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Poland:
a slowdown in the making

At 4.8%, the GDP growth rate in the third quarter of 2008 was still looking pretty good. However, the structure of growth changed remarkably. Growth of gross fixed capital formation slowed down abruptly to 3.5% (from over 15% in the first half of the year). Private consumption grew slightly less than in the first half of the year while public consumption stagnated as before. Exports of goods and non-factor services rose 7.1% in real terms as against a rise in imports of 5.9%. As a result, foreign trade contributed positively to overall growth for the first time since 2005. The provisional data for the whole year 2008 hint at a further marked deceleration in investment growth, somewhat faster growth in private consumption and a decline in imports and exports of goods and non-factor services. But the GDP growth in the fourth quarter of 2008 must have been very low.

The third quarter had left both the corporate non-financial sector and the banking system in an apparently good shape. Although the net profits earned by the former sector declined (from PLN 21.8 billion in the third quarter of 2007 to PLN 19.4 billion), the profitability rates remained high and the liquidity ratios did not change. At the end of the third quarter, the stock of short-term investments was some 20% higher than the stock of short-term liabilities to the banks and tax authorities combined. In the third quarter, banks also fared well, with net profits rising and the stock of credit assets matched by the stock of deposits.

Up until mid-January 2009, the Polish financial system had not been directly affected by the global turmoil. No financial institution based in Poland had gone bankrupt, nor had any institution requested public assistance. In common with the other new member states (NMS), the local (frequently foreign owned) banks had not got involved in the sub-prime market, because local business was lucrative enough. This also holds true for the local affiliates of foreign banks (such as Fortis) which have suffered heavy losses on their sub-prime exposures elsewhere. However, some indirect effects of external financial shocks have already made themselves felt. Even if the balance sheets of the local banks (including those that are foreign-owned) are as sound as claimed, their reputation has suffered. The financial stability indicators (that displayed excellent values at mid-year) must have actually deteriorated somewhat in the fourth quarter – for instance, on account of a major weakening of the Polish zloty (affecting the financial position of agents heavily indebted in foreign currencies) or owing to the abrupt weakening of overall economic growth observed in the closing months of 2008. The extent of the deterioration can be deduced from the provisional data on the banking system which show a sudden widening of the gap between the bank credits and deposits in domestic private sector. No doubt the rise in the stock of credits represents the effects of depreciation. (As elsewhere in the EU, mutual trust among banks has been impaired, bearing obvious consequences for inter-bank lending – and, of course, for lending to the real economy). The gap in question has been closed by depreciation having inflated the banks' foreign liabilities, the nominal value of which rose from PLN 156 billion in September to 210 billion in December 2008.

The global financial crisis and the subsequent economic turmoil had many local repercussions in the fourth quarter of the year, the most visible of which was the spectacular weakening of the Polish currency. The average monthly PLN/EUR exchange rate rose from 3.37 in September to 4.02 in December – the level that had previously in 2000 and 2005. Abnormally steep devaluation followed in January-February 2009. The government intervention possibly prevented the rate from hitting the ceiling of 5. To some extent the depreciation has been a welcome development since the previously observed trend towards appreciation had been largely driven by unproductive capital inflows. The response of the real economy to the weaker currency should by and large be positive. According to the latest Business Climate Survey (published on 20 January 2009) the proportion of firms that view exchange rates as the factor restricting expansion dropped to 10% in the fourth quarter from 17% in the third. The share of unprofitable exports fell from 10% to 6%. Moreover, firms started to substitute domestic intermediate inputs for the inputs they had previously imported.

On the other hand the weak currency has been rather costly to the agents (including the government, households, banks and many non-financial firms) which have accumulated sizeable liabilities denominated in foreign currencies. Overall the rising burden of such liabilities has not yet been considered as overwhelming. However, it has just turned out that many non-financial firms have engaged in risky transactions. They issued foreign exchange (call) options just at the time when the zloty was abnormally strong. Then, the unexpected depreciation of the zloty has resulted in huge losses (estimated at PLN 16 billion) suffered by these firms. Huge gains have been recorded by their counterparties (i.e. the banks). No doubt these losses might well push too many firms into insolvency: of course, this would harm the banks themselves. Quite likely the government will seek – and find – a compromise solution that will restrict the losses and gains over the currency options' transactions.

