MACROscope

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It’s the security, stupid!

Poland

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Executive Summary (macro)

Events in the global economy and geopolitics have definitely accelerated. Since the outcome of the US presidential election last November, we have been pointing out that the effects of this change on the global economy are difficult to predict and far from obvious. The actions of the new US administration in recent weeks have triggered a sequence of events that has caused a fundamental revision of the economic scenarios priced in by financial markets. Three themes of key importance for the economic and market outlook are playing out in parallel: 1) the turn towards greater protectionism in international trade, 2) the loosening of fiscal rules in Europe, and 3) the efforts to suspend/end hostilities in Ukraine. Each of these has different possible consequences for the future economic growth, inflationary trends and monetary policy outlook - we try to map the main effects in the table on page 7. It is still not entirely clear how (and when) these themes will finally be resolved, so it is still too early for a major revision of macroeconomic forecasts, in our view. For now, the greatest confidence we can have is that there has been a significant reassessment of priorities in Europe and that security issues in military and geopolitical sense are coming to the fore, perhaps at the expense of greater risk in financial policies.

For the time being, **we are maintaining our GDP growth forecast for this year near 3.5%** (the potential first positive effects of the planned stimulation in Europe are offset, in our opinion, by the possible effects of the strong zloty and possibly higher tariffs) and we are looking with growing optimism at the next years, when demand impulses related to the use of RRP, the expansion of defence capabilities in Europe and potentially the start of Ukraine reconstruction may accumulate. **We invariably bet that the flywheel for economic growth in the next 2-3 years will be investment**, with stable, moderate consumption growth and gradually improving export prospects.

The labour market remains in good shape, with unemployment at record lows and real wage growth still high, although slowing, and **we expect a further moderate deceleration in wages in the coming months, creating a more benign environment for disinflation than in previous years**. Nevertheless, the planned fiscal stimulation in Europe and the expected economic recovery generate **risks of increased labour market stress in the medium term**.

We see the inflation outlook for the coming months as more optimistic than just a few weeks ago: due to a lower starting point, the impact of stronger zloty and lower oil prices, the CPI growth in March may not exceed 5% y/y, from April it will start to decline, and from July it may approach 3.5% y/y, i.e. the upper end of the tolerance band around the inflation target. We maintain the view that the risk of a significant increase in energy prices at the end of this year, after the expiry of the current price freeze, is low - by that time either the energy companies will present reduced tariffs for households or the government will decide to extend the price freeze, in our view.

Such a scenario reinforces our belief that the **Monetary Policy Council will resume interest rate cuts from July this year**. At the same time, the aforementioned ‘three big themes’ from the point of view of the inflation outlook generate asymmetric upside risks, which in our view may narrow the room for monetary easing in the euro area, but also in Poland, in the medium term. As a result, **we are revising upwards our forecast for the NBP reference rate at the end of this year to 5.00%**, and we see room for at most additional 100 bp cuts over the next year.

The loosening of fiscal rules in Europe should not automatically entail an increase in the deficit or in armaments spending in Poland - in our country, these increases have already taken place. It remains an open question whether the Polish government will use the funds for defence released from the EU austerity limits to reduce borrowing needs and exit the EDP procedure more quickly, or whether a slower path of fiscal consolidation should be expected in subsequent years. Given the economic and political challenges (including the next election cycle), we rather bet on the latter scenario.

Executive Summary (markets)

FX market

The speed and scale of zloty strengthening at the beginning of the year has taken us by surprise. We assume that when (if) the ceasefire talks in Ukraine conclude with an agreement that the market finds credible, the zloty may gain even a bit more. In the second part of the year, however, we expect a gradual correction as investors' attention is likely to shift to other issues, including the possible impact of trade wars on the European economy, the gradual deterioration of Polish trade balance and the restart of the NBP monetary easing (according to our forecasts, the first rate cut in July). Another fundamental factor that - at least in theory - should work towards an increase in EUR/PLN is the accelerating expansion of Poland's money supply and central bank balance sheet in relation to the euro area.

Interest rate market

The announcement of fiscal expansion plans in Europe at the beginning of March moved up the yield curves in the euro area, but also in Poland, although to a lesser extent, as the national fiscal deficit and defence spending had already increased, which was largely priced in by the market. Meanwhile, the surprisingly low inflation in January-February revived market expectations for interest rate cuts by the MPC. We assume that a further decline in inflation and the resumption of NBP rate cuts from July will move the domestic swap and bond curves downwards in 2H25, and the pricing of diminishing room for cuts in the medium term under the influence of the announced recovery in Europe may favour a further steepening of the curves. Additionally, if a ceasefire agreement is reached in Ukraine that the market deems credible, a further narrowing of yield spreads vs German Bund and ASW spreads would be possible. On the other hand, the room for bond appreciation is still limited by the large debt supply. After February, the degree of gross financing of borrowing needs (around 50%) was below the average of recent years, plus record redemptions are ahead (over PLN 110 billion by the end of this year).

2025: Our forecasts and main risks

Indicator	Summary of our forecasts in December 2024	Summary of our forecasts in March 2025
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.	Forecast still valid. In our view, higher spending on defence and infrastructure in Europe will translate noticeably into faster economic growth not earlier than next year. The first effects may start appearing at the end of this year, but they will be offset by the impact of the strong zloty and possible escalation of trade wars.
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.	Forecast still valid.
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.	Forecast still valid.
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.	Lower inflation's starting point (effect of change in weights) + strong PLN and cheaper oil, gas = lower inflation path this year. In March, CPI may remain at 4.9% y/y, from July it may go down to ca. 3.5% y/y. Core inflation should stabilise in the range of 3.6%-4.0% y/y.
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.	We maintain our view that next NBP rate cut is likely in July, but we reduce the expected scale of the easing by the end of the year in view of new risks to inflation in the medium term from the planned fiscal expansion in Europe (and in the shorter term from a possible escalation of the tariff wars with the US).
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.	Forecast for this year still valid. The consolidation of public finances in the following years may be slowed down under the influence/pretext of the loosening of fiscal criteria in the EU.
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.	Anticipated direction of change still valid (we expect yields to go down in the coming months), but from higher levels, due to the higher than expected yield curves at the beginning of the year.
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.	The zloty surprised us with the scale of the appreciation at the beginning of the year. In case of a ceasefire agreement in Ukraine, a slight appreciation is still possible in Q2, but we see room for a rebound towards 4.30 in H2, influenced by the decline in real rates, deterioration in the trade balance, among other factors.

Economic growth

1

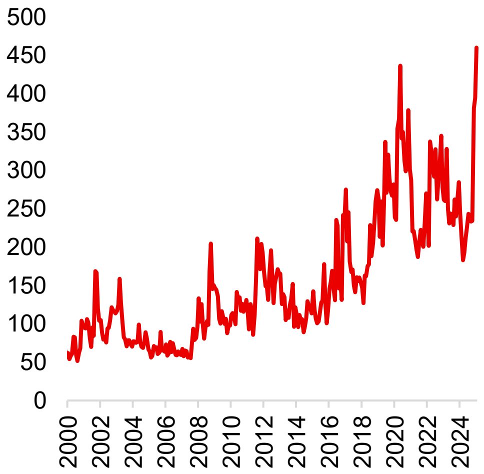
Three key themes for the macro scenario

	Impact on economic growth	*Impact on inflation*	*Implications for markets and monetary policy*
The rise of trade protectionism and the unpredictability of economic policy The volatility of the US administration's decisions means that we cannot be sure of the scale and scope of the tariffs that will ultimately be in place, but the direction we are heading seems clear: on average the level of tariffs will be higher than before the change of US presidency and will probably also affect EU countries to some extent. Uncertainty also surrounds the extent to which affected countries will choose to retaliate.	The increase in tariffs is a **supply-side shock to economic growth**, and its magnitude will depend on the final amount and sustainability of tariff increases. Not only the level of tariffs, but also the great uncertainty about the future policy may act as a brake on companies' investment decisions. Most estimates indicate that the negative effects of tariffs may be greater for the US economy than for Europe, Poland should be among the less affected countries (mainly indirect impact due to the small weight of the US in exports and a negative trade balance). **The first negative effects are possible already in the middle of this year.** On the other hand, just before the introduction of barriers, possible 'pre-emptive' increased procurement purchases.	The increase in tariffs **will raise the prices of goods** in the countries that impose them, so that if Europe decides to retaliate, inflation rates will rise (at least temporarily). **An increase in the price level is not necessarily the same as persistently higher inflation**, especially if the generated shock trims demand and economic activity. Nevertheless, what will be important for central banks will be the behaviour of inflation expectations (in the USA, there are already signs of them rising under the impact of the announcement of higher tariffs) in combination with the developments in the labour market.	A rise in inflation rates (even if transitory) **could make it difficult for central banks to ease monetary policy boldly in the short term**, especially if accompanied by a rise in inflation expectations. Possible flattening of curves (expected more rate cuts in the future). An increase in tariffs should, in theory, favour the strengthening of the currency of the country that decides to do so - **the weakening of the currencies of countries affected by tariffs is, among other things, a natural defence mechanism** to compensate for the loss of competitiveness of their goods. In the current situation, this effect seems to be outweighed by other factors.
Loosening fiscal rules in Europe Europe's response to the loss of a sense of security is to suspend fiscal rules (as in response to Covid-19) and increase defence spending. At the same time, there is a turnaround in German fiscal policy and a strong increase in infrastructure spending.	Positive demand stimulus, **supporting economic growth in Europe**. Larger multipliers for infrastructure investments than for arms purchases which, especially initially, may stimulate mainly imports. **First positive effects possible in H2 this year, greater effect in subsequent years**. In Poland, we do not assume a further increase in defence spending as a share of GDP, but its structure will evolve towards a smaller role of imported equipment, which means an increase in fiscal multipliers. Possible slowdown in fiscal consolidation in subsequent years.	**Possible inflationary impulse, relatively stronger in countries with higher capacity utilisation and lower unemployment**. In parallel with the higher demand for workers resulting from the recovery of the economy, possible actions by governments to expand the size of the armed forces could exacerbate labour market tensions.	**Narrowing room for monetary easing in Europe** due to higher structural inflation risks and possible labour market strains. **Structurally higher bond yields and steeper curves**; narrower spread to Bund but wider ASW spreads (greater competition for investor demand for bonds, whose supply in Europe may increase by 20-30%). Better growth outlook and less room for interest rate cuts **should favour European currencies, including the PLN**.
Russia-Ukraine truce In our view, it is not only the decision to suspend hostilities in Ukraine that will be important, but also the terms of the agreement, on which the economic and market effects may strongly depend.	The more we can assess the agreement as sustainable and stable, the more **positive effects for growth in Poland and Europe**: 1) more investment and consumption due to lower risk, 2) the reconstruction of Ukraine, in which Poland will be an important hub and subcontractor, 3) eventually possibly cheaper raw materials and energy. **Effects rather after 2025.**	Impulse resulting in potentially additional competition for resources (people, materials), especially in construction, **increasing wage pressures, rising prices of, inter alia, construction materials and services**. Possible partial return of migrants to Ukraine. On the other hand: **strengthening of currencies in the region and cheaper raw materials would be disinflationary**.	We assume that the **currency market and equity markets will react positively to the ceasefire** regardless of its terms. However, the durability of this reaction may depend on the scenario. The more we judge the terms of the agreement as credible, the more sustained the reduction in the risk premium for CEE and European assets will be.

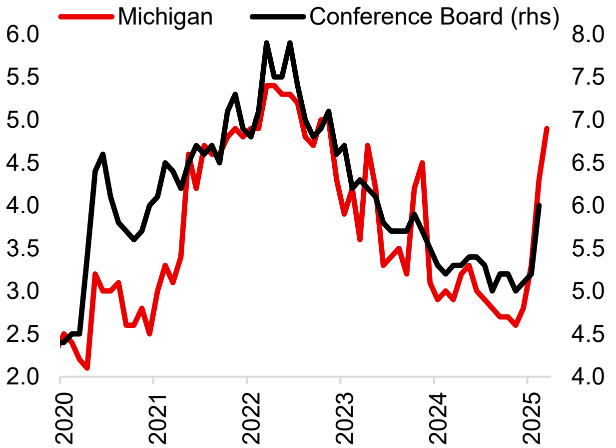
USA vs EU: trading places

Until recently, there was a fairly widespread belief that Donald Trump's presidency could bring a worsening of Europe's growth prospects and an improvement for the US, but the events of recent weeks have led markets to rethink this call. The US administration's focus on supply shock measures (tariffs, migration control), the announcement of a reduction in the fiscal deficit to 3% of GDP (from the current 7%), the surge in economic policy uncertainty, with deregulation measures and tax cuts being put on the back burner, have led to worries of an (at least temporary) slowdown in growth. At the same time, announcements of a sudden turnaround in fiscal and defence policy in Europe generated hopes for economic recovery on the Old Continent. The change in expectations was reinforced by data releases, which since mid-February have seen a wave of positive surprises in the euro area figures and negative surprises for the US.

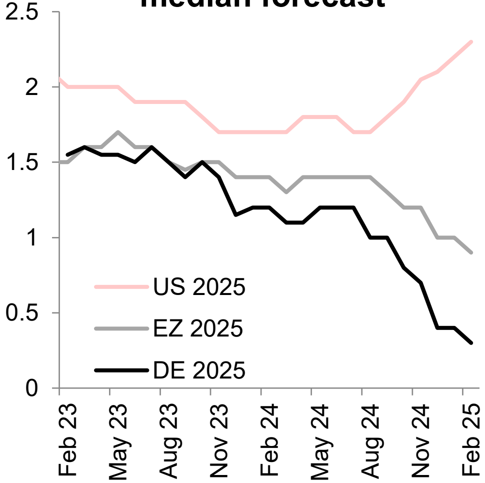
Global policy uncertainty index



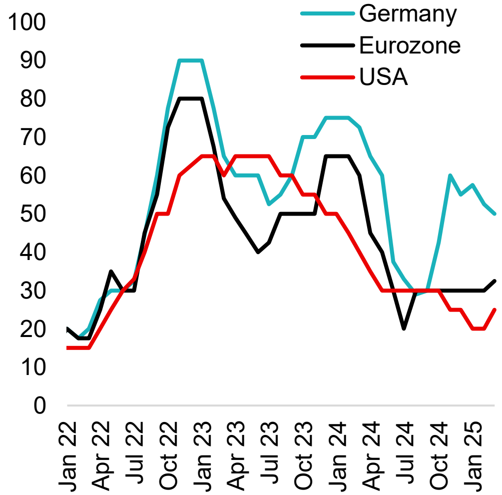
Inflation expectations of US households



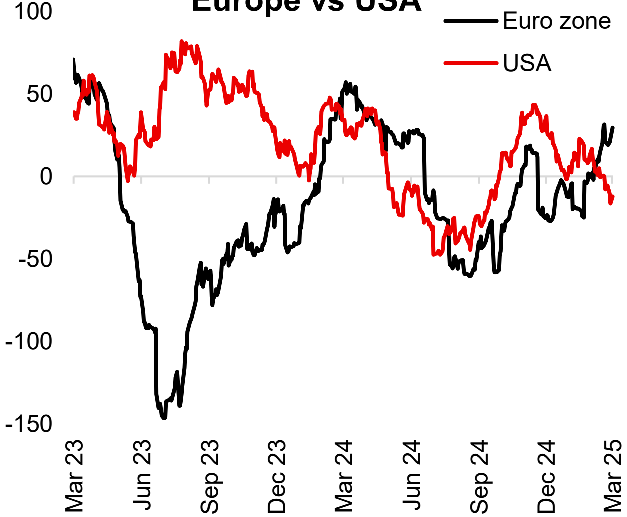
GDP, change in Bloomberg median forecast



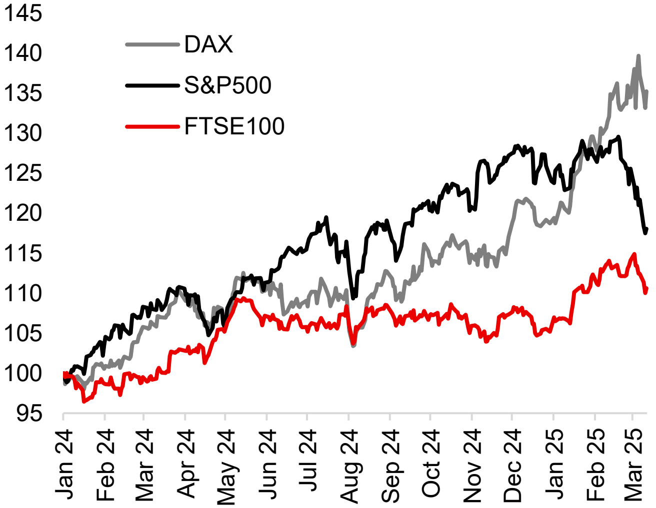
Probability of recession in the USA and euro zone (BBG)



Citi Economic Surprise Index, Europe vs USA



Stock indices (1/01/2024 = 100)



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Source: Bloomberg, Santander

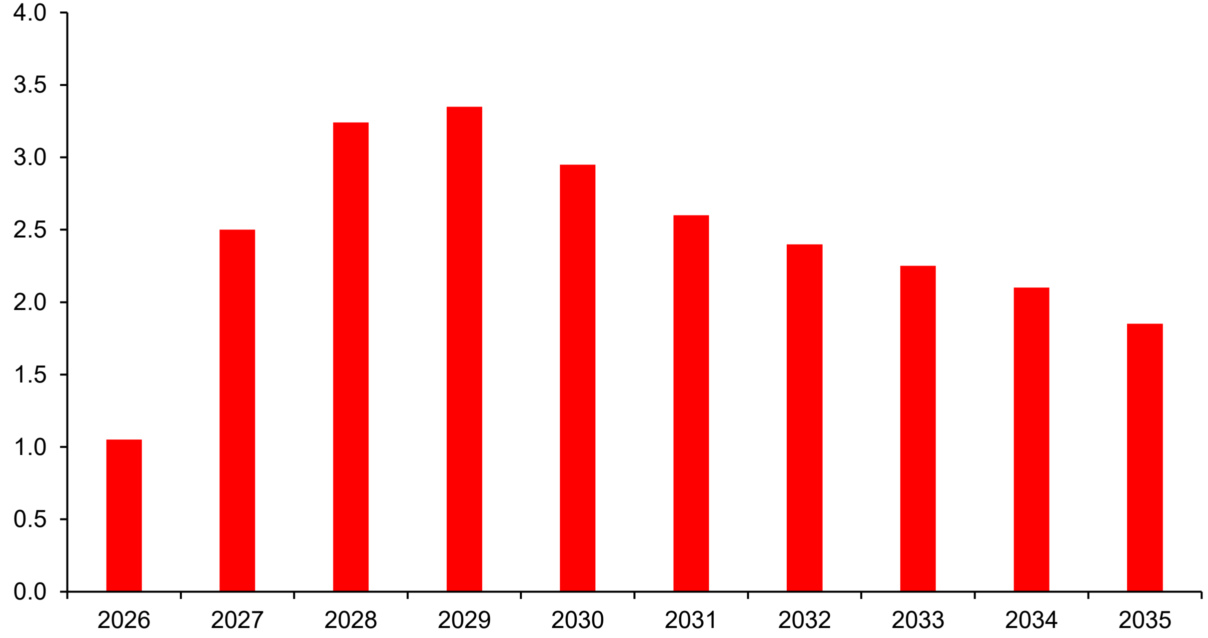
German fiscal package: defence and infrastructure

The German parties CDU/CSU and SPD have proposed a financial package, the main points of which are:

- Exemption of defence spending above 1% of GDP from the so-called debt brake mechanism, which limits the structural deficit to 0.35% of GDP. Currently, Germany spends around 2% of GDP on defence, meaning that any increase in spending in this category will not be restrained by the brake, while freeing space for other expenditure worth around €40 billion annually.
- Creation of an investment fund worth €500 billion over 12 years, including €100bn for state governments and €100bn for climate transition. It is expected that the funds will be channelled into transport infrastructure, energy, digitisation and housing, but the exact distribution still has to be determined.

