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Poland: growth turns euphoric

In the first quarter of 2007 Poland's GDP growth accelerated further. At a 7.4% rate, growth is now the highest in over ten years. Private consumption contributed 4.8 percentage points (p.p.) to that rate, gross fixed investment another 3.6 p.p., while the contribution of foreign trade was negative (-1.1 p.p.). Growth in private consumption is supported by the rising national wage bill (up 8.6% in real terms) and also by the continuing expansion of loans to the household sector. The stock of such loans rose by 35% in real terms (end-March 2007 over end-March 2006).

Growth of gross fixed investment has been fast accelerating for the past four quarters. The growth rate of investment recorded in the first quarter of 2007 (close to 30%) to some degree reflects also the unusually mild weather which permitted uninterrupted construction activities throughout the last winter.¹ But the importance of the weather must not be overestimated. Construction firms were busy because the demand for their output was extraordinarily strong. Besides, larger firms (employing over 50 persons) increased their fixed assets investments by 47% in real terms. Purchases of machinery, equipment and means of transport accounted for two thirds of these investments. 60% of larger firms' investments made in the first quarter of 2007 will extend industrial production capacities.

There are good grounds to expect the strong investment expansion to continue in the coming quarters, especially in branches supplying capital goods as well as in the construction sector itself. The reasons for this are manifold. First, the economy is currently (second quarter of 2007) running at record levels of utilization of productive capacities. The average (employment-weighted) level of capacity utilization in the corporate sector has reached over 86%.² Second, profitability has been very high and generally rising across all sectors and branches. Net profits of the entire corporate sector rose from PLN 12 billion in the first quarter of 2006 to PLN 19 billion in the same period of 2007. All liquidity indicators for the corporate sector are looking very good, with record low numbers of firms in financial distress. Currently about 95% of firms fully observe their credit obligations.³ Only some 7% of firms polled signal liquidity problems while 40% of firms judge their own money balances to be much in excess of current needs. Quite obviously, the financing of investment outlays is generally not a problem, at least to the bulk of (larger-scale) enterprises. Smaller and medium-sized firms lacking large own liquid resources (and also the bulk of the

¹ In the first quarter of 2007 the gross output of the construction sector rose phenomenally, by over 50%, and the sector's real gross value added by 40% – dwarfing the industry's 9%.

² Capacity utilization in the construction sector as well as in industrial firms delivering primarily capital goods approaches 90%, in export-oriented firms it is close to 87%.

³ See the report on the business climate in the second quarter of 2007 (accessible on the web page of the National Bank of Poland, www.nbp.pl/publikacje/koniumktura).

construction firms) continue to have quite an easy access to cheap credit. Third, firms are generally very satisfied with the strength of demand: only about 5% of firms report insufficient demand (vs. 10% one year ago). Demand is generally expected to remain very strong. The volumes of new orders placed (also in branches supplying investment goods) are record high. All in all, the conditions for a further expansion of investment activities are highly favourable. It may be worth adding that the expansion of investment in the business sector is accompanied by strongly rising public investment into infrastructure, in part financed from EU funds.⁴ Moreover, housing construction is entering a period of rather turbulent growth. The number of housing construction permits issued rose by over 50%, the number of dwellings under construction by 66%. The construction boom is supported by a fast rise in housing loans extended to the household sector. Within one year the stock of such loans jumped by close to 60%. No doubt the loan expansion has also been fuelling a genuine real estate price bubble in (and around) the larger urban centres.

The high levels of capacity utilization coincide with intensifying shortages of labour. A rising number of firms report difficulties in finding properly qualified employees, 28% of them report more or less permanent vacancies. Shortage of labour is quoted as a barrier to growth by about 11% of firms (up from 2% a year ago), with the construction sector (and also horticulture) suffering the most. Nearly half of the construction firms cannot find the workers needed. As even migrant workers from Ukraine become difficult to come by, some desperate employers have started recruiting workers in Central Asia. No doubt some firms' (and sectors') ambitious plans on expanding employment (and hence production) will be frustrated. The standard short-term response to the symptoms of labour shortages involves, first of all, wage hikes. So far the growth of average wages has been generally quite moderate, trailing behind the fast rising labour productivity. Only in construction did the average wage respond to the excess demand for labour, rising twice as fast as in other activities. Continuing gains in unit labour costs support low consumer price inflation. Producer price inflation is also low in most industries (except in construction). Nonetheless, as the elaborate forecasting model at the National Bank of Poland envisages the *possibility* of inflation rising to 3% by the end of 2008, the NBP decided to raise its interest rates by 0.25% in April and June.⁵ This will push up the market interest rates. The interest rate differentials vs. the euro area (and the US dollar) will increase further – despite inflation in Poland being lower than in the US and the euro zone. This will be favouring a renewed appreciation of the Polish zloty vs. the euro and the dollar (after having weakened somewhat in the first months of 2007).

