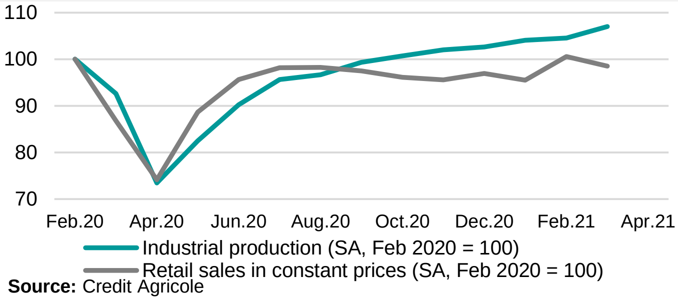
Polish Deal to reduce wage pressure

This week



Source: Credit Agricole

- **The publication of data on the industrial production and retail sales in Poland in April, which is planned for today, will be the most important event this week.** In our opinion, industrial production growth accelerated to 43.0% YoY comparing to an 18.9% growth in March, and the retail sales increased to 29.5% YoY vs. 17.1% in March. Both rates rose strongly due to last year's low base effects related to the outbreak of the COVID-19 pandemic: in April 2020, seasonally-adjusted production and retail sales fell by 20.7% MoM and 14.6% MoM, respectively. In our opinion, the publication of data for Poland will be neutral for the PLN and the yields on Polish bonds.
- **Important data from the US will be released this week.** Preliminary data on orders for durable goods in the US will be published this Thursday. We believe the number of orders increased by 1.2% MoM in April comparing to a 1.0% growth in March. The Conference Board index will be published this Tuesday. In our opinion, it will indicate a slight deterioration in consumer sentiment (118.0 pts in May vs. 121.7 pts in April). Data on new home sales (950k in April vs. 1,021k in March) will also be published on Tuesday, and it will be indicative of a slight decline in activity in the US real estate market. The final University of Michigan index will be published this Friday. In our opinion, it will not change much comparing to the preliminary estimate, and it will stand at 83.0 pts. Also, the second GDP estimate for Q1 will be published this week. We do not expect the annualised GDP growth to be revised comparing to the first estimate, so it will stand at 6.4%. We believe that the total impact of the US data on the PLN and the yields on Polish bonds will be limited.
- **The Ifo index describing the sentiment of German manufacturers operating in the processing industry, construction, trade and services sectors will be published on Tuesday.** We expect the index to rise from 96.8 pts in April to 97.5 pts in May. Our forecast is supported by an economic upturn in Germany as indicated by PMI indexes (see below). In our opinion, the publication of business survey results for Germany will be neutral for the financial markets.

Last week

- **Nominal wage growth in the Polish enterprise sector increased from 8.0% YoY in March to 9.9% YoY in April.** Last year's strong low base effects related to the outbreak of the pandemic (see MACROpulse of 20/05/2021) were the main factor driving the wages significantly up between March and April. The employment growth in the enterprise sector in April stood at 0.9% in April comparing to -1.3% in March, running below the market consensus, which was consistent with our forecast (1.1%). Last year's strong low base effects were the main factor driving the employment up in April comparing to March, just as it was the case with wages and salaries (see above). However, employment expressed in monthly terms went down by 13.4k people. This is consistent with our scenario, in which we expect a significant, lasting growth of employment in enterprises to take place only in the second half of 2021, i.e. when the negative impact of the working-time basis adjustments ceases as a result of the labour market being "unfrozen" (abatement of the positive impact of the first financial shield on employment). A stronger growth in the wages and employment combined with a significant inflation growth in April resulted in a strong increase in the real wage fund growth rate being the product of employment and average salary in the enterprise sector from 3.3% in March and 1.2% in Q1 to 6.3% YoY. Therefore, the data is consistent with our consumption growth forecast for Q2 2021 (10.2% YoY vs. 0.6% in Q1).

