

Economic Monitor

June 2008

**Main trends in the economy**

**Expectations that the March slowdown in production growth would be temporary turned out to be correct because growth in production was again high in April.**

**Construction output is growing fast and measures have been taken to protect the environment against consequences of the accelerated activity in the manufacturing and construction sectors.**

**Retail sales are also growing fast. Exports and imports have slowed, but only slightly. As expected, inflation has gone up and is projected to grow further in coming months.**

**Consumer prices should start slowing after the 3<sup>rd</sup> quarter. Employment and wages are still on the rise. Thanks to the favourable economic situation, national budget revenue is high, with a small surplus recorded in the year to April.**

The current economic situation can be summarised by the following:

- The economic outlook has improved thanks to the high growth in industrial production in April. This showed that the March slowdown in production growth had been temporary. Growth in the construction and assembly output in April stayed at a high level of the previous two months. Retail sales were also high in April.
- In April CPI inflation was slightly lower than in March. Until the 3<sup>rd</sup> quarter high prices of oil, other raw materials and food will be pushing inflation up. After the 3<sup>rd</sup> quarter price growth should slow.
- The March 2008 data on foreign trade and balance of payments, published by the Central Statistical Office (GUS) and National Bank of Poland (NBP) in mid-May, showed that growth in foreign trade slowed as projected. An optimistic signal is that the slowdown was slighter than expected.
- On the labour market, employment growth is still high. Unemployment is on the decrease and wages are growing fast.
- In the 1<sup>st</sup> quarter, financial results in the commercial sector slightly weakened from the excellent results of last year. Growth in investment was fast.
- As the economic situation was favourable, national budget revenue was on the rise. As a result, in the year to April the implementation of the budget revenue plan was much more advanced than the implementation of the expenditure plan.

**Central Statistical Office (GUS): “(...) after the temporary slowdown in March, growth in the main sectors of the economy was quite strong (...)”**

GUS: The basic trends in April show that, after the temporary slowdown in March, growth in the main sectors of the economy was quite strong. Unemployment decreased further and the number of jobs increased. Average pensions and wages in the commercial sector continued to rise year on year. In April, the year-on-year increase in prices in the main sectors of the national economy was slightly slower than in previous periods. The enterprises surveyed showed better 1<sup>st</sup>-quarter results than last year, but basic indices deteriorated because growth in expenditure slightly outpaced growth in revenue. The share of external services costs and wages increased in total expenditure. Spending on new fixed assets continued to grow at a considerably fast pace. (“Information on the Country’s Socio-Economic Situation, GUS, May 27, 2008”; [www.stat.gov.pl](http://www.stat.gov.pl))

### **National Bank of Poland (NBP): "The Polish economy is still in a period of strong growth (...)"**

NBP (Monetary Policy Council): The Polish economy is still in a period of strong growth encompassing all its sectors. Data obtained since the Council's last meeting indicate that the economic growth rate is still high, though it may decrease somewhat in the next quarters (...) The Council's assessment is that the latest macroeconomic data suggest that in the first half of 2008 the economic growth rate will probably still be higher than the rate of growth in potential GDP. ("Report from the Monetary Policy Council Meeting on May 27 and 28, 2008"; [www.nbp.pl](http://www.nbp.pl))

### **Assessments from economic institutes and independent experts**

Institute of Economics Polish Academy of Sciences (INE PAN): (...) after three years of accelerating economic growth, signs of a slowdown have started to appear, but the GDP growth rate will still be relatively high. (...) Domestic demand will continue to be the main factor behind economic growth. It will be increasing faster than GDP (...). Economic growth will also be driven by individual consumption and investment. Individual consumption will rise by around 5%, thanks to the favourable situation on the labour market and a rise in incomes due to the indexation of old-age and disability pensions and a reduction in the disability contribution under the obligatory social insurance scheme. Investment will increase by around 18%. Investment growth will be driven by the fast increase in domestic demand, shortage of production capacity, housing boom and inflow of EU funds. (INE PAN report no. 12, "Polish Economy. Projections and Opinions," May 2008; [www.czse.com.pl](http://www.czse.com.pl))

Centre for Social and Economic Research (CASE): The 1<sup>st</sup> quarter of 2008 was marked by positive surprises in the economy, which so far has been very resistant to stagflation and the world's financial crisis; the Polish banks' exposure to the American market is slight. Contrary to our expectations, the growth trend above 6% was sustained. Economic expansion was due to domestic demand, which was pushed up by the high growth rate in consumption and investment in fixed assets. (CASE report, May 2008, "Trends. Analyses. Forecasts")

