MACROscope

Warsaw, 16 December 2021

Outlook still rosy, but clouds gathering

Poland: 2022 Outlook

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Executive Summary (macro)

Almost two years after the Covid-19 pandemic broke out, we are still living in a world of elevated uncertainty. The track record of the last few quarters is encouraging, though, as the global economic recovery has proven to be less fragile than many expected, despite recurring Covid-19 waves and supply disruptions. We cannot be sure about the implications of new virus mutations, especially when global vaccination rates are still unsatisfactory, but we believe that the outlook for most advanced economies is still quite positive, creating a favourable backdrop for Poland's resilient and competitive manufacturing sector.

Polish GDP growth has been surprising positively throughout 2021 and it looks like **the economy is entering the new year with strong momentum, which should allow average GDP growth in 2022 to remain close to 5%** (see p.8), before we expect a notable slowdown in 2023, reinforced by sharp monetary policy adjustment.

Domestic demand will still be the key driver. We think that private consumption will remain buoyed by solid income growth and a reduction in excess savings (see p.16), and that it will take several quarters until the rising costs of living and credit filter through to demand weakening. Investment should be incentivised by firms' efforts to overcome the growing labour shortage, and later in the year (hopefully) by the unlocking of the EU recovery funds (see p.17). Also, we expect to see continued precautionary stock-building as a response to supply chain disruptions. We think exports will remain strongly supported by the favourable external environment, with bottlenecks in global supply chains gradually easing, international trade continuing to revive and solid GDP growth in major economies as life normalises after the pandemic. Yet the trade balance will likely deteriorate further amid booming imports (p.20).

Inflation will remain elevated for longer, we think, amid a strong economic outlook, tight labour market, persisting input cost pressure and increased company pricing power. We forecast that **after a temporary drop in 1Q, CPI growth will return to c.8% y/y in 2Q22 and then should start falling gradually in the second half, but averaging above 6.5% in 2022** (p.9). It may take until late 2023 before CPI returns to the upper end of tolerance band of the inflation target (2.5% +/- 1pp).

The central bank will continue monetary tightening (p.10). **We expect the main reference rate to peak at 3% in 2Q22**, which is more or less in line with the current market pricing. A rate hike in January by 50bp is very likely, in our view, but the exact timing of moves after that will depend on new data, pandemic development, financial market behaviour, and also on whether (and how) the appointment of new MPC members changes the balance of power in the Council. The latter is still unclear, except that the Senate's nominees are likely to be quite hawkish. Our best guess is that the nominees of the Sejm and the President could share similar views to Mr Glapiński.

High nominal GDP growth should continue to facilitate fiscal consolidation. The government planned the 2022 budget with GG deficit below 3% of GDP, which should be easily achievable unless the economy slows considerably, and/or the escalating conflict on rule of law triggers a sudden stop in EU funding. That being said, we think the appetite for further deficit reduction will be tamed by the willingness to offset tighter monetary conditions amid a slowing economy. (p.11)

The potential freeze of EU money is the biggest risk factor for the economy. The 13% upfront payment from the recovery fund is already lost, which most likely implies a delay in investment projects, but we still hope the payments will be unlocked after/if the rule of law conflict is resolved early next year. If not, the implications for economic growth could be severe, especially in 2023 (p.12). Other major risks include bigger rate hikes, if inflation proves harder to control, or a worsening global outlook if new coronavirus mutations complicate the fight with the disease (more on pages: 13-14).

Executive Summary (markets)

FX

Our house view for EURUSD is that it may bottom near 1.10 in 1Q22 and rebound to 1.18 by 4Q22. Also, MNB and NBP have started to catch up with CNB by tightening their financing conditions in a more decisive way. Taken together, these two factors imply that the PLN weakness might be short-lived. We expect EURPLN at 4.65 by the end of 2021 after which it could start declining throughout 2022 as the solid macroeconomic fundamentals should allow. We think EURPLN could reach 4.50 by the end of 2022, but no lower - two important technical supports reside at the level, and may be difficult to break. If any key risk factors described in our report materialize, leading to lower GDP growth, EURPLN might increase but plausibly not breaching the important EURPLN 4.70 level. (p.24)

FI

We think that UST and German Bund yields have upside potential and may end 2022 at 2.20% and 0.50% correspondingly, both roughly 70-80bp above current levels. We think that after the Polish ASW curve normalized (following NBP QE) and the POLGB 2x10 flattened (which is typical for a late hiking cycle) as policy tightening has already been priced in, the scope for significant moves both at the front-end and long-end of the curve is limited. We expect 2Y bond yields to end 2022 near 3.10%, based on our assumption of NBP target rate of 3.0% by mid-2022. We expect 10Y bond yields at 3.20% at the end of 2022 as further NBP hikes will pressure the curve to bull flatten, despite the trend in the core markets. In 2022, redemptions and coupons sum up to c.PLN 80bn, with biggest redemptions in April, July and September. For non-PLN denominated bonds, the biggest redemptions are concentrated in January and February (EUR) and March (USD). (p.25)

2021 Forecasts in rear view mirror

Indicator	Our view in December 2021	Outcome
GDP	After a still weak 1Q, we expect to see a stronger rebound of economic activity in 2H21, after mass vaccination removes worries about potential next waves of the pandemic. The quarterly y/y GDP growth pattern will be disrupted by base effects; annual average at 4.6%.	GDP has surprised to the upside throughout 2021, confirming the economy's resilience, despite recurring Covid-19 waves and disruptions in supply chains. GDP returned to the pre-pandemic level by mid-2021. Average GDP growth is likely to near 5.5% (c.1pp higher than we anticipated).
GDP breakdown	Consumption will be the strongest driver, supported by pent-up demand, zero interest rates and limited labour market damage. Investments subdued for longer but to revive by the end of the year. Exports consistently performing well but import rebound in 2H will make trade balance net negative for growth.	Most assumptions correct. Normalisation of consumption patterns was the key driver of economic recovery. Private sector investments rebounded quite early, but the public spending stagnation meant total investment recovery was delayed. Export expansion was clearly outpaced by the import surge, additionally boosted by high commodity prices, so the trade balance deteriorated more than we anticipated.
Labour market	Unemployment rate likely to peak in 1Q21, but still be relatively low. Job hoarding during the crisis will prevent labour demand jumping once the economy accelerates. Wage pressure is off the table for some time, which implies limited real labour income growth for households.	The labour market healed much faster than we thought, the slack disappeared at the start of the year and a labour shortage has pushed up wages. This is one of the biggest positive surprises as compared to our expectations.
Inflation	Inflation will fall towards 2% amid subdued demand, lower cost pressures on firms, and 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.	Contrary to our call, inflation rebounded faster and stronger, boosted by a combination of external factors (a surge in commodity prices and input costs amid supply chain disruptions) and local triggers (stronger rebound in labour market and domestic demand).
Monetary policy	Main rates are likely to stay on hold until the end of the MPC's 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.	After downplaying inflationary risks for some time, the MPC started its tightening cycle in October, chasing the inflation surge. The NBP reference rate rose from 0.1% to 1.75% in just three months. QE finished in 2H.
Fiscal policy	GG deficit is likely to be around 6% of GDP (as planned by the government), after 8-9% in 2020 (lower than planned). EU Budget approved, which secures major financing for Poland in 2021-27, and is supportive for economic growth.	Very rapid nominal GDP growth boosted tax revenues, allowing for faster fiscal consolidation. We estimate GG balance at the end of the year at -2% of GDP. No approval for recovery fund for Poland due to rule of law conflict.
Fixed income market	Global and Polish economy to 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.	Yields surged, doubling our forecasts for the year-end, due to much higher inflation and the start of monetary tightening cycle. Curve initially bear-steepened but then flattened after the NBP rate hikes advanced.
FX market	We expect the zloty to gain in 2021 and return towards 4.30 per euro by the year-end, the level that served as a medium-term anchor for EURPLN before the pandemic broke out.	The currency remained under pressure throughout the year, amid deeply negative real rates and the central bank's clear preference for a weaker PLN, and also the conflict with the EU implying the risk of an EU funding freeze.

2022 Forecasts and main risks

Indicator	Our view (in a nutshell)	Main risks
GDP	Economy enters the year with strong momentum. New Covid-19 variants not severe enough to halt normalisation of economic and social life. Pace of recovery gradually fading over time, but we expect average GDP growth in 2022 still near to 5%.	Coronavirus mutations escape immunity. EU funding freeze in place due to escalating rule of law conflict. Inflation gets out of control - stronger interest rate hikes. Energy crisis deepens. Geopolitical risks materialise - conflict near the eastern border.
GDP breakdown	Consumption still has upside potential until excess savings normalise. Private investment continues its revival, public spending delayed due to a lag in recovery fund approval. Exports supported by solid external demand and weak PLN.	Higher inflation and interest rates may hit consumption. EU funds on hold worsen investment outlook. If the pandemic hits harder again, new restrictions and social distancing may deepen sectoral divergence, affecting services first.
Labour market	Economy back at virtually full employment. Demand for labour keeps rising, which implies elevated wage growth.	Lower GDP growth (regardless of the reason) would imply lower labour demand and lower wage pressure. Unemployment rise not very likely, as the policy response to negative shocks would likely remain focused on job protection.
Inflation	CPI drops in the first months of the year due to temporary tax cuts, then returns to 8% and starts fading gradually amid high base effects. The return to target probably not earlier than late 2023.	Much higher energy prices in case of a severe winter or geopolitical conflict. Sharp zloty depreciation. More fiscal expansion, fuelling demand pressure.
Monetary policy	Main reference rate goes to 3.0% in 1H22. The new MPC continues flexible inflation targeting (aiming at the upper end of the band rather than 2.5% inflation target).	Stronger rate hikes if inflation proves harder to control (strong second-round effects, deanchoring inflation expectations) and/or PLN depreciates sharply.
Fiscal policy	The government's 2022 budget is planned to have a GG deficit below 3% of GDP, which should be easily achievable unless the economy slows considerably, and/or escalating conflict on rule of law triggers a sudden stop in EU funding.	Faster and stronger than expected economic slowdown.
Fixed income market	Yield curves stabilise near current levels as the MPC keeps raising the main rate towards the anticipated 3.0% level. Curve reversal possible in 2H22 after the market realises the tightening cycle is over and the GDP outlook for next quarters fades.	Hawkish policy pivot by main central banks (Fed, ECB) triggering sell-off in core debt markets could push yields much higher. If growth outlook deteriorates and tightening stops earlier, the yield spike could reverse and the curve invert quickly.
FX market	Currency still under pressure at the start of the year amid stronger dollar, Fed's hawkish policy tilt and delayed approval of the recovery fund. Zloty gains moderately during the year as rate hikes continue and conflict with EU abates.	Change of sentiment in global markets. Escalation of government's conflict with the EC. Political destabilisation. Worsening of sovereign ratings' outlook. Escalation of geopolitical tension in the east.

Economy

1

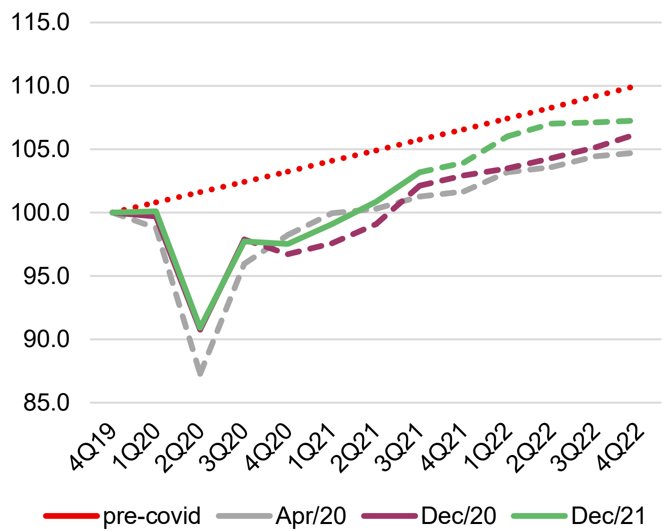
Base case (1/4): GDP outlook still positive

Poland's economic recovery has been gaining pace throughout 2021: GDP growth (q/q) in each of the first three quarters was higher than the previous one and above forecasts, so we expect c.5.5% GDP growth in the entire year. **We think that Poland will enter 2022 with solid growth momentum, and average GDP growth in 2022 close to 5%**, before a notable slowdown in 2023, reinforced by sharp monetary policy adjustment.

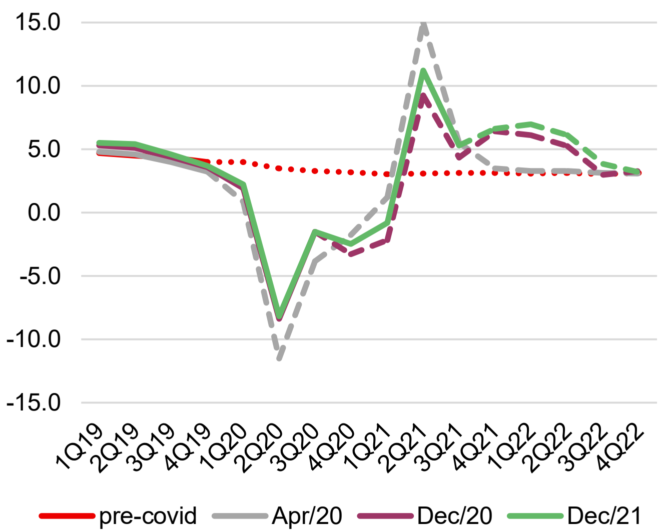
The recovery in 2021 was uneven, with some sectors reviving much faster than others (manufacturing, transport leading the way) and some clearly lagging (travel and leisure, finance). Those sectoral divergences have already started narrowing and in 2022 services should keep catching up, assuming the pandemic does not get out of control again and social behaviour converges to previous patterns. It does not mean a worse outlook for the highly competitive and diversified manufacturing and exports sector, which should benefit from still-positive growth momentum abroad, especially after/if supply bottlenecks start easing.

Elevated inflation has failed to damage corporate profit margins thus far and we expect this to remain so. Still, the challenges related to cost pressure, competition for talent and the rising cost of money will be much harder for small firms, promoting further consolidation across sectors.

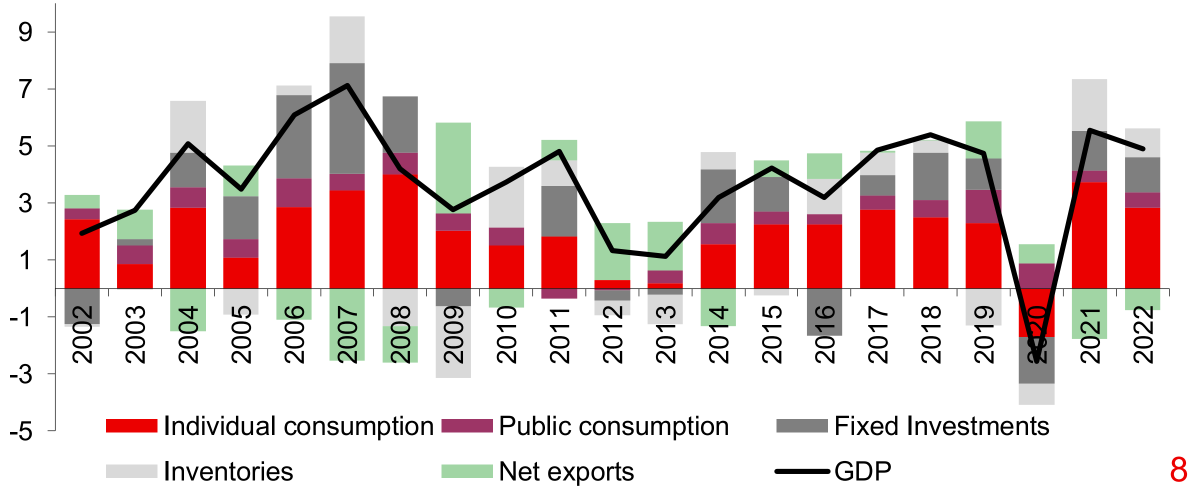
Santander's GDP forecasts (4Q19=100, s.a.)



Santander's GDP forecasts (% y/y)



GDP growth and its breakdown, %



Source: GUS, Santander

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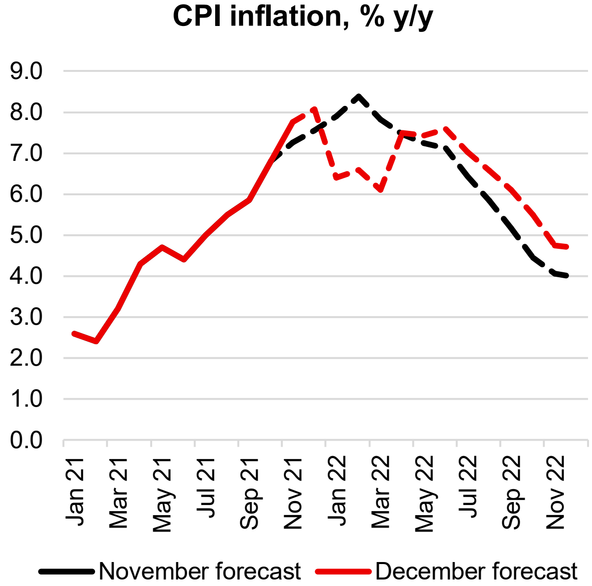
Base case (2/4): Inflation higher for longer

The inflation surge in 2021 was a global phenomenon. CPI growth was fuelled to large extent by a surge in energy and commodity prices and supply-side bottlenecks, but in Poland (which has enjoyed a stronger post-pandemic rebound than most other countries) price pressure was boosted more than elsewhere also by vibrant domestic demand and a tight labour market.

