

Poland Watch

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The cycle has turned

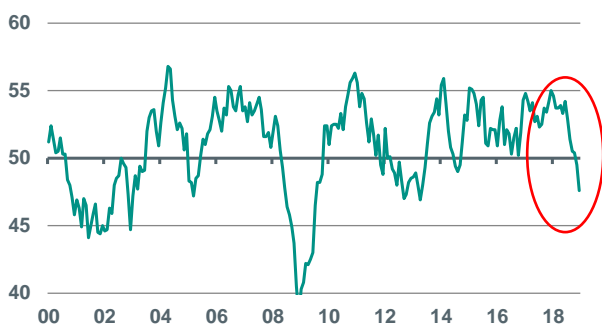
- After surging to 5.1% in 2018, growth will slow to 3.5% in 2019
- Weak export and investment in 2019/2020 will be partly offset by fiscal stimuli
- We expect a slight rebound in inflation to 2% in 2019
- Policy rate will remain at 1.5% until the second half of 2020
- We expect the zloty to outperform the euro in 2019/2020

2018 was a great year, but things are changing...

Since 1991 Poland has seen a steady economic growth without facing a single year of contraction. Growth throughout the years have been driven by strong private consumption and (foreign) investments. Also 2018 saw a strong economic performance, as the economy accelerated from 4.8% in 2017 to 5.1% in 2018 (topping expectations in the beginning of the year). That said, quarterly breakdown of GDP data shows that throughout 2018, growth has gradually lost pace.

PMI point to sharp deceleration of growth

Purchasing Managers Index (PMI mfg)



Source: EIU

Consumer confidence has peaked

Consumer confidence index



Source: Thomson Reuters

... we expect the loss of momentum to continue but no recession in the cards

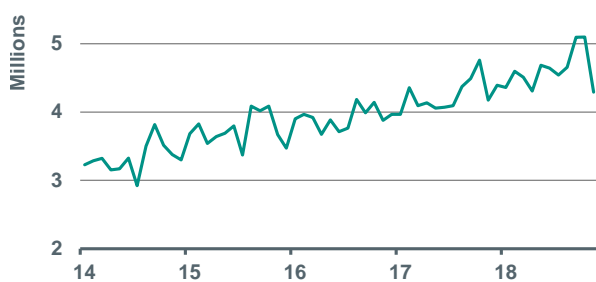
Leading indicators point towards a turn of the business cycle. The manufacturing PMI shows a sharp slowdown and consumer confidence – after reaching pre-2009 crisis levels

– has lost momentum. As stated in our [Emerging Europe Outlook 2019](#) we expect growth figures in Poland to further slow in 2019, as a cyclical downturn has set in. We expect growth to slow from 5.1% in 2018 to 3.5% and 3% in 2019 and 2020 respectively (slightly lower than consensus).

Household consumption is expected to soften to some extent, but the tightening labour market and rise in wages will prevent it from significantly declining. The contribution of net exports to GDP is expected to decline as well. The main export partner, Germany, is on the brink of a recession. German imports from Poland have slowed substantially in December last year and the leading indicators (German export orders) don't show any signs of bottoming out yet. We also expect the contribution of investments to be considerably lower than in 2018. The utilization of EU-funds has reached its peak in 2018 and will gradually wane over the period 2019/2020. The corporate sector investments continue to be driven by public investment on the back of EU-funds. Hence, lower EU-funds will have an impact on private investments as well. Moreover, the conflict between the European Commission and the Polish government over the independence of the judiciary may lead to substantial cuts in the future funds available for Poland (from 2021 onwards) and are depressing the investment outlook (see [Poland Watch: Steady growth but for how long](#) for more information on the potential cuts in EU-funds). That said, the government has introduced some new incentives for investments. Last year the government created 14 special economic zones with substantial tax breaks for businesses.

Germany imports from Poland drop end-2018

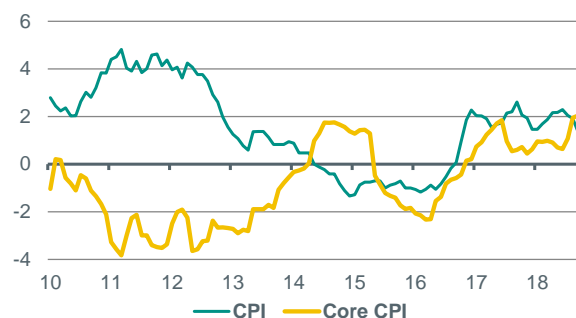
Germany import value EUR from Poland



Source: Bloomberg

Inflation hovers around 2%

% change



Source: Thomson Reuters

The major tailwind is fiscal stimuli

On 23 February, the ruling PiS party unveiled a major fiscal stimulus package of PLN 40bn (around 2% of GDP). While part of the motivation may be political (European elections, Parliamentary elections in November and presidential elections next year), the package comes at a time where the economy is set to cool-off. The proposed measures – including increased child benefits, a bonus for pensioners, reduced income taxes – are focused on social spending to boost consumption rather than on structural improvements. The fiscal deficit is forecasted to widen from an estimated 0.9% in 2018 to 2.5% in 2019/2020, which is still compliant with EU Maastricht criteria.

