Miscellanea

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Ludwik Kotecki*
ORCID: 0000-0001-8791-1218
lkotecki@protonmail.com

Leszek Pawłowicz**
ORCID: 0000-0003-2580-6708
leszek.pawlowicz@gab.com.pl

Marta Penczar***
ORCID: 0000-0002-3564-1460
marta.penczar@ug.edu.pl

Macroeconomic challenges and forecasts for Poland according to experts of the European Financial Congress

Introcudtion

The macroeconomic forecasts drawn up in the first half of 2020, during a period of deep economic crisis of supply and demand, triggered by measures taken to protect population's health and life in response to the threat of the pandemic, are subject to large average errors in estimates. They cannot be a continuation of current trends as they apply to an unprecedented and unique situation, which makes statistical

* Ludwik Kotecki – Instytut Odpowiedzialnych Finansów (Responsible Finance Institute).
** dr hab. Leszek Pawłowicz – prof. UG, Department of Banking and Finance, Faculty of Management, University of Gdańsk; Gdansk Institute for Market Economics.
*** dr Marta Penczar, Department of Banking and Finance, Faculty of Management, University of Gdańsk; Gdansk Institute for Market Economics.

and econometric models virtually inapplicable. Similarly, analog and simulation models based on analogies to similar epidemics (e.g. the Spanish flu pandemic in 1918–1920) in the past do not seem fully legitimate. This does not mean, however, that in these unusual conditions one should not build forecasts or scenarios for the future. Our predictions are based on group expertise. We have requested the assistance of outstanding Polish macroeconomists and experts of the European Financial Congress, mainly current and former major banking economists, but also academic professors as well as specialists from the National Bank of Poland, the Polish Financial Supervision Authority and rating agencies. We assume that their predictions rely on their expertise and intuition rather than on formal models.

The forecasts and opinions presented below constitute a quantitative and qualitative consensus of the 36 responses to our questions, that we have received by 9 June 2020. Quantitative forecasts were provided by 13 experts, while 34 experts presented their opinions on:

- major threats to the economic situation,
- major threats to the financial system stability,
- major opportunities for economic development and greater financial stability,
- recommended economic policy measures.

Forecasts

According to the forecasts of experts associated with the EFC, 2020 is expected to see economic recession and negative GDP dynamics at approx. -4.5 percent, followed by growth at approx. 4 percent in 2021 and 3.4 percent in 2022. The greatest discrepancies in opinions concern the situation in 2020.

This means a more pessimistic GDP forecast for the current year than that in the government convergence program updated in April of this year (-3.4 percent) and a slightly more pessimistic forecast than projected by the World Bank (-4.2 percent). On the other hand, EFC experts are more optimistic about the expected GDP growth in 2021 and 2022.

The forecast consensus also predicts a deeper decline in investment and consumption compared to the government convergence program.

Despite the economic recession in 2020 and the slowdown in 2021 and 2022, Poland will remain a leader in economic growth among the largest economies of the European Union.

However, our inflation forecasts are more pessimistic. The convergence program assumes that in 2020, inflation (CPI) will be at 2.8 percent, while the EFC experts' consensus estimates inflation at 3.1 percent. The differences of opinion among experts in this case are relatively small (standard deviation is 0.2 percentage point).

We predict a moderate increase in unemployment given the depth of the economic downturn. According to experts, unemployment will rise to 6.7 percent at the end of 2020, and fall in 2021 to 5.6 percent (according to BAEL).

Foreign trade will be of key importance for Poland's economic development, as experts predict a -6.2 percent slump in exports in 2020, but a relatively fast bounce--back to high positive rates.

Last year's expert forecasts about a gradual increase in the NBP reference rate and interbank rates have not come true. NBP's three cuts of the reference rate surprised all experts. They currently predict a much lower WIBOR3M in 2020–2022 but still expect interbank rates to grow. Although rate cuts slightly reduced the burden for borrowers, they significantly worsened the condition of the banking sector, especially that of cooperative banks. In our view, such a significant weakening of the banking sector may be counterproductive.

