Poland

Outlook 2023

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Table of contents

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1.0 Executive Summary

‘Every year is like no other but some years are even more like no other’ is perhaps the best summary of what is to come in 2023. A war next door, polycrisis at home, and an election to top it all off are nearly certain to result in a year rife with volatility and uncertainty.

Politics will trump everything else in Poland in 2023, as the ruling right-wing coalition of the Eurosceptic United Right – made up of Law and Justice (PiS) and its more radical partner United Poland – will scramble to secure an unprecedented third straight term in office.

Should they win, further consolidation of power and more democratic backsliding are in store. In fact, governance could deteriorate well before the actual election, as the ruling camp will not hold back – or so it is feared – from anything to make sure it defeats the opposition.

A win for the opposition will not, of course, magically bring Poland back to the pre-PiS era (which had so many problems that it proved a fertile ground for PiS to win in the first place). A new government will face a PiS-linked president until 2025 and a PiS-linked head of the central bank, to name just two centres of power that will remain under the influence of the incumbent government.

Economy-wise, Poland is in for a year of faltering growth and still elevated inflation, both of which could dent PiS’ chances to win. On the other hand, if analysts’ prediction of a returning economic rebound in the second half of 2023 prove true, the ruling party may well try to sell the “we have got you through the worst safely” story in the campaign.

A big question mark is Russia’s war in neighbouring Ukraine. The winter months could increase the inflow of refugees to a country struggling economically and in which political acrimony is only set to intensify ahead of the election.

On the EU front, the government must scramble to make sure that billions from the bloc’s pandemic recovery fund finally start flowing. That will be subject to much politicking – including possible tactical support from the opposition for legislative changes necessary for the funds to arrive.

If the funds are lost, a bitter blame game will ensue and could strengthen the currently small anti-EU sentiment in the general population.

2.0 Political outlook

In a country where polarisation matches that of the UK or the US, an election year will only give rise to more polarisation and accompanying acrimony. The actual vote will not take place until around October – the exact date will be set by President Andrzej Duda in the summer – but campaigning had begun already in 2022 as economic and political crises converged in the wake of Russia's war against Ukraine.

The election's framing is simple. The ruling United Right coalition aims at winning an unprecedented third straight term in office. The opposition wants to take the power back from PiS, which, it says, has ruined the economy and pushed it to the very margins of the European Union by subjugating the country's judiciary, trampling on media freedom, discriminating against minorities and refugees, all the while beating the war drums as Russian missiles keep raining down on neighbouring Ukraine.

The panoply of crises might suggest that voting patterns are in for a tectonic shift back to the centre-right led by the Civic Coalition's Donald Tusk (with the Left maybe getting a couple of seats in the new government).

But fantasy it does not need to be; PiS may have weakened in the polls but it has not collapsed and if it can weather the difficulties of the winter, the election's outcome is anything but given.

That is a big *if*, of course. The ruling party is being hammered for rampant inflation and what seems a botched response to it by the PiS-friendly National Bank of Poland (NBP) that has plunged the economy into a downturn, the real extent of which is only expected to become clear in 2023.

PiS has reasons to expect that its popularity will dwindle further as the cost of living crisis gathers momentum. If winter proves harsh, even the most dedicated voters could eventually question their allegiance to the ruling party as prices soar for essentials such as food, gasoline, or coal for heating (securing the affordable supply of which PiS had made one of its priorities, with mixed results). Depending on how deep the economic downturn will turn out to be, a possible rise in the unemployment rate is another headache for PiS.

In an election year, PiS will be tempted to further loosen fiscal policy and will most certainly try doing so. But it will have less and less wiggle room unless, warns the opposition, it wants the energy and economic crises to become underpinned by a financial one. The latter could be further exacerbated by the stalemate over €36bn from the EU's pandemic recovery fund, the disbursement of which is on hold as Brussels considers PiS' judiciary reforms anti-democratic and in breach of EU laws.

If the ruling party thinks it can weather all that, they may not be being irrational. Inflation is already showing signs of abating, feeble as they may be. Poland's economy is diverse enough to give analysts grounds to say that it could start rebounding from the bottom of the cycle (expected in Q1) as soon as around June. Any signs of economic recovery in the Eurozone will only improve the odds for a relatively clean escape from the current melee.

