INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/210

# REPUBLIC OF POLAND

July 2016

## 2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF POLAND

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2016 Article IV consultation with the Republic of Poland, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 27, 2016 consideration of the staff report that concluded the Article IV consultation with the Republic of Poland.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 27, 2016, following discussions that ended on May 16, 2016, with the officials of Republic of Poland on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed June 10, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Alternate Executive Director** for the Republic of Poland.

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

Selected Issues

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

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**International Monetary Fund**
**Washington, D.C.**

Press Release No. 16/316
FOR IMMEDIATE RELEASE
July 5, 2016

International Monetary Fund
Washington, D.C. 20431 USA

**IMF Executive Board Concludes 2016 Article IV Consultation with the Republic of Poland**

On June 27, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV Consultation[1] with Poland.

The economy is enjoying a strong economic expansion, but external factors continue to weigh on inflation. Unemployment has come down rapidly, and the economy is operating at close to full capacity. Growth is projected to remain strong in 2016 and accelerate to 3.7 percent in 2017, on the back of strong private consumption supported by the new child benefit scheme, before moderating over the medium term. A positive output gap next year should help gradually nudge inflation toward the central bank’s target by end-2017.

Downside risks have intensified. Externally, a protracted period of slow growth in the euro area, accompanied by financial market volatility, and a marked slowdown in emerging markets could propagate into Poland. Domestically, controversial policy initiatives or fiscal slippages could worsen investor sentiment and hinder economic expansion. Over the longer term, a rapidly aging population poses important challenges to potential growth and fiscal sustainability. At the same time, enduring income disparities between Poland’s prosperous west and the lagging east could undermine the quality of growth.

The government’s declared policy priorities focus on supporting a strong and inclusive growth, but some recent initiatives have weakened market sentiment. Fulfillment of election promises is expected to increase the budget deficit to 2.8 percent of GDP in 2016 and to over 3 percent of GDP in 2017, resulting in a pro-cyclical fiscal stance. The government plans to resume fiscal consolidation at a rate of ¾ percentage points of GDP a year from 2018. The banking sector remains well capitalized amid weakening profitability, but recent proposals to convert FX mortgages into zloty, if implemented, could undermine financial stability and further dent market confidence.

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

**Executive Board Assessment[2]**

Executive Directors noted that Poland is enjoying a strong economic expansion, with the economy operating at close to full capacity and unemployment coming down rapidly, reflecting Poland's progress in building strong fundamentals and policy buffers in recent years. They cautioned, however, that a weakening of institutions and policies or fiscal slippages could worsen investor sentiment and hinder economic expansion. They, therefore, encouraged the authorities to maintain sound institutions and growth-friendly policies, and advance structural reforms to support inclusive growth. Such policies would enhance resilience and, together with the Fund-supported Flexible Credit Line arrangement, provide strong insurance against external shocks.

Directors noted that the current accommodative monetary policy stance is appropriate and has helped support growth and maintain longer-term inflation expectations within the inflation target band. They urged the authorities to remain vigilant, noting that additional monetary easing could be needed if inflation expectations were to disappoint or if growth were to slow down sharply.

Directors observed that the banking sector remains well-capitalized amid weakening profitability. They stressed the importance of safeguarding financial sector stability, and welcomed the strengthened financial sector framework now in place, including the new bank resolution framework, which should now be implemented. However, Directors generally expressed concern that the new bank asset tax could undermine credit expansion and growth. They welcomed the authorities' willingness to assess the performance of the new tax and adjust its design if necessary, and encouraged them to consider a more growth-friendly tax. They also took note of the proposals to restructure foreign exchange-denominated mortgages and stressed that any decision in this regard should be mindful of the potential impact on banks and financial stability. They noted that a case-by-case approach to restructuring mortgages held by distressed borrowers rather than a blanket mortgage conversion would avoid risks of destabilizing the financial sector.

Directors concurred that the authorities' medium-term objective of 1 percent of GDP structural deficit remains appropriate, allowing for sufficient fiscal space to deal with external shocks and to address looming demographic challenges. In this regard, most Directors considered it necessary to resume fiscal consolidation without delay to take advantage of favorable cyclical conditions. Directors stressed that deficit reduction should be underpinned by growth-friendly measures to help support market confidence and maintain budget financing on favorable terms. They recommended maintaining the 2011 VAT increase, rationalizing discretionary government consumption, and reducing sizable VAT policy and compliance gaps. In this context, they welcomed the authorities' plans to

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

strengthen tax administration. Noting the need to reduce the risk of old-age poverty under the current pension system, Directors encouraged the authorities to maintain the legislated retirement age increases, which would also avoid adversely impacting the budget and improve labor force participation.

Directors encouraged the authorities to continue to implement structural reforms to boost productivity and promote inclusive growth. In this regard, they welcomed the authorities' plans to increase access to vocational training and promote innovation, including through targeted tax incentives for start-ups. Directors advised that reducing regional disparities would require improving educational attainment in Poland's east, scaling up public infrastructure to attract investment to poorer regions, and facilitating labor mobility.

## Poland: Selected Economic Indicators, 2013–21

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Projections | | | |
| **Activity and prices** | | | | | | | | | |
| GDP (change in percent) 1/ | 1.3 | 3.3 | 3.6 | 3.5 | 3.7 | 3.4 | 3.2 | 3.1 | 3.1 |
| Domestic demand | -0.7 | 5.0 | 3.4 | 3.9 | 4.0 | 3.8 | 3.5 | 3.2 | 3.2 |
| Private consumption growth | 0.2 | 2.4 | 3.0 | 3.8 | 4.1 | 3.9 | 3.5 | 3.1 | 3.1 |
| Public consumption growth | 2.2 | 4.7 | 3.4 | 3.1 | 2.8 | 2.6 | 2.3 | 2.1 | 1.8 |
| Domestic fixed investment growth | -1.1 | 10.0 | 5.8 | 3.8 | 5.1 | 4.8 | 4.4 | 4.4 | 4.4 |
| Inventories (contribution to growth) | -1.0 | 0.6 | -0.2 | 0.4 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net external demand (contribution to growth) | 2.0 | -1.6 | 0.3 | -0.4 | -0.3 | -0.4 | -0.3 | -0.1 | -0.1 |
| Output gap | -1.1 | -0.7 | -0.1 | 0.0 | 0.2 | 0.4 | 0.3 | 0.1 | 0.0 |
| CPI inflation (percent) | | | | | | | | | |
| Average | 0.9 | 0.0 | -0.9 | -0.7 | 1.1 | 1.9 | 2.4 | 2.5 | 2.5 |
| End of period | 0.7 | -1.0 | -0.5 | 0.1 | 1.5 | 2.2 | 2.5 | 2.5 | 2.5 |
| Unemployment rate (average, according to LFS) | 10.3 | 9.0 | 7.5 | 6.4 | 6.2 | 6.3 | 6.3 | 6.4 | 6.5 |
| **Public finances** (percent of GDP) 2/ | | | | | | | | | |
| General government revenues | 38.4 | 38.9 | 38.9 | 39.2 | 39.0 | 39.1 | 39.2 | 39.2 | 39.2 |
| General government expenditures | 42.4 | 42.2 | 41.5 | 41.9 | 42.1 | 41.9 | 41.7 | 41.5 | 41.3 |
| General government net lending/borrowing | -4.0 | -3.3 | -2.6 | -2.8 | -3.1 | -2.8 | -2.5 | -2.3 | -2.1 |
| General government debt | 56.0 | 50.5 | 51.3 | 51.9 | 52.9 | 53.2 | 52.8 | 52.3 | 51.6 |
| National definition 3/ | 53.3 | 48.1 | 49.0 | … | … | … | … | … | … |
| **Money and credit** | | | | | | | | | |
| Private credit (change in percent, end-period) 4/ | 3.5 | 8.6 | 6.0 | 4.6 | 5.0 | 5.5 | 5.8 | 5.8 | 5.9 |
| Credit to GDP (percent) | 58.5 | 61.2 | 62.3 | 62.6 | 63.1 | 63.3 | 63.5 | 63.7 | 64.0 |
| Deposits (change in percent, end-period) | 5.8 | 7.8 | 8.4 | 6.1 | 6.1 | 6.2 | 6.3 | 6.3 | 6.4 |
| Broad money (change in percent, end-period) | 6.2 | 8.2 | 9.1 | 6.2 | 6.1 | 6.2 | 6.3 | 6.3 | 6.4 |
| Policy Rate (percent) 5/ | 2.9 | 2.4 | 1.6 | 1.5 | … | … | … | … | … |
| **Balance of payments** | | | | | | | | | |
| Current account balance | | | | | | | | | |
| (transactions, billion U.S. dollars) | -6.7 | -11.1 | -1.1 | -3.2 | -6.6 | -10.4 | -13.6 | -15.7 | -17.4 |
| Percent of GDP | -1.3 | -2.0 | -0.2 | -0.7 | -1.3 | -2.0 | -2.5 | -2.7 | -2.8 |
| Exports of Goods (billion U.S. dollars) | 198.1 | 210.6 | 190.7 | 194.3 | 208.2 | 221.8 | 236.4 | 251.4 | 267.0 |
| Export volume growth | 6.1 | 6.4 | 6.8 | 6.1 | 6.5 | 6.0 | 5.8 | 5.6 | 5.4 |
| Imports of Goods (billion U.S. dollars) | 198.6 | 214.9 | 188.4 | 191.3 | 208.9 | 226.0 | 243.4 | 260.5 | 277.9 |
| Import volume growth | 1.7 | 10.0 | 6.3 | 7.7 | 7.4 | 6.9 | 6.4 | 5.9 | 5.6 |
| Terms of trade (index 1995=100) | 99.4 | 101.5 | 104.6 | 106.5 | 105.4 | 104.7 | 104.2 | 103.8 | 103.6 |
| Official reserves (billion U.S. dollars) | 106.2 | 100.4 | 94.9 | 106.9 | 113.7 | 122.2 | 122.5 | 125.4 | 128.5 |
| In percent of short-term debt plus CA deficit | 74.9 | 94.0 | 87.0 | 96.6 | 103.1 | 105.6 | 107.9 | 111.3 | 112.6 |
| Total external debt (billion U.S. dollars) | 384.1 | 354.7 | 328.4 | 330.9 | 332.1 | 335.1 | 334.9 | 337.7 | 341.2 |
| In percent of GDP | 73.3 | 65.1 | 69.2 | 69.7 | 67.4 | 64.3 | 60.7 | 57.8 | 55.4 |
| **Exchange rate** | | | | | | | | | |
| Exchange rate regime | | | | Freely floating | | | | | |
| Zloty per USD, period average 6/ | 3.2 | 3.2 | 3.8 | 3.9 | … | … | … | … | … |
| Zloty per Euro, period average 6/ | 4.2 | 4.2 | 4.2 | 4.4 | … | … | … | … | … |
| Real effective exchange rate (INS, CPI based) 7/ | 108.3 | 109.1 | 105.3 | … | … | … | … | … | … |
| Appreciation (percent change) | 0.7 | 0.7 | -3.5 | … | … | … | … | … | … |
| *Memorandum item:* | | | | | | | | | |
| Nominal GDP (billion zloty) | 1656.3 | 1719.1 | 1789.7 | 1863.6 | 1942.5 | 2043.1 | 2153.9 | 2270.7 | 2396.0 |

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/ Credit defined as in IFS: "Claims on other sectors."
5/ NBP Reference Rate (avg). For 2016, as of June 2.
6/ For 2016, exchange rate as of June 2.
7/ Annual average (2000=100).

INTERNATIONAL MONETARY FUND

# REPUBLIC OF POLAND

## STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

June 10, 2016

## KEY ISSUES

**Context.** Poland continued its convergence to average EU income levels, growing well above most of its peers. Yet, significant regional disparities and long-term structural challenges remain. The new government, which took office in November 2015, has introduced a number of new policies, some of which have dented investor sentiment and could weaken growth going forward. The near-term outlook is for continued expansion with low oil prices weighing on inflation. External risks to the outlook remain elevated and prospects of controversial policy initiatives have heightened domestic risks. Sound institutions, growth-friendly policies, and structural reforms are critical to achieve sustainable and inclusive growth.

**Monetary policy.** The current accommodative monetary policy stance is appropriate, and has helped support growth and maintain longer-term inflation expectations within the tolerance band. To support inflation's return to the target, interest cuts could be needed in the event of downside surprises.

**Fiscal policy.** Fiscal consolidation should resume already in 2017 to take advantage of favorable economic conditions. The distortionary tax on bank assets could slow credit expansion and investment, and should be replaced with a more growth-friendly tax on bank profits and remuneration. The planned reversal of the 2013 retirement age increases should be reconsidered to safeguard public finances and labor force participation by seniors.

**Financial sector policy.** The financial sector remains well capitalized amid declining profitability. Recent proposals for blanket conversion of Swiss franc mortgages into zloty, if implemented, risk undermining financial stability, with adverse implications for credit and growth. Instead, the focus should be on supporting distressed mortgage holders on a case-by-case basis. Prompt completion of the bank resolution framework would further strengthen the financial safety net.

**Structural reforms.** To promote sustainable and inclusive growth, reforms should focus on boosting labor force participation and productivity, and reducing regional economic disparities.

Approved By
**Thanos Arvanitis and Andreas Bauer**

Ms. Zakharova (head), Ms. Christiansen, Mr. Thegeya (all EUR), Ms. Zhang (SPR), and Mr. Yakhshilikov (RES) visited Warsaw during May 5–16, 2016. The mission met with senior government and central bank officials and representatives from trade unions and the business community. Mr. Bakker (Senior Regional Resident Representative), Mr. Sierhej, and Mr. Krogulski (Resident Representative Office) participated in the discussions. Ms. Jung, Ms. Colon, and Ms. Nguyen (all EUR) provided support from headquarters. Poland is an Article IV country and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions, except for those solely for the preservation of national or international security (Informational Annex: Fund Relations). Data provision is adequate for surveillance (Informational Annex: Statistical Issues). Staff has completed the safeguards procedures for Poland's 2015 Flexible Credit Line arrangement. For 2014, the Narodowy Bank Polski's (NBP's) external auditor was PricewaterhouseCoopers (PwC) Warsaw. PwC issued an unqualified audit opinion on the 2014 financial statements on March 25, 2015. Staff reviewed the 2014 audit results and no significant safeguards issues were identified.

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# CONTEXT

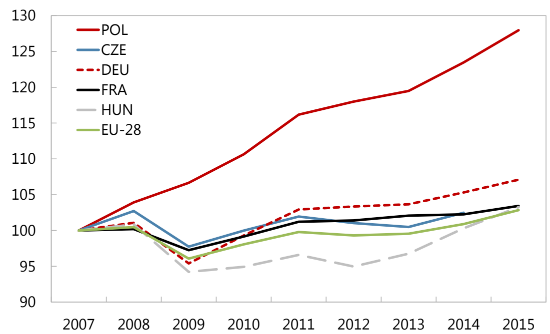
**1. Poland has enjoyed strong economic performance in recent years.** Thanks to its sound policies, close links to the German supply chain, and substantial EU transfers, Poland was the only country in the EU that avoided an outright recession during the global financial crisis. Steady economic convergence has allowed Poland to close more than a quarter of its per-capita income gap with the EU during the past two decades (Figure 1). By any means, this is an important achievement.

**Figure 1. Poland: Income Convergence**

*Poland has enjoyed strong economic performance...*

**Real GDP**

(Index; 2007=100)

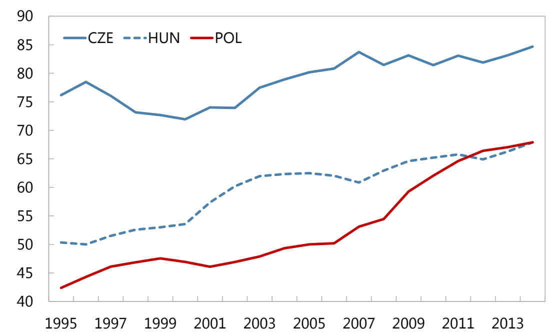



Source: Haver Analytics.

*...and convergence with the EU has continued.*

**GDP Per Capita Relative to the EU**

(Percent of EU28 average, PPS per capita)




Source: Eurostat.

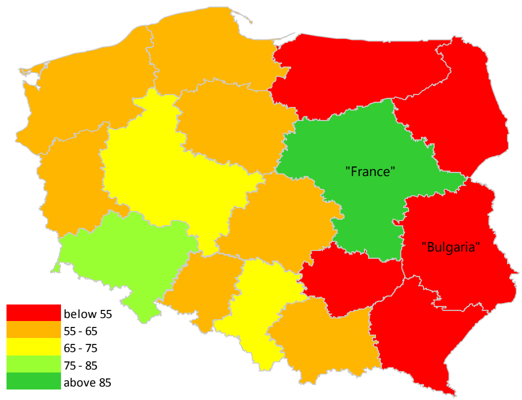
**2. However, this strong performance has masked enduring regional disparities, which are undermining the quality of growth.** Eastern regions in Poland—dominated by small-scale farming—have lower per-capita GDP, productivity, and educational attainment levels, while also exhibiting higher poverty and long-term unemployment rates. Despite strong overall economic growth, the east has not been catching up to the west (Figure 2).

**3. Going forward, Poland is also facing important long-term challenges as an aging population weighs on potential growth and public finances.** With net emigration flows to the EU continuing and birth rates among the lowest in the EU, the working-age (15–64) population is set to shrink by more than 30 percent by 2060, resulting in almost a tripling of the old-age dependency ratio (Figure 3). If left unaddressed, these trends will ultimately reduce potential growth and increase healthcare and pension-related spending, weakening public finances.

## Figure 2. Poland: Regional Disparities

*Per-capita income is notably lower in the east,…*

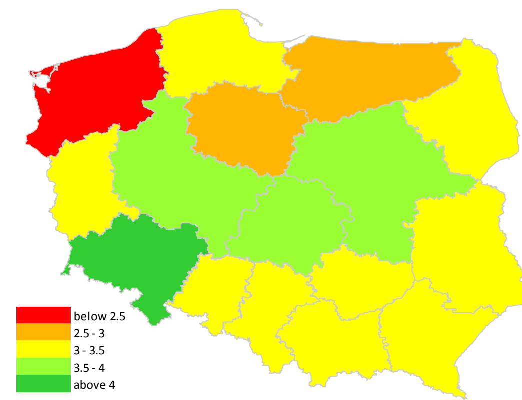
**GDP per Capita, 2014 1/**
(Percent of EU28 average, PPS-adjusted)




1/ Names in quotes denote EU countries with similar GDP per capita.

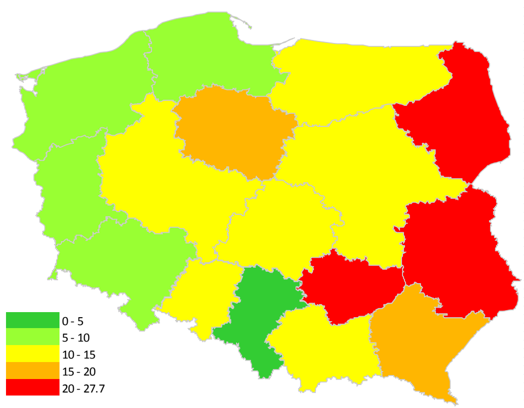
*…which is not catching up with the west.*

**Real GDP per Capita Growth, 2000–14**
(Annual average, percent)



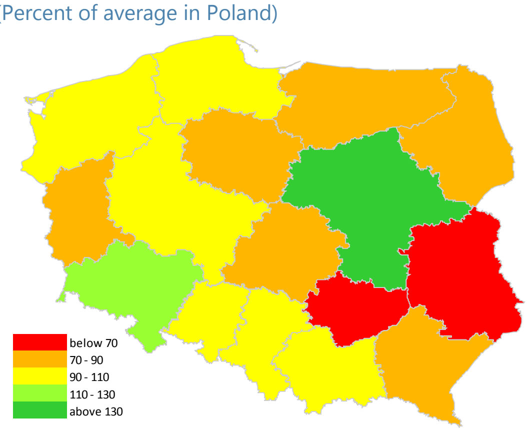

*The share of agriculture is higher in the east,…*

**Share of Employment in Agriculture, 2012**
(Percent)



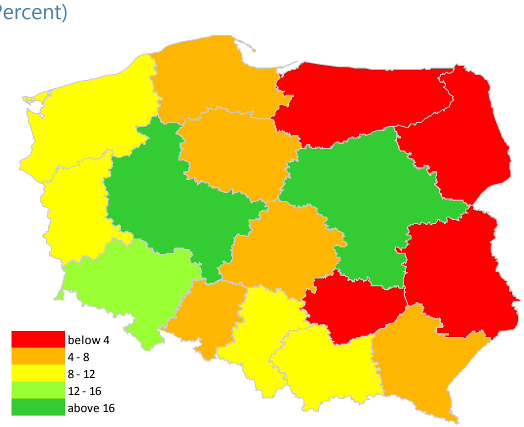

*…with lower levels of labor productivity.*

**Labor Productivity, 2012**
(Percent of average in Poland)



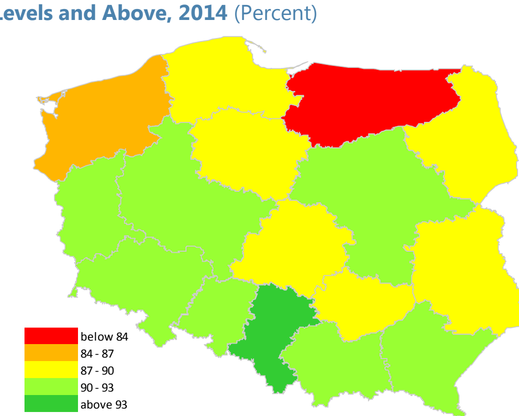

*The west receives the most FDI…*

**Employment Share of Firms with Foreign Capital, 2014**
(Percent)




*…and has higher educational attainment.*

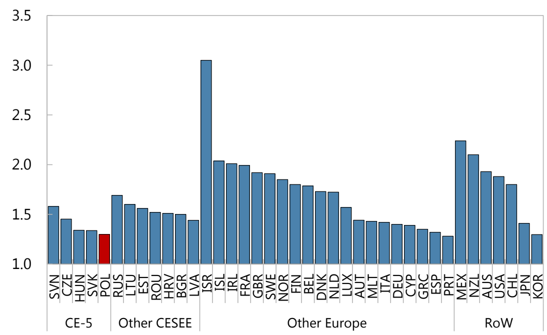
**Share of Population with Higher Secondary Education Levels and Above, 2014** (Percent)



## Figure 3. Poland: Demographic Challenges

*Fertility is among the lowest in Europe,...*

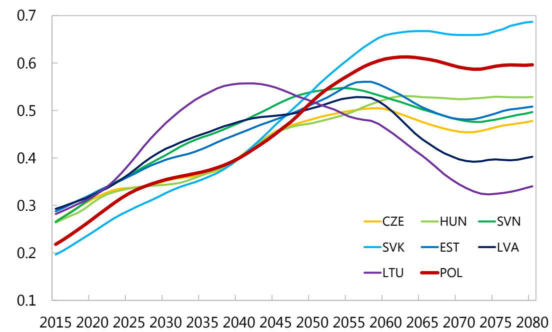
**Fertility Rates, 2012**
(Average number of children per woman over a lifetime)




Source: OECD.

*...and the population is rapidly aging.*

**Old-Age Dependency Ratio Projections**
(Number of people 65 and older relative to number of people aged 15-64)




Sources: Eurostat and IMF staff calculations.

**4. The new government's priorities focus on strong and inclusive growth.** The government, which took office in November, has approved a Responsible Development Plan, focusing on spurring growth through innovation and reducing social and regional disparities. The plan identifies five main pillars of economic policy to address long-term growth challenges: (i) reindustrialization—by promoting specializations where Poland could have a competitive advantage, supporting partnerships for strategic sectors, and attracting high-tech foreign direct investment (FDI); (ii) development of innovative firms—by improving the business environment, promoting start-ups, and enhancing cooperation between business and academia; (iii) mobilizing capital for development—by promoting domestic savings and better utilizing EU funds; (iv) foreign expansion by Polish companies abroad—by creating a strong Polish brand; and (v) social and regional development—by reversing unfavorable demographic trends, strengthening vocational education to match local market needs, and developing infrastructure in poorer regions. The government is working on specific measures to underpin the implementation of the program.

**5. Yet, some recent policy initiatives have dampened market confidence and could weaken growth going forward.** In particular, the new tax on banks could undermine credit expansion, investment, and growth. Conversion of foreign currency mortgages into zloty is being considered, and depending on its design and implementation, could adversely impact financial stability. And though the new child benefits program is likely to reduce inequality and poverty, it will complicate the needed fiscal consolidation, and could discourage female labor force participation. Furthermore, efforts to reform key institutions have raised concerns. The Venice Commission has voiced its opinion that recent changes to the Constitutional Tribunal endanger the rule of law. These changes have also prompted the European Commission to initiate a dialogue within the Rule of Law Framework and have contributed to a rating downgrade by S&P in January and a downward revision of the outlook by Moody's in May. In turn, financial market volatility has increased, foreign investor sentiment has soured, and spreads vis-à-vis German bunds have widened (Figure 12).

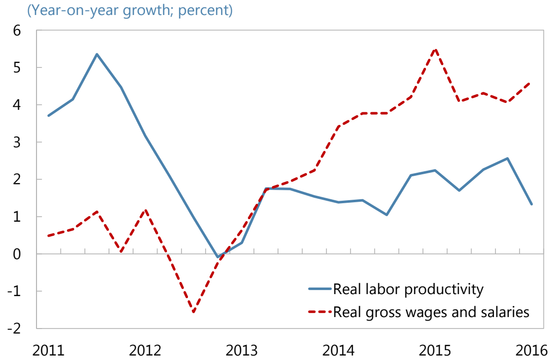
# RECENT ECONOMIC DEVELOPMENTS

**6. Growth has remained strong.** Real GDP growth rate reached 3.6 percent in 2015,[1] up from 3.3 percent in 2014, driven by strong domestic demand (Figure 13). Private consumption has been supported by declining prices, a low and declining unemployment rate, and continued robust wage growth, which boosted disposable income. Healthy credit expansion and still-accommodative financial conditions—in part on the back of quantitative easing (QE) in the euro area—helped support private investment. However, following strong real GDP growth of 4 percent (year-on-year) in the fourth quarter, the first quarter of this year recorded a growth slowdown to 2.6 percent. Nonetheless, the Purchasing Managers Index (PMI) has remained in expansionary territory into 2016, retail sales grew at 5½ percent year-on-year in April, and manufacturing sentiment has remained positive (Figure 4).

## Figure 4. Poland: Recent Economic Developments

*Wages have outpaced productivity,…*

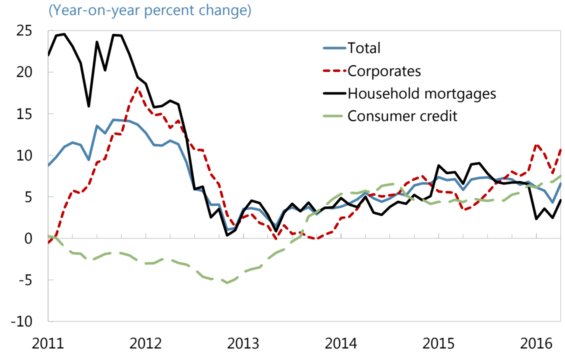
**Real Labor Productivity and Wages**
(Year-on-year growth; percent)




Sources: Eurostat, Haver Analytics, and IMF staff calculations.

*…credit expanded, though with some recent weakening,…*

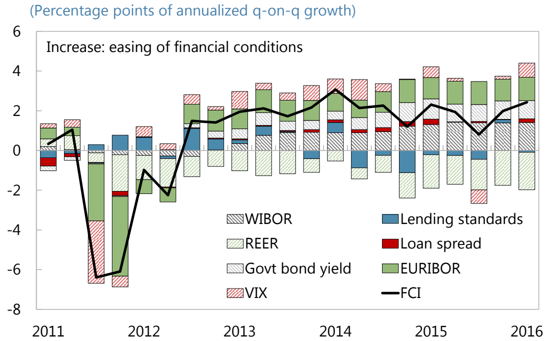
**Private Sector Credit Growth**
(Year-on-year percent change)




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

*…financial conditions remained accommodative,…*

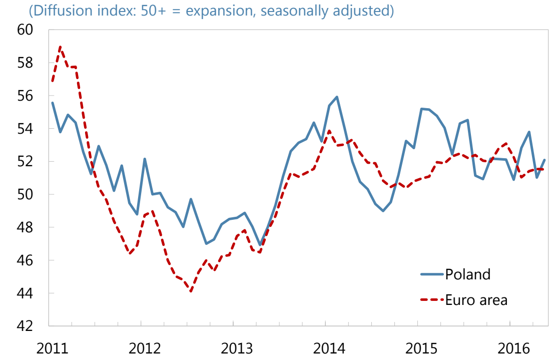
**Contributions to Financial Conditions Index**
(Percentage points of annualized q-on-q growth)




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

*…and PMI has continued in expansionary territory.*

**Purchasing Managers' Index: Manufacturing**
(Diffusion index: 50+ = expansion, seasonally adjusted)




Sources: Haver Analytics and HSBC/Markit.

[1] Growth numbers refer to constant 2010 prices.

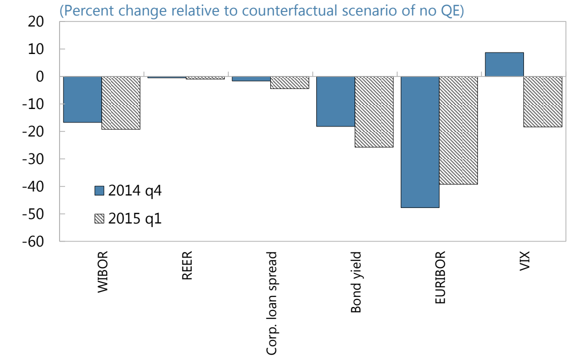
**7. Financial conditions have remained supportive.** A historically low policy interest rate since March 2015, low yields on local-currency government bonds, and QE by the European Central Bank (ECB) have continued to support financial conditions (Figure 5). While credit expansion has moderated recently, it has generally held up well alongside broadly unchanged credit standards in recent quarters—with the exception of housing loans, where tighter standards were associated with new prudential recommendations and reduced appetite among some banks to expand their housing loan portfolios. However, despite some gains during the first months of the year, Polish equities as of mid-May remained more than 15 percent below the level one year earlier, following sustained stock market losses starting in May last year. While long-term bond yields have remained close to recent lows, spreads to German bunds have widened by some 70 basis points between end-September 2015 and end-May 2016 (Figure 12).

