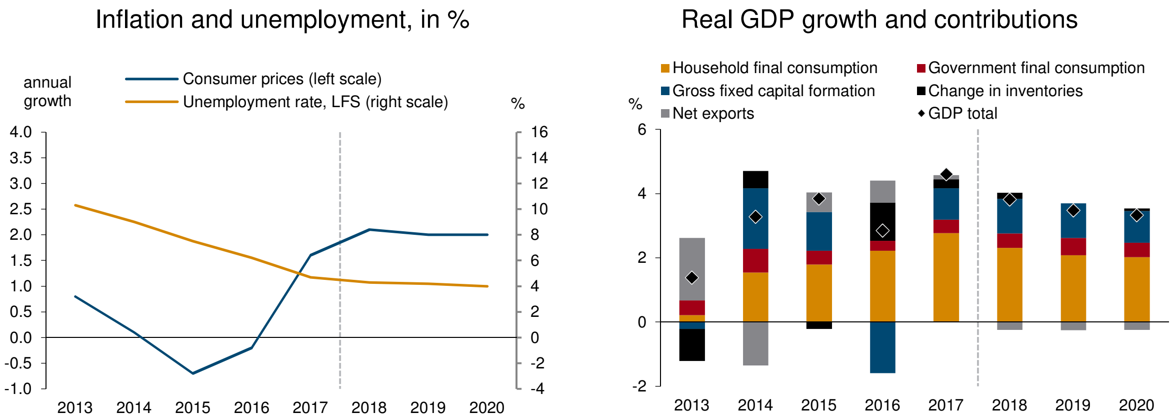
POLAND: Steady consumption-driven expansion

LEON PODKAMINER

Strong consumption-driven growth has been propelled by rising wages and employment. The economic conditions are conducive to a recovery in private-sector investment activities, though this has yet to materialise. The positive growth prospects may be endangered by the unwelcome effects of the ongoing evolution of the political system – including the country's progressive alienation from its EU partners.

Figure 54 / Poland: Main macroeconomic indicators



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

At a provisional rate of 4.6%, GDP growth in 2017 turned out to be more robust than generally expected. Growth in household consumption remained strong and steady (about 4.8%) throughout the year. Rising household consumption contributed 2.9 percentage points (pp) to overall growth in 2017, and increased public consumption contributed an additional 0.5 pp.

The performance of foreign trade was strong, though variable, across 2017. Foreign trade made a positive contribution to GDP growth in the first quarter (+0.4 pp), a negative contribution in the second (-1.3 pp) and again a positive contribution in the third (+1.1 pp). For the year as a whole, the estimated contribution of the trade balance to GDP growth was close to zero.

Provisional calculations suggest that gross fixed capital formation (GFCF) shot up by about 12% in the fourth quarter of 2017. Such a sudden acceleration in GFCF seems rather unusual: it virtually stagnated in the first half of 2017 and was reported to have increased weakly in the third quarter (by 3.3%, year on year). Anyway, the provisionally reported GFCF growth rate for the whole of 2017 (5.4%) implies that the GFCF contribution to GDP growth in 2017 was about 1 pp, with rising inventories adding 0.2 pp.

Household consumption is set to continue to grow quite robustly in 2018-2019. This is primarily due to a relatively strong rise in employment and wages (with a resultant sharply increased wage bill). Government policy measures supporting household incomes and growing private consumption include quite generous transfers to families with children, increased official minimum wage rates and higher tax-free personal income thresholds. On the other hand, the government is trying to 'economise' on pensions expenditure (the growth in the average retirement pension is lagging behind the growth in average wages and inflation).

Rising demand for (primarily skilled) labour is one aspect of the labour market situation that is currently shifting in favour of employees. Average wages are growing under the impact of tightening labour markets. The wage hikes are still quite moderate though, roughly in line with rising productivity. The presence of a large 'shadow labour army', consisting of potentially employable migrants (primarily from Ukraine), seems to be limiting the wage pressures. Also, the introduction of sizeable social transfers may have reduced, at least temporarily, the income aspirations of wage earners. In addition, the still relatively low inflation may be moderating wage claims. Labour costs are not expected to bring about much stronger cost-push inflation, although they may prevent further growth in the corporate sector's profitability indicators.

Wage developments have also much to do with the demography-related weakening of the labour supply. The lowering of the retirement age (from 67 years for both sexes to 65 for men and 60 for women), effective as of October 2017, will further reduce the labour supply – and as such may be conducive to a further growth in wages.

The financial standing of the non-financial corporate sector has been pretty strong. Net profits of the sector rose by 7.8% in the first three quarters of 2017 (compared to the same period in 2016), reaching an equivalent of about EUR 23 billion (over 6.7% of the period's GDP). Profitability of the sector is high and – though firms do generally expect some deterioration in the financial indicators in the future (on account of possibly rising costs and more intense competition). Actually, there has already been a fairly substantial deterioration across most of the branches of manufacturing and in construction (while marked improvements have been registered in mining). Financial sector corporations have also been faring relatively well. Although the net profits of commercial banks in 2017 as a whole declined by 7% (on account of higher personal costs, much higher obligatory contributions to the (centralised) banking system reserve fund and a higher tax burden), they reached an equivalent of over EUR 2.5 billion in the first three quarters of the year.

