Poland Macro Weekly

Macro Research

30 September 2022

PKO Bank Polski | Centrum Analiz

Wartime interventionism

TOP MACRO THEME(S):

- **Wartime interventionism (p. 2):** The ongoing energy crisis will not bypass the Polish economy, which has entered the slowdown phase.
- **Second round effects (p.4).** CPI inflation in September rose to 17.2% y/y and inflation became more sticky.

WHAT ELSE CAUGHT OUR EYE:

- **The state budget had a PLN 27.5 bn surplus in Jan-Aug 2022 vs 34.7 in Jan-Jul.** In August there was PLN 7bn deficit due to the transfer of central bank profit (PLN 9.6 bn) to the off-budget Anti-Covid19 Fund. The cumulated (Jan-Aug) budget revenues are still by 7.8% y/y higher, despite energy and food VAT rate cuts. We continue to see no threat to the 2022 budget plan (PLN -29.9bn), as most of the cost of dealing with the crisis will be shifted to 2023.
- The government is working on a windfall tax for large companies (250+ employees or €50mn+ in revenue). According to the preliminary proposal a 50% levy will be imposed on the product of the 2022 sales revenues and the difference in margins between 2022 and the average for 2018-19 and 2021. The government estimates the levy will bring PLN 13.5 bn new revenues.
- **S&P lowered its forecast for GDP growth in Poland to 4.0% (previously 4.5%) in 2022 and to 1.2% (previously 2.1%) in 2023.** The agency raised its inflation forecasts to 13.3% in 2022 and 11.5% in 2023. Meanwhile EBRD assumes a 1.5% GDP growth in 2022 and 4% in 2023.
- **I.Duda** and **G.Maslowska** have been proposed to the Sejm as candidates for the last two vacancies in MPC.
- **The Bank Guarantee Fund has started forced restructuring of Getin Noble Bank,** which will be transferred to a joint BFG bank and the Commercial Bank Protection Scheme, established by 8 commercial banks.

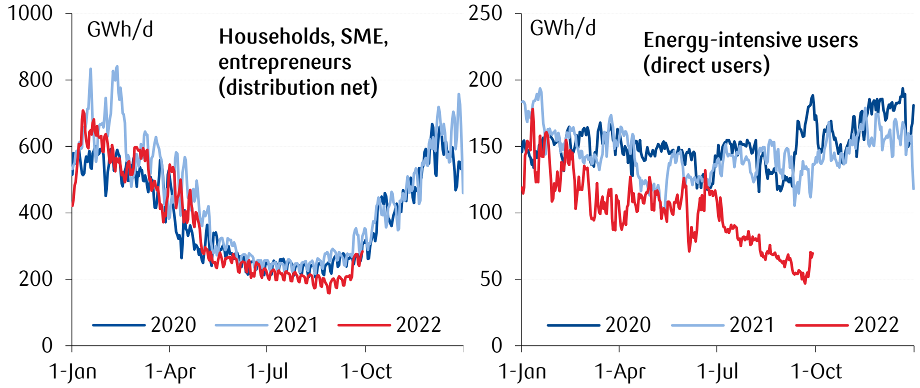
THE WEEK AHEAD:

- **NBP should finalize the cycle with a 25bp rate increase (to 7.0%) next week,** however a definite announcement of its end is hardly likely, the MPC will rather declare that the future decisions will be fully data driven. **Manufacturing PMI (Sep)** will probably once again deteriorate, but we again underline, that it overstates the magnitude of declines in industry.

NUMBER OF THE WEEK:

- **5.00** – the new all-time high for USDPLN, reflecting historical low EURUSD.

Chart of the week – Natural gas consumption by sectors in Poland



Source: ENTSOG, PKO Bank Polski.

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	2021	2022†
Real GDP (%)	5.9	4.3
Industrial output (%)	15.6	9.4
Unemployment rate# (%)	5.4	4.9
CPI inflation** (%)	5.1	14.1
Core inflation** (%)	4.1	8.5
Money supply M3 (%)	8.9	5.6
C/A balance (% GDP)	-0.7	-4.7
Fiscal balance (% GDP)*	-1.9	-2.2
Public debt (% GDP)*	53.8	50.8
NBP reference rate## (%)	1.75	7.00
EURPLN‡##	4.60	4.66*

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

Wartime interventionism

- The war is leaving an increasing mark on the world economy The ongoing energy crisis will not bypass the Polish economy, which has entered the slowdown phase and will find itself in a (technical) recession in 1h23.
- As the economy weakens, companies might find it more difficult to pass higher costs on their final customers, therefore in our baseline scenario we expect inflation to start to gradually decline from 2q23.
- The MPC is concluding the series of NBP interest rate hikes – we expect it to hike rates for the last time, to 7%, in October. The crisis is a big cost for the economy and public finances will bear its price to a large extent.
- The following essay is a summary of our latest Quarterly Bulletin - Wojenny interwencjonizm (in Polish).

The war is leaving an increasing mark on the world economy. The world, mainly Europe, is bending under the weight of the energy crisis, which forces governments to interfere more in the economy in order to protect consumers and companies.

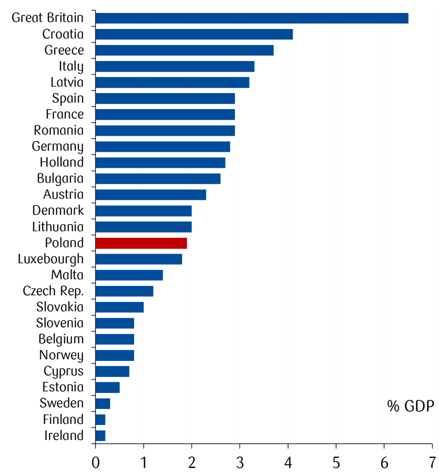
The ongoing energy crisis will not bypass the Polish economy, which has entered the slowdown phase and will find itself in a (technical) recession in 1h23. The reversal of the inventory cycle deepens the decline in GDP growth, which is visible in the data. Private consumption is holding back as real income declines, while the recent spurt of investment may not survive the test of soaring costs and uncertainty. The scale of the slowdown will be limited by public investments (including defence spending) and the continued large inflow of FDI (nearshoring is already a fact). We expect GDP growth to slow down in 2022 to 4.3% from 5.9% in 2021. In 1h23 the slowdown will likely intensify, pushing the GDP into a short-term recession, but the total 2023 result will be still positive, at 0.9% in our view.