⁴ Poland (jointly with Ukraine) will host the 2012 European Football Cup. This will boost additional multi-billion investments in infrastructure, stadiums, hotels etc.

⁵ The NBP's current GDP growth rate prediction for the first quarter of 2008 ranges (with 90% probability) between about 1% and 7%. Of course, that much could be said without a recourse to any econometrics.

Exports performed quite well in the first quarter of 2007, possibly aided by the exchange rate movements. Exporters were predominantly satisfied with the exchange rate levels. The share of unprofitable exports has been very low by historical standards (less than 5%). Things may get worse if the zloty starts strengthening again. Nevertheless, exporting firms are quite optimistic about further expansion. That optimism is well founded in a strong rise of export orders. On the import side one observes even more brisk dynamics. Generally, this is not a sign of falling competitiveness of domestic products vs. foreign imports. Rather, this is a consequence of the strong expansion of domestic demand necessitating, e.g., large imports of capital goods and other products whose domestic supply becomes insufficient.

Despite the outstanding growth performance, the public sector deficits remain quite large. Moreover, the government is bent on further cuts in taxes. This will prolong the process of fiscal consolidation. But this is not necessarily an unwelcome development as the authorities are unenthusiastic – to say the least – about the euro adoption.

Summing up, strong investment and consumption will be pulling up GDP growth in 2007-08. Trade has ceased to contribute positively to growth, though the expansion of exports will continue. Not much should happen on fiscal matters, inflation should remain moderate and the exchange rate generally stable.

