

All hands on deck Poland

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Executive Summary (macro)

The tug-of-war between market players who foresee an imminent global recession that would force central banks to cut interest rates quickly, and those expecting inflation to remain stubborn, thus making interest rates stay 'higher for longer', continues. The US economy still seems to be evading a recession, while in Europe negative signals prevail, prompting a downward revision of economic growth forecasts. On both continents, central banks are apparently approaching the end of their monetary tightening cycles, but the question of when they will begin to reverse those cycles remains open. In our view, no sooner than 2H2024 – both ECB and Fed are clearly prioritising inflation over GDP growth. The normalisation of interest rates is led by Latin America, and in September, the National Bank of Poland followed in their footsteps, surprisingly cutting its reference rate by 75bp. The difference between them is that in LatAm central banks have raised real interest rates early and strongly enough to bring inflation back closer to their targets, while in Poland the prospect of achieving the inflation target remains as remote as it was a year ago and the restrictiveness of monetary policy, measured by the level of real rates, is much lower than in most other countries. **The expected further decline in CPI in the coming months allows, in our view, to expect further NBP rate cuts this year. Our working assumption is that there will be two rate cuts of 25bp each, in October and November, bringing the main rate to 5.50% at the end of the year**, but we are aware that the risk of being wrong about the next decisions is very high - the MPC's reaction function apparently has changed a lot after the holidays and we are not able to clearly identify it. ([p.28](#))

In our view, the onset of rate cuts in Poland was so early and so strong that it increases the risk of disinflation coming to a halt in 2024. **CPI inflation, after falling in the next few months, will likely fluctuate near 7% y/y in 2024, even rebounding slightly in mid-year**, in response to accommodative monetary and fiscal policies, a recovery in domestic demand, and the reversal of base effects. Our forecasts assume the expiration of the so-called anti-inflationary shields (frozen energy prices, zero VAT on food) at the beginning of 2024 - this factor should add around 3 percentage points to CPI after the New Year. ([p.25](#))

The bold easing of monetary policy will coincide with another year of fiscal expansion. While in the previous twenty years the public finance imbalances were decreasing rather than increasing in an election year, it seems that this year will close with a fiscal gap of over 5% of GDP, whereas the deficit planned by the government for the following year equals 4.5% of GDP, with a very large scale of debt issuance (record high gross borrowing needs of over PLN420bn). The draft budget looks ambitious and lacks the usual safety margins on both the revenue and expenditure side. In addition, the election campaign, which is now entering its hottest stage, generates the risk of new promises and commitments which could burden this and/or next year. ([p.32](#))

The greater-than-expected scale of fiscal and monetary stimulation implies 'all hands on deck' strategy in terms of domestic demand stimulation. **We have revised downwards our GDP growth forecast for 2023 and 2024 - to 0.7% and 3.0% respectively** ([p.7](#)) - **due to a weaker starting point (first half of the year) and deteriorating data from the euro area, but also a greater risk of a prolonged withholding of EU funds** ([p.14](#)). However, we maintain the view that the worst phase of the slowdown cycle is over and that the next quarters will bring a gradual improvement in economic activity, driven primarily by domestic consumer demand. It will be fostered by, in addition to a benign policy-mix, a positive credit impulse ([p.24](#)) and sustained high dynamics of labour income and social benefits ([p.23](#)).

The main event of the coming weeks will be the parliamentary elections ([p.35](#)), the outcome of which may significantly affect the shape of macroeconomic policy, the institutional framework and growth outlook, including Poland's role in the EU and the possibility of unlocking the EU funding. Current polling trends indicate that predicting the outcome of the elections is fraught with great uncertainty. Uncertainty also surrounds how long the process of forming a new government will take. Should it prove impossible to form a stable arrangement, snap elections in spring 2024 cannot be ruled out.



Executive Summary (markets)

FX market

Since the publication of the last report, the zloty has weakened markedly (around 4% to the euro) and has been one of the weakest currencies of the emerging economies. The zloty's exchange rate remained relatively stable over the summer holiday period and a large depreciation is mainly a market reaction to the 'shock' interest rate cut by the MPC in September. The weaker zloty was also supported by the strengthening of the dollar, which, as well as regional factors, made the CEE currencies in general behave relatively weak against peers. The PLN exchange rate remains somewhere in the middle between the breakeven levels of exporters and importers, according to central bank surveys.

We believe that after the surprising rate cut by the NBP and the expected further monetary easing with rate hikes by the ECB, there is room for further weakening of the zloty. This may be supported by higher volatility of the zloty during the election period, probably still underestimated uncertainty regarding fiscal policy, worsening of the current account balance in the second half of the year, as well as a change in the NBP's attitude towards the exchange rate. During the September press conference, a greater preference for a weak zloty could be felt. In addition to the desire to support exporters, it is possible that this may be backed by a desire to avoid a currency loss from FX reserves in the face of a budgeted PLN6bn gain. The still high basis swap rates and currency sales by the Ministry of Finance may have a limiting effect on the scale of the discount. We assume that a rebound of the zloty with the economic recovery and the gradual weakening of the dollar on global markets is possible next year. In the medium and long run, the CEE currencies should benefit from inflows of foreign direct investment. ([p.44](#))

Interest rate market

The domestic interest rate market saw a significant drop in rates in response to the shock NBP rate cut. After an earlier significant drop in rates in response to the dovish pivot by the NBP president in July and the end of the rate hike cycle, market rates remained relatively stable over the holiday months. First, the amendment of this year's budget and then the publication of the draft budget for 2024 with a record amount of borrowing needs and planned bond issues brought a gradual increase in asset swap credit spreads. On the other hand, the surprising, in terms of scale, NBP rate cut and the dovish arguments of the NBP president led to a significant drop in rates and a steepening of the IRS and bond curves.

We believe that the market has overestimated the scale of possible interest rate cuts, so we see a room for a slight correction of market rates and flattening of the curve in 4Q. Despite a slight upward revision of interest rates in the last days before the report was published, the market is still pricing-in c100bp of NBP rate cuts by the end of this year and ca. 225bp by mid-2024. We believe that the actual scale of easing will be smaller, and the impulse for upward market rate correction could come from upward surprises in CPI, the first hawkish surprise from the MPC decision and/or communication, or further weakening of the zloty. However, **declines in market rates and a further steepening of the curve may return in subsequent quarters. High debt issuance will keep asset swap spreads elevated.** We think larger yield declines could come during the course of next year, pushing spreads to Bunds permanently deeper below 300bp. ([p.38](#))



2023 Forecasts – what has changed

Indicator	Our view in July 2023	Our view in September 2023
GDP	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.	We revise our GDP forecasts for 2023 and 2024 slightly downwards due to the weaker first half of the year and deteriorating data from Germany and the euro area. However, a recovery is still our baseline scenario, which should be supported by more accommodative than expected policy-mix: bold rate cuts and high fiscal deficit.
GDP breakdown	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.	Investments keep surprising positively this year, but we fear their performance in 2024 may be weaker due to EU funding being postponed. We still assume that consumer demand will experience a recovery driven by rising real income and accommodative fiscal and monetary policies. Depressed foreign demand and reviving domestic demand imply a gradual worsening of net exports.
Labour market	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.	Unemployment still stays at its record lows and the shortage of labour force remains a problem. We see some early signs of rising demand for workers. Wage growth is and will stay double-digit, which together with lower inflation will result in an increase in real households' income.
Inflation	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.	We expect that the trend of faster-than-expected disinflation from 2023 will stop in 2024 due to the expiration of the so-called anti-inflationary shields, and – after some time – due to the effects of low-base, weaker zloty and the recovery in domestic demand stimulated by fiscal and monetary policies.
Monetary policy	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.	The rapid cut of interest rates by the NBP in September hints that further cuts may take place this year. In our view, the MPC will cut rates to 5.50% this year and pause the cuts in 2024 because of stalling disinflation and forecasts showing the time of the return to the target moving further away.
Fiscal policy	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.	The draft budget for 2024 assumes a deficit of 4.5% of GDP, compared to 5.2% in 2023. The plan is ambitious, while the safety margins on the sides of revenues and expenditures smaller than in previous years. Pre-election promises suggest that the actual deficit in 2024 may be even higher than planned (which holds also for this year).
Interest rate market	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.	We think the market overestimated the scale of interest rate cuts and we assume room for a rise in rates and flattening of the curve in 4Q, while upward surprises in CPI may be a trigger. High debt issuance will keep asset swap spreads high.
FX market	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.	We think there is room for further weakening of the zloty after the surprising rate cut by the NBP and the expected further monetary easing with rate hikes by the ECB. This may be supported by higher volatility during the electoral period, deterioration in the current account or the dependence of the NBP's result on a weak zloty. PLN rebound is possible next year.

Economy

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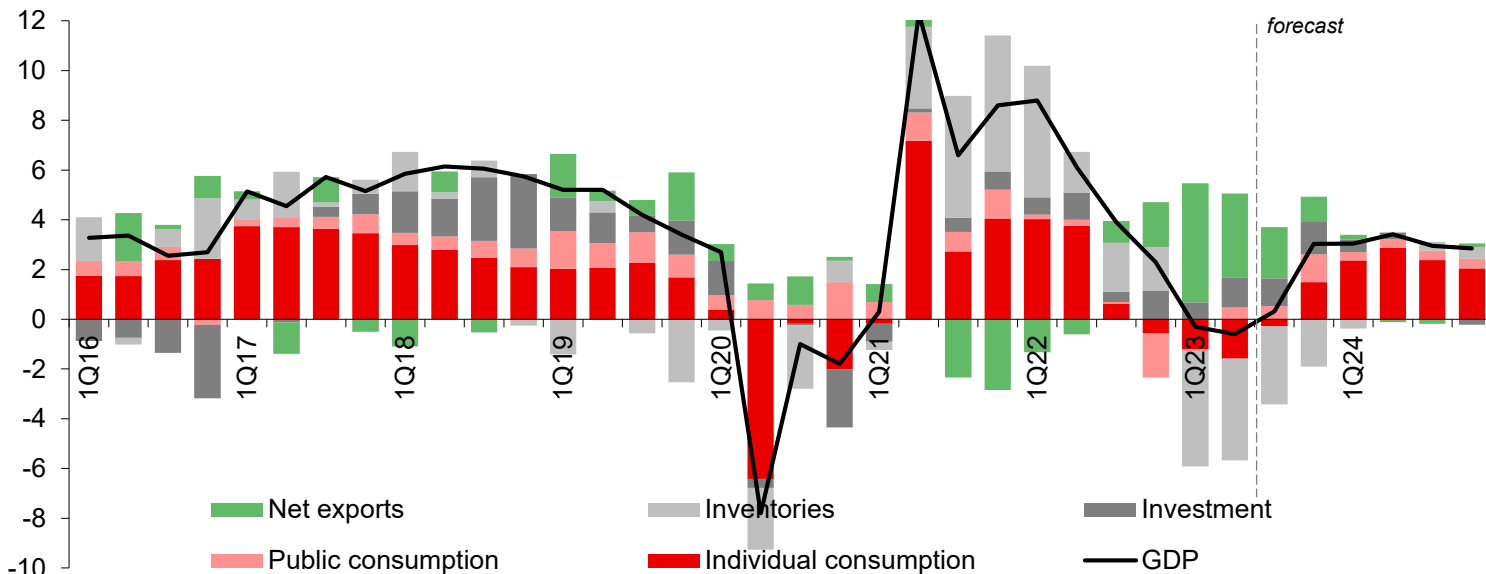
GDP growth: a recovery remains in sight

From the post-pandemic peak in 1Q22 to mid-2023, Poland's GDP recorded the second largest fall in EU (-2.8%), with a worse result only in Estonia. Over the same period, Germany contracted by just 0.2% and the vast majority of EU countries recorded growth. The worst performing countries in this period were those in CEE region (in our view, due to greater links with the countries of the former Soviet Union and therefore greater exposure to the effects of the Russian invasion of Ukraine), while the best performing were the touristic destinations of Southern Europe, most likely linked to the post-pandemic strong recovery in the service and travel sectors (revenge consumer spending).

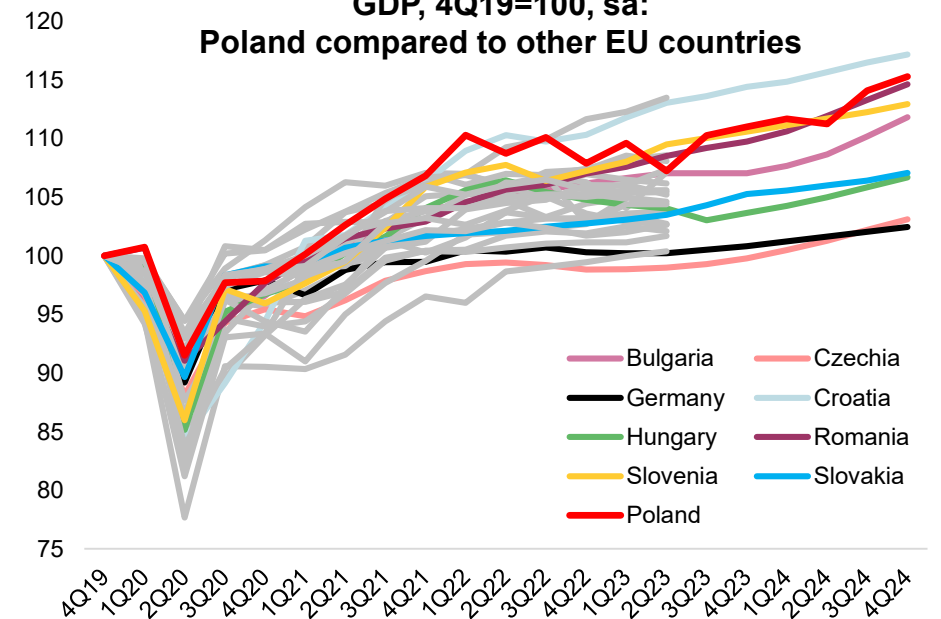
The downturn turned out to be longer than we anticipated - 2Q was not a turning point and the trough in GDP growth deepened further in 1H23. Nonetheless, we still believe that a gradual recovery in economic activity lies ahead, driven primarily by domestic consumer demand. **We are expecting GDP to advance by 0.7% in 2023 and 3.0% in 2024.** The main risks are (1) weaker foreign demand in the event of a deepening recession in the euro area, (2) further withholding of EU funding, which would weaken investment. However, these factors will be counterbalanced at least in part by expansionary monetary and fiscal policies, supporting a recovery in domestic demand and hindering further disinflation.

The projected trends for other CEE countries are similar: a gradual recovery is expected, generated by strong consumption and labour market.

GDP growth and its breakdown in Poland, % y/y



GDP, 4Q19=100, sa: Poland compared to other EU countries



Poland: Santander's forecasts, other countries: EC Spring Forecasts

Source: Eurostat, EC, Santander

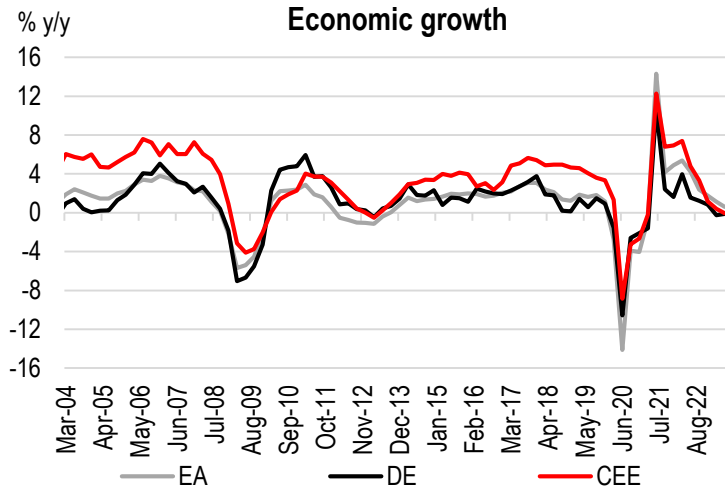


Source: GUS, Santander

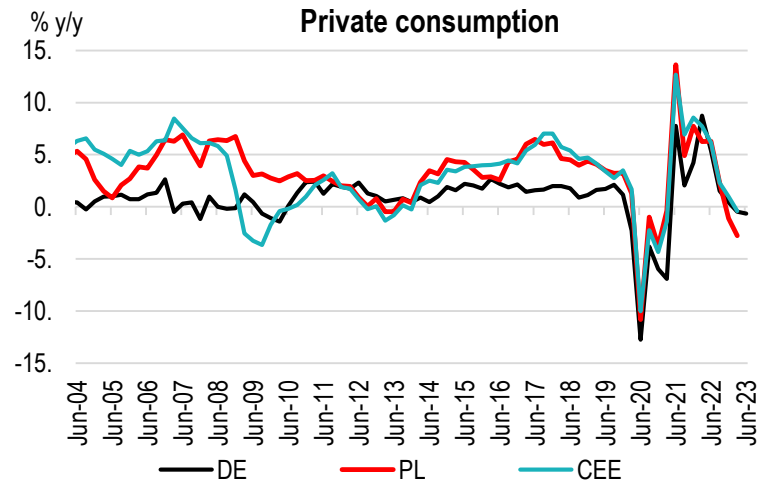
CEE: GDP growth at cyclical trough



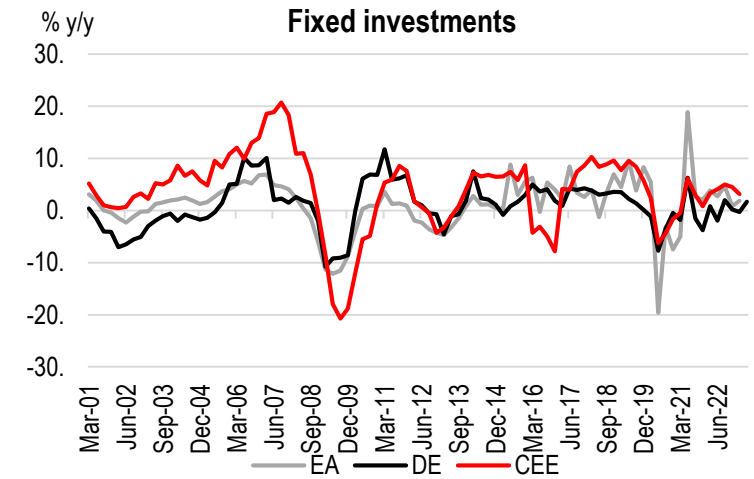
GDP growth weakened below euro area



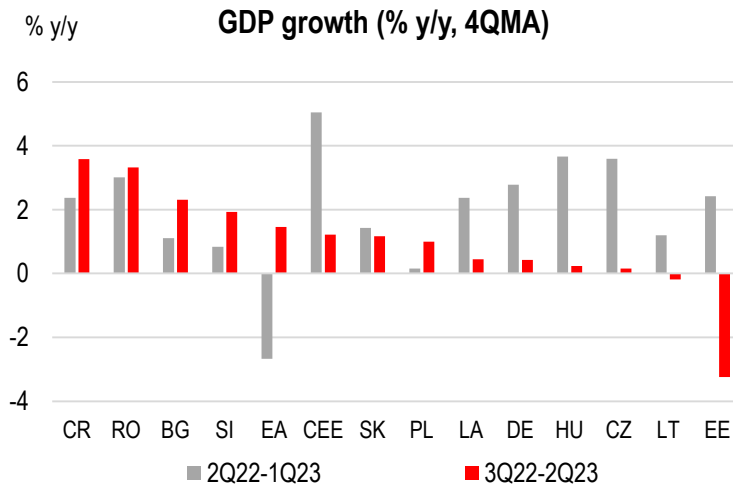
Private consumption depressed by high inflation



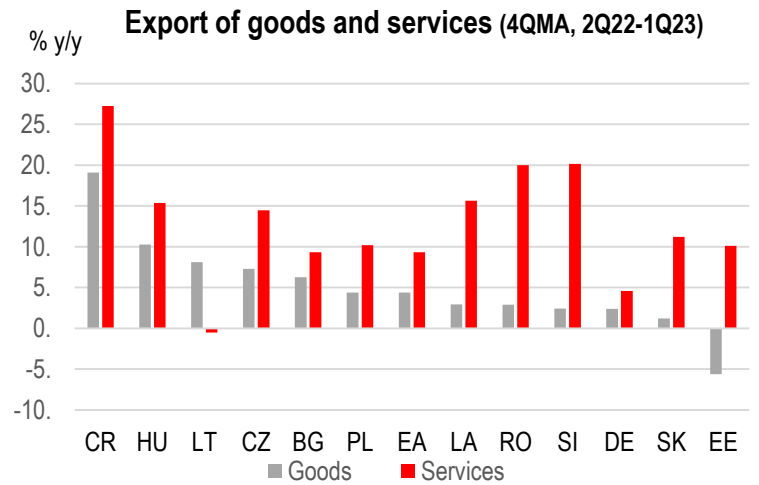
Investment growth remained surprisingly solid



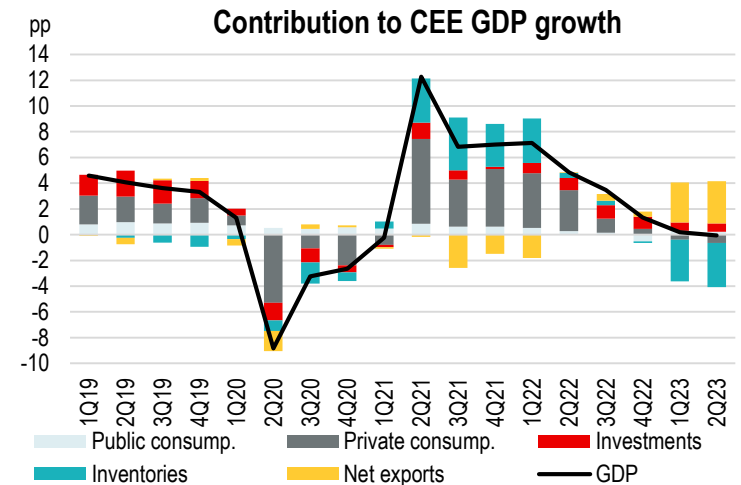
Growth strongest in southern CEE



Stronger exports of services than goods



Negative impact of inventories offset by net exports



CEE: growth set to gradually recover in 2024-25

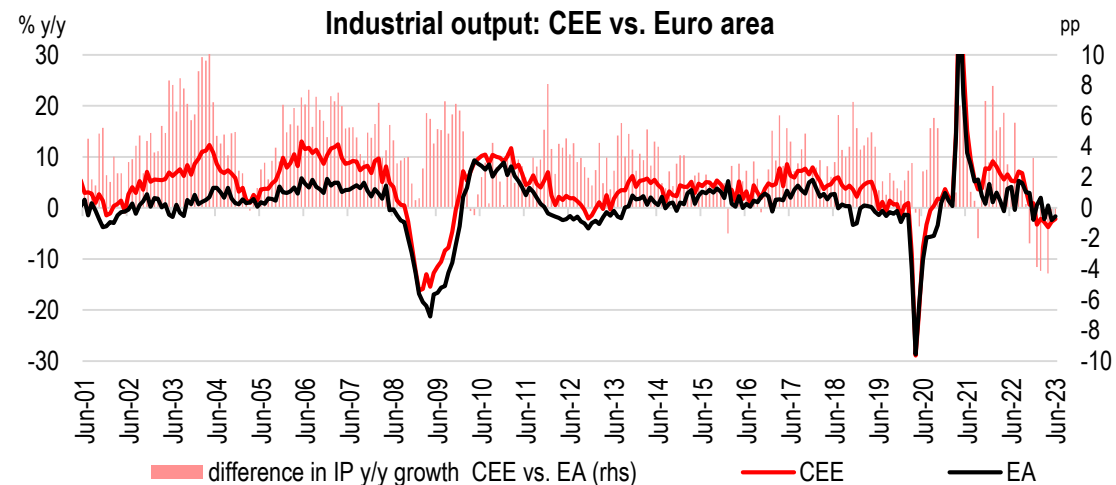


CEE region is expected to record a rebound in 2024, while prospects for 2025 are even better

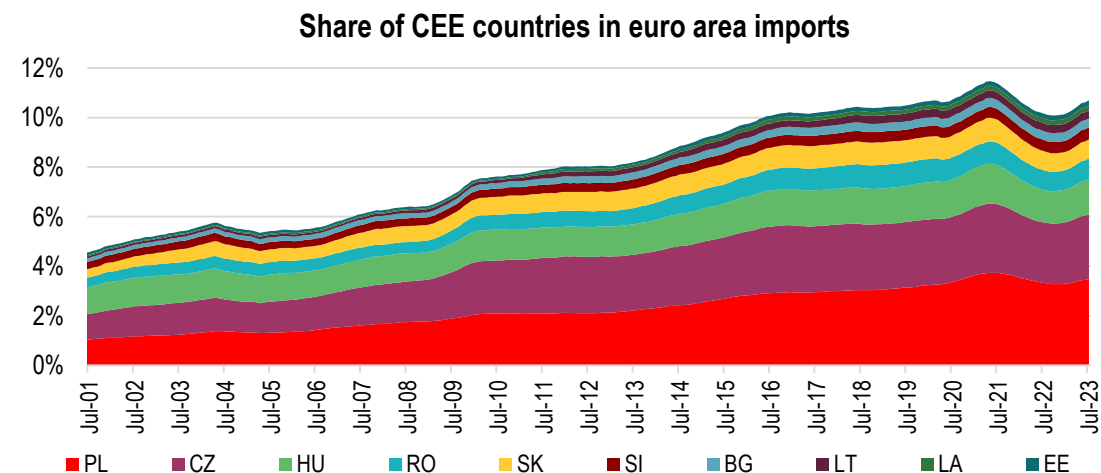
Bloomberg median forecast (Santander forecast in brackets)

GDP % y/y			
	2023F	2024F	2025F
PL	0.8 (0.7)	2.6 (3.0)	3.3 (3.3)
CZ	0.1	2.4	3.0
HU	0	2.9	3.2
RO	2.5	3.3	3.4
BG	1.6	2.5	3.2
SK	1.3	2.0	2.5
SI	1.4	2.5	2.7
CR	2.4	2.7	2.7
EE	-1.5	2.5	3.0
LA	1.1	2.4	3.0
LT	-0.4	2.3	2.4
DE	-0.3	0.9	1.5
EA	0.6	0.9	1.5
US	2.0	0.9	1.9
World	2.7	2.7	3.0

CEE industrial output growth was rarely below growth in euro area



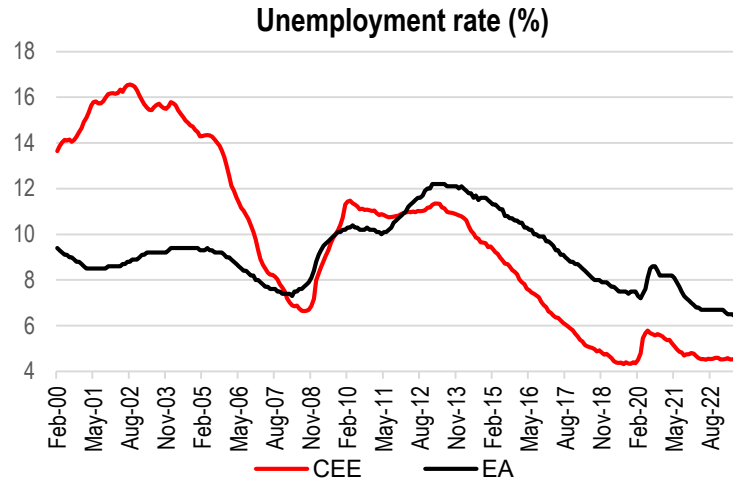
Rising share of CEE in euro area imports is positive signal for recovery



