MACROscope

Warsaw, 18 December 2024

Consumer stayin' alive, investment should be dancin'

Poland: 2025 Outlook

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Santander

Index

- Executive summary p. 3
- Global environment p. 8
- GDP p. 15
- Consumption p. 17
- Investment p. 19
- EU funds p. 22
- Companies' results p. 24
- Industry p. 25
- Loan market p. 26
- Current account p. 27
- Labour market p. 29
- Inflation p. 33
- Monetary policy p. 37
- Fiscal policy p. 39
- FI market p. 42
- FX market p. 47
- Forecasts table p. 52

Executive Summary (macro)

Based on the currently available data, we can say that the economic scenario that materialized in 2024 was close to the one we sketched out a year ago. Despite the unfavourable external environment and the protracted downturn in the euro area, the domestic economy returned to GDP growth of around 3%, mainly due to robust domestic demand, including consumption, supported by rapidly rising household incomes. The results for the third quarter were a big disappointment, but we consider them a temporary disruption of the trend, not a signal of its fundamental change. We are still not able to explain exactly what was behind the sudden slump in demand in 3Q, but we do not share the opinion about the "death of the consumer" (if anything, it was only resting) and in the coming quarters we expect the pace of economic growth to return above 3%, with further significant contribution from domestic consumption. Over time, investment will take over as the main driver of growth, financed by an abundant stream of EU funds. However, due to the slow process of contracting EU funds, we consider the expected strong recovery of investments increasingly at risk of a delay.

In our view, the international environment will remain difficult for domestic producers and exporters: the structural economic problems in Germany and the euro area may be compounded by challenges related to the protectionist trade policy of the new US administration. It is difficult to accurately assess the impact of these policies until we actually learn them. We see several factors that, in a generally difficult environment, may mitigate the problems of the European economies: a weaker euro and deeper ECB interest rate cuts, the growing scale of fiscal and monetary stimulation in China, early elections in Germany, after which the new government could and should undertake reforms aimed at reviving the economy, and in the short term also increased global demand for intermediate goods in anticipation of increased protectionism and tariffs. Overall, we expect a slight increase in domestic exports, which, however, will lag significantly behind the increase in imports, stimulated by solid domestic demand. As a result, the balance of trade will deteriorate further.

Summing up: the balance of risks to domestic and external demand has recently shifted downwards, which is reflected in a slight downward adjustment to our GDP growth forecasts, to 2.8% in 2024 and 3.4% in 2025.

We expect a slight recovery in labour demand in 2025 related to the investment cycle, because of which the unemployment rate will remain close to record lows. However, wage growth in the national economy should slow down, which will be supported by much more modest increases in the minimum wage and wages in the public sector, lower inflation and a marked deterioration in companies' margins, narrowing their space for wage negotiations.

CPI inflation will increase in 1Q25, reaching a local peak in March, slightly above 5.5% y/y. In 2Q, inflation will start to fall slightly, but only in July it will fall markedly, nearing 4% y/y. We do not expect a significant increase in energy prices at the end of the year, after the expiry of the extended protective measures approved by the government – the situation on the energy commodity markets and wholesale energy prices should allow distributors to reduce tariffs to/below 500 PLN/MWh. Core inflation will remain slightly above 4% y/y until mid-2025, after which it should start to fall slightly, which will be made possible by the global disinflation trend and slowing down unit labour costs.

In our view, it is next to impossible to pinpoint a time-consistent reaction function of the Monetary Policy Council. After several months of softening the policy statements, December brought a hawkish pivot in the NBP Governor’s forward guidance, which in our opinion indicates that the chances for policy easing starting in 1H25 have clearly decreased. We continue to expect that the monetary easing cycle will resume in July 2025, i.e. earlier than recently suggested by governor Glapiński, and the total scale of rate cuts by the end of the year will amount to 100-125 bps.

The fiscal deficit in 2025 will probably be, as also this year, close to 6% of GDP. The draft budget was again based on too optimistic assumptions, because of which we expect revenues to fall short of the government’s plans. On the other hand, the amendment to the 2024 budget is likely to slightly relieve the beginning of the next year by shifting some of the costs over time. Public debt will remain on an upward trajectory, increasing from about 54.6% of GDP at the end of this year to almost 60% of GDP in 2025 (in ESA definition) .

Executive Summary (markets)

FX market

In the short term, the Polish zloty will be affected by two opposing factors: negatively, by an appreciation of the dollar against the euro, favoured by the markets discounting the possible implications of the US elections (e.g. a narrowing of the room for interest rate cuts in the case of the Fed and a widening of it in the case of the ECB). Theoretically, the Polish currency should be positively affected by the weakening of market expectations for rapid interest rate cuts by the NBP. However, in this case, it can be debated whether this factor will outweigh the effect of increased unpredictability of monetary policy and further loss of credibility by the central bank, due to sudden and difficult to understand changes in the communication of the NBP Governor, which discourage foreign investors from acquiring Polish assets. In the medium run, we do not see a room for a significant strengthening of the zloty, among others due to the expected decline in real interest rates and an increase in the current account deficit. We expect that the EURPLN exchange rate will remain in the range of 4.30-4.40 in the coming quarters, closer to its lower band in the first half of the year, and closer to the upper band in the second half.

Interest rate market

If we are right that the first interest rate cut will be delivered in July, then the FRA and IRS curves (short end) will have to move up temporarily, pricing in a later start of the cycle. In this scenario, the swap curve inversion should deepen in early 2025. Once the policy easing cycle begins, we expect the curve to normalize and regain a positive slope (bull steepener).

In our view, the beginning of 2025 may be a period of still elevated yields on domestic bonds, which will be influenced by, among other factors, a revision of market expectations regarding the timing of NBP rate cuts – the market continues to expect them to begin in 2Q25, too optimistically – but also a high supply of Treasury bonds, due to high borrowing needs and the fact that the Ministry of Finance will enter the new year with a fairly low pre-financing. Later in the year, however, we expect a gradual decline in yields and a steeper bond curve, following a strengthening of debt on core markets and a decrease in the main NBP rates from July. The steepness could be mitigated by a possible decision of the Ministry of Finance to return to issuing Treasury bills.

2024: Our forecasts vs. reality

Indicator	Our view in December 2023	Reality
GDP	Another year of weak economic conditions abroad. Despite the unfavourable international environment, we expect stable GDP growth of around 3% y/y, driven by domestic demand. Our forecast is still above consensus, which, however, started to move upwards after the parliamentary elections. We would also consider raising our forecast if it were not for the weakness of the German economy.	Our expectations from a year ago turned out to be quite accurate. GDP growth over the whole 2024 will likely near 3%, mainly due to domestic demand, as the downturn in the euro area protracts. The results for 3Q disappointed but we consider them a temporary disruption to the trend, not its reversal.
GDP breakdown	Weakness in the euro area and the strong zloty will make for a difficult year for exporters. Balance of trade will worsen as imports rebound with domestic demand. Consumption will be the main driver of the recovery, and investments will remain in an upward trend, although advancing slower than recently. Reversal of the inventory cycle should support industry but hinder disinflation.	As we expected, the deterioration in international trade and the weakening exports hindered GDP growth, and the reversal of the inventories cycle impeded it even further. Having rebounded in 1H24, consumption growth waned in 3Q24 but the consumer is not dead, it's only resting, and, in our view, has a chance to resume at a moderate pace. Investment growth slowed down, mainly in the private sector.
Labour market	The economic rebound suggests that demand for workers will not slow down. Unemployment will remain at the record low. Because of the increase of the minimum wage by another 20% and solid increases in the public sector average wage growth in the economy will remain in double digits.	The observed developments were more or less in line with our expectations. Despite a slight weakening of labour demand, unemployment remained low and wage growth – double-digit.
Inflation	Disinflation will slow down, but CPI may still fall at the beginning of the year due to the extension of frozen electricity prices and zero VAT on food. In the second half of the year, we expect inflation to return to 6-7%. External environment is favourable for disinflation of commodity prices, but prices of services remain stubborn. Inflation's return to the target is not moving any closer.	Inflation surprised to the downside in the first months of the year by falling to 2% y/y in March, but later rebounded due to increases in the prices of energy and food, as well as low base. We expect that by the end of the year, CPI inflation will rise a bit above 5% y/y and core inflation – a bit above 4% y/y
Monetary policy	After the elections, the central bank became far more focused on inflation than on GDP growth and unemployment. Rates will remain unchanged until 4Q24, with two rate cuts, 25 bps each, possible at the end of the year.	We gave up expecting interest rates cuts this year already in 1Q, due to the evident changes in the MPC's reaction function. The hawkish pivot in the statements of the NBP Governor confirms, in our view, that interest rate cuts will not begin before 3Q25.
Fiscal policy	Negligible chance of accelerated fiscal consolidation after the change of the government, due to the electoral calendar and the previous government's additional spending, among other factors. Fiscal policy will support GDP recovery, but will not tame inflationary pressures.	Fiscal policy in 2024-2025 more expansive that was expected, with fiscal deficit at 6% of GDP, which should support economic growth.
Fixed income market	An upward adjustment in market rates, especially short-term swap rates and bonds, may take place at the beginning of the year, thanks to distant rate cuts and large issues. However, the size of adjustment may be reduced by low inflation. Later in the year, we expect a gradual decline in rates as the curve steepens.	2024 was a year of increases, not decreases in yields, which were caused by, among other factors, expectations for the size and speed of interest rate cuts in Poland and abroad becoming more realistic.
FX market	In the coming year, we expect a strong and relatively stable zloty, which may be supported by late rate cuts, weaker dollar and higher inflows of EU funds. The threshold exchange rate for profitable exports will constraint the appreciation.	Zloty strengthened in real terms, but the EURPLN exchange rate remained exceptionally stable for the whole year, reacting only slightly to local and global events.

2025: Our forecasts and main risks

Indicator	Summary of our forecasts	Main risks
GDP	We expect that the pace of economic growth will remain at above 3%, despite unfavourable external environment, still supported first and foremost by relative resilience of domestic demand.	The risks seem to be mostly negative and are related e.g. to uncertainty about the actions of the new US administration, which may potentially be negative for world trade and economic growth of China and Europe.
GDP breakdown	Over time, investments will take over as the main driver of economic growth, though their rebound seems delayed. Consumption growth will reach c. 3%, similarly to the current year, supported by increase in real wages. Contribution of inventories will be positive, and that of net exports – negative.	We see risks of slower absorption of EU funds and of a delay in the revival of investments. The risks related to consumption seem to be tilted upwards, provided that the saving rate, which has been rising steeply, will start to normalise.
Labour market	The rebound of investments should moderately increase demand for labour, keeping unemployment near its all-time low. The pace of wage growth will decline but will remain positive in real terms.	The protracted economic downturn abroad and the efforts aimed at regaining profitability by firms may lead to larger lay-offs and stronger deceleration of wage growth.
Inflation	CPI inflation will increase up to March, when it will reach its peak of c.5.7% y/y. Inflation will decrease a bit in 2Q25 and more strongly from July and should finish the year slightly below 4%. Core inflation will remain above 4% until mid-year. Later, it will trend downwards.	The risk of inflation shooting forcibly upwards after the expiration of the energy price cap seems smaller than the risk of the inflation path running below our scenario due to the disinflationary trends in Europe (low demand, falling commodity prices).
Monetary policy	We expect the NBP will begin lowering interest rates in July 2025 and that the total size of the cuts in 2025 will equal 100-125 bps. By July, it should become clear that the risk of a strong increase in CPI inflation at the end of the year is low, and that the moment of inflation returning to the target is drawing closer, not further away, which should deprive the NBP Governor and the most hawkish MPC members surrounding him of arguments for keeping the rates high.	Interest rate cuts could be hastened by further signals of the economy's weakness and of deceleration of economic expansion, which would make it much harder to postulate that a strong increase in inflation poses a risk.
Fiscal policy	Another year of public finance deficit near 6% of GDP and of growing public debt, which will near 60% of GDP (in the EU's definition). Fiscal consolidation will be postponed until after the presidential elections.	The biggest threat for the fiscal situation is a weaker nominal GDP growth, which would make the fiscal consolidation plan much less credible.
Fixed income market	We anticipate higher swap rates and yields in 1Q (especially at the short end of the curve), as market expectations for the start of NBP rate cuts become more realistic and due to high supply of debt. Later in the year, we should see declines in market rates and yields as well as a steepening of the curves.	Potentially disappointig GDP growth would increase the chances for sooner declines in short-term rates as well as the widening of credit risk premium and the pressure on the long end of the curve.
FX market	The EURPLN exchange rate should remain fairly stable in the range of 4.30-4.40, on the one hand supported by the unhurried approach of the NBP to lowering interest rates, and on the other, by negative pressure of firms' low competitiveness, deteriorating balance of payments, and declining real rates.	Ceasefire in Ukraine and a guarantee of security from the West, rising hopes for a lasting peace, would likely lead to a sharp appreciation of the CEE currencies. The opposite risks are that of further escalation of geopolitical tensions, deceleration of GDP growth, and in effect an increase in fiscal risk.

Economic growth

1

What does Trump 2.0 mean?

The declarations of Donald Trump and his advisors from before the presidential election regarding the desired directions of US policy are known (see the table), but it is not yet certain how many of these announcements will be implemented and in what exact form. As a result, it is difficult to be convinced of the scale of the impact of these actions on the economic outlook.

From the Polish point of view, the key factors seem to be the risk of weaker economic prospects of the eurozone in the face of possible US protectionist actions against the EU and China (the latter will probably be a priority), narrowing the room for Fed rate cuts while increasing the space for ECB cuts, and a potential increase in geopolitical risk in the event of a reduction in US support for Ukraine and/or less involvement in NATO.

Assessment of the economic impact seems premature, as long as we operate mainly in the realm of speculation rather than concrete decisions. The general uncertainty about Europe's development prospects has increased. However, we see several factors that, in a generally difficult environment, may mitigate the scale of the European economy's problems: a weaker euro and deeper ECB interest rate cuts, the growing scale of fiscal and monetary stimulation in China, early elections in Germany, after which the new government can/should undertake reforms aimed at reviving the economy, and in the short term also increased global demand for intermediate goods in anticipation of the upcoming increase in protectionism and custom barriers.

Policy area	Pre-election declarations
Tariffs	Universal tariffs on imports (10%-20%) to promote domestic production. China: tariff increase to 60%. A 4-year plan to displace imports of selected goods from China is possible.
Fiscal policy	Full extension of temporary tax cuts and business reliefs approved in 2017 Reduction of corporate tax to 15%. Abolition of state taxes for tips, overtime and social benefits.
Migrations	Reinstatement or even tightening of the regulations from the first term on illegal border crossing. Deportation of millions of illegal migrants. Legal migration is also limited (fewer refugees, fewer entry permits).
Foreign policy	Suspension of support for Ukraine, pressure for peace talks. Reduced involvement in NATO, greater tensions in relations with European allies.
Deregulation	Fewer regulations related to climate policy, facilitation of investments in the extraction of fossil fuels. Lower supervisory requirements for banks, easier capital raising. A quick overview of national financial supervisors.

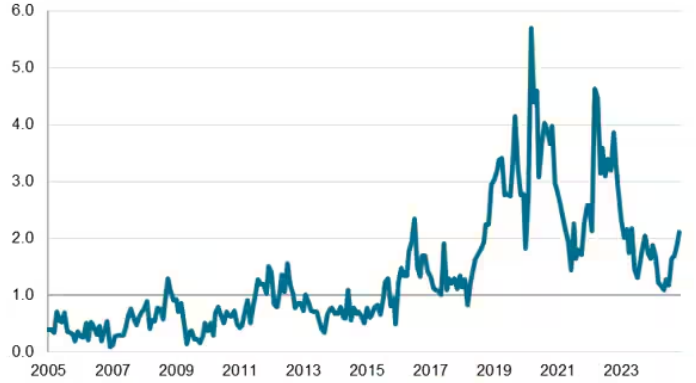
Global growth not bad, but fragmented

Being stuck in an economic system based on the European economic situation, we may get the impression that the world is unable to switch to the economic recovery phase. Meanwhile, the recovery is already taking place, but it is heterogeneous and limited to selected areas of activity - the global economy is growing at a moderate pace, but the situation varies depending on the sector and geography.

It is a common phenomenon that services are doing much better than manufacturing, as indicated by the differences PMI indicators for these sectors. The same indicators look much better in the case of the US and Asian economies than in the eurozone.

The PMI survey also indicates a growing sense of uncertainty among companies on a global scale. Companies also report that this already has measurable effects in the form of lower orders and a reduction in the expected future level of economic activity. We associate this phenomenon with Donald Trump's victory in the US presidential election and geopolitical tensions, among others.

Companies globally citing lower orders and/or future output expectations due to uncertainty



Data compiled December 2024.
Axis scale 1 = long term average
Source: S&P Global PMI.
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Global economic growth and the PMI

Data compiled December 2024 including PMI data to November 2024.
PMI (Purchasing Managers' Index) value of 50 = no change on prior month.
Source: S&P Global PMI with J.P. Morgan, S&P Global Market Intelligence.
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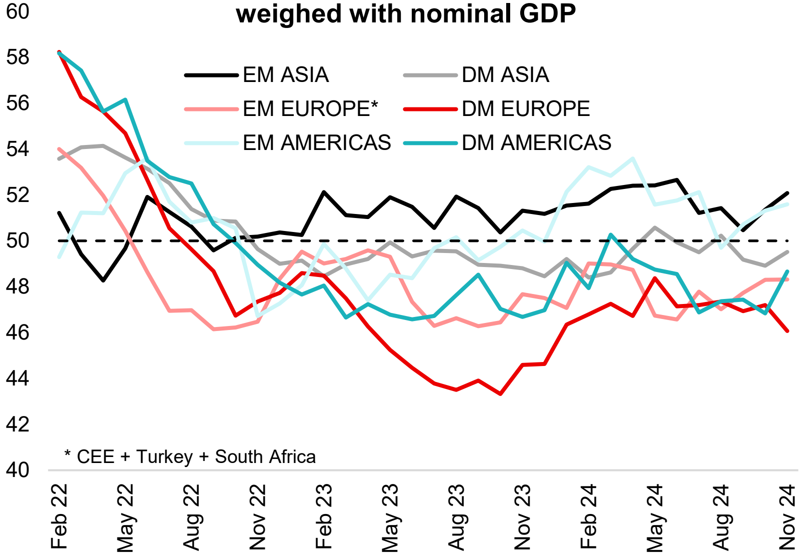
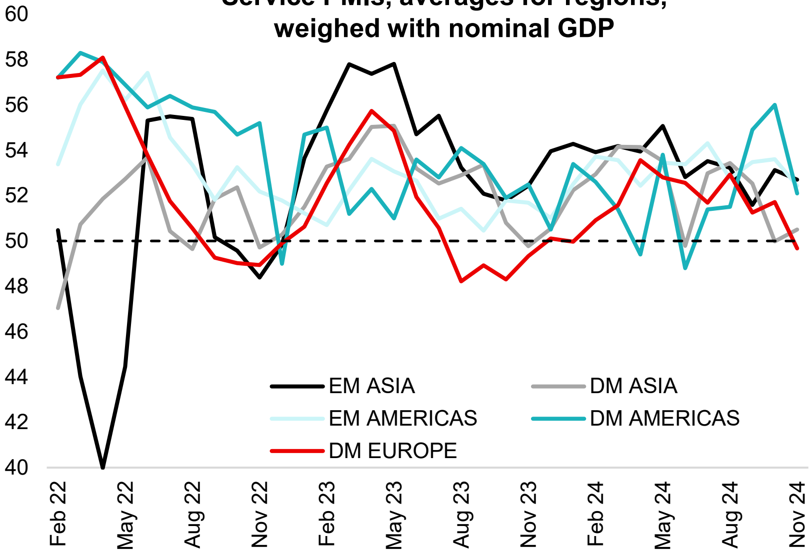
Manufacturing PMIs, averages for regions, weighed with nominal GDP



* CEE + Turkey + South Africa

Service PMIs, averages for regions, weighed with nominal GDP



Source: Bloomberg, S&P Global, Santander

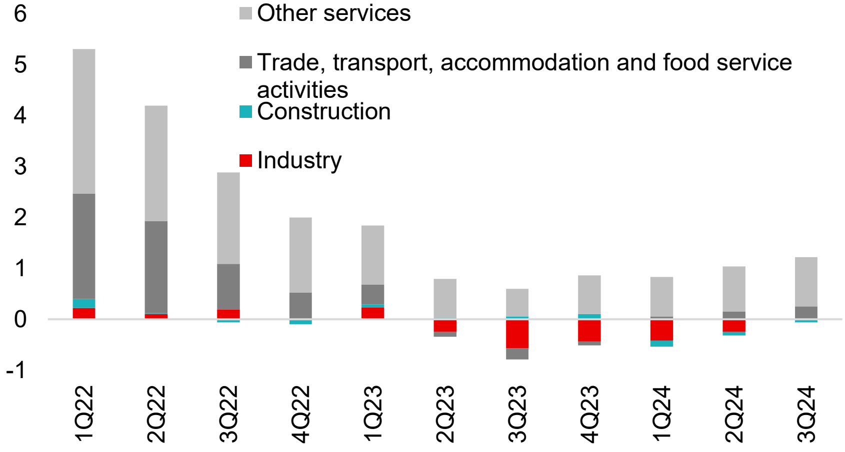
Is Europe taking part in the recovery?

You can easily get an impression that Europe is lagging behind, and the entire year 2024 was marked by idle waiting for recovery in this part of the world. In our opinion, this waiting still makes sense – maybe the eurozone will not become the economic star of the coming year, but it can provide enough demand to Polish companies to trigger a slight improvement in the economic situation. The European Commission expects an acceleration of the eurozone economy from 0.8% this year to 1.3% in 2025, the Bloomberg consensus sees a move to 1.1%, although a few months ago it was expected to be 1.4% next year.

Let us note that: (1) in the euro area as a whole, 3Q24 surprised positively in terms of GDP growth (+0.4% q/q vs +0.2% expected), in particular Spain and France contributed by beating forecasts; (2) the breakdown of this growth was also a positive surprise – private consumption improved from 0.9% y/y to 1.0% y/y, instead of falling to 0.6%, investments reduced their decline much faster than expected with a move from -3.2% y/y to -1.3% instead of -2.8%, public consumption slowed down from 2.7% y/y to 2.4% while the market was betting on 1.6%; (3) the assessment of the probability of a recession in the eurozone over the next year is not low, around 30%, but it has not changed much since the spring, despite growing fears of its largest economy falling into recession, which suggests that there are positive trends within the bloc, but they are offset by Germany's weakness; (4) in terms of value added creation, the eurozone economy is gaining momentum (0.3% y/y in 1Q, 0.8% in 2Q, 1.3% in 3Q), the value added of industry stopped falling in annual terms after five negative quarters, and the contribution of services to economic growth is gradually increasing (0.8, 1.0 and 1.2 pp in subsequent quarters of this year).

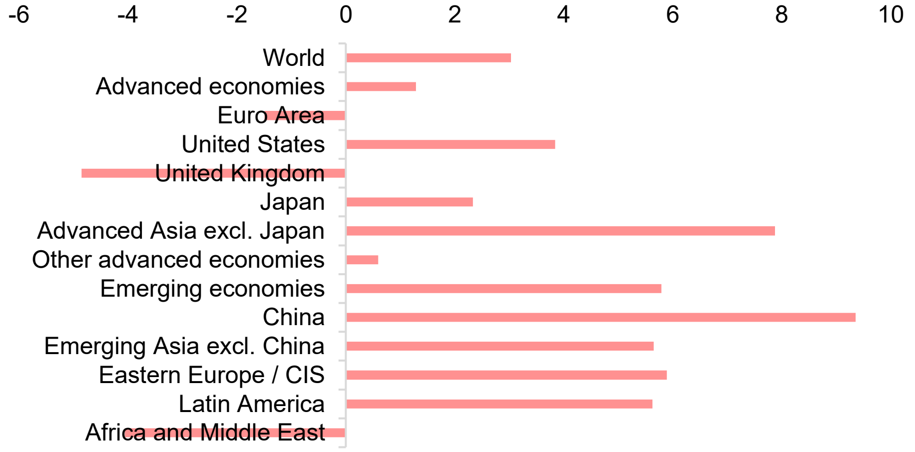
However, the outlook for the eurozone and Germany remains the main risk to our GDP forecast for Poland. The long wait for a rebound, when it is already taking place in other regions of the world, suggests that Europe's problems are to some extent structural, which will not be solved that easily. Its prospects are also affected by the change of government in the US (although, on the other hand, the weakening of the euro and reduced market rates should be a cyclical support). This lagging of the eurozone is particularly visible in the foreign trade statistics.

Contribution of value added segments to annual GDP growth in the euro zone, pp



Source: Eurostat, Santander

Export volume according to World Trade Monitor, annual y/y growth in July-September



Source: CPB, Santander

Uneven rebound in Europe vs Polish export

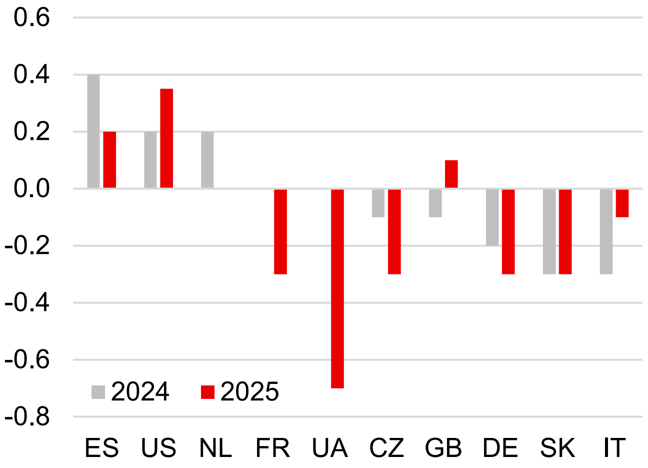
Unfortunately, the faster pace of rebound of some EU economies or the resilience of the US economy do not allow for an increase in optimism about the growth of Polish exports next year.

Over the last 3 months and among the 10 largest recipients of Polish exports, economic forecasts for 2025 have improved only in the case of Spain, the USA and the United Kingdom, but these countries make up only of 10% of domestic shipments. **The weighted average of GDP growth forecasts in 2025 for these 10 countries (according to Bloomberg surveys), after stabilization in the first half of the year, moved down again.**

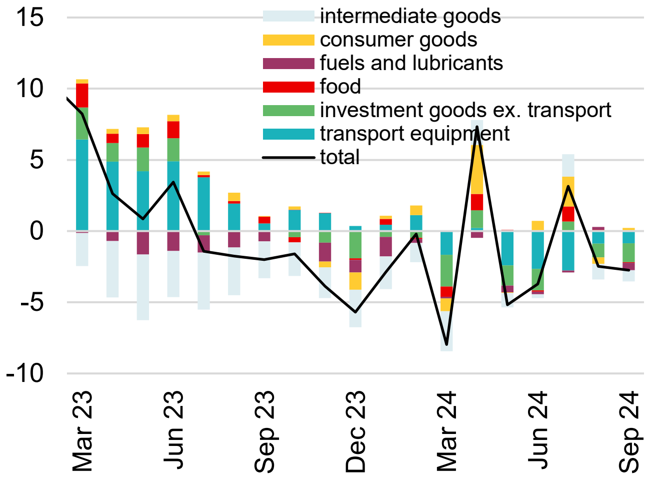
The situation of Polish producers on the foreign markets is also difficult due to the fact that the EUR/PLN remains relatively close to the export breakeven. This is a major difference compared to previous business cycles, when the zloty was rather a problem for importers, and left exporters a large buffer to improve price competitiveness.