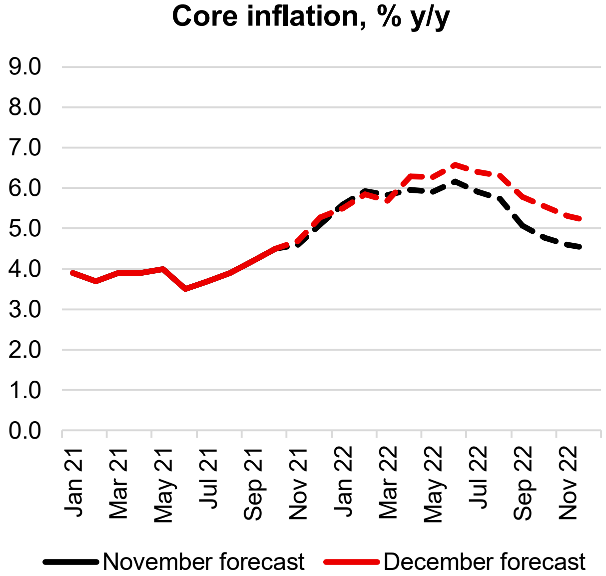
Inflation will be much less transitory than initially thought, as the economic outlook remains fairly optimistic, input cost pressure is not likely to go away quickly and companies' pricing power has clearly increased. With a tight labour market, wage growth will remain strong, which is a prerequisite for an extension of the period of heightened inflation.

The government´s anti-inflation shield may shave off some 1.5pp of headline CPI in 1Q via temporary tax reductions, but at the expense of higher inflation in late 2022 and 1H23. Also, the starting point for 2022 inflation will be probably higher than earlier assumed, due to the spike in energy costs at the turn of the year (CO2, electricity, natural gas, crude oil prices trending up again).

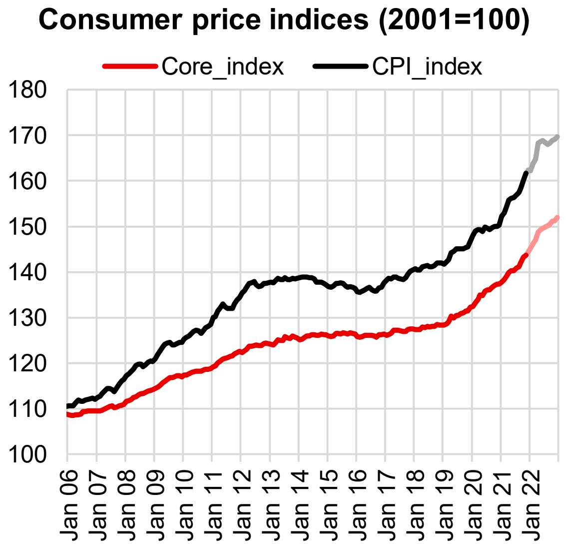
Thus, we predict that **CPI growth, after a temporary drop in January-March, will return to almost 8% y/y in 2Q and then it should start descending gradually in the second half of the year, to 4.7% y/y in December, averaging above 6.5% in 2022**. Core inflation is likely to plateau near an elevated 6% until at least mid-2022, then slowly start fading. It may take until late 2023 before both CPI and core inflation return to the upper end of the tolerance band around the inflation target (2.5% +/- 1pp).



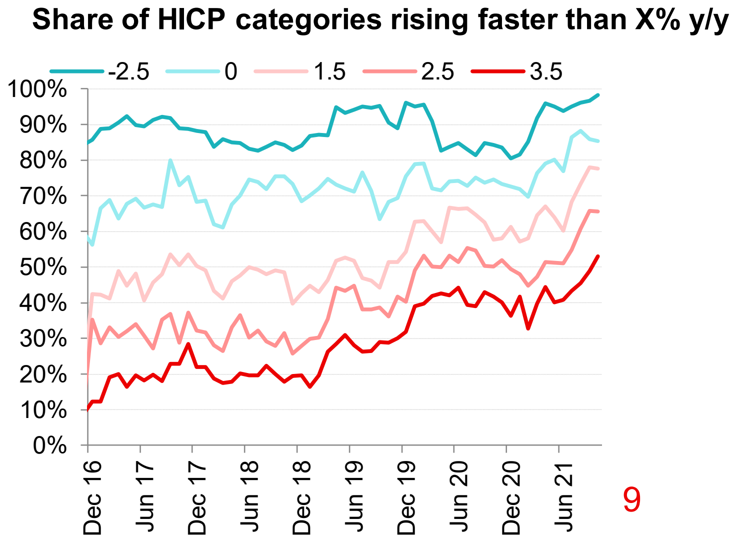
Source: GUS, Santander



Source: NBP, Santander



Source: GUS, Santander



Source: Eurostat, Santander

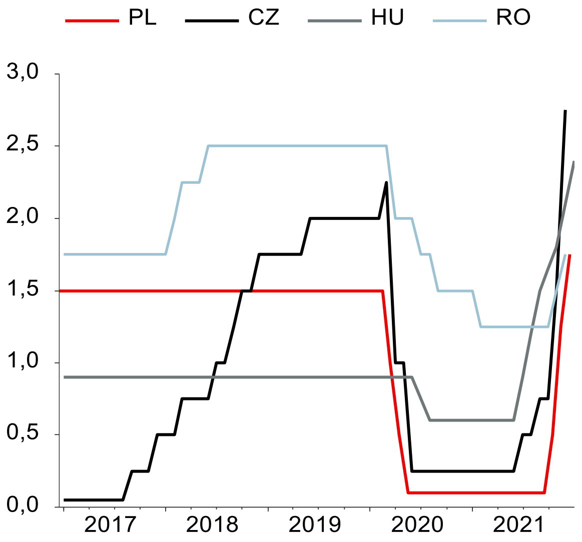
Base case (3/4): Monetary tightening in progress

After downplaying inflationary risks for some time and attributing elevated price growth entirely to factors beyond monetary policy control, the Monetary Policy Council finally pivoted in 4Q21, which resulted in jump of the official rate by 165bp (from 0.1% to 1.75%) in just three months.

Even though the central bank is signalling a flexible approach to inflation targeting (it seems to be aiming at the 3.5% upper end of the target band, rather than the 2.5% target), we think that more tightening will be needed to tame inflationary pressure in an economy running at a high speed (the output gap turned positive in mid-2021, according to NBP estimate). There is a tight labour market, reviving credit demand, high inflation expectations and new fiscal measures adding more fuel to the consumption spree. This is especially so when FX transmission does not seem to be working well (the recent rate hikes failed to strengthen the zloty), real interest rates are increasingly negative, and a global monetary policy tilt is in progress.

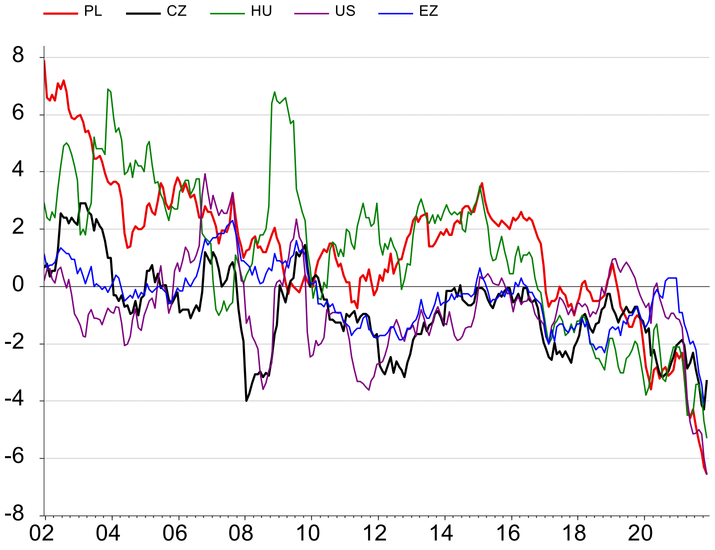
We assume the main reference rate to peak at 3% in 2Q22, which is more or less in line with the current market pricing. A rate hike in January of 50bp is very likely, in our view, but the exact timing of the any following moves will depend on new data, pandemic development, financial market behaviour and also on whether (and how) the appointment of new MPC members changes the balance of power in the Council. The latter is still unclear, except that the Senate's nominees are likely to be quite hawkish. As we wrote in September's report, it seems likely that nominees of the Sejm and the President would share similar views to Mr Glapiński.

Nominal interest rates, %



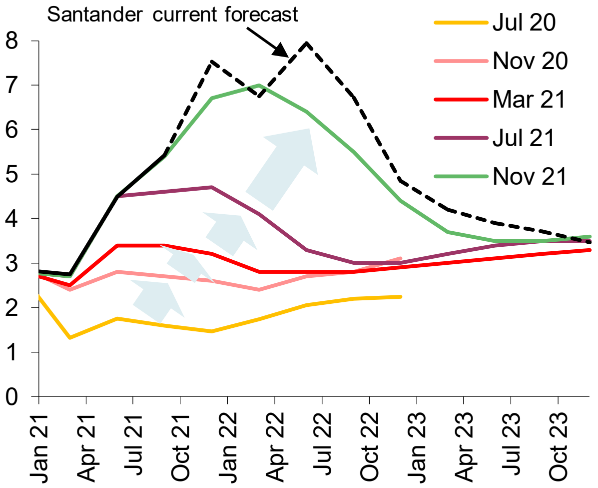
Source: Refinitiv Datastream, Santander Bank Polska

Real interest rates, %



Source: Refinitiv Datastream, Santander Bank Polska

NBP inflation projections



Source: GUS, Santander

MPC members' term of office

Appointed by	Name	Ends term of office
Senate	Kropiwnicki	25/01/2022
Senate	Gatnar	25/01/2022
Sejm	Ancyparowicz	09/02/2022
Sejm	Łon	09/02/2022
President	Zubelewicz	20/02/2022
President	Hardt	20/02/2022
Sejm	Żyżyński	30/03/2022
President/Sejm	Glapiński	21/06/2022
Senate	Sura*	16/11/2022
President	Kochalski	21/12/2025

Source: NBP, Santander

* Recommended to the Supreme Administrative Court, his appointment to the Court is up to the President

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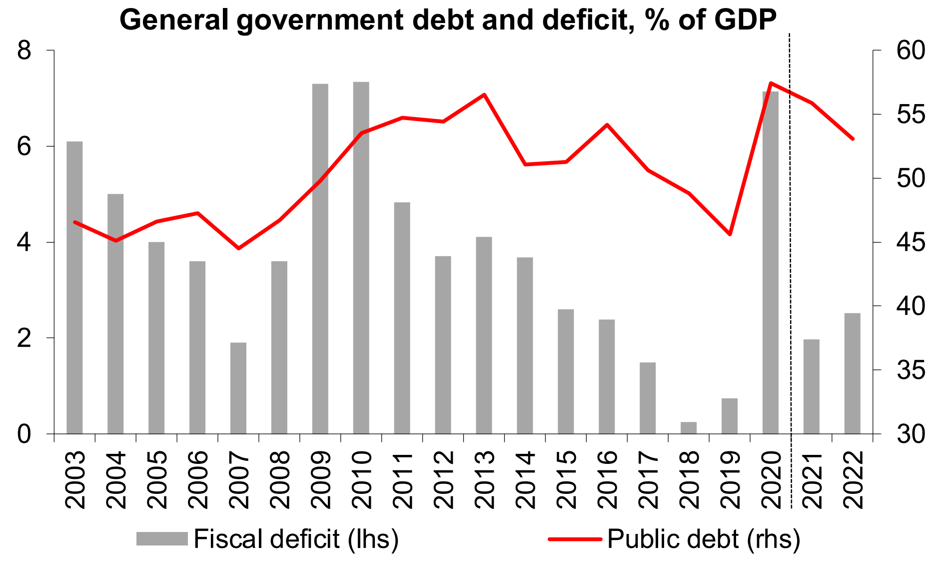
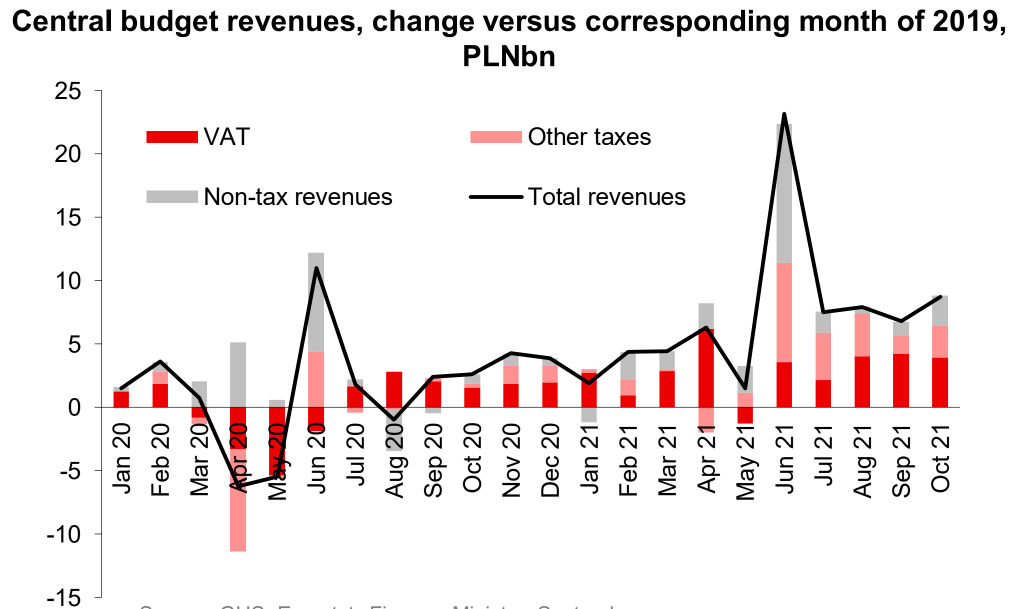
Base case (4/4): Fiscal deficit below 3% of GDP

Recent fiscal data was slightly better than we had expected and the major acceleration of inflation is positive for government revenues, so we are lowering our forecast of GG deficit in 2021 to 2% of GDP. We think that the October budget amendment (+PLN40bn to the spending limit) will again prove only to be a shift of spending items between 2022 and 2021 and will have limited impact on the deficit under Eurostat methodology. Recently, the Ministry of Finance's chief economist Łukasz Czernicki said that he expected the 2021 deficit to be "below 4%" of GDP, which we see as a very conservative assessment and expect a much better result.

We maintain our expectations for the 2022 deficit at 2.5% of GDP. Higher inflation and higher nominal GDP growth suggest upside for planned revenues but, on the other hand, the government may be tempted to use the opportunity to add some fiscal stimulus. The "anti-inflation shield" is supposed to be almost deficit-neutral by design, as its total cost of PLN10bn is to be partially offset by "savings in administration" and partially financed by revenues of energy-related public funds. We do, however, think that savings in administration, especially wages, can be hard to implement in an environment of strong wage growth. We think the government's appetite for further deficit reduction may be tamed by a willingness to offset tighter monetary conditions ahead of the looming 2023 elections.





Source: GUS, Eurostat, Finance Ministry, Santander

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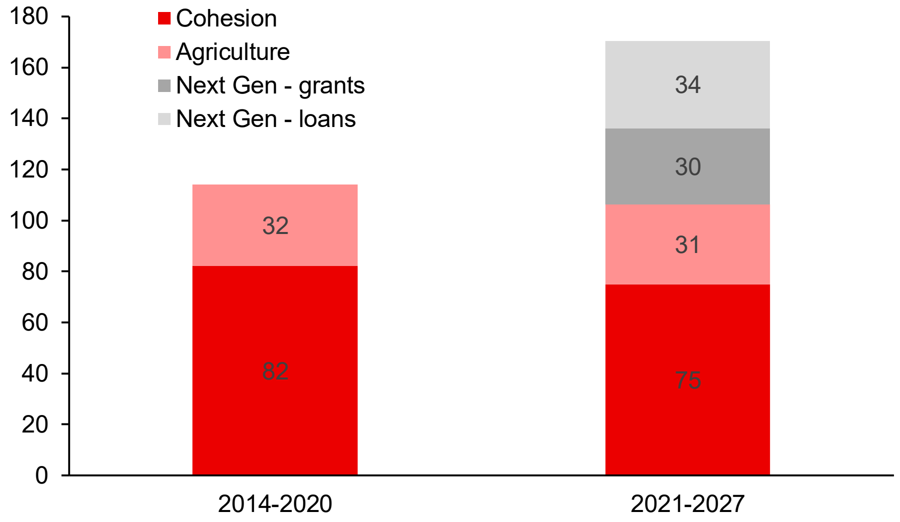
What if: EU funds are gone

We used to think that the EU Next Generation programme would have a negligible impact on Polish GDP growth in 2021, and that it would add 0.5pp in 2022 and 1.0pp in 2023. Poland's National Recovery and Resilience Plan still has no approval from the European Commission, which we believe implies no chance of the upfront payment of EUR4.7bn being made and will result in delays in investment. In our base-case scenario, we assume that the plan will eventually be approved in 1Q22 and the funds will be unlocked. Hence, we are trimming our estimate of the plan's impact by 0.2pp in 2022 in the baseline scenario.

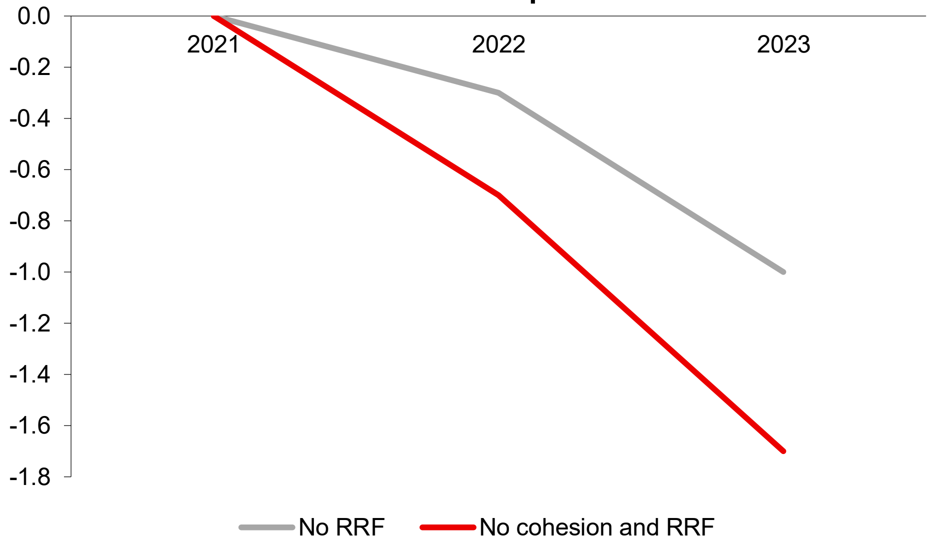
We cannot rule out, however, a risk scenario of no approval. In this case, we would have to trim our GDP forecasts for 2022 by 0.3pp and for 2023 by 1.0pp.

