MACROscope

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The return to the green island
Poland

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Index

Executive Summary (macro)

In August, global financial markets went through a short-lived but quite sharp correction, driven by renewed fears of recession in the US, triggered by weaker labour market data. In our assessment, the baseline scenario for the global economy is still a soft landing: a mild and controlled deceleration in the US, a slow recovery from the bottom in the euro area, a structural slowdown in China. That said, we assess that negative risks to global economic growth have increased in recent months, in particular recessionary risks in the German economy. Further episodes of volatility spikes in financial markets cannot be ruled out, with potential triggers being both economic surprises and (geo)political news.

Despite the challenging external environment, the Polish economy is reaccelerating in line with the scenario we have been predicting for a long time. In 2Q24 Poland recorded the fastest GDP growth in the entire EU and was the only country in the CEE region to surprise positively with the result, showing a great resilience to the protracted downturn in Germany. This was possible thanks to solid growth in consumption (the effect of rapid growth in household incomes) and better-than-expected investments. We maintain the view that consumption will be the main driver of GDP growth until the end of this year, while in the next two years, investments, very strongly stimulated by the implementation of EU-funded projects, will take over the primacy. This should allow Poland to stand out positively against other European countries in terms of economic growth, even in a situation of relative weakness of the main trading partners. We maintain our GDP growth forecast of 3.0% in 2024 and 3.5% in 2025. The protracted weakness in the Eurozone continues to hold us back from being more optimistic about the outlook for 2025.

The labour market had a few hiccups, suggesting a weakening in demand for workers. However, this appears to be a temporary situation and, as GDP growth and – especially – investment accelerate, employment should start to rise slightly next year. Nonetheless, wage growth will not remain at its current exceptionally high level in 2025, which will be affected by, among other things, a markedly lower scale of indexation of the minimum wage and public sector wages.

The slower wage growth and rising labour productivity will translate into a marked deceleration in the growth of unit labour costs, which should slow to around 3% y/y by the end of 2025, from around 7-8% y/y today. This factor will increasingly favour disinflation over time. However, over the next two quarters, CPI inflation will remain on an upward trajectory, according to our forecasts, rising to just over 5% in December this year and reaching a local peak of close to 6% y/y in March 2025.

According to the NBP governor, the prerequisite for the start of discussions on interest rate cuts is a halt in inflation growth for at least 2-3 months and forecasts clearly indicating a decline in inflation in the future. In light of our CPI forecasts, this practically rules out chances of a first rate cut in March 2025 and reinforces our view that monetary easing in Poland is likely to start in the middle of next year, probably in July. The chances of an earlier reaction from the MPC would certainly increase if the economic growth scenario turns out to be markedly weaker than we expect.

The counterweight to the still restrictive monetary policy is an expansionary fiscal policy. According to the draft budget for 2025, the fiscal deficit in 2024 is expected to be 5.7% of GDP (instead of the planned 5.1%) and in 2025 it is expected to decrease only slightly to 5.5% of GDP. A budget amendment this year is still not ruled out and the risk is increasing, in our view, as a result of the severe floods in the Southern Poland. We also see a risk that the actual implementation of the deficit next year will once again be worse than the forecast in the draft budget, which is due to, among other things, not very conservative macroeconomic assumptions and aggressive revenue forecasting. A loose fiscal policy should: (a) support economic growth, (b) will not facilitate taming inflation and may discourage the central bank from cutting interest rates quickly, and (c) it may raise objections from rating agencies, which have already drawn attention to the high deficit and dangerously fast growth of debt. However, we do not expect negative rating decisions against Poland anytime soon.

Executive Summary (markets)

FX market

In recent weeks, the volatility of the zloty has gradually decreased, resulting in a narrowing trading range for the EURPLN exchange rate. The zloty, like other currencies of the CEE region, avoided the negative impact of the strengthening yen, which affected some other EM currencies, and which was partially offset by the weakening dollar. The Ministry of Finance will probably want to avoid excessive appreciation, so it exchanges most of foreign currencies directly with the NBP. Later in the year, we assume a negative impact on the zloty from a deteriorating current account balance and a likely increase in volatility due to the US elections. These factors will be offset by rising interest rate disparity against the eurozone. The latter factor could act to strengthen the zloty against the euro toward 4.20 in 1H 2025.

Interest rate market

The last quarter was marked by a growing inversion of the swap curves, although this occurred mainly after the US data published in August with the stabilization of rates in recent weeks. This potentially creates room for a correction in the curve slope in the coming months. Our models and intuition indicate that the potential steepening and upward adjustment of market rates will not be large in view of the fact that the cycle of rate cuts that favours steepening is still quite distant, while at the same time the cycle of rate cuts in the core markets is ongoing and here possible upward adjustments in rates should not be significant. The trend of steepening of the swap curve will continue and will gain strength next year in our opinion. In the case of bonds, we assume that negative net issuance in October will support a narrowing of asset swap spreads, but then the market will focus its attention on record high issuance next year, suggesting that they will remain high in subsequent quarters. Nevertheless, we assume that the spread to Bunds will gradually narrow next year.

2024: Forecasts and main risks

Indicator	Our view in December 2023	Our view in September 2024
GDP	Another year of weak economic conditions abroad. Despite the unfavourable international environment, we expect stable GDP growth of around 3% y/y, driven by domestic demand. Our forecast is still above consensus, which, however, started to move upwards after the parliamentary elections. We would also consider raising our forecast if it were not for the weakness of the German economy.	Scenario unchanged. The 2Q24 GDP data fitted very well into our expected scenario for this year. The protracted weakness in the euro area continues to hold us back from increasing optimism about the outlook for 2025.
GDP breakdown	Weakness in the euro area and the strong zloty will make for a difficult year for exporters. Balance of trade will worsen as imports rebound with domestic demand. Consumption will be the main driver of the recovery, and investments will remain in an upward trend, although advancing slower than recently. Reversal of the inventory cycle should support industry but hinder disinflation.	Scenario unchanged. Consumption has been gradually accelerating and is the main driver of this year's economic recovery. Investment in 2Q surprised on the upside after a disappointing 1Q. Next year, the roles will reverse - consumption will slow down and investment will accelerate, taking over the first place as the driver of GDP.
Labour market	The economic rebound suggests that demand for workers will not slow down. Unemployment will remain at the record low. Because of the increase of the minimum wage by another 20% and solid increases in the public sector average wage growth in the economy will remain in double digits.	There have been growing signs of cooling demand for workers, although unemployment remains low. We anticipate a slight rebound in employment in 2025. Wage growth remains very high this year and will only slow down more markedly in 2025.
Inflation	Disinflation will slow down, but CPI may still fall at the beginning of the year due to the extension of frozen electricity prices and zero VAT on food. In the second half of the year, we expect inflation to return to 6-7%. External environment is favourable for disinflation of commodity prices, but prices of services remain stubborn. Inflation's return to the target is not moving any closer.	Inflation did surprise to the downside in the first months of the year but has already started rising and will accelerate to around 5% y/y in the second half of the year, thanks in part to rising energy costs and a low base effect. We forecast a local peak in inflation in March 2025, close to 6% y/y.
Monetary policy	After the elections, the central bank became far more focused on inflation than on GDP growth and unemployment. Rates will remain unchanged until 4Q24, with two rate cuts, 25 bps each, possible at the end of the year.	The MPC is communicating that there is no room for policy easing as long as inflation is rising, which means, in our view, that interest rates will remain unchanged until around mid-2025.
Fiscal policy	Negligible chance of accelerated fiscal consolidation after the change of the government, due to the electoral calendar and the previous government's additional spending, among other factors. Fiscal policy will support GDP recovery but will not tame inflationary pressures.	Fiscal policy 2024-2025 more expansionary than expected, which should support the recovery of the economy but hinder rapid disinflation.
Fixed income market	An upward adjustment in market rates, especially short-term swap rates and bonds, may take place at the beginning of the year, thanks to distant rate cuts and large issues. However, the size of adjustment may be reduced by low inflation. Later in the year, we expect a gradual decline in rates as the curve steepens.	Excessive, in our view, market pricing of the scale of looming rate cuts in Poland and in core markets suggests a temporary correction of market rates and yields. In the medium run, the downward trend is likely to continue along with the normalisation of monetary policy.
FX market	In the coming year, we expect a strong and relatively stable zloty, which may be supported by late rate cuts, weaker dollar and higher inflows of EU funds. The threshold exchange rate for profitable exports will constraint the appreciation.	Possible weakening of the zloty ahead of the US election. Rising rate disparity should strengthen the domestic currency in 1H 2025.

Economic growth

1

World: Are economies slowing down or accelerating?

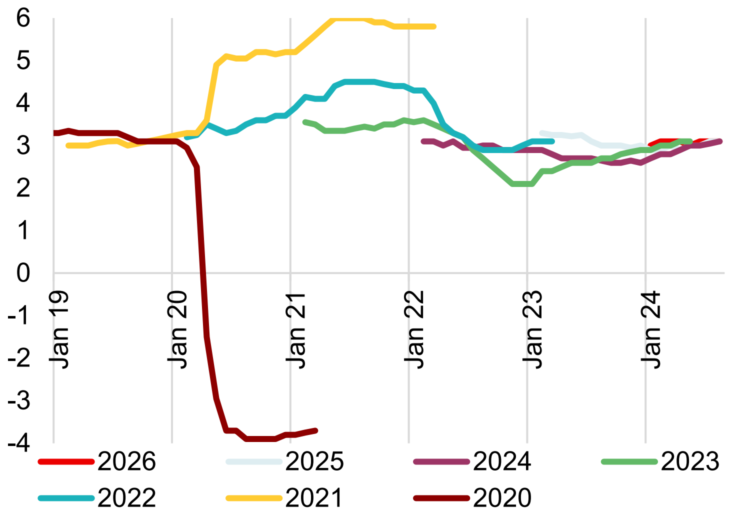
Economic growth forecasts for 2024 for most countries are slightly rising as data keep coming in. Forecasts for 2025-2026, on the other hand, suggest that **there is no tendency for either growing optimism or pessimism. Global growth is simply expected to remain close to 3% this year and in the years to come, and these forecasts are stable**. Such a stabilisation of forecasts is a different situation than in 2021 - with rising hopes about 2022, and in 2022 - when fears about 2023 were growing. However, it is not caused by the general stability of the situation, but rather by the mutually offsetting opposing tendencies: the resilience of the US, the rebound of some emerging economies, stagnation in Europe and doubts about the condition of China.

Even behind the stagnation in the European economy a polarisation of results can be seen, with Spain and France rebounding, and Germany moving on the verge of recession. Some countries have already shown two or even three quarters of solid quarter-on-quarter growth. The EU and the Eurozone as a whole are also showing consistent but mild growth – yet not strong enough to claim a transition to recovery phase.

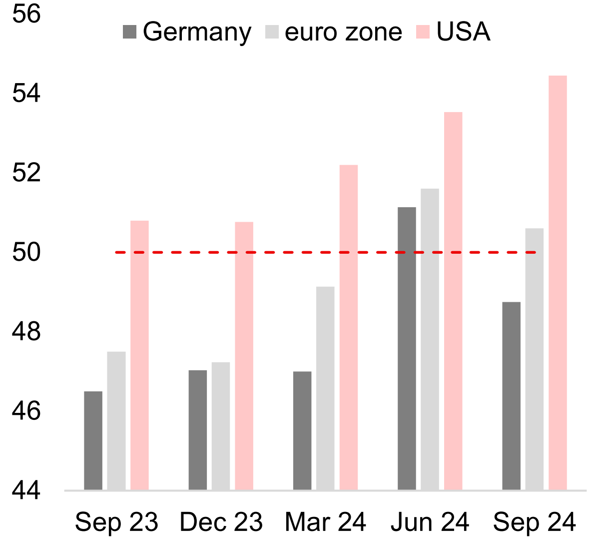
What is notable is **the current sensitivity of the markets to data on economic growth**: although the US is far from recession, this did not prevent a temporary market panic in August after several weaker data releases. There is also a palpable loss of faith in the German economy as the economic powerhouse of Europe (a label it earned in previous business cycles). This time, the forecasts for Germany are deteriorating, but this does not affect the perceptions regarding the entire Eurozone.

As for such external conditions, Poland is doing quite well.

Evolution of global GDP growth forecasts by year according to a Bloomberg survey

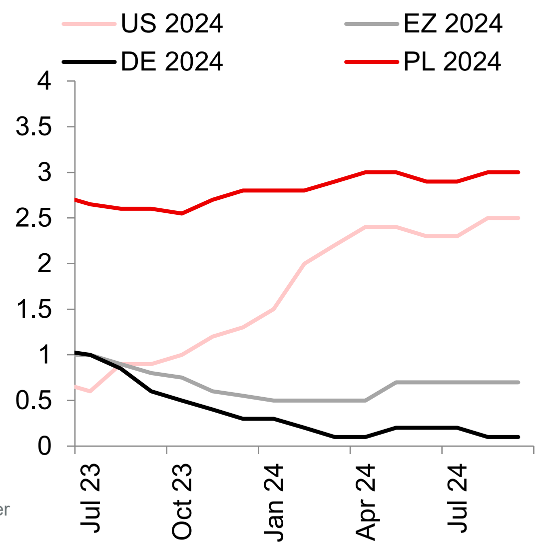


Composite PMI, quarterly average, pts

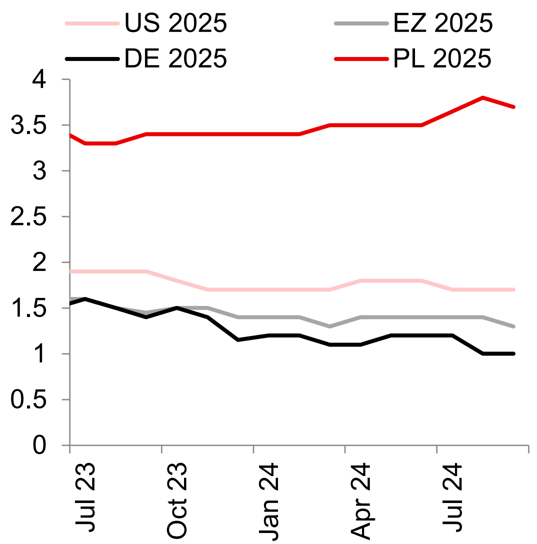


3Q24 bars show July-August average

2024



2025



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Source: Bloomberg, S&P Global, Santander

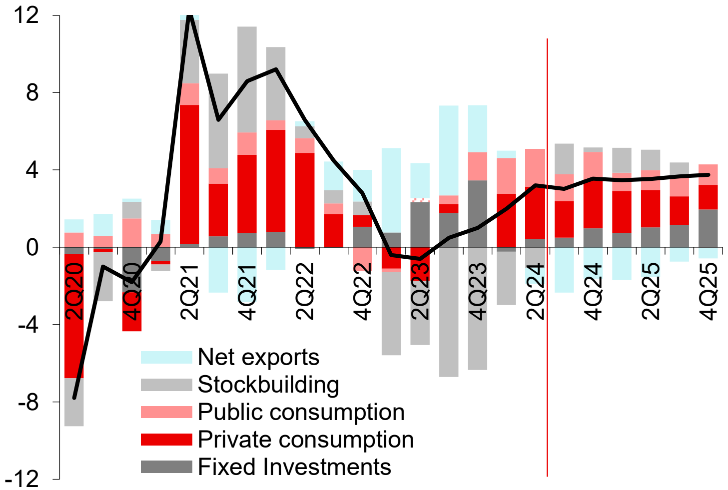
Poland: Our recovery scenario is materialising

During the summer holidays, after several weaker readings of monthly data, there was a short-term wave of downward forecast revisions for Poland (we did not jump on this bandwagon), which ended with a solid GDP result for 2Q24. In the background, the stubborn weakness of the German economy remains a burden on Poland's results and the main risk to its economic growth in the coming years. However, for the time being, **our scenario, based on the assumption of resilience to the problems of major trading partners thanks to the strength of domestic demand, is materialising**. A comparison of GDP paths for EU countries shows that Poland has started to outperform again.

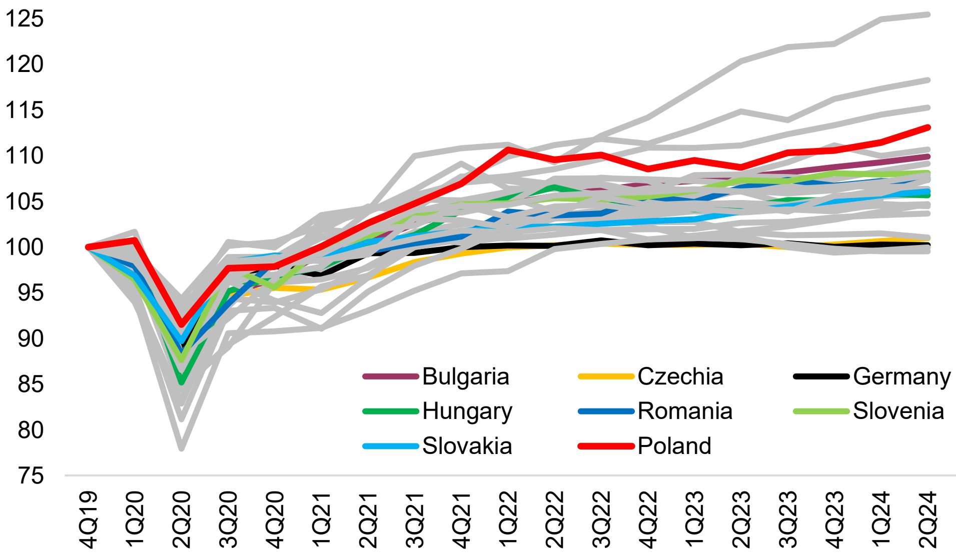
We have argued for long that consumption would be the driving force of the economy, both private and public, and after the results for the first half of the year, there is more and more evidence supporting this view. **Over time, investments will take over** and, in our opinion, they will become the backbone of growth in 2025. In 2Q24 private consumption was even stronger than we assumed based on the scale of real income growth, and contrary to fears, there was a year-on-year increase in investments. We attribute the latter to public investments. A further improvement in this area will be driven by the mobilisation of the state administration to fully use funds from the National Recovery Plan – which requires it to act urgently. It is this time pressure that is expected to make investment such an important component of growth in 2025.

So far, the elements that could have spoiled the rebound scenario – exporters operating in difficult conditions and industry not giving a growth impulse – do not significantly harm growth, and even have a prospect of improvement.

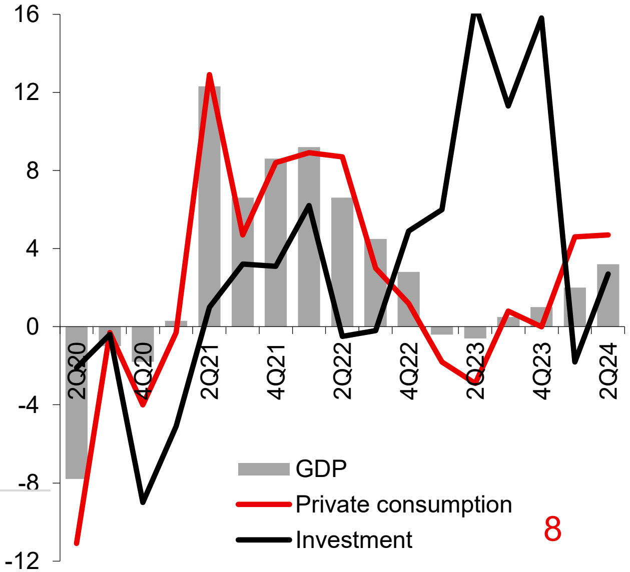
Breakdown of Polish GDP growth, % y/y



GDP level in EU countries, 4Q19=100



GDP and selected components, % y/y



Source: GUS, Eurostat, Santander

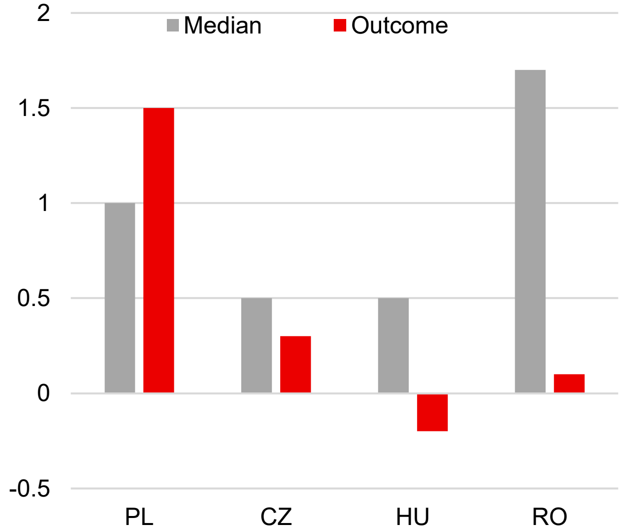
Will Poland stand out as Europe's green island again?

In the CEE region, Poland was the only economy to surprise to the upside with GDP growth in 2Q24 (3.2% y/y, as much as 0.5 percentage points above the consensus). The reading for Poland was preceded by weaker than expected data from the Czech Republic (-0.2 percentage points compared to the median forecast), Hungary (-0.7 percentage points) and Romania (-1.6 percentage points), which even has intensified the effect of the already considerable positive surprise – it was easy to conclude that the entire region has problems due to the poor condition of Germany. At that time, we emphasized that the difference in the case of Poland could stem from a larger internal market, ensuring greater resilience of the economy to the limited demand from across the Odra river (see p.13). In our opinion, Poland with surprisingly good economic growth deserves to be called a "green island" in this context.

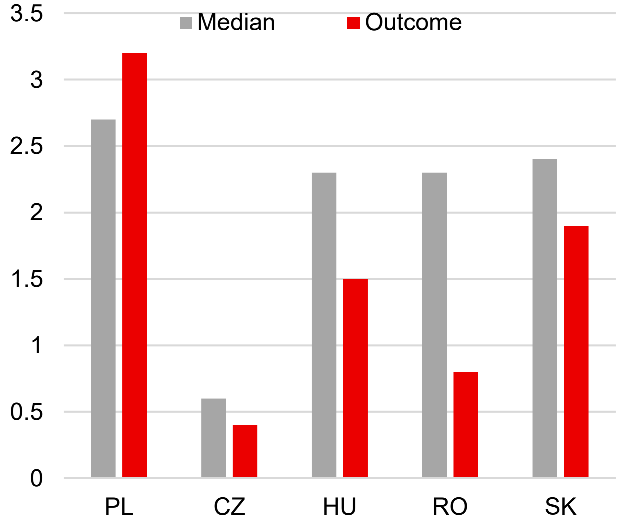
Having said that, Poland is not the only country to achieve positive growth. According to Eurostat, in 2Q24 as many as 23 out of 27 EU member states expanded in annual terms. In quarterly and seasonally adjusted terms, 20 countries recorded a positive GDP growth. **Still, both in q/q and y/y terms, Poland achieved the highest growth in the entire EU** – as compared to 7th position in 1Q24 and 15th in 4Q23 as regards q/q growth as well as 13th in 1Q24 and 11th in 4Q23 as regards y/y growth. Poland was also not the only one to surprise positively with 2Q24 result – the Netherlands, Spain and France also managed to do so.

Expectations regarding growth in Poland also distinguish the country from among EU members. Based on a survey of economists conducted by Bloomberg, it can be concluded that the **cumulative growth expected in 2024-2026 is the highest in the case of Poland and is the only one to exceed 10% in real terms.**

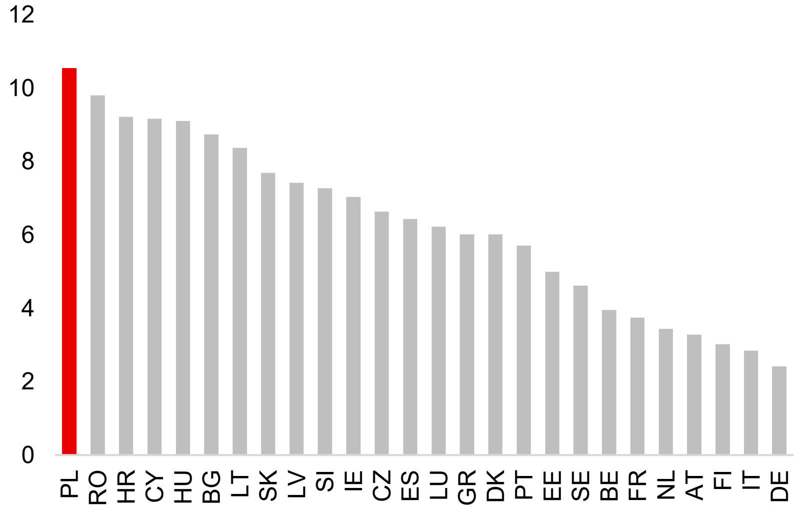
GDP growth q/q s.a. in 2Q24 vs forecasts



GDP growth y/y s.a. in 2Q24 vs forecasts



Sum of expected GDP growth in 2024-26, based on August Bloomberg consensus



Source: Eurostat, Bloomberg, Santander

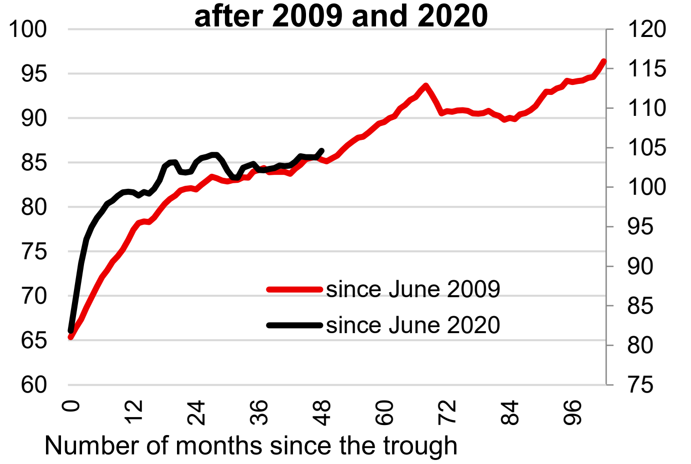
World trade: Poland's share rises

According to World Trade Monitor data, the rebound from the bottom in global trade since 2020 is similar to that of 2009. The initial phase was even stronger thanks to the fact that the pandemic responsible for the dip did not extinguish the demand, but only temporarily prevented its realisation. Four years after the 2009 low, the recovery of international trade accelerated. The repetition of that pattern is not obvious in the context of the deglobalisation hypothesis, which can be seen, for example, in the restraint in market forecasts of global economic growth for the coming years, but it should not be ruled out in advance. The question is whether Europe would be able to participate in such a rebound, since its competitiveness is weakened.

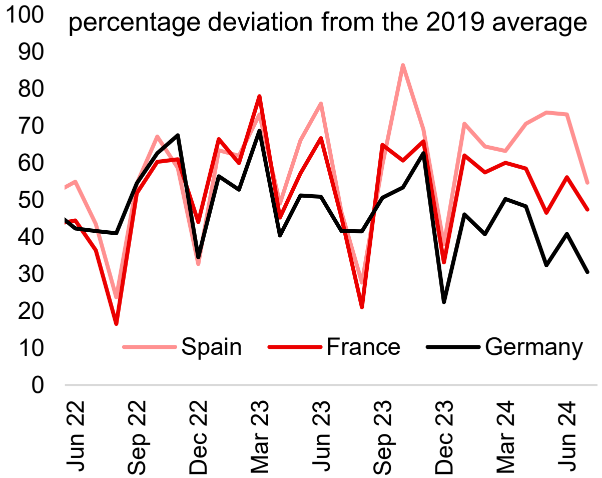
According to UNCTAD data, the EU was gradually losing its share of global trade in goods before the pandemic, and the print for 2023 is in line with this trend, although clearly better than in 2022. However, this trend was mainly due to the condition of German exports. **Poland**, on the other hand, **is still able to consistently increase its share in global trade** and is also doing so in line with the pre-pandemic trend. Between 2019 and 2023, only China, Brazil, Indonesia and the Netherlands increased their share more than Poland. However, this is a picture from 2023, and the year 2024 clearly does not spoil exporters.

It is difficult for Polish exporters to escape the weakness of demand from Germany, but it is worth mentioning that **shipments to the economically better performing countries of the Eurozone look clearly better than to Germany**, and among the 10 main recipients of Polish goods, half have seen their economic growth forecasts for 2024 revised upwards over the past three months.