According to estimates by the German Institute for Economic Research (DIW), **the investment package will add 1 pp to German GDP growth in 2026, 1.5 pp in 2027 and 0.7 pp in 2028. In the long term, it will raise German GDP by 2%.**

Estimated impact of investment package on GDP level in Germany, %



Source: DIW, Santander

ReArm Europe will make defence financing easier

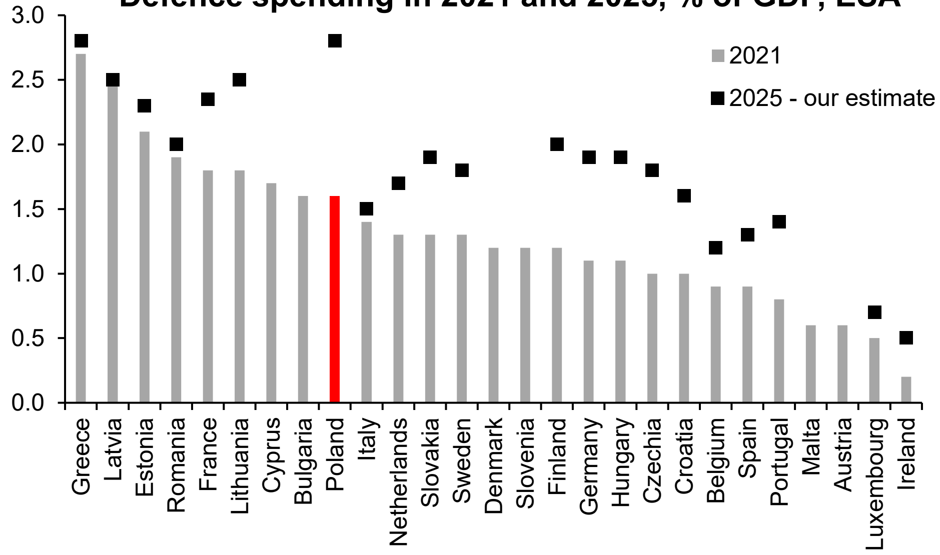
The European Commission has proposed a new instrument, ReArm Europe, aimed at increasing arms spending in the European Union.

ReArm is to consist of several elements: (1) a €150bn loan fund called SAFE, (2) exempting the increase in defence spending (in line with Eurostat COFOG definition) out of the excessive deficit procedure, up to 1.5% of GDP versus 2021, which according to the Commission estimates could free up €650bn, (3) redirecting resources from the Resilience Fund and the Cohesion Funds to defence.

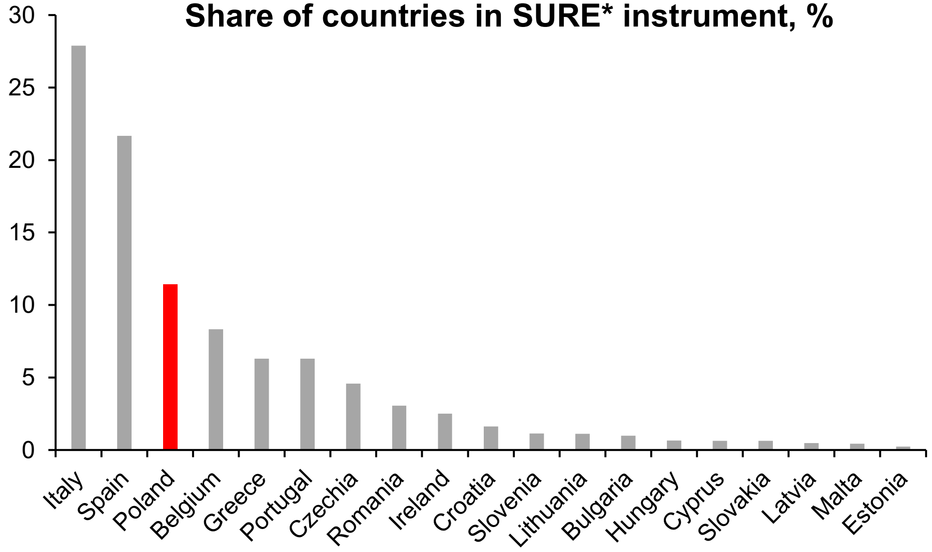
If ReArm funds were divided according to countries' share of GDP, that Poland could count on at least €7bn from the loan fund. We treat this estimate as an absolute minimum, as we expect a larger allocation in countries on the eastern border of the EU due to the directions of potential risk. In addition, if we assume that countries which can finance themselves more cheaply on the market (e.g. Germany) will not draw from the instrument, as was the case with the SURE instrument, Poland's share can be estimated at €16bn. **Thus we guestimate that a figure in the vicinity of €20bn** seems realistic. This figure includes loans up to 2027. Funding for subsequent years will be discussed when negotiating the medium-term EU budget for 2028-34.

In our opinion, the new instrument will not significantly affect the growth of new defence expenditure in Poland, as this has already increased significantly in the past years. The resources from the loan fund will therefore probably serve to reduce market borrowing needs, and the removal of defence spending from the EDP (by 2025, spending according to ESA has increased by about 1.5 per cent of GDP, so we have basically already exhausted the ReArm limit) will enable a faster exit from the procedure or an increase in spending in other categories and, as a result, a slower fiscal consolidation in subsequent years.

Defence spending in 2021 and 2025, % of GDP, ESA



Share of countries in SURE* instrument, %



* SURE was an EU programme worth €100bn started in 2020 to fight the effects of the pandemics (lifeline for workplaces and incomes), and was financed by issue of bonds by the European Commission.

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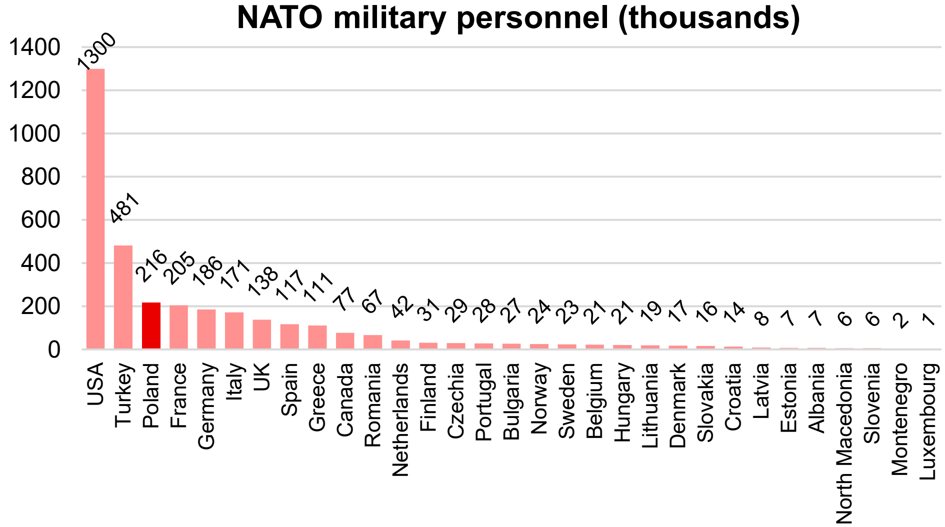
Source: Eurostat, EC, Santander

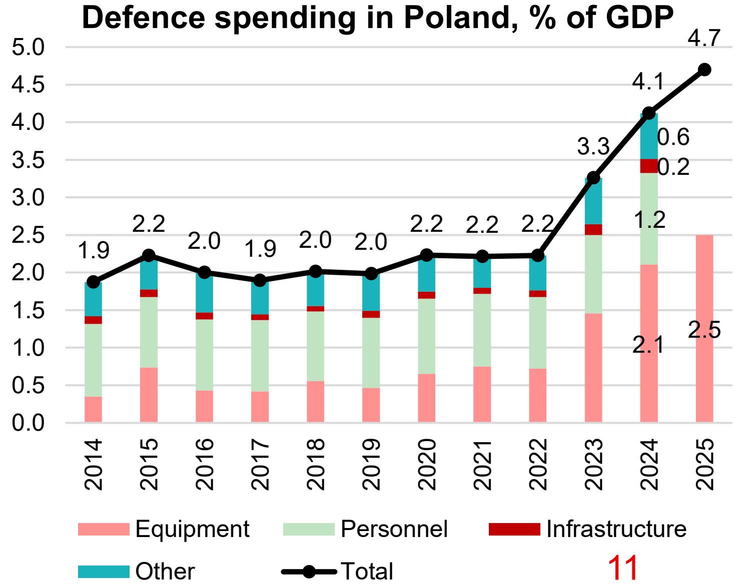
ReArm Poland: even more on defence?

Poland is the undisputed leader in NATO when it comes to defence spending: in 2025 it will reach almost 5% of GDP in cash terms (in ESA terms it is less than 3% of GDP), more than half of which is earmarked for the purchase of equipment. Compared to 2021, defence spending (cash) increased by around 2.5% of GDP and by more than 200% in current prices, and more than 70% of this increase was due to equipment purchases. The number of active personnel almost doubled: from 116k personnel in 2020 to 216k in 2024 (144k professional soldiers, 40k soldiers of the Territorial Protection Force).

Will we spend even more on defence in the upcoming years? Government representatives (Prime Minister, Minister of Finance) suggest that the baseline scenario is rather to maintain the relation of defence expenditure to GDP close to the current level. However, it should be expected that the breakdown of expenditure will change towards a decreasing share of expenditure on equipment (especially foreign equipment), and an increase in expenditure on maintenance, infrastructure and personnel. The planned reallocation of a part of RRF funds (cPLN30bn) to defence will mainly cover dual-use investment (shelters, roads, bridges) and support for Polish arms companies (defence research, equipment production). Purchases of equipment themselves are likely to be more and more of domestic, or at least European, production. All in all, this will mean a **gradual increase in fiscal multipliers for arms expenditure**.

PM Donald Tusk, in a recent speech to the parliament, mentioned the creation of a ‘half-million-strong army’, which seems a super-ambitious plan given the demographic outlook and record low unemployment. Part of this plan is to expand the reservist base by providing military training for volunteers. The expansion of the army could be a factor that makes wage pressures in the economy more persistent.





Source: NATO, MF, Santander

Impact of defence spending on GDP

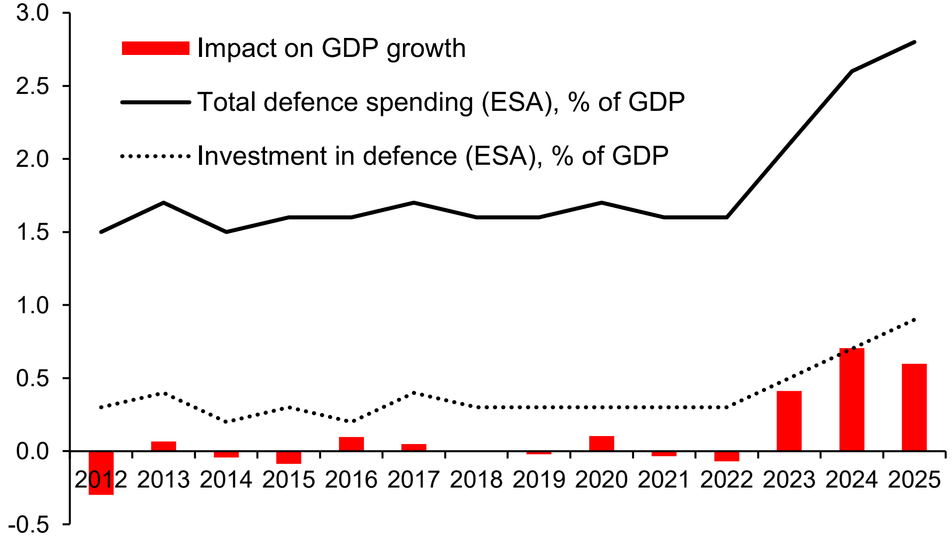
On the previous page, we focused on growth in defence expenditure in cash terms. This definition includes not only current spending, but also orders, so in our view it is a better idea to use ESA figures when estimating the impact on GDP. In this approach, total defence spending is expected to reach 2.8% of GDP in 2025 (compared to 1.6% of GDP in 2021) and investment spending 0.9% of GDP compared to 0.3% of GDP in 2021. The increase in actual expenditure is therefore much less pronounced than the cash figures would suggest.

Economic research indicates (e.g. here) that short-term fiscal multipliers for defence spending are lower than 1.0 and lower than multipliers for other types of spending. This implies that a shift in the breakdown of fiscal spending towards defence outlays lowers the average level of fiscal efficiency. At the same time, a higher multiplier is estimated to occur for personnel expenditure and a lower multiplier (almost zero in some studies) for expenditure on military equipment.

Defence spending has an impact on GDP through three channels. Firstly, they increase the overall level of security, which influences, for example, the decisions of economic agents on the location of their spending and, in particular, their investments. Second, they have a positive impact on aggregate demand. Thirdly, they stimulate supply and investment in defence-related sectors, including technology and R&D. On the other hand, however, defence-related sectors compete with civilian sectors for resources, and increase in the army size sucks workers out of the labour market. Greater defence spending therefore reduces the efficiency of resource allocation.

Based on the available studies, we estimate that an increase **in defence spending from an average of 1.5 per cent of GDP before 2022 to 2.8 per cent of GDP in 2025 generated a fiscal impulse with a strength of around 0.5 per cent of GDP in 2023-2025**. We have assumed a short-term fiscal multiplier of 0.75, which is rather optimistic.

Estimated impact of defence spending on GDP growth



Source: Eurostat, Santander

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Spare capacity in European defence industry

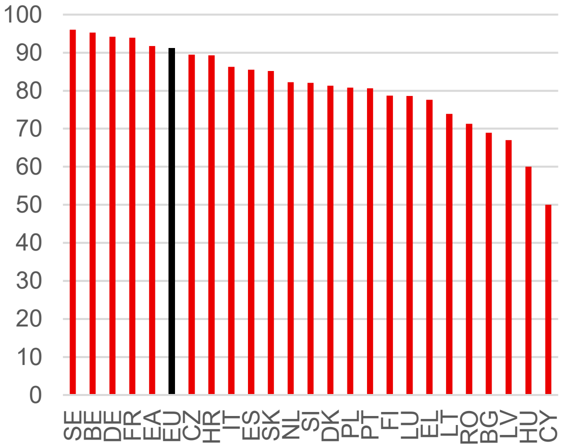
EC President Ursula von der Leyen has tempered expectations of a rapid implementation of the ReArm Europe programme by utilising EU's own production capacity. She stated that **80% of military equipment purchased by EU countries is imported and there is no chance of a rapid expansion of own production**, even though it would be desirable to place as much of the money earmarked for the rearmament of Europe in contracts supporting the EU economy as possible. The EU's Common Security and Defence Policy envisages only a gradual transition to in-house production, so that by 2030 50% of EU countries' expenditure on military equipment goes to EU manufacturers, and by 2035, 60%.

The EU's incentive to rearm comes from the need to be independent from US military protection, hence the withdrawal from US procurement can be swift, as already shown by Portugal's declaration to abandon its pending purchase of F35 aircraft. However, the supply gap it would cause would be huge. According to the Draghi Report, between Jun'22 and Jun'23, 63% of the value of military orders of EU countries went to US-based companies. On top of that, according to the findings of the Bloomberg agency, South Korea, an important global arms producer, is now limited in its ability to respond quickly to the Europe's needs (busy fulfilling a large multi-part order for Poland placed earlier, among others). **In such circumstances, the European industry may show more flexibility** e.g. Rheinmetall AG has announced that it is able to adapt one of Volkswagen's civilian factories for tank production; in Poland, the Ministry of Defence is to buy the Częstochowa steelworks from an official receiver. In general, however, it is assumed that, despite the clear political will and the strong need to strengthen Europe's armies, **the positive economic effects of rearming Europe may come only in 2026** with some chance of occurring as early as the end of this year.

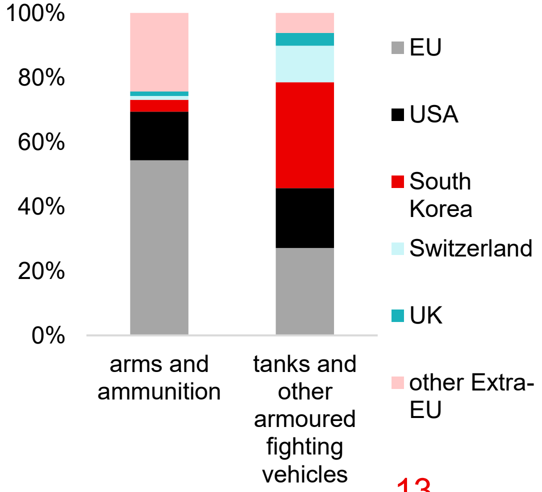
The degree of capacity utilisation in the EU countries in the industries where defence production is located suggests that there is room for output increase. This is clearly visible in fabricated metal products (incl. cannons, weapons, ammunition) where the capacity utilisation rate is 70-80% in all but few countries. To a lesser extent, spare capacity is seen in other transport equipment (incl. warships, aircraft/helicopters/drones, military combat vehicles) with an EU average capacity utilisation rate of 91%. In these industries, however, military production makes for a small part of the volume. The EU also appears to have spare capacity in metal production (utilisation rate of 74%), one of the key industries shaping the potential of the defence sector.

The importance of the defence industry to the overall value of sold industrial production in Poland is low, according to our assessment. In 2023, arms and ammunition worth PLN4.2bn were manufactured in Poland, which accounted for 0.2% of total industrial production value. Add to this the production of heavy military equipment - the category comprising it weighed 0.1% of total production in 2023. We estimate that ships, aircraft, helicopters and drones added a similar value, raising the estimate for total military production to around 0.5% of total industrial output sold.

Capacity utilisation (%): other transport equipment



EU import, 2023



Source: Eurostat, Santander

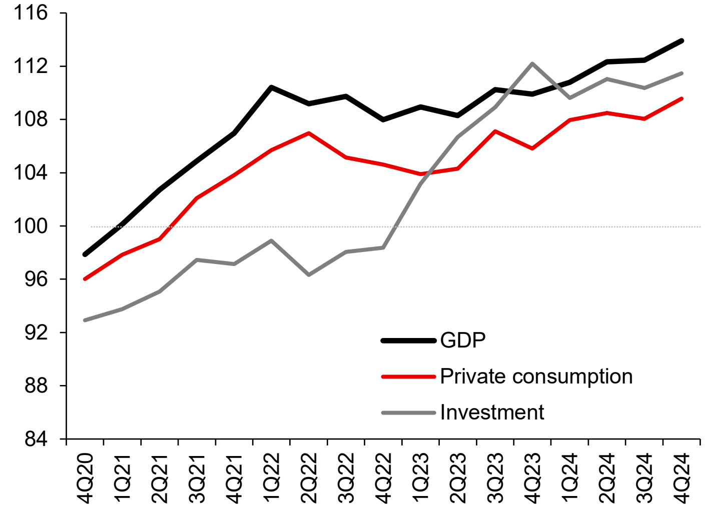
Polish economy stays resilient

We maintain our forecast that **the Polish economy will be able to generate GDP growth of 3.4% in 2025**. Poland is not exempt from the impact of geopolitical risks and general uncertainty, which have recently intensified, but the latest information from the economy offsets their impact. Detailed 4Q24 GDP data showed a stronger rebound in private consumption than the market had expected (3.5% y/y instead of 3.0% y/y) and investment (1.3% y/y against a median forecast of -0.3% y/y). In seasonally adjusted terms, private consumption and investment continued their upward trend in 4Q24.

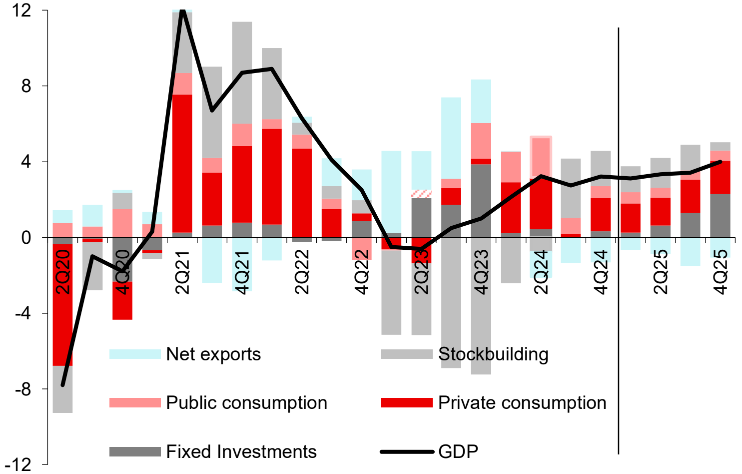
The monthly retail sales and construction production data even show an intensification of positive trends in recent months. Industrial production, still struggling with low foreign demand, showed weaker momentum.

Even in industry, however, positive accents are visible. **The manufacturing PMI broke above 50 points for the first time in nearly three years**. Out of the 36 economies we track, since last spring, the Polish PMI has rebounded from one of the last places of the table to 13th position. If the natural pessimism of Poles is taken into account (i.e. the multi-year average is subtracted from the indices), Polish manufacturing is already in the lead.