Inflation will slightly rebound in 2019...

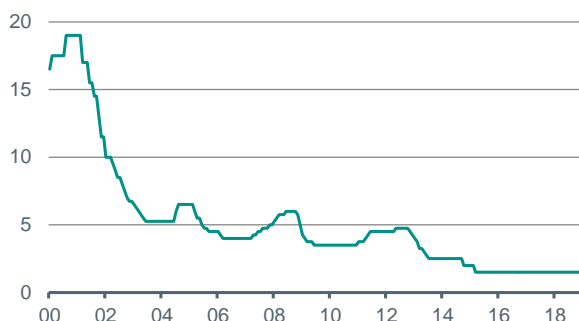
Inflation of 1.6% yoy in 2018 was at the lower bound of the Central Bank of Poland (NBP) target (target is 2.5% with a fluctuation band of +/- 1 percentage point). The effect of rising wage growth in 2018 has been offset by a strong growth in labor productivity. On the back of the fiscal stimuli we expect inflation to slightly rebound in 2019 to 2% and 2.5% in 2020.

... but we foresee no change in the monetary policy stance

As widely expected, the National Bank of Poland (NBP) kept the policy rate unchanged at 1.5% on its 5-6 March policy meeting. Though we adjusted our inflation forecast upwards due to the fiscal stimuli, our outlook on the monetary policy remains unchanged. The NBP has repeated that they should only consider rate hikes if inflation was at risk of exceeding 3.5% upper-bound and if there are clear signs of excessive credit growth. We think both are unlikely to play out in the near-term. Therefore we stick to our view that the MPC will continue to keep rates at 1.5%, at least until there is a clear signal from the ECB that they will start tightening. As we have pushed out the first ECB rate hike from March 2020 to December 2020, we only expect NBP to hike the second-half of 2020. That said, the risks of earlier monetary tightening have gone up, especially if the global outlook improves quicker than we currently expect and Poland's economy experience a revival of export growth.

Policy rate: 1.5% for longer

% growth yoy, 2018 are forecasts



Source: EIU

Zloty to outperform euro

PLN



Source: Bloomberg

Zloty to outperform euro

We still expect the zloty to outperform the euro in 2019 and 2020. There are several reasons for this. First, although we expect weaker eurozone economy to weigh on the Polish economy, the extra fiscal stimulus will probably offset this. Second, it is likely that a rate hike by the Polish central bank in the second half of 2020 will support the zloty. This is because of the fact that Polish official rates are already far above ECB rates. Moreover, during 2020 the interest rate spread between Poland and the eurozone will probably increase. However, we now expect later rate hikes and we think that investor sentiment will be less constructive than we originally had expected. These factors will dampen the upside in the zloty. Weakness on the eurozone economic data front will probably weigh on investor sentiment, dampening demand for more risk-on currencies such as the zloty. As a result our new year-end forecasts for EUR/PLN are 4.25 end of 2019 (4.15 previously) and 4.20 end of 2020 (4.0 previously).

Key forecasts for the economy of Poland

	2016	2017	2018e	2019e	2020e
GDP (% yoy)	3,1	4,8	5,1	3,5	3,0
CPI inflation (% yoy)	-0,6	2,0	1,6	2,0	2,5
Budget balance (% GDP)	-2,2	-1,4	-0,9	-2,5	-2,5
Government debt (% GDP)	54	51	48	47	46
Current account (% GDP)	-0,5	0,1	-0,5	0,0	0,0
Gross fixed investment (% GDP)	18,0	17,7	18,3	18,3	18,4
Gross national savings (% GDP)	19,1	19,8	19,0	19,5	19,4
USD/PLN (eop)	4,2	3,5	3,8	3,4	3,2
EUR/PLN (eop)	4,4	4,2	4,3	4,3	4,2

Economic growth, budget balance, current account balance for 2019 and 2020 are rounded figures

Source: EIU, ABN AMRO Group Economics

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