January 2011
IMF Country Report No. 11/24

Republic of Poland: Arrangement Under the Flexible Credit Line and Cancellation of the Current Arrangement—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Poland

In the context of the arrangement under the flexible credit line and cancellation of the current arrangement, the following documents have been released and are included in this package:

- The staff report on the arrangement for the Republic of Poland under the Flexible Credit Line and Cancellation of the Current Arrangement, prepared by a staff team of the IMF, based on information available as of January 7, 2011. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff supplement of January 7, 2011, on the assessment of the impact of the proposed Flexible Credit Line arrangement on the Fund's finances and liquidity position.
- A Press Release summarizing the views of the Executive Board as expressed during its January 21, 2011 discussion of the staff report that completed the request and/or review.
- A statement by the Executive Director for the Republic of Poland.

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

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

REPUBLIC OF POLAND

Arrangement Under the Flexible Credit Line and Cancellation of the Current Arrangement

Prepared by the European Department
(In consultation with other departments)

Approved by Anne-Marie Gulde and Aasim Husain

January 7, 2011

Executive Summary

Background: Poland's very strong economic policies in the decade prior to the global crisis contributed to very strong economic fundamentals, affording the authorities' room for maneuver when the crisis struck. A timely and comprehensive policy response, aided by access to the FCL, helped Poland avoid a recession in 2009 and supported the economic upturn in 2010.

Outlook: Looking forward, growth is expected to remain solid and balanced, as corporate profitability rises, the absorption of EU funds accelerates, and bank lending resumes. While global growth has picked up, external financial conditions remain fragile, especially given spillover risks from sovereign debt problems in some countries in Europe.

FCL: The authorities believe that cancelling the current FCL arrangement approved on July 2, 2010 and requesting a new two-year arrangement in the amount of SDR 19.166 billion (1,400 percent of quota), which they intend to continue to treat as precautionary, would help to safeguard the economy against heightened downside risks. Staff concurs and believes that such a larger and longer insurance policy would allow more time for external risks to dissipate, while preserving investor confidence and supporting macroeconomic policies going forward. In staff's view, Poland continues to meet the criteria for access under the FCL arrangement.

Fund liquidity: The impact of the proposed commitment of SDR 19.166 billion on the Fund's finances and liquidity position would be large but manageable.

Process: An informal meeting to consult with the Executive Board on a possible FCL arrangement for Poland was held on December 22, 2010.

Publication: The authorities have consented to the publication of the staff report.

Team: The report was prepared by a staff team led by James Morsink and comprising Natan Epstein and Delia Velculescu (all EUR), Ricardo Llaudes (SPR), and Erlend Nier (MCM).

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I. CONTEXT

A. Weathering the Global Crisis

1. **Poland's very strong economic policies in the decade prior to the global crisis contributed to very strong economic fundamentals**. At the outset of the global crisis, Poland had limited macroeconomic imbalances: credit and domestic demand growth had remained relatively moderate, inflation was contained, current account and fiscal deficits had been restrained, and as a result public and external debt were at comfortable levels. This performance owed much to a track record of sound policies. Poland's commitment to the EU Stability and Growth Pact helped to lower the fiscal deficit and limit government debt. Comprehensive pension reforms helped to address the long-term challenges of an aging population. A determined anti-inflationary focus—in the context of an effective inflation targeting regime and a floating exchange rate policy—built confidence in monetary institutions and anchored inflation expectations. Finally, a strong financial supervisory framework fostered a well-capitalized banking system.

2. **Notwithstanding Poland's favorable fundamentals, the economy was severely affected by the global crisis through both real and financial channels.** With Poland's key trading partners in recession, exports contracted by over 30 percent year-on-year in the first half of 2009. The freeze in global funding markets was transmitted to domestic financial markets, which experienced sharp price declines. The stock market index fell by half between June 2008 and March 2009; the exchange rate against the euro depreciated by about 30 percent from peak to trough; and interbank transactions came to a virtual standstill. The associated fall in confidence caused an abrupt decline in investment. As a result, GDP growth slowed sharply from 5.1 percent in 2008 to 0.9 percent y/y in the first half of 2009.

3. **The authorities' timely and comprehensive policy response to the global crisis helped to avoid an outright recession.** Poland was the only EU country with positive GDP growth (1¾ percent) in 2009. This enviable performance can been attributed, in part, to countercyclical policies, which were facilitated by the room for maneuver afforded by Poland's limited imbalances and buttressed by the insurance provided by the FCL arrangement approved on May 6, 2009. In particular, fiscal policy provided appropriate stimulus through a combination of tax cuts (enacted earlier but coming into effect in 2008-09) and the government's decision in mid-2009 to allow automatic stabilizers to work on the revenue side. Monetary policy was also accommodative, with aggressive cuts in the policy interest rate through the first half of 2009, complemented by facilities for exceptional liquidity support. Measures were also taken to safeguard financial stability, including the recommendation that banks retain 2008 profits, which was key to restoring capital-adequacy ratios to pre-crisis levels.

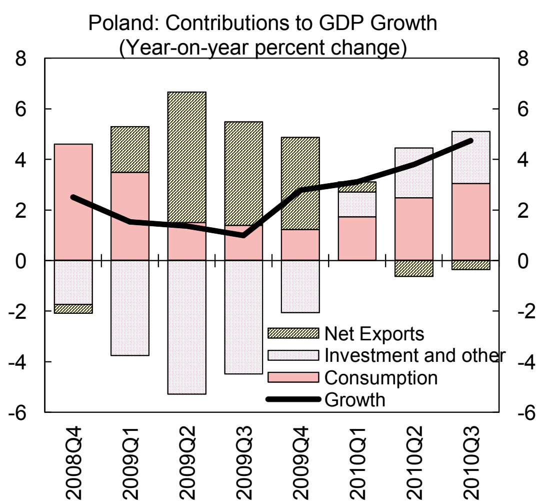
4. **Coming into 2010, macroeconomic policies were geared toward supporting the incipient economic upturn.** On the fiscal front, the authorities aimed to balance short-term

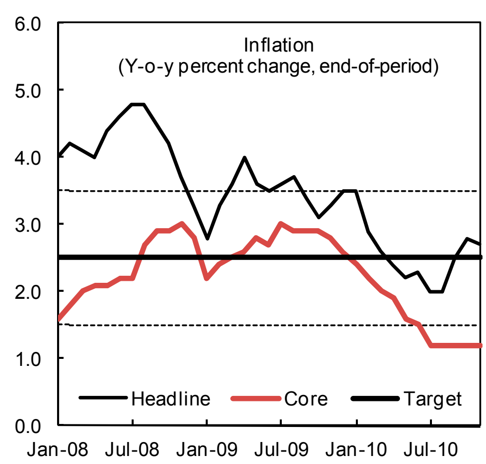
cyclical and medium-term sustainability concerns by allowing automatic stabilizers to work in 2010 while strengthening the medium-term fiscal framework, including by specifying additional corrective actions triggered by the debt thresholds under the Public Finance Act (including a nominal freeze in budgetary wages and limiting indexation of pensions to CPI inflation).[1] With inflation close to the central bank's target, monetary policy rates were kept on hold. As financial conditions normalized, exceptional liquidity facilities were gradually withdrawn. The authorities continued their efforts to enhance the resilience of the financial system, including by introducing Recommendation T, which strengthened lending standards for households. A successor FCL arrangement was approved on July 2, 2010, following the expiration of the original arrangement on May 5.

B. Recent Developments

5. **Economic growth gained momentum in 2010 more quickly than originally expected.** The increase in real GDP growth was led by inventory rebuilding, private consumption, and EU-funded public investment, while the contribution of net exports was dampened by the earlier exchange rate appreciation. Recent high frequency indicators suggest that the momentum remains strong in 2010Q4 (Figure 1). As a result, staff has revised up its GDP growth projection for 2010 to 4 percent.

6. **CPI inflation remains close to the central bank's 2½ percent target.** After falling to a low of 2.0 percent in July and August, headline inflation increased to 2.7 percent in November, driven mainly by food prices (reflecting in part a weak harvest) and higher energy prices (reflecting global developments). Core inflation has remained stable at





Sources: Polish Statistical Office.

[1] Poland's Public Finance Act establishes two debt thresholds that apply to the national definition of debt (excluding debts of the National Road Fund) at 50 and 55 percent of GDP. Breaching of the first threshold triggers mild policy changes, serving mainly as a signal to policymakers. Breaching of the second threshold requires more stringent measures that need to be implemented in the budget for the second year after the breach, aimed at curbing the increase in debt. A Constitutional debt limit is set at 60 percent of GDP.

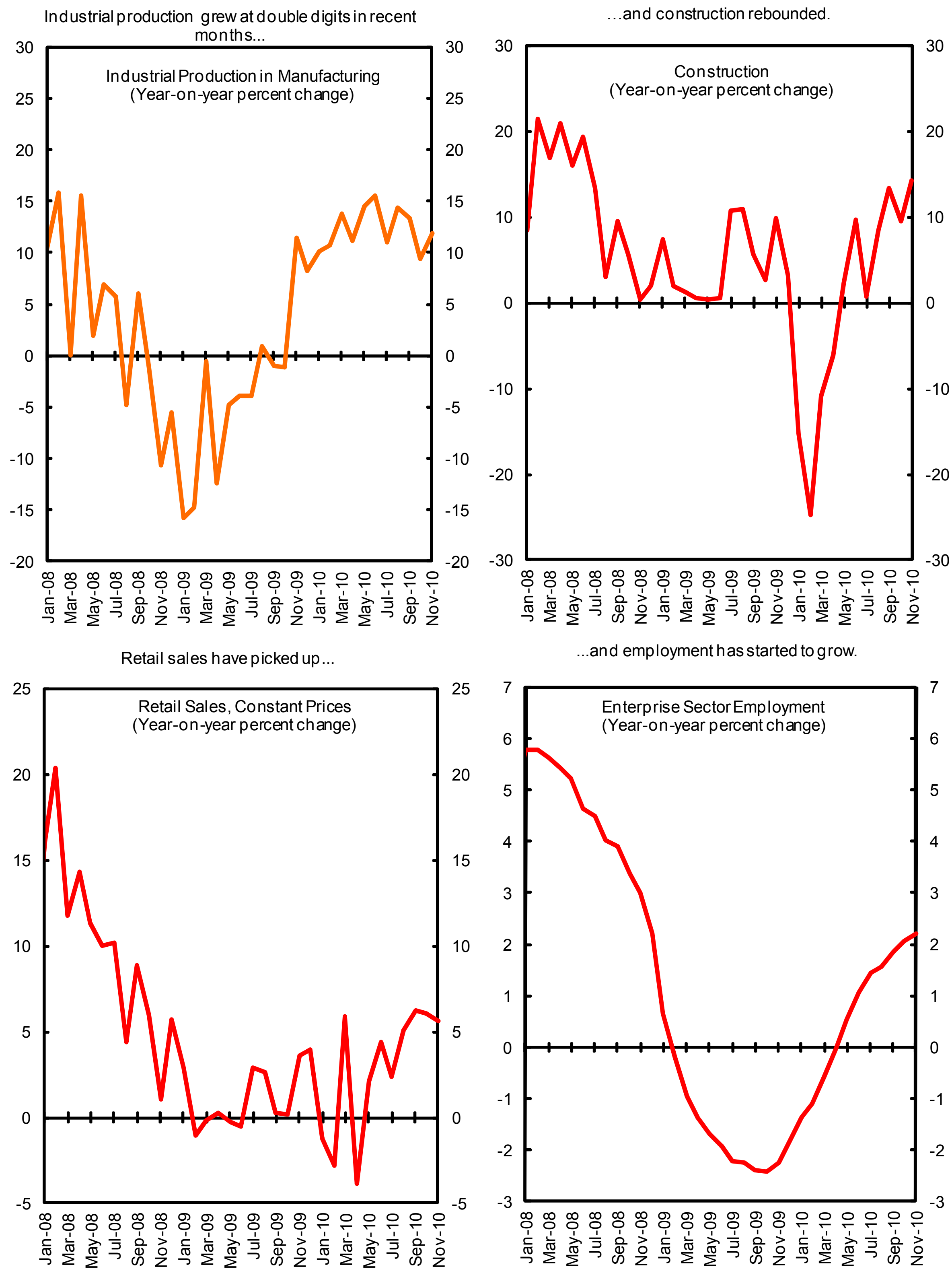
1.2 percent in recent months. Staff estimates that headline inflation reached 3 percent at end-2010.

7. **The current account deficit has widened in line with strengthening domestic demand.** The deficit increased from 2.2 percent of GDP in 2009 to 2.9 percent of GDP in the four quarters to 2010Q3, as imports accelerated more quickly than exports. The deficit is more than financed by net FDI inflows and capital transfers from the EU. The financial account has posted a large surplus so far this year, mainly reflecting large purchases of government securities by nonresidents. Strong capital inflows have put upward pressure on the exchange rate, but external financial turbulence has led to depreciations in May and November. The real exchange rate is assessed to be broadly in line with fundamentals.

8. **The fiscal deficit widened in 2010, reflecting lagged effects of the 2009 economic slowdown.** Corporate and personal income tax revenues in the first three quarters of 2010 fell relative to last year, as firms and the self-employed continued to deduct earlier losses. Consequently, the state budget deficit (net of EU funds, cash basis) increased in the first eleven months of 2010 relative to the previous year, though it remained below the 2010 budget plan, mainly due to an unbudgeted transfer of central bank profits. Local governments were also affected by the weaker-than-expected tax collections, which, together with rising capital spending, implied only a small cumulative cash surplus through the third quarter, significantly less than a year ago. The balance of social security funds net of subsidies also deteriorated year-on-year due to a fall in contributions in the third quarter coupled with higher pension payments. As a result, the general government deficit (ESA95) is estimated to rise from 7.2 percent of GDP in 2009 to 7.9 percent of GDP in 2010.