The domestic labour market has absorbed app. 1.5 million war refugees, but is now entering the "restructuring" phase. The appearance of an additional group of employees might mean, in our opinion, that **a dual labour market is currently being created in Poland, and the reaction of its two segments to the upcoming slowdown will be different**. As the first response to the slowdown companies will likely reduce employment of agency workers, mainly foreigners. Employed under a contract of employment will enjoy a greater protection. We do not expect a strong increase in unemployment, especially taking into account the demographic situation and significant declines in the working age population (by approx. 100ths. annually). The scale of the unemployment increase will depend, among others, on decisions of foreign workers (if they register as unemployed) and the main effect of lower labour demand will be lower wage growth.

New awaited regulations increase the uncertainty regarding the inflation path. We assume that the anti-inflation shield will be maintained in full until the end of 2023. Our current path takes into account the "classic" increase in energy tariffs in January 2023, raising bills by approx. 40%. However, it is more and more likely that new solutions will be introduced, making the price dependent on the level of consumption of the energy carrier (electricity and/or gas). Depending on the measurement methods adopted by the Stat Office, the difference in inflation levels would be significant (see chart), and its course would also slightly change (lower peak in 1q23 vs slower decline at the end of 2023). As the economy weakens, companies might find it difficult to pass higher cost on their final customers, therefore in our baseline scenario we expect inflation to start gradually declining from 2q23. We expect average CPI to be equal to 14.1% in 2022 and to decline close to 8% at the end of 2023. The road to the inflation target will be long and bumpy, and we do not expect CPI to reach it before 2025.

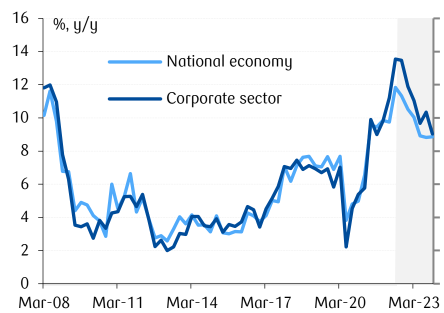
The deterioration in the current account balance by 7% of GDP in year and a half is unprecedented, but in our view this mainly reflects a temporary

Value of fiscal measures protecting against the energy crisis *



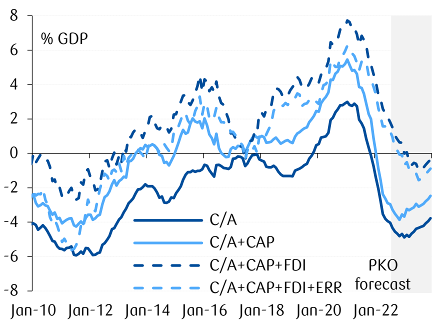
Source: Bruegel, PKO Bank Polski, *the measures announced and implemented in the period Sep'21-Sep'22.

Nominal wage growth rate



Source: GUS, PKO Bank Polski.

Measures of external imbalances



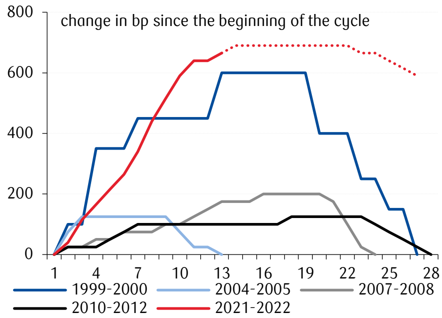
Source: GUS, NBP, PKO Bank Polski.

phenomenon rather than structural problems. Reversing the inventory cycle will reduce imports and the stabilization of the commodity markets will act similarly. **In the medium term, the situation should improve, although the current account deficit may approach 5% of GDP "along the way".**

The MPC is concluding the series of NBP interest rate hikes – we expect it to hike rates again in October, to 7%. Most likely it will be the final hike in the most severe cycle of monetary policy tightening in the modern history of Poland. Although the monetary transition is not yet complete, the impact of hikes is already visible, e.g. in the credit market freeze or slower sales growth.

The energy crisis is a big cost for the economy and public finances will bear its price to a large extent. The government is intensifying protective measures in the face of the energy shock and their scope will determine the overall scale of the widening of fiscal deficit. This year the public finances will still be relatively sound, we expect general government deficit to reach just 2.2% of GDP. Next year the deficit could increase to 5.1% of GDP, conditional on our assumptions on energy prices and the fiscal response. With nominally high economic growth, the public debt-to-GDP ratio will however remain relatively stable.

Monetary tightening cycles in Poland



Source: NBP, PKO Bank Polski.

Main macroeconomic idicators

	1q22	2q22	3q22	4q22	1q23	2q23	3q23	4q23	2021	2022	2023
Real GDP (% y/y)	8.5	5.5	3.3	0.7	-2.2	-0.8	2.2	3.9	5.9	4.3	0.9
LFS unemployment rate (%)	3.1	2.6	2.7	2.5	2.7	2.4	2.3	2.1	3.4	2.7	2.4
CPI inflation (% y/y, period avg.)	9.7	14.0	16.3	16.5	18.0	13.2	10.7	8.5	5.1	14.1	12.6
Core inflation (% y/y, period avg.)	6.6	8.4	10.0	10.3	8.8	6.9	5.4	4.5	4.1	8.8	6.4
Current account balance (% of GDP)	-2.8	-3.9	-4.5	-4.7	-4.8	-4.4	-4.2	-3.7	-0.7	-4.7	-3.7
Fiscal balance (% of GDP)‡*	-1.6	-1.5	-2.0	-2.2	-2.7	-3.5	-4.4	-5.1	-1.9	-2.2	-5.1
Public debt (% of GDP)‡*	52.1	51.6	50.3	50.8	50.5	50.7	51.0	52.3	53.8	50.8	52.3
NBP reference rate (%)	3.50	6.00	6.75	7.00	7.00	7.00	6.50	6.25	1.75	7.00	6.25

Source: GUS, NBP, MinFin, PKO Bank Polski, CPI forecast adjusted to the CPI flash for September 2022, published after the publication of the Quarterly Bulletin.

