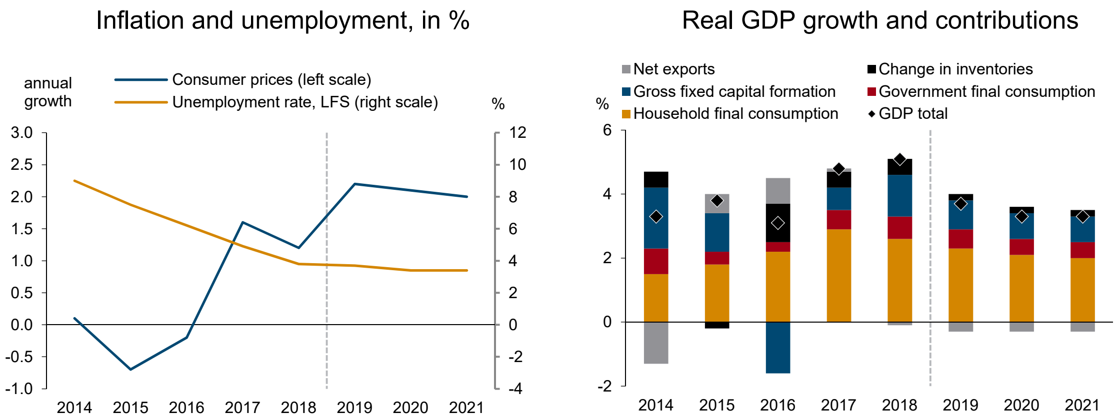
POLAND: Slower growth a real possibility

LEON PODKAMINER

Despite lower profits the corporate sector's financial standing and financing conditions are good. But private domestic firms are still reluctant to expand investment. Ongoing political changes are destabilising the country's legal framework, undermining trust in the rule of law. The conflict between the European Commission and the Polish government may lead to substantial cuts in the funds available to Poland which would also undermine public investment and reduce medium-term growth prospects.

Figure 6.16 / Poland: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

Strong GDP growth driven by domestic demand continues. Starting from the beginning of 2017, quarterly GDP growth rates have been close to 5% (year on year). The provisional estimate for the GDP growth rate for the full year 2018 is 5.1%. Consumption, rising by 4.3%, was an essential driver of growth (with private consumption rising 4.5% and public consumption by 4%). Gross capital formation increased by over 9%, with gross fixed capital formation increasing by 7.3%. Inventories rose strongly again (as they already did in 2016 and 2017), contributing 0.5 percentage points to overall growth. The contribution of foreign trade (in goods and services) to overall growth was negative, but quantitatively negligible.

Growth in private consumption will slow during the forecast period. Although under tight labour market conditions wage rates are on the rise, the total wage bill will not grow as fast as in the past. Given the contracted labour reserves, employment growth will be rather moderate. Moreover, the additional (and sizeable) social transfers addressing families with children (in place since April 2016) no longer positively affect households' disposable income. Last, but not least, household saving as a share of disposable income is likely to increase further. The gap between rising income and rising consumption spending is likely to continue to widen. This fact is reflected in differential developments in households' bank deposits and loans. The former are growing clearly faster than the latter. (The latter primarily finance households' residential investment, not consumption.) Besides, consumer demand will not keep up with the growing wage bill because a large and growing portion of that bill, representing the earnings of foreign guest workers, tends to be sent back home (mostly to Ukraine).

Gross fixed investment is not (yet) driven by domestic private firms. Instead it primarily still depends on growing public investment spending. An estimated two thirds of the increase in investment in 2018 can be attributed to spending by local authorities (who prepared, that way, for the local elections held in October 2018). The entire corporate sector's investment growth continues to be dominated by the larger foreign-owned and publicly-owned firms. The most recent business climate survey available does not augur any significant change in the structure of corporates' investment. Some 40% of the public-owned corporations plan an acceleration of investment spending – against less than 10% for the private domestic-owned firms.

Investment appears to be correlated with the increased utilisation of EU funds. The rather skewed structure of investment reflects the sectoral differences in the current investment propensities. Thus, over the first three quarters of 2018 the investment outlays in manufacturing increased by 7.3%. At the same time such outlays increased in the 'infrastructure' sectors such as 'water collection and treatment' by over 54% and 'transportation' by over 40%.[32] Much the same message follows the available data on the composition of the sales of production of the construction-and-assembly sector. The total value of sales of that sector rose 23.7% in 2018 – of which the sales of output in the form of 'complex construction on industrial sites' by only 4.2% while e.g. the sales of output classified as 'waste water treatment plants' by 94%. The EU funds still available under the current (2014-2020) perspective are still quite sizeable (possibly as much as about PLN 65bn or one third of the original total). Very likely these funds will support high investment in 2019 (primarily by the public sector). But private sector investment proper is likely to remain rather weak. Institutional (legal) and economic uncertainties (including on the growth prospects in the euro area) as well as concerns about a profit squeeze (through rising unit labour costs, rising administered energy prices) are not conducive to waging an investment offensive. It is also possible that the skilled labour which would be needed for the realisation and operation of new private-sector production facilities is siphoned off into the investment tasks financed or run by the public sector enjoying 'free access' to the EU funds.

