INTERNATIONAL MONETARY FUND

IMF Country Report No. 15/16

REPUBLIC OF POLAND

January 2015

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

In the context of the arrangement under the Flexible Credit Line and cancellation of the current arrangement, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 14, 2015. Based on information available at the time, the staff report was completed on December 30, 2014.
- A **Staff Supplement** of January 5, 2015 on the assessment of the impact of the proposed Flexible Credit Line arrangement on the Fund's finances and liquidity position.
- A **Press Release** including a statement by the Acting Chair of the Executive Board.
- A **Statement** by the Alternate Executive Director for the Republic of Poland.

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

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

REPUBLIC OF POLAND

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

December 30, 2014

KEY ISSUES

Background: Poland's strong fundamentals and sound policies helped it to successfully withstand several bouts of market turbulence and paved the way for economic recovery. While Poland has benefited from its continued transformation into a more open and dynamic economy, its substantial trade and financial linkages with global markets, combined with still-large financing needs, also make it vulnerable to external shocks.

Outlook and risks: With only modest growth in its trading partners, economic activity in Poland is expected to remain moderate in the near term. Risks remain tilted to the downside amid concerns about a protracted slowdown in the euro area, continued geopolitical tensions in the region, and uncertainty surrounding normalization of monetary policy in the United States. Domestically, the risk of continued disinflation remains high.

Flexible Credit Line (FCL): Against this background, the authorities are requesting a new two-year precautionary FCL arrangement with proposed lower access in the amount of SDR 15.5 billion (918 percent of quota) and cancellation of the current arrangement, approved on January 18, 2013. Poland's improved economic fundamentals and increased policy buffers have reduced financing needs. However, external risks remain elevated. In this context, the authorities consider that a new FCL in the requested amount would provide an important insurance against external risks, help sustain market confidence, and support their economic strategy. At the same time, the authorities consider that the substantial reduction in access sends a clear signal of their intention to fully exit from the FCL once external risks recede. In staff's view, Poland continues to meet the qualification criteria for access under the FCL arrangement.

Fund liquidity: The impact of the proposed commitment of SDR 15.5 billion on Fund liquidity would be manageable.

Process: An informal meeting to consult with the Executive Board on a possible FCL arrangement for Poland was held on December 19, 2014.

Approved By
Mahmood Pradhan and Sanjaya Panth

The report was prepared by a staff team led by Daria Zakharova and comprising Lone Christiansen, Christian Ebeke, Francisco Vazquez (all EUR), and Annette Kyobe (SPR). Excellent assistance was provided by Fernando Morán Arce and Bartek Augustyniak (both EUR).

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CONTEXT

1. **The Polish economy successfully withstood several spells of market turbulence, helped by very strong fundamentals and policies and the insurance provided by the FCL.** Alongside limited macroeconomic imbalances, able economic management helped reinvigorate growth in 2013 and first half of 2014. Amidst bouts of global financial volatility, including associated with the recent sharp depreciation of the Russian ruble, Polish financial markets have remained relatively stable and the flexible exchange rate has continued to play its stabilizing role. The well-capitalized banking system has remained resilient to external shocks. At the conclusion of the 2014 Article IV Consultation, Executive Directors noted that Poland's very strong fundamentals and economic policies had helped it weather the turmoil in financial markets and that the precautionary FCL arrangement provided important insurance against external risks.

2. **Poland continues to be exposed to external shocks through significant trade and financial integration.** Reflecting its continued transformation into a more open and dynamic economy, Poland has benefitted from increasing integration with global trade and financial markets (Figure 1). Goods exports to the European Union represent more than ¾ of total goods exports, and the industrial sector is tightly integrated into the German supply chain. Close to 90 percent of the stock of foreign direct investment (FDI) originated from the European Union as of the third quarter of 2013. The banking sector is closely interconnected with the global financial system with more than 60 percent of assets owned by foreigners, though reliance on parent bank funding has declined. In bond markets, nonresidents hold just above 40 percent of domestic treasury securities. Poland's sizable gross external liabilities and open capital account make it susceptible to spillovers arising from shifts in investor sentiment.

3. **The authorities have continued to rebuild policy space, while strengthening the already very strong economic fundamentals and the policy framework to reduce vulnerabilities.**

- **The authorities have continued to increase fiscal policy space.** During the 2013 slowdown, fiscal policy allowed automatic stabilizers to operate around gradual structural consolidation. With weak growth in 2013, the headline deficit widened from 3.7 percent of GDP in 2012 to 4 percent of GDP in 2013 but the cyclically adjusted deficit narrowed. Poland's strong public finances and its sound fiscal framework, which constrained public debt below 60 percent of GDP in 2013, have contributed to sustain favorable financing conditions. The permanent expenditure rule, implemented in 2013, should help preserve long-term fiscal sustainability, while allowing for countercyclical fiscal policy.

- **Monetary policy action helped support economic stability.** To counteract low inflation, policy interest rates were cut by a cumulative 225 basis points in the course of late-2012 and 2013. While this helped support domestic demand, inflationary pressures remain weak, primarily reflecting low energy and food prices and subdued imported inflation.

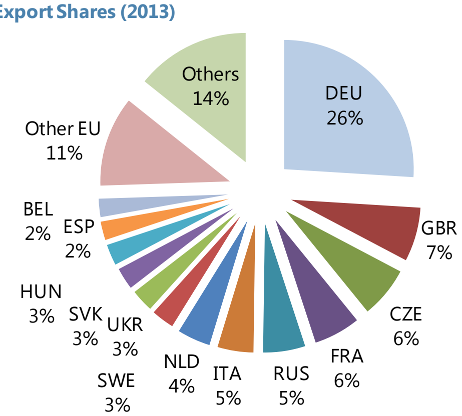
- **The authorities continued to build reserve buffers.** International reserves increased to USD 100 billion at end-October 2014 from USD 80 billion at end-2009 and are broadly adequate against standard benchmarks. Reserves are also relatively high compared to the median emerging market (EM) (Figure 2) and the flexible exchange rate has continued to provide a cushion against external shocks. The swap line with the Swiss National Bank continues to provide added insurance in the event of severe Swiss franc funding pressures.

- **The financial supervisory authority (KNF) continued to strengthen financial sector oversight.** While the legacy share of foreign currency mortgages accounts for close to half of mortgages, exposing them to exchange-rate risk, tightened rules on foreign currency lending have halted new foreign currency mortgage origination. The gradual lowering of maximum loan-to-value (LTV) ratios on new mortgages to 80 percent by 2017 will further reduce risks.

Republic of Poland: Trade and Financial Linkages

A large share of trade is with Europe…

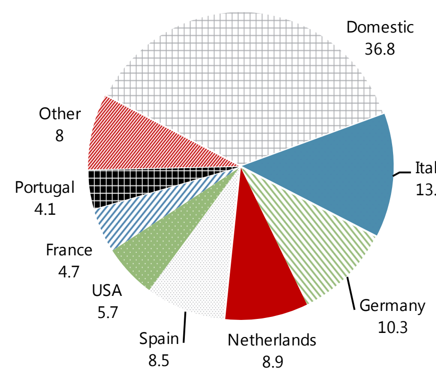
Export Shares (2013)



Sources: Direction of Trade Statistics and IMF staff calculations.

…and the banking system is largely foreign owned.

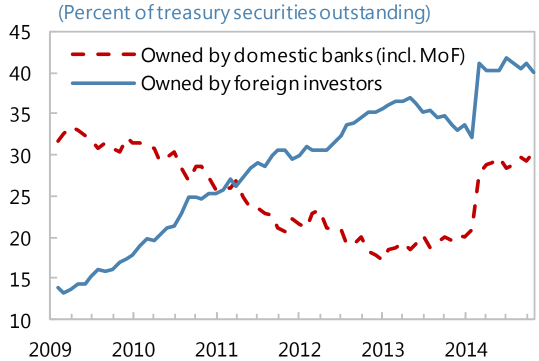
Bank Ownership Structure
(Percent of assets, 2013)



Sources: KNF and IMF staff calculations.

Nonresidents hold a large part of domestic treasuries…

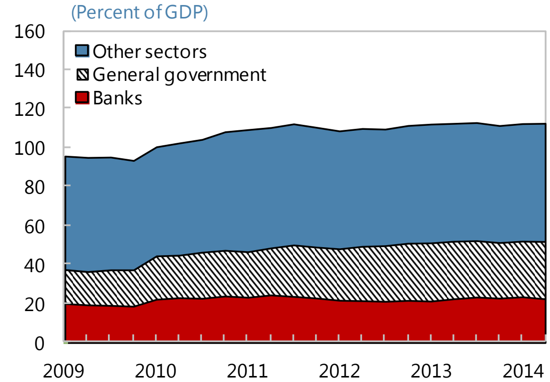
Ownership of Local Government Bonds
(Percent of treasury securities outstanding)



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

…and external liabilities are large.

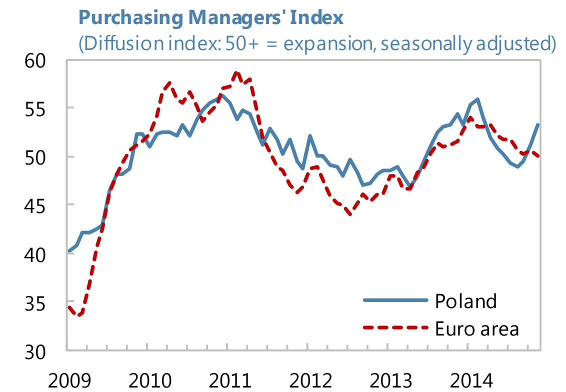
International Investment Position, Liabilities
(Percent of GDP)



Sources: National Bank of Poland and IMF staff calculations.

RECENT DEVELOPMENTS

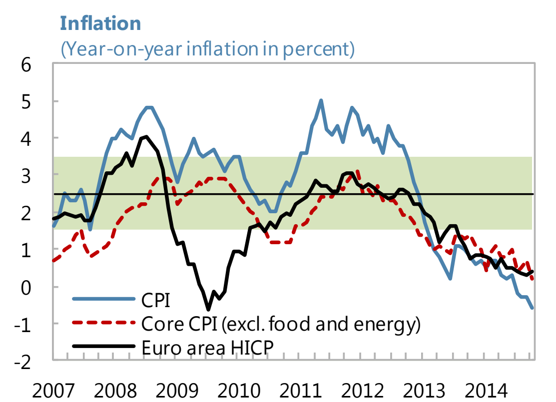
4. **After a domestic demand-led recovery in the beginning of 2014, growth has moderated.** On the back of monetary easing, economic activity gathered strength in 2013 and into the first quarter of 2014. However, growth moderated in the second quarter of 2014 amid the slowdown in the euro area and adverse confidence effects from geopolitical tensions surrounding Russia and Ukraine. While the purchasing managers' index (PMI) recently picked up and growth in the third quarter held up better than expected, recent downward revisions of growth forecasts in key European trading partners point to downside risks to the baseline forecast (Figure 3, Table 1).



Sources: Haver Analytics, HSBC/Markit, and IMF staff calculations.

5. **The labor market continued to strengthen.** The seasonally adjusted unemployment rate (LFS definition) continued to decline, reaching 8½ percent in September on the back of positive job creation in the manufacturing sector. Nominal wage growth has also held up well, supporting private consumption.

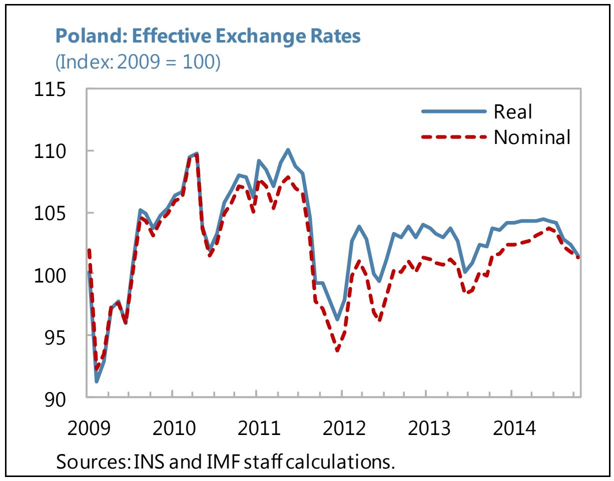
6. **Inflation remains well below the target.** Despite improvements in the labor market, headline inflation continued to decline, reaching a historic low of -0.6 percent in October. This reflected both weak imported inflation from main trading partners as well as low food and energy price inflation. In turn, repeated external supply shocks fed into core inflation through second-round effects, resulting in a downward revision of inflation projections since the 2014 Article IV consultation.



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

7. **The current account has continued to improve (Figure 4, Table 2).** The current account deficit narrowed from around 5 percent of GDP during 2010–11 to 1.4 percent of GDP in 2013. The improvement largely reflects a healthy trade surplus on the back of strong exports, in part as a result of increased trade with Central and Eastern Europe (CEE) and the Commonwealth of Independent States (CIS). The current account was largely financed by EU structural funds. Foreign direct investment has traditionally served as a relatively stable source of financing. However, partly owing

to one-off factors, net FDI inflows have recently declined. The exchange rate is broadly consistent with fundamentals and desirable policy settings.



8. The financial sector has remained well capitalized, liquid, and profitable (Figures 5 and 6, Table 3). The total capital ratio under CRDIV stood at 14.9 percent in the third quarter with the Tier 1 capital ratio at 13.7 percent. Profitability has remained healthy. The banking sector is liquid with deposit growth at 8.3 percent in September 2014 and a declining funding gap. The KNF's Asset Quality Review and stress tests, which were undertaken alongside the ECB's Comprehensive Assessment of banks in the euro area, confirmed the banking sector's resilience to shocks. The NPL ratio has continued to gradually decline, falling to 8.2 percent in September 2014 from a peak of 9 percent about one and a half years earlier. Credit growth has strengthened moderately, staying above 5 percent year-on-year in September. Liabilities to foreign financial institutions have diminished in an orderly fashion.

9. Fiscal consolidation has continued. Overall, the headline deficit is expected to decline by close to 1 percentage point of GDP to 3.1 percent of GDP in 2014 (Tables 4 and 5). Public debt is projected to drop by about 7 percentage points to 48.8 percent of GDP in 2014 owing to the one-off transfer of pension fund holdings of public debt to the social security administration. Correspondingly, the thresholds in the correction mechanism of the fiscal rule have been lowered by 7 percentage points of GDP with the aim of permanently stabilizing public debt at a lower level. Public debt is deemed sustainable under a variety of shocks. Reflecting supportive external financing conditions and very strong fundamentals, spreads on 10-year bond yields vis-à-vis Germany reached a six-year low in late-October 2014, dropping to around 170 basis points.

OUTLOOK, RISKS, AND POLICIES

10. Near-term economic activity is expected to moderate. Staff projects real GDP growth to moderate from 3.2 percent in 2014 to 3 percent in 2015. While the recent decline in oil prices may help lift growth and the current account, the direct impact will likely be limited by the relatively small share of oil in Poland's energy consumption and imports. Moreover, the worsening growth outlook in Poland's trading partners, including in the CIS, would more than offset this effect. Inflation is expected to gradually increase and enter the lower end of the tolerance band (1.5 to 3.5 percent) by early 2016, though continued decline in oil prices presents additional downside risk to this projection.

11. Over the medium term, growth is projected to gradually strengthen. Growth is expected to reach 3.5 percent in the medium term on the back of robust domestic demand, supported by higher EU structural funds under the 2014–20 EU budget and improving labor market conditions.

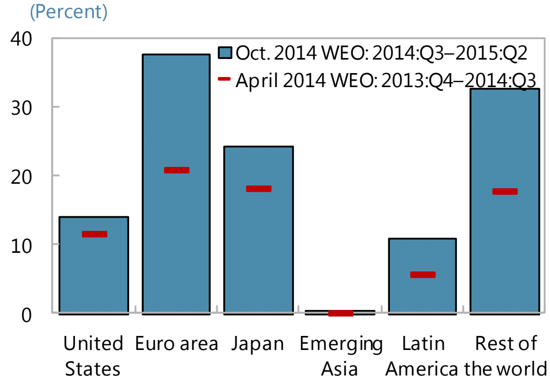
The current account deficit is projected to widen moderately along with declining net income. The output gap should close by 2017.

12. External risks have abated somewhat but remain elevated. Risks to the outlook are tilted to the downside, primarily owing to external risks, though protracted domestic low inflation could also dampen activity. The nature of risks has shifted since the time of approval of the current FCL arrangement as crisis-related risks in the euro area have subsided while other risks have arisen. ECB actions since 2012, including the successful completion of the Comprehensive Assessment, have lessened uncertainty about the health of the European banks' balance sheets, thereby reducing the risk of disorderly deleveraging stemming from bank exposures. However, the risk of a protracted period of slower growth in the euro area remains and concerns also arise from the uncertain market reaction to monetary policy tightening in the US. Further, the October 2014 WEO noted that geopolitical risks, including related to Russia and Ukraine, have added to downside risks. The October 2014 GFSR adds that while credit risks in the global financial system have declined along with improved asset quality, market and liquidity risks have increased following an increase in risk appetite. Accordingly, the external economic stress index for Poland indicates that, while external conditions have improved moderately, substantial downside risks remain (Box 1).

Global Outlook

The probability of recession has increased…

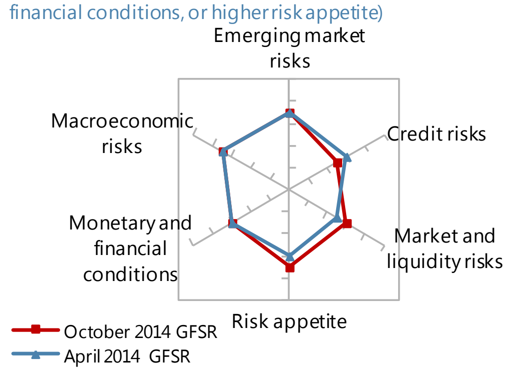
Probability of Recession, 2014:Q3–2015:Q2
(Percent)



Source: IMF World Economic Outlook, October 2014.

…as have market and liquidity risks.

Global Financial Stability Map
(Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite)



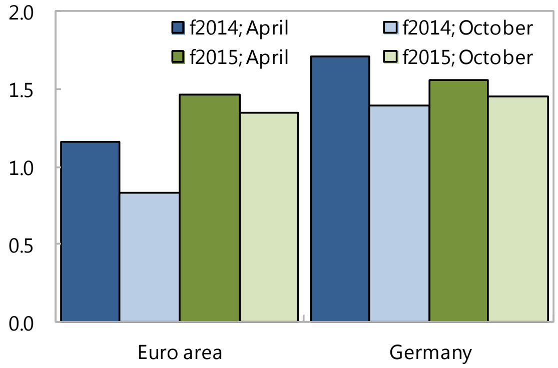
Source: IMF Global Financial Stability Report, October 2014.

- **Protracted period of slower growth in the euro area.** Prolonged slower growth among trading partners would have large effects on Poland. Poland's successful integration into the German supply-chain has shaped its trade linkages with Europe and with the rest of the world. The recent downward growth revisions in the euro area and worsening high-frequency indicators, combined with high synchronization of Poland's growth rates with those in Germany and the euro area, increase the likelihood of a further loss of growth momentum in Poland. Furthermore, a sharper-than-expected slowdown in the euro area could result in a sudden shift in market sentiment, accompanied by capital outflows.

Republic of Poland: Growth Spillovers

Growth has been revised down substantially...

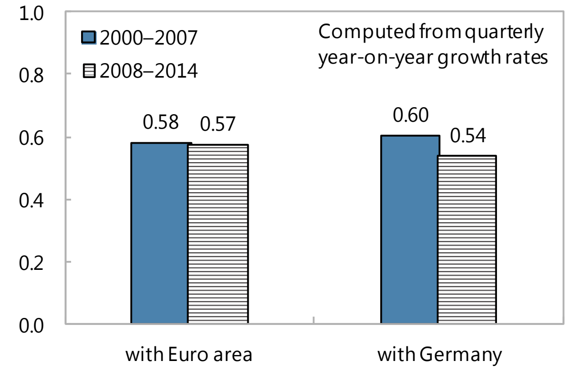
Real GDP Growth Forecasts (Percent; forecasts done in April and October 2014 for the years 2014 and 2015)



Source: IMF staff calculations.

...with expected spillovers to Poland.

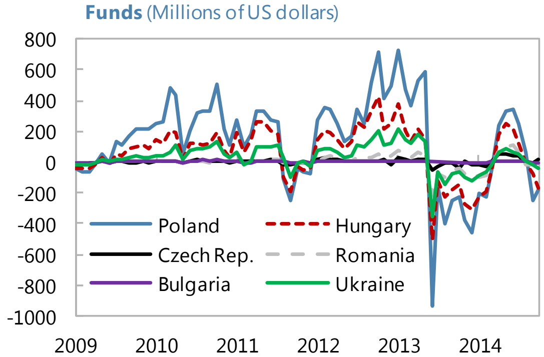
Poland: Synchronization of growth rates (Correlation coefficients of GDP growth)



Sources: Haver Analytics; and IMF staff calculations.

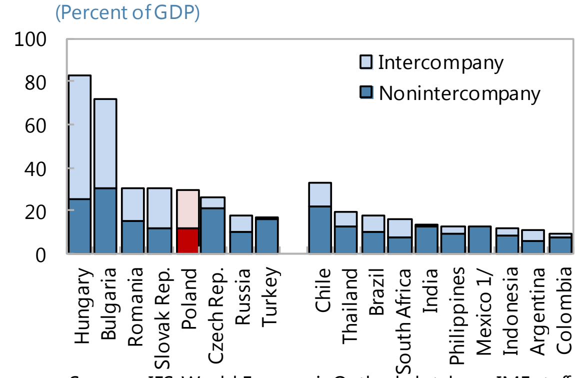
- **An abrupt surge in global financial market volatility.** Poland's open capital account makes it susceptible to spillovers arising from shifts in investor sentiment. While Poland's deep and liquid financial markets have benefitted its economy, they also present risks. Poland's sizeable portfolio inflows make it vulnerable to an abrupt surge in global financial market volatility, including from a potential worsening of the situation in Russia and a stronger-than-expected market reaction from the normalization of U.S. monetary policy—though asset purchases by the European Central Bank are a risk-mitigating factor. Poland's role as a proxy for the CEE region also involves a large zloty turnover in global markets. High short-term debt amortization needs in both financial and nonfinancial sectors make the private sector vulnerable to shocks, including a decline in rollover rates associated with tighter financial market conditions. While nonfinancial corporate (NFC) sector vulnerabilities are mitigated by the high share of intercompany loans, total external NFC debt at around 30 percent of GDP is high relative to non-European peers. Hence, large interest-rate shocks could pose a risk.