- **The construction-assembly production in Poland shrank by 4.2% YoY in April vs. -10.7% in March.** A year-on-year construction-assembly production growth in April resulted from a combination of such factors as the easing out of the last year's low base effect favouring production growth, statistical effects resulting from an unfavourable difference in the number of business days and the initial stage of recovery in the construction sector. Seasonally-adjusted construction-assembly production increased by 5.0% MoM in April, which represented the strongest monthly growth since February 2019. Despite a relatively strong recovery, construction-assembly production in April 2021 was still lower by 11.1% comparing to February 2020, which was the last month when the domestic construction sector was not affected strongly by the pandemic. In our opinion, the data on construction-assembly production in April mark the beginning of a boom in the Polish construction sector (see MACROpulse of 21/05/2021). During the first phase, it will be primarily driven by housing investments of households supported by a favourable situation in the labour market, and by the NBP interest rates, which we expect to stabilise on a historically low level in the quarters to come. During the second phase, which will be clearly seen in the second half of 2021, construction-assembly production will be increasingly supported by companies' investments, including in particular investment expenditures in the manufacturing sector. During the third phase, which is expected to begin in 2022, the activity in the construction sector will additionally be supported by an increase in public expenditures on infrastructure financed with the funds obtained from the long-term EU Recovery Fund's budget.
- **Last week saw the publication of the minutes from the April FOMC meeting.** According to the minutes, FOMC members see upward risks to their inflation forecasts published in March. At the same time, some FOMC members suggested that if the economy continued to make rapid progress towards achieving the Federal Reserve's goals for employment and inflation, "it might be appropriate" to start a discussion at one of the upcoming meetings on plans to taper the Fed's asset purchases. We believe that even if the upcoming inflation data are above market expectations, the Federal Reserve will maintain its rhetoric whereby the observed rise in inflation is only temporary. This is consistent with our assessment according to which the discussion will start this summer (see MACROmap of 17/5/2021). We stand by our scenario for the FED's monetary policy assuming a stabilization of interest rates at their current level at least until the end of 2023 and a start to the tapering of asset purchases in early 2022. However, we see a risk that the monetary policy could be tightened sooner (start of the tapering process in Q4 and the first interest rate hike in 2023).
- **According to preliminary data, composite PMI (for manufacturing and the services sector) in the Eurozone increased in May to 56.9 pts vs. 53.8 pts in April, running above market expectations (54.9 pts) and below our forecast (58.1 pts).** Thus, for the third consecutive month, the composite Eurozone PMI was above the 50-point mark separating expansion of activity from contraction, reaching its highest level since February 2018. The rise in the aggregate PMI followed from a marked increase in business activity in services (the highest level since June 2018) with slower growth in current production in manufacturing having the opposite effect. According to the press release, the strong improvement in the services sector was mainly driven by eased administrative restrictions and the waning of the pandemic in Europe. In geographical terms, a robust economic improvement was recorded in Germany, France as well as other Eurozone countries covered by the survey. What is of particular importance to Polish exports is the trends in Germany where

PMI for German manufacturing (pts)

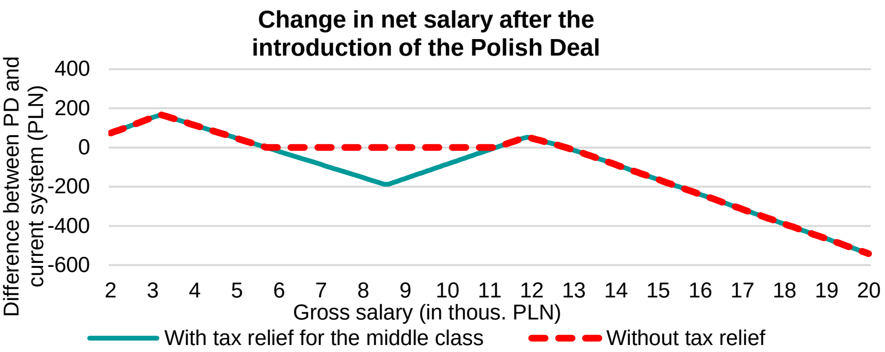
Source: Markit, Credit Agricole *the longer the lower the index value the manufacturing PMI fell to 64.0 pts in May compared with 66.2 pts in April. The decline in the indices followed from lower contributions from new orders and current production, higher contributions from delivery times and inventories, and the stabilization of the employment component. According to the press release, similarly to the previous months, German manufacturing was unable to keep up with the delivery of orders in May, reflecting strong demand coupled with issues with the supply chain and availability of intermediate goods. This is reflected in the continued increase of the backlog of work component (another record), accompanied by a strong increase in input prices (record). This, in turn, contributes to an increase in output prices (record). The decline in components for current production and new orders, including new export orders, suggests that increasing supply barriers may hold back the recovery in manufacturing in the coming months. Last week's results of the economic climate survey in the Eurozone present an upward risk for our scenario whereby the quarterly GDP growth in the euro area will increase to 1.1% in Q2 vs. a decline of 0.6% in Q1.

