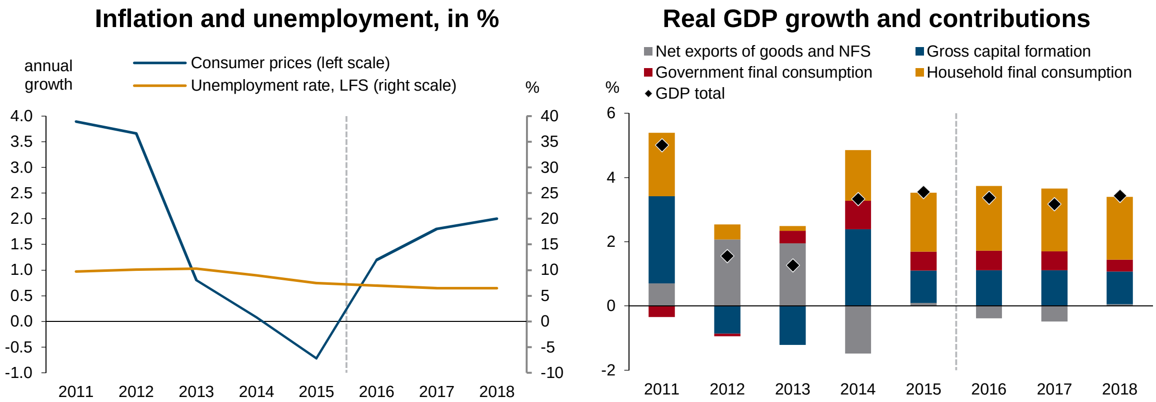
POLAND: Keeping generous promises will not be easy

LEON PODKAMINER

The current moderate and broadly based growth will continue over the period 2016-2018, with GDP growth averaging 3.4%. There is, however, every reason to expect less dynamic growth in terms of investment. 2017 will prove critical, unless the increase in social spending is offset by higher tax revenue.

Figure 50 / Poland: main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

According to provisional estimates, GDP grew by 3.6% in 2015. Rising household consumption contributed 1.8 percentage points (p.p.) to the overall growth, public consumption 0.7 p.p., gross fixed capital formation 1.2 p.p. and foreign trade (in goods and services) 0.3 p.p. As inventories contracted quite strongly in 2015, their contribution was negative (-0.4 p.p.). Gross value added rose strongly in industry and construction (by 5.4% and 4.4% respectively) and much weaker in the services sectors.

GDP growth accelerated from the second quarter of 2015, peaking (at about 3.8%) in the fourth. There are many indications that the first two quarters of 2016 may still see a continuation of GDP growth at rather high rates. However, the dynamics of gross fixed capital formation (GFCF) slowed down already in 2015: from 8.5% in the first half of the year to about 4.7% in the second. Quite likely the investment growth speed-up in early 2015 was due to a hasty spending of the last tranches of EU funds earmarked for 2007-2013. It will take some time before public investment spending out of EU funds earmarked for 2014-2020 regains momentum.

Overall GFCF in 2016 will primarily depend on the intentions of the private business sector. In ‘material terms’ these conditions are looking quite good. While nominally the net profits of the non-financial corporate sector have stagnated recently (during the first three quarters of 2015), they are still quite high and – given the deflation in producer prices – still rising in real terms. The sector’s indebtedness is quite low (with its bank deposits alone not much lower than its credit liabilities) and the financial liquidity correspondingly very high and rising.[50] The median interest rates on loans (still above, but close to, 3%) are not permissively low – but nonetheless much lower than in 2014 (when investment growth was much stronger). The availability of bank credit is high: the share of credit applications accepted by banks is high and rising (while the demand for credit has been rather stagnant). On the other hand, the capacity utilisation index is relatively low (about 80% in manufacturing) which is generally believed to discourage aggressive business investment in fixed assets. However, at approximately the same level of capacity utilisation, business investment expanded much more strongly in 2014 and 2011.[51] All in all, the ‘material’ conditions seem conducive to a stronger expansion of business investment. Nevertheless, business opinion polls (and the evidence on the demand for credit) suggest that investment growth in 2016 may not be much higher than in 2015 – and possibly even somewhat weaker.

