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PANORAMA

POLAND INSOLVENCIES

Insolvencies fall amid fair economic growth

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Poland has seen a slowing of its economy this year, compared to 2015. Nevertheless, growth is still continuing at a fair rate and, in fact, remains at a level which many other economies can only dream of. The subdued economic activity, confirmed in recent data, could bring some challenges for Polish companies. However, thus far, businesses have been benefiting from positive macroeconomic conditions and have enjoyed another year of lower business insolvencies.

Bankruptcies have been decreasing since 2014. The first half of 2016 saw 328 proceedings - a fall of 14.1% compared to the year before. In addition, new legislation means that companies now have alternatives to bankruptcy proceedings. The new legislation, implemented this year, is separated into acts of Bankruptcy Law and Restructuration Law. The latter provides various forms for restructuring businesses that are suffering from liquidity problems, with the aim of returning them back to effective operations. The new restructuring procedures are likely to become even

more frequently used than has already been seen in the second quarter of this year. This makes the latest statistics difficult to compare with previous figures. Our base line scenario assumes that proceedings will drop by 8.9% at the end of 2016 - although this forecast could be affected by an increasing number of restructuration procedures. In 2017, proceedings are expected to decrease by 4.8%.

Poland's solid economic growth is being driven by household consumption. Although the country is facing a slowdown in EU funds (which have been used intensively for investments and contributed to economic activity last year), the input from private consumption will intensify this year - especially with the continued improvements in the labour market. The unemployment rate has dropped to a level which has not been seen for 25 years. In addition, wages continue to record fair growth and inflation remains low. This environment indicates good prospects for the retail sector.

On the external side, Polish exporters are actively exploring foreign markets.

Nevertheless, recent turbulence, such as the Brexit (the UK is Poland's 2nd largest export market) and the indirect effects of the Chinese slowdown, could hamper the ambitions of Polish companies. Internally, businesses remain cautious on investments, constrained by uncertainties over external and domestic factors. Domestic issues include the possible introduction of further sectorial taxes - even though the government has not signaled its intention to do so. At the same time, the latest taxation burdens on financial institutions and retailers have not had particularly detrimental effects on Poland's economy.

Poland's economic growth structure, where the input of household consumption is crucial to expansion, favours the prospects for sectors driven by consumer demand. On the external side, exporters are continuing to reap the benefits of their price and quality competitiveness on foreign markets. Nevertheless, the findings of this publication show that household consumption has a stronger impact than exports - both on the macroeconomic side, as well as on the level of company insolvencies in Poland.

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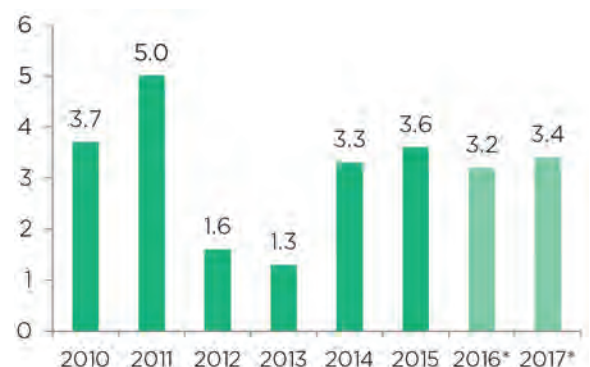
“Poland’s growth may have slowed this year, but company insolvencies are still on a downward trend. New restructuring procedures are increasingly being used as a remedy for companies suffering from payment problems.”