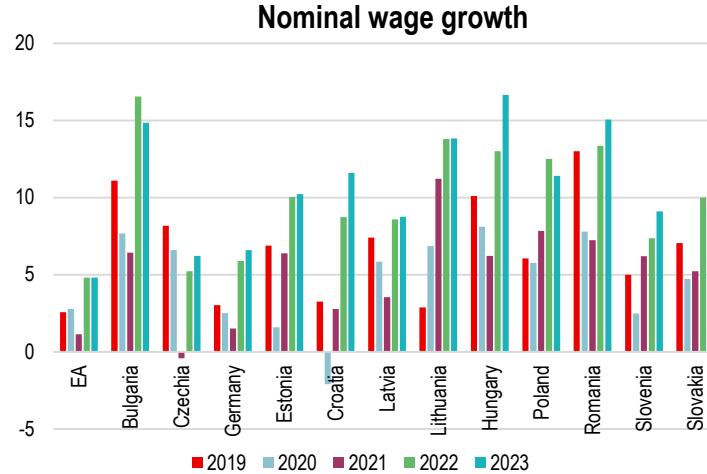


CEE: tight labour markets, better consumer sentiment

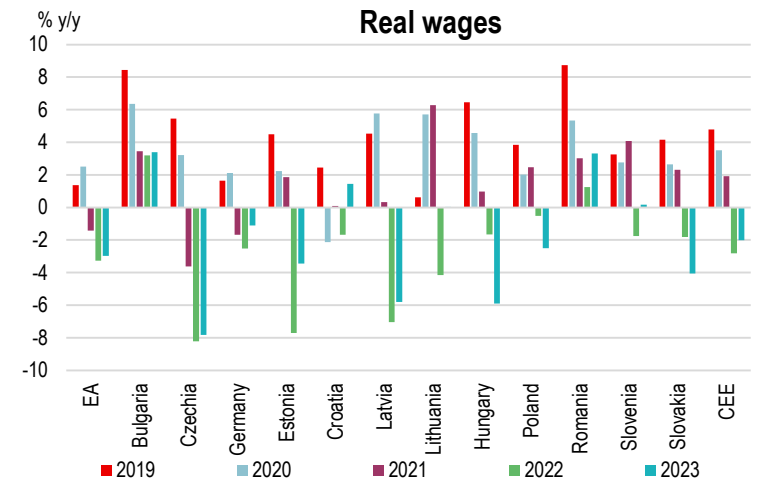
CEE unemployment rate remains low



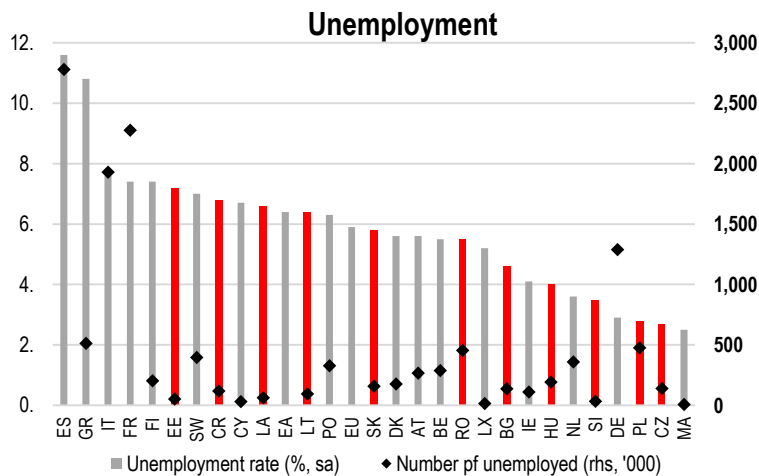
Nominal wage growth is still high



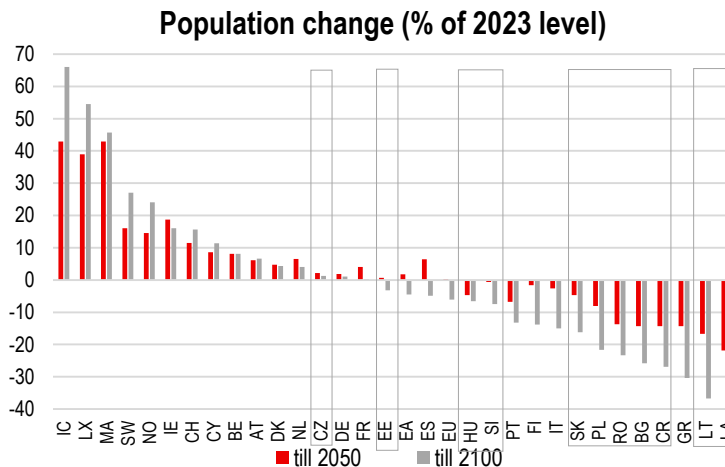
Real wages started to recover



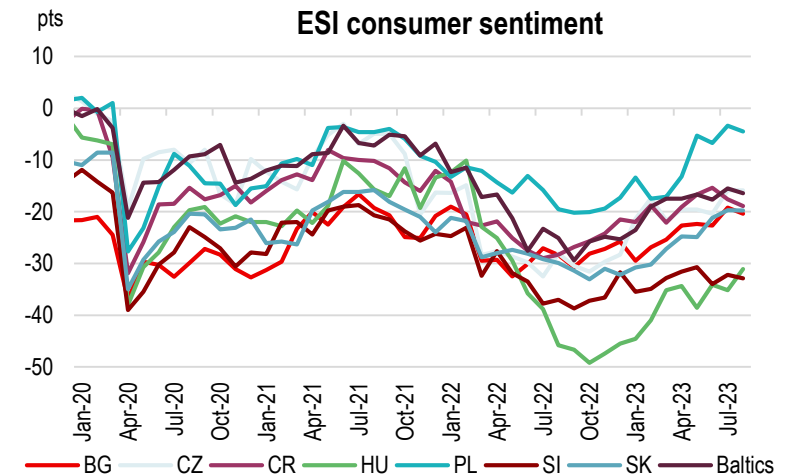
Lowest unemployment in PL&CZ and highest in Baltics and Croatia



Negative demographic changes will keep pressure on wages



Consumer sentiment has been improving



Source: Eurostat, Santander



China did not live up to expectations

The hopes for a rebound in China, which have been rising until spring, are now clearly down. **The disappointing lack of support from China to global growth has to be accounted for while assessing the chance for a "soft landing" in Europe and for its recovery later on.**

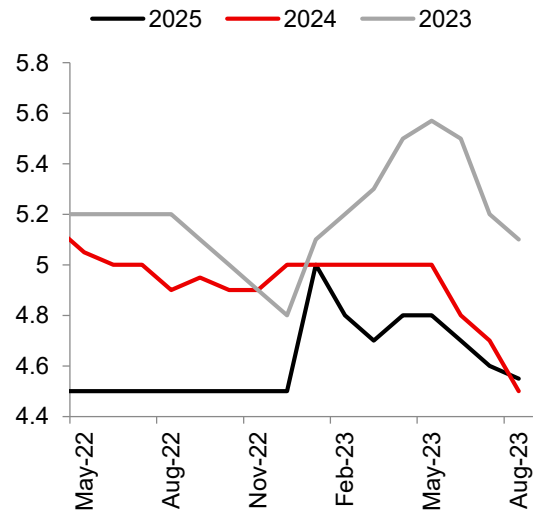
Market expectations regarding the growth of the Chinese economy have started to decrease in June, reflecting more than just a delay of rebound: both expectations for this year and the next two are being revised downwards. Similarly, the yuan, whose exchange rate can be considered a barometer of the prospects of the Chinese economy, has been clearly losing value in recent months, to the extent that the central bank had intervened at daily fixings to curb the excessive pace of depreciation.

The weakness of the Chinese economy and the problems of property developers forced a softer monetary policy (rate cuts). Data on lending to the overall economy also show that the results of the 1Q rally were not sustained.

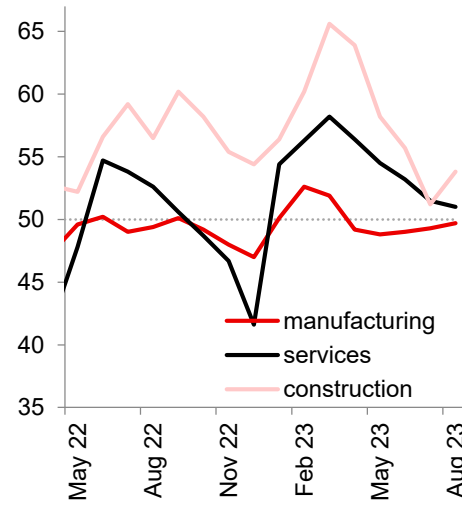
USDCNY exchange rate



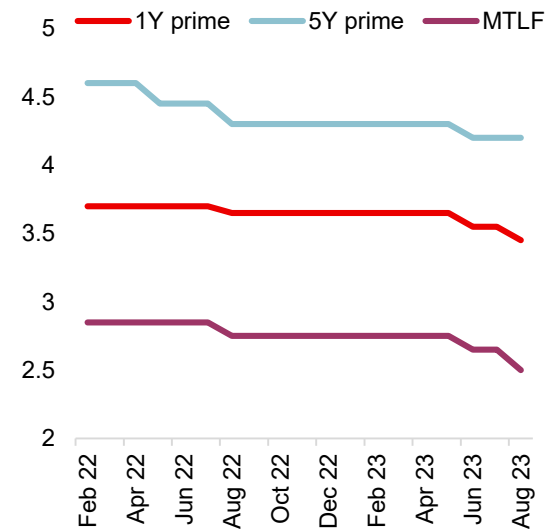
Median of GDP growth forecasts for China, 2023-2025, Bloomberg survey



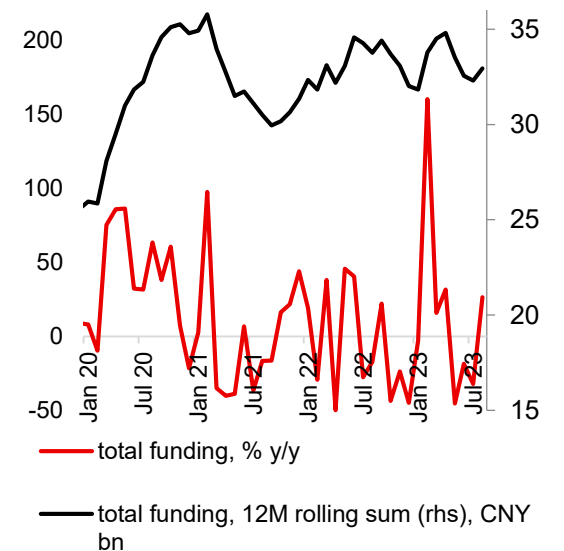
"Government" PMIs for China



Chinese central bank rates



Credit in China



Source: Bloomberg, Santander



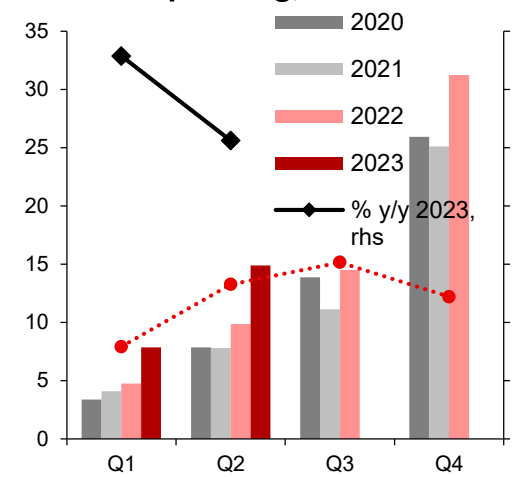
Investment: great 2023, 2024 may be a challenge

After the release of the investment data for 2Q23, which showed growth of 7.9% y/y, we revised upwards our estimate of full-year investment growth in 2023 to 6.6%. We estimate that local government and defence spending will be responsible for half of this year's investment growth. Next year, however, the public sector may contribute less. Household investment may look better, and there is growing optimism among companies (see next page). On the other hand, very low plans for the use of EU funds suggest scepticism.

Higher local government spending is, in our opinion, allocated mainly to roads, and to a lesser extent to culture, education and healthcare. In nominal terms, 2023 local government investment will be at a record high, which will be difficult to beat in 2024. Currently, local government plans presented in the March multi-annual financial forecast assume expenditures of PLN47.2bn in 2024 vs. PLN109.8bn in 2023. These figures will likely be revised upwards in subsequent plans (e.g. the plan from March 2022 assumed PLN44.2bn of investments in 2023). Still, we expect that in 2024 the contribution of local governments to investment growth will equal zero or even be negative.

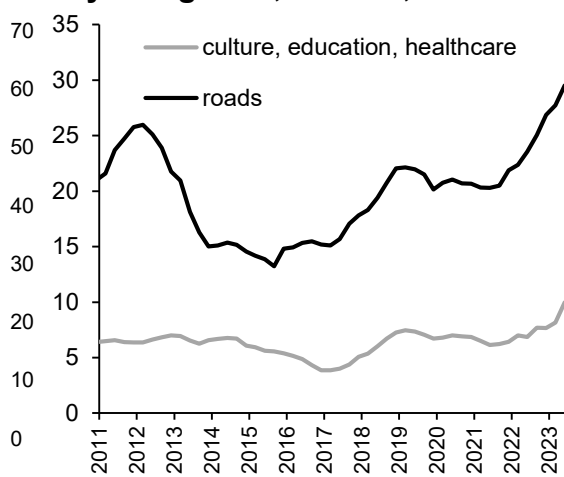
However, in 2024, the weaker contribution from local governments may be partly offset by higher infrastructure spending in the central sector, especially on roads, as the GDDKiA, which manages national roads and highways, plans to increase investment spending by around 32%. For 2024, we also assume a further increase in defence spending, but its contribution to the total investment growth will be lower than in 2023 (0.5 pp in 2024 vs. 1.5 pp in 2023). It should be noted that most of the purchased arms are imported, so they will not significantly affect GDP growth.

Local government investment spending, PLN bn



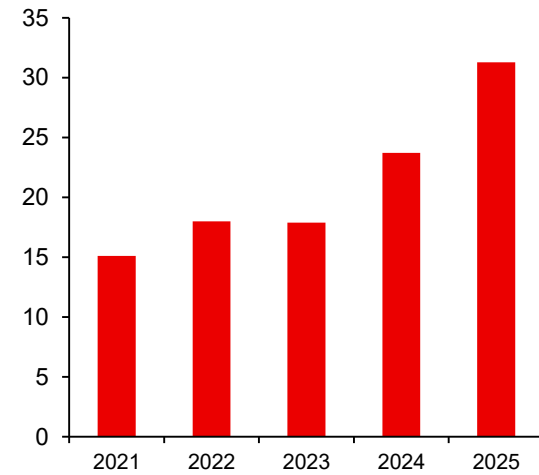
Source: GUS, Ministry of Finance, Santander

Construction spending by categories, PLN bn, 12M sum



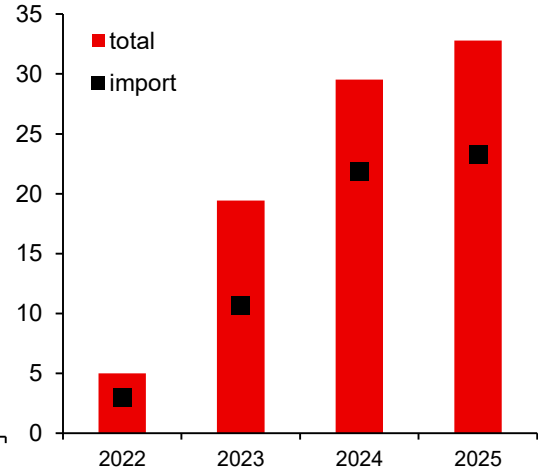
Source: GUS, Santander

Investment spending of GDDKiA – outcome and plans, PLN bn



Source: GDDKiA, Santander

Defence spending, PLN bn (estimated deliveries)



Source: government, press, Santander



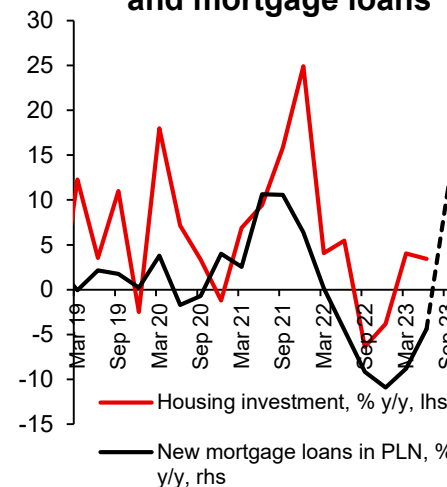
Investment: rebound in the housing market in 2024

We expect an improvement in the growth rates of household and corporate capital expenditure in the coming quarters. However, the reduced availability of EU funding may be a challenge, especially for companies.

Household investment, most of which is made of outlays on housing, has looked rather meagre in recent quarters, mainly due to the strong decline in demand for new housing. However, mortgage demand has already started to rebound strongly, which we believe will translate into a marked improvement in the corresponding component of investment in the coming quarters.

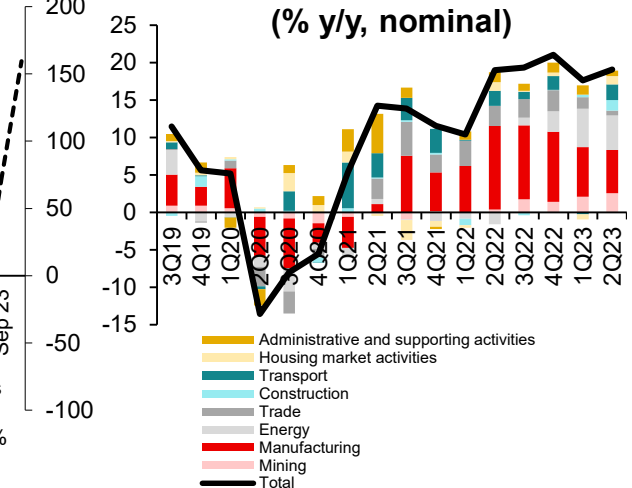
Corporate investment sentiment has been rather poor in recent quarters. Nevertheless, the sector was spending more on energy efficiency, which was particularly evident in the investment data of large companies - the "electricity generation and supply" sector made a significant contribution to the growth of the overall indicator. At the same time, investment growth in manufacturing was declining. Corporate sentiment has recently stopped deteriorating and, in our view, improving prospects of growth in the coming quarters will lead to increased spending. However, its scale may be limited by potential lower access to EU funds, due to the exhaustion of funds from the 2014-2020 financial perspective, the slow start of the 2021-2027 perspective and the RRF still remaining frozen.

Investment in housing and mortgage loans



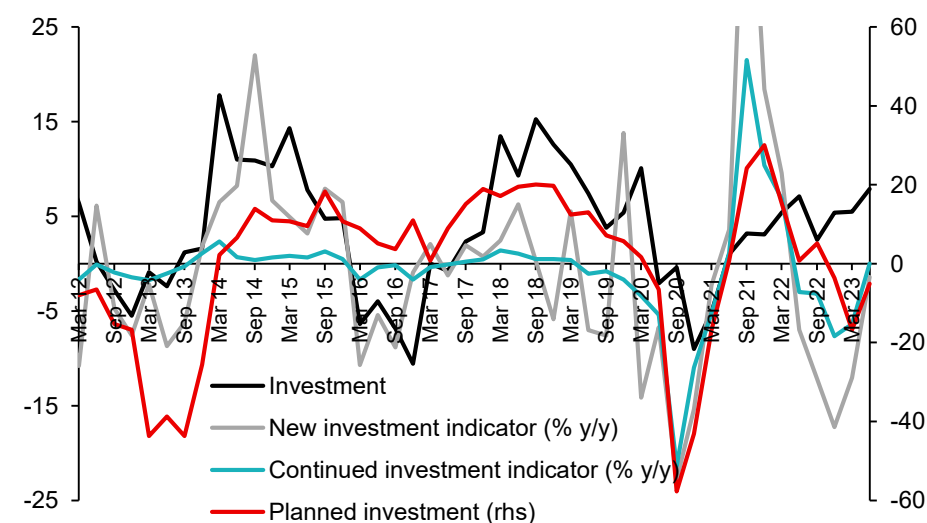
Source: Eurostat, NBP, Santander

Sectoral decomposition of large companies' investment (% y/y, nominal)



Source: GUS, Santander

Investment and the NBP's investment sentiment indicator



Source: GUS, Santander

EU funds: a sudden stop?

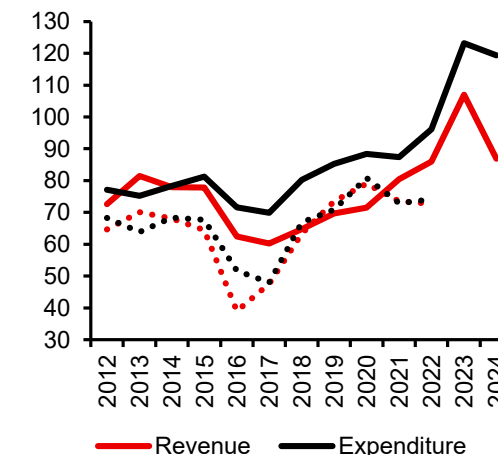
Poland could benefit from EUR78.3bn of EU funding under the medium-term budget for 2021-2027. However, the payments will not be made unless Poland meets the horizontal condition of compliance with the Charter of Fundamental Rights. It is worth to note that the transfers from the EU projected in the draft budget for 2024 are considerably smaller than in previous years, while the deficit of the European funds budget is much larger (PLN32.5bn). This raises the question, whether the low transfers and high deficit are a result of the early stage of the new financial framework and its smaller size (which, however, is offset by the EURPLN exchange rate being higher than at the start of the previous perspective), or whether they stem from an implicit assumption that the conflict with the EC will reduce the structural funds to pre-financing only. Such an assumption would, however, contradict the inclusion of the RRF in the budget.

The draft budget for 2024 includes PLN14.7bn spending from the 2021-2027 perspective and a special-purpose reserve of PLN39.8bn for financing programmes from the EU funds budget. If Poland will not receive the funds from the new financial perspective, the deficit of the EU funds budget may rise by PLN14.7bn (though the final amount should be smaller after accounting for pre-financing). Deficit of the EU funds budget is not included in the fiscal deficit, but increases the state's borrowing needs. Thus, if the EU funds will be withheld, the already-record-high financing needs may rise even more.

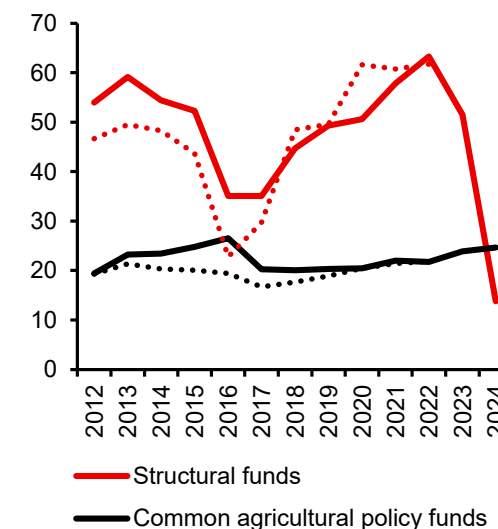
Revenues and expenditures in the EU funds budget for 2024, PLN mn

Programme	Revenues	Expenditures	Balance
2021-2027 financial perspective	14 749.1	17 203.6	-2 454.5
Reserve for financing programmes from the EU funds budget	-	39 796.8	-39 796.8
2014-2020 financial perspective	10 640.8	9 992.2	648.6
Recovery and Resilience Facility	35 950.9	35 950.9	0.0
Common agricultural policy	24 620.3	15 511.4	9 108.9
EEA FM 2014-2021 & Norwegian FM 2014-2021	906.7	872.1	34.6
Swiss-Polish Cooperation Programme II	21.3	4.3	17.0
Payroll funding	-	66.3	-66.3
TOTAL	86 889.0	119 397.5	-32 508.5

Forecasted (solid line) and actual (dotted line) EU funds budget in Poland, PLN bn



Forecasted (solid line) and actual (dotted line) transfers of EU funds to Poland, PLN bn



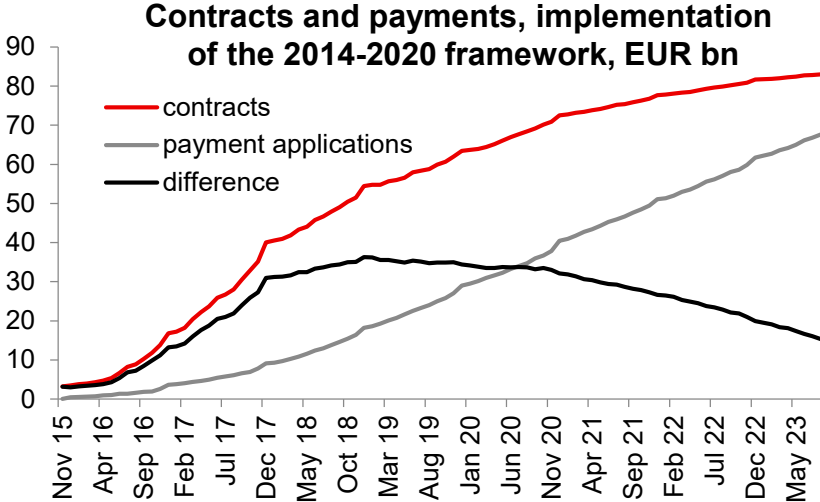


EU funds: transfer balance poised to deteriorate

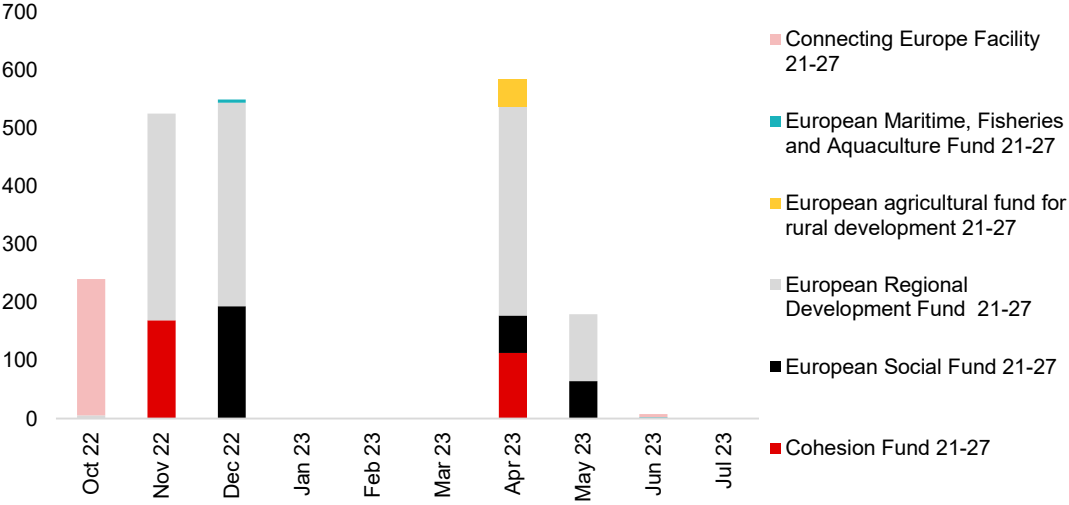
The balance of transfers between the EU and Poland significantly improved in 1H2023, mostly due to the last payments from the previous financial framework, 2014-2020. According to our estimates, the whole 2014-2020 budget has already been contracted and only around EUR15bn of funds from the perspective remain to be paid out.

The data from the Ministry of Finance show that in the last months the EU transfers from the 2021-2027 financial framework are more often zero than not. We have already written long time ago that failing to meet the conditions set for unlocking the funds from the RRF may also result in withholding the structural funds from the 2021-2027 financial perspective. Apparently, this is beginning to happen.

