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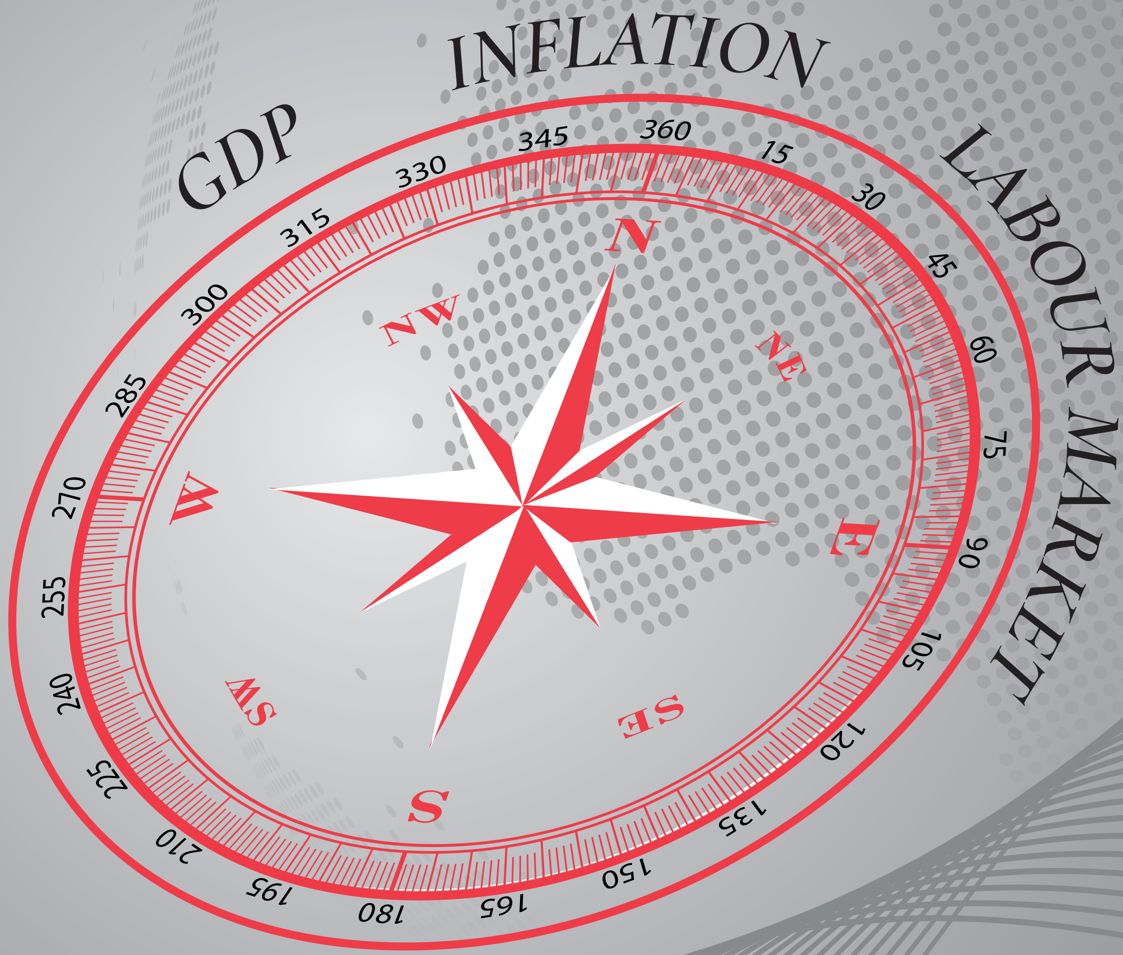

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Key numbers (forecasts)

0.7% GDP growth in 2023	**2.2%** GDP growth in 2024
12.6% average CPI inflation in 2023	**7.9%** average CPI inflation in 2024
5.5% unemployment rate at the end of 2023	**5.6%** unemployment rate at the end of 2024
12.3% average wage growth in 2023	**11.7%** average wage growth in 2024

Key findings

Economic growth will be moderate over the next two years. We expect the Polish economy to grow by 0.7% in 2023 and by 2.2% in 2024. GDP growth this year will also be lowered by the decrease in inventories. Economic growth will be driven in part by public spending. Next year, household consumption will be of greater importance; it will start to grow at a stable pace.

We are not changing our inflation forecasts. In 2023, average price growth will amount to 12.6% and core inflation to 11.0%. Service prices are still growing very rapidly and this trend is unlikely to change. For this reason, CPI inflation will amount to 7.9% in 2024, an upward revision of 0.2 pp. The start of the year will bring high growth in energy prices; after that, a sustained increase in core CPI will play the main role.

The situation in the labour market is better than we forecast in March. We estimate that the unemployment rate will rise to 5.5% at the end of the year, but as a result of seasonal fluctuations. This is over 0.5 pp less than we indicated in March. The number of unemployed people could increase slightly in H1 2024.

The good situation in the labour market is strengthening wage pressure – wage growth both this year and next will be in double digits. We are revising our forecast for 2023 upwards by 1 pp and that for 2024 by 2.3 pp. The changes next year will be linked to the greater increase in the minimum wage, among other things. They will also increase sustain price increases in 2025.

1. The state of the Polish economy in Q2 2023

When it comes to the slowdown in the Polish economy, the worst is probably behind us. The fall in GDP amounted to 0.3%, which means a very "soft landing", especially given the high starting point. Statistics Poland data shows that the slowdown is mainly hitting households – consumer spending was 2% lower than a year ago. Investments, especially by large companies, come as a positive surprise: in Q1, total outlays rose by 5.5%. Current data on industrial and construction output suggests that both trends will continue in Q2. Economy is likely to be driven by exports, too, although the results will be weaker than in Q1. The incredibly high surplus at the start of the year probably results from measurement problems and will be revised in upcoming quarters.

Inflation fell markedly in H1. In June, CPI inflation amounted 11.5%, almost 7pp less than at its peak in February. The rapid fall in inflation is mainly linked to energy and fuel prices. Food prices are still growing rapidly and the high core inflation constitutes another problem. According to Eurostat data, the prices responsible for 60% of consumer spending are growing at a rate of over 10%.

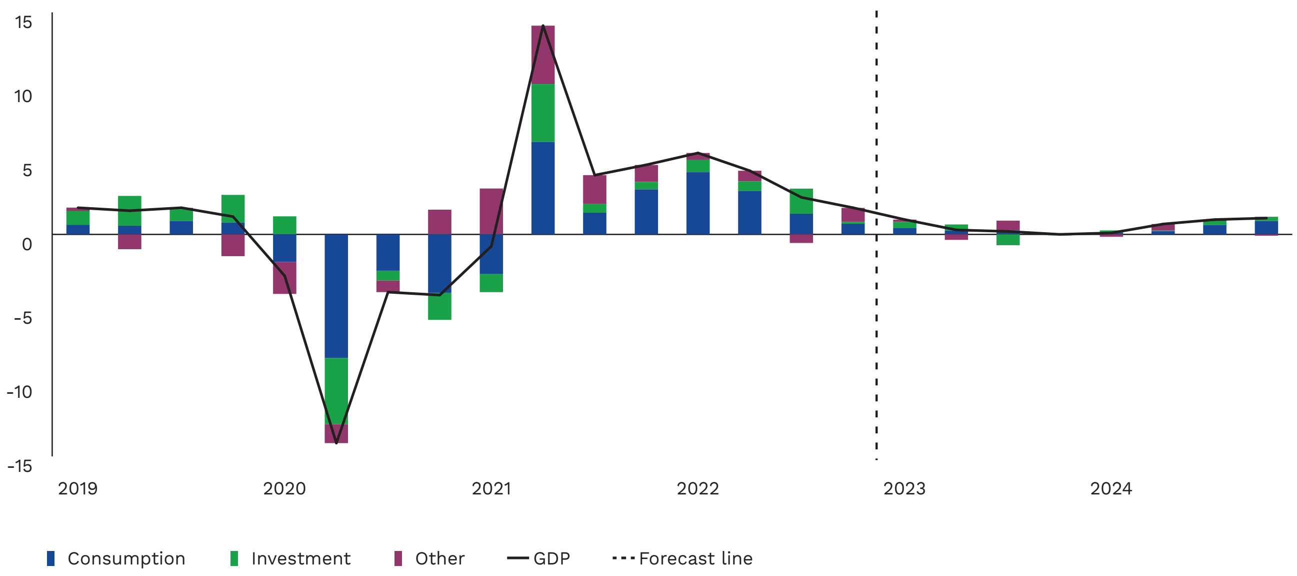
Wages are still growing rapidly. Data from Q2 shows that wages in the enterprise sector are still growing at a rate of around 12%. This growth will decelerate slightly in the coming months, but it should remain in double digits. A factor supporting wage pressure are the sharp increases in the minimum wage in Poland – from July 2023, it will be almost 20% higher than in 2022.

