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Economic Comment

4Q: slower investment and decent margins

Marcin Luziński, tel. 510 027 662, marcin.luzinski@santander.pl
Grzegorz Ogonek, tel. 609 224 857, grzegorz.ogonek@santander.pl

In 4Q2023, companies employing 50 or more people registered a 1.3% y/y decrease in revenue and a 0.2% y/y decrease in costs, due in part to a fairly low increase in the wage bill. Their pre-tax financial result amounted to PLN60bn in 4Q23, down 19.3% y/y. The average margin was still relatively high given that the economy is recovering from the downturn and we do not see much room for it to fall further. The behaviour of markups varied by sector, but the consumer-oriented ones did not witness significant declines. In our view, these developments will translate into the persistence of core inflation. Investment by large companies slowed in 4Q23 to 7.9% y/y from 15.7% y/y in 3Q23 in real terms. These figures stand in contrast to the investment result for the economy as a whole, which recorded an improvement to 8.7% y/y from 7.2% y/y. This shows, in our view, that the public finance sector was driving investment at the end of the year.

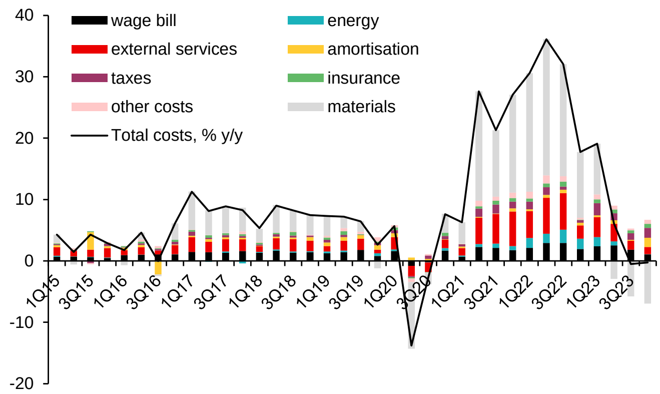
Company financial results – weaker than one year ago

Gross financial results of large and medium-sized companies amounted to PLN60bn in 4Q23, a decrease of 19.3% y/y in comparison to 4Q22, although at the same time this is a result far exceeding the ones achieved in the fourth quarters of the last years before the pandemic: PLN31bn in 2019, PLN24bn in 2018, PLN36bn in 2017.

In 4Q23, companies employing 50 or more people registered a 1.3% y/y decrease in revenues. This is the second consecutive quarter with negative growth (-1.1% y/y in 3Q), and the growth rate was still affected by the high statistical base (which will also be the case in 1Q24). Growth rate of total revenues was pulled down the most by manufacturing. On the other hand, the overall growth rate was positively affected by the generation and supply of electricity, gas and heat, as well as by most service sectors, especially vehicle trade and repair, and retail trade.

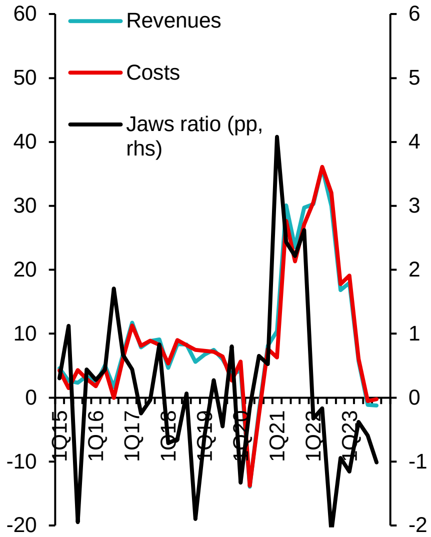
In the last quarter of 2023, companies also registered a 0.2% y/y decrease in costs (after -0.5% y/y in 3Q23). Material costs decreased by 15.0% y/y (-12.6% y/y in 3Q), and labour cost growth slowed to 7.8% y/y from 13.6% y/y in 3Q. All other types of costs increased their contribution to the annual total cost growth, most notably amortisation costs and taxes, both of which rose by 34.2% y/y. Many cost categories have recently exhibited increasing growth rather than moderation or return to the trend from before the pandemic. Material costs stand out in this respect, as they are the only ones showing a decline (to double the 1Q15 level) and energy costs stabilising near triple the 1Q15 level.

