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PANORAMA

Poland – solid economic growth results in a sustainable decrease of company insolvencies

COFACE ECONOMIC PUBLICATIONS

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The current global economic situation could be summarised as a gradual recovery for advanced economies and turbulent times for emerging countries. This would not appear to be the case for the emerging economies of Central and Eastern Europe which, in most cases, are on an improving track. Poland is outperforming this regional group. On a microeconomic level, company insolvencies in Poland are mirroring its acceleration in economic growth. Better economic prospects with decreasing unemployment, rising wages and improved consumer and business sentiments, have triggered higher GDP growth and contributed to a decrease in the number of business insolvencies. At the same time, Polish companies remain active exporters and they have been able to increase foreign trade volumes to new destinations, as well as to their core markets. Thanks to a number of improved conditions, insolvencies of Polish businesses dropped by 5.1% in 2014. So far, this year has generated lower dynamics. Insolvencies decreased by 3.3% in the first half of 2015, with economic growth of 3.4% recorded in the same period. Nevertheless, bankruptcies are twice as high as those in the first half of 2008, and the decrease in insolvencies is lagging behind the improved economic environment.

Detailed insolvency statistics confirm the positive effects of increasing private consumption and higher retail sales. Most of the sectors directly dependent on household demand are showing improved levels of solvency. Consumers are not only focusing on daily necessities but they are also more willing to purchase durable goods. Good prospects on the labour market, deflation and the low interest rate environment are among the factors supporting household spending. Sizeable contractions in the number of insolvencies have been recorded by the food manufacturing and retail sectors, among others. This report analyses the sectorial breakdown of insolvencies, to review which sectors are benefitting - and which are suffering - from the current business environment. Despite increased trading volumes and the improved sentiment, we have noticed a substantial rise in bankruptcies among transport companies, while consolidation processes and market developments have triggered insolvencies in the wholesale sector. This Panorama also discusses the impact of private consumption on business insolvencies and forecasts the level of dynamics needed in order to notice a stabilisation in the number of bankruptcies. According to our analysis, the macro environment is affecting the level of insolvencies. In Poland, GDP growth of 3.1% and private consumption dynamics of 2.9% are necessary in order to stabilize the number of company bankruptcies. Both of these levels have been already reached by the Polish economy. Our forecast assumes that the entire year of 2015 will bring a drop of business insolvencies by 8%. This improvement will be continued next year, when insolvencies are anticipated to decrease by 5%.

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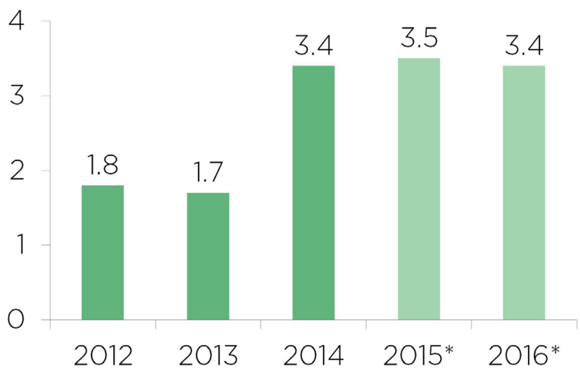
"The increased economic activity in Poland already reached levels required to stabilise the number of company insolvencies. However a long-term sustainability of business improvement could be interrupted by risk factors coming from internal or external side. The latter includes a slowdown of the Chinese economy. Although it will not hamper Polish companies so much, its indirect impact could be experienced through affecting the Polish main export destination – the Eurozone and particularly Germany."

1 POLISH COMPANIES STRIVE TO CATCH UP WITH SOLID ECONOMIC ACTIVITY

The current global economic situation could be summarised as a gradual recovery of advanced economies and turbulent times for emerging countries. This would not appear to be the case for the emerging economies of Central and Eastern Europe which, in most cases, are on an improving track. Poland is outperforming this regional group. Having suffered from the double-dip recession of its most important trading partner (the Eurozone), as well as subdued domestic demand, the combined effects of which brought real GDP growth to the weak levels of 1.8% in 2012 and 1.7% in 2013, the Polish economy has started to recover. Since late 2013, improving foreign and domestic demand have been contributing to increased economic activity. With conditions continuing to improve throughout 2014, Poland doubled its growth rate to 3.4% last year, to achieve one of the highest economic growth levels in the region.

