Poland

Outlook 2021

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1.0 Poland - Executive Summary

As everywhere else, the No. 1 story in Poland in 2021 will be the recovery from the coronavirus (COVID-19) pandemic. Poland, which emerged pretty much unscathed by the previous global crisis — the financial meltdown of 2007-2008 — appears to have weathered the first wave of the pandemic as well.

Poland's well-diversified economy should take credit for the relatively mild impact of the coronavirus crisis so far, analysts say. Poland is the least exposed country to tourism in the OECD, while also having big agri-food and business services sectors, both relatively resistant to the crisis.

Poland's surging exports of durable consumer goods also helped, especially in the second half of the year. Finally, the country has attracted a good deal of investment in industrial branches — automotive being a case in point.

Last but not least, the government quickly stepped in with substantial help, even if its efficiency is being questioned now by many businesses.

Polish industrial exports grew rapidly in the second half of the year. Before the pandemic in Poland, there was a lot of foreign direct investment in promising sectors, e.g. in the new automotive industry. Now it is paying off. All this was combined with relatively aggressive and effective relief efforts.

The initial predictions of a recession of -6% or even deeper have been gradually revised with each new dataset from the real economy once the shock of the first lockdown began subsiding in May. The current consensus is that the recession will take place — avoiding it completely was never on the cards — but it will be mild, not even -3% in 2020, some analysts venture to say.

Leading Polish banks expect the recovery in 2021 to be at least 3%, with the forecast average as high as 4.1%. A slightly sharper picture of how solid the economic rebound will be should emerge sometime in late January or February when it will become clear how well — or how badly — the authorities have handled the national vaccination programme.

Poland's growth could also be helped by the influx of new money from the EU budget for the years 2021-2027, although 2021 may well be a preparation year of planning to take advantage of the funding, so its real impact may not show until 2022.

Politically, this could be another year of tension and unrest, especially if economic recovery is sluggish or otherwise impeded by the pandemic taking unexpected turns, such as the emergence of new strains of the virus. That might make the tripartite coalition government, led by Law and Justice (PiS), vulnerable to street protests.

Another potential flashpoint could arrive with the publication of the hugely unpopular ruling of the government-controlled Constitutional Tribunal, which outlawed virtually all possibilities for women to have a legal abortion. The ruling brought hundreds of thousands of angry protesters to the streets in October and November. If the government orders the formally independent tribunal to publish the ruling, protests are likely to erupt again.

But the PiS-led government has maintained a steady lead in the polls and will not be tested in elections until 2023, giving it a manageable period to address political woes rife in post-pandemic Poland. How effective the government will be in doing that remains an open question, not least because of the internal tensions in the coalition. Unless support for the government drops dramatically, the opposition appears unlikely to mount a successful political challenge to it in a non-election year.

2.0 Political outlook

Having won a second term in office in 2019 and successfully — although only just — defended the presidency in 2020, the PiS-led political camp is now hoping for a relatively quiet two years before 2023, the year of local and general elections.

Not that 2021 is shaping up to be especially easy for the government. A number of potential pitfalls await. Perhaps the most dangerous is the protracted and sluggish recovery after the coronavirus pandemic. That could become serious if the vaccination programme does not go as planned, particularly if the government fails to vaccinate enough people to ensure immunity of the population — a possibility given the strong anti-vaccination movement in Poland — or if the vaccination process goes on for too long.

Current expectations are for the priority groups — medical workers and the over nine million strong cohort of over 60-year-olds — to become vaccinated by the autumn. That means some sort of restriction on mobility and businesses — such as gyms or restaurants — could linger on for an equally long time.

Unfortunately, the government's handling of the pandemic in October and November — when the second wave of infections hit — and the carefree negligence of preparations during the summer undermined trust in the administration's ability to listen to experts and implement effective solutions.

The still simmering conflict with the European Union over the rule of law is another political risk for the government, although it appears smaller than in November, when the issue led to the most serious crisis in Poland's ruling coalition since the election.

Poland claims to have won a concession that EU funding from the bloc's incoming budget for 2021-2027 will be governed by an objective process and punishment for abuses of the rule of law will be limited only to those that affect the proper use of the bloc's money.

A more general way of making access to funding conditional on observing the rule of law — which, some Western European member states argue is at risk in Poland because of the government's controversial overhaul of the judiciary — was made more difficult by Warsaw. Poland said that it smacked of creating a tool of political pressure rather than a mechanism of legal safeguarding.

