Euler Hermes Economic Research

Country Report

Poland

After slowing in 2016, growth should stabilize in 2017

General Information

GDP	USD475bn (World ranking 24, World Bank 2015)
Population	38mn (World ranking 36, World Bank 2015)
Form of state	Republic
Head of government	Beata SZYDLO (Prime Minister; PiS)
Next elections	2019, legislative

Strengths

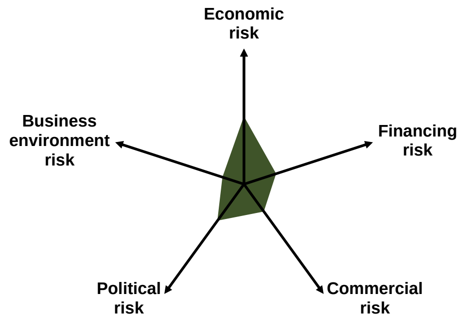
- EU membership
- Diversified sectoral external trade structure
- Solid monetary policy
- Banking sector resilient overall
- Access to the IMF's Flexible Credit Line
- Strong business environment overall

Weaknesses

- Political and policy uncertainties
- 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		Rank		Imports
Germany	25%	1	26%	Germany
Czech Republic	7%	2	10%	China
United Kingdom	6%	3	5%	Italy
France	5%	4	5%	Russia
Italy	5%	5	5%	Netherlands

By product (% of total)

Exports		Rank		Imports
Vehicles Components	6%	1	5%	Plastic Articles
Furniture	5%	2	5%	Telecommunications Equipment
Electrical Apparatus	5%	3	4%	Crude Oil
Engines	5%	4	4%	Miscellaneous Hardware
Miscellaneous Hardware	4%	5	4%	Electrical Apparatus

Source: Chelem (2015)

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Economic Overview

Solid GDP growth expected in 2017

Real GDP growth decelerated markedly to +2.8% in 2016 from +3.9% in 2015. Demand-side details show that growth was mainly driven by domestic uses (+2.7pp) while net exports made only a tiny positive contribution (+0.1pp). Consumer spending expanded by +3.6%, up from +3.2% in 2015, and public spending by +3.8% (+2.3% in 2015). Mean-while, fixed investment dropped by -5.5% in 2016, after it had increased by +6.1% in 2015, mainly due to the slow start of EU-funded projects under the new programming period and lower investment activity by SOEs. However, a strong rise in invento-ries (+1pp) reduced the decline in overall investment to -0.2% in 2016. Exports grew by +8.4% (+7.7% in 2015), slightly slower than imports at +8.7% (+6.6% in 2015). Euler Hermes expects a stabilization in 2017-2018 and forecasts full-year growth of around +3% as domestic consumption should remain robust while investment activity should gradually recover thanks to an increased utilization of EU funds.

Expansionary fiscal policy to watch

The PiS government that came into office in late 2015 has embarked on a controversial economic policy course that may reverse the fiscal consolidation course of its predecessor which had resulted in a decline of the annual fiscal deficit to -2.6% of GDP in 2015 and a reduction of public debt to around 51% of GDP. PiS also took a number of measures that have fundamentally weakened the independence and effectiveness of key state institutions, such as the constitutional court, public broadcasting, the civil service and the central bank. Moreover, PiS has announced lower taxes for SMEs (introduced at the start of 2017) and individuals and a number of expensive new social policies. However, the financing of these is uncertain. New taxes on banks and supermarkets imposed in 2016 will not be sufficient while, critically, they seem to be more focused on predominantly foreign-owned sectors, thereby risking a negative impact on FDI inflows in the future. In the short term, the fiscal loosening may indeed support consumption and growth. But in the medium term a negative impact on growth is possible because (i) more selective 'penalty' taxes may be imposed and (ii) investment may decline as investor confidence deteriorates.

Moreover, the fiscal deficit and public debt are likely to rise again – Euler Hermes expects -3% and 55% of GDP, respectively, in 2017. This is not critical as yet as Poland has fiscal buffers, including a new two-year arrangement under the IMF's Flexible Credit Line (FCL) which offers access to about EUR8bn until January 2019, if needed.

