

30 March 2021

The darkest hour is just before the dawn

- **Assumptions on the pandemic scenario** are still a cornerstone for making any economic forecast. Our basic assumption so far has been that from 3q21 the economy will be able to function without painful economic restrictions, allowing it to enter a stable and strong recovery path. We have also drawn attention to the risk of efficient implementation of the vaccination program. The risk on the supply side constraints has materialized even to a greater extent than we thought (lack of vaccines was a key obstacle to the vaccination process) and on the side of the reluctance to vaccinate to a lesser extent than we feared (recent polls show a clear decrease in the percentage of people who declare that they definitely refuse to be vaccinated). New virus mutations (especially the so called "British" variant) are the biggest and strongly negative surprise to our pandemic scenario. Due to the new, more infectious and virulent mutation of the virus 1q21 was a period of chronic restrictions in many European countries that hampered the process of economic rebound.
- **Poland is now in the middle of the third wave of pandemic, with daily number of infections at the record highs** and renewed overload of the health care system. As a consequence, at the end of 1q21 antiepidemic restrictions had to be tighten again (closure of shopping malls, hair and beauty salons, kindergartens, theaters, cinemas and fitness centers) and they are now planned to last until April 9th. In our opinion, it is very likely that this period will be extended into next weeks of April, which means that at least one month of 2q21 will be burdened with the economic costs of anti-Covid measures.
- **The second wave of the pandemic in Poland in autumn has induced a "K-shaped" recovery**, with industry being a bright spot and services (esp. HoReCa and entertainment) lagging behind. Trends in the real economy in early 2021 have not changed significantly. **Nevertheless the third wave of the pandemic and the prolonged period of restrictions have forced us to revise our GDP growth forecast in 2021 downwards to 4.7% (from 5.1%).** The growth engines identified by us a quarter ago (monetary, fiscal and trade impulses plus reduction of household savings) are still in play and will emerge in full force along with a significant easing of restrictions. This means that the economic reboot after the pandemic will be delayed, having less impact than we have previously assumed on the 2021 GDP and a stronger positive influence on the 2022 GDP (especially at the beginning of the year). Further expansion of exporters in 2021 will prevent an increase in the import-consuming component of domestic demand from reducing the positive contribution of net exports. The National Reconstruction Plan will start this year, but in our opinion its impact on GDP will be visible clearly only in 2022.

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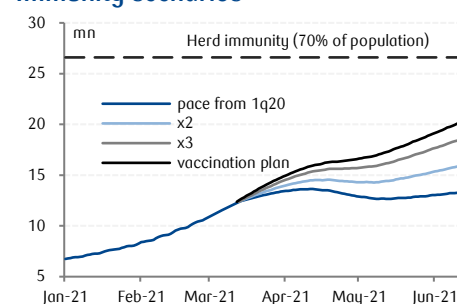
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Immunity scenarios



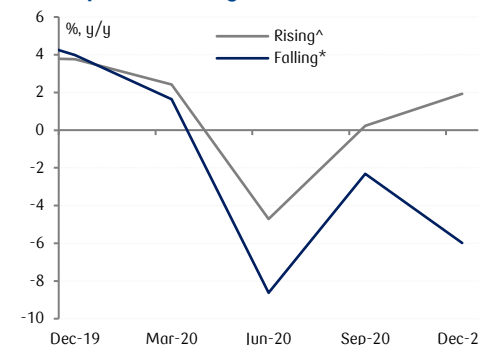
Source: PKO Bank Polski. Immuned defined either as being fully vaccinated or max. 6M past Covid-19 infection (a multiplier of 5 has been assumed to estimate the actual vs official number of cases).