Monthly Bond Funds Flows: ETFs and Mutual Funds (Millions of US dollars)



Sources: EPFR Global, Haver Analytics, and IMF staff calculations.

Nonfinancial Sector External Debt, 2013 (Percent of GDP)



Sources: IFS, World Economic Outlook database, IMF staff calculations. 1/ FDI debt instruments not available.

- **Sustained geopolitical tensions surrounding Russia and Ukraine.** Continued tensions could dampen confidence and growth and increase financial market volatility. Though direct trade and financial links to Russia are limited, Poland remains vulnerable to energy supply disruptions from Russia. Hence, gas-intensive industries could be particularly affected. In addition, confidence effects could discourage investment in Europe with direct trade and financial spillovers to Poland.

Box 1. Republic of Poland: External Economic Stress Index

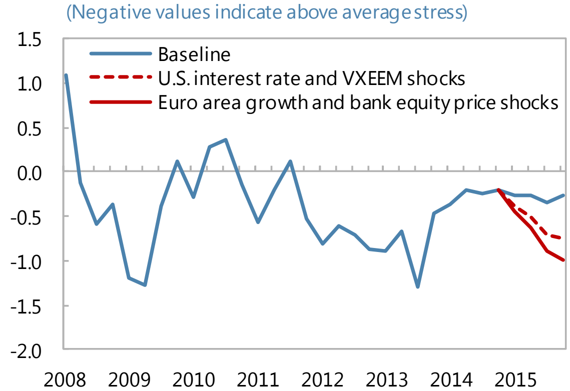
The external economic stress index for Poland is calculated following the methodology in *The Review of the Flexible Credit Line, the Precautionary and Liquidity Line, and the Rapid Financing Instrument*, IMF Policy Paper, April 2014.

The external stress index shows that while external economic conditions for Poland have improved, risks remain elevated. The index is an indicator of the evolution of the external environment as it pertains to Poland. Risks are divided into real shocks (growth in the euro area) and financial shocks (change in the US 10-year bond yield, the VXEEM, and European banks' equity price). The index is a weighted sum of standardized deviations of external risk variables from their means. The weights are estimated using balance of payments and international investment position data, all expressed as shares of GDP:

- the weight on euro area growth (0.21) corresponds to the sum of exports and FDI from the euro area;
- the weights on the change in the US long-term yield (-0.31) and the emerging market implied volatility VXEEM (-0.09) correspond to the stocks of foreign portfolio debt and foreign-held equity; and
- the weight on the European banks' equity price (0.38) is represented by the stock of cross-country bank exposure.

The index shows that external risks remain elevated. After a sharp deterioration of external conditions following Fed-tapering talks in May 2013, conditions have improved as global financial volatility has subsided and economic activity in the euro area has picked up. However, under staff's baseline, external risks would remain elevated, reflecting the recent downward revision of the euro area growth forecast and the expected increase in US interest rates.

Poland: External Economic Stress Index
(Negative values indicate above average stress)



Source: IMF staff calculations.

Adverse scenarios assume a negative shock to euro area growth and a sudden shift in market sentiment, triggered by a stronger-than-expected market reaction to the normalization of monetary policy in the US. Two downside scenarios are simulated to assess external stress under these shocks. The first scenario is based on a 100 basis point increase in long-term US interest rates above the baseline, combined with a two-standard-deviation increase in the VXEEM, as investors reassess underlying risks. This scenario is in line with that in the 2014 Spillover Report. The second scenario assumes a reduction in euro area growth by 0.5 percentage points relative to the 2015 baseline—in line with the October 2014 World Economic Outlook downside scenario of 0.5 percentage point reduction in growth in advanced economies as a result of secular stagnation—combined with a reduction in euro area bank equity valuation. As expected, the euro area shock triggers a steeper decline in the index, consistent with Poland's strong trade and financial linkages with Europe.

13. Domestically, the risk of continued disinflation remains high. Disinflation could persist owing to external factors, including declining energy and food prices and low imported inflation, although recent exchange rate depreciation is a mitigating factor. Inflation could also fail to pick up if domestic demand slows or if low inflation expectations become entrenched in the absence of further policy action.

14. Against this background, policies appropriately focus on supporting the economy while continuing to gradually build buffers.

- **The 2015 budget is broadly neutral.** The fiscal deficit is projected to reach 2.6 percent of GDP in 2015, which should allow Poland to exit the excessive deficit procedure by 2016 as planned. Public debt is projected to continue gradually declining and is deemed sustainable with a robust risk profile in terms of interest, rollover, and foreign currency risks (Annex I). The authorities' medium-term objective (MTO) of a 1 percent of GDP deficit in structural terms is adequate to put public debt on a firm downward path. This would require additional consolidation measures of about 1 percent of GDP over the medium term. Poland maintains a sound fiscal framework, anchored in a constitutional public debt limit, an expenditure rule, and three preventive debt thresholds enshrined in the Public Finance Law. The authorities are planning to conduct an expenditure review in selected spending areas to support the implementation of the rule.
- **The authorities have eased monetary policy to help support inflation.** In the context of low inflation and moderate economic activity, the Monetary Policy Committee (MPC) reaffirmed its 2.5 percent inflation target (Table 6). After halting the easing cycle in mid-2013 as the recovery started to gain strength, the main policy interest rate was lowered by 50 basis points in October 2014 to 2 percent (a historic low) to help steer inflation back to target. Nonetheless, additional policy action may be needed if inflation fails to pick up.
- **Work is continuing to strengthen financial sector supervision.** The authorities have intensified efforts to resolve the small but vulnerable credit union segment with a number of institutions developing rehabilitation plans and with merger and takeover also being carried out. Work is ongoing to establish a systemic risk board (SRB), essential for macroprudential supervision, and strengthen the bank resolution framework in accordance with the European Directive, though final legislation has been delayed owing to constitutional legal hurdles.

THE ROLE OF THE FLEXIBLE CREDIT LINE

15. The authorities have highlighted the benefits from the precautionary FCL arrangement. The FCL has complemented international reserves and Poland's very strong fundamentals and policies. It allowed space to rebuild policy buffers and further strengthen Poland's institutional framework. In turn, the economy has successfully weathered several periods of market turbulence. Despite the 2008–09 global financial crisis, the subsequent euro area crisis, the onset of US Fed tapering, and geopolitical tensions in Russia/Ukraine, Polish financial markets have remained attractive to foreign investors (Figure 7). Alongside, the authorities have continued to underscore the FCL's important stabilizing role.

16. The authorities have requested a new two-year FCL arrangement with proposed lower access of SDR 15.5 billion (about USD 23 billion). Sustained efforts to build buffers and further strengthen the policy framework have improved economic fundamentals and reduced financing needs. At the same time, the authorities note that while some risks have waned, others have arisen, with overall external risks remaining elevated. Against this backdrop, the authorities have requested an FCL arrangement with lower access. The proposed nominal access of SDR 15.5 billion is lower than the current level of SDR 22 billion and constitutes an about 30 percent reduction as a share of quota to 918 percent.

A. Access Considerations

17. The adverse scenario is used to gauge Poland's financing needs in the event external risks materialize. The scenario assumes concurrent shocks to main components of Poland's financial account. Poland's gross external financing needs are large at around 20 percent of GDP in 2015 and 2016. Potential drains on reserves could arise from a sudden reduction of portfolio inflows to government bonds or outflows from the banking system, for example precipitated by sooner-than-expected US interest-rate hikes. Short-term debt amortization needs are high in both financial and nonfinancial sectors. Hence, while the relatively stable intercompany debt mitigates risk, a decline in inflows associated with tighter financial market conditions could result in severe stress (Box 2).

18. Estimated financing needs in the adverse scenario are moderately below the current level of access. External shocks have been adjusted to reflect the changing nature of risks. In particular, in the adverse scenario, bank roll-over rates have been increased to reflect diminished crisis-related risks (Figure 8). The current account is assumed not to contribute to the financing gap, in line with Poland's past crisis experience—at the height of the 2008–09 crisis, Poland's current account *improved* from -6.6 to -3.9 percent of GDP, reflecting strong import compression following exchange rate depreciation . Alongside, improved fundamentals (including lower current account and fiscal deficits and lower reliance on foreign parent bank funding) reduce external financing needs. Strengthened buffers allow for reserve drawdown in a downside scenario, while leaving these broadly adequate. The financing gap is estimated at about USD 23 billion, below the USD 33 billion at the time of the last FCL request (Tables 7–9).

B. Exit Considerations

19. The proposed reduction in access sends a clear signal of the authorities' intention to exit from the FCL as external risks recede. The authorities' firm commitment to maintain very strong policies and fundamentals should facilitate eventual full exit from the FCL arrangement once uncertainty surrounding the effects of US monetary policy tightening, euro area growth prospects, and the situation in Russia/Ukraine diminishes.

20. The authorities have started public outreach regarding their intentions to gradually reduce FCL access, including through press interviews and direct contact with investors. To prepare financial markets for a gradual exit from the FCL, the authorities have publicly recognized the benefits of the FCL while at the same time stressing that Poland is now better prepared to deal with adverse external shocks than at the height of the crisis, including because of higher international reserve buffers. Accordingly, they have signaled that Poland is well positioned to reduce FCL access. Market reaction has been muted. To support a continued smooth exit from the arrangement, the authorities will continue communicating their plans to financial markets and the broader public going forward.

Box 2. Republic of Poland: Adverse Scenario

The adverse scenario takes as a starting point staff's baseline forecast. In the baseline, the fiscal and current account deficits have narrowed. However, gross external financing needs remain large, with the gap comfortably financed by FDI inflows, substantial external short-term (ST) and medium and long-term (MLT) private sector financing (of which 60 percent is intercompany debt), EU structural funds, and public sector external financing. Baseline rollover rates are projected at around 130 percent of the average annual amortization need during 2015–16 for the public sector and 100 percent for the private sector. In the absence of external shocks, reserve accumulation is projected at around USD 2 billion in 2015 to maintain reserves at around 120 percent of the IMF's Assessing Reserves Adequacy (ARA) metric.

Assumptions underlying the adverse scenario have been adjusted to reflect the changing nature and intensity of risks. Relative to assumptions at the time of the January 2013 FCL, two changes have been made. First, a smaller shock was applied to bank outflows (with a rollover rate of 65 percent compared to 60 percent in the 2013 FCL request) on the back of the successful completion of the ECB's Comprehensive Assessment of banks in the euro area. In turn, the shocks assumed in the adverse scenario are smaller than in Poland's previous FCL requests. Second, the adverse scenario assumes a partial drawdown of reserves. Nonetheless, reserves would remain adequate under the ARA metric.

The shocks underlying the adverse scenario reflect the potential impact on the financial account of a sudden shift in market sentiment. This could for example arise from a sharper-than-expected economic slowdown in the euro area or stronger-than-expected market reaction to the normalization of monetary policy in the US.

Assumptions underlying the adverse scenario are as follows:

FDI flows fall 25 percent. The reduction is in line with the decline in FDI in 2009.

Equity portfolio outflows of 90 percent of non-resident equity holdings. This decline is in line with equity outflows observed during the most recent EM sell-off (the second and third quarters of 2013) and half the amount of outflows seen during the most intense period of the global financial crisis.

A decline in private non-financial corporate flows of 15 percent and public sector MLT borrowing of 25 percent. ST public sector debt is fully rolled over. Rollover rates on MLT borrowing are in line with mean historical rollover rates for emerging markets.

A decline in bank flows of 35 percent. A smaller shock was applied (compared to a 40 percent decline in the 2013 FCL) to reflect reduced uncertainty about the health of the European banks' balance sheets following the recent Comprehensive Assessment.

Other investment outflows of USD 3.5 billion from non-resident deposits. This amount is USD 1.5 billion lower than outflows assumed under the adverse scenario in the 2013 FCL request, reflecting reduced reliance on foreign funding in the banking sector and is in line with the outflow observed during EM turbulence in the fourth quarter of 2013.

A drawdown of reserves of around USD 5 billion in 2015 and 2016. The drawdown represents around 20 percent of total financing needs but reserves would still allow for a small margin relative to the ARA metric. Under the adverse scenario, reserves would stand at 114 percent of the ARA metric, compared to 122 percent under the baseline forecast. This assumption differs from the 2013 FCL request, which had assumed half the baseline reserve buildup in the adverse scenario.

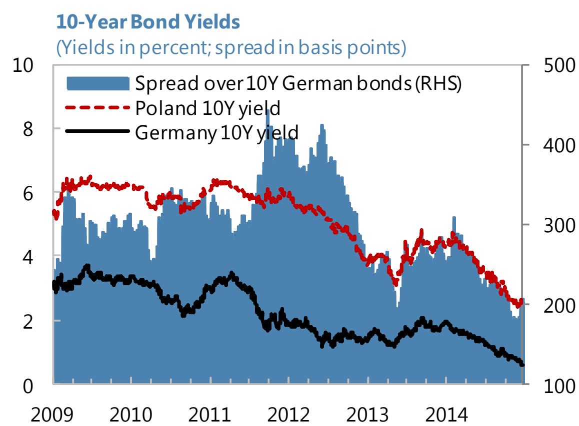
C. FCL Qualification Criteria

21. In staff's view, Poland fully meets the qualification criteria identified in ¶2 of the FCL decision (Figure 9). Poland has very strong economic fundamentals and institutional policy frameworks. The authorities are implementing—and have a sustained track record of implementing—very strong policies and remain committed to maintaining such policies in the future.

- *A sustainable external position.* Poland's external position is broadly consistent with medium-term fundamentals and appropriate policies. Model-based estimates assess that the current account and the real effective exchange rate are broadly aligned with fundamentals. While net IIP liabilities are large, sustainability concerns are mitigated by the well-diversified FDI liabilities and intercompany lending (over 40 percent of foreign liabilities are FDI investments) (Annex II). Foreign investments in the local government bond market are characterized by a favorable institutional investor base.
- *A capital account position dominated by private flows.* Capital flows are mostly from the private sector, with official creditors accounting for only 7 percent of the external debt stock as of the end of the first quarter of 2014.
- *A track record of steady sovereign access to international capital markets at favorable terms.* Poland has remained one of the highest-rated emerging market countries, with sustained access to global capital markets—even during periods of financial distress. Bond yields have declined throughout 2014 to below 3 percent in October. Sovereign spreads over 10-year German bonds have declined to levels last seen in mid-2008 and EMBI spreads stand at around 100 basis points—well below the emerging market composite. The authorities have continued to take advantage of favorable market conditions to substantially pre-finance and extend the average maturity and duration of public debt, improving its risk profile.

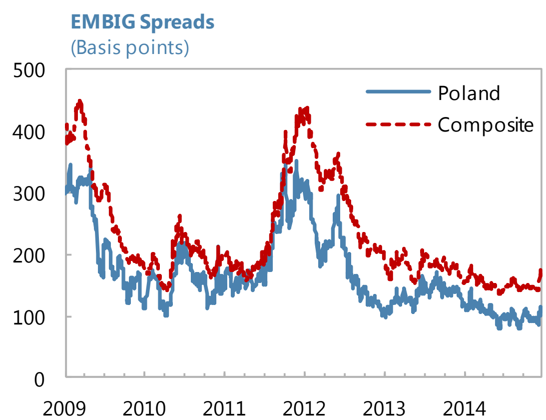
Republic of Poland: Sovereign Access to International Capital Markets

Bond yields are at historic lows...



Sources: Bloomberg and IMF staff calculations.

...with EMBI spreads below emerging market peers.



Sources: Bloomberg and IMF staff calculations.

- *A reserve position that remains relatively comfortable.* International reserves remain broadly adequate. Reserves exceed the rule of thumb across most indicators of reserve adequacy and are projected at around 120 percent of the ARA metric in 2014.
- *Sound public finances, including a sustainable public debt position.* Fiscal policy is underpinned by Poland's very strong policy framework, which includes a constitutional limit on the level of public debt and fiscal adjustments when the debt-to-GDP ratio exceeds preventive limits enshrined in the Public Finance Law. Debt sustainability analysis indicates that the baseline fiscal path is consistent with sustainable debt under a variety of macroeconomic scenarios (Annex I). Further, risks stemming from the currency composition and duration profile of public debt are limited, reflecting the strong debt management strategy.
- *Low and stable inflation, in the context of a sound monetary and exchange rate policy framework.* While external shocks have been a drag on inflation, it is expected to begin converging toward the target band supported by frontloaded monetary policy easing. Following the 50 basis point cut in October, the policy interest rates have been kept unchanged on the back of better-than-expected growth in the third quarter. However, the MPC has noted that further monetary easing would be justified in the event of an extended period of deflation. The authorities remain committed to preserving their credible and transparent inflation-targeting framework.
- *Sound financial system and the absence of solvency problems that may threaten systemic stability.* Poland's well-capitalized (capital adequacy at around 15 percent), liquid (liquid assets to total assets of 21 percent), and profitable (return on assets at just above 1 percent) banking sector serves as the core of Poland's sound financial system. While the credit union segment is weak, its size is equivalent to only about 1½ percent of banking sector assets, and the authorities are taking steps to resolve it. In addition, the outcome of the European Comprehensive Assessment increased confidence in the health of parent bank balance sheets. The National Bank of Poland (NBP) assesses that other non-bank financial institutions have only weak linkages with the banking sector and are characterized by their stable financial situation and activities. As such, there are no solvency problems to threaten systemic stability.
- *Effective financial sector supervision.* The authorities routinely undertake stress tests. Recently, KNF undertook a Comprehensive Assessment of banks in Poland, conducted in accordance with the ECB's methodology, together with stress tests of 15 major banks in Poland, allowing to assess the Polish banking sector alongside euro area banks. KNF has continued to take steps to strengthen financial sector oversight, including through completion of a thematic supervisory review of impaired assets and issuance of a letter to banks, summarizing regulatory recommendations.
- *Data transparency and integrity.* Poland has subscribed to the Fund's Special Data Dissemination Standard (SDDS) since 1996. Overall data provision is adequate for surveillance.

22. Furthermore, Poland's institutions and policy frameworks rank highly among peers. Reflecting the authorities' continuing efforts to further strengthen the already very strong institutions and policy frameworks, Poland compares favorably with other emerging markets on a number of institutional quality indicators, including on control of corruption and government effectiveness (Figure 10).

23. The authorities' letter (Appendix) highlights their determination to maintain very strong institutional policy frameworks and policies. The authorities stress their balanced approach to macroeconomic management. Mindful of economic growth considerations, they have been pursuing a conservative fiscal policy aimed at putting public debt on a robust downward path, and a new permanent expenditure rule has been introduced to guide policy implementation. Monetary policy continues to be guided by the inflation targeting framework, underpinned by the flexible exchange rate regime. Effective financial sector supervision will continue to support financial stability. The authorities reaffirm their intention to treat the FCL arrangement as precautionary.

IMPACT ON FUND FINANCES, RISKS, AND SAFEGUARDS

24. The impact of the proposed arrangement on Fund liquidity is assessed to be manageable. At around SDR 239 billion, the Forward Commitment Capacity (FCC) of the Fund appears sufficiently strong to accommodate the proposed arrangement. In particular, the cancellation of Poland' existing FCL arrangement would partially offset the liquidity effect from the proposed new FCL arrangement. Furthermore, the need to set aside New Arrangement to Borrow (NAB) resources to allow for the folding in of bilateral claims would be reduced. The net effect on Fund liquidity compares favorably with a scenario of unchanged access. Under the proposed 30 percent reduction in access, the immediate net impact of the proposed arrangement would be to lower the Fund's FCC by about SDR 10 billion (4.2 percent)—well below a reduction of 6.9 percent under unchanged access.

25. Poland's capacity to repay the Fund is strong. The authorities intend to continue to treat the arrangement as precautionary. Nonetheless, even if the full amount available under the requested FCL arrangement were to be disbursed, Poland's capacity to fulfill its financial obligations to the Fund should be manageable. In case of full disbursement in 2015, total external debt would rise to 74 percent of GDP initially, and public external debt to about 33 percent of GDP, with Fund credit representing 4 percent of GDP. Poland's total external debt service is projected to decline in the medium term both under the baseline and in the event the authorities draw on the FCL. The projected debt service to the Fund would peak in 2019 at about SDR 7.9 billion, or about 1.8 percent of GDP.

26. Staff has completed the safeguard procedures for Poland's 2013 FCL arrangement. The authorities provided the necessary authorization for Fund staff to communicate directly with the NBP's external auditor, PricewaterhouseCoopers (PwC) Warsaw, for the current FCL arrangement. As such, staff has reviewed the 2012 audit results and discussed these with PwC. Staff concluded that no significant safeguards issues emerged for the conduct of these procedures. In preparation for the proposed successor arrangement, the NBP has provided the authorization needed for an update of the safeguards procedures to be conducted by Fund staff in relation to the proposed arrangement.

Republic of Poland: Impact on GRA Finances

(Millions of SDR, unless otherwise indicated)

	As of December 1, 2014
Liquidity measures	
Forward Commitment Capacity (FCC) before approval 1/	238,595
FCC on approval 2/	228,595
Change in percent	-4.2
Prudential measures	
Fund GRA commitment to Poland including credit outstanding	
in percent of current precautionary balances	121.1
in percent of total GRA credit outstanding 3/	19.9
Fund GRA credit outstanding to top five borrowers	
in percent of total GRA credit outstanding 3/	89.1
in percent of total GRA credit outstanding including Poland's assumed full drawing	88.9
Poland's projected annual GRA charges for 2015 in percent of the Fund's residual burden-sharing cpacity	13,697
Memorandum items:	
Fund's precautionary balances (FY14)	12,800
Fund's residual burden-sharing capacity 4/	2.7

Sources: Finance Department and IMF staff calculations.

1/ The FCC is defined as the Fund's stock of usable resources less undrawn balances under existing arrangements, plus projected repurchases during the coming 12 months, less repayments of borrowing due one year forward, less a prudential balance. The FCC does not include about US$461 billion in bilateral pledges from members to boost IMF resources. These resources will only be counted towards the FCC once: (i) individual bilateral agreements are effective and (ii) the associated resources are available for use by the IMF, in accordance with the borrowing guidelines and the terms of these agreements.

2/ Current FCC minus new access plus access under the expiring program adjusted for the NAB financed portion of the expiring commitment (about SDR 16.5 billion) which was considered as already committed at the time of the most recent NAB activation and is therefore not available to finance new commitments under the current activation. This amount could be included in possible future NAB activations.

3/ As of December 1, 2014.

4/ Burden-sharing capacity is calculated based on the floor for remuneration at 85 percent of the SDR interest rate. Residual burden-sharing capacity is equal to the total burden-sharing capacity minus the portion being utilized to offset deferred charges and takes into account the loss in capacity due to nonpayment of burden-sharing adjustments by members in arrears.

