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Republic of Poland: 2009 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; 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 2009 Article IV consultation with the Republic of Poland, the following documents have been released and are included in this package:

- The staff report for the 2009 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 22, 2009, 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 July 17, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 31, 2009 discussion of the staff report that concluded the Article IV consultation.

- A statement by the Executive Director for the Republic of Poland.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF POLAND

Staff Report for the 2009 Article IV Consultation

Prepared by the Staff Representatives for the 2009 Consultation with the Republic of Poland

Approved by Marek Belka and Aasim Husain

July 17, 2009

Executive Summary

Poland is weathering the global crisis better than most of its peers. Having entered the crisis without serious internal or external imbalances, the authorities were afforded some room to undertake counter-cyclical measures. The approval of the FCL has also helped to calm markets.

Monetary policy should continue to maintain a loosening bias as inflation is set to remain within its tolerance range. Gradually cutting the policy rate remains appropriate. Should an increase in the public sector's borrowing requirements place pressure on domestic interest rates, the authorities should stand ready to accommodate the increase. A measured easing should not cause the zloty to depreciate given Poland's strengthening cyclical position relative to partners and the credibility in the NBP's anti-inflation credentials.

The limited increase in the 2009 fiscal deficit should remain anchored in a credible medium-term fiscal consolidation. Allowing for a higher fiscal deficit in 2009 to partly accommodate lower revenue as the economy slows is appropriate. But the deficit is set to remain well above the Maastricht limit even as the economy recovers, due to the recent structural relaxation. Hence a sustained fiscal consolidation should start in 2010, unless there are signs that the recovery will not materialize as expected. To help anchor confidence in the authorities' medium-term consolidation targets, the authorities should consider revamping the fiscal framework by introducing rolling and binding multi-annual expenditure limits.

The banking sector is well buffered, but risks remain. Vigilance and pre-emptive actions by the KNF have been welcome and should be continued, including by conducting bottom-up comprehensive stress tests of banks in coordination with neighboring countries to better reflect the regional dimension of the problem. In addition, credit unions (SKOKs) should be supervised by the KNF, their deposits be insured by the bank guarantee fund, and have direct access to lender-of-last resort facilities.

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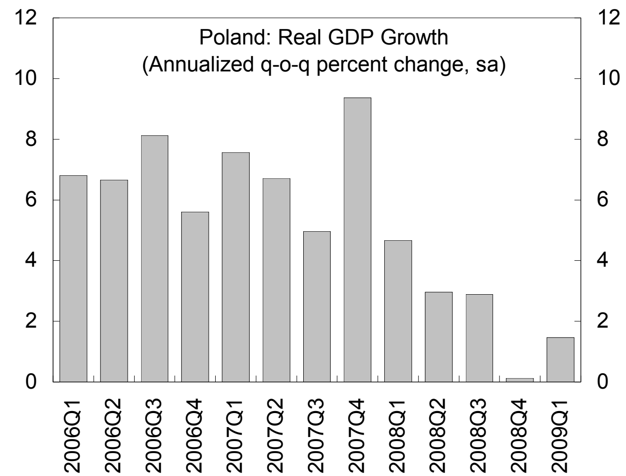
I. CONTEXT[1]

1. **Poland's rapid growth had begun to lose steam even before the global crisis hit**. Following a robust and relatively well-balanced expansion, driven by an EU accession-related investment boom and rapid credit and wage growth, economic activity began to slow in the face of gradually emerging capacity constraints. By mid-2008, inflationary pressures peaked and the unemployment rate was at record lows. Still, despite a somewhat pro-cyclical fiscal policy, external and internal imbalances were relatively limited going into the crisis.



Source: Polish Statistical Office.

2. **A sharp deceleration in activity is underway, reflecting spillovers from the global crisis through real and financial channels**.

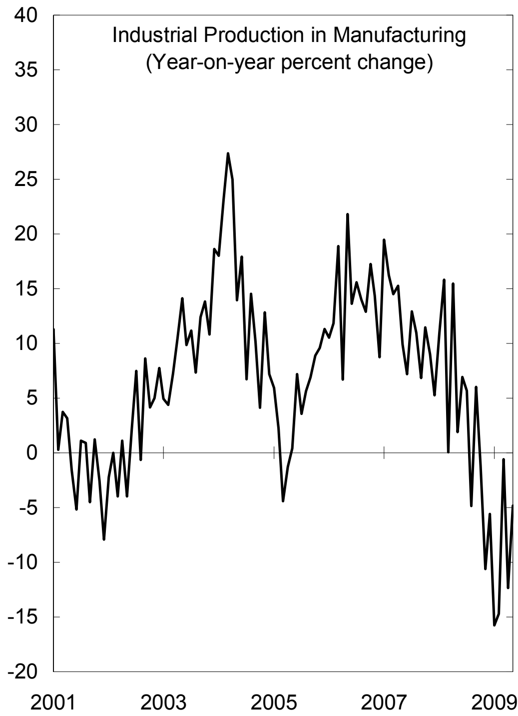
- ***Real sector channel***. With Poland's key export markets in recession, exports contracted by 30 percent (year-on-year) in the first quarter of 2009. While the share of exports in GDP of about 40 percent is relatively low compared to regional peers—reflecting the larger size of the Polish economy—the significant compression in exports is having a considerable direct impact on domestic activity (Figure 1).

- ***Financial sector channel***. As in other countries in the region, local asset markets succumbed to sharp price declines and capital outflows led to rapid zloty depreciation in the wake of Lehman Brothers (Figure 2). In addition, the interbank market froze in late October 2008, reflecting increased uncertainty, and a number of banks had difficulty obtaining foreign exchange liquidity to fund their growing foreign-currency-denominated (largely Swiss franc) mortgage portfolio.

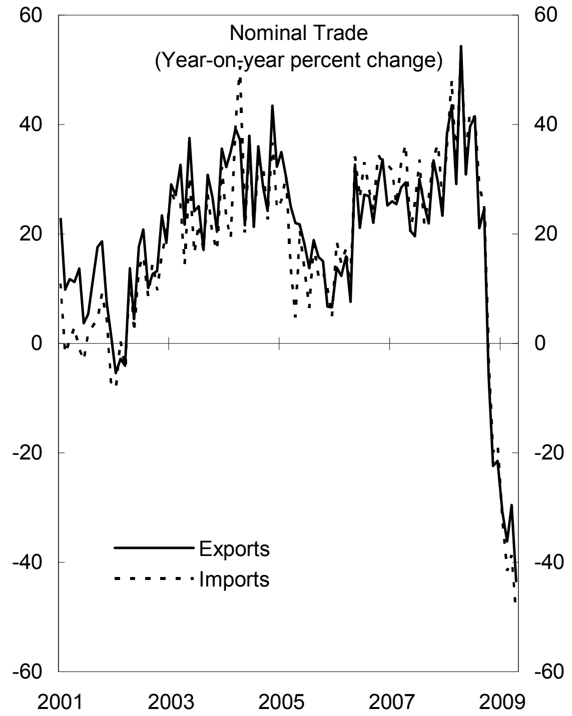
[1] A mission comprising Messrs. Thomsen (head), Hoffmaister, and Epstein and Mses. Chivakul and Velculescu (all EUR), and Ms. Goretti (SPR) visited Warsaw during June 15–23. Messrs. Allen and Sierhej, from the Warsaw Regional Office, supported the work of the mission. Poland is an Article VIII country (Informational Annex, Appendix I). Data provision is adequate for surveillance (Informational Annex, Appendix II).

Figure 1. Poland: Recent Economic Developments, 2001-09

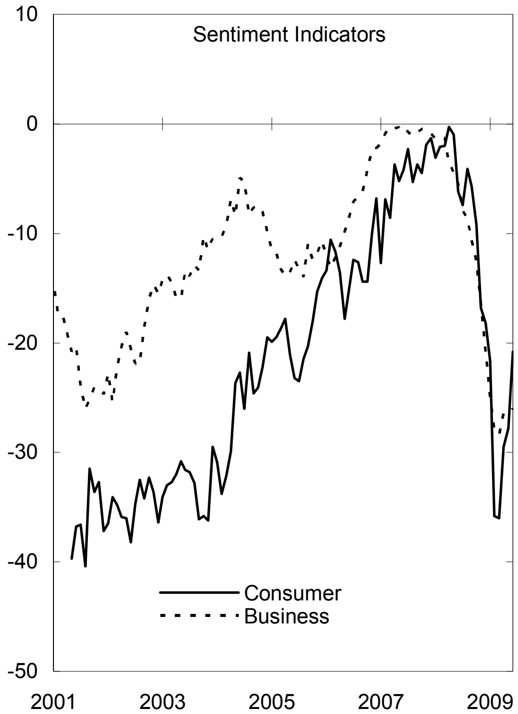
Over the last year, domestic production fell sharply...



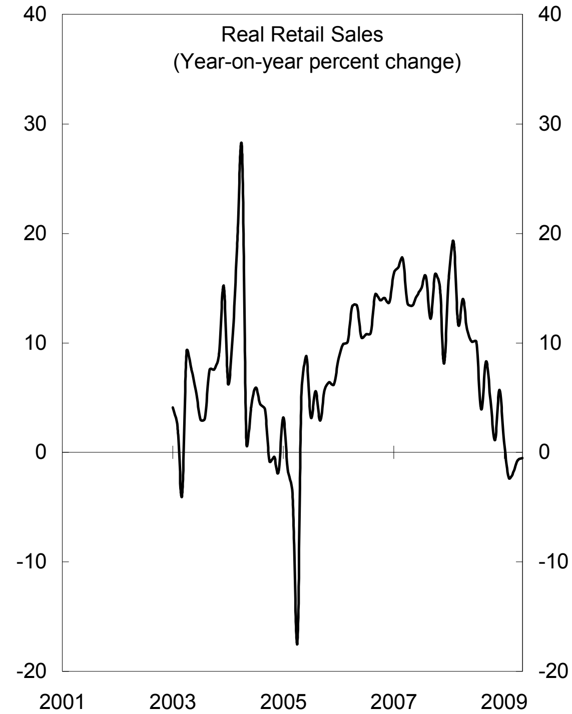
…while trade collapsed...



...so have confidence measures...



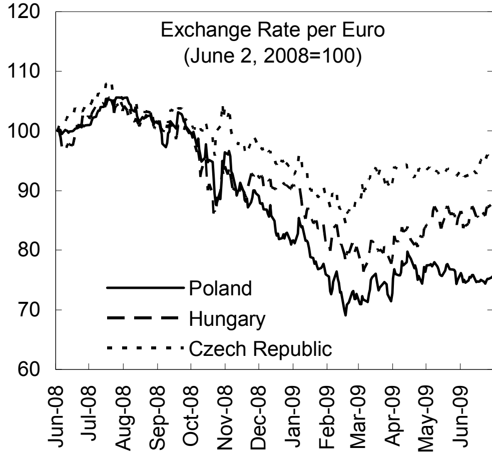
…but until recently private consumption has held up in positive territory.



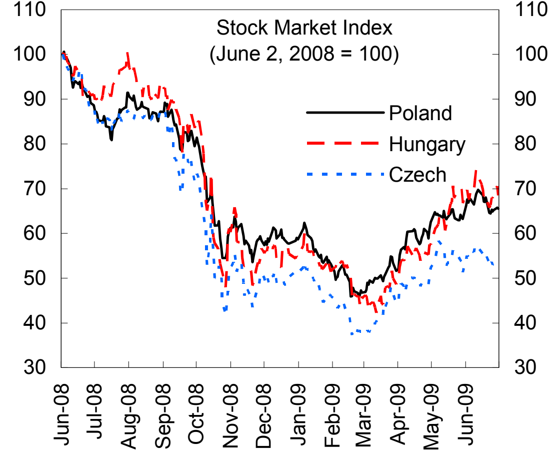
Sources: European Commission; Bloomberg; and Haver.

Figure 2. Poland: Recent Financial Markets Developments
June 2008 - July 2009

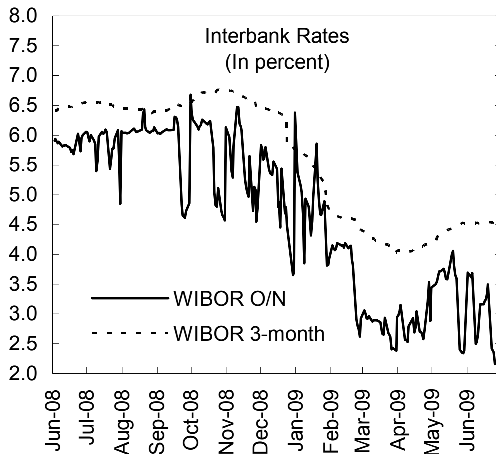
Sharp zloty depreciation against the euro reversed course recently, but less so than in other CEEs...



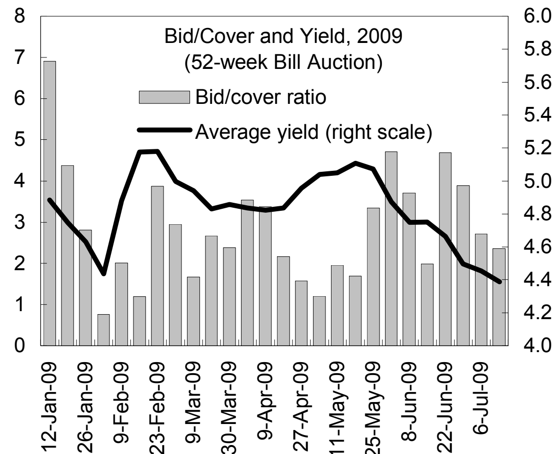
…while the stock market moved in tandem with regional peers.



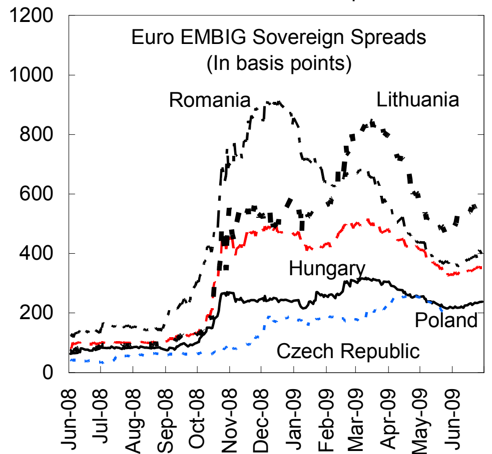
Interbank rates have declined from their 2008 highs...



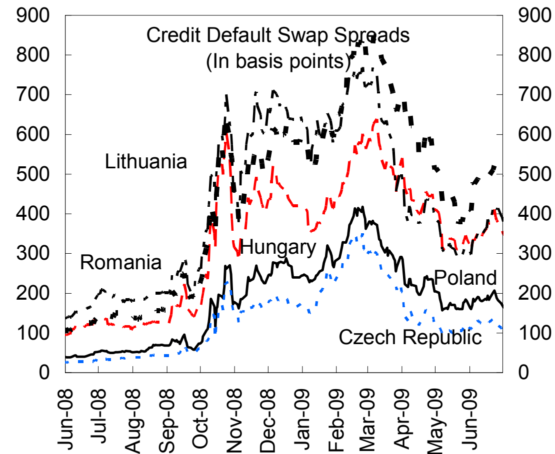
…while domestic treasury auctions has seen healthy demand this year.



Sovereign bond spreads trended higher, but remain contained relative to CEE peers...

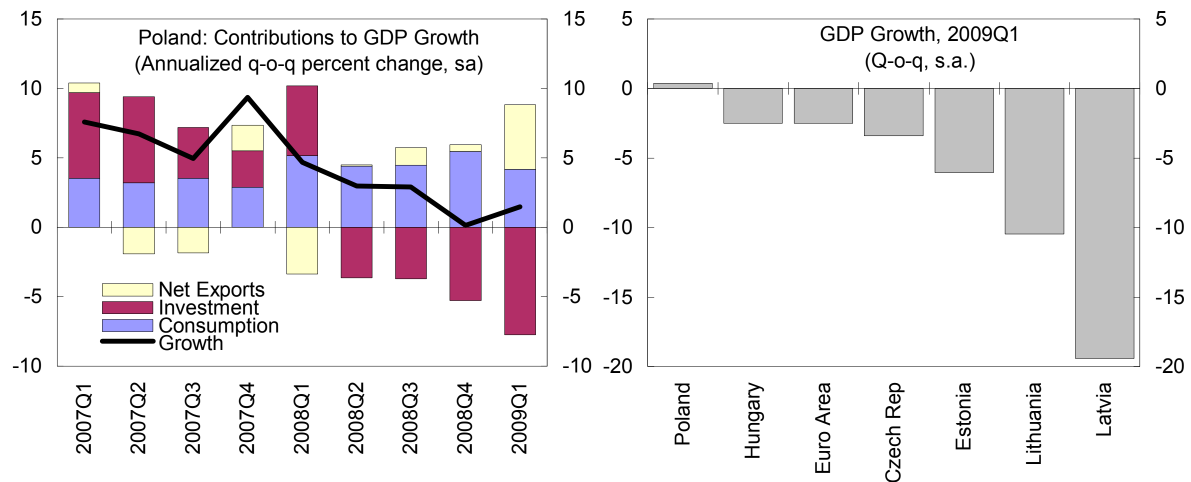


…and similar trends were seen in CDS spreads.



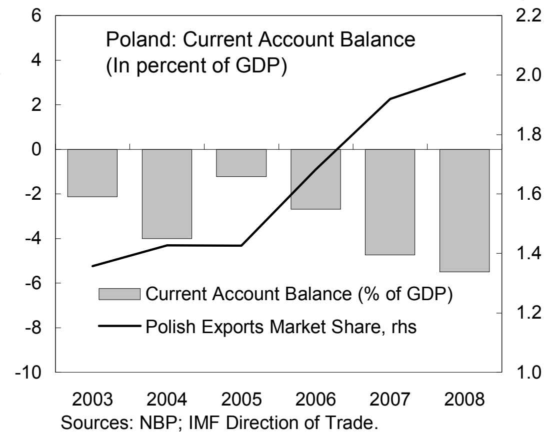
Sources: Bloomberg; and Polish Ministry of Finance.

3. **As a result, output growth has decreased sharply, albeit less so than in regional peers**. While consumption held up relatively well through the first quarter of 2009, partly supported by tax cuts that came into effect in 2008-09, investment declined significantly, and domestic demand slowed sharply as uncertainty about the economy emerged. Still, while other economies in the region contracted in the last two quarters, Poland managed to maintain slight positive growth.



Source: Polish Statistical Office.

4. **As exports fell sharply, the current account balance worsened before reversing course in recent months.** Notwithstanding gains in export market share, the current account deficit widened to 5.5 percent of GDP in 2008 from 4.7 percent of GDP a year earlier. However, the deficit declined to 4 percent of GDP in the first quarter, as domestic demand weakened, and the compression in imports more than offset the contraction in exports in early 2009. Following sustained inflows in recent years, FDI slowed sharply by about 50 percent in the first quarter of 2009 compared to a year earlier.[2]



Sources: NBP; IMF Direction of Trade.

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[2] A recent IMF TA mission investigating statistical discrepancies in Poland's 2007–08 BoP accounts concluded that these appear to be primarily concentrated in selected financial accounts. The National Bank of Poland (NBP) is following up on several areas identified by the mission and is working on adopting a new BoP compilation system, targeted for early 2010, which may solve many of these discrepancies.