Indebtedness in the non-financial private sector remains relatively low. Borrowing by firms and households is not expensive, and the interest rates on loans are quite stable. Despite this, loans to the non-financial corporate and household sectors have grown quite moderately (the stocks of such loans rose in the space of 12 months by about 6% and 3.3%, respectively). A stronger growth in loans is observed in the segment of small and medium-sized enterprises (larger firms still prefer to 'sit' on cash reserves). Borrowing by households predominantly supports the satisfaction of housing needs. Overall, the levels of private-sector indebtedness are comparatively low, and the share of non-performing loans is low and falling.

Private-sector investment remains depressed. The GFCF expansion must be attributed to the rising investment of local (and central) government, supported by the fast-growing financing through EU funds. (During the first three quarters of 2017, local government investments financed from EU funds rose four-fold.) The data available suggest that investment by private corporations remains flat. For example, in the third quarter of 2017, investment outlays by private corporations declined by 0.4% (at current prices), following a decline of 2.4% in the second quarter. But publicly owned corporations increased their investment outlays by 2.8% in the second quarter and by 11.4% in the third. Also, the information available on the structure of investment is not very encouraging. The increased investment by firms takes the form of higher outlays on means of transport (rising by close to 29% in the third quarter of 2017), while expenditure on machinery and installations and on buildings continued to decline.

Purely economic factors would suggest that fixed investment by the private sector could be expanding strongly – even if the decline in profitability of manufacturing may negatively affect that sector's propensity to invest. The basic reason why corporate investment has been sluggish has much to do with the political climate that set in after the electoral victory of the Law and Justice (PiS) party. The PiS government, in power since late 2015, blatantly flouts the constitution. In fact, it is now subordinating the judiciary system to its own will. That cannot but evoke anxiety among private (domestic) businessmen, who have reason to fear the advent of legally unrestrained arbitrary administrative harassment and interference in their activities. The importance of the 'intangible' reasons for the private sector's lack of investment is underscored by the ranking of 'obstacles to development' reported in the business climate surveys available from the National Bank of Poland (NBP). According to the most recent survey (January 2018), the ongoing regulatory (including taxation) changes are ranked as the most severe factor limiting development (ahead of the lack of skilled labourers, general uncertainty and the rising cost of raw materials).

More rapid growth in public investment co-financed by EU funds is expected in 2018-2020. The private sector is also likely to benefit, directly and indirectly, from the increased absorption of EU money. This should add much more vigour to private-sector investments.

Macroeconomic policies continue to be relaxed. Although the deflationary tendencies that have been observed since 2013 are now being overcome, the NBP is very likely to leave its policy rates unchanged. This is not a bad position, because – in spite of the vigorous rise in wages and consumer demand – the risk of any disquieting inflationary acceleration still seems rather remote. Nor is there any need to pre-empt a build-up of investment bubbles. But NBP policy follows from the fact that the bank is now dominated by 'doves' who are unconditionally loyal to the ruling party. Their priority is to avoid decisions that could slow down real growth. The Finance Ministry seems to share much the same perspective. In effect, despite relatively high growth, the financial deficit of the general government should not be expected to fall significantly below the 3% of GDP mark. That is not necessarily a bad development – at least so long as public debt is still quite low, inflation is not significant and the foreign trade balances remain positive.

Failure to respect the budget deficit limits is still a relatively minor offence against EU rules (especially given that the authorities do not intend to join the eurozone anytime soon). But domestic political developments have been more disquieting. The ruling party, which enjoys a parliamentary (though not a constitutional) majority, is violating the constitution. It is bent on subjugating all public institutions, including those in charge of controlling and balancing the powers of the government. The political system currently developing in Poland is unlikely to do any good to the country in the longer run.

The PiS authorities' sustained assault on the basic principles and institutions of a law-abiding democratic system constitutes a truly grave problem, both for Polish society and for the rest of the EU. For the time being, it is difficult to see how that assault can be contained. On the other hand, it may also be hard to square Poland's continued EU membership with its becoming another 'sovereign democracy' of an East European (rather than Western) persuasion. In practical terms, the conflict with the European institutions over the direction of Poland's internal politics is very likely to result in reduced access to EU funds after 2020.

To sum up, at present Poland's economy is in good shape. Driven primarily by consumption, its GDP is likely to rise by close to (or in excess of) 3.5% in 2018-2020 – roughly in line with our autumn 2017 forecast. Rising investment is likely to complement rising consumption in 2018-2020 on account of EU co-financing of infrastructure projects that is higher than in 2017. However, in the medium term, the positive growth prospects may be endangered by the unwelcome effects of the ongoing evolution of the political system – including the country's alienation from its major EU partners.

