INTERNATIONAL MONETARY FUND

IMF Country Report No. 13/219

REPUBLIC OF POLAND

2013 ARTICLE IV CONSULTATION

July 2013

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2013 Article IV consultation with Poland, the following documents have been released and are included in this package:

- **Staff Report** for the 2013 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 16, 2013, with the officials of Poland on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 1, 2013. 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.
- **Informational Annex** prepared by the IMF.
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its Juy 17, 2013 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Poland.

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

Financial System Stability Assessment
Selected Issues Paper

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

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REPUBLIC OF POLAND

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

July 1, 2013

KEY ISSUES

Context. The economy has slowed considerably due to weak activity in main trading partners, a contraction in public investment, and the effects of uncertainty on household consumption and firms' hiring and investment decisions. The recent turbulence in global financial markets has led to an increase in zloty volatility and sovereign spreads, although the latter remain low by historical standards. Going forward, economic activity is expected to pick up gradually in the second half of 2013, as growth in key trading partners recovers.

Interconnectedness. Substantial trade and financial linkages with euro area countries make Poland vulnerable to spillovers from the region, and its open capital account makes it susceptible to shifts in investor sentiment. Poland's integration into the German supply chain has served it well, but has also increased the impact of (positive and negative) external shocks. This points to the importance of continuing to build policy buffers to increase resilience to shocks.

Monetary policy. The monetary easing cycle that began in November 2012 is welcome, given muted inflation pressures and still high real interest rates. Monetary policy is the main macroeconomic policy tool to support the economy.

Fiscal policy. Fiscal consolidation has continued, but the economic slowdown poses challenges going forward. Despite limited space, there is scope for fiscal policy to balance structural consolidation with support for the economy by allowing automatic stabilizers to operate in 2013. As the economy recovers, additional fiscal consolidation will be needed to put the public debt ratio firmly on a downward path and rebuild fiscal buffers.

Financial sector policy. The banking sector has remained well capitalized, liquid, and profitable, but credit growth has stalled. Banking supervision has improved, but further efforts are needed. Relatively high impaired loans need to be addressed by tackling legal and tax obstacles. The authorities have continued to work on the legal frameworks for macroprudential supervision and bank resolution.

Structural reforms. Additional measures to increase labor participation and raise potential growth are needed. These include reform of the occupational pension schemes, further efforts to reduce administrative burdens, and changes to the insolvency regime. The launch of the public investment fund could support growth and help offset a decline in public investment, but it is crucial the fund's corporate governance and operations are transparent and accountable.

Approved By
Mahmood Pradhan and Vivek Arora

Ms. Kozack (Head), Ms. Lu, Mr. Ebeke, Mr. Vazquez (all EUR), and Mr. de Imus (SPR) visited Warsaw between May 7–16, 2013. The mission met with senior government and central bank officials, and representatives from trade unions and the business community. Mr. Sierhej (Resident Representative Office) participated in the discussions. Mr. Augustyniak, Ms. Adu (both EUR), and Ms. Kostrzewa (Resident Representative Office) provided excellent assistance and support to the mission. Poland is an Article VIII country and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions, except for those solely for the preservation of national or international security. (Informational Annex: Fund relations). Data provision is adequate for surveillance (Informational Annex: Statistical Issues).

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CONTEXT

1. **Poland is highly integrated with Europe through both trade and financial channels** (Appendix I). Although Poland is less dependent on trade and cross-border bank flows than some of its Eastern European neighbors, it plays a key role in the German supply chain (Box 1). This has shaped its trade and financial ties with Europe and, to some extent, the rest of the world.

- About 70 percent of Poland's domestic value added is exported to, and consumed in, Europe. More than 90 percent of the stock of inward foreign direct investment (which represents about 36 percent of GDP) originates from Europe.
- The foreign claims of BIS reporting banks amount to almost 60 percent of GDP, of which 80 percent are accounted for by assets of foreign European bank subsidiaries and cross-border funding from European banks. In turn, Polish subsidiaries have become an important source of earnings for some European parent banks.
- Spillovers from the euro area—through trade, financial, and confidence channels—therefore remain a key source of risk facing Poland.

2. **Poland is also linked with global financial markets through its open capital account**. Significant foreign investment in the government bond market—particularly since 2008–09—has increased Poland's integration with international capital markets. Given Poland's relatively deep and liquid financial markets, investors often use the zloty as a proxy for exposure to, or hedging against, risk in the region. This exposes Poland to more generalized shifts in investor sentiment, including on account of turbulence in global financial markets or shifts in risk appetite for emerging market assets.

3. **Despite its resilience in recent years and very strong fundamentals, the economy has weakened significantly over the past year**. The slowdown appears to be cyclical, as growth in Poland's main trading partners (notably Germany) has weakened, with knock-on effects on consumer and business confidence (and, therefore, private consumption and investment). Several of the factors that helped keep domestic demand resilient following the 2008-09 global financial crisis—including fiscal expansion, rising EU structural fund inflows (which supported public investment), and ample credit—have reversed and are now headwinds to the recovery. As a result, growth in 2013 is projected to be lower than in 2009. At the same time, fiscal space is limited (notably by the proximity of public debt to national legal thresholds), suggesting that the policy mix will need to rely on monetary policy to cushion the economy. A fundamental question is whether domestic demand will bounce back, or whether confidence effects and uncertainty will continue to weigh on private consumption and investment. Given Poland's exposure to shocks, rebuilding policy buffers—including through medium-term fiscal consolidation, maintaining reserve adequacy, and further strengthening the resilience of the financial sector—remains essential.

4. **The political situation is stable, but reform momentum has lost some steam**. The ruling coalition has maintained a slim majority in Parliament, but forthcoming elections at the local level and the need to manage the weak economy appear to have reduced the appetite for further major reforms.

Box 1. Economic Integration into the German Supply Chain: Benefits and Challenges for Poland[1]

In Europe, the emergence of vertical specialization has been particularly evident among German firms. The German-Central European Supply Chain (GCESC) has expanded rapidly since the mid-1990s, led by favorable "pull" factors (such as proximity and high labor-cost differentials) in Central European countries, notably the Czech Republic, Hungary, Poland and Slovakia (CE4, hereafter).

Exports from the CE4 are skewed toward "downstream" activities, although to a lesser extent in Poland. The value-added decomposition of aggregate exports from these countries suggests that trade specialization is mainly in "downstream" activities and exposure to the rest of world is greater than what traditional metrics suggest. Poland stands out as a more balanced case, with downstream and upstream activities more equally represented in its bilateral trade ties. A possible explanation is the larger size and deeper diversification of Poland's economy. Moreover, its export exposure (based on final demand) implies that its links to the rest of the world are significantly higher than what is suggested by traditional metrics.

Staff analysis finds that the integration of the CE4 into the German supply chain has had significant positive macroeconomic effects on both the real and financial side.

- The foreign value-added and the domestic value-added embodied in CE4 exports are strong complements rather than substitutes, with this finding strongest for Poland and Hungary.
- Integration into the German supply chain has contributed to higher long-term real GDP growth and fostered income convergence. Indeed, Poland's convergence outpaces that of most other countries in Europe and in the CE4. This has occurred because of positive domestic spillovers from integration into the supply chain in terms of increased domestic capital formation and technological transfer.
- Supply chains links have shaped the CE4's financial accounts towards a greater reliance on long-term capital flows (notably FDI), making them less prone to capital account reversals.

At the same time, integration into the supply chain has considerably increased the CE4's exposure to the German business cycle and global shocks.

- The co-movement of CE4 and German business cycles has deepened over the years, especially in Poland, and the exposure (based on final demand) of the CE4 to non-European trading partners is significantly higher than in the past. Poland's exposure vis-à-vis the rest of the world increased by 10 percentage points when the concept of final demand (as opposed to traditional measures) for exports was used.
- Model-based simulations confirm that the transmission of global shocks to the CE4 is more pronounced than in the past and could become even larger if German balance sheets were weaker.

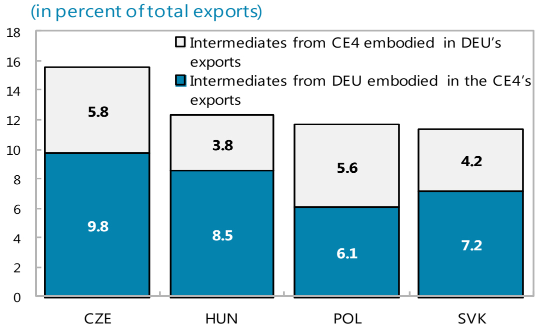
Policy implications for Poland and the rest of the CE4 are geared towards securing and maximizing the benefits generated by the supply-chain links, while continuing to increase resilience to shocks. Given its current balanced model of trade integration, the challenge for Poland is to safeguard its privileged place in the supply chain by moving up the value added chain, to compensate for labor cost convergence that will inevitably take place. This will require upgrading the skills of the labor force, through education and vocational training, continuing to improve the business environment to support entrepreneurship and innovation, and boosting investment (especially in infrastructure). Pressing ahead with efforts to build policy buffers—notably by continuing with fiscal consolidation and further strengthening the resilience of the financial system—will also be important to improve Poland's resilience to shocks.

———

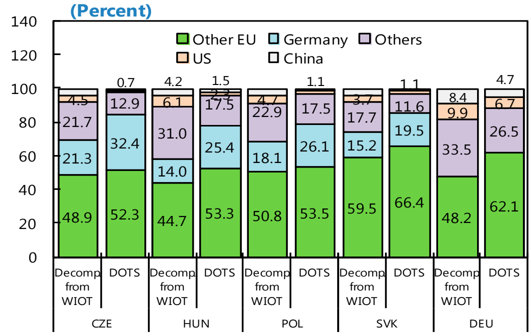
[1] See "The German-Central European Supply Chain: Cluster Report", 2013.

Box 1. Economic Integration into the German Supply Chain: Benefits and Challenges for Poland (Concluded)

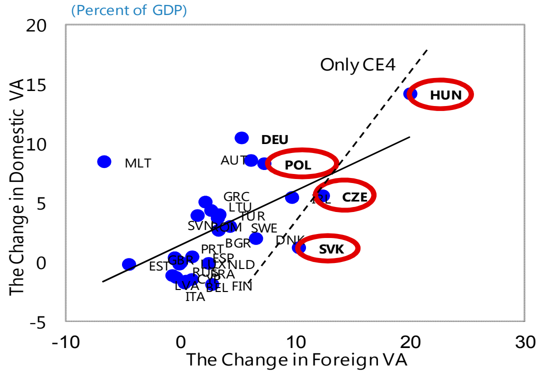
Supply-chain related activies: *Downstreamness* versus *Upstreamness*
(in percent of total exports)



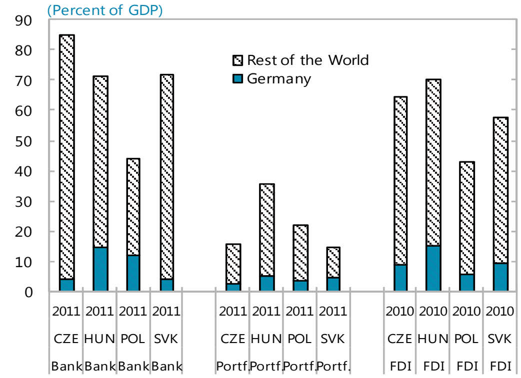
Actual Exposure of the CE-4 Countries Based on the Recipients' Final Demand, 2009
(Percent)



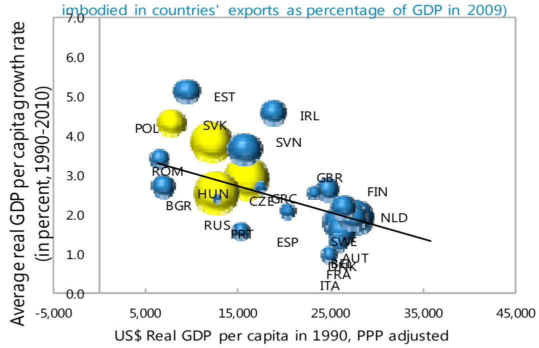
The Change in Foreign and Domestic Value Added (VA) in Total Exports, 1995-2009
(Percent of GDP)



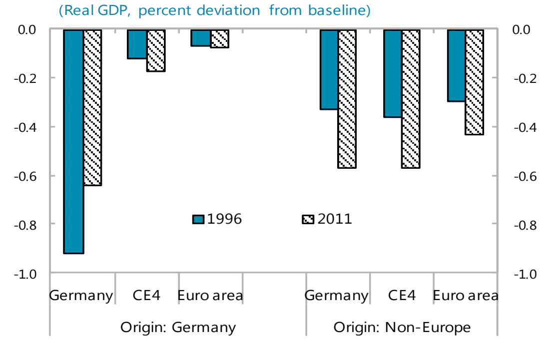
CE4: Bank Claims, FDI and Portfolio Stocks
(Percent of GDP)



Income Convergence and the Role of Supply Chains
(Bubbles represent the share of Germany foreign value added imbodied in countries' exports as percentage of GDP in 2009)



Aggregate Demand Shock: 1 percent decline
(Real GDP, percent deviation from baseline)



Sources: National Authorities; World Input Output Tables (WIOT); IMF-Direction of Trade Statistics (DOTS); OECD Statistics; IMF-Coordinated Portfolio Investment Survey; BIS Statistics; Penn World Tables; and IMF Staff estimates.