PiS also needs to make peace with its increasingly unruly coalition partner, United Poland, a small party that nonetheless has enough MPs to guarantee the government majority in the parliament. United Poland has dug in its heels over the reform of the judiciary, painting the EU as a Germany-controlled behemoth on a mission to end nation-states, no less.

The rogue coalition partner has PiS in a difficult position. The party keeps manoeuvering between what seems an achievable compromise with the EU over the recovery fund money and cosying up to United Poland over the EU's alleged usurpation of powers and, more generally, the perceived attempts by the West at uprooting traditional gender roles.

The staunchly pro-EU opposition is not without problems, either. The key issue is whether the main opposition parties – Tusk's Civic Coalition, its fellow yet separate centrist liberals from Polska 2050, the Left, and the agrarian party PSL – should run as one, giving voters a clean-cut choice between continuation and change. Simulations of how Poland's election system could work in favour – or against – the single opposition block do not offer decisive answers.

"Although opposition parties know that contesting the next election as separate lists favours the right-wing incumbent, a single united bloc remains extremely unlikely given their diverse electorates and because it would mean accepting [Civic Coalition's] hegemony," political scientist Aleks Szczerbiak wrote in an analysis earlier this year.

"Most have adopted a wait-and-see approach, and final decisions about the configuration of opposition lists may not be taken until spring," Szczerbiak added.

Amidst all the crises and uncertainty brought by Russia's war in Ukraine, Poland taking in well over a million Ukrainian war refugees without much friction seems a small miracle. Poles opened up their houses and wallets to help in the weeks and months immediately after the invasion.

Nearly a year on, Ukrainians have blended in, finding jobs and sending their children to Polish schools. Joint effort by the people and the government – which granted refugees most basic rights that Poles have – has not resulted in a backlash yet. The question is open whether a deepening economic crisis will make nationalistic fervour a factor in politics.

3.0 Macro Economy

Poland: key economic figures and forecasts, e = estimate

	2016	2017	2018	2019	2020	2021	2022	2023 (e)
Nominal GDP (EUR bn)	424.3	464.5	496	525.1	554.1	582.8	>640 (e)	~650
Real GDP (% y/y)	3.1	4.9	5.2	4.3	3.3	3.2	~4 (e)	~1
Industrial output (% y/y)	2.9	6.5	6	4.2	3.5	4	10.9[1]	~2
Unemployment rate (avg, %)	8.9	7.3	6.1	5.5	5.7	6.3	5.1[2]	~5.5
Nominal industrial wages (% y/y)	4.1	5.6	7.1	6.6	6.5	5.8	13.4[3]	~11
Producer prices (avg, % y/y)	-0.1	2.9	2.2	1.5	2	n.a.	22.6[4]	~15
Consumer prices (avg, % y/y)	-0.6	2	1.7	2.3	3	2.1	~15 (e)	~14
Consumer prices (eop, % y/y)	0.8	2.1	1.1	2.7	2.5	2	~17 (e)	~10
General government balance (% of GDP)	-2.5	-1.5	-0.2	-0.7	-7.1	-1.8	-3.5 (e)	~-5
Public debt (% of GDP)	54.1	50.6	48.9	47	44.9	43	50.3[5]	52.7
Current account balance (% of GDP)	-0.3	0.1	-0.7	0	-0.4	-0.1	-4 (e)	-2.7
Official FX reserves (EUR bn)	108.4	94.3	102.3	109	112	146.6	~156.7[6]	~180
Gross foreign debt (% of GDP)	74.5	72.6	64.5	59.8	56.9	54.9	53[7]	n/a

[1] January-November
[2] November
[3] January-November
[4] January-November
[5] As at the end of Q3 2022
[6] November
[7] As at the end of Q3 2022

EUR/PLN (avg)	4.36	4.26	4.26	4.3	4.32	4.33	4.68[8]	~4.5
USD/PLN (avg)	3.95	3.78	3.61	3.81	3.82	3.69	4.4[9]	~4.1
Sources: GUS, NBP, Ebury, Bank Pekao SA, Ministry of Finance, PKO BP, Trading Economics,								

3.1 GDP growth

The evergreen question “How high will Poland's GDP grow next year?” is in for a rare revision in 2023 to “How severe the slowdown will be?” From a number of forecasts already out, it is clear that while 2022 is still going to be a fairly decent year, with the economy expanding within the 4%-5% range, the coming year will see the growth rate dwindle to around 1%. According to the NBP, the economy might even contract next year, although the central bank’s main projection is still for feeble growth.

