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Poland: heightened uncertainty

After very weak performance in the first quarter of 2005, growth in both private consumption and gross fixed capital formation was gradually accelerating (from 1.7% and 1.2% respectively in the first quarter to an estimated 3.3% and 7% in the fourth). GDP growth accelerated – from 2.1% in the first quarter to an estimated 4.4% in the fourth. Rising consumption (private and public combined) contributed 2.8 percentage points (p.p.) to the 3.2% GDP growth in 2005, gross fixed investment a further 1.1 p.p. and net trade in goods and services as much as 1.4 p.p.[1] Exports of goods and services expanded by about 7.1% in real terms while imports by about 3.4%.

The fragility of private consumption growth reflected the protracted weakness of the principal components of household income. The real purchasing power of pensions and disability pays was stagnant while the real purchasing power of other social benefits was eroding constantly. The average wage rose by 1.3% in real terms in the first three quarters of 2005 (but merely 0.3% in the corporate sector). The entire wage bill rose by a more respectable 2.6% in real terms – on account of total employment increasing by some 1.4%, with average employment in the corporate sector up some 1.9%. In the fourth quarter wages in the corporate sector sped up so that in the entire year 2005 the wage bill of the corporate sector rose by close to 3% in real terms. In all probability growth in private consumption must have also sped up, especially as there was a strong rise in credit extended to households.

Profits of the non-financial corporate sector were lower than a year earlier. In the first three quarters of 2005 net profits amounted to PLN 40 billion, down from 46.4 billion earned in the same period of 2004. Net profitability (net profit as a share of all revenue) declined from 5.1% to 4.2% – remaining very high all the same. The financial situation of the corporate sector, its liquidity position, continued to improve, with firms' bank deposits expanding further.

The weakening of profits was most pronounced in export-oriented firms. No doubt this must be attributed to the continuing strong appreciation of the zloty which started already in the first half of 2004. Nonetheless, profitability of the export-oriented firms and branches is, on average, still higher than that of non-exporters.[2]

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[1] Change in inventories and statistical discrepancy contributed minus 1.3 percentage points.

[2] There are some exceptions though: in telecommunications and the real estate, renting and business activities' branch, profitability is high and rising. Also net profits of the financial sector have risen very strongly: those of banks by 23%, totalling some PLN 7 billion in the first three quarters of 2005, and those of insurance companies by close to 55%, totalling PLN 1.7 billion.

Despite falling profits and the stagnant volume of credits extended to the corporate sector, investments picked up, albeit only gradually. However, this positive message must be qualified. It turns out that growth of investment in the private corporate sector has been quite anaemic. Overall investment growth was due primarily to a vigorous acceleration of investment in the public sector, in particular in its coal mining branch and in large publicly-owned industrial and infrastructure firms. (Under the impact of rising energy prices, coal mining – until 2004 a permanent loss-maker – has been generating huge profits.) As long as there is no sustained recovery of investment in the private sector, its current overall acceleration need not prove sustainable.

Net exports are likely to contribute positively to GDP growth also in the coming years[3], provided the appreciation of the zloty comes to a halt, or at least slows down. Continuing gains in labour productivity and unit labour costs (low pace of wage increases) are to be expected. This will be offsetting the negative effects of moderate appreciation. But it would be incorrect to assume that any level of nominal appreciation can be neutralized through cost/wage adjustments. Although firms have demonstrated a good deal of adaptability to adverse exchange rate conditions, they may be unable to perform once the losses on exports rise too much and too fast.

The authorities have not done much to prevent the recent (second half of 2005 and January 2006) nominal appreciation. Despite generally deflationary conditions the National Bank of Poland keeps referring to higher energy prices and alluding to the lack of 'fiscal consolidation' – and traditionally drags its feet on cutting interest rates. In effect at similar inflation rates, the official Polish interest rates are about four times the Czech ones. This has certainly not been moderating the appreciation. Besides, some actions of the Finance Ministry of the new Polish government appear to be supporting the strengthening of the zloty as well. Large chunks of the Ministry's newly drawn foreign-exchange debt have been exchanged into zloty on the foreign exchange market, rather than with the National Bank. (There is additional irony in the fact that due to the NBP's ‘policy stance’ the government prefers to borrow abroad rather than domestically.)

