Leon Podkaminer

Poland: a weak start into 2005

After two years (2001-2002) of stagnation Poland's GDP growth gradually accelerated in 2003, peaking at a 7% rate in the first quarter of 2004. The 2003 acceleration was propelled by fast rising consumption, net exports, and also inventories. Throughout 2004 consumption and net exports (but not the growing inventories) were losing importance as engines of GDP growth, which was slowing down. Fortunately, there was also a gradual recovery of gross fixed investment: its growth culminated with a rate of 7.4% in the fourth quarter of 2004. Although the overall GDP growth in the final quarter of 2004 fell to 4%, it was quite legitimate to expect fixed investment to maintain its momentum – and thus to support respectable GDP growth in 2005.

The actual (as reported by the Central Statistical Office) GDP growth rate in the first quarter of 2005 was an unimpressive 2.1%. Domestic demand rose only 1.2%, with consumption up by a modest 1.8%. Gross fixed investment increased by a surprisingly low 1% and – under the impact of inventories falling (after a two-years period of expansion) – the volume of gross capital formation declined rather massively, by 3.1%. The volume of both exports and imports of goods and non-factor services (in national accounts' terms) fell in the first quarter of 2005. However, as imports contracted more strongly than exports, the contribution of foreign trade to the overall GDP growth rate turned out to be positive and significant, amounting to 0.9 percentage points.

To some observers of the Polish economy the official statistical indicators for the first quarter of 2005 must be wrong. Gross fixed investment is quite generally believed to have been underestimated on account of inadequate coverage (or underreporting of actual investment outlays in small firms and in the household sector). Also, there are some doubts about the correctness of the price deflator for gross fixed investment. Some reservations on the accuracy of the official statistical reporting for the first quarter of 2005 may be justified. The output of both the construction and capital goods' manufacturing sectors rose quite strongly which may indeed indicate higher than reported growth of gross fixed investment. On the other hand the fact that imports have declined (in real terms) in the first quarter of 2005 would seem consistent with stagnant investments. Besides, the overall (low) GDP growth is wholly consistent with other facts: low growth in the overall gross value added (by 2.2%, of which in industry by 0.9%) and very low growth of industrial sales (0.7%).

The official GDP figures for the first quarter of 2005 would not have provoked openly expressed reservations about the quality of statistical reporting, had not the expectations concerning investments been so radically disappointed. (It is rather odd that no such reservations were voiced on other occasions – especially when growth reported turned out to be higher than expected.) The investment expectations, reflecting conventional wisdom about factors conducive to fast investment growth, were (and still are) quite high. Conventional wisdom has it that strong profits, rising productivity and falling unit labour costs should all translate into fast expansion of business investments – especially if interest rates are reasonably low and falling. Since the Polish corporate sector continues to register very high profits, with an impressive record on gains in labour productivity and unit labour costs, the lack of a 'proper' response from business investment is a kind of paradox. In absence of generally accepted explanations of that paradox there is a temptation to put down the weak growth of investments to phenomena such as an insufficiently flexible labour market, high indirect labour costs, excessive red tape, 'hostile' corporate taxation – or in general delayed 'structural reforms'. These explanations do not seem convincing though. In the mid-1990s a very high and sustained expansion of business investment was observed, arguably under much less flexible labour market conditions, even more red tape, much higher tax rates etc. An alternative explanation – referring to weak expected sales prospects and relatively high spare production capacities as factors responsible for weak investments – still remains to be taken more seriously.

No special mystery lies behind the observed developments in private consumption. The weak growth in consumption is consistent with the very weak (0.7%) growth in the real purchasing power of the total wage bill (and a close to 3% fall in the real purchasing power of pensions and other social transfers combined). Also, the fall in inventories was only to be expected, following their massive increases in recent years.

Despite definite interest rate reductions, Poland continues to be an attractive destination for foreign portfolio investment (targeting primarily government bonds). EU membership has enhanced that attractiveness by reducing the risks normally associated with 'less mature' emerging markets. High capital inflows have strengthened the Polish zloty (PLN). The level, but also the instability, of the zloty/euro exchange rate has become the main cause for concern for the entire corporate sector.[1] Domestic firms face intensified foreign competition, also on the home market. The share of unprofitable exports has already been on the rise. In such circumstances the incentives to increase exports will be gradually weakening. Of course, the impressive improvements in labour productivity and unit labour costs recorded in recent years will be offsetting the effects of the strength of the domestic currency, at least for some time.

The weak macroeconomic performance is likely to encourage a further relaxation of the monetary policy. Certainly, lower interest rates administered by the National Bank of

[1] This is documented in the report on the business climate in the second quarter of 2005. (See the web page of the National Bank of Poland, www.nbp.pl/publikacje/koniunktura).

Poland will not be harmful to a sustained recovery in fixed investment. However, the role of lower interest rates in inducing stronger investment acceleration must not be overemphasized. The corporate sector already 'sits' on huge amounts of idle money stocks bearing relatively modest interest and, on the whole, does not need any sizeable external financing. Lower interest rates may be needed primarily to moderate the inflows of portfolio investment – and thus to alleviate the appreciation pressure. In any case, even a relatively resolute relaxation of the monetary policy could do very little to affect the yields on government bonds very soon. The Polish currency may remain quite strong for quite some time.

In practical terms also the fiscal policy is unlikely to affect the course of the current events to any appreciable extent. The caretaker government of Mr. Belka, awaiting its inevitable (and almost certainly humiliating) defeat in the Fall elections, lacks the authority to devise, let alone implement, any meaningful policy. Its only mission is to persevere, without having any definite economic or political purpose.

All in all, unless the corporate sector finds it expedient to expand investments on a fairly massive scale, the current weakness may well extend to the rest of 2005 and perhaps even beyond.

