

Poland's public finances are safe

TOP MACRO THEME(S):

- **Public debt-to-GDP ratio still on a downward path (p.2)** Poland's public finances are under pressure but remain healthy. With strong nominal economic growth, the public debt to GDP ratio continues to fall, despite widening deficit and some structural challenges.

WHAT ELSE CAUGHT OUR EYE:

- **M3 aggregate rose by 7.9% y/y in June boosted by low base effect.** For the first time since March 2022 the PLN-denominated mortgage loan volume increased in monthly terms, by 0.2%. This is most likely a new trend, as data on loan applications shows a strong uptick in demand, driven by the introduction of 2% Safe Mortgage Scheme subsidized by the government.
- **Unemployment rate in June declined to 5.0% from 5.1% in May.** Considering the seasonal pattern, the monthly fall in the number of unemployed persons was rather meagre, which may be related to an anaemic start of the tourist season amid retrenchment in consumer spending. However, we do not see any signs of amplification in layoffs – the number of redundancies due to workplace reasons is close to historic low, similarly to the number of unemployed persons per vacancies.
- **New industrial orders declined by 5.1% y/y in June (-8.1% y/y in May),** with export orders looking slightly better than domestic ones. Data on industrial production and foreign trade results imply that exports remain resilient to the unfavourable external environment.

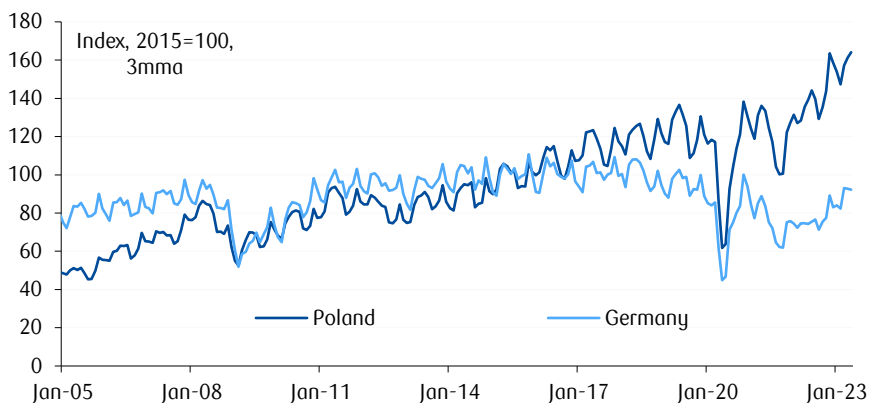
THE WEEK AHEAD:

- **Flash estimate will show further CPI inflation drop in July** (PKOe: 11.1% y/y; consensus: 10.9% y/y vs 11.5% y/y in June).
- **Manufacturing PMI has likely declined again in July,** dragged down by weaker output and new orders, though on a smaller scale than in Germany, as the Polish manufacturing sector has been decoupling from its German counterpart in recent years.

NUMBER OF THE WEEK:

- **44%** – loan-to-GDP ratio in June, the lowest since 2008.

CHART OF THE WEEK: Production output in the automotive sector



Source: Eurostat, PKO Bank Polski

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	2022	2023
Real GDP (%)	5.1	0.7
Industrial output (%)	10.5	-0.1
Unemployment rate# (%)	5.2	5.2
CPI inflation** (%)	14.4	12.1
Core inflation** (%)	9.1	10.5
Money supply M3 (%)	5.6	6.0
C/A balance (% GDP)	-3.0	0.8
Fiscal balance (% GDP)*	-3.7	-4.8
Public debt (% GDP)*	49.1	49.2
NBP reference rate## (%)	6.75	6.00
EURPLN###	4.69	4.50

Source: GUS, NBP, MinFin, ‡PKO BP Market Strategy team forecasts; *ESA2010, **period averages; #registered unemployment rate at year-end; ##at year-end, ^ under revision.

Public debt-to-GDP ratio still on a downward path

- Poland's public finances are under pressure but remain healthy. With strong nominal economic growth, the public debt to GDP ratio continues to fall, despite widening fiscal deficit and some structural challenges.
- Tax revenues are stronger than we assumed, so we decided to revise downwards the general government deficit forecast for 2023 and 2024.

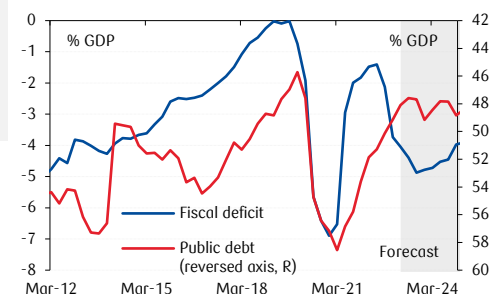
Public debt to GDP ratio declined in 1q23 (most recent data) to 48.1% from 49.1% in 2022, continuing the downward trend which started in 2q21. The ratio declined due to strong nominal GDP growth and despite higher deficit (4.0% of GDP after 1q23 on the rolling basis, vs 3.7% at the end of 2022).