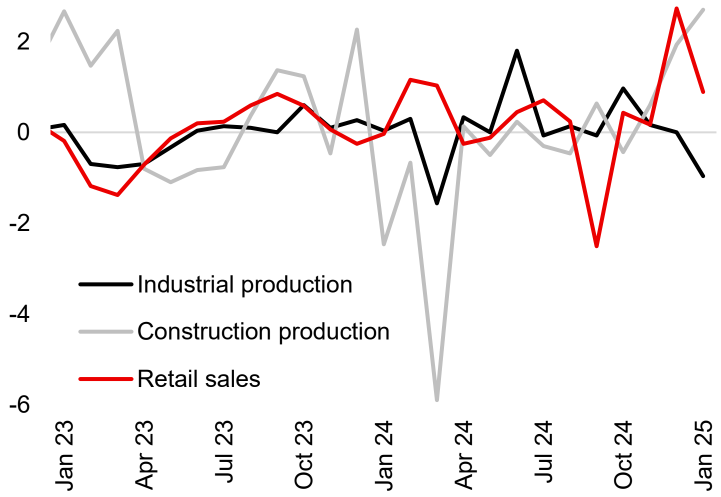
GDP and main components, 4Q19=100, s.a.



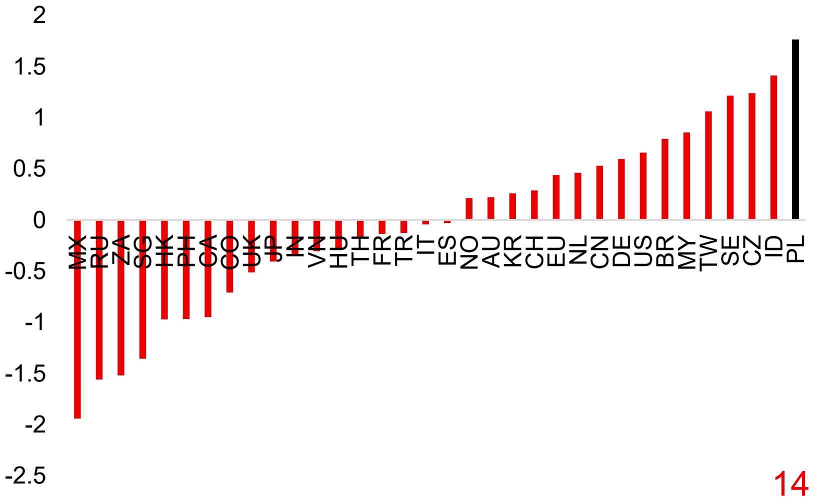
GDP y/y growth breakdown, %



Production and sales, % m/m, seasonally adjusted, 3M moving average



Manufacturing PMIs, z-scores



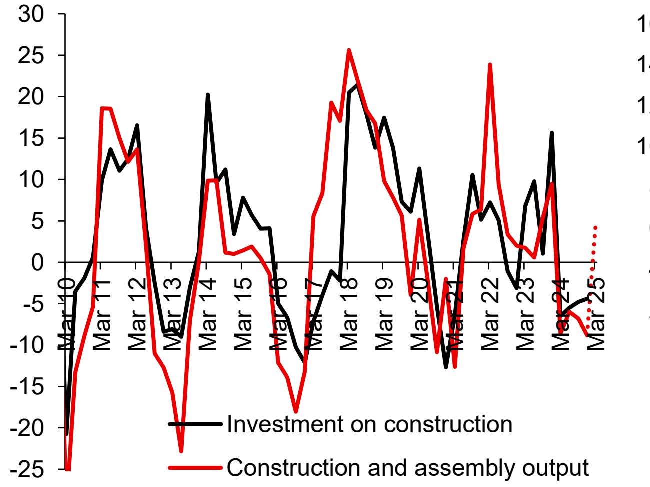
Source: GUS, Bloomberg, S&P Global, Santander

Investment: on the recovery path

Data for 4Q2024 showed a 1.3% y/y increase in investment. Although this was slightly better than could have been expected based on the annual GDP data published earlier, it confirms that 2024 was a very weak year in terms of investment. **However, we maintain our expectation that there will be a marked improvement in investment in 2025**, primarily due to the acceleration in EU cohesion and resilience fund spending.

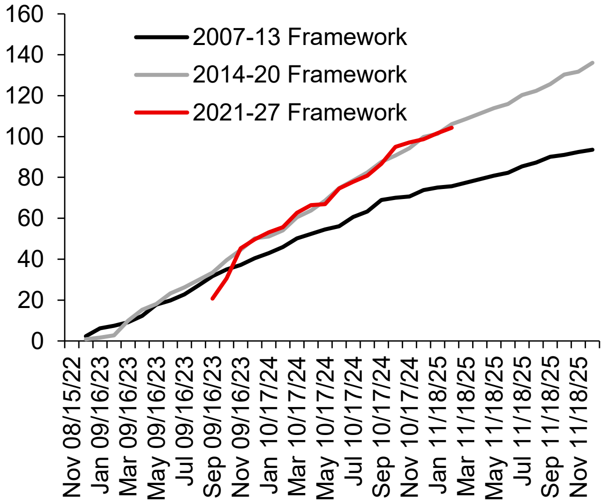
Data published in recent months support our belief in a good investment performance this year. Firstly, data on applications for cohesion fund payments have clearly improved in the last three months of 2024. Secondly, further updates on local government investment plans continue to suggest double-digit growth in investment in this sector. Thirdly, there was a clear upward surprise in construction output in January. However, this last signal should be approached with caution - due to seasonality, January output in nominal terms is less than half that of December, so strong surprises in this month occur on a regular basis.

Construction output vs investment, % y/y

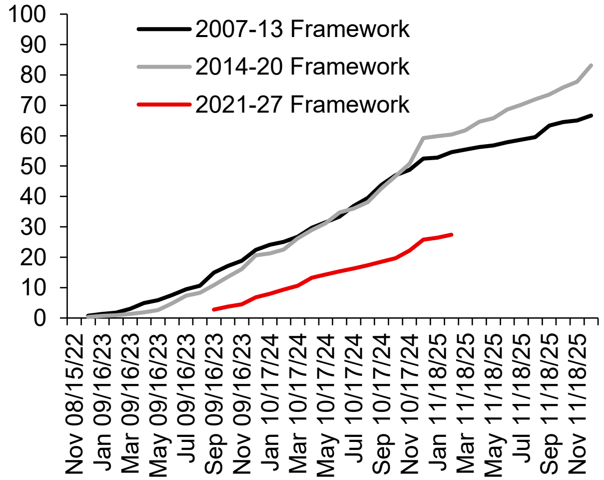


Data on cohesion find financing, €bn

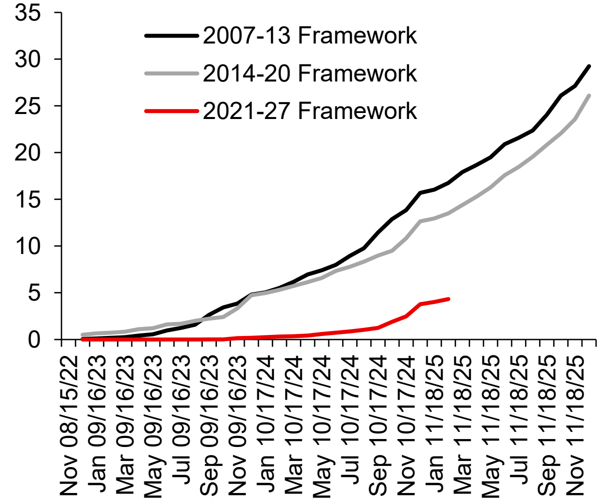
Financing applications



Financing contracts, % of budget



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: increased use of EU funds

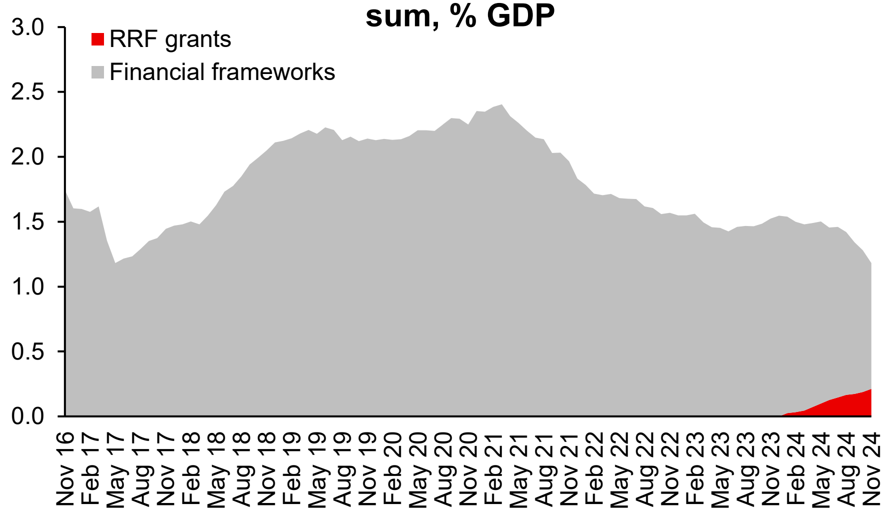
Payouts from the Polish Development Fund for the purpose of financing investments under the grant part of the Polish RRP exceeded PLN10bn, informed Minister Pełczyńska-Nałęcz in the middle of February. According to the plan from the budget act for 2025, expenditures of grants from the RRF should stand at c. PLN52bn (1.3% of the GDP we project). Simultaneously, expenditures from 2021-2027 financial framework should increase to c. PLN33bn. As a result, **we expect overall expenditures from the EU funds budget to increase in 2025 by some PLN50bn y/y** (excluding expenditures from the common agricultural policy and after accounting for the end of the previous financial framework).

As minister Pełczyńska-Nałęcz has informed, apart from PLN50bn of grants, the government plans to invest over PLN30bn of loans from the RRF in 2025. In October last year, the government envisaged investments of PLN80-100bn. **The actual amount of investment expenditures will depend on how fast contracted funds will be put to work.** According to the minister, at the beginning of March, over PLN75bn of RRF funds were contracted (a bit below 30%), including PLN48bn of grants. For comparison, a year after the previous financial framework achieved a similar state of advancement, expenditures rose by below PLN30bn (or PLN20bn, if the comparison is to be made only for the grants). On the other hand, in their peak, expenditures were rising by over PLN50bn a year. The RRF is not fully comparable to conventional EU funds, and its short timeframe may prompt faster increases in spending. However, the current state of contracting suggests that investing c. PLN80bn from the RRF in 2025 may prove to be a challenge. Nevertheless, as we noted in our previous MACROscope, even a lower use of RRF funds will make 2025 a year of investment.

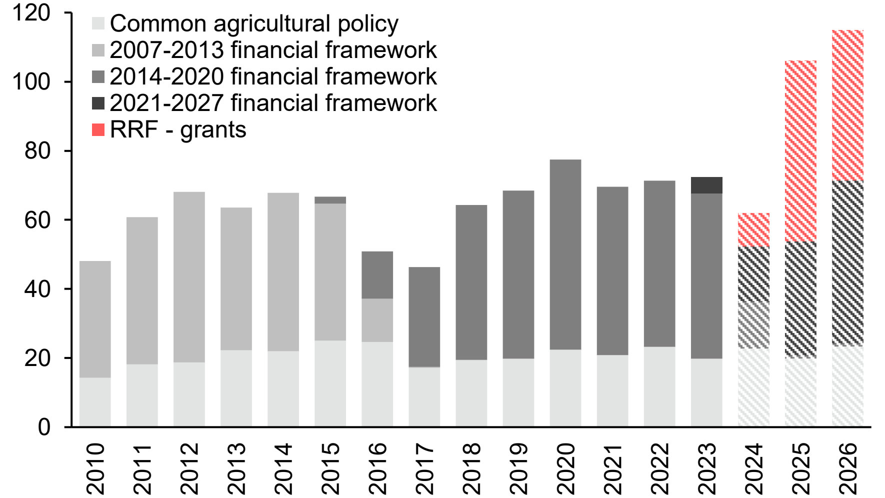
We do not expect the recently-announced Security and Defence Fund to provide additional investment stimulus beyond that which we have expected so far. The Fund will be financed with PLN30bn out of PLN40bn of RRF loans initially intended for green transformation of cities. However, as the Minister reported, the demand for these loans has so far amounted to only PLN4-5bn. The low demand suggests that changing the funds' purpose will not lead to an increased use of RRF loans but only decrease the risk of an incomplete execution of the plan. The loans moved to the Security and Defence Fund are to be used for double-use infrastructure (bunkers, roads), support for arms manufacturers, and military technology research.

The European Commission will decide on the transfer of the loans to the Security and Defence fund by the mid-April.

Expenditures from the EU funds budget, 12M moving sum, % GDP



Expenditures from the EU funds budget, PLN bn



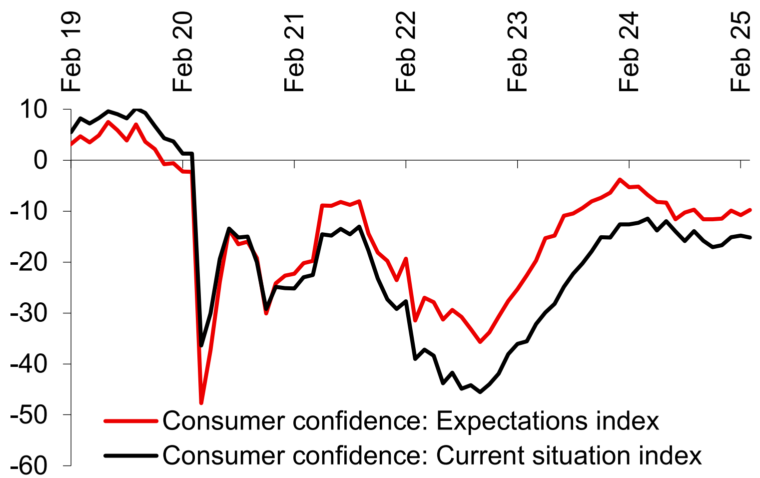
Source: data of Ministry of Finance and GUS, estimates of Santander

Consumption: keep calm and spend

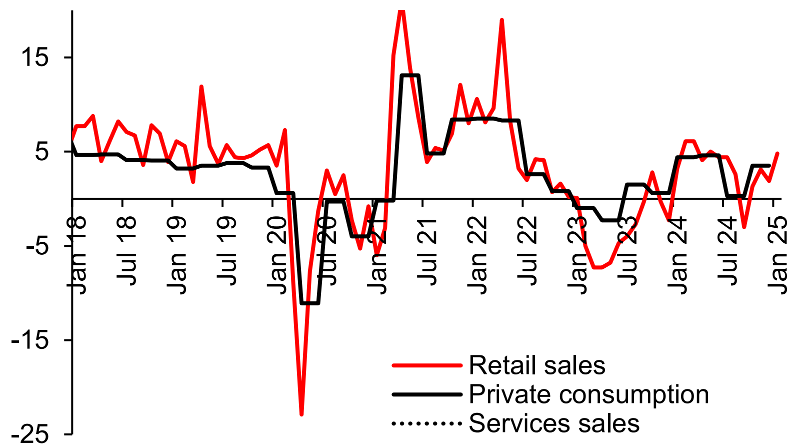
In the last quarter of 2024, private consumption grew by 3.5% y/y, thereby confirming our assumption that the consumer remains in shape and that the weak third quarter result (0.3% y/y) was driven by one-off factors. Our expectations remain unchanged - the labour market remains stable, real household incomes will grow at a solid pace this year, consumer optimism indicators remain relatively high, consumer credit growth is accelerating. **These factors will support moderate private consumption growth in the coming quarters.**

January retail sales surprised sharply upwards with an increase of 4.8% y/y. In our view, such a high result was partly due to one-off factors, so we treat it somewhat analogous to the surprisingly weak reading in September 2024, i.e. a temporary deviation from trend, but the data still support our optimism about the consumer.

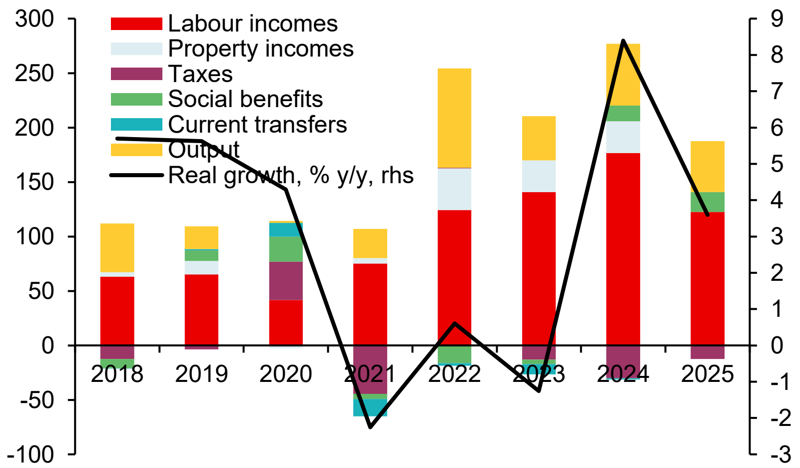
Consumer confidence indicator, pts



Retail sales and private consumption, % y/y



Decomposition of disposable income growth, % y/y



Source: Eurostat, GUS, Santander

Has the propensity to save decreased?

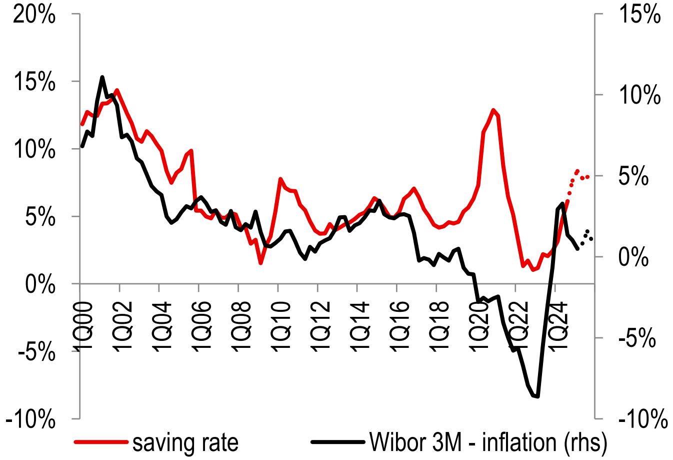
According to GUS institutional sector accounts data, the household saving rate continued to grow in 2Q24 and 3Q24. In the absence of more recent 'hard' data, we attempt to use surveys to assess the current propensity to save.

On the basis of the Economic Sentiment Indicators, it can be said that **Polish consumers have remained in a saving mode** - over the past three months there was a slight increase in the share of respondents declaring the ability to save. This is a consequence of a further improvement in real incomes on the one hand and geopolitical and economic uncertainty and fears about future finances on the other. The strength of the incentive to save is also important: market interest rates remain relatively high, also when adjusted for inflation.

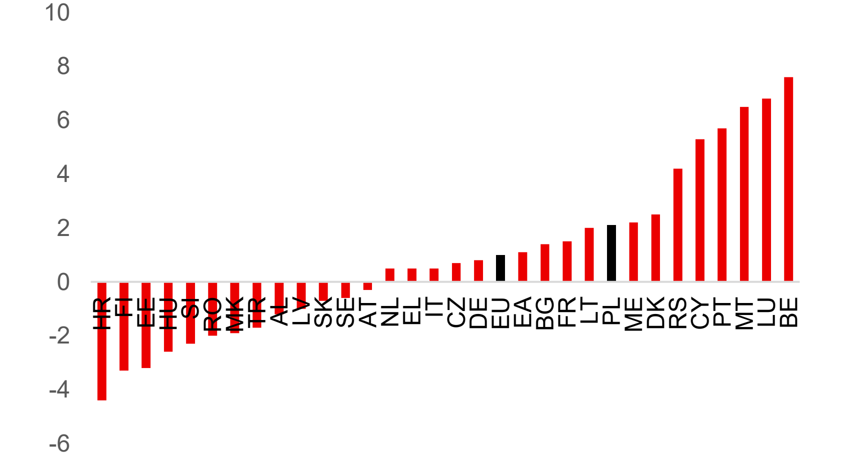
Using an econometric model, we removed the effect of financial situation assessment on the propensity to save (as declared in the GUS consumer survey). Such a measure, in our opinion, provides a better indication of current consumer stance. **The enthusiasm for saving, thus defined, has been steadily declining for almost a year and is already more than half of what it was at its peak**. Still, consumers have not returned in their behaviour to the neutral level from the pre-pandemic years.

One factor that we consider important for consumer attitudes in the coming quarters will be the development of the conflict in Ukraine. A ceasefire perceived as permanent, with security guarantees, would help normalise (i.e. decrease) the saving rate in Poland.

