

It cannot get any worse

Poland

Economic Analysis Department
Santander Bank Polska S.A.
ekonomia@santander.pl

Table of contents

■ Executive summary	p. 3
■ Global environment	p. 7
■ Local environment	p. 9
■ GDP	p. 13
■ Balance of payments	p. 18
■ Labour market	p. 19
■ Inflation	p. 24
■ Loans and deposits	p. 28
■ Monetary policy	p. 29
■ Fiscal policy	p. 32
■ FI outlook	p. 34
■ FX outlook	p. 38
■ Forecasts table	p. 43



Executive Summary (macro)

About a quarter ago, we were discussing the possible consequences of US regional banks's problems for the economic outlook. It seems we were right in our assessment that they would neither develop into a major financial crisis nor significantly worsen the growth outlook for major economies. Concerns about recession in the US have once again failed to materialise, although doubts about the economic situation are growing in Europe. This is due to – among other factors – the protracted lack of recovery in China and signs of weakening demand at the side of consumers, who are now feeling more keenly the effects of monetary tightening. We were, indeed, wrong to assume that the perturbations in the banking sector would significantly discourage the major central banks from further rate hikes. In fact, developed economies are raising interest rates and will likely continue doing so after the summer holidays. **We continue to treat a soft landing as our baseline scenario for the world economy in the coming quarters** ([p.7](#)). However, in a longer run, rate rises may eventually lead to a marked decrease in economic growth.

The newest data indicate that the the second quarter was still a period of subdued economic activity in main sectors of Polish economy, which would be probably reflected in the decline of the seasonally adjusted GDP q/q and in the annual GDP growth still close to zero. Still, we see ample reasons to believe that the second half of the year will bring a gradual recovery: credit activity, labour market signals and most business indicators are all improving, while the scale of the fiscal expansion is increasing. **In our view, the average GDP growth in 2023 will be at 1%, but the last quarter and the whole next year will be marked by growth rates of at least 3%, close to the potential rate** ([p.13](#)). The structure of GDP growth looks different than we previously thought: the first half of the year was characterised by weak consumer demand, which we, nonetheless, believe will recover in the coming quarters, due to – for example – an improvement in sentiment and real income, and a recovery in the credit market. On the other hand, we underestimated investment, the good performance of which is due to several factors: the private sector's adaptation to the challenges posed by the labour and energy markets (automation, construction of own energy sources), the activity of local governments, the inflow of foreign investment as a part of the global reorganization of supply chains, and military spending. The trade balance, after moving quickly from a deficit to a surplus at the turn of the year, which was supported by an improvement in the terms of trade and lower energy consumption during the mild winter, will return in the subsequent quarters to slightly negative values because of a faster recovery in imports than in exports. The strongly negative contribution of inventories to GDP will continue until the end of the year.

The labour market remains surprisingly resilient to downturns, which is not only a feature of the Polish economy but also a global phenomenon. Of course, it should be kept in mind that the condition of the labour market is a lagging indicator, not a leading one. However, already at the beginning of this year there were signs of a turn towards higher labour demand and a growing shortage of workers ([p.19](#)). Unemployment is at record lows, job cuts in industry are being easily absorbed by the service and public sectors, and the influx of migrants is slowing down. **In this situation, the recovery which we anticipate in the coming quarters should result in wage dynamics sustained at double-digit levels, especially with another strong increase in the minimum wage in 2024.**

Our inflation forecast has been revised downwards: the drop in CPI below 10% y/y will occur already in the third quarter, while the year will likely end within the range of 7-8% y/y ([p.24](#)). The acceleration of disinflation was supported by - among other factors - falling production and logistics costs, the strengthening of the zloty, as well as the weakness of domestic demand. Our lower estimates are also influenced by the method of accounting for this year's constant energy prices, which the Polish statistical office employed, and which is different than we anticipated. In our forecast for 2024, the big questions are the frozen energy prices and the zero VAT on food – should they be unwound, the CPI dynamics will, in our opinion, stop at around 7% y/y. In our scenario of a gradual recovery of the economy, a tight labour market and double-digit wage increases, core inflation will stabilise near 5% y/y.

The latest signals from the central bank leave no doubt: a fall in inflation below the 10% threshold will signal the start of the rate cuts, even though the NBP's new projection did not provide additional arguments for them. **The MPC may conduct the first rate cut in October, or even in September if CPI surprises positively. We expect a reduction in the reference rate to 6.0% in December this year and to 5.0% in 2024** ([p.29](#)).

The coming elections brought a lot of ideas which may increase the deficit in the current and the next year. **We estimate the public finance deficit to be slightly over 5% of GDP in the current year and about 4% in 2024, with an upward risk as the pre-election campaign has not even officially started yet.** Loose fiscal policy will not make fighting inflation easy ([p.32](#)).



Executive Summary (markets)

FX market

The zloty was one of the best-performing emerging market currencies against both the euro and the dollar in the second quarter, but also year-to-date. The scale of the appreciation of the domestic currency may have been somewhat surprising and may have been influenced by both local and global factors. The region's currencies were certainly supported by an improvement in terms of trade due to falling commodity prices, which not only improved current account flows, but also investors' sentiment toward the FX. In addition, volatility in international markets has gradually decreased in recent months, which has favoured currencies with high interest rates, especially those without significant structural imbalances.

We now see slightly more chances for a slight weakening of the zloty than a continuation of the trend from the first half of the year. The zloty's exchange rate against the euro, but also against the dollar, has approached the threshold levels of profitability of exports according to the results of the NBP's surveys among corporates, which suggests less room for appreciation of the local currency. Instead, the weakening could be supported by the expected deterioration in the current account balance due to the expected recovery in private consumption and imports, as well as upward risks for gas and oil prices. In addition, a correction in global risk appetite resulting potentially from major central banks overtightening monetary policy to the extent that fears of recession and a destabilising impact on emerging markets could take hold. The zloty could also start to lose as the MPC starts to cut rates and uncertainty about the shape of future economic policy could increase ahead of the general election. Movements towards a weaker zloty will be constrained by active FX sale by the Ministry of Finance in the market, as a strong zloty may be favoured ahead of elections and will certainly be welcomed by the NBP facilitating lower inflation. In view of this, we assume that in the longer term the zloty may remain at slightly weaker levels than at present, but with inflation still higher than in the euro area, the real effective exchange rate of the zloty may strengthen further. ([p.38](#))

Interest rate market

Domestic interest rates have continued their downward trend in recent months, with the decline in rates intensifying after the dovish shift from the NBP Governor. After the strong fall in market rates at the beginning of the year and the subsequent correction, swap rates and bond yields declined slowly remaining in a narrowing range. The declines were supported by lower-than-expected inflation readings and monthly activity data. A gradual widening of asset swap credit spreads could be observed since the election campaign began and the first election proposals were tabled. In response to the change in tone of the NBP president and the signalling of interest rate cuts, the fall in market rates gained momentum and was reinforced by lower-than-expected US inflation data. At the same time, there was a further steepening of the swap curve.

We think the downward trend in curve rates may be sustained in the longer term due to the expected decline in inflation and our expectation of rate cuts by the MPC. However, we think that inflation may surprise upwards next year and that NBP rate cuts this year are premature, which will support a steepening of the swap curve. We also think the market is pricing in an overly aggressive NBP rate cut scenario after the recent rate cuts, giving potential for periodic upward revisions. High net issuance of government bonds in Q3 should keep credit spreads high, and the decline in net bond issuance in 4Q may be transitory in view of large redemptions of Treasury securities in 1H next year. Domestic banks and investment funds are likely to remain the main buyers of bonds with increasing inflows into local funds. Foreign investors have been reducing portfolios since the beginning of the year. Periodic upward rate corrections will provide an opportunity to enter the Polish market in view of forecasts of a weakening dollar, but demand from foreign investors will certainly be constrained by high yields on the main core markets. ([p.34](#))



2023 Forecasts – what has changed

Wskaźnik	Our view in December 2022	Our view in July 2023
GDP	In our view, 1Q2023 will be the trough of the mini-recession, and then the economy will gradually rebound. A weak starting point (opposite to the 2022 situation) will weigh on the average annual growth rate, which we forecast to be close to zero.	The banking crisis did not result in a crash of the US economy, but concerns are rising about a recession in the euro area. Our baseline scenario is still a soft landing of the global economy. High frequency data suggest that the second quarter of 2023 was only little (if at all) better than the first one in terms of GDP growth, but we still expect a recovery of the domestic economy in the second half of the year.
GDP breakdown	Consumption will be the most resilient component of demand, but will also slow markedly. Investment will fall, as will exports and imports, affected by the global recession, but the contribution of net exports to GDP will be positive, as in 2022. The contribution of inventories to GDP will be clearly negative.	When it comes to investment, we were wrong. Their resilience may be caused by greater military spending, and firms' spending on automation and autonomous energy, as well as an increase in foreign investment in the form of re-shoring. Consumption disappointed in the last quarters, but we see ample reasons for a prompt recovery. A reduction of inventories began in the first quarter and will last till the end of the year.
Labour market	The economic downturn and the worsening corporate performance will translate into a decline in demand for employees. However, the scale of redundancies and the increase in unemployment should be moderate. Wage dynamics will be similar on to 2022 average. A stronger deceleration will be prevented by a jump in the minimum wage by c20% in total.	The scenario closely matched the expectations. Weaker labour demand did not cause an increase in unemployment. In fact, we can observe some surprisingly early signs of a growing demand for labour. The slowdown in wage dynamics was smaller than we assumed, and the next substantial raise of the minimum wage will help to upkeep the double-digit dynamics in 2024.
Inflation	After peaking in February (slightly above 20% y/y), inflation should slide later in the year, but we do not expect a drop below 10% until 2024. Core inflation to remain in a similar disinflationary trend and to decline to around 6% by the end of 2023.	The disinflation gained momentum and it seems that we will see a single-digit CPI reading as early as September, and a year-end reading below 8%. The decrease in core inflation is slower because of the persistency in the prices of services. In 2024, the disinflation will slow down due to the economic recovery and subsiding base effects.
Monetary policy	The MPC accepts a postponed return of inflation to target and no longer intends to raise interest rates. However, our scenario implies that there are no conditions to start rate cuts, at least until the end of 2023.	The NBP President announced that the beginning of rate cuts will begin when CPI inflation falls below 10%, which suggests that the first cut will take place in October. We expect the reference rate to fall to 6.0% by the year-end and to 5.0% by the end of 2024.
Fiscal policy	The draft budget assumes an increase in the fiscal deficit to 4.5% of GDP but we estimated the actual one will be slightly higher (over 5%) due to new spending related to the energy crisis.	The budget amendment, which increases this year's central deficit by about 0.7% of GDP, reaffirms us that the balance of the whole sector will fall below -5% of GDP. We tentatively assume around -4% of GDP in 2024, but during the pre-election campaign new promises may still be made, and these would generate additional costs.
Interest rate market	We expect the downward trend in domestic bond yields to continue, supported by disinflationary processes in Poland and abroad - even if this process was to be much slower domestically. A temporary increase in yields is possible in the first months of next year.	The downward trend in yields and the steepening of curves is likely to continue in view of the gradual decline in inflation and the rate cuts expected by the MPC. The market is pricing in an overly aggressive rate-cutting scenario, giving the potential for periodic upward rate adjustments.
FX market	The first months of 2023 may be difficult for the zloty (the recession trough), but we assume that in the later part of the year the domestic market liquidity situation and the gradual improvement in global investment sentiment will have a dominant impact on the zloty, leading to its gradual appreciation.	We believe that the potential for further appreciation of the zloty has clearly diminished as the market exchange rate approaches exporters' break-evens. We expect a slight weakening of the zloty against the euro, which could be supported by rate cuts by the MPC or a weaker current account balance in 2H. REER real exchange rate may strengthen further.

Economy



1

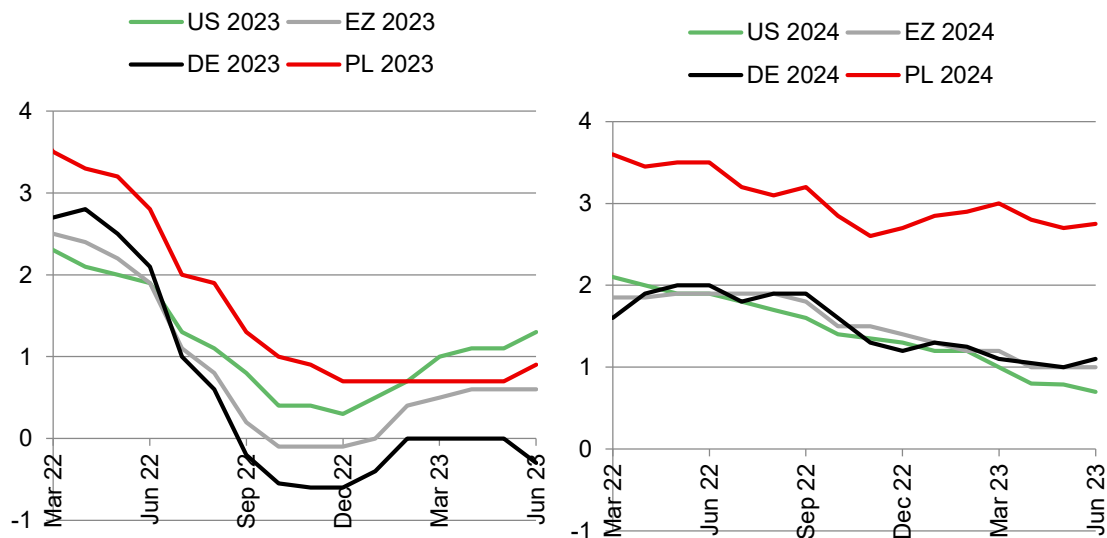


Soft landing is still the baseline global scenario

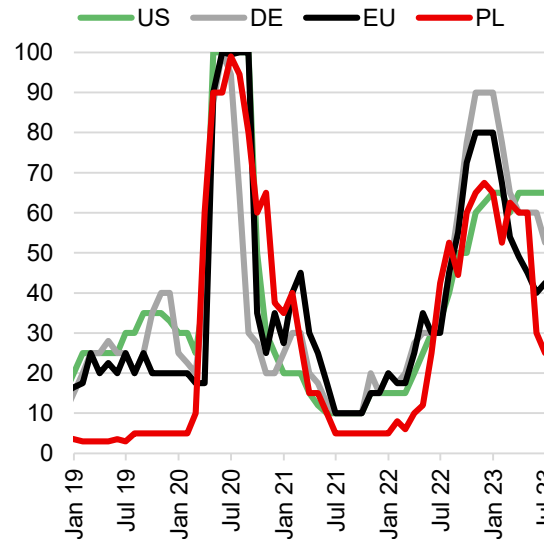
The question about how hard the global economy will land remains valid. Concerns about the impact of the banking sector turmoil on the US economy have diminished, but the signals from Europe are not good – manufacturing recession seems to be deepening, joined in June by a deterioration in sentiment in services, hitherto in rapid expansion (see [p.8](#)). The unwinding of supply chains disruptions and energy shock should have a positive impact on global growth prospects, at least partially offsetting the increasingly painful delayed effects of monetary tightening (rising real interest rates). Labour markets remain surprisingly resilient, which in itself is a signal of lower-than-expected vulnerability of economies to rate increases, and real purchasing power of wages in most countries has started to recover as inflation has fallen, boding well for consumption.

Despite the negative tone of some indicators, we remain moderately optimistic about the economic outlook for the US and Europe. We are not alone, by the way - the latest forecasts from the major central banks do not predict catastrophic scenarios, nor does the consensus of analysts' forecasts. The technical recession in the euro area and Germany is already a reality, but its significant deepening is still not, in our view, the baseline scenario for the coming year. On the other hand, it is also difficult to hope for a significant economic revival abroad in such horizon, and the higher the ECB's and the Fed's interest rates go, the greater the risk that they will end up cooling demand strongly in a few quarters.

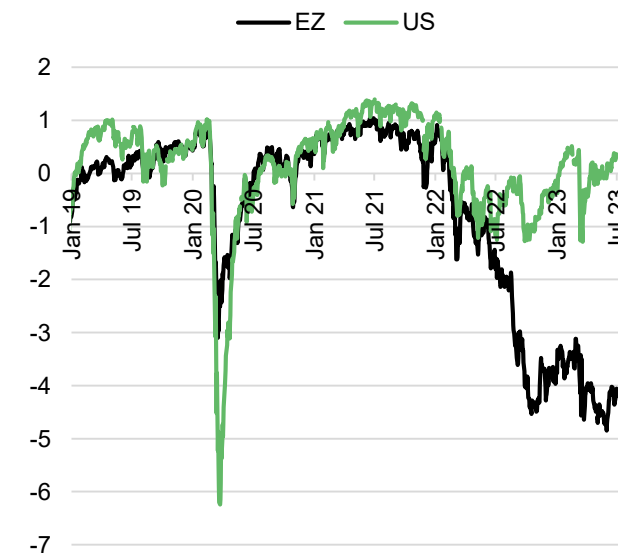
Median forecast of GDP growth in 2023 and 2024 acc to Bloomberg



Probability of recession in 1Y horizon acc to Bloomberg survey



Bloomberg Financial Conditions Index





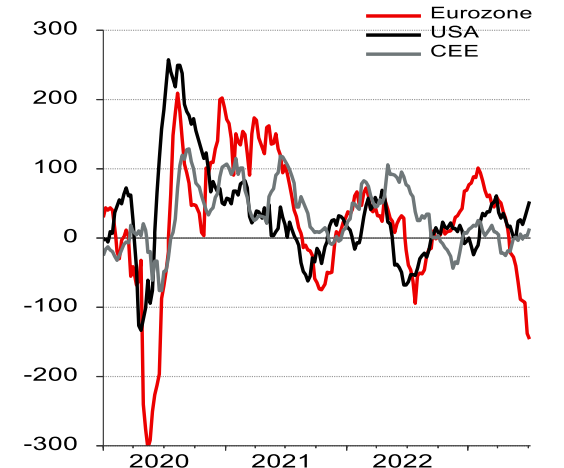
Business climate abroad is heading south

Sentiment indicators in European manufacturing have been falling and look absolutely terrible, although for the time being this pessimism is (fortunately) not fully reflected in 'hard' manufacturing data. The worst performing indicators are those for Germany, which is particularly worrying in the context of that country's role as Poland's main trading partner. The relative weakness of developed Europe against other countries, including the US, is increasingly apparent.

Until recently, worries related to manufacturing weakness were largely dampened by the widely observed strong recovery in services, which after all account for the bulk of GDP. The marked deterioration in activity indicators in the service sectors recorded in June is undoubtedly a bad sign, if it proves to be sustained.

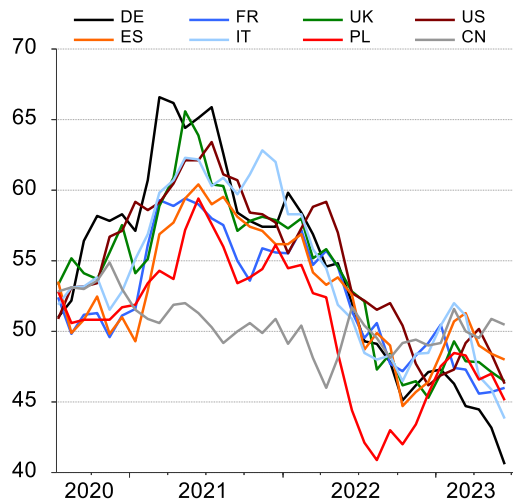
Survey sentiment indicators were able to diverge sharply from the actual economic activity in recent years (examples include the behaviour of the German Ifo, or the Polish PMI in 2022, whose steep declines were completely out of sync with the behaviour of GDP and manufacturing), prompting caution when making forecasts based on their current behaviour. The current PMI indices in Europe exaggerate, in our view, the scale of the downturn in the real economy, as evidenced, among other things, by the resilience of labour markets - low unemployment, accelerating wages.

CESI economic surprise index



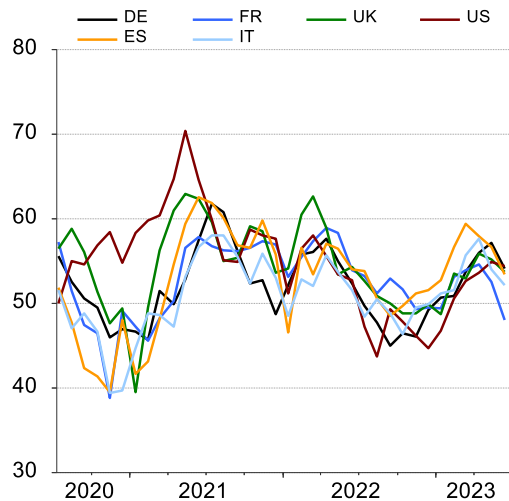
Source: Refinitiv Datastream, Santander

PMI manufacturing



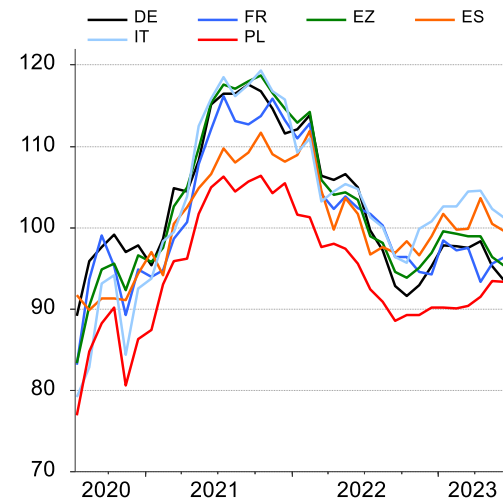
Source: Refinitiv Datastream, Santander

PMI services



Source: Refinitiv Datastream, Santander

ESI economic sentiment



Source: Refinitiv Datastream, Santander

Ifo vs. GDP growth in Germany



Source: Refinitiv Datastream, Santander Bank Polska





Business climate in Poland is improving

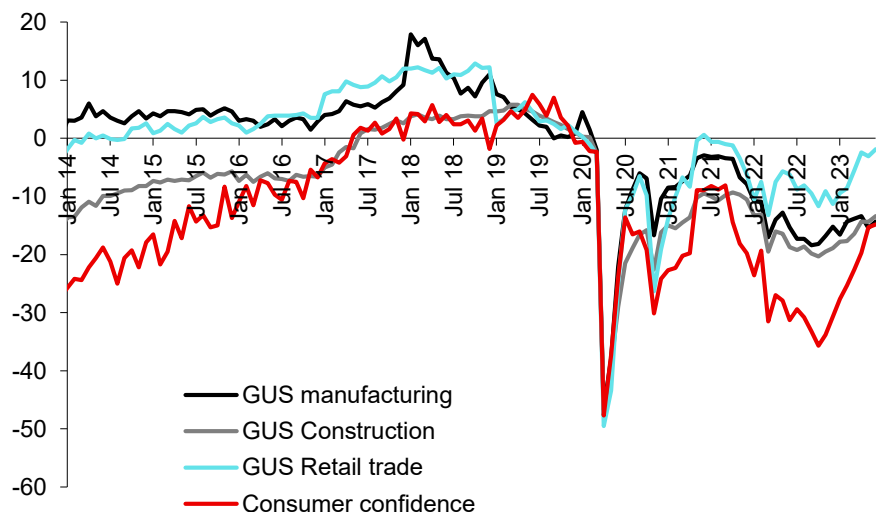
Most economic surveys for Poland point to an improvement rather than a deterioration in sentiment. A rather spectacular exception is the manufacturing PMI index, which has started to fall rapidly again in recent months. However, we have long argued that this indicator is not a very credible predictor of trends in industry, and its behaviour in recent years further reinforces this assessment (see [p.10](#)).

The situation varies from sector to sector, but even manufacturing (which is currently on the defensive virtually across Europe) is showing a slight improvement in the GUS and EC (ESI) economic surveys.

Consumer sentiment and, interestingly, retail trade sentiment are consistently going up, despite weak sales of goods in recent months.

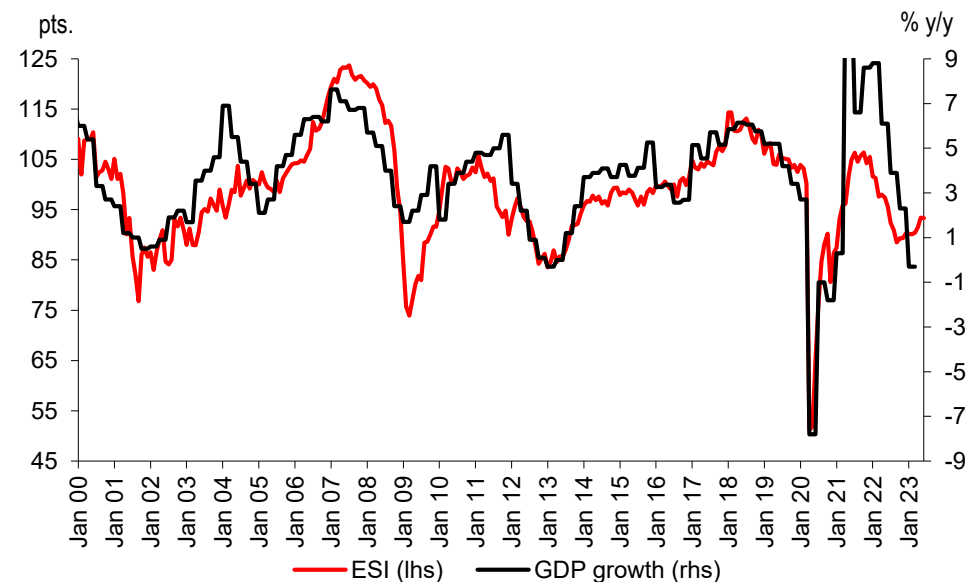
The ESI synthetic business climate index, which for the past 20 years has marked turning points in the economic cycle reasonably well, has started to wrap up, which seems consistent with our expectation of a rebound from the bottom in domestic GDP growth in the coming quarters.