Poland was not the only country to benefit from a period of high nominal GDP growth. The environment of high inflation allowed the most indebted EU economies to “grow out” of debt – between 1q22 and 1q23 the public debt to GDP ratio decreased by 21.1pp in Greece, by 18.0pp in Cyprus, by 10.8pp in Portugal and by 7.9pp in Italy. In case of Poland, the public debt to GDP ratio declined by 3.8pp, close to the EU average (3.7pp). Still though, Poland's public debt to GDP ratio is much lower (by 36pp) than the European average (in 1q23 PL: 48.1%; EU: 83.7%). Poland is also ahead of its regional peers – in Hungary the debt ratio declined only by 2pp, in Slovakia by 2.5pp, while in Czechia it rose by 1.7pp. The next few years, however, will be more difficult for public finances. The fiscally positive effects of inflation, such as growing out of debt, high tax base growth, will wane while some negative effects, such as indexation of public expenses, slowdown of real GDP growth will intensify. Nevertheless, the starting point for Poland – compared to its peers – is solid.

Polish public finances remain solid despite many headwinds, such as: (1) the need for high military spending (expected rise to 4% of GDP in 2023 from 2.2% GDP in 2021), (2) fiscal measures protecting consumers and companies from the energy crisis (MinFin estimate 1.9% GDP in 2023 and 0.3% GDP in 2024), (3) lower tax incomes due to a permanent reduction in PIT rates introduced mid-2022 and due to a zero VAT rate on food (introduced in 2022, extended for 2023 and probably prolonged again for 2024), (4) rising cost of debt service due to global increase of interest rates. In 1q23 the dynamics of general government expenditures moderated, showing some weakening of the emergency, crisis-driven expenses covered by the category “other” (see chart), which mainly includes the off-budget spending related to Covid-19 and energy crisis. We expect further decline of these expenses – energy prices (gas, electric power) are moderating which limits the fiscal cost of price freeze.

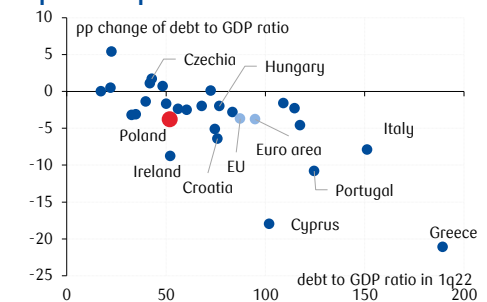
The outlook for public finances is slightly better than we previously thought thanks to the normalization of energy prices and a faster than expected rebound in tax revenues. The central budget tax revenues data (available for June already) suggests that this improvement will continue. The annual growth rate of VAT, the most crucial part of tax revenues, has finally rebounded, PIT has also likely reached the turning point. Only CIT is steadily slowing down due to declining corporate margins. All this has prompted us to revise upward our fiscal balance forecast for 2023 and 2024. We expect the fiscal deficit to be lower – at 4.8% of GDP in 2023 (prev. 5.6%) and 4.0% of GDP in 2024 (prev. 4.6%), while public debt should stabilize at around 49.0% GDP.

General government deficit and debt



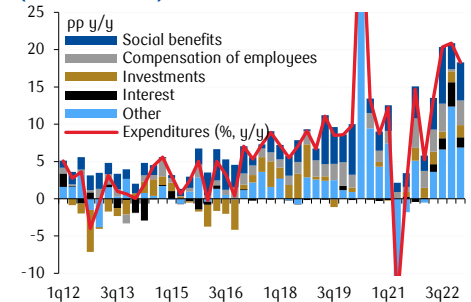
Source: Eurostat, PKO Bank Polski.

Change in the public debt to GDP ratio, 1q23 vs 1q22



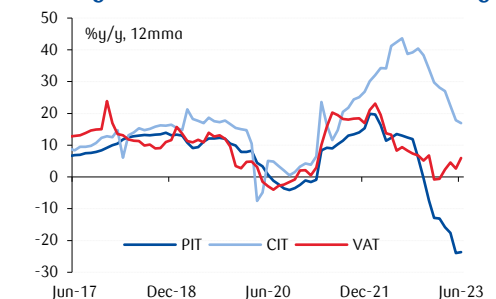
Source: Eurostat, PKO Bank Polski.

General government expenditures (breakdown)



Source: Eurostat, PKO Bank Polski. *Other* mainly consists of expenditures related to pandemic and energy crisis

The key tax revenues in the central budget



Source: MinFin, PKO Bank Polski.