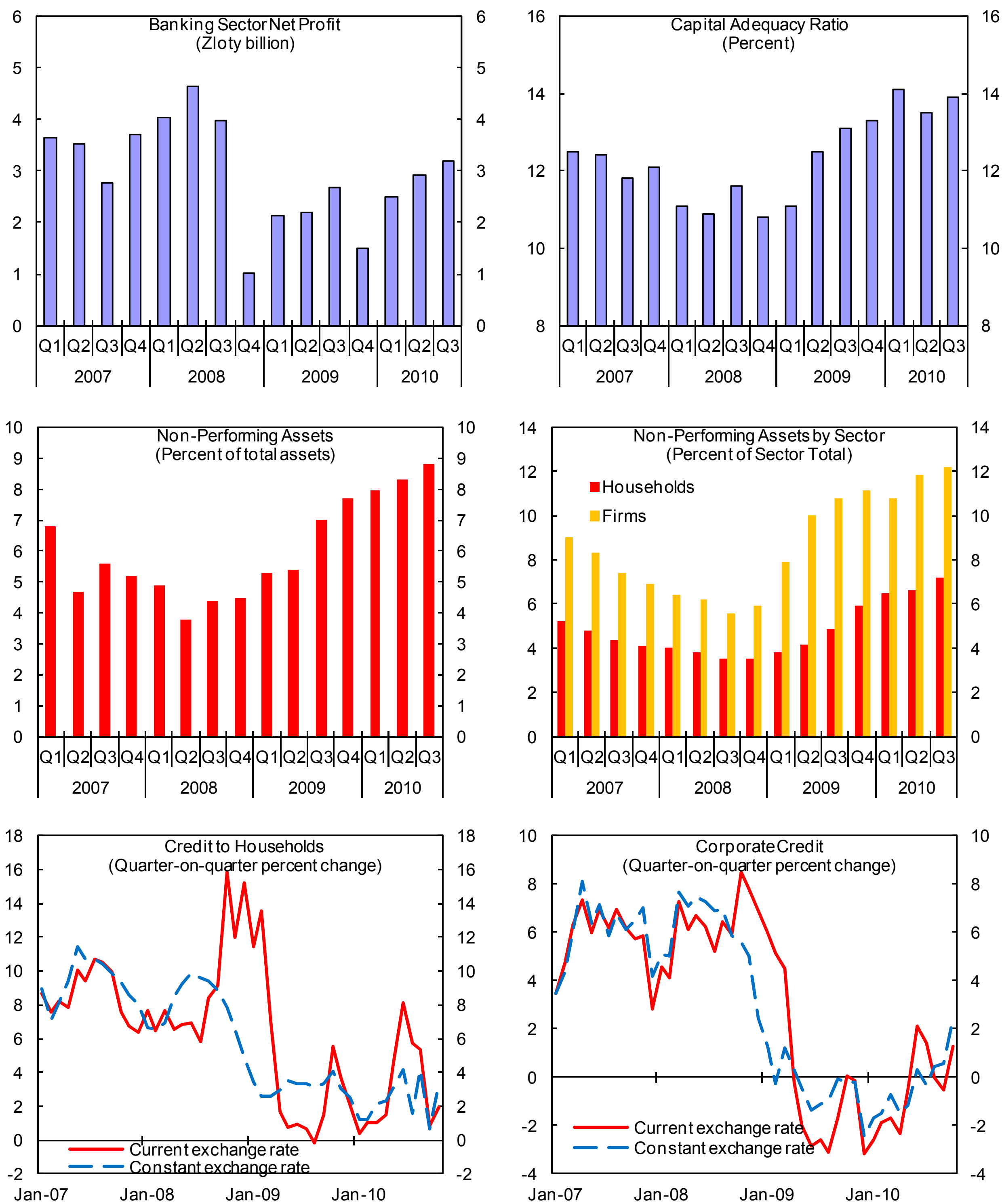
9. **The financial system remains stable.** Banks' profits have increased further this year, leading to a rise in capital adequacy ratios to about 14 percent. While non-performing loans have crept up—at 12.2 percent and 7.2 percent for loans to corporates and households, respectively, at end-September—their growth rate has slowed. Underpinned by improving domestic liquidity, credit growth is showing signs of revival, especially in mortgage lending. For consumer loans, banks are tightening standards following the introduction of Recommendation T. Growth in corporate loans also remains subdued, due to both weak demand and still relatively tight lending standards (Figure 2).

Figure 1. Poland: Recent Economic Developments, 2008-10



Sources: European Commission; and Polish Statistical Office.

Figure 2. Poland: Banking Sector Indicators, 2007-10



Sources: Polish authorities; and IMF staff estimates.

C. Outlook and Near-Term Policies

10. **Economic growth is projected to moderate slightly in 2011 and then stabilize at close to 4 percent in 2012–13.** Growth is expected to remain largely driven by domestic demand, as EU-funded public investment increases, and a pick-up in credit growth and improved corporate profitability boost private fixed investment. Private consumption growth is set to ease a little, as VAT rate hikes take effect and employment growth moderates. Public consumption is also expected to slow, given more contained growth in current government spending, including a prospective freeze on the government wage bill. Given moderating growth in key trading partners, the contribution of net exports to growth is projected to fall, and the current account deficit is projected to widen gradually to about 3½ percent of GDP. With the output gap expected to turn positive and labor market conditions improving, CPI inflation is projected to rise to a level near the upper bound of the central bank's tolerance range. Over the medium run, the economy is expected to grow at close to 4 percent.

Poland: Real GDP Growth Projections, 2010-13
(Percent)

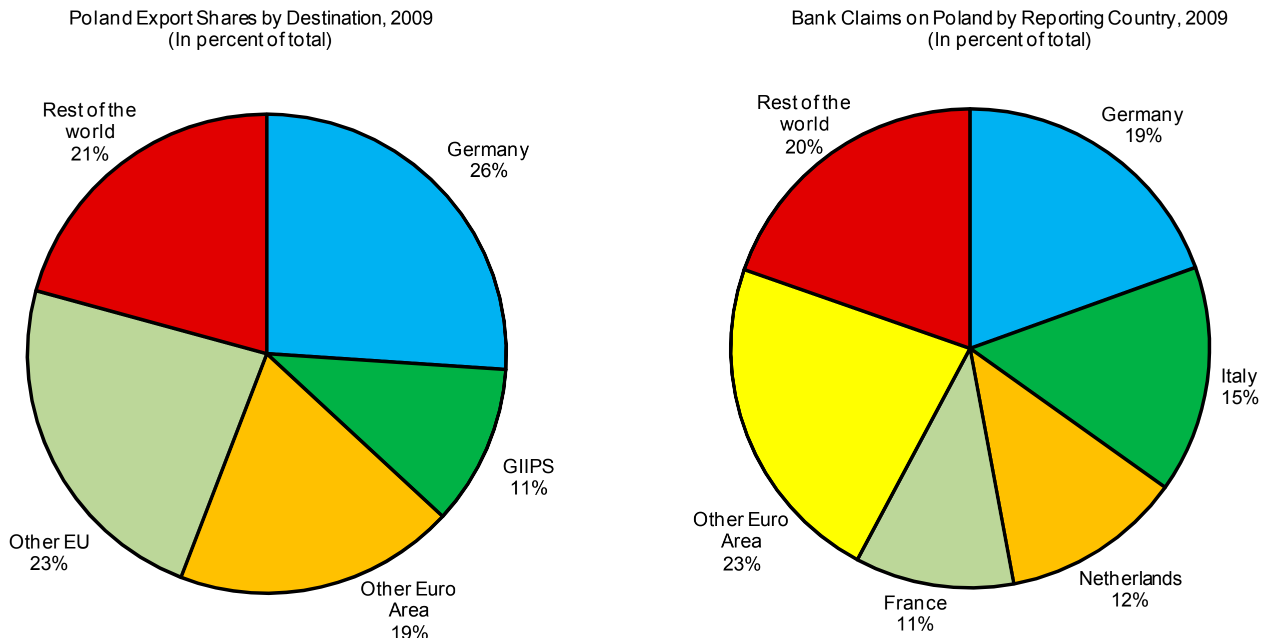
	2010	2011	2012	2013
GDP	4.0	3.8	3.9	3.9
Domestic demand	3.4	3.6	4.0	4.1
Private consumption	4.0	3.8	3.8	3.7
Public consumption	2.5	2.2	1.3	1.5
Domestic fixed investment	-1.8	4.5	7.0	7.0
Net external demand (contribution to growth)	0.6	0.2	-0.1	-0.2
Output Gap	-0.3	0.3	0.6	0.6

Sources: Polish authorities; and IMF staff estimates.

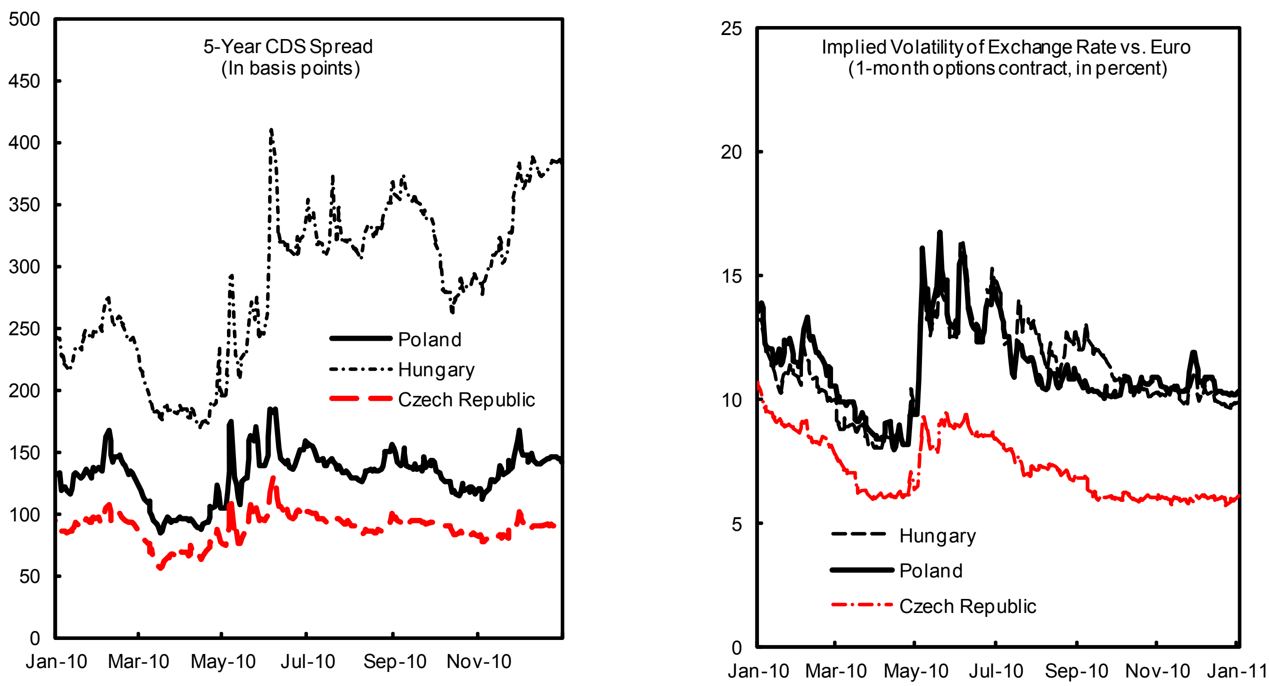
11. **Downside risks to the outlook have increased, mainly reflecting heightened uncertainty in external financing conditions.** Sovereign financing concerns in other countries could intensify funding pressures and increase financing costs for Poland. Indeed, the November 2010 financial market turbulence in Europe drove Poland's CDS spreads and government bond yields to about the levels seen in May 2010 (Figure 3). The level of nonresident portfolio exposures—with holdings of government debt at historic highs—combined with the liquidity of Polish debt markets expose the country to a sharp turnaround in risk appetite, which could further exacerbate financial strains, should risks materialize. In addition, Poland is closely integrated into Europe's banking system—which holds about 80 percent of total external claims on Poland—making it vulnerable to contagion from renewed financial strains, given its exposure to banks in Europe's core.

Figure 3. Poland: Linkages and Spillovers

Poland is closely linked with the euro area both through trade and financial channels.



CDS spreads and exchange rate volatility rose in November.



Sources: IMF, *Direction of Trade Statistics*; BIS; CMA; Bloomberg; and IMF staff estimates.

12. **Against this background, the authorities are tightening macroeconomic policies gradually.** In particular:

- **Fiscal consolidation is starting in 2011.** This year's budget contains consolidation measures amounting to about 1 percent of GDP, roughly evenly distributed between expenditure and revenue, including a limit on discretionary expenditure growth to no more than 1 percent above inflation (CPI+1)—which encompasses a freeze in the central government wage bill—and a 1 percentage point hike in VAT rates.

Consolidation Measures Included in the 2011 Budget

Measure	**Estimated 2011 Yield** (percent of GDP)
Expenditure measures	**0.4**
Expenditure rule, limiting growth of discretionary and new spending to maximum CPI+1 percent	0.3
Lower spending on active employment promotion	0.1
Tax measures	**0.5**
Lifting preferential VAT rates and increasing basic VAT rate by 1pp	0.4
Eliminating bio-fuel excise preferences	0.05
Lower VAT refunds on corporate cars	0.1

Parliament also passed legislation maintaining the CPI+1 discretionary spending ceiling as long as Poland is in the EU's Excessive Deficit Procedure. More recently, the government announced its intention to lower contributions to the private pension system from 7.3 to 2.3 percent of wages starting in April 2011, with the difference being retained by the state pension system and recorded in notional individual accounts; as a result, the general government deficit (ESA 95) will be reduced by about 1 percent of GDP over the medium term, though it will be higher in the long run. Reflecting the consolidation measures and the pension change, as well as one-off factors and some tax buoyancy, staff projects the general government deficit to fall to 5.8 and 4.6 percent of GDP in 2011 and 2012, respectively. Notwithstanding the upcoming parliamentary elections scheduled for October 2011, the authorities are determined to lower the fiscal deficit further and put government debt on a downward path, in line with their EU commitments, which call for reaching the Maastricht limit (3 percent of GDP) by 2012. The authorities consider that this will require additional measures (beyond those announced to date). Moreover, Parliament approved a plan to improve liquidity management which, together with stepped-up privatization efforts and the above-mentioned measures, will help to stabilize general government debt

(ESA95 definition) at about 56 percent of GDP by 2016 under staff's scenario based on announced policies. In the event that the 55 percent-of-GDP debt threshold is breached (the authorities expect debt under the national definition to remain below the threshold under their baseline scenario), additional measures will be triggered, including an automatic hike in VAT rates by a further 1 percentage point.

- **The central bank stands ready to respond to inflationary pressures.** Market expectations suggest that a tightening cycle will start in 2011. Given the still-large uncertainty surrounding the inflation outlook, the authorities are carefully watching developments in inflationary expectations, core inflation, potential output, and the exchange rate.

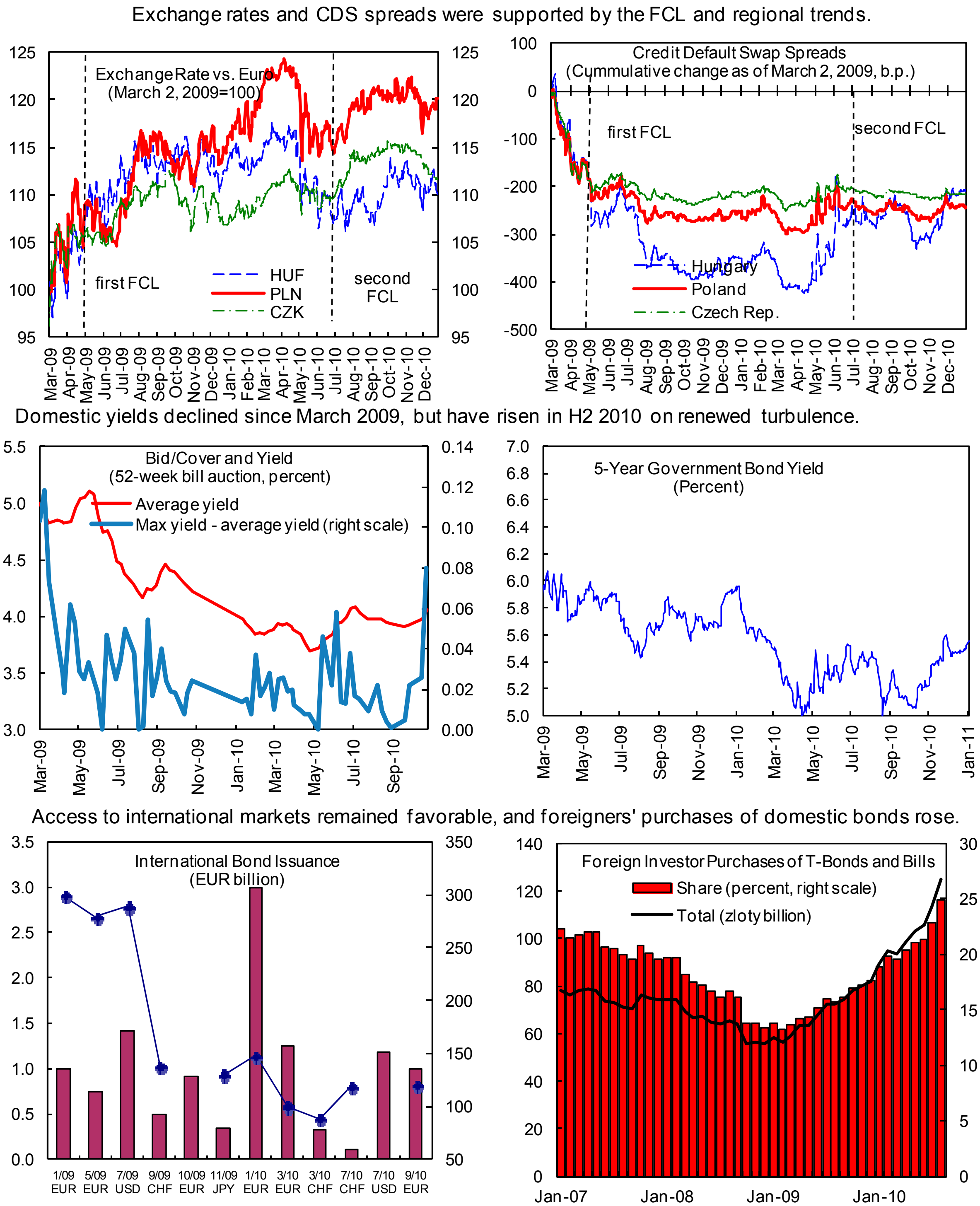
- **Financial sector policies are geared toward limiting risks, as credit is set to start expanding again.** The authorities continue to monitor closely financial developments. They have undertaken both top-down and bottom-up stress-tests, which continue to confirm the robustness of the financial system. Looking forward, they are considering various options to mitigate the risk of an acceleration of foreign currency lending by banks to unhedged borrowers.

