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Poland:
Not so soft landing ahead

In Poland, it is likely that growth will appear very weak in the initial stages. However, fast-falling inflation may lend a boost to real disposable incomes and consumption. Public spending is likely to be increased on a temporary basis, even if it is incompatible with the declared fiscal consolidation strategies. Some growth acceleration in the second half of 2013 may also follow in the wake of improvements in foreign trade (primarily rising exports, driven by growth picking up speed in the euro area and a probable corrective weakening of the Polish zloty).

In the first quarter of 2013 GDP growth continued, albeit at a low speed. Consumption, both private and public, remained essentially flat. Gross fixed capital formation, which still looked strong in the first quarter of 2012 when it increased by 6.7%, fell 2% – still not as strongly as in the fourth quarter of 2012 when it had fallen by over 4%. But the decline in inventories has accelerated. All in all, the decline in domestic demand (by 0.9%) in the first quarter of 2013 was yet less pronounced than generally expected – and less steep than in the fourth quarter of 2012. External trade in goods and non-factor services saved the day, with the volume of imports reduced by 1.7% and the volume of exports still rising, by 1.3%. The contribution of external trade to GDP growth in the first quarter of 2013 was 1.4 percentage points.

Fast disinflation has continued during the first four months of 2013. The consumer price index rose only 0.8% in April (year-on-year). Further CPI contractions are quite likely. The current disinflation emerged, fairly automatically, once the one-off hikes in the rates of indirect taxation (effective as of January 2011) and in regulated prices of some utilities (effective as of mid-2011) had been passed through into the consumer prices. The outright deflation in industrial producer prices (which set in in the third quarter of 2012) is naturally supporting a gradual consumer price disinflation as well. (Deflation in the construction sector's producer prices started even earlier, at mid-2012.) It is quite obvious that both disinflation (in consumer prices) and deflation (in producer prices) could only have developed under the weak pace of growth in household incomes – and the domestic demand generally. On the other hand, the continuing strength of the Polish currency, for about a year now, may have also been supporting disinflation/deflation.

The National Bank of Poland, taken aback by the speed of disinflation, is responding to the current developments by delayed cuts of its interest rates. The long overdue relaxation of the monetary policy may not, at present, have much of the expected impact as far as a mobilisation of lending from commercial banks is concerned. Commercial banks are likely to drag their feet. It will take time before the interest rates on loans to their clients are reduced. And even effectively lower market interest rates need not contribute meaningfully to stronger investment or consumption. Besides, to the creditworthy domestic borrowers the cost of credit may not matter all that much because the uncertainties about the future income streams are still excessive.[1] Of course, the monetary policy relaxation may help weaken the Polish currency. So far the Polish zloty has been remarkably strong vis-à-vis the euro, arguably also on account of high interest rates prevailing in Poland. The real hope might be that with somewhat lesser interest rate differentials against the international markets, the carry trade (or short-term foreign financial investment in PLN-denominated assets) would become less lucrative to the international financial investors, or more risky than it is at present. Consequently, the Polish currency might weaken more markedly (as it did back in 2009, when a strong depreciation of the Polish currency saved the country – through effects on exports and imports – from being engulfed by recession).

While inflation recedes, nominal wages are still creeping up, albeit at a slow pace. This is a clear sign of incomplete labour market flexibility (the other sign being the limited responsiveness of nominal wages to rising unemployment). In effect, after falling in the second half of 2012, *real* wages started to recover in the first quarter of 2013. The total wage bill did not fall in real terms in the first quarter of 2013 (as the decrease in employment was quite marginal). The positive effects of the current disinflation are even more pronounced with respect to the mandatory social security payments (retirement pays in the first place). All in all, the real value of household incomes has been increasing – creating the space for possibly increased consumer spending.

The financial situation of the enterprise sector (non-financial firms operating outside agriculture and employing 49 persons or more) has been progressively worsening since the second quarter of 2012. The entire net (post-tax) profit of the sector earned in the first quarter of 2013 reached PLN 17.6 billion (approximately EUR 4.2 billion), down from PLN 23.6 billion earned during the first quarter of 2012. The weakening of profits has much

[1] The corporate and household sectors' demand for loans has been stagnant. The credit liabilities of these two sectors rose by 2.6% and 3% (March 2013 over March 2012) respectively. But their deposits in the commercial banks rose, over the same period, by 6.8% and 9.7% respectively. Currently the private sector prefers liquidity to spending. The opposite is true for the public sector, which absorbs – through steeply expanding bank borrowing – the money balances saved by the private sector.

to do with weak demand and fiercer competition (both showing up in producer price deflation) – as well as with higher nominal wages. Profits have been also weakening in the banking sector. In the first quarter of 2013 banks' net profits reached PLN 4 billion (6.7% down on profits earned a year earlier).