## Figure 5. Poland: Positive Spillovers from ECB Quantitative Easing[1]

*ECB quantitative easing has affected most indicators,...*

**Impact of QE on Financial Indicators**

(Percent change relative to counterfactual scenario of no QE)

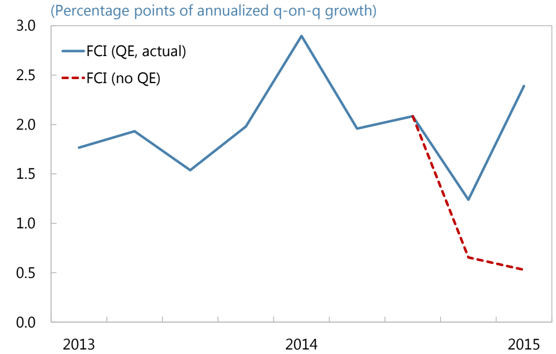



Sources: Haver Analytics and IMF staff calculations.

*...resulting in a marked easing of financial conditions,...*

**Impact of QE on Financial Conditions Index**

(Percentage points of annualized q-on-q growth)

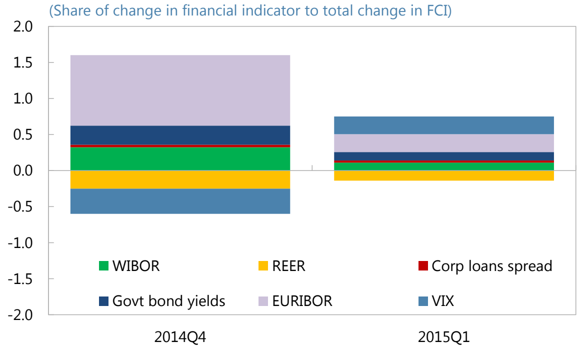



Sources: Haver Analytics and IMF staff calculations.

*...particularly owing to lower EURIBOR rates.*

**Breakdown of QE impact on FCI by financial indicators**

(Share of change in financial indicator to total change in FCI)

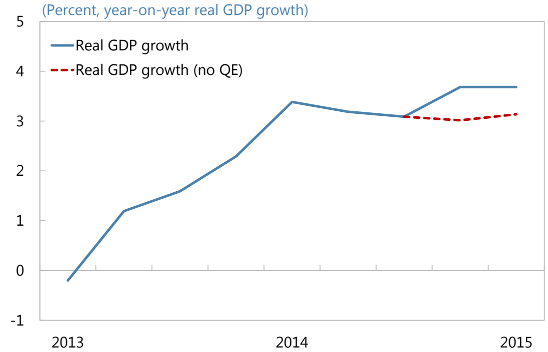



Sources: Haver Analytics and IMF staff calculations.

*In turn, financial conditions have supported growth.*

**Impact of QE on Real GDP Growth**

(Percent, year-on-year real GDP growth)




Sources: Haver Analytics and IMF staff calculations.

[1] Based on the Cross-Country Selected Issues on "Adapting to Spillovers from Unconventional Monetary Policies." With respect to the two right-hand charts, the counterfactual FCI was constructed using projections from VARs on domestic and external financial indicators, respectively, with a sample ending in 2014Q3, before the quantitative easing (QE) announcement. QE is assumed not to impact lending standards.

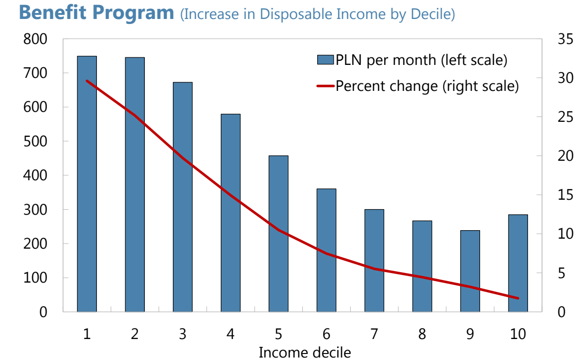
**8. Labor market conditions have continued to improve but inflation remains very low.** The seasonally-adjusted harmonized unemployment rate has been on a declining trajectory for about three years, reaching 6.3 percent in April, a historical low, as employment strengthened. Alongside, year-on-year nominal wage growth has remained robust at above 3 percent in the first quarter, boosting real wages and outperforming labor productivity growth. Yet, inflation remains subdued at -0.9 percent in May, amid weak imported inflation, in particular related to low commodity prices and euro area inflation, which have had both direct and indirect spillovers on Poland (Figure 14).[2] Core inflation has also turned negative, most recently at -0.4 percent in May. Nonetheless, while longer-term inflation expectations at the monetary policy horizon have declined somewhat, they remain anchored within the inflation tolerance band (1.5 to 3.5 percent).

**9. The external position has improved.** Poland's current account deficit declined from 2 percent of GDP in 2014 to 0.2 percent of GDP in 2015, reflecting improved terms of trade—in light of a close to 50 percent drop in oil prices—and moderately weaker non-oil imports. However, financial flows weakened as a result of reinvestment of earnings by special purpose vehicles and portfolio outflows. The overall external position in 2015 was consistent with fundamentals and desirable policies (Figure 15, Box 1, Annex I), and reserves are broadly adequate, standing at about 107 percent of the IMF's composite reserve adequacy metric at the end of last year.

# OUTLOOK AND RISKS

**10. On the basis of current policies, the outlook is for continued strong growth and rising but low inflation.** Real growth is expected to remain at 3½ percent in 2016 and accelerate to 3.7 percent in 2017 on the back of strong private consumption, boosted by a new child benefits program,[3] opening a positive output gap. This, together with dissipating effects from external price shocks, should help gradually nudge inflation toward the lower bound of the target band (1.5–3.5 percent) by the end of 2017 (Figure 6).

**Impact on Household Disposable Income of 500+ Child Benefit Program** (Increase in Disposable Income by Decile)




Sources: CenEA and Citi.

[2] See Cross-Country Report on Inflation, Selected Issues, IMF Country Report No. 15/184, 2015.

[3] According to CenEA think tank estimates, the 500+ child benefits program would reduce poverty and inequality. Specifically, disposable income of the poorest households with at least one child (lower decile) will increase by 30 percent, while the richest households (top decile) will gain only 2 percent. The median household with children will receive an additional PLN400 per month, yielding 9 percent higher disposable income.

## Box 1. Poland: External Sector Assessment

*The external position in 2015 was broadly consistent with medium-term fundamentals and desirable policies. However, vulnerabilities exist.*

**Current account.** Poland's current account deficit declined from 2 percent of GDP in 2014 to 0.2 percent of GDP in 2015, largely reflecting improved terms of trade and somewhat weaker non-oil import volume. The oil deficit declined from 3.2 percent of GDP in 2014 to 2 percent in 2015 as oil prices fell by close to 50 percent. In 2016, the current account deficit is projected to widen on the back of stronger domestic demand. The current account is broadly consistent with fundamentals and desirable policies.

**Real exchange rate.** The average real effective exchange rate (REER) depreciated by 3 percent in 2015 relative to 2014, largely reflecting nominal depreciation vis-à-vis the U.S. dollar and the Swiss franc. The REER has depreciated about 2 percent as of April 2016 relative to its end 2015 level. Various approaches suggest a modest undervaluation between 2 and 14 percent. The REER gap implied by the current account approach is -2 percent; the external sustainability approach suggests a REER gap of -6 percent; -5 percent using the REER index regression approach; and -14 percent using the levels approach. Owing to large residuals in the REER-level regressions, staff puts more weight on the other approaches. Hence, staff assesses Poland's real exchange rate in 2015 to be close to a level consistent with fundamentals and desirable policy settings with the REER gap centered around -5 percent within a range of -10 to 0 percent.

**Capital and financial account.** Bond and equity markets have experienced portfolio investment outflows since the second quarter of 2015. The larger outflows in the first two months of 2016, which were in part driven by maturing external debt, also reflect a more general EM asset sell-off on the back of heightened global risks. Foreign direct investment (FDI) also declined, mainly reflecting reinvestment of earnings by special purpose vehicles. EU funds—which finance the bulk of the current account and experienced a temporary decline in 2015 at the end of the EU budget cycle—are expected to increase in 2016. Although some of the decline in net FDI inflows was temporary, financing a widening current account in the event of oil price reversal could prove challenging if FDI inflows fall significantly below current projections.

**Foreign assets and liabilities.** A large negative net international investment position (NIIP) remained broadly stable at around -60 percent of GDP in 2014 and 2015 as the valuation effects resulting from the depreciation of the zloty against the U.S. dollar and the Swiss Franc were offset by an improved current account balance. Associated vulnerabilities are mitigated by diversified FDI liabilities (accounting for over 40 percent of foreign liabilities) and related intercompany lending.

**Reserve adequacy.** Reserves are broadly adequate at about 107 percent of the IMF's modified composite reserve adequacy metric at end-2015.

**11. Risks to the outlook are increasingly on the downside (Text-Table 1).**

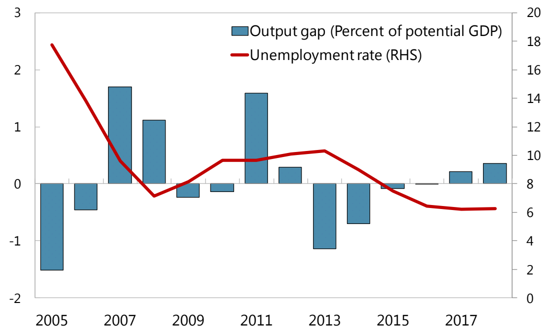
- **External.** Downside external risks have increased moderately since the 2016 Flexible Credit Line (FCL) review.
  - *Downside risk.* Unanticipated changes in growth and financial fundamentals in large economies could heighten financial volatility, which could be further exacerbated should British voters decide to leave the European Union. Persistently low inflation and debt overhang in the euro area could result in a protracted growth slowdown, spilling over to Poland through both trade and financial channels. A significant slowdown in large emerging markets (EMs) could raise risk aversion and trigger an EM asset sell-off, propagating to Poland through high foreign investor participation in the bond market.

- *Upside risk*. Stronger-than-expected growth in the euro area on the back of ECB QE could further lift growth and inflation in Poland. A faster pick-up in oil prices could speed up convergence of inflation to target.

## Figure 6. Poland: Economic Outlook

*The output gap is turning positive,...*

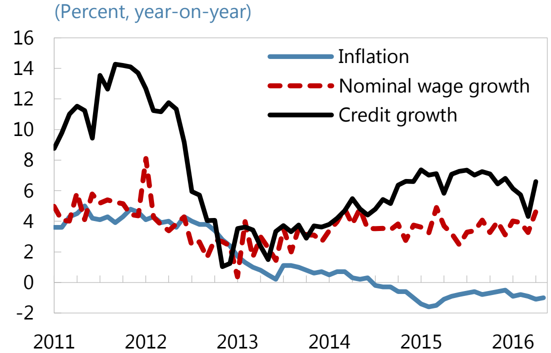
**Output Gap and the Unemployment Rate**
(Percent)




Sources: GUS, Haver Analytics, and IMF staff calculations.

*...and wages are growing steadily.*

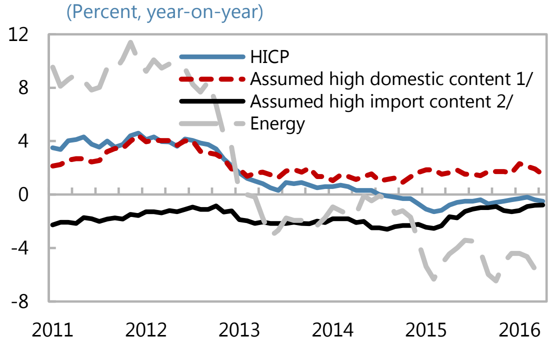
**Wage and Credit Growth**
(Percent, year-on-year)




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

*Domestic services inflation remains stable and positive,...*

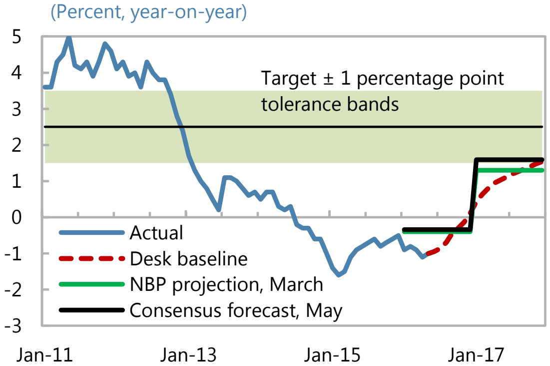
**Harmonized Consumer Price Inflation**
(Percent, year-on-year)




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

*...and headline inflation should gradually strengthen.*

**CPI Inflation: Projections**
(Percent, year-on-year)



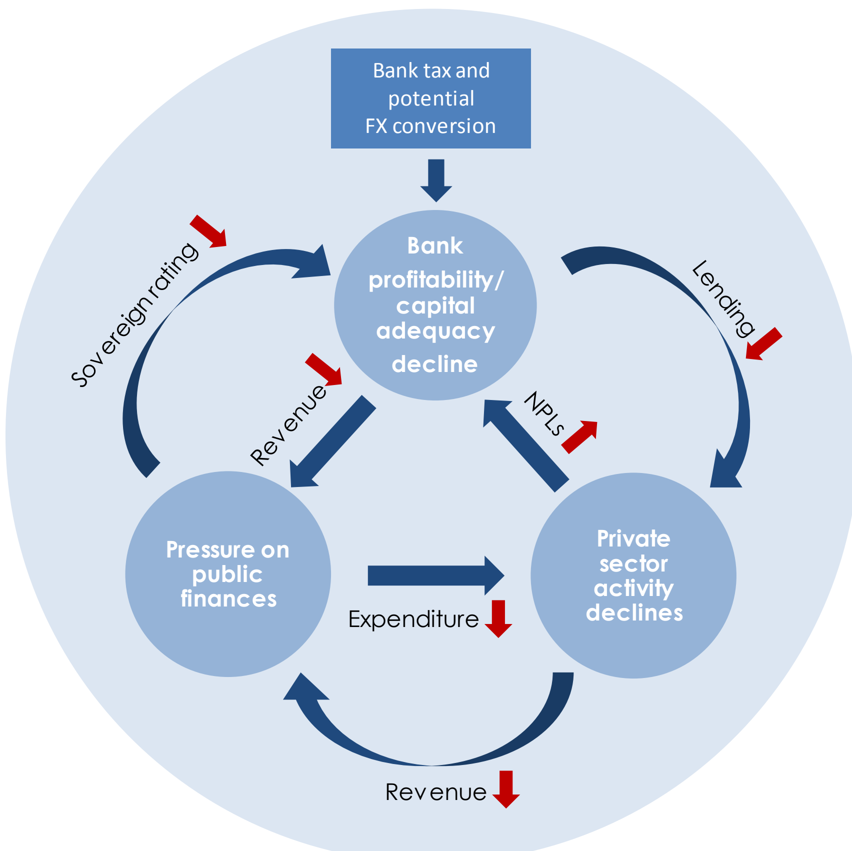

Sources: Concensus Economics, Haver Analytics, NBP, Statistics Poland, and IMF staff calculations.

- **Domestic.** While some new policy measures may boost near-term growth, domestic policies have increased uncertainty.

  - *Downside risk*. The medium-term outlook is increasingly uncertain in light of new policies and potential weakening of key institutions. Distortionary sectoral taxes could further weigh on investor sentiment. Lending activity could shift to less regulated non-banks, increasing vulnerabilities. Conversion of foreign-currency mortgages into zloty, depending on its design and implementation, could wipe out bank profits and significantly dent capital adequacy, putting financial stability at risk. Fiscal slippages could also occur given uncertain yield of announced measures, legal risks, and in light of additional measures under consideration (e.g., a potential reduction in the pension age). A higher perceived risk of political and social instability and policy unpredictability could make Poland less attractive to foreign investors. All these risks could trigger additional rating downgrades and increase debt servicing costs (Figure 7). External factors could continue to depress inflation and weigh on interest margins, bank profitability, and growth. In a tail-risk scenario, inflation expectations could become dislodged and have negative implications for the real economy.[4]

- *Upside risk*. Near-term expansionary measures could provide a larger-than-expected boost to growth. Inflation could also pick up sooner than expected.

**Figure 7. Poland: Macro-Financial Implications of Financial Measures**




[4] See "Balance Sheet Effects from Lowflation," Chapter II of IMF Country Report No. 15/183.

### Text-Table 1. Poland: Risk Assessment Matrix[1]

| Risk | Relative Likelihood and Transmission Channels | Expected Impact of Risk | Policy Recommendations |
|---|---|---|---|
| **1. Tighter or more volatile global financial conditions** | **Medium**<br>• Sharp asset price adjustment could occur as investors reassess underlying risk and respond to unanticipated changes in growth and financial fundamentals in large economies, the Fed policy rate path, and increases in U.S. term premia. This could trigger capital outflows, with high participation of foreign investors in the domestic bond market entailing a potential transmission channel.<br>• Ample liquidity in the context of the ongoing quantitative easing by the European Central Bank (ECB QE), combined with strong economic fundamentals in Poland, could mitigate the impact of tighter and more volatile global financial conditions. | **Medium**<br>• Investors could reallocate assets away from Poland, resulting in capital flow reversals and zloty depreciation.<br>• Liquidity in the FX derivatives market could be adversely affected, increasing banks' hedging costs.<br>• Risks are mitigated by strong liquidity positions in the banking sector and prudent public debt management. | • The exchange rate should be allowed to float freely, but intervention could be used to dampen excessive volatility.<br>• Fiscal policy should allow automatic stabilizers to work as needed.<br>• Interest rate hikes could be used to stem capital outflow pressure. The Narodowy Bank Polski (NBP) should provide liquidity support (including in FX) if needed. The FCL arrangement could be used if it becomes necessary. |
| **2. Sharper-than-expected global growth slowdown** | **Low/Medium**<br>• Significant slowdown in China could result in weak domestic demand, which further suppresses commodity prices, roils global financial markets, and reduces global growth. | **Medium**<br>• Indirect trade linkages to China through the German supply chain would lower Polish exports to Germany and other CEE countries.<br>• Financial volatility raises risk aversion, causing capital outflows from emerging markets, including Poland. | • Monetary policy should be further eased.<br>• Fiscal automatic stabilizers should be allowed to operate. |
| | **High /Medium**<br>• Structurally weak growth in key advanced and emerging economies, especially the euro area, could undermine medium-term growth in emerging markets as easy global financial conditions come to an end alongside insufficient reform progress. | **Medium**<br>• Significant trade linkages with Europe would weaken growth in Poland through lower exports and adverse confidence effects.<br>• NPLs would increase as growth slows.<br>• Risks are mitigated by relatively stable investor base and the banking sector's strong capital position. | |

**Text-Table 1. Poland: Risk Assessment Matrix (continued)**

| Risk | Relative Likelihood and Transmission Channels | Expected Impact of Risk | Policy Recommendations |
|---|---|---|---|
| **3. Protracted period of low inflation** | **Medium**<br>• Inflation could fail to pick up as envisaged in the baseline—either on account of external factors (low imported inflation) or domestic factors (entrenched low inflation expectations)—and remain low for a protracted period. | **Medium**<br>• Very low inflation would increase (ex-post) real interest rates and weigh on balance sheets, deterring investment and growth.<br>• To the extent that household inflation expectations in Poland are adaptive, breaking out of a protracted low inflation environment could be more difficult than in countries where inflation expectations are well anchored.<br>• Risks are mitigated by still-strong domestic demand. | • Monetary policy should be eased further. Forward guidance could help anchor inflation expectations.<br>• The exchange rate should be allowed to float freely. |
| **4. Domestic policy uncertainty and policy missteps** | **Medium**<br>• Weakening of key institutions could result in further ratings downgrades and increase the perceived risk of political and social instability and policy unpredictability.<br>• The new bank tax could reduce profits, deter credit expansion, and shift lending activity to shadow banks. A retail sales tax could discourage retail activity and result in cascading taxation.<br>• Costly conversion of foreign currency mortgages could put financial stability at risk.<br>• Lowering the retirement age would reduce pension replacement rates and labor force participation. | **High**<br>• Ratings downgrades could push up financing costs. Increased policy uncertainty would make Poland less attractive to foreign investors.<br>• Interaction of fiscal and financial sector measures could result in a vicious cycle of weaker public finances and financial sector health and lower growth.<br>• Reduced pension replacement rates would increase the risk of old-age poverty, with associated higher reliance on social benefits, and significantly weaken public finances. Lower labor force participation would reduce potential growth. | • Maintain strong policies and institutions, including a credible fiscal policy and central bank independence, as these are prerequisites for durable and sustainable growth.<br>• Refrain from introducing destabilizing policies, including blanket conversion of foreign currency mortgages.<br>• Reconsider reducing pension age. |

## Text-Table 1. Poland: Risk Assessment Matrix (concluded)

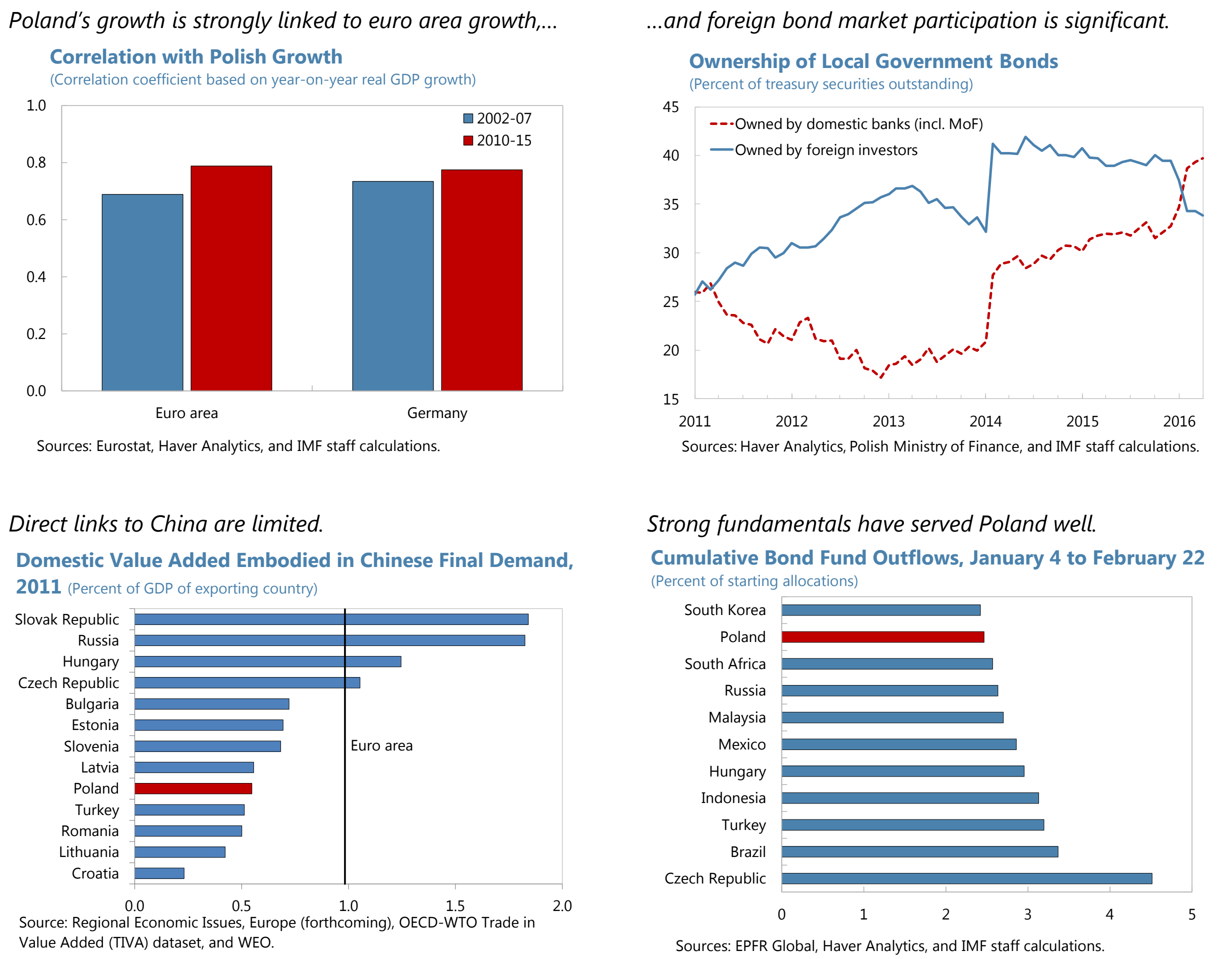
| Risk | Relative Likelihood and Transmission Channels | Expected Impact of Risk | Policy Recommendations |
|---|---|---|---|
| **5. British voters elect to leave the EU** | **High**<br>• Heightened global financial volatility with potential for knock-on risks from financial market dislocations, causing liquidity and funding freeze in parts of global financial markets.<br>• Slowdown of direct trade with the U.K. and indirect trade via other EU trading partners.<br>• Lower EU fund transfers, assuming no compensation for lost contribution from the U.K.<br>• Restrictions on migration to U.K. | **Medium**<br>• Direct financial links to the U.K. are limited, but indirect links through financial spillovers to the euro area could affect Polish banks and corporates that rely on foreign funding.<br>• The impact would depend on the nature of the possible new relationship between the U.K. and the EU. The U.K. is Poland's second largest trading partner, accounting for 7 percent of exports, with added indirect trade via other EU economies, implying economically important negative impact on Poland's exports and growth.<br>• Reduction of EU fund inflows could weigh on medium-term growth.<br>• Restricted migration to the U.K. and higher return migration could increase the domestic labor supply and unemployment (in the short term). Lower remittances would worsen the current account. At the same time, return migration could increase skill transfer, and migration to the U.K. could be replaced by other destinations. | Near term:<br>• The exchange rate should continue to play a cushioning role.<br>• Fiscal policy should allow automatic stabilizers to work as needed.<br>• The NBP should provide liquidity support (including in FX) if needed. The FCL arrangement could be used if it becomes necessary.<br>• Active labor market policies could help mitigate adverse implications of changing migration flows.<br><br>Medium term:<br>• Continue fiscal consolidation with growth-friendly measures to support growth.<br>• Maintain financial stability to weather external financial shocks. |

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

**12. Appropriate policy responses to risks, if they materialize, would depend on circumstances.**

- **External.** Poland's strong fundamentals, reserve buffers, and a stable and diversified foreign investor base serve to mitigate adverse financial spillovers. In the most recent episode of capital outflows from EMs, Poland fared well relative to peers (Figure 8). Poland's FCL arrangement with the IMF also provides an added insurance against adverse external shocks. Nonetheless, to the extent that external shocks spill over to Poland, the flexible exchange rate should be the main line of defense, while taking into consideration the impact on household balance sheets with exposure to foreign-currency denominated debt. Fiscal automatic stabilizers should be allowed to fully operate along the medium-term consolidation path. In the event of significant capital outflows, Narodowy Bank Polski (NBP) should stand ready to provide both zloty and FX liquidity to the banking sector as needed.

### Figure 8. Poland: External Spillovers



- **Domestic.** Focus should remain on maintaining economic and financial stability, including by refraining from introducing destabilizing policies. Identifying growth-friendly measures to support a credible medium-term fiscal consolidation plan would help support market confidence. The authorities should stand ready to cut policy interest rates if inflation expectations disappoint on the downside.

**Authorities' views**

**13. The authorities broadly agreed with staff's assessment of external risks, with the Ministry of Finance (MoF) being more optimistic on the domestic outlook.** The authorities concurred that growth would be primarily domestic-demand driven, with an impulse to private consumption from the child benefits program in the short run. However, the MoF was more optimistic on the growth outlook, forecasting growth to remain at around 4 percent over the medium term. On domestic risks, the MoF stressed the government's commitment to keep the deficit below 3 percent this year and next and resume fiscal consolidation from 2018. On financial sector risks, the NBP and the Polish Financial Supervision Authority (KNF) agreed with staff that blanket conversion of foreign currency mortgages as proposed by the President's office in January could pose risks to financial stability. With respect to external risks, the authorities recognized the importance of continued efforts to maintain sound policies and institutions together with strong fundamentals to mitigate adverse impact from external shocks. They noted that Poland is well equipped to manage capital flows by maintaining adequate reserves, a stable investor base, and a flexible exchange rate, supported by the FCL arrangement with the IMF.

# POLICY DISCUSSIONS

**14. This year's consultation focused on policies and institutions to support sustainable and balanced growth.** In this regard, safeguarding strong institutions, fiscal sustainability, and financial sector stability, underpinned by market-friendly policies, is a prerequisite for continued stable growth (Box 2). Further advancing structural reforms will be key to securing healthy potential growth and income convergence, while reducing regional disparities. In the short run, with a closed output gap but continued low inflation, the near-term policy mix should be carefully calibrated to maintain an accommodative monetary policy stance, while continuing gradual fiscal consolidation.

## A. Guiding Inflation Back to Target

**15. The policy interest rate has been kept unchanged during the past year.** Since the March 2015 policy interest rate cut (to 1.5 percent—a historical low for Poland), and until the oil price decline in late 2015, inflation had developed broadly in line with staff's projections. While weak headline inflation has kept real policy rates above those in some peer countries (Figure 16), Monetary Policy Council (MPC) members have resisted further rate cuts, arguing that low inflation is driven by external factors and pointing to the continued steady expansion in domestic demand. Alongside, nominal wages and credit growth have generally held up well (at 4½ percent and 6½ percent in April, respectively). Eight of the ten MPC members, whose terms expired, were replaced in January and February and the term of the NBP's governor expires in mid-June. Based on recent public statements, expectations are for policy continuity.

**16. Monetary policy should remain accommodative.** Inflation is very low but should start trending upwards as credit and wages continue to expand, fiscal policy turns expansionary, and the output gap turns positive. Encouragingly, longer-term headline inflation expectations remain within the tolerance band. Monetary policy should thus remain data-dependent, maintaining policy rates on hold for now, but the authorities should be prepared to cut rates if inflation expectations were to fall or if growth slows down sharply. In the meantime, sectoral balance sheets appear relatively robust to a prolonged spell of externally-driven low inflation (Figure 9).[5]

### Box 2. Poland: Implementation of Past Fund Advice

**Policy implementation has generally been in line with past Fund recommendations, though some new policies are inconsistent with staff advice.**

**Monetary policy.** In line with staff recommendations, the Monetary Policy Council has kept the policy interest rate at its historic low of 1.5 percent since March 2015 to counter risks of a prolonged period of low inflation. Moderate buildup of international reserves has continued.

**Fiscal policy.** Fiscal consolidation has advanced further, supported by a sustained economic recovery, savings in government consumption and recent changes to the pension system. The authorities have stated their commitment to a Medium-Term Objective (MTO) of 1 percent of GDP structural deficit, which is deemed adequate to rebuild fiscal buffers and preserve fiscal sustainability. However, some recent policy measures are of poor quality: the 2016 budget will be financed partly with one-off fiscal measures and the expenditure rule was modified to accommodate this. Additionally, a distortionary bank tax has been implemented. In addition, a reversal of the 2013 retirement age increases is being considered against Fund advice. Finally, the authorities' fiscal plans risk turning the 2017 fiscal stance procyclical, against staff advice.

**Financial sector policy.** The macroprudential framework has been finalized and restructuring of the small non-systemic credit union segment has continued through takeovers and bankruptcy. Despite staff recommendation of case-by-case restructuring of distressed foreign-currency mortgages, work has continued to design a conversion scheme for these mortgages into zloty. The bank resolution framework is nearing completion but is still awaiting the president's signature.

