

War accelerated the cycle

Poland: Economic Outlook

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Executive Summary (macro)

More than six weeks since the war in Ukraine has started, the uncertainty surrounding economic forecasts is abnormally high. Not only don't we know how long the conflict will last and what the final outcome will be, but also predicting the economic agents' reactions to multi-dimensional shocks seems like a true challenge.

After a very strong start of the year (GDP growth in 1Q22 was probably still close to 7% y/y), the real activity is likely to slow abruptly, amid trade deterioration (lower demand plus disrupted supplies), confidence drop, commodity price and interest rate spike. At the start of March we have trimmed GDP growth forecasts for 2022 to 3.5% and we keep it as such for now. We were expecting some slowdown before, but, in a way, the war has accelerated the cycle.

We remain moderately upbeat on private consumption outlook, mostly due to the strong disposable income (rapid wage growth, cuts in personal tax and additional benefits), even though inflation will consume a large chunk of this growth. The refugees' personal spending could add slightly to total consumption, but it will be probably less relevant than a change in households' saving rate. The latter may decline further, we think, due to high inflation. The risk of higher precautionary saving, suggested by recent consumer confidence survey, does not seem to be confirmed by the card data, which allows us to expect private consumption growth near 4%.

Investment prospects look not very rosy, as war and higher interest rates will likely discourage private investments in housing, firms' investment spending may stall amid elevated uncertainty and cost pressure, while public outlays will continue to suffer from EU funding slowdown.

Labour market usually reacts with a lag to the economic cycle, so the wage growth is unlikely to slow quickly. While it is rational to expect that the large inflow of refugees (if persistent) should weaken of the wage pressure in the long run, in the nearest months the tensions may stay high overall, yet different across sectors (new job applications by Ukrainian women probably mainly in services; outflow of Ukrainian men affecting mainly transport, construction, etc).

The war in Ukraine implies higher inflation. By how much exactly – still remains to be seen, as the behaviour of commodity markets will depend on the evolution of the conflict and Europe's policy response. Our baseline scenario assumes a stabilisation of CPI near 11% y/y until late summer and then its gradual descent. Yet, the risks still seem to be tilted to the upside, especially given uncertainty regarding energy and food prices and the exchange rate. We think that core inflation, after rising above 7% in mid-year, should start easing amid slowing demand and weakening labour market pressure.

Polish central bank's aggressive response to yet another inflation surprise (+100bp rate hike in April, to 4.5%, after CPI jump to 10.9%) suggests we should move our expectations for the peak reference rate in this cycle higher. The next decision(s) will be again a function of inflation data. If – as we predict – CPI stabilises near 11% y/y, the central bank may revert in May to 50bp moves and raise rates to 5.5% by June. If inflation keeps surprising to the upside, we may move towards the scenario anticipated by the market (rates at 6.5%). Another factor that could trigger more aggressive hikes would be a repeat of the currency selloff. We think the NBP's bravery in policy tightening may weaken when real data start showing a meaningful slowdown in Q2.

What makes decisive interest rate hikes even more justified is the likely expansion of fiscal policy, resulting from both the circumstances (war and its consequences) and government's discretionary decisions. Higher costs of anti-inflation measures, costs of refugee inflow, new tax reductions, higher defence spending, plus economic slowdown – all those factors will boost fiscal deficit in 2022 to c.4.7% of GDP, at least. We still hope for unfreezing the EU recovery funds, but the government does not seem to hurry with the required legislation, so the inflow of money before the year-end may be negligible.



Executive Summary (markets)

FX

After the severe depreciation of the zloty during the first weeks of the Russo-Ukrainian war the currency started to recover. However, we do not expect it to trim all the losses this year. The starting point before the war at 4.50 may prove to be the floor for EURPLN and the exchange rate will wait above it until we get more clarity on the economic cost of the war and the fight with inflation. For long we have been arguing that the generally positive outlook for PLN is based on the Polish economy's ability, proven many times, to outperform other EU countries even in times of stress. Looking forward, we are not so certain this trait will manifest itself. The scale of monetary tightening (with relatively strong pass-through to real activity due to the minimal share of loans with fixed interest) and delays in EU funds-based contracts may weigh on economic results this year, while in 2023 Polish GDP growth may turn out pretty average as compared to other EU countries. Thus we rather see EURPLN anchored at 4.65 in the medium term than breaching the pre-war 4.50 support.

FI

The prolonging chase after CPI inflation and more monetary tightening coupled with the outflow from Polish assets due to the geopolitical risk were an ugly mix for POLGBs. We do not know how the war in Ukraine evolves, but if there is no significant escalation of conflict, investors may start getting used to the elevated risk profile in the coming months. Then, given our forecasts of relatively flat CPI path at that time we might see some fresh demand on the bond market from abroad. The story gets more complicated when we add the supply side to the picture – the fiscal expansion and attempts to circumvent the constitutional debt limit have in our view already started adding an extra risk premium in POLGB prices and may keep yields quite high in the short term and soften their decline afterwards, once we get closer to interest rate cuts.



2022 Forecasts – what has changed

Indicator	Our view in December 2021	Our view in April 2022
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%.	War in Ukraine generated a sudden stop shock for the economy, albeit of moderate magnitude - after very strong start of the year, the real activity may stall in the next two quarters. GDP growth may slow to c.3.5% in 2022, as all main demand components will suffer and supply disruptions will likely weigh on output.
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.	Consumption still solid, but the shock to real disposable income will likely outweigh the boost in demand for basic goods due to refugee inflow. Investment rebound slowed by lower confidence, delay in recovery plan and rising rates. Current account gap widening amid terms of trade deterioration, but net export's contribution to GDP growth may actually improve amid domestic demand cooldown.
Labour market	Economy back at virtually full employment. Demand for labour keeps rising, which implies elevated wage growth.	Inflow of refugees may ease labour market pressures in the long run, but the short-term effect neutral at best, the impact will differ across sectors.
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.	Energy and food price shock will drive inflation higher – despite the likely extension of temporary tax cuts CPI may stay in double digits until late summer. Core inflation, after jumping above 7% in mid year, should start easing in 2H amid lower demand.
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).	Interest rate peak will be higher due to inflation surprise, pressure on the currency and looming fiscal easing. We think the NBP will stop rate hikes at 6% in mid-year
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.	Higher costs of anti-inflation measures, refugee inflow, new tax reductions, defence spending will boost fiscal deficit in 2022 to c.4.5% of GDP, at least. We still hope for unfreezing the EU funds, but the government does not seem to hurry, so the inflow of money before the year-end may be negligible.
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.	We see positive circumstances for a return of foreign demand, but the expected increased supply could prevent a quick fall of bond yields even at the time when the war in Ukraine would be over. Yield curve compression should be seen until the middle of 2023, bullish steepening should follow as the MPC moves to rate cuts.
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.	The war in Ukraine redrew the FX landscape in the region, sending PLN to the weakest levels ever. Its recovery is already advanced but may face burdens in the form of weaker than usual relative economic performance of Poland.

Economy

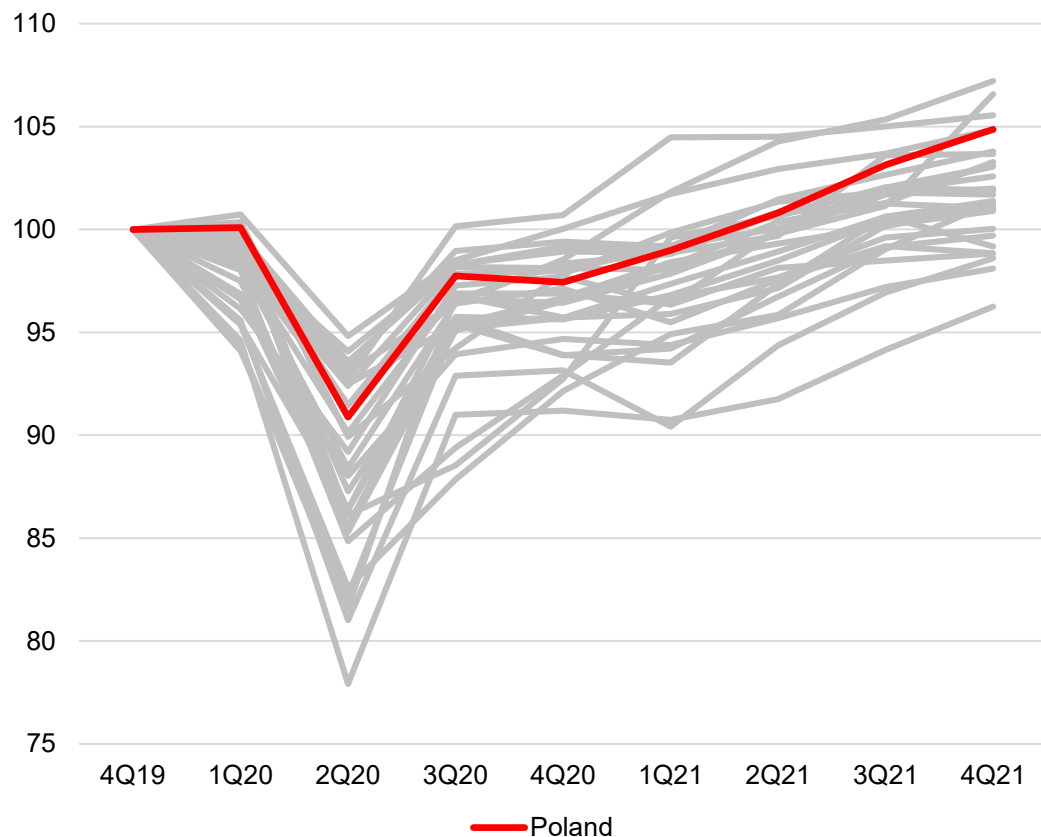
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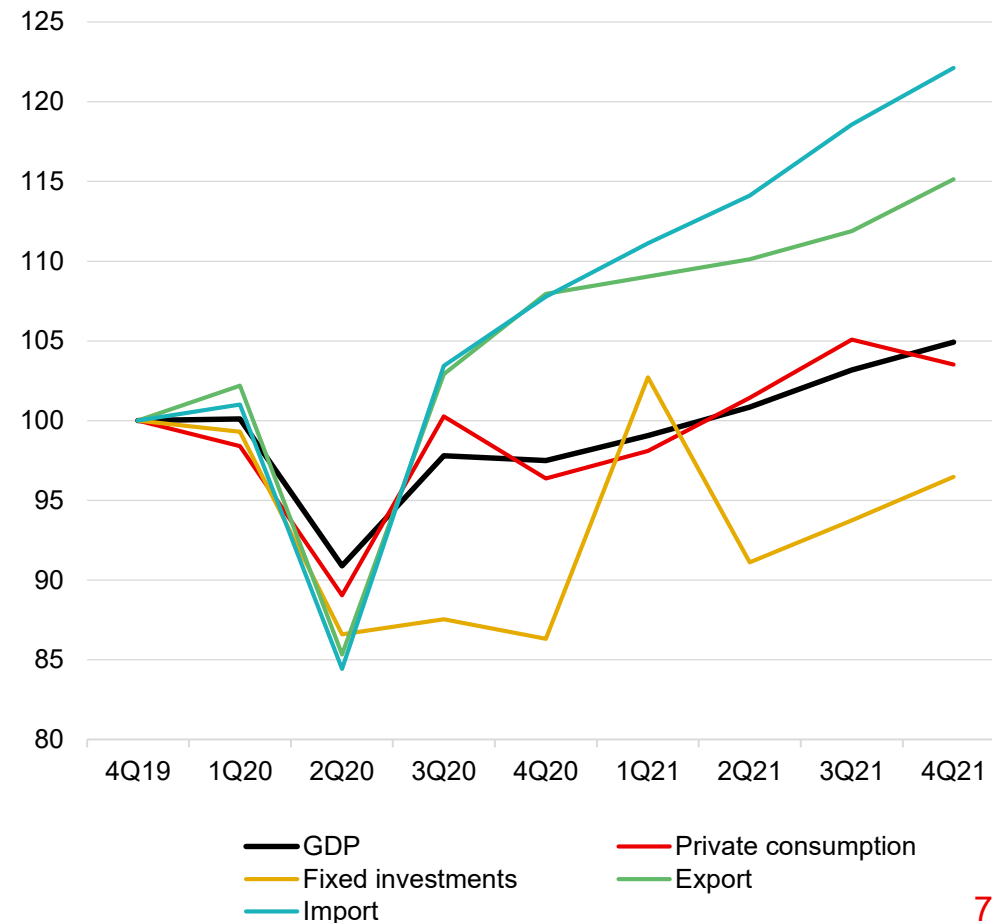
Starting point: quick post-pandemic recovery

Just before the war in Ukraine started Poland was among the fastest recovering economies in Europe, with rapid GDP growth fuelled by a rebound in all main components of demand. We were anticipating a gradual slowdown of the post-pandemic revival, albeit forecasts for 2022 were still solid, with GDP growth near 5% on average, and consumption, investment and export continuing their upward trends.

GDP level in European countries, 2019Q4=100, s.a.



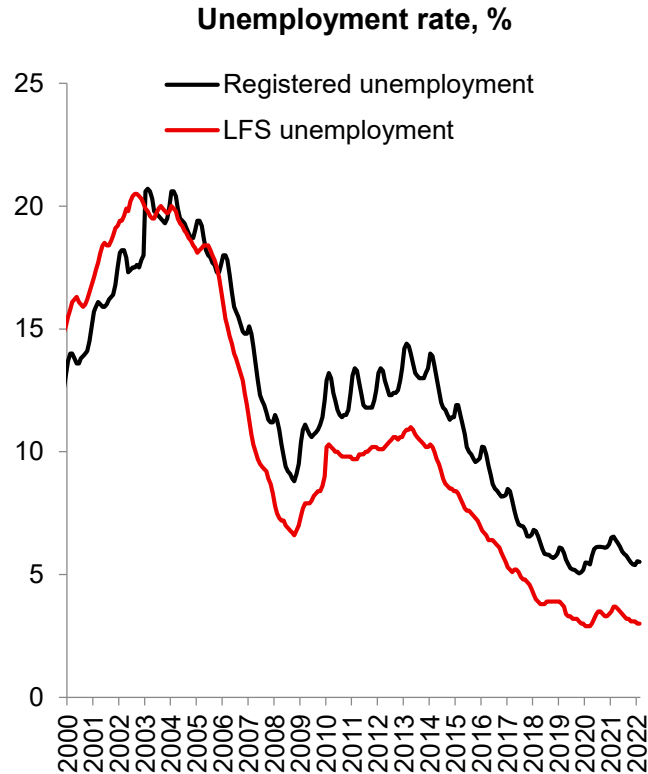
GDP and its main components in Poland, 2019Q4=100, s.a.





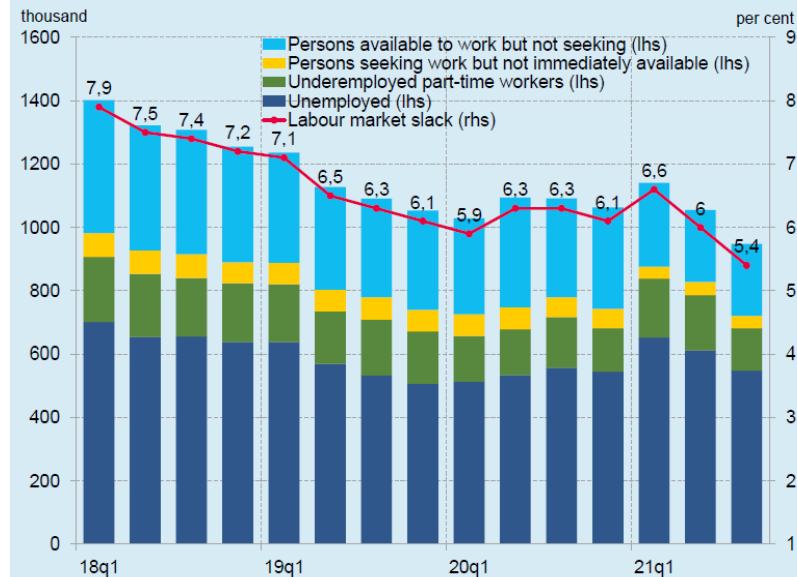
Starting point: overheating labour market

Polish labour market did not suffer much from the Covid-19 shock and quickly returned to the overheating mode, with jobless rate (3.0%) back near the all-time low, labour shortages rising across sectors and wage growth accelerating to over 10% y/y. According to central bank estimates, the labour market slack in 2H21 was the second lowest in EU and lower than before the pandemic.



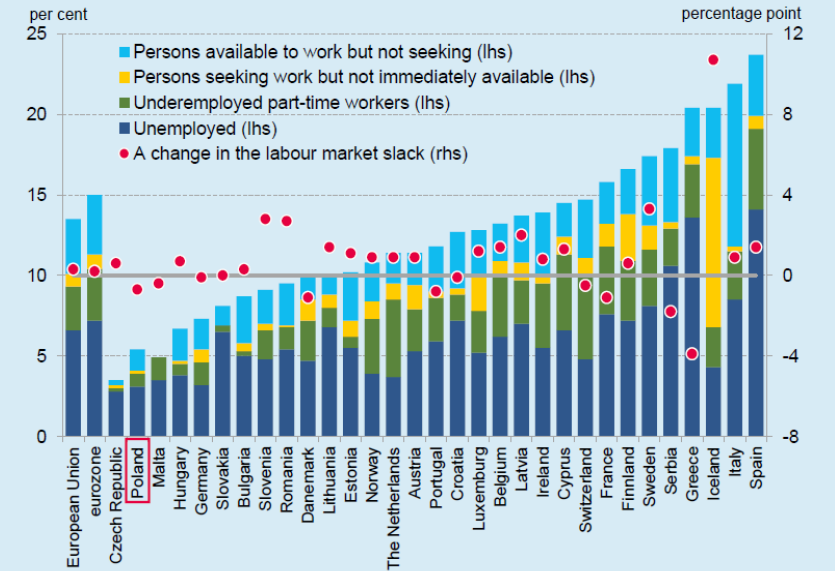
Source: GUS, Eurostat, Santander

Figure B.2.5 Labour market slack in Poland (seasonally adjusted data)



Source: Eurostat data, NBP calculations.

Figure B.2.6 Labour market slack in EU countries – level in 2021 Q3 and the change between 2019 Q4 and 2021 Q3 (seasonally adjusted data)



Source: Eurostat data, NBP calculations.

Source: NBP

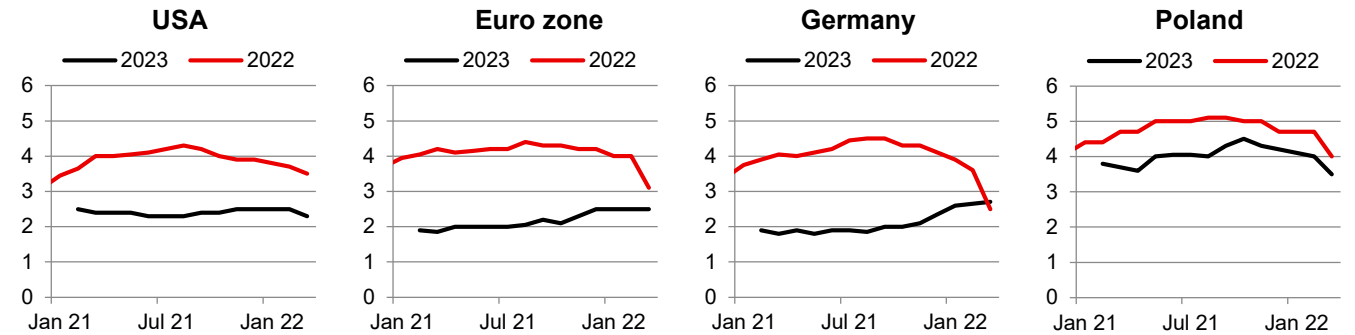


War in Ukraine: yet another shock to the system

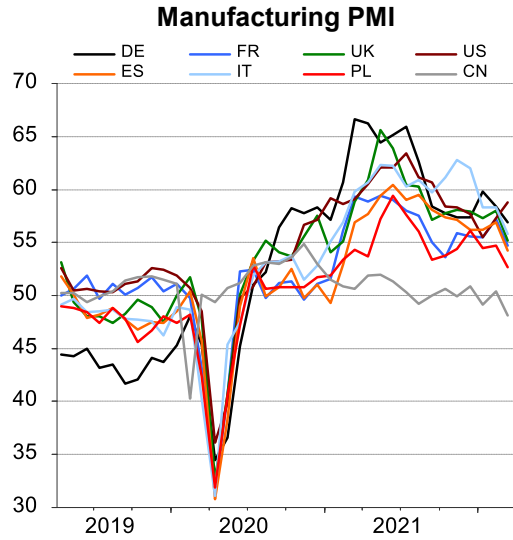
The war in Ukraine worsened the global economic growth outlook. Consensus view seems to assume that the new shock will be way smaller than the Covid crisis and not very long. The revisions for euro zone affected mainly 2020 GDP forecasts. The story is a bit different for the US and CEE, where the outlook for 2023 may be more significantly affected by much higher interest rates.

So far, economic sentiment indicators deteriorated only moderately and mainly in manufacturing, while services in developed Europe remained surprisingly resilient. Yet, the Ifo index already seems to herald a meaningful recession in Germany.