1 GROWTH HAS FLATTENED BUT REMAINS SOLID

The CEE region is on a positive track for economic expansion. The average growth rate reached 3.3% last year, supported by an inflow of EU funds in the final year of validity of the previous EU budget. As EU funds will not be as important this year, the CEE region is expected to record weaker, but still solid, growth of 3.0%. Poland, the biggest economy in the region, is expected to surpass the regional average (as it has already done in recent years), to record growth of 3.2% in 2016. Poland is the biggest beneficiary of EU funds and has made efficient use of them during recent years. While 2013 was challenging, gross fixed capital investments rose by 10% in 2014 and by 5.8% in 2015. During this period, the main driving force of the Polish economy shifted from net exports to domestic demand. A slow start to EU co-financed investments, within the new financial budget, will result in weaker growth than recorded in 2015. The first half of 2016 has already shown a 3.6% y/y decline in fixed investments. In addition to the effect of EU funding, companies have been less willing to invest, following changes to Poland’s political scene. The new Polish government, which took office last autumn, has already introduced taxes on financial institutions and the country’s largest retailers. However, it plans to introduce measures to support small and medium enterprises and to encourage innovations. These measures should bring added value to the Polish economy and its exports. Nevertheless, some businesses have adopted a ‘wait and see’ strategy and it is anticipated that investment growth should return closer to the end of the year - especially as, at this time, EU-co financed investments will be likely to regain rhythm.

The latest figures on the Polish economy have brought the progress of economic expansion into question. The slower start recorded in the first half of 2016 (growth of 3.1%) continued on in July, according to data released so far. The dynamics of industrial production and construction output were negative, while retail sales grew by 4.4%. Nevertheless, with the exception of construction, it is expected that real economy indicators will strengthen over the coming months. Private consumption, in particular, will support the country’s economic activity over the rest of the year and household consumption will continue to keep Polish growth at solid levels in 2017.

Chart 1:
Poland’s GDP growth rate (%)



* Coface forecast

Sources: Central Statistical Office and Coface

Private consumption is very important for the Polish economy and accounted for 58% of the country's nominal GDP last year. The diversified structure of the region's biggest economy has also supported expansion. Polish companies have become more active exporters and are not only exploring the Eurozone (the country's core market), but also new destinations. Nevertheless, Poland has not become overly dependent on foreign demand and the turbulence experienced by some of the biggest emerging markets has not led to a severe contraction in Poland's economic activity.

Even when the Eurozone suffered from a second year of recession in 2013 and dynamics of domestic consumption flattened during the same period, Poland still achieved positive growth (although weak) of 1.3%. In line with slowly improving economic activity in Western Europe and strengthening household consumption in Poland, the country's economy returned to solid growth rates. Coface forecasts that Polish growth will remain above 3%, despite challenges in the international environment.

2 INSOLVENCY BAROMETER

How much has the macro environment impacted insolvency statistics?

Businesses have quickly adapted to the improved macroeconomic situation in Poland. In 2013 there were 883 company insolvencies - the highest level since 2005. Then, in line with the enhanced economic situation, bankruptcies fell by 6.5% y/y at the end of 2014 and a further 12% at the end of 2015. In 2016, there were 741 company insolvencies recorded, as the micro side increasingly benefited from the positive impact of the economic environment. Rising internal and external demand contributed to improved perspectives for companies' business activities

Although further improvements have been confirmed, the scale of these improvements has been affected by the changes in bankruptcy law implemented on 1st January 2016. The law now covers insolvencies, and the restructuring of companies which experience payment problems, separately. The aim of introducing these updated regulations was to encourage greater use of insolvency procedures - especially as a recovery tool for companies facing temporary liquidity problems. In the past, Polish companies were reluctant to use insolvency proceedings and the share of judicial compositions accounted for only a 16 of all announced insolvencies. The main goal of the revised legislation is to enable debtors to restructure their businesses and thereby prevent their liquidation. This support for the continuity of businesses should help to preserve jobs and allow the uninterrupted execution of contracts. Companies in financial difficulties are entitled to use various proceedings for restructuring. These include the procedure of approval of a plan after creditors' votes, accelerated arrangement procedures, ordinary arrangement procedures and rehabilitation proceedings. For more details of the new Bankruptcy Law and Restructuration Law, see Box 1.

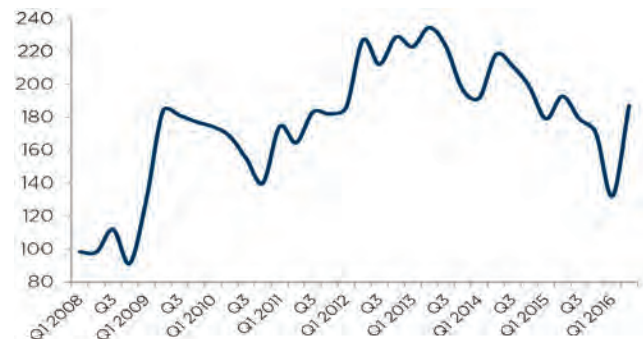
Chart 2:
Company insolvencies in Poland



Source: Coface

The improvements are continuing. Rising household consumption and growing exports during the first few months of 2016 have been beneficial for Polish companies. The first half of 2016 brought 328 insolvencies and restructuration proceedings - a fall of 14.1% compared to the year before. However, the number of proceedings is still higher than the level recorded pre-crisis, in the first half of 2008.