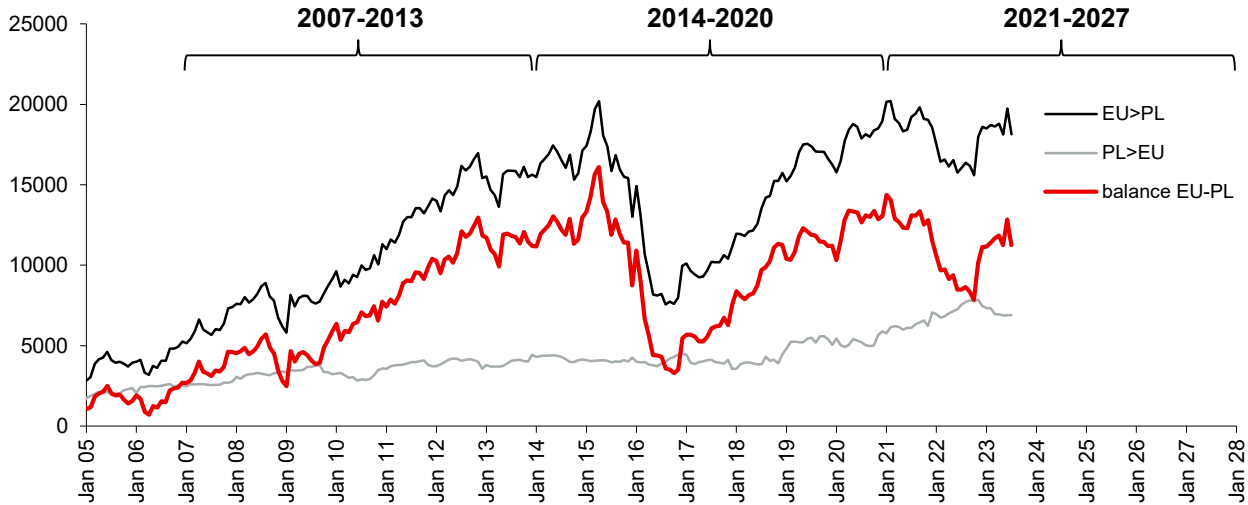
This bodes ill for the 2024 transfers – the net balance of transfers (after deducing Poland’s EU membership fee) may abruptly fall from around EUR10bn annually to nearly zero or even below it – if the money from the Recovery and Resilience Facility are not unblocked.



Financial transfers from the EU to Poland, 2021-2027 financial framework, EUR mn



Financial transfers from the EU to Poland, 12M rolling sum, EUR mn



Source: GUS, Finance Ministry, European Funds and Regional Policy Ministry, Santander



Consumption: slowly improving

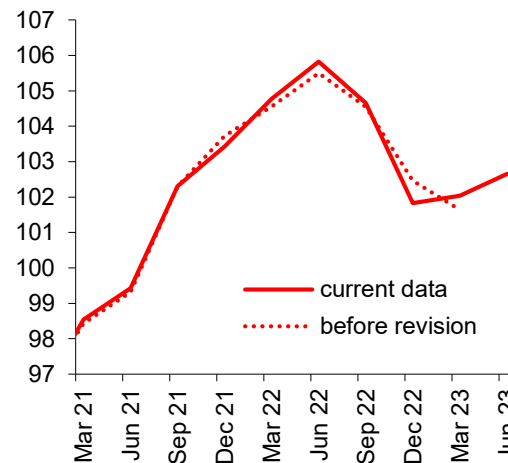
For quite some time we have been expecting a rebound in consumption in the second half of the year. The recent release of GDP data and the revision of seasonally adjusted consumption data reinforces our expectations and even suggests that this rebound has already started in 1Q23. However, we approach seasonally adjusted GDP data with a pinch of salt - strong revisions of this measure are not uncommon. However, improvement is also evident in the latest retail sales and retail trade turnover data (June and July). The improvement in durable goods sales is also a positive sign.

The reasons we see for a recovery in consumption are still the same:

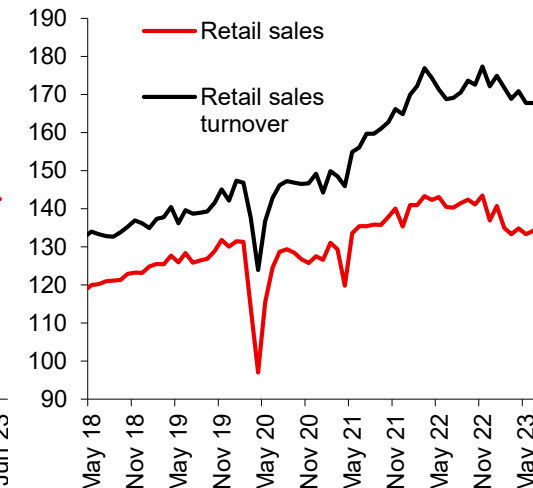
- Tight labour market: unemployment remains at a record low and wage growth is in double digits and positive in real terms. In our view, this situation will continue for the next quarters and the 20% increase in the minimum wage will be an important support for total wage dynamics next year. For more on the labour market, see pages [22-23](#).
- Falling inflation: supports real income
- Election promises: incomes will be further bolstered as a result of the ongoing election campaign. In September, the payments from the 14th pension will equal PLN2650 instead of PLN1588 (additional PLN7bn in the pockets of consumers), legislative work is underway to increase the cap on electricity consumption and to cut electricity prices by 5% retroactively (additional PLN3bn). From January 2024, child benefit increases from PLN500 to PLN800 (additional PLN25bn), and we believe that further proposals may still await.
- Improving consumer optimism: since October 2022, consumer optimism indicators have remained in an upward trend and have already reached the levels from before February 2022. In our view, these indicators will continue to improve, if only because of the good labour market situation.

Despite the improved outlook for consumption, the result for the full year 2023 could still be slightly negative due to the weak first half of the year.

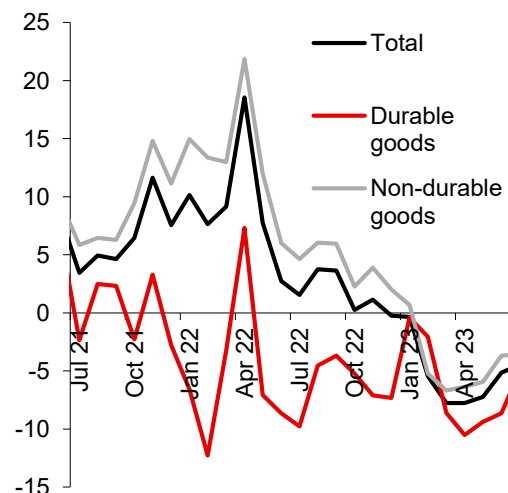
Private consumption, 4Q19=100, s.a.



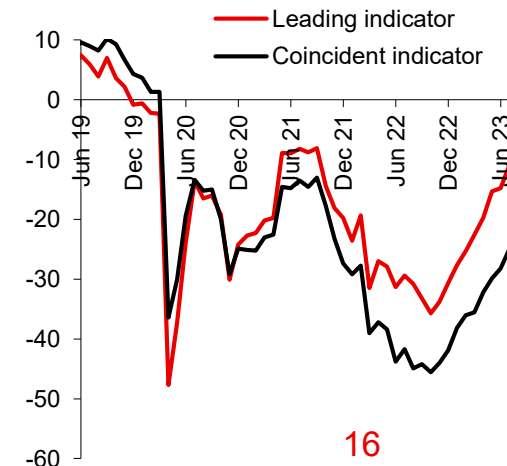
Data from the retail market, 2015=100, s.a.



Retail sales, % y/y



Consumer confidence, pts



Source: GUS, Santander

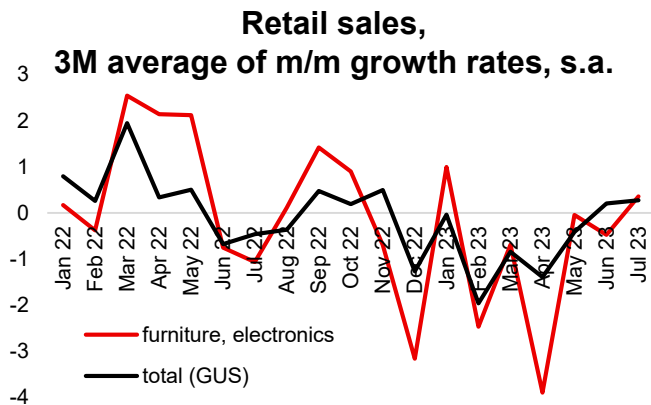


Consumption: rising appetite for bigger purchases

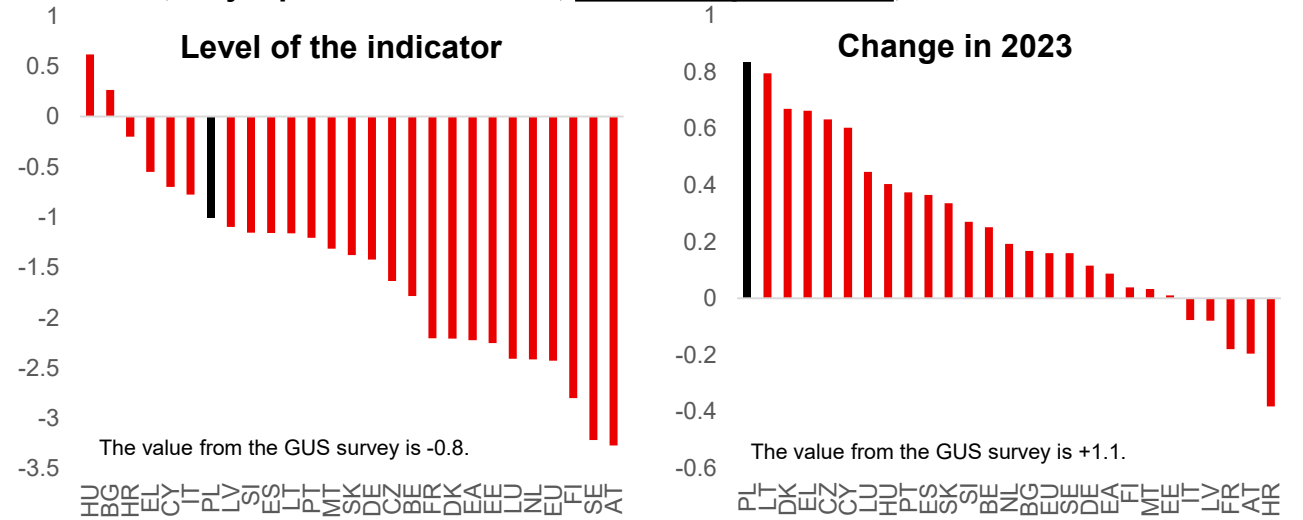
Although the ESI indicators give mixed signals about the prospects for the European economy, **in one area concerns about possible delay of the recovery seem to be small: consumer sentiment.** For Poland, this is important for two reasons: firstly, consumption, in our view, has an important role to play in the upcoming recovery; secondly, a boost in demand for durable goods in Europe should help Polish industry rise from the slump.

Consumer sentiment can be judged, among other things, by their attitude towards big ticket discretionary spending - relatively large but postponable expenditure, such as purchases of white goods or household appliances. This year, in most EU countries, indicators describing the willingness of consumers to undertake more such spending have gone up, both when referring to current consumption decisions and and the outlook for the next 12M.

Polish consumers look quite well compared to the rest of Europe when it comes to major purchases indices. We hope that this will soon be seen in real data and that the improvement already recorded in retail sales in July will not turn out to be a one-off.

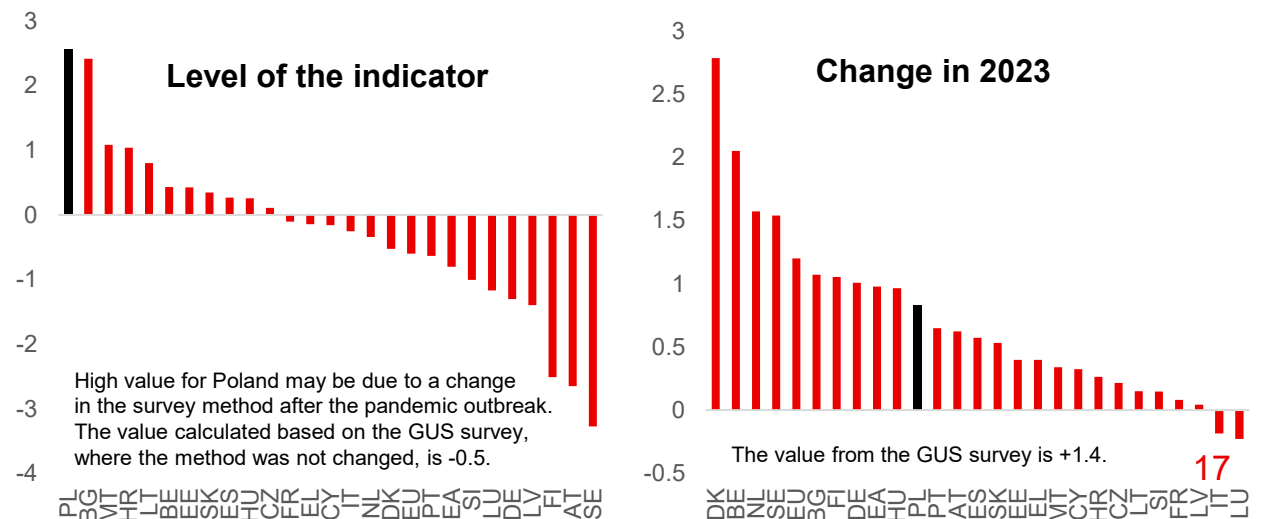


ESI, major purchases indices, current expenditures, standardised data



Source: NBP, Santander

ESI, major purchases indices, expenditures in the next 12M, standardised data



Source: EC, Santander



Consumption: spending on durables likely to rebound

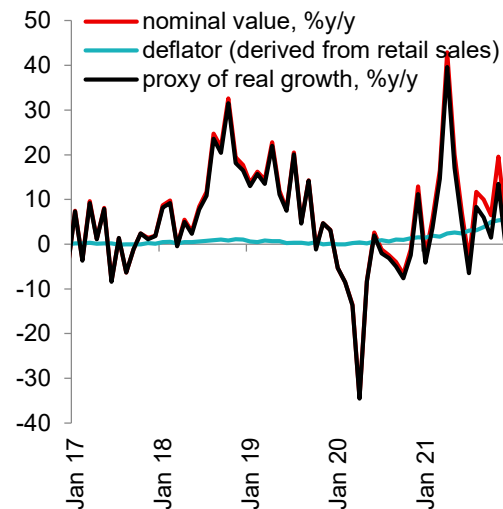
The latest retail sales data showed some improvement in purchases of durable goods.

Wholesale trade in consumer electronics/appliances is already experiencing positive sales value growth in current prices. In July, it reached 12.9% y/y, while back in February it had set a low of -20.1% y/y. If we correct these numbers with retail sales deflator, real wholesale turnover growth is also already in positive territory (+2.5% y/y) after declines of 20-30% y/y in 1Q.

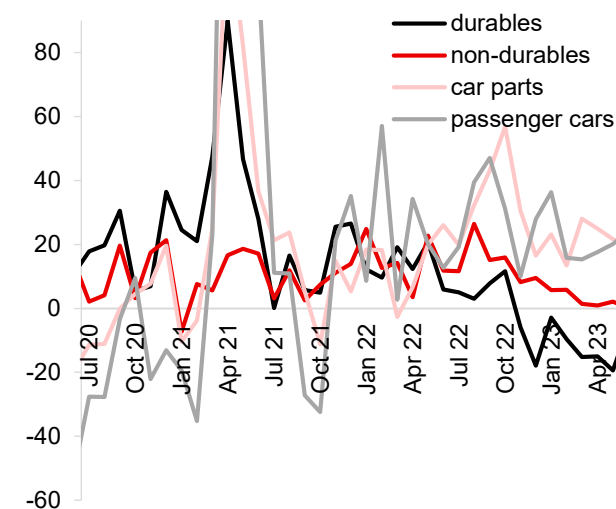
Durable goods imports remain in negative y/y territory, but clearly moved towards zero in June. At the same time, imports of cars continue to grow at a solid pace.

We base our forecast for a rebound in consumption, also in durable goods, on, among other things, a still strong stream of completed dwellings which require furnishing. We assume that the weakness in private consumption last year was caused, among other things, by the accumulation of fears and risks which postponed spending decisions not related to necessities or to the influx of refugees. The number of completed dwellings is no longer growing significantly y/y, but remains high. In view of the alleged earlier pause/delay of furnishing expenditures by some consumers, the stream of dwellings requiring furnishings may continue to grow y/y. Moreover, there has been a recent recovery in the mortgage loan market, which will help to sustain the expected rebound in durable goods sales.

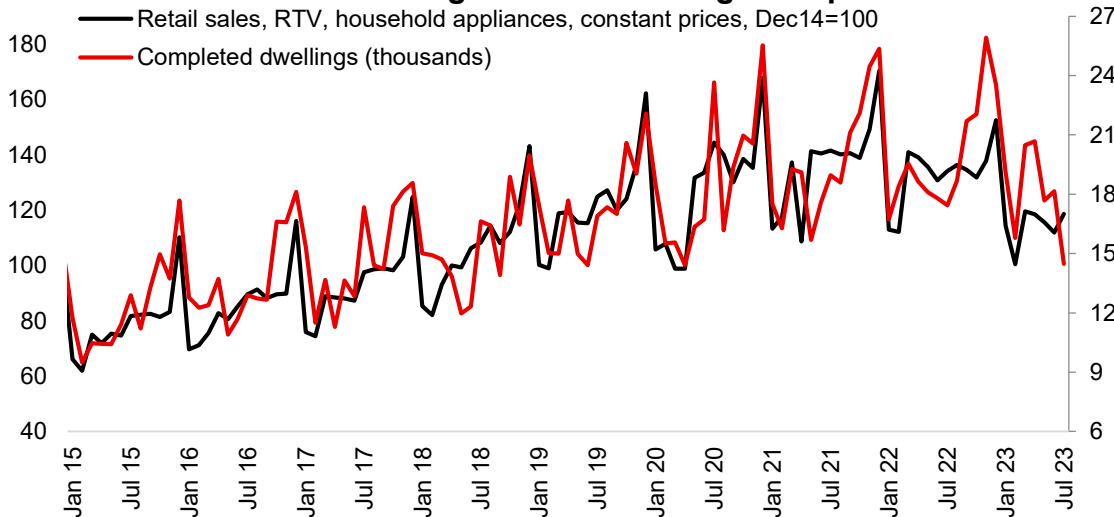
Wholesale: consumer electronics and appliances



Imports in €, % y/y, selected categories



Sales of durable goods vs. dwellings completed



Source: GUS, Santander



Output of durables still on hold

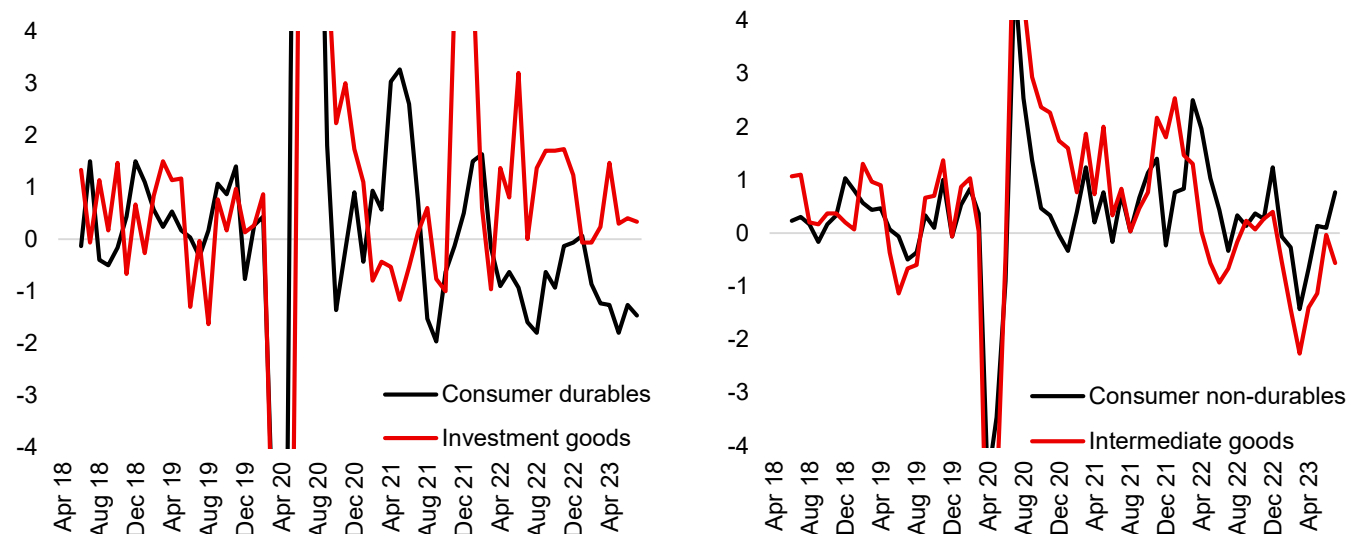
The improving ESI indicators on consumer attitudes towards greater spending are also important for Poland as the European workshop of durable goods. **This part of Polish industry could definitely use the support provided by a rebound in European demand, because so far the hard data look bad.** For example, in June, exports of durable goods fell by 10% y/y.

Output in this sector is not looking good. Admittedly, the cycles observed in recent years were quite short which suggests that durable goods sector should also soon experience a rebound. However, these previous short cycles were triggered by unusual situations. First the pandemic triggered an adjustment of home furnishings, then the post-pandemic opening up of trade encouraged the use of additional savings generated by lockdowns. Currently, there is no clearly seen event which could play a similar role. Still, generally rising consumer optimism and receding inflation should support private consumption.

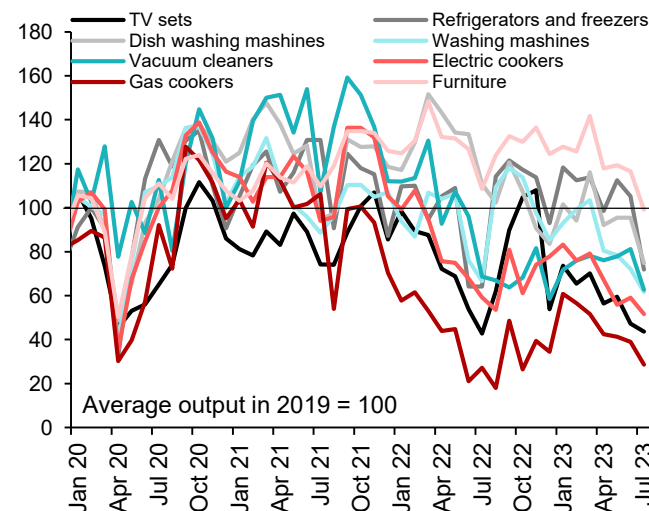
For the time being, most categories of durable goods are still well below pre-pandemic values in terms of production levels.

At the same time, the momentum in capital goods, which had been the strongest contributor to the sector's results in recent quarters, seems to be dying down. Signs of a boost to production have instead appeared in intermediate goods and non-durable consumer goods.

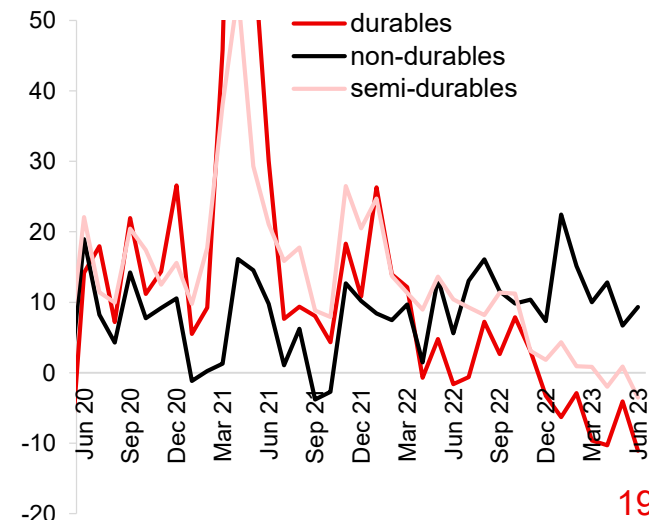
Production momentum by main commodity groups (3M average of m/m growth rates, s.a.)



Output of selected durable goods



Exports of goods in €, % y/y, selected categories



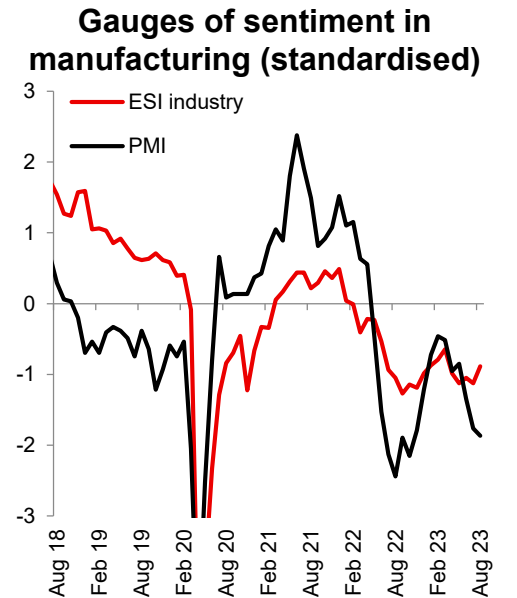
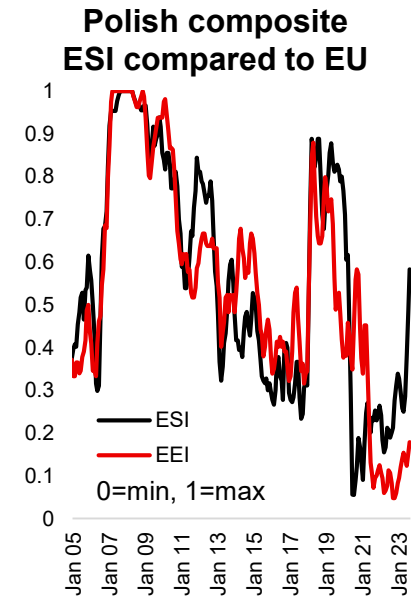
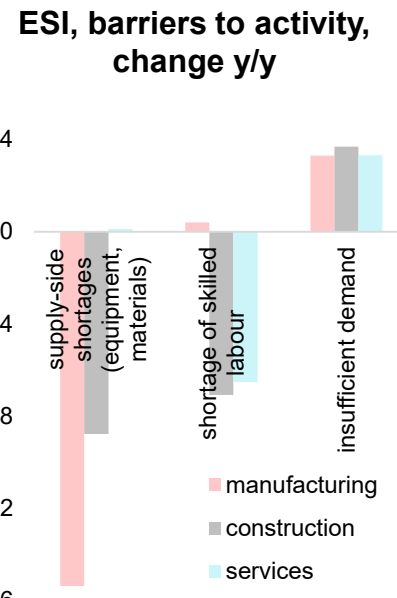
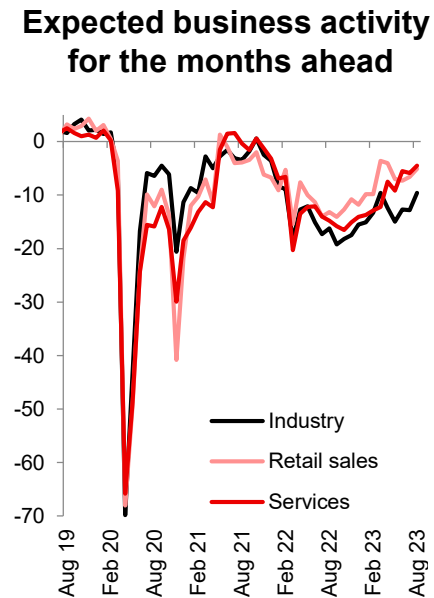
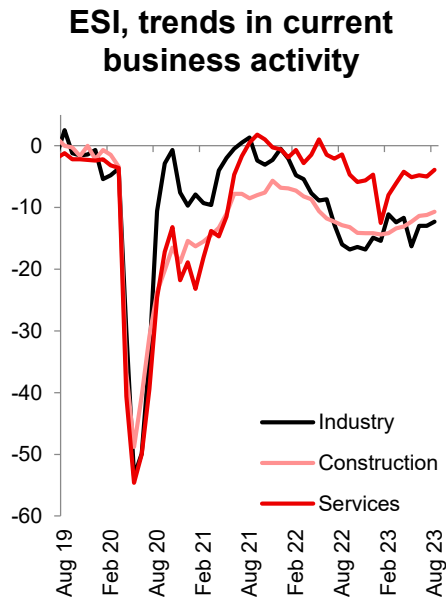


Producers' expectations suggest an improvement

Business indicators are already showing some improvement, though their signals are not obvious. So far, they are showing an upturn in some of their components, in particular in the scale of activity expected by manufacturers, despite the recent unintended accumulation of inventories by industrial companies (due to the weaker stream of orders). Based on these indicators, **we expect that 3Q will not bring yet a clear rebound, but 4Q is likely to do so.**

Although supply-side constraints to business growth are subsiding (availability of raw materials, materials and equipment) companies are signalling, albeit to a lesser extent, problems with demand (as a barrier to increased activity). As a result, current real data are not showing yet a clear rebound. Instead, it is evident that labour demand remains stable.

