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June 2014

2014 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE; 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 2014 Article IV consultation with the Republic of Poland, the following documents have been released and are included in this package:

- **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 23, 2014, following discussions that ended on May 15, 2014 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 June 5, 2014.
- **Informational Annex** prepared by the IMF.
- **Press Release** summarizing the views of the Executive Board as expressed during its June 23, 2014 consideration of the staff report that concluded the Article IV consultation with Poland.
- **Statement by the Executive Director** for the Republic of Poland.

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

Selected Issues Paper

The publication policy for staff reports and other documents allows for the deletion of market-sensitive information.

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REPUBLIC OF POLAND

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

June 5, 2014

KEY ISSUES

Context. The economy is steadily recovering from a substantial slowdown in 2012–13, helped by improving conditions in main trading partners and a rebound in job creation and household consumption. Financial markets and the zloty have stayed relatively stable amidst renewed global financial market turmoil. Going forward, growth is expected to continue to strengthen, though external risks remain on the downside.

Interconnectedness. Strong interconnectedness with Europe through both trade and financial linkages has served Poland well, but makes it susceptible to growth shocks from Europe. Poland's open capital account exposes it to changes in investor sentiment, including those resulting from a rise in geopolitical tensions surrounding Russia and Ukraine. The latter could also affect Poland through trade and energy links.

Monetary policy. Monetary policy is at a challenging juncture: inflation is well below the target, but the recovery is strengthening. While monetary policy has appropriately remained on hold, the Monetary Policy Council should stand ready to further cut rates if the recovery falters or inflation fails to pick up.

Fiscal policy. After a cyclical deterioration in the headline deficit to 4.3 percent of GDP in 2013, fiscal consolidation is projected to resume in 2014. Additional moderate fiscal consolidation would be needed in 2015–16 to reach the authorities' medium-term objective and put public debt on a stronger downward path. Ongoing pension changes are expected to result in a long-term improvement of fiscal aggregates, but will be matched by an increase in gross implicit pension liabilities.

Financial sector policy. The financial sector weathered the recent slowdown well and remains well-capitalized, liquid, and profitable. While credit growth is picking up, nonperforming loans (NPLs) remain high. Hence, tackling legal obstacles and tax disincentives to resolving NPLs remains a priority. Work to establish the macroprudential framework and bank resolution regime should be finalized.

Structural reforms. Boosting potential growth will require pressing ahead with reforms of the labor market to address duality and the business environment to boost investment.

Approved By
Mahmood Pradhan and Vivek Arora

Ms. Kozack (Head), Ms. Christiansen, Messrs. Ebeke and Vazquez (all EUR), and Ms. Kyobe (SPR) visited Warsaw during May 6–15, 2014. The mission met with senior government and central bank officials, and the representatives from trade unions and the business community. Mr. Roaf (Senior Regional Resident Representative), Mr. Sierhej, and Mr. Krogulski (Resident Representative Office) participated in the discussions. Ms. Zakharova (EUR) joined the mission during May 12–15. Messrs. Morán Arce and Augustyniak (both EUR) provided support from headquarters. Poland is an Article IV country and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions, except for those solely for the preservation of national or international security (Informational Annex: Fund Relations). Data provision is adequate for surveillance (Informational Annex: Statistical Issues).

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CONTEXT

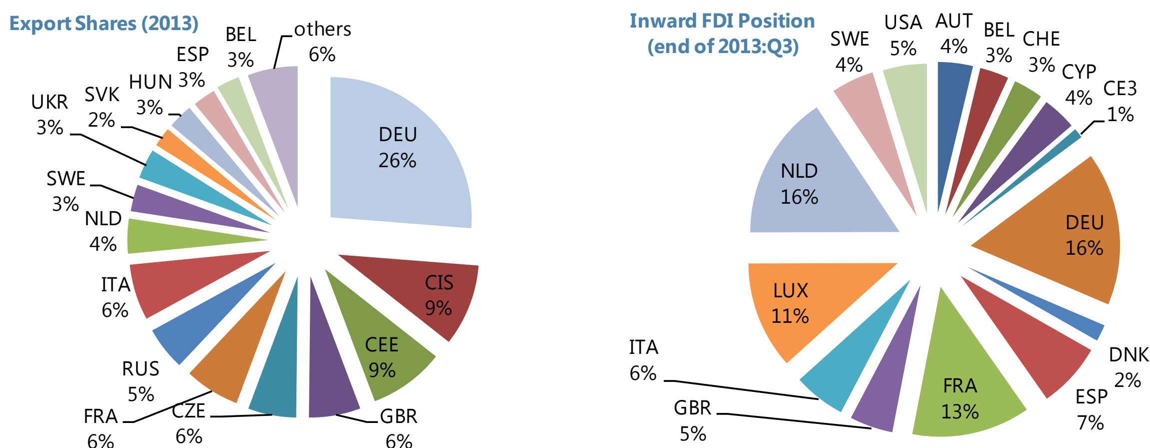
1. The Polish economy experienced a substantial growth slowdown in 2012–13, but is now recovering. Growth dropped in the second half of 2012 and into 2013 as uncertain prospects for euro area growth weighed on confidence, adding to a contraction in public investment. As a result of the slowdown and external factors (such as subdued energy prices), inflation fell sharply below the target range. A recovery is now underway as the economy expanded by a higher-than-expected 3.4 percent (yoy) in the first quarter of 2014.

2. Poland weathered bouts of emerging market volatility in 2013 and early 2014 relatively well. Strong fundamentals, combined with very strong policies and the insurance provided by the Flexible Credit Line (FCL) arrangement, helped support favorable financial market perceptions amidst Fed tapering and geopolitical tensions surrounding Russia and Ukraine.

3. Poland is highly interconnected with global markets through trade and financial links. Poland's integration with Europe—including through participation in the German supply chain—has served it well, supporting income convergence and higher living standards. However, its high interconnectedness also makes it susceptible to external shocks, including those emanating from Europe, Russia/Ukraine, and global capital markets.

- **Trade.** Europe remains Poland's main export destination (in 2011, about ⅔ of the domestic value added content of Poland's exports was consumed in Europe). Efforts to enter new markets in Eastern Europe (as a result of recent weak demand in Western Europe) led to an increase in the share of gross exports finally consumed in this region to around 15 percent in 2011, of which Russia accounted for 6 percentage points.
- **Foreign direct investment.** In 2012, close to 90 percent of the stock of inward foreign direct investment (representing around 40 percent of GDP) originated from the European Union, while exposure to Russian and Ukrainian FDI is small. Though corporate external debt is high relative to peers, vulnerabilities are mitigated by intercompany loans, which account for more than 50 percent of total corporate external debt.
- **Financial.** Poland's banking system is largely foreign-owned with foreign claims of BIS reporting banks amounting to close to 60 percent of GDP, of which more than 80 percent is accounted for by euro area banks. However, reliance on parent funding has declined in recent years and is moderate.
- **Capital markets.** Poland's open capital account makes it susceptible to spillovers arising from shifts in investor sentiment, including possibly from a sharp increase in geopolitical tensions surrounding Russia and Ukraine or global volatility arising from the normalization

of U.S. monetary policy. The increase in the share of foreign investors in the domestic bond market, induced by recent pension changes, could exacerbate these risks.[1]



Sources: Direction of Trade Statistics, National Bank of Poland, and IMF staff calculations.

4. With elections approaching next year, momentum for reforms is waning. Presidential elections are scheduled to take place in summer 2015, followed by parliamentary elections in the autumn. The appetite for significant reforms is very limited, given the election cycle and the ruling coalition's slim parliamentary majority.

RECENT ECONOMIC DEVELOPMENTS

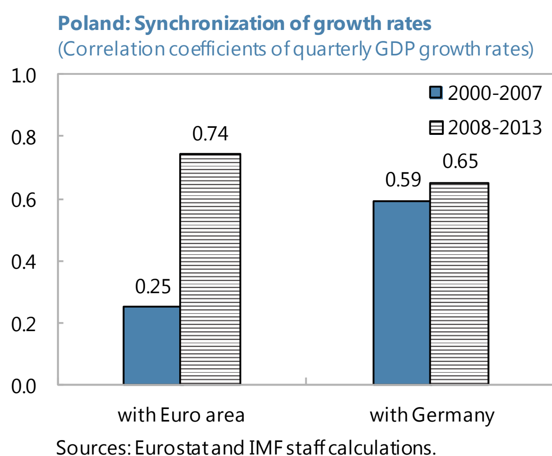
A. The Economy is Steadily Recovering

5. The economy is recovering from the 2012–13 slowdown. It grew by 1.6 percent in 2013—the same as in 2009—as the slowdown in core euro area countries and adverse confidence effects weighed on private investment and consumption, alongside a contraction in public investment. A gradual, but balanced and steady recovery started in the second quarter of last year, led by improving conditions in main trading partners (especially the euro area) and a recovery in domestic demand. More recently, household consumption has continued to strengthen along with a pick-up in retail sales growth, rising confidence, low borrowing costs, and increasing real wages. The manufacturing PMI has been in expansionary territory since July 2013, and capacity utilization is at a post-crisis peak (Figure 1 and Table 1).

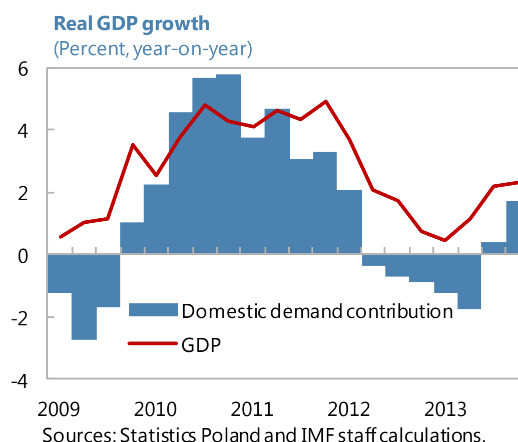
6. Labor market conditions have improved, but unemployment remains high. After reaching a six-year peak of 10.6 percent in early 2013, the seasonally adjusted unemployment rate started to decline. A pick-up in job creation in the export-oriented manufacturing sector helped

[1] Recent changes to the pension system caused a large one-off drop in pension fund holdings of public debt, leading to a mechanical increase in the share of foreign investors in the domestic bond market.

overall employment growth turn positive at the end of the year (Figure 2). However, at close to 10 percent (sa), the unemployment rate remains high and dominated by structural factors.



Sources: Eurostat and IMF staff calculations.



Sources: Statistics Poland and IMF staff calculations.

7. Inflation remains subdued and well below the target. Despite the strengthening recovery, inflation has remained muted. At 0.3 percent (yoy) in April, it is significantly below the lower band of the target range (2.5 percent ± 1 percentage point) and core inflation (excluding food and energy) is also weak (0.8 percent in April) (Figure 3). The low inflation readings appear to reflect a combination of low imported inflation, including from energy prices, and domestic factors (weak demand in 2013, favorable weather conditions for crops in 2014, and one-offs, including reductions in electricity tariffs, may still be weighing on prices). While consumer inflation expectations are highly adaptive, consensus forecasts of professional forecasters remain well anchored.

8. The current account balance continued to improve and the external position remained consistent with medium-term fundamentals. At 1.3 percent of GDP in 2013, the current account deficit narrowed to its lowest level in more than 15 years as the trade balance turned positive for the first time in two decades (and remained positive in the first quarter of 2014), partly on account of higher export market shares outside the euro area (Figure 4 and Table 2). External debt is high and gross external financing needs substantial, but this is in large part related to intercompany debt and parent bank funding (Annex I). While they have increased recently, net errors and omissions remain below the EU average of around 2 percent of GDP. Poland's external position is consistent with medium-term fundamentals (Box 1).

9. Financial markets have been resilient to Fed tapering jitters and geopolitical tensions surrounding Russia and Ukraine, despite capital outflows. Net portfolio and, for the first time in more than two decades, FDI flows were modestly negative in 2013 amid bouts of volatility in financial markets. Yet, on the back of strong fundamentals, sound policies, and the insurance provided by the FCL arrangement with the IMF, sovereign bond yields have remained low by historical standards and the zloty has been relatively stable (Figure 5). More recently, escalating geopolitical tensions surrounding Russia and Ukraine contributed to additional, moderate, financial market volatility. Although FDI was weak in 2013, this appears to reflect global trends as Poland's share in global FDI actually increased.

Box 1. External Sector Assessment

The external position is broadly in line with medium-term fundamentals and appropriate policies, though potential vulnerabilities exist.

Current account. The current account deficit has narrowed substantially from 3.7 percent in 2012 to 1.3 percent at end-2013. The cyclically adjusted current account balance is broadly consistent with fundamentals and desirable policies.

Real exchange rate. The real exchange rate is assessed to be broadly consistent with fundamentals and desirable policy settings. Alternative approaches suggest a modest undervaluation of between 0 and 8 percent (there is no estimated undervaluation using the current account norm; the estimated undervaluation using the ES estimate of the real effective exchange rate (REER) gap is 8 percent; and the estimated undervaluation using the REER regression approach is 5 percent). Nonetheless, some further reduction in the structural fiscal deficit and current account deficit would be appropriate. The zloty has fluctuated along relatively narrow margins.

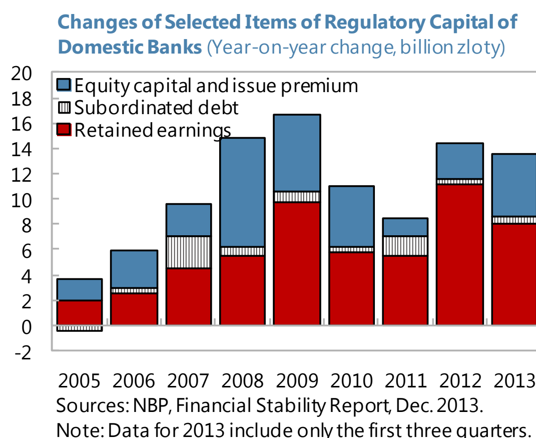
Capital and financial account. Financial flows have weakened, particularly in the domestic bond market, following Fed tapering-related announcements in May 2013. FDI flows have also weakened as a result of income repatriation, while EU funds—which finance the bulk of the current account—have remained stable. Although part of the decline in net FDI inflows was associated with one-off factors, going forward, financing of the widening current account could prove challenging should net FDI inflows fall significantly below current projections.

Foreign asset and liability position. Substantial net IIP liabilities have stabilized and stood at 69 percent of GDP in 2013. Associated vulnerabilities are mitigated by the large and diversified share of FDI liabilities and related intercompany lending (over 40 percent of foreign liabilities are FDI investments).

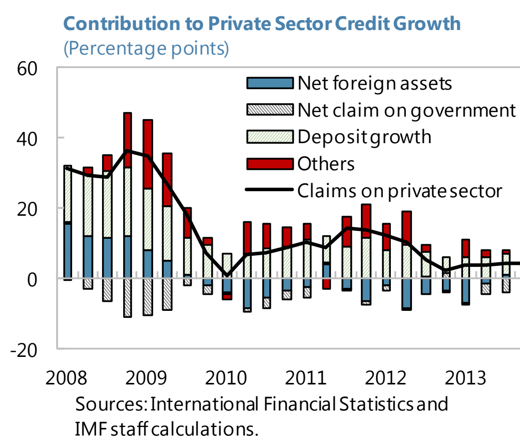
Reserve adequacy. Reserves are broadly adequate at about 126 percent of the IMF's composite reserve adequacy metric and 100 percent of short-term debt at remaining maturities (90 percent of short-term debt at remaining maturities plus the current account deficit). However, in light of downside external risks stemming from the normalization of U.S. monetary policy and geopolitical tensions surrounding Ukraine, and in preparation for an eventual exit from the FCL arrangement with the IMF, moderate reserve accumulation would be prudent.

B. The Banking System Has Remained Resilient

10. The largely foreign-owned banking system is well-capitalized, profitable, and liquid with declining reliance on external funding (Figures 6 and 7). Capital to risk-weighted assets has remained strong, reaching 15.6 percent at the end of the first quarter of 2014 (Tier 1 ratio at 14.1 percent), in large part due to retained earnings. Profits have held up and liquidity indicators have remained robust. Reliance on parent funding has declined, on-balance sheet open foreign currency positions have narrowed, and regulatory changes to curb foreign currency credit growth have led to a halt in foreign currency mortgage lending. Nonetheless, a loan-to-deposit ratio above 110 percent and reliance on swaps to fund the legacy stock of foreign currency mortgages could expose the sector to liquidity risks (Table 3).



Sources: NBP, Financial Stability Report, Dec. 2013.
Note: Data for 2013 include only the first three quarters.



Sources: International Financial Statistics and IMF staff calculations.

11. Credit expansion is strengthening. Both corporate and consumer credit are expanding, reflecting an increase in demand. In addition, for consumer loans, regulatory changes that eased documentation requirements for small loans and replaced caps on the debt-service-to-income threshold (instead allowing banks to use their internal models) likely helped support the expansion of credit. For small- and medium-sized enterprises (SMEs), the *de minimis* program on government credit guarantees was expanded to cover investment financing. NPLs, at around 8.5 percent of loans, have begun to inch down but appear notably sticky and are still elevated in the corporate sector.

OUTLOOK AND RISKS

12. The near-term economic outlook is for a continuing recovery. GDP growth is projected to reach 3.3 percent in 2014, underpinned by a rebound in domestic demand. A strengthening labor market and increasing real wages should boost private consumption, while rising credit growth and improving financial conditions should support investment. External demand is expected to recover, supported by stronger growth in Poland's main trading partners. However, inflation is expected to remain low, reaching only around 1 percent in 2014.

13. Over the medium term, growth is expected to gradually reach its potential. GDP growth is projected to accelerate to around 3.5 percent in 2015–16. The absorption of Poland's new allotment of EU structural funds for 2014–20 (euro 82 billion in current prices; the largest in the EU) should provide an impulse to public and private investment, and job creation should further reduce unemployment over the medium term. Hence, rising domestic demand is projected to continue to gradually erode the net export contribution to growth, and the current account balance is expected to widen to around 3 percent by 2016. Given the recent and projected strengthening of domestic demand growth (which is highly correlated with inflation 2–3 quarters forward) and the narrowing output gap, the baseline inflation path envisages a gradual rise toward the target. However, given low imported inflation and a stable exchange rate vis-à-vis the euro—despite substantial policy interest rate cuts last year—there are downside risks to the inflation forecast.

14. Risks to the growth outlook have become more balanced but with external factors still firmly on the downside (see also Table 4 with the Risk Assessment Matrix).

- **Global financial conditions.** A renewed worsening of global financial conditions could lead to capital outflows and an increase in interest rates, not least amidst a normalization of U.S. monetary policy (Box 2 and Chapter I of Selected Issues). An increase in the share of foreign investors in the domestic bond market, induced by the recent pension changes (see Policy Discussions, Section B), has heightened the risks stemming from a sudden reversal of capital flows—either because of renewed bouts of emerging market volatility or because of rising geopolitical tensions surrounding Russia and Ukraine. In addition, depending on the reliance on variable rate debt, interest rate shocks could raise the share of corporate sector debt at risk (Chapter II of Selected Issues).
- **Geopolitical tensions.** Poland is exposed to Russia and Ukraine through energy and trade links, while direct financial links are small (Box 3). Considering the significant gas and oil imports from Russia, spillovers from geopolitical turmoil, reflected in disruption of gas and oil supply to Poland, would severely affect gas-intensive industries. In addition, confidence effects could result in renewed financial market volatility and capital outflows.
- **Slower trading partner growth.** Poland remains vulnerable to a protracted period of slower growth in the euro area due to its strong trade and financial linkages with core euro area countries. Such a scenario would weaken growth in Poland through lower exports and adverse confidence effects.
- **Domestic risks.** On the upside, the absorption of EU funds could be more frontloaded than projected, leading to an earlier pickup in investment.

15. Risks to the inflation outlook are on the downside. Inflation could fail to pick up as envisaged in the baseline—either on account of external factors (low imported inflation) or domestic factors (entrenched low inflation expectations)—and remain low for a protracted period. In particular, should prolonged low inflation among European trading partners (which could result in continued low imported inflation if exchange rate adjustments do not offset it) materialize, domestic demand may not be sufficient to pull inflation back toward the target as envisaged in the baseline.

Authorities' views

16. The authorities shared staff's views on the outlook, and underscored that risks were mainly external. They agreed that a broad-based recovery is underway and broadly concurred with staff's forecasts for growth and inflation. They nonetheless felt that Poland's recovery hinged importantly on a continued recovery in the euro area. On risks, the authorities agreed that a protracted period of slow growth in Europe or a reversal in foreign investor sentiment—either because of global financial conditions or geopolitical issues—posed the main risks. They nonetheless felt that Poland was well-positioned to manage risks associated with reversals of investor sentiment given its well-diversified investor base, strong fundamentals, sound policies, and insurance provided by the FCL arrangement. On the potential for a sharp increase in geopolitical tensions surrounding Russia and Ukraine, the authorities emphasized that the impact on Poland would depend critically on the precise nature of the increase in tensions. They also noted that, even

if Poland avoided a significant adverse macroeconomic impact, particular sectors of the economy (such as agriculture) could be affected.

Box 2. Global Financial Spillovers and the Role of the Investor Base[1]

Ample global liquidity in recent years has increased foreign participation in many EM government bond markets. During the past decade, the foreign investor share in the Polish domestic government bond market rose by about 11 percentage points to 32 percent at end-2013, while yields on long-term zloty-denominated government bonds declined by close to 230 basis points between 2004–13.

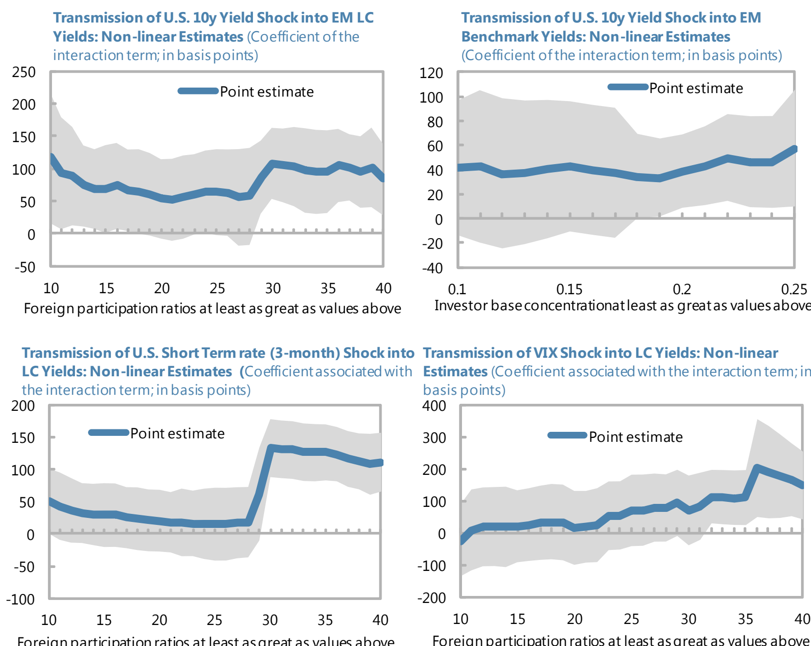
Foreign financing could quickly reverse on account of external shocks. Poland weathered the bouts of emerging market volatility in 2013 and early 2014 well. Nonetheless, cumulative capital outflows of about $7.2 billion took place between June 2013 and March 2014 and yields increased by about 30 basis points.