The waning performance of industry is most ominous. Industrial production fell by over 5% in the fourth quarter, followed by a further contraction in January. Manufacture of motor vehicles was the branch most seriously affected. Furthermore, the value of orders placed with manufacturing fell precipitously (by close to 20% in December). The customs statistical data on foreign trade in the third quarter show a 3.7% contraction in the value (in euro terms) of exports (with unchanged value of imports). The value of machinery and transport equipment exports (accounting for over 40% of total exports in 2007) fell by 10.7% in October-November (after having risen by over 6% in the first three quarters of the year).

The negative production and trade developments have been hardly matched by a few positive trends, such as a marked decline in inflation, a drop in NBP interest rates and continuing growth (albeit at an ever slower pace) in both wages and employment in the corporate sector. The earlier wage and employment developments reflected, to some degree, the widespread labour shortages. These shortages are being swiftly eliminated. One can expect, with some delay, a drop in employment and a rise in unemployment. This will slow down growth in wages and should slow down growth in unit labour costs.

Several unknowns enter the equation determining GDP growth in 2009, the first of which is the GDP growth rate in the EU itself (primarily in Germany); to a large extent, this will govern Poland's export performance. Otherwise, helped by PLN devaluation (which will probably be maintained in 2009), Poland's exports of goods and services need not fall much in real terms. On many markets the Polish products are likely to become attractive substitutes to expensive exports from the euro area countries. For several reasons, imports are likely to decline owing to lower dynamics household sector incomes and consumer demand, depreciated currency, lower demand for imported inputs in the export production, and probably somewhat weaker gross fixed investment. Falling interest rates and the continuing rather good financial position of the corporate sector suggest that investment in fixed assets need not decline much in 2009. The greatest problems are posed by the dynamics of private consumption, while public consumption may well remain constant. The correlation between private consumption growth rates and the GDP growth will remain very low – at least for the current decade. An estimate of a 3% growth rate in private consumption in 2009 seems quite conservative, especially in view of the level of household credit indebtedness that are still relatively low. All in all, our forecast for economic growth in 2009 is still in positive territory: a rare phenomenon in the EU – even among the NMS.

The growth slowdown is likely to result in a return of the public sector fiscal deficit in excess of 3% of GDP. The government response to that happening is by no means predictable. Cutting spending in an effort to adjust it to falling tax revenue is likely to push the economy into recession – clearly a politically costly option. However, allowing the deficit to balloon would also seem quite hazardous at the present juncture. Understandably, the government's response to the European Recovery Plan has been to produce a programme that envisages no additional spending. A number of EU countries (not only Hungary and the Baltic States, but also the Mediterranean countries) have been recently facing difficulties in securing funds to meet their fiscal needs. The risk is that an attempt to safeguard that (external) financing may set off a further excessive devaluation pressure on the domestic currency. Poland's foreign debt is not very large in relative terms, yet the short-term debt is rather high compared to the official reserve assets which have been contracting since August and stood at EUR 46.1 billion in January 2009. In normal times, this configuration of assets and liabilities would be considered quite safe – but not under the current conditions.