Return of inflation but monetary policy to remain loose in 2017

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 was in deflation territory from July 2014 to November 2016, mostly due to the large fall in oil/energy prices, but low food costs also contributed. The NBP lowered its key policy interest rate to 1.5% in March 2015 and has maintained that rate to date.

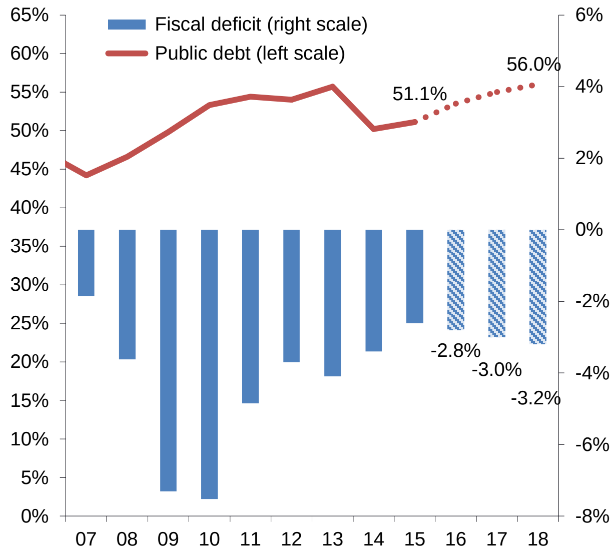
In December 2016, consumer prices finally swung back to positive inflation, increasing by +0.8% y/y, followed by +1.8% in January 2017. Euler Hermes expects inflation to remain close to +2% in 2017 as

Key economic forecasts

	2015	2016	2017f	2018f
GDP growth (% change)	3.9	2.8	2.9	3.0
Inflation (%, end-year)	-0.5	0.8	1.6	2.4
Fiscal balance (% of GDP)	-2.6	-2.5	-3.0	-3.2
Public debt (% of GDP)	51.1	53.8	55.0	56.0
Current account (% of GDP)	-0.6	-0.5	-1.0	-1.0
External debt (% of GDP)	69.5	75.4	75.0	74.0

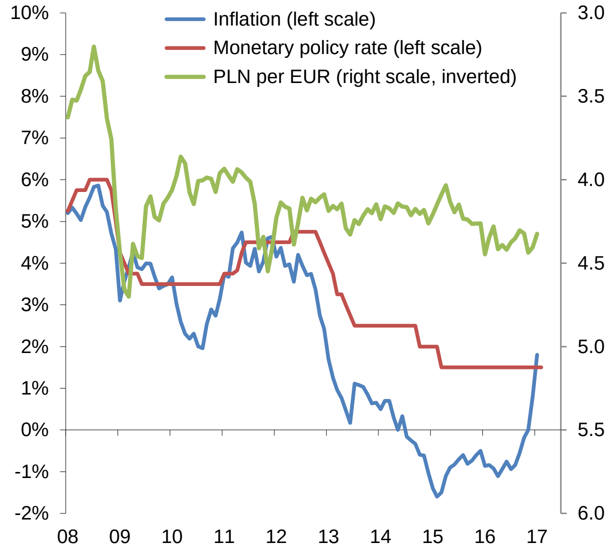
Sources: National sources, Eurostat, IHS, Euler Hermes

Public finances (% of GDP)



Sources: Eurostat, IHS, Euler Hermes

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



Sources: National sources, IHS, Euler Hermes a result of higher oil prices and some base effects, reaching an annual average of +1.7% or so. The NBP may raise its key policy interest rate slightly by a total of up to +50bp in the course of 2017.

Moderate exchange rate volatility

After stabilizing in 2012-2015, currency volatility increased again in 2016, with the PLN experiencing bouts of weakness in the wake of political events such as the start of the PiS government's implementation of its controversial policy measures in early 2016, Brexit in June, and the election of Donald Trump as U.S. President in November. The losses were mostly recovered after some time and overall the PLN depreciated by a modest -4% against the EUR in 2016. Euler Hermes expects continued moderate exchange rate vulnerability in 2017-2018.