Analysts are in broad agreement that what will drive the slowdown in 2023 will be “high inflation, monetary policy tightening, negative confidence effects related to the war in Ukraine, and slowing demand in key trading partners”, as put by the World Bank.

Supply-side disruptions, high input costs, and uncertainty related to the war in Ukraine will affect private investments. On the other hand, the National Recovery and Resilience Plan – a blueprint to spend €36bn from the European Union’s pandemic recovery fund – is expected to support public investment, but it risks delays in disbursements because of European Commission concerns over violations of the rule of law.

Consumption-wise, higher energy and food prices will weigh on household demand and will affect heavily poorer segments, who devote 50% of their monthly spending to food and energy. Inflationary pressures are expected to outstrip minimum wage growth, leading to a decline in the real minimum wage in 2023. That will be moderated by the phased adjustment of the minimum wage taking place in January and July.

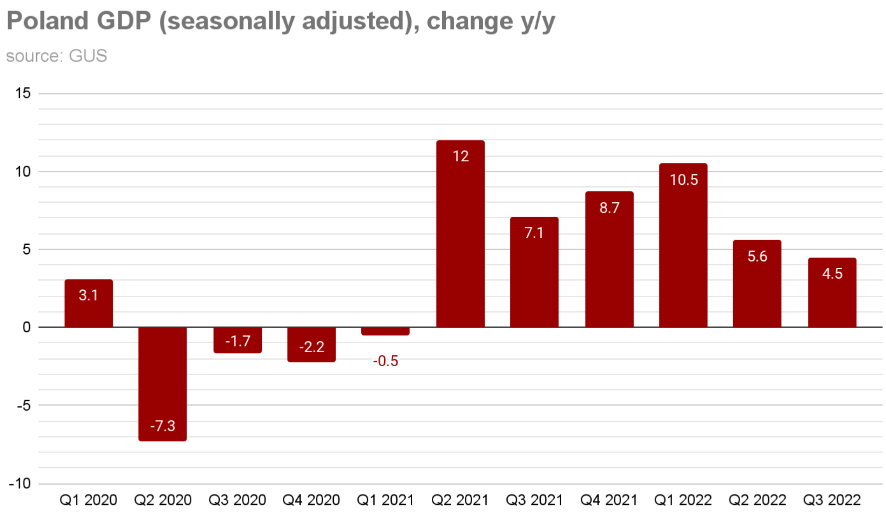
The slowdown in household spending and private investment look poised to turn out particularly striking in the first half of 2023. Already in the third quarter of 2022, household consumption growth eased 5.5pp to just 0.9% y/y while investment managed an expansion of just 2% y/y, down from a gain of 6.6% y/y in the second quarter.

Such a growth structure is, on the one hand, more disinflationary than expected (which is good) but, some analysts warn, it is also indicative of more rapid than expected “destruction of demand in the economy,”

[8] As of December 31, 2022
[9] As of December 31, 2022

according to mBank.

Zooming in on early 2023 only, Q1 appears likely to post negative GDP growth both in y/y and q/q terms. That said, a gradual economic recovery could possibly arrive at the turn of the second and third quarters already, according to Santander Bank Polska.



3.2 External environment

Just when it seemed that Poland's economy was on a (fairly) clear path towards a post-pandemic recovery, Russian President Vladimir Putin ordered tanks to roll into Ukraine. That upended all outlooks for 2022 and the crises that the war unleashed are likely to continue affecting the global economy in 2023 as well.

An EU member state, Poland stands to experience many of the bloc's problems. Poland's economy is also highly dependent on how healthy the economy of the Eurozone and the EU's major economies are.

"The EU is among the most exposed economies, due to its geographical proximity to the war and heavy – albeit much diminishing – reliance on imports of fossil fuels," the European Commission wrote in its autumn economic outlook.

"The contraction of economic activity is set to continue in the first quarter of next year. The EU and euro area, and most member states, are therefore expected to experience a technical recession this winter," the Commission also said.

Growth would return in spring, as inflation progressively relaxes its grip on the economy. However, with powerful headwinds still holding back demand, the EU economy is set to manage only lacklustre growth. For 2023 as a whole, real GDP growth in both the EU and euro area is expected at a mediocre 0.3%, which is well below the respective 1.5% and 1.4% expected only slightly earlier in the summer forecasts.