Chart 1:
Poland´s GDP growth rate (%)



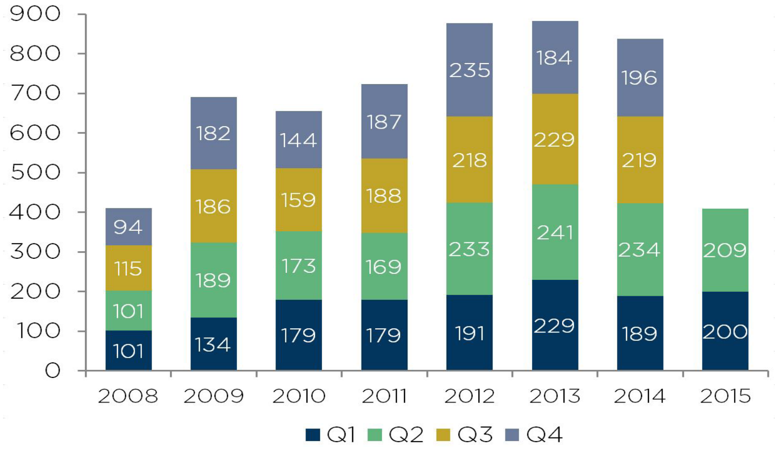
* Coface forecast

Sources: Central Statistical Office and Coface

These improvements have continued in 2015, with the economy growing by 3.6% in the first quarter and 3.3% in the second quarter. Even more important is the fact that this growth is broad-based, with rises in all crucial components including household consumption, fixed asset investments and exports.

Polish companies have been benefiting from the improved macroeconomic environments on both domestic and foreign markets. As a result, the progression was also noticed on a microeconomic level. The rising trend of company insolvencies experienced since 2010 was discontinued in 2014, when bankruptcies dropped by 5.1% at year-end. However, rather than a delivering a gradual, continued, positive impact on insolvency statistics thanks to the continued macroeconomic improvement of the Polish economy, this trend lost momentum. Changes in the economic environment are usually reflected in the level of bankruptcies after several months. However, during the first half of 2015, the fall in the number of company insolvencies slowed down and bankruptcies were only lower by 3.3% compared to the previous period last year. In nominal terms, 409 insolvencies were announced in the first half of 2015. At the same time, it should be noted that insolvency procedures are not commonly used by Polish companies.

Chart 2:
Company insolvencies in Poland



Source: Coface

The full scale of liquidity problems is much larger - with liquidations, the suspension of activities, or going out of business without conducting official insolvency proceedings, being more commonplace.

It therefore makes more sense to analyse Poland's insolvency dynamics as an indicator of the micro situation faced by companies who are exposed to changing market conditions and economic cycles, either domestically or globally.

2 SECTOR ANALYSIS

Insolvencies still on the rise in some sectors

Despite the overall insolvency statistics showing a decline in a number of bankruptcies for the first half of 2015, some sectors remained fragile. As such, improvements were not experienced throughout the whole economy. Generating profitability, following an extended period of market deterioration, is not an immediate process for some companies. In addition, there are also some sectors which have started to suffer from specific external market conditions, despite the overall improvement of the macroeconomic environment. Transport companies and plastic producers are included within this group.

