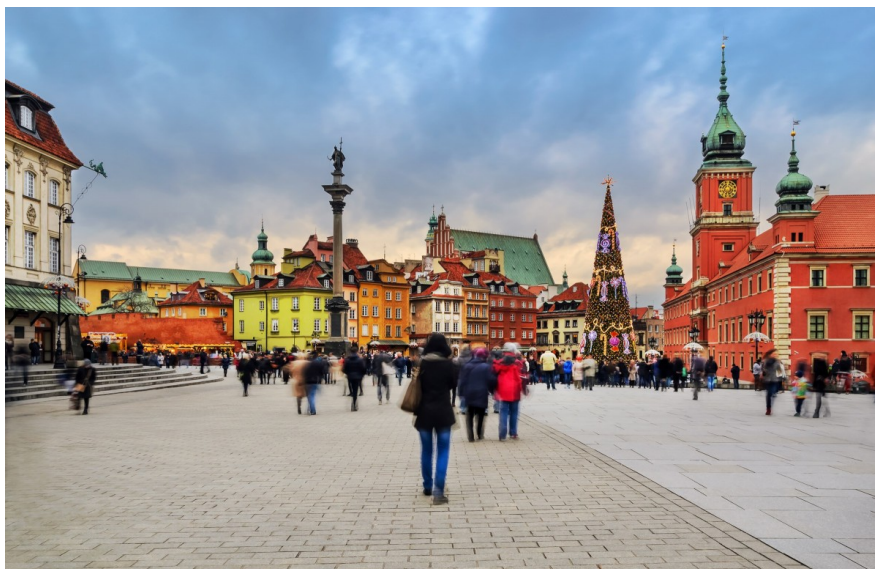


Polish first-quarter GDP shows disinflationary structure, with odds of a rate cut growing

Poland's statistics office has revised the first-quarter GDP estimate to -0.3% year-on-year. In 2023 as a whole, we expect economic growth to be around 1% on the back of the improving foreign trade balance



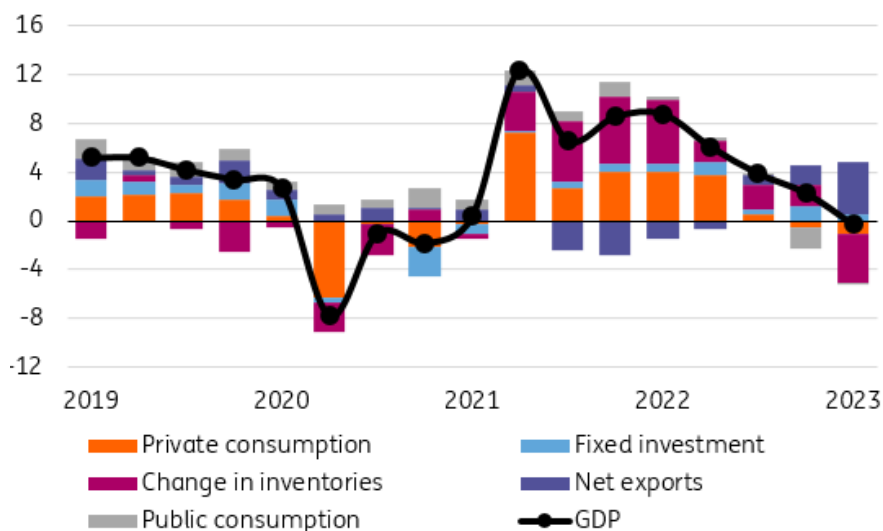
Seasonally adjusted GDP rose by a hefty 3.8% quarter-on-quarter in the first quarter of 2023, following a decline of 2.3% QoQ in the fourth quarter of last year. But seasonally adjusted data have shown surprisingly high volatility in recent quarters and should be taken with a pinch of salt.

The composition of the first quarter GDP was also revealed and shows a quite disinflationary picture, with some caveats. Domestic demand contracted by 5.2% year-on-year amid a deepening decline in consumption, which fell by 2.0% YoY, following a drop of 1.1% YoY in the fourth quarter of 2022. Investment activity continues to hold up well, expanding by 5.5% YoY in the first quarter of this year (vs +5.4% YoY increase in the fourth quarter of last year).

As expected, the change in inventories had a negative impact on activity, subtracting 4.1 percentage points from the annual GDP growth rate. This was offset by an improvement in the foreign trade balance. The positive impact of net exports on the change in annual GDP amounted

to 4.3 percentage points. The exports of goods and services increased by 3.2% YoY, while imports were 4.6% lower than a year earlier. The GDP deflator reached 15.6%.

Poland's GDP contracted in year-on-year terms in the first quarter



With respect to value added, we saw declines in trade and repair (-4.4% YoY), industry (-1.4% YoY) and transport and storage (-1.2% YoY). Most other sectors of the economy recorded increases.

2023 GDP and inflation outlook

As expected, the start of 2023 brought a decline in GDP on a year-on-year basis, but on a markedly smaller scale than we had feared. However, this does not mean that the outlook for the year as a whole is markedly better. High-frequency data point to weakness in retail sales, industry and housing construction in the second quarter. At the same time, growth in infrastructure-related construction continues. This is accompanied by continued elevated levels of inflation, which negatively affects consumers, dragging on the performance of the economy. On the other hand, investment activity will have a positive impact on the economy. Investments will most likely concentrate in large companies and the public sector (including defence spending). We expect that the main driving force of the economy will continue to be the improving foreign trade balance, mainly due to low imports.

The structure of GDP growth should be disinflationary this year due to the weakness of consumption, rising investment and the large role of foreign trade in shaping economic activity. Combined with the eradication of the direct impact of the energy shock, this should favour a further decline in inflation, with its pace being constrained by core inflation. The latter is more sticky than the headline CPI. One factor in the slower deceleration of core inflation will be a tight labour market and high wage growth. We forecast that by the end of 2023, both the headline CPI and core inflation may moderate to single-digit levels, but the outlook for 2024 is more uncertain.

National Bank of Poland rates outlook

Expectations for a cut by the National Bank of Poland (NBP) may rise (we see 30-40% odds in the

second half of the year). Theoretically, today's data show an improvement in the inflation outlook: a better GDP structure, month-on-month core CPI slowing, and NBP more vocal on rate cuts.

But the cross-country comparison (especially with the Czech Republic) suggests this could be a premature move.

Moreover, we still see important inflationary risks in the long term: a strong public acceptance of price increases, an election spending race, and strong investment mainly in energy (other sectors are still performing poorly to offset high costs).

In our view, an NBP cut would not help Polish government bonds (POLGBs) with longer maturities.

The premature cut would extend the return of CPI to the target, which is already a distant prospect (in 2025-26).

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