Chart 3:
Evolutions in Polish company insolvencies (2008=100)



Source: Coface

Restructuring procedures are gaining popularity with companies suffering from liquidity problems. During the initial months of 2016, businesses were only just becoming familiar with the new regu-

lations and only six restructuring procedures were noted in the first quarter of the year. The second quarter brought 51 such procedures and company restructures accounted for around 15 of all proceedings. Among the available forms of restructuring, the most popular were expedited arrangement proceedings (with 30 proceedings in the first half of 2016) and reorganisation proceedings, which enable debtors to conduct deep restructuring of their business (15 proceedings in the first half of 2016). During the same period, insolvencies dominated statistics, with 249 asset liquidation proceedings and 22 judicial composition proceedings.

The increased popularity of restructuring is the main reason for the overall rise in proceedings during the second quarter of 2016, as seen in chart 3. Coface forecasts that the decreasing trend in insolvencies and restructurings will continue, falling by 8.9% y/y, at year-end. However,

stronger than expected growth in restructuring proceedings could make this forecasted contraction flatter. This would not mean that businesses have been falling into payment difficulties but rather that new restructuring regulations are making an impact. Although Poland is a relatively large economy with over 1.8 million active companies, it recorded a low level of only 741 company insolvencies last year. This means that the insolvency rate was only 0.04%¹ - the lowest level in the CEE region. Nevertheless, the full scale of Polish companies' liquidity problems is much bigger. Liquidations, suspensions of activities and going out of business without conducting official insolvency proceedings, are all much more common. The new law therefore focuses on favouring restructuring procedures as a solution for companies with liquidity problems. Coface forecasts that insolvency and restructuring proceedings will decrease by 4.8% in 2017.

Box N°1

Main details of the Bankruptcy Law and Restructuring Law implemented on 1st January 2016

by Paweł Józwiak, Attorney at Law, Stefaniuk i Partnerzy Spółka Partnerska Adwokatów

The rules on insolvent entrepreneurs are contained in two separate acts - Bankruptcy Law and Restructuring Law. Under the authors' assumptions, Bankruptcy Law is designed to be applied to insolvent debtors, when the aim is to liquidate debtor's assets, while the Restructuring Law enables effective reorganisation and conclusion of arrangements with creditors.

The intention of the first stage of bankruptcy proceedings (i.e. proceedings on the declaration of bankruptcy), is fundamentally to examine whether there are grounds for declaring bankruptcy. The second stage is the actual bankruptcy proceedings. However, the manner of conducting bankruptcy proceedings may be changed by the court in a decision issued during the course of the proceedings, if such a change contributes to the satisfaction of the creditors to a higher degree, and the grounds justifying the other manner of conducting the proceedings were disclosed in the course of the proceedings. The court declares restructuring if it is determined likely that, under the arrangement, the creditors will be satisfied to a higher degree than they would be satisfied as a result of conducting bankruptcy proceedings which include the liquidation of the debtor's assets. If no basis exists to declare restructuring (for example, if in view of the debtor's previous conduct, it is not certain that the arrangement will be performed), the court will declare the debtor's bankruptcy by liquidation of the bankrupt's assets.

The Bankruptcy Law expands the catalogue of entities which cannot be declared bankrupt. The

list of entities prevented from becoming bankrupt include the State Treasury, local government, independent public health institutions, institutions and legal persons created by a law (or in the performance of a duty imposed by a law), individuals operating an agricultural farm and higher education institutions (public and private).

The Restructuring Law introduces four types of proceedings: proceedings for approval of an arrangement (*postępowanie o zatwierdzenie układu*) - which is the easiest and least formal, expedited arrangement proceedings (*przyspieszone postępowanie układowe*), arrangement proceedings (*postępowanie układowe*) and reorganisation proceedings (*postępowanie sanacyjne*). The act also provides for a new institution, in the form of a partial arrangement which can be concluded in restructuring proceedings with a selected group, or groups of creditors.