Staff analysis suggests that high foreign participation and high investor base concentration in local-currency government bond markets increase the sensitivity of yields to global financial shocks. Specifically, when foreign participation increases beyond 30 percent and investor base concentration increases above the median (0.2, based on a *Herfindahl-Hirschman* index), the transmission to yields of global financial shocks is significantly amplified in EMs. For Poland, foreign participation at 32 percent is above the foreign participation threshold, suggesting potentially significant spillovers in case of tightening of financial conditions. However, the concentration of Poland's investor (measuring 0.1 on the *Herfindahl-Hirschman* index) is more diversified than the median EM, suggesting greater resilience to shocks. As in previous bouts of volatility, Poland's strong fundamentals should also help dampen adverse financial spillovers. These results should be interpreted with caution. First, the absence of data on the profile of foreign investors (i.e. whether these are retail or institutional investors) holding EM local-currency bonds, makes it difficult to generalize this threshold. Second, most countries reached this threshold after the global financial crisis (when global liquidity increased), which makes threshold results heavily dependent on the post-crisis period.

The results point to some policy implications. Preserving strong fundamentals can help insulate countries against external shocks. Similarly, ensuring prudent debt management and promoting the diversification of the investor base—including through domestic financial deepening and improved institutional quality—can also help mitigate shocks.

International Financial Spillovers into EMs

Additional increase in the yields (in bps) at various thresholds of conditional variables



Source: IMF Staff calculations.

[1] See Chapter I of Selected Issues for details.

Box 3. Poland's Links to Russia and Ukraine

Poland imports significant natural gas and crude oil from Russia, but some factors mitigate the potential impact of energy supply disruptions.

- Russia supplies 57 percent of Poland's gas consumption and 94 percent of its crude oil consumption.
- However, relative to other countries in the region, Poland's reliance on gas in its primary energy supply is limited: only around 13 percent of energy supply comes from natural gas, with most provided by coal (56 percent) and crude oil (23 percent).
- In Poland, natural gas is used most heavily by industry (60 percent), with households (25 percent) and the electricity sector (11 percent) less reliant. In case of disruptions, gas-intensive industries, such as chemical and metallurgy (which comprise about 3 percent of GDP), would be severely affected.
- There are some mitigating factors that could reduce the adverse impact of energy supply disruptions on Poland. These include: (i) the end of the winter-heating season; (ii) gas inventories (estimated at around 30 days of imports); (iii) the long-term gas contract with Gazprom (which helps shield Poland from price hikes); and (iv) scope to import gas from Germany (rather than Eastern European neighbors, although this would not help in the case of pan-European gas disruptions). Looking ahead, Poland is in the process of building a liquefied natural gas (LNG) terminal, which is expected to be operational in 2015.

Trade links with Russia and Ukraine are moderate.

- **Russia.** About 5 percent of Poland's exports are to Russia (while imports from Russia represent slightly over 10 percent of the total), and about 6 percent of Poland's exports are finally consumed in Russia. 7 percent of Polish food exports go to Russia and bans on these exports (such as the recently imposed one on pork) could have adverse effects on Polish food processing and agricultural sectors.
- **Ukraine.** Trade links with Ukraine are modest: less than 3 percent of Polish exports go to Ukraine, while Polish imports from Ukraine represent 1.3 percent of the total.

FDI links are weak. Polish FDI in Russia stands at 2.5 percent of total FDI abroad (0.3 percent of GDP), while in Ukraine it is 1.9 percent (0.2 percent of GDP). Russia and Ukraine also have limited FDI positions in Poland.

Direct financial linkages are limited, but indirect effects could be substantial. There are risks of contagion through confidence effects and common investor linkages.

POLICY DISCUSSIONS

17. Amid continued external risks, Poland's main policy challenge is to continue adjustment while protecting the recovery. To support the recovery while continuing to rebuild buffers, gradual fiscal consolidation is appropriate (Box 4). Monetary policy is at a challenging juncture, with low inflation and a steady growth rebound. While keeping policy interest rates on hold has been appropriate, further monetary easing may be needed if the recovery falters or inflation fails to pick up. Considering the resilience of the financial sector, addressing obstacles and disincentives to dealing with NPLs, completing the macroprudential framework, and revamping the bank resolution framework are key priorities. Over the medium term, boosting potential growth will require pressing ahead with reforms of the labor market and the business environment.

Box 4. Implementation of Past Fund Advice

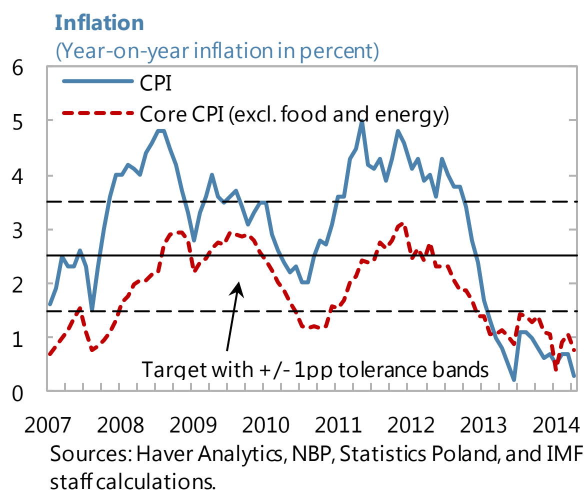
Policy implementation has been broadly in line with past Fund advice:

- **Monetary policy.** The Monetary Policy Council (MPC) continued the easing cycle to help counter the downturn, followed by forward guidance to indicate that the key policy rate would remain unchanged for an extended period. The legal framework is in the process of being strengthened, with consideration of staggered terms of MPC members.
- **Fiscal policy.** In response to the economic downturn, the pace of fiscal consolidation slowed in structural terms, avoiding unwarranted drag on the economy. Meanwhile, the authorities have remained committed to their medium-term objective (MTO), which is deemed adequate to rebuild fiscal buffers. The permanent expenditure rule was approved and would be operational starting in 2015. Recent increases in the retirement age were consistent with Fund advice, but reform of the special pension schemes still needs to be advanced.
- **Financial sector.** The authorities have stepped up oversight of the small but vulnerable credit union segment, initiating rehabilitation of a number of institutions. Work to establish a systemic risk board (SRB) and new bank resolution framework has continued, though final legislation has been delayed.
- **Structural reforms.** The authorities continued to reduce the number of regulated professions, initiated legislation to lessen duality in the labor market, and adopted a law to improve the functioning of public employment services. Ongoing work on the new insolvency regime is welcome and should be concluded without delay. Progress to improve the business climate is commendable and should be pursued further.

A. Monetary Policy: Addressing Low Inflation in the Face of External Risks

18. Substantial cuts in policy interest rates last year helped ease financial conditions. The key policy rate was lowered 225 basis points to a historical low of 2.5 percent between November 2012 and July 2013. This improved financial conditions and transmitted into lower lending rates, suggesting that the monetary transmission mechanism is working (Figure 8 and Table 5). While ending the easing cycle, the Monetary Policy Council (MPC) initiated forward guidance to maintain rates at their current levels for an extended period (currently until at least the end of the third quarter of 2014).

19. While acknowledging the importance of the past monetary easing, staff noted that further cuts may be needed if the recovery falters or inflation fails to pick up. Staff emphasized that monetary policy is at a challenging juncture: inflation remains well below the target range, but economic activity is strengthening and credit growth is rising.



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

- Though inflation is very low, this appears to partly reflect external factors as imported inflation and energy price inflation are extremely weak. At the same time, the economy is steadily improving.

- Monetary conditions remain supportive—lending rates have continued to decline and credit growth is rising (and now stands at around 5 percent).
- Given staff's projection of strengthening domestic demand growth (which is highly correlated with inflation 2–3 quarters forward) and the closing of the output gap in 2016, inflation is projected to rise toward the target under current policies.
- While the Monetary Policy Council has appropriately kept rates on hold, it should stand ready to further reduce rates if the recovery falters or if revised projections indicate that inflation would remain well below target for a protracted period (taking into account monetary policy transmission lags). On the latter, second round effects from low energy prices could weigh on core inflation, entrenching expectations of low inflation going forward. To the extent that inflation remains low due to subdued imported inflation, further rate cuts may also be associated with moderate zloty depreciation, which should help lift imported inflation.

20. Staff suggested that moderate reserve accumulation would be prudent. International reserves at about 126 percent of the IMF's composite reserve adequacy metric are broadly adequate. However, in light of downside external risks—including from U.S. Fed tapering and geopolitical tensions surrounding Russia and Ukraine—and in preparation for an eventual exit from the FCL arrangement, moderate reserve accumulation would be prudent.

21. In the event of severe external pressures, the exchange rate should be allowed to play its appropriate cushioning role, taking into account its impact on the stock of foreign currency mortgages. Intervention, including verbal, could be used to curb excess volatility. Meanwhile, the NBP should continue to stand ready to ensure adequate zloty and FX liquidity in the banking sector. To the extent that inflation fails to pick up, severe external pressures may limit the scope for policy rate cuts.

Authorities' views

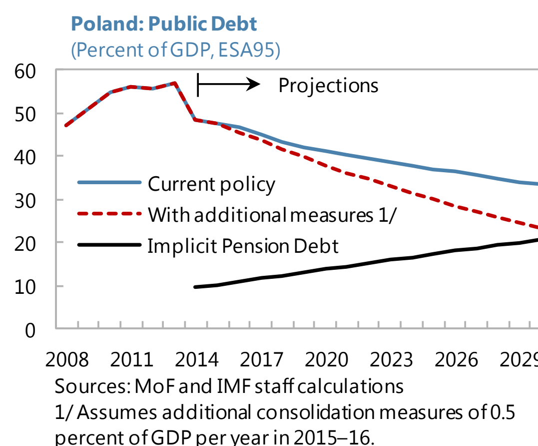
22. The authorities agreed that monetary policy faced challenges, but were more cautious than staff regarding the potential for further lowering the policy rate. In particular, the authorities felt that low inflation would primarily pose concerns if the recovery faltered. While they agreed that part of the low inflation in Poland was imported or affected by one-off factors, they viewed this as generally favorable as low food and energy prices could be having virtuous second-round effects (by lowering other prices) and thus boosting household purchasing power. Nonetheless, the authorities were of the view that inflation would pick up along with growing private consumption. On reserves, they agreed that moderate reserve accumulation would be prudent.

B. Gradually Continuing Fiscal Consolidation

23. The fiscal deficit widened in 2013 as a result of weak economic growth. The economic slowdown took a toll on tax collections (including VAT, which has seen an unfavorable trend in collection efficiency in the last five years (Chapter III of Selected Issues)). As a result, the deficit widened from 3.9 percent of GDP in 2012 to 4.3 percent of GDP in 2013 (Tables 6 and 7). In late-2013, the fiscal framework was overhauled with the approval of a permanent expenditure rule, which will begin to take effect in 2015.[2]

24. The gradual resumption of fiscal consolidation this year is appropriate given the economic recovery underway. The 2014 budget includes about ½ percent of GDP in consolidation measures, while the downsizing of the pension system's second pillar and a cyclical recovery of tax revenue (based on staff's analysis in Chapter III of Selected Issues) would provide an additional ½ percent of GDP in deficit reduction. On current policies, the headline deficit is therefore projected to fall by 1 percentage point of GDP to 3.3 percent of GDP in 2014. Public debt (ESA95) should drop by 8 percentage points to 49½ percent of GDP by end-2014, largely on account of a one-off transfer of public debt from the pension fund's second pillar to the general government. As in previous years, financing is comfortable: more than three-fourths of government 2014 financing needs have already been covered.

Poland: Public Debt
(Percent of GDP, ESA95)



Sources: MoF and IMF staff calculations
1/ Assumes additional consolidation measures of 0.5 percent of GDP per year in 2015–16.

25. The recent changes to the pension system will improve the fiscal aggregates, but staff underscored that maintaining fiscal prudence remains essential to further reduce public debt. The changes to the pension system—which entail a downsizing of the second pillar—were motivated by concerns about the performance and fiscal costs of the second pillar and have led to criticism by some observers on property rights and policy continuity grounds (Box 5).The changes are estimated to deliver an improvement in the fiscal accounts of around 30 percent of GDP in net present value terms during 2014–60, matched by an increase in gross implicit pension liabilities (Chapter IV of Selected Issues).[3] The structural fiscal deficit should drop to 2 percent of GDP by 2016, and public debt (ESA 95) is expected to fall to around 45 percent of GDP by 2019, helped by gradual asset transfers from the pension system's second pillar. However, staff noted that additional

[2] A permanent expenditure rule was passed by parliament in late 2013 and will become operational in 2015. The new rule links public expenditure growth to average GDP growth and requires additional expenditure consolidation when the debt-to-GDP ratio surpasses pre-established thresholds. Staff's assessment of the rule can be found at http:/www.imf.org/external/pubs/ft/scr/2013/cr13220.pdf.

[3] This is similar to the fiscal impact computed for the Hungarian pension changes in IMF, 2011, *The Challenge of Public Pension Reform in Advanced and Emerging Economies*.

consolidation measures of around ½ percent of GDP per year during 2015–16 would be needed to reach the authorities' medium-term objective (MTO) of a 1 percent of GDP structural fiscal deficit and put the debt ratio on a stronger downward path. Strict enforcement of the new permanent fiscal rule should help ensure that fiscal policy remains prudent. In this regard, the recent lowering of the public debt thresholds contained in the fiscal rule is welcome. Staff also noted that conducting an expenditure review (including tax expenditures) may also help identify areas where savings can be made, while protecting priority spending.

26. Staff underscored the importance of addressing legacy flaws in the pension system to help reduce long-term fiscal risks. A sizable drop in projected replacement rates increases fiscal risks stemming from old-age poverty. Hence, staff encouraged the authorities to consider ways to boost savings in the voluntary third pillar to help ensure socially sustainable pensions in the future. Other fiscal risks stemming from pre-existing flaws in the pension system could be ameliorated by revising the indexation of notional accounts in the first pillar, seeking better alignment of the disability formula with the core pension system, and implementing pending reforms in special pension schemes.

27. Fiscal policy should continue to flexibly respond to the state of the economy. In the event of a better-than-expected recovery, there is scope for a more frontloaded fiscal adjustment in 2015. However, should growth fall significantly below the baseline path, automatic stabilizers should be allowed to operate fully, while room for discretionary countercyclical fiscal policy would be limited by the relatively high debt-to-GDP ratio (Annex II).

Authorities' views

28. The authorities broadly shared staff's assessment of fiscal policy, but questioned some of the implications of the pension changes set out by staff. They agreed that the fiscal deficit was set to be substantially reduced in 2014, partly on account of the pension changes. However, the authorities' projections entailed a somewhat more conservative rebound in tax revenues than staff, coupled with slightly lower expenditure projections. The authorities also agreed with staff that additional measures would be needed to reach the MTO. On pension changes, they shared staff's assessment that the changes would yield a long-term improvement in the fiscal accounts and their figures were similar to staff's. However, they felt that staff was overstating some of the potential drawbacks of the pension changes—notably with respect to liquidity in the domestic government bond and equity markets (where they noted that there was no perceptible drop in liquidity) and policy continuity (where they felt that they had clearly explained their rationale to the markets and the public, thus mitigating risks in this area).

Box 5. Implications of Changes to the Polish Pension System[1]

The Polish pension system underwent significant changes in 2014: (i) pension funds' holdings of Treasury and Treasury-guaranteed bonds were transferred to the social security administration then Treasury securities were acquired by the Ministry of Finance and cancelled (corresponding liabilities were transferred to individual notional accounts in the first pillar and thereafter indexed by the five-year average nominal GDP growth); (ii) new pension contributions will be channeled to the social security administration, unless contributors "opt-in" to the second pillar; (iii) pension funds were banned from investing in government bonds, and current benchmarking and penalty systems were removed to encourage more active portfolio management; (iv) limits on holdings of foreign securities will be lifted over time, from the current 5 percent of pension funds' portfolios to 30 percent by 2016; and (v) pension payouts will be centralized in the public system, with a gradual transfer of assets to the first pillar starting ten years before retirement.

The changes to the pension system would lead to a long-term improvement in fiscal accounts. The changes imply a substantial downsizing of the funded second pillar, while maintaining the defined contribution nature of the pension system (since the first pillar is a notional defined contribution system). Thus, the economic implications are less fundamental than in some other countries that have undertaken similar changes to their pension system. Staff analysis indicates that, under baseline population and macroeconomic projections over 2014–60 and assuming that half of the contributors switch completely to the first pillar, the 2014 pension changes would lead to an improvement in the fiscal accounts of about 30 percent of GDP in net present value terms, matched by an equivalent increase in gross pension liabilities.

The increased reliance on the unfunded first pillar had a number of parallel implications:

- ***Explicit versus implicit liabilities.*** Since the system operates as defined contribution, the improvement in the fiscal accounts will be matched by an increase in gross implicit pension liabilities. Given demographic trends, these liabilities may not be fully covered by the stream of pension contributions beyond 2060, until the system reaches equilibrium.
- ***Intergenerational equity.*** The 1999 pension reform (which established Poland's three pillar pension system) entailed significant fiscal costs associated with the funding of the second pillar. These costs would have had to be borne mainly by the current generation, as legal debt limits prevented sharing them fully with future generations via new debt issuance. Downsizing the second pillar reduces the costs of the transition and the associated burden on the current generation.
- ***Adequacy of pensions.*** The 2014 pension changes preserved the actuarial balance of the system by keeping the defined contribution nature of the benefits. Given demographic trends, this would imply a sharp drop in replacement rates over time, increasing risks of old-age poverty and associated fiscal risks. These risks could be alleviated by promoting voluntary pension savings.
- ***Constitutional aspects and policy continuity.*** The 2014 pension changes have been controversial, particularly with respect to their constitutionality and property rights of second pillar assets. These issues are under consideration by Poland's Constitutional Tribunal. The pension changes could also raise concerns about policy continuity and credibility. To date, however, such concerns do not seem to have materialized—financial markets have been stable, as both market participants and ratings agencies do not appear to have been rattled by the changes.
- ***Domestic capital market impact.*** The downsizing of the second pillar would reduce inflows to the domestic capital market, possibly affecting its speed of development. In the short run, it could also adversely affect liquidity and increase volatility.
- ***Risk diversification.*** Concentrating pensions in the first pillar, where they are primarily indexed to the wage bill, reduces the diversification of sources of future pension income. To the extent that greater diversification helps mitigate risks arising from idiosyncratic shocks (such as to the wage bill), it will be important to seek additional forms of pension savings (including through increases in private savings). See also Chapter V of Selected Issues for an analysis of saving accelerations.

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[1] See Chapter IV of Selected Issues for details.

C. Further Enhancing the Resilience of the Financial Sector

29. The banking system continues to be resilient. Stress tests conducted by the NBP indicate that the banking system can withstand adverse macroeconomic shocks with the majority of banks able to absorb potential losses. While risks to the banking sector are mitigated by low household indebtedness (Figure 9) and a narrowing funding gap, NBP stress tests show that some banks, which are largely financed with foreign funds or hold substantial foreign currency loan portfolios, may have insufficient buffers in the event of a severe liquidity shock associated also with capital outflows and zloty depreciation. Increasing buffers in these banks would further strengthen the sector's resilience. The development of additional sources for long-term funding would also help banks prepare for Basel III liquidity requirements concerning the net stable funding ratio.

30. Supervisory measures are further strengthening the financial system. The recommendation (to take effect from July 2014) that foreign currency mortgages be issued only to borrowers with adequate foreign currency income, alongside past supervisory measures in this area, has led to a halt in foreign currency mortgage lending. However, the share of legacy foreign currency mortgages—while declining—remains sizeable, with many exhibiting high loan-to-value (LTV) ratios. In this respect, the gradual lowering of LTV ratios on new housing loans to 80 percent in 2017 is a step in the right direction. Continued careful oversight of lending practices and credit risk management is also essential in light of recent changes replacing general caps on debt-service-to-income ratios with those derived from banks' internal models. Greater budgetary flexibility would help the financial supervisory authority (KNF) ensure that its resources are deployed in the most effective manner.

31. Staff urged the authorities to continue to restructure credit unions. While the credit union segment is small, with assets accounting for around 1½ percent of banking sector assets, its capital position is inadequate. Hence, in line with the 2013 FSAP recommendation, KNF has stepped up oversight of this vulnerable segment, initiating rehabilitation of a number of institutions (Table 8).

32. A more proactive approach to address the outstanding stock of NPLs would be beneficial. The stock of NPLs in the nonfinancial sector has appeared sticky at only ½ percentage point below the 9 percent peak in January 2011. To prevent NPLs from potentially constraining credit expansion, and ultimately economic growth, tax disincentives (in the form of constraints on the deductibility of loan losses and debt relief) and legal obstacles (related to insolvency procedures) to address impaired loans should be removed.

33. Staff strongly encouraged the authorities to complete the macroprudential and bank resolution frameworks. Legislation to create the Systemic Risk Board (SRB) involving an independent body with responsibility for systemic risk identification and analysis and with powers to issue directives and recommendations regarding the use of tools continue to be delayed. Staff urged the authorities to move ahead with the legislation as establishment of the SRB is essential for macroprudential supervision. Separately, staff welcomed continued work to overhaul the bank

resolution framework but noted that a concerted effort is needed to overcome the protracted delays in final legislation.

Authorities' views

34. The authorities broadly agreed with the missions recommendations. They highlighted the continued resilience of the financial system as one of Poland's key strengths. Work to restructure the credit union segment was ongoing. The legislation to create the SRB was advancing, but the legislation to overhaul the bank resolution framework was being modified to make it consistent with the recently issued EU Bank Recovery and Resolution Directive. On NPLs, the authorities were less concerned than staff, citing the recent pick-up in credit growth and strong bank profitability. They also noted that, in practice, the tax authorities allowed for more significant deductions of loan losses and debt relief than that which would appear based on a strict reading of the statutes.

D. Deepening Structural Reforms

35. Structural reforms are crucial to ensure sustained long-term growth. Since 2007, Poland has achieved faster convergence with Western Europe than other EU new member states but its distance to advanced economies remains large. Additional structural reforms should unleash potential growth, crucial to avoiding a middle-income trap and fostering continued income convergence. For example: (i) labor market reforms would help increase the participation rate, which is below that in many regional peers, and reduce labor market segmentation, which is significantly higher than the EU average; and (ii) improvements in the business climate would help boost investment (Figure 10).

36. Staff welcomed efforts to improve the functioning of the labor market and strengthen the business climate. The authorities continued liberalizing access to regulated professions—so far benefitting about 250 professions—and parliament passed legislation to improve the efficiency of public employment services (for example, by providing funding to facilitate labor mobility). A draft law—approved by the government—aims at reducing labor market segmentation by increasing the coverage of social contributions, and work on capping the duration of temporary work contracts is underway. Some administrative requirements were eased to help support new business start-ups. Privatization has slowed considerably, with signals from the authorities that ownership transformation is coming to an end. Additional privatization revenues will be directed to capitalize the recently established state-owned investment vehicle to support infrastructure investments.

37. To further support employment and boost potential growth, staff urged the authorities to continue the reform process:

- **Labor market.** Further actions to reduce labor market segmentation are warranted, including by tightening rules on temporary contracts and making regular contracts more flexible. The plan to further open access to regulated professions is welcome, and could also help boost labor market participation.