RECENT ECONOMIC DEVELOPMENTS

A. The Economy has Lost Steam

5. **Poland's economy has slowed, amid weak external and domestic demand** (Figures 1 and 2). Real GDP growth moderated to 1.9 percent in 2012 from 4.5 percent in 2011. A slowdown in Poland's main export markets, combined with uncertain prospects for euro area growth and a sharp drop in public investment, weighed on demand and output, particularly in the construction and industrial sectors. This also led firms to hold back investment and hiring decisions, and to draw down inventories. In the face of adverse confidence effects, sluggish disposable income, falling real wage growth, and rising unemployment, household consumption slowed markedly. Relatively tight monetary and credit conditions, present until late 2012, contributed to the slowdown. High frequency indicators have been mixed.

6. **Inflation has fallen sharply below the lower band of the target range** (Figure 3). Headline CPI inflation hovered above the upper band of the target range (1½–3½ percent) during 2011 and the first three quarters of 2012, but declined rapidly since then to 0.5 percent in May as a result of weak demand, muted wage pressure, and lower fuel and energy prices. Core inflation also dropped considerably, to 1 percent in May from 2.3 percent in the previous year. Inflation expectations have continued to ease.

7. **The current account deficit narrowed considerably to 3½ percent of GDP in 2012—its lowest reading since 2005** (Figure 4). The trade deficit shrank as imports decreased for the first time since 2009 (reflecting weak domestic demand), while export growth slowed, but remained positive. Exports were sustained by gains in market share and a modest expansion towards non-euro area European Union and central and eastern European countries, which helped offset a drop in exports to the euro area, particularly motor vehicles, televisions and engines. The change in Poland's balance of payments compilation system two years ago continued to bear fruit as errors and omissions fell to -0.7 percent of GDP in 2012 from about -1.8 percent in 2011.

B. Despite Recent Turbulence, Financial Conditions have been Broadly Supportive

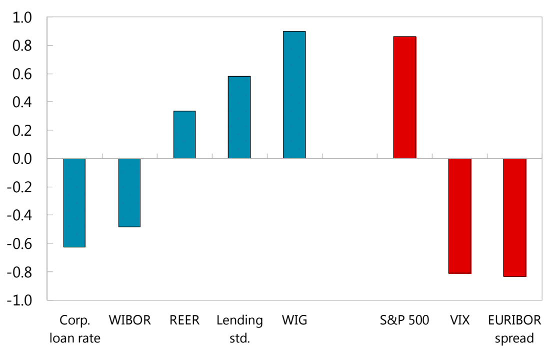
8. **After remaining relatively tight through most of 2012, domestic financial conditions improved** (Figure 5). A financial conditions index (FCI) constructed for Poland indicates that overall financial conditions started to contribute positively to growth in late 2012 (Box 2). This positive contribution has mainly originated from a decline in the key interbank benchmark rate (3-month WIBOR) in response to monetary policy easing (which began in November 2012).

Box 2. A Financial Conditions Index for Poland[1]

A financial conditions index (FCI) can be used to explore the link between financial conditions and the real economic activity. An FCI combines a wide range of high-frequency financial variables to assess aggregate financial conditions in the economy. The resulting data provide information on the evolution of financial conditions over time, and help to identify and examine the extent of macro-financial linkages. The FCI can also be used to gauge the impact of monetary policy decisions on the real economy since it captures important channels of monetary transmission. By including external variables in the construction of the FCI, it can also capture external spillovers on domestic financial conditions and economic activity.

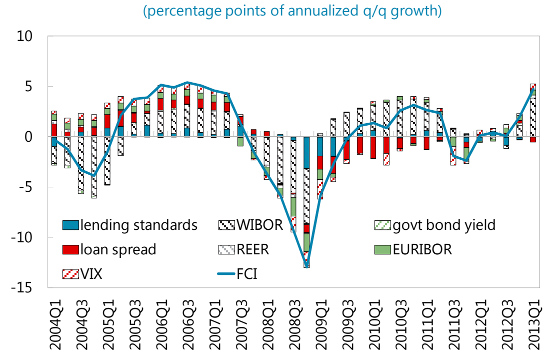
Two complementary approaches were used to construct an FCI for Poland: factor analysis (FA), which aims at extracting the "common factor" from a wide range of financial variables, and vector auto-regression (VAR), which allows for the expression of FCI in terms of contribution to GDP growth. A group of domestic financial indicators and external financial indicators are selected to construct the FCI. The FA-based FCI is driven by both external and domestic factors. For the VAR-based FCI, domestic factors dominate: the WIBOR rate, lending standards, and the corporate loan spread contribute most to the FCI. Nonetheless, external financial indicators (VIX, S&P 500, and EURIBOR-OIS spread) are also important, as they have both a direct and indirect impact on growth—the latter through their influence on domestic financial conditions.

Factor Loadings in FCI



Sources: Haver and IMF staff estimates.

Contributions to FCI, 2004Q1-2013Q1
(percentage points of annualized q/q growth)



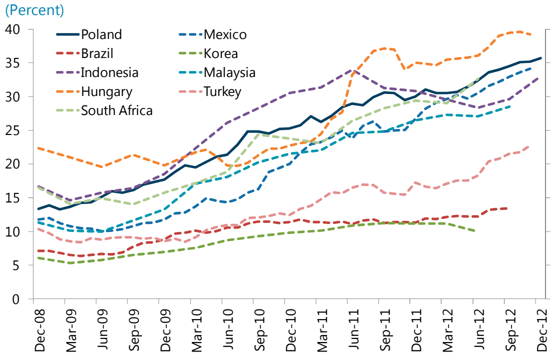
Sources: Haver and IMF staff estimates.

Financial conditions in Poland improved in the first quarter of 2013. This reflected easing monetary conditions following significant cuts in policy interest rates, as well as the very favorable external financial conditions that prevailed in the first quarter. The model results suggest that, all else equal, overall financial conditions in the first quarter of 2013 could have a cumulative positive impact of 5 percentage points on growth in the third quarter of 2013 (since the FCI is estimated to operate with a 2 quarter lag). However, the model does not incorporate important factors that are likely to continue to be a drag on growth, including limited fiscal space, weak external demand, and uncertainty effects (such as firms holding back investment and hiring decisions). Moreover, the recent tightening of external financial conditions is also likely to weigh on growth going forward. For these reasons, the overall impact on growth is likely to be substantially more muted than suggested by the model.

[1] Prepared by Giang Ho and Yinqiu Lu. See also the companion Selected Issues Paper, "*A Financial Conditions Index for Poland*."

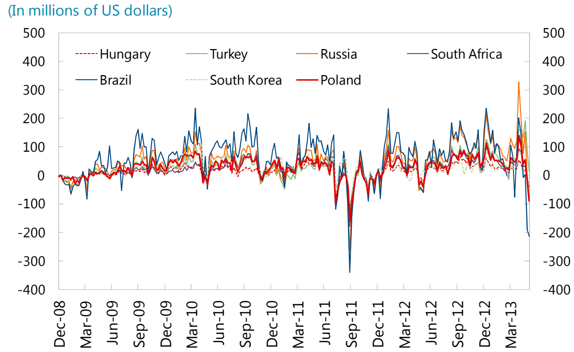
9. External financial conditions have been generally favorable, despite the recent increase in volatility. As in recent years, the current account in 2012 was mostly financed by EU transfers and FDI, notwithstanding a reduction in net FDI inflows. Moderate outflows from the domestic banking system were more than offset by strong portfolio inflows into the government bond market. As a result, the share of foreign holdings of government bonds increased further to 37 percent, a historical high. EMBI spreads dropped from 350 bps at end-2011 to around 140 bps, and sovereign CDS spreads fell by about 150 bps since end-2011 to about 120 bps. This allowed the government to pre-fund 80 percent of its 2013 financing needs by end-May. The zloty remained relatively stable and implied volatility low through late May. More recently, volatility has increased in line with global trends in emerging market countries.

Nonresident Holdings of Domestic Sovereign Debt
(Percent)



Sources: Asiabondline.adb.org; national authorities; and IMF staff estimates.

Weekly Bonds Funds Flows by ETFs and Mutual Funds
(In millions of US dollars)



Source: EPFR Bonds Funds Country Flows.

10. Poland's external position is broadly in line with medium-term fundamentals (Box 3). The (cyclically adjusted) current account deficit and real effective exchange rate (REER) are broadly in line with medium-term fundamentals and desirable policies according to the External Balance Assessment models. International reserves rose by $11 billion in 2012 (to $109 billion) and are broadly adequate: the gap between international reserves and the current account deficit plus short-term debt at remaining maturities is projected to be closed by the end of 2013 as the authorities continue to build reserve buffers. Poland has a large stock of external debt, which is expected to have peaked at 74 percent of GDP in 2012 and is projected to be on a gradual downward path. Stress scenarios suggest that external debt is relatively resilient to interest rate, growth, and current account shocks, but would increase sharply under a substantial depreciation of the zloty (Figure 6). Near-term gross external financing needs are significant, estimated at 23 percent of GDP in 2013, mainly reflecting parent bank funding and intra-company loans.

C. The Banking System has Remained Resilient

11. The largely foreign-owned banking system has remained well-capitalized, profitable, and liquid (Figure 7). The average ratio of capital to risk-weighted assets increased further to 15½ percent (with core tier 1 capital adequacy at 13¾ percent) at end-March, supported by retained profits. Profitability was strong in 2012 on account of high interest income, and, in some

Box 3. External Sector Assessment

Poland's external position is broadly in line with medium-term fundamentals and appropriate policies, but with some potential vulnerabilities.

- Model-based estimates suggest that the current account and the REER are broadly in line with fundamentals. The 2012 cyclically-adjusted current account deficit was 2.8 percent of GDP, about 1 percentage point wider than the current account norm estimated by the External Balance Assessment (EBA) model.[1] The REER at end-2012 was 3 percent less than the EBA model estimate.

- Net IIP liabilities are large at over 60 percent of GDP, but are mostly comprised of diversified FDI liabilities and intra-company lending. In contrast to some other countries in Central and Eastern Europe, FDI liabilities in Poland are more diversified and comprise both the tradable and non-tradable sectors.

- EU transfers and net FDI finance the bulk of the current account deficit. However, net financial inflows in 2012 were at their lowest level (as a percent of GDP) since 2006.[2] The other investment account experienced outflows from the banking system. Net foreign direct investment flows also slowed. However, foreign appetite for government bonds remained strong. While this has helped reduce Poland's sovereign spreads and yields, it has also increased its vulnerability to a reversal of investor appetite.