Poland: key macroeconomic indicators

	1q20	2q20	3q20	4q20	1q21	2q21	3q21	4q21	2019	2020	2021
Real GDP (% y/y)	1.9	-8.4	-1.5	-2.8	-1.5	9.1	5.4	5.7	4.5	-2.7	4.7
LFS unemployment rate (%)	3.1	3.1	3.3	3.1	3.3	3.0	3.1	2.9	2.9	3.1	2.9
CPI inflation (% y/y, period avg.)	4.6	3.2	3.1	2.9	2.7	3.3	3.2	3.4	2.3	3.4	3.1
Core inflation (% y/y, period avg.)	3.4	3.8	4.2	4.1	3.7	2.6	2.3	2.2	1.9	3.9	2.7
Current account balance (% of GDP)	1.0	2.1	2.8	3.5	3.5	2.8	2.8	2.7	0.5	3.5	2.7
Fiscal balance (% of GDP)†*	-1.9	-5.5	-6.3	-9.2	-9.7	-5.1	-5.0	-3.4	-0.7	-9.2	-3.4
Public debt (% of GDP)†*	47.6	54.8	56.7	59.7	60.6	58.3	57.8	58.8	45.7	59.7	58.8
NBP reference rate (%)	1.00	0.10	0.10	0.10	0.10	0.10	0.10	0.10	1.50	0.10	0.10

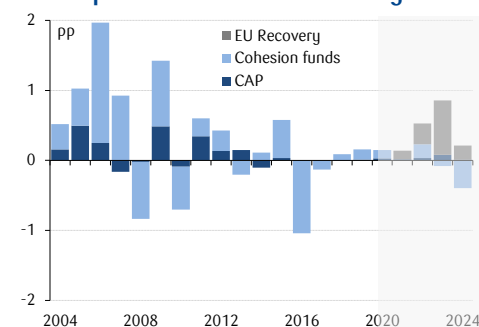
- We stick to the assumption that in 2q21 the unemployment rate will enter a downward trend and at the end of the year it will return to the pre-pandemic level. Anticrisis shields hibernate labor market until May/June or until end-2021, dependent on the firm size. Wage growth will be slightly subdued compared to the pre-pandemic period, but despite high inflation, it will maintain significant increases also in real terms. That said, in many industries (HoReCa, some manufacturing industries, e.g. clothing and footwear), 2021 will still be a period of employment restructuring.
- We still predict CPI inflation at 3.1% on average in 2021, with the balance of risks tilted upwards. Mounting reflation trends in the commodity markets and the 'second round' effects will be the main pro-inflationary factors ahead. CPI inflation is currently on an upward path and we cannot rule out that it will break 3.5% in May. However, this move will be temporary. Inflation should stabilise around 3.0% in summer. The accumulation of regulatory and tax changes at the turn of the year does not mean that this is the end of the administrative driven inflation (we expect continued housing cost increases, including water tariffs and waste disposal prices). Despite this, we expect core inflation to slow down at the end of 2021.
- We believe that the trade and current account surpluses are already permanent elements of the Polish macro picture. Despite exports expansion in 2021, trade surplus will most likely shrink due to recovery of imports (rising oil prices and domestic demand, especially investment demand, in 2h21). Rising FDI income as well as subdued tourism activity will also reduce the current account surplus, which in our view will fall from the current level of 3.6% of GDP to 2.7% of GDP in 2021. Rising FDIs (reinvested profits) will allow for further reduction of foreign debt.
- NBP interest rates are likely to remain stable even until the end of 2022. In their rhetoric, both MPC members and Governor A.Glapinski increasingly refer to the ECB and the Fed, which indicates that the decisions of Polish monetary authorities are dependent on the monetary policy of major central banks. We believe that the likelihood of interest rate cuts will not drop to zero as long as the threat of strong negative economic impact of the pandemic persists. The first signal of normalization of monetary policy may not be a rate hike, but changes in the asset purchase program.
- We estimate that fiscal deficit (ESA) will decrease to 3.4% of GDP in 2021 from 9.2% of GDP in 2020. The state budget deficit in 2021 may be lower than PLN 60 bn, owing to robust CIT and VAT as well as the NBP profit for 2020 (we estimate the NBP profit at PLN 8-10 billion). The MinFin preliminary estimates confirm our forecast that the public debt has not exceeded the 60% GDP threshold in 2020. We estimate that this ratio will decline in 2021.