GUS business climate indicators, pts.



Source: GUS, Santander

Economic Sentiment Indicator vs GDP growth



Source: GUS, European Commission, Santander

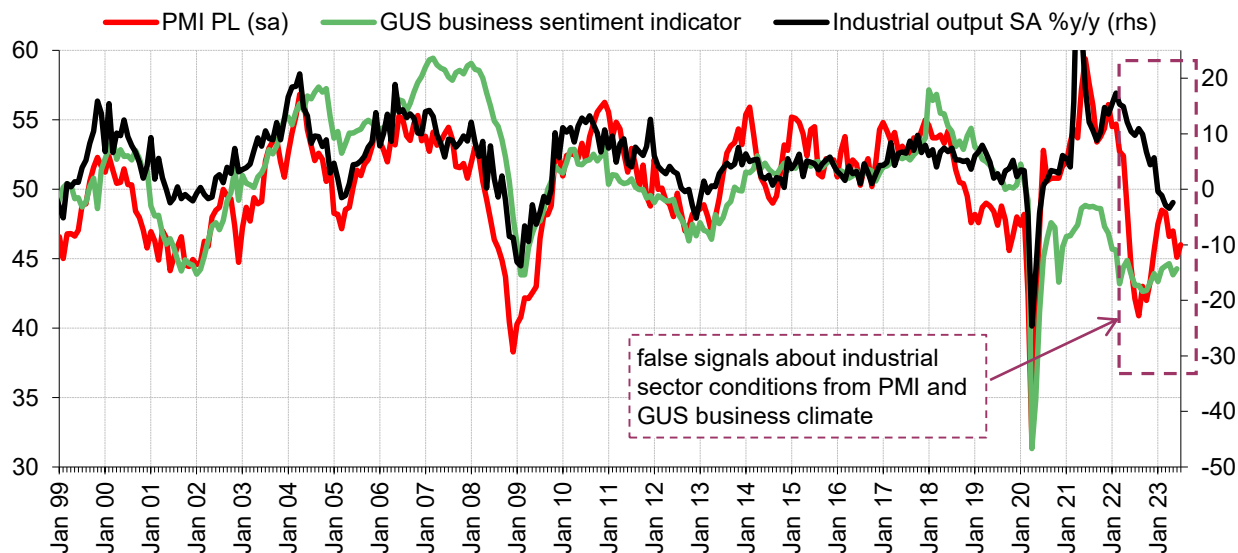


Industry: how far from the bottom?

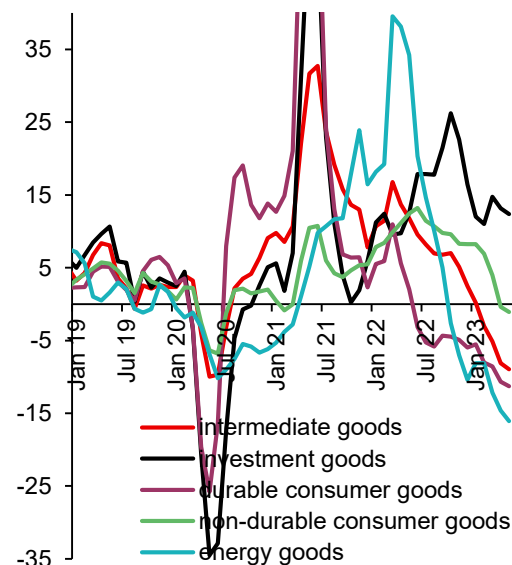
Exactly one year ago, we signalled in a report that the trend of a strong post-pandemic recovery in Polish manufacturing was reversing and since then, production has actually been decelerating, with the negative trend accelerating since the beginning of this year. The energy, mining, durable goods and intermediate goods have been mostly responsible for the declines in recent months. The weakness in the energy sector's output is, among other things, a result of the mild winter and the private sector's increasing investment in its own power generation sources. The deceleration in other divisions, on the other hand, is mainly due to a shift in demand (at home and abroad) from goods to services and the reduction of excess inventories, which proved too expensive to maintain in a high interest rate environment.

Output levels have just returned to the pre-pandemic medium-term trend, above which they had been for about two years, and in our view we are approaching another turning point, this time upwards, and the room for further output declines is running out. This will be supported, in our view, by the gradual shift of consumption from services back towards goods, the slow recovery of the euro zone from recession that we anticipate, and the important role of Poland in the ongoing rearrangement of global supply chains - in our view, the Polish economy is and will remain one of the beneficiaries of so-called re-shoring, i.e. the transfer of production from distant locations closer to final consumer markets (although we base this belief mainly on so-called anecdotal evidence, as it is difficult to confirm this thesis in the available public data so far).

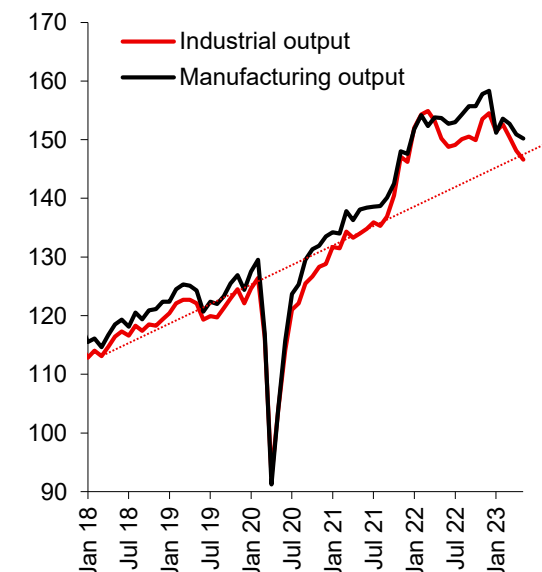
Business climate in manufacturing vs industrial output growth



Output growth % y/y by industrial groupings



Industrial production, 2015=100, s.a.

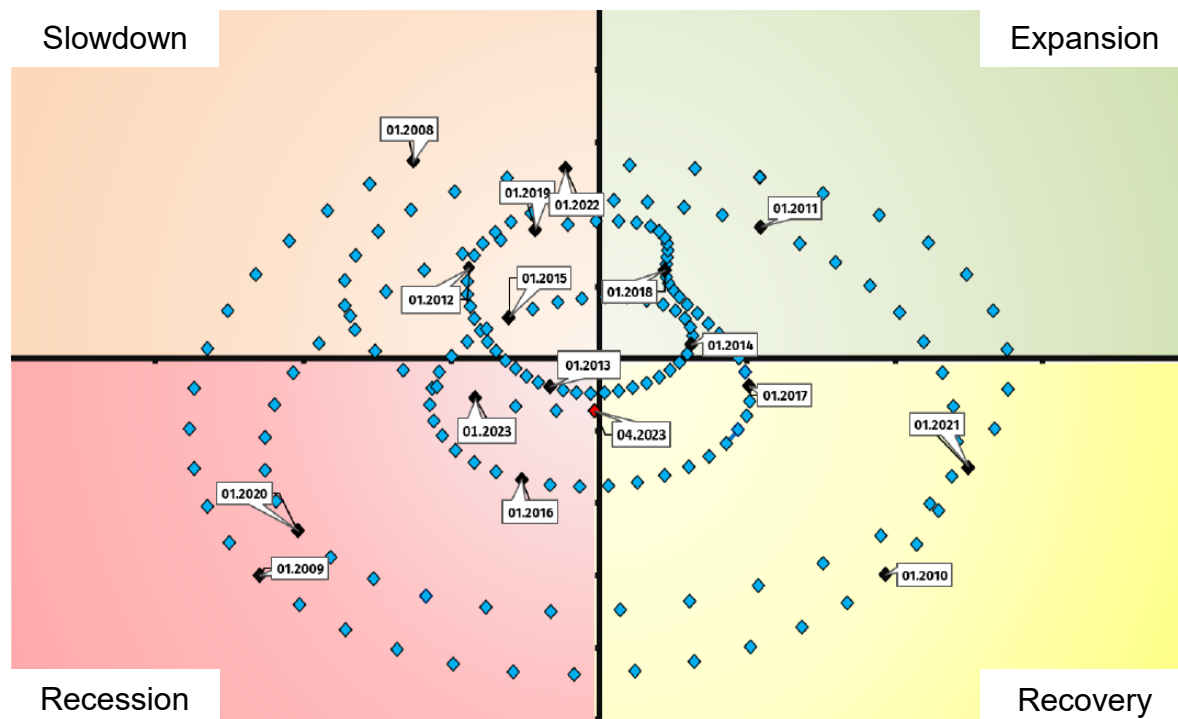




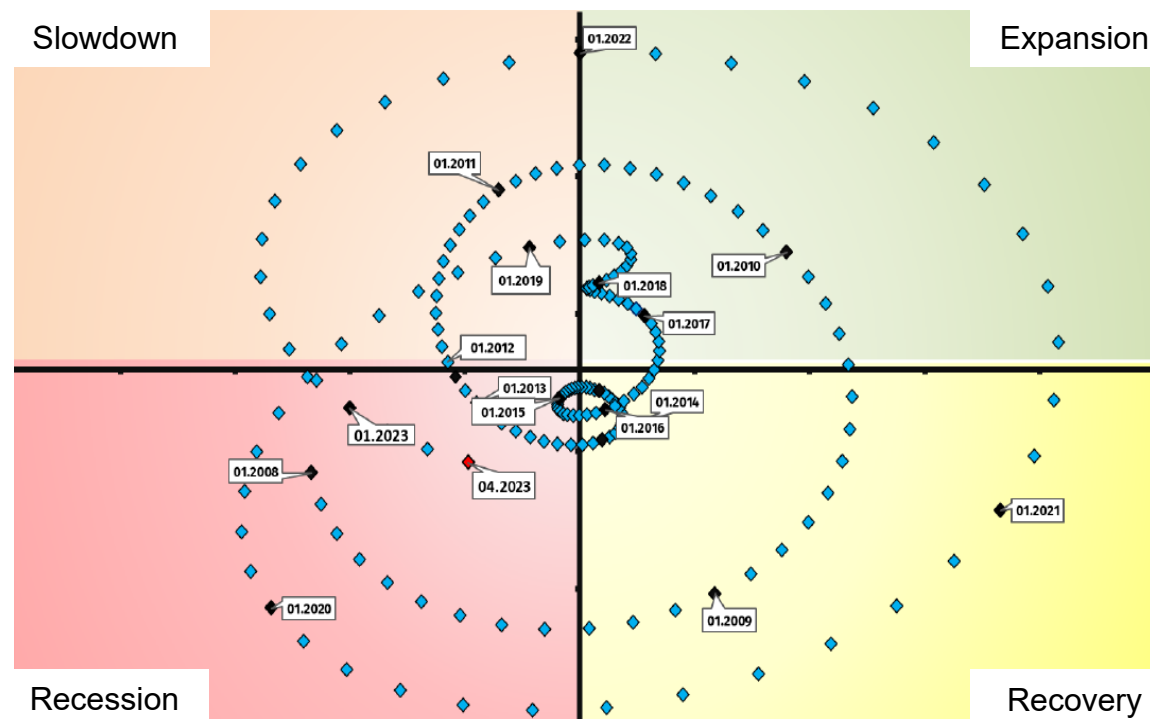
The business cycle clock turns to recovery

The newest update of the so-called '[business cycle clock](#)' published by GUS at the end of June suggests that aggregated business cycle indicators are moving out of the recessionary area and towards recovery (which, interestingly, is more clearly seen in the coincident indicator rather than in the leading one), which supports our view that the domestic economy has already passed to worst point of the current cycle.

Coincident business cycle indicator (COINC)



Leading business cycle indicator (LEAD)



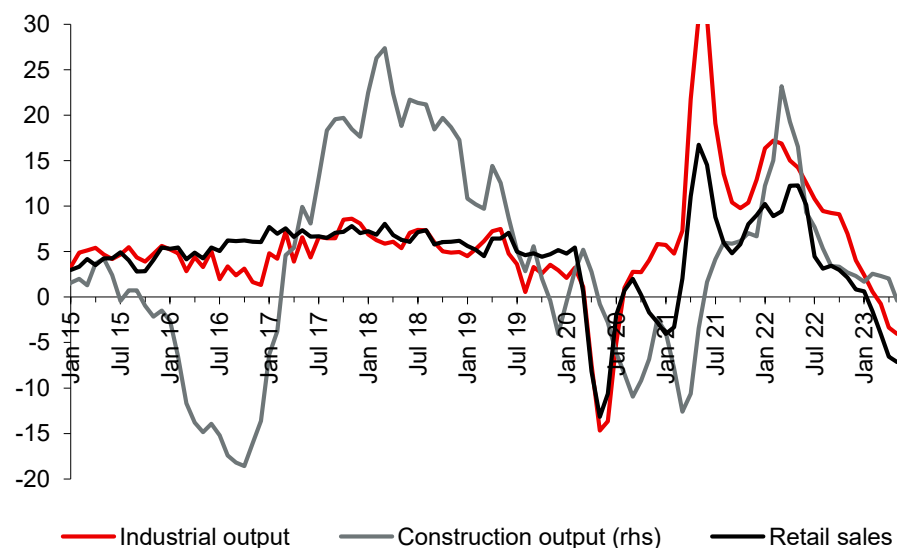


Monthly indicators suggest a worse 2Q

Despite the improvement in many indicators of economic situation, hard monthly economic activity data (such as production and retail sales) indicate that April and May saw a deepening of the negative trends observed since the beginning of the year. This implies a weak GDP growth in the second quarter of the year.

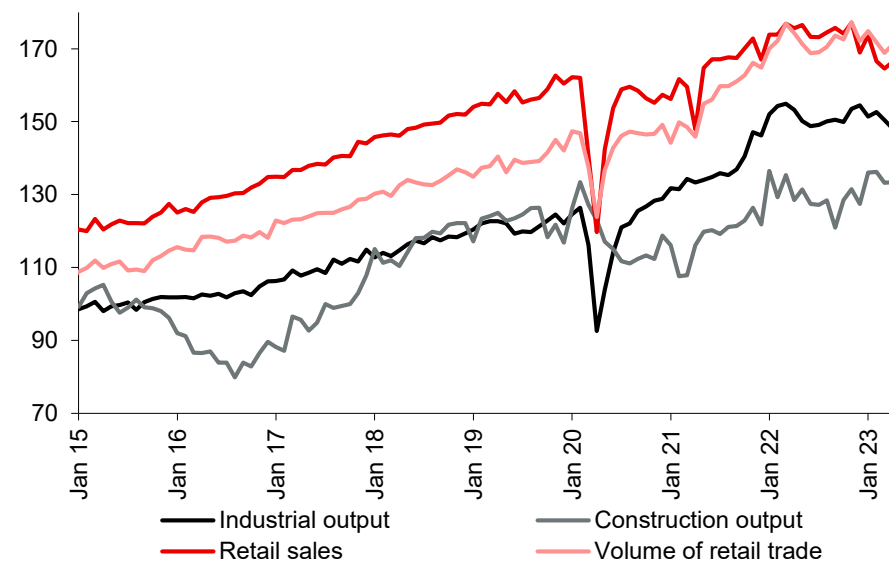
It is worth noting that similar signals from monthly data could have been observed already in the first quarter, and yet GDP growth at that time surprised positively, and strongly so. Nonetheless, this positive surprise was driven to a huge extent by the rapid increase in net exports, which seems unlikely to happen in the second quarter (in fact, recent data suggest that the surplus in net exports is gradually declining).

Production and sales at constant prices, 3mma % y/y



Source: GUS, Santander

Production and retail sales at constant prices, seasonally adjusted (2010=100)



Source: GUS, Santander

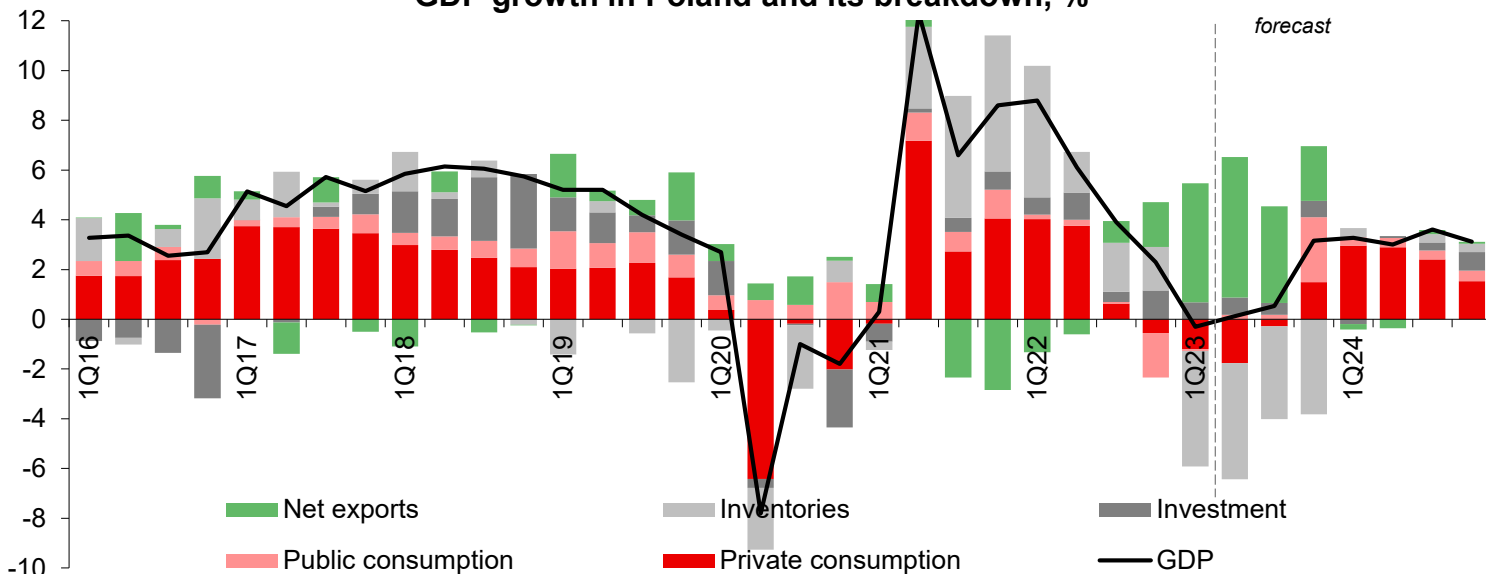


GDP growth: is the worst behind us?

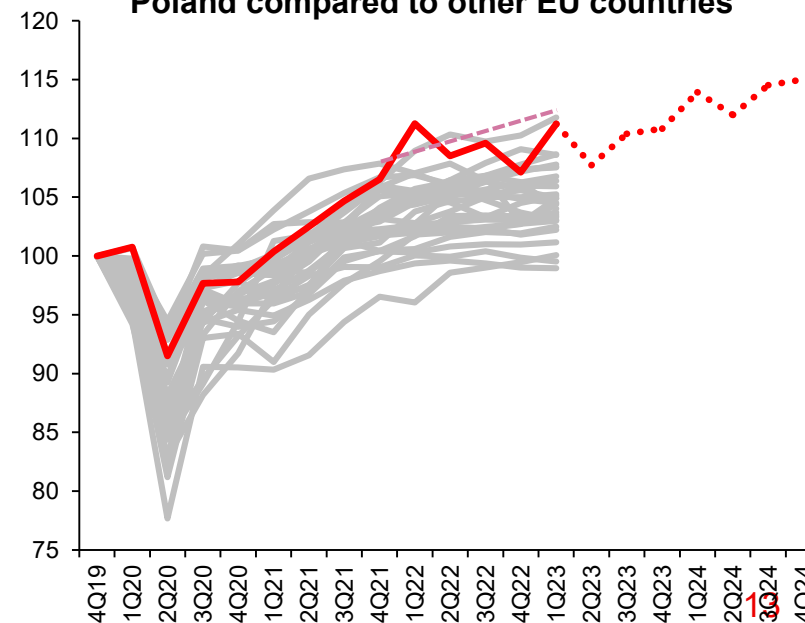
GDP growth in the first quarter of 2023, which, in our opinion, was supposed to be the trough in the recessionary cycle, proved much better than expected but the indicators from the second quarter suggest that economic activity was still slowing down, at least in the sectors which we can monitor in real time. We have adjusted downwards our forecast for the second quarter because available data suggest that consumption – especially of goods - is still in decline and inventories keep strongly decreasing. **We still expect GDP to grow by about 1% in 2023, which we believe will be driven a recovery in consumption and investment growth which we expect to stay positive. By the end of the year and during the next one, GDP growth should accelerate to above 3% y/y, based on recovering domestic demand and more or less neutral net exports.**

Seasonally adjusted GDP data showed surprising volatility during the last year, which made them hard to interpret and use to draw far-reaching conclusions, for example about the state of the economy. According to the experts of GUS, this was not caused by any significant change to the seasonal pattern, but rather one-off shocks which hit the economy (in different directions) in the first and the fourth quarter of 2022. Should this theory be accepted and both quarters be treated as atypical observations, it would seem that seasonally adjusted GDP was still in the trend of post-pandemic recovery, and not in a quasi-recession triggered by the effects of the war in Ukraine and the energy shock. Nonetheless, we do acknowledge that the seasonally adjusted series may be reviewed in the coming quarters.

GDP growth in Poland and its breakdown, %



GDP, 4Q19=100, seasonally adjusted, Poland compared to other EU countries



Investment above expectations

We have become more optimistic about this year's investments and expect growth of around 4% in real terms this year.

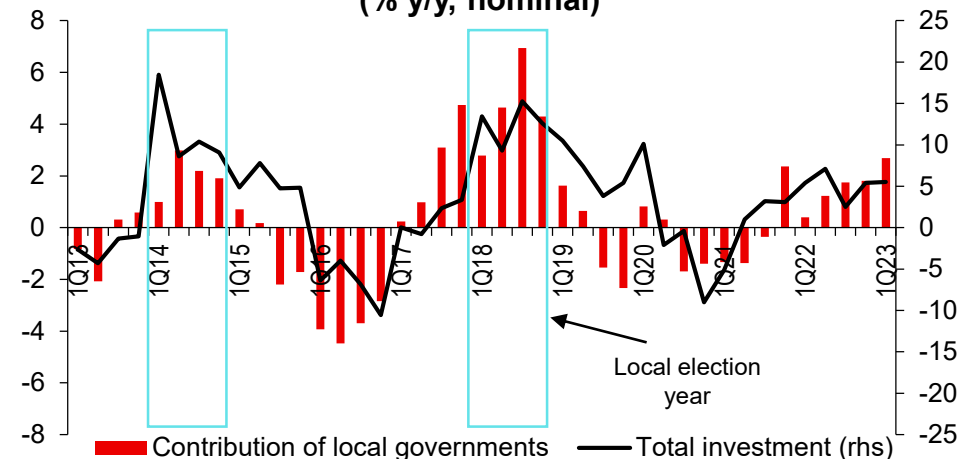
Local governments have revised their investment plans upwards, to around PLN110bn from PLN95bn. This means that nominal growth may not be 10%, as we have assumed so far, but as much as 25%, so they may add around 1.5 percentage points to total investment. This would not be very consistent with the pattern of the election cycle observed recently: the peak of the investment cycle in local government occurred typically in the year in the election year (e.g. 2014 and 2018). The next local elections will take place in 2024.

We reiterate our expectations that central sector capital expenditure will be strong this year, especially on road and rail infrastructure and arms. In our view, military spending will add around 2 percentage points to total investment growth. This component, however, is essentially all imported, and therefore does not add to GDP.

Domestic companies are in a good financial shape, but are not very optimistic about investment. However, the improvement in the economy may become a trigger for the investment process. Still, investments in the energy sector and in machinery (automation?) are growing quite significantly. In the longer term, we expect investments financed by foreign capital within the ongoing processes of nearshoring (moving production closer to the companies' headquarters or main market) and friendshoring (moving production to friendly countries).

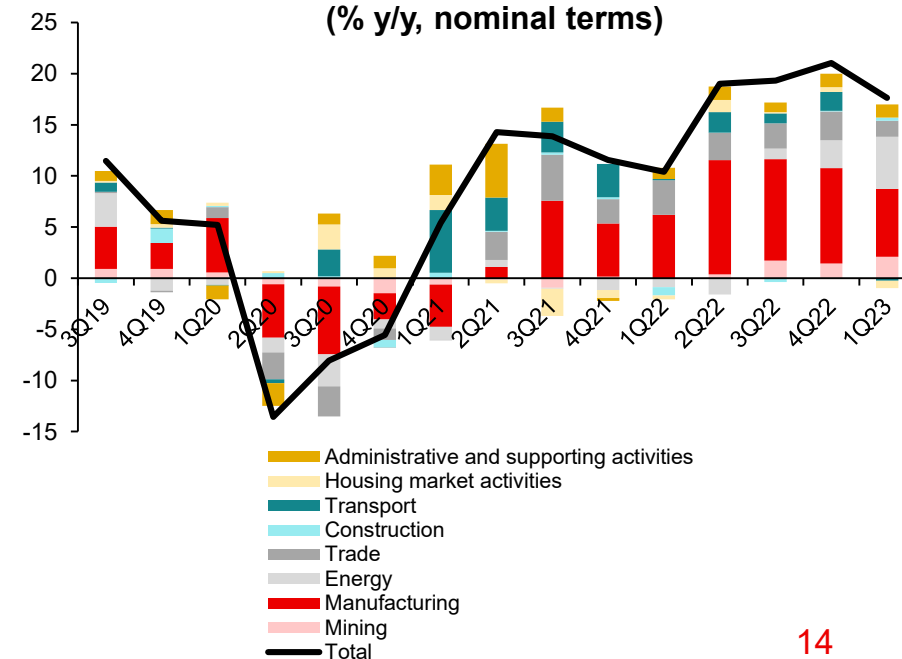
Mortgage sales are rebounding, suggesting a recovery in household investment activity. However, the full-year result in nominal terms will, in our view, be similar to that of the previous year (i.e. lower in real terms).