- **Last week, vital data regarding the US economy was published.** The number of new jobless claims dropped to 444k vs. 478k two weeks ago, slightly below market expectations (450k). The number of continued applications rose from 3.6M to 3.8M, which is to some extent attributable to the effect of the extension of benefits under the Biden package. Thus, the data show that while the situation on the US labor market is improving, the market is still far from equilibrium. Last week also saw the publication of data on building permits (1,760k i April vs. 1,759k in March), housing starts (1,569k vs 1,733k) and sales on the secondary market (5.85M vs. 6.01M), confirming the continued high activity on the US real property market. Last week, the regional NY Empire State index was also published (24.3 pts vs. 26.3 pts), as well as the Philadelphia FED (31.5 pts vs. 50.2 pts), both attesting to slower growth in manufacturing activity. Last week's data from the US economy do not change our scenario according to which annual GDP growth will reach its local maximum of 10.2% in Q2 and from Q3 2021 will follow along a downward trajectory. Consequently, throughout 2021 the American GDP will expand by 6.5% compared to a 3.5% drop in 2020, to rise by 4.0% in 2022.
- **The second GDP estimate in the Eurozone was published last week.** The quarterly GDP growth rate in the common currency area increased in Q1 to -0.6% compared with -0.7% in Q3 (-1.8% vs. -4.9%), in line with the first estimate. The decline in GDP in the Eurozone on a quarterly basis reflects the strong impact of the third wave of the pandemic and related administrative restrictions on business activity within the Eurozone in Q1. At the same time, the data confirm that the euro area experienced a double recession (during the 1st and 3rd wave of the pandemic). A quarterly decline in GDP was seen, among others, in Germany (-1.7%), Italy (-0.4%), Spain (-0.5%) and the Netherlands (-0.5%), with France being among countries recording a growth (0.4%). Detailed data on the GDP structure in the Eurozone will be announced on June 8. The data incoming from the Eurozone (see above) present an upward risk for our forecast whereby GDP in the common currency area will rise by 4.0% in 2021, compared with a 6.6% decline in 2020.

Polish Deal to reduce wage pressure

The "Polish Deal", a new social and economic program unveiled by the ruling Law and Justice (PiS) party, introduces major changes in the method of converting gross wages into net wages. Below, are the main relevant regulations and an analysis of their impact on wage pressures in the coming quarters.

The proposals presented by PiS are only general in nature and at present it is difficult to predict the final form of the laws implementing the Polish Deal. In our analysis, we only tackle changes applicable to persons employed under an employment contract. According to the available information, attention should be paid to four key changes in the tax system – raising the tax-free allowance to PLN 30,000, raising the first tax bracket to PLN 120 thousand, abolishing the tax deductibility of health insurance contributions and introducing a tax relief for the middle class. The first three changes have a clearly defined mechanism, while the last was mentioned in the Polish Deal only briefly. According to the document: "thanks to the tax relief, the reform will be neutral for taxpayers employed under an employment contract with an income of PLN 6,000-10,000 per month". According to unofficial information published by the *Dziennik Gazeta Prawna* daily, the tax relief will be calculated based on a specific algorithm. For people earning between PLN 5,700 and PLN 8,550 per month, it will be calculated according to a formula of 0.3932 times the annual income minus PLN 26,900. In turn, for people earning between PLN 8,550 and PLN 11,100 per month, the relief will be calculated as -0.4322 multiplied by annual income plus PLN 57,791. However, other methods of calculating the tax relief for the middle class are also being considered.



