INTERNATIONAL MONETARY FUND

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REPUBLIC OF POLAND

January 2017

ARRANGEMENT UNDER THE FLEXIBLE CREDIT LINE AND CANCELLATION OF THE CURRENT ARRANGEMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR AND ALTERNATE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF POLAND

In the context of the Arrangement Under the Flexible Credit Line and Cancellation of the Current Arrangement, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 13, 2017. Based on information available at the time of these discussions, the staff report was completed on December 28, 2016.
- A **Staff Supplement** of January 3, 2017, on the assessment of the impact of the proposed Flexible Credit Line arrangement on the Fund's finances and liquidity position.
- A **Statement by the Executive Director and the Alternate Executive Director** for the Republic of Poland.

The documents listed below have been released.

Letter of Intent sent to the IMF by the authorities of the Republic of Poland*

*Also included in Staff Report

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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Press Release No. 17/11
FOR IMMEDIATE RELEASE
January 13, 2017

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves New Two-Year €8.24 Billion Flexible Credit Line Arrangement for Poland

The Executive Board of the International Monetary Fund (IMF) today approved a successor two-year arrangement for Poland under the Flexible Credit Line (FCL) with reduced access in an amount equivalent to SDR 6.5 billion (about €8.24 billion, or 159 percent of quota). The Polish authorities intend to treat the arrangement as precautionary and do not intend to draw on the FCL.

Poland's first FCL arrangement was approved on May 6, 2009 (see Press Release No. 09/153). Successor arrangements were approved on July 2, 2010 (see Press Release No. 10/276); January 21, 2011 (see Press Release No. 11/15); January 18, 2013 (see Press Release No. 13/17); and January 14, 2015 (see Press Release No. 15/05).

Following the Executive Board discussion on Poland, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chairman of the Board, made the following statement:

"Poland continues to benefit from very strong economic fundamentals and policy frameworks. Economic growth remains robust, unemployment continues to decline, and deflation has dissipated. The current account is close to balance and international reserves have increased. Moreover, the banking system remains liquid and well capitalized. Poland's institutions and policy frameworks rank favorably among peers.

"The authorities are committed to maintaining strong policies and institutions to support inclusive growth, which remains their key priority. In particular, the authorities intend to maintain sustainable public finances by keeping the fiscal deficit below the Excessive Deficit Procedure limit of 3 percent of GDP in 2017 and by starting fiscal consolidation in 2018. Furthermore, the authorities remain committed to safeguarding financial stability through effective oversight and implementation of the new macroprudential and bank resolution frameworks. In this regard, the authorities' revised approach to foreign exchange mortgages

aimed at addressing consumer protection concerns while preserving banking sector soundness and stability is a welcome step.

"Notwithstanding the strengths of the Polish economy, external risks remain elevated. A possible growth slowdown and banking sector stress in the euro area could have significant spillovers via trade, financial, and confidence channels. A faster-than-expected pace of monetary policy normalization in the United States and bouts of financial market volatility could affect Poland's economy, given its sizable external financing needs. Furthermore, the upcoming Brexit negotiations and a heavy election calendar in Europe in the next twelve months add to uncertainties.

"Against this background, the new two-year precautionary Flexible Credit Line (FCL) arrangement would provide valuable insurance against external shocks, supplementing Poland's flexible exchange rate and strong reserve buffers. At the same time, the authorities' request for a significantly lower access sends a strong signal of their intention to proceed with a gradual and smooth exit from the FCL arrangement once external risks subside."

The IMF established the FCL on March 24, 2009 and further enhanced it on August 30, 2010 (see Press Release No. 10/321). The FCL is available to countries with very strong fundamentals, policies, and track records of policy implementation and is particularly useful for crisis prevention purposes. FCL arrangements are approved for countries meeting pre-set qualification criteria (see Press Release No. 09/85). The FCL is a renewable credit line, which can be approved for either one or two years. Two-year arrangements involve a review of eligibility after the first year. If the country draws on the credit line, the repayment period is between three and five years. There is no cap on access to Fund resources under the FCL, and access is determined on a case-by-case basis. Qualified countries have the full amount available up-front, with no ongoing conditions. There is flexibility to either draw on the credit line at the time it is approved, or treat it as precautionary.

Poland is a member of the IMF since 1986 and has a quota of SDR 4,095.40 million (about €5,190.8 million).

INTERNATIONAL MONETARY FUND

REPUBLIC OF POLAND

December 28, 2016

ARRANGEMENT UNDER THE FLEXIBLE CREDIT LINE AND CANCELLATION OF THE CURRENT ARRANGEMENT

KEY ISSUES

Context: Poland's economic growth remains robust, despite some weakening this year, and deflation has dissipated. The external buffers have increased, and the current account is close to balance. However, external risks remain elevated, with the key risks including a faster-than-expected pace of monetary policy normalization in the U.S., possible dislocations in emerging markets leading to bouts of financial market volatility, as well as a possible banking sector stress and growth slowdown in the euro area. The upcoming Brexit negotiations and Europe's heavy election calendar add to uncertainties.

Policies: Poland's institutions and policy frameworks rank favorably among peers. Despite some weakening in policies in late 2015 and early 2016, efforts have been made to mitigate some of the controversial policy initiatives. The financial sector policy framework has been further strengthened with the adoption of the macro-prudential and bank resolution frameworks. Structural reforms continue to focus on improving business climate and reducing labor market duality. Going forward, the authorities remain committed to maintaining financial stability, keeping the budget deficit below the Excessive Deficit Procedure (EDP) limit in 2017 and starting fiscal consolidation in 2018.

Flexible Credit Line (FCL): Against this backdrop, the authorities are requesting a new two-year precautionary FCL arrangement with half of the current access at SDR 6.50 billion (159 percent of quota) and cancellation of the current arrangement, approved on January 14, 2015. Poland's improved economic and policy buffers have reduced financing needs, but external risks remain elevated. In this context, the authorities believe that a new FCL arrangement would provide valuable insurance against external shocks, supplementing Poland's flexible exchange rate and strong reserve buffers. At the same time, the authorities consider that the significant reduction in access sends a strong signal of their intention to fully exit from the arrangement once external risks subside. In staff's view, Poland continues to meet the qualification criteria for the FCL.

Fund liquidity: The proposed new FCL for Poland would have no net impact on Fund liquidity.

Process: An informal meeting to consult with the Executive Board on a possible FCL arrangement for Poland was held on December 15, 2016.

Approved By
Thanos Arvanitis and Vitaliy Kramarenko

The report was prepared by a staff team led by Anna Ilyina and comprising Ran Bi, Xin Xu, Yuanyan Zhang (all EUR), and Yevgeniya Korniyenko (SPR). Excellent assistance was provided by Nhu Nguyen and Hannah Jung (EUR).

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CONTEXT

1. **Poland has been one of the fastest growing economies in the European Union (EU) and has shown resilience to financial market pressures in recent years**. Growing at around 3¼ percent per year on average since the global financial crisis, Poland has been rapidly closing its income gap with the EU. Moreover, Poland has generally experienced less financial stress than other emerging markets, except during extreme bouts of global market volatility (Figure 1). Robust growth with relatively low financial volatility is a result of Poland's strong policies and institutions, supported by the arrangements under the Flexible Credit Line (FCL) since 2009.

2. **Poland's trade and financial openness has been key to its strong economic performance, but it has also increased its exposure to external shocks.** Poland has strong trade links with the EU and is closely integrated into the German supply chain (Figure 4). More than ¾ of total goods exports go to the EU, and over 90 percent of the stock of foreign direct investment (FDI) originates from the EU. Poland's external debt is roughly evenly split between government debt (30 percent of GDP) and private sector debt (24 percent of GDP, excluding inter-company loans). In the domestic bond market, nonresidents hold about a third of the Polish domestic treasury securities. The banking sector reliance on external funding has declined since the crisis, but the sector remains interconnected with the global financial system through ownership links, with foreign-owned banks accounting for slightly less than 60 percent of the Polish banking sector.[1] Poland's sizable gross external liabilities and open capital account make it susceptible to spillovers from shifts in foreign investor sentiment (Figure 1).

3. **To bolster its resilience, Poland has continued to strengthen its external buffers and policy framework**:

- *External buffers*. Gross international reserves increased to USD 111 billion (122 percent of the Fund's reserve adequacy metric) as of end-November 2016 from USD 95 billion at end-2015, and are adequate on standard metrics. The current account is close to balance. Poland continues to maintain a flexible exchange rate regime. The swap line with the Swiss National Bank provides additional insurance in the event of a Swiss franc funding stress.

- *Policy and institutional framework.* The financial sector policy framework has been further strengthened. Following the adoption of the macroprudential framework, the new bank resolution framework was finalized and took effect in October 2016. Structural reforms have focused on improving business climate and reducing labor market duality.

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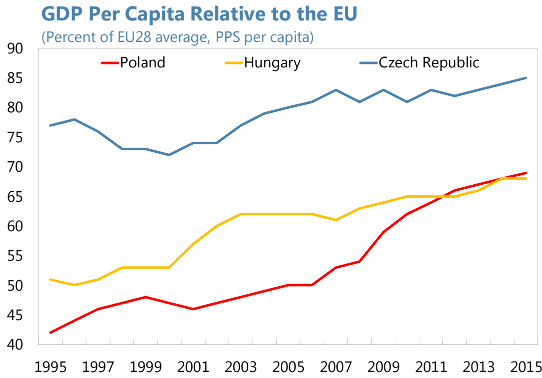
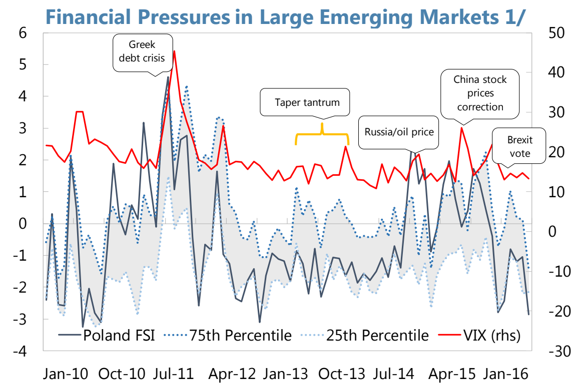
[1] The UniCredit Group has recently announced the sale of 32.8 percent (or PLN10.6 billion) of Pekao SA, the second largest bank in Poland, to the state-controlled insurance group PZU and the state-owned Polish Development Fund (PFR). The sale is part of a broader business plan that the UniCredit Group announced in mid-December aimed at improving efficiency (through cost reduction and revenue diversification measures) and strengthening the capital position. This transaction is expected to increase the share of domestic ownership of the banking sector by about 10 percentage points.

Figure 1. Poland: Convergence and Integration

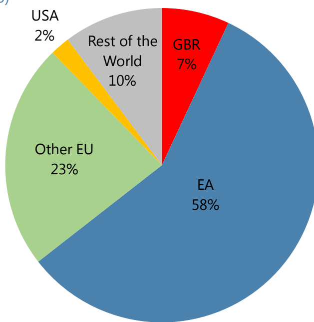
Poland has continued its steady convergence to the EU despite the global financial crisis…



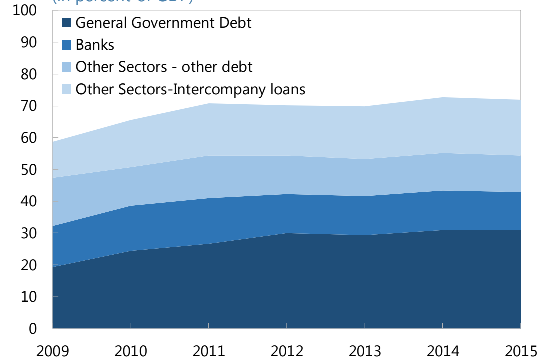
…and has generally experienced less financial stress than other emerging markets.



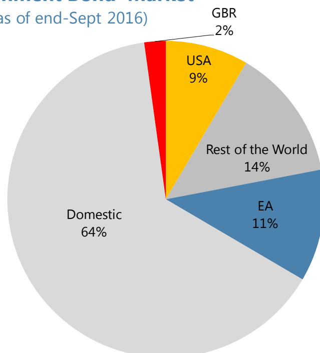
A large share of Poland's trade is with Europe.



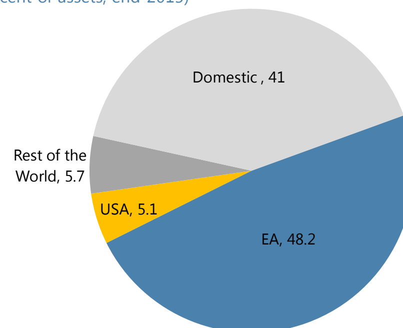
Both public and private external debt exposures are large.



Non-residents, mainly from the euro area (EA) and the U.S., hold about one third of domestic government bonds.



Prior to Unicredit's sale, the banking system was dominated by foreign banks, mainly from the euro area (EA).



Sources: Polish Financial Supervision Authority (KNF), Haver Analytics, Eurostat, EM_FSI, Datastream, and IMF staff calculations.

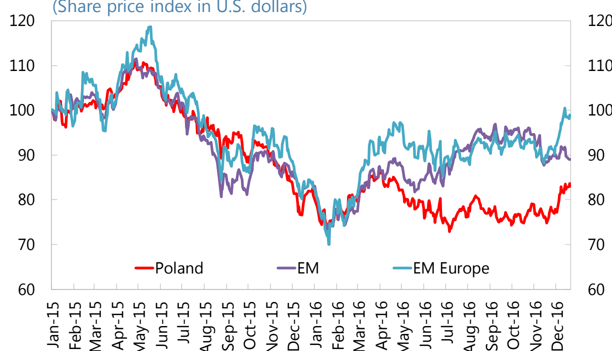
1/ To measure financial market stress, FSI for Emerging Markets (EMs) aggregates price movements relative to past levels and trends in banking, securities and exchange markets. 28 large EMs are covered by the index.

4. Despite some weakening in policies in late 2015 and early 2016, efforts have been made to reverse or mitigate some of the controversial policy initiatives. The increased policy uncertainty following the announcement of some controversial initiatives in late 2015 and early 2016, such as the proposed mandatory conversion of foreign exchange (FX) mortgages into local currency and changes to the Constitutional Tribunal, soured market sentiment and led S&P to downgrade Poland's sovereign rating to BBB+ and both S&P and Moody's to place Poland on a negative outlook. The new government's policy initiatives also raised questions during the 2016 Article IV consultation, though the IMF's Executive Board noted Poland's progress in building strong fundamentals and policy buffers in recent years.[2] Since mid-2016, however, the authorities have adopted a more market-friendly tone and have taken actions to correct some of the controversial policies. Notably the mandatory FX mortgage conversion proposed in January 2016 was replaced by

Text Figure 1. Poland: Financial Market Developments

Polish stocks underperformed Emerging Europe and other emerging markets (EMs) in the first half of 2016, but stabilized since mid-year

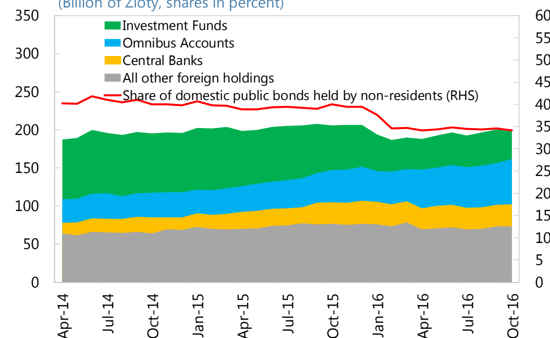
MSCI Emerging Market Equity Index
(Share price index in U.S. dollars)



Sources: Bloomberg and IMF staff calculations.

Similarly, foreign holdings of domestic government have stabilized after declining in late 2015-early 2016…

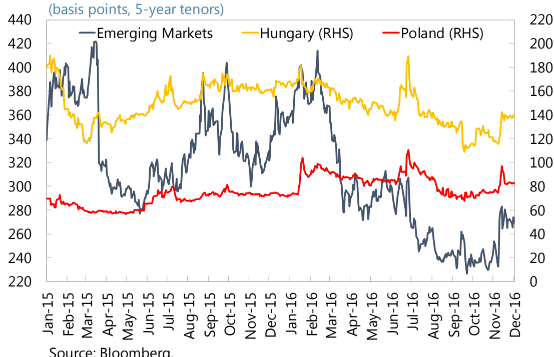
Non-resident Holdings of Government Bonds
(Billion of Zloty, shares in percent)



Sources: Haver and IMF staff calculations.

Poland's sovereign CDS spread narrowed and…

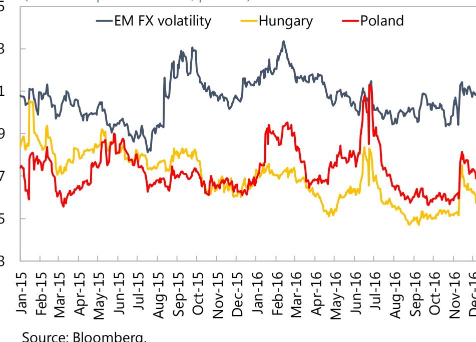
Sovereign Credit Default Swap Spreads
(basis points, 5-year tenors)



Source: Bloomberg.

…implied FX volatility declined to levels seen at end-2015 before the most recent spike following the US election…

Implied Volatility of Exchange Rate vs. Euro
(1-month options contract, percent)



Source: Bloomberg.

Note: EM FX volatility is based on the JPMorgan EM FX volatility index

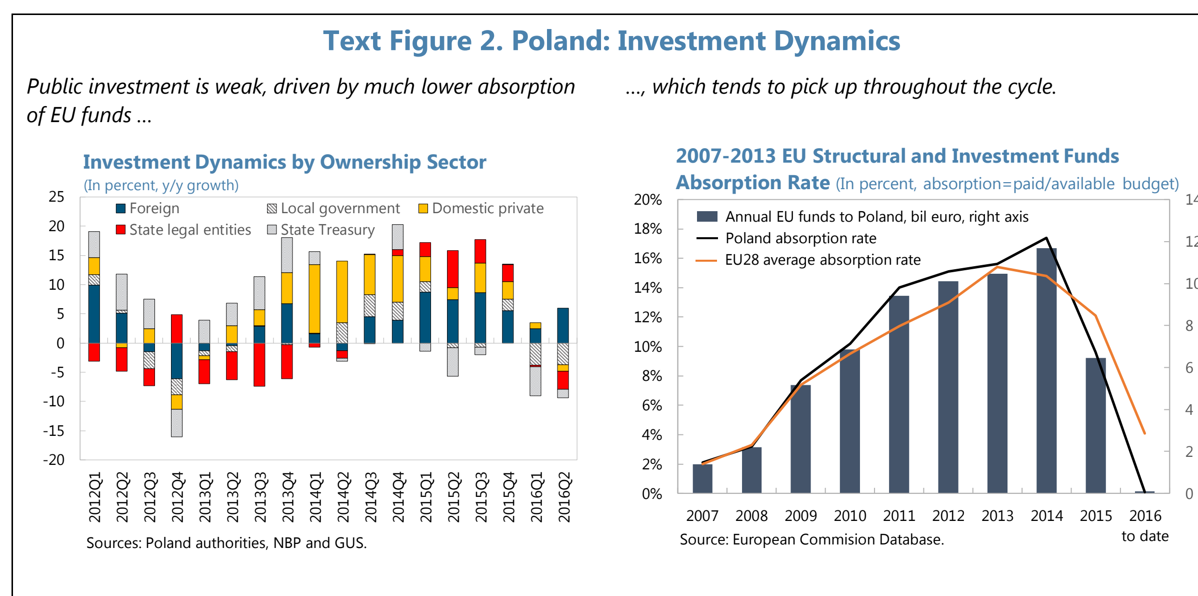
[2] See IMF Country Report No. 16/210, July 2016.

a draft law on excessive FX spreads repayment, and the distortionary retail turnover tax was suspended (see Section III). Investor sentiment improved later in the year, and S&P raised Poland's rating outlook to stable after its December review, citing reduced concerns over potential weakening of institutions and fiscal risks. The recent uptick in credit spreads and FX volatility was largely due to a reassessment of the US policy expectations after the US presidential election, and market pressures were lower in Poland than in other emerging markets (Text Figure 1).

5. Going forward, the government is committed to maintaining strong policies and institutions (see Appendix). Fostering strong inclusive growth, while maintaining strong monetary policy framework, fiscal discipline and financial stability, remain the key priorities for the Polish government. The authorities are committed to keeping the fiscal deficit below the Excessive Deficit Procedure (EDP) limit in 2017, and starting fiscal consolidation in 2018 with the structural fiscal adjustment of at least ¼ percent of GDP per year to reach a structural deficit of 1 percent of GDP.

RECENT DEVELOPMENTS

6. Growth remains robust, despite some weakening in 2016. Real GDP growth is expected to reach 2.6 percent this year, compared to 3.9 percent in 2015 (Figure 5). This dip mainly reflects lower absorption of EU funds during the transition to the new 2014–20 program, with other recipients of EU funds in the region experiencing similar declines. Private investment is also subdued partly due to uncertainty created by numerous policy and business regulation initiatives of the new government (Text Figure 2). In contrast, private consumption has been buoyant on rising employment and strong wage growth, and further boosted by the child benefits program. Labor market conditions have continued to tighten. Seasonally-adjusted harmonized unemployment rate has continued to decline, reaching a historical low of 5.7 percent in October 2016. Nominal wage growth has accelerated to an average of 4 percent in the first eleven months, the fastest since 2011. The output gap is largely closed.



7. Deflation has dissipated. After a protracted period of deflation since July 2014, reflecting low global commodity prices and deflationary pressures from the euro area, headline CPI inflation rose to zero in November 2016 on account of higher fuel and food prices (Figure 6). Core inflation also picked up recently, and long-term inflation expectations remain within the tolerance band.

8. The external position has strengthened (Figure 7). Following a significant reduction in the current account deficit in 2015 by around 1½ percent of GDP, the deficit is estimated to decline further to 0.3 percent of GDP in 2016, as stronger export performance outweighs the moderate increase in oil prices and non-oil imports. Gross international reserves increased further to USD 111 billion by end-November. Net external liabilities have declined steadily from 70 percent of GDP in 2013 to about 60 percent of GDP by the third quarter of 2016. The external position and the real effective exchange rate remain broadly in line with fundamentals (see Annex III).

9. The financial sector remains healthy, despite declining profitability. The capital adequacy ratio stood at 17.3 percent in the third quarter of 2016 with the Tier 1 capital ratio at 15.7 percent (Figure 8). The banking sector is liquid with deposit growth at 9.3 percent year-on-year in October 2016 and a declining funding gap, with the loan-to-deposit ratio close to 108 percent in the third quarter of 2016 (Figure 9). The NPL ratio has continued to edge down, reaching 7.3 percent in the third quarter of 2016. However, profitability has declined markedly[3] amid narrowing interest margins and higher costs to banks, including the bank asset tax and additional contributions to the Bank Guarantee Fund (BFG). The latest stress tests conducted by the Narodowy Bank Polski (NBP) suggest that the banking sector remains resilient to macroeconomic, market and liquidity shocks, despite declining profitability.[4] Credit growth has also slowed, especially to the corporate sector, mainly due to weak credit demand for investment. Lending standards remained unchanged for corporate credit, but tightened significantly for housing loans in response to regulatory requirements.

10. The 2016 fiscal outturn is expected to outperform the budget target. Data suggest a lower-than-expected general government fiscal deficit (on a cash basis) in the first eleven months of the year. Revenues have outperformed, reflecting increases in one-off non-tax revenues and stronger-than-expected VAT revenues due to improved compliance, partly in response to expected tightening in regulations.[5] Meanwhile, expenditures have been under-executed due to weak public investment associated with low absorption of EU funds. As a result, the 2016 fiscal deficit is estimated to be limited to around 2½ percent of GDP, lower than the budgeted deficit of 2.8 percent of GDP.

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[3] The recent increase in bank profitability in 2016 Q2 was due to a one-off factor (Visa's merger to Visa Europe). Excluding this transaction, bank profitability has declined since early 2015.

[4] See NBP Financial Stability Report, December 2016.

[5] The "fuel package" (which came into effect in August) and the "large VAT amendment" (effective from January 1, 2017) aim to close various VAT loopholes for firms in energy and certain other sectors. Additional measures to curtail tax evasion, currently at the planning stage, include central registry of invoices, registry of tax-payer bank accounts, tighter excise tax regulations and new powers for tax authorities.

However, this is still likely to represent a procyclical fiscal stance, with a structural relaxation of 0.3 percent of GDP after adjusting for one-off factors.[6] Public debt is assessed as sustainable under a wide range of shocks (see Annex I) and financing conditions have remained favorable.

OUTLOOK, RISKS, AND POLICIES

11. The outlook is for continued robust growth and a gradually rising inflation. Real GDP growth is projected to strengthen to 3.3 percent in 2017 and remain at around 3 percent in the medium term. The growth pickup in 2017 is expected to be largely driven by a rebound in public investment as the absorption of EU funds accelerates, and continued strong private consumption supported by improvements in labor market, higher wages and the child benefits' program. As a result, the output gap is expected to be closed in 2017, which, combined with rising fuel prices, planned increase in the minimum wage (by 8 percent in 2017) and some regulated prices, as well as strong wage pressures, should help nudge inflation gradually toward the lower end of the inflation target band by end-2017 with upside risks. As domestic demand strengthens and commodity prices recover, import growth is likely to outpace export growth, leading to a moderate widening in the current account deficit over the medium term.

12. External environment has become more challenging and risks remain elevated. Key external risks include a faster-than-expected pace of the monetary policy normalization in the U.S. and possible dislocations in emerging markets leading to bouts of financial market volatility, as well as banking sector stress and growth slowdown in the euro area. The *External Economic Stress Index* for Poland that tracks the evolution of indicators proxying the relative severity of these stresses compared to historical norms (see Box 1) suggests that external conditions have worsened since the January 2016 FCL review.[7] This deterioration largely reflects increased stress for euro area banks as they continued to struggle to maintain profitability in a low-growth and low-interest rate environment. Other risks remained broadly unchanged prior to the US elections: macroeconomic risks, including the risk of a euro area recession, remained the same, emerging market risks eased, while the risk appetite recovered on further easing in monetary and financial conditions (according to the Fall 2016 WEO and GFSR; see Figure 2). Following the recent US presidential election, however, market expectations shifted back to a faster pace of the monetary policy normalization on increased prospects for more fiscal stimulus in the U.S., causing the long-term bond yields and asset market volatility in emerging markets to rise, but also leading to some upward revisions of the growth forecasts for the euro area countries (Figure 2).

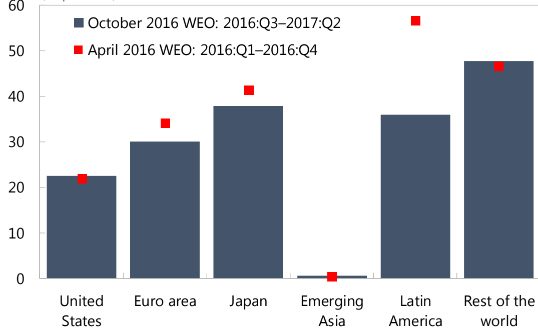
13. Brexit and other political event risks in Europe add to uncertainties. A prolonged uncertainty surrounding the Brexit negotiations between the EU and U.K. could weigh on Poland. Spillovers from the U.K. are likely to affect Poland mainly through the confidence and indirect trade and financial channels via the euro area, and to a lesser extent through direct trade links between the

[6] The 2016 structural fiscal balance adjusts for one-off mobile frequencies auction revenues of 0.5 percent of GDP.

[7] See IMF Country Report No. 16/12, January 2016.

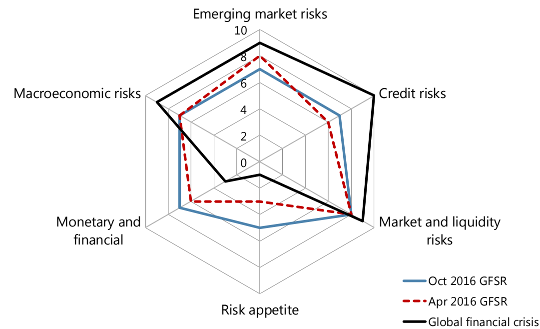
Figure 2. Poland: External Risks

Between April and October 2016, the probability of a euro area recession has remained broadly unchanged,



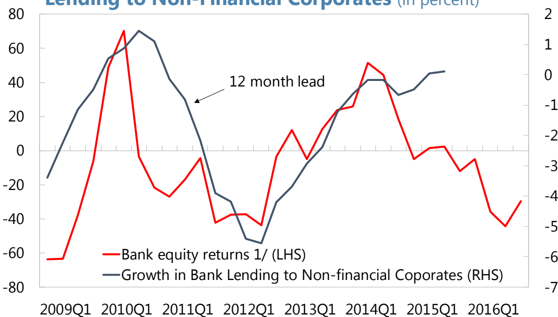
Source: IMF staff calculations.