The genuine reason why the conditions that are ‘materially supportive’ may not yet translate into a stronger acceleration of business investment seems to have to do with a strong increase in uncertainty. The uncertainty in question is not over a ‘normal’ economic uncertainty (over sales or prices) though. Instead it seems to relate to the lack of certainty concerning the future course of policy towards the business sector. The fears about unpredictable changes in business taxation and legal or other regulations (including administrative – possibly arbitrary – intrusions) seem now well grounded. After many months of ‘bad business bashing’, which was an element of the election campaign of the victorious Law and Justice (PiS) party, the level of trust the business circles have in the stability and predictability of policy seems to be rather low. Naturally, a high level of trust is a central criterion when it comes to investment decisions.[52]

The government formed by PiS, in office since early November 2015, has already proved capable of legislating whatever serves its own preferences, without paying attention to anything else. That was possible as PiS chose to ignore the existence of the Constitutional Court. It has also conducted a wholesale purge of functionaries of the public administration apparatus and firms partly owned by the state. In June 2016 the PiS nominees will finally come to rule the National Bank of Poland. After taking over the public media, PiS seems poised now to ‘tame’ the private media as well.

Taking advantage of its parliamentary majority, the ‘friendliness’ of the President and the timidity of the media, the government wastes no time and is passing a number of laws. One law, already in force, burdens the financial sector’s larger firms (including banks) with an extra tax (0.44%) on most of their

---

[50] See e.g. the January 2016 business climate survey of the National Bank of Poland: http://www.nbp.pl/home.aspx?c=/ascx/koniunktura_prezentacja.ascx

[51] At about 20%, Poland’s GFCF/GDP ratio has been singularly low. The stock of fixed productive capital seems to be rather low and may need to rise secularly.

[52] Foreign-owned firms (especially banks and retail trade organisations) have been the favourite targets of ‘business bashing’. But the foreign-owned corporations account for about 50% of total corporate sector investment in fixed assets. It is quite likely that these corporations may now be less inclined to expand their investment activities. The recent Standard & Poor’s decision to downgrade Poland’s credit rating from A- to BBB+ is likely to have some sobering effect on potential new FDI entrants as well. (S&P motivates their move by ‘... the view that Poland’s system of institutional checks and balances has been eroded significantly ...’.)

assets. The law, introducing an extra tax (0.7-1.3%) on the turnover of larger retail trade firms (believed to be capable of bringing PLN 2-3 billion sums in additional tax revenue), has been officially motivated by the desire to extract a 'fair amount' of tax revenue from large foreign-owned supermarket chains. In actual fact the new tax would primarily affect the local small retail business operating under franchise contracts with large organisations, as well as the local suppliers of large supermarket chains. Amid massive protests of native shopkeepers, the law is now being 'reconsidered'. But there is little doubt that sooner or later the government will try to find additional tax revenue needed to cover the expenses of the costly social programmes which PiS promised to introduce during its election campaign. Some of that revenue will be reducing corporate disposable income – and thus also the profitability of newly installed pieces of productive assets.

The major of the social programmes promised has already been signed into law. It provides for the payment of PLN 500 (roughly EUR 115) monthly per each child (in families with two or more children). The programme, to become effective as of 1st April, will cost about PLN 17 billion (about 1% of GDP) in 2016. The financing of that amount may be possible without additional taxation because of large one-off fiscal revenues (PLN 8 billion profit made in 2015 by the National Bank and PLN 9.2 billion earned on LTE frequencies auctioned off last October). However, in 2017 the cost of the programme may reach PLN 22 billion while the additional revenue due to the tax on the financial institutions is unlikely to generate much more than (an estimated) PLN 5 billion. Obviously an additional – and large – financing gap will appear in 2017 – even if the government manages to collect more in the value added and the corporate income taxes due.[53] That financing gap may assume even larger dimensions should other election promises be fulfilled. These promises include a massive increase in the tax-free personal income threshold, free-of-charge pharmaceuticals for seniors aged 75 or more, lower retirement age, additional public support to the loss-making coal-mining sector etc. The most costly – and consequential – would be a programme of a substantial 'easing of the burden' of servicing debt denominated in Swiss francs that many (well-off) households voluntarily incurred when that currency's worth was very low vs. the Polish zloty.