Source: Credit Agricole

Taking into account the above-mentioned changes in the tax system, we calculated, depending on varying gross monthly remuneration levels, the difference between the net monthly salary after the introduction of the Polish Deal and the rate applicable under the current regulations (see graph). In our calculations, we used annual values (of salaries, social insurance contributions and taxes) divided by 12 months, which allows us to correctly capture, among others, the exact moment the tax threshold is exceeded and the impact of the so-called 30-fold cap on the average monthly net salary.

We are presenting two ways of calculating the difference in net salary - with and without the middle class relief. If calculated taking the relief into account, the difference between net salary in the current system and after the introduction of the Polish Deal for people earning between PLN 5,700 and PLN 11,000 gross monthly is negligible. If the relief is not taken into account, those taxpayers would receive lower net salaries after the Polish Deal has been put into place compared with what they earn at present. The introduction of the Polish Deal will benefit people earning up to PLN 5,700 gross monthly. The new rules will also benefit people earning between PLN 11,100 and 12,700 gross monthly. However, it is difficult to find justification for such a change, so it is possible that adjustments will be made so that the final bill does not work to the benefit of those with relatively high salaries. After the introduction of the new rules, taxpayers earning more than PLN 12,700 monthly will get lower take-home pay. The higher the gross salary, the bigger the adverse difference (in absolute terms).

The key question is how average net pay will change for the whole economy. To answer the question, we have used the Ministry of Finance data on the gross pay breakdown in 2017. We indexed all pay levels for each income group shown in the report by the increase in average pay in the national economy between 2017 and 2020 (i.e. we increased them by 21%) to reflect the changes in income levels seen in recent years. This means that in our analysis we assume the relative pay breakdown did not change between 2017-and 2020. In fact, wages and salaries in the lower deciles probably grew faster than those in the higher deciles.

Based on that, we estimate that with gross wages and salaries unchanged, the introduction of the Polish Deal will result in an increase in average net pay in the national economy of ca. 1.0% in the scenario with the middle class relief and 0.4% in the scenario where the relief legislation is not enacted after all. The result reflects the breakdown of wages and salaries of Poles. The share of wages and salaries of lower earners (who would benefit from the introduction of the Polish Deal) in total wages and salaries is bigger than the share of the salaries of wealthier taxpayers, who would receive lower net salaries after the changes.

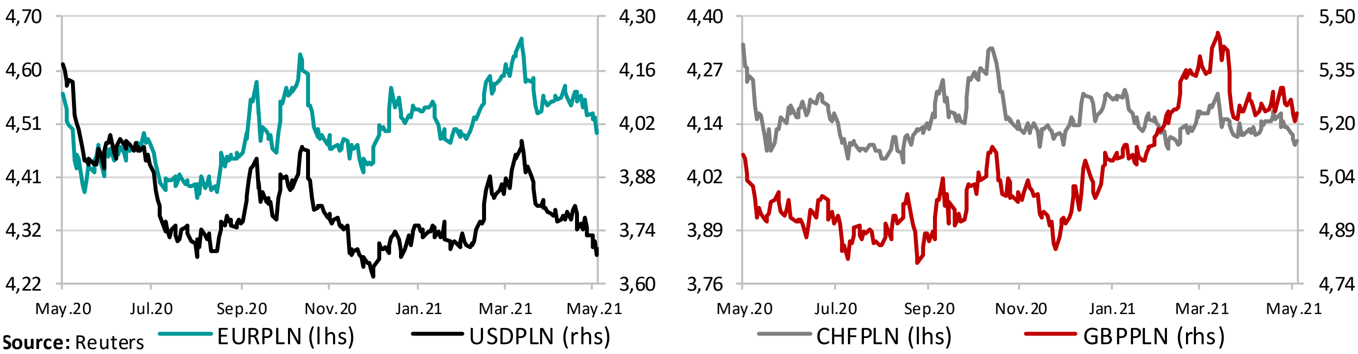
We believe that in the scenario where workers receive higher net wages and salaries we will see a drop in pressure on gross pay rises. This assessment is in line with NBP studies. Based on simulations carried out by the NBP, a 1 pp increase in the effective income tax rate would translate into an annual average rise in nominal gross pay of 0.1 pp during the first year following such a change. At the same time, a 1 pp increase in employee contributions would translate into a 0.2 pp rise in gross pay during the first year following such a change. Following the introduction of the Polish Deal we will see the opposite situation, i.e. a reduction in tax charges, however, we assume that the scale of the impact of the proposed reform on gross pay will be similar to that in NBP simulations.