- International reserves are broadly adequate, exceeding most indicators of reserve adequacy. Reserves at the end of 2012 covered about 140 percent the IMF reserve adequacy metric, within the recommended range.[3] However, they remain somewhat lower than the recommended 100 percent of short-term debt at remaining maturities plus the current account deficit in 2012, but should reach that threshold by end 2013. The FCL arrangement with the IMF also serves as a precautionary buffer against external shocks.

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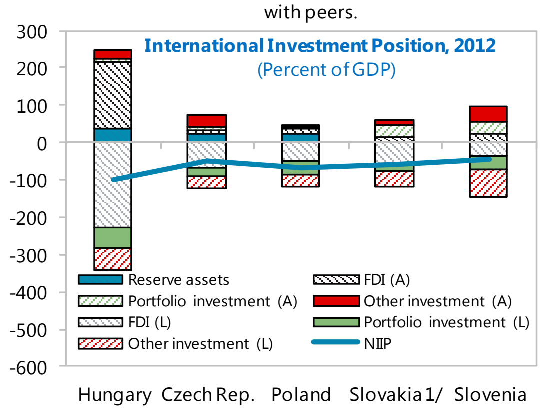
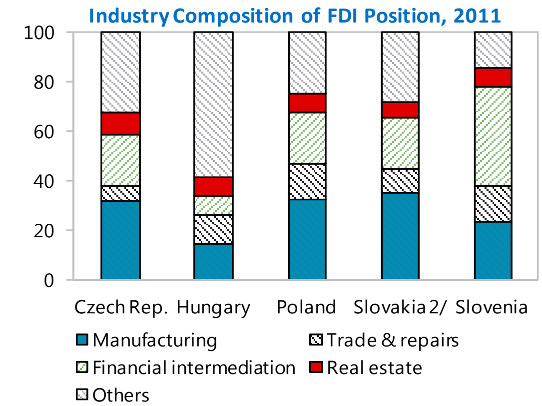
[1] See http://www.imf.org/external/np/res/eba/index.htm for a description of the methodology.
[2] The slowdown in net FDI in part reflects a large one-off outward investment by a Polish firm.
[3] International Monetary Fund, "Assessing Reserve Adequacy", February 2011.

Box 3. External Sector Assessment (Concluded)

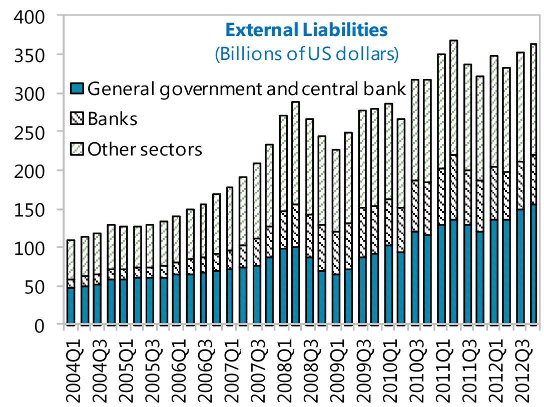
Poland has large net IIP liabilities, but broadly in line with peers.



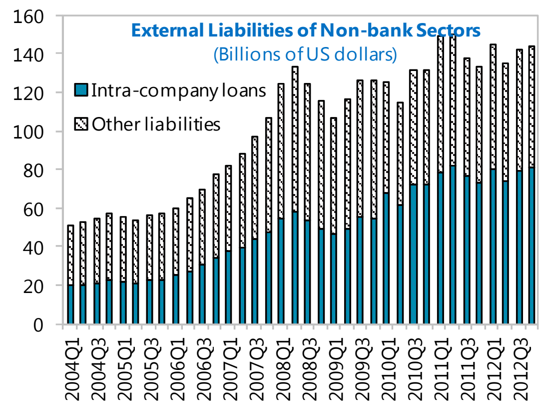
FDI is diversified.



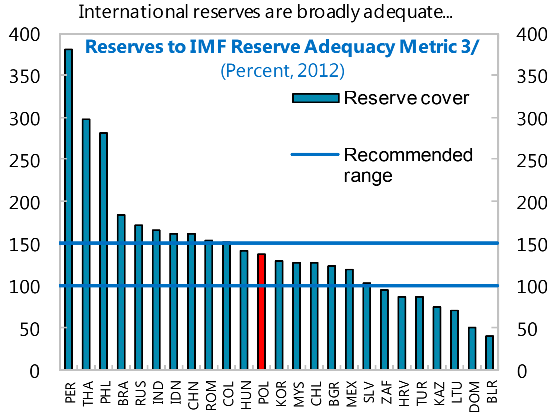
External liabilities have returned to near record levels.



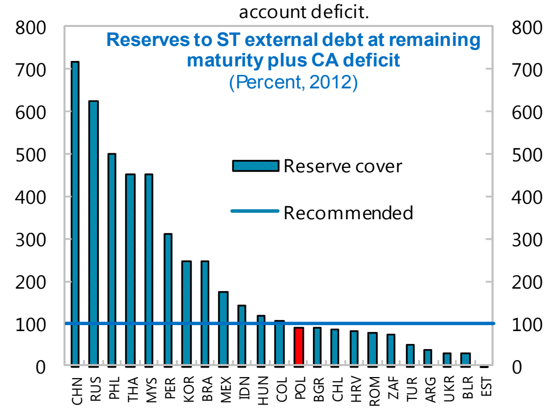
Corporate liabilities primarily are intra-company loans.



International reserves are broadly adequate...



...but below ST debt plus the current account deficit.

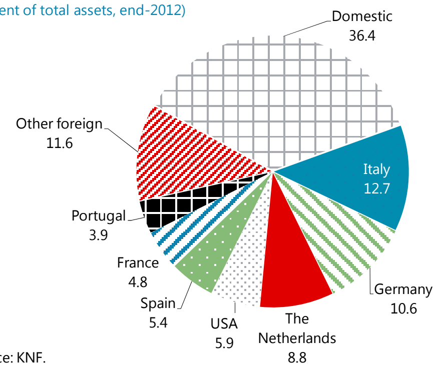


Sources: NBP; OECD; and IMF staff estimates.
1/ Data for Slovakia are for 2011.
2/ Data for Slovakia are for 2010.
3/ Coverage between 100 and 150 percent of the metric is regarded as adequate for an emerging market country.

cases, profits from Polish subsidiaries constitute an important share of consolidated group profits. Overall zloty liquidity is ample, with the NBP regularly issuing central bank bills to mop up systemic liquidity. The loan-to-deposit ratio edged down to 110 percent at end-2012 from 113 percent a year ago.

Bank Ownership

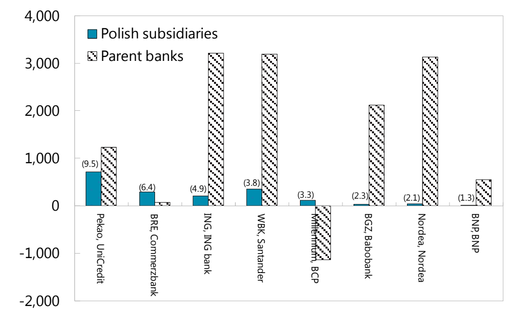
(Percent of total assets, end-2012)



Source: KNF.

Net Income of Polish Subsidiaries and their Parent Banks

(2012, in millions of euros)



Sources: SNL; and IMF staff estimates.

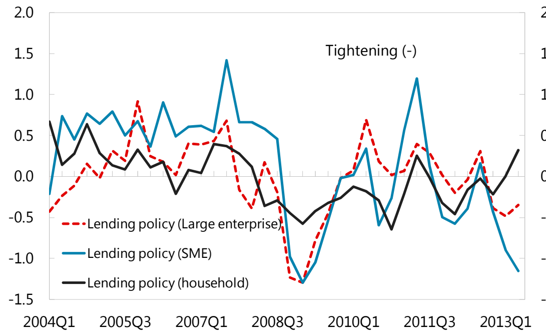
Note: Numbers in parenthesis represent individual bank's assets to GDP ratio (in percent).

12. The banking system reduced its reliance on foreign currency (FX) funding (Figure 8). Regulatory and supervisory actions to curb FX-denominated mortgages have borne fruit. A sharp drop in new FX mortgage lending is leading to a gradual decline in the stock of these mortgages (as existing loans are repaid) and a reduction in banks' on-balance sheet open FX positions. Banks have increasingly contracted cross-currency interest rate swaps instead of short-term FX swaps to hedge currency risk—the former have a longer tenor which should help reduce FX liquidity risks. The cost of hedging has also dropped substantially. Funding withdrawal by (mainly European) parent banks continued in the first half of 2012, but has begun to ease. Nordea sold its Polish subsidiary—which has a substantial foreign currency loan portfolio and a loan-to-deposit ratio of about 200 percent—to the largest Polish bank, PKO BP. Under the terms of the sale, and to help defray credit and liquidity risk, Nordea will provide PLN 15.2 billion (about 50 percent of the subsidiary's liabilities) in FX financing for 7 years and cover up to half of losses on the subsidiary's mortgage portfolio for the next 4 years.

13. Credit expansion has slowed, and impaired loans have increased. Credit growth decelerated to 3½ percent in the first quarter of 2013 (down from 11 percent a year ago), on the back of weak credit demand and tight lending policies by banks, particularly with respect to SME lending. The impaired loan ratio inched up to 9 percent mainly due to deterioration in the corporate loan portfolio, reflecting rising bankruptcies (notably in the construction sector). Looking ahead, the senior loan officer survey suggests an easing of bank lending policies for households and a rise in demand for household loans. A new government-sponsored program to partially guarantee SME credit should help ease credit constraints to these firms.[1]

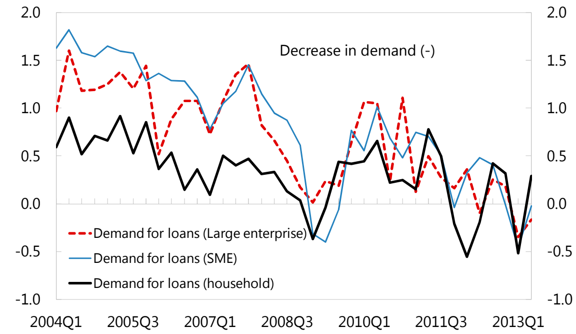
[1] Under the program, the state bank, BGK, will guarantee up to 60 percent of the amount of a loan issued by a commercial bank to an SME. Eventual losses are shared pari-passu between the commercial bank and the government. The program has an overall ceiling of about 2 percent of GDP, of which some ¼ percent of GDP is expected to be executed this year. It also complies with EU regulations on state aid.

Projected Lending Policies
(Percentage balance between tightening and easing lending policy)



Sources: NBP; and IMF staff estimates.

Projected Demand for Loans
(Percentage balance between increase and decrease in demand)



Sources: NBP; and IMF staff estimates.

OUTLOOK AND RISKS

14. The economy is expected to slow further in 2013. Real GDP growth is projected to moderate to 1.1 percent in 2013: the first half of the year is expected to be weak, followed by a recovery in the second half. The baseline assumes an improvement in economic conditions in Poland's main trading partners during the second half of the year, which should help boost household and business confidence. Domestic demand would also be supported by muted inflation pressures (which, projected at 1.6 percent in 2013, should lift real income and wages) and the effects of monetary policy easing (which should support credit expansion).

15. A gradual recovery should ensue over the medium term. Growth is projected to bounce back to 2¼ percent in 2014, with domestic demand driven by an improvement in consumption, as confidence returns, the labor market stabilizes, and credit conditions improve (Appendix II). Given ample spare capacity, private investment is expected to recover with some delay. Over the medium term, the new allocation of EU structural funds (2014–20) should boost public investment and provide further impetus to the economic recovery. Growth is projected to reach about 3½ percent by 2018, lifted by an increase in the capital stock (as public investment picks up), a rise in labor force participation (as a result of the increase in the retirement age enacted in 2012), and productivity gains (as recent progress with structural reforms takes hold). Inflation is expected to gradually return to target as the output gap closes.

16. Risks are tilted to the downside (see Risk Assessment Matrix, Appendix III).

- A protracted slowdown in Europe would hamper Poland's recovery through lower exports and confidence effects. A restoration of confidence is essential for the gradual improvement in household consumption and private investment under the baseline.

