TOWARDS A RECOVERY IN INVESTMENT

Poland stands out from neighbouring countries with an outperformance of its economy. It has also experienced an uninterrupted positive GDP growth since 1992, with the exception of 2020. Growth prospects are strong in 2025 and 2026, due to the expected rebound in public investment and despite the uncertainties related to the presidential elections in May 2025. Inflation is accelerating once again this year and is not expected to converge towards its target before 2026. Monetary authorities are likely to maintain their *status quo* for the time being, and then move towards policy easing later in the year. Regarding the impact of "Trump 2.0", Poland has limited direct trade exposure to the US, but remains vulnerable to the rise of protectionism.

GROWTH CLOSE TO POTENTIAL

Economic activity remains favourable for 2024 as a whole, even though GDP growth slowed in Q3 and scope for a significant rebound in Q4 is unlikely. The carry-over was already 2.2% in Q3, which means that Poland could see higher GDP growth than its neighbours over the past year.

With the pick-up expected in 2025 and 2026, primarily attributed to the recovery in public investment, economic growth should even exceed the medium-term potential estimated at 3% by the IMF. Improving investment prospects rely on the support from EU funds for Poland under the Recovery and Resilience Plan, which are expected to be disbursed by the end of 2026. The amounts allocated to Poland represent EUR 25.3 billion in subsidies and EUR 34.5 billion for loans at preferential rate, i.e. the equivalent of 8% of 2023 GDP. The country also benefits from EUR 76 billion in funds under the European budget, spread over the period 2021-2027.

The momentum of public investment is likely to be strong enough to offset barriers limiting growth. Consumption is expected to lose some momentum due to households turning more cautious, which is already evident in the surveys on purchase intentions for durable goods. Similarly, the long-awaited impetus of external demand is struggling to materialise as Germany, Poland's principal partner, is unlikely to see a significant rebound in its growth in the short term.

HIGHER INFLATION ON AVERAGE IN 2025

The slight drop in inflation in November and December (4.2% y/y in October, to 3.9% y/y in November and December) is probably temporary. Inflationary pressures have generally been on the rise since July 2024 and are expected to continue at least until Q1 2025. This rise in inflation comes from the increase in the cap on electricity prices since July last year, which will remain in place until September 2025. The "food" item is also pushing the consumer price index upwards. Meanwhile, softerinflation expected in the last three quarters of this year could come from a less pronounced wage growth compared to previous years. On average, inflation in 2025 could be higher than last year and a return to the inflation target will not be seen before 2026.

In terms of monetary policy, the Polish Central Bank was the first in the region to start the easing cycle in September 2023, with two consecutive policy rate cuts (the first, by 75 basis points [bps] and 25 bps the following month), followed by a pausethereafter. This recalibration is due to the expectation of slightly higher inflation from mid-2024 to Q1 2025.

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth, %	5.5	0.1	2.8	3.5	3.5
Inflation, CPI, year average, %	14.4	11.4	3.7	4.2	2.8
Gen. Gov. balance / GDP, %	-3.4	-5.3	-6.7	-5.7	-5.2
Gen. Gov. debt / GDP, %	48.8	49.7	53.2	55.0	56.9
Current account balance / GDP, %	-2.3	1.8	0.2	-0.7	-1.1
External debt / GDP, %	53.7	49.5	49.2	46.7	44.3
Forex reserves, EUR bn	156.5	175.4	214.2	220.0	225.0
Forex reserves, in months of imports	5.2	6.1	7.3	7.3	7.1

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

POLAND: EUROPEAN FUNDS FOR RECOVERY AND RESILIENCE

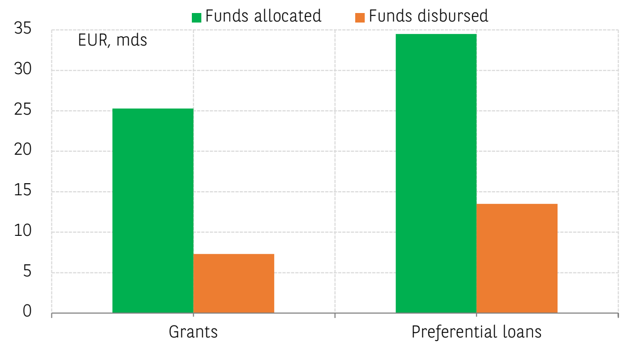

CHART 1 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

In addition, election uncertainties and the expected volatility on the currency market in the face of rising protectionism are likely to prompt greater caution, which reinforces the scenario of a monetary pause, at least in the first half of the year. Resumption of the monetary easing cycle, expected for the second half of the year, should continue next year. According to our scenario, the key rate will probably be reduced to 4.00% at the end of 2025 and to 3.50% in 2026.

GOVERNMENT DEBT ABOVE 60% OF GDP BY 2026

The widening fiscal deficit since 2020 is the result of generous government measures to support the economy. The deficit may reach 6.0% of GDP in 2024 according to estimates and should remain above 5% in 2025.