Local government's contribution to total investment (% y/y, nominal)



Source: GUS, Finance Ministry, Santander

Breakdown of investment in 50+ companies (% y/y, nominal terms)



Source: GUS, Santander



Awaiting the consumption rebound (1)

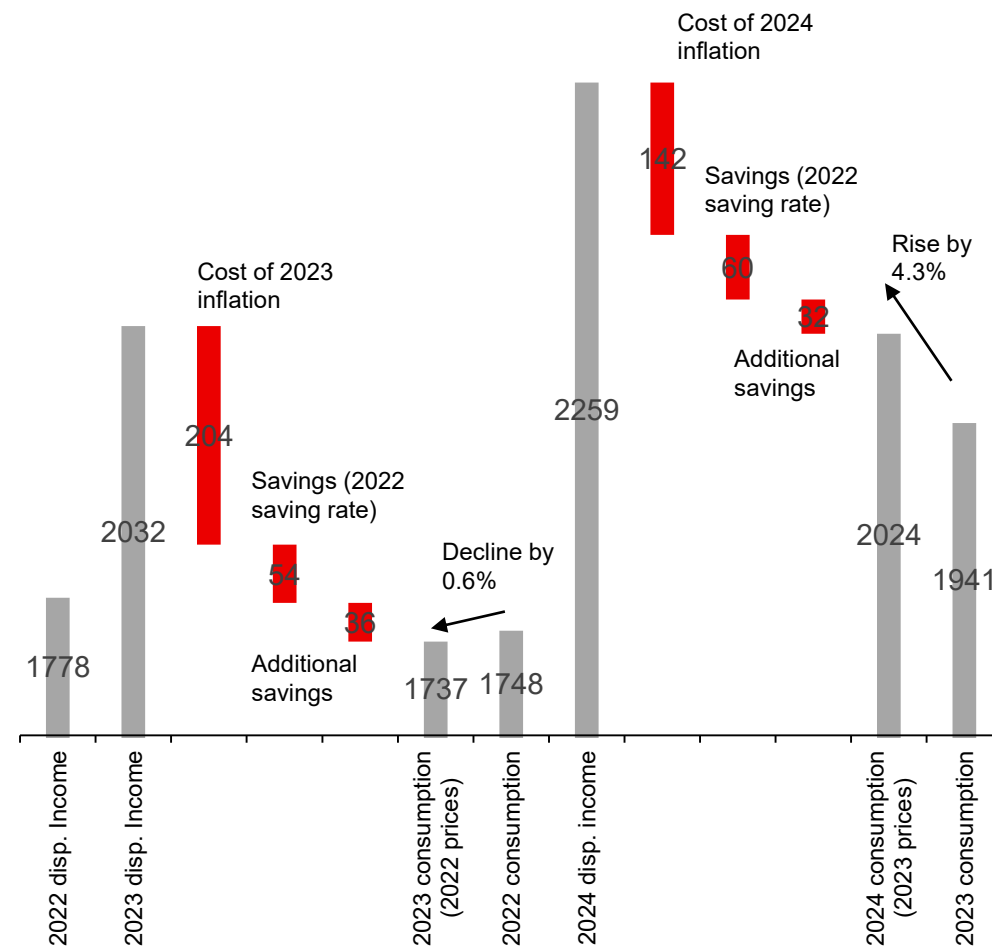
There is little evidence of a rebound in consumption in this year's hard data (to May). Private consumption data for 1Q2023 looked weak, as did April and May's retail sales and retail trade turnover readings. In contrast, improvement is already clearly visible in consumer credit sales (see [page 28](#)).

That having said, we remain moderately optimistic about the outlook for consumption, with support for our forecast coming from:

- The sound labour market situation: despite the weakening of labour demand, unemployment remains at a record low and wage growth remains at double-digit levels. In our view, this situation will continue for the next quarters, and the 20% increase in the minimum wage will be an important support for total wage dynamics next year. For more on the labour market, see [pages 19-23](#)
- Declining inflation: thanks to the fall in inflation, wages have probably increased in real terms already in June, and the real growth rate will continue to improve in the following months. We assume that not only labour wages, but total disposable income will improve.
- Election promises: additional support will be provided by the ongoing election campaign. In January 2024, child benefit increases from PLN500 to PLN800 (additional PLN25bn for households), and we believe further proposals may follow.
- Improving consumer optimism: since October 2022, consumer optimism measures have been surging and have already reached pre-February 2022 levels. In our view, these gauges will continue to improve, especially thanks to the positive labour market situation. However, even if this were not to happen, the change to date should translate into higher consumption. According to our analysis, an improvement in consumer optimism translates into an improvement in consumption within 3-4 quarters.

Despite the improved consumption outlook, the result for the full year may still be negative due to the weak first half of the year.

Disposable incomes vs consumption

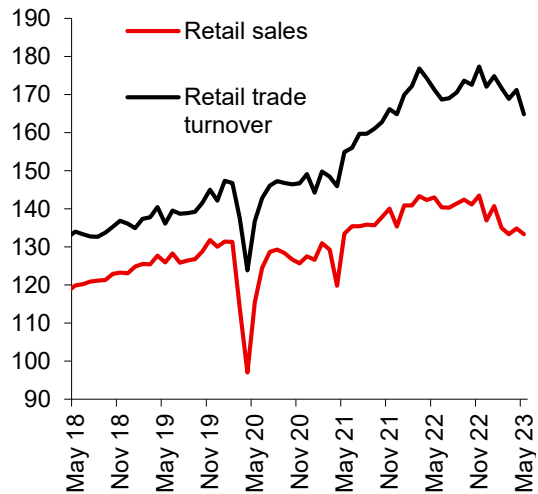


Source: GUS, Santander

Awaiting the consumption rebound (2)

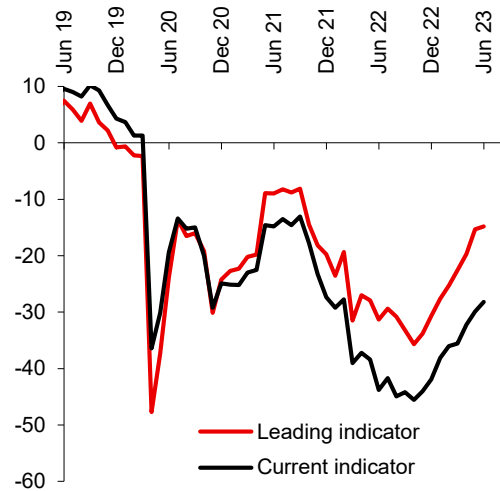


Retail sales data, seasonally adjusted index, 2015=100



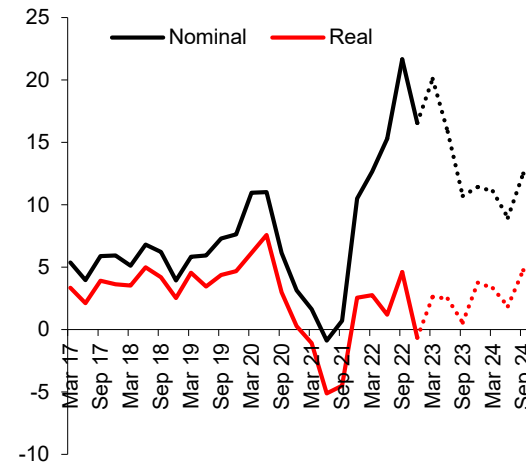
Source: GUS, Santander

Consumer confidence, pts



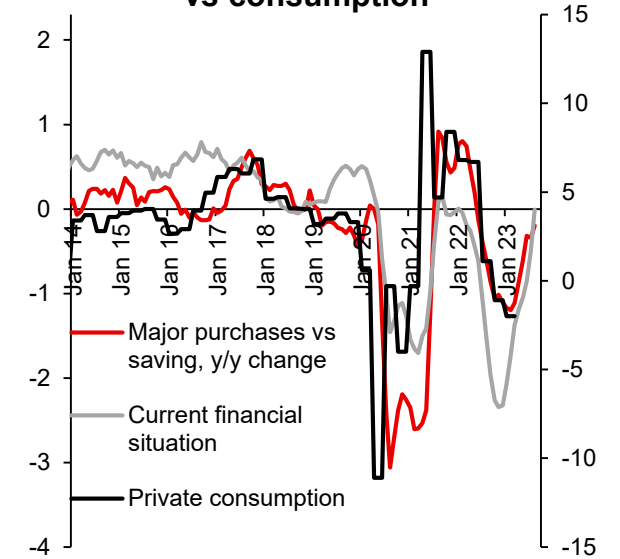
Source: GUS, Santander

Disposable incomes, % y/y



Source: GUS, Santander

Changes in consumer confidence vs consumption



Source: GUS, Santander



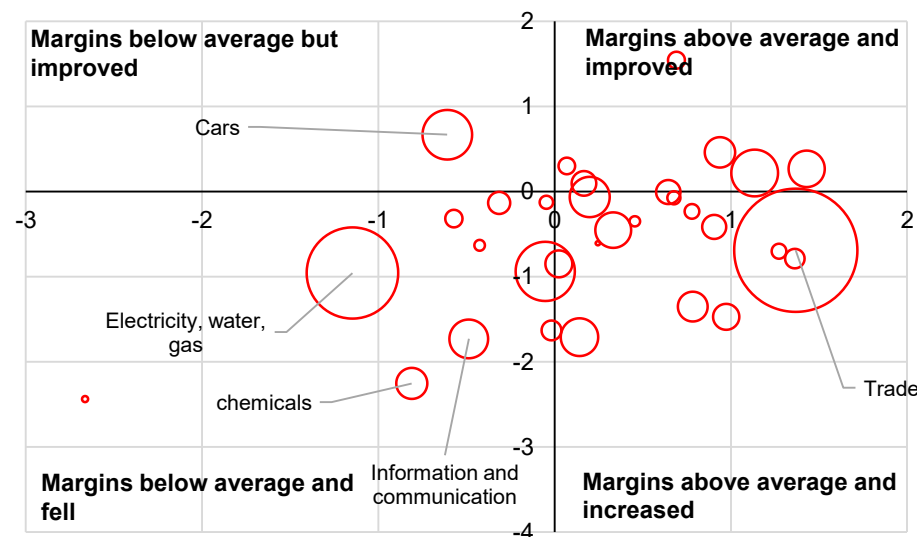
Companies results' at all-time high

2022 was very good for the Polish non-financial corporate sector. Companies employing 10 or more people earned a record PLN353bn (+13.5% y/y). However, the very good nominal result masks the fact that profitability (gross financial result to revenues) fell to 6.1% from 6.8% in 2021. (although it remained above the 2014-2021 average of 5.0%) and that the proportion of companies recording losses increased, with the total amount of losses being one of the highest in recent years. Thus, not only the average result has increased, but also its volatility. Not all companies have performed well in an environment of high inflation and slowing growth.

Above-average margins were recorded in mining, trade, transport and construction, among others. Below-average margins were recorded in electricity, gas, steam and hot water generation and supply, chemicals, motor vehicles and information and communication.

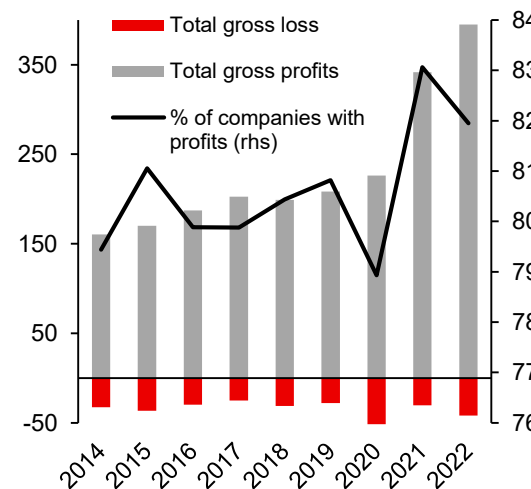
In the coming quarters, we expect an improving economy and lower inflation, which should improve the predictability of the economic situation and make it easier for companies to operate. **The main concern on the cost side may therefore be wage growth, which we believe will remain at double-digit levels. This will be felt primarily by the service sectors, where labour costs account for a higher share of costs, and those with weak performance. However, the good performance of companies provides a solid basis for improving investment in the longer term.**

Margins* in 2Q22-1Q23 in 50+ companies

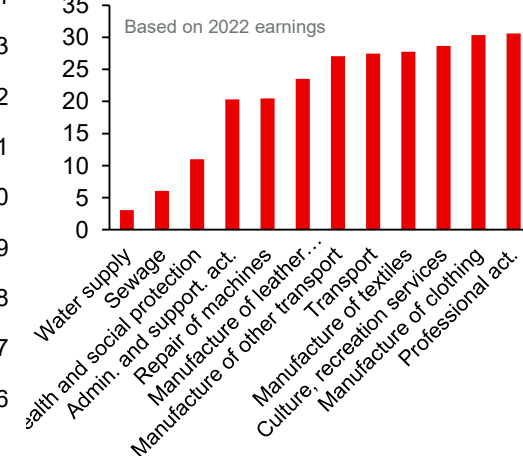


*Comparison with averages from 2010-2022 period, margins (gross financial results as % of revenues) were normalised. Bubbles' sizes reflect sector revenues

10+ companies results, PLNbn



Wage growth consuming the entire profit of a particular sector



Source: GUS, Santander



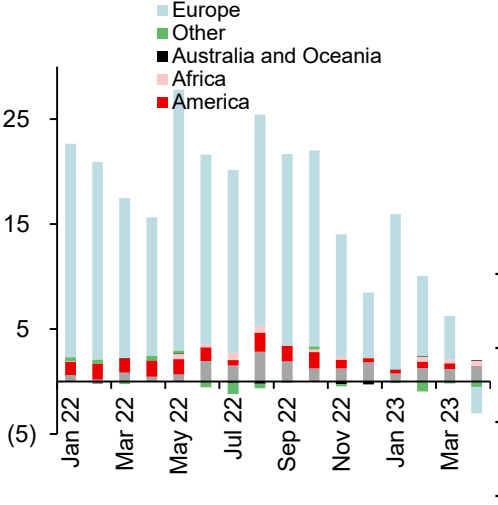
Balance of payments: surplus hard to maintain

We expect that after positive surprises during the beginning of the year, driven by weak imports, current account will correct and its monthly readings will soon alternate between surpluses and deficits. The lack of a rebound in industry is due to – among other factors – the weak economic situation in Europe, whose effects on growth of Polish exports are already negative. On the other hand, the surprising collapse of domestic demand should keep imports relatively low. This should allow the 12M current account balance to keep on improving, although slower, and then finish the year with a small surplus. In our opinion, in 2024, as a result of a recovery of our main partners and a solid rebound of domestic demand, the aggregated balance will become slightly negative.

Exports are driven by the automobile industry, which – in our opinion – is catching up after the period of logistic bottlenecks. The shortfall in European car production relative to the pre-pandemic period is still large, so there may still be a backlog of orders for parts and cars from Poland. The problem remains with consumer electronics, which Europeans had already bought during the pandemic, and of which Poland is an important supplier on the continent. It is encouraging that, as in previous down cycles, Polish exporters are still able to increase their market share in Europe.

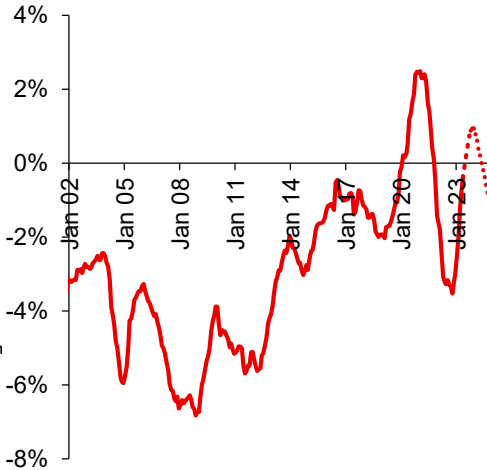
On the import side, we have a clear deceleration based on both weaker demand and disinflation in imported goods. Korean imports have broken away from the cycle (due to military spending).

Export growth % r/r – geographic decomposition



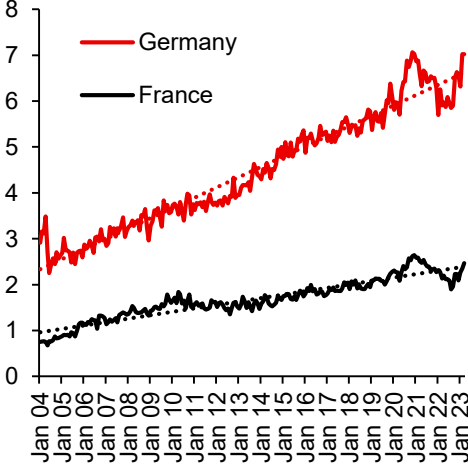
Source: GUS, Santander

Current account, 12m sum, % GDP



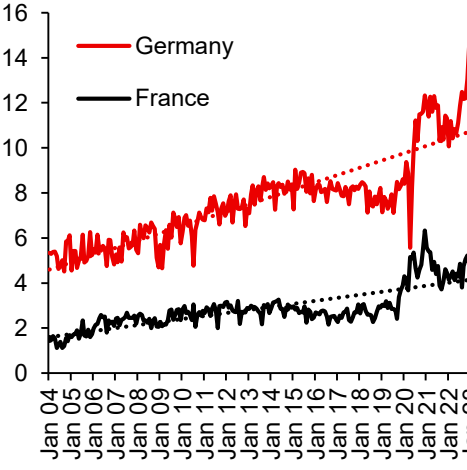
Source: NBP, Santander

Poland's share of overall imports (%)

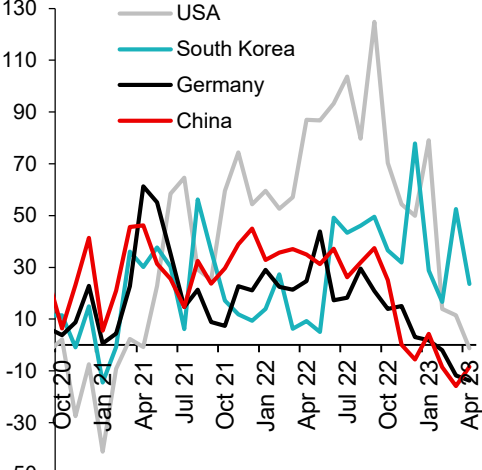


Source: Eurostat, Santander

Poland's share of import of parts for means of transport (%)



Poland's imports from chosen countries, % y/y



Source: Eurostat, Santander





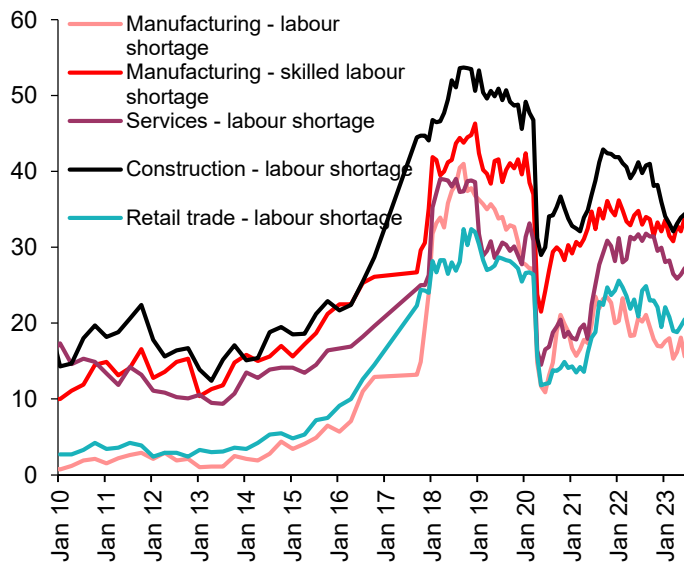
Labour market – what do employers see

From the employer side, the labour market does not look chilled. On the contrary, there are signs that labour shortages are increasing again.

The response rates in the business climate survey indicating that companies have encountered a labour shortage - rather than falling with the economic slowdown - have recently moved up, at least in some sectors. Meanwhile, the number of people not in employment, but able and willing to take up work is at an all-time low (434k according to the LFS) and continues to fall, while the inflow of economic migrants is no longer accelerating ([p.22](#)).

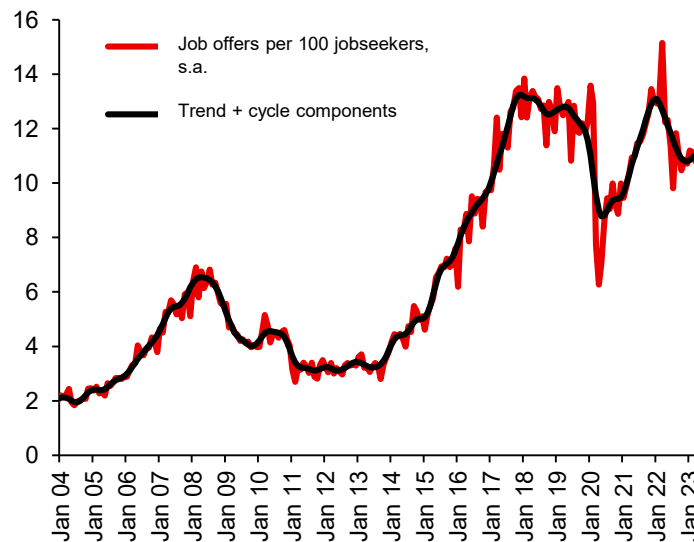
The data on job offers in job offices per every 100 unemployed people are starting to show an upward bend after being cleared of seasonal fluctuations, although the downward adjustment of this measure in 2022 was relatively small. The change seems to have happened at the turn of the year. The Manpower employment index is also sending positive signals: its latest edition shows a continuation of the upward bounce in 2Q2023. In the past, increases in the index have correlated quite well with a y/y drop in unemployment.

Percentage of companies reporting labour shortages as business barrier



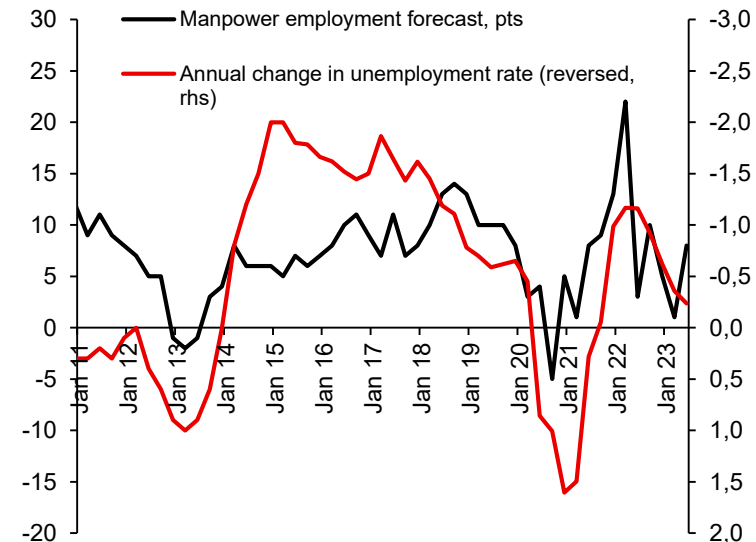
Source: GUS, Santander

Job offers vs number of jobseekers



Source: GUS, Santander

Manpower employment Forecasts vs change in unemployment rate



Source: GUS, Manpower, Santander

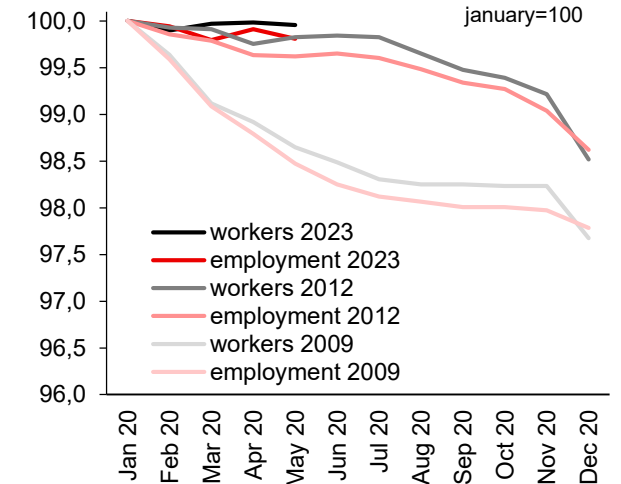


Labour market – what do employees see

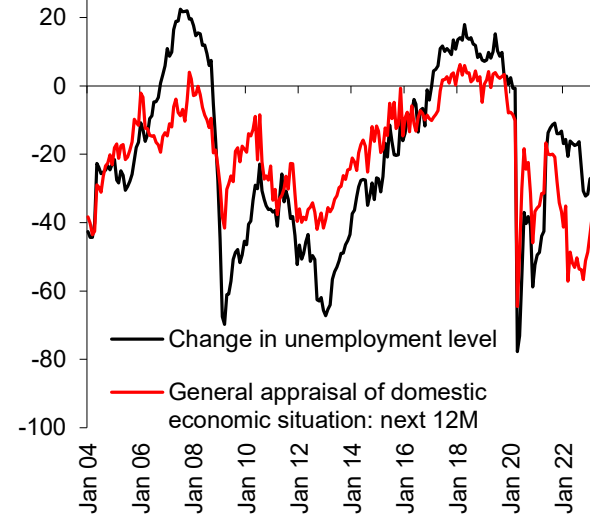
The labour market as seen by employees is still quite sound despite slower GDP growth.

