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Poland: Continuing growth conditional on competent policy

GDP growth kept accelerating in the course of 2010. Accelerating growth of private consumption has been an important factor, eventually accounting for 1.9 percentage points (pp) out of the total estimated 3.8% GDP growth rate in the whole year 2010. Government consumption kept rising as well, contributing another 0.7 pp. The positive contribution of rising inventories was also highly significant (1.8 pp). The contributions of other expenditure items turned negative: falling gross fixed investment lowered the GDP growth by 0.4 pp and the developments in foreign trade (in goods and services) by another 0.2 pp. Gross value-added generated by industry rose 9.1%, by construction by 3.8% and by the sector of market services by 1.5%.

Individual GDP expenditure items will be following different paths in 2011 and later on. The budget for 2011 stipulates a 0.7% cut in the volume of government consumption (chiefly in the form of some reductions in the public sector's employment/wage bill). Because of the upcoming parliamentary elections (scheduled for October 2011) the cut in question may in practice be less pronounced than planned. In any case, it is reasonable to expect that government consumption will not contribute meaningfully to GDP growth in 2011 (and probably also not in 2012). In 2011 rising inventories may again contribute to the overall GDP growth – but the scale of the resulting contribution may be expected to be lower than recently.

Against expectations the volume of gross fixed capital formation did not rise in 2010. To some extent this may have been caused by particularly adverse weather conditions. However, in the second half of the year a recovery in investment seems to have started. There are many indications (apart from rising construction output) that the recovery of investment will be gaining momentum in 2011. First, already in 2010 sales of capital goods industries rose by 12.6% – faster than of the total industrial production (9.8%). Second, the non-financial corporate sector's profitability and liquidity positions are very good. Net (post-tax) profit earned by the entire sector rose by 12.5% year-on-year during the first nine months of 2010 (12.9% in industry). The sector, which on the whole is not significantly dependent on bank financing, disposes of large and growing cash balances. For some time

now these balances have been idly accumulating as deposits. No doubt these money resources could be used more productively – such as for financing the expansion of fixed assets. Of course, for this to happen, the levels of uncertainty over e.g. sales prospects, exchange rates, market interest rates etc. must be further reduced. Third, in actual fact the most recent business climate poll conducted by the National Bank indicates that optimistic opinions are becoming prevalent among the corporate sector's managers. The role of identifiable barriers to the growth of firms (including the barrier of inadequate demand) is assessed to be falling quite substantially while the levels of production capacity utilization are high. Large and medium-size firms tend now to plan to expand (or renew) their capital stocks. This tendency appears to be quite pronounced especially among export-oriented (and foreign-owned) industrial firms.

The (hopefully materializing) expansion of the corporate sector's fixed capital formation will be anyway supported by the continuing infrastructure investment (co-financed by EU funds) and by investments related to the European Football Championship (to be held jointly with Ukraine next year). Last but not least, after two fairly stagnant years the demand for housing is likely to grow again, even if modestly at first.

The improvements in the business climate and the revival of growth of fixed investment are expected to accelerate in 2011-2013, if not much. This should combine with rising employment levels and real wages, thereby allowing a further growth of household consumption. Nonetheless, because unemployment will remain high, the wage pressures will remain subdued. Given the ongoing labour productivity gains, the wage increases awarded will not erode the corporate sector's profitability levels and cost gains. However, although currently firms are generally still satisfied with the prevailing levels of the exchange rates, their competitive advantages could be eroded quite quickly if the Polish zloty strengthens unduly.

The risk of an undue appreciation of the Polish currency – and the ensuing competitiveness losses – must not be underestimated. The zloty already strengthened vs. the euro by about 8% on average (2010 over 2009). No doubt this must have contributed to the external trade performing somewhat worse in 2010 than in 2009. Under a floating exchange rate regime the economic policy cannot fully control the exchange rate movements. Even if the levels of domestic interest rates (and the yields on government debt) are low, it is possible to observe high capital inflows and the emergence of appreciation pressures. Bearing these observations in mind, it may be still advisable that the economic policy avoids taking actions that can make things worse. In this context the recent (20 January 2011) decision of the Monetary Policy Council to raise the policy

interest rates seems problematic. The interest rates had been high (given low inflation prevailing) even prior to that decision. No wonder Poland experienced very high inflows of portfolio (and other) capital throughout 2010 (seen in the massive increase in gross external reserves and in gross foreign debt). That tendency may now be strengthened – to the detriment of short-term real activity and long-term financial stability.

