising as well. Cellulose price index (PIX) growth in 1Q21 was „just" 20% y/y, but high and rising demand for paper and paperboard packaging used in e-commerce sales, combined with unsatisfactory supply of recovered paper, translate into double digit growth of costs in paper and paperboard packaging segment, which is only partially reflected in producer price index. In case of metal packaging, price of both aluminium and steel sheets reached pre-pandemic level already in July/August, and rose further by over 40% since then.

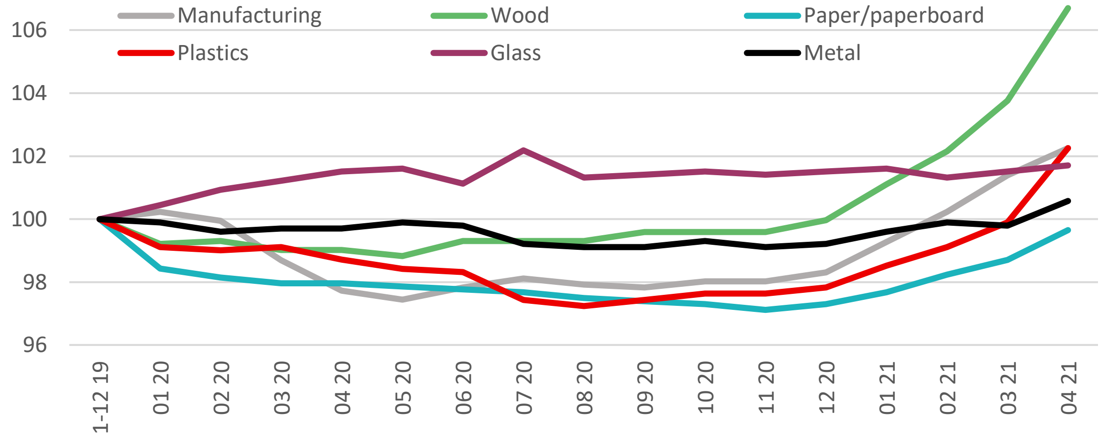
We expect that cost pressure will lead to further increase of packaging prices in all segments of the industry, which will support our forecast of 7-8% y/y sold production growth.

Packaging industry sales by segment (YoY change)



Source: GUS, Santander estimates

Producer prices by packaging industry segments, manufacturing in total (2019 = 100)



Source: GUS, Santander

Europe struggles with wood based panels availability

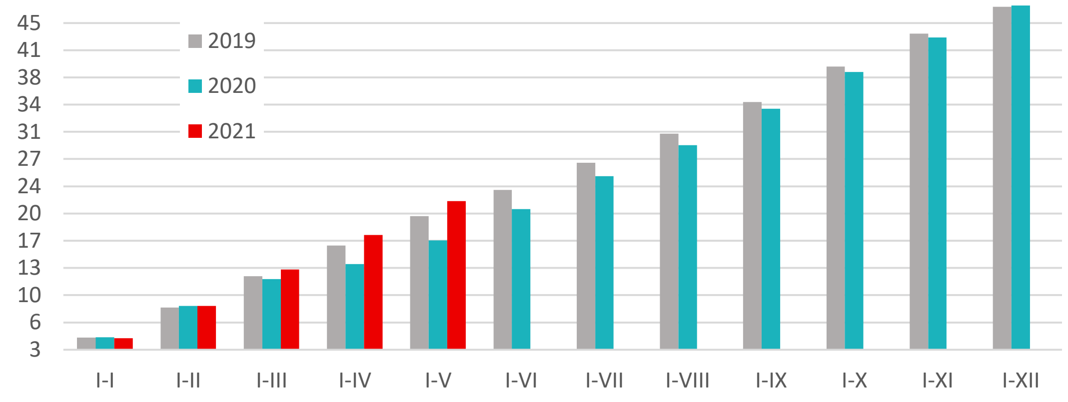
First 5 months of this year were rather successful for the furniture manufacturers, in our view. In the first months, before the impact of low-base effect, sold production was up by 5.6% (after accounting for the difference in working days). Data for April and May show that growth trend continues, in line with our scenario of 4-6% growth of sold production in 2021, meaning PLN48.6-49.6bn at year end.