The second round effects

- **CPI inflation rose to 17.2% in August. All major components except for fuel contributed to the rise in inflation.**
- **Core inflation probably rose to 10.5-10.7% y/y on our estimate and its momentum (% m/m) was the highest in the available data history (since 2001). The data points to a widespread second round effects - companies are effectively passing on higher energy and labor costs to final prices.**
- **We expect that MPC will raise NBP rates by 25bp in October.**

According to the preliminary estimate, CPI inflation in September rose to 17.2% y/y (cons: 16.5% y/y, max: 17.0% y/y, PKOe: 16.7% y/y) compared to 16.1% y/y in August. The same as in August, all major components except for fuel contributed to the rise in inflation. Core inflation rose strongly, on our estimate, to 10.5-10.7% y/y vs. 9.9% y/y in August.

Food prices for another month in a row rose significantly stronger than the seasonal pattern (1.7% m/m, 19.3% y/y). We think that prices of a wide range of goods rose rapidly, including fruits, vegetables, meat, baked goods, oils and sugar. Food prices are under pressure from high energy prices, fertilizer prices and labor costs. Similar trends are being observed in the region (see graph at the margin).

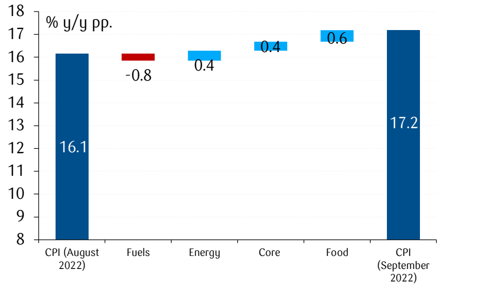
Fuel prices decreased for the third consecutive month (-2.1% m/m), driven by the global decline of oil prices.

Energy carriers became 3.7% more expensive during the month, and it was the third highest increase this year (after January and August). Solid fuels (including coal, used by households for heating) are most likely the key source of the increase in this category, but heat charges (tariff increases) likely rose as well. The prices of natural gas and electricity has probably stayed unchanged, as they are determined administratively.

The most striking part of the reading is core inflation, which has likely risen to 10.5-10.7% y/y from 9.9% in August. The momentum (% m/m) is even more impressive – according to our estimate it increased to 1.4-1.5% m/m (about 1.2% m/m after seasonal adjustment), the highest in the available data history (since 2001). We suspect that prices in education, communications and, as in the previous month, in the energy-intensive consumer goods categories (cosmetics, hygiene products, chemicals) pushing core inflation up. The data points to a widespread second round effects - companies are effectively passing on higher energy and labor costs to final prices and indexation of trade agreements is likely proceeding. **Inflation in Poland and Europe is therefore becoming more sticky.** The gloomy prospects of both domestic and global economy could certainly help to curb this pass-through effect as long as the process is not hindered by the overly expansive fiscal policy measures.

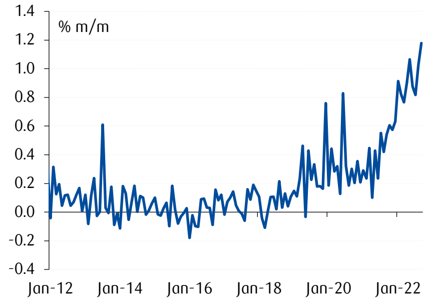
We believe that with inflation continuing to rise strongly and in a very tight market environment, the MPC will continue its interest rate hike cycle next week and will raise rates by 25bp again.

CPI inflation decomposition in September 2022 *



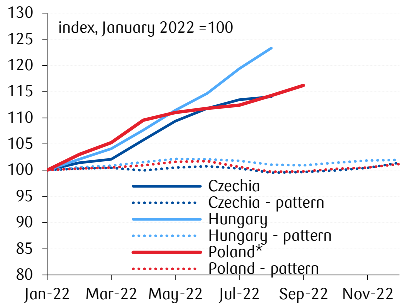
Source: GUS, PKO Bank Polski,.

Core inflation momentum (%m/m sa)



Source: GUS, PKO Bank Polski.

Food prices in CEE against seasonal pattern excl. Feb'22 VAT cut* in Poland



Source: Macrobond, PKO Bank Polski. * Poland has cut VAT rate from 5% to 0% (effectively ca. 4% decrease in food prices) in February.

Weekly economic calendar

Indicator	Time (UK)	Unit	Previous	Consensus*	PKO BP	Comment
Monday, 3 October						
POL: Manufacturing PMI (Sep)	**8:00**	**pts.**	**40.9**	**40.0**	**39.3**	**Poland manufacturing condition should once again deteriorate, following PMIs in the euro area. However Polish PMI overstates the magnitude of a slowdown in manufacturing.**
GER: Manufacturing PMI (Sep, final)	8:55	pts.	49.1	48.3	--	--
EUR: Manufacturing PMI (Sep, final)	9:00	pts.	49.6	48.5	--	--
USA: Manufacturing PMI (Sep, final)	14:45	pts.	51.5	51.8	--	--
USA: ISM Manufacturing (Sep)	15:00	pts.	52.8	52.2	--	--
Tuesday, 4 October						
EUR: PPI inflation (Aug)	10:00	% y/y	37.9	35.8	--	--
USA: Factory orders (Aug)	15:00	% m/m	-1.0	0.4	--	--
USA: Durable goods orders (Aug, final)	15:00	% m/m	-0.1	-0.2	--	--
USA: JOLTS Report (Aug)	15:00	mln	11.239	10.450	--	--
Wednesday, 5 October						
GER: Exports (Aug)	7:00	% m/m	-2.1	-2.3	--	--
GER: Imports (Aug)	7:00	% m/m	-1.5	0.8	--	--
GER: Services PMI (Sep, final)	8:55	pts.	47.7	45.4	--	--
EUR: Services PMI (Sep, final)	9:00	pts.	49.8	48.9	--	--
ROM: NBR base rate (Oct)	13:00	%	5.5	6.0	6.0	--
USA: ADP National Employment (Sep)	13:15	ths.	132	250	--	--
USA: Trade balance (Aug)	13:30	bn USD	-70.7	-70.3	--	--
POL: NBP base rate (Oct)	--	**%**	**6.75**	**7.0**	**7.0**	**We expect that MPC will finalize the cycle with a 25bp hike.**
Thursday, 6 October						
GER: Factory orders (Aug)	7:00	% m/m	-1.1	--	--	--
GER: Factory orders (Aug)	7:00	% y/y	-13.6	--	--	--
EUR: Retail sales (Aug)	10:00	% y/y	-0.9	-0.7	--	--
USA: Initial Jobless Claims (Oct)	13:30	ths	193	--	--	--
Friday, 7 October						
GER: Retail sales (Aug)	7:00	% y/y	-5.5	-5.0	--	--
GER: Industrial production (Aug)	7:00	% m/m	-0.3	-0.5	--	--
GER: Industrial output (Aug)	7:00	% y/y	-1.1	--	--	--
USA: Non-Farm Payrolls (Sep)	13:30	ths	315	250	--	--
USA: Unemployment Rate (Sep)	13:30	%	3.7	3.7	--	--
USA: Average Earnings (Sep)	13:30	% y/y	5.2	5.2	--	--