2. The global economy in 2023-2025

2.1. The European Union

The European Union will avoid recession in 2023, but GDP growth will be significantly weaker than in 2022. The European Commission (EC) forecasts that GDP growth will decline from 3.5% to 1.0% y/y. Only Sweden's economy will contract, but the contraction will be small; around 0.2%. In the other countries, GDP growth will be low, significant lower than in previous years. The biggest EU economies – Germany and France – will grow by around 0.3% and 0.7%.

Chart 1. Structure of GDP growth in the eurozone in 2019-2024 (% y/y)

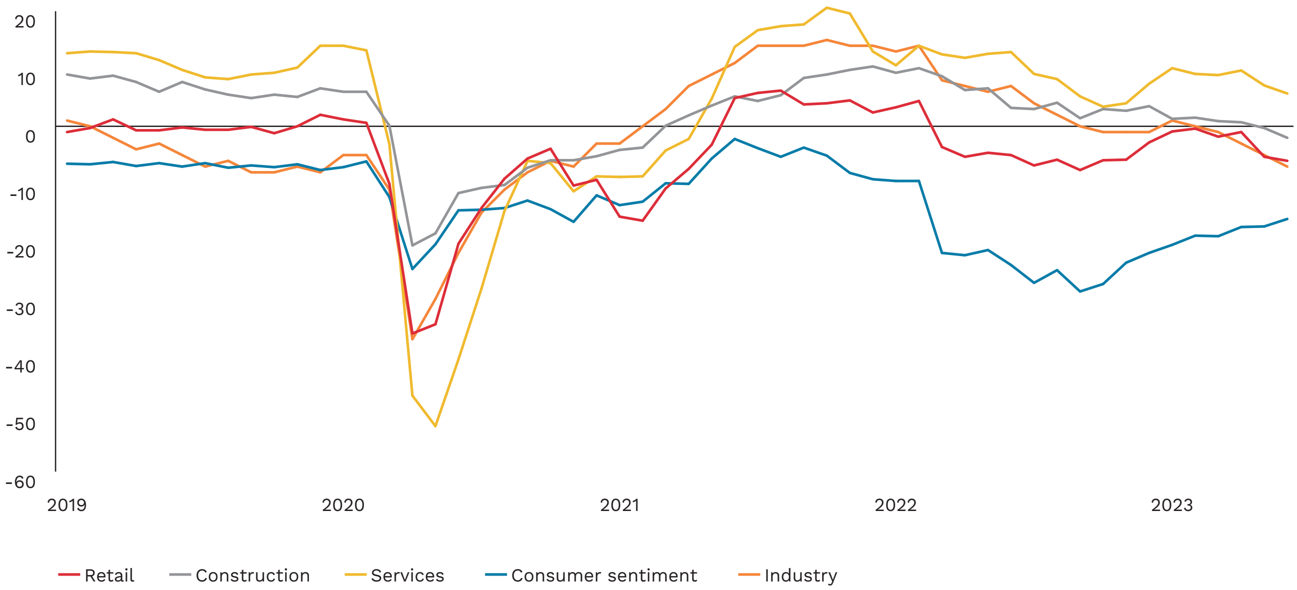


Source: prepared by the authors based on PEI's forecast.

The poor GDP results are linked to the fall in consumption. In Q1, growth in household spending fell from 1.4% to 0.8% y/y. The greatest decreases were recorded in Germany and Spain. The downward trend will continue for the rest of the year; growth will be around 0.5% in Q2 and Q3, and close to zero in Q4. Looking further ahead, the EC's research provides an ambiguous picture: consumers' assessments are improving steadily, but entrepreneurs' assessments are still not very optimistic.

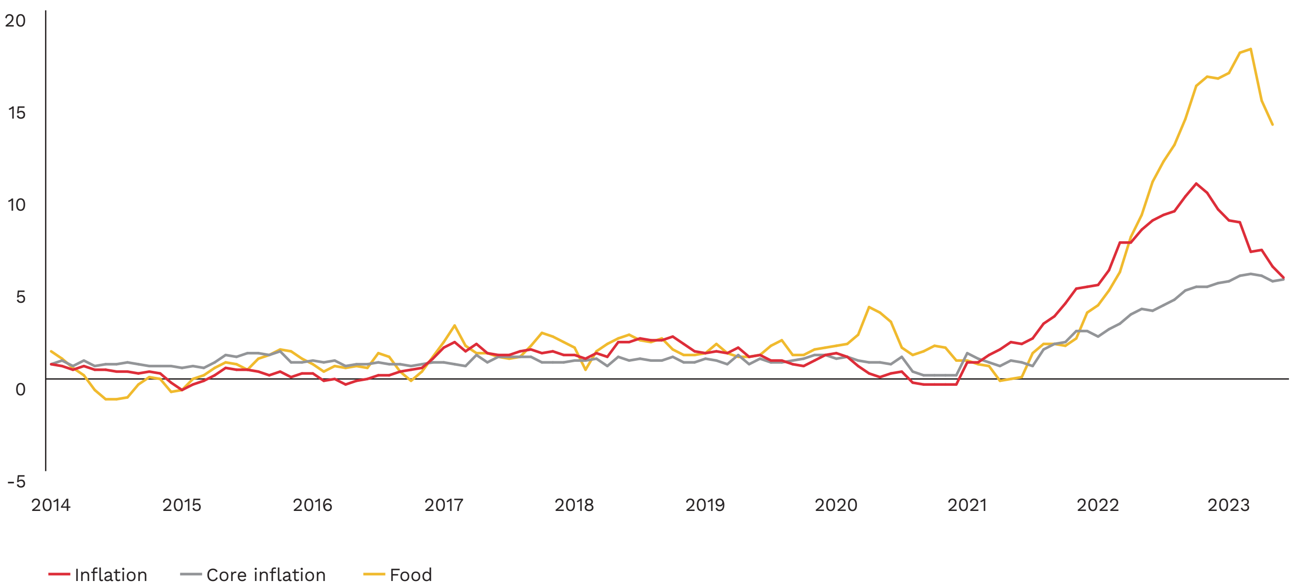
The energy crisis remains the main threat. In April, industrial production in the eurozone increased by 0.6% y/y. Electronic and automotive manufacturers achieved the best results. Production in these industries was 20% higher than the previous year. The worst results were recorded in energy-intensive and energy-related industries, such as mining, the chemical industry, and wood and paper products. The fall in production has reached 10%, and a deeper collapse cannot be ruled out.

Chart 2. Results of the European Commission's economic survey in 2019-2023



Source: prepared by PEI based on EC data.

Chart 3. Inflation in the eurozone (% y/y)



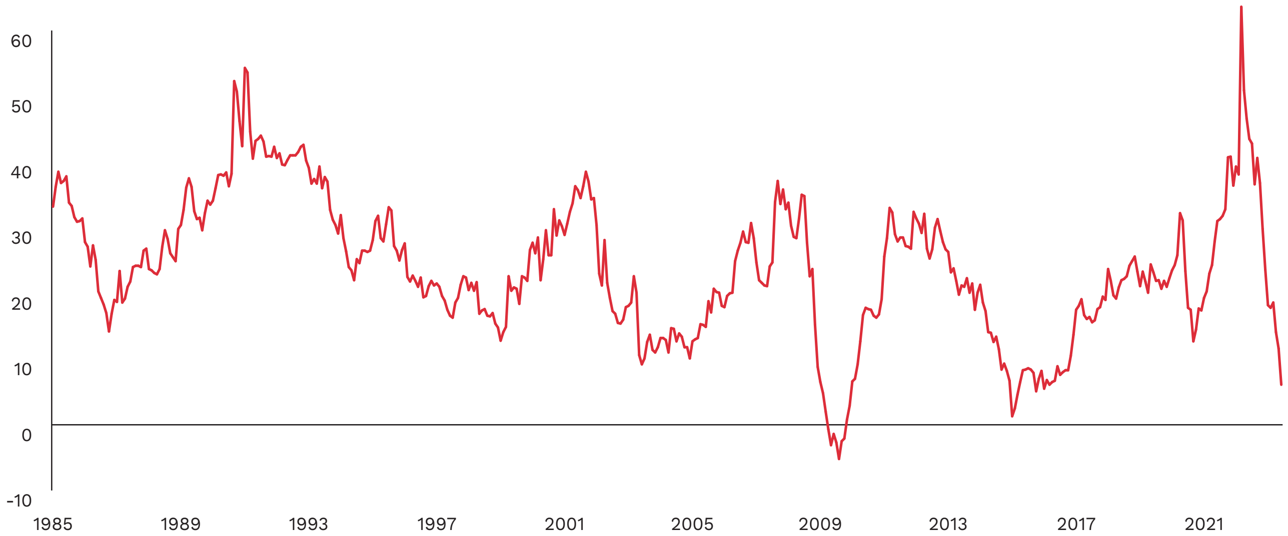
Source: prepared by PEI based on Eurostat data.