Foreign trade in goods and non-factor services is performing relatively weakly. In 2018 trade in goods and non-factor services registered a surplus worth EUR 17.1bn – against 19.4bn in 2017.Trade in services fares quite well – much better than trade in goods. In current euro terms, exports (of goods and services) rose 7.2% and imports by 9%. Unfavourable terms-of-trade developments may be a part of the problem. However, the expected (on account of faltering performance of the euro area) deteriorations in the trade (and also current account) balances – although affecting the overall GDP growth rates – are unlikely to signal any immediate and serious troubles for the country's exchange rate (which has been remarkably stable recently) or for Poland's external payments position.

---

[32] One also notices a 66% rise in the investment outlays into the coal mining sector (which is run by state-owned conglomerates fully subordinated to the government).

Corporate profitability is deteriorating. Net (post-tax) profits of the corporate non-financial sector declined by 1.4% (year on year) over the first three quarters of 2018. In industry the decline was steep (-8.5%) – largely on account of a rather dreadful performance of the coal mining branch. Also the 'electricity, gas, steam etc.' sector performed dismally, with profits declining by 35%. Profitability developments are surely influenced by gaps opening, despite rising labour productivity, between the producer prices received and production costs. Producer prices are rising quite weakly (in manufacturing by about 2% on average so far). However, production costs are rising quite visibly (under the impact of a close to 7% hike in the average nominal wage rate). The ongoing gains in labour productivity (close to 4% currently) in many sectors or branches are insufficient to close the growing gaps between costs and revenues. Subdued inflation in producer prices may reflect fairly strong competitive pressures keeping domestic prices (both producers' and consumers') in check to some extent at least. Despite reduced corporate profits the financial standing of firms in most sectors or branches is still quite satisfactory and the profitability indicators are good, by historical standards. But the situation of coal mining and electricity sectors is rather critical.

Consumer prices are suppressed – perhaps temporarily. At 1.6% the consumer price index for 2018 seems unbelievably low. However, the reported CPI may in fact be correct. As already mentioned, the rising household disposable income appears to be associated with rising saving rates. Thus the usual 'demand pull' may be weaker than perhaps commonly believed. Also, in many branches of manufacturing (and market services) the rise in costs (and wage costs in particular) has not depressed profit margins. In these branches the cost-push may not have emerged so far. Finally, the low CPI may have been a consequence of the policy of 'freezing' energy prices (electricity, coal etc.) pursued by the present government. The energy sectors are run by state-owned conglomerates and the suppression of energy prices by governmental decrees is not a problem at all (especially in view of the parliamentary elections due this coming autumn). In the meantime the 'missing' earnings of the energy suppliers are replenished by temporary subsidies from the state budget (or temporarily foregone taxes normally levied on the energy suppliers). Whether this practice (quite typical of 'planned economies') will go unnoticed by the European Commission remains to be seen. In any case this practice may be discontinued after the elections (no matter who wins). The large hikes in energy prices that would then follow could put an end to the current inflation tranquillity.

Lending is expanding rather moderately amid banks' strongly improved profits. The policy interest rate remains fairly low (1.5%) and is unlikely to go up because the National Bank is unlikely to do anything unpalatable to the government. The interest rates charged by commercial banks on new loans are also not exorbitant (on average 4.4% for household mortgage loans and 3.5% for loans to non-financial corporates). Despite this, loan growth is rather slow. Over one year ending 30 September 2018 the stock of loans to non-financial corporates increased by over 4% (by less than 0.1% for small and medium-sized firms) and by less than 4% to the household sector (mostly in the form of mortgages). The demand for bank loans remains subdued on account of low investment by corporates and high 'idle' cash resources of the private non-financial sector (primarily accumulating as bank deposits). Banks' net profits rose all the same: from PLN 10.5bn in the first three quarters of 2017 to PLN 11.6bn in the same period of 2018 (in current euro terms from 2.4bn to 2.6bn, respectively). Unlike in the non-financial corporate sector, the costs of banking operations have risen less than their revenues. The latter increased quite strongly not only on account of higher net interest income, but also because of much higher dividends earned.

Summing up: slower growth in 2019 is a real possibility. The economic strategy in fact boiling down to increased investment spending by the public sector (and by the state-owned corporations 'guided' by the politicians) does not seem to promise much success in the long – or even medium – run. Moreover, continuing conflicts between the European Commission and the Polish government (over the latter's 'reforms' undermining the independence of the judiciary) could lead to substantial cuts in the EU funds available to the country. That would undermine public investment spending and thus reduce growth in the medium run. Another downside risk pertains to a likely return of higher inflation which would then erode the purchasing power of household incomes – hence negatively affecting consumer demand as well. The situation could improve with the private sector resuming investment on a broader scale. But, for many reasons, this need not happen anytime soon.

