

Poland: shaky economic consolidation amidst political disarray

The first months of 2003 have not improved the overall economic performance very much. GDP growth in the first half of the year, estimated at somewhat above 2% (roughly the same as in the second half of 2002) has been driven primarily by private consumption. The latter remains fairly robust despite the continuing contraction in the real total wage bill as the household saving propensity is declining. This is reflected in a strong reduction in households' bank deposits, and is also responsible for the falling money supply. The long overdue cuts in interest rates also support private consumption. However, the growth of private consumption seems to be less pronounced than before. Despite falling interest rates the stock of credit extended to the enterprise sector virtually stagnates. There is little evidence of a revival in investment activities. In the first quarter of 2003, stocks increased very strongly – which may augur a renewed growth slowdown. On the other hand, foreign trade continues to support GDP growth. During the first five months of 2003, merchandise export revenues rose 4.8% in euro terms (and 27.4% in US dollar terms) while payments for merchandise imports fell 2% in euro terms (and rose 19.2% in dollar terms). The overall satisfactory performance of foreign trade can, at least partly, be attributed to the exchange rate developments. The zloty has weakened vs. the euro and thus strengthened the competitive position of the bulk of Polish exporting and import-competing firms. Also, some strengthening of the zloty vs. the dollar has made imports of primary commodities (including crude oil, the prices of which are quoted in dollar) cheaper.

Favourable exchange rate developments, lower interest costs and a lower burden of income taxation helped to improve the financial position of the non-financial corporate sector. The sector's net profit amounted to PLN 3.1 billion (vs. PLN 1.7 billion in the first quarter of 2002). Although in real terms profits currently reported are quite modest compared to those earned in the years 1994-1997, they are important for the initiation of a business investment take-off. Financial consolidation is particularly strong among larger export-oriented manufacturing firms. Mining and particularly construction firms continue to make losses.

The improvement in the profits of the non-financial corporate sector coincides with a fall in profits earned by commercial banks (from PLN 1.4 billion in the first quarter of 2002 to 1.1 billion in the first quarter of 2003). Banks' interest income declines as interest rates are falling. Besides, the banks bear the rising costs of the deteriorating quality of their assets. The improvements in foreign trade, and in the financial standing of the export sector, would probably have been less significant without strong gains in manufacturing labour productivity and declining production costs. In industry, the labour productivity rose close to 10% during the first five months of 2003 – well ahead of the average industrial wage.

Despite all these encouraging signs, the public mood is generally depressed, if only on account of a steady decline in employment and the unemployment staying at a very high level. More importantly, firms' attitudes, as revealed by business climate surveys, remain rather pessimistic. The current improvements generally tend to be viewed as temporary or seasonal. As before, weak domestic demand (and the associated phenomena such as bad financial position of customers, problems over payment arrears) is perceived as the major obstacle to expansion.

The long overdue relaxation of the monetary policy has produced positive results (also via its impact on the weakening of the zloty) without generating any recognizable signs of higher inflation. There is still some room for further cuts in interest rates. Nonetheless it is becoming obvious that the monetary policy is currently incapable of stimulating a strong investment recovery – and hence of starting an overall growth acceleration. However, the fiscal policy is in disarray. There has been an open conflict between the finance ministry, nominally responsible for the fiscal policy, and the minister of the economy and labour. The first draft budget for 2004, worked out under such conditions, bears many scars. It has many aspects, some of them clearly supportive of domestic demand. These positive aspects seem overshadowed by the desire to reduce the overall deficit, also on the ground that this would be necessary to meet the obligations implicit in Poland's forthcoming accession to the EU. The major novelty is the radical reduction in the corporate income tax from 27% to 19%. This is hoped to ignite domestic investment, and to accelerate FDI inflows. Whether or not lower corporate tax rates will produce the desired effects remains to be seen. In the end, the lower corporate income tax rate may only widen the budget deficit and necessitate further cuts in social transfers and in other productive public spending.

The Polish economy is thus still quite unstable. Some improvements, related especially to foreign trade, may have been primarily due to the currency's weakness vs. the euro. Should the zloty strengthen, e.g. under the impact of higher capital inflows, recovery may be postponed – especially if the business climate in the EU deteriorates further. The forthcoming EU accession will probably bring, at least initially, more disadvantages than clear benefits. Poland will have to lower, right away, its tariffs on many sensitive products (such as farm products, textiles and steel) supplied by some non-EU producers. On the other hand, the 'suitcase' exports to Ukraine and other countries of the CIS, which on balance bring several billion dollars of (net) revenue yearly, will be restricted by the introduction of visas to CIS citizens. Further costs related to the takeover of the *acquis* required by the EU will have to be borne. Payments to the EU budgets will have to be made while it is certain that the Polish authorities are still to learn how to extract transfers from the EU. Last but not least, the ambition nurtured especially by the National Bank to enter the eurozone 'as soon as possible' may prove costly.

