It's just a temporary power outage

Poland Macro Outlook 2023

PKO Economic Research, 13 January 2023

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Key takeaways (1)

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- **Global energy crisis, the highest level of interest rates for many years, fear of world war and the biggest geopolitical tensions since 1989, massive immigration, onset of a 3-year long election period (2023 parliamentary, 2024 – municipal, European Parliament, 2025 – presidential) - all these factors make forecasting for Poland in 2023 extremely difficult. The environment won't be supportive for the Polish economy, which might result in the weakest GDP growth ever (in the history of comparable data since 1995, excluding the pandemic recession in 2020). Poland's fundamentals, however, remain solid which means that 2023 is just a temporary power outage.**
- **#1 External environment: less grim than feared.** The external environment of the Polish economy remains challenging. 2023 will be marked by disinflation, heralded by easing supply tensions, falling commodity prices and slowing producer prices. Central banks face a dire choice in which there are no good solutions - stabilize the economy at the cost of a slower disinflation, bearing the risk of unanchoring inflation expectations, or continue to aggressively fight inflation, accepting the risk of a deep recession. Regardless of the choice, the risk of error (policy mistake) is high. Europe in 2022 managed to avoid the black scenario of a severe energy crisis, but it is a battle won, not a war. The energy crisis is a developing story, maintaining its negative impact on economic growth, but reducing its pass-through to inflation.
- **#2 Growth prospects: not as bad as it seems at first sight.** Poland will be teetering on the brink of recession of a specific nature. Private consumption, increasingly suppressed by the decline in real income and the dry loan tap, will be the weakest link in the domestic final sales. In 2h23, as inflation falls, the situation will improve. Reshoring/nearshoring/friendshoring will make Polish exports resist the global decline in demand. The need to reduce the energy intensity of the economy and the inflow of foreign capital will support investment demand. The Recovery Plan, if implemented in 2023, could help public investment demand to recover after being suppressed by rising investment goods' prices and a transition between old and new EU budgets.

Key takeaways (2)

- **#3 Labour market: lower real wages, stable unemployment.** Labour market conditions remain favourable, although there are signs of some deterioration. Labour demand has started to weaken in 2022 and households' fears of unemployment have grown stronger, whereas businesses still find it hard to fill vacant places. These contradictory tendencies suggest that labour market adjustment to economic slowdown will take place mainly through the wage channel (lower real wages). Any reduction in employment is likely to apply in the first place to foreign workers, stressing the dual nature of the domestic labour market.
- **#4 Inflation outlook: disinflation with sticky core inflation.** 2023 will be marked by a strong (over 10pp) decline in CPI inflation. It will mirror fading post-war shocks and declining domestic demand, which will limit core inflation. However, the way towards inflation target will be long and bumpy. Energy prices, capped by the government in 2023, will be the key pro-inflationary factor in the medium-term.
- **#5 Monetary policy: rate cuts on the cards.** Inflation shock has prompted the record strong and record-fast cycle of interest rate hikes in Poland. At the end of 2022, the MPC has announced a pause in the tightening cycle and entered the wait-and-see mode. As CPI inflation is expected to fall significantly in the course of 2023, the markets have started to price in first rate cuts before the year-end, which is in line with our baseline scenario. As inflation is projected to decline, real rates will keep growing.
- **#6 Fiscal policy: under pressure, but under control.** 2023 will be a challenging year for public finances. Protective measures against energy shock will be the key driver of fiscal deficit widening (to 5.1% of GDP). Substantially increased defence spending will become a permanent element of the public spending landscape. A spike in interest rates will increase debt servicing costs - we estimate that by approx. 0.7-0.9% of GDP. In 2023, most of the fiscal deficit will be recorded by off-budget units. Still double-digit nominal GDP growth means that the ratio of public debt to GDP (ESA) will increase only slightly in 2023.

Key takeaways (3)

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- **#7 Balance of payments: more resilient than regional peers.** Since the start of the energy shock in 2021, Poland's current account balance deteriorated by more than 6% of GDP, to a deficit of nearly 4% of GDP in late 2022. The deterioration was caused by a widening trade gap, seen mainly in the case of mineral fuels, that was caused by adverse terms-of-trade shock. However, current account deficit in Poland is narrower than in Hungary and Czech Republic, and it is fully financed by record strong FDIs inflow. The FDI inflow is likely to further boost exports this year. The current account balance is set to improve, as adverse shocks fade away and companies reduce their inventories.
- **#8 Macroeconomic stability: Poland still outperforming.** Poland's economic fundamentals remain stable, which is confirmed, among others, by one of the best positions in the EU in the Macroeconomic Imbalances Procedure of the European Commission. Much can still be improved, but Poland achieves at least average results in almost all macro-stability areas.
- **#9 Borrowing needs and PLN outlook.** Unprecedented conditions of financing government borrowing needs may occur in 2023. A flood of issuance across Europe (incl. the EU itself) while the ECB reduces its balance sheet could exert some indirect pressure on the Polish market. Some portion of borrowing needs in Poland will have to be covered by off-budget vehicles (mostly by the state development bank BGK). PLN fate depends mostly on sentiment in global markets and potential swings in geopolitical risk, while fundamentally the local currency remains undervalued.
- **#10 Housing market: transitory freeze.** Housing demand is at its bottom with a prospect for a gradual recovery in 2023. In our opinion housing sales will go up by 15% in 2023 as a result of interest rates cuts, improved affordability (wages rising faster than house prices) and planned public support for first-time buyers. The supply side response to slump in demand in 2022 was a strong decline in the number of housing starts. We expect that annual change in average sqm price in 2023 will be -5%.

#1 External environment: less grim than feared

Fear of the dark – fear of the recession

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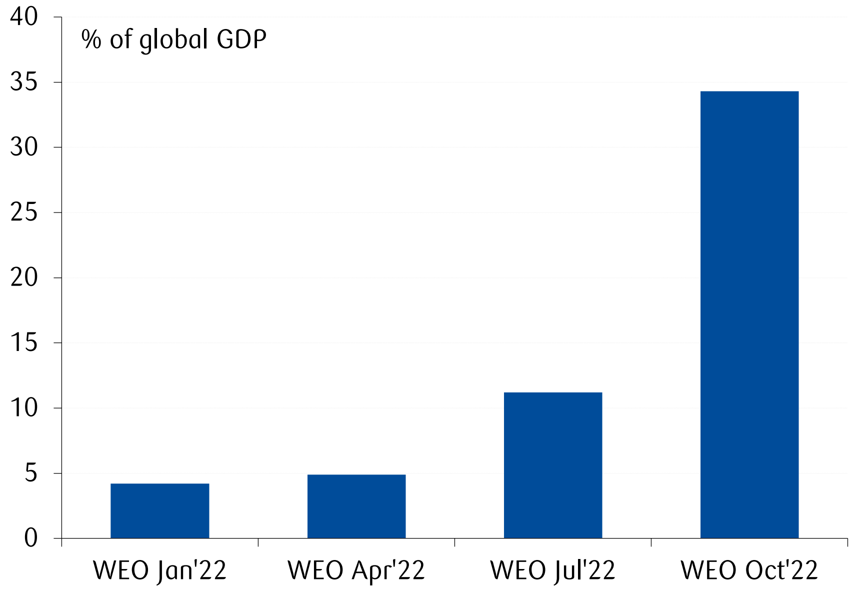
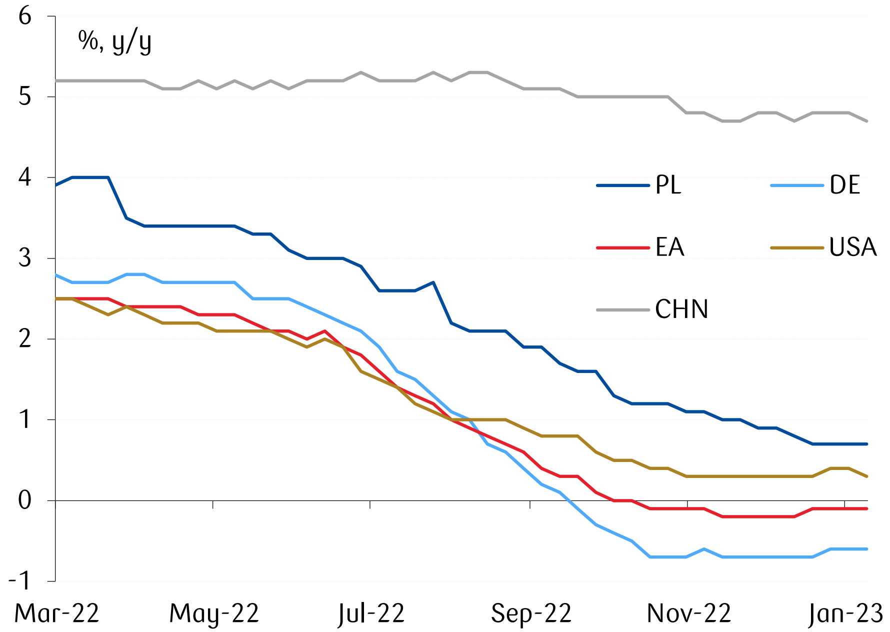
Economies in recession according to the IMF



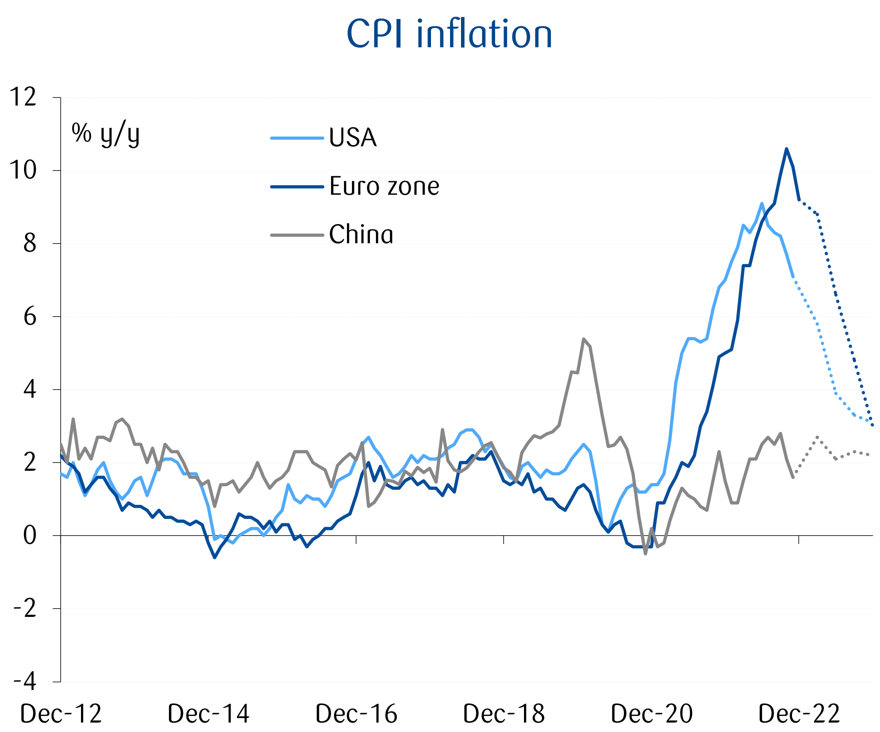
Recession defined as consecutive negative q/q change in 2022 or 2023

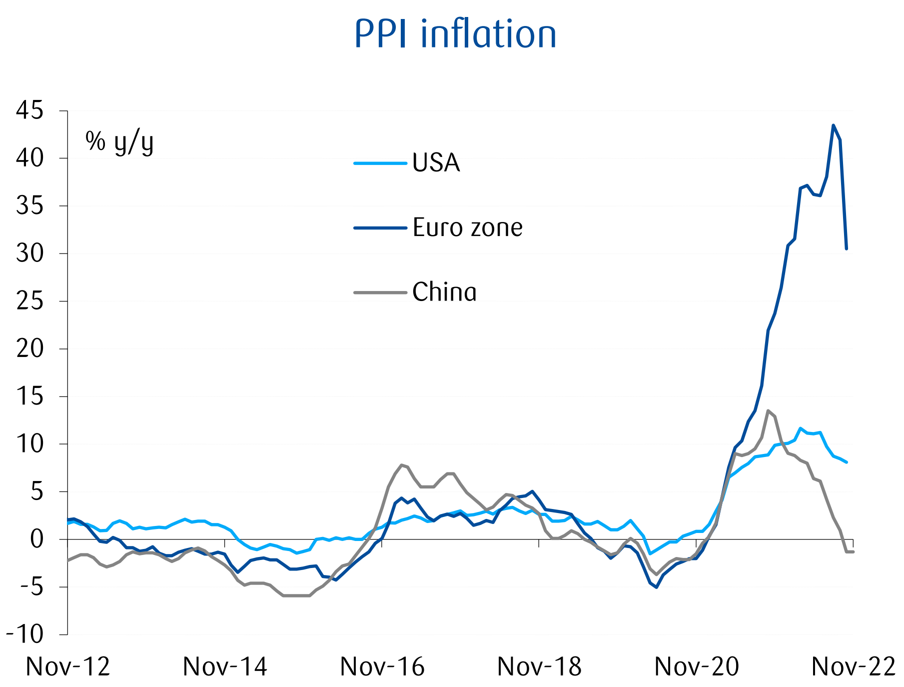
Change in GDP growth forecasts for 2023 (median forecasts in Bloomberg survey)



- According to IMF WEO (Oct'22) 2023 will be a tough year for the global economy – one third of it could be in recession due to a simultaneous downturn in three major economies – the EU, US and China. The EU will be most severely hit due to war in Ukraine and energy shock, while the US may avoid recession.
- Recession in 2023 in both the euro area and Germany (major Polish trading partner) is the base scenario for us and according to the consensus. However, a good sign is that the long-lasting trend of downward revisions into GDP forecasts has stopped.

Diverging inflationary trends across the world are starting to converge into global disinflation

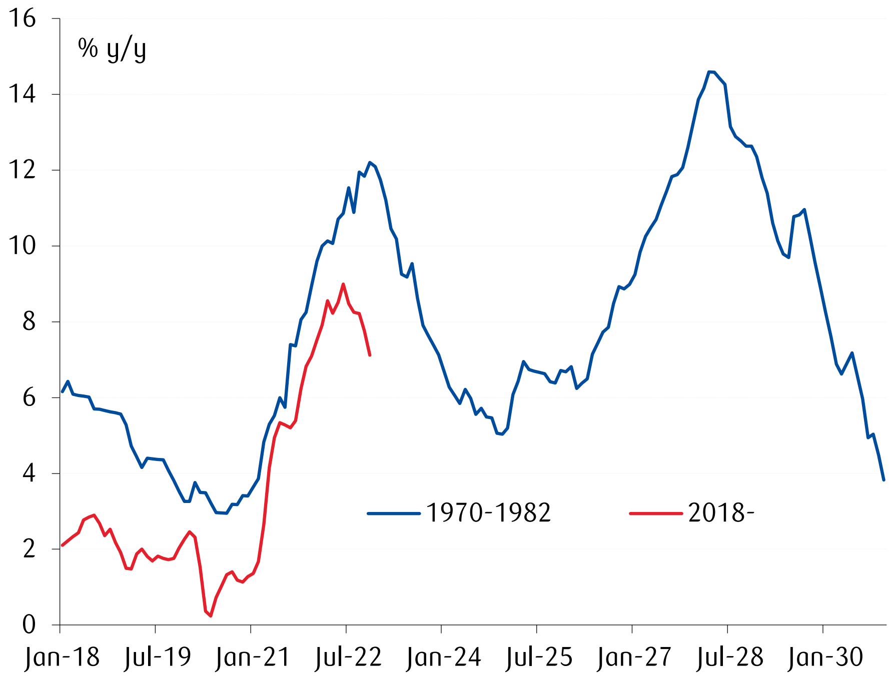




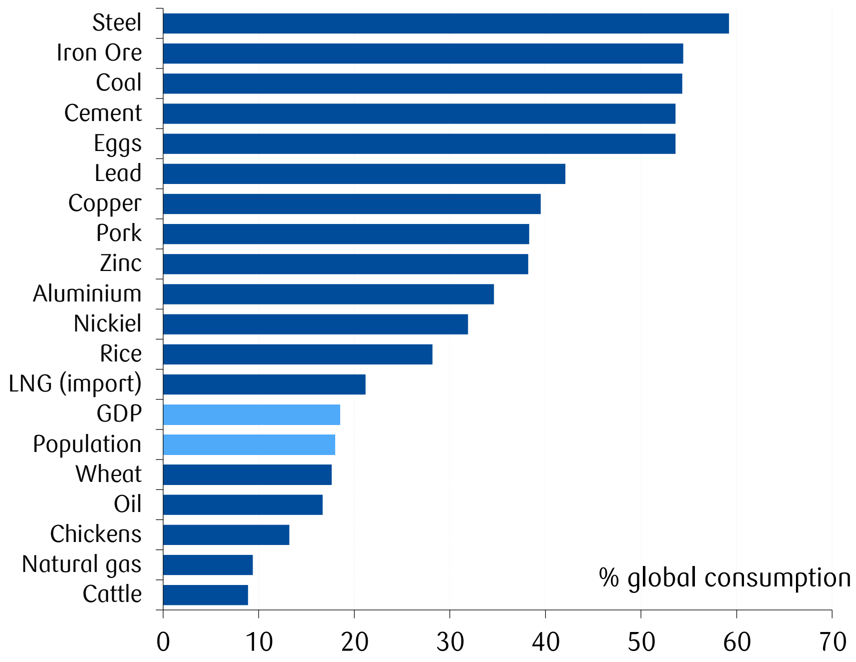
- Inflation has reached its peak both in the US and euro area. Disinflation is the unquestionable scenario for 2023. The most important reasons for inflation decline are: a) statistical base effects, b) end of energy shock, c) decline of commodity prices and fadeout of supply chains disruptions, d) real income drop and weakening demand, e) monetary policy tightening.

It may be not the end of inflationary pressures

CPI inflation in US – now and in 1970-1982



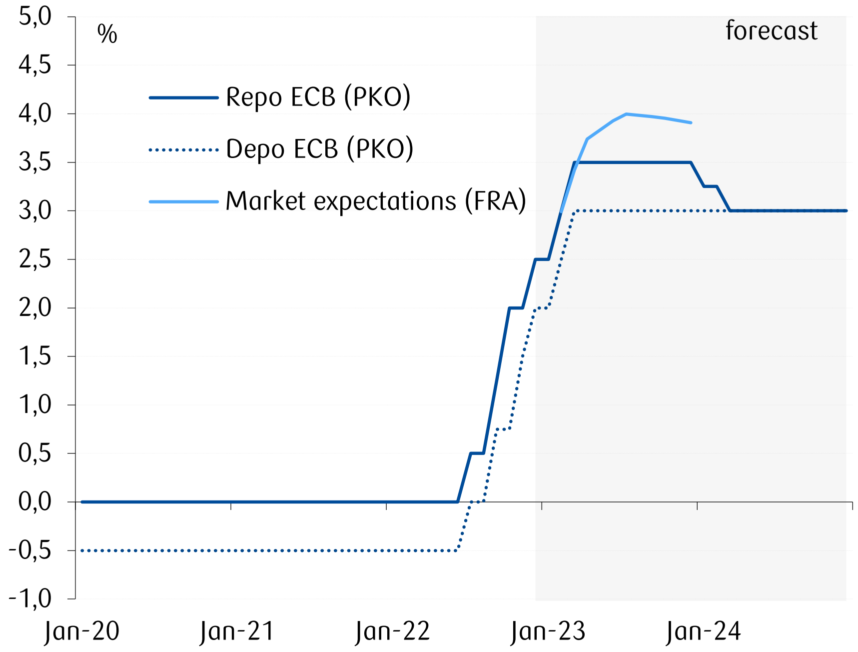
China share in global commodities consumption



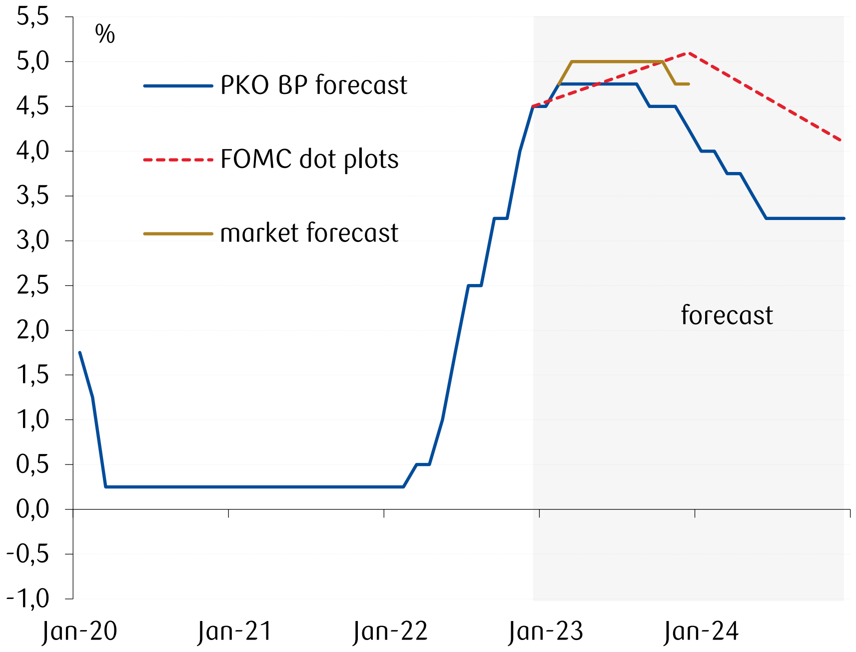
- Although disinflation seems to be an unquestionable scenario, the return of CPI towards central bank targets is still not granted and the new ‚steady state' of inflation remains a big question. Tight labour market in the US (wage increases in services), long-lasting second round effects, premature monetary easing as well as new energy shocks can all lead to a renewed wave of inflation.
- China re-opening poses a next inflationary risk, with a potential strong rebound of Chinese demand on commodities, triggered by post-pandemic recovery.

Stagnation + disinflation = monetary policy pivot

ECB rates forecast



Fed funds rate forecast



- The ECB and Fed are finalizing their tightening cycles, although in both cases the official ‚forward guidances' suggest a continuation of hawkish attitude. In our view Fed has already done enough – both headline and core inflation should decline promptly, allowing at first to reduce the scale of hikes (25bps in February) and then to end the cycle. In euro area the tightening cycle will likely last longer and the refi rate will reach 3.5%, in our view.
- Economic slowdown in 2h23 as well as accelerating disinflation may lead to a start of rate cuts (especially in the US, later in euro area).

Awaiting another „New Normal”

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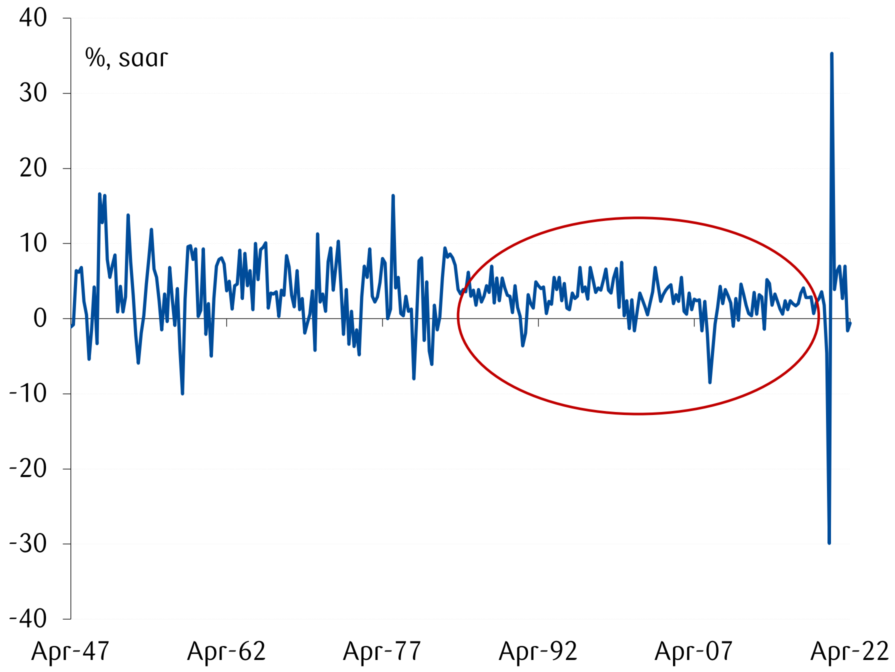
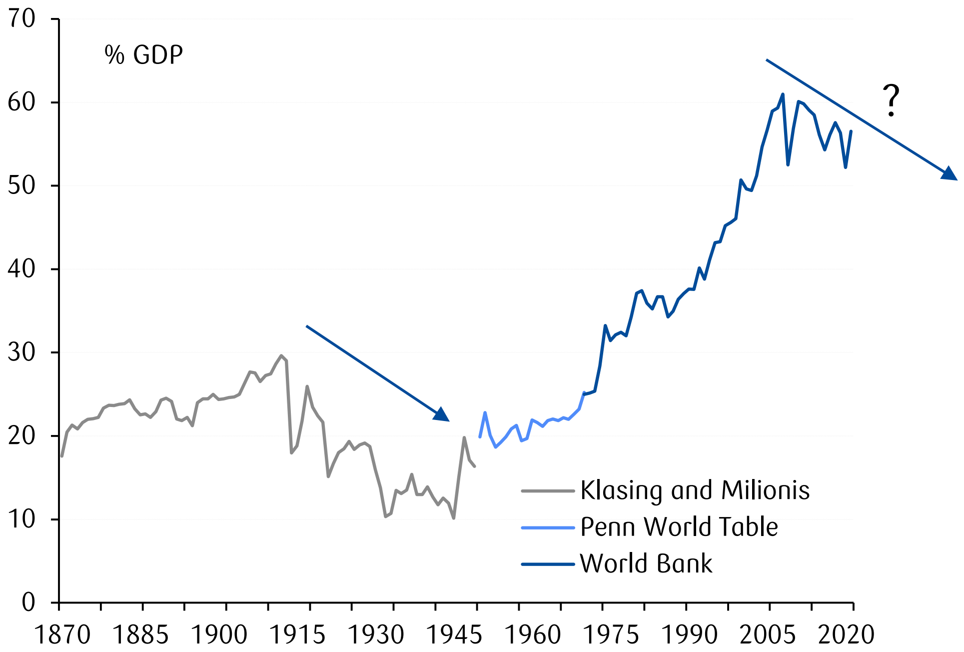
The final end of „Great Moderation”?