Weekly economic calendar

Indicator	Time (UK)	Unit	Previous	Consensus*	PKO BP	Comment
Monday, 31 July						
GER: Retail sales (Jun)	7:00	% y/y	-5.1	-0.9	--	--
GER: GDP growth (2q)	9:00	% y/y	-0.2	--	--	--
POL: CPI inflation (Jul, flash)	9:00	% y/y	11.5	11.0	11.1	Disinflation stays on track.
EUR: GDP growth (2q)	10:00	% y/y	1.0	0.3	--	--
EUR: CPI inflation (Jul)	10:00	% y/y	5.5	5.2	--	--
EUR: Core inflation (Jul, flash)	10:00	% y/y	5.5	--	--	--
Tuesday, 1 August						
CHN: Manufacturing PMI (Jul)	2:45	pts.	50.5	50.1	--	--
POL: Manufacturing PMI (Jul)	8:00	pts.	45.1	44.5	44.3	PMI will reflect further fall in production and new orders but its decline should be less profound than in the euro area.
GER: Unemployment Rate (Jul)	8:55	%	5.7	--	--	--
GER: Manufacturing PMI (Jul, final)	8:55	pts.	38.8	--	--	--
EUR: Manufacturing PMI (Jul, final)	9:00	pts.	42.7	--	--	--
USA: Manufacturing PMI (Jul, final)	14:45	pts.	49	--	--	--
USA: JOLTS Report (Jun)	15:00	mn	9,824	--	--	--
USA: ISM Manufacturing (Jul)	15:00	pts.	46.0	46.6	--	--
Wednesday, 2 August						
USA: ADP National Employment (Jul)	13:15	thous.	497	185	--	--
Thursday, 3 August						
GER: Exports (Jun)	7:00	% m/m	-0.1	--	--	--
GER: Imports (Jun)	7:00	% m/m	1.7	--	--	--
GER: Services PMI (Jul, final)	8:55	pts.	52.0	--	--	--
EUR: Services PMI (Jul, final)	9:00	pts.	51.1	--	--	--
EUR: PPI inflation (Jun)	10:00	% y/y	-1.5	--	--	--
UK: BoE meeting (Aug)	12:00	%	5.0	5.3	--	--
CZ: Central bank meeting (Aug)	13:30	%	7.00	--	7.00	--
USA: Initial Jobless Claims (Jul)	13:30	thous.	--	--	--	--
USA: Factory orders (Jun)	15:00	% m/m	0.3	-0.2	--	--
USA: Durable goods orders (Jun, final)	15:00	% m/m	--	--	--	--
Friday, 4 August						
GER: Factory orders (Jun)	7:00	% m/m	6.4	-2.5	--	--
GER: Factory orders (Jun)	7:00	% y/y	-4.3	-5.8	--	--
EUR: Retail sales (Jun)	10:00	% y/y	-2.9	--	--	--
USA: Non-Farm Payrolls (Jul)	13:30	thous.	209	185	--	--
USA: Unemployment Rate (Jul)	13:30	%	3.6	3.6	--	--
USA: Average Earnings (Jul)	13:30	% y/y	4.4	--	--	--

Source: GUS, NBP, Parkiet, PAP, Bloomberg, Reuters, PKO Bank Polski. Parkiet for Poland, Bloomberg, Reuters for others.

Monetary policy monitor

MPC Members	Hawk-o-meter*	Recent policy indicative comments^
J. Tyrowicz	5.0	"In the following five projections, prices only move further and further away from the target. On the other hand, the costs in the form of unemployment and/or smaller pay rises for employees are lower than it would result from the projection and are getting even lower. There is no room for interest rate cuts" (24.07.2023, PAP)
L. Kotecki	4.8	"Lowering interest rates at this stage would be a mistake. And I hope it doesn't happen. Behind us is only the first month of core inflation stabilization. The July Inflation Report indicates that we are missing the target even more than it seemed in March, in the previous report." (18.07.2023, Money.pl via PAP)
P. Litwiniuk	3.7	"The government has to date declared a budget policy neutral for inflationary processes but it is changing. (...) The question is what will change and how many more ideas will be presented in the frame of the election campaign - this could have a negative impact on inflationary processes." (15.06.2023, TOK FM, PAP).
H. Wnorowski	2.7	"We are dealing with a sharp decline in inflation and soon, perhaps - this is my dream - even the July reading (...) will be below 10%. If it is not July, we will certainly reach single-digit inflation, which is symbolic, in August and it will continue to fall until the end of the year. One should not rule out a scenario that still in this calendar year the MPC will judge that there are sufficient grounds for the first cut" (18.07.2023, Radio Maryja via PAP, PKO transl.)
A. Glapinski	2.4	"The MPC has decided that we are ending the cycle of rate hikes. Officially, we were in the tightening cycle, we were ready all the time to raise rates, now we are putting this weapon aside. No one expects something like this to happen anytime soon (...) Of course, if something happens, in the emergency mode, we can take that action, but we are no longer in that mode" (7.07.2023, NBPtv, PAP)
C. Kochalski	2.4	"In the light of the current data and information, a room for potential discussion of [rate] cuts may appear in some time, as we have already ended the hikes cycle. The very calendar indicates it could be after the summer vacation at the earliest. (...) We're still before a potential discussion on rate cuts, which sooner or later needs to happen." (13.07.2023, Interia.pl via Bloomberg).
W. Janczyk	2.0	"The current rates level seems adequate given the information we have today. (...) " in my opinion, in the course of the last few weeks, there has come no information that would prompt resumption of rate hikes in December. Currently, no premises can be seen that would prompt such steps." (2.12.2022, PAP).
I. Duda	2.3	"In my opinion, if the conditions are favourable, i.e. if we see a rapid drop in inflation, if it is a long-term downward trend, the MPC will have arguments to carefully discuss interest rate cuts, perhaps even after vacation. Of course, I must make a caveat here (...) everything depends on the incoming data and information" (17.07.2023, Business Insider, PAP, PKO transl.)
G. Maslowska	2.1	"Theoretically, it is possible to start the phase of interest rate cuts even before the newest inflation and GDP projection appears. (...) if, for example, in September or October, the MPC members will decide that the incoming data are so convincing that it is worth deciding on the first cut before the projection appears, I think that it would be understandable for participants of economic life" (18.07.2023, PAP)
I. Dabrowski	1.9	"(...) I think that there is a high probability that interest rates will remain at their current level until the end of September. If the MPC was to consider a motion to cut interest rates, it would rather happen in October (...) Although if we saw a rapid decline of the index by another 5p. in the summer months, and we would find ourselves at clearly single-digit inflation levels, I cannot rule out that this will happen in September." (26.06.2023, PAP)

*the higher the indicator the more hawkish views. The positioning has been made based positively on PAP survey conducted among economists at banks in Poland (scale 1-5). ^Quotes in bold have been modified in this issue of Poland Macro Weekly.