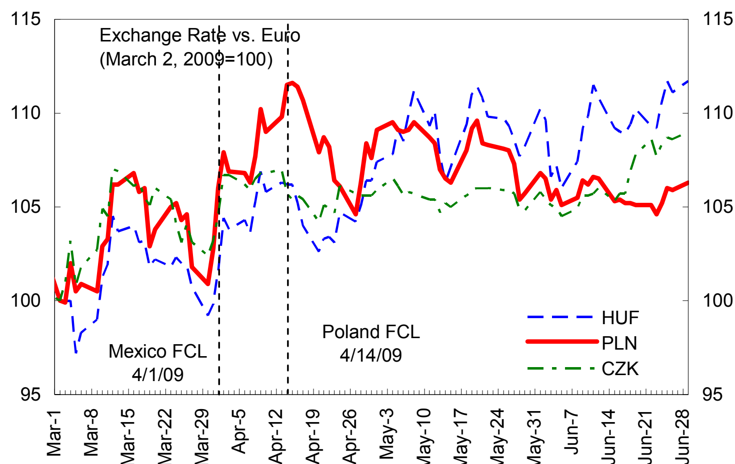
5. **Against this background, markets have welcomed Poland's FCL**. The zloty reached a four-month high against the euro immediately following Poland's FCL announcement, but has subsequently lost some ground, in line with developments in the region (Figure 3). CDS spreads narrowed by about 100 basis points over this period, although this also reflected, in part, regional trends. Shortly after the FCL was approved, the authorities tapped the euro bond market with a spread that was 20 basis points lower than in January. In early July, the authorities issued a $2 billion ten-year bond, their largest ever issuance on the U.S. market. Both papers were significantly over subscribed.

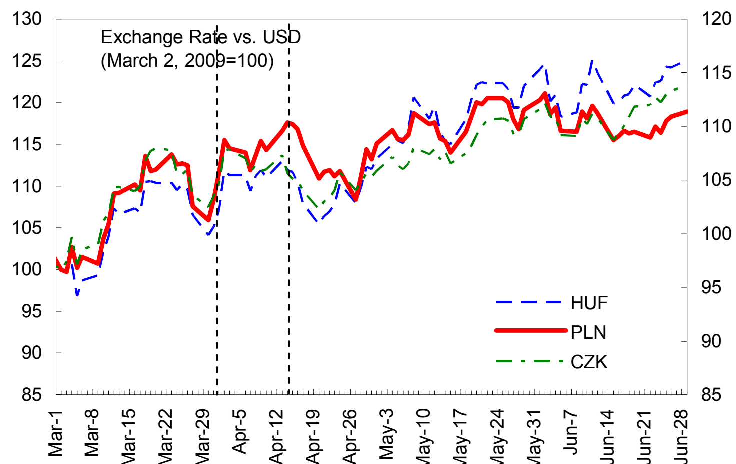
6. **A sharp slowdown in credit growth is underway**. While foreign bank exposure to the Polish banking sector has remained stable since the third quarter of 2008, surveys suggest that banks have tightened credit criteria dramatically both for corporate and individual borrowers since the fourth quarter of 2008. Such changes in lending policies have been influenced by uncertainties related to the economic outlook, growing industry-specific risks (real estate and export industries), and the expected deterioration in the capital position of the banks. Loan demand has also weakened with declining investment activity. Reflecting growing uncertainties and the continuing difficulties faced by global banking groups, Polish banks—mostly foreign subsidiaries—have a strong liquidity preference and have not been willing to lend to other banks in the interbank market beyond one-week maturities.

7. **The banking system, nonetheless, has weathered the crisis well so far**. Poland's banking system entered the crisis from a relatively strong position. Although it has experienced a rapid credit expansion as in other countries in the CEE region, Poland's credit boom started later and has been shorter (Figure 4). Still, credit risk has risen with the slowdown of the economy. NPLs started to pick up in 2009, especially in the non-financial corporate sector (Figure 5). Lower asset returns and higher funding costs have already begun to squeeze profitability—banking sector profits have fallen by about 50 percent in the first quarter of 2009 from a year earlier. But the banking system remains well capitalized with a capital adequacy ratio (CAR) of 11.7 percent at the end-April 2009, a high ratio of tier 1 capital, and record profits in 2008.

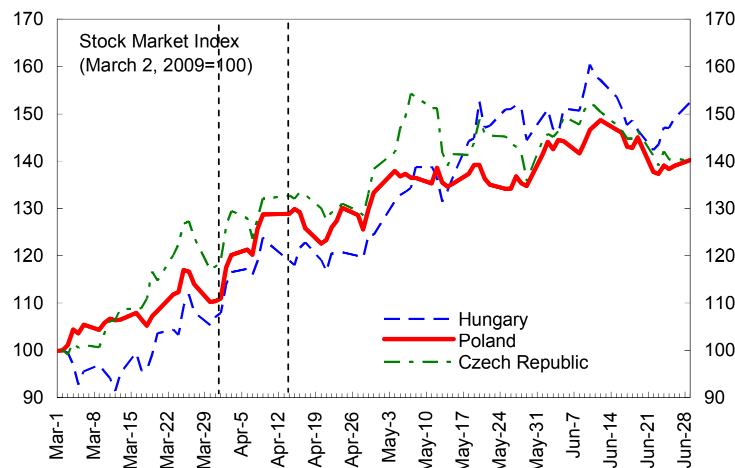
Figure 3. CE-3: Reaction to Mexico and Poland FCL Announcements
(March 2, 2009-June 29, 2009)

The zloty gained immediately following Mexico's FCL announcement.

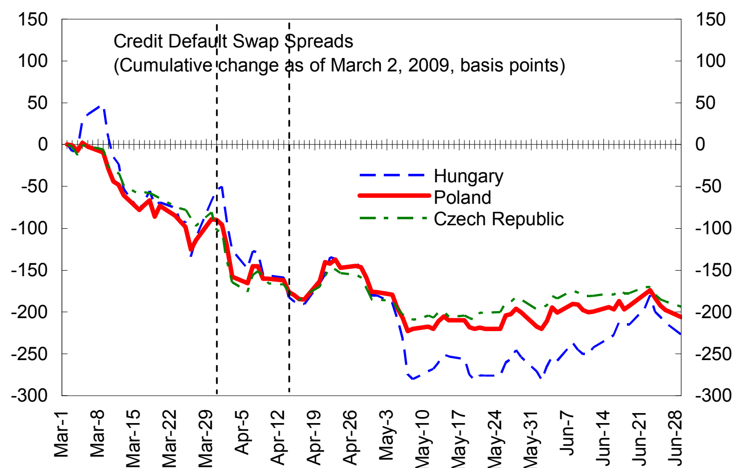




Polish equities have increased in line with the region...



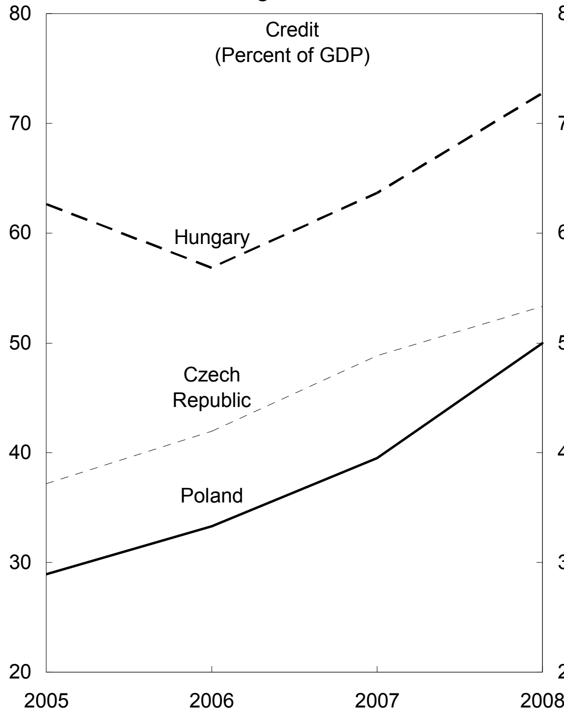
…while CDS gains followed a similar trend.



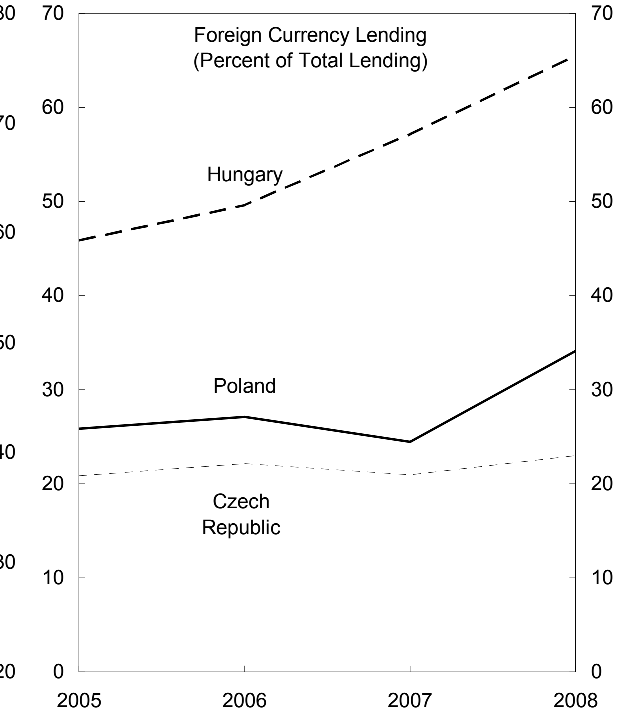
Source: Bloomberg; and DataStream.

Figure 4. CE-3: Key Lending Indicators, 2005-08

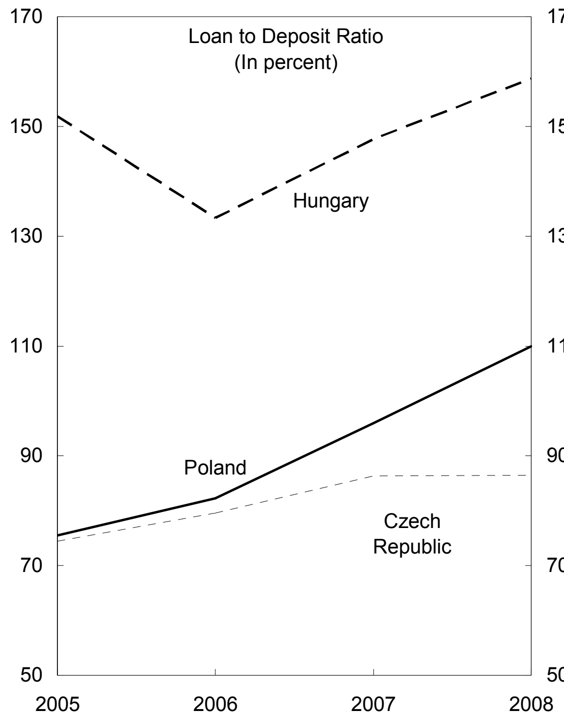
Poland's bank credit penetration is lower than its neighbors.



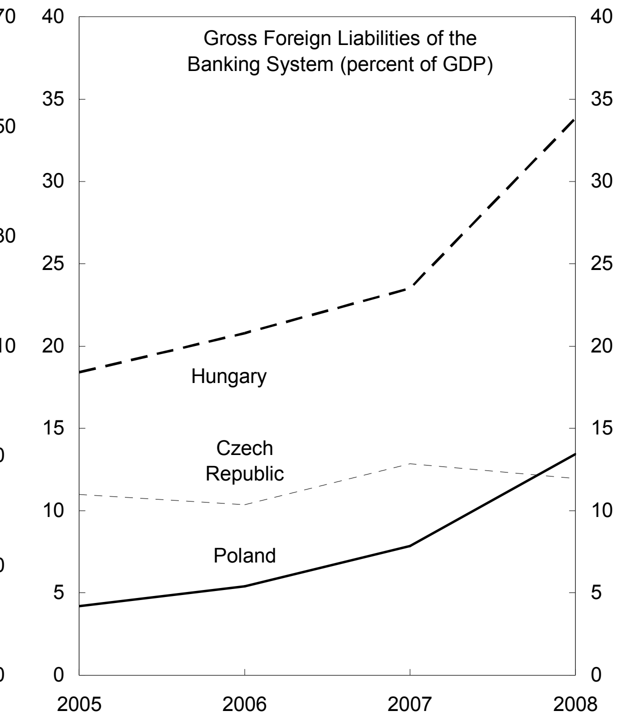
Share of foreign currency-denominated loans has increased but remained moderate.



Loan-to-deposit ratio is not high by European standards.



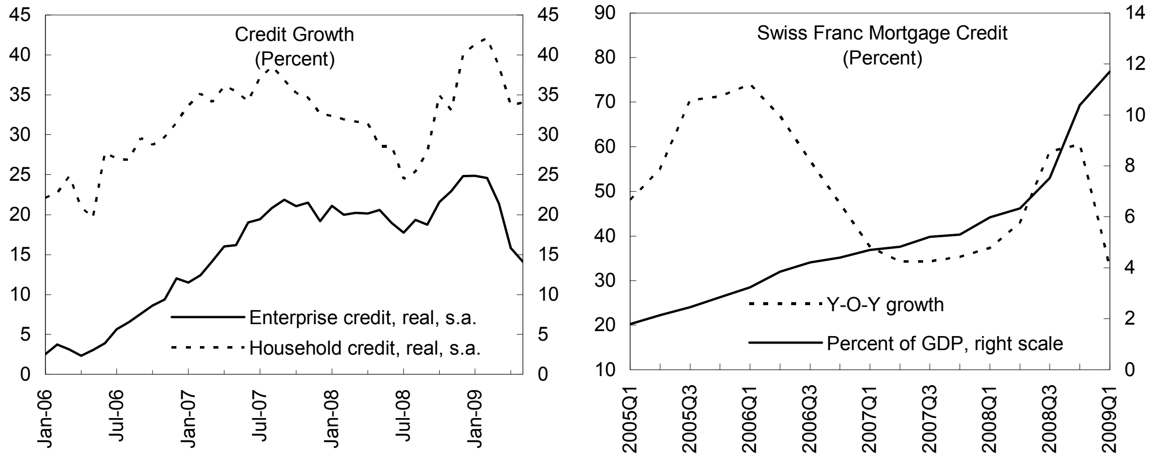
Foreign funding has risen rapidly, but from a very low base compared to the neighbors.



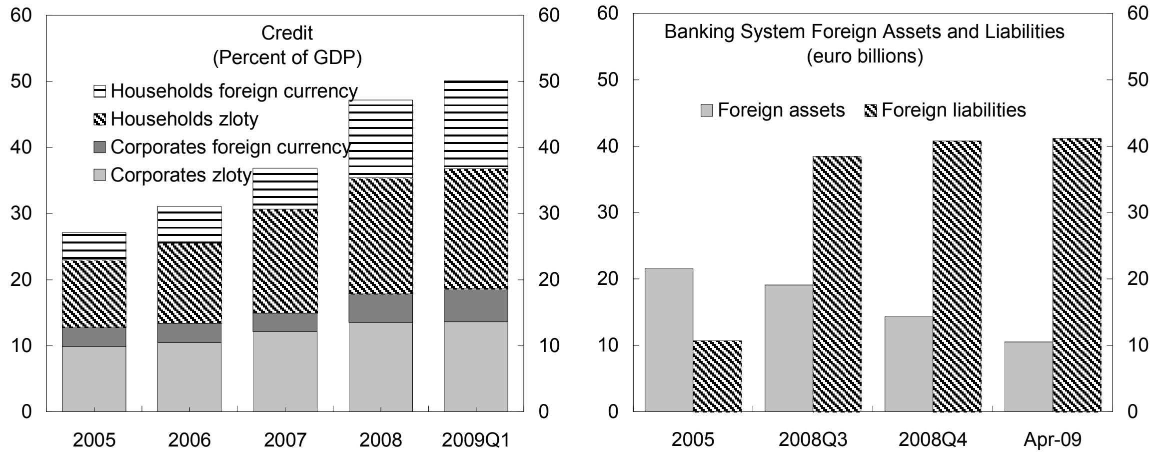
Sources: IMF, *International Financial Statistics* database; Haver; and EMED.

Figure 5. Poland: Recent Credit Developments, 2005-09

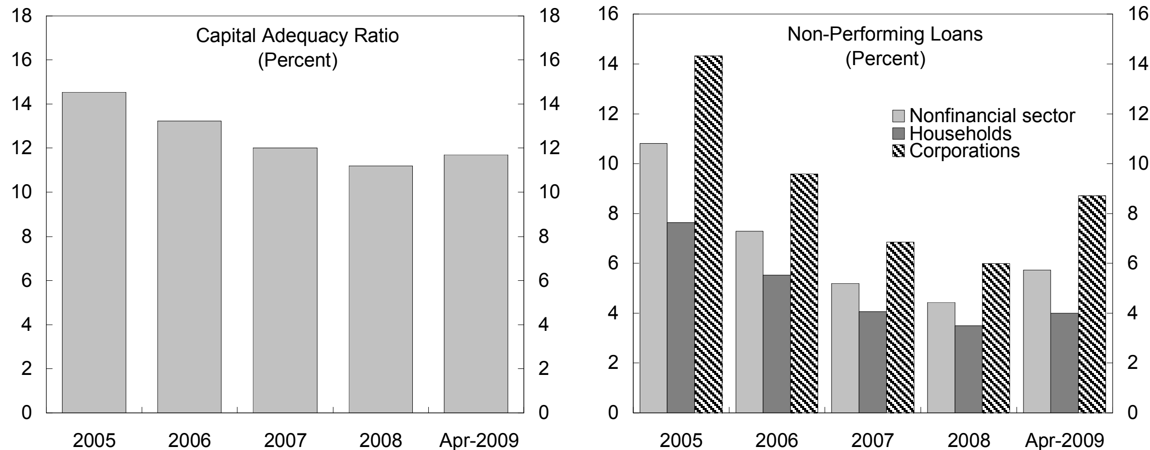
Credit—especially Swiss franc-denominated mortgages—has been growing rapidly up to end-2008, but already started to slow.



Credit growth has been funded partly by increases in foreign liabilities which have stabilized since end-2008Q3.



CAR has been boosted by retained earnings. With the ecomomy slowing down, NPL ratio of the nonfinancial sector rose to 5.7 percent by April 2009.



Sources: National Bank of Poland, and IMF staff estimates.

II. Policy Response to the Crisis

8. **Monetary policy has been accommodative**. Inflation rose through the third quarter of 2008, overshooting the NBP's tolerance range of 1½ to 3½ percent. Since then, the global commodity price boom reversed course, slower output growth set in, and wage and price pressures receded. In this regard, the size of the exchange rate pass-through to inflation has diminished, which has alleviated inflationary pressures from building up during the recent zloty depreciation episode (Annex 1). The decline in inflation, together with the room provided by euro interest rate cuts, has prompted the NBP to embark on a loosening cycle: since November, policy rates have been lowered by 250 basis points to 3.5 percent. Besides renewed price pressures in commodities, recent policy rate cuts have been tempered by concerns about zloty depreciation. The reserve requirement was recently lowered by 50 basis points to 3.0 percent.

9. **Measures have also been taken to assist bank funding and safeguard financial stability**. Specifically, to address foreign-currency funding risks and broader liquidity shortfalls, the authorities introduced dollar, Swiss franc, and euro swaps; widened the list of collateral that can be used at its discount window; and extended the maturity of repo transactions (Text Table). They have also proactively addressed a potential fall in capital buffers by stepping up the frequency of top-down stress testing and on-site inspections and have successfully convinced most banks to retain their profits from 2008. Finally, to ease the credit crunch, the authorities have introduced a credit-guarantee program offered by the state-owned bank BGK, albeit, so far, no bank has applied for it likely because of potential adverse signaling effects.

10. **A fiscal stimulus enacted before the crisis came into effect as the slowdown set in.** The 2008 general government deficit exceeded the budget target by 1½ percent of GDP, reaching almost 4 percent of GDP and prompting the EC to invoke the Excessive Deficit Procedure against Poland.[3] Revenue shortfalls due to the economic slowdown in the second half of 2008 contributed to this outcome. But the deterioration of the fiscal stance was also the result of a significant discretionary relaxation enacted in 2007—comprising mainly cuts in the tax wedge, but also one-off spending increases. This provided some stimulus as the economy slowed, with the cyclically-adjusted balance deteriorating by about 2 percentage points. Late in 2008, in response to the crisis, the authorities proposed limited employment subsidies and mortgage support for the unemployed; given their small size—less than 0.1 percent of GDP—these were not expected to affect the 2009 deficit.