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^
L. Kotecki	4.8	**“First of all, the narrative that we already have the end of the increases has been retracted, this was said in July. That is no longer the case now in September. Rather, Governor Glapinski talked about some kind of pause. I think it will be so, that we will have some kind of pause." (23.09.2022, WNP, PAP)**
H. Wnorowski	4.2	**“With the current state of knowledge, the main interest rate should not rise above 7 percent. I see no reason why it should be higher. But a caveat is needed here: this is an assessment with the current state of knowledge.” (19.09.2022, Parkiet)**
A. Glapinski	3.4	“The summer holiday period is probably the turning point in our inflation, that highest inflation point. This is the plateau, it may be a little higher or lower, but essentially this is the high ceiling from which inflation will gradually decline. (...) As we go down with inflation, there is room to lower interest rates. (...) We have not formally completed the cycle of increases. Our next decisions will depend on incoming data. (...) What about interest rates in October? Either no change in the level of rates, or an increase of 25 bps. - This is what the Council will be considering. (8.09.2022, NBP press conference, PAP)
I. Dąbrowski	3.1	**“Relax. It is not speculative capital that makes decisions only the independent Monetary Policy Council. No attacks on the zloty will change that. Personally, I like to act under pressure; I also believe in exporters.“ (29.09.2022, Twitter)**
C. Kochalski	3.1	"The space for further rate hikes has decreased significantly, and the probability of the end of the hike cycle has increased. After the MPC's September decision, the probability of no change in rates in October increased.” (12.09.2022, Reuters).
P. Litwiniuk	2.9	“I think this (PKO: 25bp hike) is the baseline scenario, it can develop towards a higher hike in September, if confirmed by incoming data up to September 7 (PKO: MPC meeting date).” (1.09.2022, TVN24, PAP)
W. Janczyk	2.4	“The coming months, I hope, will bring no particular reasons to continue the interest rate hike cycle, although the impact of energy prices in the upcoming autumn-winter season on the economy and consumers is hard to predict right now. (...) "The council will act adequately to situation in our economy. In my opinion, it will strive to keep the lowest possible interest rate levels [while] targeting a realistic return to the inflation target.” (21.07.2022, PAP).
J. Tyrowicz	--	**“There is no doubt that rates need to be raised. Whether they need to be raised at the next meeting is a completely different question, but there is no doubt that rates need to be raised, that they are far too low. If we (think) that the NBP's target reference rate should be higher, raising at 25 bps simply does not make sense. (...) We are talking about raising the interest rate by 2-3, potentially 4 bps at the maximum, for today, with today's data, after assessing how effective previous increases have been.” (Subiektywnie o finansach, PAP, 23.09.2022)**
(Vacant places (2))	--	--

*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.

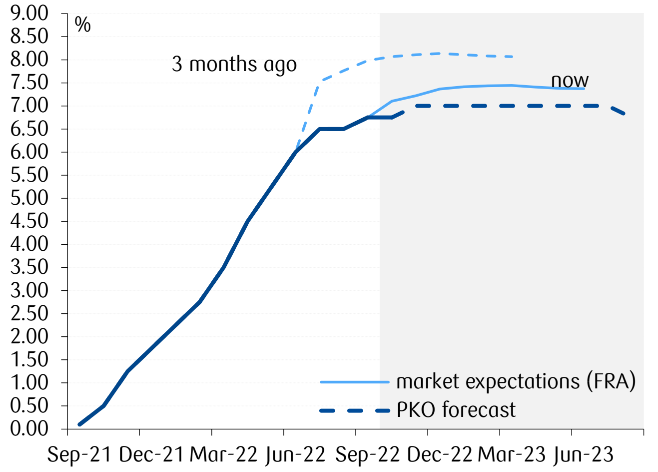
Interest rates – PKO BP forecasts vs. market expectations

		1M	2M	3M	4M	5M	6M	7M	8M	9M
Date	29-Sep	29-Oct	29-Nov	29-Dec	29-Jan	28-Feb	28-Mar	28-Apr	28-May	28-Jun
WIBOR 3M/FRA†	7.18	7.30	7.42	7.57	7.61	7.64	7.64	7.61	7.58	7.57
implied change (b. p.)		0.12	0.24	0.39	0.43	0.46	0.46	0.43	0.40	0.39
MPC Meeting	7-Sep	5-Oct	9-Nov	7-Dec	-	-	-	-	-	-
PKO BP forecast*	6.75	6.75	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00
market pricing*		6.87	6.99	7.14	7.18	7.21	7.21	7.18	7.15	7.14

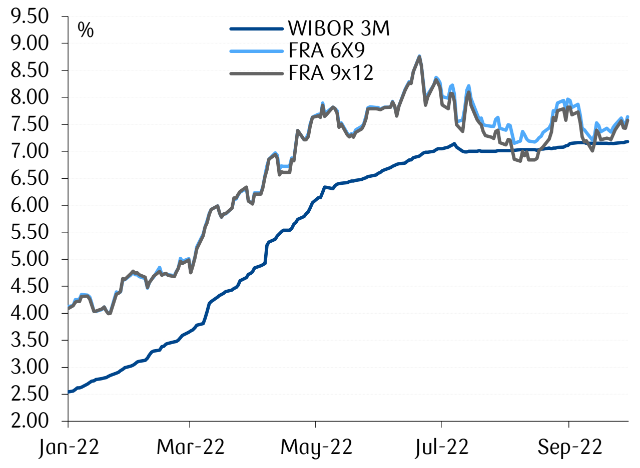
†WIBOR 3M from the last fixing, FRA transactions based on WIBOR 3M for subsequent periods, ‡in basis points, *PKO BP forecast of the NBP reference rate.