- Renewed financial stress in the euro area, or a renewed episode of distress in global financial markets, would affect Poland through both banking and financial market channels—the former through possible disorderly funding withdrawals by parent banks and the latter through shifts in investor sentiment that could lead to portfolio outflows (given the large share of foreign investors in Poland's government bond market).

- As the analysis on Poland's role in the German supply chain shows, Poland would also be adversely affected by global shocks, although the magnitude of the impact depends in part of the strength of German balance sheets.
- The recovery is also dependent on credit developments. Private domestic demand could fail to pick up as assumed under the baseline—possibly because of reduced credit availability—denting the recovery. On the upside, the government's investment support scheme could support credit expansion and economic growth by more than expected (see Section D below).
- With respect to inflation risks, a substantial and sustained depreciation of the zloty would have pass-through effects leading to higher inflation.

Authorities' views

17. The authorities shared staff's view on the near-term outlook and emphasized that risks stemmed mainly from external sources. They broadly concurred with staff's growth and inflation forecasts. They were especially troubled by the sharp deceleration in household consumption, which they attributed to confidence effects. In this regard, the authorities were concerned about the outlook for the euro area, noting that the speed of Poland's recovery would depend on the situation in Europe, including through confidence channels. Nonetheless, they shared the view that the slowdown was cyclical and also expected a recovery to take hold later in 2013. On risks, the authorities agreed that a protracted period of slow growth in Europe or a reversal in foreign investor sentiment posed the main risks. On the latter, however, they noted that these risks were mitigated by the composition of the investor base, which included pension funds, central banks, and other long-term investors. They also felt strongly that the FCL arrangement provided important insurance against risks.

POLICY DISCUSSIONS

18. Given the uncertain external environment, Poland's main policy challenge is to balance the need to support the economy with further building of policy buffers. The discussions focused on the appropriate macroeconomic policy mix in the context of narrow fiscal space and the weakening economy, the strategy for medium-term fiscal consolidation, policies to further enhance the resilience of the financial sector (including ongoing initiatives to tackle impaired loans, strengthen the bank resolution framework, and establish a macroprudential framework), and structural reforms to boost potential growth. In recent years, policies have been broadly aligned with Fund advice (Box 4).

A. Monetary Policy: Supporting Growth amid Low Inflation

19. In response to muted inflation pressures, the Monetary Policy Council (MPC) started an easing cycle in November 2012. Cumulative rate cuts since then amount to 200 bps, bringing the reference rate to 2¾ percent, a record low. On one occasion in early June, the NBP intervened in the foreign exchange market, selling foreign currency in response to excessive zloty volatility.

Box 4. Implementation of Past Fund Advice

Policy actions have been broadly in line with past Fund advice:

- **Fiscal policy:** The pace of fiscal consolidation slowed in response to the economic downturn, but the authorities remain committed to their medium-term objective (MTO). To strengthen the fiscal framework, work on the permanent fiscal rule has continued. Recent increases in the retirement age were consistent with Fund advice, but reform of the special pension regimes still needs to be advanced.
- **Financial sector:** The Fund's past advice focused on taking a more proactive approach to address the outstanding stock of impaired loans, developing the resolution and macroprudential frameworks, and providing additional supervisory resources to the financial supervisory authority (KNF). The KNF is conducting a thematic review of impaired loans, and the authorities are advancing legislation to create a Systemic Risk Board (SRB) and to overhaul the bank resolution framework.
- **Structural reforms:** Ongoing initiatives to streamline unwarranted bureaucratic barriers to economic activity should help boost potential growth. There is room to further increase labor participation and reduce administrative barriers to business. Modifications to the insolvency framework are welcome.

20. The continued monetary policy easing cycle is welcome (Figure 9). There is scope for modest additional easing, after which further policy action would need to depend on incoming data.

- With economic activity clearly below potential, a weak labor market, and subdued consumer demand, inflation is expected to remain below the target over the policy horizon. Staff analysis suggests that, under the baseline, further monetary policy easing is unlikely to significantly intensify inflation pressures.
- Ex-post real policy rates in Poland remain high as do some (but not all) measures of ex-ante real policy rates (based on surveys of inflations expectations). Policy rates adjusted for country risk premia are among the highest in the region. This, together with the improving current account position, suggests that monetary easing should not lead to destabilizing capital outflows.
- The relatively quick transmission of policy rate cuts to the key benchmark rate (3-month WIBOR) and bank lending rates (despite some initial stickiness) implies that further easing could have immediate effects, through lower household and corporate debt servicing costs (since most loans carry floating interest rates). Over time, as uncertainty dissipates, easier monetary conditions should help boost credit to the economy.
- In the event of a stronger slowdown (or downturn) under supportive external financial conditions, policy rates should be cut more. However, room for further rate cuts may be limited if the slowdown/downturn is accompanied by substantial capital outflows. In this case, the cushioning role of the flexible exchange rate should be exploited to the maximum extent possible, while paying due attention to the impact on the domestic financial system and household balance sheets. In this regard, the NBP's readiness to provide liquidity both in zloty and FX is welcome. Intervention in the foreign exchange market could be used to limit excessive volatility.

21. The functioning of the interbank market has improved. The negative spreads between the overnight interbank market rate (POLONIA) and the reference rate have narrowed and the level of excess reserves has declined, reflecting an improvement in the functioning of the interbank market and the introduction of fine-tuning operations by the NBP. Although overnight transactions still dominate uncollateralized interbank markets, the share of longer tenor transactions has increased. Following a global trend, new regulations targeted at minimizing WIBOR manipulation are to be implemented. Staff pointed out that, to facilitate the NBP's liquidity forecasting and management, it is important for the NBP to receive advanced information regarding the MOF's anticipated exchanges of foreign exchange with the NBP.

Authorities' views

22. The authorities agreed that monetary easing should continue. They shared staff's view that inflation pressures are likely to remain limited, amid weak domestic demand and a low risk of commodity price shocks. They acknowledged that real interest rates are high in Poland and, given limited fiscal space, monetary policy remains the main tool to support economy. However, the MPC remains divided: a few members are concerned about possible adverse effects of low interest rates (such as disincentives for corporate restructuring, inefficient investment, and asset price bubbles), while others worry that high real interest rates are harming growth.

B. Rebuilding Fiscal Space at an Appropriate Pace

23. Poland's fiscal consolidation continued in 2012. The deficit declined from 7.9 percent of GDP in 2010 to 5 percent of GDP in 2011 and to 3.9 percent of GDP in 2012. The latter, however, was somewhat larger than expected, as the economic slowdown reduced tax collections (mainly VAT). In recognition of Poland's structural effort and adverse economic situation, the Council of the European Union recommended that Poland be granted a two-year extension to exit the EU's excessive deficit procedure (EDP), from 2012 to 2014. While public debt (ESA95 definition) dropped for the first time since 2007 to 55.6 percent of GDP in 2012, fiscal space remains very limited due to the proximity of public debt to national legal thresholds.[2] Meanwhile, favorable market conditions and aggressive pre-financing of public borrowing needs have reduced the average cost of debt and increased the average maturity.

[2] The constitution caps public debt (national definition) at 60 percent of GDP. In addition, the Public Finance Law establishes a preventive debt threshold at 55 percent of GDP. If the ratio of debt to GDP exceeds 55 percent in year T (after adjustments for the exchange rate and liquid holdings of the Ministry of Finance), mandatory fiscal consolidation measures must be implemented in year T+2. The national definition of debt is narrower than ESA95, as it excludes liabilities of the National Road Fund and other entities. At end-2012, the national definition of public debt was 3 percentage points of GDP lower than the ESA95 definition.

24. For 2013, staff recommended maintaining the measures contained in the budget, while allowing automatic stabilizers to operate. Under the baseline—which assumes no additional measures in 2013—staff estimates that the fiscal stance would remain broadly neutral: ½ percentage point of GDP in measures would be offset by the operation of automatic stabilizers, resulting in a deficit of 4 percent of GDP and an increase in the public debt ratio (ESA95) to about 57 percent of GDP.[3] Although staff has projected revenue cautiously, there remains a risk that it will be even weaker than projected given poor performance so far this year. The authorities have not yet decided whether to amend the budget (with possible additional fiscal measures), but a budget revision in the second half of the year cannot be ruled out.

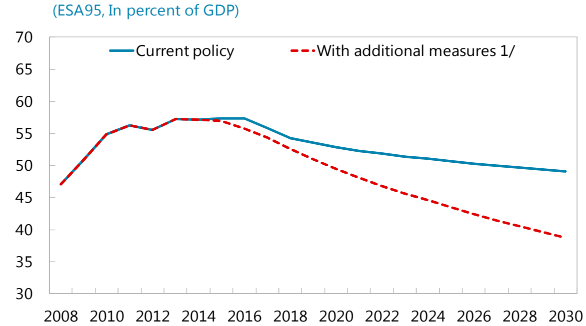
Estimated Yields of Main Fiscal Measures, 2013
In Percent of GDP

Total Yields	0.5
Expenditures (Drop (+))	0.3
Temporary Expenditure Rule	0.2
Abolition nof Early Retirement Scheme	0.1
Revenues (Increase (+))	0.1
Sale of Carbon Permits	0.1
Freeze of PIT Thresholds	0.1
Increase in Disability Contributions	0.1
Increase in Income Elegibiilty Thresholds	-0.1
Redirection of Pension Contributions	-0.1
Other (Net)	0.1

1/ Yields computed as incremental from 2012; totals may not add up due to rounding.
Sources: National Authorities and IMF staff calculations.

25. Going forward, additional fiscal consolidation measures will be needed to put the public debt ratio on a firm downward path. The authorities have maintained a medium-term objective (MTO) of a structural fiscal deficit of 1 percent of GDP, but the target date to reach it was pushed back one year to 2016. They also announced their intention to defer the reduction of VAT rates (initially set to take place in 2014), entailing a revenue gain of some 0.4 percent of GDP. Staff supported the authorities' MTO, which should be sufficient to put debt on a firm downward path. To reach this objective, staff reiterated that additional measures (beyond maintaining the VAT rate) of about 1 percent of GDP would be needed as the economy recovers. It recommended that these measures be identified and announced in advance, and implemented as the economy recovers in 2014 and 2015. To this end, staff noted that an expenditure review could prove useful to help identify areas where non-priority public expenditures can be rationalized. Staff strongly urged the authorities to avoid further cuts in public investment.

Poland. Public Debt
(ESA95, In percent of GDP)



Sources: MoF and IMF staff calculations
1/ Assumes further consolidation measures of 0.5 percent of GDP per year in 2014-15.

26. The authorities have continued to work on the design of a permanent fiscal rule. They are contemplating several variants of an expenditure rule, and plan to send the proposal to parliament later this year. Staff has argued for a simple and transparent rule (possibly akin to the Swiss debt brake) with sound counter-cyclical properties and a clear link to the MTO. As with any fiscal rule, the final choice would involve some trade-offs: staff analysis suggests none of the

3 Under the baseline, public debt under the national definition would remain below the 55 percent of GDP legal threshold. Staff calculations indicate that a combined growth and exchange rate shock (where growth falls to −1 percent and the average exchange rate depreciates by 10 percent) would push debt above 55 percent of GDP.

mechanisms offers clear dominance, but some refinements could improve their performance, especially under shock scenarios (Box 5). In addition, the effective implementation of a fiscal rule would require improvements in fiscal reporting and budgetary processes, including top-down budgeting, multi-year financial plans, and regular expenditure reviews. At the local government level, an initiative to impose additional fiscal constraints was abandoned as the current set of rules was deemed sufficient to protect long-term fiscal sustainability.