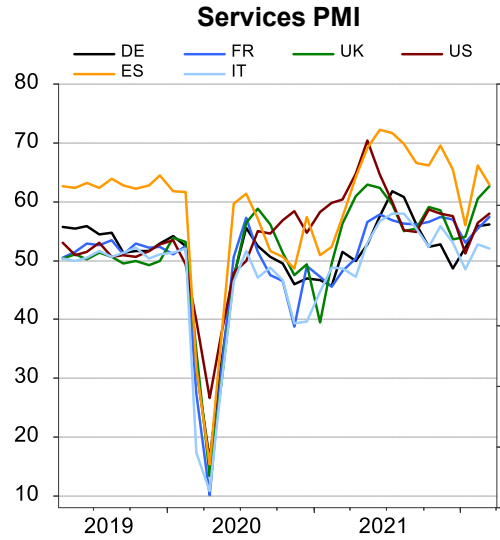
Evolution of Bloomberg consensus forecasts of GDP growth for selected economies, %



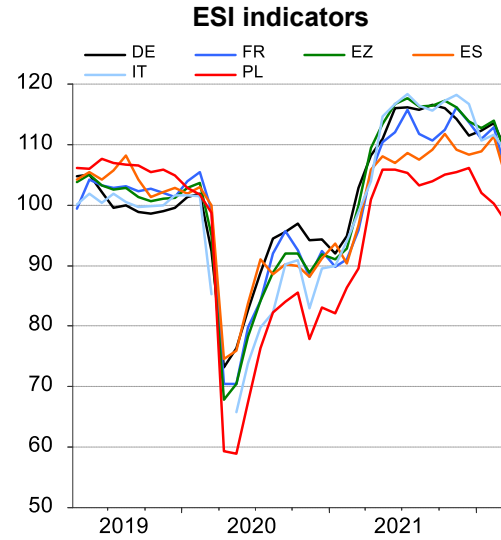
Source: Bloomberg, Santander



Source: Refinitiv Datastream, Santander



Source: Refinitiv Datastream, Santander



Source: Refinitiv Datastream, Santander



Source: Refinitiv Datastream, Santander





War in Ukraine: worse GDP outlook

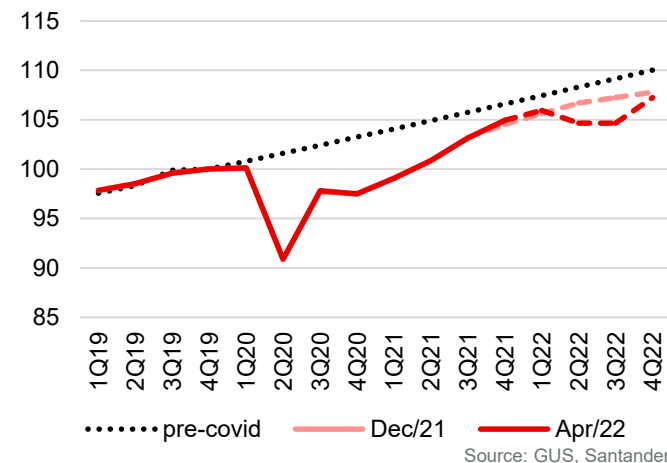
After a very strong beginning of the year (data for January-February suggested that GDP growth in 1Q22 was still close to 7% y/y), Polish economy is facing a kind of sudden-stop scenario: the real activity may stall in the next two quarters, in our view, due to both direct and indirect effects of military activity next to the Polish eastern border.

In early March we have trimmed 2022 GDP growth forecast for Poland from almost 5% to 3.5%. The final impact of the conflict is still highly uncertain and will depend on the depth (how far countries are willing to go in this war, and whether third parties decide to get involved or not) and the duration of it. Three main transmission channels of the war were considered: (1) higher prices of energy (oil, gas) and non-energy (especially food) raw materials, given the relevance of Russia and Ukraine as suppliers of these products, (2) financial markets, financial flows, and monetary policy authorities' response, (3) direct exposure to Ukraine and Russia through trade and finance.

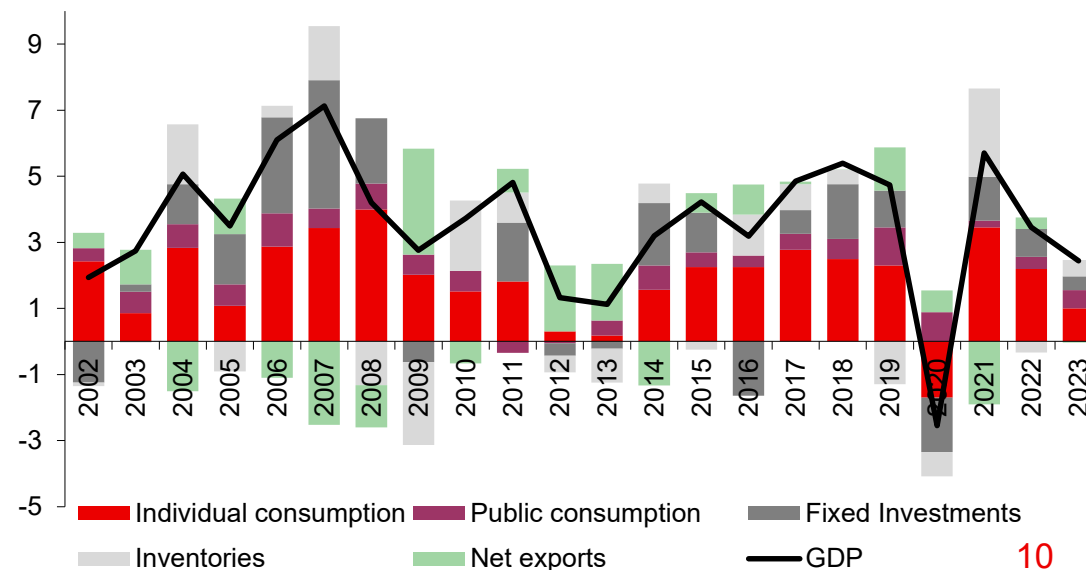
MAIN ASSUMPTIONS:

- No significant escalation of the military conflict, including no involvement of other countries.
- Sharp increase in the prices of energy and non-energy raw materials. Once the conflict is over, prices moderate, but remain above the previous baseline scenario.
- Disruption in Polish trade with Russia, Ukraine and Belarus, resulting in c.1/3 drop in Polish exports to those countries and corresponding decrease of imports.
- Economic growth slowdown in the euro zone of around 1pp vs previous forecasts.
- Mass migration: up to 3 million people arriving from Ukraine to Poland, out of which 2/3 (c.2 million) may stay in Poland and the rest leaves to other countries.
- Fiscal policy easing (higher deficit needed to finance the costs of migrant's accommodation – spending on public services, infrastructure) creating some cushion for economic growth slowdown.
- Monetary policy tightening stronger than earlier assumed, due to higher inflation but also due to the potential vulnerability of the local currency.

Poland's GDP, 4Q19=100, s.a.



Poland's GDP growth and its breakdown, %

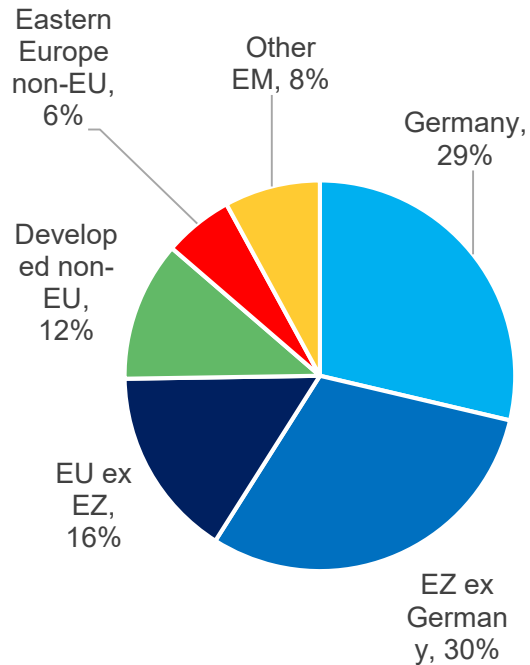


War in Ukraine: Poland's trade exposure



Polish export to Ukraine, Russia and Belarus is not big (c.5% of total) but it is reliance on critical supplies from those countries that makes some sectors vulnerable. Apart from energy (see the next page), it is about raw materials (minerals, metals, wood), but also fertilizers, oils, car parts and other critical elements of supply chains. Also, the trade with some Asian countries may suffer due to disruption in land transport routes.

Poland's exports – geographical breakdown, 2020



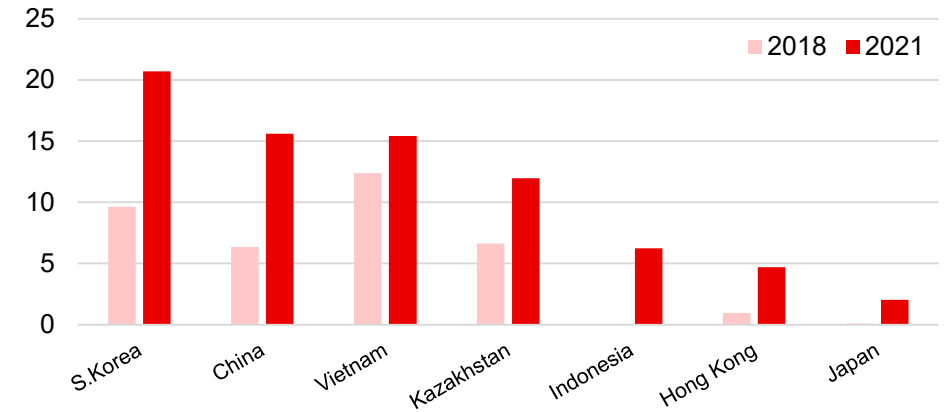
Source: GUS, Santander

Trade with Russia, Ukraine and Belarus



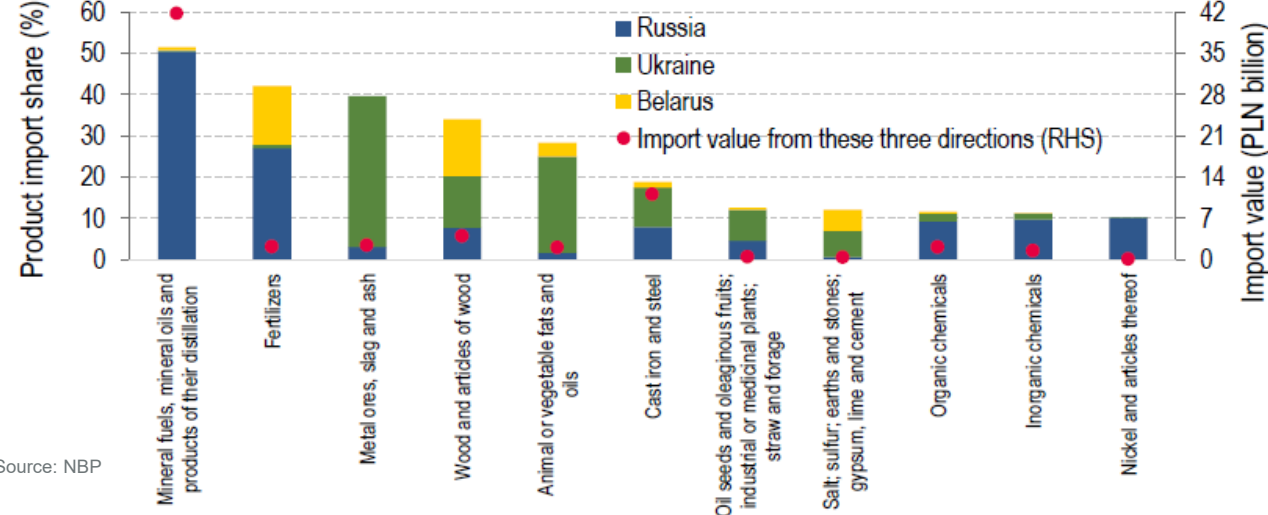
Source: NBP

Share of imports to Poland from selected Asian partners, by rail



Source: Eurostat, Santander

Share of imports from Ukraine, Russia and Belarus in selected product groups (2021)



Source: NBP

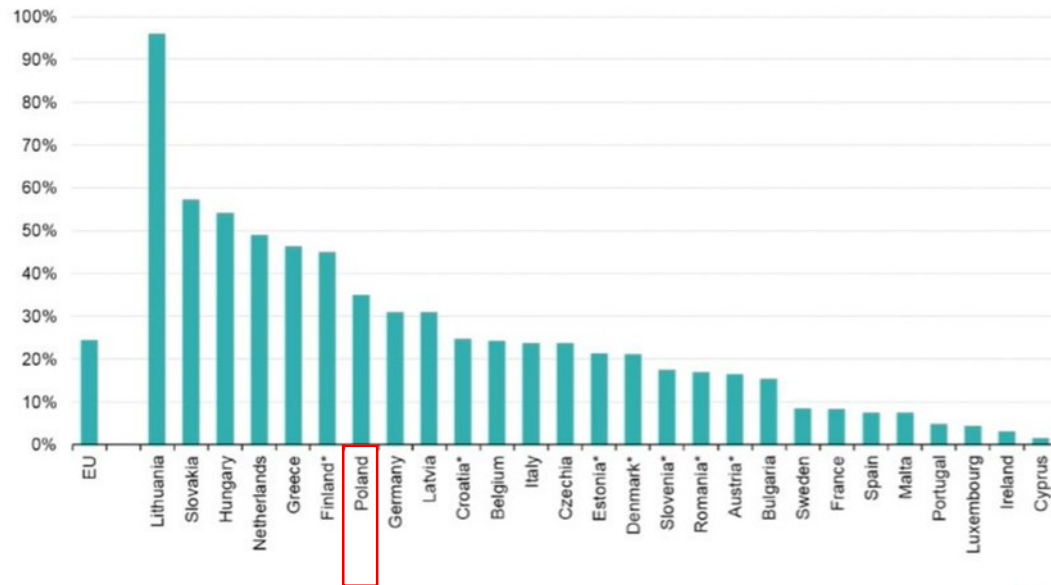


War in Ukraine: Poland's energy dependence

Poland is relying on Russian fossil fuels, but – unlike some other EU states – it is **able to reduce its dependence relatively quickly**, as it has developed the necessary infrastructure over the last years. The government plans to ban imports of Russian coal in two months, and to resign from Russian crude oil and gas by the end of 2022. It will be possible due to the expected completion of Baltic Pipe and increased shipping of oil and gas through sea terminals. Also, Poland has relatively high level of gas storage utilisation, which reduces the risk of gas rationing in case of stopped supplies from Russia.

EU's energy dependence on Russia

Imports from Russia in gross available energy in 2020

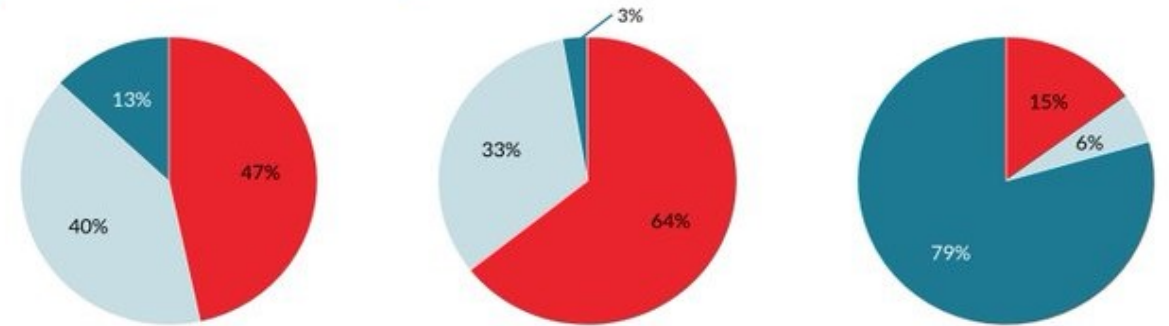


Source: Eurostat, including estimates for non-reported data for countries with *



Share of energy commodities imports from Russia in total domestic use in Poland in 2020

Import from RU Import from other countries Own extraction



Natural gas

Domestic use:
20.6 bn m3

Crude oil

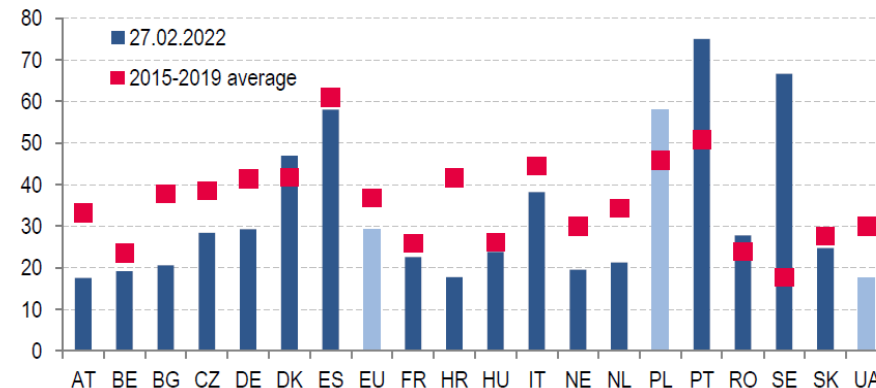
Domestic use:
26.1 m tonnes

Coal

Domestic use:
62.6 m tonnes

Source: Forum Energii

Natural gas storage capacity utilisation in Europe (% as of 27.02.2022)



Source: NBP

War in Ukraine: refugee inflow

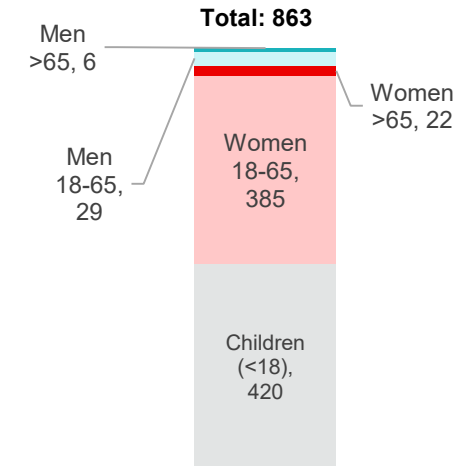
Almost 2.7m migrants arrived via PL-UA border until April 11 and the inflow may reach even 4-5 million according to some estimates. 20-30% of Ukrainians could have left Poland to other countries.

Over 860k registered in Polish social security system so far, suggesting they are planning to stay for some time. About 50% of registered refugees are children, rest are mostly women in 18-65 age cohorts.

Approx. 600k people returned to Ukraine from Poland (mostly men), as of April 11.

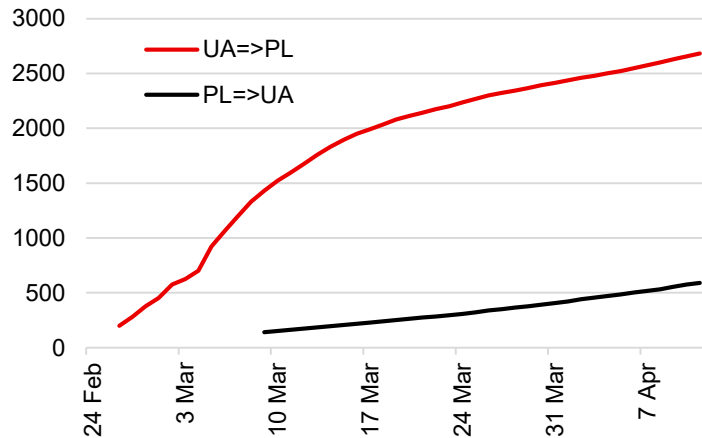
We assume net increase in population at c1.5mn. How can we define range for their consumption patterns? We think that minimum should be put at existence minimum minus housing, which is about PLN0.5bn per month. Maximum can be set at Poland's average (PLN5.5bn). We assume 2022 total at PLN15bn (30% of average for 10 months).