Table 6.16 / Poland: Selected economic indicators

	2014	2015	2016	2017	2018 1)	2019	2020 Forecast	2021
Population, th pers., average	38,487	38,458	38,435	38,434	38,400	38,400	38,410	38,420
Gross domestic product, PLN bn, nom.	1,720	1,800	1,861	1,989	2,120	2,250	2,350	2,480
annual change in % (real)	3.3	3.8	3.1	4.8	5.1	3.7	3.3	3.3
GDP/capita (EUR at PPP)	18,600	19,900	19,900	20,900	22,200	.	.	.
Consumption of households, PLN bn, nom.	1,019	1,038	1,074	1,151	1,220	.	.	.
annual change in % (real)	2.6	3.0	3.9	4.9	4.5	4.0	3.6	3.5
Gross fixed capital form., PLN bn, nom.	339	361	335	352	380	.	.	.
annual change in % (real)	10.0	6.1	-8.2	3.9	7.3	5.0	4.5	4.5
Gross industrial production (sales) 2)								
annual change in % (real)	3.5	4.8	2.8	6.6	5.9	5.0	4.5	4.0
Gross agricultural production								
annual change in % (real)	6.9	-2.7	8.5	2.9	0.5	.	.	.
Construction industry 2)								
annual change in % (real)	4.3	0.3	-14.5	13.7	19.7	.	.	.
Employed persons, LFS, th, average	15,862	16,084	16,197	16,423	16,550	16,650	16,700	16,730
annual change in %	1.9	1.4	0.7	1.4	0.8	0.6	0.3	0.2
Unemployed persons, LFS, th, average	1,567	1,304	1,063	844	650	640	590	590
Unemployment rate, LFS, in %, average	9.0	7.5	6.2	4.9	3.8	3.7	3.4	3.4
Reg. unemployment rate, in %, eop	11.4	9.7	8.3	6.6	5.8	.	.	.
Average monthly gross wages, PLN 3)	3,777	3,908	4,052	4,272	4,560	4,890	5,190	5,480
annual change in % (real, gross) 3)	3.2	4.5	4.2	3.5	5.5	5.0	4.0	3.5
Consumer prices (HICP), % p.a.	0.1	-0.7	-0.2	1.6	1.2	2.2	2.1	2.0
Producer prices in industry, % p.a.	-1.4	-2.2	-0.3	2.7	2.1	1.8	1.8	1.8
General governm.budget, EU-def., % of GDP								
Revenues	38.7	39.0	38.9	39.7	40.5	40.5	40.5	40.5
Expenditures	42.4	41.7	41.1	41.1	42.0	42.5	42.5	42.5
Net lending (+) / net borrowing (-)	-3.7	-2.7	-2.2	-1.4	-1.5	-2.0	-2.0	-2.0
General gov.gross debt, EU def., % of GDP	50.4	51.3	54.2	50.6	50.9	51.1	51.4	51.8
Stock of loans of non-fin.private sector, % p.a.	5.8	7.1	5.3	3.1	7.2	.	.	.
Non-performing loans (NPL), in %, eop	8.1	7.5	7.1	6.8	6.8	.	.	.
Central bank policy rate, % p.a., eop 4)	2.0	1.5	1.5	1.5	1.5	1.50	1.75	1.50
Current account, EUR mn 5)	-8,529	-2,409	-2,240	706	-3,389	-5,200	-5,400	-6,000
Current account, % of GDP 5)	-2.1	-0.6	-0.5	0.2	-0.7	-1.0	-1.0	-1.1
Exports of goods, BOP, EUR mn 5)	158,656	172,150	177,412	201,963	213,912	224,800	237,700	251,400
annual change in %	6.4	8.5	3.1	13.8	5.9	5.1	5.8	5.8
Imports of goods, BOP, EUR mn 5)	161,911	169,937	174,479	200,536	218,744	236,200	253,000	270,700
annual change in %	8.3	5.0	2.7	14.9	9.1	8.0	7.1	7.0
Exports of services, BOP, EUR mn 5)	36,743	40,663	44,929	51,883	58,236	62,900	67,900	73,300
annual change in %	9.4	10.7	10.5	15.5	12.2	8.0	8.0	8.0
Imports of services, BOP, EUR mn 5)	27,679	29,749	30,963	33,926	36,270	38,800	40,700	42,700
annual change in %	6.7	7.5	4.1	9.6	6.9	7.0	5.0	5.0
FDI liabilities, EUR mn 5)	14,824	13,534	16,628	9,292	7,843	.	.	.
FDI assets, EUR mn 5)	5,096	4,385	12,807	3,688	139	.	.	.
Gross reserves of NB excl. gold, EUR mn	79,379	83,676	104,440	90,967	97,633	.	.	.
Gross external debt, EUR mn 5)	293,510	303,120	321,305	318,851	338,300	345,300	366,200	387,700
Gross external debt, % of GDP 5)	71.4	70.5	75.3	68.3	68.0	66.0	67.0	68.0
Average exchange rate PLN/EUR	4.1843	4.1841	4.3632	4.2570	4.2615	4.30	4.30	4.35

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) Excluding employees in national defence and public safety. - 4) Reference rate (7-day open market operation rate). - 5) Including SPE.

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