27. In late June, the authorities concluded a comprehensive review of the pension system.[4] The review focused on the costs and benefits of the second pillar and modalities for making payouts from the second pillar. Based on the findings of the review, the authorities have proposed three options for modifying the pension system—all with significant implications for the functioning of the second pillar.[5]

- Option 1 (make the second pillar voluntary rather than mandatory). This option entails giving contributors an option to either remain in the second pillar or have their assets transferred to the first pillar (the default option would be transfer to the first pillar).
- Option 2 (like Option 1 but with an additional contribution). This option would also make participation in the second pillar voluntary. But, participants would also be required to pay an additional contribution of 2 percent of salary.
- Option 3 (transfer of holdings of non-equity securities). This option would involve the transfer of all holdings of non-equity securities to the government, with corresponding amounts recorded in individual accounts in the first pillar.

28. The implications of the proposed modifications will need to be carefully assessed. All three options are likely to reduce public debt and the fiscal deficit, while at the same time increasing future pension liabilities of the government. Since Poland's first pillar is a notional defined contribution system, the impact on fiscal sustainability should be limited. However, the public sector will bear additional fiscal risk associated with pension liabilities (including demographic risk). In terms of financial markets, despite the authorities' desire to safeguard second pillar assets invested in the equity market, liquidity in the equity and government bond markets may be affected by the reduced presence of the pension funds. Staff will continue to monitor developments, especially as a final decision is made. It will be essential that modifications are implemented transparently to reassure the public that their pensions remain secure.

[4] Poland's pension system largely consists of a mandatory (public) first pillar and a mandatory (private) second pillar (a voluntary third pillar exists but is barely utilized).

[5] In addition, the review determined that the payout phase of the second pillar will be centralized in the first pillar, via the phased transfer of assets starting ten years before retirement.

Box 5. A Permanent Fiscal Rule for Poland[1]

The Polish authorities plan to implement a permanent fiscal rule to strengthen the fiscal framework. A permanent fiscal rule would complement existing public debt limits and support the sustained attainment of the medium-term objective (MTO) over time, helping entrench fiscal consolidation. In this context, the authorities have advanced work on the design and assessment of the mechanism.

Ideally, a fiscal rule should behave in a smooth countercyclical fashion under normal macroeconomic conditions, and produce a predictable path of public sector balances, consistent with the MTO. Also, the rule should deliver robust results under various macroeconomic scenarios and provide adequate flexibility to implement countercyclical fiscal policy under extreme adverse circumstances.

Using these guiding principles, four alternative rules were calibrated and assessed for Poland. These encompassed three variants of expenditure rules, and a budget balance rule akin to the Swiss debt brake. The expenditure rules capped the growth of expenditures at or below trend GDP growth. In turn, the Swiss brake mechanism targeted a level of expenditures consistent with the MTO. The assessment was guided by the simplicity of the rules, their cyclical and long-term dynamics, their robustness to alternative macroeconomic scenarios, and their behavior under extreme adverse circumstances.

The assessment of each rule was based on Monte Carlo simulations. The exercises were conducted by projecting relevant series (i.e., GDP growth, fiscal revenues, fiscal expenditures, and inflation) over a 37-year horizon (until 2050). Each exercise entailed 500 simulations. Initial variable values were set to their actual 2012 levels. In all the simulations, government revenues, the output gap, and prices were modeled as stochastic processes, and their association was calibrated using historic information over 1995–2012. The data generating processes covered a wide range of possible GDP growth paths, following three alternative sets of assumptions regarding long-term potential GDP growth. To analyze the behavior of the rules under adverse circumstances, each set of scenarios was also modeled by imposing an extreme but likely negative shock to GDP growth.

These simulations suggest that there are no "silver bullets". None of the rules display strict dominance across attributes. At the same time, the results provide insights on the relative advantages and weaknesses of each mechanism, and some guidance for potential improvement:

- In general, the three expenditure rules exhibited a fiscal-tightening bias. This result seemed to originate from the structure of the mechanism: a limit to the growth of public expenditures also lowered the expenditure base for subsequent periods (regardless of fiscal performance and the state of the economy). This tended to introduce a one-way bias in the ratio of public expenditures to GDP, and generated protracted fiscal surpluses (unless compensated by successive tax policy cuts).

- An alternative to deal with this bias is to accumulate any deviations between the resulting fiscal balances and the MTO in a notional account, and use the latter to impose symmetric corrections when deviations become large.

- In turn, while the Swiss debt brake proved appropriate to target the MTO and more robust to alternative macroeconomic conditions, it also tended to generate excessive expenditure cuts at the one-year horizon, and a slightly more procyclical behavior of expenditures.

- More generally, the results illustrate the advantages of including the MTO in the main formula of the fiscal rule.

Based on these results, further analysis and fine-tuning of the rules under consideration seems advisable.

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[1]Prepared by Francisco Vazquez. See also the companion Selected Issues Paper, "*An Assessment of Public Expenditure rules for Poland.*"

Authorities' views

29. The authorities agreed that fiscal space was very limited and wished to avoid fiscal policy being a drag on growth. They saw the fiscal underperformance in 2012 and weak revenues so far in 2013 as clearly cyclical, reflecting the sharp slowdown. Their deficit projections for 2013 were more optimistic than staff's, notably with respect to expenditure restraint. The authorities reiterated their commitment to the MTO and concurred with staff on the importance of strengthening the fiscal framework. In this regard, they appreciated the collaborative work with staff on the analysis of alternative fiscal rules. On pensions, the authorities stressed that the review was intended to improve the functioning of the system.

C. Further Enhancing the Resilience of the Financial Sector

30. The banking system appears resilient, as detailed in the companion FSSA (Box 6). Risks have been managed well and vulnerabilities contained through effective regulatory and supervisory measures, including on foreign exchange exposure, capital adequacy, and bank funding. The main risks stem from outstanding portfolios of FX mortgage loans and potential pressures on bank funding under a scenario of renewed distress in financial markets. These risks are mitigated by several factors, including low household indebtedness, longer duration of FX hedging instruments, less reliance on parent funding, and a diversified foreign investor base. Stress tests conducted as part of the recent FSAP Update confirm the sector's resilience: bank capital and liquidity buffers can withstand large shocks and contagion risks are limited.

31. The authorities have continued to work to strengthen the resilience of the financial system. The KNF has required banks to boost their capital and liquidity buffers. It revised the prudential guidelines on consumer lending, easing documentation needs for small loans and replacing general caps on debt-service-to-income (DTI) ratios with those derived from banks' internal models. It also modified the guidelines on mortgage lending: mortgage loans will need to be in the same currency as borrower's income, limits on loan-to-value (LTV) ratios will be gradually reduced to 80 percent by 2017, and (as with consumer lending) DTI caps will be replaced with those derived from banks' internal models. While these changes in prudential guidelines allow banks to set DTI limits according to creditworthiness, the KNF will need to tighten oversight over banks' credit risk management practices to ensure that lending policies do not become too lax.

32. Bank supervision has improved considerably, but further work is needed. The frequency of targeted inspections has increased and onsite/offsite coordination has been enhanced. Nonetheless, the areas where the KNF can issue prudential regulations (resolutions) should be broadened, particularly with respect to powers to regulate permissible risks in bank activities. The recent incorporation of credit unions under KNF financial oversight is welcome, but this should be accompanied by greater budgetary autonomy and, at a minimum, increased budgetary flexibility (to reallocate resources) for the KNF. The widening regulatory and supervisory initiatives at the global and European levels also suggest that greater supervisory resources are needed.

33. Staff welcomed the recent efforts to tackle impaired loans, and urged further progress. Staff noted that the majority of loans past due 90 days or more have been past due at least one year, and that consumer loans (typically with low recoverability) comprise almost half of this stock. Banks have been gradually addressing the existing stock of impaired assets, but tax disincentives (constraints on the deductibility of loan losses and debt relief), interest accrual practices (allowing banks to accrue statutory interest for three years), and legal obstacles (stemming from the insolvency regime) need to be tackled to speed up progress. In this context, the KNF's ongoing thematic review of impaired loans is timely and should help identify areas for further improvements.

34. Staff strongly urged the authorities to put in place the new macroprudential and bank resolution frameworks as soon as possible. The authorities should press ahead with legislation to create a SRB and establish a formal and explicit macroprudential framework that will aim to identify, monitor, and contain systemic risks to the financial system. Staff advised the authorities to take this opportunity to delineate the mandates of the various institutions involved in financial oversight, secure sufficient autonomy and accountability for each, and define coordination arrangements. It welcomed the progress in advancing legislation to overhaul the bank resolution framework, which will provide critical tools for orderly bank resolution. Staff suggested that the legislation could be supported by explicit depositor preference.

35. Staff encouraged the authorities to facilitate the development of more sources of long-term bank funding. This would help to diversify banks' funding sources and prepare banks to meet the new Basel III liquidity requirements (notably the net stable funding ratio). Staff recommended that universal banks be allowed to issue mortgage covered bonds which would be subject to the same terms and conditions as those issued by the mortgage banks. At the same time, it will be important to ensure that the share of encumbered assets remains at prudent levels to allow for a smooth resolution process.

Authorities' views

36. The authorities broadly concurred with the mission's recommendations, but there were differences of views in a few areas. They agreed to consider more flexibility in KNF's internal allocation of budgetary resources, but felt strongly that full budgetary independence was not desirable. They also noted that the regulatory powers of the KNF are constrained by the Constitution. On impaired loans, the thematic review is progressing, and the KNF plans to amend the prudential framework based on the results of the review. The authorities agreed on the importance of putting in place the macro-prudential and the bank resolution frameworks, and are moving ahead with the relevant pieces of legislation. They also acknowledged the importance of developing mortgage covered bonds to support long-term funding for banks. However, they argued that allowing universal banks to issue mortgage covered bonds could reduce their quality (given different underwriting standards), and preferred to develop these markets at a gradual pace.

Box 6. FSAP Update Main Findings and Recommendations[1]

The FSAP Update, conducted earlier this year, concluded that Poland's financial system appears to be resilient with vulnerabilities contained. At the same time, it identified several elements of the financial policy framework that can be further improved to enhance the system's resilience.

Impaired loans. Accounting constraints, tax disincentives (deductibility of loan losses and debt relief), income accrual practice, and legal obstacles (insolvency regime) should be addressed to accelerate progress in cleaning up bank balance sheets and the disposal of impaired assets. The ongoing thematic supervisory review of impaired assets provides an opportunity to update regulatory guidance if warranted. The authorities are in the progress of revamping the insolvency scheme and introducing a new law on restructuring to support rehabilitation of viable debtors (rather than liquidation).

Bank supervision. Banking supervision has significantly improved. However, under the Polish legal system it remains difficult to provide the KNF with sufficient powers, independence, and resources, which is of particular concern considering its expanding perimeter and new supervisory initiatives at both the global and European levels. Consultations with banks and other stakeholders in the industry could be further strengthened.

Credit unions. The sector shows rapid growth and consolidation, but financial trends have been negative since 2009 and weak credit unions should adopt capital rehabilitation plans. Ongoing changes to the legal framework governing credit unions will strengthen their supervisory framework and safety nets.

Macro-prudential policy framework. The legislative process for setting up a SRB has started. The establishment of the SRB would provide the opportunity to adopt a supervisory approach to systemic risks and systemic institutions and clarify the objectives and the roles of the respective macroprudential, microprudential, and monetary policies. The FSAP Update recommends that the law provides the SRB with independence, accountability to Parliament, and power to make recommendations coupled with an "act or explain" mechanism.

Bank resolution framework. Draft legislation on resolution is progressing to set up a state-of-the-art resolution framework for the financial system. The planned resolution framework designates the deposit guarantee fund as the resolution agency and puts a complete suite of resolution tools at its disposal, in line with the Financial Stability Board's Key Attributes. The authorities plan to add explicit depositor preference to the framework.

Deposit insurance scheme. Poland is broadly compliant with International Association of Deposit Insurers (IADI) Core Principles and will be even more so once the resolution framework has been adopted.

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[1]See "Poland: Financial System Stability Assessment", 2013.

