Rabobank

Country update

POLAND

Summary

The general trend in Poland is continuation. Economic growth was solid at almost 4% in 2010 and is expected to stay at this level this year. The key factor will be whether investment will kick in again. The ruling PO party is most likely to win to the October parliamentary elections, which suggests a continuation of current policies. The election campaigns will likely be heated as the main opposition party PiS of Kaczynski will try to win sympathy votes. Due to the elections, the fiscal consolidation seems to be on the back burner. The government has announced the intention to get the fiscal deficit back to 3% of GDP in 2012, from almost 8% of GDP in 2010. Rather than reforming or cutting spending, the focus is on economic growth to reduce the fiscal deficit. This seems a missed opportunity. Not only the fiscal deficit but also the deficit on the current account passes under the radar. The current account deficit is increasing, but still moderate. There is much discussion about the balance of payments statistics, especially about the net errors and omissions, as these are 4% of GDP (which is similar to the current account deficit).

Things to watch:

- Parliamentary elections in October
- Execution of medium term fiscal plans
- Current account statistics
- Unbalanced economic growth

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Poland

National facts		
Type of government	Republic	
Capital	Warsaw	
Surface area (thousand sq km)	312.7	
Population (millions)	38.2	
Main languages	Polish (98%)	
	Other (2%)	
Main religions	Roman Catholic (90%)	
	Eastern Orthodox (1.3%)	
	Protestant (0.3%)	
Head of State (president)	Bronislaw Komorowski	
Head of Government (prime-minist	Donald Tusk	
Monetary unit	zloty (PLN)	

Economy		2010
Economic size	*bn USD*	*% world total*
Nominal GDP	469	0.75
Nominal GDP at PPP	718	0.97
Export value of goods and services	194	1.04
IMF quotum (in mln SDR)	1369	0.63
Economic structure	*2010*	*5-year av.*
Real GDP growth	3.8	4.7
Agriculture (% of GDP)	4	4
Industry (% of GDP)	33	31
Services (% of GDP)	65	65
Standards of living	*USD*	*% world av.*
Nominal GDP per head	12291	125
Nominal GDP per head at PPP	18815	161
Real GDP per head	10029	125

Social and governance indicators	rank / total
Human Development Index (rank)	41 / 169
Ease of doing business (rank)	70 / 183
Economic freedom index (rank)	68 / 179
Corruption perceptions index (rank)	41 / 178
Press freedom index (rank)	32 / 178
Gini index (income distribution)	34.9
Population below $1.25 per day (PPP)	2%

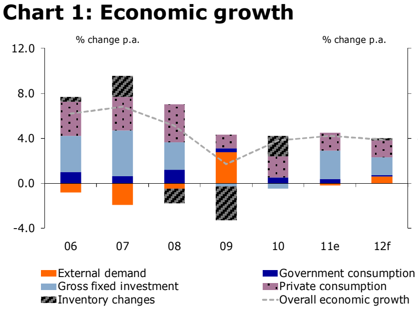
Foreign trade			2009
Main export partners (%)		*Main import partners (%)*	
Germany	27	Germany	28
France	7	Russia	8
Italy	7	Italy	7
UK	7	France	5
Main export products (%)			
Machinery, transport equipment			43
Manufactured goods classified by material			20
Miscellaneous manufactured goods			13
Food & live animals			10
Main import products (%)			
Machinery & transport equipment			34
Manufactured goods classified by material			17
Chemicals & chemical products			14
Miscellaneous manufactured goods			10
Openness of the economy			
Export value of G&S (% of GDP)			41
Import value of G&S (% of GDP)			42
Inward FDI (% of GDP)			2.2

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Introduction and update

The Polish economy was the European star performer during the financial crisis with a positive growth figure in 2009. In 2010, the economy grew close to 4%, which was above our expectations. For 2011 and 2012, growth is expected to stay at around 4%. Last year, the economic growth was largely based on the back of household and government consumption. As investment stayed behind, this raised questions about the unbalanced nature of Poland’s growth. In line with this is the worry that foreign capital, which amply flows into Poland, is used for consumption rather than for investment. However, as credit is available to firms and many firms are said to have sufficient reserves, there seems to be no reason why investments would not kick in this year. If they do, this will be an important growth driver for this year’s economic growth and help to rebalance growth. The export sector remains very dependent on Germany.