Refugees granted Polish personal identification number PESEL, thousand (as of 11th April)



Source: dane.gov.pl

Number of people crossing Poland/Ukraine border, cumulative (in thousands)



Source: Border Guard

Google Trends: ● работа в Польщі / ● работа в польше ("work in Poland" in Ukrainian / Russian language)



Source: Google Trends

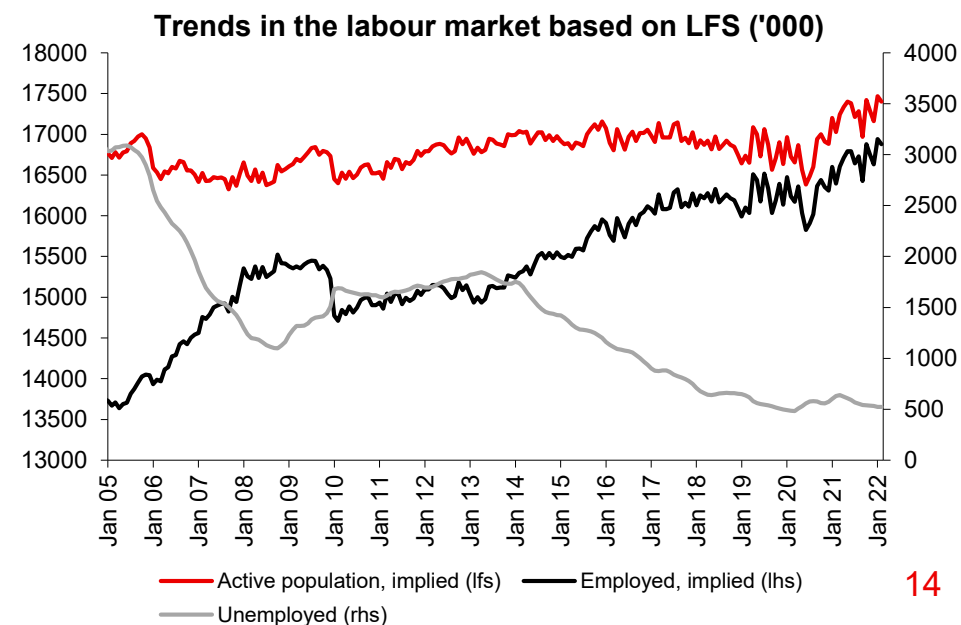
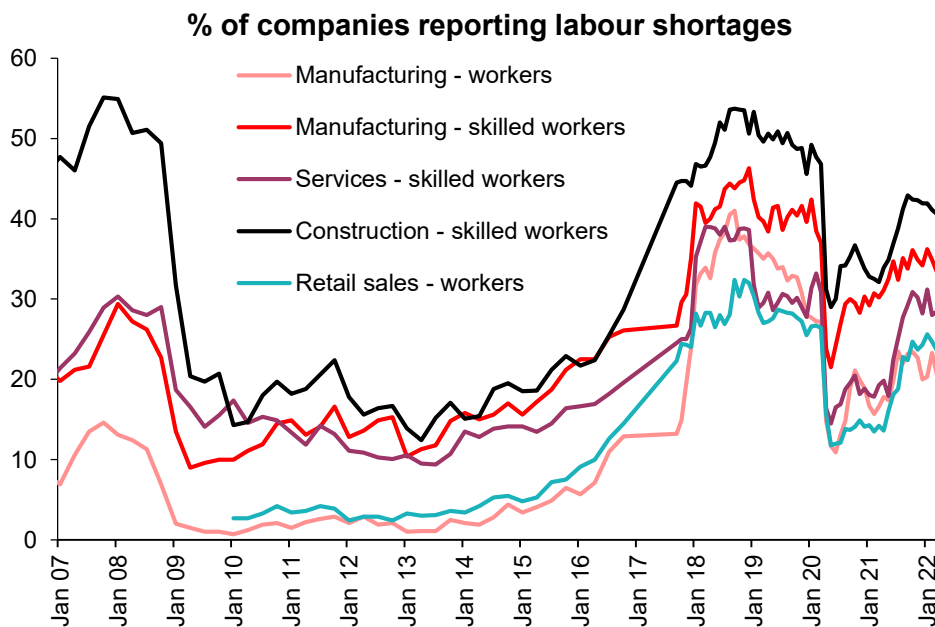


Labour market: it's complicated

Strong outflow of Ukrainian men to their homeland was expected to cause some **labour market disruptions in Poland, at least in the short run**: people flowing back from Ukraine are usually employed in Poland, while people coming in have no workplaces in Poland, often no language knowledge and random professional expertise (in the sense that their decision to move to Poland was not correlated with labour demand in Poland, obviously). So far about 30k of newly arrived Ukrainian citizens have found employment, mostly in accommodation, restaurants and in seasonal jobs (as of 4th April). Mind also that potential workforce among newly arrived refugees equals about 800k, not much more than the number of people who reverted to Ukraine (600k).

That having said, **in March Polish companies were reporting diminishing problems with finding staff**. This can however have numerous explanations: (1) outflow was not major relative to the total scale of business, (2) outflow was significant but can be dealt with in the short run (pandemic expertise), (3) output slumped as well, so the demand for jobs was smaller. Still, we see migration's net effect on the labour market as generally negative in the short run, so wage pressure is unlikely to ease soon because of this factor. Also, the situation is different across sectors, e.g. services enjoying inflow of new job applications from women, while construction, transport etc. suffering from outflow of men. In the long run, if Ukrainians' inflow proves persistent, it is natural to expect weakening of the wage pressure in general.

Labour Force Survey data reveal that the labour participation of Poles has risen significantly since mid-2020. Yet, it was not enough to prevent the resurgence of labour shortages in the last two years.



Source: GUS

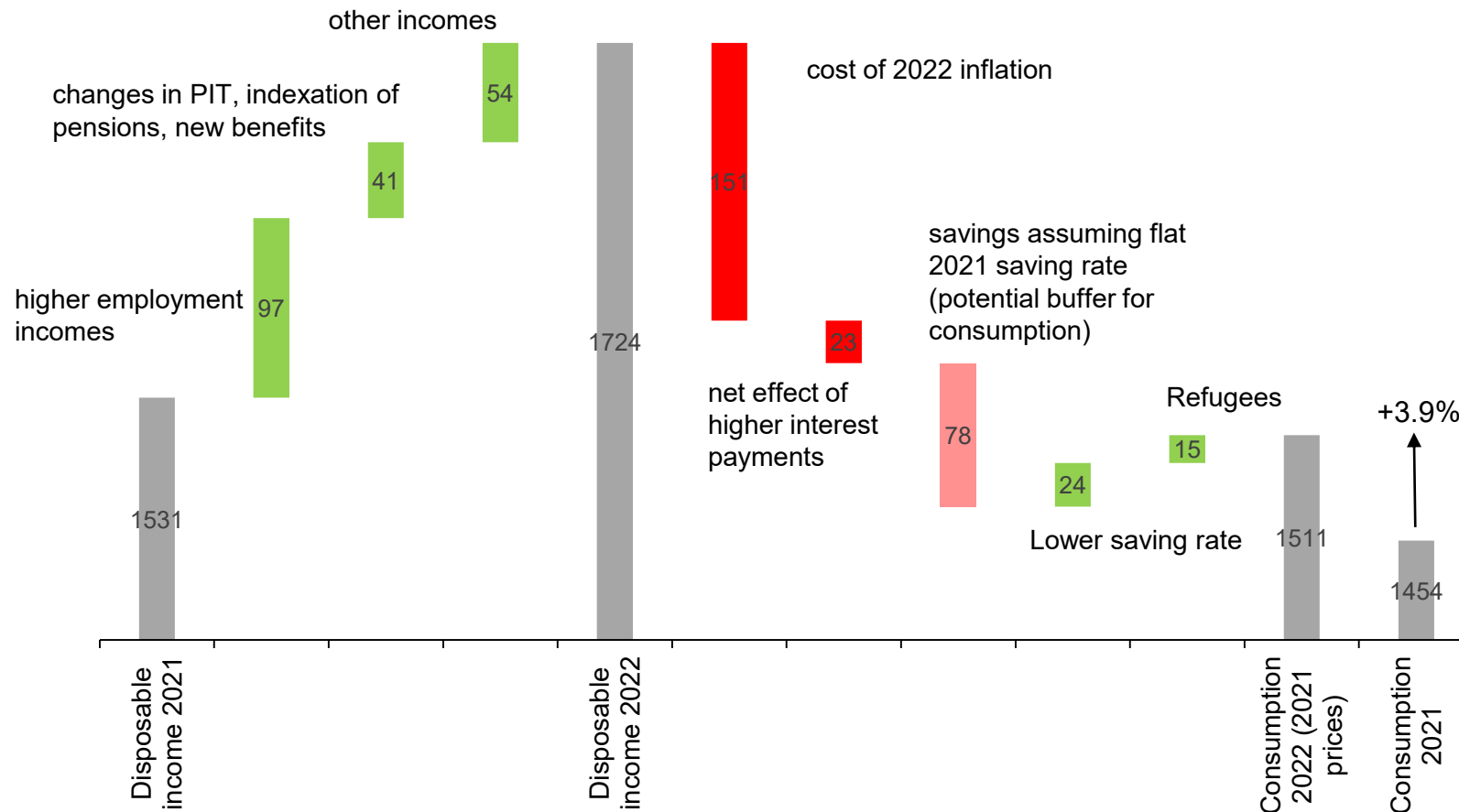
Source: Eurostat, Santander



Consumption: strong incomes provide support

We still remain moderately upbeat as regards private consumption prospects in 2022, mostly thanks to the fact that disposable incomes are likely to advance at a two-digit pace, driven by strong wage growth, cuts in personal tax and additional benefits. While inflation is consuming a large chunk of this growth, we still think there is some upside, especially given demand of refugees and possible further reduction in the saving rate amid higher inflation.

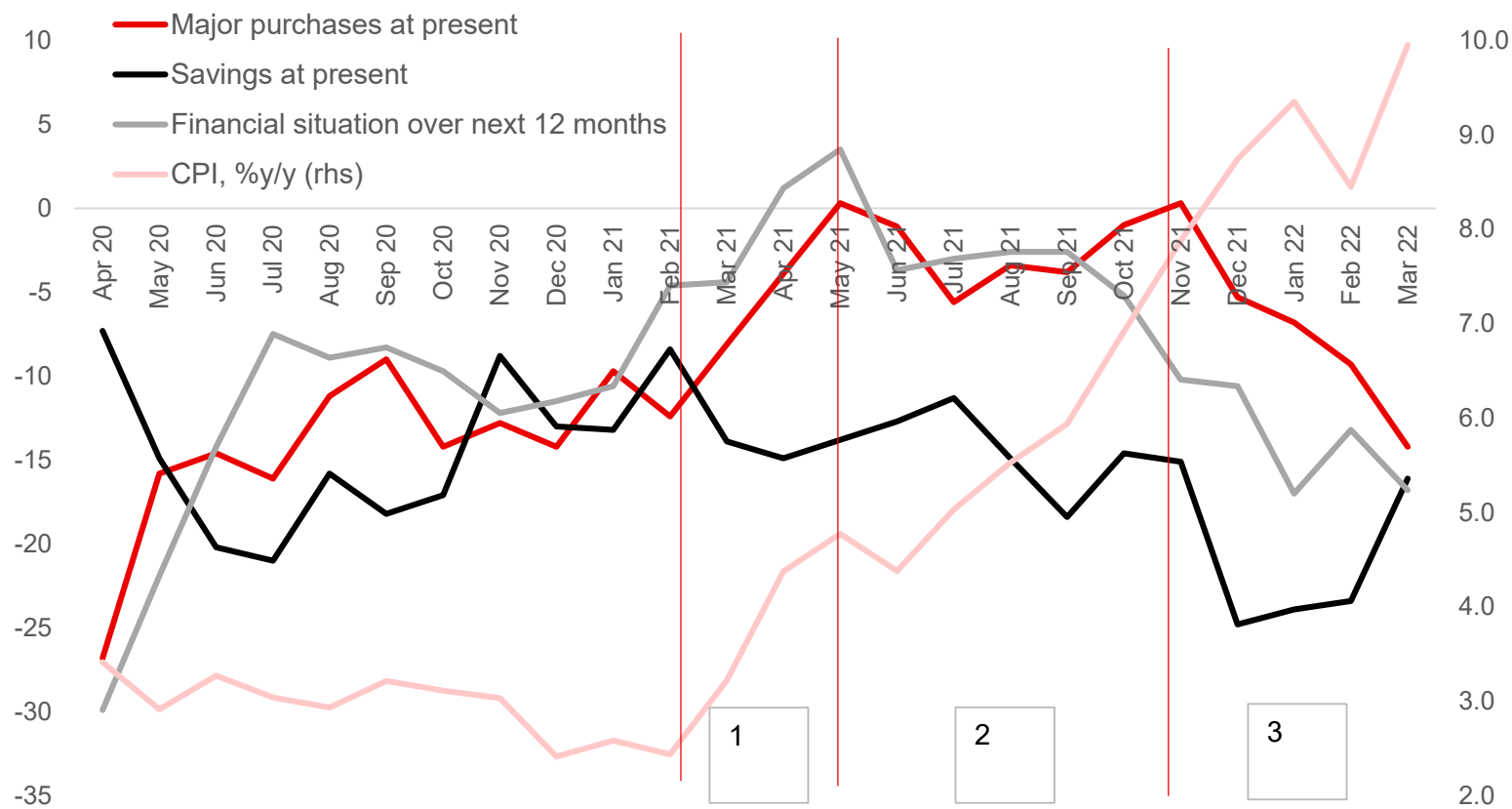
Breakdown of disposable incomes and consumption, PLNbn





Consumption: confidence survey spells trouble?

Yet, the results of consumer confidence survey suggest that the surge in inflation may be eroding households' propensity to spend. We have identified three phases of inflation's impact on consumer behaviour (which resemble a similar cycle observed during the previous supply shock episode in 2010-14). In the 1st phase of rapid inflation rise, consumers responded by advancing major purchases, in the 2nd phase they kept up spending at an accelerated pace, but started to lose the ability to accumulate savings, in 3rd stage they started to worry about their future financial situation and started cutting major purchases. The last data point shows a rebound of the preference to save in response to the war in Ukraine.



Source: GUS, Santander



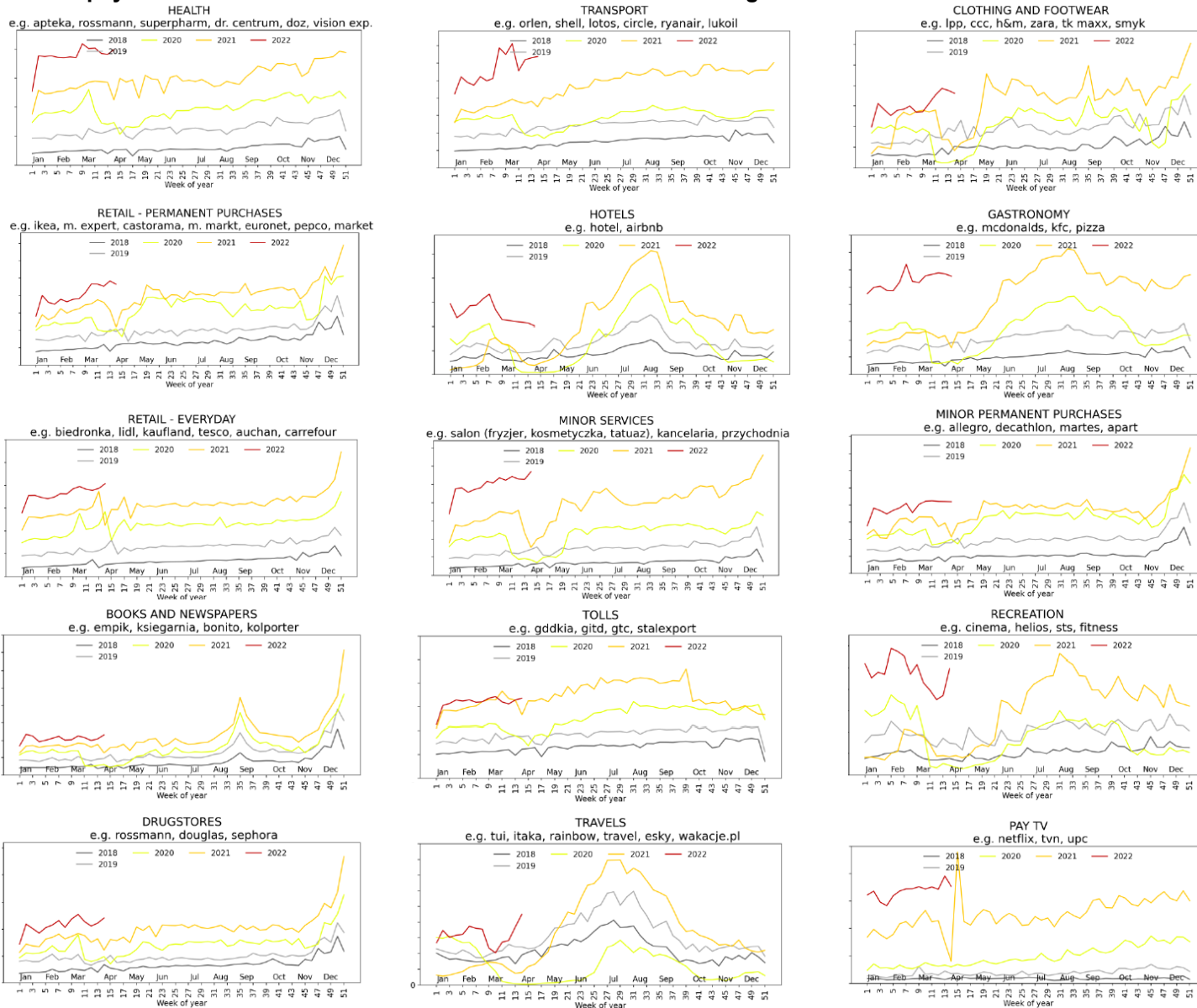
Consumption: spending patterns barely affected

Santander's card data suggest that the war has triggered **only a short-lived disruption in spending patterns of Poles.**

Spending on non-essential services (travel, gastronomy, pay tv) does not seem to have suffered a sustained, significant damage

... which reduced our worries that the war in Ukraine may trigger a significant rise in precautionary saving of households, potentially lowering private consumption outlook for the coming quarters

Card payments of Santander Bank Polska customers: selected categories based on MMC



Source: GUS, Santander

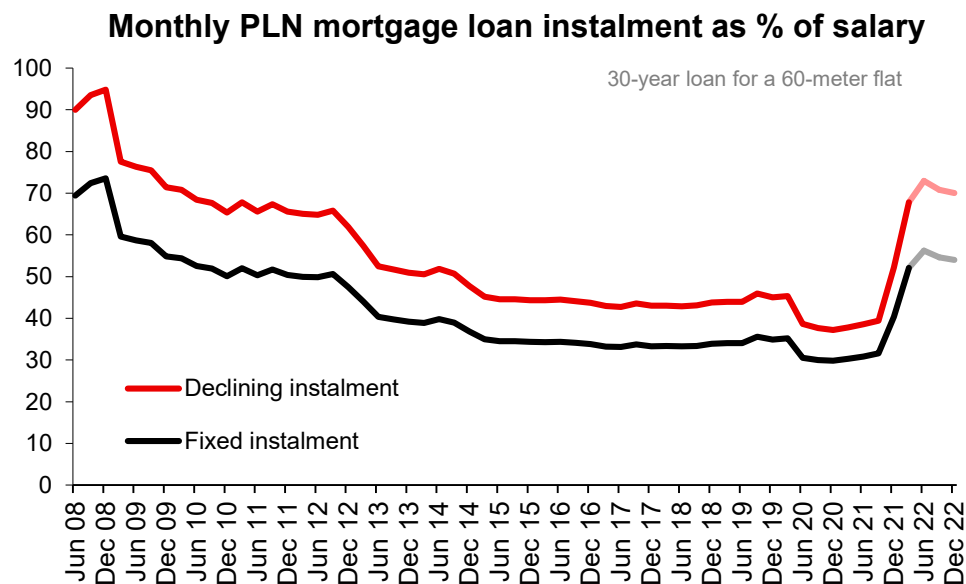




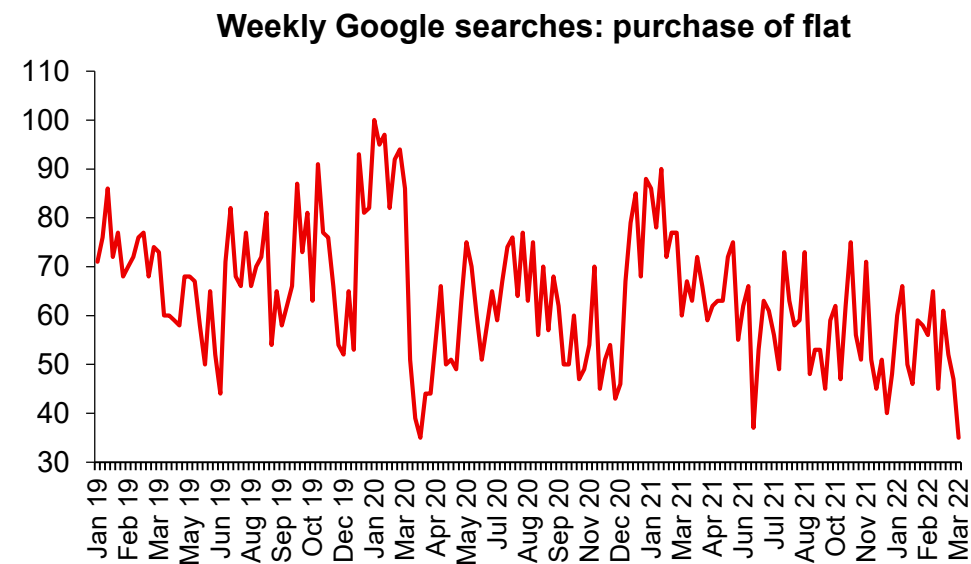
Investment: households to invest less...

In [our 2022 outlook](#) we were quite optimistic about investment in private companies and public outlays on roads, fairly optimistic about households' investment and pessimistic about investment in local governments and outlays on railways.

Now we have turned rather **pessimistic about households' investment**. War and higher interest rates will be clearly discouraging for potential investors. Monthly loan instalment vs average salary is likely to hit an all-time high soon (we do not treat pre-2009 numbers as comparable, given that FX-denominated loans were prevalent at the time) and war-related uncertainty undermines investment in real estate. On the other hand, inflow of refugees is supporting the demand side, but we would rather expect effects in the longer term.