Economic Development Institute Warsaw School of Commerce (IRG SGH): The economic slowdown was noted not only in industry and construction, but also in transport and trade (...). The slowdown was caused first of all by the weakening of economic conditions in manufacturing, construction and transport. The increase in the barometer was smaller than expected, with most of the effect attributable to a deterioration in the transport sector. (...) It was the worst deterioration in economic conditions in this sector since 2000. (...) A slowdown in economic activity in the industrial sector has been seen since the middle of last year. (...) Also in construction, economic conditions have been worsening since last year. The construction outlook worsened for a fourth time running. (...) The climate in the retail sector also deteriorated slightly. (...) The climate improved in agriculture and the banking sector. The outlook on the situation of households was similar to last year's. (...) In successive months, we will be seeing stronger economic activity due to seasonal factors, which will be translated into an improved economic climate, especially in construction, transport, the banking sector and agriculture. One can also expect an improvement in the situation of households. The seasonal revival will not have much impact on the situation in the manufacturing and retail sector. But one can expect that any possible increases in outlook indices will be smaller than last year. As a result, the IRG SGH barometer will be lower. On the basis of the trends to date, we project that in 2008 the barometer will reach the highest

value in the 3<sup>rd</sup> quarter. But the figure will be lower than a year before. (Study by Prof. Elzbieta Adamowicz and Joanna Klimkowska, PhD, [www.pte.pl](http://www.pte.pl))

Prof. Władysław Welfe, University of Łódź: The high economic growth rates exceeding 6% showed a downward trend in the final quarters of 2007. We expect that the rates will still be falling, although high growth of up to 5.5% will continue throughout 2008. Then, it will decrease further to 4.5% in 2009. Another revival is expected since 2010. This is connected with a new growth impulse associated with the absorption of EU assistance funds and organisation of the European football championship in 2012. As a result, in the years 2010-2012 economic growth will accelerate again to around 5.5%. (...) As spare production capacity has dwindled in many sectors of the economy, there is hope that high growth rates of up to 15% in fixed asset investment will continue in 2008. After a fall in investment growth to 11% in 2009, investment is expected to rebound in the years 2010-2012 due to infrastructure projects and the inflow of more foreign investment. (See: Experts' commentaries published on [www.pte.pl](http://www.pte.pl). The commentaries of NRK experts have been published by the "Nasz Rynek Kapitałowy" monthly, no. 3/2007, no. 7-8/2007, no. 10/2007, no. 12/2007, no. 3/2008 and no. 6/2008. This quotation is from a commentary to be published in no. 6/2008 of the monthly)

**In late May, GUS published its preliminary estimate for GDP growth in the 1<sup>st</sup> quarter. It put GDP growth at 6.1%.**

**Growth in GDP and foreign trade, % against previous year**

	2006	2007	4 <sup>th</sup> q. 2007	1 <sup>st</sup> q. 2008
GDP	6.2	6.6	6.4	6.1
Domestic demand			7.3	8.3
Total consumption			5.2	5.2
of which:				
Individual consumption			5.0	5.0
Accumulation	16.1	19.1	12.7	17.3
of which:				
Gross fixed capital formation	14.9		17.9	15.2
Exports		14.6	8.4	8.2
Imports		17.3	22.2	8.2
				13.7

Central Statistical Office (GUS): According to the preliminary estimate, in the 1<sup>st</sup> quarter of 2008 real GDP rose by 6.1% year on year. In the 1<sup>st</sup> quarter domestic demand grew at a slightly faster pace than GDP - 6.3%. The contribution of investment demand to GDP growth weakened to 2.2 percentage points from 3.0 points in the 1<sup>st</sup> quarter last year. The same trend affected individual consumption - 3.7 percentage points versus 4.5 points in the 1<sup>st</sup> quarter last year. The contribution of foreign demand (net exports) to economic growth was still negative at -0.4 percentage points. (...) In the 1<sup>st</sup> quarter Gross Value Added for the national economy rose by 5.5%. Gross Value Added for the industrial sector rose by 6.9% and for construction by 16.7%. In the services sector, Gross Value Added was higher by 6.7% compared to the 1<sup>st</sup> quarter of 2007; in trade and repairs it was higher by 12.0% and in transport, warehousing and communications higher by 4.7%. In the 1<sup>st</sup> quarter domestic demand was higher by 6.3% compared to the 1<sup>st</sup> quarter of last year, with GDP growth at 6.1%. Total consumption rose by 4.1%, with individual consumption up by 5.6% and public consumption down by 1.1%. Gross fixed capital formation was higher by 15.7% year on year. The investment rate, or the ratio of gross fixed capital formation to GDP in current prices, was 15.4%. (GUS report, May 30, 2008; [www.stat.gov.pl](http://www.stat.gov.pl))

## **GDP growth projections for 2008 have been revised down, but are still optimistic.**

### **Basic indicators of Poland's economic situation**

Convergence Programme March 2008, 2008 budget law    IBnGR April 2008    PKO  
BP May 2008    CASE May 2008

#### Projections for 2008

Gross Domestic Product; previous year=100	105.5	105.4	105.0	105.3
Individual consumption; previous year=100	105.1	105.1	105.3	106.5
Gross fixed capital formation; previous year=100	113.0	118.4	113.1	113.4
Industrial sales; previous year=100	110.0	108.8	106.3	107.9
Construction and assembly output; previous year=100	X	113.1	X	X
Registered unemployment rate, %, end of period	9.8	9.5	9.3	9.1
Inflation (average-annual); previous year=100	103.5	103.9	104.2	104.0

Source: GUS, Statistical Bulletin, no. 4/2008; Convergence Programme of March 2008; 2008 budget bill substantiation, September 2007; Gdańsk Institute for Market Economics projection, April 2008; PKO BP projection, May 2008; CASE projection, May 2008.