Chart 3:
Company insolvencies by sector in 1H 2015

Sector	Insolvencies in 1H 2015	Change y/y	Share
PRODUCTION, including:	**115**	3%	28.1%
Manufacturing including, but not limited to:	111	11%	27.1%
Production of metals and fabricated metal products	22	10%	5.4%
Production of rubber and plastic products	14	100%	3.4%
Production of food products and beverages	12	-43%	2.9%
Production of clothing and textiles	10	100%	2.4%
Production of wooden products excluding furniture	9	125%	2.2%
Production of machinery, equipment and electrical devices	8	-43%	2.0%
Production of goods from other non-metal natural resources (including construction materials)	8	167%	2.0%
Production of furniture	4	0%	1.0%
Production of chemicals and chemical products	3	-40%	0.7%
Production of paper and paper products	1	-80%	0.2%
Other manufacturing	20	67%	4.9%
TRADE including, but not limited to:	**89**	-14%	21.8%
Wholesale	69	11%	16.9%
Retail	20	-39%	4.9%
CONSTRUCTION	**67**	-20%	16.4%
TRANSPORT	**23**	28%	5.6%
Other sectors	115	10%	28.1%
TOTAL	**409**	**-3%**	**100.0%**

Source: Coface

Construction

The slowdown in construction company insolvencies is continuing. Following a long period of negative performance (see the heat map below), the sector showed a fall of 20% in insolvencies this year. It has been benefitting from infrastructural investments, which remain at a significant level. These infrastructural investments are especially due to the facts that 2015 is the last year when EU members can use funds from the previous EU budget and that it is also an election year in Poland (both presidential and parliamentary elections). This usually favours significant investment by the incumbent government. Moreover, the housing market has started to generate positive developments. With better prospects due to labour market dynamics, households are more motivated to purchase housing, especially as they are able to benefit from the lowest historical level of interest rates. These low interest rates are not only boosting the number of new mortgage loans, but also making bank deposits less attractive. As such, analysis of the real estate market shows that a substantial amount of housing purchases are being made for investment purposes. This overall higher demand is not only a driver for new construction companies but also for those involved in refurbishing. Nevertheless, payment experiences confirm that some companies are still suffering from previous hard times and the sizeable contraction in the prices of construction material prices mean that producers of the latter are represented in the insolvency statistics.