Table PL

Poland: Selected Economic Indicators

	2000	2001	2002	2003	2004 [1]	2004	2005	2005	2006
						1st quarter		forecast	
Population, th pers., end of period [2]	38644	38633	38219	38191	38175	38181	38162	.	.
Gross domestic product, PLN mn, nom.	723886	760595	781112	816081	885338	204124	218505	939300	1006200
annual change in % (real)	4.0	1.0	1.4	3.8	5.4	7.0	2.1	3	4
GDP/capita (EUR at exchange rate)	4670	5366	5299	4858	5114	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	9010	9250	9620	9800	10470	.	.	.	.
Gross industrial production (sales)									
annual change in % (real)	6.7	0.6	1.1	8.3	11.6	19.0 [4]	0.7 [4]	7	7
Construction output total									
annual change in % (real)	1.0	-6.4	-0.3	0.9	.	-5.0 [4]	7.6 [4]	.	.
Consumption of households, PLN mn, nom.	455405	486504	510817	530063	564067	139066	146315	.	.
annual change in % (real)	2.8	2.1	3.3	3.1	3.4	4.1	1.7	2.5	.
Gross fixed capital form., PLN mn, nom.	170430	157209	148338	150433	161686	25719	27313	.	.
annual change in % (real)	2.7	-8.8	-5.8	-0.2	5.3	3.7	1.0	3	4
LFS - employed persons, th, avg. [3]	14526.0	14207.0	13782.0	13616.8	13794.8	13465.0	13767.0	.	.
annual change in %	-1.6	-2.2	-3.0	0.6	1.3	-0.9	2.2	.	.
Reg. employees in industry, th pers., avg.	2955.0	2820.6	2670.5	2639.1	2414.0 [4]	2426.0 [4]	2411 [4]	.	.
annual change in %	-5.8	-4.5	-5.3	-1.2	-0.4 [4]	-0.6 [4]	1.2 [4]	.	.
LFS - unemployed, th pers., average [3]	2785.0	3170.0	3431.0	3328.5	3230.3	3509.0	3199.0		
LFS - unemployment rate in %, average [3]	16.1	18.2	19.9	19.6	19.0	20.7	18.9	19	19
Reg. unemployment rate in %, end of period [3]	15.1	17.5	18.0	20.0	19.1	20.5	19.3	18	.
Average gross monthly wages, PLN	1893.7	2045.1	2097.8	2185.0	2289.6	2332.2 [4]	2415.5 [4]	.	.
annual change in % (real, gross)	1.0	2.5	0.7	3.4	1.5	3.0 [4]	0.3 [4]	.	.
Consumer prices, % p.a.	10.1	5.5	1.9	0.8	3.5	1.6	3.6	3	3
Producer prices in industry, % p.a.	7.8	1.6	1.0	2.6	7.0	4.4	3.3	3	3
General governm.budget, EU-def., % GDP [5]									
Revenues	42.5	43.8	43.9	44.3	43.8	.	.	44.2	44.2
Expenditures	45.2	47.7	47.5	48.7	48.7	.	.	48.6	48.0
Deficit (-) / surplus (+)	-1.6	-3.9	-3.6	-4.5	-4.7	.	.	-4.4	-3.7
Public debt, EU-def., % of GDP [5]	36.8	36.7	41.2	45.4	43.6	.	.	46.8	47.6
Discount rate of NB % p.a., end of period	21.5	14.0	7.5	5.8	7.0	5.8	6.5	.	.
Current account, EUR mn	-10788	-6006	-5399	-4108	-2959	-648	118	-3000	-4000
Current account in % of GDP	-6.0	-2.9	-2.7	-2.2	-1.5	-1.5	0.2	-1.3	-1.7
Gross reserves of NB excl. gold, EUR mn	28555	29031	27367	26000	25904	28856	28407	.	.
Gross external debt, EUR mn	74671	81461	81046	84003	92881	87960	95892	.	.
FDI inflow, EUR mn	10334	6372	4371	3660	4892	1340	895	.	.
FDI outflow, EUR mn	18	-97	228	173	637	7	9	.	.
Exports of goods, BOP, EUR mn	39022	46537	49338	53836	65641	14451	17469	71500	77200
annual growth rate in %	38.3	19.3	6.0	9.1	21.9	19.4	20.9	9	8
Imports of goods, BOP, EUR mn	52349	55094	57039	58913	70151	15364	17787	76400	84000
annual growth rate in %	23.6	5.2	3.5	3.3	19.1	12.8	15.8	9	10
Exports of services, BOP, EUR mn	11320	10914	10545	9850	10734	2121	2589	11100	11400
annual growth rate in %	44.2	-3.6	-3.4	-6.6	9.0	8.1	22.1	3	3
Imports of services, BOP, EUR mn	9773	10021	9690	9408	10043	2167	2355	10100	10200
annual growth rate in %	49.1	2.5	-3.3	-2.9	6.7	-2.1	8.7	1	1
Average exchange rate PLN/USD	4.35	4.09	4.08	3.89	3.65	3.82	3.07	.	.
Average exchange rate PLN/EUR (ECU)	4.01	3.67	3.86	4.40	4.53	4.78	4.03	4.2	4.2
Purchasing power parity PLN/USD	1.82	1.85	1.83	1.81	1.82	.	.	.	.
Purchasing power parity PLN/EUR	2.08	2.13	2.12	2.18	2.21	.	.	.	.

Notes: 1) Preliminary. - 2) From 2002 according to census May 2002. - 3) From 2003 according to census May 2002. - 4) Enterprises with more than 9 employees. - 5) According to ESA'95, excessive deficit procedure.

Source: wiiw Database incorporating national statistics; Eurostat; EU Economic Forecasts, Spring 2005; wiiw forecasts.