That said, once funding begins to flow, the government will be in a position to boost its popularity by announcing and at least kicking off popular investment projects, such as local roads, environmental infrastructure, etc.

The propensity of the government to wage culture wars on a rapidly liberalising society could also lead to renewed street protests. That was the case in October, when hundreds of thousands took to the streets, enraged by a ruling by the government-controlled Constitutional Tribunal that eliminated practically all legal possibilities for a legal abortion in Poland.

The street rage — best summed up by the overarching slogan of the rallies: "F*** off!" — led to PiS deciding to delay the publication of the ruling, the last formal step before making it law.

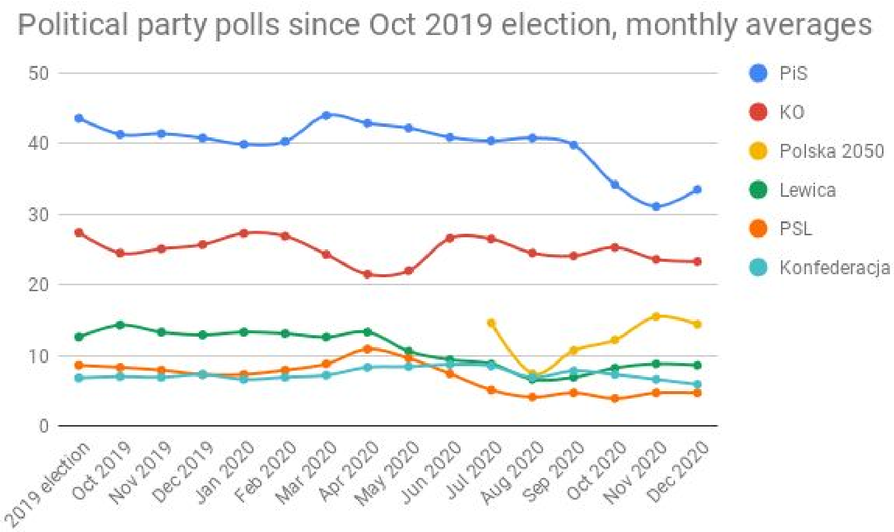
But under pressure from the conservatives, who represent a sizable part of PiS's electorate, the ruling party could still publish the tribunal's verdict and risk facing demonstrations again. Street protests had already contributed to PiS' weakening in the polls.

That said, the ruling camp is still the undisputed leader in the polls, averaging 33.5% in December surveys. That is 10.2pp ahead of the biggest opposition group, the centrist-liberal Civic Coalition (KO).

KO is yet to come up with an effective plan to encourage more people to turn out at the polling stations and vote against PiS — a key for KO and the entire opposition to win power back.

A new centrist group Polska 2050 was the third most popular political entity in December, averaging 14.4%. Lewica (Left) was at 8.6% and the far-right Konfederacja at 5.9%.

Poland's opposition has long struggled to conceive a platform to lure the less devout PiS voters. The occasionally surfacing idea of uniting for the 2023 election does not appear credible or attractive to voter groups as diverse as those voting for the Left or KO, which are fundamentally at odds over such key issues like tax policy, fiscal policy and equal rights for LGBT+ people.



3.0 Macro Economy

Overview

For all the mistakes that the Polish government has made during the coronavirus pandemic — after the prompt initial response that many said was exemplary — the fast-spreading virus inflicted less damage on the 38mn-strong economy than was feared. After a disastrous second quarter — because of one month of full lockdown that took place in April — the economy began rebounding so well that some of the most recently published forecasts now suggest a recession of less than 3% in 2020.

The year 2021 is expected to restore what Poland has long got investors and consumers used to, fast-paced economic growth relying on household consumption and investment. Consumption is already picking up and is poised to be the motor of Poland's growth this year. Investment will lag behind a bit, as companies wait for the coronavirus vaccine to roll out to more people so as to allow gradual restoration of near-normal activity. Investment recovery is only expected in 2022 but will receive an extra boost from the EU funds, including the coronavirus recovery fund.