Poland macro chartbook

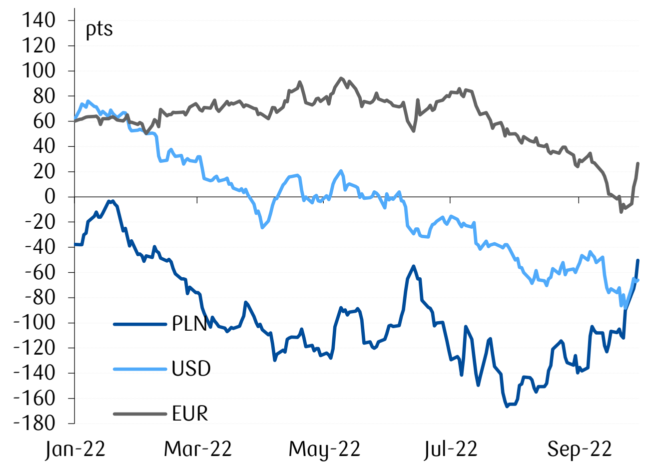
NBP policy rate: PKO BP forecast vs. market expectations



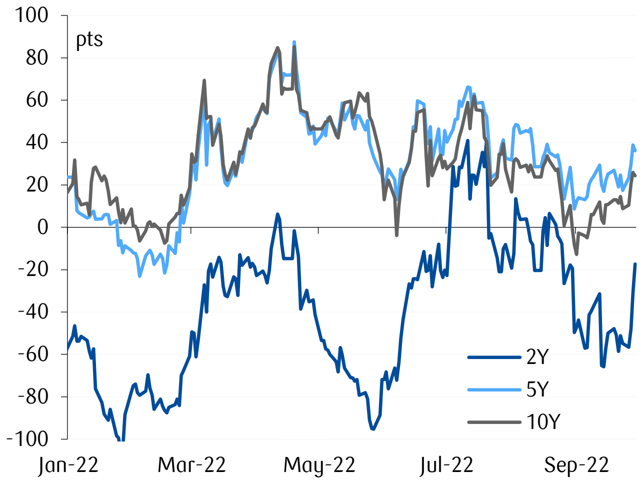
Short-term PLN interest rates



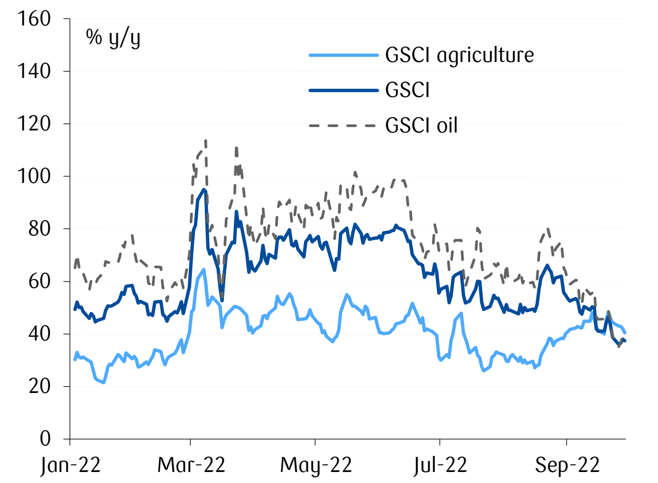
Slope of the swap curve (spread 10Y-2Y)*



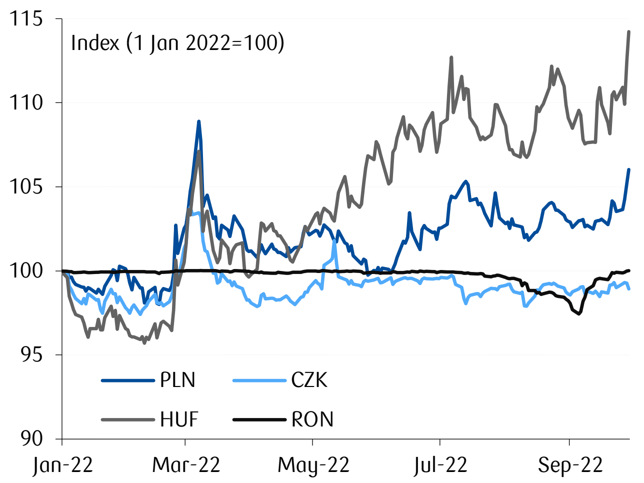
PLN asset swap spread



Global commodity prices (in PLN)

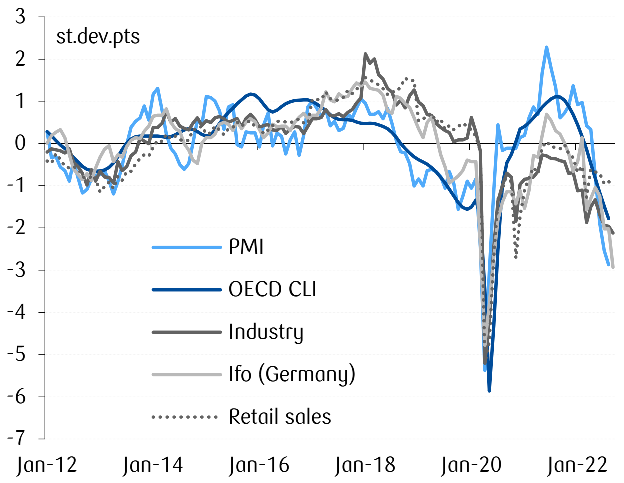


Selected CEE exchange rates against the EUR

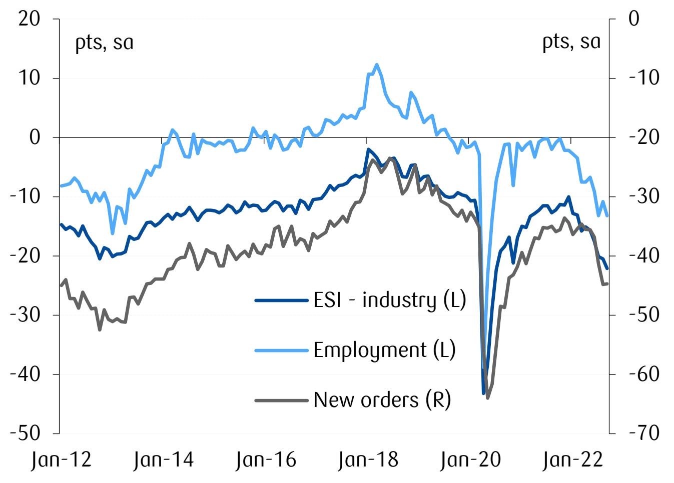


Source: Datastream, NBP, PKO Bank Polski. *for PLN, and EUR 6M, for USD 3M.

