POLAND: Can strong growth supported by public sector spending continue much longer?

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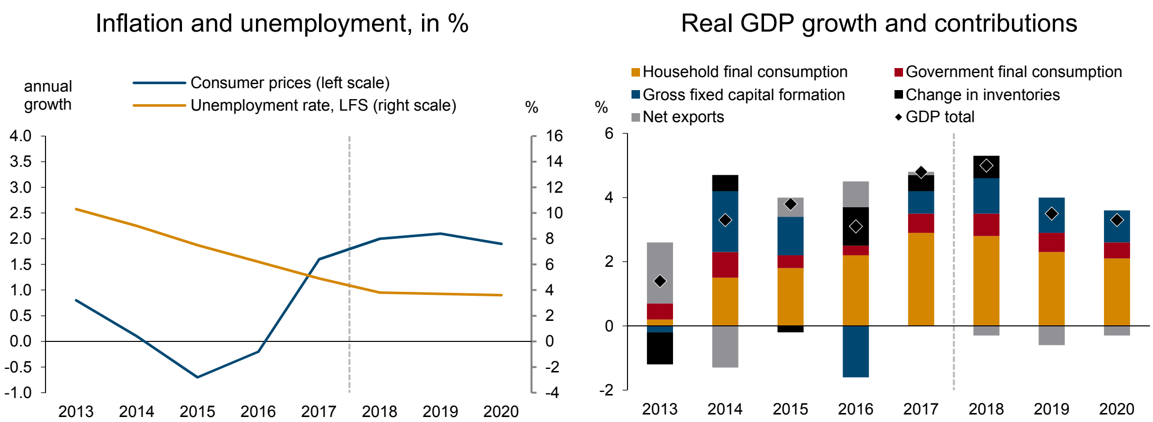
Despite lower profits the corporate sector's financial standing and financing conditions are good. But the private domestic firms are reluctant to expand investment. The ongoing political changes destabilise the country's legal framework undermining trust in the rule of law. The conflict between the 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 50 / Poland: Main macroeconomic indicators



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

Strong consumption-driven GDP growth continues. Starting from the first quarter of 2017 the growth reported has been quite fast. In the first half of 2018 real GDP grew again, by a rather impressive 5.2%. Consumption, rising by 4.6%, was an essential driver of growth (with private consumption rising 4.8% and public consumption by 4%). However, much higher growth in household consumption could have been expected. In the first half of 2018 the wage bill in the enterprise sector rose by about 9% in real terms and social transfers (including pensions) by about 6%. Additionally, disposable household incomes have been increased by higher social transfers (addressed to families with children). The gap between real household incomes and private consumption spending primarily seems to reflect rising saving propensities.[34]

Gross fixed investment increased moderately, by 4.5% in the second quarter of 2018 (slowing down from an 8% rate in the first quarter). Investment growth is driven almost exclusively by expanding public (governmental, including communal) investment spending. In the first quarter of 2018, public investment rose by nearly 35% while investment by the corporate sector grew weakly (by 3.3%). Investment by the private domestically-owned corporations continues to decline, quite strongly. The entire corporate sector's investment continues to be driven by the sector's 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 acceleration of investment spending – against 10% for the private domestic-owned firms. Acceleration of investment appears to be correlated with the increased utilisation of EU funds. A rather skewed structure of investment is reflected in the fact that while the investment in manufacturing is stagnating, investment in the construction and transportation sectors is booming.

Foreign trade in goods and non-factor services is performing relatively weakly. Growth of both exports and imports, which slowed down radically in the first quarter of 2018, strengthened somewhat in the second quarter. The negative contribution of foreign trade to the GDP growth rate was quite large (-1.2 percentage points) in the first quarter but turned into a positive small number (0.4pp) in Q2. Even if trade in services continues to perform quite well, trade in goods is less satisfactory. During the first seven months of 2018, exports of goods rose 5.7% (in current euro terms) while imports rose 8.3%. After seven months of 2018 the trade in goods registered a deficit worth some EUR 1.6bn. (In the same period of 2017, trade in goods ended in a surplus worth some EUR 1.3bn). Unfavourable terms-of-trade developments may be a part of the problem. However, the expected 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 or its external payments position.

Output of construction and also of manufacturing are performing quite well. The volume of sales by construction firms rose by over 20% during the first eight months of 2018. The volume of sales of civil engineering works (predominantly infrastructure-related) rose by over 26% and the number of dwellings completed by close to 11%. For manufacturing the respective rate is 6.7% (with the sales of intermediate goods rising by 7%, investment and durable consumer goods by 6% and non-durable consumer goods by 3.4 %).

