POLISH ECONOMIC OUTLOOK

TRENDS • ANALYSES • FORECASTS

CASE

QUARTERLY 2/2009 (41)

Special Feature:

L, U, V or W for The Shape of Recovery to Come

EXECUTIVE SUMMARY

Contrary to our expectations, Polish economy did not enter recession in the 1H2009, defined as two consecutive quarters of GDP decline in quarterly terms, as GDP grew seasonally adjusted 0.3% qoq and 0.5% qoq in the 1Q2009 and the 2Q2009, respectively. However, domestic demand decreased three quarters in a row, starting with the 4Q2008, when it fell by the seasonally-adjusted 0.2% qoq though it still rose unadjusted 3.5% yoy. In the 1Q2009 and 2Q2009, quarterly declines were stronger in quarterly and annual terms. Thus, by this gauge the economy was in a recession in the 1H2009. Domestic demand was supposed to buffer it against the global downturn, but did not. Despite this contraction, GDP grew because exports fell much less than imports did so net exports improved significantly.

The short-term outlook for the economy improved for the first time in a year. The improved prospects for the rest of the year bode better times for Polish exports. Inventory correction is almost complete and subsequent restocking should be at least neutral to economic growth. Financial markets are normalizing and fewer banks report further tightening of credit standards. Business confidence has improved. The structure of growth factors should not change in the 2H2009 from the 1H2009. Private consumption, despite its softness will remain one of its drivers though its growth will probably hover around 2% yoy. Net exports, thanks to the strong competitive edge of Polish companies that had been underpinned by the past depreciation, will remain another.

The better performance of the economy in the 1H2009 than in our previous forecast leads to an upward revision of our growth forecast to 0.5% yoy in the 3Q2009 and, consequently, in the entire of 2009 though we do make any change in the forecast for the 4Q2009 (Table 1). The outlook for 2010 is clouded by the uncertainty regarding the strength of the world-wide recovery, which is based on the inventory adjustment at present. Despite all the headwinds, recovery in Poland should gather strength in 2010, fuelled by the infrastructure investment projects and exports.

A slack in the economy should help ease inflationary pressures once the statistical effects of hikes in regulated prices disappear from the index. CPI inflation grew in the 2Q2009 to 3.7% yoy from 3.2% in the 1Q2009, largely as a result of accelerating prices of gasoline, selected foodstuffs and industrial goods. Most of the increase can be attributed to agricultural supply shocks and the weakness of the Polish currency which, despite the recent strengthening, remains 20-30% weaker than in the same period of 2008. Compared to our previous forecast, we are now expecting a slightly higher consumer inflation and lower producer inflation in 2009. The main factor behind the elevated CPI forecast are more optimistic prospects for the real economy in Poland as well as Poland's main trading partner markets. The exchange rate remains one of the major risks to the forecast as until the end of the year, the currency will remain depreciated on a y-o-y basis. We, therefore, expect the process of passing through some of the costs associated with the depreciation onto consumers to continue – at least until early 2010. Combining these factors together, we expect the CPI inflation rate to remain just above the target range of 1.5-3.5% until the end of 2009 and then gradually decline to 3.1% in the 1Q2010. It should fluctuate between 2 and 3% in the remainder of 2010. On the annual average, the consumer price inflation will reach 3.6% in 2009 and 2.7% in 2010.

Since inflation is mostly caused by the supply-side, NBP continued to conduct expansionary monetary policy in the 2Q2009. It reduced the required reserve ratio to 3.0% from 3.5% in May and it cut its key open market operations rate to 3.50% p.a. in June from 3.75% in March 2009. Since the CPI inflation has been above the target and the core inflation rate, excluding food and energy, continued to creep upward in July while the short-term prospects for the economy slightly improved, the likelihood of more cuts in NBP rates has diminished. If the October inflation report confirms a downward trend in future inflation as the impact of 2009 hikes in administered prices recedes, the MPC may decide to lower the NBP interest rates the last time in its term. Otherwise, they should remain unchanged at least through the 1H2010.

The Labor-Force-Survey employment was still growing in the 2Q2009. The unemployment increase, accompanying it resulted from a dynamic increase of the number of active population in recent period. However, the official unemployment rate did not increase in the 2Q2009, mostly for seasonal reasons, but labor markets proved more flexible than expected as well, since working time was reduced and substantial declines in wage growth occurred. The broad recourse to sickness leaves that temporarily shifted the cost of employment to the Social Insurance Fund from firms was also a factor. We do not significantly alter our unemployment forecasts from the previous PEO issue. It results from the fact that actual labor market developments seem to broadly follow our expectations thus far. Both, registered and LFS unemployment will continue to grow in the rest of 2009. We expect the registered unemployment rate to reach 12.7% at the end of 2009, while the LFS unemployment rate will probably grow to about 8%.

Increasing unemployment has moderated wage demands. Wage dynamics are going down very sharply and real wage dynamics actually fell below zero in the 2Q2009 for the first time since the mid of 2005. We expect this downward trend to last and, hence, we strongly reduce our earlier expectations concerning the nominal wage growth in the quarters to come. On average, nominal wages in 2009 should grow by no more than 3.5% and real wages should stay at the level from 2008. During 2010 nominal wage growth on a y-o-y basis can even fall further to the average of 2% yoy.

