POLISH ECONOMIC OUTLOOK
TRENDS • ANALYSES • FORECASTS
CASE
QUARTERLY 3/2008 (38)

Special Feature – Resilience of the Polish Economy

EXECUTIVE SUMMARY

Gradually slowing economy and a cloudy outlook for economic growth, falling unemployment and growing employment, a turning point in inflation trends, a sound fiscal position and a widening current account deficit characterized the 3Q2008.

As expected, the economy started slowing in the 3Q2008, impacted by the downturn in the euro area, but the slowdown was gradual and did not augur a discontinuity, which occurred in October. The culmination of the global financial crisis in October also hit the Polish economy whose growth prospects, broadly speaking, became uncertain and deteriorated. Outside events overflowed to Poland, leading to a psychological stress and the development of a crisis mindset. Commercial banks became infected by the financial contagion and imported high levels of mutual distrust. In a result, credit markets, well functioning until September, froze in October. Banks tightened lending standards and started rationing credit to the real economy that is leading businesses to reassess their investment plans.

These developments, along with the destabilization of the world economy and prospects of the most severe downturn in the postwar history make reliable predictions hard, therefore we envisage two scenarios. In our baseline scenario, when banks resume lending to the non-financial sector, the central bank reduces its interest rates to offset the impact of widening spreads on the credit market and the global downturn is moderate, the economy should grow at 3 to 4% next year. In the worse case scenario, when credit is frozen, the world plunges in the worst postwar recession the economy could even stagnate. We still assign a lower probability to the second scenario.

Were the economy to grow in line with our baseline scenario, employment should keep steady while unemployment should not rise. However, a rate slower than 3% is likely to reverse the declining trend in unemployment since labor productivity gains will make some employees redundant as output stagnates.

Inflation passed its peak in the 3Q2008 as we predicted. The supply side factors have receded as the prospects of the global downturn caused an abrupt fall in commodity prices across the board. A good global harvest also reversed inflationary trends of foodstuffs. Stagflation talk shifted to global deflation fears. Since Polish economy will likely grow much below its potential in 2009, demand pressures will likely fade soon as well. Hikes in regulated prices of energy will remain the main inflationary factor as rises in pay will be moderated while the exchange rate should be neutral. We considerably revise our forecast of the CPI inflation rate down, predicting that it will have dropped within the central bank band by the end of 1Q2009 and in the vicinity of the central bank target of 2.5% yoy by the end of 3Q2009. Since then it may remain stable. Downward surprises are likely should the economy grind to a halt. Easing of inflationary pressures will allow the central bank to reduce its interest rates: we forecast at least three to four cuts by the cumulative 1 percentage point until the summer of 2009.

The state budget position was sound after three quarters of 2008. The lower-than-projected tax revenue was more than offset by the lower-than-planned expenditure so the cash deficit came at 4.2 bn zlotys, much lower than projected. Like in 2007, the deficit will quickly rise in the 4Q2008, as the government steps in expenditure in particular for fixed business investment and EU related projects. But it will come below the 2008 target of PLN 27.1 bn. The state budget draft for 2009 is based on GDP growth of 4.8% and inflation of 2.9%. Definitely, the former assumption is overly optimistic under current circumstances. In our view, a revision of the GDP growth rate to 3% next year would reduce the tax revenue by some PLN 5 bn and raise the cash deficit to 1.7%

instead of 1.3% of GDP, keeping all other things unchanged. This should not cause a breach of the 3% threshold for the general government deficit from the Stability and Growth Pact.

The estimated four-quarter current account deficit reached 5.0% of GDP in the 3Q2008, compared with 4.7% in 2007. Revised NBP data point to a slow upward trend in this ratio in 2008 on the back of the rapidly widening trade deficit. However this deficit did not grow in the euro terms from the 2Q2008. In the 3Q2008, exports in the euro terms did not show any weakness despite a recession in the euro zone while imports were highly correlated with them as both quantities rose by 18.7% yoy and 19.9% yoy, respectively. We are expecting a slowdown in exports to show up in the statistics in the coming quarters as companies report dwindling orders. But we do not forecast a further considerable deterioration in the trade deficit because the rapid depreciation of zloty restored the competitive edge of Polish companies while imports of commodities will be much cheaper and investment imports will likely decline. Further, Poland will likely use a larger portion of the EU funds than in 2008, which will tend to dampen the current account deficit. That is why we forecast a weak downward trend of the current account deficit in 2009. This deficit should not pose a problem to be financed even under the low liquidity of international financial markets since its portion to the order of 1.6% of GDP was financed by the capital account inflows, which are EU funds almost entirely, unlikely to be reimbursed for their misuse.