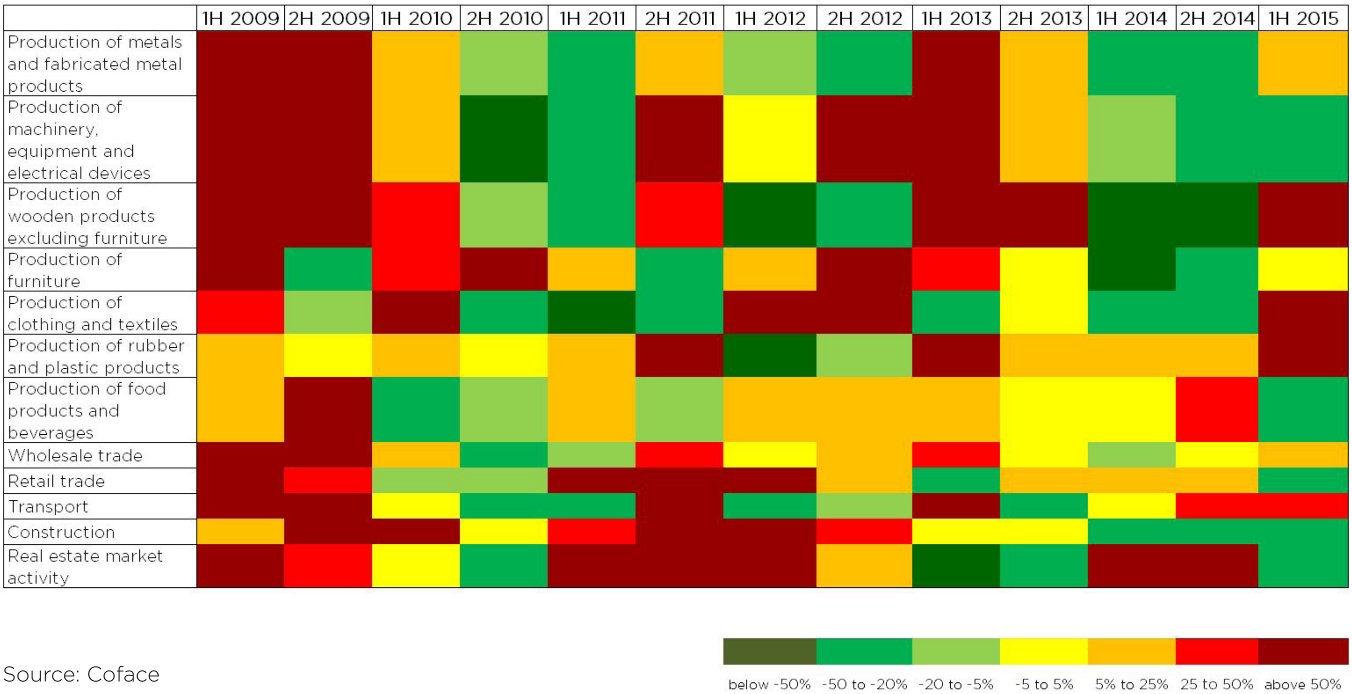
Plastics

The first half of this year brought a 100% increase in insolvencies of companies producing and manufacturing rubber and plastic products. In contrast, the plastics sector has recently recorded positive developments. These include growing demand and a significant slump in oil prices, the main commodity used by the sector. However prices of polyethylene and polypropylene have been rising. In yearly terms, a double digit growth in prices was experienced and further increases are anticipated. Although manufacturing companies have been partly transferring cost hikes to prices of final products, this cost factor has affected the entire sector.

Transport

Insolvencies of transport companies jumped by 28% in the first half of 2015, compared to the consecutive period of the previous year. The performance of Polish transport companies is heavily dependent on external demand, due to their strong exposure to providing international services. The Russian embargo on selected merchandise from the EU, US, Australia, Canada and Norway, implemented in August last year, resulted in a contraction of trade volumes. Moreover, the Russian economic recession has contributed to a decrease in exports to the country and related carriage services - which were usually more profitable than Western European destinations. A compensation for these trade volumes is coming from the recovering Eurozone. Economic improvement, however, remains slow and weak. Moreover, road transport companies are subject to minimum wage requirements for carriages in Germany, impacting their competitiveness. Last but not least, domestic competition in the sector remains strong, which imposes the acceptance of lower margins amid stable fixed costs.

Chart 4:
Heat map of insolvencies by selected sectors in respective semesters (dynamics, y/y)

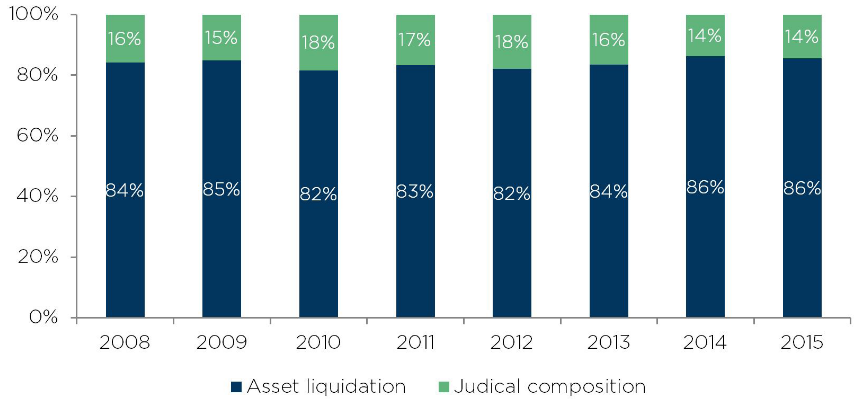


Source: Coface

Box 1. INSOLVENCY TO BECOME A REMEDY FOR COMPANIES

Poland, a relatively large economy, records a low level of company insolvencies. For the entire year of 2014, there were only 823 announced insolvencies out of nearly 1.8 million active companies in Poland. The full scale of Polish companies' liquidity problems is much bigger. Liquidations, the suspension of activities or going out of business without conducting official insolvency proceedings, are much more common. It therefore makes more sense to analyse the insolvency dynamics as an indicator of the micro situation faced by companies exposed to recovery and slowdown cycles, either domestically or globally.