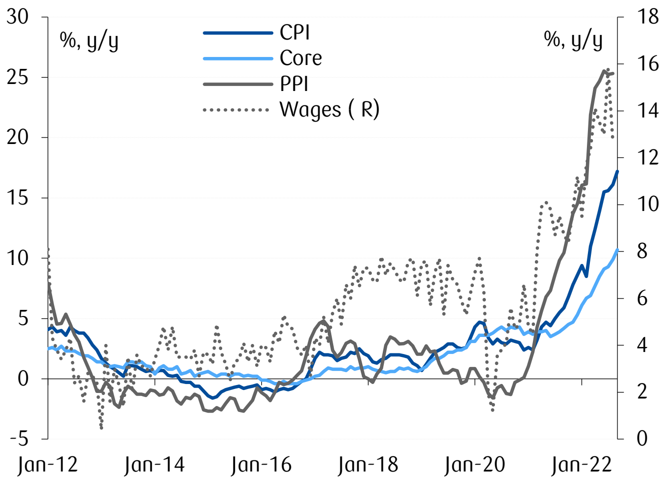
Economic sentiment indicators



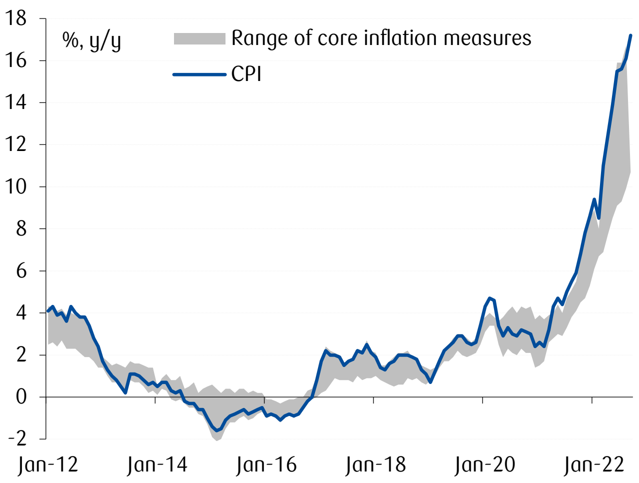
Poland ESI for industry and its components



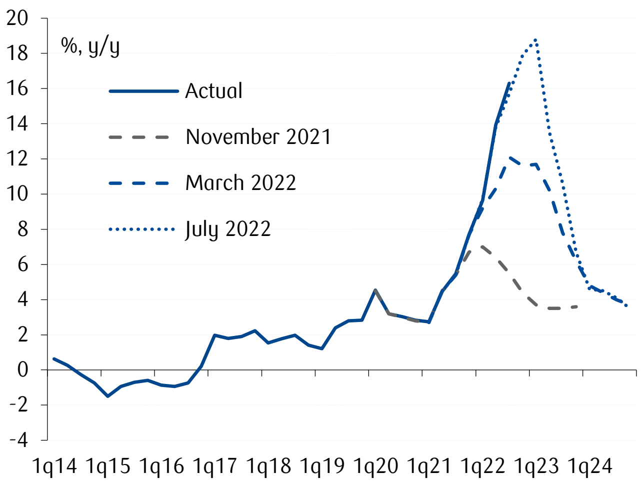
Broad inflation measures



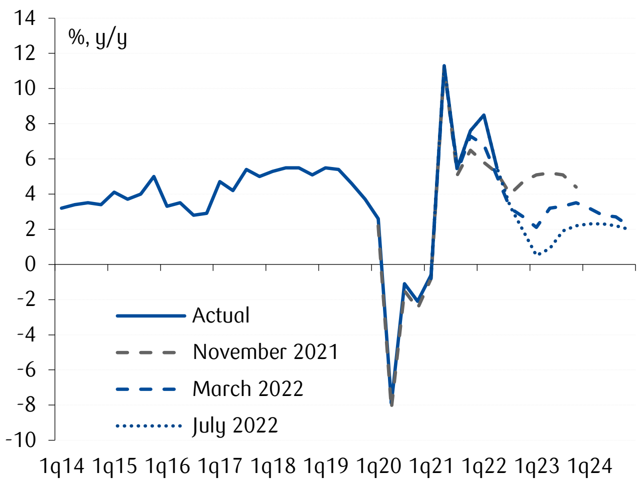
CPI and core inflation measures



CPI inflation – NBP projections vs. actual

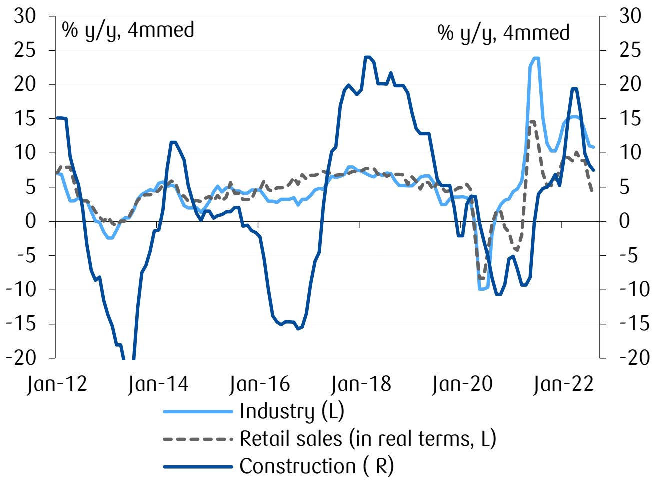


Real GDP growth – NBP projections vs. actual

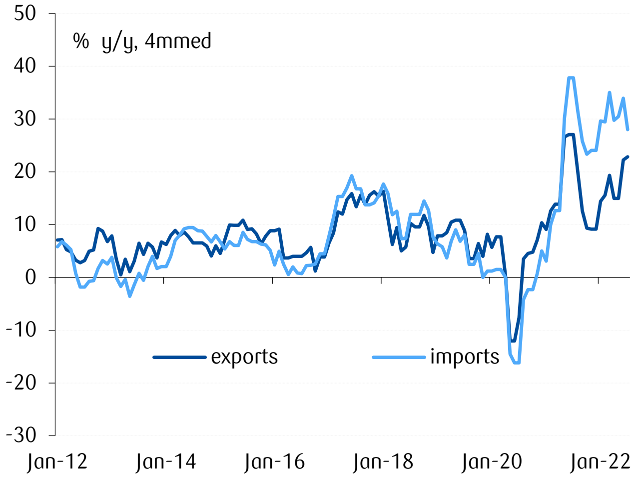


Source: Datastream, GUS, EC, NBP, PKO Bank Polski.

