Euler Hermes Economic Research

Country Report

Poland

Domestic demand continues to drive growth

General Information

GDP	USD525.9 bn (World ranking 23, World Bank 2013)
Population	38.53 mn (World ranking 34, World Bank 2013)
Form of state	Republic
Head of government	Prime Minister Ewa KOPACZ
Next elections	2015, presidential and legislative

Strengths

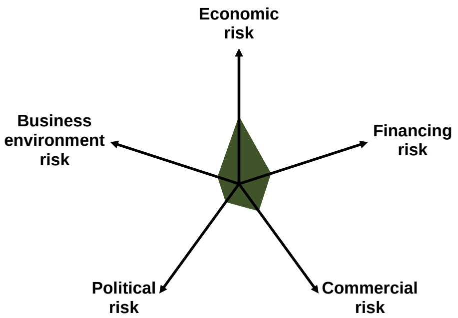
- Low systemic political risk
- Good regional and international relations; EU membership
- Diversified sectoral external trade structure
- Solid monetary policy
- Resilient banking sector
- Access to the IMF's Flexible Credit Line
- Strong business environment overall

Weaknesses

- Slow structural reform progress
- Public finances
- Non-diversified regional external trade structure
- High external debt burden

Country Rating

BB1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		2014 Rank		Imports
Germany	26%	1	22%	Germany
United Kingdom	6%	2	11%	China
Czech Republic	6%	3	11%	Russia
France	6%	4	5%	Italy
Italy	5%	5	4%	Netherlands

By product (% of total)

Exports		2012 Rank		Imports
Vehicles Components	5%	1	9%	Crude Oil
Engines	5%	2	5%	Plastic Articles
Furniture	5%	3	4%	Miscellaneous Hardware
Miscellaneous Hardware	5%	4	4%	Telecommunication Equipment
Electrical Apparatus	4%	5	4%	Electrical Apparatus

Source: Central Statistical Office, Chelem

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GDP growth to remain robust in 2015 after rebound in 2014

Real GDP growth accelerated to +3.3% in 2014 from +1.7% in 2013. Details show a strong shift from external demand-driven expansion in 2012-2013 to domestic demand-led growth in 2014. Private consumption grew by +3.1% in 2014, up from +1.1% in 2013, and public consumption by +2.8% (+2.1% in 2013). Fixed investment surged by +9.5% (+0.9% in 2013) and an increase in inventories contributed +0.4pps to 2014 growth. Net exports made a negative contribution of -1.3pps to 2014 growth (+1.5pps in 2013), because strengthening domestic demand led to accelerating import expansion (+8.7%, up from 1.8% in 2013), while export growth also picked up to +5.6% though less vigorously (+5% in 2013). Euler Hermes expects the growth momentum to continue and forecasts full-year growth of +3% in 2015 as domestic demand should remain robust while the impact of the Russia crisis, though moderate, continues to weigh somewhat on exports (4.3% of Polish exports went to Russia in 2014). GDP growth in 2016 is forecast at about +3.2%.

Further monetary policy easing likely as deflation persists

The monetary policy framework is based on inflation targeting. Since the beginning of 2004, the National Bank of Poland (NBP; the central bank) has pursued a continuous inflation target of 2.5%±1pp. Since February 2013, however, consumer price inflation has been below the target range and has been in deflation territory since July 2014, reaching a record low -1.3% y/y in January 2015. Current deflation is mostly due to sharply lower oil/energy prices, but food costs and clothing prices have also fallen recently. The NBP has lowered its key policy interest rate twice since mid-2013, by 50bps each in October 2014 and March 2015, to 1.5%. A further rate cut is possible in the near term as deflation is expected to continue in H1, before giving way to moderate inflation in H2 and 2016. Private sector credit growth has steadily picked up from 4.5% y/y at end-2013 to 7.7% y/y in November 2014.

Improved exchange rate stability and banking sector resilience

The exchange rate volatility of the floating PLN has declined. After depreciating by -1.4% against the EUR during 2013, the PLN fell by -2.8% in 2014 but has regained all of the latter in the first two months of 2015. EH does not expect drastic EUR:PLN exchange rate movements in 2015.