The recent slump in the industrial PMI does not necessarily mean that instead of a rebound we will see a deepening of the cyclical hole. This indicator is characterised by high volatility.



Source: EC, Bloomberg, Santander

ESI – Economic Sentiment Indicator
EEI – Employment Expectations Indicator



Corporate margins still high

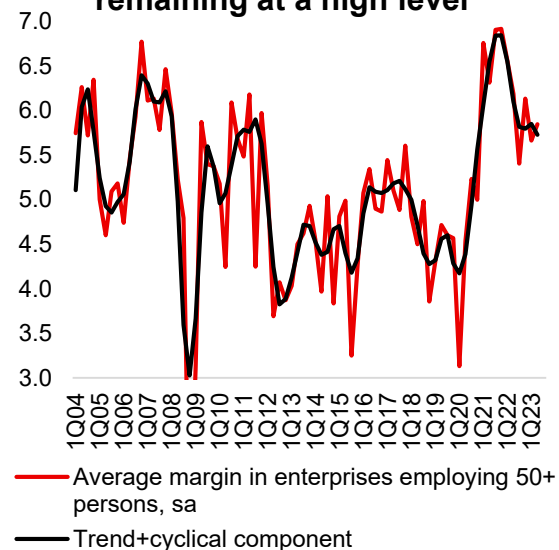
Demand couldn't have hit the wall if margins still remain high - in fact higher than in 2012-2019. On top of this, they have lost their downward momentum - after a marked downward adjustment in 1Q-3Q22, they have stabilised. In earlier reports, we considered that since companies were apparently pursuing a policy of protecting margins and there was no collapse in their financial performance, **the result would be a persistent inflation**. Core inflation is indeed showing a fairly slow decline.

We would also like to point out that the sharp deceleration and current sub-zero levels of PPI inflation do not mean that costs of Polish companies have started to fall. In fact, all major cost components are still showing double-digit growth. Some of them have already started to decelerate, but the downturn in cost dynamics does not mean that the situation of companies is improving, only that is deteriorating at a slower pace. This situation still encourages searching for savings - hence the incentive to invest in own energy sources and automation.

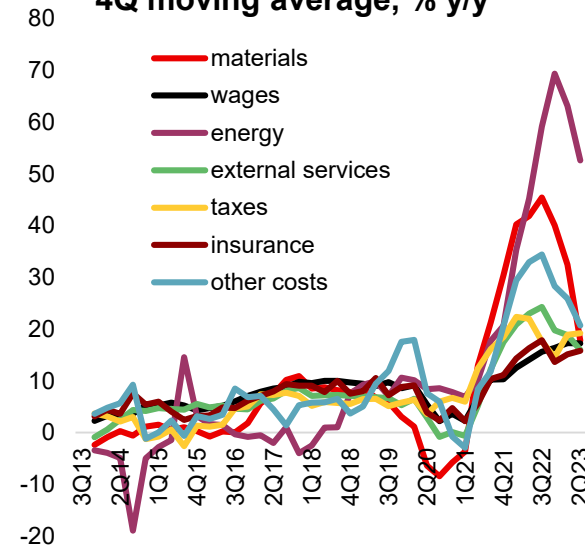
There is no sign of a downturn in the growth rates of such cost sources as the payroll fund, insurance or taxes (on average, together they make up about 24% of costs).

Firms from sectors not directly affected by global commodity prices were showing profit margins in 2Q still close to their peak levels from the last two years. If firms are able to protect margins, apparently they have conditions to do that and consumers, despite trimming expenditure, are still accepting price increases. It may be one of reasons why inflation remains sticky, which will become more apparent when the base effects, which have strongly battered CPI this year, expire.

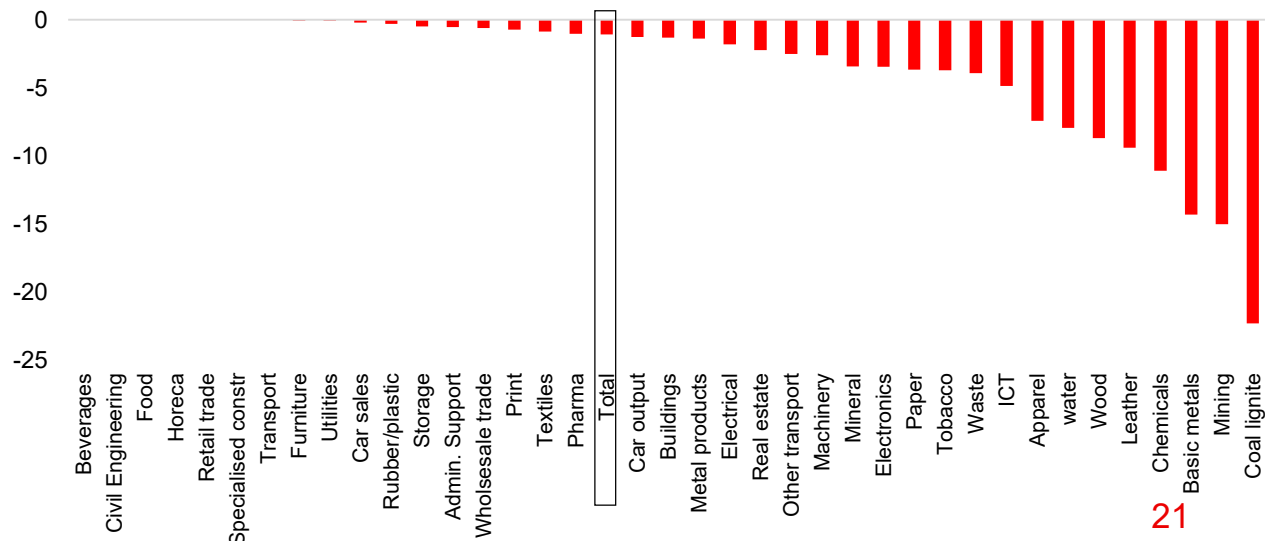
Margins stopped falling, remaining at a high level



Costs of enterprises employing 50+ persons, 4Q moving average, % y/y



Fall in average margins since the peak (maximum achieved between 1Q21 and 2Q23), pp





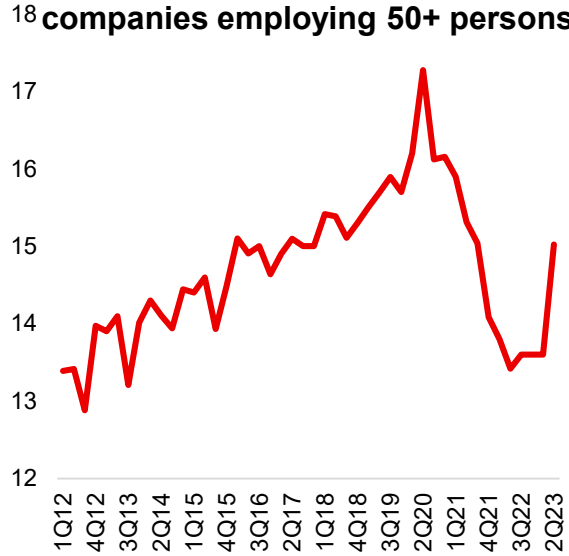
Employment stalled

The share of wage bill in company costs surged and in 2Q23 was already at 2017-2018 levels - it closed a half of the gap between the recent low and the high pre-pandemic level. This in turn means that it will be a growing problem for companies and may cause delays in hiring decisions. On the other hand, in sectors where economic activity is weakening, according to us, job hoarding is still applied. As a result, **employment growth may anchor around zero**.

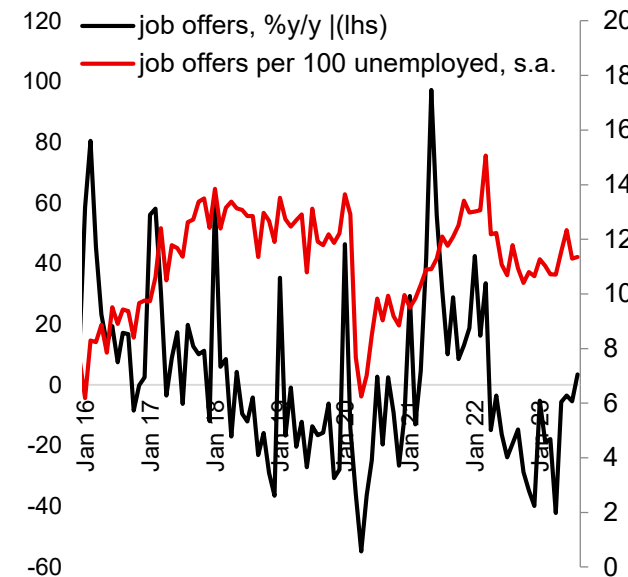
For now, we are seeing a rebound in job offers and the consumer sentiment survey does not show growing concerns about job stability - quite the contrary. Employment expectations indicators from the ESI survey are stable on the business sectors' side, but trending upwards on the consumer side.

According to corporate employment data, the pick-up in workers laid off in manufacturing by other sectors that we saw in 2H22 is no longer working in 2024. Corporate employment dropped 16.4k between January and July. However, this shows only a narrow slice of the labour market. The much broader National Accounts data show no employment fall but slower growth in 2Q than in 1Q.

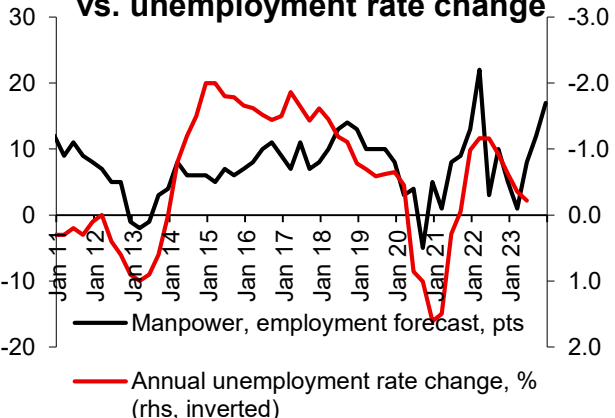
Share of wage bill in total cost of companies employing 50+ persons



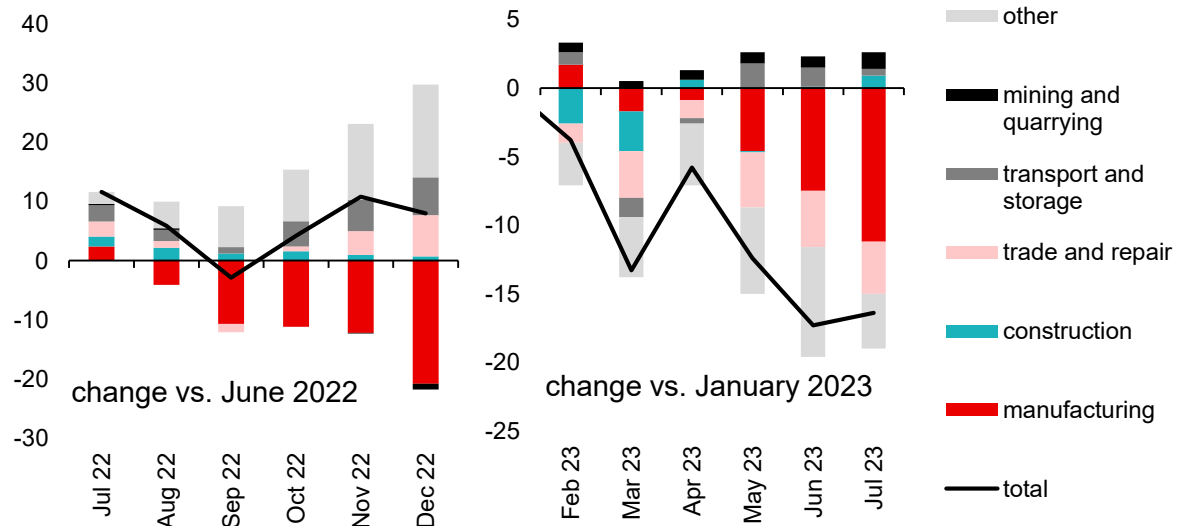
Job offers are no longer falling y/y



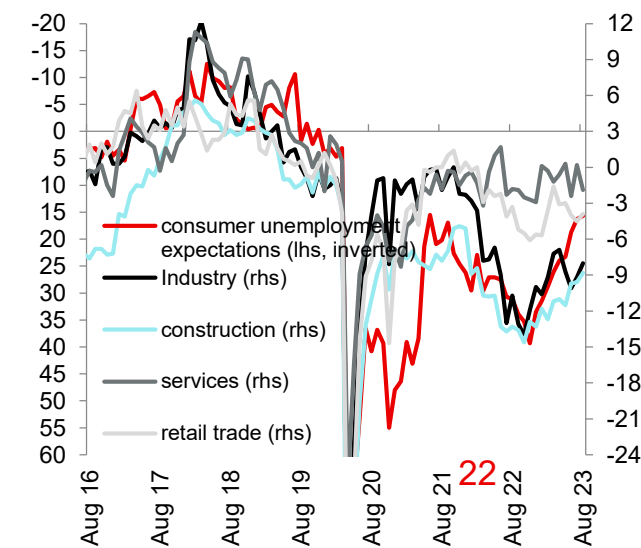
Manpower employment forecasts vs. unemployment rate change



Corporate employment change in 2H22 and 2023



Sectoral employment indicators





Wage growth to remain double-digit

In our view, the stable employment and elevated wage growth will persist. Inflation is still at a level that is difficult for households to tolerate and may keep encouraging wage pressures. In our view, **the balance of power in the labour market should support high wage growth** or at least its slower descent than in case of inflation. As a result, we should see significantly positive real wage growth in the following quarters (2H23 and in 2024).

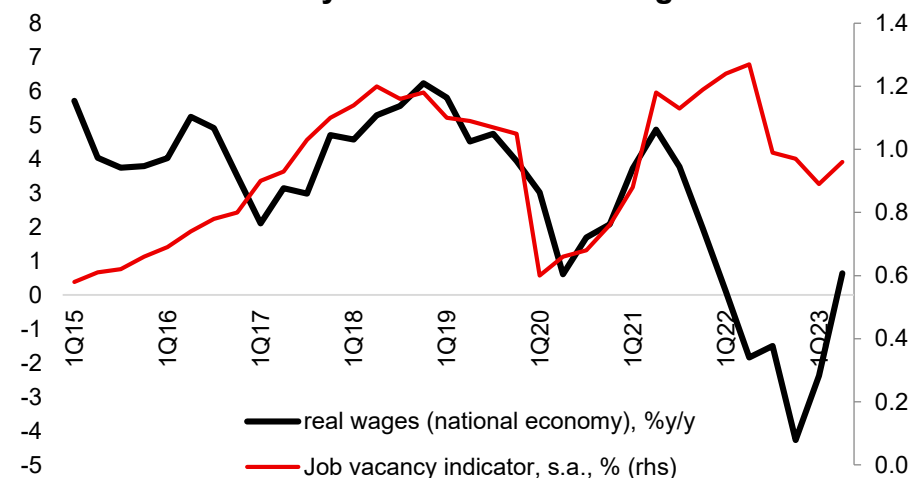
A more sustained rebound in real wages (based on the National Economy data, their growth rate turned positive only in 2Q) is indicated by the job vacancy rate published by GUS every quarter. Admittedly, it does not indicate as tight a labour market as in 2018-2019. (although unemployment is even lower now than it was then), but it is still high enough to suggest solid real wage increases.

According to LFS data, there was still a small increase in employment in 1H this year, but this was entirely based on re-activation of the economically inactive. The pool of the unemployed is at a record low (443k in 2Q23) - by comparison, in the previous phases of the early rebound in 2010 and 2014, companies could choose from 1.6-1.7mn unemployed. Hence, it is difficult for us to imagine that the expected recovery will not generate clear wage pressure.

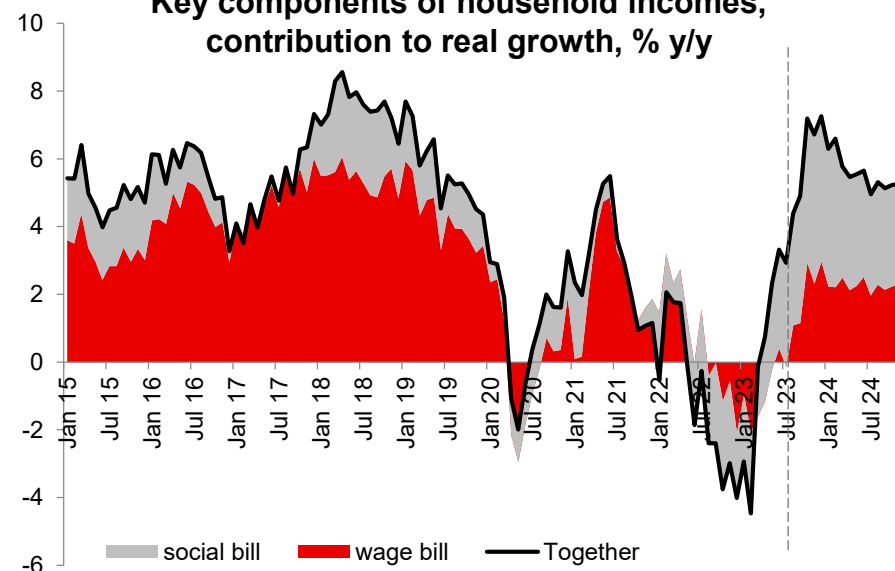
The inflow of foreigners continued, as seen in the Social Insurance (ZUS) data, with the annual increase in the number of those registered in ZUS continuing to decline: 73k in July (including 13k Ukrainians) vs. 108k in April (42k from UA), 186k in January (117k from UA). In our view, such an inflow will not reduce wage pressures, especially as, according to media reports, foreigners are increasingly choosing to move further west from Poland.

The prospect of stable employment and relatively high wage momentum add up to a favourable picture of household income. If we add to this social transfers (pensions), **it is hard not to assume a consumption rebound in 2024**. The real growth of such a measure of income, incomplete but including key components, will, in our view, already rebound before the end of 2023 to levels not seen since 2019.

Job vacancy indicator vs. real wages



Key components of household incomes, contribution to real growth, % y/y



Demand for loans goes up



Loan sales are improving and the market may soon see a boost thanks to the introduction of loans at 2% interest rates and the MPC's rate cut. The improvement in the loan market is consistent with our forecasts of a rebound in GDP growth.

The recovery in the loan market is increasingly visible. 12-month average sales of consumer loans reached PLN6.6bn in July, the highest since comparable data are available (2014). Mortgage sales amounted to PLN4.1bn in July, which is still clearly less than at the peak (around PLN8bn), but also significantly more than at the trough at the end of 2022 (around PLN2bn). On top of this, the introduction of the 2% loan caused the number of mortgage applications to shoot up. In July, applications worth PLN17.8bn were registered, compared to an average of PLN8.6bn in the previous three months. In our view, this strong influx of applications could show up in the credit data as early as August.

According to the Ministry of Development, by the end of August, 41.8k applications had been registered under the 2% loan programme and so far 5.7k contracts worth PLN2.16bn had been signed.

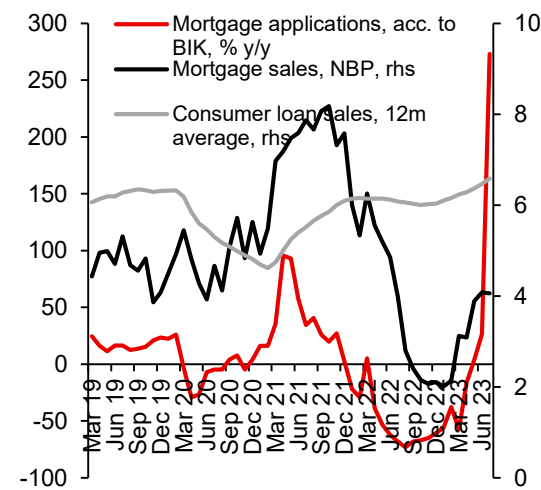
The strengthening of mortgage demand amid a low supply of new homes means that residential property prices will soon return to an upward trend.

Credit demand from businesses is slightly weaker. This is partly due to the high base effect, as companies needed increased financing in 2022 due to the strong increase in commodity prices. Still, corporate loan sales are currently above average.

We maintain our forecast that the year could close with a few percent growth in total loan volume. Deposit growth, on the other hand, should remain in the vicinity of 10% in the coming quarters, due to a positive current account balance and expansionary fiscal policy.

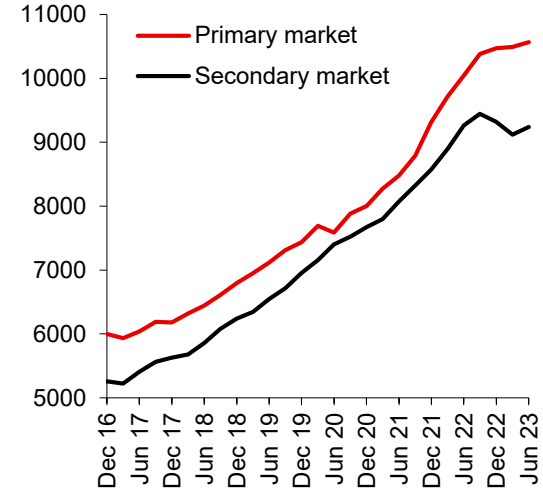
Our estimate of the credit impulse (monthly change in annual loan growth) suggests an improvement in the annual GDP, which is consistent with our economic growth forecasts.

Sales of mortgages, PLNbn



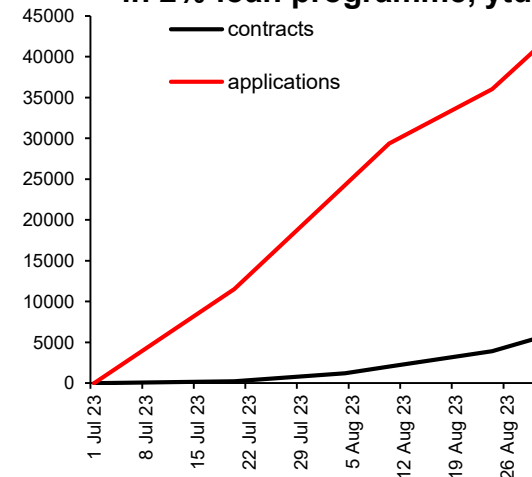
Source: NBP, BIK, Santander

Housing prices in 17 biggest cities, PLN/m2



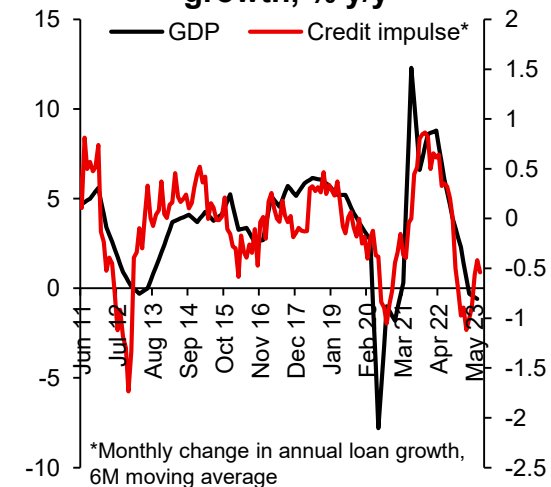
Source: NBP, Santander

Applications and contracts in 2%-loan programme, ytd



Source: GUS, NBP, Santander

Real GDP growth vs loan growth, % y/y



*Monthly change in annual loan growth, 6M moving average



Inflation: downward trend to pause in 2024

Compared to our previous MACROscope in July, we have slightly lowered our CPI inflation forecasts for 2023 - our view is that CPI will end the year slightly below 7%. The revision is mainly due to the lower run of food prices in the last two months.

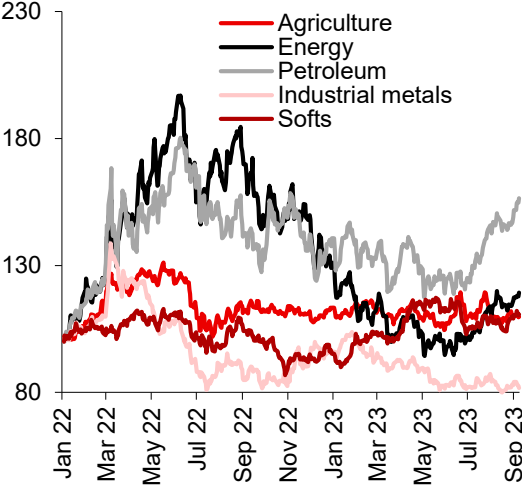
But the disinflation trend is likely to stop in 2024. CPI may even rebound slightly, first in January (expiration of anti-inflation shield) and then in the second half of the year (low base, recovery of the economy). Core inflation will stabilise at around 5%.

In the previous MACROscope, we listed factors that may stimulate inflation in 2024 (recovery of the domestic demand, solid wage growth, fiscal policy, indexation of benefits, weaker policy transmission mechanism) and curb it (global disinflation, drop in commodity prices, stronger zloty). In our view, this balance has recently shifted towards higher inflation: the public finance deficit in 2024 will be higher than we assumed, monetary policy softer, commodity prices higher. In particular, the decision to cut rates by 75bp and the weakening of the zloty will push up inflation by around 0.5pp. Upward pressure on prices could turn out to be lower in the event of a marked deterioration in the economic outlook, but this is not our baseline scenario.

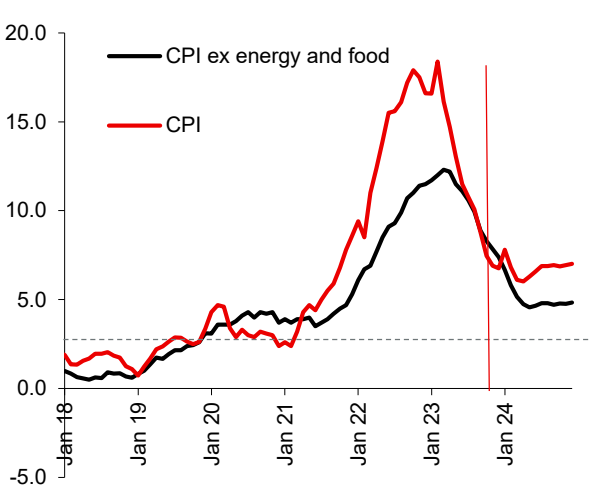
Important assumption beyond our CPI forecasts is the unfreezing of electricity prices (+2 percentage points) and the reversal of the VAT reduction on food (+1 percentage point).

In the final months of 2023, we expect CPI inflation to fall further, to just below 7% in December. In our view, the increase in the cap on electricity consumption will subtract from electricity prices in CPI approx. 2.5% m/m (approx. 0.1% mm/ from CPI). In contrast, the so-called "retroactive reduction in energy prices" will not affect CPI in our view, as it is a de facto one-off benefit.

