POLISH ECONOMIC OUTLOOK

TRENDS • ANALYSES • FORECASTS

CASE

QUARTERLY 1/2010 (44)

EXECUTIVE SUMMARY

The economy is going through a soft patch. Unemployment increased due to this and seasonal factors, but started rapidly falling in April. Macroeconomic balances mostly improved in the 1Q10. A lot of slack in the economy helped inflationary tensions ease in this period and the CPI inflation rate should remain within the central bank target band for the next four quarters at least. The four quarter rolling current account deficit rose slightly in terms of GDP while the central government deficit came lower than expected.

GDP grew by 3.0% yoy in the 1Q10, in line with our forecast of 2.9% yoy and compared with 3.3% in the 4Q09 and 1.8% in 2009. Growth was driven by consumption, sizable inventory restocking and net exports in the 1Q10. The contribution of domestic demand and net exports to economic growth reversed in magnitude relative to the 4Q09 and earlier quarters of 2009. However, the economy lost momentum in the 1Q10 as seasonally adjusted GDP grew 0.5% qoq, slower than 1.1% in the 4Q09. This softness was related to a significant drop in the fixed business investment that unexpectedly fell 12.4% yoy and seasonally adjusted 5.9% qoq, adversely affected by severe winter that delayed construction. In our view, this drop is a one-off event, but it will weigh on the year-on-year statistics in the coming quarters.

Despite the sudden drop in the fixed business investment the forecast of GDP growth for 2010 has been revised upward as private consumption proved more robust than assumed and unemployment started falling earlier than we had predicted, which leads to the upgrade of our forecast. The soft patch will likely extend into in the 2Q10, but the 2H10 should see accelerating growth buoyed by the public fixed business investment, also related to the post-flood reconstruction, and exports. We still maintain that in 2011, the economy is likely to grow between 4% and 5%, depending on the world economy developments. The euro depreciation versus the dollar should add some stimulus provided that the euro area public debt problem will not lower confidence in the global recovery.

Inflation moderated to 3.3% yoy on average in the 1Q10, down from 3.6% yoy in the 4Q09, and declined further down to 2.2% yoy in April reflecting decelerating prices of food, electricity, consumer durables and selected services. Countering this trend were prices of fuel and tobacco which rose markedly in early 2010. The downward trend in inflation should be arrested in the 3Q10, but the subsequent upward trend will be flat. Compared to the previous issue of PEO, we slightly raised our forecasts of the CPI inflation and lowered those of the PPI inflation. Expectations of higher CPI growth are motivated by the upward revision of economic growth as well as a small upward correction of the food price growth during the upcoming harvest season due to the impact of the flood. The zloty appreciation should offset increases in commodity prices, should they occur.

The central bank rates stayed flat through May 2010 and, based on our CPI inflation path, we do not expect any changes until 2011 because the acceleration in growth toward the yearend is not going to eliminate the slack in the economy.

Conditions in the labor market stopped deteriorating in the 1Q10 despite a sub-par economic growth and the adverse seasonal factors, suggesting that recovery is making inroads. The overall employment dynamics in the sector of large firms that had already stopped to worsen at the end of the 2009, started to significantly improve at the beginning of 2010 on the back of rising employment in manufacturing. However, the overall employment figures from Labor Force Survey (LFS) were bad and we ascribe this fact to harsh winter, a one-off event. Therefore, our general employment forecast for 2010 is rather optimistic. We expect that the LFS employment in 2010 will most probably stay at the same level as in 2009 while in 2011 it will rise by 1.2%. In the 1Q2010, unemployment increased to 12.9% so it was below our previous forecast, but it fell rapidly in April, also in seasonally adjusted terms. The seasonally adjusted figures confirm that the 1Q2010 can see a breakthrough in the labor market situation in Poland. We revise down our forecast of registered unemployment that should stabilize at the 2009 level at the end of 2010. In 2011, registered unemployment will continue to fall to around 10%-10.5% at the end of the year. Factoring in that the unexpectedly bad LFS figures for the 1Q2010 resulted mainly from adverse weather conditions, we assess that the LFS unemployment will fall to as low as 9.6% in the 2Q2010. It should stabilize throughout the rest of 2010, reaching 9.7% at the end of the year. In 2011, it will fall to even 8.5%.

Real wage dynamics in the entire economy more or less stabilized in the 1Q10. Since conditions on the labor market have started improving and GDP growth is likely to pick up, growth of average nominal wage will gradually accelerate. Average nominal wage growth in the enterprise sector should stay around 3% yoy in the 2Q10 while in the entire 2010, it should stay below 4%. The average nominal wage in the whole economy should rise about 5% in 2010 that translates in a 2.5% rise in purchasing power. Nominal and real wage growth is expected to accelerate in 2011 on the back of better performance of the economy.

