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## Economic Comment

### Surprising drop in production, wages still strong

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After positive surprises in the January economic numbers, the end of 1Q24 brought quite a disappointment in the activity data. Industrial output slowed to -6.0% y/y from 2.2% y/y, and construction output slowed to -13.3% y/y from -4.9% y/y (after declines of 4-5% m/m on a seasonally adjusted basis). Despite the weak performance of construction output, a recovery in the housing market is quite evident, and reflected in the improvement in statistics on the number of new constructions and building permits. We think that the effect of working days may have had a more negative impact on production statistics than we had assumed. Therefore, it is necessary to wait for next months' data to assess to what extent the weakness in production is sustainable. In 1Q2024 as a whole, industrial production increased by 0.1% y/y, following a 0.6% y/y decline in 4Q2023. In contrast, construction output declined by 8.1% y/y in 1Q2024, while it showed an increase of 9.2% y/y in 4Q2023. This means that it may be difficult to see a clear acceleration in GDP growth in 1Q24 this year compared to the end of last year (we expect around 2% y/y).

Data from the labour market were more or less in line with expectations, with wages in the corporate sector slowing to 12.0% y/y from 12.9% y/y in February and real growth remaining at 9.8% y/y (the highest since the 1990s). At the same time, with a slight reduction in FTEs on a monthly basis, annual employment growth remained at -0.2% y/y. The labour market remains tight, and declines in employment may be a result of companies' efforts to increase productivity - employment restructuring and automation. Rapid wage growth will support consumption and keep core inflation elevated.

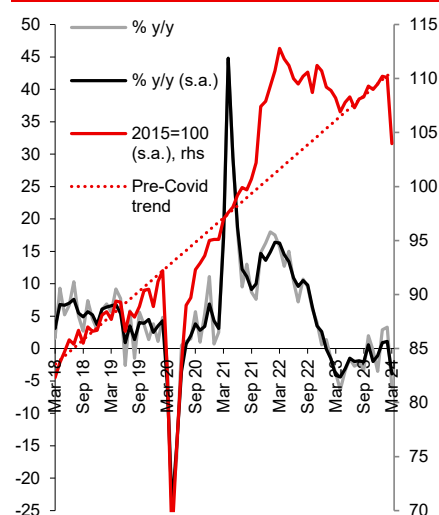
The decline in producer prices has slowed to -9.6% y/y from -10% y/y in February and we expect this measure to continue to rise in the coming months with the prospect of returning above zero by the turn of the year.

#### Surprising collapse in production

In March, Polish industrial output collapsed by 6.0% y/y while a 2.2% y/y decline had been expected by the market and we forecasted -1.1% y/y. The February print was left unchanged at +3.3% y/y and a move to negative growth seemed inevitable on the back of working day differences - just not that big negative growth. Manufacturing is to blame for the collapse, reducing its annual output growth contribution to -5.1pp in March from +3.0pp in February. In seasonally adjusted terms a decline by 5.5% m/m was reported - it takes a major event to trigger such a highly negative industrial output response, like the pandemic or the global financial crisis (last time Polish industry saw a similar of greater m/m SA decline was in 2020 and before that in 2008).

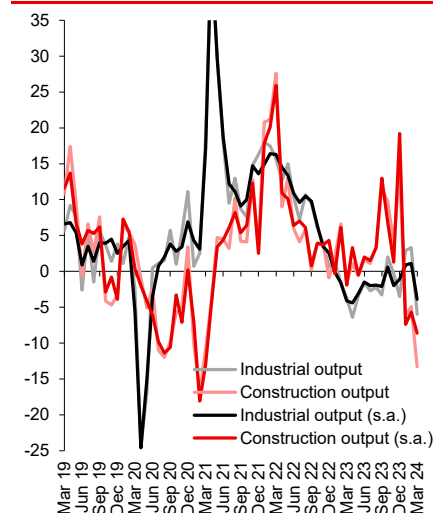
Almost all industries showed m/m output changes way below the usual seasonal pattern, which tells us that some broad factor was at play in March. Since the recent business surveys did not signal any looming activity collapse, we think that the output weakness may be related to the unusually strong negative impact of calendar effects (working day changes, the Easter effect) rather than a sudden significant deterioration of business conditions going across industries. This is why at this stage we do not want to abandon our view that the Polish economy is rebounding, and industrial output should generally reach minor-to-moderate positive growth on average this year. The average 1Q growth of output was +0.1% y/y which is still better than the -0.6% y/y recorded in 4Q23, but at the same time does not suggest any major role of industry in Poland's economic rebound in early 2024.