D. Deepening Structural Reforms and Euro Adoption

37. Structural reforms are crucial for Poland's long-term growth. Despite significant progress in reducing structural rigidities, further reforms are needed to lift potential growth and preserve the benefits generated by involvement in the German supply chain. Labor participation rates are still low and skill mismatch remains a concern. There is ample room for further improvement in the business climate, including by enhancing the frameworks for insolvency and dispute resolution. The public sector share in gross value added declined slightly in recent years, but, at around 20 percent, it remains above the authorities' target of 10 percent. Potential growth would be boosted by increasing the investment rate including in the area of infrastructure investment. The latter is crucial to ensure that Poland is positioned to fully realize the positive spillovers of integration in the German supply chain.

38. Staff welcomed the recent reforms to improve the business environment and labor market. The authorities took measures to improve the liquidity of small firms—by allowing cash-based (instead of accrual) VAT settlement—and further reduce administrative burdens. Privatization has continued, and the government intends to sell its stake in most of the remaining companies under its control (except some 20 firms considered to be strategic). The authorities also eased access to 50 regulated professions earlier this year, with particular focus on facilitating entry into these professions by the youth. Work is underway to reduce entry barriers in another 140 professions. To mitigate the impact of the economic slowdown on the labor market, more flexible work-time regulations have been proposed and a pilot project to improve job-matching is underway.

39. The authorities have launched a public investment fund, financed by the sale of equity in state-controlled companies. The objective is to have the investment fund, *Polish Development Investments* (PIR), provide equity financing to long-term commercially-viable infrastructure projects and help catalyze private sector funding. Seed capital for PIR will come from privatization revenues (some ½ percent of GDP) plus a minority participation of the public bank, BGK (intended to provide start-up funds).[6] The initial projects are likely to start in 2014.

40. To build on this progress, staff called for additional efforts to support employment and boost potential growth.

- ***Labor market***. Increasing labor force participation and reducing structural unemployment are key priorities. Reforms to align the special occupational pension schemes (notably for miners and farmers) and the formula for disability pensions with the regular system should help increase labor participation and contribute to fiscal sustainability (Appendix IV). There is also room to reduce segmentation in the labor market, by better aligning temporary and permanent work contracts. Job creation would also be supported by further efforts to ease access to regulated professions, improve education, and upgrade skills (including through vocational training).

- ***Business environment***. Business activity would benefit from changes in the insolvency law to promote rehabilitation (rather than liquidation) of viable debtors. Cumbersome construction regulations could be streamlined, including by simplifying rules on construction permits, while maintaining strong safety standards. Privatization should be continued, guided by the authorities' goal of reducing the public sector's role in the economy.

[6] Early this year, BGK received a capital injection of about ¼ percent of GDP. This operation boosted BGK's capacity to participate in long-term syndicated loans and to offer financing to local governments for infrastructure projects.

- ***Investment***. With the proceeds from sales of state owned assets to be mostly channeled to the new investment support scheme, it is crucial that PIR's corporate governance and operations are transparent and accountable, in line with best international practice, and that only commercially viable projects are selected. Ultimately, PIR could play an important role in mobilizing private funds for infrastructure projects.

41. Euro adoption remains an important long-term objective. The authorities have continued to make progress toward fulfilling entry criteria, particularly on the fiscal front given the substantial decline in the deficit since 2010. They are also continuing to work on necessary legal changes, including to the Constitution. No target date has been announced.

Authorities' views

42. The authorities emphasized advances in the structural reform agenda. They stressed the importance of the steps to ease access to regulated professions, and noted that further initiatives to identify and remove red-tape obstacles to entrepreneurship and economic activity are under way. To guide this process, efforts to improve the consultation process with social partners is ongoing. The authorities underscored that work on the new insolvency regime has continued, with the draft law expected to be submitted to parliament later in the year. They stressed that PIR would operate under strong governance and transparent reporting policies to improve efficiency and limit fiscal contingent liabilities.

STAFF APPRAISAL

43. Despite its resilience in recent years and very strong fundamentals, the Polish economy has slowed markedly. The slowdown appears to be cyclical, as weakness in euro area growth spread to Poland's main trading partners, with knock-on effects on Polish consumer and business confidence. Factors that supported growth in the past—notably fiscal expansion and rising public investment—have reversed and now pose headwinds to the recovery. Nonetheless, Poland's sound macroeconomic management (including a reduction in the fiscal deficit from 7.9 percent of GDP in 2010 to 3.9 percent of GDP in 2012), broadly adequate international reserves, resilient financial system, and precautionary Flexible Credit Line (FCL) arrangement with the Fund have helped maintain confidence. Further building buffers remains essential to increase resilience to shocks and to pave the way for an eventual exit from the FCL arrangement.

44. Growth is set to slow further in 2013, and risks are on the downside. Real GDP growth is projected to moderate to 1.1 percent in 2013, as weakness in the first half of the year is expected to be followed by a recovery in the second half. A protracted economic slowdown in Europe presents the main risk—this would hamper Poland's medium-term recovery through sustained trade, financial, and confidence effects. Shifts in global risk appetite or renewed financial stress in the euro area could lead to capital outflows, particularly from the government bond market or the banking sector.

45. The monetary easing cycle initiated in November 2012 is welcome. With economic activity below potential, inflation is expected to remain below the target over the policy horizon. At the same time, real policy interest rates in Poland remain high and policy rates adjusted for country risk premia are among the highest in the region. The transmission of policy rate cuts to bank lending rates implies that further easing could have immediate effects through lower household and corporate debt servicing costs. Over time, as uncertainty dissipates, easier monetary conditions should help boost credit to the economy. Under these circumstances, and with limited fiscal space, monetary policy remains the main tool through which macroeconomic policies can support the economy. The exchange rate should be allowed to float freely, but intervention could be used to avoid abrupt movements. The NBP should provide liquidity support if needed.

46. There is scope for fiscal policy to balance structural consolidation with support for the economy in 2013. While the debt-to-GDP ratio has remained close to an important legal threshold, there is room to allow automatic stabilizers to operate around measures contained in the 2013 budget. Under these assumptions, the general government deficit is expected to reach 4 percent of GDP in 2013, largely as a result of the impact of the growth slowdown on fiscal revenues. The strong credibility of fiscal policy has contributed to favorable financing conditions.

47. As the economy recovers, additional fiscal consolidation will be needed to put the public debt ratio firmly on a downward path and rebuild fiscal buffers. The authorities' MTO of a 1 percent of GDP structural deficit remains appropriate and should allow for sustained reductions in the public debt ratio. To reach the MTO, additional measures of about 1 percent of GDP will be necessary over 2014–16. These measures should be identified in advance and could include conducting a broad expenditure review to identify areas where non-priority spending can be reduced. Further cuts in public investment should be avoided. Finalizing the design of a permanent expenditure rule that is simple and transparent, with sufficient counter-cyclical properties and a clear link to the MTO, would help anchor public finances in the medium term. The fiscal rule should be supported by improvements in fiscal reporting and budgetary processes.

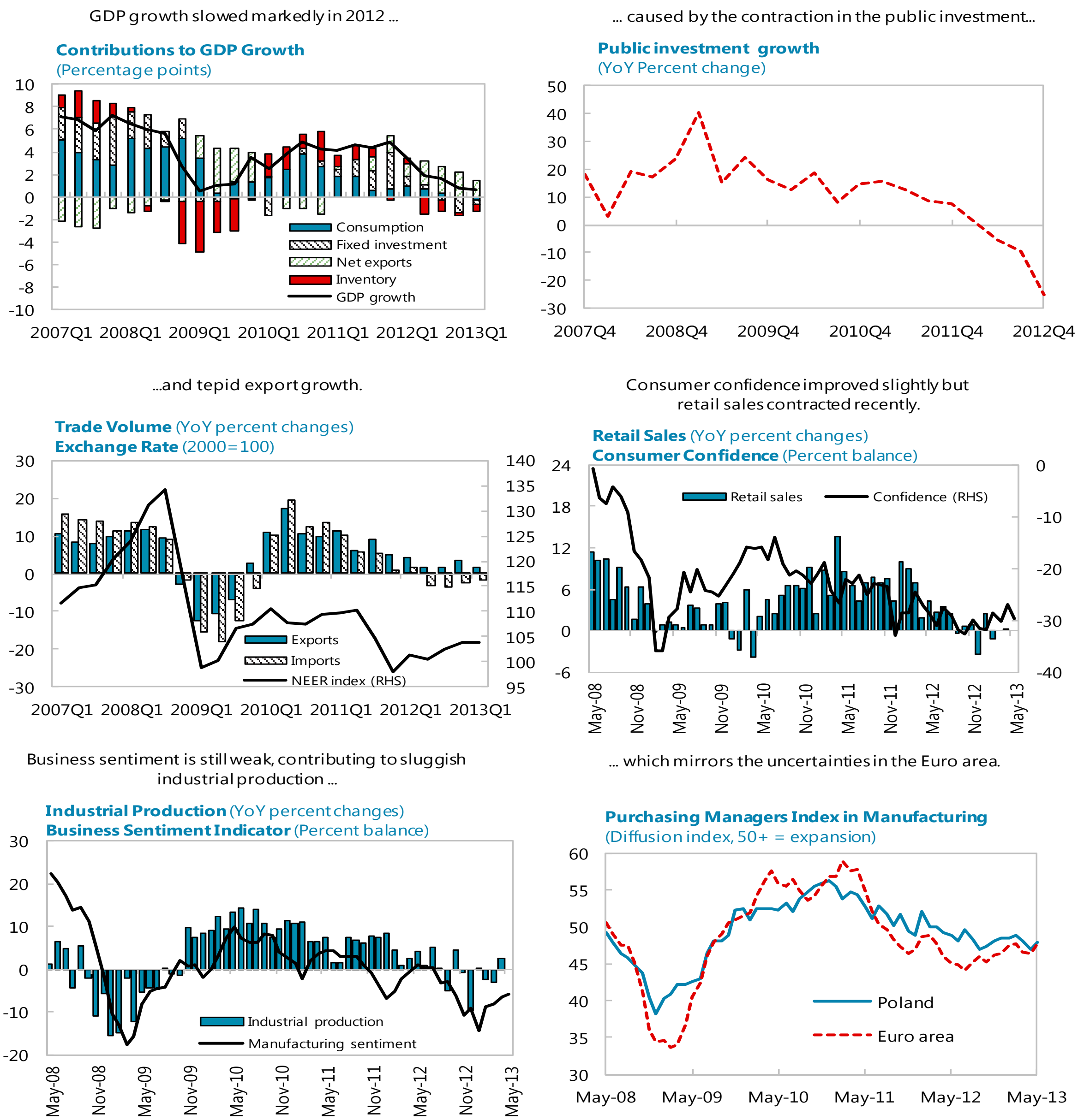
48. The changes to the pension system have significant implications for the functioning of the second pillar. Fiscal implications—with respect to public debt and future pension liabilities and risks—and financial market effects will need to be carefully assessed. It is critical that any modifications be implemented transparently, with a view to minimizing disruptions to financial markets and public expectations. It also important that other pressing reforms to the pension system proceed, notwithstanding the temporary relief provided by any modifications to the system.

49. The banking system has continued to perform well, and the recent improvements in supervision are welcome. It is well-capitalized, profitable, and liquid. Risks have been managed well and vulnerabilities contained through effective supervisory measures. Nonetheless, safeguarding asset quality will be essential, especially as the impaired loans are likely to increase as a result of the economic slowdown. In this regard, the existing stock of impaired loans should be addressed by tackling tax and legal obstacles. Improvements in bank supervision should continue by broadening the areas where the KNF can issue prudential regulations, and increasing the KNF's supervisory resources and budgetary autonomy and flexibility. The new macroprudential and bank resolution frameworks should be put in place as soon as possible.

50. The recent steps to improve the business climate and labor market are welcome, but additional reforms are needed to boost potential growth. Despite admirable progress in reducing administrative barriers to economic activity, further efforts would increase long-term growth and preserve the benefits of Poland's integration into the German supply chain. Efforts to ease access to a number of regulated professions are important and should continue. Given the growing number of bankruptcies, work to modify the insolvency regime—notably by setting up a framework conducive to restructuring of firms instead of the current bias towards liquidation—should be advanced. Reform of the special occupational pension schemes and the disability formula would help increase labor participation, and better alignment of temporary and permanent labor contracts would reduce market segmentation. With respect to the new investment fund, it is crucial that its corporate governance and operations are transparent and accountable, in line with best international practice, and that only commercially viable projects are selected.

