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Poland: the power of a weak currency

In the course of 2003 the Polish currency devalued by close to 15% vs. the euro, from 4.02 to 4.72 PLN/EUR. The zloty's weakening was not affected by capital inflows, whose size was not much lower than in 2002. Basically, the weakness of the Polish currency reflects the relatively low (by Polish standards) interest rates. The long downward slide in the National Bank's leading interest rates that started in February 2001 has continued. The NBP rediscount rate fell from 7.5% to 5.25% during 2003 (for reference, that rate was over 20% from November 1999 through June 2001). The weakening of the zloty has worsened the financial position of firms and financial intermediaries which happened to have accumulated large debts denominated in euro. Nonetheless, net profits of the banking system, as reported for the first three quarters of 2003, improved quite strongly. Moreover, with a rather meagre (2.4%) rise in banks' assets, there has been some improvement in their quality. (In September the share of 'problematic' credits was still quite high at over 21% though.)

Gross profits of the non-financial corporate sector almost doubled during the first three quarters of 2003 (vs. the same period of 2002) – and nearly trebled in manufacturing. Much of the growth in gross profits in manufacturing comes from the motor vehicle and transport equipment branches, which in 2003 managed to cut their enormous losses recorded in 2002. In all probability the net losses (close to PLN 2 billion) suffered by the corporate sector in 2002 will be replaced by handsome net profits in 2003.

Sales of industrial firms (corporate sector) rose 8.7% in real terms. With falling employment the industrial labour productivity increased by some 12%. As the average wage in industry rose 3% in 2003 and industrial producer prices by 2.6%, unit labour costs declined by about 8% (and the real unit labour cost indicator fell by 10%). No doubt, lower labour costs have improved profits.

The growth of private (household) consumption, at 2.6% in 2003, does not correspond to the real growth rate of the purchasing power of the entire wage bill (which was slightly negative). There was however a 4% rise in the real purchasing power of retirement payments. Besides, consumer demand has been undoubtedly supported by spending out of rising profits and incomes of employers. This is consistent with the fact that gross fixed capital formation was declining throughout the year.

Foreign trade played an important role in generating growth in 2003. In euro terms, exports rose strongly while imports stagnated. Of course these developments reflected the exchange rate and industrial labour cost tendencies, both stipulating quite massive real depreciation and significantly improving external competitiveness.

While conducive to a much better foreign trade performance, the productivity and labour cost improvements did not have any positive effect on the unemployment front. The unemployment rate is stuck at 20% – which is one of the reasons why the present government fares extremely badly in all public opinion polls.

The government has been unsuccessful in reigning in the very high public sector deficits. The central budget deficit planned for 2004 will again be quite high. The longer-term fiscal consolidation programme currently worked out envisages major cuts in the deficits only later on (when the presently ruling coalition will most probably be out of power). As elsewhere, the current approach to fiscal consolidation stipulates quite decisive cuts in public consumption and social transfers, coupled with cuts in corporate income taxes and reductions in personal income tax rates (primarily on higher incomes). Whether this approach, followed already since 1995, will be successful in reducing the public sector deficit is debatable. What is more certain is that it will have unwelcome social and also macroeconomic side effects. Similarly, there are good grounds to doubt the effects of the policies aimed at inducing higher labour market flexibility (e.g. through further cuts in unemployment benefits, or further relaxation of the provisions of the Labour Code).

The positive foreign trade developments are likely to continue in 2004, provided the zloty does not strengthen too much. At this moment the chances are fairly good that the zloty will stay rather weak. As inflation is low – though likely to rise moderately in 2004-2005 – the NBP will probably be reluctant to raise interest rates significantly. (Overall, the new Monetary Policy Council, which will be deciding the interest rate levels from March 2004, is going to be dominated by 'doves' – in contrast to the outgoing one, which proved fairly 'hawkish'). Despite this a strengthening of the zloty cannot be ruled out. In the closing months of 2003 prices of government debt fell significantly (not without active involvement of the London-based financial institutions). Higher yields on the government debt may induce higher capital inflows and possibly reverse the PLN/EUR trend. Besides, it is hard to assess the prospects of further export expansion. On the foreign demand side, one does not really know yet what kind of recovery will take place in the EU, and how this will relate to the sales of the specific products dominating Poland's export offer. On the supply side, little is known about the levels of capacity utilization in the export-oriented firms and branches. After a protracted (and strong) decline in gross fixed capital formation in recent years, the current export acceleration may sooner or later be braked by e.g. production bottlenecks.