...EM risks have declined and risk appetite improved, but credit risks have increased, most notably in the euro area.



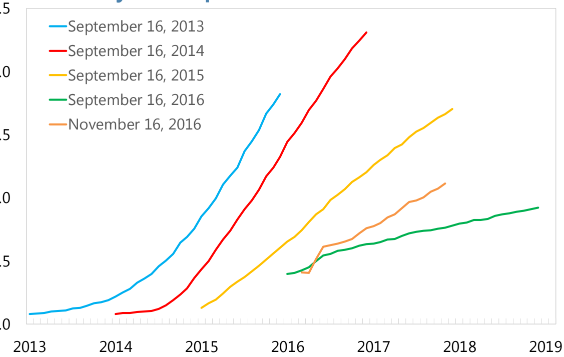
Source: IMF staff calculations.

.. with higher level of euro area banking stress more likely to hamper credit supply going forward.



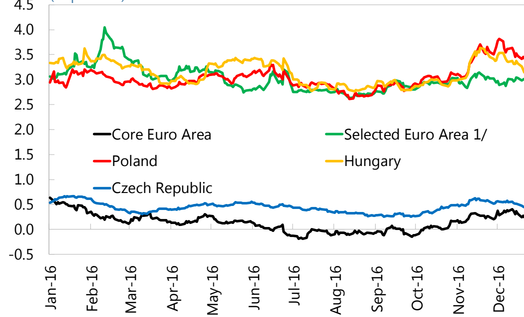
Sources: Haver Analytics, Datastream, and IMF staff calculations
Note: 1/ European Stoxx Bank Equity Index.

Following the US elections, market expectations shifted back to faster monetary policy normalization



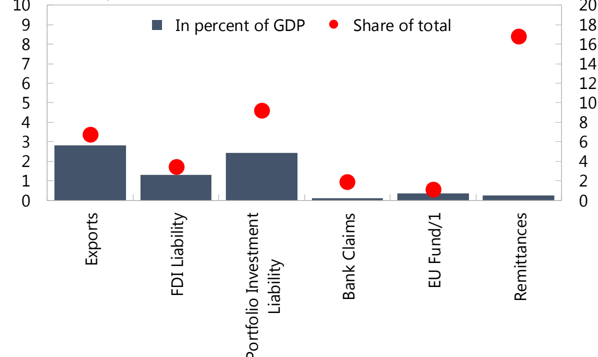
Source: Bloomberg.

...which led to a sharp increase in long-term government bonds yields, especially in relatively higher risk credits...



Source: Bloomberg.
1/ Selected Euro Area include Greece, Portugal, Spain, Ireland and Italy.

While the upcoming Brexit negotiations add to uncertainties, direct trade and financial links with the U.K. are limited.



Sources: DOT, CPIS, CDIS, BIS, Haver and Staff Calculations
1/ Share of EU fund flows to Poland multiplied by contribution from the UK

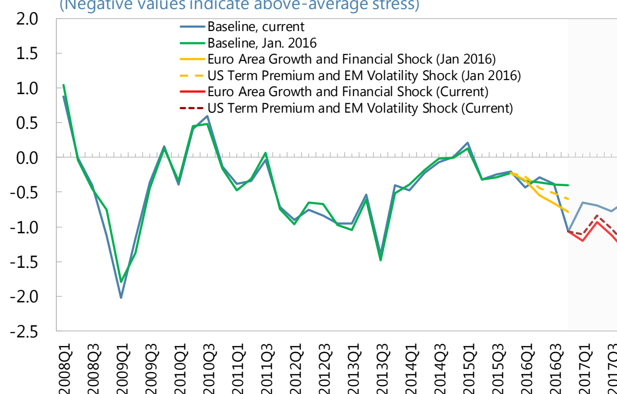
Box 1. Poland: External Economic Stress Index

The external economic stress index was introduced in January 2015, based on the methodology in "The Review of Flexible Credit Line, the Precautionary and Liquidity Line, and the Rapid Financing Instrument," IMF Policy Paper, May 2014. This box updates the index and compares it to the version published at the time of the review of the current FCL arrangement in January 2016.

The External Economic Stress Index aims to capture the evolution of external environment as it pertains to Poland. The index is a weighted sum of standardized deviations of the key external risk factors from their means. The risk factors are the same as in the January 2016 FCL report and include real shocks (growth in the euro area) and financial shocks (changes in the European bank equity prices, the 10-year US bond yield, and the emerging market implied volatility (VXEEM)). The weights are based on the time-varying trade and financial exposures, all expressed as shares of GDP and then normalized to add up to one. As of end-2015, the raw weight on the euro area growth (0.23) corresponds to the exports to the euro area (as a share of GDP); the weights on the change in the U.S. long-term yield (0.24) and the VXEEM (0.08) correspond to the stock of portfolio debt investment (as a share of GDP); and the weight on the euro area financial shock (0.20) corresponds to the gross external debt of the private sector, excluding intercompany loans (as a share of GDP).

Poland: External Economic Stress Index

(Negative values indicate above-average stress)



Source: IMF staff calculations.

External conditions have deteriorated since the last FCL review, largely reflecting pressures on the euro area banks. While the euro area growth has slowly recovered, bank shares came under pressure on concerns about profitability and sustainability of bank business models. The baseline projection assumes a steeper U.S. interest rate path, a somewhat better but still gradual recovery in the euro area, emerging market volatility (VXEEM) persisting at the end-November 2016 level, and euro area bank equity prices recovering along with the euro area growth from a lower level than at the time of the October 2016 WEO. Under these assumptions, external economic conditions under the baseline are worse than at the time of the January 2016 FCL review.

External risks remain elevated, including from uncertainties surrounding the future US policies. Following the US elections (November 8), the US long-term bond yields have moved higher and the expected path of the US monetary policy normalization has steepened, EM financial volatility remains elevated, as well as the risk of outflows from EMs and a global risk -off scenario with a rapid tightening in global financial conditions. In addition, risks related to the euro area growth slowdown and banking sector stress have not subsided. In this context, we simulate two risk scenarios (see Text chart):

- *The US Term premium and EM volatility shock* scenario assumes a 75 basis point increase in the 10 year US bond yield above the baseline that already reflects a steeper path of expected monetary normalization than prior to the US elections. The EM financial volatility (VXEEM) shock is assumed at 2 standard deviations, as in the last FCL review.
- *The euro area growth and financial shock* scenario assumes the same shocks as in the January 2016 FCL review: the euro area growth shock (0.45 percentage points decline relative to the 2017, based on the October 2016 WEO assessment of the probability of the euro area recession) combined with a 1 standard deviation fall in the euro area bank share prices. The probability of the euro recession remains the same despite a slight upgrade of the euro area growth forecast.

Under each of these scenarios, the level of external stress is well above average, but lower than during the global financial crisis (2009) or the taper tantrum episode (2013). A combined scenario can occur if the U.S. Fed has to respond to overshooting inflation, leading to a significant tightening of the global financial conditions, which would disproportionally affect the euro area countries with weak banking systems, especially those where bank balance-sheet repair has been insufficient, and drag down growth in Europe.

two countries and the status of Polish workers in the U.K. Being Poland's second largest direct trading partner, the U.K. accounted for around 7 percent of Poland's total exports in August 2016. The trade exposure, however, is much larger after including Poland's indirect trade with the U.K. via other EU economies (Poland's exports to the EU was around 80 percent of total exports in August 2016). The direct financial exposure to the U.K. is limited (Figure 2). In addition to the Brexit related uncertainties, Europe's heavy election calendar in the next 12 months may entail further political event risks that are difficult to quantify.

14. Against this background, the authorities intend to further strengthen their policies and correct or mitigate the impact of the earlier controversial policy initiatives (Table 1). Staff expressed concerns about these initiatives at the time of the January 2016 FCL review and the 2016 Article IV consultation and proposed mitigating measures, some of which have been adopted by the authorities, as discussed below.

15. Following the expansionary fiscal policies this year, the 2017 budget represents a broadly neutral fiscal stance and the medium-term consolidation will start in 2018.

- *The 2017 budget* envisages a general government deficit of 2.9 percent of GDP, just below the EDP threshold. To achieve the deficit target, the reduction in the VAT rate planned for 2017 has been postponed at least until 2019. In addition, measures to raise efficiency of the tax administration (notably, the VAT compliance) have been announced and some already implemented, contributing to tax revenue over-performance this year. To further support the authorities' efforts, the IMF's technical assistance (TA) on tax administration has been scheduled to start in 2017Q1. The authorities are strongly committed to keeping the deficit under the 3 percent EDP limit in 2017 with contingency measures on both revenue and expenditure side ready to address any revenue underperformance, including from lower-than-expected gains from the tax administration reforms.

- *Fiscal consolidation will start in 2018* with an annual adjustment in structural fiscal balance of at least ¼ percent of GDP aiming to reach the structural deficit of 1 percent of GDP (see Appendix). Fiscal consolidation will be supported by improved revenue collection (focused on better tax compliance), more progressive tax system, and targeted expenditure rationalization. Under these policies and notwithstanding the reversal of the retirement reform (see below), staff projects that the fiscal deficit will decline to around 2 percent by 2021 and public debt will remain moderate (under 55 percent of GDP) and sustainable over the medium-term (see Annex I).[8] The authorities have also sought the IMF's TA to improve the multi-year budgetary process.

[8] Staff's baseline projections assume the following: (i) on the revenue side, no reduction in the VAT rate in 2017–18 and conservatively estimated gains from the tax administration reforms (at 30 percent of the authorities' estimates); and (ii) on the expenditure side, retirement age reversal starts from 2017Q4 (the earliest possible starting date) and real public sector wage and social benefits grow moderately, which is more conservative than the authorities' assumptions of a constant real public wage bill and social benefits, as indicated by their expenditure rule.

Table 1: Policy Initiatives Proposed and Implemented by the New PiS Government		
Policy Initiatives	**Original proposal and announcement time**	**Current status / baseline assumptions (including specific corrective actions that have been taken by the authorities)**
1. Child benefits program	Proposed as a follow up on the election promise to support families with children; estimated to cost around 1 percent of GDP annually.	*Effective since April 2016;* cost in 2016 is in line with original estimates, but is estimated to be higher in the 2017 budget by about 0.2 percent of GDP; and stable (in nominal terms) from 2018 onward.
2. New bank asset tax	Proposed as a way to help finance the child benefits program; estimated to generate additional revenues of about 0.3 percent of GDP annually.	*Effective since February 2016 and is levied on total assets (less PLN 4 billion, own funds and sovereign bond holdings) at a monthly rate of 0.0366 percent.* The actual revenues have so far been lower than originally envisaged by about 0.1 percent of GDP. Minor modifications are under consideration. The NBP sees limited effect on banking sector soundness or on credit supply so far.
3. New retail turnover tax	Proposed as a way to finance the child benefits program; estimated to generate additional revenues of about 0.1 percent of GDP.	*Effective since September 2016, but was immediately suspended* after the EC ruled it to be discriminatory. A new retail tax is under consideration.
4. Reduction in VAT rate	The 2011 VAT increase was initially scheduled to expire in 2017. This would reduce VAT rate by 1 percentage point and lead to revenue reduction of about 0.4 percent of GDP annually in 2017–18.	*The government announced in October 2016 that the reduction in the VAT rate would be delayed until end-2018.*
5. FX mortgage conversion	The idea was introduced during the election campaign and the first proposal of a blanket conversion of FX mortgages was floated in January 2016; the cost to banks was estimated at PLN 67 billion (six times the annual banking sector profits and about 3.7 percent of 2015 GDP) by the financial supervisory authority (KNF).	*The President's proposal was submitted in August 2016, no longer requiring blanket conversion,* but *for banks to repay excessive FX spreads unfairly charged to customers*; estimated to cost between PLN 4 and 9 billion, per NBP estimates; passed the first parliamentary sitting and now being reviewed by the parliamentary commission; additional prudential measures are under consideration to encourage voluntary restructuring of FX mortgage loans.
6. Higher PIT tax-free allowance	Proposed as part of the election promises and mandated by the ruling of the Constitutional Tribunal in 2015 to increase the tax-free allowance of the PIT. The cost of the required amendment was expected to cost about 1.1 percent of GDP (PLN 20 billion) per year.	*Approved at end-November to increase the PIT tax-free amount for low income taxpayers, to become effective in 2017.* The fiscal cost is estimated to be close to PLN 1 billion.
7. Retirement reform reversal	Proposed as part of the election promises to reverse the 2013 retirement age increase.	*Draft law has been endorsed by the government and approved by the Parliament.*
8. Changes to the Constitutional Tribunal	On 22 December 2015, the Sejm amended the Law on the Constitutional Tribunal (CT), which triggered the EC inquiry under the Rule of Law framework. Several additional amendments and laws have been passed since then, including on the status of the CT judges and on the CT organization and proceedings.	*The EC issued recommendations in July 2016, with the deadline of end-October. In light of the developments, since then, the EC issued additional recommendations in December 2016, inviting the authorities to address the EC concerns within two months.*
Source: National authorities		

- *The reversal of the 2013 retirement age increase would require corrective measures to support the planned fiscal consolidation*. The draft law to reverse the 2013 retirement age increase[9] was approved by Parliament, and is expected to come into effect in Q4 2017. While the near-term fiscal implications are manageable, with a staff's estimated annual fiscal cost of about 0.5 percent of GDP from 2018 onward, the reversal of retirement reform could put pressure on public finances, in addition to weakening the social or financial sustainability of the pension system and reducing the labor force participation.[10] To mitigate the impact, the authorities are working on measures to provide incentives for seniors to stay in the workforce longer, and also possibly to introduce minimum years of service before the entitlement to pension benefits.[11]

- *The suspension of the retail turnover tax is a positive development.* The retail tax was suspended immediately after taking effect in September, at the request of the European Commission (EC), which judged it to be discriminatory.

16. Monetary policy is expected to remain accommodative. The Monetary Policy Council (MPC) has kept the policy rate unchanged at a historic low level, with the expectation to be on hold throughout 2017. This stance is appropriate given that inflation is projected to gradually converge to the lower bound of the target band within the forecasting horizon, with some upside risks from stronger-than-expected consumption and wage pressures. Lending rates have also dropped to historic low levels, supporting expansion of credit to households. Credit to the corporate sector, however, has slowed in recent quarters, largely reflecting weaker credit demand due to policy and regulatory uncertainties, rather than overly tight financial conditions (Figure 10).

17. Financial sector policies continue to aim at maintaining financial stability, while also addressing consumer protection concerns.

- *The new macroprudential and bank resolution frameworks should help mitigate systemic risks.* The bank resolution framework in accordance with the European Bank Recovery and Resolution Directive (BRRD) was finalized and took effect in early October 2016. The macroprudential framework has been in place since 2015.

- *The latest proposal on FX mortgages goes in the right direction.* The originally proposed mandatory conversion of all FX mortgages originated during 2000–11 has been replaced by the proposal to require banks to repay "excessive" FX spreads unfairly charged to mortgage

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[9] The 2013 retirement age increase set the long-term target to gradually increase retirement age for both men and women to 67 by 2020 and 2040, respectively. As of now, the statutory retirement age is 66 for men and 61 for women. The draft law aims to reverse the retirement age increase to 65 for men and 60 for women.

[10] See Box 3 of IMF Country Report No. 16/210, July 2016. The estimated fiscal cost reflects lower social contributions from the cohort eligible for earlier retirement, as well as higher spending on a larger number of pensioners, including retirees who receive minimum pensions or are under preferential pension regimes.

[11] Poland's defined contribution pension system provides incentives to work longer for better pension payments. The near-term impact is also mitigated by strong demand for experienced senior workers as the labor market conditions continue to tighten.

borrowers.[12] The potential cost to banks is now estimated between PLN 4 and 9 billion, which is significantly lower than the PLN 67 billion cost of mandatory conversion, as estimated by the financial supervisory authority (KNF). The proposal has passed the first Parliamentary sitting, and has been submitted to the Public Finance Commission for further revisions that are expected to bring the total cost to banks closer to PLN 4 billion (or about a third of annual banking sector profits). Meanwhile, prudential measures, such as higher risk weights, are being considered to incentivize banks to convert FX mortgages into PLN voluntarily over time. The authorities indicated that any further steps would be mindful of their potential impact on banks' soundness and on financial stability.

- *The bank asset tax remains in place*, but the authorities are considering measures to mitigate its distortionary effects on banks' activities. Staff's advice is to replace the bank asset tax with a tax on banks' profits and remuneration.

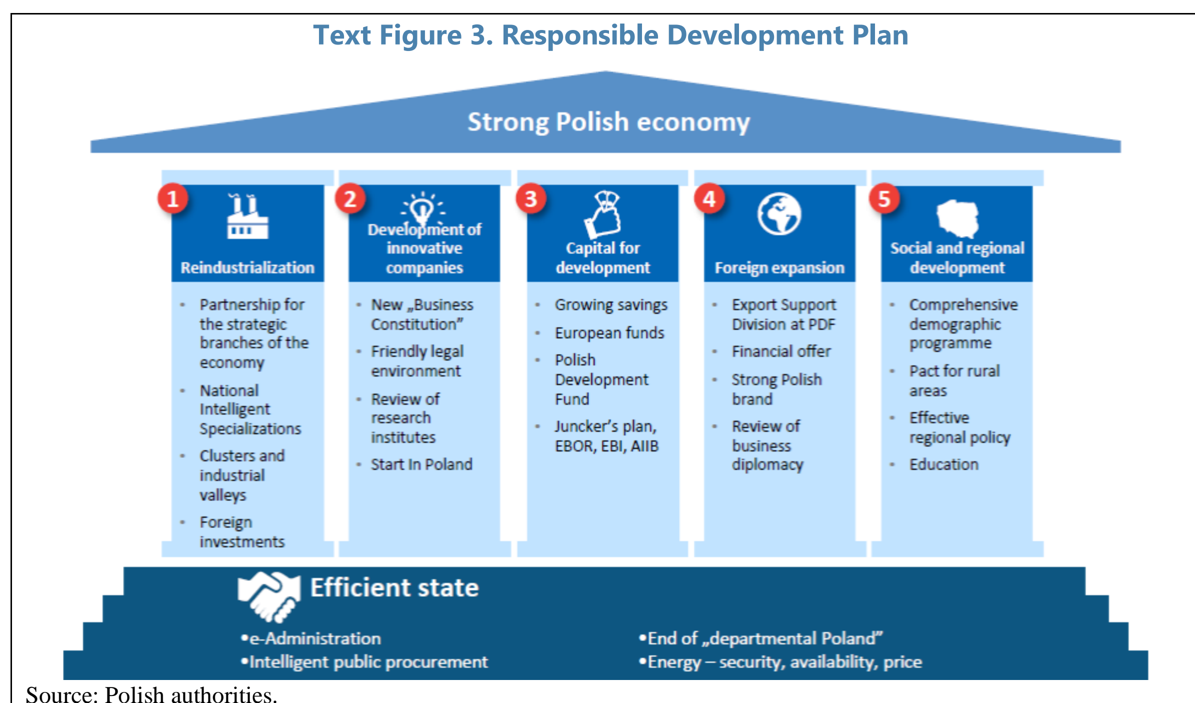
18. Structural reforms continue to focus on improving business climate, reducing labor market duality and boosting long-term growth. As noted in the most recent World Bank Doing Business report and World Economic Forum Competitiveness report, Poland's relative rankings in business environment have improved several notches, and further measures to reduce bureaucratic burden on firms are in the works. The recent changes to the labor code aim to reduce labor market duality and to improve job security while still preserving labor market flexibility (e.g., a limit of maximum three years has been put on the fixed-term labor code contracts). A package of policy measures under the Responsible Development Plan has been through public consultation and is expected to be finalized by end-year. The Plan aims to achieve strong, sustainable, and inclusive growth, supported by five pillars: reindustrialization, development of innovative companies, mobilizing capital for development, foreign expansion, and social and regional development (see Text Figure 3).

19. The ongoing "rule of law" inquiry by the European Commission (EC), if not resolved, is likely to continue to weigh on investor sentiment. The changes to the Constitutional Tribunal (CT) adopted in late 2015 have prompted the EC to initiate an investigation under its Rule of Law Framework in early 2016. In July 2016, the EC laid out a number of recommendations and set a three-month window for the authorities to address its concerns regarding the impact of changes to the Constitutional Tribunal on the robustness of Poland's rule of law. Following the recent adoption of the laws on the status of the CT judges and on the CT organization and proceedings, the EC has issued additional recommendations in late December, inviting the authorities to respond within two months. Staff urged the authorities to address these concerns in order to avoid further damage to investor confidence and dispel any doubts about the strength of Poland's legal and institutional framework.[13]

[12] The "excessive" FX spreads are defined as spreads that are more than 0.5 percent above the NBP official exchange rate, on mortgage values up to PLN 350,000 (at origination).

[13] The initiation of the EC's investigation within the Rule of Law Framework has contributed to a rating downgrade by S&P in January and a downward revision of the outlook by Moody's in May 2016.

Text Figure 3. Responsible Development Plan



Source: Polish authorities.

20. Overall, economic and financial policies remain sound. These include an appropriately accommodative monetary policy stance, sustainable public finances, and effective financial supervision (see Section IV.C for discussion of institutional framework in the context of the FCL qualification criteria). The authorities' efforts to reverse or mitigate the impact of earlier controversial policy initiatives send a clear signal of their commitments to sound economic management. These, combined with the authorities' intention to further strengthen policy buffers (see Appendix), should help Poland to maintain robust economic performance and weather global financial volatility.

THE ROLE OF THE FLEXIBLE CREDIT LINE

21. The authorities continue to see important benefits from having a precautionary FCL arrangement in recent years. The FCL continues to be viewed by the authorities and market participants as a valuable insurance against negative external shocks and a very positive signal about Poland's fundamentals and policy framework, which helped support market confidence during the euro area crisis, the onset of the U.S. Fed tapering, the geopolitical tensions surrounding Russia and Ukraine, the abrupt corrections of the Chinese stock market, as well as other bouts of financial volatility in the aftermath of the U.K. vote to leave the EU (Brexit) and the recent US elections.

22. Given the still elevated external risks, the authorities have requested a successor two-year FCL arrangement with a significantly lower access of SDR 6.50 billion (159 percent of quota or about USD 8.93 billion). Sustained efforts to improve economic fundamentals and external buffers as well as to maintain very strong policy frameworks, including by reversing or mitigating some the controversial policy initiatives, have helped Poland to reduce its financing needs. At the same time, the authorities still see significant downside external risks as well as new

uncertainties related to the future US policies and the political event risks in Europe, which argue for a more gradual exit from the FCL arrangement. Against this backdrop, the authorities intend to request a two-year FCL arrangement with significantly lower access. The proposed nominal access of SDR 6.50 billion (159 percent of quota) is half of the current access level of SDR 13 billion.

A. Access Considerations

23. Estimated financing needs in the adverse scenario are lower compared to the current FCL arrangement. This is mainly due to stronger fundamentals, including the improved current account balance and stronger reserve buffers. Given the evolution of external environment discussed above, possible shocks to FDI, equity inflows and private external financing in the adverse scenarios remain broadly similar to those underlying the calculations of the financing needs during the last January 2016 FCL review (see Box 2). Stronger reserve buffers allow a larger drawdown of about USD 13.6 and 14.6 billion in 2017 and in 2018, respectively, under the adverse scenario. Under these assumptions, the external financing gap is estimated at about 6.5 billion SDR (159 percent of quota) in 2017 and 2018 (about half of the access under the current FCL arrangement). This implies that gross reserves in the adverse scenario decline to 108 and 106 percent of ARA metrics in 2017 and 2018, respectively, while net international reserves fall only slightly below 90 percent of ARA metric.[14] This post-shock level of reserves can be considered prudent given the uncertainties surrounding the future US policies following the recent elections, the EU-U.K. Brexit negotiations and other political event risks in Europe.

B. Exit Considerations

24. The proposed significant reduction in access sends a clear signal of the authorities' intention to exit from the FCL as external risks recede. The authorities' continued efforts to improve economic fundamentals and maintain very strong policy frameworks should help facilitate an eventual full exit from the FCL arrangement when external conditions allow.

25. The authorities plan to start public outreach regarding their intentions to reduce FCL access further to ensure a smooth full exit in the future. To prepare financial markets for a further reduction in the FCL access, the authorities plan to stress the benefits of continued access to the FCL in the current highly uncertain external environment, while also highlighting that Poland is now better prepared to deal with adverse external shocks than at the height of the crisis, including because of higher international reserve buffers and a much smaller current account deficit. Accordingly, they will signal that Poland is well positioned to significantly cut its FCL access. Moreover, even though a two-year FCL arrangement is proposed, the authorities may consider their readiness to exit sooner, if external risks subside faster than expected or if Poland's fundamentals and external buffers improve substantially putting Poland in a better position to deal with potential adverse market conditions without the FCL arrangement.

[14] Net reserves are calculated as a difference between gross reserves (official and other FX reserves) and FX liabilities.

Box 2. Poland: Adverse Scenario

The baseline scenario reflects significant strengthening of external buffers. The current account deficit has narrowed since the January 2016 FCL review. The gross external financing needs have declined, though remain sizable. Baseline rollover rates are projected at close to 120 percent of the average annual amortization needs in 2016 for the public sector and at 100 percent for the private sector. In the absence of external shocks, gross reserves are projected to increase by about 16 billion USD in 2016 and remain above 120 percent of the IMF's Assessing Reserves Adequacy (ARA) metric, while net reserves will increase by about 6 billion USD. The main difference between the gross and net reserves dynamics is the repo transactions, which increased significantly this year as part of the NBP's reserve management strategy aimed to compensate for low yields in the low interest rate environment.

The adverse scenario simulates the potential impact of a sudden shift in market sentiment on Poland's external funding conditions. The key risks are discussed in Box 1. They can originate from a faster-than-expected US monetary policy normalization and possible dislocations in emerging markets (EMs) leading to bouts of financial market volatility, as well as from an increased banking sector stress and a growth slowdown in the euro area. The rollover rate on FDI is mainly affected by the economic conditions in the euro area. The public sector rollover rates are mostly influenced by the shifts of the US yield curve and by the market perception of EM risks (EM volatility). The euro area banking sector risks influence the rollover rates on the private sector debt.

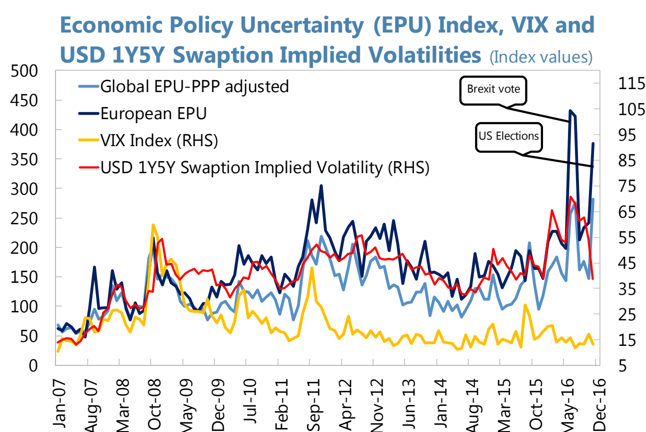
Given the evolution of external environment since January 2016, a plausible downside scenario is similar to the one from the last FCL review. Under the scenario of a rapid tightening in global financial conditions (amid a sharp rise in the US bond yields and increased market pressures in EMs), as well as increased banking stress and lower growth in the euro area, the shocks (and hence, the rollover rates) are assumed to be broadly similar to the January 2016 FCL review, with the exception of a short-term private sector rollover rate, which is assumed to be slightly lower in both 2017 and 2018 (see Table 8):

- *Equity portfolio outflows of 90 percent of non-resident equity holdings.*
- *A decline in public sector MLT borrowing of close to 20 percent;*
- *A decline in the private non-financial corporate MLT flows of around 15 percent.*
- *A decline in bank flows of close to 30 percent.*
- *Net FDI flows fall 25 percent.*
- *Other investment outflows of USD 3.5 billion from non-resident deposits.*

Due to stronger reserve buffers, there is space to allow a larger drawdown of reserves than at the time of the last FCL review (5 billion USD). Specifically, a drawdown of reserves is assumed at around USD 13.6 and 14.6 billion in 2017 and 2018, respectively, representing over 60 percent of total financing needs and about 12 percent of total reserves. The post-shock level of gross reserves remains broadly adequate at 108 and 106 of the ARA metric in 2017 and 2018 respectively, while the net international reserves remain about 90 percent of the ARA metric.

