Poland Economic Insights: No longer a positive outlier

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After surprisingly good results for 2022, the weak start of 2023 prompted us to revise our GDP forecast downwards. On the other hand it also brought a fast improvement of the C/A balance which supports PLN. Still, risks remain ahead of both national and local (elections).

Key financial figures

	2019	2020	2021	2022	2023
Real GDP (% yoy)	4.4	-2.0	6.9	5.1	0.5
Gross Fixed Capital Formation (% yoy)	6.2	-2.3	1.2	5.0	2.6
Private Consumption (% yoy)	3.5	-3.6	6.2	3.3	-0.6
Current Account Balance (% of GDP)	-0.2	2.4	-1.4	-3.0	-0.0
Unemployment (avg, %)	5.4	5.9	6.0	5.4	5.1
CPI Inflation (avg, % yoy)	2.3	3.4	5.1	14.3	13.4
Policy Rate (% eop)	1.50	0.10	1.75	6.75	6.75
EUR/LCY (avg)	4.30	4.44	4.56	4.70	4.68
Budget Balance (% of GDP)	-0.7	-6.9	-1.8	-3.7	-5.5
Public Debt (% of GDP)	45.7	57.2	53.6	49.1	50.5
Nominal GDP (EUR bn)	532.0	526.5	576.6	654.6	736.2
GDP per Capita (EUR)	13,861.0	13,819.0	15,212.8	17,317.8	19,476.6

Source: Refinitiv, local sources, RBI/Raiffeisen Research

Key conclusions:

- Monthly data suggest **Q1 likely brought a qoq GDP decline** which would mean Poland joined Czechia and Hungary in **recording a technical recession.**
- It **should be shortlived**, however, as **limited impact on the labour market and disinflation** among others may allow for a **recovery of currently weak consumer demand**. Still, the weak Q1 will weigh on full year growth and led us to revise our 2023 estimate to 0.5% yoy vs 1% previously.
- **Investment activity should remain a growth driver** as Poland also awaits benefits from the **nearshoring** and **friendshoring trends**.
- **Disinflation is in progress** with first minor signs of a reversal of broad price pressures. **Risks remain to the upside**, however, while the pace of disinflation may lead to the **indicator remaining above NBP target also in 2024**. We thus keep our **rate forecast unchanged**, expecting first cuts only next year.
- **Politics** will be in focus this year due to **Parliamentary elections scheduled for October**. This may also keep PLN under pressure thus we do not expect current EURPLN downtrend to be durable. Still a faster than expected improvement of the

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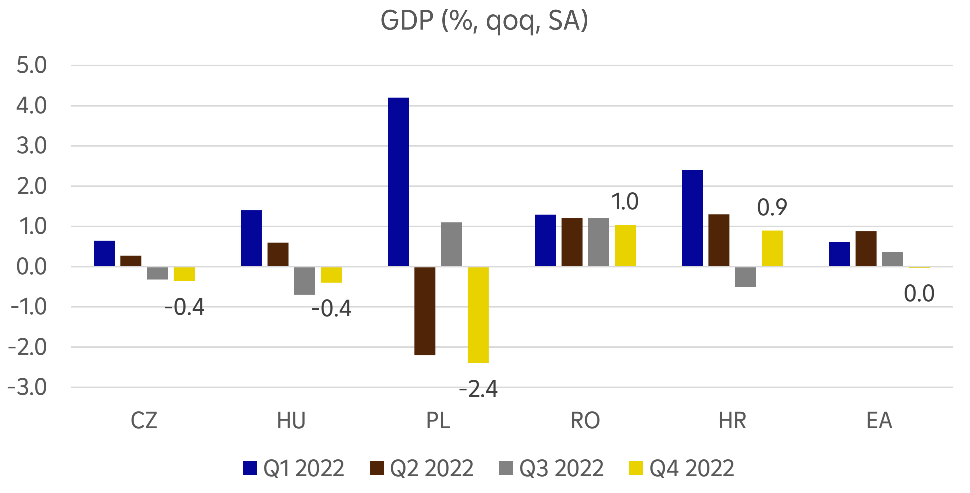
trade balance and C/A is a PLN supportive factor which prompted a downward adjustment to our EURPLN forecast (and upward in C/A balance).