Corporate profitability is deteriorating. Net (post-tax) profits of the corporate non-financial sector declined sharply (by close to 7%) in the first half of 2018. Profits decreased across most sectors, including the majority of branches of manufacturing, construction and services. The coal mining branch registered the steepest contraction in profits while profits increased in transportation, retail trade and food processing. Profitability developments are primarily influenced by gaps opening, despite rising labour productivity, between the producer prices received and production costs. The producer prices are rising quite weakly (in manufacturing by about 1.8% on average so far). However, production costs are rising quite strongly (under the impact of a close to 7% hike in the average nominal wage rate recorded in the first half of 2018). The ongoing gains in labour productivity (close to 4% currently) 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.

[34] The earnings of a large number of foreigners employed are sent back home (mostly to Ukraine) thereby reducing effective domestic consumer demand in Poland.

Despite reduced corporate profits the financial standing of firms is still quite satisfactory and the profitability indicators are good, by historical standards.

Lending is expanding moderately amid banks' strongly improved profits. The policy interest rate remains fairly low (1.5%). The interest rates charged by commercial banks on new loans are also not exorbitant (by averages of 6.4% for households and 5.1% for non-financial corporates). Despite this, loan growth is rather slow. Over one year ending 30 June 2018 the stock of loans to the non-financial corporates increased by over 6% (by less than 2% for small and medium-sized firms and by 13% for large firms) and by less than 4% to the household sector (by slightly over 3% for housing loans). 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 6.7bn in the first half on 2017 to PLN 7.8bn in the first half of 2018 (in current euro terms from 1.6bn to 1.9bn 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 higher dividends earned.

Future growth rates will critically depend on what happens to capital formation. Despite lower profits the corporate sector's financial standing is strong and financing conditions are encouraging. The conditions are conducive to an expansion of corporate investment. However, the private domestic non-financial firms (and especially smaller enterprises) appear reluctant to wage a stronger investment offensive. This reluctance seems to have much to do with the ongoing political changes which destabilise the country's legal framework and undermine trust in the rule of law. For the time being the overall investment spending may be supported by the public sector and by the corporations that are publicly-owned (and 'guided' by the officials). However, the investment spending by the public sector (and by the public-owned corporates) depends on the EU funds to a large extent. The escalating conflict between the European Commission and the Polish government (over the latter's moves undermining the independence of the judiciary) may lead to substantial cuts in the funds available to Poland. That would undermine public investment spending and reduce medium-term overall growth prospects. Moreover, even if the public investment spending is not reduced, the fact that the private sector's productive investment is stagnating will, most probably, have negative longer-term consequences for the country. The levels of capital formation (especially with respect to machinery and equipment) in Poland have been miserably low by international standards. Over the long term, a continuing low pace of capital accumulation (by the market-oriented private sector) may be incompatible with the upgrading (or even maintenance) of the country's competitive position[35].

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35 According to OECD comparative data for 2014 (https://stats.oecd.org/Index.aspx?DataSetCode=PPP2014) real per capita investment in machinery and equipment in Poland represented 40% of the German and 48% of the Czech levels. Since 2014 the GDP share of gross capital formation has fallen further, from 16% to 14.2% recently.