Fixed assets investment is likely to be decisive for growth in 2004. By the end of 2003 the decline of investments seems to have stopped. It is natural to expect investment to start rising in 2004: rising profits (and profitability), relatively low interest rates, improved stance of the banking sector, all seem conducive to rising investment. But it is too early to assess the actual size of investment growth in the coming quarters. Investors, both domestic and foreign, may wish to learn more about the conditions likely to take shape after Poland's accession to the EU on 1st May 2004. It would be quite rational for them to adopt a wait-and-see approach and thus delay investment decisions until at least some uncertainties are dispelled.

The upcoming EU accession is fraught with some other uncertainties as well. For example, Poland is not yet ready, institutionally, to receive funds from the EU to which it is theoretically entitled already in 2004. It is therefore quite possible that the funds disbursed in 2004 will be smaller than planned. Other impacts of the accession, likely to materialize in 2004, include some additional inflation (due e.g. to higher costs of adopting some EU standards, regulations and indirect tax rates) and possibly some negative supply responses (e.g. over the closures of some production facilities – primarily in food processing – not meeting the EU standards). Mutual trade with the 'old' EU is unlikely to be much affected by the accession itself. But, some negative effects will follow from the adoption of the common external EU tariffs (which for many items, such as textiles, are lower than the current national ones). Also, the 'suitcase foreign trade' with Ukraine and Belarus (right now generating huge surpluses) may be reduced. Revenues of the central government will be diminished as the customs collected will no longer be appropriated nationally. In addition, one should expect higher administrative costs of managing the everyday communication with the EU authorities. It is also far from clear what size of labour migration to expect – especially as the EU countries are currently reconsidering their earlier decisions on opening their labour markets to workers from the acceding countries. Last, but not least, it remains to be seen what fiscal adjustments will be requested from the Polish government by the EU Commission.

All in all, the year 2004 is going to be quite turbulent for Poland. Only when the dust caused by accession settles down, a more reliable evaluation of the prospects for 2005 and beyond will be possible.

