21. POLAND

Solid growth driven by domestic demand

Faster wage growth, moderate employment gains and strong consumer confidence are set to sustain private consumption as the main growth driver. Investment activity is expected to gradually recover, largely due to a higher utilisation of EU funds. A tightening labour market is expected to lead to faster price increases, particularly in the services sector. The headline government deficit is projected to drop considerably in 2017 and to remain broadly stable in 2018-2019. However, strong growth implies that the cyclically adjusted fiscal deficit is set to increase.

Strong GDP growth in the first half of 2017

The first half of 2017 witnessed a strong increase in private consumption and an accumulation of inventories, while investment activity remained weak. Despite a sizeable hit from negative net exports, GDP increased by 1.1% (q-o-q) in both the first and the second quarters. Private consumption was the main growth driver, supported by solid increases in wages and employment. Public investment took tentative steps towards an expected rebound, while private investment trends varied across sectors. Weak investment was largely explained by continued falls in sectors such as energy, other public utilities and mining, with a large presence of publicly owned and publicly controlled companies.

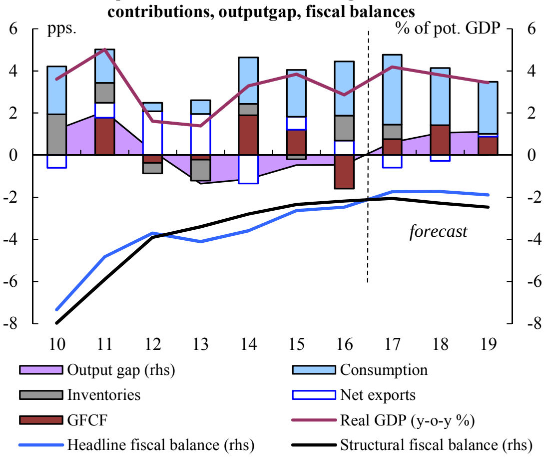
Robust growth outlook

Real GDP growth is projected to reach 4.2% in 2017 and 3.8% in 2018, before moderating to 3.4% in 2019 with an increasingly positive output gap. Growth is expected to be led by domestic demand with private consumption supported by favourable labour market trends and record-high consumer confidence. Some slowing down of consumption towards the end of the forecast period is expected, as higher inflation reduces household real disposable income and employment gains slow.

Following several quarters of weakness, investment activity is projected to gradually recover from the second half of 2017. Public investment growth is expected to be particularly strong in late 2017 and early 2018, due to a higher utilisation of EU structural funds. The rebound in private investment is forecast to be more gradual, supported by factors such as strong domestic and foreign demand, high capacity utilisation and easy access to funding.

Exports are expected to continue expanding, with further gains in export market shares. Strong domestic demand and in particular higher investment and a slight appreciation of the zloty are projected to lead to a fast increase in imports. As a result, the contribution of net exports to growth is set to stay negative in 2017 and 2018 before turning minimally positive in 2019.

Graph II.21.1: **Poland - Real GDP growth and contributions, outputgap, fiscal balances**



Tight labour market and rising inflation

Labour force participation is projected to rise at a slower pace, partly due to the lowering of the retirement age that took effect in October 2017. With the unemployment rate now at record lows, employment gains are forecast to decelerate as wage growth strengthens.

Inflation is projected to average 1.6% in 2017, rising to 2.5% in the second half of 2018 and just under 3% in the second half of 2019. Price pressures, particularly in the services sectors, are set to arise mainly from labour market developments.

Balanced risks

Risks to the macroeconomic forecast are broadly balanced. On the upside, lower economic policy uncertainty (e.g. in the energy sector) could lead to stronger private investment. Further gains in labour force participation or a change towards more permanent immigration could support private consumption, particularly in 2019. On the downside, labour shortages could become a barrier hampering investment, while faster wage growth could translate into higher inflation, which would weigh on real disposable income growth and consumer sentiment. In addition, uncertainty surrounding the rule of law could affect economic activity more negatively than expected.

Stable headline and increasing structural government deficit

The headline general government deficit is forecast to substantially narrow to 1.7% of GDP in 2017, mainly thanks to higher tax revenues and social contributions. The expected rise in revenues from indirect taxes is due to improved macroeconomic fundamentals, a number of measures to increase compliance implemented in 2016 and 2017, and a two-year extension of the application of higher VAT rates. Simultaneously, the revenues from direct taxes and from social contributions reflect mainly the strong labour market.