In contrast to the monetary policy, the fiscal policy does not overreact. The high fiscal deficits (recorded in 2009-2010) are to go down rather gradually. The macro and fiscal consequences of higher VAT rates and some cuts in public sector wages/employment envisioned in the budget for 2011 will on the whole be quite limited. More importantly, the government seems determined to substantially downsize the so-called Second Pillar of the pension system. The move should help improve public finances quite substantially without materially hurting practically anybody, except a couple of private firms managing the Second-Pillar pension funds.

In sum, so far Poland's growth has been accelerating rather moderately, without yet generating identifiable imbalances. Undue currency appreciation and excessive capital inflows constitute the major (related) risks. Under such conditions a competent monetary policy would be quite essential.

Table PL

Poland: Selected Economic Indicators

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 ¹⁾ | 2011 | 2012 | 2013 |
|---|----------|---------|---------|---------|---------|--------------------|--------|--------|--------|
| | Forecast | | | | | | | | |
| Population, th pers., average | 38165.4 | 38141.3 | 38120.6 | 38125.8 | 38151.6 | 38190 | 38180 | 38170 | 38150 |
| Gross domestic product, PLN bn, nom. | 983.3 | 1060.0 | 1176.7 | 1275.4 | 1343.7 | 1430 | 1540 | 1640 | 1750 |
| annual change in % (real) | 3.6 | 6.2 | 6.8 | 5.1 | 1.7 | 3.8 | 3.8 | 4.2 | 4.3 |
| GDP/capita (EUR at exchange rate) | 6400 | 7100 | 8200 | 9500 | 8100 | 9400 | . | . | . |
| GDP/capita (EUR at PPP) | 11500 | 12300 | 13600 | 14100 | 14300 | 14900 | . | . | . |
| Consumption of households, PLN bn, nom. | 614.3 | 652.8 | 701.6 | 773.8 | 809.4 | 860 | . | . | . |
| annual change in % (real) | 2.1 | 5.0 | 4.9 | 5.7 | 2.1 | 3.2 | 3.8 | 4.5 | 4.5 |
| Gross fixed capital form., PLN bn, nom. | 179.2 | 208.3 | 253.7 | 283.9 | 285.2 | 290 | . | . | . |
| annual change in % (real) | 6.5 | 14.9 | 17.5 | 9.6 | -1.1 | -2.0 | 4 | 6 | 7 |
| Gross industrial production (sales) ²⁾ | | | | | | | | | |
| annual change in % (real) | 3.7 | 12.1 | 9.3 | 2.6 | -3.7 | 11.1 | 8 | 7 | 6 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | -0.7 | -1.1 | 5.2 | 1.3 | 4.7 | -10.6 | . | . | . |
| Construction industry ²⁾ | | | | | | | | | |
| annual change in % (real) | 8.7 | 15.9 | 16.4 | 9.8 | 4.7 | 3.9 | . | . | . |
| Employed persons - LFS, th, average | 14115.6 | 14593.6 | 15240.5 | 15799.8 | 15868.0 | 15900 | 15950 | 16270 | 16680 |
| annual change in % | 2.3 | 3.4 | 4.4 | 3.7 | 0.4 | 0.2 | 0.3 | 2.0 | 2.5 |
| Unemployed persons - LFS, th, average | 3045.4 | 2344.3 | 1618.8 | 1210.7 | 1411.1 | 1720 | . | . | . |
| Unemployment rate - LFS, in %, average | 17.7 | 13.8 | 9.6 | 7.1 | 8.2 | 10.5 | 10 | 8.5 | 7.5 |
| Reg. unemployment rate, in %, end of period | 17.6 | 14.8 | 11.4 | 9.5 | 11.9 | 12.3 | 10.5 | 9.5 | 9.0 |