Chart 5:
Insolvency proceedings by types (first semesters of each year)



Source: Coface

Polish companies are reluctant to use insolvency procedures as a remedy, as current legislation is more supportive towards liquidating companies. In recent years, the share of judicial compositions accounted for only 1/6 of all announced insolvencies. However it is likely that the new insolvency law, scheduled to enter into force on 1st January of 2016*, will make use of insolvency procedures more common - especially as a recovery tool for companies facing temporary liquidity problems. The main goal of the new law is to be able to restructure debtors' businesses and prevent their liquidation. This support for the continuation of business should preserve jobs and allow the uninterrupted execution of contracts. Companies in financial difficulties will be able to use various proceedings for restructuring including the procedure of approval of a plan after creditors' votes, accelerated arrangement procedures, ordinary arrangement procedures and rehabilitation proceedings. Substantial changes will be implemented including, among others, redefining bankruptcy tests, removing priority of tax and social insurance claims, extending hardening periods and improving protection against fraudulent conveyances. Unified forms, to be submitted electronically, will be introduced. A central restructuring and bankruptcy register will be created. This will include free-of-charge public access to a search engine for all bankruptcy cases.

* The amendment of the Bankruptcy and Restructuring Law Act, which concerns new provisions on consumer bankruptcy, was implemented with effect from 1st January of 2015. Polish consumers have found it much easier to restructure their debts. During the first eight months of the amendment being in force, there have already been 1,024 consumer insolvencies announced. This is 17 times more than the figures announced during the past several years when the previous law was in place.

Sources: Coface, The National Law Review (article by Ewa A. Lis-Lewandowska, Squire Patton Boggs), Clifford Chance (article by Grzegorz Namiotkiewicz, Clifford Chance), COIG

Insolvencies by business legal form

If we look at different legal forms of insolvencies, it can be noticed that most businesses recorded a decrease in insolvencies, except for general partnerships (a business form in which partners have unlimited liability) and limited liability companies (a legal form that provides limited liability to its owners). Although limited liability companies accounted for the largest number of bankruptcies (as already experienced in previous statistics), their share decreased to 59% compared to 66% in 2011. There were less insolvencies among sole traders, but their share remains high, at 22%. Joint-stock companies represented one tenth of all insolvent companies.

Chart 6:
Insolvencies by business legal form

Legal form	Number of bankruptcies in 1H 2015	Change y/y	Share in total
Ltd.	243	5%	59%
Sole trader	90	-15%	22%
Joint-stock company	35	-17%	9%
General partnership	20	5%	5%
Limited partnership	12	-8%	3%
Cooperative	7	-30%	2%
Other forms	2	100%	0.5%
Total	409	-3.3%	100%

