POLAND

LOSING STEAM

The economic slowdown is likely to continue in the coming quarters. Poland is facing several challenges. Firstly, the country is highly dependent on coal imports, and the price of this commodity has soared since the end of 2021. The Central Bank has moved towards a less restrictive monetary policy despite high inflationary pressures. Finally, the moratorium on mortgage repayments in 2022 and 2023 will have a negative impact on banks' balance sheets in the short term. However, the Polish economy does have numerous strengths and should show resilience.

The quarterly accounts for the second quarter of 2022 confirm a slowdown in economic activity in all of the Central European Countries (CEC). It has been more pronounced in Poland, with a GDP contraction of 2.1% q/q after +2.5% in Q1 2022 and +1.8% in Q4 2021. Household consumption and net exports made a positive contribution to growth, of 0.9 and 0.6 points respectively, but this contribution was insufficient to compensate for the marked decline in investment. Companies also seem to have de-stocked during the second quarter.

DETERIORATION IN ECONOMIC INDICATORS

Confidence in the manufacturing industry deteriorated significantly in the past six months. PMI indices and most sub-indices fell below the 50 threshold, but still remain higher than in 2020. The introduction of a tax on windfall profits, particularly in the energy sector, could further erode the confidence of businesses and cause them to defer investment projects. Households were also more pessimistic in recent months according to surveys by Ipsos, the European Commission and the Polish Institute of Statistics.

Retail sales grew more slowly year-on-year, but are still going in the right direction. They stand at 16.3% above the pre-Covid-19 level. The good performance in consumption can be explained by several supportive measures in favour of households, as well as strong wages growth in the first half of the year. This was close to the rate of inflation, meaning that losses in purchasing power were limited. The labour market remained dynamic, with a record low unemployment rate of 2.6% in August. The second half of the year will better reflect the effects of inflation on retail sales, as wages have risen more slowly since August while price increases continue to pick up.

Industrial production is resisting well for now. It is 21.2% above its pre-Covid level, but has risen more slowly over the past four months year-on-year. There is also some divergence between sectors. Energy-intensive industries are particularly affected due to rising energy costs. Some fertiliser, chemical and steel manufacturers have been forced to temporarily suspend some of their activities. Production of durable consumer goods is also falling. By contrast, activity in the automotive sector continues to move in the right direction. In the coming months, we expect a significant downturn in overall production activity in view of the signals coming out of recent industry surveys and due to the expected slowdown in demand from European countries.

MAJOR BUT MANAGEABLE CHALLENGES

The energy crisis will weigh on the economy. In fact, Poland is dependent on imports of coal from Russia for heating, even though the country is one of the world's leading producers of this commodity. Russian coal has been subject to an embargo by Poland since April. As a result, the country has to source from other suppliers in a context where prices have soared.

FORECASTS

	2019	2020	2021	2022e	2023e
Real GDP growth, %	4.7	-2.1	5.8	3.5	1.0
Inflation, CPI, year average, %	2.1	3.4	5.1	14.0	13.0
Gen. Gov. balance / GDP, %	-0.7	-6.9	-1.9	-5.0	-4.9
Gen. Gov. debt / GDP, %	45.6	57.1	53.8	51.4	49.9
Current account balance / GDP, %	0.5	2.9	-0.7	-4.1	-2.0
External debt / GDP, %	58.8	60.3	56.5	52.0	50.0
Forex reserves, EUR bn	114.5	125.6	146.9	148.0	150.0
Forex reserves, in months of imports	5.1	5.9	6.0	5.8	5.6

e: ESTIMATE & FORECASTS

TABLE 1

SOURCE: BNP PARIBAS ECONOMIC RESEARCH

POLAND: INDUSTRIAL PRODUCTION

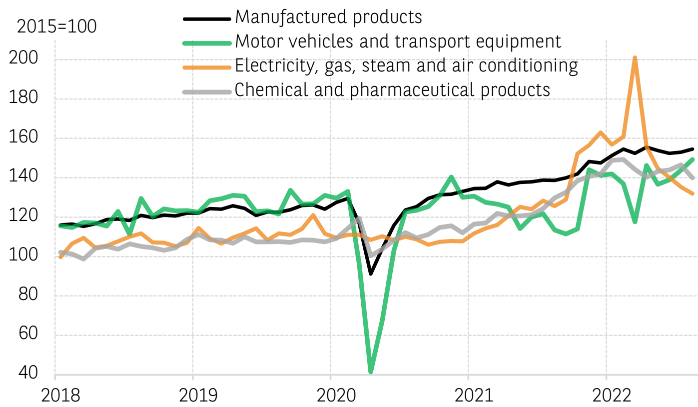

CHART 1

SOURCE: EUROSTAT, BNP PARIBAS

Poland would find it difficult to increase coal production in the short term, given high extraction costs. Also, the country's commitments to reducing CO_2 emissions have held back investment in this sector.