EU countries are in the disinflation phase. HICP inflation has fallen from 10.6% in October 2022 to 5.5% in June 2023. In part, this is due to the end of last year's energy shocks and slower increases in food prices. The rate at which prices are growing varies greatly between EU countries. In the Baltic States, the results in June were still close to 10%, whereas in Spain inflation is already in line with the European Central Bank (ECB) target. Spain's success is partly linked to the introduction of public transport subsidies and reducing the VAT rate on food to zero. However, the main factor is the rapid fall in energy prices.

Forecasts indicate that inflation in the eurozone will remain above the ECB target in both 2023 and 2024. Economists surveyed by Focus Economics expect that inflation will be around 5.6% on average in 2023 and around 2.7% in 2024. The ECB's own forecasts are similar: 5.6% and 2.6% respectively (ECB). High core inflation and escalating wage demands remain the main problem. Wage negotiations are intensifying and the ECB index for the eurozone is at its highest in nearly 30 years. Employees are trying to obtain compensation in connection with the fall in the standard of living after the surge in inflation. This process will probably be drawn out. The ECB Governing Council sees the risk of a significant increase in labour costs, which means that it could take longer for inflation to fall to the 2% target. This will happen if the growth in wages exceeds the losses in previous years.

For now, inflation expectations have fallen significantly. The EC's Economic Sentiment Indicator (ESI) research confirms that consumers believe that inflation will fall in the coming months, too. The indicator describing sentiment when it comes to prices over the next twelve months is at its lowest since 2016. There is visible variation between countries: consumers in states with high inflation, such as Latvia (55.1 points), Slovenia (33.1 points) and Hungary (29.8 points), have the most pessimistic attitudes.

Chart 4. Consumers' inflation expectations in the eurozone (points)



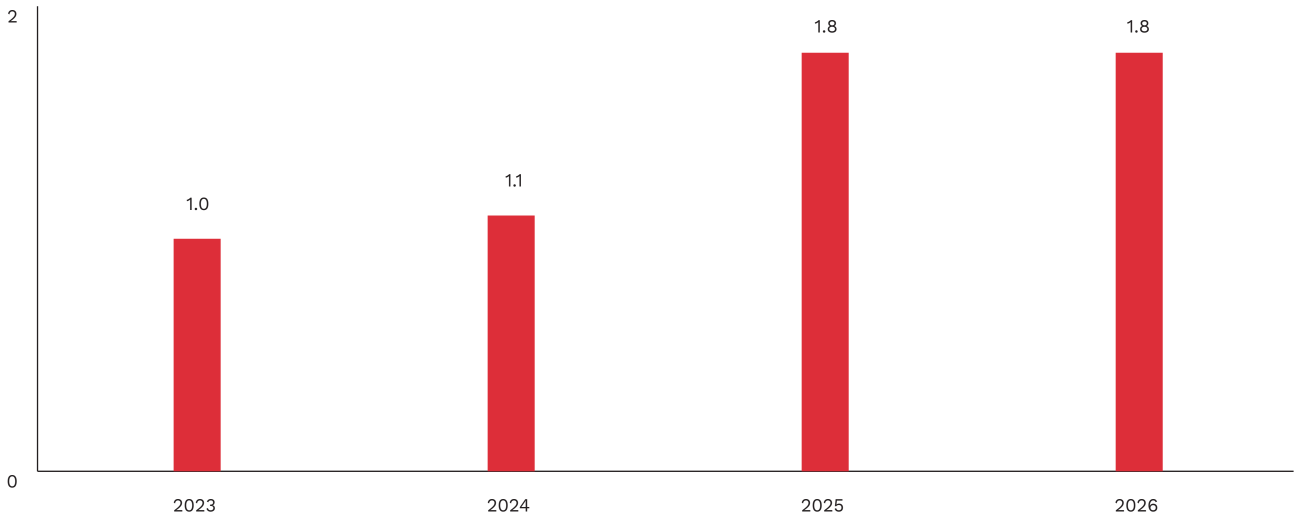
Source: prepared by PEI based on ECdata.

2.2. The United States

The American economy will grow less rapidly than the EU economy. FOMC members' current forecasts indicate that US GDP will grow by 1.0% in 2023, accelerating in subsequent years, like in Europe. However, the growth rate will be below 2%. The weaker growth rate is directly linked to the consequences of the Fed's rate hike cycle. However, the lower expectations for next year relative to the euro area are partly due to the conservative forecasts of Fed officials - the actual results may turn out to be similar.

Economic growth in the US was strong in H1. Data from Q1 points to high consumer spending by households and the public sector. This results from the improvement in the situation in the labour market and consumers spending savings amassed during the pandemic. At the same time, the data points to the first signs of weakening; that is, a fall in business investment and cooling in the labour market. The housing sector's condition will probably remain poor in upcoming quarters, with the weakening in consumer spending. The fall in companies' inventories as a result of the streamlining of supply chains will also weigh on the results.

Chart 5. GDP growth in the US (% y/y)

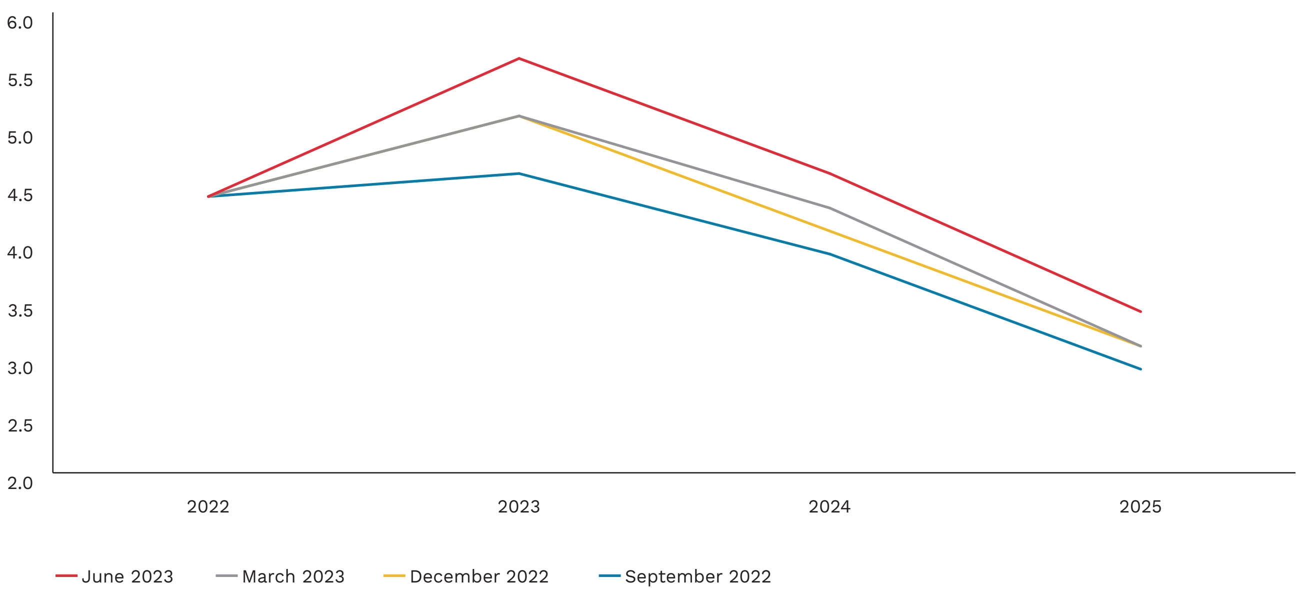


Note: Fed monetary authorities' expectations.
Source: prepared by PEI based on FOMC data.

Analysts forecast a weakening, with a trough expected around the end of 2023. Focus Economics' median forecast indicates that economic growth in Q4 2023 will amount to 0.3%, with a similar level in Q1 2024. The forecasts suggest that households are deleveraging, which will weaken consumer spending in subsequent quarters.

With the slowdown in activity, the Federal Reserve is ending its tightening cycle. After the July meeting, the Fed effective interest rate is set to oscillate in the 5.25-5.5% range. The high core inflation and the strong data from the US labour market suggests a pause before rate cuts. In recent months, real rates have risen to levels comparable with previous monetary policy tightening cycles. We expect the first rate cuts to occur in late 2023 or early 2024, but their scale will initially be small. The Fed will keep interest rates at a level similar to – or slightly above – inflation. This means maintaining their restrictive monetary policy.