Poland's top export markets will not be exceptions to the overall bleak picture of the economy in 2023. Germany is in for a recession of -0.6% while the Czech Republic and France will post feeble growth of 0.4% and 0.1%, respectively.

Poland's current account has run a deficit throughout most of 2022. The 12-month deficit increased 0.2pp to 3.9% of GDP in October, according to the National Bank of Poland's data published in December.

This was due to the deepening of the goods trade deficit to 4% of GDP from 3.9% in September, as well as to increased deficits on the primary and secondary income accounts. The record-high surplus in trade in services, which accounted for 5% of GDP, offset deficit trends to an extent.

Analysts expect that the current account deficit will continue to deteriorate and may exceed 4% of GDP in late 2022/early 2023 – but that should not become a threat to the external balance of the economy. Later on in 2023, the deficit is expected to return to below 4% of GDP.

"In 2023, the trade gap should narrow from around 4.2% of GDP to 3.2% of GDP as Polish exports are usually resilient to economic slowdown, while imports are more sensitive to a deterioration in economic conditions," according to ING.

"Terms of trade are likely to stabilise, and energy imports are likely to remain at elevated levels. At the same time, high spending on military equipment will push imports up," the Dutch bank said.

3.3 Inflation and monetary policy

Poland's inflation showed the first feeble signs of abating in November when the Consumer Price Index (CPI) eased growth to (a still shockingly high) 17.4% y/y. Price growth is expected to return in early 2023 on the back of higher VAT rates on fuels and electricity but that is forecast to be inflation's last bout. The average inflation rate is currently predicted at around 11%-12% next year – high, but still down from around the 14% average expected in 2022. By December, the CPI will have descended to single-digit levels, analysts say.

With price growth easing – albeit incrementally – the NBP is likely to wait it out without hiking its reference rate so as not to hurt the economy too much.

The central bank's aggressive tightening saw the pandemic-era interest rate of just 0.1% blown up to a 20-year high of 6.75% between October 2021 and September 2021 before pausing, as the rate setters' focus clearly shifted from containing inflation to avoiding recession. As of December 2022, interest rates remained unchanged throughout three consecutive meetings of the Monetary Policy Council, the NBP's rate-setting body.

The NBP's controversial head Adam Glapinski might say that three months of holding up rate hikes is only a "pause" but most analysts are nearly certain that – notwithstanding an unexpected inflation spurt – interest rates will remain unchanged throughout 2023.

A discussion about *cutting* rates might even return in the latter half of the year once and if inflation does show a clear downward trend while the economy continues to sputter.

3.4 Debt

Poland holds an 'A2' rating with stable outlook at Moody's, 'A-' with stable outlook at S&P Global, and 'A-' also with stable outlook at Fitch.

There are relatively small differences in how major rating agencies view Poland's economy and the regulatory and political environment influencing it. The Polish economy is diversified while the country benefits from a "fairly sound macroeconomic framework anchored by EU membership and lower public debt levels than rated peers", according to Fitch.

These positives are offset to an extent by "lower governance indicators and income levels than the 'A' median", Fitch also said in its rating update published in July.

Rating agencies in general are confident of the Polish economy's resilience to external shocks and growing macro-economic challenges thanks to the stable fiscal position and an improved external balance sheet.

"Under our baseline scenario where the fiscal deficit gradually narrows to 2.5% of GDP in 2024 and nominal GDP growth remains high, public debt/GDP will continue to fall modestly to 48.8% by end-2024 (compared with the current 'A' median of 59.2%)," said Fitch.

"We expect interest costs to start rising from 2022 given increasing yields but financing risks in the short term are moderated by stable cash buffers (PLN138 billion in June, 4.7% of GDP) and by the government having financed 85% of its 2022 needs already. Financing costs are likely to be higher than in recent years," Fitch also said in its July update.

According to S&P, Poland's ratings "could come under pressure if the negative impact of the conflict in Ukraine were more severe than we currently expect, resulting in a much weaker medium-term growth outlook”.

"Ratings downside could also materialise in the event of a material and protracted reduction in EU transfers to Poland as a result of continuous political tensions between Poland and EU authorities, for example," S&P said in an update released in September.

However, it remains plausible that “once the effects of the conflict [in Ukraine] subside, Poland resumed its strong economic performance, and the government's fiscal performance proved stronger than we currently project” and that Poland’s rating could be upgraded.

Not everyone shares the agencies’ outlook on Poland’s fiscal policy, however.