Chart 1: Economic growth



Source: EIU

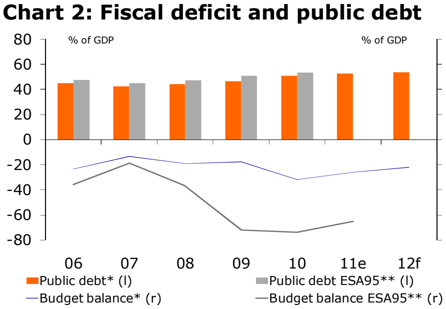
Parliamentary elections in October

Parliamentary elections will be held in October 2011. The ruling Civic Platform (PO) party of premier Donald Tusk has the best chance to win these elections. They will likely not win a majority and will thus need to partner up again. Depending on their coalition partner the policy direction might change slightly, but major policy shifts are not expected. Although the PO party is leading the polls, the opposition PiS party will challenge their lead in every way they can. The public debate might thus be heated occasionally. The PiS party of Kaczynski will try to win votes by playing the sentiment card. The twin-brother of party leader Kaczynski was President Kaczynski who got killed in the plane crash in April 2010. The one-year commemoration of this crash was held on two different places – besides the official, government-organized ceremony, Kaczynski organized his own. Is this a cunning way of Kaczynski to focus attention on his PiS party and win more votes? Despite some heated campaigning, the general policy direction toward modernization of the economy is commonly shared by both parties.

Under the radar

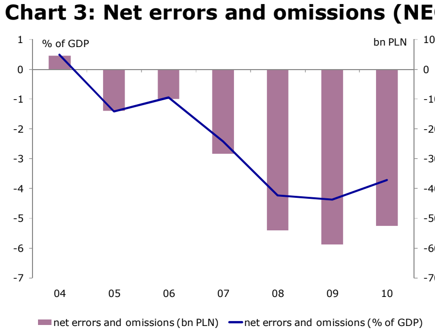
The growing twin deficit of Poland seems to have passed under the radar so far. The fiscal deficit ballooned to almost 7.9% of GDP in 2010 (ESA95 standards), according to government estimates. In their medium term fiscal plans, the government has announced to reduce the fiscal deficit to 3% of GDP in 2012. With the elections in sight, the government is very reluctant to cut fiscal spending and reform, instead it relies strongly on economic growth to reduce the deficit. This seems a missed chance. With an ageing population, low participation rate and rather high structural unemployment, the government needs to reform the pension and health care systems and address unemployment to prevent rising costs and boost long-term growth.
The public debt of Poland is estimated to be 51% of GDP in 2010 and is expected to rise slightly to 52% of GDP in 2011. This suggests that Poland will stay within its own 55% constitutional threshold[1]. Although the government will therefore able to avoid more stringent cuts, it is somewhat artificial. The government has decided to reroute some government pension contributions so it does not count towards the public debt. Similar to the fiscal deficit, after the elections the government will hopefully take another look at the fiscal situation.

Chart 2: Fiscal deficit and public debt



Source: EIU & Eurostat
* Definition used by Polish government
** Definition used by Eurostat

Chart 3: Net errors and omissions (NEO)



Source: EIU

Next to a deficit on the fiscal balance, the current account balance of Poland also has a deficit. It widened last year to 3.2% of GDP from 1.8% of GDP in 2009. This year, the current account deficit

[1] By rising above 50% of GDP, the public debt breaches the first of three constitutional thresholds (at 50%, 55% and 60% of GDP). The first threshold requires some proposals to cut spending, the second more stringent cuts, while the last hurdle prevents the government from borrowing further.

is expected to be 2-3% of GDP. As these levels are moderate, more interesting is perhaps the discussion on the quality of data and 'black holes' in the Balance of Payments (BoP) statistics. First, it seems as if Germany is exporting more to Poland than Poland is importing from Germany – about USD10bn more. Second, and more importantly, net errors and omissions (NEO) has risen to about 4% of GDP end 2010. While differences in import/export data and existence of NEO are common features in BoP statistics, the expanding nature and recent level of net errors and omissions in Poland are reasons to take a closer look. End 2010, NEO mounted to PLN 52bn or 3.7% of GDP, which is larger than the current account deficit. As the name indicates, it is unclear where the NEO stem from, but it can work in two ways; it can mean that the current account deficit is underestimated or that the inflow of foreign capital is overstated. In the former case, the current account deficit in reality is double what is currently reported. In the latter case, it suggest that total inward investment was two thirds less than reported. Most likely, NEO is a combination. The National Bank of Poland, the central bank, has been asked by the government to take a closer look at the data.

To cover the twin deficits, Poland requires a steady flow of foreign capital. Total inward investment (FDI and portfolio) was USD 19.2bn or 5.3% of GDP in 2010. This was largely due to the huge inflow of portfolio investment, USD 13.8bn. In 2011, the portfolio inflow is expected to half, while the FDI is expected to almost double. A healthy development. Besides investment flows, Poland can also county on debt creating foreign capital flows. This is expected to lead to a foreign debt stock of 54% of GDP end-2011.

