Poland

Loss of momentum

In the first half of 2019, Poland's economic growth held up well to the deterioration of international conditions. Its economic prospects remain relatively positive in the short term despite the downturn in the cycle. The economic model of competitiveness and low labour costs – the foundation of the economic transition of which Poland is a successful example – will be altered by the more generous social policies introduced by the current government. Cyclical and structural factors argue for a slowdown in investment growth over the short and medium term. Of the factors weighing on medium and long-term growth potential, the demographic decline seems the most potent.

A controlled slowdown

We have upgraded our growth forecast for 2019 from 4% to 4.3% and downgraded our 2020 forecast from 3.5% to 3.3%. Despite pressure on international trade, slowing growth in the euro zone and the contraction of Germany's GDP in Q2 2019, Polish economic activity again surprised positively over the first part of the year. First half GDP growth was a vigorous 4.4% year-on-year (y/y). Although this was slower than the 5% seen in 2017 and 2018, it was nevertheless stronger than the five-year average of 4%. The quarterly variation shows a steeper slowing (from 1.4% q/q adjusted for seasonal variations and working days in Q1, to 0.8% in Q2), and this will continue. International conditions suggest that exports, production and private investment will all lose speed over the next few quarters and ultimately feeding through into consumption, the main engine of growth.

Having disappointed in Q1, household consumption (61% of GDP) bounced back in Q2 (1.2% q/q adjusted and 4% y/y). Labour market tensions, symbolised by the historically low unemployment rate (3.3% in August according to harmonised Eurostat statistics), have maintained strong upward pressure on nominal wages (7% y/y in H1). Retail sales remained on a positive trend in August, as did consumer confidence in September. Domestic demand was also boosted by an expansionist policy mix, made possible by a degree of room for manoeuvre on the budget. Having won legislative elections, the conservative PiS Party, which has been in power since 2015, has promised increases in the minimum wage of 78% by 2023.

Total investment rose by 10.6% y/y in H1, under the continued influences of business investment and public infrastructure investment. The capacity utilisation rate has held at an historically high level of above 80% for more than a year. Exports of goods and services remained strong in year-on-year terms (up 4.9% in H1 by volume and 8.5% by value over the first seven months of the year), contributing to the robust performance of external accounts despite strong growth in imports.

However, exports slowed on a quarterly basis over the first half (down 0.4% q/q wdsa in Q1, and up 1% in Q2), whilst industrial production, notably in manufacturing, stood still in August (down 1.3% y/y in August, giving a three-month moving average of 0.6% y/y). This slowdown can be seen in the latest confidence surveys of companies in the manufacturing sector (September), which were more pessimistic about the overall economic position, the domestic & export order books, production and employment. The Manufacturing PMI supports this view of deteriorating prospects in the short term.

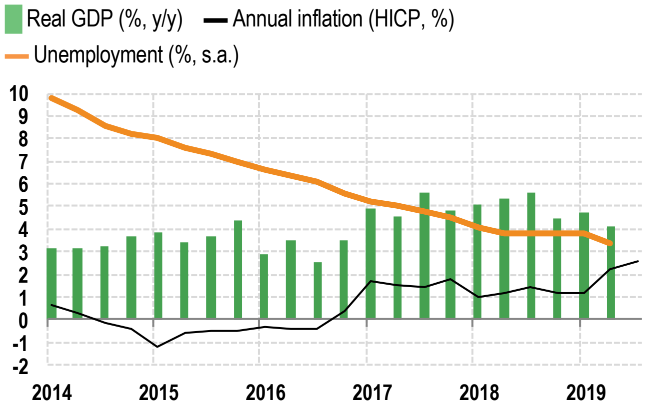
The risk of an economic slowdown in the second half led the National Bank of Poland to hold interest rates steady at the beginning of October (at 1.5%, unchanged since 2015). The NBP reiterated the transitory nature of inflation above the 2.5% target, which has been due mainly to an increase in food prices. Core inflation hit 2.4% in September whilst headline CPI inflation dropped from 2.9% y/y in August to 2.6% in September.

1- Forecasts

	2017	2018	2019e	2020e
Real GDP growth (%)	4.6	5.2	4.3	3.3
Inflation (CPI, year average, %)	2.0	1.7	2.3	3.2
Gen. Gov. balance / GDP (%)	-1.5	-0.4	-1.5	-1.4
Gen. Gov. debt / GDP (%)	50.6	48.9	47.4	46.0
Current account balance / GDP (%)	0.2	-0.6	-0.5	-2.0
External debt / GDP (%)	72.2	61.3	58.5	57.0
Forex reserves (EUR bn)	94.5	102.3	103.8	105.2
Forex reserves, in months of imports	4.8	4.8	4.5	4.3
Exchange rate EURPLN (year end)	4.2	4.3	4.3	4.3

e: BNP Paribas Group Economic Research estimates and forecasts

2- Growth, inflation and unemployment



Source: GUS, Eurostat

A review of a successful economic transition

Since the beginning of the 1990s, Poland has conducted a policy of economic liberalisation, which, combined with institutional reforms and political stability, has generated uninterrupted economic growth since 1992, at an average annual rate of 4.2%. According to the World Bank's classification, Poland is an example of a successful transition from a low- to medium-income planned economy (USD6,600 per capita in purchasing power parity terms in 1992) to a market economy highly integrated within the European Union (EU) and global value chains and, since 2009, classified as high-income (USD32,000 per capita since 2018).

