

Main trends in the economy

2008-12-30

The Polish economy and the global financial crisis

In November, as in October and September, external determinants of the macroeconomic situation of EU countries deteriorated. However, compared with the average for the EU-27 and the average for the new EU member states, the weakening of economic conditions in Poland was not as sharp.

The current assessment of economic conditions in Poland is based on the following observations:

- ? The decrease in the economic growth rate in the third quarter of 2008 was lower than projected;
- ? Data on sales in the industrial, construction and retail sectors in October show that the rate of growth was still weakening;
- ? The economic outlook surveys conducted in November by the Central Statistical Office (GUS) and the National Bank of Poland (NBP) confirmed earlier projections that the economy would be slowing down;
- ? November was another month in a row to see a drop in the consumer price index (CPI);
- ? The Monetary Policy Council has reduced central bank interest rates;
- ? In September 2008, growth in Polish exports was relatively high and outpaced growth in imports;
- ? In August the NBP-registered receipts from exports were lower than the figure projected by main banks.
- ? In October employment growth was slightly slower than projected while wage growth was slightly faster than projected;
- ? Corporate results worsened in the third quarter of 2008 but were still relatively good;
- ? In October growth in the national budget deficit accelerated but the deficit for the year as a whole is expected to be lower than planned under the 2008 budget law.

The Polish economy and the global financial crisis

Compared with the United States and western European countries, the financial crisis poses only a slight threat to Poland in a direct way. Banks' short-term liabilities account for 8% of Poland's GDP while in the United States the ratio is 15% of GDP. And in such countries as Iceland, Switzerland and Belgium, it is up to 200-300% of GDP. The involvement of financial institutions operating in Poland in the risky operations which caused the credit crunch in the United States and Britain has been only marginal in recent years. As a result, the quality of the loan portfolio held by Polish banks is incomparably higher than is the case with many western financial institutions.

But this does not mean that Poland is not exposed to negative consequences of the crisis. The reason is that the crisis is global in its economic dimension, which means it affects all countries of the world, including those which are not directly involved in its financial aspect, like for example Poland. At the same time, the fundamentals of the Polish economy are much stronger compared to the economies of the countries affected by the crisis. The economic growth projections for Poland prepared by the IMF and OECD for the years 2008 and 2009 are around 5% and 3% respectively. Meanwhile, western European countries, like Germany, Britain and Ireland, are expected to record growth rates close to 0% or negative. International institutions predict that economic growth in Poland in 2009 will probably be lower than the long-term average but at the same time much higher than in other EU countries and therefore the rate of real convergence with the EU-15 will be maintained.

However, the situation on international markets and economic growth prospects for the world and Europe for coming years are very uncertain. Additionally, the global crisis has overlapped with the cyclical economic slowdown seen in the euro zone since 2007. As a result, foreign direct investment in Central Europe has decreased sharply, costs of external financing have significantly increased, while the diminishing propensity to consume in developed countries has had a negative impact on imports, including imports of goods made in Poland. Additionally, historical observations indicate that Poland's business cycle lags that of the EU-15 by six or eight quarters. A major threat to the real economy in Poland is the restricted access to loans due to liquidity tensions on the interbank market and financial markets on the one hand and banks' great aversion to credit risk on the other.

As a result of these developments, 2010 may also turn out to be a year posing outstanding challenges to Polish businesses, households and public administration due to the overlapping of several unfavourable economic phenomena. One of two scenarios is likely to unfold. In the first scenario, the global financial crisis would be gradually spreading to include Poland and would overlap with a cyclical

slowdown. As a result, GDP growth would be slowing gradually in 2009 and 2010. In the second scenario, the global financial crisis would give Polish businesses an additional boost to adjust as early as 2009 so the sharper slowdown this year would be followed by a relative improvement in economic conditions next years. As the situation on international financial markets is unstable, the government and the National Bank of Poland have taken firm measures aimed to strengthen stability and economic growth in Poland. These include instruments designed to enhance confidence on the interbank market and reduce borrowing costs as well as mechanisms aimed to boost investment funded from public and private sources. Additionally, a considerable increase in consumer spending is to be achieved thanks to consistent tax cuts in 2009. Compared to 2007, they are to reach over 2.5% of the GDP projected for 2009. (Introduction to "Stability and Development Plan," Nov. 30, 2008; www.kprm.gov.pl)

Monetary Policy Council on reasons behind slowdown in production

NBP (Monetary Policy Council): Recent data indicate that Poland's economic growth rate will be diminishing in successive quarters. The economic slowdown will be sharper than previously expected due to the considerable weakening of economic growth in other countries, increased uncertainty about future economic developments, more difficult access to credit and higher borrowing costs (...). At the same time, data on labour market developments show that wage growth is still high and that the relationship between wage growth and labour productivity growth is still unfavourable. The slowing growth in employment is a signal that tensions on the labour market will be eased in coming quarters and that the upward pressure on wages will diminish. Growth forecasts for the global economy have been revised downwards since the Council's October meeting due to the continued turmoil on global financial markets and the growing impact of this turmoil on the real economy. At the same time, the sharp slowdown of the global economy – especially recession in the United States, euro zone and Britain – coupled with a drop in the prices of raw materials and food on world markets, contribute to a fall in inflation, something which has persuaded many central banks to make further interest rate cuts. The turbulence on global financial markets has led to a rise in risk aversion and the consequent weakening of the currencies of many countries, including countries of Central and Eastern Europe, and a higher volatility of these currencies. (Minutes of the Monetary Policy Council Meeting, November 25-26, 2008; www.nbp.pl)