“In fiscal policy, we believe that Poland will be a negative outlier next year within the region. In an election year, government borrowing needs are a major risk,” ING wrote in December.

4.0 Real Economy

4.1 Retail

Retail sales growing below 5% y/y since June point to a weakened sector. High inflation, which began outpacing wage growth in companies in May, and high interest rates of the central bank, which pushed mortgage repayments through the roof, made Poles wary of spending.

That generated pressure on consumer spending as the resulting gap in real incomes could not be offset by one-off rises in pension benefits and tax cuts. At the same time, households largely consumed the savings accumulated during the pandemic.

With inflation persisting throughout 2023 amidst an economic slowdown that will push down wages, retail sales could continue their mediocre run until the economy begins a recovery, which analysts generally expect at the turn of Q2 and Q3.

Before that happens, however, analysts expect sales of cars, fuels, furniture, audio and video equipment, and domestic appliances to remain weak. Sales of essentials – textiles, clothing and footwear, as well as food, pharmaceuticals and cosmetics – should continue registering growth, backed by over one million Ukrainian refugees who have made Poland their home, temporarily at least.

4.2 Banks

Poland's financial system is "stable but its prospects have worsened", the NBP said in the December assessment of the country's financial stability. Indeed, Polish banks, which initially raked in extra profit on the back of fast-rising interest rates, are coming face to face with the problems presented by shrinking consumer and corporate lending, the collapse of the housing credit, and external measures aimed at lessening the impact of the economic crisis on the people.

"The legal risk of FX housing loans remains the main risk to Poland's financial stability," the NBP said in its financial stability report. According to a recent analysis by the *Financial Times*, Polish banks have set aside PLN30bn in legal risk provisioning linked to FX housing loans. That could blow up to an estimated PLN100bn if the Court of Justice of the EU makes a judgement in favour of the borrowers.

“Banks’ remedial actions, including the provisions they have created and the settlement process, increase their resilience to the risk,” according to the NBP.

That said, recent comments by Jacek Jastrzebski, the head of the financial market watchdog KNF, warned of the CJEU judgement’s deeply negative impact on the financial system, possibly to the point of “breakdown”.

FX loans risk aside, the current level of capital held by the banking sector is sufficient to absorb credit losses even when macroeconomic shock scenarios are assumed, according to the NBP.

Still, the expected decline in excess capital above the combined capital requirements may “reduce banks’ propensity and capacity to provide financing to the economy,” the central bank warned.

Banks will also continue to finance the government’s so-called “credit vacation” scheme, which assumes that all mortgage borrowers – regardless of their financial situation – could have four repayments (one in each quarter) suspended in 2023. That is the continuation of the scheme that began in 2022 and is expected to cost banks a total of PLN21.3bn - PLN27.9bn.

Another challenge Polish banks might face in the new year is the rise of new problems with housing loans, only this time the ones denominated in Polish zloty.

“Recently, there have been attempts to challenge zloty loan agreements based on the WIBOR rate, which have been in force and remained unchallenged for years,” the NBP said in its stability report.

“Intensification of these attempts may contribute to undermining confidence in the credit contract itself and harm economic growth,” the central bank added.

If 2022 is anything to go by, investors in banking assets are in for a rough ride again. The sectoral stock index, WIG-Banki, fell nearly 31% by mid-December in what was a difficult year but still one without a fully-fledged economic slowdown.

4.3 Industry

Throughout much of 2022, Poland’s industrial sector used to consistently outdo what the PMI readings suggested was its condition. But towards the end of the year, the reserves have begun to dry up in yet another harbinger of economic slowdown and abating inflation. Industrial output’s growth rate had been slowing down since

September, with analysts expecting that negative trends in the sector would continue into early 2023 at least. Domestic and foreign demand are predicted to keep on losing stamina at the turn of 2022 and 2023, which would weaken industrial activity further in November and December. Year-on-year contraction in industrial output is a possibility in the first quarter of 2023.