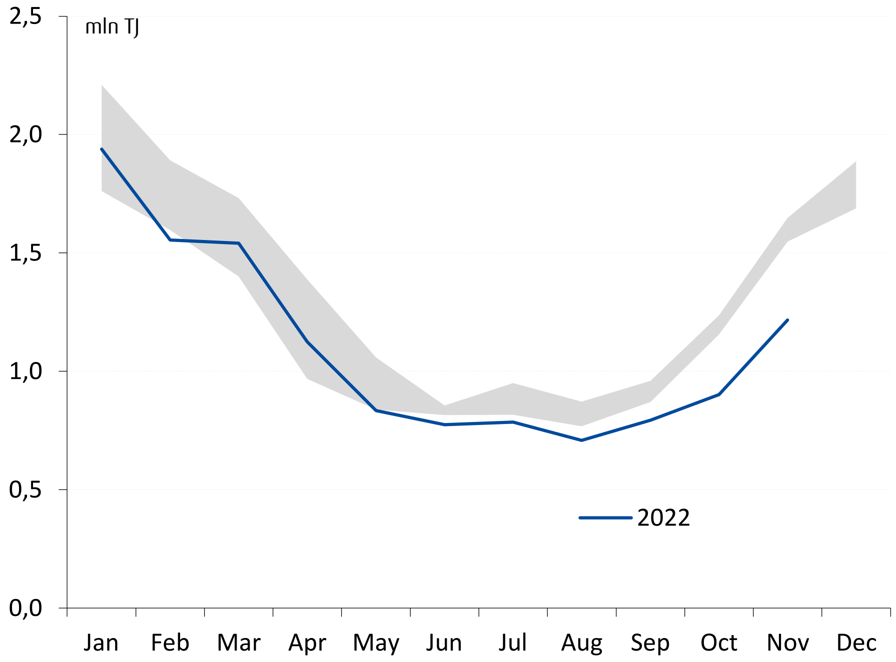
The end of globalisation? - international trade as % GDP



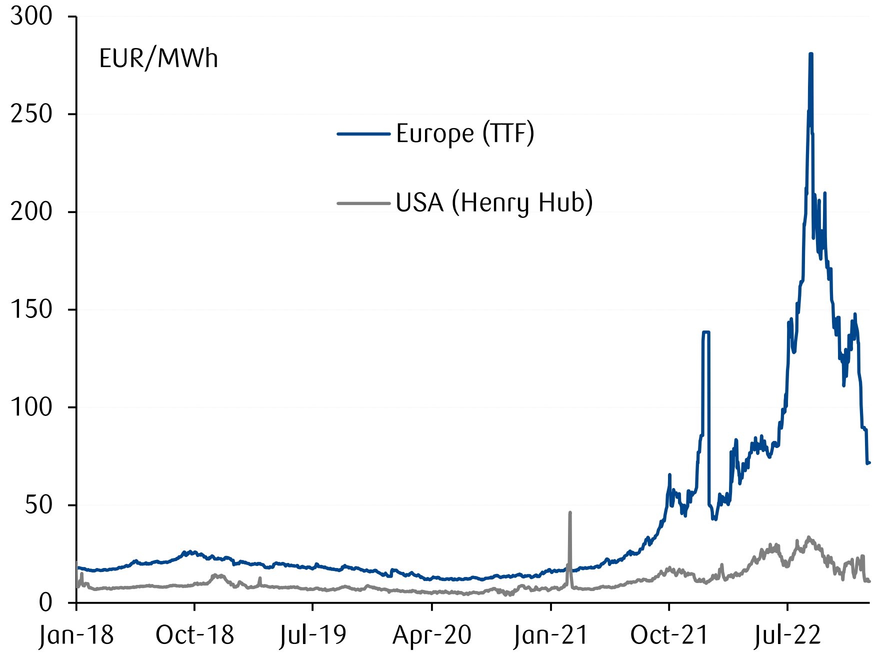
- Times of „Great Moderation” are probably over and the current decade may be marked by a much higher volatility and uncertainty amid geopolitical tensions. The access to commodities and relatively cheap energy will be of crucial importance for economies.
- We expect a slowdown or even a partial reversal of globalisation in favour of closer economic relations in some geopolitical blocks. There will be more friendshoring and less offshoring. The cost efficiency of production will recede in favour of reliability of supplies.

Natural gas crisis not as severe as feared…

Natural gas consumption in the EU compared to the historical benchmark



Natural gas price divergence in Europe and the US



- The 2022/2023 winter was not as cold as expected. With warm weather, the EU is able to get through the winter season without Russian natural gas and with no need for administrative rationing. In the extreme natural gas price environment, closing the supply-demand gap was possible thanks to a decline of industrial production (10bn m3), LNG import increases (40bn m3), substitution in the energy sector and a warm winter (10bn m3).

… but the real crisis may come in 2023/2024 season

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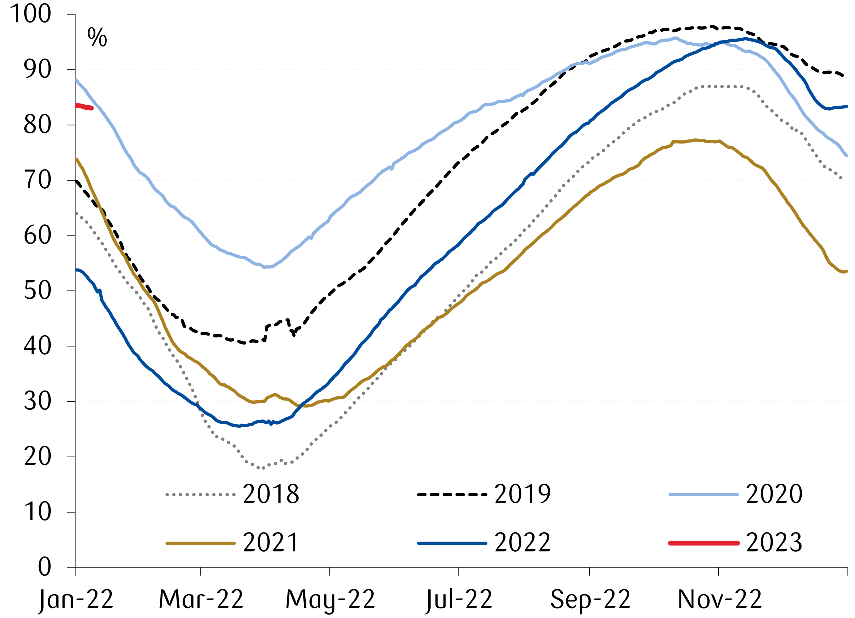
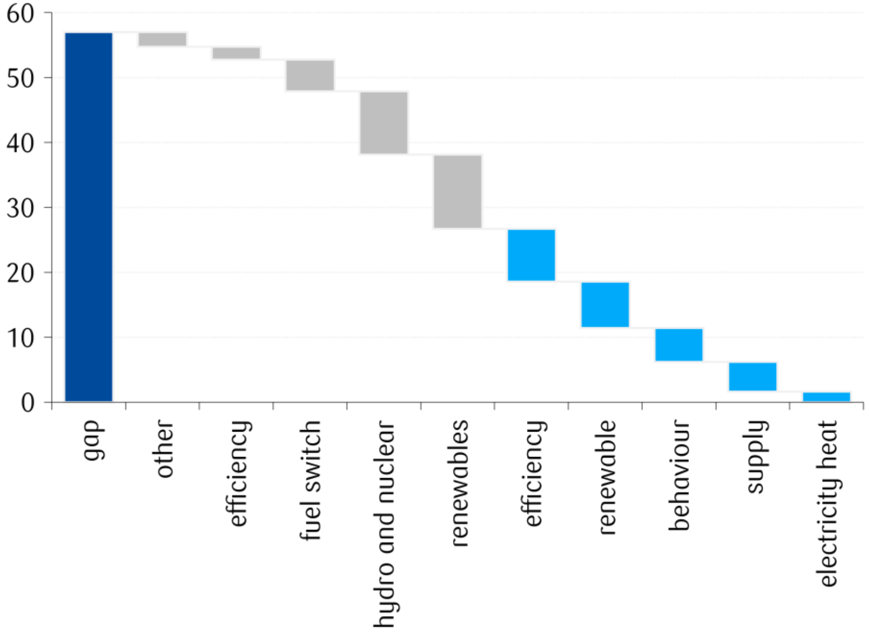
EU natural gas stock level



Expected changes and additional actions to close the supply-demand gap in the EU in 2023



- 2023 begins with a high level of natural gas stock due to the warm winter, saving measures and LNG import. However, the rest of the year might be still challenging.
- The EU demand for gas in 2023 will amount to 395bn m3. According to the International Energy Agency, the supply-demand gap of natural gas will be 57bn m3, of which 30bn m3 will be covered by activities that have been already initiated. The rest (27bn m3) will have to be covered by extra measures.

#2 Growth prospects: not as bad as it seems at first sight

The reversed carry-over effect – Poland flirting with recession in 2023

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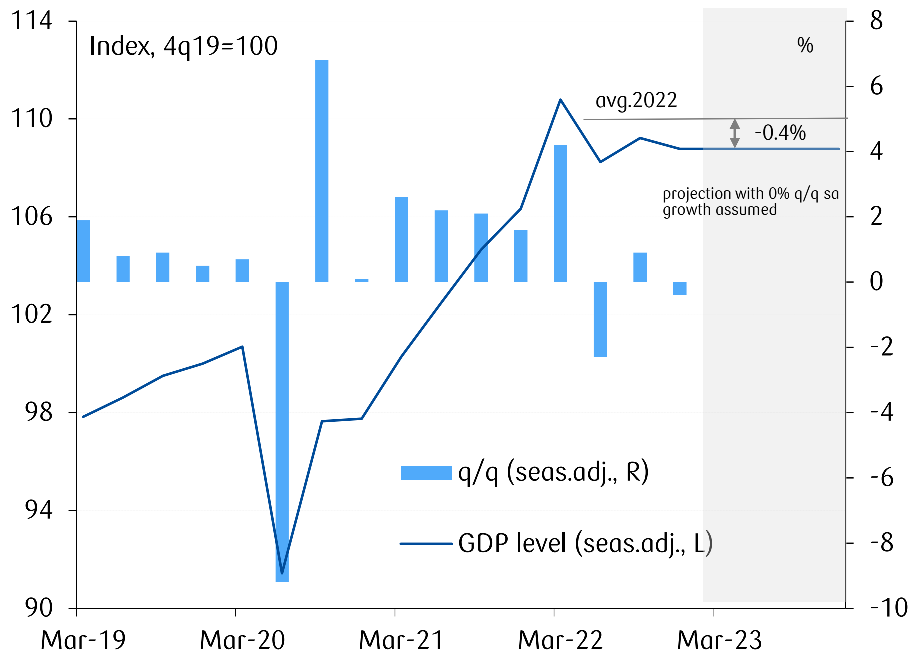
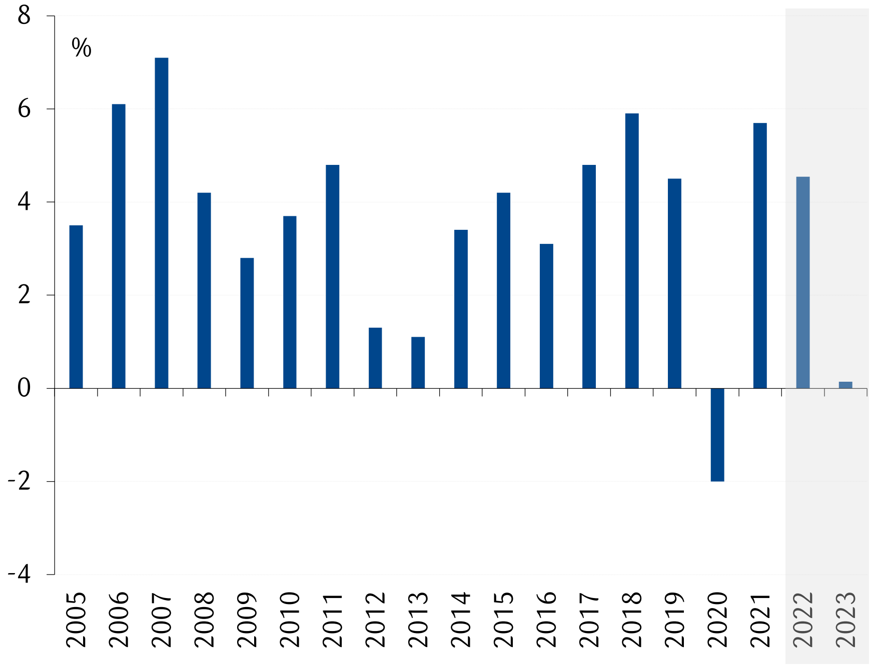
GDP level and quarterly growth rate



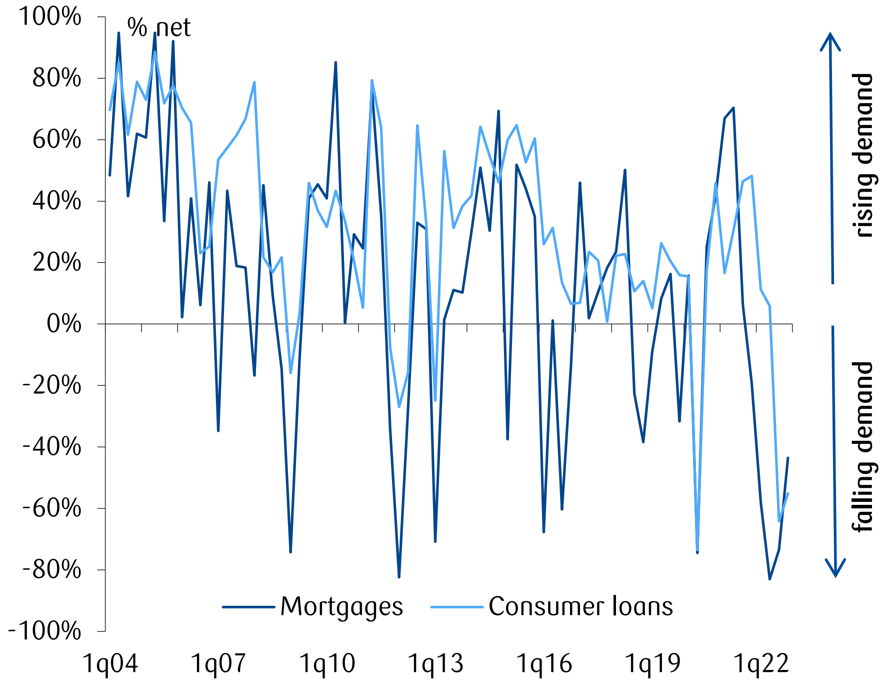
Annual GDP growth rate



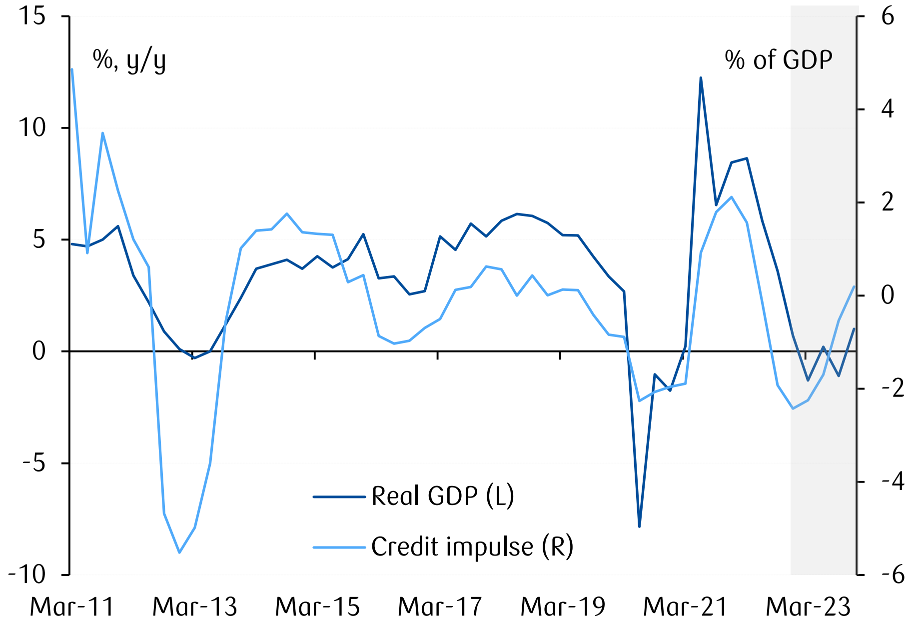
- Reversed carry-over effect from 2022 will make it difficult for the economy to keep up with the growth rate from the previous two years. Assuming GDP growth rate at 0.0% q/q in consecutive quarters of 2023, the average GDP level in 2023 falls below 2022.

Negative credit impulse weigh on GDP growth

Expected demand on loans (Bank Lending Survey)



Credit impulse vs GDP



- The largest and fastest monetary tightening in decades has generated a negative credit impulse (approx. 2% of GDP) which will weigh on GDP growth in 2023. Disinflation will reverse a course of monetary policy in 2h23 what accompanied by rising nominal income (rising creditworthiness) and muted unemployment rate reaction to recession (lowering credit risk) will help lending to recover.

Recession mainly hits consumer sector

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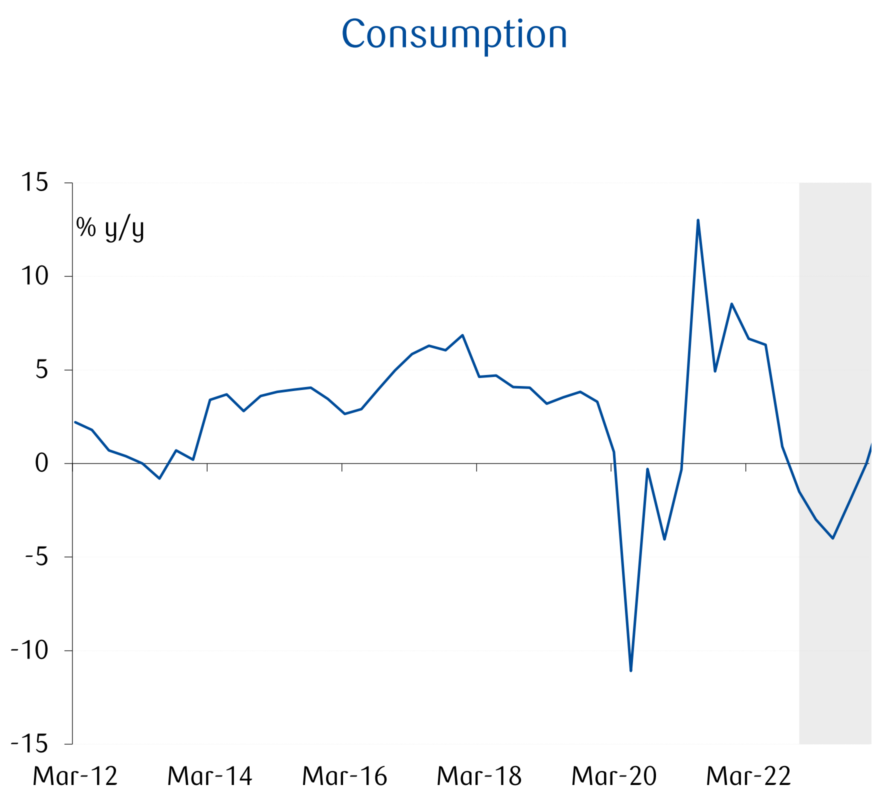

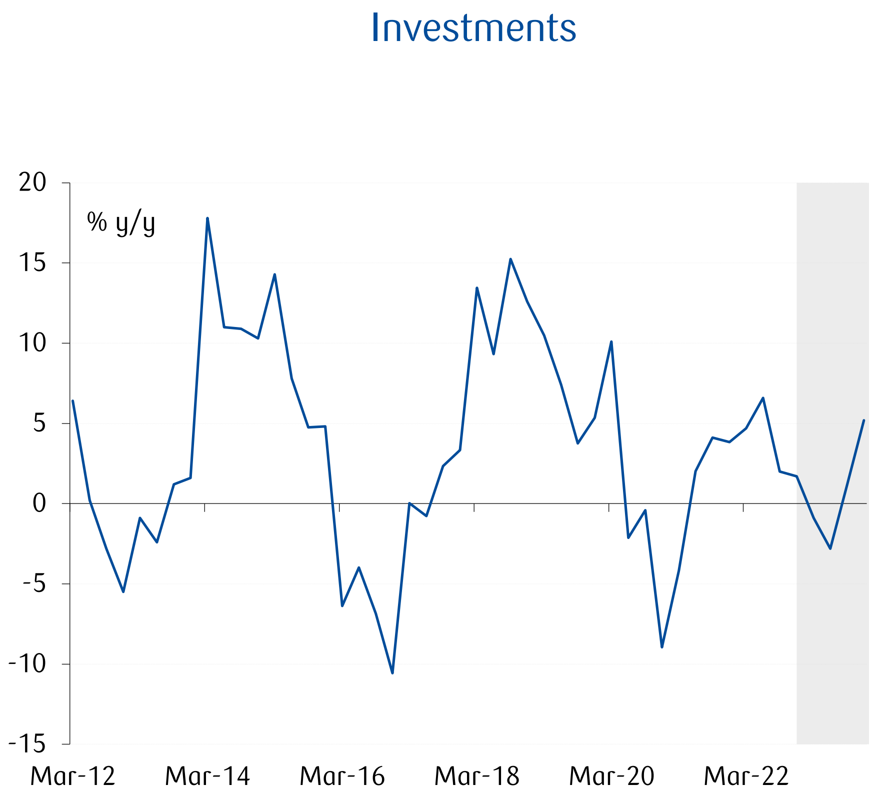

- We forecast consumer demand will drop by 2.3% in 2023. Quarterly consumption profile will essentially reflect inflation (shaping real income of households). Investment demand will stay moderate, growing by 1.3% in 2023, but with a hump-shaped quarterly profile.

Falling real income will restrict consumers in 1h23

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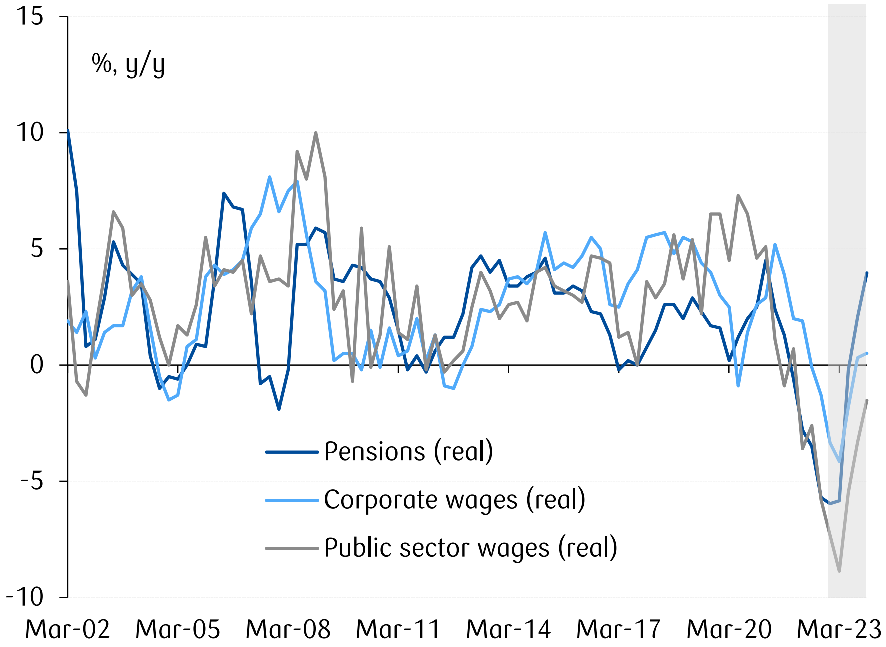
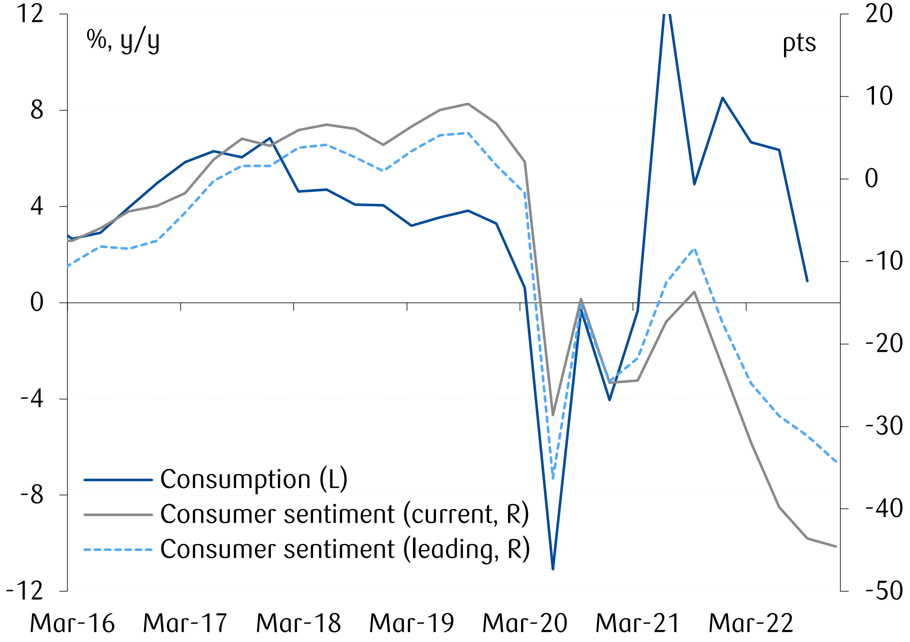
Households' real income



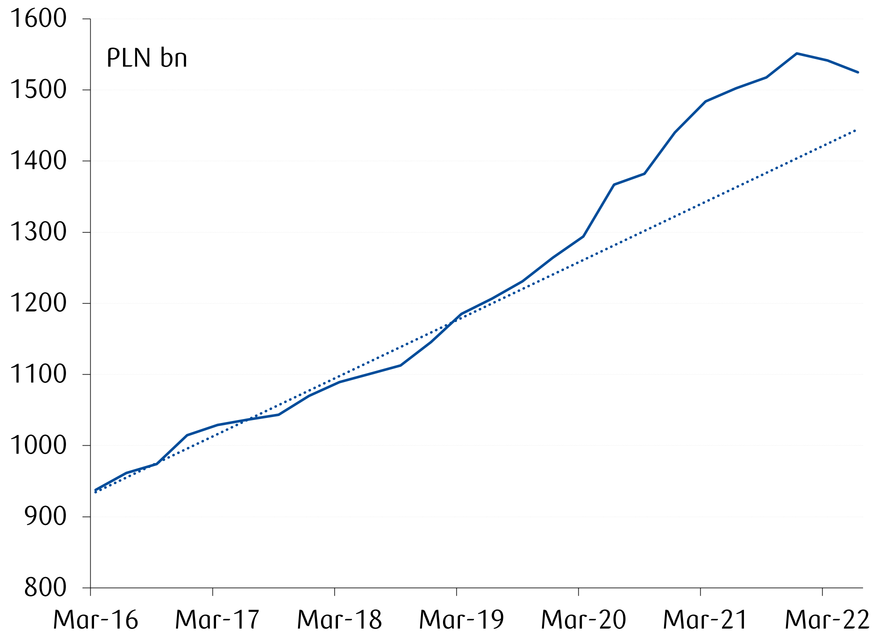
Consumer sentiment vs consumption



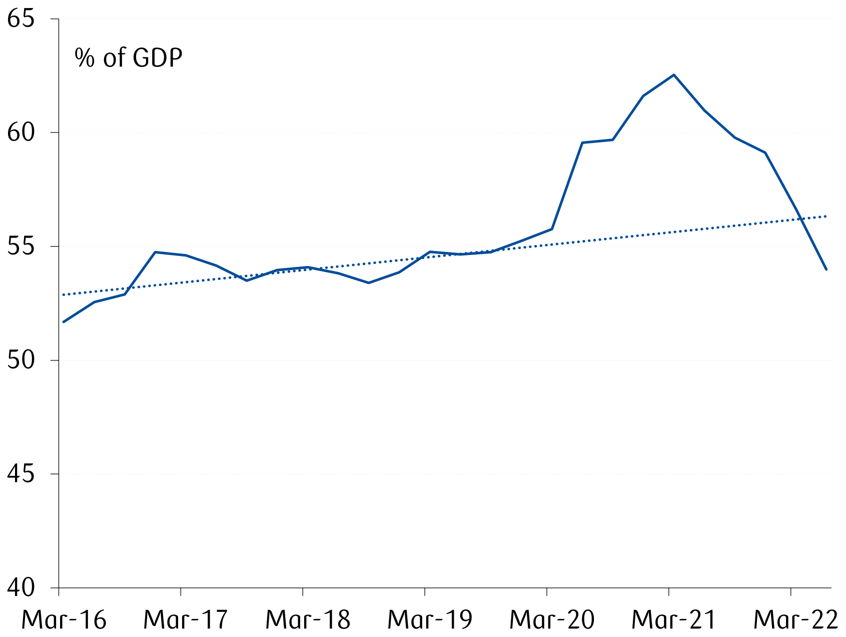
- Disinflation will boost purchasing power of consumers in 2h23 and will reverse the tide of falling consumer demand.
- The reaction of the labor market will be important for consumption – we expect that the economic slowdown will not cause a strong rise in unemployment. Stable labour market conditions accompanied by a two-digit nominal growth of wages and pensions (+13.8% y/y as of Mar-23) will also provide support for consumption.

Consumers’ savings glut has been depleted

Households financial savings*
(cash + deposits + mutual funds)



Households financial savings*
(cash + deposits + mutual funds)



- Excessive savings of households from the pandemic period, which have successfully cushioned inflation shock so far, run out – falling households liquidity won’t support consumption anymore.
- Inflow of refugees from Ukraine increased population of Poland by app. 4% and helped to neutralize consumer demand weakness (by approx. 2% of consumption and 1.2-1.5% of GDP). It will most likely continue in 2023.