### **Compared to other countries, the Polish economy is still growing at a relatively fast rate and inflation is still lower than in most new EU member states.**

### **Production growth slowed temporarily in March, but there was no reason for anxiety, the more so as the April results indicated a return to the growth path.**

After weak results in March, industrial sales rose by 14.9% year on year in April. In the electricity, gas and water supply sector sales were higher by 6.9%, in the manufacturing sector they were up by 15.7% and in the mining and quarrying sector up by 8.8%. On a seasonally adjusted basis, the increase in industrial sales reached 11.9% in April. In the four months to April, sales were 9.8% higher year on year.

In January-April 2008 the fastest growth in sales was noted by enterprises producing mainly investment goods (by around 21%) and consumer durables (17%). Sales of energy-related goods, supplies and consumer non-durables rose respectively by 8%, 6% and 4%.

Labour productivity in the industrial sector measured by sales per employee was by 6.1% higher than in January-April 2007, with employment higher by 3.5% and the average gross monthly wage up by 11.2%. In 2006 labour productivity rose by around 10% and in 2007 by 6%. Statistics for January-April 2008 suggest that the rate of growth in labour productivity weakened, but April results were strong and contributed to an improvement in productivity compared to the previous three months. It is disquieting, however, that wage growth outpaces growth in productivity as this may make Polish companies less competitive and reduce their profitability.

In January-April, industrial sales across all industries were higher than in the 1st quarter. The highest increases (of 20-30%) were recorded by industries based on relatively advanced technologies, like producers of medical and precision instruments, radio, television and telecommunications equipment, machines, motor vehicles and transport equipment.

In the 1<sup>st</sup> quarter the net financial result in the industrial sector was higher than last year while net return and the cost index deteriorated. The strongest improvement was recorded by oil processing companies, manufacturers of construction materials and furniture, and energy

companies. Manufacturers of metals, foodstuffs, rubber and plastic products recorded weaker results.

**In May 2008 the outlook for the manufacturing sector was slightly less optimistic than in April 2008 and April 2007. The outlook on current demand and production was better than in April, but the outlook for the next months was less optimistic. Projections indicate that businesses may face greater financial difficulties.**

In May 2008, some 30% of the surveyed manufacturers reported an improvement and 10% a deterioration in business conditions. Manufacturers signalled a slower rise in foreign orders. Production for the domestic market was expanding, but new orders and production were expected to slow in the next three months. Stocks of finished products stayed at a satisfactory level. In May manufacturers had a little more difficulty meeting their current financial obligations because of delays in collecting receivables. Managers signalled an improvement in their companies' financial situation and a smaller increase in employment than a month before. Prices were expected to grow at a slower rate.

In May 2008 entrepreneurs operating in all manufacturing sectors, except for producers of clothes, fur products and textile products, assessed the business climate optimistically. Producers of paper products, construction materials, chemicals, machines and electrical equipment were the most optimistic. The business climate did not change in sectors manufacturing transport equipment, rubber and plastic products, motor vehicles, metal products, or in the publishing and printing industry.

**Data for the first months of 2008, especially strong indicators in April, suggest that construction may continue to grow fast and may overcome barriers to growth. Construction growth is driven by investment demand. Growth in investment is fast because corporate profitability is high and companies have money to spend for expansion. Construction growth is also boosted by EU funding and foreign direct investment.**

In 2007 construction suffered from skill shortages. As a result, construction growth, although high, did not measure up to expectations. Figures for the first months this year indicate that construction activity accelerated. In January construction output was higher by 6.8% year on year, in February it was higher by 20.7%, in March higher by 16.3%, and in April higher by 23%. In the year to April 2008 the increase was 17.0%. All categories of construction companies recorded increases in sales. The fastest growth was recorded by companies preparing sites for development (over 50%). Civil engineering work increased by over 15%. Housing construction was also on the rise in January-April, with the number of newly completed homes being higher by over 30% year on year. The growing number of home permits and starts seems to indicate that the housing situation will continue to improve. There is every indication that 2008 will be the best year since 1990 in terms of newly completed homes.

In January-April average employment in construction was by 11.1% higher than a year before and average gross monthly wages were up by 17.5%. Wages in construction have been growing the fastest and have outpaced the average for the commercial sector for several months now. This is attributable to upward pressure on wages caused by skill shortages. But construction companies have money for wages because their performance is strong. In the 1<sup>st</sup> quarter the financial situation of construction companies was better than in the 1<sup>st</sup> quarter last year. Gross and net profit was higher, revenues grew faster than expenditures and profitability indicators improved.