Breakdown of y/y cost growth in companies employing 50+ persons, percentage points



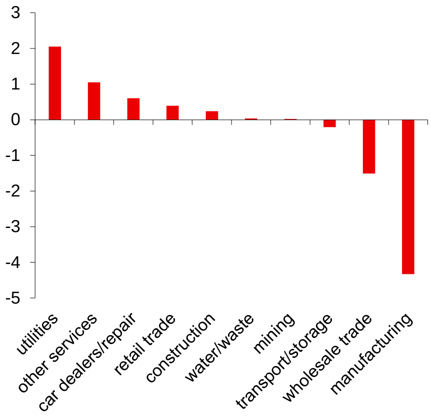
Source: GUS, Santander

Results of companies employing 50+ persons, % y/y



Source: GUS, Santander

Contributions to y/y growth of total revenues, percentage points



Source: GUS, Santander

Economic Analysis Department:

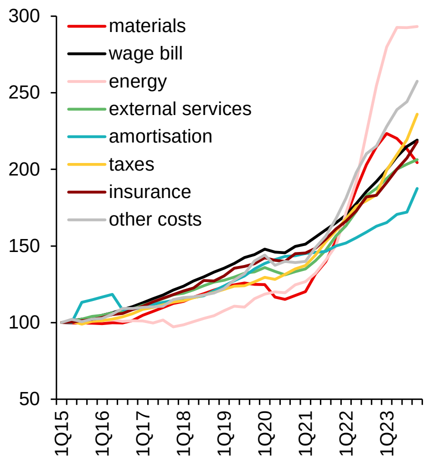
al. Jana Pawła II 17, 00-854 Warszawa
email: ekonomia@santander.pl
website: santander.pl/en/economic-analysis
Piotr Bielski +48 691 393 119
Bartosz Białas +48 517 881 807
Cezary Chrapek, CFA +48 887 842 480
Marcin Luziński +48 510 027 662
Grzegorz Ogonek +48 609 224 857

The wage bill growth in large and medium-sized companies recorded in 4Q (deceleration to 7.8% y/y) was low compared to the measure based on data from the corporate sector (12.3% y/y in 4Q, accelerating from 11.2% in 3Q), but this came after a series of readings skewed in the other direction (also against broader data on the wage bill fund in the National Economy). Besides, the behaviour of employee costs of firms with 50+ employees is generally characterised by higher volatility than the corporate sector, which includes firms with 9+ employees, so one should be careful with assessing trends on the basis of the former.

Wage bill, % y/y

Source: GUS, Santander

Cost level in companies employing 50+ persons, by category, 4Q moving average, 1Q15 = 100