Table PL

Poland: Selected Economic Indicators

	1998	1999	2000	2001	2002 ¹⁾	2002 1st quarter	2003	2003 forecast	2004
Population, th pers., end of period	38667	38654	38644	38632	38610	38628	38591	.	.
Gross domestic product, PLN mn, nom.	553560	615115	684982	749311	769426	178556	184521	804400	853400
annual change in % (real)	4.8	4.1	4.0	1.0	1.4	0.5	2.2	2.5	3.0
GDP/capita (USD at exchange rate)	4098	4011	4078	4737	4884	.	.	.	.
GDP/capita (USD at PPP - wiiw)	8490	9010	9540	10310	10510	.	.	.	.
Gross industrial production (sales)									
annual change in % (real)	3.5	3.6	6.7	0.6	1.5 ²⁾	-1.6 ²⁾	4.4 ²⁾	3	4
Gross agricultural production									
annual change in % (real)	5.9	-5.2	-5.6	5.8	.	.	.	.	.
Goods transport, mn t-kms	317052	310698	282559	253269	.	.	.	.	.
annual change in %	-3.8	-2.0	-9.1	-10.4	.	.	.	.	.
Gross fixed capital form., PLN mn, nom.	139205	156690	170430	157209	147838	25367	24680	.	.
annual change in % (real)	14.2	6.8	2.7	-8.8	-6.8	-12.8	-3.6	0	.
Construction output total									
annual change in % (real)	12.4	6.2	1.0	-6.4	-10.5 ²⁾	-16.3 ²⁾	-20.9 ²⁾	.	.
Dwellings completed, units	80594	81979	87789	105967	97595	218638	27092	.	.
annual change in %	9.3	1.7	7.1	20.7	-7.9	-15.1	23.9	.	.
Employment total, th pers., average	15800.4	15373.5	15017.5	14923.6	14900.0	15100.0	14438.7	.	.
annual change in %	2.3	-2.7	-2.3	-0.6	-0.2	.	-4.4	.	.
Employees in industry, th pers., average	3378.7	3138.4	2955.0	2820.6	2495.0 ²⁾	2507.0 ²⁾	2426.0 ²⁾	.	.
annual change in %	-1.6	-7.1	-5.8	-4.5	-5.7 ²⁾	-6.8 ²⁾	-3.2 ²⁾	.	.
Reg. unemployed, th pers., end of period	1831.4	2349.8	2702.6	3115.1	3217.0	3259.9	3321.0	.	.
Reg. unemployment rate in %, end of period	10.4	13.1	15.1	17.5	18.1	18.2	18.7	18.5	18.5
LFS - unemployment rate in %, average	10.6	13.9	16.1	18.2	19.9	20.3	20.5	20.5	20.5
Average gross monthly wages, PLN ³⁾	1232.7	1697.1	1893.7	2045.1	2133.2	2155.5 ²⁾	2228.7 ²⁾	.	.
annual change in % (real, net) ⁴⁾	4.5	4.7	1.0	2.5	2.4	2.1 ²⁾	2.9 ²⁾	.	.
Retail trade turnover, PLN mn	291197	323687	360318	375438	.	.	.	.	.
annual change in % (real)	2.6	4.0	1.0	0.2	1.7 ²⁾	5.8 ²⁾	1.2 ²⁾	.	.
Consumer prices, % p.a.	11.8	7.3	10.1	5.5	1.9	3.4	0.5	2	3
Producer prices in industry, % p.a.	7.3	5.7	7.8	1.6	1.0	0.2	3.0	.	.
Central government budget, PLN mn									
Revenues	126560	125922	135664	140527	143520	31275	33397	.	.
Expenditures	139752	138401	151055	172885	182922	47712	48827	.	.
Deficit (-) / surplus (+)	-13192	-12479	-15391	-32358	-39403	-16437	-15430	.	.
Deficit (-) / surplus (+), % GDP	-2.4	-2.0	-2.2	-4.3	-5.1	-9.2	-8.4	.	.
Money supply, PLN mn, end of period									
M1, Money	89920	111384	106456	118297	136267	114803	136211	.	.
M2, Money + quasi money	223678	268701	300424	328198	319777	319012	317874	.	.
Discount rate of NB % p.a., end of period	18.2	19.0	21.5	14.0	7.5	12.0	6.5	8	.
Current account, USD mn	-6841	-11553	-9952	-7166	-6700	-2346	-1442	-7000	-8000
Current account in % of GDP	-4.3	-7.5	-6.3	-3.9	-3.6	-5.4	-3.0	-3.4	-3.7
Gross reserves of NB excl. gold, USD mn	27325	26354	26564	25649	28660	26063	29989	.	.
Gross external debt, USD mn	59135	65365	69465	71797	81946	73135	.	.	.
Exports total, fob, EUR mn ⁵⁾	25145.4	25729.3	34382.6	40374.7	43400.2	10277	10783	46000	49200
annual growth rate in %	10.3	2.3	33.6	17.4	7.5	3.6	4.9	6	7
Imports total, cif, EUR mn ⁵⁾	41539.3	43151.2	53121.9	56222.7	58307.4	13527	13901	60600	64900
annual growth rate in %	10.8	3.9	23.1	5.8	3.7	0.6	2.8	4	7
Average exchange rate PLN/USD	3.49	3.97	4.35	4.09	4.08	4.13	3.90	3.86	3.91
Average exchange rate PLN/EUR (ECU)	3.92	4.23	4.01	3.67	3.86	3.62	4.18	4.25	4.30
Purchasing power parity PLN/USD, wiiw	1.69	1.77	1.86	1.88	1.90	.	.	.	.
Purchasing power parity PLN/EUR, wiiw	1.83	1.93	2.03	2.07	2.04	.	.	.	.

Notes: 1) Preliminary. - 2) Enterprises with more than 9 employees. - 3) From 1999 including mandatory premium for social security. - 4) From 1999 real gross wages. - 5) Converted from the national currency to EUR at the official exchange rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.