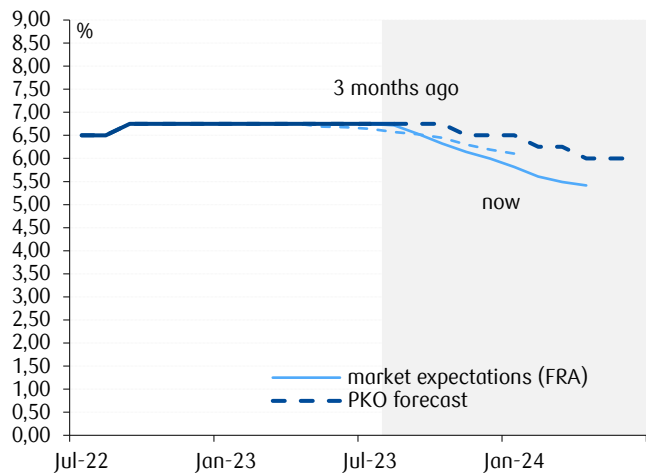
Interest rates – PKO BP forecasts vs. market expectations

		1M	2M	3M	4M	5M	6M	7M	8M	9M
Date	27-Jul	27-Aug	27-Sep	27-Oct	27-Nov	27-Dec	27-Jan	27-Feb	27-Mar	27-Apr
WIBOR 3M/FRA†	6.72	6.64	6.45	6.23	5.97	5.77	5.54	5.33	5.16	5.09
implied change (b. p.)		-0.08	-0.27	-0.50	-0.76	-0.96	-1.19	-1.39	-1.56	-1.64
MPC Meeting	6-Jul	-	6-Sep	4-Oct	8-Nov	6-Dec	-	-	-	-
PKO BP forecast*	6.75	6.75	6.75	6.50	6.25	6.00	5.75	5.50	5.25	5.00
market pricing^		6.67	6.48	6.26	6.10	5.95	5.77	5.56	5.39	5.32

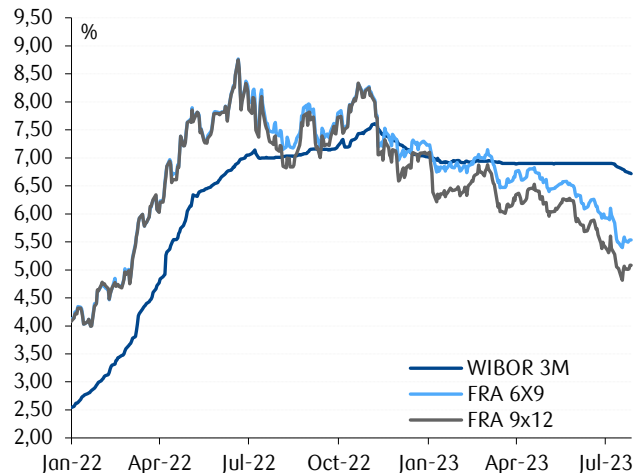
WIBOR 3M from the last fixing, FRA transactions based on WIBOR 3M for subsequent periods, †in basis points, *PKO BP forecast of the NBP reference rate.

Poland macro chartbook

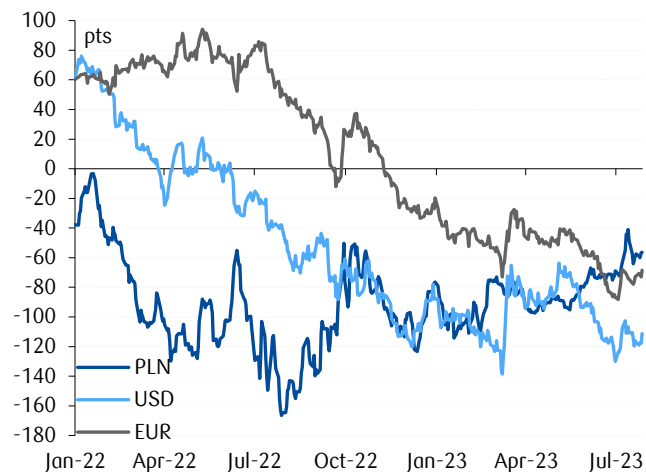
NBP policy rate: PKO BP forecast vs. market expectations