II. THE ROLE OF THE FLEXIBLE CREDIT LINE

13. **The authorities believe that precautionary access to the FCL since May 2009 has served their economy well.** They note that the two successive FCL arrangements helped to allow for a more flexible policy response to the global crisis while preserving favorable access to markets, even as volatility remained elevated (Figure 4). The first FCL arrangement provided useful insurance in the aftermath of the 2008–09 global crisis, being credited, in part, for the return of foreign investors to the domestic bond market especially after April 2009 and the successful bond placements on international markets starting in the second half of 2009. The second FCL arrangement has supported the continuation of these positive trends in 2010, cushioning the impact of turbulence in European markets.

14. **Looking forward, the authorities see a need for enhanced insurance under the FCL arrangement in response to increased downside risks and heightened external uncertainty.** Poland's economy remains exposed to possible external shocks that are beyond the authorities' control. As noted above, uncertainty has intensified and downside risks have increased since July 2010, especially related to the fragile economic and financial environment in Europe, which represents Poland's major trade and financial partner. Moreover, Poland's relatively deep and liquid financial markets give investors the opportunity to express views on the region, which makes Poland vulnerable to global or regional shocks. At the same time, the policy space to respond to such shocks is now more limited. In this context, access to the FCL on a prolonged and augmented (though still precautionary) basis would help to strengthen Poland's resilience to external shocks.

Figure 4. Poland: The FCL's Impact on Financial Markets, 2009-11



Sources: Bloomberg; Polish Ministry of Finance; Dealogic; and IMF staff estimates.

15. **The authorities view the recent reform of Fund facilities as providing a timely opportunity to expand insurance against external risks by cancelling the current FCL arrangement approved in July 2, 2010 and requesting a two-year FCL arrangement with the proposed access of 1,400 percent of quota (SDR 19.166 billion or about $29.5 billion).**[2] The new FCL instrument provides more flexibility both on access and length. The authorities would like to take advantage of these features, which were not available at the time the current arrangement was approved, and which they see as more appropriate given the risks that Poland is now facing. Indeed, a new higher-access, longer-tenor FCL arrangement would provide adequate insurance against risks that have persisted for longer than anticipated at the time of the approval of past FCL arrangements. They view that such a larger and longer insurance policy would allow more time for shocks to dissipate, while preserving investor confidence and supporting macroeconomic policies going forward.

A. Access

16. **Access under the successor arrangement is predicated on potential drains under a plausible adverse scenario.** With increased downside risks since the approval of the current FCL arrangement in July 2010, and notwithstanding a broadly adequate level of international reserves relative to standard metrics and peers (although Poland is below median on coverage of short-term debt), higher access is required to provide credible assurances of sufficient liquidity under a stress scenario. Such an adverse scenario encompasses plausible—albeit somewhat more severe—assumptions compared to those underlining the level of access in the current FCL arrangement, which aim to capture the higher and more persistent risks that Poland is now facing (Box 1). The shocks used in this scenario are in line with Poland's experience during the 2008–09 crisis and are comparable to other FCL cases. They imply potential financing gaps of $28.8 billion and $30.0 billion in 2011 and 2012, respectively.

17. **Staff believes that intensified risks to the balance of payments justify access in the requested amount.** Notwithstanding Poland's very strong fundamentals and sustained track record of implementing very strong policies, the uncertain financial market environment, particularly within Europe, justifies the need for a sufficiently large and prolonged buffer against tail risks. The proposed access equivalent to $29.5 billion for a period of two years would cover potential drains under an adverse scenario, while continuing to signal policy credibility and maintain investor confidence. It would also help to expand Poland's international reserves to around $126 billion, which would bring it closer to the international median ratio of international reserves to short-term debt.

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[2] See *The Fund's Mandate—"Future Financing Role: Reform Proposals"*, and *The Fund's Mandate – "The Future Financing Role – Revised Reform Proposals and Revised Proposed Decisions*."

Box 1. Adverse Scenario

This adverse scenario takes as a starting point staff's latest baseline forecast, which incorporates substantial FDI inflows and ample short-term and long-term external financing for both government and private sector. Baseline rollover rates are projected at over 200 percent for the public sector and around 115 percent for the private sector. As a result, reserve accumulation is projected to be around $11 billion in 2011 and $9 billion in 2012.

The scenario assumes concurrent shocks to various components of Poland's balance of payments, meant to capture a tail risk scenario. Given heightened external risks since July 2010, the current assumptions are somewhat more severe than those underlying the current FCL arrangement and, in some cases, more in line with Poland's experience during the 2008–09 crisis, while comparable to other FCL cases.

The main assumptions underlying the adverse scenario are as follows:

- A fall in FDI inflows of 25 percent relative to the baseline. This is in line with the observed decline in FDI in 2009 with respect to 2008. The current FCL arrangement assumed a 15 percent decline relative to baseline.
- Equity portfolio outflows of around 10 percent of total non-resident equity holdings. This decline is in line with the outflows observed during the most intense period of the crisis between the third quarter of 2008 and the first quarter of 2009. The assumption under the current FCL arrangement is of equity outflows of around 5 percent.
- A decline in rollover rates of around 20–25 percentage points relative to the baseline assumptions. Rollover rates were assumed to be 10–20 percentage points lower under the current FCL arrangement.
- Other investment outflows, mostly from non-resident deposits, of $4 billion, compared to a change in other investment net flows of $12 billion from 2008Q1 to 2009Q2 (the current FCL arrangement assumes outflows of $2 billion).
- As reserve coverage of short-term debt is below the international median, some reserve accumulation is important to maintain investor confidence. The buildup in reserves is thus reduced by half relative to the baseline (same assumption as under the current FCL).

18. **The access being requested under the FCL arrangement is consistent with other recent high-access cases**. The table below compares the access level being requested by Poland under the FCL to other high-access cases using a wide array of metrics. The various measures confirm that access for Poland at the 1,400 percent level is at or below the median of all recent high access cases, including as a share of GDP (6 percent), trade (<15 percent of exports or imports), and external debt (10 percent).

Poland: External Financing Requirements and Sources, 2008-12
(In million of U.S. dollars)

	2008	2009	2010 Proj.	2011 Proj.	2011 Adverse scenario	Contribution to Gap	2012 Proj.	2012 Adverse scenario	Contribution to Gap
GROSS FINANCING REQUIREMENTS (A)	**108,126**	**84,941**	**105,527**	**104,599**	**104,599**		**108,764**	**108,764**	
Current account deficit	25,554	9,598	12,803	15,488	15,488		17,835	17,835	
Medium and long-term debt amortization	29,982	12,675	26,243	19,265	19,265		17,933	17,933	
Public sector	2,660	697	6,821	4,398	4,398		8,095	8,095	
Banks	4,453	3,202	6,637	6,643	6,643		2,337	2,337	
Non-bank Corporates	22,869	8,776	12,785	8,224	8,224		7,502	7,502	
Short-term debt amortization	52,590	62,668	66,481	69,847	69,847		72,996	72,996	
Public sector	6	213	1,144	1,602	1,602		2,082	2,082	
Banks (inc. s.t. deposits)	17,482	29,189	29,867	31,659	31,659		33,230	33,230	
Non-bank Corporates	35,102	33,266	35,470	36,586	36,586		37,684	37,684	
o/w trade credit	29,234	27,296	29,461	30,388	30,388		31,300	31,300	
SOURCES OF FINANCING (B)	**106,162**	**99,683**	**123,110**	**115,963**	**81,501**		**117,590**	**83,128**	
Foreign direct investment (net)	10,365	8,696	10,268	11,391	8,543	**2,848**	12,412	9,309	**3,103**
o/w inward (net)	14,978	13,796	12,268	13,141	9,856		14,412	10,809	
Equities (net)	2,021	901	2,943	2,654	168	**2,486**	2,382	-104	**2,486**
by nonresidents	564	1,579	3,870	3,617	1,131		3,383	897	
New borrowing and debt rollover	97,867	109,119	118,770	110,938	85,809		110,067	85,194	
Medium and long-term borrowing	35,199	42,638	48,923	37,942	29,123		33,480	25,694	
Public sector	-9,019	19,812	28,581	20,272	15,609	**4,663**	21,240	16,355	**4,885**
Banks	12,628	4,273	7,174	8,488	6,535	**1,952**	3,762	2,897	**865**
Non-bank Corporates	31,590	18,553	13,169	9,182	6,978	**2,204**	8,477	6,443	**2,035**
Short-term borrowing	62,668	66,481	69,847	72,996	56,686		76,587	59,499	
Public sector	213	1,144	1,602	2,082	2,082		2,290	2,290	
Banks	29,189	29,867	31,659	33,230	25,587	**7,643**	35,453	27,299	**8,154**
Foreign subsidiaries to parent banks	20,783	22,047	23,370	24,529	18,888		26,170	20,151	
Other	7,371	7,820	8,289	8,700	6,699		9,282	7,148	
Non-bank Corporates	33,266	35,470	36,586	37,684	29,017	**8,667**	38,844	29,910	**8,934**
EU transfers	5,828	6,911	7,559	8,004	8,004		9,200	9,200	
Other	-9,919	-25,944	-16,431	-17,023	-21,023	**4,000**	-16,471	-20,471	**4,000**
GROSS RESERVES ACCUMULATION (C)	**-1,964**	**14,742**	**17,583**	**11,363**	**5,682**	**-5,682**	**8,826**	**4,413**	**-4,413**
FINANCING GAP (B - A - C)	**0**	**0**	**0**	**0**	**-28,780**	**28,780**	**0**	**-30,049**	**30,049**
In millions of SDR						18,699			19,524
In percent of quota						1366%			1426%

Sources: National authorities and staff estimates and projections.

Poland: Proposed Access Relative to Other High-Access Cases

	Proposed Arrangement	Mexico FCL Jan-2011	High-Access Cases 1/ Proposed Arrangement (Percentile)	20th Percentile (Ratio)	80th Percentile (Ratio)	Median
Access						
In millions of SDRs	19,166	47,292	89	1,522	13,690	6,934
Average annual access (percent of total)	1,400	1,500	96	170	605	267
Total access in percent of: 2/						
Actual quota	1,400	1,500	91	300	1,000	576
Gross domestic product	6	7	56	3.3	9.0	6
Gross international reserves	27	60	21	27	83	49
Exports of goods and nonfactor services	14	22	31	11.2	38.9	21
Imports of goods and nonfactor services	14	21	30	10.4	32.4	20
Total debt stock						
Of which: Public	11	16	42	9	32	12
External	10	30	42	7	21	12
Short-term 3/	32	153	46	20	91	33
M2	12	12	41	7	28	13

Sources: Executive Board documents; MONA database; and Fund staff estimates.

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

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

3/ Refers to residual maturity.

B. Qualification Criteria

19. **Staff believes that Poland fully meets the qualification criteria identified in ¶2 of the FCL decision (Figure 5).** Poland's very strong economic fundamentals and institutional policy framework, together with its sustained track record of implementing very strong policies, have allowed the authorities to adjust economic policies in a timely and effective manner during and immediately after the global crisis. Furthermore, the authorities remain committed to maintaining very strong policies as the economic recovery gains strength. Indeed, Poland's achievements and policies have been recognized by the Executive Board, most recently in the 2010 Article IV Consultation concluded on May 7, 2010 (SM/10/88 and SUR/10/40). As to the relevant criteria for the purpose of assessing qualification for a successor FCL arrangement identified in ¶2 of the FCL decision, staff's assessment is as follows:

- **A sustainable external position:** The current account deficit is projected to remain at a moderate level that is consistent with its equilibrium norm over the medium term. External debt is projected to peak at around 70 percent of GDP in 2011 and to gradually decline thereafter. Moreover, the sustainability of the external debt position is generally robust to a range of standard stress scenarios.

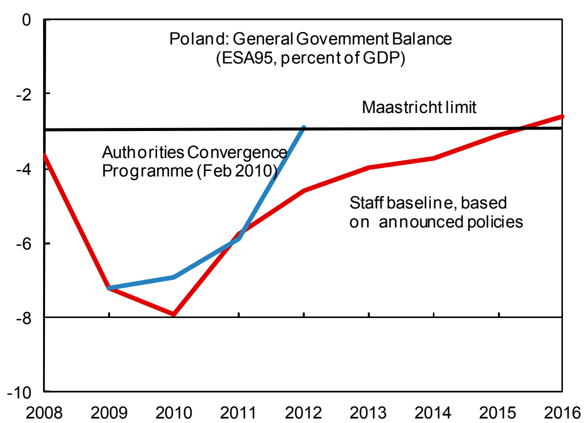
- **A capital account position dominated by private flows:** The bulk of external debt flows in Poland's financial accounts are from private creditors, with official creditors accounting for less than 10 percent of these flows by mid-2010.

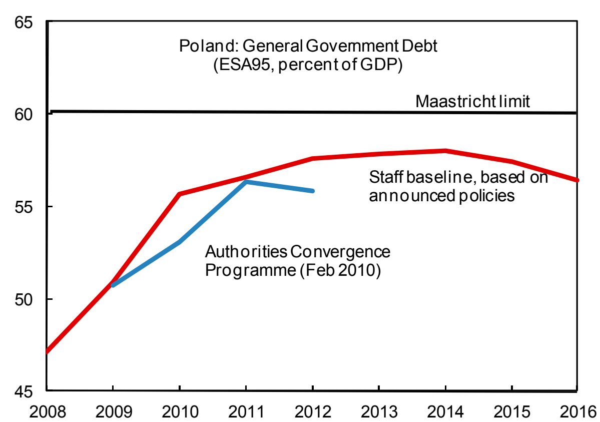
- **A track record of steady sovereign access to international capital markets at favorable terms:** Poland has continued to enjoy one of the highest credit ratings among emerging markets, which it has maintained despite the crisis and prolonged financial uncertainty in the region. In 2010, the government successfully issued about €7 billion sovereign debt in international capital markets—a record among peers—and yields and spreads are now below than those of Italy, and much lower than Spain and Portugal (though they have recently risen, in line with regional trends, given the turbulence in European markets).