In a more extreme scenario, EU cohesion funds earmarked for Poland may be blocked in the second half of 2022 within the rule-of-law conditionality mechanism. Under such circumstances, we would trim Poland's GDP growth by 0.4pp in 2022 and 0.7pp in 2023. In our view, the probability of such a scenario is low and can materialise only if the National Recovery and Resilience Plan is not approved.

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



Deviation of GDP growth from baseline in risk scenario of EU funds suspension



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Source: GUS, European Commission Santander

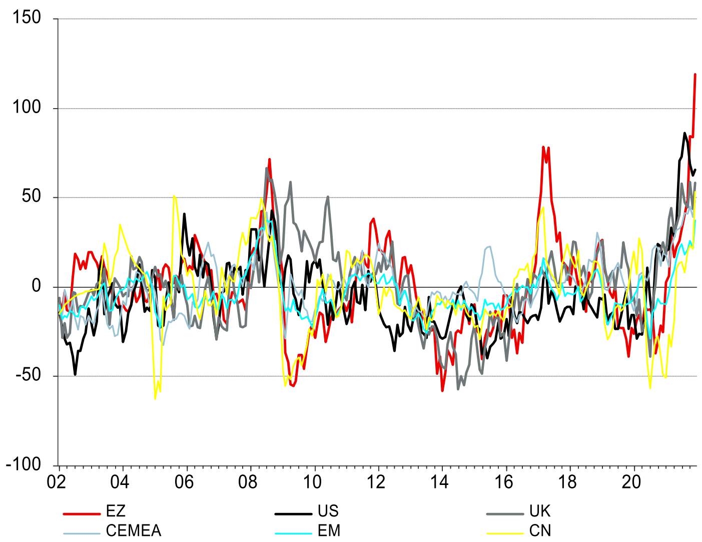
What if: Global inflation is harder to control

As inflation has been continuously surprising upwards in 2021, it cannot be ruled out that it will keep doing so in 2022. Prices of energy commodities are on the rise again at the turn of the year. Also, fertilizers' price go up as their accessibility declines (production is energy-intensive), especially for nitrogen-based fertilizers (produced from natural gas). This implies lower crops in 2022 and a risk of elevated global food prices from mid-2022 to mid-2023. The starting point for food prices is also high – the FAO index is at 10yr high now.

Higher inflation may prompt a stronger response by central banks than currently priced in. In our baseline scenario we expect NBP rates to go up to 3% in 2Q22. According to NBP models for assessing the monetary transmission mechanism (source) such hikes can deduct 0.3-0.6pp from GDP growth in 2022 and 0.3-1.4pp in 2023, versus scenario of rates remaining flat at 0.1%.

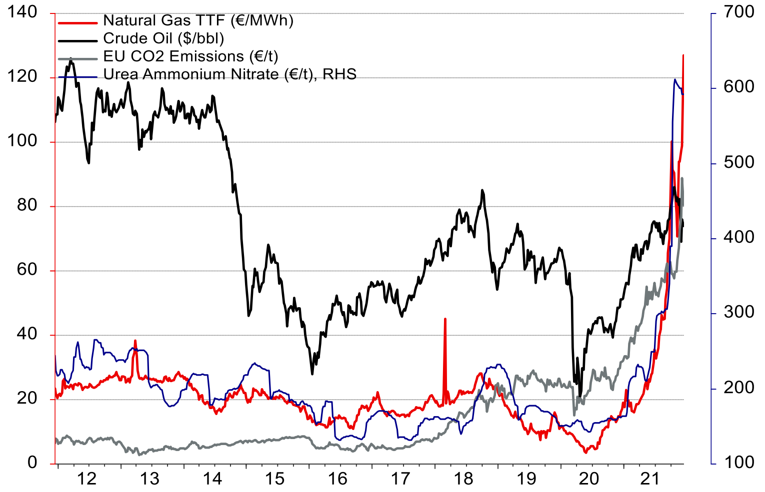
Rate hikes bringing the reference rate 200bp higher (to 5%) would deduct additionally 0.1-0.3pp in 2022 and 0.4-0.9pp in 2023. If, however, we assume that inflation surprises globally, but not only in Poland, the macroeconomic impact would obviously be stronger due to weaker global demand. Moreover, stronger monetary tightening would cause much market turbulence, possibly sending yields and EM currencies markedly higher.

CITI inflation surprise indicators



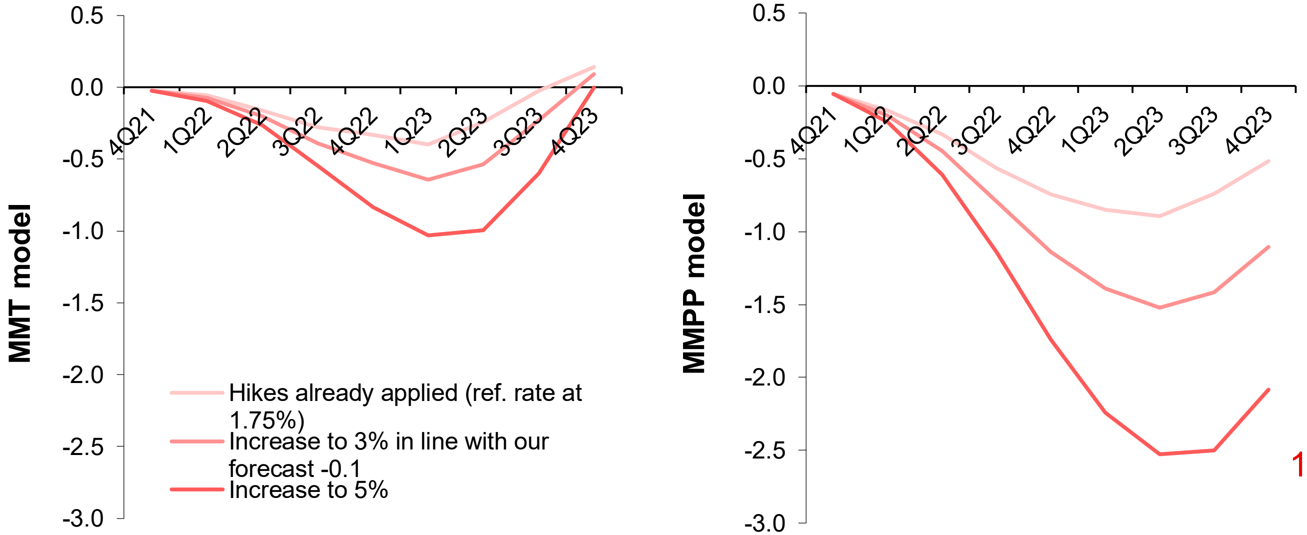
Source: Refinitiv Datastream, Santander

Commodity prices



Source: Refinitiv Datastream, Santander

Impact of rate hikes on GDP growth according to NBP models (% y/y, vs rates flat at 0.10%)



Source: Santander estimates based on NBP research results

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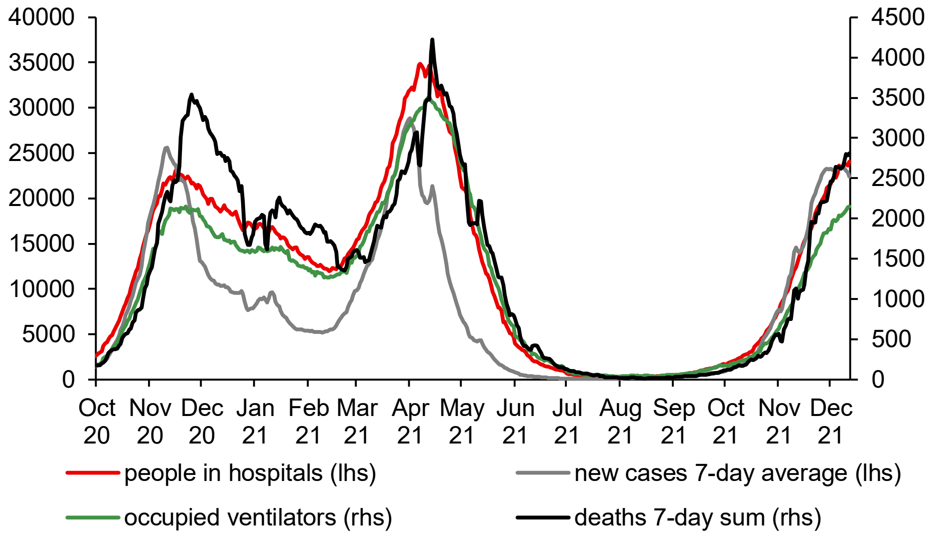
What if: Covid-19 gets more severe

The 4th Covid-19 wave in Poland seems to be levelling off. The government has not introduced any tougher restrictions during the current wave, even though it is comparable in severity to the 2020 autumn/winter and 2021 spring waves. One interesting feature of the current wave is the number of quarantined persons, which has been way higher than in the previous waves, with a peak so far of 782k on 2 December. This may affect labour supply and thus economic output, but we think this effect will be far less severe than the impact of lockdowns imposed in earlier waves of pandemic.

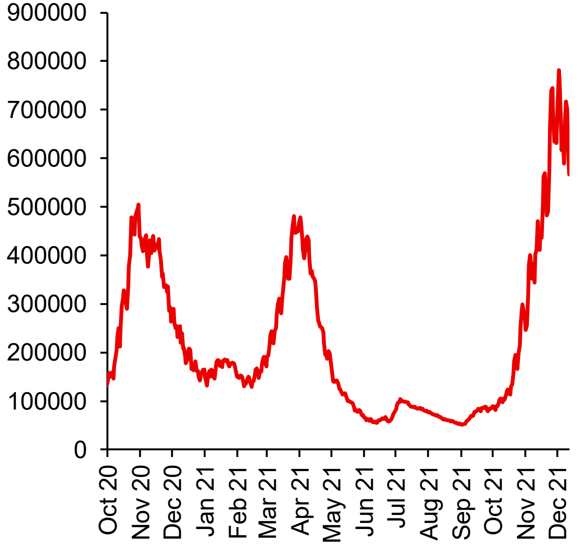
New strains have emerged that are highly infectious (Omicron), but their severity is not well established. While the current level of epidemic severity (especially deaths) has not encouraged the government to introduce restrictions, we cannot rule out that this will change if future waves prove more deadly. New lockdowns would hurt the economic growth.

Poland remains very vulnerable to the virus: even though booster vaccinations have started and are moving at a fast rate, a huge chunk of population remains reluctant to get jabbed, so the total vaccination rate is lingering slightly over 50% and remains well below herd immunity thresholds and is one of the lowest levels in the EU.

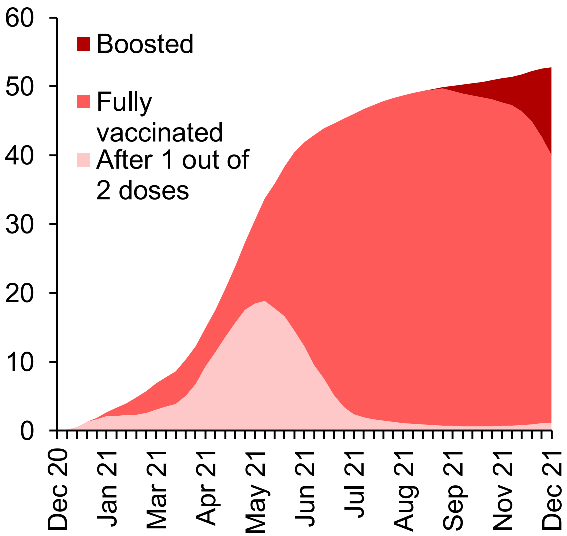
Covid-19 in Poland – main figures



Quarantined people in Poland



Percent of population vaccinated in Poland



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Source: ECDC, Ministry of Health, Michał Rogalski, Santander

What if: Global growth falters

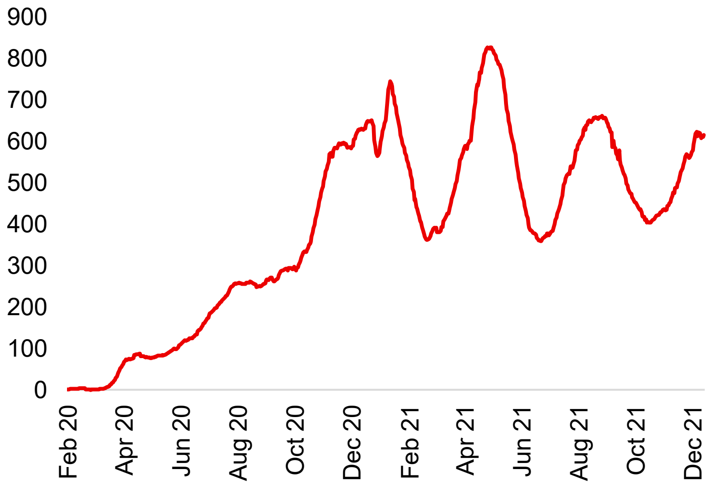
2021 was a challenging year for global growth. Despite all the know-how in handling the pandemic we cannot be sure what will the consequences of next virus mutations will be. There is a clear progress when it comes reducing deaths, at least in most developed countries with high vaccination rates, but the global count of new cases is not trending down yet, so the virus may keep spreading and mutating. The Omicron strain is more contagious than previous ones, but so far seems relatively benign.

Albeit we still see severe global supply issues as temporary, we may be wrong. They have already lasted longer than expected and a further extension may cause structural damage in the most exposed sectors like the automotive industry. The reduced ability to cover demand due to shortages adds friction to global growth. The need to expand stocks of input is another burden on companies.

Global trade turnover was quick to recover to its pre-pandemic trend (in 1H21), but recently momentum seems to have been lost.

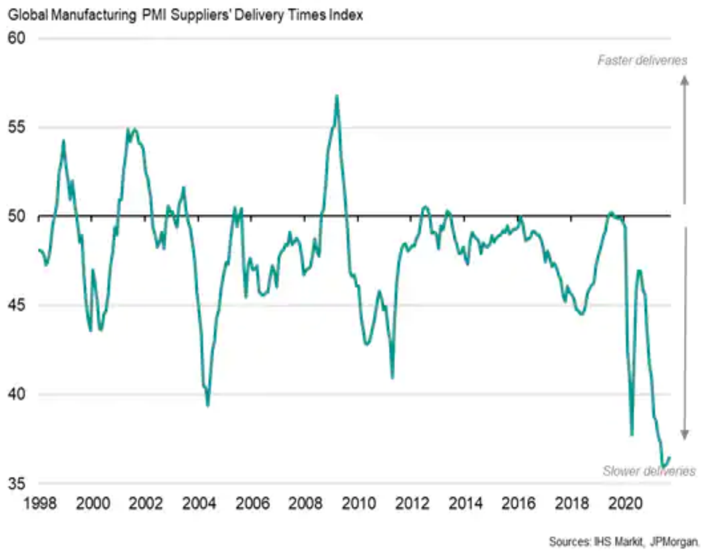
China's recent move against the global monetary policy tightening trend, the RRR cut (the second in 2021), shows that one of the key global economies does not seem comfortable with how the recovery is going. Its property market is a source of considerable risk to growth.

Global daily new coronavirus cases, 7DMA (k)

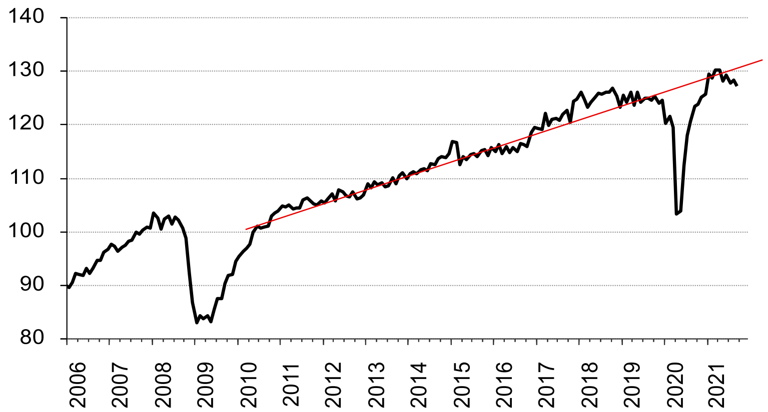


Source: ourworldindata.org, Santander

Global manufacturing supply delays



CBP index of global exports volume, 2010=100



Source: Refinitiv Datastream, Santander

Consumption: Solid income plus excess savings buffer

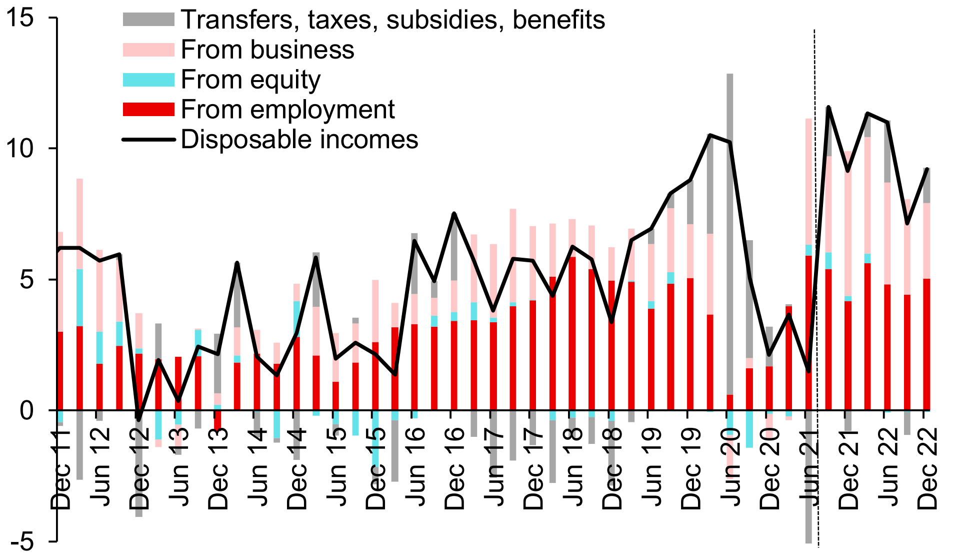
The strong and fast pace of inflation could potentially hit consumer spending when prices are rising faster than incomes. However, in the longer term these monetary distortions should disappear, as higher prices will feed into wages (especially if employees' bargaining position is strong), pensions and incomes from equity.