In addition to the risks captured in this adverse scenario, there are considerable uncertainties related to the future US policies, as well as various political event risks, such as the Brexit negotiations and the upcoming elections in Europe. These risks are hard to quantify amid an unusually high perceived policy uncertainty and mixed signals from financial markets (see Text-Figure). In this context, it is important that the post-shock reserves remain at a broadly adequate level in order to provide sufficient buffers to absorb any additional shocks from other possible tail risk events.

Economic Policy Uncertainty (EPU) Index, VIX and USD 1Y5Y Swaption Implied Volatilities (Index values)



Source: Bloomberg; www.PolicyUncertainty.com and Baker, Bloom and Davis (2016).

C. FCL Qualification Criteria

26. In staff's view, Poland continues to meet the qualification criteria identified in ¶2 of the FCL decision (Figure 3 and Text Figure 5).

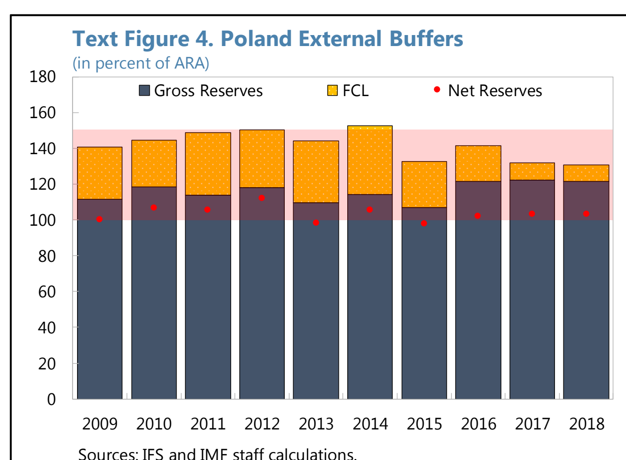
- *A sustainable external position.* Poland's external position is broadly consistent with medium-term fundamentals and appropriate policies. The current account has continued to improve and international reserves have strengthened. While the net IIP liabilities are relatively large (around 60 percent of GDP), external debt is projected to reach 71 percent of GDP by end-2016 and to gradually decline over the medium term. Furthermore, well-diversified FDI liabilities and intercompany lending (accounting for over 40 percent of total foreign liabilities) mitigate debt rollover risks (see Annex II). Foreign investor base is dominated by institutional investors and is well diversified.

- *A capital account position dominated by private flows.* Capital flows to Poland originate largely from private investors, with official creditors accounting for less than 5 percent of external debt as of Q2 2016.

- *A track record of steady sovereign access to international capital markets at favorable terms.* Poland has benefitted from sustained access to global capital markets—even during periods of high financial volatility. Bond yields have been largely stable in 2015 and 2016, with 10-year government bond yield at around 3.5 percent in December 2016, though spreads over 10-year German bonds have widened moderately during 2015–16. Poland's EMBI spread was around 110 basis points—well below the emerging market composite—in December 2016 (Figure 3). The authorities have continued to take advantage of favorable market conditions to pre-finance and extend the average maturity and duration of public debt, improving its risk profile. Gross borrowing needs for 2016 have been fully covered and the authorities have begun pre-financing their 2017 borrowing needs. Most recently, bond yields and credit spreads have spiked amid a broad-based sell-off in global bond markets after the US elections.

- *A reserve position that remains broadly comfortable.* Gross international reserves are adequate based on standard reserve metrics (Text Figure 4). Gross international reserves are projected at around 122 percent and net reserve at 102 percent of the IMF's ARA metric at end-2016. Compared to end-2015, both net and gross reserves increased notably, the latter also on account of increased repo transactions.

Text Figure 4. Poland External Buffers
(in percent of ARA)



Sources: IFS and IMF staff calculations.

- *Sound public finances, including a sustainable public debt position.* Even if the fiscal stance has been more procyclical than staff recommended in the last two years, fiscal policy is generally anchored by a strong public sector institutional framework, including both domestic rules (a constitutional public debt limit with

associated fiscal adjustment rules) and European institutional safeguards (the EDP). The authorities are committed to keeping the deficit below the 3 percent of GDP EDP limit in 2017 and to resume gradual fiscal consolidation in 2018. Debt sustainability analysis indicates that under current policies, general government debt is sustainable under a range of macroeconomic scenarios (see Annex I). The prudent debt management strategy has continued to contain potential vulnerabilities related to the currency composition and maturity profile of public debt.

- *Low and stable inflation, in the context of a sound monetary and exchange rate policy framework.* While inflation remains below the target for a prolonged period of time, it is largely driven by imported deflation, while monetary policy stance has been appropriately accommodative and domestic demand remains buoyant. Moreover, deflation has dissipated recently on the back of rising fuel and food prices, and long-term inflation expectations remain within the tolerance band. The NBP expects inflation to enter positive territory by end-2016 and to converge to the lower end of its target band by end-2017. The new president of the NBP, Mr. Glapiński, has emphasized the importance of continued central bank independence.

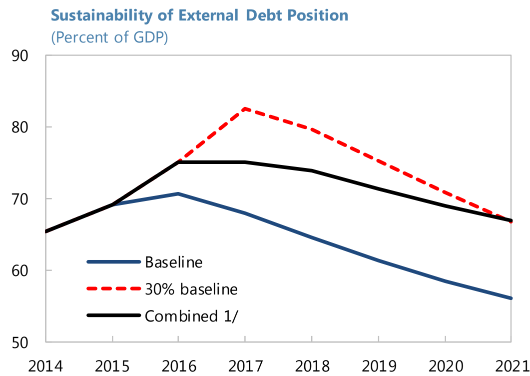
- *Sound financial system and the absence of solvency problems that may threaten systemic stability.* Despite recent decline in profitability, Poland's banking sector, which forms the core of Poland's financial system, remains well-capitalized and liquid, with non-performing loans continuing to edge down. The latest stress test conducted by the NBP suggests that the banking sector remains highly resilient to shocks. The authorities' revised approach to the FX mortgages is encouraging, as well as their commitment to be mindful of the implications for bank soundness and financial stability. The restructuring of the weak credit union segment (which is non-systemic, with the size of assets corresponding to about 0.8 percent of banking sector assets) has continued, and its connections to other financial institutions are insignificant. As such, there are no solvency problems that could threaten financial system's stability.

- *Effective financial sector supervision.* The macroprudential and bank resolution frameworks have been finalized and are being implemented, further strengthening the effective financial sector supervision. This is particularly timely in light of the impending increase in the share of domestic and state-owned financial intermediaries in the banking sector, which may create new prudential and macroprudential challenges. The expected merger of the financial supervisory authority (KNF) with the NBP is expected to further improve financial sector supervision, given that the NBP has a strong capacity for risk analysis as well as the instruments to address financial stability concerns. Moreover, the NBP has a key role in macroprudential supervision, with the NBP Governor chairing the Financial Stability Committee (FSC) in its macroprudential supervisory function.

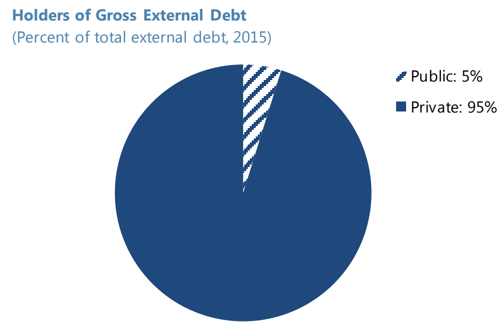
- *Data transparency and integrity.* Poland has subscribed to the Fund's Special Data Dissemination Standard (SDDS) since 1996. Overall data provision is adequate for surveillance.

Figure 3. Poland: Qualification Criteria

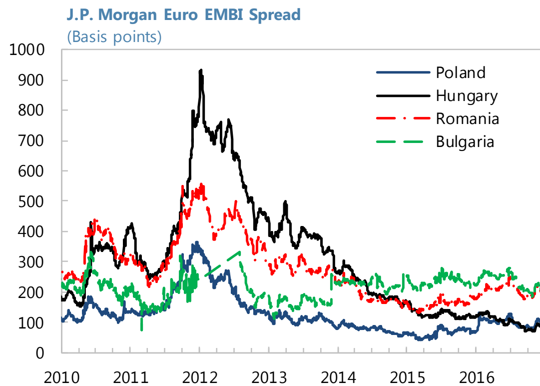
Sustainable external position.



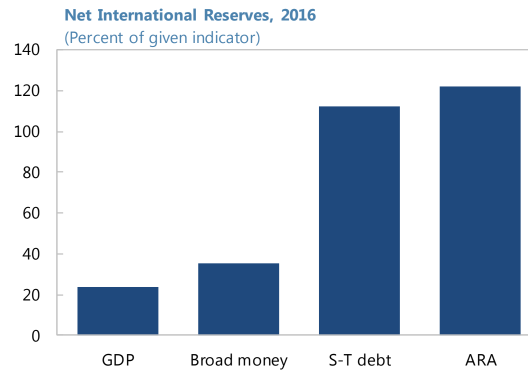
Almost all external debt is held by private creditors.



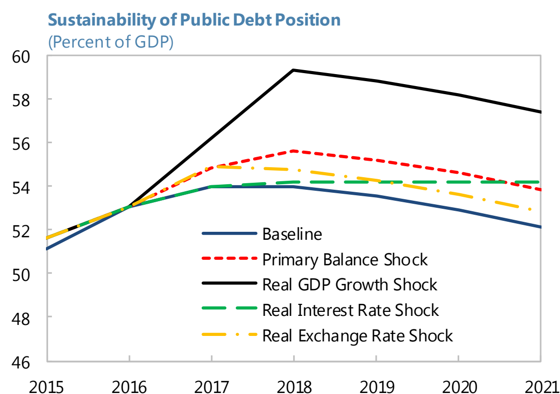
Steady sovereign access to capital markets.



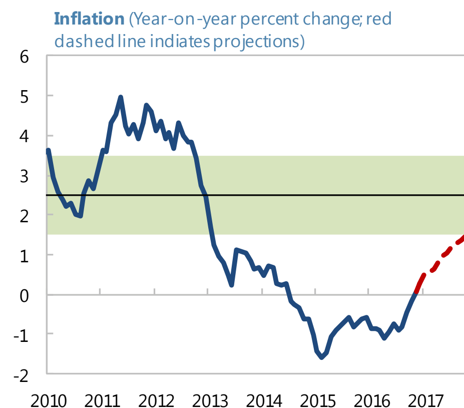
Relatively comfortable reserve position.



Sustainable public debt position.



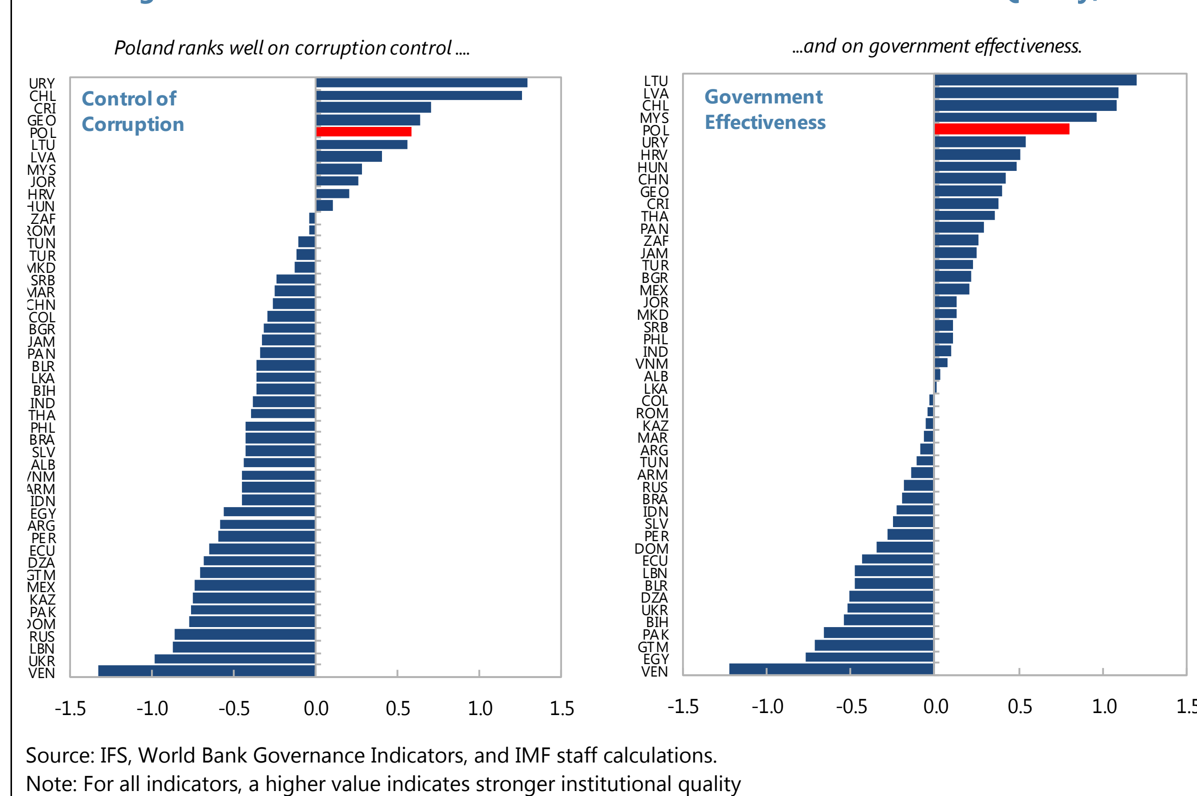
Low and stable inflation.



Sources: Bloomberg, Poland authorities, and IMF staff calculations.

1/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

Text Figure 5. Poland and Selected Countries: Indicators of Institutional Quality, 2015



Source: IFS, World Bank Governance Indicators, and IMF staff calculations.
Note: For all indicators, a higher value indicates stronger institutional quality

27. In sum, Poland's institutional and policy frameworks rank favorably among peers. Cross-country comparisons suggest that Poland's monetary and fiscal policies have been generally countercyclical (albeit with exceptions in some years), while its institutional rankings are much stronger than those of most of its emerging market peers (Text Figure 5). Following some weakening in policies in late 2015 and early 2016, the authorities have made efforts to mitigate some of the controversial policy initiatives and in doing so, have addressed some of the key concerns raised by the Executive Board at the 2016 Article IV consultation. Furthermore, the authorities' letter (see Appendix) underscores their firm commitment to maintain very strong policies and institutions going forward and further mitigate any undesirable effects from the measures implemented since the 2016 Article IV consultation (notably, the reversal of the retirement reform).

IMPACT ON FUND FINANCES, RISKS, AND SAFEGUARDS

28. The proposed much reduced access would have no net impact on Fund liquidity. Half of the current FCL arrangement (with a total access of SDR 13 billion) is financed by the New Borrowing Arrangement (NAB), which was deactivated in February 2016, and the other half is financed by quota resources.[15] Therefore, the impact of the current FCL arrangement on the Fund's Forward

[15] The current arrangement was approved when the NAB was activated, and is financed by both NAB and quota resources.

Commitment Capacity (FCC) is only SDR 6.5 billion. As the proposed access level under a successor FCL arrangement is also SDR 6.5 billion, the net impact of replacing the current FCL arrangement with a successor one is zero (see Table 11).

29. Poland's capacity to repay the Fund is strong. The authorities intend to continue to treat the arrangement as precautionary. Nonetheless, even if the full amount available under the proposed FCL arrangement were to be disbursed, Poland's capacity to fulfill its financial obligations to the Fund should be manageable. In case of full disbursement in 2017, total external debt would be 69 percent of GDP initially, and public external debt would be about 30 percent of GDP, with Fund credit representing 1.3 percent of GDP. Poland's total external debt service is projected to decline in the medium term both under the baseline and in the event the authorities draw on the FCL. The projected debt service to the Fund would peak in 2021 at about SDR 3.3 billion (0.5 percent of GDP).

30. Safeguard*s* procedures for Poland's proposed FCL arrangement are underway. The authorities have provided the necessary authorization for Fund staff to communicate directly with the NBP's external auditor, E&Y Audyt Polska. No significant safeguards issues emerged from the safeguards procedures conducted in relation to the 2015 FCL arrangement.

STAFF APPRAISAL

31. The FCL arrangements since 2009 have served Poland well, providing valuable insurance against external shocks. With the support of the consecutive FCL arrangements, Poland has weathered well bouts of market turbulence, and remains an attractive investment destination. In addition to being a financial backstop, the FCL arrangements have also generally supported strong policies and institutions and provided a positive signal that has served as an added insurance against tail risks. The authorities intend to continue treating the FCL as precautionary and consider it a temporary supplement to reserves. The proposed significant reduction in access reflects the authorities' stronger external buffers and their firm commitment to a smooth exit from the FCL as soon as external conditions allow.

32. In staff's view, Poland continues to meet the qualification criteria for continued access to the FCL. Poland benefits from strong economic fundamentals, sound macroeconomic policies, and very strong policy and institutional frameworks. Even though the IMF's Executive Board cautioned against a potential weakening of institutions and fiscal slippages at the time of the 2016 Article IV consultation, Directors noted Poland's strong fundamentals and policy buffers. Moreover, recent efforts by the authorities to adjust some of the controversial policy initiatives and to maintain sound macroeconomic and financial frameworks have helped to support investor confidence. The authorities' commitment to pursue a clear medium-term fiscal consolidation strategy and to address the consumer protection concerns related to FX mortgages while preserving banking sector stability provide a strong signal of their intention to achieve strong and inclusive growth through sound economic management.

33. Staff considers the proposed access under a two-year FCL arrangement for SDR 6.50 billion (159 percent of quota) to be appropriate. Improved economic fundamentals and external

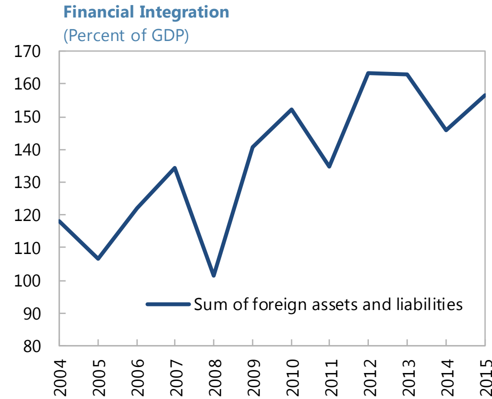
buffers have reduced financing needs under an adverse scenario. However, downside external risks remain elevated and likely protracted, with new uncertainties related to the US policies following the recent US presidential election and further political event risks, including the forthcoming Brexit negotiations between the U.K. and EU. Hence, staff agrees with the authorities that it would be premature for Poland to fully exit from the FCL arrangement at this juncture. In this context, a gradual exit with a significantly lower access strikes the right balance between providing continued insurance to Poland and signaling its stronger fundamentals and buffers, as well as the authorities' commitment to a smooth and gradual exit from the arrangement when risks subside.

34. Risks to the Fund arising from a successor FCL arrangement for Poland are judged as moderate. Risks to Fund finances are contained by the authorities' commitments to maintaining very strong policies, combined with their long-standing track record of policy implementation and very strong policy and institutional frameworks. They are further mitigated by the authorities' intention to continue to treat the FCL arrangement as precautionary, their very strong debt-servicing record, and sustainable external debt.

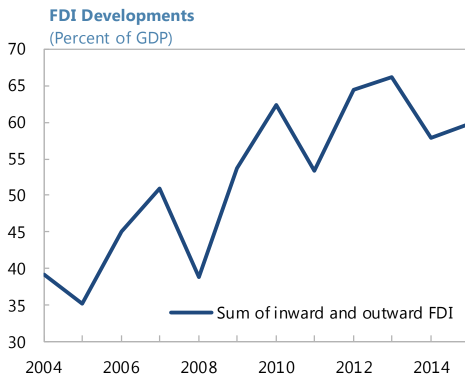
Figure 4. Poland: Trade and Financial Integration

Poland has become highly integrated through trade, …

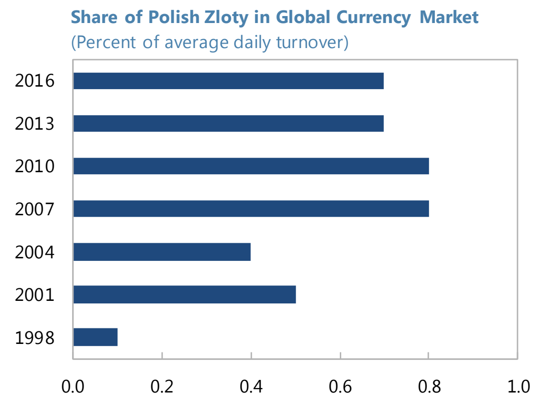
…financial markets, …



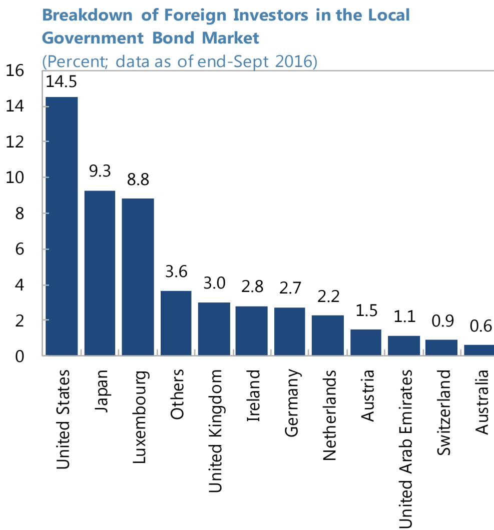
…and FDI.



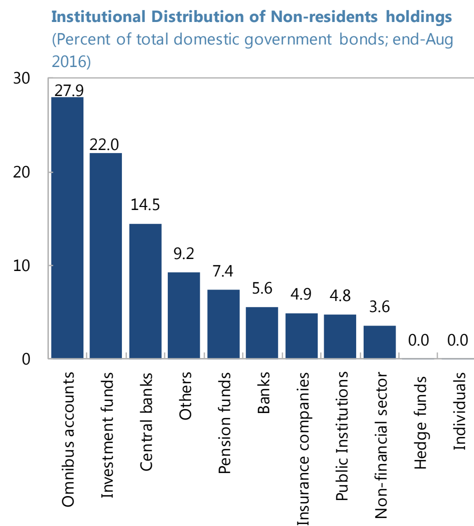
The zloty has gained in importance in global currency market



Government bond market exposure to the U.S. is large, …



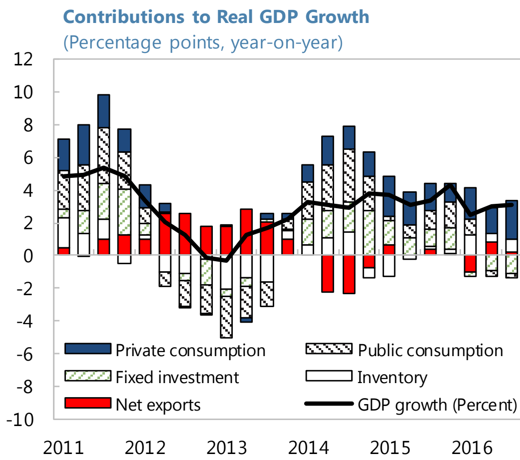
… with omnibus accounts now accounting for the biggest share of foreign holdings of domestic government bonds



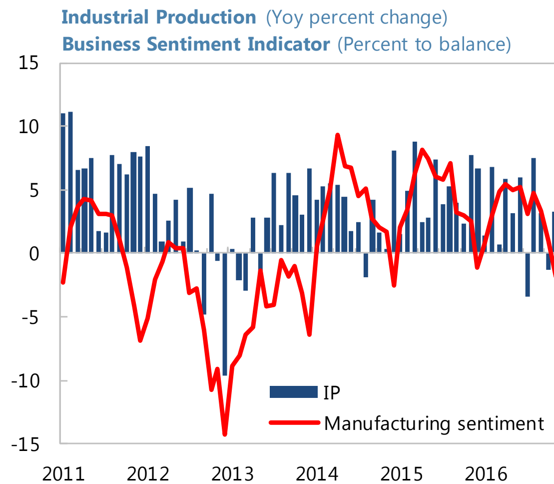
Sources: Polish authorities, IMF World Economic Outlook, BIS Triennial Central Bank Survey, Haver, and IMF staff calculations.

Figure 5. Poland: Recent Economic Developments, 2011–16

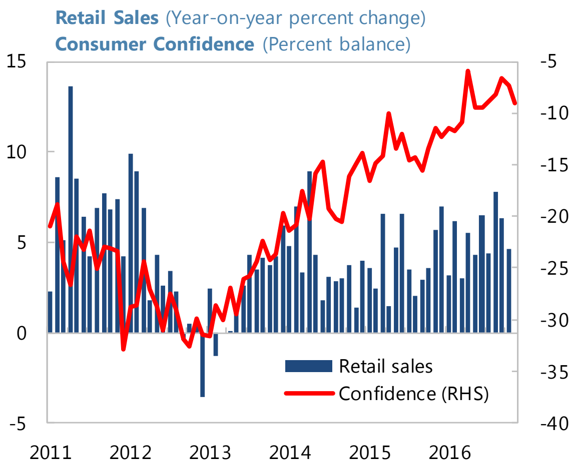
Growth slowed in the first three quarters…



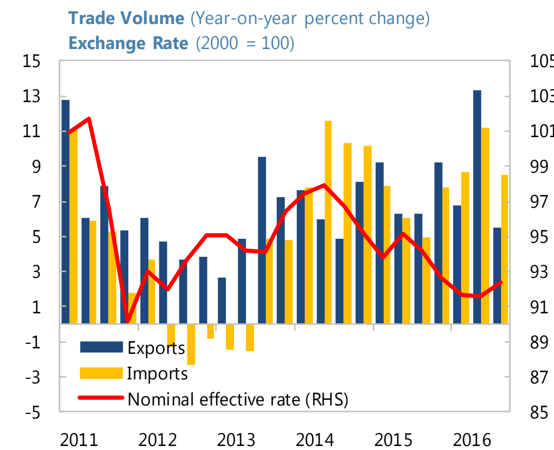
…amid weaker industrial production.



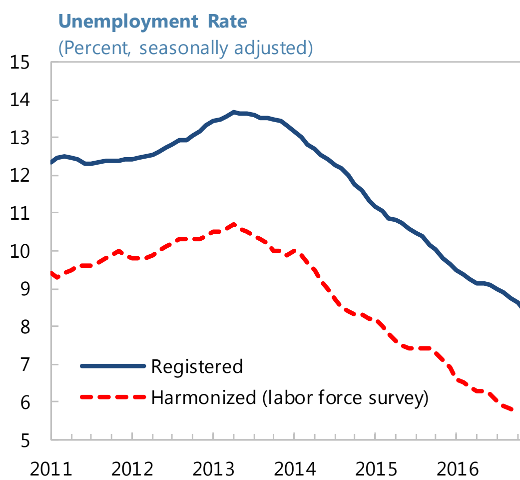
Strong retail sales with record high consumer confidence.



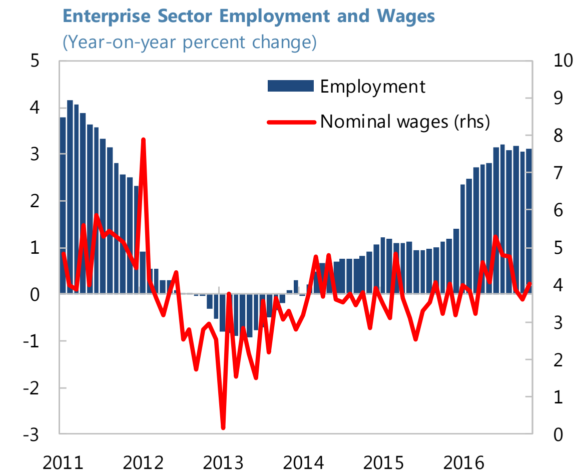
Net exports improved in the first half, but weakened in Q3.