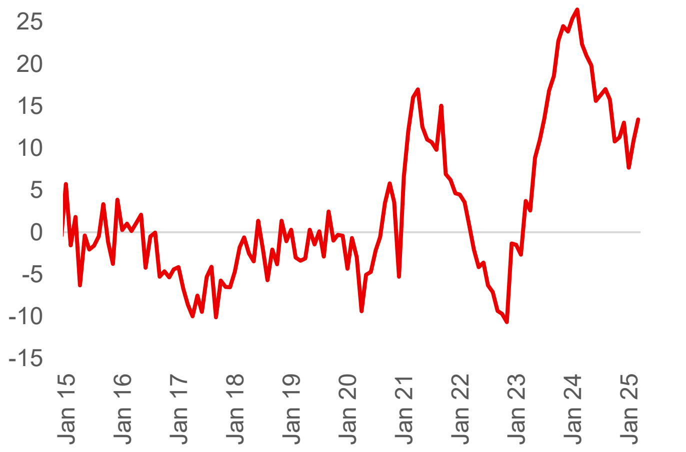
Polish households' saving rate and real interest rate



ESI, change in the share of households declaring ability to save, February 2025 vs. November 2024



Impact of factors other than the perceived financial situation on the propensity to save



Source: Eurostat, GUS, Santander

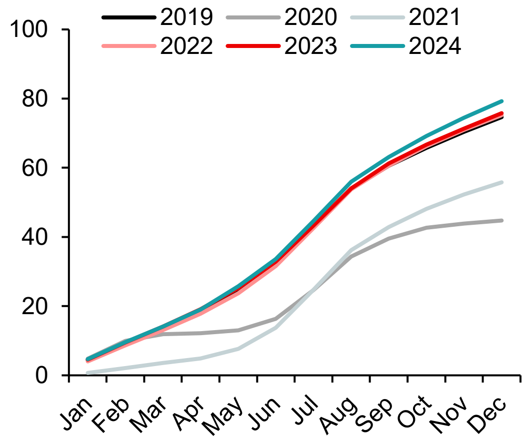
A record year for tourism

One aspect of robust domestic consumption is increased tourism, and **last year was undoubtedly a positive one for the Polish tourism sector**.

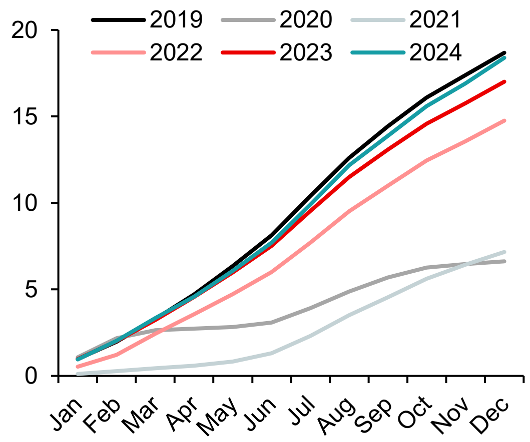
Domestic tourists spent a record 79.3 million nights in Poland, 4.6% more than in the previous year. Foreign tourists, on the other hand, spent 18.4 million overnights, 8.1% more y/y, but still slightly less than before the pandemic (18.7 million). The number of tourists from countries such as Spain, China, Greece, Cyprus and Taiwan increased by more than half.

We assume that foreign travel by Polish citizens was also very robust. This can be inferred from the increase in air traffic. According to the Central Statistical Office, the number of passengers served at Polish airports reached a record 38.6 million in 2024, 11.1 per cent or 3.9 million more than the year before and more than double that of 2019. This growth cannot be explained solely by the increased arrivals of foreign tourists to Poland.

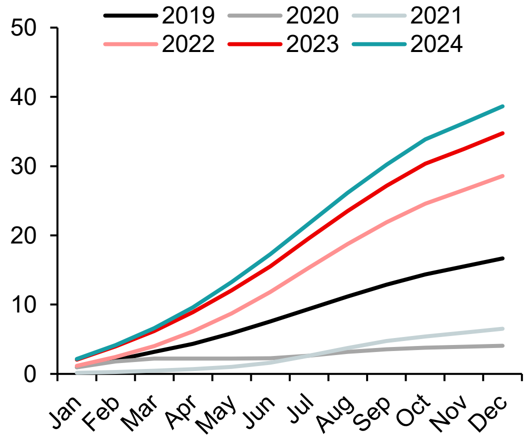
Number of nights spent in Poland by domestic tourists, million, cumulative



Number of nights spent in Poland by foreign tourists, million, cumulative



Number of passengers served at domestic airports, million, cumulative



Source: GUS, Santander

Increase in the number of tourists in 2024, per country

Country	Increase, thousands	Increase, % y/y
Germany	158.0	9.6
USA	85.1	18.0
Spain	71.2	50.2
Italy	63.5	31.3
Czechia	58.4	16.6
UK	50.3	7.8
Netherlands	37.3	21.7
China	28.5	50.3
Total	**800.9**	**11.3**

Santander

Trade: weakened exports, rising imports

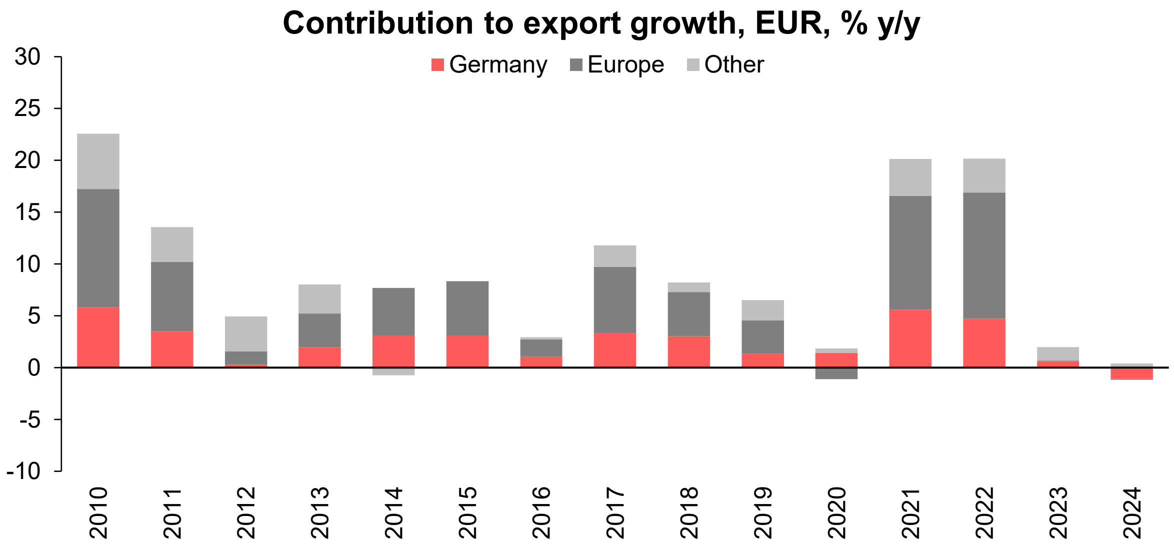
Germany remains the main source of weakness in Polish exports. An increase in exports to Ukraine is observed, including not only armaments but also some machinery and raw materials. However, Ukraine's larger contribution to the growth of Polish exports is fully offset by smaller contributions from Russia, Belarus and post-Soviet republics such as Kazakhstan and Uzbekistan.

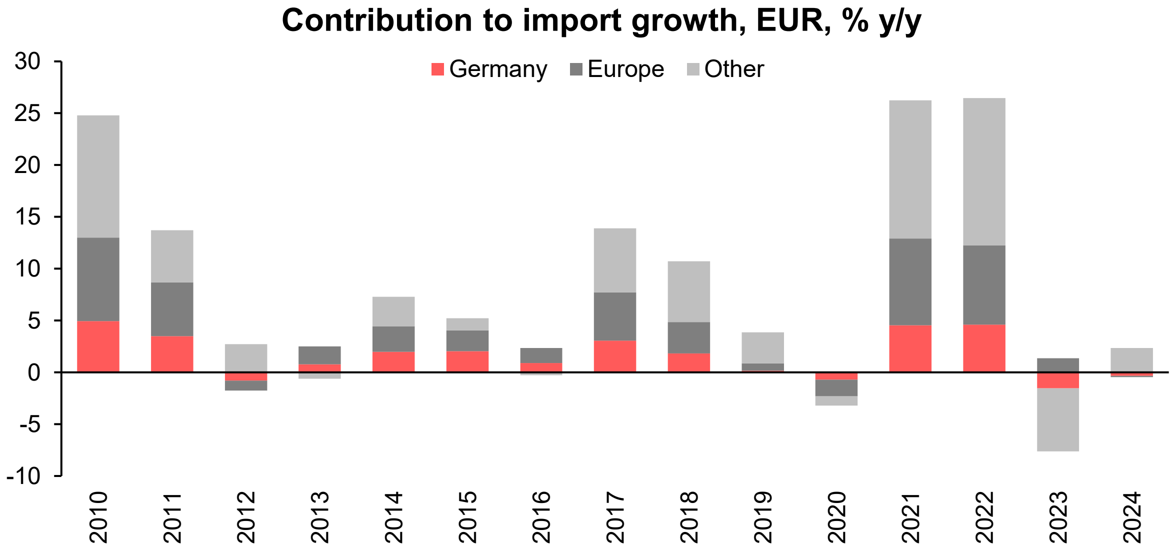
The decline in the growth rate of Polish exports is most strongly influenced by weakening demand for machinery and equipment, including vehicles and parts or electrical equipment, among others. Strong declines in exports are also visible in the case of fuels and lubricants, as well as oils and fats. On the other hand, slight increases are registered in the food or beverages and tobacco categories, and very pronounced increases in the clothing and footwear categories.

On the import side, there has already been a systematic rebound since the beginning of last year, reflecting an increase in domestic consumer demand.

As a result, there has been a measured deterioration in the Polish trade balance since the beginning of last year, bringing it down from around 1.3% of GDP in 2023 to around 0.1% in 2024.

We expect the growth rate of Polish imports to continue to reflect strong domestic demand in the following quarters and to reach close to 7% y/y for the whole of 2025 (vs. 2.3% y/y in 2024). **The performance of exports will depend on the condition of the euro area economies**, making the scale of their improvement likely to be smaller, in our view in the order of around 4% y/y (vs. -1.2% y/y in 2024).





Source: GUS, Santander

Trade: the case of Germany

Although Germany is the main source of weakness in Polish exports, the rate of decline in its total imports has been decelerating steadily more or less since the beginning of last year.

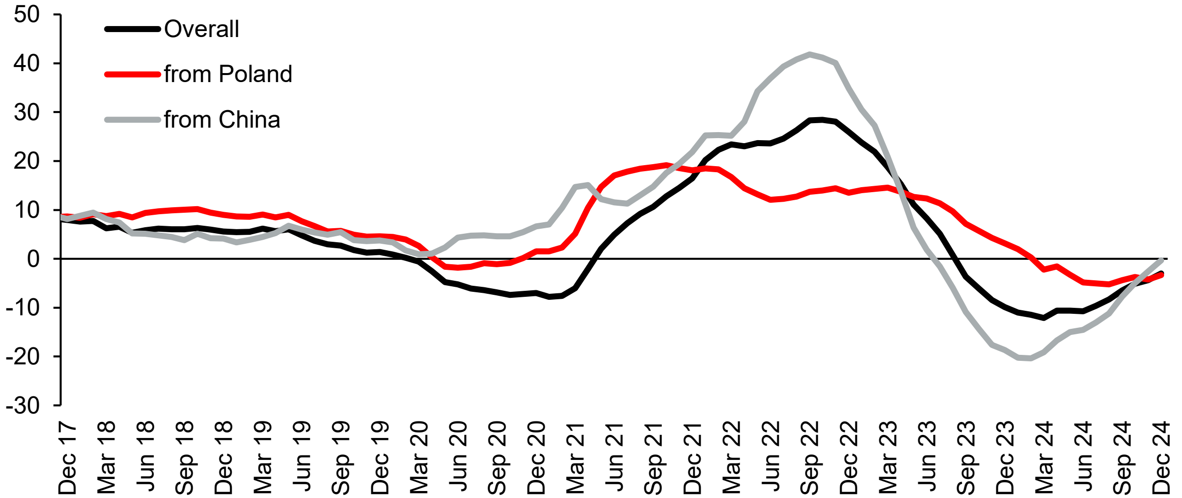
This phenomenon is not as visible in the Polish data as it is in, for example, the Chinese data because the main goods that Poland exports to Germany, including e.g. car parts, machinery, electronics, are among the categories that are still most affected by the weakness of the German economy. The import growth in these categories still shows a downward trend.

In some categories of German imports, such as food or clothing, a slight increase in demand is visible, but for the time being this is rather an exception to common trends.

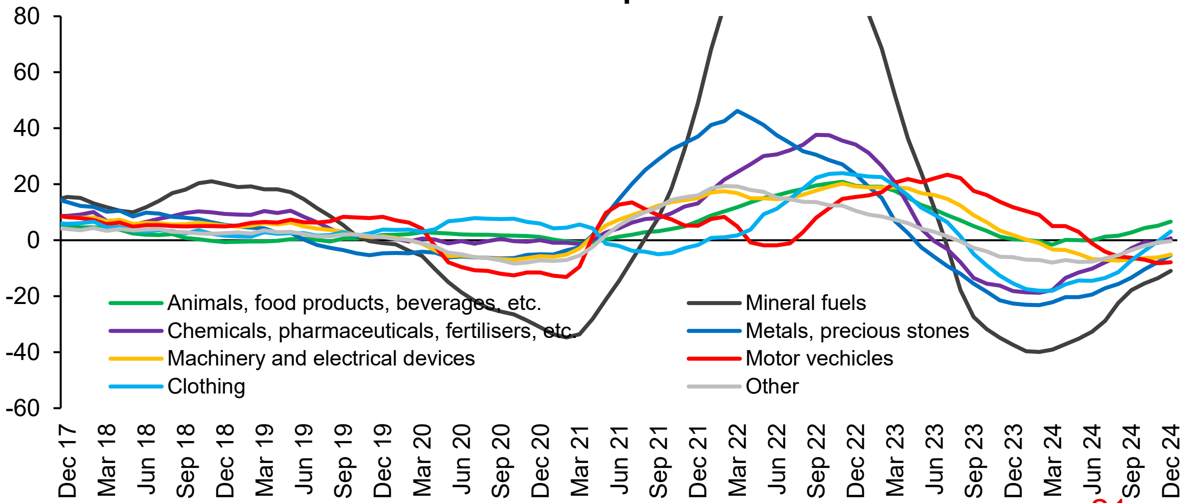
Overall, German demand is stabilising. A continuation of this trend will mean less strain on the growth of Polish exports. Nevertheless, until there is a visible economic rebound in Germany, exports to Germany should not be expected to recover significantly.

The fiscal spending package proposed by the CDU/CSU and SPD raises hopes. Although the main beneficiary of the fiscal stimulus is the arms industry, its effect will spill over to the entire economy, strengthening and/or accelerating its rebound. This, in turn, will have a measurable impact on the performance of Polish exports.

Growth of 12M moving sum of German imports, EUR, % y/y



Growth of 12M moving sums of German imports, EUR, % y/y, main components



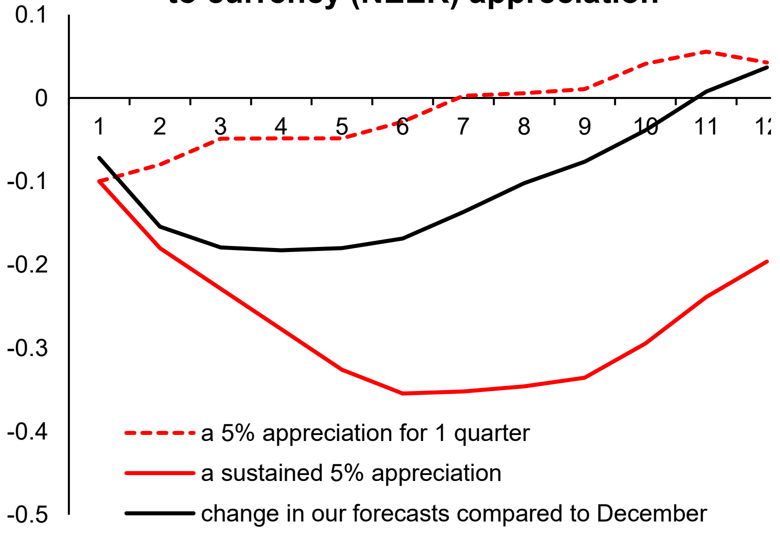
Source: StBA, Santander

Stronger zloty will decrease GDP growth and inflation

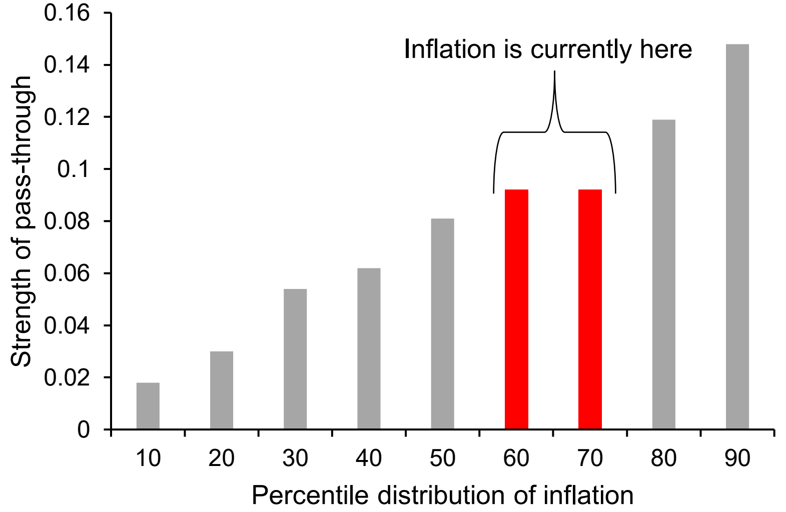
Based on the results of the NBP’s research on the impact of the exchange rate on macroeconomic variables, we estimated that **a 5% appreciation of the nominal effective exchange rate lasting 1 quarter translates into a reduction in GDP growth by less than 0.1 percentage points in the first year. On the other hand, a sustained appreciation of 5% reduces GDP growth by 0.2 pp in the first year and 0.1 pp in the following year.** With a rate change corresponding to the revision of our forecasts compared to the December MACROscope, the effect on GDP growth is -0.15 pp in 2025 and 0.0 pp in 2026. We estimate that the strength of this effect is not large enough to prompt us to revise our forecasts downwards, especially considering the good macro data at the beginning of the year (retail sales, construction output) and possible fiscal stimulus in the EU. We are therefore treating this as a risk factor at present.

The strength of the pass-through to inflation depends, among other things, on the pace of inflation (higher = stronger effect) and the state of the economic cycle (expansion = stronger effect). Price growth is currently higher than average (depending on the measure, we estimate it to be in the 60-70th percentile) and the economy is, in our view, in late recovery - early expansion phase, which means that the pass-through effect can be estimated at around 0.06-0.10 (i.e. **a 5% appreciation of the exchange rate subtracts 0.3-0.5 pp from inflation**). For inflation, the price of commodities, in particular oil, is also an important risk factor. We assume a gradual increase in the price of Brent crude oil to $75/barrel by the end of the year. A rise to $90 would raise our year-end inflation forecast by 0.4 pp and a fall to $50 would lower it by 0.8 pp.

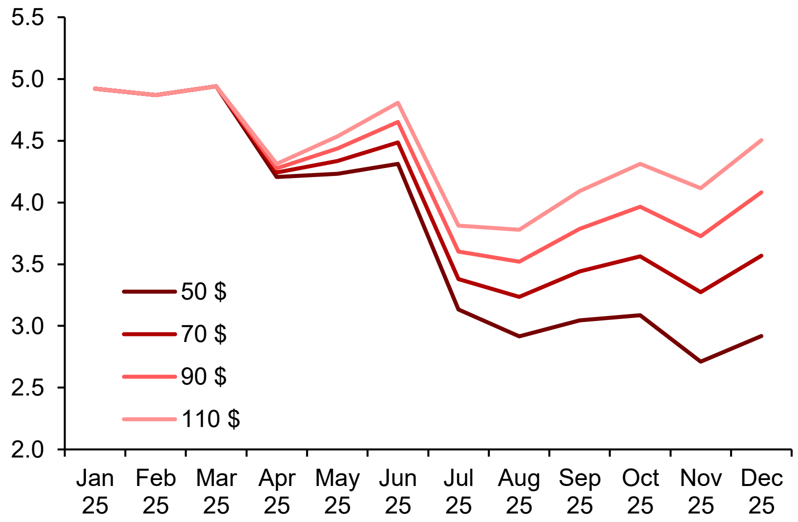
Response of GDP (in level) to currency (NEER) appreciation



Strength of currency pass-through depending on inflation (distribution percentile)



CPI inflation and forecasts of Brent price at the end of the year



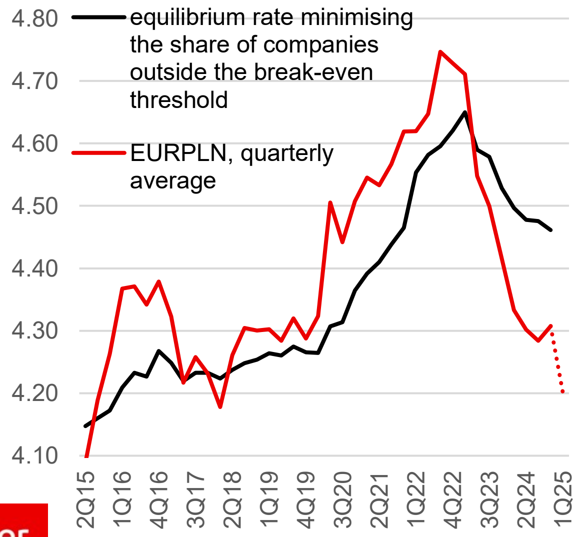
Source: NBP, Santander

How painful is the strong zloty?