Thus, we are expecting household disposable incomes to show quite a high growth rate in 2022, additionally supported by changes introduced in the Polish Deal (changes in taxes, new benefits for children– PLN20bn in total), and the anti-inflation shield (PLN3.5bn), which should more than offset the negative net effect of rate hikes on interest payments (PLN10-15bn).

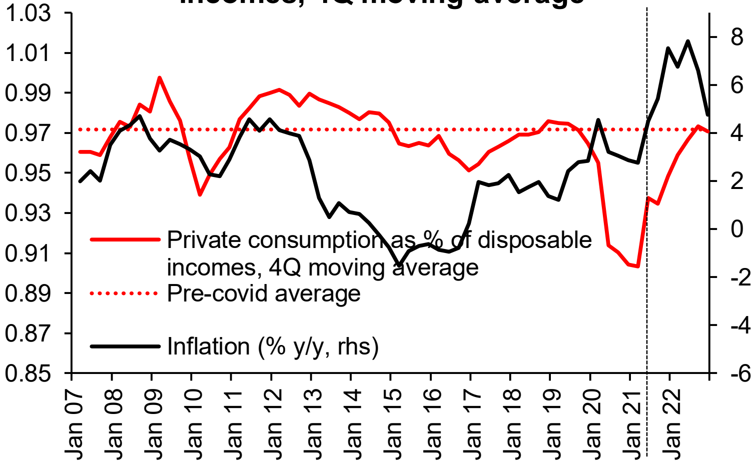
With strong growth in incomes, households will be able to continue normalising their consumption levels vs. their incomes (reduction of excess savings). Note that a rise in consumption-to-income ratio is typical when inflation is rising, as households strive to smooth their consumption path.

Weaker consumer sentiment in 4Q may signal households' higher cautiousness in 2022. A strongly dropping gauge of financial expectations usually has led to private consumption slowdown. However, unlike previous episodes, worries about future household budgets are uncorrelated with job security – which has remained stable and near its highest levels since the start of the pandemic.

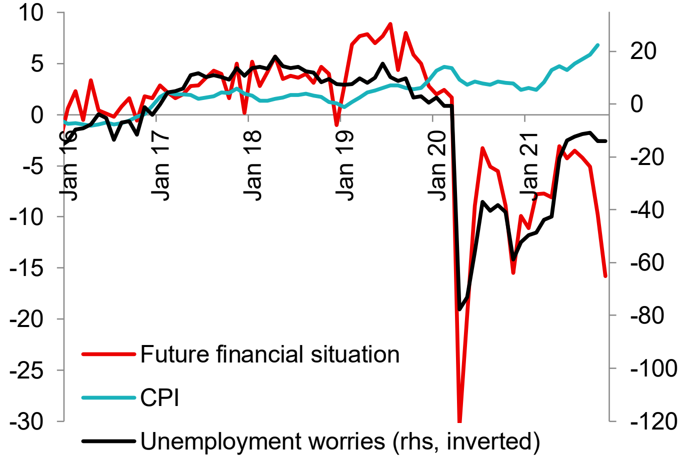
Household disposable incomes (nominal prices, % y/y)



Private consumption as % of disposable incomes, 4Q moving average



Consumer sentiment indicators



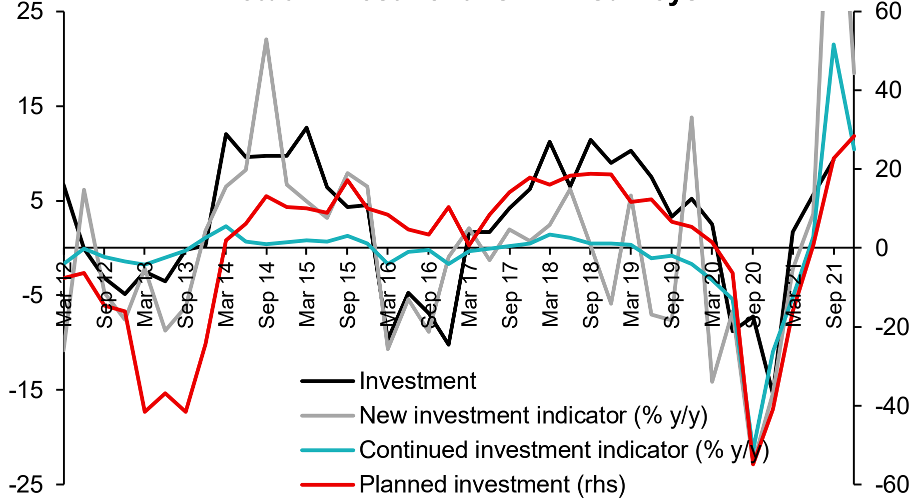
Investment: Private sector ahead of public sector

We are quite optimistic about investment in 2022, especially as regards companies and households, while the public sector may remain sluggish (but road construction is likely to be strong). In our view, delays in the National Recovery Plan are already causing delays in actual investment so we are trimming 0.2pp from our assumption of the Plan's 0.5pp positive contribution to growth in 2022 (equal to roughly 1pp of investment growth).

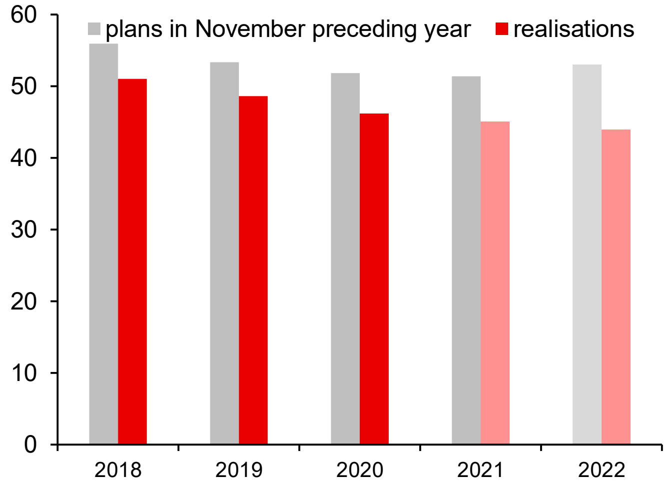
Non-financial companies have entered high investment activity mode and we think they will continue to invest in 2022 thanks to their strong financial standing, high level of capacity utilisation and problems with finding staff. Investment surveys also point to optimism on that matter. On the other side, however, problems in the car industry are clearly weighing on companies' investment in transport and other machinery, although this can actually support investment in 2022 at the cost of 2021.

We are less optimistic about public investment, though. November financial plans for local governments have not been released yet. August plans suggest a moderate rise in investment, but we think that delay in the National Recovery Plan will not allow for that. In our annual outlook for 2021 we mentioned ambitious investment plans of GDDKiA (road-building agency) and PLK (railway-building agency). GDDKiA is very active with signed contracts for 480km of roads worth PLN14.5bn, ongoing tenders for 312km and plans to start tenders for 100km more in 4Q21. Plans for 2022 are rather modest so far (250km), but high realisation in 2021 is, in our view, enough to generate high activity in 2022. On the other hand, PLK failed to deliver, with only about PLN3.0bn tenders opened as compared to plans of PLN17.0bn. Railways are struggling with financing problems (maybe the 2021 budget amendment assigning more funds will help). Thus, 2022 is likely to be very sluggish.

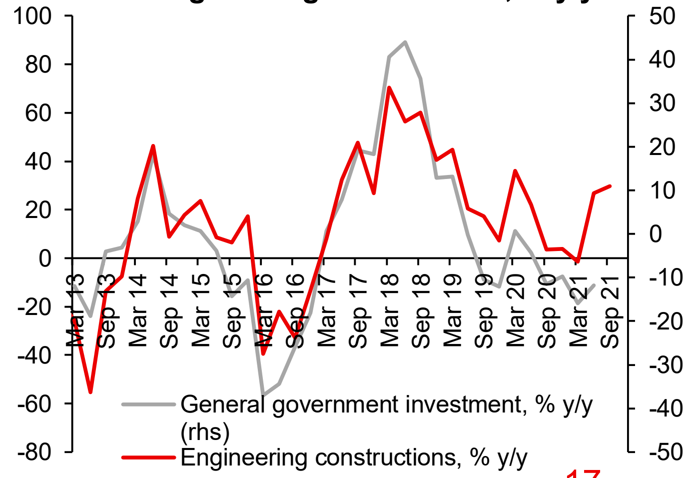
Actual investment vs NBP surveys



Local governments – investment plans and realisations, PLNbn



Investment in general government sector vs engineering construction, % y/y



Santander

Source: GUS, NBP, Finance Ministry, Santander

Labour market: Elevated wage pressure

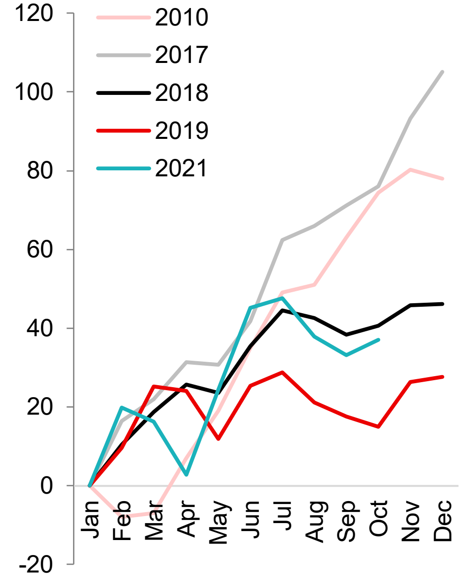
Thanks to the positive economic momentum building throughout 2021, the number of unemployed has already halved from the pandemic peak to pre-Covid levels and is at about the average level seen in 2018-2019 when acute labour shortages were reported. The same can be said about the unemployment rate as labour demand is already strong.

Survey-based labour shortage indexes are also showing that the market is getting tighter. As a result, in year-to-date terms, employment rises in 2021 behave like 2018-2019 when labour supply was already scarce and not like in the booming 2017 and the post-GFC 2010.

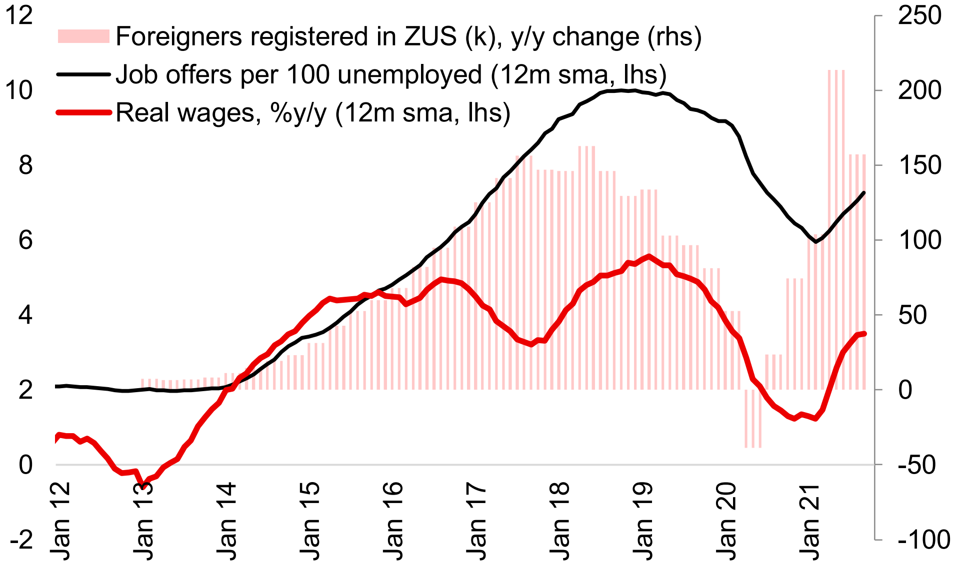
Add to this the quickly growing cost of living and it seems that wages should keep growing at an elevated pace in 2022 in nominal terms also. The rise of inflation has been so quick that it may temporarily dampen real wage growth.

LFS data have signalled that there is a significant reactivation taking place as Covid fears subside (the opposite of the escape to inactivity seen early in the pandemic), wages keep growing fast, and inflation is denting incomes. The inflow of foreign workers also seems to have accelerated, judging by social security registrations. These factors could alleviate labour shortage problems and prevent wage growth from reaching double-digit values.

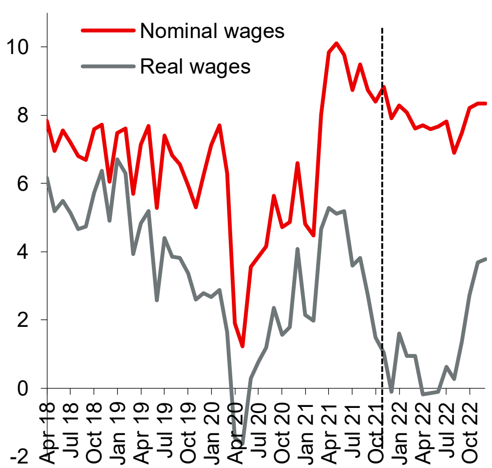
Year-to-date average employment change (k)



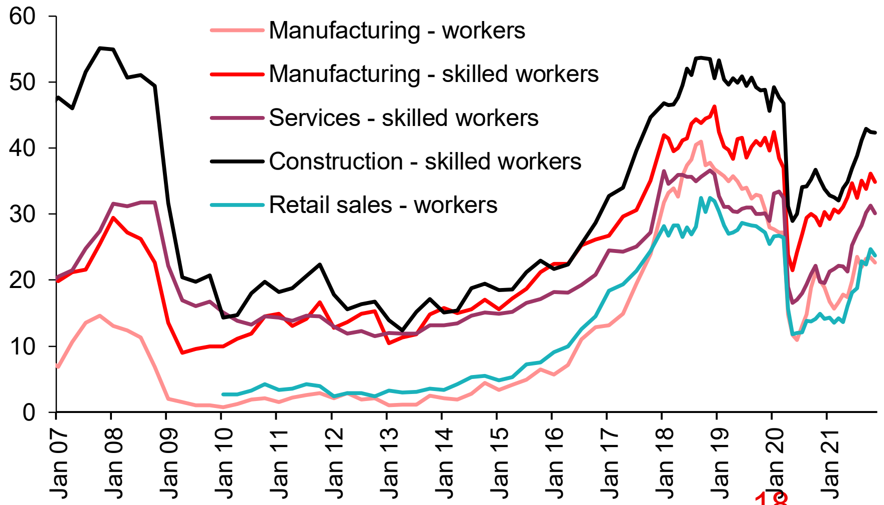
Job offers vs. real wage growth in the corporate sector



Wages in the corporate sector, %y/y



Labour shortage indexes



Source: GUS, Santander

Santander

Real estate market: Still busy

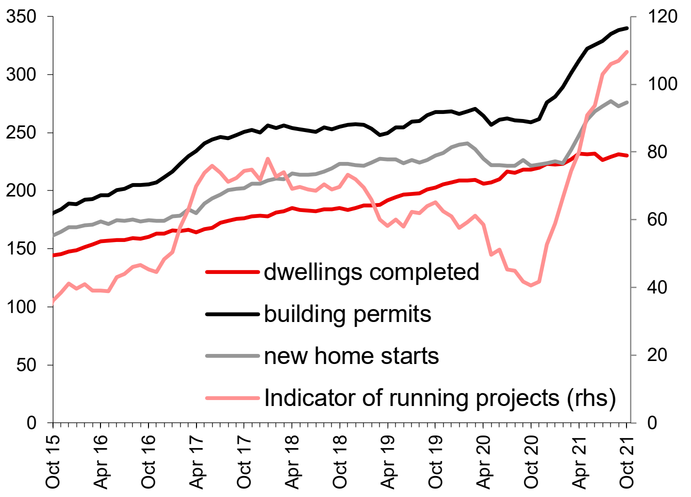
In our view, the housing market will remain active, with only slightly weaker demand vs. 2021 and higher prices. Developers are likely to cut their margins somewhat.

Activity of housing developers is currently high, with many projects ongoing. This means that supply of new houses will remain at a high level in 2022. While higher supply is an argument for lower prices, construction costs are soaring, so the effect of higher supply is likely to be offset, and we expect the sector will be forced to shave some margins.