- **A reserve position that is relatively comfortable when the FCL is requested on a precautionary basis:** International reserves remain broadly adequate when compared to peers (Figure 6). Poland is above the median on two out of three standard metrics, though coverage of short-term external debt at remaining maturity plus the current account deficit is estimated at somewhat below the median at around 74 percent in 2010, but is expected to increase to over 90 percent in 2011.

- **Sound public finances, including a sustainable public debt position:** Fiscal policy has provided appropriate counter-cyclical support to the economy during the downturn by using the fiscal space afforded by a track record of sound policies leading up to the crisis.

The recently-proposed change to the pension system will lower the fiscal deficit and reduce the accumulation of government debt over the medium run, though it leads to higher implicit pension liabilities in the long run. Looking forward, the authorities are committed to a sustained consolidation effort, as demonstrated by the measures included in the 2011 budget and their commitment to reduce the deficit to the Maastricht limit of 3 percent of GDP by 2012, detailed in their latest Convergence Programme. Stepped-up privatization efforts and planned improvements in liquidity management, together with a strengthening of debt-safety thresholds, are expected to further help to maintain debt sustainability. On staff's scenario based on announced measures, general government debt (ESA95) is projected to stabilize at about 56 percent of GDP by 2016. Nonetheless, the debt path over the medium term is sensitive to a further growth shock and slippages in the consolidation momentum.





Notes: The baseline includes identified measures announced to date.
Sources: Eurostat; and IMF staff estimates.

- **Low and stable inflation, in the context of a sound monetary and exchange rate policy framework**: The authorities remain committed to preserving their inflation targeting framework. In this context, they stand ready to respond to inflationary pressures as economic slack diminishes.

- **The absence of bank solvency problems that pose an immediate threat of a systemic banking crisis:** Poland's banking system has remained liquid, well capitalized, and profitable. There are no bank-solvency problems that pose an immediate systemic threat. Direct exposure to banks in Europe's periphery is very limited, though Poland is highly exposed to banks in Europe's core, which could be a potential source of risk. Finally, top-down and bottom-up tress tests undertaken by the NBP and the KNF continue to show that overall the system remains resilient to adverse macroeconomic shocks.[3]

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[3] See the NBPs' December 2010 Financial Stability Report, http://www.nbp.pl/homen.aspx?f=/en/systemfinansowy/stabilnosc.html

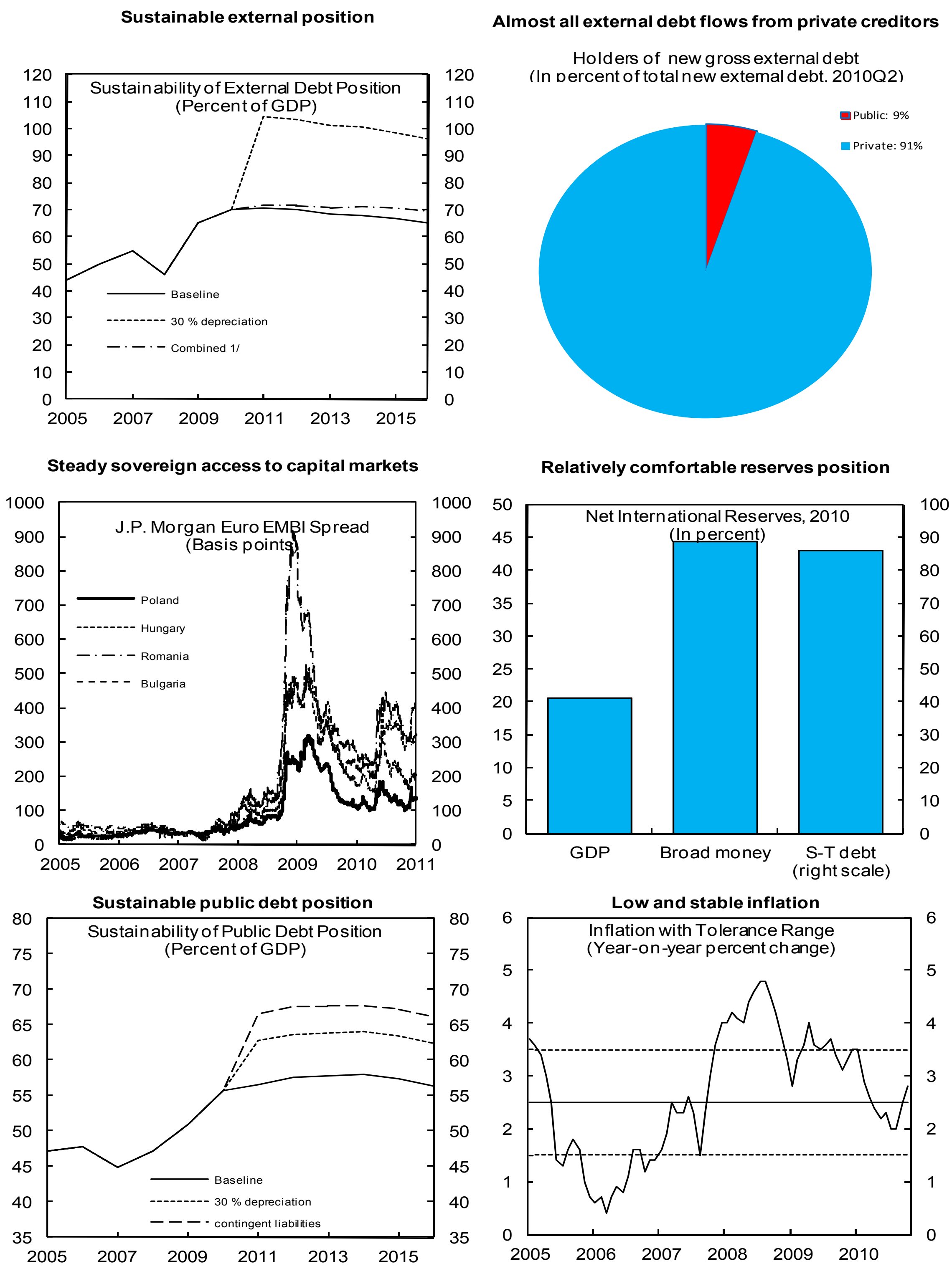
- **Effective financial sector supervision:** Poland's supervisory framework remains strong, as shown by the KNF's effective response during the crisis and its proactive stance in limiting risks related to consumer and FX-mortgage lending.

- **Data transparency and integrity:** The overall quality of Poland's macroeconomic data is good, as acknowledged by the 2003 data ROSC. Poland subscribed to the SDDS in 1996, and the authorities provide all relevant data to the public on a timely basis. The NBP has introduced a new BOP compilation system, which has reduced the size of errors and omissions. Additional ongoing work is expected to deliver a further reduction in errors and omissions in early 2011.[4]

20. **The authorities' letter (Attachment) highlights their continued commitment to implementing sound economic policies.** The government is strongly committed to preserving a sustainable growth rate and maintaining macroeconomic stability. The authorities remain determined to reduce the general government deficit and place public debt on a downward path, in line with their European commitments. To this end, they stand ready to take additional fiscal measures, as needed. Monetary and exchange rate policies will remain underpinned by the inflation targeting framework and the floating exchange rate regime. The authorities will continue to closely monitor the financial system, including through regular stress tests and enhanced surveillance of banks. They intend to treat the new FCL as precautionary.

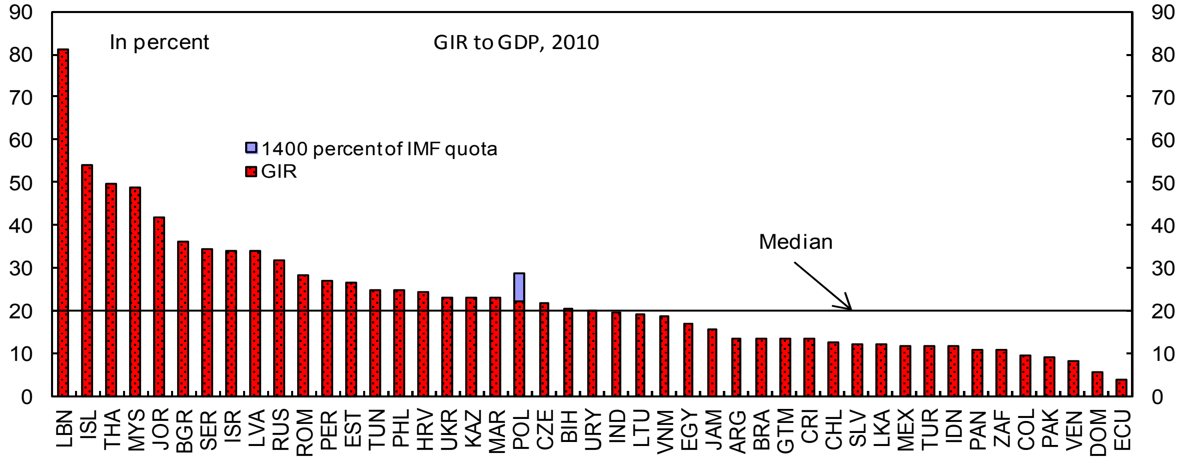
[4] The recent improvements to the BOP compilation system, which targeted the nonfinancial private sector, have not reduced the size of errors and omissions to an acceptable level. Consequently, the authorities are now taking a closer look at the reporting of banks' off-balance-sheet operations. At the same time, the authorities are re-assessing the reporting of various current account items (trade in goods, transportation, and private transfers), though these are not thought to contribute much to errors and omissions. The authorities plan to develop and implement adjustments to BOP reporting in early 2011.

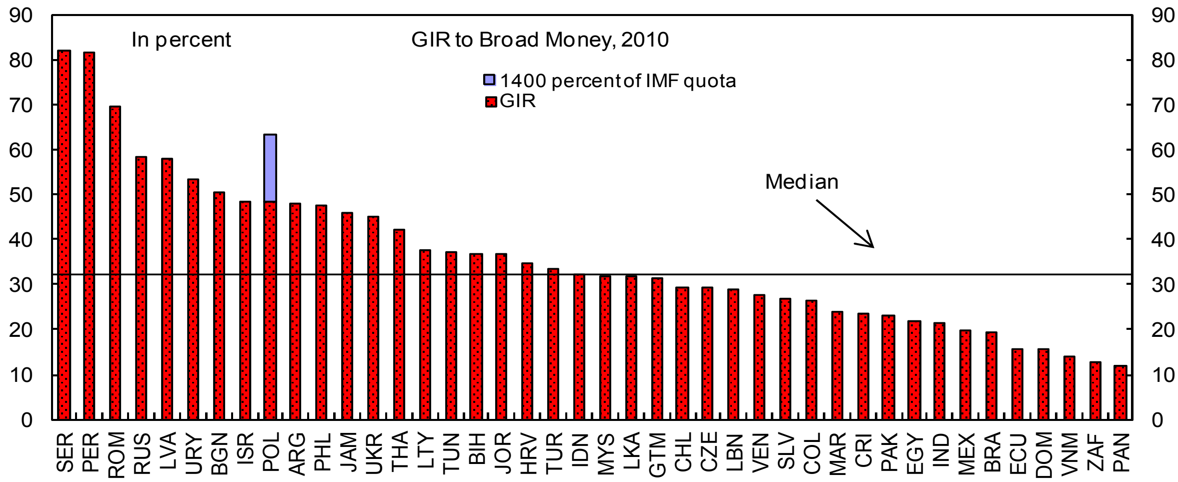
Figure 5. Poland: Qualification Criteria

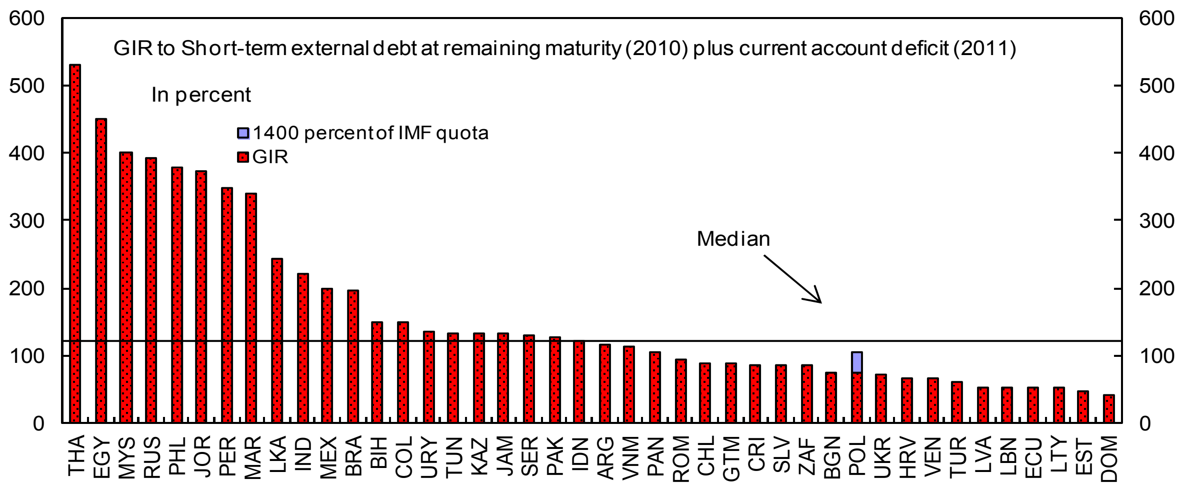


Sources: Bloomberg; Poland authorities; and IMF staff estimates.
1/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

Figure 6. Poland: Reserve Coverage in International Perspective 1/







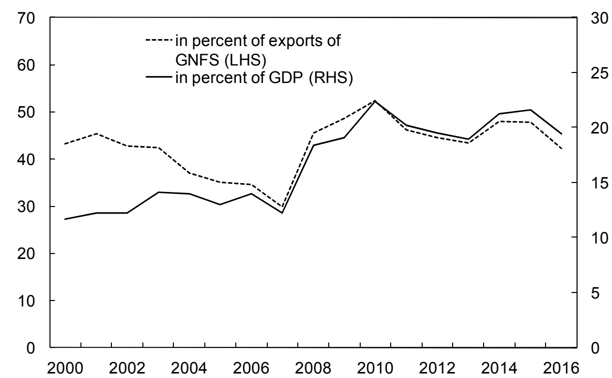
Sources: IMF, *World Economic Outlook*; and IMF staff estimates.
1/ Estimates for 2010.
2/ GIR at the end of 2010 in percent of ST debt at remaining maturity and current account deficit in 2010. The current account is set to zero if it is in surplus.

III. IMPACT ON FUND FINANCES, RISKS, AND SAFEGUARDS

21. **The Fund's liquidity position is expected to remain adequate after approval of an FCL arrangement for Poland**. The impact of the proposed FCL arrangement in the amount of 1,400 percent of quota (SDR 19.166 billion) on the Fund's finances and liquidity position would be large but manageable (see Supplement I).

22. **Poland's capacity to repay the Fund is strong.** The authorities have indicated that they intend to continue to treat the arrangement as precautionary. Nevertheless, even if a full drawing under the FCL arrangement were made, Poland's capacity to fulfill its financial obligations to the Fund would not be an issue. Poland has an excellent track record of meeting its obligations to the Fund, the government has a deep commitment to macroeconomic stability and prudent fiscal policies, and the economy's medium-term growth prospects remain strong. Moreover, even if the adverse scenario were to materialize, Poland's external debt would stay on a sustainable medium-term path, with debt service remaining manageable.