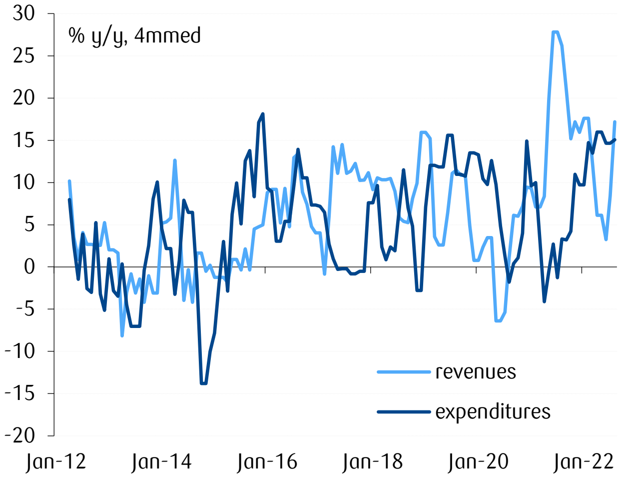
Economic activity indicators



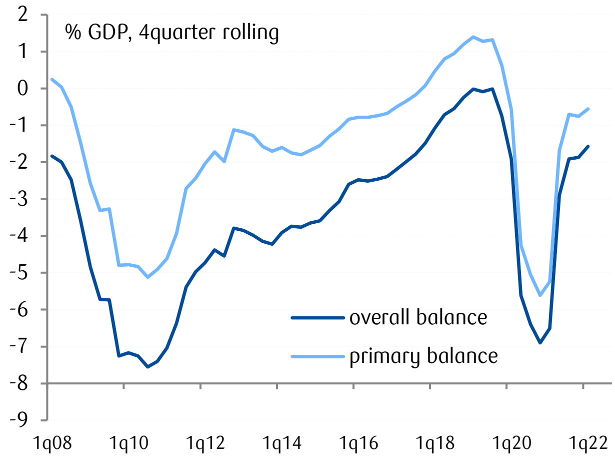
Merchandise trade (in EUR terms)



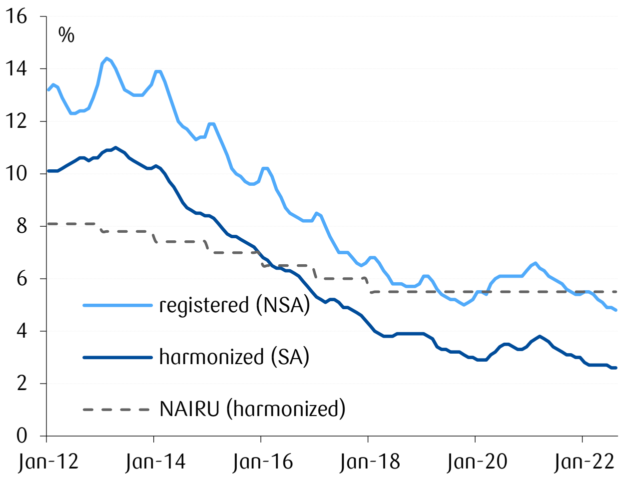
Central government revenues and expenditures*



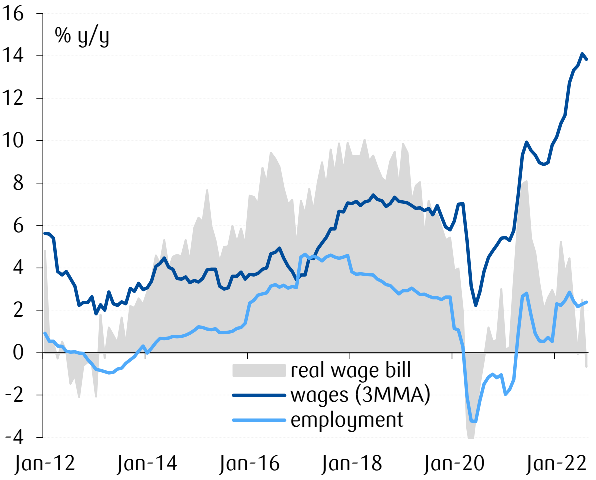
General government balance (ESA2010)



Unemployment rate

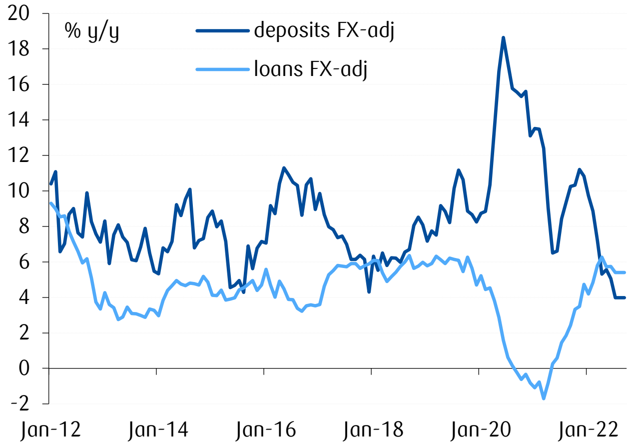


Employment and wages in the enterprise sector

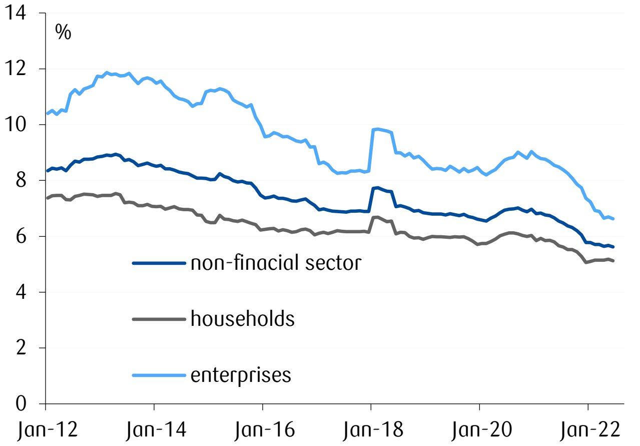


Source: NBP, Eurostat, GUS, MinFin, PKO Bank Polski. *break in series in 2010 due to methodological changes.