- **Business environment.** Despite substantial improvements, additional steps are needed to reduce unwarranted administrative burdens to facilitate entry and exit of firms and boost investment. The business climate could be further strengthened through lower costs of contract enforcement, improvements in the insolvency regime to promote rehabilitation of viable companies, and simplified zoning and construction regulations.
- **Privatization and corporate governance.** While the authorities suggested that privatization is near completion, they continue to hold stakes in more than 200 active companies. To this end, there is scope to reduce public ownership in firms that operate in competitive sectors and to ensure strong corporate governance standards in firms that will remain public.

38. Euro adoption remains an important long-term objective. The authorities continue to make progress toward fulfilling all entry criteria, not least with the fiscal deficit anticipated to be reduced below 3 percent of GDP in 2015. However, no target date for euro adoption has been announced.

Authorities' views

39. The authorities highlighted recent advances in their structural reforms agenda. They pointed to measures undertaken to improve the functioning of the labor market, including by deregulating professions, reforming public employment services to enhance their efficiency, and introducing new instruments to boost labor activity in vulnerable groups such as the youth. The planned reform agenda includes revising insolvency regulations to promote restructuring of firms instead of liquidation, streamlining construction and zoning regulations, and continued efforts to reduce red tape. To ensure successful euro adoption, the authorities expressed a preference for the additional buildup of economic buffers, including through greater labor market flexibility and further reductions in public debt.

STAFF APPRAISAL

40. On the back of Poland's very strong fundamentals and policies, growth has started to gain traction. Fiscal automatic stabilizers were allowed to operate and monetary policy was substantially eased, which helped support the growth pick-up during the second half of 2013. At the same time, strong fundamentals, combined with the insurance provided by the FCL arrangement with the IMF, helped Poland weather bouts of financial market turmoil.

41. Growth is set to strengthen further, though risks remain tilted to the downside. Economic activity is expected to continue to gather pace, led by domestic demand. External risks are firmly on the downside. A protracted period of slow growth in Europe, a sharp increase in geopolitical tensions surrounding Russia and Ukraine, or side effects from global financial conditions pose the main risks. Domestically, risks arise from a protracted period of low inflation.

42. Monetary policy has appropriately supported the economy, but rate cuts would be needed if the recovery falters or inflation fails to pick up. Monetary policy is at a challenging juncture: inflation is very low (partly reflecting external factors) but the recovery is continuing, monetary conditions appear supportive, and credit growth is rising. The MPC should stand ready to reduce rates if the recovery falters or projections indicate that inflation would remain well below target for a protracted period. Although international reserves remain broadly adequate, moderate reserve accumulation would be prudent in light of downside external risks and in order to prepare for an eventual exit from the FCL arrangement.

43. The structural fiscal consolidation planned this year is appropriate at this stage of the economic cycle. The fiscal deficit is projected to drop by 1 percentage point to 3.3 percent of GDP on account of modest consolidation measures, the effects of pension changes, and a cyclical recovery in tax revenue. Reflecting the authorities' sound public debt management strategy, financing is comfortable with over three-quarters of government financing needs for 2014 already covered.

44. The ongoing pension changes are expected to improve the fiscal aggregates but may heighten long-term fiscal risks. The changes to the pension system—which entail a downsizing of the second pillar—are estimated to deliver an improvement in the fiscal accounts of around 30 percent of GDP in net present value terms during 2014–60. However, liquidity in the government bond and equity markets could be adversely affected by the reduced presence of the pension funds, risk diversification will decline, and gross implicit pension liabilities will rise. Importantly, legacy flaws in the pension system continue to present long-term fiscal risks, and the sharp drop in future replacement rates raises risks of old-age poverty. Measures to address these risks—including better aligning the indexation mechanism of the notional pension accounts with wage and growth outcomes, addressing imbalances in the special occupational pension schemes, and examining policies to help boost voluntary private savings—will be essential going forward.

45. Over the medium term, additional fiscal consolidation is needed to put public debt on a stronger downward path. As the economy recovers, additional measures of ½ percent of GDP per year would be needed in 2015–16 to reach the authorities' MTO of a structural deficit of 1 percent of GDP. While the permanent expenditure rule should provide an anchor, strict enforcement of the rule will be important. In this regard, the recent lowering of the public debt thresholds contained in the fiscal rule is welcome.

46. The banking system has remained resilient with work to further strengthen supervision helping to contain risks. The banking system has remained well-capitalized, liquid, and able to withstand severe macroeconomic shocks. Nonetheless, addressing the elevated stock of legacy NPLs by tackling tax and legal obstacles remain essential to prevent them from unduly constraining credit growth. Final legislation to put in place the macroprudential and bank resolution frameworks should be advanced quickly.

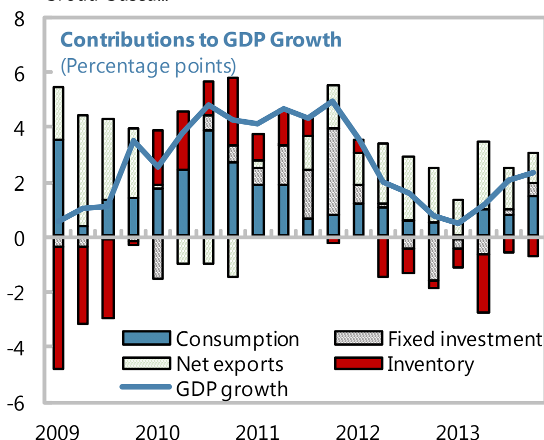
47. Recent efforts to improve the business climate and labor market are welcome, but further reforms are crucial to ensure sustained long-term growth. Progress in opening access

to regulated professions and steps to improve the business climate are welcome, but additional reforms would help further boost long-term growth. Further steps to reduce labor market segmentation, including by tightening rules on temporary contracts and making regular contracts more flexible, and ease access to regulated professions are warranted. The business climate would benefit from finalizing work on the new insolvency regime to promote rehabilitation of viable debtors and further reducing administrative barriers. Ensuring strong corporate governance standards in firms that will remain public will also be important.

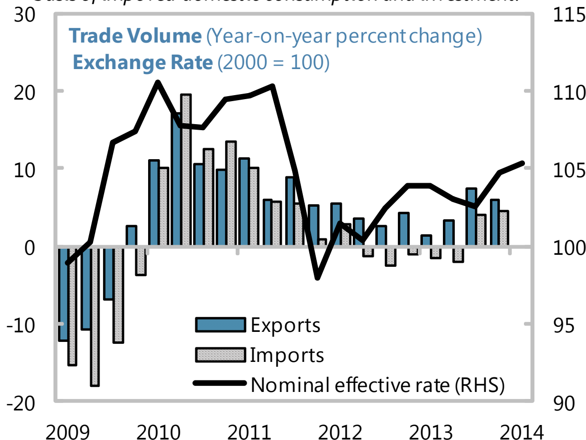
48. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

Figure 1. Republic of Poland: Recent Economic Developments, 2009–14

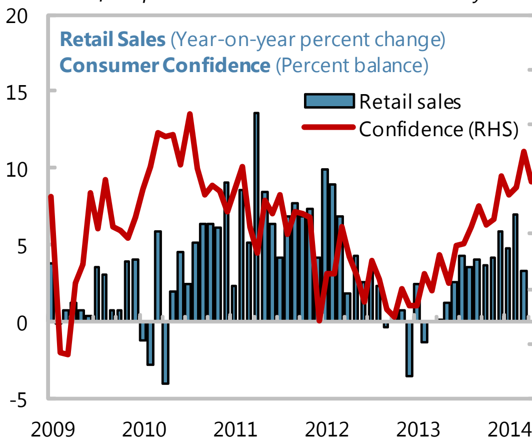
The acceleration in GDP growth in the fourth quarter was broad-based...



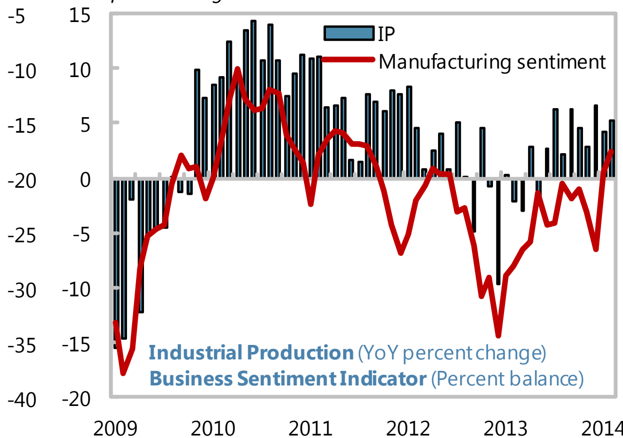
...amid resilient export growth. Imports accelerated on the basis of impoved domestic consumption and investment.



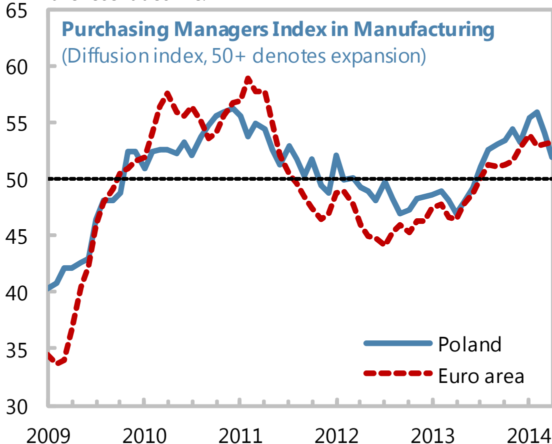
Retail sales and consumer confidence which were strong in the first quarter seem to have stabilized recently.



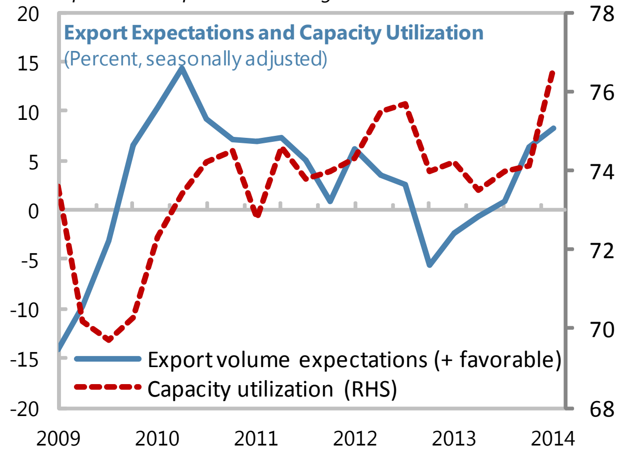
Improving business sentiment has encouraged industrial production growth...



..as PMI is well rooted in expansionary territory despite the recent decline.



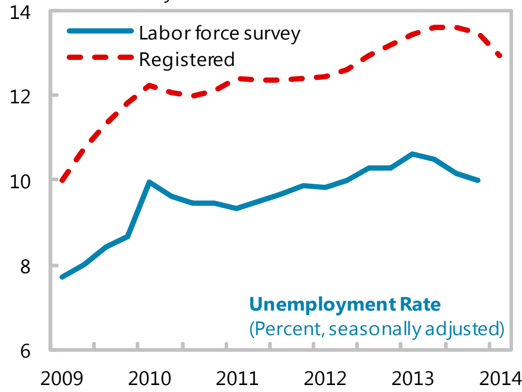
Capacity utilization expanded in the first quarter and export order expectations strengthened.



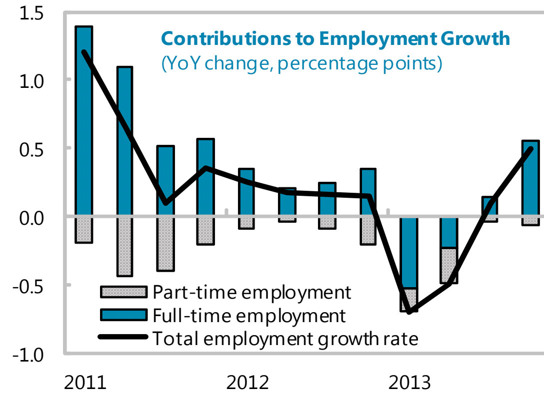
Sources: Haver, Central Statistical Office, and IMF staff calculations.

Figure 2. Republic of Poland: Labor Market, 2009–14

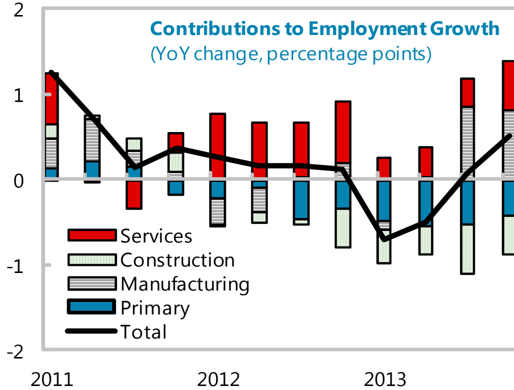
The unemployment rate remains high but has started to decline recently...



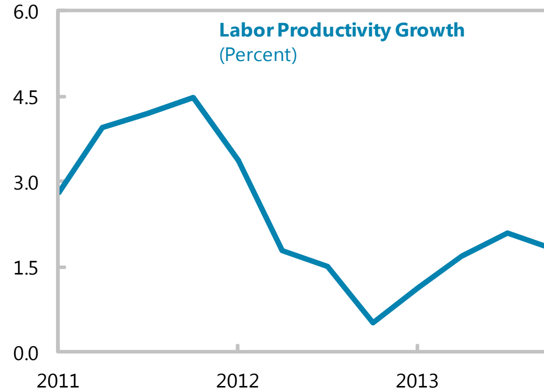
...along with improvement in full-time employment.



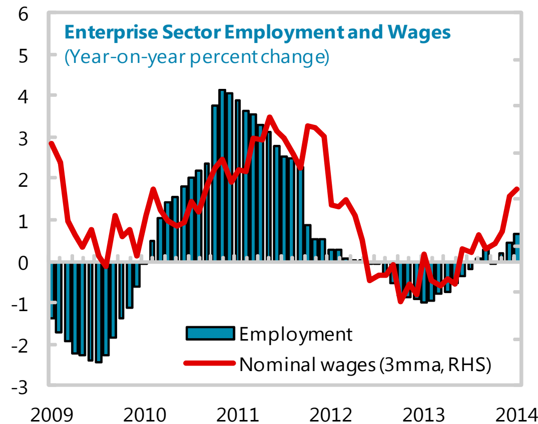
Manufacturing employment picked up recently...



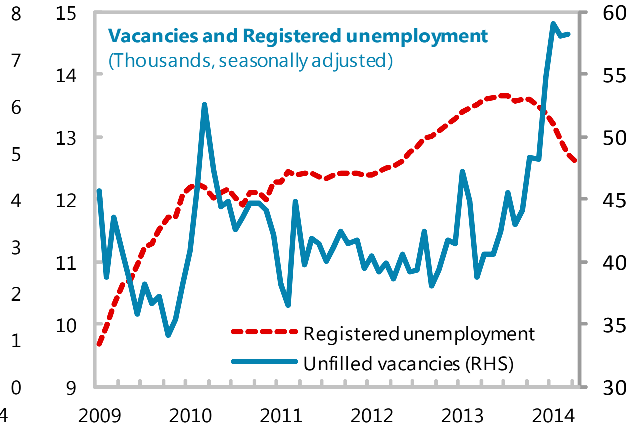
... along with steady labor productivity.



In the enterprise sector, wages have accelerated as job creation is turning positive.



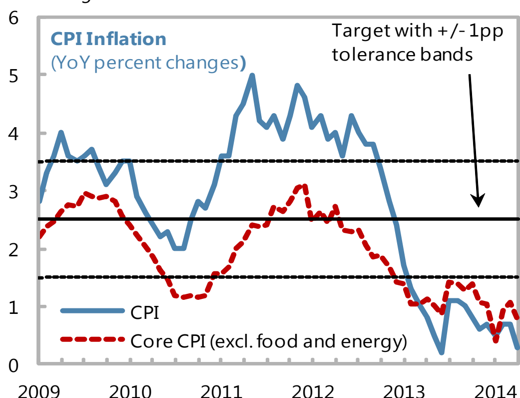
Unfilled vacancies have increased recently, consistent with favorable cyclical dynamics in the labor market.



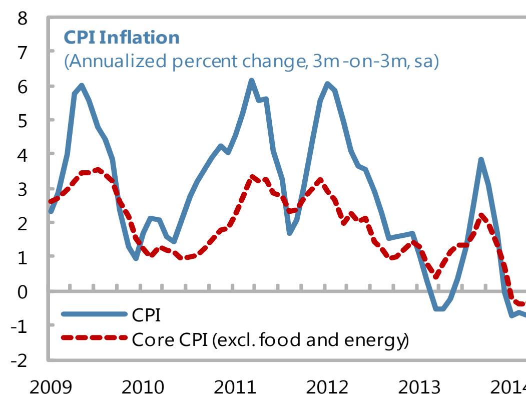
Sources: Haver Analytics, Poland Statistics Office, and IMF staff calculations.

Figure 3. Republic of Poland: Inflation, 2005–15

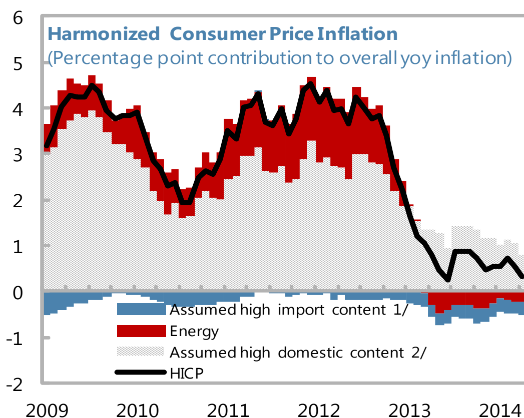
Headline and core inflation are well below the target...



...as headline momentum has yet to appear.

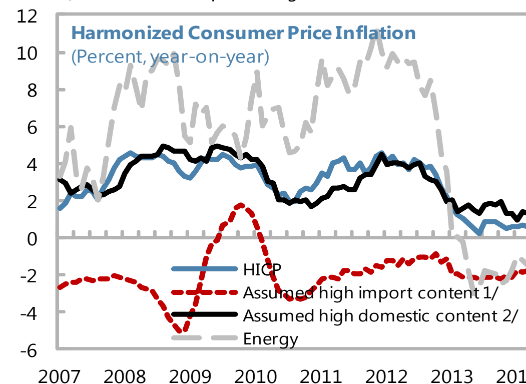


However, external factors are important in explaining the low rate of inflation...



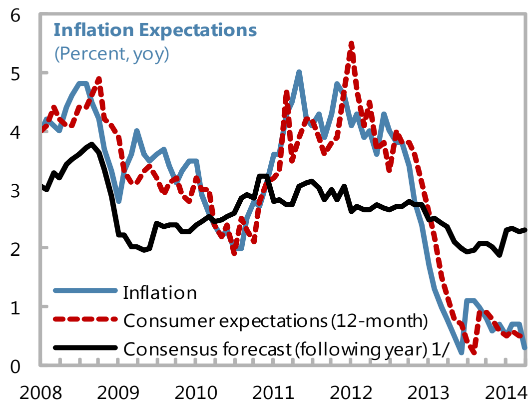
1/ Non-energy durable and semi-durable industrial goods.
2/ Nondurable goods, food, alcohol, tobacco, and services.

...as energy prices are particularly week. Meanwhile, services inflation has held up to a larger extent.



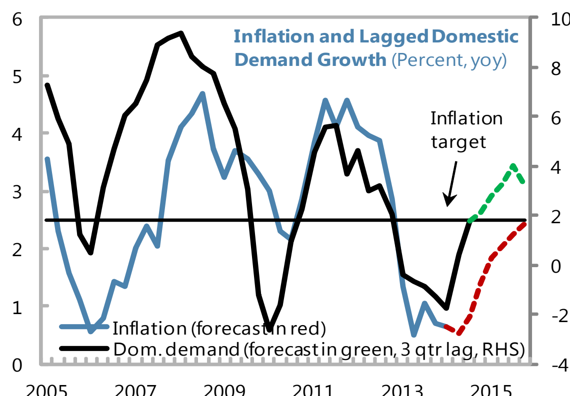
Sources: Eurostat, Haver Analytics, Statistics Poland, and Fund staff calculations. 1/ Non-energy durable industrial goods inflation. 2/ Services inflation.

While consumer expectations are highly adaptive, expectations of professional forecasters remain well anchored.



1/ Averaged forecasts from Capital Economics, Citigroup, EIU, Goldman Sachs, IHS Global Insight, and UBS.

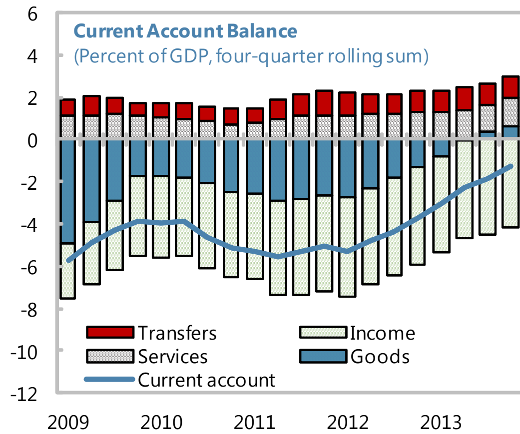
Overall, inflation is expected to pick up along with domestic demand growth.



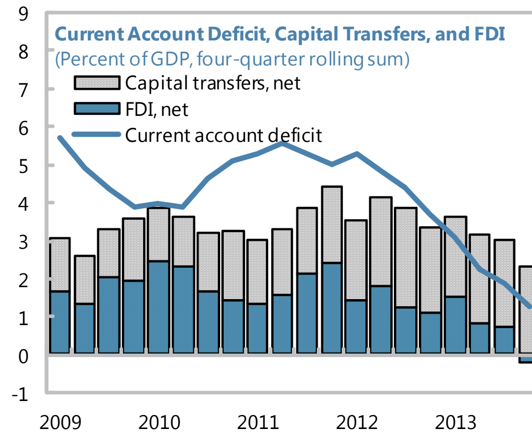
Sources: Bloomberg, Datastream, Haver Analytics, JP Morgan, NBP, Reuters, Statistics Poland, and IMF staff calculations.

Figure 4. Republic of Poland: Balance of Payments, 2009–14

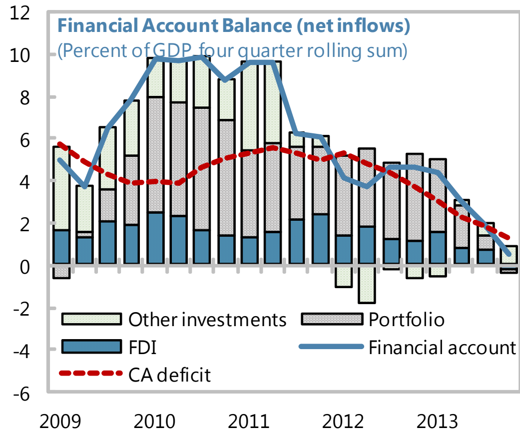
The current account deficit continues to narrow...



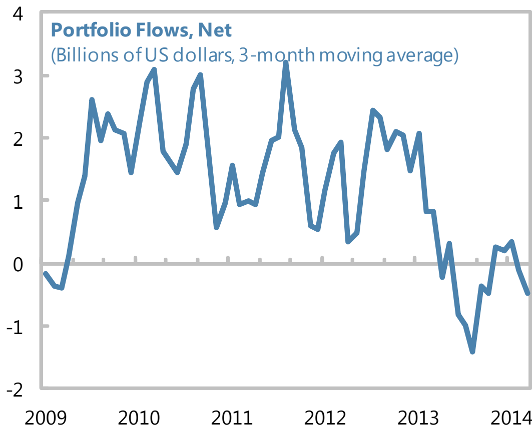
...and is mostly financed by EU transfers.