The outbreak of COVID-19 and the unprecedented scale of its economic and financial implications must result in a huge growth of public finance deficit and public debt. EFC experts estimate the average deficit for central and local government at 9.3% of the GDP in 2020 (1 percentage point more than the government) and its reduction to 4.9% of the GDP next year. As for public debt, the economists who have provided their quantitative forecasts predict central and local government debt at 57.4% of the GDP in 2020 and its further increase to 58.1% next year. Also in this case, the government is more optimistic in estimating the debt according to the EU methodology at 55.2% of the GDP this year.

Major threats to Poland's economic development

In addition to quantitative macroeconomic forecasts, we are providing the EFC experts' synthesis of major threats to economic development.

As in previous years, we have mapped internal and external threats.

The synthetic weight (importance) of individual threats is the total score assigned by experts to individual threats, with a total of 100 points being available to each expert.

In addition, each expert rated the subjective probability of individual threats, and the synthetic assessment of the likelihood of each threat is the arithmetic mean of their ratings.

We are also providing an assessment of the convergence of experts' ratings as a percentage of the total number of experts who pointed to a specific threat.

Graphically, the results of expert opinions are presented in the figure (p. 10 – "Major threats to Poland's economic situation in the perspective of 2022"), where the size of circles illustrating individual threats is the sum of the products of weight and probability of a given factor.

According to experts, external factors will have a greater impact on the economic situation in Poland in the coming years.

Among the external threats, the deep recession in the EU (rise of unemployment, drop in production, falling volumes of international trade) and a long return to the 2019 GDP level will have the greatest impact on Poland's economic growth.

It should be remembered that as early as in 2019, EFC experts claimed that the biggest threat to Poland's growth would be an economic downturn in our major trading partners and a weakening of the economic situation in China. Certainly, nobody had expected the economic downturn to be so deep. The risks highlighted by macroeconomists confirm the role of external demand as a key driver of Poland's economic growth in the recent period. This is shown by the fact that the increase in so-called value-added exports accounted for most of Poland's GDP growth in the 21st century. In this context, most survey participants underline their concerns about the effects of deepening protectionism and restrictions on international trade.

An important external threat to harmonious development, which is indicated by 82 percent of EFC experts, comes not only from disrupted supply chains, but also from a less globalized and less liberal market economy.

Another serious external threat to the economic situation in Poland in the next two years is the risk of a recurrence of infections and "lockdowns". The risk will be reduced if a COVID-19 vaccine is introduced.

Asymmetric economic recovery in Poland's main economic partners (countries' asymmetric fiscal response and adequacy of government programs) will be a significant hindrance in the phase of recovering the economy.

In this context, one should also note the Italian-German appeal to the governments of EU Member States and institutions regarding the issue of European health bonds as well as to the call for a common, uniform tax policy, a decisive fight against financial crime and a radical reduction of tax dumping[1].

In turn, business bankruptcies and rising unemployment as well as a fall in investment in response to the sharp supply and demand restrictions have been mentioned as the main internal threat to the country's economic development. A vast majority of experts are also concerned about a public finance crisis and an increase in taxes and para-taxes. Already last year, experts pointed to the excessive burden of social transfers for the state budget as a primary internal threat to harmonious economic development. Now, this threat is much greater.

In emergency situations, during a deep economic crisis, public finance along with automatic stabilizers are an important component of countercyclical economic policy. The use of budgetary policy instruments must not, however, undermine the security of state finances. Given the absence of a clear plan to return to safe levels

1 https://weareinthistogether.eu/petition/tax-dumping/

of the public finance deficit and public debt in Poland, EFC economists point to the public finance crisis as one of the greatest threats in the coming years.

Experts have also pointed out some opportunities for further development of the Polish economy, which may improve Poland's competitive position in the international arena.

First, Poland's investment appeal may increase, in particular due to lower labor costs, Asia's reduced role in supply chains and accelerated digitization and automation processes.

Second, a potential opportunity for rebuilding the value of the economy after the crisis is Poland's presence in the EU and the ability to use EU funds from the European reconstruction fund.

Third, the effectiveness of anti-crisis measures (so-called shields) and support for the development of services and industry as well as public investments contributing to the creation of jobs and reduction of unemployment provide another opportunity.

