POLISH ECONOMIC OUTLOOK

TRENDS • ANALYSES • FORECASTS

CASE

QUARTERLY 1/2009 (40)

Special Feature – Deflation Scare – Not in Poland

EXECUTIVE SUMMARY

The economy most likely entered a recession phase in the 1Q2009, defined as at least two quarters of negative quarterly growth, as we forecast that GDP is likely to decline in the y-o-y terms not only in the 1Q2009, but in the 2Q2009 as well. This view is based on the supply side developments in the 1Q2009. Credit to non-financial firms came to a standstill in the 1Q2009 mainly because of a credit crunch, i. e. problems of credit supply, but firms stopped asking for investment credit as well so demand for credits also fell.

Short-term growth prospects for the economy have markedly worsened since writing the previous report. The latest round of downward revisions to global growth forecasts is probably the last one in this slump, but it also drags down our growth forecasts for the Polish economy. Lately, the rate of decline in output in OECD countries hase been slower than in the 4Q2008 and the beginning of 2009, business confidence improved, but the bottom has not been reached yet. This poses a question mark whether the Polish economy will bottom out in the 2Q2009 as we had thought. We forecast a decline in GDP year on year in the 2Q2009, albeit slower than in the 1Q2009, a resumption of slow growth in the 3Q2009 and its pickup in the 4Q2009 above 2% yoy (Table 1). Recovery should gather strength in 2010, fuelled by the infrastructure investment and exports. Potential GDP growth will not be restored until the late 2010, depending on the strength of the world-wide recovery. Despite a slowdown in average real wage growth and rising unemployment throughout the 2009, consumption growth should remain relatively stable, supported by the decline in personal income tax whose positive impact will be more visible with the lapse of time. The government will likely arrest growth in public consumption in the 2H2009, i.e. after the elections to European parlament, because of the precarious state of public finances, but its strong growth in the 1H2009 should keep it at least unchanged, if not in a positive territory, in 2009. Public investment should pick up in the course of the year to offset the decline in the private investment to a higher and higher degree. This will exert some positive ripple effects on business investment, in particular in non-residential construction. Contrary to the previous forecast, the net export contribution to GDP growth should be positive in all quarters of 2009 as the slowly improving economic prospects in the EU will help Polish firms exploit their competitive edge over foreign companies due to the depreciated zloty despite that the zloty should firm in the course of the year.

The labor market situation in the 1Q2009 seriously deteriorated following the fall in economic growth and widely expected recession. Employment in the so-called enterprise sector decreased by 0.2% yoy in the 1Q2009. It was the first employment reduction in y-o-y terms since the 4Q2004. The situation seems to deteriorate most dynamically in the manufacturing. Following the reduction of expected GDP growth, our forecast concerning the employment growth is also more pessimistic than in the previous PEO issue. We expect that in 2009, on average, employment in the enterprise sector will actually fall by 3.6% yoy and the LFS employment will fall by 1.3% yoy. Wage dynamics is still weakening. We expect the downward trend to last, following the continuing economic downturn. On average, nominal wages will grow in 2009 by 4%-5% and real wages by about 2%. During 2010 real wage growth on a y-o-y basis can even fall to 1.4%-1.5% you, but then it will start to accelerate reaching the average of about 2% yoy. We expect the registered unemployment rate to reach 12.8% at the end of 2009, while the LFS unemployment rate will probably grow to 9%.

Inflation proved more persistent than we forecasted and Poland is an outlier among the EU countries, where inflation has been consistently downtrending. With demand side pressures in check it was the supply-side-triggered price hikes that led the inflationary process in initial months of the year – although this time they are neither high nor likely to be long-lasting. The CPI inflation rate declined to 3.2% year on year in the first quarter of 2009 from 3.7% in the final quarter of 2008, benefiting from falling prices of fuel, transportation, telecommunication and most market services. Prices of foodstuffs that were primarily responsible for the deceleration of inflation in the second half of 2008, rebounded in January 2009 and have been on the rise since then. Adding to inflationary pressures were prices of energy, continuing their upward trend and peaking in the first quarter at the highest level in more than a decade. Compared to the previous issue of PEO, we significantly raised forecasts of both CPI and PPI inflation. The factors behind this correction include primarily much higher than expected energy price adjustments in January and February that will impact annual inflation until early 2010, combined with a surprising rebound in prices of foodstuffs.

Taking into account all these factors and associated risks we expect the CPI inflation to rise temporarily in the second quarter to 3.8% year on year and then fall to 3.6% in the third quarter entering the NBP target range of 1.5%-3.5% in the summer. Inflation will remain close to the upper bound of the range in the 4Q2009 (3.4%) to fall sharply in early 2010 to below 3%, reflecting the high base from early 2009, and remain just below the mid-point of the range from the second quarter onwards. On the annual level this produces inflation of 3.5% and 2.3% in 2009 and 2010.