| Average gross monthly wages, PLN | 2360.6 | 2475.9 | 2672.6 | 2942.2 | 3103.0 | 3222 | 3460 | 3710 | 3960 |
| annual change in % (real, gross) | 1.8 | 4.0 | 5.5 | 5.9 | 2.1 | 1.2 | 2 | 3 | 4 |
| Consumer prices (HICP), % p.a. | 2.1 | 1.3 | 2.6 | 4.2 | 4.0 | 2.7 | 3.5 | 2.5 | 2.5 |
| Producer prices in industry, % p.a. | 0.4 | 1.8 | 2.0 | 2.4 | 3.9 | 2.3 | 2.5 | 2.5 | 2.0 |
| General governm.budget, EU-def., % GDP | | | | | | | | | |
| Revenues | 39.4 | 40.2 | 40.3 | 39.5 | 37.2 | 38.2 | 40 | 40.6 | . |
| Expenditures | 43.4 | 43.9 | 42.2 | 43.2 | 44.4 | 46.2 | 45.5 | 44.6 | . |
| Net lending (+) / net borrowing (-) | -4.1 | -3.6 | -1.9 | -3.7 | -7.2 | -7.9 | -5.5 | -4 | -3 |
| Public debt, EU-def., in % of GDP | 47.1 | 47.7 | 45.0 | 47.1 | 50.9 | 53.2 | 54.2 | 53.5 | 52 |
| Central bank policy rate, % p.a., end of period ³⁾ | 4.5 | 4.0 | 5.0 | 5.0 | 3.5 | 3.5 | 4.3 | 4.5 | 4.0 |
| Current account, EUR mn ⁴⁾ | -3016 | -7443 | -14701 | -17399 | -6752 | -11614 | -14000 | -16000 | -18000 |
| Current account in % of GDP ⁴⁾ | -1.2 | -2.7 | -4.7 | -4.8 | -2.2 | -3.2 | -3.5 | -3.8 | -4.1 |
| Exports of goods, BOP, EUR mn ⁴⁾ | 77562 | 93382 | 105883 | 120953 | 101715 | 122134 | 134300 | 147700 | 156600 |
| annual growth rate in % | 17.8 | 20.4 | 13.4 | 14.2 | -15.9 | 20.1 | 10 | 10 | 6 |
| Imports of goods, BOP, EUR mn ⁴⁾ | 79804 | 98918 | 118249 | 138691 | 104817 | 128494 | 143900 | 164000 | 177100 |
| annual growth rate in % | 13.4 | 24.0 | 19.5 | 17.3 | -24.4 | 22.6 | 12 | 14 | 8 |
| Exports of services, BOP, EUR mn ⁴⁾ | 13105 | 16349 | 21018 | 24207 | 20717 | 24270 | 26700 | 29400 | 31800 |
| annual growth rate in % | 21.2 | 24.8 | 28.6 | 15.2 | -14.4 | 17.2 | 10 | 10 | 8 |
| Imports of services, BOP, EUR mn ⁴⁾ | 12520 | 15768 | 17583 | 20729 | 17294 | 21195 | 24000 | 27100 | 29800 |
| annual growth rate in % | 16.1 | 25.9 | 11.5 | 17.9 | -16.6 | 22.6 | 13 | 13 | 10 |
| FDI inflow, EUR mn ⁴⁾ | 8330 | 15737 | 17241 | 10135 | 9893 | 7538 | 13000 | . | . |
| FDI outflow, EUR mn ⁴⁾ | 2767 | 7122 | 4018 | 3071 | 3711 | 3781 | 4000 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 34535 | 35237 | 42675 | 42299 | 52734 | 66499 | . | . | . |
| Gross external debt, EUR mn | 112316 | 128870 | 159106 | 174265 | 195025 | 235000 | . | . | . |
| Gross external debt in % of GDP | 44.1 | 46.6 | 48.6 | 56.8 | 59.6 | 65.3 | . | . | . |
| Average exchange rate PLN/EUR | 4.0230 | 3.8959 | 3.7837 | 3.5121 | 4.3276 | 3.9947 | 3.9 | 3.9 | 4.0 |
| Purchasing power parity PLN/EUR | 2.2321 | 2.2640 | 2.2695 | 2.3742 | 2.4691 | 2.5096 | . | . | . |

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2.

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) Reference rate (7-day open market operation rate) - 4) From 2006 including Special Purpose Entities (SPEs).

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