RBC BlueBay Asset Management

Poland: back on track

Notes from the road

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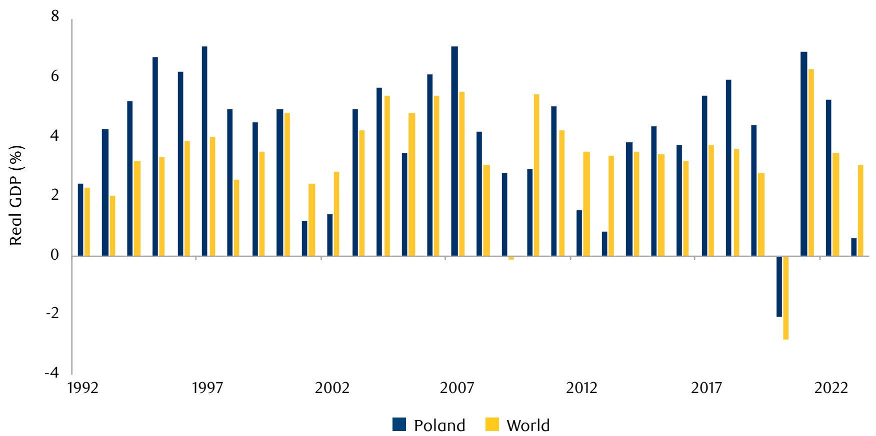
> "Poland's economy has expanded consistently over the past three decades, averaging 4.2% annually between 1991 and 2019, and increasing the country's per capita income by a factor of three."

When asked which country has the highest and most stable economic growth in Europe, Switzerland or perhaps Luxembourg or one of the Nordic countries would likely spring to mind. In fact, the answer is Poland.

Poland's economy has expanded consistently over the past three decades, averaging 4.2% annually between 1991 and 2019 (Exhibit 1), and increasing the country's per capita income by a factor of three. This is one of the longest growth cycles ever observed in global history. However, the pattern was halted in 2020 by the Covid pandemic and a deteriorating macro environment, with the war in neighbouring Ukraine driving 20% inflation soon after[1].

Exhibit 1: Poland long-term GDP growth versus world



Source: IMF WEO, Haver Analytics, Morgan Stanley Research.

[1] Poland inflation rate (tradingeconomics.com).

The near future, however, may hold brighter times. I have just returned from a research trip to the country, and the optimism I encountered was noteworthy. The attitude was upbeat across the board, from government officials to corporations. A number of developments are currently underway in the country that explain the buoyant mood at both the consumer and corporate level, and the prospect of a return to sustainable growth.

Firstly, the economy is improving, with a rapid normalisation in inflation, and this is restoring savings, purchasing power, and consumer confidence. Secondly, recent political leadership changes have resulted in better prospects for structural reforms and an improved relationship with the EU. This has given the country access to an additional EUR60 billion in grants and loans[2]. Finally, given the promising outlook for the country and relatively low equity valuations, many investors have begun to invest in the domestic equity market for the first time.