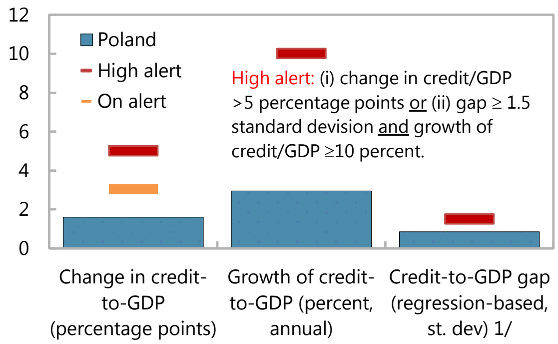
**Structural reforms.** The authorities continued to strengthen labor and product markets, in line with Fund advice. Measures have been taken to reduce labor market segmentation by better aligning social security contributions on civil law employment contracts with those on regular contracts and limiting the duration of consecutive short-term contracts. The business climate has been improved by easing regulations for business start-ups and amending the tax code to interpret legal doubts in favor of taxpayers. A new corporate insolvency regime to encourage restructuring (instead of liquidation) of viable firms took effect from January 1, 2016.

[5] See IMF Country Report No. 15/183.

## Figure 9. Poland: Credit and Asset Price Indicators

*There is no indication of overheating…*

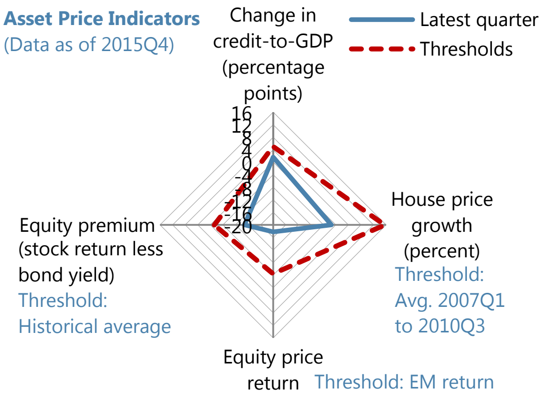
**Credit Cycle Indicators**
(Data as of 2015Q4, growth and changes are year-on-year)




Sources: Polish authorities and IMF staff calculations.
1/ 2015Q2.

*…or asset price bubbles,…*

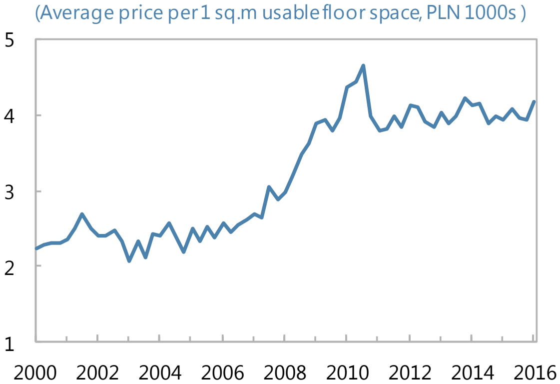
**Asset Price Indicators**
(Data as of 2015Q4)




Sources: Country authorities, Datastream, Haver analytics, and IMF staff calculations.

*…including in the housing market.*

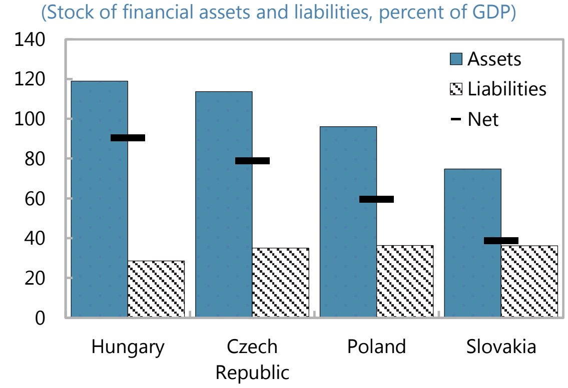
**House Prices**
(Average price per 1 sq.m usable floor space, PLN 1000s )




Sources: Statistics Poland and IMF staff calculations.

*Household balance sheets remain healthy…*

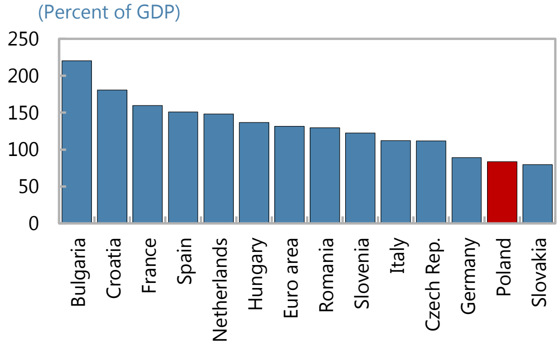
**Household Balance Sheets, 2014**
(Stock of financial assets and liabilities, percent of GDP)




Source: Eurostat and IMF staff calculations.

*…and corporate vulnerabilities manageable,…*

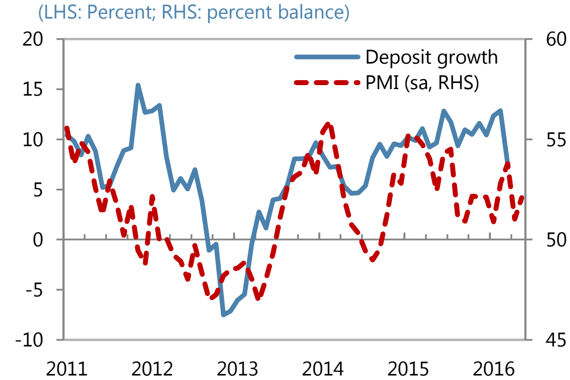
**Nonfinancial Corporate Debt, 2014 1/**
(Percent of GDP)




Sources: Eurostat and IMF staff calculations.
1/ Defined as the sum of debt securities, loans, and other accounts payable/receivable.

*…with continued deposit growth.*

**Nonfinancial Corporate Balance Sheet Health**
(LHS: Percent; RHS: percent balance)




Sources: HSBC/Markit, KNF, and IMF staff calculations.

**Authorities' views**

**17. The authorities shared staff's view of continued accommodative monetary policy.** While inflation remains very low, the authorities noted that imported deflation had supported consumers' purchasing power and so far has not had negative implications for the real economy, while balance sheets remained healthy. In turn, they argued for maintaining policy interest rates on hold in the absence of any sharp changes to growth or inflation expectations, in line with staff's view.

## B. Ensuring Growth-friendly Fiscal Consolidation

**18. Fiscal consolidation continued in 2015.** The general government deficit narrowed to 2.6 percent (a cyclical primary adjustment of 0.3 percent of GDP), benefitting from a sustained economic recovery, lower government consumption of goods and services, and an increase in social contributions. Public debt increased modestly to 51.3 percent of GDP at end-2015.

**19. However, as the output gap closed in 2016, the fiscal stance has become procyclical.** Staff estimates that implementation of election promises will increase the deficit to 2.8 percent of GDP in 2016 (a cyclical primary relaxation of 0.2 percent of GDP). Specifically, the government's new child benefits program, beginning in April 2016, is expected to cost about 1 percent of GDP annually, financed in part by a tax on bank assets and a retail tax (¼ percent of GDP)[6] and one-off mobile frequencies auction revenues (0.4 percent of GDP).

**20. The authorities' Convergence Program update envisages an increase in the fiscal deficit to just under 3 percent in 2017, with subsequent consolidation to 1.3 percent of GDP by 2019 (Text-Table 2).** This is largely based on the assumption that, on the back of strong nominal GDP growth, revenue will outpace moderate increases in social benefits and wages and salaries, which authorities intend to keep constant in real terms. The program also assumes sizable revenue gains from tax administration improvements, estimated at 0.3 percent of GDP by 2017 and increasing to 1 percent of GDP by 2019.

**21. In staff's view, on unchanged policies, the 2017 fiscal deficit will increase to 3.1 percent of GDP, postponing the fiscal consolidation further and adding to demand at a time when growth is above potential.** Moreover, there are additional risks to the 2017 fiscal stance that are not included in staff's baseline. In particular, in addition to already announced measures, the government intends to reverse the 2013 retirement age increases, which could cost an additional 0.5 percent of GDP per year, and to increase the Constitutional Court-mandated personal income tax (PIT) tax-free allowance, which if introduced gradually could initially cost 0.2 percent of GDP per year, increasing to 0.5 percent of GDP by 2019. Without

[6] A tax on assets of credit institutions, lending companies, and insurance undertakings took effect on February 1, 2016. The tax on banks will be levied on the total value of assets (less PLN 4 billion, own funds, and purchased sovereign debt) at a monthly rate of 0.0366 percent. State-owned banks (relevant for BGK with legal status of state enterprise) and banks under recovery proceedings, in receivership, in liquidation, or those who filed for bankruptcy are excluded from the tax (NBP, Financial Stability Report, February, 2016). A retail tax is still under discussion.

offsetting measures, this would also imply breaching the Excessive Deficit Procedure (EDP) threshold by a wide margin.

**Text-Table 2. Poland: Convergence Program Update**

(Percent of GDP)

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|
| **Total revenues** | **38.9** | **38.9** | **39.0** | **39.0** | **39.4** | **39.4** |
| Taxes | 19.8 | 19.8 | 20.0 | 20.0 | 20.3 | 20.5 |
| Indirect taxes | 12.8 | 12.9 | 13.0 | 12.7 | 12.9 | 12.9 |
| Direct taxes | 6.9 | 6.9 | 7.0 | 7.3 | 7.4 | 7.5 |
| Social contributions | 13.2 | 13.6 | 13.7 | 13.6 | 13.4 | 13.3 |
| Other revenues | 5.8 | 5.5 | 5.3 | 5.4 | 5.6 | 5.5 |
| **Total expenditures** | **42.2** | **41.5** | **41.6** | **41.9** | **41.4** | **40.7** |
| Compensation of employees | 10.4 | 10.2 | 10.0 | 9.8 | 9.5 | 9.4 |
| Intermediate consumption | 6.1 | 5.8 | 5.8 | 5.8 | 5.8 | 5.8 |
| Social benefits | 16.2 | 16.3 | 17.3 | 17.2 | 16.8 | 16.4 |
| Capital investments | 4.5 | 4.4 | 4.3 | 4.6 | 4.8 | 4.7 |
| Other expenditures | 4.9 | 4.8 | 4.2 | 4.5 | 4.4 | 4.4 |
| **Net lending (+) / net borrowing (-)** | **-3.3** | **-2.6** | **-2.6** | **-2.9** | **-2.0** | **-1.3** |
| *Memorandum items:* | | | | | | |
| Nominal GDP growth (authorities' projections) | | 4.1 | 4.1 | 5.6 | 6.0 | 6.5 |
| Nominal GDP growth (staff projections) | | 4.1 | 4.1 | 4.2 | 5.2 | 5.4 |

Sources: Ministry of Finance and IMF staff calculations.

22. **Over the medium term, staff projects a less ambitious deficit reduction on current policies.** Assuming a more conservative budgeting of tax administration gains, less optimistic growth assumptions, and a higher wage bill to reflect continuing upward pressure from accelerating private sector wages and the absence of specific measures to maintain public sector wages constant in real terms, staff projects that the deficit would decline to 2.3 percent of GDP by 2020, 1.3 percentage points of GDP above the government's medium-term objective (MTO) of 1 percent of GDP structural deficit. General government debt is projected to increase until 2018, then decline over subsequent years (Annex II).

23. **Fiscal policy should take advantage of strong growth to resume consolidation already in 2017.** The government's MTO of 1 percent of GDP structural deficit remains an appropriate fiscal anchor—allowing for sufficient buffers in the event external risks materialize, while also creating fiscal space to address looming demographic challenges. Relative to 2017, measures of around 2 percent of GDP would be required to reach this objective. Taking advantage of favorable economic conditions, consolidation starting in 2017 at an annual pace of around 0.5 percent of GDP would reach the MTO by 2020 (Text-Table 3). The deficit reduction should be underpinned by credible growth-friendly measures to help support market confidence and maintain budget financing on favorable terms.

**Text-Table 3. Poland: Authorities' Medium-Term Target and Staff Baseline**

(Percent of GDP)

| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|
| **Headline balance** | | | | | | | |
| Authorities' target | -2.6 | -2.6 | -2.9 | -2.0 | -1.3 | ... | ... |
| Staff projection (baseline) | -2.6 | -2.8 | -3.1 | -2.8 | -2.5 | -2.3 | -2.1 |
| Staff recommendation | -2.6 | -2.8 | -2.4 | -1.9 | -1.5 | -1.0 | -1.0 |

Source: Ministry of Finance and IMF staff calculations.

- **Staff noted that measures underlying the 2016 budget are of poor quality and pose risks to the 2017 fiscal outcome.** The 2016 budget is partly financed through one-off revenues and distortionary sectoral taxes, which should be gradually replaced with higher-quality and growth-friendly measures to avoid adverse effects on trade and credit expansion. For 2017, to keep the deficit below 3 percent, specific measures should be identified. Staff recommended maintaining the 2011 VAT increase, scheduled to expire in 2017, and rationalizing discretionary government consumption (which is sizable at around 6 percent of GDP) through the ongoing expenditure review.
- **To support the medium-term consolidation, staff recommended a menu of possible measures:** (i) closing ⅓ of the VAT policy gap by reducing preferential rates and exemptions; (ii) closing ½ of the efficiency gap in health spending, including by shifting towards ambulatory and primary care;[7] (iii) gradually closing ⅓ of the VAT compliance gap through tax administration improvements; and (iv) gradually phasing out preferential pension regimes of miners and farmers (Text-Table 4). In this respect, staff welcomed the authorities' efforts to strengthen tax administration, but cautioned that any revenue gains should be budgeted conservatively, particularly in the short run. Until higher revenues materialize, the 2011 VAT increase should be maintained.
- **Staff urged the authorities to reconsider the proposed reduction in the retirement age.** Reversing the gradual increase in the retirement age, to 67 for both men and women (by 2020 and 2040, respectively, from 65 and 60 in 2013), as currently intended, could further reduce the pension replacement rate, increasing the risk of old-age poverty and potentially further weakening public finances, thus undermining the social and financial sustainability of the pension system (Box 3). Moreover, it would reduce labor force participation at a time when potential growth is already being threatened by unfavorable demographic trends.

**Authorities' views**

**24. The authorities underscored their commitment to keep the deficit below 3 percent of GDP in 2017 and to resume consolidation in 2018 to put public debt on a firm downward path.** They indicated that no new spending measures would be implemented without first identifying financing through revenue measures or expenditure cuts. In this context,

[7] See European Commission Country Report Poland 2016.

they would consider maintaining the 2011 VAT increase, scheduled to expire in 2017. They noted that the large share of discretionary government consumption in the budget affords flexibility to cut expenditure over time. They specified a number of initiatives to improve tax administration, including by introducing a clause against tax avoidance (General Anti-Avoidance Rule), reducing the limit on cash transactions between companies, and introducing an integrated IT system to track VAT invoices. They indicated that increasing the PIT tax-free allowance could be introduced as part of a more comprehensive income tax reform, with lost revenues from the higher allowance offset by a more progressive tax regime. The authorities were more optimistic on the timing and magnitude of expected revenue gains from tax administration improvements, as well as on the medium-term macroeconomic assumptions underlying their fiscal projections. They concurred that the proposed reduction in the retirement age could reduce the pension replacement rate, but noted that adjusting parametric conditions for entitlement to retirement would mitigate this impact.

**Text-Table 4. Poland: Planned and Recommended Fiscal Measures**

| Measures | Percent of GDP |
|---|---|
| **Structural gap to MTO in 2017 1/** | 2.1 |
| **Planned additional expenditure increases and tax cuts** | |
| Rolling back of retirement age increase | 0.5 |
| Higher PIT tax-free allowance 2/ | 0.2 |
| *Total measures needed to reach MTO* | *2.8* |
| **Possible measures** | 4.9 |
| Short-term | |
| Maintain the 2011 VAT increase | 0.4 |
| Refrain from lowering retirement age | 0.5 |
| Rationalize 5 percent of discretionary government consumption 3/ | 0.3 |
| Medium-term | |
| Close one-third of VAT policy gap (reduced rates and exemptions) 4/ | 1.2 |
| Gradually phase out preferential pension regimes of miners and farmers 5/ | 1.5 |
| Close half of efficiency gap in health spending 6/ | 0.4 |
| Close one-third of VAT compliance gap 7/ | 0.6 |

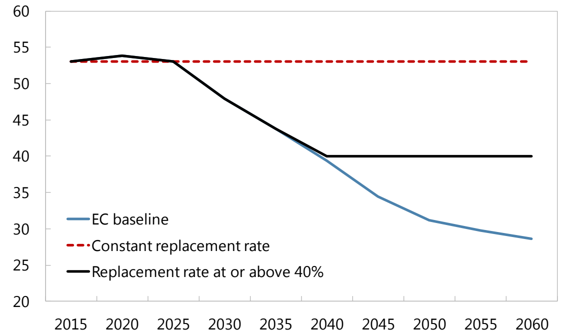
1/ Baseline assumes reversal of the 2011 VAT increase in 2017 (0.4 percent of GDP). The child benefits program (1 percent of GDP) and bank and retail taxes (0.25 percent of GDP) are factored in.
2/ According to the 2016 Convergence Program Update, the tax free allowance increases from 0.2 percent of GDP in 2017 to 0.5 percent of GDP in 2019.
3/ See IMF Country Report No. 15/182, p. 23.
4/ See study by CASE/CPB for the EC: "Study to Quantify and Analyse the VAT Gap in the EU Member States. 2015 Report."
5/ See Appendix III of IMF Country Report No. 15/182.
6/ See IMF Country Report No. 15/182, p.22.
7/ See European Commission's "Country Report Poland 2016." Preferential regimes would be aligned with those of other workers by 2021.

## Box 3. Poland: Fiscal Implications of Demographic Changes[1]

**Poland's population is expected to decline and age dramatically over the next 45 years.** According to Eurostat projections, the population is expected to decline by 30 percent between 2015 and 2060 following a sharp drop in fertility rates. The old-age dependency ratio is expected to almost triple.

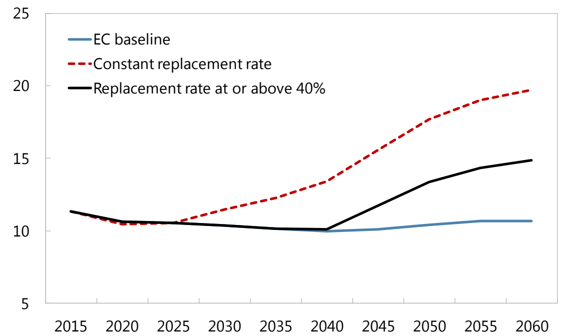
**Under unchanged policies and given expected demographic trends, average pension replacement rates would need to decline significantly in the long term to sustain the solvency of the defined contribution pension system.** According to the European Commission, average replacement rates[2] in Poland are projected to decline by about 25 percentage points to below 30 percent by 2060, despite pension reforms implemented in 2013 to gradually increase the retirement age for both men and women to 67 from 65 and 60, respectively. The projected average replacement rate will be one of the lowest in the EU, increasing the risk of old-age poverty.

**Replacement Rates**
(Percent)




Sources: European Commission and IMF staff calculations.

**Pension Expenditure**
(Percent of GDP)

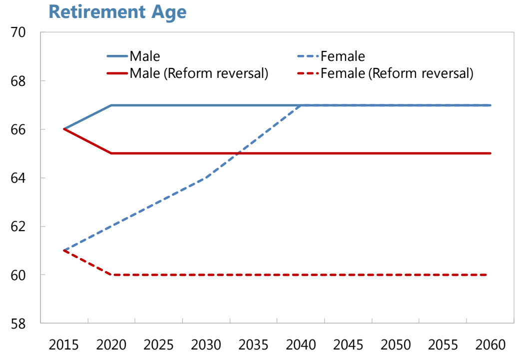



Sources: European Commission and IMF staff calculations.

**Maintaining a reasonable replacement rate, in the absence of other parametric changes, will require significant additional fiscal outlays.** Keeping the average replacement rate at the 2013 level of 53 percent would increase pension expenditure by nearly 8½ percent of GDP per year by 2060. If the replacement rate is maintained at 40 percent—the minimum recommended by the International Labor Organization—pension expenditure would increase by about 4½ percent of GDP per year by 2060.

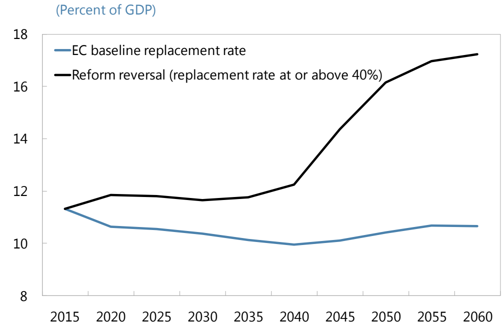
**Reversing the gradual increase in the retirement age could exacerbate the social and fiscal impact of population aging.** The replacement rate could drop even further to less than 25 percent.[3] Maintaining the replacement rate at 40 percent, in the absence of other parametric changes, would increase pension expenditure by about 6½ percent of GDP per year by 2060.

**Retirement Age**




Source: IMF staff calculations.

**Pension Expenditure**
(Percent of GDP)




Source: IMF staff calculations.

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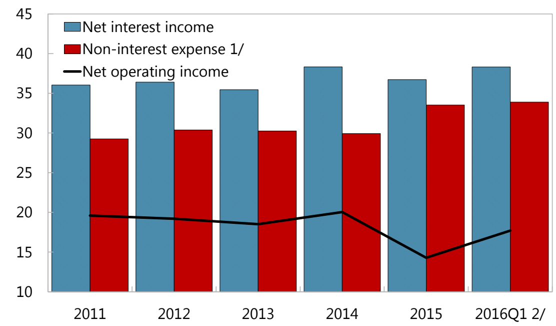
[1] The analysis was performed by David Amaglobeli and Wei Shi of the IMF's Fiscal Affairs Department.
[2] The gross average replacement rate is defined as the average pension as a share of the average wage.
[3] Estimate according to the Polish Social Insurance Institution.

## C. Maintaining Financial Stability

**25. The banking sector remains well-capitalized amid weakening profitability.** Profitability has declined markedly during the past year amid narrowing interest margins (Figure 10) and other costs on banks, including additional contributions to the Bank Guarantee Fund (BFG). Nonetheless, capital adequacy remained robust (above 15 percent in the fourth quarter of 2015), liquidity sufficient (liquid assets to total assets of more than 22 percent in the first quarter of this year, declining loans-to-deposits ratio, and almost all banks complying with the Liquidity Coverage Ratio (LCR) requirement) (Figure 11), and reliance on foreign funding manageable. NPLs are gradually coming down, though are still high in some segments (Figures 17 and 18) despite strong growth and falling unemployment. Credit standards on loans have remained broadly unchanged in recent quarters, with the exception of housing loans, where standards tightened on the back of new prudential recommendations and reduced appetite among some banks for expanding the housing loan portfolio.

**Net Interst Income and Non-Interest Expense**
(PLN billion)

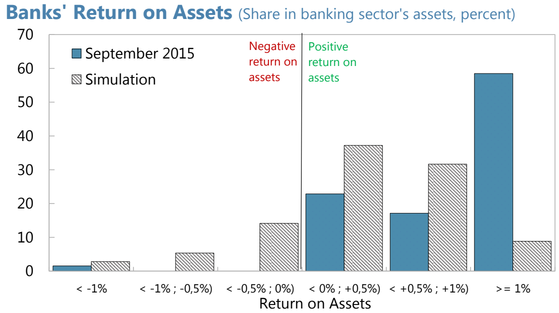



Sources: KNF and IMF staff calculations.
1/ Administrative costs and depreciation. 2/ 2016Q1 is annualized.

**26. However, new policies could significantly worsen financial sector conditions.** While the NBP has recently noted the banking sector's continued stability, it has stressed that the sector's resilience to shocks has weakened substantially on the back of new fiscal measures imposed on banks.[8]

- *Bank tax.* According to the NBP, the bank tax, combined with regulatory costs, could increase the share of banks with negative net earnings from 2 to 22 percent of banking sector assets and reduce net earnings of the commercial banking sector by 60 percent. This in turn could slow credit expansion and have adverse macro-financial implications (Box 4).

**Estimated Impact of the Bank Asset Tax on Commercial Banks' Return on Assets** (Share in banking sector's assets, percent)



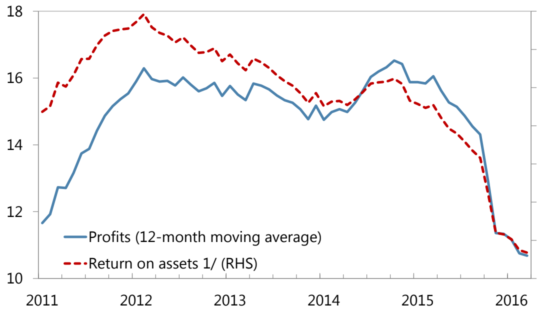

Sources: NBP, Financial Stability Report, February, 2016.
Note: The analysis includes costs associated with the asset tax, payments to BFG and the Borrowers Support Fund, and a decline in interest rates as per FRA contracts.

[8] See NBP, Financial Stability Report, February, 2016.

## Figure 10. Poland: Contribution of Narrowing Margins to Declining Profitability

*Profitability has declined....*

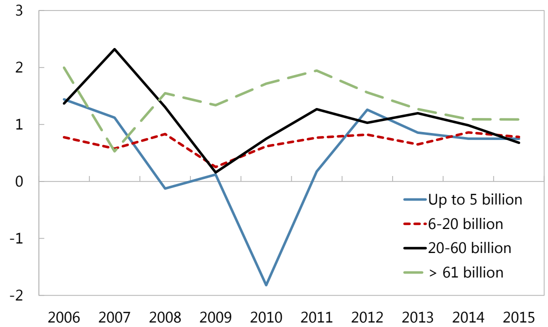
**Banking Sector Profits**
(LHS: billion zloty; RHS: percent of assets)




Sources: KNF and IMF staff calculations.
1/ 12-month profits in percent of 12-month assets.

*...across all sizes of banks,...*

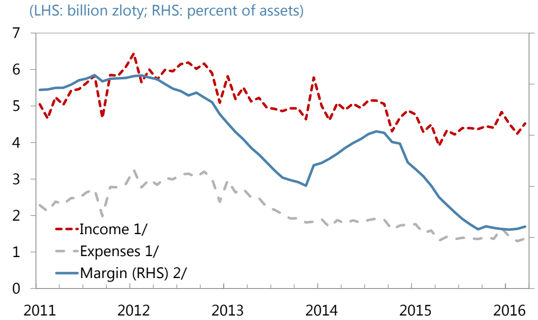
**Bank Profitability**
(Net income relative to average assets, percent)




Sources: Bankscope and IMF staff calculations.

*...as interest margins have narrowed.*

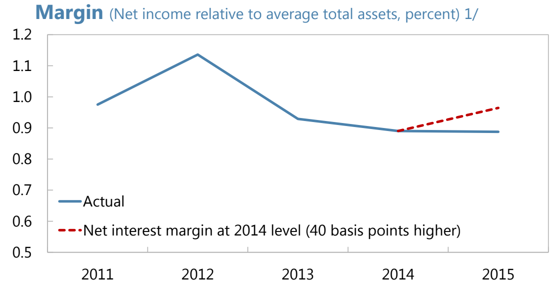
**Interest Income, Expenses, and Margin**
(LHS: billion zloty; RHS: percent of assets)




Sources: KNF and IMF staff calculations.
1/ Monthly income and expenses.
2/ Interest income less expense; 12-month sum in percent of average assets.

*The narrow margins have limited profitability.*

**Bank Profitability: Impact of Narrowing Net Interest Margin** (Net income relative to average total assets, percent) 1/

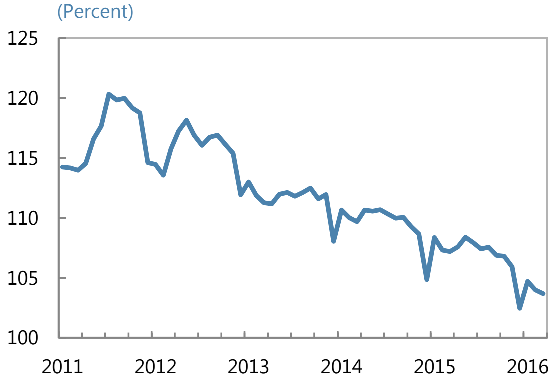



Sources: Bankscope and IMF staff calculations.
1/ Based on system GMM regression on data for 39 commercial banks and 16 financial institutions in Poland, controlling for bank characteristics such as level of capitalization, equity, bank size, and cost-to-income ratio. Net interest margin is defined as interest revenue less interest expenditure in percent of assets.

## Figure 11. Poland: Liquidity and Credit Indicators

*Loans-to-deposits are trending down.*

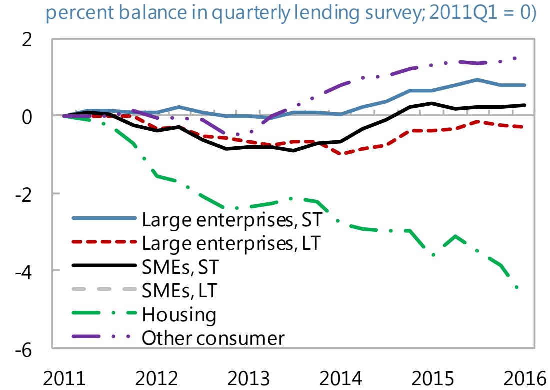
**Nonfinancial Sector Loans to Deposits**
(Percent)



Sources: KNF and IMF staff calculations.

*Credit standards are broadly unchanged, except for tightening on housing.*

**Credit Standards on Loans** (Cumulative change in percent balance in quarterly lending survey; 2011Q1 = 0)




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

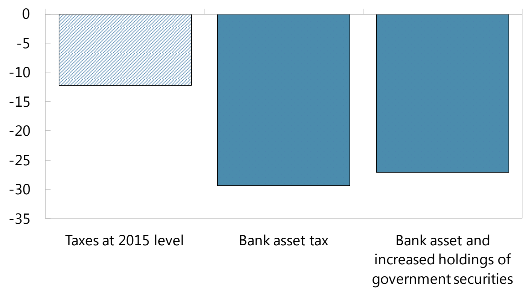
## Box 4. Poland: Macro-Financial Implications of the Bank Tax[1]

*In February 2016, Poland introduced a new tax on bank assets. Staff analysis suggests that the tax will likely significantly reduce bank profits with negative implications for credit and economic growth. However, the negative economic effects of the tax can be mitigated through better design.*

**The bank tax can significantly reduce bank profits, slowing down credit and economic growth.** The tax is levied on total assets (less PLN 4 billion, own funds, and purchased sovereign debt) at a monthly rate of 0.0366 percent. In turn, 2016 tax outlays paid by banks could double relative to 2015. Empirical analysis suggests that the tax, combined with recent regulatory costs on banks (including increased contributions to the BFG and contributions to finance the Borrower Support Fund, could reduce bank profitability by 30 percent relative to 2015. In turn, this would reduce credit growth by 3 to 4 percentage points relative to a no-tax scenario. Lower credit growth would reduce consumption and investment and ultimately lower GDP growth by up to 0.4 percentage points by end-2016.

