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Poland: investment expansion gathers momentum

GDP growth accelerated further to an estimated 6.3% in the fourth quarter of 2006. Private consumption contributed 3.4 percentage points (p.p.) to the overall GDP growth during the first three quarters of the year, with gross fixed investment and foreign trade adding another 2.2 and 0.3 p.p. respectively.

Growth of private consumption in the whole year 2006 (about 5.2%) has continued to lag behind the rising nation-wide wage bill and total social security spending (in real terms up around 7% and 6% respectively). The gap between rising disposable incomes and private consumption seems to be reflecting households' increasing housing investment (which has been additionally boosted by a truly massive expansion of housing credit to the household sector).

Growth of gross fixed investment (in firms employing over 50 persons) speeded up sharply, from 7.7% in the first quarter of 2006 to 19.8% in the third. Larger firms' investments in machinery, tools and installations rose by 23%, and in buildings and structures by about 5%. Concurrently, a strong contraction in inventories has continued at the national level.

The acceleration of growth of domestic demand to 6.1% in the third quarter of 2006, combined with a further appreciation of the Polish currency, proved sufficient to reduce the contribution of foreign trade to GDP growth by 1 p.p. In the third quarter of 2006 the longer-term tendency for exports to rise faster than imports was reversed. In the entire year 2006 the contribution of foreign trade to GDP growth was about 0 (down from 1.1 p.p. in 2005).

There are good grounds to expect the current investment expansion to continue. First, despite its recent impressive growth rates, the share of investment in the GDP is still relatively low, even by Polish standards.[1] Second, the economy is currently running at record levels of utilization of productive capacities. The average (employment-weighted) level of capacity utilization in the corporate sector has reached over 85%. (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%.) Third, profitability has been very high and generally rising across all sectors and branches (excluding the loss-making tobacco industry). Net profits of the entire corporate sector rose from PLN 40 billion in the first three quarters of 2005 to PLN 50.7 billion in the same period of 2006. All liquidity indicators for the corporate sector are looking very good, with record low numbers of firms in financial distress. (At end-2006 some 95% of firms fully observed their credit obligations,

1 In the late 1990s the GDP share of gross fixed investment stood at about 24%. Currently it is around 20%.

compared to e.g. 75% in late 2002.[2] In actual fact some 40% of the firms polled 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. Those firms, primarily smaller and medium-sized ones, that are less blessed with high own financial resources have quite easy access to relatively cheap (and abundant) credit or, alternatively, try to seek funds by going public.[3] Last but not least, firms are generally very satisfied with the strength of demand: only about 6% of firms report insufficient demand (vs. 12% one year ago, 24% two years ago). Demand is generally expected to remain very strong in the coming months. This is evidenced by record levels of new orders placed. All in all, the conditions for a further expansion of investment activities are highly favourable.

The high levels of capacity utilization happen to coincide with intensifying shortages of labour. About half of firms in the corporate sector report difficulties in finding properly qualified employees, 28% of firms 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). Thus, the registered increase in employment (by about 3.4% in 2006) must have been restricted by the availability of labour. These facts might be hard to reconcile with the still high (though falling) unemployment levels. However, one must bear in mind that very high unemployment has persisted for a very long time. Possibly, this has made a large proportion of the afflicted virtually unemployable (on account of depreciated skills and motivations). Also, large regional variations in the availability of jobs as well as of affordable housing may be preventing a more efficient matching of labour supply with labour demand. Finally, it can be argued that the sizeable (though hard to quantify) migrations of Polish workers (primarily to Great Britain and Ireland) have been conducive to the emergence of labour shortages. Firms' standard short-term response to the symptoms of labour shortages involves, first of all, wage hikes. So far the growth of wages has been quite moderate. Nonetheless, about one third of firms (with about half of total employment) plan to raise wages in the immediate future. But the wage hikes planned remain fairly moderate (with a median value of about 5%[4]). Perhaps surprisingly, high labour costs remain a concern to only about 5% of the firms polled. (This stands in stark contrast to opinions voiced by politicians and economists, also populating international economic and financial institutions, to whom rising wages represent a major risk – next only to deficit spending.)

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

3 Despite relatively low (by Polish standards) interest rates on bank loans (on average about 5.8%), bank credit is currently the dominant source of financing new investment projects for only about one third of firms. It is worth noting that banks have good grounds to be satisfied with the current situation as well. In the first three quarters of 2006 commercial banks made PLN 8 billion net profit (up from 6.6 billion a year earlier). Net interest income (interest revenue minus interest costs) totalled a handsome PLN 13.7 billion.

4 See www.nbp.pl/publikacje/koniunktura.

With moderate wage increases (combined with further strong gains in labour productivity and in unit labour costs), the very low CPI inflation (1%) recorded in 2006 is not entirely surprising. Inflation may well rise somewhat in 2007, especially as growth in consumer demand is likely to catch up with the growth of household incomes. However, the cost pressures will remain weak (energy prices are likely to weaken, or at worst stabilize, the exchange rates are likely to remain quite strong). Most importantly, much of the investment now underway is likely to further enhance productivity and/or lower costs.

