

POLAND

11

UNCHANGED POTENTIAL GROWTH

Covid-19 was only a temporary brake on Polish growth. The economy is outperforming its neighbours', with a shallower recession in 2020 and an earlier recovery. Credit risk appears to be under relatively good control, despite high levels of participation for the loan repayment moratorium scheme. Supply side constraints are even raising fears of a temporary overheating of the economy, with an increase in inflation. However, a strong current account surplus and the good control of government debt are stabilising factors. Poland's economic growth potential remains unchanged, even though the prospect of international tax harmonisation may slow down foreign investment.

IS THE ECONOMY ALREADY OVERHEATING?

The Polish economy is remarkably dynamic. Real GDP contraction in 2020 was one of the smallest in central Europe, and expected growth in 2021 and 2022 is faster than it was before Covid-19 struck. The manufacturing PMI hit fresh record levels and manufacturing production (more than 30% of GDP) has consistently been above its pre-Covid levels since October 2020.

Household consumption has proved particularly resilient, with retail sales returning to pre-crisis levels in the final quarter of 2020. A fresh wave of infections and the tightening of restrictions in March and April did result in a loss of activity. However, retail sales bounced back in May.

The Polish economy's solid performance is primarily the result of the strength of exports. The rapid acceleration in the final quarter of 2020 has continued into the beginning of 2021: exports are not only much higher than in 2020, but are also above their (pre-Covid) level of 2019. Poland is enjoying the full benefits of a powerful wave of investment in recent years (notably from FDI), which has expanded the country's export capacity.

The strength of exports has kept the current account in surplus (3.8% of GDP in 2021) despite the upturn in domestic demand. As a result, forex reserves are now at the comfortable level of nearly 6 months' imports.

The only negative point has been the marked acceleration in inflation. In May, the year-on-year increases in production prices and consumer prices hit 6.5% and 4.8% respectively, from 0.1% and 2.3% respectively in December 2020. This inflationary pressure has come in part from higher oil prices. On top of this, however, there has also been a significant rebound in capacity utilisation rates, a shortage of some inputs (labour, semiconductors, plastics, metals) and logistics issues. Corporates are facing pressure on their margins, as increases in their production costs are outpacing those in their selling prices.

In parallel, financing costs are set to rise. Inflationary pressures have also fed through into interest rates: yields on 10-year government bonds were 1.65% on 2 July, up from a low point of 1.15% at the end of January (although the July figure is still lower than the yield faced before the Covid crisis). For the time being, the Monetary Policy Committee remains divided on the opportunity to increase policy rates, with some members of the view that this rise in inflation will be transitory. However, the markets appear to be expecting a rise.

PUBLIC FINANCE: A TEMPORARY BLIP

Government debt increased by nearly 12 points of GDP in 2020, because of both the increase in the government deficit and the financing provided by public agencies.

FORECASTS

	2019	2020	2021e	2022e
Real GDP growth (%)	4.7	-2.7	5.3	5.4
Inflation (CPI, year average, %)	2.1	3.4	4.5	4.1
Gen. Gov. balance / GDP (%)	-0.7	-7.0	-4.0	-2.5
Gen. Gov. debt / GDP (%)	45.6	57.5	57.0	55.0
Current account balance / GDP (%)	0.5	3.5	3.8	3.7
External debt / GDP (%)	59.3	61.9	56.6	50.0
Forex reserves (EUR bn)	114.5	125.6	140.0	150.0
Forex reserves, in months of imports	5.1	5.9	5.9	5.7