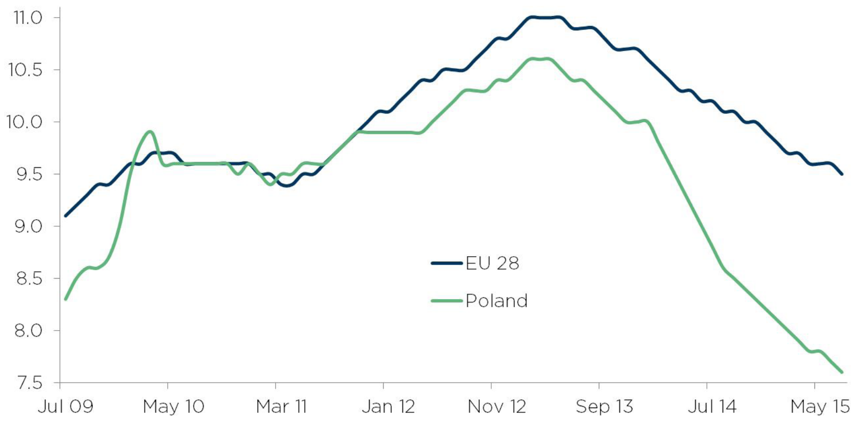
Source: Coface

3 WHAT LEVEL OF HOUSEHOLD CONSUMPTION IS NEEDED TO STABILISE THE NUMBER OF INSOLVENCIES IN POLAND?

Central and Eastern European countries are strongly dependent on exports. For the smaller economies, exports account for the bulk of their nominal GDPs. In 2014, this export share was 81.8% for Lithuania, 83.8% for the Czech Republic, 91.2% for Hungary and 91.9% for Slovakia. There are only two CEE economies where the share of exports to GDP is less than 50% - namely Romania (41.1%) and Poland (46.9%). This does not mean that these countries have not succeeded in exploring foreign markets. They are among the biggest countries in the region with a strong consumer base and they are able to benefit more from internal demand, rather than being significantly dependent on the economic performance of foreign trading partners.

In Poland, household consumption accounted for nearly 60% of GDP last year. Prior to that, private consumption was a significant contributor to saving the country from recession in the challenging years following the collapse of the Lehman Brothers bank. It was also supportive when the country was faced with the double-dip recession of Poland's main trading partner, the Eurozone, in 2012 and 2013. Nevertheless, during this latter period (especially at the end of 2012 and the beginning of 2013), the country experienced subdued internal demand with very weak growth in household consumption. Since then, Poland has started to enjoy positive developments. With increased domestic orders and the start of the Eurozone recovery, companies' assessments of their perspectives improved. Although the improvement process has been weak and gradual, many Polish companies have been able to increase export volumes to their main foreign destination. Against this backdrop, businesses became more willing to hire additional employees and increase wages. The current statistics confirm an ongoing improvement in Poland's labour market. During the first half of 2015 companies increased their workforce by 1.1% compared to the previous period last year, while wages grew by 3.6% in the same period (after an already solid growth of 3.7% for the entire year of 2014). Consequently, the unemployment rate has considerably fallen, to reach levels previously recorded six years ago (7.6% in July 2015, according to Eurostat data). The pace of contraction in unemployment has been faster than in most other European economies and the EU-28 average unemployment rate in July 2015 (9.5%) stood higher than the Polish figure. The positive outlook for Poland's labour market is expected to continue. The number of job offers has increased to record levels and the labour market is already employee-driven in the main Polish cities.

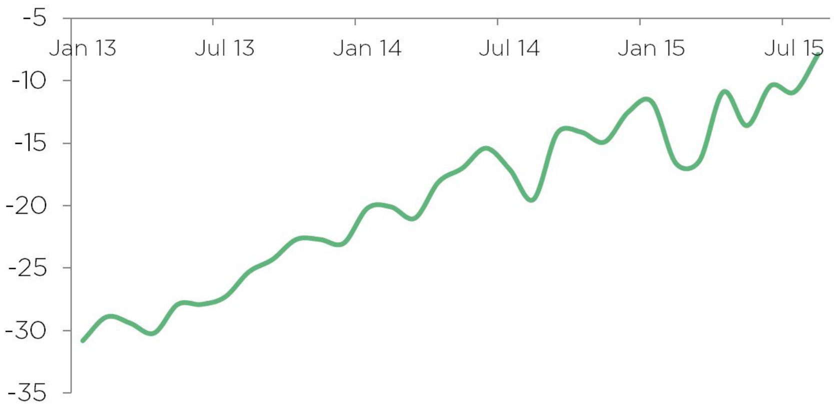
Chart 7:
The unemployment rate (%)



Source: Eurostat

With the improved labour market, Polish households have been more comfortable in their spending decisions. However they remain cautious and, in many cases, prefer to rebuild their savings following a difficult period where not only wages, but job security, were concerns. Retail sales data shows that that rebounding private consumption began with higher spending on daily necessities, whereas increased purchases of durable goods are more recent. The latest retail sales data reveals positive dynamics for both durable and non-durable goods over the last few months. Polish households were more willing to buy not only household appliances but also new cars. Passenger vehicle registrations increased by 13% in 2014 and continued their upwards trend in the first half of this year.