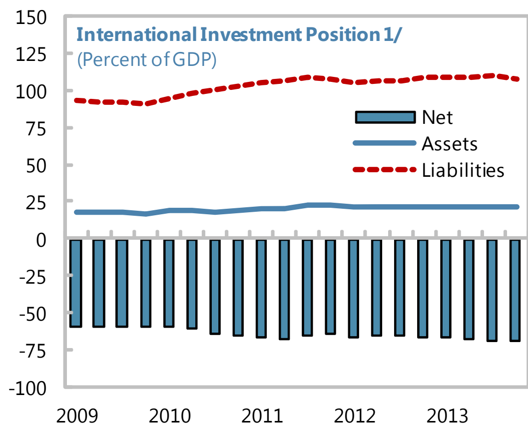
However, financial inflows have weakened...



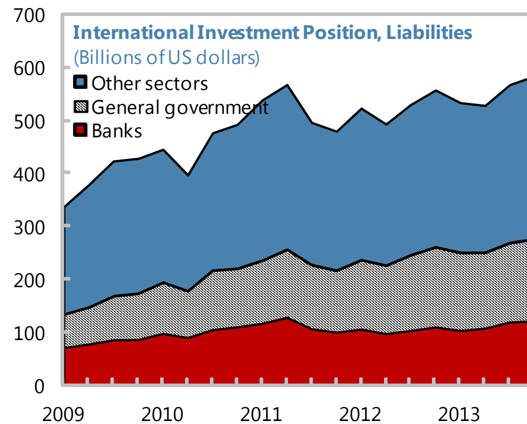
...with net portfolio outflows recently.



The IIP has stabilized,...



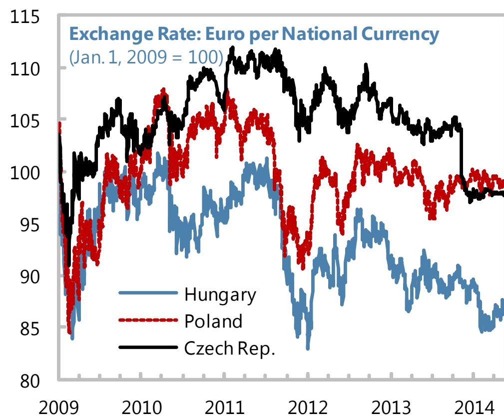
...reflecting a levelling off in liabilities across all sectors.



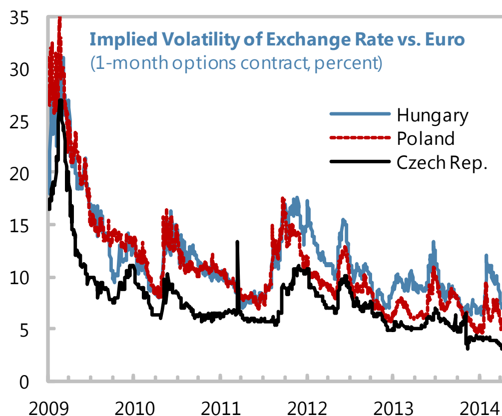
Sources: National Bank of Poland and IMF staff calculations.
1/ Excludes NBP.

Figure 5. Republic of Poland: Financial Markets, 2007–14

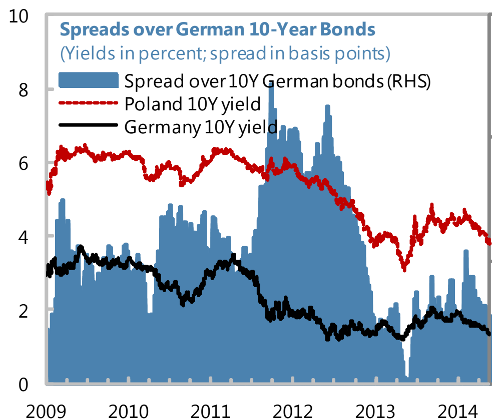
The zloty has remained relatively stable despite recent turbulence in emerging economies...



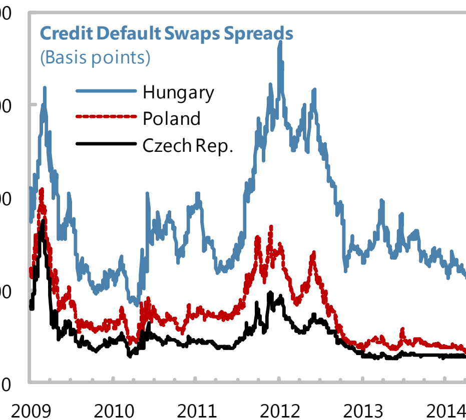
...and implied volatility has remained within recent historical patterns.



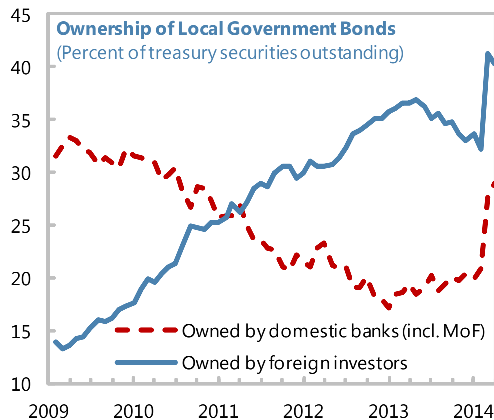
Spreads over German yields have again declined...



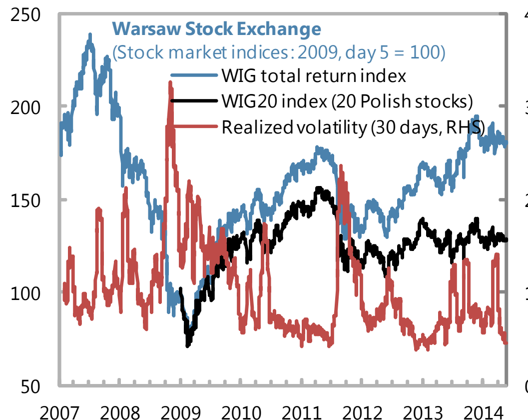
...and CDS spreads remain narrow at below 100 basis points.



Foreign investors reduced their exposure but the share recently increased due to the pension changes.



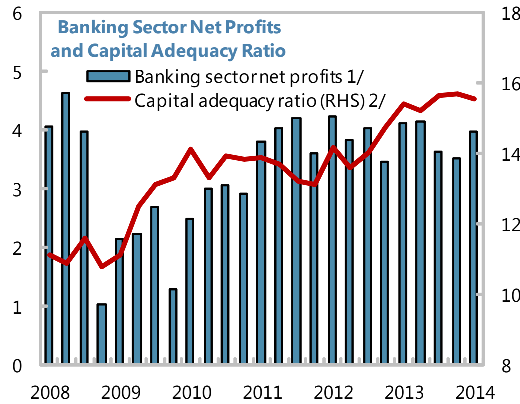
Meanwhile, the stock market has held up well, despite bouts of volatility.



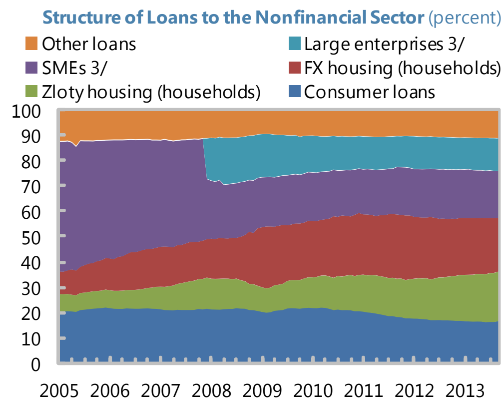
Sources: Bloomberg, Haver Analytics, Polish Ministry of Finance, and IMF staff calculations.

Figure 6. Republic of Poland: Banking Sector Capital and Asset Quality, 2005–14

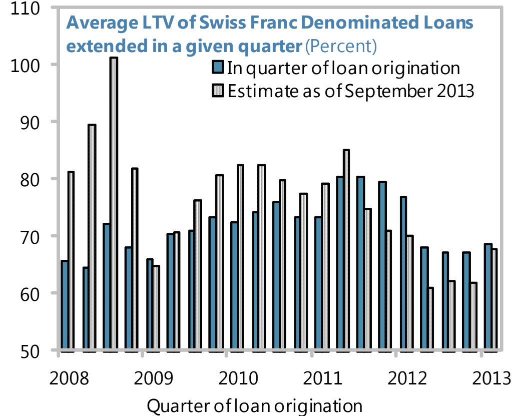
Bank profits have remained stable, capital adequacy has stayed high,...



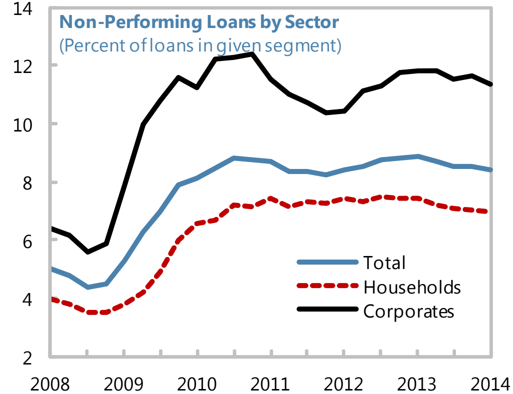
...but FX mortgages continue to account for a large share of loans...



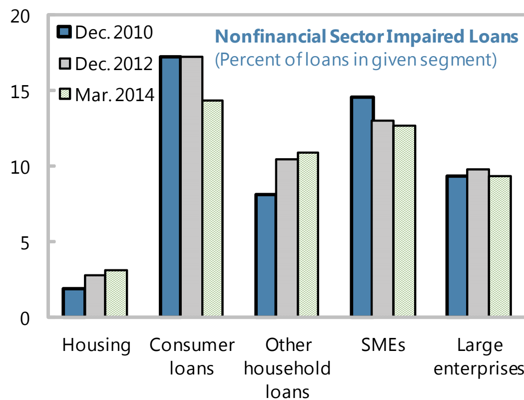
...and LTVs of Swiss franc-denominated mortgages, issued in particularly in 2008, have risen.



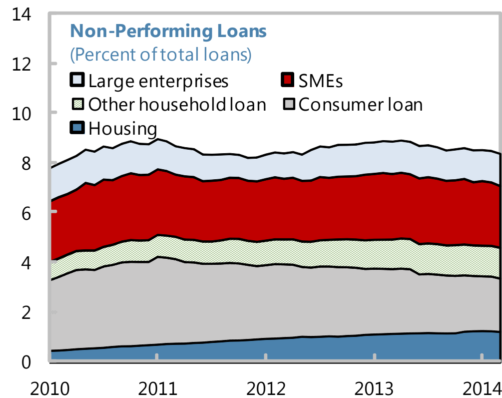
Nonetheless, the quality of loans has started to improve,...



...though SME and consumer loans continue to display high prevalence of impaired loans,...

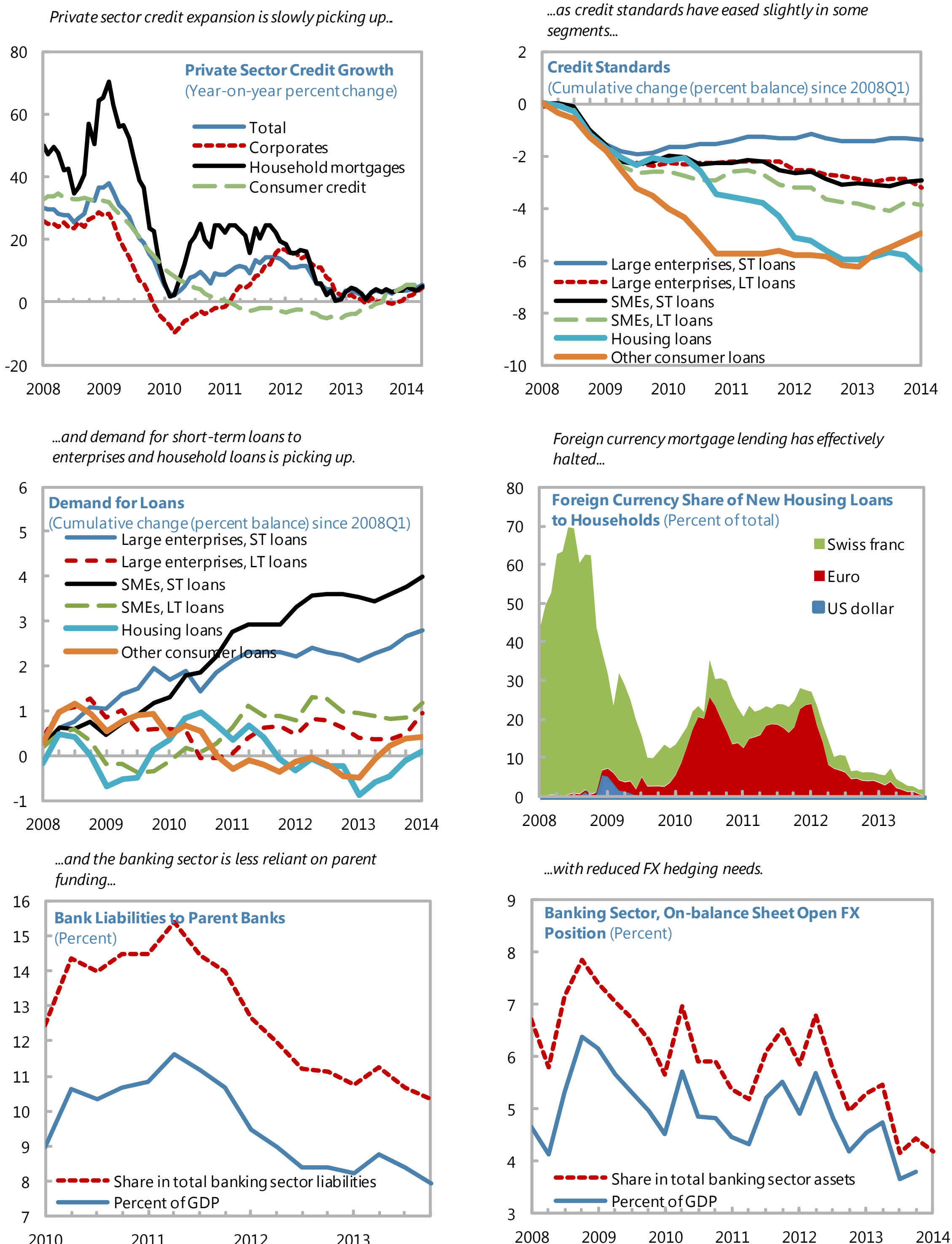


...accounting for more than 50 percent of impaired loans.



Sources: KNF, NBP, and IMF staff calculations.
1/ Billion zloty. 2/ Percent. 3/ No breakdown to distinguish SMEs and large enterprises prior to December 2007.

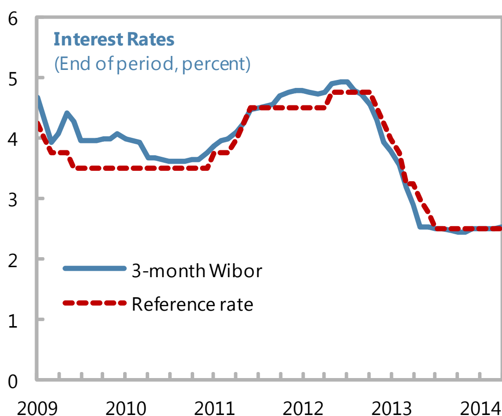
Figure 7. Republic of Poland: Bank Credit Growth and Funding, 2008–14



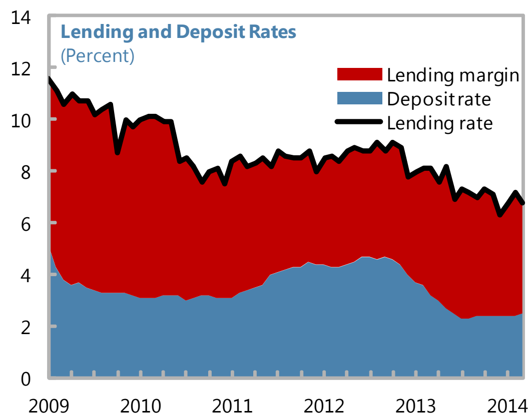
Sources: Haver Analytics, NBP, KNF, and IMF staff calculations.

Figure 8. Republic of Poland: Monetary Policy, 2007–14

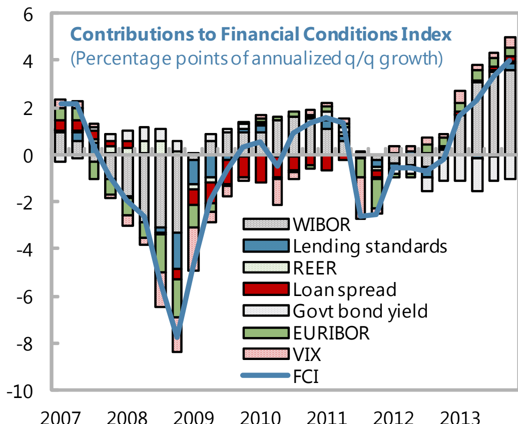
The monetary easing cycle has fully transmitted to the key interbank rate,...



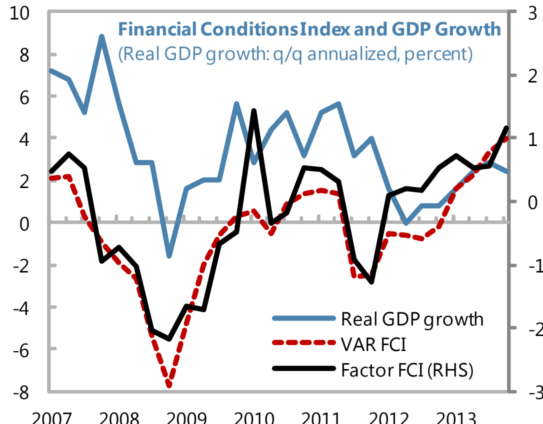
...helping lending rates to decline,...



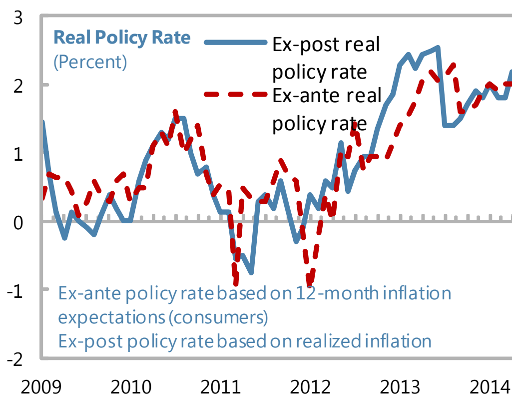
...easing financial conditions,...



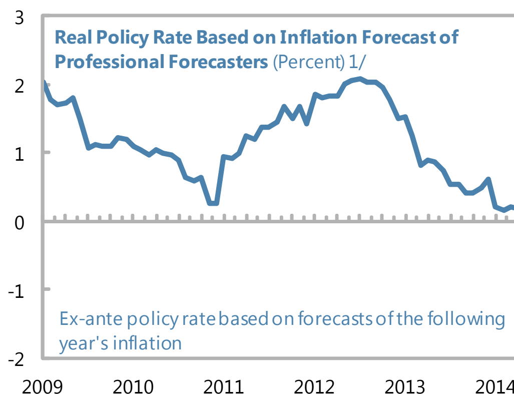
...and in turn contributing to real sector growth.



While consumer inflation expectations point to elevated real rates,...



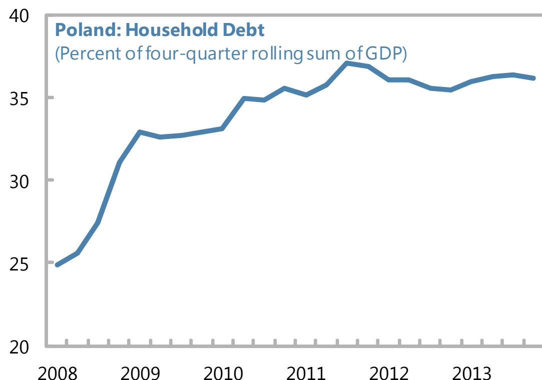
...real rates are close to zero when professional consensus inflation forecasts are taken into account.



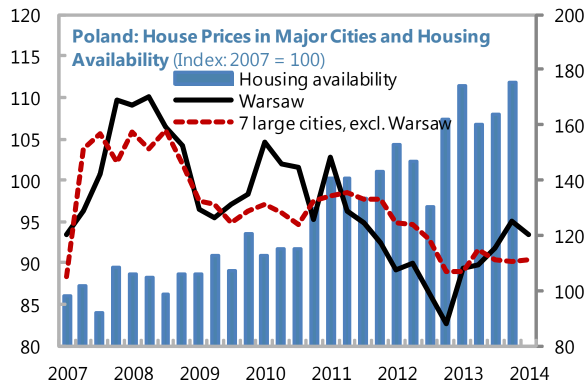
Sources: Bloomberg, Consensus Economics, Datastream, Haver Analytics, JP Morgan, NBP, Reuters, Statistics Poland, and IMF staff calculations. 1/ Based on averaged inflation forecasts from Capital Economics, Citigroup, EIU, Goldman Sachs, IHS Global Insight, and UBS.

Figure 9. Republic of Poland and Selected Countries: Assessing Imbalances, 2007–14

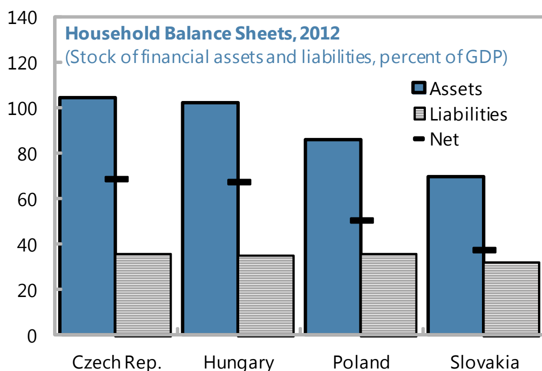
Household debt is moderate,...



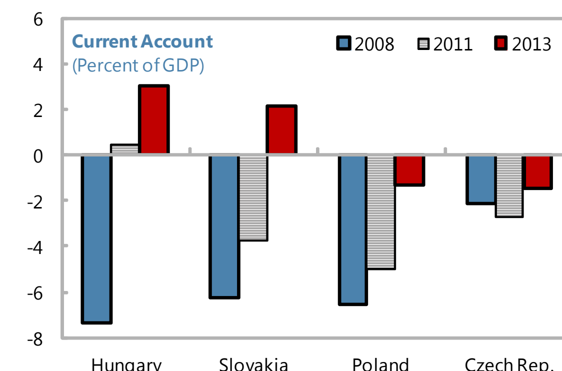
...and while house prices have suffered a significant decline,...



