INTERNATIONAL MONETARY FUND

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REPUBLIC OF POLAND

February 2022

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF POLAND

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2021 Article IV consultation with the Republic of Poland, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its February 18, 2022 consideration of the staff report that concluded the Article IV consultation with the Republic of Poland.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 18, 2022, following discussions that ended on December 13, 2021, with the officials of the Republic of Poland on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 1, 2022.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Republic of Poland.

The document listed below have been or will be separately released.

Selected Issues

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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IMF Executive Board 2021 Article IV Consultation with the Republic of Poland

FOR IMMEDIATE RELEASE

Washington, DC – **February 18, 2021:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of Poland on February 18, 2021.

While the pandemic has taken its toll on lives in Poland, as elsewhere, the economy has weathered the pandemic comparatively well. After contracting 2.5 percent in 2020, one of the least-severe recessions among members of the European Union, the economy recovered strongly in 2021, expanding an estimated 5.7 percent. Although a winter wave of the pandemic may slow growth in the near term, the economy has shown increased resilience to successive waves, and the economy is projected to grow 4.6 percent in 2022. Over the medium term, strong household and corporate balance sheets and anticipated Next Generation EU grants should maintain solid economic growth, with little scarring to output anticipated from the pandemic.

Poland's substantial fiscal buffers permitted a strong fiscal response to the crisis. Many of the initially broad-based measures were extended with greater targeting to support sectors most impacted by later waves of the pandemic. Driven by strong revenue growth associated with the economic recovery and a lower level of pandemic-related fiscal support, the general government deficit is estimated to have declined from 7.1 percent of GDP in 2020 to 2.9 percent of GDP in 2021, with general government debt decreasing slightly to 56 percent of GDP. Over the medium term, the general government deficit is projected to stabilize around 2½ percent of GDP, with debt stable around 50 percent of GDP.

Inflation has increased substantially in 2021, primarily driven by external factors, including energy prices, though core inflation has also increased in recent months and become broader based. After easing monetary policy aggressively at the start of the pandemic, the central bank has pivoted to tightening. Headline inflation is projected to remain elevated in 2022, primarily driven by energy price increases, with inflation falling within the target tolerance range by the end of 2023, assuming some further monetary policy tightening in response to emerging capacity constraints and strengthening wages.

Bank asset quality has remained stable during the pandemic, permitting a gradual removal of pandemic-related regulatory relief. Non-performing loan ratios have been broadly stable, and loan performance has not deteriorated even after the end of pandemic payment holiday schemes. Capital adequacy remains significantly above minimum levels. The legal risks stemming from foreign-currency denominated mortgages remain a source of uncertainty and potential losses for banks.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for the effective policy support during the pandemic, which will help minimize medium-term scarring. Given the strength of the recovery and inflation prospects, Directors welcomed the shift of policy focus from broad emergency responses. They recommended extending targeted support if the recovery weakens. They also encouraged continued efforts to increase vaccination coverage.

Directors considered that, given robust private demand, fiscal policy should avoid an expansionary stance and aim at rebuilding buffers. In this context, they stressed the importance of enhancing expenditure policies and transparency, including by phasing out off-budget support and improving the targeting of social benefits to shield low-income households from inflation. They also recommended offsetting revenue losses from the tax reform with savings elsewhere in the budget. Directors encouraged a moderate reduction of the fiscal deficit over the medium term to replenish policy space.

Directors supported the ongoing tightening of monetary policy, noting that further rate increases could be necessary to drive inflation back to the target and stave off overheating. They encouraged the central bank to retain flexibility, taking into account evolving economic conditions and communicating its policy decisions clearly. Directors welcomed the end of the asset purchase program consistent with the shift in monetary policy.

Directors noted that the banking sector remained sound through the pandemic, and welcomed the gradual phase-out of crisis-related measures. Given the legal risks surrounding foreign currency denominated mortgages, Directors welcomed the voluntary restructuring of these loans by banks. They recommended close monitoring of housing market conditions and continued efforts to enhance the oversight of virtual currency trade.

Directors underscored the importance of addressing labor shortages and promoting green and digital transformation, supported by an enhanced public investment framework and EU funds. Active labor market policies, especially those focused on upskilling the labor force, will help workers move to expanding activities and increase labor participation. Directors welcomed the authorities’ intention to gradually reduce the country’s reliance on coal and increase the use of renewables. In this context, they saw value in developing a long-term investment financing strategy, possibly including consideration of carbon taxation to reinforce incentives for emissions reduction.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

Table 1. Poland: Selected Economic Indicators, 2020–26

	2020	2021	2022	2023	2024	2025	2026
		Est.	Projections				
Activity and Prices							
GDP (change in percent) 1/	-2.5	5.4	4.6	3.7	3.0	3.0	3.0
Output gap (percent of potential GDP)	-2.9	-0.6	0.6	0.7	0.3	0.1	0.0
CPI inflation (percent)							
Average	3.4	3.4	5.1	7.4	5.1	3.1	2.9
End of period	2.4	2.4	8.6	6.3	3.3	3.0	2.7
Unemployment rate (average, according to LFS)	3.2	3.5	3.3	3.0	3.0	3.0	3.0
Public Finances (percent of GDP) 2/							
General government net lending/borrowing	-7.1	-2.9	-3.1	-2.5	-2.6	-2.6	-2.6
General government cyclically adjusted overall balance	-5.6	-2.6	-3.4	-2.9	-2.8	-2.6	-2.6
General government primary balance	-5.8	-1.8	-1.9	-1.2	-1.3	-1.2	-1.2
General government debt	57.4	56.2	52.1	49.8	49.7	49.5	49.6
Balance of Payments							
Current account balance, percent of GDP	2.9	-0.3	-0.5	-0.9	-1.0	-1.0	-1.0
Total external debt, percent of GDP	62.9	61.6	56.7	53.4	50.7	47.9	45.3
Memorandum item:							
Nominal GDP (billion zloty)	2326.7	2590.2	2886.6	3115.9	3307.5	3504.4	3700.5

Sources: Polish authorities; and IMF staff calculations.

1/ Real GDP according to 2015 base year. Based on data through January 19, 2022.

2/ According to ESA2010.

INTERNATIONAL MONETARY FUND

REPUBLIC OF POLAND

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

February 1, 2022

KEY ISSUES

Background: The Polish economy has rebounded strongly, with policy actions limiting the damage from the pandemic-induced recession by supporting employment and avoiding unnecessary bankruptcies. While the pandemic continues to take a toll on lives, the economy has been less impacted by successive waves of the pandemic.

Outlook and risks: The robust economic expansion is projected to continue in 2022–23, with inflation remaining high in the near term. Policies must navigate the risks from the pandemic against the countervailing risk of overheating as output moves above potential. The continuation of disputes with the EU risks delays in investments.

Policy Recommendations

Fiscal policy: An expansionary fiscal stance should be avoided in the context of overheating risks, calling for the fiscal impact of the tax reform to be offset elsewhere in the budget. However, the extension of targeted fiscal support would be appropriate should the pandemic again significantly disrupt economic activity. Some additional deficit reduction over the medium term would be appropriate to rebuild fiscal buffers.

Monetary policy: The central bank should continue to tighten monetary policy to drive inflation back to the target. The conclusion of asset purchases is consistent with monetary tightening, and this instrument should be reserved to periods of disorderly market conditions.

Financial sector policy: With the banking sector remaining stable through the pandemic and sound asset quality and capital levels, the ongoing gradual phase out of crisis-related financial sector measures is appropriate. Legal risks of foreign exchange mortgages are the main source of risk to the banking system. Banks should proactively seek to reach voluntary restructuring agreements with clients, supported by supervisory policy initiatives.

Structural policies: To bolster long-term growth and convergence, the authorities should strengthen active labor market policies, outline a strategy for the financing of the energy transition, and improve central coordination of public investment.

Approved by
Jörg Decressin (EUR) and Kristina Kostial (SPR)

Discussions were held remotely on November 29–December 13, 2021. The team comprised Alfredo Cuevas (head), Karim Foda, William Lindquist, and Marzie Taheri Sanjani (all EUR). Nadeem Ilahi (Senior Resident Representative) and Robert Sierhej and Krzysztof Krogulski (both Resident Representative Office) also participated in the discussions. Messrs. Trabinski (Executive Director) and Piasecki (Advisor to Executive Director) also joined the mission. The mission met with senior officials from the government, central bank, and financial supervision agency, along with representatives of trade unions, businesses, and financial institutions. Rafaela Jarin (EUR) provided administrative support, while Shituo Sun and Sadhna Naik (both EUR) provided analytical support.

CONTENTS

TABLES

ANNEXES

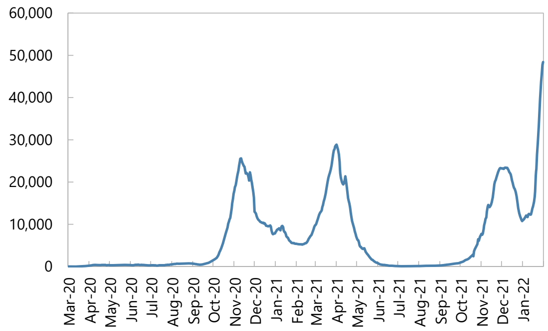
CONTEXT

1. **Poland has been enduring another difficult pandemic winter.** After COVID-19 cases declined to low levels during the summer, permitting the easing of most mobility restrictions, cases increased again in the fall, peaking in December at a similar level to earlier waves, with similar levels of hospitalization and deaths (Figure 1). The Omicron variant is leading a new surge in early 2022. The authorities modestly tightened mobility restrictions in mid-December, targeted at unvaccinated persons. At 57 percent of the population, the vaccination rate lags behind the EU average (Figure 2). The authorities have mandated vaccination for health workers and are considering mandates for the military and teachers.

Figure 1. Poland: COVID-19 Indicators

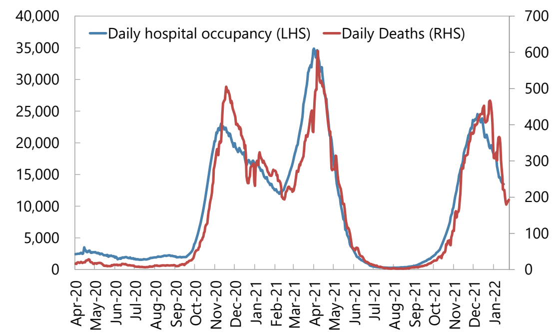
A fourth wave peaked in early December, and the Omicron variant is leading a new surge in early 2022.

New COVID-19 Cases
(7-day average)



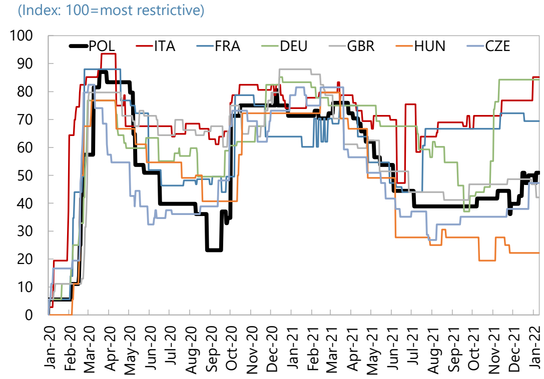
The fourth wave was accompanied by a sharp increase in hospitalizations and deaths.

COVID-19 Hospitalizations and Death
(7-day moving average for death)



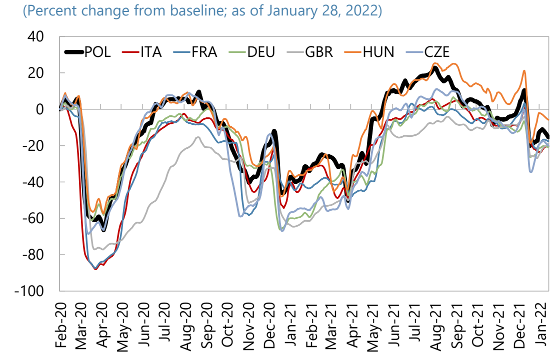
Mobility restrictions remain much lower than during earlier waves of the pandemic…

Covid-19 Government Response Stringency Index
(Index: 100=most restrictive)



…and mobility has similarly declined only modestly.

Retail and Recreation Mobility
(Percent change from baseline; as of January 28, 2022)



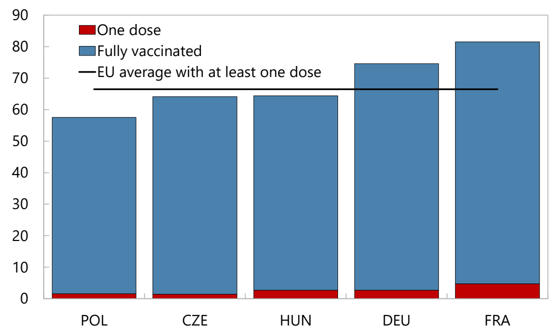
Sources: Bloomberg; European Centre for Disease Prevention and Control; Blavatnik School of Government at University of Oxford; Google; and IMF staff calculations.

Figure 2. Poland: Trends in COVID-19 Vaccination

Poland's vaccination rate lags the EU average….

COVID-19 Vaccination Rates, Selected EU Countries

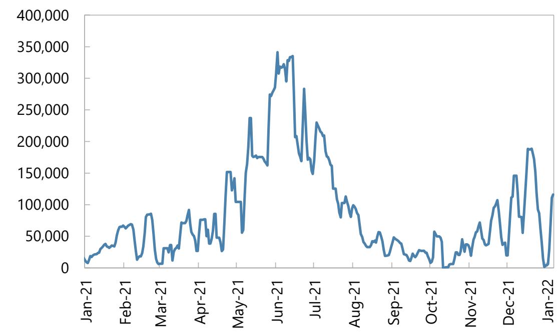
(Percentage of population; as of January 10, 2022)



…and the recent increase in vaccinations owes more to boosters and child eligibility than new adult vaccinations.

Daily COVID-19 Vaccinations Administered in Poland

(7-day moving average)



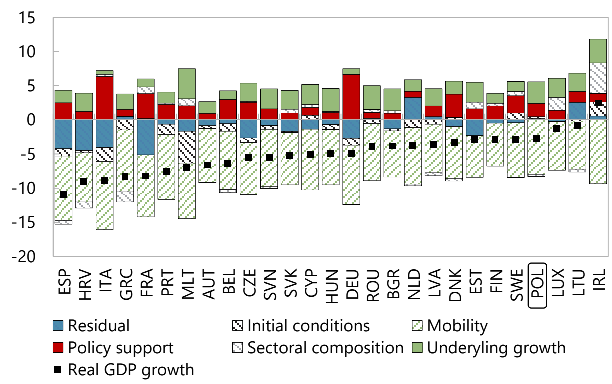
Sources: Our World in Data; and IMF staff calculations.

RECENT ECONOMIC DEVELOPMENTS

2. **Strong policy support bolstered the Polish economy in 2020.** The economy contracted 2.5 percent in 2020, much less than the EU-wide 6 percent contraction. Poland's favorable performance appears linked to its higher rate of underlying growth and to policy support. In addition to monetary easing, a favorable fiscal situation provided scope for a large fiscal response, with some 4 percent of GDP in above-the-line measures implemented. In view of the ongoing recovery, fiscal policy support has been largely phased out.

EU-27: Decomposition of Real GDP Growth, 2020

(Percentage points)



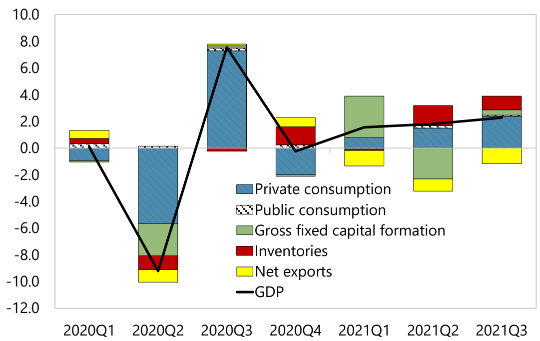
Source: October 2021 European Deaprtment Regional Economic Outlook

3. **The economy rebounded strongly in 2021.** Output recovered in Q1–Q3:2021, led by private consumption as the second and third waves receded, and the level of pre-pandemic output was surpassed in Q2 (Figure 3). The economy has been less impacted by successive pandemic waves as consumers and producers have adapted. Although supply chain issues at times affected the automotive industry, Poland's diversified industrial base has diluted its impact. Construction has lagged, reflecting a lull between cycles of EU capital transfers. High frequency data suggest that strong economic growth continued in Q4:2021.

Figure 3. Poland: Economic Activity Indicators

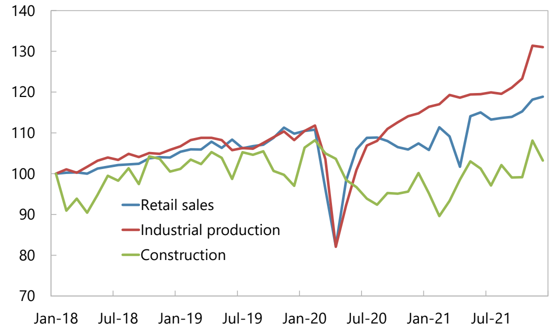
Output rebounded strongly in 2021 after a small decline in Q4:2020…

Poland: Contributions to Quarterly GDP Growth
(Quarter-on-quarter, SA; based on 2015 constant prices)



…supported by strong recoveries in industrial production and retail sales of goods.

Monthly Activity Indicators
(Index: January 2018 = 100; seasonally adjusted)



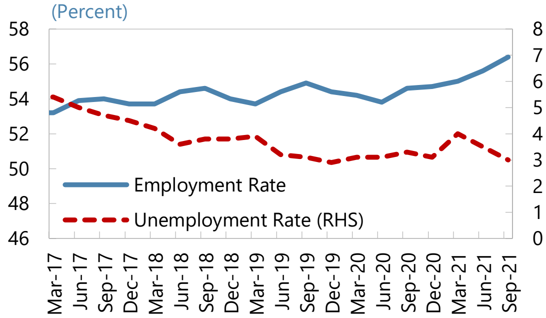
Sources: Statistics Poland; and IMF staff calculations.

4. **Significant policy support cushioned the impact of the pandemic on labor markets.** After a moderate reduction in employment and participation in 2020, labor markets have returned to pre-pandemic tightness (see Annex III). The unemployment rate has remained broadly stable between 3.0 and 4.0 percent despite the expiration of pandemic aid requirements to maintain employment. Still, employment losses persist in contact-intensive sectors. At around 9 percent year-on-year, average wages are currently increasing somewhat above the pre-pandemic trend (Figure 4). Levels of poverty and inequality have declined in Poland in recent years, but the impact of the pandemic is not fully known yet (Annex IV).

Figure 4. Poland: Labor Market Developments

The unemployment rate has remained relatively stable….

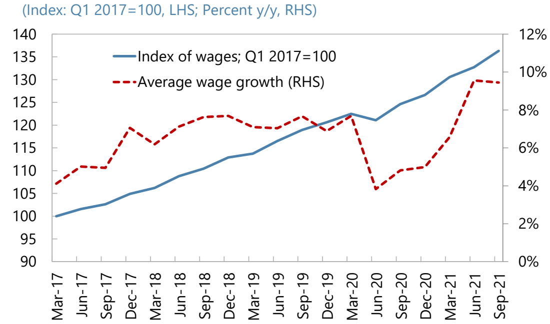
Employment and Unemployment Rates 1/
(Percent)



1/ A series break in Q1 2021 makes the increase in the unemployment rate difficult to interpret.

…while wage growth appears to have returned to the pre-pandemic trend.

Average Wage Growth 1/
(Index: Q1 2017=100, LHS; Percent y/y, RHS)



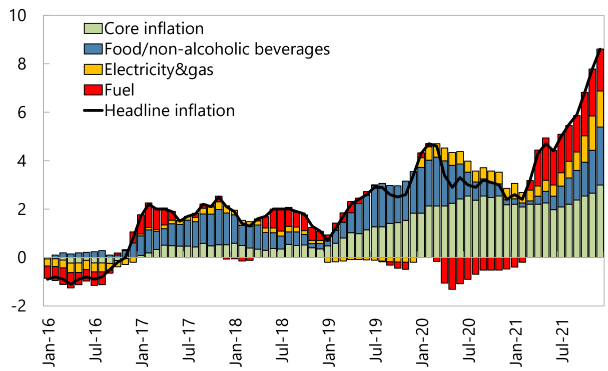
1/ The acceleration of average wage growth to nearly 10 percent y/y in Q2 2021 owes to base effects from the decline in the average wage in 2020.

Sources: Statistics Poland; and IMF staff calculations.

5. Headline inflation accelerated significantly in 2021. Rising global oil prices, combined with increases in food prices and electricity/gas, have led headline inflation to surge from 2.4 percent at the end of 2020 to 8.6 percent in December, well above the target (2.5 percent ± 1 percent). Core inflation (CPI excluding food and energy), which began to rise in 2019 alongside labor market tightness and some administered price increases, averaged 4.1 percent in 2021. While on average close to the level in 2020, core inflation trended upwards in H2:2021.

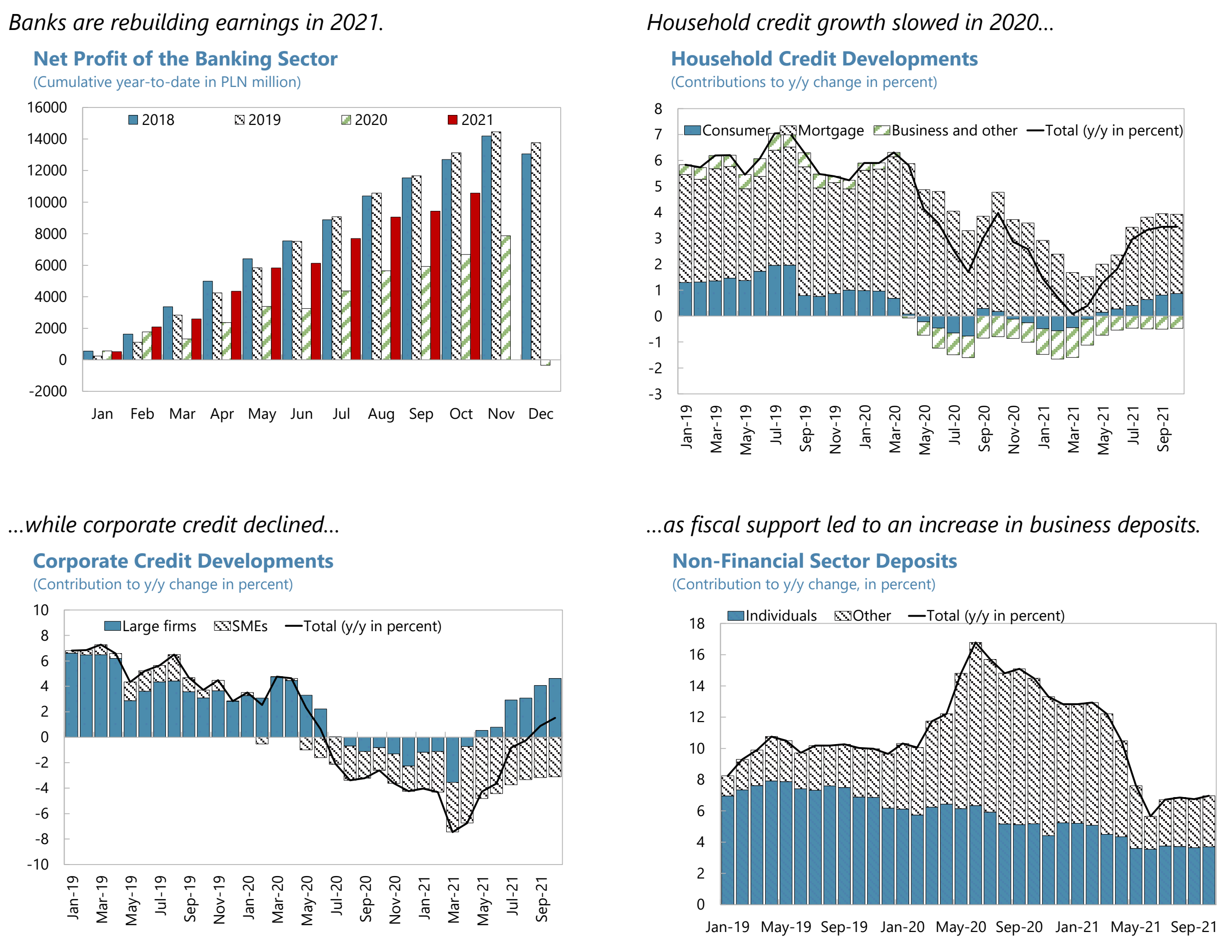
Contributions to Headline CPI Inflation

(Percent, year-on-year)



Sources: Statistics Poland; NBP; and IMF staff calculations.

Figure 5. Poland: Banking Sector Indicators

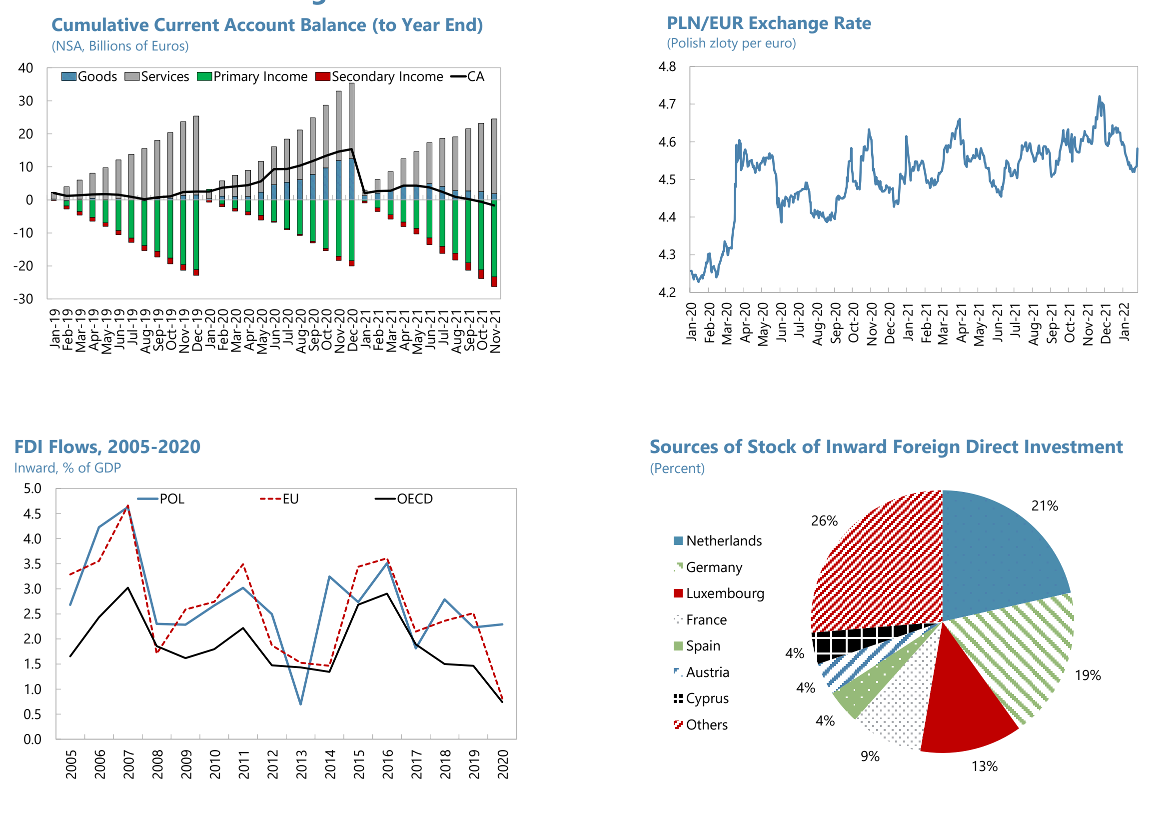


Sources: NBP; and IMF staff calculations.

6. The banking sector has remained stable. Lending to the non-financial sector declined 1 percent in 2020. Demand for credit weakened, particularly from the corporate sector, which benefited from liquidity loans as part of the pandemic response, while banks initially tightened lending conditions. Due to lower interest income, asset repricing, and larger provisioning, profits declined in 2020. Profits would have been about half 2019 levels but were erased by a large reserve for restructuring of foreign exchange mortgages created by the largest bank. Earnings are recovering in 2021 (Figure 5). At end-2020, the authorities smoothly resolved a small undercapitalized commercial bank, whose weakness pre-dated the pandemic.

7. The current account moved into deficit in 2021 as the economy recovered. Goods imports increased, driven by recovering domestic demand and high energy prices, while export growth slowed due to supply chain issues (Figure 6). The primary income deficit rebounded as the profitability of foreign companies improved. After the large recession-driven surplus of 2.9 percent of GDP in 2020, the current account is projected to return to a deficit of 0.3 percent of GDP in 2021, the first deficit since 2018. Inward FDI has remained strong, despite the pandemic.[1] The Polish zloty depreciated 2.7 percent on average against the euro in 2021, while the REER was stable on average through November relative to 2020 average.

Figure 6. Poland: External Sector Indicators



Sources: NBP; Haver; OECD; IMF Coordinated Direct Investment Survey; and IMF staff calculations.

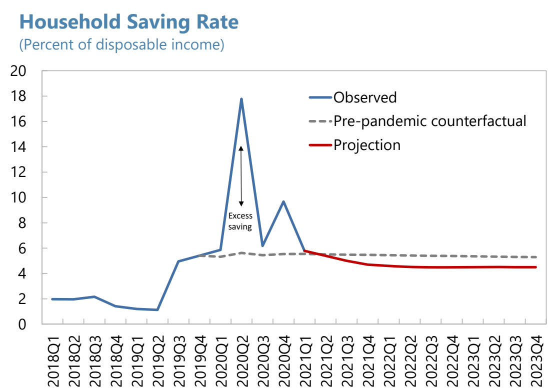
[1] An amendment to the law on FDI screening was adopted in June 2020 that for 24 months expands the scope of screening of investment in Polish companies by investors outside the EU/EEA/OECD.

OUTLOOK AND RISKS

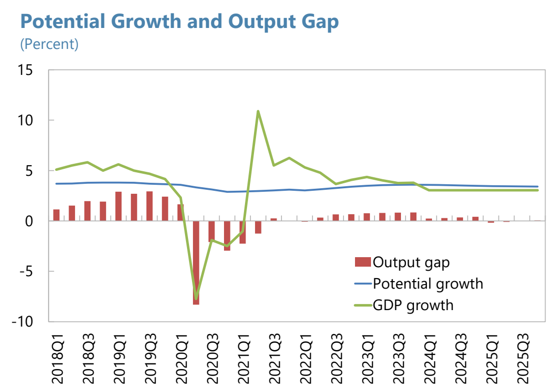
8. **Economic growth is projected to remain strong in 2022, and inflation will remain elevated in the near term.** Growth is estimated at 5.4 percent in 2021, with robust growth continuing in Q4 despite the fourth wave.[2] Growth in 2022 is projected at 4.6 percent, with quarterly growth rates accelerating following an anticipated Omicron-induced slowdown during the winter. Private consumption will continue to drive the recovery, supported by a robust labor market and strong household balance sheets. Investment is also projected to strengthen in 2022, as survey data suggest that corporates remain optimistic about new investments, while the assumed start of Next Generation EU expenditures would provide a boost to public investment. The output gap is projected to close in 2022. Recent increases to gas and electricity prices are projected to drive a further acceleration in headline inflation, projected to average 7.4 percent in 2022.

Figure 7. Poland: Economic Growth Outlook

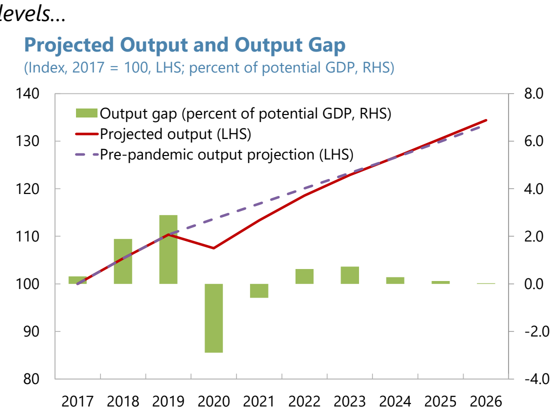
The household saving rate has quickly normalized....



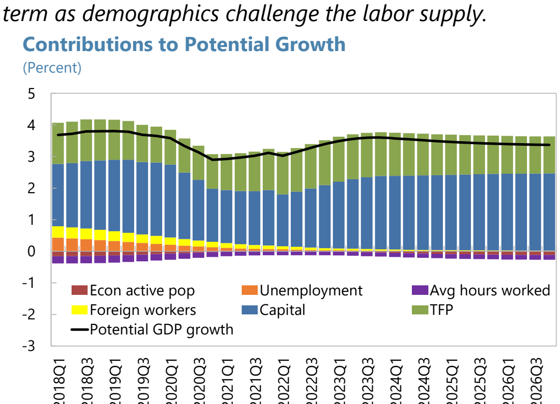
...contributing to a rapid closure of the output gap.



Output is projected to recover to pre-pandemic projected levels...



...though potential growth will decline over the medium term as demographics challenge the labor supply.



Sources: Eurostat; Statistics Poland; and IMF staff calculations and projections.

[2] The Staff Report includes data available until January 19, 2022. According to the preliminary estimate released on January 31, real GDP grew 5.7 percent in 2021.

