Euler Hermes Economic Research

Country Report

Poland

Domestic demand-driven rebound

General Information

GDP	USD489.8 billion (World ranking 24, World Bank 2012)
Population	38.54 million (World ranking 33, World Bank 2012)
Form of state	Republic
Head of government	Donald TUSK
Next elections	2015, presidential and legislative

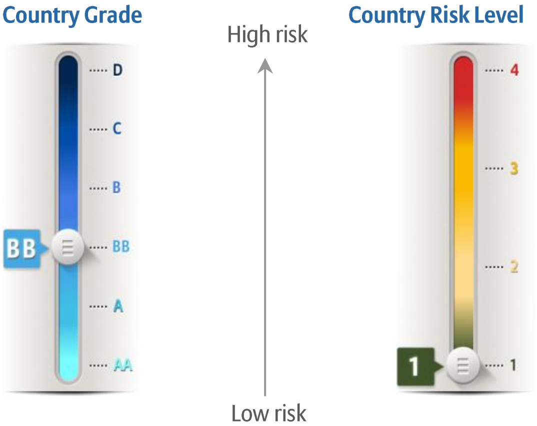
Strengths

- 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

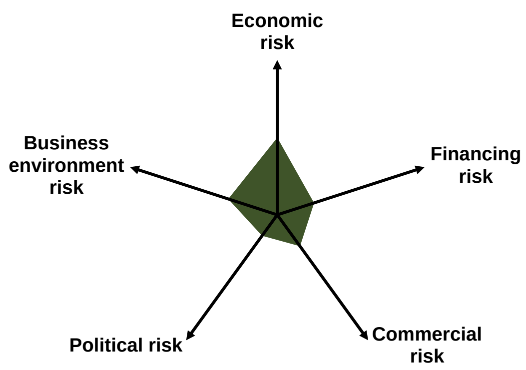
Weaknesses

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

Country Rating BB1

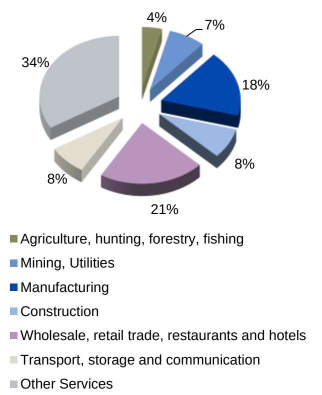


Risk Dimensions



Economic Structure

GDP breakdown (% of total, 2011)



Sources: UnctadStat, Euler Hermes

Trade structure (% of total, 2011)

By destination/origin

Exports		Rank		Imports
Germany	26%	1	27%	Germany
United Kingdom	6%	2	10%	Russia
Czech Republic	6%	3	6%	Netherlands
France	6%	4	6%	Italy
Italy	5%	5	5%	China

By product

Exports		Rank		Imports
Road vehicles	13%	1	11%	Petroleum, petroleum products and related materials
Electrical machinery, apparatus and appliances	7%	2	8%	Road vehicles
Furniture and parts thereof	5%	3	6%	Electrical machinery, apparatus and appliances
Telecommunication and sound recording apparatus	5%	4	5%	Iron and steel
Manufactures of metal	5%	5	4%	Other industrial machinery and parts

Economic Forecast

	2010	2011	2012	2013	2014f	2015f
GDP growth (% change)	3.9	4.5	2.0	1.6	3.0	3.2
Inflation (%, end-year)	3.1	4.6	2.4	0.7	2.0	2.5
Fiscal balance (% of GDP)	-7.8	-5.1	-3.9	-4.3	-3.6	-2.9
Public debt (% of GDP)	54.9	56.2	55.6	57.0	50.0	51.0
Current account (% of GDP)	-5.1	-5.0	-3.7	-1.3	-2.2	-2.5
External debt (% of GDP)	67.5	62.7	74.7	73.5	72.0	70.0