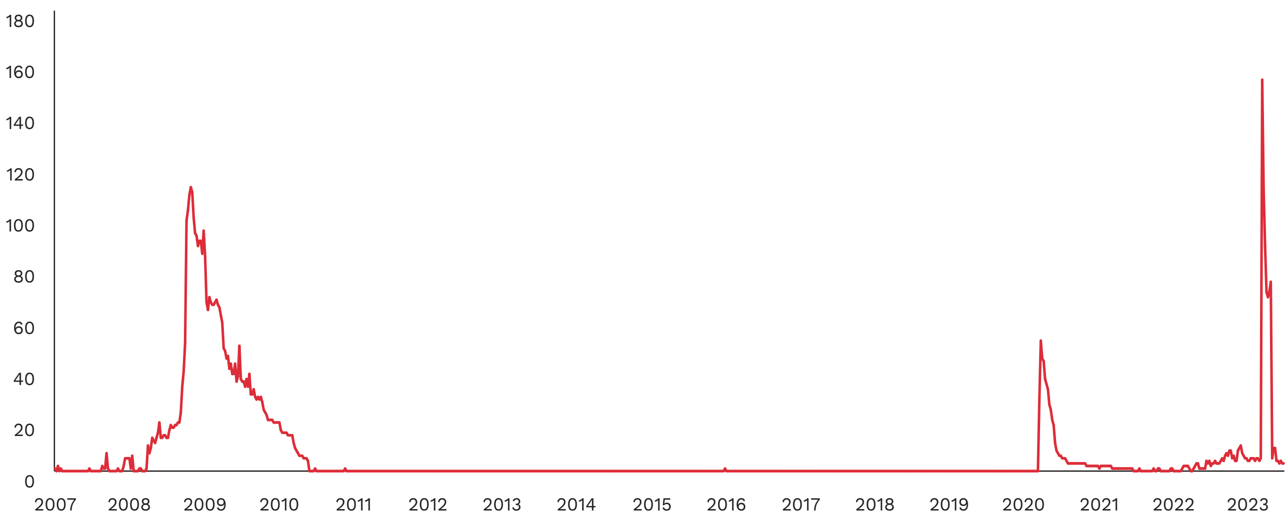
Chart 6. Forecast Fed interest rates in 2022-2025 (%)



Note: Fed monetary authorities' expectations.
Source: prepared by PEI based on FOMC data.

In the US, a banking crisis remains a threat, though it is currently limited to small regional banks. It has led to a slowdown in lending and economic growth. It is difficult to predict how small banks' situation will evolve. The markets' current behaviour suggests that big entities' situation is stable. The commercial real estate sector could be a problem.

Chart 7. Loans granted to banks from the Federal Reserve in 2007-2023 (billions of USD)



Source: prepared by PEI based on FED data.

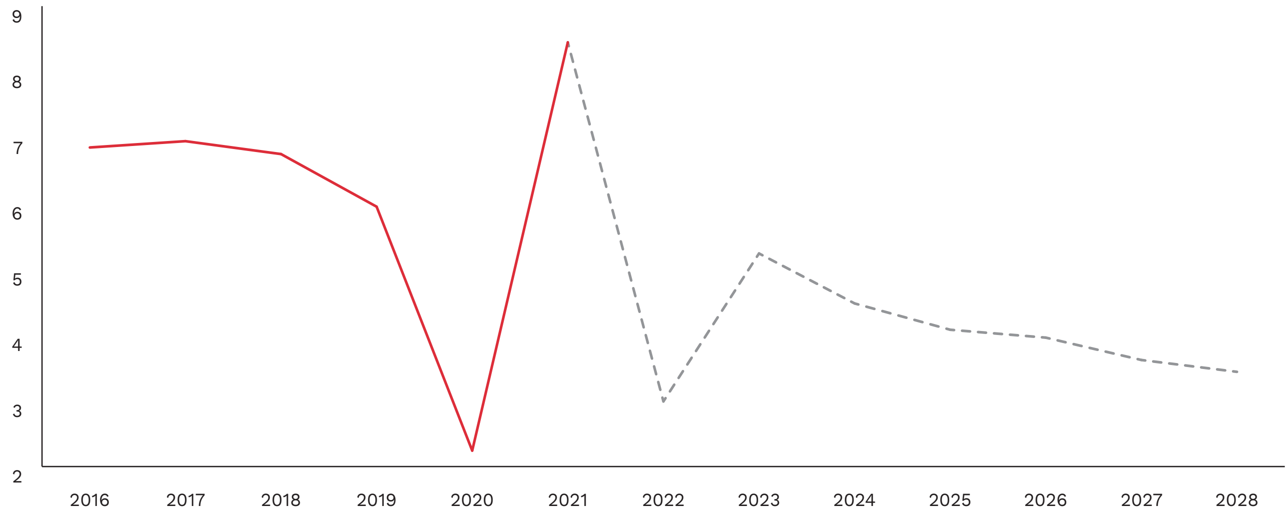
According to Green Street, a consultancy, commercial real estate prices have fallen by over 15% since April 2022. The weakening is visible in every segment of the market, especially fundamental ones; that is, the financing of office buildings and industrial facilities, shopping centres and rental apartments. This results in a smaller loss of portfolio value and reduces the potential collateral in the event of the borrower's insolvency. This is mainly a threat to small banks, many of which diversified their business activity to a very limited extent.

2.3. China

The Chinese economy will grapple with a longer period of weaker growth. In 2022, the Chinese economy grew by 3%, less than in the EU and not much more than in the US. International organisations' economic forecasts for this year are optimistic – the International Monetary Fund (IMF) forecasts that the Chinese economy will grow by 5%; that is, in line with the Chinese Community Party's target. However, after positive surprises in Q1, the past few months have been disappointing. Moreover, the forecasts unequivocally show that the growth rate will decline systematically in the coming years.

China could face problems similar to those of Japan. Nomura's chief economist indicates that China will struggle with a balance sheet recession; due to the worsening demographic situation and high debt, companies are focusing on reducing debt rather than increasing their activity. In these conditions, its growth prospects are increasingly weak. Bank for International Settlements data indicates that, in China, non-financial companies' debt amounted to 220% of GDP in Q4 last year – more than public and private debt combined in a large share of EU countries. With such a heavy burden and a weakening economy, debt repayment is starting to consume a growing share of income, effectively limiting investment. As a result, the economy is stagnating.

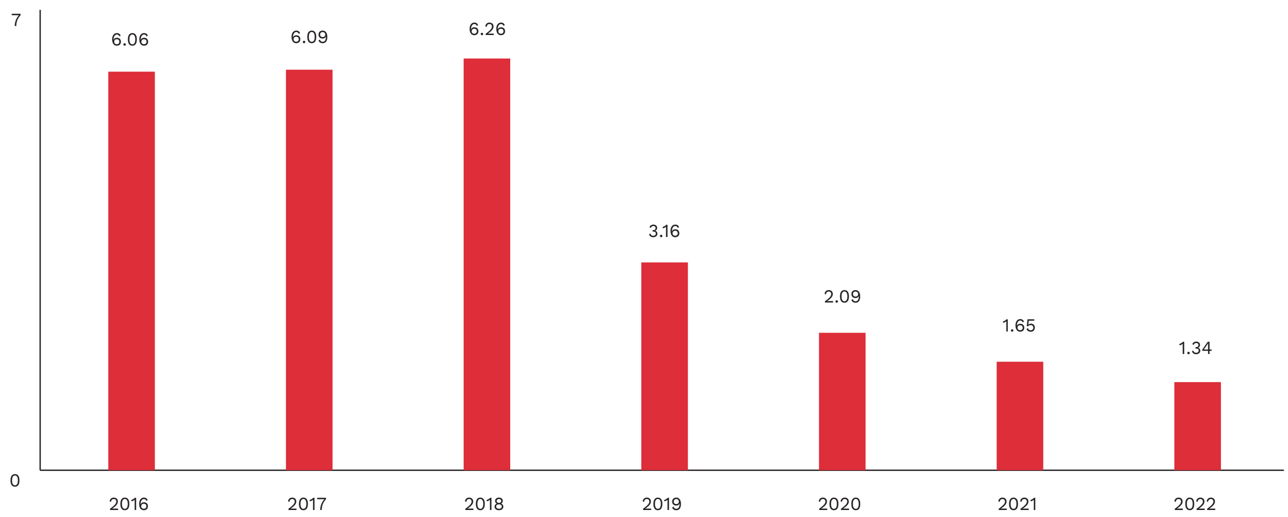
Chart 8. The Chinese economy is slowing down (% y/y)



Source: prepared by PEI based on IMF and Macrobond data.