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[3] The EDP for Poland was formally approved by EU finance ministers on July 8, 2009, requiring Poland to reduce its fiscal deficit to below 3 percent of GDP by 2012.

III. OUTLOOK AND RISKS

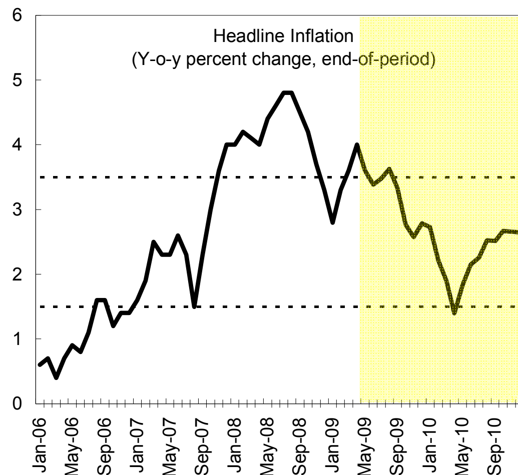
11. **The economy is set to contract in 2009 and recover slowly in 2010**. The central scenario envisages a small contraction of about ¾ percent this year, primarily reflecting a deep recession in Poland's main European trading partners and the likelihood of a credit crunch. Domestic demand is poised to continue to decline, as business confidence remains weak, unemployment rises, and credit and wage growth decline. Modest growth of about 1½ percent in 2010 is predicated on improving global conditions and moderate consumption growth, consistent with a gradual strengthening of financial conditions and a slowly improving labor market. Risks to the central scenario, stemming from a slower-than expected global recovery and uncertainty regarding domestic demand, are on the downside.

Poland: Real GDP Growth Projections, 2009-10
(Percent)

	2009	2010
GDP	-0.7	1.5
Domestic demand	-1.4	1.5
Private consumption	1.5	1.0
Public consumption	2.0	2.0
Domestic fixed investment	-4.8	2.5
Net external demand (contribution to growth)	0.8	-0.1

Sources: IMF staff projections.

12. **Inflation is projected to remain subdued**. As world commodity prices are expected to be in check and wage developments are likely to track real activity, price pressures should be subdued. With growth well below potential, headline inflation is projected to stay within the tolerance range of 1½ to 3½ percent for the foreseeable future. The impact on headline inflation of recent increases in food, fuel, and administered prices pose is likely to be temporary, in part because of favorable base effects..



Sources: Polish Statistical Office; and IMF staff projections.

13. **Poland is expected to meet its financing needs for 2009–10 with no undue pressures on the zloty**. Despite gross external financing requirements of around $100 billion (25 percent of GDP) in 2009–10, financing

gaps are not expected to emerge under the baseline scenario. Specifically, the public sector has already secured a large part of its rollover needs for 2009; [4] the decline in private sector rollover rates is expected to continue, being largely demand driven (trade credit accounts for over 80 percent of non-bank short-term debt). Moreover, declining import volumes and favorable terms of trade developments should more than offset a projected decline in exports and gradually narrow the current account deficit to about 3¼ percent of GDP in 2009–10. Given these considerations and staff's assessment that the real exchange rate is broadly aligned with fundamentals, pressures on the zloty are not expected to emerge (Box 1).

14. **In the case of unexpected external shocks, including an intensification of regional spillovers, the FCL would provide a considerable cushion**. A worsening of the crisis in Western Europe with an attendant delay in economic recovery could further slow export growth and result in additional retrenchment of foreign assets from Poland. Moreover, the risk of contagion from adverse developments in the region, not least the Baltics, can not be excluded. In turn, reduced rollover rates by parent banks and corporates could exacerbate downward pressures on the zloty. In this scenario, a more severe contraction of the Polish economy would emerge and result in mounting NPLs, heightening the pressure on private-sector balance sheets. Limited public sector access to capital markets would become a binding fiscal constraint in the presence of significant revenue shortfalls and potential bank recapitalization needs. However, the possibility to draw on the recently approved FCL would provide a considerable cushion to limit the economic impact of such an extreme scenario.[5]

15. **While sharing concerns about the downside risks, the authorities were more sanguine on growth prospects in 2009, but somewhat less optimistic about 2010**. The authorities foresee growth of about ½ percent in 2009, supported by resilient consumption. For 2010, their forecasts range from about ½ percent to 1½ percent, reflecting differences in the outlook for the external sector.

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[4] In addition to the Eurobond and dollar placements already completed, Poland has secured a $1.25 billion loan from the World Bank in early July; a further 1 billion euro refinancing from EIB and a new euro-denominated bond issuance are expected before end-2009. As of July 15, about two-thirds of the government's 2009 gross financing requirements were filled.

[5] The FCL would fully cover financing needs if roll over rates fell to about 80 percent. Details of the scenarios can be found in IMF Country Report No. 09/138.

Box 1. Poland: Real Exchange Rate Assessment

Staff estimates do not point to significant misalignment in the real exchange rate. CGER assessments for the latest reference period suggest that the sizable depreciation of the zloty since August 2008 has more than offset the real appreciation that had been registered in the first half of 2008 for an overall assessment of a 10 percent undervaluation. However, nominal exchange rate appreciation since the reference period would bring the assessment closer to equilibrium. Specifically,

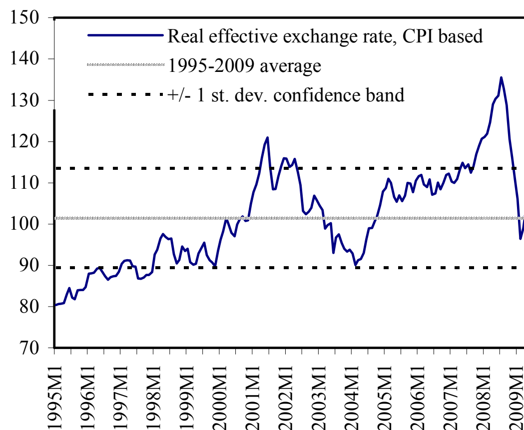
- The equilibrium real exchange rate (ERER) methodology suggests a moderate undervaluation of around -12 percent; this estimate reflects a strengthened equilibrium level driven by improvements in relative productivity and a CPI-based real exchange rate that is now in line with its historical average.

CGER Results, 2008-09
(Percent deviation from estimated equilibrium)

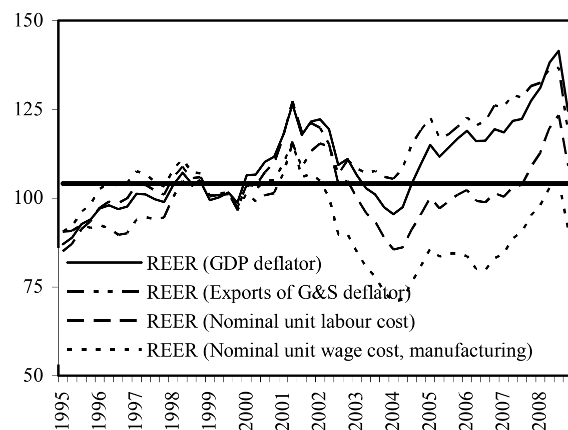
	Fall 2008	Spring 2009
Macrobalance approach	11	-5
ERER approach	15	-12
External stability approach	5	-13
CA norm	-1.8	-1.7
NFA-stabilizing CA at 2008 level	-3.3	-3.4

- The macroeconomic balance (MB) and external sustainability (ES) approaches also suggest a moderate undervaluation of 5 and 13 percent respectively, given the medium-term current account projections that are above the current account norm and NFA-stabilizing deficit.

Poland: Real Effective Exchange Rate



Poland: Alternative REER Measures



Source: National authorities; European Commission; GDS.

As regards other indicators of price and cost competitiveness, increases in ULC-based measures of the REER have also started to reverse course in late-2008 as weakening cyclical conditions help dampen wage pressures.

IV. The Policy Agenda

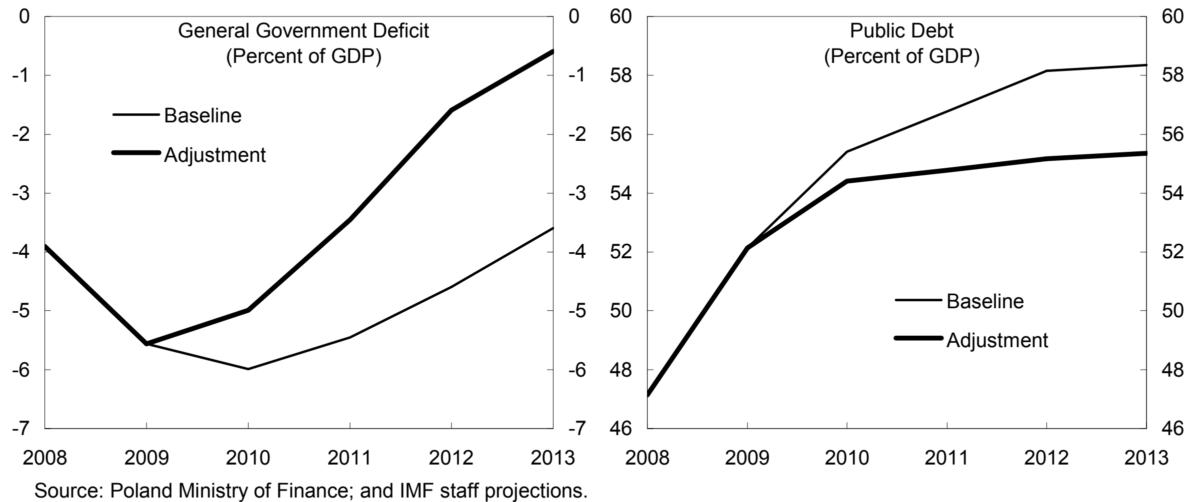
A. Setting the Stage for a Credible Medium-Term Fiscal Consolidation

16. **The revised 2009 budget entails a limited increase in the fiscal deficit.** Given staff's macroeconomic scenario, the recent state budget amendment expected to be approved by Parliament in mid-July implies that the general government deficit will rise to about 5½ percent of GDP compared to 2½ percent planned in 2009. Underlying this outcome is a shortfall in tax revenues of about 2¼ percent of GDP and higher expenditures of more than 2 percent of GDP, partially compensated by higher expected dividend receipts from state-owned companies of about ½ percent of GDP and across-the-board expenditure cuts estimated at close to 1 percent of GDP. Nevertheless, as a result of the 2008 personal income tax cuts enacted in 2007 but becoming effective in 2009, the cyclically-adjusted fiscal balance is expected to deteriorate by about 1 percentage point in 2009—following the 2 percentage points deterioration of 2008—providing a small stimulus during the downturn. So far, markets have reacted positively to the revised budget, and government bond auctions have seen high bid-to-cover ratios—averaging about 3 in recent months—and yields have remained stable despite the increase in the public sector's borrowing requirement.

17. **Staff supports the proposed increase in the deficit limit, but believes that it should be accompanied by measures to strengthen confidence in medium-term consolidation targets.** Fiscal policy should balance short-term cyclical considerations and medium-term consolidation efforts. On the one hand, taking stronger pro-cyclical measures to curb the deficit now would exacerbate the economic slowdown. On the other hand, allowing automatic stabilizers to fully operate through a higher short-run deficit would imply the need for a deeper fiscal adjustment in the coming years. Thus, even with the 2009 measures, staff expects the deficit to increase to 6 percent of GDP in 2010 and remain above the Maastricht limit in the medium term, with debt hovering close to the 60 percent-of-GDP threshold. Against this background, staff believes that the decision to increase the deficit limit should be supported by measures to strengthen the medium-term framework. In this regard, a revamped fiscal framework consistent with international best practice—including binding multi-year expenditure limits—could bolster confidence and underpin a durable consolidation (Box 2). This will help to anchor market expectations despite higher short-run financing needs and reassure European partners that Poland is committed to achieving its medium-term targets.

18. **The 2010 budget should set the stage for a sustained medium-term consolidation**. On the assumption that the recovery will begin next year, permanent measures amounting to about 1 percent of GDP starting in 2010 would be needed for a three-year period, in order to

meet the 1 percent of GDP medium-term deficit target agreed with EU partners, albeit with a one-year delay. This adjustment will help stabilize debt comfortably below 60 percent of GDP. However, to prevent a strongly pro-cyclical stance, the authorities should be prepared to delay this adjustment if the economy does not begin to recover as projected.



Source: Poland Ministry of Finance; and IMF staff projections.

19. **Spending reforms will be required to achieve a durable medium-term adjustment**. Owing to the early implementation of pension reforms in the 1990s, aging costs do not pose a significant problem to the medium-term fiscal outlook. But statutory expenditures constitute a large proportion of the budget. Hence, reforms are needed to reduce the deficit in the medium run, including in the area of social spending, where recent increases have led to additional fiscal costs. Possible options include better targeting child deductions in the personal income tax, disability contributions, and pension indexation.

20. **The authorities agree with the need to embark on a fiscal consolidation, but do not see the need for forward-looking binding expenditure rules**. They are still working on the details for the 2010 budget but remain committed to starting an expenditure-based fiscal adjustment then. They are also open to introducing a performance-budgeting system to improve the effectiveness of policies. However, they do not see a need for introducing binding expenditure ceilings in their multi-year fiscal plan, noting that these would be difficult to implement, given their dependence on uncertain projections, and could run the risk of being interpreted as entitlements. They believe that strict yearly deficit limits and the existing Public Finance Act—which triggers fiscal actions once the debt reaches certain thresholds—are sufficient to ensure the credibility of fiscal policy.

Box 2. Poland's Fiscal Framework: Proposed Changes and Options for Strengthening

The authorities have recently proposed to update their budgetary framework, which focuses on annual budgets, by introducing a multi-year financial plan for the state (MFPS). The plan would include a rolling four-year horizon—current and three years ahead—detailing a nonbinding direction for fiscal policy. The one-year ahead budget deficit would, nonetheless, be expected to be adopted the following year baring exceptional circumstances. In addition, the new framework would introduce medium-term plans at other levels of government and elements of performance-based budgeting, while maintaining Poland's national debt ceilings.[1]

The proposal introduces elements of a medium-term fiscal framework but, by focusing on nominal deficits, the pro-cyclical bias in fiscal policy remains. Moreover, the lack of binding commitments beyond a year limits its role as an effective tool to prioritize and rationalize public expenditure and articulate a high-quality medium-term consolidation.

While international best practice varies, establishing binding multi-year expenditure ceilings would strengthen Poland's fiscal framework and would be facilitated by:

- Establishing rolling forward estimates derived from the path of fiscal deficits consistent with the authorities' medium-term targets and fiscal sustainability, coupled with revenue projections in line with the economic outlook.
- Developing of an effective top-down/bottom-up reconciliation process as part of the annual budget preparation. This would compare the expenditure and revenue trends indicated by the forward estimates with the government's targets, in order to identify any necessary changes to expenditure, revenue, or fiscal policy.
- Enhancing the expenditure prioritization process, including systematic expenditure review.
- Continuing to develop performance budgeting, which will support forward estimates and the expenditure prioritization process.

Greater transparency and accountability can help to further safeguard fiscal discipline. In this regard, strengthening of fiscal institutions could enhance the objective analysis of current fiscal developments, long-term fiscal sustainability, and costing of budgetary initiatives. In addition to safeguarding the independence of projections, this could also provide a broader context for normative assessments of fiscal policy.

[1] The constitution establishes a cap of 60 percent of GDP for public debt. Currently, the government must take increasingly tough corrective actions if debt breaches triggers established at 50 percent of GDP and 55 percent of GDP.

B. Cautiously Easing Monetary Policy

21. **Further policy rates cuts are warranted**. With inflation set to remain within the tolerance range for the foreseeable future, staff considers that the loosening bias in monetary policy should continue. Moreover, should increases in the government's borrowing requirements—associated with the operation of automatic stabilizers—exert pressure on domestic interest rates, monetary policy should stand ready to accommodate fiscal policy.

22. **A measured relaxation was not expected to weaken the zloty**. Staff noted that the scope for interest rate cuts and their pace will be tempered by external financing constraints. However, while still volatile, the zloty appears to have stabilized, and lower interest rates are not expected to weaken it further. Pressures on the exchange rate are likely to continue to moderate as Poland's cyclical position and monetary policy stance relative to those of the euro area and the US strengthen. Moreover, the weakening of the zloty that has already taken place has served to align the real exchange rate with fundamentals, and the current account is set to continue to improve. Still, monetary relaxation should proceed with caution.

23. **On balance, the authorities thought that a further small interest rate cut now followed by a pause would be appropriate**.[6] While cautioning that world oil price increases may result in rising inflation, they believe that continued weak demand will contain inflationary pressures. The authorities considered that the interest rate cuts so far, together with the reduction in reserve requirements, will support the economy's return to potential growth. While further interest rate cuts cannot be ruled out, these would depend on the evolution of inflation and the economy, including financial markets and the zloty.

C. Safeguarding Financial Sector Health

24. **While the banking system is well buffered, risks remain**. The authorities' top-down stress tests suggest that the system is resilient to adverse scenarios, and only a prolonged recession would lead to general recapitalization needs (Box 3). Moreover, post Lehman Brothers, parent banks have maintained stable exposures to their Polish subsidiaries and continued to provide them with funding and capital injections, when needed.

- **Credit quality represents the most immediate risk to the Polish banking system**. NPL ratios have increased from historic lows to reach 5.7 percent at end-April 2009 and are expected to rise further with slower economic activity and higher unemployment. While the corporate sector is not highly leveraged, and strong profits through the third quarter of 2008 (Figures 6 and 7) have kept it liquid, pressures are rising as profits are falling and funding is becoming more expensive. Net corporate profits over the fourth quarter of 2008 and the first quarter of 2009 were about half the average quarterly profits in the first three quarters of 2008, partly due to financial losses from zloty depreciation, with more vulnerable sectors such as manufacturing

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[6] The MPC cut interest rates by 25 basis points on June 24, immediately after the mission.

Box 3. Poland's Financial Sector: Stress Tests

Staff's credit risk stress tests suggest that Poland's systemically important banks are resilient to a sharp increase of non-performing loans. Specifically, only one of the eight systematically important banks would see its capital adequacy ratio fall below the regulatory minimum if the NPLs were to more than triple from their end-2008 level to 15 percent. Assuming, however, that 2008 profits are retained, the CAR should remain above the minimum threshold for all banks. These results are based on stress tests of eight systemically important banks—accounting for 54 percent of total banking sector assets—using balance sheets for which end-2008 data are available from Bankscope.

The NBP's top-down stress tests show that the banking system is robust to adverse scenarios. The most important risk identified by these tests are credit risks associated with a slowing economy and rising unemployment. In an adverse scenario where GDP contracts in two consecutive years, losses are expected to be about 3 percent of total assets, more than twice the losses experienced during the 2001–03 slowdown. In this case, recapitalization needs to keep the CAR at 8 percent would amount to 0.3 percent of GDP over 2009–10.

Assumptions			Results	
	2009	2010		2009-10
Baseline				
GDP Growth (in percent)	0.4	1.4	Impairment charges (zloty billion)	34.7
Unemployment (in percent)	…	13.2	Capital needs (zloty billion) 1/	0.4
			Capital needs (percent of GDP)	0.03
Shock scenario				
GDP Growth (in percent)	-2.3	-3.2	Impairment charges (zloty billion)	61.2
Unemployment (in percent)	…	14.7	Capital needs (zloty billion) 1/	4.1
			Capital needs (percent of GDP)	0.3

Source: NBP.
1/ Value of capital increase necessary to ensure that all banks have CAR above 8 percent.
Assuming a fall in pre-impairment income of 10 percent in relation to 2008.