Unemployment is at its record lows (2,7% according to LFS), while employment is at its heights (at approx. 17mn). The labour market adjusted to the temporarily weaker situation of the firms by lowering hours worked rather than by reducing jobs (i.e. by hoarding work, which we have already seen in the past) – it can be seen in both the data from the firms and in the national accounts. It seems that the demand for labour in the whole economy recovered again, and the jobs, which were moderately cut in a few industries which face lower activity, such as manufacturing, were easily absorbed by the service and public sectors ([page 21](#)). It may explain why consumer sentiment surveys show decreasing concerns about a rise of unemployment. Despite the deceleration of the economy in the last quarters, consumers are becoming more positive about its outlook.

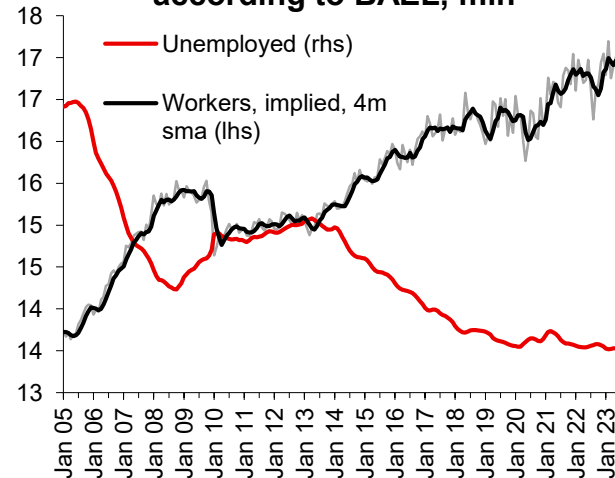
Changes in employment (FTE) and in the number of Employed in downturns



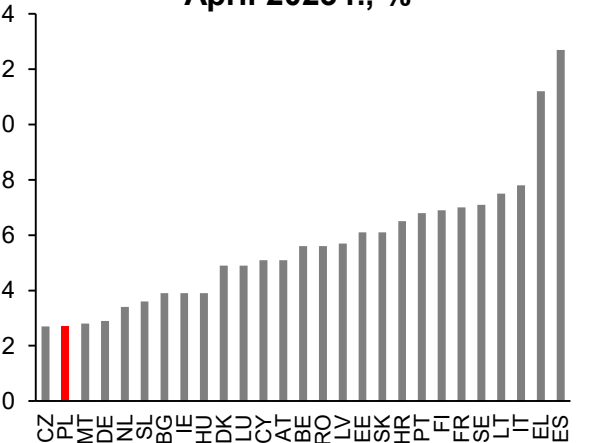
Consumer sentiment, pts.



Number of unemployed and employed according to BAEL, mln



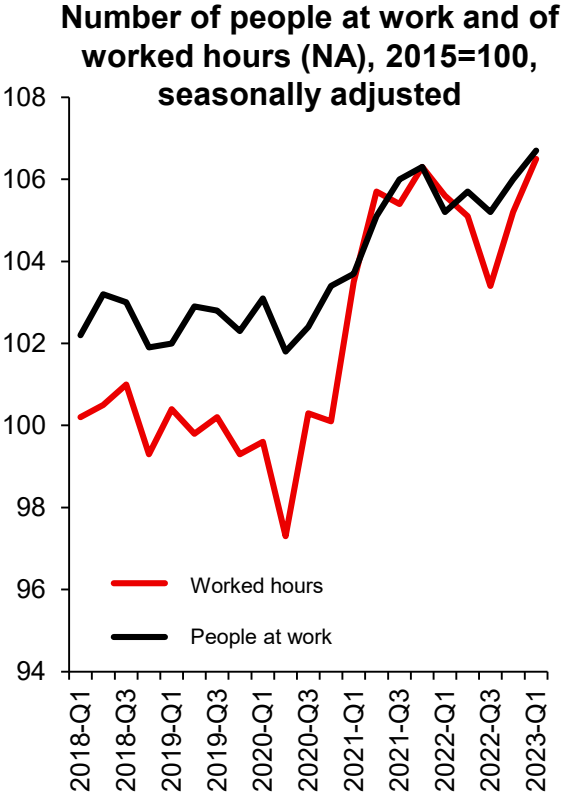
Unemployment rate according to BAEL, April 2023 r., %



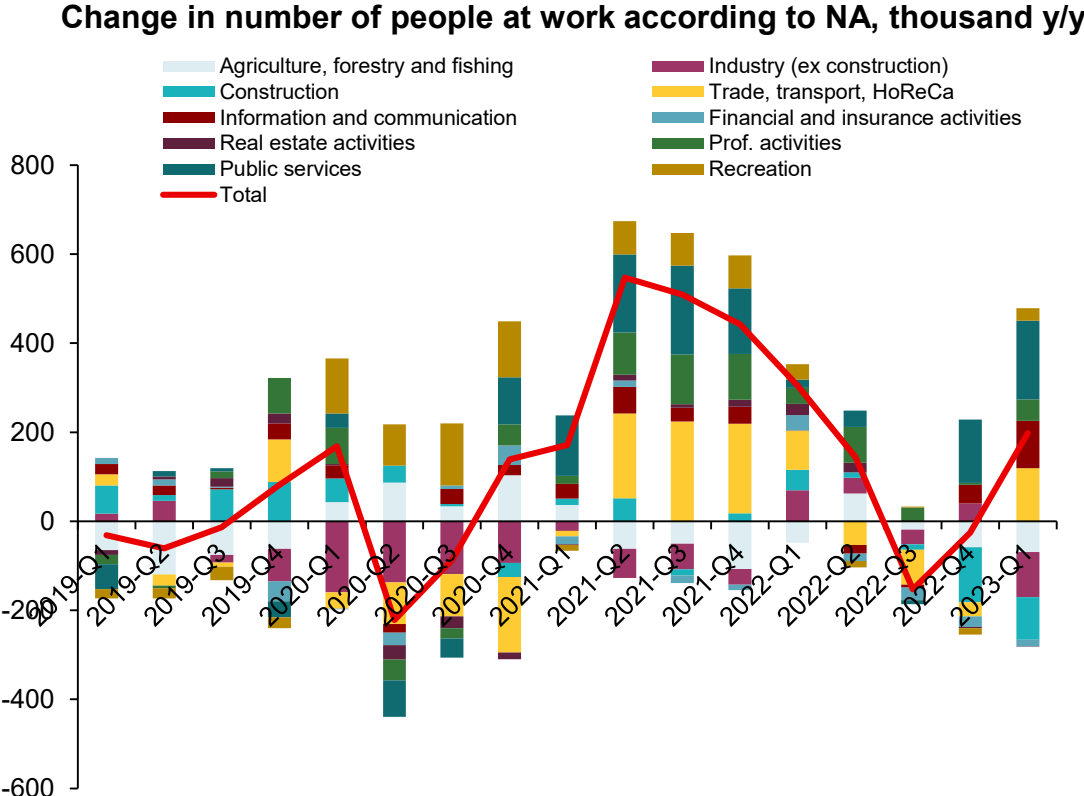


Labour market – let the data speak

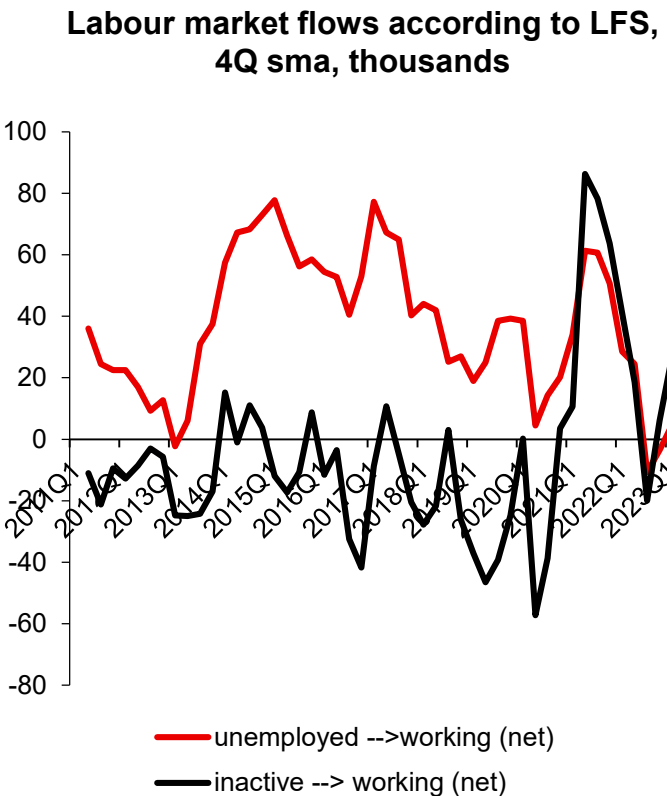
National Accounts (NA) and LFS employment data indicate that the slightly negative labour demand trends seen in 2022 have clearly reversed early this year. The number of people in work rose to a record high in 1Q2023, and the number of hours worked rebounded to an even greater extent - signalling that the utilisation of available labour resources is no longer significantly different from that at the top of the post-pandemic recovery cycle (1Q2022). The start of the year also saw a reversal in the trend in net flows between the unemployed and economically inactive and the employed (in favour of the latter). **If our forecasts for a recovery in activity in 2H2023 turn out to be accurate, expect a further increase in demand for workers, translating into increased wage pressures.**



Source: GUS, Santander



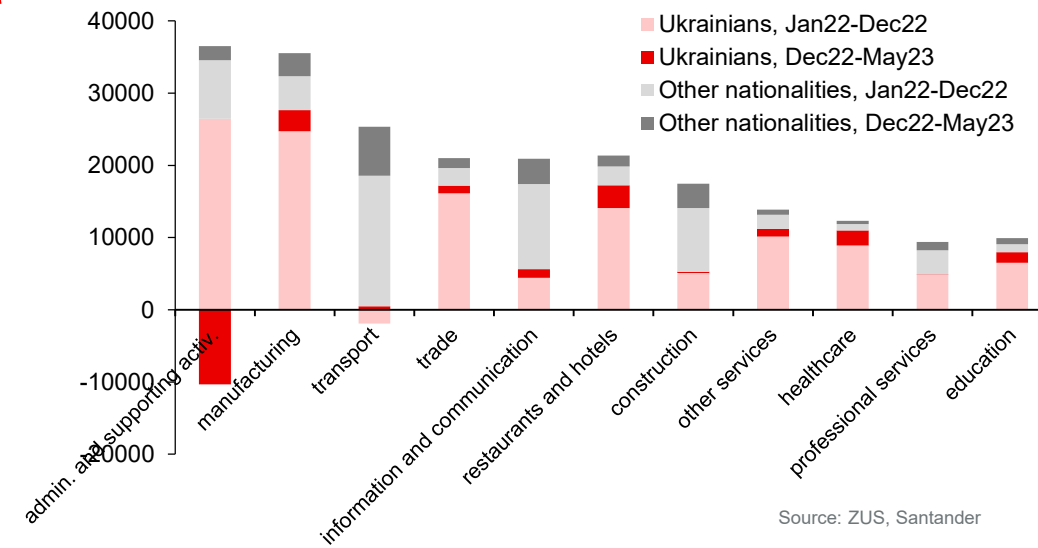
Source: Eurostat, Santander





Foreigners on the labour market

Increase of number of foreigners registered in ZUS by sectors

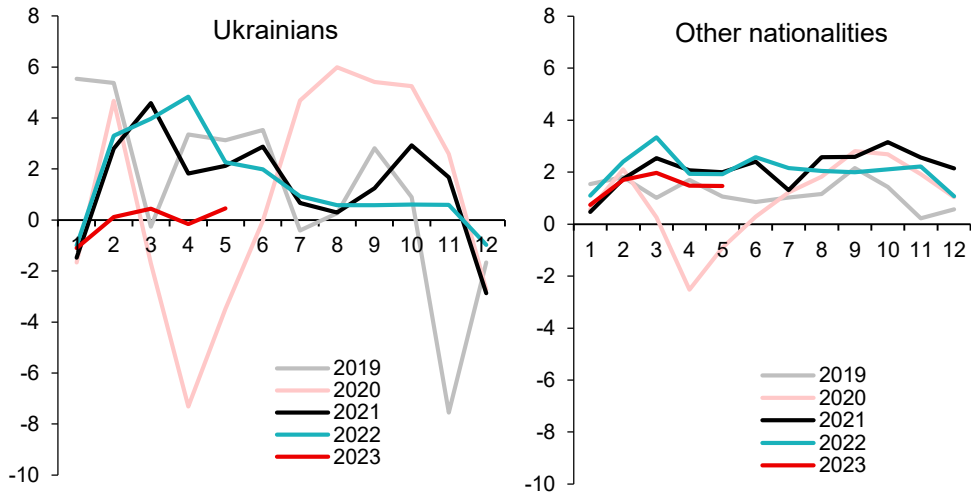


The labour market has become tighter due to, among other factors, a reduction in the scale of the inflow of foreigners, which may mean an intensification of wage pressures.

192k more foreigners were registered in Polish social security in 2022, including 125k Ukrainians. Year to date until May this year, only 22k new foreigners were registered, including 2k Ukrainians. At the same time, the data indicate a gradual shift of registered Ukrainians from low-skilled sectors (administration and support activities, i.e. mainly cleaning) towards jobs better suited to their skill (and thus probably offering higher wages).

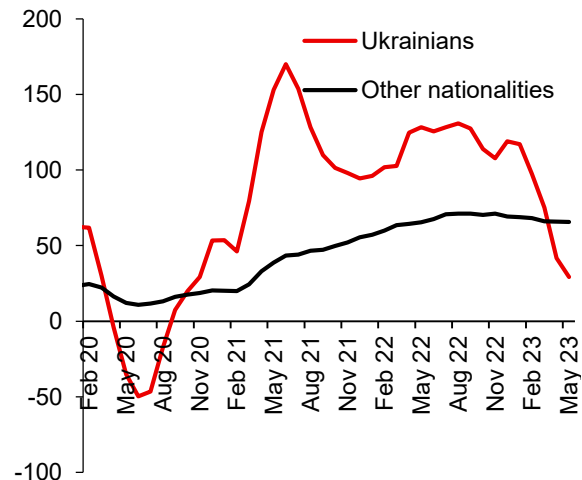
Poland has one of the highest employment rates among foreigners in the world, which means that a reduction in their inflow or departure translates relatively strongly into labour market conditions.

New foreigners registered in ZUS, % m/m



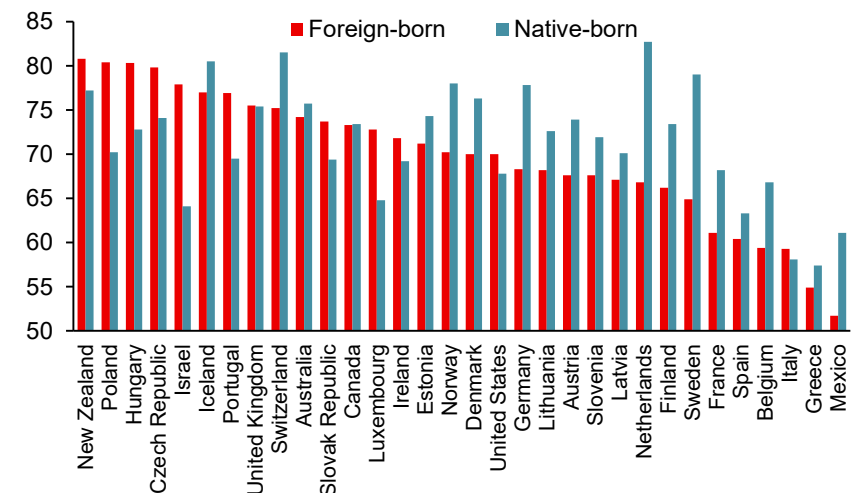
Source: ZUS, Santander

Foreigners registered in ZUS, y/y change, thousands



Source: ZUS, Santander

Employment rate, %



Source: OECD, Santander



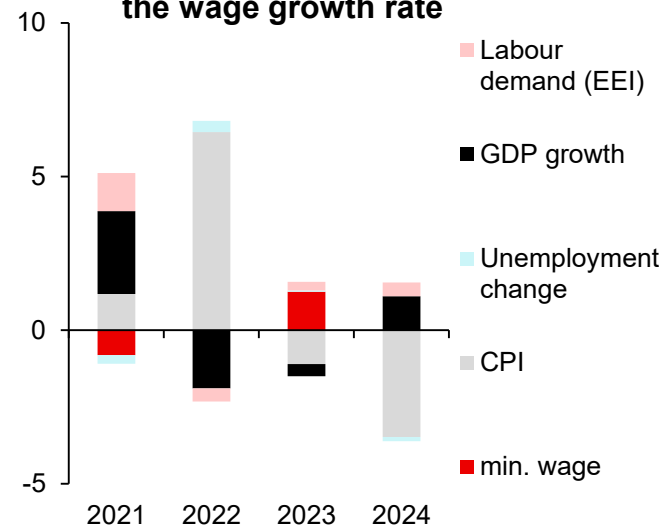
Minimum wage and wage growth

The government proposed to introduce in 2024 a two-step increase of the minimum wage, by 19.4% in total. In the current year it was also increased by almost 20%. Such huge increases are a result of – among other factors – the high inflation path. This, in turn, means that **minimum wage is one of the channels through which past inflation may affect present inflation**. This happens through the market and the administrative channels. The first one works as follows: the increase in the purchasing power of the people whose wages react to the increase of the minimum wage (directly or indirectly) increases the tolerance of these consumer for higher prices of goods and services, so it allows firms to pass their costs onto them. The administrative channel is related to the method of calculating the minimum wage which accounts for the inflation in the previous year.

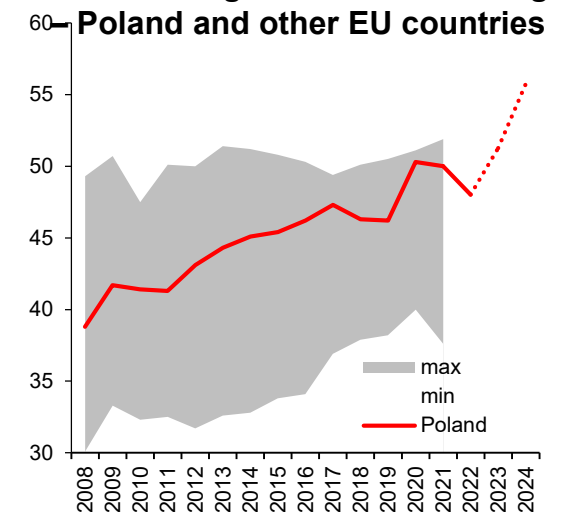
Our model explaining the behaviour of the average wage, suggests that since the increases of the minimum wage in 2023 and 24 will likely be similar in scale, their effects on the average wage should also be similar and equal to about 2 percentage points. It is a neutral factor for change in annual wage growth, or in other words, a **one that keeps the wage growth in the economy at a very high level**. In our opinion, the growth will slightly decrease because disinflation will be stronger than the economic recovery which we expect in the next year. Apart from that, the lack of a downward adjustment of the labour market during the economic slowdown will likely also mean no significant rebound of labour demand in the early stages of the recovery (due to hoarding labour instead of elastically adjusting it during the weaker periods), so this factor will have little effect on the changes in wage dynamics.

Wage growth can also be related to inflation by considering the high share of companies which base their current wage policy on keeping the real value of wages constant (i.e. they tie the size of the wage raises to past inflation). According to the surveys of GUS, this is the behaviour of 40-50% of firms.

Impact on the change in the wage growth rate



Minimum wage as % of the average Poland and other EU countries



Factors significantly impacting the level of wages in the next 3 months, percentage of respondents, June 2023





Inflation has fallen more than we assumed

CPI inflation continues to decline faster than we had anticipated. We now expect it to fall to 7-8% by the end of this year and then to stay at a similar level in 2024.

The lower forecast for this year is partly due to the fact that the GUS has taken a different approach to electricity prices than we had assumed. This change subtracts around 1 percentage point from our CPI path (see [page 25](#) for details). In addition, core inflation fell slightly more sharply than our expectations. In our view, inflation will almost certainly be in single digits in September this year. There is also a chance that this will happen as early as August (currently our forecast for August is 10.2% y/y).

For 2024, we are specifically assuming: a normalisation of VAT rates on food (+1 percentage point to inflation) and an increase in electricity and gas prices for households (+2 percentage points to inflation). Without these elements, our inflation path for next year would hover around 5%.

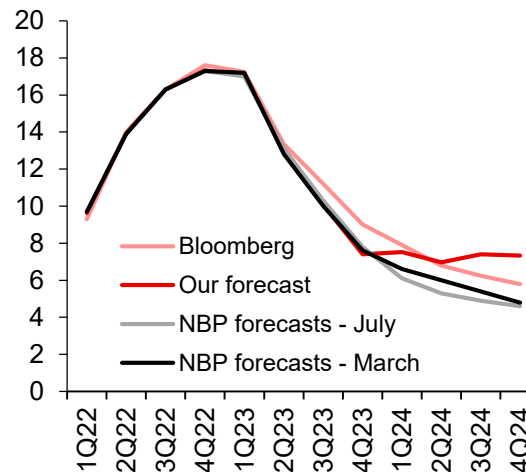
In our view, inflationary pressures will be supported by:

- Gradual recovery of the economy, double-digit wage growth, strong labour market
- Expansionary fiscal policy
- Progressive indexation of benefits
- Weakening of the monetary policy transmission mechanism (more fixed-rate mortgages, credit moratoria)

On the other hand, inflationary pressures will be dragged lower by:

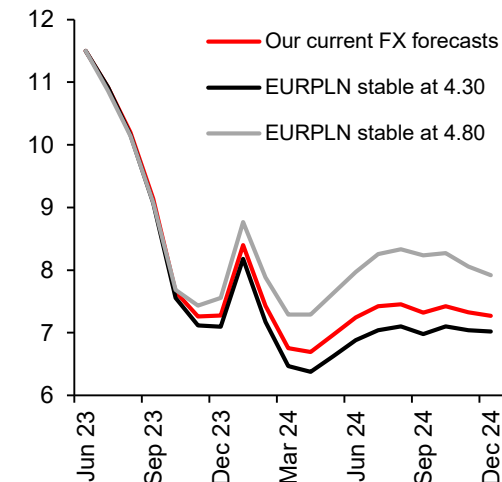
- Global disinflation, falling commodity prices and PPI inflation
- Stronger zloty

CPI inflation forecasts % y/y

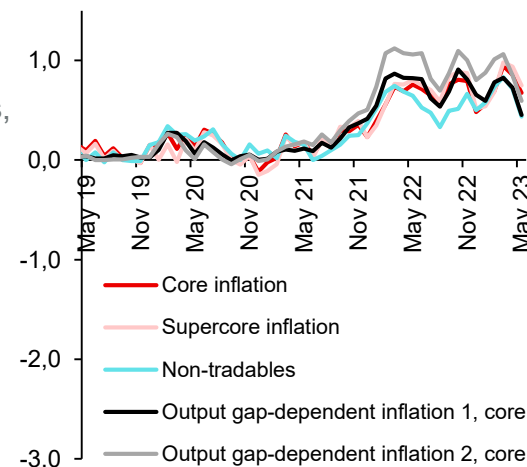


Source: GUS, Bloomberg, NBP, Santander

Our CPI Forecasts with different assumptions about EURPLN

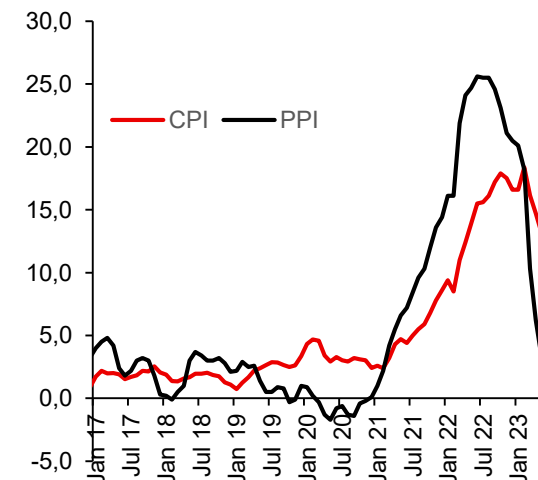


CPI momentum gauges



Source: Eurostat, NBP, Santander

CPI vs PPI, % y/y





Energy prices to rise in 2024

Energy prices were an important inflationary factor in 2022. Higher energy prices translated into the CPI directly, due to price increases for households, as well as indirectly, through increased costs for companies, which in turn caused price increases for other goods and services.

In 2023, electricity prices have gone up by around 60%, but due to the price freeze up to a certain limit, households will not feel this change in full. Until recently, we had assumed that the average price would rise slowly over the course of the year, as households will be crossing the consumption threshold. However, it turned out that the GUS added a 'lump sum' of 3.7% to consumer electricity prices in January for inflation to cover for the freeze effect, and in the remaining months of the year prices will no longer change. On top of that, this week the government increased the consumption thresholds by 1 MWh per year and this will, in our view, reduce electricity prices by 2.5% as soon as it will be introduced (September or October).