The breakdown of Polish export growth reflects the European economic stagnation in the form of a lack of growth in intermediate, consumer and investment goods (as in previous cycles, all three categories should react vividly to the transition of the eurozone into the economic recovery). You can also see the problems of the European automotive industry (shipment of cars and parts) in Polish export. A minor positive contribution is provided by food products.

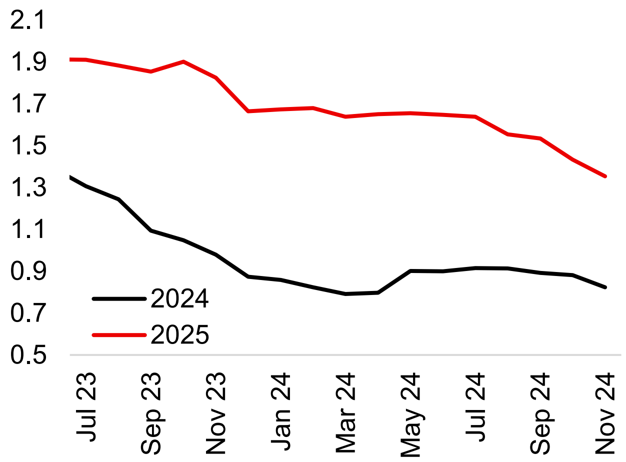
3M change in consensus forecasts for 10 main recipients of Polish export



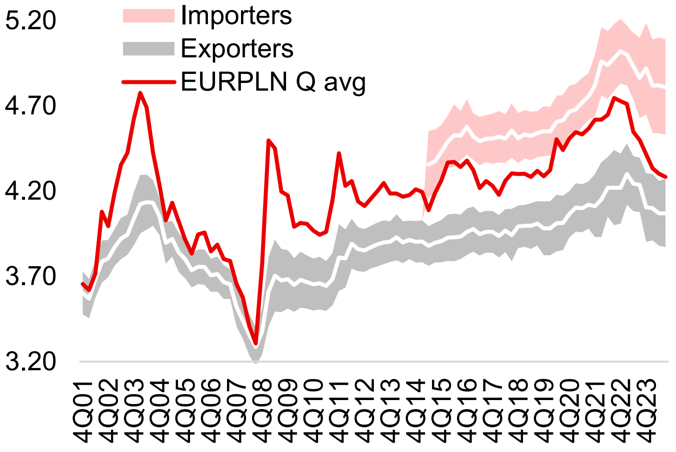
Breakdown of change in Polish export, % y/y



Average weighed GDP growth forecast form 10 main recipients of Polish export



EUR/PLN vs export and import breakevens



+/-0.5 standard deviation marked around breakevens

Source: Bloomberg, Eurostat, NBP, Santander

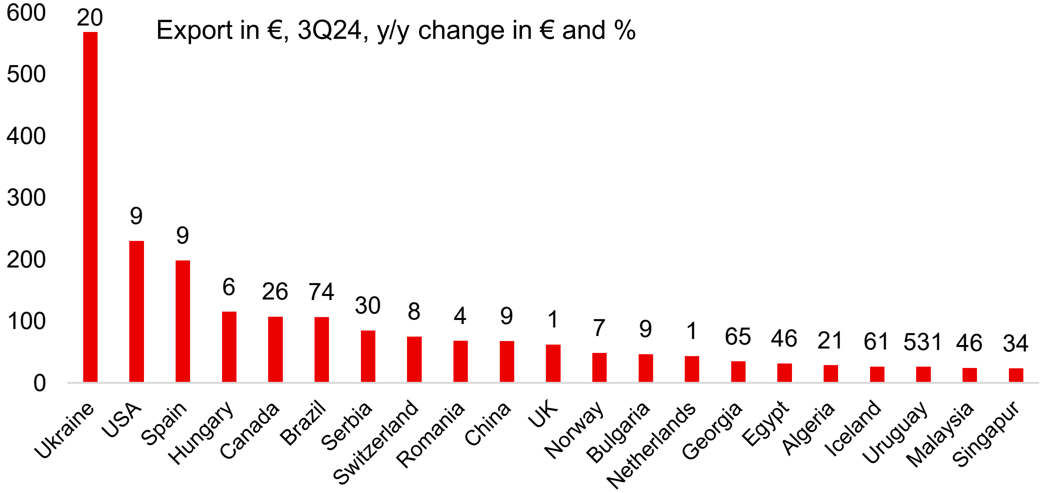
Uneven rebound in Europe vs Polish export

Polish exporters are trying to compensate for the stagnation in sales to traditional markets with greater geographical diversification, including the transatlantic expansion. For now, however, this is still a relatively small part of our export sales.

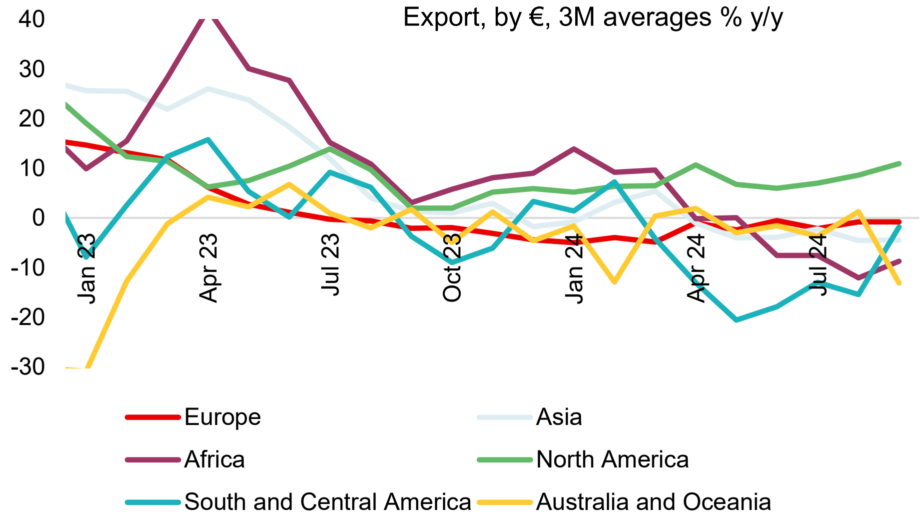
In addition, the only continent where a systematic increase in Polish exports is visible is North America, which results from the increase in turnover not only with the USA, but also with Canada.

In terms of the scale of the improvement in the annual export dynamics, Central and South America is noteworthy – after more than a year of strong declines, in 3Q24 the growth rate approached zero, which was achieved thanks to an increase in sales to Brazil by 74% y/y (one of the six countries which saw the value of exports from Poland increasing by over €100 million y/y) and to Uruguay by over 500%.

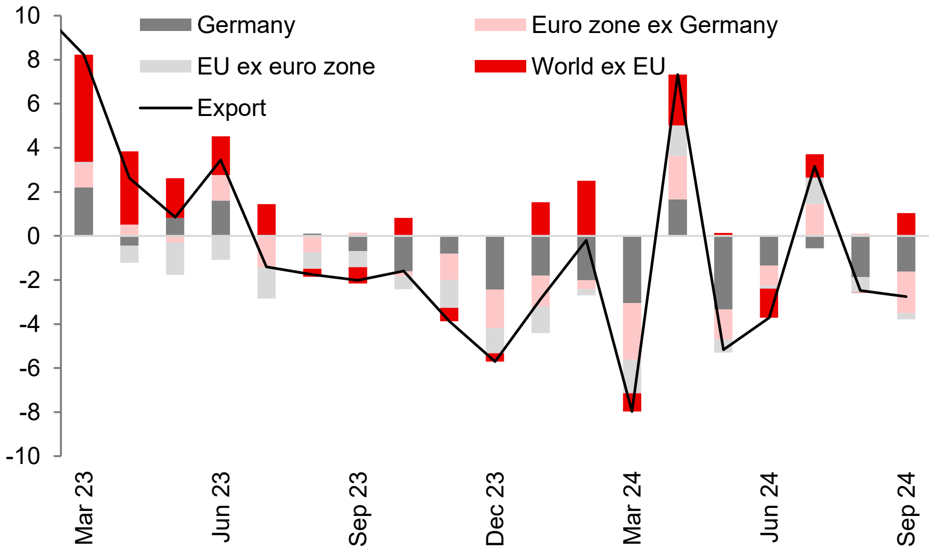
Polish export by countries, % y/y



Polish export by continents, % y/y



Polish export by geographies, % y/y

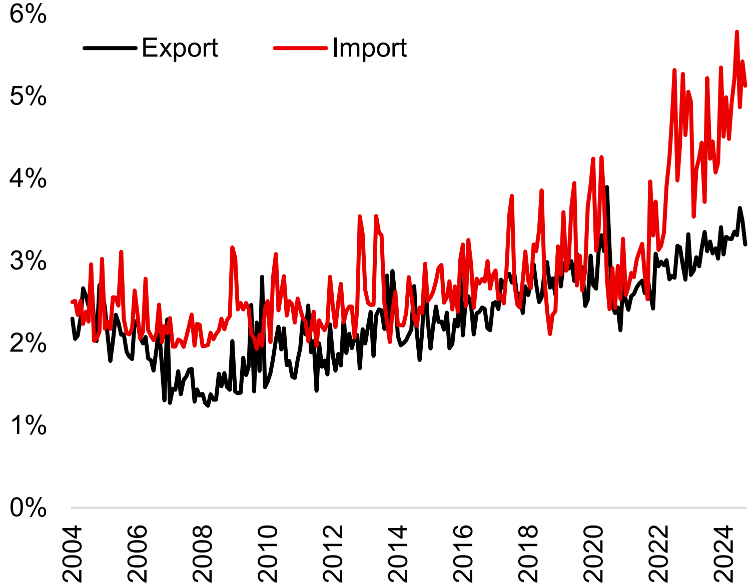


Deepening deficit in trade with the US

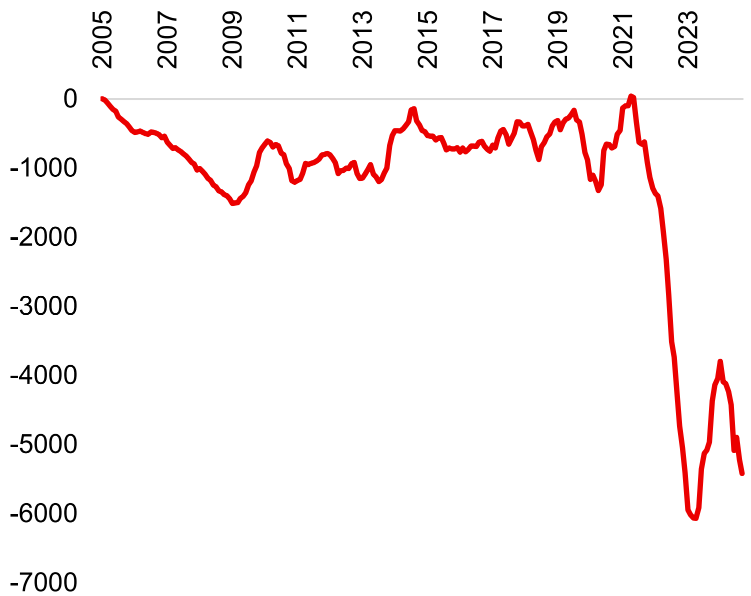
The trade wars that are to start after Donald Trump takes power in January do not have to mean a significant direct disruption in Polish's foreign trade. Although the USA is the largest recipient of Polish exports from outside Europe, its importance is overshadowed by trade relations with the EU. However, indirect effects may prove to be a problem, both those related to the possible tariffs on all shipments to the US from the EU, as well as efforts to isolate China, whose demand may be one of the main factors determining whether Europe will see a significant economic rebound next year.

On the import side, the US share is greater than in Polish exports, and it also responds to the key needs of the Polish state – diversification of energy supplies and acquisition of military equipment. **Hence, the US was among the five countries with which the balance of trade in goods fell the most compared to the pre-pandemic level.** Perhaps this will be one of the factors causing the new US administration to treat our country relatively favourably.

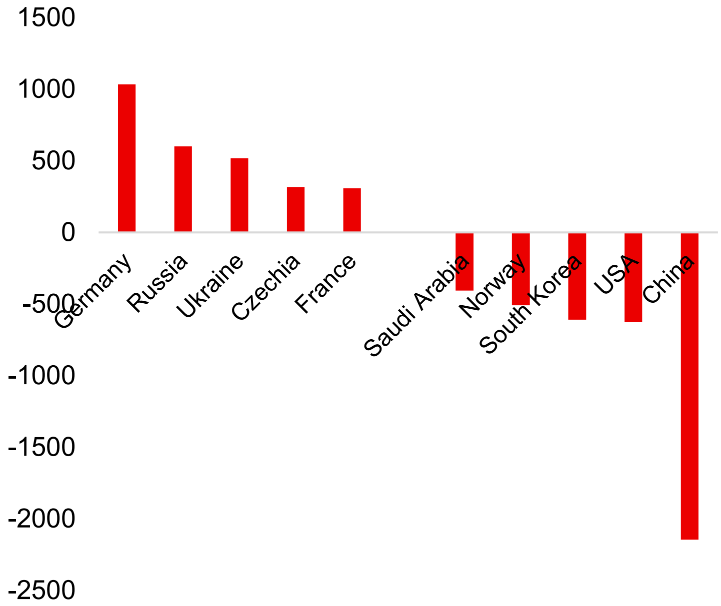
US share in Polish export and import, by value in €



US-Poland trade balance in goods, 12M moving sum, €mn



Biggest changes in Poland's goods trade balance, by countries, Sep'24 – Sep-19, €mn



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Source: GUS, Santander

Can Poland hope for special treatment from the USA?

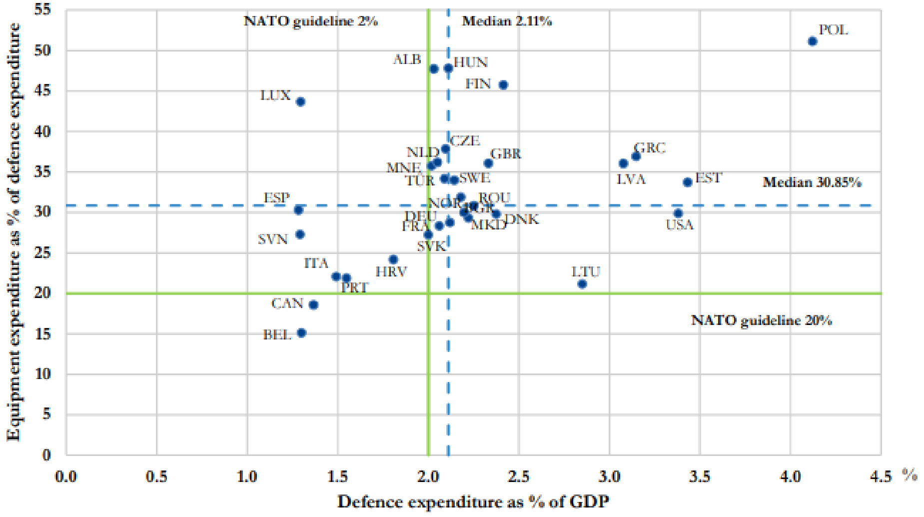
During his first term as president of the United States, Donald Trump used the criterion of trade balance when announcing changes in customs policy and aimed at disrupting bilateral trade relations in such a way that the US would achieve a surplus. If this approach were to be maintained, Poland seems to be in a good position on the eve of trade wars. However, when it comes to foreign trade, there can be no differentiation of the level of trade barriers of the USA towards individual EU countries, because the EU maintains a single external policy within the concept of the single market.

Poland is also gaining in the eyes of the US administration due to the scale of defence spending, including the share of spending on military equipment. During his first presidency, Trump reprimanded European countries for failing to meet defence spending of at least 2% of GDP, in line with NATO guidelines. Poland is the only country in the pact to exceed this level by more than twice, surpassing even the USA in this respect.

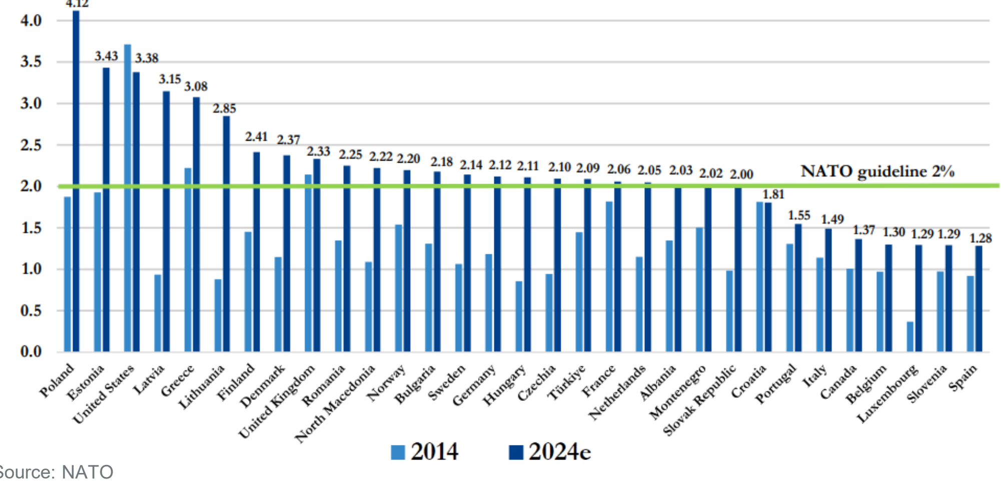
Poland is the only EU country that uses and currently has an active contract for American Abrams tanks. The current rearmament program includes many types of equipment from the USA.

All in all, these aspects allow us to assume that Polish's negotiating position will be relatively strong among European countries in contacts with the new US administration.

Defence expenditure as % of GDP vs military equipment expenditure as % of defence expenditure, 2024e



Defence expenditure as % of GDP
(based on 2015 prices and exchange rates)



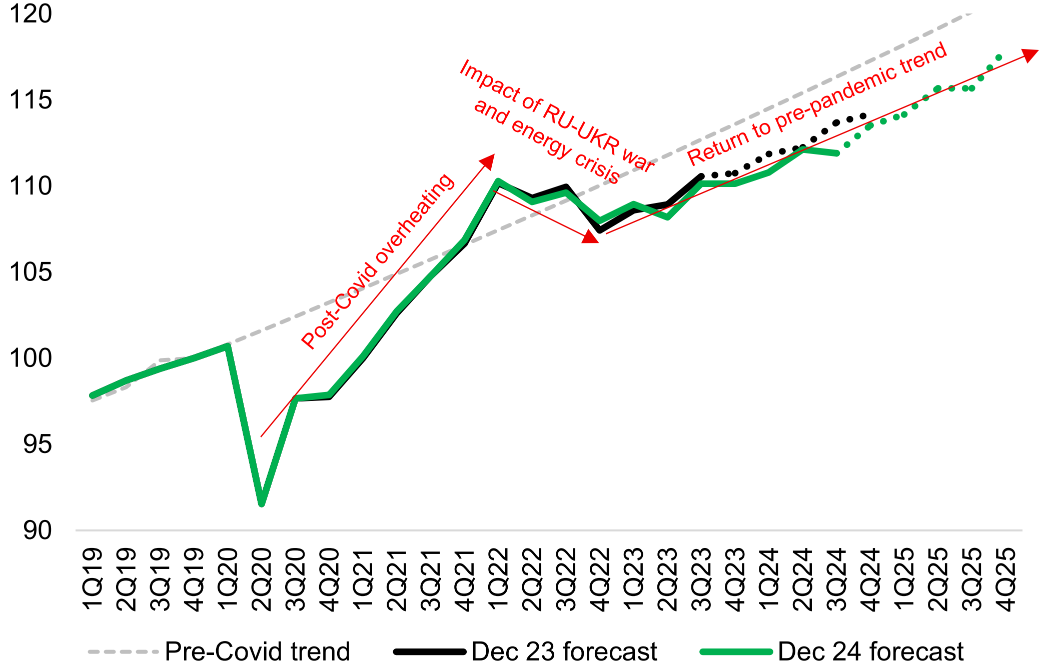
Source: NATO

Poland on the three plus growth path

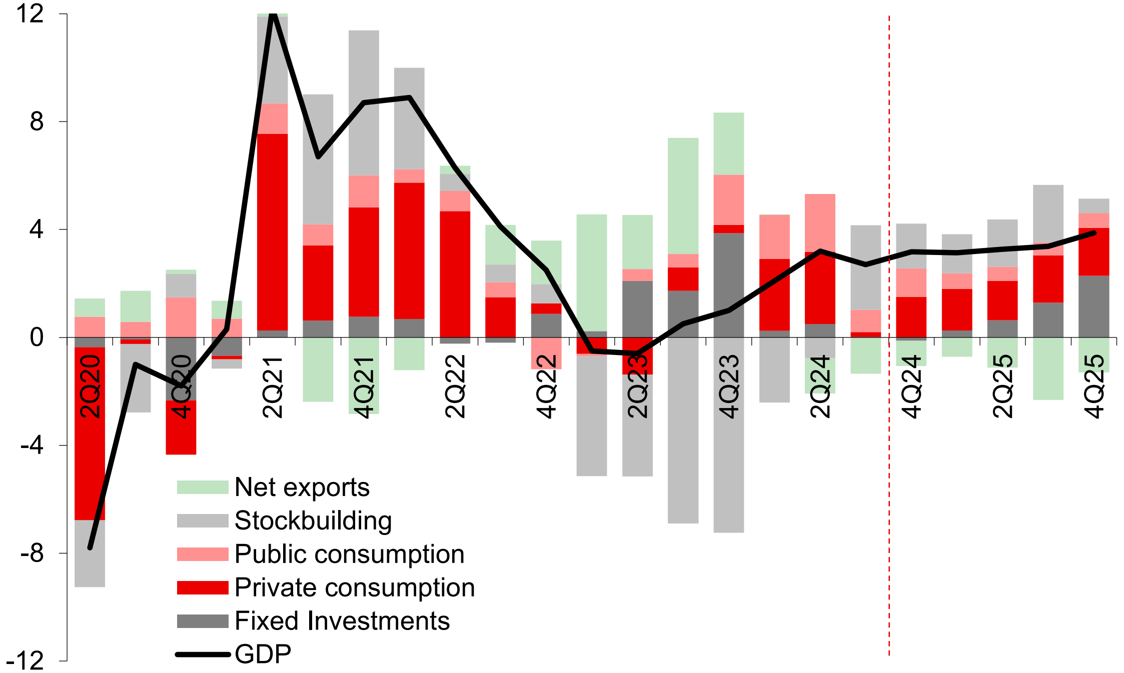
For a long time already, we have been betting on a scenario in which, after the disruption related to the energy crisis and the war in Ukraine, the Polish economy returns to the path of economic growth consistent with the pre-pandemic trend and close to potential growth (approx. 3% y/y). This scenario began to materialise at the end of 2023 and we hope for its continuation, and we interpret the disappointing 3Q24 results as a one-off, a difficult to explain disturbance, and not a signal of a changing trend. **We expect the Polish economy to grow by 2.8% y/y in 2024 and 3.4% y/y in 2025.**

Until recently, we hoped that the transition from one engine of economic growth (consumption) to another (investment) would take place relatively smoothly. However, recent data indicate that the investment recovery may be delayed somewhat (see page 19). The recovery of household savings also turned out to be stronger than we assumed, making it difficult to rebuild consumption. The gap between the two components of demand was filled by the change in inventories – a highly pro-cyclical component, which may also include accounting inaccuracies (over time, subsequent GDP revisions may lead to the reclassification of some of these expenditures as consumption and/or investments, as has been the case in the past).

Seasonally-adjusted GDP, 4Q19=100



Polish GDP growth breakdown, % y/y

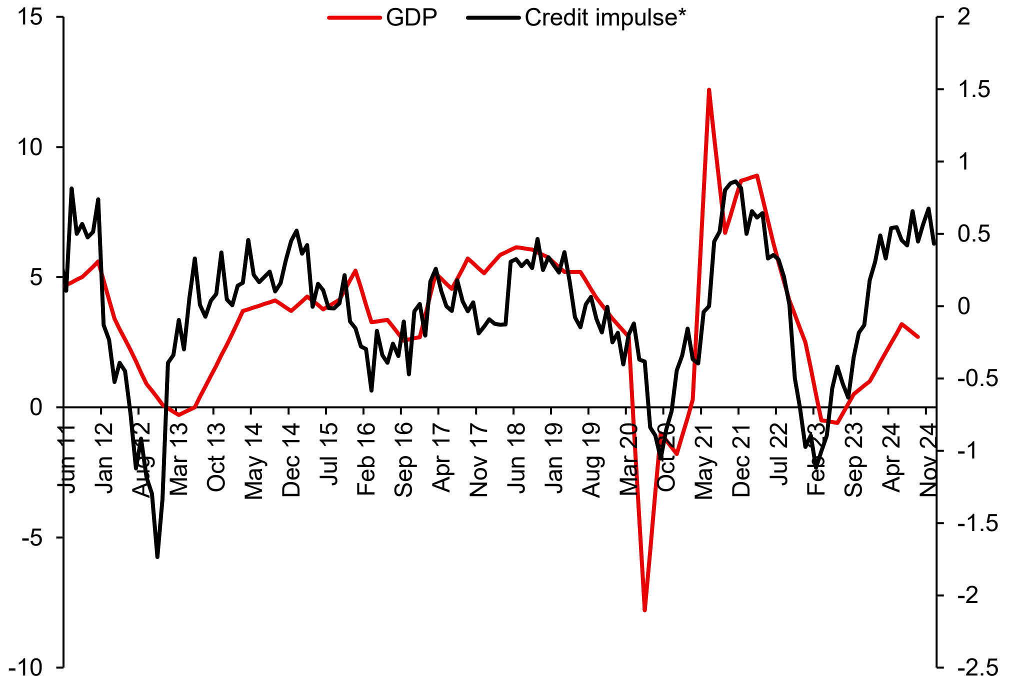


Source: GUS, Eurostat, Santander

Two signals of further recovery

The slowdown in the upward trends in the domestic economy is not announced by leading indicators, which in the last decade have generally been quite well correlated with the business cycle: the credit impulse and the slope of the yield curve. Their behaviour is consistent with maintaining GDP growth around 3%+.