These tests are based on a consistent set of macro assumptions and panel estimation of loan loss reserve. The NBP derives its macro scenarios from a medium scale structural macroeconometric model. These scenarios are translated into aggregate loss provisioning by a bank-level panel model. Interest rate levels follow a Taylor's rule while movements in the exchange rates are not captured in the main panel estimation model. The tests also assume constant assets and exogenously imposed operating profits of the banks. The macro stress tests are complemented by two simulations for households' ability to service debt, employing micro-level data from household budget surveys and credit registry. Due to limited data availability, the NBP does not have a model specifically for corporate sector default.

exports and construction experiencing large earnings declines. The household sector has been relatively healthy so far, and the portfolios of foreign-currency denominated mortgages have continued to perform well, as lower foreign interest rates have been compensating for the depreciating zloty. In addition, lending standards for foreign-currency denominated loans have been tightened since 2006, as recommended by supervisors. The main risk to the sector remains rising unemployment, should the recession last longer than expected, and a reversal of monetary policy easing abroad.

- **Direct foreign exchange risks could emerge**. Banks maintain their ability to hedge against foreign exchange (FX) and interest rate risk through their parents in light of illiquid financial markets. While direct FX risks are now under control, banks are finding it more expensive to close their open positions. The NBP's sensitivity analysis shows that only in an extreme case in which banks are unable to rollover the entire value of maturing hedging transactions, eight of them (representing 15 percent of system assets) would not meet the regulatory capital requirement.

- **Risks related to exposures to structured credit products and derivatives appear contained**. Polish banks have negligible direct exposure to U.S. subprime mortgage assets. But they have been affected by corporate losses on derivative contracts that were made as the zloty was appreciating, and subsequently back-fired once the currency trends reversed. These risks, however, are now diminishing. Exposures have been declining to about 0.4 percent of GDP in April, compared to 1.2 percent of GDP in January 2009, due to favorable exchange rate movements, but also to individual negotiations and restructuring of claims with banks. Of the remaining exposure, about 80-85 percent is naturally hedged, as it was incurred by the tradable sector. Under existing contracts, around 80 percent of options should be settled by end-2009.

- **Funding risks could arise in some banks, but measures taken by the NBP have helped**. The overall loan-to-deposit ratio stands at around 110 percent. At the aggregate level, total exposure to foreign funding has remained stable since September 2008. Funding risks, however, are not evenly distributed among banks and are particularly acute for a number of small- and medium-sized banks, which had relied on market funding. To close their funding gaps when interbank market access remains restricted, these banks resort to parent banks' assistance and aggressive offers on the deposit market. The NBP measures have mitigated some pressures, but a number of these banks had to stop expanding their balance sheets, especially in new foreign currency mortgage lending. Costly new deposits and foreign funding—due to higher risk premiums following rating agency's downgrades of Polish and their parent banks—will limit profitability and the banks' capacity to internally accumulate capital.

25. **The revival of credit activity to support growth in 2010, including through restoring the normal functioning of the interbank market, is likely to depend mainly on external factors**. Underlying credit demand exists: mortgage loans stand at only 15 percent of GDP, and half of firms do not rely on bank credit. But the supply of credit is likely to remain constrained, given the above risks and the reliance of many banks on funding and liquidity from international parent banks which are still in the process of deleveraging. Measures to unfreeze the interbank market have not yet succeeded in restoring transactions at longer maturities. To a large degree, the reluctance of foreign-owned subsidiaries to lend to each other in the Polish interbank market mirrors the reluctance of their parents to do so. This suggest that normalizing financial markets in Poland will, to a large degree, hinge on normalizing such markets globally.

26. **Vigilance and pre-emptive measures by the authorities remain key in the current situation**. In this regard, encouraging banks to boost capital buffers, mainly by retaining the record-high 2008 profits, was appropriate. Moreover, postponing the recommendation to tighten lending standards for foreign-currency denominated loans has rightly avoided a pro-cyclical action. In staff's view, as a complement to the top-down stress test performed by the NBP, a case can be made for the KNF's conducting systematic, bottom-up, bank-by-bank stress tests based on a consistent set of macroeconomic projections. This would help identify emerging weaknesses and potential bank recapitalization needs, as well as alleviate uncertainty in the financial system. A national effort in this regard would complement the EU's approach of stress-testing major banking groups, and such an exercise could be coordinated with neighboring countries.

27. **Staff supports the KNF's effort to strengthen supervision of credit unions** (SKOKs). While staff is not aware of problems in these institutions, it is a concern that they have no direct access to a lender of last resort facility, are not supervised by the KNF, and are not covered under the bank guarantee fund, but only by their internal insurance fund. While SKOKs are small (as a share of total banking assets) and, on their own, are unlikely to pose a systemic risk, any problems could spillover to the rest of the system.

28. **There has been progress in improving the framework for financial sector surveillance and crisis management**. The Financial Stability Committee was formalized by law, and the Ministry of Finance introduced a law on state treasury assistance to financial institutions and a law on recapitalization of distressed financial institutions. The former—entered into force in March 2009—allows the State Treasury to assist financial institutions with guarantees, loans, and sale of securities. The latter—still under discussion in Parliament—allows the Minister of Finance to issue a guarantee to a financial institution to increase regulatory capital or increase its capital by taking up shares, bonds or bank securities. Moreover, the governing structure of the Bank Guarantee Fund (BGF) has been modified to include the KNF—beside the NBP and the MOF—in its governing council. The BGF is no longer partly funded by the NBP, although it retains the ability to borrow through

the NBP and the state budget. In addition, the time period for deposit insurance payments in case of bank suspension—currently at around 3 months—is expected to be lowered to comply with the new EU Directive by end-2010.

29. **With the prospect of reduced intermediation through banks, it should be a matter of priority to foster the development of domestic capital markets**. The equity market has been growing in terms of market capitalization with an increasing number of IPOs, aided by active measures such as the introduction of new corporate governance rules and a new trading platform for start-ups and new companies. The privatization of the Warsaw Stock Exchange—expected in 2009—will bring further international linkages to Polish capital markets. The non-government bond market, however, remains small and illiquid. Consistent with the 2006 FSAP Update recommendations, measures to facilitate corporate debt issuance, such as enhancements in market infrastructure in the areas of custody and depository services and streamlining issuance procedures, could support the development of the market. Moreover, to diversify the funding of banks' mortgage credit portfolio, universal banks should be allowed to issue covered bonds to mobilize longer-term funds and reduce maturity mismatch.

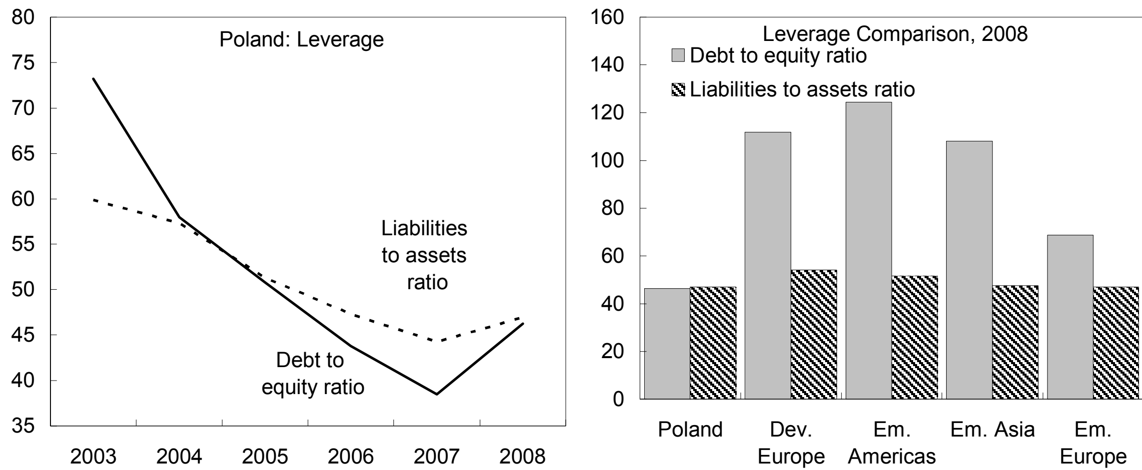
30. **The authorities agreed with the thrust of staff's recommendations.** They continue to monitor the situation in individual banks closely and to analyze system-wide issues, such as exposures to foreign-exchange options. While they are, in principle, open to undertaking a bottom-up stress-testing exercise, they are inclined to resist doing so within broader regional context unless carried out under the EU umbrella. In addition, the authorities welcomed the prospect of an FSAP update in 2010.

D. Bolstering Growth and Adopting the Euro

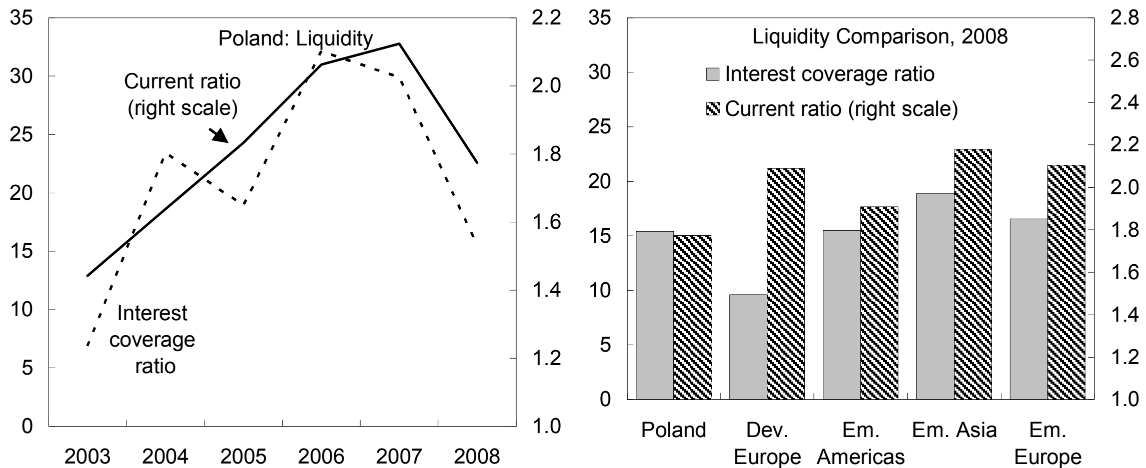
31. **Removing labor-supply bottlenecks will be vital to boosting long-term growth**. Before the crisis hit, resource constraints were emerging particularly in the labor market, reflecting Poland's low labor participation rate, especially among those above 50 years old. To address this bottleneck, the authorities reformed the early-retirement provisions by substantially tightening the eligibility requirements slashing the number of eligible citizens from over one million to about 250,000 in 2008. Staff strongly welcomed this and suggested that future priorities should include gradually increasing the effective retirement age and equalizing the statutory retirement age of men and women (Annex 2). Moreover, special pension schemes should also be reformed and merged into the general pension scheme. Besides helping to promote fiscal sustainability, labor-market reforms would complement continued efforts to improve the regulatory interface with business and reinvigorate privatization plans to enhance the economy's flexibility and bolster its long-run potential.

Figure 6. Poland: Nonfinancial Corporate Sector Indicators, 2003-08 1/

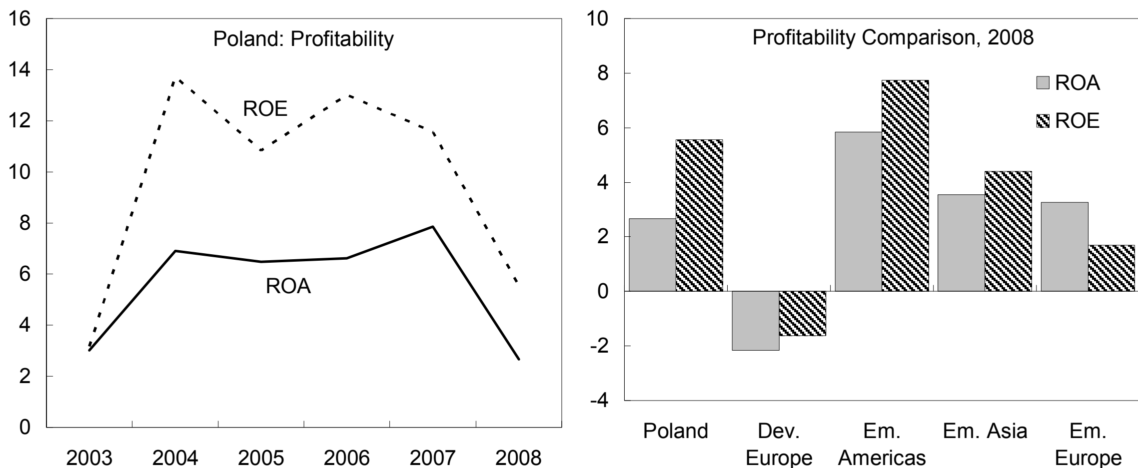
Leverage indicators have been falling and are not high compared to other countries.



Companies have maintained a relatively strong liquidity position.

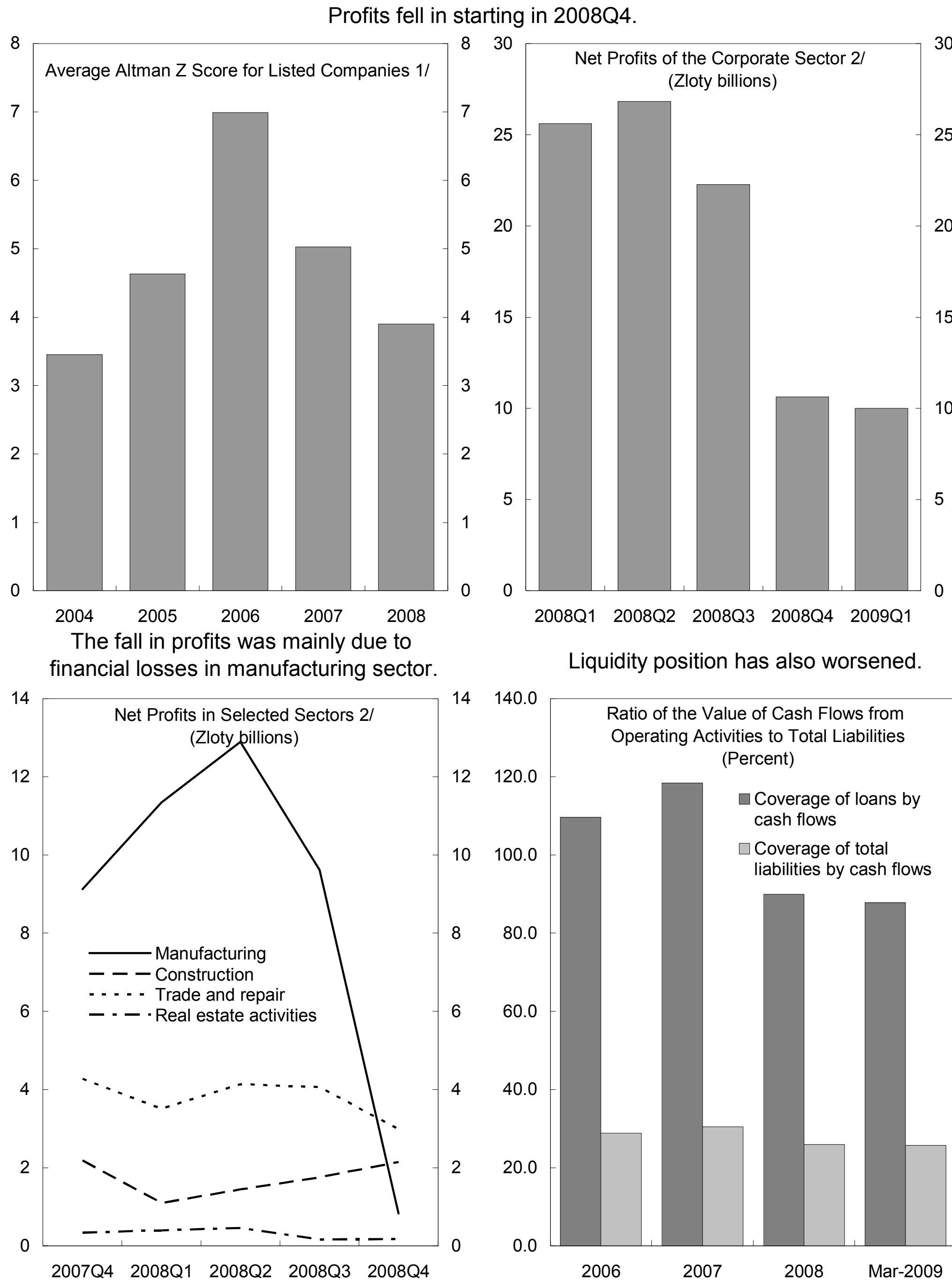


Profitability indicators are comparable to other emerging markets.



Sources: Worldscope; and IMF staff estimates.
1/ Mean values for listed companies available in Worldscope database.

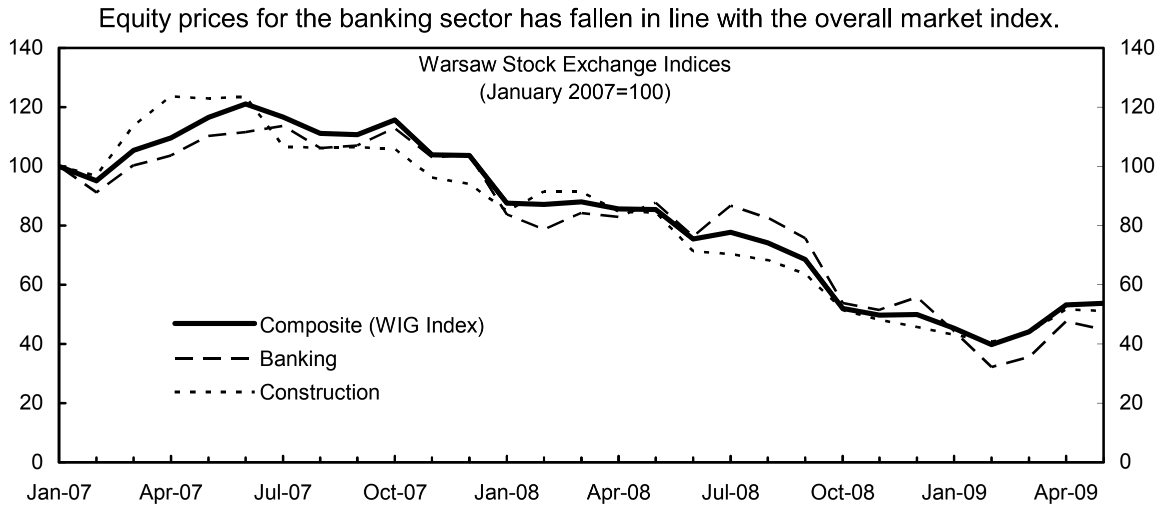
Figure 7. Poland: Recent Developments in the Corporate Sector, 2007Q4-2009Q1



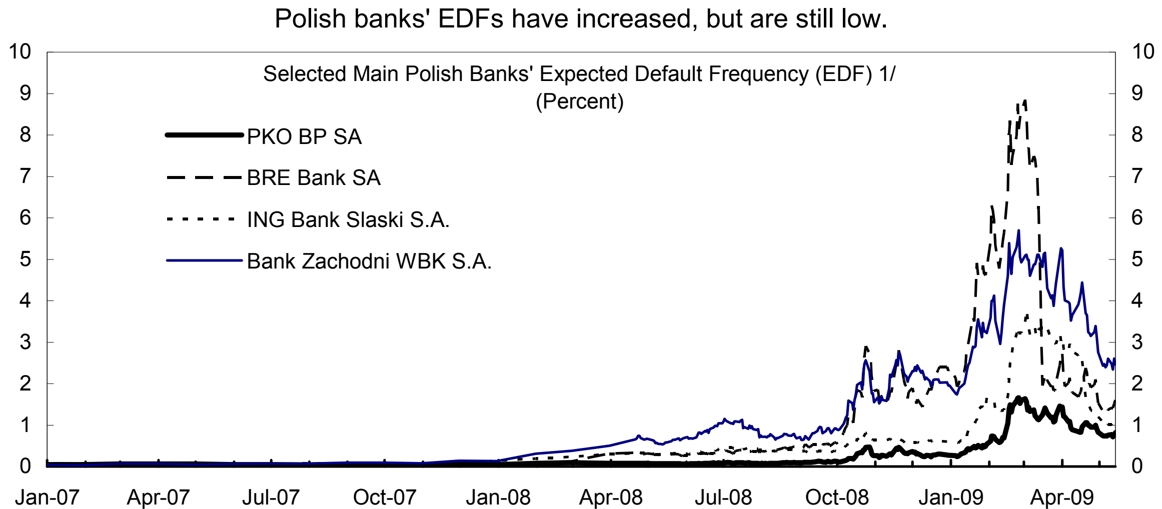
Sources: NBP, Poland Central Statistics Office (GUS), Worldscope, and IMF staff estimates.
1/ Altman z score is a one-year-ahead probability of survival developed in Altman (1968). Higher score means lower default probability. Companies with z scores above 3 are generally categorized to be in "safe zone."
2/ Using non-financial corporate data according to GUS which covers 17,440 firms employing over 50 workers.