The aims are to separate restructuring procedures, to avoid the stigma that comes with the declaration of bankruptcy and to sustain the operations of debtor companies. Restructuring enables debtor companies to curtail unprofitable businesses and agreements and enter into arrangements with creditors. Arrangements may contain a number of provisions - such as the partial cancellation of debts, payment by installments and conversions of debt to shares. Arrangements are agreed by vote and are approved by a judge-commissioner.

¹ Share of insolvencies in a total number of active companies.

3 SECTOR ANALYSIS

Chart 4:
Company insolvencies by sectors, in H1 2016

| Sector | Insolvencies in 1H 2016 | Change y/y | Share |
|---|-------------------------|-------------|---------------|
| PRODUCTION, including: | 92 | -20% | 28.0% |
| Manufacturing including, but not limited to: | 78 | -30% | 23.8% |
| Production of food products and beverages | 14 | 17% | 4.3% |
| Production of metals and fabricated metal products | 13 | -41% | 4.0% |
| Production of machinery, equipment and electrical devices | 7 | -13% | 2.1% |
| Production of rubber and plastic products | 4 | -71% | 1.2% |
| Production of chemicals and chemical products | 0 | -100% | 0.0% |
| Production of paper and paper products | 1 | 0% | 0.3% |
| Production of clothing and textiles | 5 | -50% | 1.5% |
| Production of furniture | 0 | -100% | 0.0% |
| Production of wooden products excluding furniture | 9 | 0% | 2.7% |
| Production of goods from other non-metal natural resources (including construction materials) | 7 | -13% | 2.1% |
| Other manufacturing | 13 | -7% | 4.0% |
| TRADE including, but not limited to: | 79 | -11% | 24.1% |
| Wholesale | 58 | -16% | 17.7% |
| Retail | 21 | 5% | 6.4% |
| CONSTRUCTION | 57 | -15% | 17.4% |
| TRANSPORT | 13 | -43% | 4.0% |
| Other sectors | 87 | -1% | 26.5% |
| TOTAL | 328 | -14% | 100.0% |

Source: Coface

Manufacturing

The dynamics for industrial production remain stable this year. Manufacturing, which constitutes the majority of Polish industry, generated growth of 5.6% during the first half of 2016. The only increase in insolvency and restructuring proceedings was recorded in the manufacturing of food products and beverages. One of the biggest decreases was noted in the production of metals - a sector which is benefiting from increasing demand and, in many cases, is able to focus on the most profitable contracts. Nevertheless, the unpredictability of prices in the future, as well as competition from imports, could distort the positive trend in insolvency statistics. Those businesses which are successfully exploiting foreign markets, by leveraging their competitive prices and quality, are more rarely suffering from payment problems. In the first half of this year, there were no insolvencies or restructuring proceedings among furniture manufacturers or in the production of chemicals.

Construction

Despite improving insolvency statistics (see the heat map below) and the positive environment particularly seen in new housing constructions, the overall performance for the construction sector has deteriorated. During the first half of 2016, construction output decreased by nearly 12% compared to the previous six months. A slow start to EU co-financed investments from the new EU budget, combined with potential fluctuations in prices of construction materials, is hampering the perspectives of infrastructural construction projects. Payment experience in the sector has deteriorated and the recent decision by Britain to leave the European Union means that uncertainties surround the level of available EU funds. Although the UK (one of the biggest net contributors to the EU budget) will not exit the EU immediately and the process could be spread out over several years, the Brexit could be a factor that constrains investment projects already underway - or that makes financial assessments of EU co-financed investments more cautious.