Fourth, another opportunity is the possible growth in exports due to the weak Polish zloty and low interest rates.

Threats to the stability of the financial system

EFC experts have identified two key factors threatening the stability of the domestic banking sector in the realities of the COVID-19 pandemic. First, the quality of banks' lending portfolios is expected to deteriorate (the highest probability in this edition of the survey: 82.3 percent and the highest weight: 16.3 points). The increase in irregular loans will mainly result from the higher number of business bankruptcies and their financial restructuring, higher unemployment, as well as from a reduced supply of loans from banks in the conditions of economic downturn and a lower demand for loans from customers in the conditions of uncertainty.

Second, according to EFC experts, the NBP policy of cutting interest rates three times (from 1.5% to 0.1%) combined with the Polish quantitative easing program may have a negative impact on the stability of the banking sector (threat weight: 12.6 points, with the 68.3% probability rate). This threat arises from declining net interest margins at banks in the conditions of interest rate cuts, which means a stronger decline in interest income (interest on loans) in relation to a decline in interest costs (interest on deposits), and thus a higher base risk. This will be associated with faster alignment of interest rates on loans and a limited ability to adjust the passive side (lower the price of deposits), due to the fear of losing depositors, which will lead to a higher cost of financing for banks and reduced profitability of banking activities.

As the third factor threatening the stability of the financial system, taking into account the weight and probability of occurrence, the experts name issues involved in the significant ownership participation of the State in the banking sector (probability: 58.6%; threat weight: 9.2 points), which may lead to inefficient allocation of funds, project financing based on political criteria and deterioration of the quality of management in controlled banks, including as a result of non-market based but politically motivated decisions.

A new emphasized threat, which did not appear in previous editions of the survey, is the risk of deterioration of the situation on the corporate bonds market (probability: 71.4%; threat weight: 7.5 points) resulting from a limited ability to issue debt instruments in the conditions of uncertainty, higher cost funds, as well as, indirectly, the condition of bond/debt investment funds struggling to maintain liquidity due to units redemption by clients.

From the point of view of financial system stability, EFC experts also point to the following threats:

- high fiscal burdens (including bank tax), which reduce the efficiency of government programs transmission by the banking sector to the real economy (factor L – probability: 52.9%; threat weight: 8.5 points);
- insolvencies of cooperative banks (factor E – probability: 53.9%; threat weight: 7.8 points);
- insolvencies and restructuring of the largest credit unions (SKOK) (factor F – probability: 52.9%; threat weight: 6.0 points);
- the problem of mortgage loans linked to foreign currencies – higher uncertainty on global markets translating into weaker Polish zloty, growing scale of litigation wins by clients, LIBOR rate left in contracts when the loan is converted from a foreign currency (factor D – probability: 47.6%; threat weight: 7.0 points).

A factor helping to maintain financial stability would certainly be to reduce regulations and fiscal burdens. Therefore, on the one hand, one opportunity is the absence of further legal changes causing an even greater uncertainty about the conditions for the operation of financial institutions and their more flexible alignment to actual sector problems, and, on the other hand, elimination of the bank tax, at least as for new loans for development and rebuilding of the capacity.

Another element enhancing the stability of the financial system would be to ensure that anti-crisis measures are effective, both in relation to banks themselves and to their clients. EFC experts emphasize the need for the state, on the one hand, to support the non-financial sector to limit bankruptcies and to relatively quickly restore economic activity, and on the other hand, to intervene to stabilize the financial sector. Important in this respect is a responsible NBP policy which would guarantee banks' continued access to financial operations with the central bank to support the liquidity of the banking system, and which would be focused on measures helping to grow market interest rates.

An opportunity for financial system stability would also be to ensure properly functioning restructuring mechanisms, which in the conditions of deteriorating economic conditions would limit irregular loan portfolios at banks. To this end, it is being proposed that a specialized asset management institution be established to manage "bad assets" of the banking sector.

