POLAND : MACRO OUTLOOK

Consumption takes a hit, consolidation moved to 2026

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Economy Poland - Analyses and Forecasts | Erste Group Bank AG
December 10, 2024

Spot Rates as of: December 10, 2024
Note: Information on past performance is not a reliable indicator for future performance.
Forecasts are not a reliable indicator for future performance.

Consumption takes a hit, consolidation moved to 2026

In the third quarter, the annual GDP growth rate reached 2.7%, **driven by inventory buildup rather than household consumption**, which is against our baseline for 2024. Despite this, there is optimism for a better end to the year due to recent slightly more positive industrial and retail data. **The growth forecast for 2024 has been revised to 2.8%**, with an anticipated economic **expansion of 3.3% in 2025**. Inflation rose to 4.6% in November following the unfreezing of energy prices, with a forecast of 4.1% for 2025. However, **energy prices remain a source of uncertainty**, despite the government's promises to keep them frozen in 2025. The NBP Governor views the upward inflation risks as severe and has stated that no target rate reductions will be made next year, which contradicts our forecast and the consensus. The zloty is expected to fluctuate within the 4.35-4.25 range against the euro, supported by anticipated inflows of EU funds and higher growth prospects compared to the Eurozone and most CEE peers.

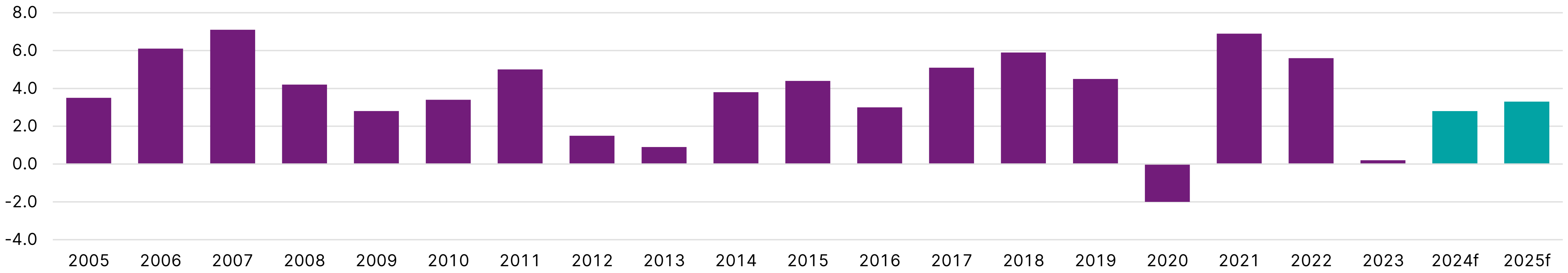
The Civic Coalition is leading in polls ahead of the Law and Justice party, with the margin slightly increasing. Early polls for the presidential elections put the coalition's candidate visibly ahead, but it is still too soon to make definitive judgments. **The fiscal situation remains challenging, with large deficits persisting and significant consolidation expected to start in 2026**. Defense spending is projected to be the highest in NATO, with 4.7% of GDP allocated to military expenditure in 2025. The debt-to-GDP ratio is expected to peak at 61% in 2026, with a decline expected after the four-year adjustment period.

Source: Eurostat, Refinitiv, Erste Group Research

GDP structure

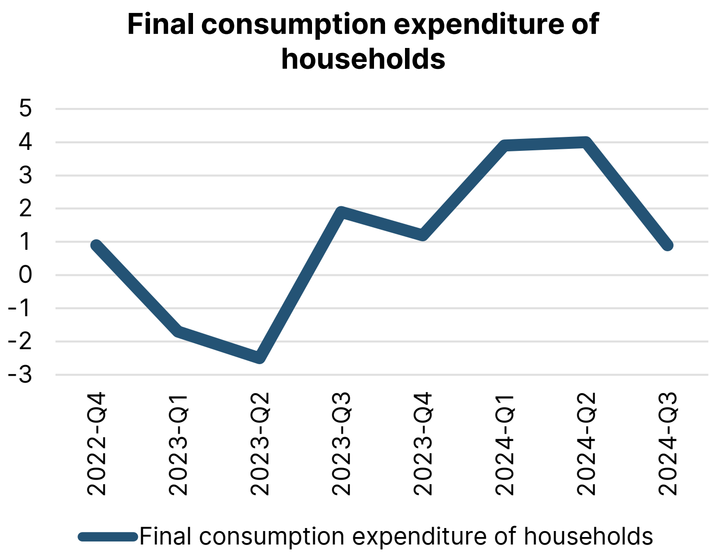
The annual growth rate reached 2.7% in the third quarter, slightly below expectations. In previous quarters, our baseline assumption was that growth would be driven by consumption, predominantly from the household sector. However, this sector experienced a significant deceleration in Q3. Despite this, we remain optimistic for a visibly better end to the year, as industrial and retail data finally surprised to the upside in October. Nonetheless, we have revised our growth forecast for 2024 to 2.8% from 3.2%. For the following year, we anticipate economic expansion at 3.3%. Real wage growth should remain positive, though not as high as in previous quarters. Households are expected to reduce their savings and reallocate more of their disposable income to spending. However, consumption growth may not be as robust as in the first half of this year. Investments are projected to pick up, supported by funds from the RRF and the new Cohesion funding period. Due to the weak external environment, net exports will likely be a drag on growth next year. Inventories should return to their normal state, especially after the volatile years since 2020.