In 2018, the headline fiscal deficit is projected to remain stable at 1.7% of GDP. Favourable macroeconomic conditions are set to support revenue growth. Expenditures are forecast to rise mainly as a result of the large increase in public investment and the lowering of the statutory retirement age.

Under a no-policy-change assumption, the headline general government deficit is expected to slightly widen to 1.9% of GDP in 2019. Public investment is projected to continue growing, while tax revenue growth is forecast to moderate.

The structural deficit is set to narrow to 2% of GDP in 2017 from 2¼% of GDP in 2016. However, against the background of strong economic growth and a consequently increasing positive output gap, the structural deficit is forecast to widen again to 2¼% of GDP in 2018 and further to 2½% of GDP in 2019.

The general government debt-to-GDP ratio is set to decline from 54.1% at end-2016 to 53% of GDP at the end of 2019.

Table II.21.1:

Main features of country forecast - POLAND

	2016		Annual percentage change						
bn PLN	Curr. prices	% GDP	98-13	2014	2015	2016	2017	2018	2019
GDP	1858.6	100.0	3.8	3.3	3.8	2.9	**4.2**	**3.8**	**3.4**
Private Consumption	1087.3	58.5	3.4	2.4	3.0	3.9	**4.9**	**3.7**	**3.2**
Public Consumption	331.8	17.9	3.1	4.1	2.4	1.7	**2.5**	**3.3**	**3.3**
Gross fixed capital formation	335.8	18.1	4.0	10.0	6.1	-7.9	**4.2**	**7.9**	**4.8**
of which: equipment	132.6	7.1	4.1	11.2	12.1	-10.3	**2.1**	**6.4**	**4.0**
Exports (goods and services)	971.3	52.3	7.9	6.7	7.7	8.8	**6.4**	**6.8**	**5.8**
Imports (goods and services)	896.1	48.2	6.5	10.0	6.6	7.9	**8.2**	**7.9**	**5.9**
GNI (GDP deflator)	1793.1	96.5	3.6	2.9	3.9	3.0	**4.2**	**3.7**	**3.3**
Contribution to GDP growth:	Domestic demand		3.6	4.1	3.4	1.1	**4.1**	**4.1**	**3.3**
	Inventories		0.0	0.5	-0.1	1.1	**0.7**	**0.0**	**0.0**
	Net exports		0.3	-1.3	0.6	0.7	**-0.6**	**-0.3**	**0.1**
Employment			0.1	1.7	1.5	0.6	**1.6**	**0.8**	**0.2**
Unemployment rate (a)			13.3	9.0	7.5	6.2	**5.0**	**4.2**	**4.0**
Compensation of employees / head			5.9	2.2	1.7	4.4	**4.8**	**5.7**	**7.1**
Unit labour costs whole economy			2.2	0.6	-0.6	2.1	**2.1**	**2.6**	**3.8**
Real unit labour cost			-1.3	0.1	-1.3	1.7	**0.0**	**0.6**	**1.3**
Saving rate of households (b)			7.5	2.1	2.2	3.9	**2.5**	**2.1**	**1.7**
GDP deflator			3.5	0.5	0.8	0.4	**2.1**	**2.0**	**2.5**
Harmonised index of consumer prices			4.1	0.1	-0.7	-0.2	**1.6**	**2.1**	**2.8**
Terms of trade goods			0.1	2.2	2.9	1.0	**1.1**	**-0.1**	**-0.1**
Trade balance (goods) (c)			-3.9	-0.8	0.5	0.6	**0.2**	**-0.4**	**-0.6**
Current-account balance (c)			-4.0	-1.4	0.1	1.2	**1.0**	**0.3**	**0.1**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-3.2	0.3	2.4	2.6	**2.5**	**1.9**	**1.8**
General government balance (c)			-4.4	-3.6	-2.6	-2.5	**-1.7**	**-1.7**	**-1.9**
Cyclically-adjusted budget balance (d)			-4.3	-3.0	-2.4	-2.2	**-2.1**	**-2.3**	**-2.5**
Structural budget balance (d)			-	-2.8	-2.3	-2.2	**-2.1**	**-2.3**	**-2.5**
General government gross debt (c)			45.9	50.2	51.1	54.1	**53.2**	**53.0**	**53.0**

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.