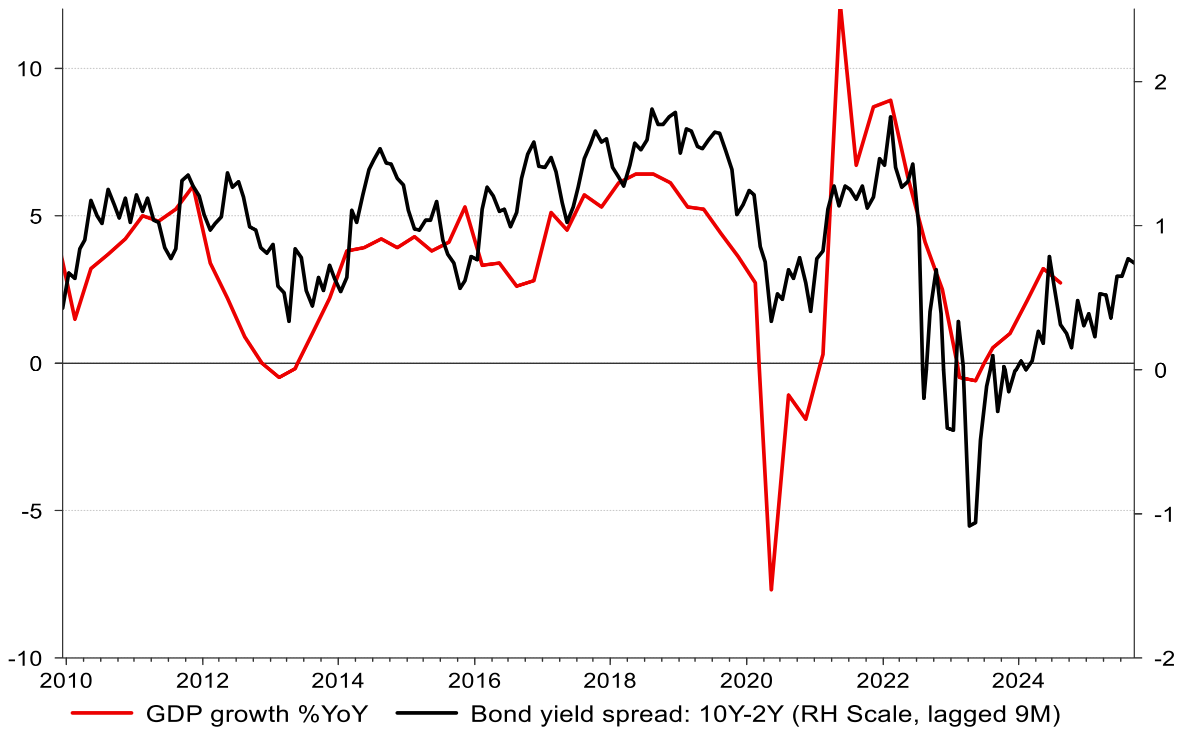
GDP growth vs credit imulse



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

Source: GUS, NBP, Santander

GDP growth vs yield curve steepness



Source: LSEG Datastream, Santander

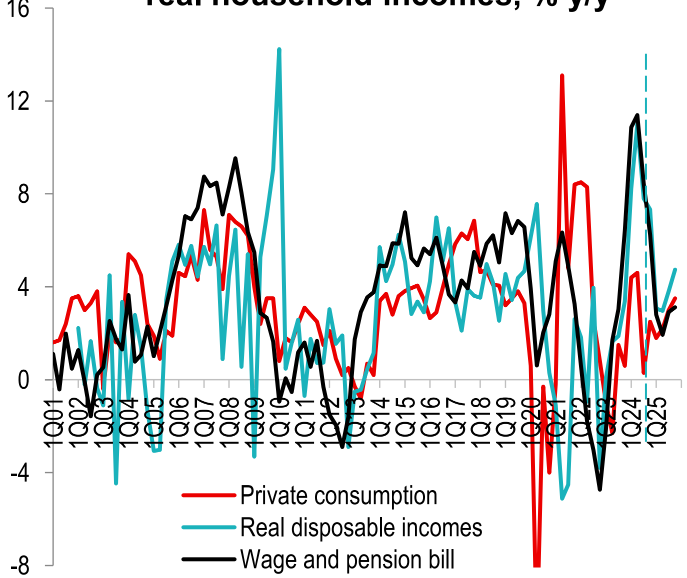
Private consumption: not as bad as it seems

The disappearance of private consumption growth in 3Q24 after a surprisingly strong first half of the year, fuelled speculations about „consumer's death", which in our opinion were premature. On the income side, households still had everything they needed to maintain solid consumption growth. Their incomes will continue to grow in real terms (albeit slightly more modestly) in 2025. There will be no return to double-digit real income growth, but there will be grounds for expecting further solid support for economic growth from private consumption.

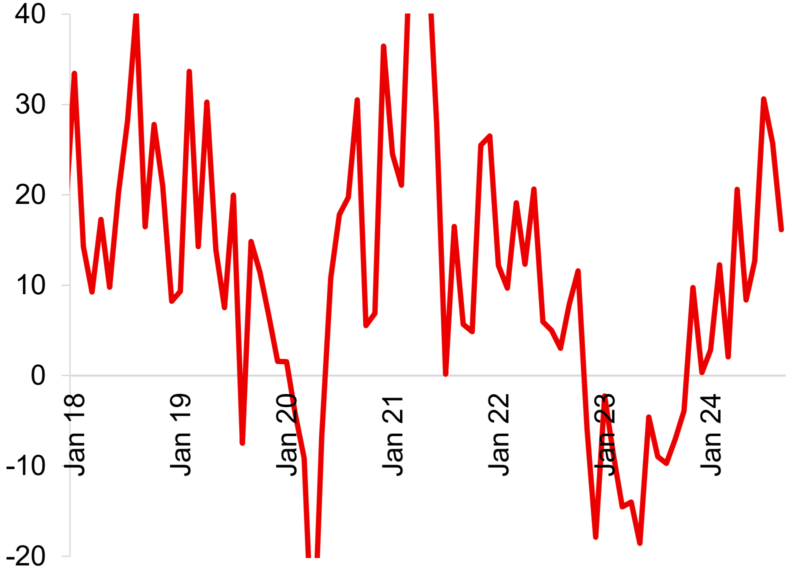
In our opinion, private consumption has stopped only for a moment and will soon return to solid growth - in 2025 it will grow by about 3%, like in 2024. Data on card spending of Santander Bank Polska customers show high momentum in the purchase of services. Imports of consumer goods, in particular durable goods, continue to grow rapidly. Consumption will be stimulated by the start of interest rate cuts during the year and by a further saturation of the economy with consumer credit.

The propensity to save remains an important player, as has been growing since the beginning of 2023 and this year is already clearly higher than before the pandemic and often cited as the reason for the weakness in consumption in 3Q24. In our opinion, its growth should clearly slow down in the next few quarters, which means that households will remain eager to spend.

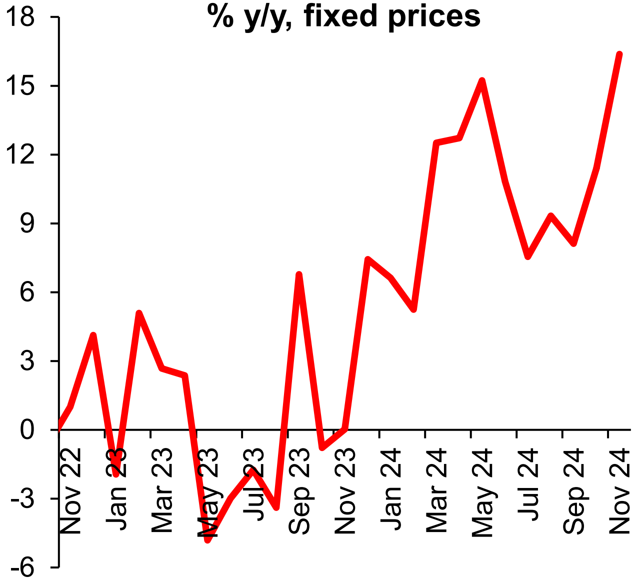
Private consumption and gauges of real household incomes, % y/y



Import of consumer durables, €, % y/y



Spending on services, estimate based on card payments, % y/y, fixed prices



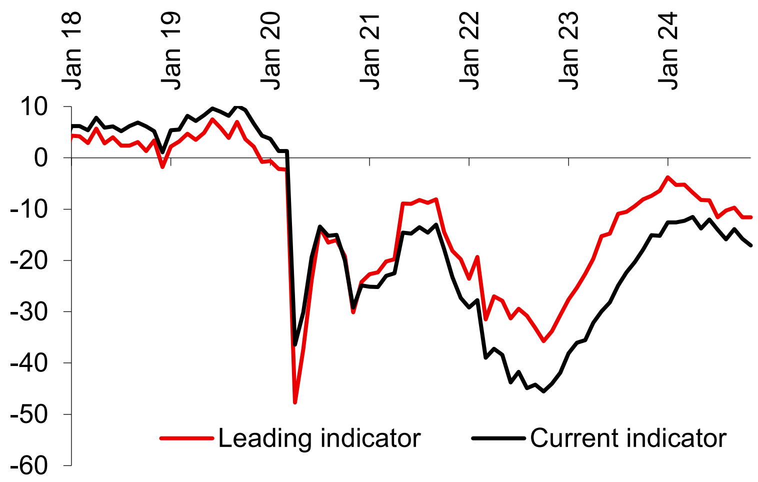
Source: Eurostat, GUS, Santander

Stabilisation of the saving rate

We assume that in 2024 there was a marked increase in the saving rate (the actual data from sectoral accounts are known only for 1Q24), in line with the long-term relationship with the real interest rate. **In our view, the saving rate will stabilise in 2025, which, with slightly slower growth in disposable income, should leave room for solid consumption growth.**

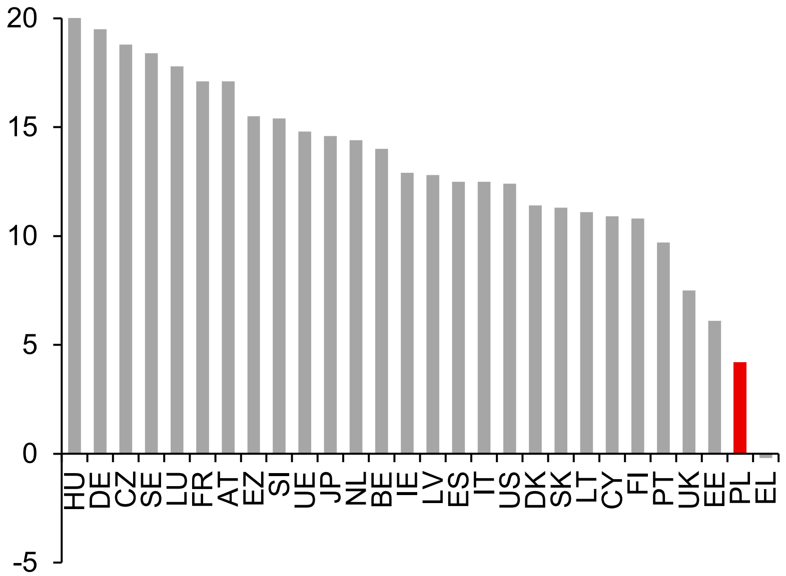
Poles are characterized by a rather low propensity to save, the saving rate is one of the lowest in the EU. However, it is worth bearing in mind that the relationship between the saving rate and the real interest rate is sometimes strongly disturbed when the savings rate is much higher. For example, after the global financial crisis, the period of elevated savings lasted about 2 years, and the Covid period combined with the war crisis lasted nearly 3 years. In both cases the growth and persistence at an elevated level covered 6 quarters, after which normalization began. Are there currently reasons for an excessive increase in the savings rate? The motivation to save may stem from the need to rebuild real value assets, deteriorated due to high inflation. An austere attitude can potentially be sustained by the erosion of consumer sentiment. However, in our opinion, it is happening too slowly to be able to disrupt consumption so much. The uncertainty related to the victory of D. Trump in the USA may be worrying, but for a large group of citizens it was actually a desirable outcome (for about 30% according to the CBOS survey). This year's return of inflation in 3Q could also have raised concerns. But if we consider this as the reason for the slowdown in consumption growth, then 4Q24 saw the payment of the energy voucher and the decision to extend the electricity price and capacity fee freeze.

Consumer optimism indicators, pts



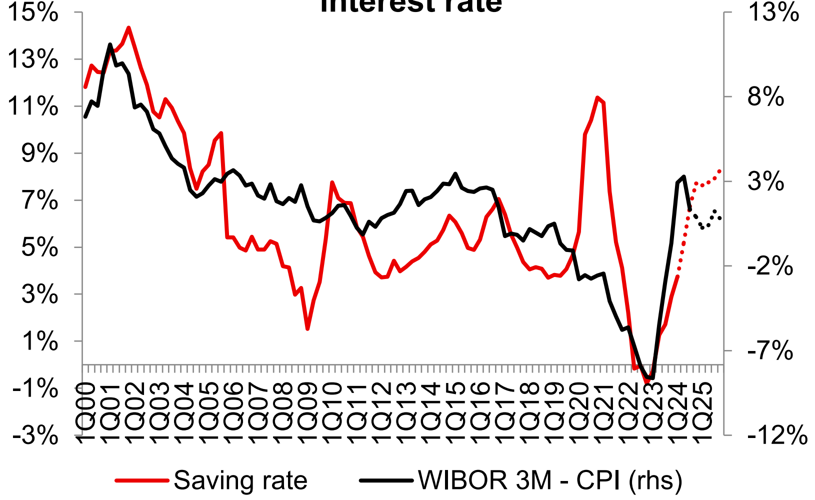
Source: GUS, Santander

Saving rate, EC estimate, 2024, %



Source: EC, Santander

Households' saving rate vs ex post real interest rate



Source: GUS, Santander

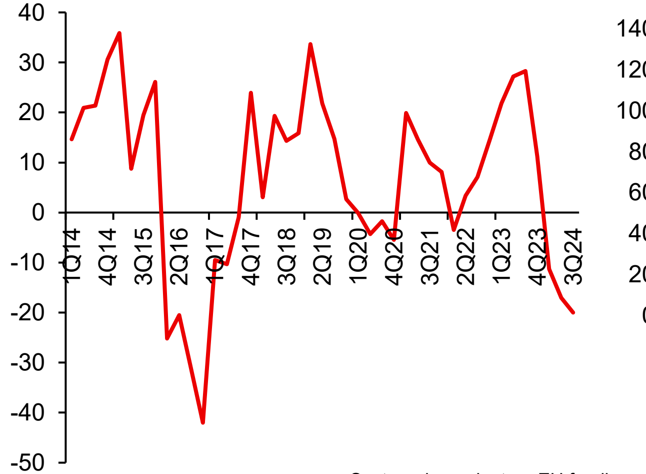
Investment: EU funds kicking in

Everything indicates that 2024 will be extremely weak in terms of investments. Although this is in line with our expectations, we did assume that the EU funds will be gradually kicking in through 2024. However, data for the first three quarters rather point to a progressive deterioration of investments financed with EU funds.

On the other hand, data on applications for EU funds payment showed an upward move in October and November – in these two months the value of applications amounted to PLN3.6bn compared to PLN4.2bn total in 1-3Q24. Bear it in mind that the payment application may appear at various stages of the investment project – also as an advance payment. Since projects financed the 2021-2027 framework are just starting, it can be assumed that these are mainly advance payments, and therefore these data indicate the start of significant projects. The high number of applications for funding and the growing number of contracts suggest that this process will intensify in the coming quarters. Since the beginning of the year, the EU funds budget has seen increasing expenditure from the Recovery Fund and so far PLN12.9bn have been used, including PLN7.6bn in subsidies. This represents only about 5% of the Fund's resources, but 47 out of 57 investments included in the RRP have already been launched, which bodes well for future spending. We write more about EU expenditure on page 22.

We maintain our forecast that in 2025 we will see a significant acceleration of investments due to the growing use of EU funds. However, this year's poor results suggest that the rebound will come a little later than we had expected.

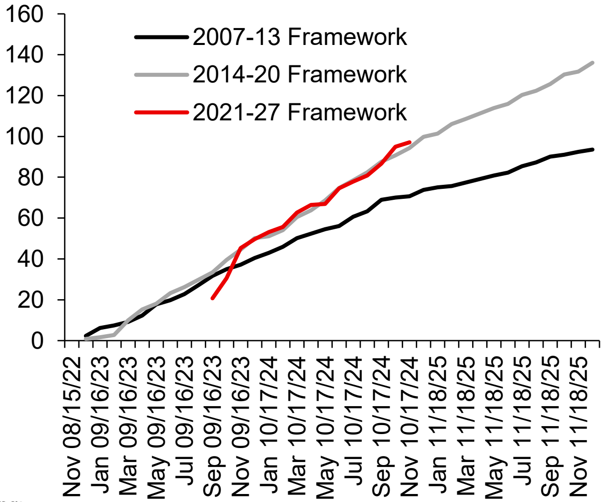
Investment in 50+ companies with major dependence on EU funding, % y/y



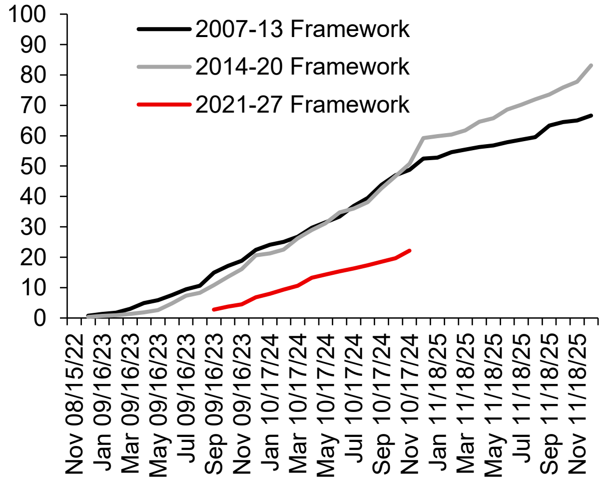
Sectors dependent on EU funding: construction, transport, energy, water supply – based on NBP research

Data on cohesion find financing, €bn

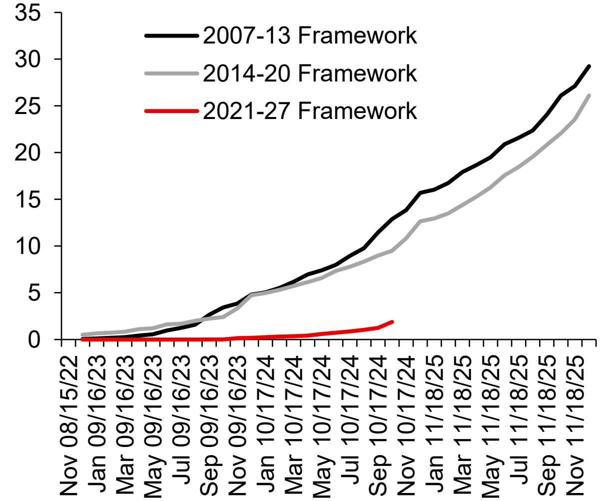
Financing applications



Financing contracts



Payment applications



The time axis puts together corresponding periods of the three EU Multiannual Financial Frameworks, e.g. Feb 2024 in the current MFF with Feb 2017 in the 2014-20 MFF and Feb 2010 in the 2007-13 MFFF.

Source: Eurostat, GUS, NBP, Ministry of Funds, Santander

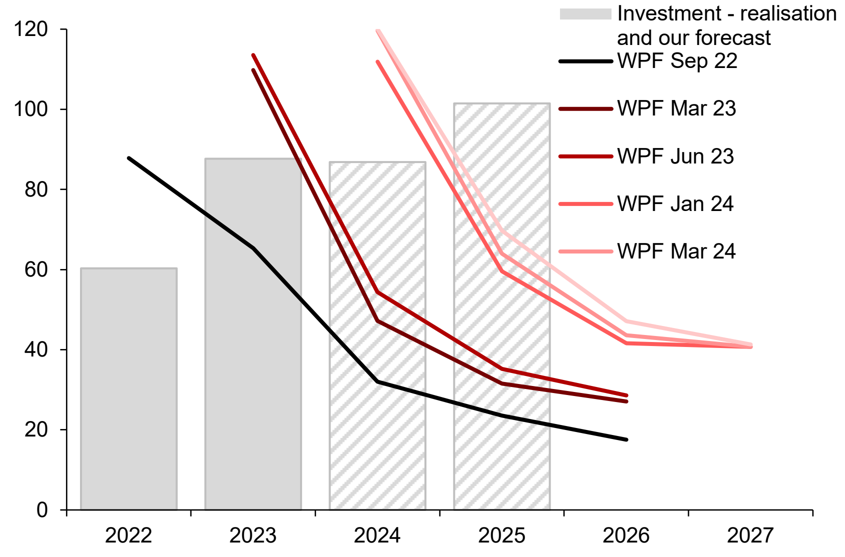
Investment: increase in the public sector

In our MACROscope with 2024 outlook, we forecast that the investment expenditures of local governments would increase only slightly, but this would be an increase comparable to a stagnation. The available data for the first three quarters of 2024 confirm our assumptions, showing a slight decrease in nominal terms.

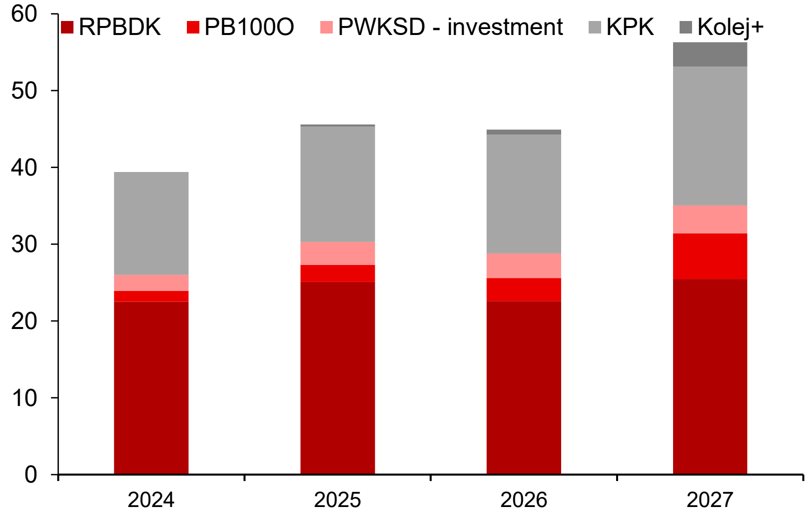
We are more optimistic about 2025: the financial plans of local governments from June (and therefore still incomplete) assume that in 2025 investments will amount to about PLN70bn. One year earlier, the plans from June 2023 assumed that in 2024 investments would amount to about PLN55bn. Based on that – and assuming the growing use of EU funds – **we forecast that local government investments will increase in 2025 by about 15% in nominal terms (about 10% in real terms)**. We will verify this assumption after the publication of the supplemented financial plans of local governments for January 2025.

We expect similar trends in the central sector, but with rather weak upward trends in military spending and transport infrastructure. Expenditure on roads is unlikely to reach the growth rates planned in the long-term programmes, because both the financial plans of the KFD (road financing fund) and GDDKiA (road management agency) assume that 2025 expenditures will be nominally similar to that in 2024 (cPLN20bn). In the case of defence spending, the budget for 2025 assumes a slight increase: to 3.2% of GDP from 3.0% of GDP in 2024 (in ESA terms).

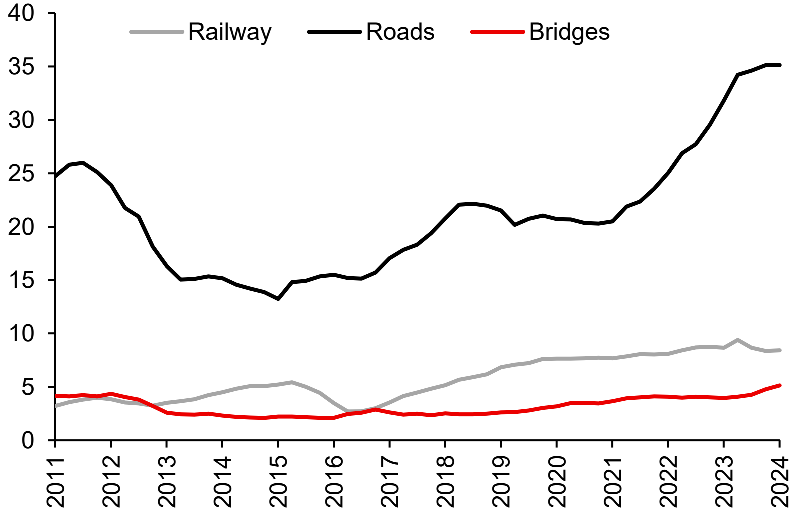
Local governments' investment – plans and realisations, PLNbn



Road and railway investment plans in multiannual programmes, PLNbn



Spending on particular construction items, PLNbn, 12m sums



Source: Eurostat, GUS, NBP, Finance Ministry, Santander

Investment: private sector slightly behind

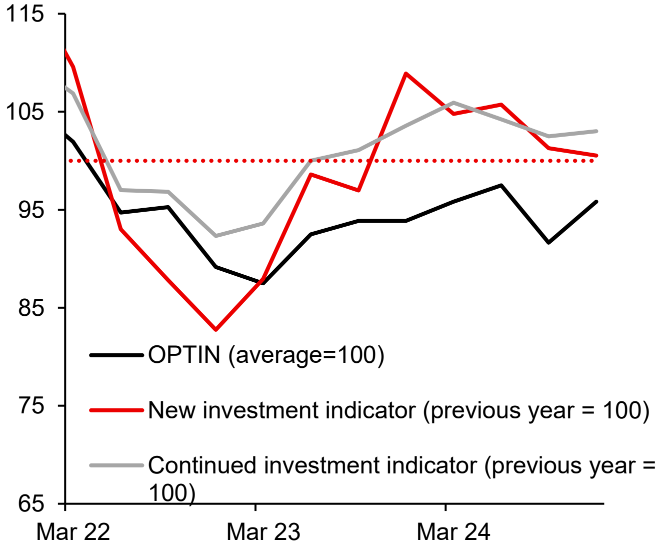
Companies' investment was weak in 2024, as we had assumed. In the first three quarters, investments of large companies decreased by 7.5% y/y in real terms, and the decline deepened from quarter to quarter. The sector's result was most strongly influenced by negative trends in transport and manufacturing.

Recently, the investment optimism of Polish companies has improved slightly, and according to the NBP, this was due to expectations of an improvement in demand and an increase in the EU funds inflow. Although we believe that corporate investments will rebound, mainly due to the growing use of EU funds, the prospects for growth are clearly good – financial results are not improving, export prospects remain uncertain, and capacity utilisation is low. In addition, the estimates of started investment project are on the downslide.

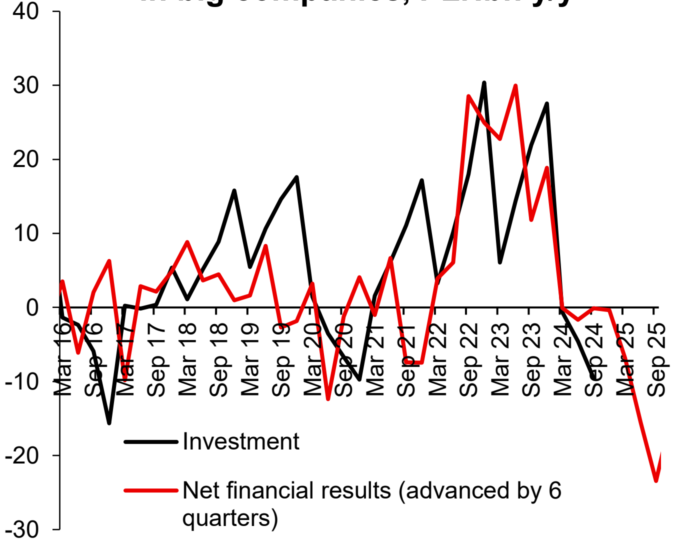
We assume an increase in investments by non-financial corporations by c5% y/y in real terms in 2024.

We also think there will also be a slight rebound in investments in the household sector. An upward risk for this forecast may potentially stem from the new housing market support program, which is to be presented in 1Q25.