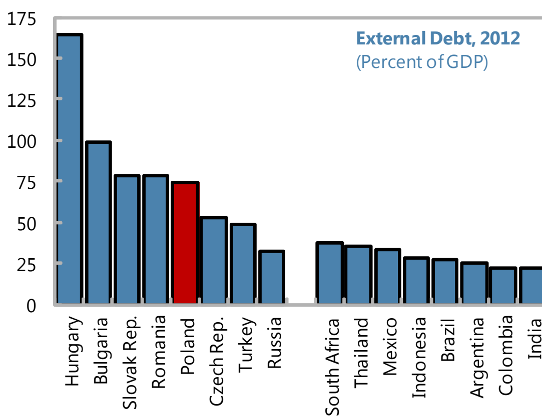
...household balance sheets have remained strong.



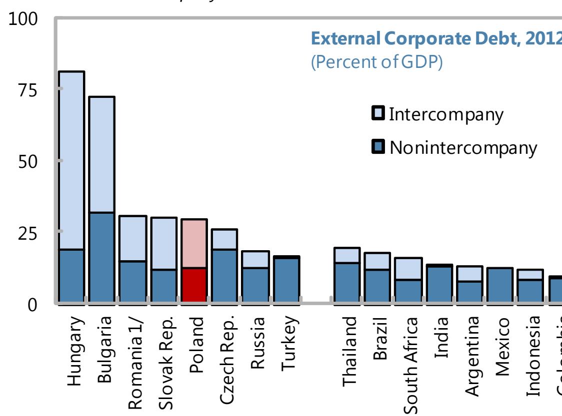
The current account deficit has declined markedly...



...but external debt is high.



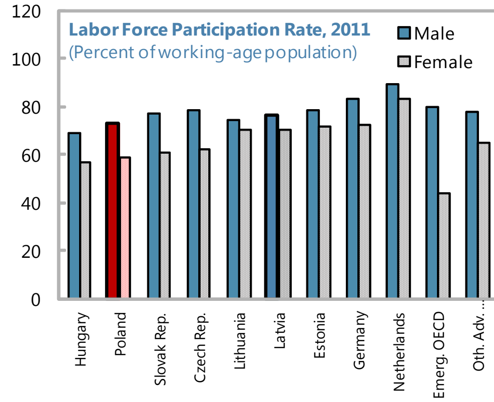
However, more than half of external corporate debt is associated with intercompany debt.



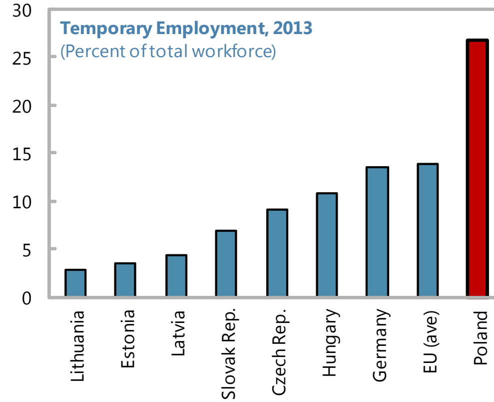
Source: Eurostat, International Financial Statistics, NBP, and IMF staff calculations.
1/ 2011.

Figure 10. Republic of Poland and Selected Countries: Structural Labor Market Indicators, 2004–14

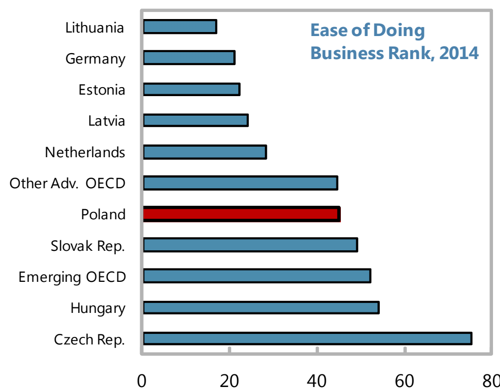
Labor force participation is below that in many advanced economies,...



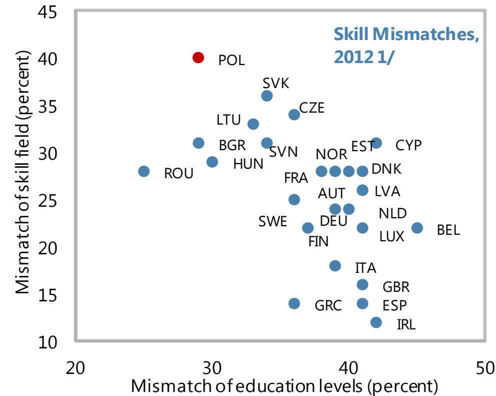
...and the extent of temporary employment is high.



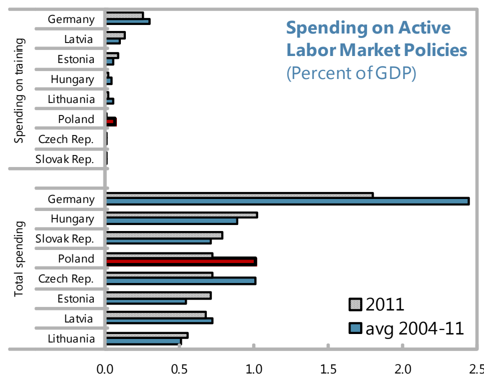
There is room for improvement in the business climate...



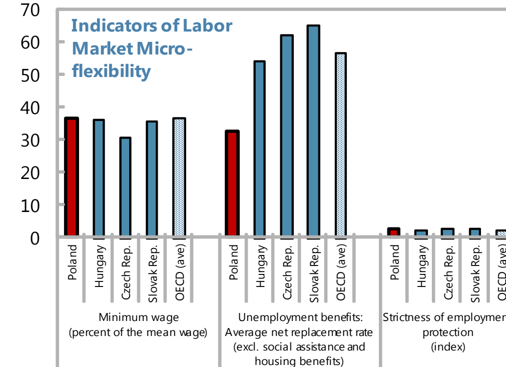
...and mismatch of skill field is high.



Spending on active labor market policies is on par with that in other emerging European countries...



...as is labor market flexibility.



Sources: World Develpment Indicators; Eurostat; World Bank Doing Business Report; SEO Economic Research and Randstad; and OECD Statistics.

1/ Note: Each axis shows the share of workers facing that type of skill mismatches. Mismatch of education levels happens when the education level of a worker (e.g. high school) does not match the job requirements (e.g. university). Mismatch of skill field happens when the worker's field of education (e.g. engineering) does not match the job requirements (e.g. medicine).

Table 1. Republic of Poland: Selected Economic Indicators, 2011–19

	2011	2012	2013	2014	2015	2016	2017	2018	2019
				Projections					
Activity and prices									
GDP (change in percent) 1/	4.5	2.0	1.6	3.3	3.5	3.5	3.6	3.6	3.6
Domestic demand	3.6	0.0	-0.1	3.1	3.4	3.7	3.7	3.7	3.7
Private consumption growth	2.6	1.3	0.8	2.7	3.0	3.2	3.3	3.4	3.5
Public consumption growth	-1.7	0.2	2.8	2.7	2.4	3.0	3.5	3.5	3.0
Domestic fixed investment growth	8.5	-1.6	-0.2	3.9	5.0	5.5	4.8	4.6	4.6
Inventories (contribution to growth)	0.7	-0.5	-1.0	0.2	0.1	0.0	0.0	0.0	0.0
Net external demand (contribution to growth)	0.8	1.9	1.7	0.2	0.1	-0.1	0.0	0.0	0.0
Output gap	0.8	-0.3	-1.3	-0.5	-0.1	0.0	0.0	0.0	0.0
CPI inflation (percent)									
Average	4.3	3.7	0.9	0.9	2.1	2.5	2.5	2.5	2.5
End of period	4.6	2.4	0.7	1.6	2.5	2.5	2.5	2.5	2.5
Unemployment rate (average, according to LFS)	9.6	10.1	10.3	9.8	9.6	9.5	9.3	9.3	9.2
Public finances (percent of GDP) 2/									
General government revenues	38.4	38.3	37.5	38.1	38.4	38.6	38.3	38.4	38.4
General government expenditures	43.4	42.2	41.9	41.3	40.9	40.7	40.7	40.6	40.6
General government balance	-5.0	-3.9	-4.3	-3.3	-2.5	-2.1	-2.4	-2.3	-2.2
Public debt	56.2	55.6	57.1	49.3	49.1	48.8	47.7	46.7	45.5
National definition 3/	53.4	52.6	53.8	...	...	...	...	...	...
Money and credit									
Private credit (change in percent, end-period)	13.9	2.4	4.5	6.8	8.0	...	...	...	...
Broad money (change in percent, end-period)	12.5	4.5	6.2	7.1	8.0	...	...	...	...
Policy Rate (percent) 4/	4.2	4.6	2.9	2.5	...	...	...	...	...
Balance of payments									
Current account balance (transactions, billion U.S. dollars)	-25.8	-18.3	-6.6	-11.7	-14.7	-18.1	-21.9	-24.8	-26.6
Percent of GDP	-5.0	-3.7	-1.3	-2.1	-2.5	-2.9	-3.3	-3.6	-3.6
Exports of Goods (billion U.S. dollars)	195.2	190.8	207.2	217.9	229.5	246.1	264.0	282.7	303.7
Export volume growth	7.7	3.9	4.6	7.2	7.6	6.7	6.7	6.6	6.7
Imports of Goods (billion U.S. dollars)	209.2	197.5	204.2	216.9	230.2	248.2	266.2	284.2	304.6
Import volume growth	5.5	-0.7	1.2	6.3	7.8	7.3	7.2	7.1	7.0
Net oil imports (billion U.S. dollars)	22.8	23.5	23.6	24.4	23.7	23.4	23.4	23.7	24.2
Terms of trade (index 1995=100)	96.2	94.7	94.9	93.1	92.6	92.6	93.0	93.7	94.2
FDI, net (in percent of GDP)	2.4	1.1	-0.2	1.3	1.4	1.4	1.5	1.5	1.5
Official reserves (billion U.S. dollars)	97.9	108.9	106.2	112.2	117.5	126.4	132.7	136.2	139.9
In percent of short-term debt plus CA deficit	79.7	87.0	90.3	104.2	102.0	104.5	105.4	105.0	106.2
Total external debt (billion U.S. dollars)	320.6	364.2	379.3	386.1	392.9	405.7	417.2	428.7	440.7
In percent of GDP	62.2	74.3	73.3	70.5	67.5	65.6	63.5	61.5	59.7
Exchange rate									
Exchange rate regime				Floating					
Zloty per USD, period average 5/	3.0	3.3	3.2	3.1	...	...	...	...	...
Zloty per Euro, period average 5/	4.1	4.2	4.2	4.2	...	...	...	...	...
Real effective exchange rate (INS, CPI based) 6/	110.4	107.6	109.5	...	...	...	...	...	...
Appreciation (percent change)	-1.5	-2.6	1.6	...	...	...	...	...	...
Memorandum item:									
Nominal GDP (billion zloty)	1528.1	1596.4	1635.7	1709.0	1805.4	1912.1	2025.7	2146.1	2273.0

Sources: Polish authorities and IMF staff calculations.

1/ Real GDP is calculated at constant average prices of previous year.

2/ According to ESA2010.

3/ Excluding debts of the National Road Fund.

4/ NBP Reference Rate (avg). For 2014, as of May 20.

5/ For 2014, exchange rate as of May 20.

6/ Annual average (2000=100).

Table 2. Republic of Poland: Balance of Payments on Transaction Basis, 2011–19

(Millions of US dollars, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016	2017	2018	2019
				Projections					
Current account balance	**-25,770**	**-18,263**	**-6,636**	**-11,724**	**-14,680**	**-18,057**	**-21,897**	**-24,796**	**-26,610**
percent of GDP	-5.0	-3.7	-1.3	-2.1	-2.5	-2.9	-3.3	-3.6	-3.6
Trade balance	-14,042	-6,698	3,042	1,076	-775	-2,104	-2,212	-1,442	-873
percent of GDP	-2.7	-1.4	0.6	0.2	-0.1	-0.3	-0.3	-0.2	-0.1
Services balance	5,668	5,966	6,972	6,487	6,520	6,786	7,286	7,954	8,655
percent of GDP	1.1	1.2	1.3	1.2	1.1	1.1	1.1	1.1	1.2
Exports of goods and services									
percentage change in unit values	16.0	1.3	4.1	5.2	5.3	7.2	7.3	7.1	7.4
percentage volume growth	9.6	3.9	4.6	7.2	7.6	6.7	6.7	6.6	6.7
growth in foreign demand	8.2	0.5	1.2	4.0	4.4	5.0	5.4	5.4	5.3
Imports of goods and services									
percentage change in unit values	15.7	-1.7	0.7	6.2	6.2	7.8	7.2	6.8	7.2
percentage volume growth	7.7	-0.7	1.2	6.3	7.8	7.3	7.2	7.1	7.0
growth in domestic demand	3.6	0.0	-0.1	3.1	3.4	3.7	3.7	3.7	3.7
Terms of trade (percentage change)	-1.6	-1.5	0.2	-1.8	-0.6	0.0	0.4	0.7	0.6
Net Income	-23,555	-22,670	-21,713	-23,772	-26,924	-29,400	-31,019	-34,629	-36,988
Net transfers	6,159	5,139	5,063	4,485	6,500	6,661	4,048	3,321	2,595
o/w EU receipts	8,397	8,525	8,519	9,289	10,421	8,293	6,989	5,635	4,240
o/w payment to EU	-5,004	-4,890	-5,744	-5,790	-6,213	-6,559	-6,661	-6,755	-6,849
Capital and financial account balance	**41,971**	**33,531**	**15,029**	**23,136**	**25,829**	**33,190**	**34,773**	**35,205**	**37,702**
Capital account balance	10,017	10,957	12,236	15,187	16,104	15,943	15,784	15,626	15,470
o/w net EU transfers	8,890	8,804	12,386	14,618	15,499	14,598	14,825	15,035	15,243
Financial account balance	31,954	22,574	2,793	7,949	9,724	17,247	18,989	19,579	22,232
Foreign direct investment (net)	12,410	5,313	-1,259	6,949	8,410	8,778	10,114	10,154	11,258
by nonresidents	20,653	6,068	-6,144	10,549	13,324	14,453	18,066	19,872	21,860
o/w privatization	2,339	2,581	2,581	2,581	2,581	2,581	2,581	2,581	2,581
Portfolio investment (net)	16,744	20,311	-515	7,500	4,314	9,469	8,875	8,925	8,975
by non-residents	15,875	20,747	2,202	10,477	7,344	13,244	12,000	12,000	12,001
o/w equities	3,079	3,888	2,343	5,182	2,000	2,000	2,000	2,000	2,000
Other investment (net)	2,983	-5,924	4,048	-6,500	-3,000	-1,000	0	500	2,000
Assets	-3,594	-1,965	628	-8,000	-4,500	-2,500	-1,500	-1,000	0
Liabilities	6,577	-3,959	3,420	1,500	1,500	1,500	1,500	1,500	2,000
Financial derivatives	-183	2,874	519	0	0	0	0	0	0
Errors and omissions	-9,918	-4,067	-7,183	-5,476	-5,821	-6,185	-6,568	-6,965	-7,382
Overall balance	6,283	11,201	1,210	5,936	5,328	8,948	6,308	3,444	3,710
Financing									
Reserve assets	-6,283	-11,201	-1,210	-5,936	-5,328	-8,948	-6,308	-3,444	-3,710
Memorandum items:									
Current plus capital account (percent of GDP)	-3.1	-1.5	1.1	0.6	0.2	-0.3	-0.9	-1.3	-1.5
Official reserves	97,866	108,914	106,220	112,155	117,484	126,432	132,740	136,184	139,894
in months of imports	5.6	6.6	6.2	6.2	6.1	6.1	6.0	5.8	5.5
Ratio of reserves to short-term debt 1/	93.6	91.9	100.3	120.7	121.0	127.6	131.3	132.1	133.1
Ratio of reserves to ST debt plus CA deficit 1/	79.7	87.0	90.3	104.2	102.0	104.5	105.4	105.0	106.2
Ratio of reserves to IMF ARA metric 2/	127.4	132.1	126.7	…	…	…	…	…	…
Total external debt (percent of GDP)	62.2	74.3	73.3	70.5	67.5	65.6	63.5	61.5	59.7
Total external debt (percent of exports) 3/	137.8	159.2	153.3	148.7	143.7	138.3	132.6	127.2	121.8
External debt service (percent of exports) 3/ 4/	43.2	48.7	51.4	41.7	36.9	36.5	35.6	34.7	33.5
Gross FDI inflows (percent of GDP)	4.0	1.2	-1.2	1.9	2.3	2.3	2.8	2.9	3.0
Net FDI inflows (percent of GDP)	2.4	1.1	-0.2	1.3	1.4	1.4	1.5	1.5	1.5

Sources: National Bank of Poland and IMF staff calculations.

1/ Projected reserve level for the year over short-term debt by remaining maturity (in percent).

2/ The IMF ARA metric is the sum of 30 percent short-term debt at remaining maturities, 10 percent of other liabilities, 5 percent of broad money, and 10 percent of exports for countries with floating rate currencies (in percent). Suggested adequacy range: 100–150.

3/ Exports of goods and services.

4/ Excluding repurchase of debt and including deposits.

Table 3. Republic of Poland: Financial Soundness Indicators, 2007–14

	2007	2008	2009	2010	2011	2012	2013	2014Q1
Capital adequacy 1/								
Regulatory capital to risk-weighted assets	12.0	11.1	13.3	13.9	13.1	14.8	15.7	15.6
Regulatory Tier I capital to risk-weighted assets	11.8	10.0	12.0	12.5	11.7	13.1	14.2	14.1
NPLs net of provisions to capital	11.4	8.3	13.8	11.5	11.6	12.9	12.2	11.6
Bank capital to assets	8.0	7.5	8.1	8.2	7.8	8.7	9.1	9.0
Asset composition and quality								
NPLs to gross loans (non-financial sector)	5.2	4.4	7.9	8.8	8.2	8.8	8.6	8.4
Sectoral distribution of loans to non-financial setor								
Loans to households	59.3	62.0	65.3	68.0	66.4	65.7	66.1	65.7
Loans to non-financial corporations	40.3	37.6	34.3	31.5	33.1	33.7	33.2	33.7
Earnings and profitability								
Return on average assets (after tax)	1.7	1.5	0.8	1.0	1.3	1.2	1.1	1.1
Return on average equity (after tax) 1/	22.4	20.7	11.2	13.3	16.1	14.0	12.2	12.0
Interest margin to gross income	59.4	55.7	51.9	53.0	55.8	55.0	55.7	57.0
Noninterest expenses to gross income	68.7	58.4	58.5	56.0	54.5	54.5	57.1	56.9
Liquidity								
Liquid assets to total assets (liquid assets ratio)	17.1	17.0	20.3	20.8	19.5	20.9	21.4	20.9
Liquid assets to total short-term liabilities	24.2	25.3	29.8	31.2	28.8	31.1	31.7	31.4
Loans to deposits	98.0	112.6	109.2	114.5	119.8	117.7	115.8	114.7
Sensitivity to market risk								
Net open positions in FX to capital 1/	0.6	0.0	2.7	0.3	-0.3	0.2	-0.1	0.0

Sources: National Bank of Poland and KNF.

Note: Data according to FSI definitions, except for asset composition and quality (indicators not part of FSI reporting template).

1/ Data for domestic banking sector.

Table 4. Republic of Poland: Risk Assessment Matrix [1/]

Risk	Relative Likelihood and Transmission Channels	Expected Impact of Risk	Policy Response
1. Side-effects from global financial conditions	**High** • Bouts of market volatility and higher-than-expected increases in long-term rates could occur as the US exits from unconventional monetary policy or in the event of geopolitical shocks.	**Medium** • Investors could reallocate assets away from Poland, resulting in capital flow reversals and zloty depreciation. • High participation of foreign investors in the domestic bond market entails a potential transmission channel, but risks may be mitigated by prudent public debt management. • Liquidity in the FX derivatives market could be adversely affected, increasing banks' hedging costs, but risks are mitigated by strong liquidity positions in the banking sector.	•The exchange rate should be allowed to float freely, but intervention could be used to dampen excessive volatility. Interest rate hikes could be used to stem pressure. • The NBP should provide liquidity support (including in FX) if needed. • The FCL arrangement could be used under extreme circumstances.
. Protracted period of slower growth in advanced and emerging economies	**High** • In advanced markets, including Europe, low growth would reflect a state of persistently weak demand that could turn into stagnation.	**Medium** • Significant trade linkages with Europe would weaken growth in Poland through lower exports and adverse confidence effects. • NPLs would increase as a result of the growth slowdown, but the banking sector's strong capital position is a mitigating factor.	• Monetary policy should be further eased. • Fiscal automatic stabilizers should be allowed to operate, while paying careful attention not to unduly widen the structural deficit.
3. A sharp increase in geopolitical tensions surrounding Russia and Ukraine	**Medium** • Significant disruptions could occur in global financial, trade, and commodity markets, triggering a re-pricing of risks and heightened market volatility. • Spillovers would materialize through trade, financial, and confidence channels.	**Medium** • Gas supply disruptions would adversely affect Poland, particularly heavy industry (which is more reliant on imported gas). • Financial market/confidence effects could lead to capital flow reversals and pressure on Polish financial markets.	• In the event of adverse growth effects, monetary policy should be further eased, unless Poland is faced with strong capital outflows, and fiscal automatic stabilizers should be allowed to operate. • The exchange rate should be allowed to float freely, but intervention could be used to dampen excessive volatility.
4. Protracted period of low inflation	**Low/Medium** • Inflation could fail to pick up as envisaged in the baseline—either on account of external factors (low imported inflation) or domestic factors (entrenched low inflation expectations)—and remain low for a protracted period.	**Medium** • Very low inflation would increase (ex-post) real interest rates, and weigh on investment and ultimately growth. • To the extent that household inflation expectations in Poland are adaptive, breaking out of a protracted low inflation environment could be more difficult than in countries where inflation expectations are well anchored.	• Policy interest rates should be cut substantially. • The exchange rate should be allowed to float freely. • The scope for rate cuts could be limited in circumstances of severe external pressure.
5. Sovereign stress in the euro area re-emerges due to incomplete reforms or unanticipated outcomes from the asset quality review and stress tests in the absence of a fiscal backstop	**Low** • Bank-sovereign-real economy links could re-intensify because of stalled or incomplete delivery of policy commitments at the national or euro area level. • Strong market pressure on euro area economies would likely reverberate across financial markets.	**Medium** • Poland could face capital flow reversals and exchange rate pressure. • High participation of foreign investors in the domestic bond market entails a potential transmission channel, but risks may be mitigated by prudent public debt management. • Liquidity in the FX derivatives market could be adversely affected, increasing banks' hedging costs, but risks are mitigated by strong liquidity positions in the banking sector.	• The exchange rate should be allowed to float freely, but intervention could be used to dampen excessive volatility. • The NBP should provide liquidity support (including in FX) if needed. • The FCL arrangement could be used under extreme circumstances.