**Construction companies are optimistic, as indicated by the recent business outlook survey. In May the outlook was positive and more favourable than in April 2008, though some assessments were more cautious.**

In May 34% of the surveyed companies indicated an improvement and 7% a deterioration in business conditions. The surveyed companies recorded an increase in orders, but expectations for the next three months were moderate. 31% of the surveyed companies, the same percentage as in May 2007, reported they were going to do some construction and assembly work on foreign markets. They expected a slight decrease in orders for construction and assembly services abroad. The outlook on current financial situation was positive. The surveyed companies also expected that in the next three months construction prices might be growing at a slower pace.

In May 4.2% of the surveyed companies reported no barriers to their construction and assembly operations. The barriers created by labour costs, competition from other companies, skill shortages and costs of materials continued to be high: these barriers were signalled respectively by 59%, 55%, 55% and 37% of companies. It is noteworthy that the barrier created by skill shortages was in third place for a second consecutive time while in previous months this barrier was the most important one. Compared to May last year the barriers created by equipment shortages and material costs diminished the most while barriers created by competition and labour costs increased.

Some 7% of the surveyed construction and assembly companies assessed their production capacity as excessive, 77% as sufficient and 16% as too low to meet orders expected in the next 12 months. In May capacity utilisation stood at 85%.

**Environmental protection requirements constrain the development of industry and construction.**

Environmental protection is particularly important in Poland owing to years of neglect and challenges associated with the development of many industries which have a negative impact on the environment. After entry to the European Union, Poland is additionally bound by the Treaty of Accession and EU directives. Thanks to EU assistance, there is a realistic chance for Poland to catch up with the EU-15 in terms of environmental protection.

The most important task is to reduce hazards resulting from soil, air and water pollution. Soil pollution is caused by unreasonable exploitation of natural resources, inadequate waste disposal and harmful chemicals. Air pollution results mainly from the operation of the power sector, some industrial processes (like coke and cement production, metallurgical and chemical industry, and oil processing), the municipal sector and transport. Under the Treaty of Accession and EU directives, Poland is required to reduce emissions of carbon dioxide, sulphur dioxide and nitrogen oxides. Poland's energy management has to be streamlined because its efficiency measured by the ratio of energy consumption to GDP is around three times lower compared to the most developed nations and around two times lower than the EU-15 average. Poland is not particularly abundant in water resources. Its water resources per head are three times lower than the EU average while water resources per square kilometre are almost two times lower than the EU average. However, the main problem is water quality. Only 7% of Poland's water resources is of highest purity (class one), around 35% of resources is of medium purity (class two) and as much as 20% is excessively polluted and not classified. As a result, Poland has to invest in the construction of sewage treatment plants and sewerage systems.

Poland is one of the few European countries with surviving large and dense forest complexes, and natural river valleys. Around one third of the country's territory is under protection.

Poland has over 30 national parks, almost 1,400 nature reserves and around 120 landscape parks. Poland's Natura 2000 sites of special protection cover 3 million hectares.

There are numerous bird sanctuaries and wildlife refuges in Poland. Some of the animals and plants, including the lynx, wild cat, beaver, crocus and edelweiss, are under strict protection. Diverse measures have been taken to protect the natural environment and reduce air pollution, including the introduction of modern technologies, production of energy from renewable sources and thermal improvements to buildings, but their scale has been insufficient. In 2006 spending on fixed assets for environmental protection and water management amounted to PLN8.9 billion. But although spending had been growing for three years, it was still lower than in the second half of the 1990s. Spending on environmental protection and water management is not only small relative to needs, but also as a percentage of total investment in the national economy. In 2006 the share of this spending in total investment was 5.7% and its share in GDP was 0.84%.

Most of the money – two thirds - was invested in sewage management and water protection, including the construction of municipal sewage treatment plants, sewerage networks and water supply systems. One fourth of the money was spent on air protection, including new fuel combustion technologies, and the modernisation of boiler houses and heat generating plants. Spending on water management involved the construction of water treatment plants, reservoirs and weirs, the regulation and lining of rivers and streams, and the construction of embankments and pump stations.

The sources of funding included own resources of companies (45.6%) and foreign resources (18.1%). The projects were also financed from the national and local government budgets, and environmental funds. Poland has to spend much more on environmental protection than it currently does. And there is a realistic chance to change this state of affairs thanks to EU assistance funds. Poland has started to implement the Infrastructure and the Environment Operational Programme for the years 2007-2013. The total value of funds to be spent on the programme exceeds EUR37 billion, of which around EUR28 billion will come from the EU's Cohesion Fund and the European Regional Development Fund, almost EUR7 billion from national public sources and around EUR2 billion from national private sources. The money will be spent to modernise transport infrastructure, protect cultural heritage, improve the health care system, support the development of research and the higher education infrastructure, revitalise urban and rural areas and introduce modern technologies. An important part of the programme will involve eliminating environmental hazards, with the following priority areas: water supply and sewage disposal, waste disposal and land conservation, resource management and environmental hazard prevention, measures adjusting companies to environmental protection requirements, nature conservation and promotion of pro-environmental attitudes.

