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Polish economy: past trends and perspectives for 2018

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Ladies and gentlemen,

Let me begin by thanking the International Group of Chambers of Commerce for organizing this event and inviting me. As president of Narodowy Bank Polski – Poland's central bank – I thought it would be most constructive if I shared with you my perspective on the Polish economy: where we are today, and where we are headed in 2018. However, before we can talk about the present and the future, we should take a step back to understand where the Polish economy came from.

Poland: transition success story

We meet today in a nice, luxurious hotel, in the buzzing center of a modern-looking city. Walking down the streets, we feel no different than in any Western capital – we have the same shops, the same cars, the same smartphones. And if we take these things for granted, then this is perhaps the best evidence of the great progress that Poland has achieved over the past 30 years. Because 30 years ago, there were hardly any luxurious hotels here, and "nice shops" were ones that offered more than vinegar on a regular basis.

Thanks to the collapse of communism and an ambitious transition towards a market economy we are quickly bridging the gap between us and Western Europe. Since the early 90s, our GDP has grown by almost 4% per year on average, effectively doubling in real terms. We have built efficient monetary institutions with an independent central bank pursuing inflation targeting strategy which is considered state-of-the-art approach to monetary policy. As a result, inflation in Poland fell from three-digit levels in 1990 to roughly 2% on average over the past decade. Through the years, price stability has facilitated a more efficient use of resources, allowing a structural fall of unemployment from double-digit levels in the early 2000s to levels comparable with Europe's most efficient economies.

By all accounts we are converging to Western European living standards. This is visible not only in hard data but also in softer metrics such as reduced pollution, better quality diets and improving health care services. We have also achieved and improved political and institutional stability through membership of NATO and the EU.

Current economic situation: this time *is* different

Today, Polish economy is one of the fastest growing in Europe. GDP growth reached a 6-year high of 4.9% in the 3rd quarter of 2017 and was comfortably above 4% in the whole year. A big contribution to growth came from consumption which is supported by rising employment and wages, very good consumer sentiment and the so called "500 plus" family support program. We also see a pick-up in investment on the back of an improved absorption of EU funds from the new financial perspective. Finally, GDP growth is also stimulated by economic recovery abroad, in particular in the euro area, as external demand for our goods and services improves.

But what makes me particularly optimistic about the prospects of the Polish economy is that last time things were looking so good, that came at a price of growing imbalances. This is not the case now. Let me expand on this a little using the metric that people often care about the most – unemployment.

Currently, unemployment in the Polish economy is at its lowest level on record – just below 5%. The only time we were near these levels was about 10 years ago at the peak of the pre-crisis boom. However, in hindsight, situation back then was unsustainable. Wages were growing at double-digit levels, inflation exceeded our upper limit for deviations from the 2.5 % target. Loans to households were growing at a pace of 40% and we had a current account deficit of about 6% of GDP.

Contrast this with current developments. Wages in the economy are growing at a moderate pace of about 5%. CPI inflation is just below the NBP's target and domestic price pressure is limited as core inflation remains below 1%. Moreover, credit in the entire economy is growing in line with nominal GDP, while current account is balanced. Therefore, this time really is different and we are not overextending ourselves.

Perspectives for 2018

The key question is of course how robust and long-lasting these tendencies turn out to be. Niels Bohr famously joked that prediction is very difficult – especially about the future. Ben Bernanke, former chair of the Fed, gave an even harsher assessment saying that economic forecasting makes weather forecasting look like physics. Unfortunately, both you – as businessmen – and I, as a central banker, have to form some views about where the economy is headed. And when it comes to forming a coherent story about future economic tendencies, it is generally difficult to do better than NBP staff in the projection published as part of our *Inflation report*. So let me share with you what we think is likely to happen over the next quarters.

Back in November, our expectation was that GDP growth would decline slightly and reach about 3.6% in 2018. This was related to our expectation that the effects of child benefits on consumption dynamics would slowly fade away and that growth in the euro area would slow down somewhat, leading to a fall in external demand for our exports. However, macroeconomic data has surprised on the upside since, so our projection will most likely be revised upwards in March. All in all, in 2018 the economy is expected to continue growing at a healthy pace, though perhaps slightly lower than in 2017. When it comes to inflation, we expect price growth to remain in line with the inflation target.

Against such background, there is little to suggest any adjustment in monetary policy parameters in the next quarters. NBP interest rates have remained unchanged since early 2015, with the main policy rate at 1.50% – historically low for Poland, but comfortably above zero and markedly higher than in most advanced economies.

As I have explained, the economy shows no signs of overheating, macroeconomic stability is maintained and inflation is set to remain in line with target. Thus, the current level of interest rates is warranted to keep the economy on the balanced growth path and to maintain macroeconomic stability.

Risk and challenges ahead

I have shared with you my forecast of how the Polish economy is likely to evolve over the next quarters. But any good forecast should include an assessment of risks. So let me now share with you some of the risks that I think about in the context of Poland's growth and development perspectives – in 2018 and beyond.

One key issue is that of potential spillovers from the unconventional monetary policy of the Western world. The Federal Reserve has already started the process of reducing its balance sheet. So far, this has not affected local markets as risk premia are low and bond investors seem convinced that inflation in advanced economies will remain low for the foreseeable future – the so called "missing inflation" view.

But what if investors' moods and expectations were to change? What if inflation – so far "missing" from the global picture – were to reappear? This would likely increase longer-term interest rates in advanced economies and trigger capital outflows and exchange rate volatility in emerging market economies.

Fortunately, as I have explained, Poland has strong fundamentals and should be quite resilient in such circumstances. In fact, given that we have left our interest rates above zero, we are in a more comfortable position than some of our peers, as monetary policy in Poland has space to react both ways. We can reduce or increase interest rates if that should be necessary to maintain price stability in the medium term and keep the economy on a balanced growth path.

On this optimistic note let me conclude by thanking you for taking an interest in our country. I trust and hope that your business ventures in Poland will be profitable, bringing you as well as the Polish economy long-term benefits. Thank you.