#### Industrial production versus pre-Covid trend



Source: GUS, Santander

#### Industrial and construction production, %/y/y



Source: GUS, Santander

Generally, the business conditions in the industry are challenging due to poor performance of the European economy - the German one in particular, strong PLN, labour shortages and high minimum wage increase, among others, but not to an extent shown in the March production data.

### Construction output also disappointed

In March, Polish construction output was down 13.3% y/y vs. -4.9% y/y growth in February, market expectations of a 6.7% y/y decline and our -6.8% y/y call. Construction of buildings dropped by 16.1% y/y (vs. -0.3% y/y in February) and civil engineering works by 17.8% y/y (vs. -7.8% in February) while output growth of specialised works improved to -3.2% y/y from -7.2% previously. In seasonally adjusted terms, construction output fell by 4.3% m/m. Due to the generally high volatility of these data this is not a rare sight, but came in the month ahead of municipal elections, which is usually a period when many projects are being finalised – and led us to expect some m/m rise.

Just like in the case of poor March industrial output we feel that the surprisingly large construction output decline is inconsistent with the sector's situation as described by companies in the business surveys. The December deadline for construction projects under the previous EU financial framework may have taken its toll on construction growth readings in early 2024, but we do not see repeated double-digit y/y declines, like the March one, as justified at this stage. On average, construction output fell by 8.1% y/y in 1Q24, while in 4Q23 it went up by 9.2% y/y – this looks consistent with the slowdown in investment that we envisage in this period.

### Housing market recovery continues

In March, 17.9k dwellings were completed, 12.4% y/y lower than a year ago. In 1Q2024 as a whole, the number of dwellings completed was 11.9% y/y lower than a year earlier. In terms of 12-month totals, the number of dwellings completed stood at 214.7k, the lowest since June 2020. Despite the poor performance in the number of housing completions, the uptick in new project activity is clear: the number of building permits was 33.1% higher y/y in March and 32.8% higher y/y in 1Q24. Construction starts, were up 30.0% y/y in March and 55.8% y/y in 1Q24. The number of dwellings under construction is still slightly lower than a year earlier, but we believe this will change soon, probably even as early as in April.

The recovery in the housing demand will, in our view, support a further increase in construction market activity, although a stronger translation into an increase in the number of dwellings completed may only become apparent in a few quarters, with upward pressure on housing prices likely to persist.

### Sentiment among companies mostly stable in April

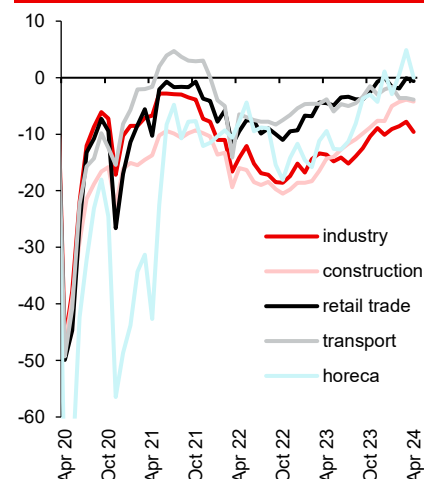
The April results of GUS business sentiment survey showed minor changes to seasonally-adjusted sectoral indices in most sectors, a large decline in hotels and restaurants and a significant decline in industry coming after three months of improvement. The current situation indices (reported without seasonal adjustment) were mostly on the rise, especially in retail and wholesale trade. The expectations components rose the most in hotels and restaurants, transport and retail trade.