The huge funds set aside for the implementation of the Infrastructure and the Environment programme in the years 2007-2013 create a unique opportunity for Poland to carry out many environmental projects. As a result, through the development of utility infrastructure and improvement in environmental quality, Poland will become more attractive as an investment location.

**Services are a sector of growing importance in the Polish economy. In April 2008 growth in retail sales, wholesales sales and transport was faster than in March, but the results were weaker than expected after the strong performance in January and February.**

In April 2008 retail sales in constant prices recorded by enterprises employing more than nine people were higher by 14% than in April 2007; in January, February and March retail sales were higher by 15.9%, 19.2% and 11.7% respectively; in the year to April the increase was

14.8%. All groups of retailers recorded increases in sales in the year to April. The highest growth (28.1%) was noted by retailers selling motor vehicles, motorcycles and parts. The second group recording high sales (24.5%) were retailers selling furniture, radio and television equipment and household appliances. The retail sales of pharmaceuticals, cosmetics and orthopaedic equipment increased by 16.0%. Retailers selling solid, liquid and gaseous fuels recorded a rise of over 9%. Those selling foodstuffs, beverages and tobacco products recorded a rise of 4%.

In April 2008 wholesale sales (in current prices) recorded by enterprises providing employment to more than nine people increased by 18.3% compared to a year before.

Transport companies employing more than nine people recorded an increase in sales in constant prices of 5.2% in April and 2.7% in the year to April. Road transport grew by 13.7%. Rail transport decreased by 4% and pipeline transport by 7.6%. Sea and inland water transport also declined.

### **In May 2008 the general climate in the retail sector did not change from April.**

In May 25% of the surveyed retailers signalled an improvement and 14% a deterioration in business conditions. As in April, around 5.0% of the surveyed retailers said they saw no barriers to their current business operations. The remainder signalled the following major barriers: market competition (signalled by 70% of the surveyed retailers), high labour costs (64%) and high fiscal burdens (53%). Compared to May last year, slight changes were recorded in individual barriers. The barriers created by high fiscal burdens and insufficient demand diminished by 2% while barriers created by high interest on loans, competition and labour costs rose.

Individual segments of the retail sector made different assessments of the business climate. Retailers selling furniture, radio and television equipment, household appliances and motor vehicles were the most optimistic in May. Retailers also signalled higher sales of textiles, clothing, footwear and food.

In May, as in previous months, the outlook on business conditions was very positive in the financial services sector, though it deteriorated from the previous month. 58% of the surveyed companies reported an improvement, versus 64% in April, and 1% reported a deterioration in business conditions. In April no company reported a deterioration. The outlook on current and future demand for financial services, sales and financial situation was slightly worse than in April. Prices and employment may be increasing at a slower pace than previously expected. In May 2008 the outlook in the transport, warehousing and communications sector was similar to that recorded in the previous month. 33% of the surveyed companies signalled an improvement and 9% a deterioration in business conditions. The outlook on current demand, sales and financial situation was positive, but in the next three months demand was expected to grow at a slower pace, leading to a reduction in sales and the worsening of the companies' financial situation. But managers signalled a rise in employment and a slight decrease in current service prices.

The outlook in the real estate, rental, education and business services sector was positive in May. The surveyed companies expected a rise in demand for their services and an improvement in their financial situation. 24% of the surveyed businesses signalled an improvement and 6% a deterioration in business conditions. The companies were going to create more jobs and prices of their services were expected to go up.

The outlook in the hotel and restaurant sector was better than in April. 26% of the surveyed businesses signalled an improvement and 11% a deterioration in business conditions. The outlook on current demand and sales was optimistic, but the outlook on the companies' financial situation was unfavourable. Demand projections for the next months were positive,

which indicates that the financial situation may start improving. Managers signalled a slower increase in prices of services than previously projected. Employment was expected to rise.

**In the 1<sup>st</sup> quarter of 2008 both the current consumer confidence index, which describes current trends in individual consumption, and the future confidence index, which describes trends expected in the next months, worsened compared with the 4<sup>th</sup> quarter of last year. The direction and scale of changes in the two consumer indices indicated that the high growth in household consumption recorded in previous quarters may slow.**

In May 2008, the two consumer confidence indices weakened. Their level indicated that the favourable economic and financial conditions determining consumption were not sustained in May and consequently one can expect a weaker growth in individual consumption. The outlook on households' financial situation and the country's economic condition was much worse than before. The outlook on job prospects and households' capacity to save also deteriorated.

Despite these unfavourable changes, the outlook on changes in households' financial situation in the previous 12 months and on the country's general economic situation was still good in May. This means that households still appreciated their higher incomes and rapid economic growth. But it is worrisome that fears of unemployment rose again because this means that Polish people have not yet noticed any major improvement on the labour market.

**In late 2007 and early 2008 consumer prices went up but construction prices decelerated.**

According to the Central Statistical Office (GUS), in April 2008 consumer prices (CPI) rose by 4.0% year on year, with the strongest contribution coming from food and household services. CPI inflation has breached the upper limit of deviation from the inflation target set by the Monetary Policy Council (2.5%+- 1 percentage point) and in April stood 0.5 percentage points above the limit.