At the end of 2006 the interest rate on ten-year Treasury bonds in Poland (about 5.2%) was much higher than the average long-term rate in the euro area (about 4.1%) – with inflation much higher in the latter area. The interest rate differential is still positive even vs. the US dollar (where the yield on long-term bonds is about 4.7%). This anomalous situation, reflecting primarily the (past) policy orientation of the National Bank of Poland[5], has been ‘helping’ to strengthen the Polish zloty vs. the euro and the dollar. Given the fact that the successor (as of January 2007) to Leszek Balcerowicz as the Head of the National Bank is unlikely to inherit the latter’s hawkish temperament, the interest rate policy may be expected to be less impulsive than in the past. This may be slowing down the pace of zloty appreciation in the future.

The strong zloty has not been, as yet, affecting growth of exports negatively. Exports expand very strongly. The share of unprofitable exports is low by historical standards (about 6%, compared to e.g. 12% at end-2001). The exports’ insensitivity to the strong zloty reflects the ongoing structural change (away from production and exports of lower-quality, price-elastic goods to more sophisticated, price-inelastic ones). Structural improvements seem to be correlated with the rising share of firms specializing in export production. Many large FDI firms (viz. networked suppliers of parts and components) belong to this category. It is quite obvious that such highly specialized export-oriented firms need not worry too much about (moderate) changes in the exchange rates. The situation is different on the import side. The strong zloty is of course having a positive impact on the corporate sectors’ total costs (as the imported intermediate inputs constitute about 20% of all material costs). But the problem is that at the current levels of the exchange rates producers supplying primarily the domestic market express fears about intensified foreign competition, especially vs. imports invoiced in US dollar. All in all, the corporate sector identifies the levels (and volatility) of the exchange rates as restricting growth much more than any other single factor. Indirectly, this would seem to indicate that the ‘captains of business’ favour an early adoption of the euro. Interestingly however, the corporate

[5] One often attributes high levels of long-term interest rates to high public sector borrowing. (Thus, in the last instance, to large fiscal deficits.) The idea behind this is that at low interest rates, public debt would not attract sufficient amounts of private capital. Because in Poland private demand for Treasury bonds is usually several times their supply, it is hard to take the 'fiscal theory' of interest rates seriously.

sector's opinion is not shared by the present authorities at all. The authorities' kind of patriotism seems to be incompatible with giving up the national currency.

The internal (and occasionally external) policy directed by the Kaczynski brothers remains turbulent and chaotic. But it meets its goal of de facto subordinating all state institutions, including the judiciary, the Ombudsman office, public media, the National Bank, state-owned firms etc. The 'Fourth Republic' whose contours seem to be emerging out of the unending political turmoil bears some semblance to the systems popular in Europe in the inter-war period. However, the re-activation of some form of 'guided democracy' is unlikely to be ultimately successful – if only because of the Polish society's proven anti-authoritarian instincts. As far as the current economic policy is concerned, the authorities' record is not that bad, if only because inaction on economic matters seems to be a virtue now. Despite the wholesale purge running throughout the administration, the policies have remained much the same. Only as far as privatization is concerned there is a definite change: for practical purposes the process has come to a halt. Besides, good luck is clearly on the side of the current rulers. For example, the budget deficit, helped by the unanticipated acceleration in GDP growth, was lower than planned in 2006. Falling unemployment and rising transfers 'from Brussels' are helpful too. Moreover, despite widespread criticism (voiced also abroad[6]) of the style of managing the economy, foreign direct investment is pouring into the country.

Summing up, strong investment and consumption will be pulling up GDP growth in 2007-2008. Trade will cease to contribute positively to growth, though the expansion of exports will continue.

[6] The criticisms notwithstanding, Poland's Fitch and Moody's ratings have been upgraded recently.