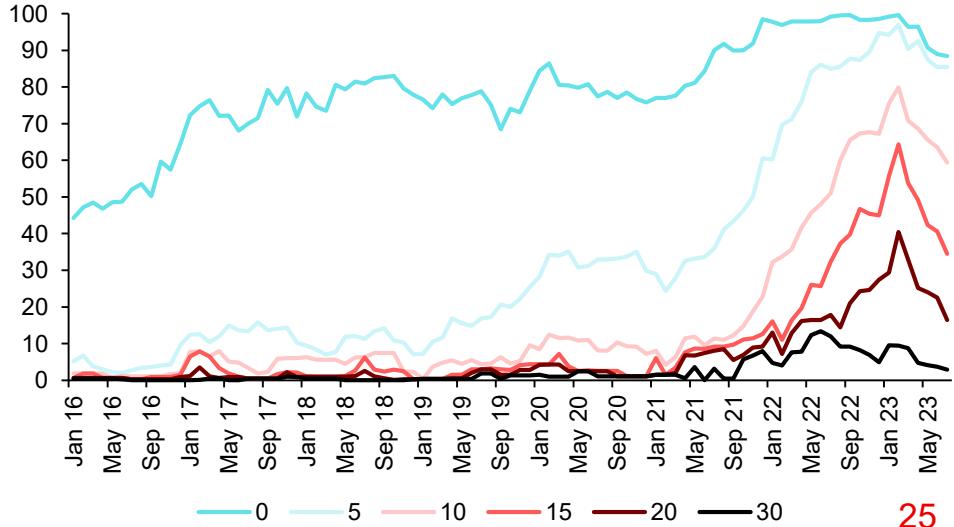
Bloomberg commodity price indices, 03/01/2022=100



CPI and core inflation, % y/y, our forecast



Share of CPI basket rising faster than x% y/y



Source: Bloomberg, Santander



Inflation: drought with less impact than feared

We expect food price growth to continue slowing in the coming months. At the end of the year, we expect an increase of around 6% y/y, with the effects of the drought adding about 0.5 percentage points to the price increase.

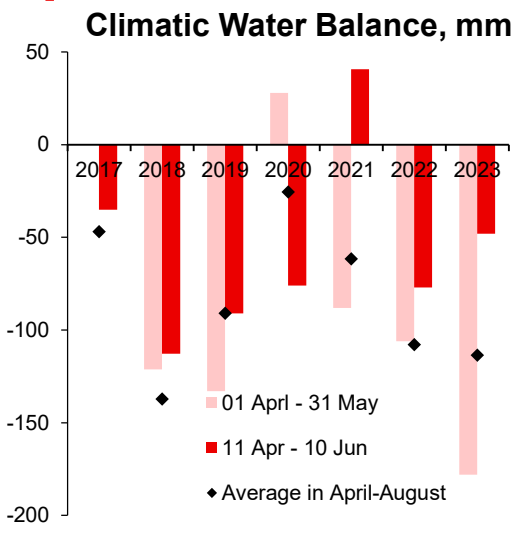
The strength of the agricultural drought has eased in recent weeks. Nevertheless, the average value of the climatic water balance this summer was clearly lower than in previous years, which undermined crops.

However, the losses were lower than we had feared. According to the GUS preliminary estimate of the main agricultural and horticultural crops, the harvest of cereals fell by 4% y/y, ground vegetables by 3% y/y, tree fruit by 9% y/y and fruit from bushes and berry plantations by 1%. A significant impact of the drought is therefore only apparent for fruit.

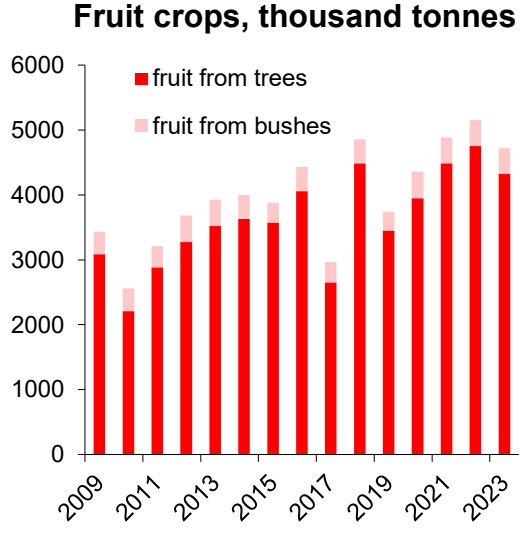
We therefore assume that fruit prices will increase between August and December by around 4% (against an average of -2.3% in 2016-2021) and vegetable prices by around 13% (against an average of 12.2% in 2016-2021). The drought effect will therefore add around 0.4 percentage points to food prices in December and around 0.1 percentage points to overall inflation.

For other food items, we expect a normalisation or even a run below the seasonal pattern (dairy products, vegetable oils), due to global oversupply.

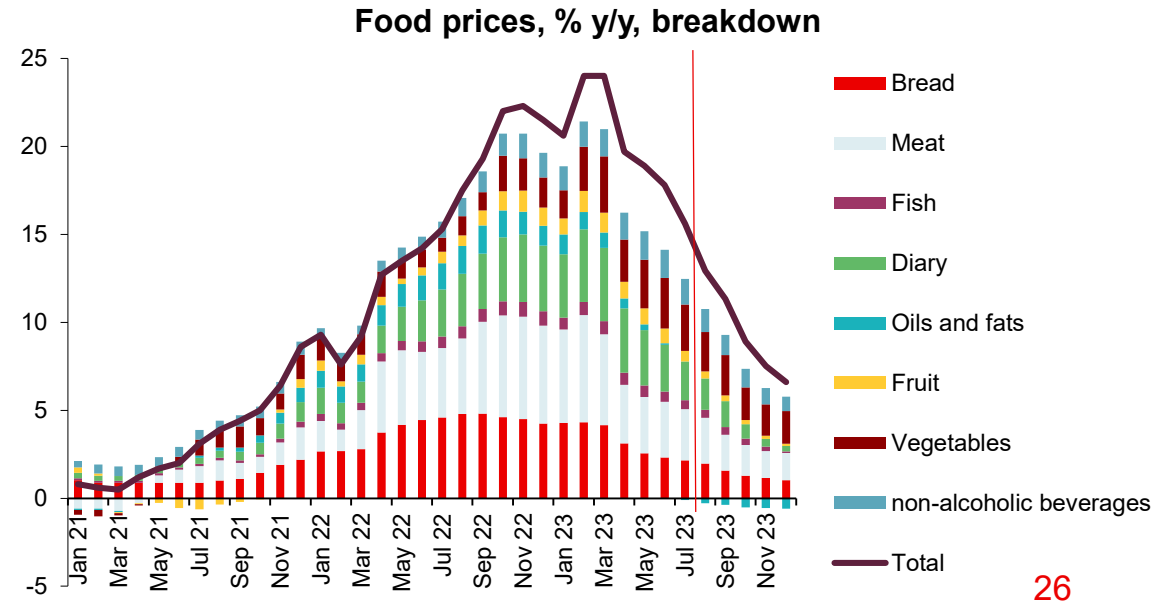
At the end of the year, we expect food dynamics of around 6.0% y/y.



Source: IUNG-PIB, Santander



Source: GUS, Santander



Source: Bloomberg, Santander

Disinflation in Poland slower than in the CEE region

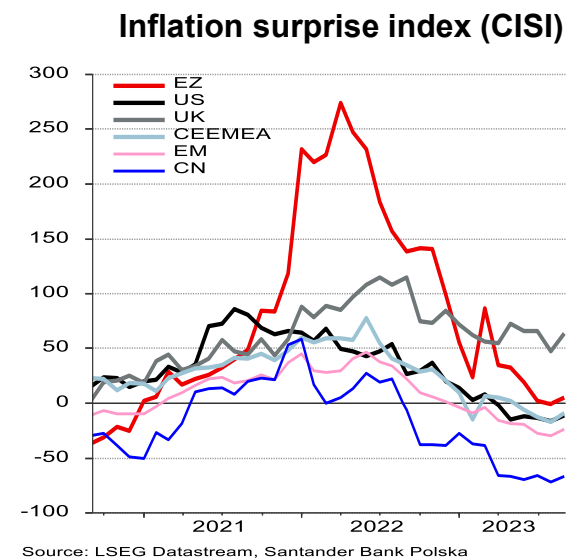
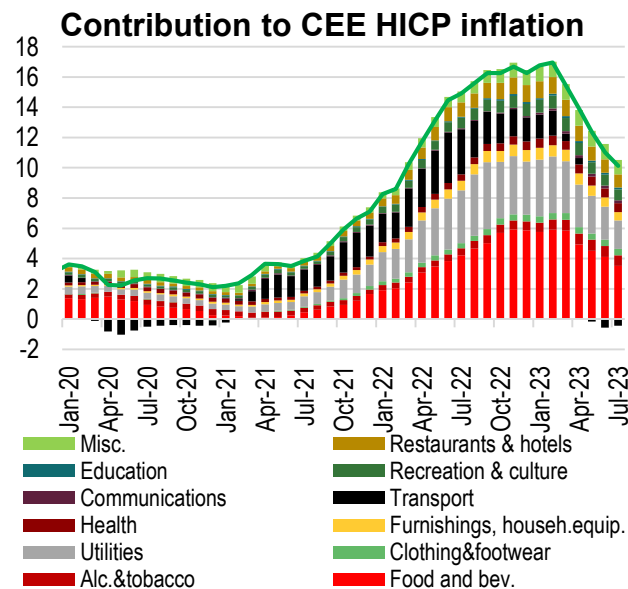
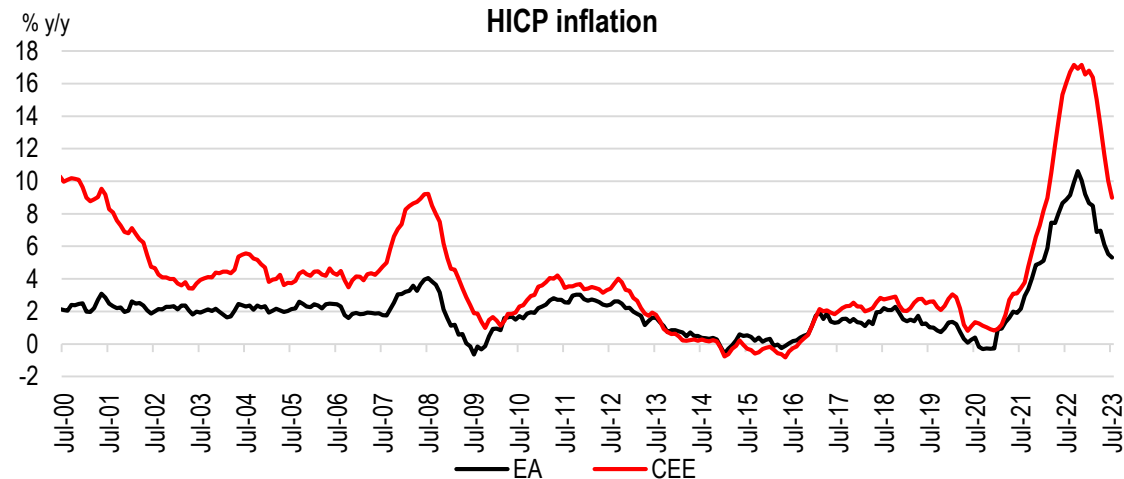


Inflation is set to decline in following years though return to target may take some time and CPI path will diverge by countries

Bloomberg median forecast (our forecast in brackets)

CPI % y/y			
	2023F	2024F	2025F
PL	12.0 (11.7)	6.0 (7.0)	4.0 (4.4)
CZ	10.9	2.5	2.1
HU	17.9	5.1	3.4
RO	10.5	5.5	4.0
BG	9.7	4.0	3.0
SK	11.2	5.1	3.5
SI	7.0	3.2	2.5
CR	7.8	3.6	2.7
EE	9.8	3.5	
LA	9.0	2.5	
LT	9.4	1.9	
DE	6.1	2.8	2.1
EA	5.5	2.5	2.1
US	4.1	2.6	2.3
World	6.0	2.7	3.7

Inflation passed the peak and started to decline driven by energy and food but also with easing momentum in core prices



Source: LSEG Datastream, Santander Bank Polska

Monetary policy: a major swing



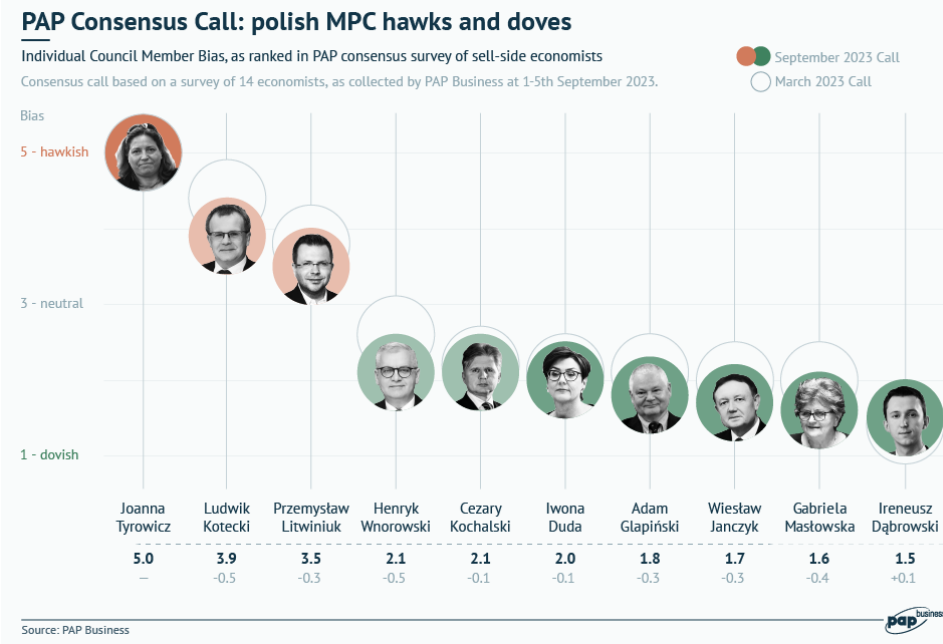
The surprisingly strong interest rate cut in September (by 75bp, to 6.0%) and the tone of the NBP president's conference mean, in our view, that further policy easing is to be expected in the coming months. We anticipate two more cuts of 25bp each: in October and November, to 5.50%, followed by a pause until at least mid-2024.

According to A.Głapiński, the MPC was prompted to act by the worsening economic outlook and falling inflation - the MPC wanted to prevent real interest rates from turning positive, to avoid undermining the demand. The September rate cut was described by the NBP president as 'overdue' rather than 'pre-emptive'. Inflation, in his view, went down to single-digit level in the first days of September, fulfilling the condition set in July for rate cuts, thus no longer being 'high' but 'moderate', and by the end of the year will be approaching 6%, i.e. 'creeping' inflation, which Głapiński believes is imperceptible to the public. The NBP president admitted that moderate inflation could prove to be 'stubborn', but 'this is something different'.

The change in the NBP's approach to the exchange rate is noteworthy: after the leaping weakening of the zloty in response to the rate cut, the NBP president declared that Poland, unlike the Czech Republic and Hungary, does not need to influence the exchange rate and that if the weakening of the zloty continues then the MPC will not worry.

Overall, we see a major swing in the MPC's modus operandi after the summer holidays, suggesting that a further decline in CPI (which is very likely by the end of this year) could trigger further rate cuts. At the same time, exchange rate weakness may not be as significant an impediment to action as we had thought.

Such monetary loosening, premature and excessive in our view, will worsen the inflation outlook, but will support the economic recovery, which should be reflected in the next inflation projections. However, the next NBP projection in November may not be so much worse than the previous one, and thus will not deliver arguments to abandon the easing cycle, especially as the projection horizon is likely to be extended to 2026, which will allow to show CPI converging towards the target at the very end of this period. **We believe that interest rate cuts will be halted at the end of this year, as the disinflation trend is likely to stop in 2024.** CPI may even rebound slightly, first in January (expiry of anti-inflationary shields, higher fuel prices and weaker zloty) and then in mid-year (low base, economic recovery, fiscal expansion).





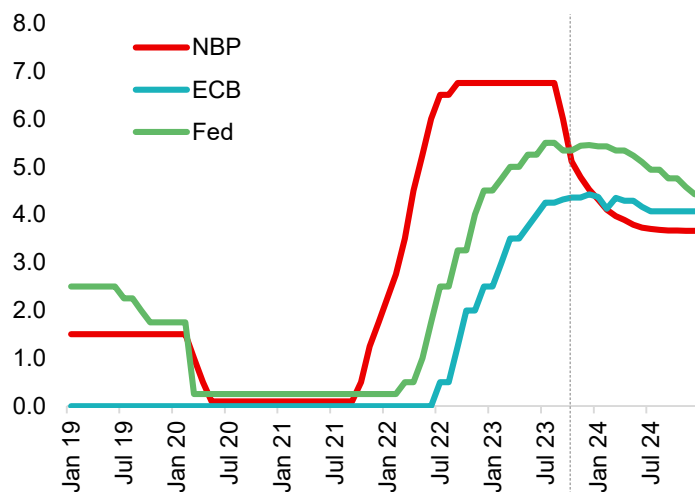
Monetary policy: overshoot market expectations

The financial market has reacted to the MPC's surprisingly abrupt turn in monetary policy by pricing-in an even larger scale of rate cuts in the future: FRA and IRS contracts are now pricing in a drop in the NBP rate by more than 200bp over a one-year horizon, in effect assuming that it will fall below the Fed and ECB main rates in 2024. In our view, this is an unlikely scenario, but such expectations could persist for another month or two, given that inflation is likely to go down further and the MPC is likely to cut rates. The turning point could be the end of the cycle with an upward rebound in CPI in early 2024.

As a reminder: according to recently published NBP research on the monetary policy transmission mechanism, **a 100bp drop in interest rates can raise inflation by around 0.3pp in the second year of their impact and accelerate GDP growth by 0.3pp in the first year after the policy change.**

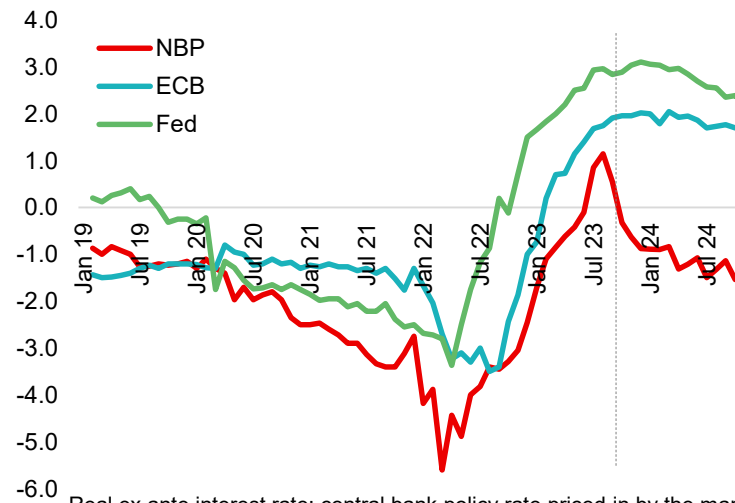
The same research suggests that in a high-inflation environment, **a 10% weakening of the exchange rate can raise inflation by up to 2pp**, with the strength of the exchange rate pass-through declining markedly with the level of inflation.

Main central bank interest rates based on market pricing as of 13/09/2023, %



Source: Bloomberg, Santander

Real ex-ante central bank interest rates, based on market pricing and CPI forecasts, %



Real ex ante interest rate: central bank policy rate priced-in by the market minus median CPI forecast % y/y one year ahead acc. to Bloomberg

Source: Bloomberg, Santander

Monetary policy: additional easing

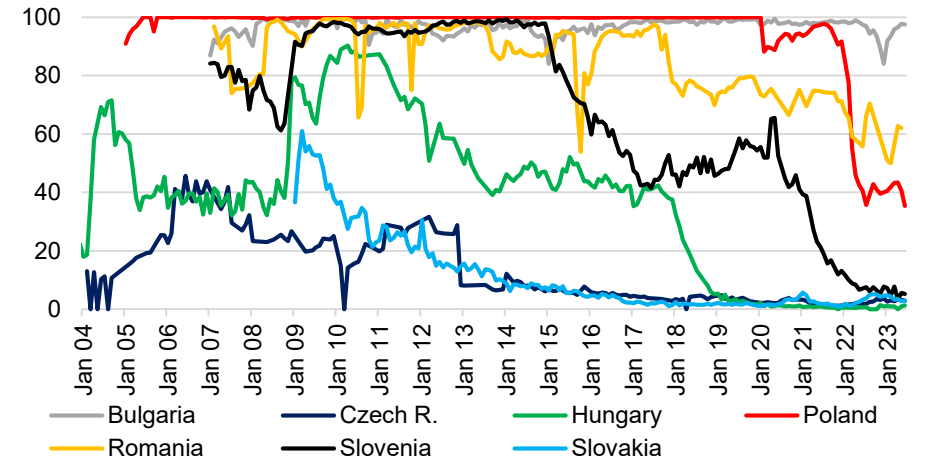


In the last six quarters, the proportion of new mortgage loans based on a fixed rate has risen sharply: from close to zero to around two-thirds of new loan origination.

This fact, plus the bold anticipation of rate cuts by the financial market (implying strong IRS declines) meant that **there was effectively a significant easing of credit conditions in the housing loans segment, even before the MPC started cutting interest rates.** This effect was further reinforced after the aggressive NBP interest rate cut in September.

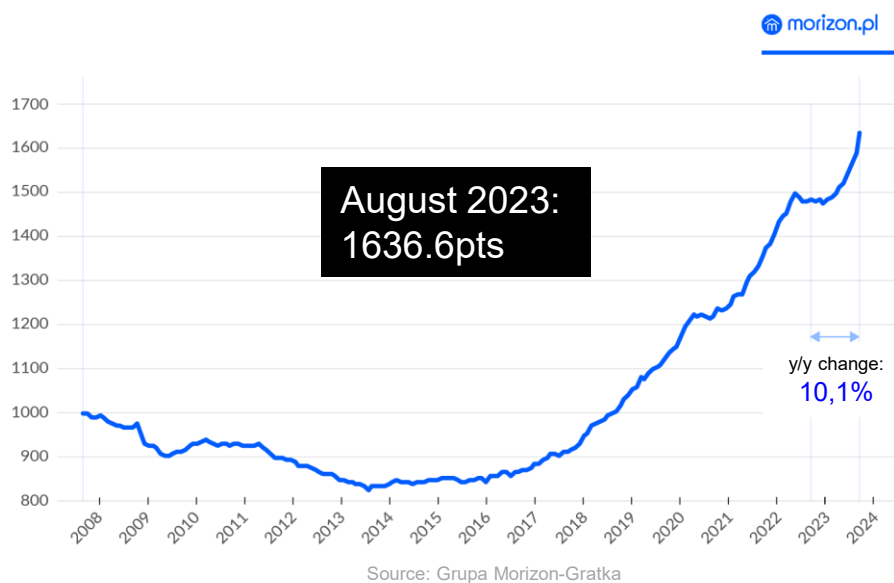
This factor, combined with the launch of the government's 2% loan programme, has contributed to the recent rebound in house prices.

Share of variable-rate loans in newly granted housing loans, %



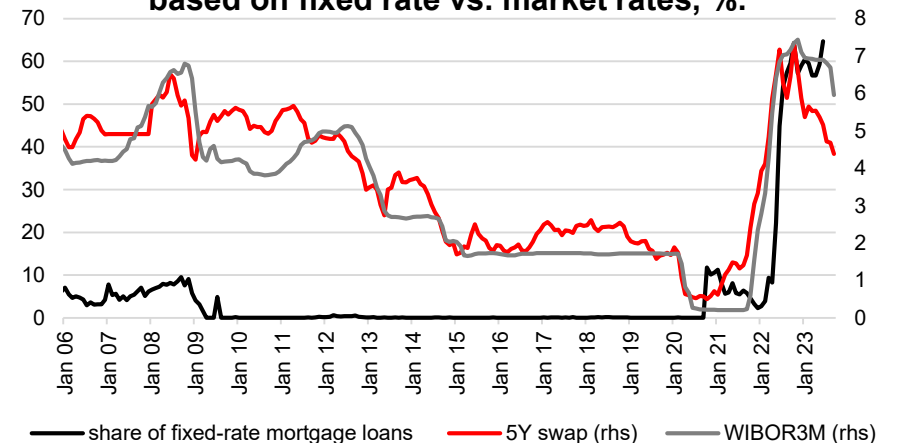
Source: EBC, Eurostat, Santander

Price index of flats and apartments



Source: Grupa Morizon-Gratka

Share of new mortgage loans in Poland based on fixed rate vs. market rates, %



Source: Eurostat, Bloomberg, Santander



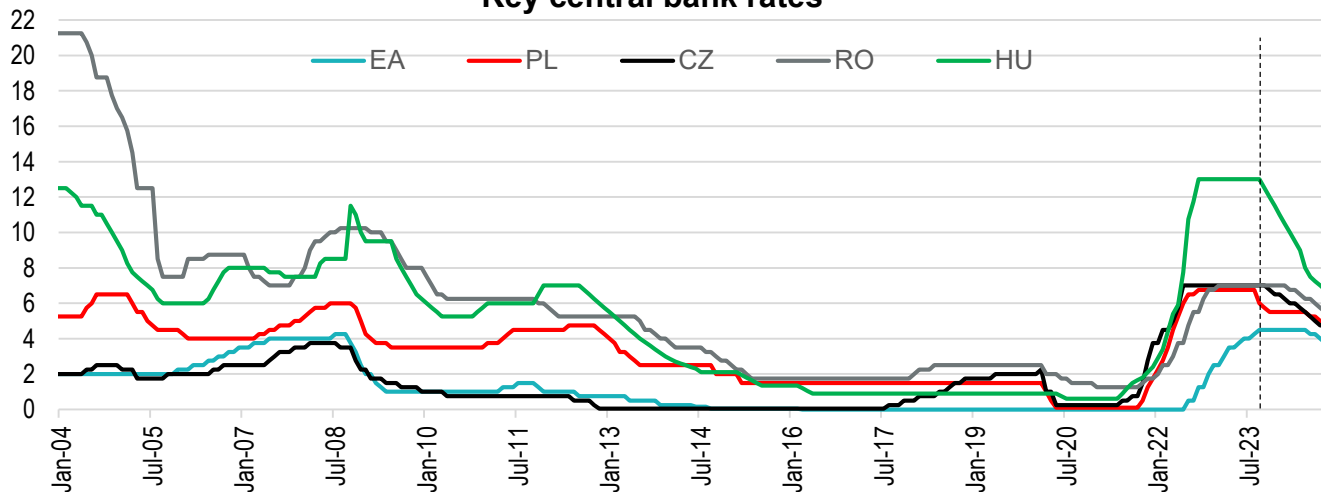
Monetary policy easing in other CEE will come later

While other central banks probably have more reasons to cut rates faster, they sound less dovish than the NBP, but will also gradually ease monetary policy this year or early next year in the face of rapidly falling inflation and weak demand. The MNB is likely to cut short-term rates again in September, with reductions in the main rate more dependent on forint volatility. While the CNB's approval of a weak koruna may have increased, a significant weakening may potentially delay the first cuts of the main rate.

