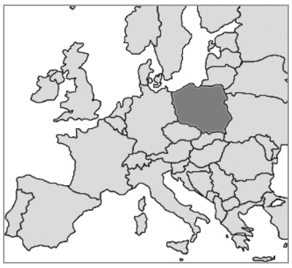

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Poland:
a gentle deceleration of growth

Growth becoming slower, but structurally sounder

The current cycle of fast GDP growth which began in the second quarter of 2006 is still far from over. However, the fastest phase of the cycle was already passed in the first quarter of 2007 when GDP rose by 7.3%. Since then growth has decelerated gently – to 6.1% in the first quarter of 2008. The slowdown is combined with changes in the dynamics of the GDP components. The role of domestic demand (up 9.3% a year ago) has been diminishing as it has risen by 6.3% currently. Public consumption, which rose by 6.2% a year ago, is now falling (by over 1%). Also, the pace of growth of fixed capital formation has diminished perceptibly (though still running at a respectable rate). Most importantly, the expansion of exports of goods and services has been accelerating while growth of imports of goods and services has been decelerating (in the first quarter of 2008 both exports and imports already rose at roughly the same – quite high – speed). In effect the high negative contribution of the trade balance to GDP growth has improved from minus 2.2 percentage points a year ago to about minus 0.4 percentage points in the first quarter of 2008. All in all, growth has been slower – but structurally much 'better' as well.[1]

Corporate non-financial sector earning high profits

Net profits of the non-financial corporate sector[2] increased to PLN 20.4 billion in the first quarter of 2008 (from EUR 19 billion a year earlier). However, profitability indicators have deteriorated somewhat, remaining more than satisfactory all the same. For example, the ratio of the sector's net profits to its total revenue fell from 4.9% to 4.6%. This development reflects the fact that costs have risen slightly faster than revenues (by 13.9% and 13.5% respectively). Interestingly, one cannot detect yet any direct impacts on costs of rising prices of imported raw materials and fuels. The share of costs of materials (imported and of domestic origin combined) in total costs of the corporate sector has actually declined, by 0.9 percentage points. This may suggest that higher prices of materials might have induced some efficiency improvements (including some substitution away from the use of the most material-intensive technologies). It may be added that the share of gross wages paid to employees in the total sector's costs has risen by 0.6 percentage points. This (anticipated) development is discussed below. Before it comes to that it is worth adding that the sector's exporting

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1 Gross value added generated by the construction sector rose, in real terms, by 41% in the first quarter of 2007, clearly suggesting a great deal of overheating (indeed reflecting slightly insane developments on the real estate markets). Currently the construction sector's GVA is rising at a much less exuberant rate of 16.7%.

2 The sector encompasses over 16,000 firms (excluding universities and firms operating in agriculture, forestry and fishery as well as in financial intermediation) employing over 50 persons.

firms overall fared very well (better than the non-exporters) on profitability, with some indicators even improving compared with the first quarter of 2007. This finding suggests that the ongoing strong nominal appreciation of the Polish zloty and rising average wages have not yet impaired the competitiveness of the export-oriented firms.

Rising wages and employment essential for supporting consumer demand

The average monthly wage rose strongly in the first quarter of 2008. At the same time there was a further rise in employment levels, resulting in the total wage bill increasing by 15.2% nominally (and about 10.7% in real terms). As mentioned above, the rising wage bill does not seem to be a problem for the corporate sector (also for the exporting firms) which report high profitability.[3] The reason for this apparent insensitivity is obvious enough: the rising labour productivity tends to compensate the rising labour costs (with some delay, if not immediately). The interesting thing to notice is, instead, a wide disparity between the rates of growth of household consumption (rising moderately, by 5.6% in the first quarter of 2008) and the gross wage bill rising at almost double that rate. This disparity is partly attributable to the gross social benefits (including primarily retirement pays and pensions) lagging – in growth terms – far behind the total wage bill in both nominal and real terms. (Total gross social benefits increased by 4.6% nominally and 0.5% in real terms.) Thus, the combined wage and social benefit incomes of the household sector rose by 6.9% in real terms – i.e. at a rate not that much different from the rate of growth of household consumption. In so far as the strong household consumption is the major pillar on which the overall GDP growth rests, rising wages are thus essential for maintaining the present prosperity – especially bearing in mind that the fiscal policy is unlikely to be supportive.[4]

Conditions still conducive to fast investment growth and further improvements in foreign trade