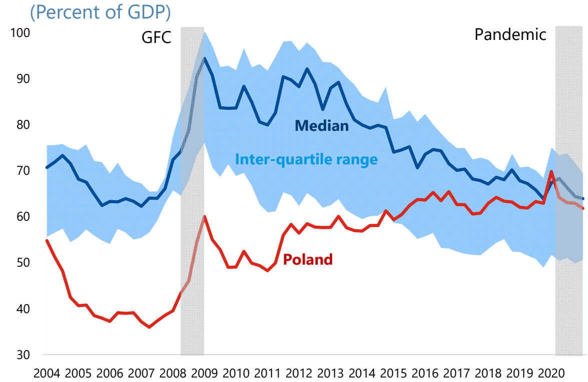
9. Economic growth is projected to average 3¼ percent over 2023–26, with minimal scarring from the pandemic. The level of output is projected to converge to pre-pandemic projections in 2024 (Figure 7).[3] Given unfavorable demographic trends, potential growth in the medium term will be largely driven by investment and productivity growth. Investment financed by Next Generation EU grants is projected to raise the level of output by nearly 1 percent by 2025, and strong non-financial corporate balance sheets should support private investment (Figure 8).

10. The current account deficit is projected to increase over the medium term as domestic demand outpaces growth in trading partners. The estimated current account deficit of 0.3 percent of GDP in 2021 is preliminarily assessed to be moderately stronger than implied by medium-term fundamentals and desirable policies (Annex IX). Over the medium term, the current account deficit is projected to increase to 1 percent of GDP, driven by the return of a deficit in trade in goods. At about 154 percent of the Fund's ARA metric, the level of gross reserves is adequate. (SDR holdings are included in the central bank's gross reserves.)

Figure 8. Poland: Non-Financial Corporate and Household Balance Sheets

Leverage in Polish firms is moderate and did not increase during the pandemic….

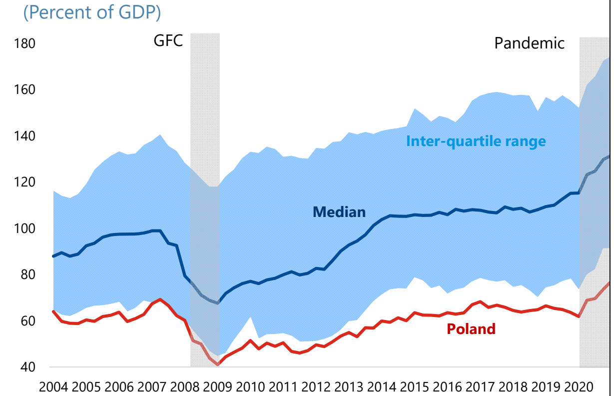
NFC Leverage in the EU
(Percent of GDP)



*Leverage = Debt as a share of equity liabilities

…while household net worth strengthened.

Household Financial Net Worth in the EU
(Percent of GDP)



*Net Worth = Financial assets - financial liabilities

Sources: ECB; and IMF staff calculations.

11. Uncertainty about the outlook is considerable, with near-term risks raising policy tradeoffs. While the baseline considers only a moderate decline in economic growth over the winter, a new wave—possibly driven by new variants—could disrupt the economy. An intensification of supply chain disruptions could constrain economic growth. Continued supply disruptions, energy price increases, and the entrenchment of higher inflation expectations in wage formation would also prolong the period of elevated inflation. The dispute with the EU on rule of law issues risks a further delay of the disbursement of Next Generation EU funds, affecting the outlook for investment. The materialization of geopolitical risks in Eastern Europe may bring economic spillovers to Poland. Over

[3] See Selected Issues Paper "Post-Pandemic Potential Output and Scarring" for further discussion.

the medium term, potential growth could disappoint if TFP growth fails to return to pre-pandemic rates. On the other hand, growth could outperform the baseline if households spend excess savings, possibly accompanied by overheating.

Authorities' Views

12. The authorities broadly agreed with staff's baseline scenario and balance of risks. The Ministry of Finance and National Bank of Poland (NBP) broadly agreed with staff's economic growth projections, though the NBP, as detailed in the November Inflation Report, projected faster growth at 4.9 percent in 2023 (under an assumption of constant policy interest rates). The authorities pointed to the future course of the pandemic, supply bottlenecks, and the impact of inflation on real income growth as key risks, while noting that they continue to work with the EU on their approval of the National Recovery Plan. The authorities anticipated that potential growth over the medium term would remain similar to pre-pandemic rates, around 3¾ percent, and agreed that scarring from the pandemic would be minimal. While the authorities agreed that the current account would likely remain in deficit over the medium term, they noted that Poland's external financing needs would be close to zero, considering anticipated capital account surpluses supported by EU capital transfers.

POLICY DISCUSSIONS

Discussions focused on two main themes: (1) completing the transition away from extraordinary policy support; and (2) structural policies to support the next wave of growth and convergence.

Transition from Extraordinary Policy Support

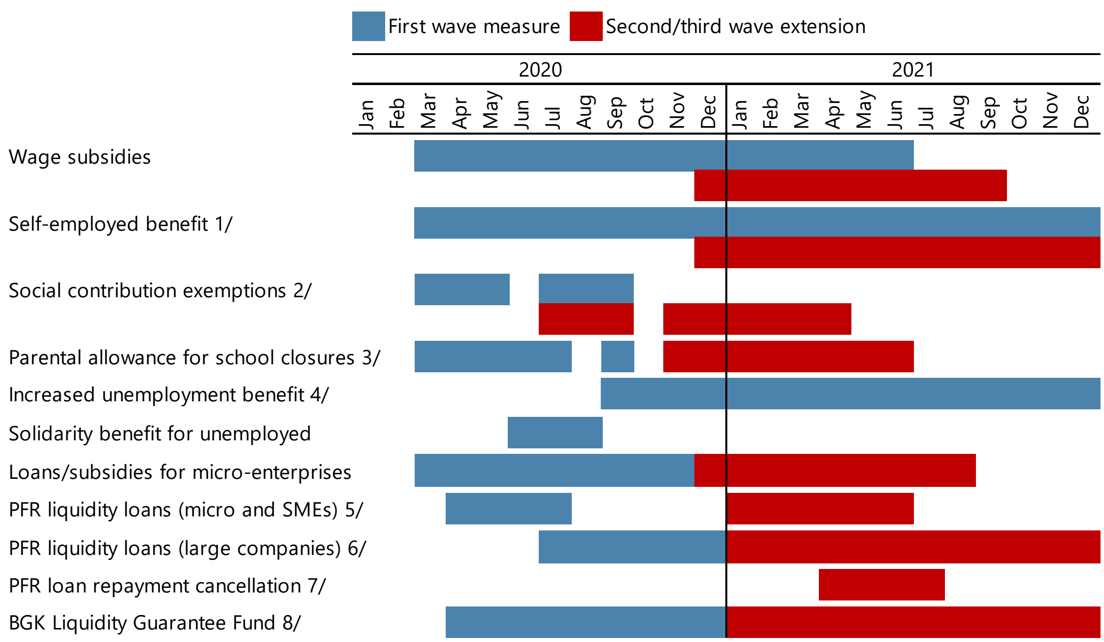
13. Upside and downside risks make the transition from policy support a delicate exercise. The baseline scenario of a strong domestic demand-led expansion calls for continuing the phase out of policy support while avoiding expansionary policies. While upside risks could lead to overheating, policymakers must also evaluate the risk of disruptions from the pandemic. Fiscal and monetary policies' have natural assignments should these risks materialize. Renewed targeted fiscal support would be the appropriate response to pandemic risks, while monetary policy tightening can primarily address overheating risks.

Fiscal Policies

14. Fiscal support appropriately became more targeted as the pandemic evolved. Policies focused on preserving jobs and incomes through wage subsidies and worker benefits. Companies were offered liquidity loans, eligible for partial forgiveness. Most measures were extended for the second/third waves, though with greater targeting (Table 1). Above the line, these measures totaled 4.4 percent of GDP in 2020 and an estimated 1.4 percent of GDP in 2021 (Table 2). Support for businesses had been mostly phased out by Q3:2021, with some targeted help for workers still in effect in Q4. The authorities have not extended support programs further during the fourth wave. While the implementation of fiscal support measures through off-budget funds (some 2 percent of GDP in 2021) was a reasonable workaround for domestic debt limits in a crisis situation, the authorities should avoid additional off-budget expenditure and allow the pandemic-related off-budget fund to wind down over time to prevent a further deterioration in fiscal transparency.

15. Substantial fiscal space exists to reintroduce targeted support, if needed. Driven by a strong recovery of tax revenues and reduced emergency support, the general government fiscal deficit is estimated to have declined in 2021 to 2.9 percent of GDP from 7.1 percent of GDP in 2020. General government debt is estimated to have declined 1 p.p. to 56 percent of GDP in 2021.

Table 1. Poland: Timeline for Duration of "Anti-Crisis Shield" Fiscal Measures



1/ Applications are allowed until three months after the state of epidemic has been lifted. The government has not yet declared an end to the state of epidemic.
2/ Exemptions for social contributions extended to April 2021, with applications to be submitted by end-June 2021.
3/ Parental allowance was extended until end-June 2021, but most payments ended after April 2021, when schools generally reopened.
4/ Unemployment benefit increased 35 percent in late 2020. This measure is permanent.
5/ PFR liquidity loan applications (micro and SMEs) must have been filed by end-July 2020. Program extended for second/third waves for companies in targeted sectors. Applications could be filed by end-June 2021.
6/ Applications for large companies are due by end-December 2021 and loans may be paid until end-Q1 2022.
7/ Repayable portion of PFR liquidity loan fully cancelled for micro and SMEs in targeted sectors, subject to cumulative decline in revenues from March 2020-March 2021 of at least 30 percent.
8/ Liquidity guarantee program was extended until December 2021.

Source: Government of Poland; Ministry of Finance.

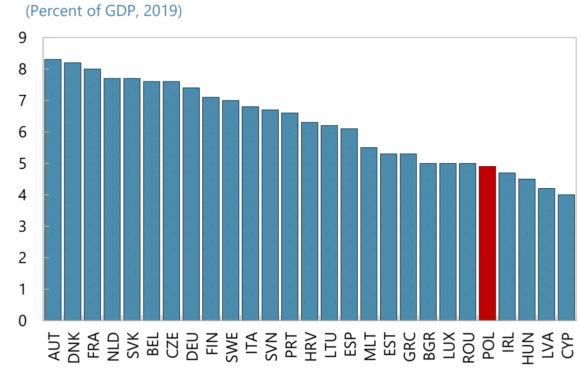
Table 2. Poland: Estimated Impact of COVID-19 Fiscal Measures on General Government Net Lending/Borrowing

	PLN billion		*Percent of GDP*	
	2020	2021	2020	2021
Subsidies	75.5	19.9	3.2	0.8
Wage subsidies for firms	15.3	5.8	0.7	0.2
Wage benefit for self-employed and civil law contracts	5.8	1.6	0.2	0.1
Exemption from social security and health contributions	13.4	3.0	0.6	0.1
PFR loan write-offs	41.0	9.5	1.8	0.4
Social benefits	5.3	4.8	0.2	0.2
Child-care benefits	2.6	1.5	0.1	0.1
Tourist vouchers	0.2	1.5	0.0	0.1
"Solidarity Allowance" and other social benefits	2.5	1.8	0.1	0.1
Other current transfers	13.3	10.1	0.6	0.4
Support for health care	4.6	10.1	0.2	0.4
Other spending	8.7		0.4	0.0
Capital transfers	9.0	0.5	0.4	0.0
Subsidies for micro and small firms	9.0	0.5	0.4	0.0
Total	103.1	35.3	4.4	1.4

Sources: Ministry of Finance; and IMF staff estimates.

16. The authorities have implemented safeguards to combat waste and fraud in pandemic support programs. The largest program has been liquidity loans granted to 350,000 corporates. SMEs were the main beneficiaries, and about 100 large companies benefited too. Social security and tax administration data verified that companies existed pre-pandemic (about 10 percent of applications were rejected, usually due to tax or social security arrears). Through ex-post analysis, the Anti-Corruption Office detected possible fraud in under 1 percent of loans, which are being followed up. Loans were distributed through banks, with usual AML procedures in place. Loan beneficiaries could not be domiciled in countries on the EU tax haven list.

General Government Health Expenditures
(Percent of GDP, 2019)



Sources: Eurostat.

17. Looking beyond the pandemic, the authorities will implement the "Polish Deal" economic program beginning in 2022. The program includes a personal income tax (PIT) reform while also calling for increases in health care spending around 2 p.p. to 7 percent of GDP, housing affordability, and investment. The PIT reform will increase the standard deduction and the threshold income for the second tax bracket, while reducing the deductibility of health contributions. The reform is estimated to reduce the labor tax wedge for low wage earners while increasing the wedge for high earners, increasing progressivity. However, on net, the reform will lower revenues. The tax reform is projected to increase the general government deficit by about 1 p.p. of GDP beginning in 2022.

Table 3. Poland: Summary of "Anti-Inflation Shield" Measures

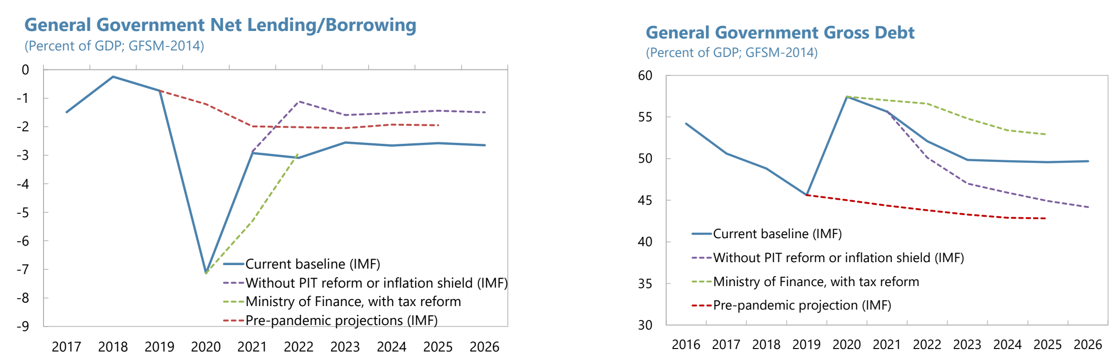
Summary of Anti-Inflation Shield Measures

Category/Action	Shield 1.0	Shield 2.0
Fuel	Excise taxes cut (Dec. 20 - May); retail turnover and emissions charges waived (Jan - May)	VAT reduced from 23 to 8 percent (Feb - July)
Electricity	Excise duty waived; VAT cut from 23 to 5 percent (Jan - March)	VAT to continue at 5 percent (April - July)
Natural gas	VAT cut from 23 to 8 percent (Jan - March)	VAT reduced to 0 percent (Feb - July)
Heating energy	VAT cut from 23 to 8 percent (Jan - March)	VAT reduced to 5 percent (Feb - July)
Vouchers	Payments to low-income households between PLN 200 and 1,100 per month	N.A.
Food		VAT reduced from 5 to 0 percent (Feb - July)
Fertilizers		VAT reduced to 0 percent (Feb - July)

Sources: Government of Poland

18. With the tax reform, the general government deficit is projected to stabilize at 2½ percent of GDP over the medium term. In 2022 the deficit will be temporarily increased by two "anti-inflation shields" consisting of VAT and excise reductions on energy and food and vouchers for low-income households (Table 3). These temporary shields are projected to cost about 0.8 percent of GDP in 2022, bringing the general government deficit to 3.1 percent of GDP. Absent the (permanent) PIT reform and anti-inflation shields, the general government deficit would be projected to decline to around 1.1 percent of GDP in 2022. In the medium term, the deficit is projected at 2½ percent of GDP, versus around 1½ percent of GDP without the PIT reform (Figure 9).

Figure 9. Poland: Medium-Term Fiscal Outlook



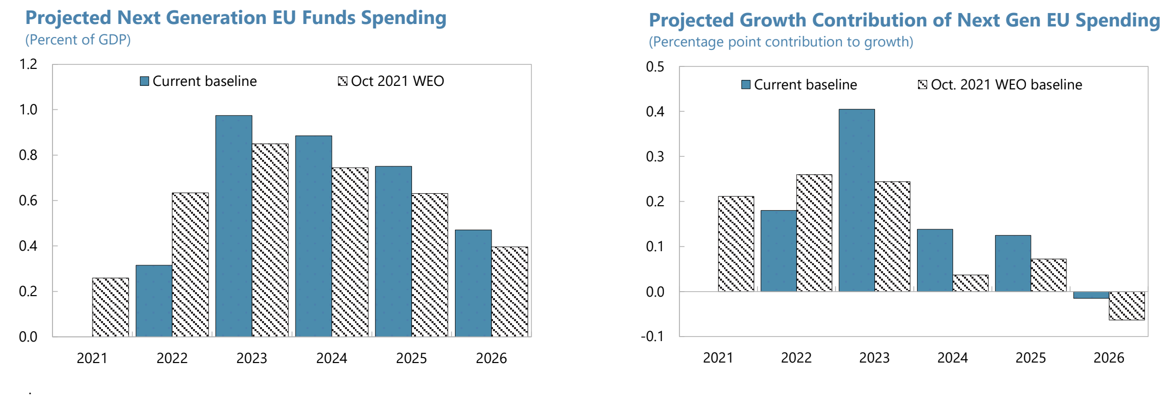
Sources: Ministry of Finance; and IMF staff projections.

19. Excluding variations in pandemic-related spending, a roughly neutral fiscal stance would be appropriate in 2022. This implies approximately a recommended deficit around 1½ percent of GDP versus the 3.1 percent of GDP projection. The expansionary nature of the PIT reform is thus inopportune in the context of overheating risks. While increased tax progressivity is a valuable goal, permanent expansionary fiscal measures should be offset elsewhere in the budget. If pandemic-related risks materialize, a temporary increase in the deficit in 2022 from additional targeted spending would be appropriate. While the tax reductions in the "anti-inflation shields" can provide some relief to households most affected by energy price inflation, they are inefficient and should be temporary, lest they mount in cost and come to be seen as a substitute for other policy adjustments to address inflation. Energy poverty risks are best addressed through targeted instruments such as the vouchers. The authorities should avoid increasing expenditures in 2022 in the context of a likely revenue windfall from the unexpectedly high inflation.

20. A modest further reduction in the general government deficit over the medium term would restore the ample policy room for maneuver from before the crisis, helping prepare for future challenges. General government debt is projected to stabilize around 50 percent of GDP over the medium term and is assessed to be sustainable, though it would increase steadily under various shocks (Annex VI), indicating limited robustness. Some additional reduction in the deficit towards the medium-term objective of 1 percent of GDP—similar to its pre-pandemic level—would create policy space to address future shocks and prepare for long-term fiscal pressures related to population aging and the energy transition. An improvement to expenditure policies, including by reversing the previous reduction in the pension age and better targeting of social benefits, could be considered for further deficit reduction.

21. Next Generation EU grants provide an opportunity to boost public investment and growth over the medium term. The authorities plan investments in green energy and efficiency, digital transformation, labor market resilience, mobility, and health care. Due to ongoing disputes with the EU on rule of law issues, however, the EC has not yet approved Poland's plan, delaying initial transfers. Poland stands to receive some 4.5 percent of 2020 GDP in grants, to be spent by 2026. Staff assumes that funds begin to flow in mid-2022, postponing the peak growth impact to 2023, when Next Generation EU spending is projected to add nearly 0.4 p.p. to growth (Figure 10). Given ample fiscal space, in the event of further delay, the authorities should consider financing key investments from budgetary resources, to be later reimbursed by the EU. While financing initial investments from own resources would temporarily increase the fiscal deficit, the additional expenditures would not generate significant demand pressure in the near term given the gradual ramping up of projects.

Figure 10. Poland: Next Generation EU



Sources: IMF staff projections.

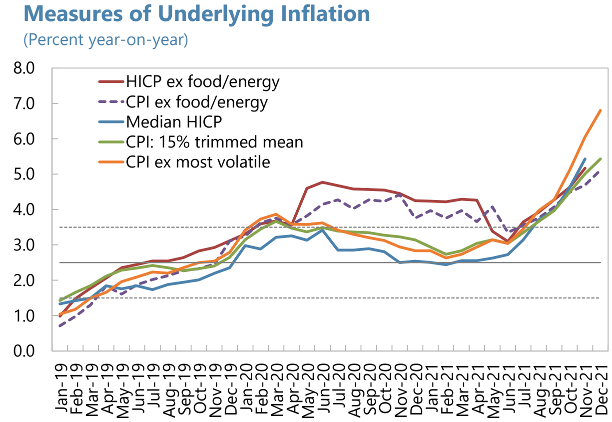
Authorities' Views

22. **The authorities stressed that the fiscal response had successfully shielded the economy from the pandemic and that PIT reform would increase tax progressivity.** They did not think that additional pandemic-related support was needed at this time. While their latest projections showed the general government deficit declining to 5.9 percent of GDP in 2021, the authorities expected the actual deficit to be much smaller. The authorities emphasized that the Polish Deal also contained incentives for innovation—such as corporate income tax allowances for R&D spending—and aimed to increase health spending. The Ministry of Finance noted that it had proposed a carveout for defense expenditures in future EU fiscal rules, expenditures which it viewed as geopolitically important. Discussions with the EC over the National Recovery Plan were ongoing at both technical and political levels, with hopes for a quick resolution. If approval is further delayed, the authorities would consider initially financing priority projects through budgetary resources.

Monetary and Exchange Rate Policies

23. **Inflationary pressures became broader based over 2021.** The significant divergence from mid-2020 to early 2021 between traditional measures of core inflation (CPI excluding food/energy) and median-based measures indicated an unusual prevalence of large, one-off price increases. The convergence of all these measures at an elevated level by the summer of 2021, however, suggests that underlying inflation pressures had become broader based. Core inflation increased by nearly 200 bps in

Measures of Underlying Inflation

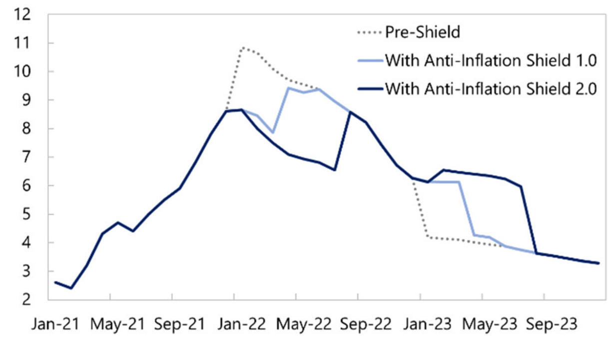


Sources: Eurostat; NBP; and IMF staff calculations.

H2:2021, reflecting a tightening labor market, buoyant demand, possible second-round effects from high energy prices, and some impact of supply chain disruptions.

24. "Anti-inflation shield" tax reductions will temporarily mitigate the impact of higher energy prices. A substantial step increase in regulated electricity and gas prices announced in December 2021 would have lifted headline inflation to over 10 percent in early 2022. However, the "anti-inflation shield" tax reductions are projected to lower fuels and food prices temporarily through July 2022 and delay large final price increases for gas and electricity until August 2022. Overall, these measures are projected to reduce headline 12-month inflation by 2.5 p.p. through July 2022 and 1.4 p.p. on average for the full year. The shields will result in a correspondingly higher rate of average inflation in 2023 through positive base effects (Table 4).

Headline Inflation: Impact of Anti-Inflation Shield
(Percent change y/y)



Sources: Statistics Poland; and IMF staff calculations.
Note: Anti-Inflation Shield 1.0 includes measures approved in December 2021. Anti-Inflation 2.0 includes additional measures approved in January 2022.

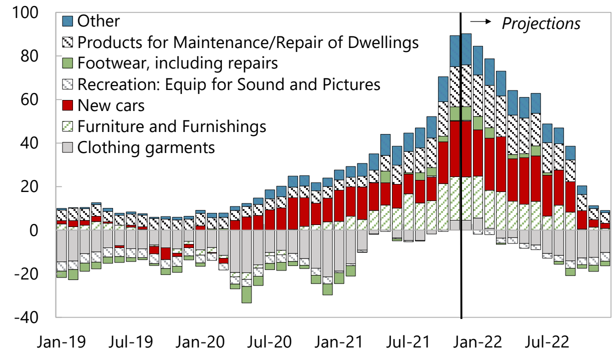
Table 4. Poland: Impact of Anti-Inflation Shield Measures on Average Headline Inflation
(Percentage point change relative to pre-Shield baseline)

	2022		2023	
	Shield 1.0	Shield 2.0	Shield 1.0	Shield 2.0
Headline	-0.5	-1.4	0.5	1.3
Fuels	-0.1	-0.2	0.1	0.2
Electricity & Gas	-0.4	-1.1	0.4	1.0
Food	-	-0.2	-	0.1

Source: IMF staff calculations
Note: Negative sign denotes percentage point reduction in average headline inflation. Positive sign denotes an increase. The impact of Shield 2.0 also includes the impact of Shield 1.0 measures.

25. Core inflation is projected to decline slowly, with 12-month headline inflation falling within the target tolerance range only at the end of 2023. Monetary policy tightening—including further tightening implied in market expectations—is projected to contribute to a gradual decline in core inflation, with a peak impact in 2023. A presumed normalization of supply chain disruptions in 2022 would also contribute to a decline in core inflation over the course of the year. While difficult to estimate precisely, the contribution of certain non-energy, non-food goods—many of which may have been subject to supply constraints—to core inflation increased considerably in 2021. These goods are estimated to have contributed around 45 bps to average core inflation in 2021, and nearly 90 bps at end-2021. Should price pressures in these categories subside in the first half of 2022 as supply constraints ease, the base effects would be disinflationary. Headline inflation is projected to average 7.4 percent in 2022 and 5.1 percent in 2023, falling within the target tolerance range by end-2023 at 3.3 percent. Core inflation is projected to average 4.9 percent in 2022 and 3.7 percent in 2023 (Figure 11). However, continued energy price pressures and the possibility of a wage-price spiral are clear risks.

HICP Core Inflation: Contributions of Non-Energy Goods
(Basis points)

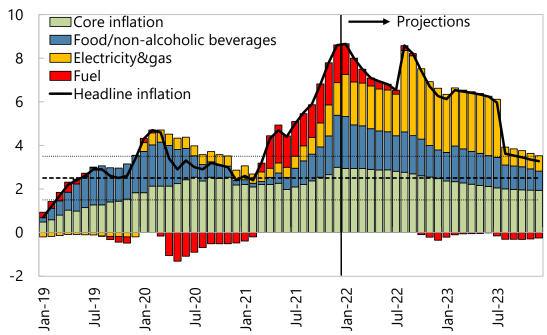


Sources: Eurostat; Haver; and IMF staff calculations
Note: "Other" includes transport spare parts, motorcycles & bicycles, and household utensils.

Figure 11. Poland: Inflation Developments and Outlook

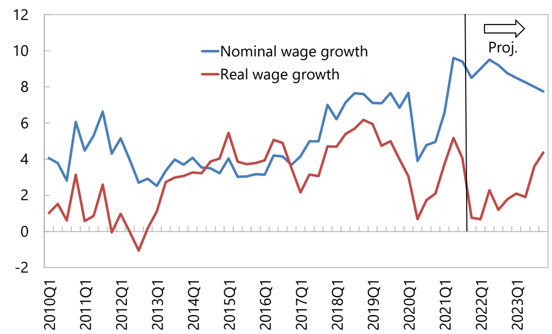
"Anti-inflation shield" tax cuts will produce a volatile path for headline inflation in 2022–23….

Contributions to Headline CPI Inflation
(Percent, year-on-year)



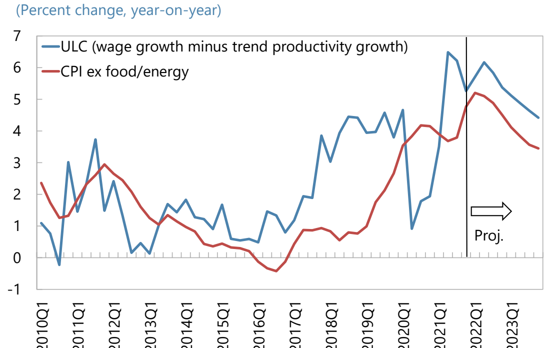
…while some projected slowdown in wage growth…

Average Wage Growth 1/
(Percent, year-on-year)



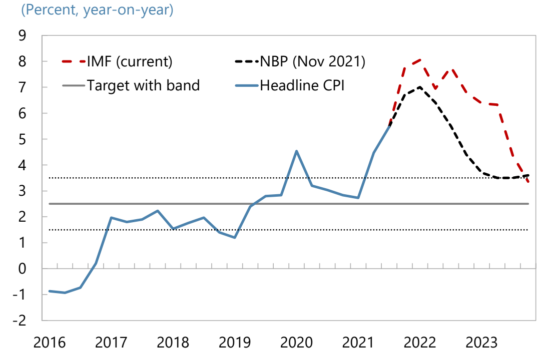
…and strong productivity growth contain ULC, contributing to a moderation of core inflation….

Core Inflation and Unit Labor Costs
(Percent change, year-on-year)



…and headline inflation returns within the target tolerance range by the end of 2023.

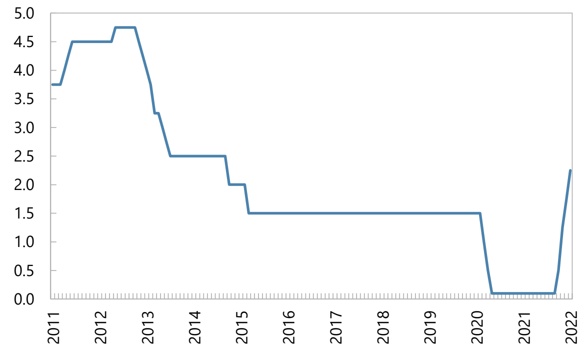
Headline CPI Inflation Projections 2/
(Percent, year-on-year)



1/ The spike is nominal wage growth in Q2:2021 is largely due to base effects and is not viewed as indicating the start of a wage-price spiral.
2/ NBP President Glapiński noted in late December 2021 that the NBP's projection for average inflation in 2022 had increased to 7.6 percent due to electricity/gas price increases, but further details are not yet available.
Sources: Statistics Poland; NBP; and IMF staff calculations and projections.

26. The NBP began tightening monetary policy last fall, starting a series of rate increases. The NBP had held the policy rate at 0.1 percent since May 2020 and until October 2021 had indicated that monetary policy tightening would be inappropriate in the context of externally driven price pressures. However, the NBP surprised markets with a 40 bps rate increase in October 2021, citing the increased risk of second-round effects from higher and persistent commodity prices. Three more rate increases followed, bringing the policy rate to 2.25 percent in January, above its pre-pandemic level. As of late January, markets were expecting a further 175 bps in tightening in 2022.

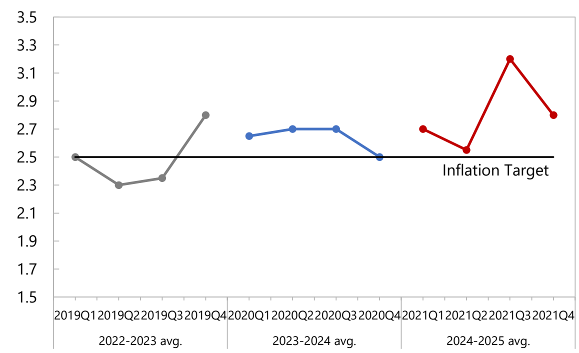
NBP Policy Rate
(Percent)



Sources: Haver; and National Bank of Poland

27. The NBP should continue to tighten monetary policies to drive inflation back to target. Though the acceleration in inflation has been largely driven by factors outside the control of monetary policy, their persistence risks intensifying second-round effects as output moves above potential. Further rate increases will be necessary to minimize second-round effects, counter overheating risks, and anchor medium-term expectations, which have risen markedly and remain above the inflation target.

Inflation Expectations, 3-4 Years Ahead
(Median of survey of professional forecasters, in percent)

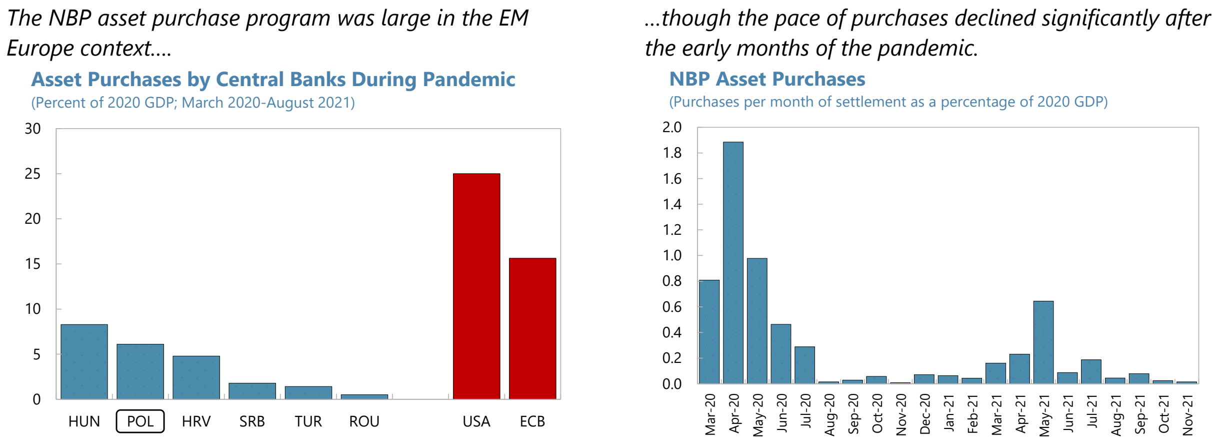


Source: NBP Survey of Professional Forecasters; and IMF staff calculations.