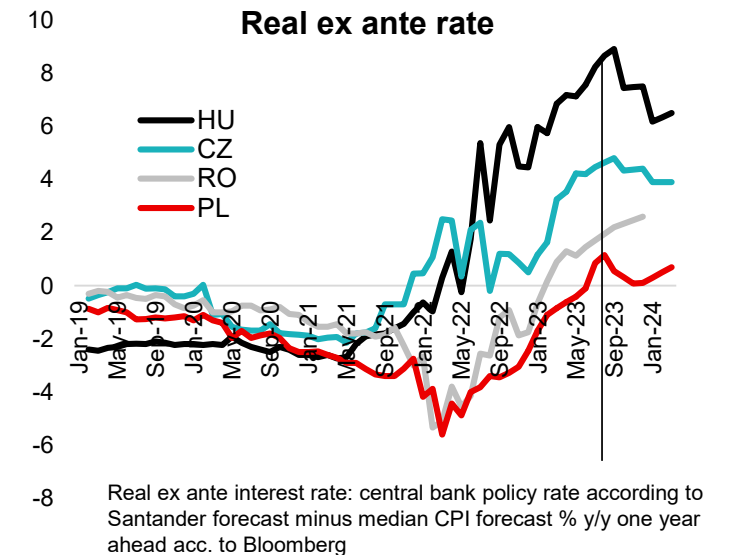
Main central bank rates
(Santander forecast for CE3 and euro area, median BBG forecast for Romania)

	2Q23	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	4Q25F
EA	4.00	4.50	4.50	4.50	4.50	4.00	3.50	3.00
PL	6.75	6.00	5.50	5.50	5.50	5.00	4.50	3.50
CZ	7.00	7.00	6.50	6.00	5.50	4.75	4.25	3.00
RO	7.00	7.00	7.00	6.75	6.25	5.75	5.25	5.00
HU	13.00	13.00	11.50	10.00	8.00	7.00	6.50	5.00

Key central bank rates



Real ex ante rate



Real ex ante interest rate: central bank policy rate according to Santander forecast minus median CPI forecast % y/y one year ahead acc. to Bloomberg



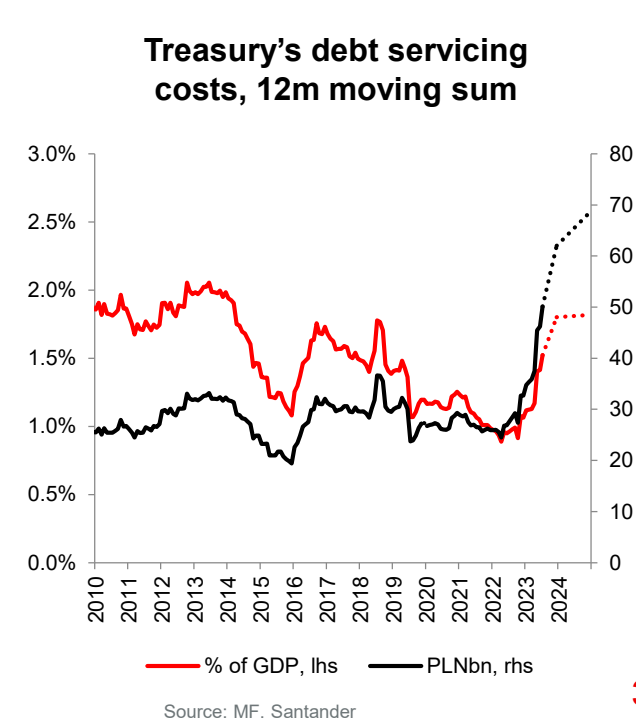
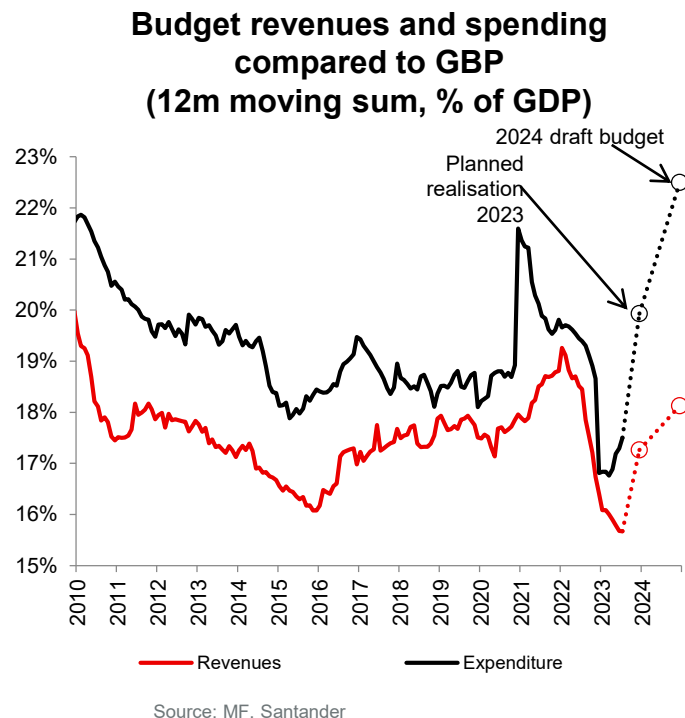
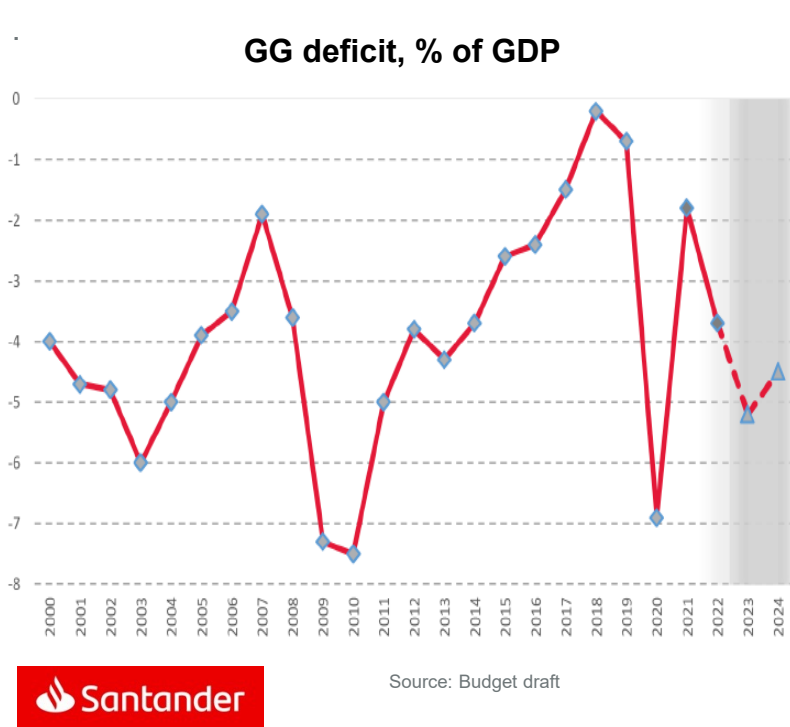
2024 budget: another year with high deficit

The government has adopted a draft budget for 2024 with a budget deficit of PLN164.8bn and the general government (GG) deficit of 4.5% of GDP (around PLN170bn). In 2023, the government expects a GG deficit of around 5.2% of GDP, which is close to our forecast. Compared to our last [MACROscope in July](#), an increase in the 14th pension from PLN1588.44 to PLN2650 (a net cost of around PLN7bn) should be added to the expenditure.

The macroeconomic assumptions seem realistic, but not prudent - in the sense that they do not, in our view, create a safety cushion for revenues. At the same time (and this is new), the forecast for 2024 assumes that expenditure will be realised below the limits and thus 1.1% of GDP has been deducted from expenditure based on this assumption. This means that also on the expenditure side, the safety margin is smaller. As a result, we see a greater risk than in previous years that the budget implementation in 2024 could be worse than planned.

The draft budget implies another year of expansionary fiscal policy with very high spending growth, which should be conducive to a recovery in domestic demand, but at the same time hinder further effective disinflation.

We wrote more about the draft budget for 2024 in [Economic Comment](#).





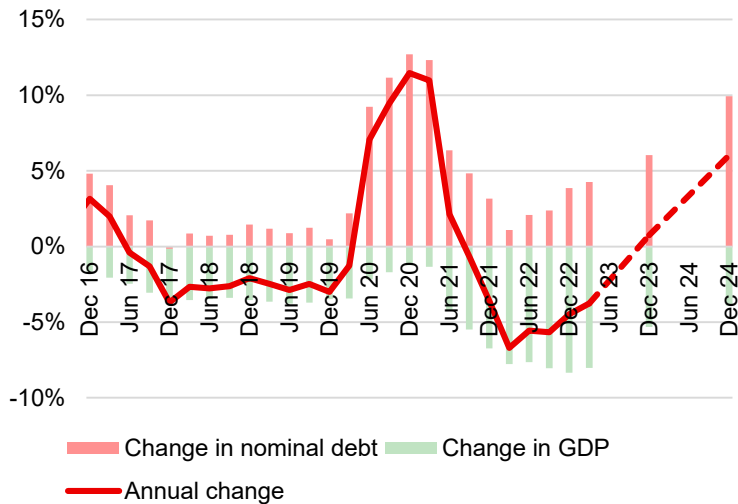
2024 budget: strong rise in debt

General government (GG) debt is expected to rise to 54% of GDP in 2024 from the 49.3% of GDP projected in 2023.

Sovereign public debt by national definition (PDP) and central government debt are expected to increase by around PLN270bn while GG debt by around PLN340 bn - the difference is probably mainly due to an increase in the debt of the Armed Forces Support Fund (FWSZ) related to the financing of the military equipment, which according to the draft budget will exceed PLN80bn. The financing plan for the FWSZ has been kept secret, but according to media reports, its expenditure will be financed mainly by trade credits: the media reported, among other things, a plan for a credit line from South Korea.

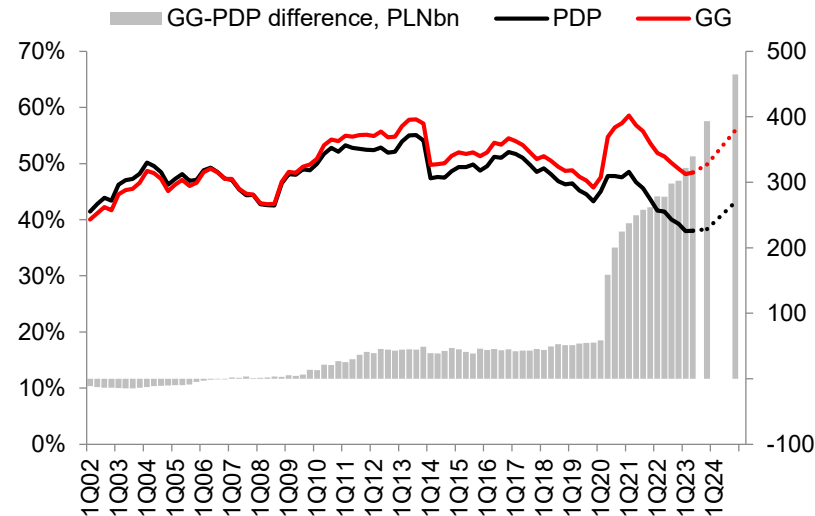
The increase in the GG debt (around PLN340bn) nominally about twice as big as the GG deficit (PLN170bn) results, among other things, from the fact that the deficit is calculated on an accrual basis and not on a cash basis, e.g. it takes into account only actual deliveries of military expenditure (according to the draft, around PLN32bn out of PLN81bn), and also does not take into account the European funds deficit (PLN33bn).

Breakdown of annual change in GG debt (% of GDP)



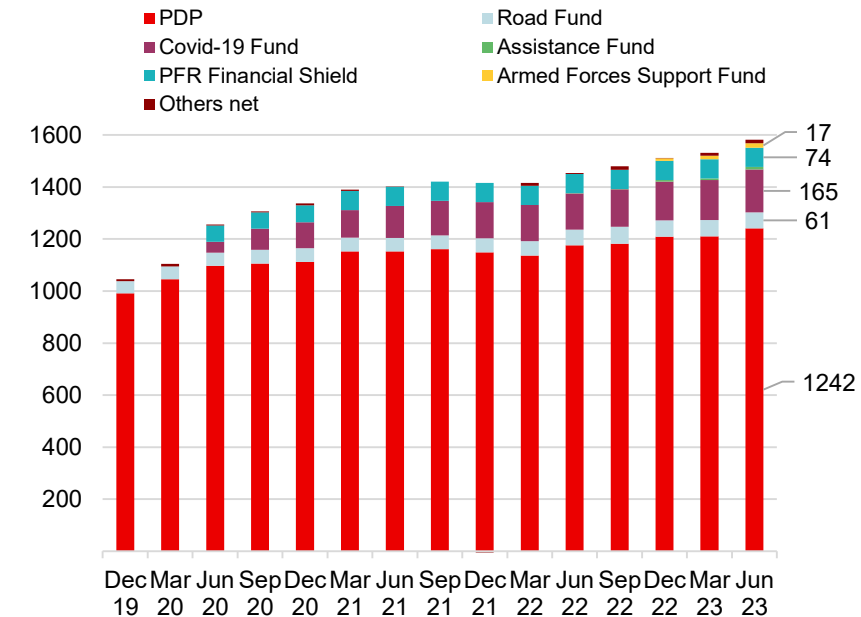
Source: MF, Santander

State debt in domestic definition (PDP) and general government (GG), as % of GDP



Source: MF, Santander

Difference between GG and PDP, PLNbn



Source: MF, Santander



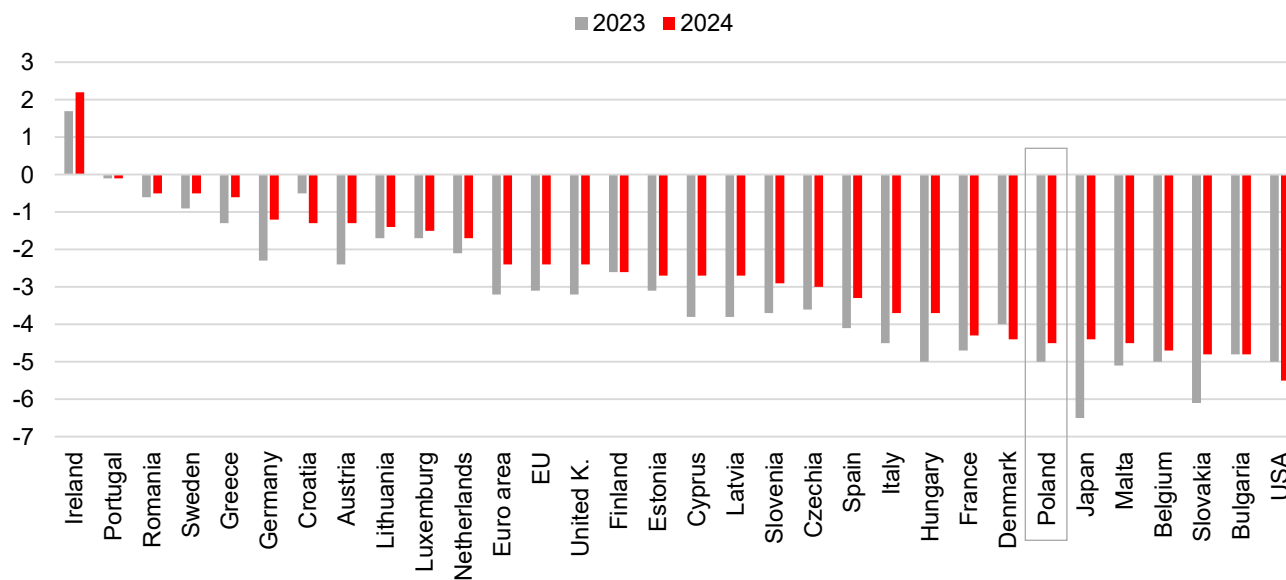
2024 budget: Poland vs. EU

In 2024, the EU fiscal rules, suspended for several years as a result of the pandemic, will be in force again. These rules indicate that the public finance deficit should not exceed 3% of GDP and debt 60% of GDP.

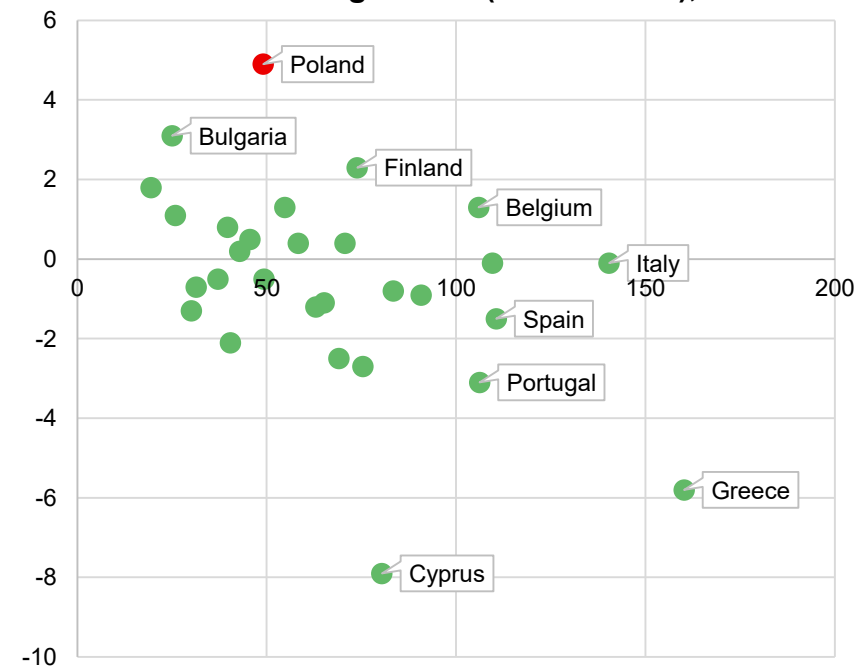
The government's planned fiscal deficit will be one of the largest in the EU and clearly above the 3% threshold, which means that Poland risks being subject to the Excessive Deficit Procedure (EDP). The EC will expect a reduction in fiscal imbalances of at least 0.5% of GDP per year (in structural deficit terms) and the Polish draft budget theoretically meets this requirement (inter alia, through a discretionary expenditure adjustment of 1.1% of GDP).

The level of debt is and will remain clearly below the EU average (around 83% of GDP), although Poland clearly stands out from other countries by the scale of the debt increase in 2024.

GG deficit 2023-24: Poland according to draft budget, other countries according to spring EC forecasts, % of GDP



GG debt 2023 (horizontal axis) vs GG debt change 23-34 (vertical axis), % of GDP



Poland acc. to draft budget, other countries acc. to spring EC forecasts

Source: MF, KE, Santander

2023 Elections: opinion polls



Parliamentary elections will be held on 15 October 2023.

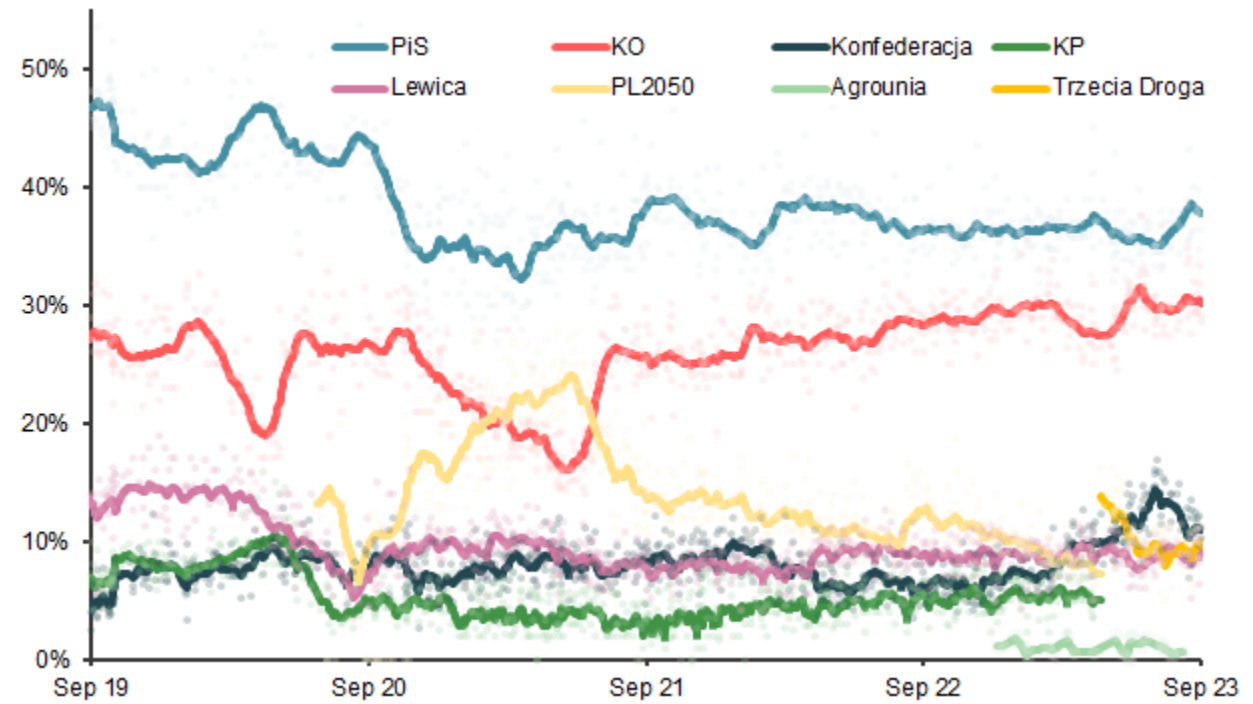
Averaged poll results show that after a moderate decline in support for the ruling party over the summer, there has been an increase in its ratings. PiS still enjoys the highest support among the society, around 38%.

Such support offers a rather slim chance of once again gaining the number of seats in the Sejm guaranteeing an independent majority (>230). However, these chances could increase if any of the opposition parties fail to cross the electoral threshold and do not enter the parliament. The electoral threshold for individual parties is 5%, for coalitions (Trzecia Droga) it is 8%.

For the opposition parties, support trends have fluctuated a lot in recent weeks and there are still four weeks to go, so everything is possible. **At this stage any prediction of the election outcome is, in our view, subject to great uncertainty.**

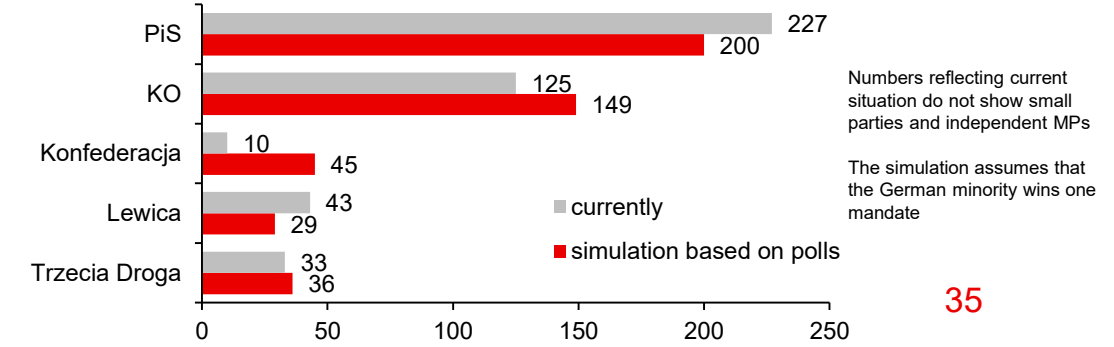
According to our estimates, an election result in line with the current trend in polls published by Politico (based on polls up to 9 September) would give PiS victory and 200 seats in the Sejm, while the KO would win 149 seats, Konfederacja 45, Lewica 29 and Trzecia Droga 36. We emphasise that this is not our prediction of the election result, but only an estimate of the number of seats on the basis of current averaged polls – the latter will be still subject to changes over the next two months.

Election preferences of Poles according to polls until 9 September (trend based on Kalman filter):



Source: Politico.eu

Simulation of seats in the Sejm based on poll trend shown by Politico, as of 9/09/2023



Source: sejm.gov.pl, Politico.eu, Santander





2023 Elections: what next?

The table presents a calendar framework for further events in the electoral process and the procedure for forming a government after the elections.

The indicated "no later than" dates represent the maximum deadlines for the individual stages as stipulated by the Polish Constitution. The actual decisions at each stage may be made more quickly.

Establishment of the new government after the elections in the optimistic scenario may last until the turn of November/ December, and in the pessimistic until late January.

Should the balance of power in parliament make it impossible to pass a vote of confidence in the new government, the next early elections may take place in early March 2024 at the latest.

In the event of snap elections, 1H2024 will witness three separate election campaigns: parliamentary, municipal and to the European Parliament.

