POLAND: A number of short-term risks

LEON PODKAMINER

Driven by a major increase in gross capital formation, the Polish economy has entered a phase of relatively rapid growth, which is likely to extend into the biennium 2015-2016. Nonetheless, some economic and non-economic risks still persist. Apart from uncontrollable external and domestic (political) risks, problems are also posed by the pursuit of a monetary policy with too restrictive an orientation.

Moderate (by Polish standards) GDP expansion continued in the second quarter of 2014, reaching a growth rate of 3.3%. Growth in household consumption continued to accelerate, approaching a speed last time recorded three years ago. But growth of public consumption came close to a standstill (after ranging between 2% and 4% for more than a year). In contrast, growth of gross fixed capital formation remained very high. Most probably part of that acceleration was due to the speeding-up of EU co-financed spending. Simultaneously there was an abrupt increase in inventories whose contribution to overall GDP growth rose from minus 0.1 percentage points in the first quarter to (plus) 1.7 percentage points in the second. Such a massive rise in inventories might be only natural to expect (given the fact that previously the inventories had been contracting for 8 consecutive quarters). But it is rather hard to expect further, similarly large, increases in inventories to continue for much longer.

While growth of exports of goods and non-factor services slowed down (from 7.6% in the first quarter to 5.9% in the second), growth of imports sped up from 6.9% to 9.8% respectively. All of a sudden foreign trade became a major drag on overall GDP growth. After 13 consecutive quarters featuring positive (and generally large) contributions of foreign trade to GDP growth, in the second quarter of 2014 that contribution was negative and rather large (-1.6 percentage points).

In the first half of 2014 investment outlays taking the form of an increase in the stocks of buildings and structures rose by close to 16% in real terms while those into machinery and equipment (other than means of transport) by 10%. Investment in the stock of machinery and equipment accounts for the bulk (over 49%) of total investment outlays. Investment outlays in manufacturing (accounting for a third of the total) rose by about 13%.

Outlays in transportation-and-storage rose by more than 24% and in waste collection, recycling etc. by more than 32%. Most likely the increased investment into these sectors has only been possible due to a generous support by transfers from EU funds. The infrastructural sectors (water supply, land transportation etc.) also feature prominently in the recent statistics on the estimated value of newly started investment projects.

The investment acceleration has added strength to the growth of output of manufacturing, with the output of investment goods rising by 8.7% in the first seven months of 2014. Output of manufactured intermediate inputs increased by 7.4% while the sales of consumer durables rose by 4.5% and of consumer non-durables by 2.4%. In real terms, sales of output of the construction sector increased by over 7% in the first half of 2014. Sales of civil engineering and of specialised construction activities rose by over 13% while the sales of activities related to the construction of residential buildings contracted by close to 2%.

The growth acceleration observed in the first half of 2014 has been combined with a deflationary tendency. With the unemployment rate persisting at over 10% and labour productivity growth still outpacing the rates of growth of wage rates by a large margin, producer prices have been following a deflationary path. Consumer price inflation has been very close to zero and still falling, across a wide spectrum of goods and services. In August the CPI turned negative. This (long unanticipated) development has had some positive aspects. With nominal wage rates following their 'natural' upward trends the unplanned disinflation has been a source of additional gains in the purchasing power of wage incomes. That has certainly helped – even if temporarily – to support the growth in household demand.

The inflation target of the National Bank of Poland (CPI of 2.5% with 1 percentage point tolerance band) has been missed by a wide margin. To some extent this has been the outcome of the monetary policy which continues – for hardly understandable reasons – a fairly restrictive course. The NBP policy interest rate of 2.5% has been maintained for a year and a half now.[1] That may have affected the levels (much higher of course) of interest rates charged by banks on their loans to the non-financial corporate sector and to households. While the high real interest rates on loans have not precluded the rise in capital formation (still financed primarily out of own resources, not by loans), high interest rates are unwelcome for another reason. They may have had something to do with the continuing strength of the Polish currency. For a long time this has not be harming the performance of foreign trade. But the recent foreign trade developments seem to indicate that the currency overvaluation may be hard to square with an acceleration of growth of domestic demand. The risk to foreign trade – and to the economy at large – following too strong a currency may finally induce those in charge of Poland's monetary policy to move the interest rates closer to those prevailing internationally. Before that change materialises, the Polish monetary policy course exposes the economy to serious risks.