**Bank Profitability: Impact Analysis**

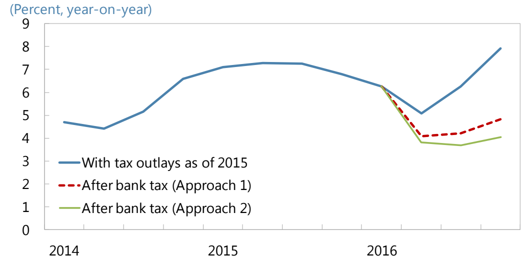
(Change in net income relative to average assets, percent)




Sources: Bankscope and IMF staff calculations.
Note: Based on results of System GMM regression. Impact is assessed on the annual levels of returns on average assets.

**Private Credit Growth: Impact Analysis**

(Percent, year-on-year)



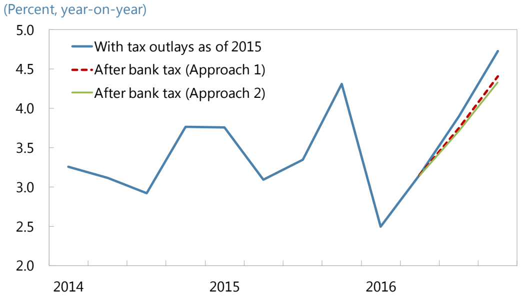

Sources: Haver Analytics and Bankscope.
Note: Based on VAR model of log of credit and log of deposits with GDP growth rate and lagged net interest margin and lagged tax to pretax income ratio. Data on credit growth does not cover "claims on other sectors", and is different from the series used in the IMF staff tables where source for data is IFS.

**There are additional potential economic implications of the tax.** The tax creates an incentive for banks to increase their holdings of government bonds, which could potentially crowd out private sector credit and intensify adverse feedback loops between the sovereign and banks, should public finances come under pressure. To mitigate the impact of the tax on profitability, banks could also shift away from corporate to more risky consumer lending, where spreads are higher, or shift lending activities to less-regulated non-banks. In turn, corporates may be able to obtain loans from other segments such as leasing companies. Also, incentives to limit the size of assets at the end of the month when the tax is levied could unduly constrain short-term liquidity in the interbank market.

**The negative economic effects of the bank asset tax could be mitigated through better design.** To the extent that a tax on banks is desired to raise revenue, a Financial Activities Tax (FAT) would be less distortionary for the private sector and the economy in general than a tax on assets (IMF, 2010). Denmark, Iceland, and Israel, for example, have imposed a FAT.[2] A FAT, levied on the sum of profits and remuneration of financial institutions, is similar to a value added tax (VAT) from which the financial sector is currently exempt. Unlike the current bank asset tax, a FAT does not distort the structure of the activities undertaken by financial institutions themselves, as the tax depends on the level of profit, and not on how profits are generated. For example, a 10–13 percent levy on bank profits and remunerations could generate the same revenue of PLN 4 billion expected from the current bank asset tax.

**Real GDP Growth: Impact Analysis**

(Percent, year-on-year)




Sources: Haver Analytics and Bankscope.
Note: Based on OLS regression of real GDP growth rate on lagged real GDP growth rates and lagged credit growth rates.

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[1] Based on Chapter III of Selected Issues.

[2] Israel levies a 17 percent (standard VAT rate) FAT. Iceland levies a 5.5 percent tax on financial institutions' wages and a 6 percent tax on profits above ISK 1 billion. Denmark levies a 10.5 percent tax on wages.

- *Foreign-currency (FX) mortgages.* Although virtually no new FX lending is taking place following stronger prudential measures by the KNF, the outstanding stock of FX mortgages accounted for about 9¼ percent of 2015 GDP at end-March 2016. Against concerns that some of these loans were extended without adequate consumer information, a framework was proposed in January for the blanket conversion of these mortgages into zloty, irrespective of borrowers' income conditions and payment capacity. Following KNF's assessment that it could cost the banking sector PLN 67 billion (3.7 percent of 2015 GDP)—close to six times the value of 2015 banking sector profits—and result in several bank bankruptcies and associated fiscal costs from deposit guarantees, a new proposal is being developed by the President's office. At this point, several alternative options for addressing FX mortgages are being discussed, and their total cost remains unclear.
- *Credit unions and cooperative banks.* The restructuring of the non-systemic credit union sector (with assets corresponding to less than 1 percent of banking sector assets) has continued. Bankruptcy of a cooperative bank in the fall of 2015 added costs to banks of PLN 2 billion.

**27. Staff stressed the importance of safeguarding financial sector stability.** As banks are operating in an environment of reduced interest margins, lower profits, and a distortionary tax on bank assets, lending activity could shift toward lending segments with higher profit margins, such as consumer loans, or shift into the less-regulated non-bank sector. In that respect, recent regulation on non-bank lending companies, which should help prevent the buildup of new vulnerabilities, is welcome (see ¶28). Nonetheless, newly introduced financial sector measures, as well as other costs on banks,[9] could significantly lower profits and weaken credit expansion and economic growth, with repercussions for fiscal consolidation. Potential bank failures could also feed back into the public sector balance sheet. In this regard, the impact of any new measures—particularly FX conversion and its interaction with other financial measures—on the health of the financial sector and the economy more broadly should be carefully thought through and the introduction of any destabilizing measures should be avoided.

- *Bank tax.* As currently designed, the tax could negatively affect lending and financial intermediation. Instead, a financial activities tax on profits and remuneration (proxying VAT from which the financial sector is exempt), would be less distortionary.
- *Foreign-currency mortgages.* Since foreign-currency mortgages are not of systemic macroeconomic or financial stability concern, blanket conversion schemes should be avoided. Instead, the focus should be on case-by-case restructuring, taking into account the level of debtor distress and payment ability. Furthermore, the new temporary payment relief scheme for zloty and FX mortgages should be allowed time to work before considering any

[9] In addition to low interest margins and the bank tax, higher contributions to the BFG are also expected to reduce bank profits.

other measures to assist FX mortgage holders.[10] Recent amendments to the consumer protection law, which took effect as of April 2016, should also help prevent misselling of financial products by banks going forward. Prudential measures related to new FX loans should continue restricting FX loans to individuals with adequate earnings in the corresponding currency.

- *Credit unions and cooperative banks.* Staff encouraged the authorities to continue restructuring of the credit union segment. In light of costs associated with the recent bankruptcy of a cooperative bank, the new bank resolution framework should be implemented expeditiously to ensure the availability of state-of-the-art resolution tools.

**28. A strengthened financial sector framework now in place should mitigate risks going forward.** The authorities have completed a macroprudential framework, which allows for early detection and prevention of systemic risk, and a law on covered bonds, which over time should help support stable funding. The new bank resolution framework, in accordance with the European Bank Recovery and Resolution Directive (BRRD), is progressing. Finally, recent regulation on non-banks limited non-interest costs of loans and constrained the practice of rolling over credit to prevent escalating debts, in particular related to consumer lending.

**Authorities' views**

**29. While the NBP shared many of staff's concerns, the MoF was more optimistic concerning foreign-currency mortgage conversion and the effects of the bank tax.** The authorities generally agreed that the bank tax has squeezed liquidity in some parts of the banking sector toward the end of the month and has incentivized banks to hold more government bonds. However, they noted that a notable shift toward more risky lending had so far not been observed. In addition, the MoF highlighted their intentions to evaluate the performance of the bank tax and adjust it if deemed necessary. While the NBP acknowledged that a costly blanket foreign-currency mortgage conversion scheme could be potentially destabilizing, the President's office assured staff that it is aware of these risks and that any solution would thus aim to preserve financial stability. At the same time, it noted its commitment to help foreign-currency mortgage holders in difficult situations. The MoF highlighted the recent consultative process with multiple agencies and stakeholders that contributed to the decision to revisit the design of the proposed conversion scheme to ensure that any future proposal safeguards financial stability.

## D. Promoting Inclusive Growth Through Structural Reforms

**30. Recent structural reforms have focused on reducing duality in the labor market and improving the business climate.** Temporary job contracts—which carry little employment protection and have discouraged investment in on-the-job training—have been better aligned

[10] To reduce vulnerabilities associated with FX mortgages, banks with significant FX exposure have been requested to retain dividends and further boost capital. A temporary payment relief program for distressed zloty and FX mortgage holders has taken effect, though with limited uptake so far.

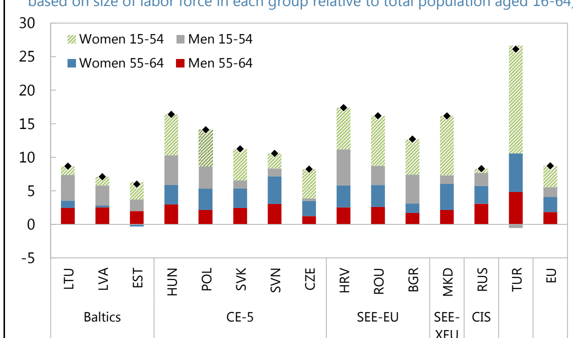
with regular contracts, including by shortening their maximum duration and increasing their social security contributions. This should help reduce labor market segmentation and improve sustainability of the pension system, while retaining sufficient labor market flexibility. Most recently, the Association of Employment Agencies reported a substantial reduction in the attractiveness of civil law contracts in favor of regular contracts. The government has also adopted a draft law introducing an hourly minimum wage for these contracts starting next year. The business climate has been improved via the introduction of a corporate insolvency law, designed to promote restructuring (instead of liquidation) of viable firms. Alongside, businesses should benefit from a number of tax-related changes, such as changes to the tax code in favor of the taxpayer in case of legal uncertainties and tax assistance to support start-ups in tax-related matters.

**31. Going forward, structural reforms should focus on reducing regional disparities and addressing looming demographic challenges to ensure inclusive and sustainable growth.**

- *Promoting regional growth*. Staff welcomed recent efforts to improve the labor market and the business environment. However, to reduce regional disparities, policies would need to address productivity gaps in the east (Box 5). This would require improving educational attainment in the east and reducing skill mismatches by better aligning education curricula with employers' needs, and investing in infrastructure to attract FDI to poorer regions. In this respect, the authorities' intention to address these issues as signaled in the Responsible Development Plan is welcome. Phasing out special tax and pension regimes for farmers would facilitate mobility from agriculture to higher-productivity sectors, while also encouraging scaling-up of farms in the east and boosting productivity in agriculture.

- *Long-term growth*. Staff supported the authorities' plans to increase access to vocational training and promote innovation through targeted tax incentives, particularly for start-ups,[11] and better utilization of EU funds. These policies would need to be complemented by continued improvement in human capital and infrastructure to help absorb new technologies, including through FDI. The adverse effects on growth of unfavorable demographic trends can be partially counteracted by increasing labor force participation of women and the elderly (Box 6). Staff recommended redirecting family cash benefits toward childcare and preschool education, which would help boost female labor force participation and need not come at the expense of lower fertility. In this respect,

**Labor Force Participation Gap Vis-a-Vis Sweden, 2013** (Percentage points; based on size of labor force in each group relative to total population aged 16-64)




Sources: OECD *Labor Force Statistics* and IMF staff calculations.

[11] The authorities' plans concerning tax incentives for innovative business start-ups appear consistent with the recommendations of the IMF's Fiscal Monitor, April 2016.

further advancing plans to increase access to pre-school facilities would be beneficial. Maintaining the retirement age increase envisaged by the 2013 pension reforms would safeguard participation of seniors.

## Box 5. Poland: Regional Disparities[1]

**Although Poland has enjoyed strong growth and steady income convergence with the EU over the last two decades, important disparities persist at the regional level.** Per-capita income is higher in the west—which is integrated into the German supply chain and enjoys higher levels of FDI—than in the east—where the economy is more reliant on less productive agriculture. Despite strong overall growth, the east has not been catching up to the west.

**Reducing regional disparities by boosting economic performance in lagging regions would promote faster and more inclusive growth.** Estimates suggest that Poland's GDP per capita could be increased by 7 percent if one-third of the gap between regions with GDP per capita below average and the four regions, which are above average, was closed. This would imply an additional 5 percentage point convergence to the EU28 average income level. Boosting labor productivity growth in lagging regions is key to reducing regional disparities. There is a strong association between income per capita and labor productivity levels: wealthier regions in Poland also tend to have higher levels of productivity.

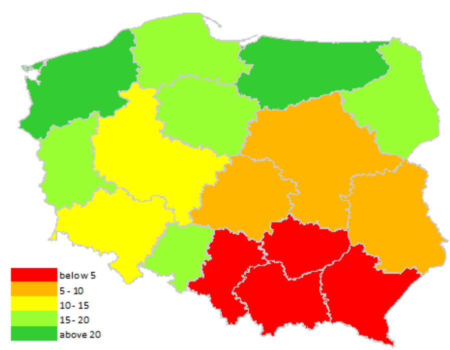
**Policies to boost regional productivity convergence would require supporting structural transformation in the east, facilitating labor mobility, and attracting FDI to less productive regions.**

- *Structural transformation.* Productivity growth in the east can be supported by reallocating labor from low-productivity agriculture to higher-productivity industry and service sectors. The subsidized pension scheme for farmers should be gradually phased out to discourage inefficient farming motivated by pension arbitrage. Moving from the current tax system based on farm size and quality of land to an income-based tax would encourage scaling up of farms, increasing their capital intensity and productivity.

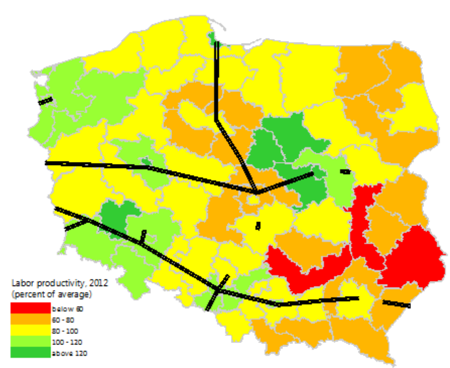
- *Labor mobility.* Active labor market policies to improve job searching efficiency across regions combined with policies to reduce skill mismatches—including by better aligning education and training curricular with employer needs—would facilitate labor mobility across sectors and regions, and help lower high structural unemployment in the east.

- *FDI.* Investor surveys suggest that access to skilled labor and good public infrastructure are important for location of new projects. Improving educational attainment and strengthening transportation networks in less productive regions would help in this regard.

**Share of Farms Larger than 20 Hectares**
(Percent)




**Highway Network and Productivity**

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[1] Based on Chapter I of Selected Issues.

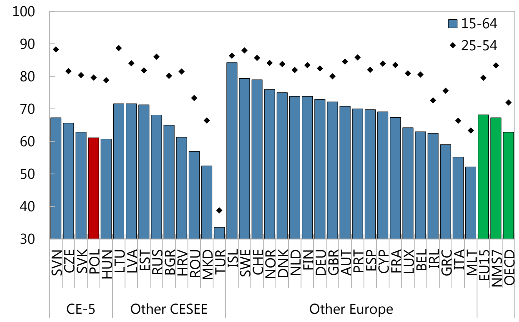
## Box 6. Poland: Female Labor Force Participation[1]

**Poland is facing a rapidly aging population.** With the working-age population expected to shrink by more than 30 percent by 2060, the old-age dependency ratio will increase dramatically. While there are about 20 people aged 65+ for every one hundred persons of working age today, by 2060, this number is expected to increase to about 60 people, with adverse implications for social spending and growth.

**Boosting female labor force participation could greatly mitigate the economic effect of aging.** While Polish women are just as educated as men and have expected life spans that are 8 years longer than that of men, the labor force participation rate among working-age women (15–64) at 61 percent as of 2014 is close to 15 percentage points below that of men. Participation is particularly low among women aged 55–64, where a gap of more than 16 percent remains relative to EU15. Lifting women's participation could help boost economic output. To that effect, a basic growth-accounting calculation for Poland suggests that aligning women's labor force participation rate with that of men could increase real output by about 5 percent.

**Female Labor Force Participation by Age, 2014**

(Percent of population in given age group)



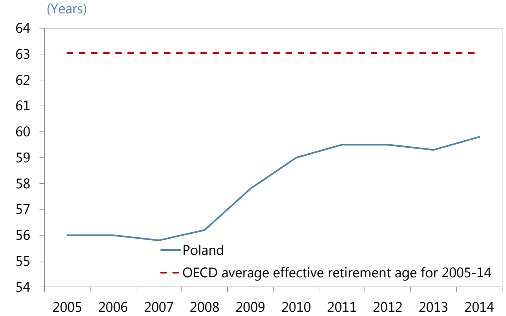

Sources: OECD.

**Policies to level the playing field between men and women can have significant impact.** While individual characteristics, attitudes, and personal choice are important drivers of female labor force participation, certain policies may also impact women's employment decisions.[2] For example, joint taxation, as is the case in Poland, would tend to have higher marginal tax rates on the second earner in a family—usually a woman—and create disincentives to work outside the home. Further, the availability of high-quality childcare facilitates working outside the home, while family cash allowances tend to discourage women from joining the workforce.

**There is room to adjust policies in Poland to increase female labor force participation.** For example, redirecting resources from family cash-transfers toward pre-school education would make it easier for women to combine family responsibilities with work outside the home. This could also help boost fertility, which is among the lowest in Europe. In contrast, the proposed lowering of the statutory retirement age would be a step in the wrong direction, as it would reduce labor force participation of women among the older age groups, further exacerbating the adverse economic effects of aging.

**Effective Retirement Age for Women, 2005–14**

(Years)




Sources: Social Security Office (ZUS), OECD, and IMF staff calculations.

________________________________

[1] Based on Chapter II of Selected Issues.

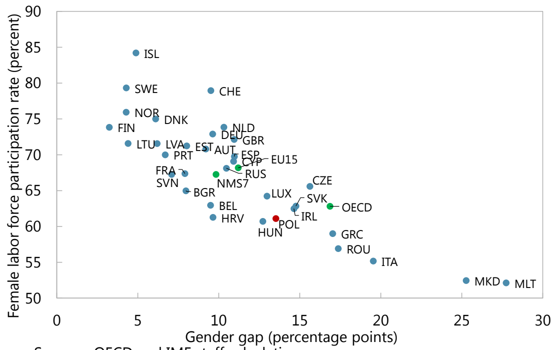
[2] See Christiansen, Lone, Huidan Lin, Joana Pereira, Petia Topalova, and Rima Turk, 2016, "Unlocking Female Employment Potential in Europe: Drivers and Benefits," Departmental Paper, International Monetary Fund, March.

## Box 6. Poland: Female Labor Force Participation (concluded)

*Polish women work significantly less than Polish men…*

**Female Labor Force Participation and the Gender Gap, 2014**

(Based on women and men aged 15 to 64)

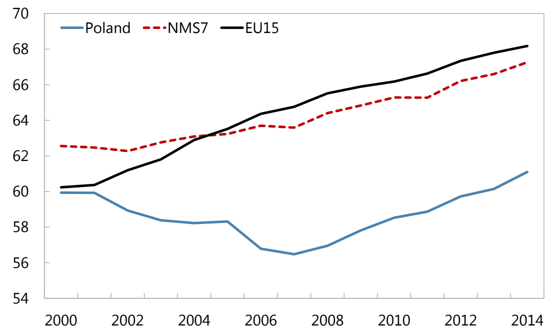



Sources: OECD and IMF staff calculations.

*…and less than women in peer economies.*

**Labor Force Participation Among Women Aged 15-64**

(Percent)

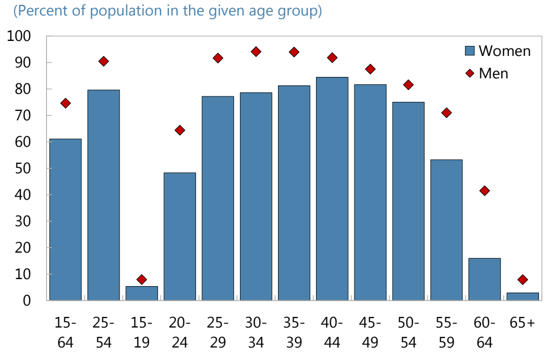



Sources: OECD and IMF staff calculations.

*The gender gap is notable among women older than 55…*

**Poland: Labor Force Participation by Age, 2014**

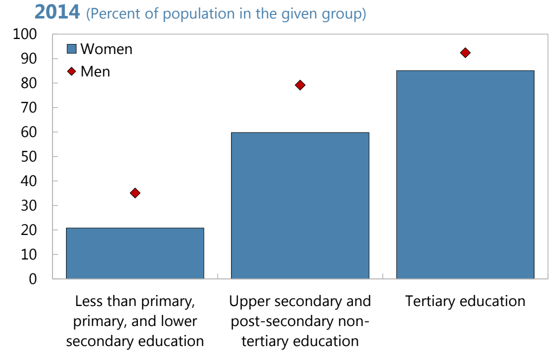
(Percent of population in the given age group)




Source: OECD.

*…but narrows with the level of education.*

**Poland: Labor Force Participation by Level of Education, 2014** (Percent of population in the given group)

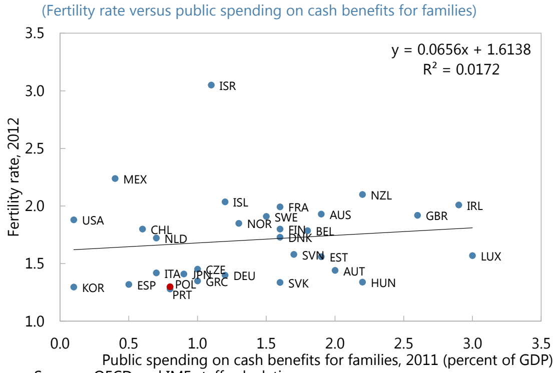



Source: OECD.

*Cash benefits do not appear associated with fertility,…*

**Fertility and Family Allowances**

(Fertility rate versus public spending on cash benefits for families)

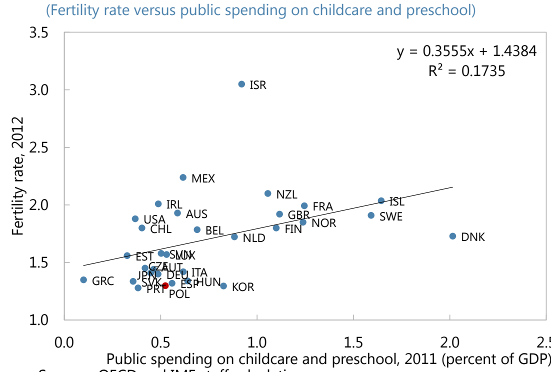



Sources: OECD and IMF staff calculations.

*…whereas childcare and fertility are positively associated.*

**Fertility and Childcare Expenditure**

(Fertility rate versus public spending on childcare and preschool)




Sources: OECD and IMF staff calculations.

### Authorities' views

**32. The authorities stressed that addressing structural challenges is a vital part of their reform agenda.** They noted that the Responsible Development Plan approved by the government earlier this year identifies barriers to growth, including the need to counteract adverse demographic trends and to promote inclusive regional growth. It also envisages promoting innovation to facilitate moving up the value added chain and further improving the business environment and the quality of public services. In this respect, EU funds are an important financing source, with the authorities envisaging increasing involvement of the private sector to ensure that the funds are invested in viable projects. It was also noted that the new child benefits program (Family 500+) is expected to increase fertility to counteract negative demographic prospects. In addition, it would reduce income inequality and child poverty and could help cover some of the cost of childcare, thereby having positive effects on female labor force participation. The authorities voiced their commitment to continue increasing access to childcare facilities.

## STAFF APPRAISAL

**33. Poland is enjoying a strong economic expansion.** Growth reached 3.6 percent in 2015 driven by robust domestic demand, supported by healthy wage and credit expansion. Unemployment has come down rapidly and the economy is operating at full capacity. External factors have kept headline inflation significantly below the target but these are expected to dissipate over time. Despite some weakening in the first quarter, growth is projected to remain strong, opening a positive output gap next year. In turn, inflation should gradually strengthen and enter the target band by end-2017.

**34. Downside risks to the outlook have intensified.** External risks include a marked slowdown in emerging markets, accompanied by financial market volatility, and a protracted growth slowdown in the euro area, which could spill over to Poland through trade and financial linkages. Domestically, some recent policy initiatives raise concerns about their negative impact on growth prospects. Specifically, a weakening of institutions and policies or fiscal slippages could worsen investor sentiment and hinder economic expansion. Over the longer term, a rapidly aging population poses important challenges to potential growth and fiscal sustainability. At the same time, enduring income disparities between Poland's prosperous west and the lagging east could undermine the quality of growth.

**35. Strong policies and institutions are critical to mitigate these risks and to support sustainable and balanced growth.** Considering the favorable cyclical position alongside weak inflation, continued monetary accommodation should go hand-in-hand with gradual fiscal consolidation. At the same time, safeguarding financial sector stability and strong institutions is essential for continued strong and stable growth. Structural reforms are key to sustainable convergence to western European income levels. The FCL arrangement with the IMF provides added insurance against external shocks.

**36. The current accommodative monetary policy stance is appropriate.** Although the recent period of deflation does not appear to have had adverse spillovers to the real economy, getting inflation back to the target is important to ensure that inflation expectations do not become unanchored. Hence, further interest rate cuts should be considered in the event of a sharp growth slowdown or if inflation expectations were to disappoint.

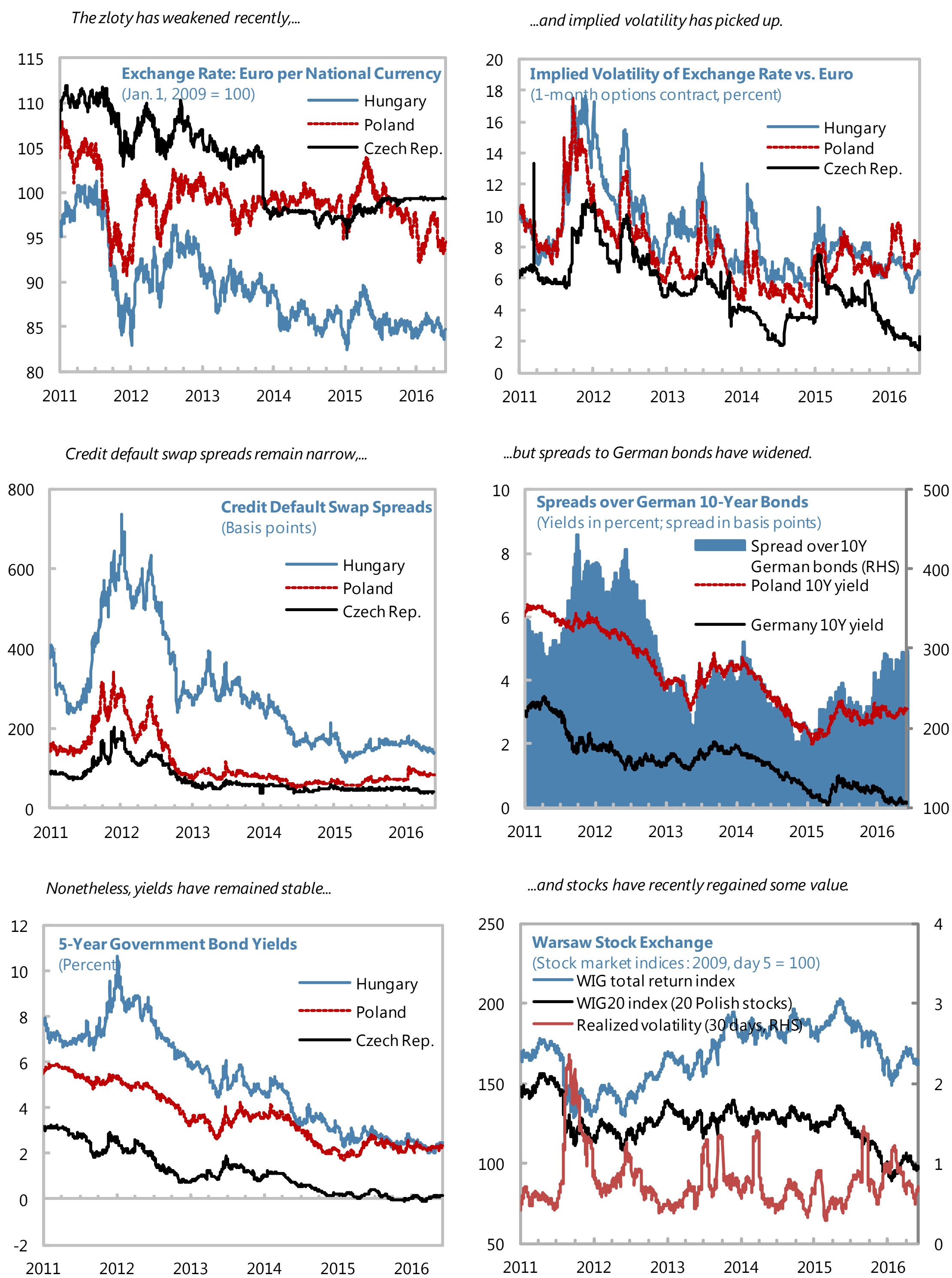
**37. Gradual fiscal consolidation should resume next year.** The implementation of election promises has turned the fiscal stance procyclical, potentially pushing the deficit above 3 percent of GDP in 2017. However, as the output gap is expected to turn positive next year, staff recommends taking advantage of the favorable cyclical position and resuming deficit reduction in 2017 underpinned by credible growth-friendly measures. This would also help support market confidence and maintain budget financing on favorable terms. Measures could include rationalizing discretionary government consumption and unifying multiple VAT rates. The distortionary tax on bank assets should be replaced with a more growth-friendly tax on bank profits and remuneration to avoid adverse effects on credit and growth. Amid adverse demographic trends, the planned reversal of the 2013 retirement age increases is ill-advised and should be reconsidered. Such a step would reduce the pension replacement rate, increasing the risk of old-age poverty and adversely impacting the budget.

**38. Maintaining financial sector stability is essential.** While banking sector capital ratios are healthy, narrowing interest margins have reduced profitability. Going forward, the bank tax may further reduce profits, potentially spilling over to the real economy through reduced credit expansion. While the outstanding stock of foreign-currency mortgages poses a vulnerability, blanket conversion schemes should be avoided as they risk undermining financial stability, with adverse implications for economic activity. Instead, focus should be on supporting distressed mortgage holders on a case-by-case basis. A prompt completion of the bank resolution framework would ensure the availability of modern resolution tools.