Inflation triggered – as elsewhere – by rising prices of food and fuels is currently still above the official 2.5% target. Increasingly, the current inflation is dominated not so much by food as by other items, primarily related to housing (rents and tariffs on some public utilities). Neither these second-round price effects, nor vigorously rising average wages have so far met with any radical response from the National Bank of Poland. Somewhat unusually, the Monetary Policy Council had, until recently, been quite dovish. Its statements read like discussions of why this particular inflation was not all that dangerous. While accepting many of the arguments to the effect that GDP growth is moderating anyway and so should be inflation (in due time of course), one could also discern a different motive behind the inactivity of the NBP. As already mentioned, the Polish currency has

3 Only to 7.4% of firms polled the high costs of labour are currently a barrier to growth – compared to e.g. 10.9% of firms naming shortages of skilled workers or 17.7% blaming the strong and volatile exchange rate. (See the website of the National Bank of Poland, www.nbp.pl.)

4 On the contrary, the policy of the current, liberally-minded government seeks to discretely reduce not only the budget deficits but also public spending. These tendencies are reflected in (1) public consumption contracting already in the first quarter of 2008; (2) passive acceptance of relative impoverishment of the recipients of social security benefits; (3) intended downsizing of the public healthcare system; (4) intended further redistribution of the burden of taxation – away from the better-off onto the lower-income population strata.

been strengthening at an amazing speed (not only vs. the US dollar, but also against the euro). This development, which has much to do with high inflows of capital (including FDI), is apparently worrying the NBP (as a potential source of loss of external competitiveness). A decisive NBP action – e.g. raising the official policy interest rates – would of course strengthen the exchange rates even further. This would re-create the macro environment of the years 2001-2002 when the uncompromising policy of the NBP plunged the country into recession (over plummeting investment, exports and imports). No doubt the desire to avoid another debacle makes the NBP more responsible this time round.[5] It is thanks to that restraint that the conditions remain broadly conducive to further expansion of investment into fixed assets and to further improvements in foreign trade. Of course, after several quarters of fast growth investment may be slowing down for quite natural reasons (high levels of uncertainty about the future course of international commodity prices, technology trends, forthcoming foreign demand and the exchange rate trends). Also the uncertainties over the availability of skilled labour and wage developments are having a bearing on investment decisions. Otherwise there are good grounds to expect a continuation of the investment expansion in the business sector (as well as into housing and infrastructure). Profitability is more than adequate, interest rates fairly moderate (by Polish standards at least) and the levels of capacity utilization very high. All these factors must bear on the opinions of firms polled. Firms generally signal the intentions to continue investment projects and to expand production capacities also in the export-oriented branches. This bodes well as far as foreign trade is concerned especially as high FDI inflows are set to continue. With the ongoing productivity gains, foreign trade (increasingly also in services) remains reasonably competitive – for the time being.

Growth deceleration all the same

Barring some extraordinary events on the global level, Poland's economic prospects are, on the whole, positive at least in the medium-term perspective. The current growth slowdown is due primarily to less vigorous growth in investments – which is a natural development given their fast growth in the recent past and the accumulation of global uncertainties. Foreign trade has been performing better than expected. Quite likely this trend will continue for some time. But it may also come to an end quite soon, especially if the zloty keeps strengthening excessively. A gentle disinflation will continue on its own with the NBP showing commendable restraint. The fast growth in wages expected under fairly tight labour markets will in fact be conducive to continuing strong growth, but the fiscal and social policies of the current government will not support the return of the vigorous growth that prevailed in 2006-2007.

[5] A strange reversal of roles has happened. Normally, the central bank's policy is criticized by the finance minister for being too restrictive (whether or not this is really the case). Recently, Poland's finance minister voiced discontent over monetary policy being too soft. This critique has had some impact: on 25 June the NBP interest rates were raised (by a symbolic 25 basis points).