Source: NBP, Santander



Source: Google Trends

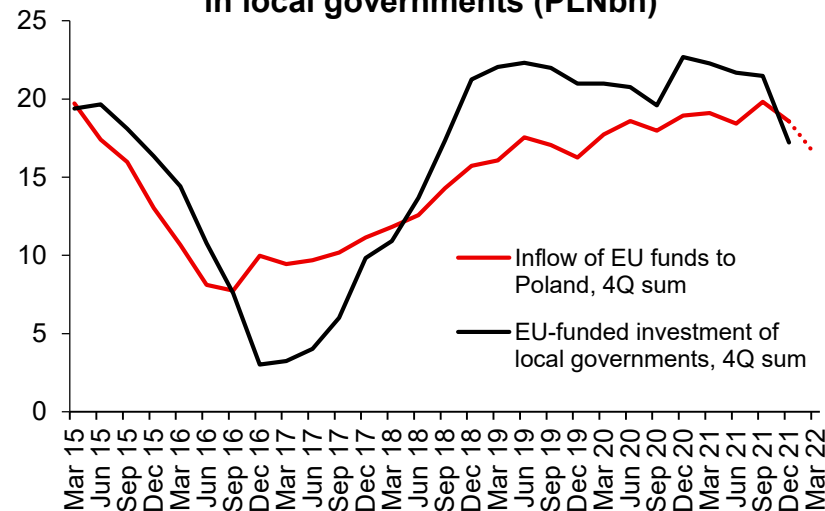


Investment: ... and companies too

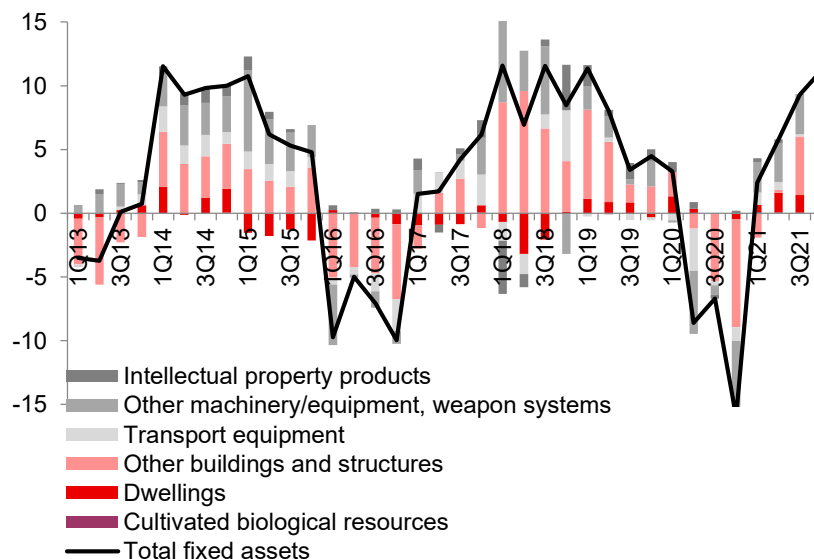
We maintain our views on public investment in 2022. While outlays in local governments were slightly better than expected in 4Q21, another planned cut in PIT tax is undermining local government's incomes, delay in disbursement of Recovery Funds is extending, and inflow of refugees is raising costs. On the other hand, we may see some higher outlays in the energy infrastructure, so the balance remains roughly unchanged.

Investment in companies is a bit more tricky. So far, we did not see many results of investment-related surveys after the war. Semi-annual investment GUS Survey pointed to some rise in 2022, but in general the business sentiment indicators plunged and we think that **higher uncertainty will be generally negative for investment**, especially given that it was recently driven mostly by equipment and transport purchases, which are by nature less inert than investment in structures, allowing for a quick deceleration.

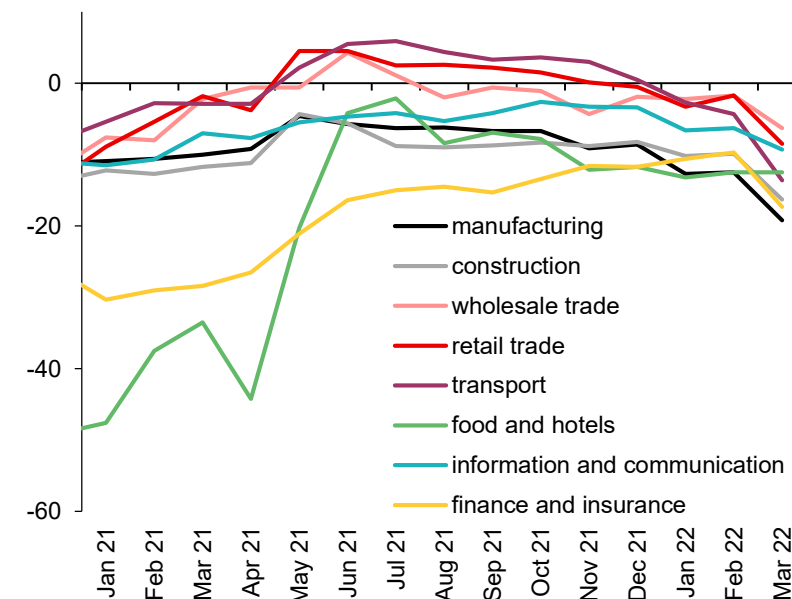
Inflow of EU funds to Poland (EURbn) and EU-funded investment in local governments (PLNbn)



Fixed investment growth breakdown by asset type, % y/y



GUS business climate indicators



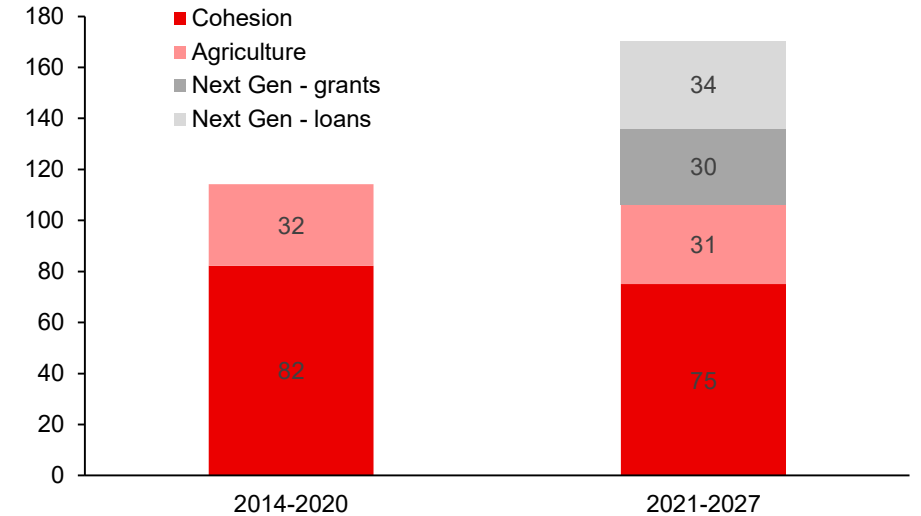


EU funds: will recovery fund get unfrozen?

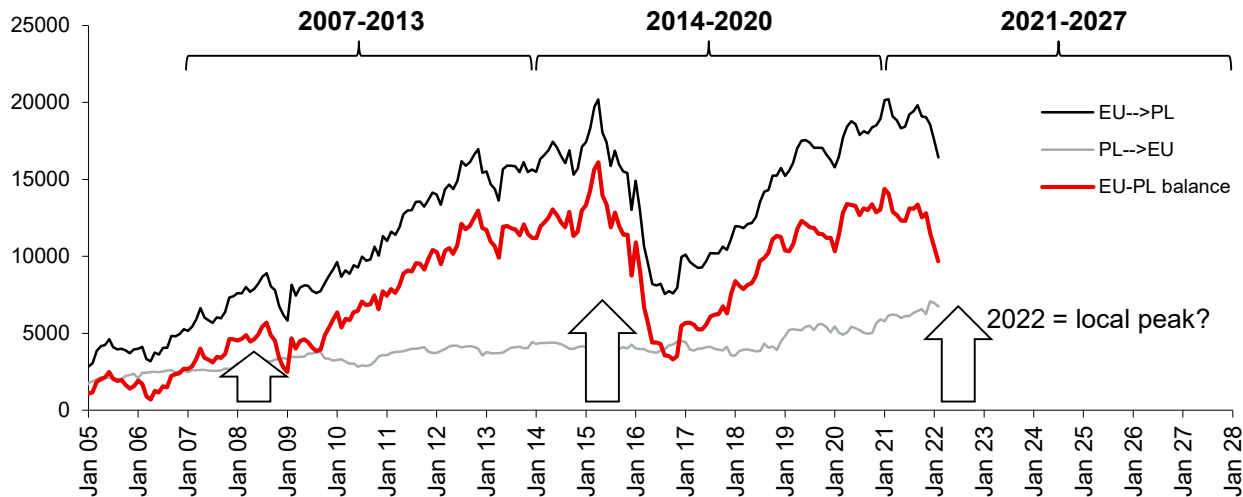
We assumed that the Recovery Fund will be unblocked in 1Q22. Clearly this forecast did not materialise. However, there were some signals that the deal may be approaching, so we are expecting it to happen in 2Q22. Still, **growing delays are negative for the investment outlook.**

Interestingly, EU funds inflow decelerated markedly over the last few months. We used to expect 2022 to be a peak in 2014-2020 framework spending, in line with 7-year cycle. But now it looks like the peak was in 2021. We do not expect 2022 to see a similarly deep slump in EU funding as in 2016 (back then it triggered a massive collapse in investment: -8%). This time, about 1/3 of 2014-2020 framework payments were still not realised, so there is a plenty of cash in the pipeline. As a result, **the decline will be most likely more spread over time.** It is hard to expect any boost in EU funding before the unfreezing of the EU recovery fund.

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

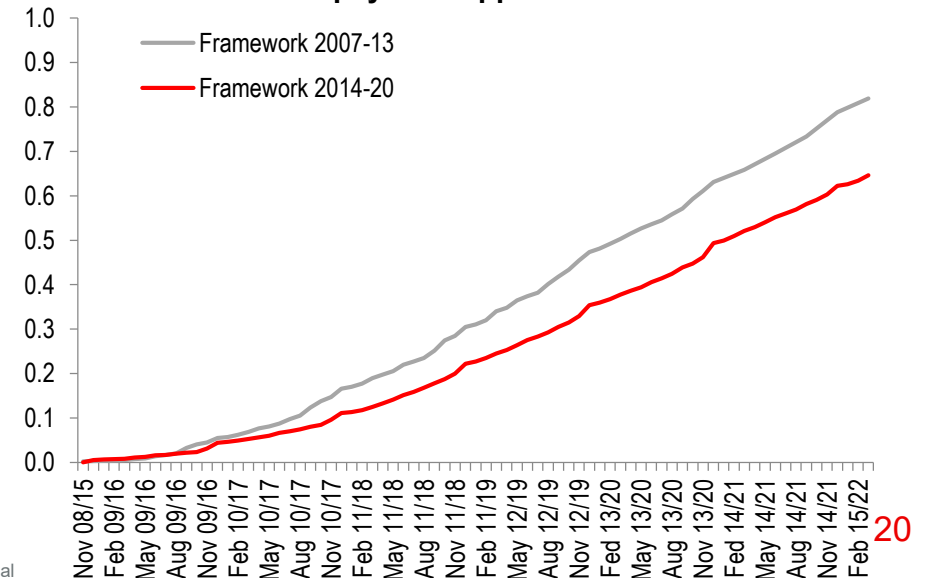


12m sum of financial flows between Poland and EU



Source: NBP, Santander

EU Cohesion Funds payment applications as % of total funds



Source: Ministry of Funds and Regional Policy, Santander



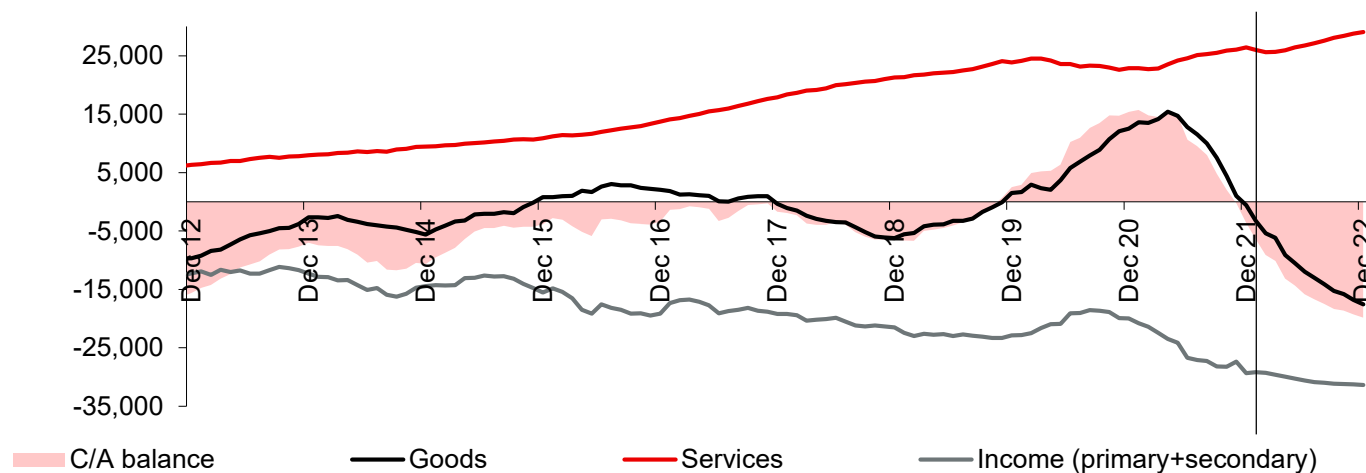
External balance: to deteriorate further

In 2021 the current account deteriorated to -0.6% of GDP from +2.9% of GDP in 2020. There were two main reasons behind this development: economic rebound supporting imports and higher prices of energy commodities (responsible for about 1/3 of the current account deterioration).

As prices of energy commodities spiked in 2022, we expect them to have a similar effect on current account versus 2021 as it happened in 2021 versus 2020. Also Poland's export of transport services can be hit by the mobility package. On the other hand, slower economic growth and weaker FX rate will be undermining imports versus exports. Thus, while we are expecting the trade balance to deteriorate in nominal terms, in real terms net exports' contribution to GDP growth does not have to be negative (in the past, net exports have always improved during economic slowdowns).

We forecast the current account deficit at 3% of GDP in 2022. Apart from worse trade balance, we think that also income balance can be a bit worse due to weaker inflows from the EU. Net remittances remain a tough call though, as we can see both stronger flows from Poland to Ukraine and from Ukraine to Poland.

Balance of payments: main balances, 12M moving sum, EURm



Source: NBP, Santander

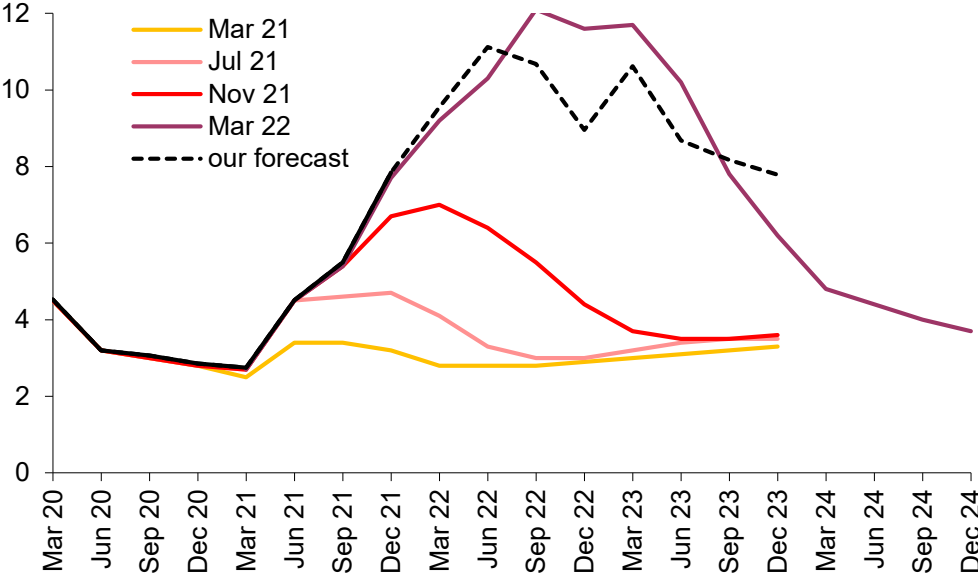


Inflation: higher for longer

Over the last few months CPI inflation has been consistently surprising to the upside, heightening and extending the expected inflation paths. This behaviour of CPI means that confidence ranges for forecasts are wider than usually, not only due to dynamic changes on the FX and commodity markets, but also due to policy response. For example, currently we are expecting the government to prolong the 'anti-inflation shield' at least until the end of 2022.

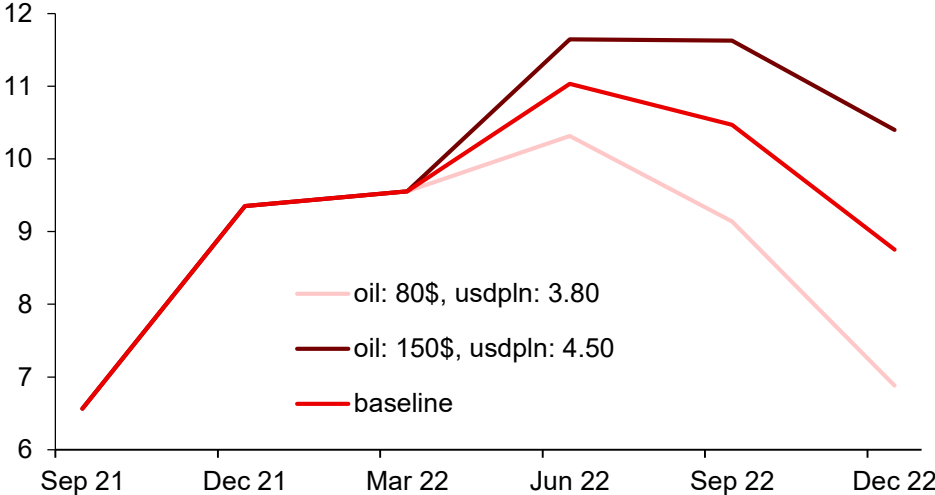
Our current baseline scenario assumes CPI stabilisation near 11% by the late summer and then a gradual decrease (with temporary spike at the start of 2023 once the temporary tax reductions expire).

CPI inflation according to subsequent NBP projections and our current forecast, % y/y



Source: NBP, Santander

Our CPI forecasts under different assumptions about average Brent and USDPLN in 2022



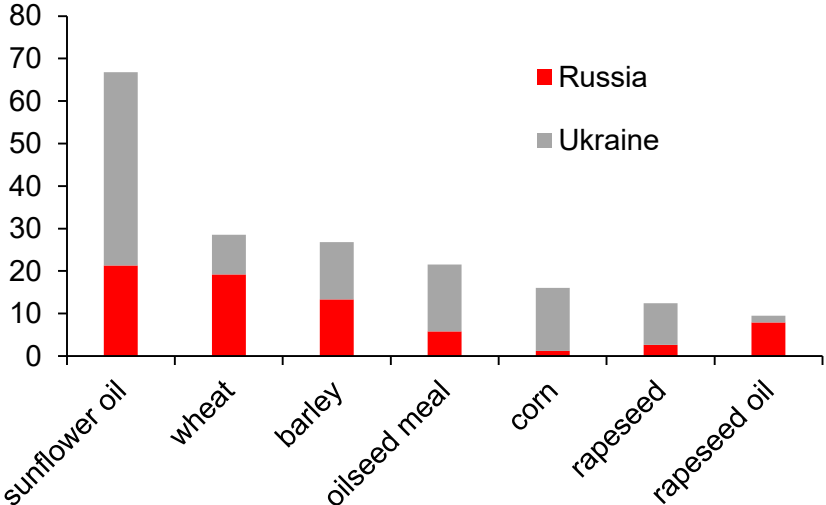
Source: Santander



Inflation: pressure on foods

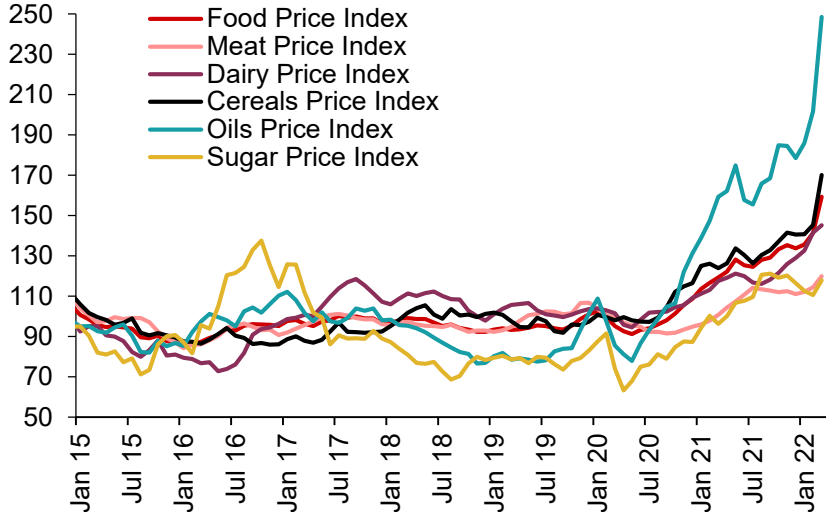
Russia and Ukraine are major producers of some cereals, oil seeds and fertilizers. War-related disruptions in supply as well as potential decline in output will put an upward pressure on global food prices, given that demand is likely to remain high. While Poland is a major food producer, it is also facing high increased demand due to inflow of immigrants. Thus, we are expecting food inflation to remain high throughout 2022 with upward risk.