*last available data (quarterly financial accounts) for 2q22.

Private investment demand – moderate… at most

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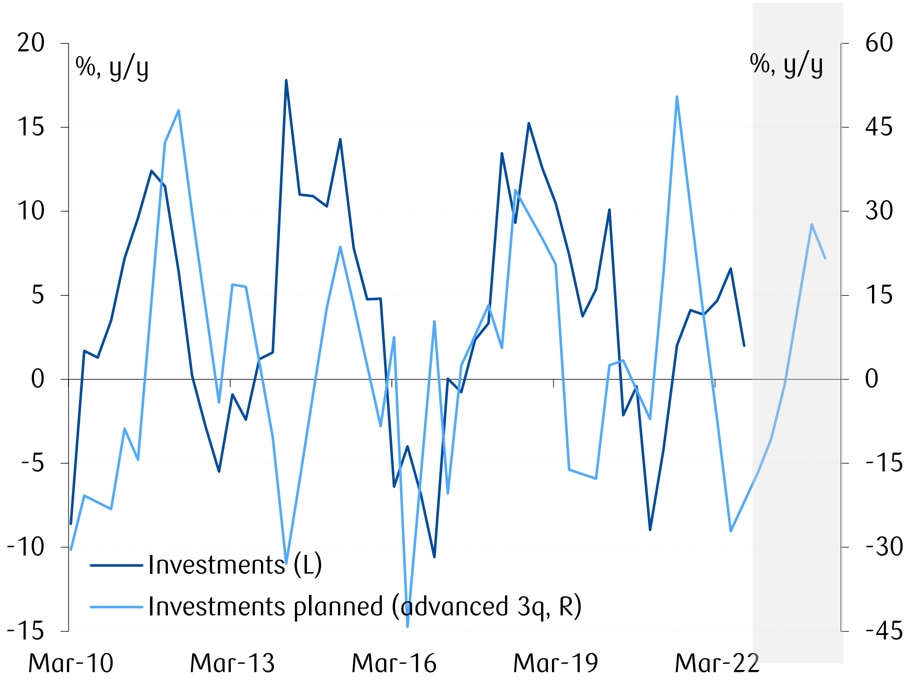
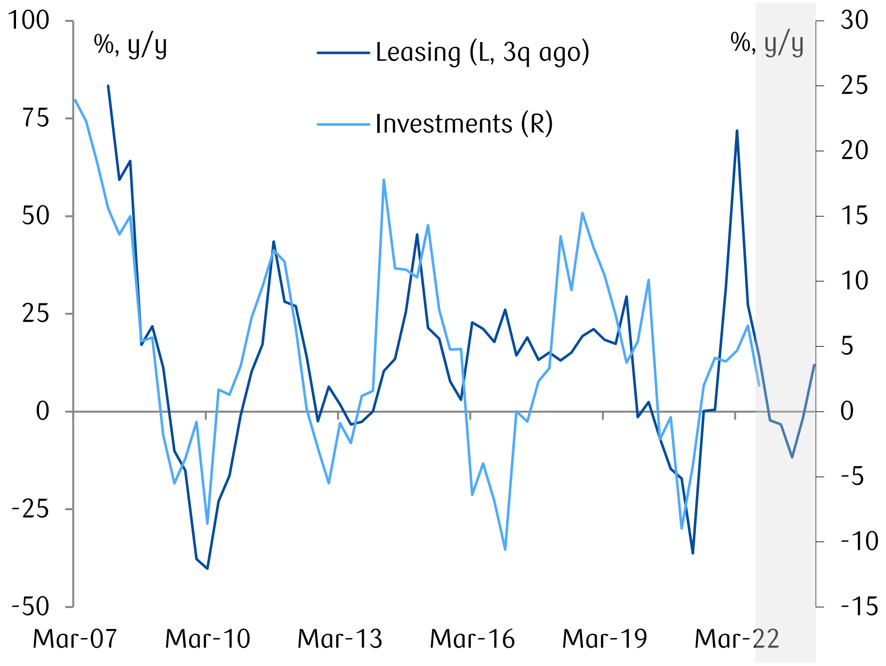
Corporate investment plans vs investments



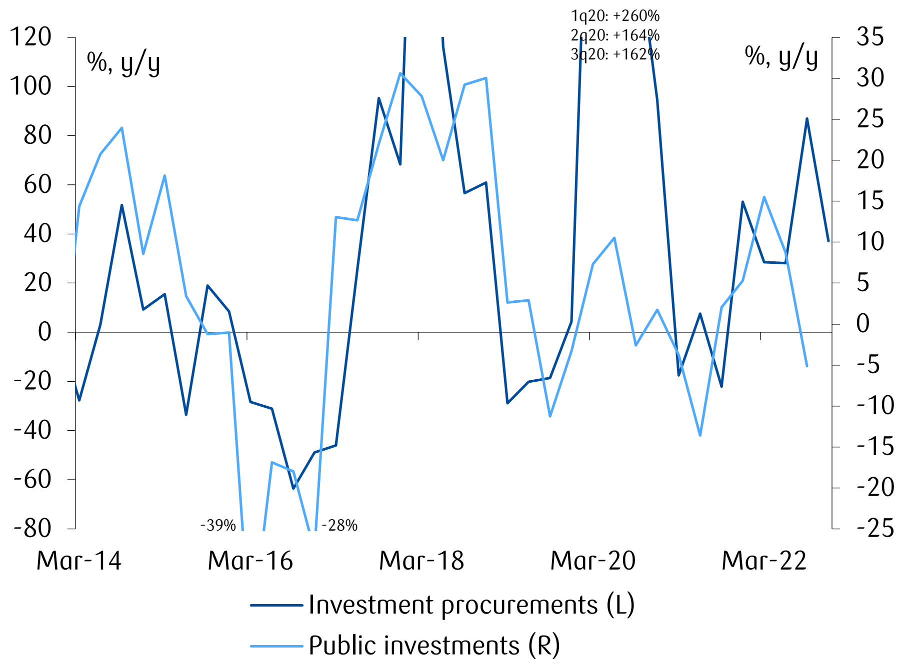
Leasing vs investments



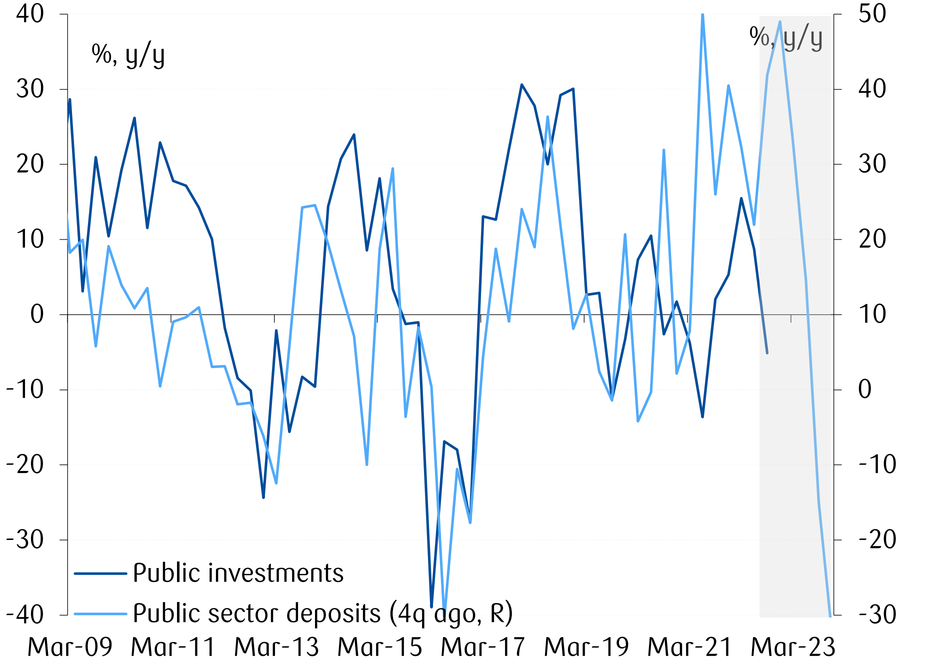
- We stick to our long held view that private investment demand will be at most moderate (+1.3% in 2023 but with hump-shaped quarterly profile). Both corporate investment plans as well as value of assets leased by corporations support our view.
- Investments may turn out to be an unobvious source of GDP growth support. The need to reduce the energy intensity of the economy and the inflow of foreign capital will support investment demand. The chances of a cyclical rebound in investments (which in our opinion has not yet fully occurred after the pandemic) will increase in 2h23.

Public investment demand under inflation and EU funds pressure

Public procurements vs public investments



Public sector deposits vs investments



- Transition between the old and new EU budgets as well as rising prices of investment goods will weigh on public investments (in real terms). Once disinflation continues, it will improve real investments growth rate in 2h23.
- Defense spending (up by ~0.8% of GDP in 2023) will additionally stimulate public investment demand.

Exports fare better than global demand cycle suggests

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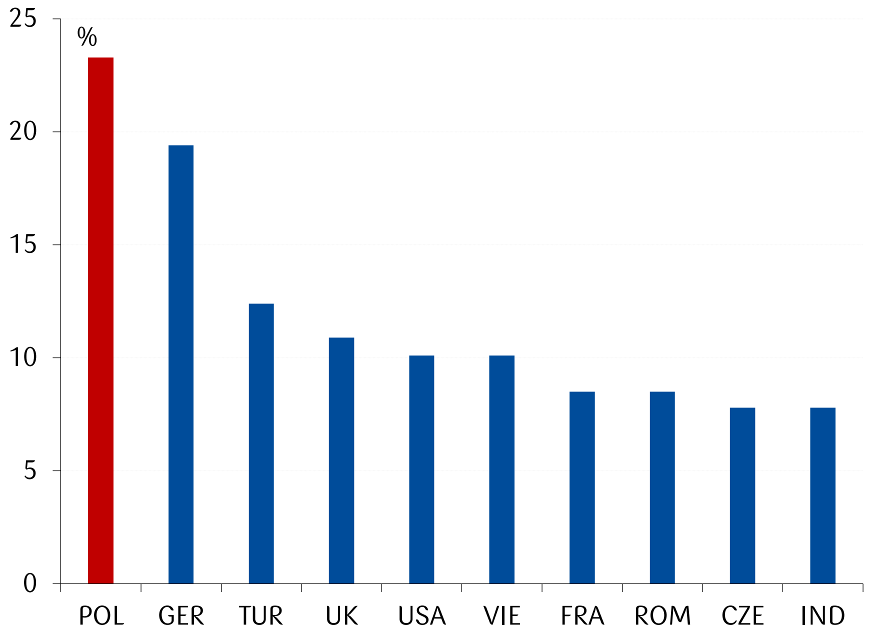
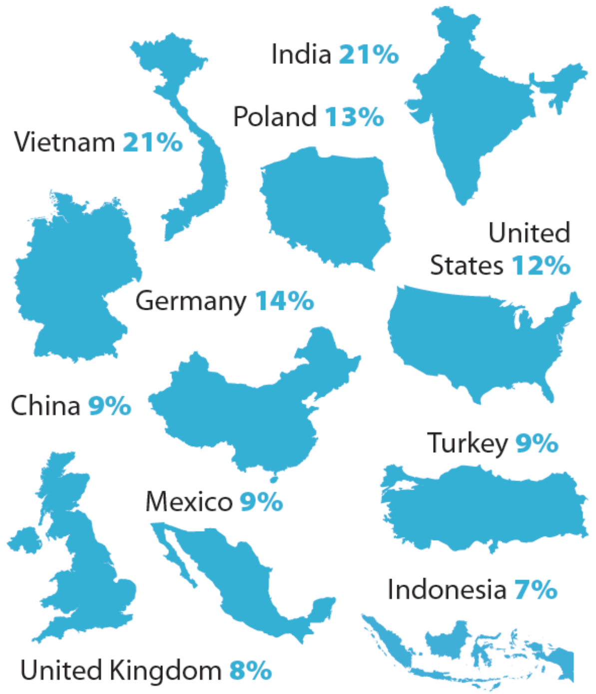
Poland as most favourite nearshoring destination among European corporations



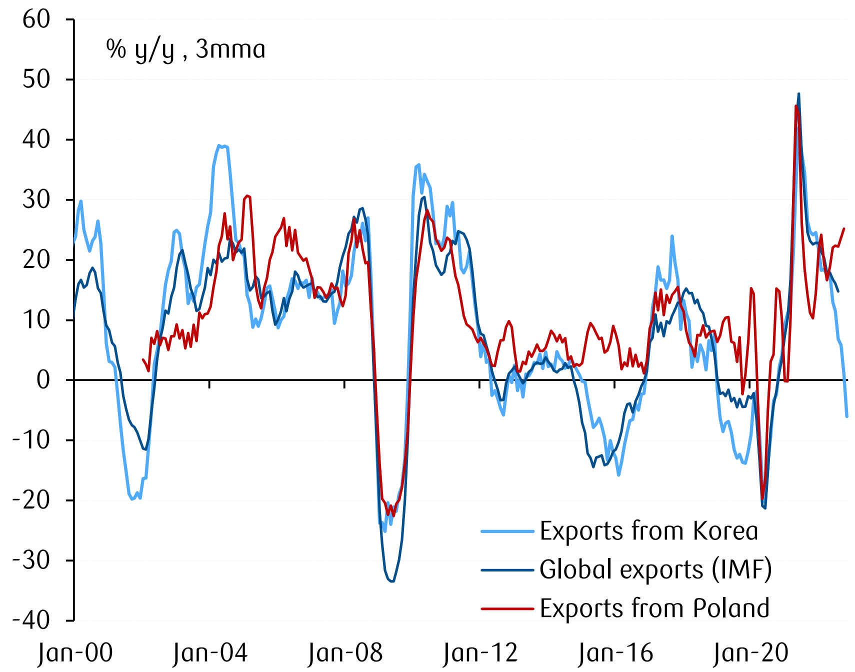
The most attractive individual countries for near-sourcing and reshoring according to Reuters-Maersk study



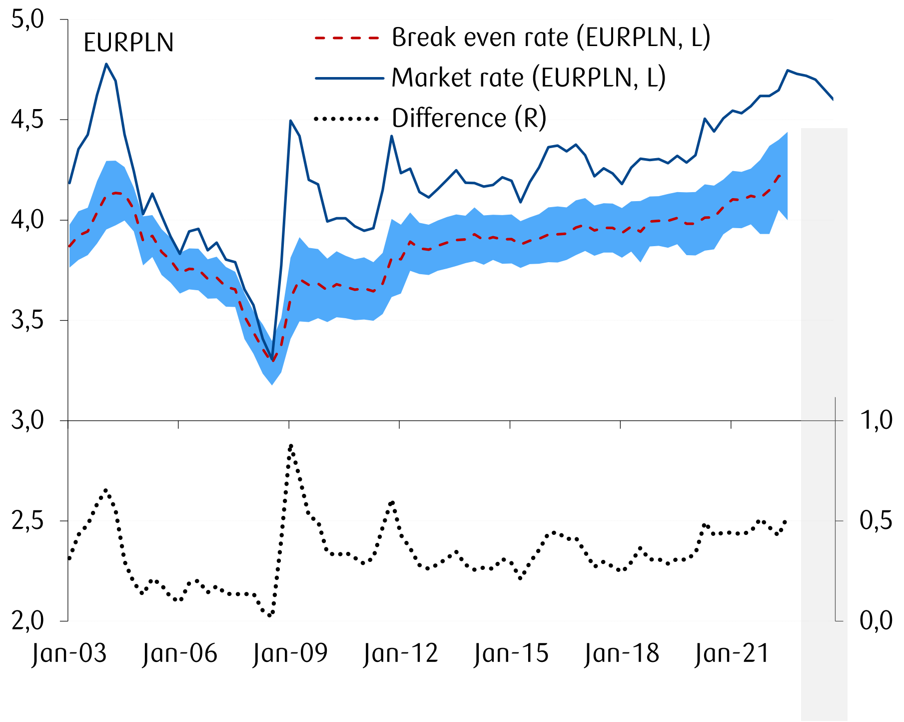
- Reshoring/nearshoring/friendshoring will make Polish exports resilient to the global decline in demand. Poland is one of the main beneficiaries of changes in global production chains after the pandemic, ranking (according to the Reuters - Maersk study) 4th in the world on the list of preferred locations for relocating production. Among European companies, Poland is the number one choice.

Less dependence on global business cycle accompanied by high profitability

Global exports vs exports from Poland



Exports break-even EURPLN rate



- Poland can withstand global downturn also thanks to undervalued PLN, which additionally boosts exports competitiveness.

EU Recovery Plan (KPO), if kicked-off, may neutralize the negative credit impulse

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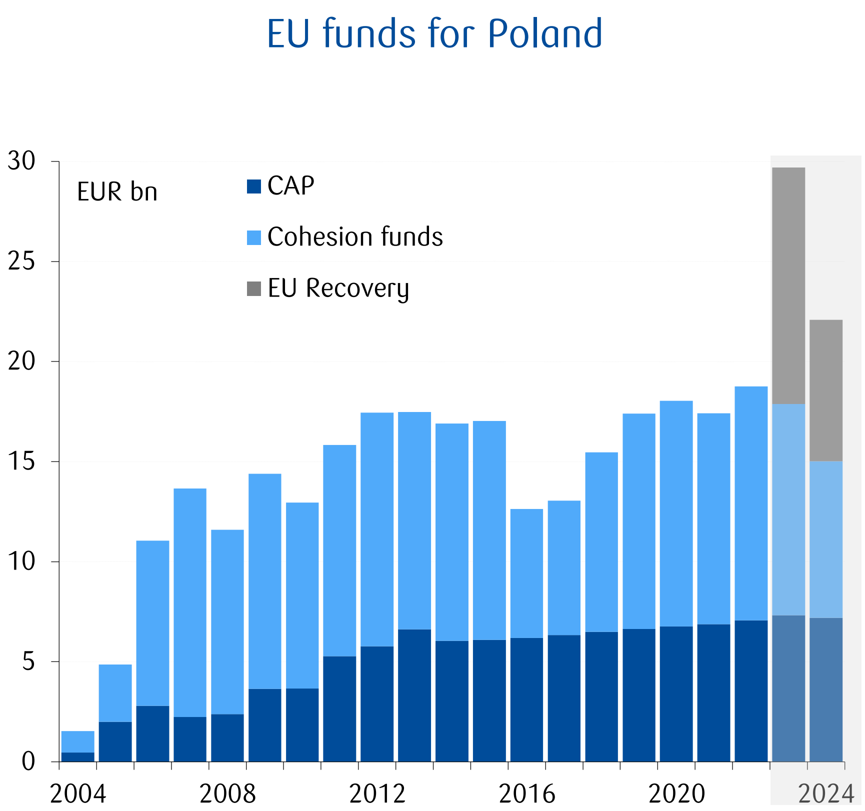
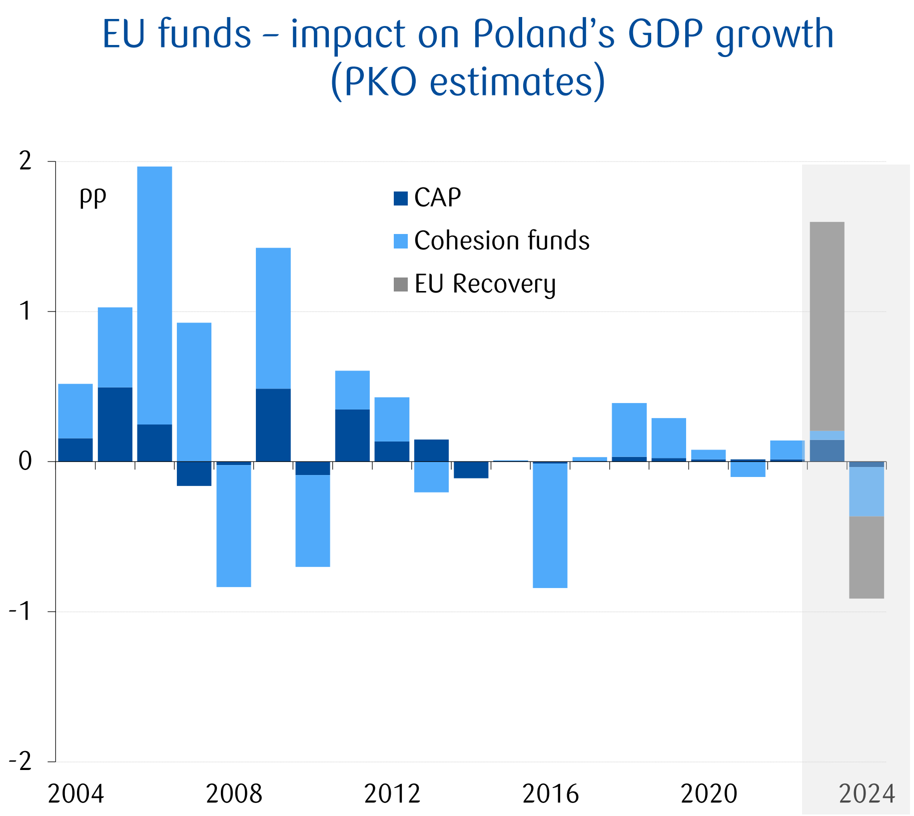


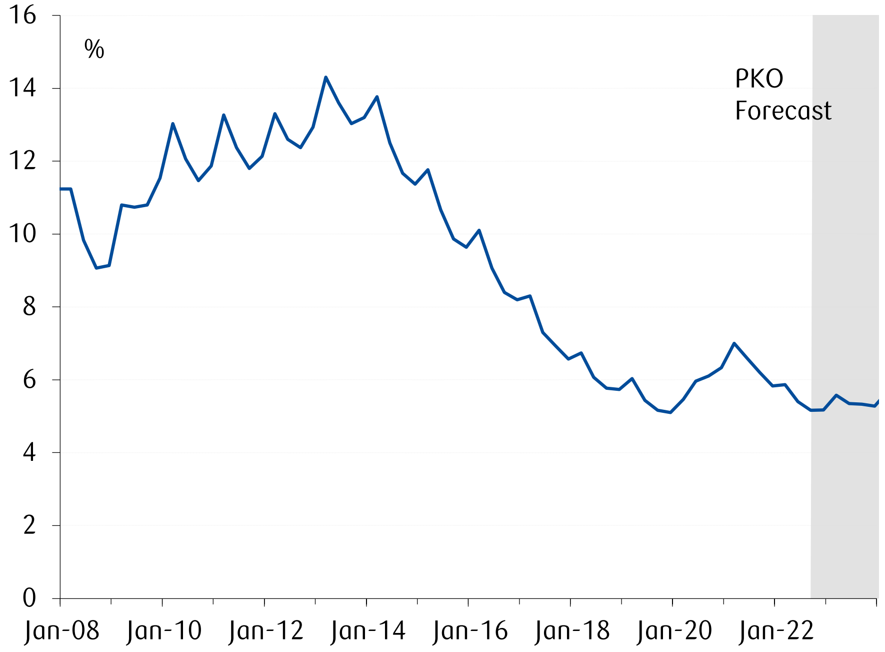


- A dispute with the EU over the Domestic Recovery Plan (KPO), if solved, may both support GDP growth rate in 2023 and also plug some hole in the current account deficit financing. As the KPO has already been fully agreed with the EU, it's the milestones to trigger the funds that matter now. Recent declarations of government officials suggest that chances of KPO kick-off increased substantially.

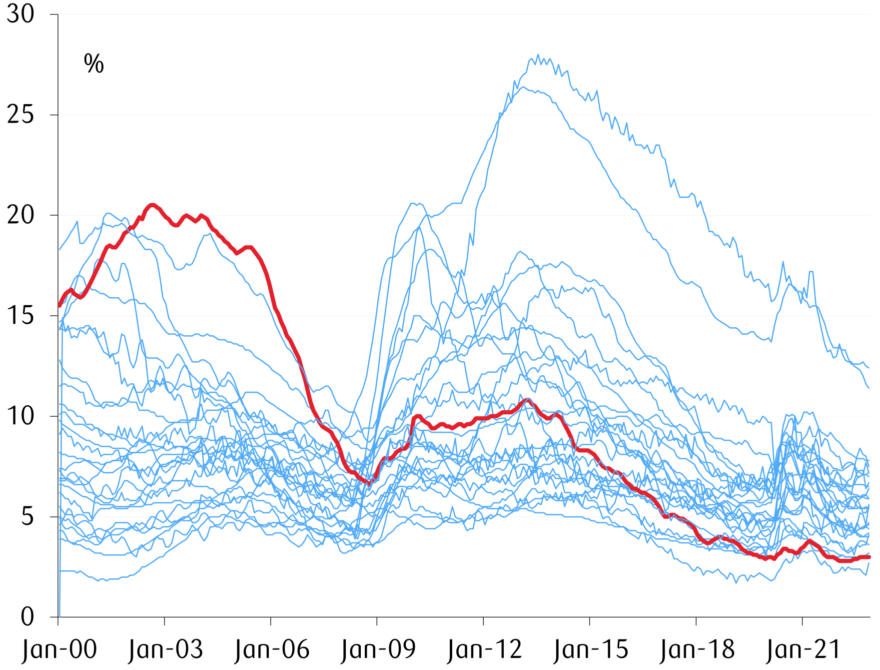
#3 Labour market: lower real wages, stable unemployment

Labour market situation remains favourable

Registered unemployment rate (local methodology)



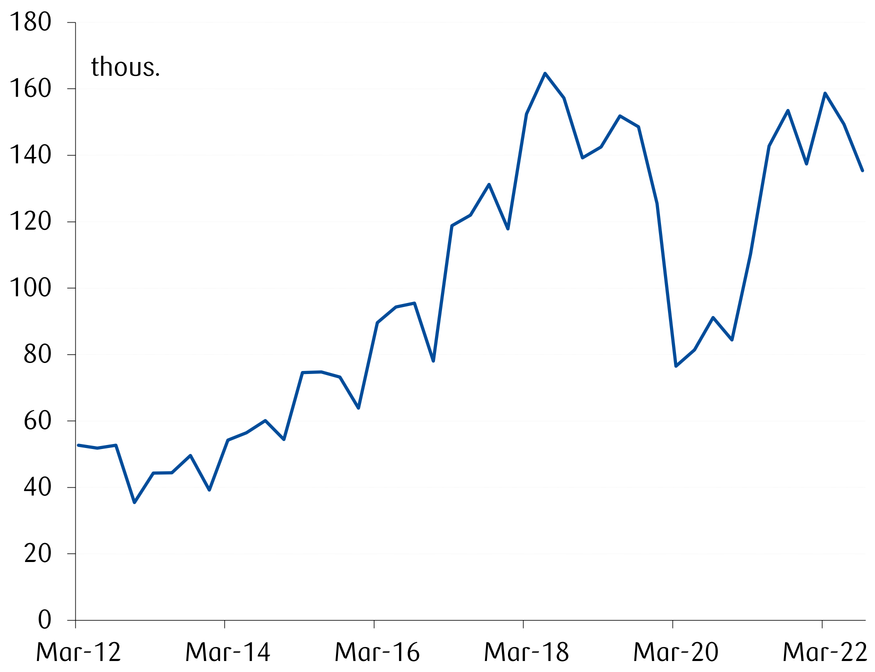
LFS unemployment rate (EU methodology): Poland – red line; all other EU states – blue lines



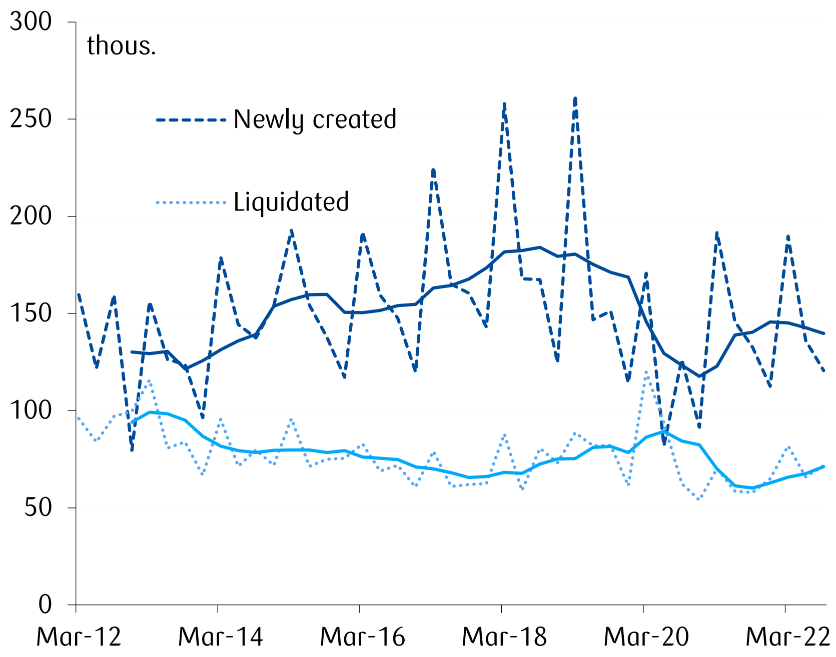
- Limited labour supply amid relatively good economic conditions has been pushing unemployment rate to record low levels, close to 5%, even despite the sudden and significant inflow of refugees from Ukraine since February 2022. This has put some pressure on nominal wages which grow at a double-digit rate. However, elevated inflation means that in real terms wages have been decreasing.