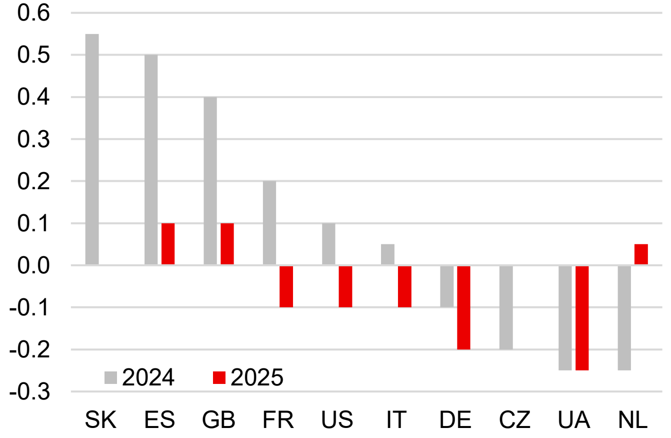
World Trade Monitor index - rebound from the trough in the volume of global exports after 2009 and 2020



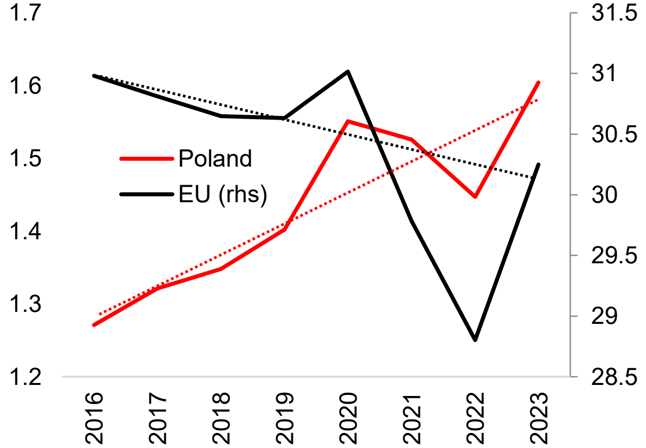
Poland's export of goods, EUR



Revisions of GDP forecasts for the 10 largest recipients of Polish goods, August vs May



Share in global exports of goods, by value, %



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Source: CPB, GUS, Bloomberg, UNCTAD, Santander

Industry: Do not set your expectations too high

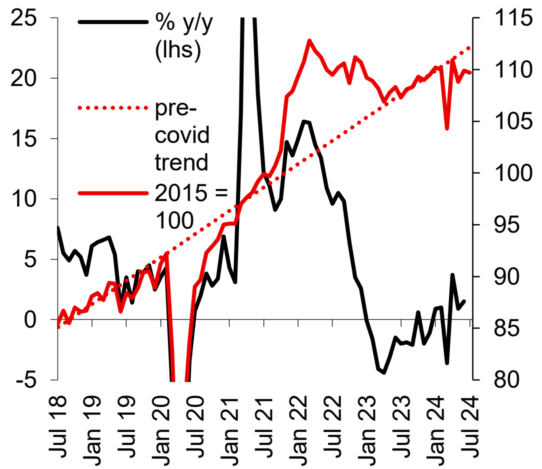
Complaining about the poor performance of the industry comes easily. Meanwhile, **in our opinion, there are signs of improvement in the sector**. While this year's output path is strongly deviating from expectations, these deviations are quite evenly distributed to the upside and to the downside. In 1Q the average production rise amounted to 0.2% y/y, with an average deviation of -0.9 percentage points from the consensus. In 2Q, the average result was 2.2% y/y with an average surprise of +0.7 percentage points. July's 4.9% y/y turned out to be much weaker than expected (7.5% y/y), but what draws our attention is that **there have already been four months of positive seasonally-adjusted production growth y/y**, by an average of 2.1%, which is not a bad result compared to the rest of the EU.

According to Eurostat data, **Poland is at the forefront of the EU in terms industrial production level** (compared to the 2021 average) in all major groupings except consumer durable goods: in intermediate goods behind Malta with a result of +0.6%, in capital goods in 4th place (+21.5%), in total consumer goods behind Denmark (+10.2%). In Europe's automotive sector, which remains under pressure, Poland ranks second behind Lithuania with +20.0%, while Germany showed +2.5% and France -1.9%.

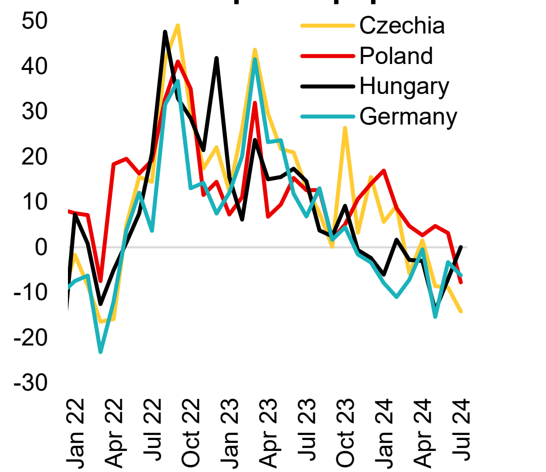
Electrical appliances, the sector dragged the total result down the most, looked as if it had bottomed out and started to bounce back in July. There are also industries where solid growth is already systematically shown (chemicals). On the other hand, the production of passenger cars has become more worrying (in July, the lowest level since the first months of the pandemic, -67% m/m, with the usual holiday downtime in the industry in August), although this may only be the impact of switch in production lines to assembling new models. We also hoped for a stronger rebound in TV set production due to Euro 2024 and the Olympic Games, but the April improvement turned out to be short-lived.

A stricter EU tariff policy towards China may help Polish production of consumer durables and the automotive sector, enabling the acceleration of total production growth.

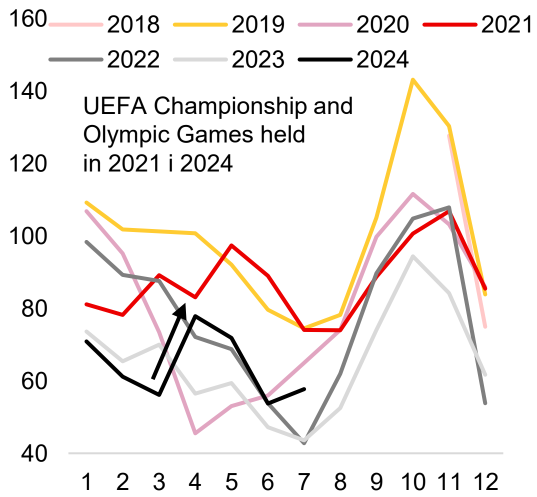
Industrial production, s.a.



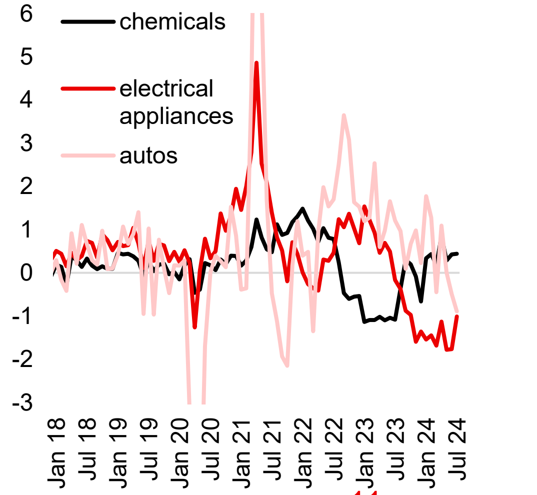
Production of cars, trailers, semi-trailers and other transport equipment



Production of TV sets by month



Contribution of particular industries to headline % y/y



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Source: Eurostat, GUS, Santander

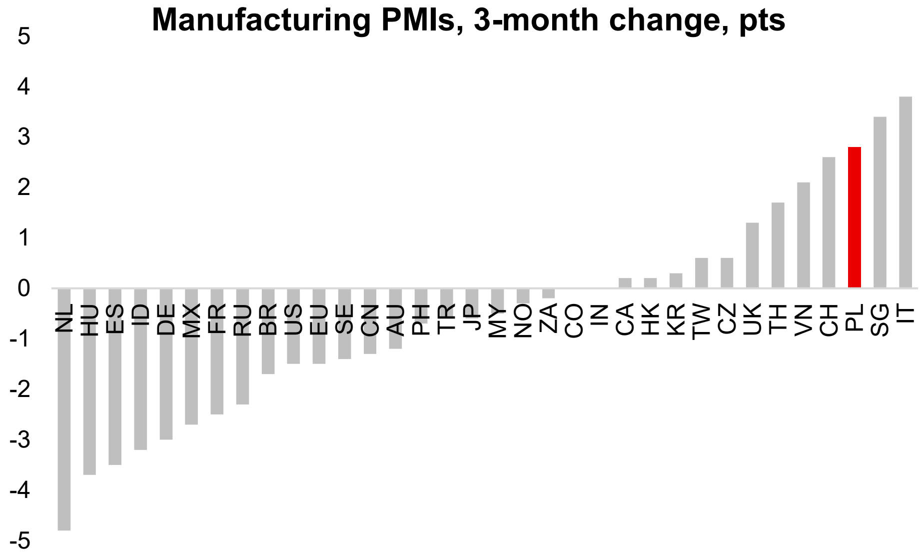
Industry: Better sentiment and margins

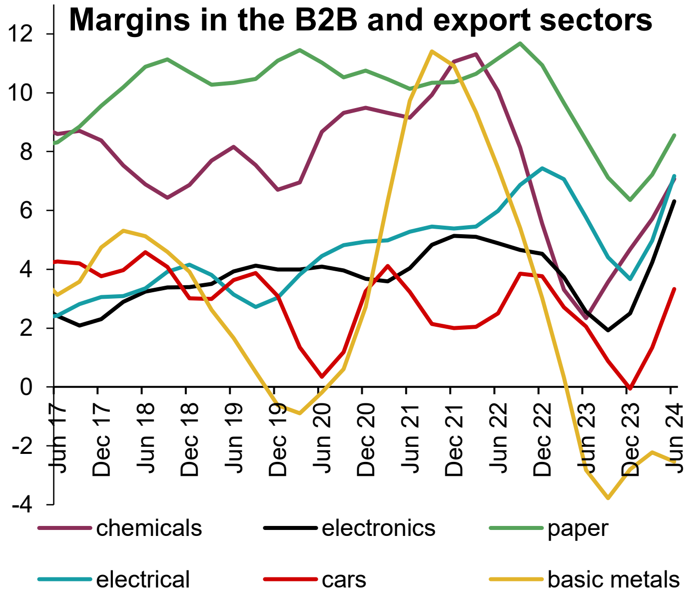
Sentiment in Polish manufacturing, measured by the PMI, **has recently improved significantly**. Although we are talking about reducing the scale of pessimism, it is worth noting that in the last three months, hardly any economy has seen such an improvement - Poland placed among the countries of South-East Asia.

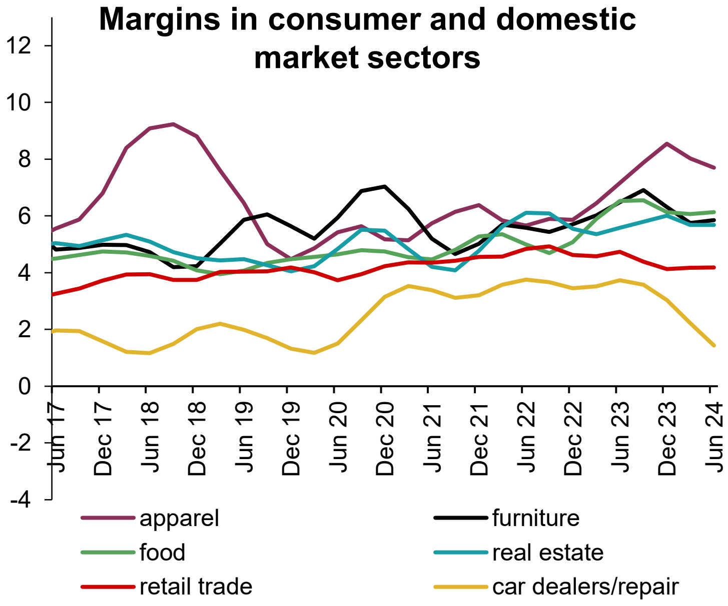
According to ESI indicators, in terms of the observed trend in current production the Polish industry is doing the best in 2.5 years, despite the still low levels of the new orders index. The expected production is at its highest level in 4 months, and the index of expected own prices is at its highest level in 6 months. However, the sector is still in an employment reduction phase, seeking a new balance amid subdued demand and high costs, including labour costs.

Our assessment of fairly good prospects for the industry is also based on the analysis of the financial results of companies that recorded an improvement in the profitability in the second quarter (see p.17). The average margin in enterprises employing 50 or more persons was dragged down in 2Q mostly by coal mining (-25.7%, s.a.), while the power generation and supply sector was down to 4.9% from 9.5% two quarters earlier. Car sales and repair have seen their margins retreating to usual pre-pandemic levels of about 2% from nearly 4% a few quarters ago. But beyond that, we have a stable track of margins in consumer-oriented sectors and an increasingly clear upward turn in B2B-focused industries and export-oriented sectors.

In our opinion, the improvement in margins in many branches of industry is a sign of coping with difficult cost conditions and gives grounds to expect that neither industry nor Polish exports will be on a slippery slope in the coming quarters.







Source: Bloomberg, GUS, Santander

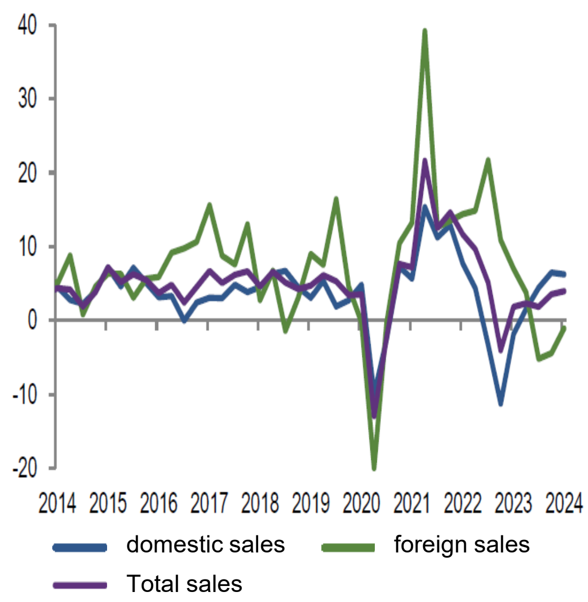
The trend and cyclical component of the data on average margins by sector are presented; margins calculated on the basis of gross financial results related to total revenues

Industry: Domestic market vs foreign market

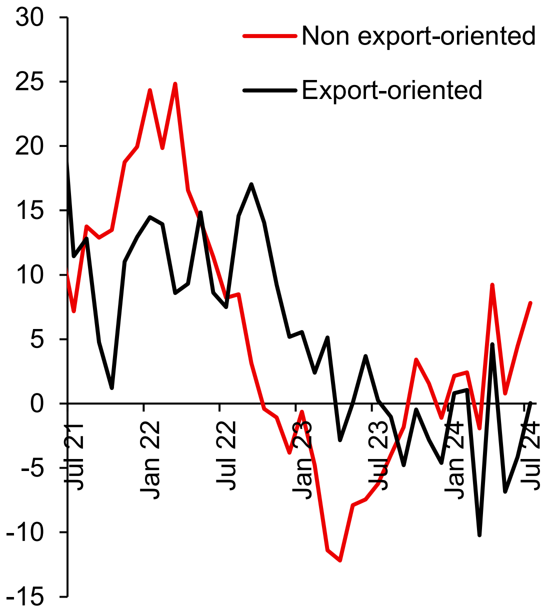
Dependence on foreign markets remains a major factor affecting results of industrial companies. Exporters continue to achieve lower revenue growth and have a lower capacity utilisation rate than companies focused domestically. Such data pattern emerged during 2023. This is an unusual situation and generally was never seen earlier. The same pattern is clearly visible in current industrial output – starting from September 2023, the annual growth rate is higher in non-export branches of industry than among industries dominated by exporters.

Recently, however, this discrepancy in results has begun to shrink. So far it is visible in revenues and capacity utilisation, and was caused by an improvement in exporters' results. As far as the production volume is concerned, the difference in y/y growth rates has not been growing for several months already, and the aggregate output of export industries did not show a decline in July.

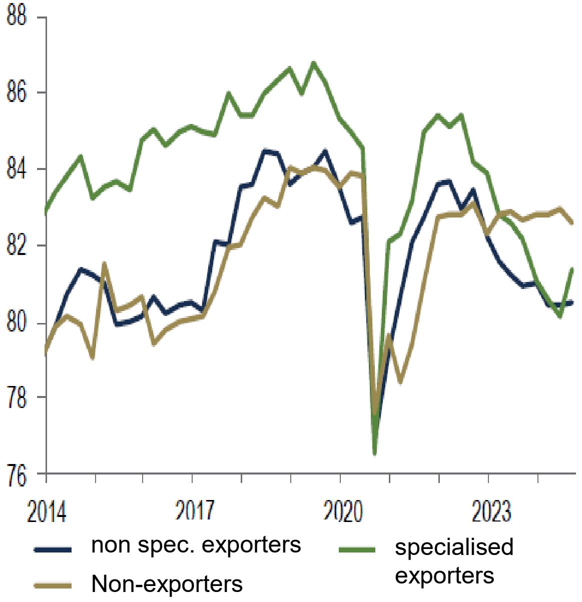
PPI-deflated sales revenues, % y/y



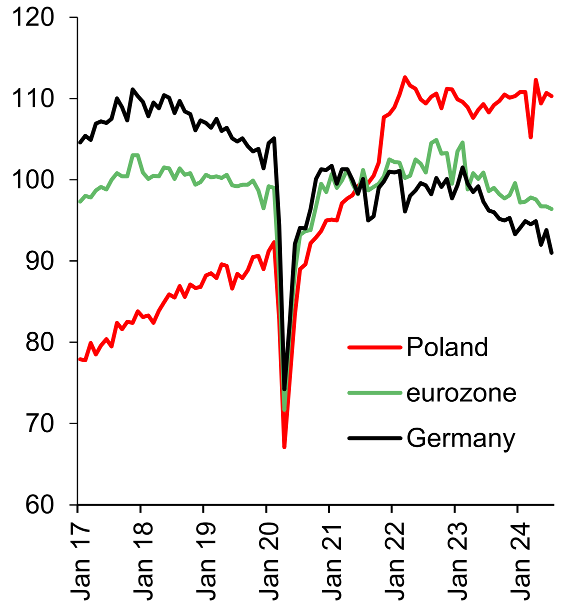
Industrial production, % y/y by share of exports in sold production



Capacity utilisation rate by sales market, %, s.a.



Industrial production, 2021 average=100, s.a.



Source: GUS, NBP Quick Monitoring, Santander

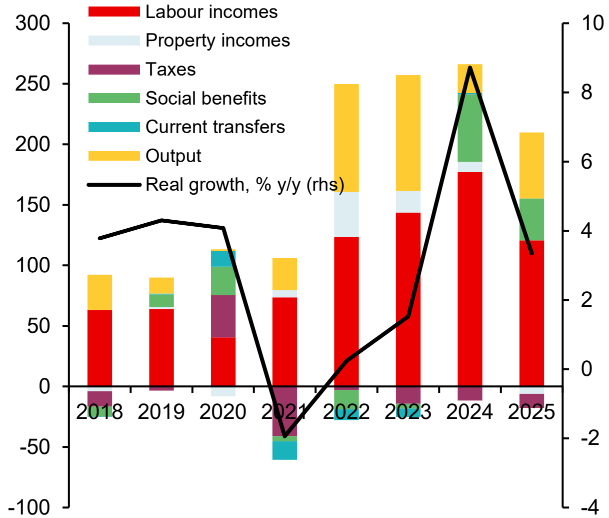
Private and public consumption – main engine

2Q24 GDP data showed an increase in private consumption by 4.7% y/y and once again confirmed our assumptions **that consumption will grow at a solid pace this year, but there will also be room for an increase in the savings rate. Next year, household incomes will grow at a slower pace in nominal terms, and inflation will be higher, which will translate into a fairly strong slowdown in real income growth and will result in slower consumption growth.**

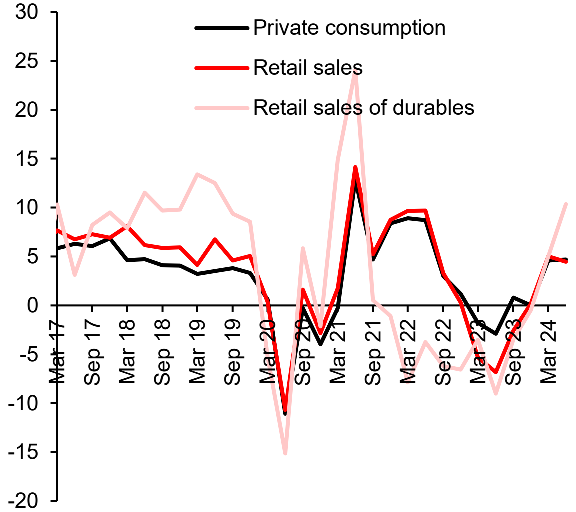
Our estimates of spending on services, based on data from Santander Bank Polska card transactions, show that this part of the economy continues to grow strongly. However, it should be noted that in the first two quarters of the year, private consumption behaved roughly in line with retail sales and therefore with spending on goods. On the plus side, the sale of durable goods, especially cars, stands out.

This year, the public consumption is another strong point in the national accounts data, which, having increased by almost 11% y/y in Q1 and Q2, added almost 2 percentage points to GDP. This is mainly due to strong wage increases in the public sector and an increase in current expenditure of budget entities. **In our opinion, in the second half of this year, this category will continue to strongly support GDP growth. For 2025, we already assume slower growth with a smaller scale of increases for the public sector. However, it will remain solid, around 5% y/y (in real terms).**

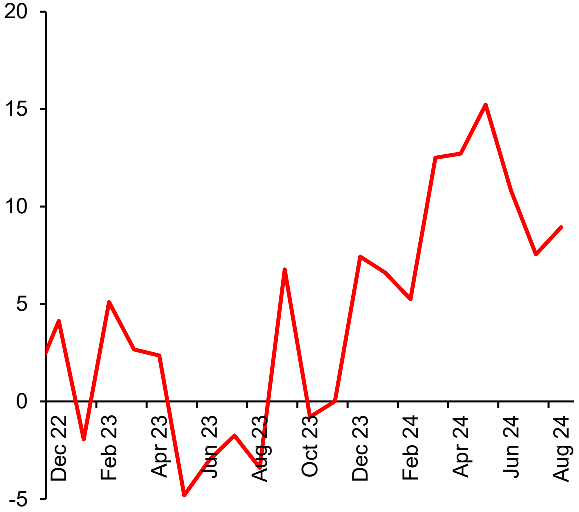
Households' disposable incomes, y/y change in PLN bn



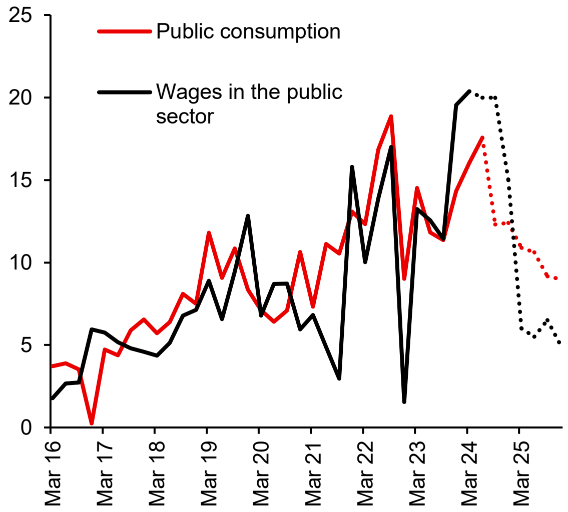
Consumption vs retail sales, % y/y, fixed prices



Spending on services, estimate based on card payments, % y/y, fixed prices



Consumption and wages in the public sector, % y/y, current prices



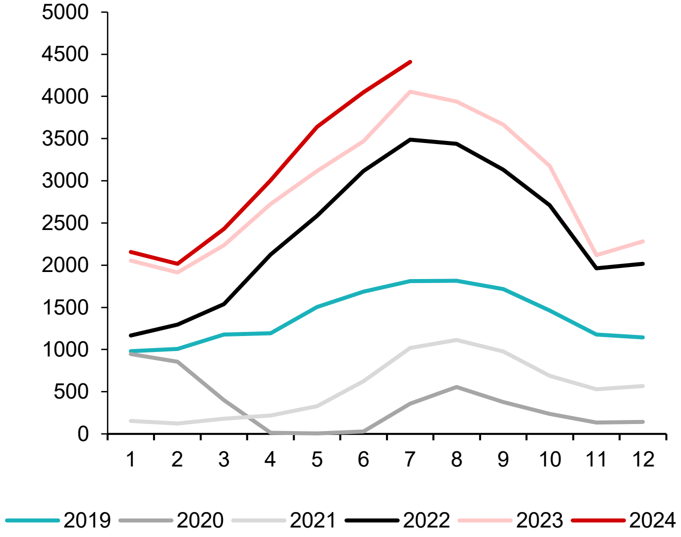
Source: Eurostat, GUS, NBP, Santander

Consumption hit by vacations abroad?

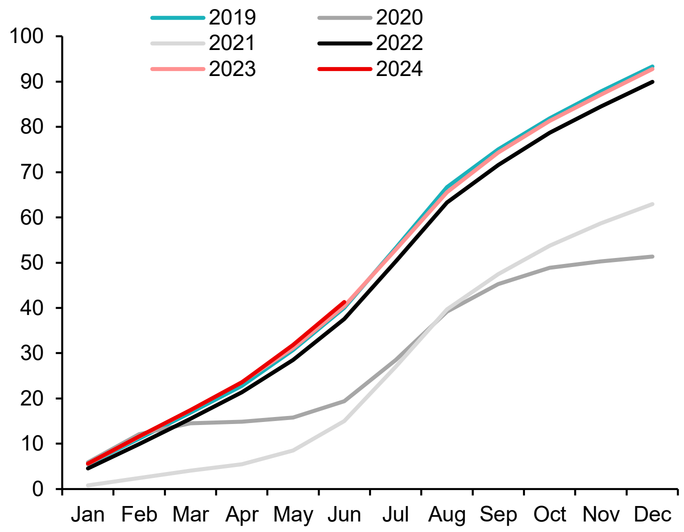
Data on tourism is a major sign of positive situation of consumers. Although the number of nights spent by Polish tourists in domestic hotel facilities is roughly the same as in the last two years (and even as in pre-pandemic 2019), the air traffic – and therefore foreign holidays – has been showing a strong upward trend for several quarters already. July 2024 set an all-time record of 4.4 million passengers transported. Year-to-date (until July), 21.7 million passengers were flown compared to 19.6 million in the same period of 2023 and 15.3 million in the same period of 2022.

The growing popularity of foreign trips is also visible in the data on the balance of payments – since mid-2022, a clear decline in the balance of income from foreign travel has been visible. **Increased foreign travel means that domestic consumers consume abroad and not at home, which has a negative impact on the numbers of private consumption. However, in our view, the impact of this effect on the consumption growth rate is negligible**.

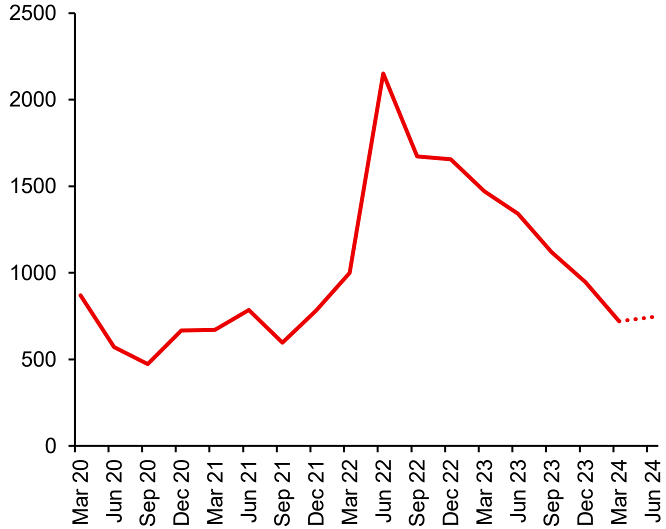
Number of air passengers on domestic airports, monthly, thousands



Number of nights spent by domestic tourists in Poland, ytd sum, mn



Foreign travel balance in the balance of payments, € mn



Santander

Source: GUS, NBP, Santander

Private consumption: Propensity to save

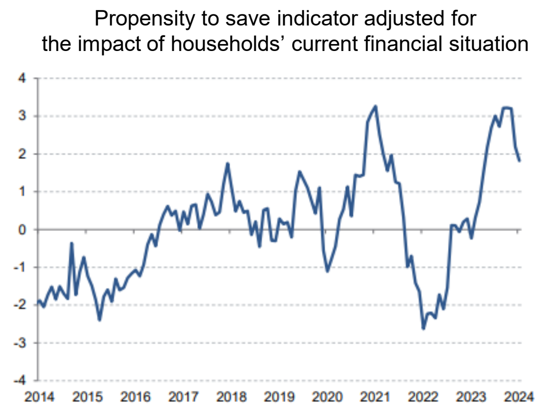
Real income growth is a key factor determining the growth of private consumption. However, it is necessary to take into account whether households are willing to spend this increase in income on higher consumption or rather on building savings. This consumer choice is also important for the CPI.