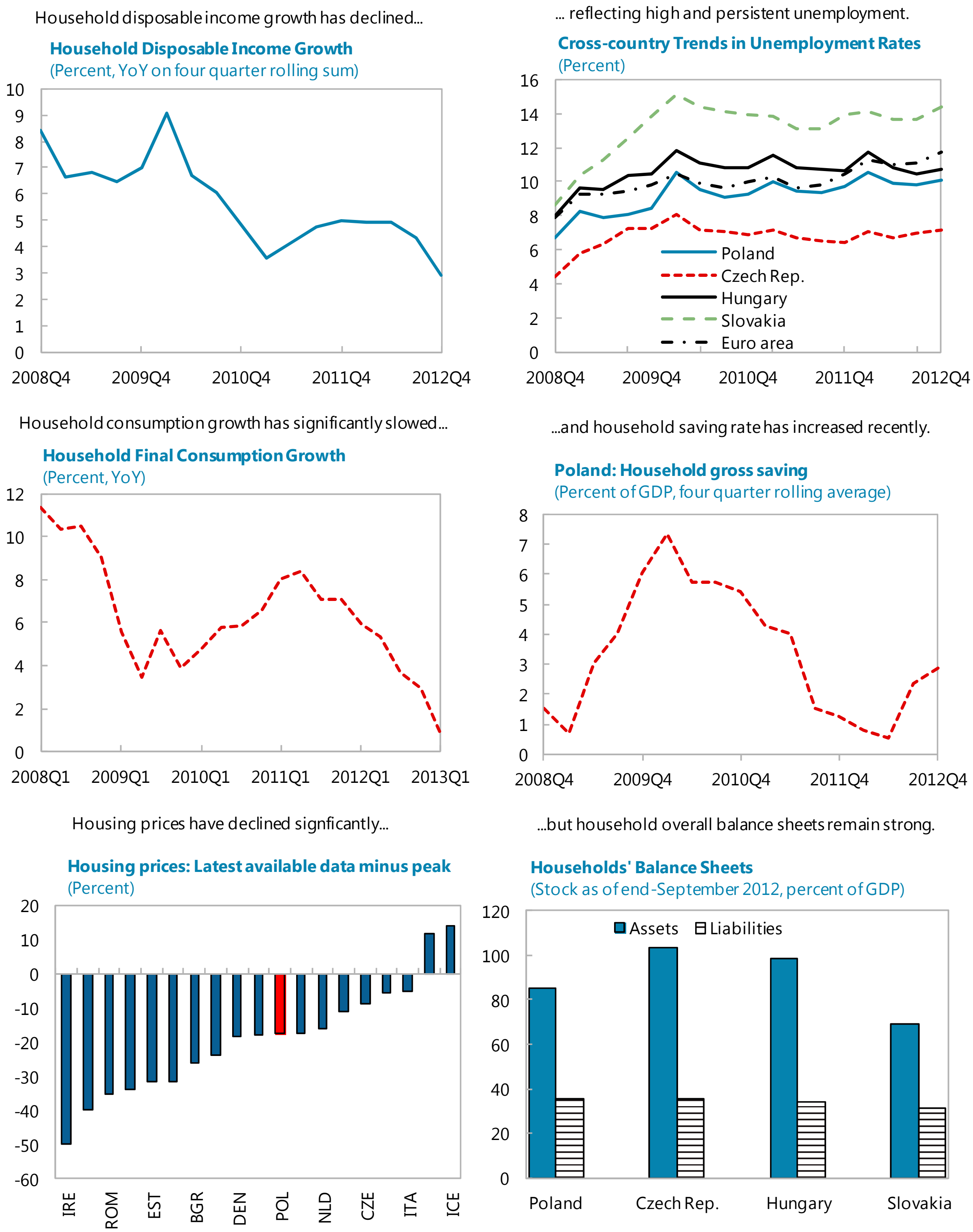
51. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

Figure 1. Poland: Recent Developments in Economic Activity, 2007–13



Sources: Haver; Central Statistical Office; and IMF staff estimates.

Figure 2. Poland: Household Sector, 2008–13

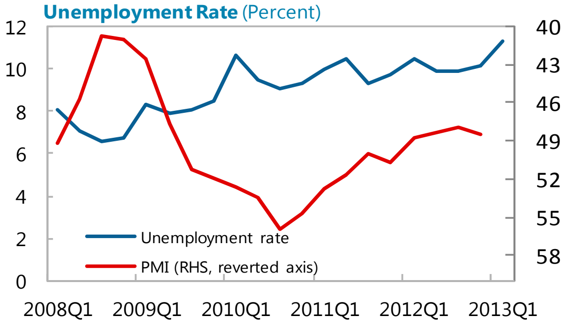


Sources: NBP; Haver; Eurostat; and IMF staff estimates.

Figure 3. Poland: Labor Market, and Inflation, 2008–13

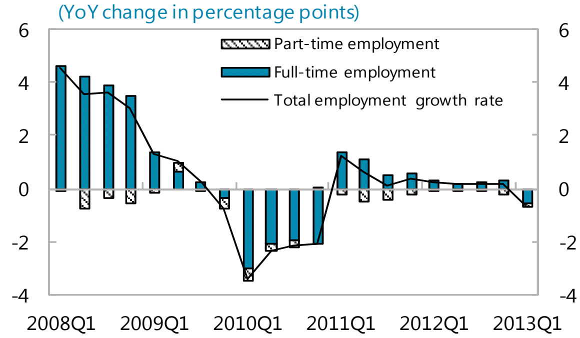
The unemployment rate remains persistently high.

Purchasing Managers' Index in Manufacturing (Diffusion index: 50+ = expansion)
Unemployment Rate (Percent)



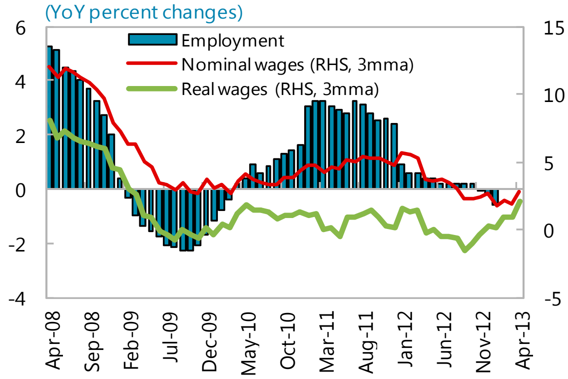
Employment growth has been sluggish and job quality has declined.

Contributions Overall Employment Growth (YoY change in percentage points)



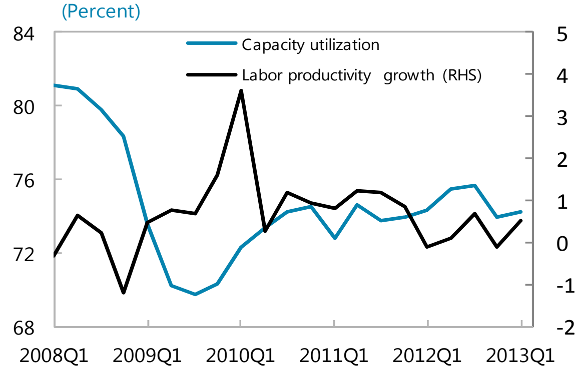
In the enterprise sector, wage pressure is muted, and employment creation is sluggish.

Enterprise Sector Employment and Wages (YoY percent changes)



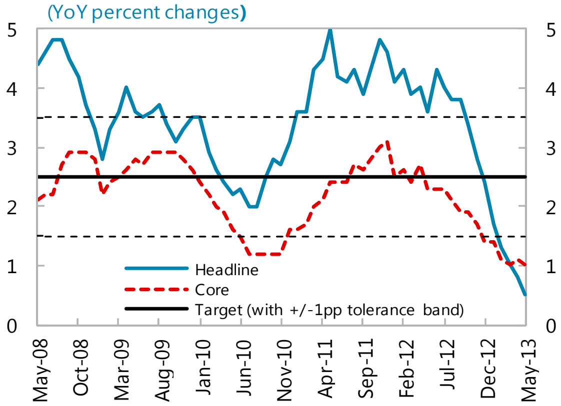
Labor productivity growth has slowed down and capacity utilization has slackened.

Capacity Utilization and Labor Productivity Growth (Percent)



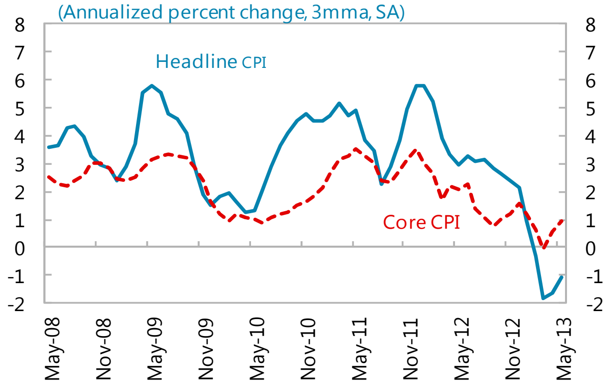
Inflation pressure continues to ease...

CPI Inflation (YoY percent changes)



...especially if measured by annualized change in 3 month moving average of headline CPI.

CPI Inflation (Annualized percent change, 3mma, SA)

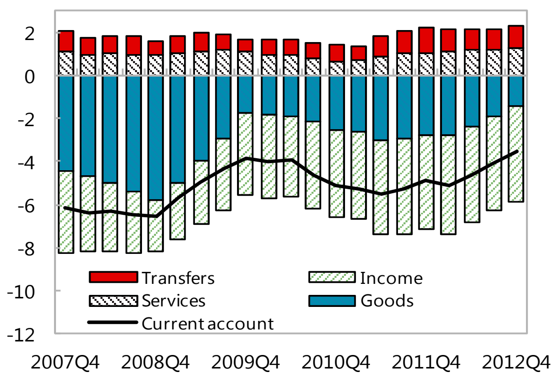


Sources: Haver; Poland Statistics Office; and IMF staff estimates.

Figure 4. Poland: Balance of Payments Developments, 2007–12

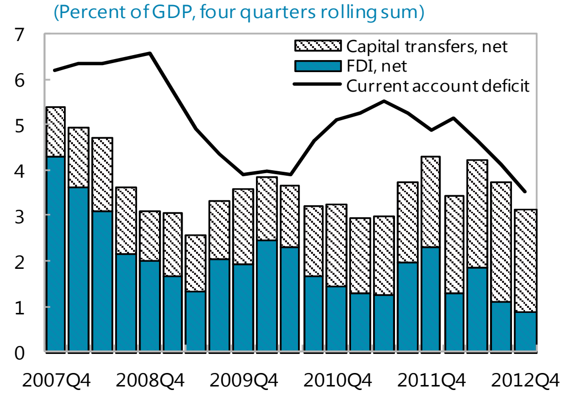
The current account deficit narrowed due to a smaller goods deficit....

Current Account Balance
(Percent of GDP, four quarter rolling sum)



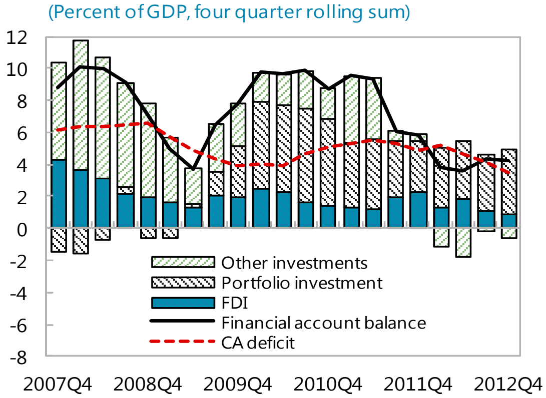
...and was mostly financed by FDI and EU transfers.