For 2024, we assume the abandonment of the energy price freeze and, at the same time, a reduction in tariff prices, by around 10%, which will translate into an increase in average household prices by around 40%. However, the uncertainty regarding this assumption is high. For gas prices, we assume an increase of 15%. It also cannot be ruled out that the government decides to extend the tariff freeze to 2024, which would lower our CPI forecasts.

The Climate Ministry has prepared an amendment to the regulation that determines how heat tariffs are calculated. The amendment is intended to prevent tariffs from being calculated on the basis of indices published by URE (energy market regulator) based on reports of energy companies for the past period, which was characterised by high prices of energy. This should reduce the risk of significant increases in heat prices in subsequent years (a return to index calculations will be possible from 1 January 2028), which is, however, consistent with our scenario assuming little change in heat prices in subsequent months.



Electricity prices

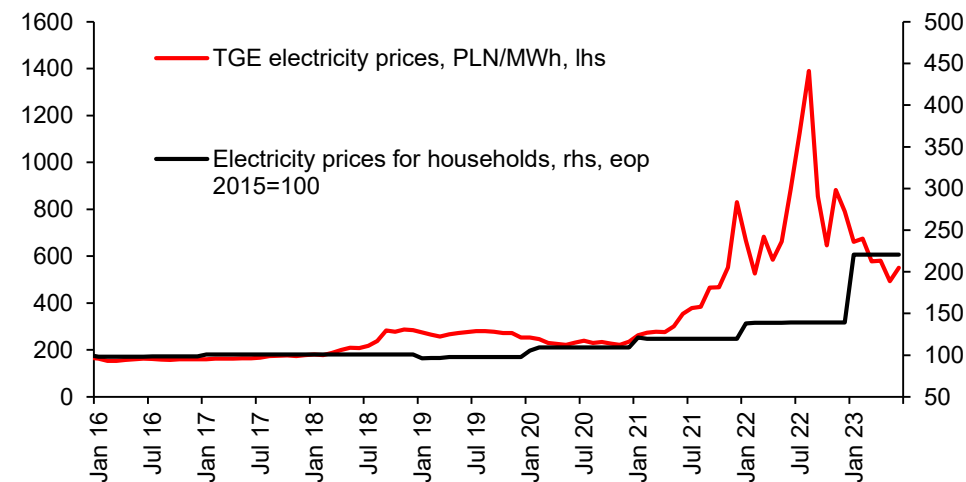
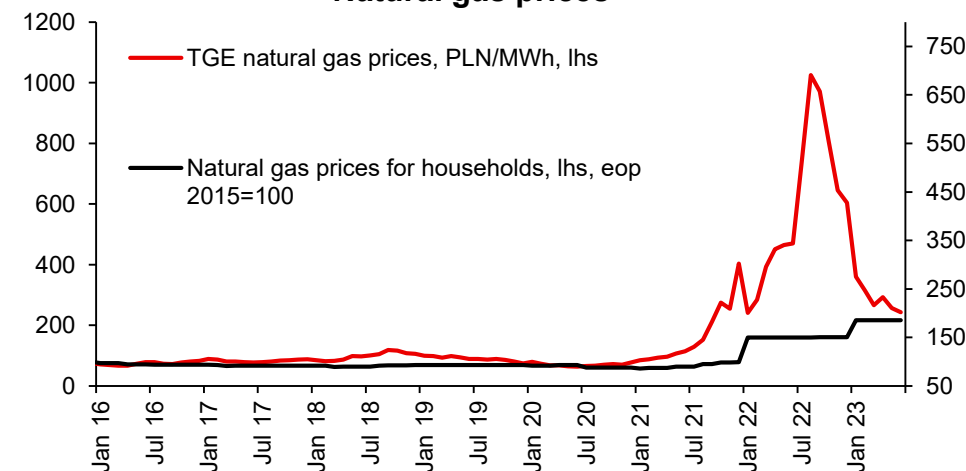


Chart shows changes in prices for households assuming no changes in taxes and no effect of price freeze

Source: GUS, TGE, Santander

Natural gas prices



Source: GUS, TGE, Santander



Core inflation under pressure from labour costs

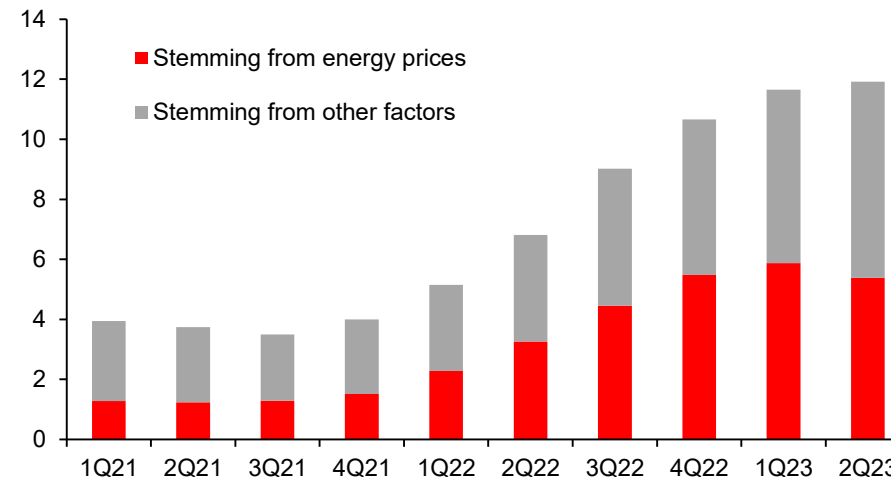
In our view, core inflation will decline in the coming quarters, mostly thanks to the fading effects of the energy shock. However, it will remain elevated by the effect of high wage growth.

The strong rise in core inflation in recent months was due to, among other things, the energy shock. Our estimates show that a 10 per cent increase in energy prices for businesses translates into a 0.5-1.0 percentage point increase in core inflation.

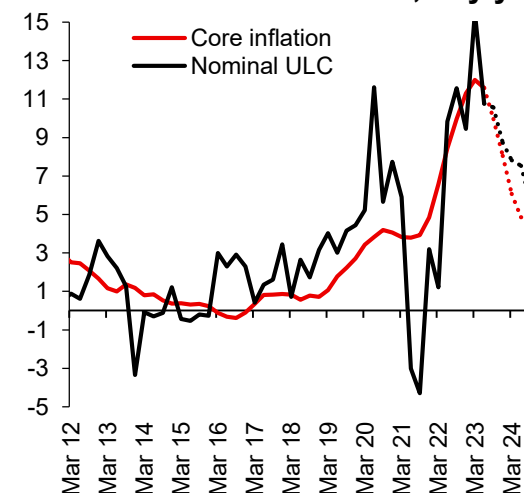
The pass-through of costs to retail prices is stronger during economic upswing, and energy price increases have a stronger impact on prices than price reductions. Based on these results, we estimate that around half of the price increase in core categories in 1Q2023 (core inflation was 12.0% y/y in 1Q2023) came from higher energy prices. The stabilisation of energy prices at 1Q2023 levels should therefore subtract around 2-3 percentage points from core inflation by the end of the year.

In our view, the effect of other factors on core inflation, in particular labour costs, will increase in the following months. This will be felt primarily in the service sectors, where labour costs account for a larger proportion of total costs than in other industries. According to our estimates, a 1% increase in wages and salaries adds around 0.5 percentage points to core inflation, so it is difficult to imagine that, with double-digit wage growth in 2024, core inflation will fall significantly below 5%.

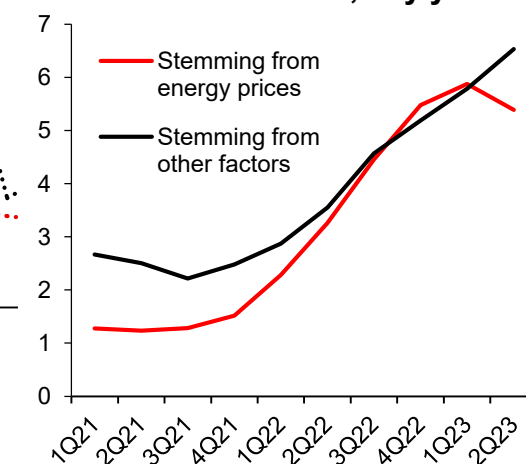
Core inflation – breakdown, % y/y



Core inflation vs unit labour costs, % y/y



Core inflation – breakdown, % y/y



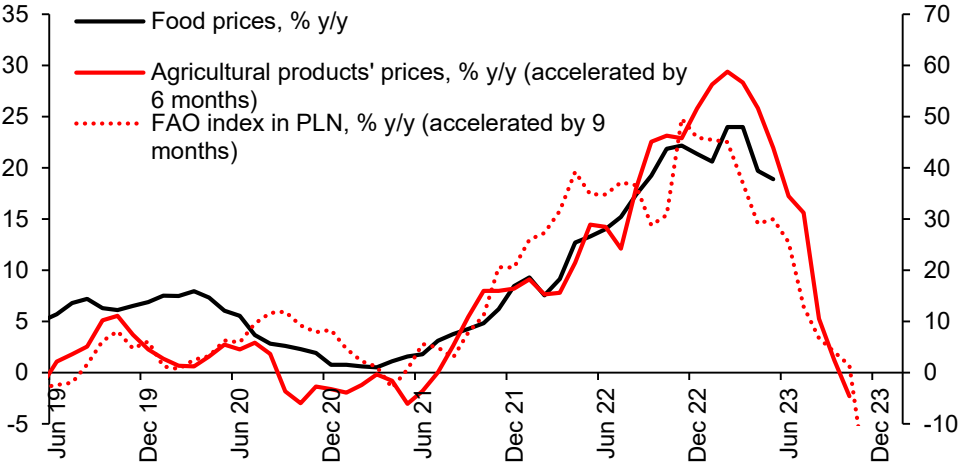


Food prices rise slower, but the risk is rising

The leading indicators for food prices in Poland - the FAO global index and domestic agricultural prices - have declined markedly in recent months. **This suggests a further slowdown in domestic food price growth.** This was possible by the waning effects of the supply shock associated with the Russian invasion of Ukraine and the increase in the supply of agricultural products in other countries.

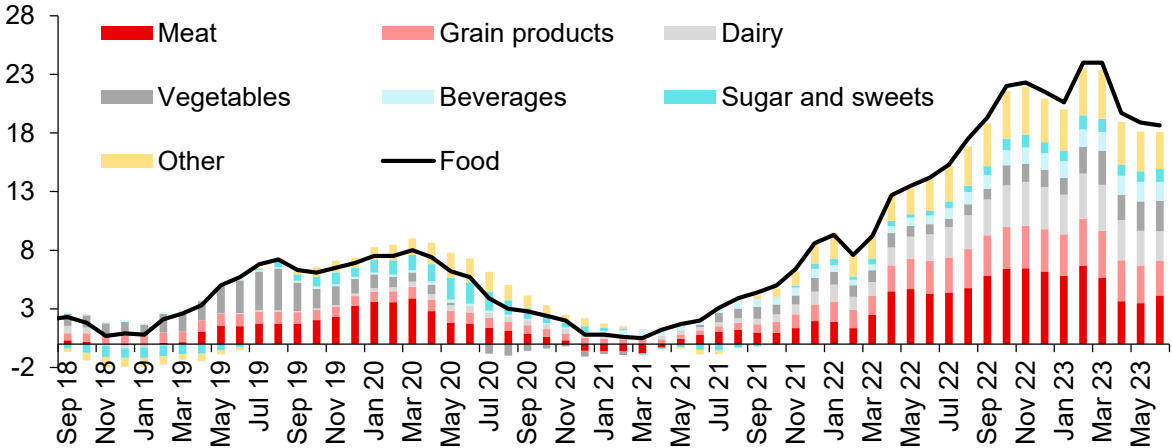
For food prices, however, the risks are asymmetric upwards - an agricultural drought is currently underway in Poland, its amplifying will mean higher vegetable and fruit prices in autumn. Weather anomalies are also occurring in other parts of the globe, e.g. the North Atlantic is record warm and an El Niño phenomenon has occurred in the Pacific. In addition, Russia is threatening to break its agreement with Ukraine on grain exports across the Black Sea. Due to the above factors and our assumed reversal of the VAT reduction on food, we expect food prices to slow down to around 8% y/y by the end of this year. Food prices' growth rate is likely to stay close to this level next year, in our view.

Food prices in Poland



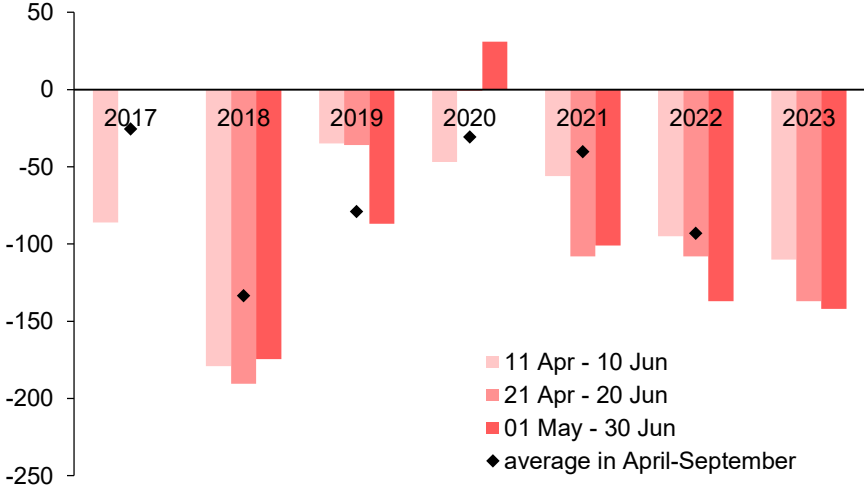
Source: GUS, FAO, Santander

Food prices – breakdown of annual increase



Source: GUS, Santander

Domestic water balance*, mm



Domestic Water Balance – difference between precipitation and evaporation
Source: IUNG-PIB, Santander





Rebound in loan origination

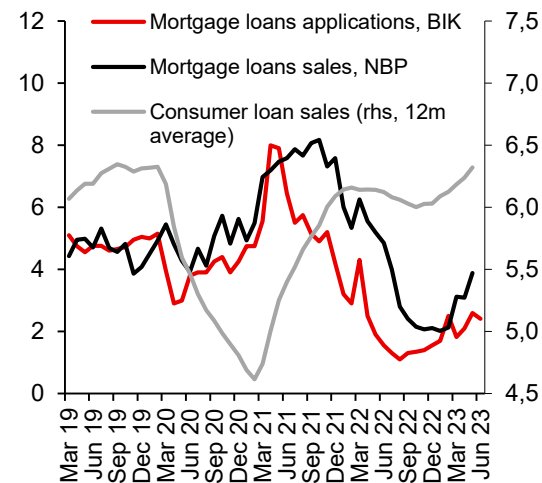
In line with our expectations, loan sales have started to improve and we expect this trend to continue in the coming months. The improvement in the credit market is consistent with our forecasts of a rebound in GDP growth.

In our March MACROscope, we suggested that credit demand would start to rebound due to: falling market interest rates, stabilisation of house prices, strong wage growth, easing of lending criteria and the introduction of a mortgage with an interest rate capped at 2% per annum. In the following months, demand for credit should also be supported by the economic rebound.

Credit volumes, on the other hand, are still under pressure due to an increased (yet lower than in the peak) propensity for early repayments. Consequently, we expect total loans to be only slightly higher at the end of the year than a year earlier. However, the credit impulse (the monthly change in annual loan growth) has already started to suggest an improvement in the annual GDP growth, which is consistent with our economic growth forecasts.

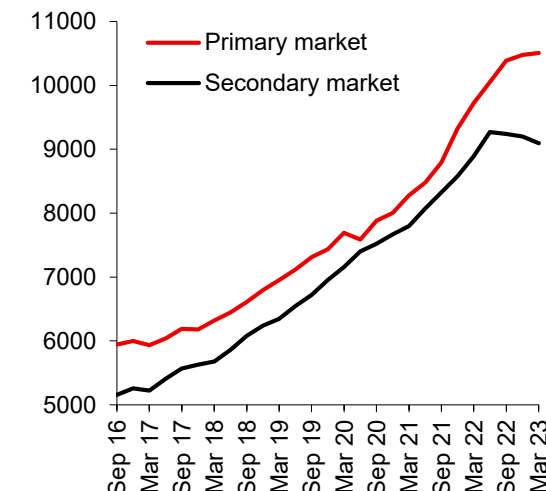
The improvement in the credit market will translate into the situation of the deposit market. However, as we assume some deterioration in the current account balance in the second half of the year, deposit growth will, in our view, remain roughly similar to that in the first half - at high single-digit levels.

Loan origination, PLNbn



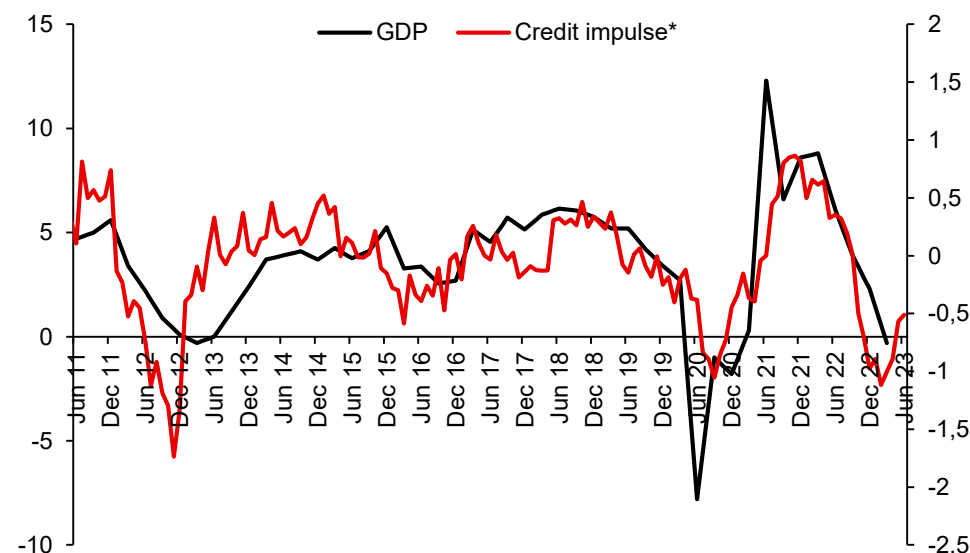
Source: NBP, BIK, Santander

Housing prices in 17 biggest cities, PLN



Source: NBP, Santander

Real GDP growth vs credit impulse



* Monthly change in annual loan growth (6m sma)

Source: GUS, NBP, Santander





Monetary policy: cuts before the election

We are changing our forecasts for the MPC monetary policy, as the latest conference of the NBP president left no doubt: a drop in inflation to single-digit levels will signal the start of rate cuts, even though the NBP's new projection did not, in our view, provide additional arguments for policy easing, showing that the horizon for achieving the inflation target has not moved closer, and forecasts for core inflation, wages and employment have been revised upwards.

Our baseline scenario is now the MPC's first rate cut decision in October, but September cannot be ruled out either, if CPI surprises positively and goes below 10% already in August (our current forecast for August is 10.2% y/y).

The NBP president has made it clear that the MPC will start cutting rates as market conditions allow for that - the decisions are to 'consume' what the market is already pricing-in. At the same time, the central bank is expected to move in small steps of 25bp. We think that the reference rate could be cut to 6.0% by the end of this year. In our view, the economic scenario will not justify more aggressive monetary easing in the short term, so cuts are likely to be put on hold after this short run and could resume around mid-2024, provided inflation continues to fall. We assume an NBP rate of 5.0% at the end of 2024.

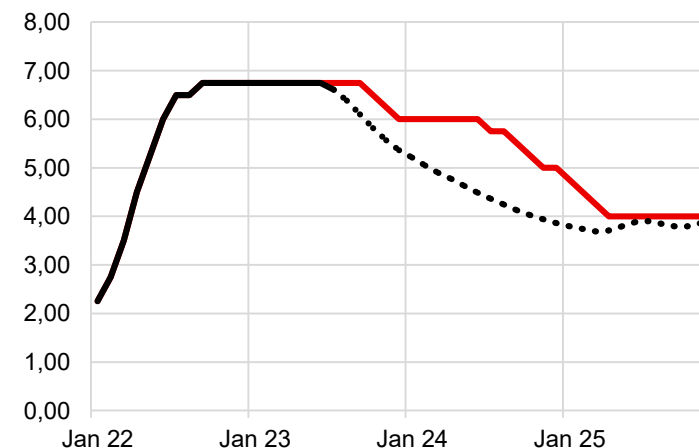
The monetary easing means a shift towards a higher trajectory of economic growth and inflation for the next quarters. According to the NBP President, the impact of the rate cuts on inflation "will not be material". Our estimates, based on the just-published results of the NBP's Monetary Policy Transmission Survey (see [p.31](#)), indicate that an interest rate cut on the scale priced by the financial market would lift CPI at the end of 2025 by around 1pp.

NBP forecasts: July vs March

	July 2023			March 2023		
	2023	2024	2025	2023	2024	2025
CPI (% y/y)	11.9	5.2	3.6	11.9	5.7	3.5
Core inflation	10.5	6.1	4.0	10.3	6.0	3.7
Food	16.0	4.0	2.2	14.2	4.2	1.7
Energy	9.9	4.4	4.6	13.0	7.0	5.7
GDP (% y/y)	0.6	2.4	3.3	0.9	2.1	3.1
Private consumption	-1.8	3.0	4.4	0.9	1.6	2.3
Fixed investments	2.8	2.1	6.7	0.0	1.2	6.0
Output gap (% potential GDP)	-0.5	-0.9	-0.5	-0.5	-0.9	-0.6
Wages (% y/y)	12.6	9.2	6.7	12.0	8.1	6.5
Employment (% y/y)	0.2	-0.8	-0.4	-0.6	-1.2	-0.4
Unemployment rate (%)	3.0	3.7	4.0	3.3	4.0	4.3
NAWRU (%)	3.9	3.9	3.9	4.1	4.0	4.0
ULC (% y/y)	12.1	5.8	2.8	10.4	4.6	2.8

Source: NBP, Santander

NBP rate according to our forecast and 13/07/2023 market pricing



— Our baseline scenario — Market pricing (FRA)

Source: Refinitiv, Santander



Monetary policy: differences in real rates

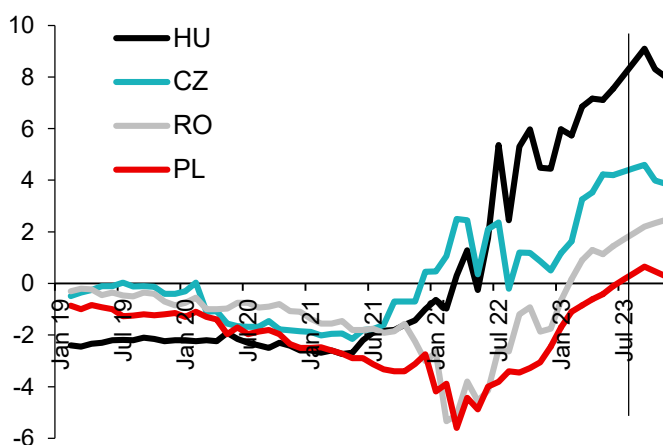
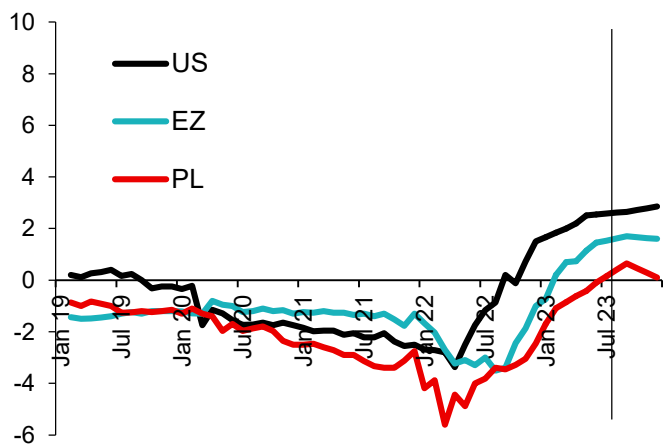
Real interest rates ex ante, calculated on the basis of market inflation expectations for a year ahead, show that Poland is clearly lagging other CEE countries - Hungary managed to come out with a positive real rate a year ago and the Czech Republic a year and a half ago, while Poland did so in June this year. Therefore, the MPC should not, in our view, think about monetary easing yet.

A comparison of the momentum of core inflation in the region leads to a similar conclusion - in Hungary and the Czech Republic the turn took place last autumn. In Poland, we have only one observation suggesting that we have passed the turning point.

While calculating real rates, we have assumed that the current median forecasts for future inflation will not change in the coming months and that central bank rates will rise by 25bp later this year in the euro area and the US, fall by 75bp in Poland, 100bp in the Czech Republic and 200bp in Hungary.