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

Table 5. Republic of Poland: Monetary Accounts, 2008–14

	2008	2009	2010	2011	2012	2013	2014 Proj.
				(Billions of zlotys)			
Central bank							
Net foreign assets	177	212	257	317	321	297	316
Net domestic assets	-51	-74	-117	-179	-153	-133	-141
Net claims on government	-21	-23	-12	-19	-16	-7	-7
Claims on banks	9	-25	-74	-93	-100	-117	-125
Other items, net	-38	-26	-31	-67	-37	-9	-9
Base money	126	138	140	138	167	164	175
o/w Currency issued	102	100	103	112	113	126	134
o/w Bank reserves	25	38	37	26	54	38	41
Deposit money banks							
Net foreign assets	-113	-135	-156	-169	-143	-147	-133
Net domestic assets	679	762	842	939	953	1,004	1,052
Net claims on the central bank	37	75	121	130	167	167	177
Net claims on government	153	171	177	191	177	204	206
Claims on private sector	633	677	735	838	858	896	957
Claims on corporates	224	217	215	253	257	259	282
Claims on households	376	421	480	537	538	562	596
Claims on other	33	40	41	47	63	75	80
Other items, net	-143	-161	-191	-219	-248	-263	-289
Deposits	566	627	687	771	810	857	919
Consolidated banking system							
Net foreign assets	64	76	101	149	177	150	183
Net domestic assets	602	644	683	733	744	829	866
Claims on government	131	148	164	172	161	197	199
Claims on private sector	633	677	735	838	858	896	957
Other items, net	-162	-182	-217	-276	-274	-264	-291
Broad money (M3)	666	720	784	882	921	979	1,049
Memorandum items:				(Percentage change from end of previous year)			
Base money	23.1	8.8	1.6	-1.1	21.0	-1.9	6.5
Broad money (M3)	18.6	8.1	8.8	12.5	4.5	6.2	7.1
Net domestic assets	36.6	7.0	6.0	7.4	1.5	11.4	4.5
Net foreign assets	-46.9	18.8	32.6	46.9	19.4	-15.2	21.6
Net claim on government	63.4	12.8	11.0	4.5	-6.6	22.5	1.4
Claims on private sector	36.4	7.0	8.5	13.9	2.4	4.5	6.8
Deposit growth	18.9	10.6	9.6	12.2	5.1	5.8	7.2
				(Percent of GDP, unless otherwise noted)			
Broad money (M3)	52.2	53.6	55.3	57.7	57.7	59.8	61.4
Private sector credit	49.6	50.4	51.9	54.8	53.7	54.8	56.0
Broad money Velocity (GDP/M3)	1.9	1.9	1.8	1.7	1.7	1.7	1.6
Money multiplier (M3/base money)	5.3	5.2	5.6	6.4	5.5	6.0	6.0

Sources: Haver, IFS, National Bank of Poland, and IMF staff calculations.

Table 6. Republic of Poland: General Government Statement of Operations, 2011–19

(Percent of GDP, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016	2017	2018	2019
				Projections					
Revenue	38.4	38.3	37.5	38.1	38.4	38.6	38.3	38.4	38.4
Taxes	20.8	20.1	19.7	20.0	20.2	20.4	20.1	20.1	20.1
Personal income tax	4.5	4.6	4.5	4.6	4.6	4.7	4.7	4.6	4.6
Corporate income tax	2.1	2.1	1.8	1.9	1.9	2.0	2.0	2.0	2.0
VAT	7.9	7.2	7.0	7.2	7.3	7.3	7.0	7.0	7.1
Excises	3.9	3.8	3.7	3.8	3.8	3.8	3.8	3.8	3.8
Other taxes	2.4	2.5	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Social contributions	11.4	12.3	12.2	12.4	12.5	12.5	12.4	12.4	12.3
Other revenue 1/	6.2	5.9	5.6	5.7	5.6	5.7	5.8	5.9	5.9
Capital revenue	1.7	1.3	1.0	1.0	0.9	1.0	1.1	1.2	1.2
Sales of goods and services	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Other current revenue	2.3	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Expenditure	43.4	42.2	41.9	41.3	40.9	40.7	40.7	40.6	40.6
Expense	37.7	37.6	38.0	37.4	37.0	36.8	36.8	36.7	36.6
Compensation of employees	9.7	9.4	9.3	9.2	9.1	9.1	9.1	9.1	9.1
Use of goods and services	5.7	5.7	5.8	5.8	5.8	5.8	5.8	5.8	5.8
Interest	2.7	2.8	2.6	2.3	2.2	2.2	2.3	2.2	2.2
Subsidies	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Social benefits	16.2	16.4	16.9	16.7	16.5	16.3	16.2	16.2	16.1
Other expense 1/	2.9	2.9	2.9	3.0	3.0	3.0	3.0	3.0	3.0
Other current expenditure	2.4	2.5	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Capital transfers	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Net acquisition of nonfinancial assets	5.7	4.6	3.9	3.9	3.9	3.9	3.9	3.9	4.0
Gross operating balance	0.7	0.7	-0.5	0.6	1.4	1.8	1.5	1.6	1.8
Net lending/borrowing (overall balance)	-5.0	-3.9	-4.3	-3.3	-2.5	-2.1	-2.4	-2.3	-2.2
Net financial transactions	-5.0	-3.5	-4.3	-3.3	-2.5	-2.1	-2.4	-2.3	-2.2
Net acquisition of financial assets	-1.3	-0.9	-1.6	0.2	0.4	0.6	-0.4	-0.4	-0.4
Currency and deposits	-0.7	0.7	-1.1	0.1	0.3	0.5	-0.5	-0.5	-0.5
Debt securities	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Equity and investment fund shares	-1.3	-1.1	-0.6	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other financial assets	0.6	0.2	0.1	0.2	0.1	0.1	0.1	0.1	0.1
Net incurrence of liabilities	3.6	2.5	2.8	3.4	2.9	2.7	2.0	1.8	1.8
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	2.1	2.6	2.1	-6.9	1.4	1.5	0.9	0.8	0.8
Loans	1.4	0.8	0.6	1.1	0.9	0.8	0.7	0.7	0.7
Other liabilities	0.1	0.3	0.0	9.3	0.6	0.4	0.4	0.4	0.4
Adjustment and statistical discrepancies	*-0.1*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Memorandum items:									
Cyclically-adjusted balance	-5.3	-3.8	-3.3	-2.7	-2.4	-2.1	-2.4	-2.3	-2.2
Primary balance	-2.3	-1.1	-1.7	-0.9	-0.3	0.1	-0.1	0.0	0.0
Cyclically-adjusted primary balance	-2.7	-1.0	-0.7	-0.4	-0.2	0.1	-0.1	0.0	0.0
General government debt	56.2	55.6	57.1	49.3	49.1	48.8	47.7	46.7	45.5
General government liabilities	63.0	62.3	63.5	56.6	56.4	56.0	55.0	53.9	52.8
General government financial assets	-32.4	-33.5	-37.0	-29.9	-30.6	-31.3	-31.3	-31.2	-31.0
Nominal GDP in billions of Zlotys	1,528	1,596	1,636	1,709	1,805	1,912	2,026	2,146	2,273

Sources: Eurostat and IMF staff calculations.

1/ Includes grants.

Table 7. Republic of Poland: General Government Financial Balance Sheet, 2012–19

(Millions of zloty, unless otherwise indicated)

	2012			2013			2014	2015	2016	2017	2018	2019
	Trans-actions	OEF	Closing Opening balance	Trans-actions	OEF	Closing Opening balance	Projections					
Net worth and its changes	....	....	....	....	....	....	....	....	....	....	....	....
Nonfinancial assets	....	....	....	....	....	....	....	....	....	....	....	....
Net Financial Worth:	-61,725	22,444	-534,945	-71,258	1,356	-604,847	-510,931	-553,384	-598,885	-633,617	-669,677	-706,014
Financial Assets	-2,255	-5,524	459,652	-25,583	-208	433,861	457,103	464,847	473,205	481,048	488,189	494,316
Currency and deposits	11,756	-6,162	71,637	-18,148	27	53,516	76,689	81,017	85,806	90,902	96,306	101,999
Debt securities	-153	-1,094	5,212	838	51	6,101	5,580	5,894	6,243	6,614	7,007	7,421
Loans	-326	-1,434	14,122	-46	556	14,632	13,696	14,469	15,324	16,234	17,199	18,216
Equity and inv. fund shares	-16,791	199	270,603	-10,262	-101	260,240	254,798	251,124	246,848	241,249	234,132	225,242
Other financial assets	3,259	2,967	98,078	2,035	-741	99,372	106,341	112,343	118,984	126,049	133,544	141,438
Liabilities	59,470	-27,968	994,597	45,675	-1,564	1,038,708	968,034	1,018,231	1,072,090	1,114,665	1,157,865	1,200,330
Currency and deposits	0	0	0	0	0	0	0	0	0	0	0	0
Debt securities	41,868	-18,525	742,617	34,903	-2,390	775,130	725,851	762,380	801,114	827,599	853,731	878,218
Loans	12,189	-6,462	149,051	10,184	329	159,564	117,902	124,556	131,919	139,752	148,062	156,814
Other liabilities	5,413	-2,981	102,929	588	497	104,014	124,281	131,295	139,057	147,314	156,073	165,299
Memorandum items:												
Net financial worth (in % of GDP)			-33.5			-37.0	-29.9	-30.7	-31.3	-31.3	-31.2	-31.1
Financial assets (in % of GDP)			28.8			26.5	26.7	25.7	24.7	23.7	22.7	21.7
Liabilities (in % of GDP)			62.3			63.5	56.6	56.4	56.1	55.0	54.0	52.8
GDP nominal prices (in Billion PLN)			1596.4			1635.7	1709.0	1805.4	1912.1	2025.7	2146.1	2273.0

Sources: National Authorities and IMF Staff calculations.

Table 8. 2013 FSAP Recommendations and Actions Taken[1]

Key Recommendations	Status
Addressing impaired loans: (i) intensify oversight of credit risk management and restructuring practices; (ii) standardize and enhance transparency of bank accounting practices; and (iii) standardize debt-to-income ratio calculation.	The authorities have completed a thematic supervisory review of impaired assets and issued a letter to banks, summarizing regulatory recommendations.
Strengthening banking supervision: (i) expand the scope for KNF to issue legally binding prudential regulations; (ii) allow KNF's Board to delegate administrative and procedural decisions to its management, increase KNF independence, and address other governance issues; and (iii) increase KNF flexibility to allocate budgetary and staff resources and enhance its analytical capabilities.	Pending.
Strengthening credit unions: (i) eliminate the dual supervision; require a solvency ratio of 8 percent in 5 years; and clarify the governance of the stabilization fund; (ii) develop an inclusive set of SKOK regulations and apply accounting principles for financial institutions to SKOKs; and (iii) develop capital rehabilitation plans for financially weak SKOKs.	Rehabilitation plans are being developed with 44 of 55 SKOKs obliged to prepare recovery plans.
Developing sound macroprudential policies: (i) ensure the macroprudential supervisory law provides for SRB's independence (with a leading role for the NBP), accountability to Parliament, and power to make recommendations coupled with an "act or explain" mechanism; and (ii) develop clear macroprudential policy objectives that are distinct from those of monetary and microprudential supervisory policy.	The legislative process for setting up a SRB is underway.
Improving the bank resolution framework: (i) ensure precedence of administrative powers over corporate insolvency procedures; (ii) ensure that the creditor claims hierarchy protects BFG's claims on resources provided for balance sheet "gap filling" measures; and (iii) include a Tier-1 capital trigger and link the "public interest" trigger to financial stability.	Draft legislation on resolution is progressing. The authorities focus on adjusting the draft BFG Act to that of BRRD.

[1] See “Republic of Poland: Financial System Stability Assessment”, IMF Country Report No. 13/221, 2013.

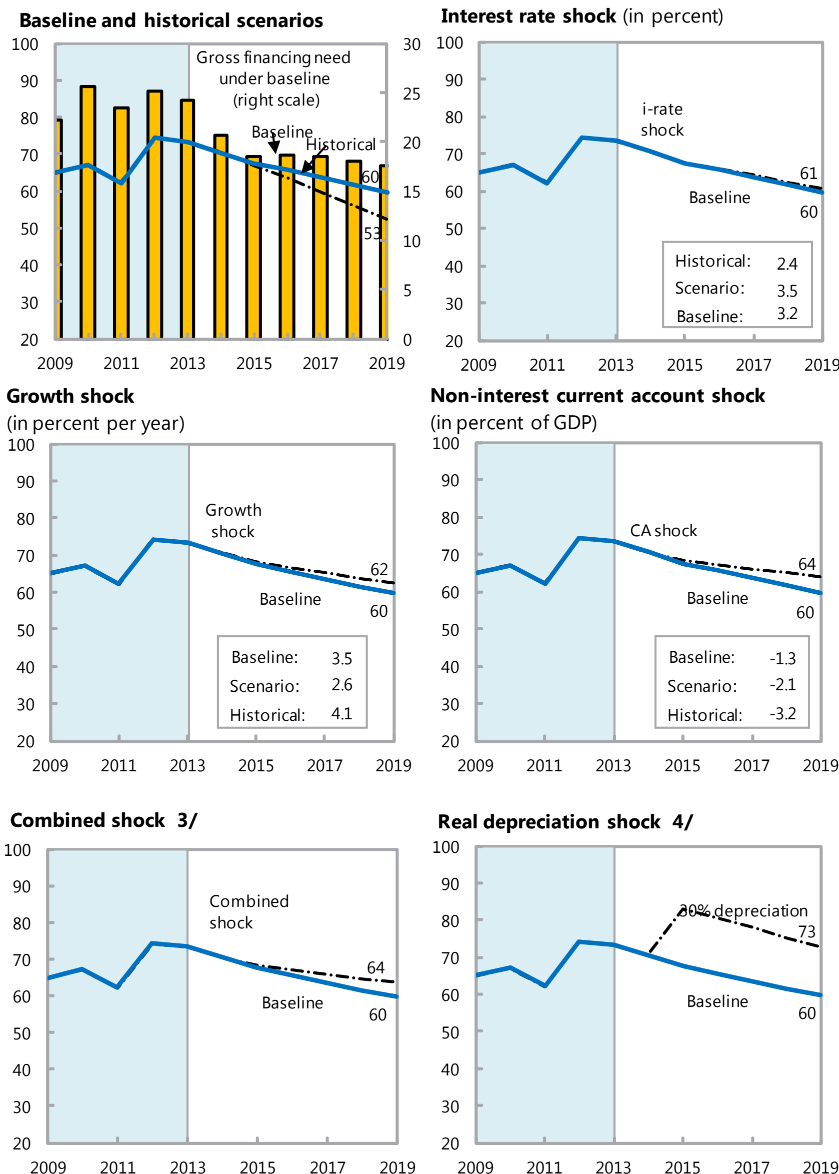
Table 8. 2013 FSAP Recommendations and Actions Taken (concluded)

Key Recommendations	Status
Improving the deposit insurance system: (i) remove the PBA from the BFG Council; (ii) ensure adequate funding and capacity, revise and introduce new regulations, and enhance protocols in light of expanded mandate; and (iii) amend code of conduct to restrict employment in member institutions to all employees.	Poland is broadly compliant with International Association of Deposit Insurers (IADI) Core Principles and will be even more so once the resolution framework has been adopted.
Strengthening pension reform and capital markets: (i) allow lifecycle strategies in pension funds, and measure performance of pension funds in relation to the benchmark portfolio; (ii) amend MCB framework to allow broader issuance and adopt a legal framework for mortgage securitization; (iii) strengthen enforcement of security interests and judicial decisions.	The pension system was changed in 2014. To protect pension fund assets in the last period of saving for retirement, they will be gradually transferred to the Social Security Fund, starting 10 years before reaching retirement age.

Annex I. External Debt Sustainability Analysis

Poland: External Debt Sustainability: Bound Tests, 2009–19 1/ 2/

(External debt, percent of GDP)



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

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

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

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

4/ One-time real depreciation of 30 percent occurs in 2015.

Republic of Poland: External Debt Sustainability Framework, 2009–19

(Percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2009	2010	2011	2012	2013			2014	2015	2016	2017	2018	2019	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	64.9	67.1	62.2	74.3	73.3			**70.5**	**67.5**	**65.6**	**63.5**	**61.5**	**59.7**	**-2.8**
2 Change in external debt	18.7	2.2	-4.9	12.1	-1.0			-2.8	-3.0	-1.9	-2.1	-2.0	-1.8	
3 Identified external debt-creating flows (4+8+9)	9.2	-2.7	-3.5	2.2	-1.7			-2.3	-1.6	-1.1	-0.7	-0.3	-0.3	
4 Current account deficit, excluding interest payments	3.4	4.0	3.9	2.3	-0.4			0.9	1.2	1.3	1.4	1.3	1.1	
5 Deficit in balance of goods and services	-80.0	-86.3	-91.9	-93.5	-93.7			-93.4	-93.0	-94.1	-95.0	-95.8	-97.0	
6 Exports	39.6	42.2	45.1	46.7	47.8			47.4	47.0	47.4	47.9	48.4	49.0	
7 Imports	-40.3	-44.1	-46.8	-46.8	-45.9			-46.0	-46.0	-46.7	-47.1	-47.4	-48.0	
8 Net non-debt creating capital inflows (negative)	-2.3	-3.1	-3.0	-1.9	-0.2			-2.2	-1.8	-1.7	-1.8	-1.7	-1.8	
9 Automatic debt dynamics 1/	8.1	-3.6	-4.5	1.8	-1.1			-1.0	-0.9	-0.6	-0.2	0.1	0.4	
10 Contribution from nominal interest rate	0.6	1.1	1.1	1.4	1.7			1.3	1.3	1.6	2.0	2.3	2.5	
11 Contribution from real GDP growth	-0.9	-2.3	-2.8	-1.3	-1.1			-2.3	-2.3	-2.2	-2.2	-2.1	-2.1	
12 Contribution from price and exchange rate changes 2/	8.5	-2.4	-2.8	1.6	-1.7			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	9.5	4.9	-1.4	9.9	0.7			-0.5	-1.4	-0.9	-1.4	-1.6	-1.6	
External debt-to-exports ratio (in percent)	163.8	158.9	137.8	159.2	153.3			148.7	143.7	138.3	132.6	127.2	121.8	
Gross external financing need (in billions of US dollars) 4/	95.7	120.3	120.8	122.8	125.2			113.0	107.6	115.2	121.0	125.9	129.7	
in percent of GDP	22.2	25.6	23.4	25.1	24.2	10-Year	10-Year	20.6	18.5	18.6	18.4	18.1	17.6	
Scenario with key variables at their historical averages 5/								**70.5**	**66.6**	**63.4**	**59.8**	**56.0**	**52.5**	**-6.3**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	1.6	3.9	4.5	2.0	1.6	4.1	1.9	3.3	3.5	3.5	3.6	3.6	3.6	
GDP deflator in US dollars (change in percent)	-19.8	4.8	5.0	-6.8	4.0	5.5	11.7	2.5	2.7	2.7	2.6	2.4	2.3	
Nominal external interest rate (in percent)	1.0	1.9	1.7	2.2	2.3	2.4	0.7	1.9	2.0	2.5	3.2	3.8	4.2	
Growth of exports (US dollar terms, in percent)	-20.1	16.0	17.3	-1.7	8.2	14.1	15.3	5.0	5.3	7.2	7.3	7.1	7.4	
Growth of imports (US dollar terms, in percent)	-27.4	19.1	16.4	-4.8	3.5	13.4	18.4	6.2	6.2	7.8	7.2	6.8	7.2	
Current account balance, excluding interest payments	-3.4	-4.0	-3.9	-2.3	0.4	-3.2	1.7	-0.9	-1.2	-1.3	-1.4	-1.3	-1.1	
Net non-debt creating capital inflows	2.3	3.1	3.0	1.9	0.2	2.7	1.4	2.2	1.8	1.7	1.8	1.7	1.8	

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

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

3/ 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.

Annex II. Public Sector Debt Sustainability Analysis

Public debt is moderately high, at 57 percent of GDP in 2013, but sustainable. Ongoing changes to the pension system are expected to generate a sizable one-off drop in the public debt-to-GDP ratio to about 49½ percent of GDP in 2014. The profile of public debt in terms of interest, rollover, and foreign currency risks appears robust. The main risk to the debt outlook stems from a negative shock to GDP growth. In addition, a relatively large share of foreign investors in the domestic debt market entails a channel of transmission from global shocks, although the composition of the investor base and the low share of public debt at floating rates provide some mitigating factors.

A. Baseline and Realism of Projections

- ***Debt levels.*** Poland's favorable public debt dynamics are underpinned by a decline in the primary deficit, a favorable differential between projected GDP growth and the real interest rate (as the economy recovers), and the effects of ongoing changes to the pension system. The latter would contribute to reduce the ratio of public debt-to-GDP relative to the 2013 Article IV projections by some 8 percentage points.
- ***GDP Growth.*** The projections assume a gradual acceleration of GDP growth, from 1.6 percent in 2013 to 3.3 percent in 2014 and further to 3.6 percent in 2019. The output gap is expected to close in 2016. In recent years, staff projections of growth have displayed small forecast errors, with some indication of a pessimistic bias relative to other countries.
- ***Fiscal Adjustment.*** Under the baseline, the primary deficit is expected to decline from 1.7 percent of GDP in 2013 to about balance in 2018–19, reflecting modest fiscal measures already in the pipeline, the changes to the pension system, and the gradual recovery in tax revenue (closer to recent historical levels). In the recent past, staff forecasts errors of the primary deficit in Poland have not displayed an apparent bias and have been more conservative than those of other countries. Overall, the projected fiscal adjustment seems feasible, as indicated by cross country benchmarks.
- ***Sovereign yields.*** The effective interest rate on public debt dropped from 6.6 percent in 2005 to 5.9 percent in 2009 and further to about 5 percent in 2013. It is projected to remain stable at around 4.8 percent over the projection period. In recent years, Poland has maintained access to capital markets at favorable terms, even during periods of global financial distress. Bond yields increased following Fed-tapering announcements, from a historic low average of 3.3 percent in May 2013 to around 4.1 percent in April 2014. Spreads over 10–year German bonds reached a minimum of 176 bps in May 2013 and increased to an average of 257 basis points in April 2014, while EMBI and CDS spreads averaged around 110 bps and 70 bps, respectively. While there is uncertainty about the impact of normalization of monetary policy in the U.S. on market conditions, pass-through from interest increases to the budget would be very slow, as about 80 percent of debt carries a fixed interest rate and the average duration stands at 3.6 years. A 100 bps parallel shift in the yield curve will lead to an increase in the interest bill of about 0.1 percent of GDP in the first year.

- ***Changes to the pension system.*** Public debt projections under the baseline are strongly influenced by ongoing changes to the pension system. From the fiscal perspective, these changes generated a large one-off drop in (explicit) public debt in the first quarter of 2014 (with a matching increase in gross implicit public pension liabilities), and a reduction in public financing needs over the medium term. The latter reflects the combined effect of lower public debt service, a partial redirection of pension contributions from the second pillar to the social security administration, and a gradual transfer of assets to the social security administration ten years before retirement. By contrast, the associated increase in public pension payments will gather pace in the long run, well beyond the projection period. Staff calculations, using baseline projections for 2014–60, indicate the pension changes would lead to a long-term improvement in the fiscal account of about 30 percent of GDP in net present value terms.

- ***Maturity and rollover risks.*** The share of short-term debt in total government debt is negligible (there have been no t-bills outstanding since August 2013). Rollover risk for 2014 is negligible as the authorities covered more than three-quarters of the financing needs by end-May. Going forward, rollover risk could increase somewhat as a result of the pension changes: the share of foreign investors in the domestic market is set to increase from about 34 percent in 2013 to 38 percent in 2014 and the overall share of external debt in total public debt will rise from 51 percent in 2013 to about 58 percent in 2014. In addition, the share of foreign currency debt in total debt will also increase from 30 percent in 2013 to 35 percent in 2014. The baseline assumes gradual convergence toward the current structure of public debt in terms of the share of foreign currency debt in total debt (30 percent) and external debt in total debt (about 50 percent).