A consequence of the weakening in China are the problems in the commercial real estate market. Prior to the COVID-19 pandemic, China systematically stimulated growth by developing the real estate markets (both housing and commercial real estate). However, slower urbanisation and business development have led to an increase in the number of unused spaces. The availability of buildings has led to a collapse in activity in construction – the number of properties being built now is five times lower than in 2016-2018.

Chart 9. Number of commercial properties being built in China in 2016-2022 (millions)



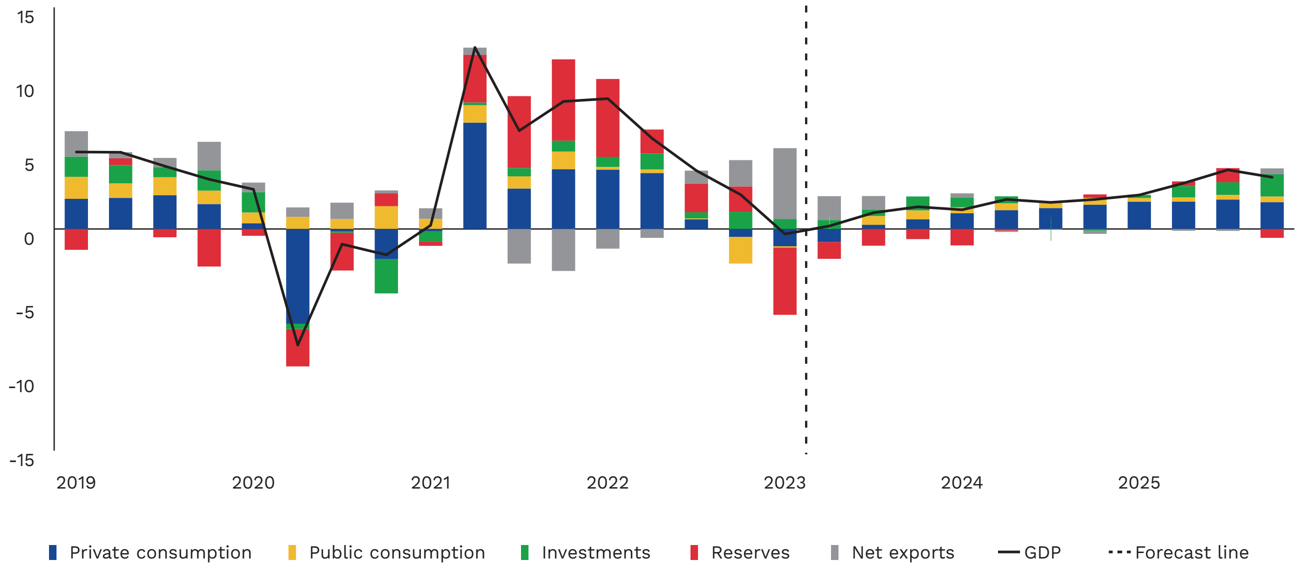
Source: prepared by PEI based on Chinese Ministry of Housing and Urban-Rural Development and Macrobond data.

3. The Polish economy in 2023-2025

3.1. Economic activity – GDP

Activity in the Polish economy is starting to improve. We uphold our forecasts from Q1. We believe that the economy will grow by 0.7% in 2023. The worst of the slowdown is probably behind us – in Q1, GDP contracted by 0.3%. The results in Q2 will be close to zero, but they will exceed 1% y/y in H2. The results in 2024 will remain below Poland's economic potential; we forecast growth slightly above 2.0%. This means a slight upward revision compared to our March forecast.

Chart 10. The structure of GDP growth – PEI forecast (%, y/y)



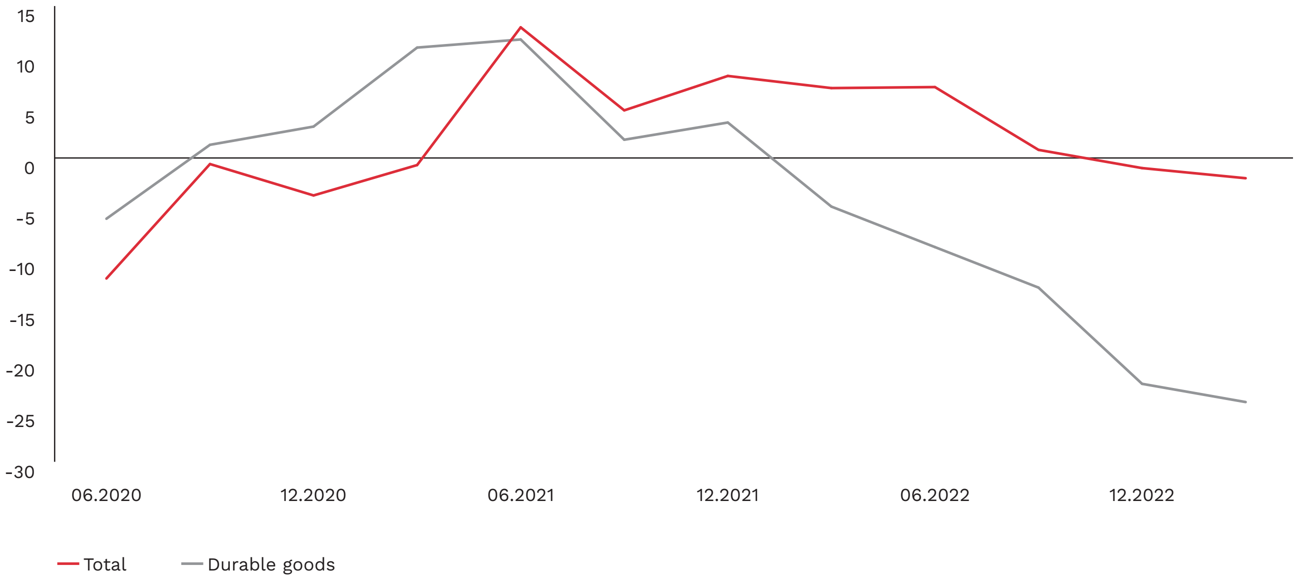
Source: prepared by PEI.

Household spending on consumption in H1 came as a negative surprise, but it will start to grow from Q3. We expect private consumption to fall by 0.4% in 2023, a revision of 0.8 pp compared to our March forecast, after the poor results in H1.

In Q1, private consumption fell by 2.0% y/y. Detailed data shows that the sharpest declines concerned durable goods; spending on them was almost 25% lower than a year ago. Sales of basic necessities were also weaker, mainly due to the departure of migrants to both Ukraine and other European countries. The main factor stabilising consumption was the sale of services, where we are seeing systematic improvement. The total figures on consumption are therefore better than the monthly figures on retail sales suggest, because the monthly index is solely based on sales of goods.

The data on retail sales leaves little room for a rebound in consumption in Q2, but the trend is likely to reverse during the summer holidays. Sales of goods are still weaker than a year ago, and the growth rate for services is likely to slow down slightly. Nevertheless, in H2, wages will start to systematically grow faster than inflation, which will contribute to a rebound in consumer activity.

Chart 11. Structure of the growth in consumption (% y/y)

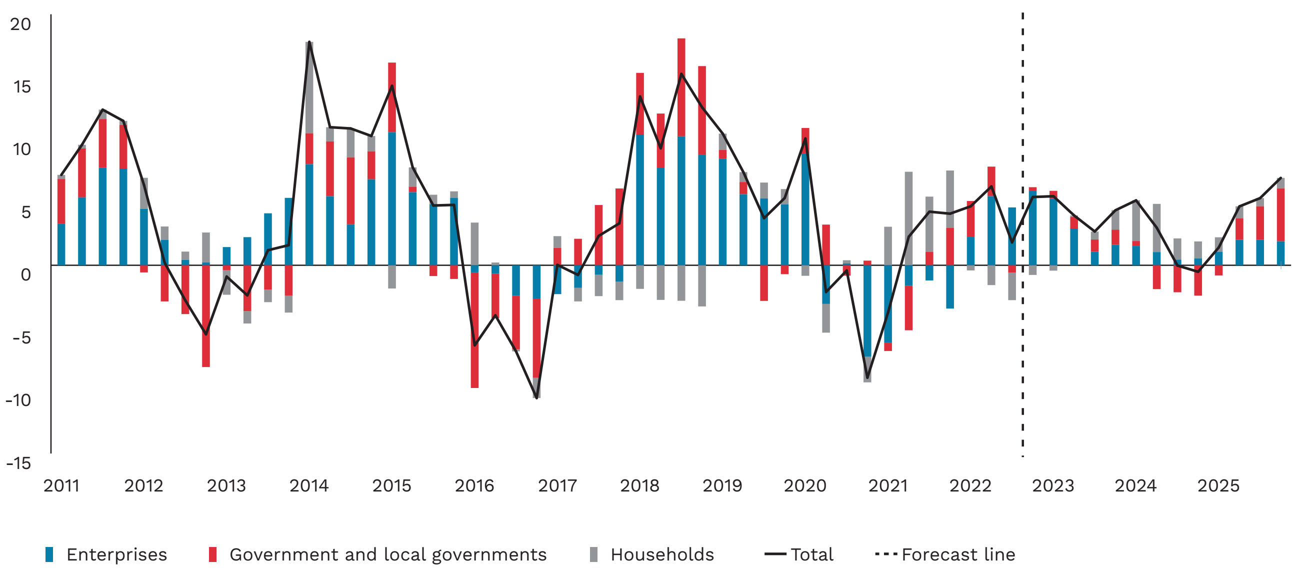


Source: prepared by PEI based on Eurostat data.