External Debt Service Assuming Full Draw of FCL



Poland: Indicators of Fund Credit, 2011-16

		Projections				
	2011	2012	2013	2014	2015	2016
Stocks from prospective drawings 1/						
Fund credit in millions SDR	19,166	19,166	19,166	11,979	2,396	0
in percent of quota	1,400	1,400	1,400	875	175	0
in percent of GDP	6	6	5	3	1	0
in percent of exports of goods and services	14	13	12	7	1	0
in percent of gross reserves 2/	27	25	23	14	3	0
Flows from prospective drawings 3/						
GRA Charges	209	263	262	233	109	7
Level Based Surcharge	239	301	301	357	117	0
Service Charges	96	0	0	0	0	0
Principal	0	0	0	7,187	9,583	2,396
Debt Service due on GRA credit (millions SDR)	544	564	563	7,777	9,809	2,402
in percent of quota	40	41	41	568	717	175
in percent of GDP	0	0	0	2	2	1
in percent of exports of goods and services	0	0	0	5	5	1
in percent of gross reserves 2/	1	1	1	9	11	3
Memo Item:						
Total external debt, assuming full drawing (in percent of GDP)	77	76	74	71	67	65

Sources: IMF Finance Department; Polish authorities; and IMF staff estimates.

1/ End of Period. Assumes full drawing under the FCL upon approval. The Polish authorities have expressed their intention to treat the arrangement as precautionary.
2/ Excludes IMF purchases.
3/ Based on the rate of charge as of mid-December 2010. Includes surcharges under the system currently in force and service charges.

23. **Staff completed the safeguard assessment procedures required for an FCL arrangement before July 2010, when the current arrangement was approved.** Safeguards procedures applicable to FCL arrangements require Fund staff to review the most recently completed external audit of the member's central bank. An authorization for staff to communicate directly with the NBP's external auditor, PricewaterhouseCoopers (PwC) Warsaw, has been provided by the authorities. Staff has reviewed the audited information provided by PwC for 2009 and discussed the results of the audit with the audit partner on June 21, 2010. No significant safeguards issues emerged from the conduct of these procedures. PwC issued an unqualified audit opinion on the NBP's 2009 financial statements on March 29, 2010.

IV. Staff Appraisal

24. **Staff assesses that Poland continues to meet the qualification criteria for access to FCL resources.** As at the time of the last FCL approval in July 2010, staff believes that the authorities' track record of very strong economic policies before and during the economic crisis contributed to overall strong economic fundamentals. Since then, the fiscal deficit widened somewhat in 2010, due to lagged effects of the economic downturn. While the recently-proposed change to the pension system will lower the fiscal deficit over the medium term, it increases implicit pension liabilities over the long term. The authorities' commitment to continue to pursue policies that preserve macroeconomic stability—exemplified by the consolidation measures in the 2011 budget and the policy plans detailed in their letter—provides strong reassurance that economic policies will remain sound. Therefore, staff's assessment is that Poland continues to meet the qualification criteria for use of GRA resources under the FCL.

25. **In light of increased external risks, staff recommends approval of a two-year FCL arrangement for SDR 19.166 billion (1,400 percent of quota).** Although Poland's underlying fundamentals and medium-term prospects remain sound, renewed financial strains in Europe present increased downside risks to the near-term outlook, given Poland's deep and open financial markets. Against this background, replacing the current one-year FCL arrangement for 1,000 percent of quota with a new two-year arrangement for 1,400 percent of quota, which the authorities intend to treat as precautionary, would provide Poland with more adequate insurance against such heightened risks, while helping to maintain confidence in the authorities' capacity to withstand such shocks without jeopardizing macroeconomic stability. Risks to the Fund resulting from a new FCL arrangement for Poland are contained by the strong policy setting, the authorities' intent to treat the arrangement as precautionary, and their very strong debt-servicing record and manageable external debt-service profile.

Table 1. Poland: Selected Economic Indicators, 2009-13

	2009	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.
Activity and prices					
GDP (change in percent) 1/	1.7	4.0	3.8	3.9	3.9
Domestic demand	-1.0	3.4	3.6	4.0	4.1
Private consumption growth	2.0	4.0	3.8	3.8	3.7
Public consumption growth	2.0	2.5	2.2	1.3	1.5
Domestic fixed investment growth	-1.1	-1.8	4.5	7.0	7.0
Net external demand (contribution to growth)	2.7	0.6	0.2	-0.1	-0.2
Output gap	-0.4	-0.3	0.3	0.6	0.6
CPI inflation (change in percent)					
Average	3.5	2.6	3.3	3.3	2.7
End of period	3.5	3.0	3.3	3.0	2.5
Unemployment rate (average, according to LFS)	8.2	8.9	8.3	8.0	7.6
Public finances (percent of GDP) 2/					
General government revenues	37.3	38.7	40.7	41.3	41.5
General government expenditures	44.4	46.7	46.5	45.9	45.5
General government balance	-7.2	-7.9	-5.8	-4.6	-4.0
Public debt	50.9	55.6	56.6	57.6	57.8
national definition 3/	49.9	53.9	…	…	…
Money and credit					
Private credit (12-month change)	10.0	. . .	. . .	. . .	. . .
Broad money (12-month change)	8.1	. . .	. . .	. . .	. . .
Policy Rate 4/	3.5	3.5	. . .	. . .	. . .
Balance of payments					
Current account balance (transactions, millions U.S. dollars)	-9,598	-12,803	-15,488	-17,835	-19,165
Percent of GDP	-2.2	-2.9	-3.3	-3.5	-3.5
Exports of Goods (millions U.S. dollars)	142,085	156,637	170,121	183,121	197,531
Export volume growth	-12.0	8.0	7.3	6.8	6.7
Imports of Goods (millions U.S. dollars)	146,440	166,720	181,593	196,151	211,344
Import volume growth	-18.0	6.4	6.6	7.0	6.9
Net oil imports (millions U.S. dollars)	12,473	16,579	19,521	20,343	21,085
Terms of trade (index 1995=100)	101.8	97.2	96.4	96.2	96.5
FDI, net (in percent of GDP)	2.0	2.3	2.4	2.5	2.5
Official reserves (millions U.S. dollars)	79,591	97,174	108,537	117,363	126,304
months of imports (goods)	6.5	7.0	7.2	7.2	7.2
Total external debt (millions U.S. dollars)	279,528	308,588	332,549	354,407	375,329
Percent of GDP	64.9	69.8	70.7	70.0	68.5
Ratio of reserves to short-term debt	80.0	83.5	109.0	119.4	125.6
Exchange rate					
Exchange rate regime	Floating				
Zloty per US$, period average 5/	3.12	3.01	. . .	. . .	. . .
Zloty per Euro, period average 5/	4.33	3.98	. . .	. . .	. . .
Real effective exchange rate (INS, CPI based) 6/	105.4	112.1	. . .	. . .	. . .
percent change	-15.1	6.3			

Sources: Polish authorities; and IMF staff estimates.

1/ Real GDP is calculated at constant 2000 prices.
2/ According to ESA95 (inc. pension reform costs). Including the authorities' recent fiscal consolidation package.
3/ Excluding debts of the National Road Fund.
4/ NBP Reference Rate (eop). For 2010, latest.
5/ For 2010, exchange rate as of December 28.
6/ Annual average (2000=100); for 2010, January-October average.

Table 2. Poland: Balance of Payments on Transaction Basis, 2007-16
(In millions of US$)

	2007	2008	2009	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.
Current account balance	**-20,253**	**-25,554**	**-9,598**	**-12,803**	**-15,488**	**-17,835**	**-19,165**	**-19,550**	**-20,979**	**-21,946**
percent of GDP	-4.8	-4.8	-2.2	-2.9	-3.3	-3.5	-3.5	-3.4	-3.4	-3.4
Trade balance	-17,057	-25,972	-4,355	-10,083	-11,472	-13,029	-13,812	-13,924	-14,478	-15,975
percent of GDP	-4.0	-4.9	-1.0	-2.3	-2.4	-2.6	-2.5	-2.4	-2.3	-2.4
Exports										
percentage change in unit values	26.2	22.8	-18.6	11.9	8.6	7.6	7.9	7.8	8.0	8.0
percentage volume growth	9.1	7.1	-12.0	8.0	7.3	6.8	6.7	6.8	6.9	6.9
growth in foreign demand	8.7	3.2	-17.0	11.5	5.8	5.2	5.5	5.6	5.6	5.6
Imports										
percentage change in unit values	29.3	25.9	-27.5	15.4	8.9	8.0	7.7	7.3	7.7	8.1
percentage volume growth	13.7	8.0	-18.0	6.4	6.6	7.0	6.9	6.4	6.9	7.3
growth in domestic demand	8.7	5.6	-1.0	3.4	3.6	4.0	4.1	3.9	4.0	4.2
Terms of trade percentage change	1.7	-1.6	4.6	-4.5	-0.9	-0.2	0.4	0.1	0.3	0.3
Services balance	4,758	5,006	4,795	4,663	5,678	5,998	6,235	6,630	7,451	8,188
Credit	28,914	35,549	28,986	32,495	35,992	38,743	41,516	44,490	48,237	52,283
Debit	24,156	30,543	24,191	27,832	30,315	32,745	35,281	37,860	40,786	44,095
Net Income	-16,448	-12,844	-16,575	-14,399	-15,711	-16,657	-18,341	-18,695	-21,255	-21,535
Net transfers	8,494	8,256	6,537	7,016	6,017	5,853	6,753	6,439	7,302	7,375
o/w EU receipts	4,523	3,885	4,610	4,458	4,823	5,543	6,458	6,220	6,719	6,786
o/w payment to EU	-3,630	-3,934	-5,194	-4,645	-4,931	-4,906	-4,881	-4,857	-4,834	-4,834
Capital and financial account balance	**43,650**	**45,422**	**43,475**	**47,642**	**44,107**	**43,917**	**45,362**	**45,215**	**40,552**	**40,961**
Capital account balance	4,771	6,115	7,040	8,176	8,264	9,511	11,095	10,671	9,855	9,757
o/w net EU transfers	4,660	5,828	6,911	7,559	8,004	9,200	10,717	10,323	9,557	9,462
Financial account balance	38,879	39,307	36,435	39,466	35,843	34,406	34,267	34,544	30,697	31,204
Foreign direct investment (net)	17,987	10,365	8,696	10,268	11,391	12,412	13,557	14,723	15,997	17,444
by nonresidents	23,651	14,978	13,796	12,268	13,141	14,412	15,807	17,223	18,747	20,444
o/w privatization	95	100	1,263	2,505	378	128	129	128	127	126
Portfolio investment (net)	-5,415	-2,097	16,051	23,024	18,205	15,402	14,112	13,009	10,408	9,509
by non-residents	925	-4,455	16,315	24,724	19,971	17,237	16,018	14,992	12,470	11,649
o/w equities	-470	564	1,579	3,870	3,617	3,383	3,164	2,961	2,771	2,589
Other investment (net)	28,353	32,032	13,380	6,173	6,246	6,591	6,598	6,812	4,292	4,251
Assets	-1,771	5,217	5,275	-2,033	-1,361	-1,414	-1,470	-1,528	-1,589	-1,649
Liabilities	30,124	26,815	8,105	8,206	7,607	8,005	8,068	8,340	5,881	5,900
Financial derivatives	-2,046	-993	-1,692	0	0	0	0	0	0	0
Errors and omissions	**-10,360**	**-21,832**	**-19,135**	**-17,256**	**-17,256**	**-17,256**	**-17,256**	**-17,256**	**-17,256**	**-17,256**
Overall balance	**13,037**	**-1,964**	**14,742**	**17,583**	**11,363**	**8,826**	**8,941**	**8,408**	**2,317**	**1,758**
Financing										
Reserve assets	-13,037	1,964	-14,742	-17,583	-11,363	-8,826	-8,941	-8,408	-2,317	-1,758
Memorandum items:										
Current plus capital account (percent of GDP)	-3.6	-3.7	-0.6	-1.0	-1.5	-1.6	-1.5	-1.5	-1.8	-1.9
Official reserves	65,746	62,180	79,591	97,174	108,537	117,363	126,304	134,712	137,029	138,787
in months of imports	4.9	3.7	6.5	7.0	7.2	7.2	7.2	7.1	6.7	6.3
Ratio of reserves to short-term debt 1/	103.1	72.4	80.0	83.5	109.0	119.4	125.6	128.2	132.4	130.0
Ratio of reserves to ST debt plus CA deficit 1/	72.1	56.5	71.2	73.6	92.9	99.8	104.2	107.0	109.8	107.6
Total external debt (percent of GDP)	55.0	46.0	64.9	69.8	70.7	70.0	68.5	68.1	66.7	65.2
Total external debt (percent of exports) 2/	134.3	113.8	163.4	163.2	161.3	159.7	157.0	153.8	147.9	141.9
External debt service (percent of exports) 2/ 3/	29.9	45.5	48.0	52.3	45.7	44.1	43.1	43.3	42.4	41.1
Gross FDI inflows (percent of GDP)	5.6	2.8	3.2	2.8	2.8	2.8	2.9	3.0	3.0	3.1
Net FDI inflows (percent of GDP)	4.2	2.0	2.0	2.3	2.4	2.5	2.5	2.5	2.6	2.7

Sources: National Bank of Poland; and IMF staff estimates.
1/ Reserve level at end of previous year over short-term debt by remaining maturity.
2/ Exports of goods and services.
3/ Excluding repurchase of debt and including deposits.

Table 3. Poland: External Financing Requirements and Sources, 2008-13
(In million of U.S. dollars)

	2008	2009	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.
GROSS FINANCING REQUIREMENTS	**108,126**	**84,941**	**105,527**	**104,599**	**108,764**	**112,610**
Current account deficit	25,554	9,598	12,803	15,488	17,835	19,165
Medium and long-term debt amortization	29,982	12,675	26,243	19,265	17,933	16,857
Public sector	2,660	697	6,821	4,398	8,095	7,369
Banks	4,453	3,202	6,637	6,643	2,337	4,403
Non-bank Corporates	22,869	8,776	12,785	8,224	7,502	5,086
Short-term debt amortization	52,590	62,668	66,481	69,847	72,996	76,587
Public sector	6	213	1,144	1,602	2,082	2,290
Banks (inc. s.t. deposits)	17,482	29,189	29,867	31,659	33,230	35,453
Non-bank Corporates	35,102	33,266	35,470	36,586	37,684	38,844
o/w trade credit	29,234	27,296	29,461	30,388	31,300	32,264
SOURCES OF FINANCING	**106,162**	**99,683**	**123,110**	**115,963**	**117,590**	**121,551**
Foreign direct investment (net)	10,365	8,696	10,268	11,391	12,412	13,557
o/w inward (net)	14,978	13,796	12,268	13,141	14,412	15,807
Equities (net)	2,021	901	2,943	2,654	2,382	2,124
by nonresidents	564	1,579	3,870	3,617	3,383	3,164
New borrowing and debt rollover	97,867	109,119	118,770	110,938	110,067	111,739
Medium and long-term borrowing	35,199	42,638	48,923	37,942	33,480	31,527
Public sector	-9,019	19,812	28,581	20,272	21,240	19,491
Banks	12,628	4,273	7,174	8,488	3,762	6,441
Non-bank Corporates	31,590	18,553	13,169	9,182	8,477	5,594
Short-term borrowing	62,668	66,481	69,847	72,996	76,587	80,213
Public sector	213	1,144	1,602	2,082	2,290	2,451
Banks	29,189	29,867	31,659	33,230	35,453	37,206
Foreign subsidiaries to parent banks	20,783	22,047	23,370	24,529	26,170	27,465
Other	7,371	7,820	8,289	8,700	9,282	9,742
Non-bank Corporates	33,266	35,470	36,586	37,684	38,844	40,556
EU transfers	5,828	6,911	7,559	8,004	9,200	10,717
Other	-9,919	-25,944	-16,431	-17,023	-16,471	-16,587
of which: Errors and omissions	-21,832	-19,135	-17,256	-17,256	-17,256	-17,256
BUFFERS						
Use of official reserves	**1,964**	**-14,742**	**-17,583**	**-11,363**	**-8,826**	**-8,941**
FINANCING GAP	**0**	**0**	**0**	**0**	**0**	**0**

Sources: National authorities and staff estimates and projections.

