POLAND

RESILIENCE

Despite the war in Ukraine, Poland's economic growth was relatively solid in 2022. However, it was erratic with a sharp GDP contraction in Q2 and Q4. For 2023, despite a negative carry-over effect, recession will probably be avoided due to continuous fiscal support. Inflationary pressures remain high in the short term due to wage pressures and the return of the VAT rate on energy to its initial rate. The temporary blocking of European funds since 2022 might, at first glance, raise concerns against a backdrop in which public and external accounts have worsened. However, the inflow of foreign direct investment is a notable shock absorber. In 2022, these flows more than offset the current account deficit.

WEAK CONSUMPTION IN 2023

Among Central European countries, Poland posted the best economic performance in 2022, despite several successive shocks. The economy grew 5.2% year-on-year, after reaching 6.7% in 2021. Hungary and Romania follow close behind, with respectively a GDP growth of 4.8% and 4.4%, on average.

However, the good performance of the Polish economy should be put into perspective, given the marked downturn in economic activity in Q4. GDP fell 2.4% q/q compared to +1.0% and -2.3% in previous quarters. Growth was dragged lower mainly by destocking and household consumption. On the other hand, investment and net exports made a positive contribution.

Several factors suggest that household consumption, the main driver of growth, will remain sluggish in the coming months. In fact, the labour market has recently shown some signs of weakness with a slight rise in the unemployment rate to 5.5% in February 2023, compared to 5.2% last September. Household purchasing power has been affected by rising inflation throughout 2022 and is unlikely to improve in the short term. Although the increase in the minimum wage was significant (+15.9% on 1st January 2023, then +3.2% again in July to reach 3,600 zlotys per month), the increase in wages in companies (+13.6% year-on-year in February) is lagging behind inflation. The increase in real wages in the private sector has been in negative territory since August and will probably remain so in the coming months. In addition, the scope for offsetting the loss of purchasing power by savings remains limited. Despite savings accumulated during the Covid-19 crisis and used in part to compensate the loss in purchasing power, it is unlikely that households will reduce their savings rate, which is already very low (4.5% in September 2022 compared to 11% on average in 2020). And household confidence is still tepid.

Investment will likely weaken this year due to uncertainties related to the legislative elections scheduled for next autumn and the increase in credit costs. Exports should suffer from the expected slowdown among the main trading partners, although confidence in industry (European Commission indices and PMI index) has tended to improve in the last few months, in line with the improvement observed in the eurozone.

However, the Polish economy is likely to escape a recession thanks to continuous fiscal support, and should improve from 2024 onwards as inflation falls and the global economy recovers.

TOWARDS A DROP IN INFLATION

Similarly to several countries in Central Europe, Poland is still experiencing high inflation. It reached 18.4% year-on-year in February after an average of 14.4% over 2022. This rise in prices is primarily the consequence of the VAT rate on energy going back up to 23% on 1st January 2023. It was temporarily lowered to 8% in February 2022 until the end of December. By way of compensation, the authorities announced a tariff freeze on gas prices at 2022 levels for all households and public services, as is being done for electricity. In March, inflation fell slightly (+16.2%), according to preliminary estimates. As for core inflation, this is self-reinforcing due to high wage pressures.

The relative easing of agricultural and energy prices on global markets is an argument for a further drop in inflation. However, global droughts could create renewed tensions on agricultural commodity prices in the short term. All in all, inflation should remain in double digits this year

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	-2.0	6.7	5.2	0.5	3.0
Inflation, CPI, year average, %	3.4	5.2	14.4	13.0	7.5
Gen. Gov. balance / GDP, %	-6.9	-1.8	-3.0	-4.9	-3.9
Gen. Gov. debt / GDP, %	57.1	53.8	48.5	47.6	46.9
Current account balance / GDP, %	2.4	-1.4	-3.1	-1.8	-1.9
External debt / GDP, %	60.7	56.6	51.0	46.2	45.0
Forex reserves, EUR bn	125.6	146.6	156.5	158.5	162.5
Forex reserves, in months of imports	5.9	5.6	4.7	5.2	5.5

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

POLAND: WAGES AND CPI GROWTH

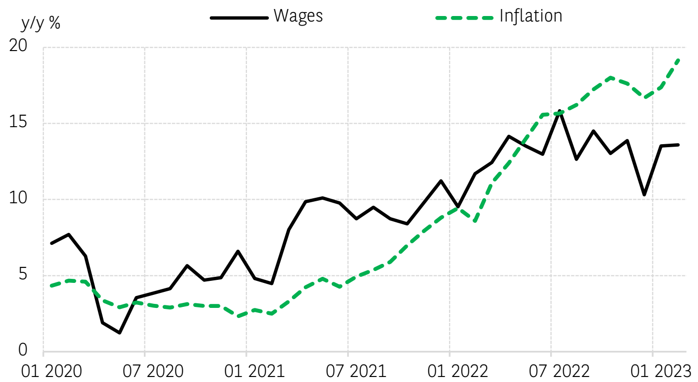

CHART 1 SOURCE: STATISTICS POLAND, BNP PARIBAS

and then gradually fall in 2024. It is unlikely to return to the Central Bank's target range of 1.5-3.5% by 2025.