The marked appreciation of the zloty began in 2H22. A stabilisation came after two years, but the last few months are again marked by a further appreciation. Periods of rapid PLN appreciation have happened before, but the current is especially negative for exporters - in terms of the proximity to the export profitability threshold, estimated by the NBP, the zloty is where it was in 2006-2008. Companies involved in foreign trade have certain adaptive capacities, which historically (based on our econometric study of the impact of exchange rate fluctuations on the profitability threshold of exports) allowed them to compensate for 50-60% of exchange rate fluctuations in three quarters. However, this capacity may now be undermined by the tightness of the labour market with strong wage growth (and thus the wage fund and its share of total costs) in recent years, cost shocks in energy prices and operating on already reduced margins.

We have calculated an ‘equilibrium rate’ for EURPLN that would minimise the proportion of firms, on the exporters‘ and importers’ side combined, operating below the break-even threshold. From mid-2015 to mid-2023, the zloty was consistently weaker than this equilibrium exchange rate, but now it remains clearly tilted in a stronger direction. On this basis, it can be said that the exchange rate has not created significant negative pressure on exporters' profitability over the past decade. For the calculations, we assumed the normality of the distribution of profitability thresholds. With this assumption, it can also be deduced that currently around 30% of exporters contracting in euros are operating below the threshold. However, this is a high estimate compared to the findings of the NBP's Quick Monitoring survey, according to which in 4Q24 around 14% of exporters reported unprofitable exports, with the share of unprofitable exports in total export revenues barely exceeding 2%. In the 4Q23 ranking of barriers to business, the exchange rate was reported as a major problem by 5% of companies (5th most considerable problem).

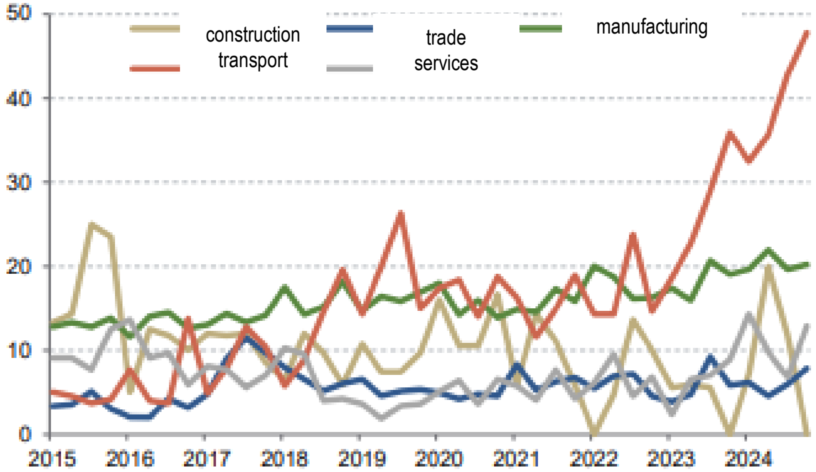
EURPLN vs equilibrium rate based on break-even profitability thresholds



Estimated share of unprofitable export companies*

* Share implied from relating the average exchange rate in each quarter to the information on break-even threshold – its mean and standard deviation, under the assumption of normality of the distribution.

NBP Quick Monitoring: share of exporters declaring the presence of unprofitable export, by business sector, %



Source: NBP, Santander

Labour market: unemployment has no way to rise

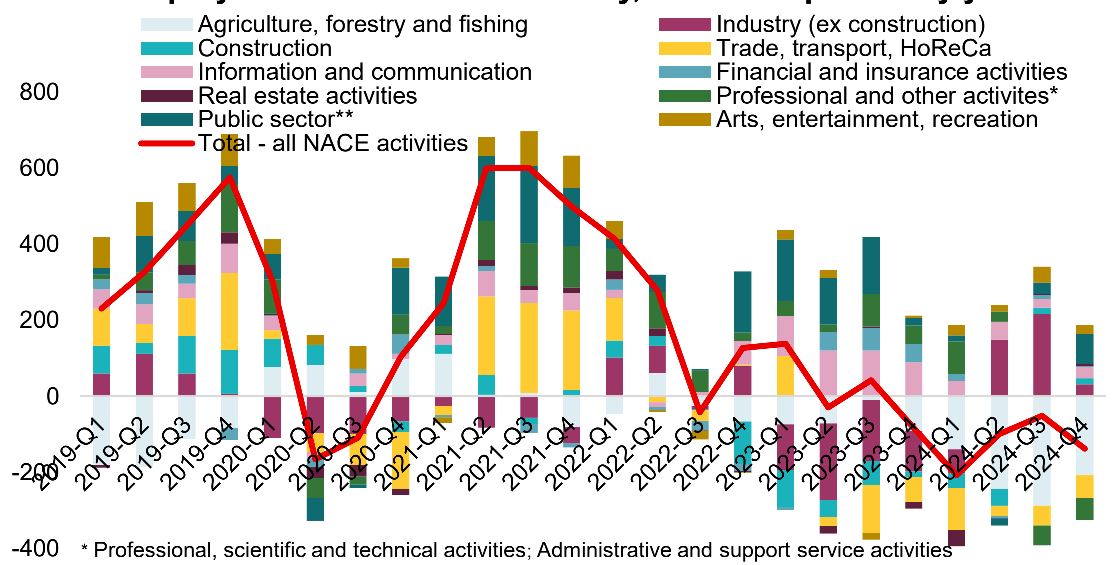
The Polish labour market remains tight. Minor y/y declines in employment in 2024 and in early 2025 do not change the broader picture that **the number of employed is still close to record levels and, in our view, will remain so through 2025**. The annual growth rate of employment in the corporate sector may gradually move towards zero this year, averaging -0.5% y/y and the number of employed may remain in a narrow band around 17.2 million, where it has remained since mid-2021. Unemployment, on the other hand, despite changes in the phases of the business cycle, over the last few years has not broken away from record lows.

Inconsistencies are evident in the incoming labour market data: the LFS unemployment rate set a new record in January, falling to 2.6% (data since 1997, seasonally adjusted), while m/m increases in registered unemployment have been larger in the last three months than in previous years. Industry, according to data from the business sector, accounted for most of the layoffs in 2024 (a year-on-year total decrease of 62k, of which manufacturing was responsible for 42k). However, according to broader data on the National Economy, the decrease was mainly in employment in agriculture, while full-time jobs in industry even slightly increased last year.

With a solid economic performance and a demographically constrained labour supply, it is hard to imagine labour market slack building in the economy, especially in view of the need to increase defence, including the size of the army**.**

A cessation of hostilities in Ukraine could trigger significant flows of Ukrainians in both directions, the net effect is difficult to predict, but it seems to us that it need not significantly worsen the overall picture of the labour market in Poland (see page 26), although it could affect shortages and wage pressures in some sectors.

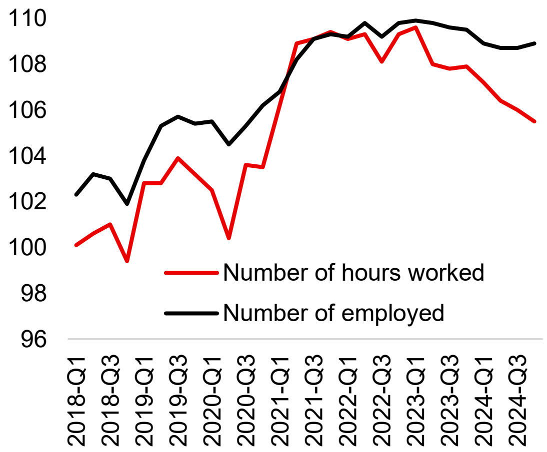
Employment in National Economy, thousand persons y/y



* Professional, scientific and technical activities; Administrative and support service activities

** Public administration and defence; compulsory social security; Education; Human health and social work activities

Employment in National Economy vs hours worked, 2015=100, sa



Employed and unemployed according to LFS, thousand persons

Source: Eurostat, GUS, Santander

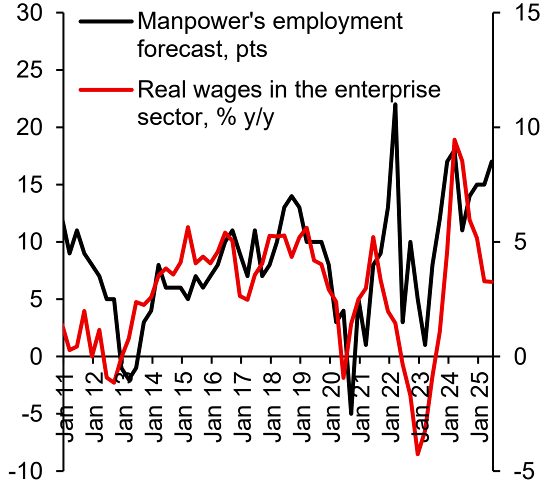
Labour market: wages keep slowing down

In 4Q24, there was a further deceleration in national economy (GN) wage growth to 12.4% y/y from 13.4% y/y in 3Q24, both readings significantly diverging downwards from the November NBP projections. **We expect that the next reading of annual wage growth in GN, for 1Q25, will already be below 10%**, which would imply a downward deviation from the central bank's new scenario as well, **and will reach around 8% y/y by the end of this year** (which would be in line with the NBP's March projection). Wage deceleration turned out to be stronger than expected also in the corporate sector data and in the services sector alone the annual growth rate even fell below 9%.

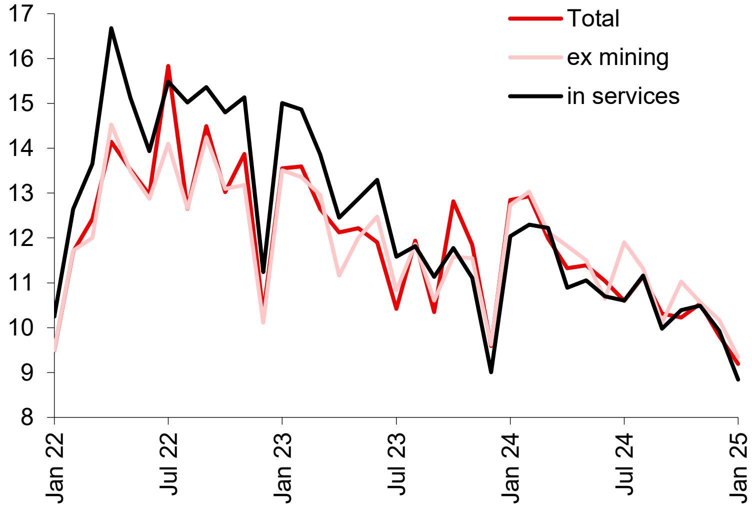
Wage growth will not descend this year in the vicinity of the rate of growth of consumer prices - in the environment of a tight labour market we do not think this is possible. The NBP's Quick Monitoring indicates a gradual reduction in the scale of wage pressure among companies, but its level still cannot be considered low. The Manpower Employment Intent Index, which we regard as a proxy for labour demand, also suggests that wage pressure remains significant, although its correlation with real wage behaviour has declined in recent years.

While a downward direction for wage growth this year can be assumed with a high degree of certainty, it is not obvious that the rate of deceleration will be uniform. The ongoing economic recovery will slow it down, as will the transition from contracting to execution of RRP projects. There are also important sectoral differences to be reckoned with - the investment cycle in Poland, and in some time from now also in the EU, will stimulate wage pressure primarily in construction and heavy industries.

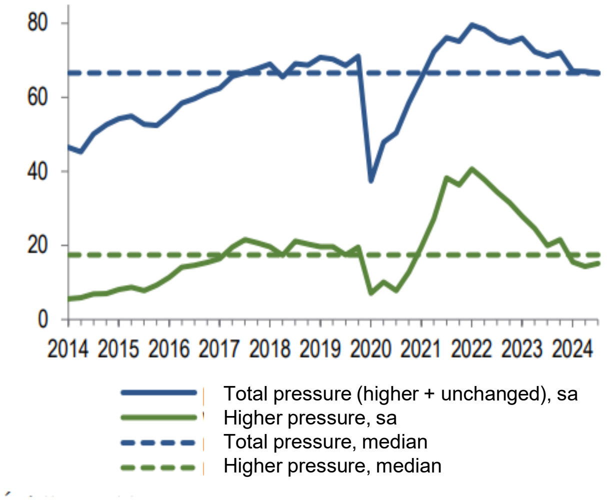
Labour demand (Manpower index) vs. real wage behaviour



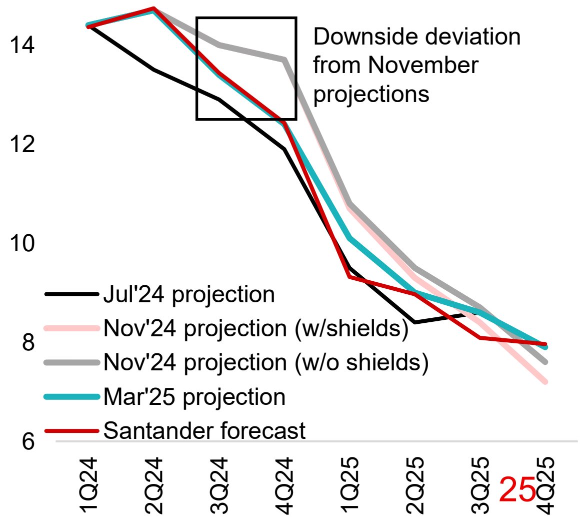
Corporate sector wages, %y/y



NBP Quick Monitoring report: share of companies signalling wage pressure, in %, sa



Comparison of wage paths in NBP projections, %y/y



Santander

Source: GUS, NBP, PAP, Santander

Ukrainians to leave or to come? (1)

The prospect of end to hostilities in Ukraine makes us wonder how this will affect migration flows. Some war refugees are likely to return to their homeland, but at the same time Ukrainian men obliged to perform military service will be able to leave Ukraine and some of them may choose to emigrate. We do not attempt to guess which of these migration directions will prevail. **Still, it is quite certain that both of these flow will be observed and that they will affect the demographic line-up of the Ukrainian diaspora in Poland in favour of men and younger people.**

According to the Ukrainian Red Cross, 30% of the population may leave Ukraine after the war, including half of young people aged 18-23. At the same time, it is estimated that 30% of emigrants will return, with people over the age of 50 being the most eager to return.

According to the NBP survey, a rapid return to Ukraine is declared by 60% of war refugees surveyed and by one in three of pre-war migrants.

A similar figure is shown by research conducted in a panel of countries, with refugees residing in countries closer to Ukraine showing a greater propensity to return than refugees residing in, for example, Germany.

According to a study by the Ukrainian Centre for Economic Strategy (CES), less than half of refugees plan to return to their country, and their willingness to live in Ukraine is decreasing over time. Most considerable declines in willingness to return were observed among those, who left Ukraine in the first months of the war. Currently, only one in four of them plans to return. According to CES, 1.2-2.2 million Ukrainians will return to the country after the end of the war (out of approximately 4 million covered in the survey). Men and urban residents are less likely to return, while those living in Poland, working remotely and the elderly are more likely to return. Additionally, according to estimates, men currently leaving are likely to leave: 290k in the optimistic scenario, 389k in a moderate scenario and 532k in a pessimistic variant. These expectations are based on a survey among men whose wives are abroad, so the actual scale of the outflow is underestimated.

Similar conclusions are drawn from the UNHCR study, which further indicates that people with children are more likely to return to Ukraine.

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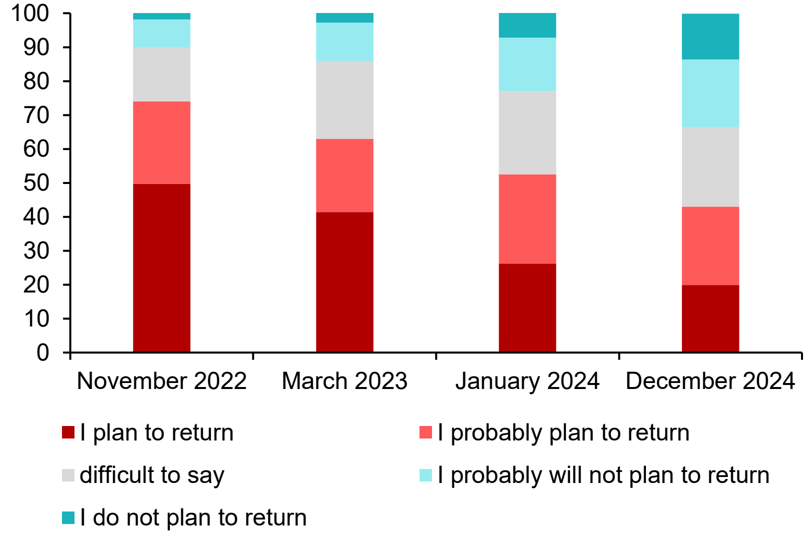
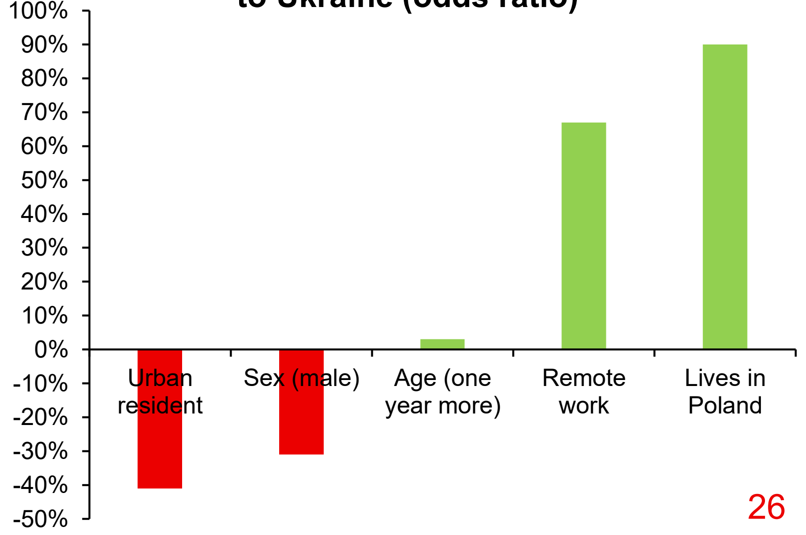
Do refugees from Ukraine plan to return? Results of consecutive CES surveys, %



Variables affecting the willingness to return to Ukraine (odds ratio)



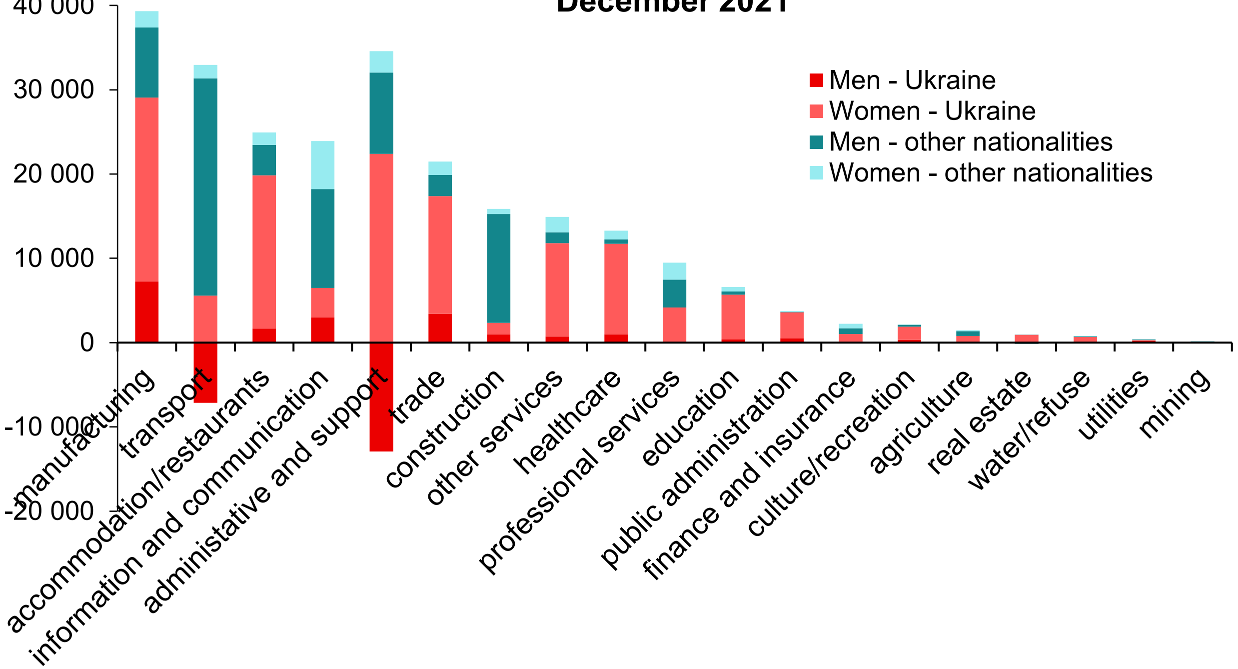
Source: CES, Santander

Ukrainians to leave or to come?(2)

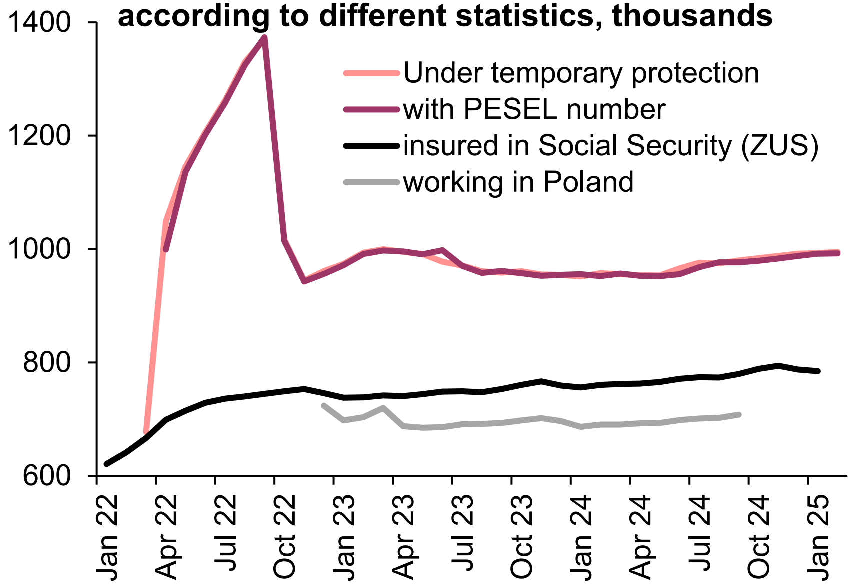
According to the Central Statistical Office (GUS), there are approximately 710k Ukrainian citizens working in Poland. As we wrote on the previous page, the net effect of post-war migration is difficult to estimate, but a fairly likely conclusion is that the demographic structure will change in favour of men due to their lower propensity to return and possible arrivals from Ukraine.