• GDP growth, household consumption, investment

After the shock of the first lockdown in Q2, when GDP declined an adjusted 7.9% y/y (-8.2% y/y without adjustment). Q3 GDP figures proved much better, with the annual fall easing to just -1.8% (unadjusted: -1.5% y/y) on the back of household consumption registering growth of 0.4% y/y, a clear — although still shaky — recovery from a drop of 10.8% y/y in the second quarter. Investment remained weak in Q3, dropping 9% y/y in Q3 — still better in comparison to a fall of 10.7% y/y in the preceding three months.

Overall, domestic demand retreated 3.2% y/y versus a drop of 9.9% y/y in the second quarter, an encouraging sign.

For 2021, there is consensus that GDP growth will return, with some forecasts expecting growth to be the same as before the pandemic or even faster. Household consumption and exports will be the main drivers of the expansion, with investment still weak. Obviously, there will still be a gap between the post-pandemic growth trajectory and the one from 2019 and it will take another couple of years to close it.

Growth forecasts by 10 leading Polish banks surveyed by the financial website money.pl average 4.1%. Individual banks' forecasts are as follows:

PKO BP 5.1%
Pekao SA 4%
Santander 4.6%
ING 4.5%
mBank 3.8%
Citi Handlowy 3.7%
BOŚ 4.2%
Bank Pocztowy 3%
Credit Agricole 3.6%

Large non-banking organisations also agree that 2021 will see a return to economic expansion. The OECD predicts growth of 2.9% while the European Commission puts it at 3.3%. The IMF predicts growth of 4.6% in 2021.

Household consumption will be back as the main driver of growth after propelling expansion for years before the pandemic. The OECD predicts household consumption to grow 1.7% in 2021 (after falling 4.5% in 2020). mBank predicts expansion of 4.8%, while Fitch Ratings put it at 5.8%. Polish employers' association Lewiatan expects household consumption to expand 3.8% this year.

Exports are expected to be the second main driver of GDP growth in 2021. Poland's sales abroad are forecast to grow around 6%, giving the country's GDP a push of some 1pp, forecasts say.

Investment will not fare that well but is still expected to move to the expansion side in 2021, most forecasts say. mBank expects an expansion of 0.5%, while Bank Pocztowy predicts 2%. Fitch Ratings forecasts investment growth of 3.5% in 2021. Growth will largely be due to public investment slowly gathering pace before the expected boom in 2022 on the back of EU funding. Companies are more likely to adopt wait and see strategies, as post-pandemic uncertainty will remain significant in 2021.

But not all forecasts are optimistic, as the OECD expects investment to contract 1.6% in 2021. Lewiatan also does not believe in investment rebounding, forecasting a contraction of 2%.

• External environment

The EU’s fifth most populous member state and the 27-nation bloc’s sixth largest economy, Poland is too closely linked to the 500mn+ market for its economic recovery not to depend — to a large extent — on its recovery. Some concern exists, therefore, about the pace of recovery in the EU as a whole and in Germany in particular — by far Poland’s largest trade partner.

But as the EU-wide vaccination effort is expected to gather pace, external demand could well turn out to be a strong positive impulse for the Polish economy. Some forecasts even say that net exports could add as much as around 1pp to Poland's GDP growth in 2021.

• Inflation and monetary policy

Inflation in Poland is likely to continue easing until the end of the year and into the early months of 2021, analysts say.

“In the first quarter of 2021, the base effects for fuel and food should temporarily reduce headline CPI to 2.5% y/y. However, in the whole of 2021, due to increases in administered prices, inflation should reach 2.8% y/y on average,” according to the most recent forecast from ING.

Generally, economists say that the stronger the economic rebound is in 2021, the higher the inflation rate. But even if growth disappoints — which would be anything below 3% — new regulatory and administrative factors could still elevate price growth. Those include a new capacity fee added to electricity bills - mostly company bills, however - to ensure money for power companies to maintain older but essential installations online to secure power supplies. There will also be a so-called “sugar tax” - ie a levy on sugary drinks - as well as the controversial tax on retail turnover.

Poland’s minimum wage will also increase by 7.7% in 2021, giving inflation another push.

Overall, inflation in Poland is forecast to come in at 2.3% -3.1%, according to forecasts by the country’s 10 leading banks.

As the National Bank of Poland’s (NBP’s) inflation target is 2.5%, it appears unlikely that interest rates will move in 2021 after being cut three times in the wake of the pandemic to an all-time low of just 0.1%.