Elections to Sejm and Senate	15/10/2023
Further steps in election procedure stemming from the Constitution:	No later than:
First Sejm meeting (max +30 days)	14/11/2023
Appointment of the Prime Minister and the government by the President (max +14 days)	28/11/2023
Prime Minister's Exposition, vote of confidence for government (max +14 days) [approved by an absolute majority in the presence of at least half the statutory number of Members]	12/12/2023
<i>If the government does not receive a vote of confidence:</i>	
1st reserve procedure: election of the Prime Minister and the government by the Sejm (max +14 days) [approved by an absolute majority in the presence of at least half the statutory number of Members]	26/12/2023
<i>If the government does not receive a vote of confidence:</i>	
2 nd reserve procedure: the President appoints the Prime Minister and the government (max +14 days)	09/01/2024
Prime Minister's Exposition, vote of confidence in government (max +14 days) [by a majority of votes in the presence of at least half the statutory number of Members]	23/01/2024
<i>If the government does not receive a vote of confidence, then:</i>	
Early elections (max +45 days)	08/03/2024
Important political events ahead:	Data:
Municipal elections	7, 14 or 24 April 2024
European Parliament Elections	9 June 2024
Presidential elections	2H25

Source: Santander

Financial markets

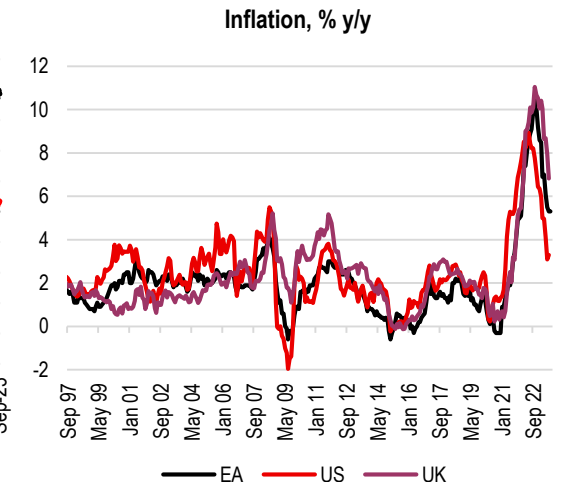
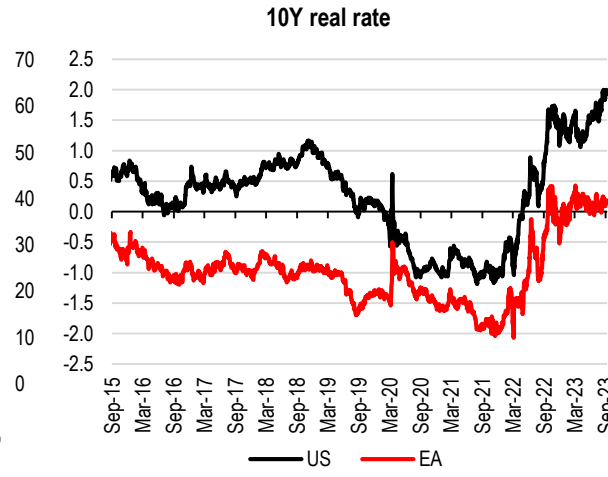
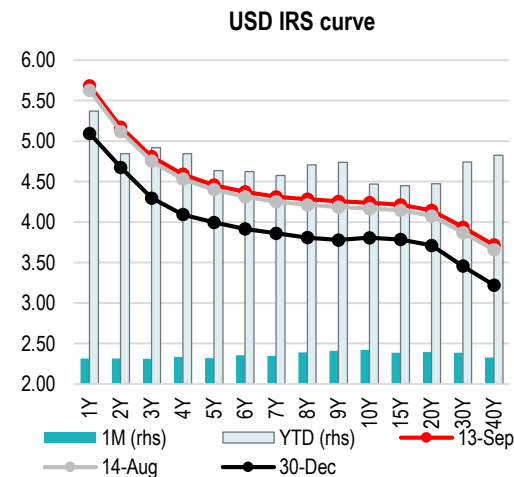
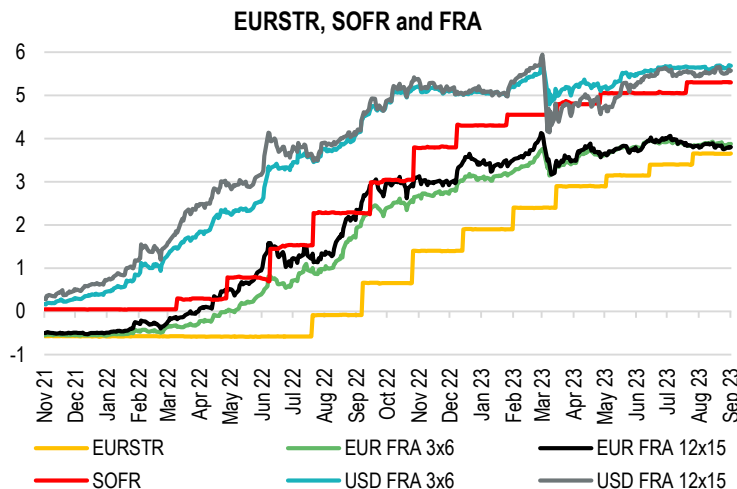
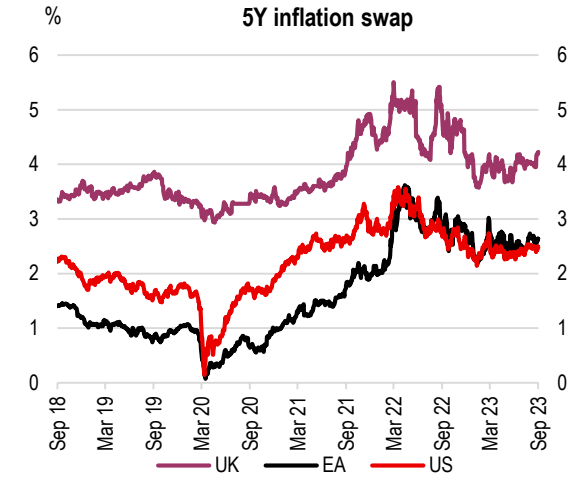
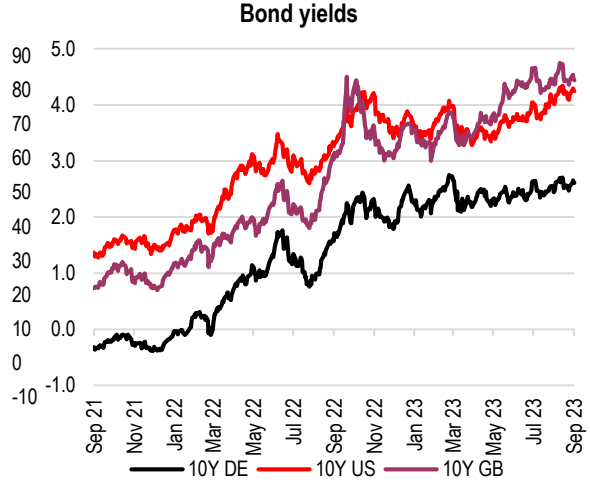
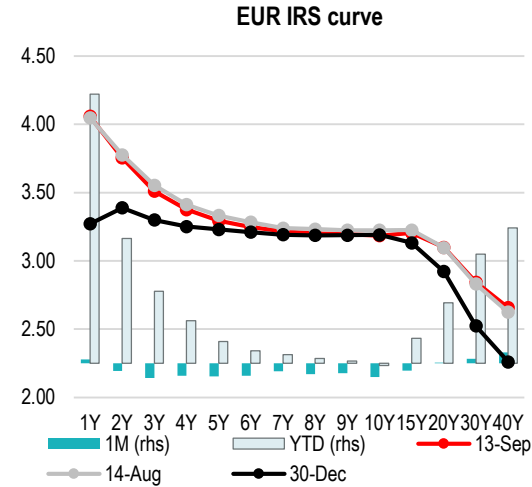
A close-up photograph of a desk with financial documents. A silver pen lies diagonally across the papers. The documents feature various charts, including a line graph with a blue line and a bar chart with multi-colored bars. The background is blurred, showing more papers and a computer monitor.

2

Further interest rate hikes from main central banks

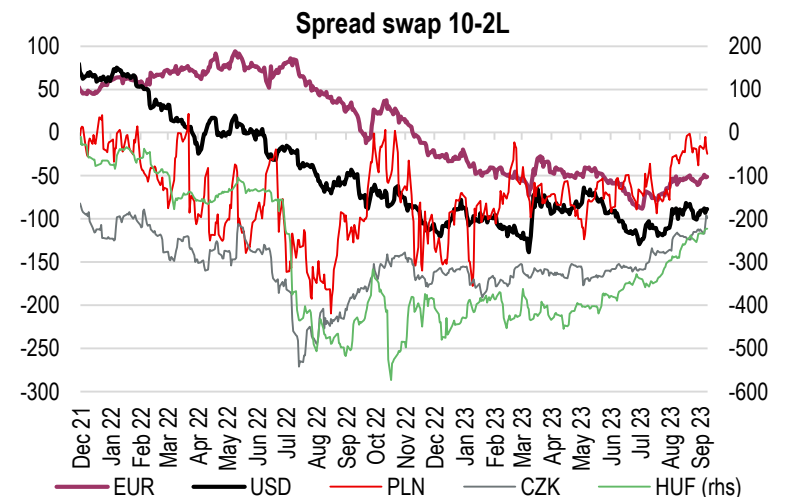
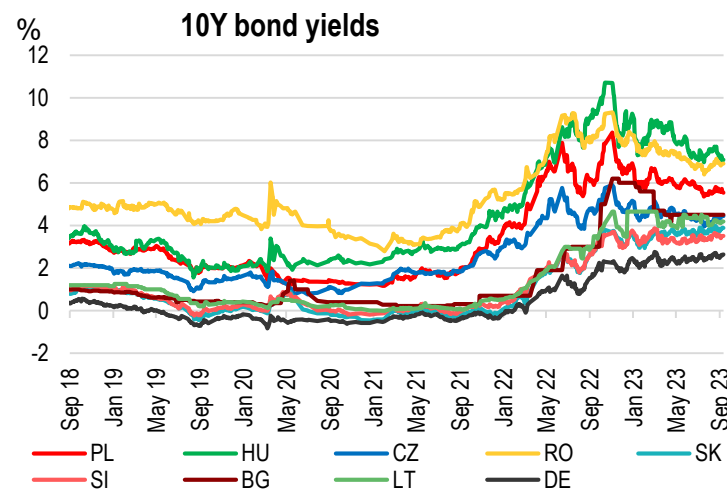
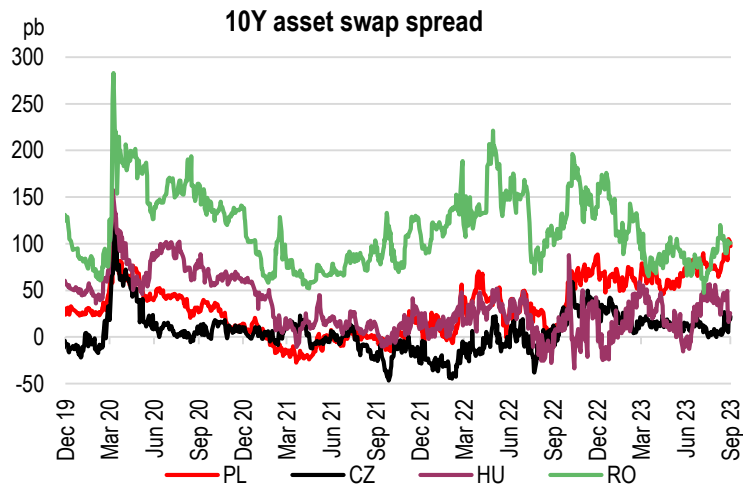
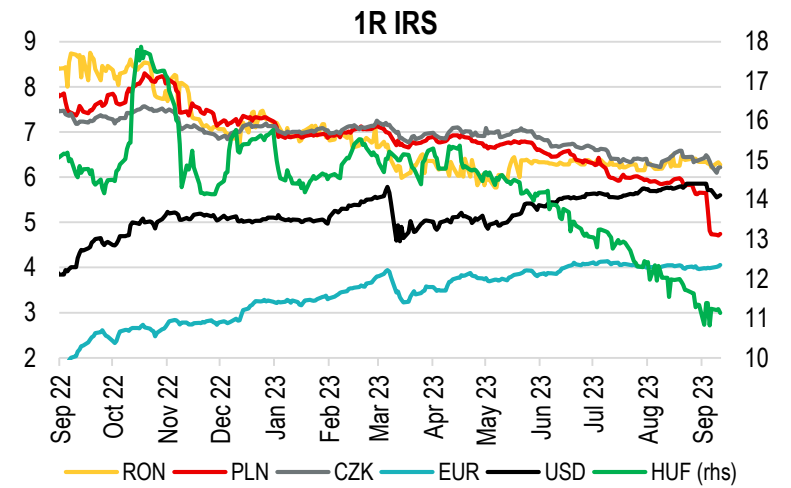
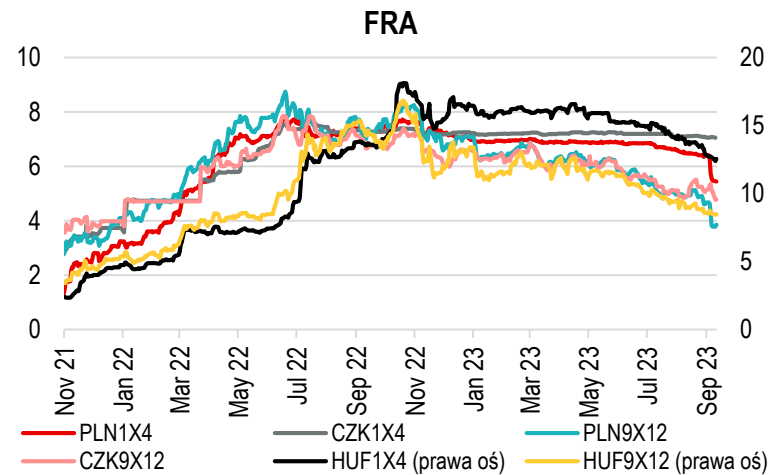


Expectations of further rate hikes became more pronounced in the core markets due to better-than-expected data from the US and hawkish Fed rhetoric at Jackson Hole, where the bank hinted that the rates may remain elevated for a longer time. Although both hard data and soft indicators from the euro area surprised negatively, swap rates inched slightly upwards. It is possible that the ECB will increase the rates by 25bp in September or October. In the US, there will likely be no hikes in September, and the chances for them in October are lower. In the UK, rates should be increased to 5.75%. EUR and USD curves may become steeper at the end of the cycle.



Curves steepening in the region

The CEE swap curves have been gradually steepening. Short term rates significantly fell. FRA1x4 rates fell the most in Hungary in anticipation of further normalisation of overnight rates and possible cuts of the main rate, which in our view may still require some more time. Czech long-term rates were the only ones rising thanks to hawkish CNB and weak koruna. The scale of swap curve steepening and spreading of asset swaps was the biggest in Poland due to the unexpected cut by the NBP and the huge debt issuance planned for the coming quarters. Long-term yields of CE4 bonds remain in a downward trend with narrowing spreads vs Bunds.

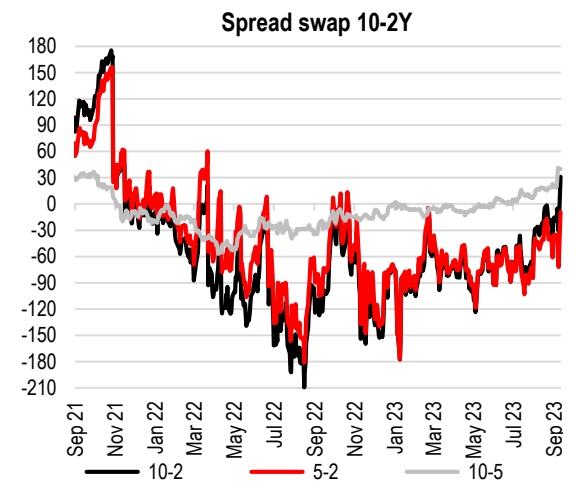
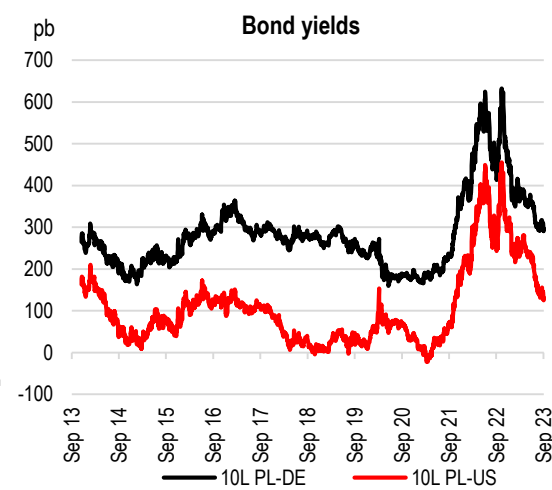
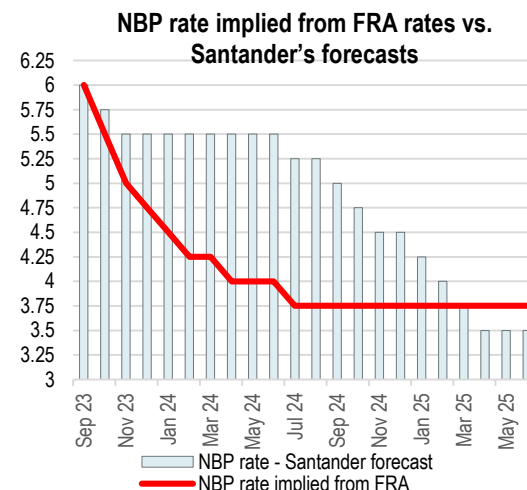
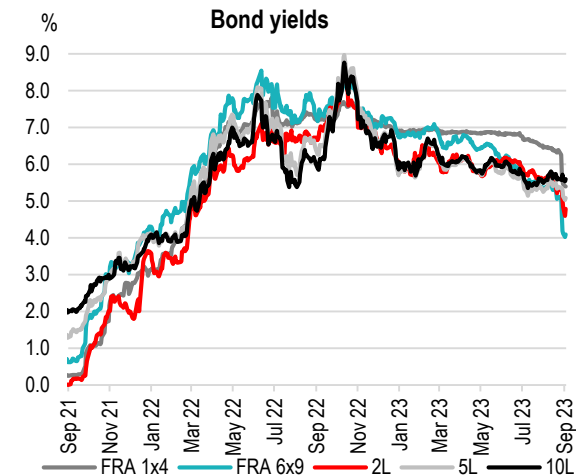
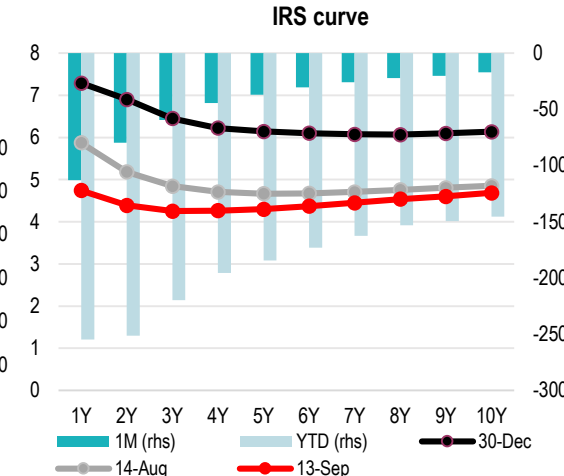
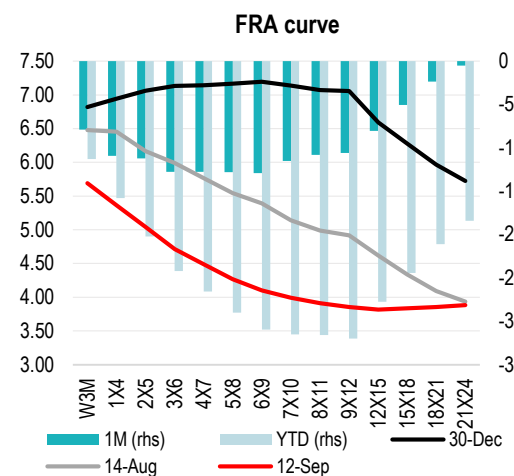




Exaggerated scale of interest rate cut expectations

Since the last report, short-term FRA rates (up to 6x9) fell by around 130bp (mainly after the MPC's decision to cut rates), though 21x24 remained almost unchanged at 3.6-3.8%. This means that after the MPC's move, markets began to once again aggressively price-in further cuts, thus assuming that the NBP's terminal rate will reach 3.50%.

Although we assume that the NBP rate could stabilise around 3.50%, we believe the cuts will be much slower and the priced-in pace is overestimated. In our view, IRS rates may increase by the end of the year, assuming that the NBP will cut rates by 50bp instead of the 100-125 expected by the market. This would allow for some curve flattening in 4Q. The first less-dovish-than-expected decision from the MPC could be the signal required for the short-term rates to move higher (e.g. in October, with an unexpected rise in inflation, which could happen in 4Q23 or 2024). Should the MPC decide to cut the rates abruptly, the terminal rate could be higher in the long term. Asset swap spreads will, in our view, remain elevated due to high issuance. Relatively fast fall of rates in Poland may permanently decrease the 10Y spread of bunds below 300bp in 2024 at the earliest.





Doubled borrowing needs in 2024...

The budget's borrowing needs are set to rise in 2024 to record high levels of PLN225.4bn net and PLN420.6bn gross, as a result of high deficit and rising debt maturities. It means that the supply of domestic treasuries should reach PLN23bn per month in 2024 (in 2023, their supply equalled on average PLN9.5bn). Further sources of risk to the already ambitious budgetary plans are the inclusion of almost PLN30bn of loans from the RFF (which may prove difficult to unlock, as they did this year) and emergence of new costly pre-election promises.

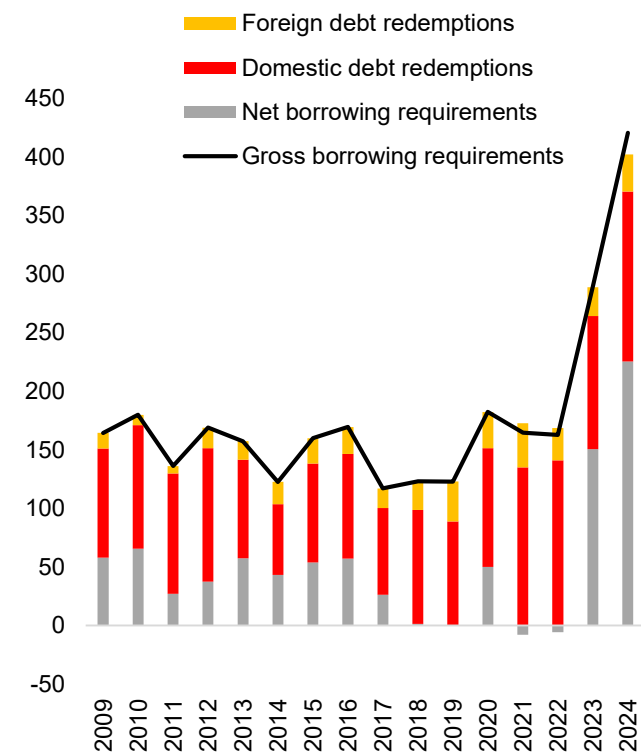
Net borrowing needs of the budget, PLNm

	2023 budget act (1)	2023 expected realisation (2)	2024 draft (3)	2024 change (3) - (2)
Total	107 516	142 968	225 394	82 426
Of which:				
1. Domestic financing	74 655	127 281	160 721	33 440
1.1 Treasury securities	74 655	62 944	160 721	97 777
1.2 Funds on budget accounts	0	64 337	0	-64 337
2. Foreign financing	32 861	15 687	64 673	48 986
2.1 Treasury bonds	-9 137	13 325	37 810	24 485
2.2 Loans received	-1 038	-863	-1 612	-749
2.3 Loans from SURE	13 471	0	28 642	28 642
2.3 Flows related to foreign currency accounts	29 566	3 225	-167	-3 392

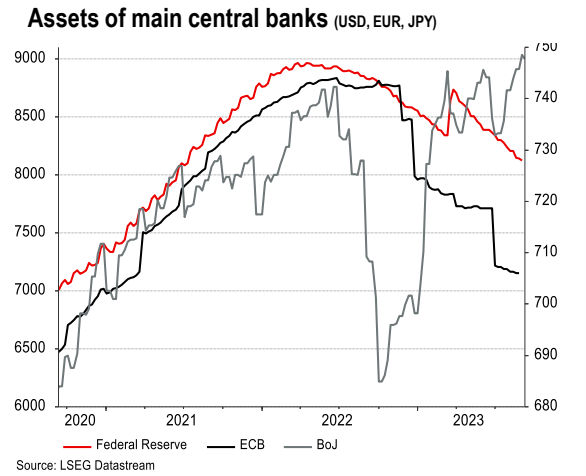
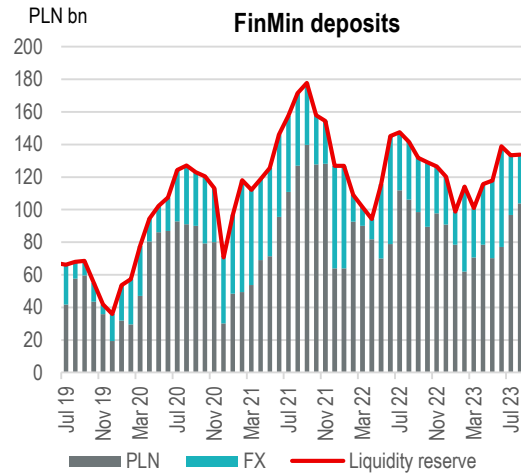
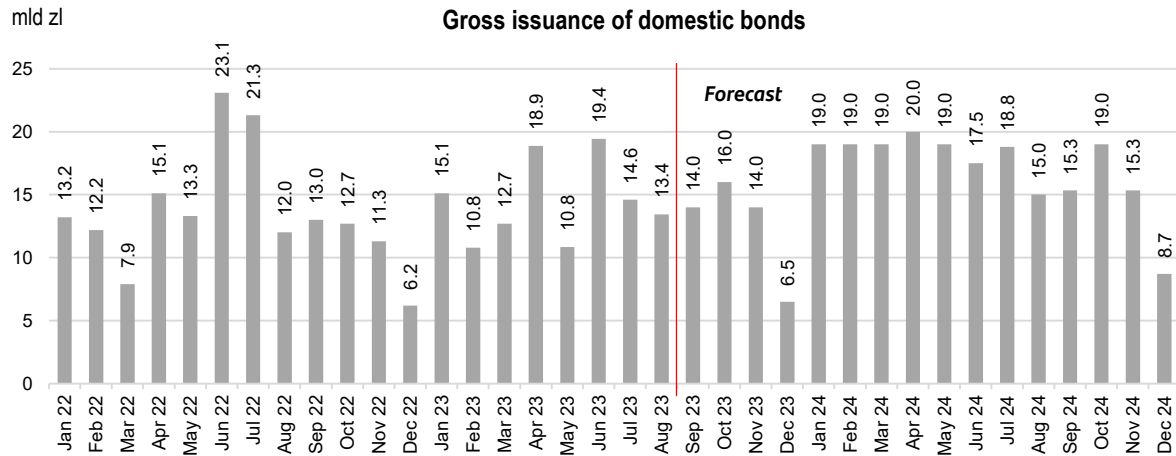
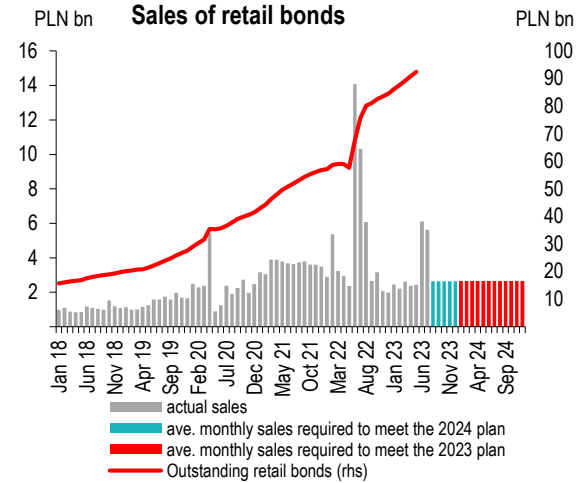
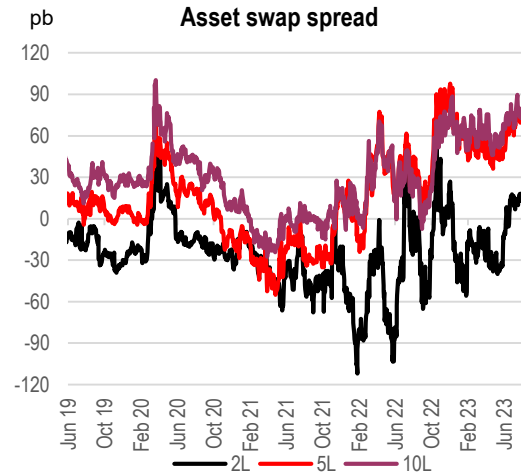
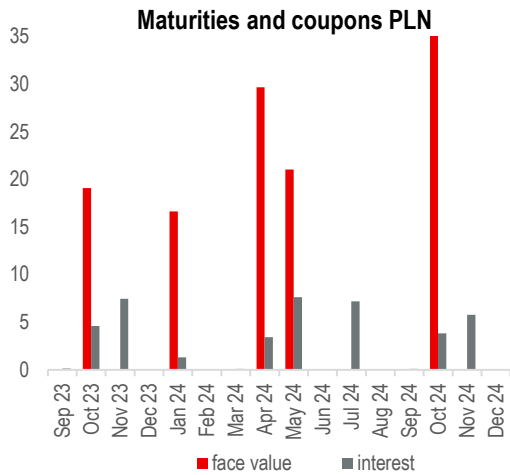
Planned issuance of state treasuries, PLNm

	2024 plan			2023 E	Change (2024 – 2023E)
	Net	Redemptions	Gross	Net	Gross
Treasury bills	54,478	0	79,051	0	54,478
Marketable bonds – fixed coupon	72,087	83,064	155,151	20,687	51,400
Marketable bonds – floating coupon	27,153	37,190	64,343	33,842	-6,689
Marketable bonds – index-linked	0	0	0	-6,518	6,518
Saving bonds	7,004	24,868	31,871	14,931	-7,927
TOTAL	160,721	145,122	305,843	62,944	97,777

Gross borrowing requirements, PLN bn



...will lead to greater issuance



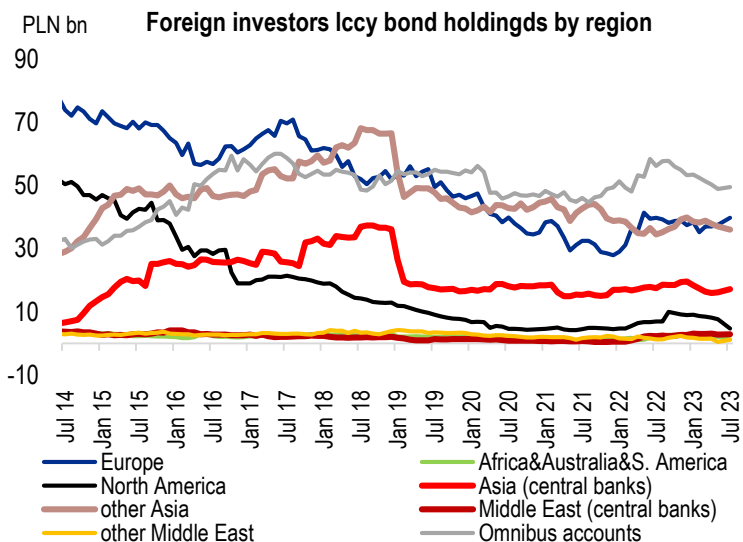
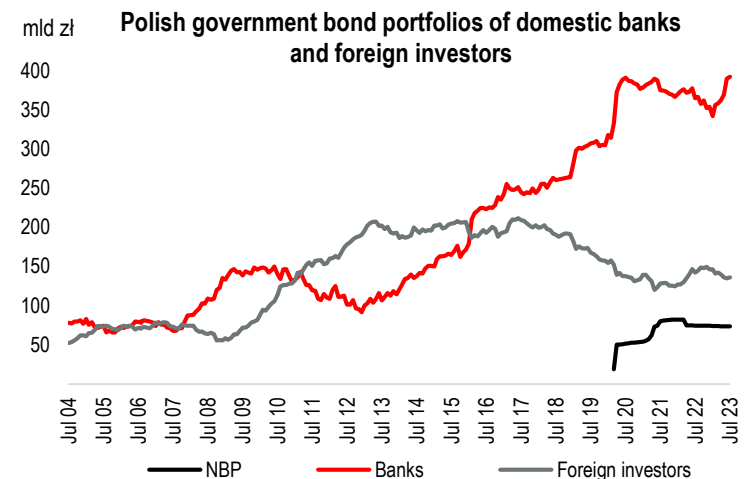
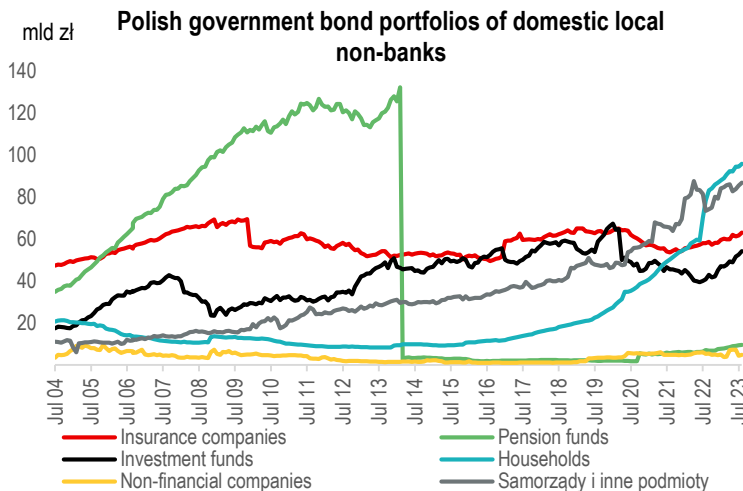


Domestic banks are the only hope

Local banks remain the main investor in the domestic government bond market, having bought around PLN38bn of bonds since the beginning of the year, including PLN20bn in June and PLN2bn in July. Households are among the main buyers, while the purchases of investment funds and insurance companies have accelerated in recent months. These trends are likely to continue in the coming months.