Table PL

Poland: Selected Economic Indicators

	2003	2004	2005	2006	2007	2008 [1]	2009	2010 Forecast	2011
Population, th pers., average	38204.6	38182.2	38165.4	38141.3	38120.6	38123.0	.	.	.
Gross domestic product, PLN bn, nom. [2]	843.2	924.5	983.3	1060.0	1167.8	1270	1330	1400	1490
annual change in % (real) [2]	3.9	5.3	3.6	6.2	6.6	4.8	1.5	2.3	3.8
GDP/capita (EUR at exchange rate)	5000	5300	6400	7100	8100	9500	.	.	.
GDP/capita (EUR at PPP)	10100	11000	11500	12400	13300	13900	.	.	.
Consumption of households, PLN bn, nom. [2]	546.2	589.4	614.3	652.8	701.1	.	.	.	.
annual change in % (real) [2]	2.1	4.7	2.1	5.0	5.0	5.4	3	3	5
Gross fixed capital form., PLN bn, nom. [2]	153.8	167.2	179.2	208.3	253.8	.	.	.	
annual change in % (real) [2]	-0.1	6.4	6.5	14.9	17.6	7.9	-3	4	8
Gross industrial production (sales) [3]									
annual change in % (real)	8.8	12.7	4.1	12.0	9.6	3.6	2	8	8
Gross agricultural production									
annual change in % (real)	-1.4	13.9	-0.7	-1.1	5.2	-4.0	.	.	.
Construction industry (build.& civil engin.) [3]									
annual change in % (real)	-6.7	-0.7	9.1	15.0	16.1	12.7	.	.	.
Employed persons - LFS, th, average [4]	13616.8	13794.8	14115.6	14593.6	15240.5	15620	.	.	.
annual change in %	0.6	1.3	2.3	3.4	4.4	2.5	-1	0.5	1
Unemployed persons - LFS, th, average [4]	3328.5	3230.3	3045.4	2344.3	1618.8	1250	.	.	.
Unemployment rate - LFS, in %, average [4]	19.6	19.0	17.7	13.8	9.6	8	12	11	10
Reg. unemployment rate, in %, end of period [4]	20.0	19.1	17.6	14.8	11.4	9.5	.	.	.
Average gross monthly wages, PLN	2185.0	2273.4	2360.6	2476.9	2691.0	2960	.	.	.
annual change in % (real, gross)	3.4	0.7	1.8	4.0	6.3	5.5	2	3	4
Consumer prices (HICP), % p.a.	0.7	3.6	2.1	1.3	2.6	4.2	3	2.6	2.5
Producer prices in industry, % p.a.	2.6	7.1	0.7	2.2	2.3	2.6	.	.	.
General governm.budget, EU-def., % GDP [5]									
Revenues	38.4	36.9	39.0	40.0	40.0	39.9	39.0	39.5	40.0
Expenditures	44.6	42.6	43.3	43.8	42.0	42.6	43.0	43.0	42.5
Net lending (+) / net borrowing (-)	-6.3	-5.7	-4.3	-3.8	-2.0	-2.7	-4.0	-3.5	-2.5
Public debt, EU-def., % of GDP [5]	47.1	45.7	47.1	47.7	44.9	45.9	46.0	45.5	45.0
Discount rate of NB % p.a., end of period	5.8	7.0	4.8	4.3	5.3	5.3	4.3	4.5	4
Current account, EUR mn	-4878	-8166	-3016	-7443	-14587	-19454	-12000	-15000	-16000
Current account in % of GDP	-2.5	-4.0	-1.2	-2.7	-4.7	-5.4	-3.9	-4.4	-4.3
Exports of goods, BOP, EUR mn	53836	65847	77562	93382	105883	118722	116400	130000	139800
annual growth rate in %	9.1	22.3	17.8	20.4	13.4	12.1	-2.0	11.7	7.5
Imports of goods, BOP, EUR mn	58913	70399	79804	98918	118249	134877	129000	140000	149800
annual growth rate in %	3.3	19.5	13.4	24.0	19.5	14.1	-4.4	8.5	7.0
Exports of services, BOP, EUR mn	9850	10815	13105	16349	20930	23554	.	.	.
annual growth rate in %	-6.6	9.8	21.2	24.8	28.0	12.5	.	.	.
Imports of services, BOP, EUR mn	9657	10787	12520	15768	17523	20452	.	.	.
annual growth rate in %	-1.1	11.7	16.1	25.9	11.1	16.7	.	.	.
FDI inflow, EUR mn	4067	10237	8330	15737	16672	11150	.	.	.
FDI outflow, EUR mn	269	757	2767	7122	3500	2679	.	.	.
Gross reserves of NB excl. gold, EUR mn	26083	25870	34535	35237	42675	42107	.	.	.
Gross external debt, EUR mn	85067	95297	112316	128869	158441	187000	.	.	.
Gross external debt in % of GDP	47.4	42.1	44.1	46.6	48.8	61.2	.	.	.
Average exchange rate PLN/EUR	4.40	4.53	4.02	3.90	3.78	3.51	4.3	4.1	4.0
Purchasing power parity PLN/EUR	2.18	2.21	2.23	2.25	2.31	2.40	.	.	.

Note: The term 'industry' refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices). - 3) Enterprices with more than 10 employees. - 4) From 2003 according to census May 2002. - 5) According to ESA'95 excessive deficit procedure; forecast wiiw estimate.

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.