28. The timing and magnitude of future monetary policy decisions will need to consider evolving economic conditions, which pose upside and downside risks to the inflation outlook. Monetary policy decisions should aim to ensure that inflation moves with a high probability toward the target within the NBP's forecast horizon. On the upside, a faster normalization of prices for supply-constrained goods or a stronger reaction of core inflation to recent rate increases may warrant smaller future rate increases or an earlier pause in the tightening cycle. However, tightening may need to progress further if inflation pressures persist or intensify, including from stronger-than-expected wage dynamics or larger second round effects from increased energy tariffs. The high degree of uncertainty surrounding these drivers, including the persistence of supply side disruptions or the degree of second-round effects from energy inflation, underscores the importance of careful monitoring and clear communication.

29. The conclusion of regular asset purchases in November is welcome and consistent with monetary policy tightening. At about 6 percent of 2020 GDP, the NBP's asset purchase program (APP) was one of the largest in emerging markets.[4] Although on a small scale, bond purchases continued until November 2021, despite initial goals of relieving financial market dysfunction and supporting monetary policy transmission having long been met (Figure 12). Like foreign exchange intervention, asset purchases should be reserved to addressing disorderly market conditions. The NBP should provide timely guidance on its intentions regarding its bond portfolio as initial maturity dates approach. Should the NBP intervene in the foreign exchange market, it should publish the relevant data, in line with best practices.

Figure 12. Poland: Asset Purchase Program



Sources: NBP; Haver; IFS database; national central banks; and IMF staff calculations.

Authorities' Views

30. The NBP broadly agreed on the appropriateness of a tighter monetary policy stance but highlighted uncertainty around evolving economic conditions. The NBP cited an ongoing economic recovery, persistence of elevated commodity prices, and global supply chain disruptions as primary drivers of inflation in Poland. The Anti-Inflation Shield will help curb inflation in 2022, though favorable labor market conditions and the potential for lasting impacts of external shocks on price dynamics could maintain inflation above the target range in the medium term. In the November Inflation Report, the NBP projected inflation to average 5.8 percent in 2022 and 3.6 percent in 2023. In December, NBP President Glapiński publicly commented that NBP revised its 2022 inflation projection to 7.6 percent, including announced extensions of the Anti-Inflation Shield that were later approved in January. If current economic conditions persist, the NBP is therefore likely to raise rates further in 2022 to drive inflation back to target and anchor expectations. However, the NBP will consider rapidly changing conditions and heightened uncertainty in future decisions to ensure medium-term price stability while remaining

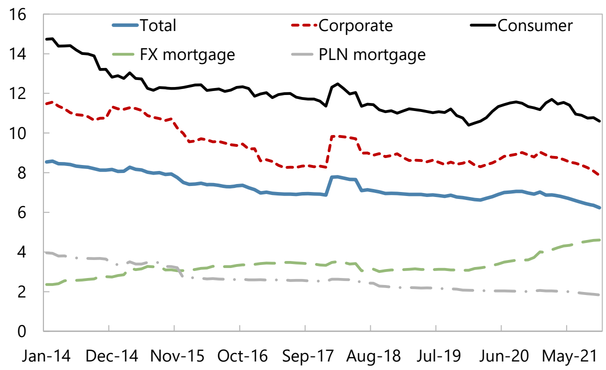
[4] See IMF European Departmental Paper "Asset Purchase Programs in European Emerging Markets" for a discussion of asset purchase programs in emerging European economies, including Poland, during the pandemic.

supportive of the economic recovery. The NBP noted that it reserved the option to intervene in the foreign exchange market and use other instruments envisaged in the Monetary Policy Guidelines, depending on market conditions.

Financial Sector Policies

31. Bank asset quality has remained stable. After increasing moderately in 2020. NPL ratios have been trending down gradually in 2021. Banks offered voluntary debt-service moratoria, and a mandatory scheme was legislated for persons who lost jobs during earlier waves of the pandemic. These programs were little used, however, as corporates and households benefited from fiscal support.

Non-Performing Loans
(Percent)

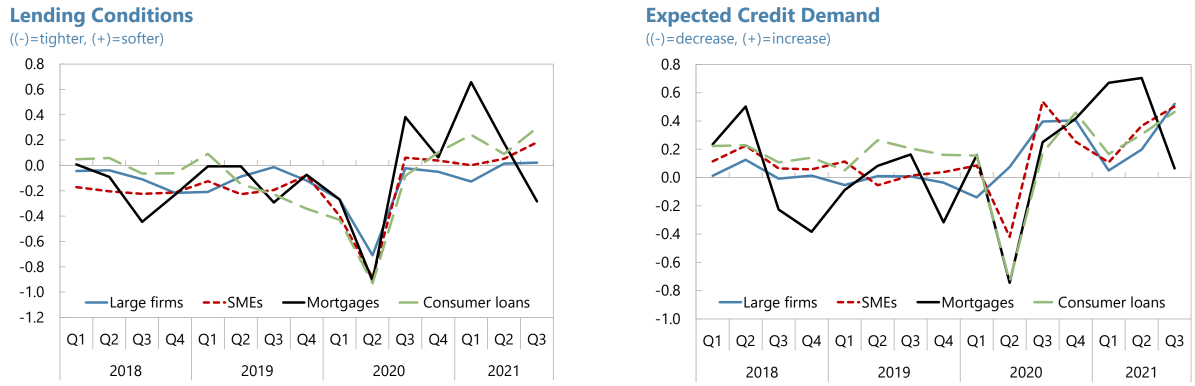


Source: NBP, based on national NPL definition.

Figure 13. Poland: NBP Loan Officer Survey

After tightening in 2020, lending conditions are loosening....

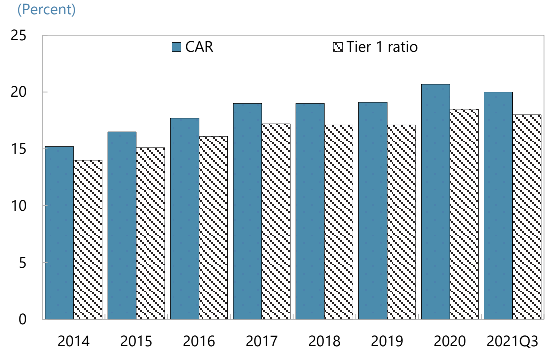
...while expected demand for credit is recovering.



Sources: NBP; and IMF staff calculations.

32. With banks well placed to support the recovery, crisis-related financial sector policies should be gradually normalized. Capital adequacy levels improved in 2020 to 20 percent of assets (versus the regulatory minimum of 10.5 percent), mainly due to retention of profits from previous years and increased holdings of zero risk-weighted government bonds. Crisis-related financial sector policies are being gradually normalized (Table 4). The 3 percent systemic risk capital buffer remains revoked, driven by concerns

Capital Adequacy of the Banking Sector
(Percent)



Source: NBP.

about the capital implications of FX mortgage legal risk. While lending conditions are loosening (Figure 13), the bank asset tax (which exempts Treasury securities) may at the margin deter credit allocation to the private sector and should be redesigned to reduce this disincentive.

33. The authorities' proposals to increase housing affordability should consider the impact on the housing market and financial stability. The housing market has returned to pre-pandemic robust conditions (Figure 14). The state development bank plans to offer partial mortgage guarantees in lieu of mortgage down payments to support applicants for smaller mortgage loans, which could increase demand for mortgage loans and fuel further price growth. Mortgages are mostly floating rate, boosting housing affordability during the recent time of extraordinarily low interest rates. However, households could become overstretched as interest rates normalize, risking a deterioration in credit quality. To mitigate these risks, it is important that banks continue conservative creditworthiness assessments in line with supervisory guidelines, including an LTV limit at 80 percent, stressed DSTI at 40–50 percent with an interest rate buffer of 250–300 bps, and loan maturities capped at 25 years. Early signals suggest increasing policy interest rates are likely to dampen demand for mortgage credit.

Table 5. Poland: Main Pandemic-Related Measures in Financial Sector

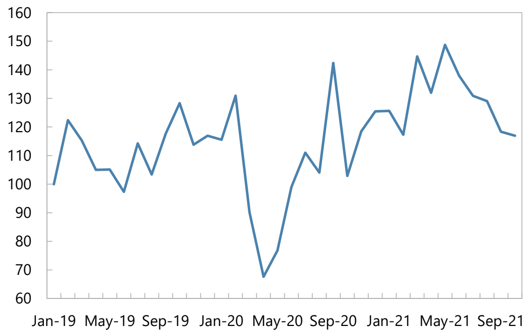
Measure	Current status
Reduced reserve requirements	**Partially reversed**. Reserve requirement was increased from 0.5 percent to 2.0 percent, effective November 30, 2021.
Repeal of systemic risk capital buffer	**Remains in place**. The 3 percent systemic risk buffer capital requirement remains repealed.
Restrictions on distribution of profits	**Partially reversed**. KNF allowed conditional payments of dividends in 2021, providing that suprevised entity meets a set of conditions related to capital adequacy and suprevisory review and evaluation.
Lower risk weights for loans collateralized by real estate	**Remains in place**. Risk weight for credit collateralized by commercial real estate remains reduced from 100 to 50 percent, providing that the business does not involve renting or sale of commercial real estate.
Longer deadline for MREL requirements	**Remains in place**: Revised MREL target dates have not been altered.
NBP asset purchase program	**Suspended**: Regular APP auctions have been suspended, effective from December 1, 2021; NBP maintains the option of returning to APP depending on market conditions.
Discount credit facility	**Discontinued**: There was no demand from banks for a program to refinance loans to firms, and NBP ended the program in October 2021.
Repo auctions	**Remains in place**: However, there has been no demand from banks since March 2020.
Credit moratoria	**Mostly reversed**: Following EBA guidelines, banks' moratoria were prolonged in subsequent waves of pandemic, with deadline set for March 2021. Mandatory moratoria remain in place, but with little use given strong labor market.
Credit guarantees	**Remains in place**: BGK gurantee schemes remain in place until end-2021; banks extended PLN18.5 billion (0.8 percent of GDP) in credits under public guarantee schemes in 2020.

Sources: NBP; KNF; and ZBP.

Figure 14. Poland: Housing Market Indicators

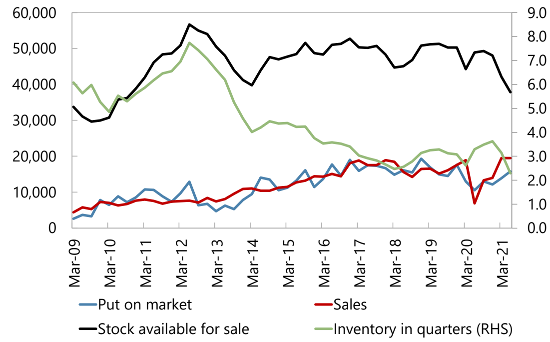
After falling at the start of the pandemic, housing starts have returned to pre-pandemic levels....

Poland: Housing Starts
(Index: Jan 2019 = 100; SA)



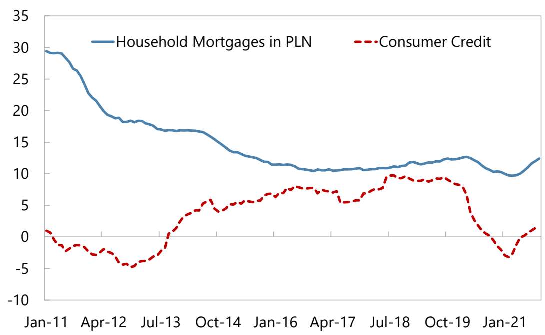
...while sales have outpaced supply in 2021, reducing the inventory of available housing.

Housing Sales and Inventory
(Units, LHS; Quarters, RHS)



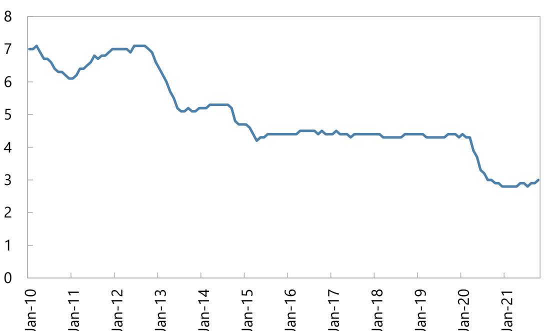
Household mortgage lending has returned to pre-pandemic growth rates....

Household Sector Credit Growth
(Year-on-year percent change)



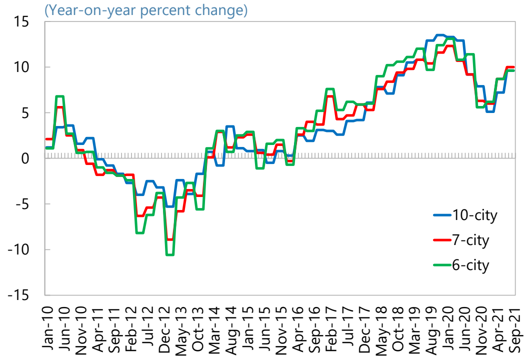
...supported by historically low mortgage lending rates, which are now beginning to increase.

Average Interest Rate on New PLN Mortgage Loans
(Percent)



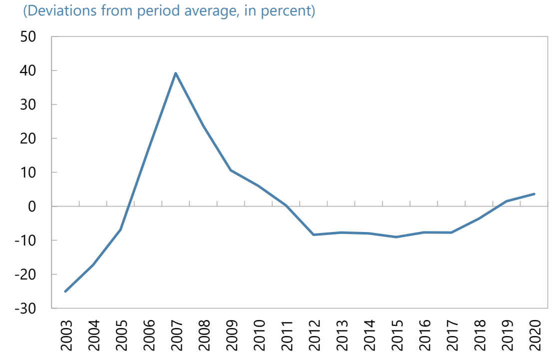
Housing price growth has accelerated after a brief slowdown at the beginning of the pandemic...

Hedonic Prices of Existing Real Estate
(Year-on-year percent change)



...pushing the price-to-income ratio back above the historical average for the first time in a decade.

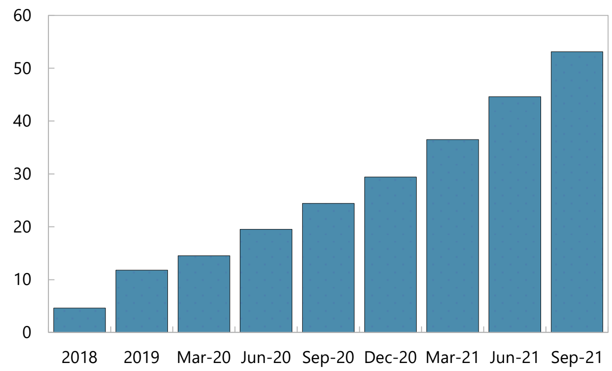
Residential Real Estate: Price-to-Income Ratio
(Deviations from period average, in percent)



Sources: Statistics Poland; NBP; Haver Analytics; and IMF staff calculations.

34. Legal risks related to FX mortgages continue to pose a burden for banks (Annex V). With long-awaited guidelines from the Supreme Court delayed, uncertainty remains large, and banks continue to increase provisions for legal risk. The range of potential losses for the sector is significant—between 5 and 130 percent of banks' capital, depending on how courts treat the conversion of mortgages to domestic currency. However, it appears that the likelihood of the costliest scenario for banks—in which banks are unable to get back the principal from borrowers—has been reduced (but not eliminated) by a verdict issued by a narrow composition of the Supreme Court Civil Chamber.

Foreign Currency Mortgage Litigations
(Number of court cases in thousands)



Source: Reports of banks quoted at Warsaw Stock Exchange.

35. Banks are gradually progressing with voluntary restructuring of FX mortgages. The KNF has proposed that banks offer clients to convert their FX mortgages at original exchange rates, providing equal treatment with original domestic currency mortgage holders of the same vintage. As an incentive, the Financial Stability Committee has also proposed a temporary reduction of FX mortgage risk weights for banks implementing such programs. The estimated conversion cost at 15 percent of banking sector capital would be manageable, but more exposed banks may be discouraged by their own higher costs. State-controlled PKO BP bank was the first to offer settlements based on the KNF proposal, recently followed by ING Bank Slaski and state-owned BOS Bank, while other banks are offering conversion programs on different terms.

36. Cooperative banks, relatively less affected by the pandemic crisis, are undergoing gradual structural changes. Cooperative banks weathered the COVID-19 crisis relatively well, with profits down by only 20 percent in 2020, and recovering above pre-pandemic levels in 2021. The cooperative segment is undergoing gradual consolidation—with 19 mergers in 2021, almost twice the pre-pandemic full-year figure—and is changing business models to increase income from fees. Given their comparatively high share of net interest margin in revenues, cooperative banks should benefit from interest rate normalization.

37. Amended AML/CFT regulations increase oversight on trading virtual currencies. In line with the EU directive, Poland revised its AML Act in 2021. The amended regulations cover entities involved in trading and exchange of virtual currencies, as well as the intermediaries in such trading. These activities became regulated in November 2021, with the obligation to apply security measures to transactions exceeding EUR 1,000 and to have clean criminal records for certain persons, like members of the management boards, in entities involved in such trading. The authorities are encouraged to follow the recommendations regarding virtual assets (VAs) and virtual asset service providers (VASPs) from the recent Council of Europe/MONEYVAL assessment against the FATF standard. The definition of VASPs should be aligned with the FATF definition.

Authorities' Views

38. The authorities noted that the banking sector had remained stable, despite the pandemic crisis. Anti-crisis measures that supported households and corporates had averted threats to banking sector stability. The ongoing economic recovery and growing demand for credit are expected to improve earnings, in addition to interest rate normalization, particularly relevant for cooperative banks. The authorities pointed to progress in consolidation of cooperative banks. While rising housing prices and mortgage credit growth warrant monitoring, the authorities did not see overheating in the residential real estate market. The authorities believed that the magnitude of new demand from state guarantees for mortgage down-payments was still difficult to assess but noted that such credits would remain subject to rigorous credit risk analysis.

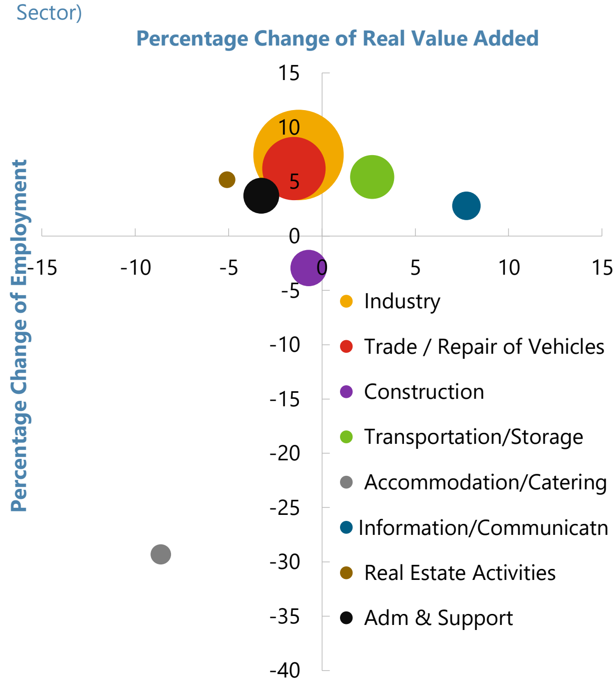
39. The authorities believed that the costliest FX mortgage scenario for banks would likely be averted, based on the verdict issued by a narrow composition of the Supreme Court. The authorities noted that strong capital buffers should allow banks to absorb higher provisions as litigation continues to grow. Three banks were offering voluntary conversions based on the KNF proposal, and some others were proposing conversions on their own terms, and there was substantial borrower interest in such settlements. Weaker banks, which may not be able to absorb the cost of restructuring agreements, were relatively small and did not pose a systemic threat.

Structural Policies for the Next Wave of Growth and Convergence

Labor Markets

40. Active labor market policies (ALMP) are needed to facilitate labor reallocation toward expanding sectors. While policy support reduced the impact of the pandemic on labor markets, the decline in output in high-contact sectors has far exceeded their declines in employment, while expanding sectors increasingly demand skilled labor. Also, certain groups including youth and low-skilled individuals may need special assistance transitioning to new jobs. ALMPs should be enhanced to facilitate upskilling and reskilling, particularly in digital skills. Decarbonization will present longer-run challenges for coal mining, which represents a small share of overall employment but has regional significance. The energy transition calls for a strategy to prevent a disproportionate impact on workers in coal-rich regions.

Real Value Added and Employment
(2021Q3 Percent Change Relative to 2019Q4, SA, Bubble Size Refers to the Employment Share of the Sector)

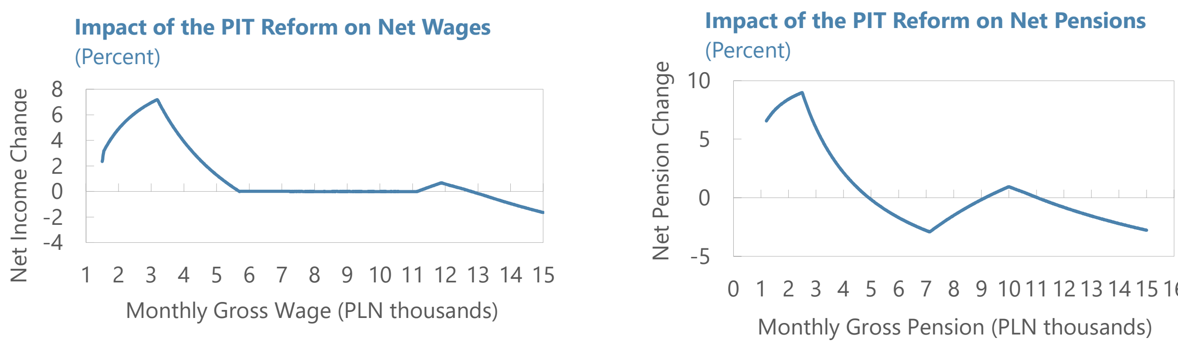


41. Although not an ALMP, the Polish Deal tax reform could positively affect labor supply, but the magnitude of this effect is uncertain. The reforms will reduce the tax wedge for lower income groups, particularly those between 50–75 percent of the average wage (Figure 15), which could incentivize inactive persons to enter the labor market. However, participation has already risen significantly, with the main drivers not fully understood, and the reform will also significantly reduce the tax burden for most pensioners, which may tip some workers into anticipating their retirement, although this is a smaller group. A positive effect of the tax reform on participation rates would help delay the ultimate impact of adverse demographic trends on the labor force. Other efforts in this direction could include the implementation of measures to allow longer periods of employment for foreign workers.

Figure 15. Poland: Impact of the Polish Deal Tax Reform on Salaries and Pensions

The reform will lower the tax burden on salaries in lower income groups….

…and pensioners will also face a sizeable reduction of their tax burden.



Source: Ministry of Finance estimates.

Climate Change

42. Poland has achieved a significant reduction in carbon emissions, but its carbon footprint remains large owing to its reliance on coal.[5] Since 1990, greenhouse gas (GHG) emissions have declined by 16 percent, even as real GDP tripled. Nevertheless, output remains more carbon intensive than in EU peers. Unlike most other EU countries, the main contributor to emissions is the power sector. Despite an increased use of renewables, domestic coal remains the mainstay of the power sector and is also prevalent in household heating. Emissions are increasing in the transport sector as efficiency improvements have been more than offset by increasing traffic.

43. In 2021, Poland adopted an energy policy strategy to significantly reduce coal power by the 2040s. The strategy specifies a comprehensive list of measures expected to reduce GHG emissions by 30 percent from the 1990 level by 2030 and the share of coal in electricity from 77 percent in 2018 to below 56 percent in 2030, underpinned by large investments in generation

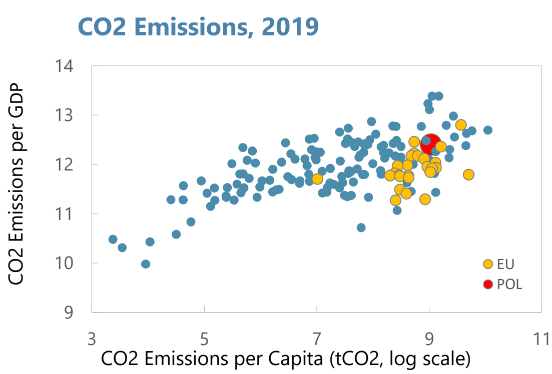
[5] See Selected Issues Paper "Challenges of Energy Transition in Poland"

and increased efficiency. A more ambitious EU climate policy and higher carbon prices in the EU ETS system may necessitate an updated energy transition plan, which should set a target date for carbon neutrality and a path to phase out coal mining. Access to clean energy is also an increasingly important factor in foreign investors' decisions.

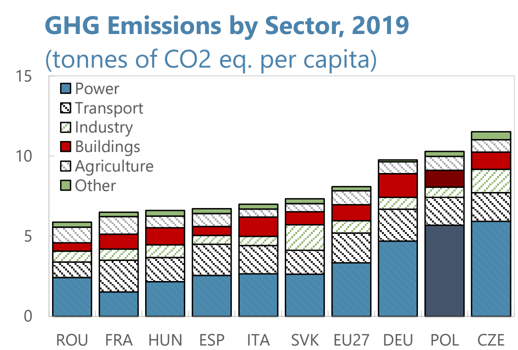
44. The power sector transition is the most pressing challenge. Given majority state ownership of most coal mines and energy producers, direct government intervention will be required. Aging energy production capacity and infrastructure and the deteriorating financial viability of coal-powered generation create risks for supply stability, which means that investments will be needed in all events. But EU support will be available if investments do not just replace capacity, but reduce emissions too. The authorities estimate that the energy transition will cost about 15 percent of 2021 GDP in the 2020s in the energy sector alone. EU financing will support the process, but other funding will also be needed, including to finance investments that may not qualify for EU funding. A carbon tax and targeted rebates should be considered to further incentivize private sector decarbonization, while seeking to protect the most vulnerable households. Carbon pricing is a cost-effective tool to discourage emissions while raising revenues to support energy transition. The authorities should review the regulatory framework for energy generation to attract private investment too.

Figure 16. Poland: Carbon Emissions

Poland's economic output remains relatively carbon intensive....



...with the power sector a large contributor to emissions.

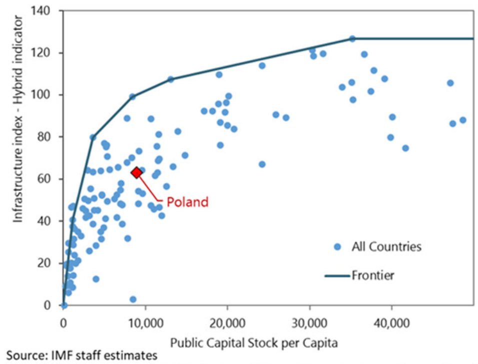


Sources: EDGAR; WEO; UNFCCC; and IMF staff calculations.

Public Investment

45. Improvements in the public investment management framework can help increase the efficiency of public infrastructure assets. Public investment is expanding towards more complex and riskier projects in support of the government's convergence program and energy transition goals. The investment efficiency gap suggests that more than one-third of public investment did not result in the increase in the level or quality of infrastructure that would have been achieved by the most efficient country. Stronger information flows across public entities can help facilitate a more collaborative infrastructure framework with greater complementarities and synergies of infrastructure projects, raising the overall efficiency of public investment.

Public Investment Efficiency Frontier
(Index)



Source: IMF staff estimates
Note: Index is based on a hybrid indicator which combines physical and survey-based indicators into a synthetic index of the coverage and quality of infrastructure networks. Methodology described in *Making Public Investment More Efficient*, IMF (2015).

Authorities' Views

46. The authorities outlined ongoing and planned AMLP and structural policy initiatives. The authorities plan to modernize Public Employment Services and strengthen access to training, with a special emphasis on digital skills. An extension of the period in which foreign workers may be employed on declaration is under consideration. The authorities believed that the PIT reform would incentivize higher participation at lower income levels and that this effect would outweigh any increase in retirements. On energy policy, they believed that the energy strategy would place Poland on a path to carbon neutrality by 2050. A revised strategy, due in 2023, would incorporate the EU's "Fit for 55" package. The authorities emphasized the need to consider energy security and preferred to guide the energy transition through tighter standards and policies rather than through direct carbon pricing. They also did not support the extension of ETS coverage to household and transport sectors, citing the risk of energy poverty. On the public investment management framework, the authorities noted that they would consider staff's recommendations, including improved coordination to facilitate the infrastructure investment strategy across different public sector entities.

STAFF APPRAISAL

47. While the pandemic has taken its toll on lives, policy actions have limited the economic damage from the pandemic. After a long period of strong growth, Poland experienced a recession in 2020, though it was one of the least severe in the European Union. The Polish economy's relative resilience owes in part to strong policy actions that averted destructive losses of employment and bankruptcies. Output has rebounded strongly and already surpassed the pre-recession peak, with the economy less impacted by successive pandemic waves. The authorities should nevertheless consider strategies to increase vaccination coverage in Poland to reduce health risks and mitigate the potential for further pandemic-related economic disruptions. The external position is preliminarily assessed to be moderately stronger than the level implied by medium-term fundamentals and desirable policies. Foreign exchange reserves are adequate to insulate against external shocks and disorderly market conditions.

48. The outlook for the Polish economy remains favorable, with minimal medium-term scarring expected from the pandemic. While ongoing pandemic waves may slow economic growth in the near term, the robust expansion is projected to continue in 2022–23, supported by a strong labor market and corporate balance sheets. Nevertheless, considerable near-term uncertainty requires deft policy management as policymakers must weigh the countervailing risks from the pandemic against the risk of overheating. Next Generation EU grants should deliver a significant boost to public investment for several years, underscoring the importance of resolving outstanding disputes with the EU.

49. **Fiscal support appropriately became more targeted as the pandemic evolved.** Many of the initially broad-based measures were extended with greater targeting to support sectors most impacted by later waves of the pandemic. The authorities also implemented safeguards to combat waste and fraud in such programs. Reduced pandemic fiscal support and a strong economic recovery contributed to a significant decline in the fiscal deficit in 2021. While most programs have been phased out, substantial fiscal space exists to extend targeted support, if necessary, to confront further waves of the pandemic.

50. **An expansionary fiscal stance should be avoided in the context of near-term overheating risks.** While the personal income tax reform appropriately aims to increase progressivity, it would be appropriate to offset its expansionary impact elsewhere in the budget. Near-term energy poverty risks would also be best addressed through targeted instruments such as vouchers. With general government debt projected to stabilize above the pre-pandemic level over the medium term, some additional deficit reduction towards the medium-term objective of 1 percent of GDP would be appropriate to rebuild buffers to address future shocks and long-term fiscal pressures.

51. **The central bank should continue to tighten monetary policies to drive inflation back to the target.** Inflation increased substantially in 2021 and is projected to remain elevated in 2022. While the recent increase in inflation has been largely driven by factors outside the control of monetary policy, their persistence and the relatively elevated level of core inflation presently suggest that further rate increases will be necessary to minimize second-round effects and stave off overheating risks as output moves above potential. The recent conclusion of regular asset purchases is welcome and consistent with monetary policy tightening. Foreign exchange intervention should be reserved to periods of disorderly market conditions.

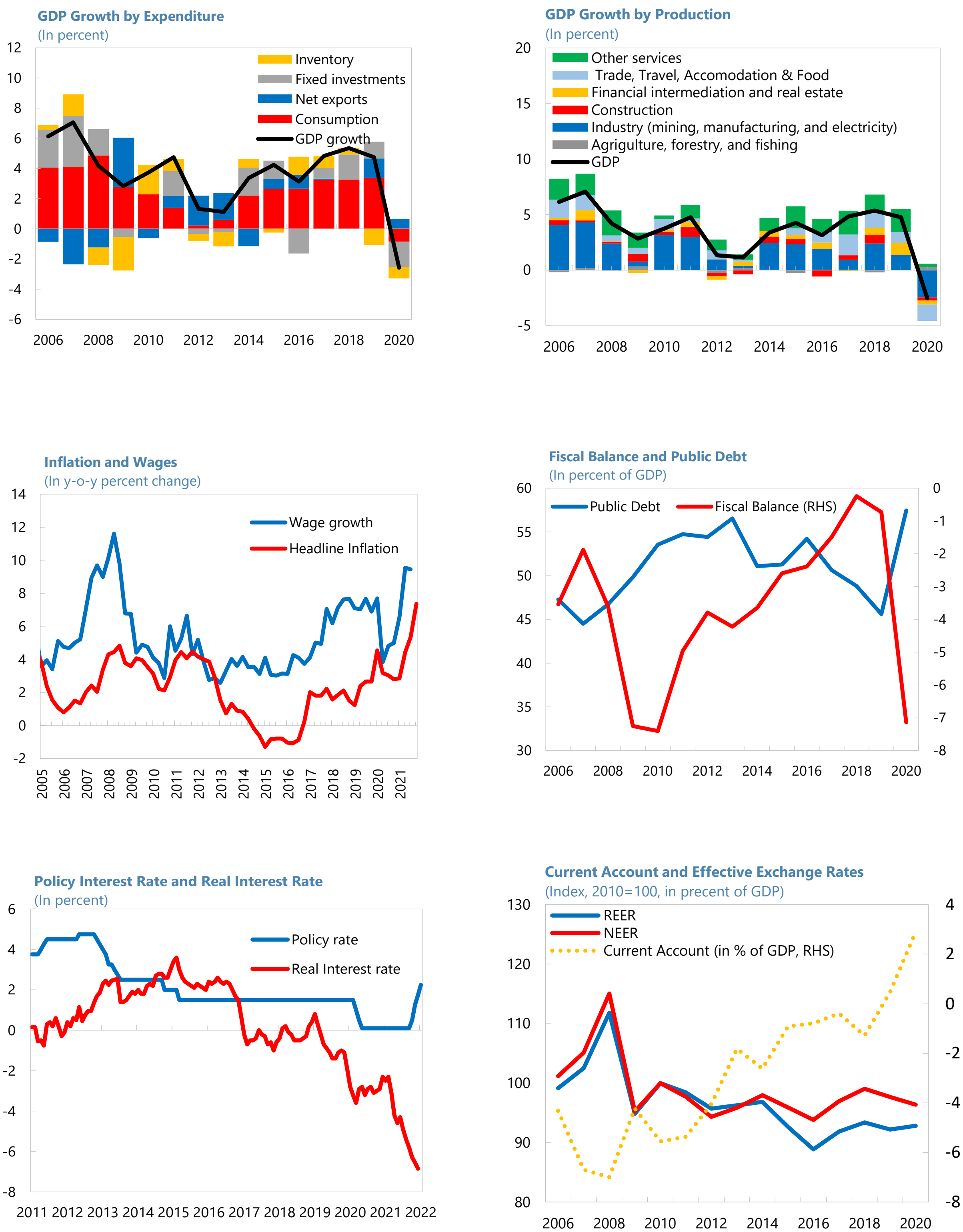
52. **The banking sector has remained stable through the pandemic, though legal risks remain significant.** Asset quality has not deteriorated, and capital adequacy levels remain significantly above regulatory minima. The ongoing gradual phase out of crisis-related financial sector measures has thus been appropriate. In the context of a robust housing market and rising interest rates, it remains important for banks to rigorously test borrowers' ability to service loans. The legal risks of foreign exchange mortgages represent the main source of risk to the banking system. Banks should proactively seek to reach voluntary agreements with clients to convert their mortgages into local currency. While conversion will be costly, it would remove a significant source of uncertainty, and the cost would be manageable for most banks. To support credit growth to the private sector, the authorities should redesign the bank asset tax, which incentivizes banks to hold government securities.