The sentiment indices still behave in line without scenario of consumption-led economic rebound, the index covering industry has not sent a strongly negative signal (it has been pretty much stable for the last six months) and the construction index is trending up.

### Employment declines slowly in line with forecasts

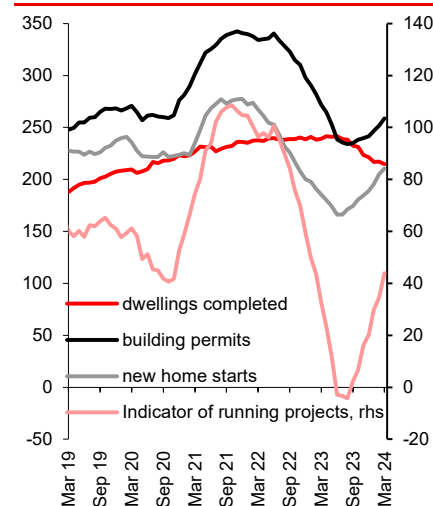
Employment declined in March by 0.2% y/y, in line with expectations. In monthly terms, the number of full-time equivalents (FTEs) fell by 9.7k, mostly due to reductions in the sectors of administrative and support activities (-2.8k, -0.7% m/m), and manufacturing (-2.7k, -0.1% m/m). In the case of the former of the two sectors, significant job cuts were observed also in February, and were likely caused by the January increase of the minimum wage, which is earned by a significant proportion of the sector's employees. Although, we expect that economic recovery should soon lead to an increase in labour demand, we do not predict increase in employment comes fast, as the unemployment rate is already very low and the remaining free labour force is limited. In effect, annual employment growth rate will likely remain below zero in the coming months.

### Industrial and construction production, %y/y



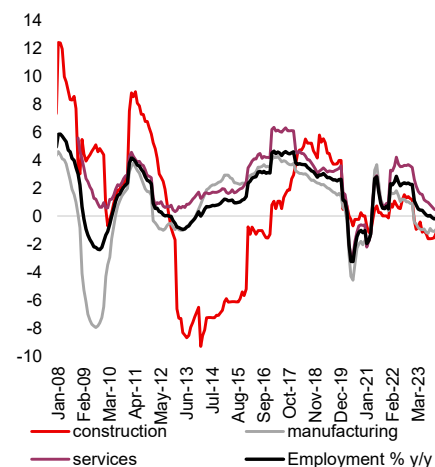
Source: GUS, Santander

### Housing market indicators, % y/y



Source: GUS, Santander

### Employment in the corporate sector, % y/y



Source: GUS, Santander

### Real wage growth still historically strong

Corporate sector wages rose in March 12.0% y/y, as expected, after increasing 12.9% y/y in February and 12.8% y/y in January. Though this means a slight deceleration of nominal growth compared to last months, real wage growth remained at 9.8% y/y, i.e. at the highest level since the 90's (thanks to the decline in inflation to 2.0% y/y in March). In most sectors, wage dynamics were close to our forecasts, save for the mining sector, where wages grew only 6.5% y/y, over 10 pp less than we anticipated, and the water supply sector, where they surged 23.1% y/y, 8.8 pp more than we expected. In effect, we estimate that wages ex. mining rose 12.1% y/y, and wages in services 12.2% y/y. We expect that wages will continue growing at a double-digit pace for the rest of the year. Real wage growth should remain close to or slight below 9% in the next couple of months, though the expected increase in inflation will likely decrease it somewhat further in the year. Still, real wages growth should be significant over the whole year, which should offer proper stimulus to consumption. Moreover, strong wage growth will be one of the factors fuelling core inflation, which in our view will remain over 4% y/y for the rest of the year.