Compared to April last year, the highest increase was recorded in prices of food (6.8%), household services (6.4%), alcoholic beverages and tobacco products (5.9%), restaurants and hotels (5.8%), transport (3.8%), education (3.2%) and health care (3.2). Prices related to communication, recreation and culture declined. A further decrease was also recorded in prices of clothing and footwear.

In April the annual producer price index (PPI) stood at 2.5% compared with April 2007. A major upward effect came from mining (9.3%), and electricity generation, gas and water supply (5.8%). From January to April, the average monthly increase in producer prices in the manufacturing sector ranged from 1.6% to 2.2%, with producer prices of tobacco and oil products having increased the fastest (respectively over 20% and almost 30%).

Construction prices are decelerating but one should remember about the high reference level of last year. In April 2008 construction prices rose by 6.2%: the increase was slower than in the previous months when it was close to 9%. Despite the fast increase in wages, prices of construction services are declining because construction materials are getting cheaper.

**Central Statistical Office (GUS): (...) in April the year-on-year increase in consumer prices was slightly slower than in the previous two months (...)**

GUS: As regards inflation, in April the year-on-year increase in consumer prices was slightly slower than in the previous two months. The highest growth was recorded in consumer prices of food, non-alcoholic beverages and household services. Producer prices rose by 2.5% year

on year. This increase was the smallest since the beginning of the years thanks to deceleration in mining and manufacturing prices. Prices in the electricity, gas and water sector accelerated. Growth in prices in the construction and assembly sector was also lower than in the previous months (6.2%). On the agricultural market, average prices of most plant and animal products stayed at a level similar to the previous month's but higher than in April 2008. The very low profitability of pig production, which had continued for quite a long time, led to the strengthening of downward trends in pig populations. ("Information on the Country's Socio-Economic Situation, GUS, May 27, 2008"; www.stat.gov.pl)

### **Monetary Policy Council warns of rising inflation**

At a meeting on May 27 and 28, the Monetary Policy Council kept the central bank interest rates unchanged, with the reference (intervention) rate at 5.75%. In a communiqué issued after the meeting, the Council warned of rising inflation.

NBP (Monetary Policy Council): The higher inflation rates expected in coming months will be largely due to an increase in regulated prices and the food and fuel price hikes which have been observed in the global economy and have affected the Polish market. This means the risk of high inflationary pressures and consequently the risk of second-round effects. Additionally, growth in energy and food prices may gradually affect other prices, especially prices of some services. In the medium term inflation may be kept in check by the continuing very good financial situation of enterprises and high investment growth conducive to productivity growth. Inflation may also be constrained by globalisation and the ensuing increased competition on the market of internationally traded goods and services, and by a slowdown of the global and Polish economy. Additionally, central bank interest rate increases implemented so far and the appreciation of the zloty in recent quarters should also reduce inflationary pressures. The Council believes that in the medium term the probability of inflation overshooting the inflation target is still higher than the probability of its running below the target. The Council does not rule out the need to further tighten the monetary policy in order to bring inflation down to the target in the medium term. In view of the increased uncertainty about prospects for global economic growth and for the Polish economy, the Council came to the conclusion that a fuller assessment of the inflation outlook would be possible after it has analysed data to be released in the near future and the June inflation projection. The Council will be trying to bring inflation down to the target in the medium term. The Council will be closely monitoring the growth and structure of domestic demand, the relation between wage and labour productivity growth in the commercial sector, growth in wages in the public sector, the degree of the expansionary fiscal policy stance, the zloty exchange rate, developments of the current account balance and the impact of globalisation on the economy and on food prices. The Council will also be analysing changes in the external environment and their influence on prospects for economic growth and inflation in Poland. ("Report from the Monetary Policy Council Meeting on May 27-28, 2008"; www.nbp.pl)

### **Inflation, money supply, exchange rates, interest rates**

	December 2007	March 2008	April 2008	May 2008		
Consumer Price Index (CPI), % change			4.0	4.1	4.0	4.2**
Producer Price Index (PPI), % change			2.5	2.9	2.5	3.0**
Construction Price Index, % change	8.4	7.1	6.2	6.0**		
Total money supply, M3, in PLN billions at end of period			561.7	581.8	593.9	598.3**
Cash money in circulation, in PLN billions at end of period				77.2	77.8	80.0
	81.0**					

Total deposits, in PLN billions at end of period	472.2	492.4	501.9	510.0**
Domestic receivables, in PLN billions at end of period	477.5	509.2	516.8	523.3**
Average exchange rate PLN/EUR100 at end of period*	358.2	352.6	346.0	337.9
Average exchange rate PLN/USD100 at end of period*	243.5	223.1	222.7	218.2
Interest rate on lombard credit (%) at end of period	6.50	7.25	7.25	7.25
Intervention (reference) rate (%) at end of period	5.00	5.75	5.75	5.75
Yield on two-year bonds (%)	6.15	6.31	6.20	6.46
Yield on five-year bonds (%)	6.11	6.14	6.13	5.38
Yield on ten-year bonds (%)	5.88	6.03	5.99	6.28

Source: GUS, Statistical Bulletins and NBP estimates; \*/according to the exchange rate at close on the last day of the period; \*\*/authors' projections

The central bank interest rates as on May 31, 2008:

- reference (intervention) rate – 5.75%
- lombard rate (official lending rate): 7.25%;
- deposit rate: 4.25%;
- rediscount rate: 6.0%.