Economy: growth optimism is rising

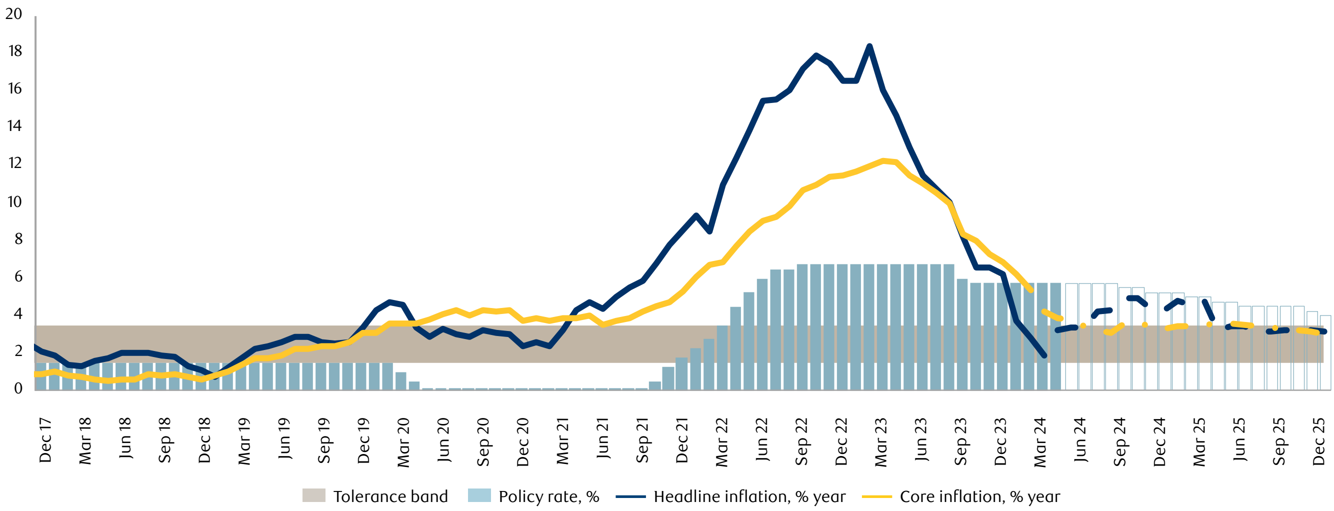
There has been a noticeable improvement in the Polish macroeconomic environment recently. From a peak of 20% in early 2023, inflation has decreased to 2.5%, the nation's long-term average (Exhibit 2). As a result, interest rates are declining and are expected to continue this descent in the second half of the year and into 2025.

Along with other consumer-friendly government initiatives, a robust rise in real wages has restored consumer confidence and savings. In the short term, consumption is expected to be a key driver of growth. In the medium to long term, public and private investments have the potential to support GDP growth towards or above the country's long-term average.

Visiting grocery chain, Dino Polska.

In terms of the country's public finances, Poland enjoys a current account surplus of about 2.0% of GDP[3]. I would draw attention to Poland's export success story throughout the last 10-20 years. The country's exports in 2023 reached EUR334 billion, compared to EUR221 billion in 2020 and EUR153 billion in 2014, a consistent 10% CAGR over the last 10 years[4]. Poland exports agricultural products along with machinery, industrial equipment, and textile products.

Exhibit 2: Polish CPI and base rate – rapid normalisation



Source: IMF WEO, Haver Analytics, Morgan Stanley Research.

[2] Poland's recovery and resilience plan - European Commission (europa.eu).
[3] Poland current account to GDP (tradingeconomics.com).
[4] Morgan Stanley.

The Polish currency has strengthened considerably but is not stretched on most valuation metrics, and in fact on a PPP basis it is still materially undervalued. As of the last count, the country's debt-to-GDP ratio is a relatively low 50% and so is private credit-to-GDP, at 35%[5]. Admittedly, the budget deficit has deteriorated since the pandemic, and it is currently -5% of GDP[6]. However, because of this year's improved economic growth and tax revenues, the deficit is expected to reduce to -4.5% of GDP by the end of 2024. The country's MoF and most economists anticipate a further reduction of 50/60bps per year, as the country develops renewable energy sources and reduces home energy subsidies.

Political change: reforms and EU funds to unlock higher growth.

Poland's October 2023 parliamentary elections, which resulted in the formation of a new Civic Coalition-led government under Prime Minister Donald Tusk, marked a significant transition in the country's political environment after eight years under the right-wing Law and Justice Party. This government has a mandate for structural reforms and initial progress has been positive, particularly the appointment of new management teams for state-owned enterprises and rule of law reforms to increase judicial independence. The latter was crucial in order to improve Poland's relationship with the EU and has resulted in the unlocking of an additional EUR60 billion in funds under the Recovery and Resilience Facility ("RRF"). This will bring the total funds received from Europe to EUR137 billion, equal to 18% of expected GDP in 2024[7]. The absorption of the RRF funds into the economy has the potential to materially lift economic growth over the next decade. According to ECB estimates, GDP growth could increase by 1.3% to 4.1% in 2026 and by 2pp to 4.6% in 2030, as compared to a scenario without the implementation of the RRF.