Transport

A mix of positive factors has contributed to the low number of insolvencies and restructuring proceedings in the transport sector. The segment is benefiting from low oil prices and the improving economic situation - not only in Poland, but also in the Eurozone, where Polish transport companies provide both international and internal services. Businesses are, however, facing problems on some foreign markets, including protectionist measures introduced by certain EU countries. Transport to the East is still generating lower export volumes and the ongoing Russian recession means that transport companies cannot expect a significant increase in freight to this usually profitable destination. Over the course of the following months, the number of insolvencies and restructuring proceedings in the sector could increase. The competition is strong and is imposing the acceptance of lower margins amid stable fixed costs. Moreover, negative effects could follow if the migration crises escalates and leads to constraints on the transfer of goods in the Schengen area. If this occurs, extended times for transport and higher operational costs will impact the transport sector and contribute to insolvencies.

Chart 5:

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



Source: Coface



Insolvencies and restructuring proceedings, by business legal form

When analysing the different business legal forms, in terms of insolvencies and restructuring proceedings, it can be seen that all forms recorded a decrease except sole traders. As a result, the share of sole traders in the statistics rose from 22% to 32%. Limited liability companies (a legal form that provides limited liability to its owners) were the most frequent bankruptcies - as was already the case in previous statistics - and still constitute over half of all proceedings. The biggest decrease was recorded by general partnerships (a business form in which partners have unlimited liability). Other company forms that noted sizeable decreases in the number of insolvencies and restructuring proceedings included joint-stock companies, limited partnerships (a business form in which partners are liable only to the extent of invested money) and cooperatives (associations owned and operated by members).

Chart 6:

Insolvencies and restructuring proceedings, by business legal form

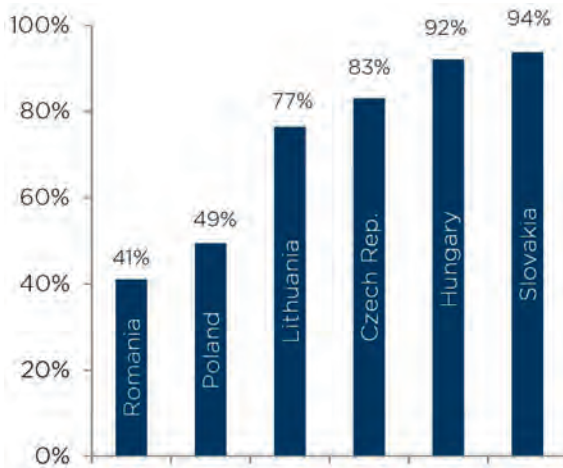
| Legal form | Number of bankruptcies in IH 2016 | Change y/y | Share in total |
|---------------------|-----------------------------------|-------------|----------------|
| Ltd. | 180 | -20% | 55% |
| Sole trader | 103 | +21% | 32% |
| Joint-stock company | 22 | -35% | 7% |
| General partnership | 8 | -56% | 2% |
| Limited partnership | 7 | -30% | 2% |
| Cooperative | 5 | -29% | 1% |
| Other forms | 3 | -25% | 1% |
| Total | 328 | -14% | 100% |

Source: Coface

4 FLUCTUATIONS IN EXTERNAL DEMAND VS. THE SUSTAINABILITY OF HOUSEHOLD CONSUMPTION. OPPORTUNITIES OR THREATS FOR POLISH COMPANIES?

The Polish economy is relatively less open than most of its counterparts in the Central and Eastern Europe (CEE) region. Exports represented just 49% of the country's GDP at the end of 2015, while this ratio was 92% for Hungary and 83% for the Czech Republic. Hungary and the Czech Republic are smaller economies and thus cannot benefit from the same level of contribution from domestic consumption. Poland's household consumption, supported by its 38 million inhabitants, brings the country some protection from the whims of external demand.

Chart 7:
Exports to GDP ratio in selected CEE economies (2015)



Source: Eurostat

Despite this, external turbulence does bring some risks for the Polish economy. As nearly half of Poland's GDP is export-driven, the country is still dependent on the situations on foreign markets. The European Union is the main receiver of Polish exports (accounting for a 79.4% share last year) and the bulk of shipments is directed to Eurozone countries (56.4% of total exports). The country split is dominated by Germany (with a 27% share last year), although relatively high volumes, exceeding EUR 10 billion, were sent to the United Kingdom and the Czech Republic. As a result, the recent decision of the British electorate to leave the EU represents risks for Polish exports. Although the process of exiting the EU will take some time, the possible contraction of British demand and questions regarding future regulations on mutual trade will cause uncertainties over business relations. In parallel, the German economy could suffer from the slowdown in China, as it is an important destination for Ger-

man exports (especially if the Chinese economy weakens further than expected). Germany has already been experiencing lower trade volumes to emerging countries (which accounted for 30% of its total exports last year). As a result, Poland's indirect dependence on the weak performance of large emerging economies could have negative effects on its exports, which include supplies of components and semi-produced goods to German manufacturers.