Unemployment has continued to decline…



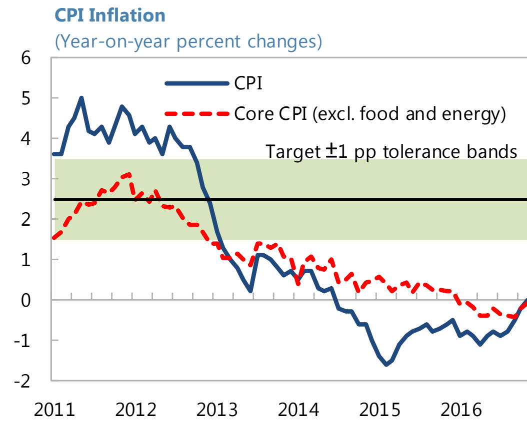
…and wage growth remains robust.



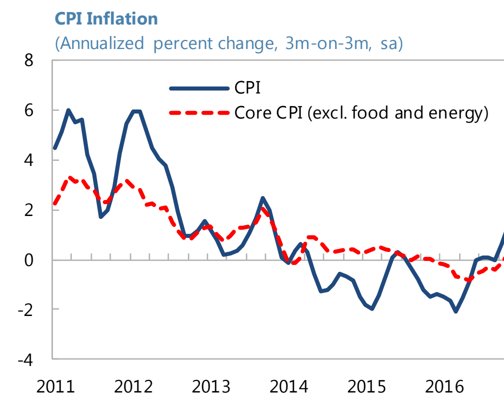
Source: Polish authorities; Haver Analytics; IMF staff calculations.

Figure 6. Poland: Recent Inflation Developments, 2004–16

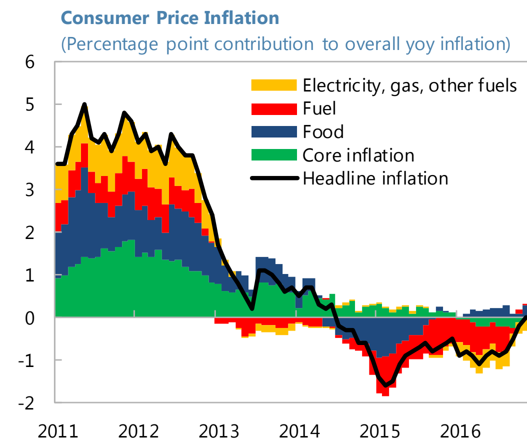
Headline and core inflation are still below target...



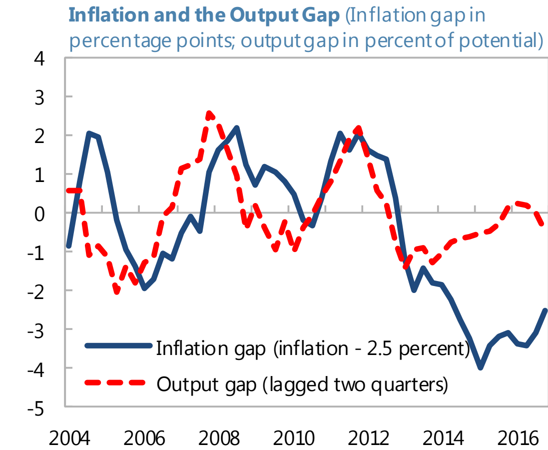
...but deflation has dissipated.



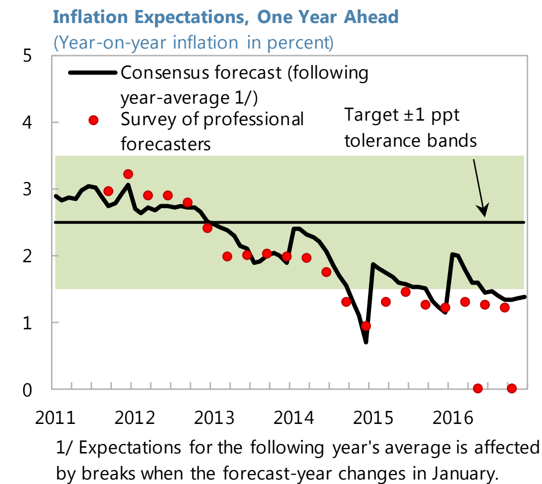
Fuel and food price inflation picked up.



Inflation is still decoupled from output gap developments.

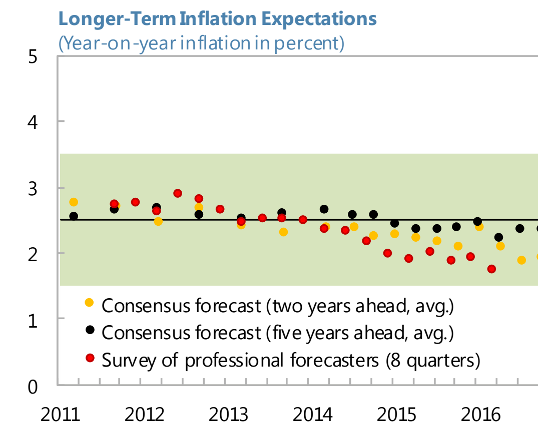


Expectations are close to the lower end of the band...



1/ Expectations for the following year's average is affected by breaks when the forecast-year changes in January.

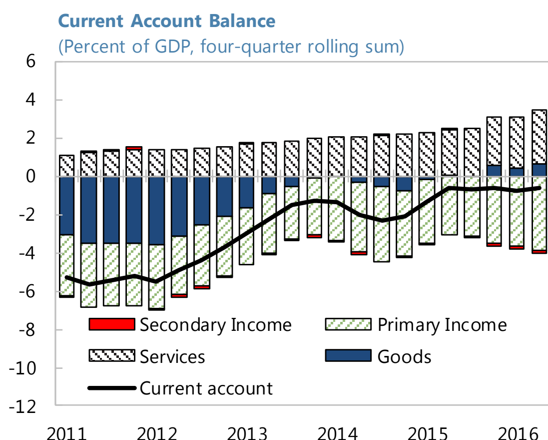
...and long-term expectations remain within the band.



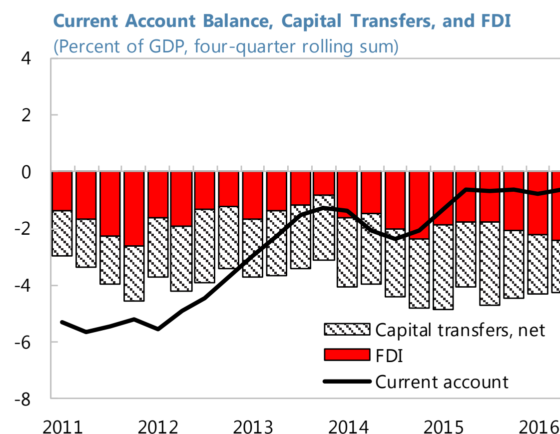
Source: Polish authorities; Haver Analytics; IMF staff calculations.

Figure 7. Poland: Balance of Payments, 2011–16

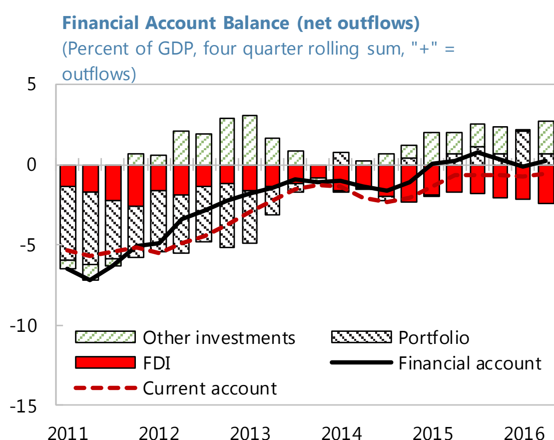
The current account deficit has improved on account of stronger exports following the depreciation...



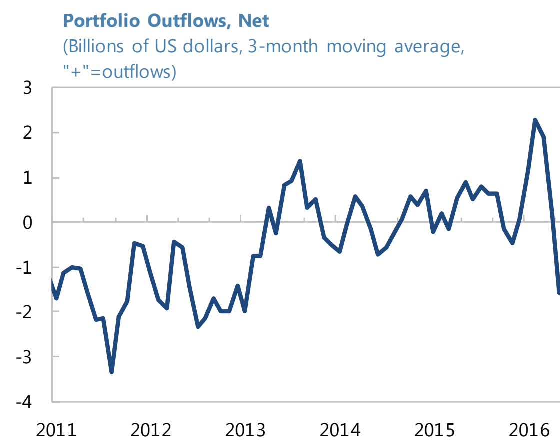
...and is financed primarily by FDI and EU transfers



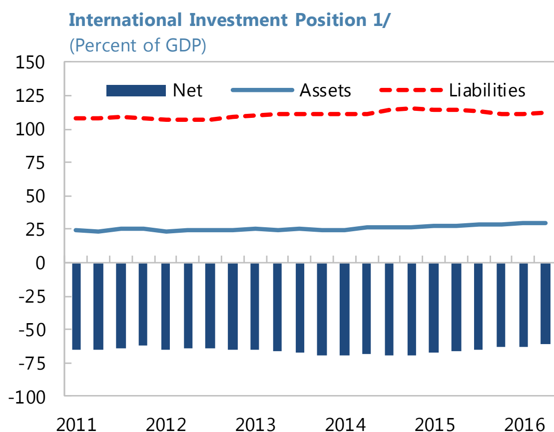
Financial flows continue to weaken ...



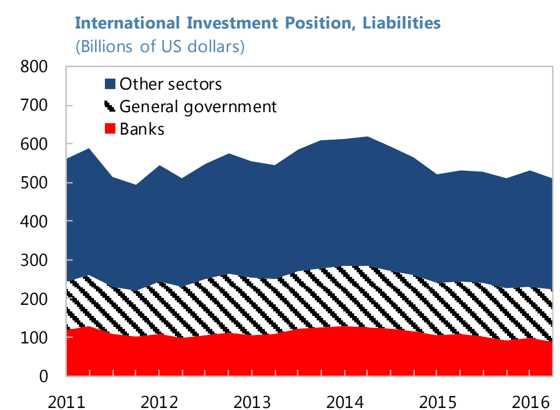
...mainly driven by net portfolio outflows.



The IIP remains broadly stable ...



...as liabilities have leveled off across all sectors.

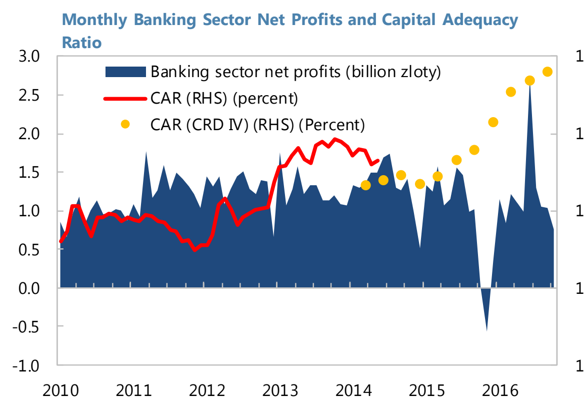


Sources: Narodowy Bank Polski and IMF staff calculations.

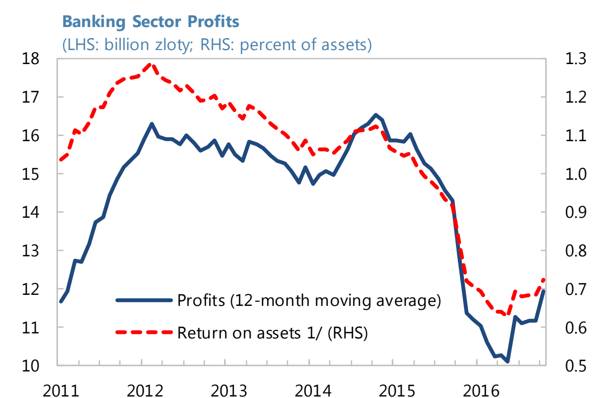
1/ Excludes NBP.

Figure 8. Poland: Banking Sector Capital and Asset Quality, 2011–16

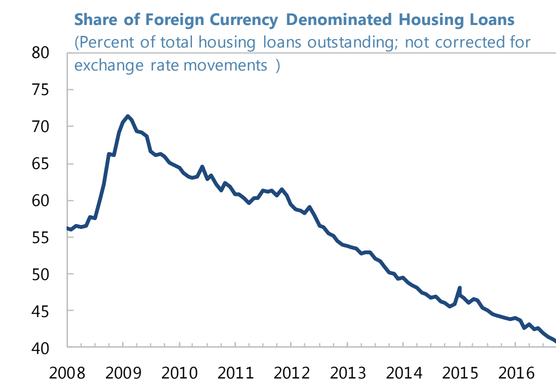
Capital adequacy remains high, ...



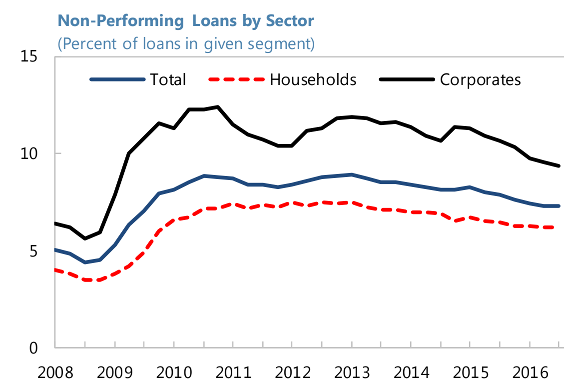
...but profitability has weakened (except a one-off transaction in 2016 Q2).



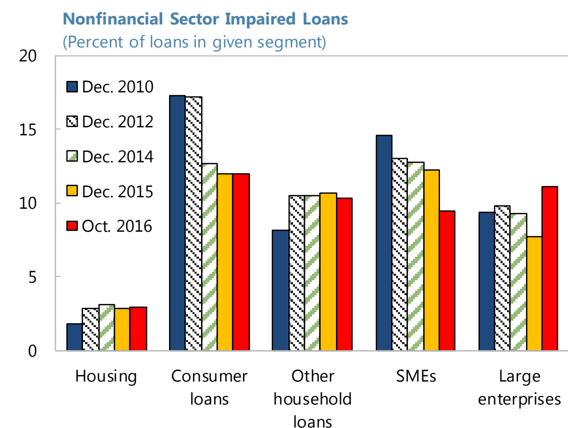
The foreign currency share of mortgages continues to decline.



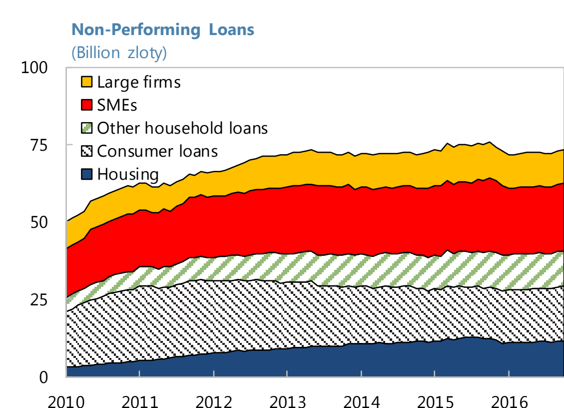
Non-performing loans (NPLs) are also gradually declining, ...



...but remain elevated for SMEs and consumer loans, ...



...which account for the bulk of impaired loans.

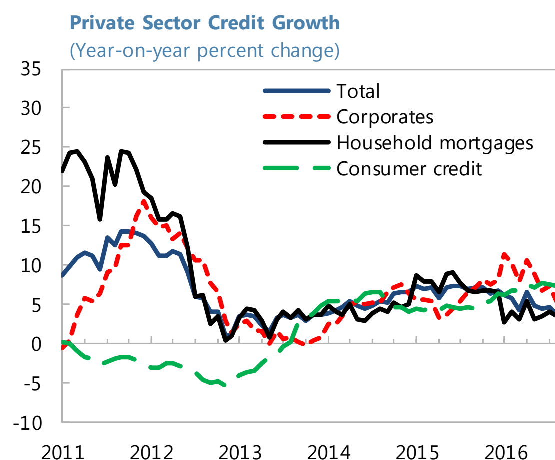


Sources: KNF, NBP, and IMF staff calculations.

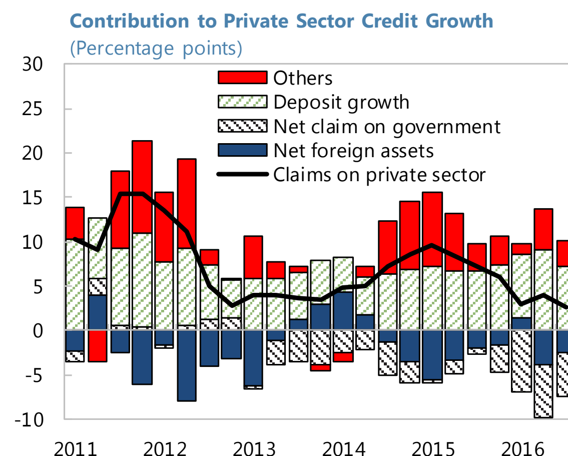
1/ 12-month profits in percent of 12-month assets.

Figure 9. Poland: Banking Credit Growth and Funding, 2011–16

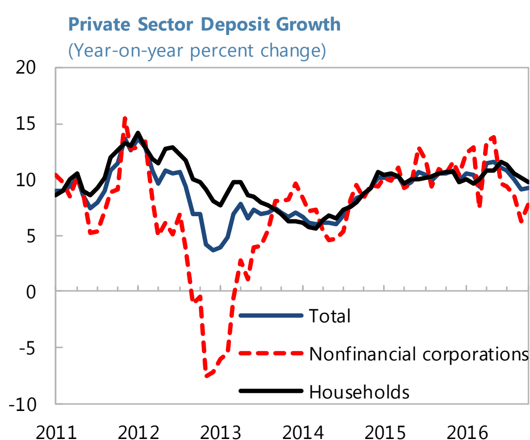
Credit expansion has slowed, especially to corporates.



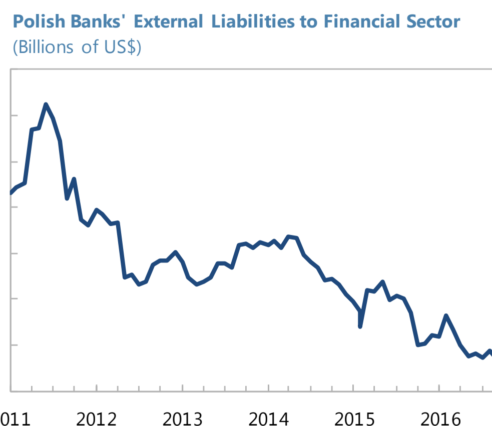
Domestic deposits remain the main funding source…



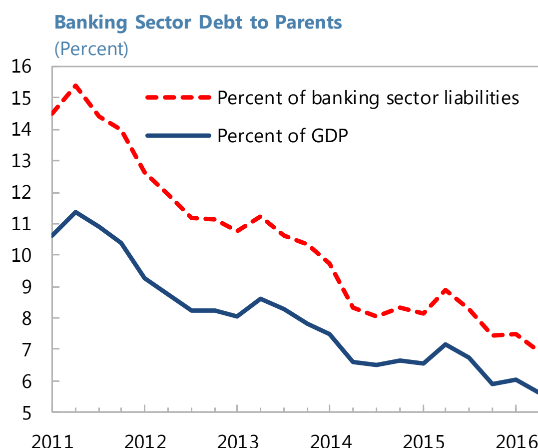
… and have been increasing.



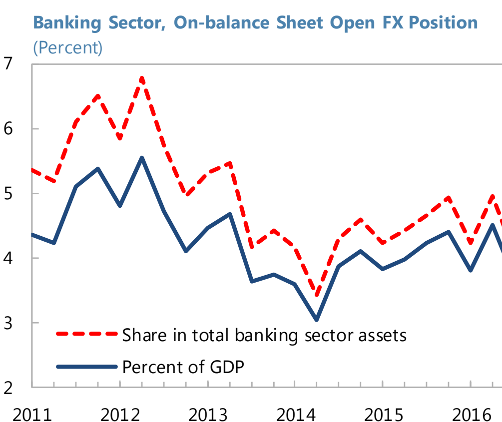
External financial liabilities have declined steadily…



…as has the reliance on foreign parent bank funding.



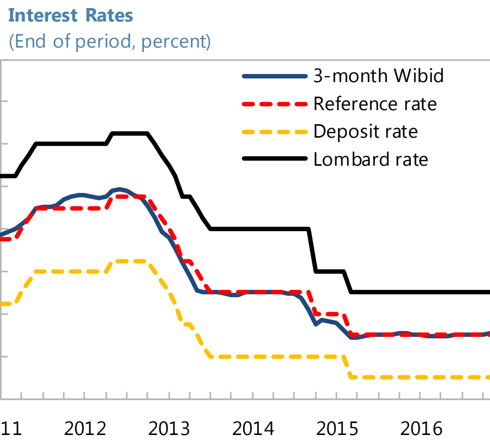
FX hedging needs remain below previous levels.



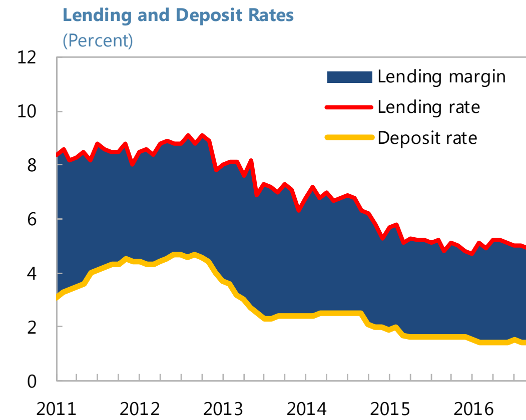
Sources: Haver Analytics, International Financial Statistics, NBP, KNF, and IMF staff calculations.

Figure 10. Poland: Monetary Developments, 2010–16

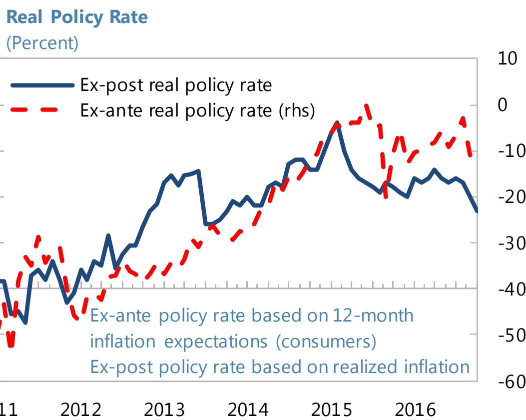
Policy rates remain at historic lows…



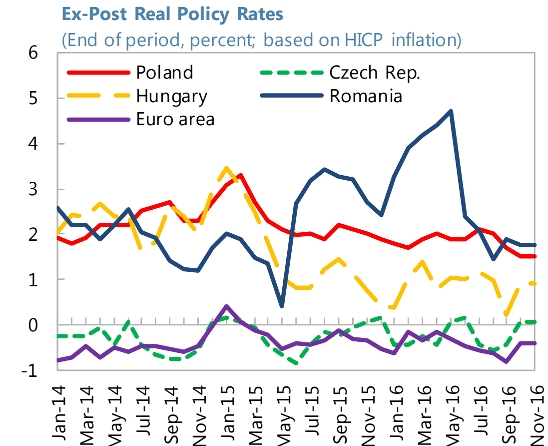
…so is lending rate.



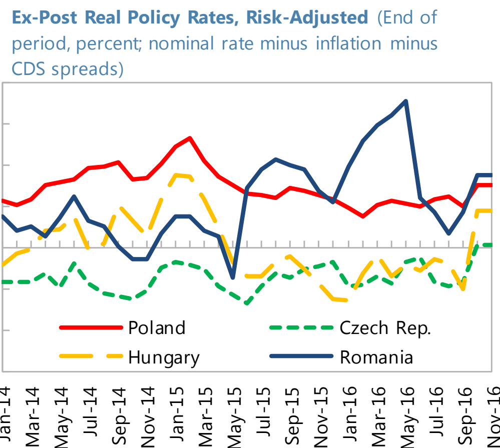
Real policy rate declined as deflation has dissipated.



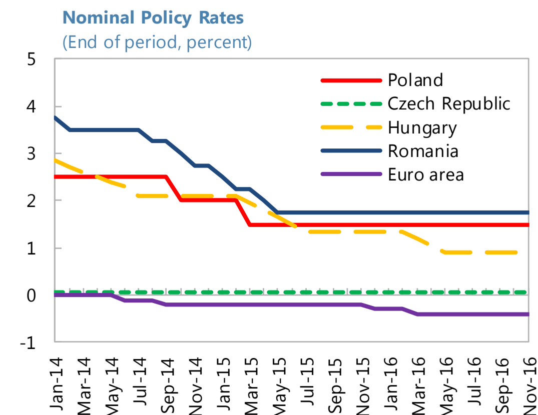
While real policy rate is relatively high compared to peers…



…and when adjusting for risks…

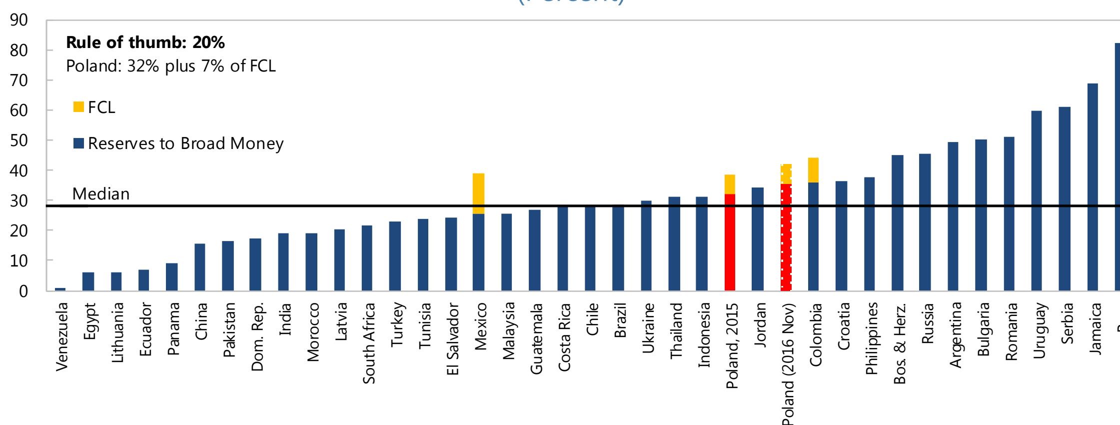


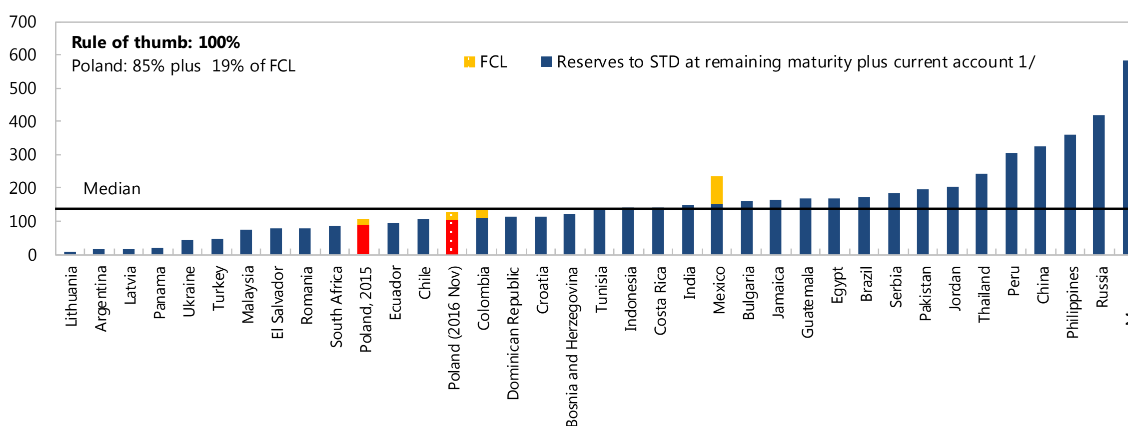
…it does not seem to overly tighten financial conditions.

