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Economic Comment

Domestic demand in recession, CPI down quickly

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1Q23 GDP was down 0.3% y/y. Seasonally adjusted GDP jumped +3.8% q/q, after -2.3% q/q in 4Q2). The breakdown of growth revealed a major weakness of domestic demand at the start of the year: -5.2% y/y, which is the second largest drop in the history of available data. Private consumption declined -2.0% y/y, in line with our expectations, while investments increased 5.5% y/y, slightly more than we estimated. Inventories contracted sharply but this was offset by the improvement in net exports. We are likely to see a gradual economic re-acceleration in the coming quarters

Flash CPI inflation in May printed 13.0% y/y versus 14.7% y/y in April and was below forecasts. What surprised us the most was core inflation, which might have fallen markedly to 11.4% y/y from 12.2% y/y. We are expecting inflation to decline further in the coming months, There is a growing chance that it will enter the single-digit area by the end of this year, but we still see it not far from 10% y/y.

CPI inflation dropped more than expected

Flash CPI inflation in May printed 13.0% y/y versus 14.7% y/y in April and was below forecasts (our call and market consensus at 13.4% y/y). Food prices were up 0.6% m/m, energy was -0.5% m/m and fuel prices registered -4.8% m/m. These categories were slightly lower than our expectations. What surprised us the most was core inflation, which might have fallen markedly to 11.4% y/y from 12.2% y/y. We are expecting inflation to decline further in the coming months, There is a growing chance that it will enter the single-digit area by the end of this year, but we still see it not far from 10% y/y.

Marginal fall of GDP and a huge fall of domestic demand

In 1Q23 GDP fell by 0.3% y/y (vs. -0.2% flash estimate released two weeks ago). Seasonally adjusted GDP jumped +3.8% q/q, after -2.3% q/q in 4Q22.

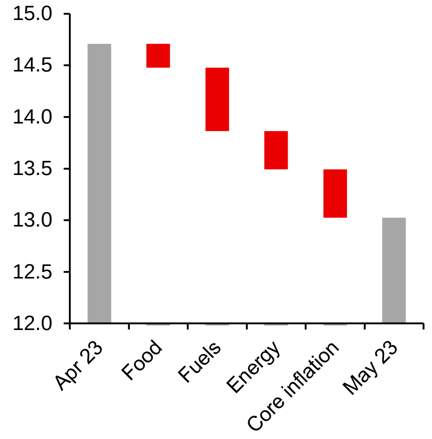
GDP growth and its components (% y/y)

	2021	2022	1Q22	2Q22	3Q22	4Q22	1Q23
GDP	6.9	5.1	8.8	6.1	3.9	2.3	-0.3
Domestic demand	8.5	5.1	10.8	7.2	3.1	0.6	-5.2
Total consumption	5.8	2.0	5.4	5.3	0.9	-3.3	-1.6
Private consumption	6.2	3.3	6.8	6.7	1.1	-1.1	-2.0
Public consumption	5.0	-2.0	1.0	1.3	0.4	-8.7	-0.5
Gross accumulation	19.4	15.9	36.9	14.6	10.5	10.4	-18.4
Fixed investment	1.2	5.0	5.4	7.1	2.5	5.4	5.5
Stock building *	3.4	2.6	5.3	1.7	2.0	1.7	-4.1
Net export *	-1.1	0.2	-1.4	-0.7	0.8	1.7	4.3