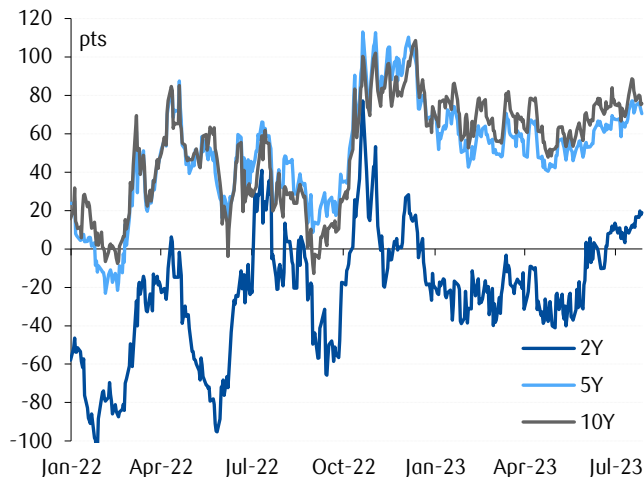
Short-term PLN interest rates



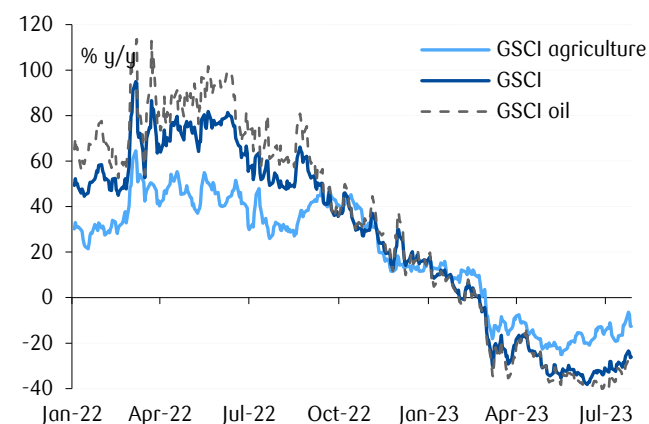
Slope of the swap curve (spread 10Y-2Y)*



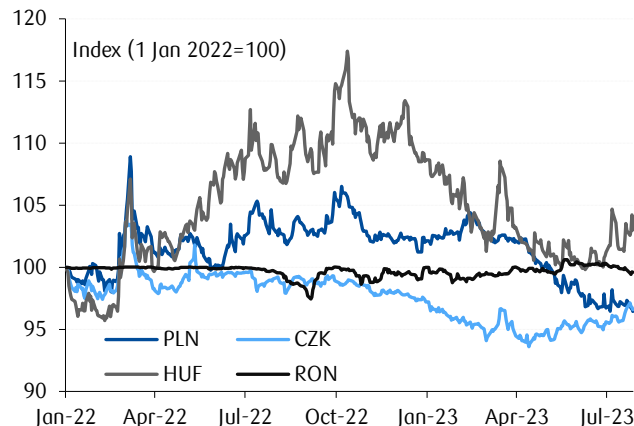
PLN asset swap spread



Global commodity prices (in PLN)

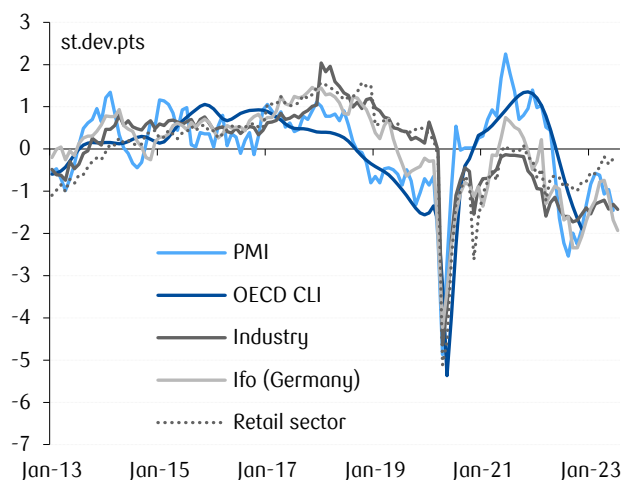


Selected CEE exchange rates against the EUR

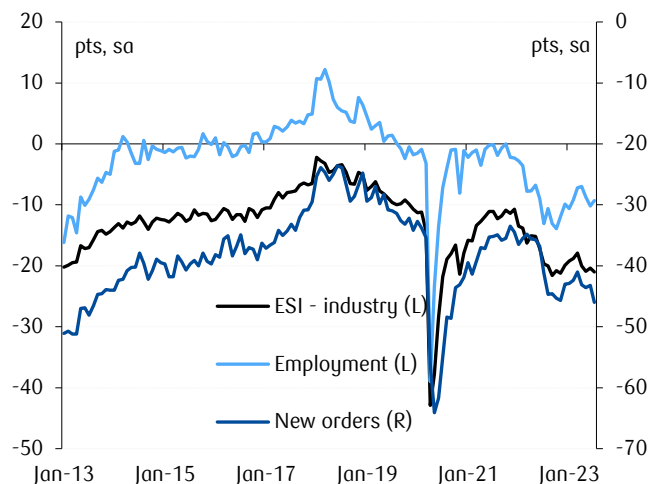


Source: Datastream, NBP, PKO Bank Polski. *for PLN, and EUR 6M, for USD 3M.