Table PL

Poland: Selected Economic Indicators

	1997	1998	1999	2000	2001	2002	2003 1)	2004	2005
								forecast	
Population, th pers., end of period 2)	38660	38667	38654	38644	38632	38215	38197 XI	.	.
Gross domestic product, PLN mn, nom. 3)	472350	553560	615115	684982	750786	771113	804700	850000	910000
annual change in % (real)	6.8	4.8	4.1	4.0	1.0	1.4	3.7	4	4
GDP/capita (EUR at exchange rate)	3298	3649	3765	4419	5296	5231	4790	.	.
GDP/capita (EUR at PPP - WIIW)	7410	7890	8410	8960	9550	9920	10230	.	.
Gross industrial production (sales)									
annual change in % (real)	11.5	3.5	3.6	6.7	0.6	1.4	6	7	7
Gross agricultural production									
annual change in % (real)	-0.2	5.9	-5.2	-5.6	5.8	-1.8	.	.	.
Goods transport, mn t-kms	329737	317052	310698	282559	253269	248685	.	.	.
annual change in %	6.6	-3.8	-2.0	-9.1	-10.4	-1.8	.	.	.
Gross fixed capital form., PLN mn, nom.	110853	139205	156690	170430	157209	148338	.	.	.
annual change in % (real)	21.7	14.2	6.8	2.7	-8.8	-5.8	-0.9	5	6
Construction output total									
annual change in % (real)	16.5	12.4	6.2	1.0	-6.4	-0.9	-5.9 4)	.	
Dwellings completed, units	73706	80594	81979	87789	105967	97595	163578	.	.
annual change in %	18.6	9.3	1.7	7.1	20.7	-7.9	67.6	.	.
Employment total, th pers., average	15438.7	15800.4	15373.5	15017.5	14923.6	14784.2	14468.6	.	.
annual change in %	2.8	2.3	-2.7	-2.3	-0.6	-0.9	-2.1	.	.
Employees in industry, th pers., average	3433.4	3378.7	3138.4	2955.0	2820.6	2735.9	2409.0 4)	.	.
annual change in %	-0.1	-1.6	-7.1	-5.8	-4.5	-3.0	-2.9 4)	.	.
Reg. unemployed, th pers, end of period	1826.4	1831.4	2349.8	2702.6	3115.1	3217.0	3175.7	.	.
Reg. unemployment rate in %, end of period	10.3	10.4	13.1	15.1	17.5	18.1	18.0	17	17
LFS - unemployment rate in %, average	11.2	10.6	13.9	16.1	18.2	19.9	20.0	20	19
Average gross monthly wages, PLN 5)	1065.8	1232.7	1697.1	1893.7	2045.1	2133.2	2341.5 4)	.	.
annual change in % (real, net) 6)	7.3	4.5	4.7	1.0	2.5	0.7	2.0 4)	.	.
Retail trade turnover, PLN mn	258166	291197	323687	360318	375438	385287	.	.	.
annual change in % (real)	6.8	2.6	4.0	1.0	0.2	1.8	6.8 4)	.	.
Consumer prices, % p.a.	14.9	11.8	7.3	10.1	5.5	1.9	0.8	2	3
Producer prices in industry, % p.a.	12.2	7.3	5.7	7.8	1.6	1.0	2.6	3	3
Central government budget, PLN mn									
Revenues	119772	126560	125922	135664	140527	143520	152176	.	.
Expenditures	125675	139752	138401	151055	172885	182922	189165	.	.
Deficit (-) / surplus (+)	-5903	-13192	-12479	-15391	-32358	-39403	-36989	.	.
Deficit (-) / surplus (+), % GDP	-1.2	-2.4	-2.0	-2.2	-4.3	-5.1	-4.6	.	.
Money supply, PLN mn, end of period									
M1, Money	79240	89920	111384	106456	118297	136611	158065	.	.
M2, Money + quasi money	179378	223678	268701	300424	328198	320183	337814	.	.
Discount rate of NB % p.a., end of period	24.5	18.2	19.0	21.5	14.0	7.5	5.8	.	.
Current account, EUR mn	-3769	-5946	-10926	-10672	-7992	-7188	-3514	-4800	-6000
Current account in % of GDP	-3.0	-4.2	-7.5	-6.2	-3.9	-3.6	-1.9	-2.5	-3.0
Gross reserves of NB incl. gold, EUR mn	19376	24209	27179	29524	30067	28450	26942	.	.
Gross external debt, EUR mn	44945	50632	65043	74672	81380	80502	79936 Sep	.	.
Exports total, fob, EUR mn 7)	22798.4	25145.4	25729.3	34382.6	40374.7	43400.2	46400	49200	52200
annual growth rate in %	17.0	10.3	2.3	33.6	17.4	7.5	7	6	6
Imports total, cif, EUR mn 7)	37484.2	41539.3	43151.2	53121.9	56222.7	58307.4	59500	61300	65500
annual growth rate in %	26.3	10.8	3.9	23.1	5.8	3.7	2	3	7
Average exchange rate PLN/USD	3.28	3.49	3.97	4.35	4.09	4.08	3.89	.	.
Average exchange rate PLN/EUR (ECU)	3.71	3.92	4.23	4.01	3.67	3.86	4.40	4.5	4.6
Purchasing power parity PLN/USD, WIIW	1.48	1.63	1.73	1.84	1.88	1.88	1.87	.	.
Purchasing power parity PLN/EUR, WIIW	1.65	1.81	1.89	1.98	2.04	2.04	2.06	.	.

Notes: 1) Preliminary. - 2) 2002 according to census May 2002. - 3) From 2001 new methodology. - 4) Enterprises with more than 9 employees. - 5) From 1999 including mandatory premium for social security. - 6) From 1999 real gross wages. - 7) Converted from the national currency to EUR at the official exchange rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.