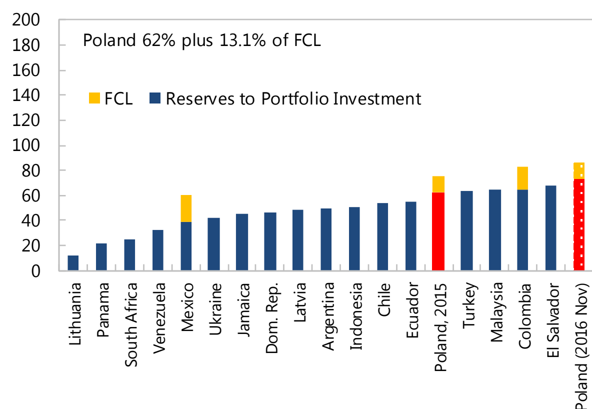


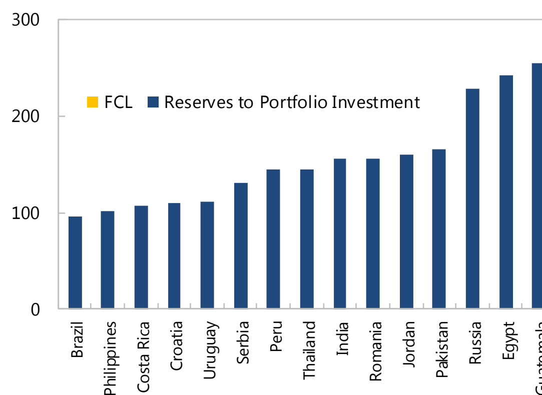
Source: Polish authorities; Haver Analytics; IMF staff calculations.

Figure 11. Poland: Reserve Coverage in International Perspective, 2015
(Percent)





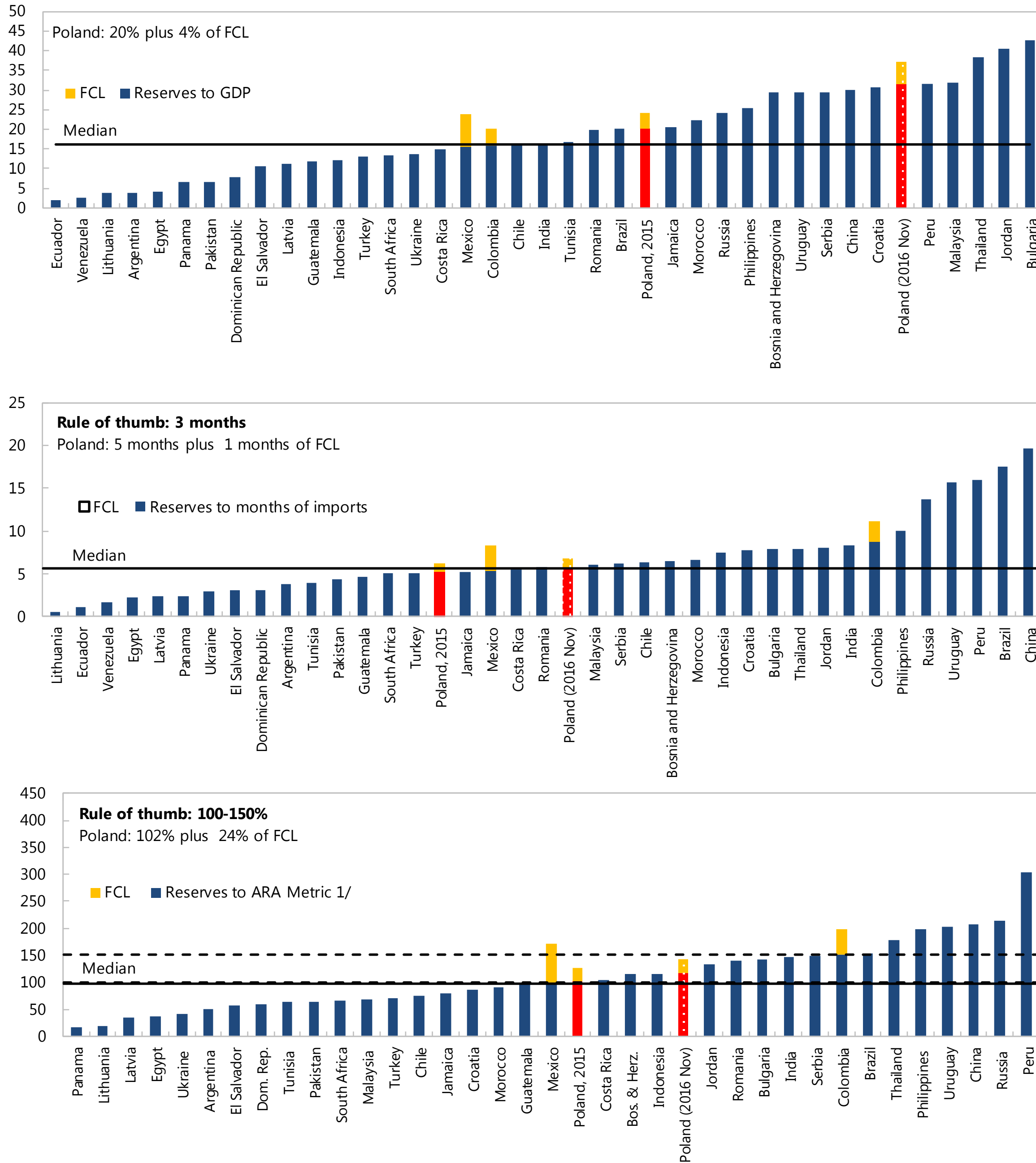




Sources: World Economic Outlook, and IMF staff estimates.

1/ Reserves at the end of 2015 in percent of short-term debt at remaining maturity and estimated current account deficit in 2015. The current account is set to zero if it is in surplus. "Poland (2016 Nov)" is based on end-November actual reserves data and 2016 projections for all other indicators.

Figure 11. Poland: Reserve Coverage in International Perspective, 2015(Concluded)
(Percent)

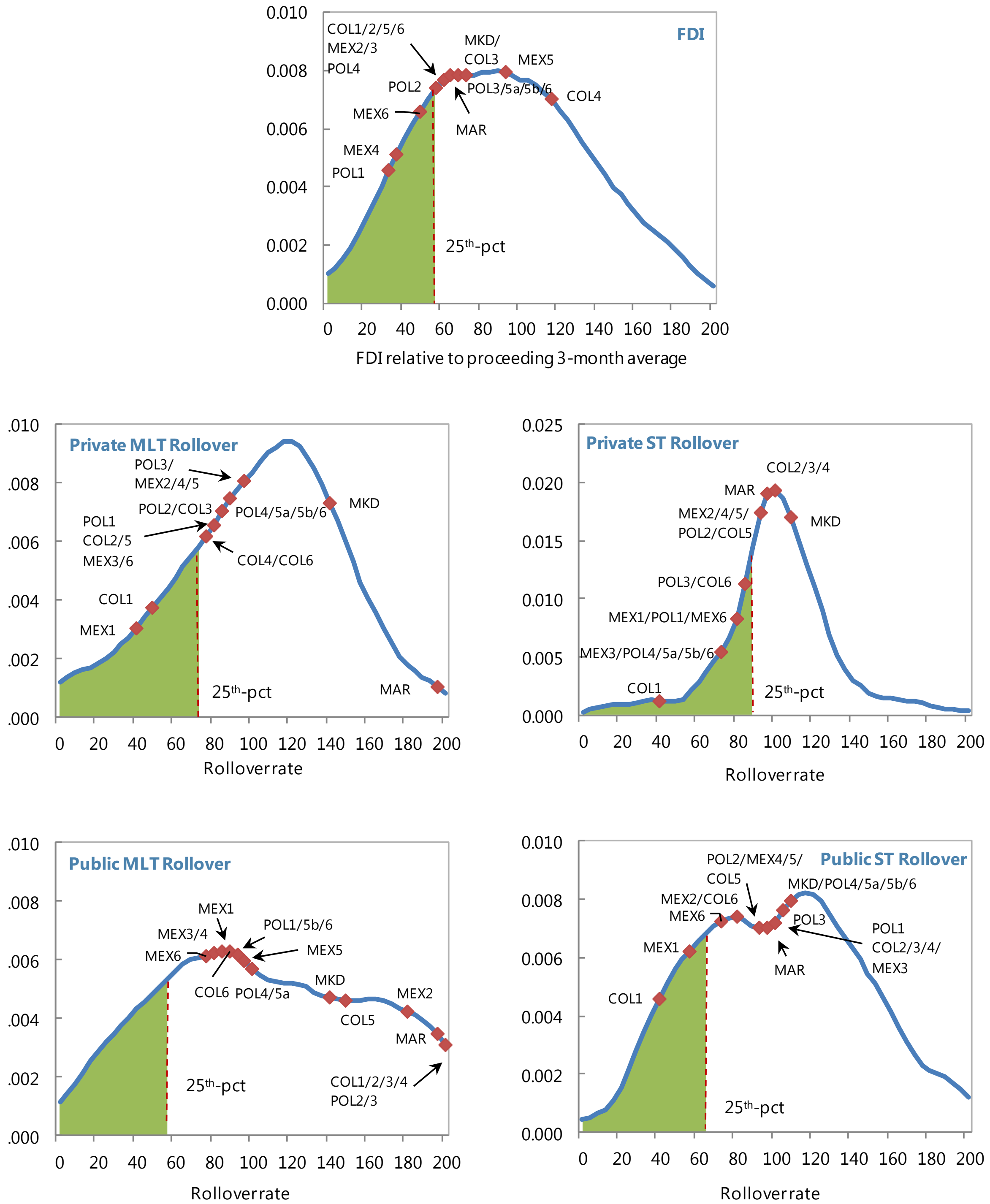


Sources: World Economic Outlook, Balance of Payments Statistics Database, and IMF staff estimates.

1/ The ARA metric was developed by IMF staff to assess reserve adequacy and is the sum of 30 percent short-term debt at remaining maturities, 15 percent of other liabilities, 5 percent of broad money, and 5 percent of exports for countries with floating rate currencies. For the stock of portfolio liabilities, data for 2014 is used depending on data availability.

Figure 12. Poland and Selected Countries: Comparing Adverse Scenarios

(Probability densities)



Source: IMF staff calculations.

1/ POL5a and POL5b denotes values for Poland as of the 2015 FCL request and January 2016 FCL review, respectively. POL6 denotes values consistent with those in the Table on External Financing Requirements and Sources of this report.

Table 2. Poland: Selected Economic Indicators, 2013–21

	2013	2014	2015	2016	2017	2018	2019	2020	2021
				Projections					
Activity and prices									
GDP (change in percent) 1/	1.4	3.3	3.9	2.6	3.3	3.3	3.1	3.0	3.0
Domestic demand	-0.6	4.9	3.4	2.2	3.9	3.7	3.4	3.1	3.1
Private consumption growth	0.3	2.4	3.2	3.5	4.0	3.6	3.4	3.0	3.0
Public consumption growth	2.5	4.1	2.3	3.6	3.0	2.8	2.4	2.3	2.1
Domestic fixed investment growth	-1.1	10.0	6.1	-5.3	4.5	5.2	4.4	4.4	4.4
Inventories (contribution to growth)	-1.0	0.6	-0.2	1.0	0.1	0.0	0.0	0.0	0.0
Net external demand (contribution to growth)	2.0	-1.4	0.6	0.4	-0.5	-0.4	-0.3	-0.2	-0.1
Output gap	-1.1	-0.6	0.3	-0.2	0.0	0.1	0.0	0.0	0.0
CPI inflation (percent)									
Average	0.9	0.0	-0.9	-0.6	1.0	1.9	2.4	2.5	2.5
End of period	0.7	-1.0	-0.5	0.2	1.5	2.2	2.5	2.5	2.5
Unemployment rate (average, according to LFS)	10.3	9.0	7.5	6.3	6.2	6.1	6.2	6.3	6.3
Public finances (percent of GDP) 2/									
General government revenues	38.4	38.7	38.9	39.3	40.1	40.4	40.1	40.1	40.1
General government expenditures	42.4	42.1	41.5	41.8	43.0	43.0	42.6	42.4	42.2
General government net lending/borrowing	-4.1	-3.4	-2.6	-2.5	-2.9	-2.6	-2.5	-2.3	-2.1
General government structural balance 3/	-3.3	-3.2	-2.7	-3.0	-2.9	-2.7	-2.6	-2.3	-2.1
General government debt	55.7	50.2	51.1	53.1	54.0	54.0	53.5	52.9	52.1
National definition 4/	53.3	48.1	48.8	...	...	...	...	...	...
Money and credit									
Private credit (change in percent, end-period) 5/	4.4	7.5	7.5	5.2	7.5	9.2	9.7	9.6	9.7
Credit to GDP (percent)	53.5	55.4	56.9	58.4	60.4	62.8	65.2	67.8	70.6
Deposits (change in percent, end-period)	6.9	8.6	8.8	8.3	9.3	9.3	8.8	8.8	8.9
Broad money (change in percent, end-period)	6.2	8.2	9.1	8.0	8.5	8.6	8.3	8.3	8.3
Policy Rate (percent) 6/	2.9	2.4	1.6	1.5	...	...	...	...	...
Balance of payments									
Current account balance (transactions, billion U.S. dollars)	-6.7	-11.4	-2.9	-1.6	-6.5	-8.7	-11.2	-13.9	-15.7
Percent of GDP	-1.3	-2.1	-0.6	-0.3	-1.3	-1.7	-2.1	-2.4	-2.6
Exports of Goods (billion U.S. dollars)	198.1	210.6	191.0	200.4	217.2	231.4	246.1	261.3	277.2
Export volume growth	6.1	6.4	6.8	7.3	6.4	5.6	5.4	5.3	5.1
Imports of Goods (billion U.S. dollars)	198.6	214.9	188.6	196.5	218.5	235.5	252.8	270.7	288.4
Import volume growth	1.7	10.0	6.3	8.1	7.8	6.6	6.1	5.7	5.4
Terms of trade (index 1995=100)	99.4	101.7	115.1	116.7	115.3	115.0	114.7	114.2	114.0
Official reserves (billion U.S. dollars)	106.2	100.4	94.9	111.3	115.1	118.2	122.3	125.3	128.0
In percent of short-term debt plus CA deficit	74.7	92.4	94.4	105.6	111.1	109.0	114.8	118.4	119.3
In percent of IMF ARA metric	109.5	114.0	106.9	122.1					
Total external debt (billion U.S. dollars)	384.1	356.7	330.0	329.8	331.3	333.1	335.7	338.9	342.4
In percent of GDP	73.2	65.4	69.2	70.7	68.1	64.6	61.4	58.4	56.0
Exchange rate									
Exchange rate regime				Freely floating					
Zloty per USD, period average 7/	3.2	3.2	3.8	4.2	...	...	...	...	...
Zloty per Euro, period average 7/	4.2	4.2	4.2	4.5	...	...	...	...	...
Real effective exchange rate (INS, CPI based) 8/	108.3	109.1	105.3	...	...	...	...	...	...
Appreciation (percent change)	0.7	0.7	-3.5	...	...	...	...	...	...
Memorandum item:									
Nominal GDP (billion zloty)	1656.8	1719.7	1798.3	1844.5	1914.4	2014.4	2125.7	2239.5	2360.5

Sources: Polish authorities and IMF staff calculations.

1/ Real GDP is calculated at constant 2010 prices.

2/ According to ESA2010.

3/ 2016 structural balance adjusts for one-off revenue receipts of 0.5 percent of GDP from LTE auction

4/ The difference from general government debt reflects different sectoral classification of certain units.

5/ Credit defined as in IFS: "Claims on other sectors."

6/ NBP Reference Rate (avg). For 2016, as of December 12.

7/ For 2016, exchange rate as of December 12.

8/ Annual average (2000=100).

Table 3. Poland: Balance of Payments on Transaction Basis, 2013–21

(Millions of U.S. dollars, unless otherwise indicated)

	2013	2014	2015	2016	2017	2018	2019	2020	2021
						Projections			
Current account balance	-6,744	-11,444	-2,932	-1,558	-6,518	-8,732	-11,234	-13,879	-15,682
percent of GDP	-1.3	-2.1	-0.6	-0.3	-1.3	-1.7	-2.1	-2.4	-2.6
Trade balance	9,692	7,755	14,577	16,851	11,818	9,319	7,270	4,999	3,720
percent of GDP	1.8	1.4	3.1	3.6	2.4	1.8	1.3	0.9	0.6
Balance on Goods	-453	-4,291	2,464	3,911	-1,248	-4,113	-6,624	-9,347	-11,260
Merchandise exports f.o.b.	198,107	210,628	191,023	200,410	217,219	231,407	246,143	261,314	277,167
Merchandise imports f.o.b.	198,560	214,919	188,559	196,499	218,467	235,520	252,767	270,661	288,428
Balance on Services	10,145	12,046	12,113	12,940	13,066	13,432	13,894	14,346	14,981
Merchandise exports f.o.b.	44,629	48,723	45,096	47,312	51,280	54,630	58,109	61,690	65,433
Merchandise imports f.o.b.	34,484	36,677	32,983	34,372	38,215	41,198	44,214	47,344	50,452
Exports of goods and services									
percentage change in unit values	9.2	6.8	0.1	4.9	8.4	6.5	6.4	6.2	6.1
percentage volume growth	6.1	6.4	6.8	7.3	6.4	5.6	5.4	5.3	5.1
Imports of goods and services									
percentage change in unit values	3.5	8.0	-11.9	4.2	11.2	7.8	7.3	7.1	6.6
percentage volume growth	1.7	10.0	6.3	8.1	7.8	6.6	6.1	5.7	5.4
Terms of trade (percentage change)	1.1	2.3	13.1	1.4	-1.2	-0.2	-0.2	-0.5	-0.2
Primary Income balance	-15,896	-18,649	-16,559	-17,677	-18,121	-18,392	-18,905	-19,283	-19,899
Secondary Income balance	-540	-550	-950	-732	-215	342	401	405	497
Capital and financial account balance	5,947	6,954	12,850	13,030	8,399	8,532	5,538	2,880	-209
Capital account balance (net)	11,964	13,305	11,331	9,564	9,729	10,903	10,656	10,650	10,006
Financial account balance (net)	-6,017	-6,351	1,519	3,466	-1,330	-2,370	-5,119	-7,770	-10,216
Foreign direct investment (net)[+ = outflows]	-4,206	-12,977	-9,815	-9,640	-9,998	-10,671	-11,379	-12,126	-12,913
Assets [Increase = +]	-3,411	6,799	4,252	5,006	5,086	5,168	5,251	5,336	5,422
Liabilities [Increase = +]	795	19,776	14,067	14,645	15,084	15,839	16,630	17,462	18,335
Portfolio investment (net)	-237	2,250	3,289	207	1,334	1,812	1,238	313	-703
Assets	2,162	5,866	11,049	4,655	4,096	4,715	3,772	4,105	3,801
Liabilities	2,399	3,616	7,760	4,448	2,762	2,902	2,533	3,792	4,504
Other investment (net)	-1,809	4,136	7,859	6,200	3,500	3,400	1,000	1,000	700
Assets	1,559	4,453	5,324	3,200	3,800	3,600	2,500	2,000	1,700
Liabilities	3,368	317	-2,535	-3,000	300	200	1,500	1,000	1,000
Financial derivatives	-710	-64	-949	0	0	0	0	0	0
Errors and omissions	-11,237	-8,212	-6,880	-4,541	-4,541	-4,541	-4,541	-4,541	-4,541
Financing									
Reserve assets [Increase = +]	945	304	1,135	6,698	3,834	3,088	4,022	3,043	2,700
Memorandum items:									
Current plus capital account (percent of GDP)	1.0	0.3	1.8	1.7	0.7	0.4	-0.1	-0.6	-0.9
Gross official Reserve	106,220	100,438	94,922	111,313	115,148	118,236	122,258	125,301	128,001
in months of imports	6.4	5.6	6.0	6.8	6.3	6.0	5.8	5.6	5.3
Gross official Reserve (euro)	77,144	82,645	86,894	103,780	...	...	...	...	...
Net Reserves (USD) 1/	95,535	93,050	86,805	93,503	97,337	100,426	104,448	107,491	110,191
Ratio of gross official reserves to short-term debt 2/	81.3	95.0	95.9	112.6	121.3	121.6	132.0	136.3	139.8
Ratio of gross official reserves to ST debt plus CA deficit 2/	74.7	92.4	94.4	105.6	111.1	109.0	114.8	118.4	119.3
Ratio of gross ofiicial reserves to IMF ARA metric	109.5	114.0	106.9	122.1	...	...	...	...	...
Ratio of net official reserves to IMF ARA metric	98.5	105.6	97.7	102.6					
Total external debt (percent of GDP)	73.2	65.4	69.2	70.7	68.1	64.6	61.4	58.4	56.0
Total external debt (percent of exports)	158.2	137.5	139.7	133.1	123.4	116.5	110.3	104.9	100.0
External debt service (percent of exports)	55.9	53.8	48.0	42.8	39.6	36.2	35.2	31.9	29.0

Sources: National Bank of Poland and IMF staff calculations.

1/ Net reserves are calculated as a difference between gross reserves (official and other FX reserves) and FX liabilities.

2/ Short-term debt is on remaining maturity.

Table 4. Poland: Monetary Accounts, 2010–16

	2010	2011	2012	2013	2014	2015	2016 Proj.
	(Billions of zlotys)						
Central bank							
Net foreign assets	257	317	321	297	332	349	427
Official reserve assets	277	338	338	320	352	370	451
Net domestic assets	-119	-180	-154	-134	-142	-139	-201
Net claims on government	-14	-20	-17	-8	-21	-15	-15
Claims on banks 1/	-75	-93	-100	-117	-85	-74	-121
Other items, net	-31	-67	-37	-9	-36	-50	-65
Base money	140	138	167	164	192	212	226
Currency issued	103	112	113	126	143	163	173
Bank reserves	37	26	54	38	49	49	53
Deposit money banks							
Net foreign assets	-167	-177	-151	-154	-159	-162	-151
Net domestic assets	830	923	934	990	1,067	1,150	1,221
Net claims on the central bank 1/	38	27	56	40	49	51	102
Net claims on government	150	167	151	178	216	241	227
Claims on private sector	730	831	849	886	952	1,023	1,076
Claims on corporates	219	261	270	275	298	324	341
Claims on households	480	537	538	562	593	633	665
Claims on other	31	32	40	49	61	67	70
Other items, net	-88	-101	-123	-113	-150	-165	-184
Deposits	663	746	782	836	908	988	1,070
Consolidated banking system							
Net foreign assets	90	140	169	143	173	187	276
Net domestic assets	693	741	752	836	886	968	971
Claims on government	137	147	134	170	195	226	212
Claims on private sector	730	831	849	886	952	1,023	1,076
Other items, net	-173	-236	-231	-220	-261	-281	-317
Broad money (M3)	784	881	921	979	1,059	1,155	1,247
Memorandum items:	(Percentage change from end of previous year)						
Base money	1.6	-1.1	21.0	-1.9	16.8	10.7	6.6
Broad money (M3)	8.8	12.5	4.5	6.2	8.2	9.1	8.0
Net domestic assets	6.4	6.9	1.5	11.1	6.0	9.2	0.4
Net foreign assets	31.9	55.2	20.7	-15.5	20.9	8.2	47.4
Net claim on government	15.3	7.4	-8.4	26.6	14.9	15.8	-6.2
Claims on private sector	8.6	13.8	2.2	4.4	7.5	7.5	5.2
Deposit growth	9.8	12.4	4.9	6.9	8.6	8.8	8.3
	(Percent of GDP, unless otherwise noted)						
Broad money (M3)	54.2	56.3	56.5	59.1	61.6	64.2	67.6
Private sector credit	50.5	53.0	52.1	53.5	55.4	56.9	58.4
Broad money Velocity (GDP/M3)	1.8	1.8	1.8	1.7	1.6	1.6	1.5
Money multiplier (M3/base money)	5.6	6.4	5.5	6.0	5.5	5.4	5.5

Sources: Haver, IFS, NBP, and IMF staff calculations.
1/ The difference between deposit money bank claims on the central bank and central bank claims on banks relates to banks' reserves and currency in vault.

Table 5. Poland: Financial Soundness Indicators, 2010–16

(Percent)

	2010	2011	2012	2013	2014	2015	2016Q1	2016Q2	2016Q3
Capital adequacy 1/									
Regulatory capital to risk-weighted assets	13.9	13.1	14.8	15.7	14.7	16.0	16.7	17.1	17.3
Regulatory Tier I capital to risk-weighted assets	12.5	11.7	13.1	14.1	13.5	14.6	15.2	15.4	15.7
NPLs net of provisions to capital	11.5	11.6	12.9	12.1	12.1	10.2	10.0	9.8	9.9
Bank capital to assets	8.2	7.8	8.7	9.1	8.9	9.4	9.6	9.6	9.8
Asset composition and quality									
NPLs to gross loans (nonfinancial sector)	8.8	8.2	8.8	8.5	8.1	7.5	7.4	7.3	7.3
Provisioning coverage for nonperforming loans (nonfinancial sector)	54.6	55.0	54.3	55.0	54.8	54.3	54.7	54.9	54.7
Sectoral distribution of loans to nonfinancial sector									
Loans to households	68.0	66.4	65.7	66.1	65.7	65.3	64.8	65.1	64.7
Loans to non-financial corporations	31.5	33.1	33.7	33.3	33.7	34.1	34.5	34.3	34.6
Earnings and profitability									
Return on average assets (after tax)	1.0	1.3	1.2	1.1	1.1	0.8	0.7	0.8	0.8
Return on average equity (after tax) 1/	13.3	16.1	14.0	12.1	12.3	8.5	7.8	8.6	8.2
Interest margin to gross income	53.0	55.8	55.0	56.1	58.2	57.2	57.9	56.1	56.4
Noninterest expenses to gross income	56.0	54.5	54.5	57.2	54.9	61.9	62.9	61.4	62.3
Liquidity									
Liquid assets to total assets (liquid assets ratio)	20.8	19.5	20.9	21.4	20.6	20.1	22.3	21.5	21.4
Liquid assets to total short-term liabilities	31.2	28.8	31.1	31.7	30.6	29.6	32.3	31.1	31.0
Loans to deposits	114.5	119.8	117.7	115.7	112.9	112.1	108.8	108.3	107.9
Sensitivity to market risk									
Net open positions in FX to capital 1/	0.3	-0.3	0.1	-0.1	0.2	1.0	0.6	0.5	0.4

Sources: NBP and KNF.

Note: Data according to Financial Soundness Indicators (FSI), except for asset composition and quality (indicators not part of FSI

1/ Data for domestic banking sector (Bank Gospodarstwa Krajowego excluded). Since 2014: data on capital in accordance with CRDIV/CRR.