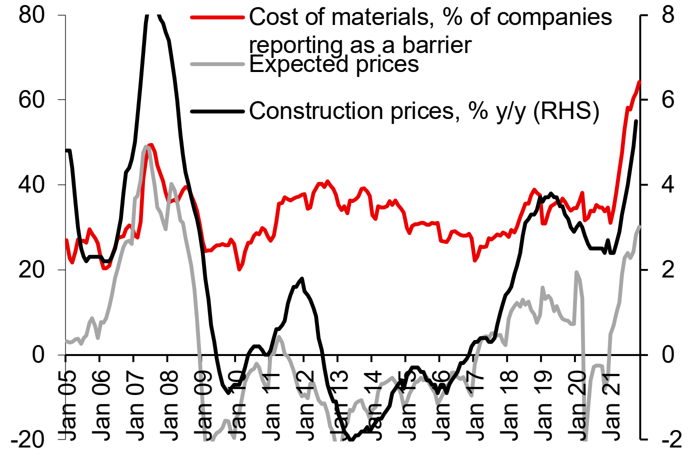
The demand side is a bit more challenging, though. Right now it is really strong and we think it will remain so at least through 1Q22, as house purchase is a rather lengthy process, with much inertia. Later, the effect of higher rates is likely to discourage potential borrowers. We expect monthly mortgage loan payments to go up by 50% in 2022 vs. mid-2021 and to approach the historical highs from 2010-2012 (earlier statistics are not comparable as FX-denominated mortgages were more popular at that time).

However, as we expect the financial situation of households to remain sound and the real interest rates to remain deep in the negative territory, the housing market may still be viewed as a vehicle for storing value in a high inflation environment and this could prop up the demand side, especially among cash buyers.

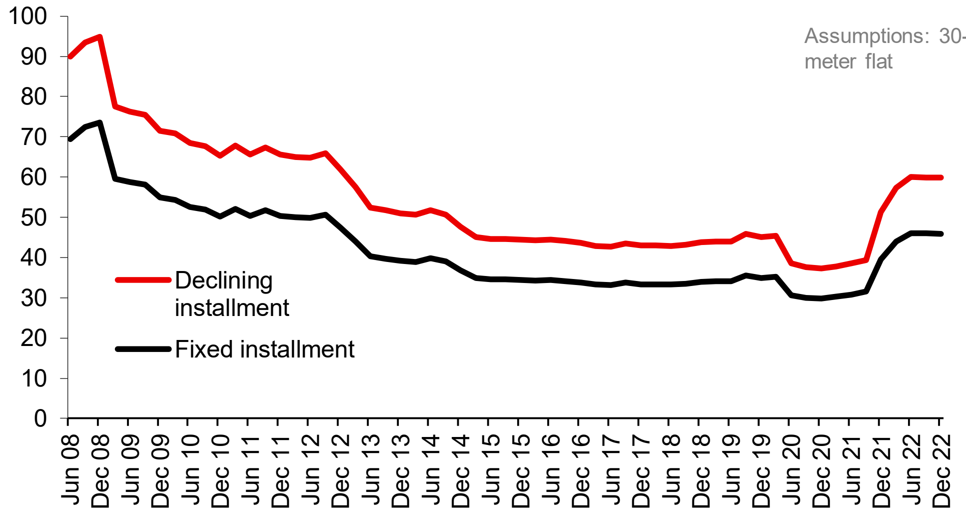
Housing market activity, 12m sums, thousands



Construction costs



PLN Mortgage monthly payments as % of average wage



Assumptions: 30-year mortgage for a 60 square meter flat

Source: GUS, Santander

Santander

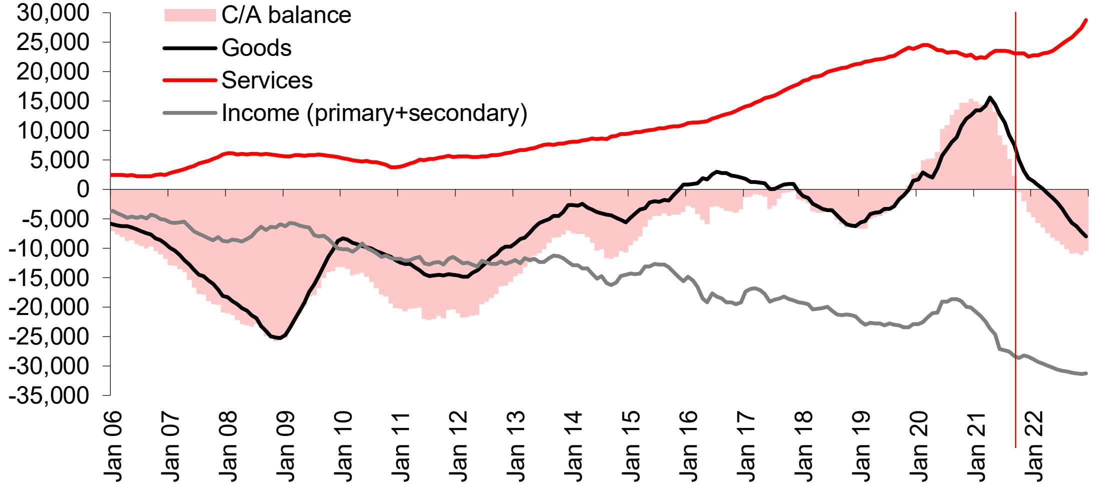
Current account: Return to (moderate) deficit

The huge current account surplus in 2020 was not justified by a structural change in Polish trade competitiveness, but to a large extent by a temporary demand suspension enforced by lockdowns. Thus, a rapid deterioration of C/A balance in 2021 can be seen as a normalisation, although boosted by some additional factors: (1) Exports of goods was weakened by a stagnation in the automotive industry, (2) Imports were boosted by sharply rising commodity prices, especially energy commodities (the oil price rise since spring alone pushed up import value by €0.9bn, or 4%). We expect these two modifiers to fade in 2022. However, strong domestic demand should keep net goods trade at moderate negative levels.

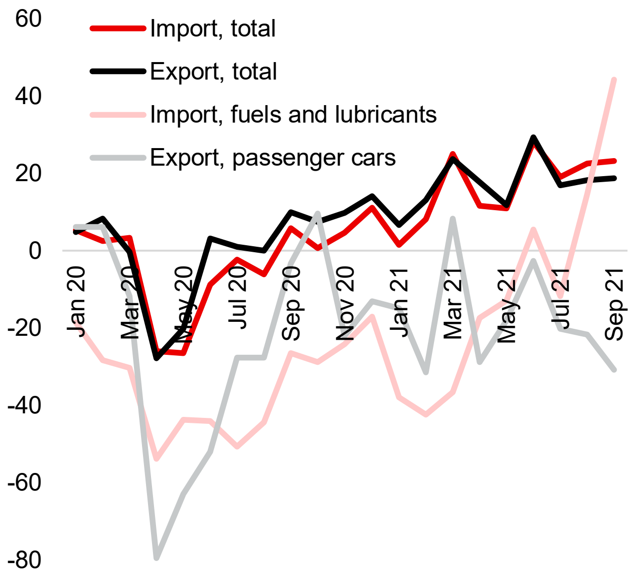
So far in the pandemic the balance of services trade has been unable to regain its strong positive trend. Out of the five main services industries, only two are back to normal i.e. contributing positively to the total balance in line with the pre-Covid trend (various business services including IT, and repair and maintenance), while three are still depressed by the pandemic: transportation (responsible for some €0.6bn of the €1bn deviation from the pre-Covid trend in the total services balance), processing of goods, and travel. Their rebound seems only a matter of time.

The income balance turned even more negative with this year's strong rebound in companies' financial results. The high net inflow of returning foreign workers is leading to significantly higher transfers abroad. This component is unlikely to change direction in 2022.

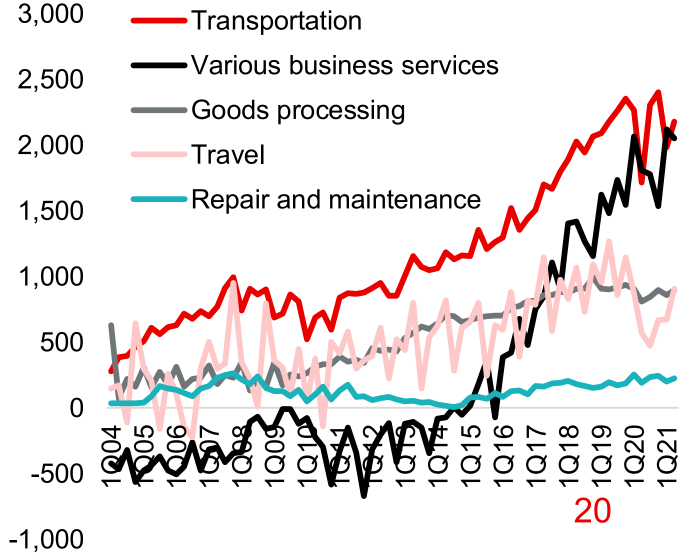
12M mov. sum of C/A and main components



% Trade growth vs. same month of 2019



Services balances, €mn



Source: GUS, Santander

Santander

Financial markets

2

Global context

Our house view:

- **10Y UST at 1.75% Eo21 and 2.20% Eo22,**
- **10Y Bund at -0.15% Eo21 and 0.50% Eo22.**

The need to tighten financial conditions in the US (and possibly in the Eurozone) creates a negative backdrop for EM assets, including Polish ones.

Inflation rates that the Fed and ECB are targeting (PCE and HICP, respectively) have risen much above the respective targets (top row).

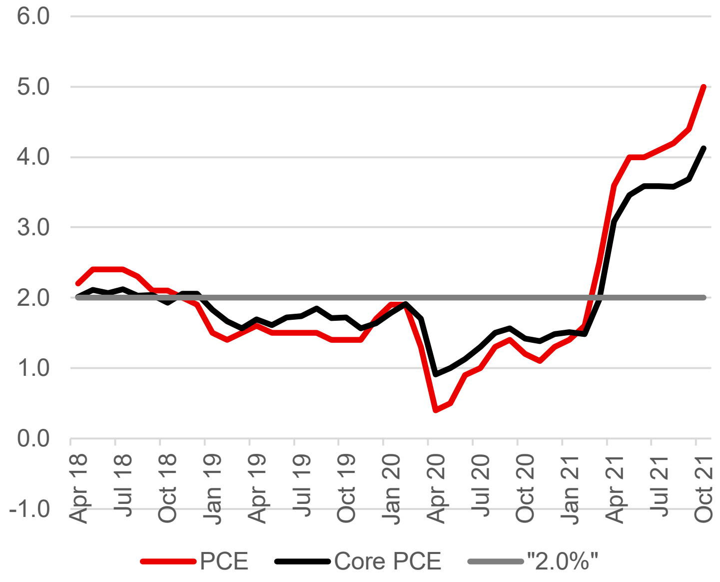
During the Congressional hearing on 30 October, the Fed's Jerome Powell retired the word "transitory" in relation to describing price dynamics in the US:

"*We tend to use **>>transitory<<** to mean that it won't leave a permanent mark in the form of higher inflation".* Also, *"I think it's probably a good time to retire that word and try to explain more clearly what we mean*".

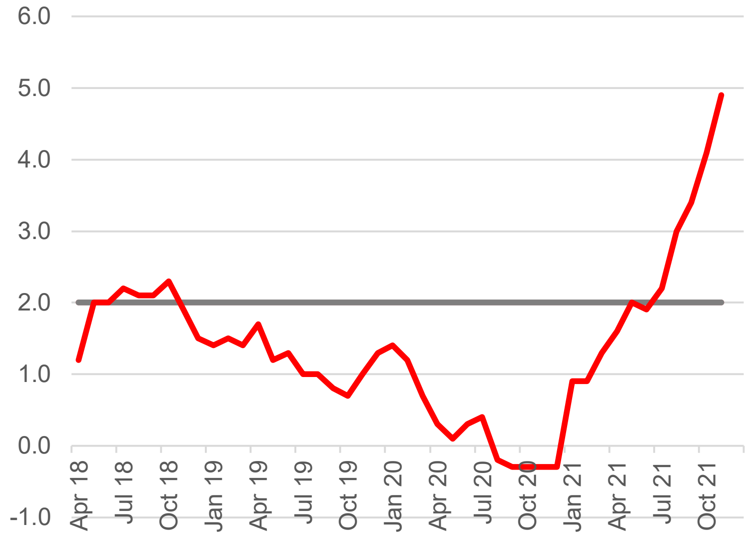
Despite increasing inflation, the ECB's Christina Lagarde said that it is "*very unlikely*" that the ECB will raise rates in 2022. But added that "*when conditions of our forward guidance are satisfied, we will not hesitate to act*".

Rates markets adjusted accordingly: around 90bp of rate hikes are priced in in the US as of December 2022, more than the dot-plot. In Europe markets so far believe the narrative of Ms. Lagarde, and rates expectations have only budged a little and only 2 years from now (bottom row).

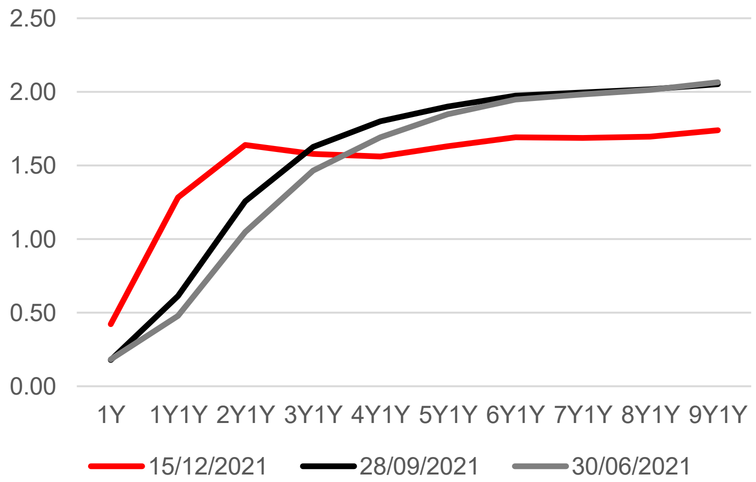
PCE and core PCE inflation vs Fed inflation target



HICP inflation vs ECB inflation target

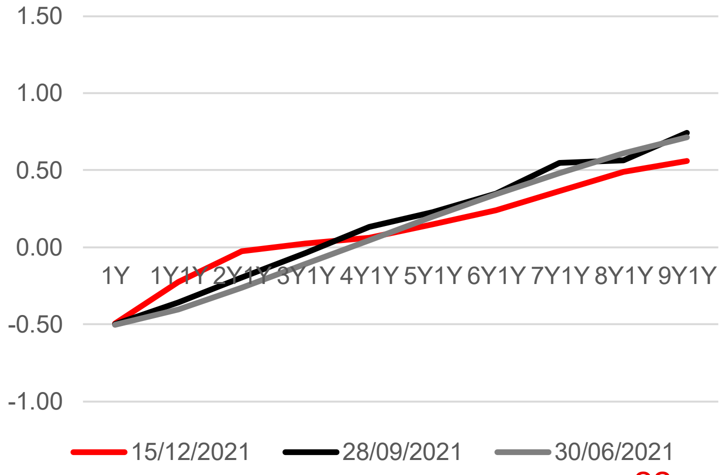


Forward IRS Curve in the US (1Y tenors)



Source: Bloomberg, Santander

Forward IRS Curve in the Eurozone (1Y tenors)



Source: Bloomberg, Santander

Santander

Regional context

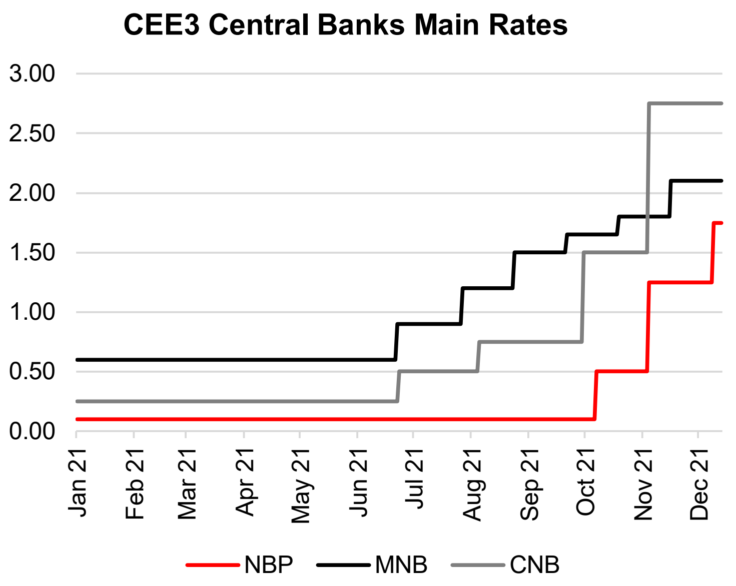
The MNB and NBP have lagged the hawkish CNB in terms of timing (NBP) and the size of hikes (MNB) for the last two quarters in the current hiking cycle. Now they seem to be catching up. **If they continue their hiking cycles in a credible way, the local currency sell-off might turn out only to be short-lived, even in the context of Fed tapering.**

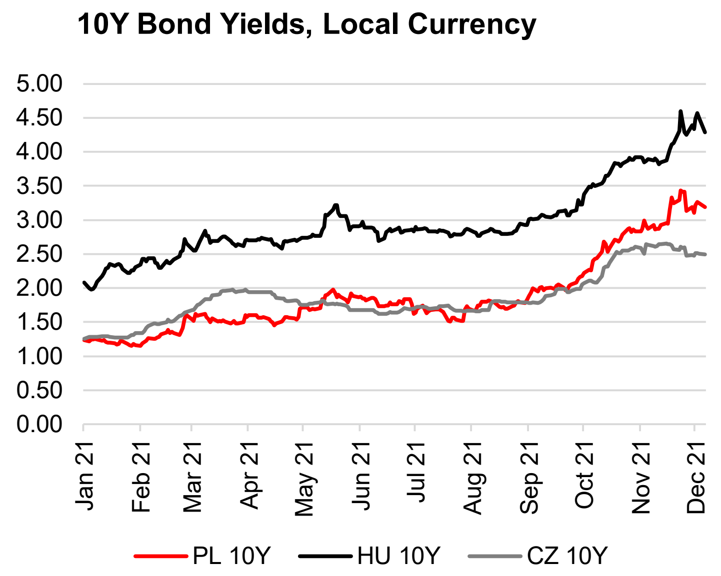
In light of the elevated headline CPI inflation in November (Poland 7.8% y/y, Hungary 7.3% y/y, Czech 6.0% y/y) the CEE3 central banks are in interest rate hiking cycles. As a result, financial conditions have tightened (top row charts).

