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Economic Comment

Swan song of the recovery, further CPI push

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GDP growth in 1Q22 rose 8.5% y/y. Private consumption performed quite poorly, but fixed investments surged, providing a positive surprise. The strongest growth contributor was stock building. We view the very good Q1 GDP data as the swan song of an exceptionally robust post-pandemic recovery. In the following quarters we expect GDP growth to decelerate, which could lead us into a technical recession in the second half of the year. As a result, annual GDP growth may slow down from 8.5% y/y in Q1 to around 1% y/y in Q4. This will create a low starting point for economic growth in 2023. Flash CPI jumped to 13.9% y/y in May from 12.4%. Even though the headline reading was a notch below our forecast we still have to say that the May CPI data is another strong argument for restrictive monetary policy, given the larger-than-expected increase in core inflation. The MPC can deliver a 75bp rate hike on 8 June.

Swan song of the GDP recovery?

GDP growth in 1Q22 rose 8.5% y/y, in line with the flash estimate released two weeks ago. In quarterly terms, GDP advanced by 2.5% q/q s.a. (0.1pp above the flash). This is a very positive result, showing that the Polish economy started the year with high momentum.

However, the breakdown of growth was not that optimistic. Contrary to our intuition, private consumption performed quite poorly, growing 6.6% y/y (after 8.0% y/y in 4Q21), which corresponds to merely 0.6% q/q s.a. This is the second quarter in a row of disappointing consumption results (it fell -1.4% q/q in 4Q21). It seems that even before the war in Ukraine broke out, the consumers were less eager to spend given inflation rising fast.

GDP growth and its components (% y/y)

	2020	2021	1Q21	2Q21	3Q21	4Q21	1Q22
GDP	-2.2	5.9	-0.6	11.3	5.5	7.6	8.5
Domestic demand	-2.9	7.6	-0.5	11.8	8.2	10.9	13.2
Total consumption	-1.0	5.3	0.3	10.6	4.2	6.7	5.1
Private consumption	-3.0	6.1	-0.2	13.0	4.7	8.0	6.6
Public consumption	4.9	3.4	2.4	4.2	2.8	4.0	0.6
Gross accumulation	-10.2	17.7	-4.6	17.2	27.3	24.1	57.3
Fixed investment	-4.9	3.8	-1.3	3.0	6.6	5.2	4.3
Stock building *	-1.1	2.4	-0.5	2.4	3.3	4.2	7.7
Net export *	0.6	-1.2	-0.2	0.4	-2.1	-2.6	-3.6

* contribution to GDP growth (percentage points)

Source: GUS, Santander

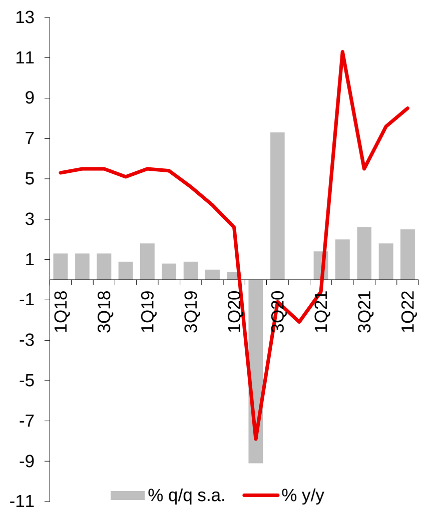
Meanwhile, fixed investments surged 11.5% q/q s.a., providing a positive surprise. Let us remind that a similar jump (11.9% q/q) took place in 1Q21, so the annual growth rate went down a bit. In 1Q21, this strong jump turned out to be temporary and now it is difficult to expect otherwise. In addition, the outbreak of war in Ukraine is likely to strongly dampen companies' willingness to invest (strong increase in costs, growing uncertainty, rising interest rates).

The strongest contributor to GDP growth in Q1 (accounting for as much as 7.7 pp) stock building. It can be expected that the stock building process is not yet over, as companies will continue to move away from the just-in-time model amid general uncertainty and disruptions in supply chains, but the contribution of this factor to GDP growth is likely to gradually decline.

Net exports subtracted 3.8 percentage points from GDP growth, driven more by weakness in exports than by growth in imports. This component will further reduce GDP dynamics in subsequent quarters.