The accommodative monetary policy is expected to continue for the time being, possibly until 2022, to prop up economic recovery, analysts say.

• Other indicators

Here’s how Poland’s 9 leading banks predict main macroeconomic indicators in 2021.

Bank	GDP change	Unemployment rate	Wages' growth	CPI	NBP interest rates
PKO BP	5.1%	5.4%	5.6%	3.1%	0.1%
Pekao SA	4%	6.2%	5.9%	2.3%	0.1%
Santander	4.6%	6.4%	3.9%	2.4%	0.1%
ING	4.5%	6.2%	5.4%	2.8%	0.1%
mBank	3.8%	6.5%	3.5%	2.6%	0.1%
Citi Handlowy	3.7%	7%	4.3%	2.4%	0.1%
BOS Bank	4.2%	6.9%	4.5%	2.3%	0.1%
Bank Pocztowy	3%	6.8%	3.1%	2.5%	0.1%
Credit Agricole	3.6%	5.6%	3.1%	2.6%	0.1%
					most favourable
					least favourable
Source: money.pl					

4.0 Budget and debt outlook

Budget revenues are planned at PLN404.4bn (€89.44bn) for 2021, while the pandemic-inflated expenditure will be PLN486.7bn. The resulting deficit of PLN82.3bn will be slightly smaller than the gap of nearly PLN110bn last year, which the government amended from its first-ever balanced financial plan because of the pandemic.

That said, the actual budget revenues were bigger last year — although it is not yet clear by how much — as the finance ministry said it had underestimated them, especially in the VAT category. That is a surprise in a recession year but also shows the resilience of the Polish economy and provides a fairly positive outlook for 2021.

“The budget deficit is expected to improve significantly in 2021, as economic growth returns and support measures are scaled back. The 2021 budget ... envisages state and general government deficits in 2021 of 3.5% and 6.0% of GDP, respectively,” Fitch Ratings said.

“One notable measure is the budgeted 104% increase in healthcare spending to 5.3% of GDP,” Fitch added.

The anti-COVID measures will continue but they will be a continuation of last year’s provisions, not new ones, the government pledged in August.

“Next year, we expect the vast majority of budget expenditures to be incurred from the state budget and at the moment we do not expect an increase in the COVID countermeasure fund ... it will be a continuation of what we started this year, not opening new streams,” Deputy Finance Minister Piotr Patkowski said, according to *Reuters*.

Poland is also going to introduce a slew of new taxes and fees to help the budget. Primary examples include a so-called “sugar tax” on sugary drinks and a higher excise tax on alcoholic drinks sold in bottles of up to 300ml in volume. The government expects that the budget will gain some PLN3bn (€660mn) from both taxes.

Also starting from 2021,Polish companies will have an opportunity for tax-free reinvestment of earned income, the so-called “Estonian CIT”.

“The basic assumption of Estonian CIT is to postpone the payment of tax only at the moment of the distribution of profit by a capital company. Thus, even though the company achieves income, it does not pay tax advances and does not pay them after the end of the tax year as long as it does not transfer the profit to its shareholders (e.g. in the form of a dividend),” tax consultancy RSM wrote in an analysis.

“The system supports the reinvestment of profits, and the absence of the need to calculate the tax due on an ongoing basis allows for simplification in the records kept for tax purposes. The financial accounting of the taxpayer should be sufficient to calculate the lump sum tax,” RSM said.

Poland is also forcing general partnership companies to pay CIT from 2021, at the basic rate of 19%. General partnerships were thus far exempt from the tax.

Next in line will be the controversial tax on retail turnover, over which Poland successfully battled the European Commission in court. The tax will be applied to stores with monthly revenues exceeding PLN17mn. A rate of 0.8% will be charged on the surplus, and on the surplus over PLN170mn, the rate will be 1.4%. According to estimates, budget revenues from this tax in 2021 will amount to PLN1.5bn in 2021.

- **Debt**

Poland’s addressing the coronavirus-driven economic crisis with CEE’s largest fiscal package — equal to up to 15% of GDP — has necessitated an increase in debt. The general government debt to GDP ratio is also expected to grow in 2021, as the administration will have to continue to cushion the lingering negative impacts of the pandemic and help recovery.

According to Fitch Ratings, the revised budget projects debt to rise to 62.2% of GDP by end-2020 and further to 64.7% by end-2021. Much of the higher funding needs will be met through government-guaranteed debt issued by the state investment fund PFR and the government bank BGK.