K-shaped recovery (value added)



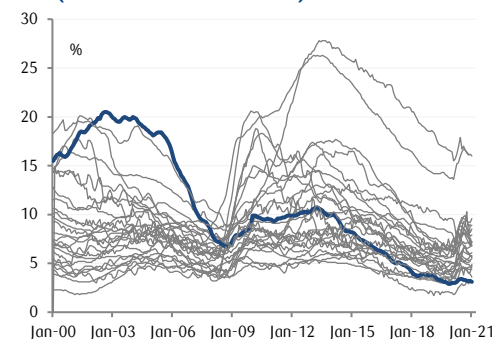
Source: StatOffice, PKO Bank Polski. ^Rising: industry, construction, transport, IT, real estate, public services. *Falling: trade, HoReCa, financial services, business services.

The impact of EU funds on GDP growth



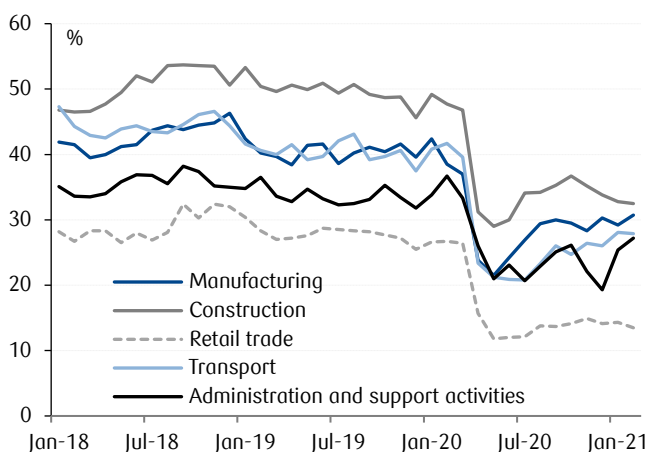
Source: MinDev, StatOffice, PKO Bank Polski.

Harmonised unemployment rate in the EU (Poland marked blue)



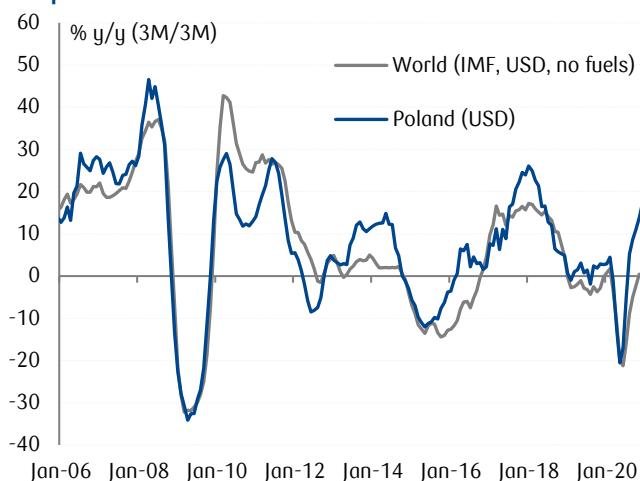
Source: Eurostat, PKO Bank Polski.