In their materials accompanying the inflation projection, NBP analysts considered the „scale of the pass-through of the current wage growth on private consumption and the increase in demand pressure" to be one of the main areas of uncertainty. According to them, the propensity to save grew to a historically high level in 2023, but in 1H24 it began to decline, i.e. households decided to use the increase in income more to increase consumption.

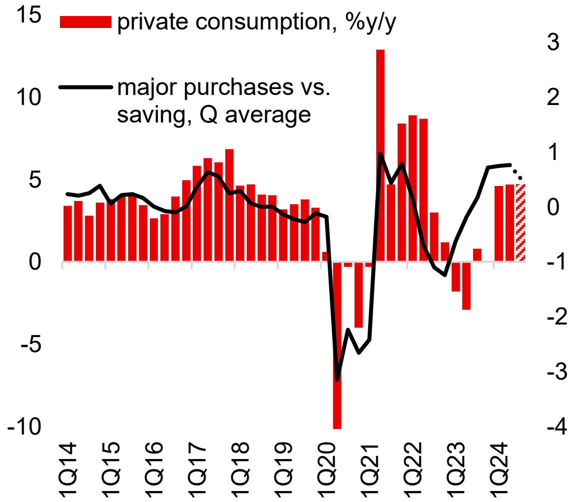
The conclusions from the current data are ambiguous. In the GUS consumer sentiment survey, the share of households indicating the possibility of saving money is constantly growing, and this indicator is already high. On the other hand, the index of openness to undertaking large expenditures in recent months has been stuck just below the long-term average, well below pre-pandemic levels, as if the "brake on consumption” was still on.

On the other hand, our leading indicator built on this survey overestimates actual consumption this year to a much lesser extent than in 2H23, as if something had changed in consumer attitude in recent quarters. We also know that imports of consumer durables (a category which, in our view, reveals consumer attitude) are accelerating this year and are already growing at a rate of almost 30% y/y, as in 2018.

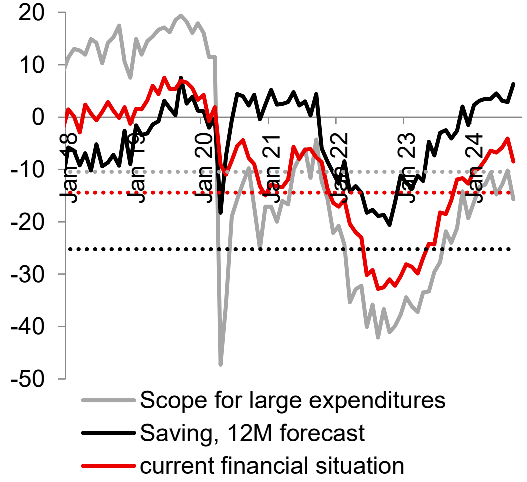
NBP propensity to save index



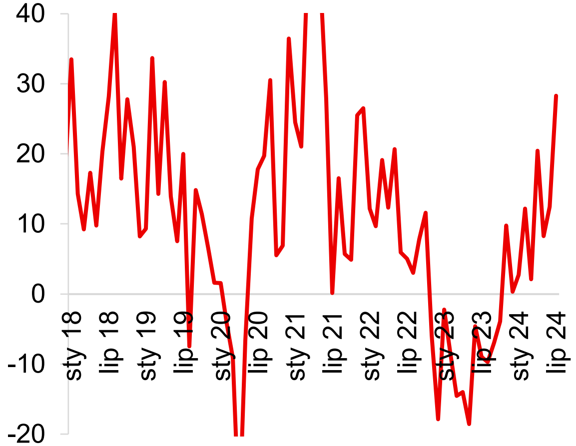
Private consumption and its leading indicator based on consumer sentiment survey



Components of consumer sentiment survey



Imports of consumer durable goods, EUR, % y/y



Source: NBP, GUS, Santander

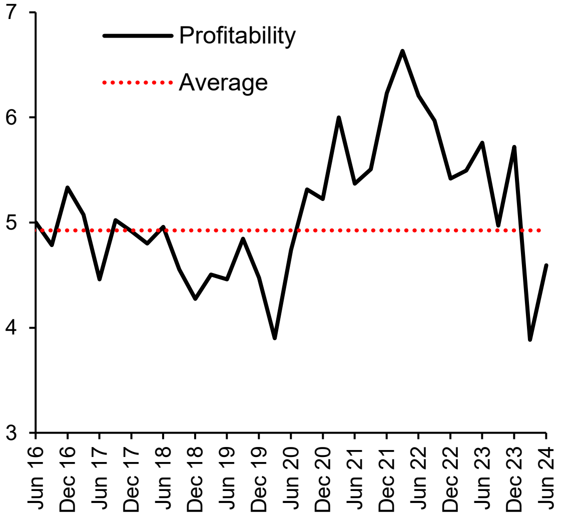
Results of companies improved slightly in 2Q24

Data from large companies (employing 50 or more people) indicated an improvement in profitability in 2Q24, after a very weak start to the year. However, the profitability of companies is still below average, and the share of companies reporting profits has also fallen. **In our view, the improvement in the domestic economy and the increase in inflation will give some room for further rise in margins in the coming quarters, although this process may be slow, especially in manufacturing, mainly due to the weak economic situation abroad.**

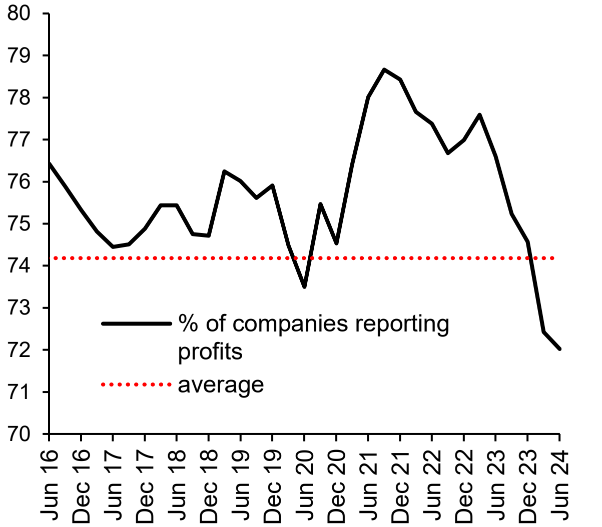
Total costs fell in 2Q24, mainly due to lower expenditure on materials and energy, although expenditure on wages, external services and insurance went up. The share of the wage bill in total costs climbed to 16.5% and this was the second highest result in the last ten years (with the record result recorded in the pandemic 2Q20). The growing weight of the wage bill in costs means greater upward pressure on prices in service companies and, in our opinion, argues for maintaining services inflation at an elevated level in the coming quarters.

Weaker financial results had an impact on the investment plans of large companies. In 2Q24, investments fell by 8.1% y/y in real terms vs -2.2% y/y in 1Q24. Sectors with a high dependence on EU financing recorded a decrease in their capital expenditures by as much as 17.5% y/y after a decrease of 11.9% y/y in 1Q24. In our opinion, this proves that **the utilisation of EU funds in the first half of the year was still at a minimal level**.

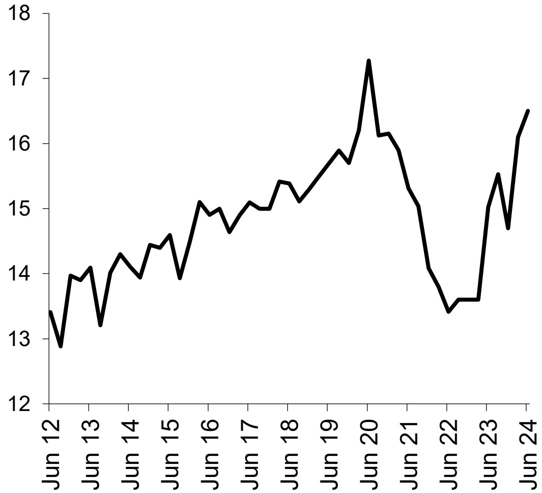
Profitability of sales, seasonally-adjusted, %



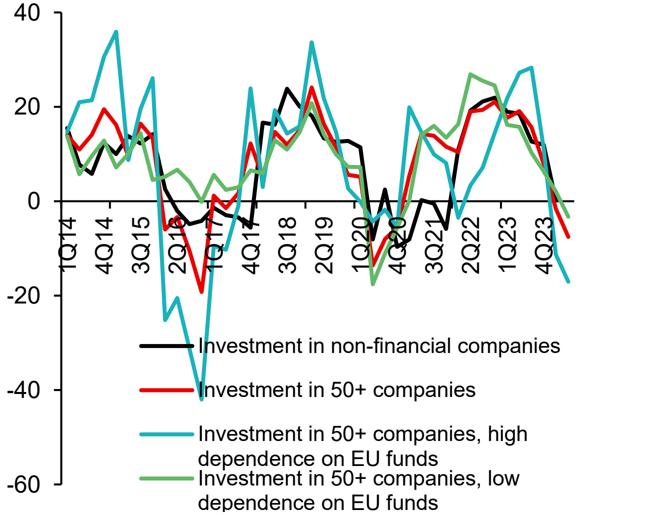
Share of companies reporting profits, seasonally-adjusted, %



Share of wage bill in total costs, %



Investment – non-financial companies vs biggest companies, % y/y, nominal terms



Sectors with high dependence on EU funds: construction, transport, energy, water supply – based on NBP research

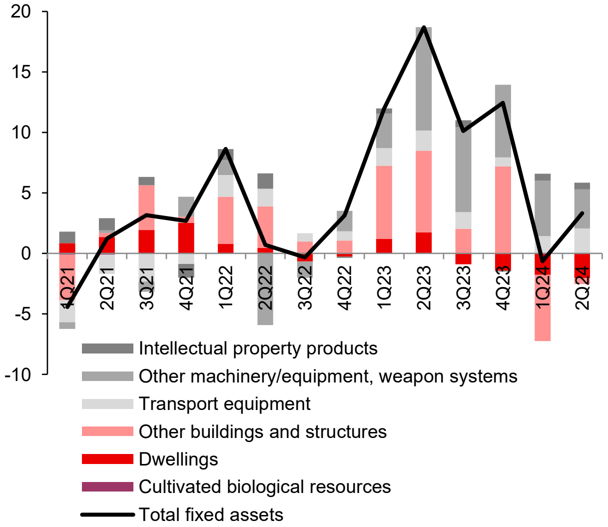
Source: GUS, Santander

Investments: Waiting for the recovery

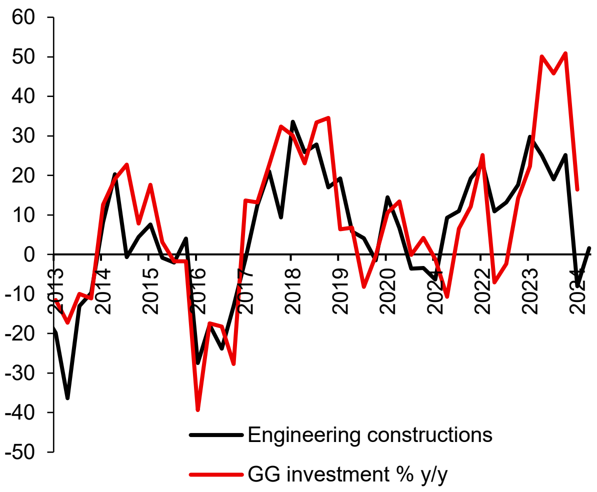
Data on investments in the entire economy in 2Q24 turned out to be better than expected and showed an increase of 2.7% y/y. Partial data released earlier showed a major weakness in large companies (down by 8.1% y/y) and were quite solid when in local governments (+2.2% y/y). Data on the breakdown of investments by asset type showed that the improvement compared to 1Q was mainly driven by stronger tendencies in non-residential construction. This, along with data showing high activity in the construction of railways, bridges, pipelines and industrial premises, leads us to believe that **public infrastructure investments were responsible for the surprisingly strong 2Q result, and not the purchase of armaments**.

We believe that in the coming quarters the corporate investment sentiment will gradually improve. Currently, it remains muted, and in 2Q deteriorated vs 1Q. According to the NBP survey, companies have become less eager to both undertake new investments and continue current projects. We are also hoping for a growing number of EU-financed investment. **In the second half of this year, however, in our opinion, the acceleration will be minor, and we are counting on a stronger recovery in 2025**. We think that the situation is quite similar to that of 2017-2018, when, thanks to the growing utilisation of EU funds, investments in the economy accelerated from 4.0% to 12.6%. However, the main difference compared to that period is the delay in the use of EU funds, which is about half a year compared to the 2014-2020 EU financial framework. Therefore, we do not assume such a marked acceleration of investment.

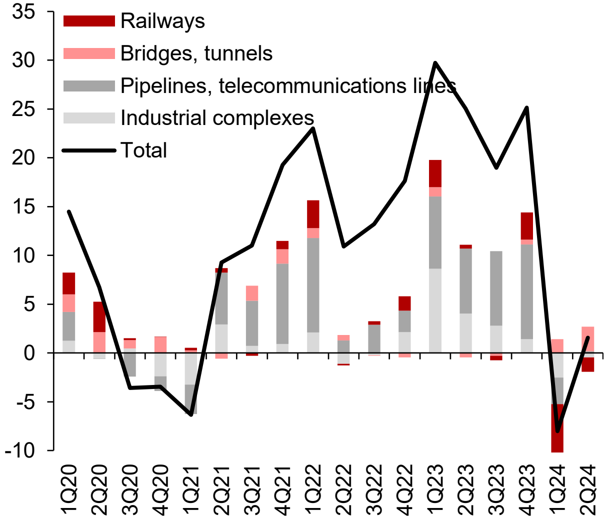
Investments, broken down by asset type, % y/y, in real terms



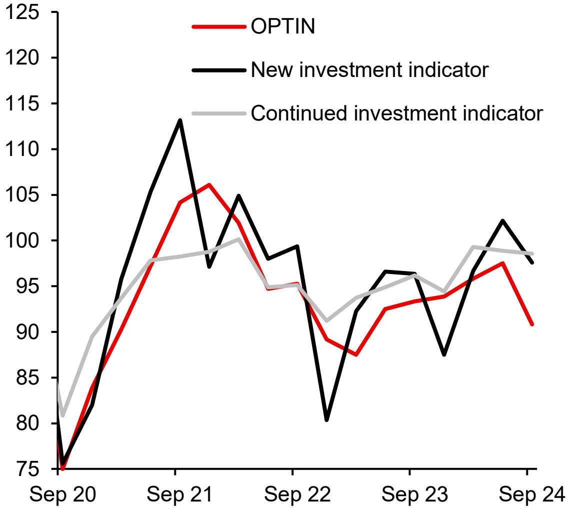
Public sector investments and expenditures on civil engineering, % y/y



Decomposition of input changes for civil engineering, % y/y



Investment sentiment in companies (NBP indicators)



Source: Eurostat, GUS, NBP, Santander

EU funds: The key driver of investment growth

Our expectations for stronger investment growth are based on the increased use of EU funds. Since the funds have been unlocked, Poland has been trying to quickly commit them to investment projects. The effects of these endeavours should become tangible already in 2025.

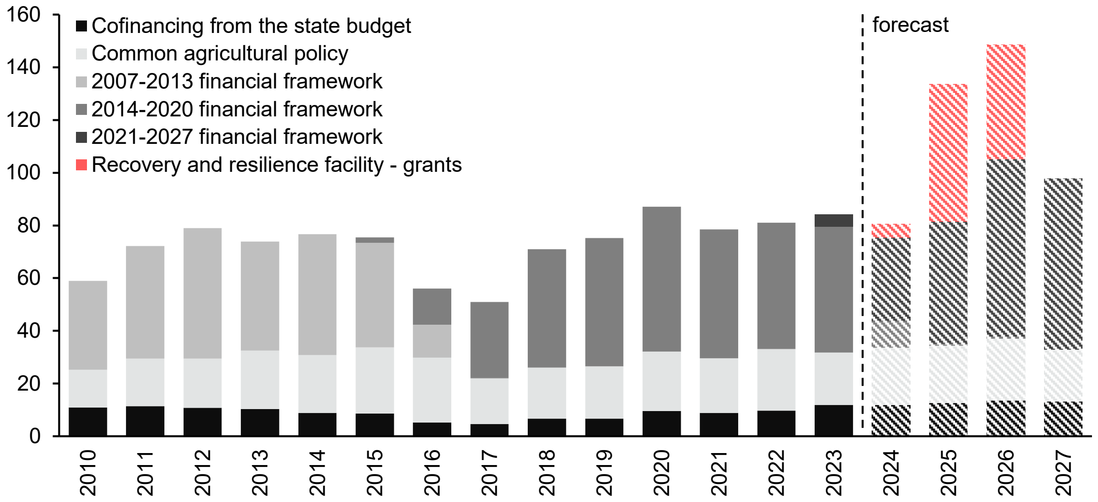
According to the draft budget act for 2025, **expenditures of the EU funds budget on the programmes from the 2021-2027 financial framework are currently planned at c. PLN33bn**. However, implementations of the budgets from previous years suggest that **the final expenditures will be greater by several bn PLN**, as with time, the government will also employ a reserve of c. PLN35bn, which has been made for the purpose of financing the EU programmes.

Moreover, **next year we should see the first effects of the Polish Recovery and Resilience Plan**. In line with the EU funds budget, expenditures from the grant part of the plan are to amount next year to c. PLN52bn, though it is worth to note that the Minister of Funds and Regional Policy said on 13 September that she expected investment expenditures from the plan's grants to reach next year c. PLN70bn.

Overall, in 2025, expenditures financed by EU funds may rise by over PLN50bn.

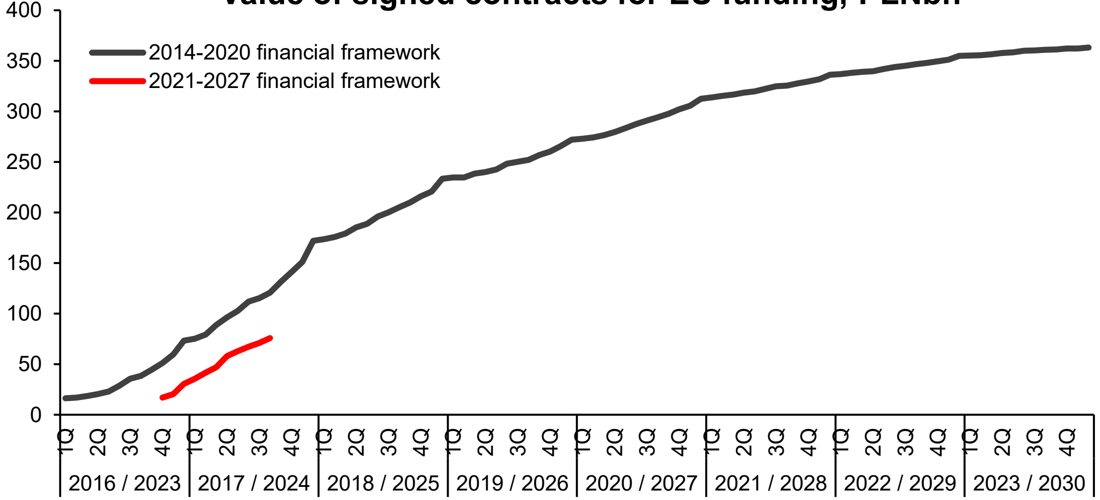
According to the plan from the draft budget, over the following years, expenditures from the 2021-2027 financial framework are to equal over PLN60bn a year. Additionally, in 2026, expenditures from the RRP's grants are to reach over PLN43bn, which means that Poland should manage to employ around 90% of its allocated grants (assuming that in 2024 expenditures will equal PLN5bn, as the Minister of Funds said they should on 13 September, and that in 2025 they will be equal to the plan from the budget).

Expenditures on EU funded programmes, PLNbn



Source: GUS, Ministry of Finance, Santander

Value of signed contracts for EU funding, PLNbn



Without Interreg
Source: Ministry of Funds and Regional Policy, Santander

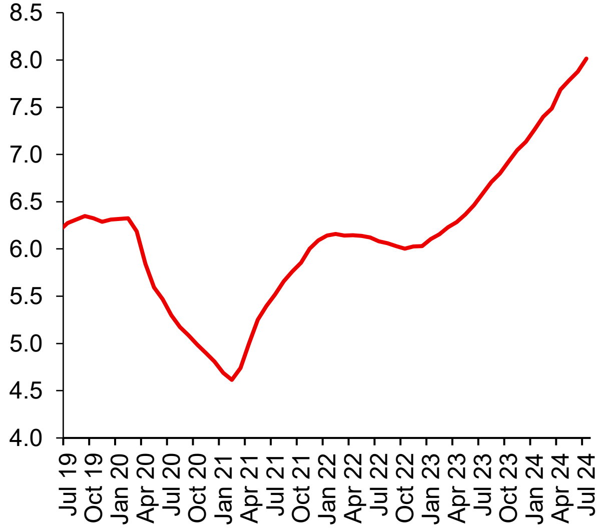
Santander

Loans: Solid sales

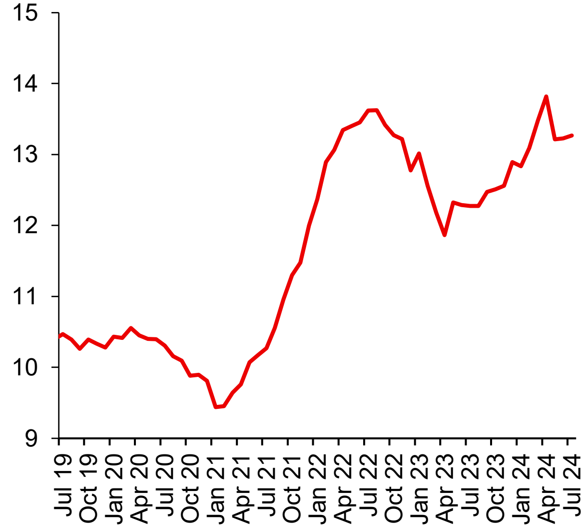
The credit market has been in a recovery phase in recent quarters. Sales of consumer loans broke the all-time record in August (both in terms of a single month and the average for the last 12 months). The mortgage market, after the expiry of the impulse related to the 2% „safe loan" programme, remains clearly more active than in 2023, with average sales of new loans at about PLN6-7bn per month. The origination of new loans in the corporate sector is also quite robust, although it is slightly below the peak from mid-2022. **In our view, the improvement in economic activity will be conducive to maintaining credit market activity at an elevated level.**

In terms of volume, the credit market is growing slowly, by only a few percent, although there has been a clear improvement in recent quarters. The relatively small increase in volumes was related to the historically high repayment rate, especially in the case of mortgage loans. We are currently observing a normalisation of this rate, which should be conducive to further growth in volumes amid solid sales. **We assume that the loan market will grow by about 5% this year**. The increase in deposits remains at a solid 8% y/y. This growth is mainly due to the increase of net foreign assets in the banking sector and in our view it will remain quite stable in the coming months.

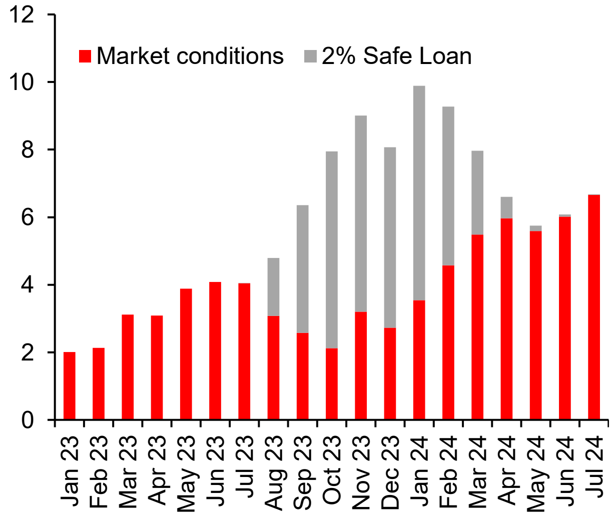
Consumer loans: new origination, average for 12 months, PLNbn



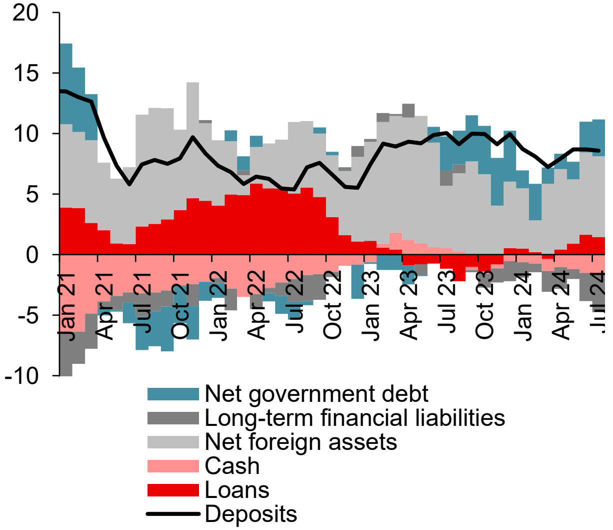
Corporate loans: new origination, average for 12 months, PLNbn



Mortgage loans: new sales, PLNbn



Deposit growth: breakdown of creation, % y/y



Santander

Source: NBP, Santander

Labour market

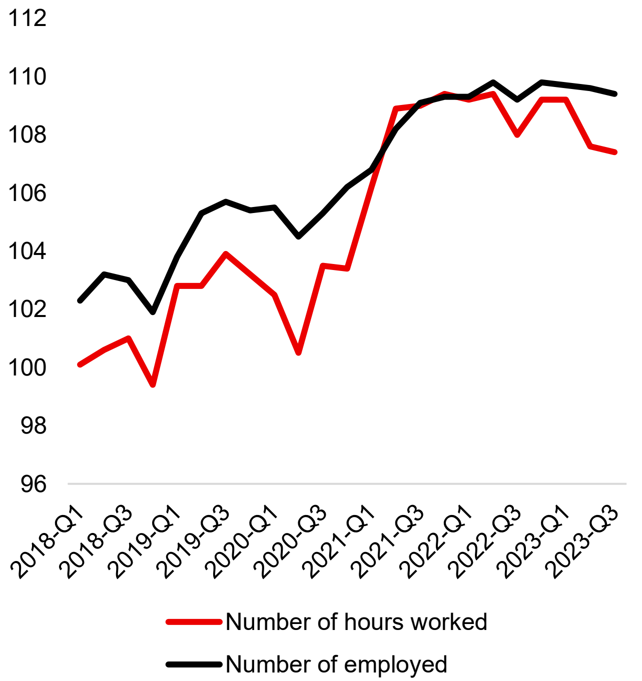
2

Economy accelerating, labour market slowing

In the past, GDP growth faster than 3% y/y has usually generated an employment boost in the Polish economy. For the time being, however, the observed economic recovery is not matched by a stronger demand for labour. On the contrary, the number of employed in the national economy and in the LFS is declining slightly, and the number of hours worked is falling even faster, indicating a decline in the utilisation of available labour resources.