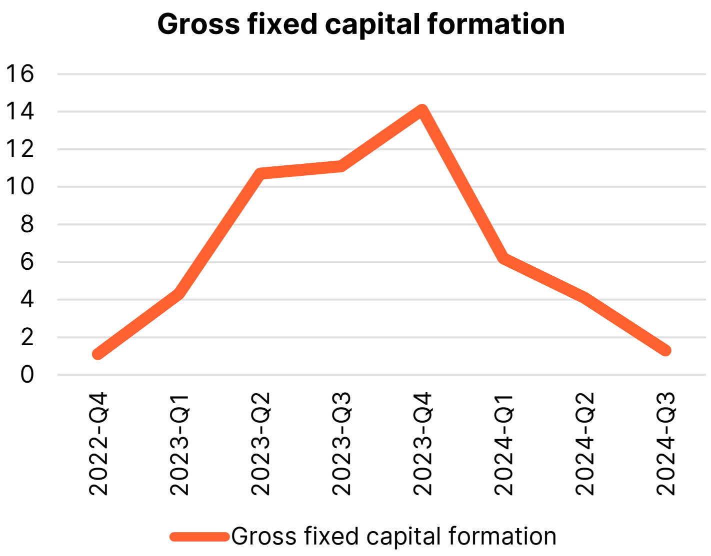
GDP growht, percent

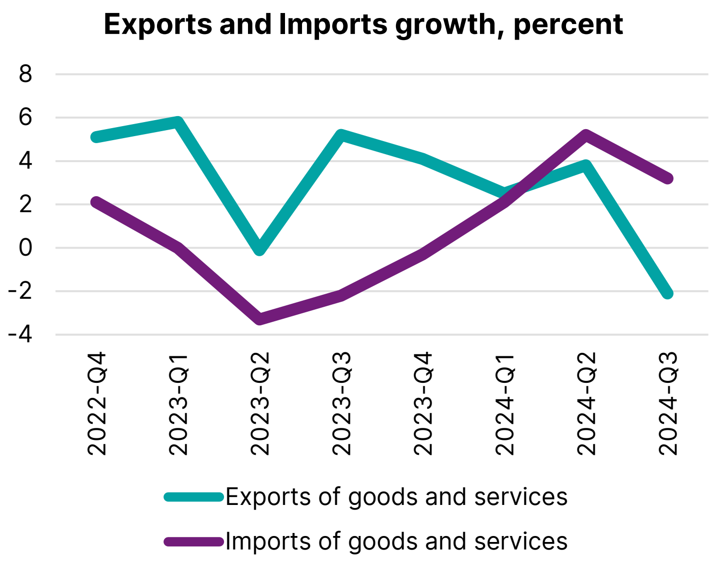


Source: Eurostat, Refinitiv, Erste Group Research

GDP structure







The third quarter breakdown (SA, 2015 constant prices) revealed that household expenditure grew by only 0.9% y/y, which was well below our expectations, even after the disappointing retail figures in recent months. This weak performance may have been partly influenced by the floods in September. Overall, households contributed only 0.5 percentage points to the growth figure, while public consumption added 1.1 percentage points. Investments slightly grew in annual terms, which we consider a relatively good result due to the high base effect. In terms of trade, a negative 3pp contribution came from trade, mainly due to a sharp decline of exports. The most significant surprise came from inventories, which increased substantially, contributing 3.5 percentage points to growth. This structure is an anomaly and should not be expected to be repeated in the last quarter.

Source: Eurostat, Refinitiv, Erste Group Research
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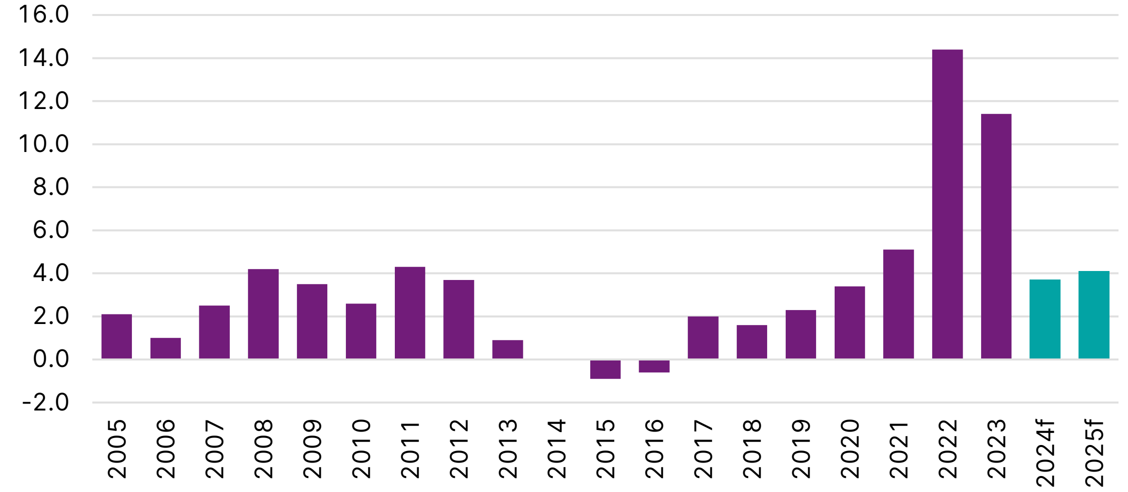
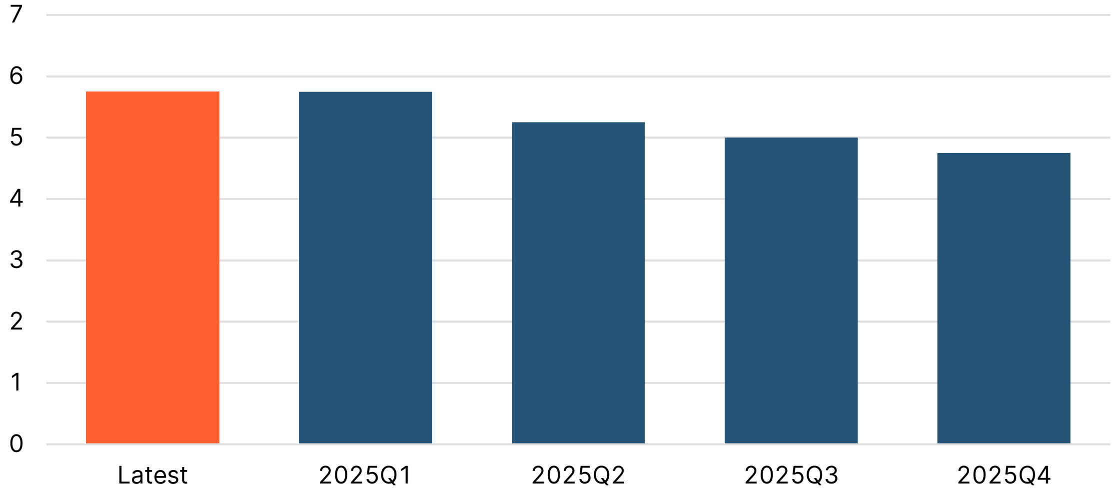
Inflation and monetary policy

Inflation, percent



Key Interest Rate, percent



Following the unfreezing of energy prices in July, annual inflation rose to 4.6% in November. Since July, the month-on-month price increases averaged 0.2%, which in annualized terms implies around 2.5% annual inflation. Moreover, the government has adopted a law on freezing the electricity prices between January and September next year. However, the annual inflation will be influenced by the low base effect until July, when the figure should drop from around 5% closer to 3.5%. The new energy tariffs, which will be available in the summer, add a portion of uncertainty to our forecast, especially due to the rising energy prices in the global markets. We currently see inflation for 2025 at 4.1%.

There have been numerous statements in the media from members of the MPC, suggesting that the first rate cut could occur in the first half of 2025. However, the recent hawkish press conference by the Governor has completely turned the tide. He remains unconvinced by the prospect of further energy price freezes and identifies several sources of inflationary pressure, including services, wages, and fiscal policy. Glapinski indicated that any consideration of monetary easing is postponed to Q4 2025, with rate cuts deferred to 2026. Our current baseline, which anticipates a 100bp reduction throughout 2025, now appears rather optimistic. We will wait until the dust settles after the conference and revisit our forecasts at a later point.

