Economic analysis and forecast

Uncertainty over investments

The data for Q1 demonstrated an unexpected increase in fixed investments, by 1.2% y-o-y, which was one of the factors that allowed Poland to note positive GDP growth of 0.8% y-o-y in this period. Although a decrease in investments seems inevitable in the latter part of the year, this should be limited assuming accelerated execution of projects financed from EU funds. This, coupled with resilient consumer demand and positive impact of foreign trade upon economic growth, should help Poland avoid a recession in 2009.

Pretty good GDP data for Q1

According to the preliminary estimates of the Central Statistical Office (GUS), GDP growth in the first quarter of 2009 was 0.8% y-o-y, a result similar to market expectations. However, this implies a clear slowdown of economic growth compared with the previous year. The fact that positive GDP growth was sustained distinguished Poland amongst other countries in Europe and across the world. It is worth emphasising that the seasonally adjusted quarter-to-quarter GDP growth was also positive at 0.4%.

Although the GDP growth rate for Q1 was in line with our forecast, its structure differed from expectations. The fact that gross fixed capital formation grew by 1.2% y-o-y (compared to a consensus forecast for a several percentage point decrease) was a rather large surprise. Private consumption growth slowed to 3.3% y-o-y, here we can also speak of a positive surprise as a more significant slowdown was expected.

Although both the above described components of domestic demand were positive and better than expected, domestic demand declined in total in Q1 by 1% y-o-y, due to a very intense drop in inventories. Limited production and reduced inventories were a natural reaction of enterprises in a situation of expected weakening of demand. The large scale of the phenomenon at the beginning of the year suggests that the impact of reduced inventories upon GDP may not be as negative in subsequent quarters.

In line with expectations, based on the monthly data, foreign trade turned out to have a positive impact upon GDP dynamics in Q1. According to GUS, the improved foreign trade balance increased GDP in Q1 by as much as 1.9 percentage points, whereas domestic demand reduced the GDP dynamics by 1.1 percentage points.

Looking at national accounts from the supply side, a noticeable decline in gross value added was noted in manufacturing (by 5.9% y-o-y), although its scale was slightly lower than estimated based on monthly industrial output data. The growth of value added slowed moderately in construction and market services, and even accelerated in non-market services.

...but it will get worse before it gets better

The GDP data for the first quarter demonstrated that the most pessimistic forecasts regarding the reaction of Polish enterprises and consumers to the global economic crisis have not materialised, at least for the time being. However, this does not imply that subsequent quarters will not bring a deeper impairment of economic conditions. A decline in investments should be expected as a delayed reaction to the crisis and the reduced availability of credit. Weaker activity will contribute to a further decline of employment and impaired situation on the labour market, which, in turn, will act towards a greater slowdown of growth in private consumption.

Although in Q2 and Q3 the GDP dynamics will probably slow further, a better-than-expected starting point decreases the risk that the forecasts predicting a recession in the Polish economy in 2009 will be fulfilled, particularly as the net exports balance should continue to positively influence the economic growth rate going forward. Therefore we expect that in 2009 as a whole GDP will grow by 0.5%.

Uncertain fixed investments

One of the keys to maintaining positive GDP dynamics in 2009 and stimulating faster economic growth in subsequent years will be the level of investments. It is also one of the most volatile and difficult-to-forecast components of GDP.

The first clear signs of economic slowdown in Poland were already noticeable in Q3 of 2008. The reduced GDP growth rate was due to – as demonstrated by GUS data – a significant slowdown of investments (in real terms to only 3.5% y-o-y in Q3 from approximately 15% y-o-y in the first half of the year). Nevertheless, in Q4 of 2008 investments slightly accelerated, to 4.6% y-o-y, despite a further considerable slowdown of GDP growth. This result was equally surprising as the positive dynamics of investments in Q1 of 2009.

