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Economic Comment

When will consumption rebound?

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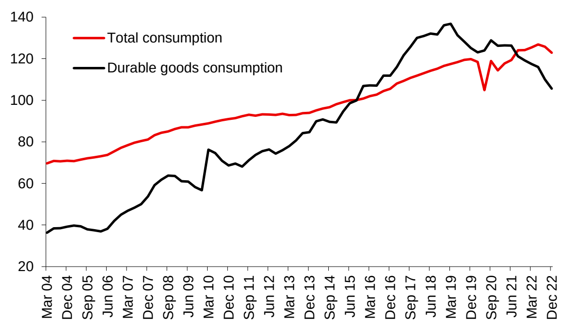
In 2022, weakness in consumption was a key factor behind the GDP slowdown. In 4Q2022, consumption fell by as much as 2.5% q/q and this was the weakest reading in the history of these data, i.e. since 1996 (if we exclude the pandemic period). Retail sales data for January (0.1% y/y) and February (-5.0% y/y) were very weak, suggesting that 1Q was unlikely to see an improvement in consumption.

In our view, however, a rebound is possible in 2Q or 3Q, as evidenced by improved consumer optimism and a revival in demand for consumer credit and mortgages. However, the momentum of the rebound may be limited by the decline in real disposable income, and will therefore require a decline in the savings rate.

In 2022, weakness in consumption was the main factor behind the economic slowdown. GDP growth slowed to 4.9% from 6.8%, down 1.9 percentage points, and the contribution of private consumption to GDP growth declined to 1.7pp from 3.5pp, down 1.8 percentage points. In 4Q2022, private consumption was 1.5% lower than a year earlier and 2.5% lower than a quarter earlier (on a seasonally adjusted basis). This was the weakest reading in the history of these data, i.e. since 1996 (if we exclude the pandemic period). Durable goods consumption looked particularly weak, and it has shown declines on a seasonally adjusted basis since mid-2021. Durable goods have been hurt by, among other things, the supply chains disruptions (cars) and, more recently, the collapse in housing market activity.

Total consumption and durable goods consumption, 2015=100



Source: Eurostat, Santander

However, we would like to remind that GUS data had already indicated strong declines in consumption, which then disappeared in subsequent revisions; this happened, for example, with 4Q2021 numbers. Thus, although consumption does not look well, we should not feel very attached to the claim that 4Q2022 reading was the weakest in many years.

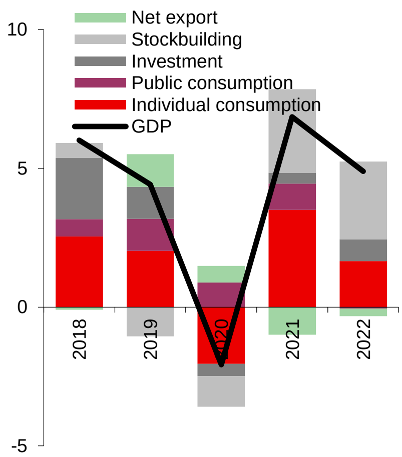
In 2022 consumption was very weak even despite the positive impulse stemming from the influx of refugees. We estimated the strength of this impulse in 2022 at around 1 percentage point. In 2023, it will still work positively in 1Q in the form of a base effect, but will be much weaker in the subsequent quarters.

It is difficult to imagine a recovery in GDP growth without a rebound in consumption. Therefore, in this analysis, we consider whether and when it might occur.

Hard data from the retail market - no signs of a rebound so far

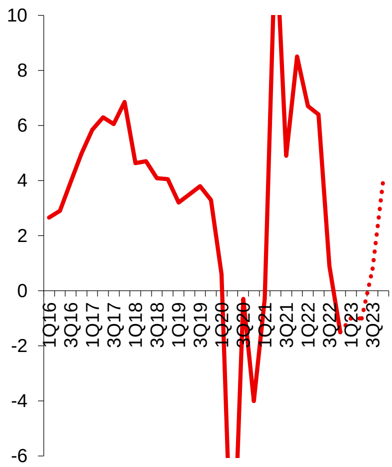
Monthly retail sales and retail trade turnover data are a quite good proxy for trends in consumption. Figures for January and February do not indicate any recovery, but rather a further slowdown. Only car sales were actually better than expected, as they were probably supported by improvements in the supply chains. We wrote more about February retail sales here.