Certainly, we will not see a decline in gross wages and salaries after the Polish Deal is put in place. It is hard to imagine a situation where employers would cut pay in response to the enacted regulations. The tax system changes will, however, drive down pressure from employees on pay rises and employers' willingness to raise gross pay. Taking into account the percentage change in average net pay in the economy and NBP simulations concerning the impact of tax changes on gross pay rises, we estimate that the changes to the tax system proposed in the New Deal will slow down wage and salary growth in 2022 by 0.1-0.2 pp in the scenario where the middle class relief legislation is enacted and by 0.04-0.08 pp in the scenario without the middle class relief. These figures should be interpreted as the difference between the hypothetical annual growth in nominal gross pay in the national economy in 2022 in the scenario where the Polish Deal is not enacted and an analogous path after the introduction of the changes into the tax system

A slight drop in pay pressure and lower willingness of employers to raise pay support our scenario of a drop in annual nominal pay growth in the national economy from 6.6% YoY in 2021 to 5.8% in 2022.

Domestic production and sales data of key importance for the PLN

FX rates



Source: Reuters

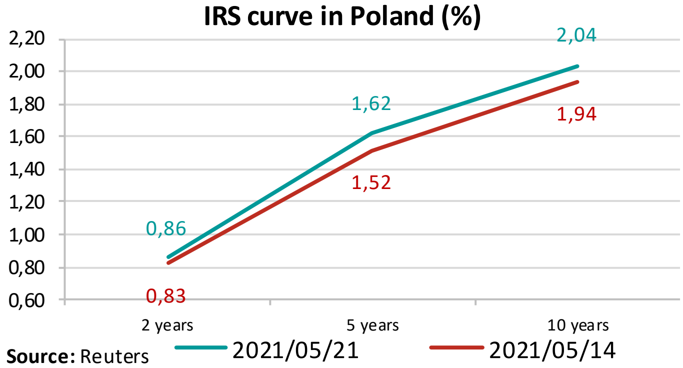
Last week, the EURPLN rate dropped to 4.4938 (the PLN strengthened by 0.6%). We saw the PLN strengthen throughout last week. On Thursday, the decline in the EURPLN exchange rate accelerated, supported by some speculation on the appreciation of the PLN driven by the fact that the adverse factors for the Polish currency, including the postponement of the resolution on foreign currency loans, became temporarily less material. As a result, on Thursday the EURPLN rate dropped below 4.50.

The hawkish tone of the *Minutes* of the April FOMC meeting also supported the strengthening of the USD against the EUR. However, it was only temporary and on the following days the EURUSD rate was back on an upward trend. The publication of flash PMIs for the Eurozone drove the volatility of the EURUSD rate up.

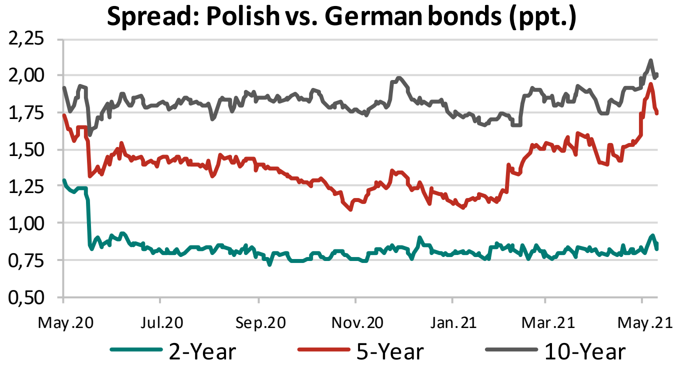
This week, of key importance for the PLN will be the publication of domestic data on industrial production and retail sales. Our forecasts are close to the market consensus and therefore we believe that their materialization will not have any significant impact on the PLN. Most likely, releases of data from the US (second GDP estimate, preliminary durable goods orders, new home sales, Conference Board index, University of Michigan index) and from Germany (Ifo index) will also have limited impact on the PLN.