There are some signs of a deterioration in labour market conditions

Vacancies



Jobs in the national economy



- Demand for labour decreased somewhat in 2022, but the number of vacancies remains relatively high in historical perspective. Number of newly created jobs has entered a downward trend, but remains clearly higher than the number of liquidated positions.
- Although the highest number of newly created jobs was in the ‚trade and repair of motor vehicles', its ratio to liquidated positions was among the lowest and stood at 1.4., while the highest ratio was recorded for public administration and HoReCa sectors.

Slowdown in wage growth will be the main channel of labour market adjustment to a deterioration of economic conditions

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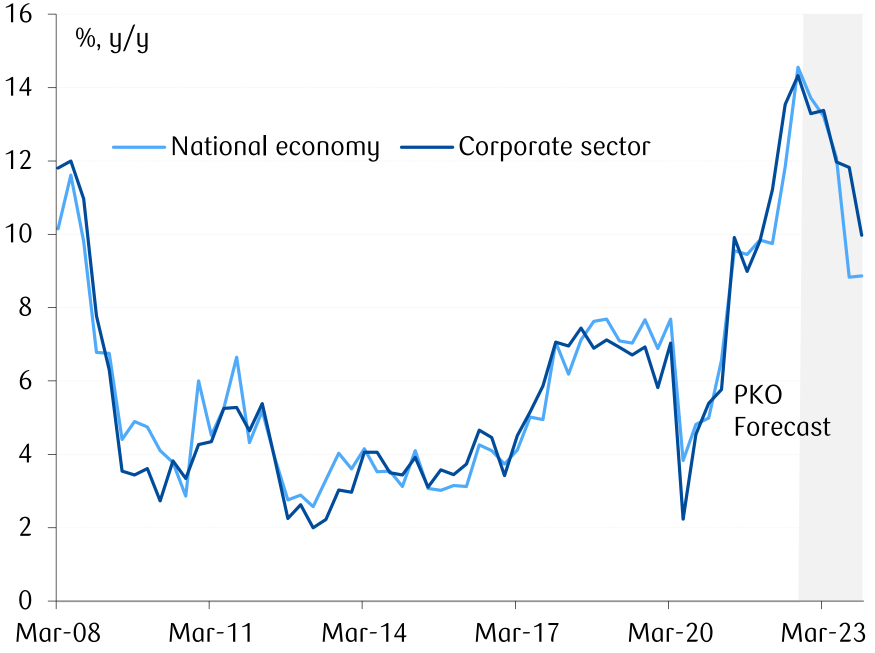
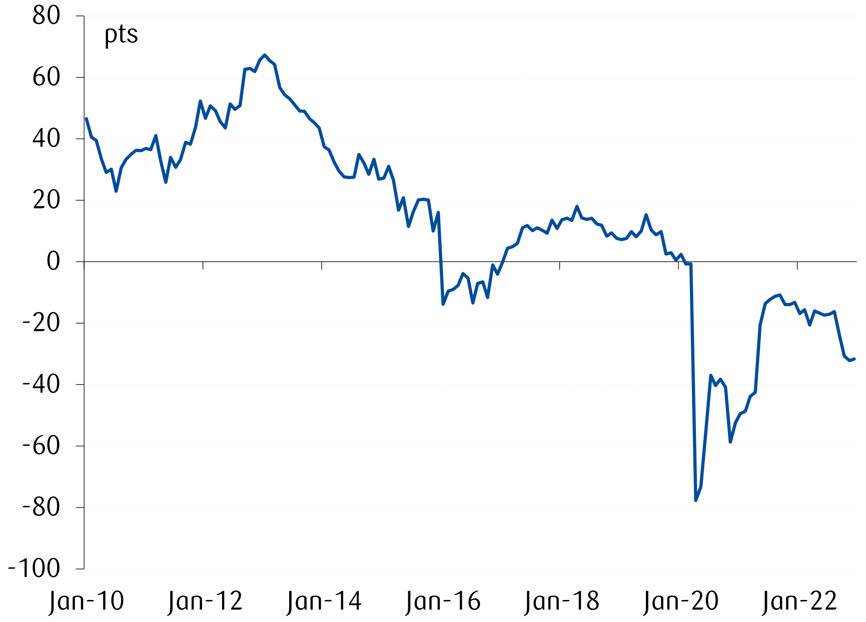
Nominal wage growth



Consumers' sentiment regarding unemployment trends in the next 12 months (with inverted sign)



- Rising consumers' fears of unemployment together with a relatively high rate of flexible components of wages (e.g. bonuses) imply that the labour market adjustment to deteriorating economic conditions will occur primarily through decelerating growth in nominal wages (weakening negotiating power of employees and higher propensity to accept lower wage amid worse consumer economic situation).

Minimum wage will be hiked by nearly 20% and it is likely to have a regionally diverse impact

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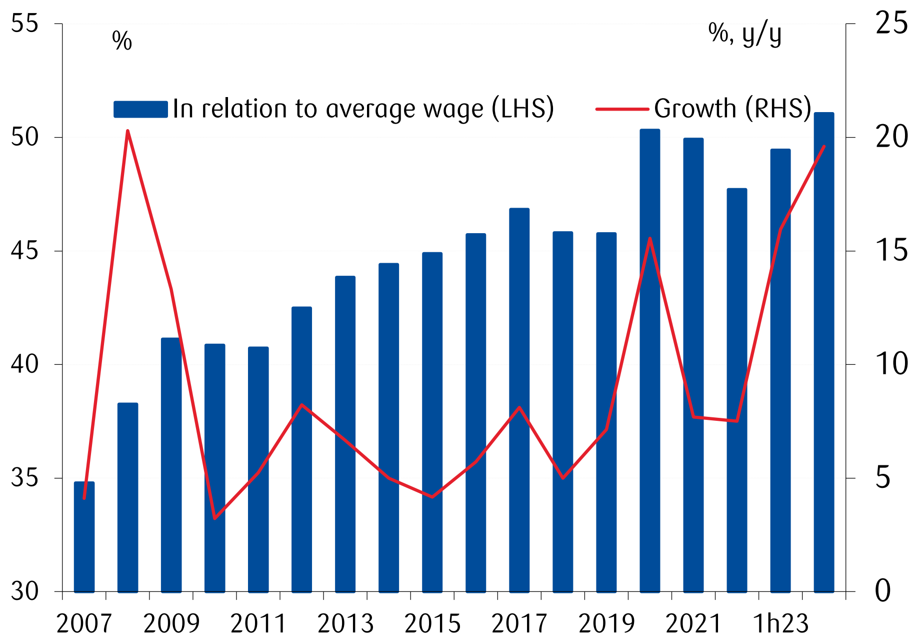
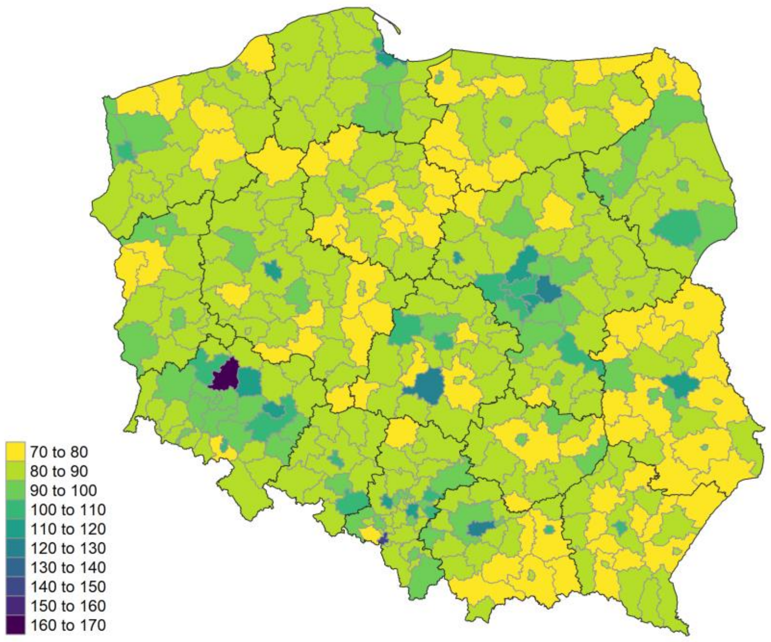
Minimum wage growth and its level in relation to the average wage in the national economy



Average wage in Poland's districts in 2021 (average national wage=100)



- As a result of the increase, the minimum wage will exceed 50% of the average wage in the national economy, which can constitute a relatively high cost burden for entities operating in Eastern Poland and for the smallest enterprises where the average wage is lower.

The new minimum wage will not affect Poland’s competitiveness

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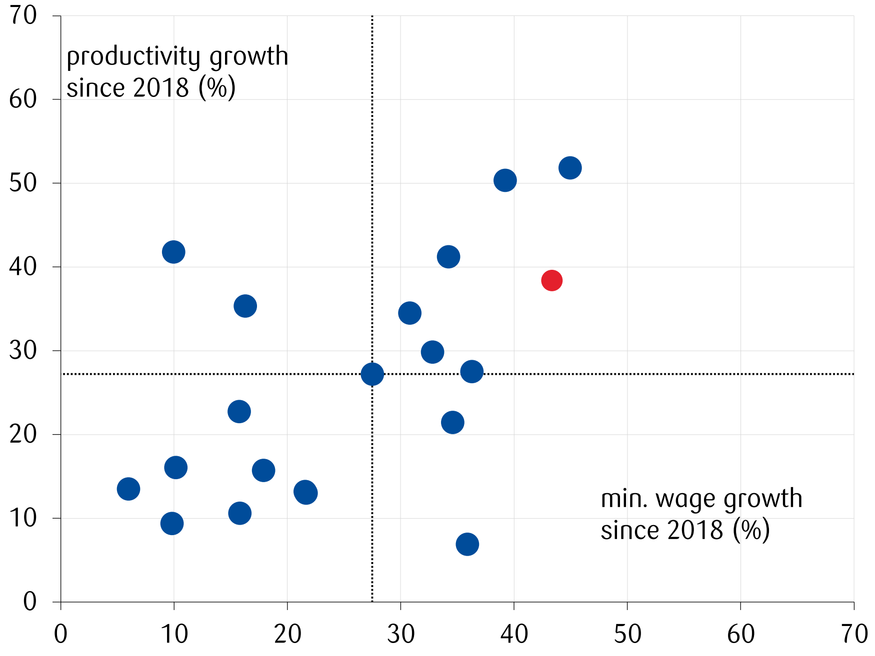
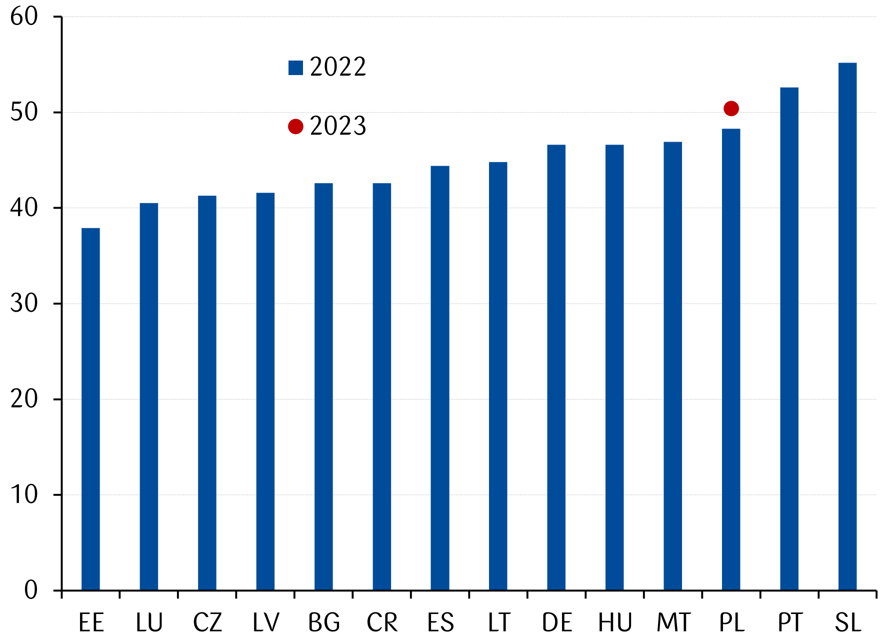
Minimum wage growth vs productivity growth (from 2018 to 3q22)



Minimum wage as the percentage of average wage in the private sector in the EU



- Minimum wage increase should not affect Poland’s competitiveness since in the past such increases where accompanied by an equivalent rise in productivity.

Unemployment rate will increase only modestly

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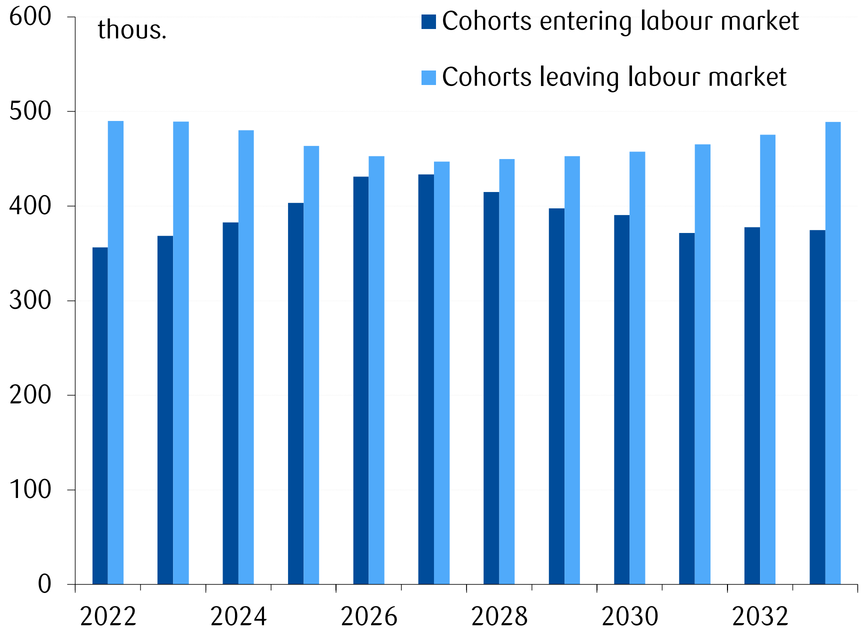
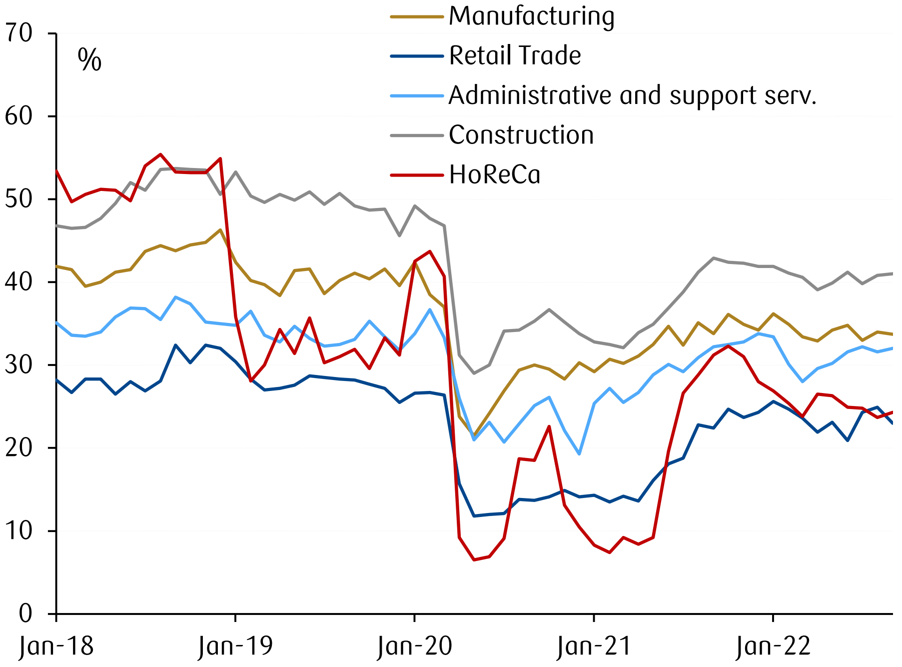
Shrinking labour supply



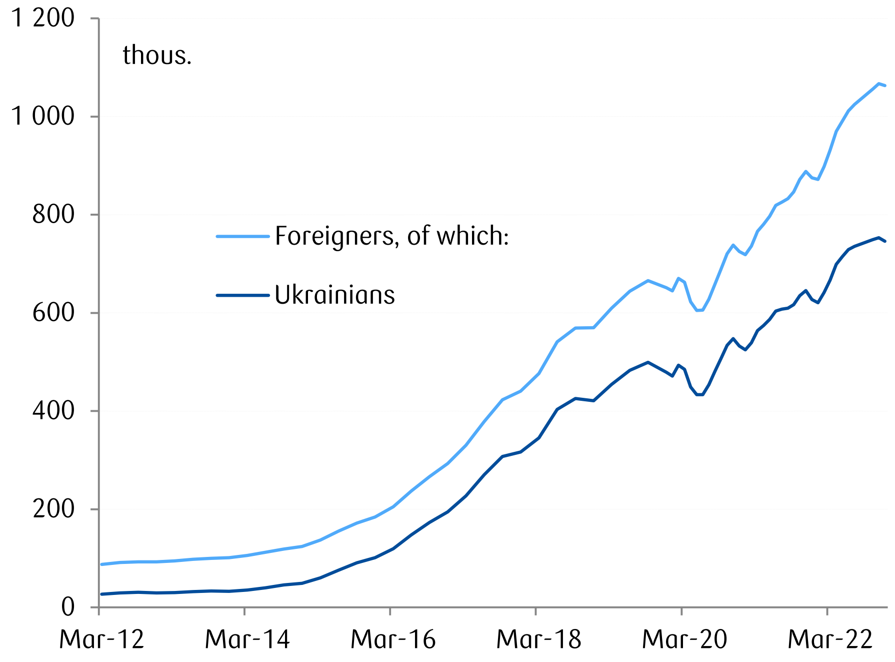
Enterprises reporting difficulties in finding qualified employees



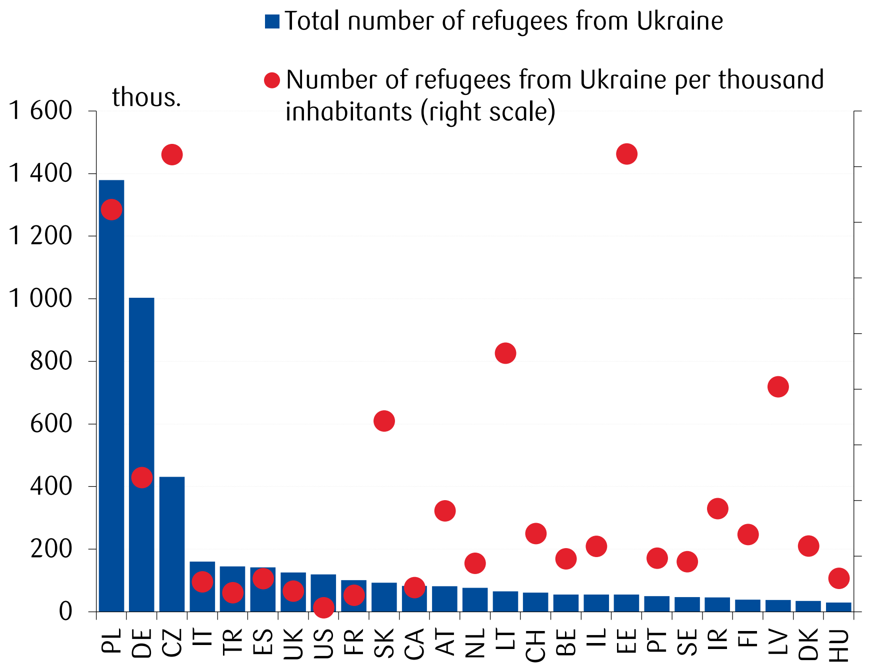
- High number of vacant places implies that an increase in unemployment rate in the near term is going to be very modest. This view is supported by demographic changes causing a decline in labour supply (increasing number of people leaving the labour market accompanied by fewer labour market entries). Moreover, enterprises are likely to hoard employment amid difficulties in finding qualified staff and the ability to adjust labour costs through the flexible components of wages.

A dual nature of the labour market

Foreigners insured in the Social Insurance Institution (ZUS)



Number of refugees from Ukraine



- Due to a dual nature of the Polish labour market, a rise in unemployment is likely to take place mainly among temporary workers, in particular immigrants.
- Estimates regarding the employment of immigrants from Ukraine are subject to high uncertainty. However, an increase in labour supply due to an inflow of refugees may be approximated by their share in Poland's population which is close to 4%.

Potential scenarios for further inflow of labour force from Ukraine

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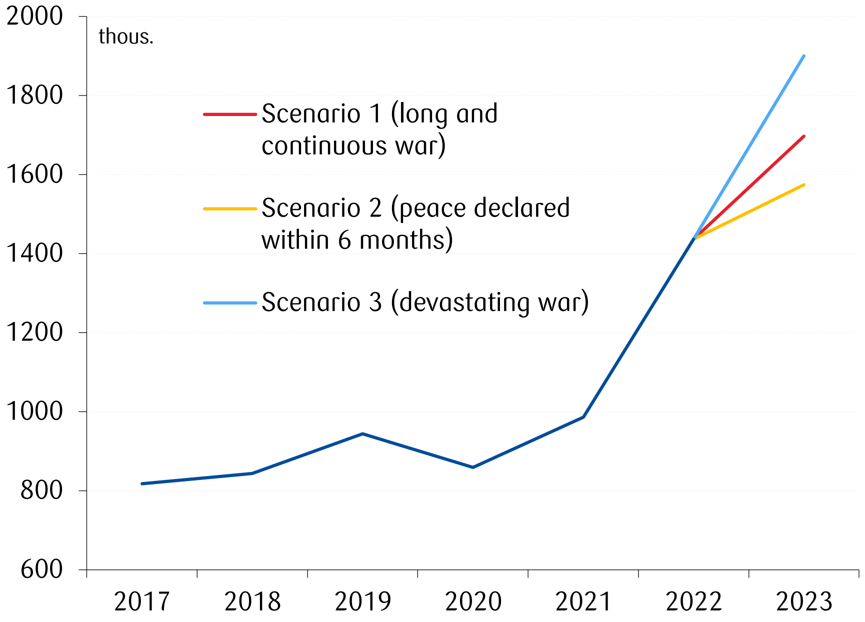
Estimated number of migrant workers from Ukraine



- Depending on different scenarios regarding the course of the war, estimates suggest that in 2023 approx. 150 thous. to nearly 460 thous. new refugees could take up employment in Poland.
- In such scenarios, the share of migrant workers from Ukraine in the labour market could be between 9.5 to 11.5%.

Potential sources for mitigating the labour supply shortages

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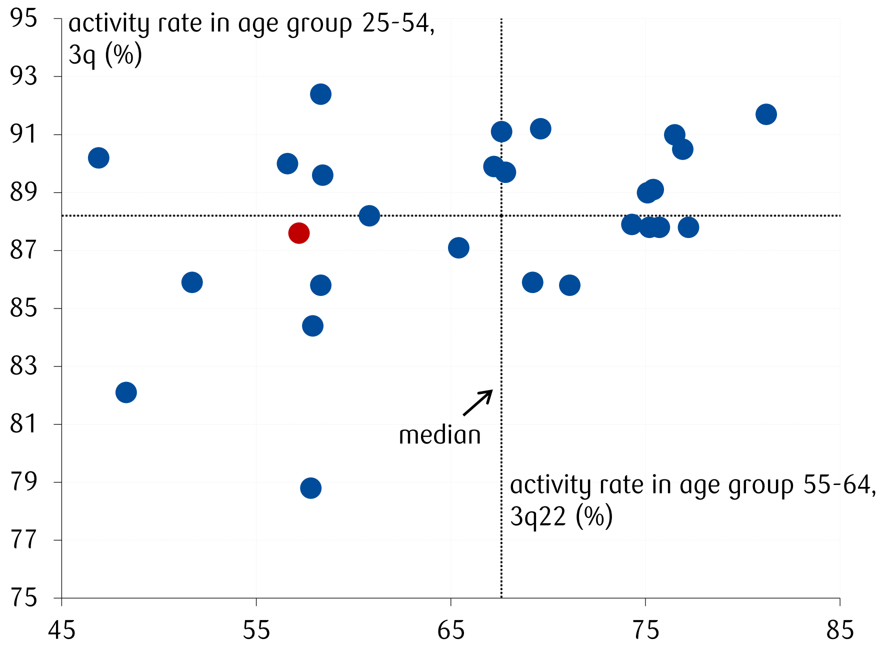
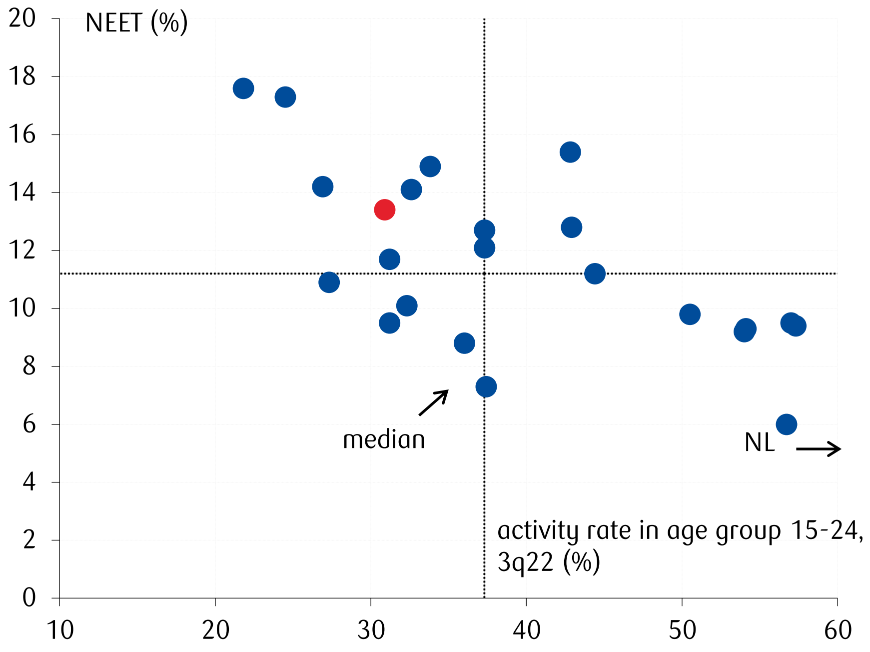
Activity rates at prime age and close to the retirement age



Activity rate among young people and the share of those not in employment, education or training (NEET)



- In the short-term labour supply will be boosted mainly by a strong migration from Ukraine. In the medium and longer-term labour tightness may be eased by higher participation rates of the youth and people close to the retirement age, which will nevertheless depend on the implementation of many activating initiatives.