STAFF APPRAISAL

27. The FCL has provided valuable insurance against external risks. Poland has remained resilient to external shocks despite bouts of financial market volatility. Bond yields are close to historic lows and spreads have narrowed. The insurance provided by the FCL has allowed the authorities to continue building buffers to further strengthen Poland’s already very strong economic fundamentals amid an uncertain external environment.

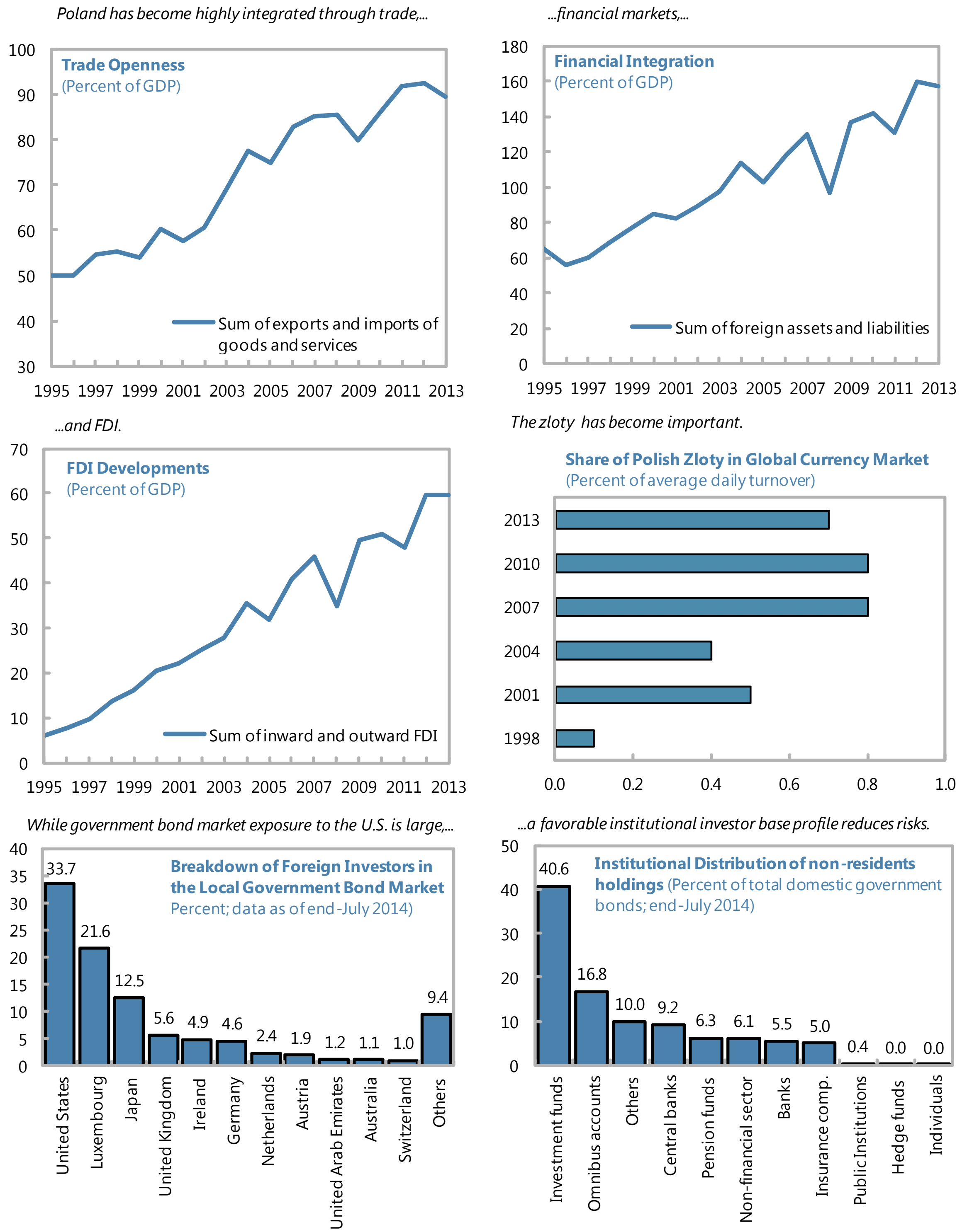
28. In staff’s view, Poland continues to fully meet the qualification criteria for access to FCL resources. At the conclusion of the 2014 Article IV Consultation, Executive Directors noted that

Poland's very strong fundamentals and economic policies had helped it weather the turmoil in financial markets and that the precautionary FCL arrangement provides important insurance against external risks. Poland continues to benefit from very strong economic fundamentals and policies, as well as sustainable public and external debt positions. The authorities have a proven track record in sound macroeconomic management, and effective supervision has kept the financial sector well capitalized and profitable. The authorities have reiterated their firm commitment to maintaining prudent policies going forward.

29. Staff considers the proposed access under a two-year FCL arrangement for SDR 15.5 billion (918 percent of quota) to be appropriate. The authorities' efforts to build buffers and further strengthen the policy framework have improved economic fundamentals and reduced financing needs. However, while external risks have abated somewhat, they remain elevated. Hence, it is premature for Poland to fully exit from the FCL arrangement. On balance, staff assesses that a gradual exit from the arrangement would be appropriate. The requested amount would continue to provide adequate insurance against adverse market conditions. At the same time, a 30 percent reduction in access sends a clear signal of the authorities' intention to fully exit from the FCL arrangement when external risks allow and is being accompanied by a clear communication strategy.

30. Risks to the Fund arising from a successor FCL arrangement for Poland are judged as manageable. Risks to Fund finances are contained by the authorities' very strong policies, combined with their sustained track record of policy implementation. Risks are further mitigated by the authorities' intention to continue to treat the FCL arrangement as precautionary, their very strong debt-servicing record, and the sustainable external debt path.

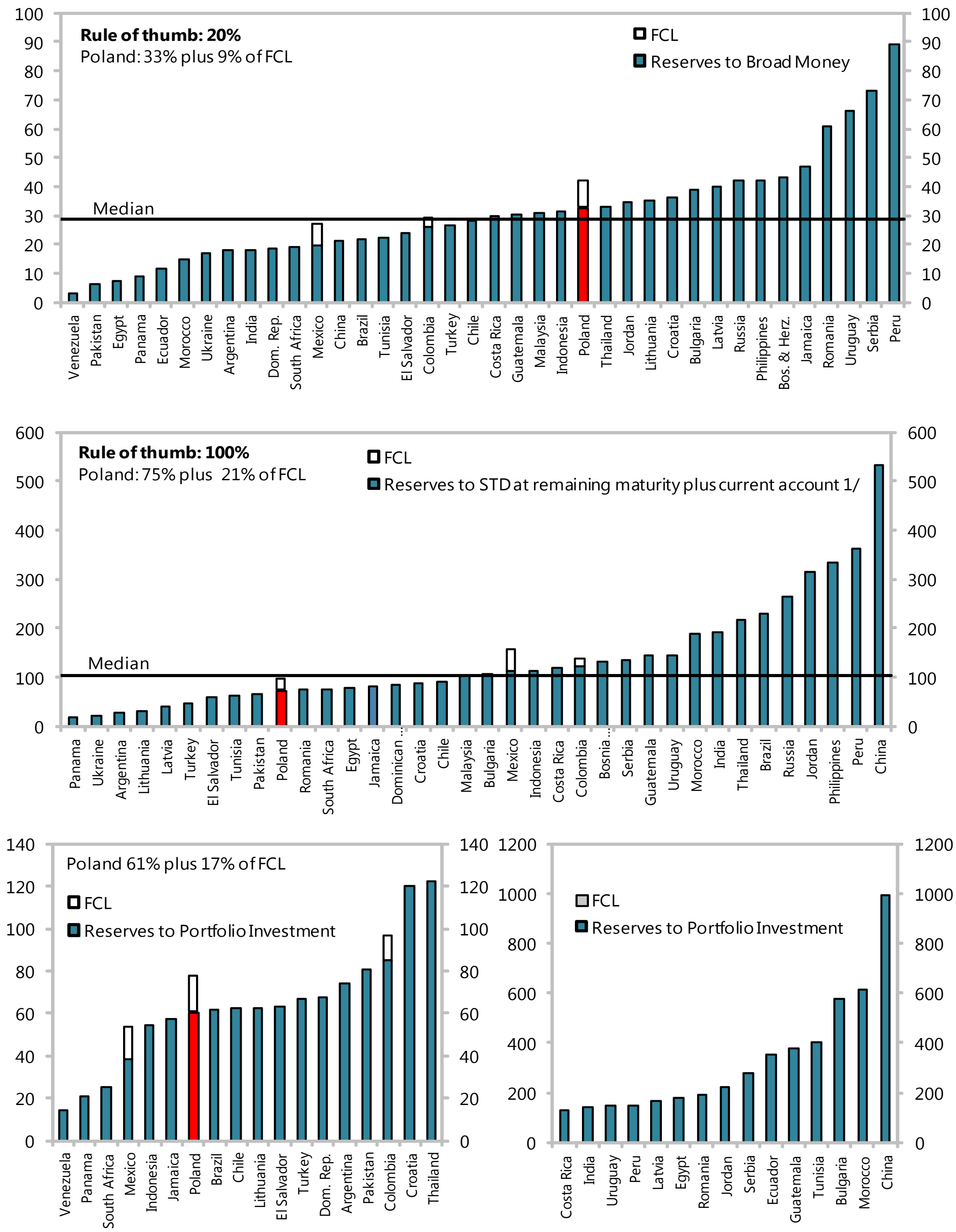
Figure 1. Republic of Poland: Trade and Financial Integration, 1995–2014



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

Figure 2. Republic of Poland: Reserve Coverage in International Perspective, 2013 (cont'd)

(Percent)

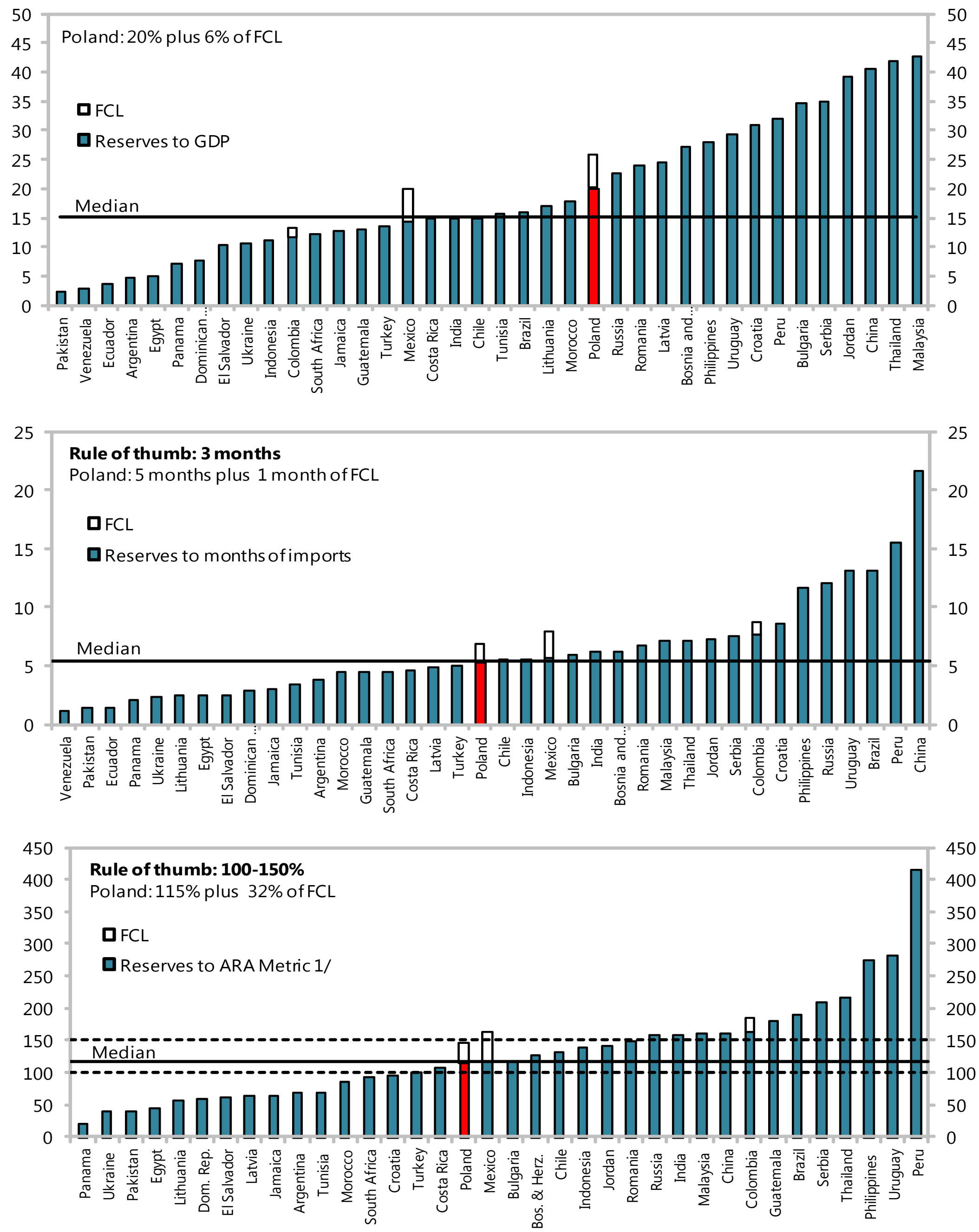


Sources: World Economic Outlook, and IMF staff estimates.

1/ Reserves at the end in percent of short-term debt at remaining maturity and estimated current account deficit in 2013. The current account is set to zero if it is in surplus.

Figure 2. Republic of Poland: Reserve Coverage in International Perspective, 2013 (concl'd)

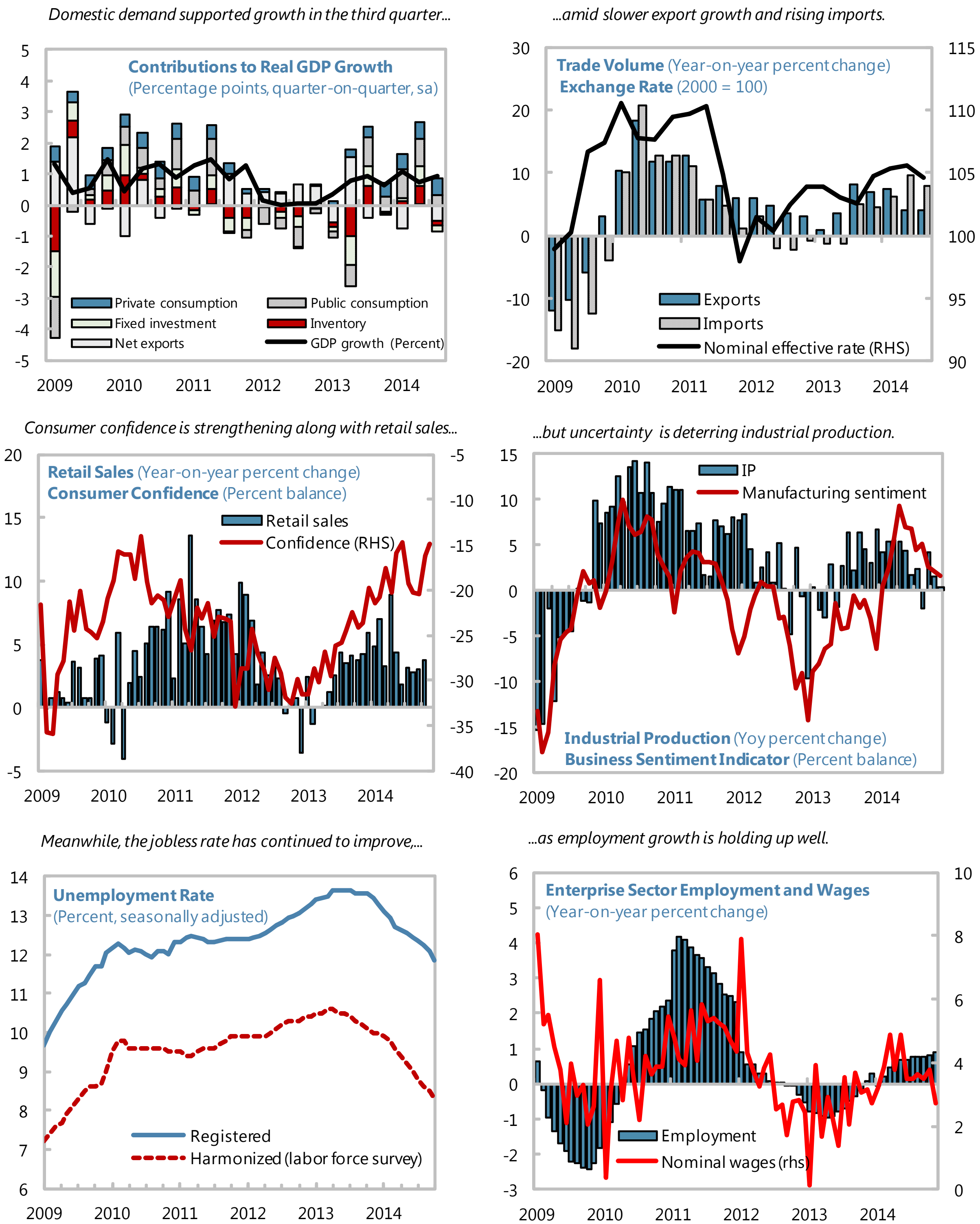
(Percent)



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

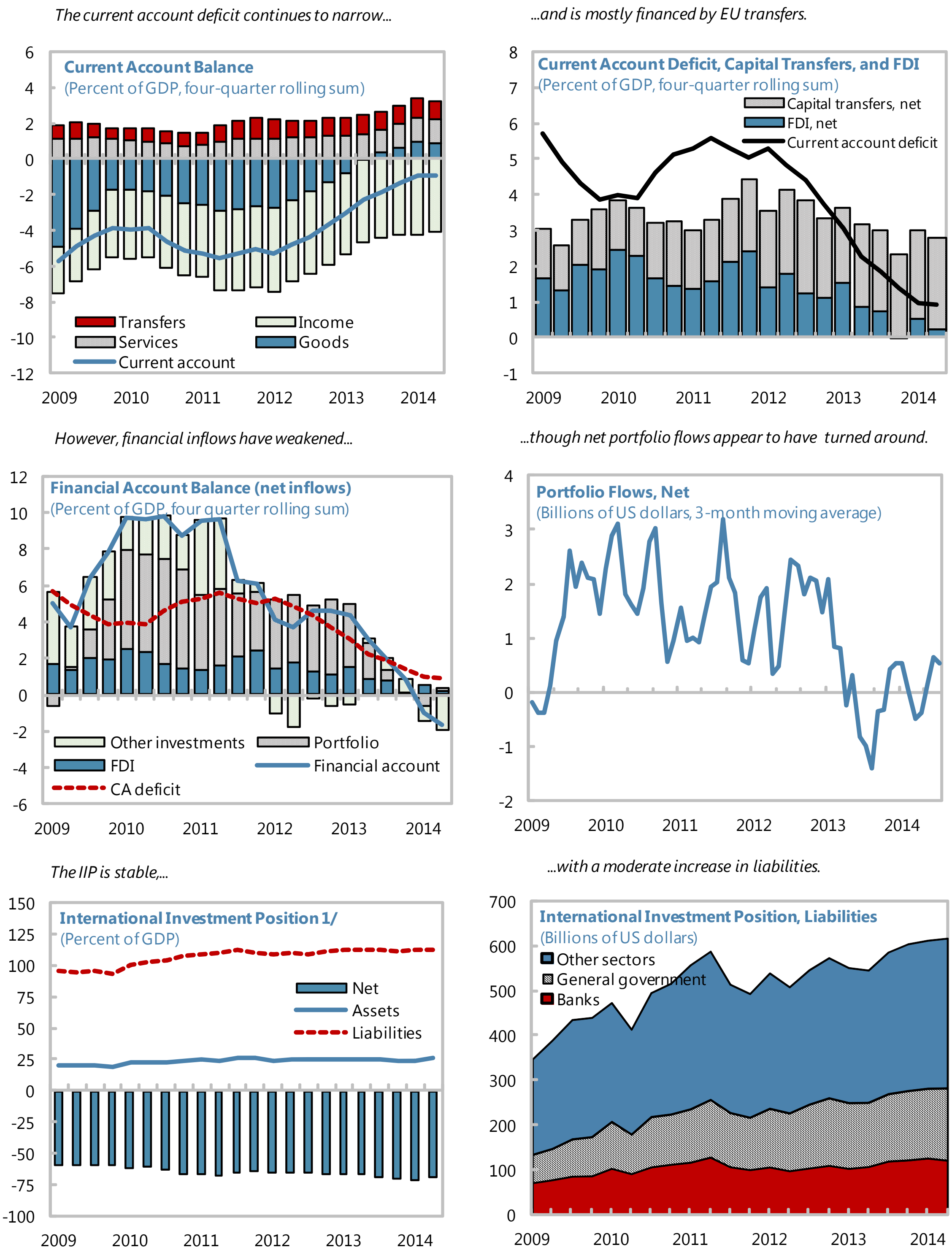
1/ The ARA metric was developed by Fund staff to assess reserve adequacy and is the sum of 30 percent short-term debt at remaining maturities, 10 percent of other liabilities, 5 percent of broad money, and 10 percent of exports for countries with floating rate currencies. For the stock of porfolio liabilities, data on 2013, 2012, or 2011 are used depending on data availability.

Figure 3. Republic of Poland: Recent Economic Developments, 2009–14



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

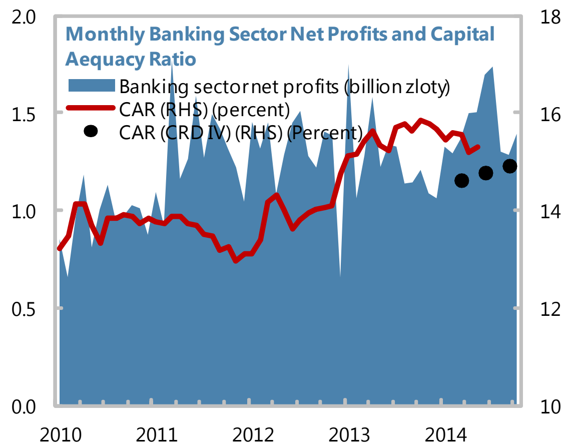
Figure 4. Republic of Poland: Balance of Payments, 2009–14



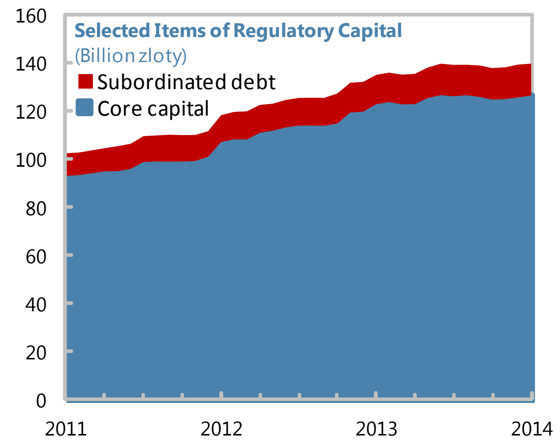
Sources: National Bank of Poland and IMF staff calculations.
1/ Excludes NBP.