Source: GUS, Santander

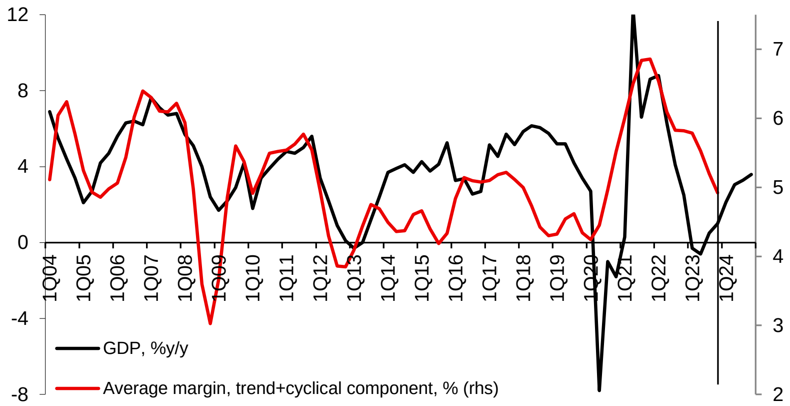
Markups remain high

The average markup fell to 4.3% in 4Q, 1 percentage point below the 4Q22 reading, but still above the multi-year average for fourth quarters of 3.5%. To rule out a strong seasonal effect, we looked at the average margin calculated on the basis of four-quarter moving totals of revenues and profits. Such measure slipped from 5.6% in 3Q to 5.4% in 4Q and thus continued its decline from the peak of 6.7% reached in 1Q22. Although the markup calculated in this way is lower than it has been in the last three years, the result from 4Q23 is still marginally above the peak value registered in the last business cycle before the pandemic.

The correction for the seasonal effect showed that in 4Q there was a slight rise of the average markup to 5.1% from 4.9% in 3Q for the measure relating gross financial result to total business revenue and to 5.8% from 5.0% for the measure based on sales revenue alone.

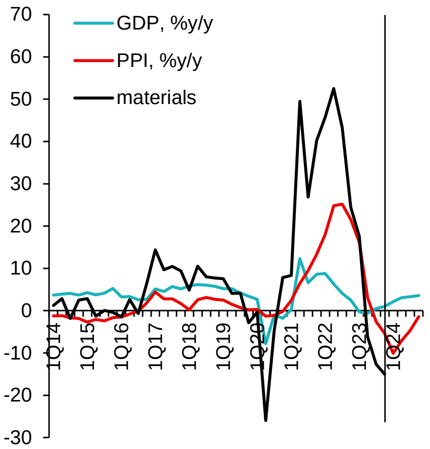
Irrespective of the method of calculation we use, the conclusion is that the average markup is relatively high for the moment when the economy is emerging from the downturn. Moreover, the downturn is hardly visible in the margins of the sectors serving households.

Average margin in companies employing 50+ persons vs. economic growth



Source: GUS, Santander

Material costs, economic growth and PPI inflation, % y/y

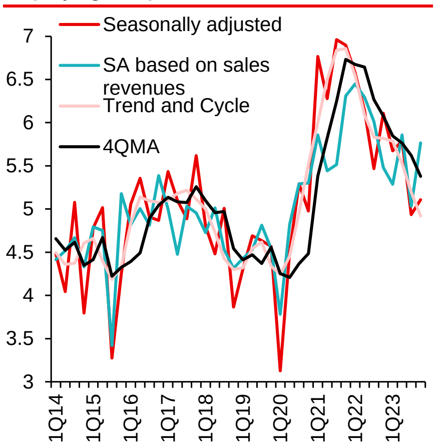


Source: GUS, Santander

We carried out further markup analysis on sectoral data based on sales revenue statistics and average markup indices cleaned of seasonal effects and further smoothed with a statistical filter identifying cycles and trends.

It is worth noting that the divergence we pointed out in the MACROscope: 2024 Outlook between the behaviour of markups in the B2B and strongly export-oriented sectors on one side and the consumer-oriented and rather domestically oriented sectors on the other side has

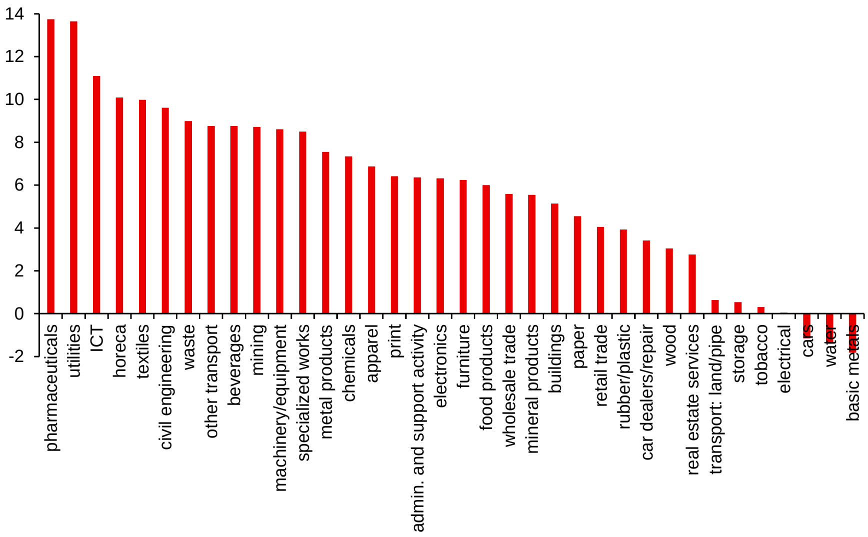
Behaviour of average markups in companies employing 50+ persons, various measures, %