Figure 8. Poland: Banking Sector's Market Indicators, 2007-09

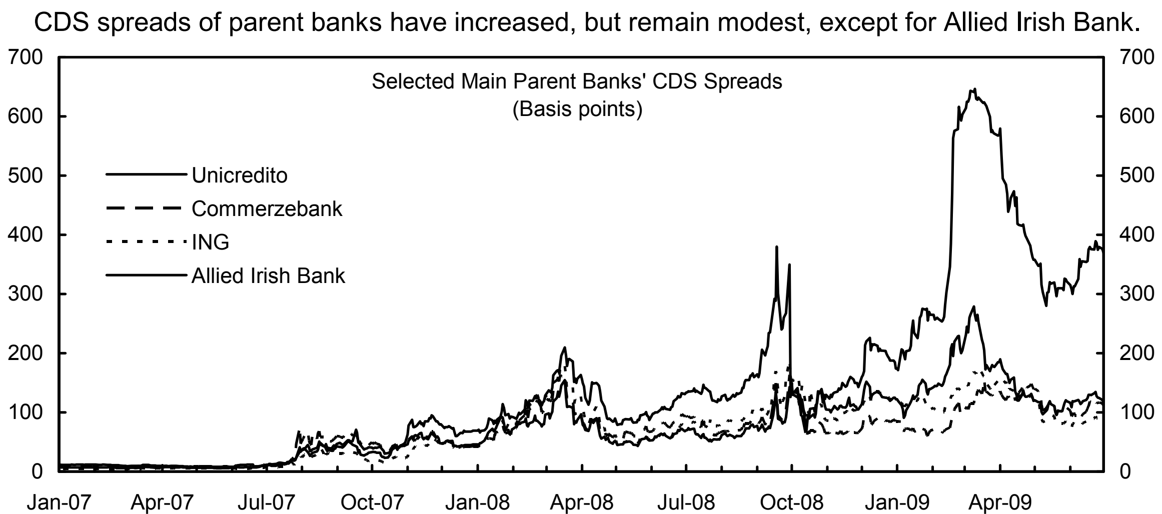
Equity prices for the banking sector has fallen in line with the overall market index.



Polish banks' EDFs have increased, but are still low.



CDS spreads of parent banks have increased, but remain modest, except for Allied Irish Bank.



Sources: DataStream; Moody's KMV; Bloomberg; and IMF staff calculations.
1/ Estimated EDF by Moody's KMV constructed with market-based data.

32. **A more flexible economy would allow Poland to adopt the euro successfully in the medium term**. On balance, staff felt that euro adoption remains beneficial for Poland. But the increased uncertainty in global markets and the current cyclical conditions have tilted the short-term balance in favor maintaining monetary policy independence and a flexible exchange rate for now. Delaying euro adoption would also allow the economy to adjust to possible changes in long-run financing prospects prompted by global deleveraging. Besides allowing for addition time to achieve the needed fiscal consolidation, it would provide time for exchange rate volatility to subside and for political support to be marshaled to ensure smooth passage of the constitutional amendment needed for euro adoption.

33. **The authorities are determined to adopt the euro as soon as possible and continue implementing structural reforms**. They recognized, however, that adopting the euro in 2012 may not be feasible and a short delay would be necessary. Still, the authorities considered that an early adoption target would help galvanize support for fiscal consolidation and structural reforms. In this connection, they will continue to give priority to reforms that would alleviate supply constraints, particularly in the labor market. This would be in line with the objectives established in their Solidarity 50+ and Poland 2030 plans.

V. Staff Appraisal

34. **Poland is weathering the global crisis relatively well.** The economy has continued to expand even as all neighboring countries and most CEE peers have been mired in deep recession. While the global financial crisis engulfed Poland's financial markets last fall—paralyzing the interbank market, causing a credit crunch, and weakening the zloty—a significant measure of stability has returned since then. This has been helped, in part, by Poland's availing itself of the FCL on a precautionary basis. As a result, the zloty has stabilized, CDS spread have declined, and the government—which throughout the crisis has preserved access to international capital markets—has seen a notable decline in interest rates on its zloty bonds.

35. **This strong performance owes much to relatively sound economic policies**. Entering the crisis without serious internal or external imbalances, policy makers were afforded some room to undertake counter-cyclical measures. Their responses have generally been timely, well-focused, and properly measured. Given the authorities' continued commitment to adjust policies appropriately as circumstances evolve, staff expects Poland to experience only a mild recession before a recovery slowly gets underway.

36. **Monetary policy should continue to maintain a loosening bias**. The lowering of policy rates since last November has been appropriate, and staff believes that further relaxation is justified by the outlook for inflation, not least by the notable easing of pressures on wages. Should the increase in the government's financing need result in an increase in interest rates—which staff considers unlikely—then the MPC should stand ready to

accommodate. In recommending a continued loosening bias, staff is taking into account that the MPC has built considerable confidence in its anti-inflation credentials over the past decade.

37. **Staff does not expect a measured, further monetary easing to cause the zloty to depreciate**. Poland's cyclical position and its monetary stance relative to the euro area and the US appear to be strengthening, suggesting that the zloty could, if anything, be subject to upward pressure. In any case, the weakening of the zloty since the onset of the crisis has facilitated adjustment, and some further depreciation—in the event of unforeseen shocks—should not pose a problem. While a flare-up in what is still an unsettled regional situation could potentially cause negative spill-over to Poland, recent experience suggests that the impact will be transitory. In this regard, the potential access to the FCL remains an important safeguard.

38. **The challenges facing fiscal policy are more complex**. On the one hand, the significant structural relaxation that has taken place recently—in part reflecting important reforms enacted before the onset of the crisis—means that the deficit is set to remain well above the Maastricht target even as the economy recovers. On the other hand, taking drastic corrective actions now would impart an unwelcome pro-cyclical impulse in the midst of the global crisis, risking to turn a mild recession into a more serious one. In staff's view, the authorities' recent decision to increase the deficit limit for 2009 to partly accommodate the inevitable revenue shortfall as the economy slows is appropriate and should unsettle neither Poland's European partners nor markets, which indeed appear already to have discounted it. A sustained fiscal consolidation should start in 2010, unless there are signs that the recovery will not materialize as expected. To help anchor confidence in the authorities' medium-term consolidation targets, the authorities should consider revamping the fiscal framework by introducing rolling and binding three-year expenditure limits.

39. **Aging costs do not pose a significant problem.** Too often overlooked, Poland's early implementation of comprehensive pension reforms means that the issue of an aging population weights much less on the medium-term fiscal outlook than in many other countries. This is another example of how good economic policies in the past are now affording policy makers room for maneuver.

40. **Even as the financial sector has been well buffered, continued vigilance is warranted.** Rising NPLs and funding cost are squeezing profits and capital adequacy ratios, but staff takes note of top-down stress tests suggesting that only very severe shocks would pose systemic risks. In this regard, vigilance and pre-emptive actions on part of the regulatory authorities—such as the welcome decision to encourage banks to retain the record-high 2008 profits—have helped to ensure that the banking system is well-buffered.

41. **Staff feels that the KNF should go further, by conducting bottom-up, comprehensive stress tests of banks.** Such an exercise should be coordinated with neighboring countries to take into account the regional dimension of the problem. This could help alleviate uncertainty and thereby facilitate the unfreezing of the interbank market, although staff acknowledges that the current reluctance to engage in interbank transactions mainly reflects concerns about the financial health of foreign parents rather than of their Polish subsidiaries. Nevertheless, credit supply is set to become increasingly constrained by scarcity of capital, posing a risk to the recovery once confidence and the demand for credit begin to return. A more comprehensive forward-looking analysis of capital adequacy would help the KNF ensure that banks move pre-emptively to shore-up capital.

42. **Looking to the medium term, the key challenge facing policy makers is to boost Poland's exceptionally low labor participation rate**. The evidence that growth had begun to falter even before the onset of the global crisis because of emerging labor shortages should serve as an important reminder of the urgency of this task. In this regard, last year's radical reforms of the system for early retirement are very encouraging. However, much more needs to be done, including by increasing and equalizing retirement rates and merging special pension schemes with the general scheme.

43. It is recommended that the Article IV consultation remain on a 12-month cycle.

Text Table. Measures to Safeguard Financial Sector Stability

Objective	Measures
To increase bank's capital buffers	• Encouraged banks to retain earnings to boost own capital. With all profits from 2008 retained, capital-adequacy ratio would increase by 1.5 percentage points.
To provide zloty and foreign currency liquidity	• Monthly three-month (and starting in May, six-month) repo operations have been introduced. • The range of collateral for liquidity-providing monetary operations has been broadened and haircuts reduced. • The NBP has started providing euro, dollar, and Swiss franc swaps to domestic banks. • NBP has secured participation in the weekly euro-Swiss franc exchange swap operations of the Swiss National Bank and the Eurosystem. • The NBP repo line with the ECB of up to €10 billion has been arranged.
To intensify financial sector surveillance	• Increased frequency of stress testing and onsite inspections. • Requested banks to review their lending policy and contingency plans. • Requested banks to submit daily reports on new exposures to foreign entities.
To promptly issue corrective measures	• Stepped up individual measures towards certain banks. For example, early warnings were issued to some banks to stop mortgage lending in foreign currency when they started experiencing FX funding difficulties. • Issued recommendations to a couple of small banks to increase their capital base as their CARs were falling close to 8 percent. • Planned consolidation for small banks that are not viable.
To boost confidence in the system	• The Bank Guarantee Fund law has been amended to increase the level of deposit guarantee from €22,500 to €50,000 and eliminate coinsurance. • The parliament passed a law to guarantee interbank lending. The government has set aside zl. 40 billion for these guarantees.
To increase coordination between agencies	• Frequent meetings of the Financial Stability Committee to discuss issues and potential measures. The committee was legally established in the fall of 2008 and it is comprised of representatives from the NBP, KNF and MOF. • The KNF has been in close contact with parent banks and supervisors.
To boost domestic credit	• Increased the capital of state-owned BGK bank by zl. 2 billion enabling it to lend about zl. 20 billion to domestic firms. • A $500 million credit line from the World Bank for Polish SMEs is in the pipeline.

Table 1. Poland: Selected Economic Indicators, 2005-10

	2005	2006	2007	2008 Prelim.	2009 Proj.	2010 Proj.
Activity and prices						
GDP (change in percent)	3.6	6.2	6.8	4.9	-0.7	1.5
Domestic demand	2.5	7.3	8.7	5.4	-1.4	1.5
Private consumption growth	2.1	5.0	4.9	5.4	1.5	1.0
Public consumption growth	5.2	6.1	3.7	7.6	2.0	2.0
Domestic fixed investment growth	6.5	14.9	17.6	8.2	-4.8	2.5
Net external demand (contribution to growth)	1.1	-1.1	-2.1	-0.7	0.8	-0.1
CPI inflation (change in percent)						
Average	2.1	1.0	2.5	4.2	3.3	2.3
End of period	0.7	1.4	4.0	3.3	2.8	2.6
Unemployment rate (average, according to Labor Force Survey)	17.7	13.8	9.6	7.1	9.4	11.2
Gross domestic saving (ratio to GDP) 1/	21.2	25.6	32.1	33.0	26.1	27.2
Gross domestic investment (ratio to GDP)	19.3	21.1	24.4	23.9	21.2	21.5
Public finances (percent of GDP)						
General government revenues	39.1	39.8	40.0	38.5	38.8	39.0
General government expenditures 2/	43.0	43.7	42.0	41.6	44.3	44.9
General government balance 2/	-3.9	-3.9	-2.0	-3.1	-5.6	-6.0
according to ESA95	-4.3	-3.8	-2.0	-3.9	…	…
Public debt	47.5	47.8	44.8	47.1	52.1	55.4
according to ESA95	47.1	47.7	44.8	47.0	…	…
Money and credit						
Private credit (12-month change)	12.6	22.9	29.5	33.9	. . .	. . .
Broad money (12-month change)	13.1	16.0	13.4	17.5	. . .	. . .
Money market rate (eop)	4.6	4.2	5.7	5.3	. . .	. . .
Policy Rate 3/	4.5	4.0	5.0	5.0	3.50	. . .
Corporate lending rate (1 year) 4/	7.1	5.9	6.1	7.5	. . .	. . .
Balance of payments						
Current account balance (transactions, millions U.S. dollars)	-3,705	-9,200	-20,100	-29,029	-12,877	-14,293
Percent of GDP	-1.2	-2.7	-4.7	-5.5	-3.2	-3.5
C/A balance plus net FDI, percent of GDP	1.4	0.9	0.6	-1.9	0.5	0.8
Exports of Goods (millions U.S. dollars)	96,395	117,468	145,337	177,278	133,642	138,234
Export volume growth	8.0	14.6	9.1	7.2	-12.8	1.6
Imports of Goods (millions U.S. dollars)	99,161	124,474	162,394	201,655	145,227	152,140
Import volume growth	4.7	17.3	13.7	8.2	-13.6	1.7
Net oil imports (millions U.S. dollars)	8,382	11,372	13,438	19,230	11,913	14,882
Terms of trade (index 1995=100)	97.5	97.2	98.9	98.0	101.6	100.4
FDI, net (in percent of GDP)	2.3	2.9	4.2	2.5	2.1	2.5
Official reserves (millions U.S. dollars)	42,571	48,484	65,746	62,180	61,703	63,763
months of imports (goods)	5.2	4.7	4.9	3.7	5.1	5.0
Total external debt (millions U.S. dollars)	132,927	169,636	233,075	242,056	241,337	240,137
Percent of GDP	43.7	49.6	54.8	45.9	59.3	58.1
Ratio of short-term debt to gross reserves	63.6	68.7	79.2	104.4	90.6	81.5
Exchange rate						
Exchange rate regime			Floating			
Zloty per US$, period average 5/	3.23	3.10	2.77	2.41	3.13	. . .
Zloty per Euro, period average 5/	4.03	3.90	3.79	3.52	4.37	. . .
Real effective exchange rate (INS, CPI based) 6/	136.3	139.4	144.8	159.1	. . .	. . .
percent change	11.8	2.2	3.9	9.9	. . .	. . .

Sources: Polish authorities; and IMF staff estimates.
1/ Derived as total savings minus the current account minus capital transfers.
2/ IMF definition (including pension reform costs).
3/ NBP Reference Rate. For 2009, latest.
4/ Annual average.
5/ For 2009, exchange rate as of July 13.
6/ Annual average (1995=100).

Table 2. Poland: Balance of Payments on Transaction Basis, 2005-14
(In millions of US$)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
					Proj.					
Current account balance	**-3,705**	**-9,200**	**-20,100**	**-29,029**	**-12,877**	**-14,293**	**-15,408**	**-15,409**	**-15,514**	**-15,820**
percent of GDP	-1.2	-2.7	-4.7	-5.5	-3.2	-3.5	-3.6	-3.4	-3.2	-3.1
Trade balance	-2,766	-7,006	-17,057	-24,377	-11,585	-13,906	-15,988	-17,987	-19,901	-21,853
percent of GDP	-0.9	-2.1	-4.0	-4.6	-2.8	-3.4	-3.7	-3.9	-4.1	-4.3
Exports										
percentage change in unit values	18.2	22.5	26.1	22.2	-24.6	3.4	7.3	6.8	6.7	6.5
percentage volume growth	8.0	14.6	9.1	7.2	-12.8	1.6	5.1	4.6	4.5	4.5
export market growth	8.6	12.6	8.7	3.8	-16.5	-0.4	4.0	5.4	5.8	6.4
growth in foreign demand	1.9	2.9	2.4	1.3	-3.1	-0.5	1.5	1.9	2.0	2.1
Imports										
percentage change in unit values	13.7	25.8	29.2	24.5	-28.0	4.8	8.0	7.4	7.1	6.9
percentage volume growth	4.7	17.3	13.7	8.2	-13.6	1.7	5.6	5.1	5.0	5.0
growth in domestic demand	2.5	7.3	8.7	5.4	-1.4	1.5	4.6	4.1	4.1	4.0
Terms of trade percentage change	0.8	-0.3	1.7	-0.9	3.7	-1.2	-0.2	-0.1	0.0	0.1
Services balance	738	753	4,718	5,006	4,799	4,674	4,857	5,053	5,281	5,527
Credit	16,258	20,584	28,790	35,457	26,729	27,648	29,677	31,709	33,822	36,029
Debit	15,520	19,831	24,072	30,451	21,930	22,974	24,820	26,657	28,541	30,501
Net Income	-6,686	-9,543	-16,254	-17,586	-12,055	-11,598	-12,314	-11,293	-10,595	-10,145
Net transfers	5,009	6,596	8,493	7,928	5,963	6,537	8,037	8,819	9,701	10,650
o/w EU receipts	3,902	4,239	4,523	3,885	4,483	4,224	4,490	4,741	5,046	5,370
o/w payment to EU	-3,031	-3,178	-3,630	-3,923	-5,050	-4,794	-4,805	-4,810	-4,808	-4,796
Capital and financial account balance	**16,290**	**14,216**	**44,602**	**48,023**	**33,358**	**37,311**	**39,285**	**41,041**	**41,179**	**40,105**
Capital account balance	995	2,105	4,771	5,989	6,600	7,378	7,323	9,780	9,781	8,554
o/w net EU transfers	1,012	2,290	4,660	5,828	6,720	7,502	7,453	9,918	9,928	8,710
Financial account balance	15,295	12,111	39,831	42,034	26,758	29,933	31,962	31,261	31,398	31,551
Foreign direct investment (net)	7,013	10,037	17,976	12,951	8,369	10,405	11,216	11,288	11,386	11,512
by nonresidents	10,363	19,198	22,959	16,533	9,869	11,405	12,216	12,788	13,386	14,012
o/w privatization	31	8	95	100	100	100	100	100	100	100
Portfolio investment (net)	12,600	-3,007	-5,032	-2,227	-1,509	680	1,109	1,127	1,171	1,216
by non-residents	15,109	1,543	930	-4,435	-1,880	1,380	1,584	1,645	1,709	1,774
o/w equities	1,333	-2,134	-453	584	-661	780	895	930	966	1,003
Other investment (net)	-4,511	5,838	28,897	31,890	21,315	18,848	19,636	18,846	18,841	18,823
Assets	-2,782	-3,734	-1,444	6,158	4,975	-310	-1,622	-2,484	-2,579	-2,708
Liabilities	-1,729	9,572	30,341	25,732	16,340	19,158	21,258	21,330	21,420	21,532
Financial derivatives	193	-757	-2,010	-580	-1,416	0	0	0	0	0
Errors and omissions	**-4,450**	**-2,536**	**-11,465**	**-20,958**	**-20,958**	**-20,958**	**-20,958**	**-20,958**	**-20,958**	**-20,958**
Overall balance	**8,135**	**2,480**	**13,037**	**-1,964**	**-477**	**2,060**	**2,919**	**4,675**	**4,707**	**3,327**
Financing										
Reserve assets	-8,135	-2,480	-13,037	1,964	477	-2,060	-2,919	-4,675	-4,707	-3,327
Memorandum items:										
Current plus capital account (percent of GDP)	-0.9	-2.1	-3.6	-4.4	-1.5	-1.7	-1.9	-1.2	-1.2	-1.4
Official reserves	42,571	48,484	65,746	62,180	61,703	63,763	66,682	71,357	76,064	79,391
in months of imports	4.1	3.6	3.9	5.1	4.9	4.7	4.5	4.5	4.5	4.7
Ratio of reserves to short-term debt 1/	101.8	97.3	106.1	97.3	69.0	79.4	90.2	98.2	108.5	115.1
Ratio of reserves to ST debt plus CA deficit 1/	92.3	80.4	73.7	68.1	60.4	67.0	74.0	80.0	87.8	92.9
Total external debt (percent of GDP)	43.7	49.6	54.8	45.9	59.3	58.1	55.6	53.0	50.3	47.8
Total external debt (percent of exports) 2/	118.0	122.9	133.9	113.8	150.5	144.8	135.4	127.3	120.0	113.2
External debt service (percent of exports) 2/ 3/	13.0	15.0	10.0	10.4	18.6	16.4	22.0	19.1	16.3	15.6
Gross FDI inflows (percent of GDP)	3.4	5.6	5.4	3.1	2.4	2.8	2.8	2.8	2.8	2.7
Net FDI inflows (percent of GDP)	2.3	2.9	4.2	2.5	2.1	2.5	2.6	2.5	2.4	2.2

Sources: National Bank of Poland; and IMF staff estimates.
1/ By remaining maturity.
2/ Exports of goods and services.
3/ Excluding repurchase of debt.