Figure 1. Forecasts of selected macroeconomic indicators in 2020–2022

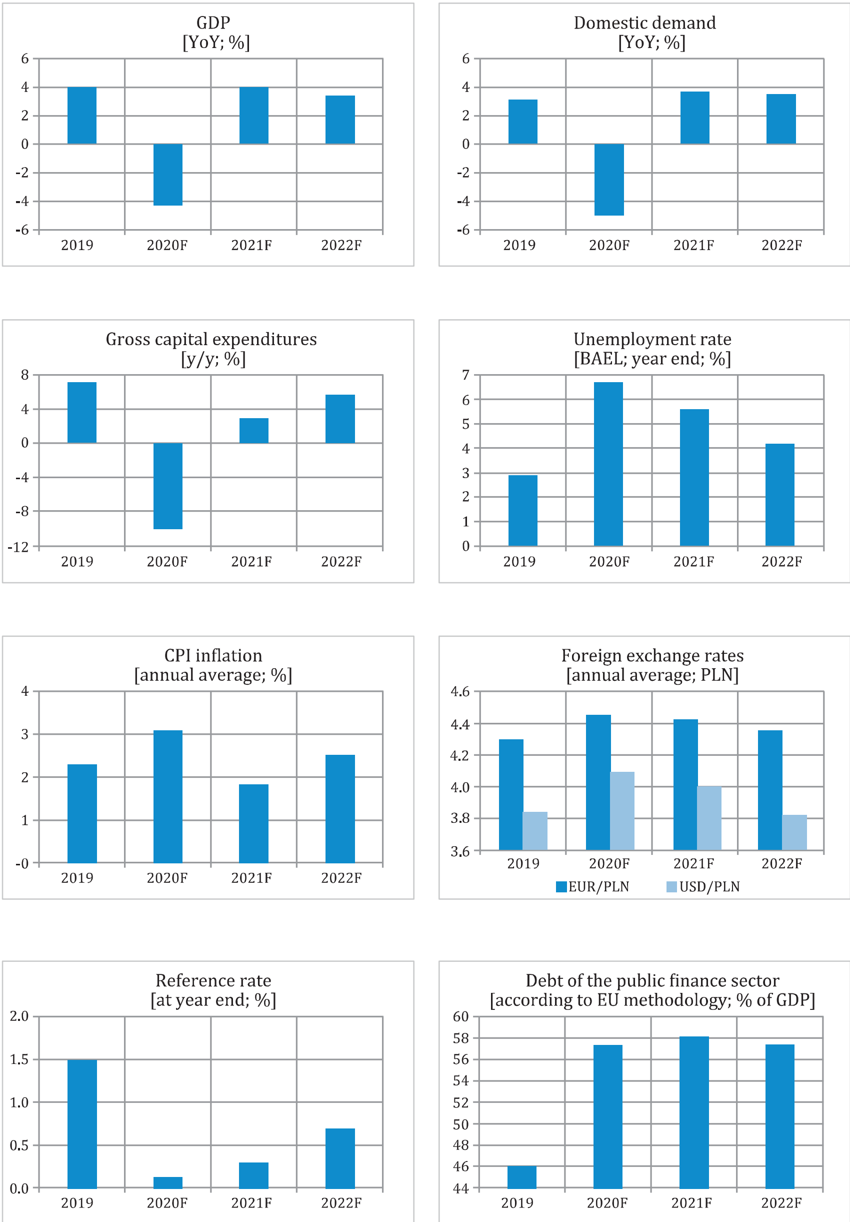


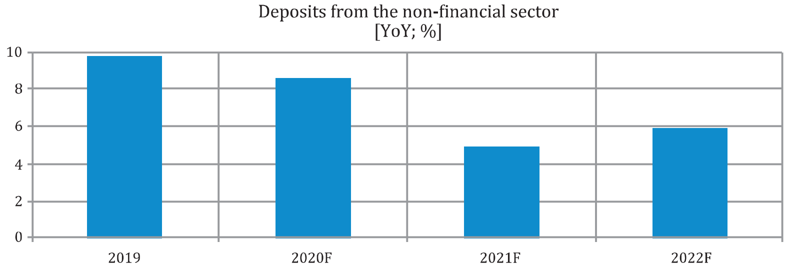
Table 1. Forecasts of selected macroeconomic indicators in 2020–2022