Table 4. Poland: Financial Soundness Indicators, 2005-10

(In percent)

	2005	2006	2007	2008	2009	2010Q3
Capital adequacy						
Regulatory capital to risk-weighted assets	14.5	13.2	12.0	11.2	13.3	13.9
Regulatory Tier I capital to risk-weighted assets	14.4	12.9	11.8	10.1	12.0	12.6
NPLs net of provisions to capital 1/	11.9	11.6	11.4	12.8	25.8	27.2
Bank Capital to Assets 1/ 2/	7.9	7.8	8.0	7.9	9.0	8.7
Asset composition and quality						
NPLs to gross loans	11.0	7.4	5.2	4.5	8.0	8.8
Sectoral distribution of loans to total loans						
Loans to households	52.3	56.4	58.8	61.4	64.8	67.1
Loans to non-financial corporations	47.4	43.3	40.8	38.2	34.7	32.4
Earnings and profitability						
Return on average assets (after-tax)	1.6	1.7	1.9	1.5	0.8	0.9
Return on average equity (after-tax) 2/	20.5	22.2	24.9	20.5	10.4	11.2
Interest margin to gross income	58.6	58.9	58.7	62.0	57.6	57.0
Noninterest expenses to gross income 3/	62.9	60.3	58.1	56.2	55.5	53.0
Liquidity						
Liquid assets to total assets (liquid assets ratio)	21.2	20.1	17.1	17.0	20.3	…
Liquid assets to total short-term liabilities	29.3	27.7	24.1	24.7	29.0	…
Sensitivity to market risk						
Net open positions in FX to capital 2/	2.0	-0.1	0.6	-0.1	0.0	…

Sources: National Bank of Poland; and KNF.

1/ Regulatory capital.

2/ Data for domestic banking sector.

3/ Operating costs to net income from banking activity.

Table 5. Poland: General Government Revenues and Expenditures, 2008-16
(In percent of GDP, ESA95 basis)

	2008	2009	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.
General government revenue	39.5	37.3	38.7	40.7	41.3	41.5	41.2	41.2	41.2
Taxes	22.8	20.3	20.4	21.0	21.4	21.5	21.4	21.6	21.6
Indirect taxes	13.5	12.8	13.4	13.9	14.2	14.1	13.9	13.9	13.9
Direct taxes	8.6	7.4	7.0	7.1	7.2	7.4	7.5	7.7	7.8
Capital taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social contributions	11.3	11.3	11.2	12.0	12.3	12.2	12.0	11.9	11.8
Other current revenue	5.0	5.0	5.2	5.5	5.1	5.1	5.1	5.1	5.1
Capital revenue	0.4	0.6	2.0	2.1	2.4	2.7	2.6	2.6	2.6
General government expenditure	43.2	44.4	46.7	46.5	45.9	45.5	44.9	44.3	43.8
Goods and services	6.2	5.6	6.2	6.1	6.0	5.9	5.8	5.8	5.7
Compensation of employees	10.0	10.2	10.0	9.9	9.6	9.3	9.1	8.8	8.5
Interest payments	2.2	2.6	2.9	3.2	3.2	3.3	3.3	3.3	3.2
Subsidies	0.6	0.5	0.6	0.6	0.6	0.6	0.6	0.5	0.5
Social benefits	16.1	17.0	16.8	16.4	16.1	15.8	15.7	15.6	15.5
Other current expenditure	2.6	2.3	2.3	2.2	2.2	2.1	2.0	2.0	1.9
Capital transfers and investment	5.5	6.3	7.9	8.1	8.2	8.5	8.4	8.4	8.4
General government balance	-3.7	-7.2	-7.9	-5.8	-4.6	-4.0	-3.7	-3.1	-2.6
Memorandum items:									
Cyclically-adjusted balance	-4.5	-7.1	-7.8	-5.9	-4.8	-4.2	-3.9	-3.1	-2.6
Primary balance	-1.5	-4.6	-5.0	-2.6	-1.4	-0.7	-0.5	0.2	0.6
Cyclically-adjusted primary balance	-2.3	-4.4	-4.9	-2.7	-1.6	-1.0	-0.6	0.2	0.6
Public debt	47.1	50.9	55.6	56.6	57.6	57.8	58.0	57.4	56.4

Sources: Eurostat; and IMF staff estimates.

Notes: The projections include measures announced to date.

Table 6. Poland: Monetary Accounts, 2004-10 (eop)

	2004	2005	2006	2007	2008	2009	Sep-10
				(In billions of zloty)			
Monetary Survey							
Net foreign assets	148	180	167	121	67	76	95
Net domestic assets	369	384	469	573	816	887	850
Claims on Central Government (Net)	69	65	73	62	104	101	94
Claims on Other Resident Sectors	279	303	373	483	658	724	719
Broad money	378	427	495	562	666	720	722
Money	182	221	276	335	350	389	390
Quasimoney	196	206	219	226	317	331	332
Capital accounts	91	96	99	106	122	169	174
Accounts of the NBP							
Net foreign assets	114	138	138	140	177	212	227
Net domestic assets	-24	-47	-41	-39	-22	-49	-91
Net claims on government	-14	-16	-17	-26	-21	-23	-25
Claims on government	0	0	0	0	0	0	0
Liabilities government	14	16	17	26	21	23	25
Claims on Other General Govt.	0	0	0	0	0	0	0
Claims on Other Resident Sectors	0	0	0	0	0	0	0
Net claims on banks	-11	-31	-24	-13	0	-27	-67
Other items, net	17	16	5	-9	18	5	1
Base money	69	71	87	103	126	138	115
o/w Currency in circulation	56	63	75	86	102	100	97
NBP Capital	3	3	3	4	5	19	19
Deposit Money Banks							
Net foreign assets	34	42	29	-19	-110	-136	-132
Net domestic assets	394	432	510	613	838	936	941
Domestic credit	361	384	462	571	783	847	838
Net claims on government	83	81	90	88	125	123	119
Claims on Other Resident Sectors	278	303	373	483	658	724	719
Banks' reserves	18	14	18	26	36	48	27
Other claims on NBP	14	34	29	16	18	41	77
Deposit	334	377	429	484	575	635	638
Demand deposits	124	162	205	254	253	298	300
Other deposits	210	215	224	229	323	338	338
Liabilities to the NBP	3	2	5	3	18	14	11
Banks' capital	88	92	96	102	117	150	155
Memorandum items:							
Nominal GDP	925	983	1,060	1,177	1,275	1,344	
Nominal GDP growth	9.7	6.4	7.8	11.0	8.4	5.3	
			(Percentage change from end of previous year)				
Base money	4.3	1.9	23.1	18.2	23.1	8.8	-7.7
Broad money	5.5	13.1	16.0	13.4	18.6	8.1	5.5
Net domestic assets	14.0	4.0	22.1	22.3	42.3	8.6	0.0
Net foreign assets	8.9	21.7	-7.5	-27.5	-44.5	13.4	34.5
Net claim on government	-7.2	-6.5	12.8	-14.9	67.9	-3.2	-15.4
Credit to other resident sectors	17.7	8.9	22.9	29.4	36.3	10.0	3.7
Deposit growth	8.3	12.8	13.8	12.7	19.0	10.5	7.7
Demand deposits	47.5	30.7	26.4	24.0	-0.6	17.8	16.1
Other deposits	-6.4	2.2	4.4	2.4	40.7	4.7	1.2
				(In percent of GDP)			
Broad money	40.8	43.4	46.7	47.7	52.2	53.6	
Domestic credit	40.0	39.1	44.2	48.7	64.0	66.0	
Private sector credit	30.1	30.9	35.2	41.0	51.6	53.9	
Velocity	2.4	2.3	2.1	2.1	1.9	1.9	
Money multiplier	5.5	6.1	5.7	5.5	5.3	5.2	

Sources: IFS and staff estimates and projections.

Table 7. Poland: External Debt Sustainability Framework, 2005-16
(In percent of GDP, unless otherwise indicated)

	Actual				Estimate	Projections							
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	43.7	49.6	55.0	46.0	64.9	**69.8**	**70.7**	**70.0**	**68.5**	**68.1**	**66.7**	**65.2**	**-4.5**
Change in external debt	-7.6	5.9	5.4	-9.0	18.9	4.9	0.8	-0.7	-1.5	-0.4	-1.4	-1.5	
Identified external debt-creating flows (4+8+9)	-11.2	-7.3	-10.5	-8.6	9.1	-3.3	-2.8	-2.6	-2.5	-2.7	-2.6	-2.6	
Current account deficit, excluding interest payments	0.1	1.6	3.6	3.8	0.7	2.1	2.2	2.2	1.8	1.1	0.8	0.6	
Deficit in balance of goods and services	0.7	1.8	2.9	4.0	-0.1	1.2	1.2	1.4	1.4	1.3	1.1	1.2	
Exports	37.1	40.4	41.0	40.4	39.2	42.8	43.8	43.8	43.6	44.3	45.1	45.9	
Imports	37.7	42.2	43.9	44.4	39.1	44.0	45.0	45.2	45.0	45.6	46.2	47.1	
Net non-debt creating capital inflows (negative)	-3.8	-5.2	-5.5	-2.9	-3.0	-3.7	-3.6	-3.5	-3.5	-3.5	-3.5	-3.5	
Automatic debt dynamics 1/	-7.5	-3.6	-8.6	-9.6	11.5	-1.7	-1.4	-1.2	-0.8	-0.3	0.1	0.4	
Contribution from nominal interest rate	1.1	1.2	1.2	1.2	1.0	0.8	1.1	1.4	1.7	2.2	2.6	2.8	
Contribution from real GDP growth	-1.5	-2.4	-2.7	-2.3	-0.9	-2.6	-2.5	-2.6	-2.5	-2.6	-2.5	-2.4	
Contribution from price and exchange rate changes 2/	-7.1	-2.4	-7.1	-8.6	11.4	...	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	3.6	13.2	15.8	-0.4	9.8	8.2	3.6	1.9	1.0	2.3	1.2	1.1	
External debt-to-exports ratio (in percent)	118.0	122.9	134.3	113.8	165.5	163.2	161.3	159.7	157.0	153.8	147.9	141.9	
Gross external financing need (in billions of US dollars) 4/	64.7	80.2	101.8	178.6	150.0	177.1	174.4	181.8	189.2	198.3	205.3	210.8	
in percent of GDP	21.3	23.5	23.9	33.7	34.8	40.1	37.1	35.9	34.5	34.1	33.3	32.2	
Scenario with key variables at their historical averages 5/						**69.8**	**69.1**	**67.2**	**64.9**	**62.5**	**59.3**	**56.0**	**-7.5**
Key Macroeconomic Assumptions Underlying Baseline													
Real GDP growth (in percent)	3.6	6.2	6.8	5.1	1.7	4.0	3.8	3.9	3.9	4.0	4.0	3.8	
GDP deflator in US dollars (change in percent)	15.9	5.8	16.6	18.4	-20.0	-1.4	2.6	3.5	4.2	1.9	2.1	2.1	
Nominal external interest rate (in percent)	2.5	3.0	3.0	2.8	1.8	1.3	1.7	2.1	2.7	3.5	4.1	4.4	
Growth of exports (US dollar terms, in percent)	18.2	22.6	26.2	22.8	-21.1	12.0	9.0	7.6	7.7	7.7	8.1	8.0	
Growth of imports (US dollar terms, in percent)	13.7	25.9	29.3	26.0	-28.3	15.4	8.9	8.0	7.7	7.3	7.7	8.1	
Current account balance, excluding interest payments	-0.1	-1.6	-3.6	-3.8	-0.7	-2.1	-2.2	-2.2	-1.8	-1.1	-0.8	-0.6	
Net non-debt creating capital inflows	3.8	5.2	5.5	2.9	3.0	3.7	3.6	3.5	3.5	3.5	3.5	3.5	

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

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

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

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

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

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

Table 8. Poland: Public Sector Debt Sustainability Framework, 2005-16
(In percent of GDP, unless otherwise indicated)

	Actual					Projections							
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	**Debt-stabilizing primary balance 9/**
Baseline: Public sector debt 1/	47.1	47.7	45.0	47.1	50.9	**55.6**	**56.6**	**57.6**	**57.8**	**58.0**	**57.4**	**56.4**	**-0.2**
o/w foreign-currency denominated	10.6	10.1	10.3	11.2	11.4	13.0	13.4	12.9	12.5	12.1	11.8	11.5	
Change in public sector debt	1.4	0.6	-2.8	2.1	3.8	4.7	0.9	1.0	0.2	0.2	-0.5	-1.0	
Identified debt-creating flows (4+7+12)	2.2	-0.9	-4.4	2.3	4.1	4.7	0.9	1.0	0.2	0.2	-0.5	-0.9	
Primary deficit	1.3	1.0	-0.4	1.5	4.6	5.0	2.6	1.4	0.7	0.5	-0.2	-0.6	
Revenue and grants	39.4	40.2	40.3	39.5	37.3	38.7	40.7	41.3	41.5	41.2	41.2	41.2	
Primary (noninterest) expenditure	40.6	41.2	39.9	41.0	41.8	43.8	43.3	42.7	42.2	41.7	41.1	40.6	
Automatic debt dynamics 2/	1.0	-1.9	-4.0	0.9	-0.2	0.4	-0.1	-0.2	-0.4	-0.3	-0.4	-0.4	
Contribution from interest rate/growth differential 3/	0.1	-0.8	-2.4	-1.3	0.2	0.4	-0.1	-0.2	-0.4	-0.3	-0.4	-0.4	
Of which contribution from real interest rate	1.6	2.0	0.5	0.9	1.0	2.3	1.9	1.9	1.8	1.9	1.8	1.8	
Of which contribution from real GDP growth	-1.6	-2.7	-2.9	-2.1	-0.7	-2.0	-2.0	-2.1	-2.1	-2.2	-2.2	-2.1	
Contribution from exchange rate depreciation 4/	0.9	-1.1	-1.5	2.1	-0.4	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	-0.3	-0.7	-1.6	-0.1	-0.1	0.0	0.0	0.1	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	-0.3	-0.7	-1.6	-0.1	-0.1	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	-0.8	1.5	1.6	-0.2	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	
Public sector debt-to-revenue ratio 1/	119.6	118.6	111.6	119.2	136.7	143.6	138.9	139.4	139.3	140.8	139.3	137.0	
Gross financing need 6/	18.9	15.4	11.1	9.9	15.1	16.0	14.0	13.0	12.4	12.2	11.5	10.8	
in billions of U.S. dollars	57.5	52.6	47.3	52.6	65.1	70.8	65.9	65.7	67.9	70.8	70.9	71.0	
Scenario with key variables at their historical averages 7/						**55.6**	**55.7**	**57.1**	**58.5**	**60.1**	**61.6**	**63.2**	**-0.1**
Scenario with no policy change (constant primary balance) in 2010-2015						**55.6**	**59.0**	**63.7**	**68.2**	**72.9**	**77.4**	**81.9**	**-0.4**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline													
Real GDP growth (in percent)	3.6	6.2	6.8	5.1	1.7	4.0	3.8	3.9	3.9	4.0	4.0	4.0	
Average nominal interest rate on public debt (in percent) 8/	6.5	6.1	5.4	5.4	5.8	5.9	6.0	6.0	6.0	6.0	6.0	6.0	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	3.9	4.6	1.4	2.3	2.2	4.9	3.7	3.6	3.4	3.5	3.4	3.4	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-8.3	12.1	19.5	-17.8	3.9	...	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	2.6	1.5	4.0	3.1	3.6	1.1	2.4	2.4	2.7	2.5	2.7	2.7	
Growth of real primary spending (deflated by GDP deflator, in percent)	5.6	7.7	3.3	8.0	3.8	8.8	2.8	2.4	2.8	2.6	2.5	2.7	
Primary deficit	1.3	1.0	-0.4	1.5	4.6	5.0	2.6	1.4	0.7	0.5	-0.2	-0.6	

1/ General government gross debt, ESA95 definition.