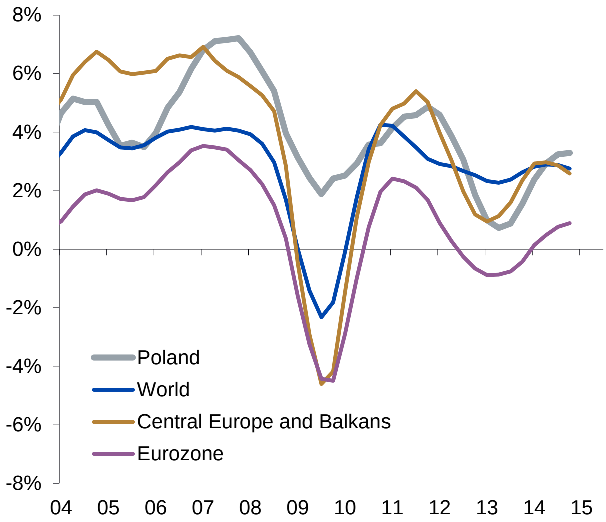
The impact of the removal of the EUR:CHF exchange rate floor on 15 January 2015 on Poland is estimated to be limited. While the CHF:PLN rate dropped by around -20% in the first week after 15 January, it has recovered and was down by just -8% as of early March. As CHF-denominated loans of household (EUR31.3 bn) and NFCs (EUR3.5 bn) account for about 16.4% of total loans or 7% of GDP, some of which is now more vulnerable to becoming NPLs, Polish banks may see increased losses. However, we do not see a systemic risk arising for the banking system. Capital adequacy and liquidity indicators are sound overall. Moreover, Poland has just extended its arrangement under the IMF's Flexible Credit Line (FCL) for two years until January 2017, which offers access to about USD23 bn if needed. The precautionary arrangement provides important insurance against external risks.

Key economic forecasts

	2013	2014	2015f	2016f
GDP growth (% change)	1.7	3.3	3.0	3.2
Inflation (%, end-year)	0.7	-1.0	1.0	2.0
Fiscal balance (% of GDP)	-4.0	-3.4	-2.9	-2.8
Public debt (% of GDP)	55.7	49.1	50.2	50.1
Current account (% of GDP)	-1.3	-1.3	-1.8	-2.2
External debt (% of GDP)	69.2	72.7	71.5	70.0

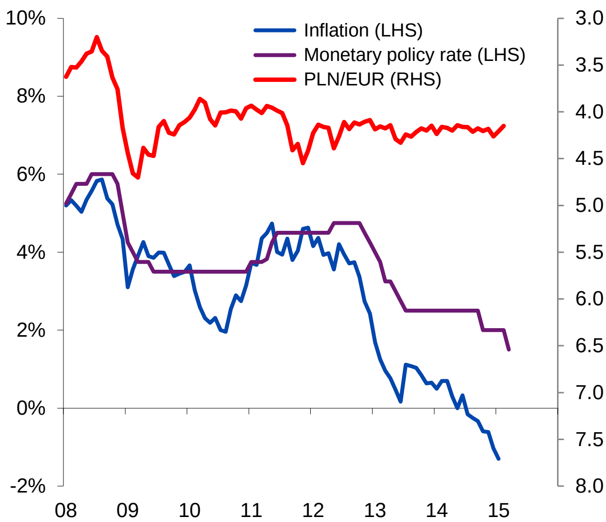
Sources: National sources, IHS, Euler Hermes

GDP growth (% y/y, 4 qtrs cumulated)



Sources: National sources, IHS, Euler Hermes

Monetary policy interest rate (%), inflation rate (y/y, %), and exchange rate



Sources: National sources, IHS, Euler Hermes

Fiscal consolidation thanks to a trick

Public debt was approaching the constitutional limit of 55% of GDP in 2013 (by domestic accounting standards, i.e. excluding the obligations of the National Road Fund), the breaching of which would force automatic spending cuts. In order to avoid such, the government overhauled the pension system (a large part of the funded private pension pillar was transferred to the public pension pillar). This has reduced public debt by around 8% of GDP as well as annual public debt-servicing costs by about 0.5% of GDP from 2014. As a result, Poland should be able to reduce its annual fiscal deficit to below -3% of GDP in 2015-2016, a target it had already set but missed in 2012-2014.