In 2024, consumer spending will increase, supported by fiscal transfers. We expect results close to 3.0%, which will still be an average result compared to historical achievements. The fiscal impulse related to the indexation of the 500+ child benefit programme will probably be moderate; we expect that, as when the programme was launched, the impact will be visible later.

Investment growth in 2023 will be high, but there will be a slowdown in 2024. We estimate that the growth rate in 2023 will be 4.1% – similar to last year and 1.5 pp more than in our March forecast. The data in H1 came as a positive surprise, mainly due to large enterprises' outlays. However, the growth in spending is likely to slow down in the coming quarters, a direct consequence of the economic slowdown and the interest rate hikes.

Chart 12. Structure of the increase in investment – PEI estimates



Source: prepared by PEI based on Statistics Poland data.

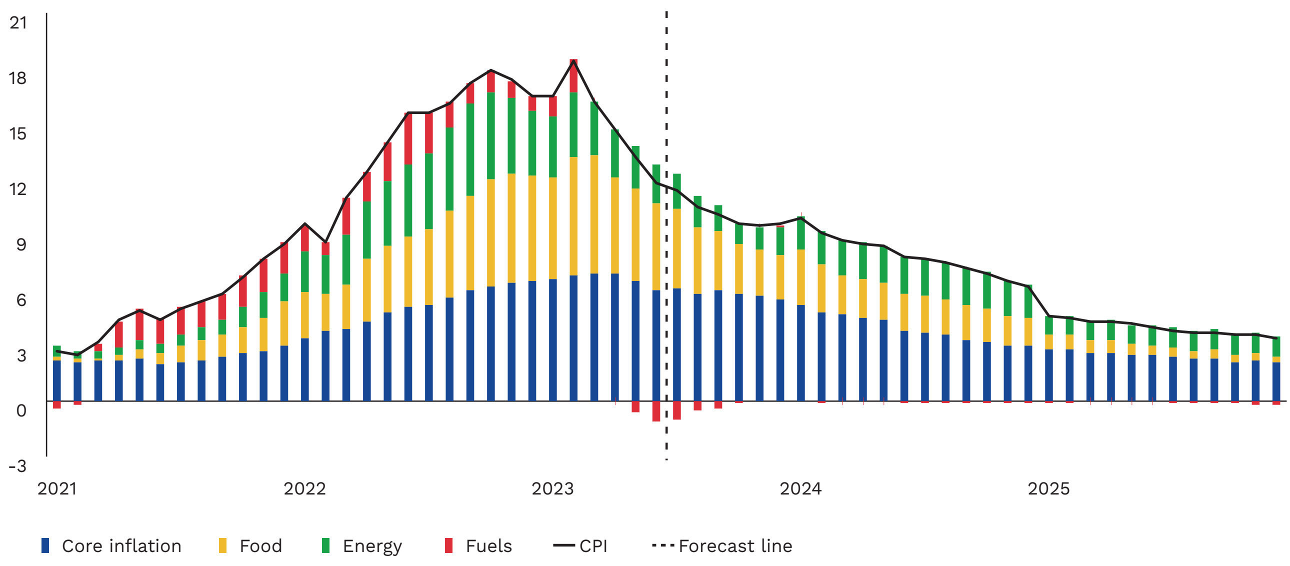
The main challenge will be the period of suspension between the EU multi-annual financial frameworks. Intensive investment from the National Recovery Plan (KPO) next year is also becoming less likely. Therefore, we are revising our investment growth forecast downwards to 1.3% y/y in 2024. We expect a decrease in public spending from Q2 2024 to Q1 2025. Its scale will probably be slightly smaller than in 2016. Outlays related to BKG's strategic investment programme, among other things, will still go ahead. The weaker results when it comes to public investmentswill be a reflection of the situation on the real estate market. Current data indicates that mortgage sales have started to grow again; in addition, demand will be boosted by the Safe Mortgage programme. We will probably see the strongest growth in household investment in H1 2024.

Net exports will increase Poland's GDP. The data from Q1 shows an incredible surplus of 4.8 pp. This result will probably be revised downwards. In the coming quarters of 2023, the surpluses will amount to around 1 pp and from the winter the balance will have a neutral impact on growth. The good results in trade will compensate for the decline in companies' inventories. We expect that this balance will reduce the growth rate throughout 2023. In 2024, the impact of inventories on GDP growth will be close to zero.

3.2. Inflation

Inflation is falling, but it will remain above the NBP target in the coming years. We are currently observing a fairly rapid fall in inflation: CPI inflation fell from 18.4% in February to 11.5% in June. All the main components of inflation are slowing down, but core inflation is decreasing at the slowest rate. The declines in the following months will be increasingly slow; the indicator will fall to a single-digit level in September or October this year. We expect inflation to average 12.6% this year. In 2024, the decrease in inflation will be small; we expect average results of around 7.9%.

Chart 13. Structure of CPI inflation – PEI forecast



Source: prepared by PEI.

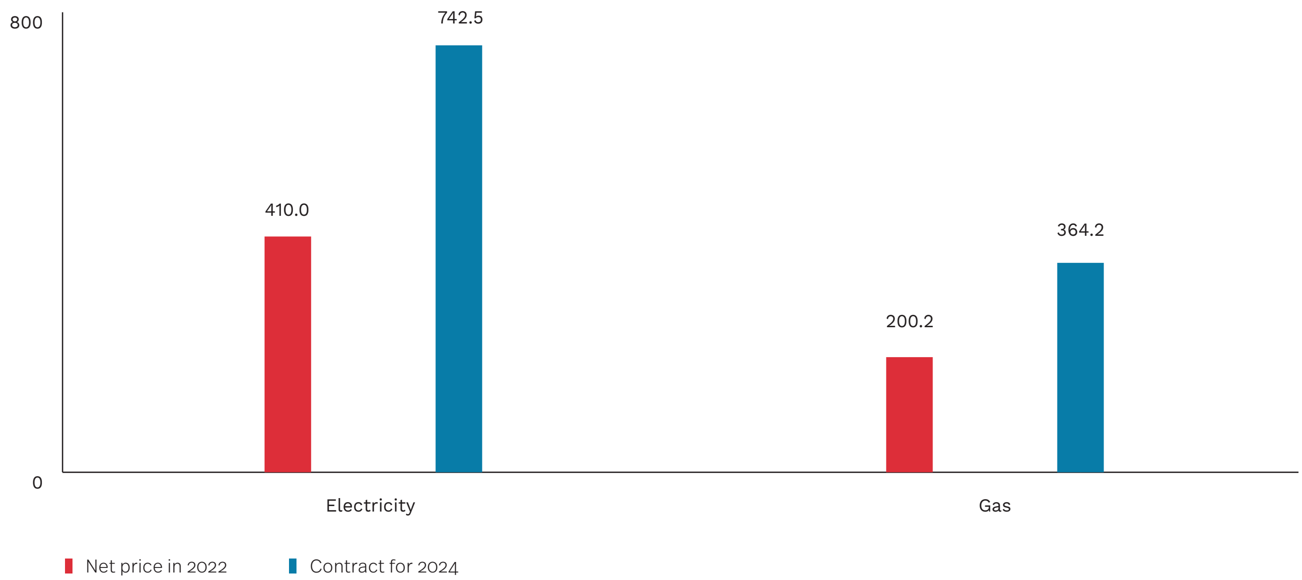
We are maintaining our core inflation forecasts. We forecast that it will amount to 11.0% in 2023 on average, 0.1 pp less than we estimated in March (11.1%). This will be mainly the result of slower growth in the prices of industrial goods caused by the strengthening of the złoty and lower freight costs. At the same time, the rapid wage growth means that the swift growth in service prices will continue – declines in the annual rate in the coming months will mainly result from statistical effects.

Chart 14. Freight price indexes (points)

Source: prepared by PEI based on Macrobond data.