Firms indicating lack of employees* as a business obstacle



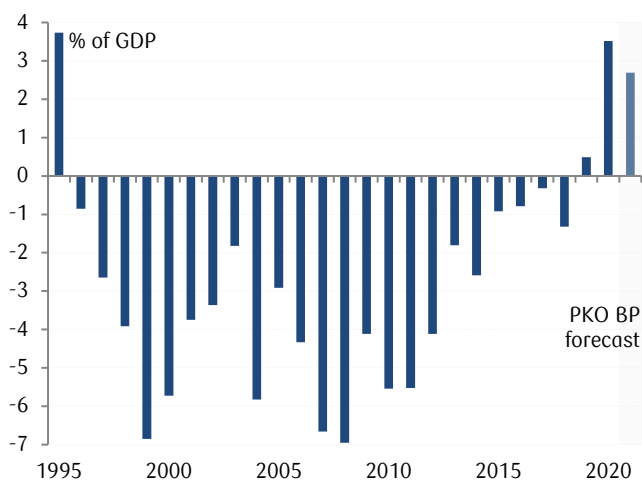
Source: GUS, Macrobond, PKO Bank Polski. *qualified employees for industry and construction.

Exports: Poland vs. world



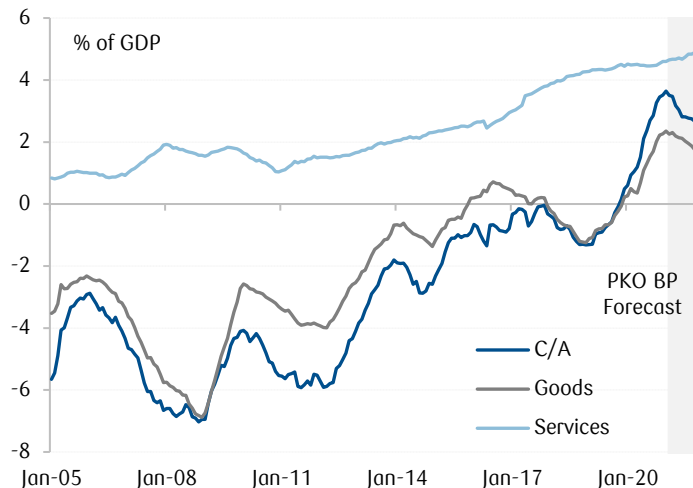
Charts in focus:

1. Current account balance



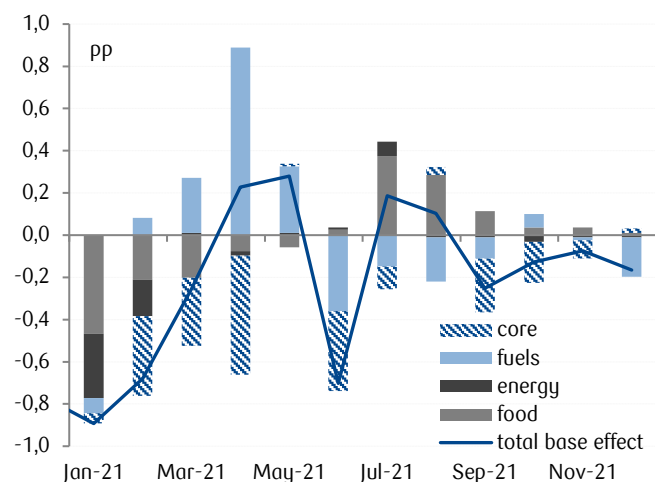
Source: NBP, GUS, PKO Bank Polski.

2. Foreign trade vs. current account



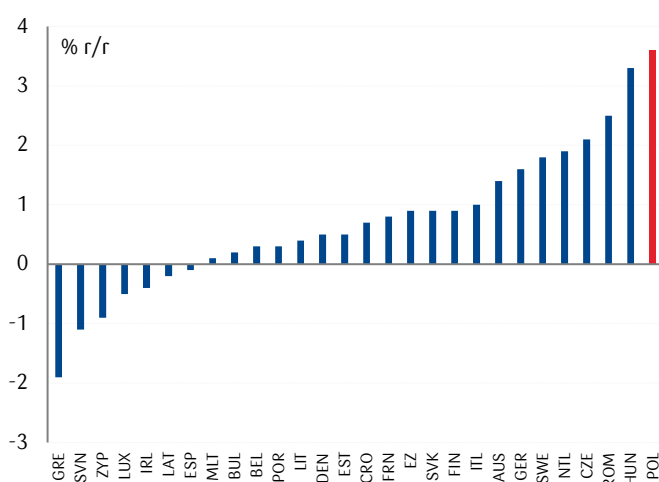
Source: NBP, GUS, PKO Bank Polski.