**39. Structural reforms should focus on addressing demographic challenges and reducing regional disparities.** Aging-related pressures can be alleviated by increasing labor force participation, particularly of women and seniors, and boosting productivity. In this respect, the authorities' intention to move up the value-added chain by increasing access to vocational training and promoting innovation is welcome. Redirecting family cash benefits toward childcare and preschool education would help boost female labor force participation. Maintaining the retirement age increases envisaged by the 2013 pension reforms would encourage participation of seniors. Reducing regional disparities would promote a more inclusive growth and speed up convergence. This would require improving educational attainment in the east, reducing skill mismatches, and investing in infrastructure to attract FDI to poorer regions.

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

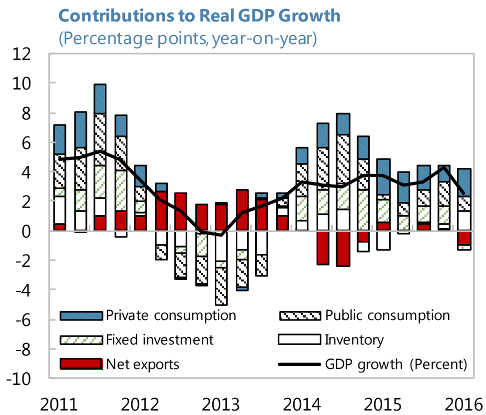
## Figure 12. Poland: Financial Market Developments, 2011–16



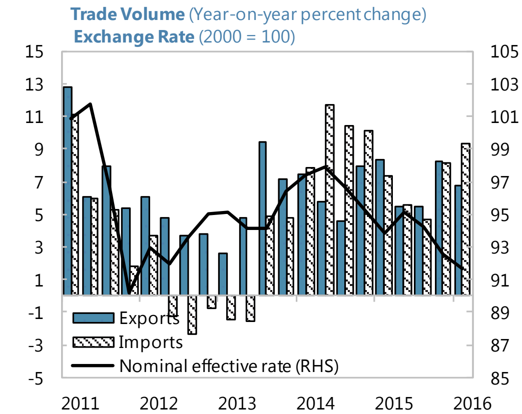

Sources: Bloomberg, Haver Analytics, Magyar Nemzeti Bank, Polish Ministry of Finance, Reuters, and IMF staff calculations.

## Figure 13. Poland: Recent Economic and Labor Market Developments, 2011–16

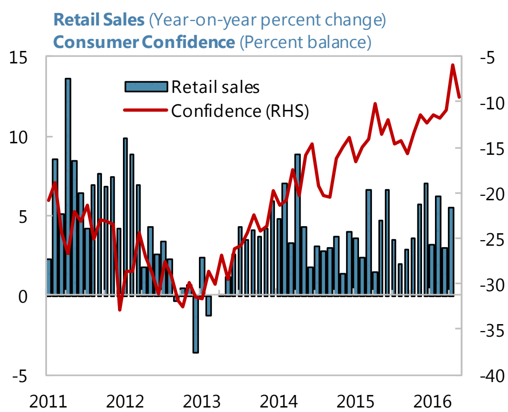
*Growth slowed down in the first quarter,...*



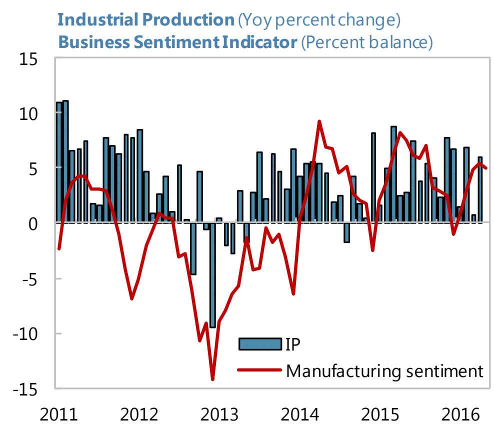

*...amid a slowdown in net exports.*



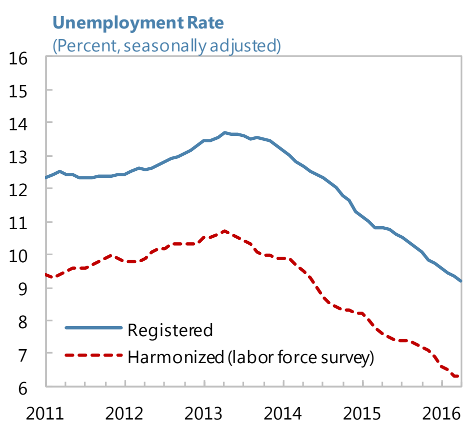

*Retail sales are overall strong but volatile...*



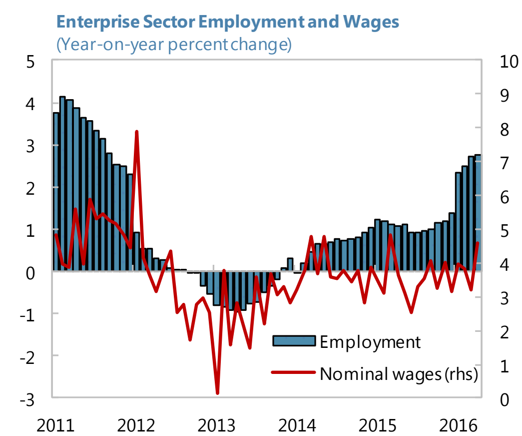

*...as is industrial production.*




*Unemployment has continued to decline,...*

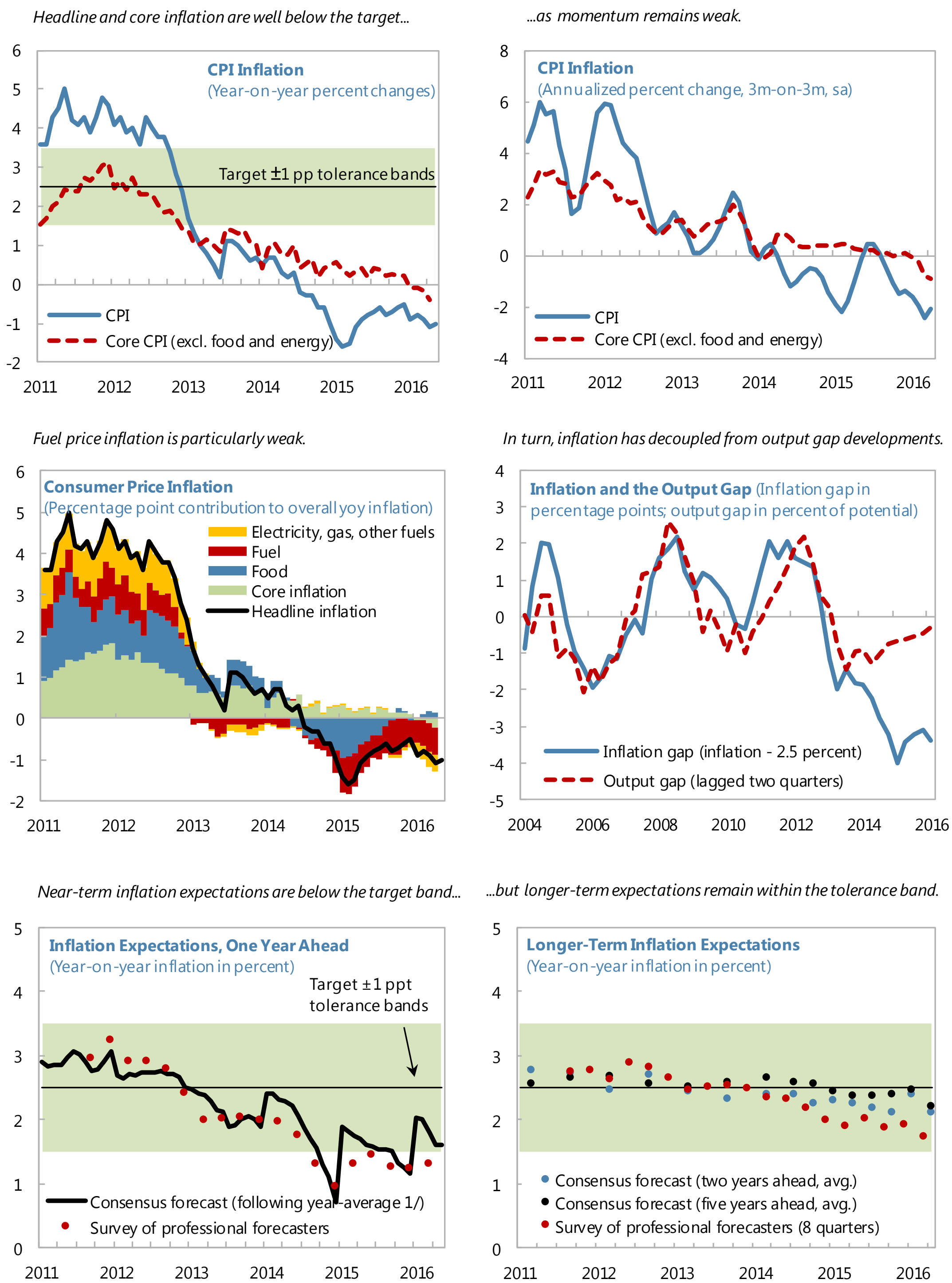



*...and wage growth remains robust.*




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

## Figure 14. Poland: Recent Inflation Developments, 2004–16

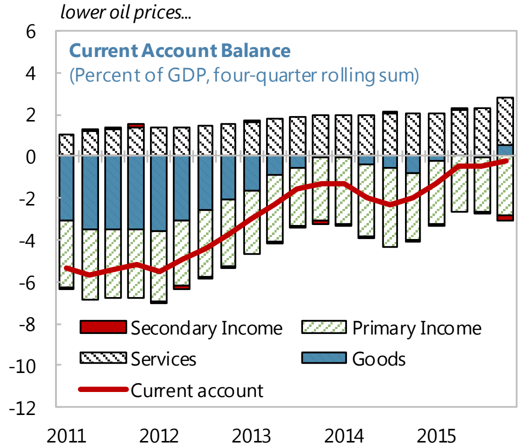



1/ Expectations for the following year's average is affected by breaks when the forecast-year changes in January.

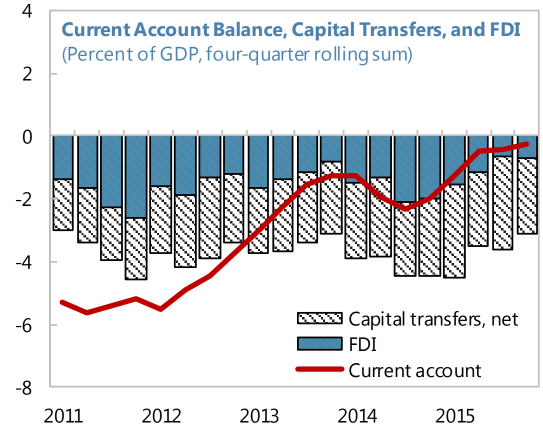
Sources: Bloomberg, Datastream, Haver Analytics, JP Morgan, NBP, Reuters, Statistics Poland, and IMF staff calculations.

## Figure 15. Poland: Balance of Payments, 2011–16

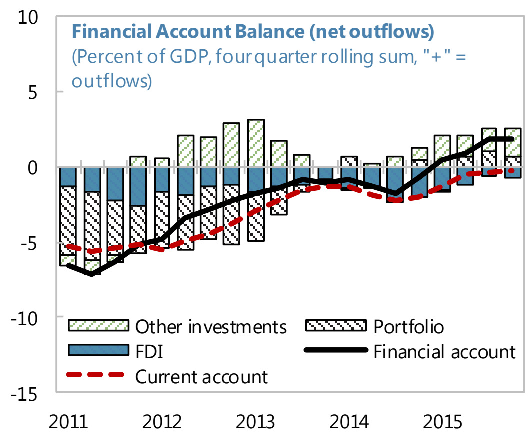
*The current account deficit has improved on account of lower oil prices...*



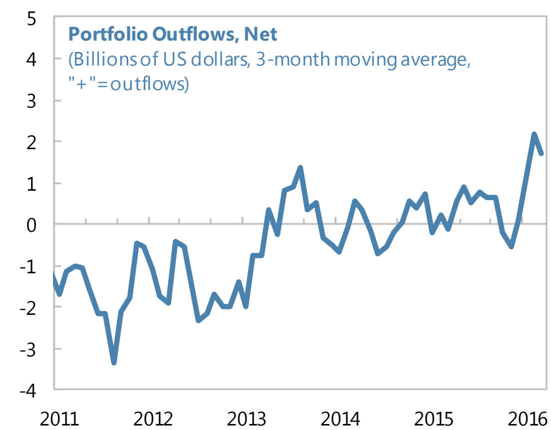

*...and is financed primarily by FDI and EU transfers.*



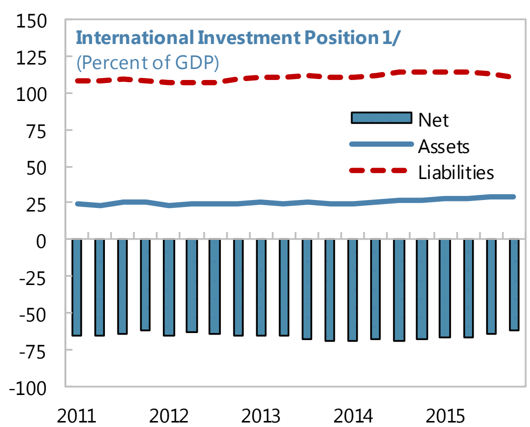

*Financial flows continue to weaken,...*



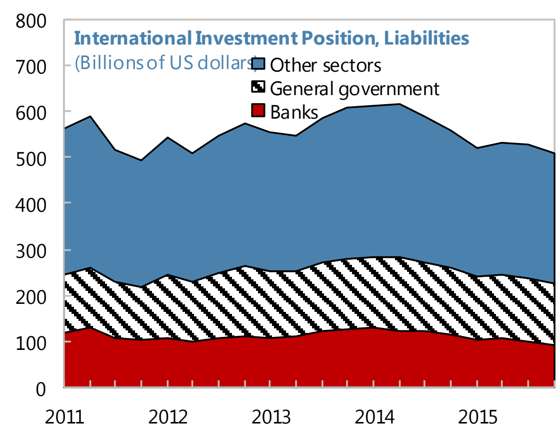

*...mainly driven by net portfolio outflows.*




*The IIP remains broadly stable,...*

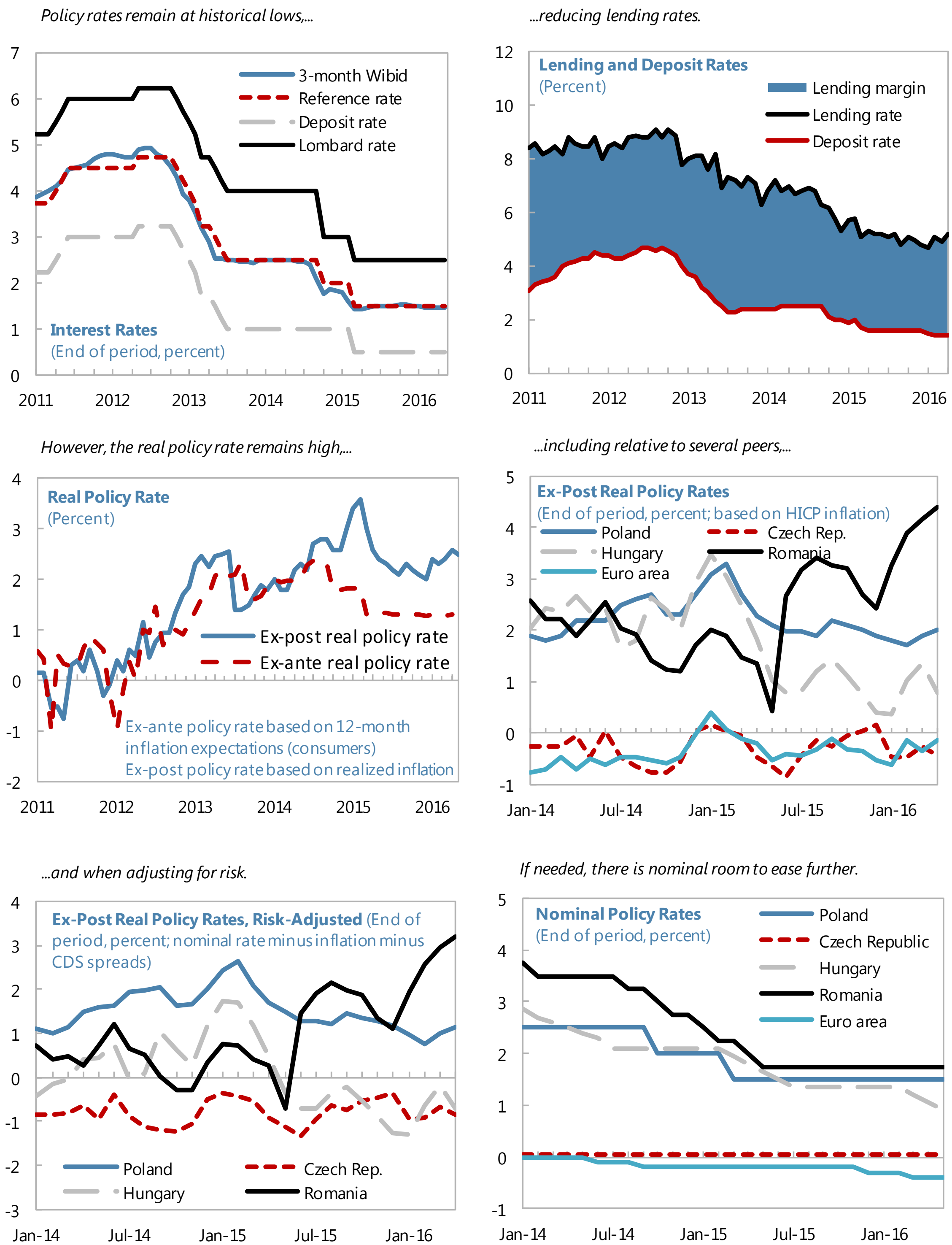



*...as liabilities have leveled off across all sectors.*



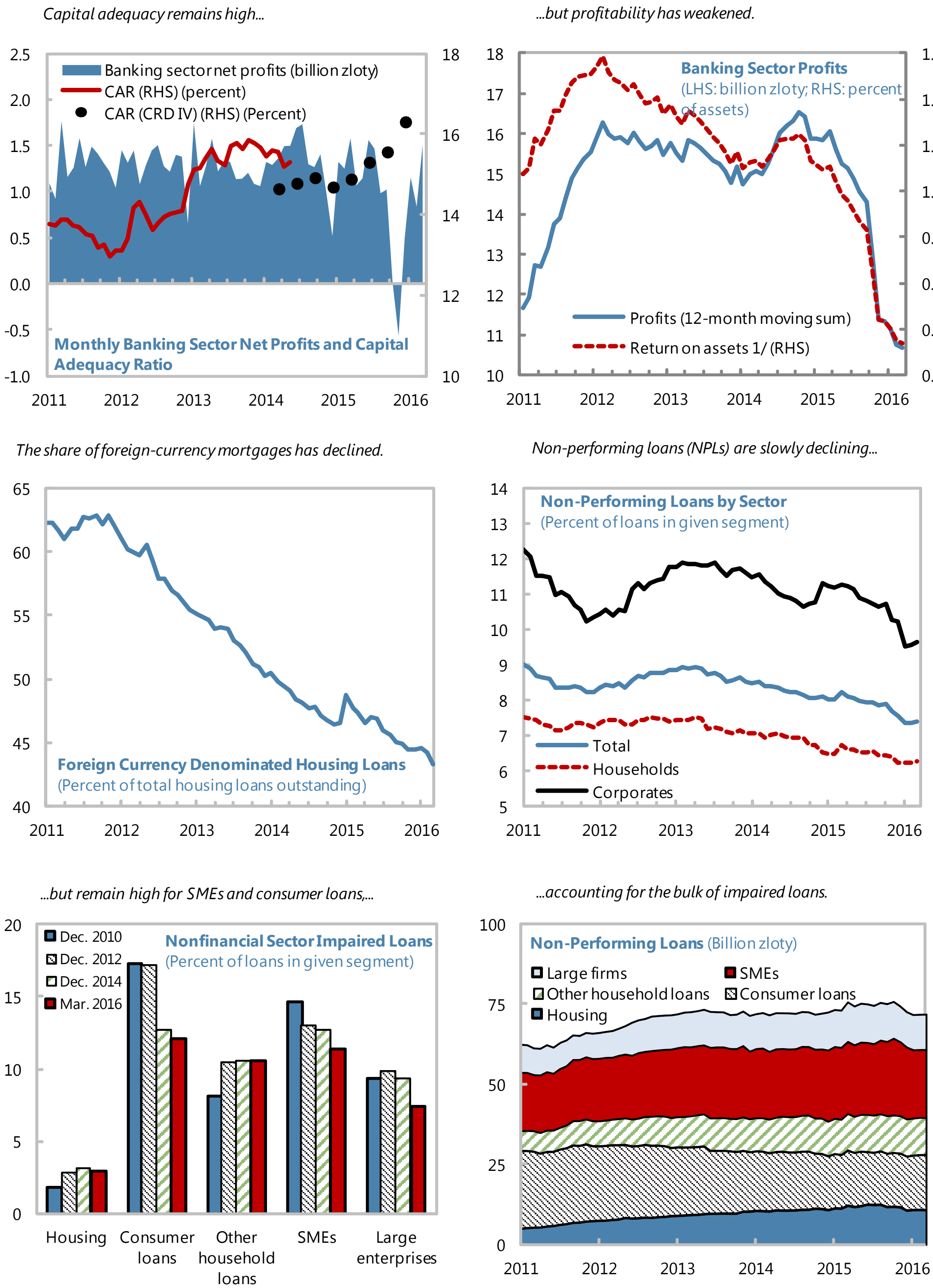

Sources: Narodowy Bank Polski and IMF staff calculations.
1/ Excludes NBP.

## Figure 16. Poland: Monetary Policy Developments, 2011–16




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

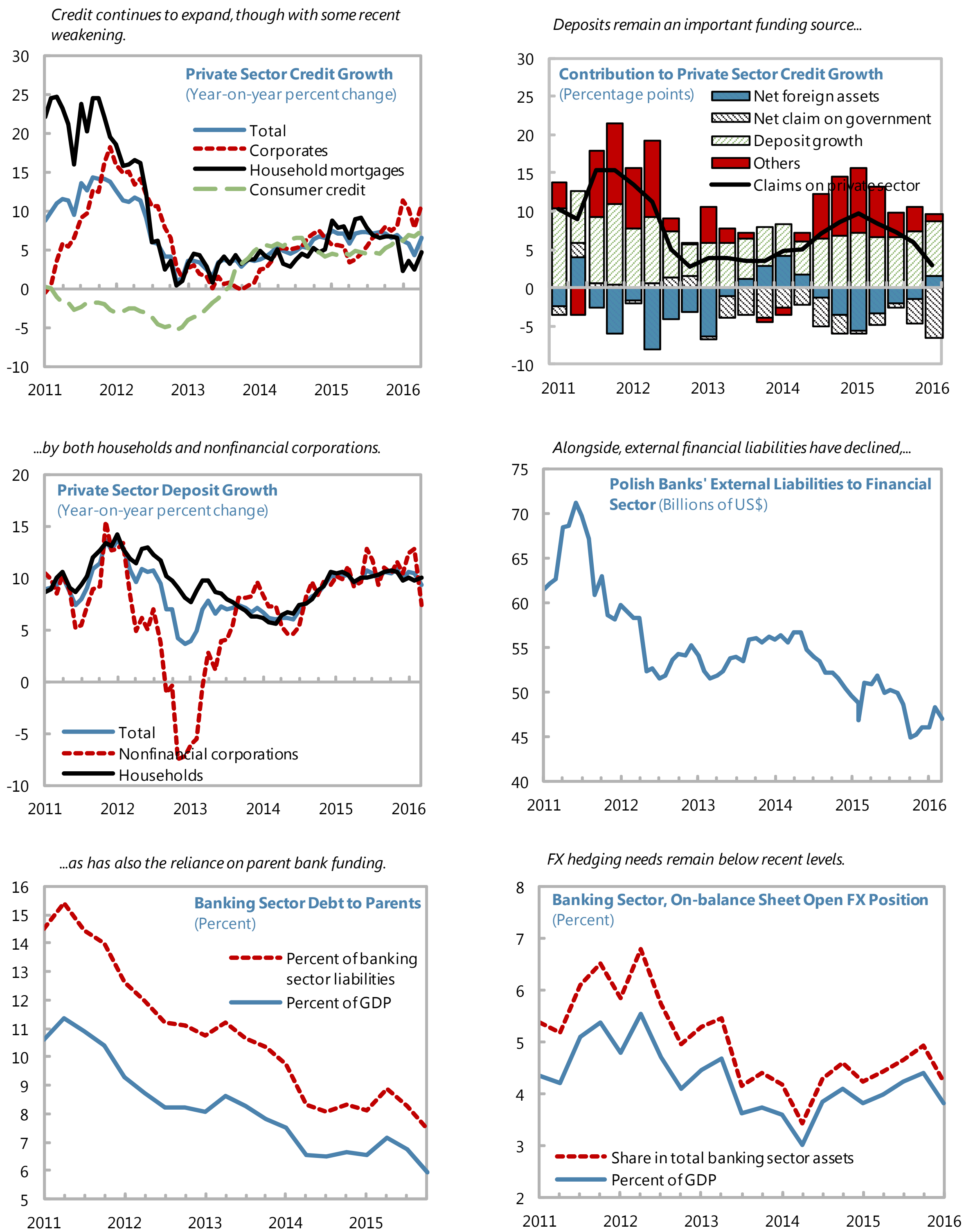
## Figure 17. Poland: Banking Sector Capital and Asset Quality, 2011–16




Sources: KNF and IMF staff calculations.

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

## Figure 18. Poland: Credit Growth and Banking Sector Funding, 2011–16




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

## Table 1. Poland: Selected Economic Indicators, 2013–21

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | Projections | | | | | |
| **Activity and prices** | | | | | | | | | |
| GDP (change in percent) 1/ | 1.3 | 3.3 | 3.6 | 3.5 | 3.7 | 3.4 | 3.2 | 3.1 | 3.1 |
| Domestic demand | -0.7 | 5.0 | 3.4 | 3.9 | 4.0 | 3.8 | 3.5 | 3.2 | 3.2 |
| Private consumption growth | 0.2 | 2.4 | 3.0 | 3.8 | 4.1 | 3.9 | 3.5 | 3.1 | 3.1 |
| Public consumption growth | 2.2 | 4.7 | 3.4 | 3.1 | 2.8 | 2.6 | 2.3 | 2.1 | 1.8 |
| Domestic fixed investment growth | -1.1 | 10.0 | 5.8 | 3.8 | 5.1 | 4.8 | 4.4 | 4.4 | 4.4 |
| Inventories (contribution to growth) | -1.0 | 0.6 | -0.2 | 0.4 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net external demand (contribution to growth) | 2.0 | -1.6 | 0.3 | -0.4 | -0.3 | -0.4 | -0.3 | -0.1 | -0.1 |
| Output gap | -1.1 | -0.7 | -0.1 | 0.0 | 0.2 | 0.4 | 0.3 | 0.1 | 0.0 |
| CPI inflation (percent) | | | | | | | | | |
| Average | 0.9 | 0.0 | -0.9 | -0.7 | 1.1 | 1.9 | 2.4 | 2.5 | 2.5 |
| End of period | 0.7 | -1.0 | -0.5 | 0.1 | 1.5 | 2.2 | 2.5 | 2.5 | 2.5 |
| Unemployment rate (average, according to LFS) | 10.3 | 9.0 | 7.5 | 6.4 | 6.2 | 6.3 | 6.3 | 6.4 | 6.5 |
| **Public finances** (percent of GDP) 2/ | | | | | | | | | |
| General government revenues | 38.4 | 38.9 | 38.9 | 39.2 | 39.0 | 39.1 | 39.2 | 39.2 | 39.2 |
| General government expenditures | 42.4 | 42.2 | 41.5 | 41.9 | 42.1 | 41.9 | 41.7 | 41.5 | 41.3 |
| General government net lending/borrowing | -4.0 | -3.3 | -2.6 | -2.8 | -3.1 | -2.8 | -2.5 | -2.3 | -2.1 |
| General government debt | 56.0 | 50.5 | 51.3 | 51.9 | 52.9 | 53.2 | 52.8 | 52.3 | 51.6 |
| National definition 3/ | 53.3 | 48.1 | 49.0 | ... | ... | ... | ... | ... | ... |
| **Money and credit** | | | | | | | | | |
| Private credit (change in percent, end-period) 4/ | 3.5 | 8.6 | 6.0 | 4.6 | 5.0 | 5.5 | 5.8 | 5.8 | 5.9 |
| Credit to GDP (percent) | 58.5 | 61.2 | 62.3 | 62.6 | 63.1 | 63.3 | 63.5 | 63.7 | 64.0 |
| Deposits (change in percent, end-period) | 5.8 | 7.8 | 8.4 | 6.1 | 6.1 | 6.2 | 6.3 | 6.3 | 6.4 |
| Broad money (change in percent, end-period) | 6.2 | 8.2 | 9.1 | 6.2 | 6.1 | 6.2 | 6.3 | 6.3 | 6.4 |
| Policy Rate (percent) 5/ | 2.9 | 2.4 | 1.6 | 1.5 | ... | ... | ... | ... | ... |
| **Balance of payments** | | | | | | | | | |
| Current account balance (transactions, billion U.S. dollars) | -6.7 | -11.1 | -1.1 | -3.2 | -6.6 | -10.4 | -13.6 | -15.7 | -17.4 |
| Percent of GDP | -1.3 | -2.0 | -0.2 | -0.7 | -1.3 | -2.0 | -2.5 | -2.7 | -2.8 |
| Exports of Goods (billion U.S. dollars) | 198.1 | 210.6 | 190.7 | 194.3 | 208.2 | 221.8 | 236.4 | 251.4 | 267.0 |
| Export volume growth | 6.1 | 6.4 | 6.8 | 6.1 | 6.5 | 6.0 | 5.8 | 5.6 | 5.4 |
| Imports of Goods (billion U.S. dollars) | 198.6 | 214.9 | 188.4 | 191.3 | 208.9 | 226.0 | 243.4 | 260.5 | 277.9 |
| Import volume growth | 1.7 | 10.0 | 6.3 | 7.7 | 7.4 | 6.9 | 6.4 | 5.9 | 5.6 |
| Terms of trade (index 1995=100) | 99.4 | 101.5 | 104.6 | 106.5 | 105.4 | 104.7 | 104.2 | 103.8 | 103.6 |
| Official reserves (billion U.S. dollars) | 106.2 | 100.4 | 94.9 | 106.9 | 113.7 | 122.2 | 122.5 | 125.4 | 128.5 |
| In percent of short-term debt plus CA deficit | 74.9 | 94.0 | 87.0 | 96.6 | 103.1 | 105.6 | 107.9 | 111.3 | 112.6 |
| Total external debt (billion U.S. dollars) | 384.1 | 354.7 | 328.4 | 330.9 | 332.1 | 335.1 | 334.9 | 337.7 | 341.2 |
| In percent of GDP | 73.3 | 65.1 | 69.2 | 69.7 | 67.4 | 64.3 | 60.7 | 57.8 | 55.4 |
| **Exchange rate** | | | | | | | | | |
| Exchange rate regime | | | | Freely floating | | | | | |
| Zloty per USD, period average 6/ | 3.2 | 3.2 | 3.8 | 3.9 | ... | ... | ... | ... | ... |
| Zloty per Euro, period average 6/ | 4.2 | 4.2 | 4.2 | 4.4 | ... | ... | ... | ... | ... |
| Real effective exchange rate (INS, CPI based) 7/ | 108.3 | 109.1 | 105.3 | ... | ... | ... | ... | ... | ... |
| Appreciation (percent change) | 0.7 | 0.7 | -3.5 | ... | ... | ... | ... | ... | ... |
| *Memorandum item:* | | | | | | | | | |
| Nominal GDP (billion zloty) | 1656.3 | 1719.1 | 1789.7 | 1863.6 | 1942.5 | 2043.1 | 2153.9 | 2270.7 | 2396.0 |

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

5/ NBP Reference Rate (avg). For 2016, as of June 2.