53. **Structural reforms are needed to bolster longer-term economic growth and convergence.** A strengthening of active labor market policies, including improved upskilling and

training with a focus on digital skills, would facilitate the movement of labor to expanding, high-productivity sectors. The personal income tax reform could also increase labor supply for the working age population, but the magnitude of the effect is uncertain. To support a growing economy, attract foreign investment, and meet energy transition goals, substantial investment in clean sources of energy will be needed. While EU financing will support the transition process, additional financing sources will be needed, underscoring the need for a long-term energy investment financing strategy. The authorities should consider a role for carbon taxation to incentivize private sector decarbonization. A more tightly coordinated infrastructure framework with strengthened collaboration across public entities can help raise the efficiency of public investment.

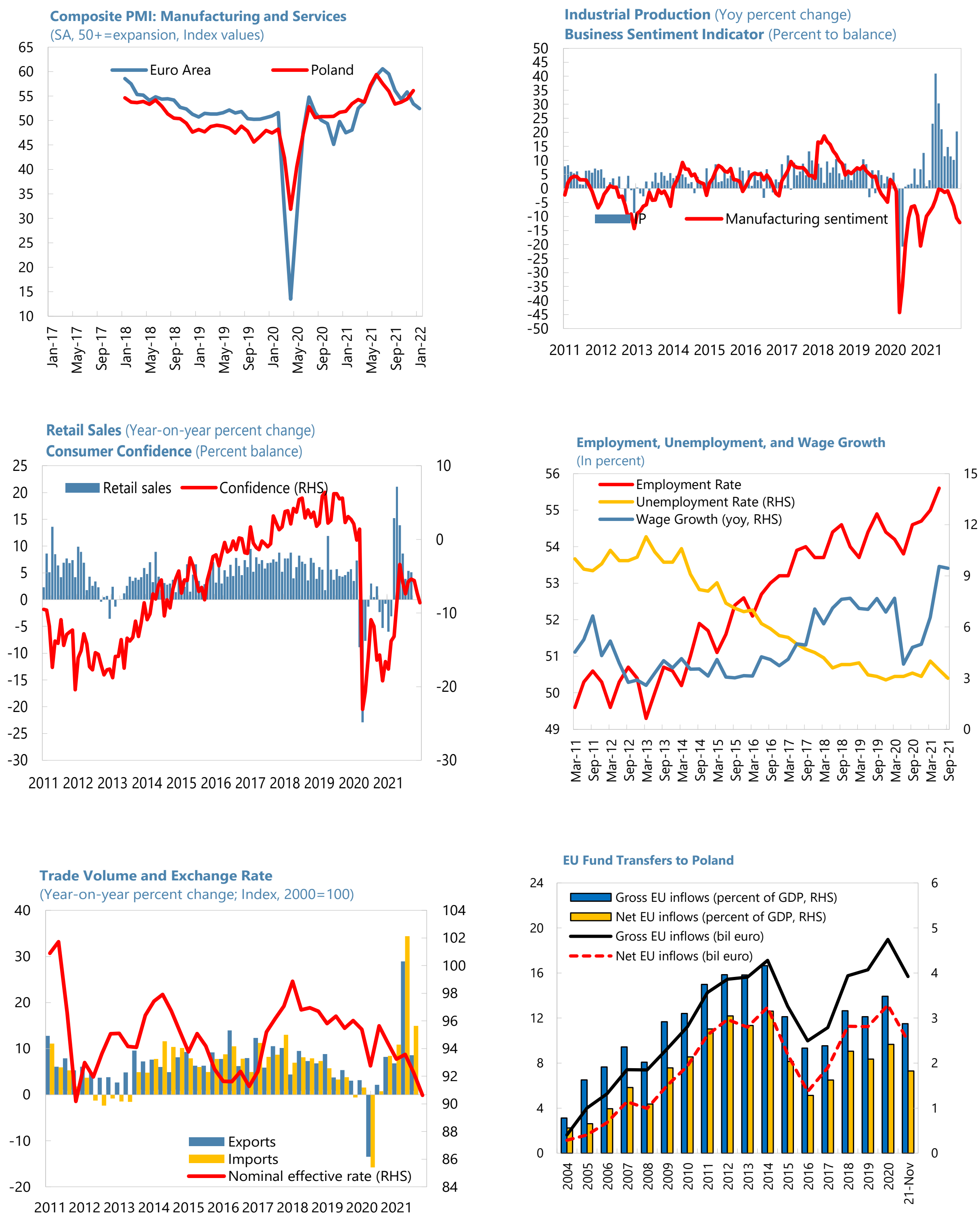
54. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

Figure 17. Poland: Selected Economic Indicators, 2006–2022



Sources: Statistics Poland; Ministry of Finance; NBP; and IMF staff calculations.

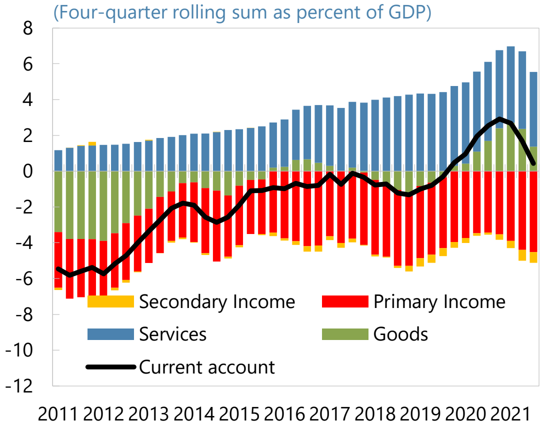
Figure 18. Poland: Selected Economic Indicators, 2011–2022



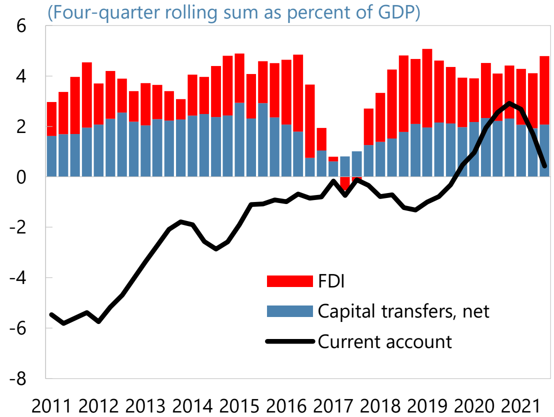
Sources: Haver; Statistics Poland; and IMF staff calculations.

Figure 19. Poland: Balance of Payments Developments, 2011–2021

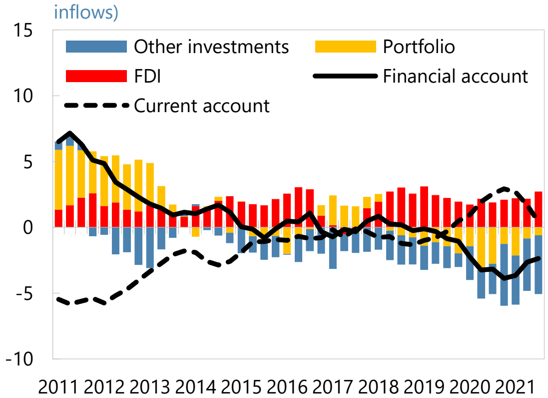
Current Account Balance
(Four-quarter rolling sum as percent of GDP)



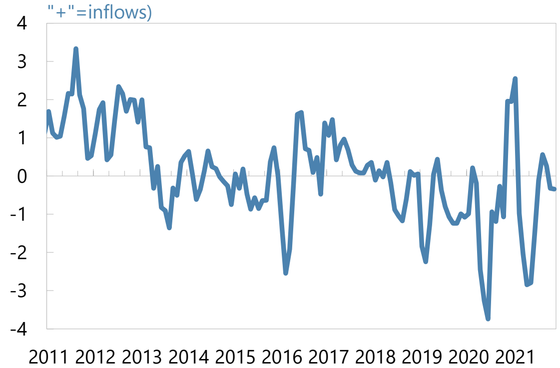
Current Account Balance, Capital Transfers, and FDI
(Four-quarter rolling sum as percent of GDP)



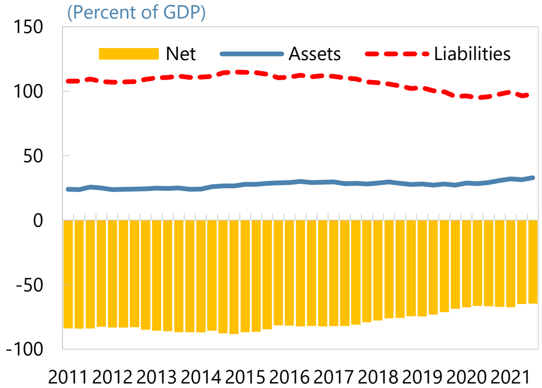
Financial Account Balance (Net Flows)
(Four-quarter rolling sum as percent of GDP, "+" = inflows)



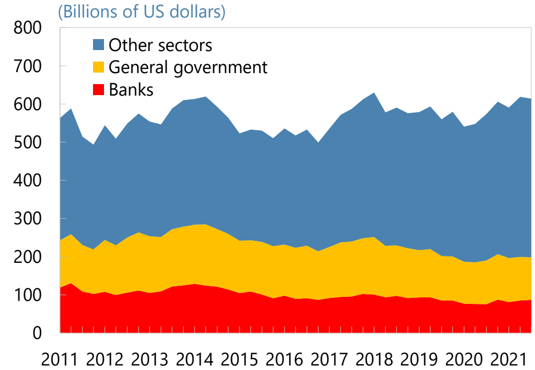
Portfolio Flows, Net
(Billions of US dollars, 3-month moving average, "+"=inflows)



International Investment Position 1/
(Percent of GDP)



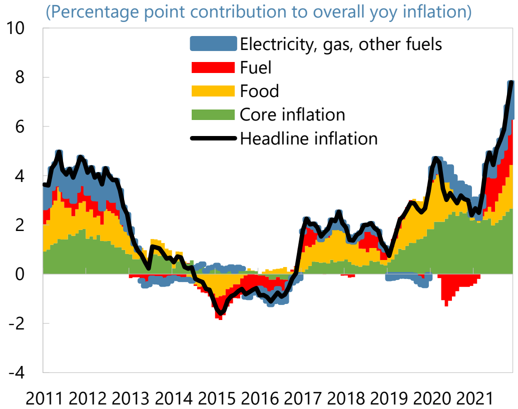
International Investment Position, Liabilities
(Billions of US dollars)



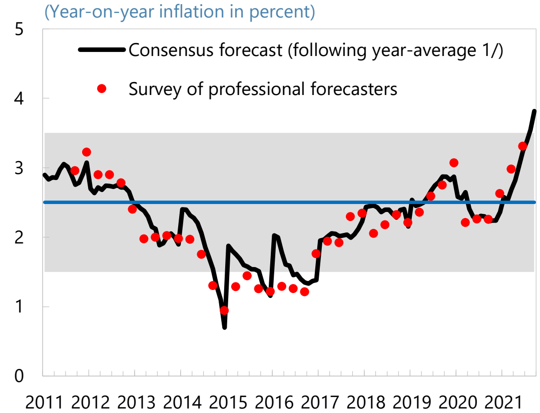
Sources: NBP; and IMF staff calculations.
1/ Excludes NBP.

Figure 20. Poland: Inflation and Asset Price Indicators, 2011–2021

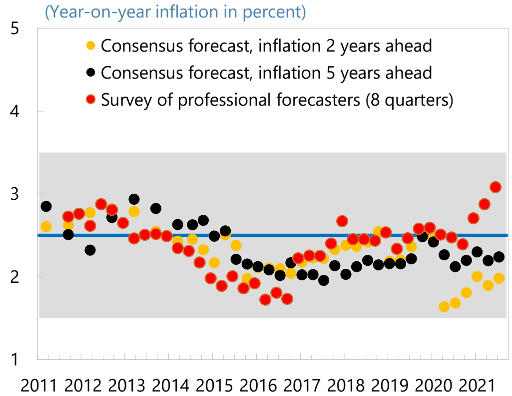
Consumer Price Inflation
(Percentage point contribution to overall yoy inflation)



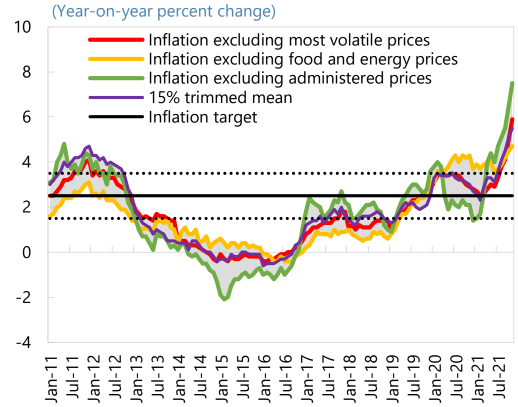
Inflation Expectations, One Year Ahead
(Year-on-year inflation in percent)



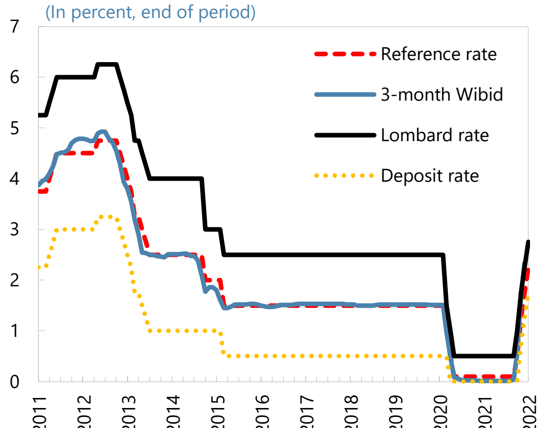
Longer-term Inflation Expectations 1/
(Year-on-year inflation in percent)



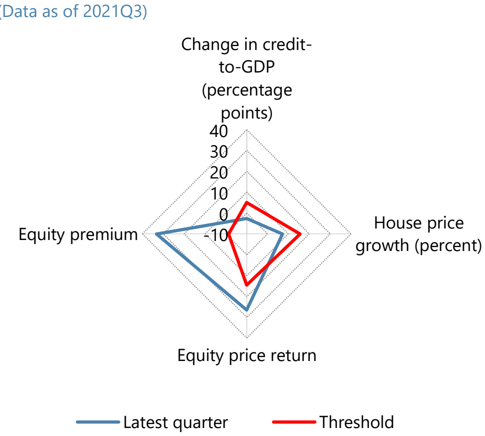
Core Inflation Indices
(Year-on-year percent change)



Interest Rates
(In percent, end of period)

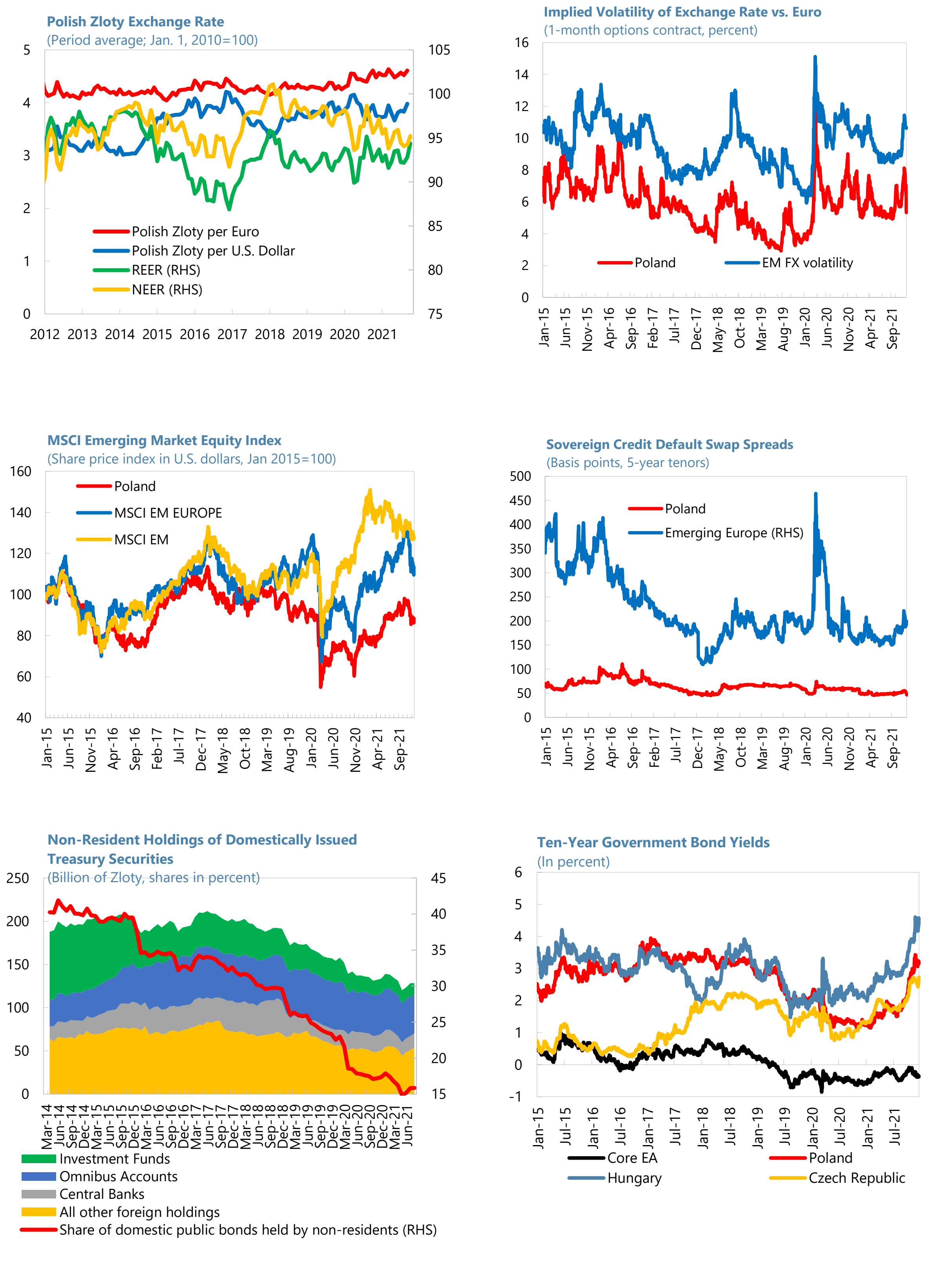


Asset Price Indicators
(Data as of 2021Q3)



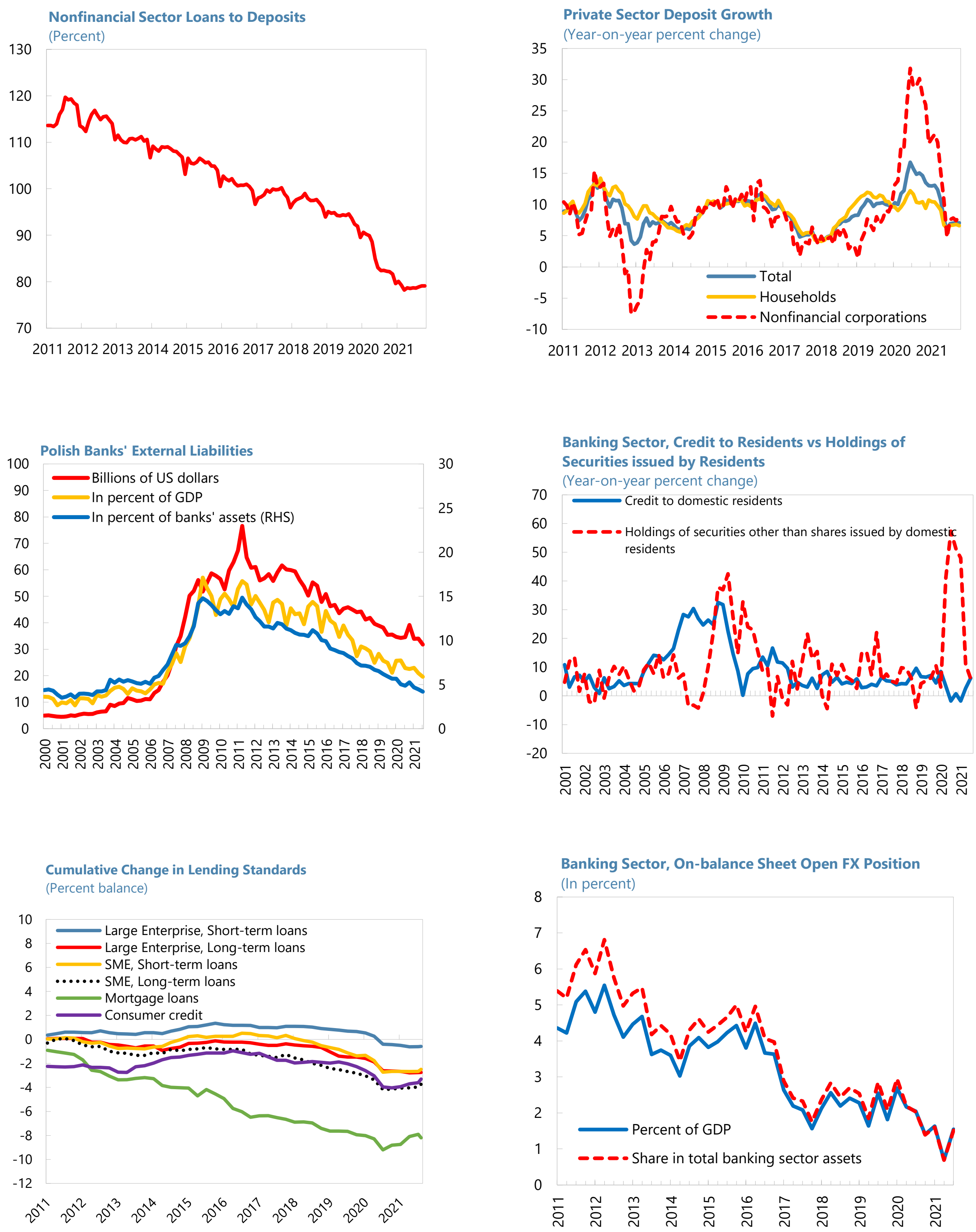
Sources: Haver; Consensus Forecast; Statistics Poland; NBP; and IMF staff calculations.
1/ Expectations for the year's average are affected by breaks when the forecast year changes in January.

Figure 21. Poland: Financial Market Developments



Sources: Bloomberg Finance L.P.; Haver Analytics; Ministry of Finance; and IMF staff calculations.

Figure 22. Poland: Banking Sector Developments



Sources: Haver; Statistics Poland; NBP; KNF; and IMF staff calculations.

Table 6. Poland: Selected Economic Indicators, 2018–2026

	2018	2019	2020	2021	2022	2023	2024	2025	2026
				Est.			Projections		
Activity and prices									
GDP (change in percent)	5.4	4.7	-2.5	5.4	4.6	3.7	3.0	3.0	3.0
Domestic demand	5.6	3.6	-3.3	8.1	6.1	3.9	3.4	3.4	3.2
Private consumption growth	4.5	3.9	-2.9	6.8	6.4	3.4	3.3	3.2	3.1
Public consumption growth	3.5	6.5	4.9	1.6	4.4	3.8	3.2	3.2	3.2
Domestic fixed investment growth	9.4	6.1	-9.0	7.0	8.7	9.1	5.0	4.5	4.0
Inventories (contribution to growth)	0.4	-1.1	-0.8	2.3	-0.2	-0.5	-0.2	0.0	0.0
Net external demand (contribution to growth)	0.0	1.3	0.6	-2.3	-1.3	-0.2	-0.3	-0.3	-0.2
Output gap	1.9	2.9	-2.9	-0.6	0.6	0.7	0.3	0.1	0.0
CPI inflation (percent)									
Average	1.6	2.3	3.4	5.1	7.4	5.1	3.1	2.9	2.6
End of period	1.1	3.4	2.4	8.6	6.3	3.3	3.0	2.7	2.5
Unemployment rate (average, according to LFS)	3.8	3.3	3.2	3.5	3.3	3.0	3.0	3.0	3.0
Saving and Investment (percent of GDP)									
Saving	19.5	20.2	20.2	18.9	18.8	18.6	18.6	18.7	18.9
Investment	20.8	19.7	17.2	19.2	19.3	19.5	19.6	19.8	19.9
Saving - Investment	-1.3	0.5	2.9	-0.3	-0.5	-0.9	-1.0	-1.0	-1.0
Public finances (percent of GDP) 1/									
General government revenues	41.3	41.0	41.5	41.7	39.7	41.1	40.9	40.8	40.6
General government expenditures	41.5	41.8	48.7	44.6	42.8	43.6	43.6	43.4	43.2
General government net lending/borrowing	-0.2	-0.7	-7.1	-2.9	-3.1	-2.5	-2.6	-2.6	-2.6
General government cyclically-adjusted balance	-1.2	-2.2	-5.6	-2.6	-3.4	-2.9	-2.8	-2.6	-2.6
General government debt	48.8	45.6	57.4	56.2	52.1	49.8	49.7	49.5	49.6
National definition 2/	46.4	43.2	47.8	...	...	...	...	...	...
Money and credit									
Private credit (change in percent, end-period) 3/	7.1	4.8	3.2	4.0	6.6	6.8	6.5	6.3	6.2
Credit to GDP (percent)	56.1	54.4	55.3	51.6	49.4	48.9	49.1	49.2	49.5
Deposits (change in percent, end-period)	8.2	8.6	12.0	6.9	6.5	6.7	6.5	6.2	6.1
Broad money (change in percent, end-period)	9.2	8.3	16.4	7.9	7.1	6.8	6.3	6.1	5.9
Policy Rate (percent) 4/	1.5	1.5	0.5	0.3	...	...	...	...	
Balance of payments									
International Investment Position, Net (Percent of GDP)	-53.7	-50.4	-46.2	-39.7	-35.0	-32.1	-29.7	-27.8	-26.0
Current account balance (billion U.S. dollars)	-7.5	2.8	17.3	-2.0	-4.1	-7.0	-8.7	-9.5	-9.8
Percent of GDP	-1.3	0.5	2.9	-0.3	-0.5	-0.9	-1.0	-1.0	-1.0
Exports of Goods (billion U.S. dollars)	256.2	260.7	270.0	329.1	367.2	395.1	419.5	447.1	475.5
Export volume growth	6.9	5.2	0.1	11.4	5.0	4.9	4.2	4.2	4.2
Imports of Goods (billion U.S. dollars)	263.6	259.0	255.6	325.5	370.9	401.6	427.3	455.1	483.7
Import volume growth	7.4	3.0	-1.2	16.9	7.5	5.3	4.8	4.8	4.6
Terms of trade (index 1995=100)	105.1	106.4	109.1	109.7	110.0	109.7	110.2	110.9	111.3
Official reserves (billion U.S. dollars)	117.0	128.4	154.2	166.1	181.5	192.5	200.1	203.8	204.7
In percent of short-term debt plus CA deficit	145.9	174.4	158.0	151.8	159.0	164.7	167.3	168.3	166.2
In percent of IMF ARA metric	123.1	133.0	150.7	154.3	...	...	...	...	...
Total external debt (billion U.S. dollars)	362.2	355.0	375.4	413.4	420.3	424.7	432.2	438.3	444.9
In percent of GDP	61.7	59.5	62.9	61.6	56.7	53.4	50.7	47.9	45.3
Exchange rate									
Exchange rate regime				Freely floating					
Zloty per USD, period average	3.6	3.8	3.9	3.9	...	...	...	...	...
Zloty per Euro, period average	4.3	4.3	4.4	4.6	...	...	...	...	...
Real effective exchange rate (INS, CPI based) 5/	101.9	100.6	101.2	...	...	...	...	...	...
Appreciation (percent change)	1.7	-1.3	0.7	...	...	...	...	...	...
Memorandum item:									
Nominal GDP (billion zloty)	2121.6	2293.2	2326.7	2590.2	2886.6	3115.9	3307.5	3504.4	3700.5

Sources: Polish authorities; and IMF staff calculations.

1/ According to ESA2010.

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

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

4/ NBP Reference Rate (avg).

5/ Annual average (2000=100).

Table 7. Poland: Balance of Payments on Transaction Basis, 2016–2027

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

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
						Est.		Projections				
Current account balance	-3,719	-2,068	-7,537	2,832	17,319	-2,010	-4,051	-7,024	-8,671	-9,488	-9,818	-10,097
percent of GDP	-0.8	-0.4	-1.3	0.5	2.9	-0.3	-0.5	-0.9	-1.0	-1.0	-1.0	-1.0
Trade balance	17,484	19,743	17,798	28,409	40,420	31,249	28,252	27,043	28,201	30,219	32,970	34,581
percent of GDP	3.7	3.7	3.0	4.8	6.8	4.7	3.8	3.4	3.3	3.3	3.4	3.3
Balance on Goods	2,262	-463	-7,327	1,699	14,379	3,624	-3,658	-6,506	-7,719	-8,021	-8,258	-9,142
Merchandise exports f.o.b.	196,383	228,214	256,230	260,732	269,991	329,143	367,220	395,092	419,546	447,092	475,463	506,734
Merchandise imports f.o.b.	194,121	228,677	263,557	259,033	255,612	325,520	370,878	401,598	427,265	455,113	483,722	515,877
Balance on Services	15,222	20,206	25,125	26,710	26,041	27,625	31,910	33,549	35,920	38,240	41,228	43,723
Merchandise exports f.o.b.	48,712	57,868	68,121	70,202	66,326	71,856	81,600	86,206	90,925	95,081	102,373	109,394
Merchandise imports f.o.b.	33,490	37,662	42,996	43,492	40,285	44,231	49,690	52,658	55,005	56,840	61,145	65,670
Exports of goods and services												
percentage change in unit values	4.6	16.7	13.4	2.0	1.6	21.9	11.6	7.6	6.2	6.6	6.3	6.6
percentage volume growth	9.3	9.6	6.9	5.2	0.1	11.4	5.0	4.9	4.2	4.2	4.2	4.2
Imports of goods and services												
percentage change in unit values	2.8	17.0	15.1	-1.3	-2.2	27.3	13.9	8.3	6.4	6.5	6.3	6.6
percentage volume growth	7.9	10.2	7.4	3.0	-1.2	16.9	7.5	5.3	4.8	4.8	4.6	4.6
Terms of trade (percentage change)	0.4	0.3	-1.0	1.3	2.6	0.5	0.3	-0.2	0.4	0.6	0.4	0.3
Primary Income balance	-19,624	-21,643	-23,614	-23,601	-21,253	-30,252	-29,406	-31,635	-34,260	-36,801	-39,546	-41,242
percent of GDP	-4.2	-4.1	-4.0	-4.0	-3.6	-4.5	-4.0	-4.0	-4.0	-4.0	-4.0	-4.0
Secondary Income balance	-1,579	-168	-1,721	-1,976	-1,848	-3,007	-2,898	-2,431	-2,612	-2,905	-3,241	-3,437
Capital and financial account balance	6,254	4,126	13,470	17,999	36,765	20,391	18,421	14,974	11,763	7,592	8,731	9,353
Capital account balance (net)	4,867	6,795	12,148	11,757	13,846	11,200	11,236	10,999	10,217	8,540	9,274	9,725
Financial account balance (net)	1,387	-2,669	1,322	6,242	22,919	9,190	7,185	3,975	1,546	-948	-543	-372
Foreign direct investment (net)[+ = outflows]	-4,398	-7,836	-15,285	-11,709	-12,505	-22,697	-22,888	-22,465	-21,550	-18,502	-13,069	-10,472
Assets [Increase = +]	13,923	3,926	2,339	5,136	4,883	6,186	6,200	6,300	6,400	6,500	6,500	6,500
Liabilities [Increase = +]	18,321	11,762	17,624	16,845	17,388	28,883	29,088	28,765	27,950	25,002	19,569	16,972
Portfolio investment (net)	-3,726	-4,593	4,413	11,824	6,799	19,593	7,245	7,810	8,384	9,089	9,818	10,048
Assets	-5,827	1,428	625	-282	-4,276	13,012	4,444	4,420	5,765	6,830	6,330	6,330
Liabilities	-2,101	6,021	-3,788	-12,106	-11,075	-6,581	-2,801	-3,390	-2,619	-2,259	-3,488	-3,718
Other investment (net)	-13,334	18,674	6,170	-2,814	10,956	488	7,422	7,631	7,065	4,721	1,856	40
Assets	2,777	6,489	6,214	1,427	15,924	11,128	8,285	8,631	7,565	6,277	6,302	6,302
Liabilities	16,111	-12,185	44	4,241	4,968	10,640	863	1,000	500	1,555	4,446	6,263
Financial derivatives	184	-1,126	-1,221	-1,234	-1,074	0	0	0	0	0	0	0
Errors and omissions	239	-7,396	-3,289	-8,347	-8,246	0	0	0	0	0	0	0
Financing												
Reserve assets [Increase = +]	22,661	-7,788	7,245	10,175	18,743	11,806	15,406	10,999	7,647	3,744	851	12
Memorandum items:												
Current plus capital account (percent of GDP)	0.2	0.9	0.8	2.4	5.2	1.4	1.0	0.5	0.2	-0.1	-0.1	0.0
International Investment Position, Net (Percent of GDP)	-58.1	-66.4	-53.7	-50.4	-46.2	-39.7	-35.0	-32.1	-29.7	-27.8	-26.0	-24.6
Gross official Reserve	114,392	113,279	116,965	128,405	154,246	166,052	181,458	192,457	200,104	203,848	204,699	204,711
in months of imports	7.1	5.9	5.3	5.9	7.2	6.1	5.9	5.8	5.6	5.4	5.1	4.8
Ratio of gross official reserves to short-term debt 1/	145.9	135.4	140.9	141.2	161.3	157.7	169.5	177.9	181.7	182.6	180.6	0.0
Ratio of gross official reserves to ST debt plus CA deficit	142.2	124.2	145.9	174.4	158.0	151.8	159.0	164.7	167.3	168.3	166.2	163.9
Ratio of gross official reserves to IMF ARA metric	138.3	117.5	123.1	133.0	150.7	154.3	…	…	…	…	…	…
Total external debt (percent of GDP)	72.1	72.3	61.7	59.5	62.9	61.6	56.7	53.4	50.7	47.9	45.3	43.4
Total external debt (percent of exports)	138.8	133.2	111.7	107.3	111.6	103.1	93.7	88.2	84.7	80.8	77.0	73.2
External debt service (percent of exports)	46.5	46.3	45.5	44.8	46.8	41.9	40.1	38.4	37.0	35.5	33.9	0.0

Sources: National Bank of Poland; and IMF staff calculations.