Source: GUS, Santander

persisted. In the former group, downward trends still prevailed during 2023. In 4Q, many of these sectors still fought to remain competitive by cutting markups (automotive, electrical appliances, paper and paper products), but some have already managed to rebound and show markup recovery (chemicals, electronics, basic metals). When the eurozone starts to recover, there should be more Polish industries with rising markups. The second group of sectors - consumer-oriented - has not experienced a phase of systematic decline in markups in recent years and some are showing a clear upward trend (clothing, food).

Average margins in 4Q23, companies employing 50+ persons, based on sales revenues, seasonally adjusted, %



Source: GUS, Santander

In the retail sector, 4Q23 saw a slight pullback in markups to 3.9% from 4.5%, which is still quite high - comparable to the average of the last years before the pandemic. In our view, however, this is not the start of a long-term negative trend. We link this behaviour to the puzzling weakness in private consumption during this particular period, which, as we described in the March edition of our MACROscope, may be related to the temporary cautious attitude of consumers in the early stages of their recovery of positive real income growth. At that time, pro-saving attitudes became apparent, which, however, with the further rebound in real incomes and the rebuilding of savings buffers, should not prevent private consumption growth. At the same time, however, we reckon that the current price war between retail chains could bring the sector's average margin even lower for some time.

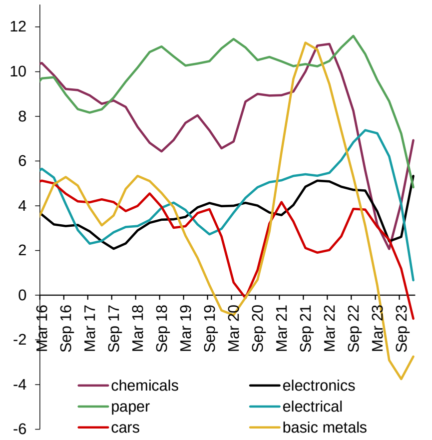
Company results outlook

Further behaviour of company results will depend, in addition to macroeconomic developments, on markup policy. In our view, so far companies across the economy have managed to protect markup levels fairly well despite the downturn (although the picture varies strongly by sector), and we assume that this approach will be maintained. Our scenario assumes that this will be allowed by the progressive recovery in private consumption, sustained moderate investment growth and, over time, maybe also a rebound in demand from Europe for Polish goods and services.

When the statistical base effect contributing to the y/y decline in the cost of materials will soon be exhausted, the other cost categories will come to the fore and total costs will begin to rise at a rate exceeding their pre-pandemic pace. What is more, we expect the cost of materials alone to rebound during 2024 due to the economic recovery demanding more input on the one hand and, on the other hand, the upward turn in PPI inflation taking place in 1Q this year, in our view.