6/ For 2016, exchange rate as of June 2.

7/ Annual average (2000=100).

## Table 2. Poland: Balance of Payments on Transaction Basis, 2013–21

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

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Projections | | | |
| Current account balance | -6,744 | -11,125 | -1,117 | -3,228 | -6,596 | -10,433 | -13,610 | -15,676 | -17,449 |
| percent of GDP | -1.3 | -2.0 | -0.2 | -0.7 | -1.3 | -2.0 | -2.5 | -2.7 | -2.8 |
| Trade balance | 9,692 | 7,110 | 13,277 | 14,140 | 10,675 | 7,258 | 4,750 | 3,167 | 1,982 |
| percent of GDP | 1.8 | 1.3 | 2.8 | 3.0 | 2.2 | 1.4 | 0.9 | 0.5 | 0.3 |
| Balance on Goods | -453 | -4,291 | 2,376 | 2,945 | -661 | -4,211 | -7,035 | -9,085 | -10,830 |
| Merchandise exports f.o.b. | 198,107 | 210,628 | 190,727 | 194,273 | 208,194 | 221,789 | 236,415 | 251,369 | 267,028 |
| Merchandise imports f.o.b. | 198,560 | 214,919 | 188,351 | 191,328 | 208,855 | 225,999 | 243,450 | 260,454 | 277,857 |
| Balance on Services | 10,145 | 11,401 | 10,901 | 11,195 | 11,336 | 11,469 | 11,785 | 12,252 | 12,812 |
| Merchandise exports f.o.b. | 44,629 | 48,112 | 43,505 | 44,314 | 47,489 | 50,590 | 53,926 | 57,338 | 60,909 |
| Merchandise imports f.o.b. | 34,484 | 36,711 | 32,604 | 33,119 | 36,153 | 39,121 | 42,142 | 45,085 | 48,098 |
| Exports of goods and services | | | | | | | | | |
| percentage change in unit values | 9.2 | 6.6 | -0.9 | 1.9 | 7.2 | 6.5 | 6.6 | 6.3 | 6.2 |
| percentage volume growth | 6.1 | 6.4 | 6.8 | 6.1 | 6.5 | 6.0 | 5.8 | 5.6 | 5.4 |
| Imports of goods and services | | | | | | | | | |
| percentage change in unit values | 3.5 | 8.0 | -4.3 | 1.6 | 9.2 | 8.2 | 7.7 | 7.0 | 6.7 |
| percentage volume growth | 1.7 | 10.0 | 6.3 | 7.7 | 7.4 | 6.9 | 6.4 | 5.9 | 5.6 |
| Terms of trade (percentage change) | 1.1 | 2.1 | 3.1 | 1.8 | -1.0 | -0.7 | -0.5 | -0.3 | -0.2 |
| Primary Income balance | -15,896 | -17,661 | -13,414 | -16,326 | -16,896 | -17,280 | -18,192 | -18,673 | -19,378 |
| Secondary Income balance | -540 | -574 | -980 | -1,041 | -374 | -411 | -168 | -170 | -53 |
| Capital and financial account balance | 5,947 | 8,760 | 19,810 | 20,248 | 17,442 | 15,316 | 7,582 | 5,373 | 2,685 |
| Capital account balance (net) | 11,964 | 13,305 | 11,327 | 12,925 | 13,250 | 14,177 | 11,699 | 11,693 | 10,991 |
| Financial account balance (net) | -6,017 | -4,545 | 8,483 | 7,323 | 4,192 | 1,139 | -4,117 | -6,320 | -8,307 |
| Foreign direct investment (net)[+ = outflows] | -4,206 | -11,084 | -3,377 | -9,606 | -10,284 | -11,000 | -11,754 | -12,549 | -13,387 |
| Assets [Increase = +] | -3,411 | 6,191 | 2,904 | 5,941 | 6,040 | 6,142 | 6,245 | 6,349 | 6,456 |
| Liabilities [Increase = +] | 795 | 17,275 | 6,281 | 15,548 | 16,325 | 17,141 | 17,998 | 18,898 | 19,843 |
| Portfolio investment (net) | -237 | 1,883 | 3,308 | 5,639 | 4,409 | 2,249 | 3,389 | 701 | -563 |
| Assets | 2,162 | 5,823 | 10,997 | 10,208 | 8,290 | 6,027 | 5,726 | 5,214 | 4,750 |
| Liabilities | 2,399 | 3,940 | 7,689 | 4,569 | 3,881 | 3,778 | 2,337 | 4,513 | 5,312 |
| Other investment (net) | -1,809 | 4,399 | 8,323 | 6,000 | 3,200 | 1,400 | 4,000 | 2,600 | 2,500 |
| Assets | 1,559 | 4,478 | 5,116 | 5,500 | 1,200 | 1,100 | 2,000 | 1,500 | 1,500 |
| Liabilities | 3,368 | 79 | -3,207 | -500 | -2,000 | -300 | -2,000 | -1,100 | -1,000 |
| Financial derivatives | -710 | -59 | -906 | 0 | 0 | 0 | 0 | 0 | 0 |
| Errors and omissions | -11,237 | -6,725 | -1,727 | -2,375 | -2,463 | -2,605 | -2,206 | -2,337 | -1,849 |
| Financing | | | | | | | | | |
| Reserve assets [Increase = +] | 945 | 316 | 1,135 | 5,291 | 6,867 | 8,490 | 247 | 2,928 | 3,143 |
| *Memorandum items:* | | | | | | | | | |
| Current plus capital account (percent of GDP) | 1.0 | 0.4 | 2.2 | 2.0 | 1.4 | 0.7 | -0.3 | -0.7 | -1.0 |
| Official reserves | 106,220 | 100,438 | 94,922 | 106,864 | 113,731 | 122,221 | 122,468 | 125,396 | 128,539 |
| in months of imports | 6.4 | 5.6 | 6.0 | 6.7 | 6.5 | 6.5 | 6.0 | 5.8 | 5.6 |
| Official reserves (million euros) | 77,144 | 82,645 | 86,894 | … | … | … | … | … | … |
| Ratio of reserves to short-term debt 1/ | 81.3 | 95.0 | 89.6 | 102.7 | 113.9 | 119.6 | 125.1 | 129.2 | 133.0 |
| Ratio of reserves to ST debt plus CA deficit 1/ | 74.9 | 94.0 | 87.0 | 96.6 | 103.1 | 105.6 | 107.9 | 111.3 | 112.6 |
| Ratio of reserves to IMF ARA metric | 109.5 | 114.0 | 106.9 | 118.1 | … | … | … | … | … |
| Total external debt (percent of GDP) | 73.3 | 65.1 | 69.2 | 69.7 | 67.4 | 64.3 | 60.7 | 57.8 | 55.4 |
| Total external debt (percent of exports) | 158.2 | 137.1 | 140.2 | 138.7 | 129.9 | 123.0 | 115.3 | 109.4 | 104.1 |
| External debt service (percent of exports) | 55.9 | 53.9 | 48.4 | 47.2 | 43.5 | 39.7 | 38.5 | 35.0 | 31.0 |

1/ Short-term debt is on remaining maturity.

Sources: National Bank of Poland and IMF staff calculations.

## Table 3. Poland: Monetary Accounts, 2010–16

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 Proj. |
|---|---|---|---|---|---|---|---|
| | | | | (Billions of zlotys) | | | |
| **Central bank** | | | | | | | |
| Net foreign assets | 257 | 317 | 321 | 297 | 332 | 349 | 397 |
| Official reserve assets | 277 | 337 | 337 | 321 | 356 | 373 | 420 |
| Net domestic assets | -117 | -179 | -153 | -133 | -140 | -137 | -171 |
| Net claims on government | -12 | -19 | -16 | -7 | -19 | -13 | -13 |
| Claims on banks 1/ | -74 | -93 | -100 | -117 | -85 | -74 | -108 |
| Other items, net | -31 | -67 | -37 | -9 | -36 | -50 | -50 |
| Base money | 140 | 138 | 167 | 164 | 192 | 212 | 226 |
| Currency issued | 103 | 112 | 113 | 126 | 143 | 163 | 174 |
| Bank reserves | 37 | 26 | 54 | 38 | 49 | 49 | 52 |
| **Deposit money banks** | | | | | | | |
| Net foreign assets | -156 | -169 | -143 | -147 | -148 | -150 | -126 |
| Net domestic assets | 843 | 940 | 953 | 1,004 | 1,072 | 1,151 | 1,188 |
| Net claims on the central bank 1/ | 121 | 130 | 167 | 168 | 146 | 138 | 175 |
| Net claims on government | 137 | 141 | 125 | 152 | 188 | 214 | 216 |
| Claims on private sector | 789 | 911 | 936 | 968 | 1,052 | 1,115 | 1,166 |
| Claims on corporates | 215 | 253 | 257 | 259 | 276 | 298 | 312 |
| Claims on households | 480 | 537 | 538 | 562 | 593 | 633 | 662 |
| Claims on other | 95 | 121 | 141 | 147 | 183 | 184 | 193 |
| Other items, net | -204 | -242 | -275 | -285 | -314 | -316 | -369 |
| Deposits | 687 | 771 | 810 | 857 | 924 | 1,001 | 1,062 |
| **Consolidated banking system** | | | | | | | |
| Net foreign assets | 101 | 149 | 177 | 150 | 184 | 200 | 271 |
| Net domestic assets | 683 | 733 | 744 | 829 | 875 | 956 | 956 |
| Claims on government | 124 | 122 | 108 | 145 | 169 | 201 | 203 |
| Claims on private sector | 789 | 911 | 936 | 968 | 1,052 | 1,115 | 1,167 |
| Other items, net | -231 | -300 | -300 | -285 | -345 | -360 | -413 |
| Broad money (M3) | 784 | 882 | 921 | 979 | 1,059 | 1,155 | 1,227 |
| *Memorandum items:* | | | | (Percentage change from end of previous year) | | | |
| Base money | 1.6 | -1.1 | 21.0 | -1.9 | 16.8 | 10.7 | 6.6 |
| Broad money (M3) | 8.8 | 12.5 | 4.5 | 6.2 | 8.2 | 9.1 | 6.2 |
| Net domestic assets | 6.0 | 7.4 | 1.5 | 11.4 | 5.6 | 9.2 | 0.1 |
| Net foreign assets | 32.6 | 46.9 | 19.4 | -15.3 | 22.3 | 8.6 | 35.8 |
| Net claim on government | 7.7 | -2.2 | -10.9 | 34.1 | 16.2 | 19.2 | 0.9 |
| Claims on private sector | 8.2 | 15.4 | 2.7 | 3.5 | 8.6 | 6.0 | 4.6 |
| Deposit growth | 9.6 | 12.2 | 5.0 | 5.8 | 7.8 | 8.4 | 6.1 |
| | | | | (Percent of GDP, unless otherwise noted) | | | |
| Broad money (M3) | 54.2 | 56.3 | 56.6 | 59.1 | 61.6 | 64.6 | 65.9 |
| Private sector credit | 54.6 | 58.2 | 57.5 | 58.5 | 61.2 | 62.3 | 62.6 |
| Broad money Velocity (GDP/M3) | 1.8 | 1.8 | 1.8 | 1.7 | 1.6 | 1.5 | 1.5 |
| Money multiplier (M3/base money) | 5.6 | 6.4 | 5.5 | 6.0 | 5.5 | 5.4 | 5.4 |

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

## Table 4. Poland: Financial Soundness Indicators, 2008–16

(Percent)

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016Q1 |
|---|---|---|---|---|---|---|---|---|---|
| **Capital adequacy 1/** | | | | | | | | | |
| Regulatory capital to risk-weighted assets | 11.1 | 13.3 | 13.9 | 13.1 | 14.8 | 15.7 | 14.7 | 16.0 | ... |
| Regulatory Tier I capital to risk-weighted assets | 10.0 | 12.0 | 12.5 | 11.7 | 13.1 | 14.1 | 13.5 | 14.7 | ... |
| NPLs net of provisions to capital | 8.3 | 13.8 | 11.5 | 11.6 | 12.9 | 12.1 | 12.1 | 10.2 | ... |
| Bank capital to assets | 7.5 | 8.1 | 8.2 | 7.8 | 8.7 | 9.1 | 8.9 | 9.5 | ... |
| **Asset composition and quality** | | | | | | | | | |
| NPLs to gross loans (nonfinancial sector) | 4.4 | 7.9 | 8.8 | 8.2 | 8.8 | 8.5 | 8.1 | 7.5 | 7.4 |
| Provisioning coverage for nonperforming loans (nonfinancial sector) | 74.3 | 58.9 | 54.6 | 55.0 | 54.3 | 55.0 | 54.8 | 54.4 | 54.8 |
| Sectoral distribution of loans to nonfinancial sector | | | | | | | | | |
| Loans to households | 62.0 | 65.3 | 68.0 | 66.4 | 65.7 | 66.1 | 65.7 | 65.3 | 64.8 |
| Loans to non-financial corporations | 37.6 | 34.3 | 31.5 | 33.1 | 33.7 | 33.3 | 33.7 | 34.1 | 34.5 |
| **Earnings and profitability** | | | | | | | | | |
| Return on average assets (after tax) | 1.5 | 0.8 | 1.0 | 1.3 | 1.2 | 1.1 | 1.1 | 0.8 | 0.8 |
| Return on average equity (after tax) 1/ | 20.7 | 11.2 | 13.3 | 16.1 | 14.0 | 12.1 | 12.3 | 8.6 | ... |
| Interest margin to gross income | 55.7 | 51.9 | 53.0 | 55.8 | 55.0 | 56.1 | 58.2 | 57.0 | 57.7 |
| Noninterest expenses to gross income | 58.4 | 58.5 | 56.0 | 54.5 | 54.5 | 57.2 | 54.9 | 61.7 | 62.8 |
| **Liquidity** | | | | | | | | | |
| Liquid assets to total assets (liquid assets ratio) | 17.0 | 20.3 | 20.8 | 19.5 | 20.9 | 21.4 | 20.6 | 20.1 | 22.1 |
| Liquid assets to total short-term liabilities | 25.3 | 29.8 | 31.2 | 28.8 | 31.1 | 31.7 | 30.6 | 29.7 | 32.4 |
| Loans to deposits | 112.6 | 109.2 | 114.5 | 119.8 | 117.7 | 115.7 | 112.9 | 112.1 | 108.8 |
| **Sensitivity to market risk** | | | | | | | | | |
| Net open positions in FX to capital 1/ | 0.0 | 2.7 | 0.3 | -0.3 | 0.2 | -0.1 | 0.1 | 1.0 | ... |

Sources: NBP and KNF.

Note: Data according to Financial Soundness Indicators (FSI), 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 (not yet available for 2016Q1 as of May 2, 2016).

## Table 5. Poland: General Government Statement of Operations, 2013–21

(Percent of GDP)

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | Projections | | | | | |
| **Revenue** | 38.4 | 38.9 | 38.9 | 39.2 | 39.0 | 39.1 | 39.2 | 39.2 | 39.2 |
| Taxes | 19.6 | 19.8 | 19.8 | 20.1 | 19.7 | 19.8 | 20.0 | 20.1 | 20.1 |
| Personal income tax | 4.6 | 4.6 | 4.7 | 4.7 | 4.8 | 4.9 | 4.9 | 4.8 | 4.8 |
| Corporate income tax | 1.8 | 1.7 | 1.9 | 1.9 | 1.9 | 1.9 | 1.9 | 2.0 | 2.0 |
| VAT | 7.0 | 7.1 | 7.0 | 7.0 | 6.6 | 6.7 | 6.7 | 6.8 | 6.8 |
| Excises | 3.7 | 3.6 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 |
| Other taxes | 2.5 | 2.8 | 2.7 | 3.0 | 2.9 | 2.9 | 2.9 | 2.9 | 3.0 |
| Social contributions | 13.3 | 13.2 | 13.6 | 13.6 | 13.7 | 13.7 | 13.7 | 13.6 | 13.4 |
| Other revenue | 5.6 | 5.8 | 5.5 | 5.5 | 5.5 | 5.5 | 5.6 | 5.6 | 5.6 |
| Capital revenue | 0.9 | 1.2 | 1.1 | 1.0 | 1.1 | 1.1 | 1.1 | 1.2 | 1.2 |
| Sales of goods and services | 2.4 | 2.6 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 |
| Other current revenue | 2.2 | 2.1 | 2.1 | 2.1 | 2.1 | 2.1 | 2.1 | 2.1 | 2.1 |
| **Expenditure** | 42.4 | 42.2 | 41.5 | 41.9 | 42.1 | 41.9 | 41.7 | 41.5 | 41.3 |
| Expense | 38.6 | 38.1 | 37.3 | 38.2 | 38.0 | 37.7 | 37.4 | 37.1 | 36.9 |
| Compensation of employees | 10.4 | 10.4 | 10.2 | 10.1 | 10.0 | 9.9 | 9.8 | 9.7 | 9.5 |
| Use of goods and services | 5.9 | 6.1 | 5.8 | 5.8 | 5.7 | 5.7 | 5.7 | 5.7 | 5.7 |
| Interest | 2.5 | 1.9 | 1.8 | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 |
| Subsidies | 0.7 | 0.6 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| Social benefits | 16.3 | 16.2 | 16.3 | 17.3 | 17.2 | 17.0 | 16.8 | 16.7 | 16.6 |
| Other expense 1/ | 2.8 | 2.7 | 2.8 | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 |
| Other current expenditure | 2.3 | 2.1 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 |
| Capital transfers | 0.5 | 0.6 | 0.5 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 |
| Net acquisition of nonfinancial assets | 3.8 | 4.1 | 4.2 | 3.7 | 4.2 | 4.3 | 4.3 | 4.4 | 4.4 |
| **Gross operating balance** | -0.3 | 0.8 | 1.6 | 0.9 | 1.0 | 1.4 | 1.8 | 2.1 | 2.3 |
| **Net lending/borrowing** | -4.0 | -3.3 | -2.6 | -2.8 | -3.1 | -2.8 | -2.5 | -2.3 | -2.1 |
| **Net financial transactions** | -4.1 | -3.3 | -2.6 | -2.8 | -3.1 | -2.8 | -2.5 | -2.3 | -2.1 |
| Net acquisition of financial assets | -0.3 | 10.1 | 0.7 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Currency and deposits | -1.1 | 0.6 | -0.7 | -2.4 | -2.6 | -2.9 | -3.1 | -2.1 | -2.2 |
| Debt securities | 0.1 | 8.4 | 0.0 | 1.7 | 1.9 | 2.1 | 2.4 | 1.4 | 1.6 |
| Loans | 0.7 | 0.7 | 0.3 | 0.3 | 0.4 | 0.4 | 0.4 | 0.3 | 0.3 |
| Equity and investment fund shares | -0.6 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other financial assets | 0.5 | 0.2 | 1.1 | 0.5 | 0.4 | 0.5 | 0.5 | 0.5 | 0.4 |
| Net incurrence of liabilities | 3.7 | 13.4 | 3.3 | 2.8 | 3.2 | 2.9 | 2.6 | 2.4 | 2.2 |
| Currency and deposits | 0.0 | 0.0 | 0.5 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 0.3 |
| Debt securities | 2.0 | 2.6 | 1.7 | 1.1 | 1.5 | 1.3 | 1.1 | 1.0 | 0.8 |
| Loans | 1.5 | 1.4 | 0.9 | 1.0 | 1.0 | 1.0 | 0.9 | 0.9 | 0.8 |
| Other liabilities | 0.2 | 9.3 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| *Adjustment and statistical discrepancies* | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| *Memorandum items:* | | | | | | | | | |
| Cyclically-adjusted balance | -3.2 | -3.0 | -2.6 | -2.8 | -3.2 | -3.0 | -2.6 | -2.3 | -2.1 |
| Primary balance | -1.5 | -1.4 | -0.8 | -1.0 | -1.4 | -1.1 | -0.8 | -0.6 | -0.4 |
| Cyclically-adjusted primary balance | -0.7 | -1.1 | -0.8 | -1.0 | -1.5 | -1.3 | -0.9 | -0.7 | -0.4 |
| General government debt | 56.0 | 50.5 | 51.3 | 51.9 | 52.9 | 53.2 | 52.8 | 52.3 | 51.6 |
| General government liabilities | 68.8 | 73.4 | 74.2 | 69.9 | 70.8 | 71.1 | 70.7 | 70.2 | 69.5 |
| General government financial assets | 33.5 | 35.2 | 35.1 | 34.1 | 33.1 | 32.1 | 31.1 | 30.1 | 29.1 |
| Nominal GDP in billions of zloty | 1,656 | 1,719 | 1,790 | 1,864 | 1,942 | 2,043 | 2,154 | 2,271 | 2,396 |

Sources: Eurostat and IMF staff calculations.

Note: According to ESA2010. 2016 projections include revenues from the bank asset and retail taxes (0.25 percent of GDP) and child benefit allowance (about 1 percent of GDP). 2016 includes one-off revenue receipts of 0.4 percent of GDP from LTE auction (negative acquisition of financial assets as per ESA 2010). Assumes no additional unfunded new spending measures, and reduction in the VAT rate in 2017. Assumes revenues from tax administration beginning in 2018, at 20 percent of the authorities' minimum estimates (increasing from 0.1 percent of GDP in 2018 to 0.35 percent of GDP in 2021). Employee compensation is assumed to grow at the rate of inflation plus a factor of real average wage growth.

1/ Includes grants.

## Table 6. Poland: General Government Financial Balance Sheets, 2013–21

(Millions of zloty)

| | 2013 | | | 2014 | | | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Trans-actions | OEF | Closing Opening balance | Trans-actions | OEF | Closing Opening balance | Projections | | | | | | |
| Net worth and its changes | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... |
| Nonfinancial Assets | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... |
| Net Financial Worth | -65,867 | -2,262 | -584,402 | -56,399 | -16,646 | -657,447 | -701,202 | -667,138 | -733,833 | -797,529 | -854,928 | -912,071 | -968,866 |
| Financial Assets | -5,689 | -3,400 | 555,044 | 173,685 | -123,607 | 605,122 | 627,355 | 634,641 | 642,067 | 654,900 | 668,854 | 682,430 | 696,130 |
| Currency and deposits | -17,564 | -386 | 85,400 | 10,912 | 8,640 | 104,953 | 94,475 | 98,379 | 102,541 | 107,853 | 113,699 | 119,866 | 126,481 |
| Debt securities | 1,255 | 436 | 32,073 | 144,137 | -134,083 | 42,127 | 47,301 | 49,255 | 51,339 | 53,999 | 56,926 | 60,014 | 63,326 |
| Loans | 12,188 | 422 | 51,855 | 12,175 | 728 | 64,757 | 69,800 | 72,684 | 75,759 | 79,684 | 84,003 | 88,560 | 93,447 |
| Equity and inv. fund shares | -9,442 | 25 | 262,260 | 3,474 | 688 | 266,422 | 266,180 | 258,542 | 250,056 | 242,579 | 234,187 | 224,184 | 212,596 |
| Other financial assets | 7,874 | -3,897 | 123,456 | 2,987 | 420 | 126,863 | 149,599 | 155,781 | 162,372 | 170,784 | 180,039 | 189,806 | 200,280 |
| Liabilities | 60,178 | -1,138 | 1,139,446 | 230,084 | -106,961 | 1,262,569 | 1,328,557 | 1,301,779 | 1,375,900 | 1,452,429 | 1,523,782 | 1,594,501 | 1,664,996 |
| Currency and deposits | -358 | -6 | 28,028 | 517 | 59 | 28,604 | 36,846 | 38,368 | 39,992 | 42,064 | 44,343 | 46,749 | 49,329 |
| Debt securities | 33,401 | -1,414 | 793,314 | 45,425 | -116,600 | 722,139 | 757,316 | 706,934 | 755,888 | 800,296 | 836,306 | 869,731 | 900,230 |
| Loans | 24,563 | 706 | 199,711 | 24,853 | 8,232 | 232,796 | 250,571 | 260,925 | 271,964 | 286,054 | 301,557 | 317,915 | 335,460 |
| Other liabilities | 2,572 | -424 | 118,393 | 159,289 | 1,348 | 279,030 | 283,824 | 295,552 | 308,056 | 324,016 | 341,576 | 360,105 | 379,978 |
| *Memorandum items:* | | | | | | | | | | | | | |
| Net financial worth (percent of GDP) | | | -35.3 | | | -38.2 | -39.2 | -35.8 | -37.8 | -39.0 | -39.7 | -40.2 | -40.4 |
| Financial assets (percent of GDP) | | | 33.5 | | | 35.2 | 35.1 | 34.1 | 33.1 | 32.1 | 31.1 | 30.1 | 29.1 |
| Liabilities (percent of GDP) | | | 68.8 | | | 73.4 | 74.2 | 69.9 | 70.8 | 71.1 | 70.7 | 70.2 | 69.5 |
| GDP nominal prices (billion PLN) | | | 1656.3 | | | 1719.1 | 1789.7 | 1863.6 | 1942.5 | 2043.1 | 2153.9 | 2270.7 | 2396.0 |

Sources: National authorities and IMF staff calculations.

**Table 7. Poland: 2013 FSAP Recommendations and Current Status[1]**

| Key Recommendations | Status |
|---|---|
| **Addressing impaired loans:** (i) intensify oversight of credit risk management and restructuring practices; (ii) standardize and enhance transparency of bank accounting practices; and (iii) standardize debt-to-income (DTI) ratio calculation. | The Polish Financial Supervision Authority (KNF) continued oversight of credit risk management and restructuring practices, including by following up on individual recommendations issued after cross-sector inspections of impairment charges in 2013 and the Asset Quality Review (AQR) in 2014. All 15 banks included in the AQR were requested to provide information on the quantitative impact of the implementation of recommendations on impairment charges. KNF found that the AQR, through recommendations to banks, had a significant measurable impact on the level of impairment losses in banks. |
| **Strengthening banking supervision:** (i) expand the scope for the Polish Financial Supervision Authority (KNF) to issue legally binding prudential regulations; (ii) allow KNF's Board to delegate administrative and procedural decisions to its management, increase KNF independence, and address other governance issues; and (iii) increase KNF flexibility to allocate budgetary and staff resources and enhance its analytical capabilities. | In line with the stipulations of the Polish constitution, KNF cannot issue legally binding, general acts (regulations). However, KNF can issue recommendations to banks regarding risk management, specifying how banks should mitigate risk. |
| **Strengthening credit unions:** (i) eliminate the dual supervision; require a solvency ratio of 8 percent in 5 years; and clarify the governance of the stabilization fund; (ii) develop an inclusive set of SKOK regulations and apply accounting principles for financial institutions to SKOKs; and (iii) develop capital rehabilitation plans for financially weak SKOKs. | The dual supervision problem has been solved and presently KNF is the only supervisor of the credit union sector. KNF has continued work to address vulnerabilities, with 33 of 42 credit unions obliged to prepare capital rehabilitation plans. Restructuring has also involved bankruptcy and take-overs by banks. The draft law on the bank resolution framework is awaiting the president's signature. The draft law covers credit unions. Applying accounting principles for financial institutions to SKOKs has been an ongoing process. The current version of the regulation came into force on January 1, 2015. |
| **Developing sound macroprudential policies:** (i) ensure the macroprudential supervisory law provides for Systemic Risk Board's (SRB's) independence (with a leading role for Narodowy Bank Polski (NBP)), accountability to Parliament, and power to make recommendations coupled with an "act or explain" mechanism; and (ii) develop clear macroprudential policy objectives that are distinct from those of monetary and microprudential supervisory policy. | The Act on macroprudential supervision over the financial system and crisis management took effect on November 1, 2015 (some provisions came into force later). It designated the Financial Stability Committee (FSC) as the macroprudential authority in Poland. The FSC consists of 4 members: the Governor of the NBP, the Minister of Finance; the Chairperson of KNF; and the President of the Board of the Bank Guarantee Fund (BFG). The FSC is chaired by the Governor of the NBP in the area of macro-prudential supervision. The FSC has soft powers. Hence, it may issue recommendations backed by the "comply or explain" mechanism and statements highlighting potential sources of systemic risk. The FSC does not have |