1/ Short-term debt is on remaining maturity.

Table 8. Poland: Statement of Operations of General Government, 2016–2026

(Percent of GDP)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
						Est.		Projections			
Revenue	38.7	39.8	41.3	41.0	41.5	41.7	39.7	41.1	40.9	40.8	40.6
Taxes	20.5	21.1	21.9	21.7	22.0	22.7	20.6	21.4	21.5	21.5	21.5
Personal income tax	4.8	4.9	5.2	5.1	5.2	5.1	4.0	4.0	4.1	4.0	4.0
Corporate income tax	1.8	1.9	2.1	2.2	2.3	2.5	2.4	2.4	2.4	2.4	2.4
VAT	7.2	7.8	8.1	7.9	8.0	8.0	7.4	8.0	8.0	8.0	8.0
Excises	3.5	3.5	3.2	3.1	3.1	3.0	3.0	3.0	3.0	3.0	3.0
Other taxes	3.1	3.1	3.2	3.4	3.5	4.1	3.8	4.0	4.0	4.0	4.0
Social contributions	13.8	13.9	14.1	14.2	14.6	14.3	14.2	14.2	14.2	14.2	14.2
Other revenue	4.4	4.8	5.3	5.1	5.0	4.7	4.9	5.5	5.3	5.2	4.9
Capital revenue	0.6	0.7	1.2	1.1	1.2	0.9	1.1	1.7	1.5	1.4	1.1
Sales of goods and services	2.4	2.4	2.4	2.3	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Other current revenue	1.4	1.7	1.8	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Expenditure	41.1	41.3	41.5	41.8	48.7	44.6	42.8	43.6	43.6	43.4	43.2
Expense	37.9	37.5	36.9	37.5	44.1	40.0	38.2	38.7	38.9	38.8	38.8
Compensation of employees	10.4	10.2	10.1	10.3	11.0	10.7	10.5	10.4	10.4	10.4	10.4
Use of goods and services	5.5	5.5	5.7	5.7	5.8	5.8	5.8	5.8	5.8	5.8	5.8
Interest	1.7	1.6	1.4	1.4	1.3	1.1	1.3	1.3	1.3	1.4	1.4
Subsidies	0.5	0.5	0.4	0.5	3.7	1.1	0.5	0.4	0.4	0.4	0.4
Social benefits	17.1	17.0	16.7	17.2	18.7	18.3	17.4	17.8	18.1	18.0	18.0
Other expense 1/	2.6	2.7	2.5	2.4	3.5	2.9	2.7	3.0	3.0	2.9	2.8
Other current expenditure	2.0	1.9	2.1	2.0	2.4	2.1	1.7	1.7	1.7	1.7	1.7
Capital transfers	0.6	0.9	0.4	0.4	1.2	0.8	0.9	1.3	1.2	1.2	1.1
Net acquisition of nonfinancial assets	3.2	3.8	4.7	4.3	4.6	4.6	4.6	4.9	4.7	4.6	4.5
Gross operating balance	0.8	2.3	4.4	3.6	-2.5	1.7	1.5	2.4	2.1	2.0	1.8
Net lending/borrowing	-2.4	-1.5	-0.2	-0.7	-7.1	-2.9	-3.1	-2.5	-2.6	-2.6	-2.6
Cyclically-adjusted fiscal balance	-1.9	-1.7	-1.2	-2.2	-5.6	-2.6	-3.4	-2.9	-2.8	-2.6	-2.6
Net financial transactions	-2.4	-1.4	-0.3	-0.7	-7.2	-2.9	-3.1	-2.5	-2.6	-2.6	-2.6
Net acquisition of financial assets	2.2	0.2	1.5	0.7	6.1	1.9	-1.0	-1.0	0.2	0.1	0.1
Currency and deposits	1.0	-0.1	0.8	0.4	3.2	1.4	-1.1	-1.0	0.1	0.1	0.1
Debt securities	0.1	0.2	0.0	0.3	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.2	0.1	0.4	0.1	1.5	0.4	0.0	0.0	0.0	0.0	0.0
Equity and investment fund shares	-0.2	-0.2	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other financial assets	1.0	0.2	0.4	0.0	0.9	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	4.6	1.6	1.8	1.4	13.2	4.9	2.1	1.6	2.8	2.7	2.8
Currency and deposits	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	3.8	1.1	-0.1	0.1	10.3	4.2	1.4	0.9	2.2	2.1	2.3
Loans	-0.1	0.0	0.7	0.4	1.5	0.4	0.5	0.5	0.5	0.5	0.4
Other liabilities	1.0	0.6	1.0	0.9	1.4	0.2	0.1	0.1	0.1	0.1	0.0
Adjustment and statistical discrepancies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Primary balance	-0.7	0.1	1.2	0.6	-5.8	-1.8	-1.9	-1.2	-1.3	-1.2	-1.2
Cyclically-adjusted primary balance	-0.2	-0.1	0.2	-0.9	-4.3	-1.5	-2.2	-1.6	-1.5	-1.3	-1.2
General government debt	54.2	50.6	48.8	45.6	57.4	56.2	52.1	49.8	49.7	49.5	49.6
General government liabilities	73.0	68.7	66.8	63.3	77.2	73.2	69.0	66.8	66.6	66.5	66.6
General government financial assets	29.1	27.7	27.8	26.8	31.6	30.6	29.6	28.6	27.6	26.6	25.6
Nominal GDP in billions of zloty	1,863	1,990	2,122	2,293	2,327	2,590	2,887	3,116	3,308	3,504	3,700

Sources: Eurostat; and IMF staff calculations.

1/ Includes grants.

Table 9. Poland: Monetary Accounts, 2016–2023

	2016	2017	2018	2019	2020	2021	2022	2023
						Est.	Projections	
	(Billions of zlotys)							
Central bank								
Net foreign assets	390	356	393	435	525	620	654	696
Official reserve assets	478	394	440	488	580	674	709	750
Net domestic assets	-252	-223	-103	-135	-159	-188	-181	-185
Net claims on government	-30	-26	-34	-39	-16	14	14	14
Other items, net	-222	-197	-70	-97	-143	-202	-195	-199
Base money	220	232	292	304	384	432	473	511
Currency issued	187	198	219	238	321	365	402	435
Bank reserves	33	34	73	65	63	67	71	76
Deposit money banks								
Net foreign assets	-156	-123	-102	-90	-96	-94	-65	-36
Net domestic assets	1,226	1,235	1,305	1,396	1,558	1,658	1,730	1,812
Net claims on the central bank 1/	36	38	76	69	65	70	74	79
Net claims on government	297	302	317	328	362	382	413	444
Claims on private sector	1,074	1,111	1,189	1,246	1,286	1,338	1,426	1,524
Claims on corporates	340	358	381	386	365	379	404	432
Claims on households	665	676	723	766	789	821	875	935
Claims on other	69	76	85	94	132	138	147	157
Other items, net	-181	-216	-278	-248	-156	-132	-183	-235
Deposits	1,070	1,111	1,202	1,306	1,462	1,563	1,665	1,776
Demand deposits	613	688	774	883	1,154	1,234	1,314	1,402
Other deposits	458	423	428	423	308	329	351	374
Consolidated banking system								
Net foreign assets	234	233	290	345	429	525	589	660
Net domestic assets	1,031	1,092	1,156	1,221	1,394	1,442	1,518	1,590
Claims on government	267	277	283	290	346	396	427	458
Claims on private sector	1,074	1,111	1,189	1,246	1,286	1,338	1,426	1,524
Other items, net	-310	-296	-317	-316	-239	-292	-336	-391
Broad money (M3)	1,266	1,324	1,446	1,566	1,823	1,968	2,106	2,250
Memorandum items:	(Percentage change from end of previous year)							
Base money	3.9	5.2	25.9	4.0	26.4	12.4	9.6	7.9
Broad money (M3)	9.6	4.6	9.2	8.3	16.4	7.9	7.1	6.8
Net domestic assets	6.6	5.9	5.9	5.6	14.2	3.5	5.2	4.8
Net foreign assets	25.2	-0.7	24.8	18.8	24.3	22.5	12.1	12.1
Net claim on government	19.0	3.5	2.5	2.3	19.5	14.4	7.7	7.3
Claims on private sector	4.9	3.4	7.1	4.8	3.2	4.0	6.6	6.8
Deposit growth	8.4	3.8	8.2	8.6	12.0	6.9	6.5	6.7
	(Percent of GDP, unless otherwise noted)							
Broad money (M3)	67.9	66.6	68.2	68.3	78.3	76.0	73.0	72.2
Private sector credit	57.6	55.8	56.1	54.4	55.3	51.6	49.4	48.9
Broad money Velocity (GDP/M3)	1.5	1.5	1.5	1.5	1.3	1.3	1.4	1.4
Money multiplier (M3/base money)	5.7	5.7	4.9	5.2	4.7	4.6	4.4	4.4

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 10. Poland: Financial Soundness Indicators, 2013–2021

(Percent)

	2013	2014	2015	2016	2017	2018	2019	2020	2021Q1	2021Q2
Capital adequacy 1/										
Regulatory capital to risk-weighted assets	15.7	14.7	16.0	17.2	18.0	18.3	18.6	19.8	19.8	19.9
Regulatory Tier I capital to risk-weighted assets	14.1	13.5	14.6	15.6	16.2	16.3	16.4	17.4	17.5	17.6
NPLs net of provisions to capital 2/	12.1	12.1	10.2	9.2	8.1	9.4	8.9	7.5	7.5	7.4
Bank capital to assets 3/	9.1	8.9	9.4	9.5	10.0	9.8	9.6	9.4	9.2	9.1
Asset composition and quality										
NPLs to gross loans (nonfinancial sector)	5.0	4.8	4.3	4.0	3.9	3.9	3.8	3.7	3.5	3.4
Sectoral distribution of loans to nonfinancial sector										
Loans to households	51.2	50.6	51.0	51.6	50.6	50.2	51.1	52.2	51.9	51.9
Loans to non-financial corporations	24.8	25.1	25.6	26.0	26.6	25.3	24.9	23.7	23.7	23.2
Earnings and profitability										
Return on average assets (after tax)	1.1	1.1	0.8	0.8	0.8	0.7	0.7	0.0	0.0	0.1
Return on average equity (after tax) RORC 1/	12.1	12.3	9.1	9.2	8.2	7.5	7.8	-0.2	0.4	1.4
Interest margin to gross income 4/	56.1	58.2	57.2	56.9	61.2	62.8	62.8	62.1	59.8	58.0
Noninterest expenses to gross income 5/	57.2	54.9	61.9	59.3	59.8	60.2	60.0	70.1	69.8	69.9
Liquidity										
One month liquidity gap to assets 6/	-46.1	-46.7	-47.7	-47.9	-49.2	-42.7	-42.6	-35.7	-36.0	-31.0
Loans to deposits 7/	106.7	103.1	100.5	96.7	95.9	94.0	89.5	79.6	78.2	78.7
Sensitivity to market risk										
Net open positions in FX to capital 1/	-0.1	0.3	0.8	0.8	0.4	0.1	0.2	8.1	6.2	0.1

Note: 2021Q2 is the latest data available shown for 2021. Data according to Financial Soundness Indicators (FSI), except for asset composition and quality (indicators not part of FSI reporting template).

Sources: IMF FSI Database; KNF.

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

2/ "NPLs net of provisions to capital" calculated as impaired loans net of provisions (non- financial sector) to total regulatory capital.

3/ "Bank capital to assets" calculated as Tier I capital to assets.

4/ "Interest margin to gross income" calculated as interest income (interest revenues minus interest expenses) to net income from banking activity

5/ "Noninterest expenses to gross income" calculated as operating cost (the sum of banks's general expense and amortisation) to net income from banking activity.

6/ "One month liquidity gap to assets" calculated as (1M assets - 1M liabilities)/assets.

7/ "Loans to deposits" include non-financial sector only.

Annex I. Implementation of Past IMF Recommendations

2020 Article IV Recommendations	Policy Actions
Monetary Policy	
The accommodative monetary policy stance should be maintained until a recovery is well established. FX intervention for monetary policy purposes could be justified if additional asset purchases failed to adequately pass through to prices.	Policy interest rates were held near zero until October 2021, when the central bank increased rates followed by additional rate hikes in the context of increased underlying price pressures and high output growth. FX intervention has not occurred in 2021.
Fiscal Policy	
Targeted fiscal support should be provided to confront further waves of the pandemic while being flexible enough to support indirectly affected sectors.	Fiscal support became more targeted to the most affected sectors during the second and third waves of the pandemic. The sectors eligible for support were expanded from the initial list.
The fiscal deficit should be gradually reduced as the recovery takes hold.	The economic recovery and smaller pandemic-related fiscal support have contributed to an estimated reduction in the general government fiscal deficit from 7.1 percent of GDP in 2020 to 2.9 percent of GDP in 2021.
Financial Sector Policy	
Redesign the bank asset tax in favor of a quasi-VAT on banks' profits and remuneration.	There are no legal initiatives to modify the design of the tax.
Banks should work with borrowers to reach voluntary agreements to settle legal disputes.	The Polish FSA has proposed a framework for voluntary conversion of FX mortgages to zloty mortgages. The Financial Stability Committee has proposed temporarily lowering risks weights on FX mortgages for participating banks.
Structural Reforms	
Adjust labor market policies to foster participation and facilitate the reallocation of labor. Enhance active labor market policies to help workers acquire the skills needed to adapt to the post-pandemic economy. Bolster public investment, supported by Next Generation EU grants.	Poland's National Recovery Plan outlines a strategy to use Next Generation EU funds to increase public investment. The authorities believe that the PIT reform will increase labor force participation. The authorities plan to modernize job search assistance services and strengthen access to training, with an emphasis on digital skills.
Source: IMF staff.	

Annex II. Implementation of 2018 Financial Sector Assessment Program Recommendations

Recommendations	Agency[1]	Time[2]	Progress
Risk Analysis			
Address weaknesses in medium-sized banks, including the affiliating banks for cooperative banks, given their systemic importance in the banking system.	PFSA	I-NT	**In Progress** Affiliating banks are limiting business activity to improve apex functions and focus on service provision for cooperative banks. The use of IPS support funds allowed safe repair of member banks at risk. IPSs have progressed in performing members' internal controls.
Replace the asset tax on financial institutions with a tax on profits and/or remuneration.	MoF	I-NT	**Not Done** There are no legal initiatives to modify the tax.
Pursue bilateral negotiations to restructure distressed FX loans instead of law changes	PFSA, MoF	I	**In Progress** In Dec. 2020, PFSA Chair proposed terms for banks to offer voluntary settlements to clients, assuming that FX mortgages would be converted on terms equalizing them with PLN mortgages of the same vintages. The client's new liability takes in account actual payments vs. payments on hypothetical PLN exposure. Mediation between banks and clients shall be conducted at Mediation Centre of the Arbitration Court at the PFSA, and mediators were recruited to increase capacity to settle CHF loans. In 2021, three banks started offering settlements proposed by PFSA Chair.
Close data gaps and improve data for credit risk and interconnectedness analysis.	PSFA	I-NT	**In Progress** The NBP started a project to build a central credit registry (KRK), with PFSA participation. KRK will allow to monitor loans of a single debtor and a group of affiliated entities at bank-level, as well as at the level of the banking sector. It will also provide a basis for sampling loans for on-site examination. The first reporting is planned in 2023.
Financial Sector Oversight			
Reform and strengthen arrangements for supervision, based on the principles that the PFSA should have (i) sufficient staffing and resources, (ii) operational independence, (iii) effective governance, and (iv) appropriate formal status in the determination of regulatory priorities.	MoF, PFSA, NBP	I	**Done** In line with FSAP recommendations, legal changes were made to grant the PFSA status of state legal person in 2019, which gave freedom in managing budget and reduced the risk of under-financing. PFSA spending and staffing have increased. Organizational changes were made to improve efficiency of supervisory activities, and new units were established.
Bank			
Provide missing essential enforcement powers including (i) those to ease rigidities constraining prompt corrective action due to Administrative Code procedures; and (ii) power to dismiss both management and supervisory board members	MoF, PFSA	NT	**Done** The power for the PFSA to dismiss both management and supervisory board members, in a situation where they no longer meet necessary requirements, has been introduced in the Banking Act and entered into force on 28 April 2021.

Recommendations	Agency[1]	Time[2]	Progress
Insurance			
Implement approach to supervision of the insurance-led financial conglomerate	PFSA	I	**Done** Repealing the waiver issued by the PFSA in 2018 and three administrative decisions on capital adequacy calculation, intragroup transactions (IGT) and significant risk concentration (RC) issued in 2019. Capital adequacy, IGT and RC reports, as well as recovery plan (incl. banks) regularly assessed as a part of on-going supplementary supervision process; organizational changes (dedicated employees, improved cooperation).
P 44Review approach to insurance conduct of business supervision across the relevant agencies to increase preventative work, especially by the PFSA	MoF, PFSA	NT	**Done** A review of the approach to insurance conduct of business supervision started in 2019 under the process of updating PFSA's model of conducting supervision of (re)insurers, with adoption and gradual implementation of Strategic Priorities for Insurance Supervision 2019–2020 (internal document). Inter alia, additional reporting for unit-linked products was introduced in 2019, new methodology in Risk Assessment Framework was based on products' lifecycle; customer protection inspections verify adoption of recommendations by (re)insurers., complaints analysis was changed to consider market practices and impact on finances of insurers. Organizational changes in PFSA and increased staffing enhanced conduct of business supervision, incl. thematic reviews/inspections and development of intermediaries register. Inspections assess management of mis-selling risk in unit-linked products, or in claim settlements on MTPL (motor third party liability). The 2nd edition of Strategic Priorities for Insurance Supervision 2021–22 envisages further works to enhance conduct of business supervision.
Capital Markets			
Conduct periodic assessments of the enforcement functions	PFSA	I	**Done** The PFSA introduced internal policy, which allows Enforcement Department to focus on significant cases, where hard supervisory tools are used. Less significant cases are dealt with by the PSFA supervisory departments authorized to use soft tools. PFSA maintains a register of administrative proceedings and monitors the stage of progress by the employee conducting the case, the manager, and the director.
Strengthen criminal law enforcement	PFSA	NT-MT	**Done** Changes from 2018 broadened PFSA's Board to include, inter alia, Minister responsible for special services to ensure immediate identification of criminal risks at the financial market. The revised law allowed effective exchange of information (including classified) among PFSA, Internal Security Agency, Central Anti-Corruption Bureau, National Tax Revenue Administration, Police, and Competition and Consumer Protection Office.

Recommendations	Agency[1]	Time[2]	Progress
			In progress PFSA proposed to add National Prosecutor's Office to the above list to facilitate exchange of information, the project is still discussed.
Macroprudential Policies			
Include vulnerability assessments of payment and settlement systems in the FSR and overall systemic risk monitoring	NBP	I	**Done** After internal analysis, NBP decided not to include assessment of risks in payment system in the Financial Stability Report. It is provided in *Polish Payment System Oversight Report* presented annually to NBP Board and to Financial Stability Committee (FSC-M), and forming basis for risk assessment by NBP and by FSC-M. The report was first presented to FSC-M in Dec. 2019, and FSC-M noted in *Macroprudential Policy Strategy in Poland* (2019) that resilience of financial infrastructure is one of systemic risk dimensions. Risks related to payment and settlement systems are monitored continuously.
Ensure the timely and substantive vetting of all use of macroprudential instruments by the FSC-M, in order to confirm the FSC-M's overall responsibility in this field	Members of the FSC-M	I	**In Progress** NBP proposed to formalize in *Macroprudential Strategy* a requirement for FSC-M to discuss changes of macroprudential instruments prior to implementation, which did not gain traction in other institutions. However, in a growing number of cases member institutions consult intended measures in FSC-M prior to implementation. FSC-M intends to review the *Macroprudential Strategy* in 2022, also with a view to enhance its competences in the use of macroprudential instruments.
Crisis Management and Bank Resolution			
Propose legal amendments to provide for (i) more timely petitions for bank bankruptcy; (ii) harmonize the triggers for bankruptcy and use of resolution powers both; (iii) address the need for third-party opinion on solvency; (iv) conduct P&A transactions in lieu of a deposit payout; and (v) BGF independence	MOF with KNF & BGF	NT	**Partially Done** (i) Timely petitions for bank bankruptcy are a matter of a proper application of the law, and not additional rules. Triggers for pay-out of deposits and resolution have been used without problems with provisions describing the triggers. (ii) Triggers for bankruptcy and use of resolution powers are compatible. PFSA had no problems identifying them. (iii) Legal provisions require audited financial statement to confirm insolvency before PFSA's filing a bankruptcy petition, which may delay the process, but such serious decisions must be based on verified data. (iv) 2018 changes introduced an additional tool to prevent deposits pay-out: takeover of insolvent or illiquid banks by a 'healthy' bank (with consent of acquiring bank) and possible BGF's financial assistance. BGF is working on proposals to introduce administrative insolvency procedures for banks, but such a significant change needs broad consultations. (v) BGF performs public functions and will be classified as public finance

Recommendations	Agency[1]	Time[2]	Progress
			sector entity from Jan. 1, 2022. MoF supervision of BGF involves only legality criteria. MoF may request BGF's Council to dismiss Management Board members in specific cases (e.g., violation of law), but cannot dismiss them independently. From Jan. 1, 2022, BFG Board members' terms will be extended from 3 to 5 years. BFG Council could dismiss Board members, incl. President, before end of term in case of: (1) punishment for criminal or tax offense; (2) resignation; (3) loss of Polish citizenship; (4) loss of legal capacity; (5) not warranting performance of assigned duties. Board members can be dismissed during their terms on inability to perform duties due to long-term illness (above 3 months).
Require recovery plans for affiliating banks, significant credit unions, and banks undergoing rehabilitation	PFSA	I	**Partially Done** Affiliating banks, as participants of IPSs, can be a part of the group recovery plan. Cooperative banks under rehabilitation are under regime of recovery plans (in case of independent banks) or IPS' group plans (for IPS members). Credit Unions (CUs) are not obliged by the law to prepare resolution plans. CUs recognized by BGF as intended for resolution may be obliged to prepare such plans. SKOK Stefczyka (the largest CU) is preparing a resolution plan, monitored by BGF (draft has been prepared). Other CUs are designed for standard insolvency process and, in case of loss, CUs must prepare and present rehabilitation program for PFSA approval. Major CUs were obliged to prepare such programs and are now revising them to reflect new circumstances (mostly COVID19 pandemic impact). Most of banks under rehabilitation were required to submit recovery plans.
Cooperative Banks and Credit Unions			
Strengthen the supplementary internal control and resolution arrangements to address elevated risk and develop strategies to promote further integration/consolidation	PFSA, MoF, ABs, IPS	I	**In Progress** Cooperative banking sector is undergoing consolidation, helped by IPSs, with 19 mergers in 2021 and 36 since 2018. IPSs are strengthening internal control and the PFSA reviews its quality. The PFSA promotes integration, including sharing of services and products, and cooperation among cooperative banks is gaining importance. IPSs have made progress in performing internal control among members.
Develop and implement a restructuring strategy to (i) consolidate viable and resolve non-viable credit unions through exit; and (ii) revisit whether a stand-alone credit union sector remains appropriate	PFSA, MoF	I	**In Progress/Done** Restructuring and consolidation of credit unions' sector is ongoing. CUs initiate mergers within the sector, facing problems with inability to generate funds and lack of interested external stakeholders. (i) Mergers, takeovers by banks and insolvencies reduced number of CUs from 30 in 2018 to 22 in Sep. 2021. (ii) Balance sheet of CUs is steadily declining, and their share in Polish financial sector is very small, but they still provide basic services important for financial inclusion to 1.36 million customers. The priority is to maintain the sector's

Recommendations	Agency[1]	Time[2]	Progress
			activity with restructuring and recovery. A working group in Financial Stability Committee developed, and FSC approved recommendations for actions supporting stability of the CUs sector.

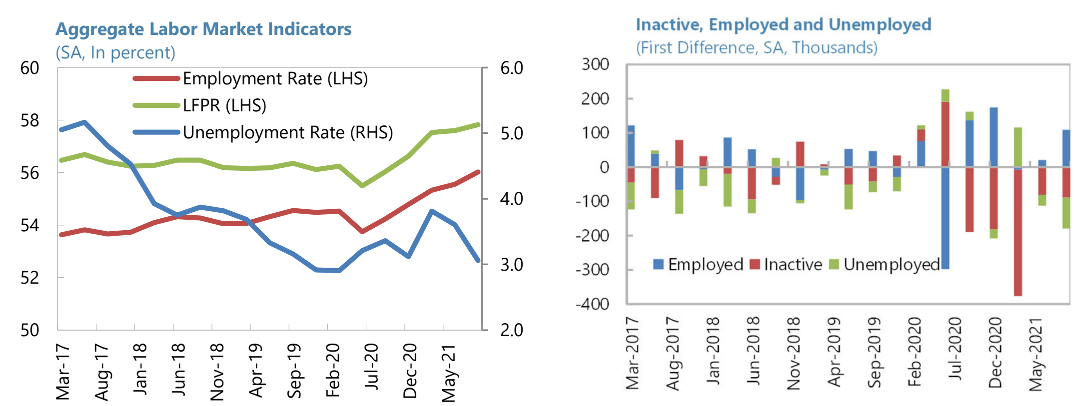
[1] Agencies: MoF=Ministry of Finance; NBP=National Bank of Poland; PFSA=Polish Financial Supervision Authority; BGF=Bank Guarantee Fund; FSC-M=Financial Stability Committee-Macroprudential

[2] Time Frame: C = continuous; I (immediate) = within one year; NT (near term) = 1–3 years; MT (medium term) = 3–5 years

Annex III. Labor Market Developments During Pandemic

1. The pandemic has had a limited and temporary impact on the Polish labor market. The pandemic and associated containment measures initially caused temporary stress in the labor market, with the unemployment rate (s.a.) peaking at 3.8 percent in 2021:Q1, the employment rate dropping to 53.7 percent in 2020:Q2, and the labor force participation rate (LFPR) dropping to 55.5 percent in 2020:Q2.[1] However, the trend reversed and by 2021Q3 the unemployment rate stood at 3.1 percent; the employment rate (for 15–89 year-olds) reached an all-time high of 56.0 percent, and the LFPR (for 15–89 year-olds) reached 57.8 percent. The number of economically inactive persons dropped to an all-time low of 12.5 million. Among EU countries, Poland has had one of the lowest increases in the unemployment rate and one of the largest employment rate increases during the pandemic.

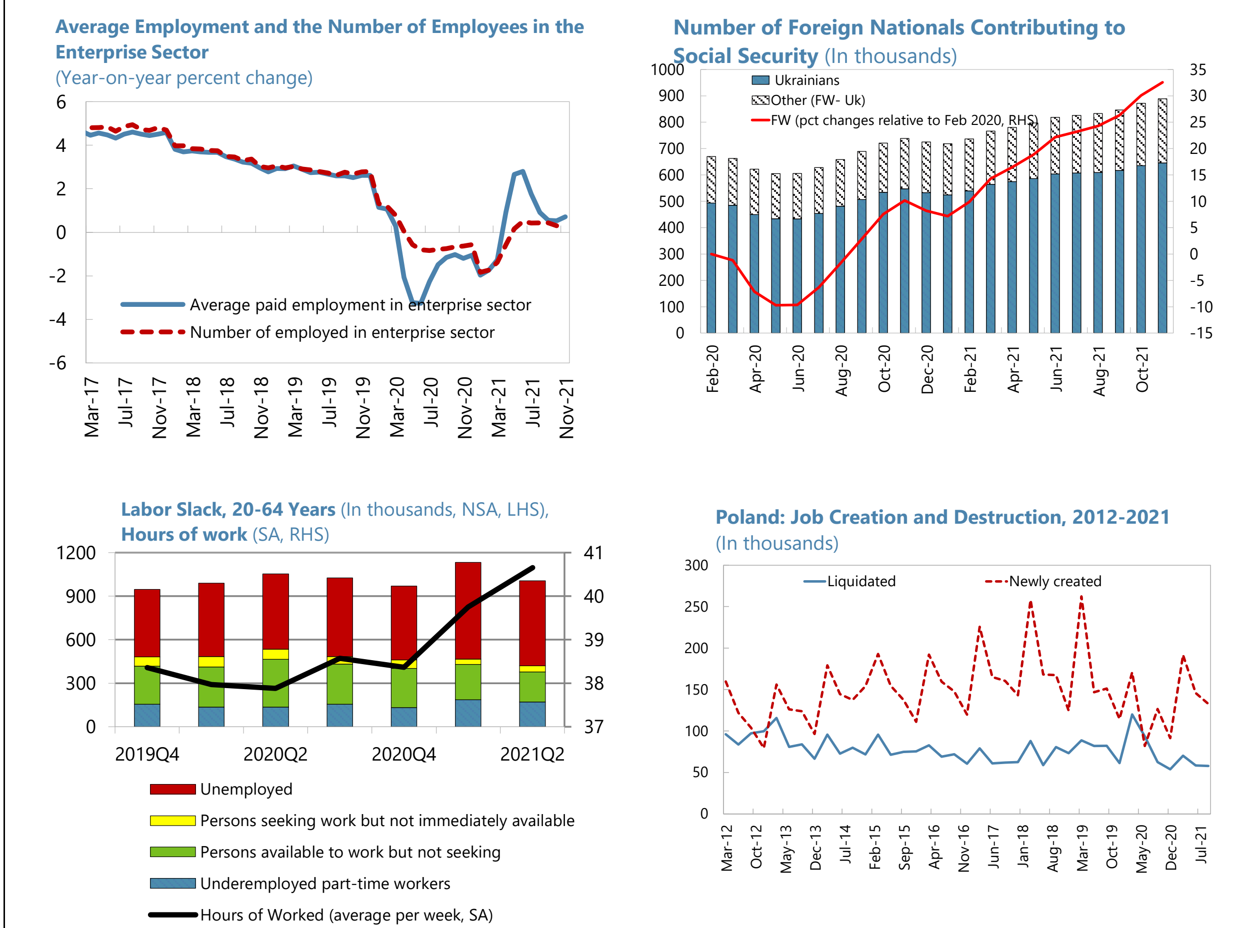
Figure 1a. Aggregate Labor Market Developments



2. The recovery is advanced, but some measures of slack have not fully returned to pre-pandemic levels. Employment growth in the enterprise sector turned negative in 2020 but bounced back in 2021. The number of foreign workers, primarily Ukrainians, contributing to social security declined between February and August 2020, but has recovered and has exceeded the pre-pandemic level since September 2020. The number of liquidated jobs increased in the first half of 2020 but quickly recovered to its historical norm. Nonetheless, slack in the form of the number of part-time workers and, especially, unemployed individuals is still above the pre-pandemic level. This may reflect in part the surge in participation. Also, the creation of new jobs, although recovering in the course of 2021, remained below pre-pandemic highs. This may reflect mismatches between the skill requirements of expanding sectors and the skills of individuals who are available to work.

