POLISH ECONOMIC OUTLOOK

TRENDS • ANALYSES • FORECASTS

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Special Feature – Is There a Room for Fiscal Stimulus?

EXECUTIVE SUMMARY

Poland was hit by the global financial crisis in the 4Q2008 that caused an economic slump of Western economies. These developments spilled over to Poland and growth considerably weakened. Employment continued to grow at a slow pace in the 4Q2008 while the number of unemployed persons started rapidly increasing at the turn of the year. Inflationary pressures eased in the 4Q2008 on the back of falling fuel and food prices (cereals). Despite weak growth, the trade deficit continued to grow because of the collapse in exports. The central government cash deficit came above expectations in the 4Q2008, but the full-year shortfall was below original projections. The most meaningful structural reform was the elimination of early pensions.

Polish economy abruptly entered near-stagnation in the 4Q2008, as seasonally adjusted GDP grew only 0.3% qoq, versus 0.8% in the 3Q2008. GDP grew 2.9% yoy compared with 4.8% in the 3Q2008. A large decline in exports and inventory-unloading were the main factors of this slowdown, compared with the 3Q2008. Private consumption expenditures upheld its strong rate of growth. A new year started with a further worsening of business climate. We outlined two scenarios in the PEO 3/2009. GDP growth in 2009 could reach 3%, contingent on the resumption of lending by commercial banks to the non-financial sector, decisive cuts in the central-bank interest rates and the moderate global downturn. Meantime, banks have further restrained lending while the world economy slipped into the deepest recession since the second world war. Only, the NBP has delivered and cut decisively its interest rates, but their transmission to market interest rates on credits was poor. Since the bad-case scenario is unfolding, we forecast a stagnation in the economy in the 1H2008 and a slow recovery afterwards; GDP should grow less of 1.5% in 2009, consumption will reamain the engine of growth.

GDP growth near zero in the 1H2009 will support further disinflation whose roots have been mainly on the supply side so far. Soft demand will arrest demand inflation while hikes in regulated energy prices, instituted at the beginning of 2009, are counterproductive in this respect. The major risk to disinflation is the strong depreciation of the zloty on the wave of irrationally high risk-aversion vis-a-vis currencies in Central Europe to the levels far off of the fundamentals. In our view, Polish zloty should start gradually firming until the yearend, and assuming this scenario, we forecast a decline the CPI inflation rate to 1.7% yoy in the 4Q2009; the average 2009 rate would drop to 2.1%. A rather quick return of the inflation rate to the middle of the NBP target of 2.5% yoy and the economic stagnation underpin our prediction of more interest rate cuts; the easing cycle will likely end up in the 1H2009 at the rate 3.00-3.25%, the lowest in history.

Favorable trends on the labor market are over. Employment is likely to decline and unemployment to rise for the next 4 to 6 quarters. The registered rate of unemployment increased more in December 2009 and, in particular, in January 2009 than seasonal factors would point to. We forecast that this rate will reach 12.2% at the 2009 yearend and continue increasing in 2010. The expectations of a rapid rise in the cyclical unemployment have already started capping wage demands so the rise in nominal wages will be much lower than in 2008, but the rise in real wages will decelerate less than proportionately due to disinflation.

The current account deficit rose in euro terms in each quarter of 2008 on the back of the widening trade imbalance, but it was quite stable in GDP terms. The 4Q2008 was distinct from previous quarters in a sense that the prices of commodities stopped pushing it upward whereas the collapse in exports that had grown quite fast before, replaced them. Poland should continue to register a positive growth differential versus its main EU and post it even vis-a-vis its East European partners, which would tend to increase the deficit. However, we think that due to the collapse in private business investment in this country and low prices of commodities imports will shrink more than exports in euro terms. The large-scale zloty depreciation that gives Polish companies a strong competitive edge, will also be instrumental in the reversal of the widening trend in the trade deficit and support the decline in the current account shortfall relative to GDP.

The 4Q2009 witnessed a twice larger increase in the cash central government budget deficit than government expectations. The state revenue was much lower than predicted while a lower-than planned expenditure was unable to offset it. Our forecast from the PEO 3/2008 proved accurate that the 2008 deficit would reach PLN 24 bn, i.e. below the original projection of 27 PLN bn. The government sticks to the deficit projection of PLN 18.1 bn in 2009 despite a downward revision of its growth forecast, planning large expenditure cuts. However, we are skeptical that they will be sufficient since government growth forecasts seem overly optimistic. The work of automatic stabilizers such as income taxes and social security premia will also tend to raise the deficit of local governments and social insurance. Local governments will also speed up their infrastructure outlays. Therefore we forecast that the general government deficit will reach 3.0 - 3.5% of GDP in 2009, compared with the government target of 2.5% of GDP. The breach of 3% could cloud the outlook for the ERM-2 entry.