Inflation will slow down in two stages. The current stage – the rapid decline in inflation to a single-digit level as the shocks in the food and energy markets fade – is currently coming to an end; this process is further supported by favourable statistical effects. The decline in inflation from around 8% to the NBP target will be much slower due to persistent core inflation and rapid wage growth. In addition, we cannot rule a temporary increase in inflation at the beginning of 2024, with the return to the standard VAT rate on food (5%) and less support for households when it comes to energy prices.

Chart 15. Prices of power exchange contracts for 2024 (PLN/MWh)

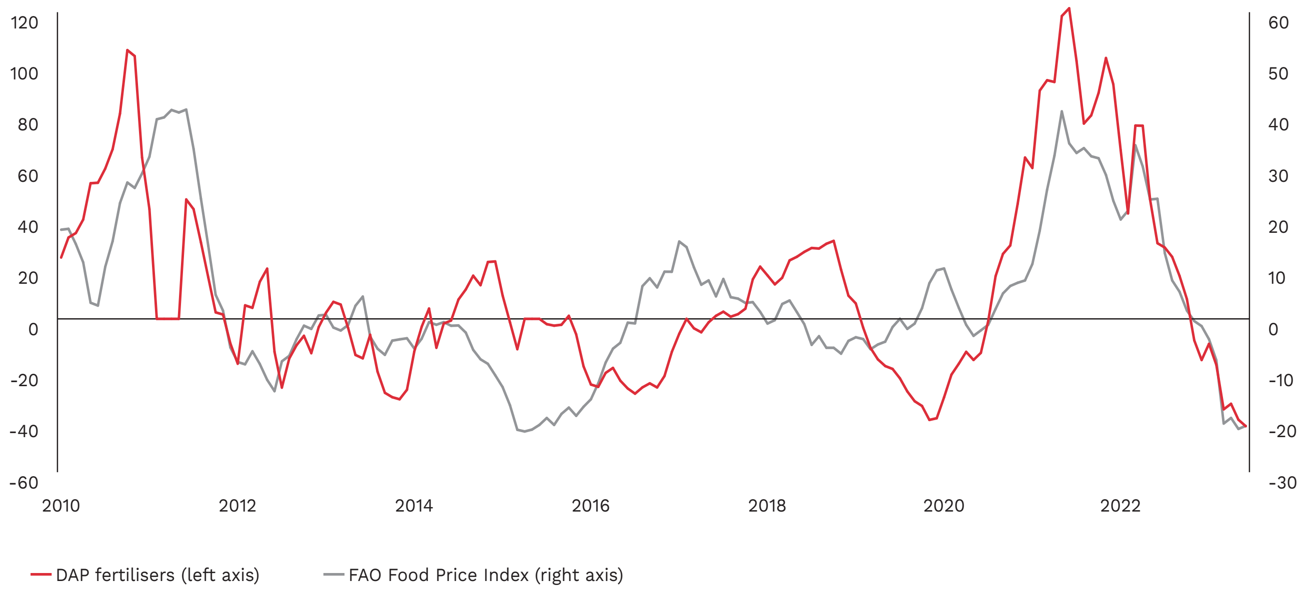


Note: weighted average price of BASE contracts for 2024 from the entire history of quotations since 2021. The price of the commodity accounts for about half the energy bill; the actual increase in prices for consumers will be twice as small.

Source: prepared by PEI based on TGE data.

High energy prices will push up inflation next year. In 2023, the government froze net energy prices for households at last year's level. The increase in bills resulted from the return to the standard VAT rate; the prices are now among the lowest in the EU. However, energy supply companies have been contracting electricity and gas for the next year on a regular basis since 2021. As a result, the current fall in commodity prices is having a limited impact on energy companies' costs. Technically, we assume a partial withdrawal of support, which should increase energy prices by around 17.4%, but the final increase for consumers will depend on the government's decisions.

Chart 16. Fertiliser and global food prices (% y/y)



Source: prepared by PEI based on FAO and World Bank data.

The growth in food prices will slow down systematically. The price growth rate will slow down from 22.9% in Q1 to 7.5% on average in 2024. So far, the decrease in prices has been moderate; Statistics Poland indicates that food prices increased by 17.8% in Q2 2023. The decline has been less sharp than forecasted few months ago; for example, in March, NBP analysts expected the growth in food prices to decline to 16.4% – that is, 1.4pp less. The index will slow down more strongly in late 2023, supported by falling global prices of fertilisers and basic food products in the FAO Food Price index. During summer, we will see a seasonal drop in food prices, month on month.

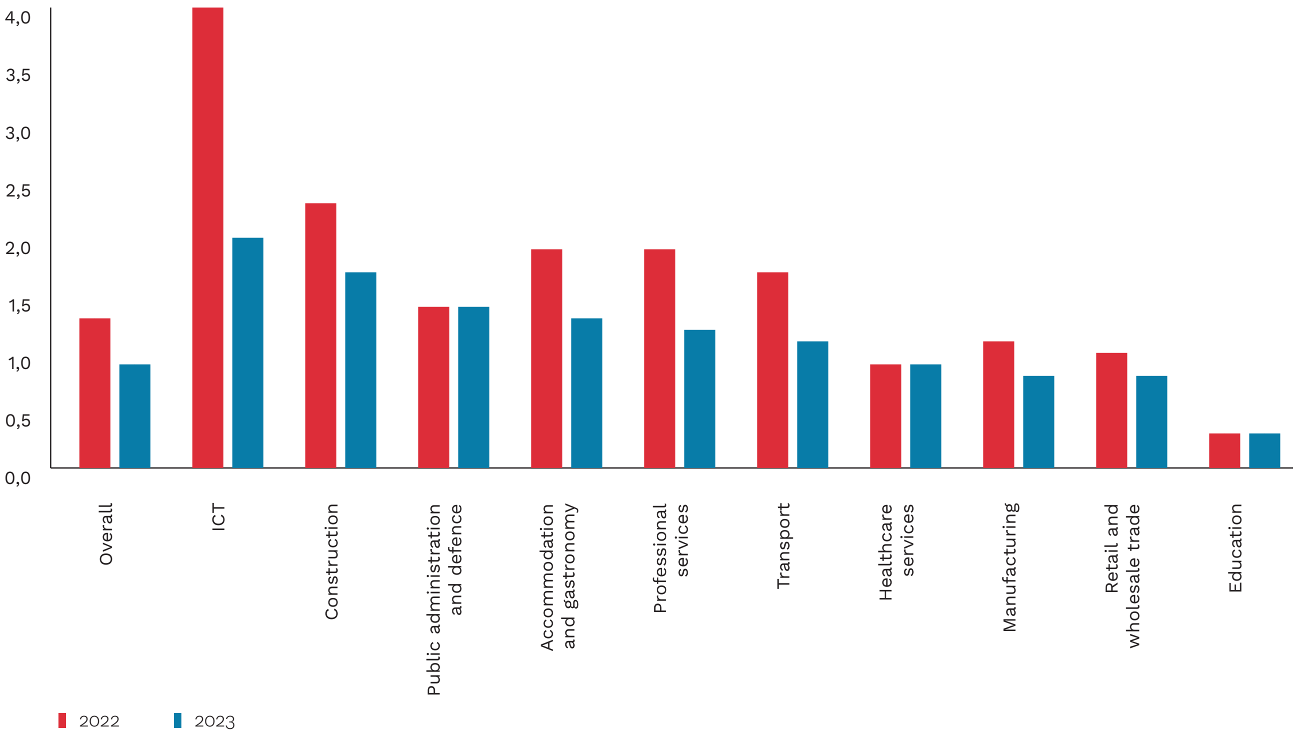
3.3. The labour market

Despite lower economic activity, the labour market remains stable. Poland's Ministry of Family and Social Policy estimates that the registered unemployment rate dropped to a record low in June (5.0%). According to Eurostat, the unemployment rate in Poland in May was 2.7%, the second-lowest level in the EU after the Czech Republic.

The economic slowdown will reduce the demand for labour. According to Statistics Poland, there were 114,900 vacancies at the end of Q1, 27.6% fewer than a year ago. The demand for labour decreased in almost every sector. The largest fall in demand for employees occurred at companies in the ICT (-49.1%) and transport (-34.7%) sectors. Despite the significant decrease, companies from the ICT and construction sectors are still the ones most willing to increase employment.