S&P, in turn, projects net general government debt to increase to 58.7% of GDP by end-2021 and stabilise thereafter.

The European Commission expects the general government debt-to-GDP ratio to surge to around 56.5% in 2020 from 45.8% in 2019 and to remain at the level of some 56.5%-57.3% over 2021-2022.

"At the moment, we do not have any concerns over Poland's public debt sustainability,” Karen Vartapetov, chief analyst responsible for Poland's ratings, told the state-run news agency PAP, in a comment that reflects the current consensus on Poland’s debt standing.

In the extraordinary circumstances, the higher public leverage post-COVID-19 would be seen as moderate in the global context anyway, the analyst added.

“Fiscal metrics were relatively strong pre-COVID-19, affording space for a countercyclical fiscal policy response. In 2021, we project general government fiscal deficits at slightly above 5 percent of GDP and net debt at some 59% of GDP. Our fiscal projections are conservative, and we do not expect the debt-to-GDP ratio to return to the declining path it was on before the pandemic until 2023," Vartapetov said.

Poland also pre-financed over 30% of its 2021 borrowing needs, Deputy Finance Minister Sebastian Skuza said on December 31, *Reuters* reported.

5.0 Real Economy

• Retail

Early on in 2020 at the onset of the coronavirus pandemic, retail was one of the sectors to suffer the biggest downturn. But during the summer, the sector readjusted — for example by betting on developing online sales channels — and while turnover figures remained patchy, the slowdown turned out less painful than expected.

The most recent available figures for November are a case in point. Polish retail sales declined 5.3% y/y in constant prices. The decline was surprisingly small, given that throughout much of November retailers were under renewed restrictions imposed to contain the second wave of the pandemic.

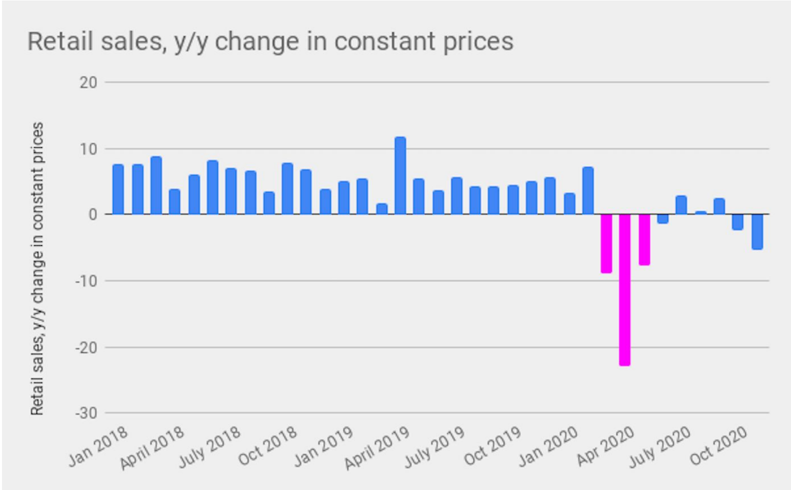
The outlook for the retail sector is moderately optimistic. "The recently announced next round of stricter measures [which came] into force after Christmas and will last until mid-January should not have a strong negative effect on December figures," Erste noted.

"Recent months indicate that the successive waves of the pandemic will have a smaller impact on consumer spending. Essentially, consumption will remain one of the pillars of the economy in 2021," Bank Millennium said.

Despite the pandemic, spending has been propped up by the still favourable labour market situation.

Poland's unemployment rate grew 1.1pp y/y to 6.1% in November, the latest available figures show. The return to the pre-crisis demand for labour is not expected before later in 2021, depending on how the authorities handle the pandemic in the coming weeks.

Effective distribution of the coronavirus vaccine will be key to reinvigorating demand for labour. But it has not been dead, either. Polish wages are still on the increase, having grown 6.6% y/y in the third quarter, and are generally expected to grow 3%-6% in 2021.



• **Banks**

The outlook for Poland's banking sector for 2021 is for heightened risk, the National Bank of Poland (NBP) warned in early December.

Polish lenders could suffer a loss of PLN2.9bn (€648.6mn) in 2021 in the wake of the slowdown inflicted on the economy by the coronavirus pandemic, the NBP said. The banking sector could be in the red for the first time since 1993.