The trade performance in the second quarter, which seems to be the first consequence of the currency overvaluation (and indirectly of too high interest rates), is unlikely to improve in the coming months. If anything, because of the importance of Russia and Ukraine to Poland's exporters, trade may continue to be a drag on growth.[2] Also, while there are some grounds for optimism concerning gross fixed investment it is less clear what is going to happen with respect to the inventories. All in all, growth may slow down in the second half of 2014. This opinion seems to be supported by the most recent statistics

1 On 9 October 2014 the policy rate was lowered to 2%.

2 According to the customs statistics, the share of Eastern Europe (consisting of Russia, Ukraine, Belarus and Moldova) in Poland's merchandise exports fell to 7.5% in the first seven months of 2014 (from 9.1% in the same period of 2013). For merchandise imports the respective rates are 12.9% and 13.7%. So far the declines in trade with Eastern Europe have not had perceptible effects on foreign trade's contributions to GDP growth. But Russia is an important importer of Polish foodstuffs (e.g. dairy products, fruit and vegetables). Russian countersanctions, targeting foodstuffs, could be hurting the agro-food sector – which is why the sector has been promised some extra support by the European Commission. Also, Russia is an important supplier of energy carriers. Russian supplies cover about 96% of Poland's demand for crude oil and about 70% of natural gas.

(for August 2014) showing declines (even if still quite slight) in the volumes of sales of output of the industrial and construction sectors.

Barring extraordinary – and hardly predictable – changes in the external and internal[3] circumstances, Poland's development in 2015-2016 can be expected to be driven, as in 2014, by expanding domestic demand. The investment push which is an essential aspect of this development has been triggered by both external and internal (largely cyclical) economic impulses. These positive impulses were much weaker during the less dynamic years 2012-2013.

Upon his nomination to the post of the next President of the European Council, Prime Minister Tusk designated his successor: Eva Kopacz, until now the Chairperson of the Parliament's lower chamber. Her main merit seems to have been the unconditional loyalty to Mr Tusk. Otherwise, she is widely judged to be rather impulsive. As a Health Minister (2007-2011) she presided over the reform of the public health system. Arguably, that reform is the major failure of Mr Tusk's governments, still awaiting a radical overhaul.

[3] The outcomes of the next parliamentary elections (autumn 2015) are also hardly predictable now. If the elections are decisively won by the Law and Justice party (of former PM Kaczynski), the course of policy (including on economic matters) may change radically. The direction of that change could not be predicted with any certainty.