3. Statistical base effects in inflation



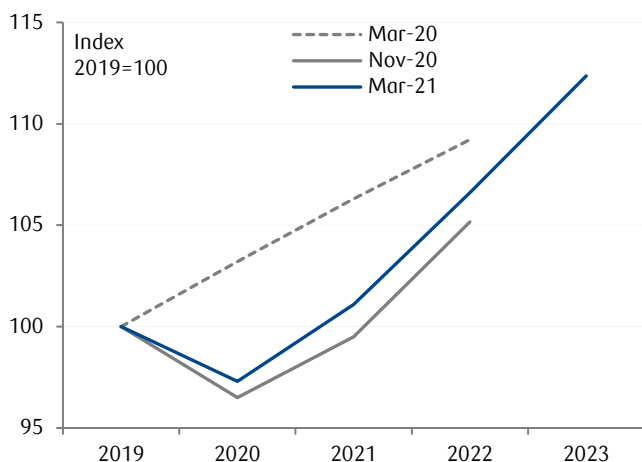
Source: GUS, NBP, PKO Bank Polski.

4. HICP inflation in Europe (Feb21)



Source: Eurostat, PKO Bank Polski.

5. GDP level acc. to the NBP's projections



Source: NBP, PKO Bank Polski.

6. Sovereign bonds' yields



Source: Reuters Datastream, PKO BP.