A strong rise in state expenditure and a negligible rise in state revenue in the 1Q2009 suggest that fiscal policy became strongly expansionary in the 1Q2009. This is related to the work of automatic stabilizers as well as to a deliberate action of the government that simply moved expenditure to the first months of the year. However, the government projection of the deficit looks increasingly unrealistic under recession as its forecast was based on a much better performance of the economy. The government will have to overhaul its budget in the middle of the year, but this fact has already been discounted by financial markets and it has little economic merit. We forecast the central government cash deficit will grow to 41 bn zlotys in 2009 or 3.1% of GDP, estimated at around 1310 bn zlotys. The public sector deficit may exceed 5%-6% of GDP in 2009. The original 2009 deficit plans were consistent with the intent to adopt the euro in 2012, but this date is beyond reach at present.

Unprecedented drops in exports and imports in the 1Q2009 should not be matched in the coming quarters as conditions will slowly start improving in the external environment of Poland, and the much depreciated zloty will allow Polish companies to exploit their competitive edge. The latter is the main reason why Polish exports fell less than imports despite shallower recession in Poland than in partner countries. The current account was near balance in the 1Q2009 and this augurs its substantial decline in the course of 2009 to 2-3% of GDP from 5.5% of GDP in 2008. These developments will underpin the zloty that is fundamentally undervalued so it will gradually strengthen over 2009 an 2010.

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

Indicator	Data							CASE forecasts					
	2006	2007	2008	2008				2009				2009	2010
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4		
Nominal GDP, PLN bn	1060.0	1176.7	1271.7	297.8	310.6	314.3	349.0	305.7	319.6	322.2	363.1	1310.6	1380.3
(% change, yoy)													
GDP	6.2	6.7	4.9	6.1	6.0	5.0	3.0	-1.3	-0.5	0.1	2.0	0.0	3.0
Private Consumption	5.0	5.0	5.4	5.6	5.6	5.1	5.3	2.0	2.1	2.7	2.9	2.5	2.0
Fixed Investment	14.9	17.6	8.1	15.7	14.7	3.5	4.4	-10.0	-10.9	-6.4	-2.5	-6.9	1.0
(4Q, % of GDP)													
CA balance	-2.7	-4.7	-5.5	-5.0	-5.2	-5.3	-5.5	-4.1	-3.5	-2.9	-2.5	-2.5	-2.6
(% change, yoy)													
Exports (NBP, EUR)	20.4	13.4	12.7	21.2	19.8	19.5	-7.5	-22.9	-19.0	-17.0	4.8	-14.2	7.0
Imports (NBP,(EUR)	24.0	19.5	14.9	22.5	21.7	22.6	-4.4	-28.9	-25.7	-19.5	-0.6	-19.1	5.0
(% change, yoy)													
Industrial sales	11.2	9.5	3.3	8.5	8.5	3.4	-6.3	-10.0	-5.8	-2.0	1.0	-4.3	2.5
Gross value added	6.0	6.6	5.0	5.6	6.3	4.9	3.5	-1.2	-0.6	0.1	1.9	0.1	3.2
CPI	1.0	2.5	4.2	4.1	4.3	4.7	3.7	3.2	3.8	3.5	3.4	3.4	2.3
PPI	2.3	2.3	2.5	3.0	2.5	2.1	2.4	5.0	5.5	5.5	5.6	5.4	3.3
Nominal Ave. Wage	4.9	8.7	10.4	10.1	11.6	10.6	7.7	6.3	5.3	4.0	2.3	4.4	3.2
Employment %, LFS	3.1	3.1	3.7	4.6	3.5	3.6	3.0	0.7	-1.5	-1.9	-2.4	-1.3	0.0
Registered unemployment rate (%, eop)	14.8	11.4	9.5	10.9	9.4	8.9	9.5	11.2	10.9	11.7	12.8	12.8	14.3
PLN/EUR, eop	3.83	3.58	4.17	3.53	3.35	3.41	4.17	4.50	4.40	4.35	4.10	4.33	3.90
WIBOR 3M, %, ave	4.20	5.68	5.88	6.15	6.65	6.63	5.88	4.17	4.00	3.80	3.75	3.65	4.50
Central bank key rate eop	4.00	5.00	5.00	5.75	6.00	6.00	5.00	3.75	3.50	3.25	3.25	3.25	4.00
(% change, yoy eop)													
Broad Money (M3)	16.0	13.4	18.6	13.6	16.3	17.3	18.6	17.5	15.0	10.0	7.0	7.0	8.5
Loans to HH	33.4	37.9	44.6	37.4	34.4	33.5	44.6	43.7	32.5	20.0	11.0	11.0	9.0
Loans to Firms	13.7	24.1	29.0	25.2	24.5	24.1	29.0	25.8	21.0	13.0	6.1	6.0	5.0
(% GDP)													
Fiscal Balance	-3.9	-1.9	-3.9	n.a.	n.a.	n.a.	-3.9	n.a.	n.a.	n.a.	n.a.	-5.5	-3.7
Public Debt eop	47.7	44.9	47.1	n.a.	43.1	n.a.	47.1	n.a.	n.a.	n.a.	n.a.	52.0	54.0

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

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