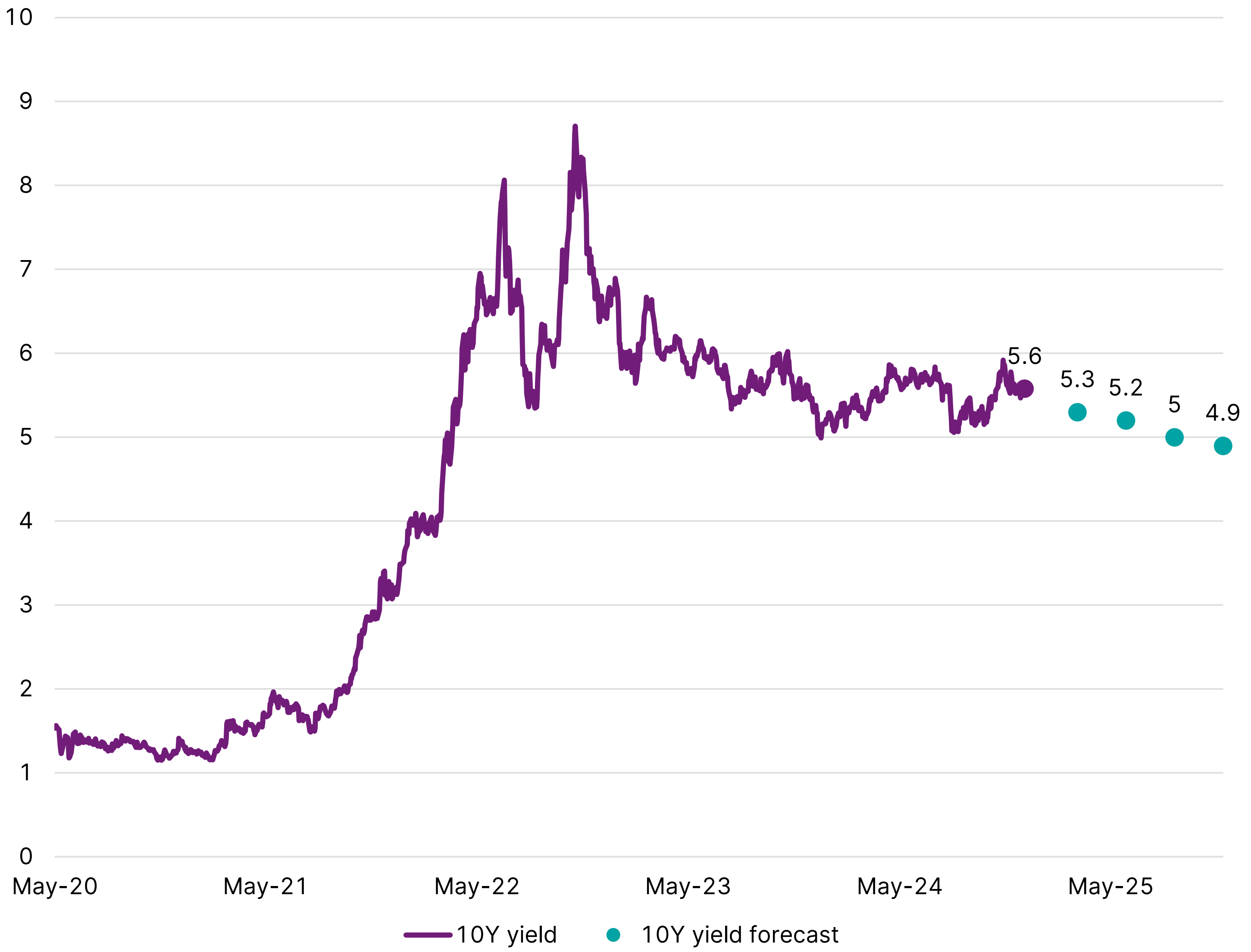
Source: Eurostat, Refinitiv, Erste Group Research

Yields and spreads

The 10Y benchmark nearly reached 6% at the end of October, when markets switched anticipations towards Trump victory. This narrative increased inflation expectations in the US, which pushed the 10Y Treasury yields higher, consequently making Polish long-term bonds less attractive to investors.

As anticipated, the climb of the 10Y yield towards 6% was an overreaction by the market. Since late October, the yield has decreased by 45 basis points, falling below 5.5%. In our baseline scenario, the yield is projected to gradually decline, reaching 5% in the second half of 2025. This projection is based on the strength of the Polish economy, coupled with an expected influx of EU funds. However, global developments introduce a significant layer of uncertainty.

10Y yield development and forecast



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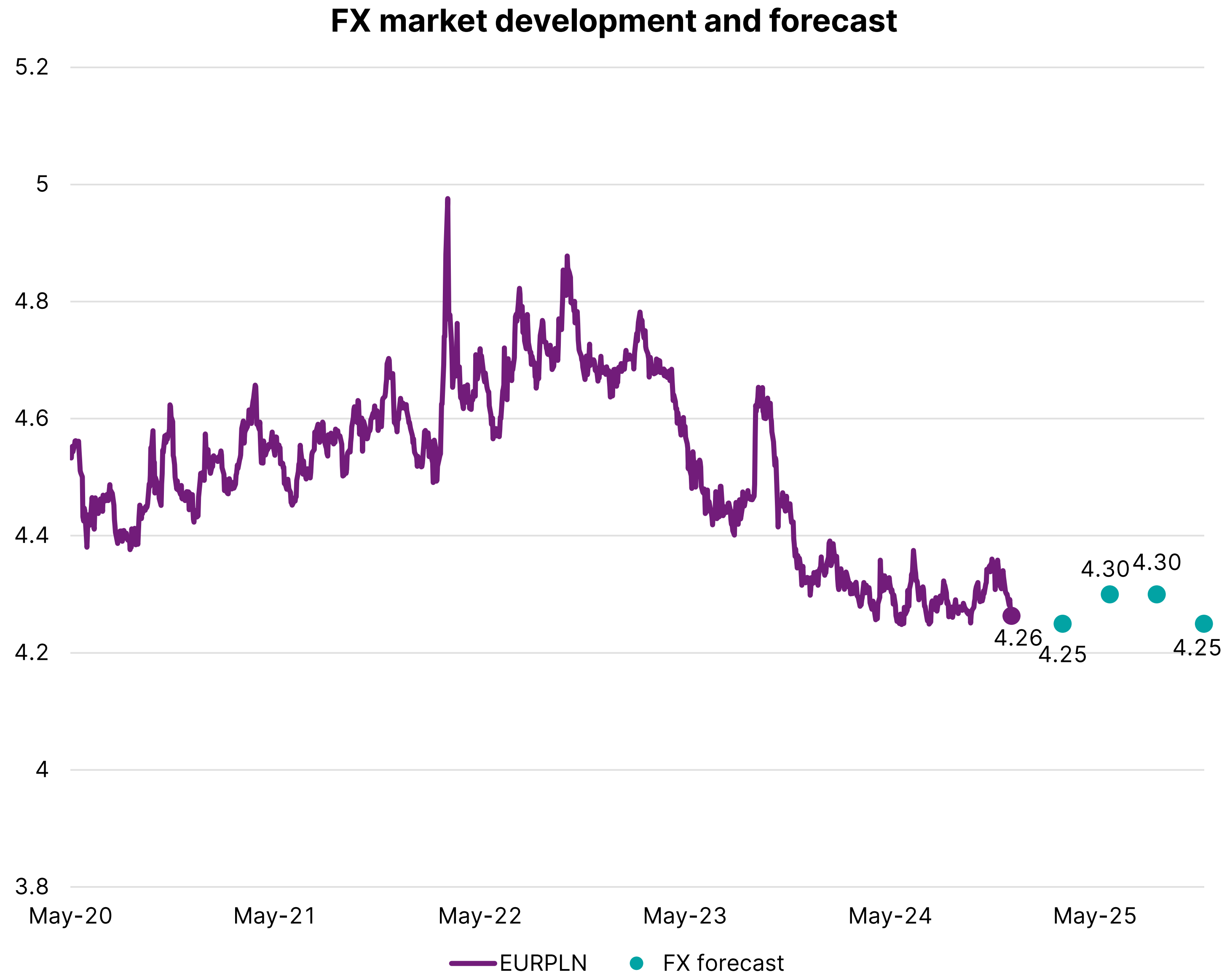
FX Market



Already in October, a month prior to the US Presidential elections, the markets became nervous, causing the zloty FX rate to approach 4.35 against euro. Currently, the rate hovers around 4.30, though volatility persists.

In the near term, we expect the volatility to remain. If the claims of the NBP Governor are supported by other MPC members, the FX rate will strengthen possibly below 4.25. Over the longer-term period, zloty is expected to fluctuate within the 4.35-4.25 range, with a bias towards stronger exchange rate. This expectation is supported by a substantial anticipated inflow of EU funds, either from the Cohesion budget or the RRF, which should bolster the currency. Additionally, our growth forecast for the coming year is significantly higher than that of the Eurozone and most CEE peers, which should further support the currency.