Table 24 / Poland: Selected economic indicators

	2013	2014	2015	2016	2017 [1]	2018	2019 Forecast	2020
Population, th pers., average	38,514	38,487	38,458	38,435	38,400	38,400	38,400	38,400
Gross domestic product, PLN bn, nom.	1,657	1,720	1,799	1,859	1,960	2,070	2,170	2,270
annual change in % (real)	1.4	3.3	3.8	2.9	4.6	3.8	3.5	3.3
GDP/capita (EUR at PPP)	17,900	18,600	19,800	19,900	20,900	.	.	.
Consumption of households, PLN bn, nom.	995	1,019	1,038	1,074	1,140	.	.	.
annual change in % (real)	0.3	2.6	3.0	3.9	4.8	4.0	3.6	3.5
Gross fixed capital form., PLN bn, nom.	312	339	361	336	350			
annual change in % (real)	-1.1	10.0	6.1	-7.9	5.4	6.0	6.0	5.5
Gross industrial production (sales) [2]								
annual change in % (real)	2.3	3.4	4.8	2.8	6.6	5.5	5.0	4.8
Gross agricultural production								
annual change in % (real)	0.5	6.9	-2.6	8.4	3.9	.	.	.
Construction industry [2]								
annual change in % (real)	-10.2	4.3	0.3	-14.5	13.7	.	.	.
Employed persons, LFS, th, average	15,568	15,862	16,084	16,197	16,490	16,610	16,660	16,690
annual change in %	-0.1	1.9	1.4	0.7	1.8	0.7	0.3	0.2
Unemployed persons, LFS, th, average	1,793	1,567	1,304	1,063	810	750	730	700
Unemployment rate, LFS, in %, average	10.3	9.0	7.5	6.2	4.7	4.3	4.2	4.0
Reg. unemployment rate, in %, eop	13.4	11.4	9.7	8.3	6.6	.	.	.
Average monthly gross wages, PLN	3,659	3,777	3,908	4,047	4,330	4,570	4,820	5,060
annual change in % (real, gross)	2.8	3.2	4.5	4.2	5.0	3.3	3.3	3.0
Consumer prices (HICP), % p.a.	0.8	0.1	-0.7	-0.2	1.6	2.1	2.0	2.0
Producer prices in industry, % p.a.	-1.3	-1.3	-2.0	-0.3	2.7	2.0	1.8	1.8
General governm.budget, EU-def., % of GDP								
Revenues	38.5	38.7	38.9	38.7	39.0	39.0	39.5	40.0
Expenditures	42.6	42.3	41.6	41.2	42.0	42.0	42.5	42.5
Net lending (+) / net borrowing (-)	-4.1	-3.6	-2.6	-2.5	-3.0	-3.0	-3.0	-2.5
General gov.gross debt, EU def., % of GDP	55.7	50.2	51.1	54.1	54.6	54.7	54.7	54.7
Stock of loans of non-fin.private sector, % p.a.	3.3	5.8	7.1	5.3	3.1	.	.	.
Non-performing loans (NPL), in %, eop	8.5	8.1	7.5	7.1	6.9	.	.	.
Central bank policy rate, % p.a., eop [3]	2.5	2.0	1.5	1.5	1.5	1.75	1.50	1.50
Current account, EUR mn [4]	-5,028	-8,529	-2,409	-1,250	346	900	1,100	700
Current account, % of GDP [4]	-1.3	-2.1	-0.6	-0.3	0.1	0.2	0.2	0.1
Exports of goods, BOP, EUR mn [4]	149,113	158,656	172,150	177,412	197,836	210,500	226,300	239,900
annual change in %	5.7	6.4	8.5	3.1	11.5	6.4	7.5	6.0
Imports of goods, BOP, EUR mn [4]	149,448	161,911	169,937	174,479	197,338	211,200	227,700	243,600
annual change in %	0.2	8.3	5.0	2.7	13.1	7.0	7.8	7.0
Exports of services, BOP, EUR mn [4]	33,592	36,743	40,663	45,018	52,059	55,400	59,200	62,800
annual change in %	5.1	9.4	10.7	10.7	15.6	6.5	6.8	6.0
Imports of services, BOP, EUR mn [4]	25,948	27,679	29,749	30,941	34,123	35,800	38,800	41,100
annual change in %	0.0	6.7	7.5	4.0	10.3	5.0	8.5	5.8
FDI liabilities, EUR mn [4]	658	14,824	13,534	15,213	4,826	.	.	.
FDI assets, EUR mn [4]	-2,524	5,096	4,385	10,233	3,118	.	.	.
Gross reserves of NB excl. gold, EUR mn	74,257	79,379	83,676	104,440	90,967	.	.	.
Gross external debt, EUR mn [4]	278,948	293,510	303,120	318,956	343,000	365,300	390,100	410,800
Gross external debt, % of GDP [4]	70.7	71.4	70.5	74.9	74.5	75.0	75.5	76.0
Average exchange rate PLN/EUR	4.1975	4.1843	4.1841	4.3632	4.2570	4.25	4.20	4.20

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) Reference rate (7-day open market operation rate). - 4) Including SPE.

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