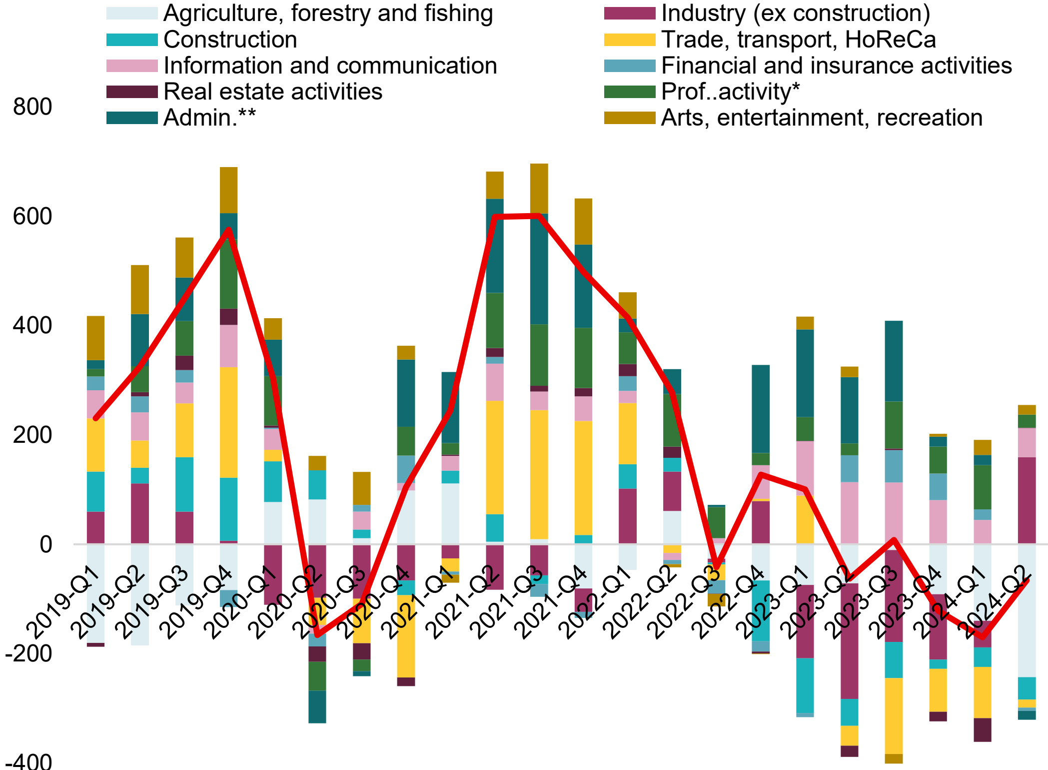
In our previous report, we suggested that the weakness seen in the employment numbers may be more the result of a reduction in labour supply than a decline in demand for workers. Over time, however, there are more and more signs that the deceleration does, indeed, originate from the demand side (see next page). At the same time, the decline in the labour force implies that the unemployment rate remains close to record lows despite the lower number of employed.

Number of employed in the national economy and hours worked, 2015=100 s.a.



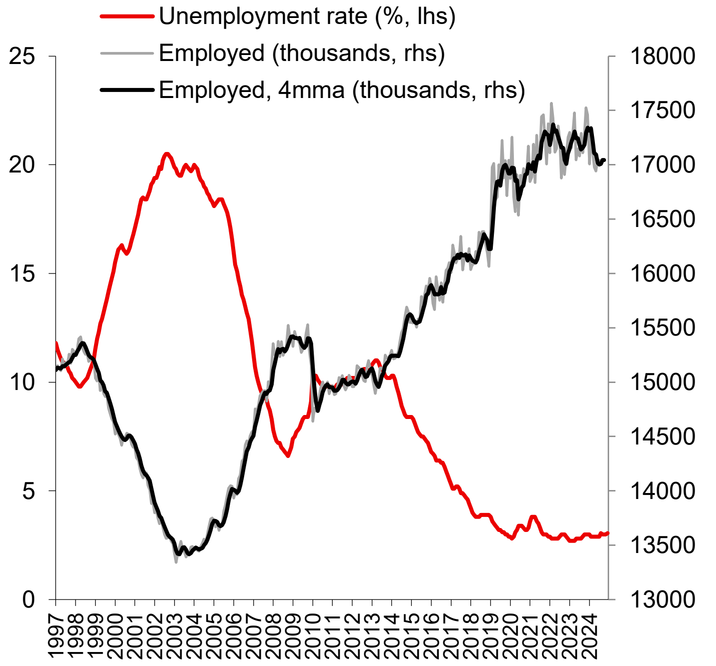
Source: Eurostat, Santander

Number of employed in the national economy, thousands y/y



* Professional, scientific and technical activities; administration and support activities
** Public administration and defence; compulsory social security; education; health care and social work assistance

LFS unemployment rate and implied number of employed

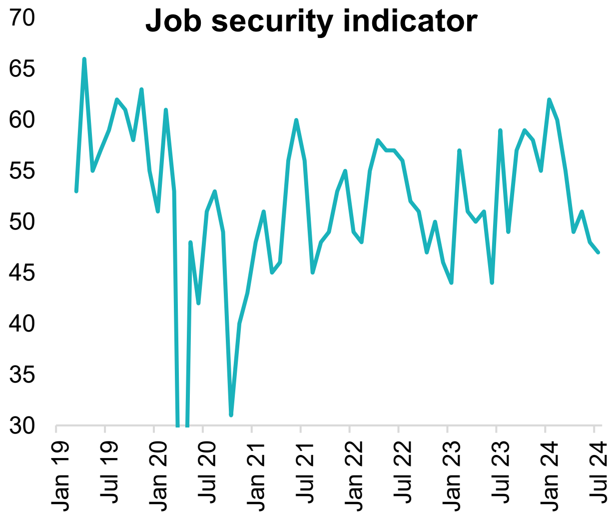


Source: Eurostat, Santander

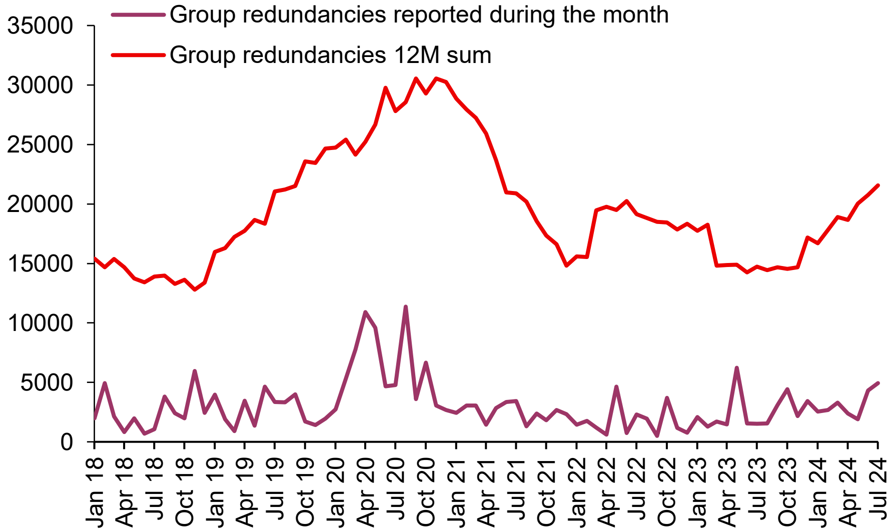
The labour market's cooling, but hasn't yet grown cold

There are more and more signs that the situation on the labour market is cooling, although the pieces of information are not unequivocally negative. Group redundancies have been on the rise. Business climate surveys indicate lower hiring plans, especially in industry (although not all of them, e.g. the NBP's Quick Monitoring suggests an increase in companies' optimism in this respect). Households' concerns about employment prospects are increasing and their sense of job security is declining. The number of job vacancies available in labour offices fell markedly in August (but the number of job offers on online portals has recently started to rebound). The last two months have also seen an increase in the number of new unemployed in data from labour offices, inconsistent with the seasonal pattern.

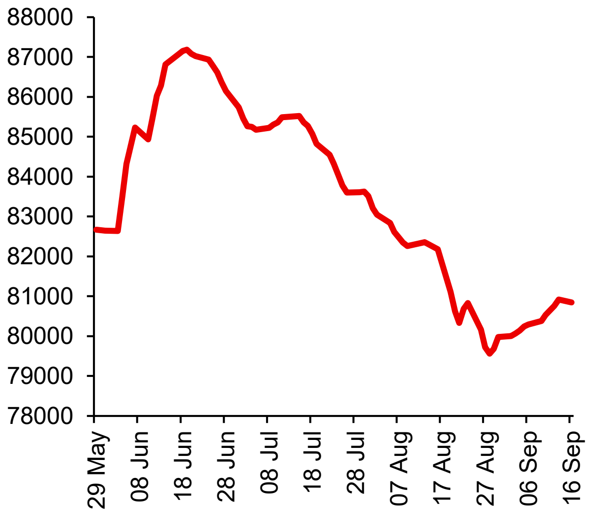
Overall, the situation on the labour market still does not look bad, but there is no shortage of warning signs either.



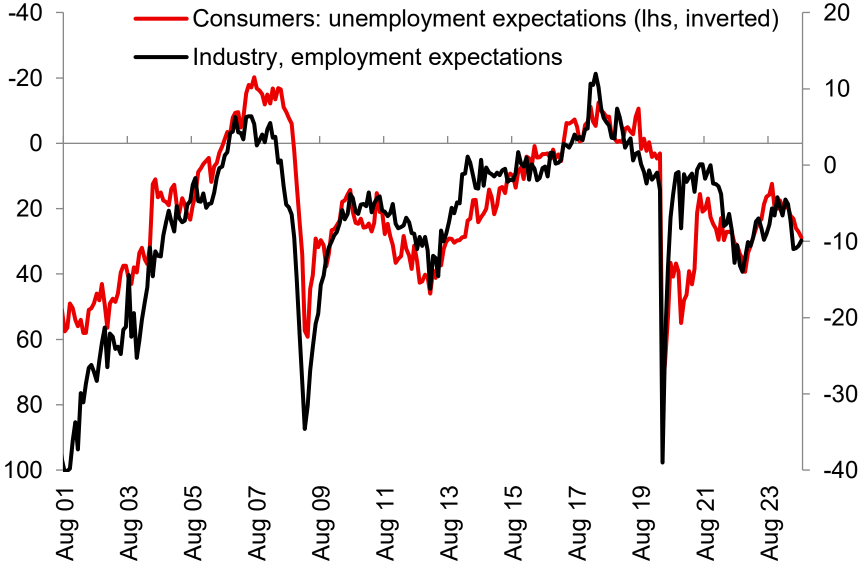
Group redundancies



Number of job offers on the website pracuj.pl, 10-day moving average



Selected ESI indicators for Poland



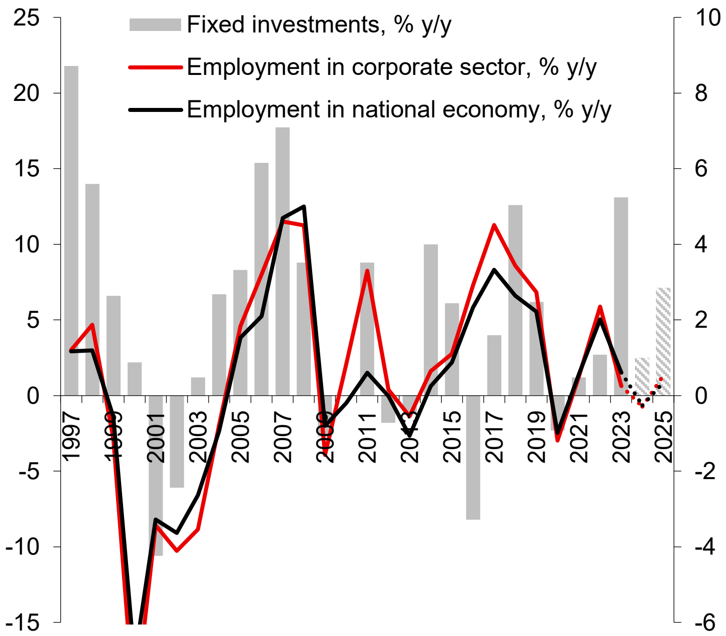
Source: Eurostat, GUS, EC, pracuj.pl, Santander

Approaching a turning point?

On the other hand, the unemployment rate remains close to its record low, and according to a survey published recently by the stats office, by the end of the year, companies plan to hire over four times more new employees than they intend to lay off. Moreover, July data from the corporate sector showed a slight rebound in employment, and a number of business sentiment surveys pointed to improving sentiment towards employment prospects. All of this suggests that the current slowdown in labour demand may be a prelude to a gradual rebound in the following quarters, provided that the trend of economic recovery (in line with our forecasts) continues.

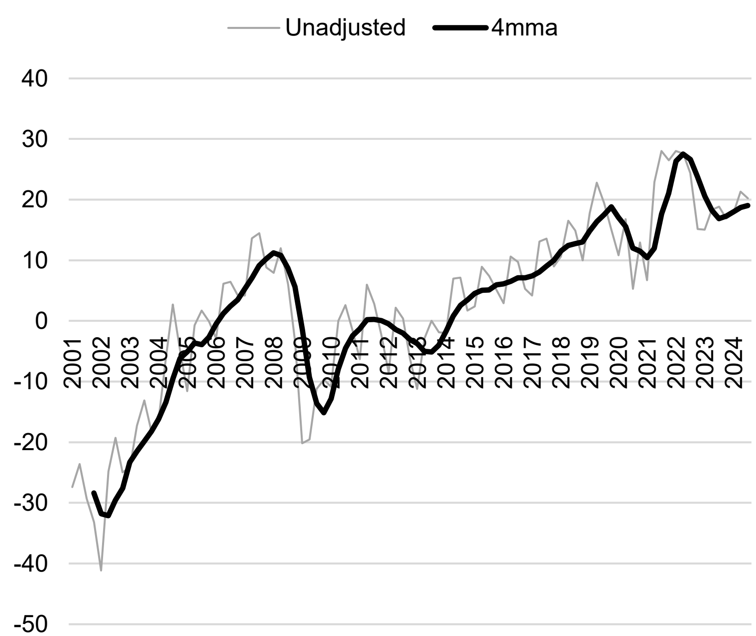
We assume a break in the slightly negative employment trends over the next quarters. This will be supported by further economic growth, increasingly based on a recovery in investment (which is historically much more strongly correlated with employment change than GDP growth itself).

Employment vs investment growth, %



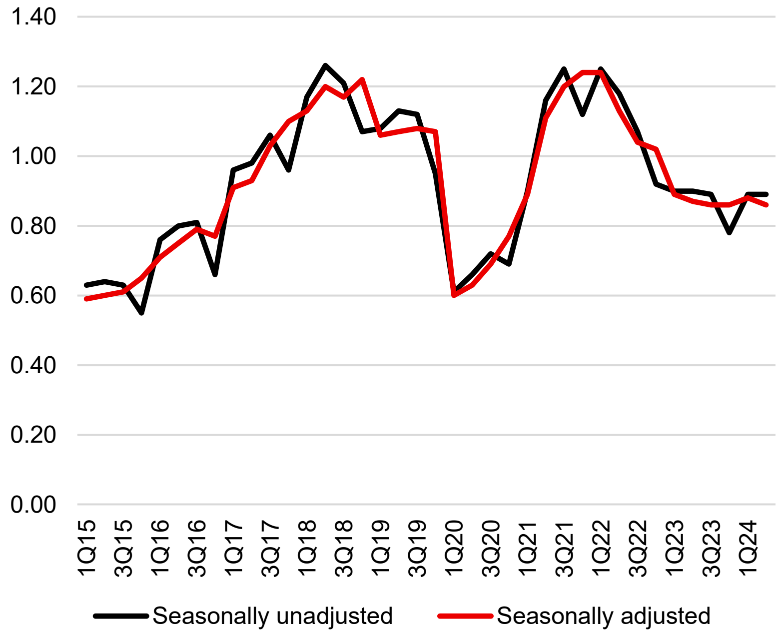
Source: GUS, Santander

Employment forecast index



Source: NBP Quick Monitoring, Santander

Vacancy indicator



Source: GUS, Santander

Wage growth record high, should decelerate

Wage growth in the national economy accelerated in 2Q to 14.7% y/y, the highest in 25 years, mainly due to record increases in the public sector (around 25% y/y). A gradual deceleration of wages is already visible in the corporate sector, although their growth still remains in double digits.

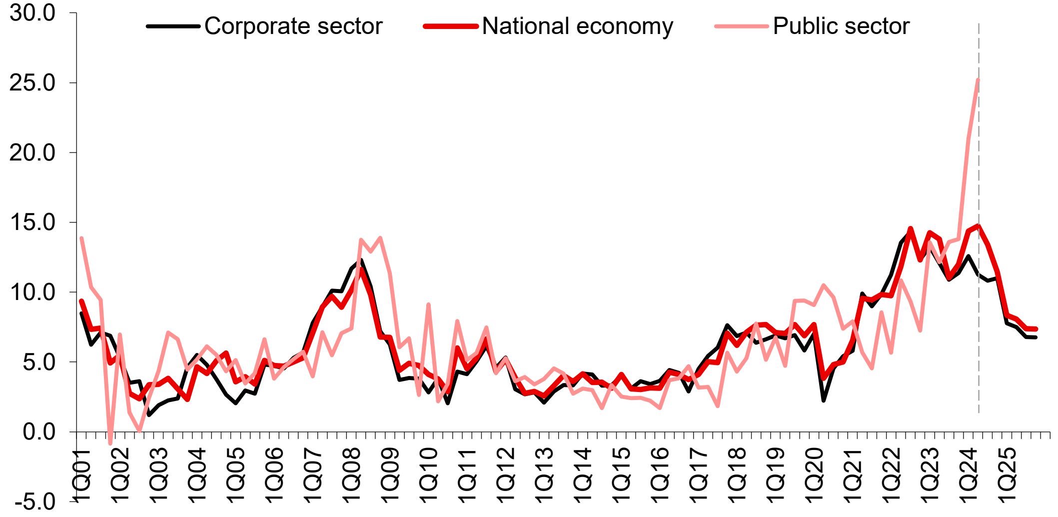
Surveys, including the NBP's Quick Monitoring, indicate that wage pressures are weakening, although in terms of level they are still comparable to the situation in 2018, when the labour market started to be a source of rising inflationary pressure.

We expect a marked deceleration in wage growth in 2025, to around 7-8% on an annual basis, which will result from a much smaller scale of minimum wage increases than in previous years (8.5%) and more modest increases in the public sector (around 5%), among other factors.

The indexation of social benefits in 2025 will also be more modest than this year. The increase in pensions from March 2025 will be around 6-7%.

Nevertheless, the fall in inflation we anticipate from 2Q25 should stabilise the real purchasing value of household disposable income in the second half of next year.

Wage growth, % y/y

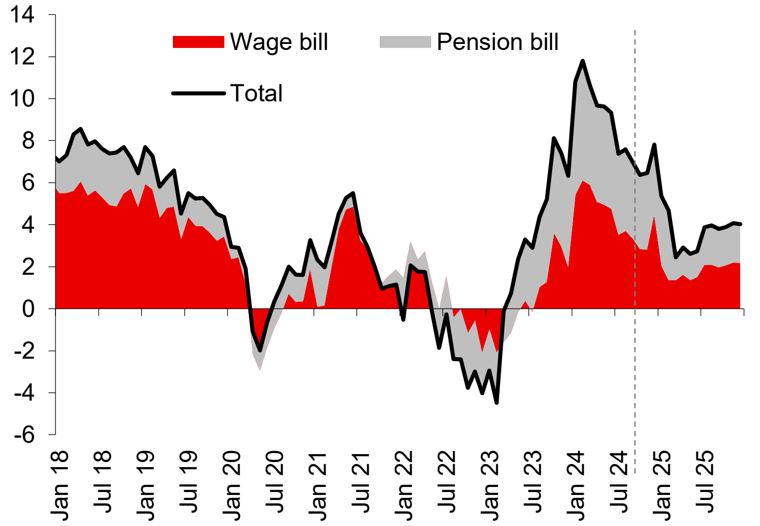


Source: GUS, Santander

Share of firms reporting rising wage pressure, %

Source: NBP Quick Monitoring, Santander

Wage bill and pension bill in constant prices, % y/y



Santander

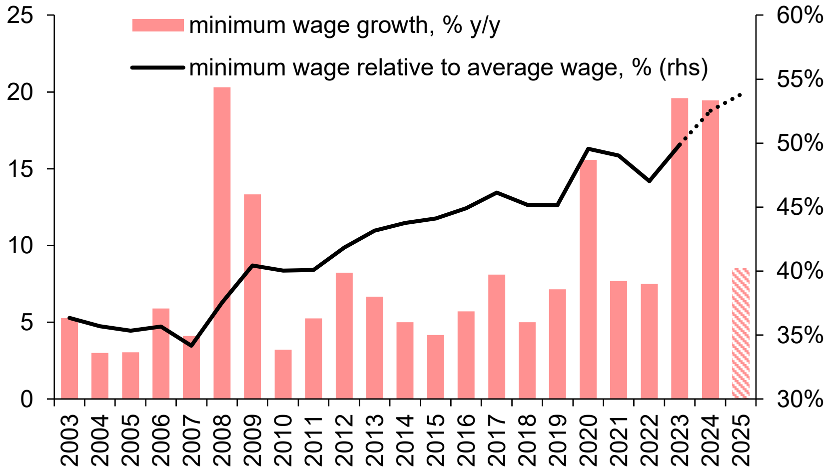
Minimum wage will go up by 8.5%

According to the government's draft regulation, the minimum wage will rise to PLN 4666 in 2025, which means an increase of 8.5% from the current level of PLN 4300. Therefore, the scale of the increase will equal only half of that from 2023 or 2024, when minimum wage grew by nearly 20%. However, it is higher than the amount previously proposed by the government (PLN 4646, i.e. +7.6%). This means slightly more support for household incomes and their consumer spending next year, while posing a greater cost challenge for companies (especially the smallest ones) and making the disinflation process somewhat more difficult, which for the central bank may be one of the arguments against earlier interest rate cuts.

The ratio of the minimum wage to the average wage in the national economy is set to rise to 53.83% according to the government, which would put it at its highest level in at least 25 years.

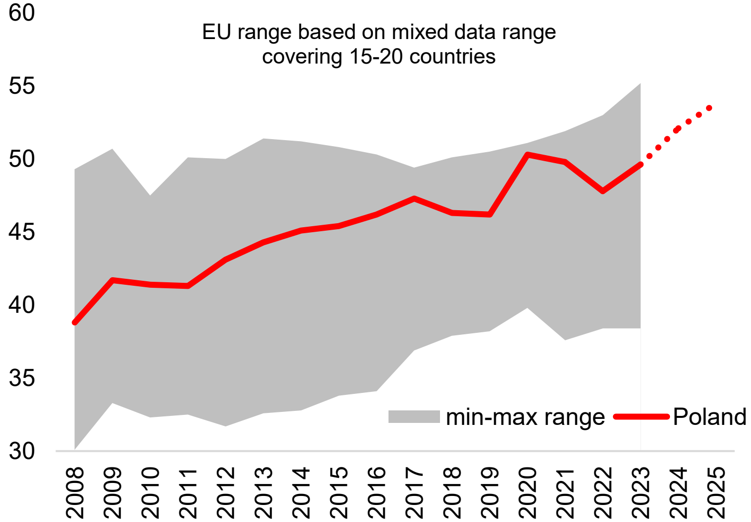
According to our estimates, **an increase in the minimum wage on this scale could affect around 4 million people (around 23% of the working population)** and account for around 2 percentage points of the increase in the average wage in the national economy.

Minimum wage in Poland



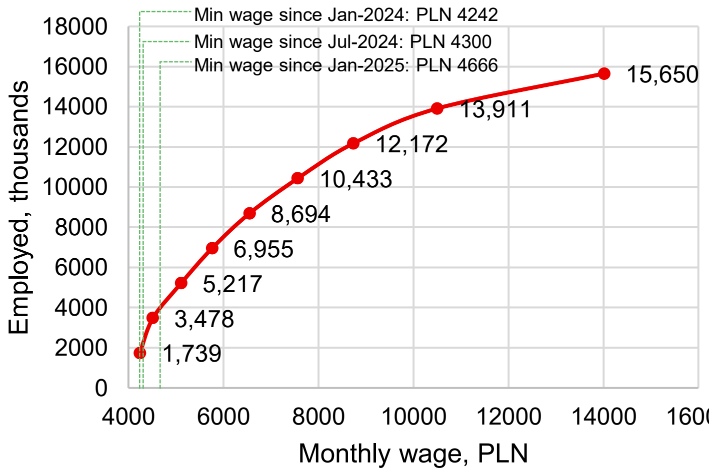
Source: GUS, Santander

Minimum wage as % of average wage across EU



Source: Eurostat, Santander

Number of employed with monthly wage no higher than … (in March 2024)



Source: GUS, Santander

Santander

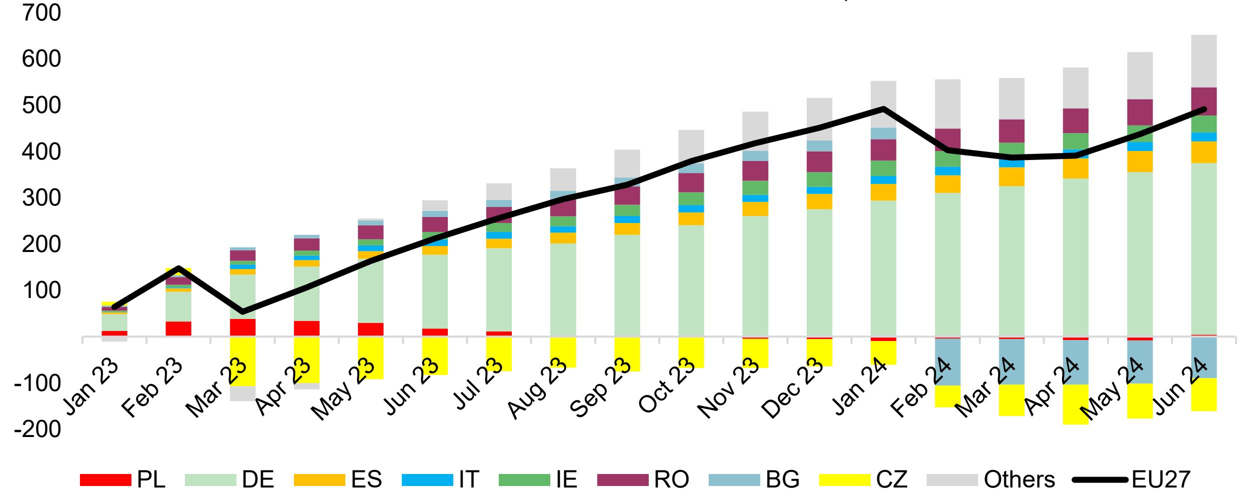
Migration from Ukraine rising again?

Since mid-2023, the inflow of migrants from Ukraine to Poland has been almost zero. According to Eurostat data, during this period the number of Ukrainians under temporary protection in the EU grew most strongly in Germany, Romania, Spain and Ireland. Since June this year, however, a slight increase in migration to Poland has been observed again.

According to the National Bank of Ukraine, around 400,000 people may leave Ukraine by the end of this year and another 300,000 by 2025 due to problems with access to electricity and damaged energy infrastructure.

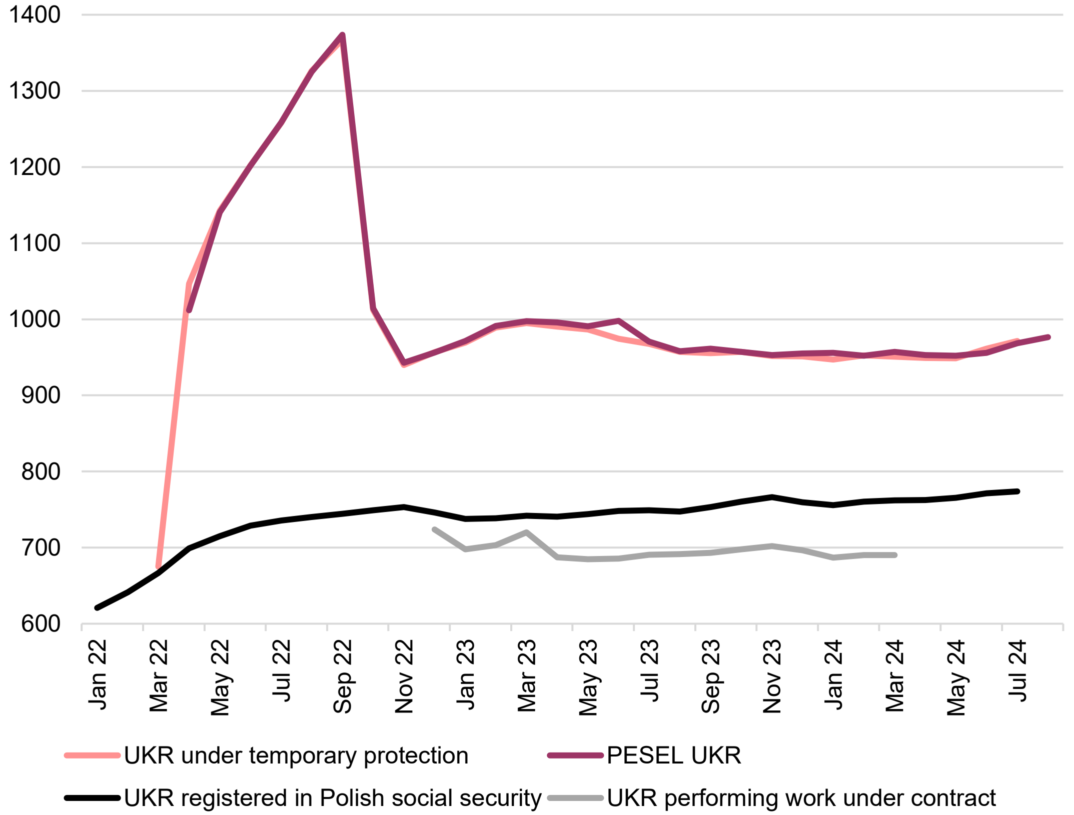
It is possible that some of them will stay again in Poland. One argument in favour of this may be the prolonged economic stagnation in Germany, affecting, among other things, the situation on the labour market over there.