Ratio	Measure	2019	SURVEY RESULTS 2020F	2021F	2022F	NUMBER OF EXPERTS
GDP (y/y; %)	mean	4.1	**-4.5**	**4.0**	**3.4**	[13]
	st. deviation		1.4	1.4	1.0	
Domestic demand (y/y; %)	mean	3.0	**-5.0**	**3.8**	**3.6**	[10]
	st. deviation		1.7	2.1	1.1	
Individual consumption (y/y; %)	mean	3.9	**-4.2**	**4.3**	**3.1**	[12]
	st. deviation		2.3	2.3	0.8	
Gross fixed capital formation (y/y; %)	mean	7.2	**-10.1**	**3.0**	**5.7**	[12]
	st. deviation		2.8	2.7	3.8	
Unemployment rate (BAEL; year end; %)	mean	2.9	**6.7**	**5.6**	**4.2**	[9]
	st. deviation		1.1	2.0	0.7	
Gross wages in national economy (y/y; %)	mean	7.2	**3.6**	**3.8**	**4.6**	[10]
	st. deviation		0.7	0.9	0.7	
Employed in national economy (end of period; y/y; %)	mean	2.2	**-2.8**	**0.4**	**1.2**	[6]
	st. deviation		2.4	1.7	1.3	
Inflation (CPI; annual average; %)	mean	2.3	**3.1**	**1.8**	**2.5**	[12]
	st. deviation		0.2	0.9	0.5	
Base inflation excl. food and energy prices [%]	mean	2.0	**3.1**	**1.4**	**2.4**	[10]
	st. deviation		0.4	1.2	0.8	
EUR/PLN (annual average)	mean	4.30	**4.45**	**4.43**	**4.36**	[13]
	st. deviation		0.07	0.11	0.14	
USD/PLN (annual average)	mean	3.84	**4.09**	**4.01**	**3.82**	[13]
	st. deviation		0.28	0.33	0.17	
Reference rate (year end; %)	mean	1.50	**0.13**	**0.30**	**0.71**	[13]
	st. deviation		0.12	0.51	0.72	
WIBOR 3M (year end; %)	mean	1.71	**0.33**	**0.39**	**0.69**	[10]
	st. deviation		0.13	0.18	0.46	
5Y bond yield (annual average; %)	mean	1.97	**1.08**	**1.30**	**1.42**	[10]
	st. deviation		0.50	0.61	0.29	
Public finance sector balance according to EU methodology (% GDP)	mean	-0.7	**-9.3**	**-4.9**	**-4.3**	[11]
	st. deviation		0.9	1.8	1.8	
Public finance sector debt according to EU methodology (% GDP)	mean	46.0	**57.4**	**58.1**	**57.4**	[11]
	st. deviation		2.9	3.6	3.5	

Table 1 – continued

Ratio	Measure	2019	SURVEY RESULTS 2020F	2021F	2022F	NUMBER OF EXPERTS
Export of goods and services (fixed prices; y/y; %; according to national accounts)	mean	4.7	**-6.2**	**6.4**	**6.5**	[9]
	st. deviation		6.5	5.2	3.4	
Import of goods and services (fixed prices; y/y; %; according to national accounts)	mean	2.7	**-6.5**	**5.9**	**7.2**	[9]
	st. deviation		5.6	5.6	3.4	
Current account balance of payments (% GDP)	mean	0.5	**0.6**	**0.4**	**-0.3**	[10]
	st. deviation		1.6	1.3	0.8	

Figure 2. Forecasts of change dynamics for selected banking sector indicators in 2020–2022