Table 6. Poland: General Government Statement of Operations, 2013–21

(Percent of GDP)

	2013	2014	2015	2016	2017	2018	2019	2020	2021
						Projections			
Revenue	38.4	38.7	38.9	39.3	40.1	40.4	40.1	40.1	40.1
Taxes	19.6	19.6	19.8	20.3	20.5	20.8	20.6	20.7	20.8
Personal income tax	4.6	4.6	4.7	4.8	4.9	4.9	5.0	4.9	4.9
Corporate income tax	1.8	1.7	1.8	1.8	1.8	1.9	2.0	2.0	2.1
VAT	7.0	7.1	7.0	7.1	7.1	7.3	7.1	7.2	7.2
Excises	3.7	3.6	3.5	3.5	3.5	3.5	3.5	3.5	3.5
Other taxes	2.5	2.6	2.8	3.0	3.0	3.1	3.0	3.0	3.1
Social contributions	13.3	13.2	13.5	13.8	13.9	13.9	13.8	13.7	13.5
Other revenue	5.5	5.8	5.6	5.2	5.7	5.7	5.7	5.8	5.8
Capital revenue	1.0	1.2	1.1	0.7	1.2	1.2	1.2	1.3	1.3
Sales of goods and services	2.4	2.5	2.4	2.4	2.4	2.4	2.4	2.4	2.4
Other current revenue	2.2	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Expenditure	42.3	42.1	41.5	41.8	43.0	43.0	42.6	42.4	42.2
Expense	38.5	38.0	37.3	38.7	38.7	38.7	38.3	38.0	37.8
Compensation of employees	10.4	10.4	10.2	10.3	10.2	10.1	10.0	9.8	9.7
Use of goods and services	5.8	5.9	5.9	5.9	5.9	5.9	5.9	5.9	5.9
Interest	2.5	1.9	1.8	1.7	1.6	1.6	1.6	1.6	1.6
Subsidies	0.7	0.7	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Social benefits	16.3	16.2	16.1	17.4	17.6	17.7	17.6	17.4	17.3
Other expense 1/	2.9	2.9	2.8	2.9	2.9	2.8	2.8	2.8	2.8
Other current expenditure	2.3	2.1	2.2	2.3	2.3	2.2	2.2	2.2	2.2
Capital transfers	0.5	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Net acquisition of nonfinancial assets	3.8	4.1	4.2	3.2	4.3	4.3	4.3	4.4	4.4
Gross operating balance	-0.2	0.7	1.7	0.6	1.4	1.7	1.8	2.1	2.4
Net lending/borrowing	-3.9	-3.4	-2.6	-2.5	-2.9	-2.6	-2.5	-2.3	-2.1
Structural fiscal balance 2/	-3.3	-3.2	-2.7	-3.0	-2.9	-2.7	-2.6	-2.3	-2.1
Net financial transactions	-4.0	-3.5	-2.6	-2.5	-2.9	-2.6	-2.5	-2.3	-2.1
Net acquisition of financial assets	-0.5	10.0	0.7	0.8	0.1	0.0	0.0	0.0	0.0
Currency and deposits	-1.2	0.6	-0.7	-0.1	-0.9	-0.9	-0.9	-0.9	-0.8
Debt securities	0.1	8.3	0.0	0.2	0.2	0.2	0.2	0.2	0.2
Loans	0.7	0.7	0.3	0.3	0.3	0.3	0.3	0.2	0.2
Equity and investment fund shares	-0.6	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other financial assets	0.4	0.1	1.1	0.4	0.4	0.4	0.4	0.5	0.4
Net incurrence of liabilities	3.5	13.5	3.2	3.4	3.0	2.7	2.6	2.3	2.1
Currency and deposits	0.0	0.0	0.5	0.4	0.4	0.4	0.4	0.4	0.3
Debt securities	2.0	2.7	1.7	1.6	1.3	1.0	1.0	0.9	0.7
Loans	1.5	1.4	0.9	1.1	1.0	1.0	1.0	0.9	0.9
Other liabilities	0.1	9.2	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Adjustment and statistical discrepancies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Cyclically-adjusted balance	-3.3	-3.2	-2.7	-2.5	-2.9	-2.7	-2.6	-2.3	-2.1
Primary balance	-1.4	-1.5	-0.8	-0.8	-1.3	-1.0	-0.9	-0.6	-0.5
Cyclically-adjusted primary balance	-0.8	-1.2	-0.9	-0.7	-1.3	-1.0	-0.9	-0.6	-0.5
General government debt	55.7	50.2	51.1	53.1	54.0	54.0	53.5	52.9	52.1
General government liabilities	68.9	73.6	74.0	70.9	71.9	71.8	71.4	70.7	70.0
General government financial assets	33.9	35.6	35.2	34.2	33.2	32.2	31.2	30.2	29.2
Nominal GDP in billions of zloty	1,657	1,720	1,798	1,845	1,914	2,014	2,126	2,239	2,360

Sources: Eurostat and IMF staff calculations.

1/ Includes grants.

2/ 2016 structural balance adjusts for one-off revenue receipts of 0.5 percent of GDP from LTE auction.

Table 7. Poland: General Government Financial Balance Sheets, 2013–21

(Millions of zloty)

	2013			2014			2015	2016	2017	2018	2019	2020	2021
	Trans-actions	OEF	Closing Opening balance	Trans-actions	OEF	Closing Opening balance	Closing Opening balance	Projections					
Net worth and its changes	....	....	....	....	....	....	....	....	....	....	....	....	....
Nonfinancial Assets	....	....	....	....	....	....	....	....	....	....	....	....	....
Net Financial Worth	-66,421	-720	-579,301	-58,418	-25,999	-663,717	-696,559	-676,587	-739,524	-797,175	-853,099	-907,507	-961,354
Financial Assets	-7,938	-1,858	561,732	172,394	-122,324	611,802	633,479	631,324	636,105	649,164	663,781	676,919	689,886
Currency and deposits	-19,215	-386	85,741	10,849	8,645	105,235	96,150	98,623	102,360	107,703	113,655	119,739	126,209
Debt securities	2,275	554	38,013	143,444	-134,083	47,374	47,328	48,545	50,385	53,015	55,944	58,939	62,124
Loans	12,180	422	51,854	12,177	728	64,759	69,106	70,883	73,569	77,409	81,687	86,060	90,709
Equity and inv. fund shares	-9,569	149	262,345	3,525	790	266,660	267,851	256,294	246,862	239,603	231,587	221,590	209,957
Other financial assets	6,391	-2,597	123,779	2,399	1,596	127,774	153,044	156,980	162,929	171,433	180,907	190,591	200,888
Liabilities	58,483	-1,138	1,141,033	230,812	-96,325	1,275,520	1,330,038	1,307,911	1,375,629	1,446,339	1,516,881	1,584,426	1,651,240
Currency and deposits	-358	-6	28,028	517	10,681	39,226	36,846	37,794	39,226	41,273	43,554	45,886	48,365
Debt securities	33,378	-1,414	793,320	46,384	-116,600	723,104	758,790	721,973	767,486	806,452	841,632	873,031	901,410
Loans	24,577	706	199,732	24,872	8,233	232,837	250,904	257,356	267,109	281,051	296,583	312,459	329,341
Other liabilities	886	-424	119,953	159,039	1,361	280,353	283,498	290,788	301,808	317,562	335,111	353,050	372,124
Memorandum items:													
Net financial worth (percent of GDP)			-35.0			-38.6	-38.7	-36.7	-38.6	-39.6	-40.1	-40.5	-40.7
Financial assets (percent of GDP)			33.9			35.6	35.2	34.2	33.2	32.2	31.2	30.2	29.2
Liabilities (percent of GDP)			68.9			74.2	74.0	70.9	71.9	71.8	71.4	70.7	70.0
GDP nominal prices (billion PLN)			1656.8			1719.7	1798.3	1844.5	1914.4	2014.4	2125.7	2239.5	2360.5

Sources: National authorities and IMF staff calculations.

Table 8. Poland: External Financing Requirements and Sources, 2013–18
(Millions of US dollars, unless otherwise indicated)

	2013	2014	2015	2016 Proj.	2017 Proj.	2017 Adverse scenario	2018 Proj.	2018 Adverse scenario	Kernel Rollover 2016	Kernel Rollover 2017	2017 vs 2016 shock
GROSS FINANCING REQUIREMENTS (A)	**133,873**	**124,168**	**103,635**	**101,183**	**105,379**	**105,379**	**103,676**	**103,676**			
Current account deficit	6,744	11,444	2,932	1,558	6,518	6,518	8,732	8,732			
Medium and long-term debt amortization	57,306	55,262	44,329	46,824	48,308	48,308	48,398	48,398			
Public sector	14,201	10,465	6,921	4,802	12,255	12,255	11,818	11,818			
Banks	6,027	11,836	10,536	10,151	9,263	9,263	8,877	8,877			
Non-bank Corporates	37,078	32,962	26,872	31,871	26,789	26,789	27,704	27,704			
Short-term debt amortization	69,823	57,462	56,374	52,801	50,553	50,553	46,546	46,546			
Public sector	3	6	5	6	6	6	6	6			
Banks (inc. s.t. deposits)	19,903	14,591	15,107	13,596	12,916	12,916	10,979	10,979			
Non-bank Corporates	49,917	42,865	41,262	39,199	37,631	37,631	35,561	35,561			
o/w trade credit	31,263	26,846	25,842	24,550	23,568	23,568	22,272	22,272			
SOURCES OF FINANCING (B)	**134,818**	**124,472**	**104,770**	**107,505**	**109,213**	**82,771**	**106,764**	**80,022**			
Foreign direct investment (net)	4,206	12,977	9,815	9,640	9,998	7,499	10,671	8,003	69	69	*same*
o/w inward (net)	795	19,776	14,067	14,645	15,084	12,218	15,839	12,829			
Equities (net)	1,463	533	-5,817	-1,334	-604	-1,263	-1,170	-2,444			
by nonresidents	2,648	3,146	4,115	1,646	1,481	148	1,333	133			
New borrowing and debt rollover	128,893	106,171	101,846	99,607	96,882	77,098	94,637	75,337			
Medium and long-term borrowing	66,052	55,735	49,045	49,054	50,336	41,357	49,382	40,591			
Public sector	16,799	13,235	14,516	8,846	14,390	11,246	14,432	11,280	92	92	*same*
Banks	7,010	10,889	10,345	9,931	9,961	7,192	9,463	6,832	78	78	*same*
Non-bank Corporates	42,243	30,141	24,185	30,278	25,986	22,919	25,487	22,480	86	86	*same*
Short-term borrowing	62,841	50,436	52,801	50,553	46,546	35,741	45,255	34,746			
Public sector	3	7	6	6	6	6	6	6	110	110	*same*
Banks	17,913	13,132	13,596	12,916	10,979	8,454	9,332	7,186	68	65	*lower*
Non-bank Corporates	44,925	37,298	39,199	37,631	35,561	27,281	35,917	27,554	75	72	*lower*
EU capital transfers	12,429	14,126	8,087	6,903	7,018	7,018	7,811	7,811			
Other	-12,173	-9,335	-9,162	-7,311	-4,081	-7,581	-5,185	-8,685	*USD 3.5 bln outflow*	*USD 3.5 bln outflow*	
GROSS RESERVES ACCUMULATION (C)	**945**	**304**	**1,135**	**6,322**	**3,834**	**-13,599**	**3,088**	**-14,645**	*drawdown*	*drawdown*	
FINANCING GAP (B - A - C)	**0**	**0**	**0**	**0**	**0**	**-9,009**		**-9,009**			
(In billion USD)						**-9.0**		**-9.0**			
(In billion SDR)						**-6.5**		**-6.5**			
(In percent of quota)						**159%**		**159%**			
Memo Items:											
Gross Reserves in bln USD	106	100	95	111	115	101	118	103			
Net Reserves in bln USD	96	93	87	93	97	83	100	85			
Ratio of reserves to IMF ARA metric	109	114	107	122	122	108	121	106			
Ratio of net reserves to IMF ARA metric	98	106	98	102	103	89	103	88			

Table 9. Poland: Indicators of Fund Credit, 2016–21

	2016	2017	2018	2019	2020	2021
		Projections				
Stocks from prospective drawings 1/						
Fund credit (millions SDR)	0	6,500	6,500	6,500	4,063	813
in percent of quota	0	159	159	159	99	20
in percent of GDP	0	1	1	1	0	0
in percent of exports of goods and services	0	2	2	2	1	0
in percent of gross reserves 2/	0	4	4	4	2	0
Flows from prospective drawings 3/						
GRA Charges	0	63	79	79	70	32
Level Based Surcharge	0	0	0	0	0	0
Service Charges	0	33	0	0	0	0
Principal	0	0	0	0	2,438	3,250
Debt Service due on GRA credit (millions SDR)	0	95	79	79	2,507	3,282
in percent of quota	0	2	2	2	61	80
in percent of GDP	0	0	0	0	0	0
in percent of exports of goods and services	0	0	0	0	1	1
in percent of gross reserves 2/	0	0	0	0	1	2
Memorandum item:						
Total external debt, assuming full drawing (percent of GDP)	71	69	66	62	59	56

Sources: IMF Finance Department, Polish authorities, and IMF staff calculations.

1/ End of Period. Assumes full drawing upon FCL approval in early 2017. The Polish authorities have expressed their intention to treat the arrangement as precautionary.

2/ Excludes IMF purchases.

3/ Based on the rate of charge as of December 2, 2016.

Table 10. Poland: Proposed Access Relative to Other High-Access Cases

	Proposed Arrangement FCL	Proposed Arrangement (Percentile)	High-Access Cases 1/			
			20th	65th	80th	Median
			Percentile (Ratio)			
Access						
In millions of SDRs	6,500	49	1,522	11,332	15,500	6,782
Total access in percent of: 2/						
Actual quota	159	1	356	801	1,111	600
Gross domestic product	1.9	5	2.9	7.3	9.4	5.8
Gross international reserves	7.8	0	24.1	54.1	84.6	44.6
Exports of goods and nonfactor services 3/	3.4	0	10.5	26.5	36.8	19.4
Imports of goods and nonfactor services	3.5	1	9.3	22.7	30.6	16.9
Total debt stock 4/						
Of which: Public	3	6	8	15	27	12
External	3	0	7	15	20	12
Short-term 5/	10	3	21	51	104	36
M2	3	3	6	14	23	12

Source: Executive Board documents, MONA database, and Fund staff estimates.

1/ High access cases include available data at approval and on augmentation for all the requests to the Board since 1997, which involved the use of the exceptional circumstances clause or SRF resources. Exceptional access augmentations are counted as separate observations. For the purpose of measuring access as a ratio of different metrics, access includes augmentations and previously approved and drawn amounts.

2/ The data used to calculate ratios is the actual value for the year prior to approval for public, external, and short-term debt, and the projection at the time of program approval for the year in which the program was approved for all other variables (projections for 2016 were used). In the case of Poland's proposed reduced access, 2017 projections are used.

3/ Includes net private transfers.

4/ Refers to net debt.

5/ Refers to residual maturity.

Table 11. Poland: Impact on GRA Finances

(Billions of SDR, unless otherwise indicated)

	As of December 6, 2016
Liquidity measures	
Forward Commitment Capacity (FCC) before approval 1/	209.0
FCC on approval 2/	209.0
Change in percent	0.0
Prudential measures	
Fund GRA commitment to Poland including credit outstanding	
in percent of current precautionary balances	42.8
in percent of total GRA credit outstanding 3/	13.2
Fund GRA credit outstanding to top five borrowers	
in percent of total GRA credit outstanding 3/	81.2
in percent of total GRA credit outstanding including Poland's assumed full drawing	76.6
Poland's projected annual GRA charges for FY17 in percent of the Fund's residual burden sharing capacity	41.3
Memorandum items	
Fund's precautionary balances (FY16) 4/	15.2
Fund's Residual Burden Sharing Capacity 5/	0.0275

Sources: Finance Department and IMF staff calculations.

1/ The FCC is defined as the Fund's stock of usable resources less undrawn balances under existing arrangements, plus projected repurchases during the coming 12 months, less repayments of borrowing due one year forward, less a prudential balance. The FCC is currently solely based on quota resources and does not include resources that could be made available under the NAB or the bilateral borrowing agreements.
2/ The cancellation of the current FCL (SDR 13 bn) will add SDR 6.5 bn to uncommitted quota resources and raise the FCC by the same amount, since this arrangement was financed in equal proportion from quota and NAB resources. The new FCL will lead to a reduction in uncommitted quota resources and will lower the FCC by the access amount requested under the arrangement, that is SDR 6.5 bn. Hence, there will be no impact on the FCC resources.
3/ As of December 6, 2016.
4/ Per EBS/15/32, "Review of Fund's Income Position for FY 2015 and FY 2016", April 2016.
5/ Burden-sharing capacity is calculated based on the floor for remuneration at 85 percent of the SDR interest rate. Residual burden-sharing capacity is equal to the total burden-sharing capacity minus the portion being utilized to offset deferred charges and takes into account the loss in capacity due to nonpayment of burden sharing adjustments by members in arrears.

Annex I. Public Sector Debt Sustainability Analysis

Public debt is moderately high, but remains sustainable. The profile of public debt appears robust to interest, rollover, and foreign currency risks. A negative shock to GDP growth represents the largest risk to the debt outlook. While a large share of foreign investors in the domestic debt market may entail some risks, a well-diversified investor base is a mitigating factor.

A. Baseline and Realism of Projections

Debt levels. Public debt is rising faster than previously expected in 2016, reaching 53 percent of GDP as the government takes advantage of the favorable market conditions to pre-finance future borrowing needs. In light of the authorities' new Public Debt Management Strategy for 2017–20, public debt is projected to further increase to 54 percent of GDP in 2017–18, before gradually declining to 52 percent of GDP by 2021. Debt dynamics are mainly driven by the primary deficit, which initially increases before taking a declining path in 2018. A favorable differential between projected GDP growth and the real interest rate also contributes to a gradual decline in debt levels over the medium term.

GDP growth. Real GDP growth has moderated to below 3 percent in 2016 in the first three quarters of 2016. The projections assume a pickup in growth to 3.3 percent in 2017–18 with a small positive output gap, followed by a subsequent moderation to 3.0 percent by 2021 as output trends back toward potential. In recent years, staff projections of growth have displayed small forecast errors, with some indication of a pessimistic bias relative to other countries.

Fiscal adjustment. Under the baseline, the primary deficit is expected to increase to 1.3 percent of GDP by 2017, before declining to 0.5 percent of GDP by 2021. The dynamics reflect the government's broadly neutral fiscal stance indicated in 2017 budget, and thereafter fiscal consolidation measures to improve revenue collection and contain expenditure over the medium term. In the recent past, staff forecast errors of the primary deficit in Poland have not displayed any notable bias and have been more conservative than for other countries. Overall, the projected fiscal adjustment appears feasible, as indicated by cross-country benchmarks.

Sovereign yields. The effective interest rate on public debt has been on a declining path since the global financial crisis, reflecting Poland's strong fundamentals and favorable external financing conditions. The effective interest rate is projected at 3.5 percent in 2016, and is expected to remain at a similar level over the medium term. Yields on 10–year bonds have increased by about 40 basis points year-to-date to 3.5 percent, and spreads of Polish euro-denominated bonds over 10–year German bonds have increased to 88 basis points. CDS spreads increased marginally to 78 basis points.

Maturity and rollover risks. Rollover risks are well managed. The average maturity of outstanding debt is estimated at 5.3 years, and the share of short-term debt in total government debt is under 1 percent. T-bill issuance resumed in January 2016, following a period since August 2013 when there were no outstanding T-bills. Gross borrowing requirements for 2016 have been fully financed, taking advantage of favorable market conditions. Domestic banks have increased their holdings of treasury securities, which are exempt from the new bank asset tax, by about 3 percent of GDP during January to August 2016. The share of foreign investors in the domestic treasury market decreased from 38 percent in January to 34 percent in August 2016. The overall share of external debt in total public debt was about 54 percent as of June 2016. In addition, the share of foreign currency debt in state debt is about 34 percent as of August 2016. In line with the new debt management strategy, the baseline assumes gradual convergence toward the current structure of public debt in terms of the share of foreign currency debt in total debt (about 30 percent) and external debt in total debt (about 50 percent).

Debt sustainability analysis (DSA) risk assessment. The heat map highlights risks associated with the relatively large external financing requirements (about 22 percent of GDP in 2015), and the share of public debt held by non-residents (about 54 percent at end-June 2016). The latter is partly due to a significant participation of foreign investors in the domestic bond market. U.S. investors comprise 15 percent of foreign investors, exposing the bond market to liquidity risks in case of interest rate hikes in the U.S..

Fan charts. The symmetric fan charts, which assume symmetric upside and downside risks, indicate that the debt-to-GDP ratio could drop to below 50 percent by 2020 with a 25 percent probability. On the other hand, the upper bands indicate that debt-to-GDP ratios could surpass 60 percent by 2020 with a 25 percent probability. A more stringent exercise, however, combining restrictions to the upside shocks to interest rates and GDP growth (200 bps and 1 percent, respectively), increases the probability of debt-to-GDP surpassing 60 percent in 2020 to 50 percent. This result illustrates the degree of uncertainty around the baseline.

B. Shocks and Stress Tests

Primary balance shock. An assumed deterioration in the primary balance by 0.8 percentage point relative to the baseline during 2017–18 pushes the public debt-to-revenue ratio up to about 138 percent during 2018–19. Gross financing needs peak at about 10.3 percent of GDP in 2017 and converge to the baseline by 2021.

Growth shock. The stress scenario assumes a drop in GDP growth by about 1.9 percentage points in two consecutive years (2017–18) relative to the baseline, combined with a 0.5 percentage point drop in inflation and deterioration in the primary balance by 1 percent in 2017 and further by 2 percent in 2018. Under these assumptions, public debt increases to about 59 percent of GDP in 2018 before trending downward to about 57 percent of GDP by 2021. Gross financing needs increase to about 11 percent of GDP during 2017–18, but then converge toward the baseline in the outer years.

Interest rate shock. A permanent 279 bps increase in the nominal interest rate starting in 2018 (equivalent to the difference between the maximum real interest rate during 2004–14 and the average real interest rate over the projection period), leads to an increase in the effective interest rate on debt by 49 bps in 2018 (compared to the baseline) and further gradual increases to 165 bps by 2021. Under this scenario, public debt increases by 2 percent of GDP relative to the baseline by 2021.

Exchange rate shock. This scenario assumes a nominal exchange rate depreciation of about 20 percent in 2017 (from 3.9 PLN/US$ to 4.7 PLN/US$), calibrated to emulate the maximum historic movement of the FX rate over the last 10 years. Under this scenario, gross public debt increases by 1 percentage point to 55 percent of GDP in 2017–18 before trending down to about 53 percent by 2021. The resilience reflects the predominance of public debt in local currency.

Combined shock. Under the combined shock, the public-debt-to-GDP ratio jumps to 63.2 percent in 2018 and gradually declines to 62.9 percent in 2021. In turn, gross financing needs increase to 11.5 percent of GDP in 2018, and trend downwards to around 9 percent of GDP in the outer years.

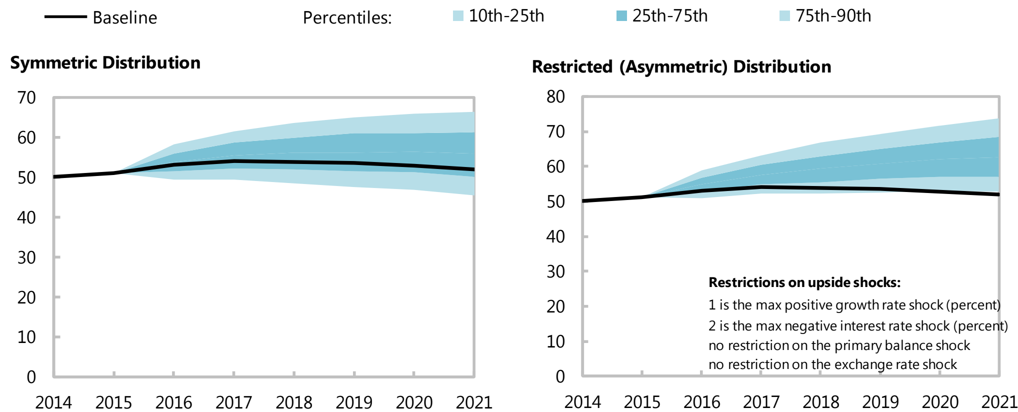
Poland: Public Sector Debt Sustainability Analysis (DSA)—Risk Assessment

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

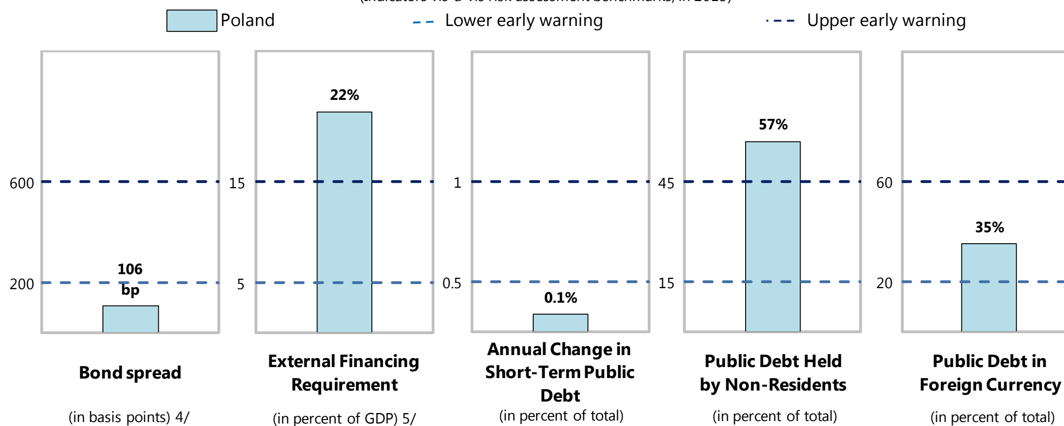
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2015)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

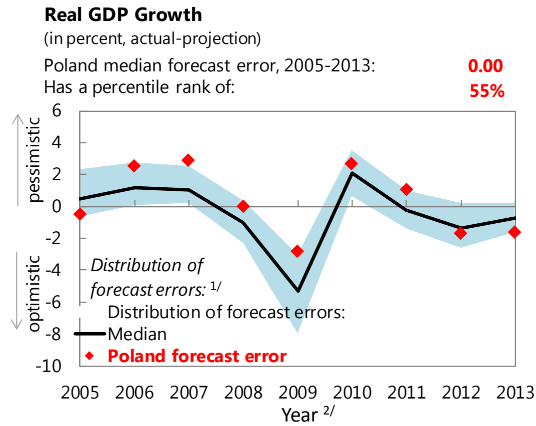
200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

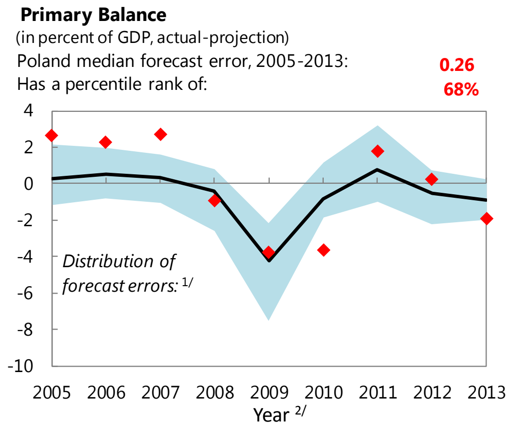
4/ Long-term spread of Polish euro-denominated bonds over German bonds, an average over the last 3 months, Aug to Oct 2016.

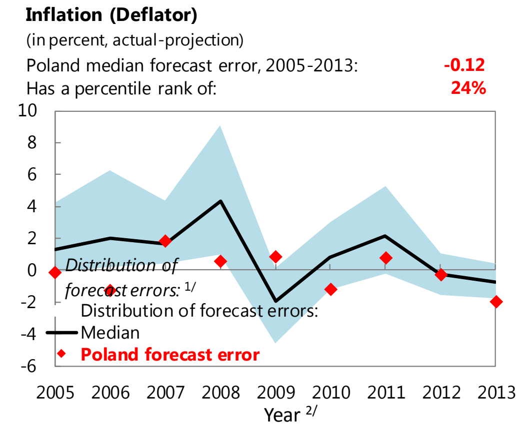
5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Poland: Public DSA—Realism of Baseline Assumptions

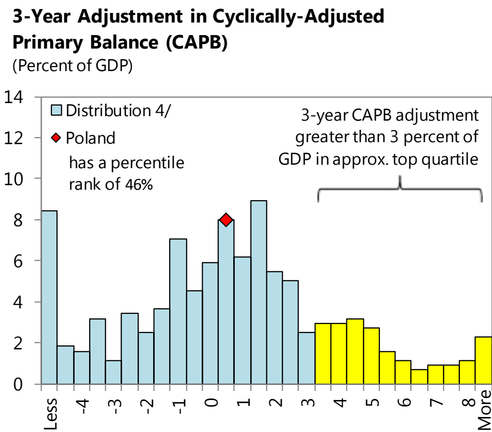
Forecast Track Record, versus all countries

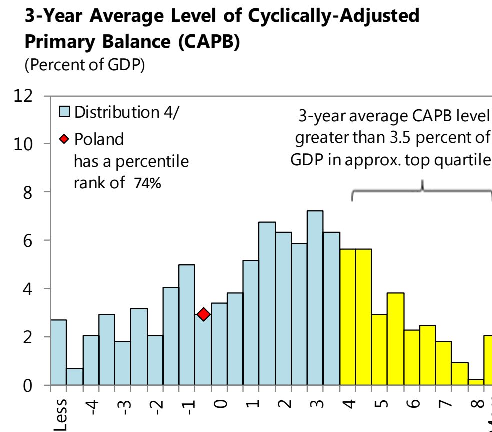




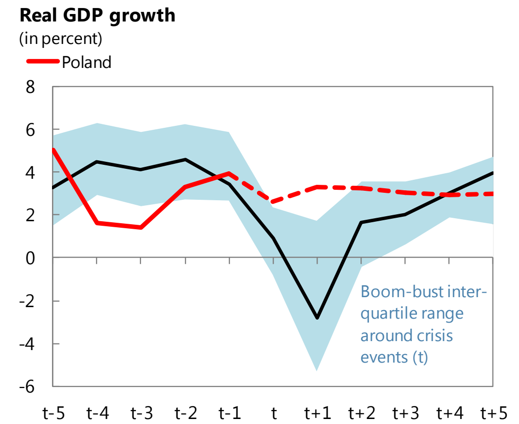


Assessing the Realism of Projected Fiscal Adjustment





Boom-Bust Analysis 3/



Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Poland has had a negative output gap for 3 consecutive years, 2013-2015. For Poland, t corresponds to 2016; for the distribution, t corresponds to the first year of the crisis..