Current account deficit remains modest

The current account deficit declined from -3.5% in 2012 to just -1.3% in both 2013 and 2014. Euler Hermes forecasts the annual deficit to increase moderately to around -2% of GDP in 2015-2016. Net foreign direct investment inflows increased from +0.7% of GDP in 2013 to +1.5% of GDP in 2014.

External debt burden remains high

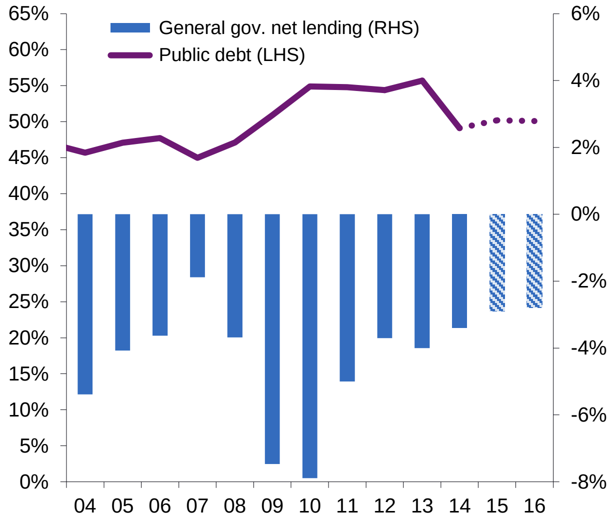
Total external debt has slightly increased in 2014 and stood at EUR292 bn at end-Q3 of the year. In relation to GDP it remained at a relatively high level of 73% of GDP (up from 46% in 2008). Short-term external debt accounts for about 12% of the total. The estimated annual external debt-service in 2015 is estimated at a heavy 33% of export earnings.

Foreign exchange reserves do not cover all short-term debt (on a remaining maturity basis)

After decreasing moderately from mid-2013 to mid-2014, foreign exchange reserves have risen again to an all-time high of EUR82 bn in January 2015. The current level of reserves is comfortable with regard to import cover (more than five months). In other terms, however, reserves cover just about 70% of the estimated external debt payments falling due in the next 12 months, which is well below an adequate level of at least 100%.

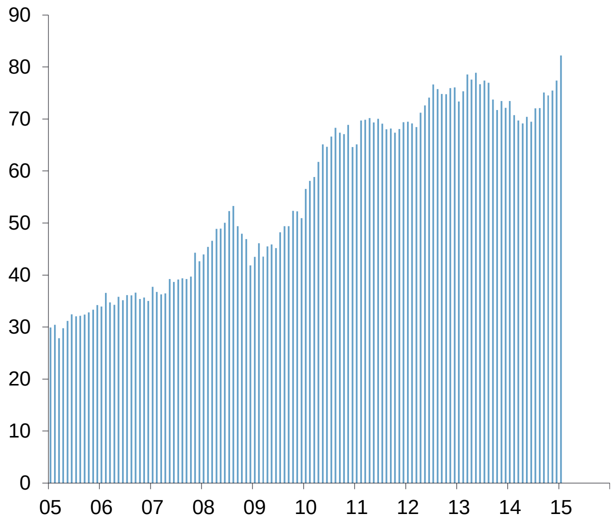
Nonetheless, external liquidity risk will remain low in the short term. Since May 2009, Poland has been granted access to successive arrangements under the IMF's FCL which was last renewed for two years in January 2015 (over roughly USD23 bn; see above). The FCL is being offered to strongly performing economies with a solid record of timely and effective economic policy adjustments. While the Polish authorities have never tapped the FCL, the precautionary arrangement helps to safeguard the economy against downside risks.

Public finances (% of GDP)



Sources: National sources, IHS, Euler Hermes

Foreign exchange reserves (EUR bn)



Sources: National sources, IHS, Euler Hermes

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