PKO macroeconomic forecasts

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Real economy										
GDP growth (% y/y)	1.6	1.4	3.3	3.8	3.1	4.8	5.4	4.5	-2.7	4.7
Domestic demand (% y/y)	-0.5	-0.6	4.8	3.3	2.3	4.9	5.6	3.5	-3.9	3.9
Individual consumption (% y/y)	0.8	0.3	2.6	3.0	3.9	4.8	4.3	4.0	-3.0	4.2
Investments (% y/y)	-1.8	-1.1	10.0	6.1	-8.2	4.0	9.4	7.2	-8.4	1.9
Domestic final sales (pp.)*	0.0	0.3	4.2	3.5	1.0	4.1	5.1	4.9	-3.0	3.7
Inventories (pp.)	-0.5	-0.9	0.6	-0.2	1.3	0.8	0.5	-1.4	-0.9	0.2
Net exports (pp.)	2.2	1.3	-1.4	0.6	0.8	0.3	0.0	1.2	0.8	1.0
Potential output (% y/y)	3.4	3.3	3.3	3.3	3.4	3.3	3.3	3.2	3.0	3.0
Nominal GDP (PLN bn)	1623	1647	1720	1745	1861	1989	2122	2288	2317	2497
Labour market										
LFS population 15+ (% y/y)	0.1	0.0	-0.2	0.0	-0.9	-0.4	-0.5	-0.5	0.0	-0.9
LFS employment (% y/y)	0.2	-0.1	1.9	1.4	0.7	1.4	0.4	-0.1	0.1	0.1
Participation rate (%)	55.9	55.9	56.2	56.2	56.2	56.4	56.3	56.2	56.1	56.6
LFS unemployment rate (%)	10.1	9.8	8.1	6.9	5.5	4.5	3.8	2.9	3.1	2.9
Registered unemployment rate (%)	13.4	13.4	11.4	9.7	8.2	6.6	5.8	5.2	6.2	5.4
Wages - national economy (% y/y)	3.6	3.7	3.5	3.3	3.8	5.3	7.2	7.2	5.3	6.2
Labour productivity (% y/y)	1.5	1.5	1.4	2.3	2.3	3.4	5.0	4.7	-2.8	4.6
ULC (% y/y)	2.1	1.9	2.2	1.0	1.5	1.8	2.1	2.3	8.4	1.6
Prices										
CPI inflation (% y/y)	3.7	0.9	0.0	-0.9	-0.6	2.0	1.7	2.3	3.4	3.1
Food prices contrib. (pp.)	1.0	0.5	-0.2	-0.4	0.2	1.0	0.6	1.2	1.2	0.4
Energy and fuel prices contrib. (pp.)	1.4	-0.3	-0.2	-0.7	-0.7	0.5	0.6	-0.1	-0.1	1.2
Core inflation contrib. (pp.)	1.3	0.7	0.4	0.2	-0.1	0.4	0.4	1.2	2.3	1.6
Core inflation (% y/y)	2.2	1.2	0.6	0.3	-0.2	0.7	0.7	1.9	3.9	2.7
GDP deflator (% y/y)	2.1	0.0	0.7	1.3	0.3	1.9	1.2	3.1	4.1	2.9
Monetary statistics										
M3 money supply (PLN bn)	921.4	978.9	1059.0	1155.0	1265.7	1324.4	1446.1	1561.8	1819.5	1955.9
M3 money supply (% y/y)	4.5	6.2	8.2	9.1	9.6	4.6	9.2	8.0	16.5	7.5
M3 money supply, real (% y/y)	2.1	5.6	9.2	9.6	8.7	2.5	8.1	4.7	14.1	4.1
Loans, total (PLN bn)	908.0	942.9	1007.1	1077.3	1130.0	1172.3	1259.6	1323.6	1333.9	1378.9
Loans, total (% y/y)	1.5	3.8	6.8	7.0	4.9	3.7	7.4	5.1	0.8	3.4
Deposits, total (PLN bn)	841.7	889.5	972.3	1045.7	1144.6	1194.6	1300.0	1406.8	1602.2	1681.3
Deposits, total (% y/y)	5.9	5.7	9.3	7.5	9.5	4.4	8.8	8.2	13.9	4.9
Balance of payments										
Current account balance (% of GDP)	-4.1	-1.8	-2.6	-0.9	-0.8	-0.3	-1.3	0.5	3.5	2.7
Merchandise trade balance (% of GDP)	-2.5	-0.7	-1.4	0.2	0.5	-0.1	-1.2	0.2	2.3	1.6
FDI (% of GDP)	1.2	0.8	2.4	2.1	0.9	1.4	2.6	1.6	1.0	1.7
External debt (% of GDP)	71.7	70.3	73.1	71.7	76.3	67.0	64.2	58.8	59.4	54.0
Fiscal policy										
Fiscal balance (% of GDP, ESA2010)	-3.8	-4.2	-3.6	-2.6	-2.4	-1.5	-0.2	-0.7	-9.2	-3.4
Primary balance (% of GDP, ESA2010)	-1.1	-1.7	-1.7	-0.8	-0.7	0.1	1.2	0.7	-7.9	-2.2
Primary struct. balance (% of GDP)	-1.2	-1.1	-1.0	-0.4	-0.1	0.1	0.4	-0.7	-6.9	-1.9
Public debt (% of GDP ESA2010)	53.9	56.0	50.7	51.3	54.2	50.6	48.6	45.7	59.7	58.8
Monetary policy										
NBP reference rate (%)	4.25	2.50	2.00	1.50	1.50	1.50	1.50	1.50	0.10	0.10
Real reference rate (CPI defl., %)	1.85	1.80	3.00	2.00	0.70	-0.60	0.40	-1.78	-2.31	-3.30
Real reference rate (core infl. defl., %)	2.85	1.50	1.50	1.30	1.50	0.60	0.90	-1.60	-3.60	-2.21
Lombard rate (%)	5.75	4.00	3.00	2.50	2.50	2.50	2.50	2.50	0.50	0.50

Source: GUS, NBP, MF, BIS, PKO Bank Polski, *domestic demand excluding inventories.