The conflict between the National Bank and the new government formed by the party of the Kaczyński brothers, which had been widely expected prior to the elections, has actually been quite muted so far. That (minor) conflict will be played out later. At the moment the brothers have more urgent, fundamental, tasks to accomplish. They are busy provoking major conflicts which are to discredit and demolish the entire constitutional framework of the Republic that had been developed (by 'wrong parties' and 'wrong personalities') during the past 16 years. Their actions aim not only at elimination – by means foul rather than fair

3 Foreign trade contributed positively to GDP growth in 2000, 2001, 2002 and 2003. Only in 2004, under the conditions of the 'accession boom', its contribution was negative (but otherwise small).

– political competitors (and erstwhile allies alike); they have also been trying, with a remarkable degree of success, to hollow out the basic institutions (the parliament itself) and principles (division of branches of government, system of checks and balances, separation of the state and religion, independence of the media, protection of minorities etc.) of a modern state. All that may serve the purpose of creating a rather anachronistic – at least as far as contemporary European standards are concerned – political system.

At present the new authorities do not waste too much effort on the formulation, let alone actual execution, of any coherent economic or social policy. The low priority given to economics was exposed first when two rather anonymous outsiders were nominated key economics Ministers (for finances, state property). This was then followed by their unceremonious sacking. But the replacements, chosen for purely political reasons, seem equally incompetent. Fortunately, the budget for 2006 is there, worked out under the previous government (of Mr. Belka). Thus at least in the short run the fiscal policy should not perhaps be unpredictable. The predictability of other elements of economic policy, however, is currently rather low. What seems quite obvious is that the brothers' generally combative mood will occasionally (or perhaps even quite frequently) lead to conflicts with e.g. domestic business, or trade unions, foreign investors, or the managers of the publicly-owned concerns. Also, their relationships with the unloved Brussels bureaucracy are likely to be strained.

Summing up, GDP growth acceleration requires a more definite revival of the private sector's propensity to invest and a return to more exporter-friendly levels of the exchange rates. But, at present, one does not see good reasons why the investment attitudes of the private sector should be improving anytime soon. Apparently, on average firms are satisfied with the stocks of fixed capital at their disposal. They seem to be capable of raising output by increasing employment. One could perhaps be more optimistic about the exchange rate trends: the current strengthening should stop sooner rather than later, especially if the National Bank and the Finance Ministry decide to cooperate (or, if the former decides to subordinate). But, of course, one cannot be quite sure about the medium-term strength of the Polish currency – especially given what is going on in the political arena.