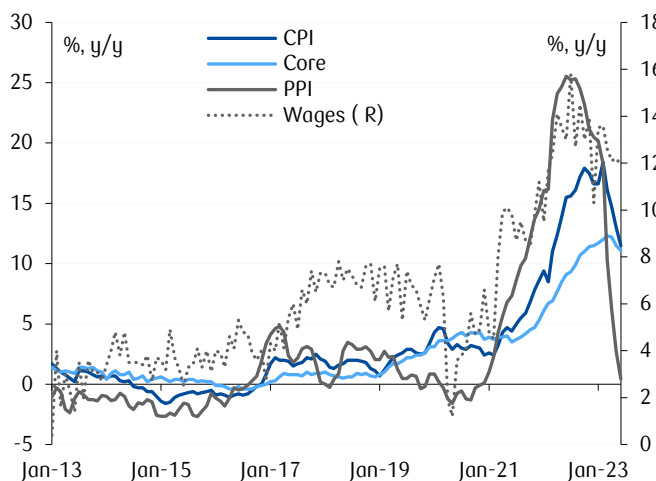
Economic sentiment indicators



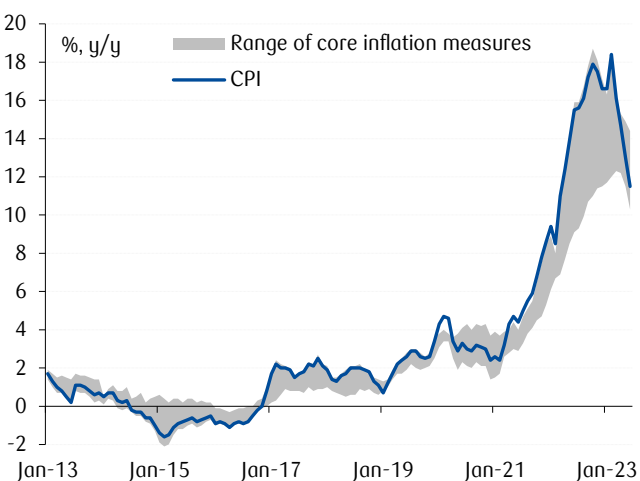
Poland ESI for industry and its components



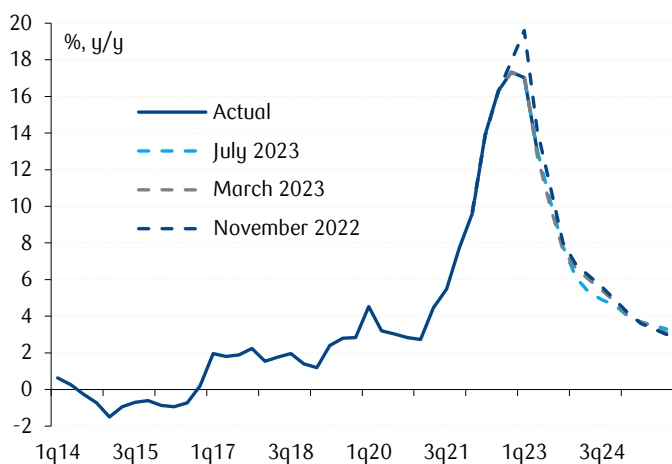
Broad inflation measures



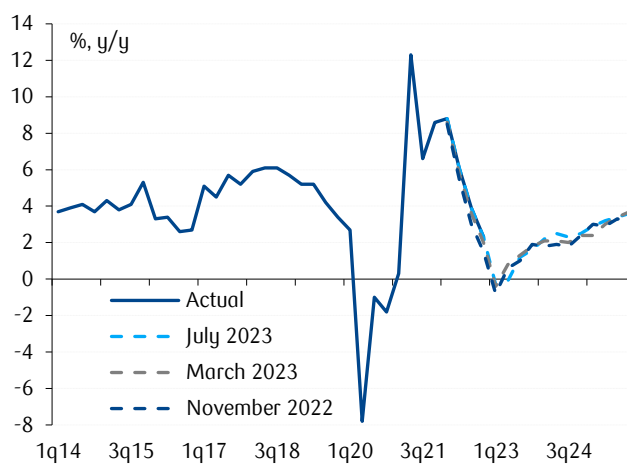
CPI and core inflation measures



CPI inflation - NBP projections vs. actual

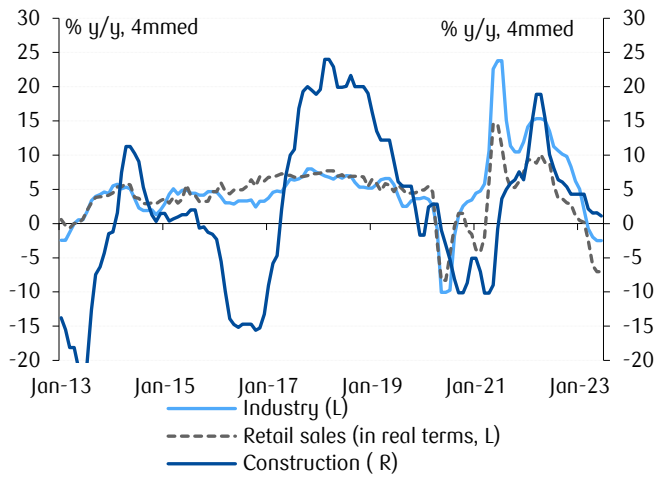


Real GDP growth - NBP projections vs. actual

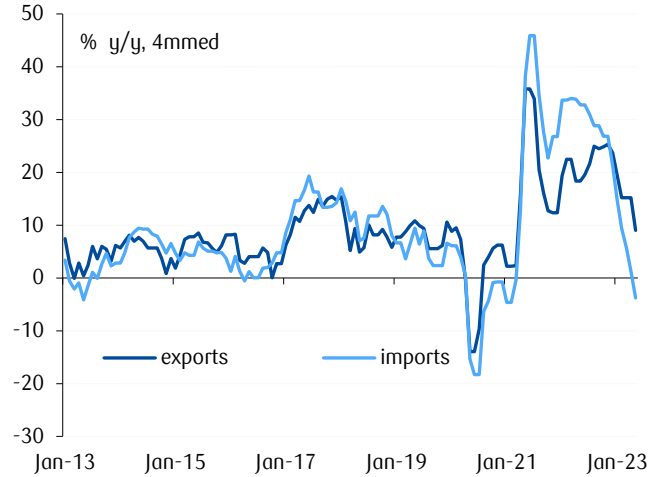


Source: Datastream, GUS, EC, NBP, PKO Bank Polski.