Sound results in April and May look even more positive when we account for the fact that during this period pandemic restrictions in Germany, the most important export market, were remaining among the strictest among the EU markets in April, and the most restrictive of the TOP20 export markets in May. In spite of the above, furniture industry managed to remain on the growth path, which makes us positive about the remaining part of the year.

At present, the single highest obstacle for keeping growth trend at 5-6% is the raw materials availability - even though the shortage of wood-based panels stocks seems to be more pronounced in other EU markets than in Poland, it still remains a challenge on the domestic market. Panels shortage is coupled with low availability of wood from local sources – demand from foreign markets, including extra-EU, is so high, that it impedes satisfactory level of supply for domestic processing.

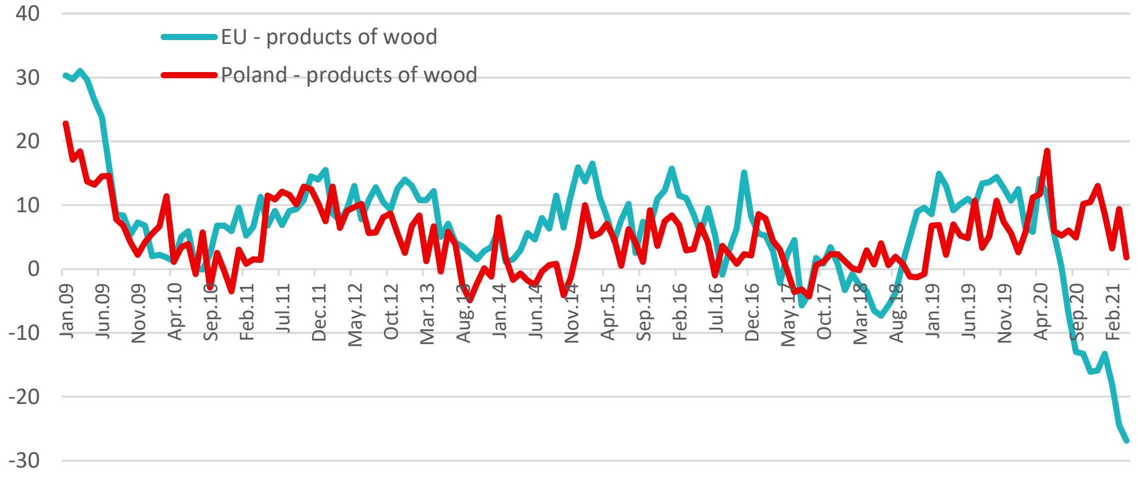
Low availability of wood-based panels coupled with lower availability of wood translates into a strong growth of cost base, which should in turn translate into an increase in producer prices of the furniture industry. But this may be challenging, when we consider that cost competitiveness is one of the biggest advantages of the Polish furniture industry. But we expect that cost pressure on other EU markets may be even stronger, or at least as strong as in Poland, which should make introducing necessary price increases that much easier.

Sold production of the furniture industry (PLNbn)



Source: GUS, Santander

Assessment of stocks of finished products (net responses, NACE division 16)