Table 3. Poland: External Debt Sustainability Framework, 2004-14
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	51.4	43.7	49.6	54.8	45.9	**59.3**	**58.1**	**55.6**	**53.0**	**50.3**	**46.0**	**-5.2**
Change in external debt	1.9	-7.6	5.9	5.2	-8.9	13.5	-1.3	-2.5	-2.6	-2.7	-4.3	
Identified external debt-creating flows (4+8+9)	-8.9	-11.2	-7.1	-10.3	-8.4	1.3	-0.3	-1.9	-1.7	-1.7	-1.7	
Current account deficit, excluding interest payments	2.7	0.1	1.5	3.5	4.3	2.0	2.1	1.6	1.1	1.1	0.9	
Deficit in balance of goods and services	2.2	0.7	1.8	2.9	3.7	1.7	2.2	2.6	2.8	3.0	3.1	
Exports	37.7	37.1	40.4	40.9	40.3	39.4	40.1	41.0	41.6	41.9	40.6	
Imports	39.9	37.7	42.2	43.8	44.0	41.1	42.3	43.6	44.4	44.9	43.7	
Net non-debt creating capital inflows (negative)	-5.8	-3.8	-5.0	-5.3	-3.2	-2.3	-2.9	-3.0	-3.0	-3.0	-2.8	
Automatic debt dynamics 1/	-5.8	-7.5	-3.6	-8.6	-9.4	1.6	0.5	-0.5	0.2	0.2	0.2	
Contribution from nominal interest rate	1.3	1.1	1.2	1.2	1.2	1.2	1.3	1.9	2.2	2.1	1.9	
Contribution from real GDP growth	-2.3	-1.5	-2.4	-2.7	-2.2	0.4	-0.8	-2.4	-2.1	-1.9	-1.7	
Contribution from price and exchange rate changes 2/	-4.8	-7.1	-2.4	-7.1	-8.5	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	10.8	3.6	13.0	15.5	-0.6	12.2	-0.9	-0.6	-0.9	-1.0	-2.6	
External debt-to-exports ratio (in percent)	136.4	118.0	122.9	133.9	113.8	150.5	144.8	135.4	127.3	120.0	113.2	
Gross external financing need (in billions of US dollars) 4/	42.3	39.8	52.9	65.8	96.6	102.9	92.0	86.1	83.3	81.3	0.6	
in percent of GDP	16.7	13.1	15.5	15.5	18.3	25.3	22.3	19.9	18.2	16.8	0.1	
Scenario with key variables at their historical averages 5/						**59.3**	**52.5**	**46.7**	**41.5**	**36.8**	**32.7**	**-6.6**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.3	3.6	6.2	6.8	4.9	-0.6	1.5	4.3	3.9	3.9	3.8	
GDP deflator in US dollars (change in percent)	10.8	15.9	5.8	16.6	18.3	-22.4	0.2	0.5	1.4	1.9	5.9	
Nominal external interest rate (in percent)	3.0	2.5	3.0	3.0	2.8	2.0	2.3	3.5	4.2	4.3	4.2	
Growth of exports (US dollar terms, in percent)	32.1	18.2	22.5	26.1	22.2	-24.6	3.4	7.3	6.8	6.7	6.5	
Growth of imports (US dollar terms, in percent)	30.4	13.7	25.8	29.2	24.5	-28.0	4.8	8.0	7.4	7.1	6.9	
Current account balance, excluding interest payments	-2.7	-0.1	-1.5	-3.5	-4.3	-2.0	-2.1	-1.6	-1.1	-1.1	-0.9	
Net non-debt creating capital inflows	5.8	3.8	5.0	5.3	3.2	2.3	2.9	3.0	3.0	3.0	2.8	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

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

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ 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.

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

Table 4. Poland: Financial Soundness Indicators, 2002-09

(In percent)

	2002	2003	2004	2005	2006	2007	2008	Apr-2009
Capital adequacy								
Regulatory capital to risk-weighted assets	14.2	13.8	15.4	14.5	13.2	12.0	11.2	11.7
Regulatory Tier I capital to risk-weighted assets	14.2	13.9	15.3	14.4	12.9	11.8	10.1	10.6
NPLs net of provisions to capital 1/	...	31.1	22.5	11.9	11.6	11.4	12.8	19.0
Asset composition and quality								
NPLs to gross loans	...	21.2	14.9	11.0	7.4	5.2	4.4	5.7
Sectoral distribution of loans to total loans								
Loan to households	41.4	43.8	47.8	52.6	56.7	59.3	61.4	62.2
Loans to non-financial corporations	58.6	55.9	51.8	47.1	43.0	40.4	38.2	37.5
Earnings and profitability								
Return on average assets (after-tax)	0.5	0.5	1.4	1.6	1.7	1.7	1.5	1.1
Return on average equity (after-tax) 2/	6.1	5.8	16.9	20.6	22.5	22.4	20.7	15.6
Interest margin to gross income 1/	54.4	55.7	56.4	57.7	58.9	59.4	61.8	61.0
Noninterest expenses to gross income 1/	71.5	78.9	77.1	72.3	69.6	68.7	60.6	61.8
Liquidity								
Liquid assets to total assets (liquid assets ratio)	24.1	23.1	19.4	21.2	20.1	17.1	17.0	17.6
Liquid assets to total short-term liabilities	27.4	32.6	27.8	29.6	28.1	24.2	24.7	25.8
Sensitivity to market risk								
Net open positions in FX to capital 2/	1.1	0.4	1.6	2.0	-0.1	0.6	0.0	1.0

Source: National Bank of Poland.

1/ Data for 2009 are Q1.

2/ Data for domestic banking sector.

Table 5. Poland: General Government Revenues and Expenditures, 2005-10
(In percent of GDP)

	2005	2006	2007	2008 Prelim.	2009 Proj.	2010 Proj.
General government revenue	39.1	39.8	40.0	38.5	38.8	39.0
Taxes	19.8	21.2	21.6	21.4	20.5	20.6
Direct taxes	5.1	5.7	6.2	6.4	5.4	5.6
Indirect taxes	14.6	15.3	15.2	14.9	14.9	14.9
Other taxes	0.1	0.1	0.1	0.1	0.2	0.2
Social security contributions	12.0	11.9	11.8	10.7	10.5	10.8
Other taxes and nontax	7.3	6.7	6.5	6.4	7.7	7.6
General government expenditure	43.0	43.7	42.0	41.6	44.3	44.9
Goods and services	17.6	17.6	17.5	17.7	17.3	17.4
Transfers and subsidies	19.8	20.1	18.5	18.2	19.5	19.8
Interest payments	2.5	2.6	2.3	2.0	2.5	2.7
Capital and net lending	3.1	3.3	3.6	3.7	5.1	5.0
Cash-accrual correction	-0.4	0.1	0.0	-0.8	…	…
General government balance 1/	-3.9	-3.9	-2.0	-3.1	-5.6	-6.0
General government balance 2/	-4.3	-3.8	-2.0	-3.9	…	…
Financing	4.3	3.8	2.0	3.9	5.6	6.0
Domestic	2.7	3.1	1.3	3.5	4.4	5.0
External	1.2	0.7	0.6	0.4	0.5	0.5
Privatization	0.3	0.0	0.1	0.1	0.6	0.5
Memorandum items:						
Structural balance	-2.6	-3.1	-2.1	-3.5	-5.4	-5.6
Primary balance	-1.7	-1.2	0.3	-2.0	-3.1	-3.3
State balance	-4.2	-3.8	-2.8	-3.5	-3.3	-4.6
Rest of government balance	-0.1	0.0	0.8	-0.5	-2.3	-1.4
Public debt 3/	47.5	47.8	44.8	47.1	52.1	55.4

Sources: Polish authorities; and IMF staff estimates and projections.
1/ IMF definition (including pension reform costs)
2/ ESA 95 definition
3/ National definition

Table 6. Poland: Public Sector Debt Sustainability Framework, 2004-14
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	**Debt-stabilizing primary balance 9/**
Baseline: Public sector debt 1/	46.7	47.5	47.8	44.8	47.1	**52.1**	**55.4**	**56.8**	**58.2**	**58.4**	**57.6**	**-0.6**
o/w foreign-currency denominated	12.2	12.9	11.7	10.5	11.6	13.3	12.8	12.0	11.9	11.7	11.4	
Change in public sector debt	-1.8	0.8	0.3	-2.9	2.3	5.0	3.3	1.4	1.4	0.2	-0.7	
Identified debt-creating flows (4+7+12)	-2.4	1.8	-0.9	-4.6	2.2	3.2	3.6	1.6	1.0	-0.1	-0.9	
Primary deficit	3.5	1.3	1.3	-0.3	1.2	3.1	3.3	2.6	1.6	0.6	-0.3	
Revenue and grants	37.7	39.1	39.8	40.0	38.5	38.8	39.0	39.5	40.1	40.4	40.6	
Primary (noninterest) expenditure	41.2	40.4	41.1	39.6	39.7	41.8	42.2	42.1	41.8	40.9	40.3	
Automatic debt dynamics 2/	-4.7	0.8	-2.2	-4.2	0.8	0.7	0.9	-0.7	-0.5	-0.5	-0.5	
Contribution from interest rate/growth differential 3/	-1.8	-0.2	-0.8	-2.4	-1.4	0.7	0.9	-0.7	-0.5	-0.5	-0.5	
Of which contribution from real interest rate	0.5	1.3	1.9	0.5	0.7	0.4	1.6	1.6	1.6	1.6	1.6	
Of which contribution from real GDP growth	-2.4	-1.6	-2.7	-2.9	-2.0	0.3	-0.7	-2.2	-2.1	-2.1	-2.1	
Contribution from exchange rate depreciation 4/	-2.9	1.1	-1.3	-1.8	2.2	...	...	...	...	...	...	
Other identified debt-creating flows	-1.1	-0.4	0.0	-0.1	0.2	-0.6	-0.5	-0.3	-0.1	-0.1	-0.1	
Privatization receipts (negative)	-1.1	-0.4	0.0	-0.1	0.2	-0.6	-0.5	-0.3	-0.1	-0.1	-0.1	
Residual, including asset changes (2-3) 5/	0.6	-1.0	1.2	1.7	0.1	1.8	-0.4	-0.2	0.3	0.3	0.2	
Public sector debt-to-revenue ratio 1/	123.7	121.4	120.0	112.2	122.5	134.5	142.2	143.7	145.0	144.5	141.9	
Gross financing need 6/	23.1	18.8	14.4	11.8	11.9	15.0	16.5	15.9	14.9	13.7	12.5	
in billions of U.S. dollars	71.4	56.5	52.3	57.1	51.0	56.7	67.7	68.6	67.9	66.3	63.9	
Scenario with key variables at their historical averages 7/						**52.1**	**52.3**	**52.7**	**53.9**	**55.0**	**56.0**	**-0.8**
Scenario with no policy change (constant primary balance) in 2009-2014						**52.1**	**55.3**	**57.1**	**59.9**	**62.6**	**65.3**	**-0.6**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.3	3.6	6.2	6.8	4.9	-0.7	1.5	4.3	3.9	3.9	3.8	
Average nominal interest rate on public debt (in percent) 8/	5.5	5.8	6.0	5.4	4.8	5.5	5.4	5.5	5.5	5.5	5.6	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	1.4	3.1	4.5	1.5	1.7	0.8	3.3	3.1	3.1	3.0	3.0	
Nominal appreciation (increase in US dollar value of local currency, in percent)	25.1	-8.3	12.1	19.5	-17.8	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	4.1	2.6	1.5	4.0	3.0	4.6	2.2	2.4	2.4	2.5	2.6	
Growth of real primary spending (deflated by GDP deflator, in percent)	6.0	1.6	8.0	2.9	5.0	4.8	2.4	4.1	3.0	1.9	2.2	
Primary deficit	3.5	1.3	1.3	-0.3	1.2	3.1	3.3	2.6	1.6	0.6	-0.3	

1/ General government.

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

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

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.

Table 7. Poland: External Financing Requirements and Sources, 2008-11
(In million of U.S. dollars)

	2009 Proj.	2010 Proj.	2011 Proj.
GROSS FINANCING REQUIREMENTS	**100,522**	**92,044**	**86,127**
Current account deficit	**12,877**	**14,293**	**15,408**
Medium and long-term debt amortization	**25,150**	**21,819**	**18,725**
Public sector	6,397	5,996	3,820
Banks	4,366	6,579	7,175
Non-bank Corporates	14,387	9,244	7,730
Short-term debt amortization	**62,495**	**55,932**	**51,994**
Public sector	213	213	213
Banks (inc. s.t. deposits)	29,465	29,465	29,465
Non-bank Corporates	32,817	26,254	22,316
o/w trade credit	26,971	21,577	18,340
SOURCES OF FINANCING	**100,045**	**94,104**	**89,046**
Foreign direct investment (net)	**8,369**	**10,405**	**11,216**
o/w inward (net)	9,869	11,405	12,216
Equities (net)	**-490**	**458**	**677**
by nonresidents	-661	780	895
New borrowing and debt rollover	**83,001**	**75,611**	**70,719**
Medium and long-term borrowing	**27,069**	**23,618**	**18,725**
Public sector	8,316	7,795	3,820
Banks	4,366	6,579	7,175
Non-bank Corporates	14,387	9,244	7,730
Short-term borrowing	**55,932**	**51,994**	**51,994**
Public sector	213	213	213
Banks	29,465	29,465	29,465
Foreign subsidiaries to parent banks	22,047	22,047	22,047
Other	7,418	7,418	7,418
Non-bank Corporates	26,254	22,316	22,316
EU transfers	**6,600**	**7,378**	**7,323**
Other	**2,566**	**252**	**-889**
of which: Errors and omissions	**-20,958**	**-20,958**	**-20,958**
BUFFERS			
Use of official reserves	477	-2,060	-2,919
FINANCING GAP	**0**	**0**	**0**

Sources: National authorities and staff estimates and projections.

Table 8. Poland: Medium-Term Scenario, 2005-14

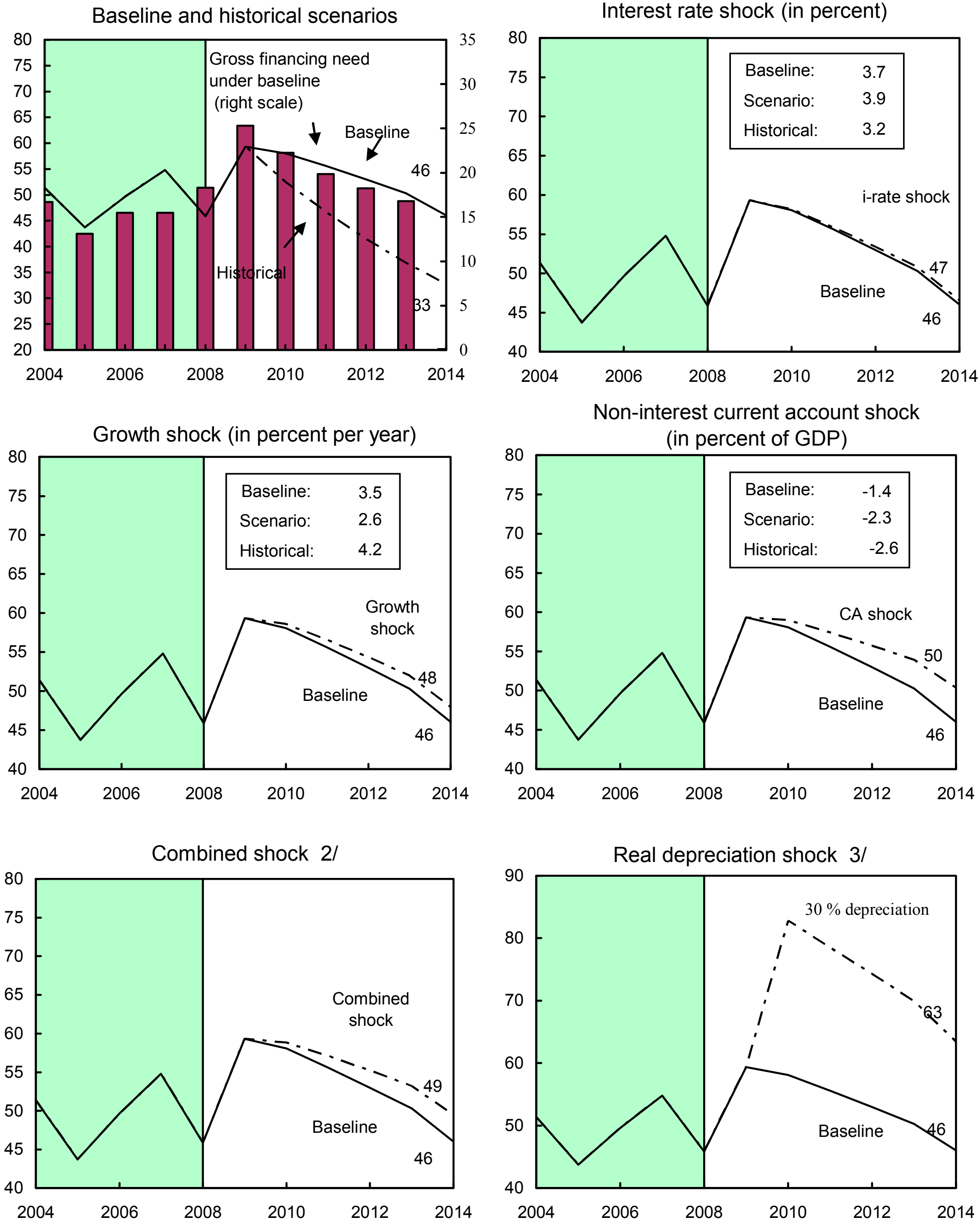
	2005	2006	2007	2008	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.
Activity and prices										
GDP (change in percent)	3.6	6.2	6.8	4.9	-0.7	1.5	4.3	3.9	3.9	3.8
Domestic demand growth	2.5	7.3	8.7	5.4	-1.4	1.5	4.6	4.1	4.1	4.0
Private consumption growth	2.1	5.0	4.9	5.4	1.5	1.0	3.5	3.5	3.4	3.3
Public consumption growth	5.2	6.1	3.7	7.6	2.0	2.0	2.0	2.0	2.0	2.0
Domestic fixed investment growth	6.5	14.9	17.6	8.2	-4.8	2.5	10.0	7.5	7.5	7.5
Nominal GDP (zloty millions)	983	1,060	1,177	1,272	1,322	1,370	1,464	1,558	1,658	1,766
CPI inflation (average change in percent)	2.1	1.0	2.5	4.2	3.3	2.3	2.6	2.5	2.5	2.5
CPI inflation (end of period change in percent)	0.7	1.4	4.0	3.3	2.8	2.6	2.5	2.5	2.5	2.5
Unemployment rate	17.7	13.8	9.6	7.1	9.4	11.2	12.1	12.5	12.1	11.6
Gross domestic saving (ratio to GDP) 1/	21.2	25.6	32.1	33.0	26.1	27.2	28.8	29.7	30.5	31.4
Private savings	21.9	26.2	30.5	32.5	26.6	28.2	29.0	28.9	28.6	28.6
Public savings	-0.8	-0.6	1.6	0.6	-0.5	-1.0	-0.3	0.8	1.9	2.8
Gross domestic investment (ratio to GDP)	19.3	21.1	24.4	23.9	21.2	21.5	22.7	23.5	24.3	25.1
Public finances (percent of GDP)										
General government revenues	39.1	39.8	40.0	38.5	38.8	39.0	39.5	40.1	40.4	40.6
General government expenditures 2/	43.0	43.7	42.0	41.6	44.3	44.9	45.0	44.7	44.0	43.3
General government primary balance	-1.3	-1.3	0.3	-1.2	-3.1	-3.3	-2.6	-1.6	-0.6	0.3
General government balance 2/	-3.9	-3.9	-2.0	-3.1	-5.6	-6.0	-5.5	-4.6	-3.6	-2.7
Public debt	47.5	47.8	44.8	47.1	52.1	55.4	56.8	58.2	58.4	57.6
Balance of payments (percent of GDP)										
Current account balance	-1.2	-2.7	-4.7	-5.5	-3.2	-3.5	-3.6	-3.4	-3.2	-3.1
Capital account, net	0.3	0.6	1.1	1.1	1.6	1.8	1.7	2.1	2.0	1.7
Financial account, net	5.0	3.5	9.4	8.0	6.6	7.2	7.4	6.8	6.5	6.2
Total external debt	43.7	49.6	54.8	45.9	59.3	58.1	55.6	53.0	50.3	47.8

Sources: Polish authorities; and IMF staff estimates.