* contribution to GDP growth (percentage points),
Source: GUS, Santander

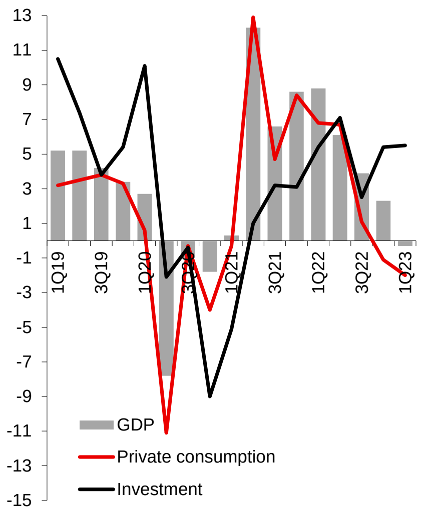
The breakdown of growth revealed a major weakness of domestic demand at the start of the year: -5.2% y/y, which is the second largest drop in the history of available data, after the pandemic-struck 2Q20. In seasonally adjusted terms domestic demand declined -2.1% q/q, after -2.9% q/q in 4Q22, thus formally entering a technical recession. The private consumption declined -2.0% y/y, in line with our expectations, while investments increased 5.5% y/y, slightly more than we estimated. Inventories contracted sharply in 1Q23, dragging the GDP growth down by 4.1 pct. points. We were anticipating a correction in inventories for quite some time, but the scale in 1Q exceeded expectations. On the other hand, it was more than offset by the improvement in net exports, which added 4.3pp to GDP growth. The data suggest that the sharp improvement in Poland's external balance was not only a result of better terms of trade (change in relative prices), but also a consequence of import drop in constant prices (-4.6% y/y).

CPI inflation change, decomposition, %y/y



Source: GUS, Santander

GDP and its components, % y/y



Source: GUS, Santander

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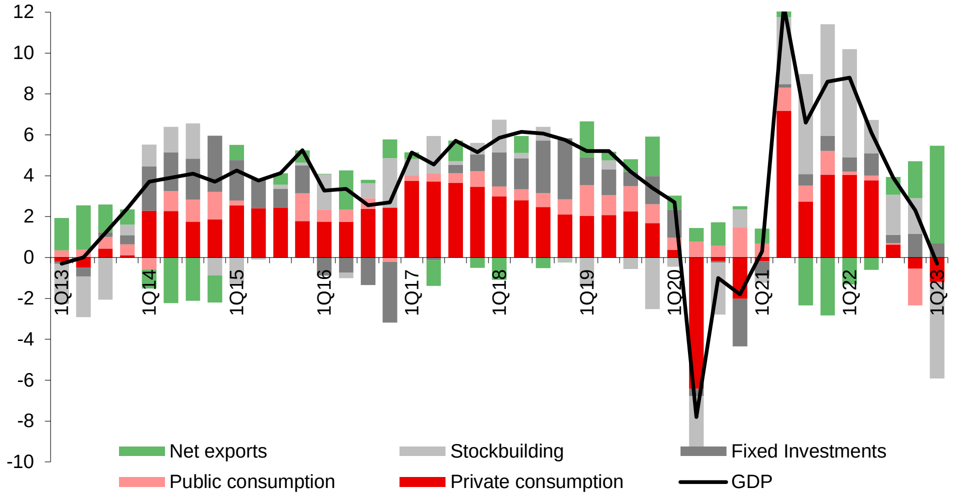
Summing up, GDP growth in 1Q23 was surprisingly strong (our forecast several week ago was at -1.5% y/y, market consensus at -0.8%), and its breakdown seems to be consistent with our view that we are likely to see a gradual economic re-acceleration in the coming quarters. We still see reasons to believe that private consumption has the potential to bottom out later this year. The adjustment in inventories started later than we anticipated and still has some room to go, but not large if we are right about the looming turnaround in consumption demand. Investments may be slowing, but should continue supporting economic growth this year, while contribution of net exports should weaken in the coming quarters. Overall, we keep our forecast of GDP growth in 2023 at around 1.0% y/y. The second quarter may be still close to zero y/y (negative q/q s.a.) but more visible rebound is expected in 2H..

GDP growth and its components (% y/y)



Source: GUS, Santander

Looking at GDP from the value-added side does not provide a picture that is easy to interpret. Seasonally unadjusted year-on-year data are subject to strong base effects, while seasonally adjusted q/q growth shows very unintuitive changes. The least puzzling situation is in manufacturing, where a decline in activity is evident regardless of the way one looks at it. Trade (despite weakness in consumption), transport (despite weakness in manufacturing and exports) and real estate services performed better than our estimates, while the performance of catering and accommodation category was again strongly disappointing.

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