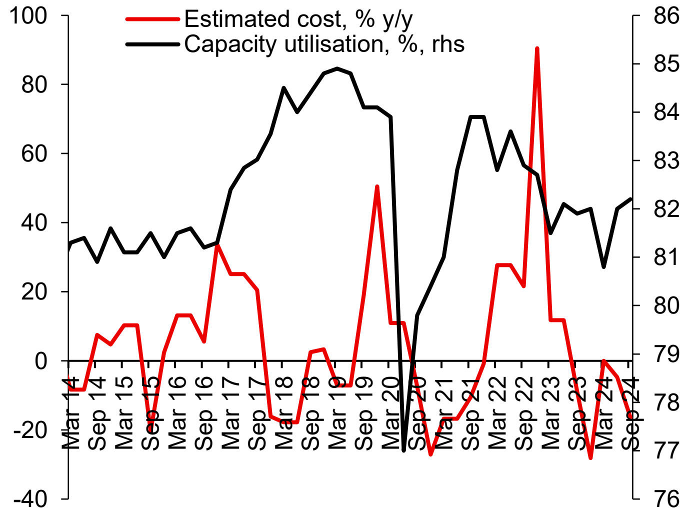
NBP investment optimism indicators



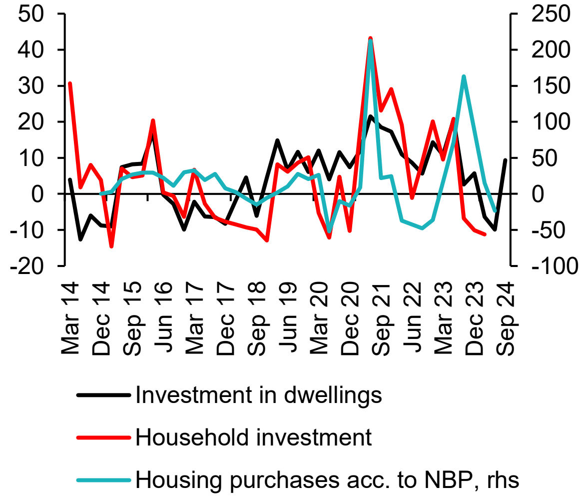
Investment vs results in big companies, PLNbn y/y



Estimated cost of started investment, capacity utilisation



Household investment vs investment in dwellings, % y/y



Source: GUS, NBP, Santander

Santander

EU funds: source of investment growth in 2025

The use of EU funds in 2024 is weaker than we expected. Nevertheless, in 2025 we should see a significant increase in the expenditure of the European Funds Budget (EFB).

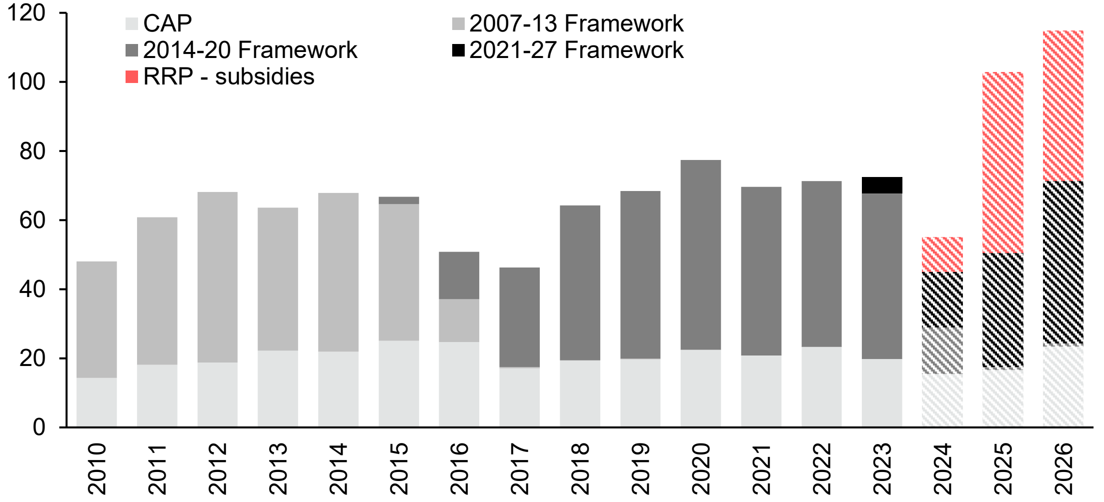
So far the usage of the 2021-27 financial framework was modest. According to our estimates, expenditures from the financial frameworks in 2024 amounted to PLN22bn, with the new framework making up about PLN8bn. We expect that by the end of the year, expenditure from the new budget may amount to about PLN16bn, in line with the plan from the Budget Act, but also below our previous forecasts. The EFB spending from both frameworks should amount to about PLN30bn.

We expect that in 2025 the Recovery and Resilience Fund will become the main source of EU funds spending.

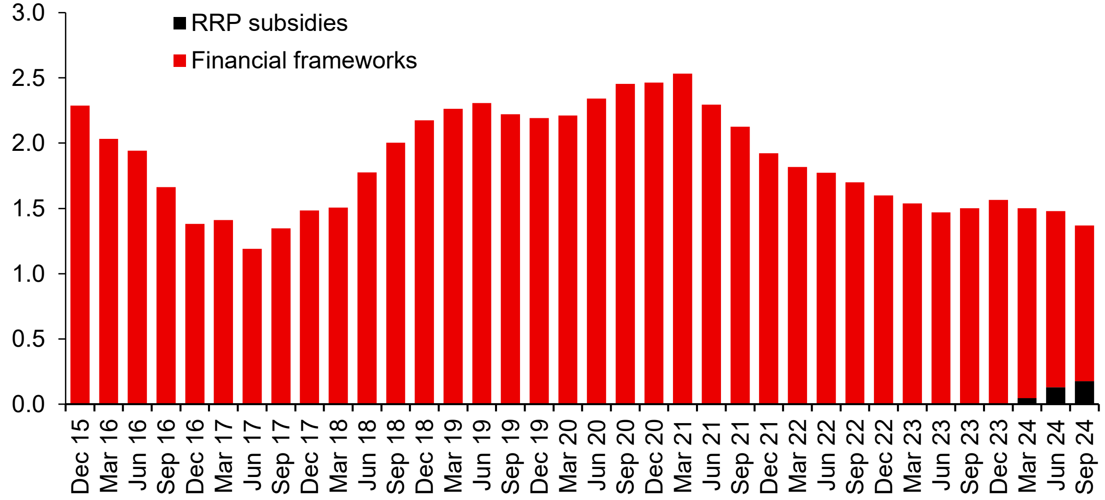
At the beginning of December, the Ministry of Funds and Regional Policy announced that the expenditure from the subsidy part of the RRF amounted to PLN7.6bn. In our opinion, by the end of the year, it may approach PLN10bn.

The total value of the RRF is about PLN260bn, including cPLN100bn in subsidies. In order for a significant part of the funds to be used, their spending will have to be accelerated. We assume that expenditures from the subsidy part of the RRF will amount to PLN50bn in 2025, in accordance with the plan from the Budget Act for 2025. It should be emphasized that this amount does not include expenses from the loan part of the RRF. Back in October, Minister Pełczyńska-Nałęcz suggested that in 2025 the total investment expenditure from the RRF could amount to PLN80-100bn, which suggests that the expenditure financed by loans could amount to at least PLN30bn. Nevertheless, even if the actual expenditure turns out to be lower, it should still make 2025 the year of investment.

EFB spending, PLNbn



EBF spending within financial frameworks and RRF subsidies as % of GDP, moving 4-quarter average



Source: GUS, Finance Ministry, Santander

EU funds: strong jump in transfers

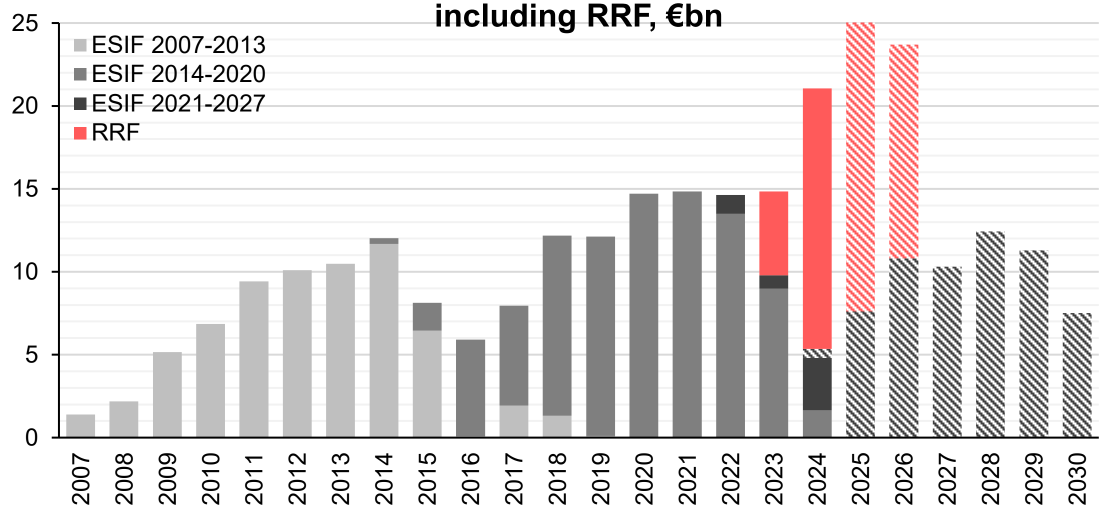
While the EBF spending will be more modest this year than in 2023, transfers from the EU to Polish have already increased well above their 2023 levels.

The Finance Ministry data (bottom chart) show that since the beginning of the year, the inflow of conventional EU funds (i.e. funds from the Common Agricultural Policy and Financial Frameworks) to Poland has been weakening significantly. Nevertheless, the extension of the data to include transfers of grants and loans from the Recovery and Resilience Facility shows that the twelve-month rolling sum of funds sent to Polish since April has been well above the 2023 level.

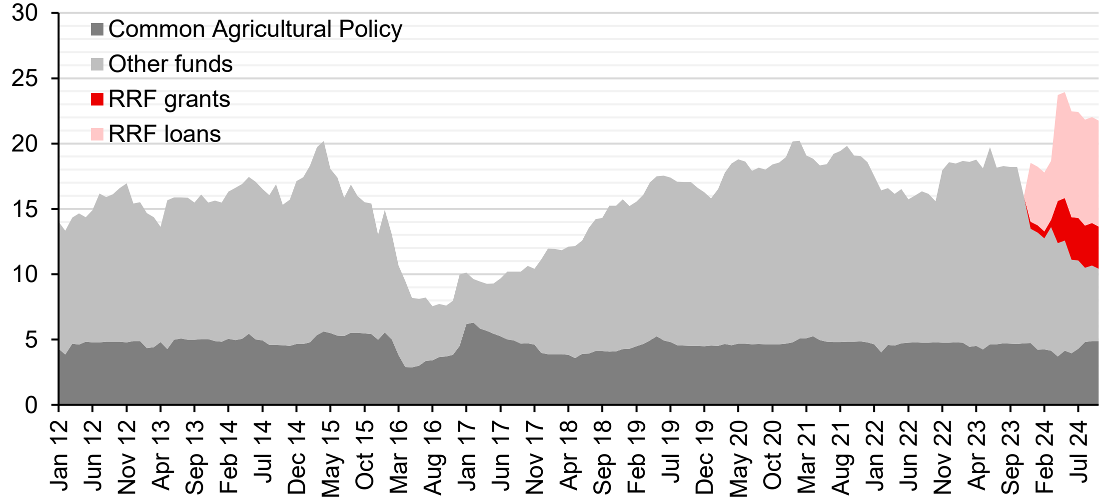
In mid-December, Poland received the 2nd and 3rd tranches of the RRF, containing €4.1bn in subsidies and €5.3bn in loans. RRF payments account for the majority of this year's total transfers of EU funds and amounted to €15.7bn. As a result, **the total inflow of structural and investment funds, as well as recovery funds, will slightly exceed €20bn this year.**

In 2025, despite the early stage of the implementation of the new financial framework, the recovery funds may allow to achieve an even higher sum of transfers. However, the final result will depend on the date of submission of the 6th and 7th payment application under the RRP. Both applications are to be submitted in 2025. We assume that the government will try to send them in time to allow the European Commission to consider them and transfer the funds in the same year.

Realised and expected inflow of cohesion and investment funds including RRF, €bn



EU transfers to Poland, 12m moving sum, €bn



Source: EC, Finance Ministry, Santander

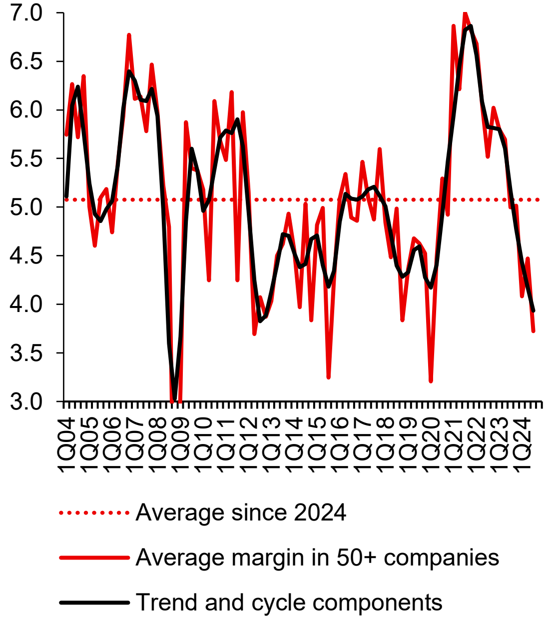
Low profitability of companies

The average margin achieved by companies employing 50 or more people reached a historically very low level in 3Q24. The share of companies reporting net profit was at the lowest level since 2014.

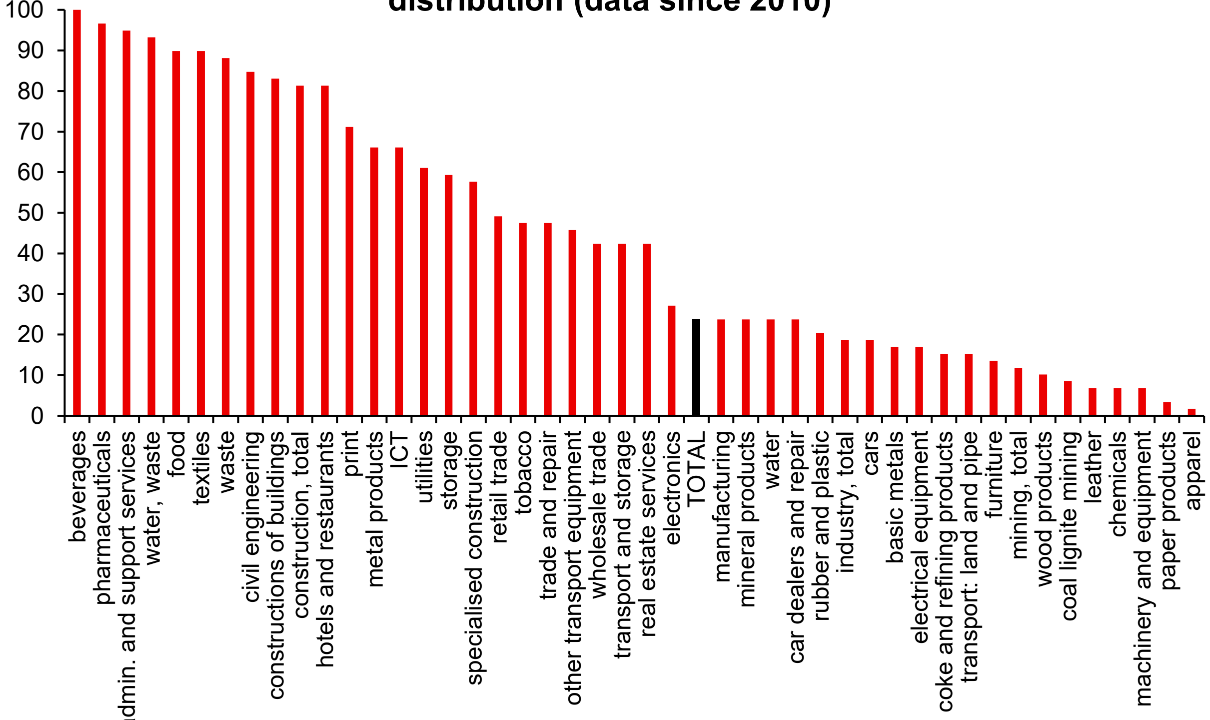
We assume that in 2025 companies will want to fight for an improvement in profitability, which will be conducive to a more assertive attitude in wage negotiations (see page 31), but will also delay the inflation's decline to the target and have a negative impact on labour demand. Weaker results will also have a negative impact on investment enthusiasm in companies, although EU funds should provide a strong enough impulse to improve the situation compared to 2024.

However, it is worth bearing in mind that the situation is extremely diverse between industries. In some sectors, margins are the highest since comparable data are available (2010) – e.g. in the production of beverages, food or pharmaceuticals. In others – they are close to zero (production of clothing, paper, machinery and equipment, chemicals, coal mining).

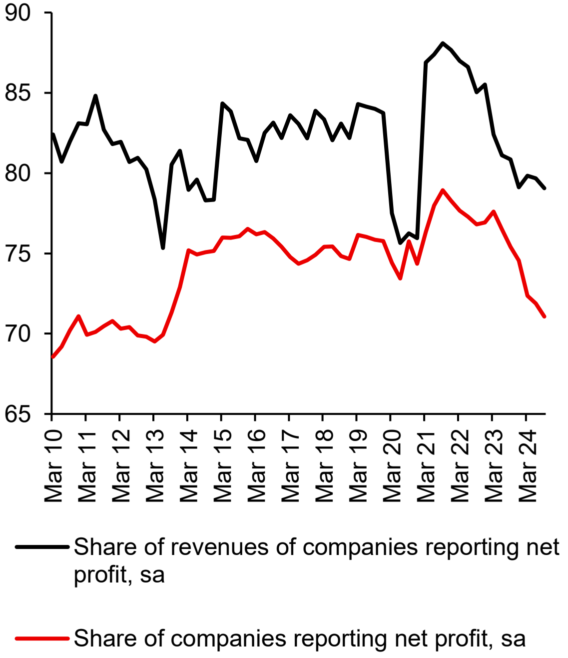
Margins in companies employing 50+ people



Sales margins* by sector, 3Q24 as percentile of distribution (data since 2010)



Share of companies reporting gains



* Margins calculated as a ratio of gross financial result and revenues from sales

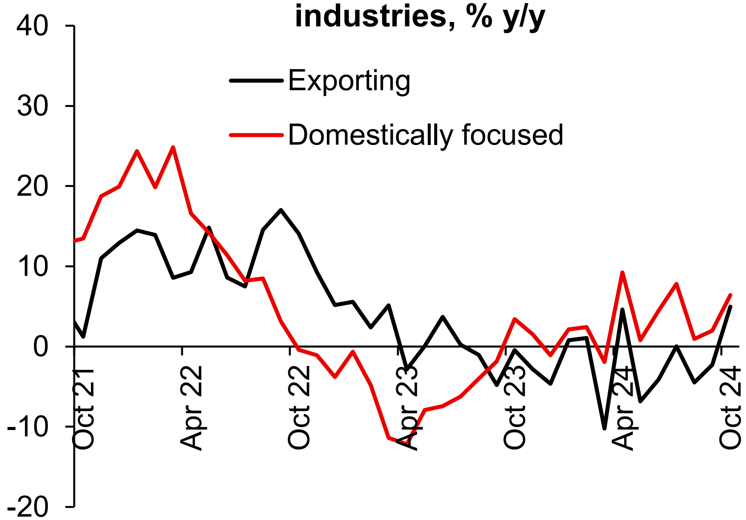
Source: GUS, Santander

Industry: resilient, but not immune

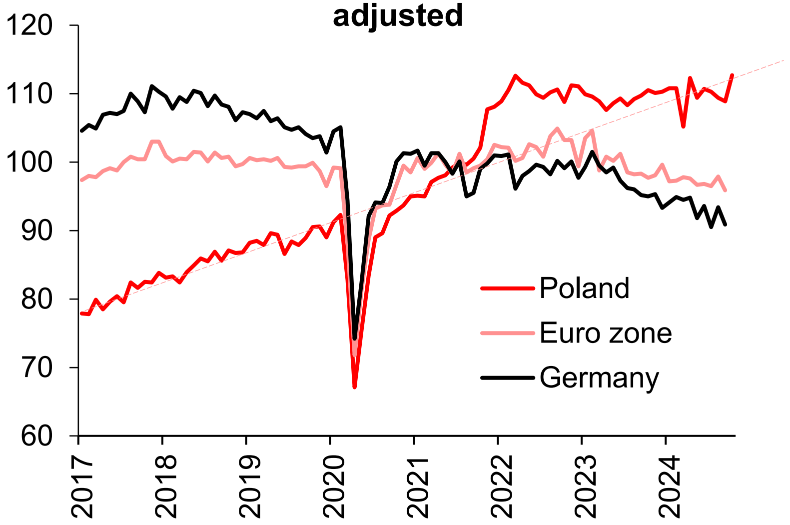
After the massive October rebound in sold production of industry, we can say that our forecast for this year that the industry will return to the pre-pandemic trend in terms of volume, was accurate. However, we were a bit more optimistic, to be honest. Admittedly, the sector's results turned out to be extremely sensitive to calendar effects (working days, postponement of Easter, and thus unusual two long weekends in May), so disappointments alternated with upward surprises. However, recent months have been rather a history of weaker readings, and the October jump appeared after a weak series. All this happened with Germany balancing on the verge of recession, and in particular with large declines in the Germany industry, which is a key source of orders for Polish suppliers. In addition, domestic producers were undermined in the fight for orders by a relatively large increase in the minimum wage, high energy prices and a fairly strong zloty, in a situation of intensified price competition (falling PPI indices in Europe, but also in China). In this context, and in the light of the fact that a year ago we assumed that the main trading partner would be in better shape, the results of the Polish industry should be considered good, or at least adequate to the external conditions.

The outlook for the industry remains challenging. It is still difficult to assume that Europe will transition to a full-fledged economic recovery if it is to face the aggressive policy of the new US administration in 2025. However, the need of the hour, i.e. strengthening defence, may force greater industrial activity, also in Poland. We also do not lose faith in the Polish consumer, who was able to help industry sectors oriented towards the internal market achieve better results than the exporting industries. Finally, our scenario also assumes a (postponed, but still) recovery in the construction industry, which will ensure an improvement in demand for building materials, wood and metal products. **We are expecting industrial output to advance by 3% in 2025.**

Output in exporting and domestically focused industries, % y/y



Industrial output volume, 2021=100, seasonally adjusted



Source: Eurostat, GUS, Santander

High activity on the credit market

Since the end of last year, the credit market has been recovering. The improvement is particularly visible in the case of consumer loans, the sales of which have been steadily increasing, and in October they reached PLN10.0bn, which is the highest result since comparable data have been available (i.e. since December 2014). Nevertheless, such high sales results will probably prove difficult to maintain, which is why we expect them to normalise to PLN7-8bn per month in the coming quarters.

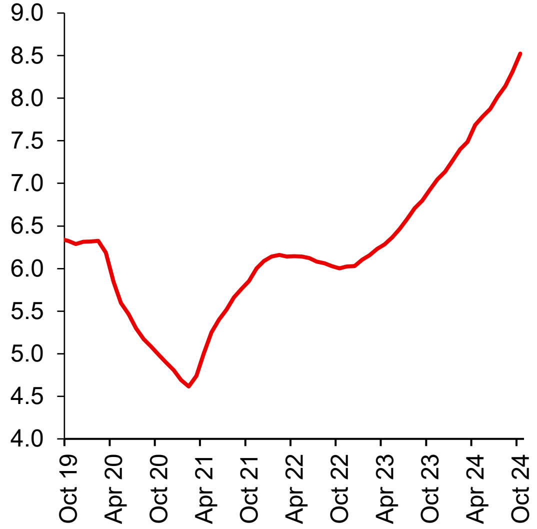
Sales of housing loans are still at a high, although no longer record-breaking level, exceeding PLN6bn per month. We assume that the market dynamics will stabilise in the coming quarters. **However, a lot can be changed by a potential new housing program, the details of which are to be presented in 1Q25.**

The results of corporate loan sales are below their records from previous quarters, but they do not look bad and suggest that enterprises are willing to increase their activity. **The ongoing economic recovery should encourage companies to increase the use of credit in the coming quarters**.

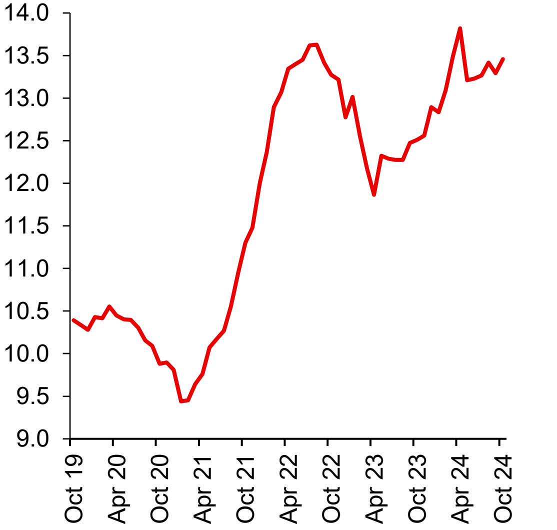
The growth rate of loans in terms of volume (and adjusted for exchange rate effects) has been steadily increasing since the beginning of the year, from 2.5% y/y in January to 4.7% y/y in October, thanks to which it is slowly approaching its pre-pandemic average of around 6% y/y. **We assume that in 2025, the dynamics of the credit market will be close to this value**.

In the case of deposits, we assume that the growth rate will remain at the level of 7-8% y/y in 2025, backed by the dynamics of the credit market and loose fiscal policy.