The explanation can be sought in Eurostat data regarding the structure of investments by type, however such data for the first quarter of 2009 are not yet available. The data for Q4 of 2008 suggest that the relatively high growth of gross fixed capital formation was achieved primarily thanks to outlays in construction. In the last quarter of the previous year, due to an intense increase in construction investments, and at the same a significant drop in the dynamics of other investments (such as machinery and equipment), the share of construction investments grew to almost 60%, and was the highest since Eurostat started to publish such data (i.e. since the beginning of 2004). It can be expected that due to the long cycle of construction production, investment projects initiated several quarters ago were (and are) still being performed both in the end of 2008 and in 2009, in particular numerous residential investments related to the boom in this market segment observed some time ago. However, it should be mentioned that the growth rate of residential investments is weakening rapidly. Although in the light of the Eurostat data, in Q1 and Q2 of 2008 they grew nominally by approximately 25% y-o-y, in Q3 growth slowed to 9.5% y-o-y, and in Q4 was only 3.2% y-o-y.

In other areas of construction investment (including infrastructure) the slowdown is also noticeable. Their nominal growth in Q4 dropped to 5.2% y-o-y from 7.5% y-o-y in Q3, whereas in H1 of 2008 they expanded by double digits (as they did consistently since Q2 of 2006). Therefore, one should question whether it is possible to maintain positive growth of construction investments in subsequent quarters. The answer depends
to a significant extent on the utilisation of EU funds, the bulk of which are dedicated to investments.

Increasing role of EU funds

The significance of EU funds for the Polish economy is increasing each year. They represent a vital element stimulating investment activity in the country. Based on the available data, it can be estimated that the relation of the EU funds dedicated to investments to GDP grew from 0.5% in 2004, i.e. the first year of Poland’s membership in the EU, to 1.3% in 2008. The role of EU funds is particularly important at a time of a global crisis. They serve as a type of buffer limiting the negative influence of the economic downturn upon general investment activity in the Polish economy, notably reduced inflows of foreign direct investments and lower availability of domestic funds for investments (as a result of deteriorating financial results of enterprises and difficult access to credit).

In 2009, the relation of the EU funds dedicated to investments to GDP may change to approximately 1.8%. However, this will happen only on the assumption that almost all of the funds frontloaded by Brussels, i.e. approximately €6bn (9.5% of the funds value from the entire financial perspective for 2007-2013) will be spent. Thanks to this, also taking into account domestic co-financing of EU projects, the real dynamics of investments in 2009 will be almost three percentage points higher, and real GDP dynamics – almost 0.5 percentage points higher. In 2010, the positive impact of EU funds upon investment dynamics may even reach six percentage points, and on GDP dynamics – almost one percentage point.

Red tape impeding investments

However, the positive scenario outlined above is far from assured. For example, there is considerable uncertainty over the functioning of the mechanism for advance financing of EU projects that was expanded this year, with a view to reducing the dependency of investments on obtaining bank credits, whose availability is currently limited.

The information provided by the Ministry of Regional Development in mid April showed that many institutions handling the use of EU funds did not yet put in place procedures necessary to release advance payments. For example, of the 16 provincial authorities, which manage regional programs, only the Mazowieckie voivodship currently applies this mechanism. Moreover, several voivodships do not plan it at all. The remaining regions, although they do not exclude such a possibility, do not so far grant advance payments. However, it should be emphasised that even in the case of EU programs, where the application of advance payments is possible, some problems arise. One is the need to provide collateral for advance payments exceeding PLN 4m (approx. €0.9m), which may slow down the execution of large projects. This is all the more worrying given that the marked slowdown of economic activity may negatively impact the capacity of the central and local governments to co-finance EU projects, exacerbating problems caused by difficult access to bank loans.

Decline of investments rather inevitable, but GDP growth positive

To summarise: given their high share in total investments, construction investments are of key importance for total investment activity in the economy. In the second half of 2008 and Q1 of 2009, the growth rate of construction investments slowed down significantly, but still remained positive, “saving” the dynamics of investments in Poland from their first decline below zero since Q2 of 2003. However, it should be emphasised that construction will slow down more significantly (which is demonstrated, on one hand, by suspension of projects due to lack of demand, and on the other hand, by decreasing number of issued building permits), which in the situation of declining dynamics of other investments (including machinery, equipment and means of transportation) in subsequent quarters will result in a negative growth rate of total investment outlays. Nevertheless, thanks to EU projects, the scale of the decline in investments should be limited and remain in the single digits. Therefore (but also thanks to resilient consumer demand and positive contribution of net exports to GDP) Poland should avoid a recession in 2009, which will be an unique achievement compared with other European economies.

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