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Poland: Public DSA—Baseline Scenario

(Percent of GDP, unless otherwise indicated)

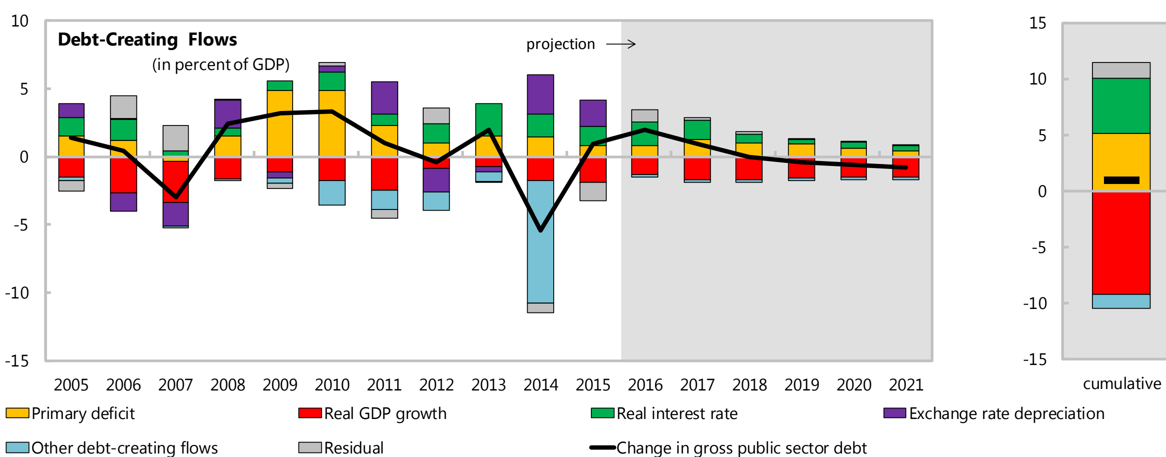
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2005-2013 [2/]	2014	2015	2016	2017	2018	2019	2020	2021
Nominal gross public debt	50.1	50.2	51.1	53.1	54.0	54.0	53.5	52.9	52.1
Public gross financing needs	13.6	8.3	7.7	5.6	9.5	8.6	8.9	7.9	7.2
Real GDP growth (in percent)	3.9	3.3	3.9	2.6	3.3	3.3	3.1	3.0	3.0
Inflation (GDP deflator, in percent)	2.7	0.5	0.6	0.0	0.5	1.9	2.4	2.3	2.4
Nominal GDP growth (in percent)	6.7	3.8	4.6	2.6	3.8	5.2	5.5	5.4	5.4
Effective interest rate (in percent) [4/]	5.3	3.6	3.7	3.5	3.2	3.2	3.2	3.2	3.2

As of DEC/22/2016		
Sovereign Spreads		
EMBIG (bp) 3/		88
5Y CDS (bp)		78
Ratings	Foreign	Local
Moody's	A2	A2
S&Ps	BBB+	A-
Fitch	A-	A-

Contribution to Changes in Public Debt

	Actual			Projections							
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	cumulative	debt-stabilizing primary balance [10/]
Change in gross public sector debt	1.2	-5.5	0.9	2.0	0.9	-0.1	-0.4	-0.6	-0.8	1.0	-1.3
Identified debt-creating flows	0.8	-4.8	2.2	1.0	0.8	-0.3	-0.5	-0.7	-0.8	-0.4	
Primary deficit	2.0	1.5	0.8	0.8	1.3	1.0	0.9	0.6	0.5	5.1	
Primary (noninterest) revenue and grants	39.6	38.7	38.9	39.3	40.1	40.4	40.1	40.1	40.1	240.1	
Primary (noninterest) expenditure	41.7	40.2	39.7	40.1	41.4	41.4	41.0	40.8	40.6	245.2	
Automatic debt dynamics [5/]	-0.5	2.8	1.4	0.5	-0.3	-1.0	-1.2	-1.1	-1.1	-4.3	
Interest rate/growth differential [6/]	-0.6	-0.1	-0.4	0.5	-0.3	-1.0	-1.2	-1.1	-1.1	-4.3	
Of which: real interest rate	1.2	1.7	1.5	1.8	1.4	0.6	0.4	0.4	0.4	4.9	
Of which: real GDP growth	-1.8	-1.8	-1.9	-1.3	-1.7	-1.7	-1.6	-1.5	-1.5	-9.2	
Exchange rate depreciation [7/]	0.0	2.9	1.9	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.7	-9.0	0.0	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-1.2	
Privatization (+ reduces financing needs) (negative)	-0.6	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Liabilities not included in debt [8/]	-0.1	-9.2	0.0	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-1.2	
Residual, including asset changes [9/]	0.3	-0.7	-1.3	0.9	0.2	0.2	0.0	0.0	0.0	1.4	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread of Polish euro-denominated bonds over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi (1+g)$ and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ From 2014 onwards, reflects the transfer of pension fund assets and liabilities to the social security administration.

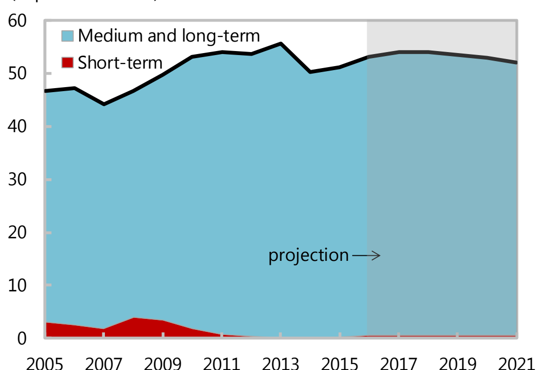
9/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

10/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

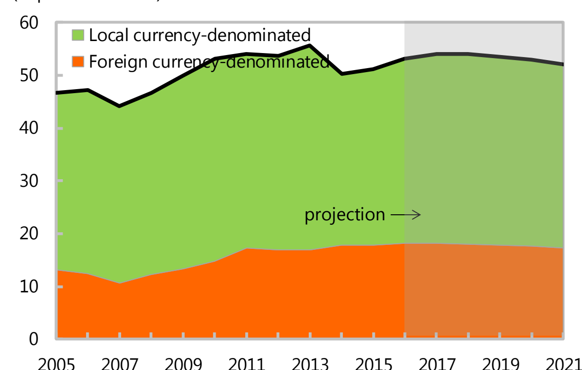
Poland: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



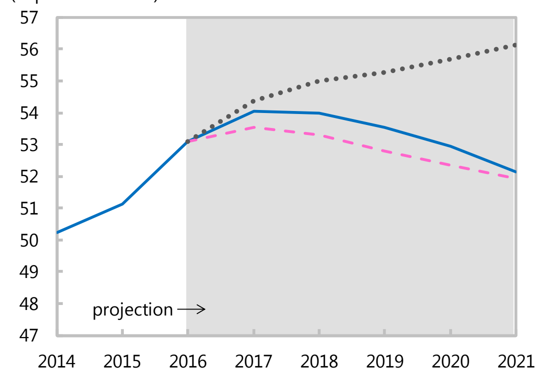
By Currency
(in percent of GDP)



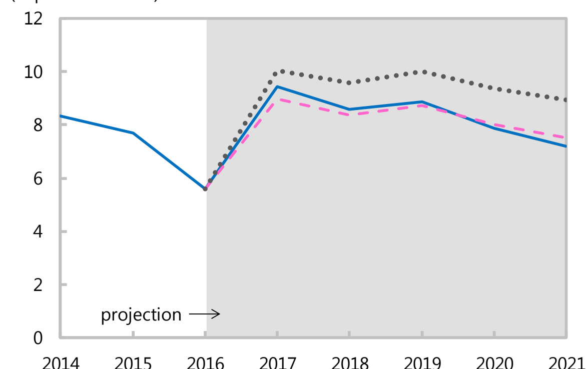
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

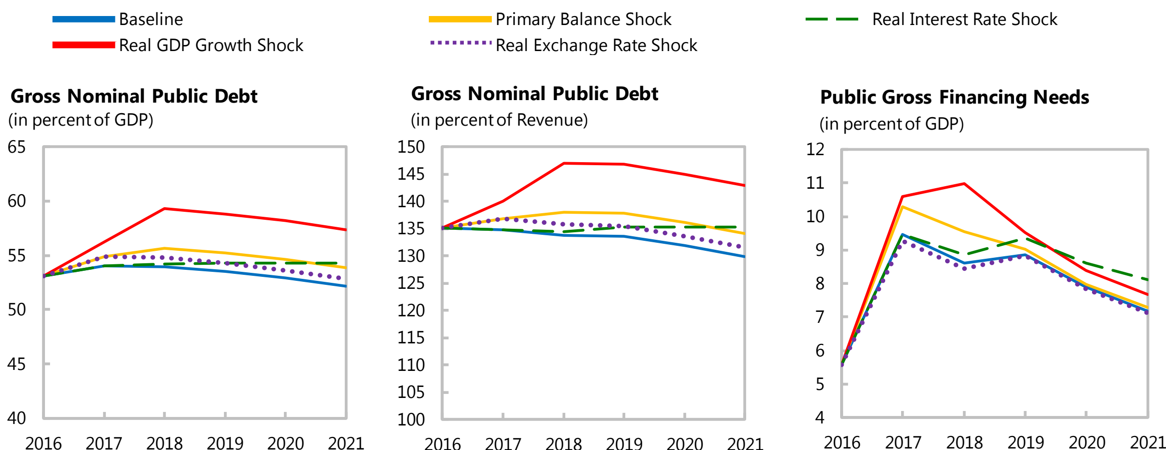
Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	2.6	3.3	3.3	3.1	3.0	3.0
Inflation	0.0	0.5	1.9	2.4	2.3	2.4
Primary Balance	-0.8	-1.3	-1.0	-0.9	-0.6	-0.5
Effective interest rate	3.5	3.2	3.2	3.2	3.2	3.2
Constant Primary Balance Scenario						
Real GDP growth	2.6	3.3	3.3	3.1	3.0	3.0
Inflation	0.0	0.5	1.9	2.4	2.3	2.4
Primary Balance	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Effective interest rate	3.5	3.2	3.2	3.2	3.2	3.2

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	2.6	3.9	3.9	3.9	3.9	3.9
Inflation	0.0	0.5	1.9	2.4	2.3	2.4
Primary Balance	-0.8	-1.9	-1.9	-1.9	-1.9	-1.9
Effective interest rate	3.5	3.2	3.4	3.5	3.7	3.8

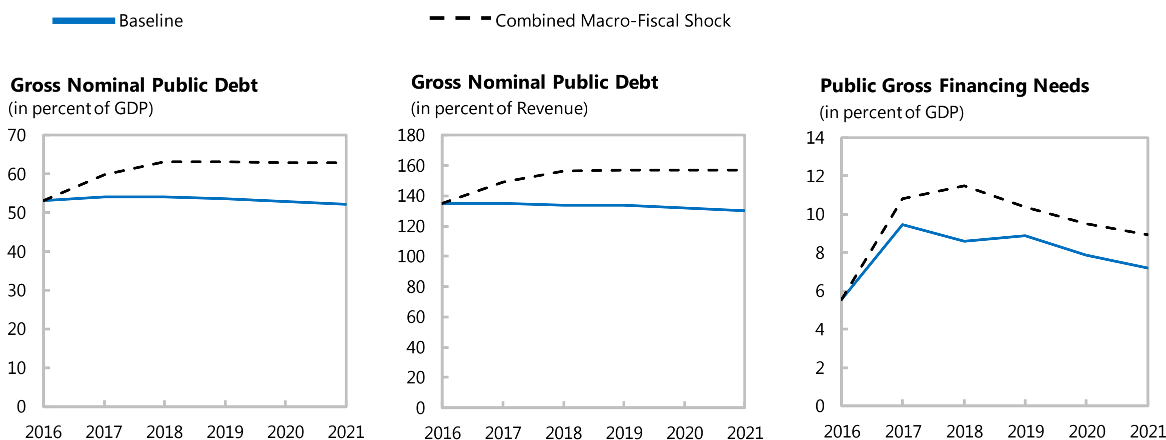
Source: IMF staff.

Poland: Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

	2016	2017	2018	2019	2020	2021
Primary Balance Shock						
Real GDP growth	2.6	3.3	3.3	3.1	3.0	3.0
Inflation	0.0	0.5	1.9	2.4	2.3	2.4
Primary balance	-0.8	-2.1	-1.8	-0.9	-0.6	-0.5
Effective interest rate	3.5	3.2	3.2	3.3	3.3	3.3
Real Interest Rate Shock						
Real GDP growth	2.6	3.3	3.3	3.1	3.0	3.0
Inflation	0.0	0.5	1.9	2.4	2.3	2.4
Primary balance	-0.8	-1.3	-1.0	-0.9	-0.6	-0.5
Effective interest rate	3.5	3.2	3.7	4.1	4.5	4.8
Combined Shock						
Real GDP growth	2.6	1.4	1.4	3.1	3.0	3.0
Inflation	0.0	0.0	1.4	2.4	2.3	2.4
Primary balance	-0.8	-2.2	-2.9	-0.9	-0.6	-0.5
Effective interest rate	3.5	3.3	3.6	4.1	4.5	4.8

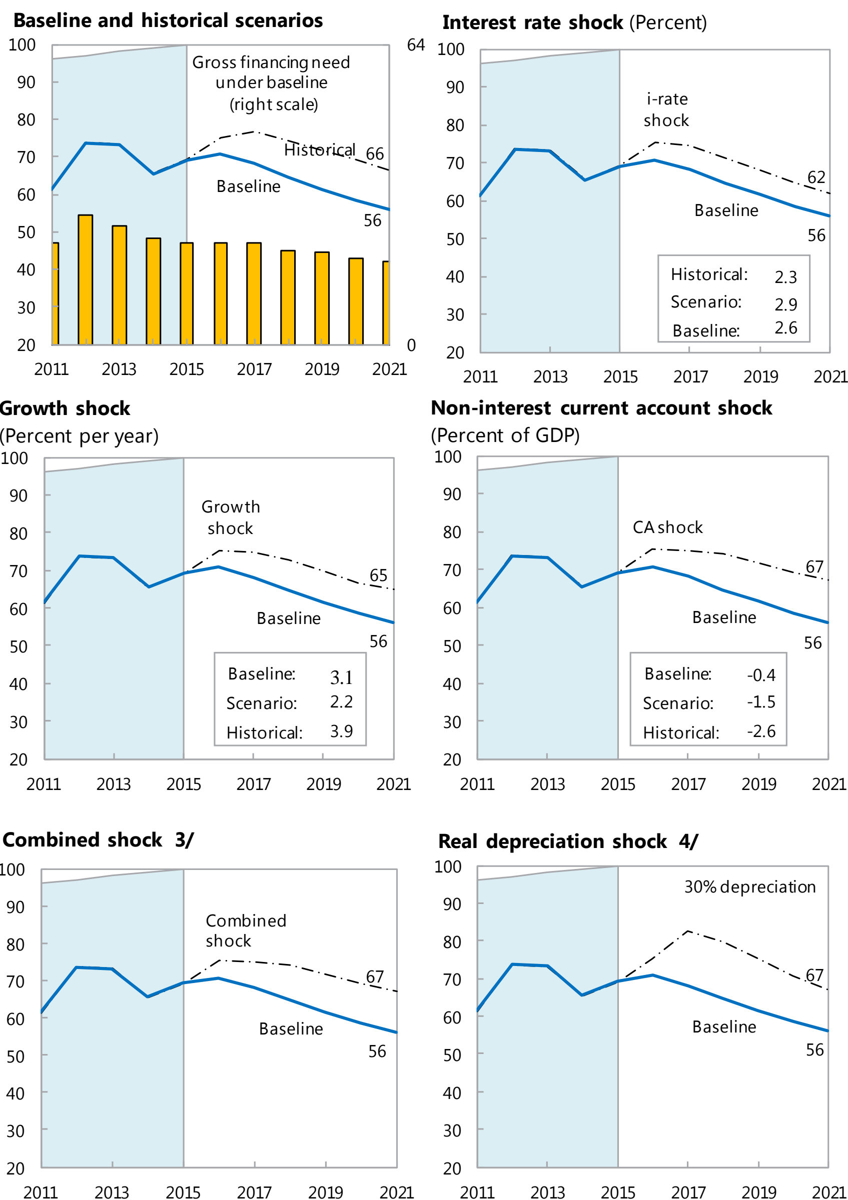
	2016	2017	2018	2019	2020	2021
Real GDP Growth Shock						
Real GDP growth	2.6	1.4	1.4	3.1	3.0	3.0
Inflation	0.0	0.0	1.4	2.4	2.3	2.4
Primary balance	-0.8	-2.2	-2.9	-0.9	-0.6	-0.5
Effective interest rate	3.5	3.2	3.2	3.3	3.3	3.3
Real Exchange Rate Shock						
Real GDP growth	2.6	3.3	3.3	3.1	3.0	3.0
Inflation	0.0	5.4	1.9	2.4	2.3	2.4
Primary balance	-0.8	-1.3	-1.0	-0.9	-0.6	-0.5
Effective interest rate	3.5	3.3	3.1	3.1	3.1	3.1

Source: IMF staff.

Annex II. External Debt Sustainability Analysis

Poland: External Debt Sustainability: Bound Tests, 2011–21[1,2]

(External debt, percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2016.

Poland: External Debt Sustainability Framework, 2013–21

(Percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2013	2014	2015			2016	2017	2018	2019	2020	2021	
						I. Baseline Projections						Debt-stabilizing non-interest current account 5/
External debt	73.2	65.4	69.2			**70.7**	**68.1**	**64.6**	**61.4**	**58.4**	**56.0**	**-3.9**
Change in external debt	-0.4	-7.8	3.7			1.6	-1.1	-3.4	-3.2	-3.0	-2.4	
Identified external debt-creating flows (4+8+9)	-2.2	-3.6	0.1			-3.0	-3.7	-4.0	-3.6	-3.1	-2.7	
Current account deficit, excluding interest payments	-0.3	0.5	-1.0			-1.2	-0.2	0.0	0.3	0.6	1.4	
Deficit in balance of goods and services	-90.7	-93.7	-95.9			-102.7	-107.9	-109.2	-110.0	-110.5	-111.5	
Exports	46.3	47.6	49.5			53.1	55.1	55.5	55.7	55.7	56.0	
Imports	-44.4	-46.2	-46.4			-49.5	-52.7	-53.7	-54.4	-54.8	-55.4	
Net non-debt creating capital inflows (negative)	-1.3	-3.0	-2.9			-3.0	-2.3	-2.2	-2.2	-2.2	-2.2	
Automatic debt dynamics 1/	-0.6	-1.1	4.0			1.1	-1.2	-1.8	-1.7	-1.4	-1.8	
Contribution from nominal interest rate	1.6	1.6	1.6			1.4	1.5	1.7	1.8	1.8	1.2	
Contribution from real GDP growth	-1.0	-2.3	-2.9			-1.8	-2.2	-2.1	-1.9	-1.7	-1.6	
Contribution from price and exchange rate changes 2/	-1.2	-0.4	5.3			1.5	-0.5	-1.4	-1.6	-1.5	-1.3	
Residual, incl. change in gross foreign assets (2-3)	1.8	-4.2	3.7			4.6	2.6	0.6	0.4	0.0	0.3	
External debt-to-exports ratio (in percent)	158.2	137.5	139.7			133.1	123.4	116.5	110.3	104.9	100.0	
Gross external financing need (in billions of US dollars) 3/	133.9	124.2	103.6			100.6	105.4	103.7	108.4	106.5	107.6	
in percent of GDP	25.5	22.8	21.7	10-Year Historical Average	10-Year Standard Deviation	21.6	21.6	20.1	19.8	18.4	17.6	
Key Macroeconomic Assumptions												
Nominal GDP (US dollars)	524.4	545.1	477.1			466.1	486.9	515.3	546.4	580.3	611.3	
Real GDP growth (in percent)	1.4	3.3	3.9	3.9	1.8	2.6	3.3	3.3	3.1	3.0	3.0	
Exchange rate appreciation (US dollar value of local currency, percent)	3.0	0.1	-16.3	0.4	12.0	-4.7	0.6	0.6	0.5	0.8	-0.1	
GDP deflator in US dollars (change in percent)	3.3	0.6	-15.8	2.7	12.6	-4.8	1.1	2.5	2.9	3.2	2.3	
Nominal external interest rate (in percent)	2.3	2.3	2.2	2.3	0.6	2.1	2.3	2.6	2.9	3.1	2.2	
Growth of exports (US dollar terms, in percent)	9.2	6.8	-9.0	9.4	15.3	4.9	8.4	6.5	6.4	6.2	6.1	
Growth of imports (US dollar terms, in percent)	3.5	8.0	-11.9	9.0	19.2	4.2	11.2	7.8	7.3	7.1	6.6	
Current account balance, excluding interest payments	0.3	-0.5	1.0	-2.6	2.2	1.2	0.2	0.0	-0.3	-0.6	-1.4	
Net non-debt creating capital inflows	1.3	3.0	2.9	2.6	0.8	3.0	2.3	2.2	2.2	2.2	2.2	
						II. Stress Tests for External Debt Ratio						Debt-stabilizing non-interest current account 5/
A. Alternative Scenarios												
A1. Key variables are at their historical averages in 2016-2021 4/						**75.2**	**76.6**	**74.3**	**71.8**	**69.1**	**66.4**	**-5.4**
B. Bound Tests												
B1. Nominal interest rate is at baseline plus one-half standard deviation						75.2	74.7	71.2	67.8	64.6	61.9	-4.1
B2. Real GDP growth is at baseline minus one-half standard deviations						75.2	74.9	72.6	69.7	66.7	64.8	-3.4
B3. Non-interest current account at baseline minus one-half standard deviations						75.2	75.1	74.0	71.5	69.1	67.2	-4.5
B4. Combination of B1-B3 using 1/4 standard deviation shocks						75.2	75.0	74.0	71.4	69.0	67.0	-4.0
B5. One time 30 percent real depreciation in 2017						75.2	82.6	79.7	75.3	70.8	66.8	-5.3

Source: IMF staff calculations.

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ Defined as current account deficit, plus amortization on short-term and medium- and long-term debt.

4/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

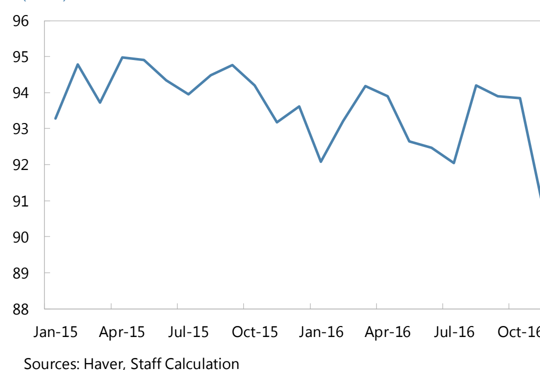
5/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Annex III. External Sector Assessment

The external position in 2016 is broadly consistent with medium-term fundamentals and desirable policies.

Current account. Following a significant reduction in the current account deficit in 2015 by around 1½ percent of GDP, the deficit is estimated to decline further to 0.3 percent of GDP in 2016 as stronger export performance outweighs the moderate increase in oil prices and non-oil imports. The oil deficit stabilized around 2 percent of GDP, as the oil price decline came to a halt. The current account is broadly consistent with fundamentals and desirable policies given a small EBA-implied current account gap of 0.6 percent of GDP (the difference between actual cyclically adjusted CA of -0.2 percent of GDP and current account norm of -0.8 percent of GDP). In 2017, the current account deficit is projected to widen on the back of stronger domestic demand and higher oil prices.

Real exchange rate. The real effective exchange rate (REER) fluctuated in 2016 broadly around the same level as in 2015 prior to the US elections, which led to the nominal depreciation of the zloty by about 3 percent. Various approaches suggest an undervaluation between 1.5 and 18 percent. The REER gap implied by the current account approach is -1.5 percent; the external sustainability approach suggests a REER gap of -6 percent; -8 percent using the REER index regression approach; and -18 percent using the levels approach. Owing to large residuals in the REER-level regressions, staff puts more weight on the other approaches. Hence, staff assesses Poland's real exchange rate in 2016 to be close to a level consistent with fundamentals and desirable policy settings with the REER gap centered around –5 percent within a range of –10 to 0 percent.



Sources: Haver, Staff Calculation

Capital and financial account. Portfolio outflows started from mid-2015, reflecting political uncertainties during the elections, and accelerated in the first two months of 2016, triggered by a combination of controversial domestic policy initiatives, the S&P downgrade and heightened global risks that resulted in a general EM asset sell-off. The outflows were partially reversed in subsequent months. However, the more recent post-US election wave of portfolio rebalancing away from EM assets has affected Poland as well. Foreign direct investment (FDI) is expected to recover slowly this year following the temporary decline in 2015 driven by reinvestment of SPV's retained earnings. The EU fund inflows remain weak in 2016, given low absorption of EU funds, but are expected to accelerate next year as the absorption of EU funds picks up. If portfolio outflows continue as US yields increase further, or the decline in FDI proves to be more persistent than assumed in the baseline, financing a widening current account balance can become more challenging.

Foreign assets and liabilities. A large negative net international investment position (NIIP) remained broadly stable at around -60 percent of GDP in 2015 and 2016; but projected to decline over the medium term to around 50 percent of GDP. Associated vulnerabilities are mitigated by well-diversified FDI liabilities (accounting for over 40 percent of foreign liabilities) and related intercompany lending.

Reserve adequacy. Reserves are broadly adequate with gross reserves at about 122 percent and net reserves above 102 percent of the IMF's modified composite reserve adequacy metric as of end-November 2016. Compared to end-2015, both net and gross reserves increased notably, the latter also on account of increased repo transactions.

Appendix. Letter from the Authorities Requesting Flexible Credit Line

Warsaw, December 19, 2016

Ms. Christine Lagarde

Managing Director

International Monetary Fund

Dear Ms. Lagarde,

Over the past 7 years the consecutive arrangements under the IMF's Flexible Credit Line (FCL) have provided Poland with valuable additional insurance against external shocks. During the prolonged period of heightened external risks, the arrangements have played an instrumental role in sending a reassuring signal to markets on the strength of Poland's fundamentals, policies and institutions. As stated in the last Article IV consultation, alongside the additional line of defense provided by the FCL, Poland maintains strong fundamentals, illustrated by solid GDP growth, declining unemployment, improving current account and adequate international reserves.

We are committed to maintaining sound policies and strong democratic institutions to support robust and inclusive growth. The government has succeeded in restraining the general government deficit below the 3 percent of GDP threshold despite the implementation of a costly pro-family set of measures which aims to boost the long-term growth. The currently estimated 2016 deficit is lower than planned, as our first initiatives in boosting tax compliance begin to bear fruit. Sound fiscal policy is a key pillar of our program. In order to maintain sound public finances, we remain firmly committed to conducting fiscal policy in accordance with domestic and European rules. In particular, we intend to keep the general government deficit below 3 percent of GDP in 2017 and to achieve a structural deficit of 1 percent of GDP over the medium-term. For 2017, the planned general government deficit of 2.9 percent is underpinned by sizable efficiency gains from the tax administration reforms. Should revenue perform better than expected, any revenue outperformance will be at least partially saved taking into account medium-term fiscal stability. Although the risk of breaching 3 percent is very limited, we stand ready to undertake necessary adjustments—both on revenue and expenditure side. The impact of reversal of the 2013 retirement age increase will be mitigated by improving conditions on the labor market and incentives to remain in the labor force for longer, provided both by the government and employers. Over the medium-term the pace of consolidation will be determined by the automatic correction mechanism of the stabilizing expenditure rule that requires a lower dynamic of expenditure by 1.5-2 percentage points than average GDP growth until achieving the MTO and reducing public debt below 43 percent of GDP. We are committed to adhere to the fiscal consolidation path that envisages fiscal tightening starting in 2018, with at least 0.25 percent of GDP per year. Fiscal consolidation will be supported by improvements in revenue collection (focused on better tax compliance and limitation of tax evasion), greater progressivity of the tax system, and targeted expenditure rationalization.