For next year, we assume an inflow of around PLN10-12bn to debt funds. Households' net purchases of retail bonds could amount to around PLN7bn, which would implement the finance ministry's plan. It is difficult to be exceptionally optimistic about non-resident's demand for Treasury Bonds next year given that for many years their exposure to the domestic debt market remained reduced (with the exception of 2022). Bond yields in core markets are relatively high, and while NBP interest rate cuts may encourage foreign investors to buy, a more difficult fiscal situation may discourage them.

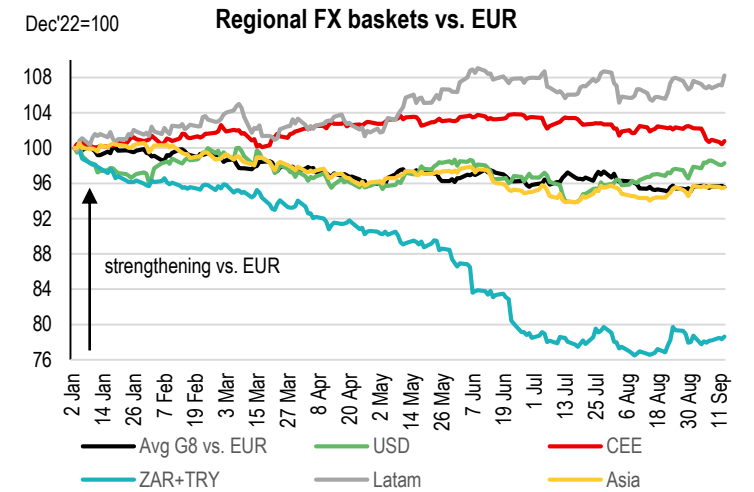
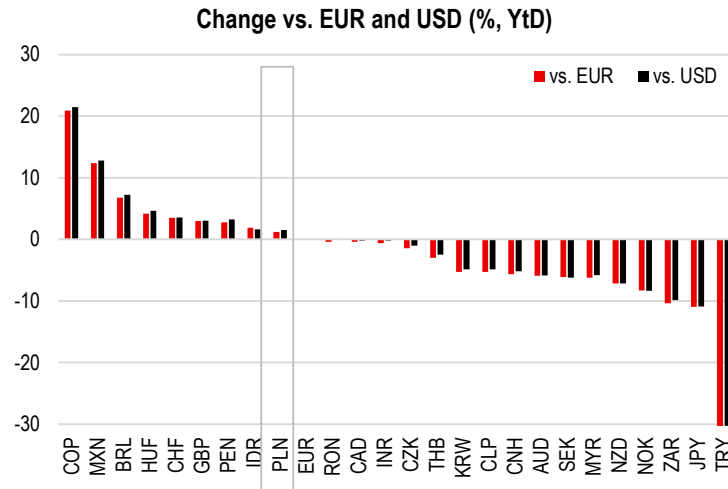
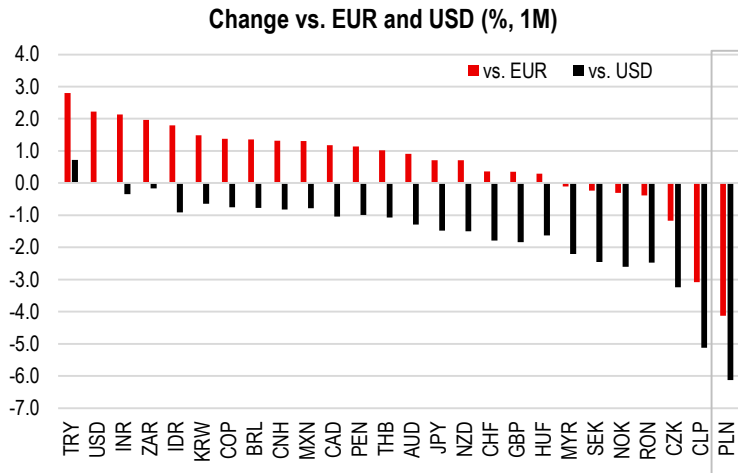
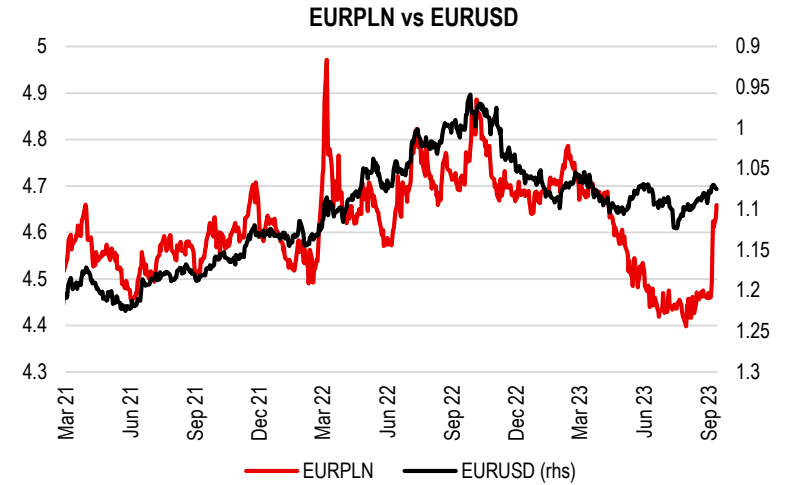
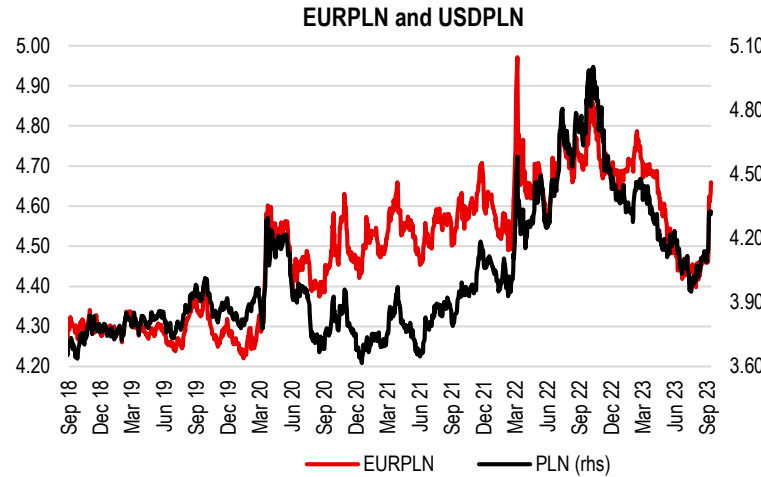
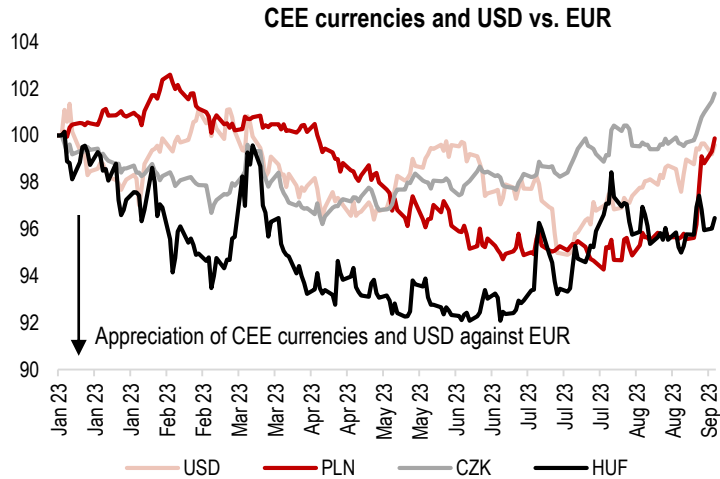
Domestic banks are likely to remain the main buyers of domestic debt. We assume that the scale of deposit growth could generate demand in the order of PLN70bn, with a steeper curve encouraging more purchases.



Purchases of local government securities (Santander's forecast for 2023-24)

	Banks	NBP	Foreign investors	Investment funds	Insurance	Households	General government sector	Others	Total
2015	20.7	0.0	10.8	0.2	-0.7	1.4	0.8	-0.5	32.7
2016	64.0	0.0	-14.2	3.1	6.9	1.1	4.4	3.3	68.7
2017	8.4	0.0	10.2	6.9	0.8	4.2	2.4	2.8	35.6
2018	20.2	0.0	-11.3	-1.7	5.3	4.1	9.2	9.2	34.9
2019	40.9	0.0	-34.1	12.0	-0.8	7.4	-0.7	-45.3	-20.6
2020	71.9	53.6	-23.6	-18.8	-7.0	13.4	12.6	5.2	107.3
2021	-10.5	28.5	-9.2	-3.3	-1.6	14.4	20.3	-0.1	38.6
2022	-12.6	-7.8	21.6	1.8	3.9	32.8	4.7	2.0	46.5
1H23	35.9	-0.7	-11.3	5.5	2.2	6.7	-7.1	9.6	40.7
2023E	60.6	-0.7	-17.0	8	3	13	-14	10	62.9
2024	105.0	-4.5	17.2	15.0	5.0	7.0	10.0	6.0	160.7

Zloty weakened fast and deeply ...





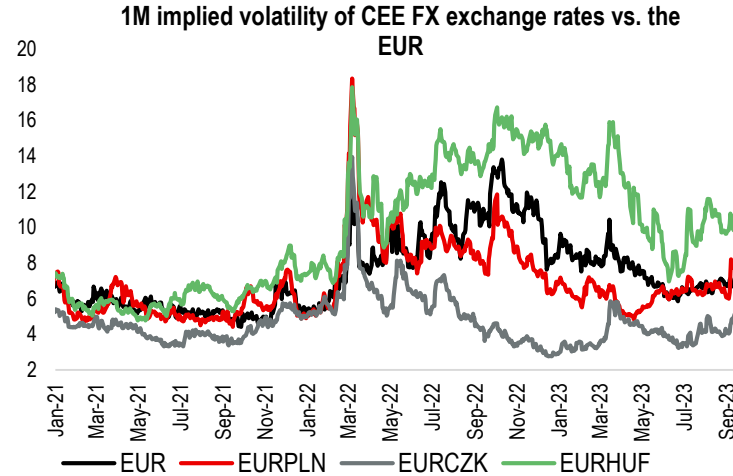
... in reaction to interest rate cuts

Since the last days of August, the zloty has gradually lost ground against the euro. Such a trend had already been evident for some time for other currencies in the region. The forint had been losing since June and the Czech koruna since April. The region's currencies had been negatively affected by the strengthening of the dollar against the euro since mid-July. In addition, the region's currencies were influenced by local factors.

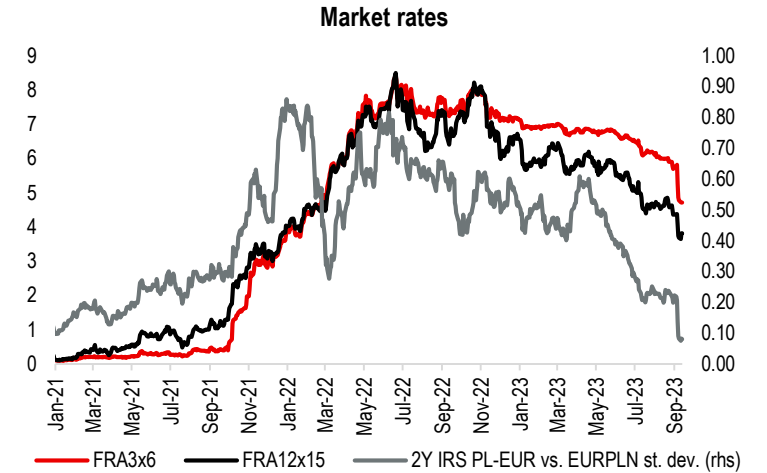
The koruna weakening is the result of the weakest economic performance in the region. The Czech economy still has not recovered from the pandemic. Besides, with inflation falling, the CNB accepted the possibility of a weaker currency and abandoned currency interventions. In Hungary, one-day rate cuts, which stabilised the currency during the time of rising inflation, contributed to the forint's weakening. In Poland, rising expectations of rate cuts may also have had a slightly negative impact on the zloty, but the sudden rate cut delivered by the MPC was met with a sharp reaction from the zloty's exchange rate. As a result, the zloty was one of the weakest currencies of emerging economies over the past month.

Despite the still low global volatility, we think that local factors, including much softer monetary and fiscal policies than in other countries in the region, may negatively affect the zloty in the coming quarter.

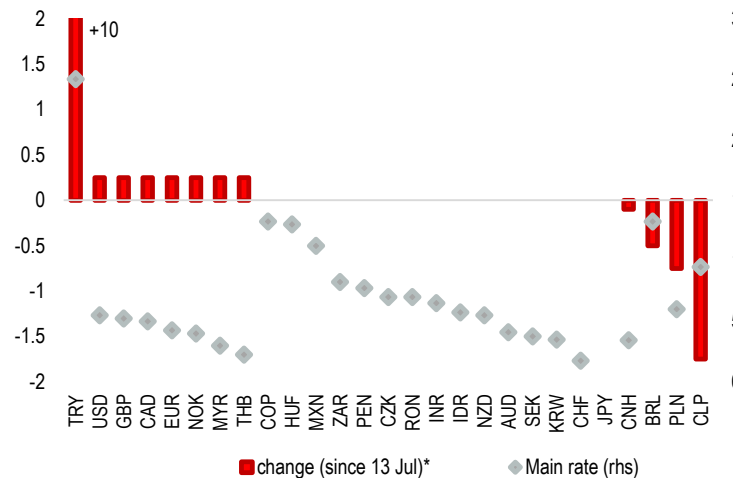
Zloty volatility highest this year despite still low global volatility



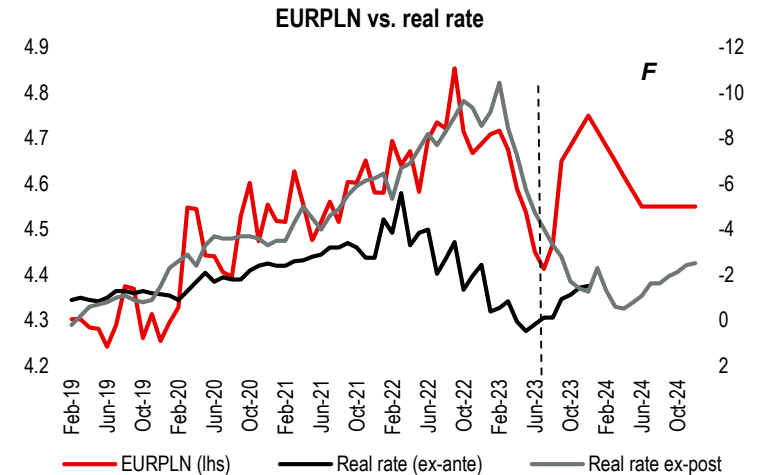
Falling rate disparity vs. the euro



Key rates of central banks



Limited room for PLN gains without higher real rates



Change of the MPC's approach negative for PLN



Although the MPC maintained the wording on possible currency interventions in its latest press release and maintained its assessment that a strengthening of the zloty would be consistent with the fundamentals, we believe that the MPC's approach might have changed.

During the press conference, the NBP president said that the central bank will not intervene in the market and added that, unlike the Czech Republic and Hungary, Poland does not need to influence the exchange rate, and if the weakening of the zloty continues, the Council will not worry. It is worth recalling that the 2024 draft budget includes, among other things, the payment of PLN6bn in profit from the NBP and this result will, in our opinion, be difficult to achieve without a depreciation of the exchange rate.

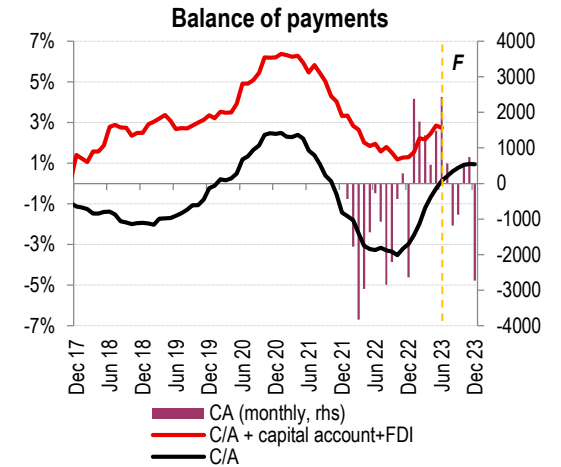
In 2H, the zloty may be negatively impacted by a weakening current account as well as fiscal and election risks. We also see a fairly high risk of a shortage of EU funds in the following quarters. Then, the FinMin's currency measures may not be enough to stop the zloty's depreciation.

The weakening of the zloty may be limited by the still high basis swap rates and verbal interventions. In the longer term, the zloty may be supported by foreign direct investment inflows resulting from reshoring.

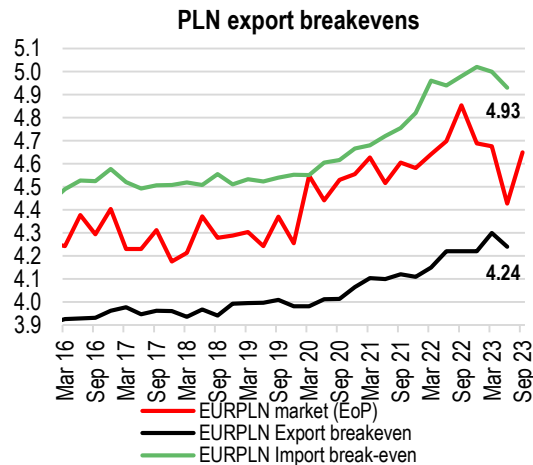
Zloty should not be much stronger vs. today levels in order to avoid FX losses by the NBP

	USD	AUD	CAD	NZD	EUR	GBP	NOK	Sum
Share in FX reserves	41%	8%	10%	3%	20%	12%	6%	100%
FX reserves based on avg NBP FX rates (PLN bn, EoP 2022)	223	44	53	15	105	63	29	531
Avg NBP FX rate (EoP 2022).	4.40	2.99	3.25	2.79	4.69	5.30	0.45	
NBP FX reserves based on avg purchase FX rate (PLN bn)	204	43	53	15	103	63	27	509
Avg purchase rate of NBP FX reserves	4.03	2.97	3.25	2.81	4.62	5.29	0.42	
Current FX rate (13 Sep)	4.33	2.78	3.19	2.56	4.64	5.40	0.40	
FX change (%) (current FX rate vs. FX reserves purchase FX r	7.4	-6.3	-1.8	-8.9	0.6	2.0	-2.6	
Contribution to NBP FX rate YtD (current rate) PLN bn	3.7	-0.9	-0.3	-0.5	0.1	0.2	-1.7	0.7

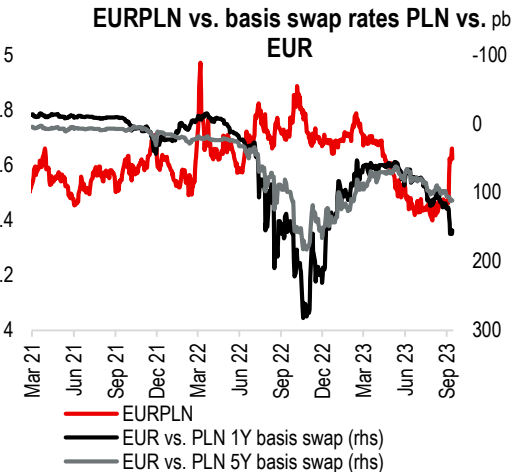
We expect weaker current account balance in 2H23



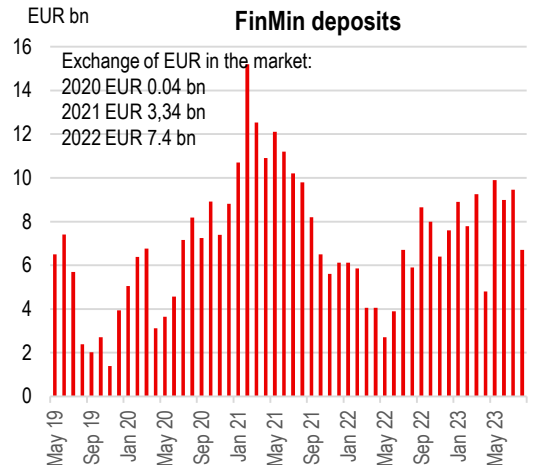
NBP pointed importance of export breakeven rate



High basis swap spreads may limit scale of zloty weakening



Similar as sale of FX deposits by the FinMin



Forecasts

3



Economic Forecasts

		2021	2022	2023E	2024E	1Q23	2Q23	3Q23E	4Q23E	1Q24E	2Q24E	3Q24E	4Q24E
GDP	PLNbn	2 631.3	3 078.3	3 406.2	3 747.8	800.4	806.7	859.5	939.7	858.5	867.2	919.5	998.8
GDP	% y/y	6.9	5.1	0.7	3.0	-0.3	-0.6	0.3	3.0	3.0	3.4	3.0	2.9
Domestic demand	% y/y	8.5	5.1	-2.0	3.2	-5.2	-4.1	-1.8	2.1	3.1	3.8	3.3	2.8
Private consumption	% y/y	6.2	3.3	-0.5	4.3	-2.0	-2.7	-0.5	3.0	4.0	5.0	4.2	4.0
Fixed investment	% y/y	1.2	5.0	6.6	0.7	5.5	7.9	7.0	6.0	4.0	1.5	0.0	-1.0
Industrial output	% y/y	14.5	10.4	-1.9	4.2	-0.9	-3.3	-2.6	-0.9	0.5	4.7	5.8	6.1
Construction output	% y/y	1.6	7.6	0.6	1.7	1.9	0.6	0.6	0.0	-8.3	-1.8	6.2	6.9
Retail sales (real terms)	% y/y	7.4	5.5	-3.8	5.8	-5.3	-6.8	-4.6	1.3	3.8	2.0	4.2	4.4
Gross wages in national economy	% y/y	8.9	12.1	12.4	9.6	14.3	13.8	10.6	11.1	9.7	9.4	9.4	9.6
Employment in national economy	% y/y	0.6	2.3	0.3	0.5	0.8	0.2	0.1	0.0	0.5	0.4	0.6	0.7
Unemployment rate *	%	5.8	5.2	5.2	5.4	5.4	5.0	5.0	5.2	5.4	5.0	4.9	5.2
Current account balance	EURmn	-8 261	-19 612	7 017	-6 189	5 476	4 439	-1 490	-1 408	2 747	981	-4 837	-5 080
Current account balance	% GDP	-1.4	-3.0	0.9	-0.8	-1.2	0.1	0.8	0.9	0.6	0.1	-0.3	-0.8
General government balance (ESA 2010)	% GDP	-1.8	-3.7	-5.3	-4.5	-	-	-	-	-	-	-	-
CPI	% y/y	5.1	14.3	11.8	6.8	17.0	13.1	9.9	7.0	6.9	6.3	6.9	6.9
CPI *	% y/y	8.6	16.6	6.8	7.0	16.1	11.5	8.8	6.8	6.1	6.6	6.9	7.0
CPI excluding food and energy prices	% y/y	4.1	9.1	10.3	5.0	12.0	11.6	9.8	7.8	5.9	4.7	4.8	4.8

* 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	5.50	4.50	6.75	6.75	6.00	5.50	5.50	5.50	5.00	4.50
WIBOR 3M	%	0.54	6.02	6.54	5.33	6.93	6.90	6.53	5.79	5.65	5.62	5.30	4.73
Yield on 2-year T-bonds	%	0.79	6.35	5.61	4.68	6.16	6.00	5.34	4.95	5.01	4.81	4.58	4.35
Yield on 5-year T-bonds	%	1.39	6.36	5.68	5.15	6.11	5.92	5.36	5.33	5.47	5.30	5.03	4.82
Yield on 10-year T-bonds	%	1.97	6.10	5.88	5.43	6.16	5.99	5.60	5.78	5.77	5.58	5.31	5.07
2-year IRS	%	1.19	6.62	5.55	4.39	4.68	7.21	7.21	7.38	6.39	6.18	5.08	4.55
5-year IRS	%	1.69	5.92	4.97	4.28	4.31	6.53	6.22	6.62	5.53	5.37	4.59	4.39
10-year IRS	%	2.01	5.68	5.09	4.56	4.10	6.16	5.95	6.49	5.47	5.34	4.78	4.78
EUR/PLN	PLN	4.57	4.69	4.61	4.60	4.71	4.55	4.49	4.70	4.70	4.60	4.55	4.55
USD/PLN	PLN	3.86	4.46	4.26	4.11	4.39	4.18	4.11	4.35	4.28	4.14	4.03	3.97
CHF/PLN	PLN	4.22	4.67	4.66	4.34	4.75	4.65	4.63	4.63	4.54	4.36	4.25	4.19
GBP/PLN	PLN	5.31	5.50	5.33	5.56	5.33	5.23	5.25	5.50	5.60	5.54	5.55	5.55

* 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 **13.09.2023** has been prepared by:

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