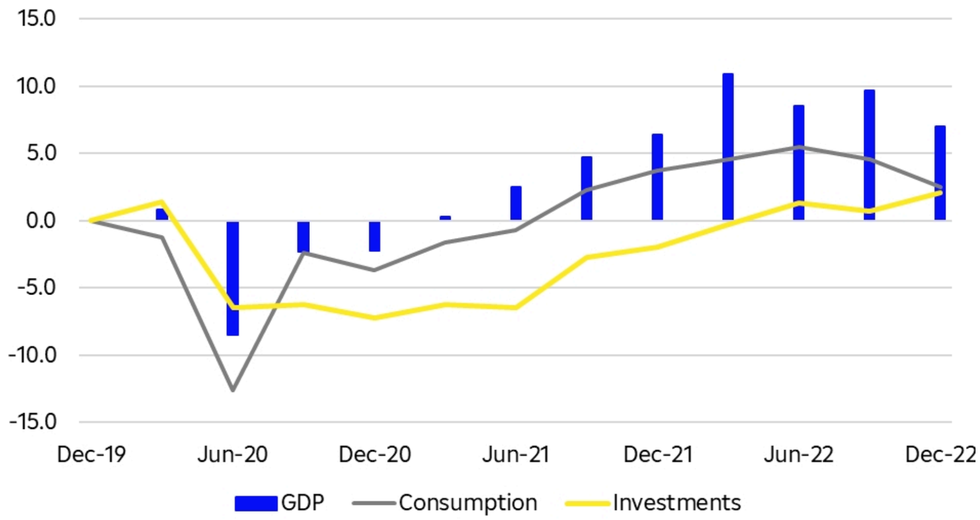
Poland avoided technical recession so far, but this may change after Q1



Source: Local statistical offices, Eurostat, RBI/Raiffeisen Research

The **start of the war in Ukraine** in March 2022 **drastically changed the outlook for Europe** as a whole. As we assumed **energy** would be impacted and thus weaken the **energy-reliant industrial sector** - key for Poland - we downgraded our outlook substantially back then (initially to 3.7% in 2022 and 1.8% in 2023). In the end, the **outstanding growth in Q1 last year of 8.6% yoy gave a boost to full-year results** (which reached 5.1%) even despite the gradual slowdown that unfolded later in the year. Meanwhile, as **high inflation and rates hit consumers** we had to dampen our expectations for this component - a situation that should reverse in 2023 but only to some extent. Thus today our **GDP forecasts for 2023 are even lower and we just downgraded further our forecast of 1% to 0.5%.** This results from a reversal of last year's situation - Q1 is likely to reveal a technical recession in Poland and thus weigh on the full-year results even if mild recovery is observed in the next quarters. With that, Poland would join Hungary and Czechia which already saw a recession in H2 2022 and would no longer be a positive outlier as observed in the years before, in particular during the pandemic amid the relatively mild drop in GDP and fast recovery.