Number of Ukrainian citizens under temporary protection in EU, cumulated sum since December 2022, thousands



Source: Eurostat, Santander

Number of Ukrainians in Poland and on the Polish labour market according to various available sources, thousands



Source: Eurostat, dane.gov.pl, GUS, ZUS, Santander

Santander

Inflation

3

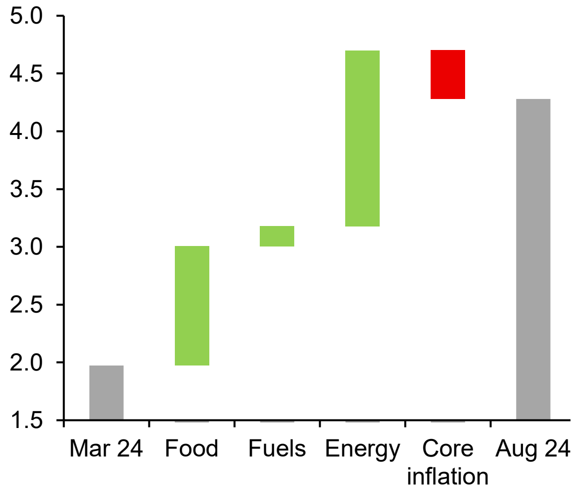
Inflation to climb more, but not for long

In August, CPI inflation amounted to 4.3% y/y, which was its highest print this year. The increase compared to this year's minimum of 2.0% y/y in March was mainly due to regulatory factors: the July increase in energy prices and the April normalization of VAT rates on food. In the coming months, we expect CPI inflation to continue to rise, to around 5.0% y/y in September, which will result from the base effect caused by the introduction of free medicines for selected social groups in September 2023. We expect the peak in March 2025 to be slightly below 6.0% y/y. A stronger decline in inflation will take place in July 2025, when the base effect related to this year's increase in energy prices will become apparent. In our opinion, CPI inflation will amount to approx. 4% y/y at the end of 2025. Decisions on energy prices (see page 32) and excise duty on tobacco (we assume an increase in March) will be important for the path of inflation in 2025.

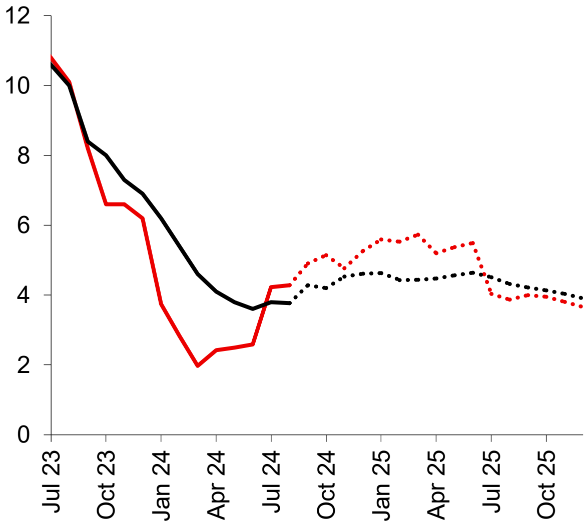
In our opinion, core inflation will be quite stable at around 4% y/y.

Currently, price momentum remains at a low level. Categories registering double-digit annual growth rates have evaporated from inflation (at the peak of inflation, as many as 3/4 of the CPI basket grew at such a pace). Measures of core price momentum from time to time show stronger jumps, but they prove to be short-lived.

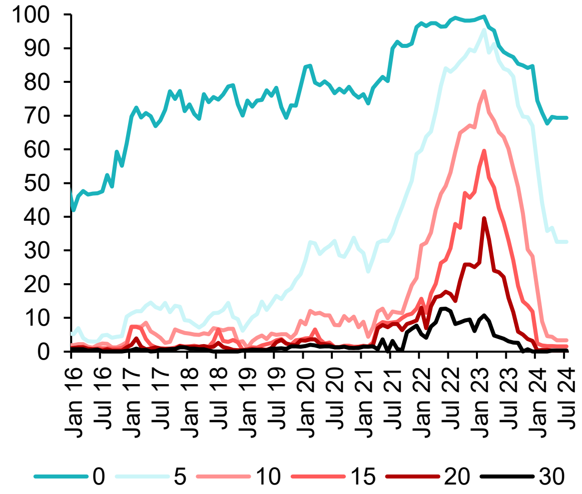
Breakdown of CPI change – August vs March, % y/y



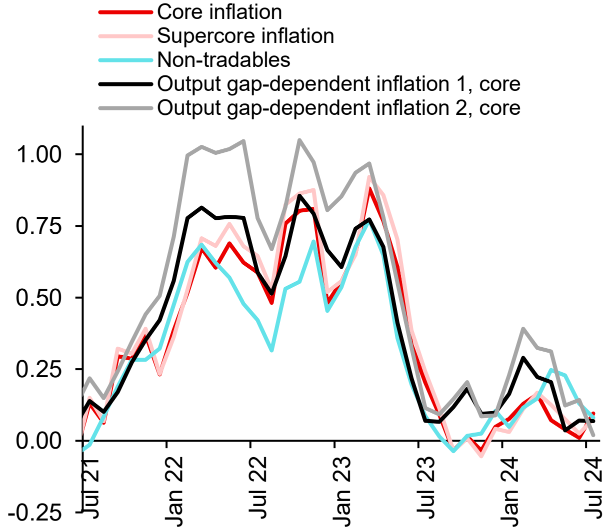
CPI and core inflation (ex food and energy), % y/y



Share of basket rising faster than…



Price momentum: 3-month moving averages of %m/m growth corrected for medians and changes in taxes



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Source: Eurostat, GUS, NBP, Santander

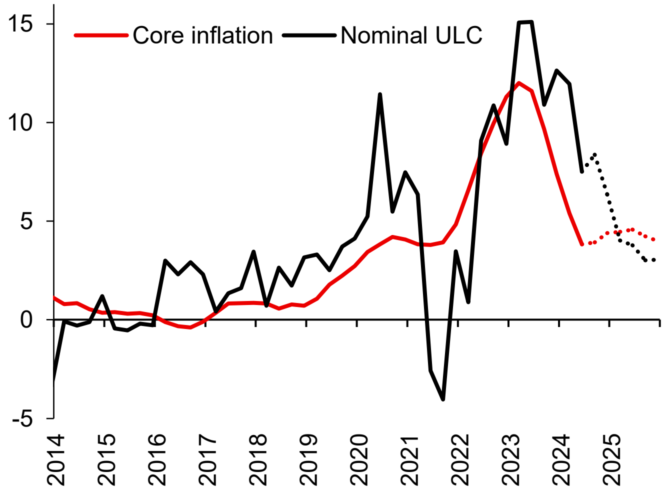
Labour costs and productivity supporting disinflation

The acceleration in economic growth in recent quarters has translated into improved labour productivity, which in turn has slowed the nominal unit labour costs down from more than 15% y/y at the peak in mid-2023 to 7.5% y/y in mid-2024. We assume that maintaining economic growth at a solid level with a certain slowdown in wage growth will translate into a further slowdown in this measure.

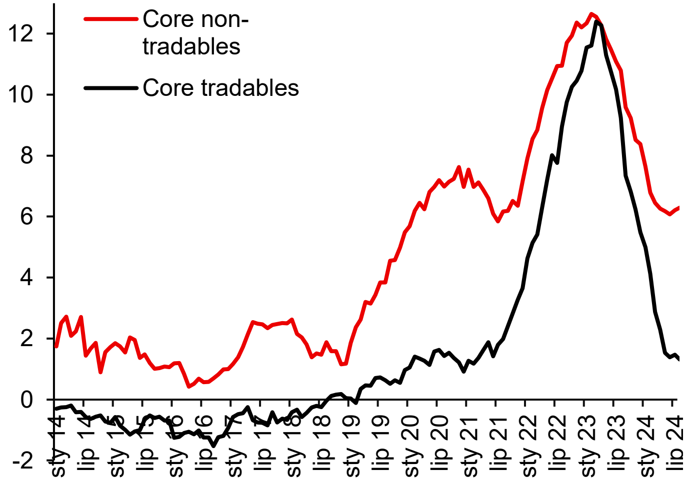
Lower growth in unit labour costs should be conducive to lower core inflation growth over time, especially since the part of the core inflation basket subject to international trade, i.e. dependent on foreign prices, has already decreased very markedly (below 1.5% y/y), and the part more dependent on domestic factors remains elevated (approx. 6% y/y). In our view, however, the decline in core inflation will be slow, in part due to changes in administered and regulated prices (excise duty on alcohol and tobacco, water and sewage prices, as well as others of the sort).

Labour productivity, 2015=100, sesonally adjusted

Core inflation vs unit labour costs, % y/y



Core inflation – breakdown, % y/y



Source: Eurostat, GUS, NBP, Santander

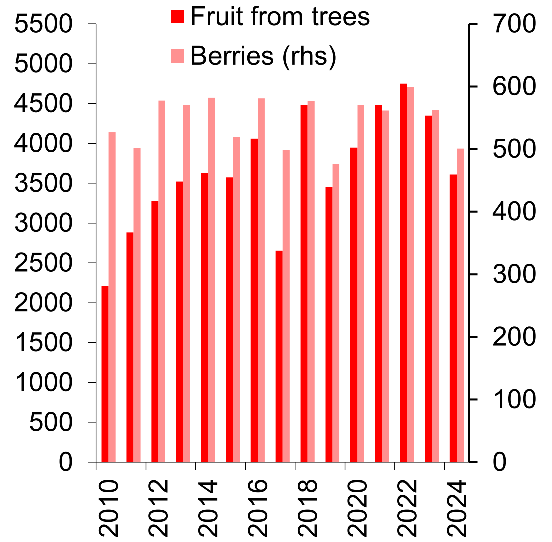
Impact of drought on prices

According to preliminary estimates by GUS from the end of July, in 2024 most major crops will witness lower harvests. The y/y decline in harvest is expected, among others, in basic cereals, estimated at 25.6 million tonnes (-4% y/y), rapeseed and turnip rape (3.4 million tonnes, -0.9% y/y), as well as fruit from trees, shrubs and berry plantations, which, according to the GUS estimates, amounted to a total of c. 4.1 million tonnes (-17% y/y). **Noteworthy is the very low expected fruit harvest (the lowest since 2019), which may lead to increased upward pressure on their prices in the second half of the year. Fruit prices are already rising stronger than suggested by the typical seasonal pattern.**

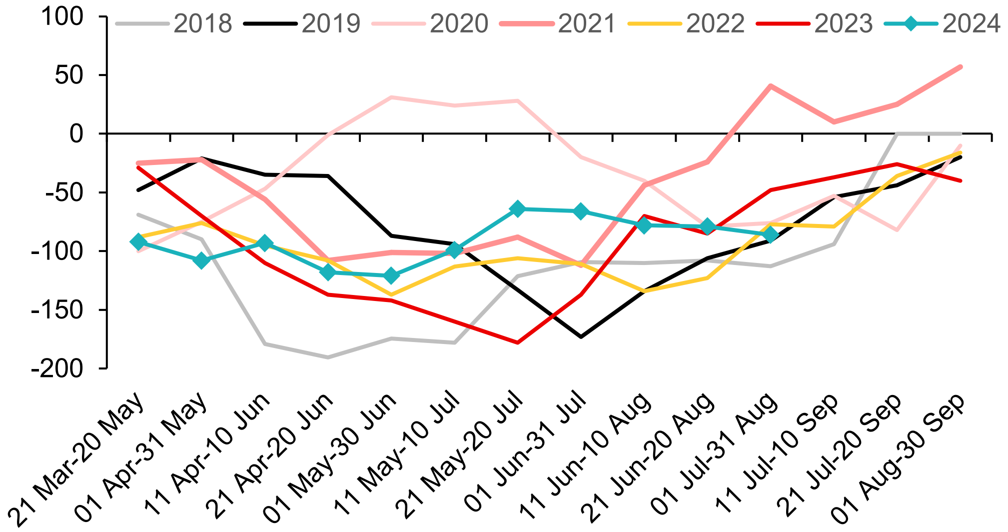
Lower crop production was related to April frosts, rainfall deficit in the second half of April and May, and extreme climatic events in June and July. Since the GUS report, the weather has remained unfavourable – although the Climatic Water Balance improved in the middle of the season, contrary to the pattern from previous drought years, it deteriorated again and the current readings are some of the worst in recent years, just like at the beginning of the season. As a result, **GUS's preliminary harvest estimates, mostly showing y/y declines, may still require a downward revision**.

The only main category of crop production, for which the GUS estimates showed an increase, were field vegetables. Their production is expected to amount to c. 3.8 million tonnes (+2% y/y). This means that in the case of vegetables, there is less likelihood of increased price pressure in autumn, although so far this year they are also deviating upwards from the usual seasonal pattern in terms of monthly price changes.

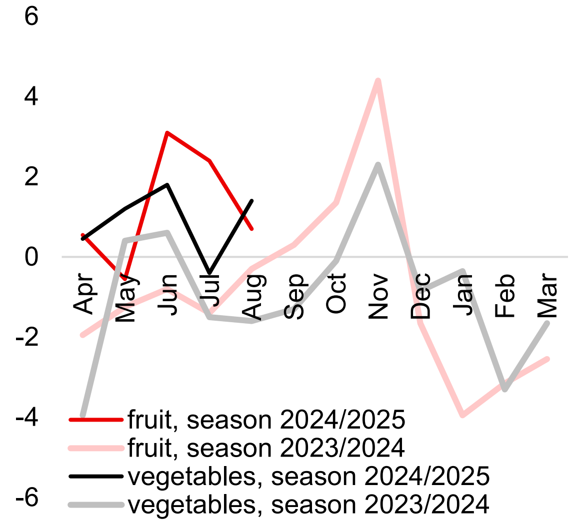
Fruit harvest in thousands of tons



Climatic Water Balance, mm



Fruit and vegetable prices, % m/m, adjusted for median increases for each month



Source: GUS, IUNG-PIB, Santander

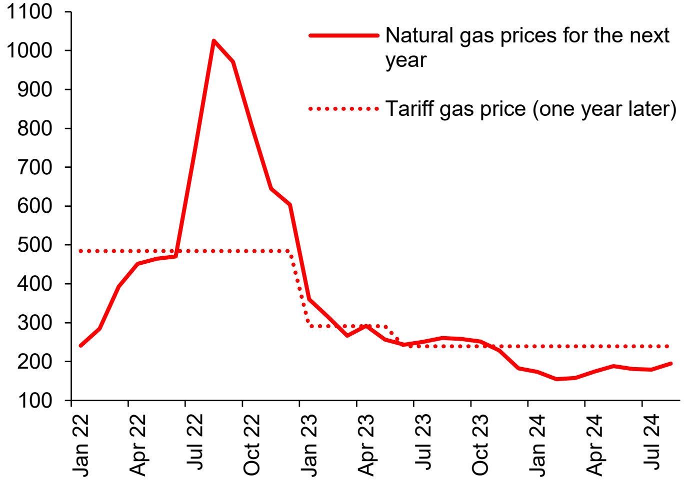
Energy prices: Stable in 2025?

As was the case in recent years, the government's decisions will be crucial for energy prices also in 2025. In the current legal status, energy tariffs are in force until the end of 2025, and gas tariffs until mid-2025. In the case of energy tariffs, the electricity sale price is "frozen" at PLN500/MWh until the end of 2024 (the tariff price is PLN622.80/MWh); additionally, the government does not charge a capacity fee. In the case of gas, no price freeze has been introduced. This means that **without any legislative or tariff action, electricity prices will increase by about 20% in January 2025, which would add about 1 percentage point to CPI inflation.**

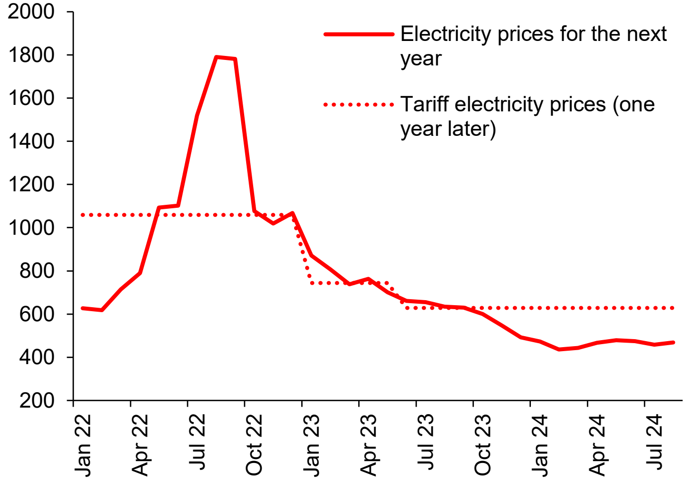
Government representatives suggested that some form of protective measures would be maintained in 2025 (PLN2bn was reserved for that in the 2025 budget), but without any details. In addition, wholesale electricity and gas prices have decreased to such an extent that, in our opinion, they justify the adjustment of the current tariffs to the level of the actual "frozen" prices: on the Polish Power Exchange (TGE), in the period from January to August, energy prices for 2025 averaged PLN462/MWh (the "frozen" price is PLN500/MWh, the tariff price is PLN622.80/MWh), and gas prices averaged PLN175/MWh. We also think that there is some room for reductions in tariffs. Although the current tariffs have been introduced for a longer period than usual, it cannot be ruled out that the government will force a change at the beginning of 2025 – as it happened in July 2024. Another solution is, of course, to maintain protective measures.

We assume that electricity and natural gas prices will remain stable in January 2025. District heating coal prices have also fallen significantly, but we do not see the potential for a decrease in heating tariffs.

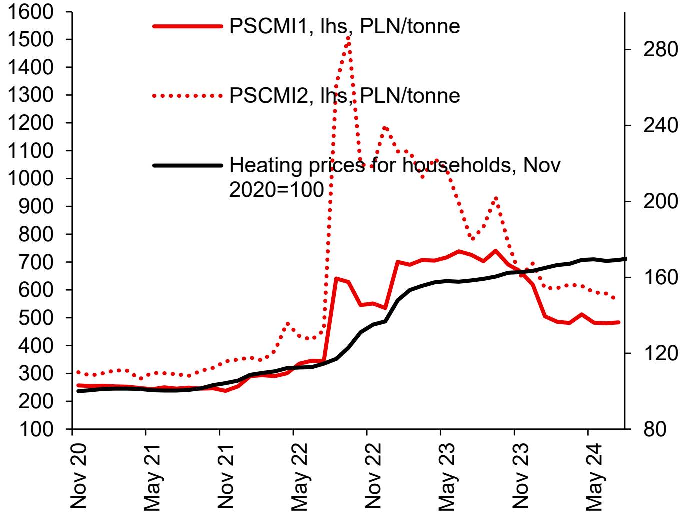
Natural gas prices, PLN/MWh



Electricity prices, PLN/MWh



Prices of heat and heating coal



PSCMI1 – coal price for energy generation
PSCMI2 – coal price for heat generation

Source: TGE, GUS, URE, Santander

4

Monetary policy: Rate cuts possible in 2025

Most MPC members see the possibility of interest rate cuts starting in 2025, albeit at different times (see next page). It is noteworthy that the recent comments indicate a blurring of difference in views on monetary policy between the group of Senate-appointed MPC members and the rest.

The NBP governor has retreated from his July statement about the possibility of considering reductions only in 2026 and is now also allowing for the possibility in 2025.

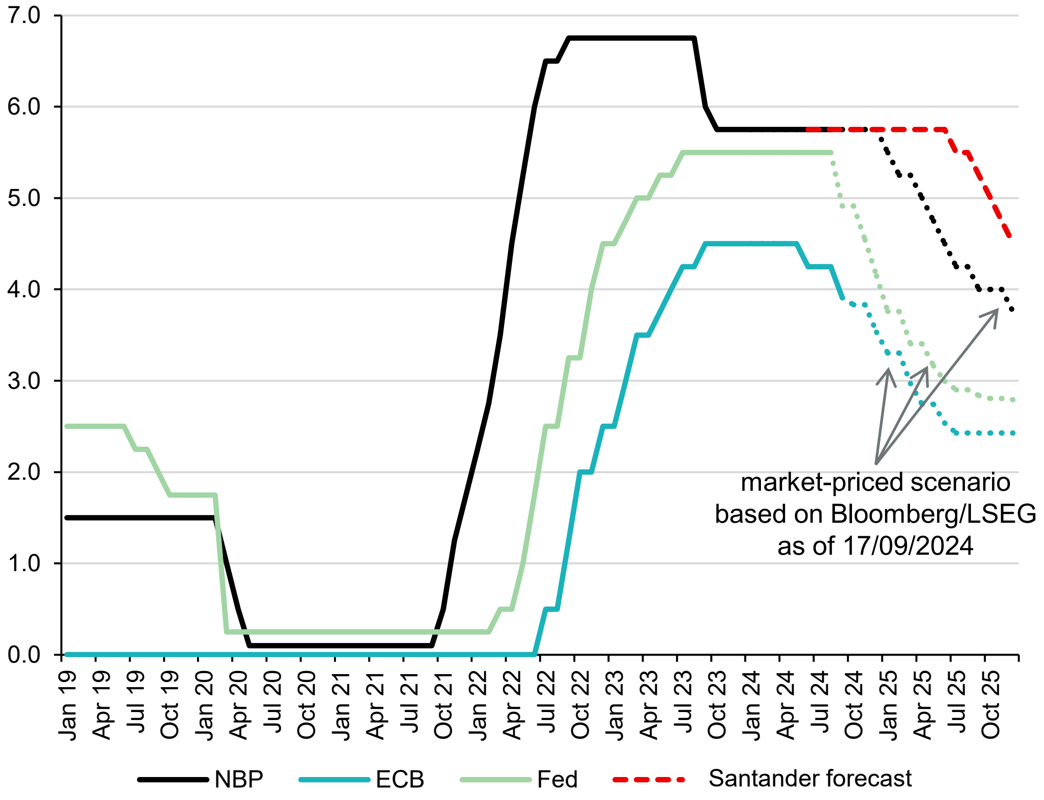
According to Mr. Glapiński, it will be possible to start discussing policy easing when inflation is no longer rising (for 2-3 months) and forecasts clearly point to a decline in the following months.

Given our inflation forecast, which shows CPI peaking in March (near 6%), **we maintain the view that the MPC may start cutting rates in mid-2025, most likely in July**, after it has seen at least a couple of CPI prints confirming the end of the upward trend and has seen the new NBP projection update.

A decision to cut rates as early as March seems unlikely to us - at this meeting the last known inflation data point will be the CPI for January, not even recalculated according to the new weights in the basket; we believe January will show an inflation increase compared to previous months.

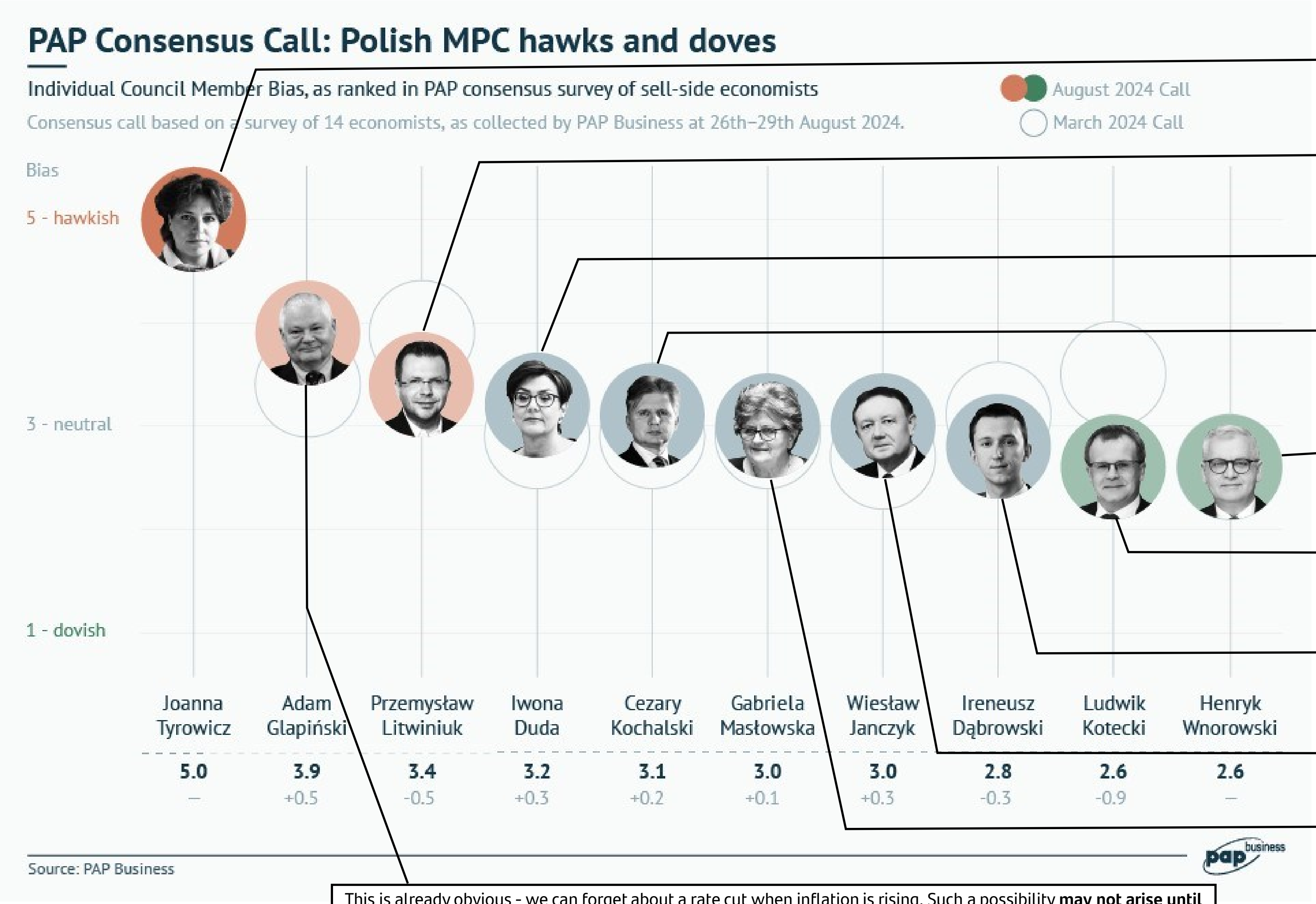
The chances of a faster response from the central bank would rise, in our view, in case of disappointing pace of economic recovery in the following quarters and/or a significant appreciation of the zloty exchange rate.