e: ESTIMATES & FORECASTS

TABLE 1

SOURCE: BNP PARIBAS GROUP ECONOMIC RESEARCH

MANUFACTURING PMI

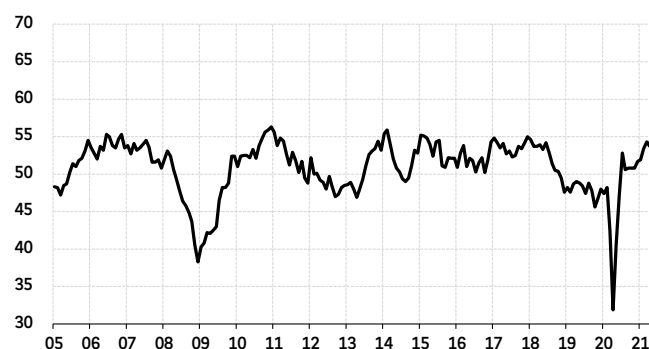


CHART 1

SOURCE: DATASTREAM

However, as the economy reopened, and with production capacity nearly fully used, the need for fiscal support has eased. It is now limited to those sectors most affected by social distancing measures. The fiscal cost of support measures should be limited to 1.7% of GDP in 2021, from nearly 4.5% of GDP in 2020.

Many measures were also financed by the country's development fund and the public development bank, BGK. These did not affect the budget balance but did contribute to the rise in government debt.

The financing of the deficit and extra-budgetary support measures was significantly helped by the purchasing of government (and government-

guaranteed) securities by the central bank. The bank now holds nearly PLN 143 bn (6.2% of GDP) of public debt on its balance sheet, equivalent to nearly half of the public debt issued since the onset of the pandemic.

Poland is likely to be one of the main beneficiaries of European recovery efforts. The country could receive nearly EUR 15 billion per year in subsidies over the first two years of the European Union's new multi-year budget (2021-2027), with loans on top of this if Poland uses this option. The time needed for negotiations before the implementation of the European recovery plan (coming on top of structural funds) is likely to delay the effective payment. A slight delay in payment will delay support to growth. Thus, the effect is likely to be stronger in 2022 than in 2021, providing a new driver to growth, as the current cyclical momentum will probably have been running out of steam by next year.

CREDIT RISK RELATIVELY WELL MANAGED

The authorities introduced a moratorium on repayments of loans to households and corporates, running initially until September 2020, and then limited just to corporates (and significantly less widely used) in the first half of 2021.

At the end of March 2021, 0.8% of loans were still covered by a running moratorium. However, 13.5% of loans (in value) had also benefited from a moratorium that has now expired. The non-performing loan rate on these was 4.6%, more or less in line with the European average. This figure is slightly higher than the 3.7% ratio for all loans, which had been stable for a year, even though lending by Polish banks to the private non-financial sector had not increased (meaning that non-performing loans have not been diluted).

Provisioning for loans covered by a moratorium hit banks' profitability. Their return on equity fell from 7.9% at end-2019 to 3.6% at end-2020. The Swiss franc mortgage issue has also required more provisioning: a ruling by the European Court of Justice has opened the way for loans to be cancelled and resulted in a growing number of claims in the Polish courts. Although the Supreme Court has yet to rule on the case, local banks began to write provisions at around 30% of their net income in 2020.

Against this background, the Polish banking system remains well capitalised, with an increase in its capital adequacy ratio to 17.8% by end-2020. The sector's exposure to real estate business (20% of total loans to the corporate sector) generated a limited non-performing loan rate of 3.2%.

ECONOMIC GROWTH PROSPECTS ARE UNAFFECTED

As has been the case everywhere, the Covid-19 pandemic brought productivity gains to a sudden stop (because of periods of under-activity linked to – admittedly sporadic – lockdown restrictions). But nothing suggests that the economy's growth potential has been lastingly damaged. Unemployment is now falling (6.1% in May, from 6.5% at its peak in February) although there is still unused capacity in the labour market. Moreover, Poland has continued to benefit, throughout 2020 and into the early months of 2021, from strong foreign direct investment, a source of both expansion in production capacity and productivity gains.

FDI INFLOWS (EUR BN, 12-MONTHS SUM)



CHART 2

SOURCE: CEIC

The tax level, which is a pulling factor in Poland's attractiveness, may eventually vanish: the 2018 introduction of special economic areas has resulted in tax rates well below the 15% minimum rate now being discussed at an international level. The country has used this tax approach to attract new investors in the automotive industry and in business services mainly. This attractiveness remained strong throughout the pandemic. Similarly, Poland has one of the lowest tax rates on digital services (1.5%) amongst European nations, but such taxes are likely to be harmonised across the EU by 2023.

Completed on 5 July 2021

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