Additional handouts to families with children will certainly be supporting growth in private consumption in 2016. Whether they will have that effect later on is less obvious if only because the additional tax burden placed on the business sector may well lead to higher inflation which then would be eroding the real purchasing power of households' disposable incomes.

The changing perceptions of Poland's economic and political environments, as well as the prospects of possibly rising public sector deficits, have weakened the national currency. Although this implies some losses on foreign debts service (including on mortgages denominated in Swiss francs) it will be advantageous to the foreign trade sector in 2016 – and very likely also in 2017. It may be expected that under the new monetary authorities the monetary policy will be relaxed. That should be also preventing a stronger zloty appreciation.

On 16th February 2016 the Minister of Development unveiled 'The Economic Long-Term Plan for Balanced Development'. All this is wishful thinking. The Plan lacks coherence and is empty of any details. One remembers plenty of such 'long-term plans' from the era of 'central planning'. They used to

[53] According to the government, the revenue losses due to tax evasion are gigantic (PLN 10-40 billion in corporate income taxes and PLN 35-45 billion in value added taxes). The details of the calculations behind these estimates are not known. Statistics show that generally the VAT and CIT taxes actually collected do not tend to fall behind the values planned.

be announced, with fanfares, just to ‘boost the moods of the masses’, or to compensate for the sorry state of everyday reality – but not to guide the actual policy.

2017 is going to be critical not only as far as fiscal developments go. Very likely the public sector revenues due to extraordinary tax burdens placed on the business sector will not be sufficient to cover the costs of expanded social spending. Excessive public sector deficits may not be acceptable to the European Commission (which does not belong to the fans of the PiS rule). Making use of the National Bank’s ‘printing press’ is also outlawed under the EU Treaties. The government is unlikely to wage an open war with the EU – just because it will need its money more than ever. The remaining options would be risky politically as they would stipulate either higher general taxation (for example higher VAT rates) or a downsizing of the spending programmes. It is to be feared that, in order to make the necessary fiscal tightening less visible to the public, PiS could then stage large-scale public spectacles over issues such as the predecessors’ (or political opponents’) ‘corruption’, ‘treason of national interests’, ‘bad morality’, ‘complicity in the plot to assassinate the former State President Lech Kaczynski’ or even their ‘incorrect ethnic provenience’[54].

Summing up, Poland’s economic forecast is still positive, with GDP expected to rise by 3.4% per annum over 2016-2018. However, rather large fiscal imbalances likely to emerge in 2017 may necessitate adjustments that can slow down growth in 2017-2018.

[54] In 2007, only after two years in power, PiS staged such a fascinating public spectacle (lavishly reported, on line, by the media). The role of the chief villain was assigned to Andrzej Lepper, the charismatic leader of the populist ‘Samoobrona’ party, and – at that time – formally Deputy Prime Minister in the PiS-led coalition government. The PiS functionaries in charge of the Justice and Secret Police departments (currently both back in their former offices) concocted a plot to discredit the ‘inconvenient’ Mr Lepper. The plot misfired as Mr Lepper proved less corrupt than believed. The affair resulted in the collapse of the government and the new elections (lost by PiS miserably).