Peak of postpandemic growth reached in Q1 2022



0=Q4 2019; qoq growth SA

Source: CSO, RBI/Raiffeisen Research

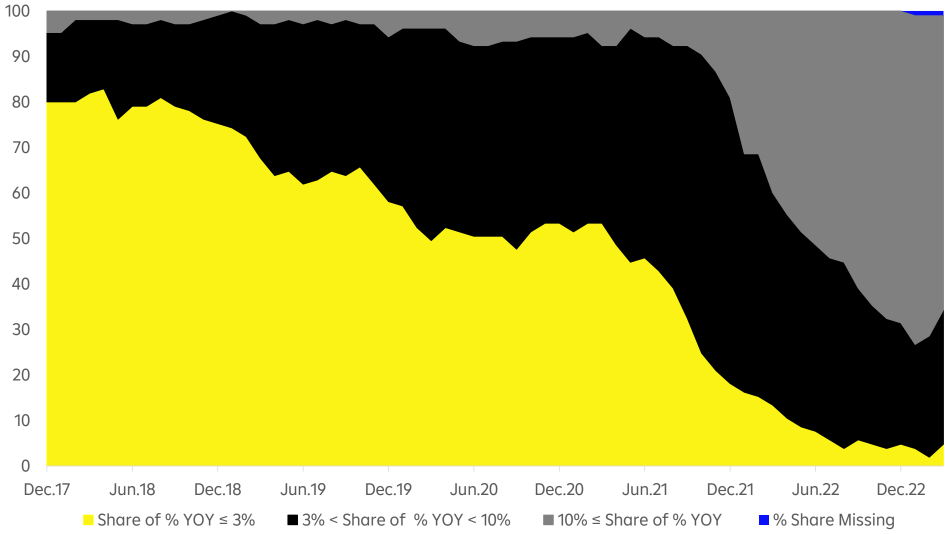
Consumer demand likely at trough

What is more, despite the rocky GDP growth in 2022, in fact, the peak of the post-pandemic recovery has already been reached in Q1 last year. The **slowdown in the**

following quarters was limited by still high consumer demand (particularly in services as well as supported by the inflow of refugees from Ukraine) which was nevertheless declining each quarter since Q1 2022. The **consumer recession is of course driven by uncertainty, high rates and inflation** and according to recent retail sales data (-7.3% yoy in March) now includes not just durable goods but even basic consumer goods. Still, we expect that **Q1 was actually the trough in the downtrend of consumer demand** which seems to be supported by the **improvement in consumer sentiment** as well as the fact that (as we assume in the baseline scenario) the **impact on the labour market** from the current slowdown should and so far indeed is, **very limited**. While some deterioration will surely unfold in the next months, we expect that it will be fairly small (unemployment staying well below pandemic levels of around 7%) **relatively high wage growth together with government measures that limit the impact of inflation will also support consumption** recovery later in the year. As **CPI will remain in a downtrend** throughout the year we also expect **real wages dynamics to return to positive values** again this year. Finally, it is worth noting that the weakness in consumer demand is especially visible in goods, durable in particular as shown by industrial output data where durable goods output declined in 2022 on a yoy basis while it recorded the highest growth in 2021 compared to other categories. This is obviously also a sign that the **shopping spree for (durable) goods from the pandemic has been redirected towards services in 2022.**

Amid weakness in consumption, **investments should support growth**, also those boosted by **EU funds** (or prefinanced by the state-owned PFR amid lack of agreement with EU on NextGeneration EU). What should also support this category is **defense spending** as well as **possible benefits from the process of nearshoring and friendshoring** (Poland has been mentioned in a report from Reuters as one of the most attractive investment destinations, together with Germany). This should also be **supportive for Polish exports and net foreign trade** while already in the second half of 2022 this component turned positive again, adding as much as 1.7pp in Q4. The turnaround, after a mere 0.2pp contribution in full 2022, should continue and we expect more support from foreign trade in 2023 (even if occurring also amid weakening imports).

Inflation: some turnaround visible, but price pressures still broad
62% of items recorded inflation above 10% in March