Russia and Ukraine are major exporters of grains and oil seeds, % of global exports



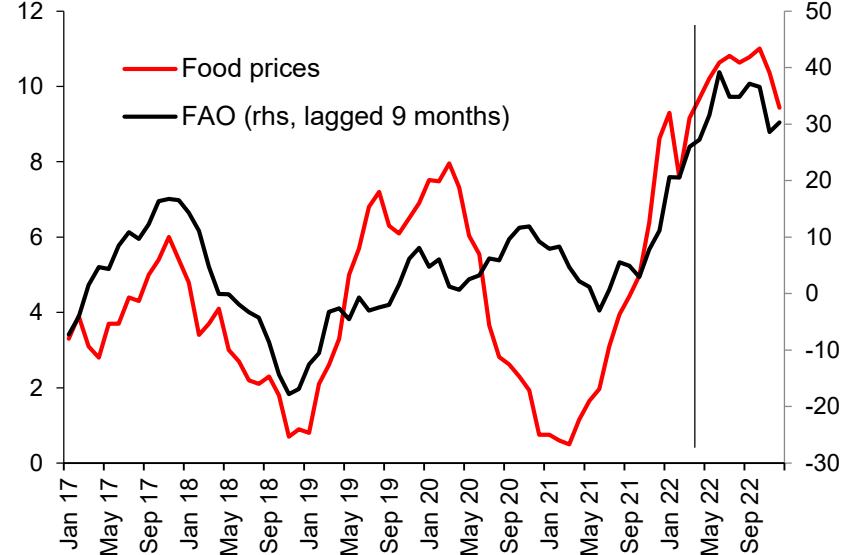
Source: UN Comtrade, Santander

Global Prices of grains and oils are already spiking, FAO price indices (USD)



Source: FAO, Santander

Food inflation in Poland, % y/y



Source: FAO, GUS, Santander



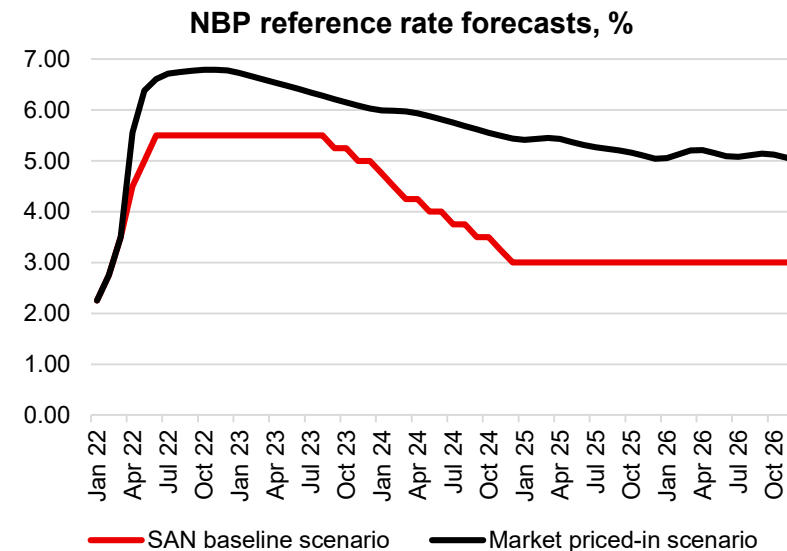
Monetary policy: moving the goal posts

Polish central bank's yet another aggressive response to inflation surprise (+100bp rate hike in April, following +75bp in March) suggests we should move our expectations for peak reference rate in this cycle higher. Yet, we are not convinced that the next moves will be equally strong. Their size will be most likely a function of next inflation data. If – as we predict – CPI stabilises near 11% y/y, the central bank may revert to 50bp move in May and then **raise the main rate to 5.5% by June**. If inflation keeps surprising to the upside, we may move closer to the scenario anticipated by the financial market (NBP reference rate peaking near 6.5% in 2H22).

The scenario priced-in by the market (rates up to 6.5%) is in fact consistent with the scale of monetary tightening theoretically needed to bring inflation to the tolerance band around the target, which could be derived from the results of March inflation projection and the NBP's estimates of the monetary transmission (rate hike by 100bp implies CPI lower by 0.2-0.4pp in the long run) presented at the press conference after Inflation report publication.

However, another important factor affecting interest rate decisions is the exchange rate behaviour. According to the NBP, 10% PLN move implies c.1pp CPI change (highly asymmetric: stronger effect of depreciation than appreciation, stronger during high economic growth). Based on those estimates, one can say that a persistent 10% zloty depreciation requires (roughly) additional rate hikes by 250bp to neutralise its inflation impact. Yet, since early March when the zloty selloff was culminating (EURPLN near 5.0) the Polish currency has regained c. 6-7% against both euro and dollar. So, we may say that the zloty appreciation seen in the last few weeks has reduced the required scale of interest rate hikes by c.150bp.

We think the NBP's bravery in policy tightening may weaken over time, when real data start showing a meaningful economic slowdown in Q2. So, unless they deliver aggressive tightening at the nearest meetings, the likelihood of rates climbing above 6% should be declining.



Source: Santander, Refinitiv (as of 2022/04/11)

MPC reshuffle almost completed

Old MPC	Leaves office	New MPC	Nominated by
Gatnar	25/01/2022	Kotecki	Senate
Kropiwnicki	25/01/2022	Litwiniuk	Senate
Ancypanowicz	09/02/2022	Janczyk	Sejm
Łon	09/02/2022	?	Sejm
Zubelewicz	20/02/2022	Dąbrowski	President
Hardt	20/02/2022	Wnorowski	President
Żyżyński	30/03/2022	?	Sejm
Glapiński	21/06/2022	Glapiński?*	President
Sura	16/11/2022	Tyrowicz?*	Senate
Kochalski	21/12/2025	?	President

* President's candidate still has to win approval from Sejm

** According to media leaks; Senate still hasn't formally proposed candidate



Fiscal outlook: deficit likely to grow

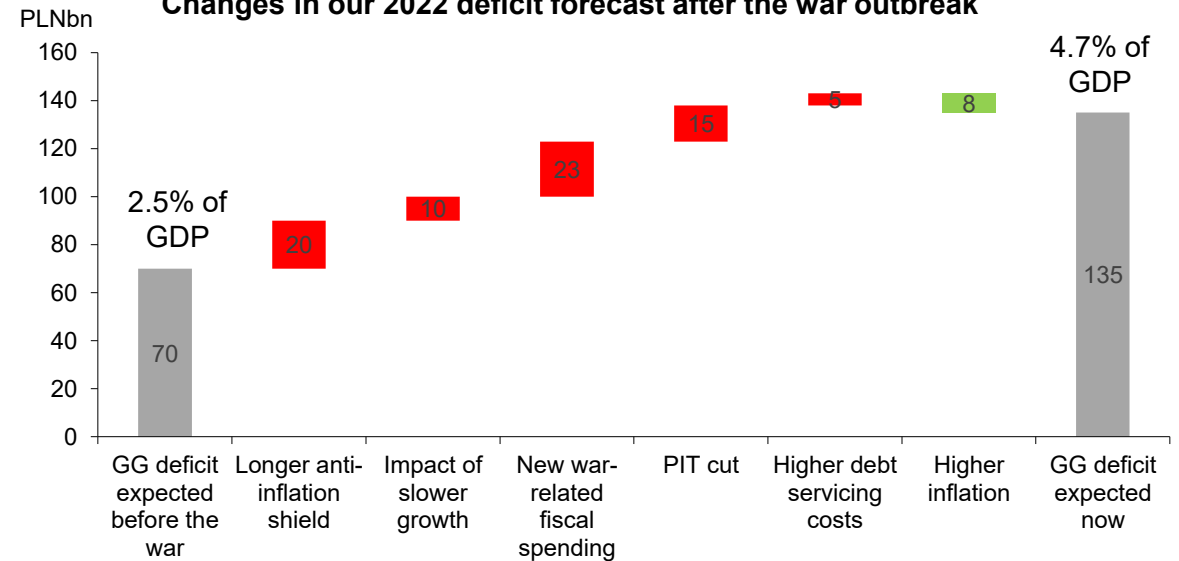
War in Ukraine and its consequences imply higher costs for the budget. Some of them result from unexpected circumstances (costs of refugee inflow, slowing economy), others from government's discretionary decisions (extension of "anti-inflation" shield, introduction of the "anti-Putin" shield, cut in PIT taxes since July). Significant rise of interest rates and bond yields also implies a gradual rise in debt financing costs.

Higher inflation will provide some protection for budget revenues, but not as strong as you would normally expect, as the "anti-inflation" shield effectively reduced indirect taxes (sometimes to zero) on those products, which prices are rising the most.

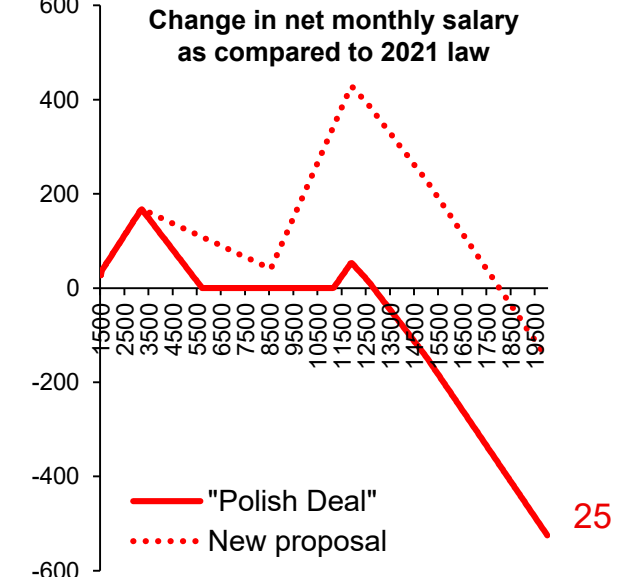
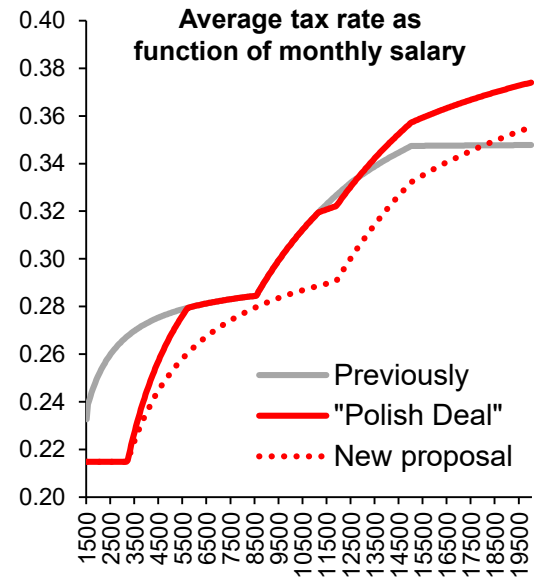
We estimate that fiscal deficit (GG) in 2022 may go up to c.4.7% of GDP, vs. 1.8% in the previous year and c2.5% expected by us just before the war started. Some of the impulse is likely to be passed into 2023 (e.g. already announced higher spending on national defence and probably unavoidable higher spending on key public services, like healthcare, education, administration).

As long as the nominal GDP growth stays close to 10%, deficit below 5% of GDP implies that the debt-to-GDP ratio should continue its downward trend. In 2021 it has decreased to 54.2% according to ESA-95 or 44.1% according to the domestic definition (which excludes the Covid bonds, among others).

Changes in our 2022 deficit forecast after the war outbreak



Summary of new PIT reform proposal



Financial markets

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

2



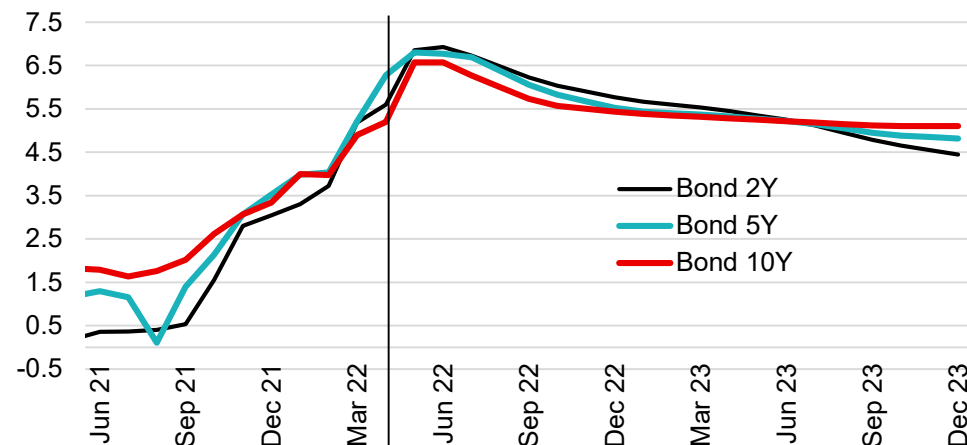
FI outlook: more inflation, more hikes, stagflation risk

We expect to see yields going higher on core markets this year. The high inflation environment, which keeps generating a stream of upside CPI surprises, and rate hikes in the pipeline of Fed and ECB should allow for this. We expect the ECB to turn to rate hikes in 4Q22 while the Fed, which has already started raising rates, may keep adding to this at every meeting this year. The planned end of QE in the Eurozone and a switch to QT in the USA should also support higher bond yields.

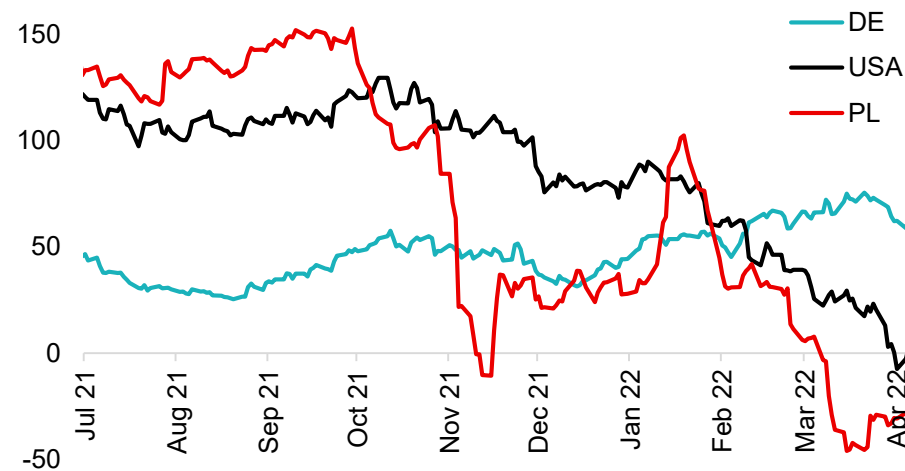
At the same time the stagflation risk, exacerbated by the war in Ukraine (sanctions, strengthening of the global supply shock) may act towards a decrease of the slope of core market yield curves. The US curve is already at the point of inversion.

On top of the core market background and the upside drive on high inflation/rate hikes story the Polish yield curve has also faced upside pressure for being close to the source of the geopolitical risk. We believe that the latter factor may already have exhausted its negative potential on POLGBs and we could soon see some returning demand from abroad (see [page 29](#)) However, this foreign demand could meet additional supply due to further fiscal easing (see [page 25](#)) as a result **the Polish curve does not have to reduce its slope** – the same way core market curves are expected to do. **Also the local asset swap spreads may remain wider than in late 2021 or before the pandemic.**

POLGB benchmarks: yield, monthly average



Government bonds: yield curve slope (10Y – 2Y) in bps



Source: Bloomberg, Santander



FI outlook: higher borrowing needs

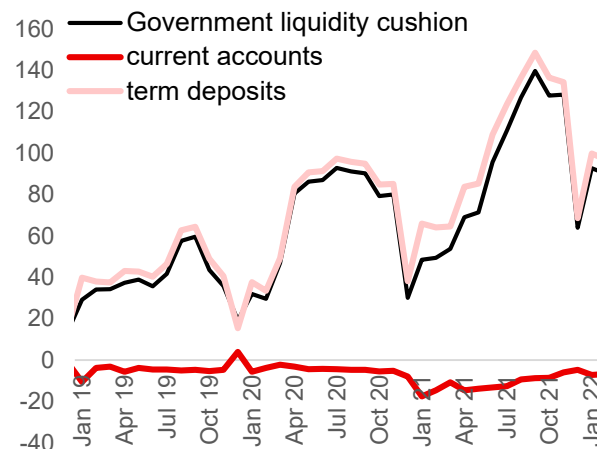
Net 2022 borrowing needs shown in the budget were around PLN60bn and PLN222bn in gross terms. Of this 61% is already covered according to MinFin which leaves some PLN86bn to be covered, with PLN95bn of maturing POLGBs still this year. This compares to 60% coverage of 2021 needs at the end of 1Q21. This is a misleading picture. Coverage of all this year's needs plus some pre-financing may be a challenge and require some non-standard measures from the Ministry of Finance. Sizes sold at ordinary and switching auctions have recently tended to decrease.

We argue (see [page 25](#)) that net borrowing needs will go up by PLN60bn as compared to the budget act. This leaves additional cPLN50bn to be covered still this year, possibly going up by other 40-50bn if the government would want to enter 2023 with c.20% pre-financing share (the lowest fraction seen in recent years).

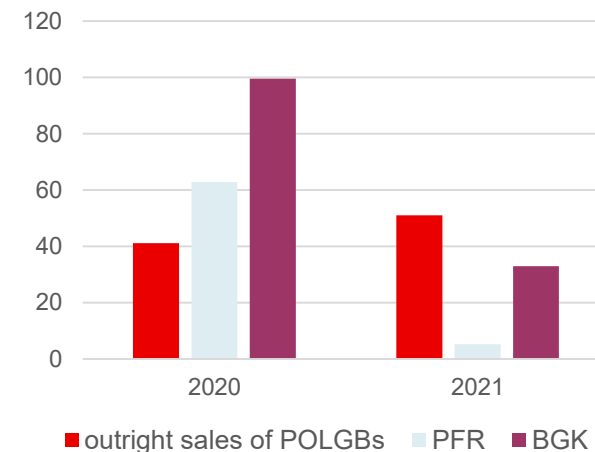
The easiest way is to utilise the government liquidity cushion which was at PLN90bn in February. So far the government was not in a situation where it would have to heavily rely on it. We assume it would be reluctant to reduce it below PLN30bn. Eurobond auctions could be another option now that PLN has stabilised, or T-bills (currently inactive) – heavily used during the global financial crisis (net increase by PLN40bn in 2008) and at the start of the pandemic (c.PLN18bn). We might see a mix of these measures by the ministry to check which channel works best in this challenging environment.

In 2020 and to some extent in 2021 PFR and BGK bonds were issued instead of POLGBs, some 30% of which were bought by NBP. But the QE purchases are over, last PFR issuance was in Jan21 and BGK's in Nov21, and the papers are illiquid.

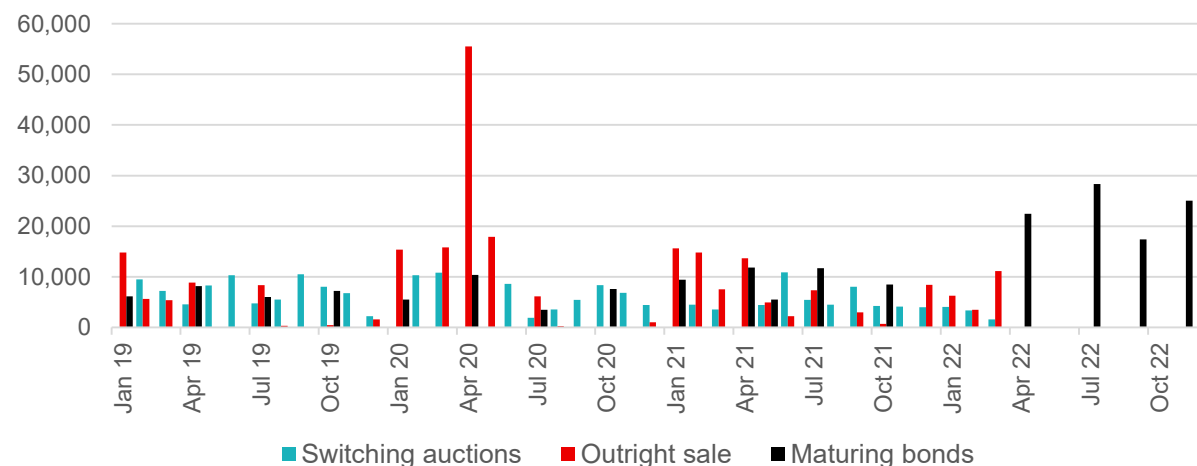
Money on government accounts, PLNbn



Bond supply by issuer, PLNbn



POLGB sales and redemptions, PLNmn



Source: Finance Ministry, PAP, Bloomberg, Santander



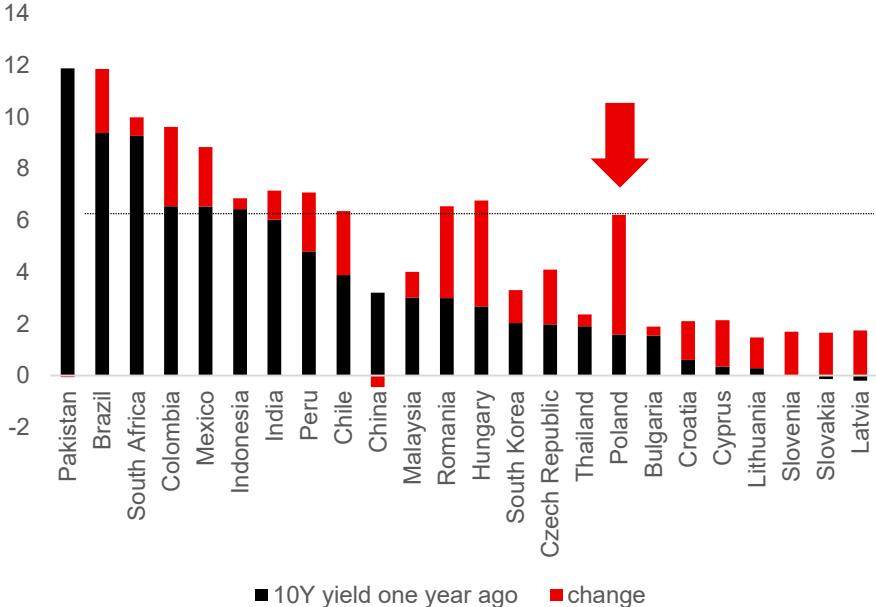
FI outlook: who will buy POLGBs? (1/2)

Polish yields are not the highest in EM space but jumped by most on the Russia-Ukraine war so may be really attractive when investors get used to this risk factor.