- ***DSA risk assessment.*** The heat map highlights risks associated with the share of public debt held by non-residents, plus the relatively large external financing requirements (25 percent of GDP in 2012). The latter, however, is heavily influenced by the external gross financing needs of the private sector, which include a substantial share of intercompany financing.

- ***Fan charts.*** Symmetric fan charts, which treat upside and downside risks equally likely, show that public debt is more likely to enter a downward trajectory during the projection period. The lower bands indicate that the debt-to-GDP ratio could drop to around 40 percent by 2019 with a 25 percent probability. On the other hand, the upper bands indicate that debt-to-GDP ratios could surpass 55 percent by 2019 with a 10 percent probability. A more stringent exercise, however, combining restrictions to the upside shocks to interest rates and GDP growth (200 bps and 1 percent, respectively), increases the probability of debt-to-GDP surpassing 55 percent in 2019 to 25 percent. This result is still commensurate with a sustainable debt path, but it illustrates the degree of uncertainty around the baseline.

B. Shocks and Stress Tests

- ***Primary balance shock.*** An assumed deterioration in the primary balance by 0.9 percentage points in 2014–15 delays by two years the downward trend of the debt-to-GDP ratio and pushes up slightly public debt to revenues to about 130 percent in 2015 (from about 127 percent in 2014). Gross financing needs peak to about 12 percent of GDP in 2015 but converge to the baseline by 2017.
- ***Growth Shock.*** The stress scenario assumes a drop in GDP growth by 1.9 percentage points in two consecutive years (2014–15) relative to the baseline, combined with a 0.5 percent drop in inflation and deterioration in the primary balance by 0.9 percent in 2014 and further by 1.8 percent in 2015. Under these assumptions, public debt increases to about 54 percent of GDP in 2016 before trending downward to about 50 percent of GDP by 2019. Gross financing needs increase to about 14 percent of GDP in 2016, but then converge quickly toward the baseline in the outer years.
- ***Interest rate shock.*** A permanent 200 bps increase in the nominal interest rate starting in 2014 (equivalent to the difference between the maximum real interest rate during 2003–13 and the average real interest rate over the projection), would lead to an increase in the effective interest rate on debt by 52 bps in 2015 and further gradual increases to 170 bps by 2019. Under this scenario, public debt dynamics deteriorate marginally relative to the baseline. Public debt remains at about 48 percent of GDP by 2016, while gross financing needs reach about 12 percent of GDP at the end of the projection period.
- ***Exchange rate shock.*** The combined shock also assumes an exchange rate depreciation of about 26 percent in 2015 (from 3.1 PLN/USD to 3.9 PLN/USD), calibrated to emulate the maximum historic movement of the FX rate over the last 10 years. Under this scenario, Gross public debt increases to about 50 percent of GDP in 2015 before trending downward to about 46 percent by 2019. The resilience reflects the predominance of public debt in local currency.
- ***Combined shock.*** Under the combined shock, the public-debt-to-GDP ratio jumps sharply to about 60 percent in 2016 and remains broadly stable afterward. In turn, gross financing needs increase to about 14 percent of GDP in 2015–16, and remain between 12–14 percent of GDP in the outer years.

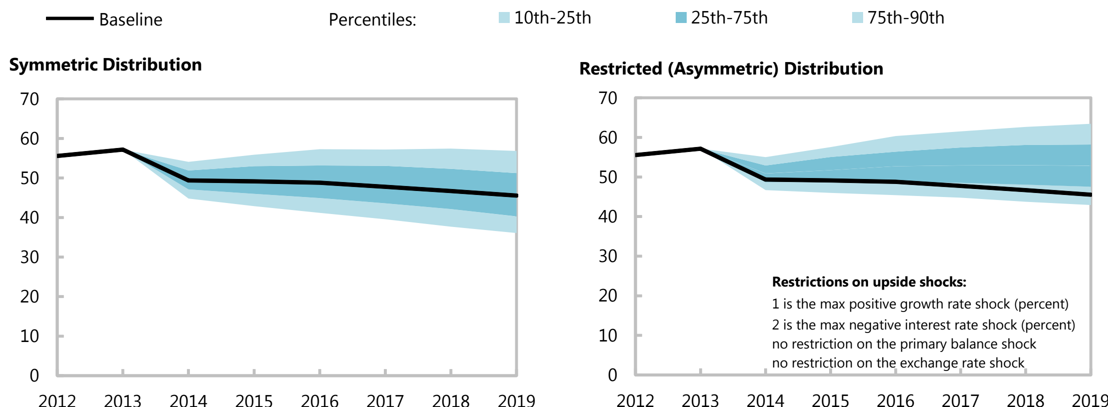
Republic of Poland: Public Sector Debt Sustainability Analysis (DSA)—Risk Assessment

Heat Map

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

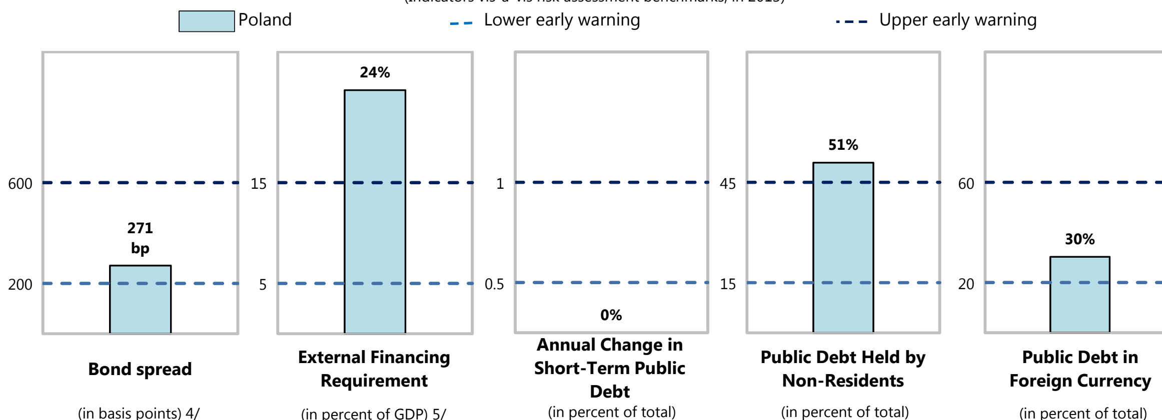
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2013)



Source: IMF staff.

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

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

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

Lower and upper risk-assessment benchmarks are:

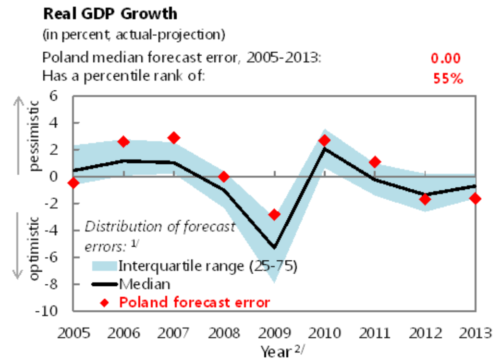
200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

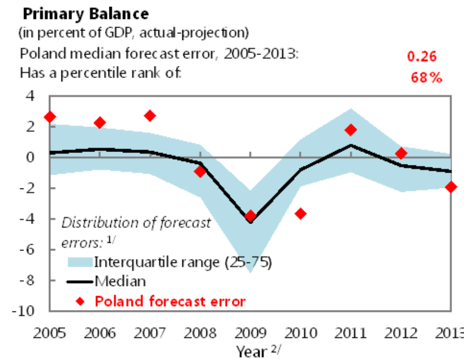
4/ Long-term bond spread over German bonds, an average over the last 3 months, 22-Jan-14 through 22-Apr-14.

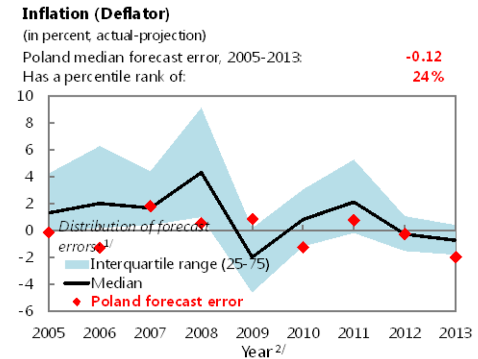
5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Republic of Poland: Public DSA—Realism of Baseline Assumptions

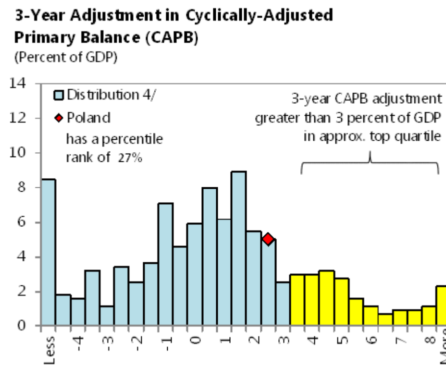
Forecast Track Record, versus all countries

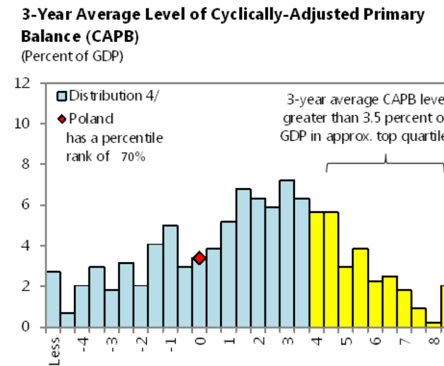




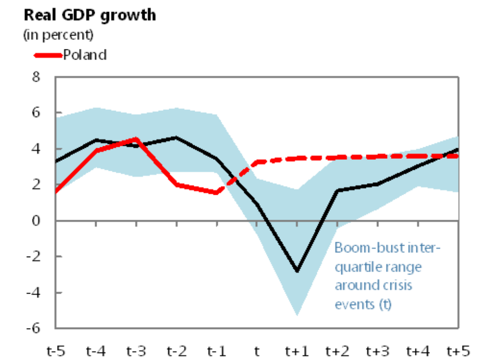


Assessing the Realism of Projected Fiscal Adjustment





Boom-Bust Analysis 3/



Source : IMF Staff.
1/ Plotted distribution includes all countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Poland has had a negative output gap for 3 consecutive years, 2011-2013. For Poland, t corresponds to 2014; for the distribution, t corresponds to the first year of the crisis..
4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Republic of Poland: Public DSA—Baseline Scenario

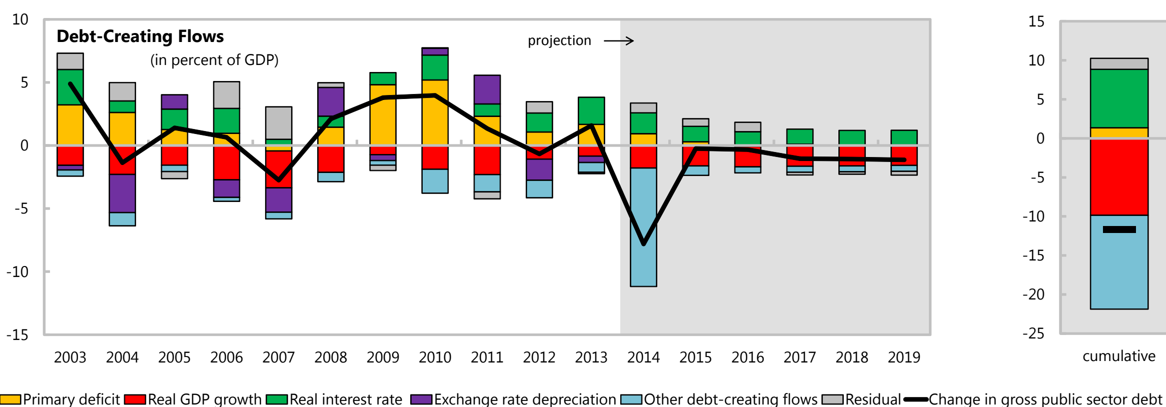
(Percent of GDP, unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of April 22, 2014		
	2003-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019	Sovereign Spreads		
Nominal gross public debt	49.1	55.6	57.1	49.3	49.1	48.8	47.7	46.6	45.5	EMBIG (bp) 3/		259
Public gross financing needs	16.1	13.9	11.4	10.4	10.6	11.7	10.7	10.7	10.7	5Y CDS (bp)		70
Real GDP growth (in percent)	4.6	2.0	1.6	3.3	3.5	3.5	3.6	3.6	3.6	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	2.7	2.4	0.9	1.2	2.1	2.3	2.3	2.3	2.2	Moody's	A2	A2
Nominal GDP growth (in percent)	7.3	4.5	2.5	4.5	5.6	5.9	5.9	5.9	5.9	S&Ps	A-	A-
Effective interest rate (in percent) [4/]	6.0	5.3	4.9	4.2	4.8	4.8	5.0	5.0	5.0	Fitch	A-	A-

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing
Change in gross public sector debt	1.6	-0.7	1.6	-7.8	-0.2	-0.3	-1.0	-1.1	-1.1	-11.6	primary
Identified debt-creating flows	0.9	-1.6	1.7	-8.6	-0.8	-1.1	-0.8	-0.9	-0.8	-13.0	balance [10/]
Primary deficit	2.4	1.1	1.7	0.9	0.3	-0.1	0.1	0.0	0.0	1.4	-0.9
Primary (noninterest) revenue and grants	38.7	38.3	37.5	38.1	38.4	38.6	38.3	38.4	38.4	230.0	
Primary (noninterest) expenditure	41.1	39.4	39.2	39.0	38.7	38.5	38.4	38.4	38.4	231.3	
Automatic debt dynamics [5/]	-0.7	-1.2	0.8	-0.1	-0.4	-0.5	-0.4	-0.4	-0.4	-2.4	
Interest rate/growth differential [6/]	-0.6	0.4	1.3	-0.1	-0.4	-0.5	-0.4	-0.4	-0.4	-2.4	
Of which: real interest rate	1.4	1.5	2.1	1.6	1.2	1.1	1.2	1.2	1.2	7.5	
Of which: real GDP growth	-2.0	-1.1	-0.8	-1.8	-1.6	-1.6	-1.6	-1.6	-1.6	-9.9	
Exchange rate depreciation [7/]	-0.1	-1.7	-0.5	...	...	...	...	...	...	...	
Other identified debt-creating flows	-0.8	-1.4	-0.8	-9.4	-0.7	-0.5	-0.5	-0.5	-0.5	-12.0	
Privatization (+ reduces financing needs) (negative)	-0.6	-1.1	-0.6	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.6	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Liabilities not included in debt [8/]	-0.2	-0.3	-0.1	-9.3	-0.6	-0.4	-0.4	-0.4	-0.4	-11.5	
Residual, including asset changes [9/]	0.7	0.9	-0.1	0.8	0.6	0.7	-0.2	-0.2	-0.3	1.4	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

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

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

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

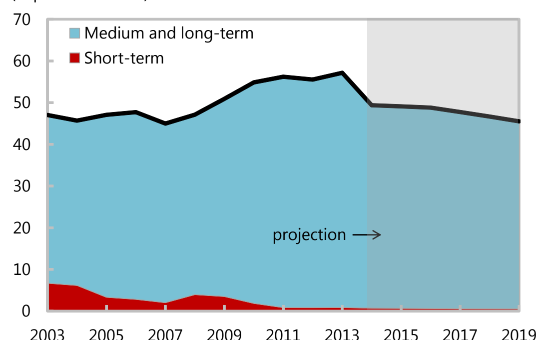
8/ From 2014 onwards, reflects the transfer of pension fund assets and liabilities to the social security administration.

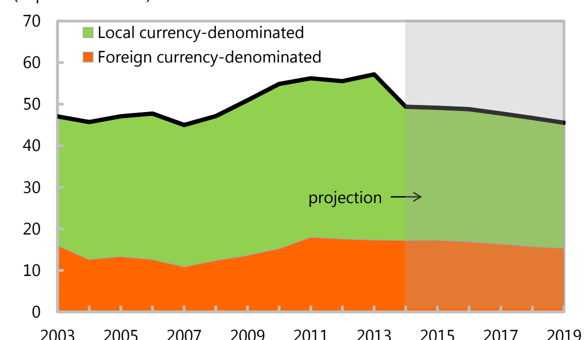
9/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

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

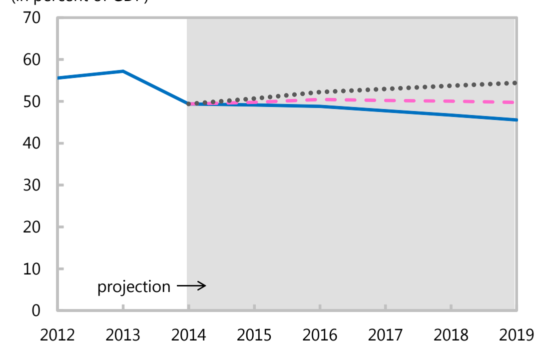
Composition of Public Debt

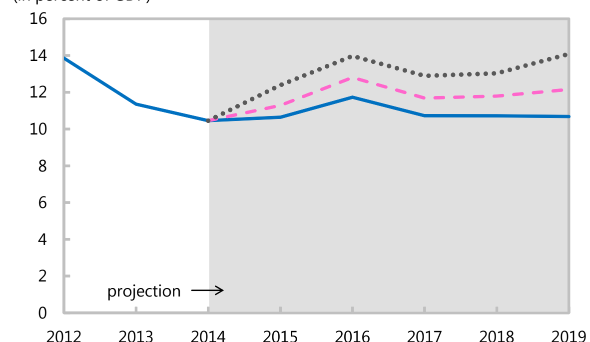




Alternative Scenarios

Baseline   Historical   Constant Primary Balance





Underlying Assumptions
(in percent)

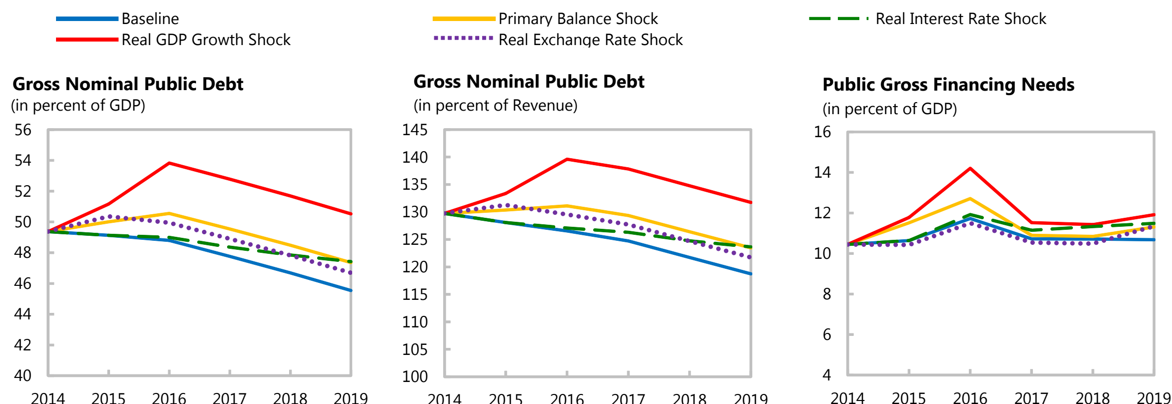
Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	3.3	3.5	3.5	3.6	3.6	3.6
Inflation	1.2	2.1	2.3	2.3	2.3	2.2
Primary Balance	-0.9	-0.3	0.1	-0.1	0.0	0.0
Effective interest rate	4.2	4.8	4.8	5.0	5.0	5.0
Constant Primary Balance Scenario						
Real GDP growth	3.3	3.5	3.5	3.6	3.6	3.6
Inflation	1.2	2.1	2.3	2.3	2.3	2.2
Primary Balance	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Effective interest rate	4.2	4.8	4.8	4.9	4.9	4.9

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	3.3	4.1	4.1	4.1	4.1	4.1
Inflation	1.2	2.1	2.3	2.3	2.3	2.2
Primary Balance	-0.9	-2.1	-2.1	-2.1	-2.1	-2.1
Effective interest rate	4.2	4.8	4.8	5.0	5.1	5.1

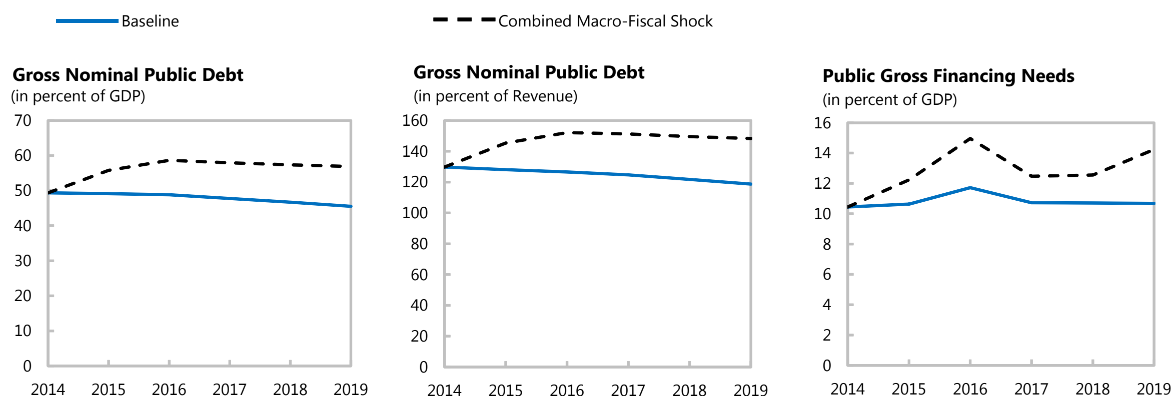
Source: IMF staff.

Republic of Poland: Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2014	2015	2016	2017	2018	2019
Primary Balance Shock						
Real GDP growth	3.3	3.5	3.5	3.6	3.6	3.6
Inflation	1.2	2.1	2.3	2.3	2.3	2.2
Primary balance	-0.9	-1.2	-0.8	-0.1	0.0	0.0
Effective interest rate	4.2	4.8	4.8	5.0	5.0	5.0
Real Interest Rate Shock						
Real GDP growth	3.3	3.5	3.5	3.6	3.6	3.6
Inflation	1.2	2.1	2.3	2.3	2.3	2.2
Primary balance	-0.9	-0.3	0.1	-0.1	0.0	0.0
Effective interest rate	4.2	4.8	5.2	5.8	6.2	6.6
Combined Shock						
Real GDP growth	3.3	1.6	1.6	3.6	3.6	3.6
Inflation	1.2	1.6	1.8	2.3	2.3	2.2
Primary balance	-0.9	-1.2	-1.7	-0.1	0.0	0.0
Effective interest rate	4.2	5.2	5.1	5.8	6.1	6.4

	2014	2015	2016	2017	2018	2019
Real GDP Growth Shock						
Real GDP growth	3.3	1.6	1.6	3.6	3.6	3.6
Inflation	1.2	1.6	1.8	2.3	2.3	2.2
Primary balance	-0.9	-1.2	-1.7	-0.1	0.0	0.0
Effective interest rate	4.2	4.8	4.8	5.1	5.1	5.1
Real Exchange Rate Shock						
Real GDP growth	3.3	3.5	3.5	3.6	3.6	3.6
Inflation	1.2	8.8	2.3	2.3	2.3	2.2
Primary balance	-0.9	-0.3	0.1	-0.1	0.0	0.0
Effective interest rate	4.2	5.2	4.7	4.9	4.9	4.9

Source: IMF staff.