1/ Derived as total savings minus the current account minus capital transfers.

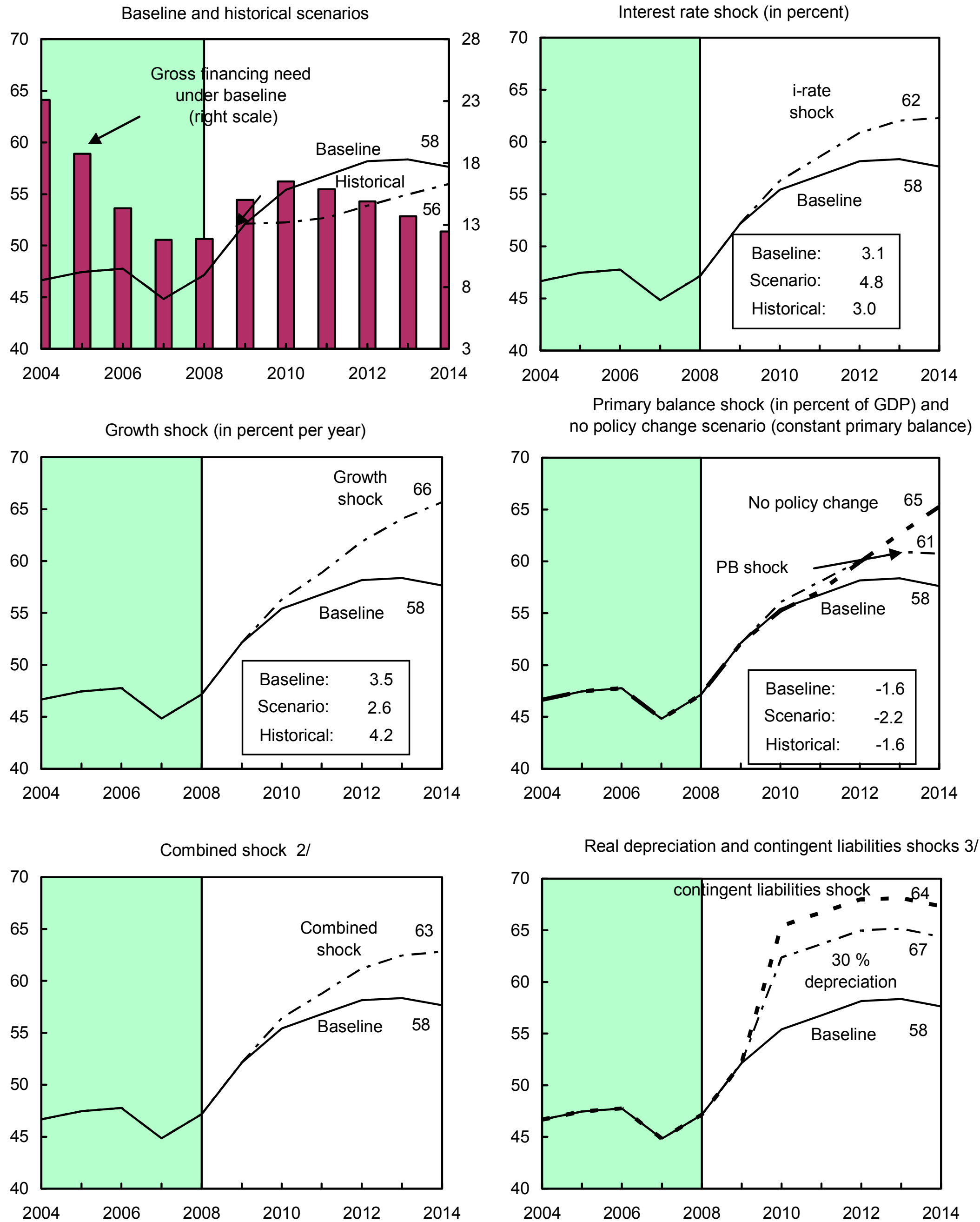
2/ IMF definition (including pension reform costs).

Figure 9. Poland: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



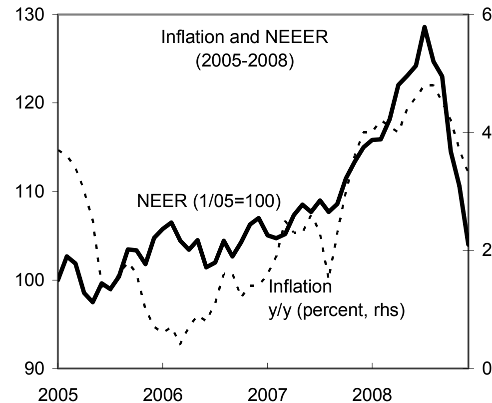
Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2009.

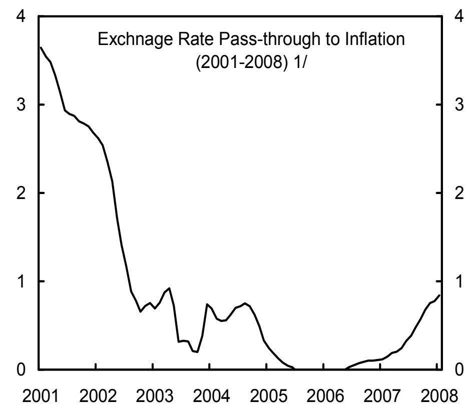
Figure 10. Poland: Public Debt Sustainability: Bound Tests, 2004-14 1/
(Percent of GDP)



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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Poland: Inflation and the Exchange Rate Pass-Through





1/ Cumulative (18-months) impulse response of inflation (in percent) to a one-percent shock to the exchnage rate over five-year rolling samples.

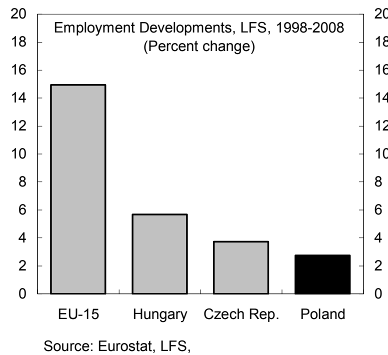
The recent depreciation of the zloty has brought to the fore concerns about its potential inflationary effects. Prior to the intensification of the adverse spillovers from the global crisis, the argument had been made in reverse: inflation had been contained through the moderating effect of the convergence-driven nominal exchange rate appreciation.

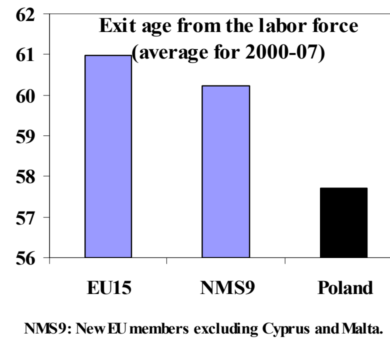
But since EU accession, the exchange rate has appeared to play a diminishing role in influencing headline inflation. Specifically, Poland's nominal effective exchange rate (NEER) had appreciated in the period 2006–08 while headline inflation was steadily rising—from about 1 percent in early-2006 to around 4.5 percent by mid-2008. Moreover, as the NEER had depreciated in recent months, inflation fell.

Indeed, empirical evidence supports a waning exchange rate pass-through effect to prices. In the late 1990's and early part of this decade, the exchange rate pass-through was relatively high. But as EU accession neared and Poland's inflation targeting framework gained credibility, the pass-through appears to have declined sharply. These results stem from a series of (cumulative) impulse response of prices to an exchange rate shock obtained from a rolling five-year VAR estimation over the period 1997–2008. Staff's model also includes import and producer prices and assumes that commodity-price shocks, followed by exchange-rate shocks are transmitted first to import prices, then to the PPI and the CPI.

Boosting Labor Market Participation While Promoting Fiscal Sustainability

Poland's labor market developments compare unfavorably to those in the region largely reflecting adverse supply incentives. Privileged schemes have promoted early withdrawal from the labor market. These problems are deeply rooted in the past, when early retirement and disability pensions were used to disguise open unemployment. While reforms made in the mid-90s curtailed regulations on disability, early exit from the labor force has remained an issue.

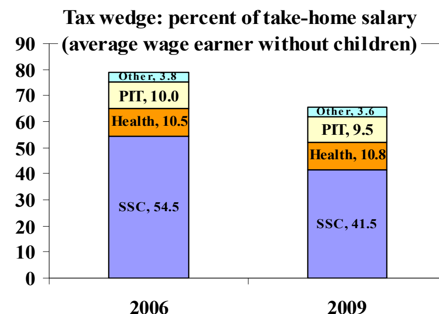




Recent reforms have helped rebalance work incentives. Specifically,

- ***Tightening early retirement eligibility***. Early retirement for certain sectors (e.g., teachers) was abolished in late-2008, and job-specific early retirement rights were cut leaving 250,000 people covered compared to a million people before. Only those who worked in harmful conditions before 1999 remain eligible. Age-specific privileges were also eliminated, with the ending of women's rights to retire at 55 after 30 years of work (including education and maternity). The reforms are crucial for longer-term fiscal sustainability, but do not yield immediate budgetary gains.

- ***Cutting the tax wedge***. Social security contributions were cut by lowering the disability contribution from 13 to 6 percent of gross wage. In addition, personal income taxes were reduced by consolidating the existing three-bracket system (19, 30, and 40 percent) into two brackets (18 and 32 percent). These reforms have reduced the tax wedge from almost 80 percent to about 65 percent. The roughly 1½ percent of GDP tax revenue loss was not offset by spending measures.



But further reforms are needed and can support fiscal sustainability. Specifically, farmer's pensions and special retirement schemes should be merged and aligned with general pension system. In addition, the retirement age for men (65 years of age) and women (60 years of age) should be equalized at the higher level and the statutory retirement age gradually increased. In the medium term, these reforms and those recently implemented will contribute to broaden the tax base and bolster tax collections. In the short term, the fiscal costs of these reforms must be accommodated within the budgetary envelope and the authorities' medium-term fiscal objectives.

INTERNATIONAL MONETARY FUND

REPUBLIC OF POLAND

Staff Report for the 2009 Article IV Consultation—Informational Annex

Prepared by the European Department

July 17, 2009

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II. Statistical Issues 7

Appendix I. POLAND: Fund Relations
(As of May 31, 2009)

I. **Membership Status**: Joined 6/12/86; Article VIII

II. **General Resources Account**:

	SDR Million	Percent Quota
Quota	1,369.00	100.0
Fund holdings of currency	1,171.21	85.55
Reserve position in Fund	197.82	14.45

III. **SDR Department**

	SDR Million	Percent Allocation
Holdings	34.26	N/A

IV. **Outstanding Purchases and Loans**: None

V. **Latest Financial Arrangements**:

	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Flexible Credit Line	5/06/09	5/06/10	13,690.00	0.00
Stand-By	8/05/94	3/04/96	333.30	283.30
Stand-By	3/08/93	4/08/94	476.00	357.00

VI. **Projected Obligations to Fund**: None

VII. **Exchange Rate Arrangement**:

Poland accepted the obligation of Article VIII, Sections 2, 3, and 4 on June 1, 1995. The exchange system is free of restrictions on the making of payments and transfers for current international transactions.

Since April 12, 2000, the zloty has floated freely.

Prior to that, the zloty had been pegged to a currency composite made up of the U.S. dollar, deutsche mark, pound sterling, French franc, and the Swiss franc. As of January 1, 1999, the currency composite was changed to a basket comprised of 55 percent Euro and 45 percent U.S. dollar. From January 1, 1995, the zloty was redenominated, with new Zl 1 equaling old Zl 10,000. The central parity of the zloty was adjusted under a crawling peg policy at a pre-announced monthly rate. On May 16, 1995, a band of ±7 percent was introduced around the central rate. Following the implementation of the new system, the zloty initially appreciated by about 5 percent above the central rate. In September 1995, the exchange rate was allowed to appreciate a further 1 percent within the band. In December 1995, the central parity was raised by 6 percent, and at the same time the authorities allowed the actual exchange rate to

appreciate by 22 percentage points. On January 8, 1996 the monthly rate of crawl was reduced to one percent. On February 26, 1998, with the zloty pushing towards its upper limit, the newly-formed Monetary Policy Council (RPP) widened the fluctuation band from ±7 percent to ±10 percent. At the same time, the rate of crawl was reduced from one percent to 0.8 percent per month. On July 17, 1998, the crawling peg's monthly rate of depreciation was cut from 0.8 percent to 0.65 percent. On September 9, 1998, the monthly rate of depreciation was reduced further to 0.50 percent. On October 29, 1998, the zlotys trading band was widened to 12.5 percent. On March 25, 1999, the zloty's trading band was widened to ±15 percent, and the rate of crawl was lowered to 0.3 percent per month. On December 31, 1999, the official rate was PLN 4.08 per US$1. On April 12, 2000, the crawling band regime was abolished and the zloty has since floated freely.

Poland maintains an exchange system free of 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 that have been notified to the Fund pursuant to Executive Board Decision No. 144–(52/51). Those exchange restrictions are contained in the following legal instruments:

- Council Regulation (EC) No. 2488/2000 of November 14, 2000, as amended (freezing of funds and economic resources of former Yugoslav President Slobodan Milosevic and certain other natural persons).
- Council Regulation (EC) No. 2580/2001 of December 28, 2001, as amended (freezing of funds and economic resources of certain persons, groups and entities with a view to combating terrorism).
- Council Regulation (EC) No. 881/2002 of May 29, 2002, as amended (freezing of funds and economic resources of persons and entities associated with Osama bin Laden, the Taliban and Al-Qaida).
- Council Regulation (EC) No. 1210/2003 of July 8, 2003, as amended (freezing of funds and economic resources of certain persons and entities in respect of Iraq).
- Council Regulation (EC) No. 314/2004 of February 24, 2004, as amended (freezing of funds and economic resources in respect of Zimbabwe).
- Council Regulation (EC) No. 798/2004 of April 28, 2004, as amended (freezing of funds and economic resources in respect of Burma/Myanmar).
- Council Regulation (EC) No. 872/2004 of April 30, 2004, as amended (freezing of funds and economic resources of persons and entities associated with Liberia's former President Taylor).

- Council Regulation (EC) No. 1763/2004 of October 14, 2004, as amended (freezing of funds and economic resources of certain persons indicted by the International Criminal Tribunal for the former Yugoslavia).

- Council Regulation (EC) No. 560/2005 of April 14, 2005 (freezing of funds and economic resources of certain persons who constitute a threat to the peace and national reconciliation process in Côte d'Ivoire).

VIII. **Article IV Consultation**

The last Article IV consultation was concluded on April 16, 2008. In concluding the consultation, Directors noted Poland's strong and well-balanced economic growth, but at the same time noted that resource constraints were beginning to emerge, particularly in the labor market. They welcomed the authorities' intention to pursue reforms to enhance work incentives. On fiscal policy, Directors noted the need for medium-term consolidation and stressed importance of strengthening Poland's medium-term budgetary framework. They called on the authorities to ensure that there were no disruptions in the timeliness and effectiveness of financial supervision. Directors found that the authorities' commitment to macroeconomic stability, reinvigoration of structural reforms, and the adoption of the euro augured well for Poland's prospects of taking full advantage of its EU membership.

IX. **Technical Assistance, 1992–2009**

Department	**Subject/Identified Need** **Counterpart**	**Action**	**Timing**	
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	Oct. 1992	NBP
MAE	Resident expert-Advisor to President of NBP		Nov. 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	Nov. 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 visits	Expert	Late 1995	NBP
FAD	Tax administration (VAT) short-term assignments of field experts	Nine	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
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 Mission	Follow-up	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	Mission	November 1998	MoF

	revenues of proposed tax reform			
FAD	Discussion of tax administration	Mission	March 1999	MoF
FAD	Tax administration seminar	Mission	April 1999	MoF
STA	Government Finance Statistics MoF/Local	Mission	October 1999	
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	
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

X. **Resident Representative**

Mr. Mark Allen, the Senior Regional Resident Representative for central and eastern Europe, took up his duties in Warsaw in June 2009.

Appendix II. POLAND: Statistical Issues

1. Poland has a comprehensive macroeconomic database that has been improving in recent years and is adequate for surveillance. The authorities publish a full range of economic and financial statistics, and cooperate fully in providing data to the Fund. Data on the core indicators are available on a timely basis (see the attached Table of Common Indicators Required for Surveillance). Consistent with its commitment to provide a comprehensive set of high quality data, in an open manner, the country subscribes to the IMF's Special Data Dissemination Standard (SDDS) and its metadata are posted on the Fund's Dissemination Standards Bulletin Board.

Real sector statistics

2. The Central Statistical Office (GUS) compiles a wide range of real sector statistics, most of which are published promptly in the monthly *Statistical Bulletin*. The main problems for users include (i) the short span of comparable data series, reflecting the upheavals associated with transition to a market economy; (ii) inconsistencies between annual and higher frequency data, reflecting differences in weights and in coverage; and (iii) lack of easy electronic retrieval of these data.

3. The national accounts follow the concepts and definitions of the *European System of Accounts 1995 (ESA 95)*, which is based on the *System of National Accounts 1993 (SNA 1993)*. The GUS compiles annual and quarterly GDP estimates by the production and expenditure approaches in current and constant prices, a full set of accounts by institutional sectors, supply and use tables, input/output tables, annual financial accounts, and regional accounts. The statistical techniques are basically sound. The constant price estimates are compiled in average prices of the previous year, using deflation techniques that generally follow international standards. However, national accounts data still have some problems—the subannual data are collected on a cumulative rather than on a discrete basis, and plans to introduce proper benchmarking have been delayed. In addition, seasonal adjustment on relatively short period leads to frequent and large backward revisions.