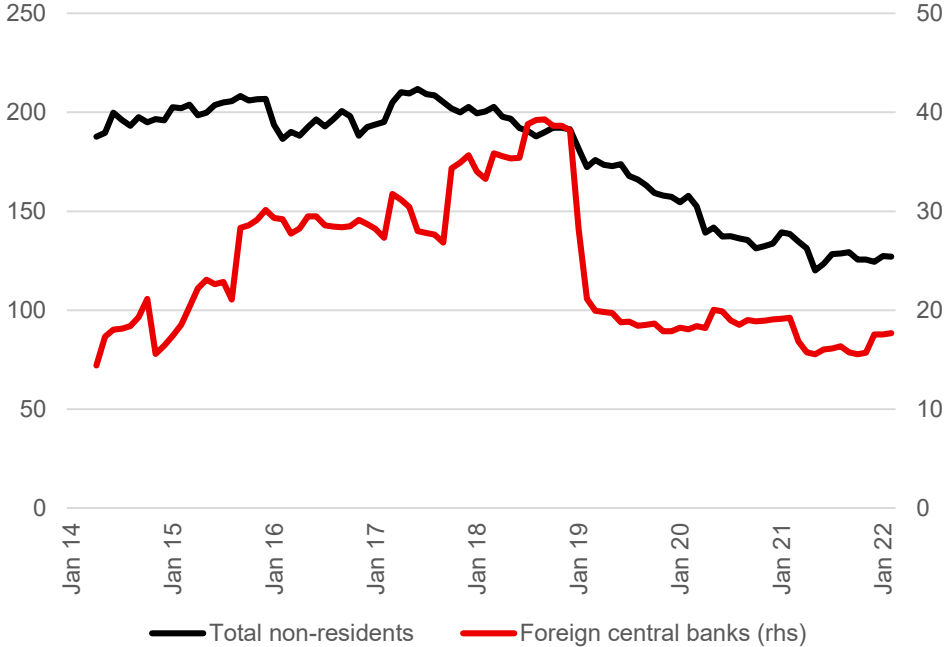
Yield hunting is what triggered a huge demand from Asian central banks for POLGBs in 2014-2018. Their Polish bond holdings were up from PLN5bn to PLN37bn back then. Now they are at PLN17bn. Poland holds the same or better sovereign rating from S&P than Malaysia or Thailand while now offering much higher yield. It also scores better than India and Indonesia where the yield is higher but not as dramatically higher as a year ago.

Generally, the holdings by **foreign investors have been falling for years, so they seem underweight and waiting for a trigger** – the sense of regained control over inflation may be such a signal and we are about to enter a period of flat CPI growth now.

10Y government bond yields in EM countries and Poland's regional peers



POLGB holdings, PLNbn





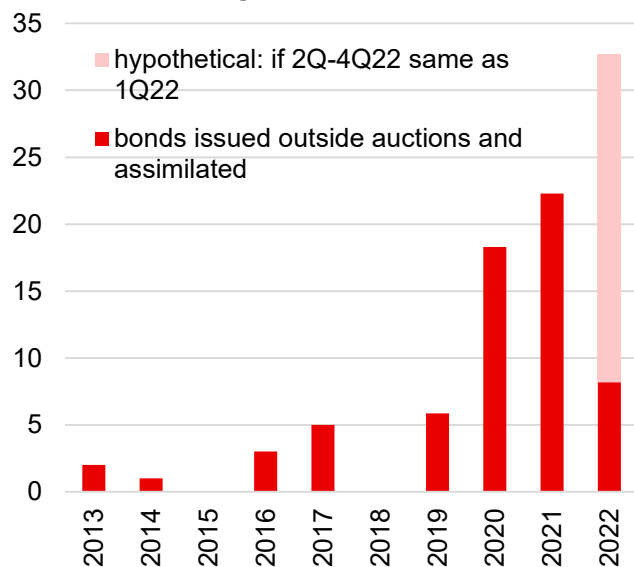
FI outlook: who will buy POLGBs? (2/2)

On the other hand banks' ALM demand is based on developments in bank deposits and credits. High interest rates discourage credit demand and encourage early repayments. The war increased cash preference. So POLGB demand from ALMs may go down – by the end of February local banks' bond holdings rose by PLN7bn, but if the correlation with deposit changes was to hold then any positive annual change this year would be a success.

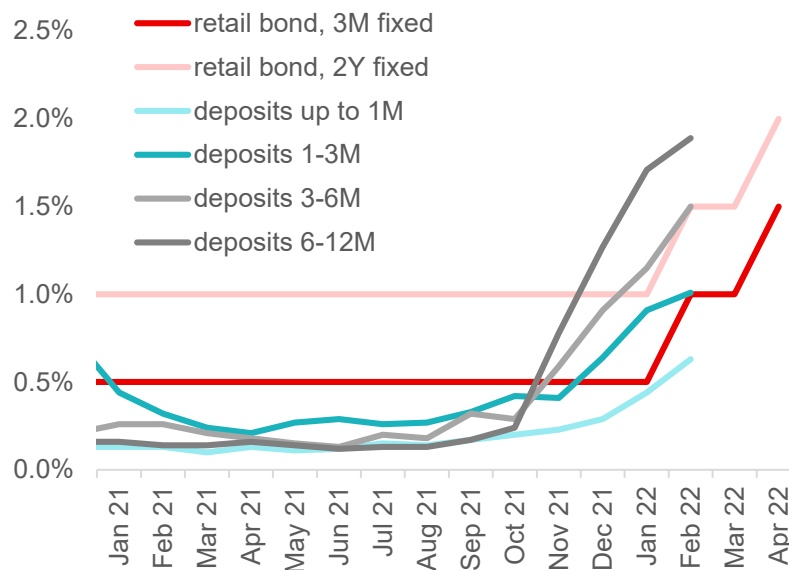
Households proved an important and reliable source of demand in recent years, but retail bonds yield is falling behind alternatives as simple as bank deposits. Households increased their holdings at c.PLN14bn/year in 2020 and 2021 but we think that without a more aggressive pricing policy and with higher costs of living of the households this could drop to PLN10bn this year.

Since 2020 plenty of bonds are introduced via placements at public institutions and later assimilation with benchmark series, MF showed in 1Q22 that it wants to keep active such an alternative route of injecting the supply rather than showing larger sizes at auctions.

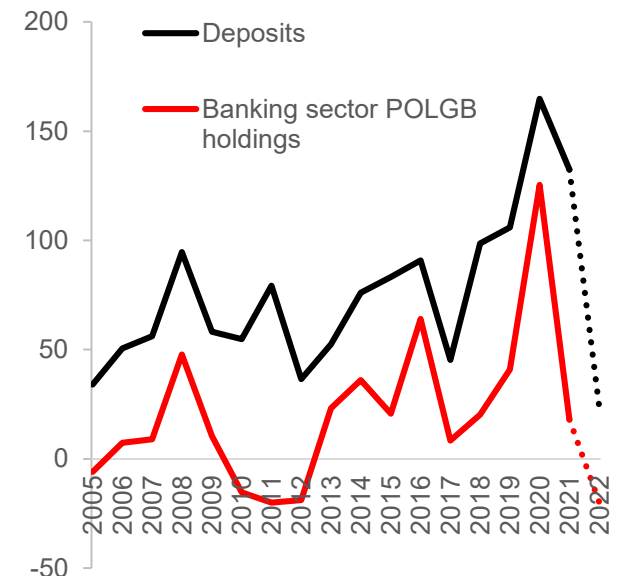
Assimilated government bonds, PLNbn



Interest on bank deposits and selected retail bonds



Banking sector deposits and bond holdings annual change, PLNbn



Source: GUS, Santander



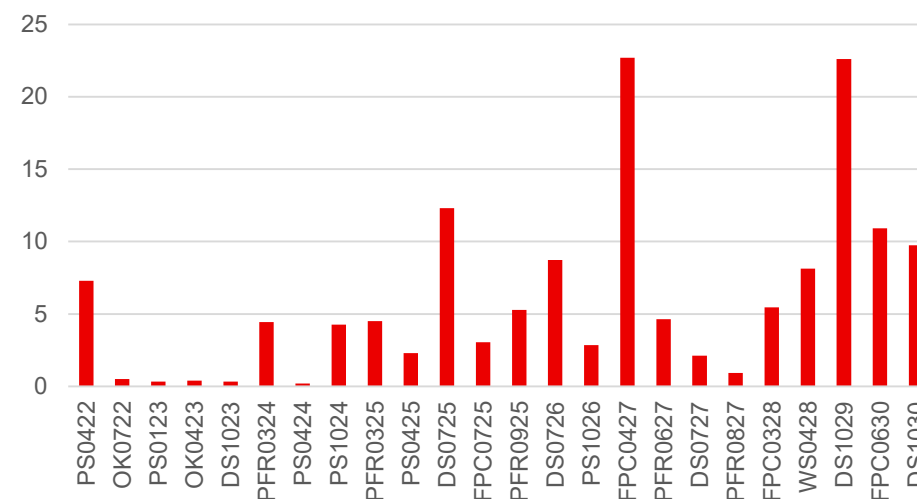
NBP QE: redemption coming

There is still no official NBP's QE reinvestment policy. The only redemption so far, a year ago, had a negligible size of PLN50mn, so the issue was not urgent.

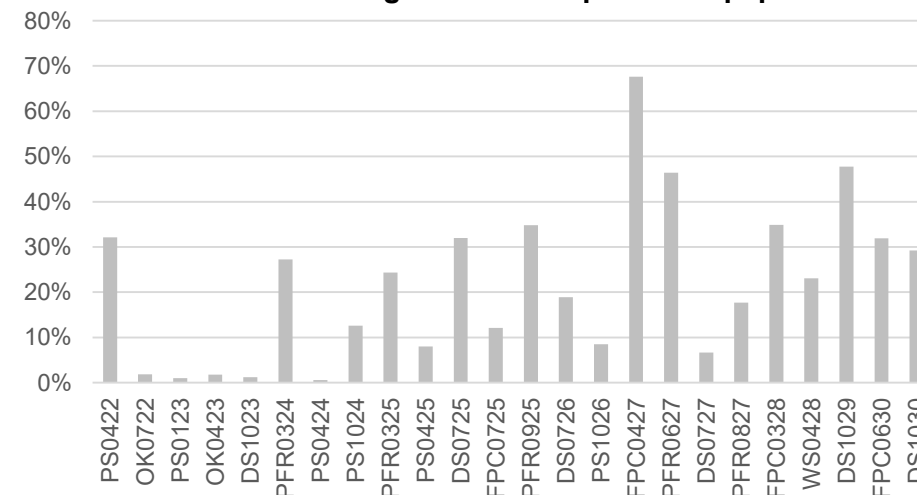
NBP holds PLN7.3bn of PS0422 government bond with maturity date of 25 April 2022 (the last four digits in the name of Polish bonds indicate maturity month and year). This is 32% of the total outstanding amount of the paper and 5% of total NBP QE bond holdings. Fed QT in 2018-2019 was conducted at an average pace of c0.9% of total QE assets per month. The size of the coming NBP QE redemption looks too big to just ignore and the market could really use some fresh demand. On the other hand, after April the next important redemption will only be in two years time so NBP may be unwilling to work now on policy that will start to matter in two years, when monetary, economic and market conditions may be totally different.

The NBP governor was asked at his last press conference earlier this month about the plans for POLGBs in the bank's portfolio. He said that reinvestment is an option, but there is still time to decide. At the same time he emphasised that the NBP does not do asset purchases any more. We think the most likely scenario is that the central bank will not reinvest the bonds maturing in April.

NBP QE holdings by bond series, PLNbn



NBP QE holdings by bond series
% of outstanding amount of a particular paper



Source: Finance Ministry, NBP, Santander



FX outlook: no support from growth outperformance

We assume that this year the starting point before the war, 4.50, will be the floor for EURPLN. **The exchange rate will stay within the trading range seen before the conflict** where it will wait until it gets more clear how painful for real economy was the fight with inflation, once the high inflation period is over.

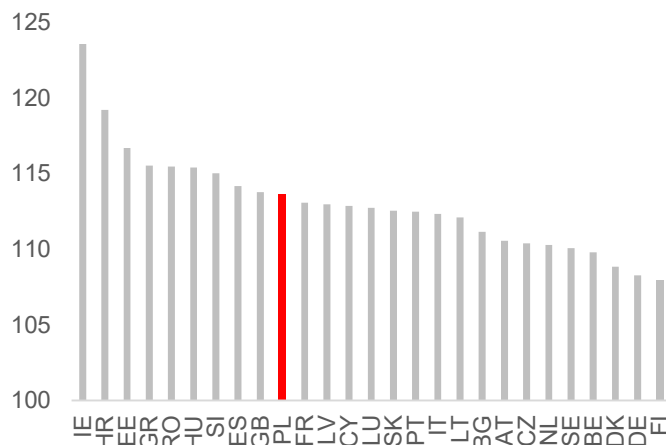
For long we have argued that the positive prospects of PLN are based on the Polish economy's ability, proven many times, to outperform other EU countries. This time we are not so certain this would work, so we assume rather stabilisation of EURPLN than its clear decline. The scale of monetary tightening and delays in EU funds-based contracts may be enough to decrease Poland's growth advantage in 2022 to an low level and to make it pretty average in the EU in 2023. Taking together the GDP growth revisions for 2022 and 2023 that occurred between February and March (as reported by Bloomberg), Poland saw one of the largest declines. What is more, its expected compound GDP growth in the 2021-2023 period is far from the top of the EU ranking.

The collapse of Poland's C/A balance between the middle of 2021 and now (see [page 21](#)) makes the case against the zloty.

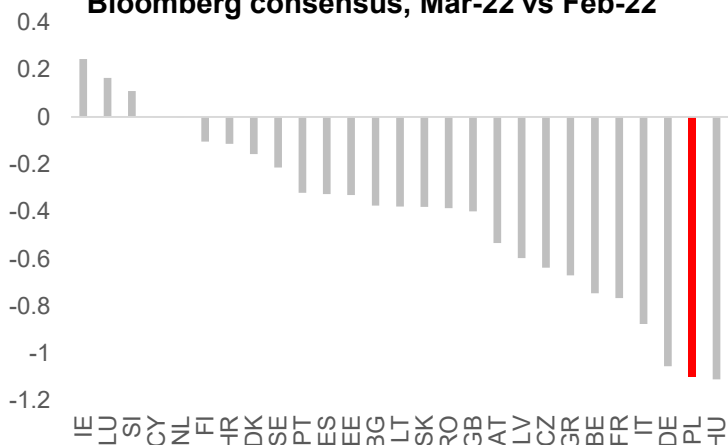
We are also worried about the gap between EURPLN and inverted EURUSD which suggests plenty of upside potential of the former. However the EURUSD level may be depressed by the exposure of the European economy to Russian energy commodities and a solution leading to broader EU's independence from Russian supply or the end of the war could see EURUSD move towards closing the FX gap.

EURPLN's upside potential is limited in our view by the NBP' preference for a stronger zloty – a great ally in combating elevated inflation. NBP FX interventions in the first weeks of the war did not seem to achieve much, but were just warning shots, judging by the only small decline of FX reserves at that time. In the meantime the NBP secured swap lines with ECB and Fed.

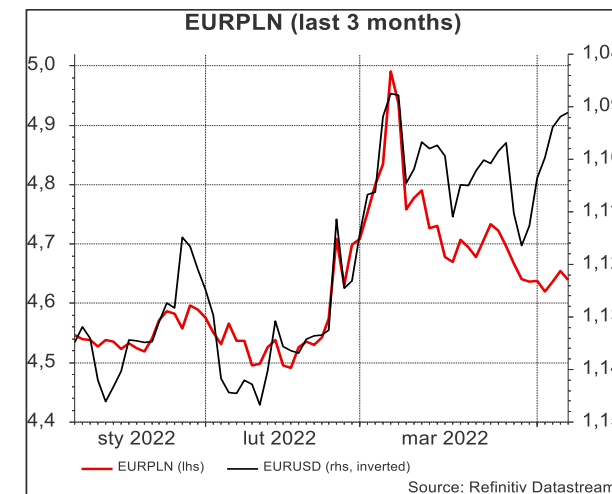
Expected GDP level in 2023, 2020=100



Sum of changes to 2022 and 2023 GDP growth Bloomberg consensus, Mar-22 vs Feb-22



EURPLN (last 3 months)





FX outlook: we are not in 2015

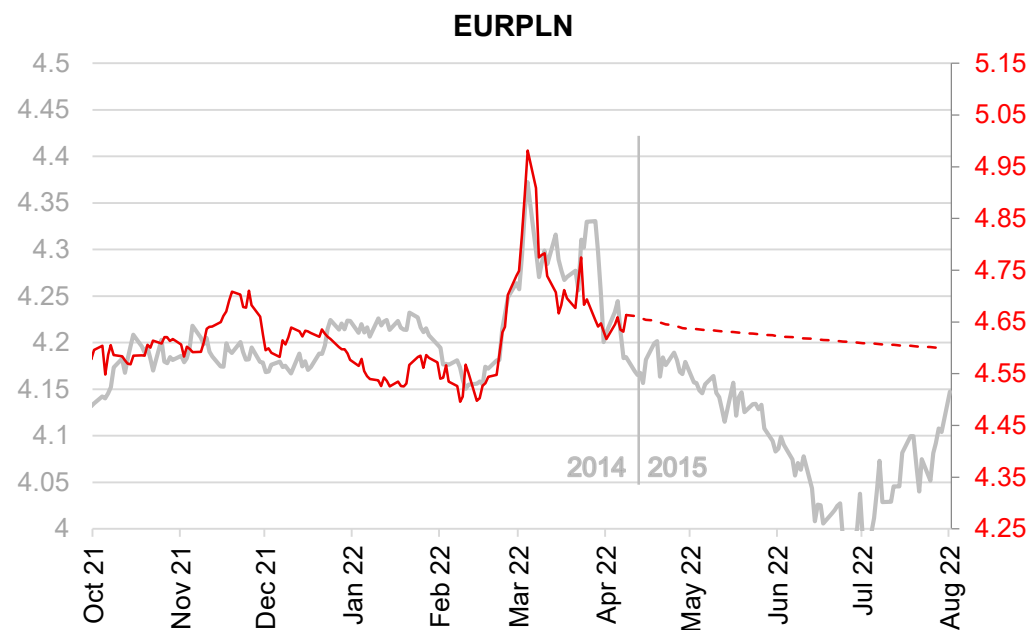
So far the EURPLN behaviour during the Russia-Ukraine war looks similar to what had happened in 2014-2015, Crimea annexation and the Ukraine war with pro-Russian separatists. Levels are different and the scale of the PLN depreciation was much greater this time, but the shape of the exchange rate path is quite similar. How far can the similarity go? The circumstances that made the EURPLN descend in 2015 even below the starting point of the conflict are absent today. In fact they are the opposite of the currency could rely on back then:

(1) Poland was entering the longest and deepest deflation of all the EU countries – now its inflation is relatively high in the EU and possibly this will last longer than in other EU countries because of how the government anti-inflation shields work and other fiscal stimulus tools that the government chose to apply.

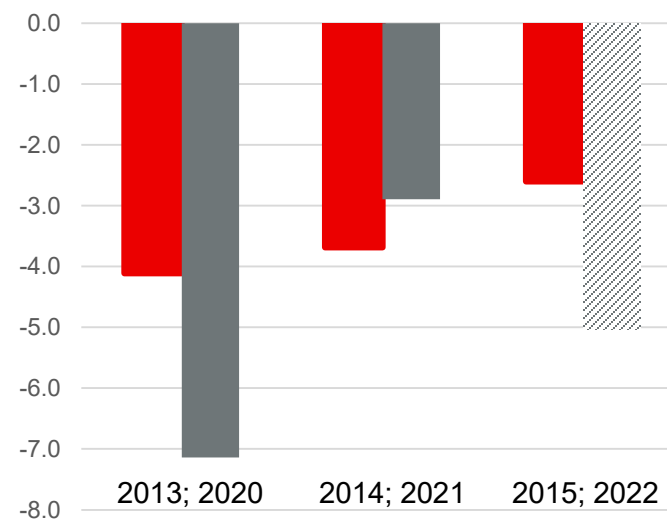
(2) real interest rate was highly positive and rising due to MPC’s reservations to cut below the all-time low 1.50% - now the rate hikes fail to catch up with inflation, positive real rate seems a taboo among the decision makers which got used to highly negative real rates and seem to assume they are sustainable.

(3) general government deficit in the process of being reduced, 4.1% in 2013, 3.7% in 2014, 2.6% in 2015, 2.4% in 2016 – now it is likely to expand from possibly less than 3% in 2021 to 4.7% or more.

Thus, we are expecting the zloty to gain at a markedly slower pace than back in 2015.