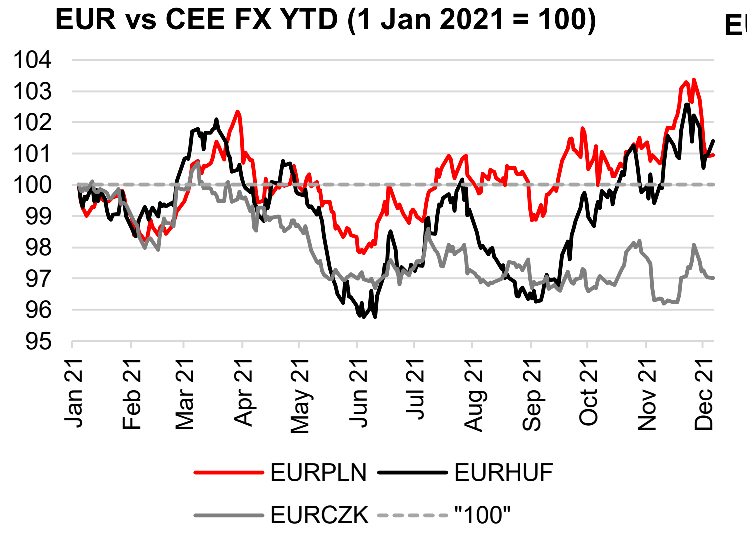
The most aggressive tightening took place in the Czech Republic and this has helped keep EURCZK under control: EURCZK has declined YTD (bottom left chart). On the other hand, both the EURHUF and EURPLN are higher YTD, which partly reflects the fact that the hiking cycle started later (NBP) or has been progressing in small steps (MNB).

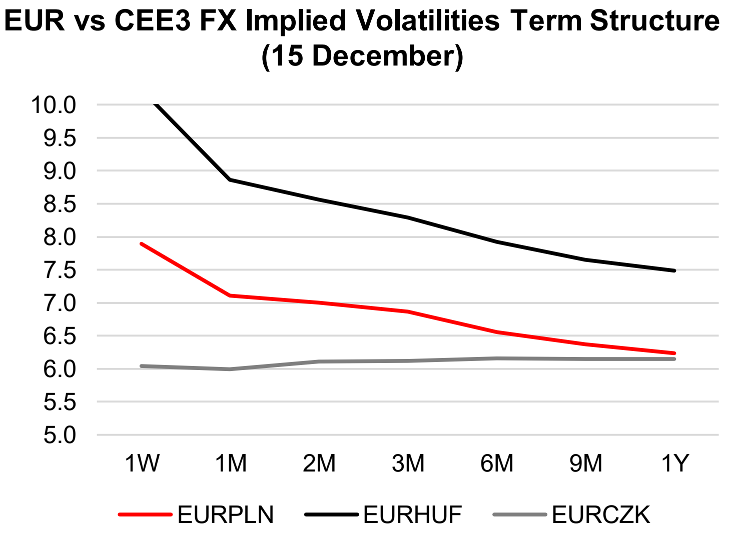
If the MNB and NBP continue tightening in a credible way (e.g. MNB has decided lately on: a higher rate corridor, higher 1-week deposit rate, and the end of QE. While the NBP is mulling a continuation of hikes at "a similar pace as so far") the HUF and PLN sell-off due to Fed tapering may only be short-lived.

Recently, EURPLN and EURHUF implied volatility term structures have inverted (bottom right charts) which suggests investors have become slightly nervous. Possible reasons include fears about the year-end NBP FX interventions (as happened exactly one year ago) in order to weaken the zloty and boost the NBP's return, which is mainly transferred to the state, as well as uncertainty related to Fed and ECB meetings.









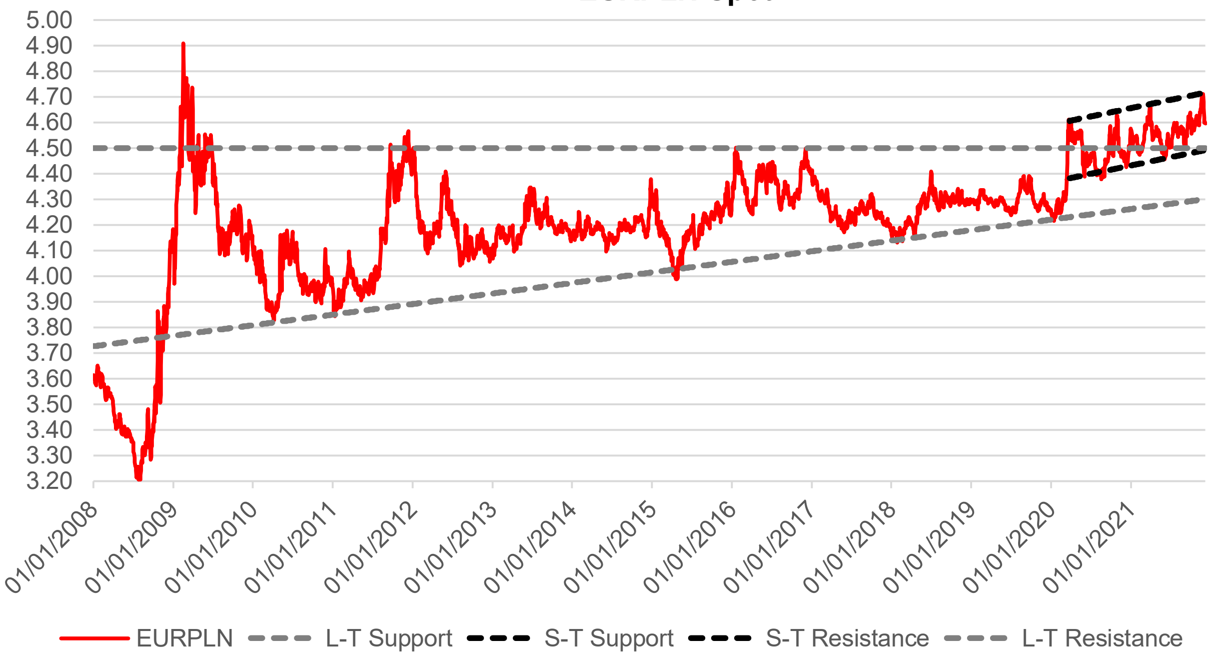
Source: Bloomberg, Santander

FX market: EURPLN gradually lower

We expect EURPLN at 4.65 at the end of 2021 after which it should decline towards 4.50 by the end of 2022, based on a still solid performance by the Polish economy, but also on clearly higher NBP interest rates and unlocking EU funding after the rule of law conflict is solved. Here are a few factors to watch:

- **Stronger dollar**. The acceleration of Fed tapering and the prospect of US interest rate increases by spring 2022 might strengthen the USD and put extra pressure on EM FX. **We forecasts EURUSD at 1.10 in 1Q22 and at 1.18 by 4Q22.**
- Money from **EU Recovery Fund**. The Polish government missed the upfront payment, but a deal is still possible at the beginning of 2022. Please see page 12.
- **Local monetary policy**. We expect NBP rate hikes to stop at 3.0% in mid-2022 (see page 10). This forecast is more or less in line with current market pricing. PLN might be under pressure in case NBP under-delivers the hikes.
- **Covid-19** became less important for the economy as people adjusted to working from home. Also, Omicron Covid-19 variant seems to be less severe. We expect lower impact on PLN from this risk source going forward.
- **Geopolitics.** Conflict on the EU eastern border might linger for longer and escalate.

EURPLN Spot



Source: Bloomberg, Santander

EURPLN in a long-term perspective. One might see that due to the Covid-19 pandemic, EURPLN has finally broken above from the long-term wedge (grey, dashed). The multi-year resistance at 4.50 has become a new support.

EURPLN in a short-term perspective. The mini-trend (black, dashed) is upward sloping with current bands at 4.50 and 4.70.

Despite our bullishness on the PLN in 2022, we think it is very unlikely for EURPLN to fall below 4.50. This level is a double support (for both long-term and short-term).

On the other hand, further zloty weakening might encounter significant resistance at 4.70 (upper band of the upward trend). Only if the 4.70 level breaks would the path to 4.90 (all-time high from the Lehman crisis) be open.

FI market: Flattening yield curve

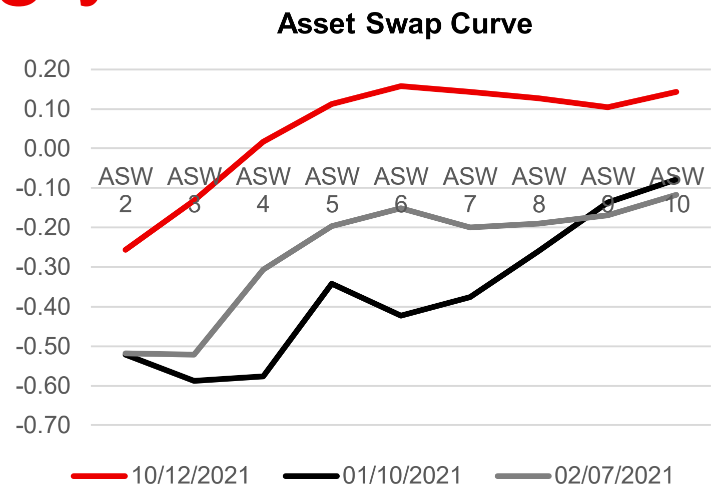
In 2021, the bond curve flattened significantly (bottom left) as the NBP hiked rates. In 4Q21 asset swaps have almost returned to their pre-pandemic levels (top left) as the NBP wound down the QE program.

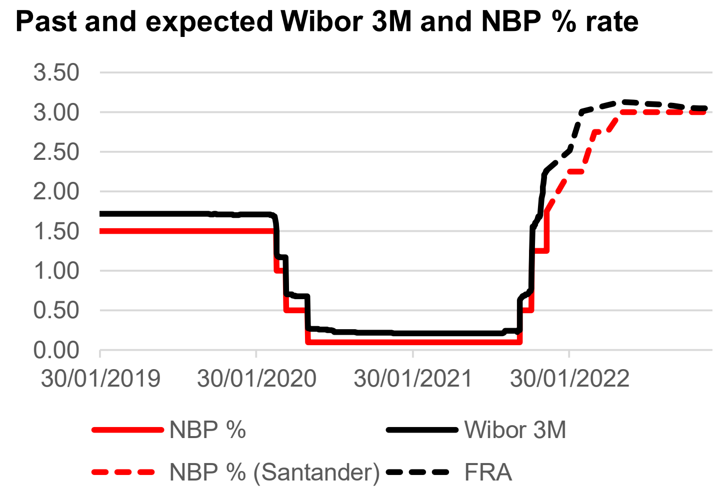
We expect 2Y bond yield at 3.10% at the end of 2022. Rates markets have priced in a lot of the tightening already. The 2Y POLGB yield spread vs NBP reference rate should narrow as 2022 progresses.

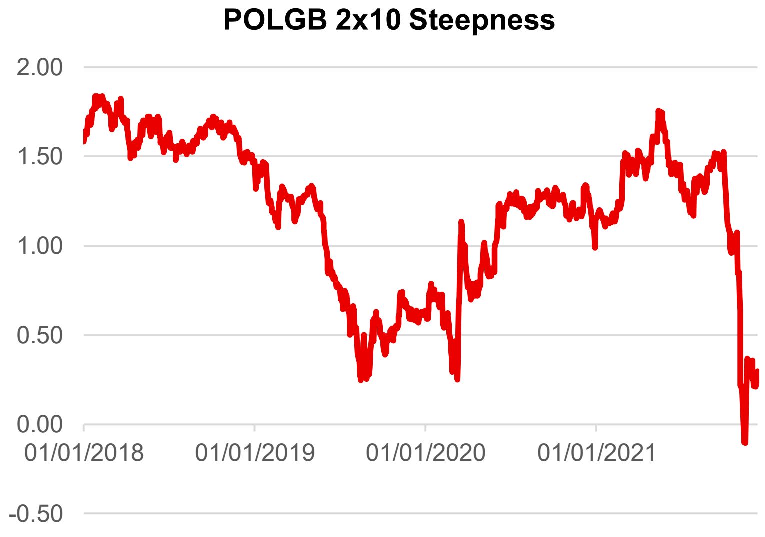
In our base scenario, we expect 10Y bond yields to end 2022 at 3.20%. This is a natural consequence of: a) our expectation of the NBP's terminal rate at 3.0% by mid-2022, and b) the fact that 2x10 curve often inverts when the hiking cycle comes to an end.

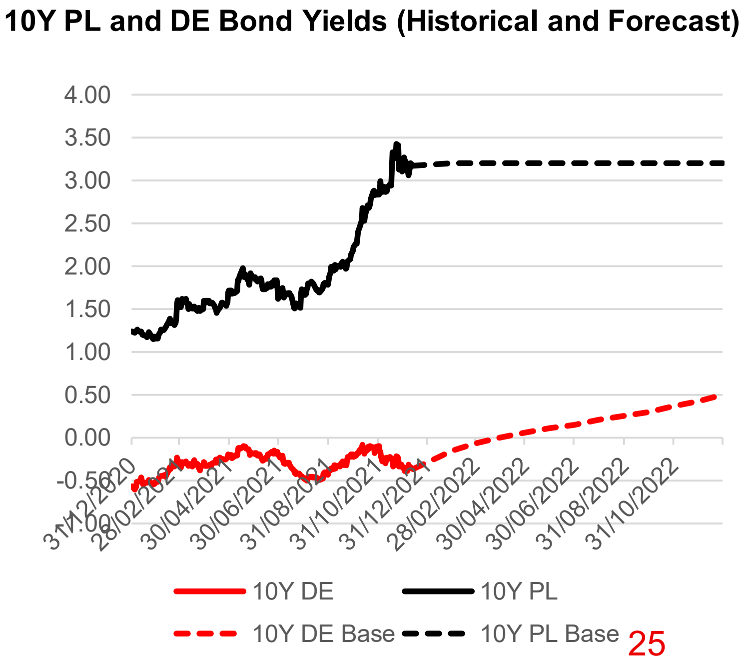
We reckon yields might remain roughly unchanged year on year (3.20%), despite the expected rise in core markets' yields.

There are risks, however. If risk factors materialise (see p.12-15) with a potentially negative impact on Polish GDP growth, it might lead to lower long-end yields, possibly reaching 2.5% or less.









Santander

Source: Bloomberg, Santander

Redemptions and coupon payments in 2022

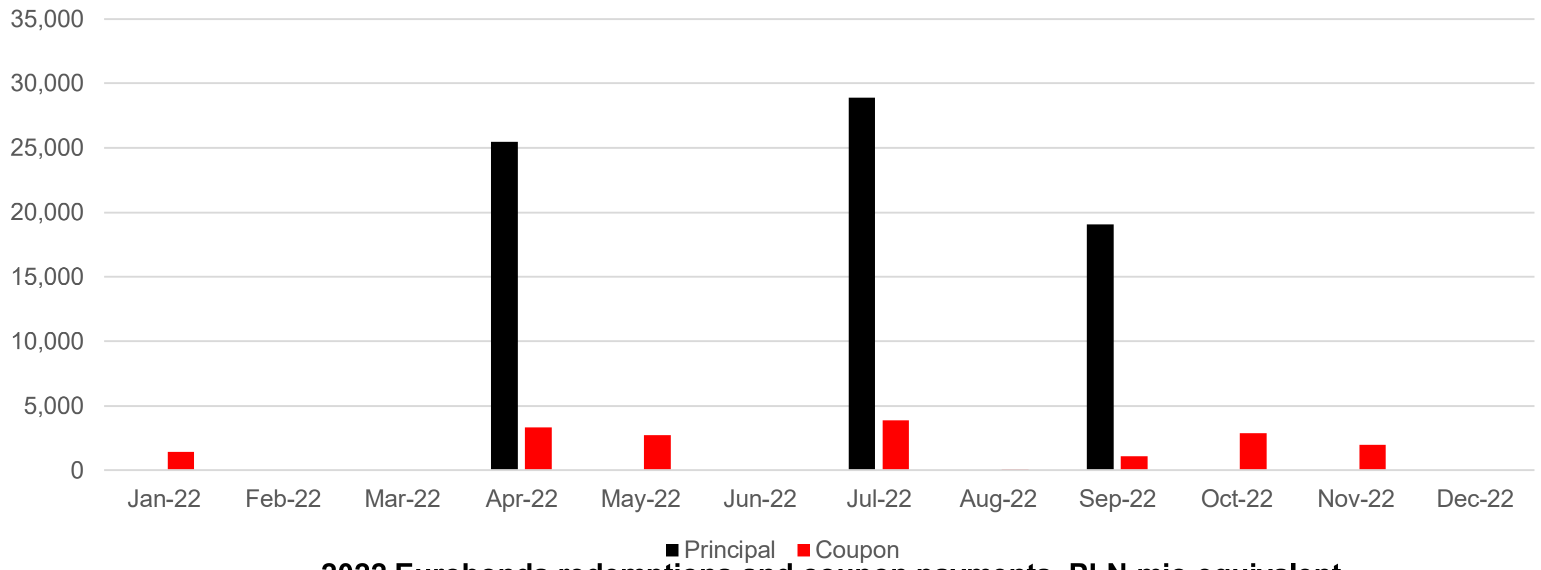
As for PLN-denominated government bonds, in 2022 a total of PLN73.5bn of bonds mature. The maturities come in April (PS0422, PLN 25.5bn), July (OK0722 and PP0722, total PLN 28.9bn) and September (WS0922, PLN 19.1bn).

In 2022, a total of PLN17.4bn of coupons will be paid. The amount was computed at WIBOR 6M at 2.58%. As WIBOR 6M might increase further, the amount of coupons might increase as well.