Figure 5. Republic of Poland: Banking Sector Capital and Asset Quality, 2009–14

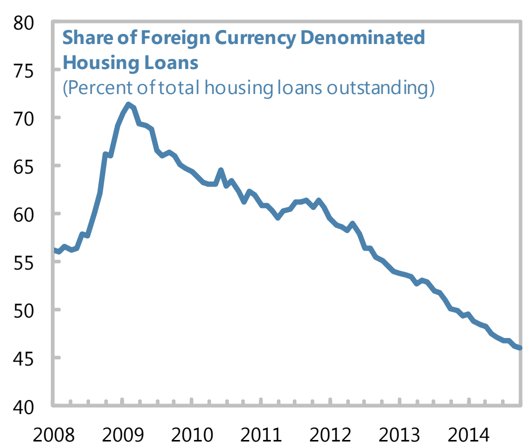
Bank profits remain strong and capital adequacy high,...



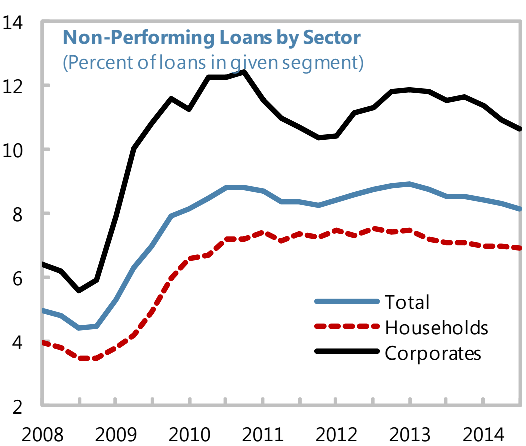
...with core capital a dominant factor,...



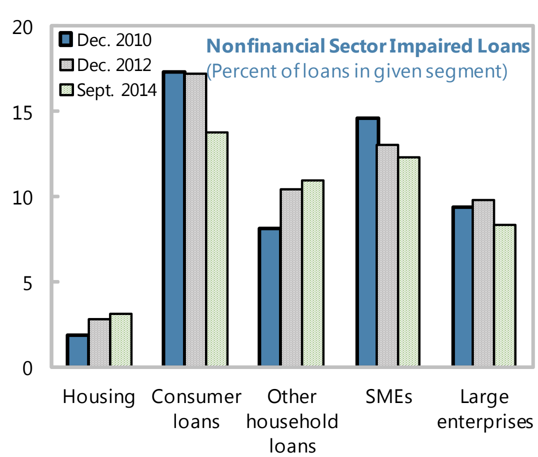
...and the foreign currency share of mortages is declining.



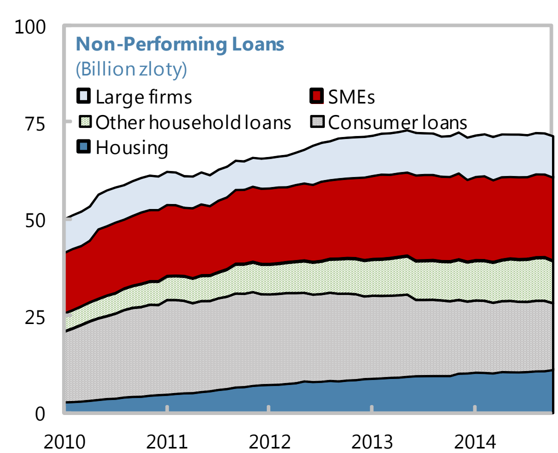
Alongside, the quality of loans has started to improve,...



...though NPLs remain high for SMEs and consumer loans,...

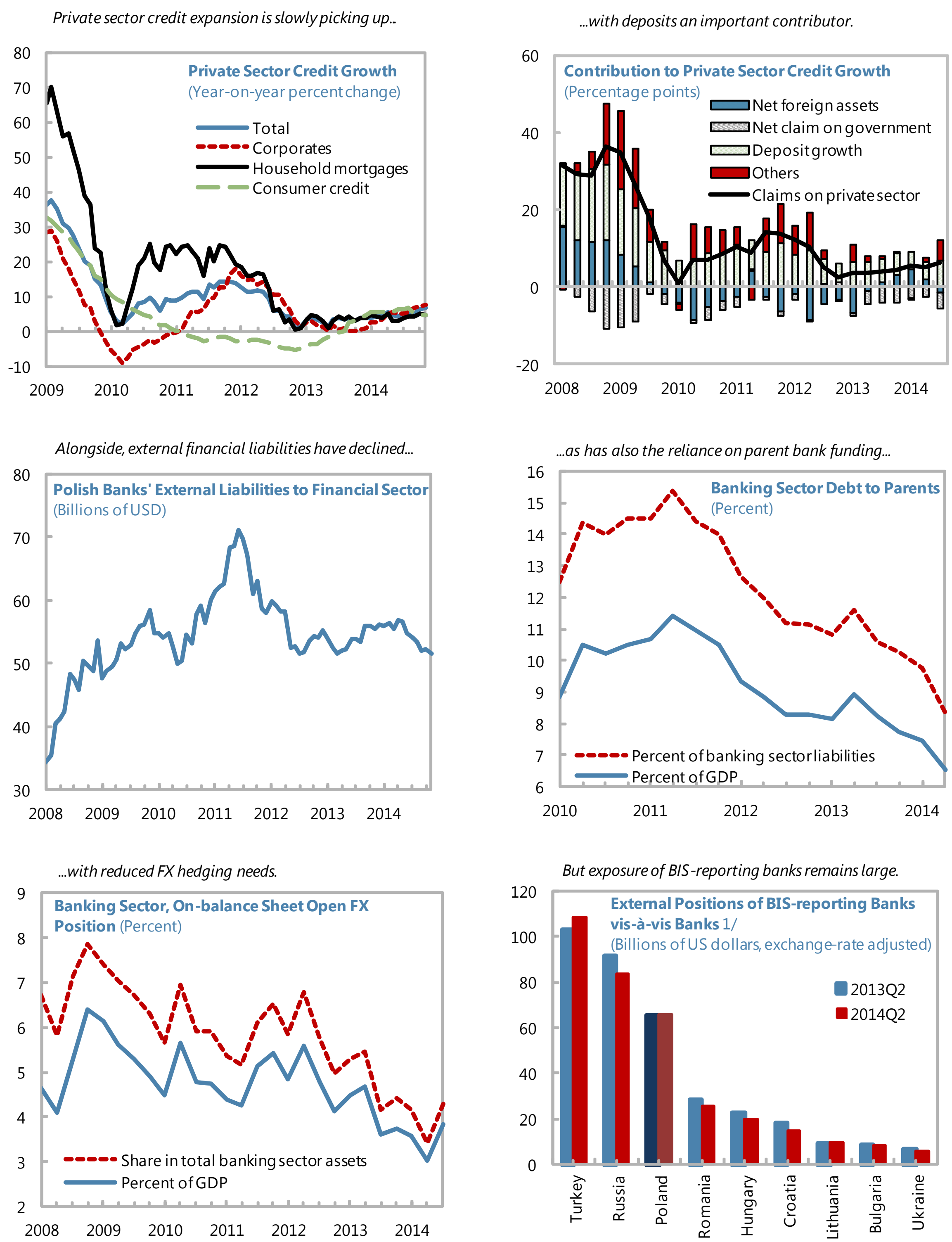


...accounting for the bulk of impaired loans.



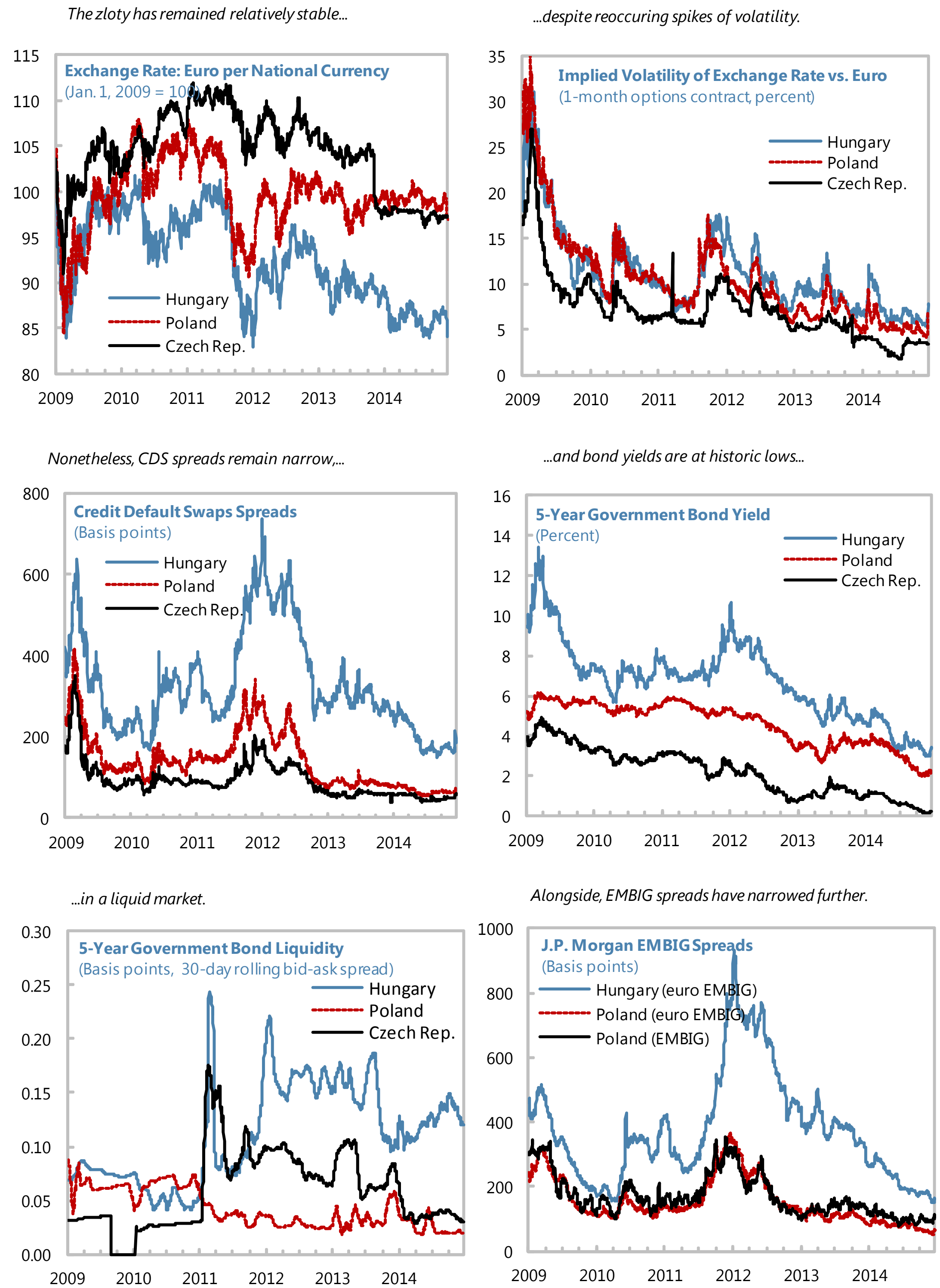
Sources: KNF, NBP, and IMF staff calculations.

Figure 6. Republic of Poland: Bank Credit Growth and Funding, 2009–14



Sources: BIS Locational Banking Statistics, Haver Analytics, IFS, NBP, KNF, and IMF staff calculations.
1/ This chart is based on BIS methodology and data, while the middle-left chart is based on NBP methodology and data. The charts are therefore not directly comparable.

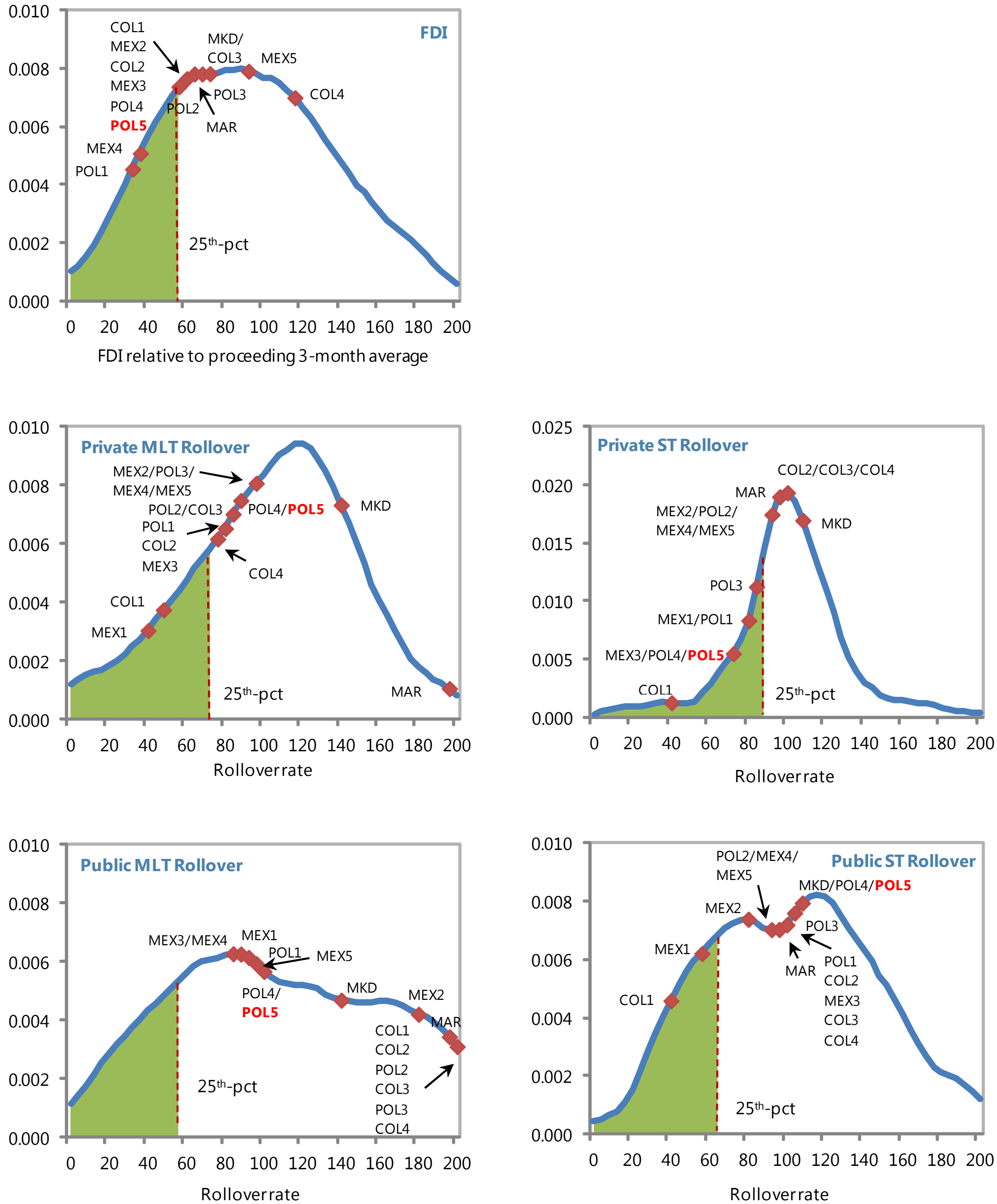
Figure 7. Republic of Poland: Financial Markets, 2009–14



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

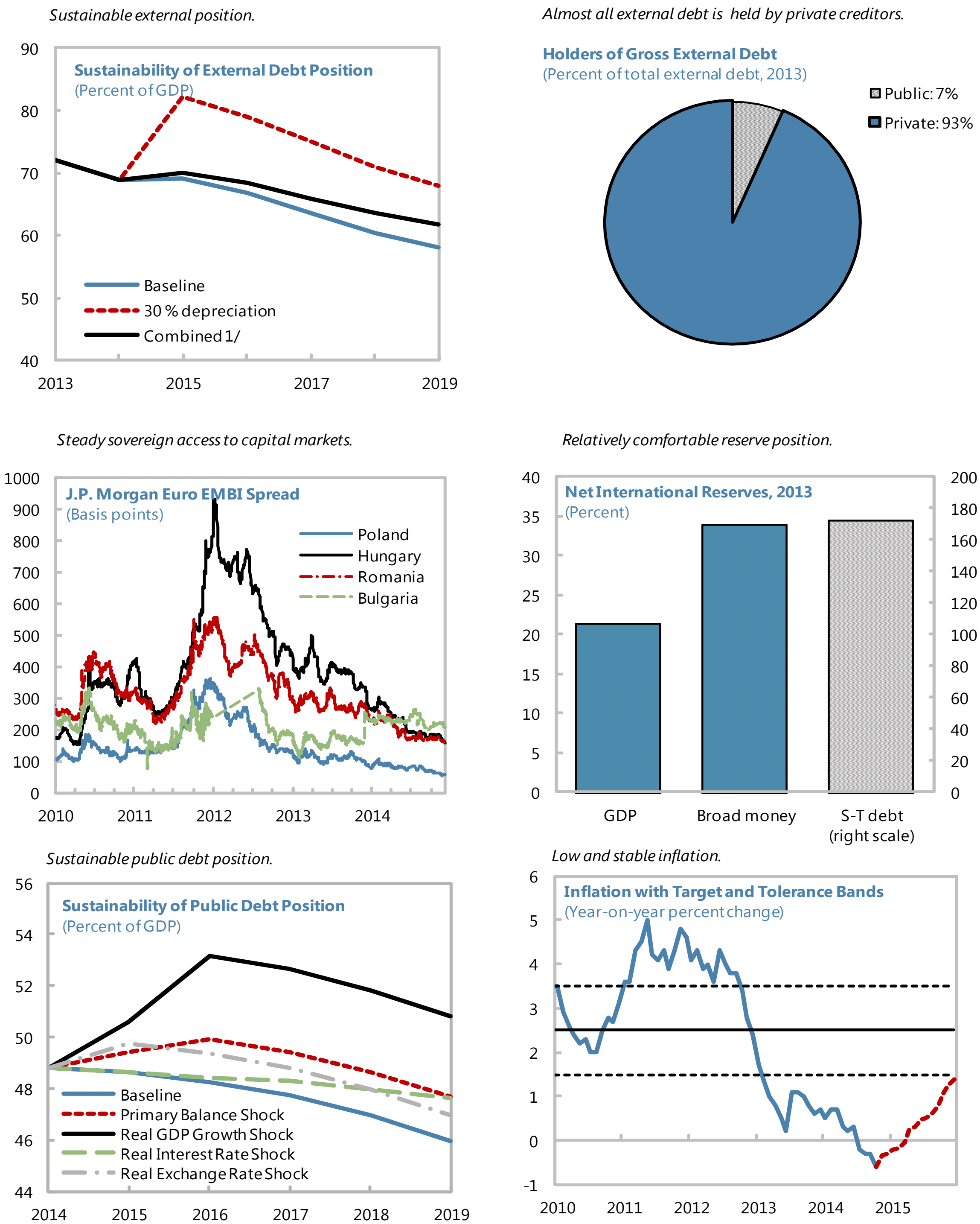
Figure 8. Republic of Poland and Selected Countries: Comparing Adverse Scenarios

(Probability densities)



Source: IMF staff calculations.

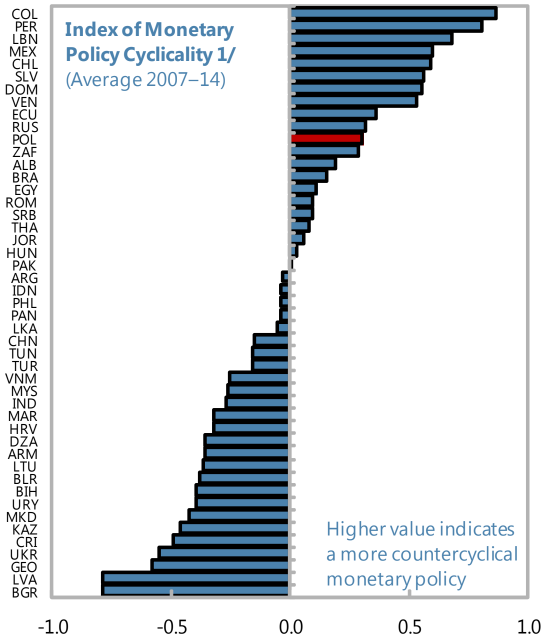
Figure 9. Republic of Poland: Qualification Criteria



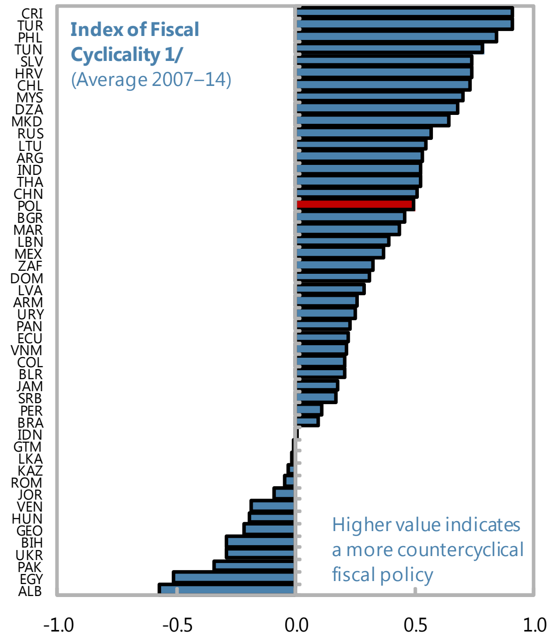
Sources: Bloomberg, Poland authorities, and IMF staff calculations.
1/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

Figure 10. Republic of Poland and Selected Countries: Indicators of Institutional Quality

Monetary and fiscal policies have been countercyclical.