Source: Eurostat, Refinitiv, Erste Group Research

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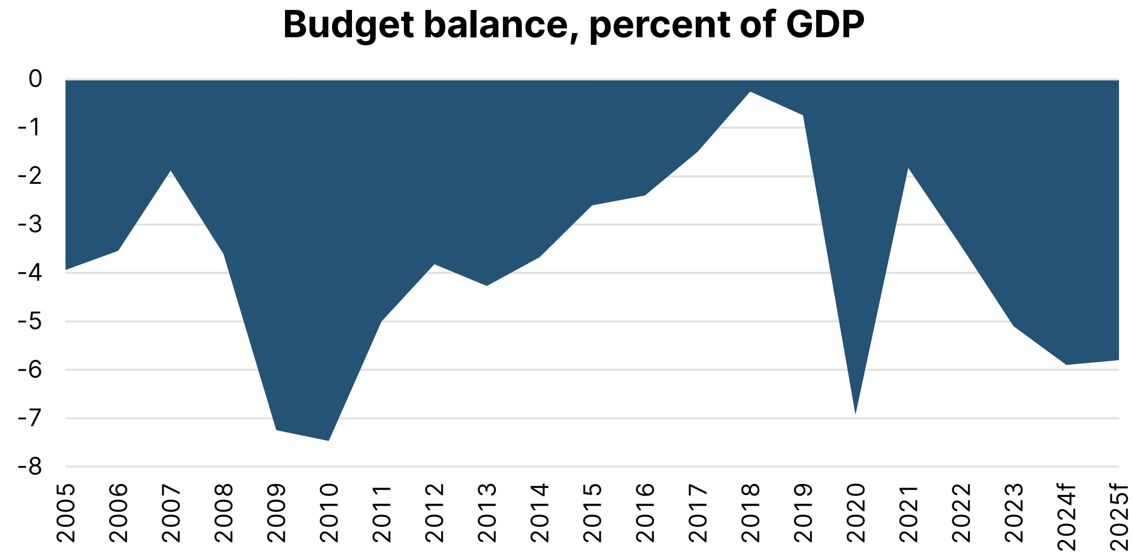
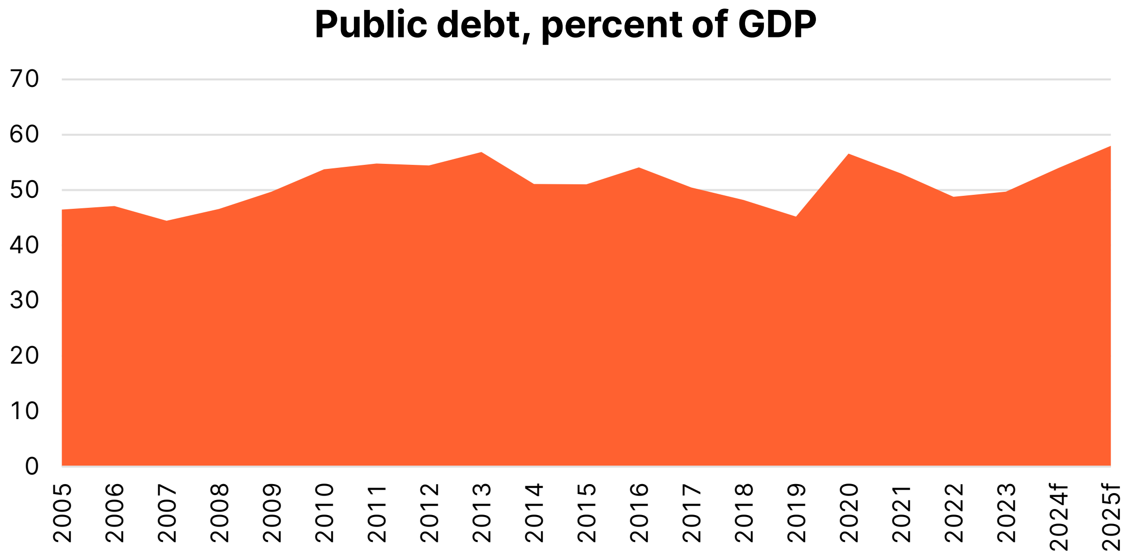
Fiscal Situation





Despite Poland being placed under the Excessive Deficit Procedure, large deficits persist, necessitating sharper consolidation from 2026 onwards. Most of the spending in 2025 will be allocated to defense (4.7% of GDP), healthcare (approximately 6% of GDP), and other investments, such as the construction of sustainable energy sources. Our expectations for this year's deficit are 5.9% of GDP, a 0.2% upward revision due to increased expenditure resulting from the floods in September, as well as a slight downward revision of the expected 2024 GDP. Next year, the deficit is also projected to remain large, at 5.8% of GDP. Public debt is on an upward trajectory, with a projected increase of 10 percentage points between 2023 and 2026. The 60% threshold will be surpassed in 2026, and the debt-to-GDP ratio is expected to stabilize only in 2028. Details about the medium-term fiscal outlook will be discussed in the Special Topic section at the end of the report.

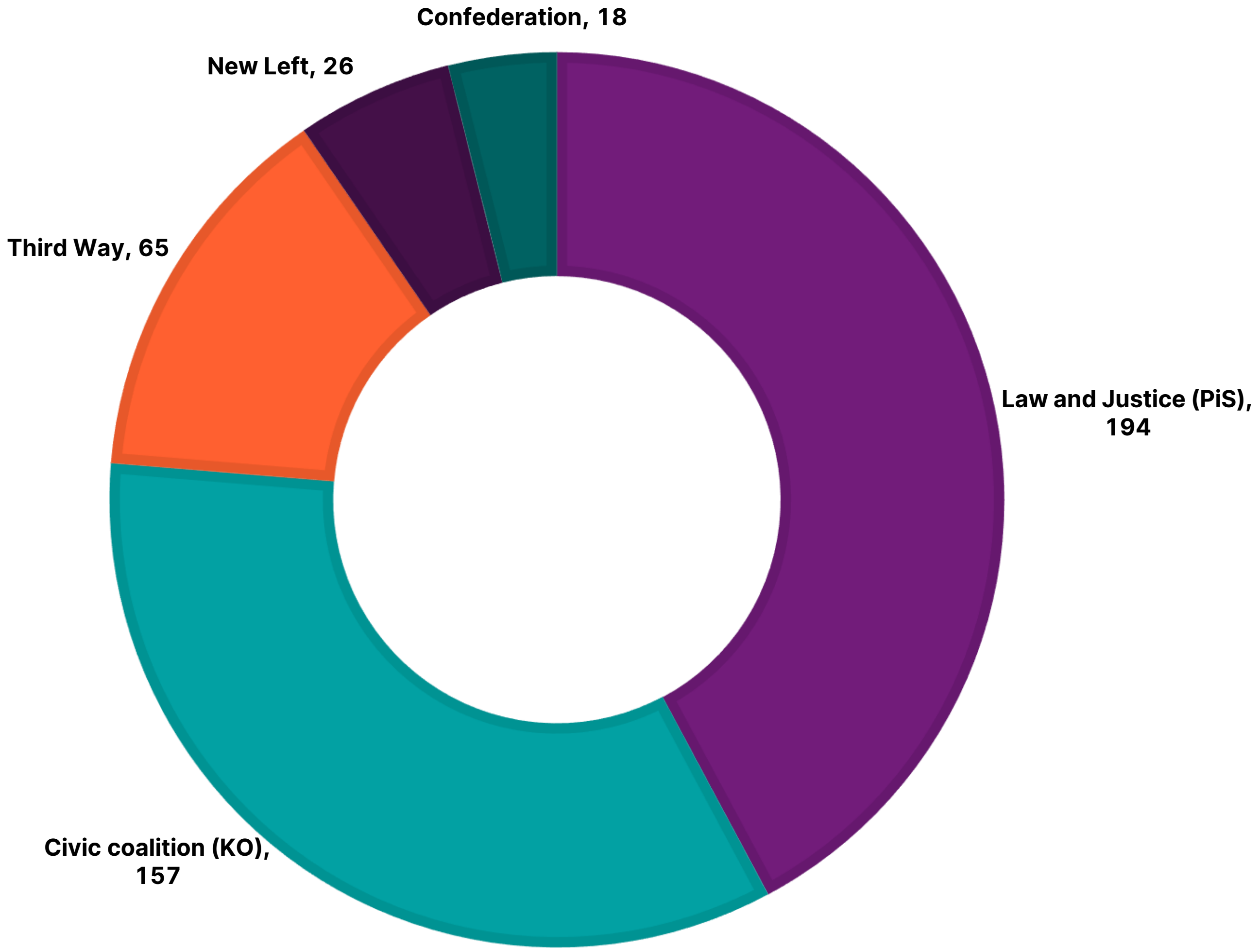
Source: Eurostat, Refinitiv, Erste Group Research
December 10, 2024