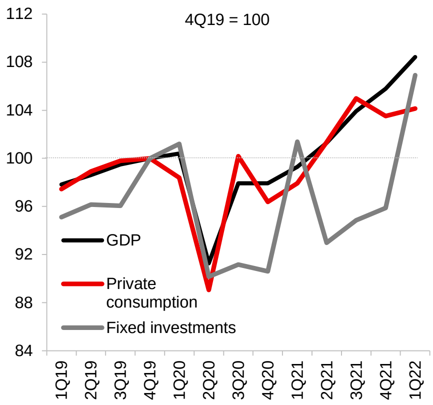
On the value added side, the results of the first quarter were somewhat less impressive, although still good. Gross value added increased by 1.8% q/q, most notably in trade and

Polish GDP growth



Source: GUS, Santander

Level of GDP and main components, seasonally adjusted data



Source: GUS, Santander

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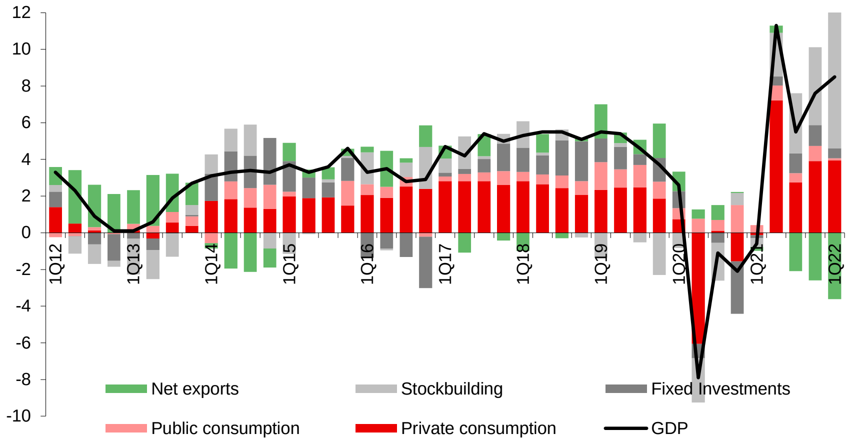
repairs, construction and transport (seasonally adjusted q/q growth in the range of 4%-5.5%), not badly in industry (2.5% q/q). A very big negative surprise is another strong decline in accommodation and food services (-24.8% q/q), which is hard to explain given the easing of pandemic restrictions.

GDP growth breakdown, demand side (% y/y)



Source: GUS, Santander

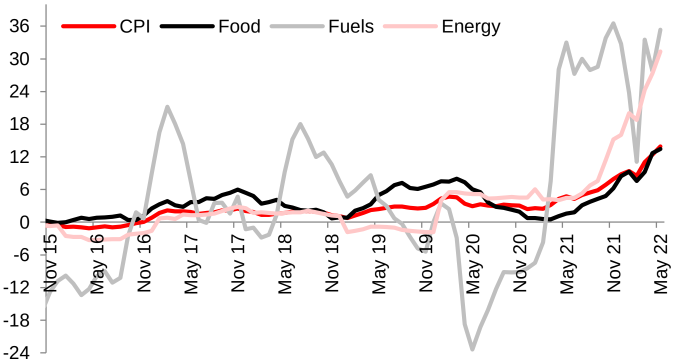
All in all, we view the very good Q1 GDP data as the swan song of an exceptionally robust post-pandemic growth recovery. In the following quarters, we expect GDP growth to decelerate, which could lead us into a technical recession in the second half of the year. As a result, annual GDP growth may slow down from 8.5% y/y in Q1 to around 1% y/y in the last quarter of the year. This will create a low starting point for economic growth in 2023.

Inflation trends grew stronger in May

Flash CPI jumped to 13.9% y/y in May from 12.4%, with the m/m change of prices at 1.7%. Market consensus was divided ahead of the release with the median around 13.5%, but with many estimates (including ours) pointing to c.14% y/y.

For us, the main source of surprise was core inflation going up to 8.5% y/y while we thought it could reach 8.2%. This is another all-time high. On the other hand food inflation proved relatively benign (+1.3% m/m vs. our +2.5% forecast) after the huge April rise by 4.1% m/m (most likely related to Easter and the hosting of refugees). Fuel prices were up 5% vs. our 6.5% estimate and energy prices rose 3.4% while we thought this CPI component might have already lost momentum (our forecast was 1.1%, previous two readings were 2.4% in April and 4.7% m/m in March).

CPI inflation and main components, % y/y



Source: GUS, Santander

Inflation may now go above 15% y/y in June and we assume that the path would then flatten. There might be some gentle easing of inflation pressure in late 2022, with our current December forecast at c.14% y/y. The upside surprise in core CPI suggests that the very high inflation may be harder to eradicate and can lead to even higher expectations about further rate hikes.

Even though the headline reading was a notch below our forecast we still have to say that the May CPI data is another strong argument for restrictive monetary policy and the MPC can deliver a 75bp rate hike when it meets on 8 June.

Additional information is available on request. Please contact Santander Bank Polska S.A. Financial Management Division. Economic Analysis Department. al. Jana Pawła II 17. 00-854 Warsaw. Poland. phone +48 22 534 18 87. email ekonomia@santander.pl. http://www.santander.pl.