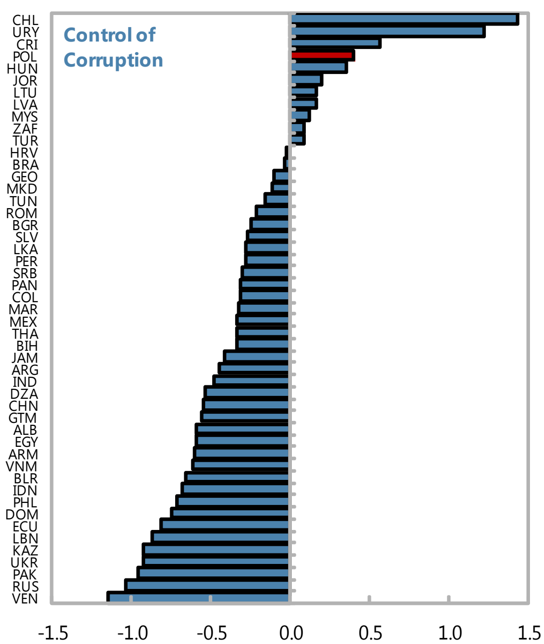


1/ Measured by the 10-year average correlation between the cyclical component of real GDP and the cyclical component of the real short-term interest rate.

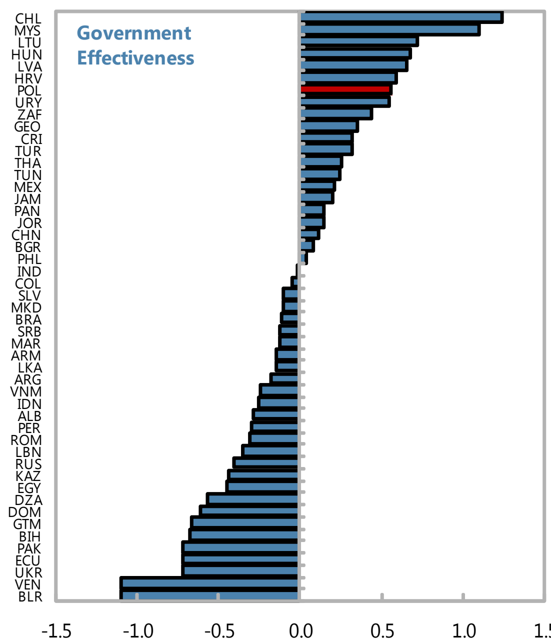


1/ Measured by the 10-year average correlation between the output gap and the cyclical component of gov. expenditures to GDP.

In addition, Poland ranks well on corruption control ....



...and on government effectiveness.



Source: IFS, World Bank Governance Indicators and IMF staff calculations.

Note: For all indicators, a higher value indicates stronger institutional quality.

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/	4.8	1.8	1.7	3.2	3.0	3.3	3.4	3.5	3.5
Domestic demand	3.8	-0.4	0.2	4.7	3.8	3.8	3.9	3.7	3.7
Private consumption growth	2.9	0.9	1.0	3.1	3.7	3.1	3.3	3.5	3.6
Public consumption growth	-2.3	0.2	2.1	2.6	3.8	3.2	3.5	3.5	3.5
Domestic fixed investment growth	9.3	-1.5	0.9	10.2	5.2	5.9	5.6	4.2	3.9
Inventories (contribution to growth)	0.7	-0.6	-1.0	0.2	-0.2	0.1	0.0	0.0	0.0
Net external demand (contribution to growth)	0.9	2.1	1.5	-1.3	-0.8	-0.5	-0.5	-0.1	-0.2
Output gap	1.3	0.2	-0.9	-0.5	-0.5	-0.2	0.0	0.0	0.0
CPI inflation (percent)									
Average	4.3	3.7	0.9	0.1	0.5	2.1	2.5	2.5	2.5
End of period	4.6	2.4	0.7	-0.3	1.4	2.5	2.5	2.5	2.5
Unemployment rate (average, according to LFS)	9.6	10.1	10.3	9.3	9.1	9.0	8.9	8.7	8.5
Public finances (percent of GDP) 2/									
General government revenues	39.0	39.1	38.2	39.0	39.3	39.5	39.1	39.2	39.1
General government expenditures	43.9	42.9	42.2	42.1	41.9	41.6	41.4	41.3	41.1
General government balance	-4.9	-3.7	-4.0	-3.1	-2.6	-2.1	-2.3	-2.1	-2.0
Public debt	54.8	54.4	55.7	48.8	48.6	48.2	47.7	46.9	46.0
National definition 3/	52.5	52.0	53.0	...	...	...	...	...	...
Money and credit									
Private credit (change in percent, end-period)	13.9	2.4	4.5	5.9	8.0	...	...	...	...
Broad money (change in percent, end-period)	12.5	4.5	6.2	6.6	7.6	...	...	...	...
Policy Rate (percent) 4/	4.2	4.6	2.9	2.0	...	...	...	...	...
Balance of payments									
Current account balance (transactions, billion U.S. dollars)	-25.8	-18.3	-7.1	-10.4	-15.0	-17.1	-19.8	-22.1	-24.0
Percent of GDP	-4.9	-3.7	-1.4	-1.9	-2.7	-3.0	-3.3	-3.4	-3.5
Exports of Goods (billion U.S. dollars)	195.2	190.8	207.2	216.6	215.9	230.8	249.4	268.5	288.3
Export volume growth	7.9	4.3	5.0	4.7	3.5	6.0	6.5	6.7	6.6
Imports of Goods (billion U.S. dollars)	209.2	197.5	204.2	214.8	218.6	234.2	250.4	268.9	288.8
Import volume growth	5.5	-0.6	1.8	8.1	5.0	7.2	7.5	7.0	7.0
Net oil imports (billion U.S. dollars)	22.9	23.5	23.7	22.8	17.7	19.2	20.5	22.0	23.0
Terms of trade (index 1995=100)	98.1	96.8	96.9	99.4	98.8	99.6	101.6	102.2	102.6
FDI, net (in percent of GDP)	2.4	1.1	-0.1	1.2	1.3	1.4	1.4	1.4	1.4
Official reserves (billion U.S. dollars)	97.9	108.9	106.2	102.7	104.7	105.2	105.4	104.9	105.4
In percent of short-term debt plus CA deficit	68.3	81.1	73.1	80.3	84.1	85.4	87.4	90.6	94.5
Total external debt (billion U.S. dollars)	320.6	364.2	379.3	376.8	380.3	384.5	388.9	394.2	402.8
In percent of GDP	61.2	73.3	72.1	68.8	69.3	66.9	63.7	60.6	58.1
Exchange rate									
Exchange rate regime					Floating				
Zloty per USD, period average 5/	3.0	3.3	3.2	3.4	...	...	...	...	...
Zloty per Euro, period average 5/	4.1	4.2	4.2	4.2	...	...	...	...	...
Real effective exchange rate (INS, CPI based) 6/	110.4	107.5	108.3	...	...	...	...	...	...
Appreciation (percent change)	-1.4	-2.6	0.7	...	...	...	...	...	...
Real effective exchange rate (ULC, based)									
Memorandum item:									
Nominal GDP (billion zloty)	1553.6	1615.9	1662.1	1714.2	1798.2	1886.7	1992.4	2109.7	2236.4

Sources: Polish authorities and IMF staff calculations.

1/ Real GDP is calculated at constant 2010 prices.

2/ According to ESA2010.

3/ Excluding debts of the National Road Fund.

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

5/ For 2014, exchange rate as of December 4.

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**	**-7,105**	**-10,395**	**-14,995**	**-17,067**	**-19,833**	**-22,084**	**-24,036**
percent of GDP	-4.9	-3.7	-1.4	-1.9	-2.7	-3.0	-3.3	-3.4	-3.5
Trade balance	-14,042	-6,698	3,042	1,769	-2,694	-3,415	-1,080	-436	-514
percent of GDP	-2.7	-1.3	0.6	0.3	-0.5	-0.6	-0.2	-0.1	-0.1
Services balance	5,668	5,966	6,972	6,558	5,811	6,126	7,043	7,701	8,262
percent of GDP	1.1	1.2	1.3	1.2	1.1	1.1	1.2	1.2	1.2
Exports of goods and services									
percentage change in unit values	15.9	3.1	3.8	4.5	-0.3	6.9	8.0	7.7	7.4
percentage volume growth	9.9	4.3	5.0	4.7	3.5	6.0	6.5	6.7	6.6
growth in foreign demand	8.2	0.6	1.8	3.3	4.2	5.1	5.2	5.3	5.3
Imports of goods and services									
percentage change in unit values	16.4	-0.5	0.6	5.2	1.7	7.2	6.9	7.4	7.4
percentage volume growth	8.5	-0.6	1.8	8.1	5.0	7.2	7.5	7.0	7.0
growth in domestic demand	3.8	-0.4	0.2	4.7	3.8	3.8	3.9	3.7	3.7
Terms of trade (percentage change)	-1.7	-1.3	0.1	2.6	-0.6	0.9	2.0	0.5	0.4
Net Income	-23,555	-22,670	-22,182	-23,104	-24,168	-26,215	-29,751	-32,740	-34,640
Net transfers	6,159	5,139	5,063	4,381	6,056	6,436	3,955	3,392	2,855
o/w EU receipts	8,397	8,525	8,519	9,028	9,354	7,394	6,198	4,974	3,719
o/w payment to EU	-5,004	-4,890	-5,744	-5,628	-5,577	-5,848	-5,908	-5,962	-6,007
Capital and financial account balance	**41,971**	**33,531**	**16,497**	**12,361**	**22,498**	**23,330**	**26,084**	**28,063**	**31,537**
Capital account balance	10,017	10,957	12,234	14,753	14,438	14,294	14,151	14,009	13,869
o/w net EU transfers	8,890	8,804	12,386	14,207	13,912	13,016	13,148	13,270	13,370
Financial account balance	31,954	22,574	4,263	-2,392	8,060	9,037	11,933	14,053	17,667
Foreign direct investment (net)	12,410	5,313	-300	6,754	7,340	8,204	8,628	8,851	9,559
by nonresidents	20,653	6,068	-5,167	10,253	11,751	13,264	16,580	18,570	20,426
o/w privatization	2,322	2,587	2,587	2,587	2,587	2,587	2,587	2,587	2,587
Portfolio investment (net)	16,744	20,311	473	6,054	4,219	2,333	-195	-298	3,608
by non-residents	15,875	20,747	2,652	8,948	6,940	5,698	2,930	2,776	6,629
o/w equities	3,079	3,888	2,602	5,182	2,000	2,000	2,000	2,000	2,000
Other investment (net)	2,983	-5,924	3,583	-15,200	-3,500	-1,500	3,500	5,500	4,500
Assets	-3,594	-1,965	-11	-9,000	-2,000	-2,000	0	1,000	500
Liabilities	6,577	-3,959	3,594	-6,200	-1,500	500	3,500	4,500	4,000
Financial derivatives	-183	2,874	507	0	0	0	0	0	0
Errors and omissions	-9,918	-4,067	-8,184	-5,476	-5,488	-5,746	-6,102	-6,502	-6,931
Overall balance	6,283	11,201	1,208	-3,510	2,015	518	149	-523	569
Financing									
Reserve assets	-6,283	-11,201	-1,208	3,510	-2,015	-518	-149	523	-569
Memorandum items:									
Current plus capital account (percent of GDP)	-3.0	-1.5	1.0	0.8	-0.1	-0.5	-0.9	-1.2	-1.5
Official reserves	97,866	108,914	106,220	102,710	104,724	105,242	105,391	104,868	105,437
in months of imports	5.6	6.6	6.2	5.7	5.7	5.4	5.1	4.7	4.4
Official reserves (million euros)	74,259	83,020	77,508	81,710	83,313	83,725	83,844	83,427	83,880
Ratio of reserves to short-term debt 1/	78.3	85.7	78.8	91.0	97.4	101.8	107.0	114.4	120.4
Ratio of reserves to ST debt plus CA deficit 1/	68.3	81.1	73.1	80.3	84.1	85.4	87.4	90.6	94.5
Ratio of reserves to IMF ARA metric 2/	124.1	126.0	114.8	119.6	122.1	123.1	…	…	…
Total external debt (percent of GDP)	61.2	73.3	72.1	68.8	69.3	66.9	63.7	60.6	58.1
Total external debt (percent of exports) 3/	137.8	159.2	153.3	146.0	147.9	139.8	130.9	123.2	117.3
External debt service (percent of exports) 3/ 4/	43.2	58.4	54.8	55.7	47.3	42.8	38.8	35.0	30.9
Gross FDI inflows (percent of GDP)	3.9	1.2	-1.0	1.9	2.1	2.3	2.7	2.9	2.9
Net FDI inflows (percent of GDP)	2.4	1.1	-0.1	1.2	1.3	1.4	1.4	1.4	1.4

Sources: National Bank of Poland and IMF staff calculations based on BPM5 methodology.

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

(Percent)

	2007	2008	2009	2010	2011	2012	2013	2014Q3
Capital adequacy 1/								
Regulatory capital to risk-weighted assets	12.0	11.1	13.3	13.9	13.1	14.8	15.7	14.9
Regulatory Tier I capital to risk-weighted assets	11.8	10.0	12.0	12.5	11.7	13.1	14.1	13.7
NPLs net of provisions to capital	11.4	8.3	13.8	11.5	11.6	12.9	12.1	12.4
Bank capital to assets	8.0	7.5	8.1	8.2	7.8	8.7	9.1	8.5
Asset composition and quality								
NPLs to gross loans (non-financial sector)	5.2	4.4	7.9	8.8	8.2	8.8	8.5	8.2
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	65.3
Loans to non-financial corporations	40.3	37.6	34.3	31.5	33.1	33.7	33.3	34.1
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	12.1	12.6
Interest margin to gross income	59.4	55.7	51.9	53.0	55.8	55.0	56.1	59.2
Noninterest expenses to gross income	68.7	58.4	58.5	56.0	54.5	54.5	57.2	55.1
Liquidity								
Liquid assets to total assets (liquid assets ratio)	17.1	17.0	20.3	20.8	19.5	20.9	21.4	21.5
Liquid assets to total short-term liabilities	24.2	25.3	29.8	31.2	28.8	31.1	31.7	32.7
Loans to deposits	98.0	112.6	109.2	114.5	119.8	117.7	115.7	114.1
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	-0.1

Sources: Narodowy Bank Polski 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 (since 2014: Bank Gospodarstwa Krajowego excluded). Since 2014: data on capital in accordance with CRDIV/CRR.

Table 4. 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	39.0	39.1	38.2	39.0	39.3	39.5	39.1	39.2	39.1
Taxes	20.6	20.0	19.5	20.0	20.1	20.2	19.8	19.9	19.9
Personal income tax	4.4	4.5	4.5	4.6	4.6	4.6	4.6	4.6	4.6
Corporate income tax	2.0	2.1	1.8	1.8	1.9	1.9	1.9	1.9	1.9
VAT	7.8	7.1	6.9	7.0	7.1	7.1	6.8	6.9	6.9
Excises	3.8	3.7	3.7	3.7	3.8	3.8	3.8	3.8	3.8
Other taxes	2.5	2.6	2.7	2.8	2.8	2.8	2.7	2.7	2.7
Social contributions	12.2	13.0	13.2	13.5	13.7	13.7	13.6	13.5	13.4
Other revenue 1/	6.3	6.1	5.5	5.5	5.5	5.6	5.7	5.8	5.8
Capital revenue	1.7	1.3	1.0	0.9	0.8	0.9	1.0	1.1	1.1
Sales of goods and services	2.4	2.4	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Other current revenue	2.2	2.4	2.2	2.3	2.4	2.4	2.4	2.4	2.4
Expenditure	43.9	42.9	42.2	42.1	41.9	41.6	41.4	41.3	41.1
Expense	38.0	38.1	38.1	38.2	37.9	37.7	37.5	37.4	37.2
Compensation of employees	10.6	10.4	10.3	10.2	10.1	10.1	10.1	10.1	10.1
Use of goods and services	5.8	5.9	5.9	5.9	5.9	5.9	5.9	5.9	5.9
Interest	2.5	2.7	2.5	2.2	2.1	2.1	2.0	2.0	2.0
Subsidies	0.8	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Social benefits	15.7	15.9	16.3	16.5	16.5	16.3	16.2	16.1	16.0
Other expense 1/	2.6	2.6	2.5	2.7	2.7	2.7	2.7	2.7	2.7
Other current expenditure	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Capital transfers	0.6	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Net acquisition of nonfinancial assets	6.0	4.8	4.1	3.9	4.0	3.9	3.9	3.9	3.9
Gross operating balance	1.1	1.0	0.1	0.8	1.4	1.8	1.6	1.8	1.9
Net lending/borrowing (overall balance)	-4.9	-3.7	-4.0	-3.1	-2.6	-2.1	-2.3	-2.1	-2.0
Net financial transactions	-4.9	-3.4	-4.0	-3.1	-2.6	-2.1	-2.3	-2.1	-2.0
Net acquisition of financial assets	-1.3	-0.9	-1.5	0.5	0.1	0.1	0.1	0.0	0.0
Currency and deposits	-0.7	0.7	-1.1	0.4	-0.1	0.0	0.0	0.0	0.0
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	-1.0	-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	3.5	2.5	2.5	3.6	2.6	2.2	2.3	2.1	2.1
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	-6.8	1.1	1.0	1.2	1.0	1.0
Loans	1.3	0.8	0.6	1.0	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	-5.4	-3.8	-3.4	-2.9	-2.4	-2.0	-2.3	-2.1	-2.0
Primary balance	-2.4	-1.1	-1.5	-0.9	-0.5	0.0	-0.2	0.0	0.0
Cyclically-adjusted primary balance	-2.9	-1.1	-0.9	-0.7	-0.3	0.1	-0.2	0.0	0.0
General government debt	54.8	54.4	55.7	48.8	48.6	48.2	47.7	46.9	46.0
General government liabilities	62.0	61.6	62.5	56.0	55.8	55.4	54.9	54.1	53.1
General government financial assets	-31.9	-33.1	-36.4	-29.6	-30.5	-31.1	-31.6	-31.8	-31.8
Nominal GDP in billions of Zlotys	1,554	1,616	1,662	1,714	1,798	1,887	1,992	2,110	2,236

Sources: Eurostat and IMF staff calculations.

1/ Includes grants.

Table 5. 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	-508,210	-547,560	-586,152	-629,054	-670,286	-710,976
Financial Assets	-2,255	-5,524	459,652	-25,583	-208	433,861	451,668	455,814	459,377	465,177	471,472	477,430
Currency and deposits	11,756	-6,162	71,637	-18,148	27	53,516	75,997	79,720	83,643	88,326	93,527	99,146
Debt securities	-153	-1,094	5,212	838	51	6,101	5,529	5,800	6,085	6,426	6,805	7,213
Loans	-326	-1,434	14,122	-46	556	14,632	13,563	14,228	14,928	15,764	16,692	17,695
Equity and inv. fund shares	-16,791	199	270,603	-10,262	-101	260,240	251,268	245,596	238,815	232,264	224,844	215,986
Other financial assets	3,259	2,967	98,078	2,035	-741	99,372	105,311	110,470	115,907	122,397	129,604	137,390
Liabilities	59,470	-27,968	994,597	45,675	-1,564	1,038,708	959,878	1,003,374	1,045,529	1,094,230	1,141,757	1,188,406
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	720,041	751,787	781,562	815,482	846,595	875,513
Loans	12,189	-6,462	149,051	10,184	329	159,564	116,760	122,480	128,507	135,703	143,693	152,326
Other liabilities	5,413	-2,981	102,929	588	497	104,014	123,077	129,107	135,460	143,045	151,468	160,568
Memorandum items:												
Net financial worth (in % of GDP)			-33.1			-36.4	-29.6	-30.5	-31.1	-31.6	-31.8	-31.8
Financial assets (in % of GDP)			28.4			26.1	26.3	25.3	24.3	23.3	22.3	21.3
Liabilities (in % of GDP)			61.6			62.5	56.0	55.8	55.4	54.9	54.1	53.1
GDP nominal prices (in Billion PLN)			1615.9			1662.1	1714.2	1798.2	1886.7	1992.4	2109.7	2236.4

Sources: National Authorities and IMF Staff calculations.

Table 6. Republic of Poland: Monetary Accounts, 2008–14

(Percent of GDP, unless otherwise indicated, eop)

	2008	2009	2010	2011	2012	2013	2014 Proj.
				(Billions of zlotys)			
Central bank							
Net foreign assets	177	212	257	317	321	297	320
Official reserve assets	184	228	277	337	337	321	344
Net domestic assets	-51	-74	-117	-179	-153	-133	-149
Net claims on government	-21	-23	-12	-19	-16	-7	-7
Claims on banks 1/	9	-25	-74	-93	-100	-117	-114
Other items, net	-38	-26	-31	-67	-37	-9	-28
Base money	126	138	140	138	167	164	172
Currency issued	102	100	103	112	113	126	131
Bank reserves	25	38	37	26	54	38	41
Deposit money banks							
Net foreign assets	-113	-135	-156	-169	-143	-147	-142
Net domestic assets	679	762	842	939	953	1,004	1,059
Net claims on the central bank 1/	37	75	121	130	167	167	166
Net claims on government	153	171	177	191	177	204	216
Claims on private sector	633	677	735	838	858	896	949
Claims on corporates	224	217	215	253	257	259	279
Claims on households	376	421	480	537	538	562	591
Claims on other	33	40	41	47	63	75	79
Other items, net	-143	-161	-191	-219	-248	-263	-272
Deposits	566	627	687	771	810	857	917
Consolidated banking system							
Net foreign assets	64	76	101	149	177	150	178
Net domestic assets	602	644	683	733	744	829	866
Claims on government	131	148	164	172	161	197	209
Claims on private sector	633	677	735	838	858	896	950
Other items, net	-162	-182	-217	-276	-274	-264	-292
Broad money (M3)	666	720	784	882	921	979	1,044
Memorandum items:			(Percentage change from end of previous year)				
Base money	23.1	8.8	1.6	-1.1	21.0	-1.9	4.6
Broad money (M3)	18.6	8.1	8.8	12.5	4.5	6.2	6.6
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	-15.3	18.6
Net claim on government	63.4	12.8	11.0	4.5	-6.6	22.5	6.0
Claims on private sector	36.4	7.0	8.5	13.9	2.4	4.5	5.9
Deposit growth	18.9	10.6	9.6	12.2	5.1	5.8	7.0
			(Percent of GDP, unless otherwise noted)				
Broad money (M3)	52.2	52.9	54.5	56.7	57.0	58.9	60.9
Private sector credit	49.6	49.7	51.2	53.9	53.1	53.9	55.4
Broad money Velocity (GDP/M3)	1.9	1.9	1.8	1.8	1.8	1.7	1.6
Money multiplier (M3/base money)	5.3	5.2	5.6	6.4	5.5	6.0	6.1

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

1/ The difference between deposit money bank claims on the central bank and central bank claims on banks relates to banks' reserves and currency in vault.