"The pandemic contributed to the emergence of new significant risks in the financial system and aggravated the already existing ones. The main pandemic-resulting risk is a sharp increase of credit losses," the NBP said.

Corporate loan portfolios are seen as particularly risky for the banks, as the corporate sector will continue to struggle to shake off the impact of the pandemic throughout 2021, according to the NBP.

"Excess of capital in the sector increased by [about] PLN29.5bn (€6.52bn) after the release of the systemic risk buffer – 3% of TREA, or total risk exposure amount - in March 2020 and was further increased by retained earnings of 2019," according to the analysis.

Still, some banks would require capital injections in order to meet capital requirements, the NBP warned.

"The shock related to COVID-19 ... exacerbates the condition of individual banks with low capital levels and profitability. These risks overlap with – to a large extent independent of other risks – the legal risk associated with FX housing loans," the NBP noted.

Late 2020 might have seen the first bank give in already. State-owned Pekao bank, Poland's second-biggest lender, took over privately-owned Idea Bank following a request from the country's banking authorities to prevent Idea's bankruptcy, Pekao said on December 31.

On the positive side, Polish banks should absorb losses and keep on lending. "The initial concerns over the risk of a credit crunch have not been confirmed," according to the central bank.

Overall, Poland's financial system should go through 2021 in a relatively good shape, despite all the problems expected for banks. Other than the looming decline in earnings, the NBP warned that legal risk associated with FX housing loans was on the rise.

"The increasing number of borrowers who have filed lawsuits and the rising percentage of court rulings against banks make it necessary to create additional provisions, which as a consequence negatively affect banks' earnings and their further growth," the NBP said.

"The sovereign-bank nexus is gaining in importance as a result of the banking sector's increased exposure to Treasury bonds or bonds guaranteed by the State Treasury," the central bank also said.

In theory, that does not bode well for performance of banking stocks on the Warsaw Stock Exchange. The bourse's index tracking banks' shares, the WIG Banki, already dropped nearly 30% in 2020.

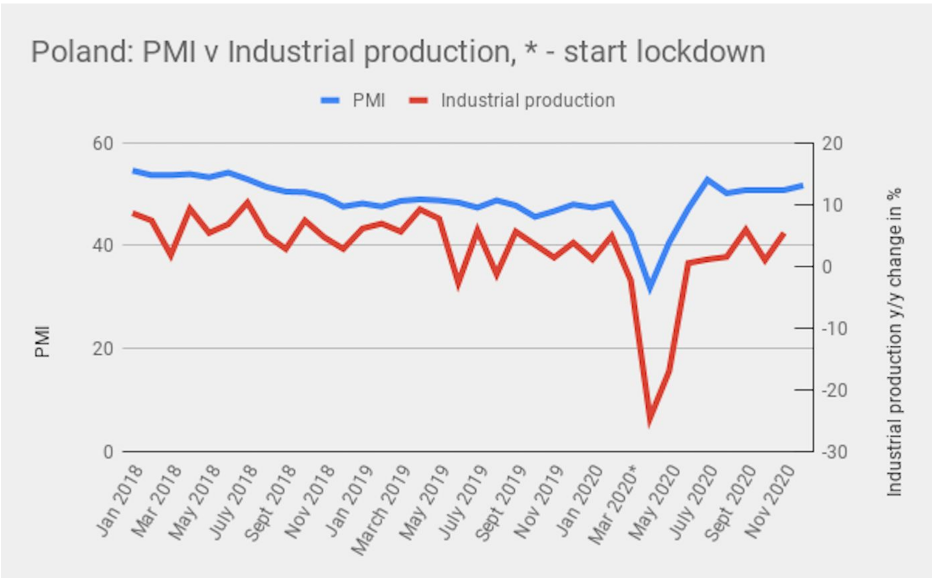
• Industry

Poland's industrial sector will spend much of 2021 attempting to leave behind the coronavirus-induced downturn for good.

Poland's Manufacturing PMI only crawled above the 50-point mark separating contraction from growth in July (although it had been below that much earlier before the pandemic, since October 2018).

Aside from the PMI readings possibly pointing to recovery, actual performance of the sector was also promising recently. Output jumped 5.4% y/y in November, the second best result in nine months.