Sources: IHS Global Insight, national sources, Euler Hermes

Economic Growth

Rebound in 2014-2015

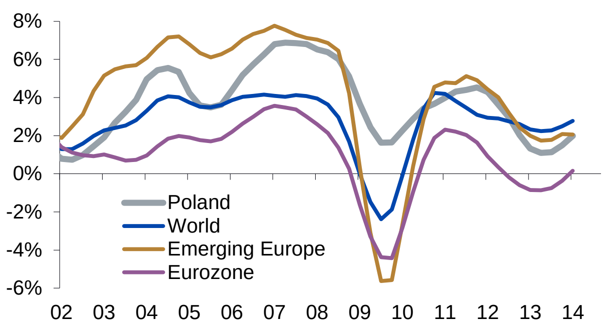
Real GDP growth moderated to +1.6% in full-year 2013 as domestic demand remained weak. Private consumption grew by +0.8% and public consumption by +2.8% but fixed investment declined by -0.2% and a drop in inventories subtracted -1pp from growth. Exports increased by +4.6%, outpacing imports at +1.2% so that net exports were the sole growth driver with a contribution of +1.6pps.

A view on quarterly data, however, illustrates that a gradual shift from external demand-driven to domestic demand-driven growth started in mid-2013. This shift has continued in Q1 2014 when real GDP growth of +3.4% was propelled by a strong rebound of fixed investment (+10.7% y/y) and robust increases of private and public consumption (+2.6% and +0.7% y/y, respectively). Net exports made a smaller contibution to Q1 growth (+0.5pp), because strengthening domestic demand led to faster import expansion (+6.9% y/y), while export growth also picked up to +7.6% y/y though less vigorously. EH expects the growth momentum to continue and forecasts full-year growth of +3% in 2014 and +3.2% in 2015.

Corporate insolvencies forecast to decline

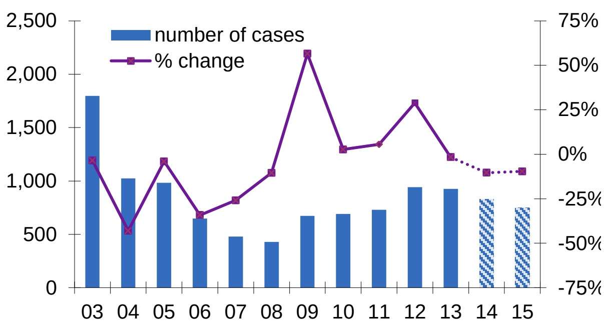
The sharp increase in the number of insolvencies from 2008 to 2012 came to a halt in 2013 (926 cases). EH expects the economic rebound to feed through to corporates' financials and insolvencies to decline by about 10% each in 2014 and 2015.

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



Sources: IHS Global Insight, national sources, Euler Hermes

Insolvencies



Sources: National sources, Euler Hermes

Solid monetary policy and low inflation

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. After a period of monetary tightening until May 2012 in response to elevated inflation, the key policy interest rate has been successively lowered from 4.75% in November 2012 to 2.5% in July 2013, as inflation moderated.

As domestic demand weakened, consumer price inflation decelerated from an average 4.4% in 2011 to 3.7% in 2012 and 0.9% in 2013. In April 2014, inflation fell to 0.3% y/y, but as domestic demand will continue to recover, EH forecasts it to increase to about 2% at end-2014 and 2.5% at end-2015, subject to upside risks stemming from global food and energy prices.

Moderate exchange rate volatility

The exchange rate volatility of the floating PLN has declined. After appreciating by 7.4% against the EUR during 2012, the PLN fell by 1.4% in 2013 and was broadly unchanged at end-May 2014 as compared to end-2013. What's more, the US quantitative easing tapering talks in 2013 and its eventual implementation in 2014 have had no significant impact on the PLN – reflecting sound monetary policies and robust economic fundamentals – in contrast to a number of other emerging market currencies which have fallen substantially over the past 12 months. EH does not expect drastic PLN exchange rate movements in 2014.

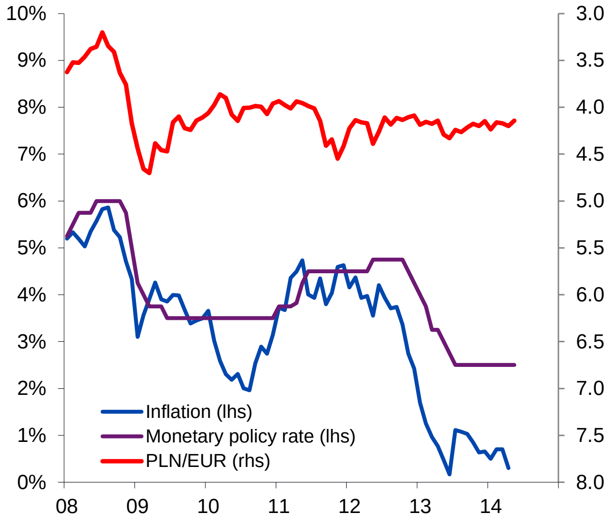
Banking sector has been resilient but vulnerabilities remain