4. The concepts and definitions of the CPI follow the *ESA 95* standards and Eurostat's requirements for the Harmonized Consumer Price Index. The CPI does not cover the imputed rents of owner-occupied dwellings. The weights for the index are obtained from the average annual expenditures primarily taken from the national Household Budget Survey (HBS) of the previous calendar year, and are updated annually. From 1999 onwards, the national classification is based on the Classification of Individual Consumption by Purpose (COICOP). The scope of the index covers all resident households, except those in some rural areas. Historical series are constructed using a chain method. Time series data are available for the index with reference periods of 1990 and 1998.

5. The producer price index (PPI) is based on the *1993 SNA* concepts and definitions for recording and valuation of product prices and weights. Its scope includes mining and

quarrying, manufacturing and electricity, gas and water supply. Output price indices are also calculated for agriculture, construction, and business services such as transport, storage, and communication. Since 2000, the index is classified by the Polish Classification of Activities based on the General Industrial Classification of Economic Activities within the European Communities, first revision (NACE, Rev.1), the Classification of Products by Activity, and the List of Products of the European Communities. The PPI does not include any estimation for missing prices or quality and seasonal adjustments.

Government finance statistics

6. The Ministry of Finance (MoF) provides detailed monthly state budget data on its website, compiled on a cash basis. Fiscal data for other levels of government are published or provided to IMF missions on a less frequent basis. Consolidated general government data are published only on an annual basis, at the time of the budget, as an estimated outturn at the time of the preparation of the next budget, and as the final outturn in late spring of the following year. The limited breakdown of expenditure by category hinders fiscal analysis and identification of priority areas for fiscal consolidation; consequently they play a very limited role in the public policy debate, although non-state budget expenditure accounts for a large share of general government expenditure.

7. Data for inclusion in the *Government Finance Statistics Yearbook* are reported to the Fund on a regular basis and, since 2004, according to the framework of *GFSM 2001*. The authorities have provided comparable data, compiled on an accrual basis, for 2001–03. Monthly cash data on consolidated core operations of the central government are reported in the GFSM 2001 cash flow statement for the *IFS.* The Central Statistical Office also produces fiscal data according to the *ESA95* methodology for submission to the EU and use in Poland's Stability Programs. However, GFS and *ESA95* data, while providing a superior classification of revenues and expenditure, traditionally became available with long lags and only on an annual basis, diminishing their value for surveillance purposes.[8]

Monetary statistics

8. The National Bank of Poland (NBP) regularly reports analytically useful data to the Fund with minimal delay. High-frequency data (every ten days) on the central bank balance sheet and the monetary survey are also available with minimal delay. As a member of the European Union, the country has adopted the recommendations of the European Central Bank (ECB) for the compilation of monetary and financial statistics; data compiled from March 2002 onward are generally consistent with the ECB framework, and previously released data have been revised back to December 1996.

9. The mission that prepared the data module of the Report on the Observance of Standards and Codes (ROSC) in January 2003 found that the concepts and definitions used

[8] In 2007, STA and Eurostat finalized bridging the annual ESA and GFS data for all EU countries.

by the NBP to compile monetary statistics were in broad conformity with the guidelines outlined in the *Monetary and Financial Statistics Manual (MFSM)*. Nevertheless, the following concepts and principles underlying valuation and classification of financial instruments deviate from the *MFSM*: (i) financial derivatives are indistinguishably recorded under other assets/other liabilities; (ii) accrued interest on loans and deposits are included as part of other assets/other liabilities, but not with the respective underlying instruments; (iii) similarly accrued interest on securities other than shares issued by the depository corporations are included as part of other liabilities; (iv) loan-loss provisions are classified as *special reserves* under *capital accounts and reserves*; and (v) valuation of shares and other equity on the asset side of the balance sheets of the NBP and other depository corporations is not at market prices. The first three practices differ from the *MFSM* guidelines, but are in conformity with the ECB framework.

10. Regarding financing data, the ROSC mission noted material differences between government finance statistics and the corresponding monetary data. The data ROSC mission recommended that the NBP, in cooperation with the MoF, reconcile monetary and government finance statistics and carry out a reconciliation exercise on a regular basis.

11. Compiled monetary data, based on the SRFs, have been published in the February 2008 issue of the IFS Supplement. The new data provide breakdowns of the claims on, and liabilities to the central government and general government, which were previously not available. However, breakdowns of the claims on, and liabilities to, other resident sectors are not available.

External sector statistics

12. While improvements have been made in the balance of payments data, some issues need to be addressed. While there are valid differences in definitions between the customs (GUS) and payment-based trade data compiled by the NBP, the two data sources need to be further cross-checked for broad consistency. The NBP now reports net foreign assets rather than the net international reserves previously shown in the monetary survey. Also, the coverage and reporting of the stock of external debt, especially at maturities up to one year, could be improved. The 2003 data ROSC mission recommended including interest on an accrual basis, making explicit the legal requirement that the NBP disseminate balance of payments statistics, separating insurance from transportation when making the c.i.f./f.o.b. adjustment, publishing on a regular basis a reconciliation table between international merchandise trade statistics and "goods" in the balance of payments, and undertaking periodic revision studies.

POLAND: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

AS OF JUNE 30, 2009

	Date of latest observation	Date received	Frequency of data[6]	Frequency of reporting[6]	Frequency of publication[6]	Memo Items:	
						Data Quality – Methodological soundness[7]	Data Quality Accuracy and reliability[8]
Exchange Rates	6/30/2009	6/30/2009	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	5/2009	6/12/2009	M	M	M		
Reserve/Base Money	5/2009	6/12/2009	M	M	M	O, LO, O, LO	O, O, O, O, O
Broad Money	5/2009	6/12/2009	M	M	M		
Central Bank Balance Sheet	5/2009	6/12/2009	M	M	M		
Consolidated Balance Sheet of the Banking System	5/2009	6/12/2009	M	M	M		
Interest Rates[2]	6/30/2009	6/30/2009	D	D	D		
Consumer Price Index	5/2009	6/15/2009	M	M	M	O, O, O, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2008	5/31/2009	A	A	A	LO, O, O, O	O, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	5/2009	6/15/2009	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	5/2009	6/15/2009	M	M	M		
External Current Account Balance	4/2009	6/17/2009	M	M	M	O, O, O, LO	O, O, O, O, LO
Exports and Imports of Goods and Services	4/2009	6/17/2009	M	M	M		
GDP/GNP	Q1/2009	5/29/2009	Q	Q	Q	O, LO, O, O	LO, LO, O, O, LO
Gross External Debt	Q1/2009	6/30/2009	Q	Q	Q		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extrabudgetary 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); Irregular (I); Not Available (NA).
[7] Reflects the assessment provided in the data ROSC published in October 2003 and based on the findings of the mission that took place during January 8–22, 2003 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) 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 of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND

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International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2009 Article IV Consultation with the Republic of Poland

On July 31, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Poland.[1]

Background

Poland's rapid growth had begun to lose steam even before the global crisis hit. Following robust and relatively well-balanced expansion, driven by an EU accession-related investment boom and rapid credit and wage growth, economic activity began to slow down in the face of capacity constraints. By mid-2008, inflationary pressures peaked and the unemployment rate was at record lows.

As world commodity prices are expected to remain in check and wage developments are likely to track slower economic activity, price pressures are projected to be subdued. With output growth well below potential, headline inflation is forecasted to stay within the tolerance range of 1½ to 3½ percent for the foreseeable future.

External imbalances have been relatively limited, and the equilibrium exchange rate has been broadly aligned with fundamentals. The current account deficit widened to 5.5 percent of GDP in 2008, from 4.7 percent of GDP a year earlier. However, the current account deficit is projected to narrow significantly this year, as domestic demand has weakened and the fall in imports offset the contraction in exports.

[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. 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.

Macroeconomic policies have provided stimulus. The fiscal deficit was allowed to increase as the slowdown set in, with the general government deficit reaching 3.9 percent of GDP at end-2008, compared with the budget target of 2.5 percent of GDP. Meanwhile, the decline in inflation, together with the room provided by euro interest rate cuts, prompted the central bank to embark on a loosening cycle since last November. The policy rate was cut by cumulative 250 basis points to 3.5 percent. Besides renewed price pressures in commodities, recent policy rate cuts have been tempered by concerns about zloty depreciation.

The banking system has weathered the global crisis relatively well. Capital-adequacy ratios (CAR) have declined, but the banking system remains well capitalized with a CAR of 11.7 percent at the end of the first quarter of 2009, a high ratio of tier 1 capital, and record profits in 2008. However, credit risk has risen with the slowdown of the economy, while a sharp deceleration in credit growth is underway as new foreign funding dried up and uncertainty about future economic developments have emerged. Reflecting these uncertainties and the difficulties that banking groups are facing at the global level, the interbank market has seen very little activity beyond one-week maturities. Still, the authorities' top-down stress tests suggest that the system is resilient to adverse scenarios, and only a prolonged recession would lead to general recapitalization needs.

Executive Board Assessment

Executive Directors noted that the strength of Poland's fundamentals, policies, and institutions had enabled it to withstand the global crisis better than most of its peers, as reflected in a limited buildup of external and internal imbalances. Financial markets have broadly stabilized, and investor confidence has strengthened, attributable in part to Poland's Flexible Credit Line arrangement with the Fund.

Directors noted that a significant deceleration in economic activity is underway, reflecting adverse spillovers through real and financial channels. They commended the authorities for the timely, well-focused, and measured policy response. Sound policies in the past are now affording policy-makers room for maneuver. The authorities' continued commitment to adjust policies as circumstances warrant would help Poland to endure a mild recession this year.

Directors welcomed the accommodative stance of monetary policy. Given a benign outlook for inflation and public confidence in the National Bank of Poland's strong antiinflation credentials, most Directors supported the authorities' intention to maintain a loosening bias, while remaining vigilant about price developments. Some Directors considered that a pause in interest rate cuts appears warranted in light of uncertainties surrounding external financing conditions. Directors noted that further measured monetary easing is not likely to result in undue depreciation pressures on the zloty.

Directors recognized that the challenges facing fiscal policy are more complex, reflecting the need to balance short-term cyclical priorities and longer-term objectives. They broadly supported the authorities' recent decision to raise the deficit limit for 2009 to

accommodate the revenue shortfall. Noting that the deficit is set to remain above the Maastricht target through the medium term, Directors welcomed the authorities' commitment to take corrective actions to preserve debt sustainability. They called for fiscal consolidation to start in 2010 if the recovery materializes as expected, with a few seeing limited scope for further delaying the consolidation process if the medium-term deficit targets were to be achieved. Introducing rolling and binding multi-annual expenditure limits, together with measures to enhance the expenditure prioritization process, could help anchor confidence in the medium-term targets. These efforts should be complemented by a further strengthening of fiscal institutions.

Directors welcomed the authorities' pre-emptive actions to safeguard financial stability, notably steps to encourage banks to retain the record-high 2008 profits, as well as ongoing efforts to strengthen the supervisory framework. While the banking system remains well-capitalized, continued vigilance is warranted, given banks' rising non-performing loans and funding costs. Directors welcomed the plan to conduct bank-by-bank bottom-up stress tests to ensure that, if needed, banks move preemptively to shore up capital. This exercise should help reduce uncertainty and facilitate the unfreezing of the local interbank market.

Directors stressed that raising Poland's labor participation rate is the key to boosting long-term growth. In this regard, they welcomed last year's reforms of the early retirement system, and highlighted the need to continue reforming the pension system, including by gradually increasing the retirement age and merging special pension schemes with the general scheme. Reinvigorating structural reforms more broadly, including the privatization plan, will help enhance the economy's flexibility, bolster its long-run potential, and facilitate successful euro adoption in the medium term.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Poland: Selected Economic Indicators, 2005-09

	2005	2006	2007	2008 Prelim.	2009 Proj.
Real economiy (change in percent)					
Real GDP	3.6	6.2	6.8	4.9	-0.7
Real domestic demand	2.5	7.3	8.7	5.4	-1.4
CPI (end of period)	0.7	1.4	4.0	3.3	2.8
Unemployment rate (in percent)	17.7	13.8	9.6	7.1	9.4
Gross domestic saving (percent of GDP) [1/]	21.2	25.6	32.1	33.0	26.1
Gross domestic investment (percent of GDP)	19.3	21.1	24.4	23.9	21.2
Public finances (percent of GDP)					
General government balance [2/]	-3.9	-3.9	-2.0	-3.1	-5.6
according to ESA95	-4.3	-3.8	-2.0	-3.9	…
Public debt	47.5	47.8	44.8	47.1	52.1
according to ESA95	47.1	47.7	44.8	47.0	…
Money and credit					
Private sector credit (12-month change)	12.6	22.9	29.5	33.9	. . .
Broad money (12-month change)	13.1	16.0	13.4	17.5	. . .
Money market rate (eop)	4.6	4.2	5.7	5.3	. . .
Balance of payments					
Current account balance (percent of GDP)	-1.2	-2.7	-4.7	-5.5	-3.2
Official reserves (millions U.S. dollars)	42,571	48,484	65,746	62,180	61,703
Reserve cover (months of merchandise imports)	5.2	4.7	4.9	3.7	5.1
Total external debt (percent of GDP)	43.7	49.6	54.8	45.9	59.3
Fund relations (May 31, 2009)					
Quota (SDR million)			1,369.0		
Fund holding of currency (SDR million)			1,171.2		
Holding of SDRs (SDR million)			34.3		
Exchange rate					
Exchange rate regime			Floating		
Present exchange rate (July 13, 2009)			PLN 3.13 = US$1		
Zloty per US$, period average	3.23	3.10	2.77	2.41	…
Zloty per Euro, period average	4.03	3.90	3.79	3.52	…
Real effective exchange rate (INS, CPI based) [3/]	136.3	139.4	144.8	159.1	…

Sources: Polish authorities; and IMF staff estimates.
[1/] Derived as total savings minus the current account minus capital transfers.
[2/] IMF definition (including pension reform costs); estimates assume full execution of EU Fund spending in the 2009 budget, amounting to 2.5 percent of GDP.
[3/] Annual average (1995=100).

Statement by Katarzyna Zajdel-Kurowska, Alternate Executive Director for the Republic of Poland and Pawel Gasiorowski, Advisor to the Executive Director
July 31, 2009

We would like to thank staff for the report and the constructive consultations held in Warsaw. Our authorities broadly agree with the staff's assessment and policy recommendations and look forward to the upcoming mid-review of the Flexible Credit Line arrangement.

Macroeconomic outlook

So far, Poland has only been modestly affected by the world financial crisis. A strong reliance on domestic demand (with consumption still growing) and strong fundamentals have safeguarded the Polish economy against a severe external storm. Moreover, despite a sharper-than-expected deterioration in Poland's main trading partners (mainly the euro area countries), net export brought in an unexpectedly positive contribution to GDP growth in the first quarter of 2009. Hence, economic growth still remains in the positive territory. In the first quarter, GDP growth was up by 0.8 percent y/y and 0.4 percent q/q , following 2.9 percent y/y and 0 percent q/q growth in the last quarter of 2008. Preliminary data for the second quarter also point to encouraging results. Against this background, the authorities also remain moderately optimistic on the growth outlook, but uncertain external trends put risks to the forecasts on the down side.

Fiscal policy

The economic slowdown combined with the negative short-term effects of the tax cuts imposed at the beginning of the year has negatively affected the revenue side of the budget. The revenue shortfall is estimated at PLN30 bn, which is 10 percent of the amount expected earlier. By avoiding a sharp rise in the deficit, but protecting the economy against further deceleration, the proposed supplementary budget with selective expenditure cuts was accepted by the Parliament. As a result the central budget deficit has increased by only PLN9 bn, to PLN27 bn (2.1 percent of GDP), which is slightly above the 2008 outcome.

Borrowing needs of the government are fully covered. Since the beginning of the year, the Ministry of Finance entered the foreign market several times, issuing EUR1.75 bn of Eurobonds and USD3.5 bn of dollar bonds, which together with the financing from the World Bank (Development Policy Loan) and the EIB exceeds the total government's foreign currency borrowing needs this year. Additionally, the government is planning to reinvigorate the privatization process.

The authorities remain fully committed to the Maastricht criteria, as well as the budgetary policy framework of the EU's Stability and Growth Pact, and they continue to strengthen medium-term fiscal planning to maintain a sustainable path for public debt (e.g, elements of a system of performance based budgeting were implemented to improve effectiveness of public spending).

Monetary policy

The authorities agree with the staff's assessments of the future inflationary trends as well as the recommendations towards monetary policy. Despite the sizable depreciation of the Polish zloty in January-February, headline inflation has already returned to its tolerance range, scaling down inflationary expectations. Monetary policy maintains an accommodative bias. Apart from the main policy rate cuts this year, the Monetary Policy Council (MPC) reduced the reserve requirement on deposits by 0.5 percentage points to 3.0 percent to improve the liquidity of the banking sector.

Financial sector

Polish financial institutions entered the period of difficult economic conditions with a sound financial position. This was due, among others, to very high profits generated by financial institutions in 2008 and historically good asset quality in banks. The banking sector still plays a leading role as it comprises over 80 percent of total assets of the financial sector. The banks are in good shape, with an average capital adequacy ratio of 10.6 percent as of the first quarter of 2009. In an environment of scarce capital from market sources, high earnings became the first source of recapitalization. Taking into account increased uncertainty, the Polish Financial Supervision Authority (KNF) has recommended the banks to retain 2008 profits. Following this recommendation, the majority of banks did not pay high dividends and built an adequate capital buffer. In the coming quarters, the profitability of financial institutions is expected to worsen. Macroeconomic top-down stress tests show, however, that even if banks' revenues significantly decrease, the majority of the sector is able to absorb the hypothetical cost of credit risk with the revenue it generates and the capital buffer it holds, without threatening the required capital adequacy ratio of 8 percent.

Most of the banks operating in Poland follow a traditional funding model, based primarily on customers' deposits. The financing of credit portfolio by assets backed securities does not exist, hence the credit risk stays at the loan originator. Although the mortgage loans portfolio was growing very fast, mortgages represent only 17 percent of GDP. Over half the mortgages have been originated in foreign currency and are financed by credit lines from mother-banks. So far an outflow of external financing has not been observed in the banking sector due to—among other factors—a very low NPL ratio for mortgages. Therefore, the liquidity risk is contained and temporary problems of limited access to the domestic interbank market did not strongly affect the situation of banks. Temporary problems were solved by measures taken by the National Bank of Poland.

In response to the worsening economic growth outlook, banks tightened lending policies, both with regard to loans to corporates and loans to houseaholds. Nevertheless, credit growth is still positive, although—in the corporate sector in particular—low. The impact of a negative feedback between a procyclical contraction of the loan supply by banks and GDP growth may be limited due to the still small scale of financing in the economy and the high reliance of enterprises' on their own funds and funds provided by foreign parents or related parties.

The transmission of the global crisis to the Polish financial system has been limited so far. First, the exposure of banks towards foreign financial institutions has been significantly reduced since the third quarter of 2008, as a result of banks' preference to hold liquid assets in zloty and the supervisory actions of the KNF. Second, a withdrawal of funding was observed on the Warsaw Stock Exchange, but the banking system was not affected. Oppositely, starting from September 2008, banks received significant liquidity support from foreign financial institutions, mainly from their parents. Third, even as the liquidity in the markets used by banks to hedge market risk decreased, banks can still hedge their positions through operations with parents and instruments offered by the National Bank of Poland under the "Confidence Pact".

The staff report properly describes the measures taken by our authorities with regard to the financial system. It is worth noting that to date the National Bank of Poland did not need to use the ECB repo line.

Stress tests of the financial sector

Our authorities have concluded preliminary top-down stress tests based on extreme assumptions. Results were published and are clearly presented in the staff report. The preparation of the bottom-up tests is underway.

Although our authorities appreciate the idea of a regional stress testing exercise, they consider that results for banking systems may provide limited added value. The countries in the region differ greatly in terms of their macroeconomic and institutional situation. Therefore the aggregation of information from such a diverse group of countries is likely to produce misleading results, leading to potentially flawed policy conclusions.