Table 19 / Poland: selected economic indicators

	2011	2012	2013	2014	2015 1)	2016	2017 Forecast	2018
Population, th pers., average	38,534	38,536	38,514	38,487	38,525	38,500	38,550	38,560
Gross domestic product, PLN bn, nom.	1,567	1,629	1,656	1,719	1,770	1,850	1,940	2,050
annual change in % (real)	5.0	1.6	1.3	3.3	3.6	3.4	3.2	3.4
GDP/capita (EUR at exchange rate)	9,900	10,100	10,200	10,700	11,000	11,000	11,700	12,400
GDP/capita (EUR at PPP)	16,800	17,600	17,900	18,600	19,800	.	.	.
Consumption of households, PLN bn, nom.	948.7	988.2	994.1	1,019.3	1,040.0	.	.	.
annual change in % (real)	3.3	0.8	0.2	2.6	3.1	3.4	3.3	3.3
Gross fixed capital form., PLN bn, nom.	324.1	322.5	311.7	337.5	360.0	.	.	.
annual change in % (real)	8.8	-1.8	-1.1	9.8	6.0	5.0	5.0	5.0
Gross industrial production (sales) 2)								
annual change in % (real)	6.8	1.3	2.3	3.4	4.9	5.0	4.5	5.0
Gross agricultural production								
annual change in % (real)	0.1	1.2	0.7	6.6	-2.8	.	.	.
Construction industry 2)								
annual change in % (real)	15.3	-5.2	-10.3	4.3	0.3	.	.	.
Employed persons, LFS, th, average 3)	16,131	15,591	15,568	15,862	16,000	16,100	16,100	16,100
annual change in %	1.1	0.2	-0.1	1.9	0.9	0.5	0.3	0.3
Unemployed persons, LFS, th, average 3)	1,723	1,749	1,793	1,567	1,308	1,210	1,120	1,120
Unemployment rate, LFS, in %, average 3)	9.7	10.1	10.3	9.0	7.5	7.0	6.5	6.5
Reg. unemployment rate, in %, end of period	12.5	13.4	13.4	11.4	9.8	.	.	.
Average monthly gross wages, PLN	3,404	3,530	3,659	3,777	3,880	4,100	4,300	4,500
annual change in % (real, gross)	1.4	0.1	2.8	3.2	3.5	3.5	4.0	3.5
Consumer prices (HICP), % p.a.	3.9	3.7	0.8	0.1	-0.7	1.2	1.8	2.0
Producer prices in industry, % p.a.	7.3	3.3	-1.2	-1.3	-2.1	0.0	1.5	1.5
General governm.budget, EU-def., % of GDP								
Revenues	38.8	38.9	38.4	38.8	38.6	39.5	39.0	39.0
Expenditures	43.6	42.6	42.4	42.1	41.5	42.4	42.5	42.5
Net lending (+) / net borrowing (-)	-4.9	-3.7	-4.0	-3.3	-2.9	-2.9	-3.5	-3.5
Public debt, EU-def., % of GDP	54.4	54.0	55.9	50.4	51.7	52.5	53.3	54.0
Central bank policy rate, % p.a., end of period 4)	4.5	4.3	2.5	2.0	1.5	1.0	1.5	2.0
Current account, EUR mn	-19,647	-14,458	-5,028	-8,298	-710	-6,400	-9,000	-16,700
Current account, % of GDP	-5.2	-3.7	-1.3	-2.0	-0.2	-1.5	-2.0	-3.5
Exports of goods, BOP, EUR mn	132,420	141,026	149,113	158,657	171,715	183,700	192,900	202,500
annual change in %	12.1	6.5	5.7	6.4	8.2	7.0	5.0	5.0
Imports of goods, BOP, EUR mn	145,709	149,156	149,448	161,911	169,115	181,000	191,900	203,400
annual change in %	12.9	2.4	0.2	8.3	4.4	7.0	6.0	6.0
Exports of services, BOP, EUR mn	29,370	31,949	33,592	36,279	39,199	40,800	42,400	44,100
annual change in %	9.8	8.8	5.1	8.0	8.0	4.0	4.0	4.0
Imports of services, BOP, EUR mn	24,206	25,947	25,948	27,705	29,301	30,500	31,700	33,000
annual change in %	3.2	7.2	0.0	6.8	5.8	4.0	4.0	4.0
FDI liabilities (inflow), EUR mn	13,274	5,771	658	12,826	6,532	.	.	.
FDI assets (outflow), EUR mn	3,415	1,055	-2,524	4,609	148	.	.	.
Gross reserves of NB excl. gold, EUR mn	71,691	78,403	74,257	79,379	83,676	.	.	.
Gross external debt, EUR mn	250,947	279,739	278,948	291,878	303,400	306,200	329,300	348,000
Gross external debt, % of GDP	66.0	71.9	70.7	71.0	71.7	72.0	73.0	73.0
Average exchange rate PLN/EUR	4.1206	4.1847	4.1975	4.1843	4.1841	4.35	4.30	4.30
Purchasing power parity PLN/EUR	2.4226	2.3978	2.4087	2.4059	2.3259	.	.	.

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) From 2012 according to census March 2011. -
4) Reference rate (7-day open market operation rate).

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