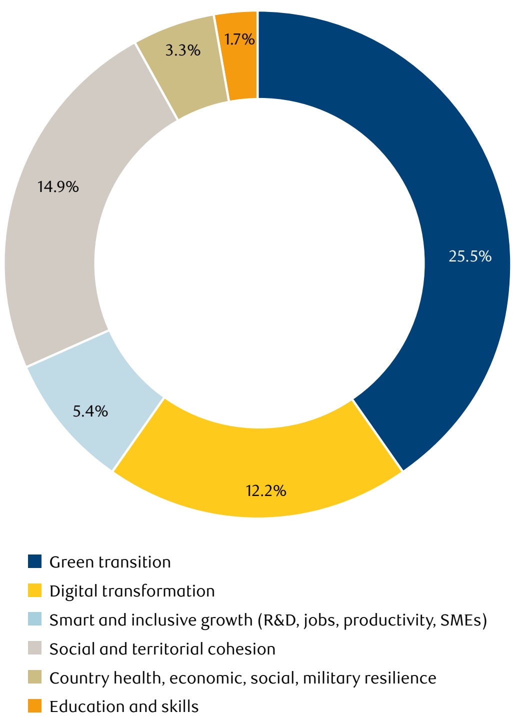
> **"The government is working on details of an energy reform plan, aimed at developing wind farms and boosting the amount of electricity produced by renewable sources."**

Over the near term, with public investment rising, the potential crowding-in effects can also boost private investment. It is generally accepted among economists that the fiscal multiplier tends to be in the 1.25x range, with every USD1 of public investment attracting USD0.25 of private investment. Over the longer term, reforms and the transition to a greener, more digitalised economy are likely to lead to higher productivity and quality growth.

A trip to Pepco, a fast-growing discount retailer.

The government is working on details of an energy reform plan, aimed at developing wind farms and boosting the amount of electricity produced by renewable sources, with an interim target of 30% of energy from these sources by 2030. Poland is among the EU economies with the highest carbon intensity. Energy sector reform will therefore be crucial as a catalyst for further private investment into the sector, as an addition to the EU funds, given 68% of the RRF funds to be received by 2026 are intended to be invested in the green transition (Exhibit 3).

Exhibit 3: EU funds expected deployment – energy reform takes the lion's share



Source: MoF Poland, RBC GAM, as at April 2024.

5 Poland: government debt in relation to GDP 2023 | Statista.
6 Poland government budget (tradingeconomics.com).
7 'Good news': Poland to get up to 137 bln euros in funds, says EU chief | Reuters.

Deepening capital markets

The Polish equity market is up 30% in USD absolute terms since the election in mid-October 2023[8], however valuations for the market remain relatively attractive. Moreover, I note that positioning in Polish equities has been rising since 2022, but GEM funds in aggregate remain underweight the market, and also Poland's weight within EM is well below the long-term average. Previous cases of structural reforms after political events (for example, India in 2014 and Brazil in 2016) support a constructive outlook for the country's domestic equity market.

However, as is frequently the case, there are risks. One potential risk is a resurgence of inflation, which may be revived by strong real wage growth and rising energy prices. This may slow down the pace of interest rate cuts, hurting investments and GDP. Additionally, during my meetings with government officials, I felt that many details around how the EU funds will be deployed needed more clarity, and once those plans are outlined, they will be reliant on strong execution.

[8] Bloomberg.

Author

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Guido is a portfolio manager and head of research for the RBC Emerging Markets Equity team at RBC GAM. Guido is currently responsible for research in Taiwan and Central and Eastern Europe. Prior to joining the organization in 2010, Guido worked as an emerging markets portfolio manager and also as an equities analyst at a U.K.-based asset management firm, specializing in global emerging market strategies. He had previously worked at a global asset management firm as a securities analyst, where he progressed to become a junior portfolio manager. Guido began his career in the investment industry in 1998 as an equity and derivatives trader in Italy.

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