Table PL

Poland: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004	2005 [1]	2006 forecast	2007 forecast
Population, th pers., end of period [2]	38654	38254	38248	38219	38191	38174	38157	.	.
Gross domestic product, PLN mn, nom. [3]	666308	744622	779205	807860	842120	922157	967700	1029600	1099700
annual change in % (real) [3]	4.5	4.2	1.1	1.4	3.8	5.3	3.2	3.8	4.2
GDP/capita (EUR at exchange rate) [3]	4078	4853	5553	5480	5013	5327	6299	.	.
GDP/capita (EUR at PPP - wiiw) [3]	8640	9400	9600	9980	10210	11060	11550	.	.
Gross industrial production (sales)									
annual change in % (real)	3.6	6.7	0.6	1.1	8.3	12.6	3.8	7	7
Gross agricultural production									
annual change in % (real)	-5.2	-5.6	5.8	-1.9	-0.8	7.5	-2.1	.	.
Construction output total									
annual change in % (real)	6.2	1.0	-6.4	-0.3	0.9	-7.0	5.0	.	.
Consumption of households, PLN mn, nom. [3]	414581	469306	497809	531100	543203	582449	.	.	.
annual change in % (real) [3]	5.4	3.0	2.2	3.3	1.9	4.0	2.3	2.5	3
Gross fixed capital form., PLN mn, nom. [3]	162458	176739	161277	151472	153758	165848	.	.	
annual change in % (real) [3]	6.6	2.7	-9.7	-6.3	-0.1	6.3	6.2	6	6
LFS - employed persons, th, avg. [4]	14757.0	14526.0	14207.0	13782.0	13616.8	13794.8	14200	.	.
annual change in %	-3.9	-1.6	-2.2	-3.0	0.6	1.3	2.9	.	.
Reg. employees in industry, th pers., avg.	3138.4	2955.0	2820.6	2670.5	2639.1	2655.1	2426.0 [5]	.	.
annual change in %	-7.1	-5.8	-4.5	-5.3	-1.2	0.6	1.1 [5]	.	.
LFS - unemployed, th pers., average [4]	2391.0	2785.0	3170.0	3431.0	3328.5	3230.3	3070		
LFS - unemployment rate in %, average [4]	13.9	16.1	18.2	19.9	19.6	19.0	18.0	17.5	17
Reg. unemployment rate in %, end of period [4]	13.1	15.1	17.5	18.0	20.0	19.1	17.6	.	.
Average gross monthly wages, PLN	1697.1	1893.7	2045.1	2097.8	2185.0	2273.4	2515.9 [5]	.	.
annual change in % (real, gross)	4.7	1.0	2.5	0.7	3.4	0.7	1.2 [5]	.	.
Consumer prices, % p.a.	7.3	10.1	5.5	1.9	0.8	3.5	2.1	2.5	2.5
Producer prices in industry, % p.a.	5.7	7.8	1.6	1.0	2.6	7.0	0.7	1	1.5
General governm.budget, EU-def., % GDP [6]									
Revenues	44.9	42.5	40.9	42.3	40.9	40.8	41.8	41.4	41.3
Expenditures	47.0	45.2	44.7	45.6	45.8	44.7	45.0	45.0	44.6
Deficit (-) / surplus (+)	-1.4	-1.6	-3.7	-3.3	-4.8	-3.9	-3.6	-3.6	-3.4
Public debt, EU-def., % of GDP [6]	40.3	36.8	36.7	41.2	45.3	43.6	46.3	47.0	47.3
Discount rate of NB % p.a., end of period	19.0	21.5	14.0	7.5	5.8	7.0	4.8	.	.
Current account, EUR mn	-11716	-10788	-6006	-5399	-4108	-8401	-3700	-3800	-3800
Current account in % of GDP	-7.4	-5.8	-2.8	-2.6	-2.1	-4.1	-1.5	-1.5	-1.4
Gross reserves of NB excl. gold, EUR mn	26224	28555	29031	27367	26000	25904	34536	.	.
Gross external debt, EUR mn	65121	74670	81461	81045	84818	94035	105559 IX	.	.
FDI inflow, EUR mn	6824	10334	6372	4371	4067	10070	6500	.	.
FDI outflow, EUR mn	29	18	-97	228	269	631	867	.	.
Exports of goods, BOP, EUR mn	28215	39022	46537	49338	53836	65847	76400	82500	89100
annual growth rate in %	-2.5	38.3	19.3	6.0	9.1	22.3	16	8	8
Imports of goods, BOP, EUR mn	42361	52349	55094	57039	58913	70399	76400	84100	92500
annual growth rate in %	4.9	23.6	5.2	3.5	3.3	19.5	9	10	10
Exports of services, BOP, EUR mn	7850	11320	10914	10545	9850	10821	12900	13300	13700
annual growth rate in %	-18.8	44.2	-3.6	-3.4	-6.6	9.9	19	3	3
Imports of services, BOP, EUR mn	6553	9773	10021	9690	9408	10026	11200	11300	11650
annual growth rate in %	10.9	49.1	2.5	-3.3	-2.9	6.6	12	1	3
Average exchange rate PLN/USD	3.97	4.35	4.09	4.08	3.89	3.65	3.23	.	.
Average exchange rate PLN/EUR (ECU)	4.23	4.01	3.67	3.86	4.40	4.53	4.03	4	4
Purchasing power parity PLN/USD	1.75	1.82	1.85	1.83	1.84	1.87	1.85	.	.
Purchasing power parity PLN/EUR	1.99	2.07	2.12	2.12	2.16	2.18	2.20	.	.

Notes: 1) Preliminary. - 2) From 2000 according to census May 2002. - 3) Revised data (FISIM adjustment, new methodology in government sector, new estimate of shadow economy etc.). - 4) From 2003 according to census May 2002. - 5) Enterprises with more than 9 employees.- 6) According to ESA'95, excessive deficit procedure.

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