On the Warsaw Stock Exchange, stock prices were very volatile in May. At the end of the month prices stayed at levels recorded at the end of April.

### **Growth in exports and imports slowed in March compared to February, but the slowdown was more moderate than projected.**

#### **Jobs on the rise, the number of unemployed decreasing.**

The situation on the labour market is still changing fast. At the end of April 2008 the registered unemployment rate fell to 10.5%. The decrease in unemployment is attributable to fast job creation in Poland. In April 2008 the number of people employed in the commercial sector was by 5.6% higher than in April 2007; in February 2008 it was higher by 5.9% and in March by 5.8%. Wages are growing fast. In April 2008 they were higher by 12.6% than a year before.

#### **Ramka:**

Central Statistical Office (GUS): Growth in average employment in the commercial sector was still high in April 2008 (5.6% year on year), with the highest increases recorded in the real estate and business services sector and construction. The registered unemployment rate decreased to 10.5%, the lowest level since the end of 1998. Preliminary results of the labour force survey for the 1<sup>st</sup> quarter also show that trends on the labour market are still favourable: the number of employed rose year on year, the employment rate increased as did the economic activity rate, and the unemployment rate fell to 8.1%. The purchasing power of average gross monthly wages in the commercial sector was higher in April by 8.5% year on year, compared to a rise of 6.1% last year. The acceleration in real wages was associated with a high growth rate in nominal wages. Higher than average wage increases were recorded in mining, construction and the real estate and business services sector. As a result of the indexation of old-age and disability pensions in March, April was a second consecutive month in which gross real pensions were higher than a year before. ("Information on the Country's Socio-Economic Situation, GUS, May 27, 2008"; www.stat.gov.pl)

#### **Wages on the rise.**

Central Statistical Office (GUS): In April the purchasing power of average gross monthly wages in the commercial sector was by 8.5% higher than in April 2007. Last year the increase was 6.1%. In the year to April gross real wages rose by 7.7% year on year versus 6.0% in January-April 2007. (“Information on the Country’s Socio-Economic Situation, GUS, May 27, 2008”; www.stat.gov.pl)

### **Employment, wages and unemployment**

	December 2006	December 2007	January 2008	February 2008	March 2008	April 2008
Average employment in the commercial sector */in thous.	4,995	5,241	5,348	5,371	5,384	5,389
Change in employment, % against previous year		4.1	4.9	5.9	5.9	5.8
		5.6				
Average gross monthly wage in the commercial sector */in PLN	3,028	3,246	2,970	3,033	3,144	3,138
Nominal wage change, % against previous year	8.5	7.2	11.5	12.8	10.2	12.6
Real wage change, % against previous year	7.2	3.3	7.4	8.5	6.1	8.5
Average gross monthly old-age pension in PLN	1,280	1,305	1,309	1,310	1,421	1,427
Registered unemployed, in thous.	2,309	1,747	1,813	1,778	1,702	1,606
Unemployment rate (in %)	14.8	11.4	11.7	11.5	11.1	10.5

Source: GUS, Statistical Bulletins; \*/in enterprises employing over nine people

### **Centre for Social and Economic Research (CASE) on the situation on the labour market**

#### **Ramka:**

CASE: The high economic growth was reflected in a further fast increase in jobs and a fall in unemployment. (...) There were already four EU countries with higher unemployment than Poland. We project that the registered unemployment rate will fall to 9.2% at the end of the 2<sup>nd</sup> quarter, and 9.1% at the end of 2008 and that the BAEL [labour force survey] unemployment rate will range from 6.5% to 7%. (CASE report, May 2008, “Trends. Analyses. Forecasts”; www.case.gov.pl)

#### **In the 1<sup>st</sup> quarter of 2008 corporate profitability was still very high, though some indicators slightly worsened. According to expects, this deterioration was temporary because the 1<sup>st</sup> quarter of a year is always weaker.**

In the 1<sup>st</sup> quarter of 2008 financial results in the commercial sector were better than in the corresponding period of the previous year. But basic economic and financial indicators worsened, despite the better results. In the 1<sup>st</sup> quarter the financial condition of enterprises was characterised by the following trends:

- Revenues from overall business operations were by 13.5% higher than in the 1<sup>st</sup> quarter last year; business expenditures were higher by 13.9%. As a result the cost index worsened from 93.9% to 94.2%;
- The commercial sector generated a gross profit of PLN25.7 billion, compared to PLN23.7 billion in the corresponding period of the previous year. The net profit reached PLN20.4 billion compared to PLN19.0 billion. A total of 67% of enterprises showed a net

profit, which means that one in three businesses was still loss-making. The share of profit-making companies in revenues from overall operations amounted to 81%<sup>1</sup>;

- Net return on sales amounted to 4.6% versus 4.9% in the 1<sup>st</sup> quarter of 2007;
- Of the surveyed companies, 46.4% reported exporting activity. The share of exports in total revenues was 20.6%. The financial situation of exporters was better than that of the surveyed companies as a whole, with 72% of exporters reporting a net profit;
- All major sectors of the economy were profitable, but profitability differed greatly from sector to sector;
  - Financial liquidity index was 33%.