General government balance, % of GDP



Source: GUS, Bloomberg, Santander

Forecasts

3



Economic Forecasts

		2019	2020	2021	2022E	1Q21	2Q21	3Q21	4Q21	1Q22E	2Q22E	3Q22E	4Q22E
GDP	PLNbn	2,293.2	2,326.7	2,603.1	2,902.6	587.4	617.0	647.5	751.3	667.1	685.1	717.2	834.7
GDP	% y/y	4.7	-2.5	5.7	3.5	-0.8	11.2	5.3	7.3	7.0	3.8	1.4	2.2
Domestic demand	% y/y	3.6	-3.4	8.2	3.2	0.3	12.4	8.6	11.2	7.9	3.4	0.8	1.8
Private consumption	% y/y	4.0	-3.0	6.2	3.9	0.1	13.1	4.7	7.9	8.0	4.0	1.0	3.0
Fixed investment	% y/y	6.1	-9.0	8.0	5.0	1.7	5.6	9.3	11.7	-2.5	9.0	7.0	5.0
Industrial output	% y/y	4.2	-1.1	14.5	6.7	7.8	30.2	10.5	12.8	16.3	6.7	4.8	-0.2
Construction output	% y/y	3.6	-3.5	1.6	5.6	-12.5	1.8	5.8	6.3	18.7	2.8	3.7	2.9
Retail sales (real terms)	% y/y	5.1	-3.0	7.4	3.8	1.2	14.4	6.1	8.7	8.9	6.2	0.8	0.2
Gross wages in national economy	% y/y	7.2	5.3	8.9	9.3	6.6	9.6	9.4	9.8	10.2	9.7	8.9	8.3
Employment in national economy	% y/y	2.2	-1.0	0.2	1.5	-1.4	1.1	0.9	0.3	1.7	1.6	1.4	1.6
Unemployment rate *	%	5.2	6.2	5.4	5.1	6.4	5.9	5.6	5.4	5.4	5.0	4.9	5.1
Current account balance	EURmn	2,523	15,287	-3,537	-19,855	3,233	1,320	-3,360	-4,730	-3,331	-4,421	-5,882	-6,221
Current account balance	% GDP	0.5	2.9	-0.6	-3.2	2.8	2.0	0.9	-0.6	-1.7	-2.7	-3.0	-3.2
General government balance (ESA 2010)	% GDP	-0.7	-6.9	-1.8	-4.7	-	-	-	-	-	-	-	-
CPI	% y/y	2.3	3.4	5.2	10.1	2.7	4.5	5.5	7.8	9.6	11.1	10.7	9.0
CPI *	% y/y	3.4	2.4	8.7	8.4	3.2	4.4	5.9	8.7	10.9	11.3	10.3	8.4
CPI excluding food and energy prices	% y/y	2.0	3.9	4.1	6.9	3.8	3.8	3.9	4.8	6.5	7.2	7.2	6.9

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

Source: GUS, NBP, Santander



Market Forecasts

		2019	2020	2021	2022E	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22E	3Q22E	4Q22E
Reference rate *	%	1.50	0.10	1.75	5.50	0.10	0.10	0.10	1.75	3.50	5.50	5.50	5.50
WIBOR 3M	%	1.72	0.67	0.54	4.99	0.21	0.21	0.22	1.50	3.46	5.12	5.67	5.73
Yield on 2-year T-bonds	%	1.56	0.50	0.79	5.73	0.08	0.20	0.43	2.47	4.07	6.46	6.48	5.90
Yield on 5-year T-bonds	%	1.99	0.96	1.39	5.77	0.65	1.10	0.89	2.91	4.41	6.62	6.38	5.68
Yield on 10-year T-bonds	%	2.41	1.52	1.97	5.48	1.35	1.73	1.80	3.01	4.29	6.12	6.00	5.50
2-year IRS	%	1.74	0.62	1.19	5.84	0.37	0.71	0.88	2.81	4.68	6.39	6.43	5.86
5-year IRS	%	1.85	0.85	1.69	5.22	0.91	1.42	1.48	2.94	4.31	5.65	5.69	5.22
10-year IRS	%	2.05	1.15	2.01	4.90	1.45	1.87	1.79	2.94	4.10	5.27	5.28	4.97
EUR/PLN	PLN	4.30	4.44	4.57	4.61	4.55	4.53	4.57	4.62	4.62	4.63	4.59	4.62
USD/PLN	PLN	3.84	3.89	3.86	4.04	3.77	3.76	3.87	4.04	4.11	4.13	3.99	3.93
CHF/PLN	PLN	3.86	4.15	4.22	4.38	4.17	4.13	4.22	4.38	4.46	4.45	4.33	4.29
GBP/PLN	PLN	4.90	5.00	5.31	5.41	5.20	5.26	5.34	5.45	5.52	5.49	5.37	5.27

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

Source: NBP, Bloomberg, Santander

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#3 BEST OVERALL FORECASTER - POLAND



#2 BEST OVERALL FORECASTER - POLAND



#1 BEST OVERALL FORECASTER - POLAND



Sectoral supplement

Strategic Sectors

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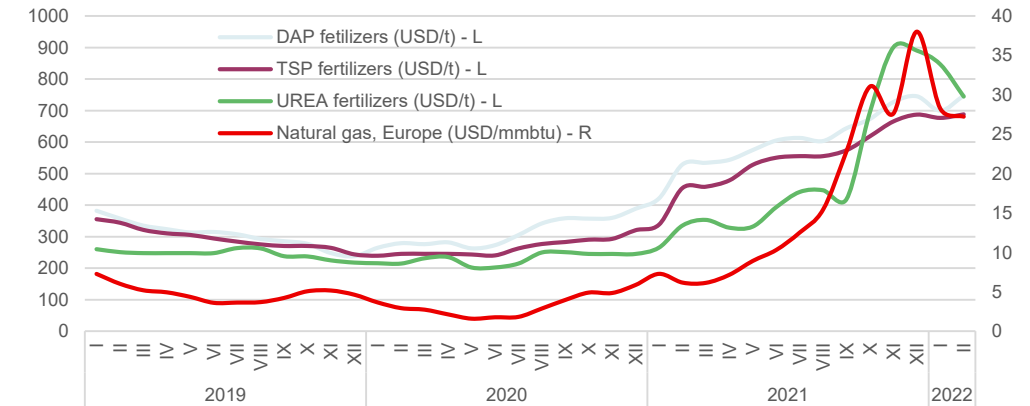
Cost pressure is growing in agriculture...

The beginning of 2022 brought continuation of cost increases in agricultural production. Russian aggression against Ukraine increased uncertainty on the market. Russia is the EU's main supplier of gas, which is used in the production of nitrogen fertilizers. Russia is also an important supplier of potassium fertilizers - Russia and Belarus are jointly responsible for 65% of world exports. Both Russia and Ukraine are important exporters of grains, oilseeds and derived products thereof (e.g. sunflower oil). As a result of sanctions imposed on Russia and logistic problems with agricultural raw materials export from Ukraine (acts of war in the Black Sea), supply on the global market has decreased. Due to lower supply, prices of wheat and coarse grains, oilseeds, but also mineral fertilizers, increased.

On the one hand, revenues of cereal producers grew. In mid-March, average price of wheat on the Polish market was higher by 25% MoM and by 80% YoY. Prices of other grains and rapeseed also increased significantly. Farmers are, therefore, in a position to obtain high prices for their products. In addition, these agricultural raw materials were produced at relatively low costs, many months earlier. On the other hand, prices of agricultural inputs, including mineral fertilizers, have increased significantly. In the coming months, concerns about this year's grain production in Europe will support prices on the market. There is no guarantee that prices in the second half of the year will fully compensate strong increase in costs. So, it is possible, that many farmers will reduce their use of mineral fertilizers, which could have a negative impact on the 2022 harvest.

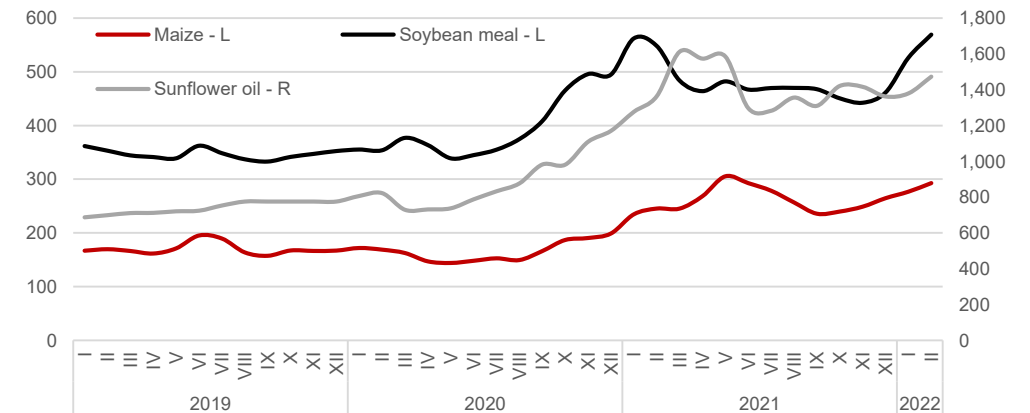
High prices of grains and oilseeds translate into higher prices of animal feed. Soybean meal on the world market was more expensive by 15% YoY in February. Average prices of sunflower oil increased by 8%. In some countries, that import large volumes of animal feed from Ukraine, industrial feed shortages appeared. In the EU, such problems were noted in Spain and Italy. Concurrently, livestock prices also increased but strong cost pressure affects profitability of livestock production. As a result, potential for development of production seems limited, in the short term.

Global prices of gas and mineral fertilizers



Source: World Bank

Global prices of raw materials for animal feed production (USD/t)



Source: World Bank

...as well as in food industry

Impact of the war is also visible in the food industry. In January and February, soft indicators showed stabilization of sentiment but in March deterioration was recorded. GUS's general business climate indicator in food industry amounted to -7.9 points in March, compared to +0.1 points a year before. However, decrease of the index was relatively small, and opinions of food industry remained more positive than the average in manufacturing sector.

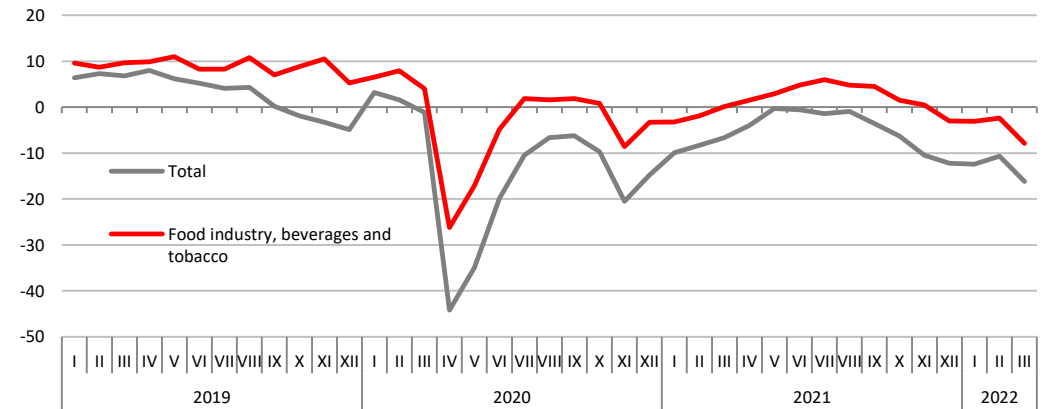
Demand was not an important issue for companies in Q1 2022. There was a clear decline in the importance of this barrier, especially in March. Currently, the mismatch between supply and high demand, both domestically and abroad, is an important challenge. On the domestic market, additional demand is generated by refugees - about 2.5 million people have already come to Poland from Ukraine.

The percentage of enterprises that indicated shortage of employees increased significantly (27% in Q1 2022 vs. 22% in Q3 2021). However, significance of this barrier decreased in March. It may indicate, that the outflow of Ukrainian men, who return to fight for their country, is not a problem for food companies, or that these gaps can be filled quickly.

In March, more enterprises than before reported shortage of raw materials (23% vs. 15% in Q3 2021). It may result from lowered supplies of some semi-finished products from Ukraine and strong increase in their prices. Additionally, sentiment in the sector could have been affected by limited possibilities of increasing supply of materials and food commodities in the context of rapidly growing demand.

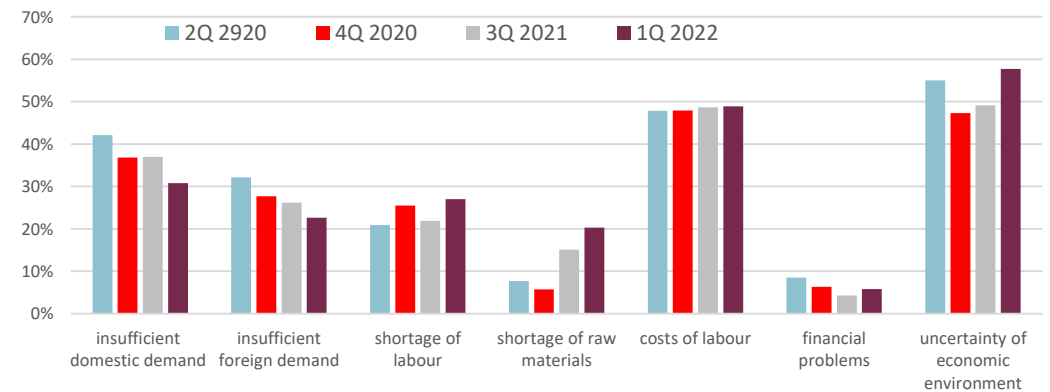
In the coming months, increase in agricultural commodity prices will be one of the most important challenges for food companies. During the first month of the war, price changes were very dynamic. We also see many factors (e.g. expected decline in Ukrainian spring crops) that may support higher prices in the second half of the year. Passing on increased costs down the value chain of the food industry can be a challenge for companies.

General business climate indicator in manufacturing in Poland



Source: GUS

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



Source: GUS

War deepens automotive supply crisis

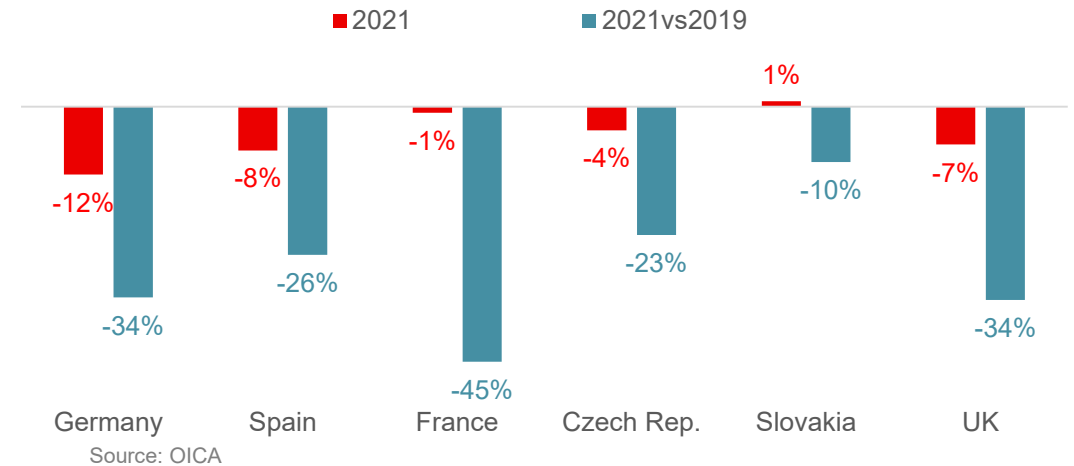
New passenger car registrations in Europe were 2% lower in 2021, down 26% vs 2019. China (+4% YoY and back to 2019 levels) and the United States (+3% YoY and -12% vs 2019) performed much better. Results of the survey of trends in demand, new orders, inventories, consumers' willingness to buy cars in the EU, and dealers' opinions on buying interest and waiting times for cars indicate that final demand was clearly higher than supply.

The main obstacle to increase car production in 2021 was low availability of semiconductors but supply disruptions also affected many other materials. Production dynamic was evident different between European, in part due to greater resilience of Asian car companies to the crisis.

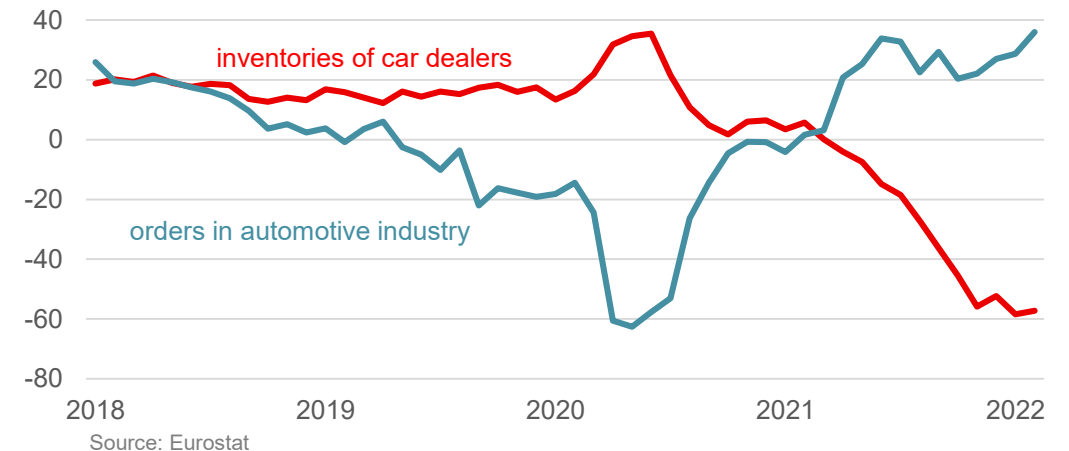
Although availability of semiconductors has not structurally improved significantly, noticeable improvement in production at the turn of the year could suggest that the worst of the autumn crisis is behind the sector. War in Ukraine, however, is strongly affecting automotive industry. Ukraine was an important supplier of wire harnesses, particularly to German car manufacturers. Suspension of supplies caused significant reduction in production volume at VW, Audi, Skoda, BMW, and Mercedes plants. Efforts are being made by car companies and suppliers to increase wire harnesses production or move it to other locations, mainly Romania and Morocco but this may take several months. It is estimated that, as a result, car production in Europe could fall by up to 15%.

Also at risk is eventual decrease in supply and price of palladium used in the production of catalytic converters, with Russia providing about 40% of global extraction of this commodity. The same is true for nickel, which is essential for battery production, although here Russia's share is smaller. War is also affecting supplies of steel and aluminium for the automotive industry. Mariupol and Odessa plants provided about half of the world's supply of neon, gas used in semiconductor production. Although semiconductor manufacturers claim to have stocks for few months worth of production and diversified their supplies, in the longer term availability of neon is a threat. Russia accounts for 2% of EU car exports and 1% of parts exports. It accounts for a small share of most companies' sales, but it represents 31% of Renault Group's European volumes and is Skoda's second market (13% of volumes).

Change in production volumes of passenger cars in the main producing countries in Europe



Inventories of car dealers and orders in the automotive industry in the EU (business survey, balance of indications up/down)



Availability of drivers in road transport is decreasing

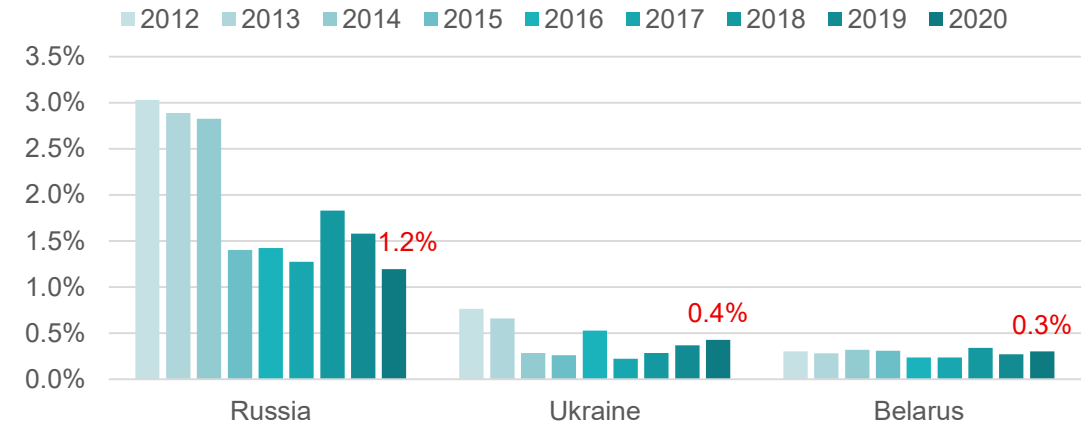
In 2021, Polish road freight carriers >9 employees increased the weight of transported goods by 1,4%, as well as the number of kilometres driven on toll roads in Germany (+11,2%), where Poland increased its share by 1,2 p.p. High and growing demand is evidenced by data from the economic survey for Poland and the EU, although at the turn of the year a decline in the perception of demand was visible, as well as rising freight rates.

Until recently, long-term forecasts were optimistic. Further growth in the EU economy was assumed, with a CAGR of 4,4% between 2021 and 2025 for the value of the European road transport market. Outbreak of war in Ukraine, however, will mean a decline in transport demand as a result of a reduction in the rate of economic growth in Europe, including Poland, as well as reduction in traffic to eastern destinations. But demand is less of a concern for domestic carriers. There has been little exposure to eastern directions and the EU economy will still provide large volumes even with a decline in GDP growth rate.

The biggest threat is decline in driver availability. It is estimated that in the first days of the war even about 30% of Ukrainian drivers did not show up to work and reported leaving for Ukraine. Considering that about 30% of drivers on international routes at national carriers come from Ukraine, this means a decrease in number of drivers on these routes by about 9%. Decrease in supply of drivers takes place in a situation of an already large structural shortage of drivers. As a result, carriers are losing operational capacity, which may mean a decrease in revenue and, in addition, contractual penalties for unfulfilled orders. In a situation of fairly high demand, a decrease in supply may lead to dynamic transport rates increases.

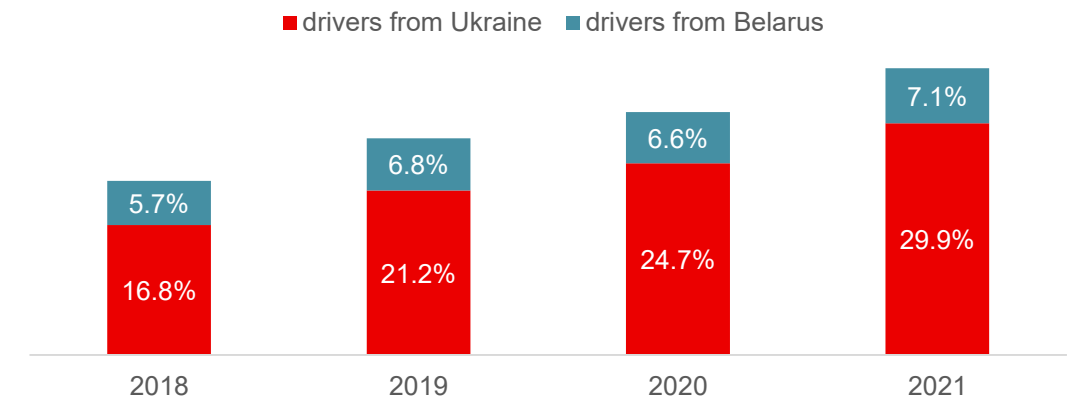
However, profitability of carriers remains a question. In 2021, carriers were able to pass on rising costs to customers and earn high margins but in 2022 this may become increasingly difficult. Fall in supply of drivers may accelerate wage increases, which would have risen anyway as a result of further Mobility Package regulations on posting of drivers. The war has also caused oil prices to rise further. As a result of increased production costs and low availability, vehicle prices have risen by several percent, and interest rates have been rising since October, increasing the cost of fleet financing.