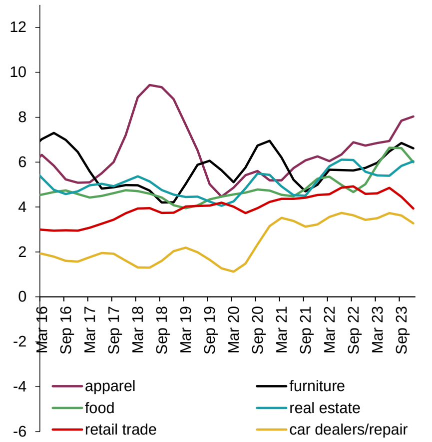
In our opinion, average wage growth in the economy this year should remain close to 12% y/y, which, with almost unchanged employment levels, would mean that the wage bill should show a similar growth rate on average. For all companies employing 50 or more people, this would mean an increase in employee costs of around PLN90bn for the whole of 2024 relative to 2023, i.e. it would consume more than 30% of the gross financial result generated last year.

Average markups in selected sectors (B2B/export-oriented), trend and cyclical component, %



Source: GUS, Santander

Average markups in selected sectors (consumer-, domestically-oriented), trend and cyclical component, %



Source: GUS, Santander

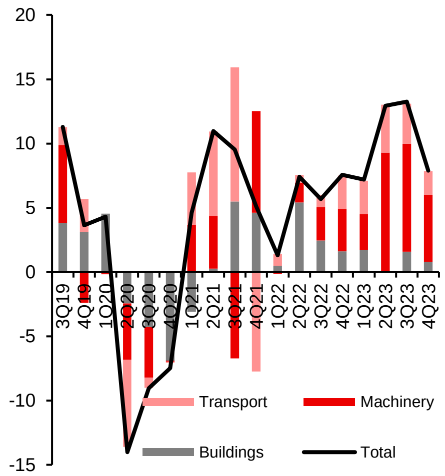
Given the correlation between the average margin in large and medium-sized companies and economic growth, at least a stabilisation of the former should be expected to occur in the coming quarters. The second important factor that could hinder further declines of markups this year is the level of inflation. During the deflationary period of 2014-2015 in Poland, companies found it hard to rebuild markups, while during the period of very high inflation the opposite was true - so in the conditions of 2024 with inflation so far low, but in the second half of the year probably pushing above the target band again, a further decline in markups is uncertain. On the other hand, the experience of 2018-2019 shows that in a tight labour market, there may be a systematic deviation of markups downwards from the levels suggested by its relationship with GDP growth. Taking into account these three factors - the business cycle, the level of inflation and the state of the labour market - we estimate that markups may have limited space to fall in 2024 and will not descend to the levels recorded in the low phase of previous business cycles.

At the same time, many cost categories will continue to grow at above-average rates. Therefore, in our view, it may be difficult for cost inflationary pressures to subside this year, and thus for the persistence of core inflation to disappear (i.e. its descent to levels consistent with keeping CPI inflation in line with the target on a sustained basis). According to our forecasts, core inflation, after hitting a bottom in April (just above 4% y/y), will start to rebound back to around 5% by the end of this year.

Slowdown of investments

Growth of investments in large and medium-sized companies slowed in 4Q23 to 7.9% y/y from 15.7% y/y in 3Q23 in real terms, including on buildings to 2.0% y/y from 4.0% y/y, on machinery to 11.3% y/y from 18.9% y/y and on transport equipment to 13.5% y/y from 21.1% y/y. These figures stand in contrast to the investment result for the economy as a whole, which recorded an improvement to 8.7% y/y from 7.2% y/y. This shows, in our view, that the public finance sector must have been the main driver of investment at the end of the year. In the previous quarters of the year, investment growth in the sector of large companies was quite robust, but according to the NBP, this was the result of the activity of a relatively small group of the largest investors.