Poland

Selection of economic indicators	2006	2007	2008	2009	2010	2011e	2012f
Key country risk indicators							
GDP (% real change pa)	6.2	6.8	5.1	1.7	3.8	4.2	3.9
Consumer prices (average % change pa)	1.0	2.5	4.2	3.5	2.6	3.4	2.8
Current account balance (% of GDP)	-2.8	-4.8	-4.8	-2.3	-3.3	-2.8	-3.1
Total foreign exchange reserves (mln USD)	46371	62967	59306	75923	88822	91300	90680
Economic growth							
GDP (% real change pa)	6.2	6.8	5.1	1.7	3.8	4.2	3.9
Gross fixed investment (% real change pa)	14.9	17.6	9.6	-1.1	-2.0	10.0	6.2
Private consumption (real % change pa)	5.0	4.9	5.7	2.1	3.2	2.7	2.5
Government consumption (% real change pa)	6.0	3.7	7.4	2.0	3.2	2.3	0.4
Exports of G&S (% real change pa)	14.6	9.1	7.1	-6.8	11.0	5.9	6.7
Imports of G&S (% real change pa)	17.3	13.7	8.0	-12.4	11.4	6.6	5.6
Economic policy							
Budget balance (% of GDP)	-2.4	-1.4	-1.9	-1.8	-3.2	-2.6	-2.2
Public debt (% of GDP)	45	43	44	46	51	53	54
Money market interest rate (%)	4.2	4.7	6.3	4.6	4.0	4.6	4.9
M2 growth (% change pa)	16	14	20	8	8	8	6
Consumer prices (average % change pa)	1.0	2.5	4.2	3.5	2.6	3.4	2.8
Exchange rate LCU to USD (average)	3.1	2.8	2.4	3.1	3.0	3.0	3.1
Recorded unemployment (%)	16.2	12.7	9.8	11.0	12.1	11.4	10.0
Balance of payments (mln USD)							
Current account balance	-9394	-20253	-25554	-9738	-15399	-14190	-15730
Trade balance	-7006	-17057	-25972	-4377	-8434	-10400	-12270
Export value of goods	117468	145337	178427	142071	161985	174540	185790
Import value of goods	124474	162394	204399	146448	170419	184940	198060
Services balance	736	4758	5006	4784	4103	5200	3660
Income balance	-9728	-16448	-12844	-16605	-17228	-17580	-17990
Transfer balance	6604	8494	8256	6460	6160	8600	10870
Net direct investment flows	10727	17987	10365	8696	5300	9300	12000
Net portfolio investment flows	-6158	-8236	-4909	9224	13882	6560	1580
Net debt flows	22550	41133	30184	28635	28281	10540	8630
Other capital flows (negative is flight)	-11812	-13370	-13653	-19408	-18152	-10900	-8100
Change in international reserves	5913	17260	-3567	17409	13912	1310	-1620
External position (mln USD)							
Total foreign debt	139033	195376	218022	241818	264349	268870	269540
Short-term debt	34558	60366	64904	68324	67842	72350	75750
Total debt service due, incl. short-term debt	63536	82526	117554	116891	124861	132410	138020
Total foreign exchange reserves	46371	62967	59306	75923	88822	91300	90680
International investment position	-166307	-242161	-243450	-280603	n.a.	n.a.	n.a.
Total assets	117880	156761	136807	154879	n.a.	n.a.	n.a.
Total liabilities	284187	398922	380257	435482	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	-2.1	-4.0	-4.9	-1.0	-1.8	-2.1	-2.4
Current account balance (% of GDP)	-2.8	-4.8	-4.8	-2.3	-3.3	-2.8	-3.1
Inward FDI (% of GDP)	5.8	5.6	2.8	3.2	2.2	2.7	3.2
Foreign debt (% of GDP)	41	46	41	56	56	54	52
Foreign debt (% of XGSIT)	87	98	90	125	123	113	107
International investment position (% of GDP)	-48.7	-57.0	-46.0	-65.2	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	40	41	49	60	58	56	55
Interest service ratio incl. arrears (% of XGSIT)	3	3	4	3	3	3	3
FX-reserves import cover (months)	3.9	4.1	3.0	5.3	5.4	5.1	4.7
FX-reserves debt service cover (%)	73	76	50	65	71	69	66
Liquidity ratio	103	99	86	90	90	90	89

Source: EIU