Political landscape

According to recent polls, the Civic Coalition (KO) has slightly increased its lead, currently polling at 33%, while the main opposition party, Law and Justice (PiS), would receive approximately 30.5%. However, significant changes have occurred among the smaller parties in the government. The far-right Confederation party would garner nearly 12% of the votes, compared to 7.2% in last year's general elections. On the other hand, the Third Way party has lost more than 6 percentage points since the GE, currently polling at 8.3%.

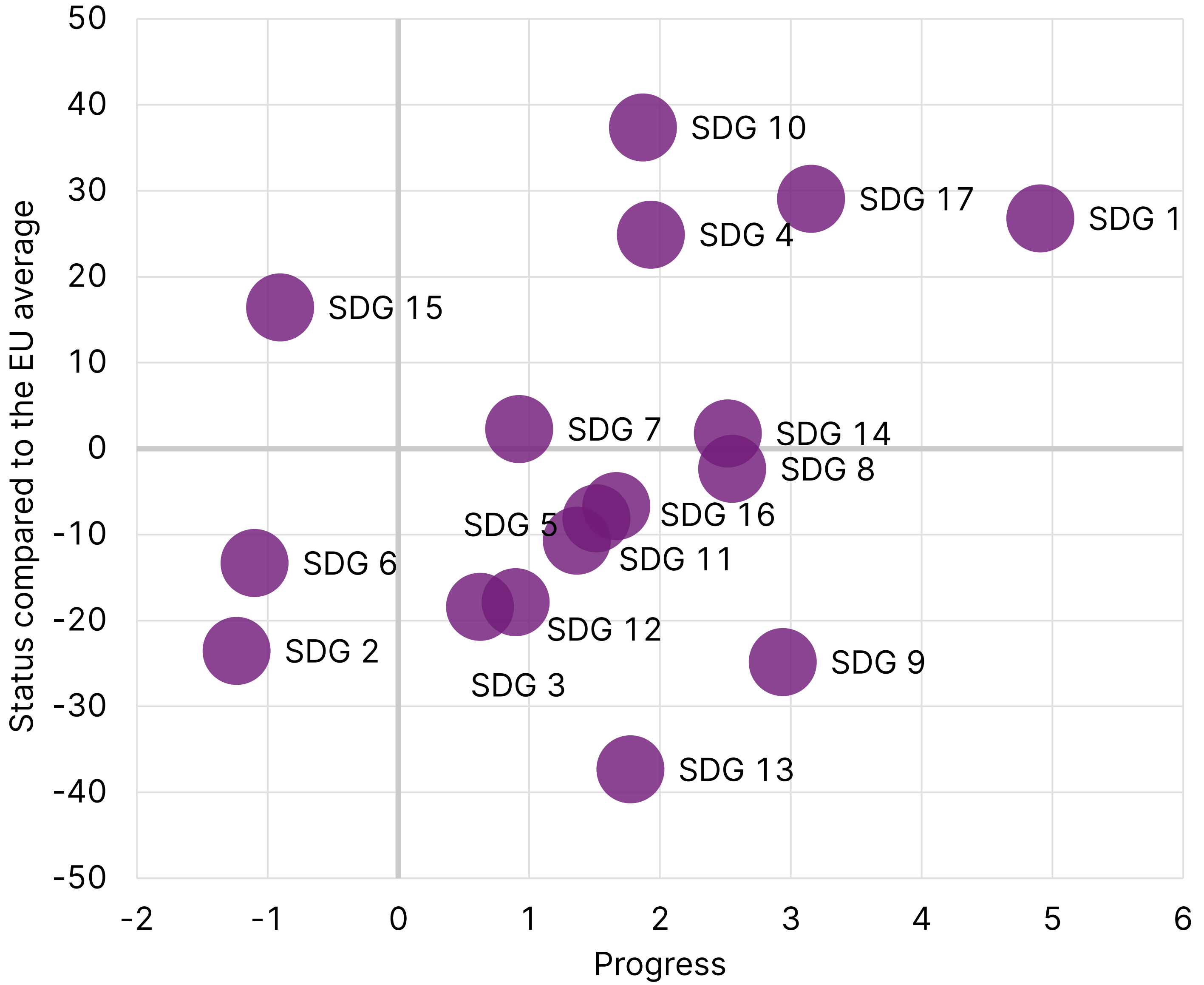
The 2025 presidential election is scheduled for May next year, and the main candidates are already known. The Civic Coalition will nominate Warsaw Mayor Rafał Trzaskowski, while the Law and Justice party supports Karol Nawrocki, the president of the Institute of National Remembrance. According to Unitied Surveys, Trzaskowski is currently polling at around 50.4%, visibly ahead of Nawrocki, who is at 27%.

Parliamentary seats



Source: Eurostat, Refinitiv, Erste Group Research

Social Development Goals



The green transition in Poland will be significantly supported by the RRP and RepowerEU initiatives. To date, Poland has received the initial payment from both grants and loans, with applications for the second and third payments submitted in September. The two payments, worth in total €9.4b, have been given endorsement by the EC and the funds are expected to reach the treasury at the end of December.