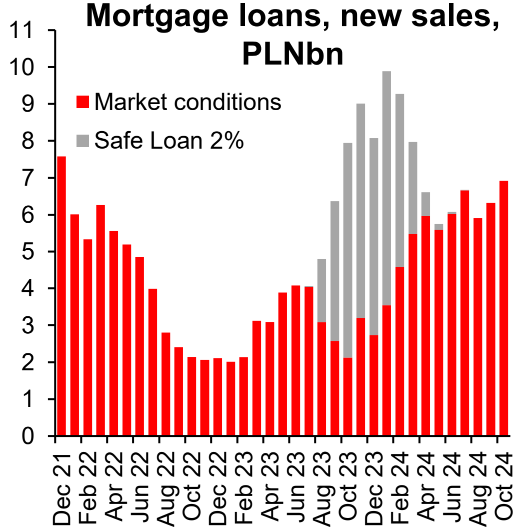
Consumer loans, new sales, 12M moving average, PLNbn



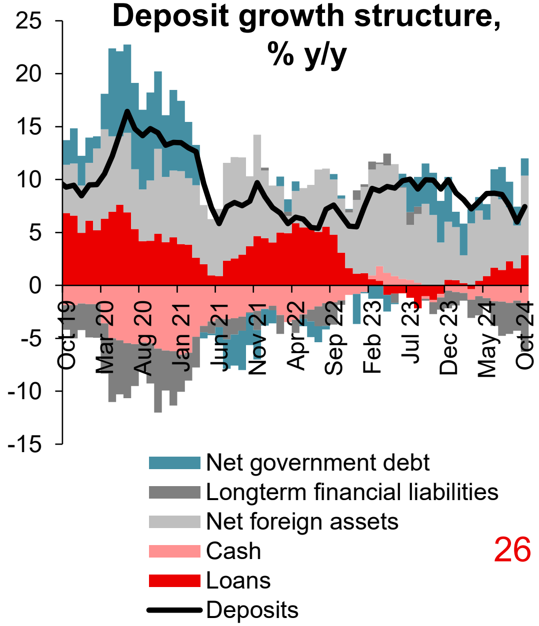
Loans to companies, new sales, 12M moving average, PLNbn



Mortgage loans, new sales, PLNbn



Deposit growth structure, % y/y



Source: BIK, ZBP, NBP, Santander

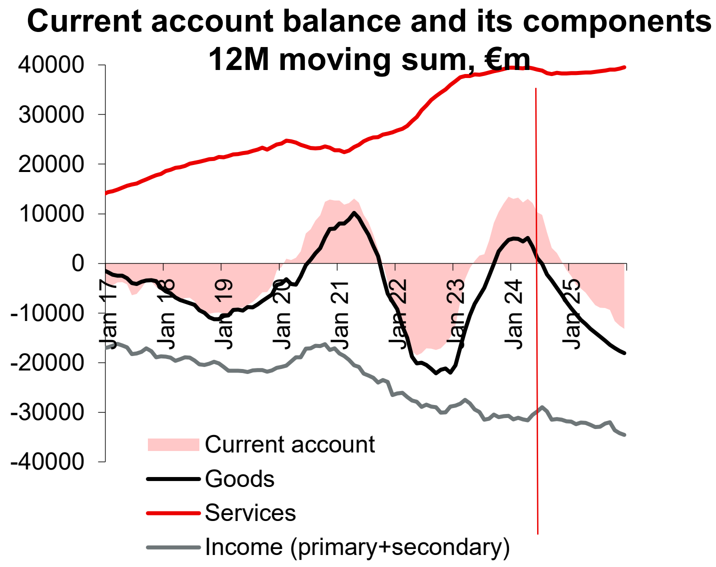
Further deterioration of the current account balance

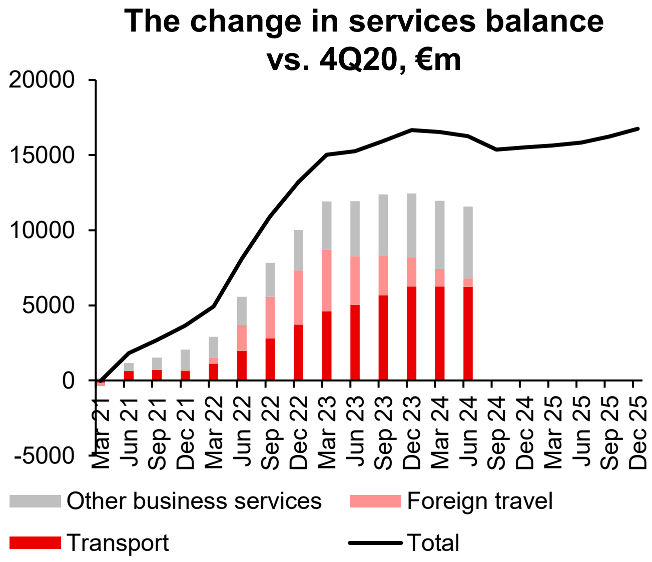
In 2024, the current account balance gradually deteriorated, from +1.8% of GDP in December 2023 to +0.3% of GDP in October. We assume a further deterioration to -0.2% of GDP in December and -1.5% of GDP at the end of 2025. **The main reason for the current account balance move to deficit will be the behaviour of the goods balance**, for which we expect that imports will grow faster than exports.

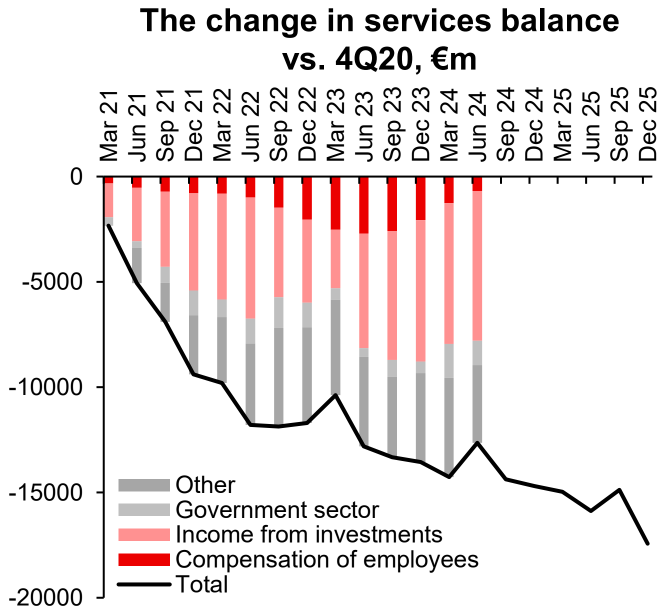
In 2024, the balance of services deteriorated, mainly due to the decreasing surplus in foreign travel, which in turn resulted from a strong increase in Poles' demand for these services. We believe that this trend will continue, although the deterioration of the balance will not be as strong as this year. Along with a slight improvement in the economic situation in Europe, surpluses of transport and business services balances should increase. **On this basis, we expect the balance of services to stabilise in 2025**.

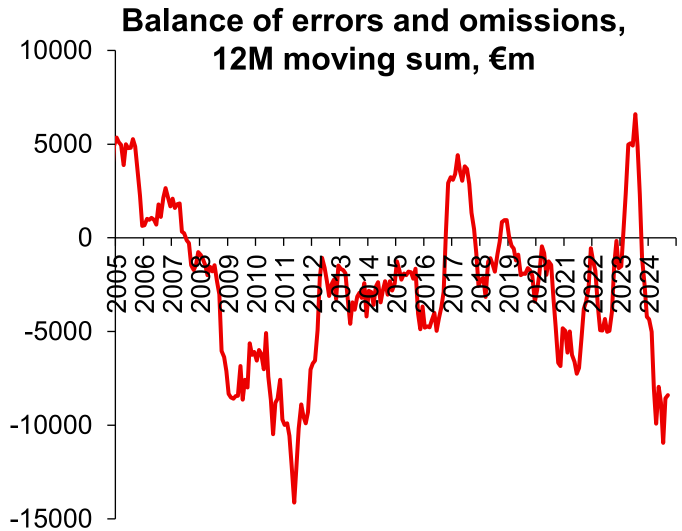
We assume a continuation of the gradual deterioration of the income balance in the coming quarters. This will be supported by the progressive improvement in the results of Polish companies, and thus also by the increase in the outflow of income from the Polish economy. A stronger inflow of EU funds should work in the other direction, but it is worth remembering that the majority of these funds goes outside the current account.

In 2024, there was a striking change in the balance of errors and omissions, which jumped from a highly positive to a highly negative value. The imbalance of this account has risen to the highest level in almost 15 years and means that the current account deficit may actually be larger than it would appear from the NBP data. This means that there is a risk of data correction.









Source: NBP, Santander

Labour market

2

Labour market: stabilization

In recent quarters, the situation on the labour market has been quite stable, though tilting slightly downwards. The number of LFS and registered unemployed increased slightly, and the number of notifications of collective redundancies increased quite significantly. On the other hand, signals from leading indicators are mixed. For example, according to the PMI survey, employment forecasts for the next 12 months were the worst in two years in November, although the GUS business surveys do not indicate anything similar, and the PIE survey even showed a strong rebound.

The reduction in activity on the labour market is influenced by relatively high labour costs. Depending on the industry, 50-70% of companies report this factor as a serious barrier to business growth and it is currently the most frequently signalled problem.

According to the PMI report, changes in employment in companies in the past year were generated mainly by retirements and reductions in temporary staff. The loss of employment is often the result of difficulties or reluctance related to replacing those who leave, because this gives flexibility in adjusting labour costs in conditions of rigidity in the form of rapid increases in the minimum wage.

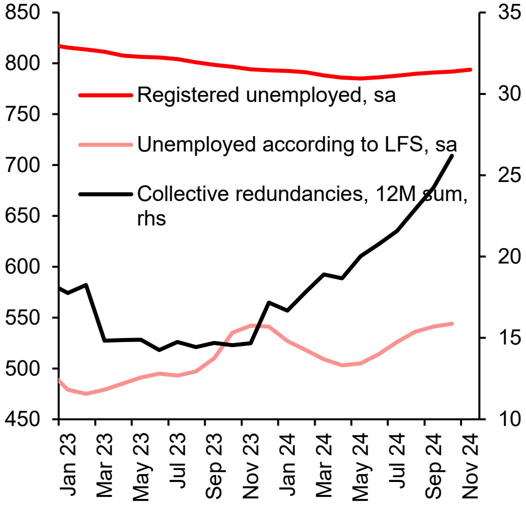
It is worth noting that the last two PMI reports already mention filling staff shortages and creating new jobs, which interrupted the record-breaking 28-month period of employment reductions. Similarly, in the PIE business survey in December, there was a sharp improvement in the attitude of companies towards employment, which, however, may be a one-off deviation.

The labour hoarding index calculated as part of the ESI survey by the European Commission suggests that in Poland, the pressure from labour costs seems to be reducing the tendency to maintain more labour resources to wait out the downturn. The indicator has been in a downward trend since the beginning of 2023 and is one of the lowest among EU countries.

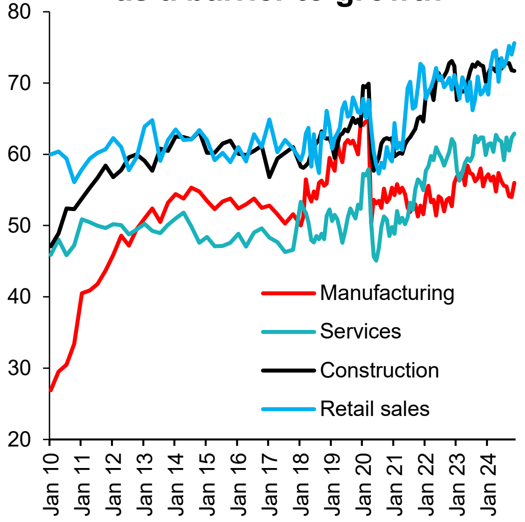
We assume that the slight improvement in the economic situation in 2025 will translate into an improvement in the situation on the labour market, although it is likely to remain in the stabilisation phase.

Santander

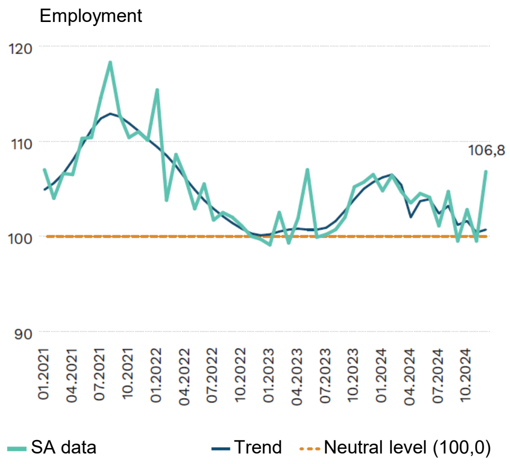
Number of unemployed and of collective redundancies, thousand



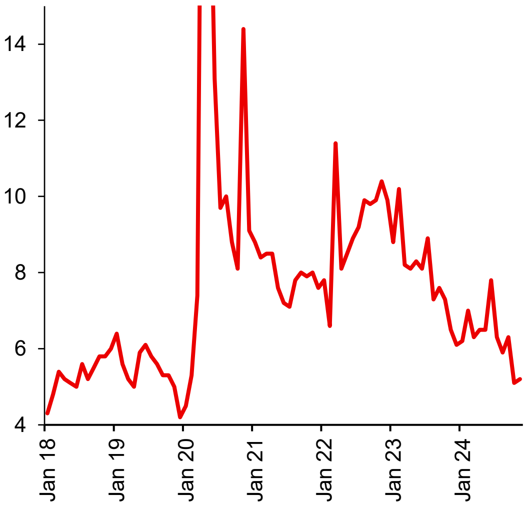
Share of companies indicating employment costs as a barrier to growth



PIE-MIK employment indicator



ESI: labour hoarding*



Source: Eurostat, GUS, PIE, KE, Ministry of Family, Labour and Social Policy, Santander

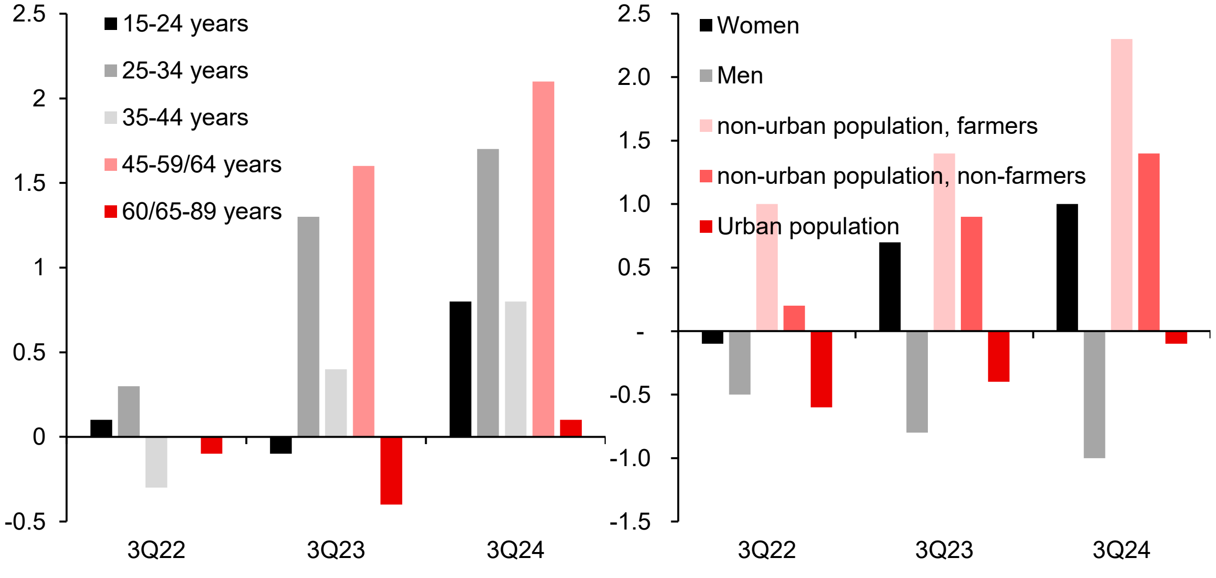
* LHI calculated as the percentage of companies that at the same time expect a decrease in production and plan to at least maintain the level of employment

Labour market: reactivation

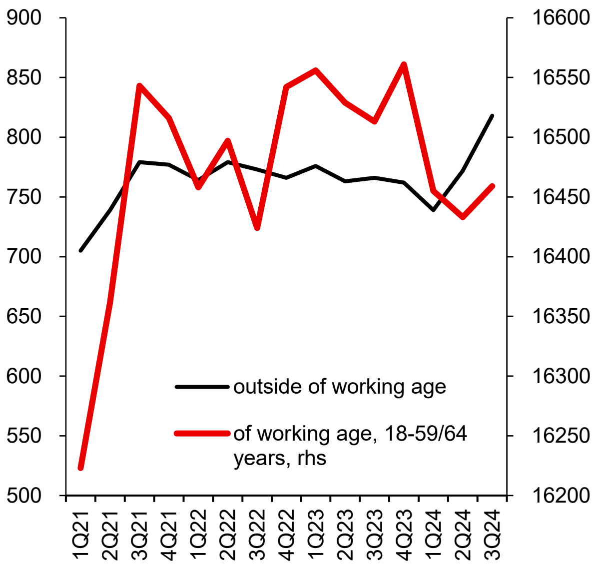
Despite a slight weakening of the labour market, it is still visible that the pool of free labour continues to diminish. Firstly, the unemployment rate is still very close to its historical minimum, and secondly, the increase in the number of economically active people stemmed mainly from labour force buffers which we identified in our MACROcope from June this year – i.e. was caused by those employed in agriculture and by groups in which economic activity deviates downwards from patterns in developed countries (in particular, older age groups). Over the past quarters, the number of people workers outside the working age has been growing at a rapid pace, clearly more strongly than the number of people of working age.

After a period of high wage increases, including the minimum wage, the conditions are conducive to professional reactivation, which was particularly visible among women. However, people returning to the labour market join the ranks of the unemployed to a greater extent than the employed, because companies are cautious about hiring.

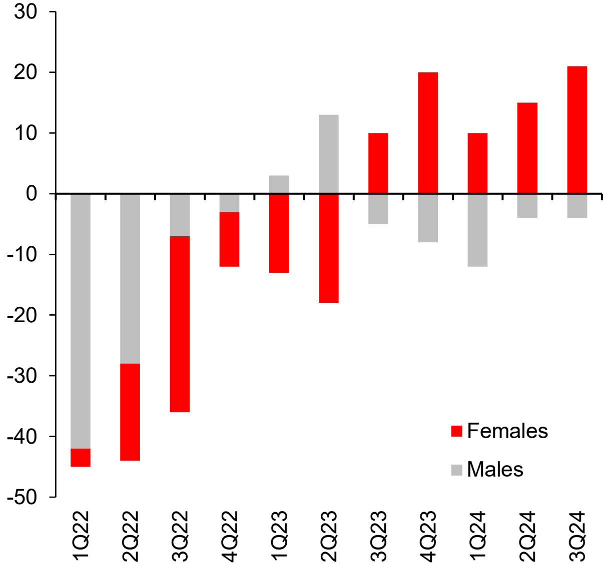
Activity rate, change compared to 3Q21, in percentage points.



Employed, thousands



Unemployed returning to work after a break (reactivating), in thousands of people



Source: GUS, Santander

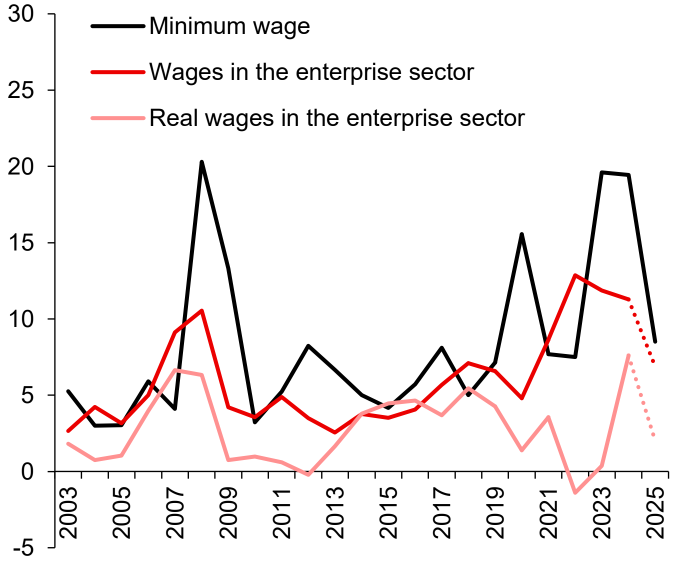
Labour market: wage growth descents

We assume that the combination of limited demand and limited free labour will lead to **a gradual decline in wage growth in 2025, though it will remain at a relatively high level**. The impulse from the increase in the minimum wage will also be weaker, because in January it will grow "only" by 8.5% (10.0% y/y). There will also be no supplementary increase in July.

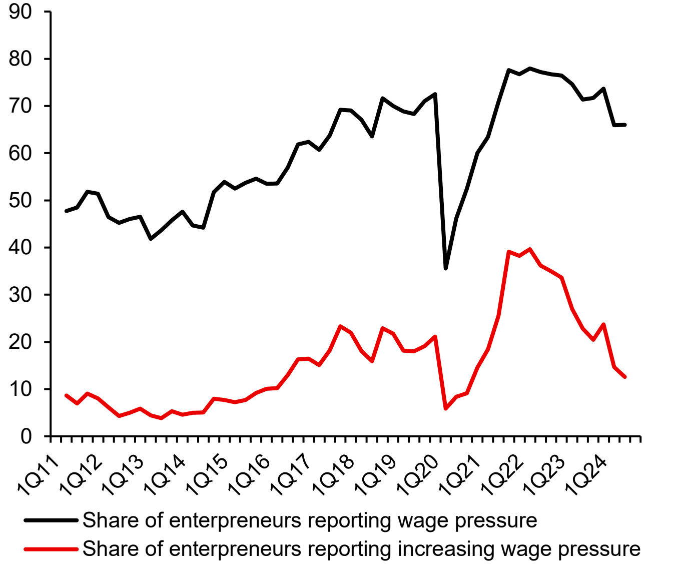
Available surveys of entrepreneurs confirm that wage growth will slowly decline. According to the NBP Quick Monitoring, wage pressure is at a level similar to the median from the last decade. In the PIE survey, the index of planned wage increases declined below the lower range of fluctuations from recent months, and its trend value reached the lowest level since 1H21.

We agree with the November NBP projection that wages in the national economy will grow on average by c. 7% y/y at the end of next year, but we also expect that wage growth will fall to c. 8% y/y already in 1Q25. As a result, the annual average (7.5%) will be lower than the central bank's projection of c. 9%. After the rapid decline in the average margin over the last two years, companies can approach salary negotiations more assertively.

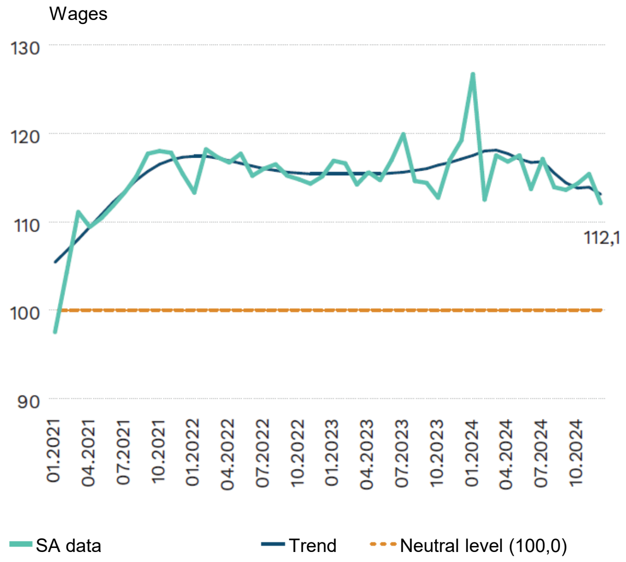
Growth rate of minimum wage and average wage in the enterprise sector, % y/y



Wage pressure according to the NBP Quick Monitoring survey



PIE-MIK index of wage plans



Source: GUS, NBP, PIE, Santander

Inflation

3

Inflation: the last months of increases

Since July, when the increase in the price of electricity and gas pushed CPI inflation above the upper band of deviations from the NBP target, we have been observing a further, steady increase in consumer price growth. In November, inflation fell slightly, from 5.0% y/y to 4.7% y/y, but this was mainly a statistical effect related to the sharp increase in fuel prices in November 2023, after they remained at a low level in the pre-election period. In December, inflation will likely rise again, in our view to around 5.0% y/y.

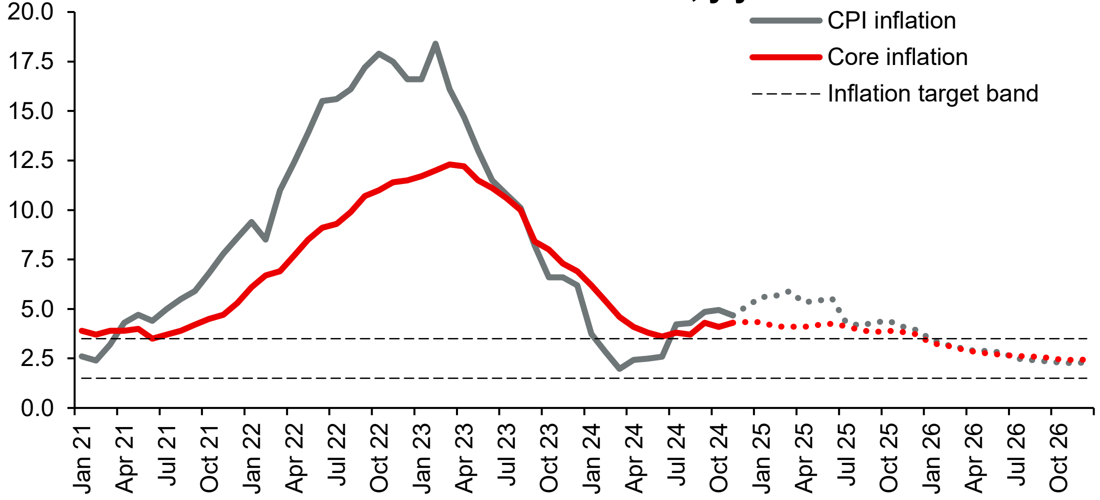
We expect that the increases in inflation will continue until March 2025, when its rate will reach over 5.5% y/y, driven by e.g. rising inflation of food prices.

Inflation should fall in the subsequent months of 2025, which will be supported by the extension of the energy price cap, which should translate into a significant reduction in their annual growth rate in the middle of the year. As a result, **at the end of 2025, CPI inflation should be close to 4.0% y/y. In our view, inflation will return to the NBP target band at the turn of 1Q and 2Q26.**

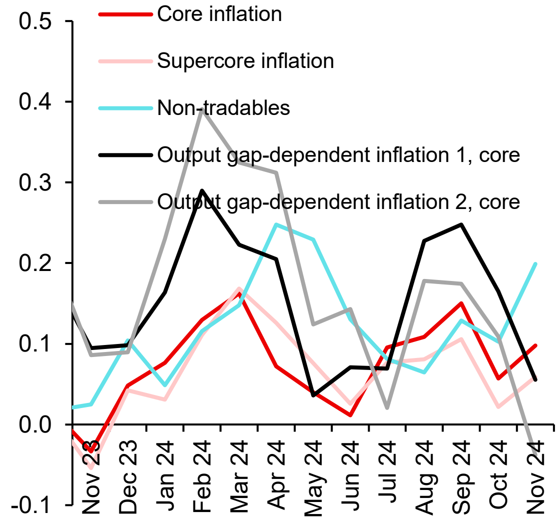
Core inflation (net of food and energy prices), which stood at 4.3% y/y in November, will likely remain above 4% y/y until the middle of next year, and will return to the target band at the beginning of 2026. We base this expectation on the forecast that unit labour costs in the economy will continue to slow down.

In our opinion, it cannot be said that the upward pressure on prices in core categories will completely fade away. Although it remains clearly lower than in the period of the highest inflation of 2022-2023, 4 out of 5 measures of price momentum we calculate remain above zero (i.e. above the median) and it is difficult to see any significant change in recent months.