Chart 8:
The current consumer confidence indicator



Source: Central Statistical Office

Domestic demand, especially private consumption, has become a main driving force for Polish economic growth. Besides the improved situation on the labour market, increased consumer spending is also due to a more positive assessment of future perspectives. Households feel more comfortable with purchasing decisions as they perceive the improvements in the labour market as sustainable. Consumer sentiment indicators have thus been rising since 2013, recently reaching the highest levels recorded previously in 2008. Thanks to this positive consumer sentiment, the solid growth dynamics in retail sales are expected to continue over the following months.

Other factors, besides the labour market improvements, are supporting growth in private consumption. The slump in commodities prices, including a 60% drop in oils price since a middle of last year, has resulted in low inflation figures for many economies. This is combined with an oversupply of agro-food production due to good harvests and an embargo on a part of exports imposed by Russia. The Polish economy has been showing deflation of consumer prices since July 2014. Households are benefitting from this economic environment which enhances their purchasing power.

As the Polish economy is supported by a significant consumer base and with good prospects for household spending, does this mean that a slump in company insolvencies will be recorded over the following quarters? Based on previous statistical data, a strong correlation can be seen between growth in private consumption and the number of insolvencies in Poland[1]. Coface estimates that private consumption needs to increase by at least 2.9% y/y, in order to stabilise bankruptcies of Polish companies. In terms of growth of the entire economy – GDP needs to rise by at least 3.1% y/y, in order to reduce business insolvencies.

The correlation between company insolvencies and private consumption, as well as GDP growth, has been less strong in recent quarters. This is a result of factors that have had significant impacts on business bankruptcies in Poland. Although growth in private consumption has been solid in all quarters since the beginning of 2014[2], the retail sector has been subject to the next stage of consolidation processes. In addition, the increased level of household spending has been cautious, resulting in the necessity to adopt low margins. Moreover, the sector is suffering from an ongoing period of deflation. Another cause of the slower decrease in the number of company insolvencies

[1] The correlation coefficient is -0.85 in a case of private consumption growth and -0.72 in a case of GDP growth (2005-1H2015 data).
[2] Since Q1 2014, growth in private consumption was at least 3% y/y in each quarter.

is related to the difficulties experienced by the transport sector. As explained above, bankruptcies in the sector have been rising due to lower export volumes to the East (caused by the Russian embargo and the economic deterioration). Furthermore, the profitability of carriages executed in Germany is constrained by German minimum wage requirements, which also concerns Polish truck drivers.

These factors include the impact of external risks, despite Poland's relatively low share of exports to GDP (47%) compared to most other CEE economies. As such, the positive prospects for household spending will still make contribute to the decrease in insolvencies. Bankruptcies, however, will also remain subject to other contributors from domestic demand and the performance of external markets - especially the Eurozone, Poland's main trading partner.

Chart 9:
The number of company insolvencies and growth in private consumption and GDP

Source: Coface

The Polish economy is heavily dependent on private consumption. Company insolvencies are subject to consumer spending and household sentiment with regards to purchasing. The rebounding private consumption will still have a positive effect on the number of company insolvencies in Poland. Both private consumption and GDP growth have already reached sufficient levels sufficient to stabilise business bankruptcies in Poland. However the recent weakening of the fall in insolvencies is a result of other factors affecting selected sectors.

If trade barriers (such as the Russian embargo) were rejected, this would stimulate a further increase in exports and a have a positive effect on companies. Our forecast assumes that the entire year of 2015 will bring a drop in business insolvencies of 8% and that this improvement will be continued next year, when insolvencies are anticipated to fall by 5%.