[1] A series break in the Q1:2021 Labor Force Survey makes it difficult to interpret the increase in the unemployment rate in Q1:2021.

Figure 1b. Aggregate Labor Market Developments

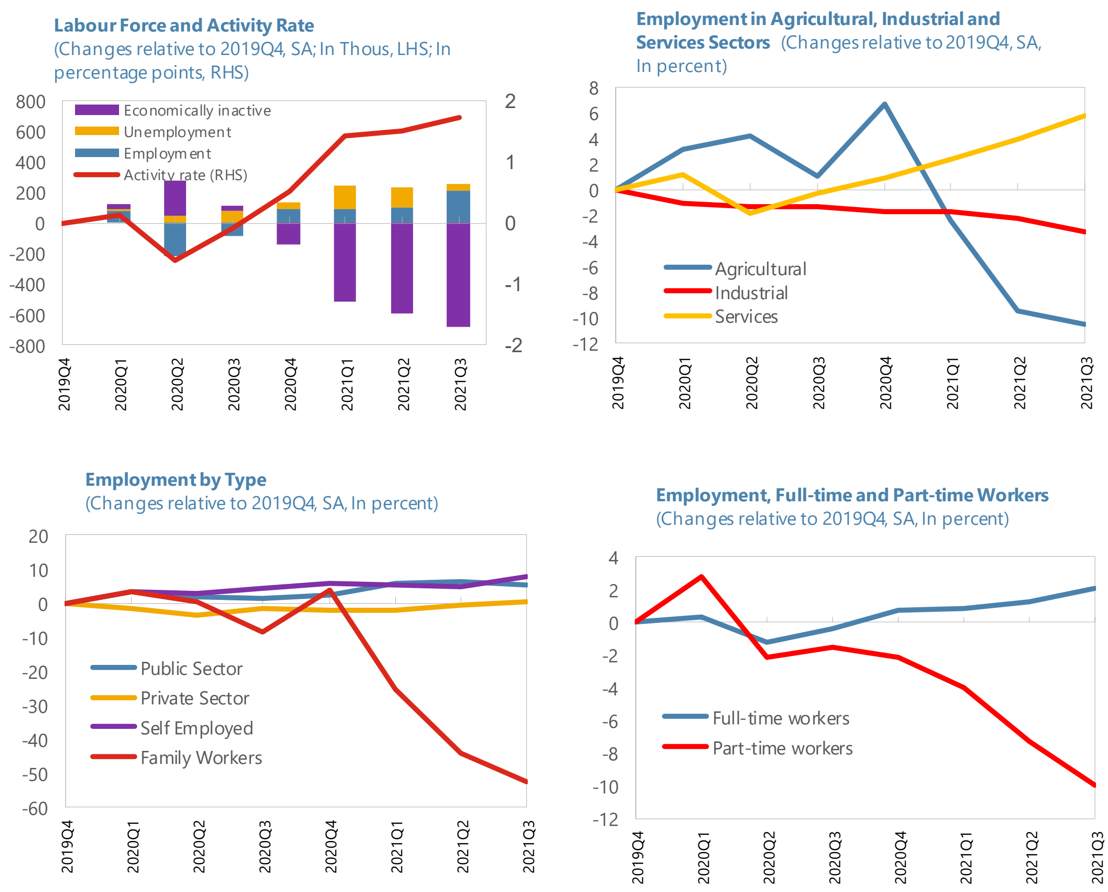


Sources: Central Statistical Office of Poland, ZUS, Haver Analytics, Eurostat, IMF Staff Calculations

3. Some differences across sectors and employment types have been visible during the pandemic. There have been employment losses in the agricultural sector relative to end-2019 and to a lesser extent in the industrial sector, while employment in services has grown. The employment losses for part-time and family workers amount to 10 percent and 52.3 percent, respectively, as of 2021:Q3, while full time employment has increased.

4. Differences across age groups and gender have also been observed during the pandemic. Labor stress seems to have been overall less severe (or the recovery more benign) for women than for men in Poland, as shown in Figure 3, where the gender gap is defined as the difference between percent changes in labor market variables for males and females. The dynamic of inactivity rates relative to pre-pandemic levels for different age groups shows that the youngest groups have suffered a persistent but modest impact as the number of inactive persons aged 15–24 stayed elevated (by 3 percent as of 2021:Q3). In contrast, prime-age workers' inactive population,

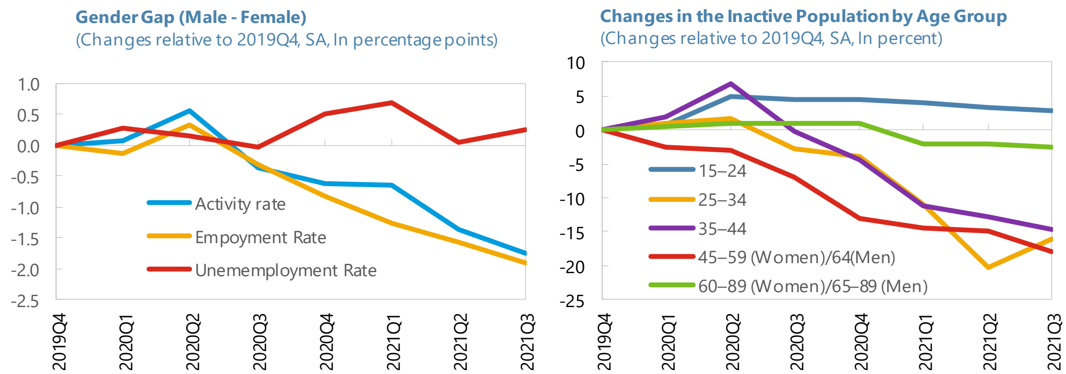
Figure 2. Sectoral Employment During the Pandemic



Sources: Central Statistical Office of Poland, Haver Analytics, IMF staff calculations.

after initially rising in some cases, have dropped substantially (by 17 percent for 25–59 year-old women/25–64 year-old men), signaling their strong return to the labor market. The pattern of recovery in unemployment is also interesting. Initially the newly unemployed were people who lost jobs, but as the recovery progressed the presence of people not previously employed gain weight among the group of the unemployed, reflecting the rise in participation. Also, low-skilled workers have experienced relatively more persistent unemployment, as shown in Figure 4 (although even for this group a tightening labor market helped reduce unemployment in recent quarters). Therefore, a well-designed skills policy can help reduce long term unemployment. Moreover, reskilling and upskilling, especially for low-skilled workers in contact-intensive sectors, should focus on enhancing digital skills, addressing knowledge deficits, and fostering the acquisition of new skills through lifelong learning. In this context, the authorities' plans to strengthen access to training, with a special emphasis on digital skills are welcome.

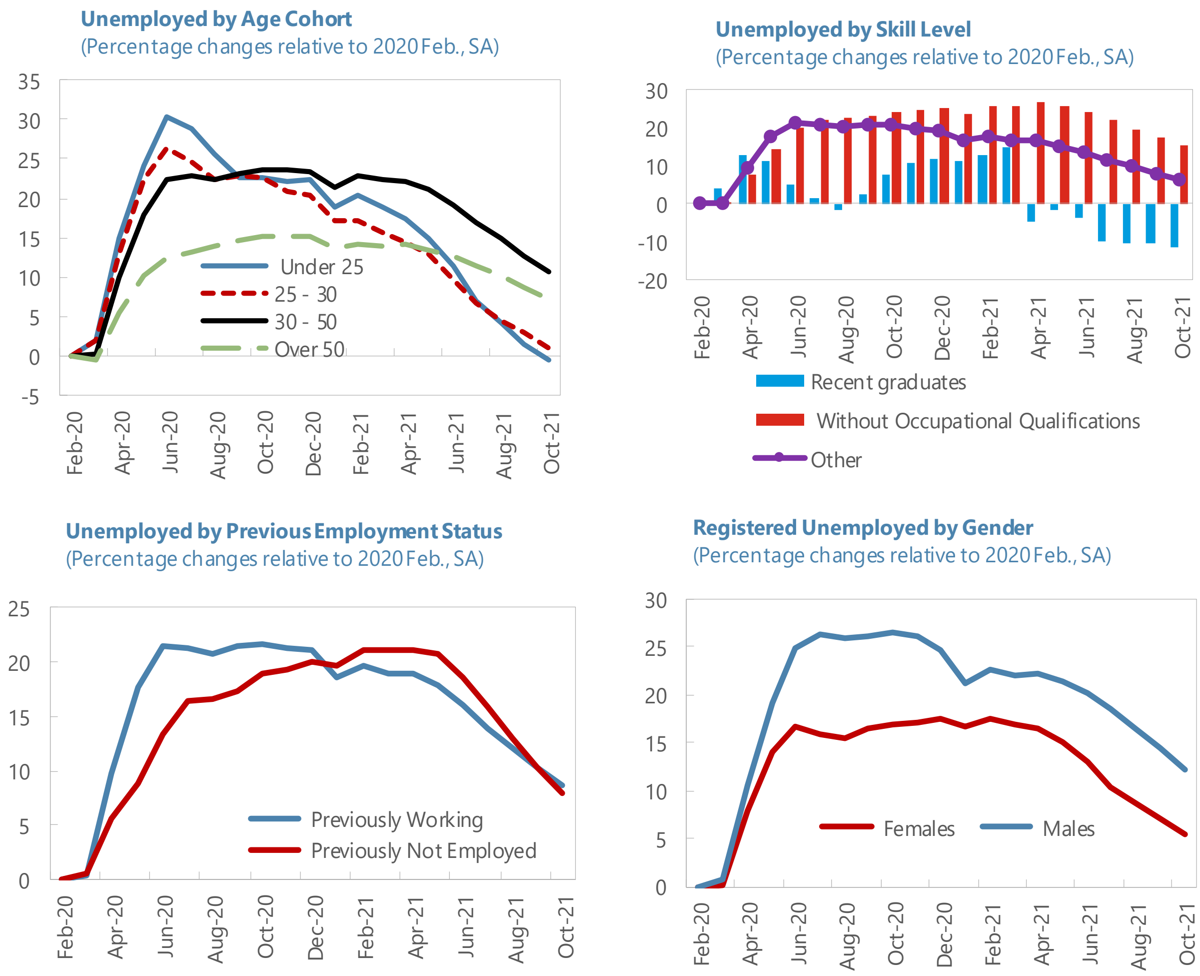
Figure 3. Gender and Age Gaps in the Labor Force During the Pandemic



Sources: Central Statistical Office of Poland, Haver Analytics, IMF staff calculations.

5. The drive for sectoral labor reallocation can be significant in the wake of the pandemic. Sectoral employment and value-added data highlight the asymmetric and potentially persistent impact of the COVID-19 shock in contact-intensive sectors, with transition challenges looming large, especially for low-skilled workers who may have a hard time integrating into expanding digital sectors due to skill mismatches. Relative to pre-pandemic, the value-added in the accommodation and catering sector dropped significantly (Figure 5). Employment in most contact-intensive sectors has not yet recovered, with significant losses in the accommodation and catering sectors. However, this sector has a low labor share. High-tech sectors such as information and communication experienced employment growth, thanks to the ability to work remotely and growing e-commerce. The productivity loss in the accommodation and catering sector has been the largest, although this loss has been moderating over time.

Figure 4. Unemployment During the Pandemic



Sources: Central Statistical Office of Poland, Haver Analytics, IMF staff calculations.

Figure 5. Sectoral Transition, Employment, Value-Added

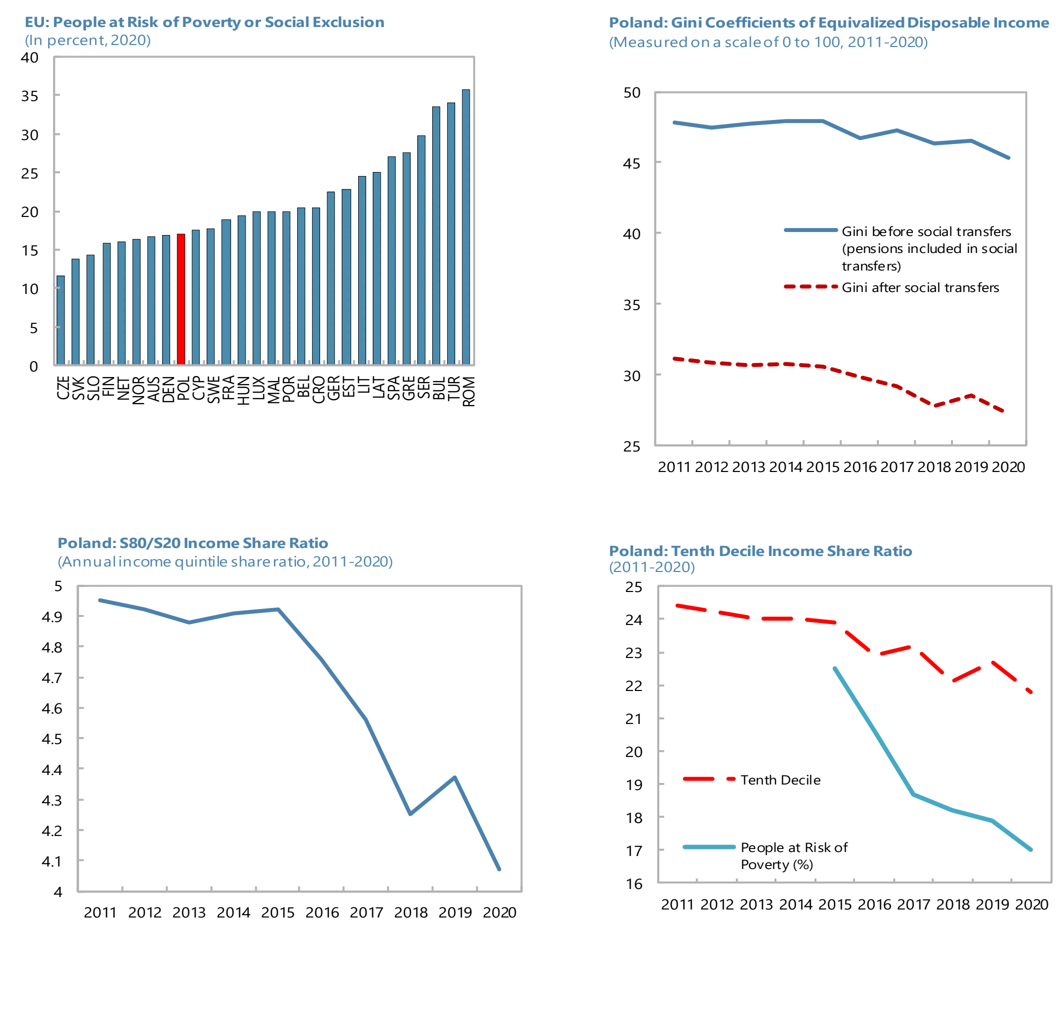
Sources: Central Statistical Office of Poland, Haver Analytics, IMF staff calculations

Notes: Employment of Adm & Support sector includes administrative and support service activies.

Real value added of Adm & Support sector includes Public administration and defense, compulsory, social security, education, health care and social work; professional, scientific and technical, administration and support service activities.

Annex IV. Inequality and Poverty

1. Poverty and inequality have declined in Poland in recent years. The share of the population at risk of poverty declined over the last five years by more than 5 percentage points to around 17 percent, lower than the EU average. Data also point to a reduction in inequality over the last decade including a sustained decline in the Gini coefficient and the ratio of the average income of the 20 percent highest income to the 20 percent lowest income (S80/S20 ratio). Also, the share of the 10 percent of earners with the highest income has fallen over time. Social transfers, including pensions, have played a significant role in income redistribution. Because the relevant survey data for 2020 refer to 2019 incomes, no conclusions can yet be drawn regarding the evolution of poverty and inequality during the pandemic.



Source: EU-SILC Survey, Eurostat
2020 data is provisional as per Eurostat-SILC Database

Annex V. Foreign Exchange Mortgages: Legacy Portfolio with Substantial Legal Risks

1. **Foreign currency (FX) housing loans are a legacy issue in Poland.** FX mortgages became more popular in the early 2000s prior to the Global Financial Crisis (GFC). They were mostly issued in Swiss franc (CHF), as large interest differentials and a favorable exchange rate made for lower servicing costs than zloty (PLN) borrowing. Exchange rate (XR) risk was perceived as muted, with PLN appreciation seen as a structural trend driven by income convergence and access to the euro area. While not all banks offered such products, most foreign-owned and medium-sized domestic banks sold FX loans aggressively to gain market share. Supervisors gradually tightened prudential regulations (Box 1), with a recommendation against FX loans to unhedged households effectively ending the practice in 2013. Despite a steady decline in the share of the portfolio in the last decade, FX mortgages still represent a third of banking sector capital and almost half of own funds.

Box 1. Evolution of Prudential Regulations on FX Mortgages

Banking supervisors initially flagged risks associated with FX mortgages, but with portfolios continuing to grow, prudential regulations were enacted and gradually tightened:

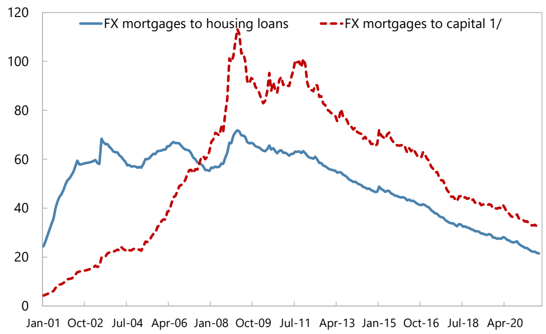
- **Recommendation S in 2006:** Imposed conservative parameters to assess creditworthiness of borrowers: interest rate not lower than PLN-denominated loans, and 20 percent higher principal required to account for XR risk.
- **Amendment of Recommendation S in 2008:** Banks were obligated to clearly present risk and costs of FX mortgages before signing loan agreements.
- **Amendment of Recommendation S in 2011:** Banks should limit XR risk by avoiding currency mismatches between the borrower's income and credit. Maximum debt service-to-income ratio for FX mortgages set at 42 percent (versus 50 percent for PLN-denominated loans).
- **Amendment of Recommendation S in 2013:** Retail mortgages should be granted in the same currency as the borrower's main income. The 2013 revision to Recommendation S effectively banned FX mortgage lending.
- **Other prudential requirements:** Risk weight on FX mortgages was increased gradually to 150 percent in 2017, compared to 35 percent for PLN mortgages, while the Polish FSA requires capital add-ons for banks with substantial exposures to FX mortgages.

2. **FX mortgages are not a major source of credit risk.** Despite the post-GFC appreciation of the CHF against the PLN, FX mortgages continued to perform well, partly because a decline in CHF LIBOR dampened debt service increases, and partly because regulations mostly limited their use to higher-income borrowers. FX mortgage NPL ratios are below the average NPL ratio and similar to that for PLN mortgages from corresponding vintages. The recent uptick in the NPL ratio mainly reflects provisions for legal risks rather than delinquent payments. While credit risk on FX mortgages is not a systemic threat, the most exposed banks may face challenges in meeting the heightened capital requirements.

Figure 1. Background on FX Mortgages

The active FX mortgage portfolio has declined over time....

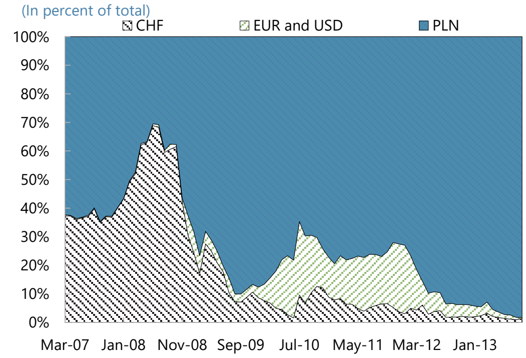
Relative Size of FX Mortgages
(Current XRs, in percent)



1/ Banking sector capital and reserves.

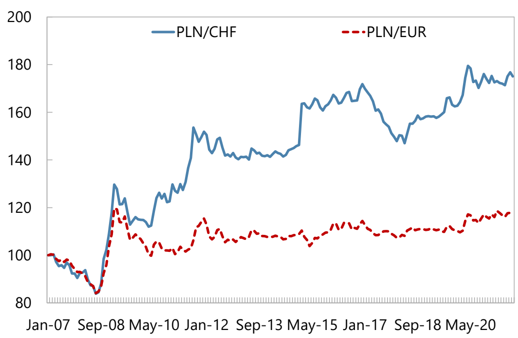
...as regulations banned such loans to unhedged households.

Currency Structure of New Mortgages
(In percent of total)



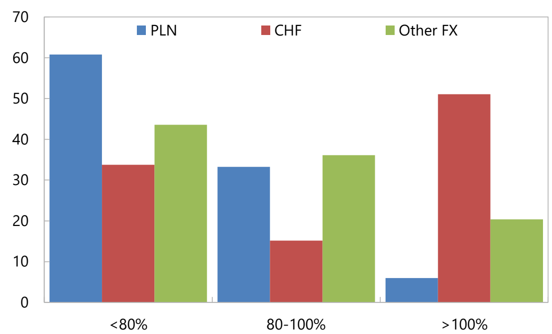
Despite the impact of CHF appreciation on CHF borrowers...

Exchange Rate Developments
(Jan. 2007 = 100)



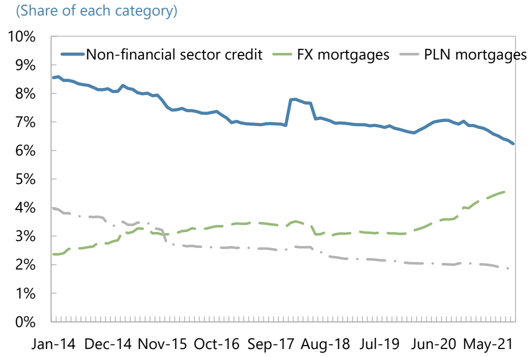
...raising LTV ratios significantly...

Mortgage LTVs by Currency in 2015
(Percent of loans in each category)



...the credit quality of the FX portfolio remains sound...

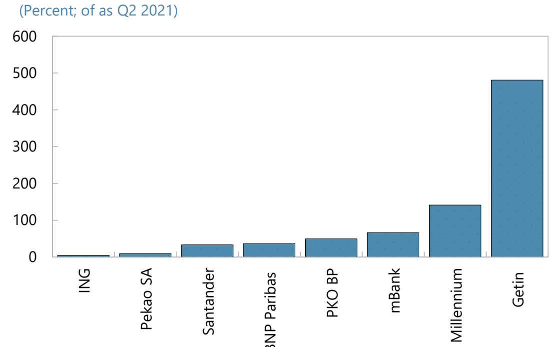
Non-Performing Loans[1]
(Share of each category)



1/ National NPL definition

...though the relative burden of FX mortgages is uneven across banks.

CHF Mortgages in Percent of Banks' Own Funds
(Percent; of as Q2 2021)



Sources: NBP; KNF; Bankier.pl; reports of banks quoted at WSE; and IMF staff calculations.

3. **Legal risks for FX mortgages have increased sharply.** While PLN depreciation did not erode credit quality, it did inflate the value of principal. Loan-to-value (LTV) ratios for majority of CHF loans exceeded 100 percent by 2015, despite prior amortization. Attempts to enact a mechanism incentivizing conversion to PLN failed to gain legislative approval, leaving dissatisfied borrowers with the option of litigation in court. The number of court cases began to accelerate after the EU Court of Justice (ECJ) verdict of October 2019, which stipulated that contracts containing unfair clauses could be nullified, though judgement was left to domestic courts. After this decision, borrowers have been winning about 90 percent of cases, whereas banks had previously prevailed in ¾ of cases. Courts typically consider XR indexation clauses to be unfair because they refer to banks' internal XRs, with no objective benchmark, and that FX risks may not have been sufficiently disclosed.

4. **Courts have frequently decided to nullify contracts, but verdicts are not homogeneous.** For example, some verdicts mandate conversion to PLN at the original XR but leave the interest rate based on CHF LIBOR. Courts mostly refrain from deciding final settlements between banks and clients, leaving the settlement for separate proceedings. Most verdicts are preliminary, as banks appeal to higher-level courts.

5. **Uncertainty around legal scenarios remains high.** Heightened legal risks have prompted banks to increase provisioning, based on the likelihood of increased lawsuits and possible outcomes. With the heterogeneous lines of judgement and lack of clarity on final settlements, broad outcomes are difficult to predict. The Supreme Court's Civil Chamber was expected to issue guidelines as early as March 2021 to clarify important legal issues for lower courts (Box 2), but this has been delayed without a clear timeline for a decision—although in the meantime some interim guidance from a small panel of Supreme Court judges has become available (see below).

Box 2. Issues to be Clarified by Supreme Court

- If XR indexation clauses of FX loans are judged unfair and not binding, can they be replaced with exchange rate clauses based on civil code or customary standards?
- If setting a binding exchange rate for FX-denominated or FX-indexed loans is not possible, could the remaining contractual provisions be binding for both parties?
- If a contract is nullified, but principal was paid by banks (fully or in part) and borrowers made repayments to bank, are claims of borrowers and banks separate, or is there one claim equal to the difference between the two claims?
- If a contract is nullified because of unfair clauses, does limitation of banks' claims to get back principal disbursed to borrowers start at the time of loan disbursement?
- If a contract is nullified, and any of its parties can claim amounts paid to the other party, could it also claim remuneration on using these amounts by the other party?

6. **The NBP has rightly identified FX mortgage litigation as the main risk to financial system stability.** To defuse this risk, the Chairman of the Polish Financial Supervisory Authority (KNF) has proposed that banks offer voluntary conversion of FX mortgages at original exchange

rates, applying the same terms from PLN loans at the time. The KNF estimates that voluntary conversion would cost PLN 35 billion—about a third of outstanding FX loans or 19 percent of own funds of affected banks—but the cost adverse legal scenarios would be much higher (Table 1), posing a risk to financial sector stability. However, the probability of the costliest scenario, in which banks would be unable to get back principal due to limitation of their claims, appears to have diminished after the narrow (seven-person) Civil Chamber of Supreme Court verdict that limitations of claims cannot start at the date of credit disbursement.

Table 1. Possible Cost of Selected Legal Scenarios

Legal scenario	Description	Estimated Cost PLN billion	 Percent of own funds
NBP exchange rate	Keeping contracts but replacing banks' internal XRs with NBP official XRs	8.8	5
PLN plus LIBOR	Keeping contracts but converted to PLN at original XRs with LIBOR interest	78.5	43
Voluntary conversion	Voluntary conversion as proposed by KNF, FX mortgages converted at original XRs with terms at par with PLN loans from the same vintages	34.5	19
Nullifying with repayment of principal and cost of capital plus markup	Nullifying agreements, banks get back principal and receive remuneration for cost of capital (WIBOR plus markup)	56.4	31
Nullifying with repayment of prinicipal and cost of capital	Nullifying agreements, banks get back principal and remuneration for cost of capital (WIBOR)	70.5	39
Nullifying with principal	Nullifying agreements, banks get back principal, no remuneration for cost of capital	101.5	56
Nullifying without principal and remuneration	Nullifying agreements without returning principal (due to limitation of banks' claims), no remuneration for cost of capital	234	130

Note: The first three scenarios apply to all outstanding credits; others also cover repaid loans.
Source: KNF Opinion for Supreme Court, June 2021.

7. Progress with FX mortgage restructuring has so far been uneven. The KNF restructuring proposal was well received by banks, and the NBP signaled a willingness to support conversion—which would require banks to purchase foreign currency to close open FX positions—provided that broad participation is reached, covering most banks and FX loans. To date, only three banks (state-controlled PKO BP and BOS Bank, and private ING Bank Slaski) have formally launched such programs. PKO BP shareholders agreed to create a reserve for this purpose, covering about a third of outstanding FX loans. PKO BP noted an initial positive response, with several thousand customers, out of about 100,000 active FX loans, expressing interest in conversion during the first week. So far, about 10,000 restructuring settlements have been submitted to KNF's arbitration court. While other banks are expected to follow suit, the KNF proposal may be too costly for the most exposed banks, some of which are offering their own proposals. For example, Millennium Bank has concluded more than 4,000 restructuring agreements on its own terms, about one-tenth of its FX mortgage portfolio.

8. Current legal uncertainties may actually incentivize voluntary restructurings. Despite recent borrower-friendly court judgements, final outcomes remain far from clear. With both banks and borrowers facing uncertainty, voluntary restructuring agreements can reduce the risk of an inferior outcome for both sides. Financial sector authorities support voluntary settlements, as evidenced by the Financial Stability Committee's (KSF-M) recommendation to temporarily reduce FX mortgage risk weights for banks actively engaged in restructuring in line with KNF guidelines. The recommendation awaits an implementing regulation from the Ministry of Finance.

Annex VI. Public Sector Debt Sustainability Analysis

General government debt is projected to decline from 57 percent of GDP in 2020 to 56 percent of GDP in 2021, based on rapid real and nominal GDP growth and a decline in the fiscal deficit. Over the medium term, debt is projected to stabilize around 50 percent of GDP. Debt is assessed to be sustainable, with debt sustainability bolstered by a favorable outlook for economic growth. However, debt would increase steadily over the medium term under various shock scenarios, underscoring the prudence of some additional reduction in the fiscal deficit over the medium term to place debt on a downward path.

Baseline and Realism of Projections

1. Debt levels. General government debt is estimated to have declined modestly to 56 percent of GDP in 2021, driven by a rebound in real and nominal GDP growth and reduction in the fiscal deficit to an estimated 2.9 percent of GDP. A continued increase in government deposits estimated at 1.5 percent of GDP in 2021 prevented a further decline in debt. Following an anticipated decline in the fiscal deficit by 2023 under current policies to around 2½ percent of GDP, debt would stabilize over the medium term around 50 percent of GDP. A decline in baseline nominal GDP growth (as both real GDP growth and inflation slow) and an increasing effective interest rate serve to stabilize debt after 2023, despite a relatively constant primary deficit.

2. GDP growth. Following a contraction of 2.5 percent in 2020, real GDP growth is estimated at 5.4 percent in 2021 and projected at 4.6 percent in 2022 and to average 3¼ percent over 2023–26. An anticipated (yet threatened by delays) boost in investment spending financed by Next Generation EU grants is projected to increase GDP growth in 2022–23, but the boost would fade over 2024–26 due to base effects and the phasing out of additional spending. Since 2012, staff's GDP growth projections have been pessimistic on average, with a fairly large forecast bias relative to other countries.

3. Fiscal path. The fiscal deficit is estimated to have declined from 7.1 percent of GDP in 2020 to 2.9 percent of GDP in 2021, as revenues recovered, and crisis-related expenditures were phased out. After a temporary increase to 3.1 percent of GDP in 2022 tied to anti-inflation tax reductions, the deficit would stabilize at about 2½ percent of GDP over the medium term. Staff fiscal projections have shown little bias on average in recent years. While the projected adjustment in the primary balance is relatively large in historical and international context, most of the adjustment already occurred in 2021 by letting most pandemic-related emergency measures lapse.

4. Sovereign yields. The effective interest rate on government debt has been on a declining path since the global financial crisis, reflecting Poland's strong fundamentals and favorable global interest rates. The effective interest rate declined from 3.0 percent in 2019 to 2.9 percent in 2020 and is estimated to have fallen to 2.2 percent in 2021 as the much lower interest rates observed since early 2020 have increased their weight through new issuance to finance significant deficits and maturing debt. However, Polish Treasury yields increased significantly in the last quarter of 2021 as market expectations for policy interest rates increased quickly, with the ten-year yield increasing in the last quarter by around 100 bps to above 3.0 percent. Should these rates hold, the effective interest rate is projected to increase gradually to 3 percent over the medium term, still lower than the average of 3.3 percent over 2014–2019. The lower effective interest rate is projected to reduce the share of tax revenues devoted to interest payments from an average of 7.2 percent over 2015–2020 to 6.0 percent over 2021–2026. In total, yields on ten-year domestic Treasury securities increased more than 200 basis points in 2021 to nearly 3.4 percent. CDS spreads were broadly stable in 2021 around 50 basis points.

5. Maturity and rollover risks. Maturity risks are well managed. The average maturity of outstanding debt is estimated at 4.8 years, and the share of short-term government debt is under 1 percent of the total. There have been significant shifts in the composition of domestic Treasury investors since 2020, as foreign investors reduced their share from 23 percent at end-2019 to 16 percent by October 2021. The central bank is a major new presence in the market, having acquired a 10 percent share of outstanding Treasury securities since March 2020. Despite selling bonds to the central bank, domestic banks' holdings of outstanding Treasury securities have been stable at about 46 percent of total. The overall share of external debt in general government debt declined from 57 percent in 2015 to 35 percent in 2020. In addition, the share of foreign currency debt in state debt was 24 percent in 2020. In line with the authorities' debt management strategy, the baseline assumes that the share of foreign currency debt in total debt will remain at less than 25 percent and external debt in total debt no more than 40 percent over the medium term.

6. Debt sustainability analysis (DSA) risk assessment. The heat map highlights risks associated with large gross public financing needs, the relatively large economy-wide external financing requirements (about 17 percent of GDP in 2020), and the share of public debt held by non-residents. Gross public financing needs estimated at 8 percent of GDP were large in 2021, but financing needs were comfortably met. Gross external financing needs are boosted by a high level of intra-company FDI loans, which tends to be more stable than other sources of external debt. While the share of public debt held by non-residents is high, this risk is mitigated by the important role of institutional investors, which tend to be more long-term investors. The willingness of domestic banks and the NBP to step into the Treasury market during the turmoil at the onset of the pandemic in 2020 also facilitated the smooth exit of foreign investors amid global capital flow reversals.