Chart 8:
Poland's main export partners

| Export partner | Dynamics of exports in 1H 2016* | Share in total |
|------------------|---------------------------------|----------------|
| 1 Germany | 3.3% | 27.2% |
| 2 Czech Rep. | 3.3% | 6.7% |
| 3 United Kingdom | -1.0% | 6.5% |
| 4 France | 4.2% | 5.8% |
| 5 Italy | 4.3% | 5.1% |
| 6 Netherlands | -1.0% | 4.3% |
| 7 Spain | 10.2% | 2.9% |
| 8 Sweden | 7.9% | 2.9% |
| 9 Russia | 0.5% | 2.7% |
| 10 Hungary | 0.7% | 2.6% |

* Calculated from EUR volumes

Source: Central Statistical Office

Moreover, the pace of the Eurozone's recovery remains disappointing. In the second quarter of 2016, Euro area GDP growth was 0.3% q/q. This indicates a slowdown in the progress of recovery, as real GDP increased by 0.6% in the previous quarter. Poland's main trading partners recorded weak results. Growth was flat in France and Italy, although German GDP rose by 0.4% q/q - boosted by both exports and consumer spending. Private consumption is expected to remain a significant growth driver for Germany, as for other Eurozone economies. The latest growth readings show a divergence between Poland's main trading partners. While Germany exceeded forecasts, both France and Italy performed below expectations and neither give reason to hope for a rebound in the near future. The UK's growth in the second quarter was solid (+0.6% q/q, +2.2% y/y) but as the Brexit referendum took place at end of this period, performance will be much weaker in the second half of 2016. Following the Brexit, Coface

has revised down the UK's GDP growth forecast to 1.2% in 2016 and 1.1% in 2017.

Chart 9:
GDP growth forecasts for selected regions and countries

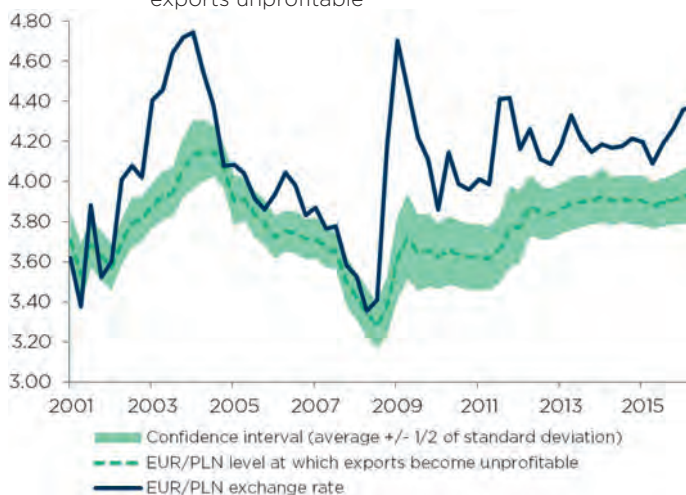
| Coface GDP growth forecast | | |
|----------------------------|-------|------|
| | 2016 | 2017 |
| Eurozone | 1.7% | 1.7% |
| Germany | 1.5% | 1.7% |
| UK | 1.2% | 1.1% |
| CEE region | 3.0% | 3.1% |
| Russia | -1.5% | 0.8% |
| Poland | 3.2% | 3.5% |

Source: Coface

Trade within the CEE region is important for CEE economies. Over 15% of Poland's total exports were sent to its regional peers last year. Among these, the highest volume (representing nearly EUR 12 billion) was exported to the neighbouring Czech Republic. After enjoying a tremendous rate of growth of 4.5% last year, the Czech economy is still expanding. In the first quarter of 2016, Czech growth reached 3.0% - and a further 2.5% in the second quarter. Most of the other CEE countries are also delivering fair growth rates - mainly driven by household consumption, which has been boosted by improvements on labour markets.