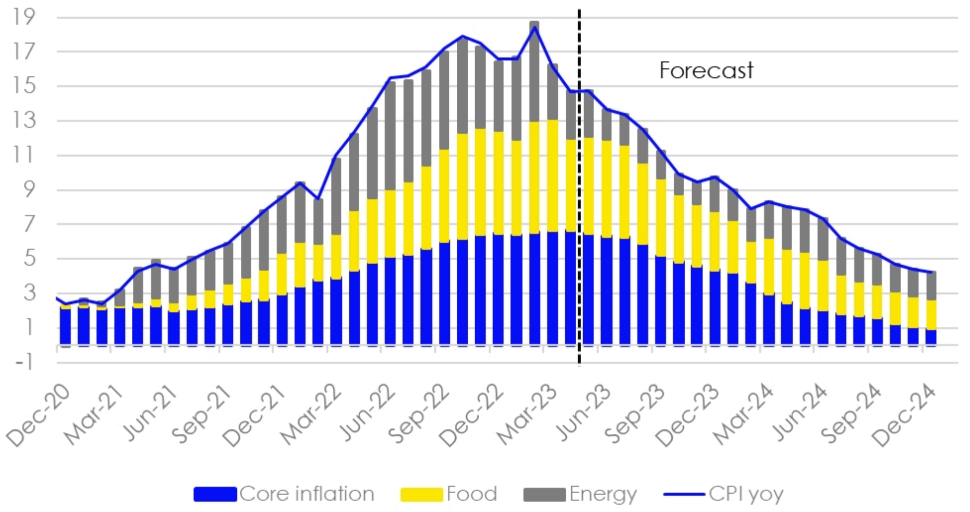


calculations based on HICP inflationa data
Source: Eurostat, RBI/Raiffeisen Research

Inflation - the slow way down

The **long-awaited peak of headline inflation seems to have arrived in February** and, after the annual adjustment of the underlying consumer basket, was lower than expected at **18.4% yoy**. **The next** months, as confirmed in March, **will show disinflation** that may bring the indicator to single digits into year-end. Also, **core inflation is possibly near or at its peak** after reaching **12.3% yoy in March** but here the downward path is less certain and we expect it to be flatter (especially in the near term when it may stay close to the peak). **The fast decline in CPI will thus be mainly driven by base effects in fuel and energy.** On the other hand, monthly dynamics of food and core inflation have been still exceeding historical patterns which can still be observed in the nearest months (although it is worth noting that the latest CPI data for April provided a sign food price growth may be finally normalising). We are still **waiting for a turnaround in services prices,** which are now rising faster than goods inflation, in line with the **changes to the consumer pattern** described in the earlier section. Once a downtrend is visible in service prices like accommodation and restaurants, it may be more certain that price pressures are durably abating. **Surely of help will be the expected and already visible lowering of price pressures abroad** (euro area) while also **recent strengthening of the PLN** (if persistent) would accelerate the disinflation process. For now however, as risks still loom over the PLN and in terms of war in Ukraine or financial markets conditions, and as the food and core inflation price pressures persist, **we still see upside risks to our forecast while assuming inflation will remain above the NBP target** range of 1.5-3.5% possibly even in 2024. For the interest rate outlook such risks and our forecasts imply that this year **rate cuts may not occur in Poland even if still priced in by the markets** (during March turmoils on the markets even 100bp cuts were priced in at some point). Of course, on the other side of the dilemma is the **weakness of the economy**, however, as we expect that a trough has been reached in Q1 in terms of the slowdown we also see this as a factor supporting later hikes than this year. Lately, also the wording from the NBP seems to be moving towards this scenario after the NBP Governor softened his rhetoric about the rate cut outlook already this year.

Disinflation started in headline CPI, but Core inflation should remain elevated



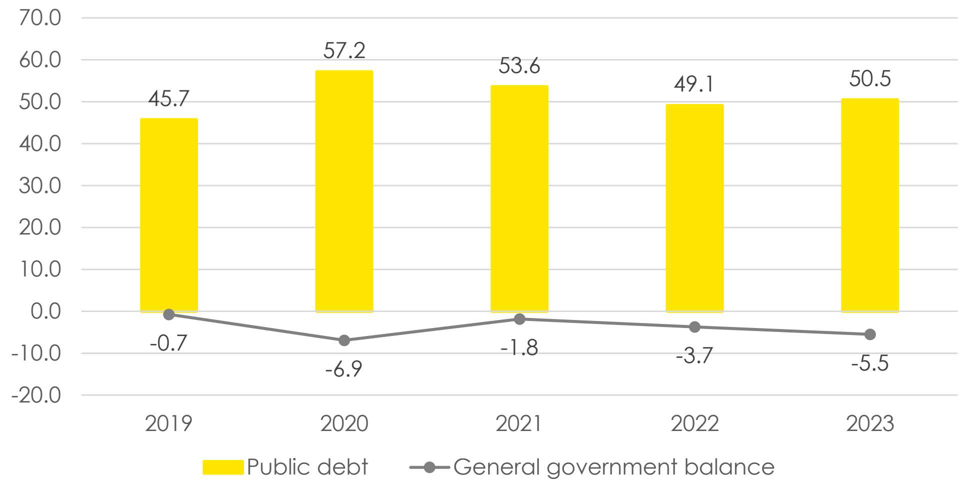
Source: National statistical office, NBP, RBI/Raiffeisen Research