Structural reforms are on the right track though for political reasons they have been delayed and watered. We think that the global crisis environment will lead to their vigorous introduction to enhance the confidence in the economy. One of them is the road map to the euro adoption in 2012, which is ambitious but still realistic.

Since the subject of the resilience of the Polish economy to the financial crisis is highly topical right now, it is tackled in our Special Feature.

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

Indicator	Data 2005	Data 2006	Data 2007	Data 2008 Q1	Data 2008 Q2	Data 2008 Q3	CASE forecasts 2008 Q4	CASE forecasts 2009 Q1	2009 Q2	2009 Q3	2009 Q4	2008	2009
Nominal GDP, PLN bn	983.3	1060.1	1175.3	295.3	309.9	315.8*	356.3	312.1	328.1	338.0	382.4	1277.5	1360.7
(% change, yoy)													
GDP	3.6	6.2	6.7	6.0	5.8	4.5*	3.4	2.2	2.9	4.0	4.4	4.9	3.4
Private Consumption	2.0	5.0	5.0	5.6	5.5	5.3*	5.2	3.0	4.0	3.6	4.1	5.2	3.8
Fixed Investment	6.5	14.9	17.6	15.7	15.2	12.5*	6.4	-2.8	-4.7	1.1	3.5	12.8	0.0
(4Q, % of GDP)													
CA balance	-1.2	-2.7	-4.7	-4.9	-4.9	-5.0*	-4.8	-4.7	-4.5	-4.4	-4.5	-4.8	-4.5
(% change, yoy)													
Exports (NBP, EUR)	17.8	20.4	13.4	20.3	20.9	18.7	8.4	1.6	3.5	4.0	4.7	17.4	3.5
Imports (NBP,(EUR)	13.4	24.0	19.5	20.6	21.5	19.9	9.0	2.2	2.9	3.9	4.4	19.0	3.4
(% change, yoy)													
Industrial sales	3.7	11.2	9.5	8.5	8.5	3.4	2.3	0.9	2.2	3.4	7.5	5.6	3.5
Gross value added	3.3	6.0	6.6	5.5	6.1	4.4*	3.6	2.3	2.8	4.0	4.4	4.8	4.8
CPI	2.1	1.0	2.5	4.1	4.3	4.7	3.8	3.5	3.0	2.8	2.9	4.2	3.0
PPI	0.7	2.3	2.3	3.0	2.5	2.1	2.4	1.8	1.5	1.5	1.9	2.5	1.7
Nominal Ave. Wage	3.8	4.9	8.7	11.5	11.7	10.7	8.8	9.5	9.1	7.6	6.7	10.6	8.2
Employment %, LFS	2.3	3.1	3.1	4.6	3.5	2.5	1.5	0.5	0.3	0.0	0.0	3.1	0.2
Registered unemployment rate (%, eop)	17.6	14.8	11.4	10.9	9.4	8.9	9.1	9.5	8.8	8.9	9.4	9.1	9.4
PLN/EUR, eop	3.86	3.83	3.58	3.53	3.35	3.41	3.55	3.50	3.47	3.45	3.40	3.55	3.40
WIBOR 3M, %, eop	4.60	4.20	5.68	6.15	6.65	6.63	6.40	5.70	5.40	5.10	5.05	6.40	5.05
Central bank key rate eop	4.50	4.00	5.00	5.75	6.00	6.00	5.75	5.25	4.75	4.50	4.50	5.75	4.50
(% change, yoy eop)													
Broad Money (M3)	13.1	16.0	13.4	13.6	16.3	17.3	16.5	13.4	13.2	13.1	14.0	16.5	9.0
Loans to HH	26.0	33.4	37.9	37.4	34.4	33.5	37.5	34.0	29.5	25.0	18.0	37.5	18.0
Loans to Firms	2.5	13.7	24.1	25.2	24.5	24.1	30.0	25.0	21.0	18.0	13.1	30.0	13.1
(% GDP)													
Fiscal Balance	-4.3	-3.8	-2.0	n.a.	n.a.	n.a.	-2.4	n.a.	n.a.	n.a.	n.a.	-2.4	-2.8
Public Debt eop	47.1	47.7	44.9	n.a.	43.1	n.a.	43.9	n.a.	n.a.	n.a.	n.a.	43.9	44.0

(*) means estimates or forecasts

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

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