Annual GDP growth breakdown, % y/y



Source: GUS, Santander

Consumption – actual data and our forecast, % y/y



Source: GUS, Santander

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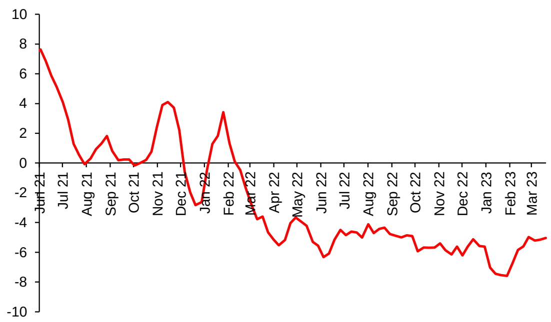
Our estimate of spending on services, based on Santander Bank Polska card transactions, shows a clear and deepening decline starting in March 2022. The trough seems to have been reached in January 2023, but subsequent months have not seen a clear improvement either.

Spending on services, based on card transactions, % y/y



Source: Santander Bank Polska

To sum up, there is no improvement in hard data describing the first two months of the year , neither in those for goods nor in those for services.

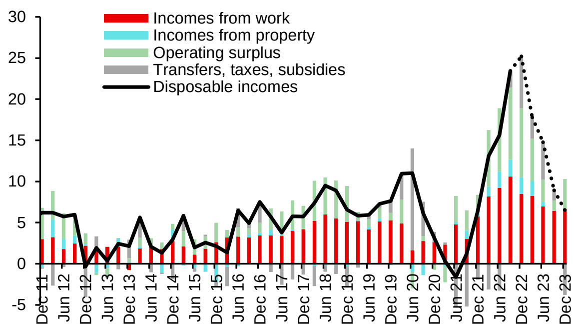
Household incomes - it's going to get worse

Although real wages in the corporate sector have been declining on an annual basis since May 2022, real household disposable income has continued to rise - probably throughout the whole year (data up to 3Q are already available, 4Q is our estimate). This was possible thanks to reduction of PIT rate, and additional social benefits, linked to rising energy prices. Profits from economic activity were also hefty, thanks to high inflation and the entrepreneurs' ability to pass on rising costs to consumers.

However, after peaking in 4Q2022, the growth rate of nominal disposable income will – in our view – decline faster than inflation, and real incomes will fall, despite the high increase in the minimum wage (16.0%), the high indexation of social benefits (14.8%) and higher-than-usual PIT refunds (additional PLN7bn). Labour demand has weakened and, as a result, wages are unlikely to accelerate (although the February data on wages surprised on the upside and the latest NBP Quick Monitoring report indicated that more companies are planning pay rises), and employment growth will remain low (but even here there are positive signals, albeit tentative so far - e.g. an increase in the Manpower index). In the second half of the year, the positive effect of the tax cuts will disappear and corporate profit income will come under pressure. Net interest income will, in our view, remain at a similar level to 2022 and will therefore not add to growth.

Thus, the behaviour of real disposable income will not be conducive to a rebound in private consumption. However, just as in 2H2022 the disposable income data alone could not explain the slump in consumption, also in 2023 other factors can come into play. In addition, we see upside rather than downside risks to our income forecasts due to some positive signals from the labour market, described above.

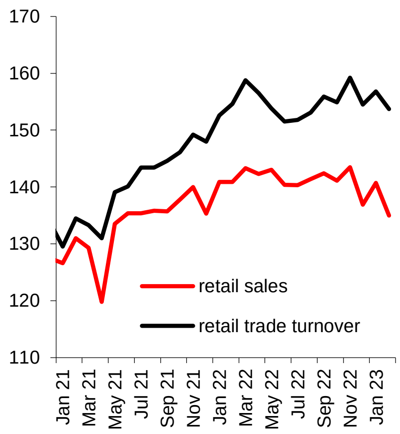
Breakdown of nominal income growth, % y/y



Source: GUS, Santander

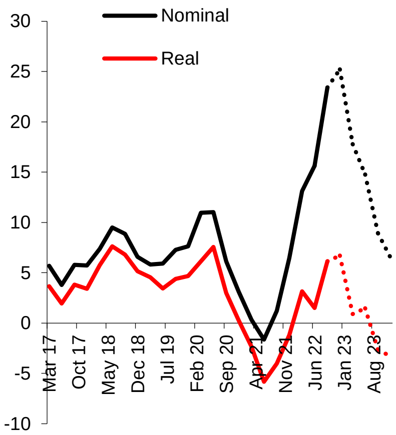
As households consumed less in real terms in 2H2022 than a year earlier, while their real incomes grew, the savings rate increased to around 5% in 2022 from 2.8% in 2021. In 1H2022, on the other hand, households saved significantly less than a year earlier. This means that in 2022 consumer decision depended not only on income behaviour, but rather on other factors –