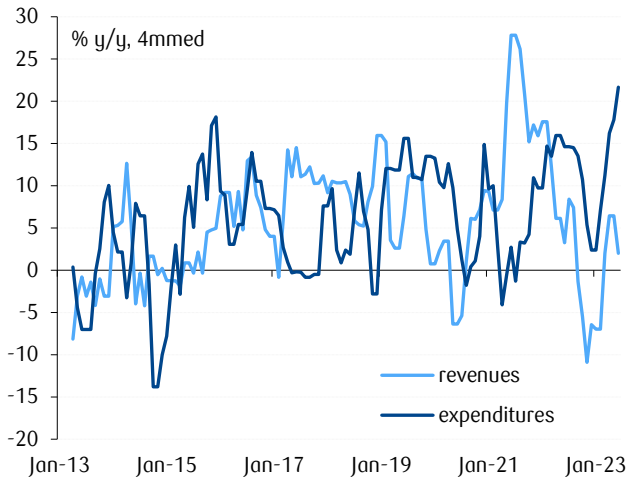
Economic activity indicators



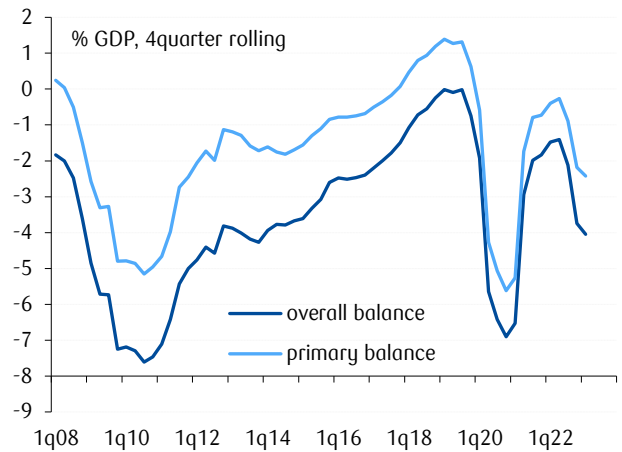
Merchandise trade (in EUR terms)



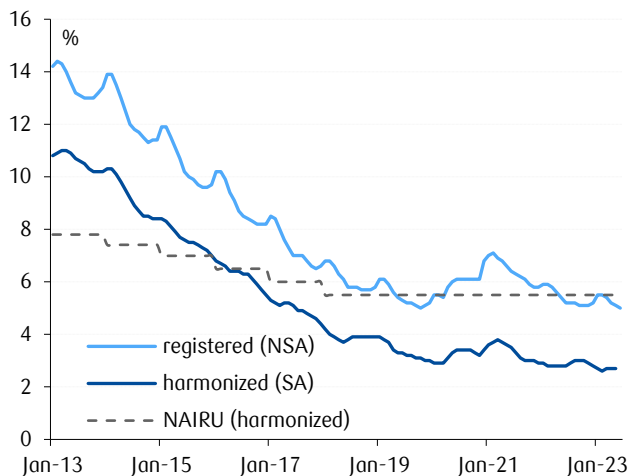
Central government revenues and expenditures*



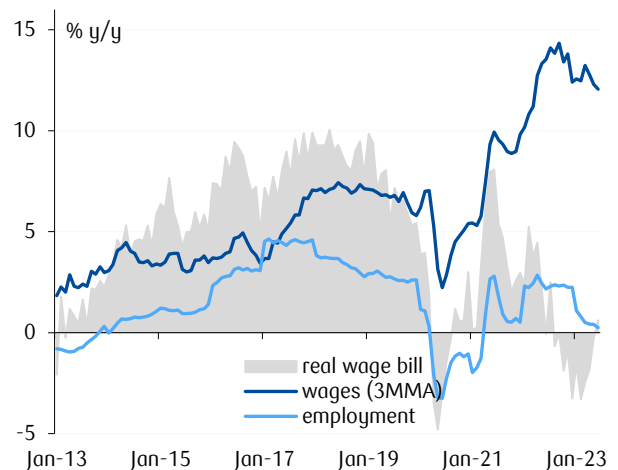
General government balance (ESA2010)