Table PL

Poland: Selected Economic Indicators

	2004	2005	2006	2007 [1]	2007	2008	2008	2009	2010
					1st quarter			Forecast	
Population, th pers., end of period	38173.8	38157.0	38125.5	38116.0	38116.0	38110.0	.	.	.
Gross domestic product, PLN bn, nom. [2]	924.5	983.3	1060.0	1167.8	267.7	294.1	1280	1390	1500
annual change in % (real) [2]	5.3	3.6	6.2	6.6	7.3	6.1	5.5	5.3	5
GDP/capita (EUR at exchange rate)	5341	6401	7137	8098	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	10960	11480	12340	13580	.	.	.	.	.
Gross industrial production (sales)									
annual change in % (real)	12.6	3.7	11.2	10	13.1 [3]	8.5 [3]	10	8	8
Gross agricultural production									
annual change in % (real)	7.5	-4.3	-1.2	.	.	.	.	.	.
Construction output total									
annual change in % (real)	-7.0	1.5	13.7	16.1	50.4 [3]	14.8 [3]	.	.	.
Consumption of households, PLN bn, nom. [2]	589.4	614.3	652.8	701.1	175.3	192.7	.	.	.
annual change in % (real) [2]	4.7	2.1	5.0	5.0	6.8	5.6	5	5	4
Gross fixed capital form., PLN bn, nom. [2]	167.2	179.2	208.3	253.8	38.5	45.3	.	.	.
annual change in % (real) [2]	6.4	6.5	14.9	17.6	23.8	15.7	16	12	6
LFS - employed persons, th, avg.	13794.8	14115.6	14593.6	15240.3	14839.0	15515.0	.	.	.
annual change in %	1.3	2.3	3.4	4.4	5.3	4.6	3	2	1
Reg. employees in industry, th pers., avg.	2663.1	2665.4	2714.3	2804	2556.0 [3]	2646.0 [3]	.	.	.
annual change in %	0.9	0.1	1.8	3.5	3.2 [3]	3.5 [3]	2	2	1
LFS - unemployed, th pers., average	3230.3	3045.3	2344.3	1618.8	1894.0	1361.0	.	.	.
LFS - unemployment rate in %, average	19.0	17.8	13.8	9.6	11.3	8.1	9	8	8
Reg. unemployment rate in %, end of period	19.1	17.6	14.8	11.4	14.3	11.1	10	.	.
Average gross monthly wages, PLN	2273.4	2360.6	2476.9	2691.0	2737.8 [3]	3049.9 [3]	.	.	.
annual change in % (real, gross)	0.7	1.8	4.0	6.3	5.9 [3]	7.2 [3]	6	5	4
Consumer prices, % p.a.	3.5	2.1	1.0	2.5	2.0	4.1	4	3	2.6
Producer prices in industry, % p.a.	7.0	0.7	2.3	2.3	3.3	3.0	3.5	.	.
General governm.budget, EU-def., % GDP [4]									
Revenues	36.9	39.0	40.0	40.4	.	.	.	.	.
Expenditures	42.6	43.3	43.8	42.4	.	.	.	.	.
Net lending (+) / net borrowing (-)	-5.7	-4.3	-3.8	-2	.	.	-2.5	-2.5	-2.5
Public debt, EU-def., % of GDP [4]	45.7	47.1	47.6	45.2	.	.	.	.	.
Discount rate of NB % p.a., end of period	7.0	4.8	4.3	5.3	4.3	6.0	6	5.5	5
Current account, EUR mn	-8207	-3008	-7283	-11499	-2474	-3876	-16800	-21000	-20500
Current account in % of GDP	-4.0	-1.2	-2.7	-3.7	-3.6	.	-4.7	-5.4	-4.9
Gross reserves of NB excl. gold, EUR mn	25904	34536	35235	42812	36488	46729	.	.	.
Gross external debt, EUR mn	95163	112234	128818	156309	133288	.	.	.	.
Gross external debt in % of GDP	42.0	44.1	46.6	47.9	.	.			
FDI inflow, EUR mn	10453	8317	15198	12834	3356	3231	16900	.	.
FDI outflow, EUR mn	668	2756	7134	2395	104	974	2200	.	.
Exports of goods, BOP, EUR mn	65847	77562	93406	105348	24664	30399	122200	139300	157400
annual growth rate in %	22.3	17.8	20.4	12.8	13.4	23.3	16	14	13
Imports of goods, BOP, EUR mn	70399	79804	98945	116659	26986	33397	136500	157000	179000
annual growth rate in %	19.5	13.4	24.0	17.9	19.5	23.8	17	15	14
Exports of services, BOP, EUR mn	10815	13105	16354	20874	4427	5408	24400	28500	33300
annual growth rate in %	9.8	21.2	24.8	27.6	27.7	22.2	17	17	17
Imports of services, BOP, EUR mn	10787	12520	15755	17977	3809	4787	20700	23800	27400
annual growth rate in %	14.7	16.1	25.8	14.1	13.5	25.7	15	15	15
Average exchange rate PLN/USD	3.6540	3.2348	3.1025	2.7667	2.9670	2.3886	.	.	.
Average exchange rate PLN/EUR (ECU)	4.5340	4.0254	3.8951	3.7829	3.8871	3.5760	3.6	3.6	3.6
Purchasing power parity PLN/USD	1.8587	1.8984	1.8656	1.9111	.	.	.	.	.
Purchasing power parity PLN/EUR	2.2091	2.2441	2.2537	2.2554	.	.	.	.	.

Note: The term 'industry' refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 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) According to ESA'95 excessive deficit procedure; forecast wiiw estimate.

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