Politics in focus ahead of October elections

What complicates the outlook for Poland for this year even more (and relatively more than in other countries in CE) are **the upcoming Parliamentary elections** (October). **If won by the ruling Law and Justice (PiS), it would warrant prolonging of the already known policies** (thus less uncertainty) but **imply possible ongoing struggles with the EU**, a less EU friendly environment compared to the opposition and risk more regulatory uncertainty amid many changes made in the last years that are a burden to firms as well as foreign investors.

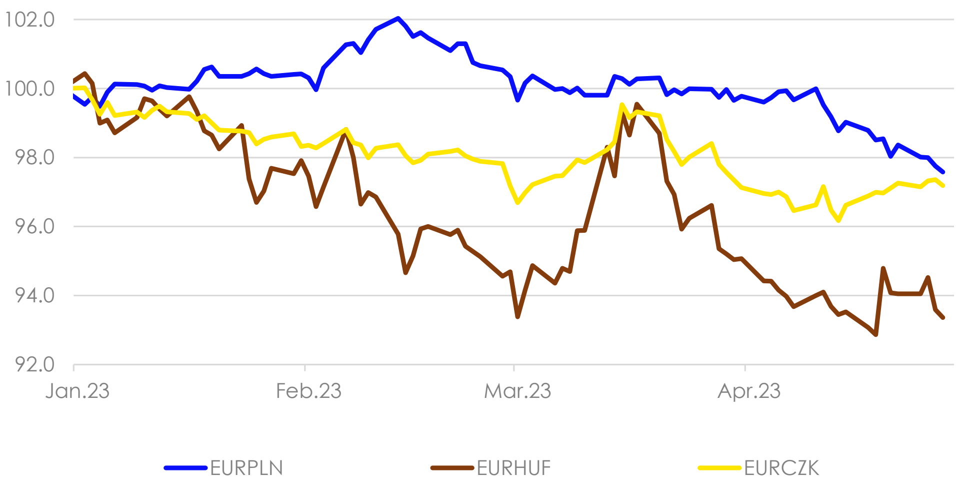
On the other hand, **a victory of the opposition would surely mean a large shift in the political landscape adding to uncertainty** while **possibly improving relations with the EU**. What is certain is that the stakes are high and thus the election campaign ahead may bring nervousness and shifts in polls (which so far still show the advantage of the governing party). It **remains to be seen whether this will lead to further easing on the fiscal side** while already now it is clear that **2023 will show a deterioration in public finances**. This will come after an already sizeable increase in the deficit in 2022 (to 3.7% vs 1.8% in 2022) amid anti-inflationary shields introduced throughout the year. However, **in 2022, the budget situation was supported on the income side amid high inflation that boosted tax collections**. As a result the debt-to-GDP ratio decreased further to 49.1%. Meanwhile, **in 2023, as government shields will persist in the modified form**, the **income side will no longer be as supported** as in 2022 while indexed expenditures will rise. Adding to that the **increased defense spending** it should lead the **deficit to even above 5%** and as a result also break the downtrend in **public-debt-to-GDP, returning it to above 50%**. From a longer-term perspective, it will be key though what happens after the elections, especially as we expect more focus on the consolidation of public finances in Europe following once again a more easy approach due to the energy crisis.