Retail sales and retail trade turnover, seasonally adjusted data, 2015=100



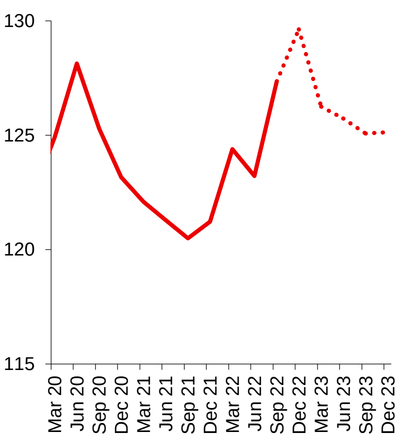
Source: GUS, Eurostat, Santander

Disposable incomes, % y/y



Source: GUS, Santander

Real disposable incomes, seasonally adjusted, % y/y, 2015=100



Source: GUS, Santander

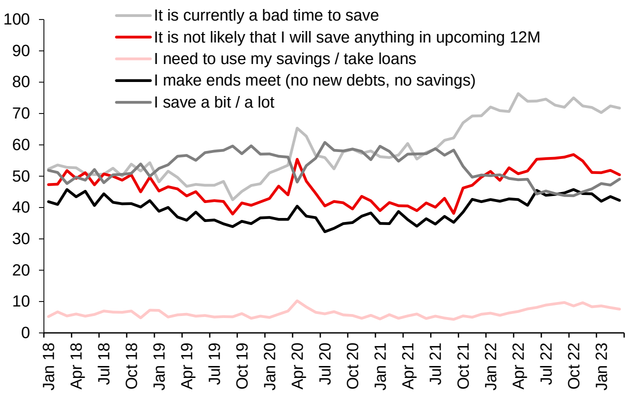
probably on prudency: fears about the impact of the war in Ukraine and about the looming energy crisis. Bear in mind that 2022 was also a time of rising interest rates and rapidly rising inflation, which intensified the need to curb consumption and to review spending. At the same time, rising rates, and thus the debt service burden, gave consumers an incentive to overpay and prepay their loans (deleveraging, negative for current consumption). Deleveraging was not even stopped by loan moratoria. During this period, deposit rates also rose and there was an attractive offer of retail government bonds, which 'locked in' funds for a longer period.

Consumer optimism indicators - improving

Consumer optimism indicators show that it was declining in 1H2022. The current consumer optimism index (BWUK) slipped even lower than during the Covid pandemic, and set a new record low. The economic survey also showed that, during this time, consumers were losing their ability to put money aside and were sometimes forced to rely on savings to make ends meet.

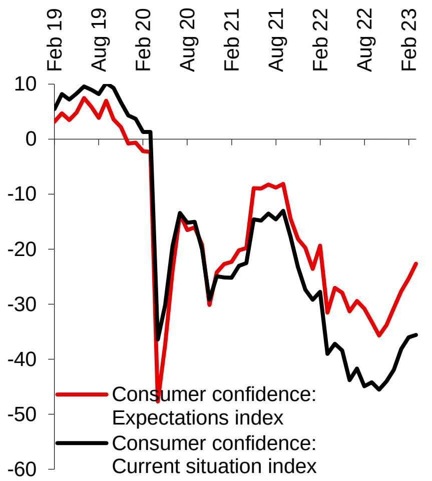
An important caveat needs to be made here: the savings reported by consumers in economic surveys are different from savings calculated on the basis of consumption and disposable income data. The contradiction between these indicators is therefore misleading. The former savings are similar to deposits, i.e. to money actually put aside. The latter savings are the difference between disposable income and consumer spending, in line with economic definition. For example, loan payment reduces the value of the money set aside on a deposit (savings in the colloquial sense), but does not affect the difference between disposable income and consumer spending (savings in the economic sense).