4 CONCLUSION

The current global economic situation could be summarised as a gradual recovery of advanced economies and turbulent times for emerging countries. This would not appear to be the case for the emerging economies of Central and Eastern Europe which, in most cases, are on an improving track. Eastern European countries have rebounded not only thanks to a gradual recovery of their main trading partner, the Eurozone, but primarily from rising household consumption. This scenario has been confirmed for Poland. Private consumption has risen by a solid 3% in each of preceding quarters, whereas internal demand has been the main driving force for the Polish economy since late 2013. The country is expected to record broad-based growth, with one of the highest GDP increases in the entire region. Coface forecasts that Poland's growth will reach 3.5% this year and 3.4% next year.

As mentioned above, internal demand is the strongest contributor to Poland's economic growth. The consumer side is benefitting from improvements in the labour market, with falling unemployment and rising wages. Moreover, household purchasing power is being supported by a significant drop in oil prices and the overall deflation of consumer prices. The positive trend is likely to continue, as shown by the high level of consumer sentiment indicators, among other factors. The business side is also looking more positive. With more orders from internal counterparts and external clients, Polish companies have increased their workforce, as well as their capacities. In terms of the latter, gross fixed capital formation has jumped by an average of over 9% each quarter, since the beginning of 2014.

With the environment of solid economic growth, including significant support from the domestic side, the number of company insolvencies is decreasing. According to our analysis, the dynamics of GDP growth need to reach at least 3.1% y/y in order to stabilise bankruptcies of Polish enterprises. The dynamics of private consumption need to reach a minimum of 2.9% y/y . Both of these levels have been already reached by the Polish economy. The rising trend of company insolvencies was discontinued in 2014, when bankruptcies dropped by 5.1% y/y. However, despite the ongoing improvement of the Polish economy, the contraction in the number of insolvencies has slowed down during the course of this year, to record a decrease of 3.3% y/y in bankruptcies at the end of first half of 2015. The insolvency statistics vary according to sectors. Basically, sectors directly dependent on consumer demand are benefitting from rising household spending. Among these, the trade sector has recorded a 14% fall in insolvencies – although this improvement hides crucial factors that the sector has had to manage. These include the deflation of prices, which affects the profitability of companies, as well as the next stage of consolidation processes. In terms of the latter, wholesale company insolvencies grew by 11% during the first half of this year. The retail sector has reached a further stage in consolidation, to become a significant direct partner for producers, skipping wholesale entities in many cases. As such the supply chain has been shortened, negatively affecting the wholesale sector.

Despite a strong consumer base, the Polish economy is open to foreign trade. The country's exports to GDP share was nearly 47% last year. This makes the country's final output subject to both internal demand and the performance of foreign markets – in particular the Eurozone, Poland's main trading partner. The impact of external risks can be seen in the insolvency statistics. Polish companies were, for the most part, efficient in relocating their exports after Russia implemented an embargo, in August last year, on some shipments. Nevertheless, some companies are still suffering from this ban. The transport sector has experienced lower order volumes for Eastern routes, which were usually more profitable than Eurozone destinations. Moreover, Polish transport companies are suffering from regulations on minimum wages covering Polish truck drivers in Germany, a crucial market for Polish transport businesses. Insolvencies of transport companies increased by 28% y/y during the first half of 2015. Nevertheless, this is a better result than the one recorded during the first quarter, when bankruptcies jumped by 86%. Polish transport companies are heavily affected by the performance of external markets, due to their strong foreign exposure. Poland is the leader among all EU countries in terms of volumes of international road carriages.

Rebounding private consumption and increasing retail sales are supporting the lower number of company insolvencies in Poland. This does not, however, make insolvencies immune from external risks, which currently represent the main threats to the Polish economy and the level of company bankruptcies. The pace of the Eurozone recovery (particularly German economic activity), the situation of the global commodities markets and the slowdown of several emerging economies worldwide, are all affecting the business activities of Polish companies and consequently the number of insolvencies. Nevertheless, internal factors could also hamper businesses, such as the impact of droughts (mostly affecting agro-food production), blackout periods this summer and the unclear results of the parliamentary elections scheduled for October this year. In the meantime, various election promises have been declared. Our base line scenario assumes that company insolvencies will decrease by 8% this year and then drop by 5% in 2016.

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