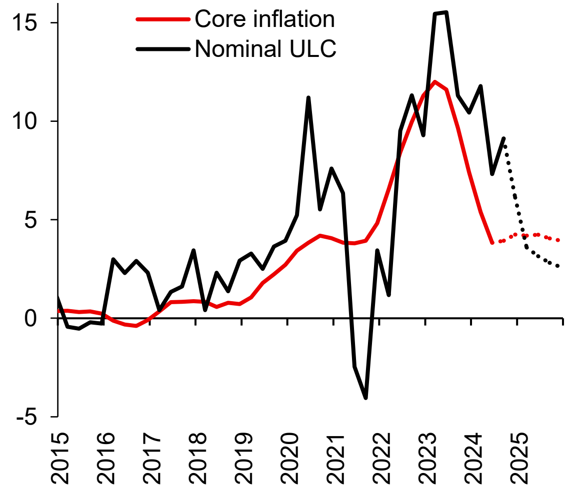
CPI and core inflation, y/y



Price momentum: 3M moving averages of m/m increases corrected for the median and changes in tax rates



Core inflation and unit labour costs, % y/y



Source: GUS, Eurostat NBP, Santander

Santander

The pace of food price growth will increse further

At the beginning of 2024, the pace of food price growth decreased dynamically, reaching zero in March, and then returned to an upward path, supported by the normalization of VAT rates. In November, the growth rate reached 4.8% y/y. **In our view, it will continue to rise in the coming months and will peak in March 2025 before starting to decline. In our opinion, in 2025, food prices will increase by an average of about 5% compared to about 3.5% in 2024.**

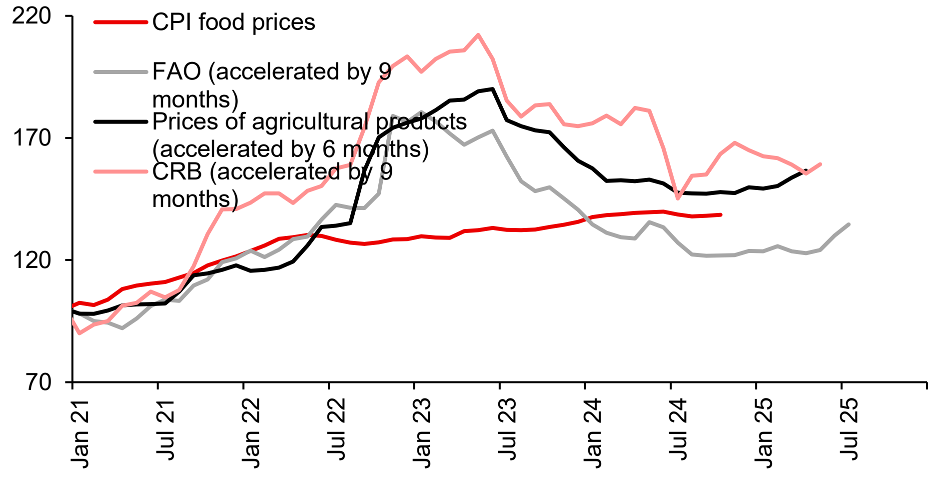
Currently, we see two strong shocks in the food market – concerning milk and fruit. Fruit prices are rising faster than usual, mainly due to weaker domestic harvests, which have been harmed by adverse weather conditions. In the case of milk, the global supply turned out to be lower than anticipated. For now, this affects mainly butter prices, which have been going up intensively for several months. We assume that these two shocks will translate into further price increases in the coming months.

Climate change is causing shocks to occur more and more often, so food price forecasts are constantly subject to upside risks. This year, unfavorable weather conditions had a strong negative impact on the supply of chocolate, coffee, and olives, among others. From the point of view of the Polish consumer, however, these are products of lesser importance.

In the case of meat, we expect rather weak upward trends, which is related to the ongoing recovery of supply. Beef may become more expensive, especially the global economic situation improves, but it accounts for a small part of the basket. We also expect a moderate increase or stabilization in the case of cereal, oilseed, and vegetable prices, due to good supply.

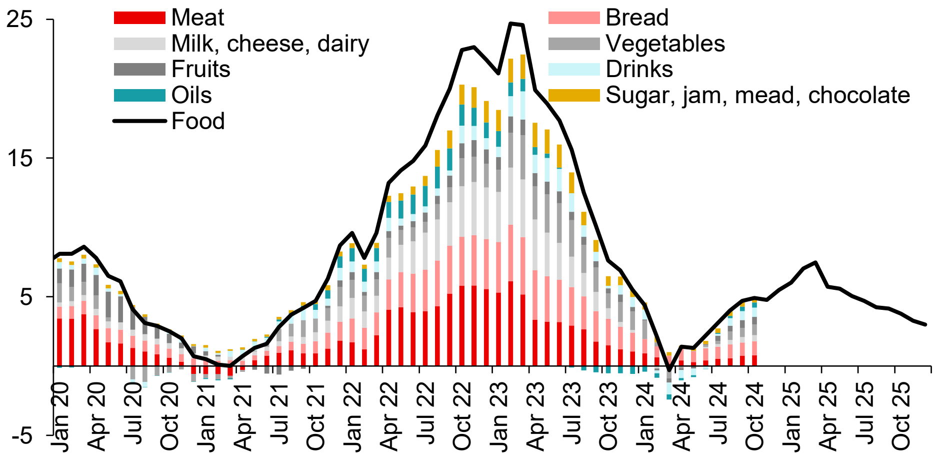
Our forecasts are supported by the recently observed rebound in food price indices – FAO and CRB in the global case, and purchase prices of agricultural products in the domestic case.

Food prices, December 2020 = 100



Source: GUS, FAO, Bloomberg, Santander

Food prices – annual growth decomposition



Source: GUS, Santander

Energy: extended price cap

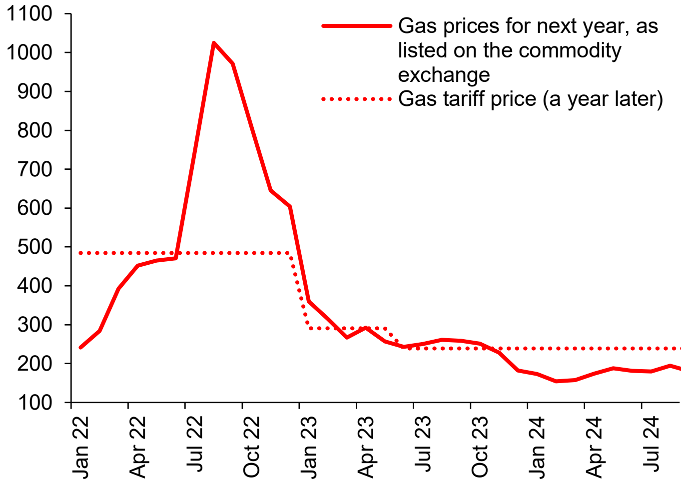
As we expected, the government decided to extend the energy price cap. Electricity prices will therefore remain stable at the level of PLN500/MWh until the end of September, when the new tariffs are to enter into force. Currently, we assume that the new tariffs will be reduced to the level of the price cap (currently the tariff stands at PLN622.80/MWh), which will be possible thanks to the low path of wholesale energy prices this year. On the other hand, the withdrawal of the capacity fee has been extended only until the end of June, so we assume that it will be restored in July, which will raise the average bill by about 8% and add 0.35 percentage points to the inflation rate. From January 2025, the renewable energy sources fee increases to 3.5 PLN/MWh from 0 PLN/MWh, which will add less than 0.5% to the average bill. The distribution tariff for electricity has been set at the 2024 level.

The tariff for gas sales is valid until mid-2025 and, in our opinion, the next tariff will be set at the same level, with a downward risk. Distribution rates for 2025, on the other hand, have been raised by about 25%, which will add about 5.5% to the gas bill and 0.15 pp to CPI inflation in January 2025.

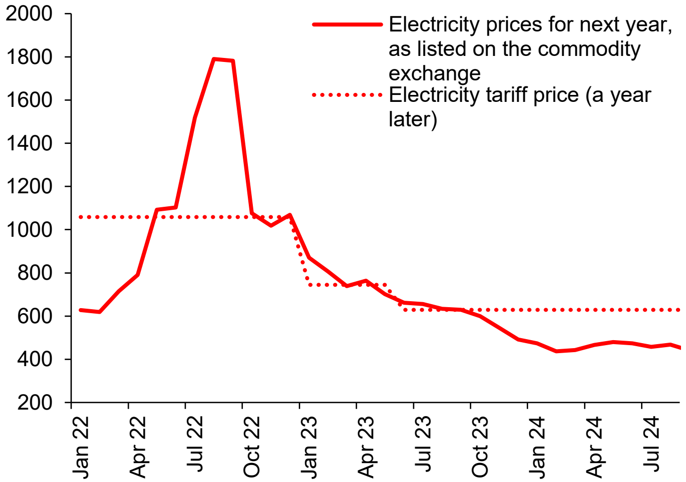
We assume that the new tariffs for the sale of energy will be set at a level that guarantees stability of the bills. In our view, a sharp decline in wholesale energy prices even gives some space for them to fall, which, however, we do not assume in the baseline scenario. Therefore, we do not expect a jump in energy prices in the 2H25, as suggested by the NBP Governor after the December meeting.

Despite the decline in heating coal prices, we do not see any potential to reduce heating tariffs.

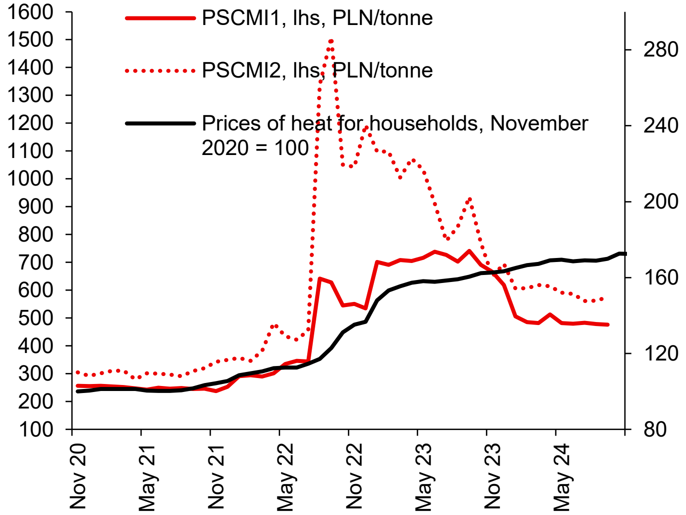
Gas prices, PLN/MWh



Electricity prices, PLN/MWh



Prices of heat and heating coal



PSCMI1 – price of coal for the energy industry
PSCMI2 – price of coal for the heating industry

Source: TGE, GUS, URE, Santander

Economic policy

4

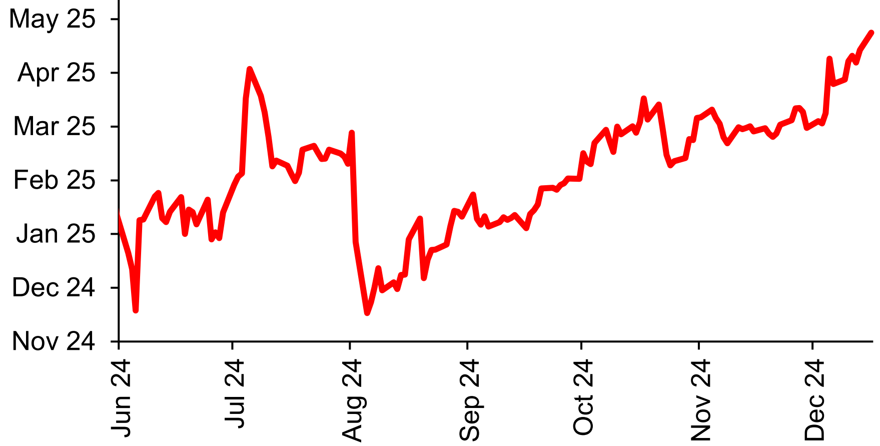
Monetary policy: another pivot of the NBP Governor

After three months of gradually softening his statements and suggesting that rate cuts are drawing closer, NBP Governor Adam Glapiński again turned hawkish in December, signalling that the start of the discussion on policy easing is postponed to October, and the first rate cuts may not appear until 2026. Interestingly, this came after a series of disappointing data and pieces of information, which analysts and investors considered a reason for greater concern about the prospects of the European and Polish economies, and which raised questions about the need for earlier, not later, cuts.

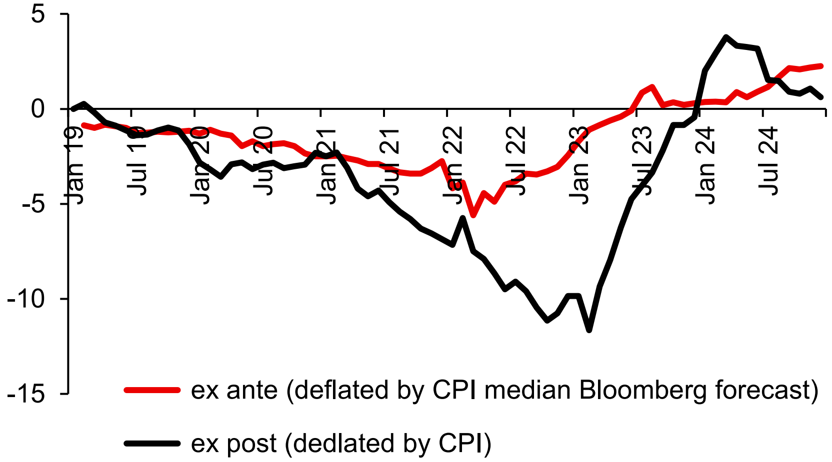
The current situation is somewhat similar to that from July this year, when A. Glapiński first suggested no rate cuts until 2026. At that time, almost all MPC members publicly expressed a different opinion, and the NBP Governor withdrew from his declaration at the end of the summer holidays. This time, there were also voices of opposition from the MPC, and according to L. Kotecki, the December statement about postponing the discussion on cuts (again?) did not reflect the stance of the Council. However, differently than in July, this time at least two MPC members (G. Masłowska, I. Dąbrowski) not only agreed with the Governor's opinion about delaying interest rate cuts but also suggested that cuts should be postponed even before the December meeting of the Council. Assuming that J. Tyrowicz has not suddenly changed her views, it is enough that at least one member of the Council, who has not yet spoken after the last conference, is of a similar opinion to Governor Glapiński in order to effectively block possible motions for rate cuts.

We maintain our view that the first cut will take place in July 2025, 1) after the presidential election, 2) when the MPC sees convincing evidence in the CPI data that the upward trend in inflation is over, 3) and when the new NBP projection, whose results will be known to the MPC at the July meeting, will show that in the next few quarters CPI inflation will return to the target. Although there is a group in the MPC who may want to cut rates as early as March, in our opinion they will not build a majority. On the other hand, we believe that Governor Glapiński will not be able to convince the majority to hold off the cuts for too long in the face of the incoming data.

Date of the first rate cut by the NBP – market pricing



Real NBP rate, %



Source: LSEG, Bloomberg, Santander

The MPC is once again divided

Statements of Monetary Policy Council members:

Adam Glapiński	Almost half of the Council has publicly stated that the discussion on interest rate cuts will start at least after March. Now it is said that **such a discussion may start in October next year**. But this will not be a discussion that will lead to a reduction in interest rates, because we will be dealing with the beginning of a new wave of inflation growth. **The cuts are postponed even to 2026.** This is not just my view, I am saying what it looks like in the Council. (5/12, press conference)
Gabriela Masłowska	There is no certainty, but there is a good chance for a rate cut in 2025. Will it be in the second quarter? I have doubts, rather in the second half of the year, but we cannot be 100% sure, because we do not know what will happen next to many factors. (18/11, PAP) **Interest rate cuts will take place rather in the second half of next year, or the end of the year. (…) The end of 2025, or maybe even the first quarter of 2026.** (6/12, PAP)
Ireneusz Dąbrowski	**The conditions to start the cycle of cuts will appear between March and July 2025**, depending on the pace of disappearance of inflationary processes and the assumed delay of the effects of the MPC decision. (19/11, PAP) **It will be possible to cut interest rates in the third quarter of 2025.** The decision to cut rates does not necessarily have to be postponed to 2026 (6/12, Bloomberg) If I were to make decisions on interest rates on my own, I would start a nine-month cycle of cuts in the third quarter of 2025 and would stop in the first half of 2026 or in mid-2026 with the main rate at around 3.5%.(9/12, Rzeczpospolita)
Przemysław Litwiniuk	In my opinion, **the conditions for lowering interest rates will appear in July**, after the risks of the election cycle disappear. (9/12, TOK FM)
Henryk Wnorowski	This (extension of energy price cap until September) **does not rule out the possibility of talking about possible reductions when we get acquainted with the March inflation projection**. (6/12, Bloomberg)
Cezary Kochalski	I have already suggested that 2025, and more specifically **the March projection, may be the moment to discuss monetary policy easing**. I maintain my position. On the other hand, I am not sure whether there will be sufficient certainty in March as to whether the conditions for rate cuts will be met, or only in the following months. (6/12, Bloomberg)
Ludwik Kotecki	**I still see March as the moment when this discussion should begin.** But whether it will end with a decision to cut rates – no one knows. (…) Reductions must be responsible. There must not be a situation in which we would have to withdraw from them. (11/12, Rzeczpospolita) I believe that 100 bps (of rate cuts) is the maximum that is possible next year. Because we should be careful, it should be a little less.(11/12, PAP) The reaction of the NBP Governor to the clarification of the issue of the Energy price cap was, in my opinion, incomprehensible, excessive and could unfortunately have had a political context. (…) Secondly, this interpretation of facts and forecasts was only his, not the entire Council's. The Governor should present the Council's stance at the conferences. The message of the conference did not reflect the course of the discussion at the MPC meeting. We did not agree to discuss rate cuts in October next year or interest rate cuts in 2026. The majority of MPC members did not dismiss the possibility of such a discussion in March, without prejudging its outcome. (11/12, PAP)

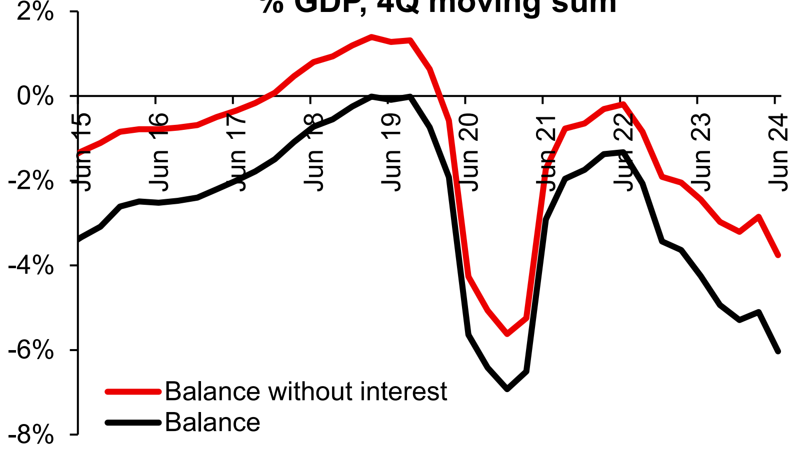
Fiscal policy: amendment of the 2024 budget

In November, the Sejm amended the budget act for 2024. This was mainly due to weaker than expected budget revenues – the assumed revenues were revised down by PLN56.4bn. The total expenditure has not changed, so the deficit also increased by PLN56.4bn, to PLN240.3bn. VAT revenues were revised down by PLN22.9bn, CIT revenues by PLN11.5bn, and PIT revenues by PLN11.5bn, with the latter being mainly due to the transfer of PLN8.2bn from PIT to local governments.

After the second quarter, the balance of the public finance sector, expressed as a moving sum of four quarters, amounted to -6.0% of GDP. **We assume that by the end of the year the result will slightly improve and will close at 5.7% of GDP**, the level assumed by the government in the budget amendment. We see some risk of exceeding 6% this year, but it seems slightly smaller after the release of data from local governments, which after three quarters showed a surplus of PLN21.1bn compared to PLN8.3bn after three quarters of 2023.

In the first half of the year, revenues of the public finance sector increased by 11.7% y/y or PLN79bn, including PLN34.5bn from contributions, PLN23.8bn from VAT, and PLN11.4bn from income taxes. Expenditures increased by 15.4% y/y or PLN110bn, including PLN57.5bn for benefits and PLN33.9bn for salaries.

Public finance sector balance, % GDP, 4Q moving sum



Main budget parameters

	2023 execution	2024 amendment	2025 plan
Revenues (PLN m)	573 958	626 076	632 848
Expenditures (PLN m)	659 586	866 376	921 618
Balance (PLN m)	**-85 629**	**-240 300**	**-288 770**
GG balance (% GDP)	**-5.1%**	**-5.7%***	**-5.5%**
GG debt (% GDP)	**49.6%**	**54.6%**	**59.8%**

* Value given by the Minister of Finance

Source: MF, Eurostat, Santander

Fiscal policy: deficit near 6% of GDP in 2025?

In our view, the risks to the public finance deficit in 2025 are asymmetric upwards and we assume that the deficit will amount to 5.8% of GDP compared to the government's expectations of 5.5% of GDP.

Already in our September commentary on the draft budget act, we postulated that the macroeconomic assumptions were not too conservative, and the assumed growth rates for some tax revenues, especially VAT, were too optimistic. Currently, the government's CIT forecasts also seem to be too high and, in our opinion, total tax revenues may be by PLN25bn lower than assumed in the budget act.

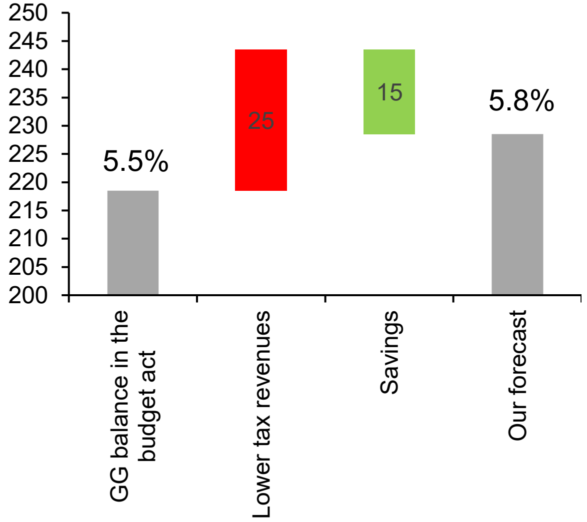
In addition, since this year we are facing presidential elections (in May), it cannot be ruled out that by then there will be new proposals to increase social benefits.

An important factor behind the increase in the deficit in recent years has been the increase in debt servicing costs and defence spending, which in 2021 totalled less than 3% of GDP and will amount to slightly more than 5% of GDP in 2024. We assume that in 2025 this expenditure will stabilize in relation to GDP, so it will not significantly affect the increase in a year-on-year comparison.

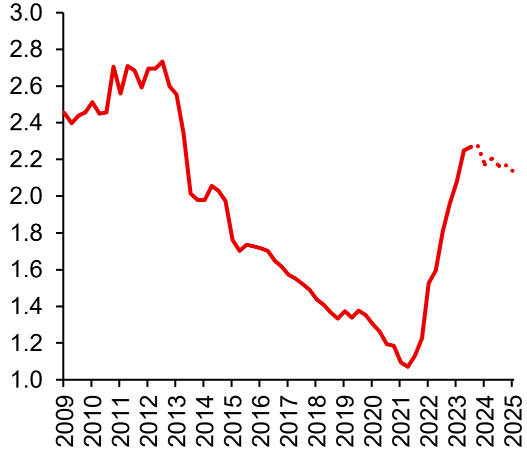
We assume that the government will be able to generate savings in other places, thanks to which the public finance deficit has a chance to remain below 6% of GDP. However, in our opinion, it is likely that in 2025 it will not be possible to reduce the deficit compared to 2024, which may require faster consolidation in the following years to meet the requirements of the European Commission.

With a fairly high deficit and low inflation, public debt will build up quickly, and in 2026 it may exceed 60% of GDP (in GG terms).

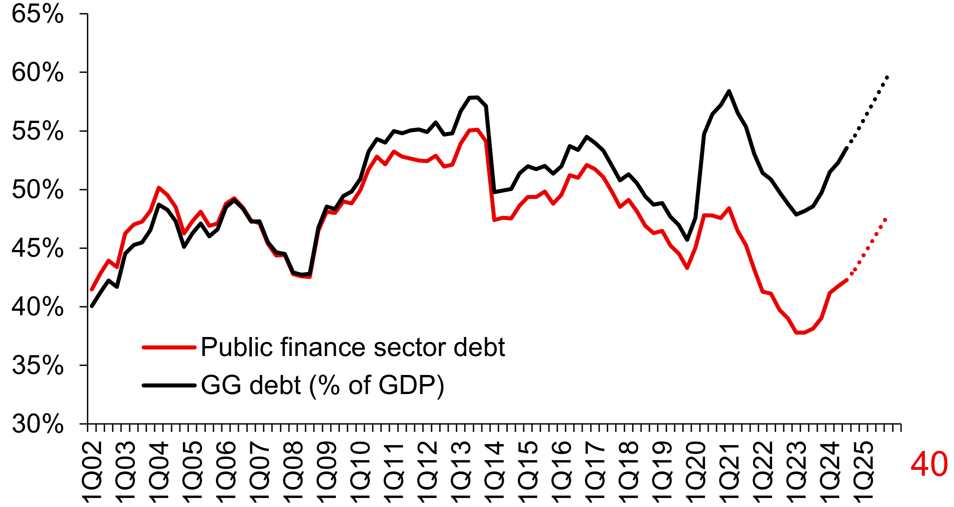
Public finance sector balance, PLN bn, % GDP



Costs of servicing public debt, % GDP, 4Q moving sum



Public debt, % GDP



Source: MF, Eurostat, Santander

Financial markets

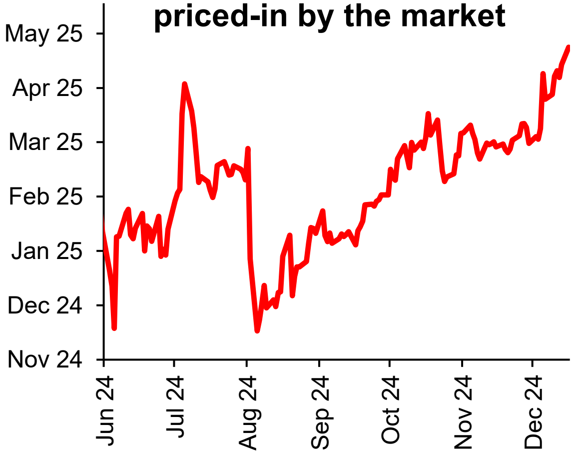
5

Interest rate market: NBP rate cuts only a matter of time

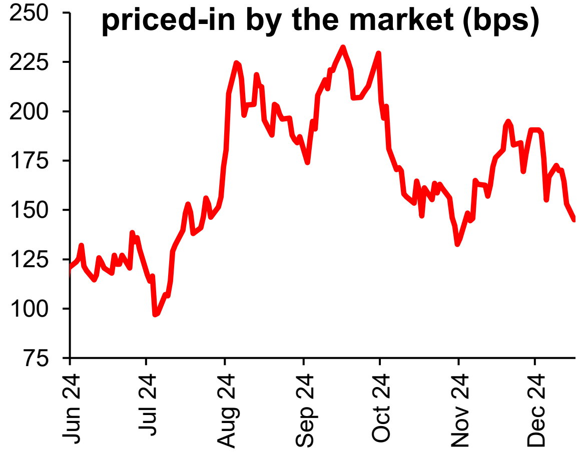
Despite the sudden turns in the rhetoric of the Polish central bank, which are difficult to explain on economic grounds, we think that NBP interest rate cuts are only a matter of time. The NBP Governor seems to control the majority in the MPC to a lesser and lesser extent, and even if in the first half of 2025 he will still have the ability to block rate cuts, we assume that in the end the MPC's decisions will be determined by economic arguments – a slowdown in wage pressure, an expected decline in CPI and inflation forecasts, further monetary easing abroad.

If we are right about the date of the first NBP rate cut in July, then the FRA and IRS curves (short end) will have to move up temporarily, pricing in a later start of the cycle. The swap curve inversion should deepen in this scenario in early 2025, and once the easing cycle begins, we expect the curve to normalize and return to its bull steepener.