Within this turbulent external environment, most of Poland's trading partners are showing signs of recovery - although the Russian market is another matter. Looking back to 2013, Russia was Poland's 5th largest trading partner, receiving exports of over EUR 8 billion. In 2015 it had fallen to 7th place, with EUR 5 billion of Polish exports. The primary

Chart 10:
The level of EUR/PLN that makes Polish exports unprofitable



Source: National Bank of Poland

reason for this fall in exports to Russia was the embargo on meat, fish, fruit, vegetables and milk products from the EU, US, Australia, Canada and Norway (that Russia introduced as a retaliation measure against US/EU sanctions implemented in August 2014). The ban covered just 0.5% of Polish total exports but more than 10% of its exports to Russia. Moreover, 80% of Poland's agro-food exports to Russia became banned. Many Polish companies which were focused on trading with Russia were forced to look for other markets. Those businesses which were unable to do so went bankrupt in many cases. The heat map of company insolvencies (chart 5) clearly indicates that there were increases in the number of proceedings for the food sector and transport in the second half of 2014. Both of these sectors were significantly impacted by the Russian-introduced embargo. Trade volumes were then weakened due to a contraction in the Russian economy. In 2015, the recession in Russia led to a negative growth rate of -3.7%. Coface forecasts a mild improvement for this year, with still negative growth of -1.5%. As a result, exports from Poland to Russia in recent quarters recorded slumps of around 30%. A minor rebound has been recorded this year, with a 0.5% increase in exports to Russia - but most of this increase is attributable to a statistical base effect.

Exporters are benefiting from the fact that Poland has its own currency. The most recent depreciation of the Polish zloty has particularly enhanced the profitability of business sales to foreign markets. The EUR/PLN exchange rate remains the most important for Poland, as most of its exports are settled in euros. According to a regular survey conducted among entrepreneurs by the National Bank of Poland, the current level of exchange rates is acting as a comfort buffer for Polish exporters. The latest survey indicates that exports would become unprofitable if the EUR/PLN rate decreases to 3.93 (the average spot level for the EUR/PLN was 4.40 in June). At the same time, many Polish exports are assembled using imported, as well as Polish, components. In fact, when comparing the dynamics of Polish imports and exports, it can be seen that they move relatively in parallel, confirming the high contribution of imports to exports. A weaker domestic currency increases the cost of imports and, as components are often purchased from Asia, many transactions are settled in USD. Nevertheless, the balance of gains and costs remain beneficial for Polish exporters - most of whom continue to report profitable business operations on foreign markets.

Data on the structure of the Polish economy confirms that private consumption accounts for a higher share of nominal GDP than exports. Household consumption created 58% of GDP last year. To analyse the links between the dynamics of Polish exports and the level of business bankruptcies in Poland, as well as the correlation between

private consumption and company insolvencies, Coface has calculated the correlation coefficients².

allenges in 2013, growth in private consumption has remained solid, exceeding 3% y/y in each quarter, since the beginning of 2015. The labour market is in good shape. The unemployment rate declined

Chart 11:

Yearly dynamics of Polish private consumption and exports and the nominal level of company insolvencies, per quarter



Source: Coface

Not surprisingly, the correlations are negative in both cases (i.e. there are less company insolvencies if households spend more, or if exports increase). While the correlation coefficient for exports to insolvencies is -0.55, the correlation is much stronger between private consumption and insolvencies, at -0.78. Similarly, businesses also report stronger contributions from household demand and spending to their liquidity performance, than from business activities with foreign markets. The greater impact of Polish private consumption than exports on payment solvency is also confirmed by the coefficient of determination³. Over the analysed period, the coefficient between household consumption and insolvencies was 0.60 – but 0.31 in the case of relations between exports and bankruptcies.