The banking system has been resilient to the 2008-2009 global financial crisis and has remained liquid, well-capitalised and profitable. However, private sector credit growth decelerated from a healthy pace of 13.9% in 2011 to just 2.4% in 2012, as credit demand weakened and lending conditions tightened, but has picked up slightly to 5.6% y/y in March 2014. Non-performing loans as a share of total loans have stabilised at above 8% in 2013 (up from 4.4% at end-2008), suggesting that the worsening in the corporate loan portfolio and the rising insolvencies may have come to an end. Regulatory and supervisory measures have reduced the share of foreign-exchange denominated mortgage lending from 65% of all mortgages at end-2011 to an estimated 50% at end-2013, but the level is still high and continues to pose vulnerabilities.

Fiscal consolidation thanks to a trick

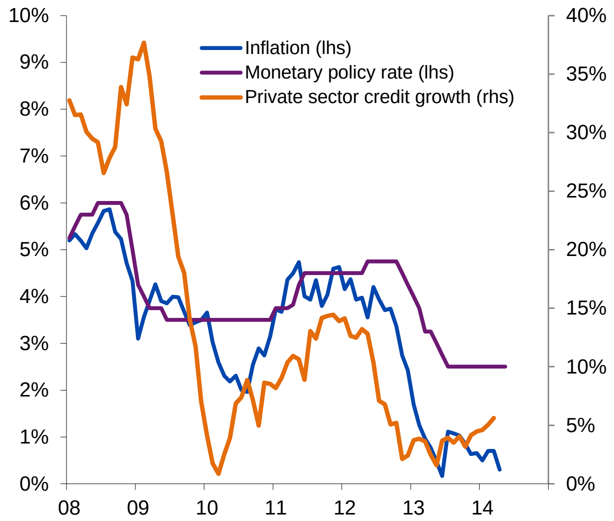
The government clearly missed its target of reducing the fiscal deficit to below 3% of GDP in both 2012 (3.9%) and 2013 (4.3%), owing to lower-than-expected tax revenues. As a consequence, gross public debt rose to 57% of GDP in 2013 (ESA-95 basis). By domestic accounting standards (i.e., excluding the obligations of the National Road Fund) public debt was approaching the constitutional limit of 55% of GDP in 2013, the breaching of which would force automatic spending cuts. In order to avoid such, the government has overhauled the pension system (a large part of the funded private pension pillar has been transferred to the public pension pillar). This has reduced public debt by around 8% of GDP and will also reduce public debt-servicing costs by about 0.5% of GDP in 2014. As a result, Poland should be able to lower the fiscal deficit to around 3% of GDP by 2015. However, while the pension overhaul reduces fiscal pressures in the short term, it will raise costs in the future (significantly after 2020).

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



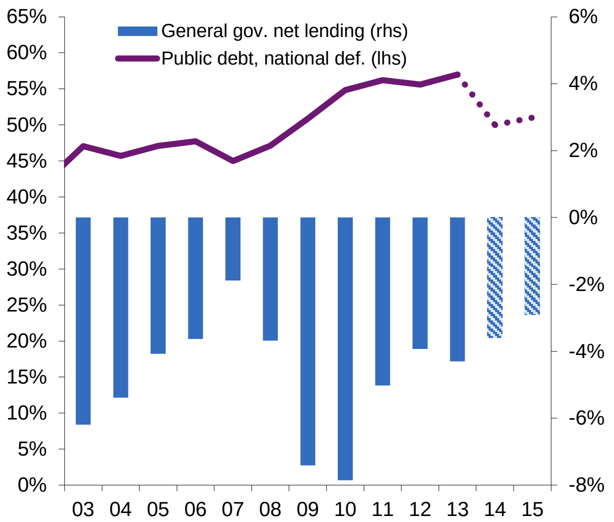
Sources: IHS Global Insight, national sources, Euler Hermes