7. Fan charts. The symmetric fan charts, which assume symmetric upside and downside risks, indicate that the debt-to-GDP ratio could drop to around 47 percent by 2026 with a 25 percent probability. On the other hand, the upper bands indicate that the debt ratio could increase to 55 percent by 2026 with a 25 percent probability. In a more stringent exercise, assuming only downside shocks to interest rates and GDP growth, there is a 25 percent chance that debt-to-GDP could increase to 57 percent of GDP in the medium term.

Shocks and Stress Tests

8. Primary balance shock. Under an assumed deterioration in the primary balance by 1 percentage point (p.p.) in 2022 and 2023, public debt would increase to 52 percent of GDP in 2023 and stabilize there until 2026, about 2 p.p. higher than in the baseline. Gross financing needs would be proportionally larger in 2022 and 2023.

9. Growth shock. This scenario assumes a decline in GDP growth by about 2.5 p.p. in both 2022 and 2023 relative to the baseline, along with a 0.5 p.p. decline in inflation and a deterioration in the primary balance by 1.3 and 2.6 p.p. in 2022–23. Under these assumptions, public debt would increase to 56 percent of GDP in 2026, about 7 p.p. higher than in the baseline, while gross financing needs would increase in 2022–23, with marginal increases over the medium term.

10. Interest rate shock. A permanent 500 bps increase in the nominal interest rate beginning in 2022 leads to an increase in the effective interest rate and worsens debt dynamics, with public debt increasing to 53 percent of GDP in 2026, 3 p.p. higher than in the baseline. Gross financing needs increase to 6 percent of GDP in 2026 versus 5 percent in the baseline.

11. Exchange rate shock. This scenario assumes a 22 percent nominal exchange rate depreciation in 2022, calibrated to emulate the maximum historical movement of the exchange rate over the last 10 years. The impact on the stock of the public debt over the medium term and gross financing needs, however, would be marginal. This resilience reflects the predominance local currency-denominated debt in the stock of government debt (76 percent in 2020).

12. Combined shock. Under the combined macro-fiscal shock—which combines lower GDP growth, a larger primary deficit, higher interest rates, and an exchange rate shock—the public debt/GDP ratio increases to 58 percent of GDP in 2022 and increases to 62 percent of GDP in 2026. Gross financing needs also remain above the baseline during the projection period.

Figure 1. Poland: Public Sector Debt Sustainability Analysis—Baseline Scenario

(in percent of GDP, unless otherwise noted)

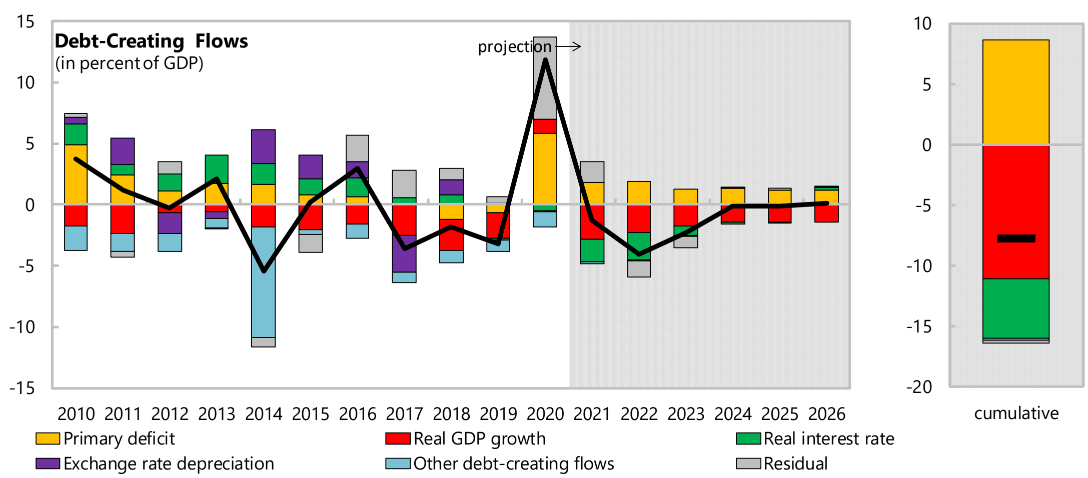
Debt, Economic and Market Indicators [1/]

	Actual				Projections		
	2020 [2/]	2021	2022	2023	2024	2025	2026
Nominal gross public debt	57.4	56.2	52.1	49.8	49.7	49.6	49.7
Public gross financing needs	8.9	7.9	6.4	5.7	6.0	5.5	4.8
Real GDP growth (in percent)	-2.5	5.4	4.6	3.7	3.0	3.0	3.0
Inflation (GDP deflator, in percent)	4.1	5.6	6.6	4.1	3.0	2.8	2.5
Nominal GDP growth (in percent)	1.5	11.3	11.4	7.9	6.1	6.0	5.6
Effective interest rate (in percent) [4]	2.9	2.2	2.5	2.7	2.8	2.9	3.0

As of December 17, 2021		
Sovereign Spreads		
EMBIG (bp) 3/		356
5Y CDS (bp)		46
Ratings	Foreign	Local
Moody's	A2	A2
S&Ps	A-	A
Fitch	A-	A-

Contribution to Changes in Public Debt

	Actual				Projections				
	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	11.8	-1.3	-4.1	-2.3	-0.2	-0.1	0.1	-7.8	-1.2
Identified debt-creating flows	5.1	-3.0	-2.7	-1.4	-0.2	-0.2	0.0	-7.6	
Primary deficit	5.8	1.8	1.9	1.2	1.3	1.2	1.2	8.6	
Primary (noninterest) revenue and grants	41.5	41.7	39.7	41.1	40.9	40.8	40.6	244.8	
Primary (noninterest) expenditure	47.4	43.5	41.5	42.3	42.3	42.0	41.8	253.4	
Automatic debt dynamics [5/]	0.5	-4.7	-4.5	-2.5	-1.6	-1.4	-1.2	-16.0	
Interest rate/growth differential [6/]	0.7	-4.7	-4.5	-2.5	-1.6	-1.4	-1.2	-16.0	
Of which: real interest rate	-0.5	-1.9	-2.2	-0.8	-0.1	0.0	0.2	-4.9	
Of which: real GDP growth	1.1	-2.8	-2.3	-1.8	-1.4	-1.4	-1.4	-11.1	
Exchange rate depreciation [7/]	-0.1	…	…	…	…	…	…	…	
Other identified debt-creating flows	-1.2	-0.1	-0.1	-0.1	0.0	0.0	0.0	-0.2	
Privatization (+ reduces financing needs)	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.4	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Incurrence in liabilities not included in debt	-1.3	-0.2	-0.1	-0.1	-0.1	-0.1	0.0	-0.6	
Residual, including asset changes [8/]	6.7	1.7	-1.4	-0.9	0.1	0.1	0.1	-0.2	



Sources: Bloomberg Financial L.P. and IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread 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/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

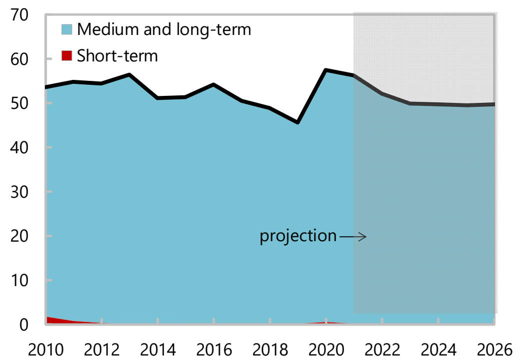
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 2. Poland: Public Debt Sustainability Analysis —Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

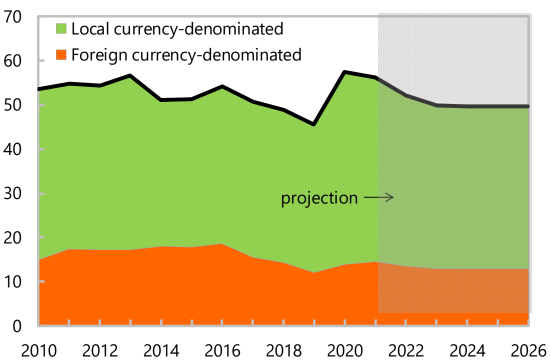
By Maturity

(in percent of GDP)



By Currency

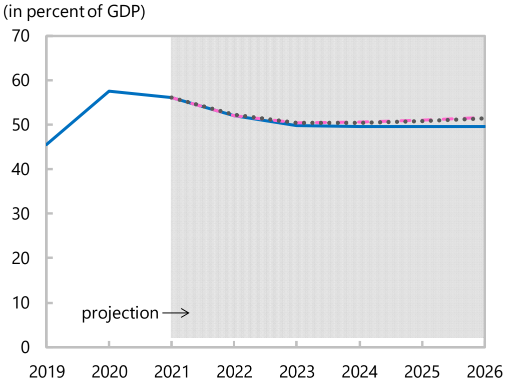
(in percent of GDP)



Alternative Scenarios

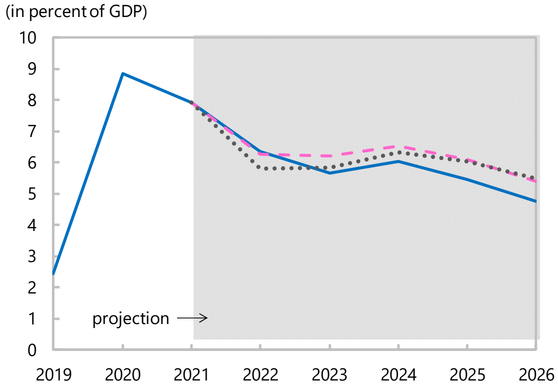
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

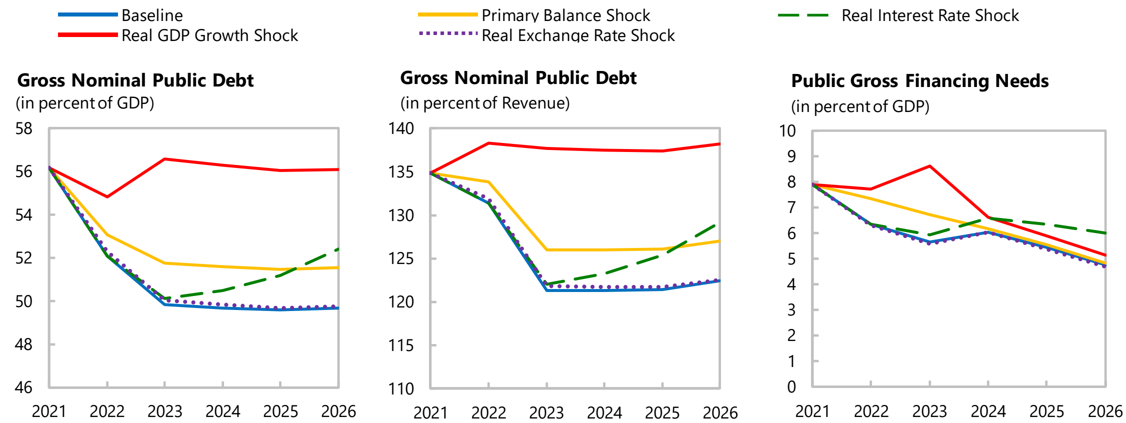
Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	5.4	4.6	3.7	3.0	3.0	3.0
Inflation	5.6	6.6	4.1	3.0	2.8	2.5
Primary Balance	-1.8	-1.9	-1.2	-1.3	-1.2	-1.2
Effective interest rate	2.2	2.5	2.7	2.8	2.9	3.0
Constant Primary Balance Scenario						
Real GDP growth	5.4	4.6	3.7	3.0	3.0	3.0
Inflation	5.6	6.6	4.1	3.0	2.8	2.5
Primary Balance	-1.8	-1.8	-1.8	-1.8	-1.8	-1.8
Effective interest rate	2.2	2.5	2.7	2.8	2.9	3.0

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	5.4	3.0	3.0	3.0	3.0	3.0
Inflation	5.6	6.6	4.1	3.0	2.8	2.5
Primary Balance	-1.8	-1.2	-1.2	-1.2	-1.2	-1.2
Effective interest rate	2.2	2.5	3.0	3.4	3.9	4.3

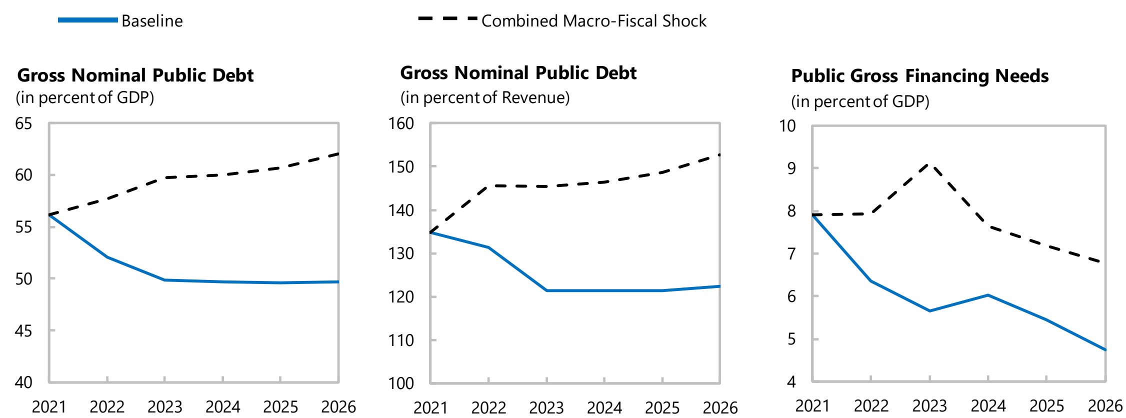
Source: IMF staff.

Figure 3. Poland: Public Debt Sustainability Analysis —Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2021	2022	2023	2024	2025	2026
Real GDP growth	5.4	4.6	3.7	3.0	3.0	3.0
Inflation	5.6	6.6	4.1	3.0	2.8	2.5
Primary balance	-1.8	-2.8	-2.2	-1.3	-1.2	-1.2
Effective interest rate	2.2	2.5	2.7	2.9	3.0	3.1
Real Interest Rate Shock						
Real GDP growth	5.4	4.6	3.7	3.0	3.0	3.0
Inflation	5.6	6.6	4.1	3.0	2.8	2.5
Primary balance	-1.8	-1.9	-1.2	-1.3	-1.2	-1.2
Effective interest rate	2.2	2.5	3.3	3.9	4.7	5.4
Combined Shock						
Real GDP growth	5.4	2.1	1.2	3.0	3.0	3.0
Inflation	5.6	5.9	3.5	3.0	2.8	2.5
Primary balance	-1.8	-3.1	-3.8	-1.3	-1.2	-1.2
Effective interest rate	2.2	2.6	3.3	4.2	4.9	5.6

Real GDP Growth Shock	2021	2022	2023	2024	2025	2026
Real GDP growth	5.4	2.1	1.2	3.0	3.0	3.0
Inflation	5.6	5.9	3.5	3.0	2.8	2.5
Primary balance	-1.8	-3.1	-3.8	-1.3	-1.2	-1.2
Effective interest rate	2.2	2.5	2.7	3.0	3.1	3.1
Real Exchange Rate Shock						
Real GDP growth	5.4	4.6	3.7	3.0	3.0	3.0
Inflation	5.6	12.0	4.1	3.0	2.8	2.5
Primary balance	-1.8	-1.9	-1.2	-1.3	-1.2	-1.2
Effective interest rate	2.2	2.6	2.6	2.8	2.9	3.0

Source: IMF staff.

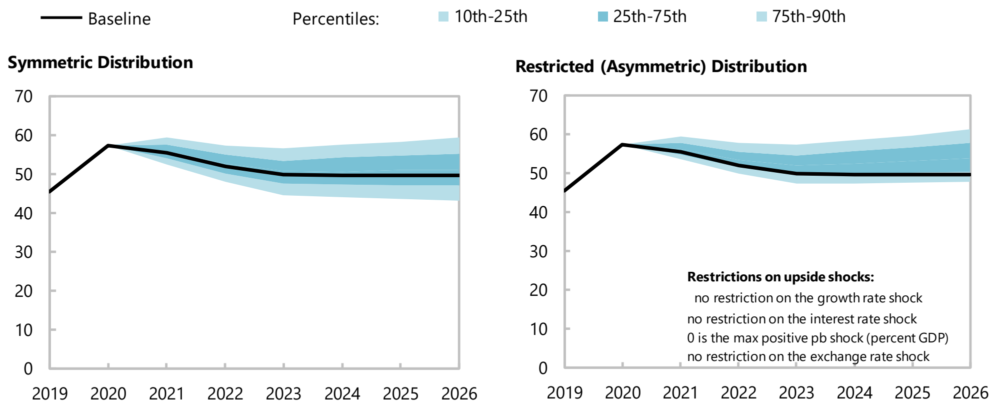
Figure 4. Poland: Public Debt Sustainability Analysis Risk Assessment

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

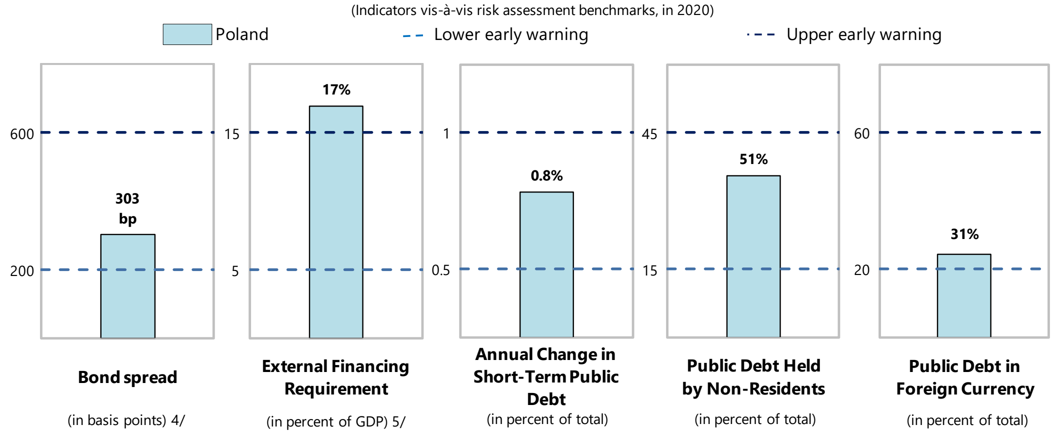
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



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.

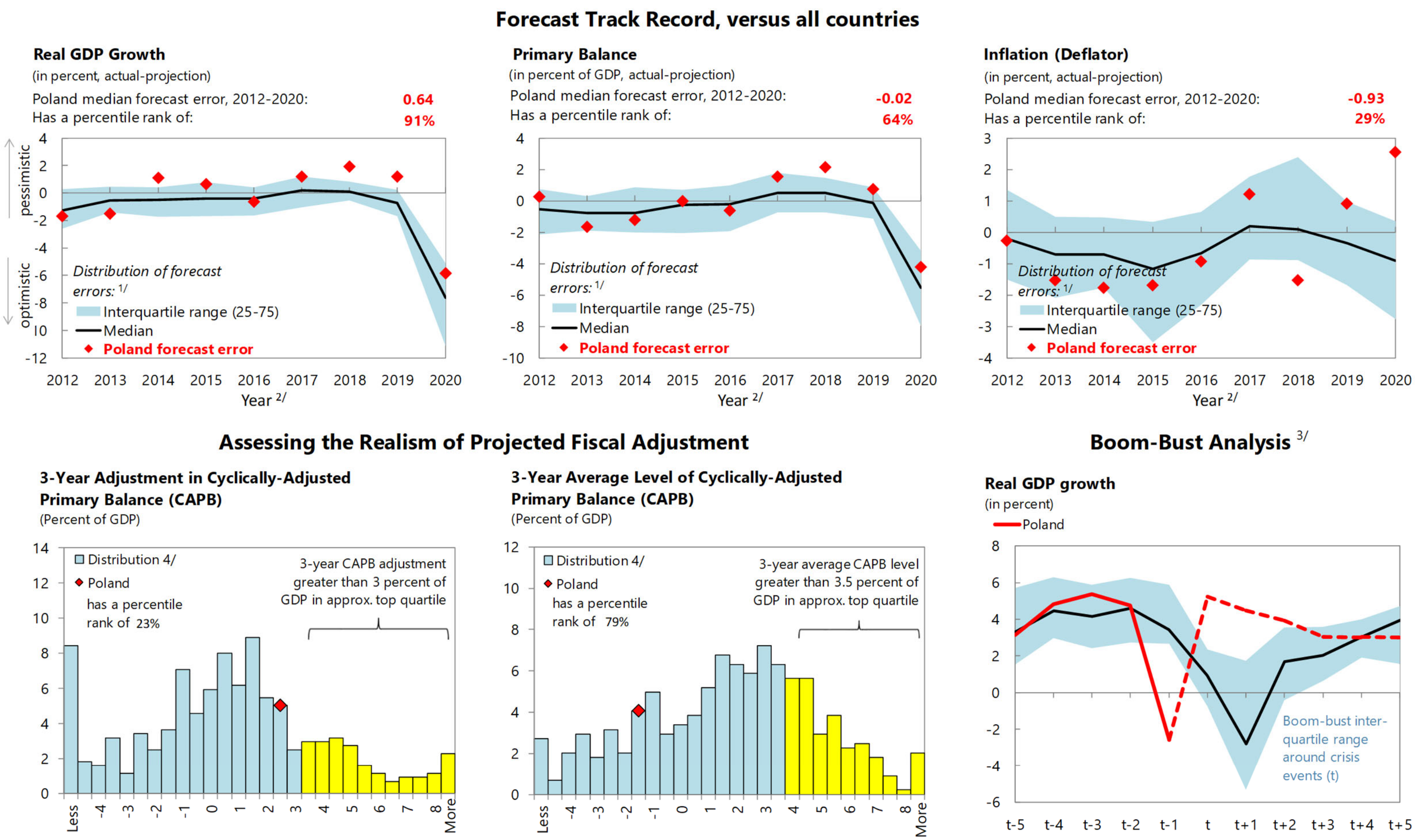
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, 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 bond spread over German bonds, an average over the last 3 months, 18-Sep-21 through 17-Dec-21.

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.

Figure 5. Poland: Public Debt Sustainability Analysis—Realism of Baseline Assumptions



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 cumulative increase in private sector credit of 55 percent of GDP, 2017-2020. For Poland, t corresponds to 2021; 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.

External Debt Sustainability Framework, 2017–26

(In percent of GDP, unless otherwise indicated)

	Actual						Projections						
	2017	2018	2019	2020			2021	2022	2023	2024	2025	2026	
							I. Baseline Projections						**Debt-stabilizing non-interest current account 5/**
External debt	72.7	61.7	59.4	62.9			**61.6**	**56.7**	**53.4**	**50.7**	**47.9**	**45.3**	**0.4**
Change in external debt	0.7	-11.1	-2.2	3.5			-1.3	-4.9	-3.3	-2.8	-2.8	-2.6	
Identified external debt-creating flows (4+8+9)	-6.4	-8.3	-3.0	-4.3			-7.6	-6.0	-5.1	-5.7	-4.9	-4.4	
Current account deficit, excluding interest payments	-1.0	0.0	-1.9	-4.1			-0.7	-0.5	-0.4	-0.4	-0.4	-0.4	
Deficit in balance of goods and services	-3.7	-3.0	-4.8	-6.8			-4.7	-3.8	-3.4	-3.3	-3.3	-3.4	
Exports	54.3	55.2	55.4	56.4			59.8	60.5	60.5	59.8	59.2	58.8	
Imports	50.6	52.2	50.7	49.6			55.1	56.7	57.1	56.5	55.9	55.4	
Net non-debt creating capital inflows (negative)	-0.4	-1.6	-2.7	-2.0			-1.8	-1.2	-0.9	-2.5	-2.4	-2.0	
Automatic debt dynamics 1/	-5.1	-6.7	1.7	1.8			-5.1	-4.3	-3.8	-2.8	-2.1	-2.0	
Contribution from nominal interest rate	1.4	1.3	1.5	1.2			1.0	1.1	1.3	1.4	1.4	1.4	
Contribution from real GDP growth	-3.2	-3.5	-2.9	1.5			-3.1	-2.6	-1.9	-1.5	-1.4	-1.3	
Contribution from price and exchange rate changes 2/	-3.3	-4.5	3.1	-0.9			-3.1	-2.8	-3.1	-2.7	-2.1	-2.1	
Residual, incl. change in gross foreign assets (2-3)	7.1	-2.8	0.8	7.8			6.3	1.1	1.8	2.9	2.1	1.8	
External debt-to-exports ratio (in percent)	133.9	111.7	107.3	111.6			103.1	93.7	88.2	84.7	80.8	77.0	
Gross external financing need (in billions of US dollars) 3/	113.2	123.2	112.2	86.4			100.8	103.9	107.6	110.4	112.2	113.6	
in percent of GDP	21.5	21.0	18.8	14.5	10-Year Historical Average	10-Year Standard Deviation	15.0	14.0	13.5	12.9	12.2	11.6	
Key Macroeconomic Assumptions													
Nominal GDP (US dollars)	526.6	587.4	597.2	596.6			670.8	741.4	795.1	853.2	916.0	983.0	
Real GDP growth (in percent)	4.8	5.4	4.7	-2.5	3.0	2.4	5.4	4.6	3.7	3.0	3.0	3.0	
Exchange rate appreciation (US dollar value of local currency, percent)	4.4	4.6	-5.9	-1.5	-2.3	5.1	1.0	-0.8	-0.6	1.1	1.3	1.6	
GDP deflator in US dollars (change in percent)	4.8	6.6	-4.8	1.6	-0.8	6.9	5.1	4.8	5.9	5.3	4.4	4.5	
Nominal external interest rate (in percent)	2.1	1.9	2.4	2.0	2.3	0.3	1.8	1.9	2.5	2.8	3.0	3.1	
Growth of exports (US dollar terms, in percent)	16.7	13.4	2.0	1.6	6.1	8.2	19.2	11.9	7.2	6.1	6.2	6.6	
Growth of imports (US dollar terms, in percent)	17.0	15.1	-1.3	-2.2	4.3	9.9	25.0	13.7	8.0	6.2	6.2	6.4	
Current account balance, excluding interest payments	1.0	0.0	1.9	4.1	0.1	2.1	0.7	0.5	0.4	0.4	0.4	0.4	
Net non-debt creating capital inflows	0.4	1.6	2.7	2.0	0.0	1.0	1.8	1.2	0.9	2.5	2.4	2.0	
A. Alternative Scenarios							**II. Stress Tests for External Debt Ratio**						**Debt-stabilizing non-interest current account 5/**
A1. Key variables are at their historical averages in 2018-2024 4/							**75.5**	**76.5**	**78.2**	**81.0**	**83.0**	**84.8**	**10.2**
B. Bound Tests													
B1. Nominal interest rate is at baseline plus one-half standard deviation							76.7	75.0	76.0	78.2	79.0	78.8	-1.6
B2. Real GDP growth is at baseline minus one-half standard deviations							78.1	77.0	78.6	81.6	83.1	83.6	-1.0
B3. Non-interest current account at baseline minus one-half standard deviations							78.6	77.7	79.6	82.6	84.2	84.8	-2.0
B4. Combination of B1-B3 using 1/4 standard deviation shocks							78.6	77.7	79.5	82.7	84.3	85.0	-1.5
B5. One time 30 percent real depreciation in 2019							78.9	76.8	76.2	78.1	78.5	79.5	-0.6

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

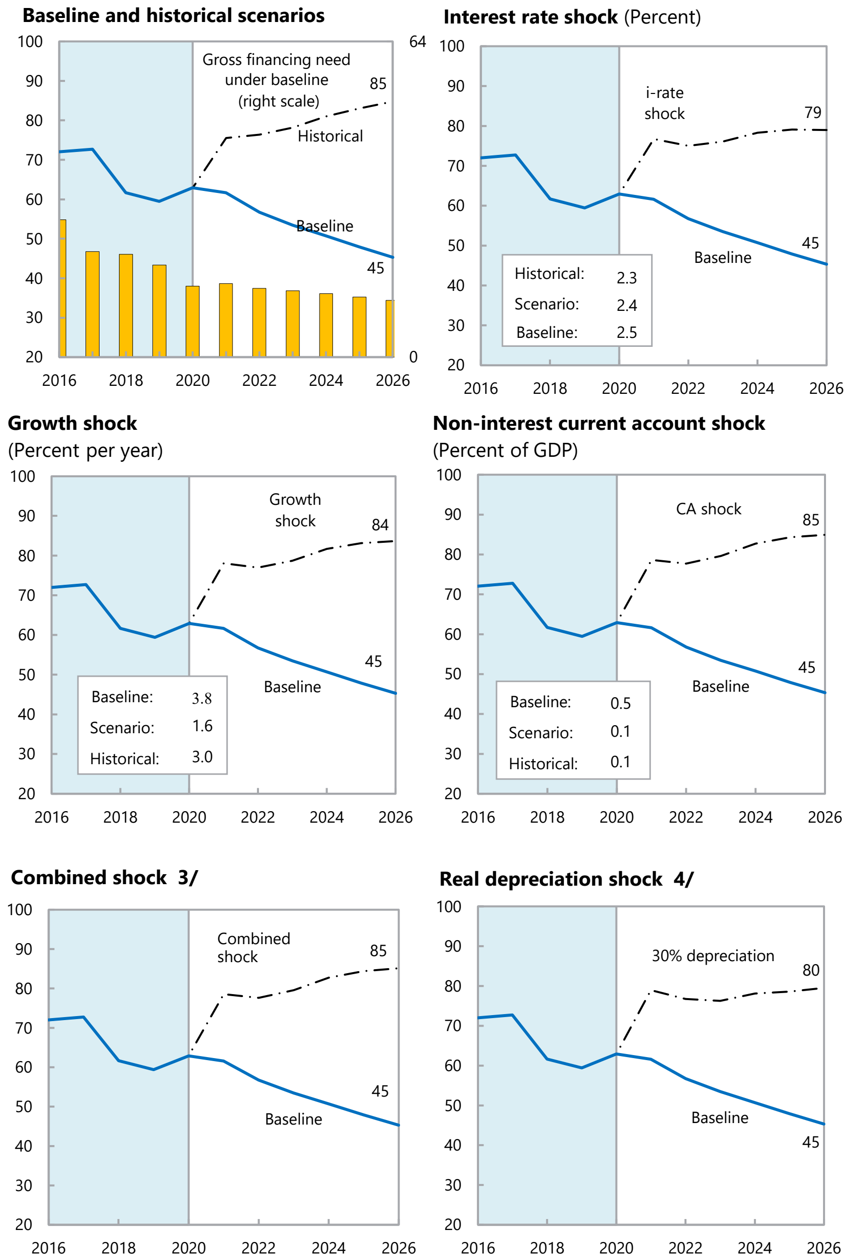
3/ Defined as current account deficit, plus amortization on short-term and medium- and long-term debt.

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

Figure 1. Poland: External Debt Sustainability: Bound Tests[1,2]

(External debt in 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 2021.

Annex VIII. Risk Assessment Matrix[1]

Source of Risk	Relative Likelihood	Impact if Realized	Policy Response
Conjunctural and Structural Risks			
Uncontrolled COVID-19 local outbreaks and subpar/volatile growth in affected countries. Outbreaks in slow-to-vaccinate countries force new lockdowns. For many Emerging Markets and Low-Income Countries, policy response to cushion the economic impact is constrained by lack of policy space, with some market access countries facing additional financial tightening as a reassessment of growth prospects triggers capital outflows, depreciations, and debt defaults.	**High**	**Medium** External demand remains volatile, with continued disruptions to global supply chains, dampening the recovery in industry and exports.	• Maintain and intensify public health measures and redouble efforts to increase vaccination rates. • Support affected workers but begin to incentivize reallocation of resources if it appears that the pandemic will be disruptive for a longer period or prompt more permanent changes in behavior. • Extend NBP asset purchase program in the case of financial market dysfunction. • Provide liquidity support to banks and use regulatory actions to facilitate the absorption of changes in asset quality and encourage private debt resolution.
Global resurgence of the COVID-19 pandemic. Local outbreaks lead to a global resurgence of the pandemic (possibly due to vaccine-resistant variants), which requires costly containment efforts and prompts persistent behavioral changes rendering many activities unviable.	**Medium**	**High** Demand in contact-intensive industries remains depressed, setting back the recovery and potentially leading to more bankruptcies if sectoral viability comes into question.	

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within one year and three years, respectively.