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

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

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

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

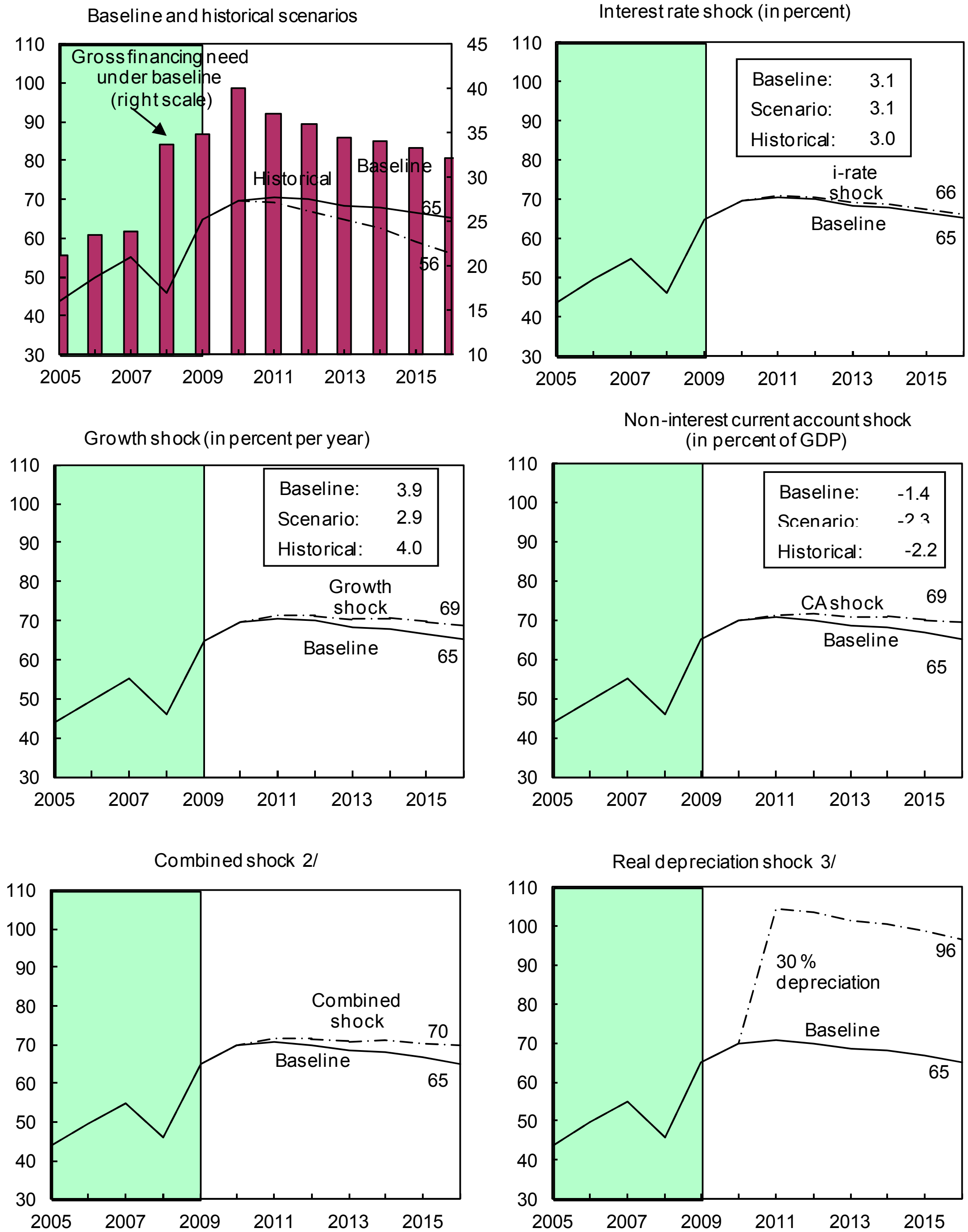
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

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

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

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

Figure 7. Poland: External Debt Sustainability: Bound Tests, 2005-16 1/
(External debt in percent of GDP)



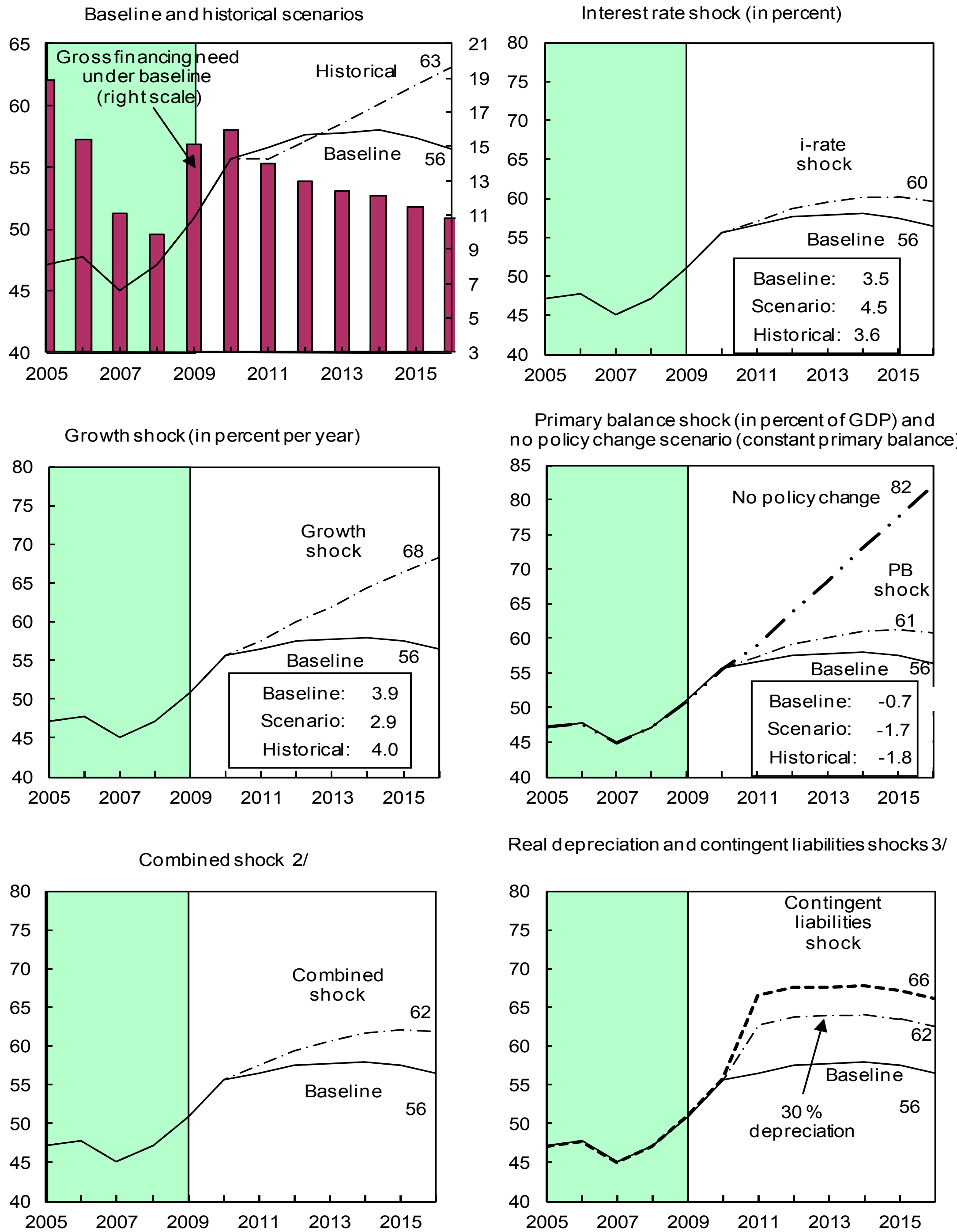
Sources: International Monetary Fund, Country desk data, and staff estimates.

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

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

3/ One-time real depreciation of 30 percent occurs in 2010.

Figure 8. Poland: Public Debt Sustainability: Bound Tests, 2005-16 1/
(Public debt in percent of GDP)



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

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

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

AUTHORITIES' LETTER

REPUBLIC OF POLAND
MINISTER OF FINANCE
JAN VINCENT – ROSTOWSKI

DZ-5/912/1-240/DYS/11/1

NBP
NATIONAL BANK OF POLAND
PRESIDENT
MAREK BELKA

DZ-WZ-KK-083/01/11

Warsaw, January 3rd, 2011

Mr. Dominique Strauss - Kahn
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431, USA

Dear Mr. Strauss - Kahn,

The first Flexible Credit Line (FCL) arrangement as well as its successor have turned out to be valuable assets for Poland's economy. During the last two years Poland has successfully met external challenges to its economic performance. While global recovery has recently resumed, progress towards global financial stability has remained vulnerable, exposed to downside risks and associated with increasing volatilities in investors' sentiment. In particular, sovereign debt problems in several euro-area countries and the related market pressures on them have been a potential source of risk for the economies of Central and Eastern Europe.

In these circumstances, Poland has maintained strong macroeconomic fundamentals, underpinned by sound policies, assisted by FCL arrangements. These efforts have been successful, and Poland has been able to maintain access to international markets at satisfactory spreads.

In 2009 Poland was the only EU country to avoid recession and in 2010 the economy has gained further momentum. We are strongly committed to remain on this upward track while preserving the macroeconomic stability necessary to ensure sustainability.

The Polish government is determined to reduce the general government deficit as well as putting public debt on a downward path, in line with our European commitments. Measures to curtail public expenditures such as the abolition of early retirement for 4 million employees, the freezing of public sector wages, immediate tax measures to increase revenues, and automatic conditional VAT increases if the debt level were to exceed the 55% debt/GDP threshold, as well as steps designed to improve management of public funds, have already been introduced. The recently announced pension reform is expected to additionally decrease the general government deficit by approximately 1% of GDP on an annualized basis, 0.7 of which will take place in 2011. Restrictions on local government expenditures currently planned will reduce the general government deficit by 0.6% of GDP in 2012 and a further 0.6% of GDP in 2013. Additional fiscal disciplinary measures will be implemented, if necessary.

The inflation-targeting framework has served Poland well and will be maintained. This framework, combined with the free-floating exchange rate regime, will keep inflation low and stable over the next 24 months.

Poland's banking system was able to withstand the crisis well and currently shows no solvency problems. The surveillance of banks has been enhanced, in line with FSAP recommendations. Financial institutions are closely monitored by the authorities, including the use of stress-tests, which show Polish institutions' resilience to adverse shocks. In order to strengthen analyses, supervision and coordination between the state agencies responsible for the financial sector, Financial Stability Committee comprising representatives from the MoF, NBP, KNF (Financial Supervisory Authority) was established in 2008.

We see the redesigned FCL as a key instrument for the Fund to address the current situation on global markets. We believe that Poland is currently well qualified to apply for an extended and increased FCL arrangement. Being amongst the strongest performers in Europe Poland is clearly eligible for the enhanced FCL. The coordinated international support program has reduced, but not eliminated sovereign debt stress inside the euro area and the associated risks for other economies. Furthermore, the recent crisis has demonstrated the increasing financial interconnectedness of countries and, therefore, also expanding spillovers and contagion. In our view the amount of the FCL requested by Poland adequately reflects the potential financing needs of the economy in the face of increased external risks. As in 2009, when Poland (among others things thanks to its access to the FCL) proved to be a pillar of stability in emerging Europe, we believe that other economies in the region will also benefit from the changes we are requesting to the FCL for Poland.

Therefore, we request the approval of a Flexible Credit Line arrangement for Poland in the amount of SDR 19.166 billion (1400 percent of quota) covering a period of 24 months. Should the arrangement be approved, it is Poland's intention that the FCL remain a precautionary facility.

Sincerely Yours,

/s/
Minister of Finance
JAN VINCENT-ROSTOWSKI

/s/
President of the National Bank of Poland
MAREK BELKA

INTERNATIONAL MONETARY FUND

Republic of Poland—Assessment of the Impact of the Proposed Flexible Credit Line Arrangement on the Fund's Finances and Liquidity Position

Prepared by the Finance and Strategy, Policy and Review Departments

(In consultation with other Departments)

Approved by David Andrews and Aasim Husain

January 7, 2011

1. **This note assesses the impact of the proposed Flexible Credit Line (FCL) arrangement for Poland on the Fund's finances and liquidity position, in accordance with the policy on the FCL.**[1] The proposed arrangement would cover a 24-month period with access of SDR 19.166 billion (1,400 percent of quota). It would succeed the current FCL arrangement, which would be cancelled prior to approval of the proposed arrangement. The full amount of the proposed access would be available throughout the arrangement period, in one or multiple purchases.[2] The authorities intend to treat the arrangement as precautionary.

I. Background

2. **Against the backdrop of a global economic and financial crisis, a one-year FCL arrangement with access equivalent to SDR 13.69 billion was approved on May 6, 2009 and treated as precautionary by the authorities.** This arrangement was succeeded by another FCL arrangement on identical terms which was approved on July 2, 2010. The authorities' timely and effective policy responses to the impact of the global crisis on Poland have been successful in maintaining stability, with Poland being the only EU country with positive GDP growth (1¾ percent) in 2009. As a consequence, no drawings were made under either the previous or the existing FCL arrangement. Poland has a history of strong

[1] See *GRA Lending Toolkit and Conditionality—Reform Proposals* (imf.org), *GRA Lending Toolkit and Conditionality—Reform Proposals* (imf.org), *Flexible Credit Line (FCL) Arrangements,* Decision No.14283-(imf.org), adopted March 24, 2009, *The Funds Mandate—The Future Financing Role—Revised Reform Proposals and Revised Proposed Decisions* (imf.org), and *The Fund's Mandate--Flexible Credit Line (FCL) Arrangements*, Decision No.14714-(imf.org), adopted August 30, 2010.

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

performance under Fund arrangements and an exemplary record of meeting its obligations to the Fund.[3]

3. **Total external and public debt levels are significant but sustainable.** External debt, which was in the 44–55 percent of GDP range in the years preceding the recent crisis, is projected to peak at about 70 percent of GDP in 2011-12, and gradually decline over the medium term. Short-term debt on a residual maturity basis is estimated at about a third of total external debt in 2010, and this share is projected to decline to about one-quarter over the medium term. Public external debt, in turn, is estimated at 23 percent of GDP in 2010, and is projected to decline gradually over the medium term. Gross public debt (ESA95 definition), which stayed below 50 percent of GDP in 2005-2008, is estimated at around 56 percent of GDP in 2010, as a result of the countercyclical fiscal policy followed by the authorities in response to the global crisis. The debt ratio is projected to stabilize at around 56-58 percent of GDP in the coming years. Sustainability analyses suggest that both external and public debt are generally robust to, and remain manageable under, a range of scenarios.[4]

4. **The substantial access under the proposed arrangement could add significantly to the Fund's credit exposure.** If the full amount available under the FCL arrangement—which the authorities intend to treat as precautionary—were drawn, Poland's outstanding use of GRA resources would reach SDR 19.166 billion, among the highest of individual country exposures.[5]

5. **If the full amount available under the proposed FCL arrangement is purchased in 2011:**

- **Fund credit would represent a modest part of Poland's external debt.** Total external debt would rise to 77 percent of GDP initially, and public external debt to about 30 percent of GDP, with Fund credit representing over 6 percent of GDP (Table 1). At its peak, Poland's outstanding use of GRA resources would account for about 8 percent of total external debt, and about 21 percent of both public external debt and gross international reserves.