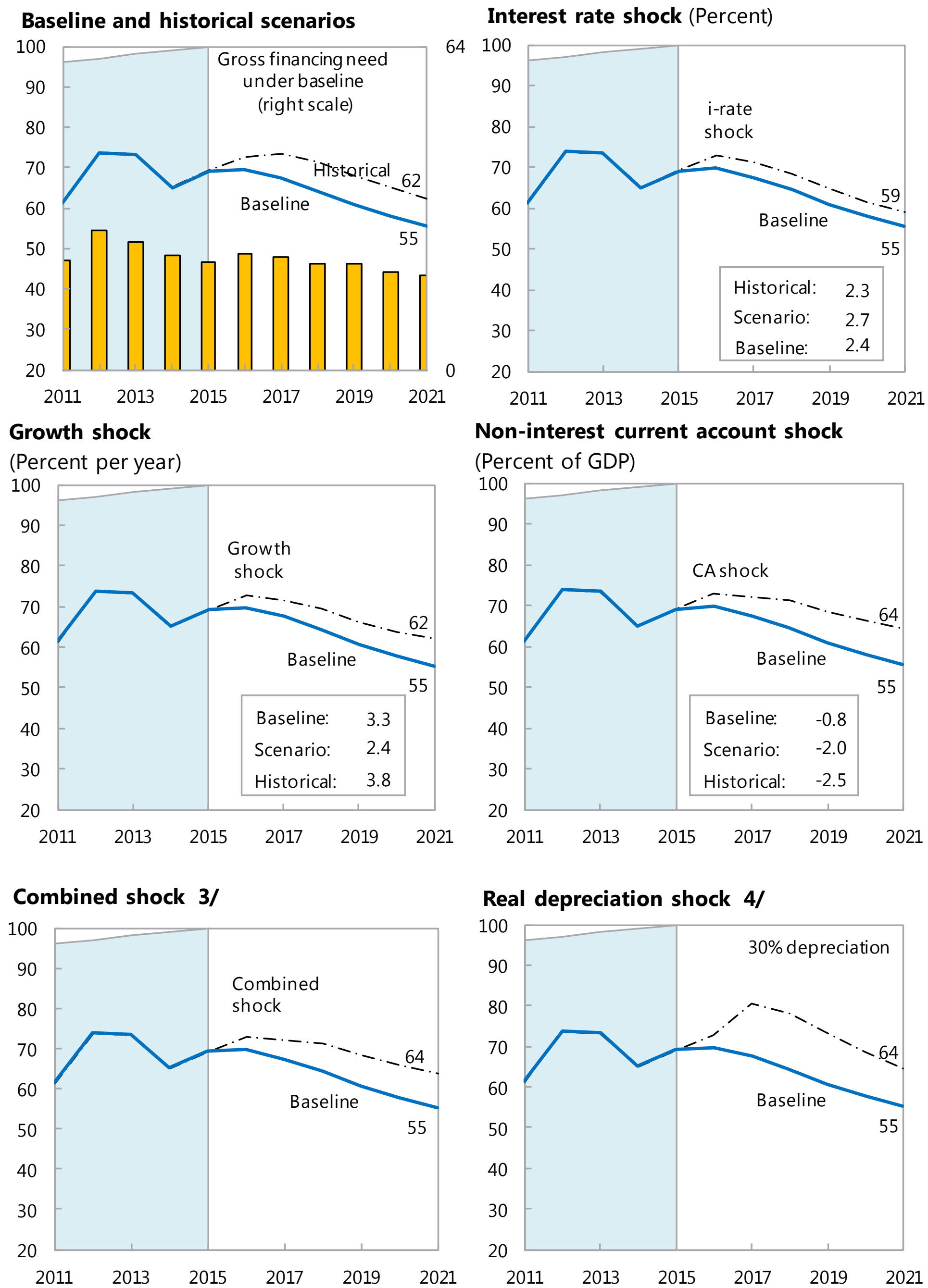
**Table 7. Poland: 2013 FSAP Recommendations and Current Status (concluded)**

| Key Recommendations | Status |
|---|---|
| | power to implement macroprudential tools, which may be implemented by FSC member institutions (the Ministry of Finance and KNF). Accountability is ensured as the Chair is obliged to present an annual report to Parliament. The Act sets a clear macroprudential policy objective, which is to strengthen the resilience of the financial system in case systemic risk materializes, thereby supporting long-term sustainable economic growth. |
| **Improving the bank resolution framework:** (i) ensure precedence of administrative powers over corporate insolvency procedures; (ii) ensure that the creditor claims hierarchy protects BFG's claims on resources provided for balance sheet "gap filling" measures; and (iii) include a Tier-1 capital trigger and link the "public interest" trigger to financial stability. | The draft law is progressing. On May 20, 2016, it was adopted by the Sejm (Lower Chamber). On June 10, it was adopted by the parliament and is currently awaiting the president's signature. The draft law covers issues (i), (ii), and (iii) as indicated by FSAP recommendations. |
| **Improving the deposit insurance system:** (i) remove the Polish Bank Association (PBA) from the BFG Council; (ii) ensure adequate funding and capacity, revise and introduce new regulations, and enhance protocols in light of expanded mandate; and (iii) amend code of conduct to restrict employment in member institutions to all employees. | The draft law on the BFG is progressing. On May 20, 2016, it was adopted by the Sejm. On June 10, it was adopted by the parliament and is currently awaiting the president's signature. The draft law removes PBA from the BFG Council. BFG is continuing to expand and strengthen their staff in accordance with their new tasks. In addition, the proposed target levels of BFG funds are above those established in the Deposit Guarantee Scheme Directive (DGSD) and Bank Recovery and Resolution Directive (BRRD). |
| **Strengthening pension reform and capital markets:** (i) allow lifecycle strategies in pension funds, and measure performance of pension funds in relation to the benchmark portfolio; (ii) amend the mortgage covered bond framework to allow broader issuance and adopt a legal framework for mortgage securitization; (iii) strengthen enforcement of security interests and judicial decisions. | Pension funds do not offer lifecycle strategies. However, in order to protect pension fund assets in the last period of saving before retirement, assets will be transferred gradually to the Social Security Fund, starting 10 years before reaching retirement age. The performance of pension funds is measured relative to an external benchmark.<br>The Act amending the Act on covered bonds and mortgage banks was adopted by Parliament in July 2015. The entry into force of this law on January 1, 2016 removed the main barriers to the development of the covered bond market. The Act of November 8, 2013, amending the Act on Corporate Income Tax, introduced changes (effective of January 1, 2014) in taxation rules aimed at improving the economic effectiveness of securitization by changing the moment banks recognize revenue from the sale of rights to payments from bank receivables securitized through sub-participation. |

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

# Annex I. External Debt Sustainability Analysis

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




Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2016.

## Poland: External Debt Sustainability Framework, 2013–21

| | Actual | | | | | Projections | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2013 | 2014 | 2015 | | | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | |
| | | | | | | **I. Baseline Projections** | | | | | | **Debt-stabilizing non-interest current account 5/** |
| 1 **External debt** | 73.3 | 65.1 | 69.2 | | | **69.7** | **67.4** | **64.3** | **60.7** | **57.8** | **55.4** | **-4.3** |
| 2 Change in external debt | -0.4 | -8.2 | 4.1 | | | 0.5 | -1.7 | -3.1 | -3.6 | -2.9 | -2.4 | |
| 3 Identified external debt-creating flows (4+8+9) | -2.2 | -3.3 | 1.3 | | | -2.4 | -3.6 | -3.5 | -3.0 | -2.6 | -2.3 | |
| 4 Current account deficit, excluding interest payments | -0.3 | 0.4 | -1.4 | | | -0.7 | -0.1 | 0.4 | 0.7 | 0.9 | 2.1 | |
| 5 Deficit in balance of goods and services | -90.8 | -93.7 | -95.9 | | | -97.5 | -101.6 | -103.2 | -104.4 | -105.1 | -106.1 | |
| 6 Exports | 46.3 | 47.5 | 49.3 | | | 50.2 | 51.9 | 52.3 | 52.7 | 52.8 | 53.2 | |
| 7 Imports | -44.5 | -46.2 | -46.5 | | | -47.3 | -49.7 | -50.9 | -51.8 | -52.3 | -52.9 | |
| 8 Net non-debt creating capital inflows (negative) | -1.3 | -2.6 | -1.6 | | | -1.6 | -2.3 | -2.1 | -2.1 | -2.1 | -2.1 | |
| 9 Automatic debt dynamics 1/ | -0.6 | -1.1 | 4.3 | | | -0.2 | -1.3 | -1.9 | -1.6 | -1.5 | -2.3 | |
| 10 Contribution from nominal interest rate | 1.6 | 1.6 | 1.6 | | | 1.3 | 1.4 | 1.6 | 1.7 | 1.7 | 0.7 | |
| 11 Contribution from real GDP growth | -0.9 | -2.3 | -2.7 | | | -2.3 | -2.5 | -2.2 | -1.9 | -1.8 | -1.7 | |
| 12 Contribution from price and exchange rate changes 2/ | -1.3 | -0.4 | 5.4 | | | 0.8 | -0.2 | -1.2 | -1.4 | -1.4 | -1.3 | |
| 13 Residual, incl. change in gross foreign assets (2-3) | 1.8 | -4.8 | 2.8 | | | 2.9 | 1.9 | 0.4 | -0.6 | -0.3 | -0.1 | |
| External debt-to-exports ratio (in percent) | 158.2 | 137.1 | 140.2 | | | 138.7 | 129.9 | 123.0 | 115.3 | 109.4 | 104.1 | |
| **Gross external financing need (in billions of US dollars) 3/** | 133.9 | 123.8 | 101.8 | | | 109.1 | 110.6 | 110.3 | 115.8 | 113.6 | 114.5 | |
| in percent of GDP | 25.5 | 22.7 | 21.4 | 10-Year Historical Average | 10-Year Standard Deviation | 23.0 | 22.5 | 21.2 | 21.0 | 19.4 | 18.6 | |
| **Key Macroeconomic Assumptions** | | | | | | | | | | | | |
| Real GDP growth (in percent) | 1.3 | 3.3 | 3.6 | 3.8 | 1.8 | 3.5 | 3.7 | 3.4 | 3.2 | 3.1 | 3.1 | |
| Exchange rate appreciation (US dollar value of local currency, percent) | 3.0 | 0.1 | -16.3 | 0.4 | 12.0 | -3.9 | -0.5 | 0.6 | 0.4 | 0.5 | 0.0 | |
| GDP deflator in US dollars (change in percent) | 3.4 | 0.6 | -15.9 | 2.7 | 12.6 | -3.4 | 0.0 | 2.3 | 2.6 | 2.8 | 2.3 | |
| Nominal external interest rate (in percent) | 2.3 | 2.3 | 2.2 | 2.3 | 0.6 | 2.0 | 2.2 | 2.5 | 2.8 | 3.0 | 1.3 | |
| Growth of exports (US dollar terms, in percent) | 9.2 | 6.6 | -9.5 | 9.3 | 15.4 | 1.9 | 7.2 | 6.5 | 6.6 | 6.3 | 6.2 | |
| Growth of imports (US dollar terms, in percent) | 3.5 | 8.0 | -12.2 | 9.0 | 19.3 | 1.6 | 9.2 | 8.2 | 7.7 | 7.0 | 6.7 | |
| Current account balance, excluding interest payments | 0.3 | -0.4 | 1.4 | -2.5 | 2.3 | 0.7 | 0.1 | -0.4 | -0.7 | -0.9 | -2.1 | |
| Net non-debt creating capital inflows | 1.3 | 2.6 | 1.6 | 2.5 | 0.8 | 1.6 | 2.3 | 2.1 | 2.1 | 2.1 | 2.1 | |
| **A. Alternative Scenarios** | | | | | | **II. Stress Tests for External Debt Ratio** | | | | | | **Debt-stabilizing non-interest current account 5/** |
| A1. Key variables are at their historical averages in 2016-2021 4/ | | | | | | **72.7** | **73.5** | **71.3** | **68.0** | **65.1** | **62.3** | **-5.0** |
| **B. Bound Tests** | | | | | | | | | | | | |
| B1. Nominal interest rate is at baseline plus one-half standard deviation | | | | | | 72.7 | 71.4 | 68.2 | 64.5 | 61.4 | 58.8 | -4.5 |
| B2. Real GDP growth is at baseline minus one-half standard deviations | | | | | | 72.7 | 71.6 | 69.6 | 66.3 | 63.5 | 62.2 | -3.2 |
| B3. Non-interest current account at baseline minus one-half standard deviations | | | | | | 72.7 | 72.0 | 71.2 | 68.4 | 66.2 | 64.3 | -4.8 |
| B4. Combination of B1-B3 using 1/4 standard deviation shocks | | | | | | 72.7 | 72.0 | 71.1 | 68.2 | 65.9 | 63.9 | -4.4 |
| B5. One time 30 percent real depreciation in 2017 | | | | | | 72.7 | 80.6 | 78.0 | 73.0 | 68.6 | 64.5 | -5.6 |

Source: IMF staff calculations.

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

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

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

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

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

# Annex II. Public Sector Debt Sustainability Analysis

*Public debt was moderately high at 51.3 percent of GDP at the end of 2015, but sustainable. The profile of public debt appears robust to interest, rollover, and foreign currency risks. 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, although composition of the investor base is a mitigating factor.*

## A. Baseline and Realism of Projections

**Debt levels**. Debt is projected to increase by 1.9 percentage points of GDP between 2015 and 2018, before declining by 1.6 percentage points of GDP to 51.6 percent of GDP by 2021. Debt dynamics are driven by the primary deficit, which initially increases before taking a declining path in 2018. A favorable differential between projected GDP growth and the real interest rate also contributes to a decrease in debt levels.

**GDP growth.** The projections assume an acceleration of growth to 3.7 percent by 2017 with increasing private consumption, and a subsequent slowdown to 3.1 percent as output trends back toward potential. The output gap is expected to close this year. In recent years, staff projections of growth have displayed small forecast errors, with some indication of a pessimistic bias relative to other countries.

**Fiscal adjustment**. Under the baseline, the primary deficit is expected to increase to 1.4 percent of GDP by 2017, before declining to 0.4 percent of GDP by 2021. The dynamics reflect the government's expansionary fiscal stance in 2017, and thereafter nominal GDP growth that outpaces government consumption and increases in social security benefits over the medium term. 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 3.7 percent in 2015, reflecting Poland's strong fundamentals and favorable global financial conditions. The effective interest rate is projected at 3.5 percent in 2016, and maintains a similar level in the medium term. Yields on 10–year bonds have increased by 25 basis points year-to-date to 3.2 percent, and spreads of Polish euro-denominated bonds over 10–year German bonds have increased to 110 basis points, reflecting higher market risk. CDS spreads increased by 10 basis points year-to-date to 82 basis points.

**Maturity and rollover risks**. Rollover risks are well managed. The average maturity of outstanding debt is 5.4 years, and the share of short-term debt in total government debt is under 1 percent as of May 2016. T-bill issuance resumed in January 2016, following a period since August 2013 when there were no outstanding t-bills. Currently, 68 percent of gross borrowing requirements for 2016 have been pre-financed, taking advantage of favorable market conditions. Treasury securities held by domestic banks, which are exempt from the authorities' new bank asset tax, increased by almost 5 percent of GDP over January to March 2016, compared to an increase of 1.3 percent over the same period in 2015. The share of foreign investors in the domestic treasury market decreased from 38 percent in January to 35 percent in March 2016. The overall share of external debt in total public debt was about 57 percent as of Q4 2015. In addition, the share of foreign currency debt in state debt is about 34 percent as of February 2016. 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 (about 30 percent) and external debt in total debt (about 50 percent).

**Debt sustainability analysis (DSA) risk assessment**. The heat map highlights risks associated with the relatively large external financing requirements (about 22 percent of GDP in 2015), and the share of public debt held by non-residents (about 57 percent at end-2015). The latter is influenced by the large participation of foreign investors in the domestic bond market. U.S. investors comprise 25 percent of foreign investors, exposing the bond market to liquidity risks in case of interest rate hikes in the U.S.

**Fan charts**. The symmetric fan charts, which assume symmetric upside and downside risks, indicate that the debt-to-GDP ratio could drop to below 50 percent by 2020 with a 25 percent probability. On the other hand, the upper bands indicate that debt-to-GDP ratios could surpass 60 percent by 2020 with a 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 60 percent in 2020 to 50 percent. This result illustrates the degree of uncertainty around the baseline.

## B. Shocks and Stress Tests

**Primary balance shock**. An assumed deterioration in the primary balance by one percentage point during 2016 pushes the public debt-to-revenue ratio up to about 140 percent during 2018. Gross financing needs peak at about 10.4 percent of GDP in 2017 and converge to the baseline by 2021.

**Growth shock**. The stress scenario assumes a drop in GDP growth by about 1.8 percentage points in two consecutive years (2017–18) relative to the baseline, combined with a 0.5 percentage point drop in inflation and deterioration in the primary balance by 1.4 percent in 2017 and further by 0.6 percent in 2018. Under these assumptions, public debt increases to about 58.4 percent of GDP in 2018 before trending downward to about 56.7 percent of GDP by 2021. Gross financing needs increase to about 11 percent of GDP during 2017–18, but then converge toward the baseline in the outer years.

**Interest rate shock**. A permanent 250 bps increase in the nominal interest rate starting in 2017 (equivalent to the difference between the maximum real interest rate during 2004–14 and the average real interest rate over the projection period), leads to an increase in the effective interest rate on debt by 45 bps in 2018 (compared to the baseline) and further gradual increases to 148 bps by 2021. Under this scenario, public debt increases by 1.9 percentage points relative to the baseline by 2021.

**Exchange rate shock.** This scenario assumes an exchange rate depreciation of about 20 percent in 2017 (from 3.9 PLN/US$ to 4.7 PLN/US$), calibrated to emulate the maximum historic movement of the FX rate over the last 10 years. Under this scenario, gross public debt increases by 1 percentage point to 54 percent of GDP in 2018 before trending down to about 52.3 percent by 2021. The resilience reflects the predominance of public debt in local currency.

**Combined shock**. Under the combined shock, the public-debt-to-GDP ratio jumps to 62.2 percent in 2017 and maintains that level until 2021. In turn, gross financing needs increase to 11.5 percent of GDP in 2017, and trend downwards to around 9 percent of GDP in the outer years.

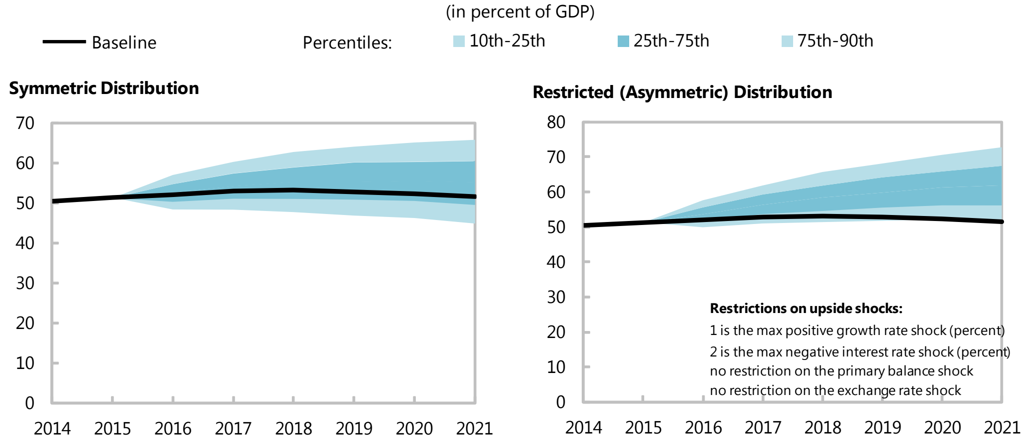
## Poland: Public Sector Debt Sustainability Analysis (DSA)—Risk Assessment

### Heat Map

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

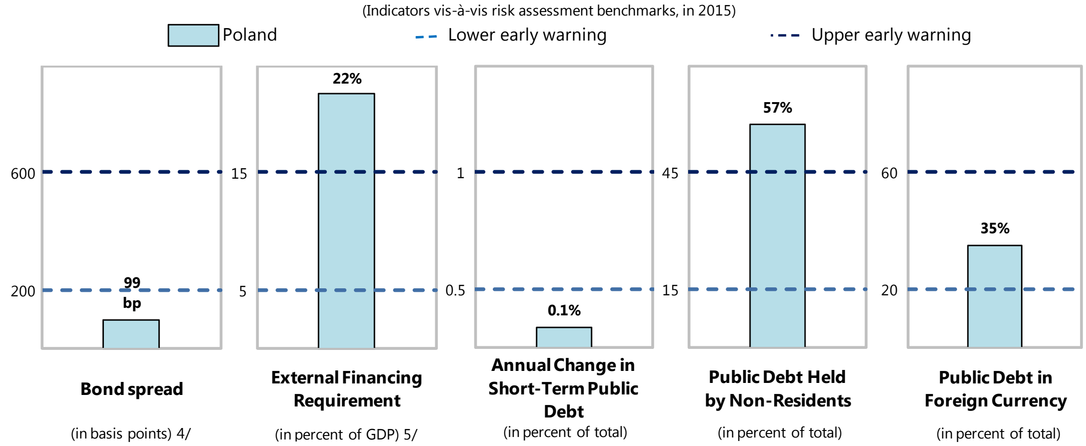
### Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)




### Debt Profile Vulnerabilities

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




Source: IMF staff.

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

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

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

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

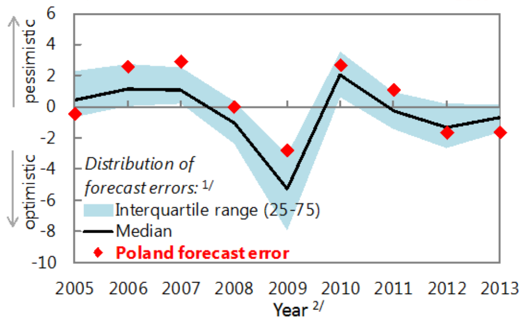
4/ Long-term spread of Polish euro-denominated bonds over German bonds, an average over the last 3 months, until June 8, 2016.

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

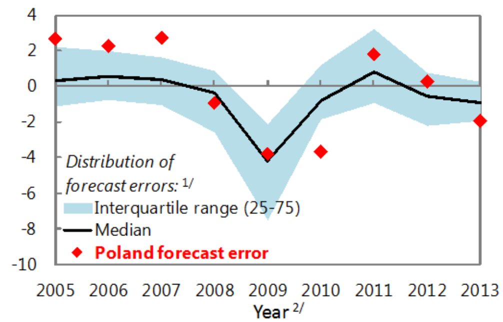
## Poland: Public DSA—Realism of Baseline Assumptions

### Forecast Track Record, versus all countries

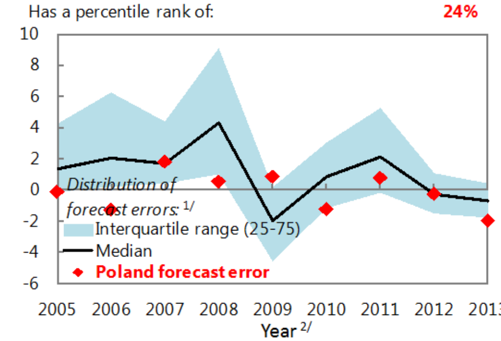
**Real GDP Growth**
(in percent, actual-projection)
Poland median forecast error, 2005-2013: 0.00
Has a percentile rank of: 55%




**Primary Balance**
(in percent of GDP, actual-projection)
Poland median forecast error, 2005-2013: 0.26
Has a percentile rank of: 68%

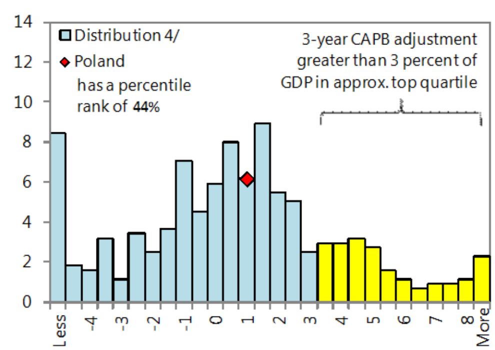



**Inflation (Deflator)**
(in percent, actual-projection)
Poland median forecast error, 2005-2013: -0.12
Has a percentile rank of: 24%

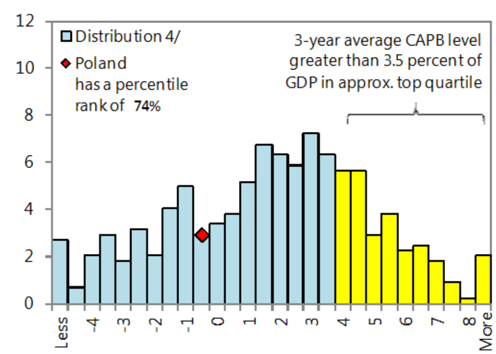



### Assessing the Realism of Projected Fiscal Adjustment

**3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)**
(Percent of GDP)

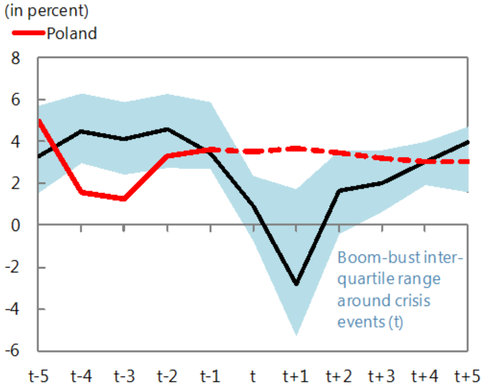



**3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)**
(Percent of GDP)




### Boom-Bust Analysis 3/

**Real GDP growth**
(in percent)




Source : IMF Staff.
1/ Plotted distribution includes all countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Poland has had a negative output gap for 3 consecutive years, 2013-2015. For Poland, t corresponds to 2016; for the distribution, t corresponds to the first year of the crisis..
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

## Poland: Public DSA—Baseline Scenario

(Percent of GDP, unless otherwise indicated)

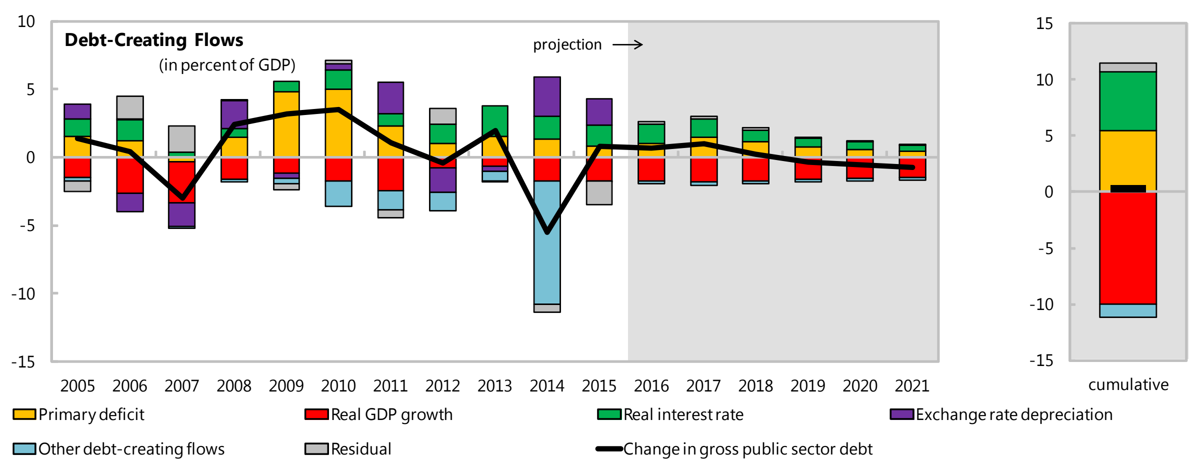
### Debt, Economic and Market Indicators [1/]

| | Actual | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2005-2013 [2/] | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
| Nominal gross public debt | 50.2 | 50.5 | 51.3 | 51.9 | 52.9 | 53.2 | 52.8 | 52.3 | 51.6 |
| Public gross financing needs | 13.7 | 8.3 | 7.8 | 9.0 | 9.5 | 8.7 | 8.7 | 7.8 | 7.1 |
| Real GDP growth (in percent) | 3.9 | 3.3 | 3.6 | 3.5 | 3.7 | 3.4 | 3.2 | 3.1 | 3.1 |
| Inflation (GDP deflator, in percent) | 2.7 | 0.5 | 0.4 | 0.6 | 0.5 | 1.7 | 2.1 | 2.3 | 2.4 |
| Nominal GDP growth (in percent) | 6.7 | 3.8 | 4.1 | 4.1 | 4.2 | 5.2 | 5.4 | 5.4 | 5.5 |
| Effective interest rate (in percent) [4/] | 5.3 | 3.6 | 3.7 | 3.5 | 3.4 | 3.4 | 3.4 | 3.4 | 3.4 |

| As of June 08, 2016 | | |
|---|---|---|
| Sovereign Spreads | | |
| EMBIG (bp) 3/ | | 110 |
| 5Y CDS (bp) | | 82 |
| Ratings | Foreign | Local |
| Moody's | A2 | A2 |
| S&Ps | BBB+ | A- |
| Fitch | A- | A |

### Contribution to Changes in Public Debt

| | Actual | | | Projections | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2005-2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | cumulative | debt-stabilizing primary balance [10/] |
| Change in gross public sector debt | 1.2 | -5.5 | 0.8 | 0.7 | 1.0 | 0.3 | -0.3 | -0.5 | -0.7 | 0.3 | |
| Identified debt-creating flows | 0.8 | -4.9 | 2.5 | 0.5 | 0.8 | 0.0 | -0.4 | -0.6 | -0.8 | -0.6 | |
| Primary deficit | 2.1 | 1.4 | 0.8 | 1.0 | 1.4 | 1.1 | 0.8 | 0.6 | 0.4 | 5.4 | -1.2 |
| Primary (noninterest) revenue and grants | 39.6 | 38.9 | 38.9 | 39.2 | 39.0 | 39.1 | 39.2 | 39.2 | 39.2 | 234.9 | |
| Primary (noninterest) expenditure | 41.6 | 40.2 | 39.7 | 40.2 | 40.4 | 40.2 | 40.0 | 39.8 | 39.6 | 240.3 | |
| Automatic debt dynamics [5/] | -0.5 | 2.8 | 1.7 | -0.3 | -0.4 | -0.9 | -1.0 | -1.0 | -1.1 | -4.7 | |
| Interest rate/growth differential [6/] | -0.6 | -0.1 | -0.2 | -0.3 | -0.4 | -0.9 | -1.0 | -1.0 | -1.1 | -4.7 | |
| Of which: real interest rate | 1.2 | 1.7 | 1.6 | 1.4 | 1.4 | 0.8 | 0.6 | 0.5 | 0.5 | 5.2 | |
| Of which: real GDP growth | -1.7 | -1.8 | -1.8 | -1.7 | -1.8 | -1.7 | -1.6 | -1.5 | -1.5 | -10.0 | |
| Exchange rate depreciation [7/] | 0.0 | 2.9 | 1.9 | … | … | … | … | … | … | … | |
| Other identified debt-creating flows | -0.7 | -9.1 | 0.0 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -1.2 | |
| Privatization (+ reduces financing needs) (negative) | -0.6 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Contingent liabilities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Liabilities not included in debt [8/] | -0.1 | -9.3 | 0.0 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -1.2 | |
| Residual, including asset changes [9/] | 0.4 | -0.6 | -1.7 | 0.2 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 0.8 | |




Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

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

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

5/ Derived as [(r - 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.

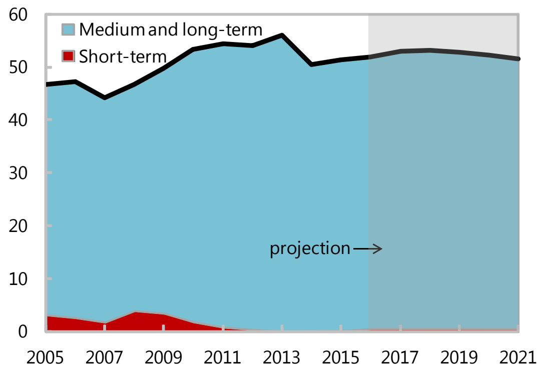
9/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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.