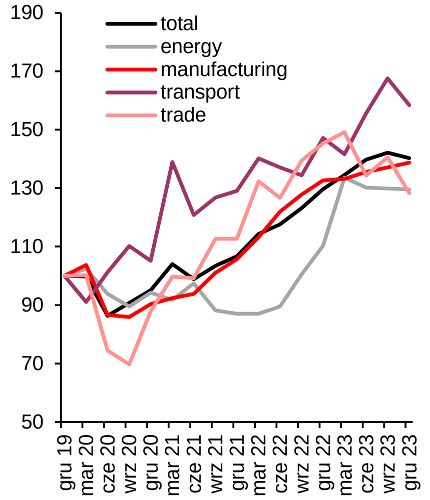
Real growth structure of large companies' investments by types of assets, % y/y



Source: GUS, Santander

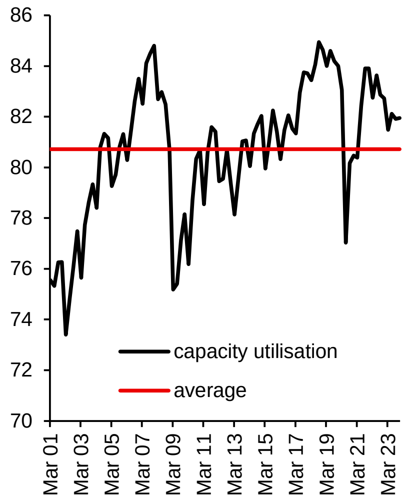
Transport, manufacturing, trade and energy were the strongest contributors to the year-on-year slowdown in investment across the sector. Weaker trends are also evident in the seasonally adjusted data, although using such figures is subject to some error due to the fact that we do not have consistent data on investment in real terms. The seasonally adjusted nominal data suggest that in 4Q23, investments of large companies declined in quarterly terms for the first time since 2021, with notable declines in trade, transport and mining. Outlays in energy have been declining slightly since 2Q23 after a strong bump at the turn of 2022, while outlays in manufacturing continue to rise, albeit at a rather sluggish pace. Seasonally adjusting the national accounts data after first deflating them using the investment deflator indicates even slightly more weakness in investment in 4Q23.

Investments of large and medium-size companies, 4Q19 = 100, seasonally adjusted, nominal