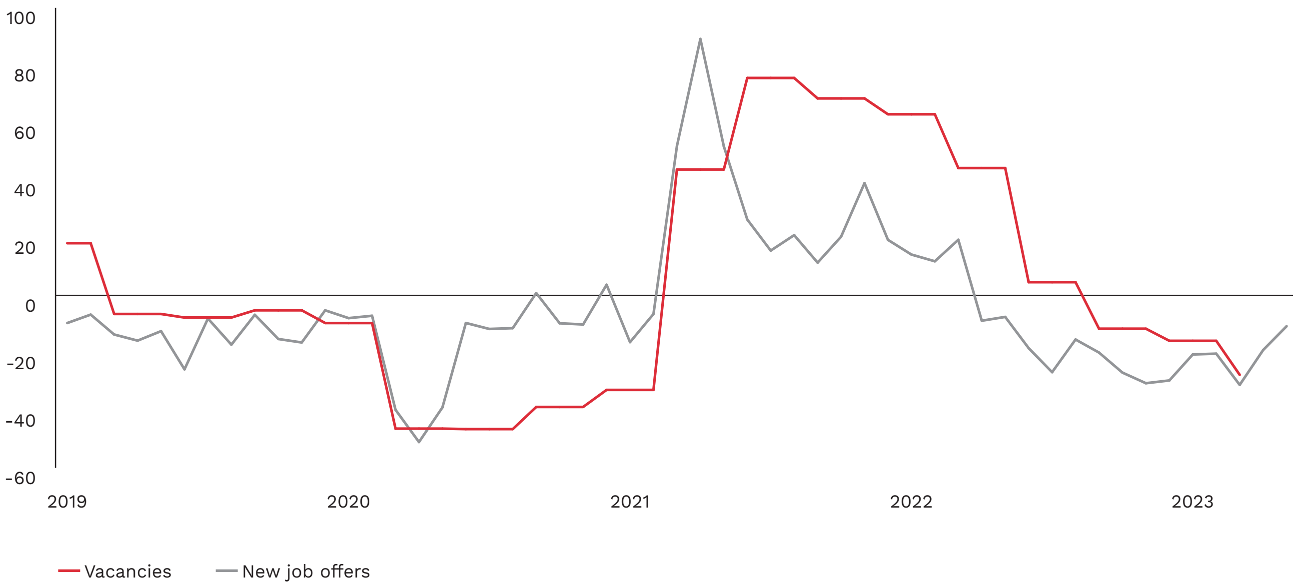
The data from Q2 suggests a slightly smaller decline in the demand for employees. In May, 94,800 new job offers were registered at labour offices. This means that the percentage change increased from -19% in April to -11% in May. Business climate indicators suggest that the current trends in employment will continue. Construction companies are pointing to visible improvement in the labour market. In this industry, surveys on the expected employment rate has been rising steadily for three quarters.

Chart 17. Vacancy indicator in Q1 2023 (%)



Source: prepared by PEI based on Statistics Poland data.

Chart 18. Vacancies and new job offers (%, y/y)

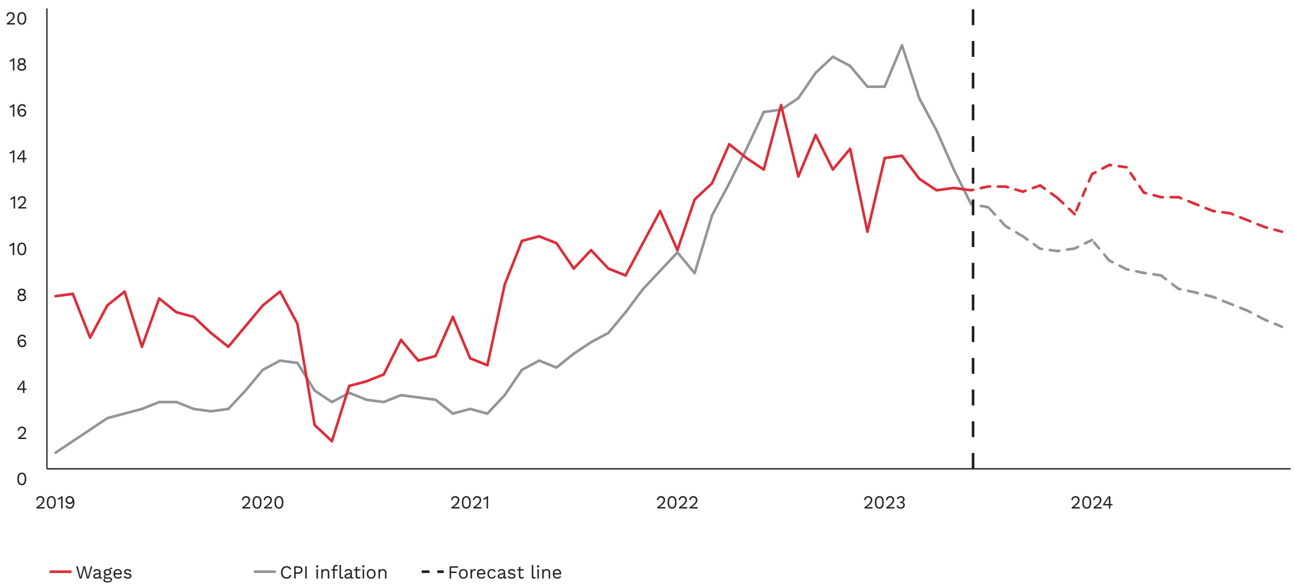


Note: new job offers are released each month, whereas the vacancy indicator is published each quarter.
Source: prepared by PEI based on Statistics Poland data.

Fewer seasonal jobs and lower demand for labour will result in a slight increase in unemployment in Q4. We forecast that the registered unemployment rate at the end of 2023 will be 5.5%. Nevertheless, the rebound in economic activity in subsequent quarters will push up the demand for employees again. This means that Poland will not experience the increase in unemployment expected earlier. We expect that the unemployment rate in 2024 will be similar to that in 2023.

In the coming months, real wages will start to rise, after declining for more than a year. In the current quarter, wage growth will overtake inflation. By the end of the year, wages will be growing at a double-digit rate. In January 2024, the minimum wage will increase by 22% y/y, translating into higher overall wage growth next year. We expect wages to increase by 11.7% in 2024, on average.

Chart 19. Increase in wages and inflation (%, y/y)



Note: forecasts are presented each quarter.
Source: prepared by PEI based on Statistics Poland data.

Wage growth that exceeds inflation and productivity growth will be made possible by labour costs' heightened share in companies' total costs. Over the past two years, wages' share in companies' total costs has declined from 15.7% in 2019 to 13.6% in 2022. Currently, the lower level leaves room for a greater increase in wages at the expense of lower profitability compared to previous years. In these conditions, the noticeable increase in the minimum wage will not have negative employment consequences.

Forecast table

Description	2023				2024			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Economic activity (%, y/y)								
GDP	-0.3	0.2	1.1	1.5	2.3	2.5	2.0	2.0
Household consumption	-2.0	-1.5	0.5	1.3	2.3	2.7	2.9	3.3
Public consumption	-0.5	0.0	3.2	3.1	2.3	2.4	2.1	2.4
Capital expenditures	5.5	4.0	2.7	4.4	5.2	3.0	0.0	-0.5
Exports	3.2	1.0	0.5	2.9	3.4	3.3	4.0	4.5
Imports	-4.6	-1.5	-1.0	3.0	3.3	3.6	4.2	5.0
Inflation (%, y/y)								
CPI	17.0	13.2	10.7	9.5	9.2	8.2	7.4	6.5
Core inflation	12.0	11.5	10.6	10.1	8.7	7.5	6.3	5.4
Labour market								
Registered unemployment rate	5.5	5.0	5.0	5.5	5.6	5.3	5.3	5.6
Wages in the national economy (%, y/y)	12.8	12.2	12.3	11.8	13.2	11.8	11.2	10.5

Description	2022	2023	2024	2025
Economic activity (%, y/y)				
GDP	5.1	0.7	2.2	3.3
Household consumption	3.3	-0.4	2.8	3.5
Public consumption	-2.1	1.6	2.3	1.6
Capital expenditures	5.0	4.1	1.3	5.1
Exports	6.2	1.9	3.8	3.7
Imports	6.0	-0.8	4.1	3.7
Inflation (%, y/y)				
CPI	14.3	12.6	7.9	4.8
Core inflation	9.1	11.0	7.0	5.2
Labour market				
Registered unemployment rate (end of the year)	5.5	5.5	5.6	5.6
Wages in the national economy (%, y/y)	12.8	12.3	11.7	8.5

Note: the forecasts are based on the *Makromodel gospodarki narodowej Polskiego Instytutu Ekonomicznego* (Welfe, 2020) developed in cooperation with external experts.

Source: prepared by PEI.

List of charts

The Polish Economic Institute

The Polish Economic Institute is a public economic think tank dating back to 1928. Its research primarily spans macroeconomics, energy and climate, foreign trade, economic foresight, the digital economy and behavioural economics. The Institute provides reports, analyses and recommendations for key areas of the economy and social life in Poland, taking into account the international situation.

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