Despite the contraction of profits, the corporate sector disposes of huge (and still rising) own financial resources much of which are idly resting on deposit accounts. These resources, supported by bank loans or other external funds if necessary, could support higher investment in fixed assets – should the future become less uncertain – and promising higher sales. At the moment the uncertainties dictate a 'wait-and-see' tactics especially with respect to investment. Consequently, the corporate sector's investment outlays fell 1.6% in the first quarter of 2013. On the other hand, most recent information does not suggest a further deterioration of investment sentiments among the corporate sector's managers. Overall quite optimistic moods seem to prevail among the export-oriented firms whose investments were not reduced in the first quarter of 2013[2].

The first big boom in infrastructure investment (financed out of the public purse and supported by EU transfers) is already over. But the next one, to be co-financed out of the ample means to be provided by the forthcoming EU Multiannual Financial Framework for 2014-2020, is already on the horizon. Public investment is likely to start growing anew in the second half of 2013, even if at the cost of higher public sector deficits. Similarly, it is quite likely that the government will refrain from moves that could restrict the rise in public sector deficits. Rather, one could expect further unplanned 'concessions' to the public. The substantial extension of the (paid) maternity leave, legislated recently, is just one example of changing official priorities. While officially the economic policy is still chasing the fiscal consolidation goals, in practice it is again (as back in 2009) becoming less restrictive. The new wave of official generosity may have come too late to prevent a further decline in the popularity of Donald Tusk (and of his government). But it may help prevent the advent of outright recession.[3]

All in all, the Polish economy still faces rather tough times in 2013. Growth seems likely to be very weak at first – but falling inflation could give some boost to real disposable incomes and consumption. Moreover, public spending is likely to be increased and should provide some additional defence against recession. Foreign trade developments may prove helpful

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2 As reported by the recent Business Climate Survey: http://www.nbp.pl/publikacje/koniunktura/raport_2_kw_2013.pdf

3 The European Commission has recently recommended extending the deadline for Poland's fiscal consolidation (as defined in the Excessive Deficit Procedure) by two years, to 2014 'at the latest'. 'The Commission postulates that Poland should reach a headline deficit target of 3.6% and 3.0% of GDP in 2013 and 2014 …'

too, especially if a (likely) corrective weakening of the national currency is retained for some time. Of course, the scale of external trade's positive impulses will depend on what happens to the euro area. But even if the euro area does not avoid recession in 2013, Poland's GDP growth should still be positive. Later on, with growth resuming in the euro area (and in Germany in particular), growth – to a greater degree driven by expanding investment – should also accelerate in Poland.