Domestic production and sales data in the spotlight

IRS curve in Poland (%)



Spread: Polish vs. German bonds (ppt.)



Source: Reuters

Last week, 2-year IRS rates rose to 0.86 (up by 3 bps), 5-year rates to 1.62 (up by 10 bps) and 10-year ones to 2.04 (up by 20 bps). Last week's rises were a continuation of the trend seen in previous weeks. Investors' concerns about rising inflation amid economic recovery were driving IRS rates up. The hawkish tone of the *Minutes* of the April FOMC meeting was another factor driving IRS rates up. On Friday, the Ministry of Finance held a debt auction at which it sold 2-, 5-, and 10-year bonds for PLN 4.0bn against demand of PLN 7.9bn. The strong demand for bonds limited the rise of IRS rates.

This week, the market will focus on the publication of domestic data on industrial production and retail sales, planned for today. We believe, however, that the impact of the data on IRS rates will be limited. Most likely, releases of data from the US (second GDP estimate, preliminary durable goods orders, new home sales, Conference Board index, University of Michigan index) and from Germany (Ifo index) will have limited impact on the curve).

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland

Indicator	Apr.20	May.20	Jun.20	Jul.20	Aug.20	Sep.20	Oct.20	Nov.20	Dec.20	Jan.21	Feb.21	Mar.21	Apr.21	May.21
NBP reference rate (%)	0,50	0,10	0,10	0,10	0,10	0,10	0,10	0,10	0,10	0,10	0,10	0,10	0,10	0,10
EURPLN*	4,54	4,44	4,44	4,41	4,40	4,53	4,60	4,47	4,55	4,52	4,52	4,63	4,56	**4,53**
USDPLN*	4,15	4,00	3,95	3,74	3,68	3,86	3,95	3,75	3,73	3,72	3,74	3,95	3,79	**3,74**
CHFPLN*	4,30	4,16	4,17	4,10	4,07	4,21	4,32	4,13	4,21	4,18	4,11	4,18	4,15	**4,12**
CPI inflation (% YoY)	3,4	2,9	3,3	3,0	2,9	3,2	3,1	3,0	2,4	2,6	2,4	3,2	4,3	
Core inflation (% YoY)	3,6	3,8	4,1	4,3	4,0	4,3	4,2	4,3	3,7	3,9	3,7	3,9	3,9	
Industrial production (% YoY)	-24,6	-16,8	0,5	1,1	1,5	5,7	1,0	5,4	11,1	0,7	2,5	18,9	**43,0**	
PPI inflation (% YoY)	-1,4	-1,7	-0,8	-0,6	-1,3	-1,4	-0,4	-0,2	0,1	1,0	2,2	3,9	5,3	
Retail sales (% YoY)	-22,6	-8,6	-1,9	2,7	0,4	2,7	-2,1	-5,3	-0,8	-6,0	-2,7	17,1	**29,5**	
Corporate sector wages (% YoY)	1,9	1,2	3,6	3,8	4,1	5,6	4,7	4,9	6,6	4,8	4,5	8,0	9,9	
Employment (% YoY)	-2,1	-3,2	-3,3	-2,3	-1,5	-1,2	-1,0	-1,2	-1,0	-2,0	-1,7	-1,3	0,9	
Unemployment rate* (%)	5,8	6,0	6,1	6,1	6,1	6,1	6,1	6,1	6,2	6,5	6,5	6,4	**6,2**	
Current account (M EUR)	717	1556	3333	650	1273	1330	2307	1956	477	3341	1585	938		
Exports (% YoY EUR)	-29,6	-19,2	4,3	2,2	2,4	6,6	3,7	10,0	14,6	-0,9	5,9	27,7		
Imports (% YoY EUR)	-28,9	-27,3	-7,4	-3,6	-4,0	2,1	-4,2	4,1	12,4	-4,0	6,2	24,6		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland