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#4 Inflation outlook: disinflation with sticky core inflation

CPI inflation on a slide, but target is still far away

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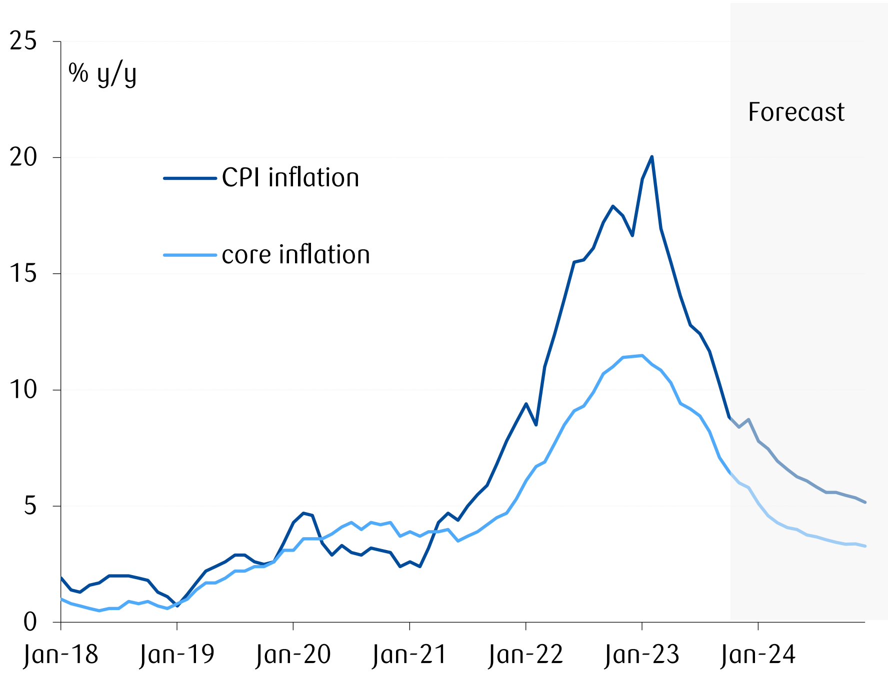
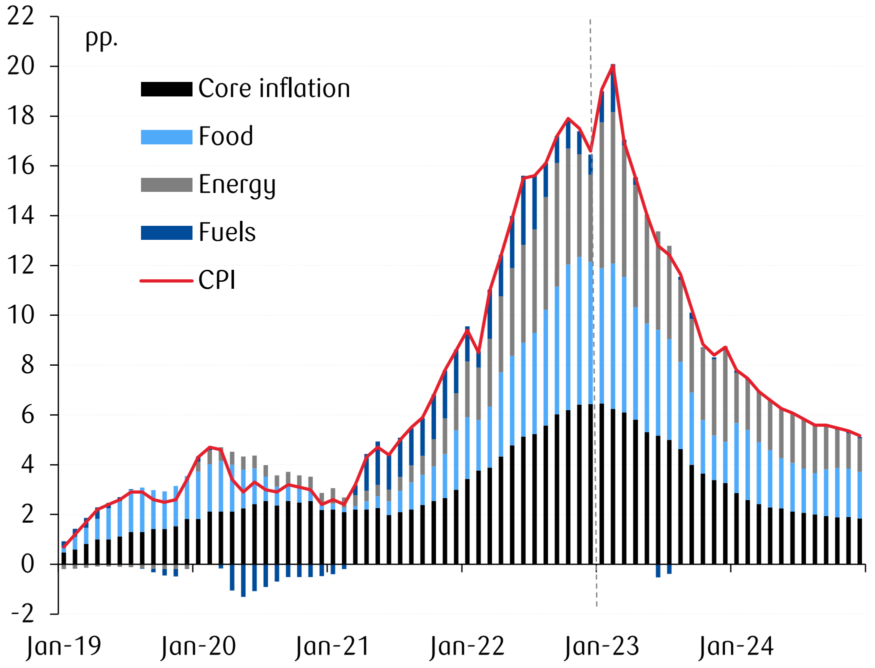
CPI inflation peak is just around the corner



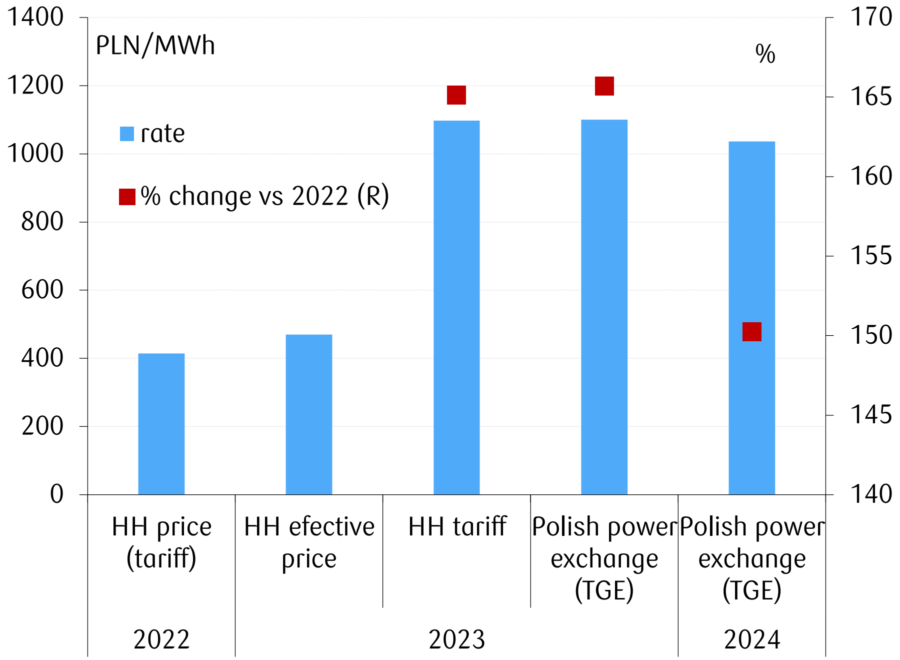
Declining core inflation and fading energy shock will push inflation down



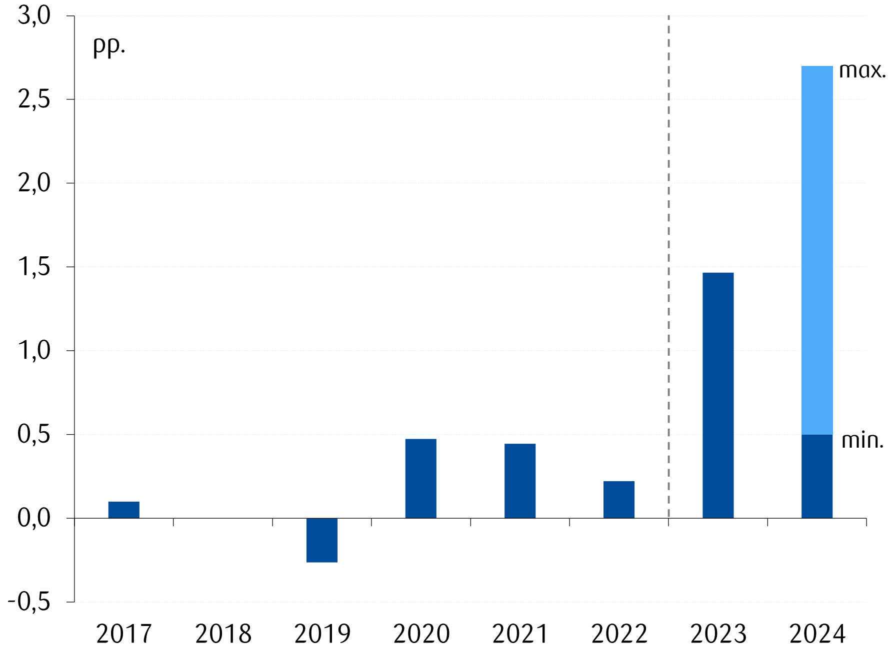
- 2023 will be a year of disinflation. We forecast that by the end of 2023 the headline CPI inflation will decline by over 10pp compared to its peak expected in February. However, the road towards the inflation target (2.5% +/-1pp) will be long and bumpy – it might be reached in 2025 at the earliest.

Energy prices – the biggest anchor for elevated inflation

Market, regulated and effective^ energy price for households



Electric energy contribution to the CPI



- (Electric) Energy prices are the key long term pro-inflationary factor, which might keep CPI inflation in Poland above the target. As retail prices are regulated, the surge in market prices that occurred in 2022 has not fully impacted the HH bills. In 2023, due to protective measures, prices for retail customers will reflect less than 1/10 of the scale of the market price increases. This creates a significant inflation ballast for the coming years and might add as much as over 2pp to the CPI inflation in 2024.

^ in 2023 the new HH tariff prices will apply to app. 20% of energy consumption by the HH sector

Would it be possible (reasonable) to make the CPI decline faster?

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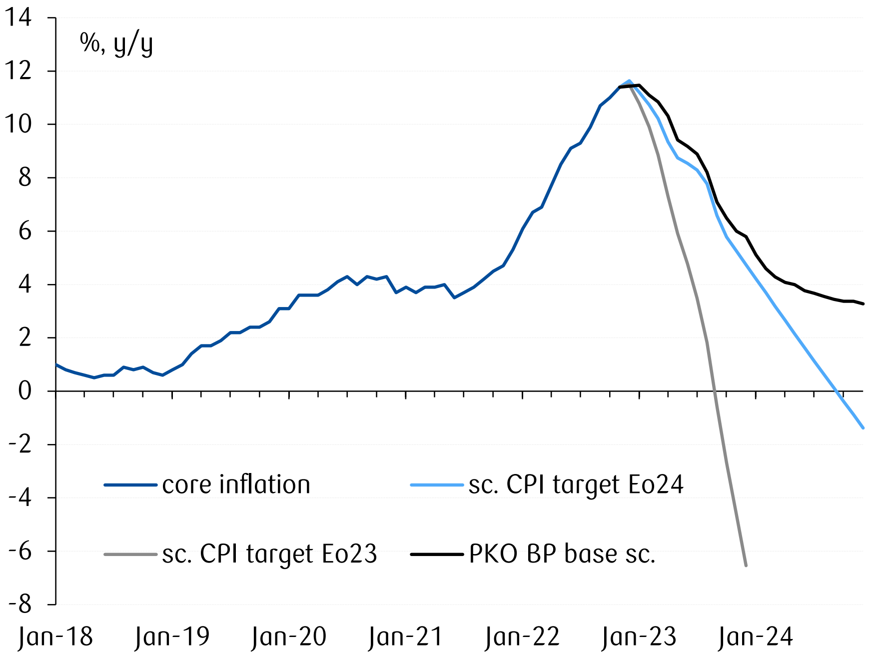
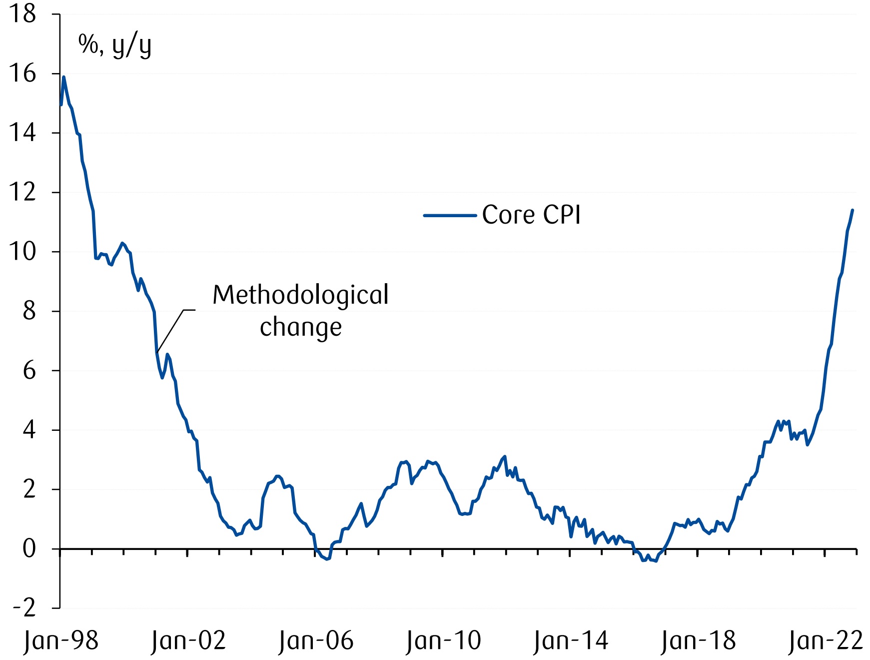
A hypothetical path of core inflation leading to the return of CPI inflation to the target at the end of 2023 or 2024



The history of core inflation in Poland



- For some commentators the fact that the CPI target might be reached in 2025 at the earliest is a strong argument in favour of further interest rate hikes. Taking into account the ‚energy balast' and assuming CPI neutral commodity prices, would it be possible to make the CPI decline faster and reach the target at the end of 2024 or even 2023?
- Theoretically yes, but to reach the CPI target earlier the core inflation would have to decline rapidly, much stronger than ever before, at rates which can be attributable only to a period of rapid and drastic demand declines.

Weakening demand should trigger core inflation decline

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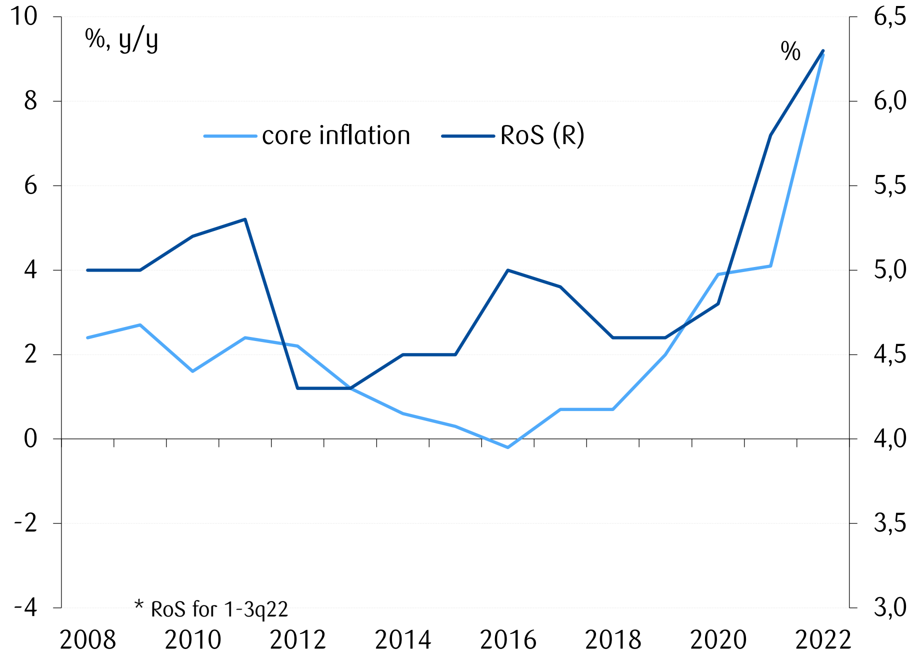
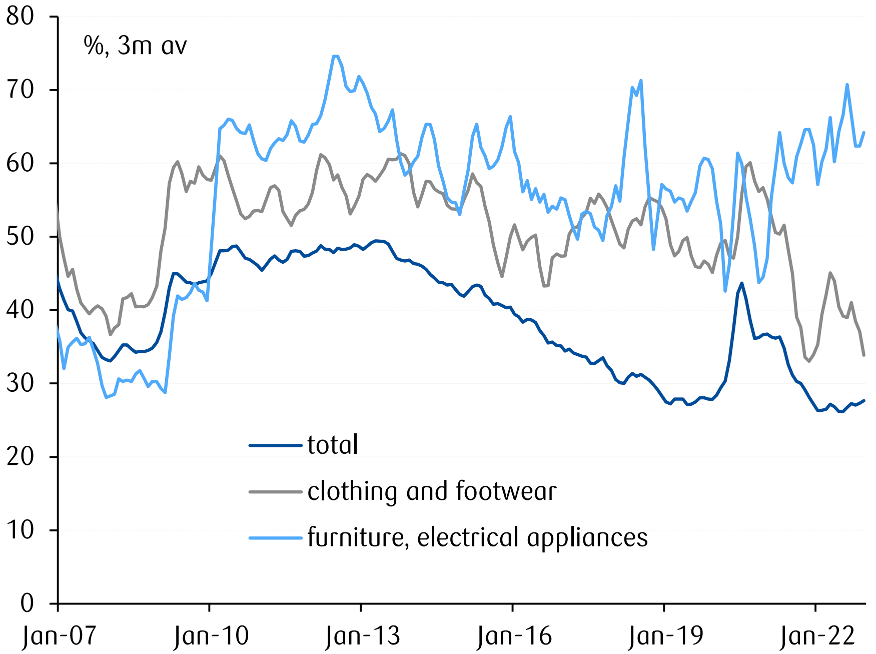
Core inflation vs return on sales* as a proxy for margins



Share of retail companies facing insufficient demand



- Declining real incomes are limiting private domestic consumption, although this effect is partly neutralised by the ‚new' demand coming from migrants. Nevertheless, already in 3q22 private consumption was stagnating, and in our view in 4q22 it has started to decline in y/y terms. Declining demand normally results in rising price competition – leads to declining margins, reduces price pressures and pushes down core inflation. This is our scenario for 2023.
- The decline in core inflation won't be fast and is not granted – economic sentiment surveys show that despite stagnating demand the share of retailers facing insufficient demand is still relatively low, and started to rise only in the furniture / electrical appliances sector.

Fading shock in energy and fuel prices will push inflation down

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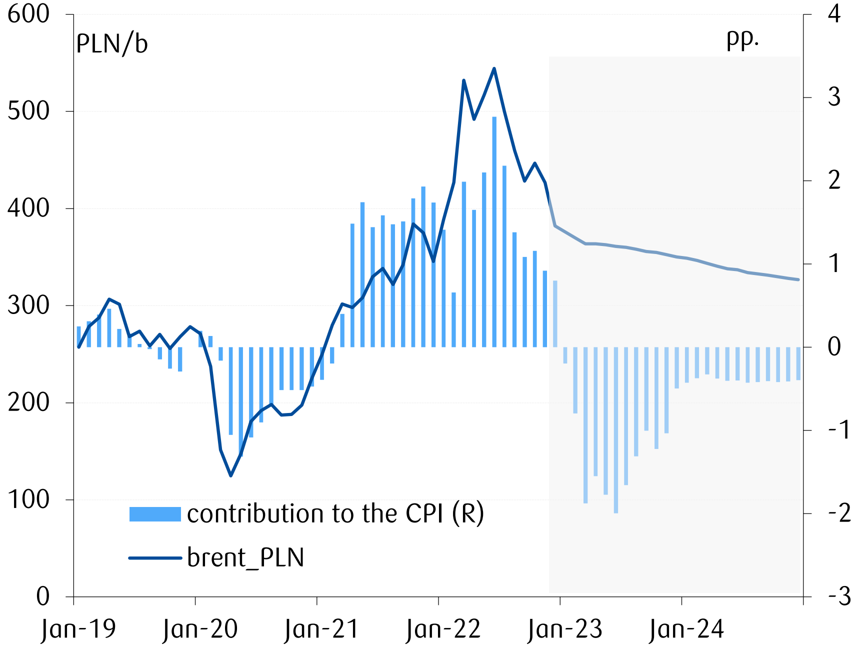
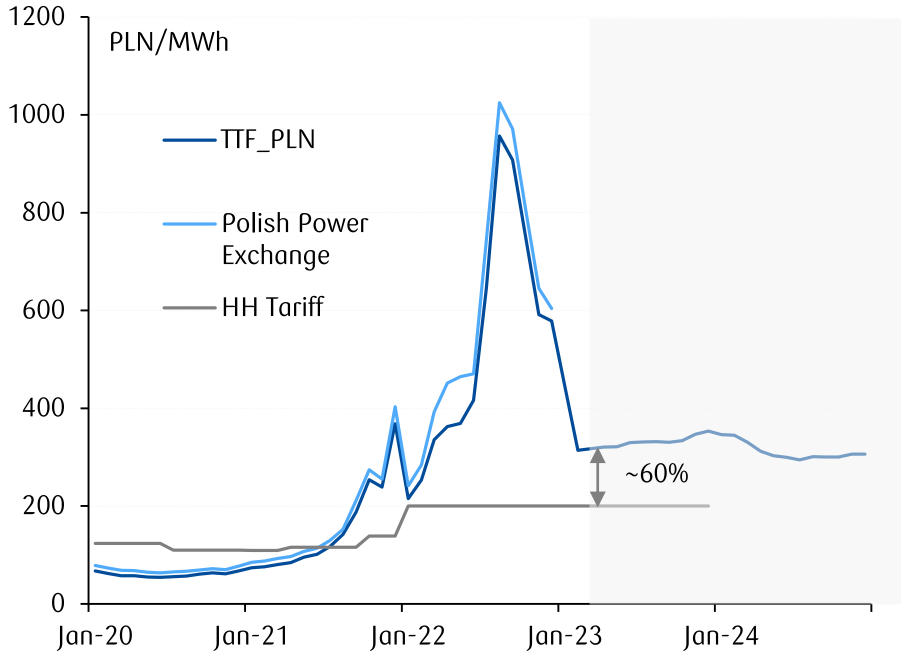
Fuel prices and their impact on CPI inflation



European and local gas prices



- Fading shocks in global fuel and European natural gas prices will help to reduce the CPI inflation. Taking into account the current future contracts for crude oil (Brent) and our FX forecasts, the disinflationary impact of fuel costs (excluding changes in margins or taxes) will be almost as large as its proinflationary impact in 2022.
- The massive decline in natural gas prices will mainly impact the CPI inflation indirectly, via lower cost pressure. As in the case of electricity, natural gas prices for households are capped for 2023, at around 40% below the current market level.

Food inflation on a downward path

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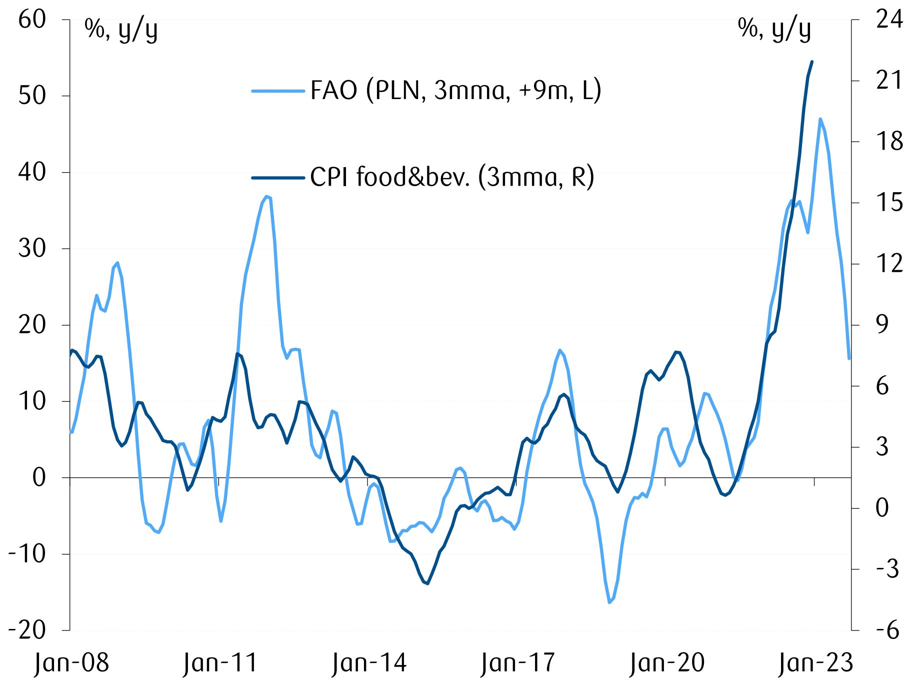
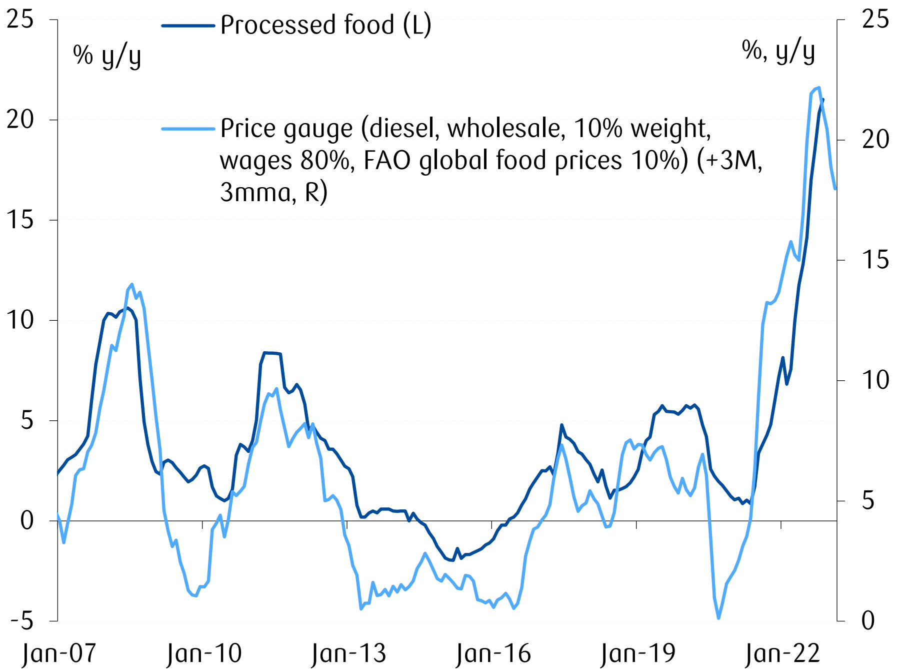
FAO vs local food prices



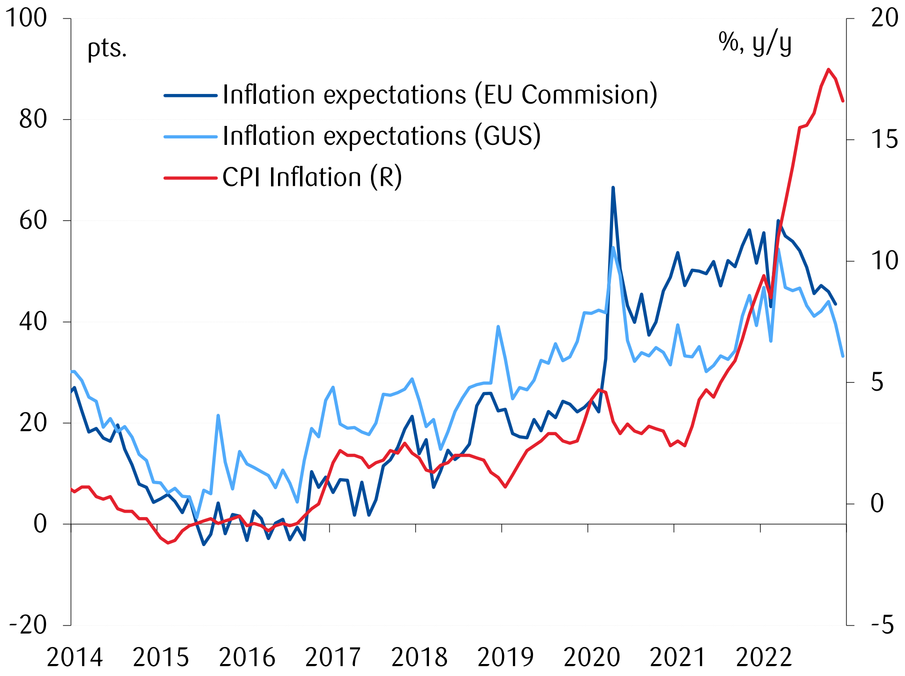
Food production costs (proxy) vs food prices



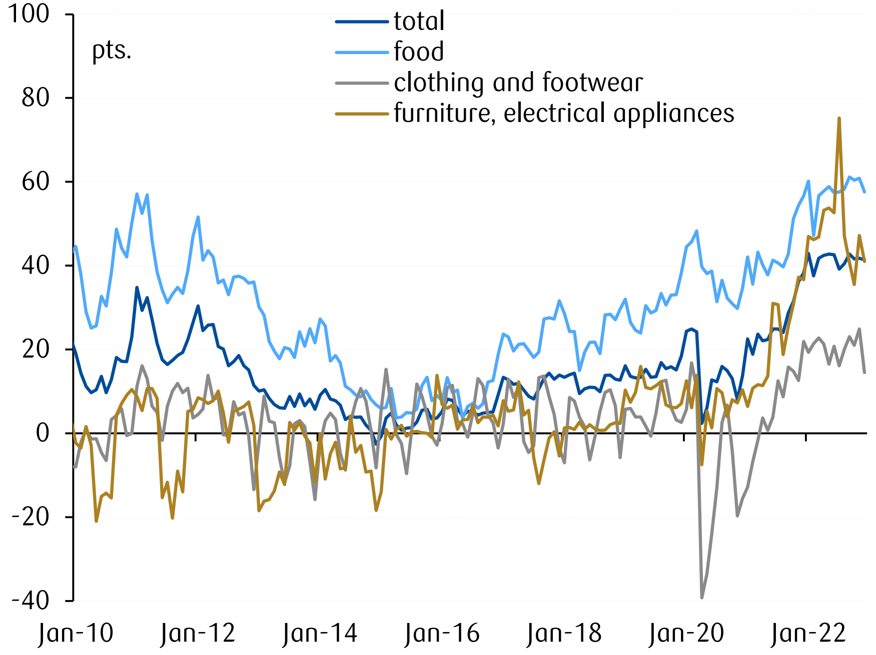
- Global food prices (measured by FAO) follow the trends seen among other commodities. In the face of still undervalued PLN the strength of global food prices disinflation in PLN terms is weaker, but still suggest that the domestic food inflation has likely reached its peak and should start to gradually decline.

