POLAND

A RESILIENT ECONOMY

The second wave of Covid-19 that swept Poland in Q4 2020 was more severe than the first wave in Q2 2020. In contrast, economic growth was not hit nearly as hard thanks to the resilience of industrial output and demand (exports and household consumption). The authorities' stimulus measures combined with industry's competitiveness – which was not undermined much by the pandemic – bolstered growth, and the trade surplus increased. Against the background, a somewhat weak zloty is more a choice than a by-product of deteriorated fundamentals. The European budget agreement, as Poland is one of the main beneficiaries of the Recovery Plan, should provide additional support for growth.

THE SECOND WAVE OF COVID-19 WAS MORE SEVERE THAN THE FIRST

The curve of new Covid-19 cases and deaths suddenly worsened in October, with nearly 25,000 new cases a day. The Polish authorities responded by imposing a new lockdown as of November.

Limited primarily to retail stores, the new lockdown did not prevent manufacturing output from continuing to grow in November (5.1% year on year). It is now 3% higher than pre-Covid levels. This performance was mainly driven by automotive production and all of the sectors providing its inputs (plastics, metals, car suppliers).

The dichotomy between underperforming services and resilient manufacturing is expected to persist since the virus is still spreading actively and new restrictions were introduced in January 2021 (including the closing of schools for a month). Moreover, the vaccination campaign will be rolled out in several phases (with the healthcare workforce to be the first to benefit), which does not augur well for herd immunity before mid-2022 at the earliest, according to the timetable that was presented. This suggests that the most highly exposed sectors will continue to underperform in the quarters ahead.

GROWTH SHOULD HAVE OUTPERFORMED IN Q4

Economic indicators have proven to be rather resilient. In terms of demand, exports seem to have been the main driver of Q4 growth (+9% y/y in September and October), thanks notably to the automotive industry. This is a remarkable performance considering that global exports of goods (excluding China) stagnated over the same period. Poland's strong performance is notably due to its attractiveness for non-resident investors in recent years, which developed both its export potential and the size of its domestic market.

As a result, the current account surplus swelled to 4% of GDP in 2020. During the year, there were no shocks to the country's capital flows (even foreign direct investment held up fairly well), and Poland managed to consolidate its foreign reserves, which facilitated the implementation of an accommodative monetary policy.

Household consumption also proved to be very resilient, levelling off in October and November near the September 2020 level, despite the shutdown of some retail segments. Poland is likely to be one of the rare countries in which Q4 consumption was stronger than pre-Covid levels. The European Commission survey on the opportunity to make major purchases also shows that Polish households have higher spending intentions than consumers do in most of the other EU countries.

FORECASTS

	2019	2020e	2021e	2022e
Real GDP growth (%)	4.1	-3.3	4.9	4.3
Inflation (CPI, year average, %)	2.4	3.4	2.4	2.7
Gen. Gov. balance / GDP (%)	-0.7	-9.0	-5.0	-2.8
Gen. Gov. debt / GDP (%)	46.0	58.0	60.0	58.0
Current account balance / GDP (%)	0.5	4.0	2.1	1.5
External debt / GDP (%)	59.4	56.8	50.0	46.0
Forex reserves (EUR bn)	114.5	127.1	133.3	137.0
Forex reserves, in months of imports	5.1	6.5	6.5	6.2
Exchange rate EURPLN (year end)	4.3	4.6	4.3	4.3

TABLE 1

e: ESTIMATE & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

MANUFACTURING PRODUCTION AND RETAIL SALES (LEVELS)

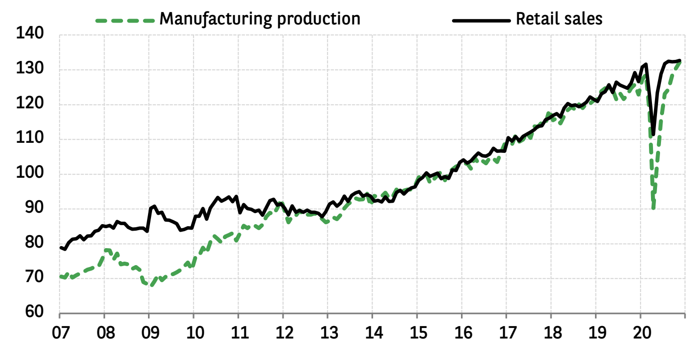

CHART 1

SOURCE: CEIC

The labour market's relatively strong performance is a major support factor for the resilience of household demand: the unemployment rate was limited to 6.1% (vs a pre-Covid level of 5.4%) and wages have held up well. Consequently, unit labour costs rose sharply in Q2 (+10% y/y) before easing thereafter, although they are still holding at significant levels (+5.4% in Q3). Transport and logistics costs have also risen in the wake of the Covid-19 pandemic. Looking at December's manufacturing PMI, the record-high level of the input price component also illustrates the strong cost pressures. This has been partially offset by relatively low oil prices since March.