GUS on GDP growth in the third quarter of 2008

Central Statistical Office (GUS): According to initial estimates, gross domestic

product (GDP) rose in the third quarter of 2008 by 4.8% compared with the corresponding period of last year. Domestic demand is still the main factor behind GDP growth. Growth in domestic demand was slower than GDP growth and reached 4.3% in the third quarter. Individual consumption contributed 3.2 pct points to GDP growth against 3.0 pct points a year before; investment demand contributed 0.7 pct points against 3.2 pct points in the third quarter last year. For the first time in two years the contribution of external demand (net exports) to economic growth was positive (0.3 pct points against -2.3 pct points in the third quarter last year). In the third quarter of 2008 domestic demand was higher by 4.3% than in the corresponding quarter of last year, with GDP growth rate at 4.8%. Total consumption was higher by 4.0%, with individual consumption higher by 5.1% and public consumption at last year's level. Gross fixed capital formation was higher by 3.5% compared to the corresponding period of last year. The investment rate (ratio of gross fixed capital formation to gross domestic product in current prices) was 20.4% against 20.7% a year before. (GUS report, Nov. 28, 2008; www.stat.gov.pl)

GDP growth estimates for 2007 and the first three quarters of 2008 (according to GUS data available on Nov. 28, 2008)

Most of the new EU member states have experienced a sharper economic slowdown and higher inflation rates than Poland.

INE PAN, IBnGR and CASE: opinions and projections

Institute of Economics Polish Academy of Sciences (INE PAN): "The financial crisis has already arrived in Poland, borrowing criteria have been tightened, financial institutions have less confidence in each other and the price of money on the interbank market has increased. Much will depend on how fast the global financial markets will stabilise and how sharp the economic slowdown in European countries will be. If the financial markets stabilize relatively quickly, then the decrease in the economic growth rate will be smaller. Developments in the EU, our most important economic partner, are especially important for the Polish economy. Recession in such countries as Germany, France and Britain will definitely have an adverse impact on the size of our exports and the rate of economic growth. However, one may expect that the consequences of the

financial crisis will be a bit smaller and less painful for Poland than for rich industrialised countries and Poland's neighbours, like the Czech Republic and Hungary. There are several factors to support this argument: compared with industrialised economies, Poland is less dependent on loans; Polish businesses fund their investment projects from their own resources to a larger extent than businesses in other countries; banks operating in Poland were not involved in risky operations on the sub-prime market; Poland's ties with the global economy are weaker compared with the Czech Republic's and Hungary's; the economy is driven by domestic demand. (INE PAN report entitled "Poland's Economy. Projections and Opinions," November 2008; www.inepan.waw.pl)

Gdańsk Institute for Market Economics (IBnGR): (...) the projection has been made with the following assumptions: the negative impact of the global financial crisis on the Polish real economy will be limited while in the EU-15 the economy will slow considerably. (...) From a sectoral perspective, construction will still be growing the fastest. The increase in value added in this sector will reach 12.5% in 2008 and 8.9% in 2009. The financial crisis may become a major threat to construction growth because part of it is financed by bank loans. Demand for construction services, especially in the residential and industrial construction sectors, may be constrained by a reduction in the supply of loans and more difficult access to them. The industrial sector will be growing at a slightly slower pace than construction. The increase in gross value added in this sector is projected at 5.6% in 2008 and 4.4% in 2009. In industry, the risk factor now is the danger that exports will slow as a result of possible recession in European Union countries. The increase in value added in the market services sector is projected at 5.2% and 3.7% in 2008 and 2009 respectively. The sector is important for the economy because its contribution to GDP growth amounts to around 60%. Domestic demand is and will continue to be the driving force behind the economy in 2008 and 2009. IBnGR projects that domestic demand will increase by 5.9% in 2008 and 4.8% in 2009. A rise in investment spending will be the most important factor behind the increase in domestic demand. IBnGR forecasts that investment growth will be in a double-digit figure (13.1%) in 2008 but next year will drop considerably to 8.1%. There will be two reasons behind the slowdown in investment. Firstly, it is expected that the flow of foreign investment to Poland will slow. Secondly, the above-mentioned restricted access to bank loans will make some investors abandon their investment plans. Individual consumption is projected to grow by 5.1% in 2008 and 4.3% in 2009. The decrease in consumption growth in 2009 will also result from the reduced availability of loans and will be additionally due to a deterioration in consumer

outlook and reduced propensity to buy. IBnGR projects that Poland's GDP will grow by 5.1% in 2008. The fourth quarter will be the weakest, with a growth rate projected at 4.2%. According to IBnGR, the possible impact of the financial crisis on Poland's real economy will not be seen before the first half of 2009. Then, one may expect the Polish economy to slow to 3.2% in the first quarter and 3.4% in the second quarter. In the second half of the year GDP growth should accelerate to slightly above 4%. As a result, IBnGR projects that the 2009 growth will reach 3.9%. (IBnGR report entitled "The State and Projection of Economic Conditions," October 29, 2008; www.ibngr.pl)

Centre for Social and Economic Research (CASE): In the baseline scenario, which assumes that banks will resume financing the real economy, the NBP will cut interest rates to offset the increase in margins on loans and the global recession will turn out to be shallower than pessimistic forecasts, our economy should grow at a rate of 3-4% in 2009. However, if these assumptions prove to be wrong, especially the first one, the economy may even succumb to stagnation. But parallels with the year 2001 are deceptive because the Polish economy is now much more balanced. We still assess the latter scenario as less probable than the baseline scenario. If the first scenario becomes a reality, then employment will stay at the present level and unemployment will not be increasing, although there will be more redundancies on the labour market. These, however, will be offset by a rise in new jobs. (CASE report entitled "Trends. Analyses. Forecasts," end-November, 2008; www.case.research.eu)