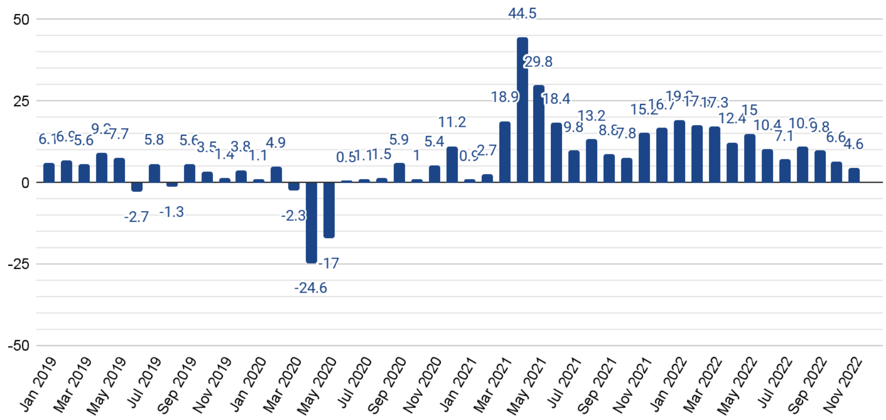
If there is a cause for optimism, it is in the same PMI data. The PMI might have painted an overly pessimistic picture of Poland's industry here and now but analysts believe that some of the trends that the index has hinted at will become more pronounced in the coming months.

"Firstly, the scale of disturbances in supply chains is decreasing. Secondly, cost inflation is weakening ... Third, business optimism has increased although it is still close to historical lows," Poland's PKO BP bank said in a comment in December.

Some analysts also pointed to a steep increase in production of investment goods in Q3 2022 but that is unlikely to last in 2023 (or at least in the first half of 2023) as it was likely a realisation of earlier demand.

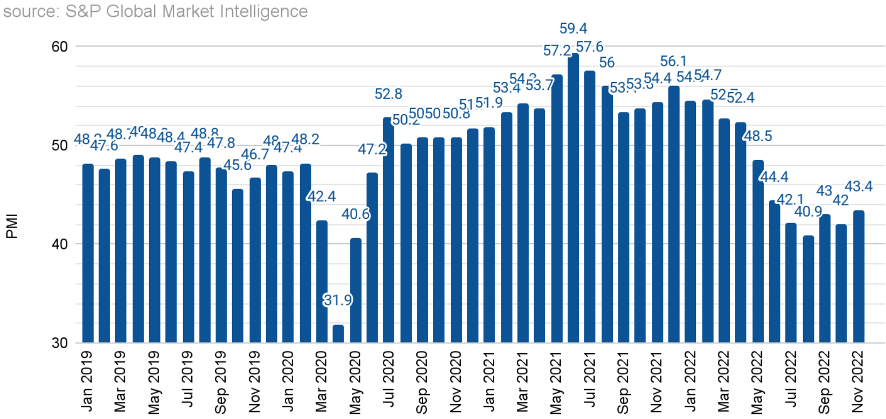
Poland industrial production y/y

source: GUS



Poland PMI

source: S&P Global Market Intelligence



4.4 Energy and power

Arguably, Poland's energy and power sector is in for two major events in 2023. The big breakthrough should be a government decision on the financing model of Poland's first nuclear power plant. The decision will be an effect of the (currently ongoing) talks between the government, the US nuclear technology provider for the plant, Westinghouse Electric, and the project's possible stakeholders like pension funds. Securing the financing model will further strengthen the fundamentals of the project alongside key paperwork: an environmental decision and a location decision. From then on, necessary but minor work is expected to push the project steadily towards an actual kick-off of construction works in 2026. The plant is expected to go on-grid in 2033.

Risks to Poland's nuclear plans in 2023 include a change in the government, even though the likelihood that will kill the project appears low. Despite political polarisation permeating nearly every aspect of life in Poland, the opposition has spoken favourably of nuclear power, recognising – not without difficulty – that an energy mix relying too much on renewables can only work with fossil fuels-fired back-up.

That said, until the first reactor is up and running in 2033 (that is the plan at least), Poland *is* going to build a wind- and solar-power energy generation fleet. To that end, the PiS government said it would remove the infamous rule that no wind turbine can be closer to any residential area than distance equal to 10 times the turbine's height. Introduced in 2016, the rule effectively locked out nearly all possible locations for the development of onshore wind power.

Both the progress in the development of nuclear power and the U-turn on onshore wind come in the context of Poland's coal-heavy energy mix having to undergo a dramatic transformation in line with the EU's climate policy, however begrudgingly Poland is going to meet its goals.

Until the first new onshore wind farms start feeding electricity to the grid and until the first nuclear reactor fires up, Poland will remain one of the EU's dirtiest economies, climate-wise. At the end of 2022, coal and lignite were responsible for generating some 70% of the country's electricity – and that will likely remain the figure at the end of 2023.