to 6.2% in June 2016, compared to over 10% in 2013 and close to 20% when Poland joined the European Union in 2004 (according to Eurostat data⁴). A further contraction of the unemployment rate is anticipated. Improvements on the labour market are particularly noticeable in the country's main cities - locations which are considered as 'the employee market'. The rise in employment has been accompanied by fair growth in wages, which rose by 3.5% y/y in 2015 and accelerated to 4.0% y/y in the first half of 2016. At the same time, the Polish economy remains in the state of deflation which began over two years ago. The negative dynamics of consumer prices are still mainly due to the low prices of commodities on global markets and not a result of households refraining from spending. Recently, there have been minor increases in the food component of CPI readings but the level of price changes is still low enough to support household spending. At the same time, interest rates remain at historically low levels. In addition, a new child allowance, called "Family 500+", was introduced in April this year. The programme provides a monthly subsidy of PLN 500 (ca. EUR 116) per child to low-income families and all families with at least two children. The first effects have already been a rise in private consumption but, due to compensated payments of allowances arriving at the end of the first half of 2016, more benefits for Poland's retail sales should be seen during the latter half of this year. Clearly, this blend of market conditions has led

Chart 12:

Coefficients of relations between domestic and foreign demand to insolvencies

| Indicator | Correlation coefficient (R) | Coefficient of determination (R ²) |
|--|-----------------------------|--|
| Private consumption / Company insolvencies | -0.78 | 0.60 |
| Exports / Company insolvencies | -0.55 | 0.31 |

Source: Coface

Current prospects for household spending in Poland appear to be secure. Following the chal-

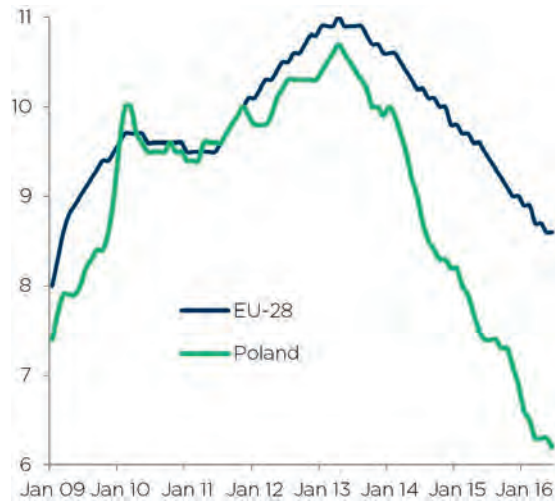
² The correlation coefficient is a measure that determines the degree to which two variable's movements are associated. It varies from -1 to +1, with -1 indicating perfect negative correlation and +1 indicating perfect positive correlation.

³ The coefficient of determination indicates how much of the variability of a factor can be caused or explained by its relationship to another factor. It varies from 0 to 1, with a higher value indicating a stronger relationship between two factors.

⁴ Labour Force Survey. According to the national methodology the unemployment rate amounted to 8.8% in June 2016.

to improved household confidence assessments, with indicators already above pre-crisis levels.

Chart 13:
Unemployment rate (%)



Source: Eurostat

Despite these positive effects, trade companies are still widely represented in the statistics for insolvencies and restructuring proceedings (chart 4). They accounted for 24% of all proceedings during the first half of 2016, although this share is somewhat due to the high representation of trade businesses in the Polish economy. Strong competition is obliging them to accept low margins, which is especially harmful for smaller companies with weak negotiation capabilities. The sector is

now subject to a new tax burden, implemented on 1st September this year, which targets the biggest retailers. Nevertheless, good prospects for Polish household demand should compensate for the negative effects of this tax. Retail is benefiting from positive demand and we do not anticipate a significant increase in bankruptcies for the sector, although companies will still be faced with the above-mentioned challenges.

In summary, business profitability is being enhanced by company operations on foreign markets. The perspectives are particularly good for manufacturers of merchandise with high external demand. These sectors include the automotive, furniture, white goods and IT segments. At the same time, gains are being experienced by companies which are directly addressing the rising demand from domestic households. Household consumption is forecast to be a crucial growth driver for the Polish economy over the next few quarters. The solvency picture should therefore see further improvements, while the newly introduced restructuring legislation should help companies suffering from liquidity problems to return to effective business operations. Nevertheless, there are still potential risks for both domestic and foreign operations. The recent turbulence on external markets has spread to the global economy, affecting business sentiment in some countries. At the same time, businesses are still facing challenging domestic environments and these uncertainties could hinder their expansions. Those companies with inadequate business strategies, or excessive indebtedness, will not enjoy the benefits of their positive economic surroundings.