



# Weekly Briefing

**Poland Economy briefing:**  
**Poland Domestic Economic Development**  
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The latest development in the Polish economy has been mainly driven by the discussion related to the international rating and the growing prices of energy. The briefing takes these two important issues and discusses the possibility of future investment in Poland. First, stable international ratings might help to attract foreign investments. From the perspective of growing energy prices the critical issues are to attract foreign investment in the energy sector, then limit the electricity prices and finally build the more competitive economy.

As presented by Fitch international rating agency the forecast of Poland's GDP dynamics in 2018 will grow to 4.8 percent from 4.4 percent in 2017. This, however, is not seen as the constant and there are expectations for the slowdown from the second half of 2019. The GDP dynamic will count approximately 3.4 percent to 3.6 percent. At the moment the government policy supports consumption, while in the second half of 2018 and the beginning of 2019 investments should become the main driver of economic growth. According to the Fitch report: *economic growth will slow down in 2019 and 2020. Investments will also slow down as the rate of increase in spending of EU funds decreases, while the net trade component may weigh heavily on the importing nature of economic growth.* The second observation says that the tight labor market and low currency depreciation are likely to push inflation up, which will trigger the central bank's reaction in the form of interest rate hikes in the second half of 2019. According to the Fitch statement, the rating of Poland reflects the country's strong macro fundamentals, supported by a sound monetary framework and solid banking sector. On the other hand, the presented rating is constrained by weak GDP per capita and high declining net external debt.

The S&P Agency increased the long-term rating of Poland, while Fitch did not change the rating of our country's creditworthiness. The S & P agency upgraded our country's rating to "A-" from "BBB +", and its outlook remained stable. The decision taken by Fitch was justified by the conclusions that a diversified economy and strong macroeconomic foundations that are supported

by a strong economic framework and a solid banking sector. The major problem remains unanswered: still low level of GDP per capita and high foreign debt compared to countries in the region. The rating is stable, however, Fitch recognizes the negative actions regarding the rating: first, any sign the Polish government will meet the EU criterion of the general government deficit will be reduced by three percent of GDP as a fiscal anchor or in the medium term will not stabilize public debt in relation to GDP, second the framework of macroeconomic policy will weaken, which could potentially result in lower GDP growth and third a worsening of the standards of governance or business climate, which would have a negative impact on the economy.

Apart from the ratings, the important issue for the future of domestic and foreign investment are the prices of energy. As announced by the Association of Entrepreneurs and Employers *Within a few years, we can have the most expensive electricity in Europe, and already at the moment, large customers pay significantly more per megawatt over the region.* The rising energy prices will affect not only our wages but also prices throughout the country. To follow the obvious conclusions the electricity prices constitute a cost that is particularly acute for production enterprises with high consumption. For distributors, rising electricity prices mean higher risks. From the point of view of the consumer, more expensive electricity is associated with an increase in the prices of products and services. Economists from Credit Agricole reach similar conclusions. Higher electricity prices mean lower wage growth and more expensive products. Apart from the mentioned issue the problem, in the long run, we can expect even a gap in the supply of electricity.

The major reasons for the growing of the electricity prices are mainly rooted in two factors. The first of these is the increase in the prices of CO2 emission allowances, the price of which on the European Power Exchange (EEX) in September amounted to 21.42 EUR / t, which means an increase of 215.3% y/y. The second factor is the higher price of coal, which in September amounted to 100.69 USD/t (11.1% y/y, the price of coal). The factors mentioned above have a

particularly strong impact on energy prices in Poland, as about 80 percent electricity in Poland arises in coal-fired power plants.

## **Conclusions**

The discussed ratings presented by S&P or Fitch allow to be the optimist, however, when it comes to the reality of the future investment in Poland the situations might worry. By 2030 our demand for power may increase from 26 gigawatts to 33 gigawatts. At the same time, there are no new power plants in Poland that could meet growing needs, and more than 60 percent. existing installations are already old enough that soon it will no longer be able to continue working. In the next few years we can have the most expensive electricity in Europe, and already at the moment, large customers pay significantly more per megawatt than countries in the region (about 69 euros in Poland vs. 57 euros in the Czech Republic or 38 euros in Germany). According to Polish Energy Group, the largest, state-controlled Polish electricity producer, in 2018 saw Poland with the highest wholesale prices for energy in comparison to neighboring countries. In Germany, the price was lower by PLN 46 (EUR 10.7) per MWh on average, in the Czech Republic – by PLN 41 (EUR 9.5), while in Sweden – by PLN 29 (EUR 6.78).

The increase in electricity prices will affect not only the increase in prices of final products but also the reduction of other costs by enterprises, including, above all, labor costs. This is in line with our forecast of a slowdown in wage growth in 2019 (6.6% compared to 6.9% in 2018). Due to the consumption of electricity necessary to produce final products, currently observed increases in energy prices will be most strongly felt in the chemical sector (Grupa Azoty, Orlen, Lotos, Ciech, etc.), metallurgy in steel and glassworks, electromechanical industry, including production of transport means, cement plants, and mining, which additionally drives the costs of electricity generation. The Union of Entrepreneurs and Employers suggests that the government should conduct remedial actions within the framework of the formulation of Poland's energy policy. The major

steps that should be taken include: Investing in distributed energy, as well as improving the regulatory framework for energy clusters, it becomes necessary to balance future demand for energy - clusters concentrate in different energy sectors, and by strengthening the decentralization of production, storage and supply and significantly reduce the risk of blackout. As said by the experts there is the need to create a framework and stimulate the formation of energy clusters, i.e. agreements concluded by means of agreements between locally operating entities that deal with the production, consumption, storage, and sale of, among others, electricity but also heat or fuels.

The above-mentioned situation will push the government into more investment in renewable sources of energy, increase the share of "green" sources in the Polish energy mix, including wind farms in particular, including on the sea. One of the visible examples are the investment by Polish Energy Group Energy The in the area of production are the project of the Ostrołęka C coal power plant with the capacity of about 1,000 MWe and the project of construction of a hydroelectric power plant in the second stage on the Vistula with a capacity of approximately 80 MWe. The government offers special subsidies for investments such as: hydropower plants (over 5 MWe), wind farms (over 5 MWe), photovoltaic power plants (over 2 MWe / MWth), biomass power plants (over 5 MWth / MWe) or biogas (over 1 MWe), including energy production also under high-efficiency cogeneration conditions. In order to be self-reliant in electricity production the government conducting the variety of investment in hydro energy power plant e.g. in Lower Silesia province eight projects, or wind energy plants e.g. in Western Pomeranian province seven projects.

To sum up, the government need to implement the new strategy for energy development. The latest document passed in 2009 needs to revise and update. As agreed by the government the Minister of Energy is responsible for the new document. In this context, Poland sees the basic point of reference and the foreign context for Polish energy policy are activities undertaken in this area at the EU level. On the other hand, the foreign (non-EU) investors are welcomed. One of

the illustrative example here is the investment sponsored by Pinggao. It is a subsidiary of the state-owned company State Grid Corporation of China, the world's largest revenue group in terms of revenues, which employs over 1.5 million people. The second example is Sinohydro is a Chinese state-owned hydropower engineering and construction company that opened offices in Warsaw and Wrocław. In the near future there are expectation that the Polish government will attract more FDI in the energy sector.