Table PL

Poland: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 [1)]	2007	2008
								forecast	
Population, th pers., end of period	38254	38248	38219	38191	38174	38157	38122	.	.
Gross domestic product, PLN mn, nom. [2)]	744622	779205	807860	842120	923248	980666	1047900	1123300	1203100
annual change in % (real) [2)]	4.2	1.1	1.4	3.8	5.3	3.5	5.8	5.3	5
GDP/capita (EUR at exchange rate) [2)]	4853	5553	5480	5013	5333	6384	7054	.	.
GDP/capita (EUR at PPP - wiiw) [2)]	9390	9600	9980	10210	11050	11670	12600	.	.
Gross industrial production (sales)									
annual change in % (real)	6.7	0.6	1.1	8.3	12.6	3.7	11.3	8	7
Gross agricultural production									
annual change in % (real)	-5.6	5.8	-1.9	-0.8	7.5	-4.2	-1.8	.	.
Construction output total									
annual change in % (real)	1.0	-6.4	-0.3	0.9	-7.0	1.5	12.0 [3)]	.	.
Consumption of households, PLN mn, nom. [2)]	469306	497809	531100	543203	583690	607270	.	.	
annual change in % (real) [2)]	3.0	2.2	3.3	1.9	4.3	1.8	5.2	5	4
Gross fixed capital form., PLN mn, nom. [2)]	176739	161277	151472	153758	167158	178391	210300	.	.
annual change in % (real) [2)]	2.7	-9.7	-6.3	-0.1	6.4	6.5	16.7	15	10
LFS - employed persons, th, avg. [4)]	14526.0	14207.0	13782.0	13616.8	13794.8	14115.3	14600	.	.
annual change in %	-1.6	-2.2	-3.0	0.6	1.3	2.3	3.4	.	.
Reg. employees in industry, th pers., avg.	2955.0	2820.6	2670.5	2639.1	2663.1	2426.0	2481.8 [3)]	.	.
annual change in %	-5.8	-4.5	-5.3	-1.2	0.9	1.1	2.3 [3)]	.	.
LFS - unemployed, th pers., average [4)]	2785.0	3170.0	3431.0	3328.5	3230.3	3045.3	2500		
LFS - unemployment rate in %, average [4)]	16.1	18.2	19.9	19.6	19.0	17.8	15	14	13
Reg. unemployment rate in %, end of period [4)]	15.1	17.5	18.0	20.0	19.1	17.6	14.9	13	12.5
Average gross monthly wages, PLN	1893.7	2045.1	2097.8	2185.0	2273.4	2360.6	2480	.	.
annual change in % (real, gross)	1.0	2.5	0.7	3.4	0.7	1.8	4	.	.
Consumer prices, % p.a.	10.1	5.5	1.9	0.8	3.5	2.1	1.0	1.8	2
Producer prices in industry, % p.a.	7.8	1.6	1.0	2.6	7.0	0.7	2.3	1.5	2
General governm. budget, EU-def., % GDP [5)]									
Revenues	39.6	40.1	41.0	39.9	38.7	39.1	39.8	40.2	39.2
Expenditures	41.1	43.8	44.2	44.6	42.6	43.5	43.5	43.5	42.4
Deficit (-) / surplus (+)	-1.5	-3.7	-3.2	-4.7	-3.9	-4.4	-3.7	-3.3	-3.2
Public debt, EU-def., % of GDP [5)]	36.8	36.7	39.8	43.9	41.9	42	42	42.1	41.5
Discount rate of NB % p.a., end of period	21.5	14.0	7.5	5.8	7.0	4.8	4.3	4.4	.
Current account, EUR mn	-10788	-6006	-5399	-4108	-8670	-4130	-5000	-5500	-6000
Current account in % of GDP	-5.8	-2.8	-2.6	-2.1	-4.3	-1.7	-1.9	-2.0	-2.0
Gross reserves of NB excl. gold, EUR mn	28555	29031	27367	26000	25904	34536	35235	.	.
Gross external debt, EUR mn	74670	81461	81045	84818	94881	111904	121546 [IX]	.	.
Gross external debt in % of GDP	40.2	38.4	38.7	44.3	46.6	45.9	.	.	.
FDI inflow, EUR mn	10334	6372	4371	4067	10292	7703	11200	.	.
FDI outflow, EUR mn	18	-97	228	269	636	2493	1500	.	.
Exports of goods, BOP, EUR mn	39022	46537	49338	53836	65847	77562	93500	108500	119400
annual growth rate in %	38.3	19.3	6.0	9.1	22.3	17.8	21	16	10
Imports of goods, BOP, EUR mn	52349	55094	57039	58913	70399	79804	96600	113000	126600
annual growth rate in %	23.6	5.2	3.5	3.3	19.5	13.4	21	17	12
Exports of services, BOP, EUR mn	11320	10914	10545	9850	10815	13077	16300	18300	19600
annual growth rate in %	44.2	-3.6	-3.4	-6.6	9.8	20.9	25	12	7
Imports of services, BOP, EUR mn	9773	10021	9690	9408	10033	11541	14400	16100	17200
annual growth rate in %	49.1	2.5	-3.3	-2.9	6.6	15.0	25	12	7
Average exchange rate PLN/USD	4.35	4.09	4.08	3.89	3.65	3.23	3.10	.	.
Average exchange rate PLN/EUR (ECU)	4.01	3.67	3.86	4.40	4.53	4.03	3.90	4.05	4.0
Purchasing power parity PLN/USD	1.82	1.84	1.83	1.83	1.85	1.85	1.81	.	.
Purchasing power parity PLN/EUR	2.07	2.12	2.12	2.16	2.19	2.20	2.18	.	.

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; from 2005 wiiw.

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