Source: Eurostat

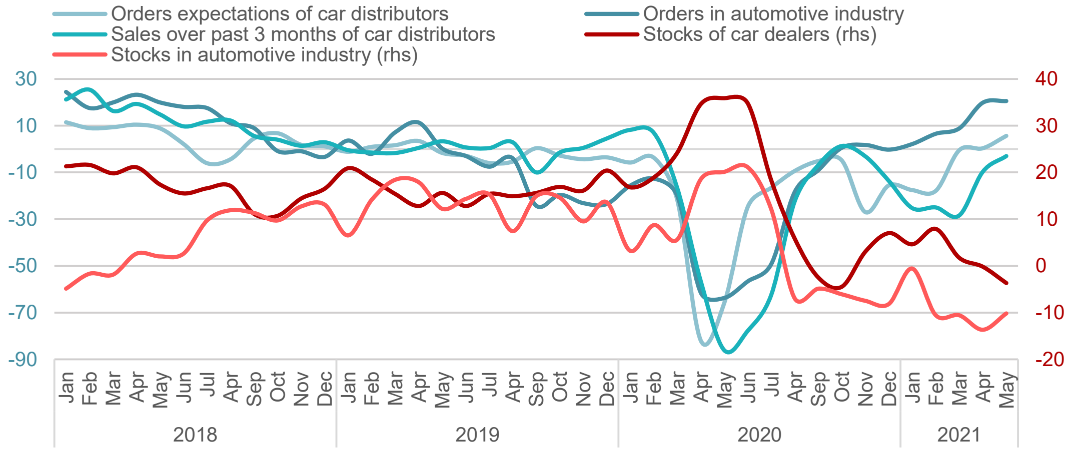
Automotive: low car supply increases substitution

Prolonged semiconductors supply problems continue to cause constraints in car production. Supply disruptions have delayed production of around 0.5 million cars worldwide. And demand for cars in the EU is greater than current supply - stocks of cars reported by manufacturers and distributors are at low levels, dealers are expecting rising orders, car prices are rising and there are many months of waiting for cars ordered in production. Semiconductors supply is not expected to meet automotive demand until 2022.

Production volumes of passenger cars in January-May 2021 in countries that are the main recipients of Polish production were higher than a year earlier, but still clearly below 2019 levels. Dynamics in this period in Germany amounted to 25% y/y, but at the same time was 30% lower than in 2019. Against this background, automotive industrial production in Poland performed well, being 50% higher y/y and 3% higher than in the corresponding period in 2019. At the beginning of May VDA revised its forecast for passenger car production volumes in Germany from 4.2 mn to 4.0mn units, which would give an increase of 14% compared to 2020, but also 14% less compared to 2019. LMC Automotive forecasts that passenger car registrations in Western Europe will increase by 10% in 2021, 17% less compared to 2019.

Low new car sales benefit automotive parts distributors. Postponed purchases of new cars often cause the need to repair or replace parts in older cars. And potential of the domestic market is high due to large car park (24 mn) with their high average age (14.1 years), which continues to grow through high imports of used cars, mostly over 10 years old. Other markets in the region also have high potential in total, which benefits WSE-listed distributors Inter Cars and Auto Partner, among others, by increasing the share of these markets in sales last and this year. Revenues of parts distributors in Poland increased by 5% in 2020, and 82%* of them expect positive dynamics also in 2021. Profitability of distributors has also improved, supported by high demand with limited supply - among others as a result of lower availability of certain raw materials or problems with deliveries from Asia.

Situation of the automotive industry and car dealers in the EU (survey results – balance of up/down)



Source: Eurostat

Situation of auto parts distributors in Poland (survey results - balance of up/down)

Source: Eurostat

* MotoFocus.pl survey

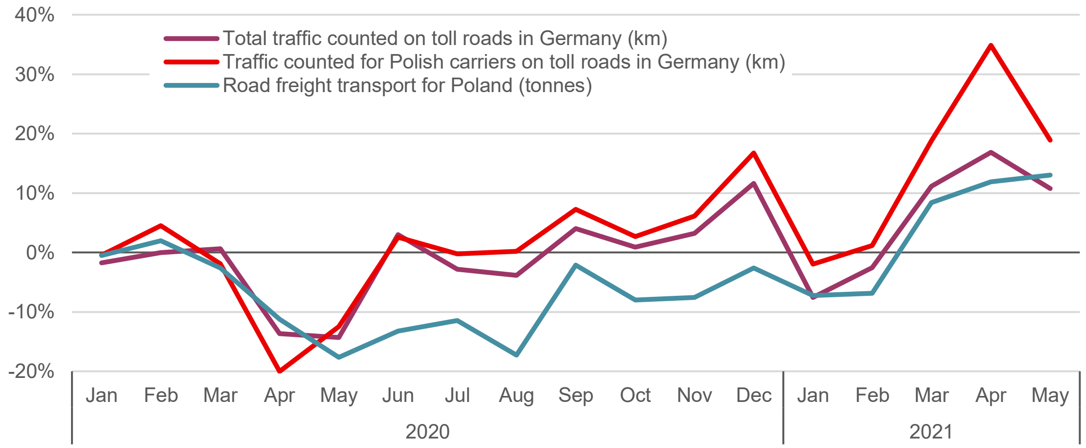
Road transport: volumes and rates are rising