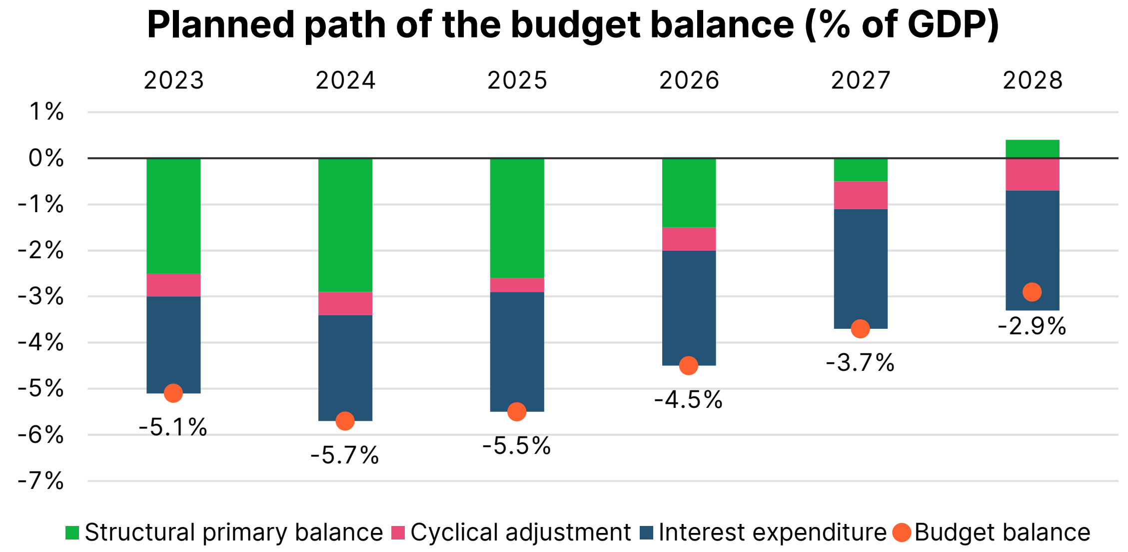
Additionally, plans for the first nuclear power plant are beginning to materialize. The first tranche of 4.6 billion zloty is scheduled to be spent in 2025, with a total budget of 60 billion zloty allocated between 2025 and 2030. The commencement of electricity production is planned for 2033.

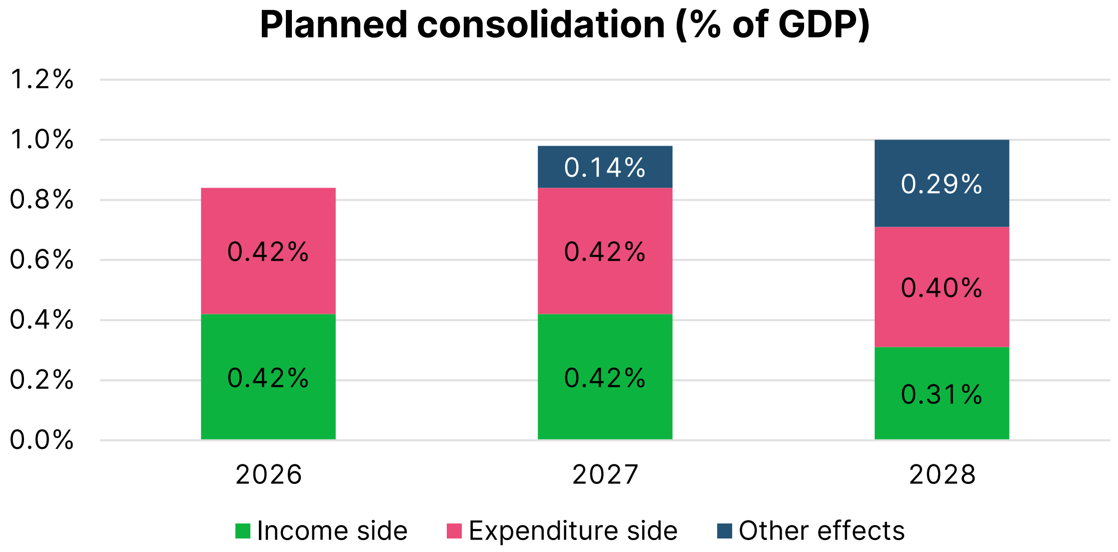
Source: Eurostat, Refinitiv, Erste Group Research

How does Poland plan to consolidate?

Special topic

Consolidation to start only in 2026





According to the Medium-term Fiscal-Structural Plan of the Polish Ministry of Finance, policymakers have decided to adopt a four-year consolidation path. As previously noted, minimal consolidation is expected next year, with significant tightening starting only in 2026. From the revenue side, the focus will be particularly on indirect taxes, which have lower fiscal multipliers compared to expenditure-side measures. Specifically, excise duties will be increased, and personal income tax thresholds will not be adjusted, effectively imposing a "silent" tax increase on workers, whose salaries significantly increased throughout 2024. Deficit reduction on the expenditure side will be governed by the stabilizing expenditure rule, which sets a maximum cap on planned government expenditure. Consequently, public security benefits will contribute 0.1% of GDP to consolidation annually, while public consumption will help reducing the deficit by 0.2% of GDP.

Source: Eurostat, Refinitiv, Erste Group Research
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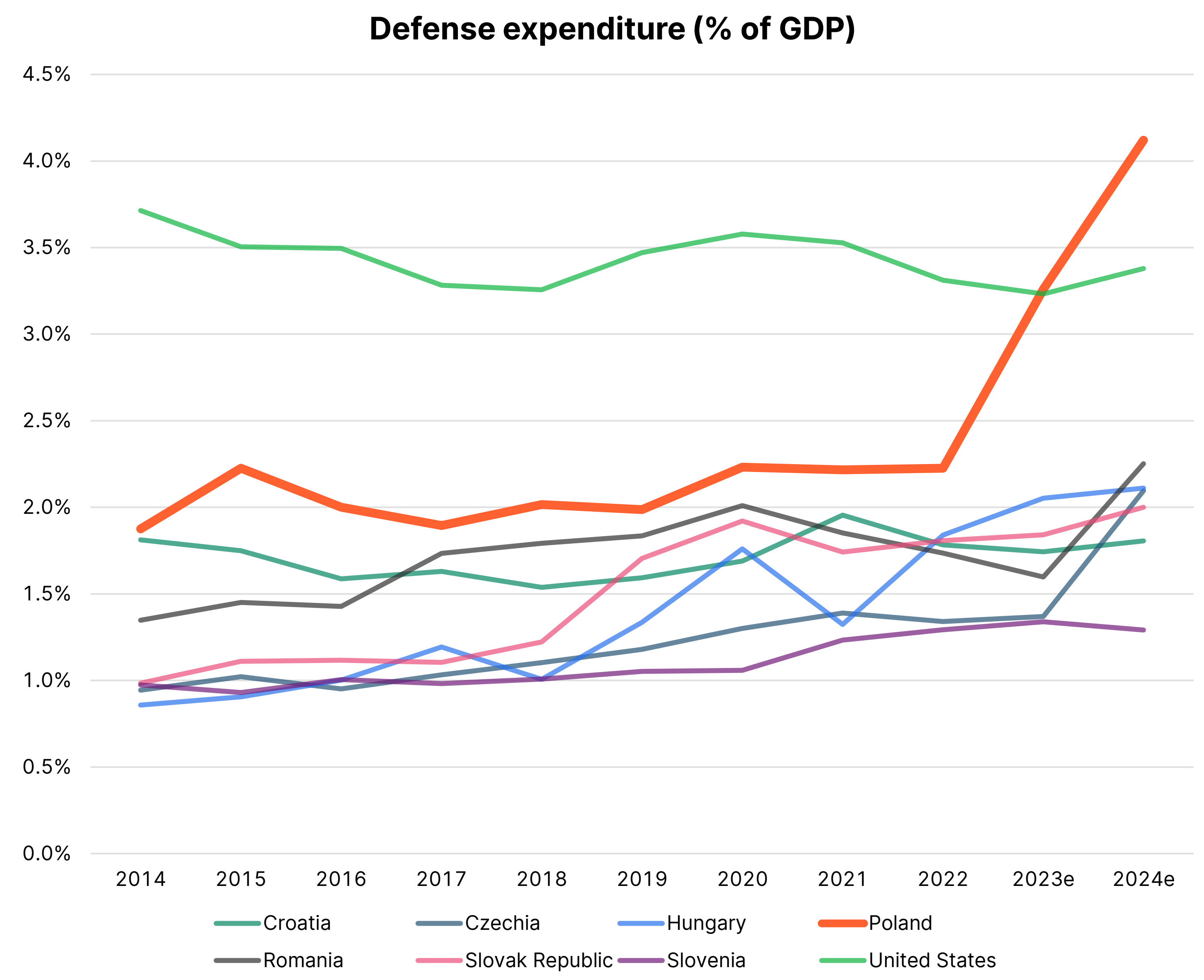


SPECIAL TOPIC

Defense spending weighs on budget

In terms of GDP, Poland is expected to be the highest defense spender in NATO in 2024, at 4.1%. This ratio is projected to increase further next year, with an anticipated allocation of 4.7% of GDP to military expenditure. Currently, it is relatively difficult to quantify the impact on fiscal figures.