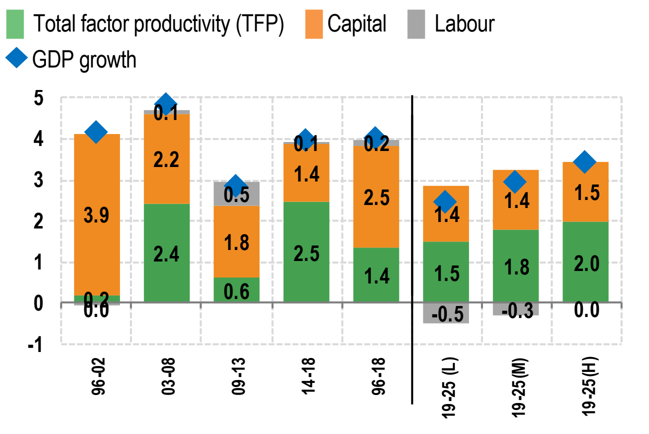
Under the classical approach of breaking down growth into factors of production (capital and labour) and changes in total factor productivity (TFP), our estimates indicate that the accumulation of capital contributed 61% of GDP growth between 1996 and 2018. Efficiency gains, measured by the contribution to growth of TFP, contributed 34% to growth, the remainder coming from an increase in the labour factor. To borrow Paul Krugman's phrase, the "perspiration" behind growth, that is the contribution of factors of production, came almost exclusively from the accumulation of physical capital. Meanwhile, the "inspiration" came both from technical progress, and improvements in the institutional framework, business environment and human capital.

According to Marc Schiffbauer and Gonzalo Varela ("Macro and micro features of successful economic convergence: the case of Poland", World Bank, January 2019), "the progressive integration into the EU bloc boosted growth and productivity because of three key factors: (i) increased openness to trade, investment and talent, (ii) increased domestic competition and regulatory harmonisation with the EU and (iii) increased certainty in reforms, through a commitment to EU institutions." Alongside private domestic and foreign investment, public investment benefited from European co-financing, particularly in infrastructure projects, as Poland has been the leading recipient of European structural funds.

At the same time, demographic decline has limited growth in the active population and employment: the fertility rate has fallen (1.4 children per woman in 2018, from 2 in 1990), the migratory balance is structurally negative, the natural balance (births less deaths) has been negative since 2013, the population is ageing (17% were aged over 65 in 2018, from 9% in 1990) and the activity rate is below the European average (70%, compared to 74% in the EU in 2018 according to Eurostat), particularly amongst women.

In the absence of any increase in the quantity of labour, its quality has improved through better standards of education and skills in the labour force that has accompanied the increasing sophistication of production and exports. The share of the active population (aged 15 to 64) educated to degree level or above rose from 10% in 1997 to 27% in 2018 (Eurostat figures), bringing it close to the EU average of 29%.

3- Contributions to GDP growth and potential GDP growth



Source: AMECO, World Bank, BNP Paribas calculations

Impediments to potential growth

Some structural factors will hold back potential growth over the medium to long term (see Eco Emerging, "Poland: Trees don't grow to the sky", April 2019). With a central scenario (M) estimating potential growth of 2.9% through to 2025, we have a low-range estimate (L) of 2.4% and a high-range figure (H) of 3.4%.

The main differentiating factor between these three scenarios is the demographic constraint. Demographic projections established by the Polish Office of Statistics, Eurostat, the United Nations and the US Census Bureau agree on an acceleration of the decline in the Polish population that began in 2014 over the next few decades (-0.3% per year between now and 2030). Despite family policy measures (family benefits, childcare, etc.) and scope for increases in the activity rate (notably amongst women), only massive immigration can offset the demographic decline and avoid a negative contribution from the labour factor to economic growth by 2025.

Moreover, there are cyclical and structural factors that argue for a slowing of investment and thus the accumulation of the capital factor over the short and medium term. The rates of growth in investment seen over the past two years are not sustainable at the same level, given the expected downturn in the private investment cycle in machinery & equipment and construction and the expected reduction in disbursements from European structural funds for 2021-27 (public investment).

Lastly, the quality of the business environment, the improvement in human capital and the quest for productivity gains through innovation and the shift up-market of Polish products will be essential to underpin economic growth in Poland over the medium and long term.

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