Source of Risk	Relative Likelihood	Impact if Realized	Policy Response
Conjunctural and Structural Risks			
De-anchoring of inflation expectations in the U.S. leads to rising core yields and risk premia. A fast recovery in demand (supported by excess private savings and stimulus policies), combined with COVID-19-related supply constraints, leads to sustained above-target inflation readings and a de-anchoring of expectations. The Fed reacts by signaling a need to tighten earlier than expected. The resulting repositioning by market participants leads to a front-loaded tightening of financial conditions and higher risk premia, including for credit, equities, and emerging and frontier market currencies.	Medium	Medium An unanticipated increase in core yields may prompt an increase in long-term domestic interest rates, capital outflows, and currency depreciation.	• Adjust policy interest rates in line with cyclical conditions and inflation expectations. • Allow flexible exchange rate to adjust. • Central bank asset purchases can be used to alleviate government bond market dysfunction, if necessary. • Tighten the fiscal stance in line with cyclical conditions in the event of a fast recovery in demand.
Widespread social discontent and political instability. Social tensions erupt as a withdrawal of pandemic-related policy support results in unemployment and, amid increasing prices of essentials, hurts vulnerable groups (often exacerbating pre-existing inequities).	Medium	Medium An inadequate policy response and depressed global economy lead to higher unemployment and poverty.	• Social spending and unemployment support should be extended but should be targeted according to need. • Broader fiscal and monetary policies should remain accommodative.
Rising commodity prices amid bouts of volatility. Commodity prices increase by more than expected against a weaker U.S. dollar, post-pandemic pent-up demand and supply disruptions, and for some materials, accelerated plans for renewable energy adoption. Uncertainty surrounding each of these factors leads	Medium	Medium Headline inflation increases rapidly, which in combination with a tight labor market, increases pressures for wage increases, raising the possibility of a wage-price spiral.	• Allow flexible exchange rate to adjust. • Adjust policy interest rates should higher headline inflation threaten second-round effects, an increase in medium-term inflation expectations, and the

Source of Risk	Relative Likelihood	Impact if Realized	Policy Response
Conjunctural and Structural Risks			
to bouts of volatility, especially in oil prices.			achievement of the inflation target over the medium term
Intensified geopolitical tensions and security risks. Geopolitical tensions in selected countries/regions cause economic/political disruption, disorderly migration, higher volatility in commodity prices (if supply is disrupted), and lower confidence, with spillovers to other countries.	High	Medium Lower confidence could increase risk aversion against EMs and result in capital outflows and depreciation pressures.	• The flexible exchange rate should be allowed to adjust as a first line of defense. • Central bank asset purchases can be used to alleviate government bond market dysfunction, if necessary.
Cyber-attacks on critical infrastructure, institutions, and financial systems trigger systemic financial instability or widespread disruptions in socio-economic activities and remote work arrangements.	Medium	Medium Cyber-attacks would present a disruption, given Poland’s increasing digitalization and use of remote work. Financial system disruptions may impede the allocation of credit.	• Strengthen crisis preparedness. • Increase investment in cyber resilience, especially in the financial system and in government.
Higher frequency and severity of natural disasters related to climate change cause severe economic damage to smaller economies susceptible to disruptions and accelerate emigration from these economies. A sequence of severe events in large economies reduces global GDP and prompts a recalculation of risk and growth prospects. Disasters hitting key infrastructure or disrupting trade raise commodity price levels and volatility.	Medium	Medium EU members may receive migrants from economies facing severe disruptions. An increased global focus on climate change may intensify pressures to decarbonize economies.	• Work with EU partners on region-wide response to migration. • Intensify domestic focus on decarbonization of energy sources, leveraging EU funds. • Easy monetary and fiscal policies as appropriate in response to disruption in global economy due to severe events in large economies.

Source of Risk	Relative Likelihood	Impact if Realized	Policy Response
Domestic Risks			
Court rulings lead to larger-than-expected losses for banks on foreign exchange mortgages. A Supreme Court ruling on outstanding legal questions related to foreign exchange mortgages is issued that is unfavorable to banks.	Medium	**High** An unfavorable ruling prompts a shift in expectations for the number of lawsuits brought against banks and the size of eventual judgments. Banks with larger exposure to foreign exchange mortgages face large losses and fail to satisfy minimum capital requirements. Negative market reaction against banking sector increases borrowing costs for sector at large.	• Banks facing capital shortfalls present credible plans to rebuild capitalization to required levels. • Central bank should provide liquidity as needed to solvent banks. • Banks should intensify efforts to reach voluntary settlements with borrowers to reduce uncertainty about size of eventual losses.
Rule of law disputes with the EU lead to significant delay of Next Generation EU funds. A failure to resolve quickly the dispute leads to a protracted stalemate, with a significant delay in EC approval of Poland's National Recovery Plan preventing the timely release of the funds.	Medium	**Medium** Key investment projects to be funded by Next Generation EU funds are delayed, lowering economic growth. The ongoing dispute with the EU hurts business confidence, especially among foreign investors, dampening private investment growth.	• Utilize substantial fiscal space available to pre-finance investment projects through market borrowing to compensate for delay in transfer of funds. • Ensure that structural transformation is on track. Facilitate structural reforms, focusing on business climate and labor market reforms, improving education and vocational training, and boosting infrastructure investment and R&D support, to attract investment (including FDI) and boost future productivity and income growth. Maintain investment focus on Next Generation EU priorities in digitalization and climate change investments.

Annex IX. External Sector Assessment

<table>
<tr><td colspan="8">Overall Assessment: On a preliminary basis and adjusting for transitory factors, the external position in 2021 is projected to be moderately stronger than the level implied by medium-term fundamentals and desirable policies. However, this assessment is highly uncertain given the lack of full-year data for 2021 and the COVID-19 crisis, and a complete analysis will be provided in the 2022 External Sector Report. As the economy recovers from the pandemic, the current account balance is estimated to have returned to a deficit of 0.3 percent of GDP in 2021 from 2.9 percent in 2020, reflecting higher import growth, partially linked to higher energy prices, lower exports due to global supply chain disruptions, and the normalization of the primary income deficit as the profitability of domiciled foreign companies recovers. The course of the pandemic is the main near-term risk, and uncertainty remains high over the medium term. However, as the economy recovers, the CA deficit is expected gradually to reach 1 percent of GDP, as private net saving returns to a lower level. Next Generation EU (NGEU) grants are expected to boost investment, contributing to the decline of the CA balance. Reserves are adequate to insulate against external shocks and disorderly market conditions.

Policy Responses: In the short term, policies should remain vigilant against the remaining risk of the pandemic, which may call for renewed targeted fiscal support. In the medium term, policies should boost investment by (i) deploying the NGEU grants to tackle infrastructure gaps, digitalization, and climate change challenges; and (ii) using public policies to encourage corporate investment and productivity, including through initiatives to increase the availability of clean energy and supply of skilled labor and ensuring that the banking sector remains sound and reducing disincentives to allocate credit to the private sector by redesigning the bank asset tax.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="7">Background. The net international investment position (NIIP) is projected to shrink to −40 percent of GDP in 2021 from −46 percent in 2020. Gross assets and liabilities are projected to reach around 58 and 97 percent of GDP, respectively. The projected stock of net FDI (equity and debt), accounting for 37.4 percent of gross external liabilities, remains diversified across sectors and source countries. While projected gross external debt in 2021 remains sizable at 61.6 percent of GDP, 29 percent of the debt is liabilities to direct investors via intercompany lending, and 73 percent of the debt is of long maturity (as of Q3:2021). Short-term debt (excluding short-term intercompany debt), amounting to 16 percent of total debt (8 percent of GDP) in Q3:2021, is mainly owned by banks (currency and deposits) and the non-financial private sector (trade credit). Automatic debt dynamics, helped by NGEU grants, are projected to reduce the negative NIIP in the medium term.

Assessment. While sizable external debt is a vulnerability, rollover risk is mitigated by the large share of long-term debt and intercompany lending that tends to be automatically rolled over. Adequate reserves reduce residual rollover risk from short-term debt (gross reserves are estimated at around 158 percent of short-term debt in 2021).</td></tr>
<tr><td>2021 (% GDP)</td><td>NIIP: −40</td><td>Gross Assets: 58</td><td colspan="2">Res. Assets: 25</td><td colspan="2">Gross Liab: 97</td><td>Debt Liab (Q3:2021): 45</td></tr>
<tr><td>Current Account</td><td colspan="7">Background. The CA moved from large deficits toward surplus between 2008 and 2020. This turnaround features a larger trade surplus (mainly services), despite sustained high primary income deficits from reinvested earnings and dividend payments to direct investors and net earnings of foreign workers in Poland. Low investment and high saving by the corporate sector have been partially offset by net borrowing by households and the government. Poland’s CA balance is estimated to have returned to a small deficit of 0.3 percent of GDP in 2021, the first deficit since 2018. The main drivers of the 2021 external balance are: (i) lower exports due to global supply chain disruptions, (ii) higher import growth, due to higher energy prices and recovering domestic demand, and (iii) the normalization of the primary income deficit. In the medium term, in the context of a domestic demand-led economic expansion, and the utilization of the NGEU grants, the CA deficit is expected to reach 1 percent of GDP.
Assessment. The EBA CA model estimates a cyclically adjusted CA of 0.3 percent of GDP and a CA norm of −2.1 percent of GDP, with the standard error of 0.6 percent of GDP. An adjustment of −0.6 percent of GDP to the cyclically adjusted CA balance has been made to account for transitory pandemic-related factors. This COVID-19 adjustment consists of +0.3 pp to reflect the contraction in tourism net exports, +0.5 pp to reflect net exports of medical supplies triggered by the health emergency, and −1.4 pp to reflect shifts in household consumption composition from services toward consumer goods. The resulting Staff CA gap of 1.8 (±0.6) percent of GDP includes identified policy gaps of 2.2 percent of GDP and an unexplained residual of -0.4 percent of GDP.</td></tr>
<tr><td>2021 (% GDP)</td><td>CA: -0.3</td><td>Cycl. Adj. CA: 0.3</td><td>EBA Norm: −2.1</td><td>EBA CA Gap:</td><td>COVID-19 Adj.: −0.6</td><td>Other Adj.: 0.0</td><td>Staff CA Gap: 1.8</td></tr>
<tr><td>Real Exchange Rate</td><td colspan="7">Background. The NEER and REER depreciated by 4.7 percent and 2.1 percent, as of Nov-2021, compared to the 2020 average. Unlike the global financial crisis during the pandemic, movements in the NEER and REER have been muted. In nominal terms, the average annual exchange rate in 2021 appreciated by 1 percent against USD and depreciated by 2.7 percent the euro respectively compared to the average of 2020. Over the same period, inflation in Poland has been only slightly higher than in its trading partners.
Assessment. The EBA REER index and level models estimate undervaluation of 2.1 and 17.4 percent, respectively. Consistent with the IMF staff CA gap, the IMF staff assess the REER to be undervalued in the range of 2.5 to 5.1 percent, with a midpoint of 3.8 percent (given an estimated elasticity of 0.47).</td></tr>
<tr><td>Capital and Financial Accounts: Flows and Policy Measures</td><td colspan="7">Background. The capital account, dominated by inflows of EU funds for financing investment projects, has averaged about 2 percent of GDP over the past ten years. The capital account surplus is estimated to be around 1.7 percent of GDP in 2021 and is projected to remain strong, supported by Next Generation EU inflows and other EU transfers, before declining to 1 percent over the medium term. As foreign companies’ profitability normalizes, FDI inflows are projected to strengthen, and financial flows to revert to historical norms. Financial account net flows are estimated at -1.4 percent of GDP (negative sign means inflow) in 2021.
Assessment. Foreign holdings of domestic government securities have declined significantly since 2016 and, as of Nov-2021, represented 15.5 percent of the total. Nevertheless, the overall stock remains sizable at 4.8 percent of GDP and could pose some risks, although the diversified foreign investor base is a mitigating factor.</td></tr>
<tr><td>FX Intervention and Reserves Level</td><td colspan="7">Background. FX reserves are estimated to have increased to US$166.6 billion at end-2021. Net reserves, which exclude the central bank’s repo operations (part of its reserve management strategy) and government FX deposits, stood at US$151 billion at Nov-2021, is increasing due to the central bank’s conversion of a portion of EU funds received by the government to zloty. This is consistent with the central bank’s strategy of building an adequate precautionary reserve buffer. The zloty is free-floating.

Assessment. At about 154 percent of the IMF’s reserve adequacy metric, the projected level of gross reserves is adequate to guard against external shocks and disorderly market conditions.</td></tr>
</table>

INTERNATIONAL MONETARY FUND

REPUBLIC OF POLAND

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

February 1, 2022

Prepared by European Department

CONTENTS

FUND RELATIONS

(As of December 31, 2021)

Membership Status: Joined 6/12/1986; Article VIII

General Resources Account:

	SDR Million	Percent Quota
Quota	4,095.40	100.00
Fund Holdings of Currency	3,091.23	75.48
Reserve Tranche Position	1008.09	24.62
Lending to the Fund		
New Arrangement to Borrow	30.38	

SDR Department:

	SDR Million	Percent Allocation
Net Cumulative Allocation	5,229.90	100.00
Holdings	4226.60	80.82

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

In Millions of SDR

Type	Approval Date	Expiration Date	Amount Approved	Amount Drawn
FCL	1/13/2017	11/2/2017	6,500.00	0.00
FCL	1/14/2015	1/13/2017	13,000.00	0.00
FCL	1/18/2013	1/13/2015	22,000.00	0.00
FCL	1/21/2011	1/17/2013	19,166.00	0.00
FCL	7/02/2010	1/20/2011	13,690.00	0.00

Projected Payments to Fund (SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2022	2023	2024	2025	2026
Principal					
Charges/Interest	0.82	0.86	0.86	0.86	0.86
Total	0.82	0.86	0.86	0.86	0.86

Article IV Consultation:

The last Article IV consultation was concluded on February 3, 2020. Poland is on the standard 12-month consultation cycle.

Resident Representative:

Mr. Nadeem Ilahi has been the Senior Regional Resident Representative for Central and Eastern Europe since August 2018.

Exchange Arrangements: Exchange Arrangements: The currency of Poland is the zloty. The exchange rate arrangement is free floating. Poland accepted the obligations under-Article VIII, Sections 2, 3, and 4 on June 1, 1995. Poland maintains an exchange system free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions, except for the exchange restrictions imposed by Poland solely for the preservation of national or international security as introduced by the European Union (EU) within the framework of the Common Foreign and Security Policy.

Table 1. Republic of Poland: Technical Assistance from the Fund, 1992–2021

Department	Subject/Identified Need	Action	Date	Counterpart
MAE-Coordinated	Periodic visits by experts from central banks cooperating in providing technical assistance to the NBP under the coordination of MAE	Experts' visits	1992–94	NBP
MAE	Payments system, banking supervision, monetary research and analysis	Mission	May 1992	NBP
MAE	Review of progress in the modernization of operational functions	Mission	October 1992	NBP
MAE	Resident expert-Advisor to President of NBP		November 1991–92	NBP
MAE	Additional steps in the modernization process of the NBP	Mission	April 1993	NBP
MAE	Monetary programming and operations, and payments system	Mission	November 1993	NBP
MAE	Central bank modernization	Mission	August 1994	NBP
MAE/LEG	Review of the exchange and payments system	Mission	February 1995	NBP/MoF
MAE	Exchange rate system	Mission	March 1995	NBP
MAE	Review of government securities market, payments system and public debt management	Mission	August 1995	NBP/MoF
MAE	Asset consolidation exercise	Expert visits	Late 1995	NBP
FAD	Tax administration (VAT)	Nine short-term assignments of field experts	August 1992–October 1994	MoF
FAD	Tax administration	Mission	November 1992	MoF
STA	Framework for monetary statistics	Mission	February 1993	NBP
STA	Framework for monetary statistics (follow-up)	Mission	November 1993	NBP

Table 1. Republic of Poland: Technical Assistance from the Fund, 1992–2021 (continued)

Department	Subject/Identified Need	Action	Date	Counterpart
STA	Government finance statistics	Mission	August 1995	NBP/MoF
STA	Money and banking statistics	Mission	January 1996	NBP
STA	Government finance statistics	Mission	July 1996	NBP/MoF
STA	Balance of payments statistics	Mission	November 1996	NBP/MoF
STA	Balance of payments statistics	Follow-up mission	April 1997	NBP/MoF
STA	Review of progress in implementing the SDDS	Visit	February 1998	
FAD	Public expenditure management	Mission	April 1998	MoF
MAE	Operational aspects of monetary and exchange rate policy	Mission	September 1998	NBP
FAD	Tax administration	Mission	October 1998	MoF
FAD	Examination of impact on revenues of proposed tax reform	Mission	November 1998	MoF
FAD	Discussion of tax administration	Mission	March 1999	MoF
FAD	Tax administration seminar	Mission	April 1999	MoF
STA	Government Finance Statistics	Mission	October 1999	MoF/Local
FAD	Tax administration—Introduction of expert	Mission	November 1999	MoF
FAD	Administering Social Security	Mission	March 2000	MoF
IMF/IBRD	FSAP	Mission	May/Sept 2000	MoF/NBP
MAE	Monetary Operations	Mission	July 2001	NBP
FAD	Expenditure restructuring	Mission	December 2001	MoF
MAE	Stress testing	Mission	January 2002	NBP
STA	Data ROSC	Mission	January 2003	CSO/MoF/NBP
STA	Government finance statistics (GFSM 2001)	Mission	October 2003	MoF
STA	Government finance statistics (GFSM 2001)	Mission	January 2005	MoF

Table 1. Republic of Poland: Technical Assistance from the Fund, 1992–2021 (concluded)

Department	Subject/Identified Need	Action	Date	Counterpart
IMF/IBRD	FSAP Update	Mission	April/May 2006	MoF/NBP
FAD	Developing a multi-annual fiscal framework	Mission	June 2008	MoF
STA	Errors and omissions in balance of payments accounts	Mission	July 2009	NBP
FAD	Medium-term fiscal framework	Mission	April 2010	MoF
MCM	Detailed assessment of observance of BCP for effective banking supervision	Mission	Feb/March 2011	KNF
STA	Errors and omissions in balance of payments accounts	Mission	June 2011	NBP
FAD	Developing the fiscal regime for oil and gas	Mission	April 2012	MoF
MCM	Macroprudential framework	Mission	May 2012	NBP
IMF/WB	FSAP update	Mission	Feb/March 2013	MoF/ KNF/NBP
FAD	Tax administration—Modernization challenges and strategic priorities	Mission	November 2014	MoF
MCM	Bank Resolution	Mission	March 2016	BFG
FAD	Medium-term budget framework	Mission	February/November 2017	MoF
FAD	Tax administration	Mission	April/June 2017	MoF
IMF/WB	FSAP update	Mission	Jan/May 2018	MoF/ KNF/NBP
FAD	Medium-term budget framework (MTBF), developing chart of accounts	Mission	Apr/Dec 2019	MoF
FAD	MTBF developing standardized chart of accounts (SCoA)	Resident advisor	May 2019	MoF
FAD	MTBF outstanding issues in development of SCoA	Virtual Mission	Mar/Jun 2021	MoF
FAD	Public Investment Management Assessment (PIMA)	Virtual Mission	Sep/Oct 2021	MoF

STATISTICAL ISSUES

(As of January 25, 2022)

Assessment of Data Adequacy for Surveillance

General: Data provision is adequate for surveillance.

National Accounts: Statistics Poland (GUS) compiles and disseminates annual and quarterly GDP by production and expenditure approaches, both at current and previous year's prices following the *2008 SNA* and *ESA 2010*. Quarterly financial accounts of general government sector are compiled by the Statistics Poland (GUS). Annual and quarterly financial accounts by institutional sectors are compiled by Narodowy Bank Polski (NBP) following the *ESA 2010* standards and disseminated regularly on its website according to an advance release calendar: the annual financial accounts on the 20th of October the following year and quarterly financial accounts on the 20th calendar day of the 4th month following the end of the reference quarter (i.e., on the 20th of January, April, July, and October). Poland also publishes "flash estimates" of GDP within weeks of the reference quarter.

Price Statistics: The consumer price index does not cover imputed rents of owner-occupied dwellings. The scope of the index covers all resident households, except those in some rural areas. The producer price index does not include any estimation for missing prices; quality and seasonal adjustment techniques are also not implemented. Poland publishes "flash estimates" of CPIs, and a monthly Harmonized Indices of Consumer Prices (HICP) according to a uniform methodology of the European Union.

Government Finance Statistics: The Ministry of Finance (MoF) is responsible for compiling monthly data. The data are compiled in accordance with the IMF's Government Finance Statistics Manual 2001 (GFSM 2001). Monthly cash data cover "core" central government. Revenue and expense are divided by economic type. Financing is classified by sector and by type of debt instrument.

Starting in 2015 (annual data for 2014), GUS is responsible for collecting, processing, and disseminating annual government finance statistics. The data are compiled according to European System of Accounts (ESA2010) and adjusted to GFS Manual 2014. The annual reports cover presentation of fiscal data on operations of the general government sector divided by central government, local government, and social security funds. Revenue and expense are divided by transactions. Financing is classified by sector and by type of debt instrument. General government data are released on a quarterly basis, derived from detailed ESA data. Monthly and annual data are regularly disseminated on the SDDS website.

Monetary and Financial Statistics: Beginning with data for January 2004, the NBP provides the European Central Bank (ECB) with monetary accounts in accordance with the ECB's framework for monetary statistics using the national residency approach. The ECB reports monetary data for Poland to the IMF for publication. Data on other financial corporations (OFC) are currently not available.

Financial Sector Surveillance: In November 2009, NBP in cooperation with GUS, the Polish Financial Supervision Authority (KNF) and MoF began reporting financial soundness indicators (FSI) in line with the IMF's *Financial Soundness Indicators Compilation Guide*. Poland is currently reporting all core FSIs and 21 of the 28 encouraged FSIs on a quarterly basis with a lag of approximately one quarter. NBP also implemented EU regulation 680/2014, which covers supervisory reporting defined by the Implementing Technical Standards (ITS) prepared by the European Banking Authority. First data were collected with reference date March 2014 for own funds and liquidity related reporting. Financial reporting on a consolidated basis according to the ITS was reported for the first time for September 2014.

External Sector Statistics:

Poland, as all other EU countries, disseminates balance of payments and international investment position data in accordance with the sixth edition of the *IMF's Balance of Payments and International Investment Position Manual (BPM6)* and external debt statistics in line with the 2013 *External Debt Statistics: Guide for Compilers and Users* (2013 *EDS Guide*).

Poland participates in the Coordinated Direct Investment Survey and Coordinated Portfolio Investment Survey and reports data for the Reserves Data Template to the IMF.

Data Standards and Quality

Subscriber to the Fund's Special Data Dissemination Standard (SDDS) since April 17, 1996. Uses SDDS flexibility option on the timeliness of the data on general government and central government operations.

Table 1. Republic of Poland: Table of Common Indicators Required for Surveillance–as of January 25, 2022

	Date of latest observation	Date received	Frequency of data[7]	Frequency of reporting[7]	Frequency of publication[7]	Memo Items: Data Quality – Methodological soundness[8]	Memo Items: Data Quality Accuracy and reliability[9]
Exchange Rates	1/25/2022	1/25/2022	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	12/2021	1/05/2022	M	M	M		
Reserve/Base Money	11/2021	01/05/2022	M	M	M	O, LO, O, LO	O, O, O, O, O
Broad Money	11/2021	01/05/2022	M	M	M		
Central Bank Balance Sheet	11/2021	01/05/2022	M	M	M		
Consolidated Balance Sheet of the Banking System	11/2021	01/05/2022	M	M	M		
Interest Rates[2]	11/2021	01/05/2022	D	D	D		
Consumer Price Index	12/2021	01/14/2022	M	M	M	O, O, O, O	O, O, O, O, O
Revenue, Expenditure, Balance, and Composition of Financing[3] – General Government[4]	2020	10/21/2021	A	A	A	LO, O, O, O	O, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	10/2021	12/27/2021	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	11/2021	01/20/2022	M	M	M		
External Current Account Balance	11/2021	01/15/2022	M	M	M	O, O, O, LO	O, O, O, O, LO
Exports and Imports of Goods and Services	11/2021	01/15/2022	M	M	M		
GDP/GNP	Q3/2021	11/30/2021	Q	Q	Q	O, LO, O, O	LO, LO, O, O, LO
Gross External Debt	Q3/2021	12/30/2021	Q	Q	Q		
Balance of Payments	Q3/2021	12/30/2021	Q	Q	Q		
International Investment Position[6]	Q3/2021	12/30/2021	Q	Q	Q		

[1] Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign and domestic financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Not Available (NA).

[7] Reflects the assessment provided in the data ROSC published on November 6, 2001, and based on the findings of the respective missions that took place during May 10–18, 2001 for the dataset corresponding to the variable in each row. For fiscal data, also takes account of the 2009 Fiscal Transparency ROSC. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

[8] Same as footnote 7, except referring to international standards concerning (respectively) source data, statistical techniques, assessment and validation, and revision studies.

[9] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

Statement by Mr. Piotr Trabinski, Executive Director, and Mr. Bartosz Piasecki, Advisor to the Executive Director
February 18, 2022

On behalf of the Polish authorities, we thank the mission team led by Mr. Alfredo Cuevas for constructive dialogue, which resulted in the well-balanced Article IV report. The mission was conducted virtually due to a sudden increase in infection rates. The authorities appreciate the staff's insightful report and thorough analyses of macroeconomic developments, as well as a judicious choice of selected issues focusing on the relevant topics. The authorities broadly agree with the thrust of the staff's appraisal and appreciate their recommendations, which they intend to thoroughly assess.

Recent developments, outlook, and risks

In recent years, the economy successfully withstood several periods of market turbulence on the back of the country's strong fundamentals and timely macroeconomic policies. Poland's economy expanded by 43 percent in the decade leading up to 2019, almost three times faster than the euro area economy. While 2019 marked the 28th consecutive year of Poland's GDP expansion, the COVID-19 outbreak significantly affected the dynamics of economic activity, leading to a 2.5 percent contraction of the GDP in 2020.

The economy rebounded in 2021, exceeding the authorities and market projections. According to the authorities' initial projections, the GDP was expected to grow by 4.9 percent in 2021, followed by 4.6 percent in 2022. However, the newest data indicate that GDP grew by 5.7 percent in 2021, thus, was notably higher than projected. Going forward, in 2022 the growth is projected to be driven by private consumption, which should remain strong thanks to a better situation in the labor market, and a decline in the household savings rate. A tax wedge reduction will further support consumer spending. Absent major headwinds, investment demand is projected to increase, while an increase in foreign demand for goods and services could also contribute to growth in exports. As imports should grow at a higher pace than exports, the net export is expected to weigh negatively on GDP growth in 2022.

The main sources of uncertainty and risk regarding the outlook continue to be the evolution of the pandemic and possible new variants of the COVID-19 virus. The authorities continue with a vaccination campaign focusing their efforts on the unvaccinated part of the population. Although, the share of the fully vaccinated population is lower than the EU average, the economy adapted well during the successive waves of the pandemic.

Fiscal policy

The authorities are committed to gradually consolidating public finances and rebuilding fiscal buffers. Although the public debt-to-GDP ratio rose sharply due to pandemic-related expenditures and contraction of the economy, peaking at 57.4 percent of GDP in 2020, the authorities expect its gradual decline over the medium-term. The stronger performance of the state budget in 2021, suggests that debt is expected to drop slightly to 57 percent in 2021 and fall further to 56.6 percent of GDP in 2022, while continuing its downward trajectory going forward.

The authorities are attentive to the need to maintain debt sustainability. In October 2021, the revision of the 2021 budget was approved, which adjusts the forecast for state budget revenues upward and accounts for an increase in expenditures. Given the overperformance of tax revenues, the authorities decided to reduce the state budget deficit from 3.2 to 1.6 percent of GDP in 2021, while ensuring resources necessary for the recovery.

More recently, the Parliament approved the Polish Deal package aimed at making the tax and social security system more progressive by alleviating the fiscal burdens on the lowest-earning households. The main objectives of this new package include: 1) changes in tax administration, 2) bolstering public spending on medical services by making most of the taxpayers' health insurance contributions proportional to their incomes, and 3) reforms to the Personal Income Tax (PIT), Corporate Income Tax (CIT), and Value Added Tax (VAT). The key elements of the PIT reform include an increase in the personal allowance and a tax threshold as well as changes in health insurance contributions, making it non-deductible. The PIT reform has an additional tax relief for middle-class taxpayers. Moreover, there are several proposals aimed at tax support for Research and Development activity, tax relief for taxpayers resettling in Poland, as well as for taxpayers abstaining from retirement after reaching the required age, among a number of other tax reliefs. The authorities have also envisaged measures that would mitigate any potential negative impact of the proposed changes on public finances.

Major efforts have been made to soften the negative impact of rising prices on households. The Parliament approved the "Anti-inflation shield" which is worth in total about 0.7 percent of GDP. Key elements of this new government program include: 1) a temporary reduction in taxes, including VAT, excise, and other taxes on energy sources (natural gas, electricity, heating, fuels) as well as 0 percent VAT rate for basic food and fertilizers); 2) a direct one-off subsidy from the budget to lower-income households; and 3) compensation payments to gas distributors to freeze tariffs for households and certain public entities.

The authorities are strongly committed to sound, effective, and efficient supervision of the Public Financial Management (PFM). In this regard, the authorities thank staff for conducting the recent PIMA mission in the second half of 2021. They intend to strengthen the public investment management system and supervision in line with staff's recommendations.

Monetary policy

In September 2021, the Monetary Policy Council (MPC), which constitutes one of the bodies of the National Bank of Poland (NBP) responsible for designing monetary policy, published the

Monetary Policy Guidelines to outline key elements in Poland's monetary policy strategy for 2022 against the backdrop of current and expected macroeconomic conditions**.** The authorities' strategy is based on a medium-term inflation target of 2.5 percent with a symmetrical band for deviations of ± 1 percentage point. The scope, manner, and scale of monetary policy instruments used by the NBP will be considered flexibly, in line with developments in the economy.

As in previous years, the MPC has emphasized the flexibility of the inflation targeting regime. The authorities are prepared in the case that inflation may temporarily deviate from the target due to macroeconomic and financial shocks. While setting the appropriate pace of bringing inflation back to the target, the MPC will be guided by the nature of the economic shock and the persistence of its consequences. When deciding on the changes to monetary policy parameters, the MPC will take into consideration the following: 1) the need to accommodate price adjustments related to the post-pandemic rebound of the economy, 2) the process of Poland's real convergence, and 3) the consequences of the structural changes taking place in the economy, including the energy transition.

Inflation reached 5.1 percent on average in 2021, which is a two-decade high, and thus is running above the NBP's target. In December 2021, inflation increased to 8.6 percent in annual terms. Significant contributors to the increase in inflation in 2021 were the rise in global commodity prices, a record-high increase in prices of CO2 emission allowances, rising prices of goods constrained by broken supply chains, as well as increases in electricity and natural gas prices on local and global levels. The ongoing economic recovery, including an increase in demand driven by rising household income, has also added to an increase in inflation. These factors, together with a rise in regulated tariffs on electricity, natural gas, and thermal energy, will also contribute to inflation in 2022.

On February 8, 2022, the MPC raised the NBP's interest rates for the fifth month in a row. The NBP reference rate rose to 2.75 percent. Since October 2021, the reference rate has risen by 2.65 percentage points in total. The MPC decided to increase interest rates to reduce the risk of inflation running above the NBP's inflation target in the monetary policy transmission horizon. This risk stems from further economic recovery and the expected continuation of favorable labor market conditions, as well as the likelihood of longer-lasting impact of external shocks on price dynamics. The MPC remains committed to conducting data-driven assessments regarding the scale of monetary tightening necessary for achieving medium-term price stability and supporting sustainable economic growth. According to the MPC, zloty appreciation would be consistent with the direction of monetary policy conducted by the NBP.

Financial sector

The banking sector proved to be resilient throughout the COVID-19 pandemic, with sound asset quality and sufficient capital buffers. Recent increases in interest rates will improve the banking sector's income and profitability. Demand for credit will positively contribute to financial sector's earnings. Consolidation of cooperative banks is projected to continue, with an aim of widening their client base, reducing operation costs, and adapting to the digital needs of the clients**.** The authorities do not intend to implement changes to the bank asset tax.

Foreign currency denominated mortgages remain the main source of risk for banks, but significant progress has been made to address this challenge. The Polish Financial Supervision Authority (PFSA) has prepared a framework for banks to launch a voluntary conversion of FX mortgages to zloty. So far, three banks are offering settlements based on the PFSA's framework. Some other banks have offered their clients conversion proposals on their own terms with borrower interest in such settlements. Banks' strong capital buffers should be sufficient to absorb provisions as the number of litigations could increase, depending on the final ruling of the Supreme Court.

The authorities are committed to improving the AML/CFT framework. In 2021, in accordance with the Fifth Anti-Money Laundering Directive, the Polish authorities revised the AML/CFT framework to include the establishment of registers of virtual asset service providers and trust and company service providers. The authorities are planning to further strengthen the framework in line with international best practices.

Structural reforms

The Polish Deal package aims to address the recovery beyond the short-term consequences of the pandemic. The five main objectives for the coming years include: 1) creating a more progressive tax and social security system through the reduction of the tax wedge for people with low incomes; 2) increasing spending on health care up to 7 percent of GDP in 6 years; 3) boosting investments with the objective of job creation; 4) supporting the housing market with a range of new instruments, such as state guarantees for some mortgage loans; 5) supporting old age pensioners by changing the tax system.

Directing the country's resources, to the most vulnerable, is central to the Polish Deal package. Through the newly created strategic investment program under the Polish Deal package, local governments in underdeveloped regions are allowed to apply for up to 95 percent of non-returnable co-financing for investment projects, including utilities infrastructure, green transition to zero emissions, and waste management. The program is also expected to boost local entrepreneurship and the job market.

Poland is committed to reducing its carbon emissions and transforming the energy sector to be greener and more sustainable. The Polish energy strategy will incorporate the EUs "FIT for 55" package. To address the country's energy transformation needs, the Ministry of Climate and Environment released for the public's consultation the draft of an Act, which envisages establishing a new Energy Transformation Fund (ETF) responsible for supporting the transformation of the energy sector with the aim of reducing greenhouse emissions and achieving the climate policy objectives.

The Polish National Recovery Plan aims to strengthen the post-pandemic economic recovery and improve its resilience to future unexpected shocks. The program will be supported by funds from the Recovery and Resilience Facility (RRF), a vehicle established by the European Commission in the form of grants and loans. The authorities have applied for European grants in five areas that are in line with the EU's priorities: 1) building the resilience and competitiveness of the economy; 2) the green transformation of the energy sector; 3) digital transformation; 4) health care system improvements; and 5) green and smart mobility. So far, the program awaits the European Commission's final approval.