Consumer confidence: attitudes towards saving



Source: GUS, Santander

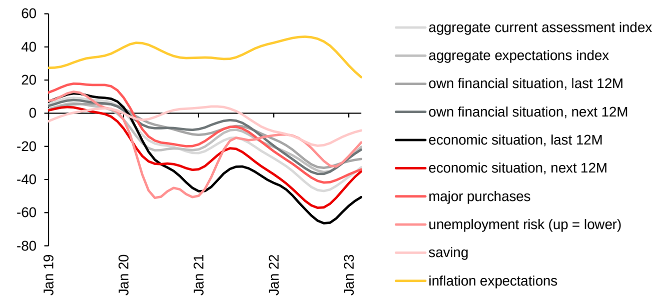
Consumer confidence, pts



Source: GUS, Santander

Recent months have witnessed a marked improvement in consumer optimism. Indicators have been improving steadily since August 2022. In the case of the GUS index, all its components have improved, with the strongest expansion in assessments of future changes in the economic climate and households' own financial situation.

Detailed consumer confidence indicators, pts, seasonally adjusted and smoothed



Source: GUS, Santander

Does an improvement in the consumer confidence mean that an improvement in consumption is to be expected? Using econometric analysis, we tested whether a rebound in the consumer sentiment indicators heralds an improvement in actual consumption.

Analysis based on the VAR models and Granger causality tests suggests that an improvement in consumer optimism indices indeed has a positive effect on consumption, with the peak of the positive effect falling around 3-4 quarters after the initial rise in optimism. Durable goods consumption is more sensitive to changes in consumer optimism than total consumption. Total consumption is most sensitive to changes in the index assessing the past financial situation of households and the conditions for saving; Durable goods consumption – responds the most to changes in an indicator of households' past financial situation and future economic conditions. Retail sales and retail turnover react the most to swings in the indicator of past household financial situation.

The consumer sentiment indicators therefore suggest an imminent improvement in consumption - as early as 2Q or 3Q2023. It should be noted, however, that the strength of this impulse is not overwhelming, as the optimism indices have gone up by only a few points, which would allow us to expect (according to the models) an improvement in consumption in the order of 0.5-1.0%. In our view, however, the next few months should see a further improvement in consumer optimism: fears about the energy crisis are already allayed, the precautionary effect of the war has also, in our view, already subsided, although the conflict itself may still escalate, borrowers have been heavily overpaying loans in 2022, which now - along with some fall in market rates – allows them to benefit from cheaper servicing of the remaining loans. Loan moratoria are also still available this year. The fear of further interest rate rises has also disappeared.

In such circumstances, consumers will be – in our view - more eager to spend more and will not build additional saving buffers. Consumption will be smoothed, as the incoming weakening in real incomes will be viewed as transitory. Households' liquidity will be supported by higher-than-usual PIT returns (about PLN7bn) and maturing retail bonds (about PLN10bn in ROR series), which partially will not be rolled over, we think.

Credit market - a rebound just around the corner?

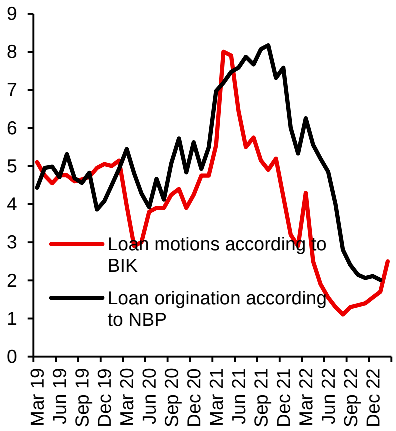
Credit demand drivers have improved somewhat in recent months: market interest rates have fallen slightly, house prices have stabilised, while wages continued to grow at double-digit rates, and the KNF (financial authority) has relaxed criteria for granting fixed-rate loans. Sales of new mortgages have stopped falling and appear to have bottomed out, and an increase was clearly visible in the value of motions for new home loans, which we believe suggests an imminent rebound in lending. Such a rebound would not only be a visible sign of improving household optimism, but would also generate higher demand for durable goods.

Consumer credit volumes have been declining since August, but January's data showed a twitch in new loan sales. In January, loans worth PLN5.7bn were originated, compared to PLN5.0bn a year earlier. However, it is important to bear in mind that the law lowering the maximum non-interest cost of loans came into force in December 2022, and this will have a negative impact on the availability of credit from non-bank lending companies.

Summary

The hard data on consumption from the beginning of the year still point to a deep slump. In our view, however, a rebound is possible in 2Q or 3Q - this is mainly evidenced by improving consumer optimism, and by revival in demand for consumer credit and mortgages. However, the momentum of the rebound may be limited by the decline in real disposable income, and will therefore require a fall in the savings rate.

Mortgages loans – motions and origination, PLNbn



Source: BIK, NBP, Santander

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