Indicator		2020				2021				2020	2021	2022
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Gross Domestic Product (% YoY)		1,9	-8,4	-1,5	-2,8	-1,3	9,2	4,7	5,7	-2,7	4,6	4,9
Private consumption (% YoY)		1,2	-10,8	0,4	-3,2	0,6	10,2	3,6	4,3	-3,0	4,5	4,5
Gross fixed capital formation (% YoY)		0,9	-10,7	-9,0	-10,9	-1,4	4,6	5,6	6,1	-9,6	4,3	7,8
Export - constant prices (% YoY)		2,0	-14,5	2,0	8,0	7,0	12,2	8,1	9,2	-0,2	9,0	8,3
Import - constant prices (% YoY)		0,4	-18,0	-1,0	7,9	9,0	9,1	6,3	6,1	-1,9	7,5	8,9
GDP growth contributions	Private consumption (pp)	0,8	-6,2	0,2	-1,7	0,4	5,7	2,1	2,1	-1,7	2,5	2,5
	Investments (pp)	0,1	-1,8	-1,7	-2,8	-0,2	0,7	0,9	1,3	-1,8	0,7	1,3
	Net exports (pp)	0,9	1,1	1,7	0,4	-0,6	2,3	1,4	2,2	0,8	1,4	0,0
Current account (% of GDP)***		1,1	2,2	2,9	3,5	3,8	3,0	2,7	2,9	3,5	2,9	2,3
Unemployment rate (%)**		5,4	6,1	6,1	6,2	6,4	5,7	5,6	5,6	6,2	5,6	5,1
Non-agricultural employment (% YoY)		0,7	-1,8	-0,7	0,0	0,0	1,8	0,9	0,7	-0,5	0,9	0,4
Wages in national economy (% YoY)		7,7	3,8	4,8	5,0	6,6	7,0	6,5	6,3	5,3	6,6	5,8
CPI Inflation (% YoY)*		4,5	3,2	3,0	2,8	2,7	4,4	4,3	4,2	3,4	3,9	2,7
Wibor 3M (%)**		1,17	0,26	0,22	0,21	0,21	0,21	0,21	0,21	0,21	0,21	0,26
NBP reference rate (%)**		1,00	0,10	0,10	0,10	0,10	0,10	0,10	0,10	0,10	0,10	0,10
EURPLN**		4,55	4,44	4,53	4,55	4,63	4,46	4,42	4,37	4,55	4,37	4,27
USDPLN**		4,13	3,95	3,86	3,73	3,95	3,81	3,71	3,64	3,73	3,64	3,44

* quarterly average
** end of period
***cumulative for the last 4 quarters

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST* CA	FORECAST* CONSENSUS**
		Monday 05/24/2021				
10:00	**Poland**	**Industrial production (% YoY)**	**Apr**	**18,9**	**43,0**	**44,5**
10:00	**Poland**	**Retail sales (% YoY)**	**Apr**	**17,1**	**29,5**	**27,2**
		Tuesday 05/25/2021				
8:00	Germany	Final GDP (% QoQ)	Q1	-1,7	-1,7	-1,7
10:00	Germany	Ifo business climate (pts)	May	96,8	97,5	98,1
14:00	**Poland**	**M3 money supply (% YoY)**	**Apr**	**14,4**	**12,0**	**12,6**
15:00	USA	Case-Shiller Index (% MoM)	Mar	1,2		
16:00	USA	New home sales (k)	Apr	1021		950
16:00	USA	Richmond Fed Index	May	17,0		
16:00	USA	Consumer Confidence Index	May	121,7	118,0	119,0
		Wednesday 05/26/2021				
10:00	**Poland**	**Registered unemplyment rate (%)**	**Apr**	**6,4**	**6,2**	**6,3**
		Thursday 05/27/2021				
14:30	USA	Initial jobless claims (k)	w/e	444		430
14:30	USA	Second estimate of GDP (% YoY)	Q1	6,4	6,4	6,4
14:30	USA	Durable goods orders (% MoM)	Apr	0,8	1,2	0,7
		Friday 05/28/2021				
14:30	USA	Real private consumption (% MoM)	Apr	3,6		
15:45	USA	Chicago PMI (pts)	May	72,1		70,0
16:00	USA	Final U. of Michigan Sentiment Index (pts)	May	82,8	83,0	82,9

*The forecasts of macroeconomic indicators for Poland were prepared by Credit Agricole Bank Polska S.A. The forecasts of foreign indicators were prepared by Crédit Agricole Corporate and Investment Bank

** Reuters

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