Monetary policy interest rate (%), inflation rate (y/y, %), and private sector credit growth (y/y; %)



Sources: IHS Global Insight, national sources, Euler Hermes

Public finances (% of GDP)



Sources: IHS Global Insight, national sources, Euler Hermes

External Sector

Current account deficit has narrowed

The current account deficit declined from 5% of GDP in 2011 to 3.7% in 2012 and just 1.3% in 2013. EH forecasts the annual deficit to increase moderately to about 2.0-2.5% in 2014-2015. Foreign direct investment registered a net outflow of 0.2% of GDP in 2013 but shifted back to a net inflow in the first two months of 2014.

External debt burden is high

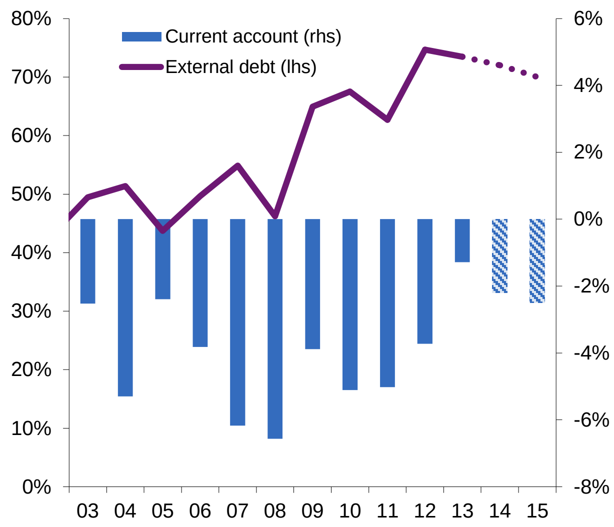
Total external debt remained broadly stable in 2013 and stood at EUR 275bn at the end of the year. In relation to GDP it declined slightly but remained at a relatively high level of 73.5% of GDP (up from 59% in 2009). Short-term external debt accounts for about 20% of the total. The estimated annual external debt-service in 2014 will amount to a heavy 32% of export earnings.

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

After increasing gradually from 2011 to mid-2013, reaching a peak of EUR78.9bn in May 2013, foreign exchange reserves have fallen to EUR69.7bn in March 2014. The current level of reserves is still 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 2014, which is well below an adequate level of at least 100%.

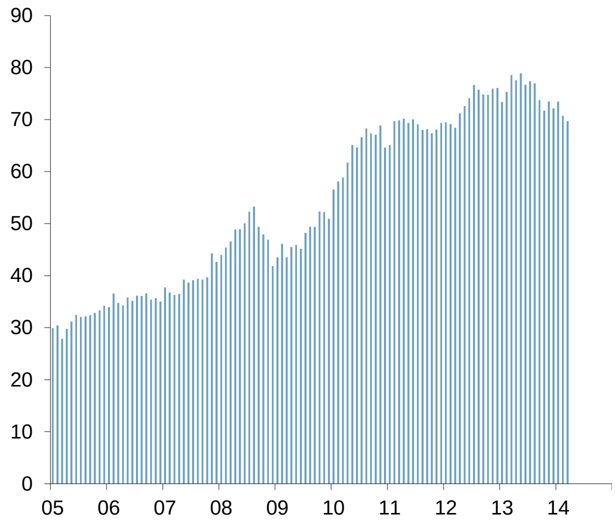
Nonetheless, external liquidity risk will remain low in the short term. Since May 2009, Poland has been granted access to successive arrangements under the IMF's Flexible Credit Line (FCL) which was last renewed for two years in January 2013 (over roughly USD34bn). The FCL is being offered to strongly performing economies with a solid record of timely and effective economic policy adjustments. No drawings have been made under the FCL arrangements so far and the Polish authorities intend to continue to treat the arrangement as precautionary. The arrangement helps to safeguard the economy against downside risks.

Current account and external debt (% of GDP)



Sources: IHS Global Insight, national sources, Euler Hermes

Foreign exchange reserves (EUR billion)



Sources: National Bank of Poland, Euler Hermes

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Contact Euler Hermes Economic Research Team
research@eulerhermes.com

Last review: 2014-06-02
Country Risk Analyst:
Manfred Stamer
manfred.stamer@eulerhermes.com