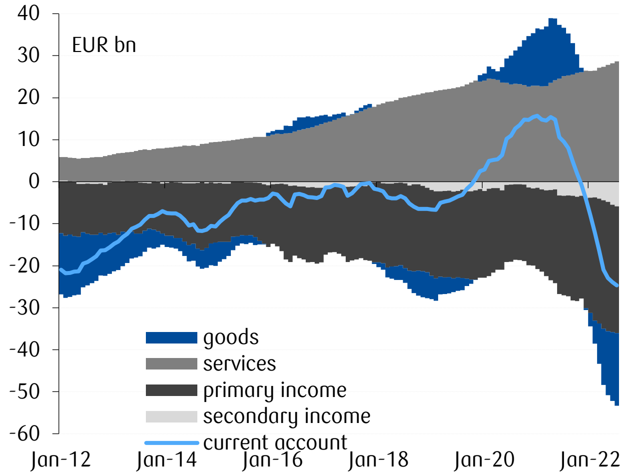
Loans and deposits



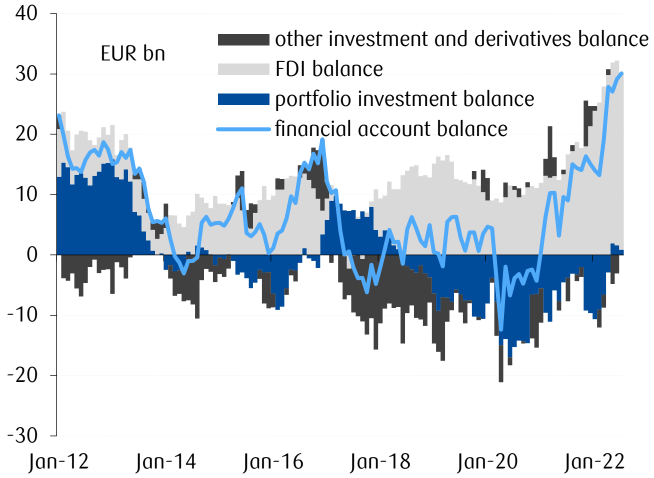
Non-performing loans (NPLs) – by sectors*



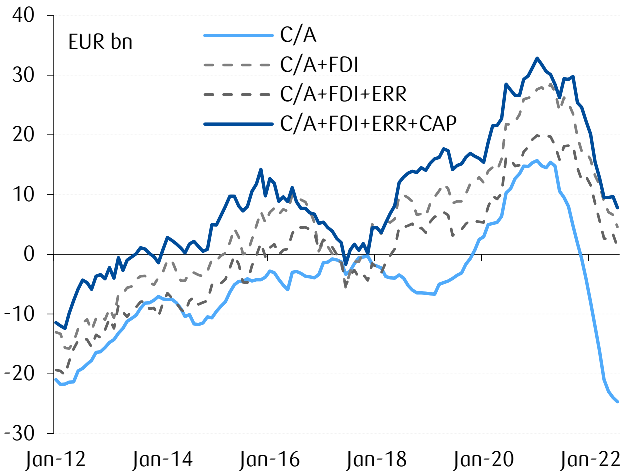
Current account balance



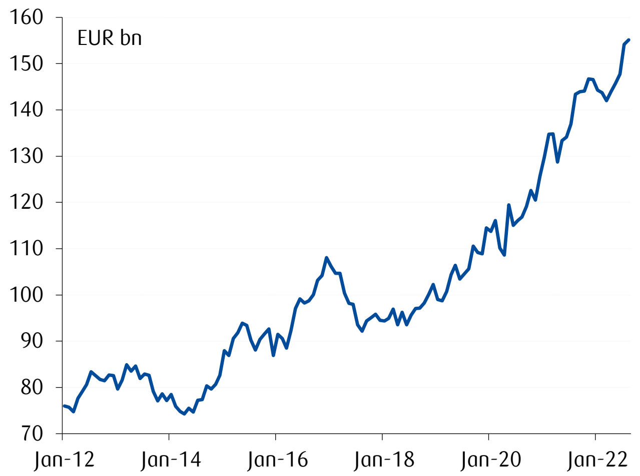
Financial account balance



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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- Will Poland escape a technical recession? (Sep 23 , 2022)
- Energy prices frozen for this winter? (Sep 16 , 2022)
- Awaiting the end of rate hikes (Sep 9, 2022)
- Inflation sparked investments? (Sep 2, 2022)
- Costs jump, deals slow (Aug 26, 2022)
- It's payback time (Aug 19, 2022)
- Inflation seems to be losing steam (Aug 12, 2022)
- Prepare(d) for slowdown (Aug 5, 2022)
- Unemployment at the bottom and inflation plateau (Jul 29, 2022)
- Slowdown just ahead (Jul 22, 2022)
- Turning point? (Jul 15, 2022)
- Inflation vs recession dilemma (Jul 8, 2022)
- NBP rate hikes coming to an end (Jul 1, 2022)
- Dry loan tap has frozen the market (Jun 24, 2022)
- A bitter pill of interest rate hikes (Jun 10, 2022)
- Growth borrowed from the future (Jun 3, 2022)
- Not all gold that glows (May 27, 2022)
- GDP growth rate at 5%? (May 20, 2022)
- Less reliant on Germany? (May 13, 2022)
- MPC is slowing down (May 6, 2022)
- 100bps month by month? (Apr 29, 2022)
- Nothing lasts forever (Apr 22, 2022)
- Deleveraging (Apr 8, 2022)
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- The calm before the storm (Mar 18, 2022)
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- #StandWithUkraine (Mar 04, 2022)
- Russian invasion - repercussions for Poland (Feb 25, 2022)
- A moment of relief for the MPC (Feb 18, 2022)
- NBP likes stronger PLN (Feb 11, 2022)
- Can we afford the Anti-Inflationary Shield? (Feb 4, 2022)