However, it should be noted that Poland is one of the Central European Countries that is best prepared for the energy crisis, owing to an investment strategy that has been in place for several years to diversify gas supply sources. Poland has terminals for importing liquefied natural gas, in Świnoujście. Similarly, the Baltic Pipe gas pipeline linking Norway and Poland via Denmark has been operational since 1st October 2022 and will be operating at full capacity by 2023. Poland is also supplied via Germany. Since April the country has no longer been importing Russian gas. Regarding stocks of gas, the tanks were 98% full at the end of September.

Challenges also concern the banking sector. The moratorium on mortgages, which has been in effect since July, will have a negative impact on banks' balance sheets. According to the authorities, the cost is estimated at 20 billion zlotys for banks, or EUR 4.2 bn, if all households were to decide to exercise this option.

The moratorium allows households to suspend their repayments on loans contracted in zlotys for four payment dates in 2022 and four others in 2023. As this measure is not conditional on household income it could be very widely used, particularly as almost all mortgage loans are taken out on a variable rate basis. The tightening of monetary policy since 2021, through hikes in the key interest rate, has in fact been reflected in the cost of mortgage lending.

The banking system should be able to cope with this measure. Its prudential ratios are strong. For example, the solvency ratio of the banking system as a whole was at 15.6% in Q1 2022, well above the required threshold. The non performing loan ratio remains very low, at 2.8% in Q1 2022.

POLAND: POLICY RATE AND INFLATION

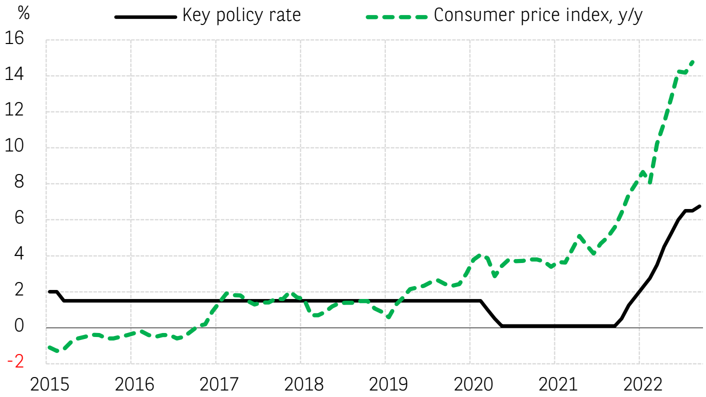

CHART 2 SOURCE: EUROSTAT, NBP, BNP PARIBAS

TOWARDS A LESS RESTRICTIVE MONETARY POLICY

Inflation has continued to accelerate. It reached 14.8% year-on-year in August, far in excess of the central bank's 2.5% inflation target. Since the end of 2021, it has been driven higher mainly by the cost of food, rents and energy bills. As for inflation excluding food and energy, it has risen sharply since the end of 2021 and stood at 10.7% year-on-year in August, driven by high wage growth (+13.8% year-on-year on average over the past three months). In the short term, inflationary pressures will remain high.

Despite inflationary pressures, the Central Bank has slowed its pace of monetary tightening since July. The increase was 25 basis points (bps) to 6.75% in September, after 50 bps in July, 75 bps in June and 100 bps in April. These actions are in line with the Central Bank's recent communications on the risks to growth. However, it still has plenty of room for manoeuvre, judging by real interest rates which are still broadly negative.

AN ECONOMY RESILIENT TO SHOCKS

Despite the expected slowdown in the coming months, the Polish economy could grow by an average of 3.5% in 2022 due to significant carry-over effects in 2021 and Q1 2022. A more pronounced slowdown is expected in 2023, but Poland should still stand out from other Central European Countries with a better economic performance. This resilience can be explained by several factors.

Firstly, the authorities have implemented several series of support measures since end 2021 to deal with inflationary risks. They represent around 3 to 4% of GDP in 2022 and have taken the shape of reductions in the rate of income tax, VAT on certain food and energy products, and excise duties. Households have also benefited from direct payments to support their purchasing power. Recently, an amount of 3,000 zlotys (640 euros) was allocated to those relying on coal for their heating. In September, the authorities also announced a freeze on household electricity tariffs in 2023.

Secondly, Poland is an economy that is somewhat less exposed to the deterioration in the international environment than its neighbours. Exports account for 50% of GDP, compared to 90% and 80% in Slovakia and the Czech Republic respectively.

Finally, twin deficits (budgetary and current) are no longer a cause for concern. Financing the current account deficit is not a major problem. FDI flows will most likely cover much of the gap in 2022 and 2023. External liquidity and solvency indicators are solid. The ratio of debt servicing to exports of goods and services was moderate at 17% in 2021. External debt was also moderate, at 56.5% of GDP.

Public accounts are also sound. The numerous support measures put in place this year are estimated at around 3 to 4% of GDP and the public deficit is expected to reach 5% of GDP in 2022. Revenues remain strong in 2022, being almost comparable to those of last year over the first 7 months of the year. In addition, the recently announced taxation on super-profits will also provide support if this measure is implemented quickly. Furthermore, the proportion of government debt denominated in foreign currencies is moderate. The increase in the cost of financing on the bond markets remains manageable with a very low ratio of interest charges in relation to tax revenues.

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