### Annual PPI growth recovers but remains deeply negative

Producer price growth accelerated to -9.6% y/y from -10% y/y in February, i.e. which was nearly in line with our forecast and market consensus at -9.5% y/y. The annual growth rate for February was revised upwards from -10.1% y/y amid monthly price revisions of 0.1-0.5pp in all major categories. Meanwhile, data for March showed a 0.1% m/m drop, ca. 0.2 pp below our estimate, which comprised a small price increase in mining and a slight decline in manufacturing prices of -0.1% m/m. Core PPI growth recovered to -9.3% y/y from -9.5% y/y. All in all, PPI data confirmed the bottom in price growth dynamics is behind us.

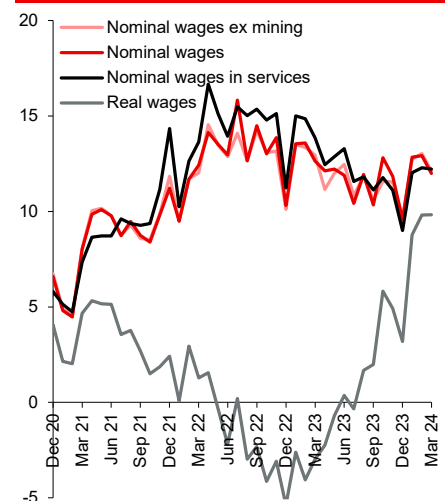
In the next months we expect further recovery in annual price growth into positive territory at the turn of the year. In the short term this will be backed by stabilization of the zloty vs. euro and weakening vs. the dollar in April and rising metal and oil prices in recent weeks. In 2H some rebound in demand will also back producer price growth recovery. Still negative growth in PPI is partly a disinflationary signal though as showed in corporate results statistics largest weakening in margins was recorded for export sectors, which lower prices to defend sales and market shares.

Construction price growth decelerated to 7.3% y/y from 7.5% y/y with 0.4% m/m growth in all key

### Prices of agricultural products stabilise

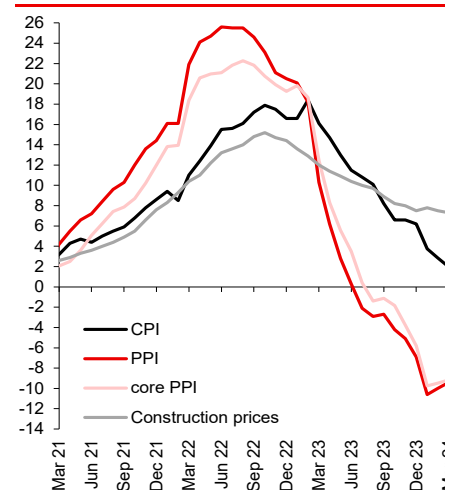
Prices of agricultural products were roughly stable in March, falling by 0.1% m/m and 15.1% y/y. Lower prices were recorded in cereals, while prices of potatoes and meat increased slightly. In our view, the development of agricultural commodity prices on the wholesale market suggests that room for a further decline in retail prices is running out. The normalisation of VAT rates on food in April may therefore mark a turning point in the retail market.

### Wages in the corporate sector, % y/y



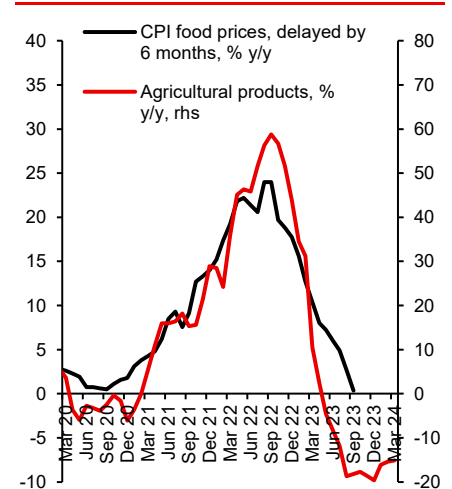
Source: GUS, Santander

### PPI and other inflation measures, % y/y



Source: GUS, Santander

### Prices of agricultural products vs retail food prices, % y/y



Source: GUS, Santander

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