The central government (CG) cash deficit came lower than projected by the government in the 1Q10 and this tendency continued through April. Expenditures were lower while revenues were higher than projected. The latter were supported by economic growth, however it was not strong enough to produce a year-on-year growth in the tax revenue in this period. We forecast that in 2010, the CG deficit will be lower by 1% of GDP than forecast by the government. This will help reduce the general government ESA95 shortfall relative to official projections as well. The risk of breaching a 55% threshold for the public debt is negligent in 2010. Our forecast of the public debt ratio in 2010 is lowered and it is also a factor, why we expect that this ratio should not cross the line in 2011, either. Other factors are the appreciation of the zloty, large proceeds from privatization and a large payment from the NBP profits.

The current account deficit is a non-issue. It is predicted to slightly rise to 2-2.5% of GDPP in 2010 due to the negligent deficit in trade. Both export and import should continue to post strong upward trends in 2010. Adjusted for the net capital surplus that captures most of the EU aid, the current account shortfall should not exceed 1-1.5%of GDP. These developments will further decrease external financing needs of Poland so they will support the zloty exchange rate on top of the net capital inflows, in particular of FDI. The zloty rate will be quite volatile due to disruptions on the financial markets, but its upward trend will not be compromised.

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

Indicator	Data							CASE forecasts					
	2007	2008	2008	2009			2010	2010			2011	2010	2011
				Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1		
Nominal GDP, PLN bn	1176.7	1275.4	1344.0	327.0	331.9	371.4	327.4	344.8	349.2	389.2	349.7	1416.1	1510.0
(% change, yoy)													
GDP	6.8	5.1	1.8	1.1	1.8	3.3	3.0	3.1	3.7	4.2	4.2	3.5	4.0
Private Consumption	4.9	5.7	2.3	1.6	2.3	1.7	2.2	3.2	3.1	3.7	3.4	3.1	3.7
Fixed Investment	17.6	9.6	-0.8	-3.3	-1.4	1.1	-12.4	-3.0	4.9	5.6	16.5	1.0	10.0
(4Q, % of GDP)													
CA balance	-4.7	-5.1	-1.6	-2.8	-2.1	-1.6	-1.9	-1.9	-1.4	-1.3	-1.3	-1.3	-2.5
(% change, yoy)													
Exports (NBP, EUR)	13.4	14.2	-17.1	-21.8	-19.5	1.5	19.0	23.7	19.5	15.1	12.0	19.2	11.0
Imports (NBP,(EUR)	19.5	17.2	-25.4	-29.7	-27.0	-10.3	19.1	24.0	18.5	20.2	11.7	20.4	12.5
(% change, yoy)													
Industrial sales	10.7	3.6	-4.3	-6.7	-1.3	5.6	9.5	9.9	8.2	4.9	7.0	8.2	9.0
Gross value added	6.7	5.1	1.9	1.0	2.0	3.3	2.8	3.2	3.5	4.1	4.3	3.4	4.1
CPI	2.5	4.2	3.5	3.7	3.5	3.3	3.0	2.2	2.4	2.8	2.7	2.6	2.5
PPI	2.0	2.2	3.4	4.2	2.2	2.0	-1.6	-0.4	2.0	2.5	2.4	0.6	1.4
Nominal Ave. Wage	7.9	10.1	5.5	4.4	4.9	4.7	4.1	3.2	3.6	4.2	3.6	3.5	4.6
Employment %, LFS	3.1	3.7	0.7	1.0	0.5	-0.5	-0.9	-0.4	0.0	0.0	0.5	-0.3	1.2
Registered unemployment rate (%, eop)	11.2	9.5	11.9	10.6	10.9	11.9	12.9	11.5	11.3	11.9	12.4	11.9	10.3
PLN/EUR, ave	3.78	3.52	4.33	4.45	4.20	4.17	3.99	3.97	3.87	3.83	3.75	3.85	3.68
WIBOR 3M, %, ave	5.68	5.88	4.27	4.44	4.18	4.27	4.10	3.90	3.90	3.95	4.20	4.20	4.50
Central bank key rate eop	5.00	5.00	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.75	3.50	4.00
(% change, yoy eop)													
Broad Money (M3)	13.4	18.6	8.1	14.4	9.6	8.1	5.5	7.0	8.5	9.5	9.0	9.5	12.0
Loans to HH	37.9	44.6	15.5	35.7	26.3	12.0	5.7	8.5	9.5	11.0	12.0	11.0	15.0
Loans to Firms	24.1	29.0	1.0	15.0	6.8	-3.3	-9.0	-6.0	-2.5	0.5	2.0	0.5	9.0
(% GDP)													
Fiscal Balance	-1.9	-3.7	-7.1	n.a.	n.a.	-7.1	n.a.	n.a.	n.a.	n.a.	n.a.	-5.8	-4.5
Public Debt eop	45.0	47.2	51.0	n.a.	n.a.	51.0	n.a.	n.a.	n.a.	n.a.	n.a.	52.5	54.8

Sources: CSO (GUS), Eurostat, MoF, NBP and CASE own calculations. Cut-off date: May 31, 2010. Data are corrected backwards due GUS and NBP revisions.

Authors: Maciej Krzak (editor), Mateusz Walewski and Przemyslaw Wozniak.
Media contact: Anna Madalińska: anna.madalinska@case-research.eu; tel. +48 22 622 6627 ext. 23.