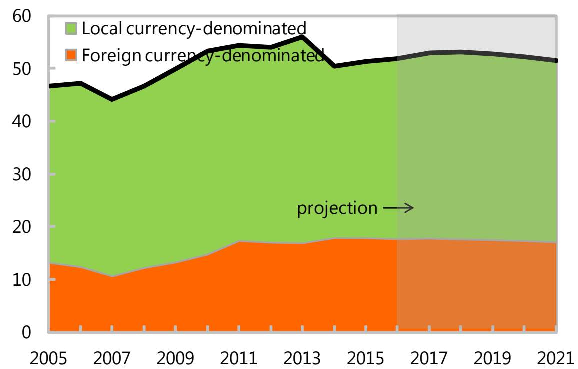
## Poland: Public DSA—Composition of Public Debt and Alternative Scenarios

### Composition of Public Debt

**By Maturity**
(in percent of GDP)



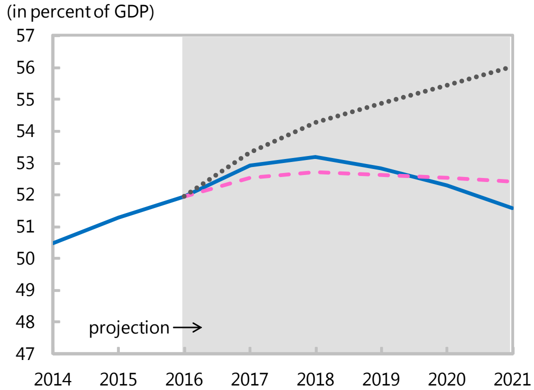

**By Currency**
(in percent of GDP)



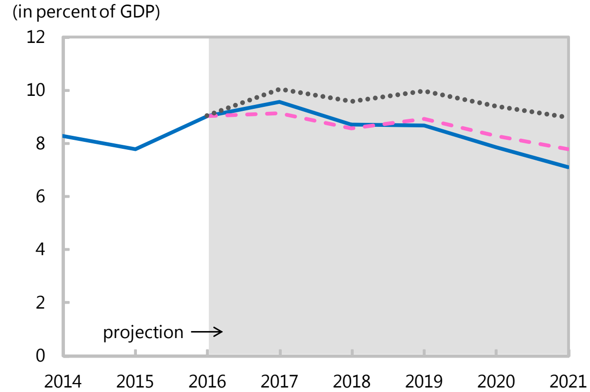

### Alternative Scenarios

Baseline    Historical    Constant Primary Balance

**Gross Nominal Public Debt**
(in percent of GDP)




**Public Gross Financing Needs**
(in percent of GDP)




### Underlying Assumptions
(in percent)

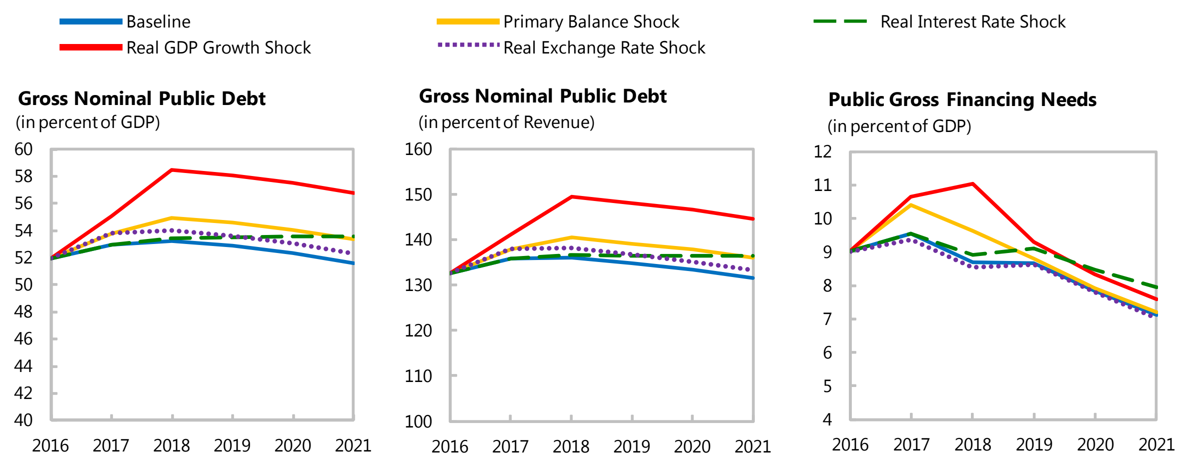
| Baseline Scenario | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|
| Real GDP growth | 3.5 | 3.7 | 3.4 | 3.2 | 3.1 | 3.1 |
| Inflation | 0.6 | 0.5 | 1.7 | 2.1 | 2.3 | 2.4 |
| Primary Balance | -1.0 | -1.4 | -1.1 | -0.8 | -0.6 | -0.4 |
| Effective interest rate | 3.5 | 3.4 | 3.4 | 3.4 | 3.4 | 3.4 |
| **Constant Primary Balance Scenario** | | | | | | |
| Real GDP growth | 3.5 | 3.7 | 3.4 | 3.2 | 3.1 | 3.1 |
| Inflation | 0.6 | 0.5 | 1.7 | 2.1 | 2.3 | 2.4 |
| Primary Balance | -1.0 | -1.0 | -1.0 | -1.0 | -1.0 | -1.0 |
| Effective interest rate | 3.5 | 3.4 | 3.4 | 3.4 | 3.4 | 3.4 |

| Historical Scenario | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|
| Real GDP growth | 3.5 | 3.8 | 3.8 | 3.8 | 3.8 | 3.8 |
| Inflation | 0.6 | 0.5 | 1.7 | 2.1 | 2.3 | 2.4 |
| Primary Balance | -1.0 | -1.9 | -1.9 | -1.9 | -1.9 | -1.9 |
| Effective interest rate | 3.5 | 3.4 | 3.5 | 3.7 | 3.8 | 3.9 |

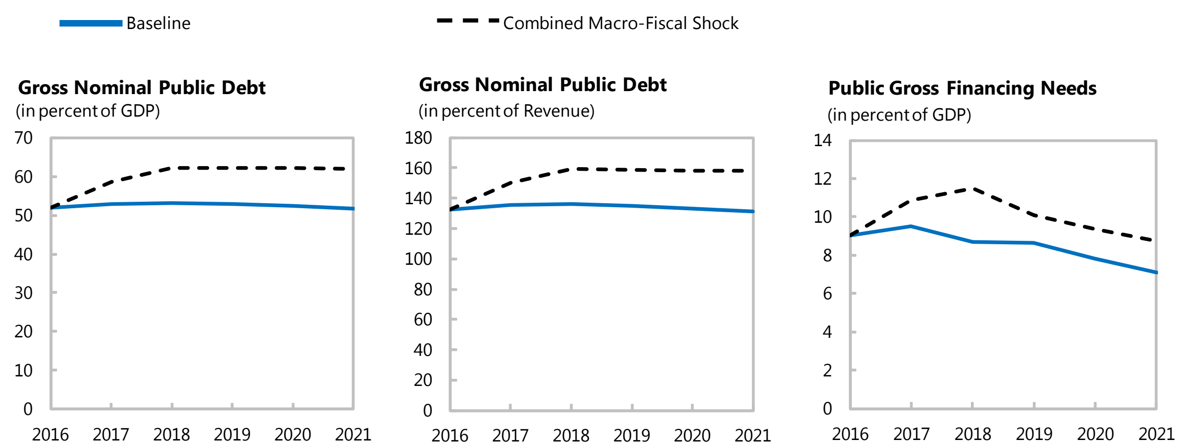
Source: IMF staff.

## Poland: Public DSA—Stress Tests

### Macro-Fiscal Stress Tests




### Additional Stress Tests




### Underlying Assumptions

(in percent)

| **Primary Balance Shock** | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|
| Real GDP growth | 3.5 | 3.7 | 3.4 | 3.2 | 3.1 | 3.1 |
| Inflation | 0.6 | 0.5 | 1.7 | 2.1 | 2.3 | 2.4 |
| Primary balance | -1.0 | -2.3 | -2.0 | -0.8 | -0.6 | -0.4 |
| Effective interest rate | 3.5 | 3.4 | 3.4 | 3.5 | 3.5 | 3.5 |
| **Real Interest Rate Shock** | | | | | | |
| Real GDP growth | 3.5 | 3.7 | 3.4 | 3.2 | 3.1 | 3.1 |
| Inflation | 0.6 | 0.5 | 1.7 | 2.1 | 2.3 | 2.4 |
| Primary balance | -1.0 | -1.4 | -1.1 | -0.8 | -0.6 | -0.4 |
| Effective interest rate | 3.5 | 3.4 | 3.8 | 4.2 | 4.6 | 4.9 |
| **Combined Shock** | | | | | | |
| Real GDP growth | 3.5 | 1.8 | 1.6 | 3.2 | 3.1 | 3.1 |
| Inflation | 0.6 | 0.1 | 1.2 | 2.1 | 2.3 | 2.4 |
| Primary balance | -1.0 | -2.4 | -3.0 | -0.8 | -0.6 | -0.4 |
| Effective interest rate | 3.5 | 3.5 | 3.8 | 4.2 | 4.5 | 4.8 |

| **Real GDP Growth Shock** | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|
| Real GDP growth | 3.5 | 1.8 | 1.6 | 3.2 | 3.1 | 3.1 |
| Inflation | 0.6 | 0.1 | 1.2 | 2.1 | 2.3 | 2.4 |
| Primary balance | -1.0 | -2.4 | -3.0 | -0.8 | -0.6 | -0.4 |
| Effective interest rate | 3.5 | 3.4 | 3.4 | 3.5 | 3.5 | 3.5 |
| **Real Exchange Rate Shock** | | | | | | |
| Real GDP growth | 3.5 | 3.7 | 3.4 | 3.2 | 3.1 | 3.1 |
| Inflation | 0.6 | 5.5 | 1.7 | 2.1 | 2.3 | 2.4 |
| Primary balance | -1.0 | -1.4 | -1.1 | -0.8 | -0.6 | -0.4 |
| Effective interest rate | 3.5 | 3.5 | 3.3 | 3.3 | 3.3 | 3.3 |

Source: IMF staff.

INTERNATIONAL MONETARY FUND

# REPUBLIC OF POLAND

## STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

June 10, 2016

Prepared By European Department

## CONTENTS

# FUND RELATIONS

(As of April 30, 2016)

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

**General Resources Account:**

| | SDR Million | Percent Quota |
|---|---|---|
| Quota | 4,095.40 | 100.00 |
| Fund Holdings of Currency | 3,865.88 | 94.40 |
| Reserve Tranche Position | 229.52 | 5.60 |
| Lending to the Fund | | |
| New Arrangement to Borrow | 227.51 | |

**SDR Department:**

| | SDR Million | Percent Allocation |
|---|---|---|
| Net Cumulative Allocation | 1,304.64 | 100.00 |
| Holdings | 313.06 | 24.00 |

**Outstanding Purchases and Loans:** None

**Latest Financial Arrangements:**

**In Millions of SDR**

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

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

| | Forthcoming | | | | |
|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2019 | 2020 |
| Principal | | | | | |
| Charges/Interest | 0.38 | 0.54 | 0.54 | 0.54 | 0.54 |
| **Total** | 0.38 | 0.54 | 0.54 | 0.54 | 0.54 |

**Exchange Arrangements:**

The zloty is freely floating.

Poland accepted the obligation of Article VIII, Sections 2, 3, and 4 on June 1, 1995. Poland maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions, except for the exchange restrictions imposed by Poland solely for the preservation of national or international security as introduced by the European Union (EU) within the framework of the Common Foreign and Security Policy. The consolidated list of such sanctions is available at: http://eeas.europa.eu/cfsp/sanctions/consol-list/index_en.htm.

**Article IV Consultation:**

The last Article IV consultation was concluded on July 10, 2015. In concluding the consultation, Directors welcomed Poland's recovery from the 2012–13 slowdown, supported by very strong economic fundamentals and policies, which paved the way for continued robust growth and further integration with European and global markets. They added that Poland's strong policy framework has increased the economy's resilience but observed that downside risks to the outlook remain. Directors noted that the precautionary FCL arrangement continued to provide important temporary insurance against external risks. On monetary policy, Directors welcomed the March policy interest rate cut, which should help limit the risk of prolonged low inflation and agreed that there could be a need to ease monetary policy further if inflation expectations continue to disappoint. Directors recommended moderate reserve accumulation to strengthen the resilience to shocks. With respect to the financial sector, Directors commended the continued strong performance of the banking sector and welcomed the new bankruptcy and insolvency law and encouraged the authorities to expedite implementation of other key financial sector reforms, including the adoption of comprehensive macroprudential and bank resolution frameworks. They supported the authorities' case-by-case approach to restructuring distressed Swiss franc-denominated mortgages. On fiscal policy, Directors considered that continued gradual consolidation would create additional policy space to allow for a timely and effective response to shocks without unduly weighing on growth. In this regard, they agreed that the medium-term objective of a structural deficit of 1 percent of GDP remained appropriate, and encouraged the authorities to identify specific expenditure savings and reduce the large VAT revenue gap to ensure that this objective be met. Directors commended that continued efforts to raise spending efficiency and reform of the special pension schemes would help address fiscal pressures from population aging. Directors encouraged the authorities to continue to implement structural reforms to boost productivity, safeguard competitiveness, and allow the economy to move up the value-added chain, thereby facilitating income convergence.

**Resident Representative:**

Mr. Bas Bakker replaced Mr. James Roaf as the Senior Regional Resident Representative for Central and Eastern Europe, effective August 4, 2015.

**Republic of Poland: Technical Assistance from the Fund, 1992–2016**

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

**Republic of Poland: Technical Assistance from the Fund, 1992–2016 (continued)**

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

**Republic of Poland: Technical Assistance from the Fund, 1992–2016 (concluded)**

| Department | Subject/Identified Need | Action | Date | Counterpart |
|---|---|---|---|---|
| IMF/IBRD | FSAP Update | Mission | April/May 2006 | MoF/NBP |
| FAD | Developing a multi-annual fiscal framework | Mission | June 2008 | MoF |
| STA | Errors and omissions in balance of payments accounts | Mission | July 2009 | NBP |
| FAD | Medium-term fiscal framework | Mission | April 2010 | MoF |
| MCM | Detailed assessment of observance of BCP for effective banking supervision | Mission | Feb/March 2011 | KNF |
| STA | Errors and omissions in balance of payments accounts | Mission | June 2011 | NBP |
| FAD | Developing the fiscal regime for oil and gas | Mission | April 2012 | MoF |
| MCM | Macroprudential framework | Mission | May 2012 | NBP |
| IMF/WB | FSAP update | Mission | Feb/March 2013 | MoF/ KNF/NBP |
| FAD | Tax administration—Modernization challenges and strategic priorities | Mission | November 2014 | MoF |
| MCM | Bank Resolution | Mission | March 2016 | BFG |

# STATISTICAL ISSUES

**Poland—Statistical Issues Appendix**
**(As of March 2016)**

## I. Assessment of Data Adequacy for Surveillance

**General**: Data provision is adequate for surveillance.

**National Accounts**: The Central Statistical Office (GUS) compiles and disseminates annual and quarterly GDP by production and expenditure approaches, both at current and previous year's prices following the *2008 SNA* and *ESA 2010*. A supply and use table is only available for the year 2010. Quarterly financial accounts of general government sector are compiled by the Central Statistical Office (GUS). Annual and quarterly financial accounts by institutional sectors are compiled by Narodowy Bank Polski (NBP) following the *ESA 2010* standards and disseminated regularly on its website according to an advance release calendar: the annual financial accounts on the 20th of October the following year and quarterly financial accounts on the 20th calendar day of the 4th month following the end of the reference quarter (i.e., on the 20th of January, April, July, and October).

**Price Statistics**: The consumer price index does not cover imputed rents of owner-occupied dwellings. The scope of the index covers all resident households, except those in some rural areas. The producer price index does not include any estimation for missing prices; quality and seasonal adjustment techniques are also not implemented.

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

Starting in 2015 (annual data for 2014), GUS is responsible for collecting, processing, and disseminating annual government finance statistics. The data are compiled according to European System of Accounts (ESA2010) and adjusted to GFS Manual 2014. The annual reports cover presentation of fiscal data on operations of the general government sector divided by central government, local government, and social security funds. Revenue and expense are divided by transactions. Financing is classified by sector and by type of debt instrument. General government data are released on a quarterly basis, derived from detailed ESA data. Monthly and annual data are regularly disseminated on the SDDS website. Data for 2013 were prepared by the Ministry of Finance according to GFS2001, while data for 2014 were prepared by the Central Statistical Office according to GFSM2014.

## I. Assessment of Data Adequacy for Surveillance (concluded)

**Monetary and Financial Statistics**: Beginning with data for January 2004, the NBP provides the European Central Bank (ECB) with monetary accounts in accordance with the ECB's framework for monetary statistics using the national residency approach. Data on other financial corporations (OFC) are currently not available. An earlier Report on the Observance of Standards and Codes (ROSC) mission recommended that the NBP, in cooperation with the MoF, reconcile monetary and government finance statistics and carry out a reconciliation exercise on a regular basis.

**Financial Sector Surveillance**: In November 2009, NBP in cooperation with GUS, the Polish Financial Supervision Authority (KNF) and MoF began reporting financial soundness indicators (FSI) based on the IMF's *Financial Soundness Indicators Compilation Guide*. Poland is currently reporting all core FSIs and 19 of the 28 encouraged FSIs on a quarterly basis with a lag of approximately one quarter. NBP also implemented EU regulation 680/2014, which covers supervisory reporting defined by the Implementing Technical Standards (ITS) prepared by the European Banking Authority. The first data was collected for March 2014 for own funds and liquidity related reporting. Financial reporting on a consolidated basis according to the ITS scheme was reported for the first time for September 2014.

**External Sector Statistics**: Largely to improve data accuracy, the NBP fully depends on survey-based source data, starting in the first quarter of 2010. STA undertook an evaluation mission to Poland in July 2009, and followed up in June 2011 to assess further data improvements and anticipated revisions in the external sector accounts. Due to the comprehensive work on improving the data sources, the errors and omissions reduced from 4 percent of GDP in 2004 to around 2 percent of GDP in recent years, which is comparable to the level in other European countries. Authorities are committed to further improving the compilation system for the external sector statistics.

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

Poland reports Coordinated Direct Investment Survey and Coordinated Portfolio Investment Survey data to the IMF.

## II. Data Standards and Quality

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

Data ROSC was published in 2003.

| Republic of Poland: Table of Common Indicators Required for Surveillance–as of May 31, 2016 | | | | | | | |
|---|---|---|---|---|---|---|---|
| | Date of latest observation | Date received | Frequency of data[7] | Frequency of reporting[7] | Frequency of publication[7] | Memo Items: | |
| | | | | | | Data Quality – Methodological soundness[8] | Data Quality Accuracy and reliability[9] |
| Exchange Rates | 5/31/2016 | 5/31/2016 | D | D | D | | |
| International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1] | 4/2016 | 5/20/2016 | M | M | M | | |
| Reserve/Base Money | 4/2016 | 5/6/2016 | M | M | M | O, LO, O, LO | O, O, O, O, O |
| Broad Money | 4/2016 | 5/13/2016 | M | M | M | | |
| Central Bank Balance Sheet | 4/2016 | 5/6/2016 | M | M | M | | |
| Consolidated Balance Sheet of the Banking System | 4/2016 | 5/13/2016 | M | M | M | | |
| Interest Rates[2] | 5/31/2016 | 5/31/2016 | D | D | D | | |
| Consumer Price Index | 4/2016 | 5/12/2016 | M | M | M | O, O, O, O | O, O, O, O, O |
| Revenue, Expenditure, Balance, and Composition of Financing[3] – General Government[4] | Q4/2015 | 5/20/2016 | A | A | A | LO, O, O, O | O, O, O, O, NA |
| Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government | 3/2016 | 5/20/2016 | M | M | M | | |
| Stocks of Central Government and Central Government-Guaranteed Debt[5] | 3/2016 | 5/20/2016 | M | M | M | | |
| External Current Account Balance | 3/2016 | 5/13/2016 | M | M | M | O, O, O, LO | O, O, O, O, LO |
| Exports and Imports of Goods and Services | 3/2016 | 5/13/2016 | M | M | M | | |
| GDP/GNP | Q1/2016 | 5/31/2016 | Q | Q | Q | O, LO, O, O | LO, LO, O, O, LO |
| Gross External Debt | Q4/2015 | 3/31/2016 | Q | Q | Q | | |
| International Investment Position[6] | Q4/2015 | 3/31/2016 | Q | Q | Q | | |

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

**Statement by the IMF Staff Representative**
**June 27, 2016**

1. **This statement provides information that has become available since the Staff Report was circulated to the Executive Board on June 14, 2016**. The information does not alter the thrust of the staff appraisal.

2. **The authorities recently indicated that although they will support legislation later in the year that would reverse the 2013 retirement age increases and increase the constitutional court-mandated personal income tax (PIT) tax-free allowance, these changes are unlikely to take effect before 2018**. This will postpone the fiscal impact of the retirement age increase, about 0.5 percent of GDP per annum, by one year. The government will also reform the PIT framework to introduce a unified tax on income, and social security and health contributions. The staff report accounts for these measures as fiscal risks that are not included in the baseline projections.

**Statement by Ludwik Kotecki, Alternate Executive Director for Republic of Poland and Joanna Osinska, Advisor to Executive Director**
**June 27, 2016**

On behalf of our Polish authorities, we would like to thank staff for constructive consultations held in Warsaw and an interesting set of papers. Poland has continued to enjoy a strong economic growth, while strengthening its policy buffers. The fiscal deficit dropped to 2.6 percent of GDP in 2015, which was a better outcome than expected. The current account deficit and unemployment rate reached historically low levels. The financial sector remains sound and resilient. Inflation, driven mostly by external factors, is still subdued. A new government, which took office in November 2015, is focused on supporting a strong and inclusive growth while maintaining the sustainability of public finance. Overall, the outlook is for a robust growth and a gradual return of inflation towards the target over the medium term.

**Economic Outlook**

Poland's real GDP grew by 3.6 percent in 2015. Domestic demand remained the key source of that growth, with private consumption supported by higher disposable income (declining prices coupled with growing wages) and decreasing unemployment. Also, a healthy credit expansion, accommodative financial conditions and a relatively high competitiveness of Polish companies helped support private investment. Poland continues to rank favorably in terms of economic growth among the EU countries.

The economic growth is expected to remain strong. It is forecast to accelerate to 3.8 percent in 2016, and to increase gradually thereafter to 4.1 percent in 2019. Growth will be supported, among others, by an increased inflow of the EU structural funds. Poland is set to be the biggest beneficiary of the European multi-annual financial framework for the years 2014-2020.

Along with the stronger economic growth, unemployment has been steadily declining and it reached a historically low level of 6.3 percent in March/April 2016. Notably, this is well below the EU average and it constitutes the lowest level since the beginning of economic transition in Poland in the early 1990s.

**External Sector**

In 2015, the current account (CA) deficit—at 0.2 percent of GDP—reached its lowest level in two decades. This was mainly due to a record high trade surplus, reflecting lower oil prices and improved terms-of-trade. In the recent quarters, exports have been supported by an increase in the economic activity in other EU countries. At the same time, imports have recently strengthened due to an improvement of dynamics of domestic demand. This has only been partially mitigated by the positive effect of lower oil prices. The overall external position in 2015 was consistent with fundamentals and desirable policies. The CA deficit continues to be comfortably covered by the capital account surplus, driven mainly by the inflow of the EU funds.

The official foreign reserves remain broadly adequate at about 107 percent of the IMF's modified composite reserve adequacy metric, as of end-2015. Their level has further slightly increased since the beginning of the year, in both EUR and USD-terms, to around 97 and 108 billion, respectively, at end-May. In addition, Poland continues to benefit from the precautionary Flexible Credit Line (FCL) arrangement with the Fund, since January this year with a further lowered level of access—in line with the authorities' request and their exit strategy. The FCL provides a valuable added insurance against adverse external shocks.

**Fiscal Policy**

The new government's priority objective is to promote strong and inclusive economic growth while pursuing fiscal policy within the constraints of the domestic and the EU fiscal rules. The general government deficit is expected to remain at 2.6 percent of GDP this year (unchanged from 2015), to increase to 2.9 in 2017, and to decrease gradually thereafter to 1.3 percent of GDP in 2019. The authorities reiterate their commitment to keeping the deficit below 3 percent of GDP in line with EU framework, and obeying the domestic expenditure rule. The latter should also ensure keeping the general government debt significantly below the 60 percent of GDP threshold—at end-2015 it amounted to 51.3 percent of GDP.

The government's flagship social scheme is the new family support program *Family 500 plus*, implemented from April 2016 onwards. The program is intended to facilitate an increase in the fertility rate and support disposable incomes of families with children. This should help counter unfavorable demographic trends, improve future labor supply and strengthen growth potential over the longer term. The program would also help reduce poverty and inequality.

New expenditures related to the implementation of the authorities' priority social and economic goals require strengthening of the revenue side of the state budget. To this effect, a wide set of measures are being taken, including, inter alia, a new tax on the financial institutions' assets (already implemented) and a comprehensive strategy to improve tax administration and fight tax evasion. The strategy includes (i) an introduction of a General Anti-Avoidance rule against tax avoidance; (ii) a reduction of the limit on cash transactions between companies from EUR 15,000 to PLN 15,000; (iii) a reorganization of tax and customs administration and establishment of the National Fiscal Administration—drawing on the Fund's TA recommendation[1] to establish a single and unified, national tax administration; (iv) an introduction of an integrated IT system to track VAT invoices; among others.

Importantly, the above measures should be looked at in the context of the government's recognition that the so called "VAT gap" in Poland remains one of the highest in the EU. Thus, the authorities consider that a significant improvement in the effectiveness of the tax collection is crucial. It may also create additional fiscal space for the implementation of the government's priority social and economic measures. Two other proposals in this regard are currently in the sphere of public debate, namely (i) a revision of the 2013 retirement age

[1] IMF, Fiscal Affairs Department, *Poland: Tax Administration Modernization Challenges and Strategic Priorities*, January 2015.

increases and (ii) an increase in the personal income tax (PIT) tax-free allowance, as mandated by a constitutional court's ruling.

Both proposals are at the stage of conceptual work with the intention to present a draft legislation by the end of the year. However, as indicated recently by government officials, implementation before 2018 is rather unlikely. The authorities are of the view that potential adverse impact of the considered changes to the retirement age can be mitigated by adjusting parametric conditions for entitlement to retirement. Regarding the increase in the PIT tax-free allowance, the authorities consider that it could be introduced as a part of a more comprehensive income tax reform, with lost revenues from higher new allowance offset by a more progressive tax regime.

**Monetary Policy**

Amid depressed global commodity prices, inflation in Poland remained very low, at -0.9 percent on average in 2015. While the CPI deflation had bottomed out since early-2015, it remains at -0.9 percent, as of May. Recently, also the core inflation has turned negative and it currently stands at -0.4 percent, as of May. These weak price dynamics are related to the pass-through from low commodity prices to other CPI components and a still slightly negative output gap. Nevertheless, so far, the low inflation has not materially affected neither households nor corporates. Firms continue to report good financial and liquidity conditions, with the share of profitable companies close to all-time-highs; and consumer demand is growing steadily.

Against this backdrop, the Narodowy Bank Polski (NBP) took advantage of its flexible approach to inflation targeting, striving to maintain price stability in the medium term, while supporting balanced economic growth. Since March 2015 the Monetary Policy Council (MPC) has kept the policy rate at the all-time low of 1.50 percent (completing the easing cycle of 325 bps initiated in late-2012). The MPC recognizes the external nature of the price shocks and points to the stable domestic economic growth accompanied by marked improvement in the labor market conditions. At this juncture, the MPC considers the current level of interest rates as conducive to keeping the Polish economy on the sustainable growth path and maintaining macroeconomic balance.

**Financial Sector**

The Polish financial sector has remained stable and resilient, supported by the solid economic growth. Banks remain liquid, well-capitalized and maintain low leverage, which result both from the high value of regulatory capital and the conservative level of risk weights used to calculate capital adequacy. In line with recommendations issued by the Financial Supervisory Authority, banks maintained their capital buffers with the capital adequacy ratio reaching 16.7 percent at the end of Q1 2016 and Tier 1 capital representing around 90 percent of total capital. At the same time, the funding structure of Polish banks remains favorable, as evidenced by a low funding gap, a large share of household deposits in liabilities and low reliance on the potentially less stable market funding.

Although in Q4 2015 and Q1 2016 the earnings and profitability ratios of the banking sector decreased, they remain at comfortable levels. The decrease in profitability was mainly the result of less favorable environment (i.e. low interest rates) as well as higher costs of banking activity (due to a one-off contribution to the Bank Guarantee Fund due to deposit payouts as well as initial contributions to the Borrower Support Fund established to provide a temporary support to housing loan borrowers in difficult financial situation). In Q1 2016, for the first time, banks had to pay the new asset tax introduced in February. Contrary to market expectations, however, the additional tax has not significantly influenced the profitability in the first months after its introduction. Also, credit flow to the economy has been growing at a steady pace. Nonetheless, more time is needed to more thoroughly assess its overall impact. The authorities intend to evaluate the performance of the new tax and adjust it if deemed necessary.

Work has further progressed on measures to strengthen the financial sector and improve supervision. The new macroprudential authority (Financial Stability Committee) became fully operational in November 2015. The bank resolution framework—in line with the European Bank Recovery and Resolution Directive (BRRD)—has just been completed and finally approved by the Parliament. Loan-to-value limits for housing and commercial real estate loans, which came into force in early 2014, are gradually being tightened to help further enhance loan quality. Since January 2016, the borrowers' contribution should constitute at least 15 percent of the real estate's value. The share of non-performing loans (NPLs) is slowly, yet steadily decreasing. The coverage of NPLs by provisions remains at a comfortable level.

While virtually no new foreign-currency (FX) lending is taking place following the introduction of stronger macroprudential measures, the outstanding stock of FX mortgages accounts for around 9 percent of GDP, as of April, and the portfolio is runoff mode. The government expressed its commitment to help FX mortgage holders in difficult situations, recognizing their concerns that some of these loans had been extended without adequate consumer information. Several alternative options for addressing this issue are being discussed with multiple stakeholders, however, no specific proposal has been subject to official consideration yet. The government is cognizant of the importance of ensuring that any future proposal safeguards financial stability. To this aim, the government considers that potential costs for banks would likely have to be extended over a longer time horizon.

**Structural Reforms**

The authorities have continued to implement structural reforms, as indicated in the staff report. Directions of Poland's economic development in the years to come have been indicated in the new government's *Plan for Responsible Development*[2]. It provides for increasing the potential of the Polish economy through mobilizing domestic human and financial capital, fostering innovations through increased R&D spending and developing highly specialized industries, capable of building globally recognizable brands and products as well as creating highly paid jobs. The aim of the *Plan* is to substantially increase the level of investment over the next decade. Necessary actions to achieve that target include development of financial instruments offered by the Polish Development Fund—newly

[2] https://www.mr.gov.pl/media/14873/Responsible_Development_Plan.pdf

established entity integrating currently existing development institutions with the goal to increase their effectiveness. An important element of the strategy is creating a favorable institutional and legal environment increasing Poland's investment attractiveness for foreign capital. The *Plan* also focuses on social (in particular in the areas of demography and education) and regional development promoting inclusion of small cities and rural areas. Specific measures underpinning the *Plan's* objectives will be reflected in the *Strategy for Responsible Development* expected to follow by the end of the year.