Table 7. Republic of Poland: External Financing Requirements and Sources, 2012–16

(Millions of US dollars, unless otherwise indicated)

	2012	2013	2014	2015	2015	2016	2016	Kernel Rollover		2015 vs 2013
			Est.	Proj.	Adverse scenario	Proj.	Adverse scenario	2013	2015	shock
GROSS FINANCING REQUIREMENTS (A)	**137,687**	**134,277**	**132,694**	**127,869**	**127,869**	**124,560**	**124,560**			
Current account deficit	18,263	7,105	10,395	14,995	14,995	17,067	17,067			
Medium and long-term debt amortization	53,139	57,306	59,419	60,683	60,683	57,725	57,725			
Public sector	11,318	14,201	12,980	14,255	14,255	13,340	13,340			
Banks	12,396	6,027	7,433	5,823	5,823	5,964	5,964			
Non-bank Corporates	29,425	37,078	39,006	40,605	40,605	38,422	38,422			
Short-term debt amortization	66,285	69,866	62,880	52,191	52,191	49,768	49,768			
Public sector	190	2	2	2	2	3	3			
Banks (inc. s.t. deposits)	18,031	19,934	17,941	14,891	14,891	14,146	14,146			
Non-bank Corporates	48,064	49,930	44,937	37,298	37,298	35,619	35,619			
o/w trade credit	30,102	31,271	28,144	23,359	23,359	22,308	22,308			
SOURCES OF FINANCING (B)	**148,888**	**135,485**	**129,184**	**129,884**	**100,060**	**125,078**	**96,339**			
Foreign direct investment (net)	5,313	-300	6,754	7,340	5,359	8,204	5,989	61	61	*same*
o/w inward (net)	6,068	-5,167	10,253	11,751	8,813	13,264	9,948			
Equities (net)	3,321	1,390	4,299	1,091	109	1,108	111			
by nonresidents	3,888	2,602	5,182	2,000	100	2,000	100			
New borrowing and debt rollover	136,721	128,932	108,930	114,034	90,675	108,908	86,881			
Medium and long-term borrowing	69,682	66,052	56,739	64,266	53,338	62,340	51,974			
Public sector	24,629	16,799	16,745	19,194	14,012	17,038	12,438	98	98	*same*
Banks	12,589	7,010	6,838	6,496	4,223	6,496	4,223	59	73	*lower*
Non-bank Corporates	32,464	42,243	33,155	38,575	35,103	38,806	35,313	74	86	*lower*
Short-term borrowing	67,039	62,880	52,191	49,768	37,337	46,567	34,907			
Public sector	2	2	2	3	3	3	3	110	110	*same*
Banks	19,934	17,941	14,891	14,146	9,195	13,439	8,735	59	62	*lower*
Non-bank Corporates	47,103	44,937	37,298	35,619	28,139	33,126	26,170	75	75	*same*
EU capital transfers	8,804	12,386	14,207	13,912	13,912	13,016	13,016			
Other	-5,271	-6,923	-5,006	-6,494	-9,994	-6,158	-9,658	*USD 5 bln outflow*	*USD 3.5 bln outflow*	
GROSS RESERVES ACCUMULATION (C)	**11,201**	**1,208**	**-3,510**	**2,015**	**-4,819**	**518**	**-5,232**	*half reserve accumulation in baseline*	*reserve drawdown*	
FINANCING GAP (B - A - C)	**0**	**0**	**0**	**0**	**-22,989**	**0**	**-22,989**			
Financing Gap (in bln USD)					**23.0**		**23.0**			
(in bln SDR)					**15.5**		**15.5**			
(% of quota)					**918%**		**918%**			

Table 8. Republic of Poland: Indicators of Fund Credit, 2015–20

	2015	2016	2017	2018	2019	2020
	Projections					
Stocks from prospective drawings 1/						
Fund credit (millions SDR)	15,500	15,500	15,500	9,688	1,938	0
in percent of quota	918	918	918	574	115	0
in percent of GDP	4	4	4	2	0	0
in percent of exports of goods and services	9	9	8	5	1	0
in percent of gross reserves 2/	23	23	23	14	3	0
Flows from prospective drawings 3/						
GRA Charges	130	163	163	144	67	4
Level Based Surcharge	166	209	209	240	54	0
Service Charges	78	0	0	0	0	0
Principal	0	0	0	5,813	7,750	1,938
Debt Service due on GRA credit (millions SDR)	374	372	371	6,196	7,871	1,942
in percent of quota	22	22	22	367	466	115
in percent of GDP	0	0	0	1	2	0
in percent of exports of goods and services	0	0	0	3	4	1
in percent of gross reserves 2/	1	1	1	9	12	3
Memorandum item:						
Total external debt, assuming full drawing (percent of GDP)	74	71	68	63	59	56

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

1/ End of Period. Assumes full drawing upon FCL approval in early 2015. The Polish authorities have expressed their intention to treat the arrangement as precautionary.

2/ Excludes IMF purchases.

3/ Based on the rate of charge as of December 15, 2014. Includes surcharges under the system currently in force and service charges.

Table 9. Republic of Poland: Proposed Access Relative to Other High-Access Cases

	Proposed Arrangement FCL	Proposed Arrangement (Percentile)	High-Access Cases 1/ 20th	65th	80th	Median
			Percentile (Ratio)			
Access						
In millions of SDRs	15,500	81	1,386	10,981	15,418	6,662
Average annual access (percent of quota)	459	70	171	394	647	271
Access during the first year (percent of quota)	918					
Average annual access (percent of total) 2/	459	69	300	778	1,009	575
Total access in percent of: 3/						
Actual quota	918	72	341	800	1,053	600
Gross domestic product	4.6	27	3.0	7.3	9.6	6.2
Gross international reserves	22.2	15	25.8	54.6	85.3	48.3
Exports of goods and nonfactor services 4/	9.5	15	11.2	27.9	39.0	19.9
Imports of goods and nonfactor services	9.9	22	9.7	22.9	32.9	17.8
Total debt stock 5/						
Of which: Public	8	19	8	16	29	12
External	6	16	7	15	22	12
Short-term 6/	29	39	21	51	112	36
M2	8	25	6	15	24	12

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

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

2/ Correspond to quotas prior to 2008 Reform.

3/ The data used to calculate ratios is the actual value for the year prior to approval for public, external, and short-term debt, and the projection at the time of program approval for the year in which the program was approved for all other variables (projections for 2014 were used).

4/ Includes net private transfers.

5/ Refers to net debt.

6/ Refers to residual maturity.

Appendix. Letter from the Authorities Requesting Flexible Credit Line

Warsaw, December 22, 2014

Ms. Christine Lagarde
Managing Director
International Monetary Fund

Dear Ms. Lagarde,

Since 2009, the consecutive arrangements under the IMF's Flexible Credit Line (FCL) have served Poland's economy well. During a prolonged period of heightened external risks, the FCL provided valuable additional insurance against adverse external shocks, fostering Poland's macroeconomic performance and financial stability, and supporting market confidence. As noted at the conclusion of the last Article IV consultation, alongside the additional line of defence provided by the FCL, Poland's very strong fundamentals and policies have helped it weather the turmoil in financial markets.

Meanwhile, Poland has continued to build its policy buffers. Fiscal deficit and public debt have been substantially reduced in recent years. The current account balance has improved. Supported by a strong regulatory and supervisory framework, the banking sector has remained well-capitalized, liquid, and profitable, and reliance on parent bank funding has declined.

Looking forward, we are determined to maintain very strong institutional policy frameworks and policies. The government favours a balanced approach to macroeconomic management. Mindful of economic growth considerations, the government has been pursuing conservative fiscal policy aimed at putting public debt on a robust downward path. A new permanent expenditure rule has been introduced, thereby further strengthening the already very strong fiscal framework. Monetary policy continues to be guided by the inflation targeting framework, underpinned by the flexible exchange rate regime. Alongside, effective financial sector supervision has continued to support financial stability.

Poland's open economy has benefited from integration with global markets, including the German supply chain. At the same time and despite Poland's improved economic fundamentals and strong policies, its open capital account, combined with relatively high financing needs, makes it susceptible to shifts in investor sentiment.

While in the government's assessment some of the external risks have receded since the last FCL request, new concerns have emerged. First, a potential surge in financial market volatility owing to uncertainties related to the eventual normalization of U.S. monetary policy poses a risk of a sudden shift in market sentiment toward emerging market assets. Second, protracted slow growth in Poland's main trading partners would affect its economy through trade linkages and the confidence channel. Third, we recognize the growing risks stemming from geopolitical tensions, surrounding Russia and Ukraine.

In light of these concerns, we believe that the FCL would continue to be instrumental in mitigating external risks in case of a tail event. At the same time, these risks have to be considered in the context of Poland's improved economic fundamentals and its increased policy buffers. On balance, we believe that a new two-year FCL arrangement at lower access would provide sufficient insurance against adverse external shocks, while sending a strong signal of Poland's commitment to exit the facility as soon as external conditions allow.

We have initiated extensive communication efforts regarding Poland's exit strategy. Through direct outreach to investors and the general public, including by top Ministry of Finance officials, we have signalled our intention to begin a smooth gradual exit from the FCL. The outreach has been favourably received by investors and other stakeholders with only muted market reaction, reinforcing our belief that Poland is well prepared to begin gradual exit from the arrangement.

In sum, given the strengthened fundamentals and buffers and considering the balance of risks, we request the approval of a successor 24-month FCL arrangement for Poland in a reduced amount equivalent to SDR 15.50 billion (918 percent of quota) and wish to cancel the current arrangement approved on January 18, 2013 effective upon approval of the new FCL arrangement. We reaffirm our intention to treat the instrument as precautionary.

Sincerely Yours,

/ s /	*/ s /*
Minister of Finance MATEUSZ SZCZUREK	President of Narodowy Bank Polski MAREK BELKA

Annex I. Public Sector Debt Sustainability Analysis

Public debt is moderately high but sustainable. Its structure and risk profile in terms of interest, rollover, and foreign currency risks is robust, and contingent liabilities are not deemed material. The main risk to the debt outlook stems from a negative shock to GDP growth. In addition, a large share of foreign investors in the domestic debt market entails a risk, albeit the composition of the investor base and the low share of debt at floating rates provide some mitigating factors.

A. Baseline and Realism of Projections

- ***Debt levels***. The adoption of ESA2010 accounting standards resulted in a 1½ percentage point decline in the recorded ratio of public debt to GDP to 55.7 percent at end-2013. A further one-off drop to 48.8 percent of GDP in 2014 is expected as a result of changes to the pension system. 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 reduce the ratio of public debt-to-GDP by some 9 percentage points in 2014.
- ***GDP Growth***. The projections assume a gradual acceleration of GDP growth, from around 3 percent during 2014–15 to 3.5 percent in 2019. The output gap is expected to close gradually over the medium term. 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 1.5 percent of GDP in 2013 to about balance during 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 forecast errors of the primary deficit in Poland have not displayed an apparent bias and have been more conservative than for other countries. Overall, the projected fiscal adjustment seems feasible, as indicated by cross country benchmarks.
- ***Sovereign yields***. The effective interest rate on public debt declined from 6.6 percent in 2005 to 5.9 percent in 2009 and further to about 5 percent in 2013. It is projected to decline to 4.6 percent by 2015. In recent years, Poland has maintained access to capital markets on favorable terms, even during periods of global financial distress. Yields on 10–year bonds declined by almost 200 basis points year-to-date to 2½ percent in November 2014—a new record low. In turn, spreads over 10–year German bonds dropped below 180 basis points in November, while EMBI and CDS spreads dropped to around 95 basis points and 65 basis points, respectively. While there is uncertainty about the impact of Fed tapering on market conditions, the pass-through from interest increases to the budget would be very gradual, as about 80 percent of debt carries a fixed interest rate and the average duration stands at about 3 years. A 100 basis points 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 changes to the pension system.[1] 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 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. Staff calculations using baseline projections for 2014–60 indicate the pension changes would lead to net positive cash flows to the fiscal sector of 30 percent of GDP in net present value terms.
- ***Maturity and rollover risks***. Rollover risks are well managed. The average maturity of outstanding debt is estimated at 4.2 years, and the share of short-term debt in total government debt is negligible (there have been no t-bills outstanding since August 2013). In recent years, the authorities have taken advantage of favorable market conditions to actively pre-finance debt. The 2014 financing needs were covered by September 2014, and pre-financing for 2015 took place in the third quarter of 2014. The pension changes caused a mechanical increase in the share of foreign investors in the domestic market as well as in the share of foreign debt (according to the nationality of the holders): the share of foreign investors in the domestic market increased from about 34 percent in 2013 to about 41 percent in 2014 and the overall share of external debt in total public debt increased from 51 percent in 2013 to about 58 percent in 2014. In addition, the share of foreign currency debt in total debt also increased from 30 percent in 2013 to about 37 percent in 2014. In line with the debt management strategy, the baseline assumes gradual convergence toward the current structure of public debt in terms of the share of foreign currency debt in total debt (30 percent) and external debt in total debt (about 50 percent).
- ***DSA risk assessment***. The heat map highlights risks associated with the relatively large external financing requirements (26 percent of GDP in 2013), plus the share of public debt held by non-residents (51 percent at end-2013). The latter is influenced by the large participation of foreign investors in the domestic bond market. Risks associated with a sudden pullout by foreign investors are ameliorated by the composition of the investor base, which is dominated by "real money" institutional investors. In turn, external financing requirement are heavily influenced by the financing needs of the private sector, which include a substantial share of cross-border, intercompany financing, which tends to ameliorate the risk of a sudden stop.
- ***Fan charts***. The symmetric fan charts, which assume symmetric upside and downside risks, show that public debt is more likely to enter a downward trajectory during the projection period. The

[1] In February 2014, the pension funds' holdings of public debt were transferred to the social security administration (together with the corresponding pension liabilities), causing a one-off drop in public debt of about 9 percent of GDP. In addition, the pension changes entailed the gradual transfer of contributor's assets from the second to the first pillar, starting 10 years prior to their retirement.

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 0.8 percentage points during 2014–15 pushes up slightly the public debt-to–revenue ratio to about 127 percent during 2016–17 and opens up a gap of about 4 percentage points relative to the baseline. Gross financing needs peak to about 11.5 percent of GDP in 2015 and converge to the baseline by 2019.
- ***Growth Shock***. The stress scenario assumes a drop in GDP growth by 1.8 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 53 percent of GDP in 2016 before trending downward to about 51 percent of GDP by 2019. Gross financing needs increase to about 12 percent of GDP during 2015–16, 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 2015 (equivalent to the difference between the maximum real interest rate during 2003–13 and the average real interest rate over the projection), leads to an increase in the effective interest rate on debt by 42 bps in 2016 and further gradual increases to 137 bps by 2019. Under this scenario, public debt dynamics deteriorate marginally relative to the baseline and remains below 49 percent of GDP throughout the projection. Gross financing needs peak at about 11 percent of GDP in 2015 and drop to about 8 percent at the end of the projection horizon.
- ***Exchange rate shock:*** The combined shock also assumes an exchange rate depreciation of about 27 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 down to about 47 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 to about 58 percent in 2017 and declines gradually afterward. In turn, gross financing needs increase to about 13 percent of GDP in 16, and remain around 10 percent of GDP in the outer years.

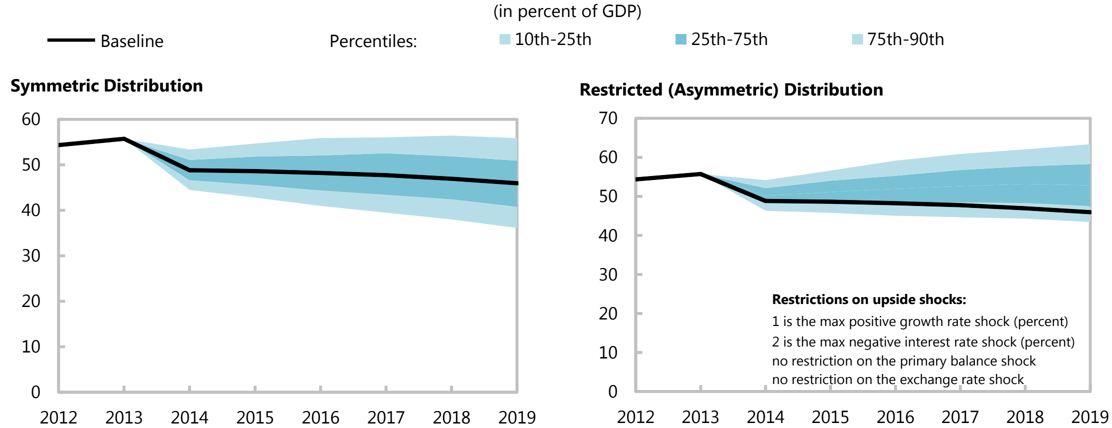
Republic of Poland: Public Sector Debt Sustainability Analysis (DSA)—Risk Assessment

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

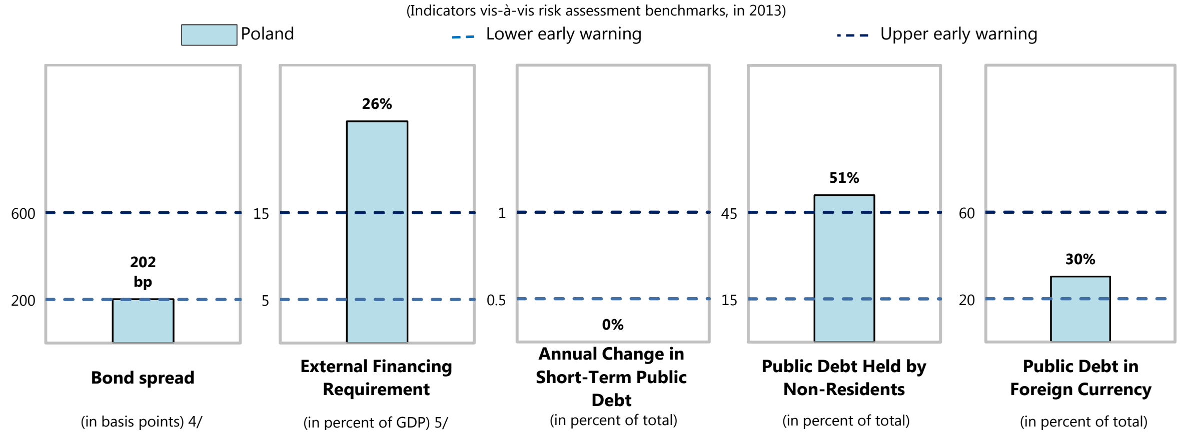
Evolution of Predictive Densities of Gross Nominal Public Debt

(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.

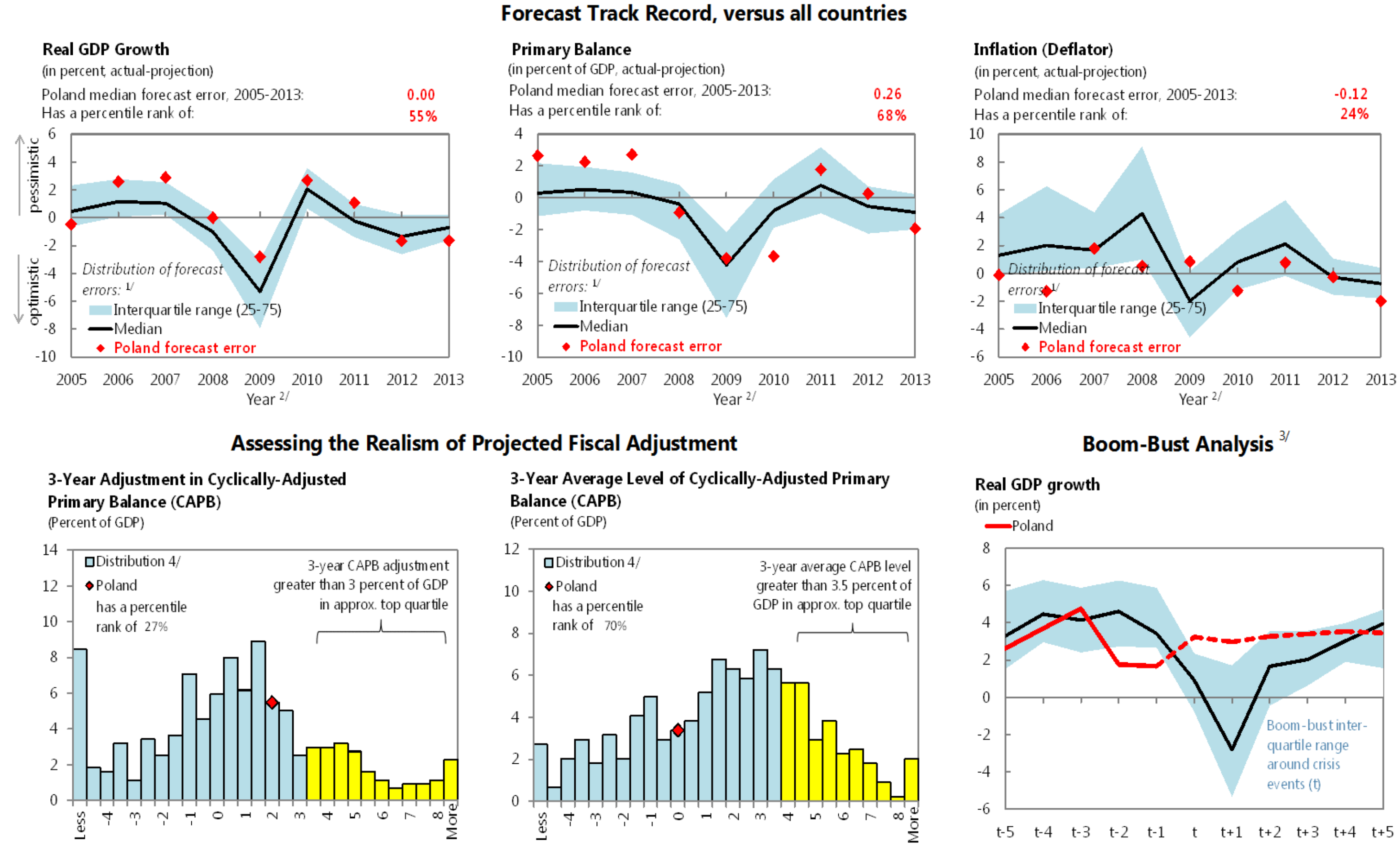
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, 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, 5-Aug-14 through 5-Nov-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