Table PL

Poland: Selected Economic Indicators

	2002	2003	2004	2005	2006 ¹⁾	2006	2007	2007	2008
						1st quarter		forecast	
Population, th pers., end of period	38219	38191	38174	38157	38122	38149	38115	.	.
Gross domestic product, PLN mn, nom. ²⁾	808578	843156	924538	983302	1057855	242379	267077	1147100	1240400
annual change in % (real) ²⁾	1.4	3.9	5.3	3.6	6.1	5.5	7.4	6	5.5
GDP/capita (EUR at exchange rate) ²⁾	5485	5020	5341	6401	7122	.	.	.	.
GDP/capita (EUR at PPP - wiiw) ²⁾	9990	10220	11070	11700	12930	.	.	.	.
Gross industrial production (sales)									
annual change in % (real)	1.1	8.3	12.6	3.7	11.3	12.3 ³⁾	13.1 ³⁾	10	10
Gross agricultural production									
annual change in % (real)	-1.9	-0.8	7.5	-4.2	-1.8	.	.	.	.
Construction output total									
annual change in % (real)	-0.3	0.9	-7.0	1.5	12.0 ³⁾	2.2 ³⁾	51.1 ³⁾	.	.
Consumption of households, PLN mn, nom. ²⁾	532615	545136	585983	610362	647905	160353	175013	.	.
annual change in % (real) ²⁾	3.4	2.0	4.4	2.0	5.2	5.4	6.9	6	5
Gross fixed capital form., PLN mn, nom. ²⁾	151472	153758	167158	179180	210460	29813	39443	.	.
annual change in % (real) ²⁾	-6.3	-0.1	6.4	6.5	16.5	7.6	29.6	22	18
LFS - employed persons, th, avg. ⁴⁾	13782.0	13616.8	13794.8	14115.3	14594.0	14098.0	14839.0	.	.
annual change in %	-3.0	0.6	1.3	2.3	3.4	3.1	5.3	.	.
Reg. employees in industry, th pers., avg.	2670.5	2639.1	2663.1	2665.4	2481.8 ³⁾	2477.0 ³⁾	2556 ³⁾	.	.
annual change in %	-5.3	-1.2	0.9	0.1	2.3 ³⁾	1.5 ³⁾	3.2 ³⁾	.	.
LFS - unemployed, th pers., average ⁴⁾	3431.0	3328.5	3230.3	3045.3	2344.3	2701.0	1894.0	.	.
LFS - unemployment rate in %, average ⁴⁾	19.9	19.6	19.0	17.8	13.9	16.1	11.3	11	10
Reg. unemployment rate in %, end of period ⁴⁾	18.0	20.0	19.1	17.6	14.9	17.8	14.4	13	12.5
Average gross monthly wages, PLN	2097.8	2185.0	2273.4	2360.6	2477.2	2539.6 ³⁾	2737.8 ³⁾	.	.
annual change in % (real, gross)	0.7	3.4	0.7	1.8	4.0	4.3 ³⁾	5.9 ³⁾	5	5
Consumer prices, % p.a.	1.9	0.8	3.5	2.1	1.0	0.6	2.0	2.3	2.5
Producer prices in industry, % p.a.	1.0	2.6	7.0	0.7	2.3	0.6	3.3	1.5	2
General governm.budget, EU-def., % GDP ⁵⁾									
Revenues	39.3	38.4	37.0	39.1	39.6	.	.	40.2	39.2
Expenditures	44.3	44.7	42.7	43.5	43.6	.	.	43.5	42.4
Deficit (-) / surplus (+)	-5.0	-6.3	-5.7	-4.3	-4.0	.	.	-3.3	-3.2
Public debt, EU-def., % of GDP ⁵⁾	39.8	47.1	45.7	47.1	47.8	.	.	42.1	41.5
Discount rate of NB % p.a., end of period	7.5	5.8	7.0	4.8	4.3	4.3	4.3	4.4	.
Current account, EUR mn	-5399	-4108	-8670	-4130	-6273	-1396	-1833	-8700	-11000
Current account in % of GDP	-2.6	-2.1	-4.3	-1.7	-2.3	-2.2	-2.7	-3.0	-3.5
Gross reserves of NB excl. gold, EUR mn	27367	26000	25904	34536	35235	34952	36488	.	.
Gross external debt, EUR mn	81045	84818	94881	112112	126715	115468	.	.	.
Gross external debt in % of GDP	38.6	44.2	46.5	45.9	46.7	.	.	.	.
FDI inflow, EUR mn	4371	4067	10292	7703	11093	3384	2433	.	.
FDI outflow, EUR mn	228	269	636	2493	3319	15	257	.	.
Exports of goods, BOP, EUR mn	49338	53836	65847	77562	93268	21728	24944	108200	124400
annual growth rate in %	6.0	9.1	22.3	17.8	20.2	23.3	14.8	16	15
Imports of goods, BOP, EUR mn	57039	58913	70399	79804	97164	22080	26170	115600	138700
annual growth rate in %	3.5	3.3	19.5	13.4	21.8	23.4	18.5	19	20
Exports of services, BOP, EUR mn	10545	9850	10815	13077	16329	3464	4242	19600	22500
annual growth rate in %	-3.4	-6.6	9.8	20.9	24.9	32.5	22.5	20	15
Imports of services, BOP, EUR mn	9690	9408	10033	11541	14561	3185	3794	17500	20100
annual growth rate in %	-3.3	-2.9	6.6	15.0	26.2	39.0	19.1	20	15
Average exchange rate PLN/USD	4.08	3.89	3.65	3.23	3.10	3.19	2.97	.	.
Average exchange rate PLN/EUR (ECU)	3.86	4.40	4.53	4.03	3.90	3.83	3.89	3.9	3.9
Purchasing power parity PLN/USD	1.83	1.83	1.85	1.85	1.84	.	.	.	.
Purchasing power parity PLN/EUR	2.12	2.16	2.19	2.20	2.15	.	.	.	.

Note: The term "industry" refers to NACE classification C+D+E.

1) Preliminary. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices; revision in government sector, shadow economy, etc.). - 3) Enterprises with more than 9 employees. - 4) From 2003 according to census May 2002. - 5) According to ESA'95 excessive deficit procedure; forecast wiiw estimate.

Source: wiiw Database incorporating national statistics; Eurostat; wiiw forecasts.