Unemployment rate

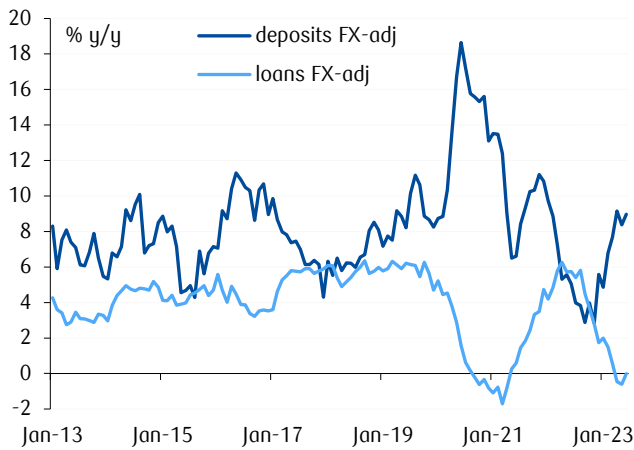


Employment and wages in the enterprise sector

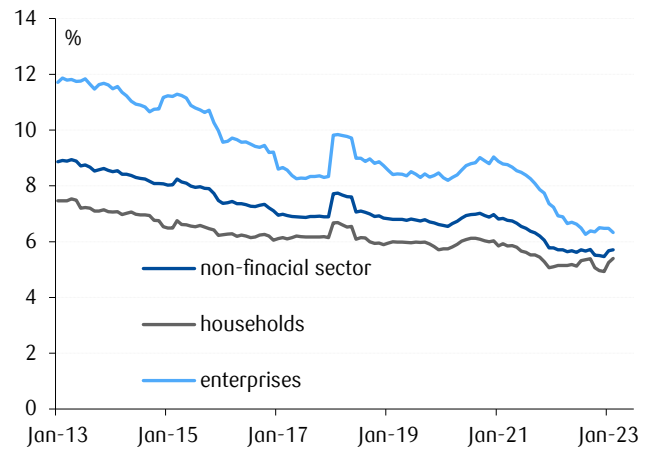


Source: NBP, Eurostat, GUS, MinFin, PKO Bank Polski. *break in series in 2010 due to methodological changes.

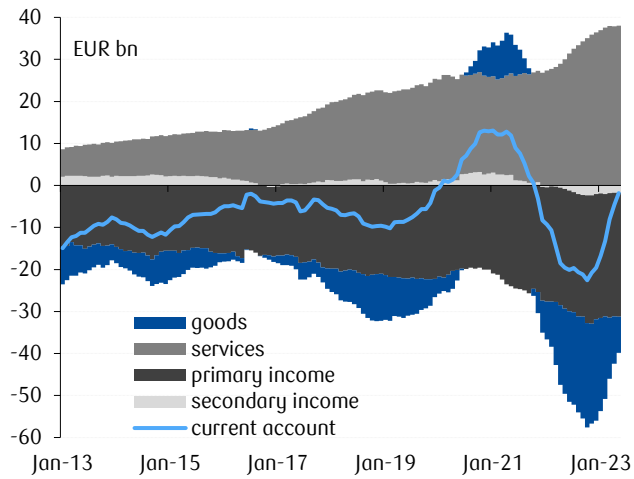
Loans and deposits



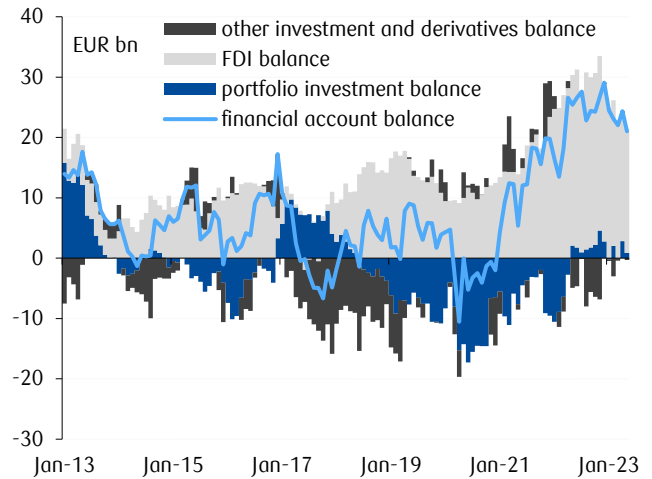
Non-performing loans (NPLs) - by sectors*



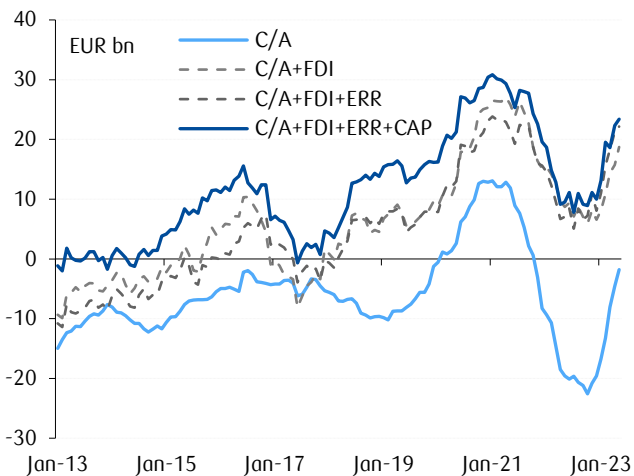
Current account balance



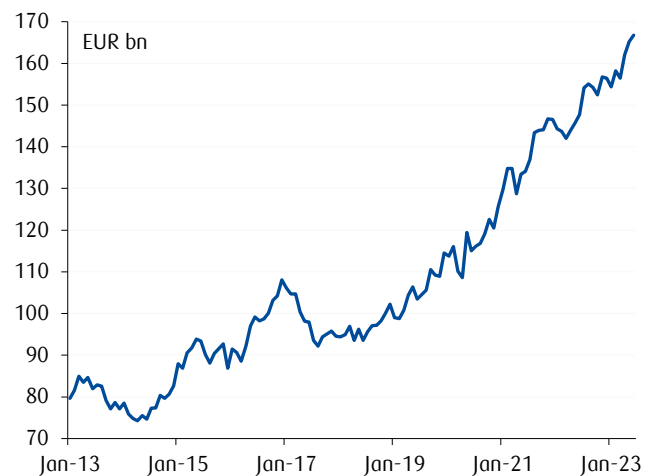
Financial account balance



External imbalance measures



NBP FX reserves (in EUR terms)



Source: NBP, PKO Bank Polski. *break in series in Jan2018 due to methodological changes.

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- [External position rapidly improving](#) (June 16, 2023)
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