The coal sector is not going to give up, either. As Russia's war in Ukraine highlights the importance of energy security, Polish miners have been quick to talk up coal as the foundation of Poland's economy. In an election year, they are certain to find political backers, too, possibly making Upper Silesia – where the bulk of coal production is taking place – once again a pivotal battleground for power.

Electricity prices and, more broadly, the cost of energy, will also be a hot political issue in 2023. The government attempted to defuse problems by freezing the price of megawatt-hour (MWh) of electricity for households and companies (except for large corporates); gas prices were also capped for households and so-called vulnerable users like hospitals or schools. The government said that there was "no room" for capping gas prices for companies as well.

Even with these measures in place, higher costs of energy will seep through to end users indirectly, possibly exacerbating the cost of living crisis. With the government's room for response getting limited due to the increasingly difficult fiscal situation, its political standing could well become precarious unless an economic recovery arrives faster than expected and is more pronounced.

4.5 Construction

The October bout of activity in the construction sector was likely the last one for the foreseeable future. "We expect negative growth in construction output ... for most of 2023 due to weak investor sentiment in the private sector and the government's declaration to limit public investment next year as part of seeking savings," Santander Bank Polska said in December.

The residential construction segment appears poised to be a drag on the industry's performance in 2023 in particular. A strong increase in prices of building materials and rising barriers to demand – due to a reduced availability of housing loans and a decrease in cash demand for apartments related to the uncertainty accompanying the war in Ukraine – are expected to drive a gradual decline in construction activity in the new year.

Another adverse factor will be the EU funds, or, more precisely, the in-between period next year after "old" EU-funded projects are completed while "new" ones from the bloc's budget for 2021-2027 have not been started yet.

The new perspective of the EU budget for 2021-2027 remains in the implementation phase, which is not supportive of infrastructural investments. "Weak activity in construction will stay with us for longer and the sector should not significantly support GDP growth in the coming quarters," Bank Millennium wrote in December.

In short, a rebound in the construction industry will come once the cycle reversal in public investment becomes reality, the EU funds will start flowing, and the central bank's rates will fall (or at least there are solid grounds for them to start falling).

5.0 Fiscal policy outlook

The lower house of the Polish parliament, the Sejm, passed the 2023 budget bill on December 15. While the bill still has to go through the opposition-controlled Senate, it is unlikely that it will be subject to any major changes.

The budget bill assumes revenues at PLN604.7bn, which is 22% more than in the previous year's plan, the increase owing in large part to inflation. Expenditure has been planned at PLN672.7bn, an increase of 28% versus the 2022 budget bill. The resulting deficit of PLN68bn marks a whopping increase of 127.7% versus 2022.

The government assumes that the deficit of the public finance sector will be 4.5% of GDP, while the debt of the general government sector will come in at 53.3% of GDP.

The budget bill also assumes that GDP in 2023 will increase by 1.7 percent, and the average annual inflation will amount to 9.8 percent. Both indicators are at odds with most forecasts, which predict growth of around 1% only, while inflation is expected to average somewhere between 13% and 14% (both forecasts are highly uncertain, given a lack of clarity on the course of Russia's war in Ukraine and Poland's tumultuous political year due to the election).

A key increase in budgetary spending plans is boosting outlays for defence to 3% of GDP – 1pp above Nato-recommended level – as Poland is building one of the EU's largest and arguably most technologically advanced armies. The context for that being obviously Russia's aggression against Ukraine.

Critics say that the budget bill does not tell the whole story of what the government plans, expenditure-wise, in the new year. The bill does not contain financial plans of state entities like the Polish Development Fund, for example, which has led to accusations that the government is channelling billions outside of the parliament's control.

6.0 Markets outlook

6.1 FX

The zloty may be long-term undervalued against the euro by a margin of around 3% (according to ING's long-term equilibrium €/PLN model).

"We attribute this to a mix of risks, both external, particularly the conflict in Ukraine, and internal, particularly tensions with the EU, elevated CPI risk and
expansionary fiscal policy undermining POLGBs [government bonds]," ING said in December.

Some analysts say that Russia's war in Ukraine taking a turn for the worse – a renewed Russian offensive, more economic pressure on the EU – could weaken the zloty again after it regained some strength in late 2022 against the euro and other major currencies.

A lot will depend on the EUR/USD pair, which remains "crucial for the zloty", according to DM BOS, a brokerage house.