Inflation expectations started to decline

Inflation expectations (households)



Price expectations among retailers



- Consumer inflation expectations surveys in Poland are difficult to interpret (the share of population expecting stable or rising inflation has never declined below 40%, Poles tend to strongly overestimate the current level of inflation), but they clearly show that the peak in inflation fears has already been passed. Declining inflation expectations of households might reduce their willingness to accept higher prices, especially amid decline in real incomes.

#5 Monetary policy: rate cuts on the cards

The fastest and strongest rate hikes cycle ever

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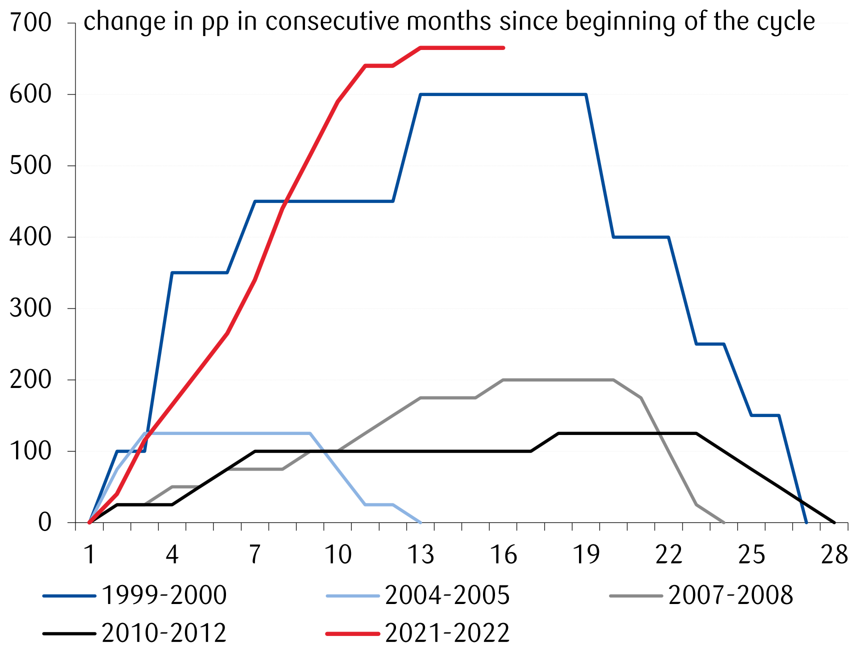
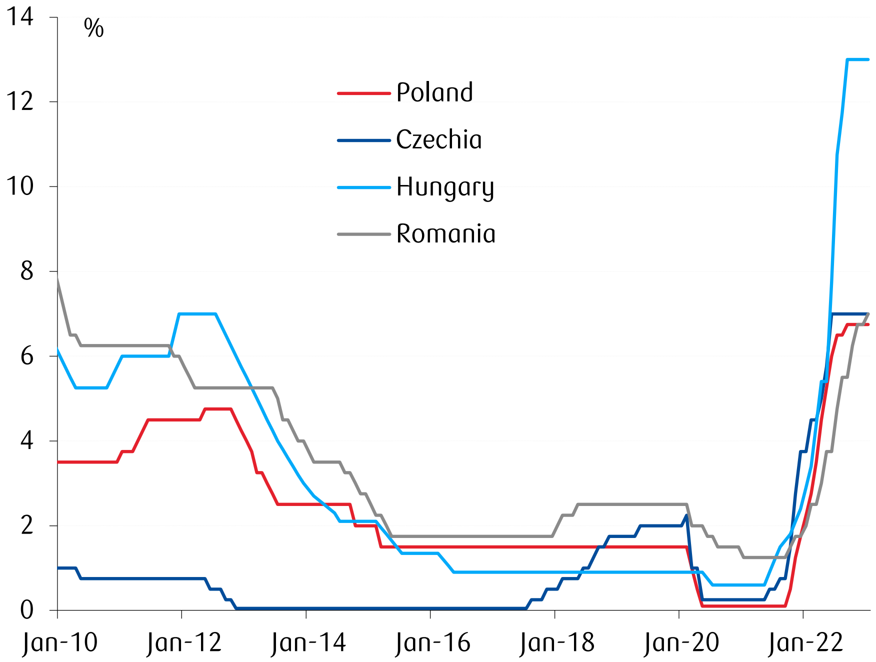
Current cycle of rate hikes vs. previous ones



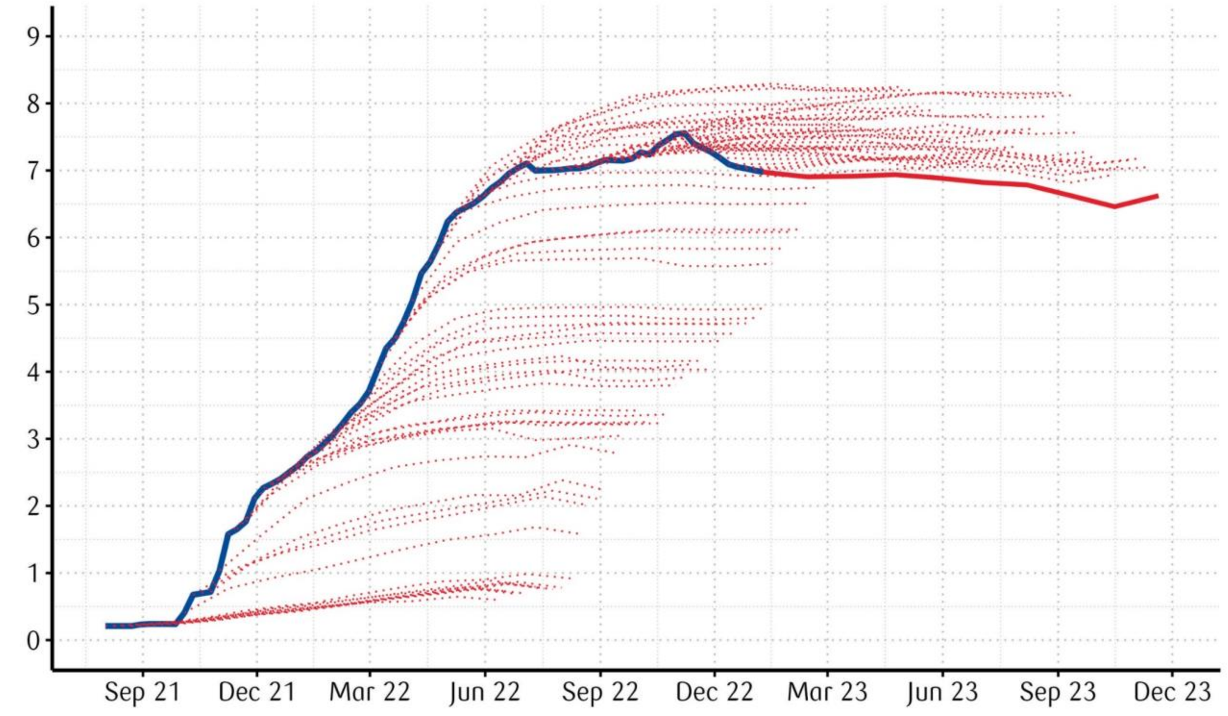
Central banks' rates went up in the whole region



- Inflation shock has prompted a record-strong and a record-fast cycle of interest rate hikes in Poland. Similar reaction of monetary policy has been observed in other CEE economies.
- Now most banks in the region are keeping rates on hold while waiting for the effects of earlier hikes to materialize.

Markets have started to price in rate cuts before the end of 2023

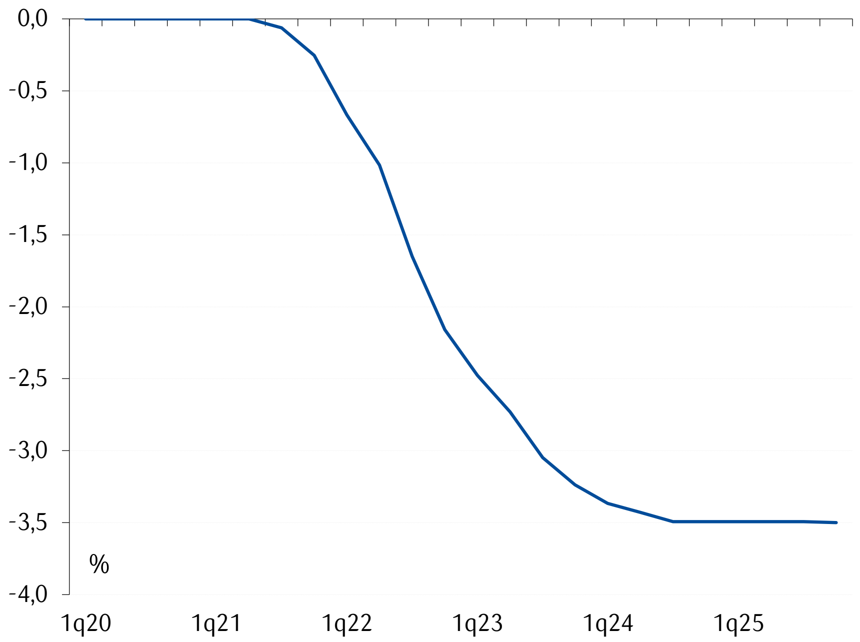
Market expectations (actual WIBOR3M – blue line; WIBOR3M implied from FRA curve – red line)



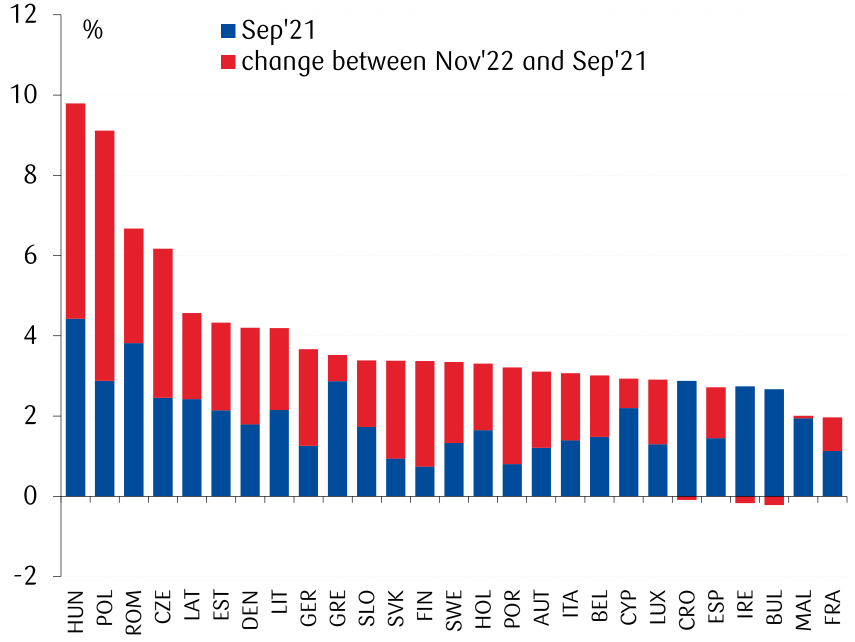
- The MPC has announced a pause in the cycle of hikes and entered the wait-and-see mode.
- As the inflation is expected to fall in the course of 2023, the markets have started to price in first rate cuts before the year-end, which is in line with our baseline scenario.

Waiting for effects of rate hikes

The cumulative effect of rate hikes on CPI inflation



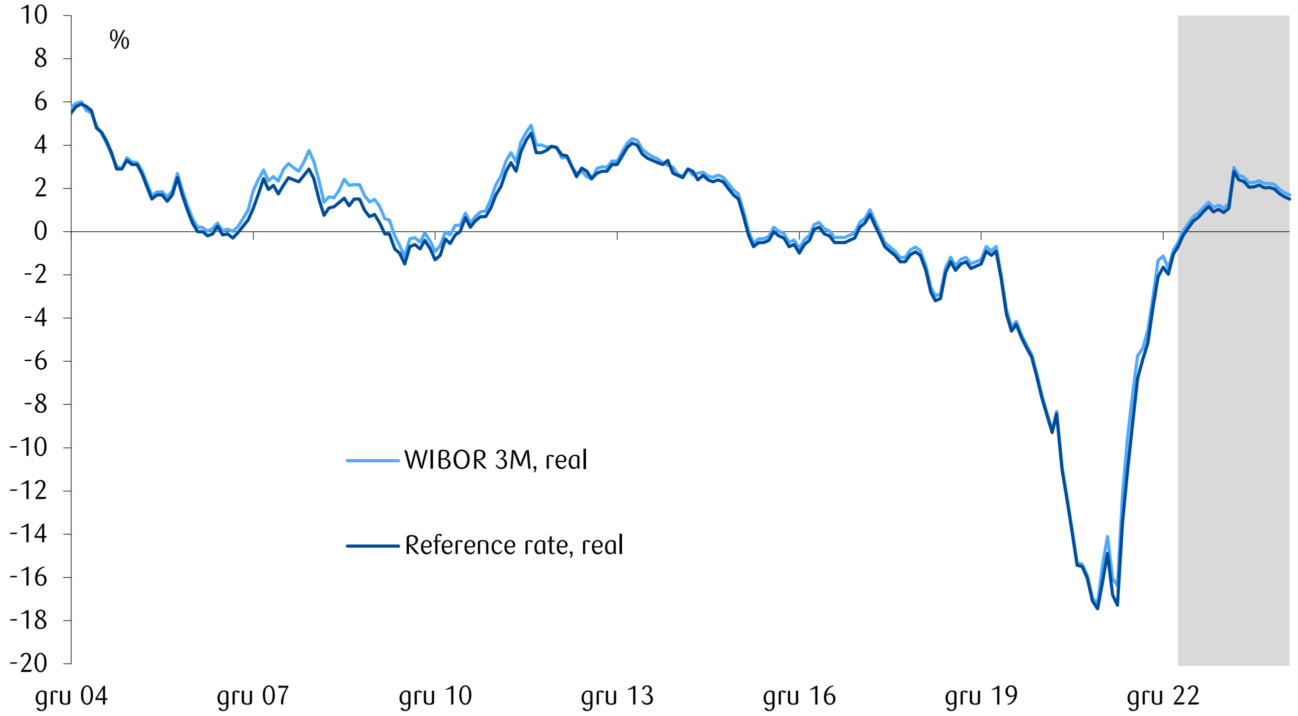
Interest rate on new mortgages



- The MPC accepts that CPI inflation's return to the target will be slow, as central bankers fear of negative effects of further rate hikes.
- NBP estimates that interest rate hikes done so far will lower the annual inflation by 3.5pp (not taking into account other disinflationary factors) by the end of 2025. Earlier estimates pointed to a similar effect of rate hikes on GDP growth.

As inflation is expected to decline, real rates are set to rise

Ex ante real* interest rates in Poland



- Real interest rates will soon start turning positive, after years in the negative territory. As inflation is projected to decline, the real rates will keep growing.

* deflated with the year-ahead CPI inflation, on PKO BP forecast

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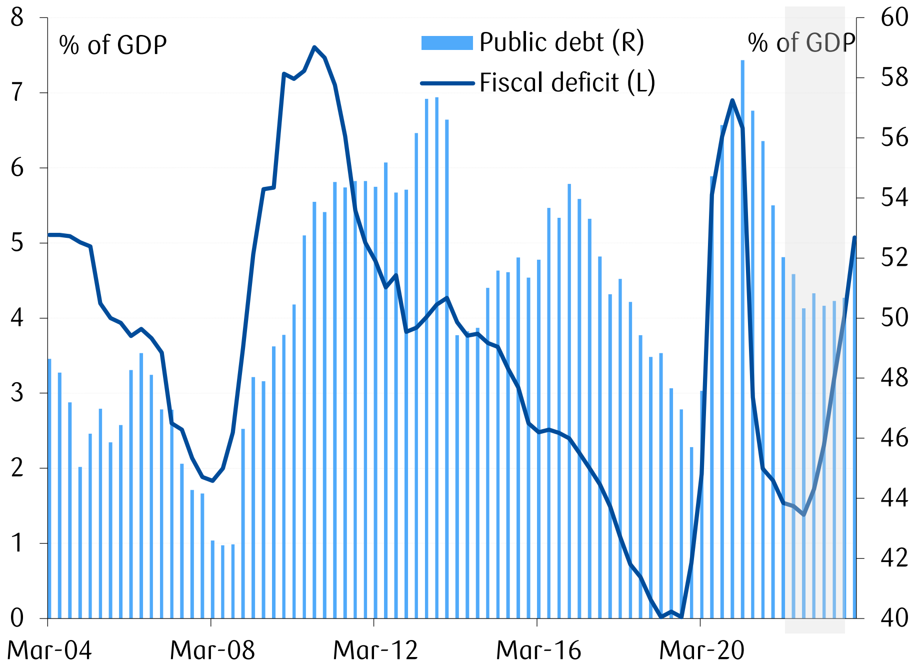
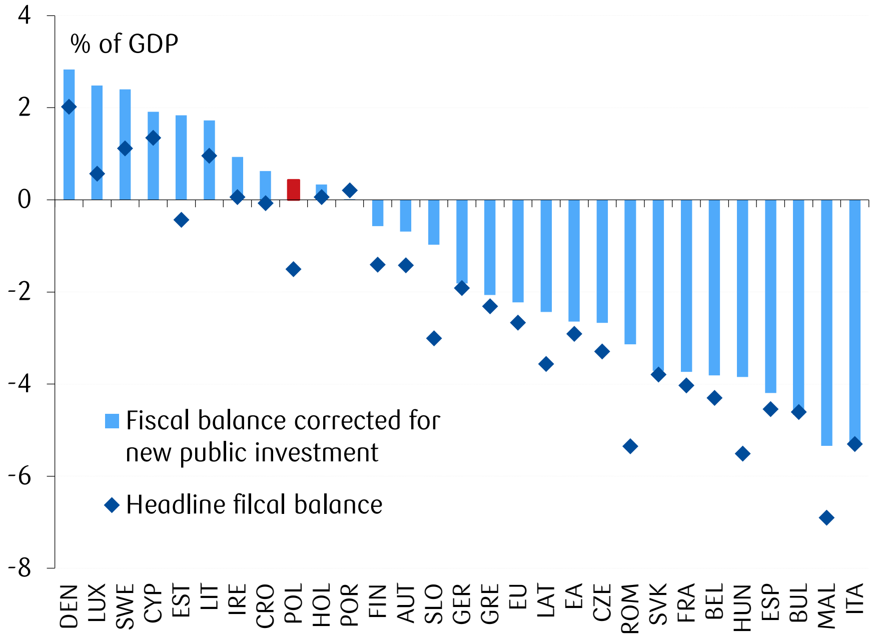
#6 Fiscal policy: under pressure, but under control

Domestic public finances are no threat to macroeconomic stability

Fiscal deficit and debt (ESA)



Fiscal balances of all EU economies after 2q22



- Poland’s fiscal position at the onset of energy crisis was one of the strongest in the EU. A widening in fiscal deficit in 2023 will be mainly an aftermath of fiscal packages shielding the economy from energy price spike.

Fiscal protective measures – cautious as compared to the EU peers

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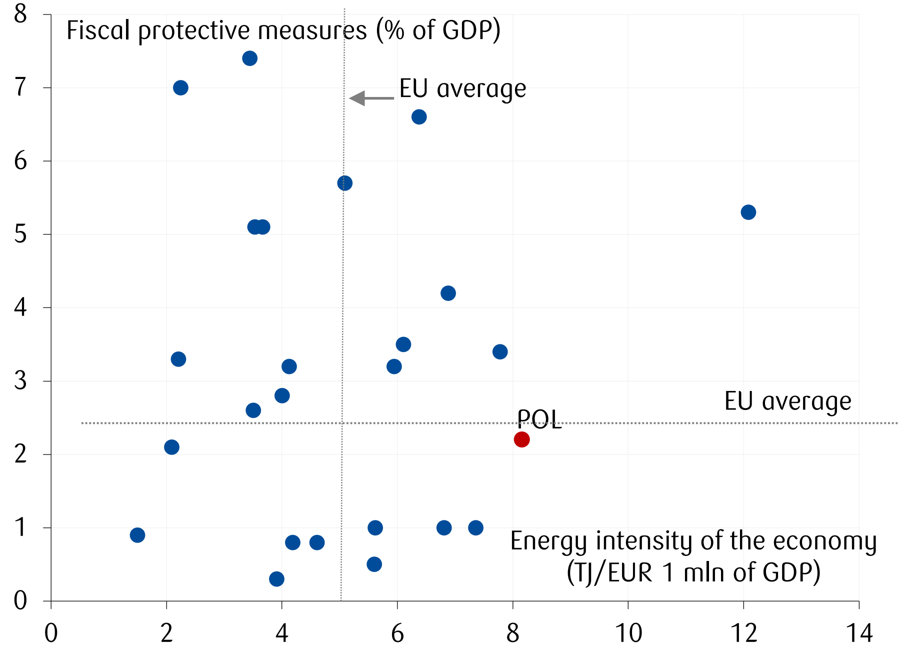
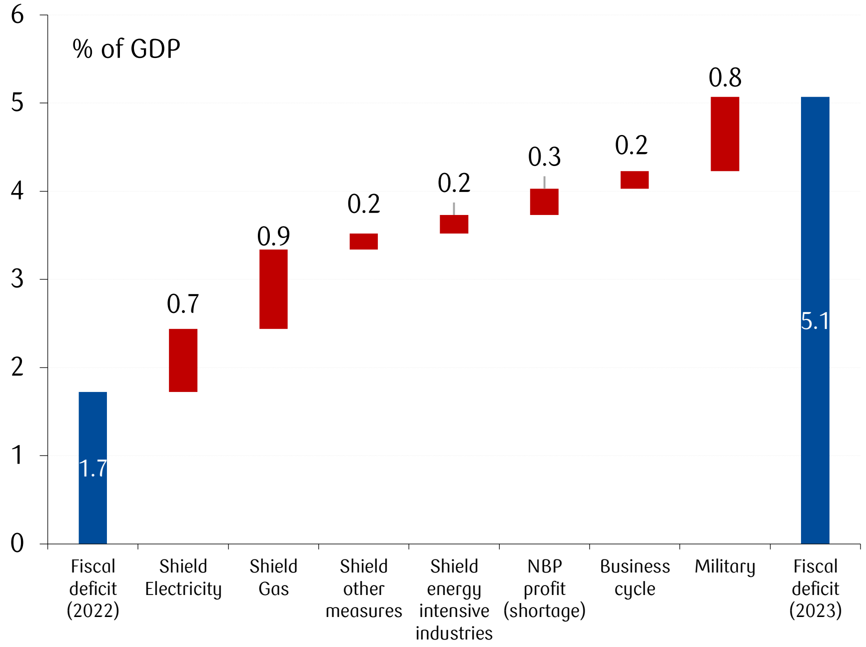
Fiscal protective measures vs energy intensity of GDP growth



Key drivers of fiscal deficit change between 2022 and 2023

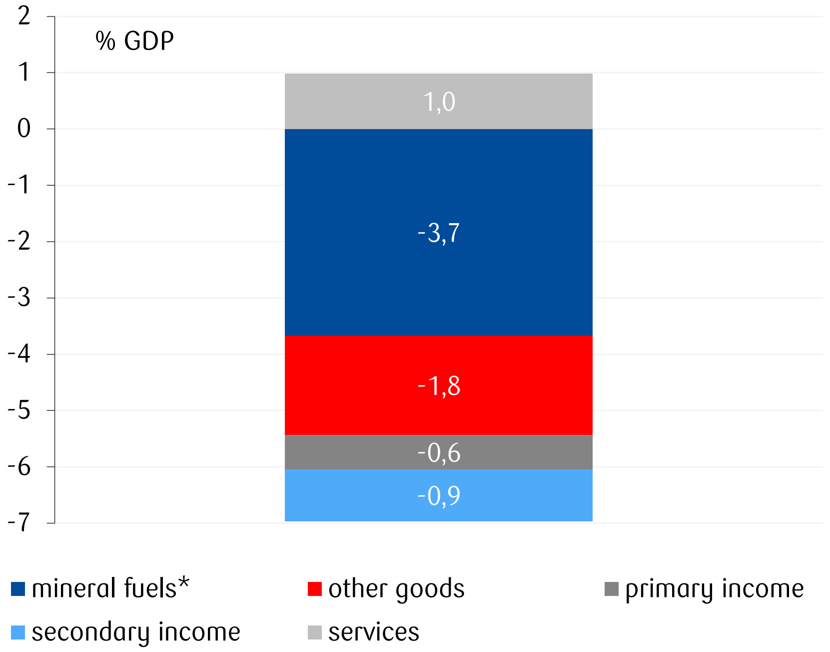


- Given the energy intensity of Poland's GDP growth (clearly above the EU average), local fiscal package to protect the economy against the energy price spike (below the EU average) can be considered as modest.
- Fiscal protective measures include: electricity price caps for households, SMEs, local govts and sensitive users (e.g. schools, hospitals), freezing gas prices for households and sensitive users, VAT rate for food at 0% until mid-2023, subsidies for energy intensive industries.

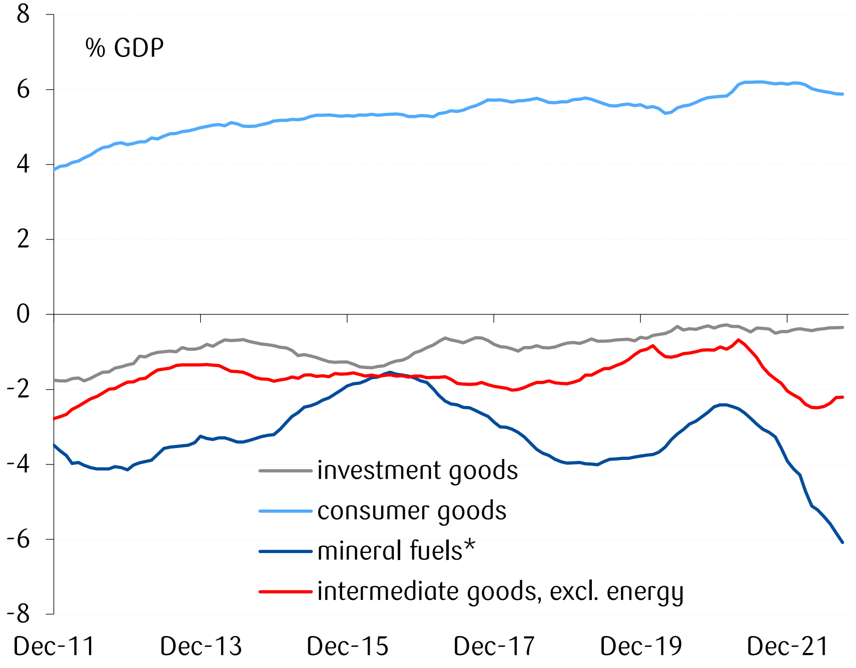
#7 Balance of payments: more resilient than regional peers

A substantial current account deterioration…

Decomposition of CAB change since start of 2021



Trade in goods - balance



- Since the start of the energy shock in 2021, Poland's current account deteriorated by more than 6% of GDP, to a deficit of nearly 4% of GDP in late 2022. The deterioration was caused by a widening trade gap, seen mainly in the case of mineral fuels.