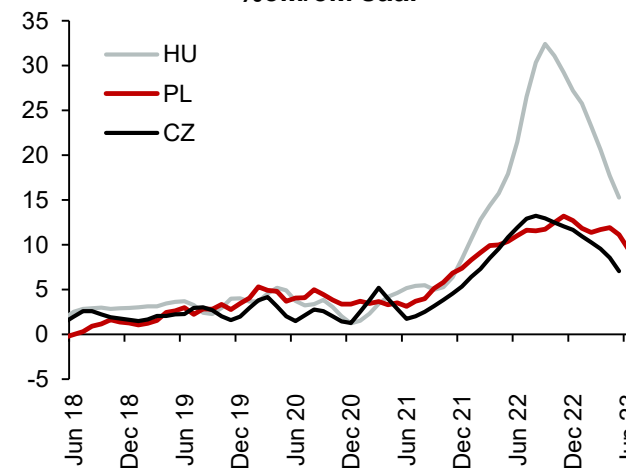
Real interest rates more or less explain the differences in central bank attitudes: MNB has embarked on a monetary policy turnaround because, according to projections, they are much closer to returning to target than Poland (CPI is expected to be 1pp above the target band in 1Q2024); the pressure of real rates on demand is high there and would increase without rate cuts. The CNB is still cautious in communicating a dovish turn in monetary policy, even though it has pushed the real rate much further up than the NBP and, according to projections, inflation there is expected to enter the target band as early as 1Q2024. The Fed and ECB are not thinking about the end of the cycle because real rates are too low to guarantee a return to target. Against this background, the MPC's willingness to cut rates quickly in Poland looks rather unusual.

Real ex-ante interest rates, %



Source: Bloomberg, Santander

Core inflation momentum in CEE region, %3M/3M saar



Source: Refinitiv Datastream, Santander



Monetary policy: transmission mechanism

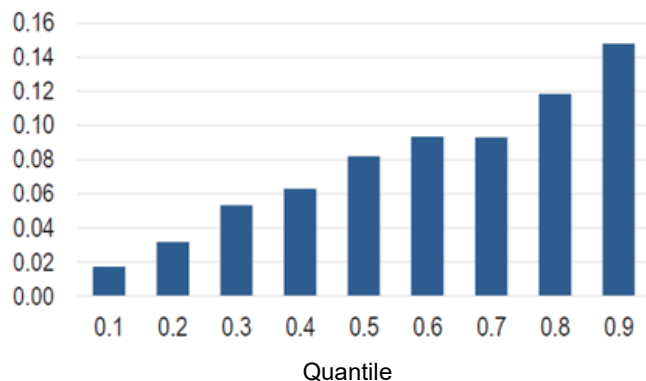
According to [the NBP's report on the monetary policy transmission mechanism](#), which was published at the end of June, 100bp of rate hikes can reduce inflation by 0.3pp in the second year after the hike and decrease GDP by 0.3pp in the first year after the tightening.

The report points to a greater price elasticity in the economy which increases the efficiency of monetary policy and decreases the losses in GDP growth.

The role of expectations in the transmission mechanism was also underlined – this channel, according to the research of the NBP, can be even more effective than the direct interest rate channel, which may be the reason why the NBP was trying hard to reduce inflation expectations through optimistic statements about expected swift decrease in inflation.

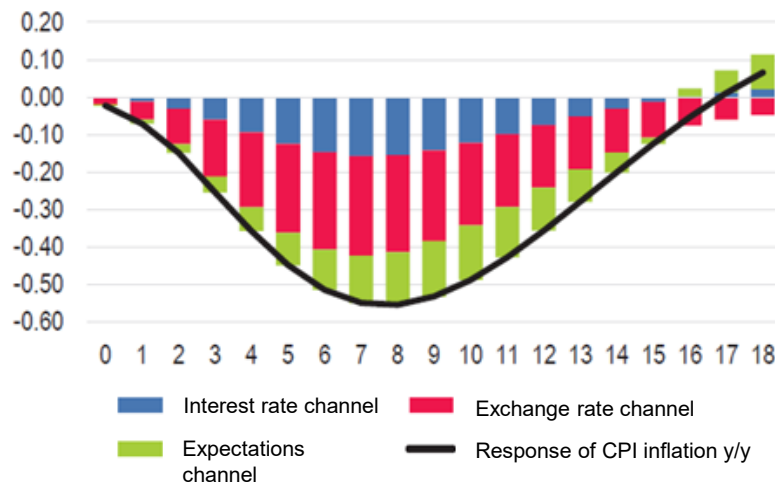
The report also shows that in a high inflation environment, exchange rate has a much stronger effect on the CPI, equal to 0.2 pp for every 1% change in the nominal effective rate (in a normal environment, the effect is below 0.1 pp). In the 2017 report, the NBP presented results which suggested that the effect of exchange rate changes in the current phase of the business cycle (i.e. at the crossroads of depression and recovery) should be weaker than usual.

Long-term effect of exchange rate pass-through on inflation rate



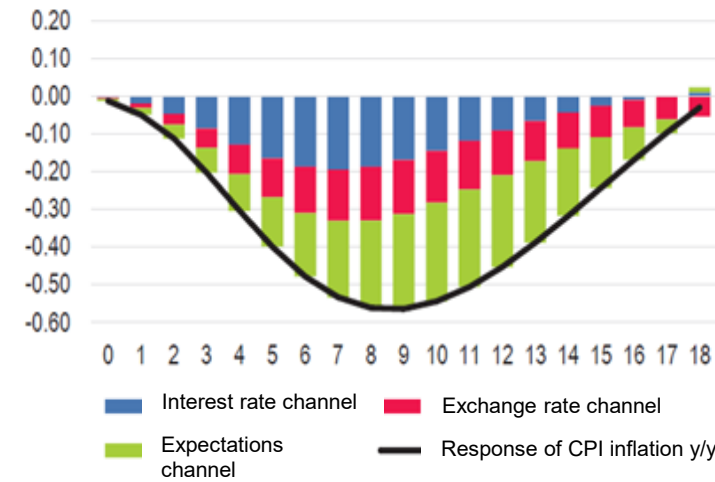
Source: NBP

Strength of transmission mechanism channels – effect on CPI inflation y/y



Note: The horizontal axis shows quarters after the shock. The stimulations are based on the MMPP model (the small model of monetary policy)

Strength of transmission mechanism channels – effect on core inflation y/y



Note: The right axis shows quarters after the shock. The stimulations are based on the MMPP model (the small model of monetary policy)



Fiscal policy: promises begin

According to the Convergence Report from April, the government expects the general government deficit at 4.7% of GDP in 2023 and at 3.4% in 2024. In our opinion, the deficit this year will exceed 5% of GDP and in the next year it will be close to 4%.

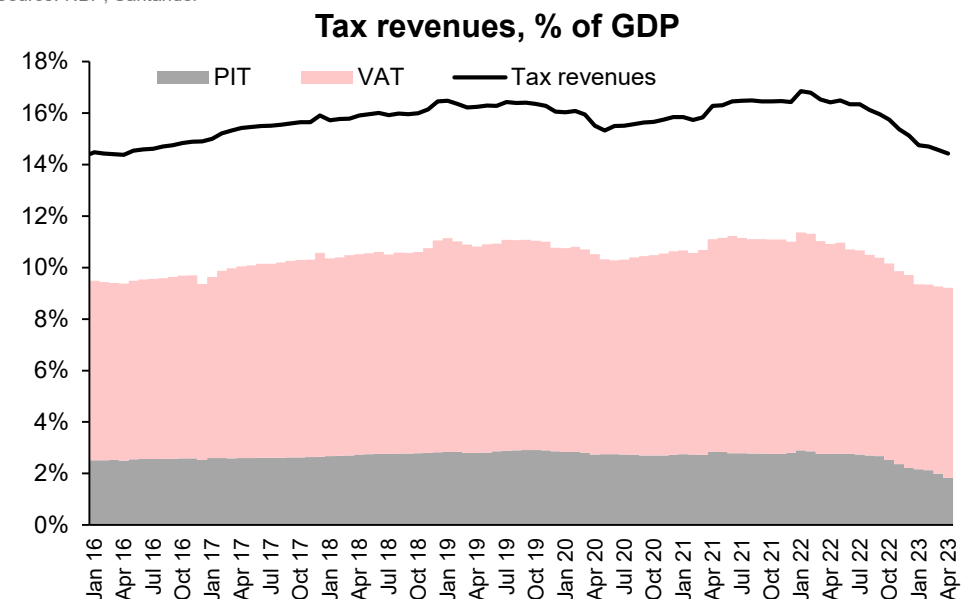
We expect a deficit of 5.3% of GDP this year and our forecast has been broadly stable. The update of the budget (PLN24bn increase in the budget deficit) and forecasts of lower inflation are neutralised by forecasts of higher GDP growth. We expect the deficit to reach 4% of GDP in 2024, assuming that no further deficit-increasing pre-election promises will be made. This assumption will likely be proven false, so we consider it is subject to an upward risk. We will get to know more after the release of the Budget Bill (in September) and after any new promises will surface; in our opinion, the competing parties have not said their last word yet. On the other hand, the European Commission is planning to return to monitoring of the fiscal rules. It is possible that the current rules will be changed, but still, stricter stance of the Commission may reduce the government's ability to increase the deficit significantly beyond 3% of GDP.

The last months saw a significant decrease in tax inflows to the budget in comparison to GDP. Since the peak in February 2022, the relations of tax revenues to GDP decreased by 2.5 pp. The decrease in budget revenues may hinder new pre-election promises.

Summary of pre-election promises of the main political parties

Pre-election promise	Annual cost, PLNbn
PIS	27.0
Increase of the child benefit	25.0
2% mortgage rate, exemption from motorway toll-fees, free medicine	2.0
PO	88.5
Increase of the child benefit	25.0
Increase of the tax-free amount	45.0
1500 zł for mothers returning to the labour market	9.0
Subsidies for renting a property	6.0
0% mortgage rate, financing of sick leave of micro-entrepreneurs, subsidies for renovation loans	3.5

Source: NBP, Santander



Source: GUS, Ministry of Finance, Santander

Financial markets

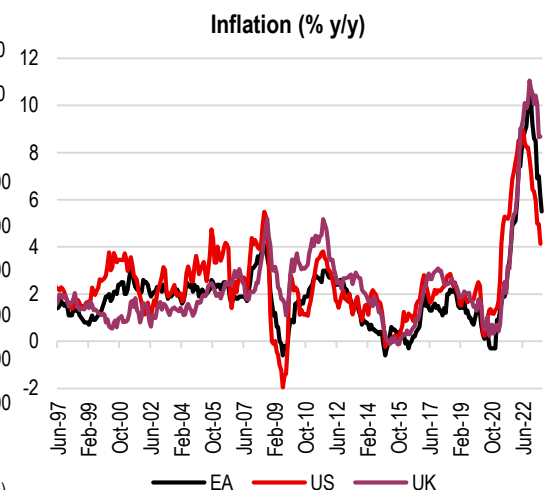
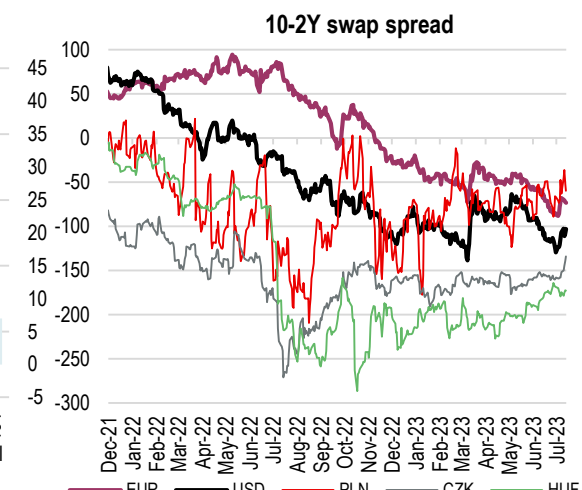
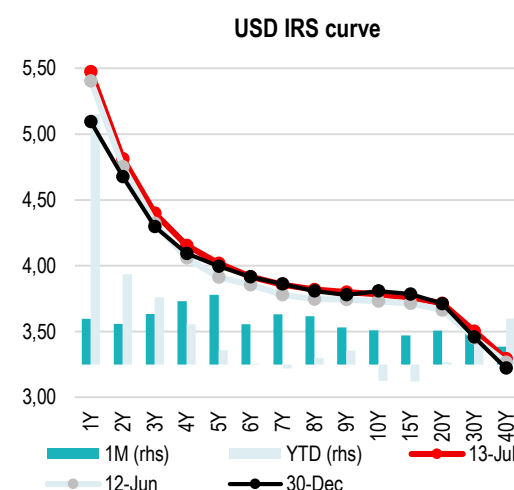
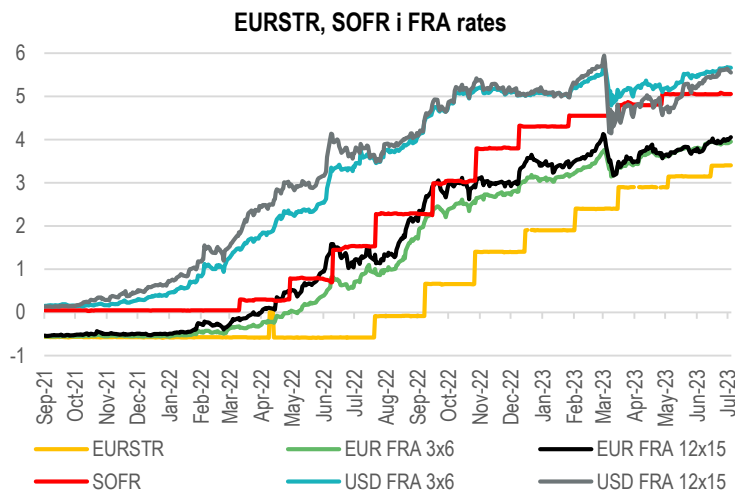
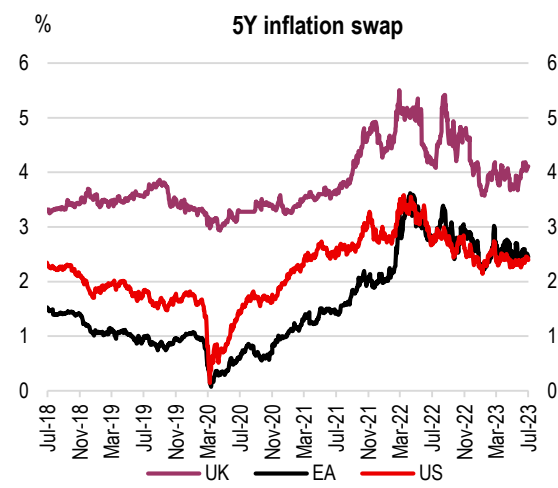
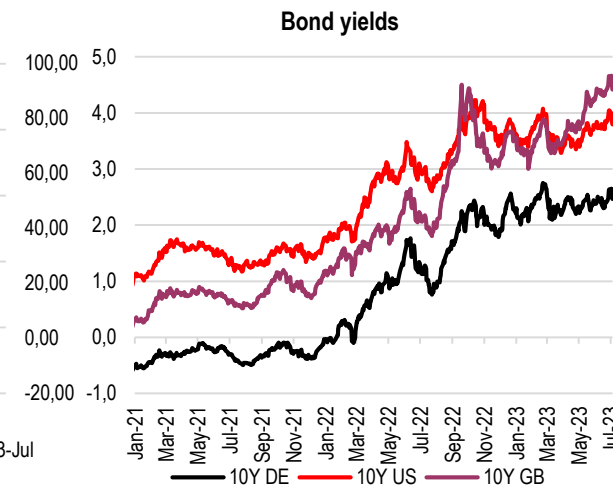
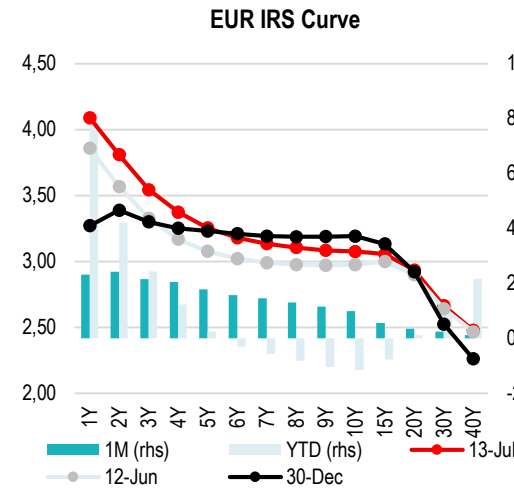
A close-up photograph of a desk with financial documents. A silver pen lies diagonally across the papers. The documents feature various charts, including a line graph with a blue line and a bar chart with multi-colored bars. The background is blurred, showing a computer monitor and other office equipment.

2



FI: Further hikes of main central banks' rates

In the core debt markets, there was an upward revaluation of expectations for further rate rises. This was partly due to better-than-expected US data (especially from the labour market) and hawkish statements from the Fed and ECB governors. Both J. Powell and C. Lagarde signaled the need for further monetary tightening in view of the persistence of core inflation in the euro area and the strong US labour market. We expect two more rate hikes in the euro area to 4.5%, in the US in July and November to 5.75% (and in the UK to 6%) and the start of the easing cycle in 2H24. We also expect further rate hikes in Norway and Sweden. The EUR and USD curves may steepen towards the end of the cycle with a further rise in long-term Bund yields.





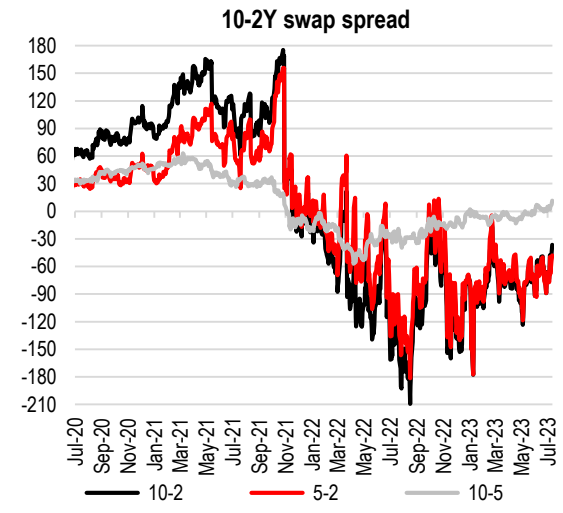
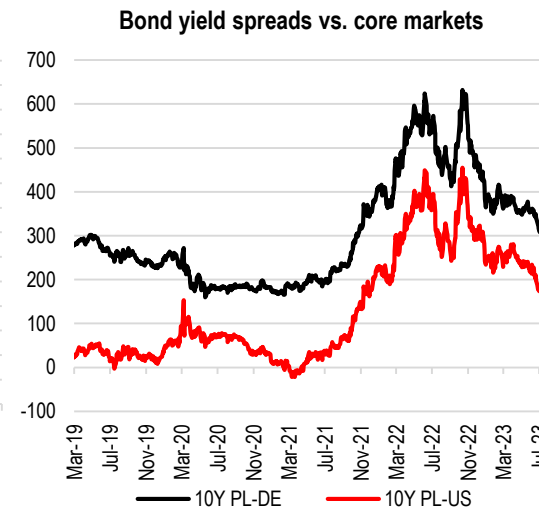
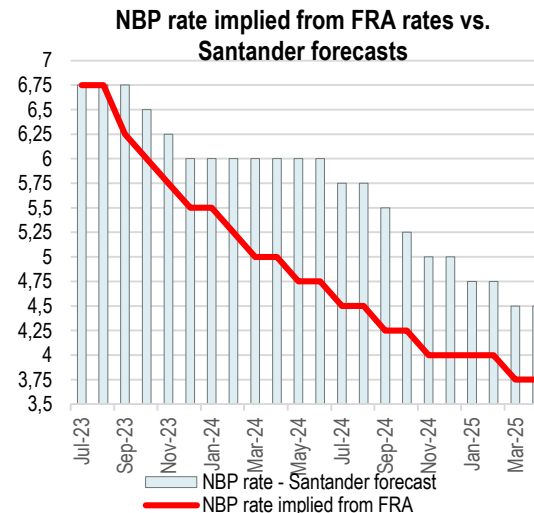
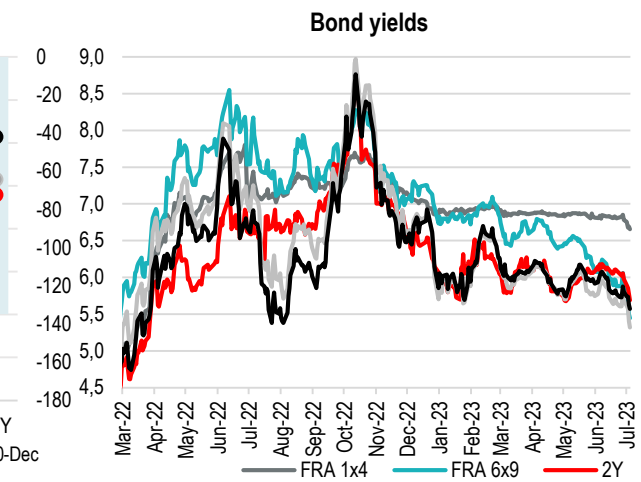
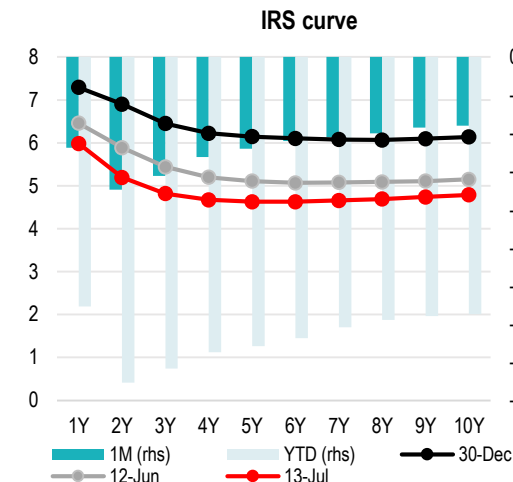
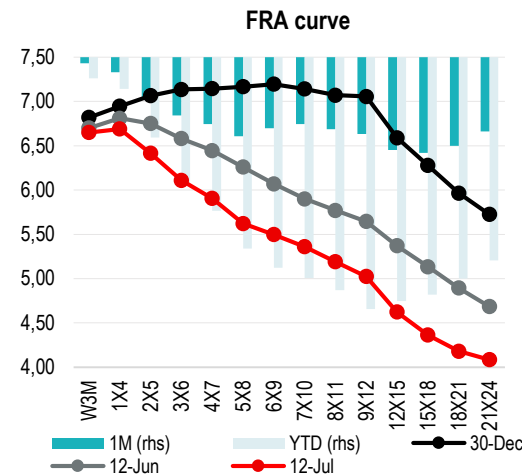
FI: Declines of domestic market rates

After the significant drop in market rates in recent months and the steepening of the curves, we think that the potential for further declines is running out. The market is already pricing in four rate cuts (125bp) by the year-end and 6 (150bp) next year, which seems to us to be too aggressive.

The market is pricing-in a 50bp NBP rate cut in September. Our forecast assumes that CPI will not fall below 10% in August, which would not yet open the door to cuts in September. That having said, we assume that the MPC will move in small steps of 25bp. In our view, this could provide an opportunity for some rebound in market rates.

However, the downward trend swap curve with a steepening tendency is likely to remain in place as inflation falls. The market may be setting its sights on rate cuts being delayed at most until inflation clearly surprises upwards, which could only happen next year. As rate cuts are premature in our view, we expect a larger reduction in short-term market rates.

Periodically, there could be upward rate revisions e.g. on the occasion of an upward surprise in CPI (slower deceleration in food inflation, rebound in oil prices), a sizable correction in the zloty or further significant election fiscal promises.





