Euler Hermes Economic Research

Country Report

Poland

Robust growth at risk due to policy changes? Not yet

General Information

GDP	USD548bn (World ranking 23, World Bank 2014)
Population	38mn (World ranking 36, World Bank 2014)
Form of state	Republic
Head of government	Beata SZYDLO (Prime Minister; PiS)
Next elections	2019, legislative

Strengths

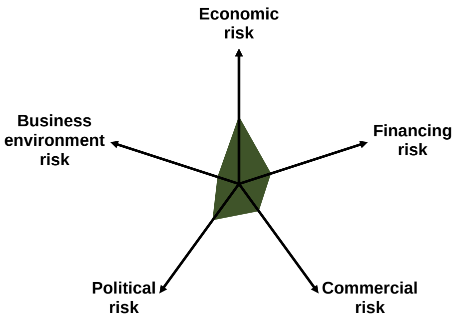
- EU membership
- Diversified sectoral external trade structure
- Solid monetary policy
- Banking sector resilient overall
- Access to the IMF's Flexible Credit Line
- Strong business environment overall

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		2015 Rank		Imports
Germany	27%	1	23%	Germany
United Kingdom	7%	2	12%	China
Czech Republic	7%	3	8%	Russia
France	6%	4	5%	Italy
Italy	5%	5	4%	Netherlands

By product (% of total)

Exports		2013 Rank		Imports
Vehicles Components	6%	1	7%	Crude Oil
Furniture	5%	2	5%	Plastic Articles
Engines	5%	3	5%	Telecommunication Equipment
Electrical Apparatus	5%	4	4%	Miscellaneous Hardware
Miscellaneous Hardware	5%	5	4%	Electrical Apparatus

Source: Central Statistical Office of Poland, Chelem

Economic Overview

GDP growth to remain robust in 2016

Real GDP growth picked up to +3.6% in 2015 from +3.3% in 2014. Demand-side details show that growth was mainly driven by domestic uses (+3.2pps) while net exports made only a small positive contribution (+0.4pps). Private consumption grew by +3.1%, up from +2.6% in 2014, government consumption by +3.5% (+4.9 in 2014) and fixed investment by +6.1% (+9.8% in 2014). However, a decrease in inventories (-0.4pps) reduced overall investment growth to +4.1% in 2015. Exports grew by +6.5% (+6.4 in 2014) slightly faster than imports at +6% (+10% in 2014). Euler Hermes expects the momentum will continue and forecasts full-year growth of around +3.5% in 2016 as domestic demand should remain robust, supported by continued low energy prices and some fiscal loosening, which should offset any negative impact from recent legislative measures in the short term. However, these measures may begin to affect the economic performance next year and we forecast a moderation of growth to +3.3% in 2017.

Fiscal consolidation at risk under new government

The previous government's policy course of gradual fiscal consolidation resulted in a decline of the annual fiscal deficit to just below -3% of GDP in 2015 and a reduction of public debt to around 51% of GDP. The new PiS government that came into office in late 2015 has announced a controversial economic policy course that may reverse the fiscal improvements in recent years. PiS has already taken 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 potentially the central bank. Moreover, PiS has announced lower taxes for individuals and SMEs and a number of expensive new social policies. However, the financing of these is uncertain. New taxes on banks, insurers and supermarkets 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. In the medium term (perhaps already in 2017), 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 -3.6% and 52.5% of GDP, respectively, in 2016. This is not critical as yet as Poland has fiscal buffers, including an arrangement under the IMF's Flexible Credit Line (FCL) which offers access to about EUR16bn until January 2017, if needed. Nonetheless, S&P downgraded Poland's long-term foreign currency sovereign rating to BBB+ from A- in January 2016, indicating some market concerns.

Monetary policy to remain loose as deflation persists

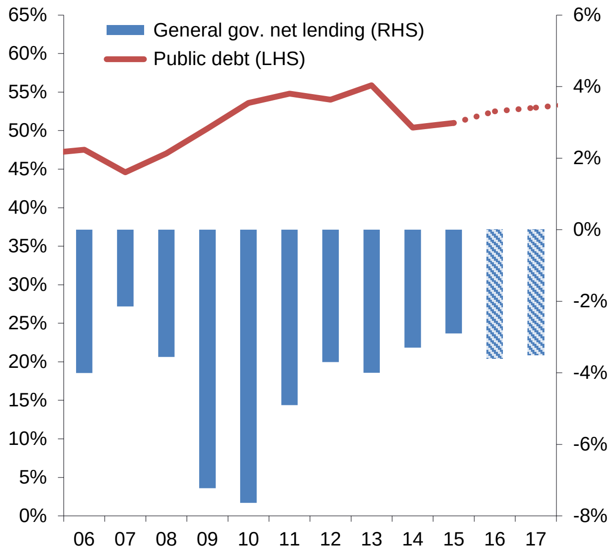
The monetary policy framework is based on inflation targeting. Since the beginning of 2004, the National Bank of Poland (NBP; the central bank) has pursued a continuous inflation target of 2.5%±1pp. Since February 2013, however, consumer price inflation has been below the target range and has been in deflation territory since July 2014, reaching a record low -1.6% y/y in February 2015. Current deflation (-0.8% y/y in February 2016) is mostly due to the continued fall in oil/energy prices, but low food costs

Key economic forecasts

	2014	2015	2016f	2017f
GDP growth (% change)	3.3	3.6	3.5	3.3
Inflation (%, end-year)	-1.0	-0.5	1.0	1.5
Fiscal balance (% of GDP)	-3.3	-2.9	-3.6	-3.5
Public debt (% of GDP)	50.4	51.0	52.5	53.0
Current account (% of GDP)	-2.0	-0.2	-1.5	-1.6
External debt (% of GDP)	71.4	71.5	74.0	75.0