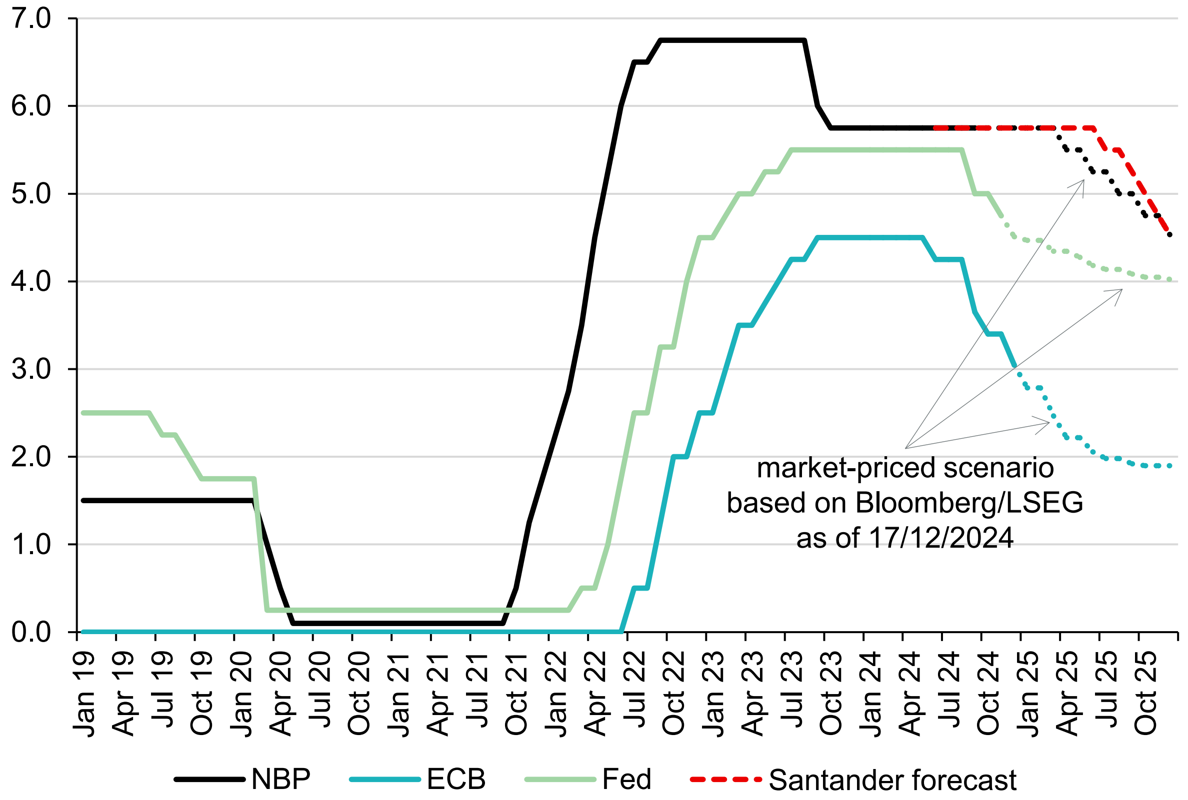
Date of the first NBP rate cut priced-in by the market



Sum of interest rate cuts in 2Y priced-in by the market (bps)



Central banks' main interest rates, %



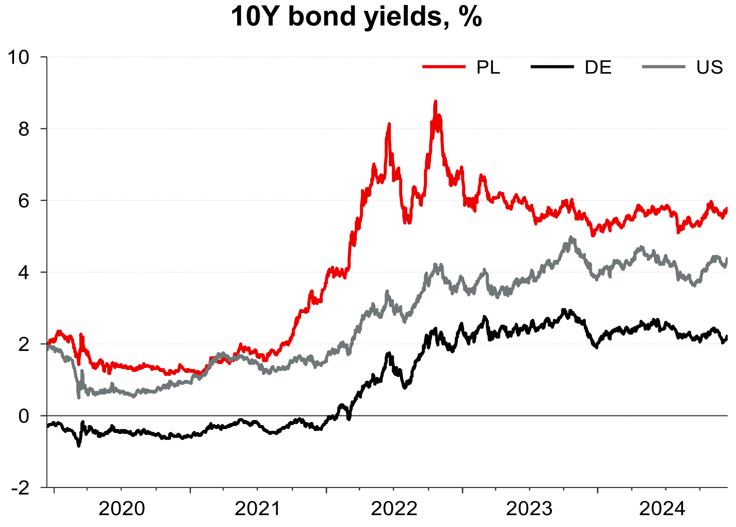
Source: Bloomberg, LSEG, Santander

Bond yields: downward direction

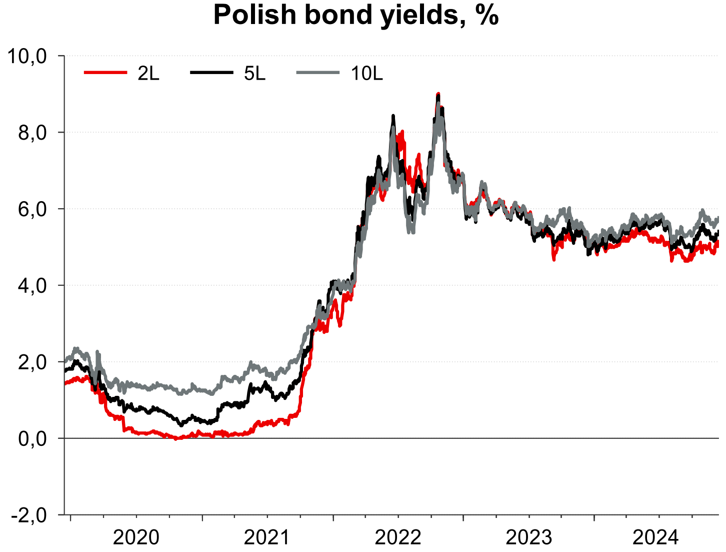
2024 was supposed to be the year of bonds, but for the better part (with exception of the summer months), yields on the core markets and in Poland were increasing. This was due to, among other things, the fact that market expectations regarding the monetary policy easing cycles of the main central banks turned more realistic – at the end of 2023, these expectations were too optimistic about the timing and size of the Fed and ECB rate cuts.

In our view, the start of 2025 may be a period of still elevated yields on domestic bonds, which will be influenced by, among other things, a revision of market expectations regarding the NBP rate cuts – the market is still pricing-in it too optimistically for 2Q25 – but also a high supply of POLGBs, due to high borrowing needs and the fact that the Ministry of Finance will enter the new year with a fairly low level of their pre-financing.

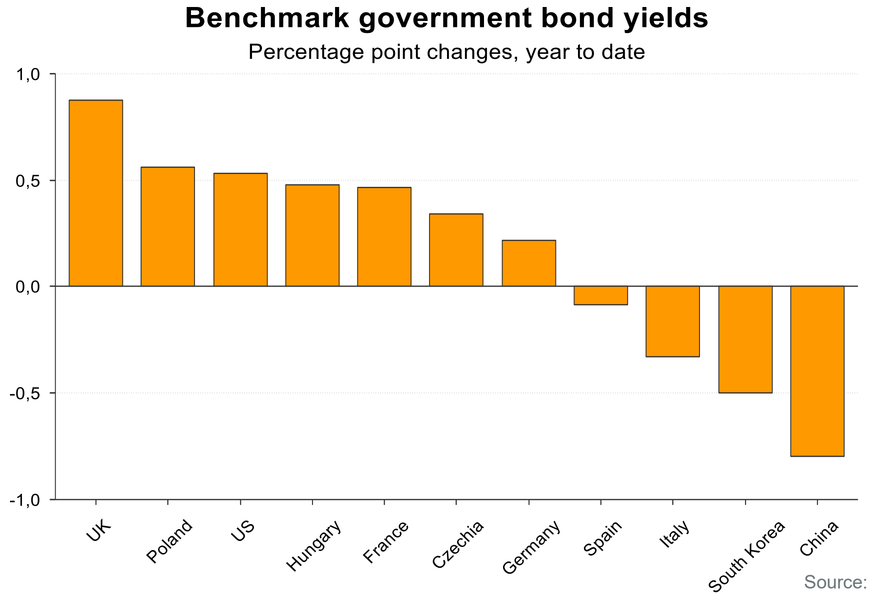
Later in the year, however, we expect a gradual decline in yields and a greater steepening of the bond curve (bull steepener), following the strengthening of debt on the core markets and a decrease in the NBP rates from July. The steepening could be mitigated by a possible decision of the Ministry of Finance to restore the issue of Treasury bills.



Source: LSEG Datastream, Santander



Source: LSEG Datastream, Santander



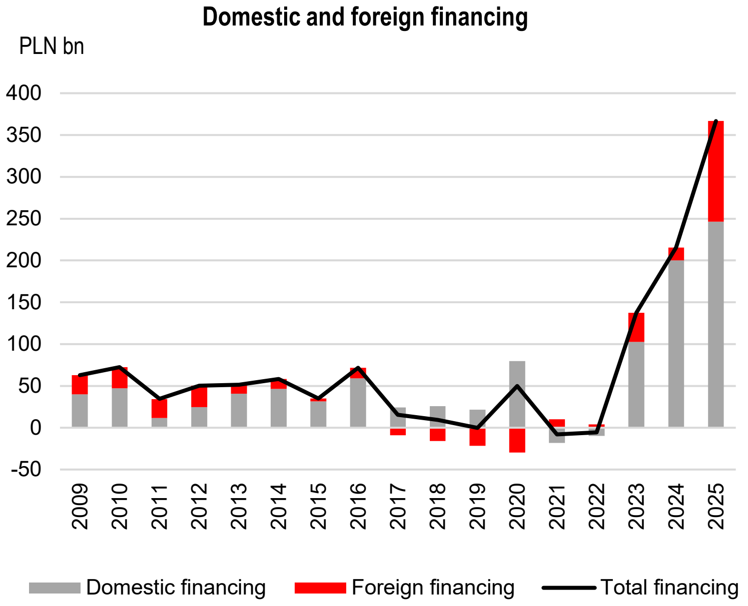
Source: LSEG Datastream, Santander

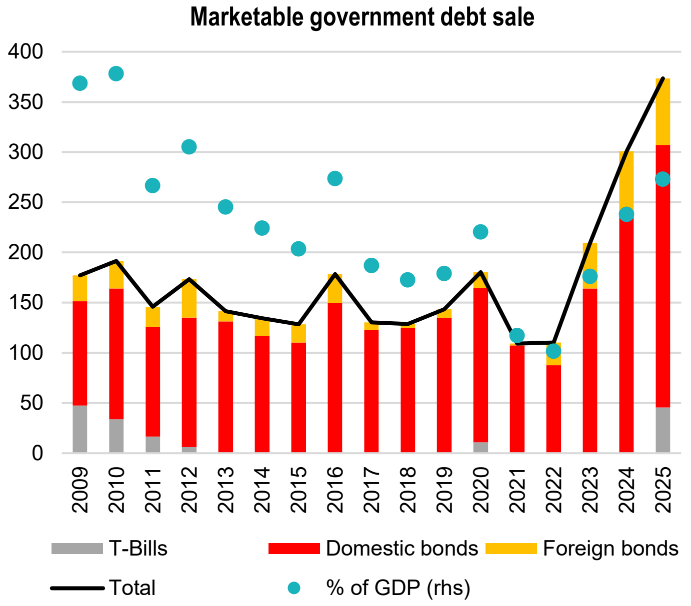
Another year of high debt issuance …

2025 will again be a year of record-high budget borrowing needs and record issuance of government bonds, which we have already written about in detail in previous reports.

In addition, the Ministry of Finance will enter the new year with a fairly low level of pre-financing of borrowing needs for 2025 (probably about a dozen or so percent).

The low pre-financing rate and high debt redemptions in the period from April to July may mean that in the first half of 2025 the Ministry of Finance will decide to restore the issue of Treasury bills (provided for in the draft budget, as in the previous year). This would probably make it easier to reach for demand from the domestic banking sector, which is in a situation of very high (and growing) excess liquidity. The room for the issuance of shorter debt securities was created by the fact that the average debt maturity has increased markedly in recent months (to 5.88 in November from 5.25 at the end of 2023), mainly due to the issuance of long-term foreign currency debt.





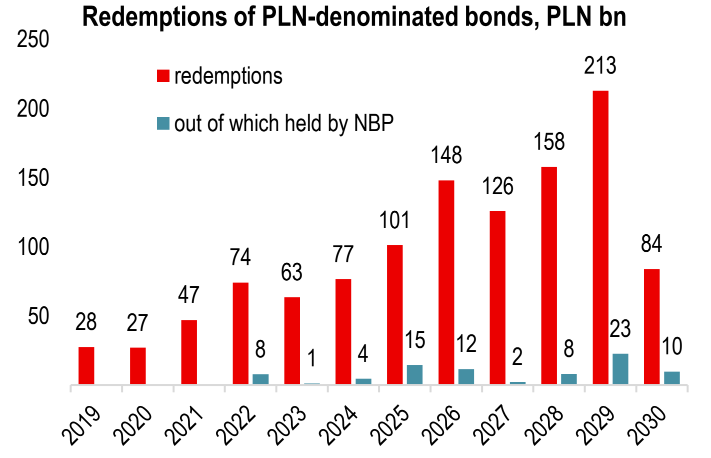
Debt securities	Net issuance (PLN bn)				Gross issuance (PLN bn)			
	2024 Budget bill (1)	2024 Planned realization (2)	2025 Plan (3)	2025-24 change (3) - (2)	2024 Budget bill (4)	2024 Planned realization (5)	2025 Plan (6)	2025-24 change (6) - (5)
T-Bills	47.3	0	45.7	45.7	47.3	0	45.7	45.7
T-Bonds – fixed coupon	64.6	79.3	102.8	23.5	141.4	167.3	182.2	14.9
T-Bonds – floating coupon	22.5	18.6	48.6	30.0	50.7	58.3	67.3	9.0
T-Bonds – CPI linked	0	15.9	11.8	-4.1	0	15.9	11.8	-4.1
Saving/retail bonds	14.4	42.1	37.2	-4.9	40.8	82.4	73.9	-8.5
Domestic bonds – SUM	148.8	156.0	246.2	90.2	280.3	323.8	381.0	57.2
Foreign bonds – SUM	31.0	28.5	42.9	14.4	62.6	59.2	66.3	7.1

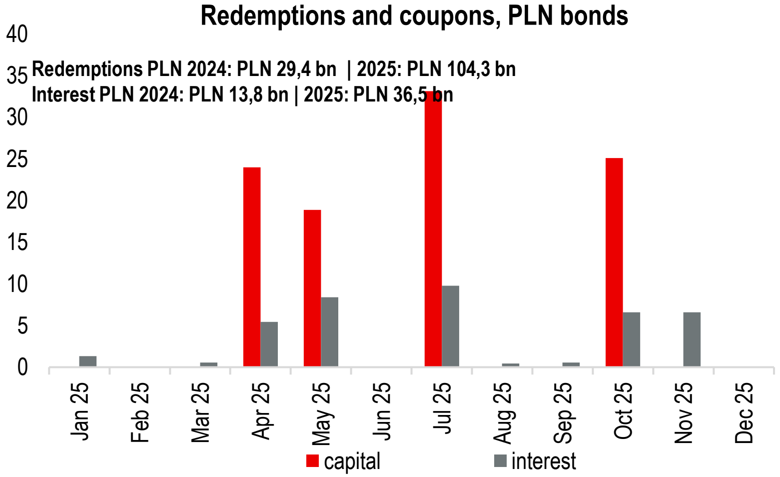
BGK bond issuance plans

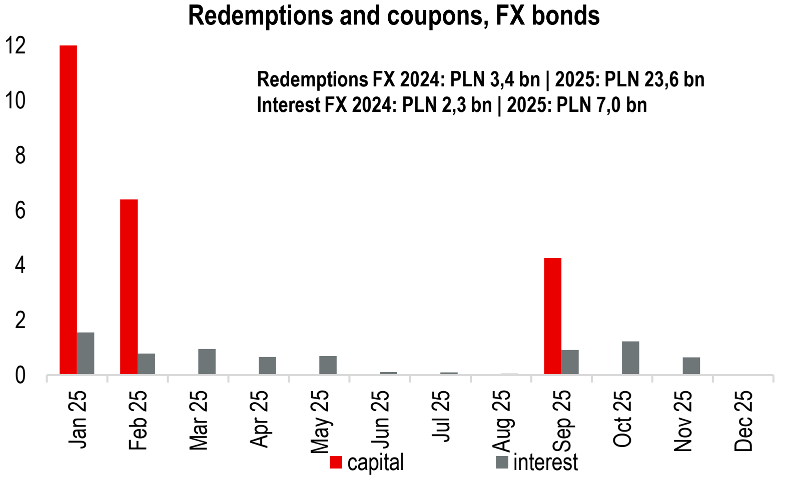
	2024	2025
Road Fund	9.5	8.1
Support Fund	8.2	8.3
Covid Fund	49.3	26.0

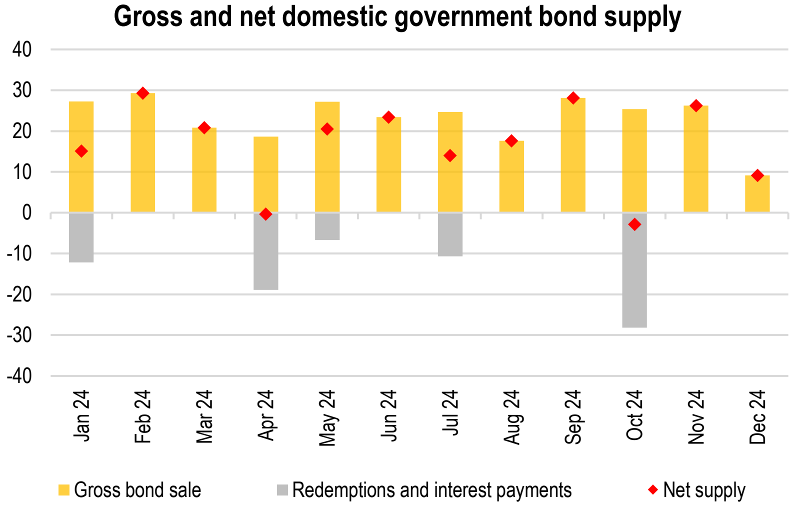
Source: LSEG, MoF, Santander

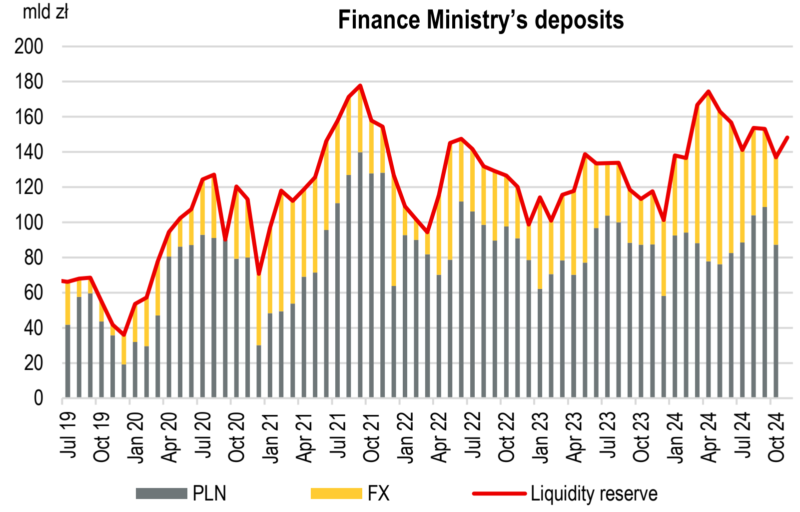
… and rising debt maturities

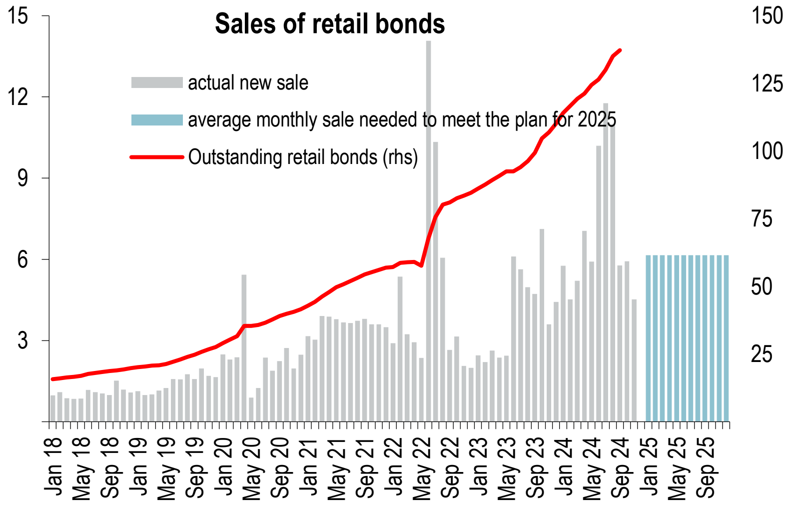












Source: LSEG, MoF, Bloomberg, Santander

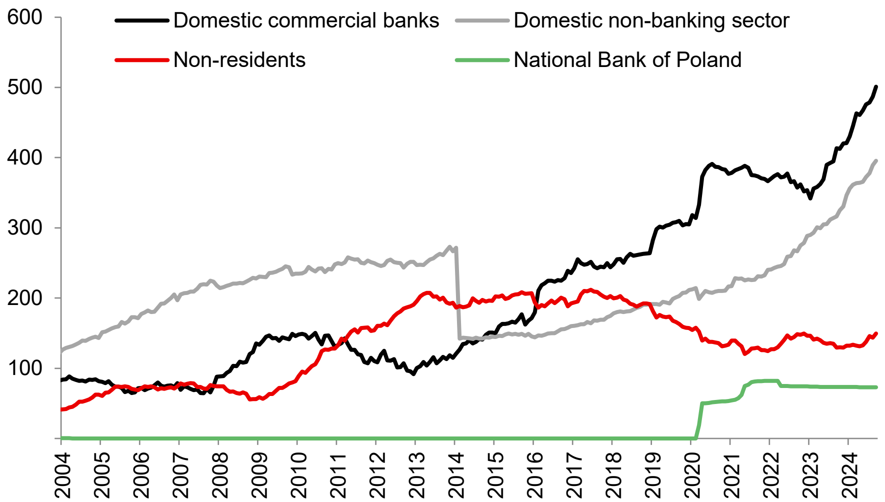
Local banks still the biggest buyers of POLGBs

The structure of domestic Treasury Securities holders is still clearly dominated by domestic banks, and this situation will not change in the next year. This will be facilitated by, e.g., high and growing structural excess liquidity of the banking sector and the structure of the bank tax.

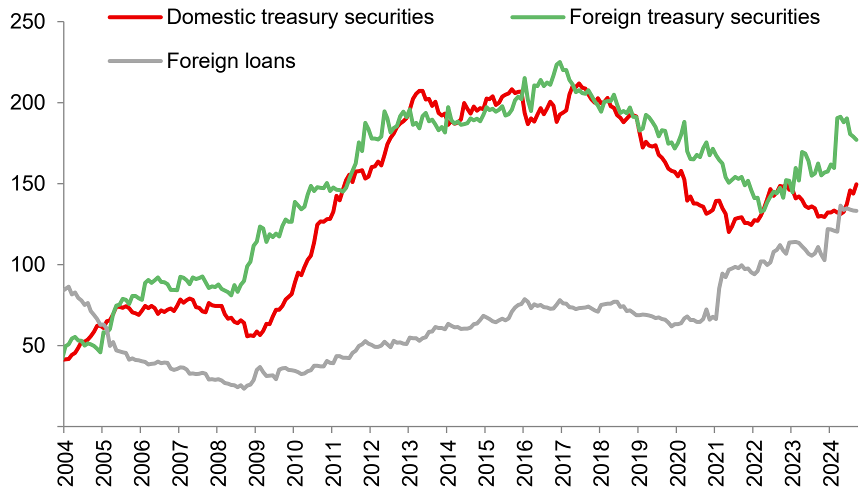
The importance of households is also constantly growing, as they are rapidly expanding their portfolio of savings bonds. We assume that savings bond sales will remain strong in 2025.

The involvement of foreign investors in the domestic debt market has increased slightly but remains moderate. The unpredictability of the NBP's policy and concerns about the prospects of the European economy may prevent non-residents from investing more, at least in the first months of the year.

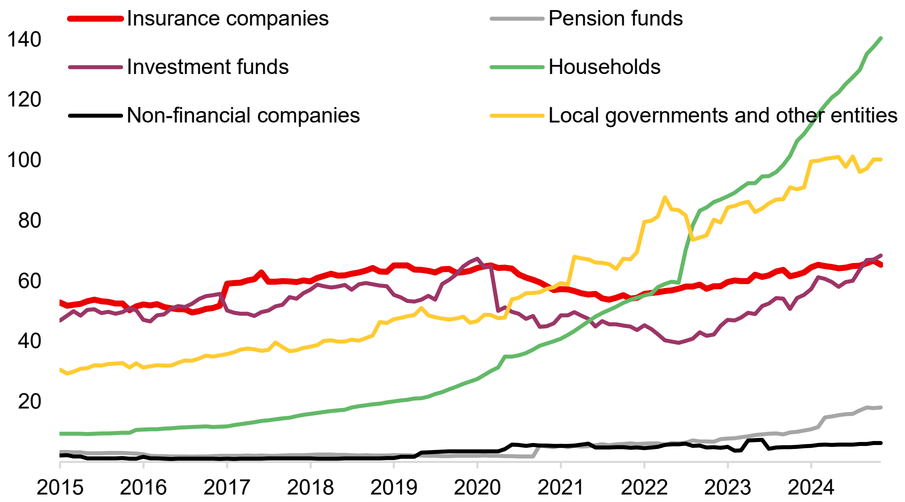
Ownership of domestic treasury securities, PLN bn



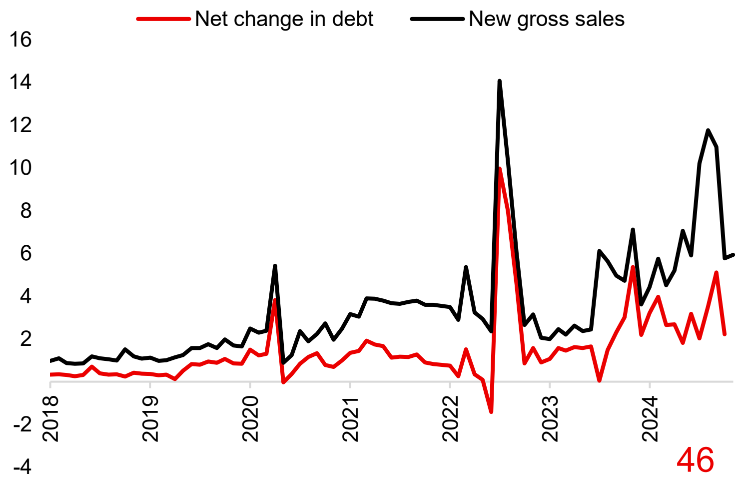
Domestic and foreign debt held by non-residents, PLN bn



Domestic treasury securities owned by the non-banking sector, PLN bn



New sales of saving bonds, gross and net, PLN bn



Santander

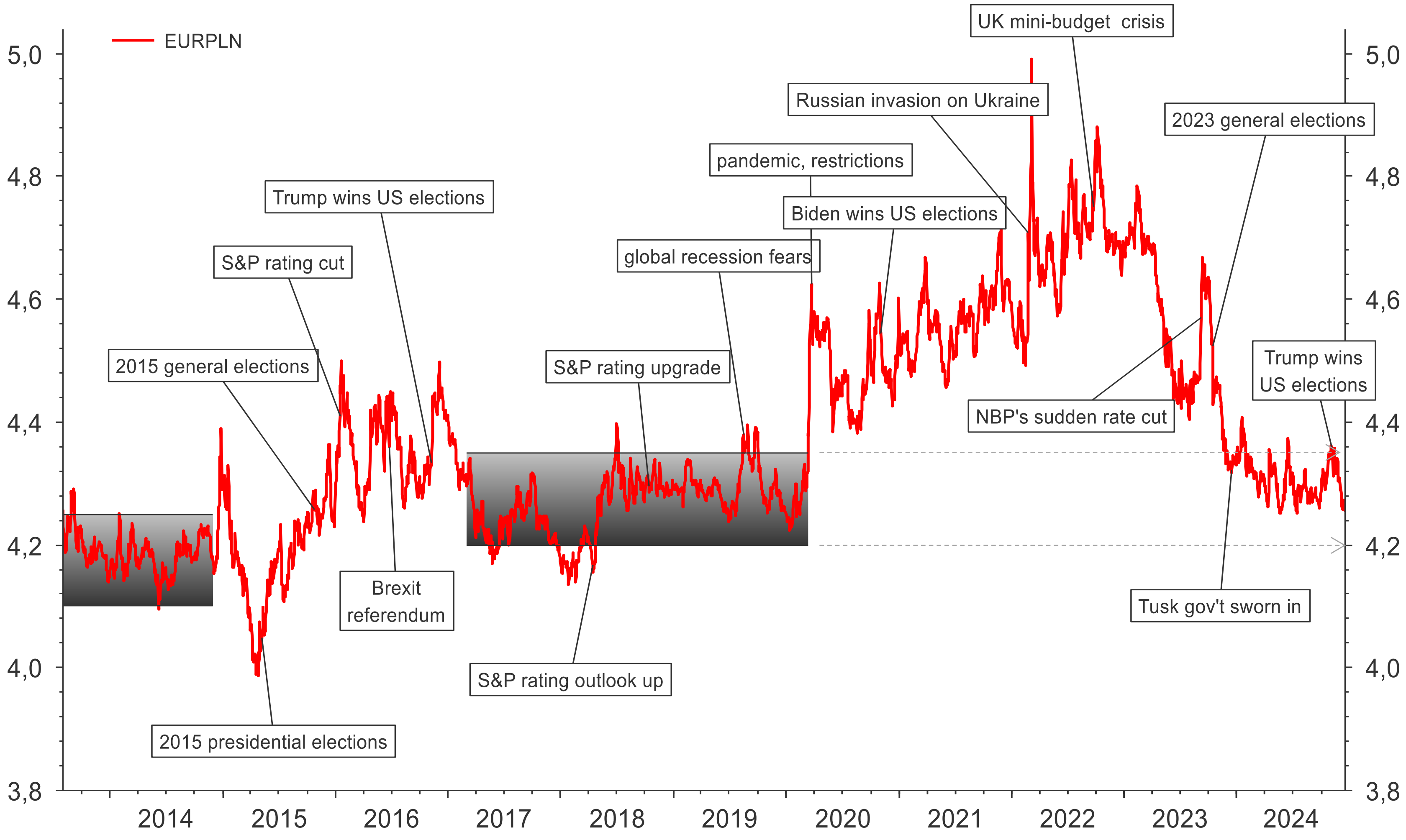
Source: Ministry of Finance, Santander

PLN: stabilization within the pre-pandemic range

After the parliamentary elections in autumn 2023 and the change of government, the EURPLN exchange rate returned to the narrow range of pre-pandemic fluctuations and remained surprisingly stable over the past year.