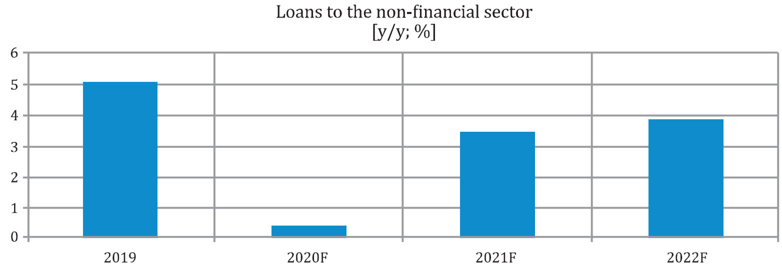
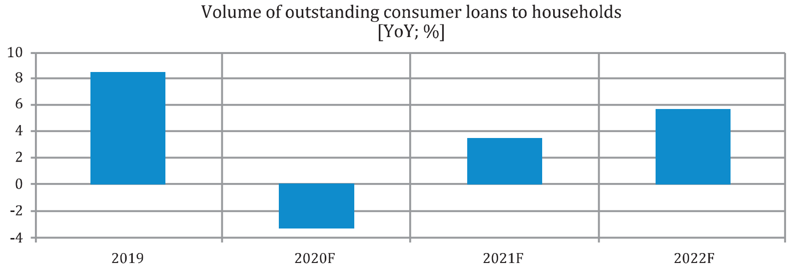


Figure 2 – continued



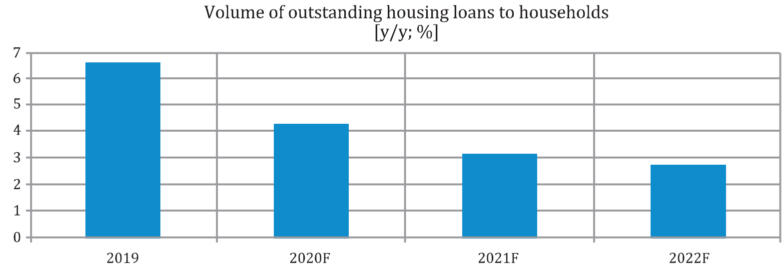
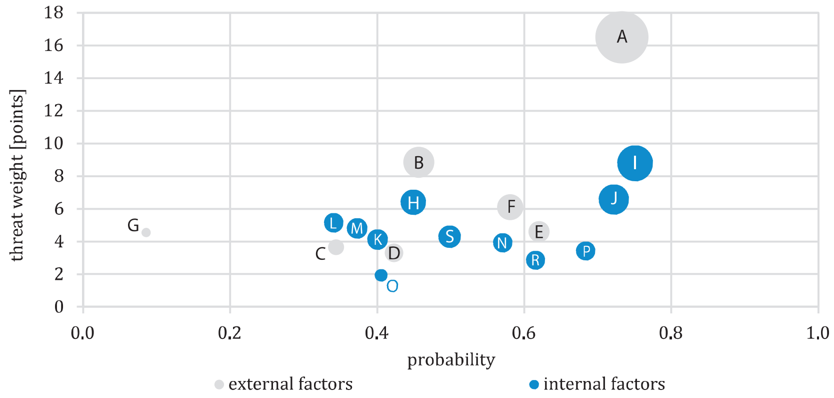


Table 2. Forecasts of change dynamics for selected banking sector indicators in 2020–2022

Ratio	Measure	2019	SURVEY RESULTS			NUMBER OF EXPERTS
			2020F	**2021F**	**2022F**	
Loans to the non-financial sector (y/y; %)	**mean**	5.1	**0.5**	**3.4**	**3.9**	[5]
	st. deviation		2.7	0.8	0.8	
Deposits from non-financial sector (y/y; %)	**mean**	9.8	**8.5**	**4.9**	**5.9**	[5]
	st. deviation		4.9	1.2	0.8	
Volume of outstanding consumer loans to households (y/y; %)	**mean**	8.4	**-3.3**	**3.5**	**5.7**	[5]
	st. deviation		4.4	1.7	1.6	
Volume of outstanding housing loans to households (y/y; %)	**mean**	6.6	**4.3**	**3.1**	**2.7**	[5]
	st. deviation		2.4	2.1	1.3	
Volume of outstanding loans to non-financial enterprises (y/y; %)	**mean**	3.0	**-0.9**	**1.9**	**4.5**	[5]
	st. deviation		3.8	0.9	1.6	
Deposits from households (y/y; %)	**mean**	9.7	**7.1**	**4.9**	**6.3**	[5]
	st. deviation		3.5	1.8	1.2	
Deposits from non-financial enterprises (y/y; %)	**mean**	10.0	**12.7**	**4.9**	**5.2**	[5]
	st. deviation		10.4	1.9	0.6	