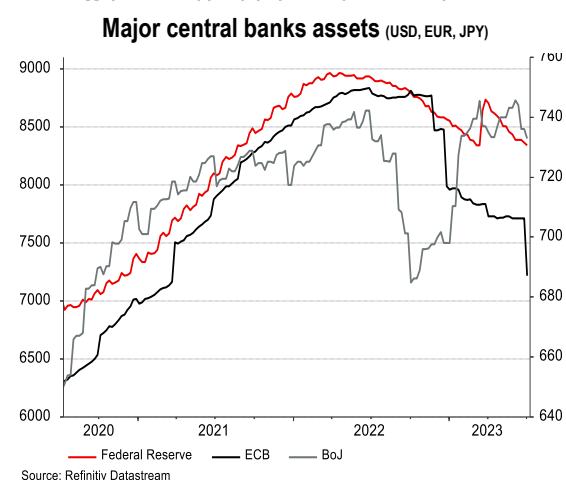
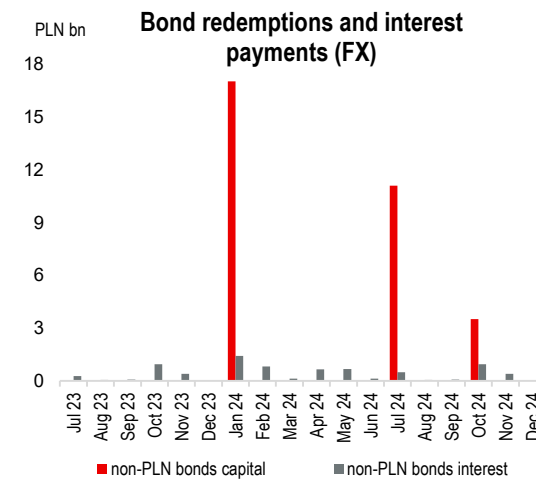
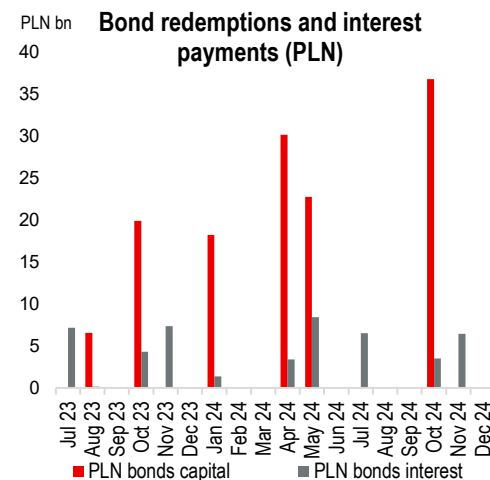
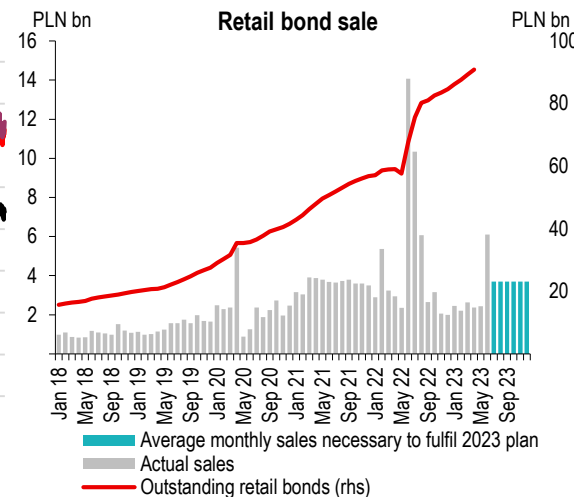
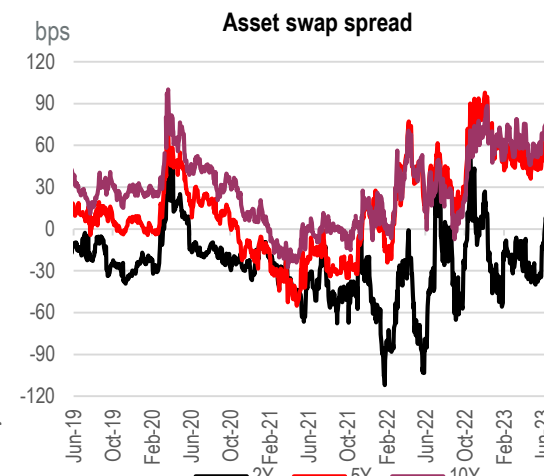
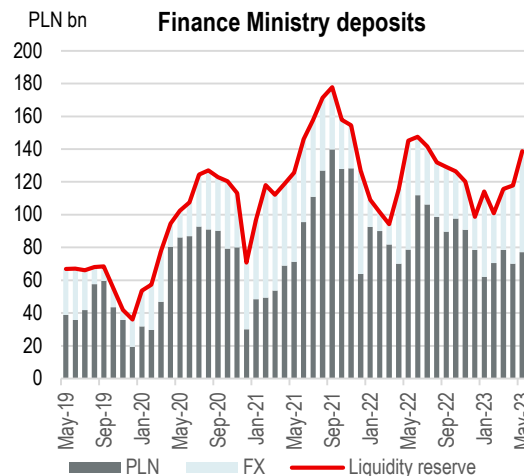
FI: Big net issuance in 3Q, but then smaller?

The Ministry of Finance has announced that it has financed 94% of the borrowing needs initially planned at PLN261bn.

The latest budget amendment shows that the Finance Ministry, despite increasing the estimate of net borrowing needs to around PLN150bn from around PLN110bn, left the planned issuance of domestic bonds unchanged. The increased borrowing needs would be financed from the reduction of the liquidity reserve (PLN139bn after June).

Although the amendment implies low issuance, the Finance Ministry has planned quite a large bond supply for 3Q (PLN18-30bn), which – combined with low maturities – results in a high net issuance. On top of this, the FinMin sold a large pool of bonds at latest switch auction (PLN6bn). This suggests a desire to keep the reserve at a relatively high level ahead of significant maturities in 1H24 (c. PLN70bn of bonds). Higher issuance in 3Q would mean more room to reduce issuance in 4Q opening the way for a slight narrowing of asset swap credit spreads.

However, we think significant redemptions in 2024 and possible more election spending could keep asset swap credit spreads at elevated levels in 2024 as well.

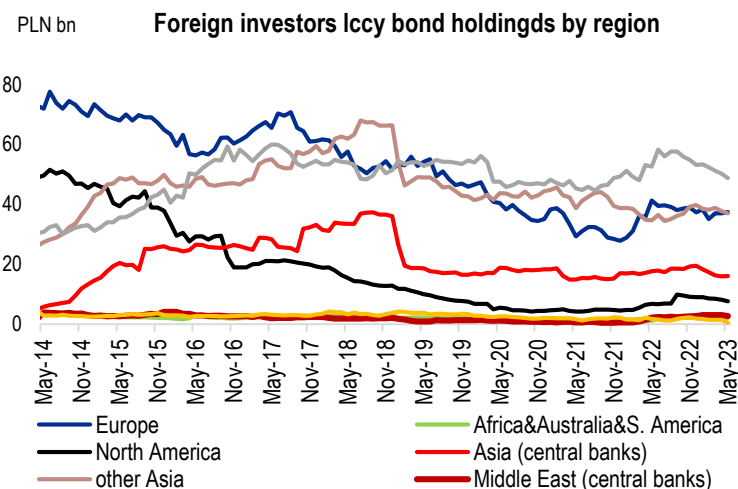
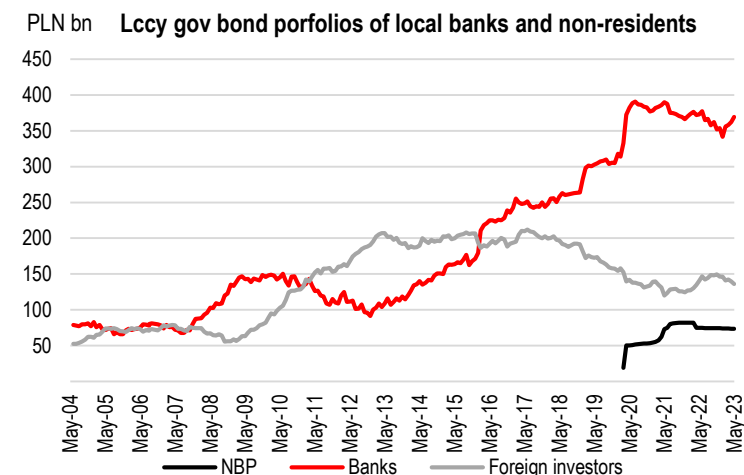
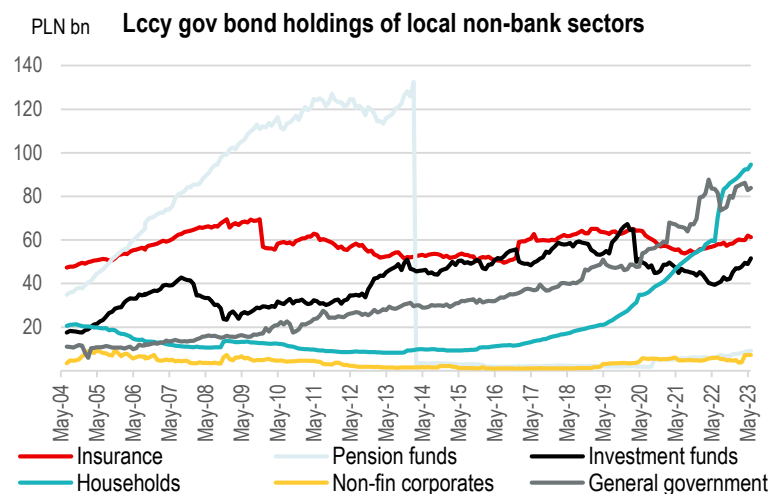


FI: Foreign investors still reducing their exposure



Local banks remain the main investor in the domestic government bond market, as they have bought around PLN15bn of bonds since the beginning of the year, including PLN7bn in May alone. Leading buyers include households, although the scale is smaller than the Finance Ministry's plans. Domestic investment funds are also a large net buyer of paper due to sizable inflows since the beginning of this year (around PLN7.1bn to debt funds, including PLN1.5bn in June). These trends are likely to be maintained in the coming months.

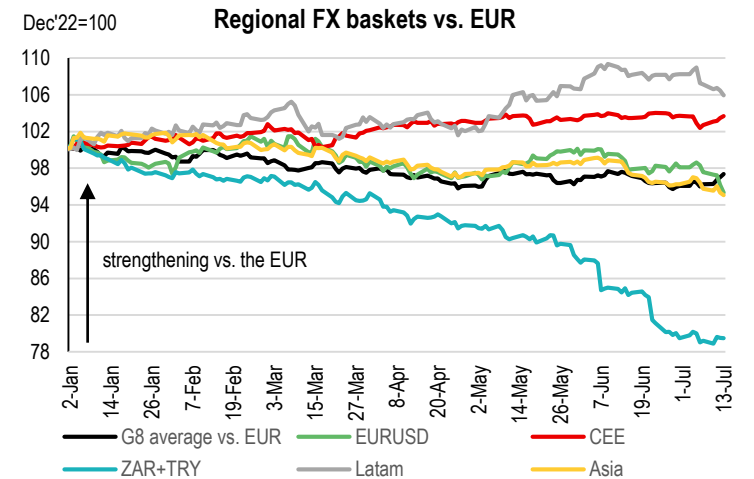
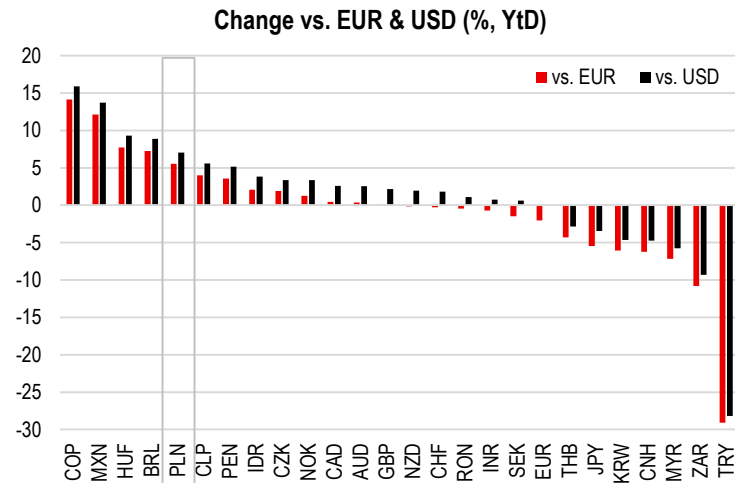
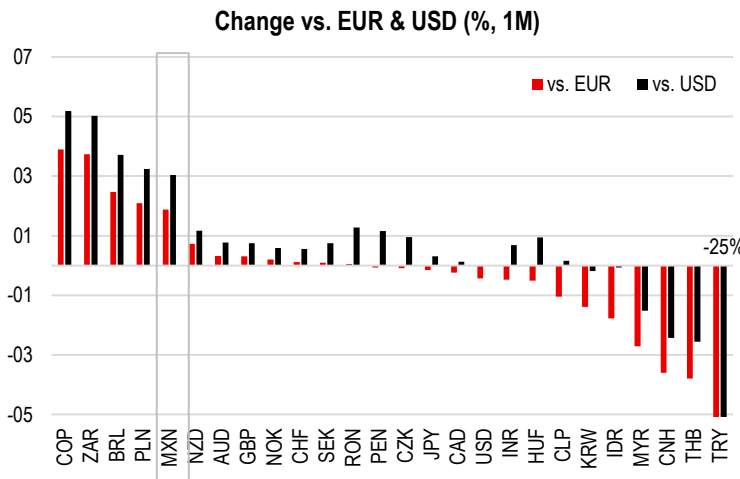
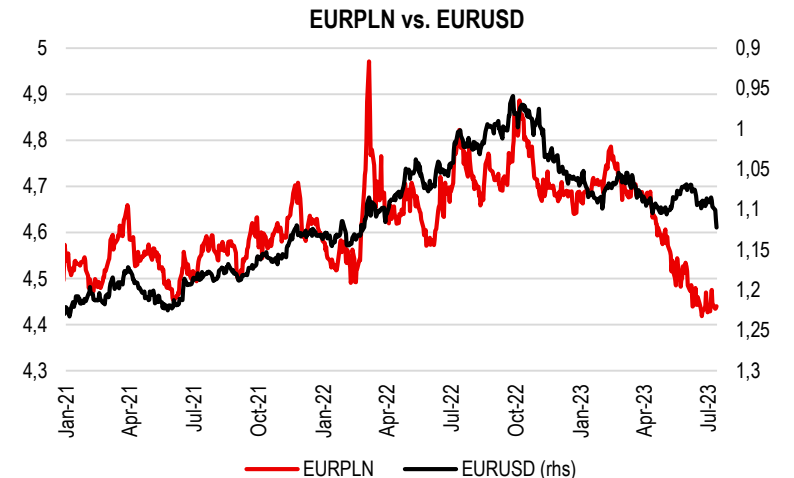
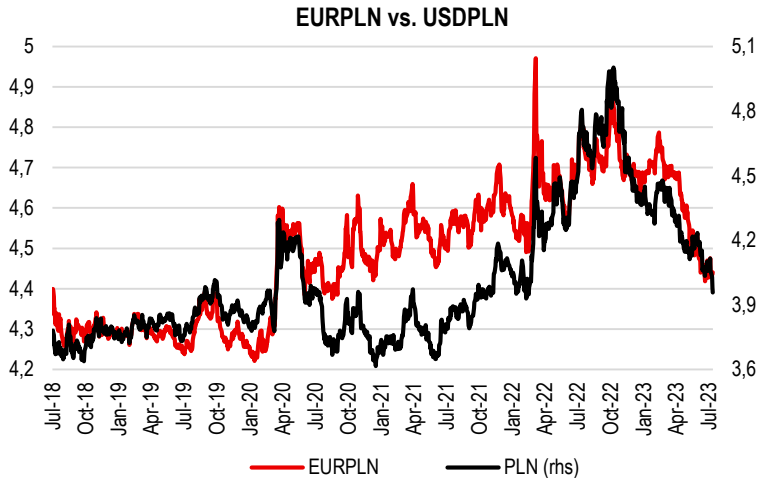
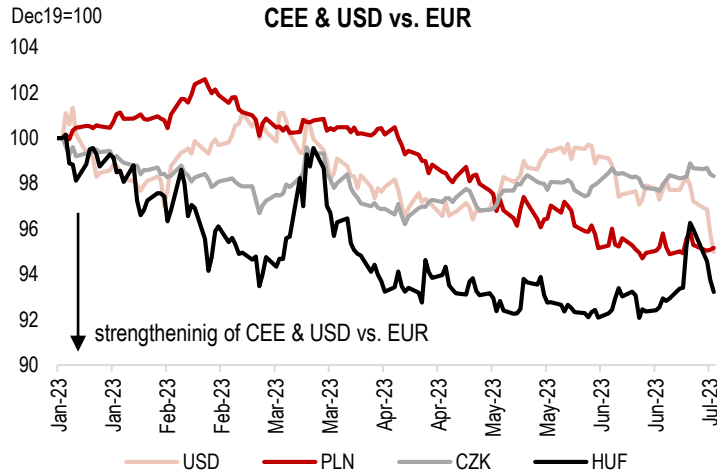
Since the beginning of the year, foreign investors have been successively reducing their portfolios of domestic bonds, including central banks and investment funds, which were buying Polish debt last year. Investors from Europe are the positive exception, as they have increased their holdings. The prospect of interest rate cuts and falling yields could be an incentive for foreign investors to return to the domestic market. Perhaps foreign investors will increase their exposure on the occasion of corrective upward movements in rates, if the long-term downward trend in yields is to be maintained. This could be supported by a further weakening of the dollar. A constraint on demand for domestic debt may be high yields in the core markets, particularly in the US or UK, which may be preferred by clients of funds there.



Lccy government bond holdings of foreign investors

	EoP (PLN bn)						change versus previous period					
	2020	2021	2022	1Q23	Apr	May	2020	2021	2022	1Q23	Apr	May
Banks	4.0	2.6	3.1	4.2	3.6	4.0	1.1	-1.4	0.5	1.1	-0.6	0.4
Central banks	19.1	17.6	21.4	19.3	19.0	18.9	1.2	-1.5	3.8	-2.1	-0.3	-0.1
Public institut.	0.4	0.3	1.5	1.3	1.6	1.5	0.0	-0.2	1.2	-0.1	0.2	-0.1
Insurance	13.0	9.3	5.1	6.0	6.2	6.2	-1.5	-3.8	-4.2	0.9	0.2	0.0
Pension funds	13.2	13.6	17.9	17.9	17.5	17.4	1.9	0.4	4.3	-0.1	-0.4	-0.1
Mutual funds	17.4	14.2	20.0	18.4	18.2	17.7	-9.4	-3.2	5.8	-1.5	-0.2	-0.6
Hedge funds	1.7	1.5	1.8	1.7	1.7	1.7	-1.1	-0.3	0.3	0.0	0.0	0.0
Households	0.0	0.0	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Non-fin corp.	0.7	0.5	2.1	1.7	1.7	1.4	-0.1	-0.2	1.5	-0.4	0.0	-0.2
Other	17.4	15.7	19.8	19.9	19.8	18.4	-7.6	-1.8	4.2	0.1	-0.1	-1.4
Omnibus acc.	46.6	49.2	53.3	51.2	50.2	48.8	-8.0	2.7	4.1	-2.1	-1.0	-1.4
Total	133.6	124.4	146.0	141.9	139.6	135.9	-23.6	-9.2	21.6	-4.2	-2.3	-3.7

FX: PLN one of the strongest EM currencies



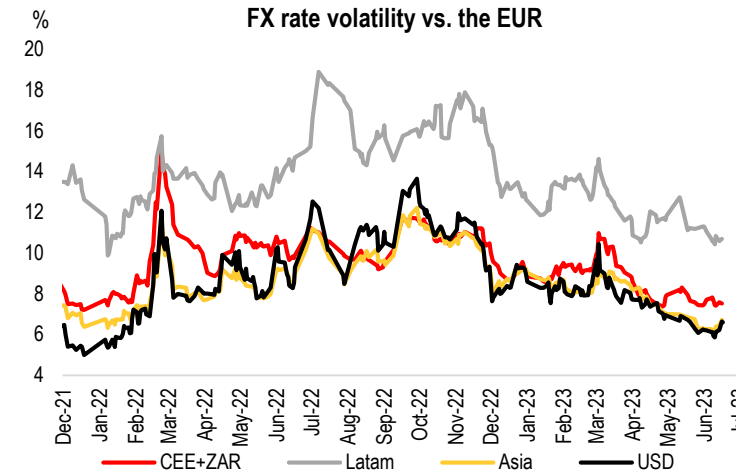
FX: Low global volatility and high rates



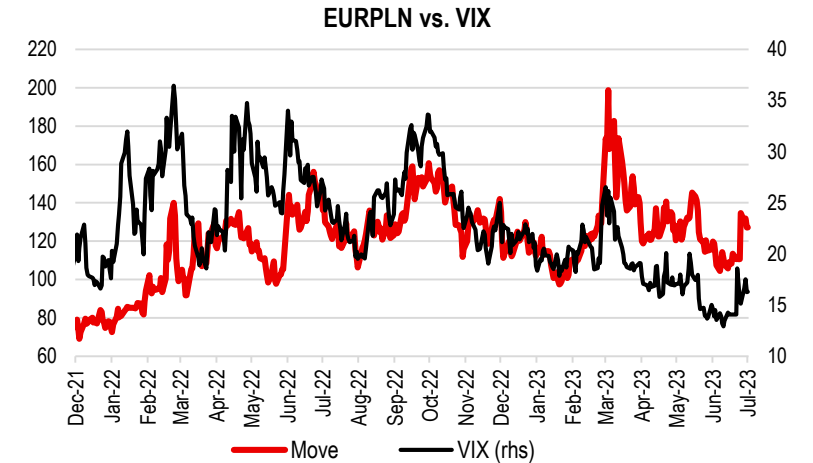
Since mid-February, the zloty has been in an appreciating trend against the major currencies: EUR and USD. This has been fostered by a drop in global volatility, benefiting most of the high-interest-rate currencies, economies without major structural imbalances, particularly in South America, where rates were raised faster and inflation also fell faster, pushing real rates higher, and in the Central European region.

A reversal of carry trade positions could occur with an increase in risk aversion. At present, it is difficult to pinpoint a factor that could lead to this, but it could be a further rise in the US real rate, intervention by the BoJ to support the yen, or the return of geopolitical tensions.

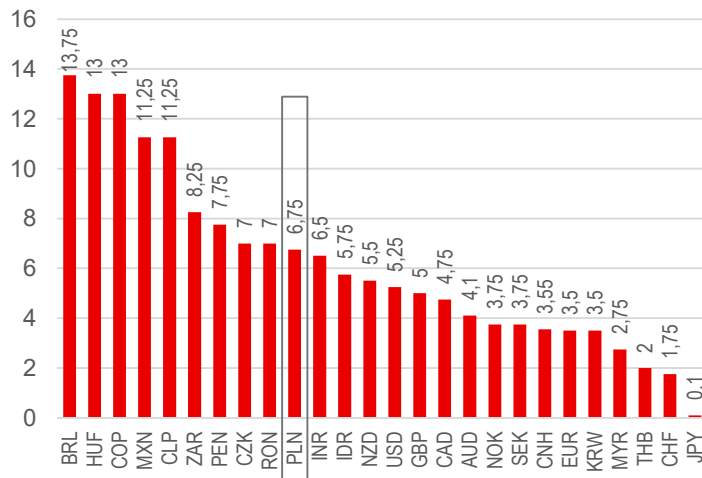
Drop in EMFX volatility versus the euro



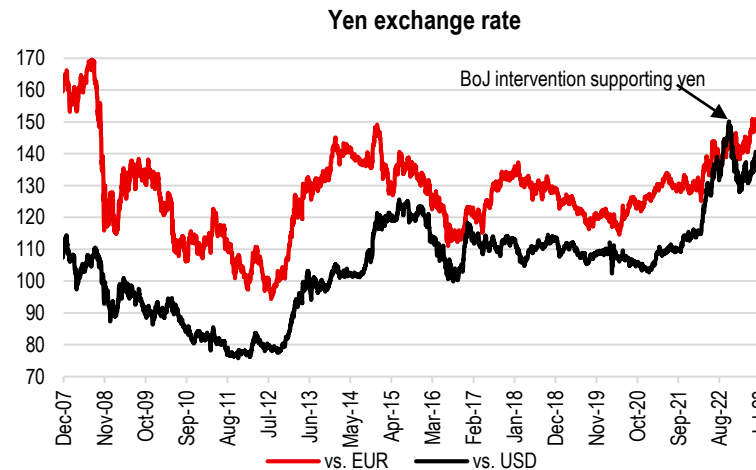
... and in equity and bonds market vols despite turmoil in the US banking sector



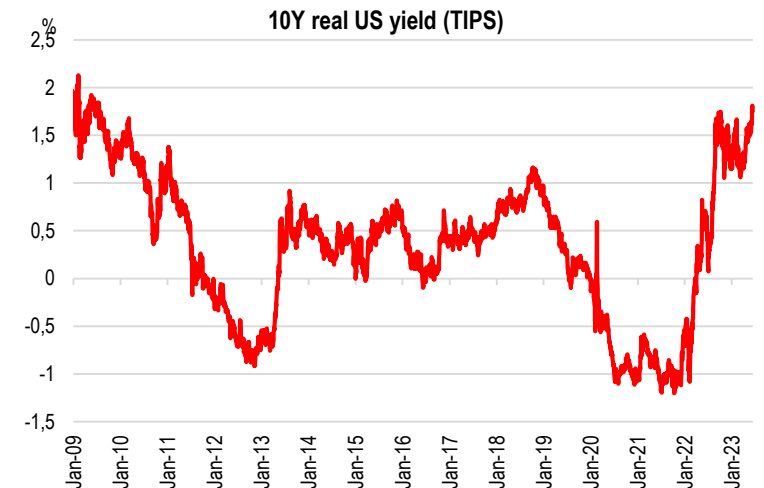
Central banks key rate



Yen weakened since the start of the year



Hawkish Fed and ECB may weaken risk appetite



Source: Refinitiv, Santander Bank Polska

Note: CEE: PLN, CZK, HUF, Latam: BRL, MXN, CLP, COP, PEN; Asia: CNH, KRW, MYR, THB, IDR, INR; VIX – volatility index for SP500; Move – volatility index for US government bonds

FX: Upcoming months may bring weaker PLN

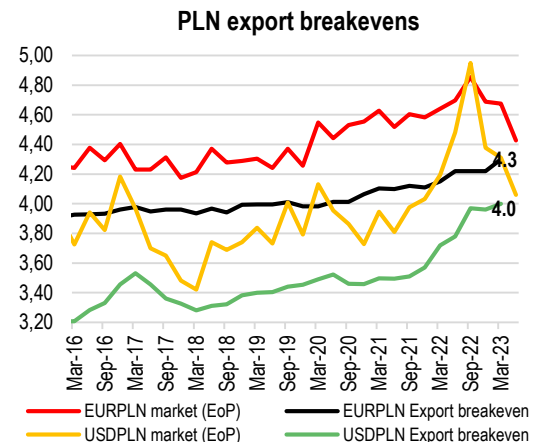


The high CPI inflation disparity vis-à-vis the euro area, remains the main structural factor limiting the appreciation of the zloty as it moves the threshold rate of profitability of exports higher and higher. Currently, the EURPLN threshold exchange rate is at 4.30. Admittedly, the deflated PPI exchange rate has weakened markedly, but this was mainly due to the higher share of gas in European manufacturing and was only a temporary improvement in energy competitiveness vis-à-vis the euro area in 2022. On the other hand, since October, prices in manufacturing have been falling rapidly in Poland relatively to Europe, was possibly also due to the strengthening of the zloty, but perhaps such a trend also suggests that the Polish manufacturing industry can remain competitive even with a slightly stronger zloty.