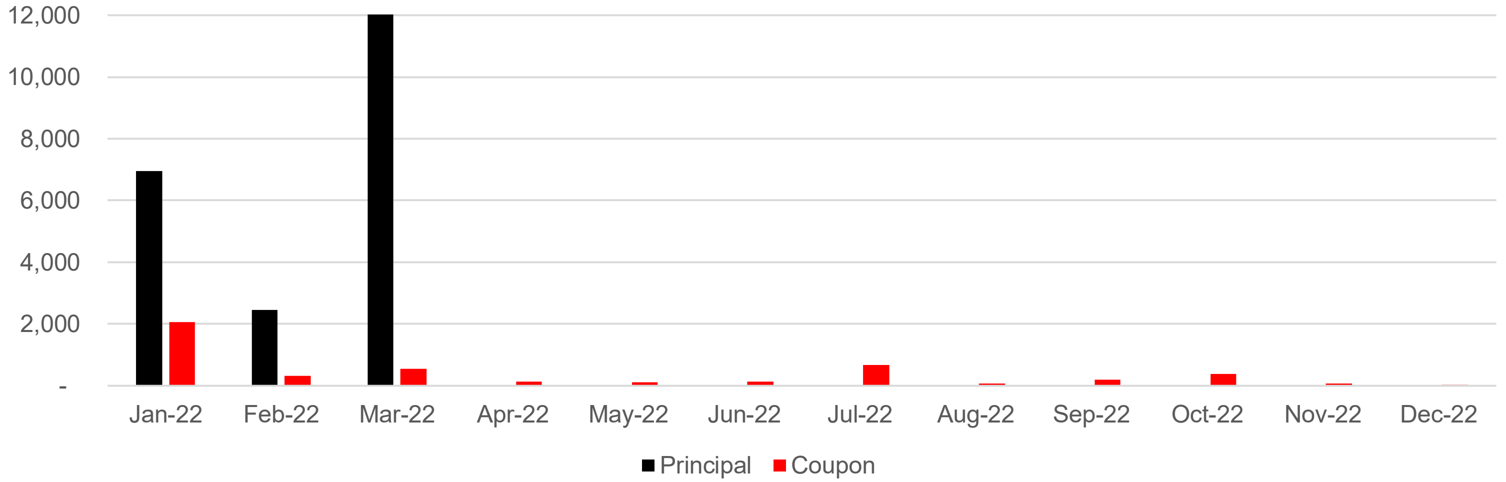
As for foreign currency-denominated government bonds, in 2022 a total of cPLN22.0bn matures, and all of it in the first quarter (EUR bonds in January and February; USD bond in March).

In 2022, a total of c PLN 4.7bn coupons will be paid on those bonds spread throughout the year with the biggest payments in January (slightly over PLN 2.0bn).

2022 POLGB redemptions and coupon payments, PLN mio



2022 Eurobonds redemptions and coupon payments, PLN mio equivalent



Source: Bloomberg, Santander

Forecasts

3

Economic Forecasts

		2019	2020	2021E	2022E	1Q21	2Q21	3Q21	4Q21E	1Q22E	2Q22E	3Q22E	4Q22E
GDP	PLNbn	2,293.2	2,326.7	2,585.3	2,890.0	587.4	617.0	647.5	733.4	668.9	705.1	716.8	799.3
GDP	% y/y	4.7	-2.5	5.5	4.9	-0.8	11.2	5.3	6.6	7.0	6.1	3.8	3.2
Domestic demand	% y/y	3.6	-3.4	7.8	5.9	0.3	12.4	8.6	10.0	8.3	7.5	4.9	3.7
Private consumption	% y/y	4.0	-3.0	6.7	5.0	0.1	13.1	4.7	9.9	9.5	7.0	3.0	1.0
Fixed investment	% y/y	6.1	-9.0	8.4	7.3	1.7	5.6	9.3	13.0	-1.5	12.0	11.2	6.2
Industrial output	% y/y	4.2	-1.1	13.0	8.1	7.8	30.2	10.5	7.6	5.9	7.2	9.5	9.5
Construction output	% y/y	3.6	-3.5	0.8	2.1	-12.5	1.8	5.8	3.7	3.4	-4.0	3.0	5.4
Retail sales (real terms)	% y/y	5.1	-3.0	7.2	2.7	1.2	14.4	6.1	8.0	9.1	3.6	-1.0	0.3
Gross wages in national economy	% y/y	7.2	5.3	8.4	7.7	6.6	9.6	9.4	8.2	7.8	7.5	7.3	8.1
Employment in national economy	% y/y	2.2	-1.0	0.2	2.1	-1.4	1.1	0.7	0.3	2.0	2.0	2.1	2.3
Unemployment rate *	%	5.2	6.2	5.5	5.1	6.4	5.9	5.6	5.5	5.6	5.1	5.0	5.1
Current account balance	EURmn	2,523	15,287	-4,581	-8,627	2,746	372	-4,331	-3,368	1,260	-837	-6,054	-2,996
Current account balance	% GDP	0.5	2.9	-0.8	-1.4	2.7	1.7	0.4	-0.8	-1.0	-1.2	-1.5	-1.4
General government balance (ESA 2010)	% GDP	-0.7	-7.1	-2.0	-2.5	-	-	-	-	-	-	-	-
CPI	% y/y	2.3	3.4	5.1	6.4	2.8	4.5	5.4	7.5	6.4	7.5	6.6	5.0
CPI *	% y/y	3.4	2.4	8.1	4.7	3.2	4.4	5.9	8.1	6.1	7.6	6.1	4.7
CPI excluding food and energy prices	% y/y	2.0	3.9	4.1	5.9	3.8	3.8	3.9	4.8	5.7	6.4	6.2	5.3

* 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	3Q21	4Q21E	1Q22E	2Q22E	3Q22E	4Q22E
Reference rate *	%	1.50	0.10	1.75	3.00	0.10	0.10	0.10	1.75	2.75	3.00	3.00	3.00
WIBOR 3M	%	1.72	0.67	0.51	3.05	0.21	0.21	0.22	1.41	2.62	3.12	3.23	3.23
Yield on 2-year T-bonds	%	1.56	0.50	0.77	3.03	0.08	0.20	0.43	2.38	2.85	3.05	3.10	3.10
Yield on 5-year T-bonds	%	1.99	0.96	1.35	3.09	0.65	1.10	0.89	2.77	3.05	3.10	3.10	3.10
Yield on 10-year T-bonds	%	2.41	1.52	1.95	3.14	1.35	1.73	1.80	2.93	3.10	3.10	3.15	3.20
2-year IRS	%	1.74	0.62	1.16	3.44	0.37	0.71	0.88	2.70	3.30	3.47	3.50	3.50
5-year IRS	%	1.85	0.85	1.67	3.19	0.91	1.42	1.48	2.86	3.17	3.20	3.20	3.20
10-year IRS	%	2.05	1.15	2.00	3.14	1.45	1.87	1.79	2.90	3.10	3.10	3.17	3.20
EUR/PLN	PLN	4.30	4.44	4.57	4.59	4.54	4.53	4.57	4.63	4.65	4.63	4.58	4.53
USD/PLN	PLN	3.84	3.89	3.86	4.05	3.77	3.76	3.87	4.05	4.19	4.15	4.00	3.87
CHF/PLN	PLN	3.86	4.15	4.22	4.24	4.17	4.13	4.22	4.38	4.37	4.28	4.20	4.13
GBP/PLN	PLN	4.90	4.99	5.32	5.45	5.20	5.25	5.34	5.49	5.71	5.61	5.35	5.17

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

Source: NBP, Bloomberg, Santander

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MACROscope

Warsaw, December 15, 2021

Sectoral supplement

Strategic Sectors Department

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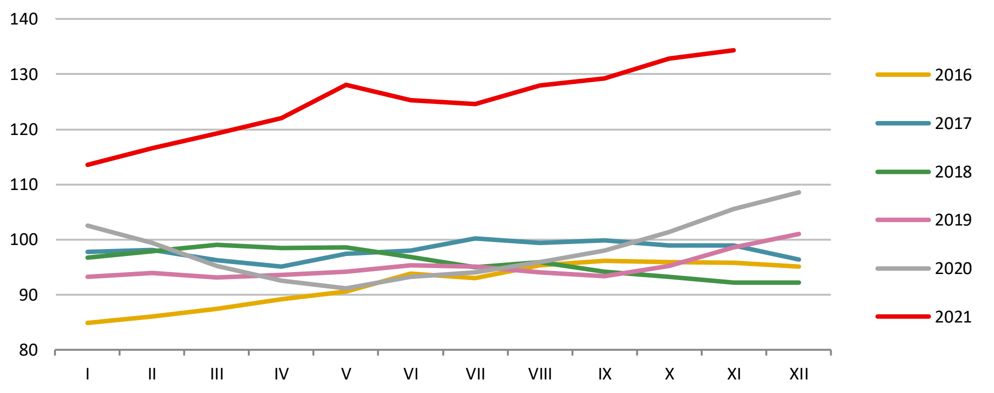
High world food prices

In the fourth quarter of this year, world food prices remained in an upward trend. In November, FAO price index reached 134 points. It was a level higher by 5% than in May and higher by 27% in annual terms. Importantly, increase of the index value is a result of high quotations of all raw materials, which are index components. An important reason for the increase in prices is growing demand for agricultural raw materials, combined with supply constraints. Canada, an important exporter of wheat and rapeseed, has experienced a significant decline in production. Wheat harvest was also lower in Russia, which introduced export duties, to reduce a scale of price increases on the domestic market. In Australia, there have been concerns about quality of grain. In turn, on sugar market, fall in production in Brazil, which is the largest producer and exporter in the world, is putting a positive pressure on prices. High demand, combined with a stable supply of raw material, drives the price increase on milk market. Lower dynamics were recorded on meat market, but also in this case world prices were higher than a year ago. In addition to raw materials prices, an important factor, which also affects food prices are higher transport costs.

High prices of agricultural commodities support value of food exports. During the first nine months of this year, value of foreign sales of agri-food products from Poland amounted to EUR 27,1 billion and was higher by 7% YoY. The fourth quarter should bring the maintenance of high dynamics, which is supported by global demand, but also by weak Polish zloty. Importantly, social restrictions introduced in some countries, related to the next wave of the pandemic, are much milder than during the first wave. The value of exports throughout the year may exceed EUR 36 billion..

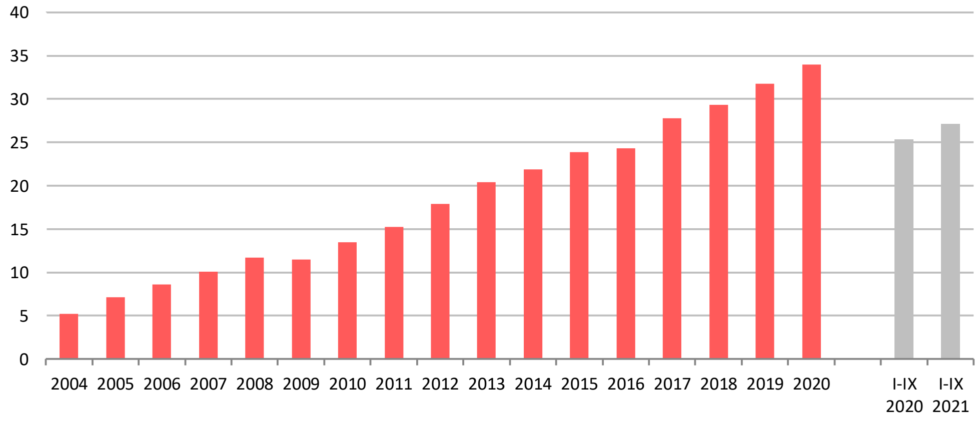
But rising food prices are a challenge for consumers. However, this may be an opportunity for Polish enterprises. Higher price sensitivity of foreign consumers may, in the short term, favor the search for cheaper products. Polish food has a great advantage related to the ratio of quality and price.

FAO Food Price Index (av. 2014-16 = 100)



Source: FAO

Value of food export from Poland (billion EUR)



Source: GUS

Challenges in food industry

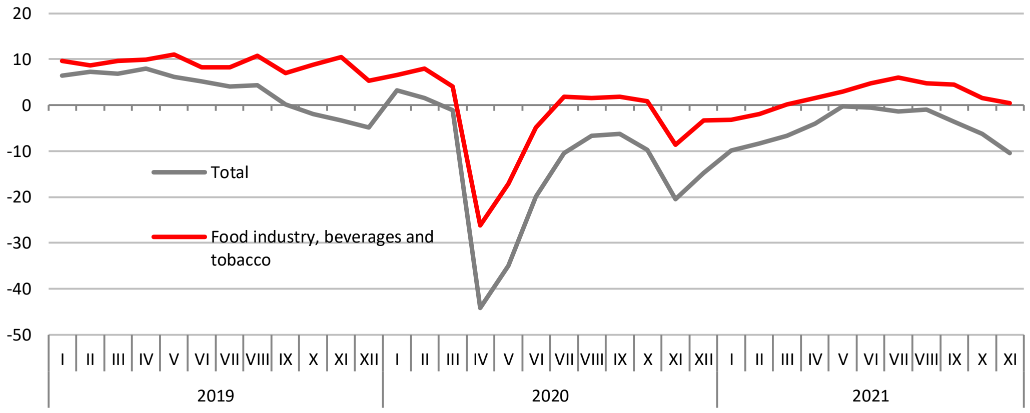
Soft indicators show relatively good sentiment in the food industry. In November business tendency survey, carried out by the Central Statistical Office (GUS), food sector positively assessed the current situation of companies and the current order portfolio. There is a slight weakening of moods compared to the previous months. However, opinions of food industry remained more positive than the average in manufacturing.

In the months October-November, demand was no important issue for the companies. On the other hand, the percentage of enterprises that indicated a shortage of employees increased significantly (30% vs. 22% in 3Q). Increase in employment costs was also mentioned slightly more often. This may be due to specificity of the pre-Christmas period. It is a time of hard work for the food industry. During this period, staff shortages, especially in production departments, are very noticeable.

In October and November, more enterprises than before reported a shortage of raw materials (18% vs. 15% in 3Q). On the one hand, the food industry has not experienced any disruptions in its supply chains due to the pandemic. On the other hand, it is worth noting that in recent months prices of raw materials for processing and materials used in food processing and agricultural production have increased sharply. In some cases, supply problems were noted. In addition, costs of transport and other services for industry, including municipal services, became higher. As a result, the sourcing of raw materials, materials and services used in production may be greater challenge than in the past.

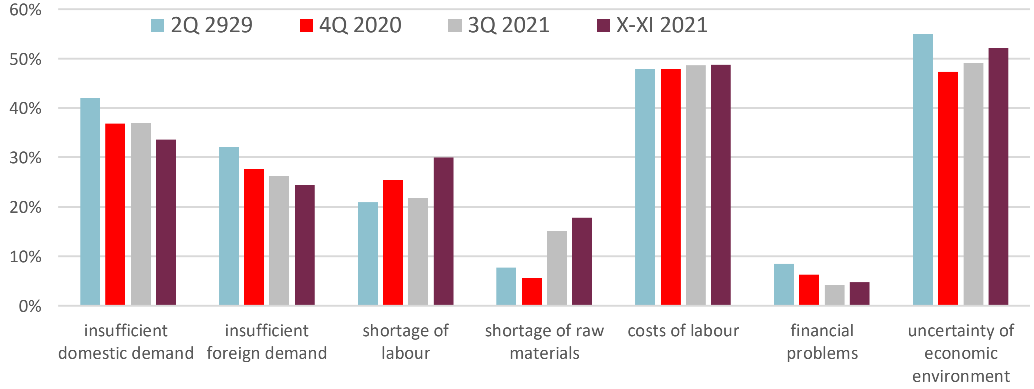
The pandemic remains an important risk factor in 2022. General uncertainty regarding current situation and future supports the purchases of agricultural raw materials by countries, which are large food importers. The issue of high prices of energy-producing raw materials is also important - it puts pressure on profitability in the entire food production and distribution chain. The result is a limited potential to develop production in short term, which can strengthen food prices.

Business tendency survey in manufacturing in Poland



Source: GUS

Selected barriers to doing business in food industry in Poland - percentage of responses



Source: GUS

Strong Black Friday impact keeps growth above 30%

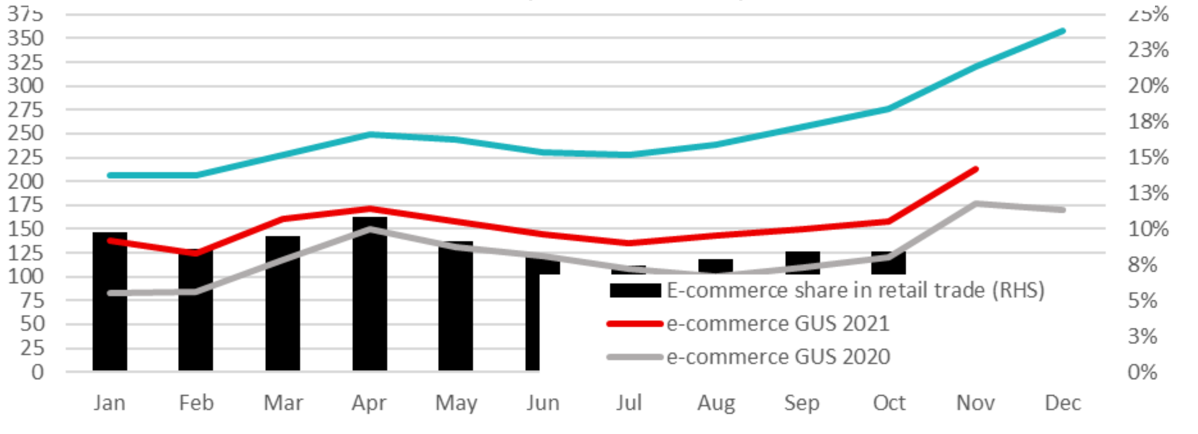
The effect of Black Friday on online sales was clearly stronger this year – not only because of the pandemic but also thanks to organic growth of e-consumers and their spending. Online payments of Bank's clients in the Black Friday week were almost two times higher than in an average week from the period of 1-3Q of a given year. In our view, November may bring CSO reading of online sales above PLN 10 bln, compared to present „barrier:" of roughly 8,1 PLB bln. Even though payments data for the first weeks of December show continued uptick in payments, we see a declining trend from November's peak celebration.