Despite the fact that the central budget deficit was in line with projections in the 1H2009, the government decided to revise the 2009 cash shortfall upward to PLN 27 bn or from PLN 18.2 bn. A combination of caps on expenditure and raised dividends should fill the gap in the state revenue. We do not take issue with these estimates. The ESA-95 general government deficit that unexpectedly rose to 3.9% of GDP in 2008 will likely hit 5.5% to 6% this year, but the outlook for 2010 is better in our view because of the conservative macroeconomic assumptions for the state budget draft.

We forecast that a large deficit this year is to cause a rise in the public debt by 5 percent of GDP to about 52%. Risks that the 55% precautionary threshold will be breached in 2010 are elevated, but there is a chance that the ratio will stay below this level under a number of assumptions, out of which high privatization proceeds seem the most important.

On the external side, trends from the 1Q2009 were continued in the 2Q2009. The four quarter rolling current account deficit sharply declined to 2.7% in the 2Q2009 from 5.4% of GDP in the 4Q2009. The huge improvement in the trade balance and a decline in the income deficit were the main factors of this change. The rate of decline in exports bottomed out in the 2Q2009 while the scale of import collapse increased. Since the Polish economy keeps on weakly growing while its partner economies shrink, this is due to the strong depreciation of the zloty. Our qualitative forecast with regard to the tendencies, exhibited by the current account components, remains unchanged. Such a rapid improvement in the current account may result in its position close to balance in 2009 unless the economic growth in Poland unleashes more demand for imports in the 4Q2009.

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

Indicator	Data							CASE forecasts					
	2006	2007	2008	2008		2009		2009		2010		2009	2010
				Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2		
Nominal GDP, PLN bn	1060.0	1176.7	1271.7	314.2	349.0	314.5	326.6	330.1	366.7	328.8	343.2	1337.9	1405.6
(% change, yoy)													
GDP	6.2	6.8	4.9	5.0	2.9	0.8	1.1	1.2	2.0	2.5	3.1	1.0	3.0
Private Consumption	5.0	4.9	5.4	5.1	5.3	3.3	1.9	2.7	2.5	2.3	2.9	2.1	2.9
Fixed Investment	14.9	17.6	8.2	3.5	4.6	1.2	-2.9	-3.8	-2.2	-1.4	1.1	-2.3	1.6
(4Q, % of GDP)													
CA balance	-2.7	-4.7	-5.4	-5.3	-5.5	-3.9	-2.1	-1.1	-0.1	-0.5	-1.1	-0.1	-0.9
(% change, yoy)													
Exports (NBP, EUR)	20.4	13.4	12.7	19.5	-7.5	-22.9	-22.8	-20.3	3.8	9.0	10.0	-16.3	11.5
Imports (NBP,(EUR)	24.0	19.5	14.9	22.6	-4.6	-28.8	-32.0	-25.7	-1.8	8.0	9.0	-22.6	9.9
(% change, yoy)													
Industrial sales	11.2	9.5	3.3	2.2	-6.3	-10.0	-6.7	-4.0	1.0	5.0	3.5	-5.1	4.5
Gross value added	6.0	6.7	4.9	4.9	3.4	1.2	0.8	1.2	1.9	2.3	3.0	1.2	2.9
CPI	1.0	2.5	4.2	4.7	3.7	3.2	3.7	3.8	3.6	3.1	2.2	3.6	2.7
PPI	2.3	2.3	2.5	2.1	2.4	4.9	4.2	3.0	3.6	2.1	2.7	3.9	2.9
Nominal Ave. Wage	4.9	8.7	10.4	9.8	6.8	6.8	4.4	3.0	1.4	3.6	1.8	3.5	2.3
Employment %, LFS	3.1	3.1	3.7	3.6	3.0	1.3	1.0	0.5	0.0	-0.5	-1.0	0.7	-0.5
Registered unemployment rate (%, eop)	14.8	11.4	9.5	8.9	9.5	11.2	10.7	11.3	12.7	14.1	13.3	12.7	14.2
PLN/EUR, eop	3.89	3.78	3.52	3.31	3.77	4.50	4.45	4.17	4.10	4.00	3.95	4.30	3.85
WIBOR 3M, %, ave	4.20	5.68	5.88	6.63	5.88	4.17	4.44	4.15	3.95	3.90	3.90	3.95	4.20
Central bank key rate eop	4.00	5.00	5.00	4.75	5.00	3.75	3.50	3.50	3.25	3.25	3.25	3.25	3.75
(% change, yoy eop)													
Broad Money (M3)	16.0	13.4	18.6	17.3	18.6	17.5	14.4	10.0	7.5	8.0	7.9	7.0	9.5
Loans to HH	33.4	37.9	44.6	33.5	44.6	43.7	35.7	19.0	10.0	7.0	8.0	11.0	9.0
Loans to Firms	13.7	24.1	29.0	24.1	29.0	25.8	15.0	9.5	1.0	- 2.0	-1.0	1.0	5.0
(% GDP)													
Fiscal Balance	-3.9	-1.9	-3.9	n.a.	-3.9	n.a.	n.a.	n.a.	-5.5	n.a.	n.a.	-5.5	-4.5
Public Debt eop	47.7	44.9	47.1	n.a.	47.1	43.6.	n.a.	n.a.	52.0	n.a.	n.a.	52.0	54.5

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

The publication of this issue is supported financially by Bank PEKAO SA and Fortis Bank Polska SA.