Table 1 / Poland: Selected Economic Indicators

	2010	2011	2012	2013 1)	2013	2014	2014	2015	2016
					January-June			Forecast	
Population, th pers., average 2)	38,184	38,534	38,536	38,514	38,465	38,487	38,530	38,525	38,500
Gross domestic product, PLN bn, nom.	1,417	1,528	1,596	1,636	774.7	810.9	1,690	1,770	1,860
annual change in % (real)	3.9	4.5	2.0	1.6	0.8	3.5	3.3	3.2	3.1
GDP/capita (EUR at exchange rate)	9,200	9,600	9,900	10,100	.	.	.	.	.
GDP/capita (EUR at PPP)	15,400	16,400	17,100	17,700	.	.	.	.	.
Consumption of households, PLN bn, nom.	856.2	921.6	967.5	981.2	494.1	510.1	1,010	1,060	1,110
annual change in % (real)	3.1	2.7	1.2	0.7	0.0	2.4	2.5	3.0	3.0
Gross fixed capital form., PLN bn, nom.	281.3	308.7	306.6	301.2	109.9	118.4	320	340	360
annual change in % (real)	-0.4	8.5	-1.6	-0.2	-3.1	9.4	6.0	5.0	5.0
Gross industrial production (sales) 3)									
annual change in % (real)	11.1	6.7	1.2	2.3	-0.2	4.5	5.0	4.5	5.0
Gross agricultural production									
annual change in % (real)	-3.2	0.1	1.2	0.9	.	.	.	.	.
Construction industry 3)									
annual change in % (real)	3.9	15.3	-5.3	-10.2	-20.1	9.8	.	.	.
Employed persons, LFS, th, average 4)	15,961	16,131	15,591	15,568	15,410	15,683	15,600	15,680	15,760
annual change in % 4)	0.6	1.1	0.2	-0.1	-0.6	1.8	0.2	0.5	0.5
Unemployed persons, LFS, th, average 4)	1,699	1,723	1,749	1,793	1,878	1,716	1,730	1,740	1,750
Unemployment rate, LFS, in %, average 4)	9.6	9.7	10.1	10.3	10.9	9.9	10.0	10.0	10.0
Reg. unemployment rate, in %, end of period	12.4	12.5	13.4	13.4	13.2	12.0	12.5	11.5	11.5
Average monthly gross wages, PLN	3,224	3,404	3,530	3,650	3,760	3,913	3,770	3,940	4,140
annual change in % (real, gross)	1.4	1.4	0.1	2.5	2.1	3.5	3.0	3.0	3.0
Consumer prices (HICP), % p.a.	2.7	3.9	3.7	0.9	0.9	0.5	0.3	1.5	2.0
Producer prices in industry, % p.a.	1.8	7.3	3.3	-1.2	-1.2	-1.1	-1.0	1.5	2.0
General governm.budget, EU-def., % of GDP									
Revenues	37.5	38.4	38.3	37.5	.	.	46.5	36.9	37.0
Expenditures	45.4	43.4	42.2	41.9	.	.	41.5	40.3	40.0
Net lending (+) / net borrowing (-)	-7.8	-5.1	-3.9	-4.3	.	.	5.0	-3.3	-3.0
Public debt, EU-def., % of GDP	54.9	56.2	55.6	57.0	.	.	52.0	52.5	52.0
Central bank policy rate, % p.a., end of period 5)	3.5	4.5	4.3	2.5	2.8	2.5	2.0	2.0	2.5
Current account, EUR mn 6)7)	-19,665	-19,398	-13,697	-5,245	-2,430	-1,956	-4,000	-8,500	-11,200
Current account, % of GDP	-5.5	-5.2	-3.6	-1.3	-1.3	-1.0	-1.0	-2.0	-2.5
Exports of goods, BOP, EUR mn 6)	117,938	132,277	140,812	148,855	72,231	77,455	159,300	170,500	182,400
annual change in %	.	12.2	6.5	5.7	4.7	7.2	7.0	7.0	7.0
Imports of goods, BOP, EUR mn 6)	128,334	144,728	147,958	148,220	72,257	77,225	158,600	170,500	182,400
annual change in %	.	12.8	2.2	0.2	-1.7	6.9	7.0	7.5	7.0
Exports of services, BOP, EUR mn 6)	26,714	29,337	32,019	33,792	16,110	16,113	34,100	36,100	38,300
annual change in %	.	9.8	9.1	5.5	6.7	0.0	1.0	6.0	6.0
Imports of services, BOP, EUR mn 6)	23,390	24,151	25,810	25,768	11,765	12,416	26,800	28,400	30,100
annual change in %	.	3.3	6.9	-0.2	-0.1	5.5	4.0	6.0	6.0
FDI inflow (liabilities), EUR mn 6)7)	13,356	13,274	5,634	70	346	5,824	.	.	.
FDI outflow (assets), EUR mn 6)7)	6,590	3,170	445	-2,770	-2,545	3,039	.	.	.
Gross reserves of NB excl. gold, EUR mn	66,253	71,028	78,403	74,257	78,879	71,484	.	.	.
Gross external debt, EUR mn 6)	238,421	250,248	278,037	277,495	275,863	285,293	288,000	305,000	.
Gross external debt, % of GDP	67.2	67.5	72.9	71.2	70.8	70.9	.	.	.
Average exchange rate PLN/EUR	3.9947	4.1206	4.1847	4.1975	4.1781	4.1755	4.20	4.15	4.15
Purchasing power parity PLN/EUR	2.3872	2.4242	2.4199	2.4288	.	.	.	.	.

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) Reference rate (7-day open market operation rate). - 6) BOP 6th edition. - 7) Including Special Purpose Entities (SPEs).

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