- **External debt service would increase over the medium term, but would remain manageable under staff's medium-term macroeconomic projections**. Poland's projected debt service to the Fund would peak in 2015 at SDR 9.8 billion, or close to

[3] See *Republic of Poland—Assessment of the Impact of the Proposed Flexible Credit Line Arrangement on the Fund's Finances and Liquidity Position* (IMF Country Report 09/138, Sup. 1, 04/28/2009).

[4] A more detailed description of external and public debt is provided in the staff report.

[5] The largest GRA credit exposure was SDR 23.359 billion to Brazil in 2003. Currently, the largest GRA exposure is to Romania in the amount of SDR 9.8 billion.

2½ percent of GDP.[6] In terms of exports of goods and services, external debt service to the Fund would peak at about to 5½ percent, and would then account for about half of total public external debt service.

Table 1. Poland: Capacity to Repay Indicators 1/

	2011	2012	2013	2014	2015	2016
Exposure and Repayments (In SDR millions)						
GRA credit to Poland	19,166.0	19,166.0	19,166.0	11,978.8	2,395.8	--
(In percent of quota)	(1,400.0)	(1,400.0)	(1,400.0)	(875.0)	(175.0)	(0.0)
Charges due on GRA credit 2/	543.8	564.0	563.5	589.9	226.0	6.8
Debt service due on GRA credit 2/	543.8	564.0	563.5	7,777.2	9,809.0	2,402.5
Debt and Debt Service Ratios 3/						
In percent of GDP						
Total external debt	76.9	75.8	73.9	71.3	67.3	65.2
Public external debt	29.6	28.9	27.9	25.5	22.4	21.3
GRA credit to Poland	6.3	5.8	5.4	3.2	0.6	--
Total external debt service	20.2	19.5	19.0	21.3	21.6	19.4
Public external debt service	2.7	2.6	2.5	4.4	4.8	2.9
Debt service due on GRA credit	0.2	0.2	0.2	2.1	2.4	0.6
In percent of Gross International Reserves						
Total external debt	262.3	261.4	259.8	270.4	294.9	307.1
Public external debt	100.9	99.5	98.0	96.7	98.2	100.3
GRA credit to Poland	21.4	20.1	18.9	12.0	2.6	--
In percent of Exports of Goods and Services						
Total external debt service	46.1	44.5	43.5	48.0	47.8	42.3
Public external debt service	6.1	5.8	5.7	10.0	10.7	6.3
Debt service due on GRA credit	0.4	0.4	0.4	4.7	5.4	1.2
In percent of Total External Debt						
GRA credit to Poland	8.1	7.7	7.3	4.5	0.9	--
In percent of Public External Debt						
GRA credit to Poland	21.2	20.2	19.3	12.5	2.7	--

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

1/ Assumes full drawings under the FCL upon approval. The Polish authorities have expressed their intention to treat the arrangement as precautionary, as balance of payments pressures have not materialized.
2/ Based on the rate of charge as of December 9, 2010. Includes surcharges and service charges.
3/ Staff projections for external debt, GDP, gross international reserves, and exports of goods and services, as used in the staff report that requests the proposed FCL, adjusted for the impact of the assumed FCL drawing.

[6] The figures on debt service used in this report are calculated assuming that full amount available under the arrangement is purchased upon approval of the arrangement, and that all repurchases are made as scheduled.

6. **The impact of the proposed arrangement on the Fund's liquidity, and on its potential exposure to credit risk, would be substantial:**

- **The net effect of the cancelation of the current FCL arrangement and the approval of the proposed arrangement would be to reduce the Fund's one-year forward commitment capacity (FCC) by about 4 percent from its current level.** The net liquidity impact would be to reduce the FCC by SDR 5.5 billion to about SDR 111 billion, assuming the approval of the proposed FCL arrangement for Mexico. This level of liquidity remains relatively comfortable by historical standards. However, the liquidity position could change quickly, particularly given the current potential for other large requests for Fund support owing to stresses in some sovereign debt markets and the potential for spillovers, underscoring the need for the continued close monitoring of the Fund's liquidity position.

- **If the resources available under the FCL arrangement were fully drawn, GRA credit to Poland would represent about a quarter of total GRA credit outstanding.** However, the concentration of Fund credit among the top five users of Fund resources would remain stable at close to its current level of about 74 percent.

- **Potential GRA exposure to Poland would be almost three times the Fund's current precautionary balances.**

Table 2. FCL Arrangement for Poland—Impact on GRA Finances
(In SDR millions, unless otherwise indicated)

	As of 12/31/2010
Liquidity measures	
Current one-year Forward Commitment Capacity (FCC) 1/	132,130
FCC including the proposed FCL for Mexico	116,366
Net impact on FCC on approval of FCL	5,476
FCC including the proposed FCLs for Mexico and Poland	110,890
Prudential measures, assuming full FCL drawing	
Fund credit to Poland	
In percent of total GRA credit outstanding 2/	25.6
In percent of current precautionary balances	261.8
Fund credit outstanding to five largest debtors	
In percent of total GRA credit outstanding, before approval	73.8
In percent of total GRA credit outstanding, upon approval of the FCL 2/	73.5
Memorandum items	
Current precautionary balances (FY2010) 3/	7,320
Total FCL commitments, including proposed FCL 4/	68,780
Quota of FTP members with actual and proposed FCLs, in percent of total quota of FTP members	2.9

Sources: Finance Department.

1/ The FCC measures the Fund's capacity to make new credit commitments over the next 12 months. It includes the liquidity effects of resources made available under borrowing and note purchase agreements.
2/ Based on current Fund credit outstanding plus full drawings under the proposed FCL.
3/ Precautionary balances exclude amounts in Special Reserves attributable to profits on gold sales in FY2010.
4/ Excluding Poland's existing FCL and including the new proposed FCL for Mexico.

II. ASSESSMENT

7. **The proposed arrangement would have a large, but manageable impact on the Fund's liquidity.** The current liquidity position is sufficiently strong to accommodate the net liquidity impact of the proposed arrangement. However, close monitoring of the Fund's liquidity position is warranted in light of the significant uncertainty surrounding the recovery from the global crisis and the potential for substantial demand for Fund resources. In this regard, the continued availability of supplementary resources under the bilateral borrowing and note purchase agreements, as well as early effectiveness of the expanded NAB, are key for maintaining the adequacy of the Fund's resources.[7]

8. **Poland intends to treat the FCL arrangement as precautionary, but if it did prove necessary to draw, this would feature prominently among the Fund's single credit exposures.** Poland's overall external debt and debt service ratios are expected to remain manageable including should adverse shocks materialize such that a purchase became necessary. In addition, Poland's capacity to repay is expected to remain strong given its sustained track record of implementing strong policies, including during the global financial crisis, and sound institutional policy framework, which provide assurances about the future course of policies. Nonetheless, the scale of the Fund's potential exposure to Poland—in conjunction with the recent increase in commitments to other members and the possibility of further credit expansion under already existing or new Fund arrangements—underscores the need to strengthen the Fund's precautionary balances.

[7] For an update on the Fund's liquidity position see *The Fund's Liquidity Position—Review and Outlook: Update* (IMF Policy Paper, imf.org).

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 11/15
FOR IMMEDIATE RELEASE
January 21, 2011

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves New Two-Year US$30 Billion Flexible Credit Line Arrangement for Poland

The Executive Board of the International Monetary Fund (IMF) today approved a successor two-year arrangement for Poland under the Flexible Credit Line (FCL) in an amount equivalent to SDR 19.17 billion (about US$30 billion, or 1,400 percent of quota). Poland's first FCL arrangement was approved on May 6, 2009 (see Press Release No. 09/153). A successor arrangement was approved on July 2, 2010 (see Press Release No. 10/276). The Polish authorities have stated that they intend to treat the arrangement as precautionary and do not intend to draw on the FCL.

Following the Executive Board discussion of Poland, Mr. John Lipsky, First Deputy Managing Director and Acting Chairman of the Board, made the following statement:

"Poland's macroeconomic performance was strong in the decade leading up to the global crisis, supported by sound economic policies. Inflation was brought down to low single digits, the commitment to the EU Stability and Growth Pact helped lower the fiscal deficit relative to GDP and limit government debt, and strong financial oversight bolstered the resilience of the financial system.

"Strong policy frameworks allowed the authorities to undertake countercyclical monetary and fiscal policies in response to the global crisis, while preserving financial sector stability. At the same time, the FCL arrangement supported investor confidence. As a result, Poland was the only EU economy to avoid a recession in 2009, and the government maintained access to international capital markets on favorable terms.

"The economy gathered momentum in 2010, underpinned by low interest rates, a neutral fiscal stance, improving external demand, and rising confidence in the wake of the second FCL arrangement. Looking forward, economic growth is projected to remain solid and balanced. The authorities are committed to keep implementing economic policies that preserve macroeconomic stability.

"However, sizeable downside risks remain, particularly from the possibility of further spillovers of financial turbulence in other parts of Europe. Against this background, the Executive Board today approved the authorities' request for a new arrangement under the FCL facility as a successor to the previous arrangement approved in July 2010. The authorities intend to continue to treat the FCL arrangement as precautionary.

"The augmented duration and size of this successor FCL—new features made possible by the recent reform of IMF facilities—will allow the FCL to play an even stronger role in insuring Poland against external risks while continuing to support the authorities' overall macroeconomic strategy."

The FCL was established on March 24, 2009 for countries with very strong fundamentals, policies, and track records of policy implementation and is particularly useful for crisis prevention purposes. FCL arrangements are approved for countries meeting pre-set qualification criteria (see Press Release No. 09/85).

The FCL was further enhanced with reforms approved in August 30, 2010 (see Press Release No. 10/321). The duration of the line was expanded from one year to up to two years (with an interim review of continued qualification after one year) and the removal of the implicit cap on access to resources of 1000 percent of a country's IMF quota. The repayment period on any drawings is between three and a quarter and five years. Access is determined on a case-by-case basis, and is fully available from the start, rather than being phased over time as in traditional IMF arrangements. Disbursements under the FCL are not conditioned on implementation of specific policy targets or meeting quantitative criteria. There is flexibility to either draw on the credit line at the time it is approved, or treat it as precautionary.

Qualification criteria

The qualification criteria are the core of the FCL and serve to highlight the IMF's confidence in a qualifying member country's policies, and its ability to take corrective economic policy measures when needed. At the heart of the qualification process is an assessment that the member country has very strong economic fundamentals and institutional policy frameworks; is implementing—and has a sustained track record of implementing—very strong policies; and remains committed to maintaining such policies in the future.
The criteria used to assess a country's qualification for an FCL arrangement are a sustainable external position; a capital account position dominated by private flows; a track record of access to international capital markets at favorable terms; a reserve position that is relatively comfortable when the FCL is requested on a precautionary basis; and sound public finances, including a sustainable public debt position. The criteria also includes low and stable inflation, in the context of a sound monetary and exchange rate policy framework; no bank solvency problems that pose systemic threats to banking system stability; effective financial sector supervision; and data integrity and transparency.

Statement by Katarzyna Zajdel-Kurowska, Alternate Executive Director for Poland and Beata Jajko, Advisor to the Executive Director
January 21, 2011

We would like to thank staff for the report that supports Poland's request for an arrangement under the Flexible Credit Line (FCL). Our authorities agree with the staff appraisal and their assessment of the qualification criteria. The Polish authorities believe that the previous FCL arrangements served the economy well and provided adequate insurance against negative spillover risks. Notwithstanding Poland's strong fundamentals and favorable outlook, the external environment remains uncertain. Therefore the authorities consider that a new 2-year arrangement under the FCL with higher access would provide an essential buffer against a possible increase in risk aversion. As in the past, the Polish authorities intend to treat the new FCL arrangement as a precautionary instrument, and they would highly appreciate the Board's approval of their request.

Fiscal Policy

The widening of the general government deficit in 2010 mostly reflected the lagged effects of the economic slowdown, tax wedge cuts implemented in 2007-2009, and higher public investment. Poland remains one of the largest net beneficiaries of EU Funds. However, the absorption of these funds, directed mostly to enhance the potential of the economy, requires a co-financing from both the State budget and the local governments. Based on current assumptions, the Ministry of Finance expects the general government deficit at 7.9 percent of GDP in 2010. A much lower than assumed 2010 State budget deficit (by approximately PLN 7 billion—with PLN 6 billion on the expenditure side) should mitigate the potential risk of the worse than expected outcome for the local governments (preliminary data for local governments will be known in February).

The authorities are fully committed to the budgetary policy framework under the EU Stability and Growth Pact and are determined to keep the deficit on a declining path to meet the 3 percent of GDP deficit target in 2012.

The already announced fiscal consolidation measures, both on the expenditure and revenue side, should allow a 2.6–2.7 percentage point reduction in the general government deficit in 2011. Measures on the expenditure side mostly reflect the implementation of the temporary expenditure rule (establishing a ceiling of CPI plus 1 percent on the growth of discretionary and new "fixed" spending), changes in the pension system, freezing of nominal wages in the public sector and lower spending on active employment policies. It will be coupled with tax measures, mostly an increase in VAT rates.

The consolidation efforts will be continued in 2012. Should the already introduced measures not be sufficient, additional steps will be taken to assure the required reduction in the deficit. Detailed measures will be presented in the April update of the Convergence Program.

The deficit reduction strategy and recently introduced liquidity management regulations are expected to contribute to the decline in the general government debt as of 2011.

In order to ensure the long-term sustainability of the public finances, our authorities have already undertaken steps towards keeping the deficit on a sustainable level over the mid- and long term. A permanent expenditure rule, stabilizing the structural deficit at 1 percent of GDP, is being analyzed, which together with stronger control over expenditures, and the strengthened fiscal framework will keep the public finances on a sustainable path in the long term.

Monetary Policy/Financial Sector

The latest readings of inflation indicators do not show immediate inflationary pressure, despite the fact that headline CPI inflation increased to 3.1 percent year-on-year in December 2010. In the coming months, inflation is likely to rise slightly, mainly driven by the economic recovery, supply-side factors and higher VAT rates.

The Monetary Policy Council is fully committed to stabilizing inflation at 2.5 percent in the medium term and shall act as appropriate to fulfill its mandate. The MPC vigilantly monitors economic developments and is ready to address them by adjusting interest rates. The possible monetary tightening is already reflected in market expectations.

The National Bank of Poland, the Ministry of Finance, and the Polish Financial Supervision Authority (KNF) cooperate in the macro-prudential field within the framework of the Financial Stability Committee. The Committee has promoted financial stability mainly through microprudential policies, regulation and supervision recommendations. However, the instruments and the institutional arrangements for a macroprudential approach are still evolving; current discussions include: the appropriate role for microprudential, monetary, and fiscal policies.

The financial crisis has shown the need for improvement in regulations related to foreign exchange lending. Despite the fact that foreign exchange credit risk has not significantly materialized in Poland, KNF considers introducing measures to prevent a rapid increase of foreign currency lending to unhedged households as important for preserving macroeconomic and financial stability. These measures would also increase the effectiveness of the monetary transmission mechanism. Recommendations S and T, introduced by the KNF, are some of the examples of the pre-emptive measures already implemented.

Our authorities are conducting the preparatory work for the FSAP update planned for next year. The ROSCs of the Basil Core Principles and IAIS Insurance Core Principles have been already scheduled for the first half of this year.