Snap | 20 March 2023 Poland

# Polish data points to first quarter GDP contraction and sizable price pressures

Industrial production fell on a yearly basis for the first time since the outbreak of the pandemic and data shows a strong decline in employment last month, which goes against the seasonal trend. This fits with the scenario of a decline in GDP on an annualised basis in the first quarter



## Industrial output negative in annual terms

Industrial production fell 1.2% year-on-year in February, following a 1.8% YoY increase in January (data revised from 2.6%), as calendar effects were no longer as favourable. Production growth in mining (+3.5% YoY) was accompanied by declines in other areas. In manufacturing, output shrank by 0.9% YoY with deep (more than 20% YoY) declines in metals and chemicals production. Production related to the automotive industry and electrical equipment (including batteries for electric vehicles) continued to grow, supported by better-functioning global value chains and a high backlog of orders in the automotive sector.

Despite signs of stabilisation in the manufacturing sector (slower decline in new orders reported by purchasing managers), production activity is stabilising at a relatively low level, and in the first quarter, industrial value added is likely to be at a lower level than in the same period last year.

Snap | 20 March 2023 1

Combined with the weakness in trade, this will translate into an annualised decline in GDP in the first quarter of this year. We currently estimate this at around 1%.

# Employment decelerates, solid wage growth, but still below inflation

In February, employment in the business sector increased by just 0.8% YoY, weaker than a month ago (1.1%) and below the consensus (1.0%). On a sequential month-on-month basis, employment dropped by about 4,000 full-time equivalents, which goes against the seasonal growth trend and was a negative surprise.

Manufacturing employment continues to decelerate (22,000 jobs were lost from the peak in April 2022 to February), with furniture and textile manufacturing, among others, continuing to perform very poorly. Service industries, however, remain strong, especially information and communication, which hit new employment records. Industrial companies are most likely adjusting capacity to weakening demand, given weak household spending, among other factors, and the collapse in the housing market, which is spilling over to related industries.

The strong condition of services is likely in part the result of the further relocation of business to Poland from neighbouring countries in the East.

Keep in mind, however, that the data does not include refugees employed in Poland on the basis of special permits (i.e., not under a labour contract). According to surveys, they are finding employment in simple jobs, among others. In view of the very high government estimates of refugees taking up employment, this may suggest a substitution of domestic workers in some industrial sectors.

Average wages in the business sector, however, rose as much as 13.6% YoY, similar to January (13.5%) and better than expectations (12.0%). Wage pressures remain strong, both due to the tight labour market in some industries and the historically high minimum wage hike from January (by 15.9%). However, wage growth continues to lag behind inflation (18.4% YoY in February) uninterrupted since July 2022. As a result, we are seeing a loss of real household purchasing power. In addition to weak sentiment (e.g., planned purchases of durable goods), this had a decisive impact on the deceleration of consumer spending in the fourth quarter and most likely in the first as well.

### Monetary policy conclusions

The overall picture that emerges from the data is unfavourable. The magnitude of the cost shock has been such that companies are still continuing to raise prices (this is shown by core CPI inflation and producer price inflation PPI for January-February). At the same time, the weakening of consumer demand so far (YoY consumption decline since 4Q22) has been insufficient to slow the inflationary process. Reports from businesses suggest a demand barrier to further price hikes is already emerging, but for now, this is not evident in the data.

At the same time, data from the labour market shows that companies are starting to adjust to the economic slowdown through employment (the drop in February is worrisome) because the pace of wages is de facto determined by the strong increase in the minimum wage and inflation expectations (the CSO wrote a commentary about "premiums due to inflation"). As a result, the pace of expected disinflation may be slow, supporting our concern about persistently high core

Snap | 20 March 2023 2

inflation.

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Snap | 20 March 2023 3