Despite inflationary pressures, monetary policy has become less restrictive. After raising the key rate by 450 basis points over the first 9 months of 2022, the Central Bank of Poland has since maintained a monetary status quo. The latest release does not provide signals about the future approach to monetary policy, but concerns about growth seem to indicate the end of the monetary tightening cycle. Bearing in mind inflation levels, a less restrictive monetary policy alongside with uncertainties about the outcome of the general election, the zloty should a priori depreciate again this year after a limited drop of 2.6% against the euro in 2022. However, the central bank's likely intervention in the foreign exchange market will help to limit downward pressures. Since 1st January 2023, the zloty has remained more or less stable against the euro.

THE TEMPORARY BLOCKING OF EUROPEAN FUNDS IS MANAGEABLE

European funds, which constitute a significant source of funding, are still blocked by the EU as progress on judicial reforms is still deemed insufficient. These funds are estimated at EUR 35 billion under the recovery and resilience plan and EUR 76.5 billion under the 2021-2027 Budget.

However, the temporary absence of European funds does not present major concerns despite the deterioration of external and public accounts. The Polish economy should continue to show resilience given solid macroeconomic fundamentals and structural assets.

The country is an attractive destination for foreign direct investment (FDI), which constitutes a stable source of funding. In terms of volume, FDI stock received by Poland, at EUR 291.3 billion in Q3 2022, exceeds other Central European countries, although the situation is more mixed when compared to GDP. In 2022, net FDI flows in Poland even continued to rise to EUR 26 billion (4% of GDP) after reaching EUR 23.4 billion in 2021. Over the recent period, the influx of FDI can be explained by the relocation of production activity within Central European countries in the face of supply shocks linked to the Covid-19 crisis and protectionist measures implemented by the United States against China since 2018. FDI flows largely contributed in convering the current account deficit, representing EUR 19.5 billion over the same period.

The current account, which structurally has a negative balance, reached -3.1% of GDP in 2022, mainly due to the deterioration of the trade balance and primary incomes. Without the balance of services' surplus, the current account deficit would have been more pronounced. Nevertheless, external liquidity and solvency ratios are solid. Foreign exchange reserves were comfortable, at EUR 158.2 billion in February 2023, and the country even built up these reserves in 2022 (+EUR 9.9 billion). These reserves cover about 5 months of imports. Over the next two years, an improvement in the current account is to be expected due to a reduction in the energy and food bill. Similarly, the rebound in the global economy over this period should also contribute to the improvement in the current account.

In terms of public finances, fiscal consolidation was temporarily halted to mitigate the shocks faced by the economy since 2020. In 2022, the budget deficit, estimated at 3% of GDP, is less pronounced than expected, thanks in part to the good performance of tax revenues.

POLAND: CURRENT ACCOUNT BALANCE & FDI FLOWS

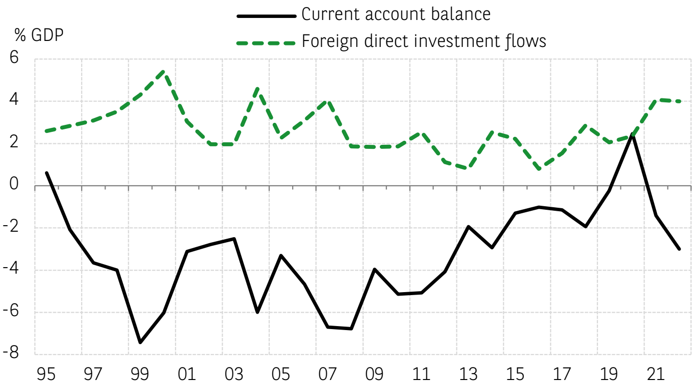

CHART 2

SOURCE: IMF, BNP PARIBAS

In 2023, the budget deficit is expected to be higher. The authorities are anticipating a deficit of around 4.5% of GDP in the 2023 Budget due to the extension of support measures for households, including amongst other things, energy subsidies and price freezes on certain foods. A strong increase in military spending is also expected. It is estimated to be in the region of 4% of GDP in 2023, compared to 2.4% in 2022. The electoral context, generally accompanied by generous measures, should also have a significant impact on public accounts.

The rise in the rate of government bonds does not raise any concerns in terms of the sustainability of public debt. Interest expense in relation to tax revenue remains very low at 6.9%. The majority of the debt already issued by the Polish authorities is at a fixed-rate (71.5% at the end of 2022) so that the apparent interest rate would only be progressively affected by the rise in bond yields. Only inflation-linked bonds and floating-rate bonds will be affected, but they only represent 28.5% of Government debt. It is to be reminded that the Government debt-to-GDP ratio estimated at 48.6% of GDP, is among the lowest in the European Union, and must not exceed 60% according to the Constitution.

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