* including classified transactions

...amid adverse terms-of-trade shock

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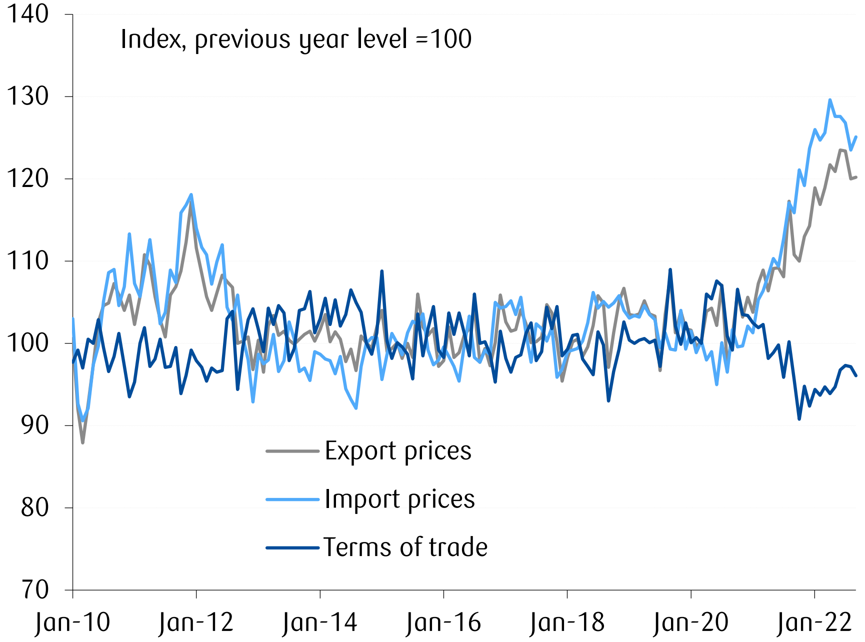
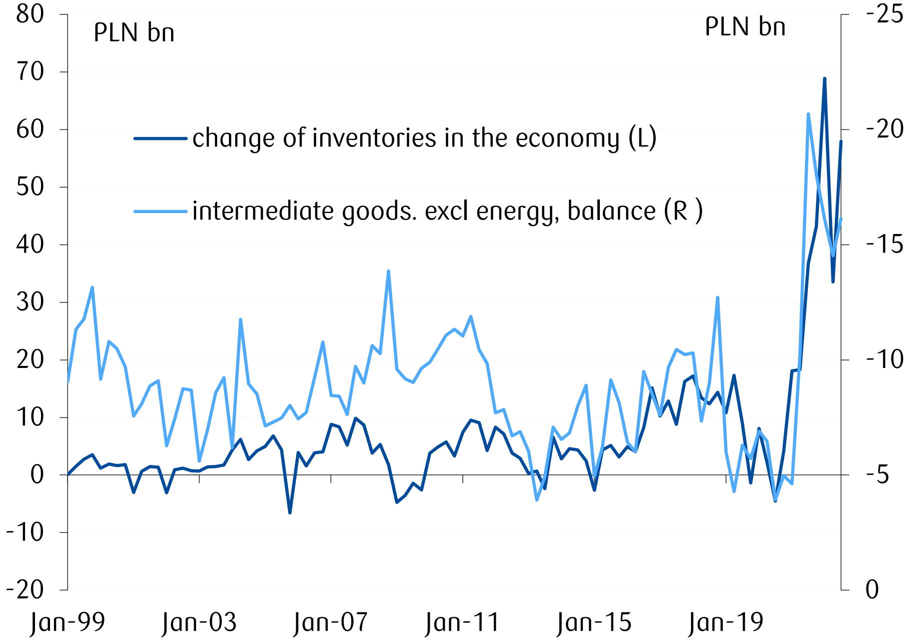
Prices in international trade



The shock was amplified by the cycle of inventories



- The deterioration resulted from a negative terms-of-trade shock, seen mainly in soaring prices of imported energy commodities.
- The shock was amplified by unusually strong accumulation of inventories, amid soaring prices and disrupted supply chains.

Poland's balance of payments position better than for all CEE peers

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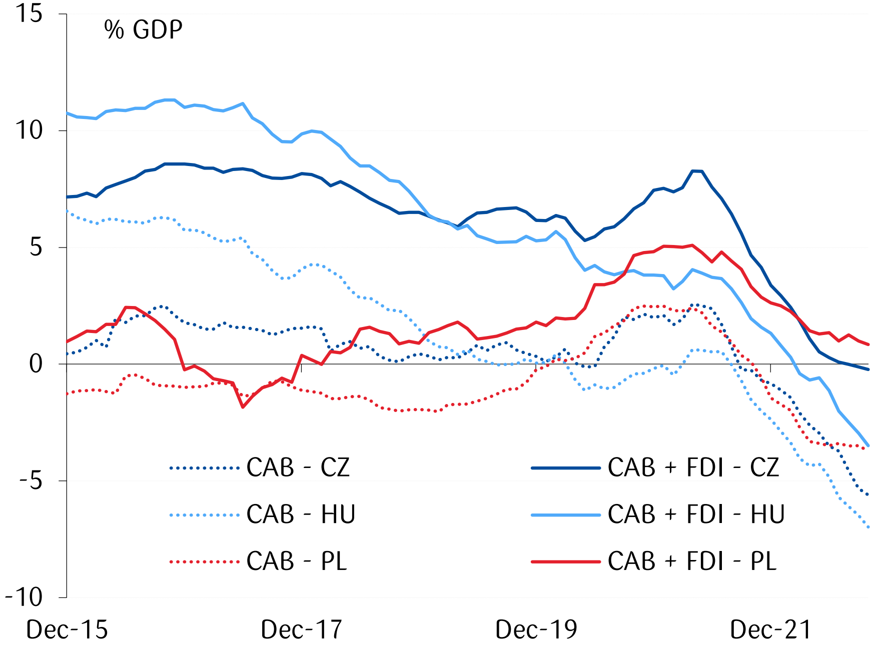
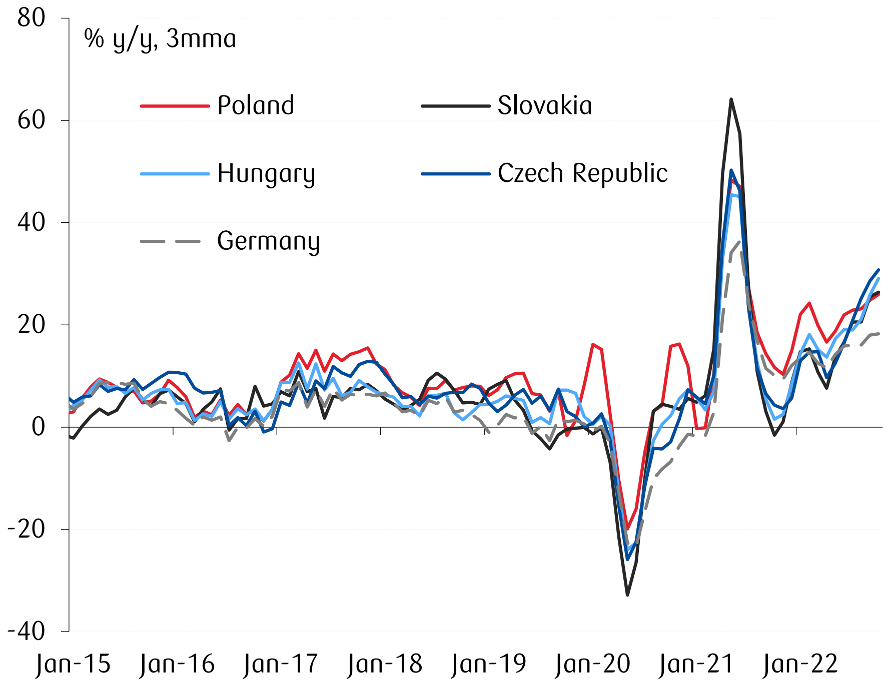
Poland's CAB corrected with FDI inflows the strongest in the CEE region



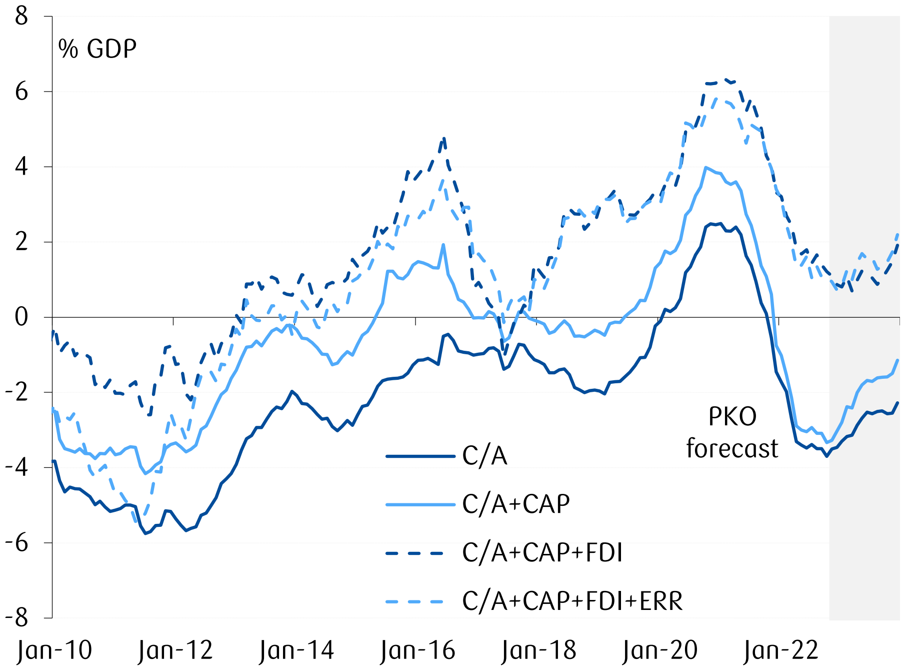
Growing share in the region's exports



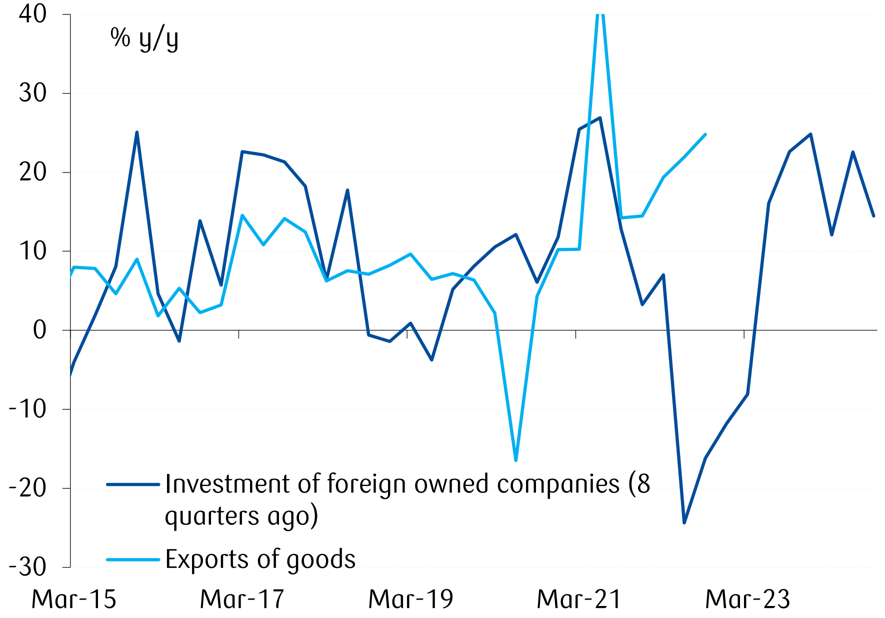
- Similar tendencies have been observed in other commodity-importing CEE economies. However, the current account deficit in Poland is lower than in Hungary, Romania and even the Czech Republic. Moreover, it is more than fully financed by large FDIs inflow.

Brighter balance of payments outlook

As shocks fade away CAB is likely to improve



Exports will grow on the past FDI inflow



- The CAB is likely to improve, as adverse shock fade away and companies reduce their inventories. Exports performance will be boosted by investment outlays already made, and planned by foreign-owned companies.

EU Recovery Plan (KPO), if kicked-off, may additionally improve CAB financing

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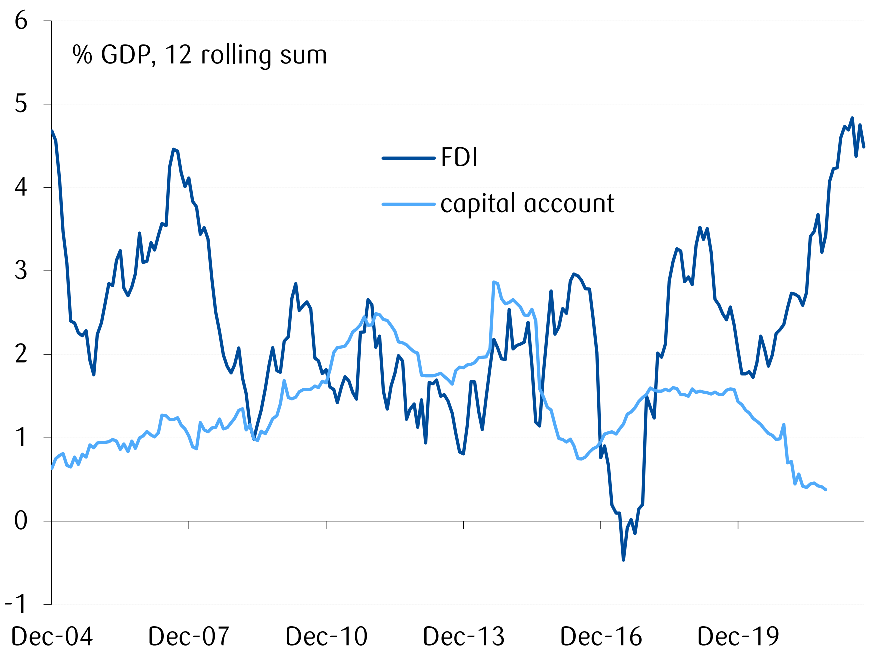
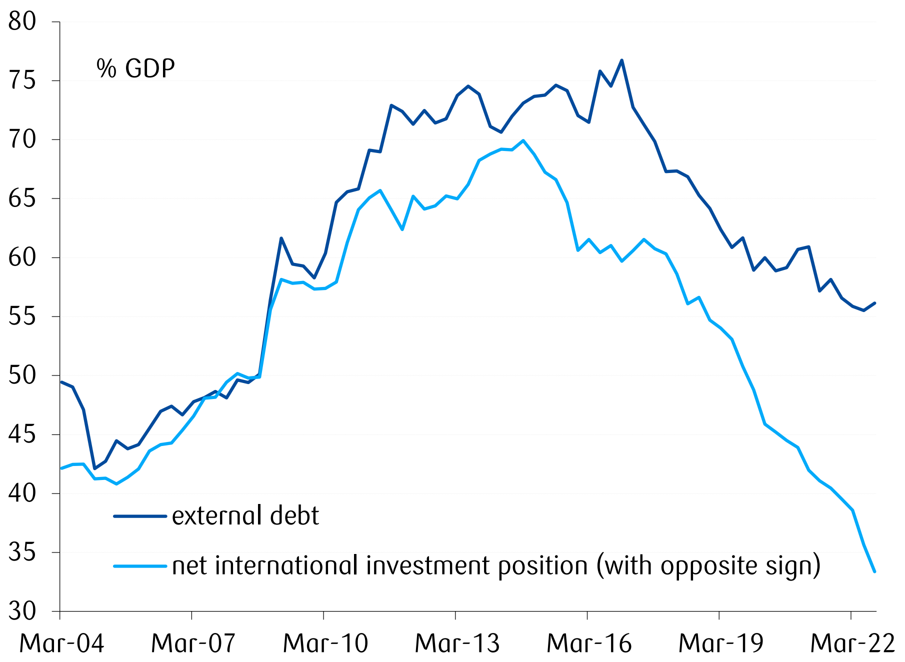
Capital account to be boosted by EU funds



Other measures of external balance look solid

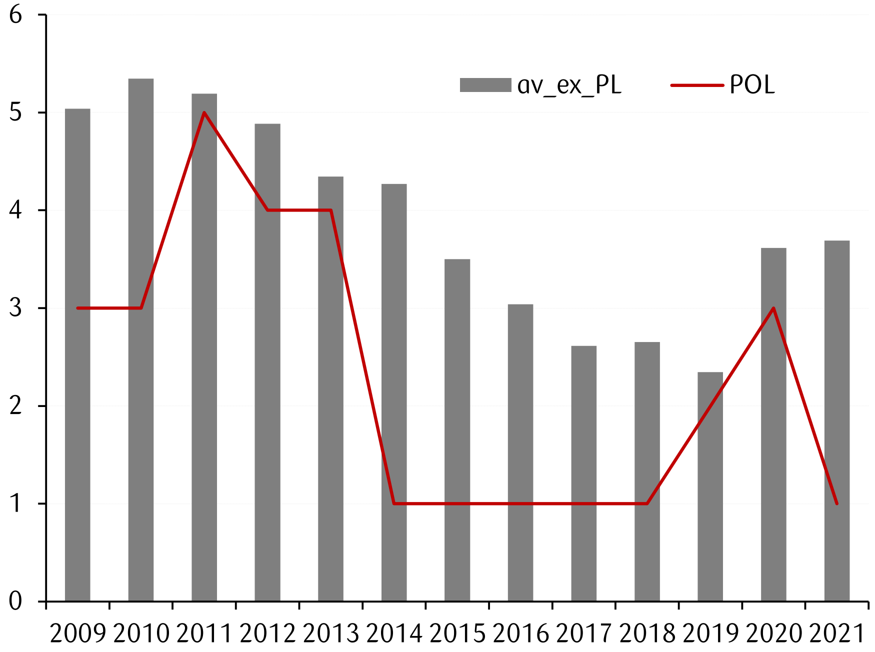


- Funds from the Domestic Recovery Plan (KPO) might further improve current account deficit financing.
- Other measures of external balance look remarkably solid, especially the net international investment position, that has recently declined below 35% of GDP, a threshold for macroeconomic imbalance in the EC’s Macroeconomic Imbalances Procedure.

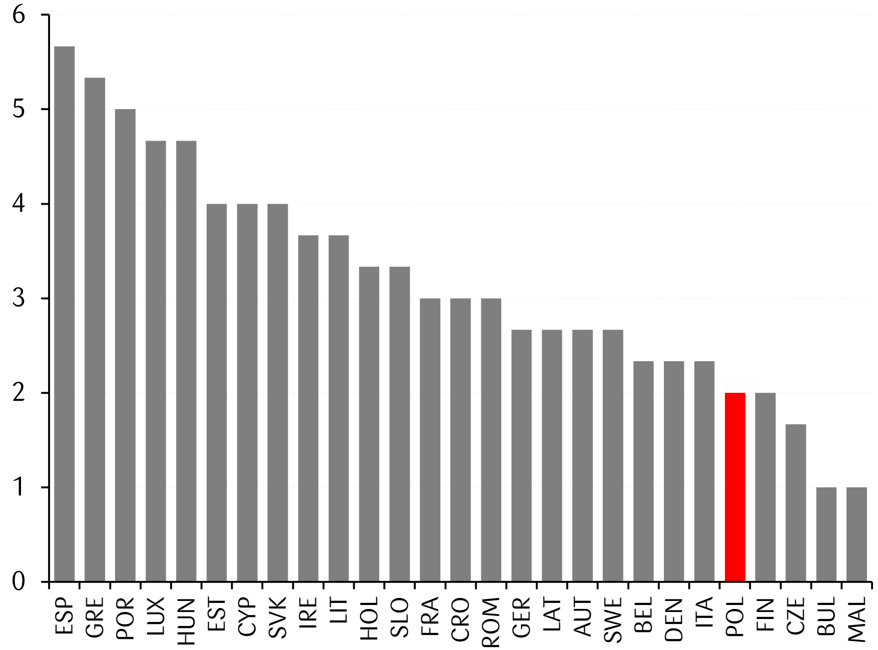
#8 Macroeconomic stability: Poland still outperforming

Hard to find any macroeconomic imbalances

Number of macroeconomic imbalances according to the European Commission (Macroeconomic Imbalances Procedure)



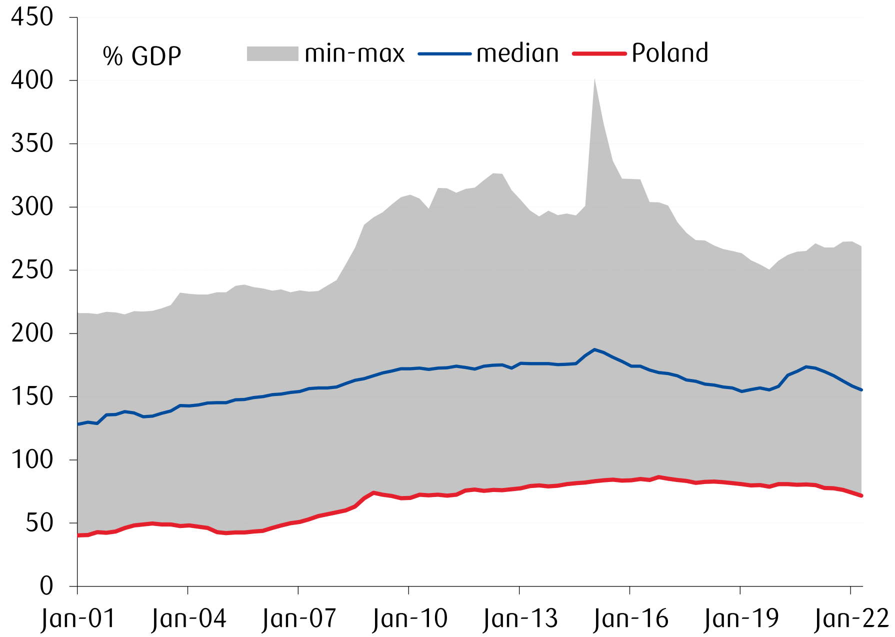
Average number of imbalances in the last 3 years according to the European Commission (Macroeconomic Imbalances Procedure)



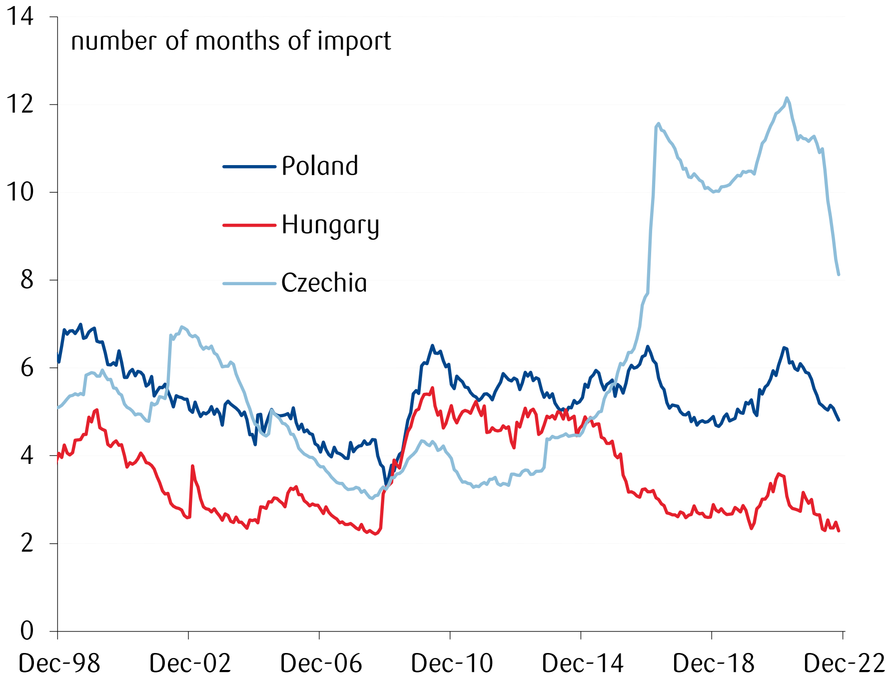
- Poland is one of top performers in the European Commission's Macroeconomic Imbalances Procedure. In 2021 Poland exceeded indicative threshold only in 1 among 14 indicators (net international investment position was below -35% GDP). However, it is not an issue for macro stability, because it derives from high inflow of FDIs and high level of profitability of foreign companies.
- In 2022 the NIIP improved to above -35% GDP, so probably Poland may have no macroeconomic imbalances in the 2022 edition.

Resilient to interest rate shock and capital outflows

Private sector debt (% GDP) in EU countries



Number of months of imports that could be financed with foreign exchange reserves



- Despite the adverse shocks of recent years (Covid-19, energy shock, war), Poland's fundamentals have been improving - the foreign debt as well as private sector debt ratios are systematically decreasing. Poland is the least indebted (private sector) economy in the EU, what reduces vulnerability to an interest rate shock. Domestic foreign exchange reserves secure almost 5 months of imports.