"Markets are seeing that the European Central Bank is a few months behind the Fed on rate hikes – this could mean that [the ECB's] rate hikes in 2023 will take place even when the Fed decides to pause. As a result, increases in EUR/USD – weakening of the dollar against the euro – may bring down the USD/PLN pair," DM BOS' Marek Rogalski told the newspaper *Rzeczpospolita* in December.

As the fundamental backing behind the zloty should improve next year, local policy risk will rise, analysts say.

"We expect the C/A deficit to tighten, owing to, eg, more favourable terms on trade. Poland is also likely to draw some €20bn from the 'old' EU budget. Moreover, the government decided to lean towards hard currency funding. All these are likely to be converted via the market under the current FX strategy of the ministry of finance," ING said in December.

FX risks centre around domestic politics. Poles will go to the polling stations in the autumn of 2023 to give – or deny – PiS its third straight term in office.

"The government is attempting to reset relations with the EU, possibly encouraged by Hungary's pro-EU turn. While reaching an actual compromise will take time (and may prove impossible ahead of the general elections), it is likely to improve Poland's market perception. Moreover, opinion polls show increasing support for EU-oriented opposition, which the markets find supportive for PLN," according to ING.

Erste puts it more curtly: "We think that [the zloty] will remain on the back foot [in 2023] as the global economy enters recession. We expect a turnaround to take place from the second half of the year."

6.2 Stocks

Arguably, there are reasons to expect that Polish stocks could do better in 2023 than they did in 2022, the year of tanking valuations and no IPOs.

Historically, the Warsaw Stock Exchange would go into a bear market quickly after the NBP would begin a tightening cycle. That did happen again, as the bourse's main index, the WIG, peaked already in November 2021 – exactly one month after the NBP's first rate hike –and has been going down steadily since. As of mid-December, the index's value was nearly 20% down in 2022.

Valuations are already low and the NBP rate hike cycle appears to be over, however, and speculation is rife already about possible easing to come in late 2023. That alone might signal better times on the Warsaw bourse, although analysts say it may well take more than that for the indices to start flying again.

"A positive outcome of the war in Ukraine, unblocking of EU funds, and greater clarity about the likely post-election landscape in Poland" could all serve as catalysts to spur interest in Polish stocks again, according to DM BOS, a Polish brokerage house.

According to BM mBank, another brokerage house, the first half of 2023 could be attractive to investors in companies from telecom and IT segments, which, however, could fare comparatively worse in the latter half of the year, when the entire market is expected to bounce back.

Once – and if – Polish banks dodge a ruling by the Court of Justice of the EU concerning their FX mortgage loan portfolios, they could be back in investors' favour, according to BM mBank's brokers. Also, the expected easing in commodity prices could offer a worthy investment cause in industrial companies in the second half of 2023.

"Food companies will continue to report great results in the coming quarters. Sentiment towards clothing companies should improve in the second half of the year. Experts also have a positive attitude towards the discounted e-commerce sector, and Allegro and Shopera are considered top picks," the newspaper *Puls Biznesu* wrote in December.

Also the gaming sector is supposed to be resistant to recession, with CD Projekt and 11 bit studios supported by the high exchange rate of the dollar and the upcoming premieres, the newspaper added, based on BM mBank's recommendations.

6.3 Bonds

Government borrowing needs are seen as a risk in an election year. Some analysts expect the general government deficit to increase from 4.5% to over 6% of GDP, as total 2023 borrowing needs could near PLN200bn (estimates vary greatly, however, which is a reflection of the general volatility and uncertainty). This will include social programmes, military spending, pre-financing of EU-backed projects, etc.

"Moreover, weakening domestic activity (particularly household consumption) suggests risks of even higher borrowing needs due to a potentially softer tax base," ING said in an analysis in December.

Local buyers, mostly banks, should purchase PLN80bn-PLN90bn net next year. This stems from continued lacklustre demand for credits (particularly mortgages), while deposit growth recovers. The Ministry of Finance may also reduce its high cash buffer (currently at PLN128bn) by PLN30bn-PLN40bn. The rest should be covered by foreigners, either in PLN or hard currency.

The government has already tapped the US$ market. Moreover, government foreign purchases (eg, of military equipment) may offer additional funding sources from sellers.

Despite the very large headline number, however, covering 2023 borrowing needs is manageable unless the government decides on last minute spending ahead of the 2023 elections. Asset swap widening on the long end is to remain a major risk.