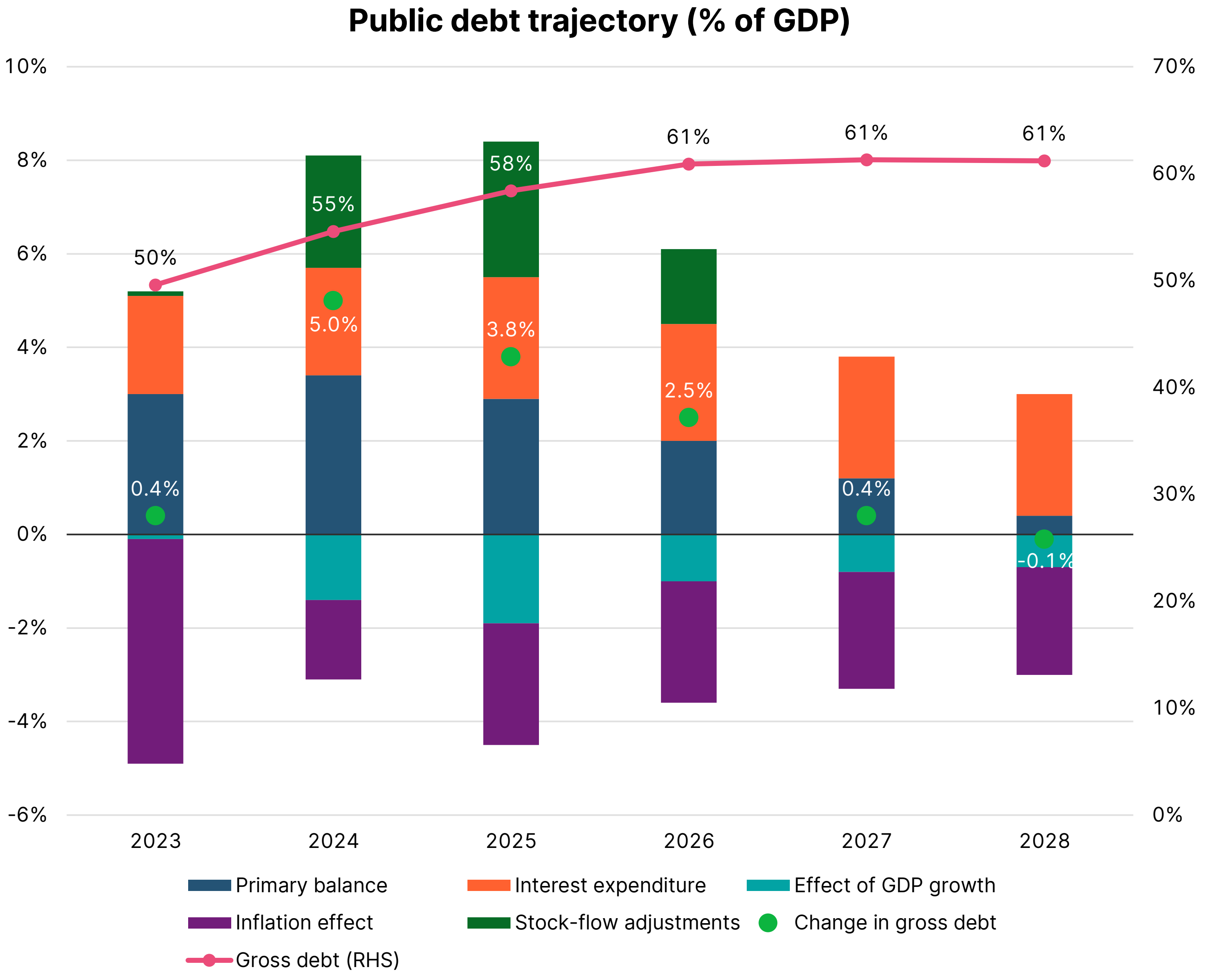
For the (ESA) budget balance, transactions are recorded only at the time of equipment delivery (accrual basis). Therefore, defense expenditure does not affect the general government balance to a significant extent for the time being. Conversely, defense expenditure on a cash basis is recorded in government debt at the time it is incurred, without any link to the delivery date. The rise in debt since 2023 and its projected increase over the medium term are partially due to prepayments for military equipment, which will be delivered in the following years.

Source: Eurostat, Refinitiv, Erste Group Research

Debt to peak at 61% of GDP

The rapid growth of the debt-to-GDP ratio can be attributed to several factors. Firstly, in 2023, the stagnation of the economy did not increase the denominator of the ratio. In the current and following year, the GDP effect will negatively influence the ratio; however, defense expenditures will exert an opposing force.

After the four-year adjustment period, the debt is projected to decline under the baseline scenario as well as in three alternative scenarios. The first scenario assumes higher interest rates at both ends of the yield curve. The second scenario anticipates weaker long-term economic growth, and the third accounts for poorer structural fiscal performance.



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Poland: Forecasts

	2018	2019	2020	2021	2022	2023	2024f	2025f	2026f
Percent					**Annual average**				
Real GDP growth	5.9	4.5	-2	6.9	5.3	0.1	2.8	3.3	3.2
Private consumption growth	4.4	3.5	-3.6	6.2	5	-0.3	3	3	3.5
Fixed capital formation growth	12.6	6.2	-2.3	1.5	1.7	12.6	2.5	6.5	5
Inflation	1.6	2.3	3.4	5.1	14.4	11.4	3.7	4.1	2.8
Unemployment rate	5.8	5.2	6.8	5.8	5.2	5.1	5.1	5	5
Percent of GDP									
Budget balance	-0.3	-0.7	-6.9	-1.8	-3.4	-5.1	-5.9	-5.8	-4.5
Public debt	48.2	45.2	56.6	53.0	48.8	49.7	54.0	58.0	60.0
Current account balance	-2.0	-0.3	2.4	-1.3	-2.2	1.8	-0.3	-1.0	-1.0
					End of year				
EURLCY	4.29	4.25	4.55	4.58	4.68	4.34	4.25	4.25	4.20
Central bank policy rate	1.50	1.50	0.10	1.75	6.75	5.75	5.75	4.75	4.00
3M interbank offer rate	1.72	1.71	0.21	2.54	7.02	5.88	5.85	5.00	4.15
2Y Yield	1.33	1.47	-0.04	3.33	6.66	5.00	4.80	4.20	3.30
5Y Yield	2.27	1.77	0.37	3.95	6.84	5.00	5.10	4.30	3.70
10Y Yield	2.83	2.05	1.25	3.67	6.85	5.22	5.30	4.90	4.75

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Source: Eurostat, Refinitiv, Erste Group Research