Main central bank interest rates, %



Source: Bloomberg, LSEG, Santander

MPC members see policy easing in 2025



From the analysis of the NBP forecasting model, **the interest rate that had a chance of bringing inflation down to the target is 7.75%** (6/09)

I believe that the first rate cut could take place **after the July projection**, if the Council gains confidence that the disinflation path is stable. (16/09)
I think (rate cuts) certainly not this year. Next year is not out of the question, but I would be more inclined to the view that **the second half of the year would be the moment**. (6/09)

As you can see, this moment (to start discussing cuts) is moving away. Perhaps **the second half of 2025** is a good time to start discussing interest rate cuts. (22/07)

In my view, rate cuts this year are ruled out, but the discussion may start **after the projection is published in March** (10/07)
{...} referring to the July projection and the available information, I believe that **the space for such a discussion could emerge as early as 2025** (11/07)

The MPC will stay on hold until at least the March inflation projection - this is beyond discussion. (...) A rate cut could occur as early as **2Q25**, especially if there are additional arguments for a cut from the major central banks (12/09)
I can see these reasons to talk about reductions **in 2Q25** (31/07)

Discussion of small rate adjustment could emerge in **1Q/2Q of 2025** if next projections confirm sustained decline in inflation to target (5/07)
I see a majority in the MPC ready to start discussing monetary easing **in 1Q25** (6/09)

The most likely scenario is for interest rates to remain at current levels until the end of this year, with **reductions possible in 1Q or 2Q 2025** (8/08)

The government has taken away the MPC's ability to cut rates by loosening the anti-inflation dials. (...) We have positive real interest rates, which I very much dislike and would very much prefer not to see. (17/06)

Given the current macroeconomic conditions, it is reasonable to keep interest rates unchanged at the next upcoming meetings. However, it cannot be ruled out that **2025 will bring a discussion of an interest rate cut**, but obviously on a very small scale. (28/08)

This is already obvious - we can forget about a rate cut when inflation is rising. Such a possibility **may not arise until 2026** when inflation starts to fall. (4/07)
This moment (of reduction) may occur after **2Q2025, but as God permits, after 1Q, or maybe after 3Q, so generally it is now said around mid-2025** (...) **Optimistically it may be this March projection.** (5/09)

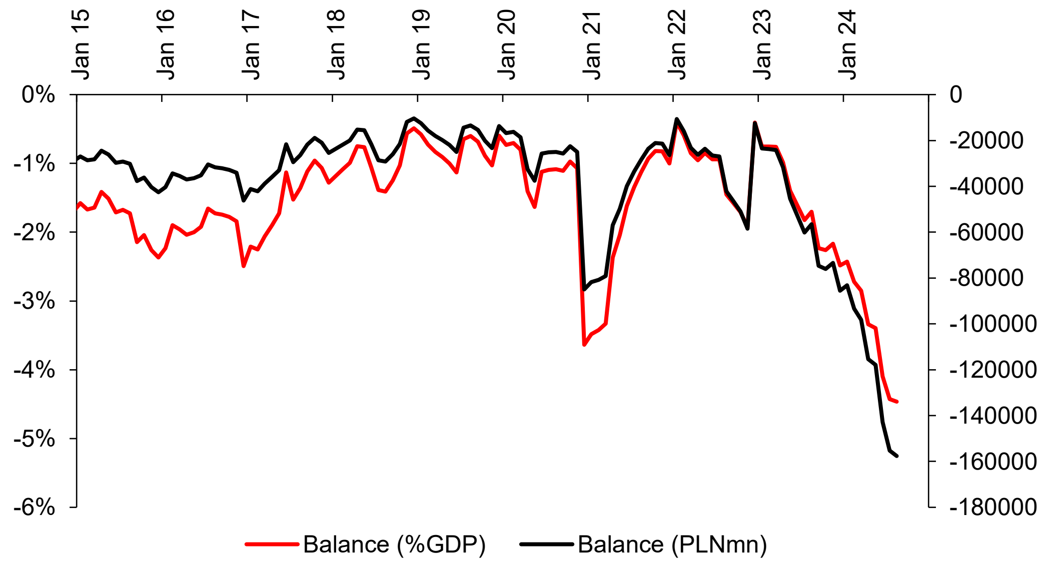
Santander

2024 budget: Uncertain amendment, higher deficit

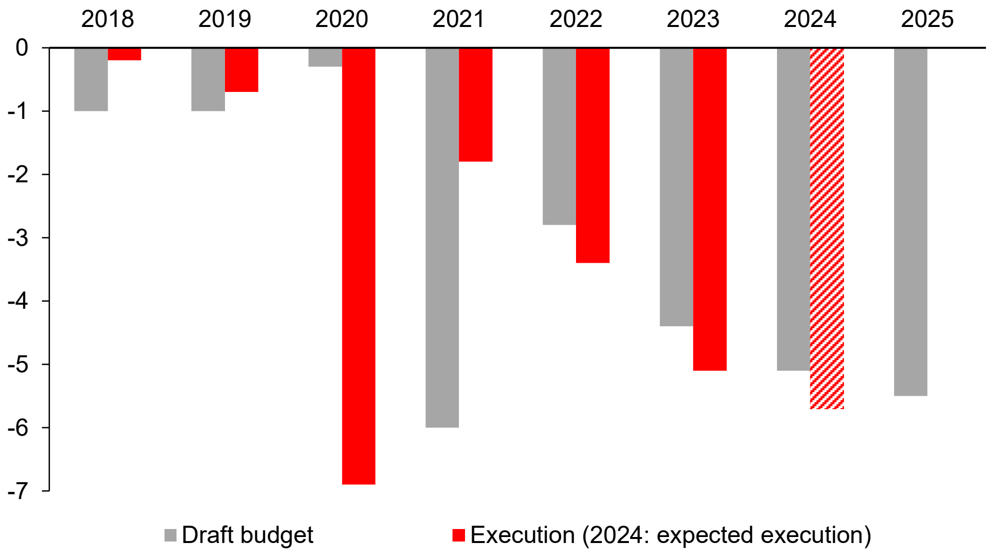
This year's general government fiscal balance is expected at -5.7% of GDP, i.e. significantly worse than the previously planned -5.1% of GDP. While we are not surprised that the expected fiscal balance has been revised, the size of the downward revision is by 0.2 percentage points of GDP greater than we had anticipated. About 0.2 percentage points out of this revision stem from a downward revision of the nominal GDP forecast (by 2.7 percentage points), and the rest - from new expenditures not provided for in the original budget act.

The state budget's revenues may be short of around PLN40bn vs plan, because of which **the government does not rule that it may need to amend the 2024 budget act. However, the government does not consider it to be the baseline scenario**. We think that the current flood in southern Poland increases the risk of budget amendment, as costs of reconstruction will make it more difficult to find savings on the spending side of the budget. **If the amendment does take place, the 2024 fiscal deficit will be even higher.**

Budget balance, 12M moving sum



GG balances planned in draft budget acts and their executions, %GDP



Source: Ministry of Finance, Santander

2025 budget: Postponed consolidation

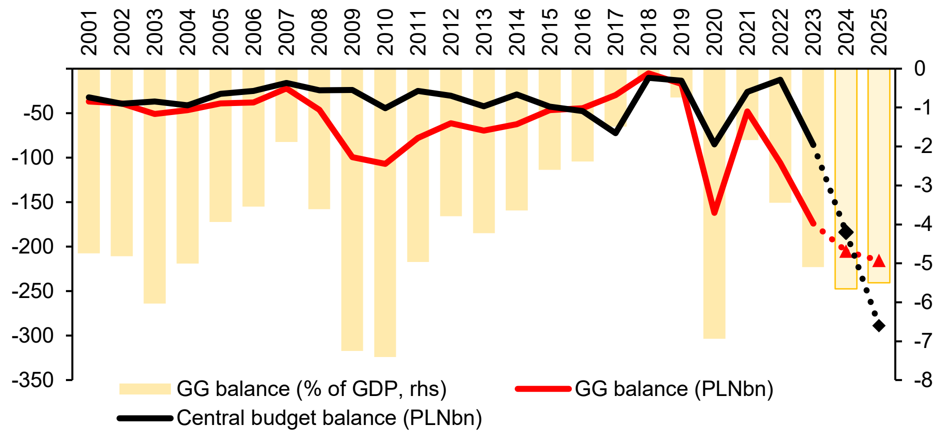
The scale of the deficit reduction in 2025 is quite modest – it amounts to only 0.2 percentage points of GDP, although until recently the forecasts of the EC, rating agencies and analysts assumed consolidation by at least 0.5 percentage points. The draft budget for 2025 does not take into account the EU's recommendation on the expenditure reduction path, as it has not yet been approved. For this reason, and in connection with the inclusion of Poland in the excessive deficit procedure, **it should be assumed that in the coming years Poland will have to increase the pace of fiscal consolidation**. However, rapid consolidation may be hindered, for example, by the high military spending from previous years, which affects the GG's result with a delay (along with the actual deliveries of equipment).

Moreover, **we see a risk that in 2025 the deficit will also be worse than the forecast in the draft budget**. Before the outbreak of the Covid-19 pandemic, the budget results were usually better than planned. However, in recent years, the final deficits have been 0.6-0.7% of GDP higher than originally planned. It seems that this is due to two issues: less conservatism in the adopted economic assumptions and the correction for the so-called "natural savings" on the expenditure side.

Nevertheless, although rating agencies have earlier pointed to risks arising from high deficit and rapid debt growth, according to their recent comments, **an increase in the deficit in 2024 and 2025 should not have negative consequences for Poland's rating**. According to S&P Global Ratings, the key risks to Poland's rating would stem from a prolonged economic slowdown or new external shocks, rather than from short-term fiscal developments. In Fitch's opinion, the high deficit in 2025 does not pose a risk to the rating, and only a lack of fiscal consolidation in the coming years could be a reason to revise Poland's credit rating.

Readers who wish to learn more about the 2025 draft budget are referred to our Economic Comment.

Central budget and GG balances



Source: MF, Eurostat, Santander

Main budget parameters

	2023 execution	2024 planned	2025 draft
Revenues (PLNmn)	573 958	642 381	632 618
Expenditure (PLNmn)	659 586	826 381*	921 618
Balance (PLNmn)	**-85 629**	**-184 000**	**-289 000**
GG balance (% of GDP)	**-5.1%**	**-5.7%****	**-5.5%**
GG debt (% of GDP)	**49.6%**	**54.6%**	**59.8%**

Source: Finance Ministry; * sum from the budget act 2024 adjusted to be in line with revenues and deficit
** value cited by Finance Minister at press conference on 28.08.2024.

Santander

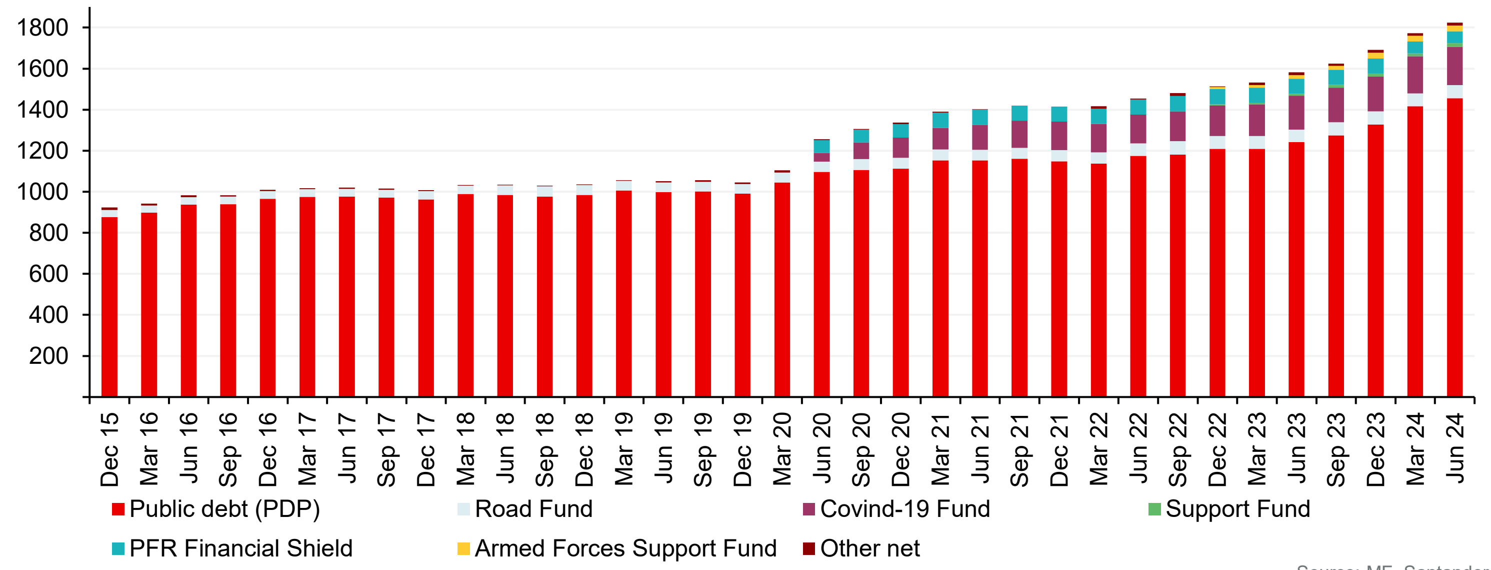
Public debt: Approaching 60% of GDP

According to the draft budget act for 2025, **the general government debt (according to the EU definition) is to increase from 54.6% of GDP in 2024 to 59.8% of GDP in 2025.** As a result, next year, the value of Poland's debt will be on the brink of 60% of GDP, and thus will near the reference value defined in the EU's fiscal framework.

The sovereign public debt (i.e. debt measured according to the national methodology) is expected to increase from 43.3% of GDP in 2024 to 47.9% of GDP in 2025. This means that it should still remain clearly below the safety threshold of 55% of GDP, resulting from the Public Finance Act.

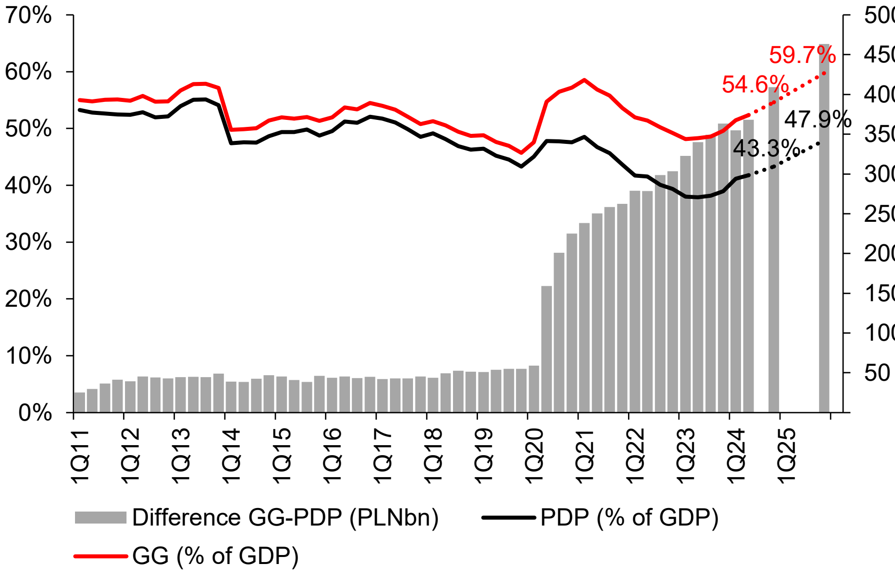
The difference between debt in both definitions is growing to a record amount of PLN470bn, which means an increase in the debt of off-budget funds by about PLN63bn. Most of this can be attributed to the financing of the Armed Forces Support Fund.

Difference between public debt (PDP) and general government debt, nominal terms, PLNmn



Source: MF, Santander

Public debt in domestic (PDP) and EU (GG) definitions, % of GDP



Source: MF, Santander

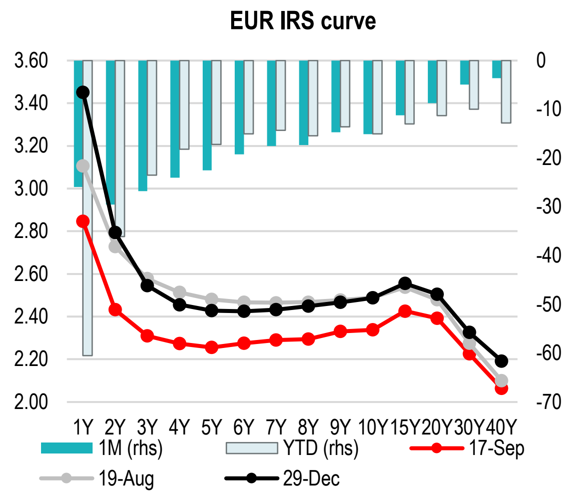
Santander

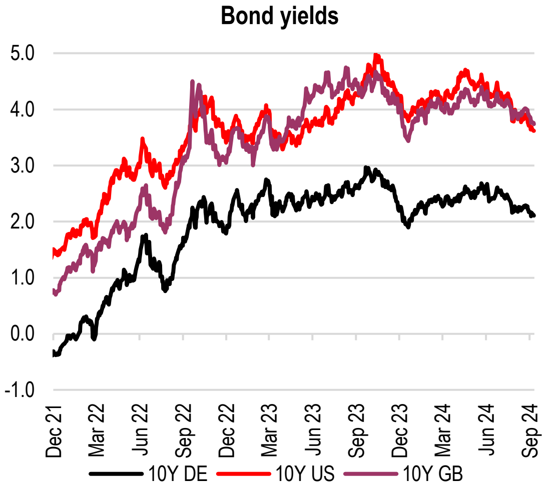
Financial markets

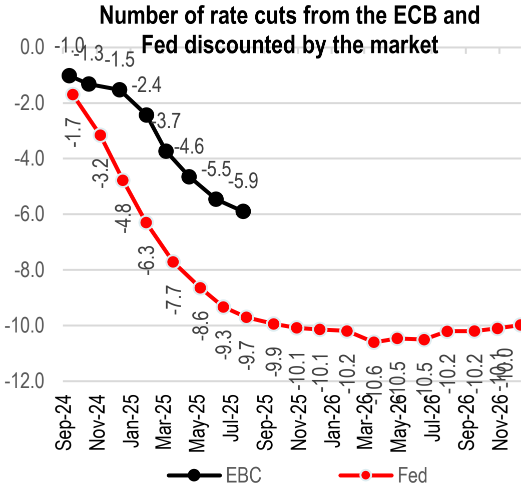
5

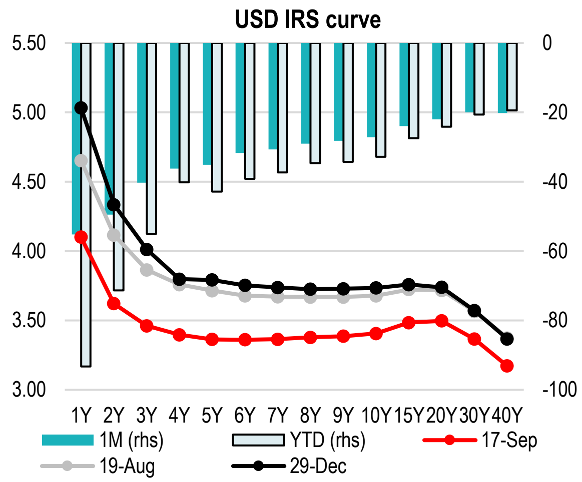
Time of rate cuts from the ECB and Fed

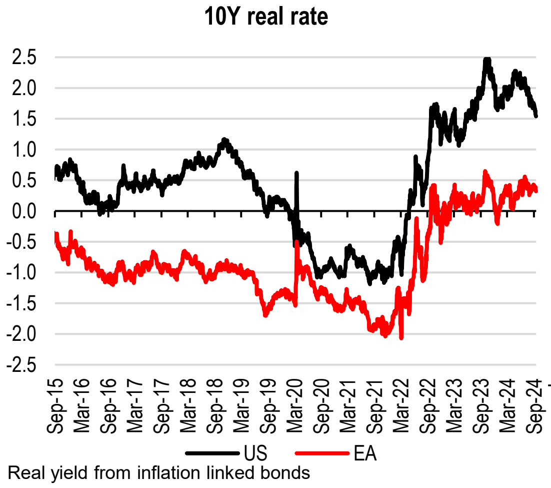
2Q24 was marked by a renewed fall in market rates in the euro area and the US as the ECB began its rate cuts cycle and the timing of the first Fed rate cut approached. The decline in rates accelerated in response to weak US non-farm payrolls data for July. Subsequent data, for August, failed to dispel fears of a slowdown. Negative surprises in activity data have prevailed in recent months in both the US, the euro area and China. Inflation surprise indexes also trended downwards. This coincided with a change in tone by Chairman Powell, who suggested that the Fed needed to be more concerned about growth. Since July, yields in the core markets have fallen by 30-70 bps in the euro area and 60-120 bps in the US with a larger decline for short-dated rates. In addition to the fall in expected inflation, the fall in real rates has contributed to lower US yields. Bond curves in the US and Germany gradually steepened, with the US curve no longer inverted for the first time since June 2022, suggesting growth concerns and expectations of rate cuts. We expect a smaller scale of cuts (25bp cuts from the ECB and 75bp from the Fed) than the market is pricing in (50bp from the ECB and 100bp from the Fed), giving room for an upward correction in rates. We assume a further steepening of the core market curves.

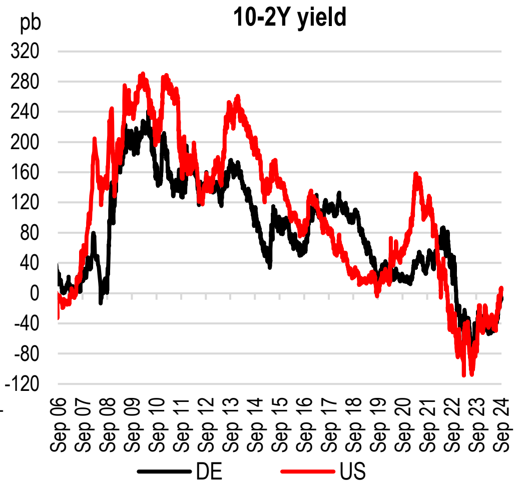










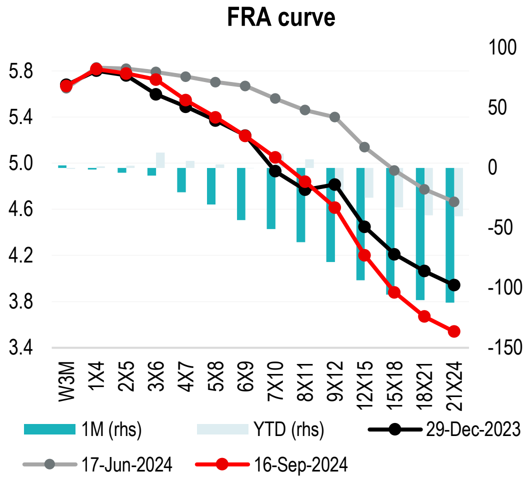


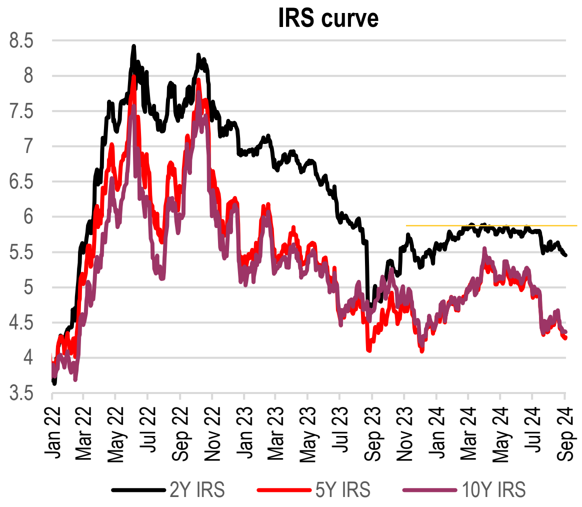
Source: LSEG, Bloomberg, Santander

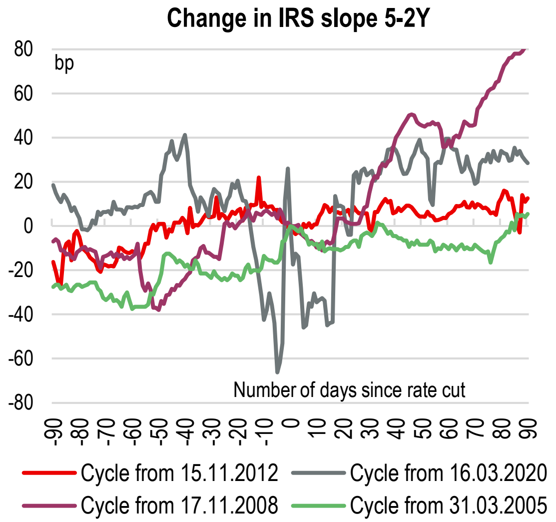
Swap curve more inversed, time for steepening?

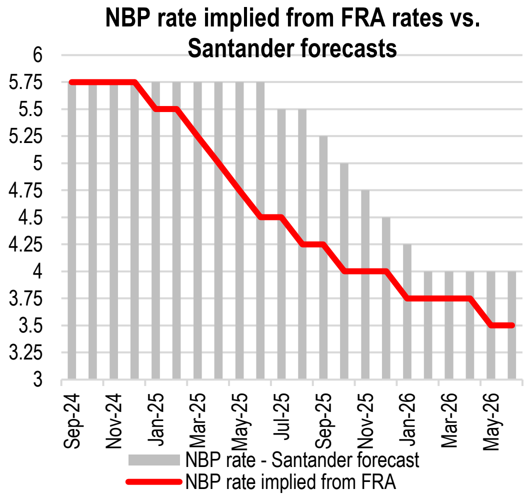
In the last quarter, local swap rates fell by 20-70 bp particularly at the longer end of the curve. The downward move came in response to US labour market data for July. The FRA market is pricing in 200bp of rate cuts in 2025 starting in January, including 125bp in 1H. We assume a first cut in July 2025 but given that monetary easing has already started in the core markets, it may be difficult to see a major upward correction of market rates. The case for such a move could be triggered by a significant upward surprise in inflation or activity data. At the same time, similar signals would have to start coming from the economies of major trading partners.

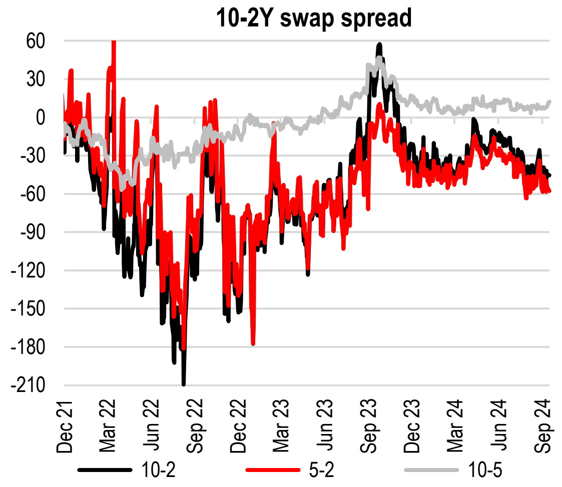
The steepening of the core market curves accelerated with the first ECB rate cut (June). Locally, after the strong flattening, we assume steepening by the end of this year, including the 2-5Y, as indicated by our model towards -25-30 bps, supported by, among other things, strong GDP growth and the steepening of the euro curve. We assume a continuation of curve steepening in 2025 amid falling inflation and rate cuts. Historically, the curve has steepened even 3 months before the first rate cut in the event of an expected slowdown (2012) or falling inflation (2005) and with some delay after the first rate cut in the shock period (2020). In 2008, the curve steepened both before and after the start of the monetary easing cycle.

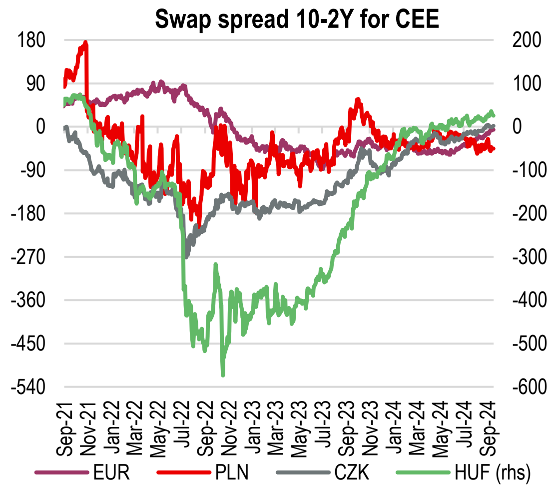












Source: LSEG, Santander

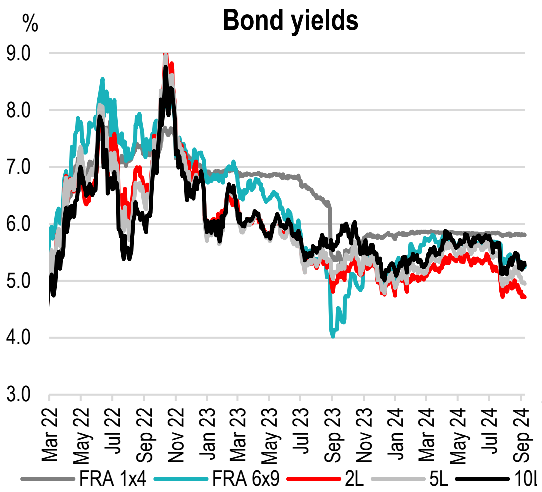
Asset swap spreads still high

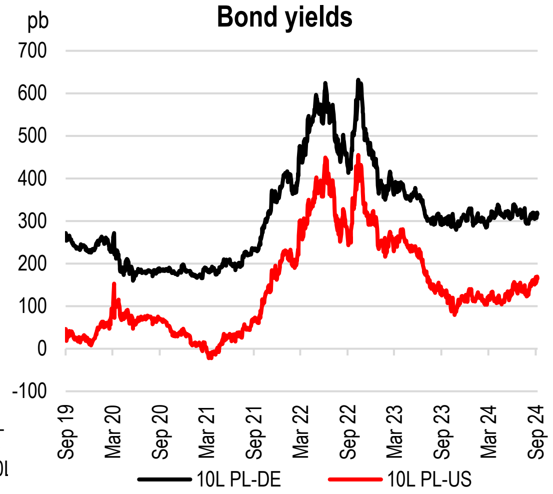
The fall in bond yields in the last quarter was smaller than that in swap rates, leading to credit spreads widening by 25-35 bp, except for the 2Y, which even fell slightly last month as yields fell deeper. At the same time, however, positive net debt issuance may have had some impact. We assume net supply of POLGBs close to neutral until the end of the year, but also anticipate a slight upward adjustment of swap rates.