Table PL

Poland: Selected Economic Indicators

	2009	2010	2011	2012 [1)]	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., average [2)]	38152	38184	38534	38560	38207	38521	38540	38530	38525
Gross domestic product, PLN bn, nom.	1344.5	1416.6	1528.1	1595.3	370.2	377.8	1640	1720	1820
annual change in % (real)	1.6	3.9	4.5	1.9	3.5	0.5	1.2	2.7	3.5
GDP/capita (EUR at exchange rate)	8100	9200	9600	9900	.	.	.	.	.
GDP/capita (EUR at PPP)	14200	15300	16200	17000	.	.	.	.	.
Consumption of households, PLN bn, nom.	809.7	856.2	921.6	962.7	247.4	249.3	990	1030	1090
annual change in % (real)	2.1	3.1	2.7	0.8	1.7	0.0	1.2	2.0	3.5
Gross fixed capital form., PLN bn, nom.	284.6	281.3	308.7	309.3	46.6	45.0	310	330	360
annual change in % (real)	-1.3	-0.4	8.5	-0.8	6.8	-2.0	0.0	4.0	6.0
Gross industrial production (sales) [3)]									
annual change in % (real)	-3.8	11.1	6.7	1.2	4.4	-1.6	0.6	2.5	6.0
Gross agricultural production (EAA)									
annual change in % (real)	6.1	-3.2	-1.0	2.3	.	.	.	.	.
Construction industry [3)]									
annual change in % (real)	4.7	3.9	15.3	-5.3	13.6	-15.6	.	.	.
Employed persons, LFS, th, average [4)]	15868.0	15960.5	16130.5	15590.7	15398.0	15291.0	15590	15620	15700
annual change in % [4)]	0.4	0.6	1.1	0.2	0.2	-0.7	0.0	0.2	0.5
Unemployed persons, LFS, th, average [4)]	1411.1	1699.3	1722.6	1749.2	1809.0	1944.0	1800	1780	1750
Unemployment rate, LFS, in %, average [4)]	8.2	9.6	9.7	10.1	10.5	11.3	11.0	10.8	10.5
Reg. unemployment rate, in %, end of period	11.9	12.3	12.5	13.4	13.3	14.3	13.8	13.3	13.0
Average gross monthly wages, PLN [5)]	3101.7	3224.1	3403.5	3540.0	3664.2	3740.8	3620	3720	3850
annual change in % (real, gross) [5)]	2.0	1.4	1.4	0.0	1.3	0.8	0.8	0.8	1.5
Consumer prices (HICP), % p.a.	4.0	2.7	3.9	3.7	4.2	1.3	1.5	2.0	2.0
Producer prices in industry, % p.a.	3.1	1.8	7.3	3.3	5.8	-0.5	0.0	2.0	2.0
General governm.budget, EU-def., % of GDP									
Revenues	37.2	37.6	38.4	38.4	.	.	37.6	36.9	.
Expenditures	44.6	45.4	43.4	42.3	.	.	41.6	41.0	.
Net lending (+) / net borrowing (-)	-7.4	-7.9	-5.0	-3.9	.	.	-3.9	-3.6	-3.3
Public debt, EU-def., % of GDP	50.9	54.8	56.2	55.6	.	.	56.5	57.0	57.0
Central bank policy rate, % p.a., end of period [6)]	3.5	3.5	4.5	4.3	4.5	3.3	2.25	2.5	2.5
Current account, EUR mn [7)]	-12153	-18121	-17974	-13484	-4488	-2645	-12000	-14900	-16500
Current account, % of GDP [7)]	-3.9	-5.1	-4.8	-3.5	-5.1	-2.9	-3.1	-3.6	-3.8
Exports of goods, BOP, EUR mn [7)]	101715	124998	140137	146595	35823	37284	152500	160600	172600
annual change in %	-15.9	22.9	12.1	4.6	4.3	4.1	4.0	5.3	7.5
Imports of goods, BOP, EUR mn [7)]	107140	133893	150193	151908	37937	36889	153400	162600	175600
annual change in %	-24.5	25.0	12.2	1.1	4.5	-2.8	1.0	6.0	8.0
Exports of services, BOP, EUR mn [7)]	20717	24718	26950	29381	6444	6549	30600	33000	36300
annual change in %	-14.4	19.3	9.0	9.0	10.8	1.6	4.0	8.0	10.0
Imports of services, BOP, EUR mn [7)]	17294	22381	22905	24566	5358	5473	25300	27300	30600
annual change in %	-16.6	29.4	2.3	7.3	9.4	2.1	3.0	8.0	12.0
FDI inflow, EUR mn [7)]	9339	10518	13642	2663	1054	883	.	.	.
FDI outflow, EUR mn [7)]	3331	5489	5280	-647	1830	-2132	.	.	.
Gross reserves of NB excl. gold, EUR mn	52734	66253	71028	78676	70626	80809	.	.	.
Gross external debt, EUR mn	194396	237359	248085	276101	261015	.	280000	290000	310000
Gross external debt, % of GDP	62.6	66.9	66.9	72.4	68.5	.	.	.	.
Average exchange rate PLN/EUR	4.3276	3.9947	4.1206	4.1847	4.2322	4.1563	4.25	4.20	4.15
Purchasing power parity PLN/EUR	2.4767	2.4040	2.4424	2.4380	.	.	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary. - 2) From 2011 according to census March 2011. - 3) Enterprises with 10 and more employees. - 4) From 2012 according to census March 2011. - 5) Quarterly data refer to enterprises with 10 and more employees. - 6) Reference rate (7-day open market operation rate). - 7) Including Special Purpose Entities (SPEs).

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