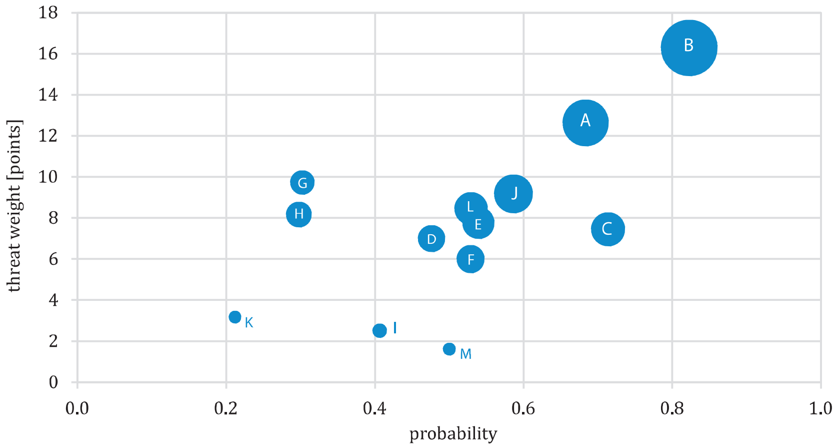
Figure 3. Major threats to the economic situation of poland in the perspective of 2022



* circle size indicates the sum of the products of the indicator's weight and probability, as assigned by individual experts

		Weight (1 means the highest weight)	Probability	Percentage of respondents
A	In 2020, a deep recession in the European Union and a long return to the 2019 GDP levels.	1	0.73	94%
B	New infection waves and lockdowns until a COVID-19 vaccine is introduced.	2		88%
C	Insufficient and/or ineffective monetary and fiscal packages			59%
D	Asymmetrical economic recovery of Poland's main economic partners			65%
E	Greater volatility on global financial markets		0.62	74%
F	Greater volatility on global financial markets			82%
G	Collapse of the euro zone due to the crisis			56%
H	Public finance crisis	5		82%
I	Bankruptcies and rising unemployment	3	0.75	85%
J	Decline in investment	4	0.72	82%
K	Reduced EU funds for Poland as a result of EU procedures on the rule of law			71%
L	Banking/financial crisis			68%
M	No control over coronavirus infections, problems in the healthcare sector			65%
N	Higher taxes and para-taxes (fees, contributions)			79%
O	Risk of political instability			47%
P	Deterioration of financial conditions (more difficult access to credit, limited ability to issue bonds or equities)		0.69	65%
R	Postponement of major structural reforms			68%
S	Restrictions on democracy/ civil liberties			71%
T	Other external factors			6%
U	Other internal factors			6%

Figure 4. Major threats to the stability of the polish financial system in the perspective of 2022



* circle size indicates the sum of the products of the indicator's weight and probability, as assigned by individual experts

		Weight (1 means the highest weight)	Probability	Percentage of respondents
A	NBP policy – interest rate cuts, quantitative easing (Polish QE)	2	0.68	72%
B	Deterioration of the credit portfolio quality	1	0.82	83%
C	Deterioration of the situation on the corporate bond market		0.71	76%
D	The problem of mortgage loans linked to foreign currencies (higher uncertainty on global markets translating into weaker Polish zloty, growing scale of litigation wins by clients, LIBOR rate left in contracts when the loan is converted from a foreign currency)			83%
E	Insolvencies of cooperative banks		0.54	83%
F	Insolvencies and restructuring of the largest credit unions (SKOK)			79%
G	Collapse of a medium-sized bank causing destabilization of the Polish banking system	3		72%
H	Banking/financial crisis in the European Union resulting from problems being magnified during the COVID-19 pandemic			72%
I	Structural mismatch of domestic banks' assets and liabilities			55%
J	Excessive State participation in the banking sector	4	0.59	76%
K	Aggressive marketing of toxic financial instruments			52%
L	High fiscal burdens (including bank tax) which reduce the efficiency of government programs transmission by the banking sector to the real economy	5		83%
M	Other			10%