The reaction of the FX market to the result of the US elections in November this year was moderate and short-lived. Nevertheless, we assume that in the new reality the dollar will not weaken against the euro as quickly as we had previously assumed, so we move our exchange rate forecasts up a bit: we assume that in the coming quarters, the EURPLN will move in the 4.30-4.40 range rather than 4.20-4.30, as we previously assumed.

At the same time, we should expect greater volatility than in recent months, which may be caused by both economic and political events (e.g. decisions of central banks, economic and trade policy of the US, as well as its actual scope) and security-related events (the development of the war in Ukraine or the conflict in the Middle East).

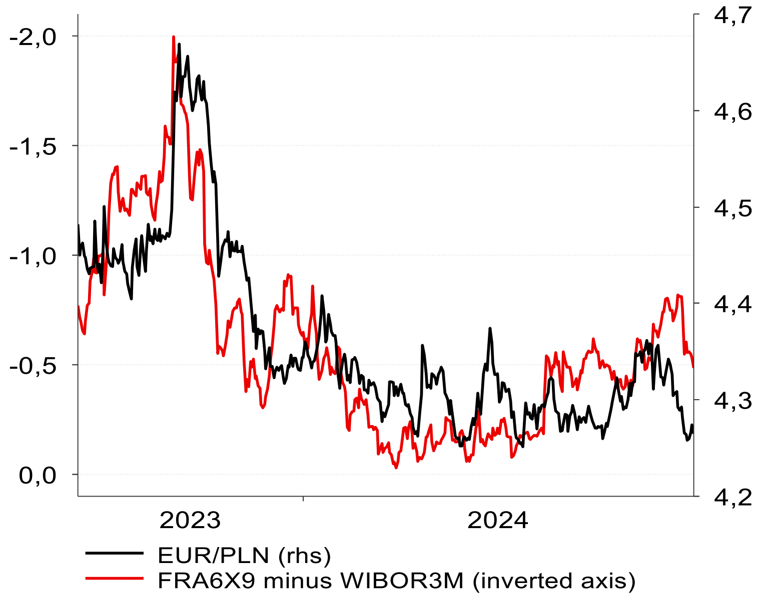


Source: LSEG Datastream, Santander

PLN: stronger dollar vs. postponed NBP rate cuts

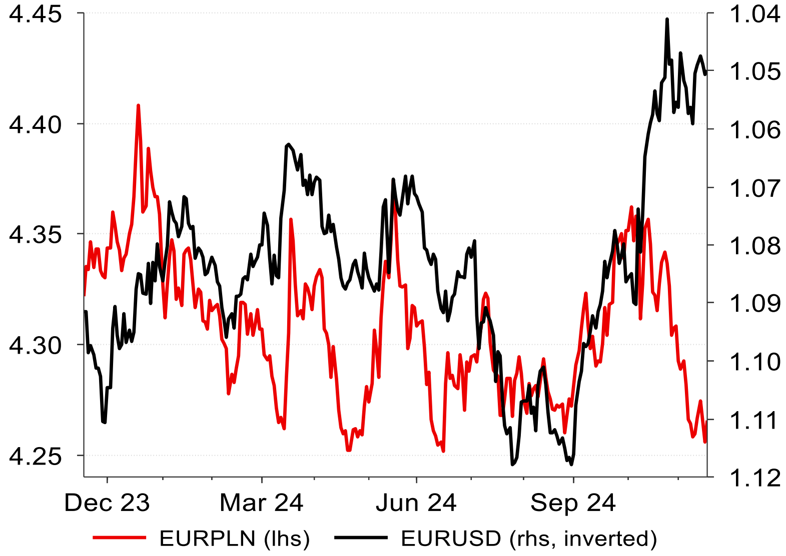
In the short term, the zloty exchange rate will be affected by two opposing factors. Our currency is negatively affected by the strengthening of the dollar against the euro, which is supported by the markets discounting the possible implications of the US elections (e.g. a narrowing of the space for interest rate cuts in the case of the Fed and a widening of it in the case of the ECB) – although, as can be seen from the example of recent weeks, the relationship between the EURPLN and EURUSD exchange rates is not close. Theoretically, the decline in market expectations for rapid interest rate cuts by the NBP should have a positive effect. However, it is debatable whether this factor will outweigh the effect of the increase in the sense of unpredictability of monetary policy and the further loss of credibility by the central bank due to the sudden, difficult-to-understand changes in the forward guidance of the NBP Governor, which discourage foreign investors from engaging in Polish assets.

EURPLN and market expectations for interest rates



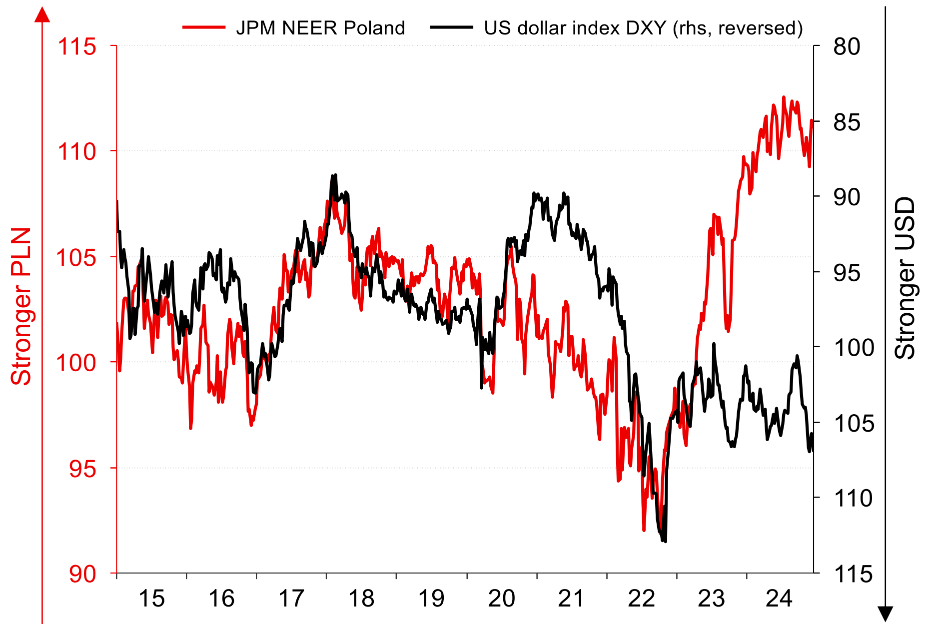
Source: LSEG Datastream, Santander Bank Polska

EURPLN and EURUSD



Source: LSEG Datastream, Santander

Nominal effective exchange rates of the zloty and the dollar



Source: LSEG Datastream, Santander

Santander

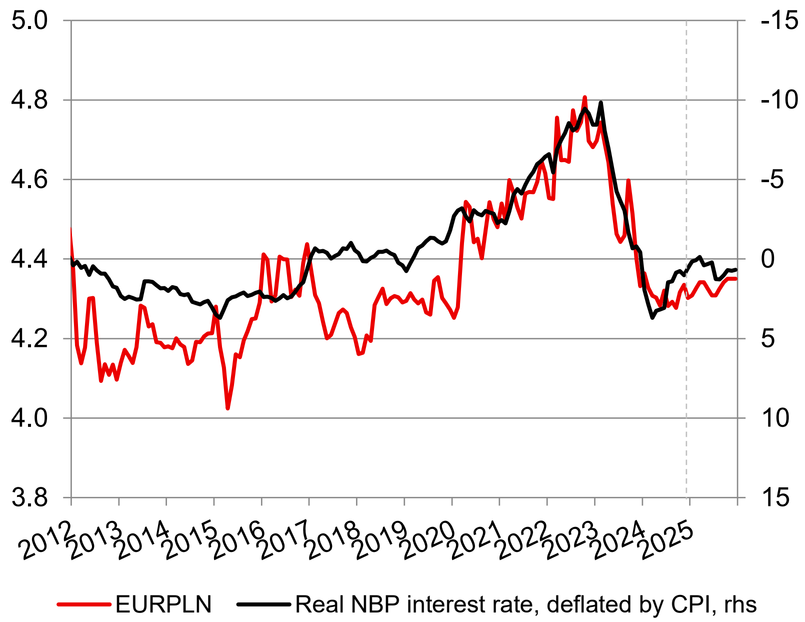
PLN: limited space for appreciation

In the medium term, we do not see space for a significant strengthening of the zloty, e.g. due to the anticipated gradual decline in real interest rates and the increase in the current account deficit.

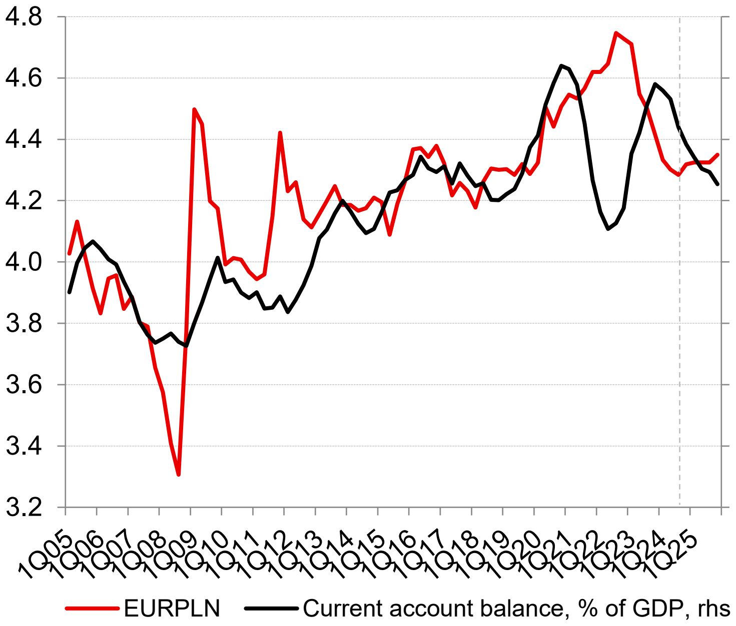
It is worth noting that the real effective exchange rate of the zloty has strengthened very significantly over the last two years, which makes it difficult for Polish exporters to cope with the downturn in Western European markets by undercutting their competitiveness.

In our opinion, the strengthening of the currency is also not in the government's interest – on the contrary, a weaker zloty means greater chances for economic recovery and higher nominal GDP, which would be beneficial for tax revenues.

EURPLN and real NBP interest rate

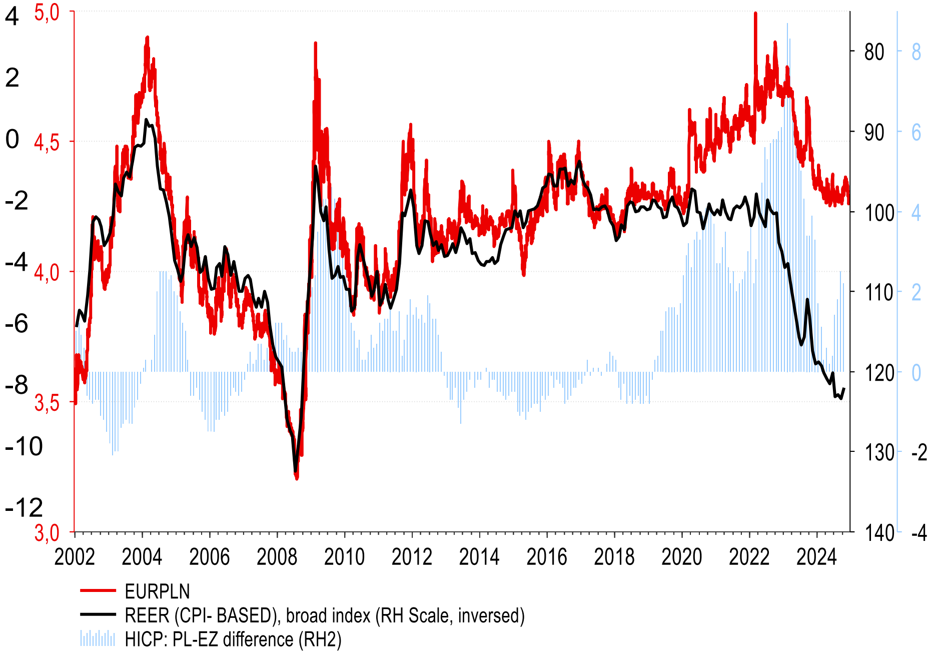


EURPLN and current account balance



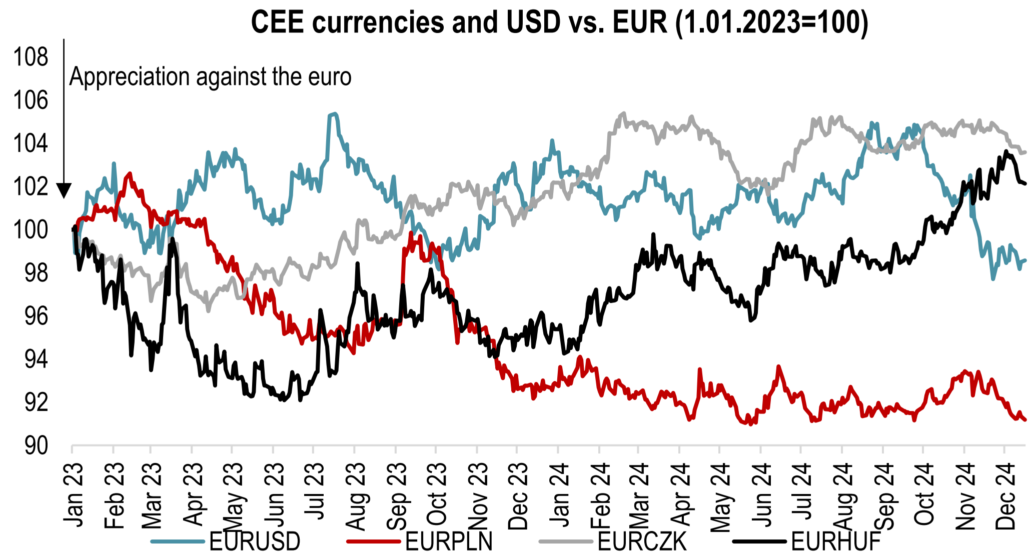
Source: NBP, GUS, Santander

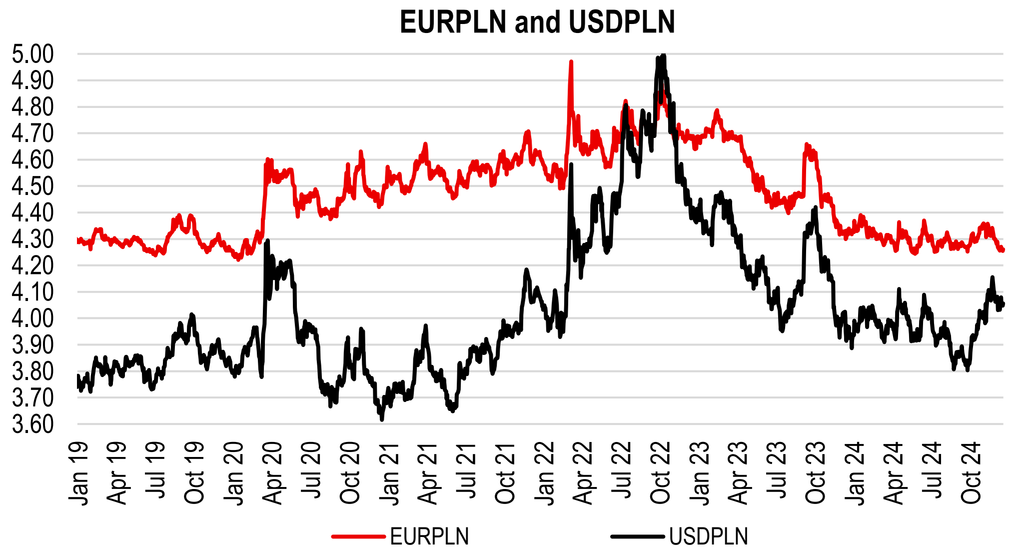
EURPLN and real effective exchange rate

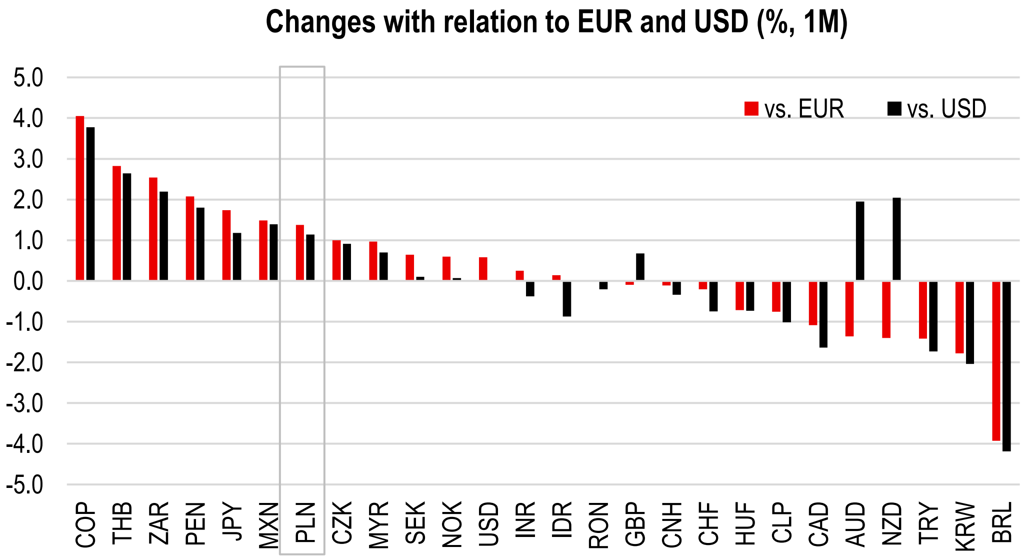


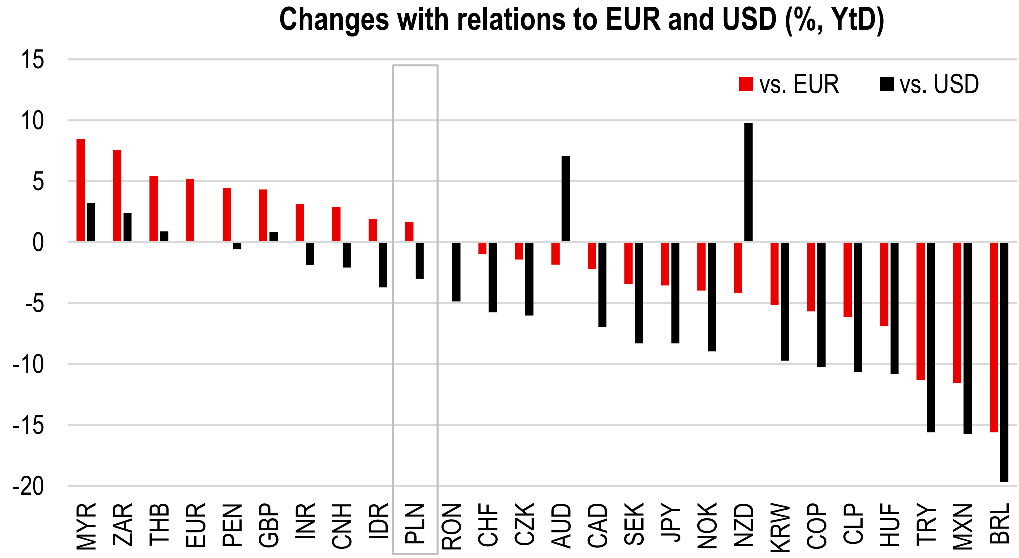
Source: LSEG Datastream, BIS, Santander

FX market overview









Source: Bloomberg, LSEG, Santander

Forecasts

6

Economic Forecasts

		2022	2023	2024	2025	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25
GDP	PLNbn	3,100.8	3,401.6	3,606.1	3,896.9	835.8	863.3	905.0	1,002.0	896.7	934.5	978.0	1,087.7
GDP	% y/y	5.3	0.1	2.8	3.4	2.1	3.2	2.7	3.2	3.1	3.3	3.4	3.9
Domestic demand	% y/y	4.8	-3.1	4.0	5.0	2.3	4.8	4.4	4.3	4.1	4.6	5.9	5.3
Private consumption	% y/y	5.0	-0.3	3.0	2.9	4.4	4.6	0.3	3.0	2.5	2.5	3.0	3.5
Fixed investment	% y/y	1.7	12.6	0.8	6.7	1.9	3.2	0.1	-0.5	2.0	4.0	8.0	9.5
Industrial output	% y/y	10.4	-2.1	1.2	3.2	-0.1	1.9	1.0	2.1	1.3	3.8	4.4	3.4
Construction output	% y/y	7.7	4.8	-7.6	6.9	-8.6	-6.0	-6.8	-8.7	4.8	6.2	8.6	7.1
Retail sales (real terms)	% y/y	5.5	-3.6	3.1	3.6	5.0	4.5	1.3	1.9	1.6	1.1	4.7	6.8
Gross wages in national economy	% y/y	12.1	12.8	13.4	7.5	14.4	14.7	13.4	11.2	7.9	7.7	7.1	7.2
Employment in national economy	% y/y	2.0	0.6	-0.2	0.2	0.2	0.1	-0.4	-0.5	0.0	0.0	0.3	0.4
Unemployment rate *	%	5.2	5.1	5.1	5.0	5.3	4.9	5.0	5.1	5.4	5.0	5.0	5.0
Current account balance	EURmn	-14,872	13,485	-1,319	-13,156	4,567	668	-5,281	-1,273	849	-2,676	-6,291	-5,038
Current account balance	% GDP	-2.2	1.8	-0.2	-1.5	1.6	1.3	0.4	-0.2	-0.6	-1.0	-1.1	-1.5
General government balance (ESA 2010)	% GDP	-3.4	-5.1	-5.7	-5.8	-	-	-	-	-	-	-	-
CPI	% y/y	14.3	11.6	3.7	4.9	2.9	2.5	4.5	4.9	5.7	5.4	4.3	4.1
CPI *	% y/y	16.6	6.2	5.1	3.9	2.0	2.6	4.9	5.1	5.9	5.5	4.3	3.9
CPI excluding food and energy prices	% y/y	9.1	10.2	4.4	4.0	5.4	3.8	3.9	4.2	4.2	4.2	4.0	3.8

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

Source: GUS, NBP, Santander

Market Forecasts

		2022	2023	2024	2025	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25
Reference rate *	%	6.75	5.75	5.75	4.50	5.75	5.75	5.75	5.75	5.75	5.75	5.25	4.50
WIBOR 3M	%	6.02	6.52	5.86	5.50	5.86	5.86	5.85	5.85	5.85	5.77	5.48	4.91
Yield on 2-year T-bonds	%	6.35	5.67	5.05	4.57	5.05	5.28	4.89	4.98	4.98	4.90	4.42	3.99
Yield on 5-year T-bonds	%	6.36	5.66	5.32	5.14	5.19	5.55	5.23	5.30	5.34	5.35	5.05	4.80
Yield on 10-year T-bonds	%	6.10	5.83	5.54	5.36	5.36	5.70	5.45	5.66	5.65	5.55	5.25	5.00
2-year IRS	%	1.19	6.62	5.63	5.20	6.39	6.18	5.05	4.90	5.22	5.48	5.09	5.02
5-year IRS	%	1.69	5.92	5.01	4.78	5.53	5.37	4.59	4.57	4.70	5.13	4.60	4.71
10-year IRS	%	2.01	5.68	5.10	4.89	5.47	5.34	4.80	4.78	4.77	5.23	4.69	4.85
EUR/PLN	PLN	4.69	4.54	4.31	4.33	4.33	4.30	4.28	4.32	4.33	4.33	4.33	4.35
USD/PLN	PLN	4.46	4.20	3.98	3.99	3.99	4.00	3.90	4.04	4.08	4.00	3.95	3.92
CHF/PLN	PLN	4.67	4.68	4.52	4.29	4.57	4.42	4.50	4.60	4.44	4.28	4.22	4.20
GBP/PLN	PLN	5.31	5.50	5.22	5.09	5.06	5.04	5.07	5.19	5.24	5.24	5.27	5.24

* 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 **17.12.2024** has been prepared by:

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