THE POLICY MIX WILL REMAIN ACCOMMODATIVE, WHICH IS SUSTAINABLE

Poland entered the Covid-19 crisis with moderate public debt (46% of GDP in 2019). This should enable it to maintain economic support efforts in the short term, albeit smaller than those implemented last spring. The main difference is that the second wave of Covid 19 has had a smaller impact on activity in fall 2020 than in the spring (factories were allowed to remain open). The first economic stimulus plan was comprised of strictly fiscal measures equivalent to 4.5 points of GDP as well as a cumulative total of nearly 7 points of GDP of subsidised and/or state-guaranteed loans granted by the Polish Development Fund and by the state-owned bank BGK. All these factors drove up public debt to 58% of GDP in 2020.

Additional measures were rolled out in December for about 1.5% of GDP, but they were limited to the sectors hardest hit by the lockdown, such as the transport sector. These measures included the exemption of charges, subsidised loans and compensation for low activity (partial unemployment, assistance for households that have lost their jobs). Thanks to the smaller cost for public finances and positive nominal GDP growth, the increase in public debt should decelerate, to 60% of GDP in 2021.

As part of the European Recovery Plan, nearly EUR 19 bn (in subsidies) will be disbursed in 2021-2022 based on the assumptions published by the European Commission. The so-called "rule of law" clause is not applicable as long as the European Court of Justice (ECJ) has not ruled on the appeal filed by Hungary and Poland. Given the Court's usual delays in handling cases, this ruling is unlikely to disrupt the first disbursements.

The central bank (NBP) is not planning a new public securities purchasing programme. Under the first programme, it purchased the equivalent of 4.7% of GDP (i.e. more than 15% of the central bank's assets), which helped bring down 10-year rates from more than 2% before the Covid crisis to 1.25% in early 2021. Over the same period, the central bank has not changed its key rates since the rate cuts of spring 2020 (which brought the key policy rate to 0.1%). Even so, an accommodating bias remains in place with an implicit target of maintaining the zloty at relatively low level (PLN 4.6 for EUR 1 currently), even though the size of the current account surplus would justify a stronger currency.

CREDIT RISK IS STILL MILD, BUT SHOULD RISE IN A MANAGEABLE WAY

The growth of bank lending to the non-financial private sector has dropped off sharply since the beginning of the Covid-19 pandemic. Loans outstanding amount to 50.7% of GDP. The increase in lending to the private sector (nearly 7 points of GDP) came from state-owned financial institutions (Polish Development Fund, BGK) and thus did not increase the exposure of the banking sector.

The first 6-month moratorium on the repayment of bank loans was initiated in March 2020 and ended in September. At the end of the first half of 2020, 12.3% of corporate loans and 8.4% of household loans were eligible according to NBP, although the banks determined eligibility on a case-by-case basis. The share of the loans eligible declined sharply thereafter, notably for households, as unemployment fears vanished rapidly. A new moratorium was introduced in mid-December 2020, but it is limited to corporate loans.and should not exceed 3 months for companies that already benefited from the first moratorium, and 6 months for the others.

10-YEAR GOVERNMENT BOND RATE (%)

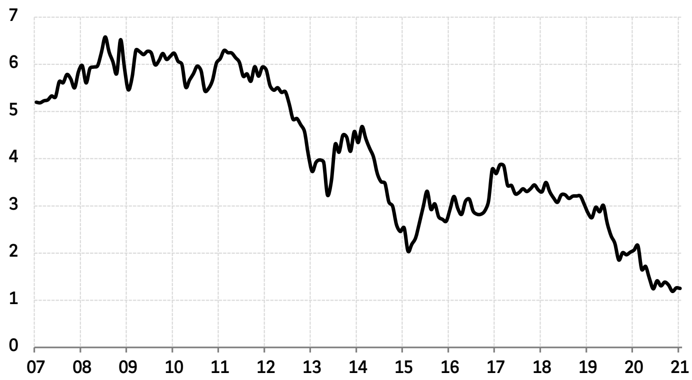

CHART 2

SOURCE: REFINITIV

By category, the share of late loan payments has not changed (5.7% of loan payments were late by more than 30 days), despite greater difficulties in the sectors' hardest hit by the pandemic. The increase in credit risk can be seen in the greater proportion of loans under close monitoring (which rose from 8% to 13% of corporate loans). These loans require provisions, which automatically affects bank profitability. The Return on Assets (ROA) diminished from 0.7% at year-end 2019 to 0.45% at the end of H1 2020. The restructuring of household loans previously granted in Swiss francs (CHF) also contributed to the decline in profitability: the ECJ ruled in favour of their cancellation, which meant that banks had to set aside provisions equivalent to 15% of their annual profit.

Against this background, the banks continue to be well capitalised (CET1 ratio of 16.9%) and should be capable of facing up to the risk of an increase in the non-performing loan ratio, which for the moment is holding at 3.8%.

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