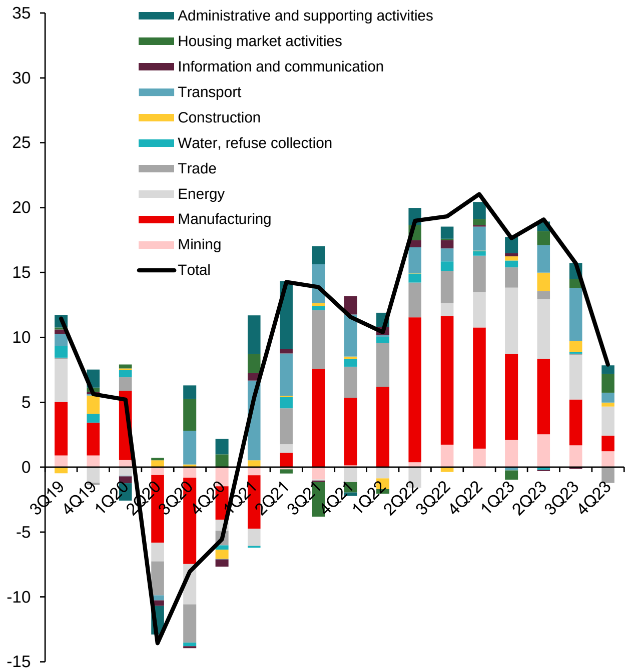
Source: GUS, Santander

Capacity utilisation in Polish companies, %



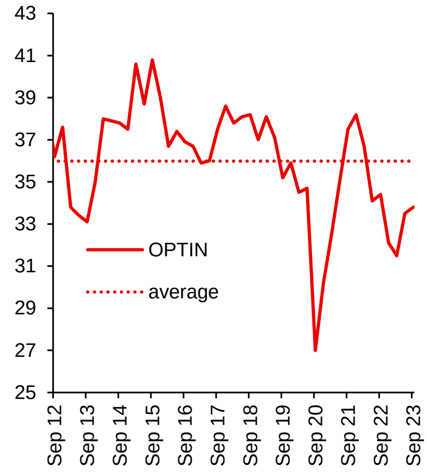
Source: GUS, Santander

Nominal growth breakdown of large companies' investments by sectors, % y/y



Source: GUS, Santander

NBP's OPTIN index of investment optimism, pts

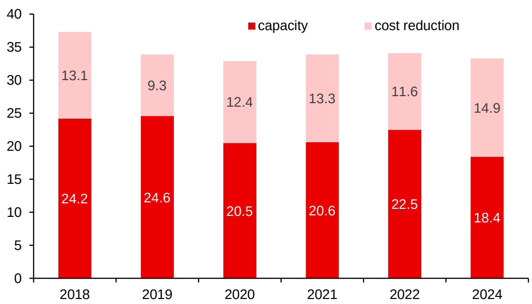


Source: NBP, Santander

Companies are not very optimistic about investment

According to the ESI survey, at the beginning of 2024, the investment optimism among industrial and service companies was lower than in the corresponding periods of 2022 and 2023. In the case of industry, sentiment in intermediate and capital goods firms was weaker than in the previous two years, while in the consumer goods and food sectors it was similar. According to the NBP Quick Monitoring, investment optimism, is slowly rising but remains depressed. Companies declare they are unfreezing investments put on hold due to the energy crisis, but at the same time they are losing interest in new projects. One of the factors behind the low level of investment optimism was the stop in the EU funding due to the end of the 2014-2020 budget framework. In our opinion, the end of the settlement period for projects from the previous perspective - in line with the N+3 rule - could also be seen in data on construction output, which showed good results at the end of 2023 and weaker at the beginning of 2024. According to this year's NBP survey, investments aimed at reducing costs were quite popular, while the percentage of companies planning to increase production capacity was the lowest in years - this is consistent with the weak performance of investments in buildings with a fairly rapid increase in outlays on machinery.

Targets of new investment, %



Source: NBP, Santander

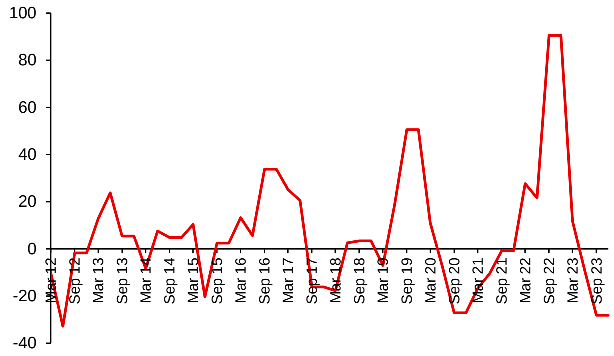
Corporate investments may be moderate in 2024

Slower growth in investment by large companies in 4Q2023 was consistent with our assumptions. The shock of the Russian aggression against Ukraine triggered the need to cut costs, especially when it came to energy. This resulted in a strong investment impulse in the energy sector. Outlays in this sector remain at an elevated level and, in our view, will continue to do so in the coming quarters. In terms of annual growth, on the other hand, the sector is now showing negative readings.

We believe that disinflation in 2024 will be a further disincentive to investment in cost reduction, although high wage growth and, consequently, employee costs may work in the opposite direction. Relatively low levels of capacity utilisation will mean limited willingness to expand capacity. Reduced profits may also exert a negative pressure on the investment activity. On the other hand, the unblocking of EU funds should support investment plans in the second half of 2024 and in 2025, especially in public companies.

Due to the above factors, we expect investment growth in the non-financial corporate sector (as a whole, not only in bigger companies) to slow down to 4.0% in 2024 from 6.0% in 2023.

Book value of new investment projects, % y/y



Source: GUS, Santander

Additional information is available on request. Please contact Santander Bank Polska S.A. Financial Management Division. Economic Analysis Department. al. Jana Pawła II 17. 00-854 Warsaw. Poland. phone +48 22 534 18 87. email ekonomia@santander.pl. http://www.santander.pl.