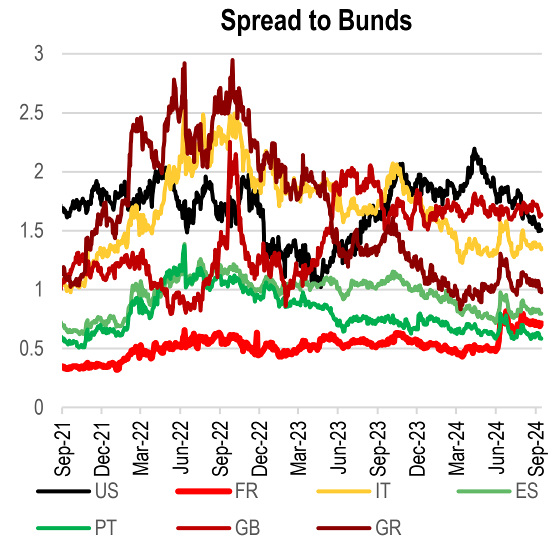
We assume that credit spreads will remain above their long-term averages for 5-10Y rates also in the coming months driven by large bond supply in 2025.

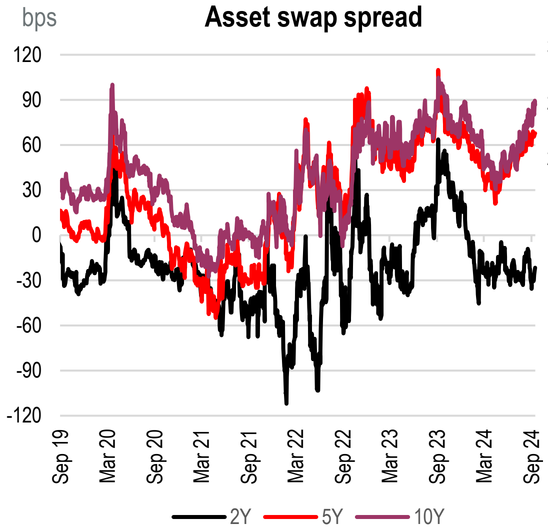
The spread to Bunds remains slightly above 300 bp. It did not change significantly in the last quarter with a sizeable increase for Romania, a continued high spread for France and decreases for the Czech Republic and Hungary. We anticipate that the spread to Bunds will remain above 300 bp until the end of the year.

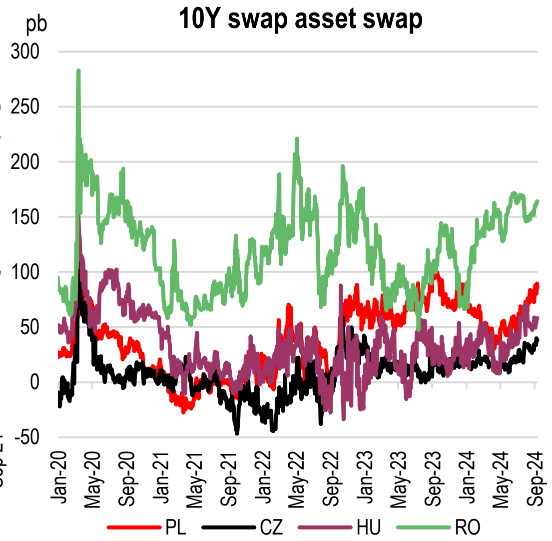
In 2025, we assume greater demand for debt in the face of looming interest rate cuts, which may be enough to see gradually narrowing credit spreads (as was the case earlier this year) as well as the spread to Bunds falling below 300 bp. The recent high correlation with Bund yields and the expected Bund correction should translate into a 15-25 bp increase in local bond yields.

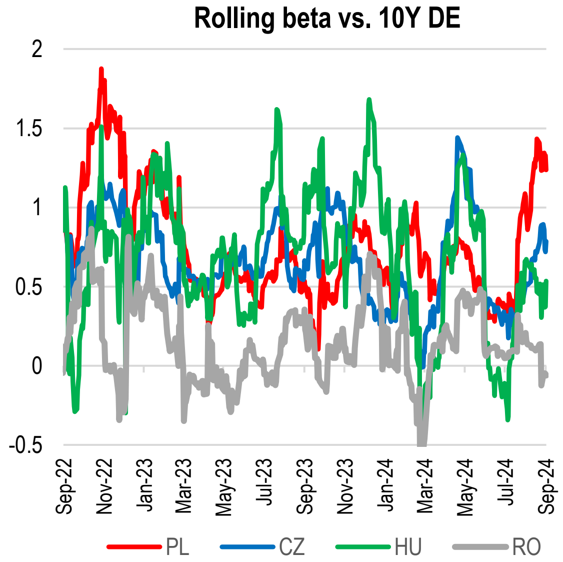








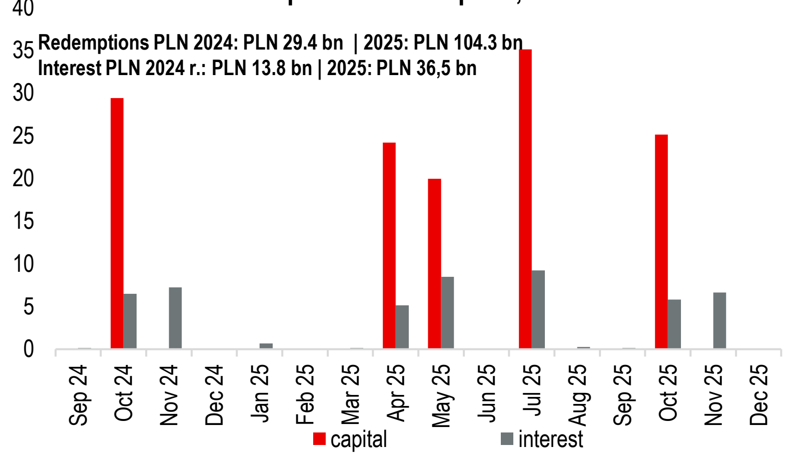




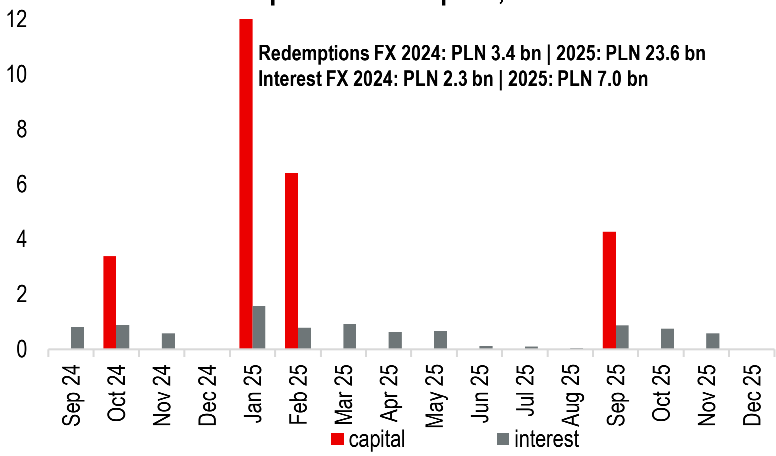
Source: LSEG, Santander

High retail bond sale, wholesale bonds still on the rise

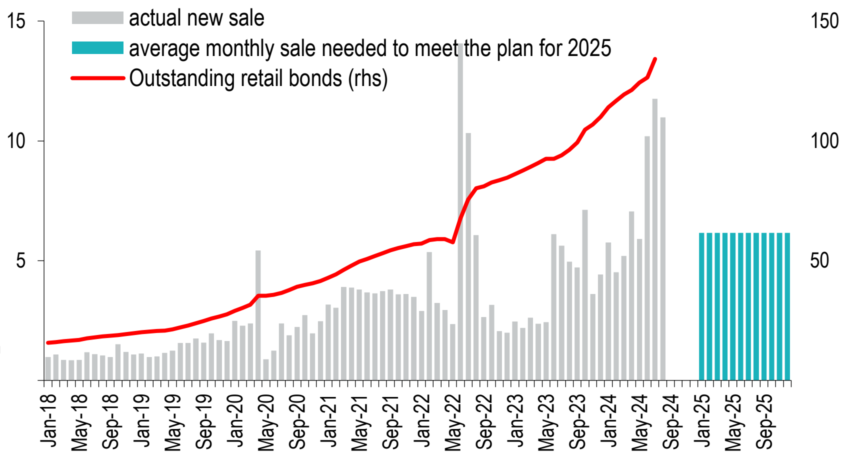
Redemptions and coupons, PLN bonds



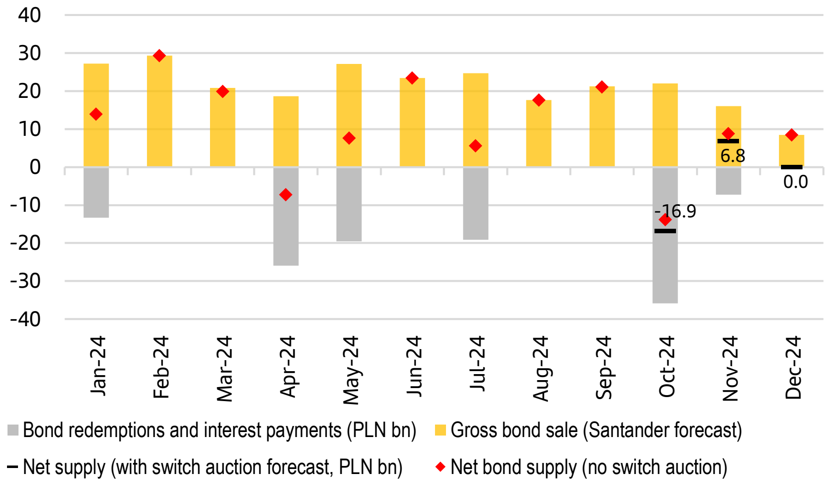
Redemptions and coupons, FX bonds



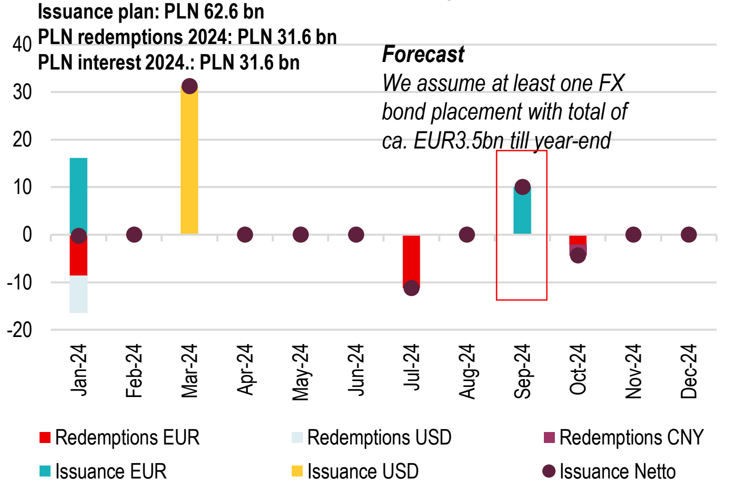
Retail bond sale



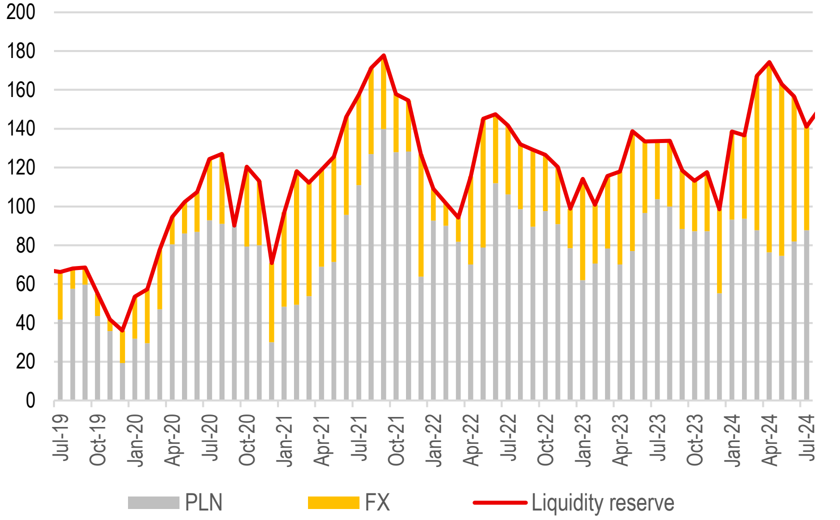
Gross and net domestic government bond supply



Gross and net supply of FX bonds



Finance Ministry deposits



Santander

Source: LSEG, Ministry of Finance, Bloomberg, Santander

Record high gross borrowing needs

According to the provisions of the draft budget, borrowing needs will increase in 2025 to a record level of PLN553.2bn gross and PLN366.9bn net (i.e. by 30% and as much as 70% more than the respective outcome expected for this year). In relation to GDP, the numbers are also record high at 14.1% and 10.1%, respectively. Net borrowing needs mainly consist of the central budget deficit (PLN289bn), the deficit of the European funds budget (PLN28bn), plus as much as almost PLN60bn are "loans and advances granted".

In order to assess the actual scale of demand for new investor demand, net borrowing needs need to be adjusted by three factors: (1) down by c.PLN60bn, i.e. the amount resulting from the repayment by the state budget of PFR and BGK debt maturing in 2025, (2) up by c.PLN27bn, i.e. the total value of PFR, BGK and State Treasury bonds currently remaining on the NBP balance sheet and maturing in 2025, and (3) upwards by the issuance of BGK bonds at the level of PLN26bn. In total: **adjusted net borrowing needs in 2025 are about PLN360bn, i.e. 65% more than in 2024**.

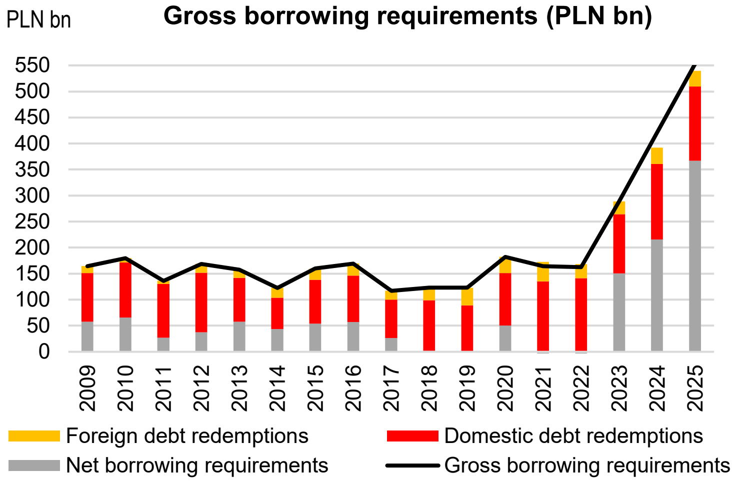
The actual borrowing needs of the budget may turn out to be lower than assumed if – in accordance with the regularity from previous years – the implementation of the EU funds budget will be better than expected (in recent years the difference was about PLN20bn).

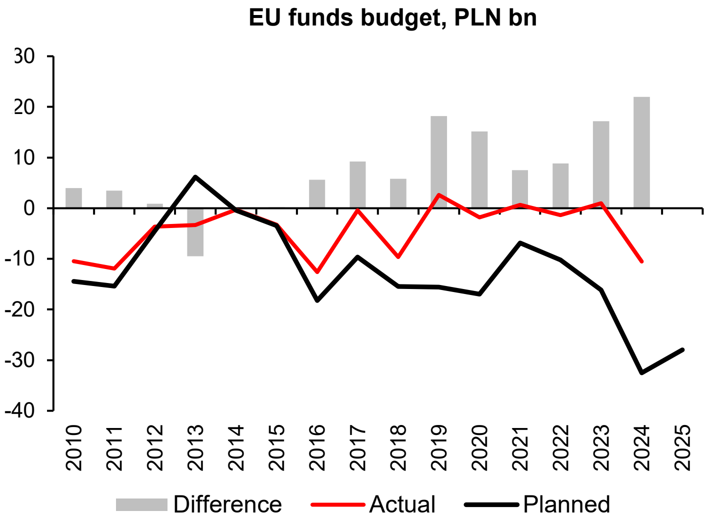
The main source of financing for borrowing needs is to be record issues of domestic market Treasury securities worth some PLN215bn net and PLN321bn gross. For comparison, this year's projected issuance is PLN114bn net and PLN233bn gross.

	2024 Budget bill (1)	2024 Planned realization (2)	2025 Plan (3)	2025 change (3) - (2)
Central budget deficyt	184,0	184,0	289,0	105,0
EU funds deficit	32,5	10,5	28,0	17,5
Loans granted	22,6	18,6	60,0	41,4
EU prefinancing	0	0	-0,15	-0,02
Payments related to international organizations	16	1,7	1,1	-0,6
Liquidity management	0	-12,2	-10,5	1,6
EU funds management	11,6	13,5	-0,6	-14,1
Other	-24,0	-0,443	-0,02	0,4
SUM (net borrowing needs)	**252,3**	**215,7**	**366,9**	**151,2**
Incl..:				
1. Domestic financing	148,8	194,9	252,1	57,2
1.1 Treasury securities	148,8	150,8	252,1	1012
1.2 Budget deposit accounts	0	44,1	0	-44,1
2. Foreign financing	103,5	20,8	114,8	94,1
2.1 Treasury bonds	31,0	28,5	42,9	14,4
2.2 Loans	-0,496	-0,9	-2,9	-2,0
2.3 Loan from RRF	40,0	38,5	25,2	-13,2
2.3 Flows related to FX account	32,9	-45,3	49,5	94,9

Bonds in the NBP portfolio maturing in 2025, PLN bn

Series	Nominal value	Coupon payments
PFR0325	4,506	0,073
PS0425	2,288	0,017
FPC0725	3,055	0,038
DS0725	12,299	0,400
PFR0925	5,278	0,086
Sum	**27,426**	**0,614**





Source: Ministry of Finance, Santander

Issuance plans

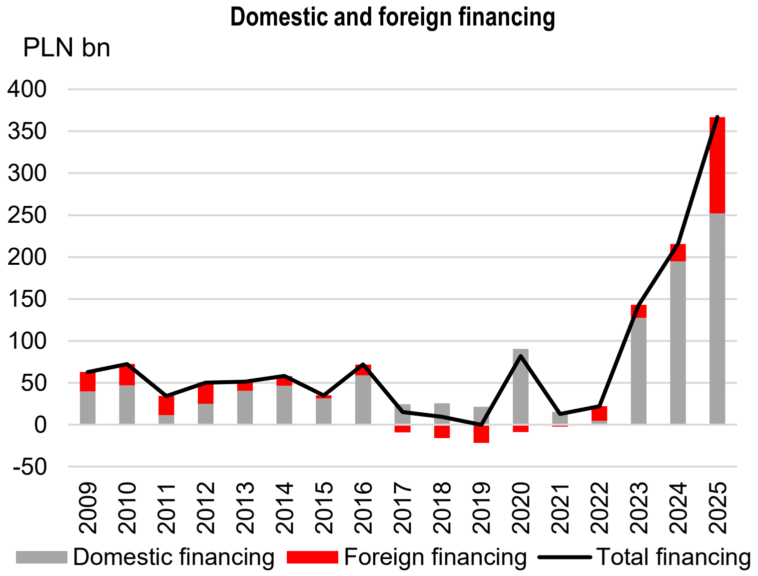
The draft budget act assumes an average monthly gross issuance of Treasury Securities at the level of c.PLN27bn, which, assuming there will be c.35 auctions as in the current year, would give approx. PLN9-10bn per auction.

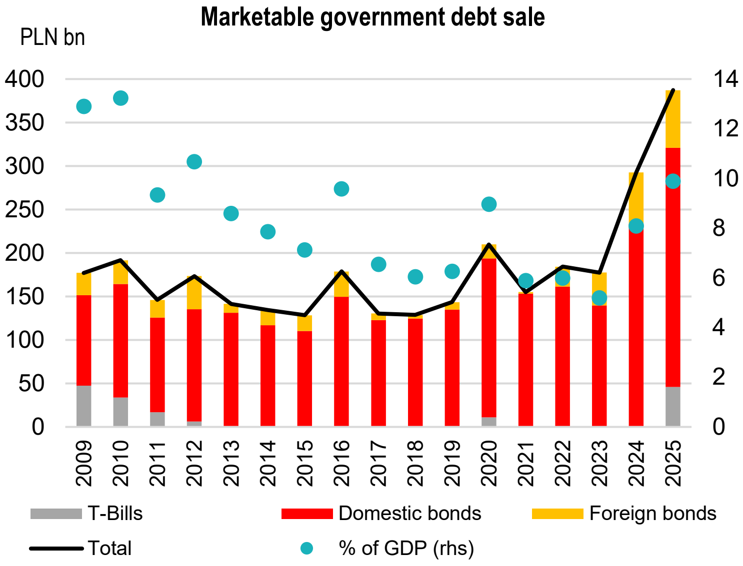
The Ministry of Finance has planned to issue PLN46 bn of Treasury bills. The supply of bonds may be so large that the Ministry of Finance may finally supply at least part of the planned issuance of Treasury bills. The issuance of bills would meet with increased interest, for example from banks, which could redirect part of the liquidity invested in NBP bills to take advantage of the tax benefit. In the case of high demand for bonds, which may be supported by the cycle of interest rate cuts, the supply of bills could be correspondingly smaller.

Domestic financing will be complemented by retail bond issues at the net level of PLN37bn and gross level of some PLN74bn. The plan for next year looks realistic, but it could be jeopardized in the event of a significant reduction in interest rates.

After many years of foreign exchange debt reduction, the Finance Ministry plans to increase it for the second year in a row. The share of foreign currency debt in total debt will increase, but due to the high issuance of domestic debt, it will still be relatively low and, according to our estimates, will slightly exceed 25%. The ministry is planning a loan from the EU under the National Recovery Plan at the level of PLN25bn.

We assume BGK's issuance (for the funds it manages) to be slightly smaller than this year.





Treasuries	Net issuance (PLN bn)				Gross issuance (PLN bn)			
	2024 Budget bill (1)	2024 Planned realization (2)	2025 Plan (3)	2025-24 change (3) - (2)	2024 Budget bill (4)	2024 Planned realization (5)	2025 Plan (6)	2025-24 change (6) - (5)
T-Bills	47,3	0	45,7	45,7	47,3	0	45,7	45,7
T-Bonds – FI	64,6	79,4	106,3	26,9	141,4	161,9	191,1	29,2
T-Bonds – FRN	22,5	20,6	51,0	30,4	50,7	57,8	72,0	14,2
T-Bonds – CPI linked	0	13,6	11,8	-1,8	0	13,6	11,8	-1,8
Saving bonds	14,4	37,2	37,2	13	40,8	77,5	73,9	-3,6
Domestic bonds – SUM	148,8	150,8	252,1	101,6	280,3	310,9	394,6	83,7
Foreign bonds – SUM	31,0	28,5	42,9	14,4	62,6	59,3	66,3	7,0

BGK bond issuance plans

	2024	2025
Road Fund	9.49	8.9
Support Fund	8.2	8.24
Covid Fund	48.1	26

Santander

Source: LSEG, Ministry of Finance, Santander

Domestic banks still key buyer, foreign investors return

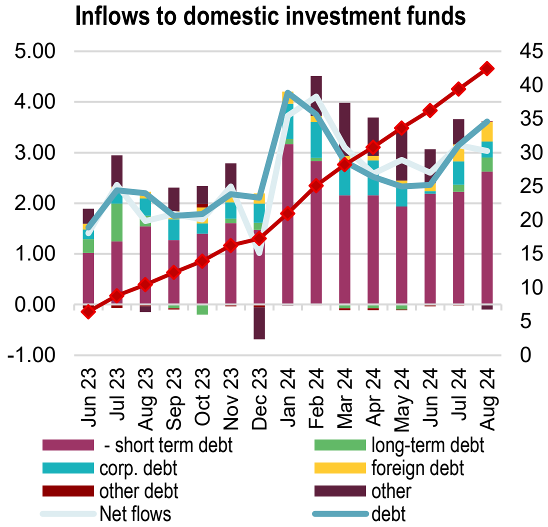
Domestic banks remain the main buyers of local debt and we assume this trend will continue in the coming quarters. Foreign investors woke up in June and July, increasing their portfolios by over PLN 13bn after a prolonged pause.

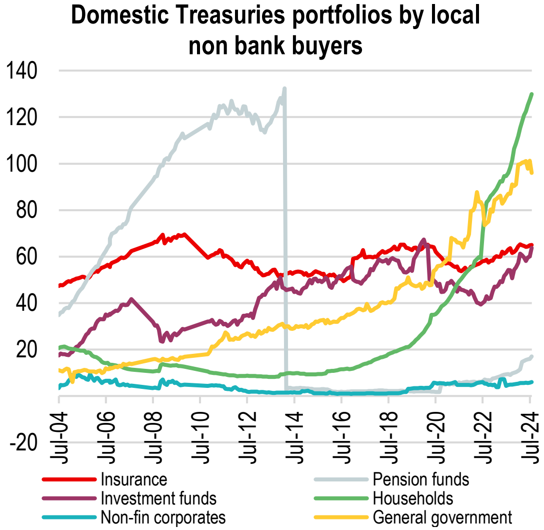
Interest on retail bonds has been gradually declining, but we maintain our view that total issuance could be as much as PLN 30bn higher this year than planned, which could reduce wholesale bond issuance.

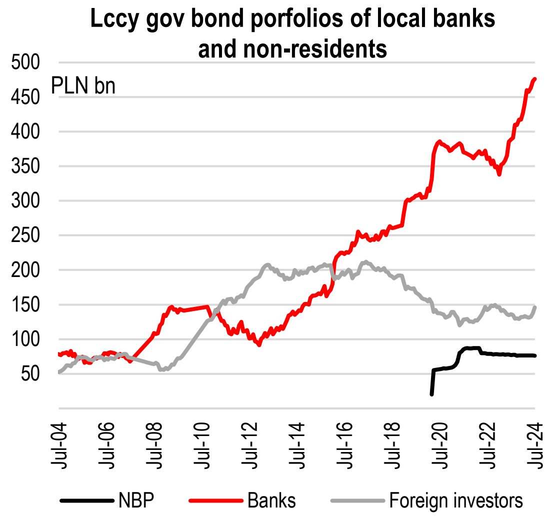
We assume that domestic banks will increase their government bond portfolios by at least PLN 150bn in 2025. This estimate is based on the assumption of an increase in deposits and total assets of the banking sector next year by around 7-10%, a further increase in the sector's excess liquidity, a further slight increase in the share of bonds in banks' total assets from the current 15.5%, as well as the maturity of BGK and PFR bonds held by banks (around PLN 47bn) and the transfer of these funds to POLGBs.

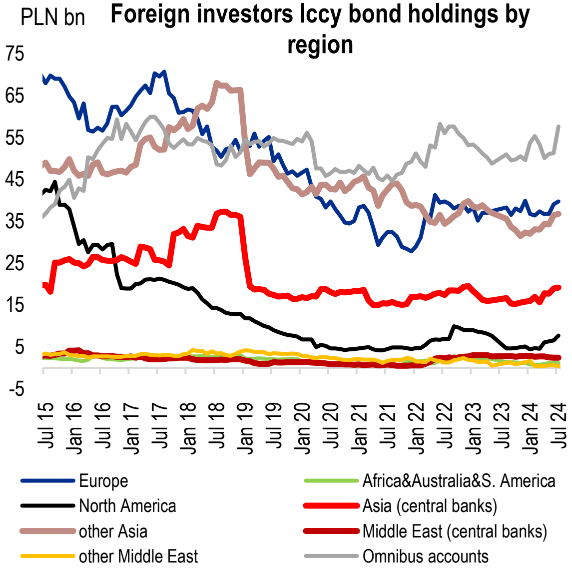
We think that the inflow of private money to mutual funds may continue at around PLN 30 billion per year (compared to around PLN 22 billion for the first seven months of this year), of which a slightly larger portion than in the current year will go to the domestic debt market.