Public finances to deteriorate further in 2023



data in % GDP
Source: CSO, RBI/Raiffeisen Research

EURPLN finally on the move after being the weak outlier in Q1



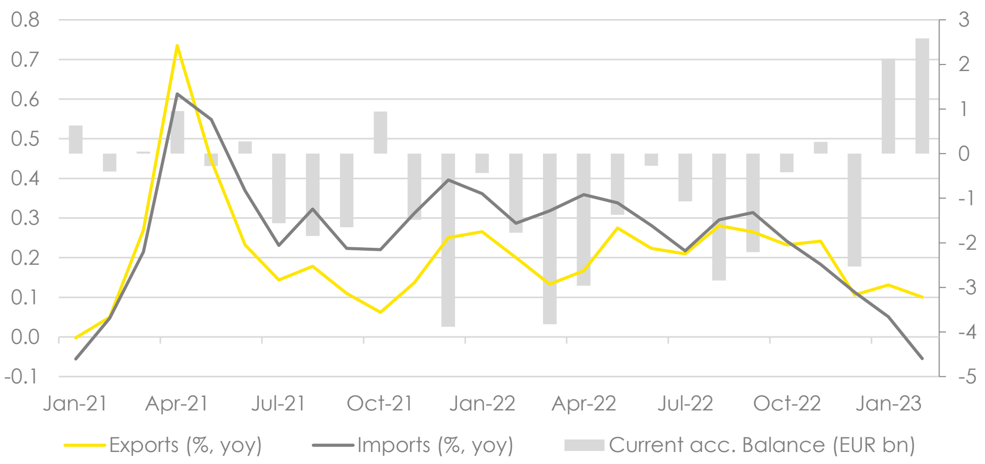
100 = 31 Dec 2022
Source: Refinitiv, RBI/Raiffeisen Research

In the last months, **the EUR/PLN exchange rate has been fluctuating around the 4.70 level** which seemed to be the marking point for **shifts in sentiment** toward the PLN and which was **mainly driven by global factors**. Still, the consolidation persisted even amid strengthening HUF and CZK, as these currencies benefited from an improved outlook in Europe amid a milder-than-feared winter and, therefore, a less severe energy crisis.

Only in the last weeks this relative weakness and stability has ended as the **improvement of global sentiment** coincided with **better fundamentals in Poland** allowing for a break **below the 4.60 level** - not seen since June last year. This was largely driven by global factors and a rebound in EUR/USD but also by local ones. In particular, of relevance, was the **faster-than-expected improvement in the balance of payments**. February data confirmed a further improvement in the trade surplus which kept the current account surplus above EUR 2bn for the second month in a row and **narrowed the 12-month CA deficit to 1.9% of GDP**. Although the rise in the trade surplus occurs as once again (typically during a slowdown) **imports decline more than exports and are driven by weak consumer demand**, this fast improvement nevertheless signals the **reversal of imbalances observed last year** and is a positive factor for the PLN. Recent weeks brought also **a reversal of rate cut expectations** that at some point reached 100bp for this year while, as noted above, we would see room for cuts only in 2024.

These **two factors may remain supportive for the złoty** but **will not be enough in our view to keep EURPLN in a lasting downtrend**. Moreover, on the local side, also the **deteriorating fiscal situation** and the **likely rise in political risk ahead of elections** may limit appetite for the PLN or even lead to some weakening. Finally, global factors (incl. conditions in the financial sector that led to the large shifts in sentiment lately) and the EUR/USD fluctuations will also remain highly relevant for the PLN. All in all, this should translate in our view to a new lower range of sideways fluctuations. With that, **we also see room for EURPLN to return to 4.70 in the next months**. As a result, while we lowered our estimate for EURPLN in the next quarter (from 4.75-4.80 closer to 4.70) **we still expect the exchange rate to stay well above the pre-pandemic levels** and keep fluctuating above the 4.50 barrier.

Current account and trade balance improvement came faster than expected



Source: NBP, RBI/Raiffeisen Research

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Poland

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