#### **Financial results in the commercial sector**

	1 <sup>st</sup> q. 2006	2006	1 <sup>st</sup> q. 2007	2007	1 <sup>st</sup> q. 2008	
Gross return on sales (in %)			4.8	5.8	6.1	6.1 5.8
Net return on sales (in %)			3.6	4.7	4.9	5.0 4.6
Financial liquidity index	32.4	35.1	33.3	33.8	33.0	
Gross profit/loss in PLN billions	15.9	86.3	23.7	104.9	25.7	
Net profit/loss in PLN billions	12.0	69.8	19.0	86.2	20.4	

Source: GUS, Statistical Bulletins

#### **Budget surplus recorded in January-April 2008.**

##### ***Ramka:***

Central Statistical Office (GUS): In January-April 2008 national budget revenue was PLN90,576.3 million and expenditure was PLN89,975.4 million, which respectively accounted for 32.1% and 29.1% of the amounts planned for 2008 under the budget law. As a result, there was a budget surplus of PLN600.9 million. (...) Receipts from indirect taxes rose by 9.2%, of which receipts from excise tax rose by 4.9%. Their share in total revenue was respectively 59.0% and 18.4%, compared to 60.2% and 19.5%. (...) Receipts from corporate income tax were by 25.8% higher than a year before (their share rose from 11.5% to 13.0%), and receipts from personal income tax were higher by 10.6% (their share decreased by 0.1 percentage point to 14.1%). Receipts for the national budget from EU funds and other non-refundable sources accounted for 7.8% of total revenue. The largest amount of money, 5.6% of total revenue, was transferred under the Common Agricultural and Fishery Policies. The implementation of the budget law's expenditure plan was by 3.1 percentage points lower than in the previous year. Subventions paid to local government units amounted to PLN17,328.7 million (...) and accounted for 42.6% of the total amount of money allocated for subventions under the budget law. The share of subventions in total expenditure was 19.3% versus 18.8% last year. Money spent for servicing domestic and foreign debt accounted for 9.2% of total expenditure (10.0% in the previous year). Subsidies for the Social Insurance Fund declined by 4.9% while subsidies for the Pension Fund were higher by 36.7%. ("Information on the Country's Socio-Economic Situation," May 27, 2008; www.stat.gov.pl)

#### **Selected items of the national budget (in PLN billions)**

	2007 implementation	2008 budget law	Jan.-April 2007	Jan.-April 2008
Revenue (indirect taxes, income tax, receipts from customs) in PLN billions	236.0	281.8	81.2	90.6

<sup>1</sup> Data for 16,416 companies providing employment to 50 and more people.

Expenditure	252.9	308.9	83.3	90.0
Balance	-16.9	-27.1	-2.1	0.6

Source: GUS, Statistical Bulletins.

### **Treasury debt and public debt in PLN billions**

	December 2006	December 2007	January 2008	February 2008	March 2008
Treasury debt in PLN billions	478.5	501.5	500.1	498.6	497.4
of which					
- domestic debt	352.3	380.4	377.0	379.4	380.1
- foreign debt	126.2	121.1	123.1	119.3	117.3
Public debt in PLN billions	505.0	527.5	X	X	

Source: GUS, Statistical Bulletin, no. 3/2008, table 25 and 26, p. 80 and 81.

### **Summary**

The business community and experts have insisted that the government should take advantage of Poland's favourable economic conditions and carry out structural and institutional reforms to sustain high economic growth, stabilise inflation and ensure economic equilibrium. The Ministry of the Economy is working on the National Reform Programme for 2008-2011, which is to help Poland implement the Lisbon Strategy.

Prime Minister's Office: The most important tasks the government faces in the first half of 2008 is to simplify economic law and reform the pension system. The document the Ministry of the Economy is preparing is an update on the national reform programme for the implementation of the Lisbon Strategy. The changes planned will help to harmonise the programme's guidelines with the policy pursued by this government. The most important will be legislative work, to be started in the first half of the year, aimed to simplify economic law under the enterprise bill. The government has already adopted a draft amendment to the law on economic freedom and a draft amendment to the civil code. We will now be working on amending the labour code, tax law and company law. Legal solutions are to be worked out by the end of June to speed up the implementation of pension reform, including bridge pensions for those employed in special conditions. Additionally, work is underway on the programme to streamline spending on government administration. ([www.kprm.gov.pl](http://www.kprm.gov.pl))

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