INTERNATIONAL MONETARY FUND

REPUBLIC OF POLAND

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

June 5, 2014

Prepared By European Department

CONTENTS

FUND RELATIONS ____ 2

STATISTICAL ISSUES ____ 7

FUND RELATIONS

(As of April 30, 2014)

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

General Resources Account:

	SDR Million	Percent Quota
Quota	1,688.40	100.00
Fund Holdings of Currency	1,220.59	72.29
Reserve Tranche Position	467.82	27.71
Lending to the Fund		
New Arrangement to Borrow	340.40	

SDR Department:

	SDR Million	Percent Allocation
Net Cumulative Allocation	1,304.64	100.00
Holdings	986.94	75.65

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

In Millions of SDR

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

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

	Forthcoming				
	2014	2015	2016	2017	2018
Principal					
Charges/Interest	0.30	0.42	0.42	0.42	0.42
Total	0.30	0.42	0.42	0.42	0.42

Exchange Arrangements:

The zloty is freely floating.

Poland accepted the obligation of Article VIII, Sections 2, 3, and 4 on June 1, 1995. 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 as introduced by the European Union within the framework of the Common Foreign and Security Policy. The consolidated list of such sanctions is available at: http://eeas.europa.eu/cfsp/sanctions/consol-list/index_en.htm.

Article IV Consultation:

The last Article IV consultation was concluded on July 17, 2013. In concluding the consultation, Directors emphasized that Poland's sound macroeconomic management, strong fundamentals, resilient financial system, and adequate international reserves have helped preserve confidence in the country's policies. The Precautionary Flexible Credit Line arrangement has provided insurance against external risks. At the same time, they observed that Poland's high trade and financial interconnectedness with Europe and open capital account make it susceptible to shocks. Directors commended the authorities' commitment to fiscal sustainability. For 2013, most Directors agreed that automatic stabilizers should be allowed to operate fully around budgeted measures, though a few considered that further consolidation measures could be necessary. Directors broadly agreed that the medium-term objective of a structural deficit of 1 percent of GDP by 2016 remains appropriate. However, they noted that additional fiscal measures would be needed to put the public debt ratio firmly on a downward path. Directors looked forward to the implementation of a simple and transparent expenditure rule, which should allow for countercyclical fiscal policy. On monetary policy, Directors agreed that the accommodative monetary policy stance is appropriate in a context of muted inflationary pressures and narrow fiscal space. However, a number of Directors advised a cautious approach to further easing, given risks associated with a low rate environment. Directors welcomed the findings of the Financial System Stability Assessment that the banking system is well capitalized, profitable, and liquid. At the same time, they underscored that safeguarding asset quality will be essential. Directors looked forward to the establishment of macroprudential and bank resolution frameworks. Directors encouraged continued structural reforms to boost potential growth and maximize the benefits of integration into global supply chains.

Resident Representative:

Mr. James Roaf replaced Mr. Mark Allen as the Senior Regional Resident Representative for Central and Eastern Europe, effective August 8, 2013.

Republic of Poland: Technical Assistance from the Fund, 1992–2014 (continued)

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

Republic of Poland: Technical Assistance from the Fund, 1992–2014 (continued)

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

Republic of Poland: Technical Assistance from the Fund, 1992–2014 (concluded)

Department	Subject/Identified Need	Action	Date	Counterpart
STA	Government finance statistics (GFSM 2001)	Mission	October 2003	MoF
STA	Government finance statistics (GFSM 2001)	Mission	January 2005	MoF
IMF/IBRD	FSAP Update	Mission	April/May 2006	MoF/NBP
FAD	Developing a Multi-annual Fiscal Framework	Mission	June 2008	MoF
STA	Errors and omissions in Balance of Payments Accounts	Mission	July 2009	NBP
FAD	Medium-term fiscal framework	Mission	April 2010	MoF
MCM	Detailed Assessment of Observance of BCP for Effective Banking Supervision	Mission	Feb/March 2011	KNF
STA	Errors and omissions in Balance of Payments Accounts	Mission	June 2011	NBP
FAD	Developing the Fiscal Regime for Oil and Gas	Mission	April 2012	MoF
MCM	Macroprudential Framework	Mission	May 2012	NBP
IMF/WB	FSAP Update	Mission	Feb/March 2013	MoF/ KNF/NBP

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance (continued)

General: Data provision is adequate for surveillance.

National Accounts: The Central Statistical Office (GUS) compiles and disseminates annual and quarterly GDP by production and expenditure approaches, both at current and previous year's prices following 1993 SNA and ESA 1995. A full set of annual accounts, including financial accounts by institutional sectors, is also compiled but with a lag of 2 years. A supply and use table is only available for the year 2005.

Price Statistics: The CPI does not cover the imputed rents of owner-occupied dwellings. The scope of the index covers all resident households, except those in some rural areas. The PPI does not include any estimation for missing prices or quality and seasonal adjustments.

Government Finance Statistics: General government data are released on a quarterly basis, and compiled on the same basis as the annual general government data, i.e. derived from detailed ESA (European System of Accounts) data. Revenue and expense are available according to the full economic classification and, in addition, expense is also available according to COFOG (Classification of the Functions of Government).

Further significant enhancements to government data are necessary to comply with the accrual basis of reporting and to compile full information on financial and nonfinancial asset stock data for general government.

Monetary and Financial Statistics: Beginning with data for January 2004, the National Bank of Poland (NBP) compiles monetary accounts in accordance with the ECB's framework for monetary statistics using the national residency approach. An earlier ROSC mission recommended that the NBP, in cooperation with the Ministry of Finance, reconcile monetary and government finance statistics and carry out a reconciliation exercise on a regular basis. In November 2009, the NBP began reporting financial soundness indicators based on the IMF's *Financial Soundness Indicators Compilation Guide*. Data are reported on a quarterly basis with a lag of approximately one quarter.

I. Assessment of Data Adequacy for Surveillance (concluded)
Balance of Payments: Largely to improve data accuracy, the NBP reduced its reliance on the International Transactions Reporting System (ITRS) and increased its reliance on survey-based source data, starting in the first quarter of 2010. STA undertook an evaluation mission to Poland in July 2009, and followed up in June 2011 to assess further data improvements and anticipated revisions in the external sector accounts. Due to the comprehensive work on improving the data sources, the errors and omissions reduced from 4 percent of GDP in 2004 to around 2 percent of GDP in recent years, which is comparable to the level in other European countries. Authorities are committed to further improving the compilation system for the external sector statistics. Starting with the data for Q1 2014, Poland, as all other EU countries, will start disseminating balance of payments data in accordance with the sixth edition of the *IMF's Balance of Payments and International Investment Position Manual (BPM6)*.

II. Data Standards and Quality	
Subscriber to the Fund's Special Data Dissemination Standard (SDDS) since April 17, 1996. Uses SDDS flexibility option on the timeliness of the data on general government and central government operations.	A data ROSC was published in 2003.

Republic of Poland: Table of Common Indicators Required for Surveillance–as of May 23, 2014

	Date of latest observation	Date received	Frequency of data[7]	Frequency of reporting[7]	Frequency of publication[7]	Memo Items:	
						Data Quality – Methodological soundness[8]	Data Quality Accuracy and reliability[9]
Exchange Rates	5/23/2014	5/23/2014	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	4/2014	5/21/2014	M	M	M		
Reserve/Base Money	4/2014	5/07/2014	M	M	M	O, LO, O, LO	O, O, O, O, O
Broad Money	4/2014	5/07/2014	M	M	M		
Central Bank Balance Sheet	4/2014	5/07/2014	M	M	M		
Consolidated Balance Sheet of the Banking System	4/2014	5/14/2014	M	M	M		
Interest Rates[2]	5/23/2014	5/23/2014	D	D	D		
Consumer Price Index	4/2014	5/14/2014	M	M	M	O, O, O, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q4/2013	4/21/2014	A	A	A	LO, O, O, O	O, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	3/2014	5/20/2014	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	3/2014	5/20/2014	M	M	M		
External Current Account Balance	3/2014	5/12/2014	M	M	M	O, O, O, LO	O, O, O, O, LO
Exports and Imports of Goods and Services	3/2014	5/12/2014	M	M	M		
GDP/GNP	Q4/2013	2/28/2014	Q	Q	Q	O, LO, O, O	LO, LO, O, O, LO
Gross External Debt	Q4/2013	3/31/2014	Q	Q	Q		
International Investment Position[6]	Q4/2013	3/31/2014	Q	Q	Q		

[1] Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Not Available (NA).
[7] Reflects the assessment provided in the data ROSC published on November 6, 2001, and based on the findings of the respective missions that took place during May 10-18, 2001 for the dataset corresponding to the variable in each row. For fiscal data, also takes account of the 2009 Fiscal Transparency ROSC. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[8] Same as footnote 7, except referring to international standards concerning (respectively) source data, statistical techniques, assessment and validation, and revision studies.
[9] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

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

IMF Executive Board Concludes 2014 Article IV Consultation with the Republic of Poland

On June 23, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of Poland.

The economy is steadily recovering from the 2012–13 slowdown on the back of Poland's very strong fundamentals and policies. Real GDP growth moderated to 1.6 percent in 2013 as the slowdown in core euro area countries had knock-on effects on consumer and investor confidence. However, a steady recovery is now underway with growth accelerating to 3.4 percent year-on-year in the first quarter of 2014, led by improving conditions in main trading partners and a recovery in domestic demand. Nonetheless, partly reflecting external factors, CPI inflation remains well below the target range, declining to 0.2 percent year-on-year in May. As the trade balance turned positive in 2013, the current account deficit narrowed to its lowest level in more than a decade.

The outlook is for a continuing recovery but external risks remain firmly on the downside. Growth is expected to reach 3.3 percent in 2014 but strong trade and financial linkages with core euro area countries make it vulnerable to growth shocks. Although the U.S. tapering of unconventional monetary policy has so far had only limited impact on Polish financial markets, a further tightening of global financial conditions could lead to capital outflows and increase interest rates, as could rising geopolitical tensions surrounding Russia and Ukraine. Poland's Flexible Credit Line (FCL) arrangement with the IMF helps mitigate these risks.

Policies have appropriately supported the recovery while continuing adjustment. The fiscal balance worsened to 4.3 percent of GDP in 2013 on account of weak economic growth, which took a toll on tax collections. However, the cyclically-adjusted balance continued to gradually improve and the fiscal framework was overhauled with the approval of a permanent expenditure rule. More recently, the pension system underwent significant changes, entailing a downsizing of the second pillar. Monetary policy has kept rates on hold after a substantial easing cycle ended in

[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.

July 2013. The banking sector has remained well capitalized, profitable, and liquid, reliance on parent funding has declined, and foreign currency mortgage issuance has effectively halted. However, the share of foreign currency mortgages remains high and the Non-Performing Loan (NPL) ratio, while starting to edge down, has remained sticky at around 8½ percent.

Executive Board Assessment[2]

Executive Directors noted that Poland's very strong fundamentals and economic policies had helped it weather the turmoil in financial markets during 2013–14, and welcomed the current economic recovery, buoyed by more robust domestic and external demand. Noting that external risks—including geopolitical developments, tightening global financial conditions, and slower growth in main trading partners—remain elevated, Directors encouraged the authorities to strengthen the economy's resilience by rebuilding policy buffers and stepping up critical structural reforms. They noted that the precautionary FCL arrangement provides important insurance against external risks.

Directors advised that a measured pace of fiscal consolidation over the medium term would help restore the fiscal deficit to more prudent levels without weighing unduly on growth. The authorities' medium-term objective, and a stronger downward trajectory for the public debt ratio, could be achieved through better expenditure prioritization, following a review of public expenditures, and improved tax compliance and efficiency of tax administration. Directors considered that the changes to the pension system would deliver an improvement in the fiscal accounts, and urged the authorities to address legacy flaws in the pension system and consider measures to deal with the sharp drop in future replacement rates. Directors also advised continued monitoring of liquidity in the government bond and equity markets, given the reduced presence of pension funds.

Directors concurred that the monetary stance was broadly appropriate within the context of limited inflationary pressures and subdued euro area inflation. However, heightened vigilance is needed, as policy interest rates could be further reduced if the recovery falters or if revised projections indicate below-target inflation for a protracted period.

While noting that international reserves remain broadly adequate, most Directors concurred that moderate reserve accumulation would be prudent in light of external risks. However, some Directors questioned the need for further reserve accumulation given that they were assessed to be broadly adequate under the IMF's metric.

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

Directors commended the resilience of the banking system, which remains well capitalized, profitable, and liquid. However, they called for enhanced financial sector supervision, given the elevated ratio of NPLs and the large share of foreign-currency-denominated mortgages. Directors advised tackling legal obstacles and tax disincentives to resolving NPLs, and expediting the completion of the macro-prudential and bank resolution frameworks—including legislation to create a Systemic Risk Board.

Directors encouraged the authorities to deepen structural reforms to achieve more inclusive sustainable growth. They called for further liberalization of regulated professions and other labor market reforms, to help reduce segmentation and unemployment. Additional privatizations, further reduction of administrative barriers, and finalization of the work on the new insolvency regime to promote rehabilitation of viable debtors would also help improve the business climate.

Republic of Poland: Selected Economic Indicators, 2011–14

	2011	2012	2013	2014
				Proj.
National Income, prices, and unemployment				
Nominal GDP (billion zloty)	1528.1	1596.4	1635.7	1709.0
Real GDP (change in percent)	4.5	2.0	1.6	3.3
CPI inflation (percent, average)	4.3	3.7	0.9	0.9
CPI inflation (percent, end of period)	4.6	2.4	0.7	1.6
Unemployment rate (percent)	9.6	10.1	10.3	9.8
Public finances (percent of GDP) 1/				
General government revenues	38.4	38.3	37.5	38.1
General government expenditures	43.4	42.2	41.9	41.3
General government balance	-5.0	-3.9	-4.3	-3.3
Public debt	56.2	55.6	57.1	49.3
Money and credit				
Private sector credit (change in percent, eop)	13.9	2.4	4.5	6.8
Broad money (change in percent, eop)	12.5	4.5	6.2	7.1
Policy rate (percent) 2/	4.2	4.6	2.9	2.5
Balance of payments				
Current account balance (percent of GDP)	-5.0	-3.7	-1.3	-2.1
Official reserves (billion U.S. dollars)	97.9	108.9	106.2	112.2
Total external debt (percent of GDP)	62.2	74.3	73.3	70.5
Exchange rate				
Exchange rate regime		Floating		
Zloty per USD, period average 3/	3.0	3.3	3.2	3.1
Zloty per Euro, period average 3/	4.1	4.2	4.2	4.2
Real effective exchange rate (INS, CPI based) 4/	110.4	107.6	109.5	…

Sources: Polish authorities; and IMF staff calculations.

1/ ESA2010.

2/ NBP Reference Rate (avg). For 2014, rate as of May 20.

3/ 2014, exchange rate as of May 20.

4/ Annual average (2000=100).

Statement by Dominik Radziwill, Alternate to the Executive Director for the Republic of Poland, and Joanna Osinska, Advisor to the Executive Director, June 23, 2014

On behalf of our Polish authorities, we would like to thank staff for the constructive consultations held in Warsaw and the comprehensive set of papers. The authorities broadly agree with staff's assessments and policy recommendations.

Economic Outlook

Between late 2011 and early 2013, the Polish economy was experiencing a cyclical slowdown with growth moderating to below 2 percent due to unfavorable economic conditions in the euro area (Poland's main trading partner), lower household consumption, fiscal tightening, and falling public investments financed with EU structural funds. Last year, however, the economy started to recover. Since the last quarter of 2013, economic growth has been driven mainly by a rebound in domestic demand, which was supported by a rise in private consumption and investment growth. The acceleration in private consumption resulted from an improvement on the labor market. In the coming quarters, consumption growth should be further spurred on by an increase in households' real disposable income, prompted by low inflation. Private investment activity will be supported by rising exports thanks to higher growth among Poland's trading partners, low financing costs and the government's "Polish Investments" program. According to official projections, economic growth is expected to reach levels well above 3.0 percent in 2014.

Poland remains one of the top EU performers in terms of economic growth. Over the recent years, Poland has been the fastest catching-up-economy in the EU. In contrast to other countries, Poland avoided recession and its cumulative real GDP growth since 2008 reached 20 percent—almost twice as much as for Slovakia, the second top performer.

Labor market conditions are also slowly improving. The unemployment rate, although still high, has decreased to 9.7 percent in April—the lowest level over the past three years. While productivity has been steadily rising, limited wage pressure keeps unit labor costs in check and translates into improving labor cost competitiveness.

External Sector

The current account (CA) deficit in 2013, at 1.3 percent of GDP, reached its lowest level in over a decade. A favorable competitive position and weak domestic demand, translating into lower imports, fuelled a sharp improvement in the balance on goods and services. Export dynamics were sustained by gains in the market share and an expansion toward Central and Eastern European as well as other developing markets.

In April 2014, according to preliminary data, the current account recorded the highest surplus in the recent history. This contributed to a reduction of the overall CA deficit in terms of 12-month GDP to only 0.8 percent. It was accompanied by a substantial capital account surplus, primarily a factor of a strong inflow of the EU structural funds. External debt is relatively stable—approximately 70 percent of GDP. At the same time, around two-thirds of corporate external debt is either intercompany or trade credit, which substantially reduces roll-over risk. The level of official reserves slightly decreased over the last few months, but remains broadly adequate, fully covering short-term external debt. Moreover, Poland continues to benefit from the precautionary Flexible Credit Line arrangement with the Fund which provides an additional reserve buffer against external shocks and helps strengthen investor confidence.

Fiscal Policy

In 2013, the Polish authorities faced challenging conditions for fiscal consolidation. An unfavorable external environment, cyclical slowdown and the widened output gap translated into a significant decline in tax revenues. This hindered the realization of the previously foreseen fiscal adjustment path. In December 2013, the Ecofin Council issued a new recommendation extending the deadline for correction of Poland's deficit by one year, to 2015. Poland's general government deficit, in 2013, widened to 4.3 percent of GDP, which was lower, however, than the 4.8 recommended by the Council. At the same time, in response to the Council's recommendation, the Polish authorities took further consolidation measures. In result, in the recent European Commission's assessment, Poland has met the recommended change in the structural balance foreseen for 2014 and is expected to stay within the ceiling of the headline deficit recommended by the Council.

Looking ahead, the government is committed to reducing the excessive imbalance in public finances in a manner which would not pose a threat to medium-term growth prospects. In line with the Council recommendation, the authorities are aiming at bringing down the deficit in a sustainable manner below 3 percent of GDP in 2015. In addition, fiscal policy in the coming years will be oriented towards achieving the medium-term budgetary objective (MTO) of 1 percent of GDP. This will be fostered by compliance with the new stabilizing expenditure rule introduced last year.

This year, the general government sector is projected to record a one-off surplus of 5.8 percent of GDP due to the effect of the recent reform of the pension system. This follows a review concluded by the authorities last year and their decision to introduce changes to the second pension pillar in order to eliminate inefficiencies inherent in its original design. The creation of the second pension pillar in 1999 led to a significant financing gap in the first pillar, operating on the PAYGO basis. This gap had to be financed with transfers from the state budget, which necessitated additional debt issuance. In the years 1999–2012 the accumulated amount of that debt reached 17.5 percent of GDP.

As a result of the reform, part of the pension fund assets (Treasury securities and Treasury-guaranteed bonds) were transferred from the second (privately managed) to the first (public) pillar. Cancellation of the acquired Treasury securities (after their equivalent was registered on the individual social security sub-accounts) led to a significant reduction in the general government debt (from 57.1 percent of GDP in 2013 to, projected, 49.5 in 2014). Changes to the pension system had been subject to extensive discussions with all stakeholders. The authorities also placed high importance on ensuring that they clearly communicate the changes to the markets. Rating agencies assessed the changes as rating neutral. In the long term, the effects are expected to be positive—thanks to lower debt, servicing costs, and borrowing requirements. Furthermore, given the significant reduction in the debt-to-GDP ratio, two new lower public debt thresholds triggering downward corrections in the expenditure growth limits were introduced in the public finance law—together with the new stabilizing expenditure rule. They are equal to, respectively, 43 and 48 percent of GDP, and they replaced the previous 50 percent threshold.

Monetary Policy

In 2013, inflation pressure in Poland was very weak and the headline CPI remained significantly below the inflation target. The low inflation rate resulted from low demand pressures, and favorable dynamics of electricity and food prices. The Monetary Policy Council (MPC) continued the cycle of interest rate cuts initiated in late 2012. Over the entire cycle, NBP reference rate was reduced by 225 bps, from 4.75 percent in November 2012 to the all-time low 2.50 percent in July 2013. The MPC has kept the interest rates unchanged ever since, and on several occasions signaled that the rates should further remain unchanged in subsequent quarters. The Council currently assesses that NBP interest rates ought to be kept unchanged until the end of the third quarter of 2014. The MPC does not exclude interest rate adjustments if the incoming information supports such a decision.

Financial Sector

Amid the GDP slowdown in 2012–13 and the sovereign debt crisis in the euro area, the Polish financial sector has remained stable and resilient. In spite of the impact of the financial crisis on some of the foreign parent institutions, there has been no evidence of disorderly deleveraging in the Polish banking sector. Banks maintain low leverage ratios, remain liquid, well-capitalized, and highly profitable. The banking sector has ample capital resources to meet credit demand as growth picks up, while improving economic fundamentals should in turn further strengthen its position.

Despite an unfavorable environment, the net profits of Polish banks have been stable since reaching a record high in 2011. In line with recommendations issued by the Financial Supervisory Authority, banks maintained their capital buffers with the capital adequacy ratio reaching 15.6 percent at the end of Q1 2014 and Tier 1 capital representing around 90 percent of total capital. At the same time, the liability structure of Polish banks improved

as the parent-based funding was reduced in an orderly fashion and, to some extent, substituted with deposits from non-financial residents.

After a slower credit growth in 2013, the expansion picked up this year. As of Q1:2014, overall credit to the non-financial sector grew by 4.4 percent y-o-y (after exchange rate adjustment). The growth in loans to enterprises continues to be supported by the successful government guarantees program “De Minimis”, now covering both—working capital and investment loans.

Simultaneously, work is progressing on further measures to strengthen the financial sector and improve supervision, including macroprudential and bank resolution frameworks. Regulatory and supervisory actions to reduce the share of FX loans in new mortgage lending proved successful as the FX mortgage portfolio has been in runoff mode since mid-2012. Loan-to-value limits for housing and commercial real estate loans, which came into force in early 2014 and will be gradually tightened until 2017, should contribute to strong loan quality going forward. While still high, the share of NPLs in non-financial sector decreased slightly over the past year, on the account of improving economic conditions and sales of NPLs by some banks. The coverage of NPLs by provisions remains at a comfortable level.

Structural Reforms

The Polish authorities continue to implement their structural reforms agenda. Starting this year, they plan to undertake new measures to improve tax compliance and strengthen the efficiency of tax administration. They maintain efforts to further advance labor and product market reforms, with a focus on increasing the labor participation rate, especially among women, limiting labor market segmentation, and reducing youth unemployment. Important steps have been taken to facilitate access to regulated professions, with subsequent tranches of de-regulations gradually entering into force. In addition, the authorities remain committed to further improving the business environment and reducing red-tape.