Table 25 / Poland: Selected economic indicators

	2014	2015	2016	2017 1)	2017	2018	2018	2019	2020
					January-June			Forecast	
Population, th pers., average	38,487	38,458	38,435	38,400	38,422	38,413	38,400	38,400	38,400
Gross domestic product, PLN bn, nom.	1,720	1,800	1,861	1,989	933	988	2,110	2,210	2,310
annual change in % (real)	3.3	3.8	3.1	4.8	4.4	5.1	5.0	3.5	3.3
GDP/capita (EUR at PPP)	18,600	19,800	19,900	20,900	.	.	.	.	.
Consumption of households, PLN bn, nom.	1,019	1,038	1,074	1,151	574	609	.	.	.
annual change in % (real)	2.6	3.0	3.9	4.9	4.7	4.5	4.8	4.0	3.6
Gross fixed capital form., PLN bn, nom.	339	361	335	352	131	141			
annual change in % (real)	10.0	6.1	-8.2	3.9	1.1	6.0	6.0	6.0	5.5
Gross industrial production (sales) 2)									
annual change in % (real)	3.5	4.8	2.8	6.6	5.8	6.4	6.0	5.0	4.8
Gross agricultural production									
annual change in % (real)	6.9	-2.6	8.4	2.8	.	.	.	.	.
Construction industry 2)									
annual change in % (real)	4.3	0.3	-14.5	13.7	7.2	23.4	.	.	.
Employed persons, LFS, th, average	15,862	16,084	16,197	16,423	16,388	16,455	16,550	16,650	16,700
annual change in %	1.9	1.4	0.7	1.4	1.8	0.4	0.8	0.6	0.3
Unemployed persons, LFS, th, average	1,567	1,304	1,063	844	895	663	650	640	620
Unemployment rate, LFS, in %, average	9.0	7.5	6.2	4.9	5.2	3.9	3.8	3.7	3.6
Reg. unemployment rate, in %, eop	11.4	9.7	8.3	6.6	7.0	5.9	.	.	.
Average monthly gross wages, PLN 3)	3,777	3,908	4,052	4,272	4,434	4,572	4,600	4,880	5,150
annual change in % (real, gross)	3.2	4.5	4.2	3.5	3.0	5.7	5.5	4.0	3.5
Consumer prices (HICP), % p.a.	0.1	-0.7	-0.2	1.6	1.6	1.1	2.0	2.1	1.9
Producer prices in industry, % p.a.	-1.4	-2.2	-0.3	2.7	3.4	1.2	1.6	1.8	1.8
General governm.budget, EU-def., % of GDP									
Revenues	38.6	38.9	38.7	39.4	.	.	39.5	40.0	40.0
Expenditures	42.2	41.5	41.1	41.1	.	.	42.0	42.5	42.5
Net lending (+) / net borrowing (-)	-3.6	-2.6	-2.3	-1.7	.	.	-2.5	-2.5	-2.5
General gov.gross debt, EU def., % of GDP	50.2	51.1	54.1	50.5	.	.	50.9	51.1	51.4
Stock of loans of non-fin.private sector, % p.a.	5.8	7.1	5.3	3.1	4.0	5.5	.	.	.
Non-performing loans (NPL), in %, eop	8.1	7.5	7.1	6.8	.	.	.	.	.
Central bank policy rate, % p.a., eop 4)	2.0	1.5	1.5	1.5	1.50	1.50	1.50	1.50	1.50
Current account, EUR mn 5)	-8,529	-2,409	-2,240	706	1,951	1,152	-2,200	-7,100	-8,000
Current account, % of GDP 5)	-2.1	-0.6	-0.5	0.2	0.9	0.5	-0.4	-1.4	-1.5
Exports of goods, BOP, EUR mn 5)	158,656	172,150	177,412	201,963	99,899	105,158	211,100	221,900	234,700
annual change in %	6.4	8.5	3.1	13.8	13.6	5.3	4.5	5.1	5.8
Imports of goods, BOP, EUR mn 5)	161,911	169,937	174,479	200,536	98,433	106,300	216,600	233,900	250,500
annual change in %	8.3	5.0	2.7	14.9	15.7	8.0	8.0	8.0	7.1
Exports of services, BOP, EUR mn 5)	36,743	40,663	44,929	51,883	24,247	27,317	56,600	60,600	64,800
annual change in %	9.4	10.7	10.5	15.5	14.9	12.7	9.0	7.0	7.0
Imports of services, BOP, EUR mn 5)	27,679	29,749	30,963	33,926	15,567	16,516	35,300	37,800	39,700
annual change in %	6.7	7.5	4.1	9.6	9.4	6.1	4.0	7.0	5.0
FDI liabilities, EUR mn 5)	14,824	13,534	16,628	9,292	1,796	5,121	9,000	.	.
FDI assets, EUR mn 5)	5,096	4,385	12,807	3,688	1,287	-19	2400	.	.
Gross reserves of NB excl. gold, EUR mn	79,379	83,676	104,440	90,967	94,360	89,986	.	.	.
Gross external debt, EUR mn 5)	293,510	303,120	321,305	318,851	321,834	311,451	337,600	364,000	380,500
Gross external debt, % of GDP 5)	71.4	70.5	75.3	68.3	68.9	62.7	68.0	70.0	70.0
Average exchange rate PLN/EUR	4.1843	4.1841	4.3632	4.2570	4.2685	4.2200	4.25	4.25	4.25

1) Preliminary. - 2) Enterprises with 10 and more employees. - 3) Half-year data refer to enterprises with 10 and more employees. - 4) Reference rate (7-day open market operation rate). - 5) Including SPE.

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