While Poland's economic activity was still disrupted in late 2020, the disruption was not nearly as severe as during the early weeks of the pandemic, offering hope for recovery in 2021. Supply chains remain operational, while Polish manufacturers enjoyed growth in foreign demand for durable goods, which make a sizable part of the sector's output.



• Energy and power

Poland's energy mix remains some 75%-dependent on burning coal, making the Polish economy increasingly the odd one out in the EU, which — regardless of the pandemic — has now embarked on the path of the most ambitious ever climate and energy policy. Its bottom line is the reduction of climate-warming emissions of carbon dioxide by 55% (versus 1990 levels) in 2030 and to bring them down to virtually zero in 2050.

Poland has been a vocal opponent of that radical shift, arguing its dependence on coal puts it in a risky position unless there is more time available for the transition. But there seems no escape for the Polish coal sector from the scenario of an accelerating reduction of coal's role. That has already seen demand for the polluting fuel drop at the advantage of gas — admittedly another fossil fuel — and renewable energy.

The government will now face the challenge of drawing up a proper plan to reduce coal's share in power generation — a plan that will find acceptance from mining unions, Poland's state-owned power companies and the European Commission. The plan's early iteration, made public at the beginning of 2021, raised doubts about meeting those objectives.

For Polish state-run utilities PGE, Enea, Energa, and Tauron, energy transformation is becoming reality fast. Facing increasing costs of CO2 permits, they are already investing in gas and renewables, a trend that is only expected to pick up speed in 2021.

The PiS government pledged construction of no fewer than six nuclear reactors. If all goes to plan — which is far from given in the capital-intensive and time-consuming investment process in the energy sector — the end of the 2020s should see a pronounced shift from coal towards renewables and, in the early 2030s, to nuclear.

One of the key steps in the process will come this year, when Poland says it will pick technology for the first two reactors. The US appears to be a frontrunner to win the order.

6.0 Markets outlook

• PLN

In late December and in early January, the National Bank of Poland (NBP) was reported to have intervened on the FX market, weakening the zloty. The NBP has long expressed concern about a too strong zloty, which hits exporters and hinders economic recovery.

The NBP's move was consistent with the central bank's previous rhetoric and commonly communicated preferences for a weak zloty. The NBP pushing to weaken the zloty is seen as the basic scenario for the Polish currency in 2021. That said, the central bank will face appreciation trends such as the incremental reduction of risk aversion of investors, as economies — probably — will enter the post-pandemic recovery.

"The NBP is consistently the most dovish central bank in the region ... The NBP wants to offset the factors calling for a stronger zloty in 2021, ie, current account surplus (3.5% of GDP in 2020 and 2% in 2021), appreciating euro and the US dollar, and record inflows of portfolio capital to emerging markets ahead of the expected global economic recovery from the second quarter of 2021 onwards," according to ING.

"The exchange rate channel works [as a tool to help economic recovery] but its use has side effects: higher inflation and Polish government bond yields rise," ING said.

• Stocks

In 2020, trading on the Warsaw Stock Exchange totalled PLN297bn (€61.68bn), or PLN1.2bn on average per month. That compares to a monthly average of just PLN763mn in 2019. Market volatility and — later last year — investors' renewed enthusiasm after the COVID-19 vaccines' development, as well as the successful IPO of Poland's e-commerce giant Allegro all contributed to the heightened trading figures in Warsaw.

In store for 2021 is — possibly — a somewhat calmer market and opportunities to gain on investing in sectors battered during the pandemic, analysts claim.

One such asset class will be banks, unless they steer clear of the calamities prophesied for them by the central bank, mainly the first sectoral loss in three decades.

Another interesting group could be state-controlled energy companies after the government announced plans for a gradual weaning off of coal in Poland's energy mix. The government also wants to carve out coal assets from the energy companies, PGE, Tauron, Enea and Energa, which is another idea that could possibly improve their standing with investors.

“The passing of COVID-19 will create more room for improving the results of Polish companies than for similar entities from [other] emerging markets,” mBank wrote in an analysis.

“[We] recommend overweighting the following sectors, financial on the back of mergers and acquisitions as well as conditional dividend payments, fuel, in line with the expected increase in gas price and refining margins coming back, and industrial companies because of lower cost pressure, the improvement in the economic situation in Germany, and the favorable EUR/PLN exchange rate,” mBank wrote.