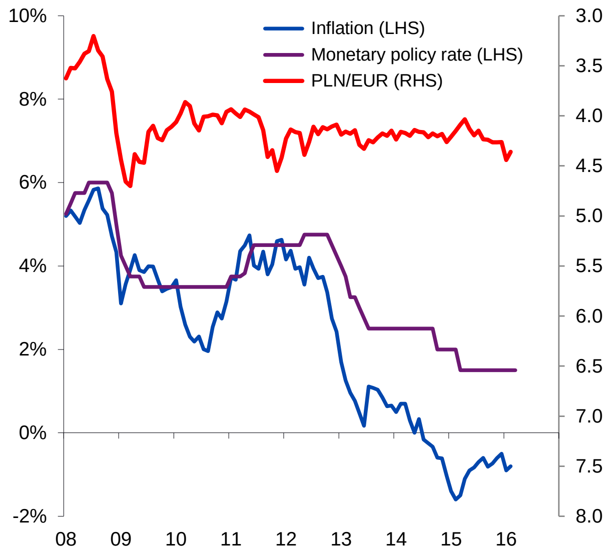
Sources: National sources, IHS, Euler Hermes

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 also contribute. 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 2017. Private sector credit growth has fallen somewhat from 10.2% y/y in January 2015 to 5.9% y/y in December 2015.

Exchange rate volatility has increased

The exchange rate volatility of the floating PLN against the EUR had much declined in 2012-2015. However, after the PiS government began to implement its controversial policy measures in early 2016, the currency volatility has increased strongly and the EUR:PLN fell to a temporary low of 1:4.50 in mid-January (down -5.5% from end-2015), before improving to an average 1:4.40 in February. Euler Hermes expects continued exchange rate vulnerability and bouts of weakness in 2016-2017.

New challenges for the banking sector

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. Average profitability of the banking system weakened somewhat but is still solid and capital adequacy and liquidity remained robust.

In 2016, new challenges are waiting:

(i) a new tax of 0.44% per year on financial institutions' assets, entered into force on 1 February;

(ii) a conversion of CHF mortgage loans into PLN loans, still under consideration by the authorities.

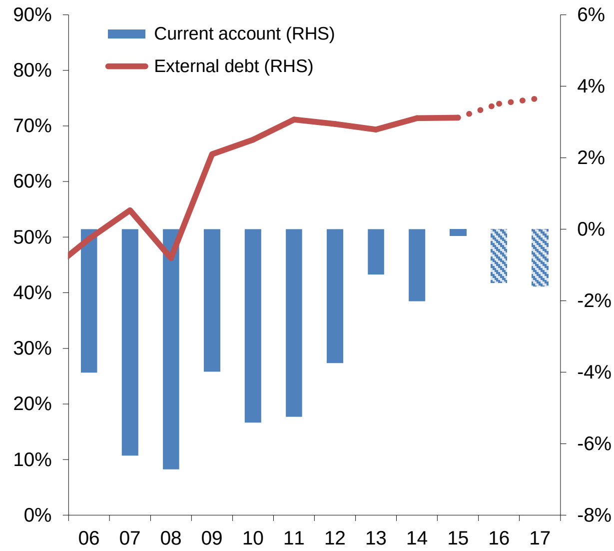
Euler Hermes does not see a systemic risk arising for the banking system. However, these measures will impair banks' profitability and most likely also credit growth. Smaller banks could be significantly weakened and are at risk of failure.

Low external liquidity risk

The current account deficit declined to just -0.2% of GDP in 2015 and is forecast to remain moderate in 2016. External debt has slightly increased in 2015 and stood at EUR306bn at end-Q3, equivalent to a relatively high 72% of GDP (up from 46% in 2008).

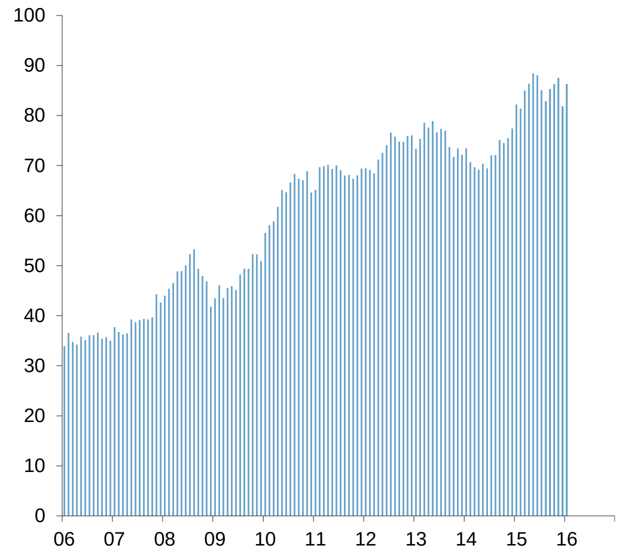
Foreign exchange reserves stood at EUR86bn in January 2016, a comfortable level with regard to import cover (five months). In other terms, however, reserves cover just about 85% of the estimated external debt payments falling due in the next 12 months, which is below an adequate level of at least 100%. 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)



Sources: National Bank of Poland, Euler Hermes

Contact Euler Hermes Economic Research Team

research@eulerhermes.com

Last review: 2016-03-16
Country Risk Analyst:
Manfred Stamer
manfred.stamer@eulerhermes.com