Monetary policy will continue to be guided by the long-standing inflation targeting framework, underpinned by a flexible exchange rate.

Polish financial system remains strong, resilient and well supervised. We would like to assure that safeguarding stability of the financial sector remains one of the foundations of our policies.

As an open economy, Poland has benefited from integration with global markets. Nonetheless, this has also generated an exposure to potential external shocks. Despite Poland's improved economic fundamentals and strong policies, its open capital account, combined with relatively high financing needs, renders it susceptible to shifts in investor sentiment. Since the last FCL request, some external risks have abated, but new concerns have also emerged. On the upside, the continued quantitative easing by the European Central Bank has strengthened the recovery in the euro area, which may translate into higher growth in Poland owing to high degree of synchronization of business cycles. However, a potential surge in financial market volatility stemming from the uncertainties surrounding the path of normalization of advanced economies' monetary policy poses a risk of a sudden shift in market sentiment away from emerging market assets. Moreover, the ultimate impact of Brexit on the EU economy remains unknown. Finally, risks related to the geopolitical tensions linked to the conflict between Russia and Ukraine have not receded. In this context it is also worth noting that Poland is assisting Ukraine in various ways including by accommodating a large number of Ukrainian economic migrants. This in turn brings positive effects to our labor market and shall help to compensate the effects of the planned retirement age changes.

In view of the above, we believe that the FCL would continue to play an important role in mitigating external risks in case of tails events. Nevertheless, we find that these risks have to be reflected upon in the context of Poland's improved economic fundamentals and enhanced policy buffers. On balance, we consider that a new two-year FCL arrangement, albeit at a substantially lower access, would provide additional insurance against adverse external shocks, while conveying a strong signal of Poland's commitment to exit the facility as soon as external conditions permit. In this context, we have continued our efforts to communicate our intention to proceed with a smooth and gradual exit strategy to market participants and the broader public. Our outreach has met only muted market reaction.

Concluding, in light of the strengthened fundamentals and buffers, and considering the balance of risks, we request the approval of a successor 24-month FCL arrangement for Poland in the amount equivalent to SDR 6.5 billion (159 percent of quota) and wish to cancel the current arrangement effective upon approval of the new FCL arrangement. We reaffirm our intention to treat the instrument as precautionary.

Sincerely yours,

/s/
Minister of Economic Development
and Finance
MATEUSZ MORAWIECKI

/s/
President of Narodowy Bank Polski
ADAM GLAPINSKI

INTERNATIONAL MONETARY FUND

REPUBLIC OF POLAND

January 3, 2017

ASSESSMENT OF THE IMPACT OF THE PROPOSED FLEXIBLE CREDIT LINE ARRANGEMENT ON THE FUND'S FINANCES AND LIQUIDITY POSITION

Approved By
Andrew Tweedie and Vitaliy Kramarenko

Prepared by the Finance and Strategy, Policy, and Review Departments (in consultation with other departments)

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INTRODUCTION

1. **This note assesses the impact of the proposed Flexible Credit Line (FCL) arrangement for Poland on the Fund's finances and liquidity position, in accordance with the policy on FCL arrangements.**[1] The proposed arrangement would cover a 24-month period and access would be in an amount of SDR 6.50 billion (159 percent of quota). It would succeed the existing FCL arrangement, which would be cancelled prior to approval of the proposed arrangement. The full amount of access proposed would be available throughout the arrangement period, in one or multiple purchases.[2] The authorities intend to treat the arrangement as precautionary.

BACKGROUND

2. **Since the onset of the global economic and financial crisis, Poland has entered into five successive FCL arrangements with the Fund.** Access under the FCL peaked at SDR 22.0 billion (1,303 percent of quota) during the fourth arrangement, approved on January 18, 2013; access under the successor arrangement, approved on January 14, 2015, was reduced to SDR 15.5 billion (918 percent of quota), and this was subsequently lowered to SDR 13.0 billion (770 percent of quota) on January 13, 2016.[3] [4] Limited macroeconomic imbalances prior to the crisis, effective pursuit of counter-cyclical policies during the crisis, and sustained efforts to build buffers and further strengthen the policy framework all served to limit Poland's external financing needs during and after the crisis. No drawings have been made under any of the previous or the existing FCL arrangement. Poland has a history of strong performance under Fund arrangements and an exemplary record of meeting its obligations to the Fund.

[1] See *GRA Lending Toolkit and Conditionality – Reform Proposals* (3/13/09) and *Flexible Credit Line (FCL) Arrangements,* Decision No.14283-(09/29), adopted March 24, 2009, as amended by Decision No. 14714-(10/83), adopted August 30, 2010; the *Fund's Mandate – the Future Financing Role: Reform Proposals* (http://www.imf.org/external/np/pp/eng/2010/062910.pdf, 6/29/2010), and *the IMF's Mandate – the Future Financing Role: Revised Reform Proposals and Revised Proposed Decisions* (http://www.imf.org/external/np/pp/eng/2010/082510.pdf, 8/25/2010); *Review of the Flexible Credit Line, the Precautionary and Liquidity Line, and the Rapid Financing Instrument – Specific Proposals*.(http://www.imf.org/external/np/pp/eng/2014/043014.pdf, 5/1/2014 and Decision No. 15593 – (14/46)).

[2] If the full amount is not drawn in the first year of the arrangement, a review of Poland's continued qualification under the FCL arrangement must be completed before purchases can be made after the first year.

[3] See Republic of Poland—Review Under the Flexible Credlit Line Arrangement.

[4] Following the 14th Review quota increases, which became effective on February 2, 2016, Poland's quota increased from SDR 1,688.4 million to SDR 4,095.4 million. As a result access under the FCL fell to 378 percent, and then to 317 percent, of the new quota.

Table 1. Poland: External Debt and Debt Service, 2012-17 1/

			2012	2013	2014	2015	2016	2017
			(In billions of US dollars)					
Total External Debt			369.0	384.1	356.7	330.0	329.8	331.3
	of which :	Public	150.3	153.5	145.7	147.8	144.9	142.9
		Private	218.7	230.6	211.0	182.2	184.9	188.4
Net External Debt			288.1	299.2	267.5	236.3	231.5	228.1
	of which :	Public	150.3	153.5	145.7	147.8	144.9	142.9
		Private	137.8	145.7	121.8	88.6	86.6	85.2
Total External Debt Service			133.5	135.7	139.5	113.4	106.0	106.3
	of which :	Public	11.3	14.2	10.5	6.9	4.2	12.3
		Private	122.2	121.5	129.0	106.5	101.8	94.1
Net External Debt Service			104.3	105.7	104.6	81.2	74.4	73.2
	of which :	Public	11.3	14.2	10.5	6.9	4.2	12.3
		Private	92.9	91.5	94.2	74.3	70.2	60.9
			(In percent of GDP)					
Total External Debt			73.7	73.2	65.4	69.2	70.7	68.1
	of which :	Public	30.0	29.3	26.7	31.0	31.1	29.4
		Private	43.7	44.0	38.7	38.2	39.7	38.7
Net External Debt			57.5	57.0	49.1	49.5	49.7	46.9
	of which :	Public	30.0	29.3	26.7	31.0	31.1	29.4
		Private	27.5	27.8	22.3	18.6	18.6	17.5
Total External Debt Service			26.7	25.9	25.6	23.8	22.7	21.8
	of which :	Public	2.3	2.7	1.9	1.5	0.9	2.5
		Private	24.4	23.2	23.7	22.3	21.8	19.3
			-	-	-	-	-	-
Net External Debt Service			20.8	20.2	19.2	17.0	16.0	15.0
	of which :	Public	2.3	2.7	1.9	1.5	0.9	2.5
		Private	18.6	17.4	17.3	15.6	15.1	12.5

Source: Polish authorities and IMF staff estimates.

1/ End of period, unless otherwise indicated.

3. **Total external and public external debt levels are both projected to decline in 2017, even taking into account the impact of the new proposed FCL arrangement** (Table 1) External debt, which was in the 44-55 percent of GDP range in the years preceding the global crisis, peaked at almost 74 percent of GDP in 2012 before declining to 65 percent in 2014. External debt has since risen to an estimated 70.7 percent of GDP in 2016, but is projected to decline to 68.1 percent of GDP in 2017. Short term debt on a residual maturity basis is estimated at 30 percent of total external debt in 2016 and is projected to decline to 28.7 percent in 2017. Public external debt is estimated at 31.1 percent of GDP in 2016, but is projected to decline to below 29½ percent of GDP in 2017. Gross public debt (ESA95 definition), is projected to rise slightly from 53 percent of GDP in 2016 to 54 percent in 2018 before declining gradually to 52 percent of GDP in 2021. Net external debt is projected to fall below 47 percent of GDP in

2017. Sustainability analyses suggest that both external and public debt are generally robust to, and remain manageable under, a range of scenarios.[5]

4. Even if the resources available under the proposed FCL arrangement were fully drawn, the Fund's exposure to Poland would be moderate and represent just over 13 percent of total GRA credit outstanding.

- Poland would become the Fund's fourth largest individual exposure, after Portugal, Greece, and Ukraine.
- Potential credit exposure to Poland would be about 43 percent of the Fund's current precautionary balances.
- However, Fund credit would only represent a modest part of Poland's external debt (Table 2). Fund GRA credit to Poland would add around 1.3 percent of GDP to the country's total external debt, and represent around 4.6 percent of Poland's public external debt, in 2017. Poland's outstanding use of GRA resources would account for 5.6 percent of gross international reserves in 2017, falling to around 5.3 percent of the total in 2019.
- External debt service would increase in the medium-term, but remain manageable. Poland's projected debt service to the Fund would rise to about SDR 3.3 billion in 2021, or about 0.5 percent of GDP. Peak debt service to the Fund would be less than 1 percent of exports of goods and services in 2021, and amount to only 3.3 percent of projected total external debt service.

[5] Note that the debt sustainability analysis does not assume any drawings under the FCL arrangement, consistent with the approach applied in other cases.

Table 2. Poland—Capacity to Repay Indicators (2015-22) 1/

	2015	2016	2017	2018	2019	2020	2021	2022
Exposure and Repayments (In SDR millions)								
GRA credit to Poland	--	--	6,500.00	6,500.00	6,500.00	4,062.50	812.50	--
(In percent of quota)	--	--	158.71	158.71	158.71	99.20	19.84	--
Charges due on GRA credit 2/	--	--	96.46	79.95	79.95	70.92	32.86	2.00
Debt service due on GRA credit 2/	--	--	96.46	79.95	79.95	2,508.42	3,282.86	814.50
Debt and Debt Service Ratios 3/								
In percent of GDP								
Total external debt	69.16	71.29	68.54	65.11	61.87	58.81	56.40	--
Public external debt	30.97	31.62	29.86	27.89	25.90	24.20	22.84	--
GRA credit to Poland	--	--	1.33	1.26	1.19	0.70	0.13	--
Total external debt service	23.77	22.72	21.73	19.91	19.37	17.58	16.67	--
Public external debt service	1.45	0.90	2.52	2.29	2.81	2.38	2.00	--
Debt service due on GRA credit	--	--	0.02	0.02	0.01	0.43	0.54	--
In percent of Gross International Reserves								
Total external debt	347.62	296.25	287.76	281.74	274.57	270.50	267.53	--
Public external debt	155.68	130.16	124.14	119.48	113.75	110.15	107.16	--
GRA credit to Poland	--	--	5.64	5.50	5.32	3.24	0.63	--
In percent of Exports of Goods and Services								
Total external debt service	48.04	42.78	39.60	36.20	35.16	31.93	28.99	--
Public external debt service	2.93	1.69	4.56	4.13	5.05	4.28	3.58	--
Debt service due on GRA credit	--	--	0.04	0.03	0.03	0.78	0.96	--
In percent of Total External Debt								
GRA credit to Poland	--	--	1.96	1.95	1.94	1.20	0.24	--
In percent of Public External Debt								
GRA credit to Poland	--	--	4.55	4.60	4.67	2.94	0.59	--
In percent of Total External Debt Service								
Debt service due on GRA credit	--	--	0.09	0.08	0.07	2.43	3.31	--
U.S. dollars per SDR (period average)	1.40	1.39	1.36	1.36	1.36	1.37	1.37	1.37
U.S. dollars per SDR (end of period)	1.39	1.36	1.36	1.36	1.37	1.37	1.37	1.36

Sources: Polish authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

1/ Assumes full drawings under the FCL upon approval. The Polish authorities have expressed their intention to treat the arrangement as precautionary, as balance of payments pressures have not materialized.

2/ Based on the rate of charge as of December 2, 2016. Includes service charges.

3/ Staff projections for external debt, GDP, gross international reserves, and exports of goods and services, as used in the staff report that requests the proposed FCL, adjusted for the impact of the assumed FCL drawing.

5. Taking into account the cancellation of the current FCL, the proposed new FCL arrangement would have no net impact on Fund liquidity. Half of the current FCL arrangement (with a total access of SDR 13.0 billion) is financed by the New Arrangements to Borrow (NAB) and the other half is financed by quota resources.[6] Therefore, the positive impact of cancelling the current FCL arrangement on the Fund's Forward Commitment Capacity (FCC) would be only SDR 6.5 billion. As the proposed access level under a successor FCL arrangement (which will be financed solely using quota resources) is also SDR 6.5 billion, the net impact of replacing the current FCL arrangement with a successor would leave the Fund's net liquidity position unchanged (Table 3). If Poland were to draw upon the proposed FCL arrangement, however, there would be an additional impact on the FCC as Poland would no longer participate in the Financial Transactions Plan.

Table 3. Poland—Impact on GRA Finances
(in SDR billions unless otherwise noted)

	As of December 6, 2016
Liquidity measures	
Forward Commitment Capacity (FCC) before approval 1/	209.0
FCC on approval 2/	209.0
Change in percent	0.0
Prudential measures	
Fund GRA commitment to Poland including credit outstanding	
in percent of current precautionary balances	42.8
in percent of total GRA credit outstanding 3/	13.2
Fund GRA credit outstanding to top five borrowers	
in percent of total GRA credit outstanding 3/	81.2
in percent of total GRA credit outstanding including Poland's assumed full drawing	76.6
Poland's projected annual GRA charges for FY17 in percent of the Fund's residual burden sharing capacity	41.3
Memorandum items	
Fund's precautionary balances (FY16)	15.2
Fund's Residual Burden Sharing Capacity 4/	0.0275

Sources: Finance Department and IMF staff calculations.
1/ The FCC is defined as the Fund's stock of usable resources less undrawn balances under existing arrangements, plus
2/ The cancellation of the current FCL (SDR 13 bn) will add SDR 6.5 bn to uncommitted quota resources and raise the FCC by
3/ As of December 6, 2016.
4/ Burden-sharing capacity is calculated based on the floor for remuneration at 85 percent of the SDR interest rate. Residual burden-sharing capacity is equal to the total burden-sharing capacity minus the portion being utilized to offset deferred charges and takes into account the loss in capacity due to nonpayment of burden sharing adjustments by members in arrears.

[6] The current arrangement was approved when the NAB was activated, and therefore is financed by both NAB and quota resources.

ASSESSMENT

6. The proposed FCL arrangement would have no net impact on the Fund's liquidity position. The impact of the proposed new FCL arrangement on the FCC will be exactly offset by the impact of the cancellation of Poland's existing FCL arrangement. At close to SDR 210 billion, the FCC appears sufficiently strong to accommodate the proposed arrangement.

7. Poland intends to treat the FCL arrangement as precautionary, but if it is drawn in full, Poland would be one of the Fund's largest borrowers. Poland would become the fourth largest user of the Fund's GRA resources after Portugal, Greece, and Ukraine. However, Poland's overall external debt and debt service ratios are expected to remain manageable even with a drawing under the arrangement. In addition, Poland's capacity to repay is expected to remain strong given its sustained track record of implementing strong policies, including during the global financial crisis, and sound institutional policy framework.

Annex I. Poland: History of IMF Arrangements

Prior to the FCL arrangements approved in May 2009, July 2010, January 2011, January 2013, and in January 2015, Poland has several Fund arrangements in the 1980s and the 1990s. It fully repaid its remaining outstanding credit in 1995 (Table I.1). Poland has an exemplary track record of meeting its obligations to the Fund.

From 1990 to 1995, Poland had three Stand-By Arrangements (SBAs) and one arrangement under the Extended Fund Facility (EFF).

Annex Table I.1. Poland: IMF Financial Arrangements, 1990-2016
(In SDR millions)

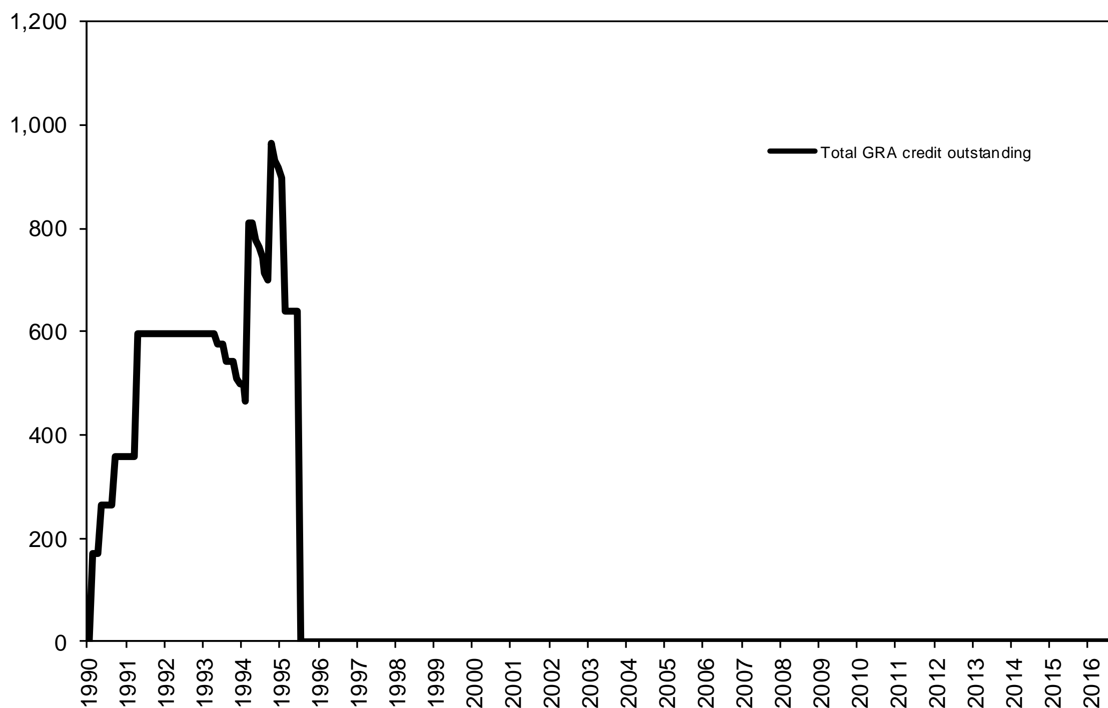
Year	Type of Arrangement	Date of Arrangement	Date of Expiration or Canellation	Amount of New Arrangement	Amount Drawn	Purchases	Repurchases	Fund Exposure 1/
1990	SBA	5-Feb-90	4-Mar-91	545.0	357.5	357.5	0.0	357.5
1991	EFF/CFF	18-Apr-91	8-Mar-93	1,224.0	76.5	239.1 2/	0.0	596.6
1992						0.0	0.0	596.6
1993	SBA	8-Mar-93	8-Apr-94	476.0	357.0	0.0	98.9	497.7
1994	SBA	5-Aug-94	4-Mar-96	333.3	283.3	640.3	219.4	918.6
1995						0.0	918.6	0.0
…								
2009	FCL	6-May-2009	05-May-2010	13,690.0	0.0	0.0	0.0	0.0
2010	FCL	2-Jul-2010	20-Jan-2011	13,690.0	0.0	0.0	0.0	0.0
2011	FCL	21-Jan-2011	17-Jan-2013	19,166.0	0.0	0.0	0.0	0.0
2013	FCL	18-Jan-2013	17-Jan-2015	22,000.0	0.0	0.0	0.0	0.0
2015	FCL 3/	14-Jan-2015	13-Jan-2017	13,000.0	0.0	0.0	0.0	0.0

Source: Finance Department.

1/ As of December 6th, 2016
2/ Includes a purchase of SDR 162.6 million under the Compensatory Financing Facility.
3/ The initial access amount was SDR 15,500 million (378 percent of quota), but the access amount was reduced to SDR 13,000 million (317 percent of quota) on January 13, 2016. See EBS/15/157.

Since the global financial crisis, Poland has had several FCL arrangements under which no drawings have been made. A one-year FCL arrangement equivalent to SDR 13.69 billion (1,000 percent of quota) was approved on May 6, 2009 which the authorities treated as precautionary. This arrangement was succeeded by another FCL arrangement on identical terms which was approved on July 2, 2010 and a two-year FCL arrangement in the amount of SDR 19.166 billion (1,400 percent of quota) approved on January 21, 2011. On Jan 18, 2013 a successor FCL in the amount of SDR 22.0 billion (1,303 percent of quota) was approved. Most recently, on January 14, 2015, another two-year FCL arrangement in the amount of SDR 15.5 billion (378 percent of quota) was approved, but the access amount was reduced to SDR 13.0 billion (317 percent of quota) a year later.

Annex Figure I.1. Poland: IMF Credit Outstanding, 1990-2016
(In SDR millions)



Source: Finance Department.

Statement by Miroslaw Panek, Executive Director for the Republic of Poland
and Remigiusz Urbanowski, Alternate Executive Director
January 13, 2017

In the global environment of elevated economic, political and financial risks, as well as amid rising concerns over the effectiveness of policies in advanced countries, Poland's economy has remained resilient with a robust growth and a relatively low financial volatility. The Flexible Credit Line (FCL), alongside very strong fundamentals and prudent macroeconomic management, has been an important element reinforcing markets' confidence in the strength of Poland's institutions and policies.

The external risks to the Polish economy have evolved, remaining at an elevated level. While some of the previously identified risks have abated, new uncertainties have emerged. Our authorities believe that the continued additional insurance provided by the FCL remains relevant to sustaining market confidence. Therefore, they wish to request the approval of a successor FCL arrangement for two years, with a significantly reduced level of access. The authorities continue to believe that exit from a precautionary arrangement should be state- rather than time-dependent. Thus, the decision to ultimately exit the arrangement will be based on the assessment of existing tail risks and accumulated buffers. These considerations are reflected in this request.

Buffers

Although the FCL provides additional insurance, the authorities believe that sustained resilience of the economy to external shocks should be primarily achieved through a persistent build-up of the internal and external buffers.

- **The growth remains solid despite some weakening in 2016.** After reaching 3.9 percent in 2015, the economic growth is expected to decelerate to around 3 percent in 2016. The slower pace of economic growth is mainly linked to the stagnation of public investments associated with lower absorption of EU funds during the transition to the new 2014-20 European Union financial perspective. In 2017 the process of absorption should be accelerated and have positive impact on the growth rate. Private consumption remains the main driver of growth. Consumer demand is underpinned by low unemployment (a historical low of 5.7 percent in October 2016) and a solid nominal wage growth in the enterprise sector (4 percent in November 2016).
- **The external imbalances continue to narrow.** In 2016 the Current Account (CA) deficit is projected to have decreased further from the level of 0.6 percent in 2015, on the back of a decent export performance.
- **International reserves remain broadly adequate against standard metrics.** The reserve buffers have been further strengthened from the level of USD 94.9 billion at the end of 2015 to USD 110.8 billion in November 2016.
- **The government's priority is to promote a strong and inclusive economic growth while pursuing fiscal policy within the constraints of the domestic and the EU fiscal rules.** The general government deficit is expected this year to outperform the budget target. As a result of stronger than expected revenues, the deficit in 2016 is expected to have been lower than initially projected

at the level of 2.6 percent of GDP (after eleven months the budget deficit reached 50.4 percent of the year's planned volume). Over the medium term Poland is committed to adhere to the fiscal consolidation which will be supported by improvements in revenue collection, greater progressivity of the tax system and targeted expenditure rationalization. Public debt – 51.1% at the end of 2015 and expected to have slightly increased at the end of 2016, remains safely below the 60% threshold and is highly sustainable. With stable credit outlook, Poland enjoys favorable financing conditions on domestic and international financial markets.

- **Monetary policy, with the policy rate at the historic low level, is conducive to keeping the Polish economy on the sustainable growth path.** Annual consumer price growth has definitely left the negative territory in November 2016. Also producer prices have been growing. Faster price growth has resulted mainly from the dissipating effects of the earlier sharp fall in global commodity prices. Price growth has been contained by low inflation abroad and small but still negative output gap in the domestic economy. The November NBP's projection indicates that inflation is expected to reach the lower bound of the target range within the next two years, driven by higher energy commodity prices and the expected re-acceleration in GDP growth.
- **Efforts have been continued to maintain a strong financial sector.** The banking sector remains well-capitalized, liquid, and profitable. The implementation of the bank resolution framework in accordance with the EU Bank Recovery and Resolution Directive was completed in October 2016, and should contribute to reducing the systemic risks.
- **A steady progress has been made on the structural front**. Directions of Poland's economic development in the years to come have been outlined in the government's Plan for Responsible Development. The aim of the Plan is to foster more inclusive economic growth through mobilizing domestic human and financial capital, revitalizing innovations and higher specialization of domestic industry. An important element of the strategy is creating a favorable institutional and legal environment that increases Poland's investment attractiveness for foreign capital. The Plan also focuses on social and regional development promoting inclusion of small cities and rural areas.

Looking forward, the Polish authorities are determined to maintain very strong institutional policy frameworks and prudent policies. The government priorities are focused on advancing inclusive growth while maintaining fiscal discipline and financial stability.

Risks

As an open economy, Poland has benefited from the integration with global markets, but at the same time the economy remains highly exposed to potential external shocks. Its open capital account and relatively high financing needs, especially in an environment of still elevated external risks, make it susceptible to potential sudden shifts in investor sentiment. While in the authorities' assessment, some of the external risks have receded since the last FCL request, new concerns have emerged.

- On the upside, the continued quantitative easing by the European Central Bank has strengthened the recovery in the euro area, which may translate into higher growth in Poland owing to a high degree of synchronization of business cycles.

- However, a potential surge in financial market volatility stemming from the uncertainties surrounding the path of normalization of advanced economies' monetary policy poses a risk of a sudden shift in market sentiment away from emerging market assets.

- Moreover, the ultimate impact of Brexit on the EU economy remains unknown. The international economic, financial and political effects of the presidential elections in the US are to be seen.

- Finally, risks related to the geopolitical tensions linked to the conflict between Russia and Ukraine have not receded.

In the light of these concerns, the authorities believe that a successor precautionary FCL would continue to provide an important protection in case of the realization of a tail risk. In their opinion, the additional valuable insurance provided by the FCL remains relevant to help sustain market confidence and support their economic policies aimed at further strengthening the economic fundamentals. Although the strengthened policy buffers have improved Poland's resilience against external shocks, a full exit from the facility would be premature at this stage. Therefore, a successor two-year FCL with a significantly reduced access limit confirms Poland's strong commitment to exit the instrument as soon as external conditions allow, providing at the same time sufficient protection against potential adverse developments.

Exit

Poland's intention to gradually reduce its reliance on the facility has been signaled on previous occasions. To ensure a smooth and orderly process, the authorities will continue extensive communication undertakings on their exit strategy, through direct outreach to investors and to the general public. The primary goal of the outreach is to reinforce the trust that Poland is well prepared to further reduce its FCL access and if external risks subside faster than expected - to exit from the arrangement entirely.

Conclusion

Given the strengthened buffers and considering the balance of risks, Polish authorities are requesting the approval of a successor 24-month FCL arrangement in the reduced amount equivalent to SDR 6.5 billion (159 percent of quota). Simultaneously, they wish to cancel the current arrangement approved on January 14, 2015 effective upon approval of the new FCL.

The authorities are committed to continue strengthening policy buffers and make further progress towards exit from the facility, taking into account the evolution of the external conditions. They reiterate their intention to treat the arrangement as precautionary.