This means that sectors where employment of female Ukrainian citizens has grown strongly after 2021 will potentially be more strongly affected by the outflow of the workforce. These are: accommodation and catering, trade, healthcare/social care, education. Sectors, which are less likely to see outflows or can even see inflows are these, which saw rising men employment: transport, information and communication, construction.

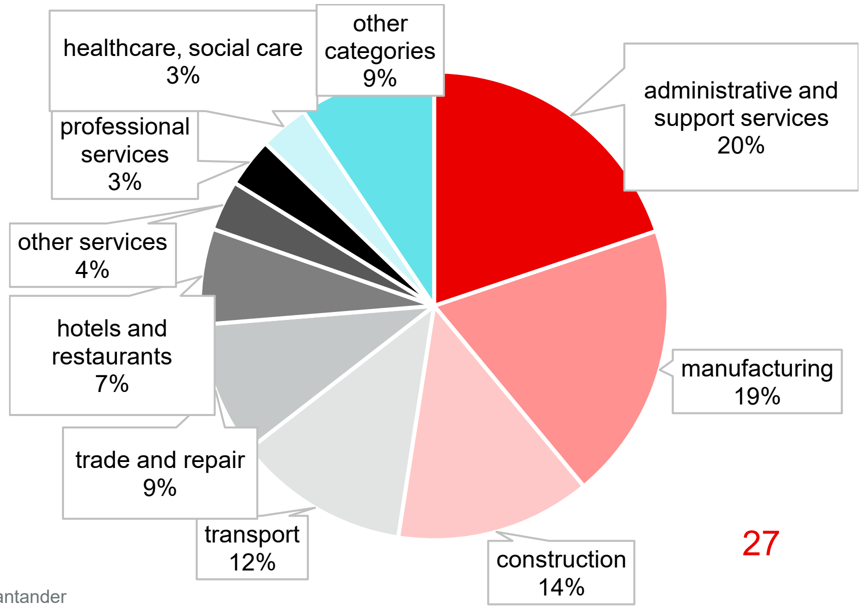
Foreigners in Social Security, by sector, change August 2023 to December 2021



Number of Ukrainian citizens in Poland and on Polish labour market according to different statistics, thousands



Ukrainian citizens in Social Security (ZUS) by sector, in Nov 2024



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Source: ZUS, Eurostat, dane.gov.pl, Santander

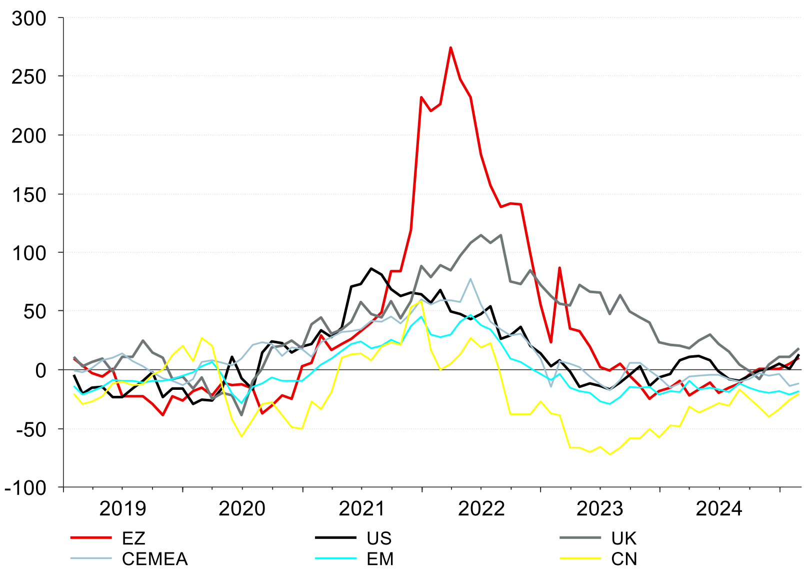
Inflation: lower forecasts and increasing risks

In January and February, CPI inflation equalled 4.9% y/y and we think it will remain near this level also in March. Over the next months, inflation should decline, and, in the summer, it could near the upper bound around the target (3.5% y/y). At the end of the year, inflation should fall slightly below 4% y/y. **Currently, our projected path is lower than in previous months due to three factors: the revision of the CPI basket, the strengthening of the zloty, and the lower path of forecast oil prices.** Our expected paths for core inflation and energy remained relatively stable.

The revision of the CPI basket lowered the January and February inflation rates by 0.4 pp. The revision reduced the importance of non-core categories (food, energy, fuel) and increased that of core categories, which have been growing at a slower % y/y rate in recent months. This is the main reason for the reduction in the estimate of headline CPI inflation. The change in the basket also lowered core inflation figures. However, monthly growth in January and February remained elevated and we therefore assume that core inflation will remain in the 3.5-4.0% y/y range until the end of the year.

Despite the downward trajectory in inflation over the next few months, in our view, **upside risks intensify in the longer term**. These include a potential end to the war in Ukraine, fiscal expansion in the euro area, the impact of tariff wars and weather anomalies that could drive up food prices. In some economies, inflation has been surprising upwards and/or starting to rise already for several months. In Poland, it is difficult to speak of a 'last mile problem' for the time being, as inflation is almost double the target, but it cannot be ruled out that this phenomenon will emerge in a few quarters, extending the sustained return of inflation to the 2.5% target.

Citi's index of inflation surprises



Source: LSEG Datastream, Santander

Annual inflation rates in selected economies

	Jan 23	Feb 23	Mar 23	Apr 23	May 23	Jun 23	Jul 23	Aug 23	Sep 23	Oct 23	Nov 23	Dec 23	Jan 24	Feb 24	Mar 24	Apr 24	May 24	Jun 24	Jul 24	Aug 24	Sep 24	Oct 24	Nov 24	Dec 24	Jan 25	Feb 25
Poland	16,6	18,4	16,1	14,7	13,0	11,5	10,8	10,1	8,2	6,6	6,6	6,2	3,7	2,8	2,0	2,4	2,5	2,6	4,2	4,3	4,9	5,0	4,7	4,7	4,9	4,9
Czechia	17,5	16,7	15,0	12,7	11,1	9,7	8,8	8,5	6,9	8,5	7,3	6,9	2,3	2,0	2,0	2,9	2,6	2,0	2,2	2,2	2,6	2,8	2,8	3,0	2,8	2,7
Hungary	25,7	25,4	25,2	24,0	21,5	20,1	17,6	16,4	12,2	9,9	7,9	5,5	3,8	3,7	3,6	3,7	4,0	3,7	4,1	3,4	3,0	3,2	3,7	4,6	5,5	5,6
Euro area	8,6	8,5	6,9	7,0	6,1	5,5	5,3	5,2	4,3	2,9	2,4	2,9	2,8	2,6	2,4	2,4	2,6	2,5	2,6	2,2	1,7	2,0	2,2	2,4	2,5	2,3
USA	6,4	6,0	5,0	4,9	4,0	3,0	3,2	3,7	3,7	3,2	3,1	3,4	3,1	3,2	3,5	3,4	3,3	3,0	2,9	2,5	2,4	2,6	2,7	2,9	3,0	2,8

Legend: decrease increase

Source: LSEG, Santander

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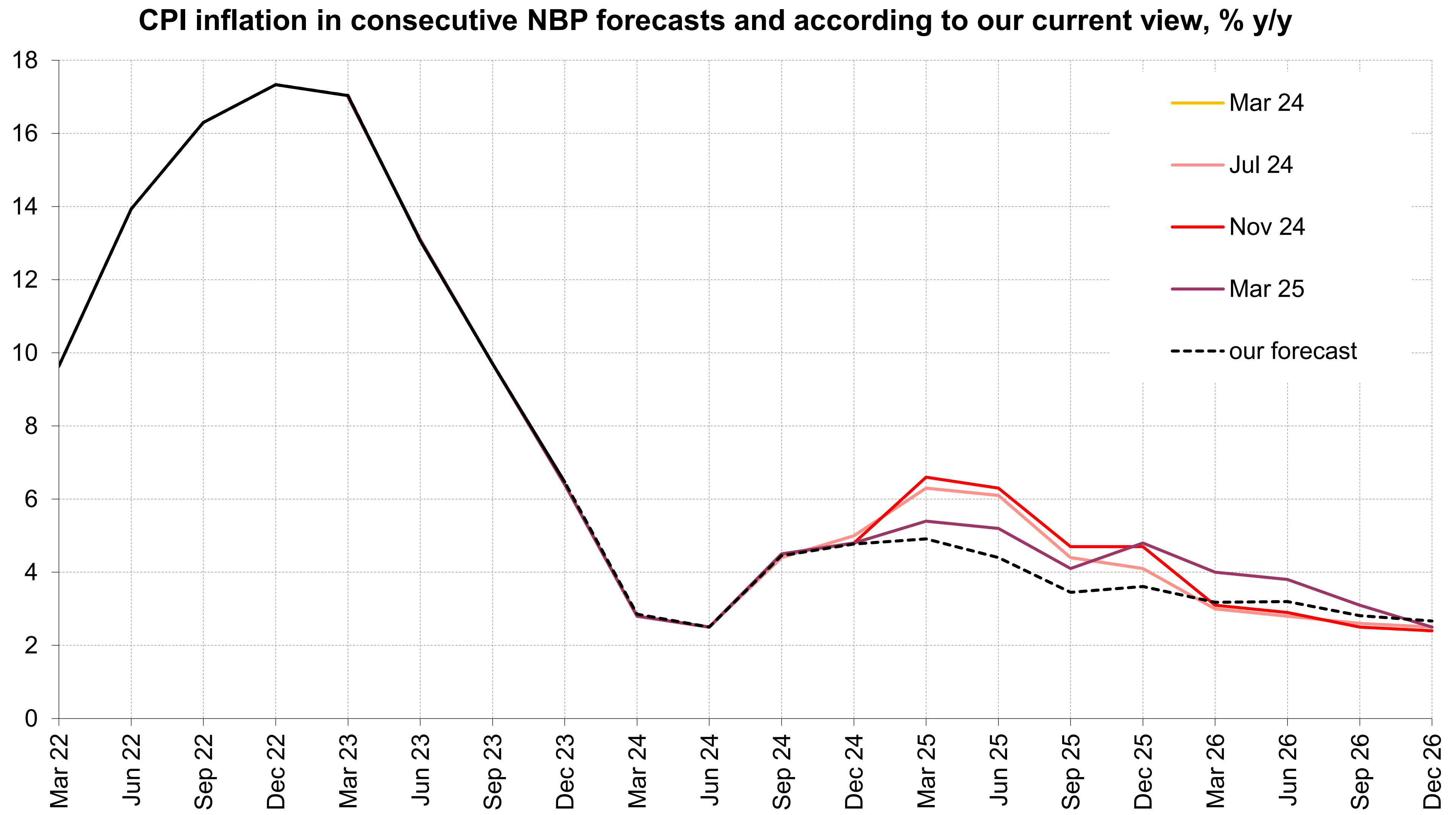
Inflation: expected paths



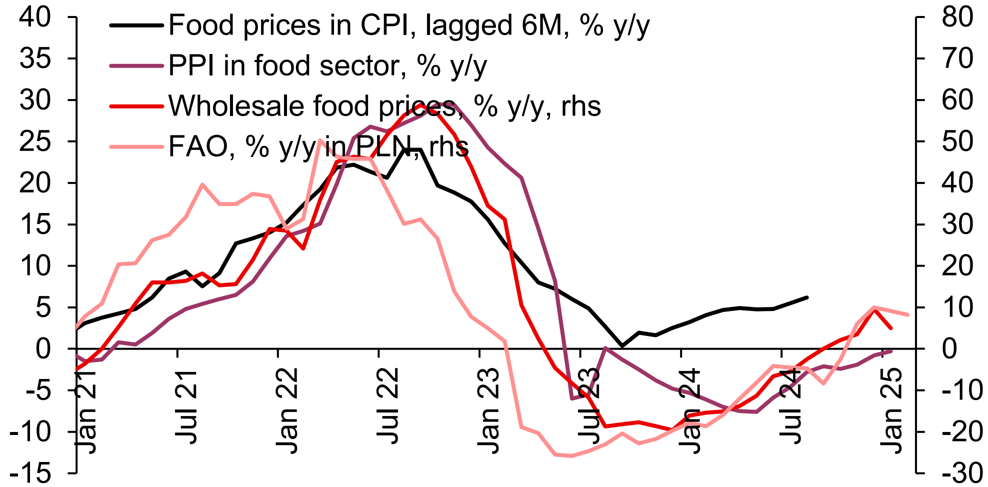
Source: GUS, NBP, Santander

Food prices: increased weather-related risks

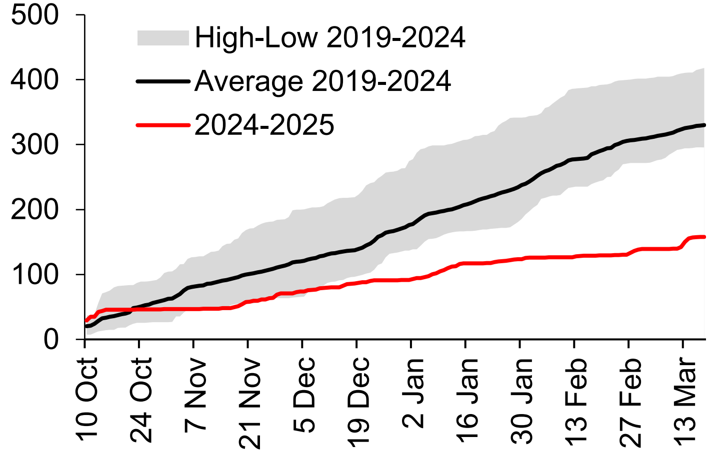
Wholesale food price indices have been climbing recently, which we believe will dictate a further pick-up in Poland's retail price growth, although there will be a base effect in April due to the reintroduction of VAT on food products in 2024. However, **we still assume that on average, food prices will rise by around 5% y/y this year**.

However, domestic upward risks are intensifying, mainly related to weather effects. Firstly, there has been very low precipitation for several months, which means an increased risk of agricultural drought. The problem also affects other regions in Europe, including Ukraine, which is a major food producer. In addition, high temperatures at the beginning of March may have stimulated earlier vegetation, with frosts occurring in the following weeks, which may have harmed fresh shoots. A faster start to vegetation also further strains low soil water supplies.

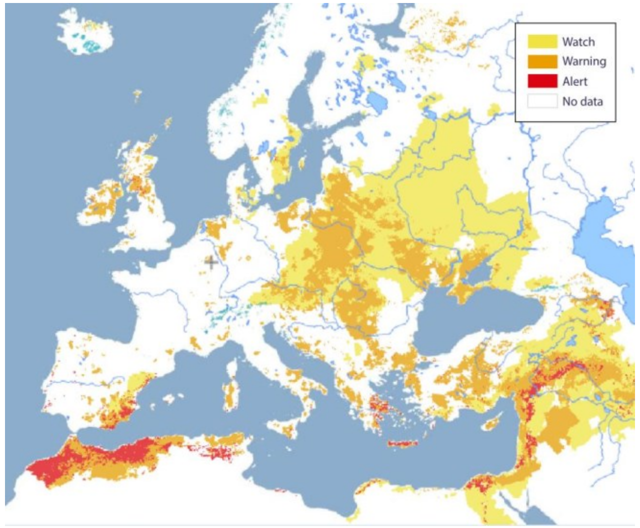
Food price indices, % y/y



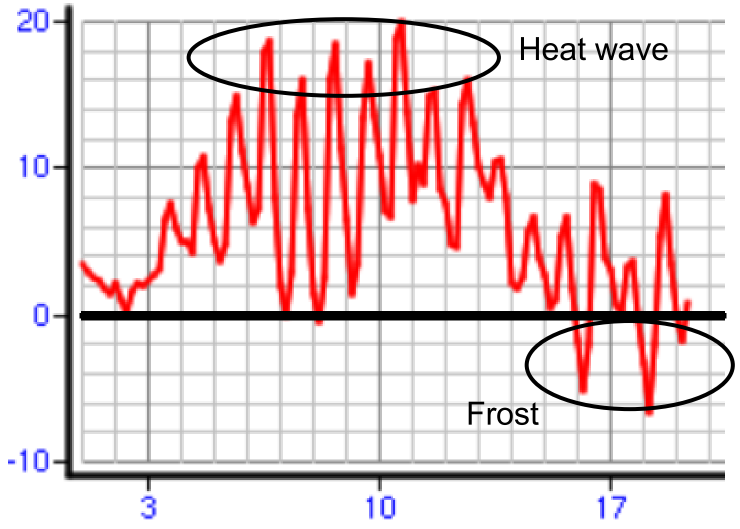
Sum of rainfall in Poland since 1 October, mm



Map of EU drought alerts



Temperature in Warsaw in March



Source: Bloomberg, GUS, FAO, www.meteo.waw.pl, European Comission

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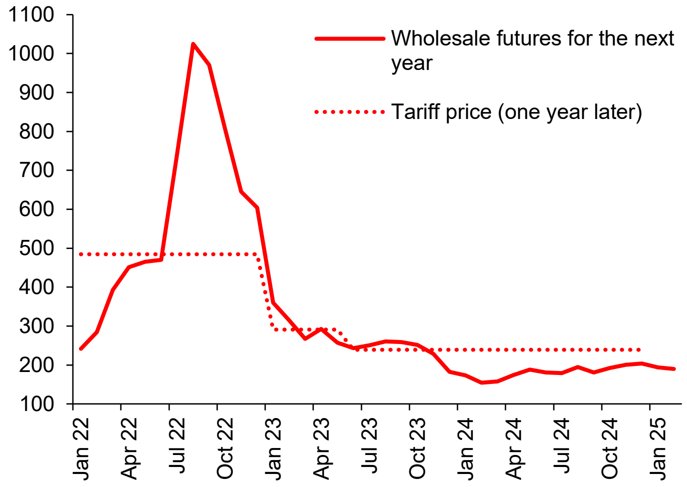
Energy prices: we believe in stabilisation

In December's MACROscope, we called that natural gas and electricity prices would remain roughly unchanged this year, primarily due to the relatively low wholesale energy market prices. While natural gas prices have started to rebound this year, at the same time there have been suggestions from government representatives that an extension of fiscal action is being considered. The cost of introducing a maximum price by the end of September has been estimated at PLN 4 billion, so an extension to the end of the year would cost cPLN1.5bn more, in our opinion definitely feasible for this year's budget. We assume that the capacity fee will be reinstated in July. Its possible suspension until the end of the year is an additional cost of PLN1.5bn.