We estimate that ongoing pandemic may add around 10 p.p. to industry's growth rate, which translate into relatively high, ~30% share in online sales growth.. Even though this stands lower in y/y terms, it is still above what we expected in our base scenario back in 1H 21. Overall we see that the industry may realise the upper level of our forecast, which means around PLN 91 bln. In 2021 in total, sales growth could reach 30% compared to 32% dynamic after first 10 months.

We see that among detailed categories there are two growth champions – electronics, white goods and furniture and fashion (clothes, shoes). In both cases we speak about PLN 3,6 bn additional spending this year, which makes these two categories responsible for ~43% of this years sales growth. It is almost level with all other categories combined. Readings in November and December should change this picture slightly as consumers buy many different products for Christmas.

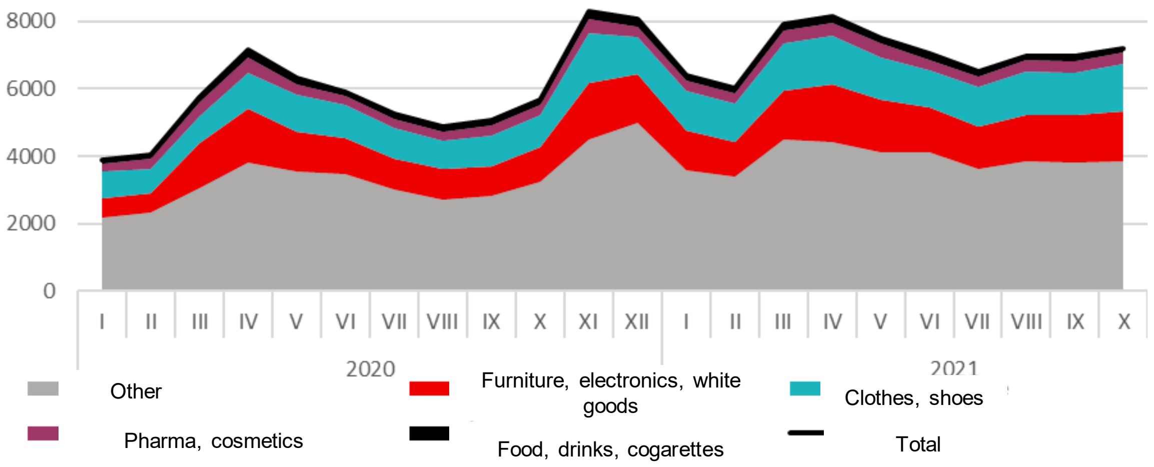
In our base case scenario for 2022, depending on the pandemic we expect about 11% to 18% online sales growth, which translates into 101-108 PLB bn.

Retail e-commerce sales index (12.2019 = 100)



Source: GUS, Santander

Retail e-commerce sales by category (mln PLN)



Source: GUS, Santander

Packaging sector grows at long unseen rate

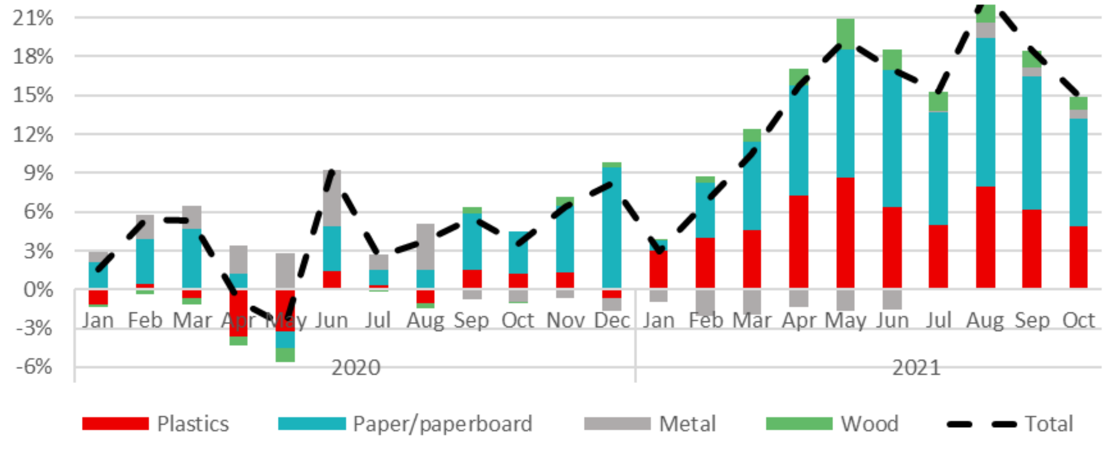
Galloping production cost inflation coupled with solid demand bring packaging sector a record high growth rate compared to past few years. We estimate that since March this year sector is growing at a rate above 10% y/y, and given the strong consumption impulse in the last months of the year we expect that at year end, packaging production value may reach above 51,5 PLN bln. What supports our estimates is index of industrial production of key packaging offtake sectors. After 10 months of 2021 these noted an average growth of about 10%. Furthermore, packaging export value grew in the first 8 months of 2021 by 19% relative to 2020 and 16% relative to the same period in 2019.

Packaging prices note significant growth but we see that packaging companies have not yet passed full production cost increases on final products prices. Share of materials of companies' revenues in 3Q 21 was still growing, reaching ~58% in case of paper and paperboard packaging and ~56% in case of plastic packaging.

We expect that cost impulse from raw materials may be close to its peak and we may see some stabilisation on 1Q 22 after this year's wild increases. Prices of both primary plastics used in packaging sector and cellulose seem to be stabilising in 4Q 21. This may mean that we will no longer see declining profitability and liquidity of packaging companies.

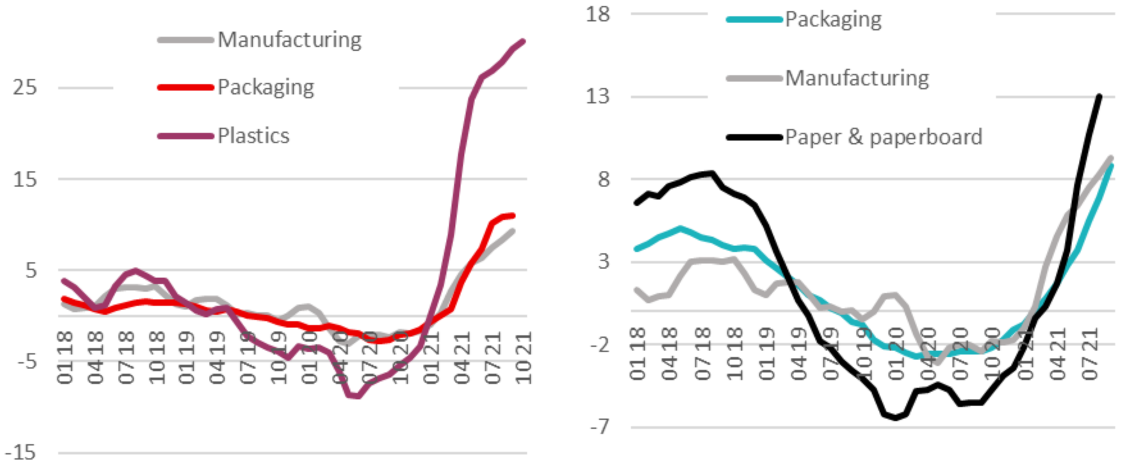
On the other hand, since January 2023 there will be new inflationary factor, which is the reform of extended producer responsibility system. New tolls will be calculated per tonne of packaging depending on material used, and will be paid by the company that first puts the packaging on market (uses it to package goods sold). This will increase packaging price while being more or less neutral to packaging producers.

Sold production by material type (change y/y)



Source: GUS, Santander

Producer prices y/y chanage, EU27



Source: Eurostat, Santander

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Difficult situation of car parts suppliers

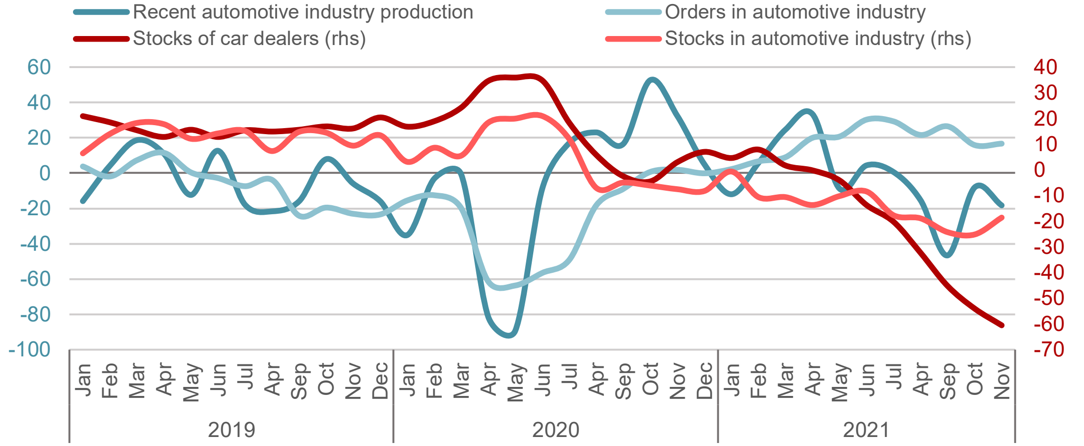
Supply crisis in the sector continues. As a result, passenger car registrations in Europe in January-October 2021 increased by only 3% YoY, which was 25% less than the comparable period in 2019. However, the low sales volumes are not as severe in their impact on dealers, as relatively strong demand allows them to obtain high prices and margins.

In a similar situation are car manufacturers, who are able to pass on rising production costs in part to customers. However, production levels vary between companies. Asian manufacturers have significantly less problems with semiconductor supplies. In the Czech Republic, for example, Skoda's plants are performing much worse this year (-11% y/y) than Hyundai's (+22% y/y). There are also differences between the various groups' assembly plants, which result, among other things, from giving high priority to production with higher profitability, i.e. vehicles with electric drives, premium brands or models from the SUV segment.

At a disadvantage are manufacturers of parts and components supplying mainly first assembly, who with low sales volumes must additionally face high prices for production materials, energy and sea freight rates. Their production and order receipt by OEMs is uncertain and volatile. This is caused, on the one hand, by material availability problems hindering parts production and its delivery to OEMs. These include, apart from semiconductors, most of the key raw materials for automotive production, such as steel and aluminium, plastics, resins, and recently the supply of magnesium, used in aluminium alloys, has also been threatened. On the other hand, car assembly plants can delay the receipt of manufactured parts if a shipment of semiconductors does not arrive, which halts the production of cars, and with just-in-time systems there is no room for storage of components.

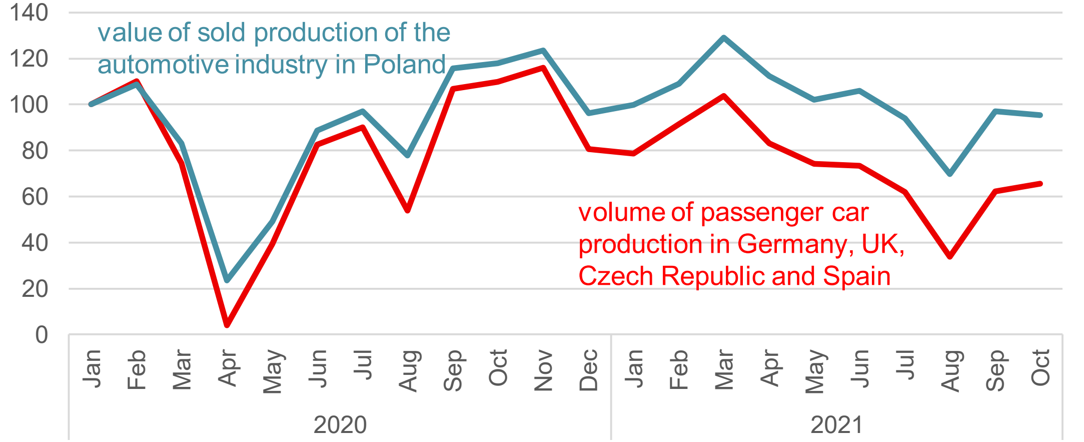
Prevailing view among industry experts is that the worst of the supply crisis is passing, but the situation will improve gradually. IHS Markit predicts that light vehicle production volumes in Europe will fall by 3% for the whole of 2021, and will rise by 16% and 11% in 2022 and 2023 respectively. LMC Automotive, on the other hand, expects passenger car sales in Western Europe to decline by 3% in 2021 and grow by 7% in 2022.

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



Source: Eurostat

Sold production of automotive in Poland vs. passenger car production volumes at main importers of parts produced in Poland (100=Jan 2020)



Source: GUS, VDA, SAP, ANFAC, SMMT

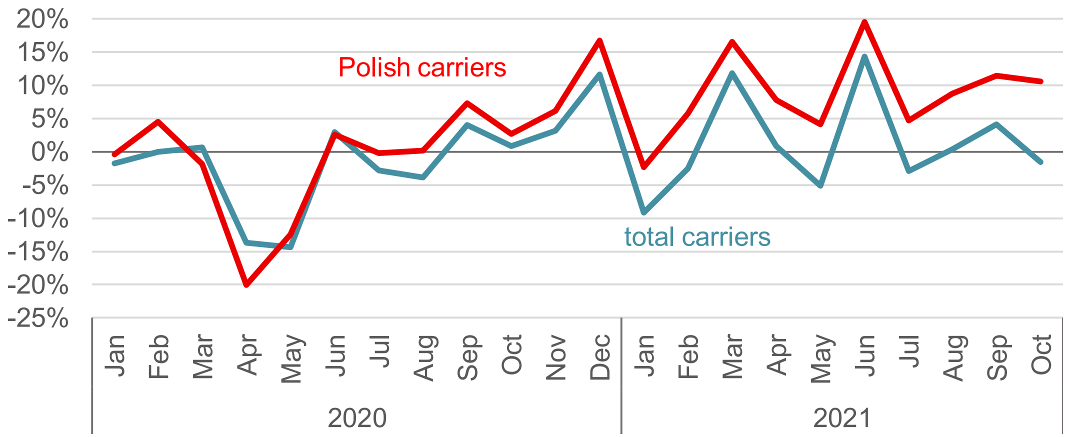
High demand for transport and regulation changes

GUS data shows that the weight of goods transported by Polish road carriers in January-October 2021 was unchanged YoY, which was 8,5% less than in the comparable period of 2019. In contrast, the number of kilometres driven by them on toll roads in Germany increased by 11% YoY, which was 9% higher than the comparable period in 2019. This was a better result than other carriers driving on German roads, which recorded dynamics of +3% YoY and -0,5% vs. 2019. Thanks to this, the share of Polish carriers in transport in Germany increased by more than 1 percentage point to 17,3%, which, taking into account importance of the German market, may indicate a further strengthening of their position in the road transport market of the whole EU.

Factor driving the transport growth is good situation in EU industry and trade. Good mood could only be spoiled by the PMI index indicating a third consecutive month of decline in foreign orders in domestic industry. A favourable overall demand situation in the EU, high fuel prices, a limited supply of drivers and rising wages translated into an upward trend in freight rates for many months. Short-term demand and rate forecasts from the EU land transport survey show that this trend should continue in the coming months.

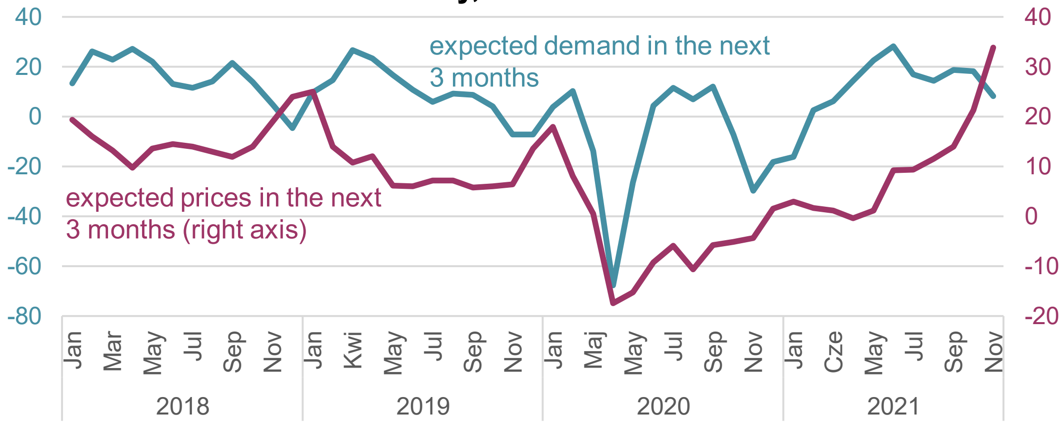
Significant regulatory change lies ahead for the sector. In Poland, the Parliament has just passed a law on drivers' working time, which is designed to bring Polish law in line with EU regulations contained in the Mobility Package. At this stage of the legislative process, however, no adjustments proposed by the industry were taken into account, which may still happen in the Senate. Further regulations of the Mobility Package, coming into force in February 2022, concerning posted work in cross-trade and cabotage, as well as ongoing adaptations of national legislation, raise concerns in the sector about a significant increase in wage costs. This may reduce profitability and competitiveness of national carriers in the European market and consequently increase competition on the domestic market and in bilateral transport.

Kilometres billed to road carriers on toll roads in Germany - change vs. 2019



Source: BAG

Expected demand and prices in land transport (NACE 49) in the EU - results of the economic survey, balance of indications increase/decrease



Source: Eurostat

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