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Prepared for tough times

PKO BP macroeconomic vulnerability index for EU countries and the UK

Country	Fiscal spere	Inflationary processes	Foreign stability	FX	Financial markets inficators	Loans and money	Private and foreign debt	TOTAL
Denmark	1,1	0,5	0,9	0,3	0,2	-0,1	-0,1	**0,4**
Czechia	-0,3	-1,2	-0,3	2,1	0,3	1,0	0,8	**0,4**
Germany	-0,1	0,6	0,3	-0,1	0,4	0,2	0,3	**0,2**
Greece	0,3	0,2	-0,8	0,3	0,0	1,6	0,0	**0,2**
Ireland	0,6	0,8	2,1	-0,7	0,5	-0,6	-1,2	**0,2**
Croatia	0,7	-0,3	0,2	0,5	-0,2	-0,3	0,8	**0,2**
Austria	-0,1	0,5	0,0	-0,1	0,7	-0,2	0,2	**0,1**
Portugal	0,2	0,5	-0,1	0,3	0,3	-0,4	0,1	**0,1**
Finland	0,0	0,9	-0,4	-0,5	0,3	0,8	-0,1	**0,1**
Spain	-0,6	0,8	-0,1	-0,3	0,2	0,5	0,1	**0,1**
Luxembourg	0,5	0,8	-0,5	-0,2	-0,1	-0,1		**0,1**
Poland	0,3	-0,9	-0,2	-0,3	-0,8	1,6	0,9	**0,1**
Slovenia	0,0	0,3	0,0	0,1	-0,1	-0,6	0,7	**0,0**
Sweden	0,7	0,5	0,3	-1,6	0,5	0,2	-0,5	**0,0**
Netherlands	0,4	-0,6	0,9	0,3	0,8	-0,7	-1,0	**0,0**
Italy	-1,0	0,7	-0,2	-0,3	0,0	0,4	0,5	**0,0**
France	-0,8	1,2	-0,3	-0,5	0,4	0,1	-0,5	**-0,1**
Cyprus	0,8	0,6	-0,5	0,2	-0,1	1,0	-2,6	**-0,1**
Romania	-0,6	0,1	-0,9	1,1	-1,1	0,0	0,9	**-0,1**
Slovakia	-0,4	-0,2	-0,6	0,7	-0,3	-0,2	0,4	**-0,1**
Belgium	-0,6	0,4	-0,4	-0,2	0,5	-0,3	-0,4	**-0,2**
Latvia	-0,2	-1,3	-0,5	0,7	-0,6	-0,1	0,6	**-0,2**
Malta	-0,6	0,8	1,8	-0,3	-0,4	-0,8	-2,4	**-0,3**
Estonia	0,5	-1,9	0,5	0,8	-2,1	-0,4	0,7	**-0,3**
Bulgaria	0,0	-0,6	0,0	0,7	-1,5	-1,9	0,9	**-0,3**
UK	-0,7	0,6	-0,7	-1,5	0,2	-0,2	-0,2	**-0,4**
Lithuannia	0,7	-1,7	0,0	0,7	-1,6	-1,9	0,8	**-0,4**
Hungary	-0,8	-1,6	-0,6	-2,2	0,2	-0,8	0,5	**-0,7**

More about methodology in:
PKO Poland Macro Weekly (in English)
and PKO Makro Focus (in Polish)

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#9 Borrowing needs and PLN outlook

Non-residents have been steadily increasing holdings of POLGBs

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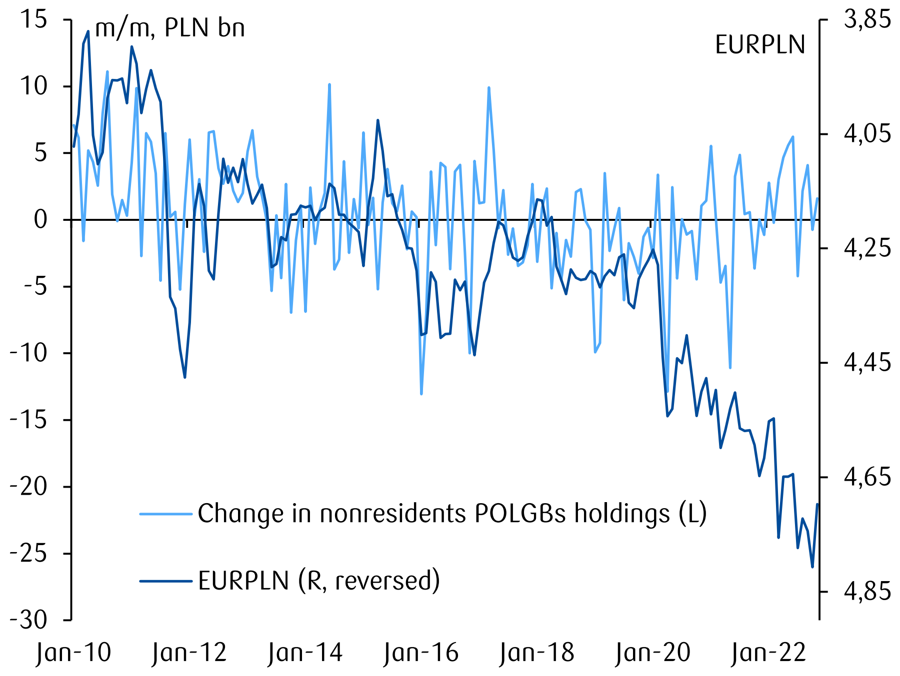
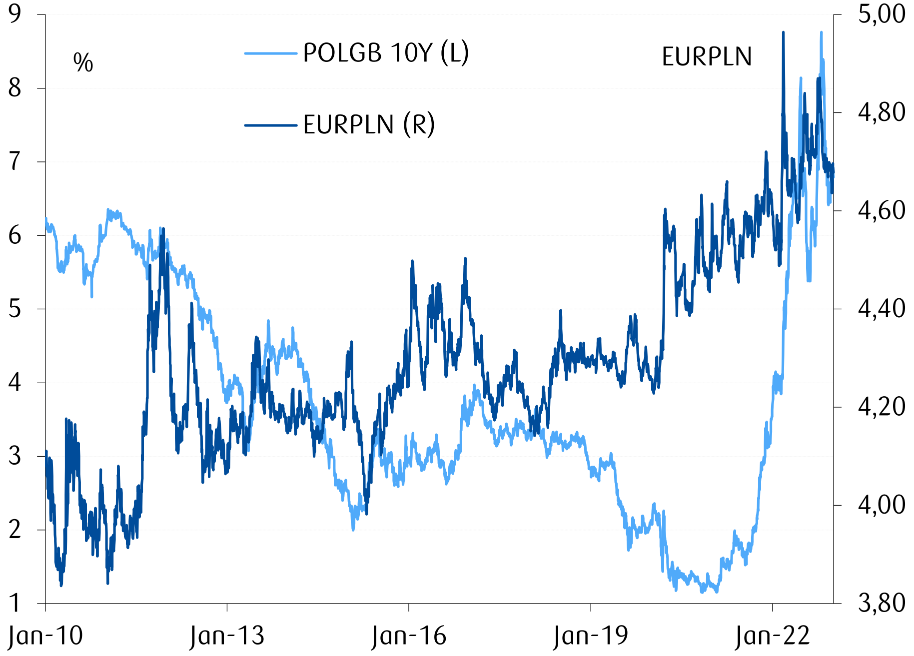
Foreign investors' exposure on POLGBs vs. EURPLN



EURPLN vs POLGB 10Y yields



- Non-resident have been increasing holdings of POLGBs even despite a tough year in the global bonds market amid policy tightening by major central banks. A spike in yields resulted mostly from interest rates hikes, without a major widening of credit spreads.

Equity outflows could partially weigh on PLN

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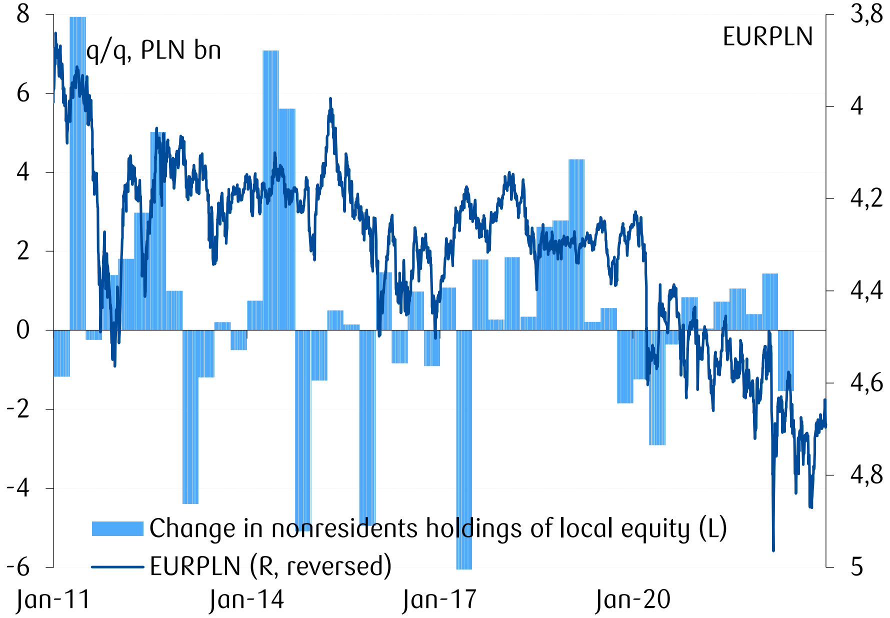
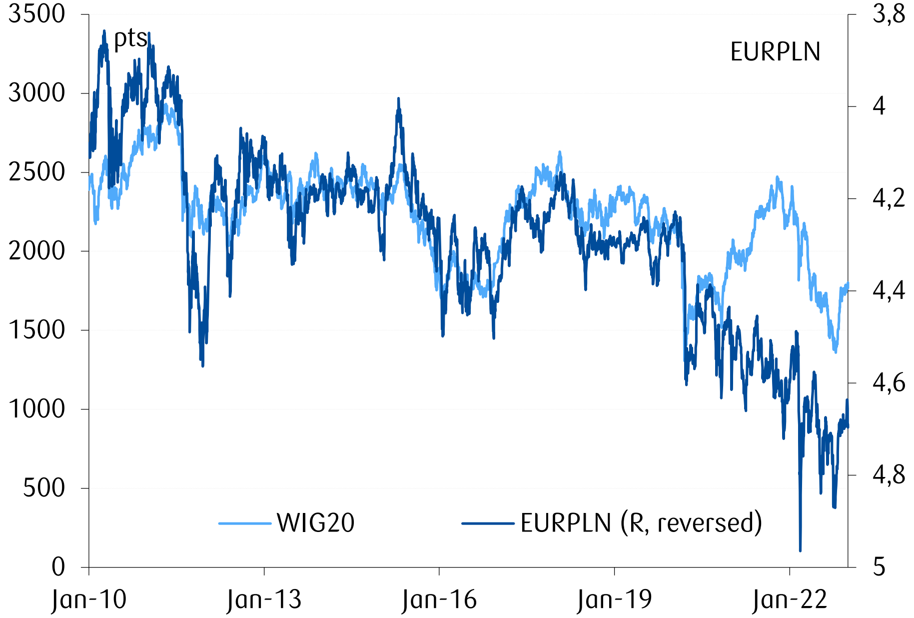
Foreign holdings of local equity vs PLN



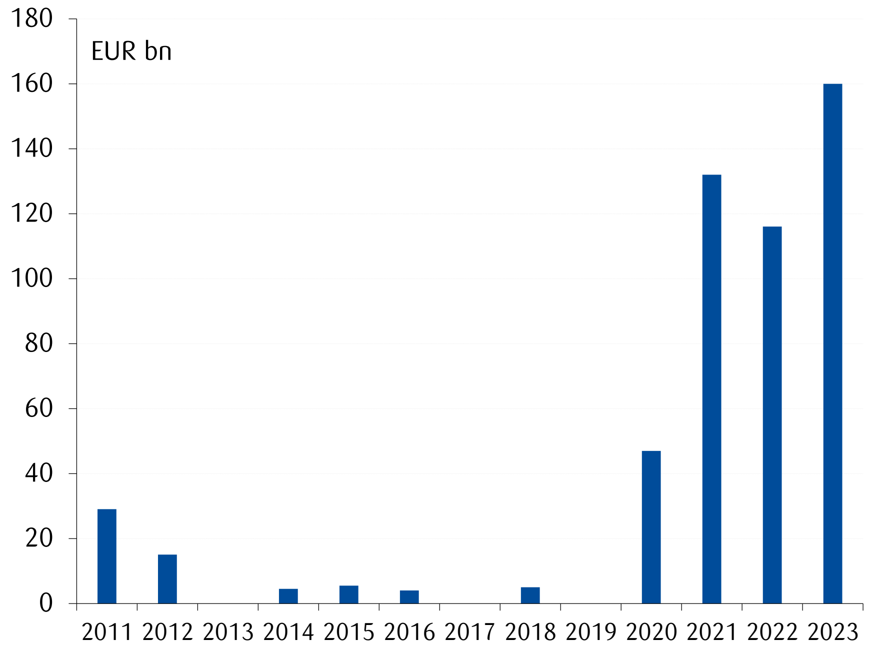
EURPLN vs. WIG20



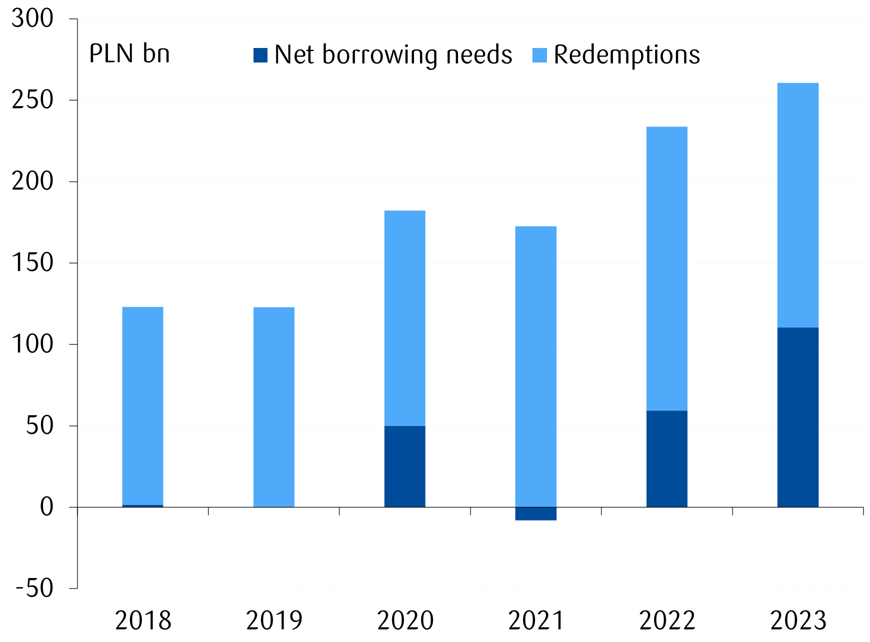
- Local equity sell-off could have partially amplified EURPLN weakness. That said, a recent rebound of local stock exchange index suggests that recent wave of fears has diminished.

Government borrowing needs will swell in Europe

Issuance of the EU-wide bonds



Gross borrowing needs of state budget in Poland



- A flood of issuance in the whole Europe (incl. the EU itself) while the ECB reduces its balance sheet could exert some pressure on the Polish market. Given a widening fiscal deficit, some portion of borrowing needs in Poland will be covered by off-budget vehicles (mostly by the state development bank, BGK).

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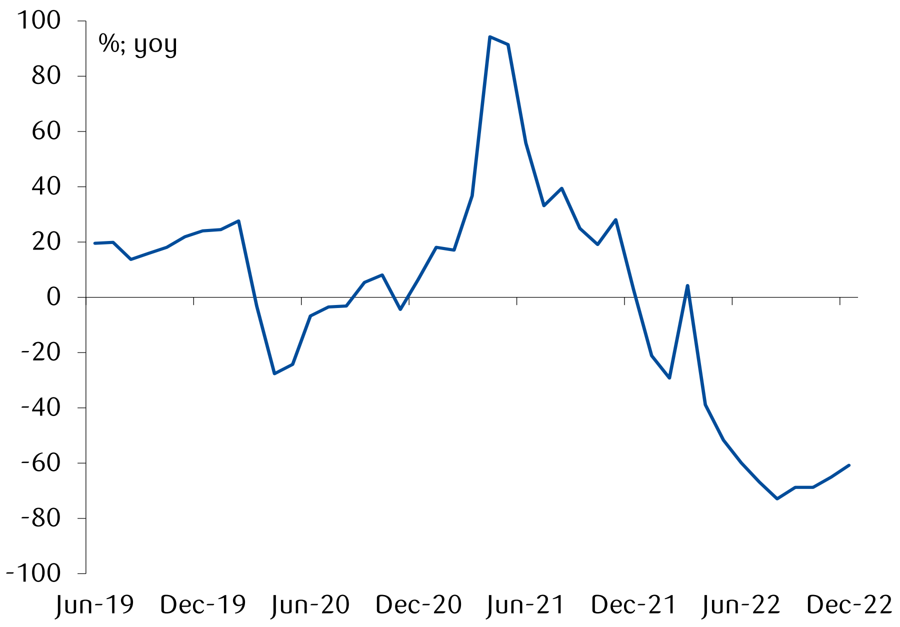
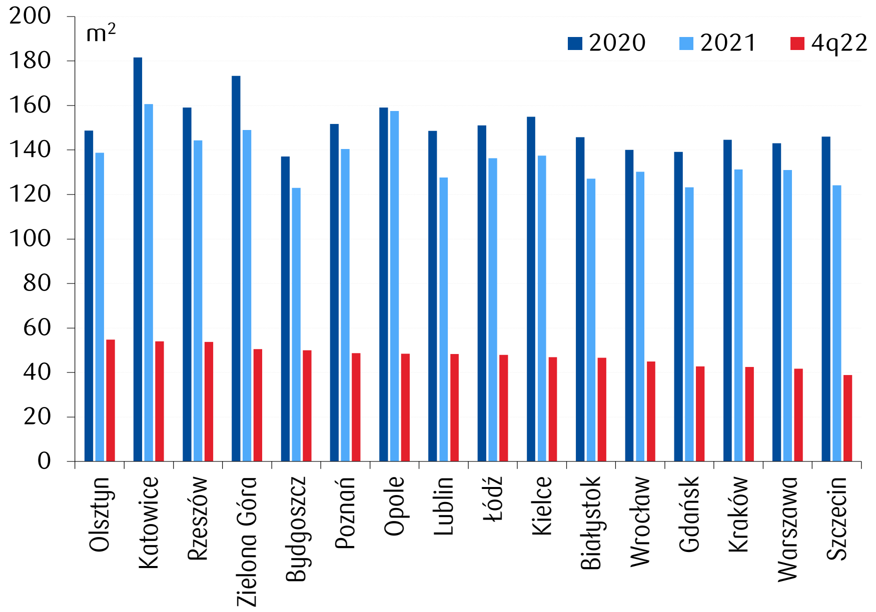
#10 Housing market: transitory freeze

Housing demand at its bottom with recovery outlook for 2023

Change in value of mortgage applications



Housing affordability in the largest cities*



* assuming mortgage for household (2 adults, 1 child) with twice average income and 20% own contribution.

- The reason for the decline in transactional volume is a marked reduction in creditworthiness due to interest rate hikes, very conservative prudential regulations as well as higher IRR expectations by investment buyers.
- In our opinion housing sales will go up by 15% in 2023 as a result of start of rate cuts, improving affordability (wages rising faster than house prices) and planned public support for first-time buyers.

Housing starts freeze

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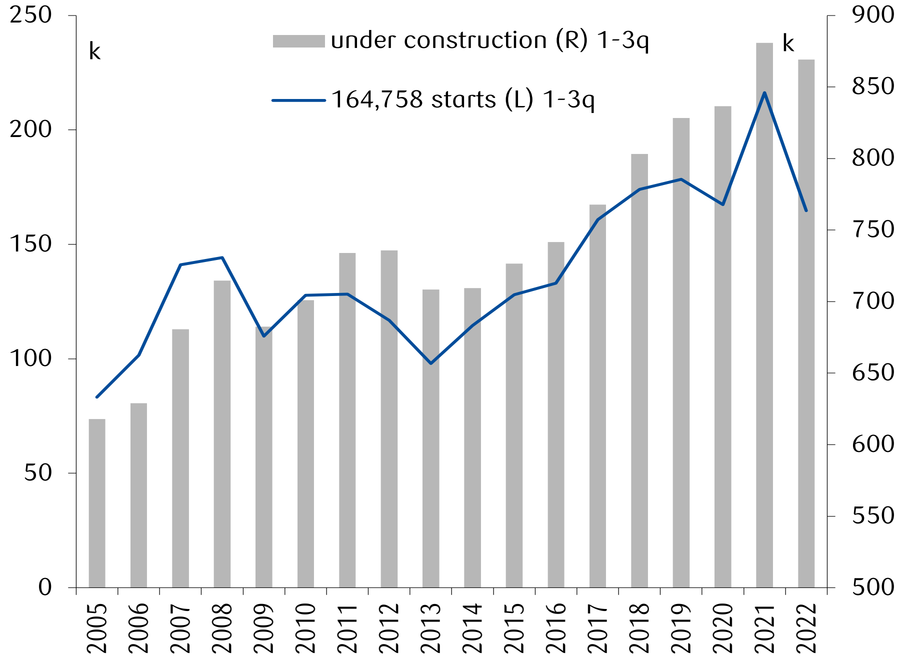
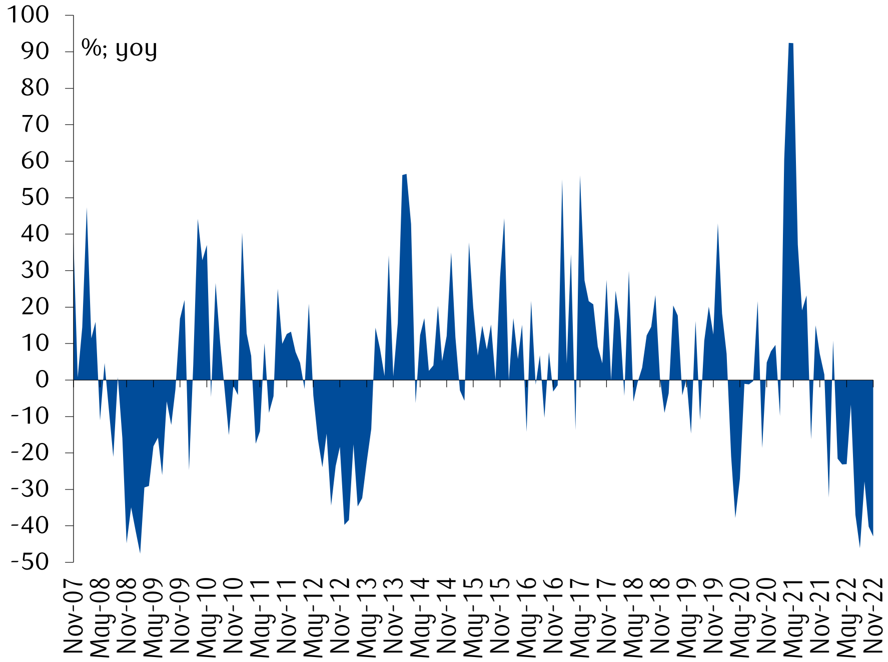
Housing starts and under construction in 1-3q



Housing starts change



- Looking at the market from the supply side, we can still see a large number of projects under construction and a rapidly growing number of completed apartments in the primary market. The supply side response to current situation is a strong decline in the number of building permits and housing starts.
- We expect that housing starts will fall by about 10% this year.

Housing prices are stable with limited potential to fall

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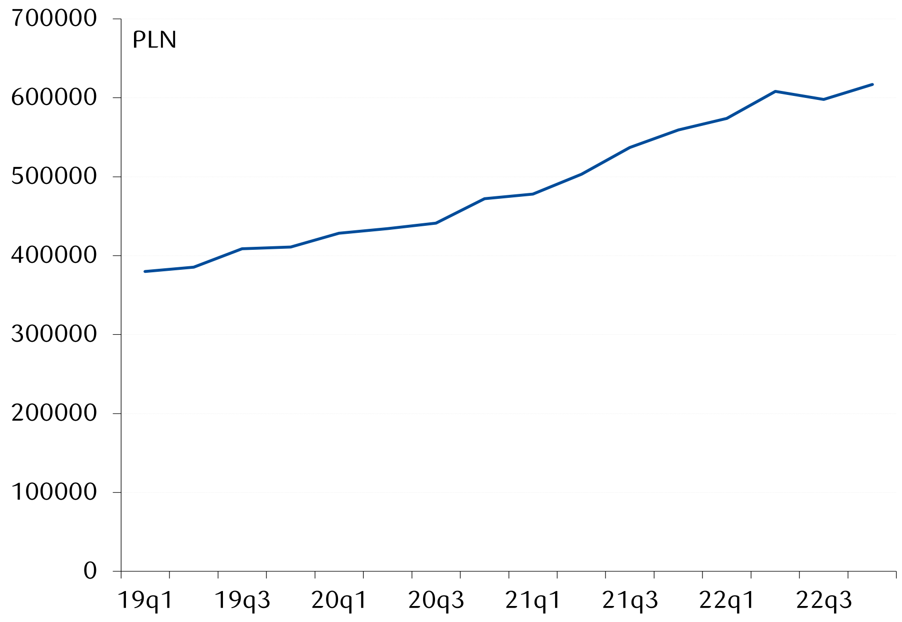
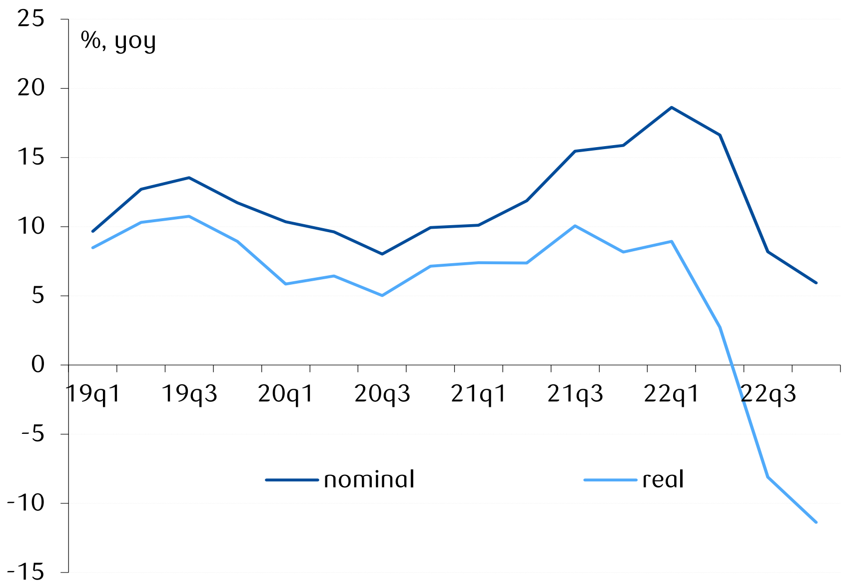
Average transaction value in primary market



Change of sqm price in primary market



- Continued decline in transaction volume with a rapidly growing number of completed and unsold units creates short-term oversupply in the housing market. Sale time of the entire offer is still below 2 years, which is typical housing construction time. This means that the potential for house prices declines seems moderate.
- We expect that average sqm price in the housing market will be lower by 5% y/y at then end of 2023.

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Macro and market forecasts

Macroeconomic forecasts

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	2016	2017	2018	2019	2020	2021	2022F	2023F
Real economy								
Real GDP (%, y/y)	3.1	4.8	5.9	4.5	-2.0	6.8	4.5	0.1
Domestic demand (%, y/y)	2.3	4.9	6.3	3.3	-2.7	8.4	5.3	-1.2
Domestic final sales (pp)	1.0	3.7	5.5	4.2	-2.0	6.2	2.4	-0.4
Investments (%, y/y)	-8.2	4.0	12.6	6.2	-2.3	2.1	3.4	1.3
Private consumption (%, y/y)	3.9	4.8	4.4	3.5	-3.6	6.3	3.0	-2.3
Inventories (pp)	1.3	0.8	0.4	-1.0	-0.8	2.6	2.7	-0.8
Net exports (pp)	0.8	0.3	0.0	1.3	0.8	-2.0	-0.5	1.3
Exports (%, r/r)	9.3	9.6	6.8	5.3	-1.1	12.5	3.8	2.0
Imports (%, r/r)	7.9	10.2	7.5	3.2	-2.4	16.1	5.0	-0.3
Labour market								
Employment (%, y/y, period avg.)	2.9	4.5	3.4	2.7	-1.2	0.5	2.4	1.3
Unemp. rate (%, eop)	8.2	6.6	5.8	5.2	6.8	5.8	5.2	5.4
Wages (%, y/y, period avg.)	4.1	5.6	7.1	6.6	4.8	8.8	13.1	11.8
Prices								
CPI inflation (%)	-0.6	2.0	1.7	2.3	3.4	5.1	14.3	13.2
Core inflation (%)	-0.2	0.7	0.7	1.9	3.9	4.1	9.0	8.7
Monetary policy								
NBP reference rate (%)	1.50	1.50	1.50	1.50	0.10	1.75	6.75	6.25
NBP lombard rate (%)	2.50	2.50	2.50	2.50	0.50	2.25	7.25	6.75
Balance of payments								
Current account (% of GDP)	-1.0	-1.1	-1.9	-0.2	2.5	-1.4	-3.6	-2.6
Merchandise trade (% of GDP)	-0.3	-1.0	-2.3	-0.8	1.3	-1.3	-4.5	-3.8
Fiscal policy								
Public deficit (ESA2010, % of GDP)	-2.4	-1.5	-0.2	-0.7	-6.9	-1.8	-1.7	-5.1
Public debt (ESA2010, % of GDP)	54.5	50.8	48.7	45.7	57.2	53.8	50.8	52.7
Monetary aggregates (fx adj.)								
Deposits (%, y/y)	8.9	5.7	8.1	8.2	13.1	10.8	0.1	3.6
Loans (%, y/y)	3.5	6.2	6.0	4.7	-0.8	4.7	2.6	2.1

Financial market forecasts

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	3q22	2022	1q23	2q23	3q23	2023
Exchange rates						
EUR/USD	0.98	1.07	1.05	1.06	1.07	1.08
EUR/PLN	4.87	4.69	4.65	4.62	4.60	4.58
USD/PLN	4.95	4.40	4.43	4.36	4.30	4.24
CHF/PLN	5.07	4.77	4.74	4.57	4.47	4.32
EUR/CHF	0.96	0.98	0.98	1.01	1.03	1.06
GBP/PLN	5.56	5.30	5.27	5.27	5.29	5.30
Interest rates						
WIBOR 3M	7.21	7.02	6.95	6.95	6.70	6.45
PLN OS 2	7.49	6.73	6.60	6.45	6.25	5.76
PLN OS 5	7.41	6.88	6.60	6.30	5.84	5.47
PLN OS 10	7.16	6.88	6.50	6.15	5.63	5.32
EURIBOR3M	1.17	2.13	3.30	3.30	3.30	3.30
LIBOR USD 3M	3.75	4.77	4.85	4.85	4.60	4.35
SARON CHF 3M	-0.14	0.55	1.08	1.25	1.25	1.25

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Happy 2023!

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