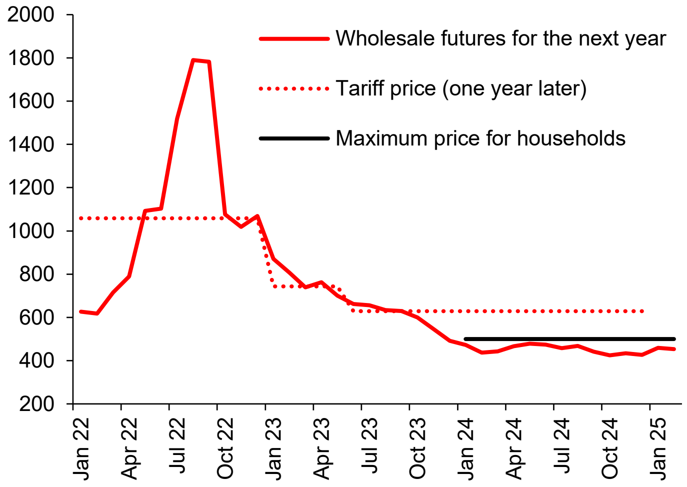
It has been reported in the media that the URE (Energy market regulator) has rejected the tariff change proposed by PGE-Obrót (one of the largest power companies, dominant around Warsaw and in eastern Poland). This, in our view, confirms the URE's determination to prevent price increases for households. On the other hand, the CEO of Tauron (dominant company in south-western Poland) said that due to the fall in wholesale prices, tariff prices may go down and further price freezes may not be needed.

We therefore maintain our forecast that the new gas and energy prices to be introduced in July will be similar to those currently paid by households.

Natural gas prices, PLN/MWh



Electricity prices, PLN/MWh



Source: TGE, GUS, URE, Santander

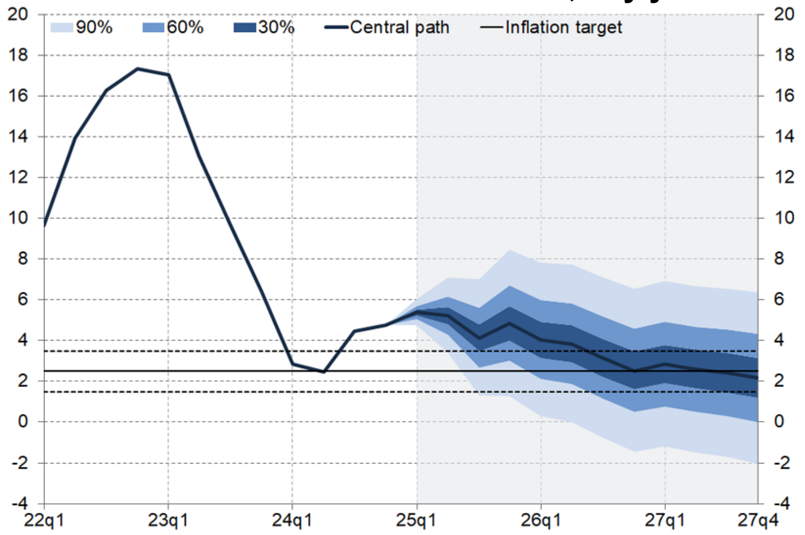
Monetary policy: cuts closer, but shallower

Since December, NBP President Adam Glapiński has maintained a hawkish tone in his monthly conferences after MPC meetings, focusing primarily on risks to the inflation outlook at the horizon of the end of this year, highlighting the risk of an upward rebound in inflation after the expiry of the energy price freeze and arguing that the prospect of interest rate cuts has receded.

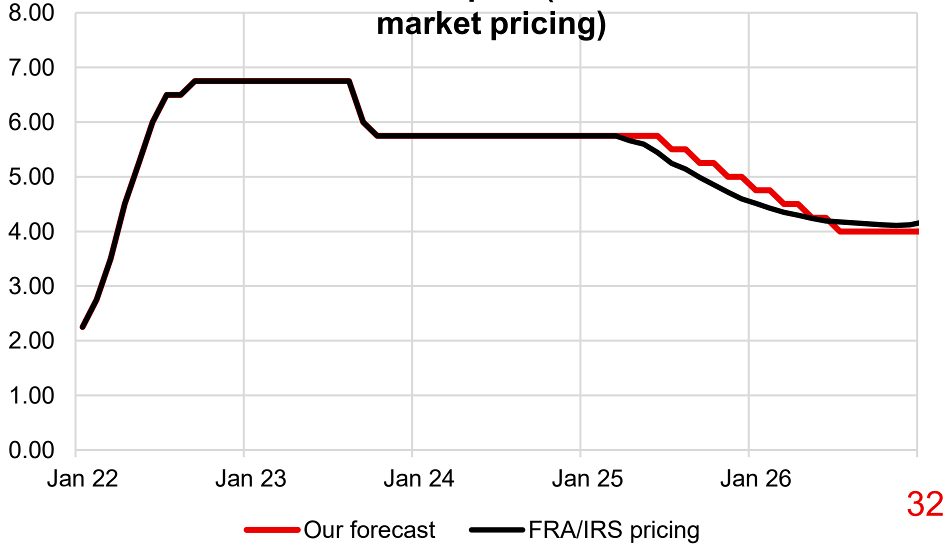
In our view, the outlook for inflation in the short term (up to a year) has recently improved, and we assess the risk of an upward CPI bounce in 4Q25 under the influence of energy prices as low. Moreover, despite the seemingly hawkish rhetoric of the NBP President's conference in March, its most important message was, in our view, that the MPC had started discussing the conditions for an interest rate cut, i.e. decided to do what, according to President Glapiński's earlier statements, should have been postponed until at least October. **This reinforces our belief that the MPC may decide to resume interest rate cuts in July this year**, after the presidential election and after inflation enters a downward trend and the risk of rising electricity prices in 4Q25 disappears (by then, in our view, either the energy companies will have submitted lower tariffs or the government will have extended the price freeze).

At the same time, we see more and more arguments that monetary easing in the coming quarters should be cautious, in light of the increasingly likely shift towards looser fiscal policy in Europe, the effect of which is likely to be a revival of economic growth in the coming years, but also an intensification of wage and inflationary pressures. As a result, we believe that **the scope for NBP rate cuts in the medium term is narrowing rather than growing** under the influence of the changes in the economic and geopolitical environment in recent weeks. As a result, we are **revising our reference rate forecast upwards to 5.00% by the end of this year and 4.00% by the end of 2026**. The swap market is currently pricing in a similar scenario.

NBP March inflation forecast, % y/y



NBP interest rate path (our forecast vs market pricing)



Source: GUS, NBP, LSEG, Santander

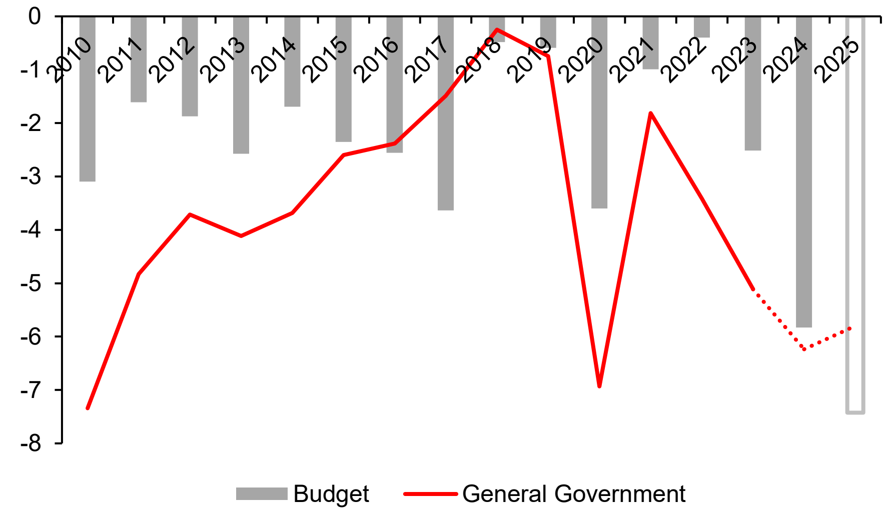
Fiscal policy: deficit close to 6%

The budget deficit for 2024 was PLN211bn, thus roughly halfway between the deficit originally assumed in the Budget Act (PLN184bn) and figure put in the amendment (PLN240bn). Realisation at a lower level than assumed in the amendment was mainly due to lower expenditure (PLN834bn as compared to PLN866bn limit).

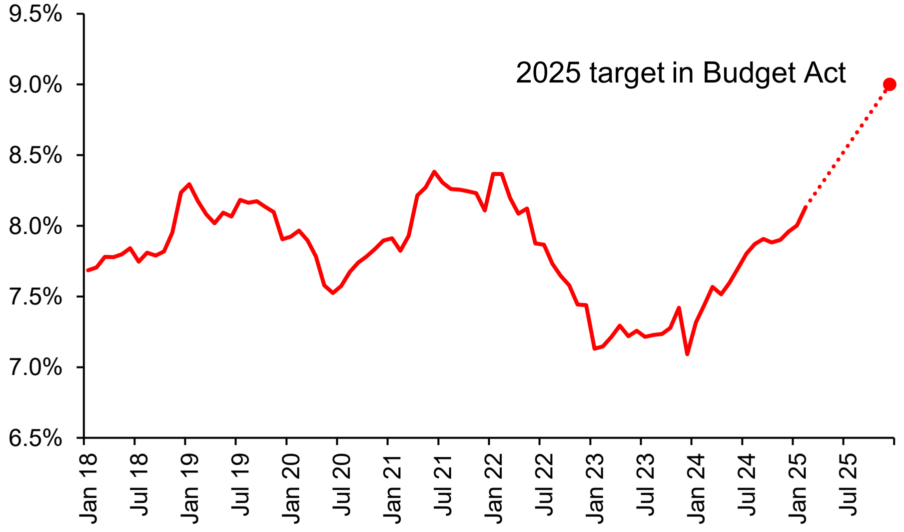
Despite the lower realisation of budget expenditures, in 4Q2024, they amounted to PLN267bn compared with PLN207bn in 3Q2023. Meanwhile, after 3Q24, the general government deficit calculated as 4Q sum rose to 6.2% of GDP from 6.0% after 2Q24. The 4Q24 general government deficit has to stay below PLN95bn in 4Q24 in order to bring the entire year's number below 6.0% of GDP. Thus it has to be lower than in 4Q23 (PLN98.7bn), which in our view may be difficult given the PLN60bn annual increase in the budget expenditure, even if we assume that local governments will close the year in surplus (which we believe is likely). **We therefore assume that the general government deficit in 2024 will be 6.2% of GDP.**

We remain pessimistic about the realisation of the deficit in 2025 and believe it will be 5.8% of GDP, higher than the 5.5% of GDP assumed in the Budget Act. For the time being, we do not yet have a large set of fiscal 2025 data that would allow us to revise our assumptions. We think that the main risk for the budget revenues is to be found in VAT. Even though these look quite strong after February (+17% y/y), the annual growth rate has to exceed 21% to meet the target.

Budget and general government balances, % of GDP



VAT revenues as % of GDP, 12m moving average



Source: MF, Santander

Financial markets

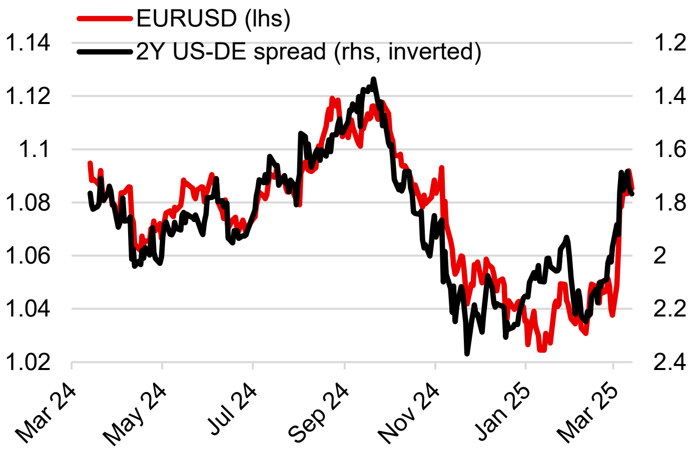
5

Markets facing uncertainty

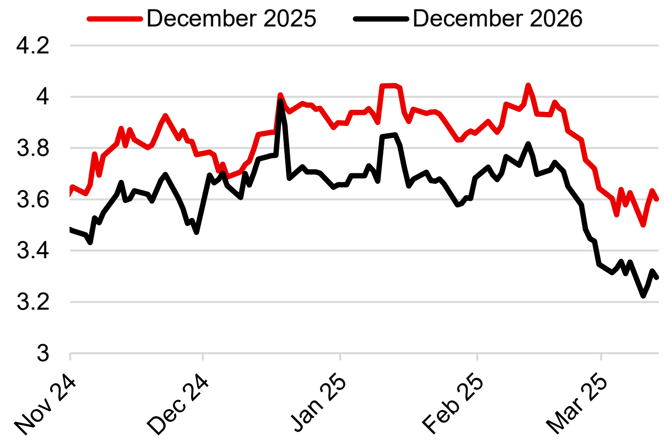
Financial markets are currently reevaluating what the economic and geostrategic policies of Donald Trump's administration might mean for economic scenarios and asset prices. In short, markets have begun to price in, among other things:

- An increase in uncertainty regarding trade and economic policy changes and their effects on the real economy.
- A decrease in the belief in the exceptionalism and resilience of the US economy, an increase in fears of a slowdown and perhaps even a recession in the US under the influence of increased trade barriers, fiscal cuts, high unpredictability of economic and institutional conditions, causing an erosion of business and consumer confidence.
- Improved growth prospects for the euro area economy due to the plans to loosen fiscal rules, increase infrastructure spending, and expand defence capabilities.
- Increased expectations of the scale of possible future rate cuts by the Fed, narrowing the space for ECB rate cuts.
- Possible end or at least suspension of fighting in Ukraine, possibly in the longer term easing of economic and financial sanctions on Russia.

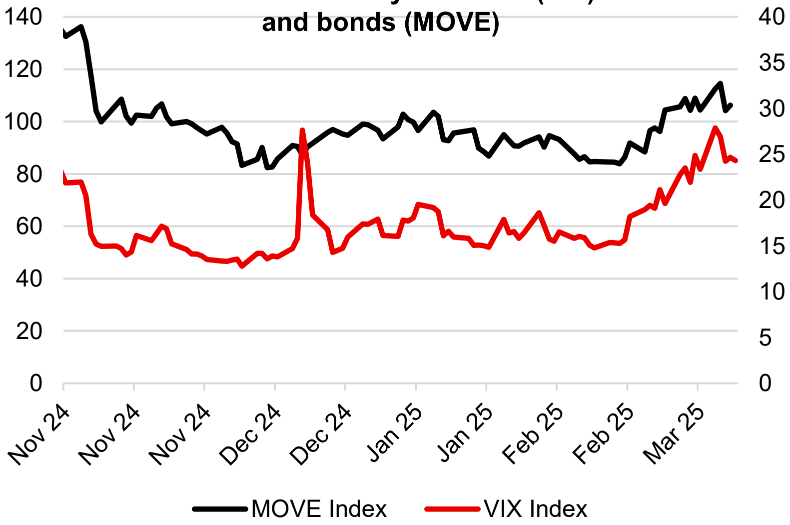
EURUSD vs. 2Y US-DE yield spread



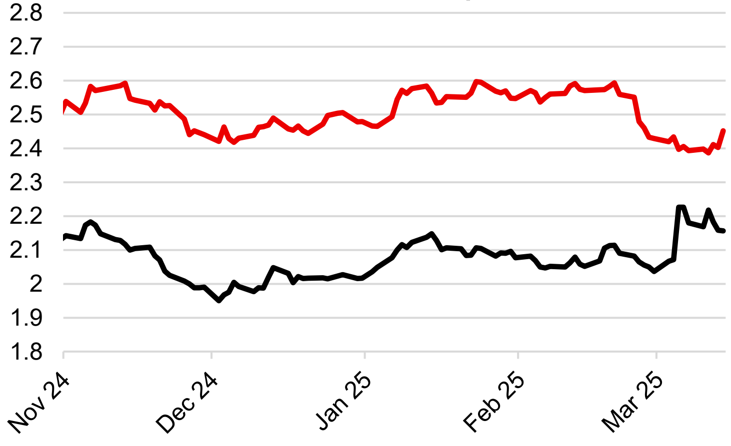
Fed rate at the end of 2025 and 2026 implied by the futures market



Indices of volatility of stocks (VIX) and bonds (MOVE)



Inflation swaps



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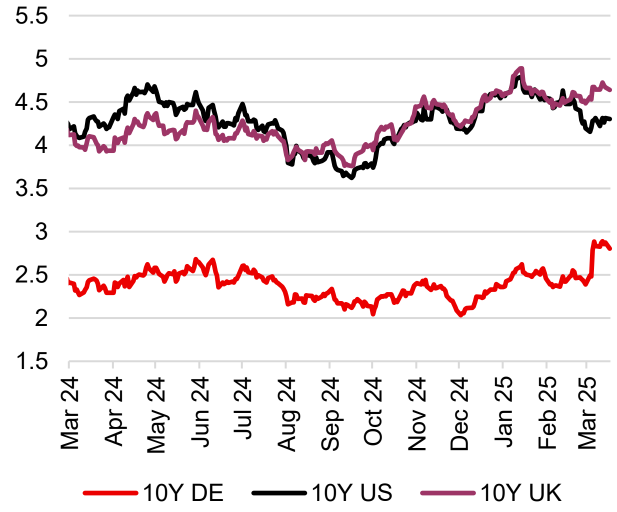
Increased volatility in core FI markets

The beginning of March saw a 40-50 bp surge in euro area bond yields in reaction to the announcement of EC plans to increase defence spending (ReArm Europe) and loosen EU fiscal rules, as well as a preliminary agreement in Germany on an infrastructure and armaments spending program. These plans, if finally approved, may, on the one hand, significantly increase net debt issuance in the euro area (according to SCIB Macro Strategy Team estimates, by 20-30% in 2025 and 30-40% in 2026), and on the other hand, increase inflationary pressure, narrowing the room for rate cuts by the ECB.

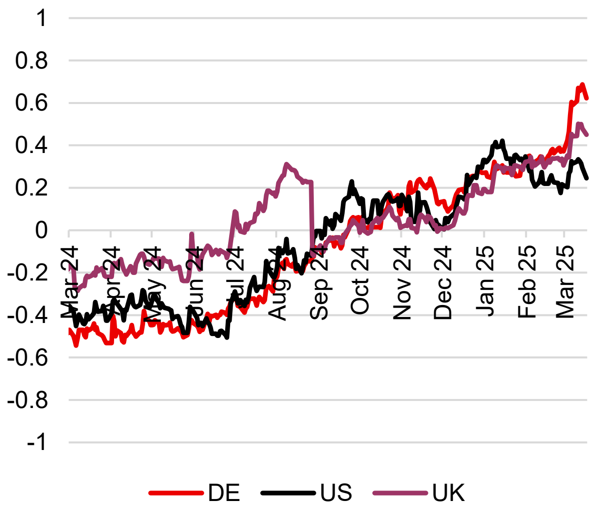
We assume that the rise in yields and the steepening of European curves is structural, although at least a partial correction is possible, particularly if the next stages of work on the ReArm Europe package introduce joint financing plans (e.g. a bank for rearmament) that relieve individual countries of some of the financial burden.

In the US market, after a marked fall in Treasuries yields during the first six weeks of D.Trump's presidency, the trend has started to reverse, despite intensifying concerns about economic growth, falling stock prices and an increase in the expected scale of rate cuts by the Fed. This may have been influenced by concerns about the impact of a decelerating economy on public finances and the gradual erosion of investor confidence in US assets as an oasis of safety, among other things, due to the new administration's difficult-to-predict actions.