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 obervations 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

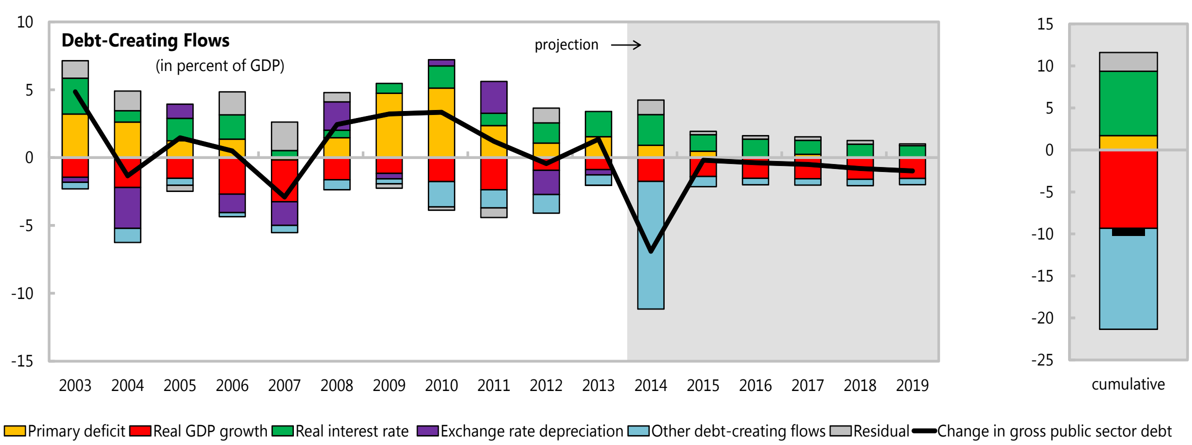
(Percent of GDP, unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of November 05, 2014		
	2003-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019	Sovereign Spreads		
Nominal gross public debt	48.6	54.4	55.7	48.8	48.6	48.2	47.7	46.9	46.0	EMBIG (bp) 3/		178
Public gross financing needs	16.0	13.5	10.9	7.2	10.6	9.7	8.6	8.5	7.4	5Y CDS (bp)		65
Real GDP growth (in percent)	4.5	1.8	1.7	3.2	3.0	3.3	3.4	3.5	3.5	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	2.9	2.2	1.2	-0.1	1.9	1.6	2.1	2.3	2.5	Moody's	A2	A2
Nominal GDP growth (in percent)	7.5	4.0	2.9	3.1	4.9	4.9	5.6	5.9	6.0	S&Ps	A-	A
Effective interest rate (in percent) [4/]	5.9	5.1	4.7	4.1	4.5	4.6	4.5	4.5	4.5	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	1.4	-0.4	1.4	-6.9	-0.2	-0.4	-0.5	-0.8	-1.0	-9.8	primary
Identified debt-creating flows	0.8	-1.5	1.4	-8.0	-0.4	-0.6	-0.8	-1.1	-1.1	-12.0	balance [10/]
Primary deficit	2.4	1.1	1.5	0.9	0.5	0.0	0.2	0.0	0.0	1.7	-1.1
Primary (noninterest) revenue and grants	39.4	39.1	38.2	39.0	39.3	39.5	39.1	39.2	39.1	235.3	
Primary (noninterest) expenditure	41.8	40.2	39.7	39.9	39.8	39.5	39.4	39.3	39.1	237.0	
Automatic debt dynamics [5/]	-0.8	-1.2	0.6	0.5	-0.2	-0.2	-0.5	-0.6	-0.7	-1.7	
Interest rate/growth differential [6/]	-0.7	0.6	1.0	0.5	-0.2	-0.2	-0.5	-0.6	-0.7	-1.7	
Of which: real interest rate	1.2	1.5	1.9	2.3	1.2	1.4	1.0	1.0	0.8	7.7	
Of which: real GDP growth	-2.0	-0.9	-0.9	-1.8	-1.4	-1.5	-1.6	-1.6	-1.5	-9.3	
Exchange rate depreciation [7/]	-0.1	-1.8	-0.4	...	...	...	...	...	...	...	
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	-1.0	-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/]	0.6	1.1	0.0	1.1	0.3	0.3	0.3	0.3	0.1	2.2	



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 - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) 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 - π (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.

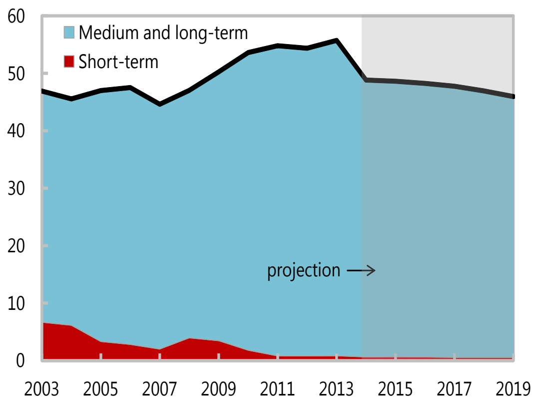
10/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

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

Composition of Public Debt

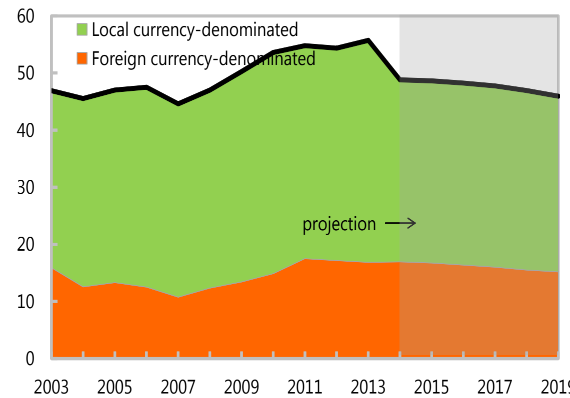
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

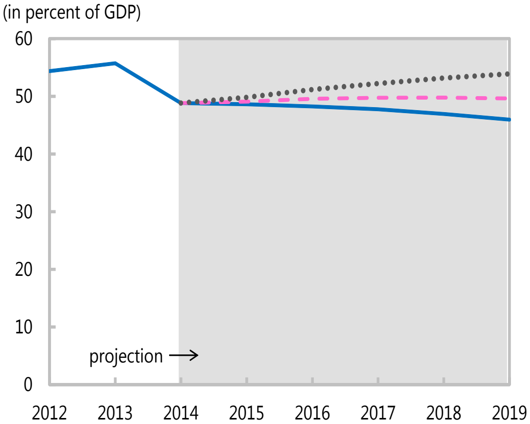


Alternative Scenarios

Baseline — Historical — Constant Primary Balance

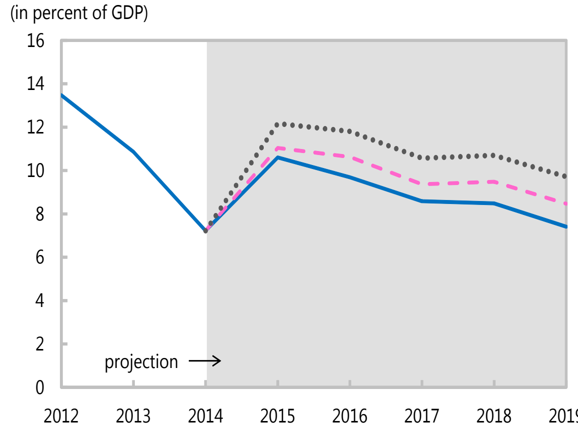
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	3.2	3.0	3.3	3.4	3.5	3.5
Inflation	-0.1	1.9	1.6	2.1	2.3	2.5
Primary Balance	-0.9	-0.5	0.0	-0.2	0.0	0.0
Effective interest rate	4.1	4.5	4.6	4.5	4.5	4.5
Constant Primary Balance Scenario						
Real GDP growth	3.2	3.0	3.3	3.4	3.5	3.5
Inflation	-0.1	1.9	1.6	2.1	2.3	2.5
Primary Balance	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Effective interest rate	4.1	4.5	4.6	4.5	4.5	4.5

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	3.2	4.1	4.1	4.1	4.1	4.1
Inflation	-0.1	1.9	1.6	2.1	2.3	2.5
Primary Balance	-0.9	-2.1	-2.1	-2.1	-2.1	-2.1
Effective interest rate	4.1	4.5	4.5	4.4	4.4	4.4

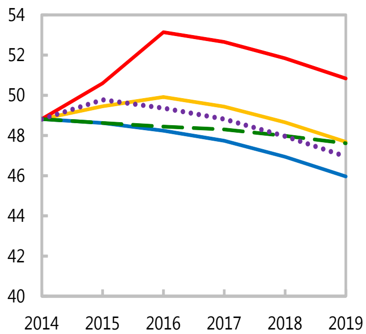
Source: IMF staff.

Republic of Poland: Public DSA—Stress Tests

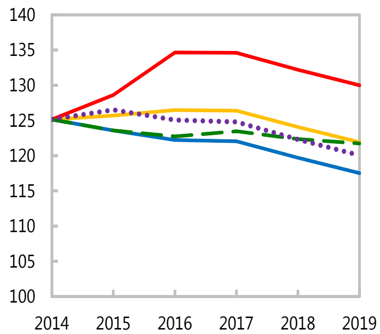
Macro-Fiscal Stress Tests

Baseline
Real GDP Growth Shock
Primary Balance Shock
Real Exchange Rate Shock
Real Interest Rate Shock

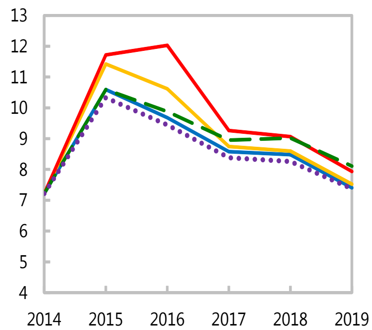
Gross Nominal Public Debt
(in percent of GDP)



Gross Nominal Public Debt
(in percent of Revenue)



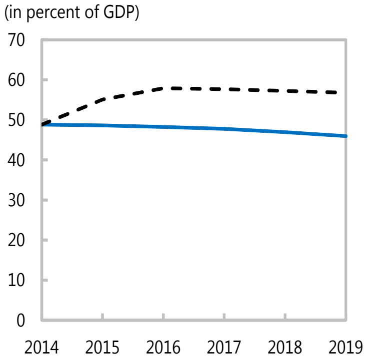
Public Gross Financing Needs
(in percent of GDP)



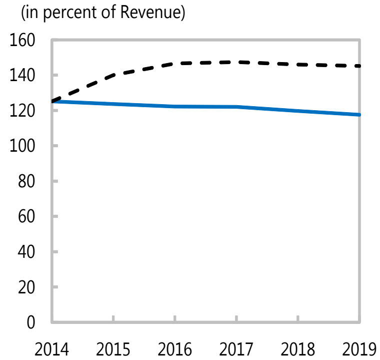
Additional Stress Tests

Baseline
Combined Macro-Fiscal Shock

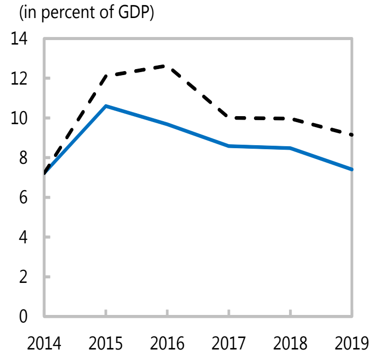
Gross Nominal Public Debt
(in percent of GDP)



Gross Nominal Public Debt
(in percent of Revenue)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Primary Balance Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	3.2	3.0	3.3	3.4	3.5	3.5
Inflation	-0.1	1.9	1.6	2.1	2.3	2.5
Primary balance	-0.9	-1.3	-0.8	-0.2	0.0	0.0
Effective interest rate	4.1	4.5	4.6	4.6	4.5	4.5
Real Interest Rate Shock						
Real GDP growth	3.2	3.0	3.3	3.4	3.5	3.5
Inflation	-0.1	1.9	1.6	2.1	2.3	2.5
Primary balance	-0.9	-0.5	0.0	-0.2	0.0	0.0
Effective interest rate	4.1	4.5	5.0	5.2	5.5	5.8
Combined Shock						
Real GDP growth	3.2	1.2	1.5	3.4	3.5	3.5
Inflation	-0.1	1.4	1.1	2.1	2.3	2.5
Primary balance	-0.9	-1.4	-1.8	-0.2	0.0	0.0
Effective interest rate	4.1	4.9	4.9	5.2	5.5	5.8

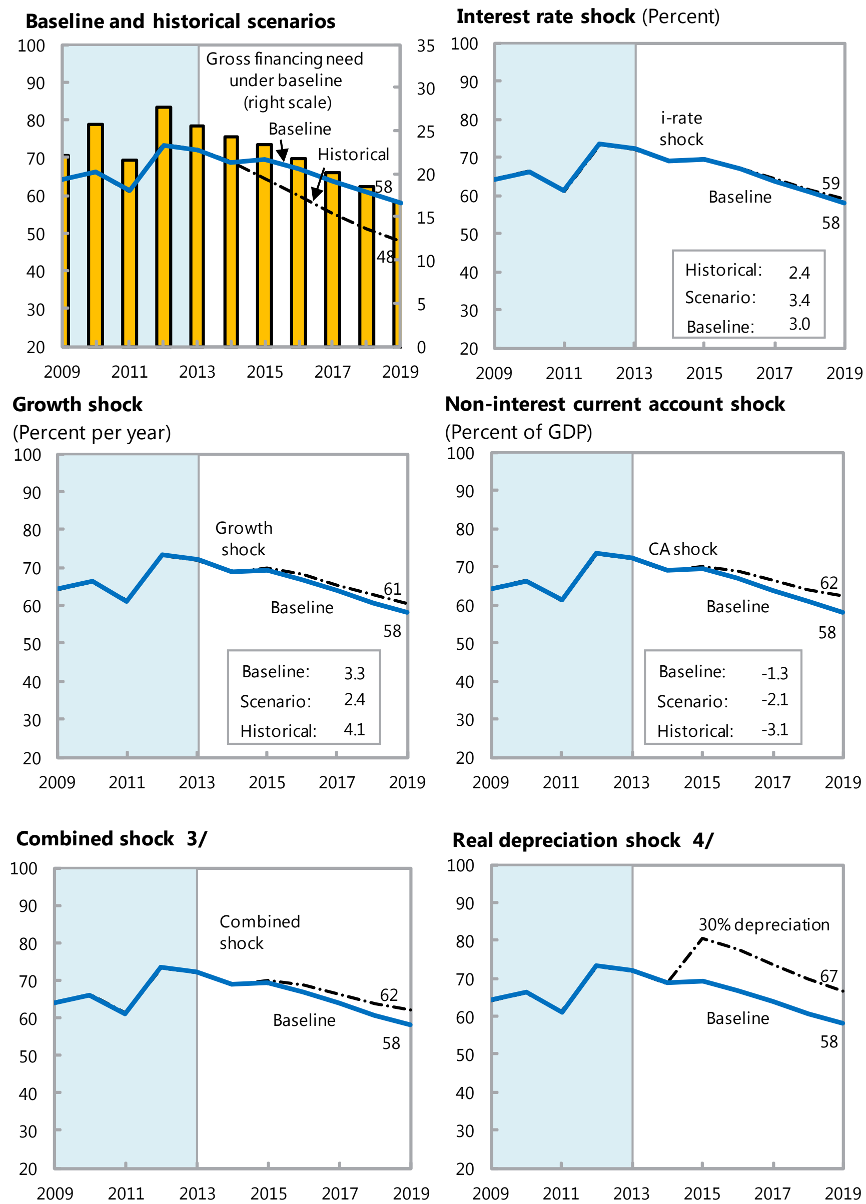
Real GDP Growth Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	3.2	1.2	1.5	3.4	3.5	3.5
Inflation	-0.1	1.4	1.1	2.1	2.3	2.5
Primary balance	-0.9	-1.4	-1.8	-0.2	0.0	0.0
Effective interest rate	4.1	4.5	4.6	4.6	4.6	4.6
Real Exchange Rate Shock						
Real GDP growth	3.2	3.0	3.3	3.4	3.5	3.5
Inflation	-0.1	8.6	1.6	2.1	2.3	2.5
Primary balance	-0.9	-0.5	0.0	-0.2	0.0	0.0
Effective interest rate	4.1	4.9	4.5	4.4	4.4	4.4

Source: IMF staff.

Annex II. External Debt Sustainability Analysis

Republic of 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**	64.1	66.2	61.2	73.3	72.1			**68.8**	**69.3**	**66.9**	**63.7**	**60.6**	**58.1**	**-3.1**
2 Change in external debt	18.0	2.0	-5.0	12.1	-1.2			-3.3	0.5	-2.4	-3.2	-3.1	-2.5	
3 Identified external debt-creating flows (4+8+9)	8.6	-2.8	-3.6	2.4	-2.1			-2.5	-1.0	-1.0	-0.6	-0.4	-0.2	
4 Current account deficit, excluding interest payments	3.3	3.9	3.9	1.9	-0.3			0.3	1.1	1.2	1.3	1.3	1.4	
5 Deficit in balance of goods and services	-79.0	-85.1	-90.4	-92.2	-92.2			-92.7	-93.2	-95.2	-96.4	-97.3	-98.0	
6 Exports	39.2	41.6	44.4	46.0	47.0			47.1	46.9	47.9	48.7	49.2	49.6	
7 Imports	-39.8	-43.5	-46.0	-46.2	-45.1			-45.6	-46.3	-47.4	-47.7	-48.1	-48.4	
8 Net non-debt creating capital inflows (negative)	-2.3	-3.1	-3.0	-1.9	-0.4			-2.2	-1.7	-1.8	-1.7	-1.7	-1.7	
9 Automatic debt dynamics 1/	7.5	-3.6	-4.5	2.3	-1.4			-0.6	-0.5	-0.4	-0.2	-0.1	0.1	
10 Contribution from nominal interest rate	0.6	1.1	1.1	1.7	1.6			1.6	1.6	1.8	2.0	2.1	2.1	
11 Contribution from real GDP growth	-1.5	-2.2	-2.9	-1.1	-1.2			-2.2	-2.0	-2.2	-2.1	-2.1	-2.0	
12 Contribution from price and exchange rate changes 2/	8.4	-2.6	-2.7	1.7	-1.8			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	9.4	4.8	-1.4	9.8	0.9			-0.8	1.5	-1.4	-2.6	-2.7	-2.3	
External debt-to-exports ratio (in percent)	163.8	158.9	137.8	159.2	153.3			146.0	147.9	139.8	130.9	123.2	117.3	
Gross external financing need (in billions of US dollars) 4/	96.5	122.6	113.0	137.7	134.3			132.7	127.9	124.6	123.2	120.6	115.7	
in percent of GDP	22.1	25.7	21.6	27.7	25.5	10-Year	10-Year	24.2	23.3	21.7	20.2	18.5	16.7	
Scenario with key variables at their historical averages 5/								**68.8**	**64.1**	**59.7**	**55.4**	**51.2**	**47.7**	**-5.8**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	2.6	3.7	4.8	1.8	1.7	4.1	1.8	3.2	3.0	3.3	3.4	3.5	3.5	
GDP deflator in US dollars (change in percent)	-19.7	5.2	5.0	-6.9	4.2	5.6	11.7	0.8	-2.7	1.4	2.7	2.9	3.1	
Nominal external interest rate (in percent)	1.0	1.9	1.7	2.7	2.3	2.4	0.7	2.3	2.3	2.7	3.1	3.4	3.6	
Growth of exports (US dollar terms, in percent)	-20.1	16.0	17.3	-1.7	8.2	14.1	15.3	4.3	-0.3	6.9	8.0	7.7	7.4	
Growth of imports (US dollar terms, in percent)	-27.4	19.1	16.4	-4.8	3.5	13.4	18.4	5.2	1.7	7.2	6.9	7.4	7.4	
Current account balance, excluding interest payments	-3.3	-3.9	-3.9	-1.9	0.3	-3.1	1.7	-0.3	-1.1	-1.2	-1.3	-1.3	-1.4	
Net non-debt creating capital inflows	2.3	3.1	3.0	1.9	0.4	2.7	1.3	2.2	1.7	1.8	1.7	1.7	1.7	

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.

INTERNATIONAL MONETARY FUND

REPUBLIC OF POLAND

January 5, 2015

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

Approved By
Andrew Tweedie and Sanjaya Panth

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

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INTRODUCTION

1. **This note assesses the impact of the proposed Flexible Credit Line (FCL) arrangement for Poland on the Fund's finances and liquidity position, in accordance with the policy on FCL arrangements.**[1] The proposed arrangement would cover a 24-month period and access would be in an amount of SDR 15.5 billion (918 percent of quota). It would succeed the existing FCL arrangement, which would be cancelled prior to approval of the proposed arrangement. The full amount of access proposed would be available throughout the arrangement period, in one or multiple purchases.[2] The authorities intend to treat the arrangement as precautionary.

BACKGROUND

2. **Since the onset of the global economic and financial crisis, Poland has entered into successive FCL arrangements with the Fund under which no drawings have been made.** A one-year FCL arrangement equivalent to SDR 13.69 billion (1,000 percent of quota) was approved on May 6, 2009 which the authorities treated as precautionary. This arrangement was succeeded by another FCL arrangement on identical terms which was approved on July 2, 2010 and a two-year FCL arrangement in the amount of SDR 19.166 billion (1,400 percent of quota) approved on January 21, 2011.[3] On Jan 18, 2013 a successor FCL in the amount of SDR 22.0 billion (1,303 percent of quota) was approved. Poland's economy recovered well in 2010–11, reflecting very strong economic fundamentals and decisive counter-cyclical policies. Limited macroeconomic imbalances prior to the crisis and counter-cyclical policies during the crisis aided the strong recovery. More recently, sustained efforts to build buffers and further strengthen the policy framework further improved the already very strong economic fundamentals and reduced financing needs. As a consequence, no drawings have been made under any of the previous or the existing FCL arrangement. Poland has a history of strong performance under Fund arrangements and an exemplary record of meeting its obligations to the Fund.

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

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

[3] Soon after the approval of the FCL arrangement, the 2008 Quota and Voice Reform became effective and increased Poland's quota from SDR 1,369.0 million to SDR 1,688.4 million. This implied that the access under the FCL was reduced to 1,135 percent of quota.