Banks' profitability has fallen

In 2015, Polish banks overall coped fairly well with the -10% depreciation of the PLN against the CHF in the wake of the removal of the EUR:CHF exchange rate floor by the Swiss National Bank in January, even though CHF-denominated loans of household and NFCs accounted for about 16.4% of total loans or 7% of GDP. In February 2016, a new tax of 0.44% per year on financial institutions' assets provided a new challenge for banks.

These measures combined with low interest rates have markedly impaired banks' profitability. Moreover, private sector credit growth fell from 10% y/y in January 2015 to 3% y/y in November 2016, despite the low interest rates.

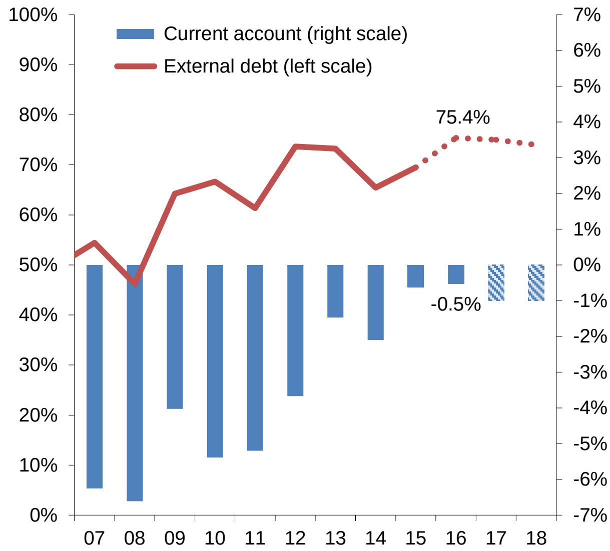
Government proposals to convert foreign exchange mortgages into PLN have been postponed, for now, but could undermine further banks' profitability and financial stability, if implemented. Smaller banks could be significantly weakened and are at risk of failure. However, Euler Hermes does not see a systemic risk arising for the banking system.

External liquidity risk to remain low

The current account deficit remained low at just -0.5% of GDP in 2016 and is forecast to remain moderate in 2017. External debt has slightly increased in 2016 and stood at EUR315bn at end-Q3, equivalent to a relatively high 75% of GDP (up from 46% in 2008).

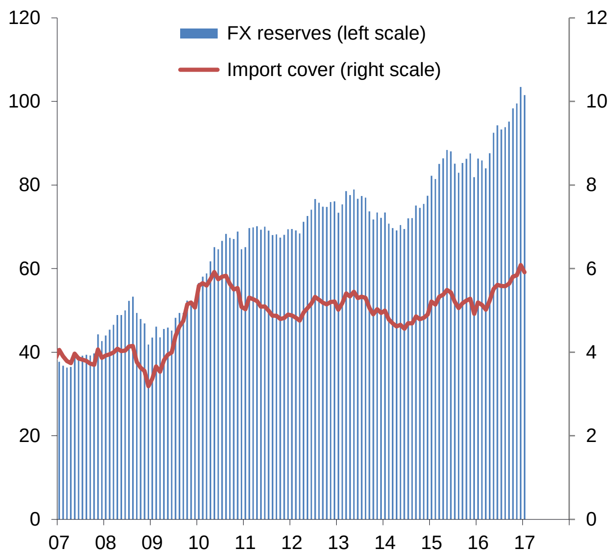
Foreign exchange reserves rose to EUR102bn in January 2017, a comfortable level with regard to import cover (six months). In other terms, however, reserves cover just about 70% of the estimated external debt payments falling due in the next 12 months, which is below an adequate level of at least 100%. Nonetheless, external liquidity risk will remain low in the short term as the IMF's FCL (see above) helps to safeguard the economy against downside risks.

Current account and external debt (% of GDP)



Sources: National sources, IHS, Euler Hermes

Foreign exchange reserves (EUR bn) and import cover (months)



Sources: National Bank of Poland, Euler Hermes

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