The deficit plans are consistent with the intent to adopt the euro in 2012, but this date is becoming more and more uncertain because of the soft zloty and its high volatility likewise the lack of political consensus in this country. The necessary amendments of the Constitution hinge on the yes by the main opposition party. Even if the government were able to stick to its deficit target, it is unable to eliminate the political risk before presidential and parliamentary elections due in 2010 and 2011, respectively. This may lead to the excessive volatility of the zloty.

The debate whether Poland should adopt an expansionary fiscal policy to prop its economy like others do, has recently been lively in Poland. The government rejected this possibility, sticking to the "road map to euro". We take the subject in our Special Feature: Is There a Room for Fiscal Stimulus?

Table 1. The Polish economy – main macroeconomic indicators and CASE forecasts

Indicator	Data							CASE forecasts					
	2005	2006	2007	2008				2009				2008*	2009
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4		
Nominal GDP, PLN bn	983.3	1060.1	1175.3	295.3	309.9	312.1	349.3	304.2	317.6	322.5	364.4	1266.6	1308.7
(% change, yoy)													
GDP	3.6	6.2	6.7	6.0	5.8	4.8	2.9	0.0	0.7	1.6	2.8	4.8	1.4
Private Consumption	2.0	5.0	5.0	5.6	5.5	5.1	5.2	2.2	2.8	3.2	3.7	5.4	3.1
Fixed Investment	6.5	14.9	17.6	15.7	15.2	3.5	3.5	-9.0	-6.1	-3.0	-1.9	7.9	-4.0
(4Q, % of GDP)													
CA balance	-1.2	-2.7	-4.7	-4.9	-5.1	-5.2	-5.4	-5.2	-4.6	-4.4	-4.3	-5.4	-4.3
(% change, yoy)													
Exports (NBP, EUR)	17.8	20.4	13.4	20.3	21.3	17.9	-8.5	-23.1	-17.3	-13.9	4.3	12.1	-13.1
Imports (NBP,(EUR)	13.4	24.0	19.5	21.7	24.2	21.1	-3.2	-22.2	-19.9	-13.7	-1.3	14.1	-14.0
(% change, yoy)													
Industrial sales	3.7	11.2	9.5	8.5	8.5	3.4	-6.3	-12.0	-5.0	-2.0	1.0	3.3	-4.3
Gross value added	3.3	6.0	6.6	5.5	6.1	4.7	3.4	0.1	0.9	1.8	2.7	4.9	1.4
CPI	2.1	1.0	2.5	4.1	4.3	4.7	3.7	2.9	2.1	1.8	1.7	4.2	2.1
PPI	0.7	2.3	2.3	3.0	2.5	2.1	2.4	2.7	2.3	2.4	2.4	2.5	2.4
Nominal Ave. Wage	3.8	4.9	8.7	10.1	11.6	10.6	7.7	6.7	6.5	4.4	2.8	10.4	5.0
Employment %, LFS	2.3	3.1	3.1	4.6	3.5	3.6	3.0	1.2	-1.0	-1.5	-2.0	3.7	-1.0
Registered unemployment rate (%, eop)	17.6	14.8	11.4	10.9	9.4	8.9	9.5	11.2	11.4	11.2	12.2	9.5	12.2
PLN/EUR, eop	3.86	3.83	3.58	3.53	3.35	3.41	4.17	4.70	4.50	4.20	4.00	4.17	4.00
WIBOR 3M, %, eop	4.60	4.20	5.68	6.15	6.65	6.63	5.88	4.40	3.85	3.80	3.75	5.88	3.75
Central bank key rate eop	4.50	4.00	5.00	5.75	6.00	6.00	5.00	3.75	3.25	3.25	3.25	5.00	3.25
(% change, yoy eop)													
Broad Money (M3)	13.1	16.0	13.4	13.6	16.3	17.3	18.6	17.0	15.0	10.0	7.0	18.6	7.0
Loans to HH	26.0	33.4	37.9	37.4	34.4	33.5	44.6	40.0	29.5	20.0	11.0	44.6	11.0
Loans to Firms	2.5	13.7	24.1	25.2	24.5	24.1	29.0	26.0	21.0	13.0	6.1	29.0	6.0
(% GDP)													
Fiscal Balance	-4.3	-3.8	-2.0	n.a.	n.a.	n.a.	-2.8	n.a.	n.a.	n.a.	n.a.	-2.8	-3.5
Public Debt eop	47.1	47.7	44.9	n.a.	43.1	n.a.	46.1	n.a.	n.a.	n.a.	n.a.	46.1	47.0

(*) data or estimates

Sources: CSO (GUS), Eurostat, NBP and CASE own calculations.

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