Table 1. Republic of Poland: External Debt and Debt Service, 2010–14 1/

		2010	2011	2012	2013	2014
		(In billions of US dollars)				
Total External Debt		315.3	320.6	364.2	379.3	376.8
of which:	Public	109.6	116.0	150.3	153.5	154.1
	Private	205.7	204.6	213.9	225.8	222.8
Net External Debt		242.0	243.6	283.3	294.4	287.7
of which:	Public	109.6	116.0	150.3	153.5	154.1
	Private	132.3	127.6	133.0	140.9	133.6
Total External Debt Service		101.6	100.5	133.5	135.7	143.7
of which:	Public	6.8	4.9	11.3	14.2	13.0
	Private	94.7	95.6	122.2	121.5	130.7
Net External Debt Service		77.9	76.4	103.9	105.3	109.7
of which:	Public	6.8	4.9	11.3	14.2	13.0
	Private	71.1	71.5	92.6	91.1	96.7
		(In percent of GDP)				
Total External Debt		66.2	61.2	73.3	72.1	68.8
of which:	Public	23.0	22.1	30.3	29.2	28.1
	Private	43.2	39.0	43.1	42.9	40.7
Net External Debt		50.8	46.5	57.0	56.0	52.5
of which:	Public	23.0	22.1	30.3	29.2	28.1
	Private	27.8	24.3	26.8	26.8	24.4
Total External Debt Service		21.3	19.2	26.9	25.8	26.2
of which:	Public	1.4	0.9	2.3	2.7	2.4
	Private	19.9	18.2	24.6	23.1	23.9
Net External Debt Service		16.4	14.6	20.9	20.0	20.0
of which:	Public	1.4	0.9	2.3	2.7	2.4
	Private	14.9	13.6	18.6	17.3	17.7

Source: Polish authorities and IMF staff estimates.
1/ End of period, unless otherwise indicated.

3. **Total external and public debt levels are projected to decline broadly and remain sustainable.** External debt, which was in the 44-55 percent of GDP range in the years preceding the recent crisis, peaked at almost 73 percent of GDP in 2012-13, and is projected to decline gradually over the medium term. Short term debt on a residual maturity basis is estimated at about 30 percent of total external debt in 2014, and this share is projected to decline to below one-quarter over the medium term. Public external debt, in turn, is estimated at 28 percent of GDP in 2014, and is projected to decline below 25 percent of GDP by 2018. Gross public debt (ESA95 definition), which rose to around 55 percent of GDP in 2013, is projected to fall below 50 percent in 2014 (pre-2008 levels). Net external debt is projected to fall below 45 percent of

GDP in 2018. Sustainability analyses suggest that both external and public debt are generally robust to, and remain manageable under, a range of scenarios.[4]

4. The proposed FCL arrangement —despite its reduced access—would continue to be a substantial Fund commitment. The proposed reduction in access sends a clear signal of the authorities' intention to exit from the FCL as external risks recede. However if the full amount available under the FCL arrangement were drawn, Poland would be one of the highest Fund exposure to date.

5. If the full amount available under the proposed FCL arrangement were disbursed in 2015, Fund exposure to Poland would be manageable.

- Fund credit would represent a modest part of Poland's external debt (Table 2). Total external debt would rise to 74 percent of GDP initially, and public external debt to about 33 percent of GDP, with Fund credit representing about 4 percent of GDP. At its peak, Poland's outstanding use of GRA resources would account for about 6 percent of total external debt, 13 percent of public external debt and 19 percent of gross international reserves.
- External debt service would increase in the medium-term, but remain manageable under staff's medium-term macro projections. Poland's projected debt service to the Fund would peak in 2019 at about SDR 7.9 billion, or about 1.8 percent of GDP. In terms of exports of goods and services, debt service to the Fund would peak at 3.6 percent in 2019. This would account for 54 percent of total public external debt service, which would increase to about 7 percent of exports of goods and services.

[4] Note that the debt sustainability analysis does not assume any drawings under the FCL arrangement.

Table 2. Republic of Poland—Capacity to Repay Indicators, 2013–19 1/

	2013	2014	2015	2016	2017	2018	2019
Exposure and Repayments (In SDR millions)							
GRA credit to Poland	--	--	15,500.0	15,500.0	15,500.0	9,687.5	1,937.5
(In percent of quota)	--	--	918.0	918.0	918.0	573.8	114.8
Charges due on GRA credit 2/	--	--	373.8	371.8	371.4	384.1	120.9
Debt service due on GRA credit 2/	--	--	373.8	371.8	371.4	6,196.6	7,870.9
Debt and Debt Service Ratios 3/							
In percent of GDP							
Total external debt	72.1	68.8	73.6	71.1	67.7	62.9	58.6
Public external debt	29.2	28.1	32.7	31.3	29.1	25.6	22.4
GRA credit to Poland	--	--	4.3	4.2	3.9	2.3	0.4
Total external debt service	25.8	26.2	22.3	20.6	19.0	18.7	17.1
Public external debt service	2.7	2.4	2.7	2.4	2.1	3.5	3.3
Debt service due on GRA credit	--	--	0.1	0.1	0.1	1.5	1.8
In percent of Gross International Reserves							
Total external debt	357.1	366.9	314.4	316.2	319.1	341.2	374.2
Public external debt	144.5	150.0	139.7	139.5	137.4	138.7	143.4
GRA credit to Poland	--	--	18.5	18.5	18.6	12.6	2.8
In percent of Exports of Goods and Services							
Total external debt service	54.8	55.7	47.5	43.0	39.0	38.0	34.4
Public external debt service	5.7	5.0	5.8	5.1	4.4	7.0	6.7
Debt service due on GRA credit	--	--	0.2	0.2	0.2	3.0	3.6
In percent of Total External Debt							
GRA credit to Poland	--	--	5.9	5.9	5.8	3.7	0.7
In percent of Public External Debt							
GRA credit to Poland	--	--	13.3	13.3	13.5	9.1	1.9
In percent of total external debt service							
Debt service due on GRA credit	--	--	0.5	0.5	0.5	7.9	10.4
U. S. dollars per SDR (period averag	1.52	1.54	1.53	1.54	1.55	1.55	1.56
U. S. dollars per SDR (end of period	1.54	1.53	1.54	1.54	1.55	1.56	1.56

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

1/ Assumes full drawings under the FCL upon approval. The Polish authorities have expressed their intention to treat the arrangement as precautionary, as balance of payments pressures have not materialized.
2/ Based on the rate of charge as of December 15, 2014. Includes surcharges and service charges.
3/ Staff projections for external debt, GDP, gross international reserves, and exports of goods and services, as used in the staff report that requests the proposed FCL, adjusted for the impact of the assumed FCL drawing.

6. The immediate net impact of the proposed arrangement would be to lower the Fund's forward commitment capacity (FCC) by about SDR 10 billion (4.2 percent). As the existing FCL arrangement was approved after the 2011 first activation of the expanded and amended New Arrangements to Borrow (NAB), the ratio of 3:1 of NAB-to-quota resources would apply for financing of purchases under the arrangement based on prevailing guidelines. In the absence of a new arrangement, the cancellation of the existing arrangement would free up the quota resources (and thereby raise the FCC by SDR 5.5 billion). Approval of the proposed new FCL arrangement will reduce the FCC by the full amount of the arrangement (SDR 15.5 billion).[5] Thus, the net liquidity impact would be to reduce the FCC by about SDR 10 billion to about SDR 228.6 billion (Table 3).[6]

7. If the resources available under the proposed FCL arrangement were fully drawn, the Fund's exposure to Poland would represent almost one fifth of total GRA credit outstanding.

- The level of access relative to quota would fall from 1,303 percent of quota to 918 percent with the new FCL, or from SDR 22 billion to 15.5 billion. It would still be sizable and exceed the median of the peak levels of exceptional access cases while still remaining significantly below the levels of several recent exceptional access cases with drawing such as Greece (EFF, 2012), Ireland (EFF, 2010), Portugal (EFF, 2011) and precautionary arrangement of Mexico (FCL, 2014).
- Poland's outstanding use of GRA resources, at SDR 15.5 billion, would be one of the highest of individual country exposures to date.
- The concentration of Fund credit among the top five users of Fund resources would decrease slightly to 88.9 percent from 89.1 percent currently.
- Potential credit exposure to Poland would be about 1.2 times the Fund's current precautionary balances.

[5] The freed up NAB resources cannot be used to finance new commitments unless NAB participants and the Executive Board were to approve an increase in the maximum resources available during the current activation period. Such an increase is not being proposed at this time. However, the resources would be available to finance new commitments if the NAB is activated in the future NAB activation period.

[6] If Poland were to draw upon the proposed arrangement, there would be an additional impact on the FCC as Poland would no longer participate in the Financial Transactions Plan and the NAB Resource Mobilization Plan.

Table 3. Republic of Poland—Impact on GRA Finances
(millions of SDR unless otherwise noted)

	as of 12/01/2014
Liquidity measures	
Forward Commitment Capacity (FCC) before approval 1/	238,595
FCC on approval 2/	228,595
Change in percent	-4.2
Prudential measures	
Fund GRA commitment to Poland including credit outstanding	
in percent of current precautionary balances	121.1
in percent of total GRA credit outstanding 3/	19.9
Fund GRA credit outstanding to top five borrowers	
in percent of total GRA credit outstanding 3/	89.1
in percent of total GRA credit outstanding including Poland's assumed full drawing	88.9
Poland's projected annual GRA charges for 2015 in percent of the Fund's residual burden sharing capacity	13,697
Memorandum items	
Fund's precautionary balances (FY14)	12,800
Fund's Residual Burden Sharing Capacity 4/	2.7

Sources: Finance Department and IMF staff estimates.

1/ The FCC is defined as the Fund's stock of usable resources less undrawn balances under existing arrangements, plus projected repurchases during the coming 12 months, less repayments of borrowing due one year forward, less a prudential balance. The FCC does not include about US$461 billion in bilateral pledges from members to boost IMF resources. These resources will only be counted towards the FCC once: (i) individual bilateral agreements are effective and (ii) the associated resources are available for use by the IMF, in accordance with the borrowing guidelines and the terms of these agreements.
2/ Current FCC minus new access plus access under the expiring program adjusted for the NAB financed portion of the expiring commitment (about SDR 16.5 billion) which was considered as already committed at the time of the most recent NAB activation and is therefore not available to finance new commitments under the current activation. This amount could be included in possible future NAB activations.
3/ As of December 01, 2014
4/ Burden-sharing capacity is calculated based on the floor for remuneration at 85 percent of the SDR interest rate. Residual burden-sharing capacity is equal to the total burden-sharing capacity minus the portion being utilized to offset deferred charges and takes into account the loss in capacity due to nonpayment of burden sharing adjustments by members in arrears.

ASSESSMENT

8. **The proposed FCL arrangement would have a significant but manageable impact on the Fund's liquidity position.** At close to SDR 239 billion, the FCC appears sufficiently strong to accommodate the proposed arrangement, especially since the cancellation of Poland' existing FCL arrangement would partially offset the liquidity effect from the proposed new FCL arrangement with

a lower access. In addition, the 2012 Borrowing Agreements (which are not included in the FCC) will provide a second line of defense to the Fund's lending capacity as they become effective.[7]

9. Poland intends to treat the FCL arrangement as precautionary, but if drawn, this would feature prominently among the Fund's largest single credit exposures. Poland's overall external debt and debt service ratios are expected to remain manageable even with a drawing under the arrangement. In addition, Poland's capacity to repay is expected to remain strong given its sustained track record of implementing strong policies, including during the global financial crisis, and sound institutional policy framework, which provide assurances about the future course of policies.

[7] As of [December 4, 2014], 35 agreements have been approved by the Board for a total of SDR [287] billion, of which 33 agreements have become effective for a total of SDR [276] billion.

Annex I. Poland: History of IMF Arrangements

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

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

Annex Table I.1. Poland: IMF Financial Arrangements, 1990–2015

(In SDR millions)

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

Source: Finance Department.

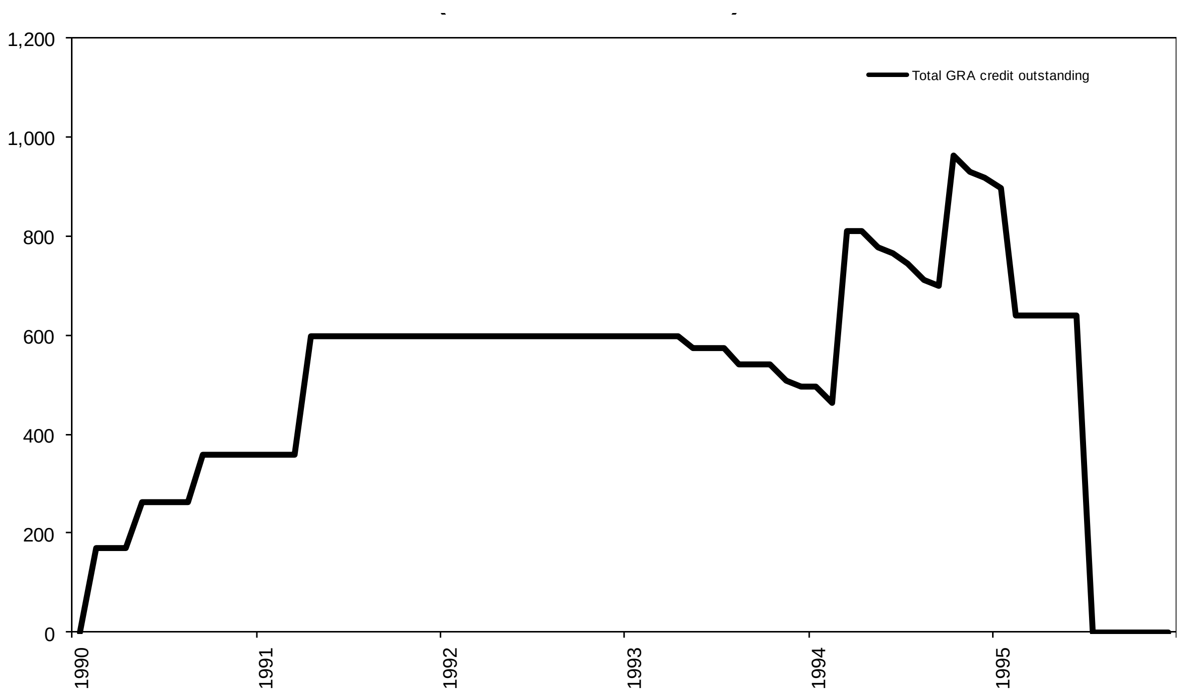
1/ As of November 11th, 2014

2/ Includes a purchase of SDR 162.6 million under the Compensatory Financing Facility.

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

Annex Figure I.1. Poland: IMF Credit Outstanding, 1990-1995

(In millions of SDRs)



Source: Finance Department.

Press Release No. 15/05
FOR IMMEDIATE RELEASE
January 14, 2015

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves New Two-Year US$23 Billion Flexible Credit Line Arrangement for the Republic of Poland

The Executive Board of the International Monetary Fund (IMF) today approved a successor two-year arrangement for the Republic of Poland under the Flexible Credit Line (FCL) with reduced access in an amount equivalent to SDR 15.5 billion (about US$23 billion, or 918 percent of quota). The Polish authorities intend to treat the arrangement as precautionary and do not intend to draw on the FCL.

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

Following the Executive Board discussion of the Republic of Poland, Mr. Min Zhu, Deputy Managing Director and Acting Chairman of the Board, made the following statement:

"Poland has very strong economic fundamentals and policy frameworks. The fiscal position is sound and public debt is sustainable. Its credible inflation targeting regime is an effective tool for macroeconomic management. The flexible exchange rate has played a stabilizing role, acting as a shock-absorber during periods of volatility in global financial markets. The banking system is liquid, well capitalized, and profitable, bolstered by an effective financial supervision.

The authorities have continued to rebuild policy space and further strengthen policy frameworks. Gradual fiscal consolidation has continued and a permanent expenditure rule, implemented in 2013, is expected to help safeguard long-term fiscal soundness. International reserves have increased and are broadly adequate against standard benchmarks. In the banking system, reliance on cross-border parent bank funding has declined and foreign currency mortgage origination was halted with the tightening of prudential rules.

External risks have abated somewhat but remain elevated. A protracted period of slower growth in the euro area could have large effects on Poland via trade and confidence channels. An abrupt surge in volatility in global financial markets, or a severe deterioration in external financing conditions could affect Poland's economy given its relatively high external financing needs. Persistent geopolitical tensions in the region add to downside risks.

Against this background, a successor two-year FCL arrangement with lower access, which the authorities intend to continue to treat as precautionary, reinforces Poland's buffers against external risks, helps sustain market confidence, and supports the authorities' sound economic strategy. In addition, the lower access sends a clear signal of the authorities' intention to exit from the FCL arrangement once external risks recede."

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

The Republic of Poland is a member of the IMF since 1986 and has a quota of SDR 1,688.40 million (about US$2,485.51 million).

Statement by Dominik Radziwill, Alternate Executive Director for the Republic of Poland, and Joanna Osinska, Advisor for the Executive Director
January 14, 2015

During a prolonged period of heightened external risks dating back to the global financial crisis, the consecutive arrangements under the IMF's Flexible Credit Line (FCL) have served the Polish economy very well. Alongside solid fundamentals and prudent policies, the FCL provided additional insurance against adverse external shocks. It helped foster Poland's macroeconomic performance and financial stability, and supported market confidence. The Polish economy successfully withstood several bouts of global financial volatility.

Meanwhile, Poland has been further building up its buffers. This has been accompanied by an evolution of risks in the external environment of the Polish economy. These risks continue to remain elevated. Our Polish authorities believe that continued additional insurance provided by the FCL remains important to support their economic policies and help sustain market confidence. The authorities wish to request a renewal of the FCL arrangement for another two years, with a reduced level of access. They continue to believe that exit from a precautionary arrangement should be state- rather than time-dependent. Thus, decisions regarding exit should be based on the assessment of the probability of tail risks, given the existing buffers. These considerations are reflected in their current request.

Buffers

Poland has made important progress in rebuilding its policy space. Macroeconomic imbalances have been substantially reduced and fundamentals further strengthened. Access to the FCL provided a temporary "breathing space" and helped support policy adjustment.

- **Economic growth has picked up pace.** After a significant slowdown in 2012–13, the Polish economy returned to higher growth pace last year. Strong investments and rebound in private consumption led to an acceleration in domestic demand. The authorities expect the official forecast of 3.3 percent GDP growth in 2014 to materialize.
- **Fiscal policy space has been gradually regained.** Both, fiscal deficit and public debt have been substantially reduced. The fiscal deficit was reduced from 7.6 percent of GDP in 2010 to 4.0 percent in 2013 (ESA2010) and is currently well on track to allow for the exit from the EU's Excessive Deficit Procedure as scheduled. Public debt at the end of 2014 is expected to have fallen to roughly 50 percent of GDP. A permanent expenditure rule has been introduced to enhance long-term fiscal sustainability.
- **External imbalances have narrowed**. The current account (CA) balance substantially improved, from -6.5 in 2008 to around -1.3 percent of GDP in 2013 (BMP6), reaching its lowest level in over a decade. While exports to non-EU partners had generally been steadily increasing in recent years, a significant decline in trade has been registered in the context of the recent Russia-Ukraine tensions. Nevertheless,

for 2014, the authorities expect the CA to narrow further. In addition, the capital account continues to register a surplus, primarily due to the strong inflow of the EU structural funds.

- **International reserves have increased.** Reserves continue to be broadly adequate according to standard metrics. They increased from around USD 80 billion at end-2009 to around USD 100 billion at end-2014.
- **Monetary policy has continued to support economic stability**. In late-2012 and 2013 the Monetary Policy Council (MPC) cut main policy interest rate by a cumulative 225 basis points (bps) and further by 50 bps in October 2014 to a new historic low of 2 percent. In the opinion of the MPC, this adjustment and stable economic growth limit the risk of inflation remaining below the target in the medium term. However, given the uncertainty regarding the economic conditions in the external environment of the Polish economy, the MPC does not rule out further adjustments.
- **Efforts have continued to maintain a strong financial sector**. The banking sector remains well-capitalized, liquid, and profitable. It continues to be supported by a strong regulatory and supervisory framework. The reliance on parent bank funding has declined alongside the reduction in FX loans outstanding.
- **Steady progress on the structural front has continued**. Various measures have been implemented over the last years. In the latest World Bank's Doing Business 2015 report, Poland was ranked 32nd—the highest in history.

Looking forward, the Polish authorities are determined to maintain very strong institutional policy frameworks and prudent policies. The government favours a balanced approach to macroeconomic management, effectively combining conservative fiscal policies with economic growth considerations.

Risks

As an open economy, Poland has benefited from integration with global markets, but at the same time remains highly exposed to potential external shocks. Its open capital account and relatively high financing needs make it susceptible to potential sudden shifts in investor sentiment.

In the authorities' view, while some of the external risks have receded since the last FCL request, new concerns have emerged. On balance, risks continue to remain elevated.

- The authorities recognize the growing risks stemming from geopolitical tensions surrounding Russia and Ukraine.
- They are also of the view that a potential surge in financial market volatility, linked to uncertainties related to the eventual normalization of U.S. monetary policy, may pose a risk of a general abrupt shift in market sentiment toward emerging market assets. This would affect Poland, especially given the Polish zloty's role as a proxy for the Central and Eastern European region.

- Finally, protracted slow growth in Poland’s main trading partners could affect its economy through trade linkages and the confidence channel.

In light of these concerns, the authorities believe that a successor precautionary FCL would continue to be instrumental in mitigating external risks in case of a tail event. They are of the view that additional insurance provided by the FCL remains important to help sustain market confidence and support their economic policies aimed at further strengthening the buffers.

With all these aspects considered, a successor two-year FCL arrangement at a lower level of access would provide sufficient insurance against adverse external shocks, while sending a strong signal of Poland’s commitment to exit the facility as soon as external conditions allow. At the same time, while the strengthened buffers allow for a reduction in the level of access, a full exit from the facility would be premature at this stage.

Exit

Poland’s intention to gradually reduce its reliance on the facility has been signaled on previous occasions. To ensure a smooth and orderly process, the authorities have proactively initiated extensive communication undertakings on their exit strategy, through direct outreach to investors and the general public, including press interviews by top Ministry of Finance officials. The outreach has been favorably received by investors and other stakeholders, as a proof of strength of the economy reinforcing the trust that Poland is well prepared to begin gradual exit from the arrangement.

Conclusion

Given the strengthened buffers and considering the balance of risks, our Polish authorities are requesting the approval of a successor 24-month FCL arrangement in a reduced amount equivalent to SDR 15.5 billion (918 percent of quota). Simultaneously, they wish to cancel the current arrangement approved on January 18, 2013, effective upon the approval of the new FCL.

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