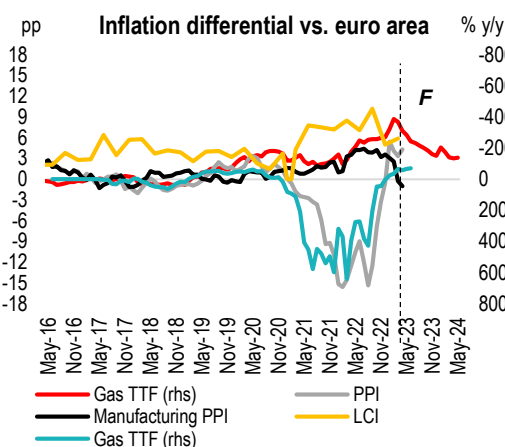
We believe that in the second half of the year, the current account balance could be weaker with upside risks for imports under the influence of a revival in consumption, concerns about gas supplies or a recovery in the global economy with upside risks also for oil prices.

The zloty could also lose in case of pre-election volatility spike, continued tensions with the EU (non-approval of the Supreme Court law by the Constitutional Tribunal possible even until the end of 2024 could mean no Recovery Fund inflow), or rising yields in core markets.

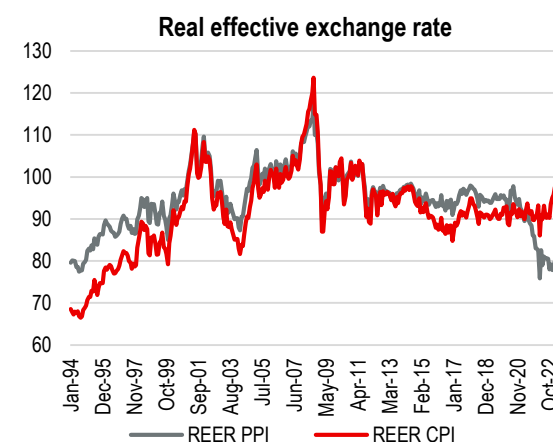
Inflation weakens PLN equilibrium rate



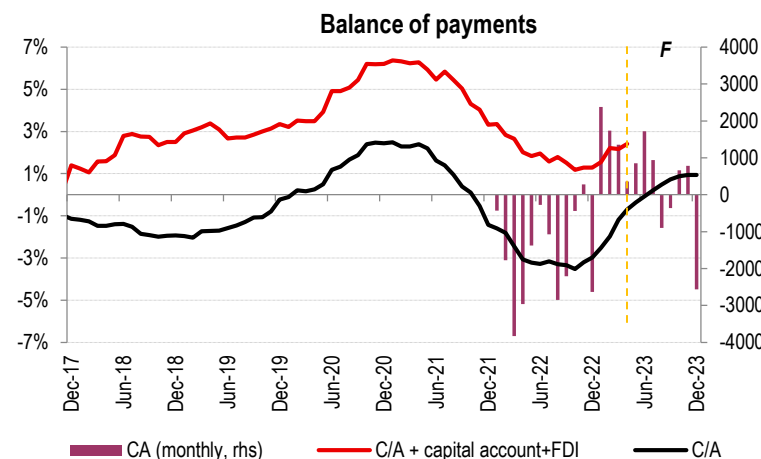
Inflation differential vs. euro still high though declines



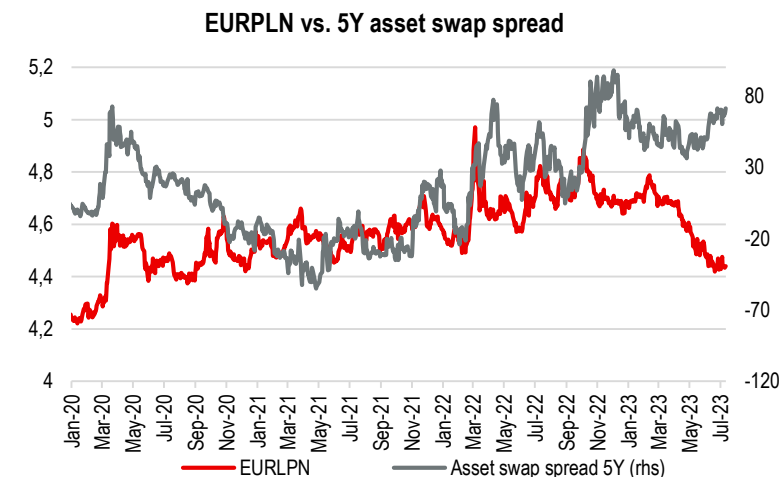
PPI deflated REER weakening may result mainly from gas prices



Recovery in private consumption will weaken current account in 2H amid weaker exports and upward risk to commodity prices



Fiscal and elections risks and lack of EU funds may be not fully discounted by the market



FX: But the scale of the correction will be limited

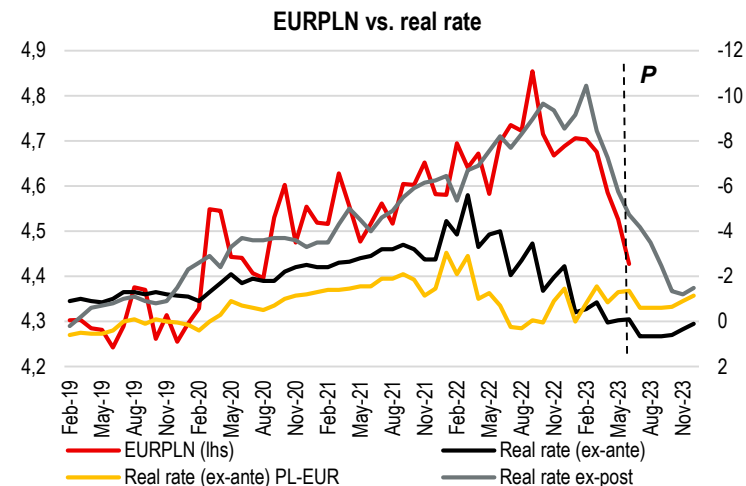


The strengthening of the zloty observed since October, which intensified in February, coincides with an increase in the real rate. We think that a further decline in inflation will ensure a gradual increase in the ex-post real rate. The ex-ante rate stabilises with our current rate forecasts assuming the NBP rate falling to 6% by the end of the year, but could rise further from early next year with a further fall in inflation in 2025 and a slow decline in NBP rates. We think the MPC may hold off on further rate moves in 1H24 after cuts in 2H23, which will support further increases in the ex-ante real rate and periodic upward revisions in FRA and IRS rates.

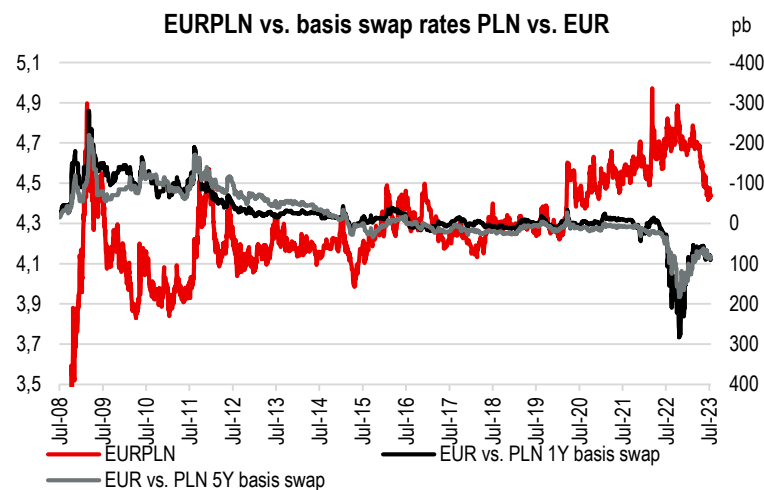
The zloty may still be favourably affected by fairly high basis swap rates. High basis swap may result from relatively large FX deposits in the banking sector, which may not change fast structurally.

In periods of increased volatility, BGK may activate more currency selling to maintain the strength of the zloty, which may be favoured by the NBP due to its impact on inflation, but also by the FinMin before the elections, while the situation of exporters may not be the most important at present.

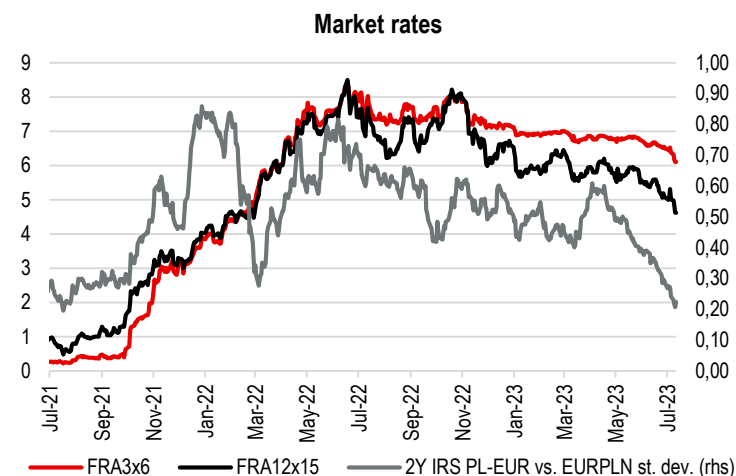
Further increase in the real rates may support PLN



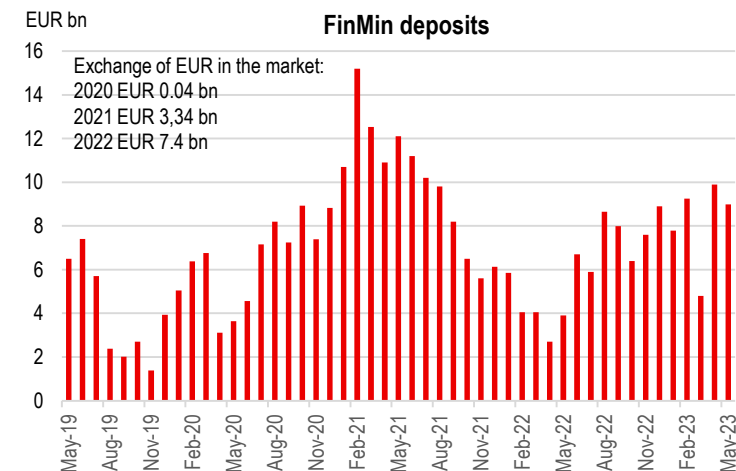
Positive basis swaps may limit play against the zloty



We presume MPC will cut rates at slower pace than assumed by the market



FinMin may support PLN exchanging large part of FX deposits in the market



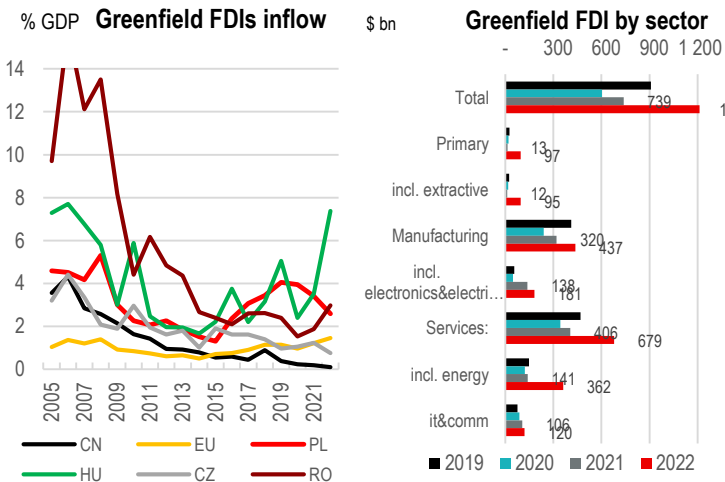


FX: REER can strengthen further

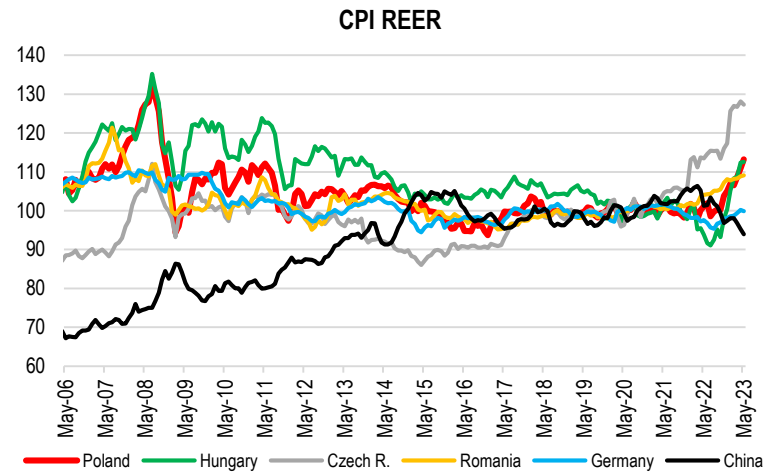
According to [IMF estimates](#), in 2022 the REER was undervalued by around 1-3%, assuming that the natural level of the C/A balance for Poland is negative. A strengthening of the REER this year would be partly in line with the IMF's assumptions. The small scale of the weakening of the zloty to the euro, which we expect, while maintaining a positive inflation differential to the euro area, could work towards a further strengthening of the real exchange rate of the zloty. Such a process would work towards balancing the Polish economy by lowering inflation.

In the longer term, support for the zloty and exports will come from inflows of foreign direct investment resulting from reshoring.

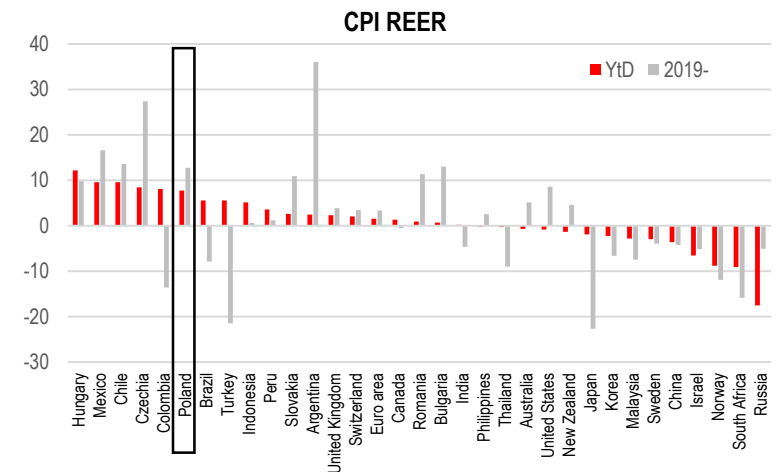
FDI inflows may strengthen exports and PLN



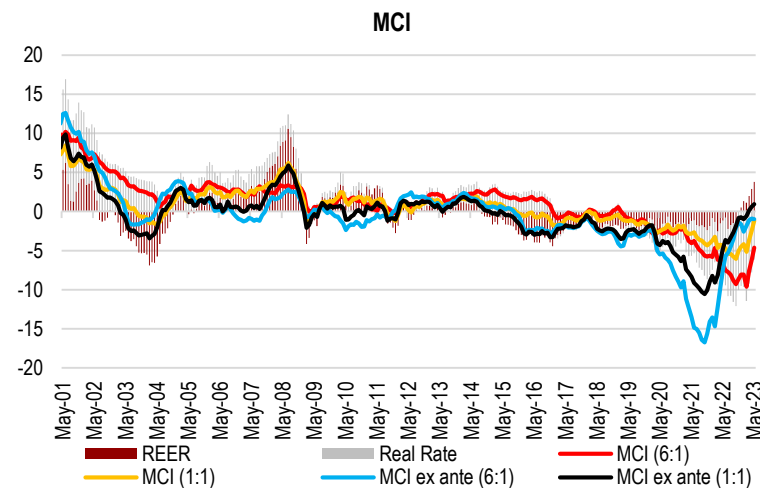
Real FX rates gain in the CEE region



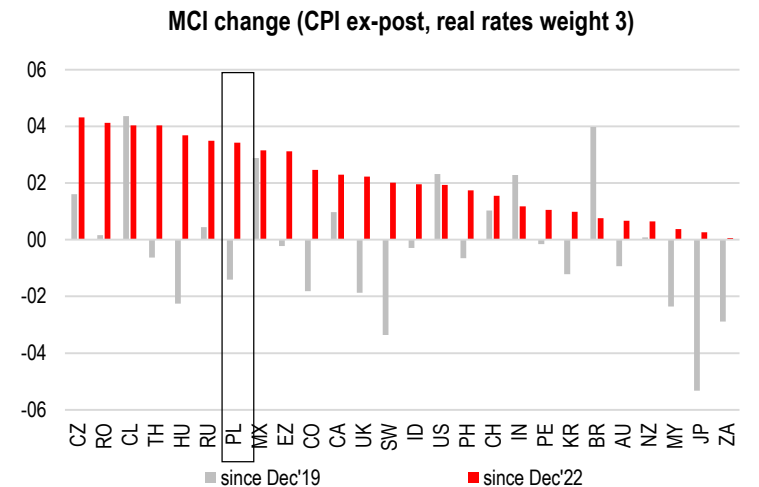
... along with Latam currencies



Tightening of monetary conditions this year ...



... was one of the largest globally but was relatively limited since 2019



Forecasts

3



Economic Forecasts

		2021	2022	2023E	2024E	1Q23E	2Q23E	3Q23E	4Q23E	1Q24E	2Q24E	3Q24E	4Q24E
GDP	PLNbn	2,631.3	3,078.3	3,399.7	3,766.8	800.4	805.5	851.8	942.1	863.5	862.0	912.4	1,003.3
GDP	% y/y	6.9	5.1	1.0	3.3	-0.3	0.1	0.5	3.2	3.3	3.0	3.6	3.1
Domestic demand	% y/y	8.5	5.1	-3.1	3.5	-5.2	-5.7	-3.4	1.0	3.7	3.6	3.6	3.1
Private consumption	% y/y	6.2	3.3	-0.6	4.3	-2.0	-3.0	-0.5	3.0	5.0	5.0	4.2	3.0
Fixed investment	% y/y	1.2	5.0	3.7	1.6	5.5	4.5	3.0	3.0	-1.5	0.5	2.0	3.5
Industrial output	% y/y	14.5	10.4	-2.0	4.5	-0.9	-3.9	-2.6	-0.8	0.6	5.5	6.0	6.1
Construction output	% y/y	1.6	7.6	0.5	1.2	1.9	1.2	0.4	-0.7	-8.9	-3.0	5.7	6.9
Retail sales (real terms)	% y/y	7.4	5.5	-3.7	5.8	-5.3	-6.9	-4.4	1.7	4.3	2.5	4.4	4.4
Gross wages in national economy	% y/y	8.9	12.1	12.8	10.7	14.3	11.8	12.1	13.2	11.8	11.4	10.0	9.7
Employment in national economy	% y/y	0.4	2.2	0.2	0.6	0.5	0.2	0.1	0.1	0.6	0.4	0.6	0.6
Unemployment rate *	%	5.8	5.2	5.3	5.5	5.4	5.0	5.0	5.3	5.5	5.0	5.1	5.3
Current account balance	EURmn	-8,261	-19,612	6,993	-11,129	5,476	2,939	-309	-1,113	1,503	-1,563	-5,129	-5,941
Current account balance	% GDP	-1.4	-3.0	0.9	-1.3	-1.2	-0.1	0.7	0.9	0.4	-0.2	-0.8	-1.4
General government balance (ESA 2010)	% GDP	-1.8	-3.7	-5.3	-3.9	-	-	-	-	-	-	-	-
CPI	% y/y	5.1	14.3	11.9	7.3	17.0	13.1	10.1	7.4	7.5	7.0	7.4	7.3
CPI *	% y/y	8.6	16.6	7.4	7.3	16.1	11.5	9.1	7.3	6.8	7.2	7.3	7.3
CPI excluding food and energy prices	% y/y	4.1	9.1	10.4	5.1	12.0	11.6	10.0	8.1	6.1	4.9	4.8	4.7

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

Source: GUS, NBP, Santander



Market Forecasts

		2021	2022	2023E	2024E	1Q23	2Q23	3Q23E	4Q23E	1Q24E	2Q24E	3Q24E	4Q24E
Reference rate *	%	1.75	6.75	6.00	5.00	6.75	6.75	6.75	6.00	6.00	6.00	5.50	5.00
WIBOR 3M	%	0.54	6.02	6.75	5.83	6.93	6.90	6.76	6.39	6.18	6.12	5.80	5.23
Yield on 2-year T-bonds	%	0.79	6.35	5.77	5.22	6.16	6.00	5.45	5.48	5.33	5.36	5.23	4.97
Yield on 5-year T-bonds	%	1.39	6.36	5.81	5.35	6.11	5.92	5.66	5.54	5.45	5.47	5.34	5.15
Yield on 10-year T-bonds	%	1.97	6.10	5.90	5.57	6.16	5.99	5.77	5.68	5.65	5.70	5.58	5.37
2-year IRS	%	1.19	6.62	5.85	5.08	6.39	6.18	5.42	5.43	5.24	5.20	5.08	4.81
5-year IRS	%	1.69	5.92	5.10	4.58	5.53	5.37	4.74	4.78	4.67	4.61	4.55	4.47
10-year IRS	%	2.01	5.68	5.15	4.79	5.47	5.34	4.85	4.93	4.87	4.84	4.79	4.68
EUR/PLN	PLN	4.57	4.69	4.56	4.52	4.71	4.55	4.45	4.52	4.55	4.54	4.51	4.50
USD/PLN	PLN	3.86	4.46	4.19	4.04	4.39	4.18	4.03	4.14	4.15	4.08	3.99	3.93
CHF/PLN	PLN	4.22	4.67	4.58	4.26	4.75	4.65	4.48	4.45	4.40	4.30	4.21	4.15
GBP/PLN	PLN	0.18	0.19	0.19	0.18	5.33	5.23	5.15	5.16	5.42	5.46	5.50	5.49

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

Source: NBP, Bloomberg, Santander

This analysis is based on information available until **13.07.2023** has been prepared by:

**ECONOMIC ANALYSIS DEPARTMENT
SANTANDER BANK POLSKA S.A.**

al. Jana Pawła II 17, 00-854 Warszawa

email: ekonomia@santander.pl

Web site: <https://www.santander.pl/en/economic-analysis>

Piotr Bielski , Director	+48 691 393 119
Bartosz Białas , Economist	+48 517 881 807
Cezary Chrapek , CFA, Economist	+48 887 842 480
Marcin Luzziński , Economist	+48 510 027 662
Grzegorz Ogonek , Economist	+48 609 224 857

IMPORTANT DISCLOSURES

This report has been prepared by Santander Bank Polska S.A. registered in Poland and authorized and regulated by The Polish Financial Supervision Authority.

This material has been prepared for information purposes only and does not constitute a prospectus or other offering document, a solicitation or an offer to buy or sell any securities, related investments or other financial instruments. This report is neither research, a “research report” as commonly understood under the securities laws and regulations promulgated thereunder nor an investment advice.

The information and opinions contained in this report have been obtained from, or are based on, public sources believed to be reliable, but no representation or warranty, express or implied, is made that such information is accurate, complete or up to date and it should not be relied upon as such. Information and opinions contained in the report are published for the assistance of recipients, but are not to be relied upon as authoritative or taken in substitution for the exercise of judgement by any recipient, are subject to change without notice and not intended to provide the sole basis of any evaluation of any instruments.

Any reference to past performance should not be taken as an indication of future performance. This report is for the use of intended recipients only and may not be reproduced (in whole or in part) or delivered or transmitted to any other person without the prior written consent of Santander Bank Polska S.A.. Any decision to purchase or subscribe for securities in any offering must be based solely on existing public information on such security or the information in the prospectus or other offering document issued in connection with such offering, and not on this report. The material in this report is general information intended for recipients who understand the risks associated with investment.. Furthermore, this document is intended to be used by market professionals (eligible counterparties and professional clients but not retail clients). Retail clients must not rely on this document. To the fullest extent permitted by law, no Santander Group company accepts any liability whatsoever (including in negligence) for any direct or consequential loss arising from any use of or reliance on material contained in this report. All estimates and opinions included in this report are made as of the date of this report. Unless otherwise indicated in this report there is no intention to update this report. Santander Bank Polska S.A. and its legal affiliates may make a market in, or may, as principal or agent, buy or sell securities of the financial instruments or derivatives mentioned, discussed or related to in this report. All reasonable care has been taken to ensure that the information contained in this report is not untrue or misleading. No representation, however, is made as to its accuracy or completeness. No reliance should be placed on it and no liability is accepted for any loss arising from reliance on it.

Santander Bank Polska S.A. or any of its affiliates, salespeople, traders and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, Santander Bank Polska S.A. or any of its affiliates’ trading and investment businesses may make investment decisions that are inconsistent with the opinions expressed herein.

No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

© Santander Bank Polska S.A. 2023. All Rights Reserved.

Thank You.

Our purpose is to help people
and business prosper.

Our culture is based on believing
that everything we do should be:

Simple Personal Fair



MEMBER OF
**Dow Jones
Sustainability Indices**
In Collaboration with RobecoSAM

