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FOCUS NOTES: POLAND

Written By:

Dr. Stella Kanellopoulou:
Research Economist
skanellopoulou@eurobank.gr

GDP growth remains robust, yet Swiss franc appreciation weights on household disposable income

- **GDP growth remained robust; it stood at 4.3% yoy in Q2-11 driven by domestic demand supported by accelerating investment growth**
- **The CHF appreciation weights on household disposable income since 30% of household debt is denominated in CHF.**

GDP growth still robust driven by solid domestic demand

GDP growth remained robust in the second quarter; the Polish economy expanded by 4.3% yoy in Q2-11 (vs. 4.4% yoy in Q1-11) and by 1.1% qoq for the second successive quarter. Moreover, Poland was the only country in the region where output did not slow in the second quarter (unlike Czech Republic, Hungary and Slovakia). Domestic demand rose 2.4% on the quarter (4.3% yoy). Private consumption grew by 3.5% yoy and 0.9% qoq in Q2-11 vs. 3.9% yoy and 0.7% qoq in Q1-11 but the largest contribution to domestic demand, came from investment spending. Gross fixed capital formation accelerated to 7.8% yoy in Q2-11 from 6.0% yoy recorded a quarter earlier. This acceleration was supported by preparations for the 2012 European Football Championship coupled with inflows of EU structural funds. Meanwhile, net exports were neutral for growth (vs. -0.1% negative contribution in Q1-11) after subtracting from overall growth in each of the preceding four quarters.

These encouraging Q2-11 growth figures indicate that, so far, Poland once again manages to avoid deceleration in growth although Euro area growth recedes. This is partly due to Poland's large domestic sector which makes the economy less vulnerable to the slowdown in export markets such as Germany. Moreover, the recent zloty's depreciation will help make Polish exports more competitive abroad while at the same time will render imports less attractive, thus helping domestic manufacturers. However, the economic deceleration in the Euro area (notably Germany, Italy and France, which are Poland's biggest export markets) is expected to take its toll on Poland's exports, initially affecting

manufacturing, as evidenced by the recent PMI slowdown (51.8 in August vs. 52.9 recorded in July).

On the consumption front, private consumption is set to decelerate as the sharp depreciation of the zloty against the Swiss franc (CHF), in which most mortgages are denominated, should result in higher debt serving costs and hence weights on household disposable income. Furthermore, wage growth is limited, albeit positive in real terms (it stood at 5.4% yoy in August up from 5.2% yoy in July) but not to the extent of boosting private consumption. Recent employment growth slowdown (it stood at 3.0% yoy in August from its peak of 4.0% yoy in March) is not supportive either.

Looking ahead, real GDP growth is projected to ease to 0.6% qoq and 0.5% qoq in Q3-11 and Q4-11 respectively, and to 3.7% yoy in H2-11 after 4.3% yoy in H1-11. Overall, we expect GDP growth to average 4.0% yoy in 2011 as a whole and decelerate to 3.8% yoy in 2012 on the back of the economic activity deceleration in most European countries.

Households with loans denominated in FX are in strain due to CHF recent appreciation

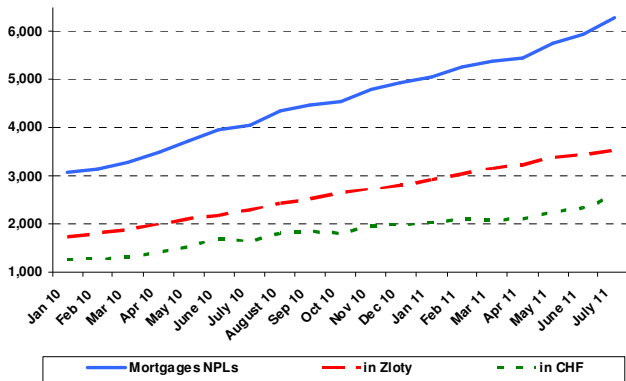
A large share of household and corporate loans is denominated in FX; namely, 31.4% of total outstanding loans in July 2011. More precisely, household debt in FX accounts for 38.4% of total household loans in July 2011 with 30% of household debt denominated in CHF. Thus, the recent CHF appreciation should weight on household disposable income. Furthermore, a rise in Non Performing Mortgage Loans

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denominated in CHF was observed recently; they increased by 11% mom in July and by 30.9% since the beginning of this year (while mortgage debt denominated in zloty increased by 26% year-to-July). (Figure 1)

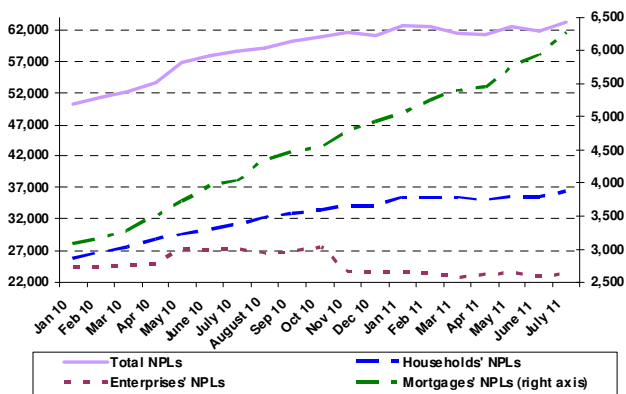
Figure 1
Recent surge in mortgages NPLs denominated in CHF



Source: National Bank of Poland, Eurobank Research.

Total NPLs are rising on households' NPLs rise; they grew by 3.1% year-to-July with household NPLs growing by 7% year-to-July, while mortgages NPLs increasing by 27.6% year-to-July (mortgages account for ca 68% of total household loans). (Figure 2)

Figure 2
Total NPLs acceleration due to households' NPLs rise on mortgages' NPLs escalation



Source: National Bank of Poland, Eurobank Research.

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Eurobank EFG, 20 Amalias Av & 5 Souri Str, 10557 Athens, tel: +30.210.333.7365, fax: +30.210.333.7687, contact email: Research@eurobank.gr

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