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Poland: Country overview

Official EU language: Polish

Capital: Warsaw

Geographical size: 311 928 km2

Population: 36 620 970

GDP per capita (PPS): EUR 30 100, below the EU average

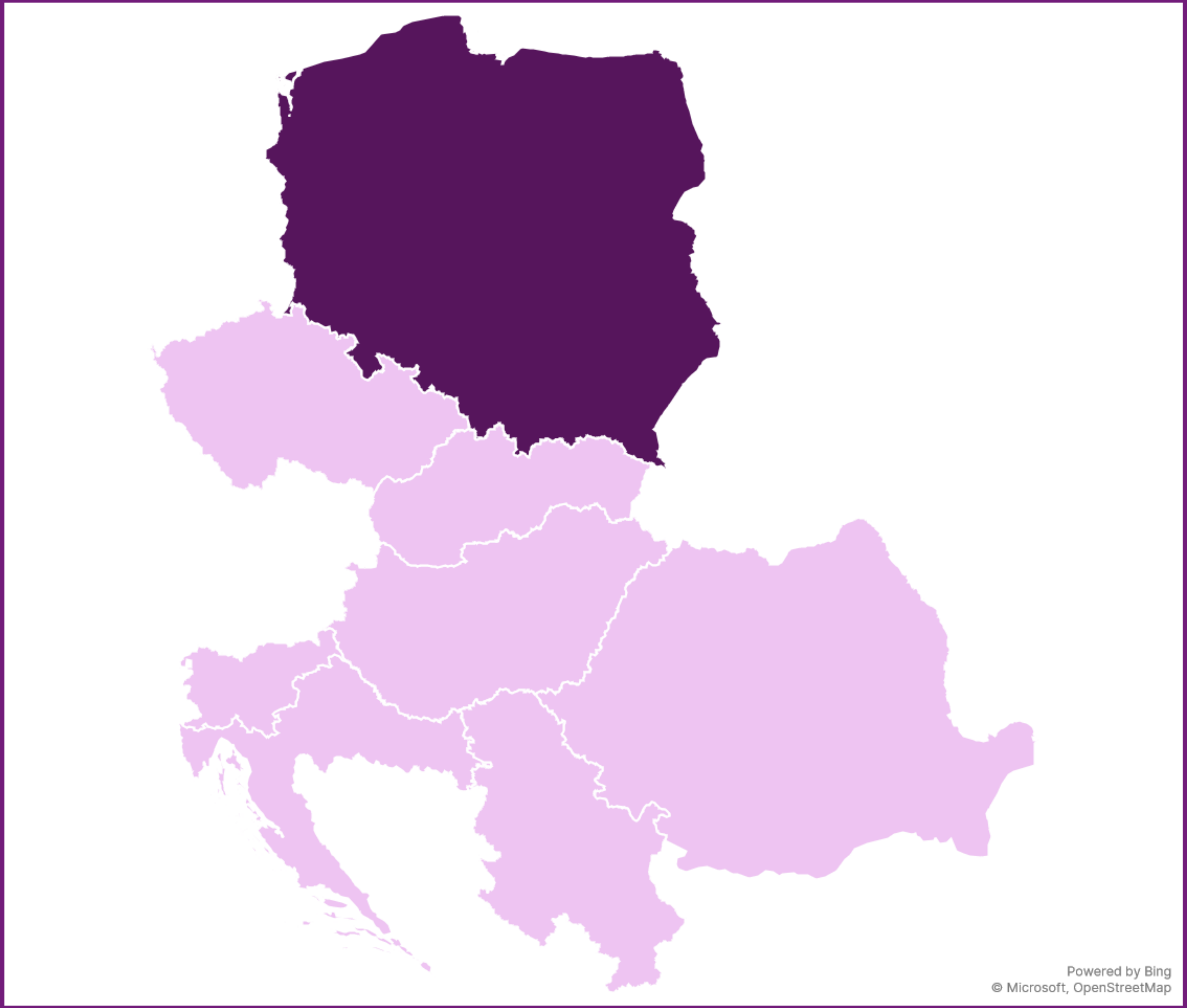
Currency: Polish Zloty PLN

Credit Ratings:

- **Moody's: A2, outlook stable**
- **S&P: A-, outlook stable**
- **Fitch: A-, outlook stable**

EU member state: since 1 May 2004

Schengen: member since 21 December 2007



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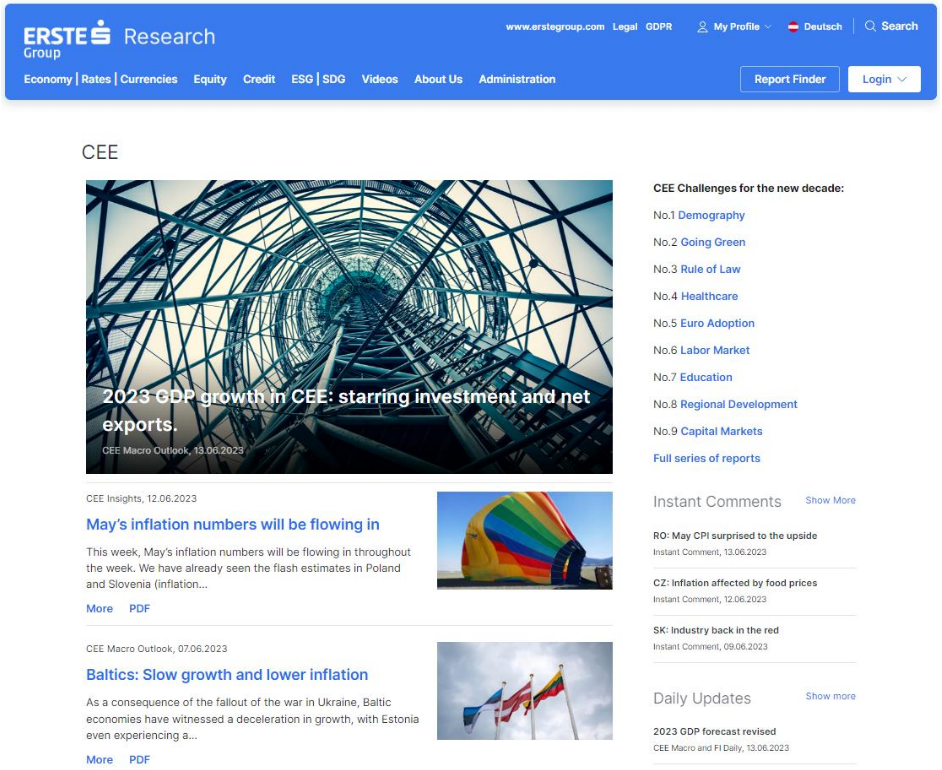

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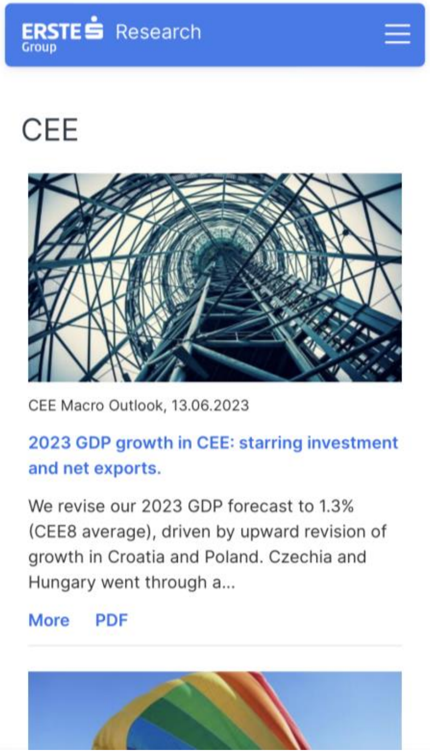

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