We assume that in view of the global interest rate cut cycle and the looming rate cut cycle in Poland, foreign investors may increase their exposure to domestic debt.









Domestic Treasuries net purchases (Santander Forecast for 2024-25)

	Banks	NBP	Foreign investors	Mutual funds	Insurers	Households	Geberal government	Others	Total
2016	64.0	0.0	-14.2	3.1	6.9	1.1	4.4	3.3	68.7
2017	8.4	0.0	10.2	6.9	0.8	4.2	2.4	2.8	35.6
2018	20.2	0.0	-11.3	-1.7	5.3	4.1	9.2	9.2	34.9
2019	40.9	0.0	-34.1	12.0	-0.8	7.4	-0.7	-45.3	-20.6
2020	66.9	58.5	-23.6	-18.8	-7.0	13.4	12.6	5.2	107.3
2021	-10.4	28.4	-9.2	-3.3	-1.6	14.4	20.3	-0.1	38.6
2022	-11.7	-8.7	21.6	1.8	3.9	32.8	4.7	2.0	46.5
2023	67.6	-1.8	-14.0	10.2	4.9	23.9	15.3	3.4	109.4
I 2024	9.5	0.1	0.0	4.0	0.8	3.4	0.1	1.1	19.1
II 2024	14.6	0.1	1.3	-0.6	-0.4	2.8	0.7	3.2	21.6
III 2024	18.2	0.1	-1.3	-1.0	-0.3	2.7	0.3	0.3	19.1
IV 2024	-2.4	-0.4	-1.1	-1.6	-0.4	1.6	0.3	0.5	-3.3
V 2024	6.3	0.1	1.4	1.6	0.2	2.8	-3.2	0.2	9.4
VI 2024	8.9	0.1	5.0	0.4	0.6	2.2	3.4	0.2	20.8
VII 2024	3.2	-0.6	8.3	3.8	0.1	2.5	-5.2	1.4	13.4
YTD 2024	58.5	-0.5	13.6	6.5	0.6	18.0	-3.6	6.9	100.0
2024F	97.1	-4.5	10.0	8.0	0.0	37.2	-4.0	7.0	150.8
2025F	165.0	-14.6	25.0	20.0	5.0	40.0	7.0	5.0	252.1

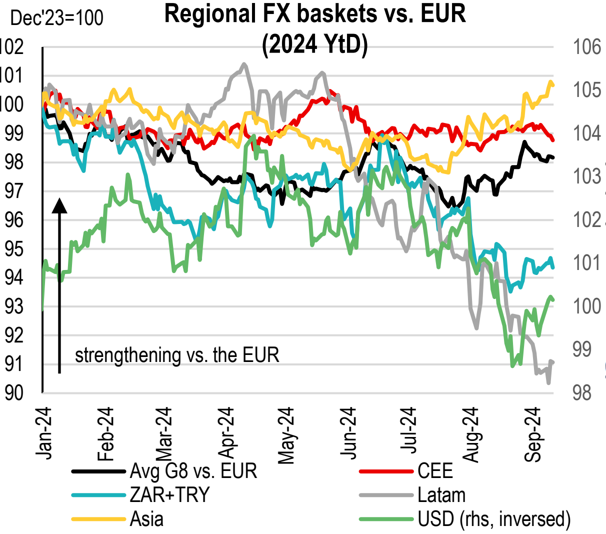
Source: LSEG, Ministry of Finance, analizy.pl, Santander

Weak dollar vs. strong yen, but zloty stable

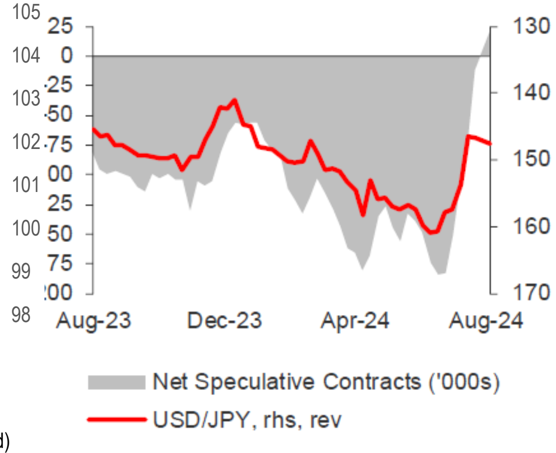
The zloty has remained fairly stable over the past month, with the EURPLN exchange rate oscillating in a range 4.25-4.33 and the range of fluctuations narrowing in recent weeks with a further gradual decline in volatility in the region. The surge in volatility in equity and bond markets around the Bank of Japan's rate hike and weak US data translated into a strengthening of the yen and a reduction in carry trade positions, but this has influenced mainly LatAm currencies. This was accompanied by a weakening trend in the dollar, which had a positive impact on Asian currencies, but without a significant impact on CEE currencies. In addition to the drop in volatility, the zloty was supported by a deeper drop in euro rates than in zloty rates, leading to an increase in the market rate disparity.

During the latest wave of weakness, local peaks in the EURPLN exchange rate were lower than previously. The resilience of the zloty is partly a reflection of the lack of serious structural weaknesses in the Polish economy, which is has been accelerating. In contrast to the region, Poland's Q2 GDP data surprised positively (3.2% y/y). Although the latest industrial production data surprised negatively, we expect a solid GDP growth performance in Q3 and Q4, driven by private consumption.

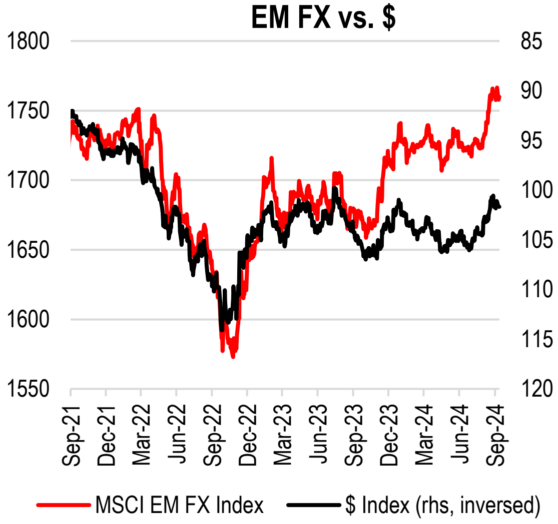
CEE avoids reduction of carry trade



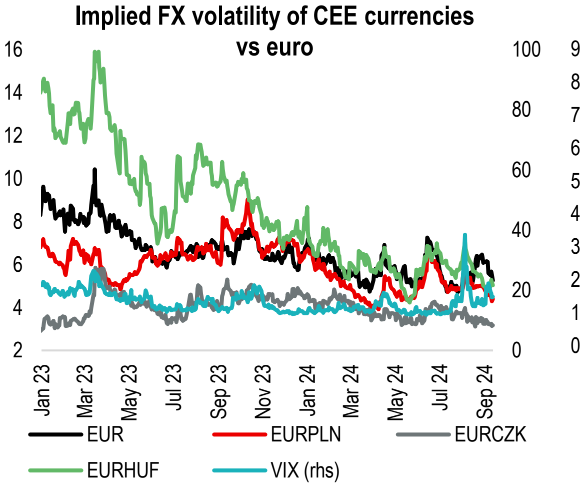
Decline of short JPY positions (CFTC) after rate hikes and BoJ interventions



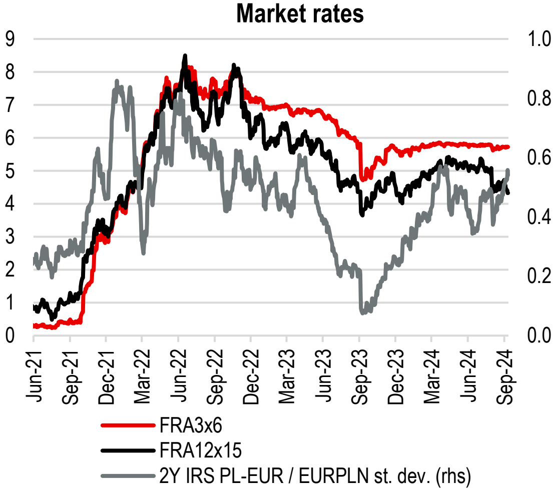
Weaker dollar after US data



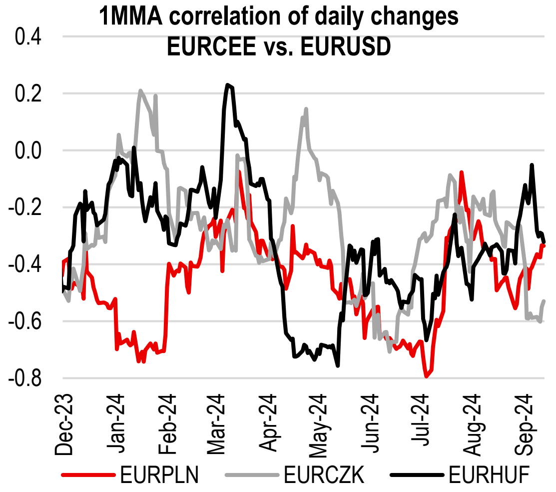
Lower volatility of CEE FX



Higher rates disparity after deeper decline in euro rate



PLN sensitivity to changes in the $ declined



Santander

Source: LSEG, NBP, Ministry of Finance, Santander

US elections and trade balance weakening

The market may increasingly pay attention to the US election, which may generate greater volatility in the face of high uncertainty about the outcome.

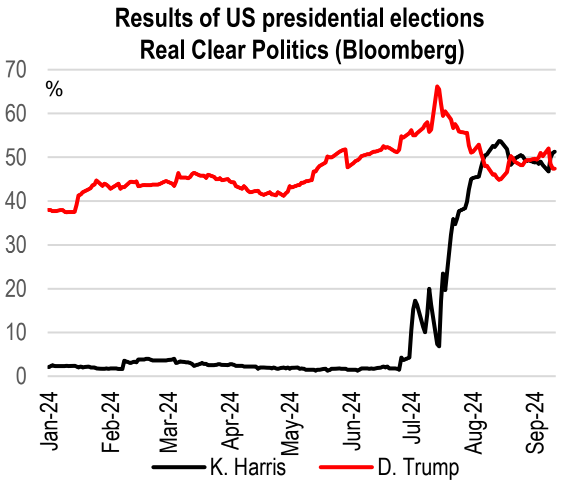
The zloty may be negatively impacted by a further deterioration in the current account balance later in the year with strong consumption supporting imports. Further strengthening of the yen may have a similar impact.

We assume that with a weak export performance, the Ministry of Finance will not be willing to exchange foreign currencies on the market (over EUR 11bn in MoF accounts after August). This is confirmed by the large increase in foreign exchange reserves in recent months.

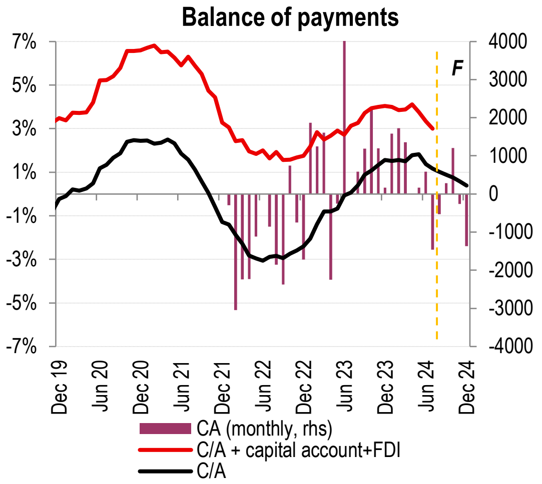
In the long run, the negative factors for the zloty may be offset by the positive ones. We assume a gradual weakening of the dollar in the coming quarters, due to the assumption that the impact of faster interest rate cuts than in the euro area will have a greater impact on EURUSD than the US election result.

We assume that the negative and positive factors will cancel each other out and we think that EURPLN will remain near 4.25-4.35 in the following quarters. A deepening interest rate disparity could push EURPLN towards 4.20 in H1 2025.

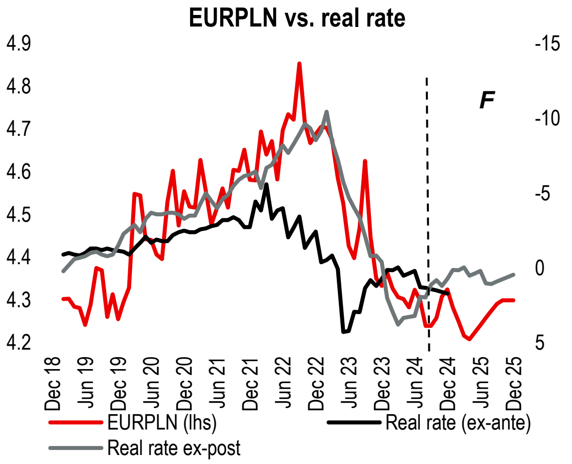
US elections may affect the $ and geopolitical situation



We expect weaker current account balance

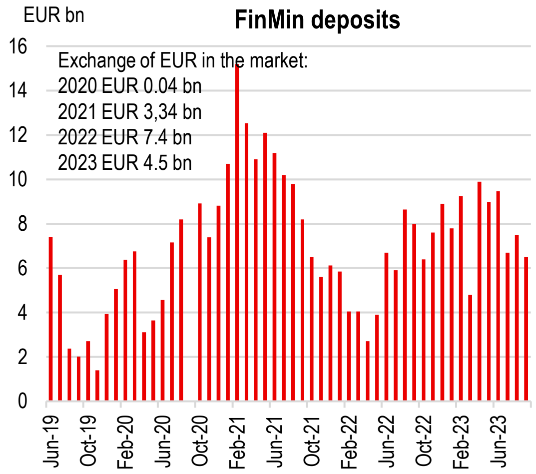


Real ex-post and ex-ante rates give no clear signal for the EURPLN

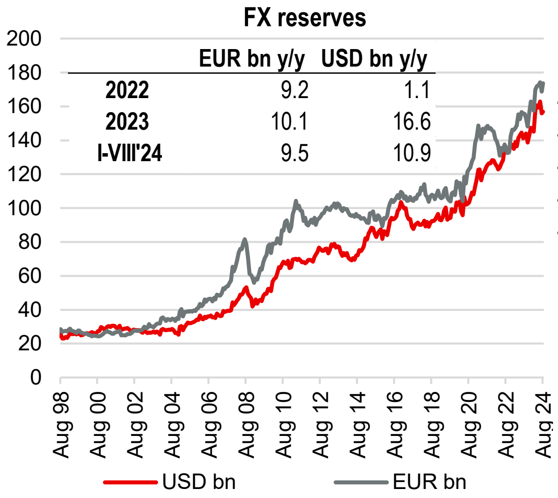


Source: based on Santander CPI forecast

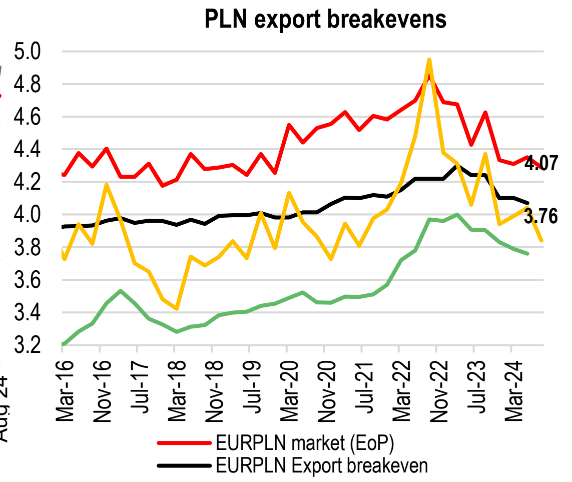
FX inflows to FinMin accounts will record high this year



FX reserves on the rise



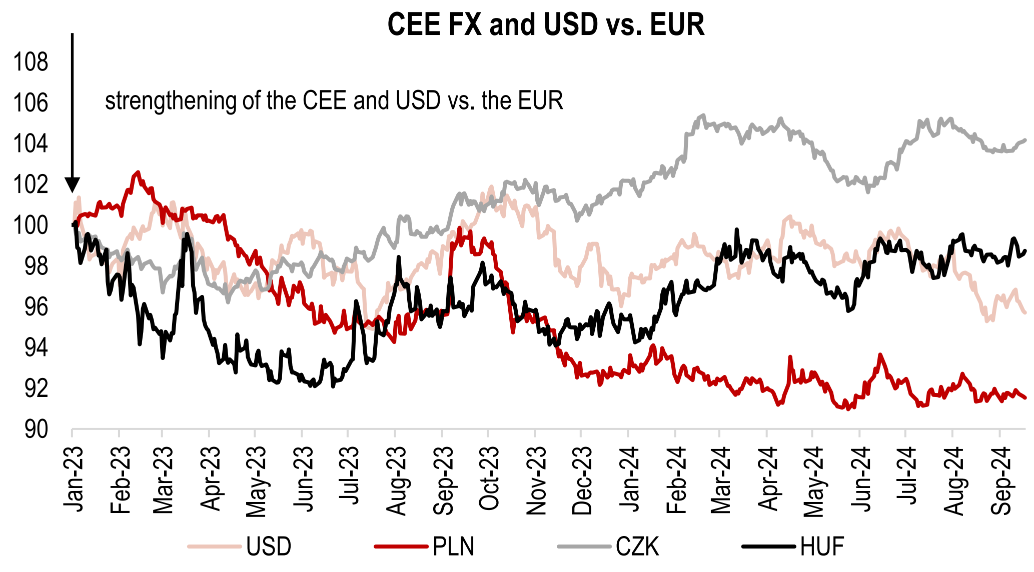
Market rate close to exports breakeven rate

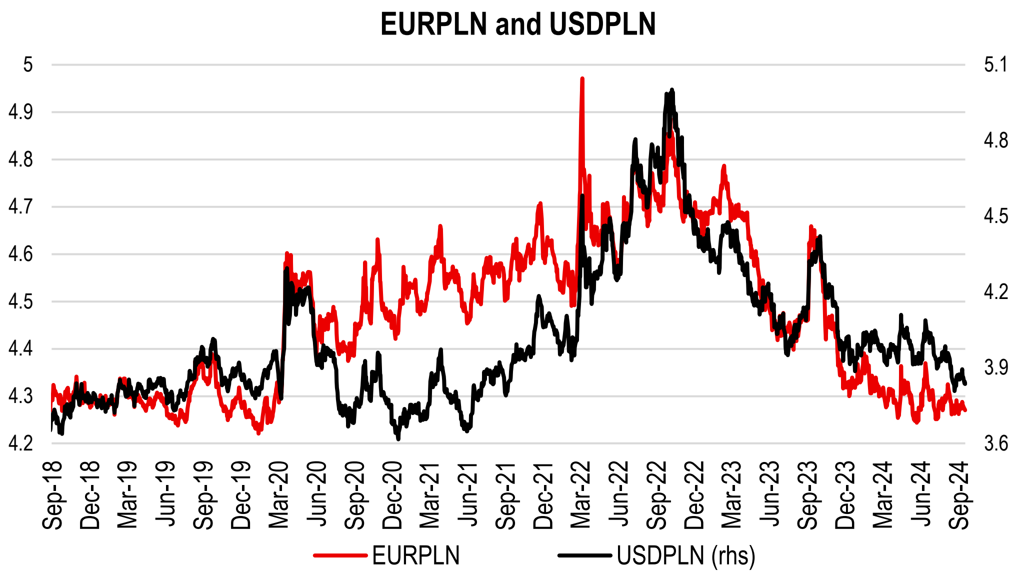


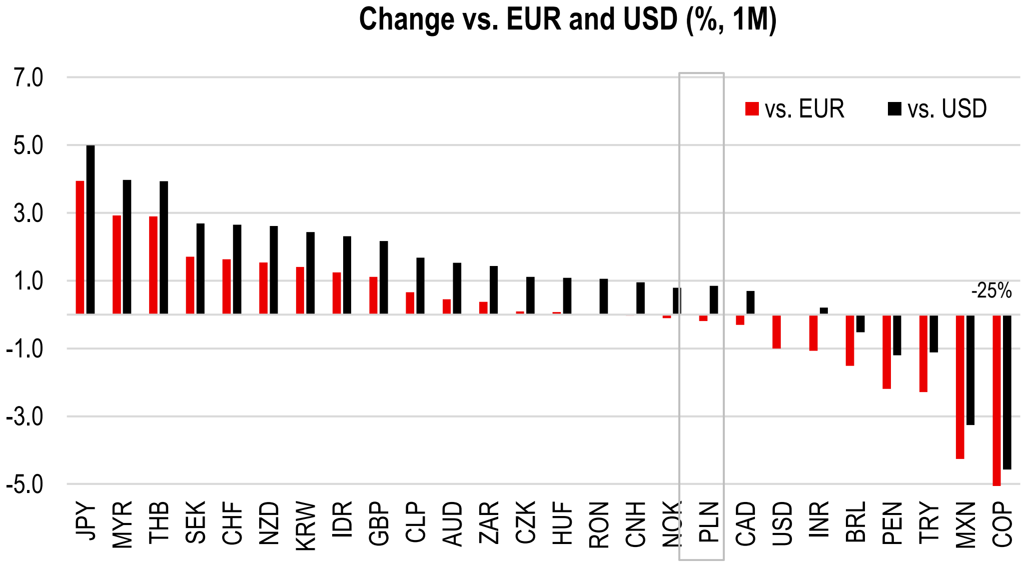
Santander

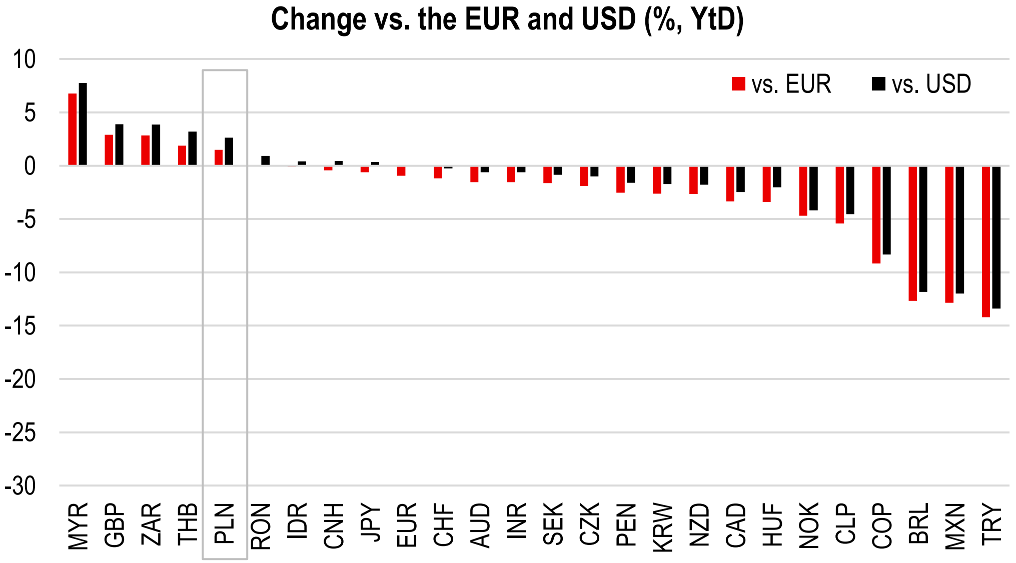
Source: LSEG, NBP, Ministry of Finance, Santander

FX market review









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Source: Bloomberg, LSEG, Santander

Forecasts

6

Economic Forecasts

		2022	2023	2024	2025	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25
GDP	PLNbn	3,074.8	3,410.1	3,625.9	3,911.3	833.1	860.1	914.0	1,018.6	905.9	935.2	977.4	1,092.8
GDP	% y/y	5.6	0.2	3.0	3.5	2.0	3.2	3.3	3.5	3.4	3.4	3.5	3.6
Domestic demand	% y/y	5.2	-3.2	4.4	4.9	1.7	4.3	5.7	5.4	5.5	5.3	4.6	4.4
Private consumption	% y/y	5.4	-1.0	4.4	2.9	4.6	4.7	3.2	5.1	3.5	3.3	2.5	2.5
Fixed investment	% y/y	2.7	13.1	2.5	7.1	-1.8	2.7	3.0	4.0	6.0	6.5	7.0	8.0
Industrial output	% y/y	10.4	-2.1	1.7	7.1	-0.1	1.9	2.3	2.8	4.5	7.2	8.5	8.4
Construction output	% y/y	7.7	4.8	-4.7	6.8	-8.7	-6.1	-4.3	-1.9	6.9	8.8	9.8	3.1
Retail sales (real terms)	% y/y	5.5	-3.6	4.1	5.0	5.0	4.5	2.8	4.3	3.5	3.0	5.2	8.0
Gross wages in national economy	% y/y	12.1	12.8	13.5	7.8	14.4	14.7	13.4	11.5	8.3	8.1	7.4	7.3
Employment in national economy	% y/y	2.0	0.6	-0.3	0.4	0.2	-0.7	-0.3	-0.2	0.3	0.3	0.4	0.4
Unemployment rate *	%	5.2	5.1	5.1	4.9	5.3	4.9	5.0	5.1	5.2	4.9	4.9	4.9
Current account balance	EURmn	-15,716	11,673	4,159	-4,995	4,663	743	-771	-476	2,098	-2,112	-2,969	-2,012
Current account balance	% GDP	-2.4	1.6	0.5	-0.5	1.5	1.4	1.0	0.5	0.2	-0.1	-0.4	-0.5
General government balance (ESA 2010)	% GDP	-3.4	-5.1	-5.7	-5.5	-	-	-	-	-	-	-	-
CPI	% y/y	14.3	11.6	3.7	4.7	2.9	2.5	4.5	5.1	5.6	5.4	4.0	3.8
CPI *	% y/y	16.6	6.2	5.3	3.7	2.0	2.6	4.9	5.3	5.7	5.5	4.0	3.7
CPI excluding food and energy prices	% y/y	9.1	10.2	4.4	4.3	5.4	3.8	4.0	4.4	4.4	4.6	4.2	3.9

* End of period; other variables – average in period
All shaded areas represent Santander's estimates

Source: GUS, NBP, Santander

Market Forecasts

		2022	2023	2024	2025	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25
Reference rate *	%	6.75	5.75	5.75	4.50	5.75	5.75	5.75	5.75	5.75	5.75	5.25	4.50
WIBOR 3M	%	6.02	6.52	5.86	5.50	5.86	5.86	5.85	5.85	5.85	5.77	5.48	4.89
Yield on 2-year T-bonds	%	6.35	5.67	4.98	4.12	5.05	5.28	4.90	4.69	4.58	4.20	3.90	3.79
Yield on 5-year T-bonds	%	6.36	5.66	5.28	4.93	5.19	5.55	5.24	5.14	5.23	5.05	4.80	4.63
Yield on 10-year T-bonds	%	6.10	5.83	5.47	5.02	5.36	5.70	5.45	5.38	5.30	5.10	4.93	4.75
2-year IRS	%	1.19	6.62	5.63	5.17	6.39	6.18	5.05	4.90	5.22	5.48	5.10	4.88
5-year IRS	%	1.69	5.92	5.01	4.73	5.53	5.37	4.59	4.57	4.70	5.13	4.61	4.46
10-year IRS	%	2.01	5.68	5.10	4.80	5.47	5.34	4.80	4.78	4.77	5.23	4.69	4.52
EUR/PLN	PLN	4.69	4.54	4.31	4.26	4.33	4.30	4.29	4.32	4.25	4.23	4.28	4.30
USD/PLN	PLN	4.46	4.20	3.95	3.69	3.99	4.00	3.91	3.89	3.76	3.67	3.67	3.68
CHF/PLN	PLN	4.67	4.68	4.41	4.03	4.57	4.42	4.45	4.19	4.07	4.00	4.01	4.02
GBP/PLN	PLN	5.31	5.50	5.22	5.02	5.06	5.04	5.04	4.93	4.83	4.77	4.81	4.84

* End of period; other variables – average in period
All shaded areas represent Santander's estimates

Source: NBP, Bloomberg, Santander

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This analysis is based on information available until **17.09.2024** has been prepared by:

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