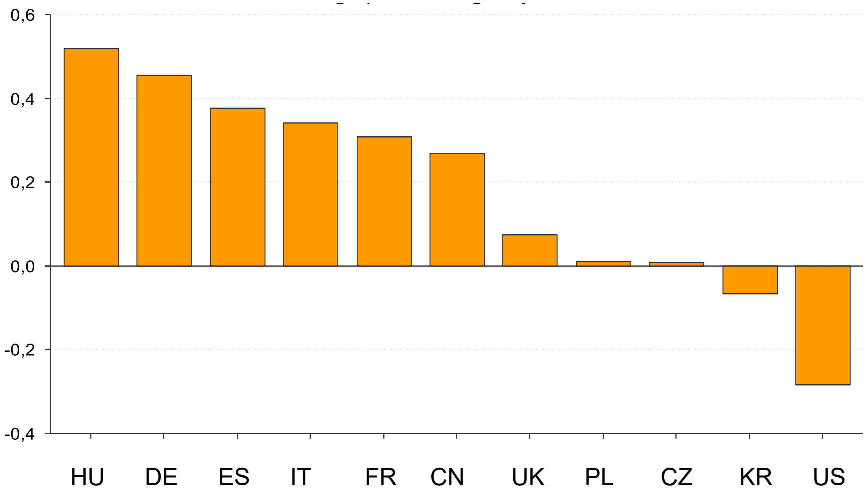
10Y bond yields



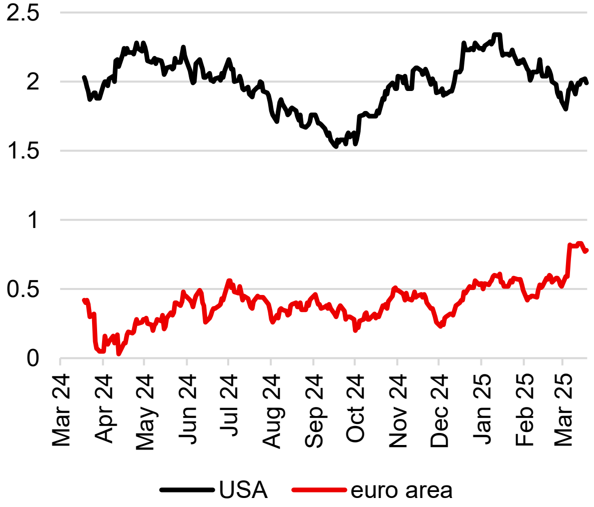
2-10Y yield spread



Benchmark bond yields, change since the beginning of 2025, in percentage points



10Y real rates



Source: LSEG Datastream, Santander

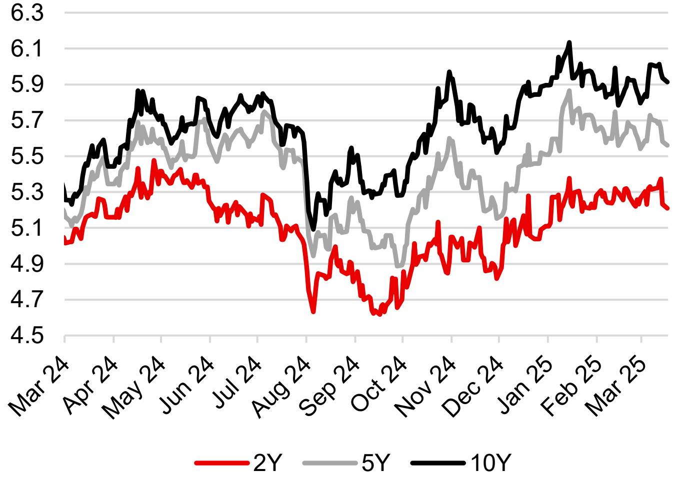
Local bonds: the worst already behind us?

The announcement of fiscal expansion plans in Europe at the beginning of March moved up also the Polish bond curve, although to a lesser extent, as the Polish fiscal deficit and defence spending had already increased, which was largely priced in by the market. As a result, the spread of 10Y POLGB yields against Bund narrowed by almost 30 bps. In our view, a further fall in the spread against Germany and a narrowing of ASW spreads would be possible if a ceasefire agreement is reached in Ukraine, which the market finds credible.

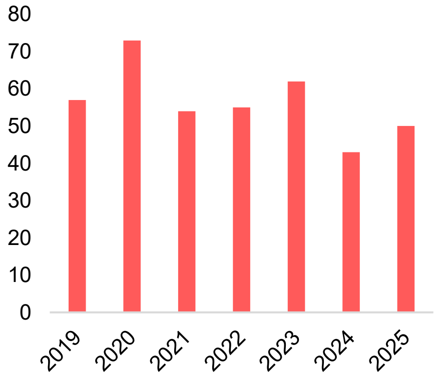
Meanwhile, the surprisingly low inflation in January-February has revived market expectations of interest rate cuts by the MPC, despite the hawkish tone of the NBP governor's statement. **We assume that a further decline in inflation and the resumption of NBP rate cuts from July will move the domestic swap and bond curves downwards in H2**, while the perception of diminishing room for rate cuts in the medium run under the influence of the looming economic recovery in Europe may favour a further steepening of the curves.

On the other hand, the room for bonds strengthening is still limited by the large debt supply. After February, the degree of financing of gross borrowing needs (around 50%) was below the average of recent years, plus record redemptions are ahead (over PLN 110 billion by the end of this year).

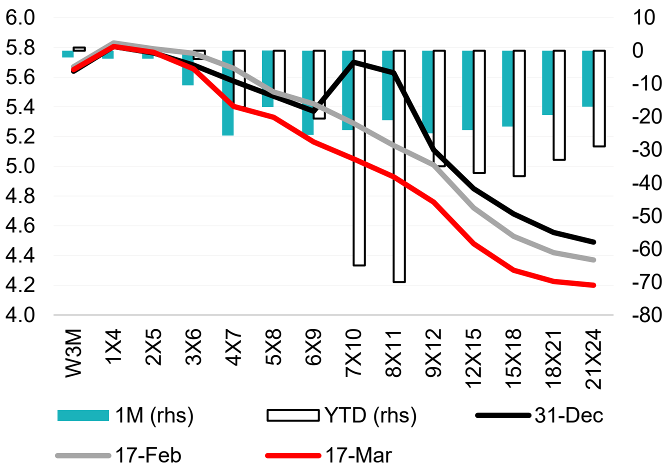
Yields of Polish bonds



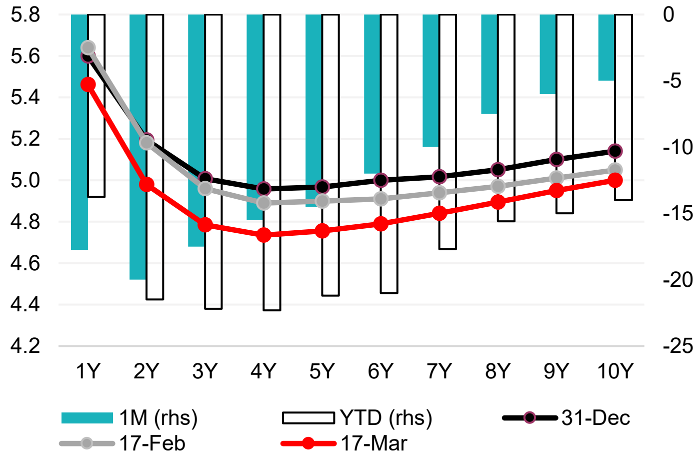
Coverage of gross financing needs, (relative to the Budget Law plan), at the end of February %



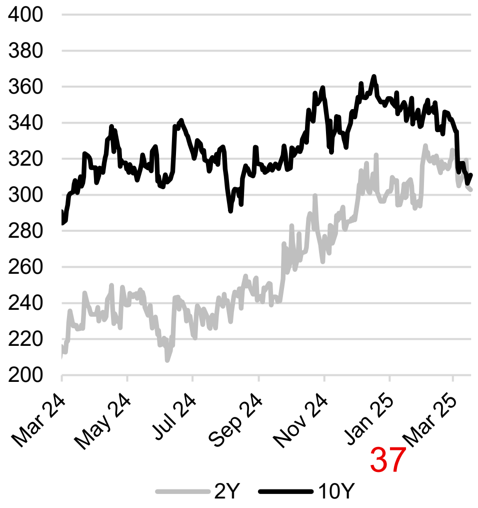
FRA curve



IRS curve



PL-DE bond yield spreads



Source: LSEG Datastream, MF, Santander

Zloty started the year on a stronger note

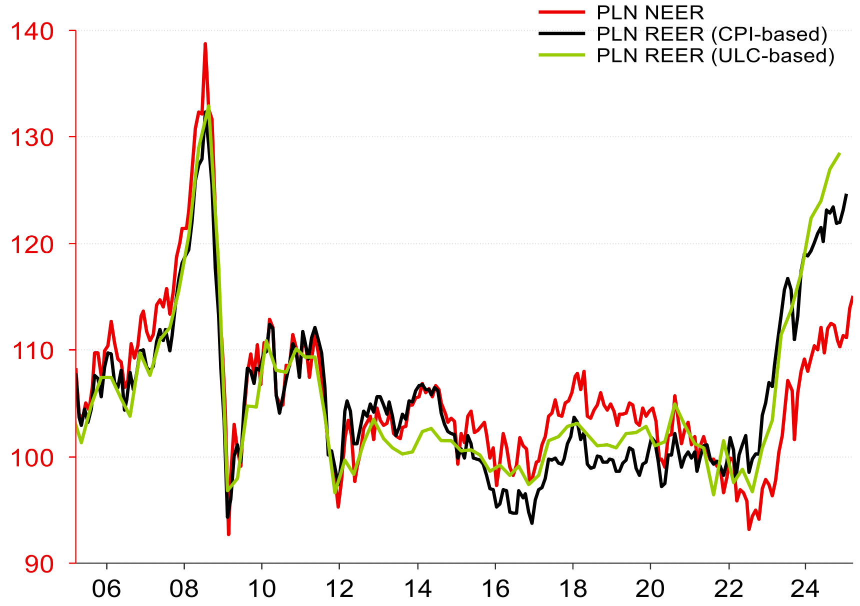
In the first two months of this year, the zloty was one of the fastest strengthening currencies from emerging markets, gaining more than 3% against the euro and around 5% against the US dollar. The EURPLN exchange rate broke through successive barriers, temporarily descending to around 4.13, a level last seen in early 2018, i.e. during Donald Trump's first presidency.

In our view, a key role in the strengthening of the zloty was played by growing hopes for a suspension of fighting in Ukraine, fuelled by news of the start of talks between US and Russian representatives. At the same time, the Polish currency was supported by the growing expected interest rate disparity (signals a lack of conditions for rate cuts by the MPC with expectations of further cuts in the euro area), as well as the resilience of the domestic economy to economic stagnation in the euro area and relatively low perceived exposure to a possible escalation of the US-EU tariff dispute.

The appreciation of the zloty against the euro slowed down in March, perhaps in part due to the growing belief that the prospect of a truce in Ukraine may not be as imminent as some investors thought.

We continue to believe that the Polish currency is very strong in real terms. The real effective exchange rate of the zloty (REER) has strengthened by around 5% since the beginning of the year and almost 30% since the end of 2022, implying a significant loss of competitiveness for Polish exports. According to BIS data, the scale of the zloty's appreciation since the beginning of 2020 is the second largest (after the Argentine peso) among all currencies included in the Bank's database. Such a move will, in our view, be reflected in a worsening outlook for Poland's export-oriented industry, which is already struggling with the prolonged economic stagnation of Poland's main trading partners (in particular Germany). At the same time, the strengthening of the zloty is conducive to a lowering of inflation forecasts for the coming months, which in our view should make it easier for the central bank to start cutting interest rates in July.

Indices of zloty's nominal (NEER) and real (REER) exchange rate



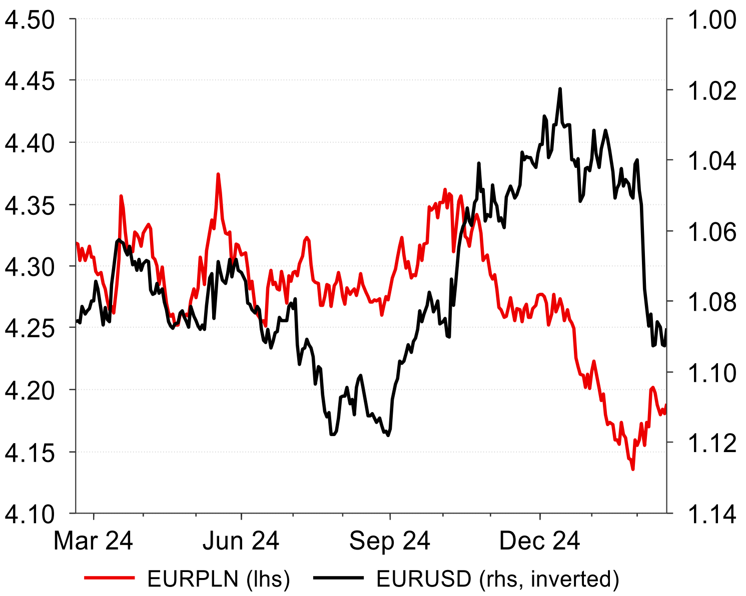
Source: LSEG Datastream, Santander

EURPLN likely to rebound in 2H

We assume that when (if) the ceasefire talks in Ukraine end with an agreement that the market finds credible, the zloty may strengthen further. Given the course of the talks so far, it seems that this may not happen as quickly as some investors have been betting, but we make a working assumption that it can happen in 2Q25.

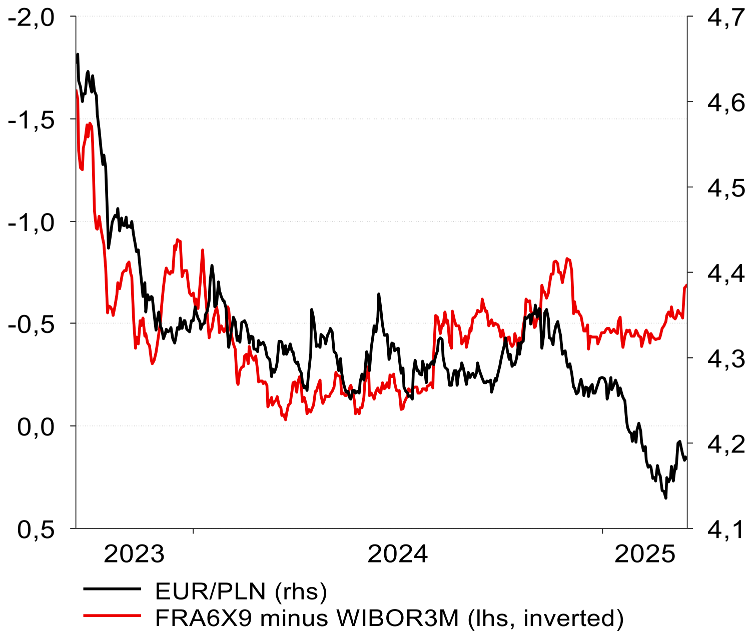
In the second part of the year, however, we expect a gradual correction as the market's attention is likely to shift to other issues, including the possible impact of trade wars on the European economy, the gradual deterioration of Polish trade balance and the start of the NBP monetary easing cycle (according to our forecasts, the first cut in July). Another fundamental factor that - at least in theory - should work towards an increase in EUR/PLN is the accelerating expansion of Poland's money supply and central bank balance sheet relative to the euro area.

EURPLN vs EURUSD

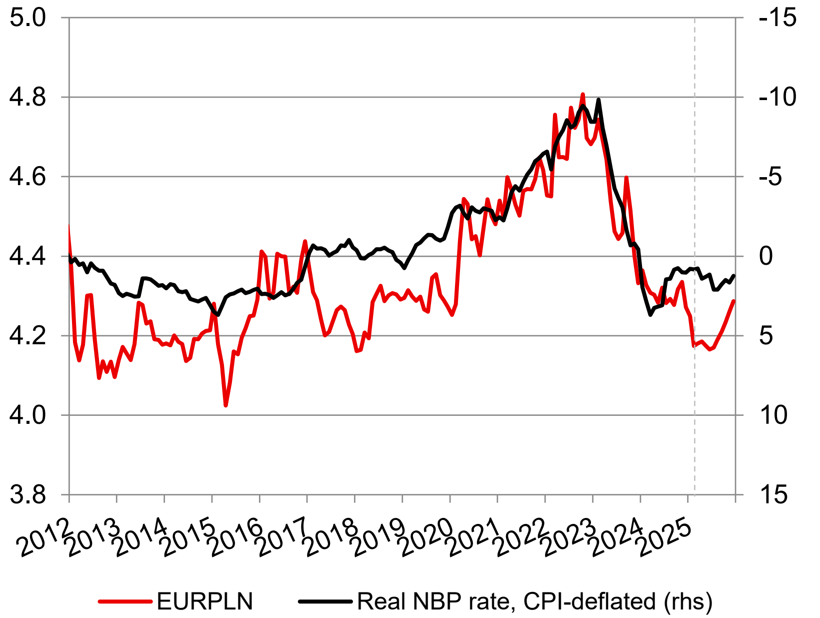


Source: LSEG Datastream, Santander

EURPLN vs interest rates expectations



EURPLN vs real rate (inverted)



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Source: LSEG Datastream, MF, Santander

Forecasts

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Economic Forecasts

		2022	2023	2024	2025	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25
GDP	PLNbn	3,100.9	3,401.6	3,617.4	3,874.7	835.8	863.3	905.0	1,013.4	890.1	925.6	968.1	1,090.9
GDP	% y/y	5.3	0.1	2.9	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	4.1	4.9	2.3	4.8	4.4	4.8	4.6	4.4	5.2	5.5
Private consumption	% y/y	5.4	-0.3	3.1	2.9	4.4	4.6	0.3	3.5	2.5	2.5	3.0	3.5
Fixed investment	% y/y	1.7	12.6	1.5	6.7	1.9	3.2	0.1	1.3	2.0	4.0	8.0	9.5
Industrial output	% y/y	10.4	-2.1	1.1	1.8	-0.1	2.0	1.1	1.4	-0.5	1.7	2.9	3.3
Construction output	% y/y	7.7	4.8	-7.6	4.9	-8.6	-6.0	-6.8	-8.8	3.9	3.9	6.3	4.9
Retail sales (real terms)	% y/y	5.5	-3.6	3.2	4.9	5.0	4.5	1.3	2.2	3.3	2.3	6.0	7.8
Gross wages in national economy	% y/y	12.1	12.8	13.7	7.6	14.4	14.7	13.4	12.4	8.5	7.9	7.0	6.9
Employment in national economy	% y/y	2.0	0.6	0.2	-0.1	0.2	0.1	0.3	0.1	-0.3	-0.3	0.0	0.2
Unemployment rate *	%	5.2	5.1	5.1	5.0	5.3	4.9	5.0	5.1	5.4	5.0	4.9	5.0
Current account balance	EURmn	-14,872	13,485	1,175	-9,103	4,567	501	-4,277	384	895	-1,828	-5,039	-3,132
Current account balance	% GDP	-2.2	1.8	0.1	-1.0	1.6	1.3	0.5	0.1	-0.3	-0.5	-0.6	-1.0
General government balance (ESA 2010)	% GDP	-3.4	-5.1	-6.2	-5.8	-	-	-	-	-	-	-	-
CPI	% y/y	14.3	11.6	3.6	4.1	2.9	2.5	4.5	4.8	4.9	4.4	3.5	3.6
CPI *	% y/y	16.6	6.2	4.7	3.7	2.0	2.6	4.9	4.7	4.9	4.5	3.6	3.7
CPI excluding food and energy prices	% y/y	9.1	10.2	4.3	3.8	5.4	3.8	3.9	4.1	3.7	3.8	3.8	3.9

* 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	5.00	5.75	5.75	5.75	5.75	5.75	5.75	5.25	5.00
WIBOR 3M	%	6.02	6.52	5.86	5.60	5.86	5.86	5.85	5.85	5.86	5.77	5.56	5.23
Yield on 2-year T-bonds	%	6.35	5.67	5.05	4.94	5.05	5.28	4.89	4.99	5.27	5.09	4.83	4.56
Yield on 5-year T-bonds	%	6.36	5.66	5.33	5.33	5.19	5.55	5.23	5.34	5.65	5.50	5.23	4.93
Yield on 10-year T-bonds	%	6.10	5.83	5.55	5.63	5.36	5.70	5.45	5.70	5.93	5.80	5.55	5.25
2-year IRS	%	6.62	5.63	5.22	4.81	5.22	5.48	5.09	5.07	5.15	4.92	4.68	4.50
5-year IRS	%	5.92	5.01	4.80	4.59	4.70	5.13	4.60	4.77	4.91	4.70	4.48	4.28
10-year IRS	%	5.68	5.10	4.90	4.86	4.77	5.23	4.69	4.92	5.09	4.95	4.80	4.60
EUR/PLN	PLN	4.69	4.54	4.31	4.21	4.33	4.30	4.28	4.31	4.20	4.18	4.19	4.26
USD/PLN	PLN	4.46	4.20	3.98	3.88	3.99	4.00	3.90	4.04	3.99	3.83	3.83	3.86
CHF/PLN	PLN	4.67	4.68	4.52	4.32	4.57	4.42	4.50	4.60	4.44	4.30	4.25	4.28
GBP/PLN	PLN	5.50	5.22	5.09	5.01	5.06	5.04	5.07	5.17	5.03	4.97	4.99	5.07

* 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 **19.03.2025** has been prepared by:

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