GUS data on the weight of goods transported by Polish road carriers (>9 empl.) shows that after an 8% decline in volumes in 2020, January-May 2021 saw an increase of 4% y/y, which however was still 3% less than the comparable period in 2019. While the beginning of the year was slightly weaker, the March-May period showed a stabilisation in volumes m/m.

Situation appears to be better in terms of transport work, as indicated by data on kilometres charged to Polish carriers for tolls in Germany. Polish-registered carriers definitely performed well on German roads - from January to May this year number of toll kilometres driven by them increased by 13.5% y/y, which was also a better result than that achieved at the same time in 2019. (+6.5%), but also better than all carriers using German roads (+5.6%), including competitors from Central and Eastern Europe - operators from Lithuania (+10.3%) or Romania (+11.1%). As a result, carriers from the region increased their share in German toll roads traffic, at the expense of German entities, which rose by 1,7% YoY since the beginning of the year.

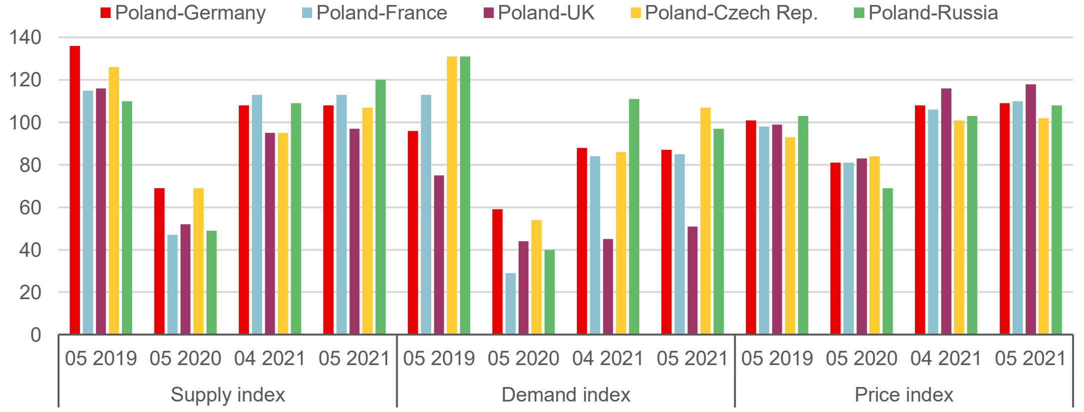
Demand for road transport is growing as a result of good economic situation in Europe, opening up of economies and problems with supply of goods from Asia, which are partly being replaced by equivalents from Europe. Freight rates are also rising - due to, among other factors, a limited supply of vehicles and possibility of acquiring new road tractors, a shortage of drivers and rising fuel costs. It also seems that it is becoming increasingly competitive to sea transport on the East Asia-Europe route, which as a result of problems with container availability and bottlenecks (Suez Canal blockage, congestions and hold-ups at ports), has not only become less available and stable, but also significantly more expensive. The FBX global ocean container price index increased by 240% from the beginning of July 2020 to the end of June 2021, while the price index on the route from China/East Asia to Northern Europe FBX11 skyrocketed by 550% in the same period.