Share of international transport performed for Russia, Ukraine and Belarus in total transport of Poland (in t-km)



Source: Eurostat, Santander Bank Polska

Share of drivers from Ukraine and Belarus in the number of drivers in international transport among Polish carriers



Source: Santander Bank Polska estimates

Construction materials availability in CEE to drop

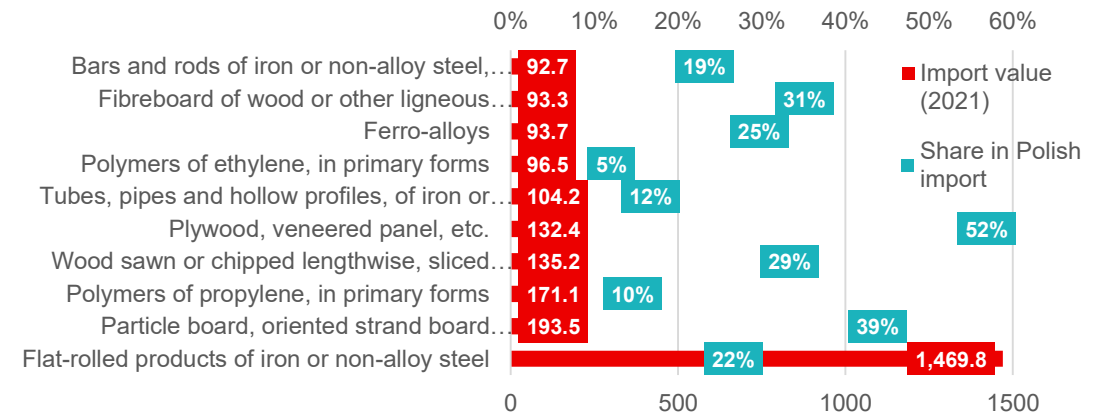
Imposing sanctions on Russia and Belarus limiting exports of select products to EU may not exhaust a list of construction materials whose availability might drop in the CEE region w case of major deceleration of economic relations between EU, Russia and Belarus, and as a result of major damage done to the Ukrainian industry sector.

Geographically, we see significant concentration of Russian construction materials deliveries in the CEE region. The highest dependency (in value terms) is seen in Latvia, Lithuania, and Estonia, where these products accounted for almost 18% of imports. In Poland we saw over 10% share of Russia in construction materials imports but in major product categories this share reached even a few dozen %. Wood based panels is one of the most affected product categories, in all segments – fibreboard, particleboard, and plywood. Especially in the latter segment the imports from Russia posed a major challenge for domestic manufacturers. Decreased shipments in these categories will deepen insufficient supply of wood based panels used by the furniture industry at EU and regional level, translating into increased costs to furniture manufacturers. The strength of the Russian wood products export is also seen in shipments to Italy, where furniture industry takes advantage of cheaper materials.

Another product category exposed to reduced import shipments is the steel industry, especially in the flat and long products segments, including rebars which are very important to the construction industry. Since the war broke out we saw rebar price increase of about 30% in one month, or 40% in case of Hot Rolled Coils.

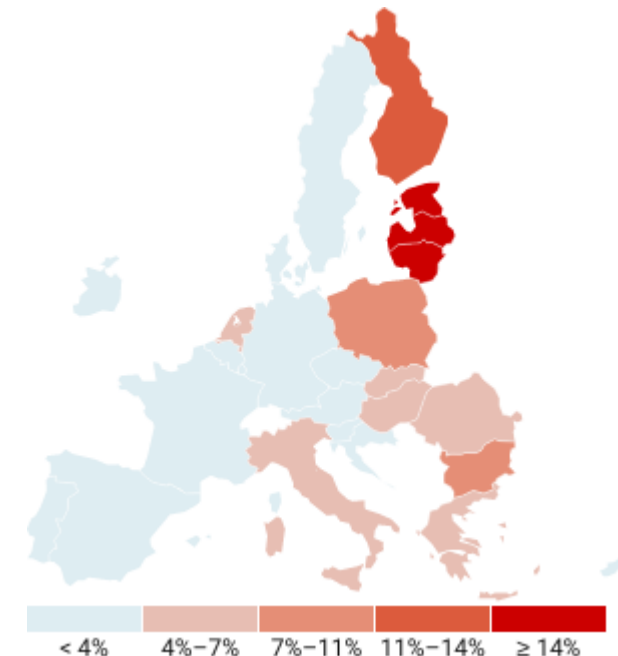
Another product category worth mentioning are shipments of polymers of propylene and ethylene. Even though Russia was not a major supplier (<10% in imports) it could potentially deepen shortage of raw materials for packaging production as well as plastic products for construction industry.

TOP construction materials imported to PL from UA/RU/BY (in EUR)



Source: Eurostat, Santander

Share of Ukraine, Russia, and Belarus in construction materials import



Source: Eurostat, Santander

Will renovation boom help joinery manufacturers?

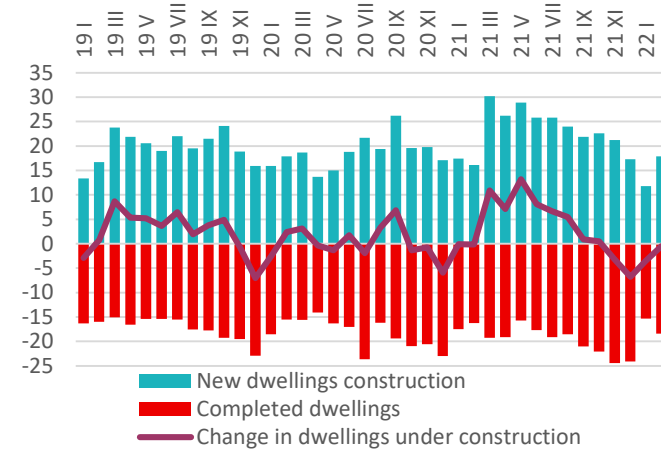
Last year was very good for the joinery industry in terms of production. In total, sector has managed to increase production by 8,9% YoY, or still satisfactory 6,3% over 2019 level, which means that lower production volume in 2020 due to COVID has been covered by a wide margin.

We estimate that, in value terms, joinery sector could have grown by ~20-30% YoY. For 2022 we assume a sustaining slightly lower growth rate but we see high uncertainty surrounding Russian invasion on Ukraine and its influence on commodities prices. As a result, in 2022 we expect lower production volume growth and increased role of price increases in sold production growth.

Strong growth of gross wages and salaries in recent years has outpaced residential prices growth (average for TOP9 Polish cities). As a result, between 2015 and 2021 average purchasing power on the residential market (credit capacity/average sqm price) increased by as much as 10%. In 2022, assuming reference rate at 5%, purchasing power decreases by ~40%, which is even lower than it was back in 2015. Credit capacity is further reduced by new regulations of UKNF on stress tests for mortgages.

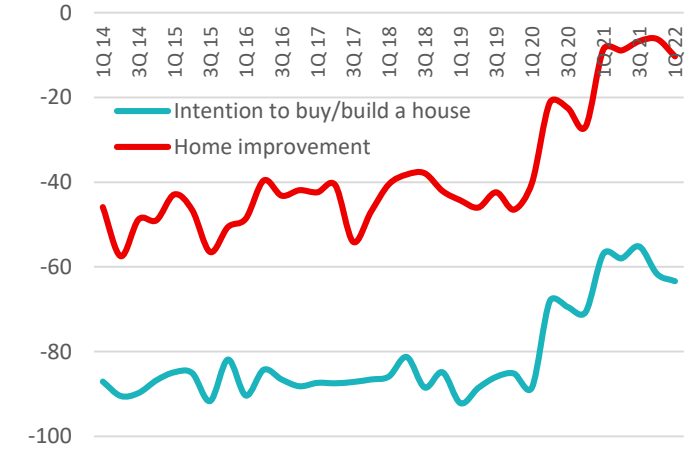
Considering record high number of dwellings under construction and a residential investment cycle length of at least over a dozen months, we expect that rather than a crush in demand for construction materials, we will see a gradual decrease. This can be partially offset by the need to accommodate as much as 2,5 mln people that had to leave Ukraine. We write more on this subject in a dedicated report available under the link <https://www.santander.pl/korporacje/rozwiązania-sektorowe/stolarka-budowlana>

Balance of dwellings under construction (thou pcs)



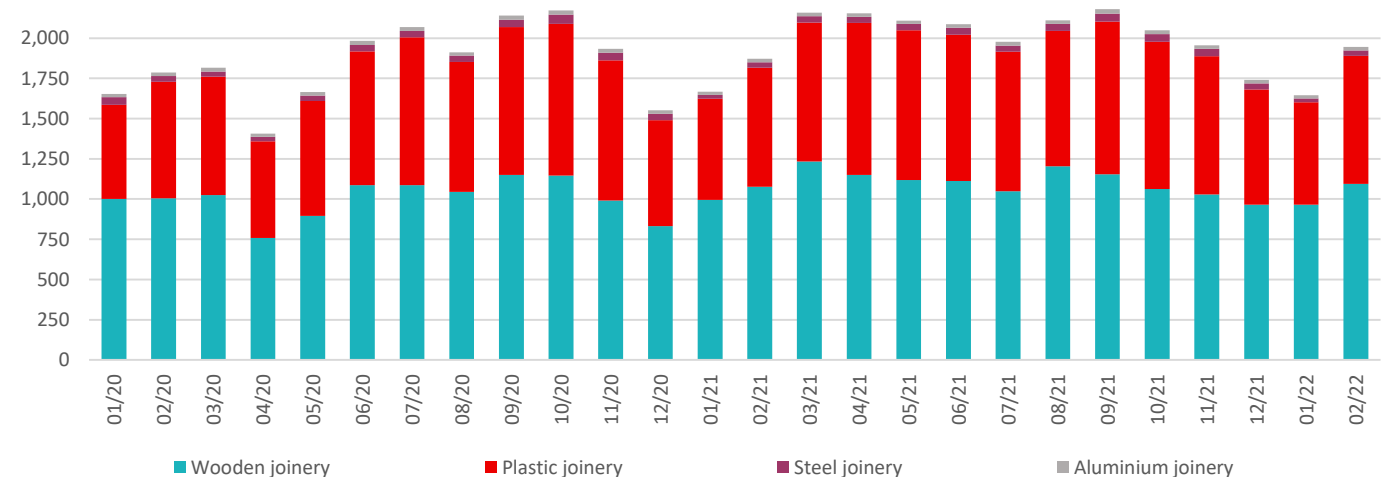
Source: GUS, Santander

Renovation and home purchase/construction intention index



Source: Eurostat

Builder's joinery production volume by segment (thou pcs)



Source: GUS

Packaging will become even more expensive

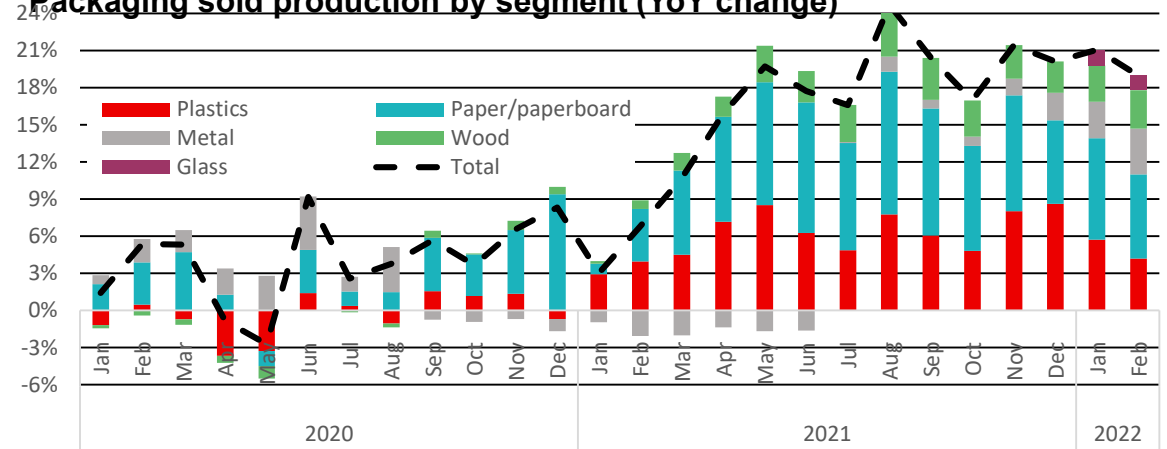
At a time when prices of cellulose and plastics used in packaging production hit all time highs last year, it seemed that most probable base scenario was gradual normalisation or even slight decrease in raw materials price pressure. At present, judging by prices of gas and plastics, we must expect further increases in packaging prices and price inflation will be a major factor in sector's sales growth.

Sector's growth will be further accelerated by increased retail sales related to accommodating refugees from Ukraine. Sector's segment which will benefit the most from this will be paper and paperboard packaging as it has the strongest focus on domestic market (around 70-75% of sold production). This will consolidate this segment's position as the largest within the packaging sector.

In case of plastic packaging we saw rapid increase in cost inflation – even though polypropylene prices grew by only 9-18% (depending on type) in the second part of March, compared to the same month in 2019 we are talking about price increases in range of 90-130%. Polyethylene prices were 9% up YoY and 102% above 2019 level. These increases could be further supported by lower availability of plastics in primary forms imported from Russia. In that case lower shipments of plastics would not shake Polish packaging sector but it would deepen problems with plastics availability, which might already have its impact on lower production volume growth rate.

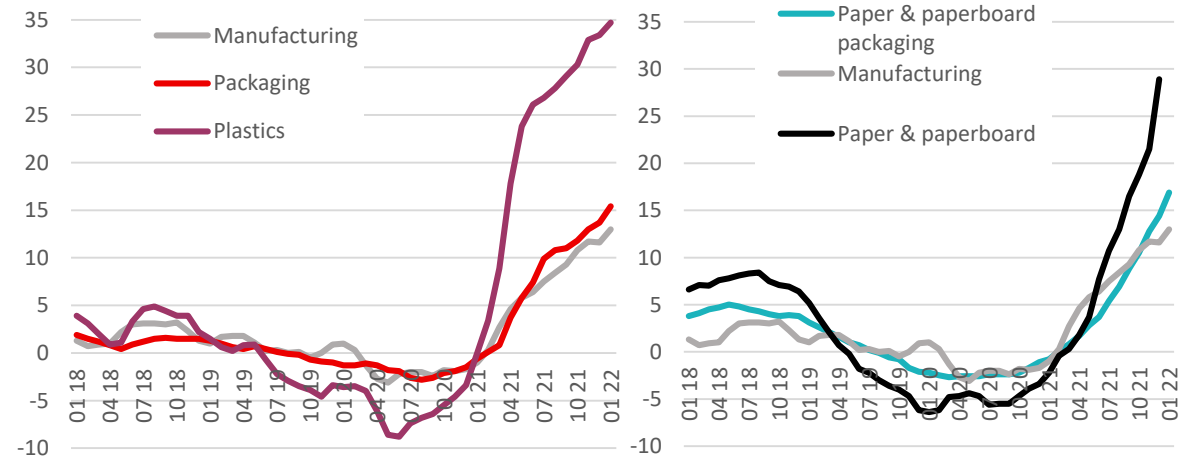
On the domestic demand side we see double digit growth of sold production indices of main packaging offtakes but we estimate that demand for packaging grows underperforms manufacturing sector average, mainly due to relatively slower growth of food processing industry (+12% YoY). Overall, packaging industry maintains high double digit growth rate, which will gradually decelerate due to increasing base effect from last year. Nevertheless, we expect that 12-15% YoY growth in sold production of packaging is a reasonable scenario, in which case sold production of the packaging industry could reach ~60 PLN bln vs our estimate of 52 PLN bln in 2021.

Packaging sold production by segment (YoY change)



Source: GUS, Santander Bank Polska

Packaging producer prices in the EU27 vs manufacturing (YoY change)



Source: Eurostat

Source: Eurostat

Expensive oil and imports drop to drive particleboards prices

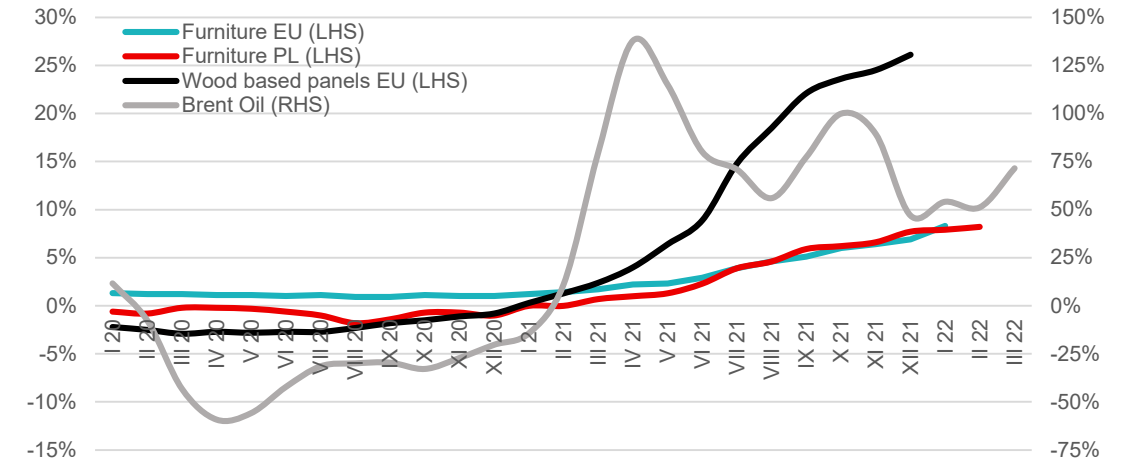
Sold production of the furniture industry grew last year by 22% vs 0,4% growth in 2020. Since about August last year we see accelerated production growth in value terms, which is a result of historic high inflation of furniture prices, both in Poland (where historically prices grew slower than EU average or furniture sector in Italy or Germany), and at the level of EU as a whole. We can see that this trend continues in 2022 and given the current macro-geopolitical environment it will further accelerate.

Oil price rise combined with sanctions and boycott of the Russian commodity quickly finds it way into prices of oil based products, such as glues used in particleboard manufacturing. Shortages of materials for furniture production do not change remain at an elevated level but did not change significantly since the end of 1H 21. Nevertheless, we expect that in an environment of decelerating trade with Russia we can also see decreased import of particleboards, which would be an additional booster to furniture price inflation.

Polish furniture export value grew in 2021 by almost 16%, below average for the manufacturing sector at 19% YoY. Maybe these are first signs of weakening demand in the face of furniture price increases. Among main growth drivers were parts of furniture (semi-finished products) and upholstered furniture. Germany noted the highest growth in export value at +450 EUR mln, followed by France (+222 EUR mln), and the UK (+200 EUR mln).

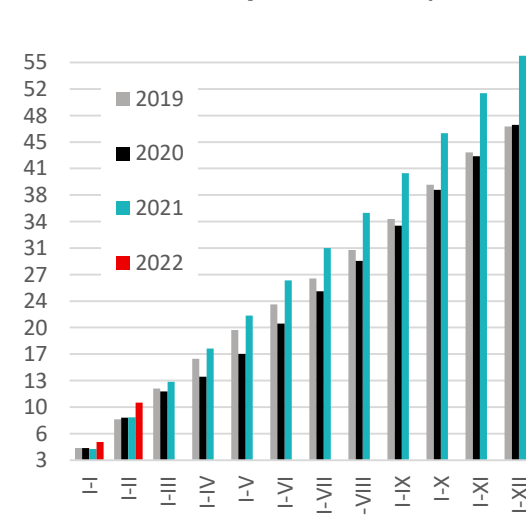
Outlook for the furniture production sector remains uncertain – on one hand cost inflation forces rapid price increases, and export sales grow at a below average level for the manufacturing sector. On the other hand, we may see a renovation boom related to accommodation of war refugees, similar to the one after the first lockdown in 2020, which would up our forecast of sold production growth above 10% YoY.

Producer prices, Brent Oil, YoY change



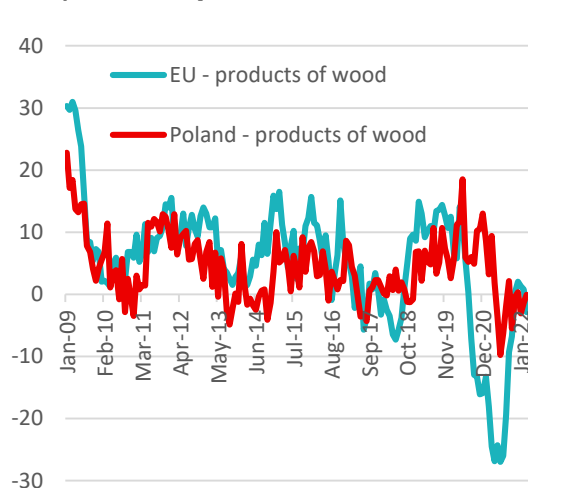
Source: GUS, Investing.com, Santander

Furniture sold production (PLN bln)



Source: Eurostat

Stocks of finished products (PKD 16), net responses



Source: Eurostat

This analysis is based on information available as of **01.04.2022** and has been prepared by:

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