Five major economic policy measures recommended for Poland by 2022

I. Continued anti-crisis measures

For obvious reasons, the economic measures recommended by EFC experts differ from those advised in previous editions of "Macroeconomic Challenges and Forecasts for Poland". Among the recommendations in this edition, anti-crisis and short-term measures are definitely predominant. Economists point to the necessity of state aid in terms of liquidity, flexibility and deregulation of the economy, and loan guarantees. These include, in particular:

- support for financial liquidity, including through loan guarantees or merchant credit insurance, subject to job retention,
- deregulation, simplification of business activity,
- supporting measures aimed at aligning production and services with the "new normalcy",
- intensification of active labor market measures vis-a-vis the unemployed and economically inactive through training, assistance in retraining,
- adoption of a migration policy aimed primarily at workers from the East and favouring their permanent settlement in Poland,
- improvement of the restructuring program for businesses and banks,
- monitoring the efficacy and flexible adjustment of the anti-crisis package.

II. Increasing the transparency of public finance and rationalizing the budgetary policy

Despite the crisis and the need to pursue a counter-cyclical fiscal policy leading to an increase in the deficit and public debt, concern for transparency and efficacy of the budgetary policy ranks at the top of recommended measures. What is particularly surprising is the repeated call for restoring transparency in public finance, and respecting Polish, constitutional and statutory, as well as EU fiscal rules. EFC economists recommend:

- a reduction of irrational public spending, better targeting of social spending,
- putting additional welfare projects on hold and increasing allocations to public investment,
- restoring credibility of public finance through greater transparency and planned return to the stabilizing expenditure rule.

III. Increasing healthcare system capacity

The crisis caused by a dangerous virus with a diameter of about 100 nanometers has laid bare the glaring unreadiness of the Polish administration and healthcare system for such threats. One cannot rule out that a longer time will be needed to fight the epidemic or that successive epidemiological threats of this kind may occur in the future. Hence, in addition to current coping with the epidemic, it is so important to learn lessons as we go. Specific recommendations with regard to health protection and health care include:

- higher expenditure on health care (salaries, staff, tests, test laboratories, etc.),
- development of an efficient information gathering system enabling early identification of potential outbreaks,
- preparation (strengthening) of the health care system, as well as administration (including local governments) and businesses, to rapidly extinguish new outbreaks (through mass testing, monitoring of new cases, quick isolation of those infected and/or at risk of infection, etc.) in order to avoid another lockdown,
- development and immediate implementation of a public sanitary protection plan, careful lifting of epidemic restrictions, perhaps geographically selective.

IV. Increasing public investment as a way of rebuilding the post-crisis economy

Another area that has received great support among experts includes public investment, a classic way of stimulating the economy. It proves to be essential for at least three reasons: it is a good response to a crisis of the demand, it is important to maintain or increase the economic potential of the Polish economy, it can be a way to obtain support from the EU. The following in particular are being recommended:

- public investment in key areas: digitization (infrastructure, 5G) and the green economy, which would favour both a change in the energy mix and the use of a significant pool of EU funds for this purpose,
- support for private investment through government and EU aid programs,
- expansion of the scope of pro-investment instruments (tax breaks, subsidies) geared toward investment in innovation,
- intensification of communication measures regarding available automation/robotization technologies and the resulting potential for growing business efficiency.

V. Improving regulatory and legal stability

The factor contributing to the growth of private investment is the stability of law and regulations. EFC experts once again call for the need to reduce legal and institutional uncertainty, to enhance stability of the rules of the game and predictability of the regulatory environment.

To improve regulatory and legal stability, it is necessary to:

- depoliticize the economy and introduce fundamental changes in the current corporate governance policy applied toward the economic entities effectively controlled by the state,
- seek a permanent agreement with the European Commission on the rule of law, resuscitate the “fuses” of democracy – the Constitutional Tribunal, the Supreme Court, prosecutors and the President,
- improve the transparency, stability and predictability of the regulatory environment in order to mitigate risks and to make private investment more attractive.