YoY freight transport by road in Poland and toll traffic in Germany



Source: GUS, BAG

Spot market indices for transport from Poland for vehicles of GVW>16t (points, 100=value as of 01.2020)



Source: metrix.trans.info

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'Defrosting' of economy supports demand for food

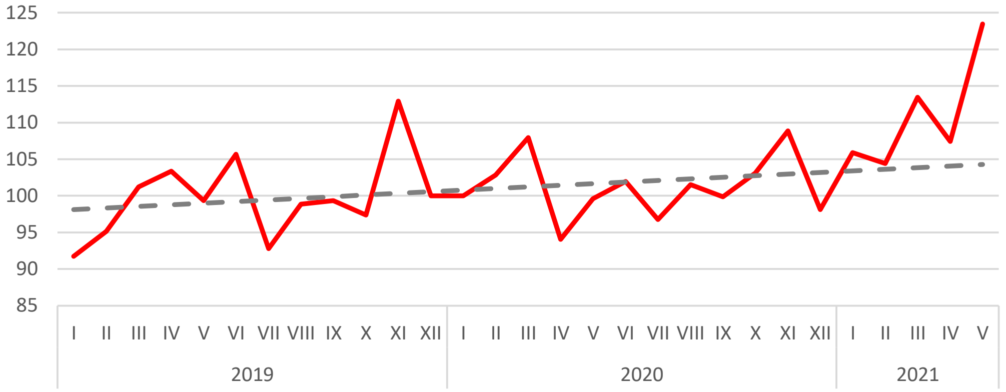
Food industry is benefiting from improved epidemic situation. Gradual removal of restrictions concerning food service and hotels, which began in May, improvement of weather and beginning of 'barbecue' season support orders for food products. Demand from HoReCa sector is very important for food industry, not only in terms of volume of purchases, but for higher margins as well. Importantly, 'defrosting' applies not only to Poland, but also to other EU countries. The value of sold production of food industry (food, beverages, tobacco) in May was higher by 4% compared to April. However, after taking into account the difference in number of working days, monthly dynamics of sold production amounted to as much as 15%. In turn, in comparison to the level from January 2020, i.e. before the pandemic, sold production in May was higher by 23%. May was the fifth month in a row in which that dynamics were positive.

In June and in the summer months, conditions for development of sales in food industry should be even better. Firstly, most of the social restrictions in the EU countries were lifted in June. Secondly, the Member States have significantly facilitated tourism within the EU. These factors support both traveling around Poland and foreign trips. In practice, this should mean higher demand from the EU's HoReCa sector.

This direction is partially confirmed by soft indicators. The GUS business tendency survey, carried out in June, showed a large share of food companies that expected an increase in domestic and foreign orders in the coming months. Similarly, survey in the HoReCa sector, conducted in the EU countries, showed a large share of companies that expected an increase in demand in the next 3 months and an increase in employment. Interestingly, both gastronomy and hotels also expected an increase in prices of their services.

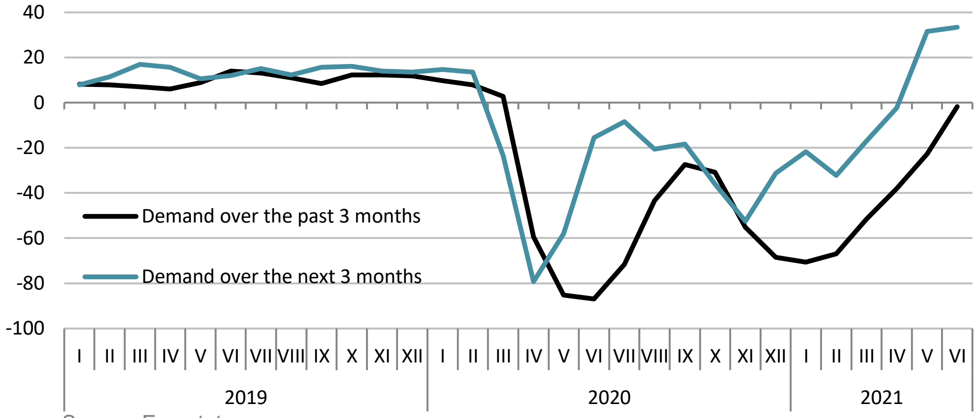
A threat to the described scenario is the risk of increase in infections related to new variants of COVID-19.

Index of sold production in food industry (Jan 2020 = 100), calendar adjusted



Source: GUS, Santander caltulations

Business tendency survey in food service in the EU (balance of answers)



Source: Eurostat

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This analysis is based on information available as of **01.07.2021** and has been prepared by:

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