This year, the budgetary consolidation margin is limited, taking into account the electoral challenges (presidential election scheduled for May 2025) and the magnitude of military expenditure (4.7% of GDP in 2025). The budget also contains an important social component, including, among other things, a 16% increase in healthcare expenditure, a revaluation of wages in certain public sectors and a renewal of the family assistance programme (Family 800+).

The deterioration of the fiscal trajectory is not jeopardising the government's solvency. Government debt is mainly contracted at fixed-rate and the Treasury's ability to refinance itself is strong. Similarly, the government's interest payment remains contained at 9.2% of revenue (1.5% of GDP). However, the proportion of debt to GDP could exceed the threshold of 60% of GDP by 2026, a threshold set out in the Polish constitution, in addition to EU budgetary rules. In the meantime, the prospect of a limited adjustment to public accounts in the short term is reflected in the bond market by rates that remain well above the pre-COVID situation (5.7% in mid-January for the 5-year government bond compared to 1.8% at the end of December 2019).

TRUMP 2.0: POLAND IS EXPOSED TO TARIFF MEASURES

Poland will not escape tariff measures of the Trump administration, even if the country has for years had a marginal bilateral trade balance (of goods) and barely a deficit towards the United States (USD -2.2 billion in 2023; USD -208.7 billion for the EU). The tariff measures planned by the Trump administration will probably be applied to all EU countries indiscriminately. The surplus of the EU's bilateral trade balance with the US, which has also increased since Donald Trump's first mandate, suggests substantial tariffs.

The Polish economy is exposed to the Trump administration's policy through commercial, financial and exchange rate channels. On the first aspect related to trade, Poland's direct exposure is marginal and suggests an initially limited impact since the share of goods exports to the United States was only 2.9% of total exports on average over the last 5 years (1.4% of GDP). By contrast, the indirect impact through Germany, which is more exposed to the US, could be significant. In total, the direct and indirect exposure of Polish exports to tariff measures represents around 15% of GDP. The main export items from Poland to Germany relate to automotive (9.8% of the total in 2022) and machinery and equipment (26.4%). In addition, being a relatively open economy (exports/GDP: 46.8% in 2023), Poland is vulnerable to external shocks given the negative impact of tariff measures on global trade.

On the financial side, the likely slowdown in foreign direct investment (FDI) flows, most of which come from Germany, could put a serious brake on Poland's ambitions to move up the value chain in the short term. Rising economic and geopolitical uncertainties will inevitably lead to a postponement of foreign investment projects. In addition, a reallocation of capital flows in favour of the US is likely in the short term.

US BILATERAL TRADE BALANCES

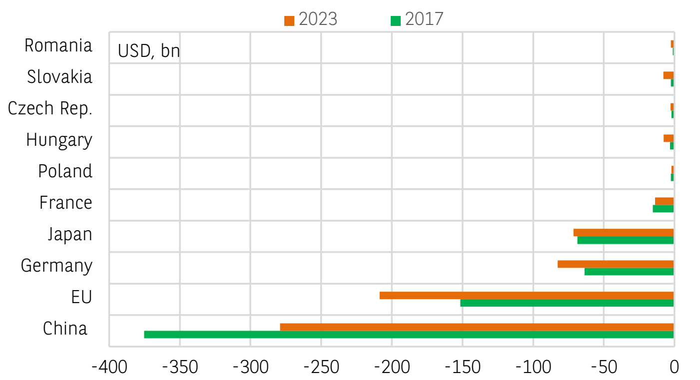

CHART 2 SOURCE: US CENSUS BUREAU, BNP PARIBAS

However, this situation remains manageable and does not present a major risk to external accounts. The current account deficit expected for this year remains moderate and Poland has very comfortable liquidity (foreign exchange reserves of EUR 214.2 billion in December 2024) to meet its needs if necessary.

On the exchange rate side, currency volatility and the upward trajectory of the dollar further weaken countries with a large proportion of their debt denominated in foreign currencies. In Poland, the share of government debt in foreign currencies is moderate, amounting to 24.4% of total debt in 2023 (12.1% of GDP). However, currency risk exposure has nevertheless increased since 2024 as the Polish government is very active on the eurobond market (EUR 7.7 billion raised in 2024) to partially meet its financing needs. This year, Poland has already raised EUR 3 billion in January out of the EUR 10.2 billion planned by the government for 2025. Government exposure to currency risk remains manageable due to supervisory rules in place. The authorised proportion of debt in foreign currencies is set at 25% in Poland.

The expected trend in 2025 is a slight depreciation of the Polish zloty against the euro and the dollar. Caution in monetary policy and the prospect of strong growth in the region should ease downward pressures on the zloty. Last year, the Polish currency reported a modest appreciation of 2.2% against the euro and a limited depreciation of 3.3% against the dollar.

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