Current Account Deficit, Capital Transfers, and FDI
(Percent of GDP, four quarters rolling sum)



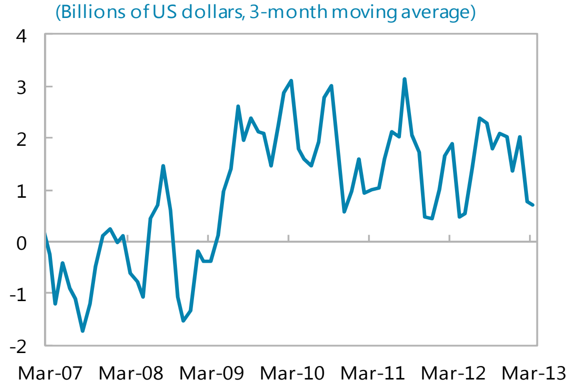
FDI and other investment flows were weak...

Financial Account Balance
(Percent of GDP, four quarter rolling sum)



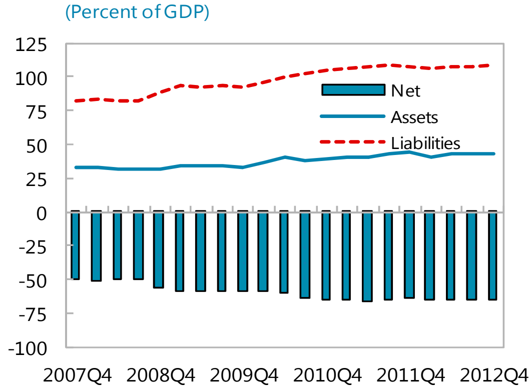
..but net portfolio inflows remained robust through the first quarter of 2013.

Portfolio Flows, Net
(Billions of US dollars, 3-month moving average)



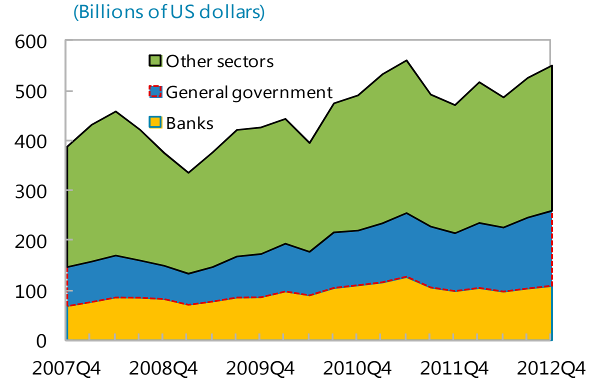
The IIP has has stabilized at a large negative value...

International Investment Position
(Percent of GDP)



...reflecting a levelling off of private sector liabilities.

International Investment Position, Liabilities
(Billions of US dollars)

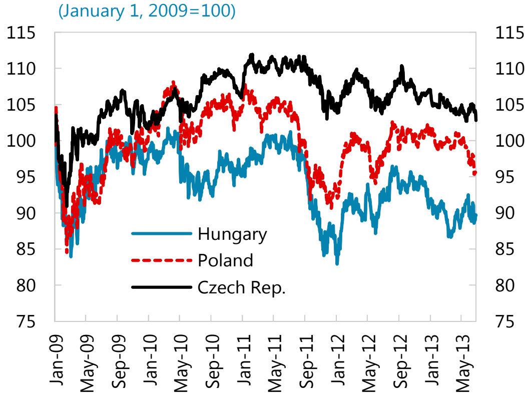


Source: National Bank of Poland.

Figure 5. Poland: Financial Market Developments, 2009–13

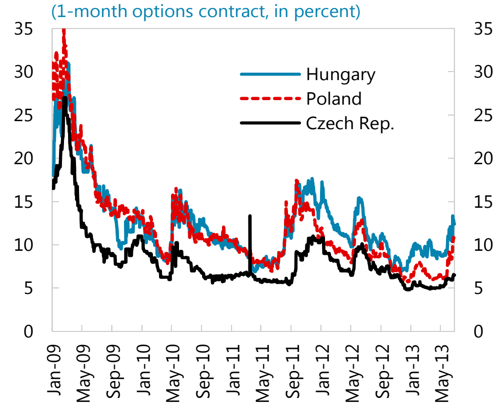
After being relatively stable, the zloty has depreciated recently…

Exchange Rate vs. Euro
(January 1, 2009=100)



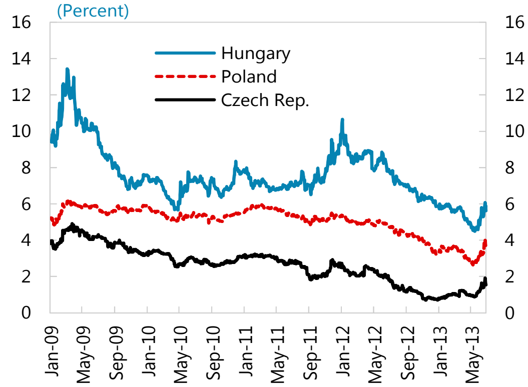
…and implied volatility has increased.

Implied Volatility of Exchange Rate vs. Euro
(1-month options contract, in percent)



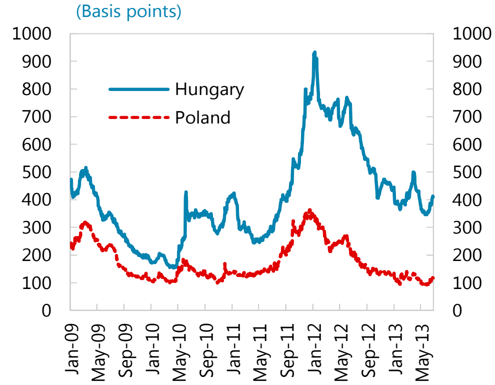
After trending downward, yields on Polish government bonds have increased recently…

5-Year Government Bond Yield
(Percent)



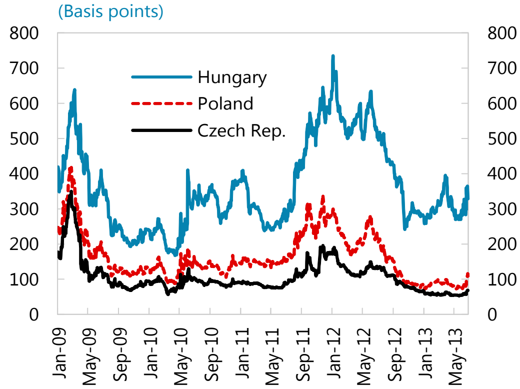
…as have EMBI spreads.

J.P. Morgan Euro EMBI Spread
(Basis points)



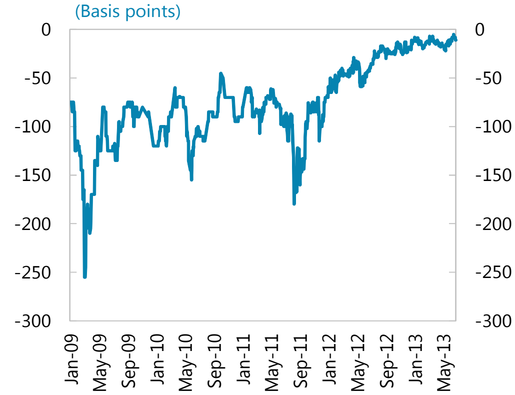
CDS spreads have stabilized at around 100 bps…

Credit Default Swaps Spreads
(Basis points)



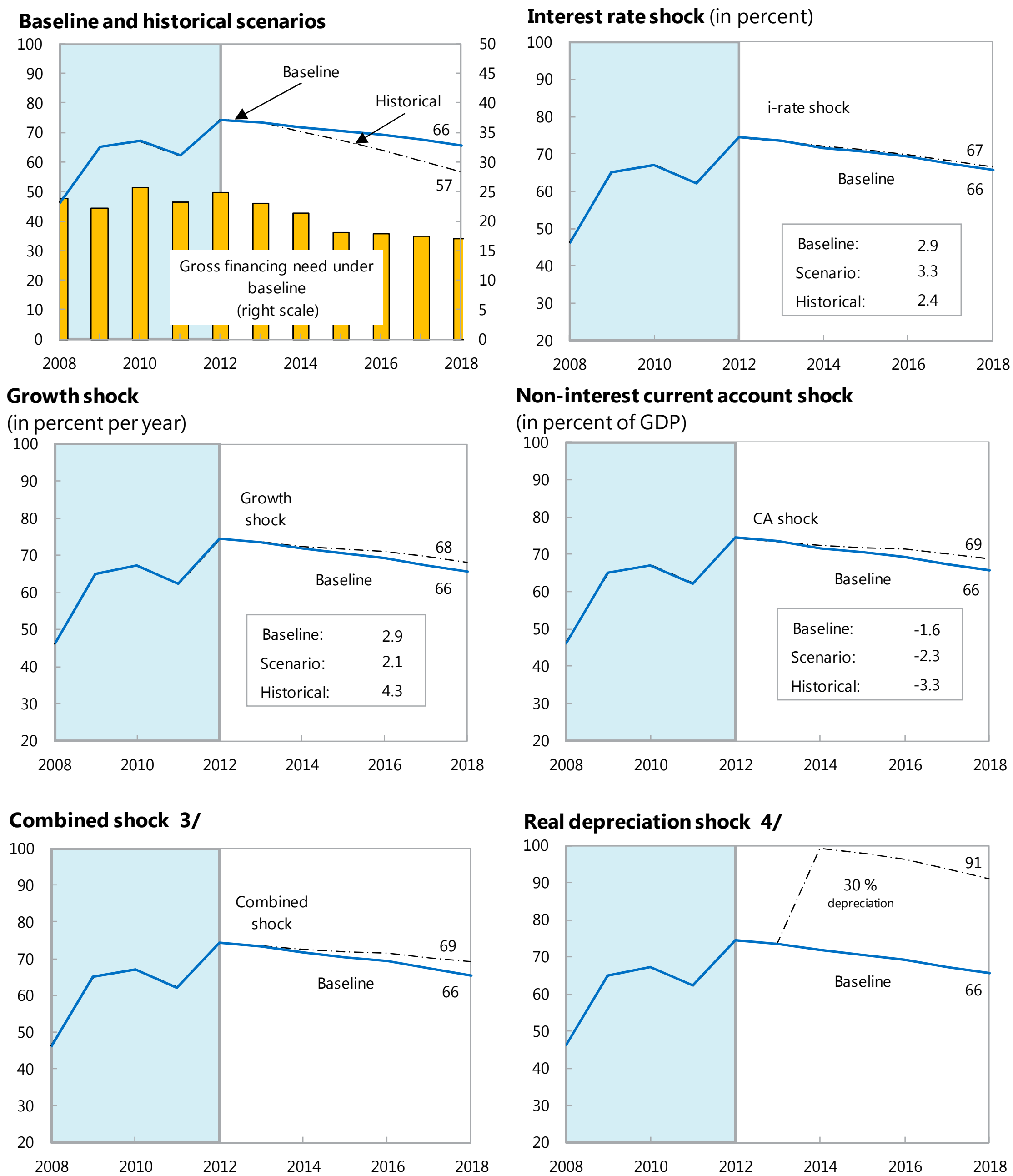
…and the cost of rolling over FX hedging positions has declined substantially.

Poland: Basis Swap
(Basis points)



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

Figure 6. Poland: External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)



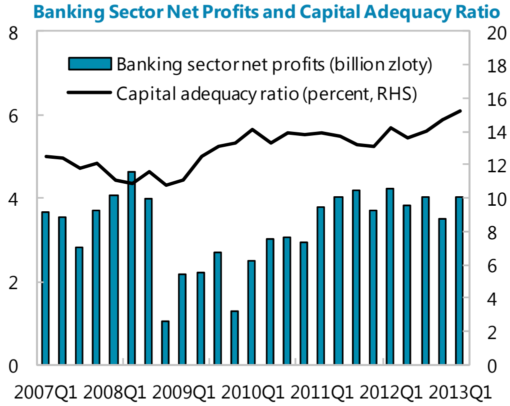
Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2013.

Figure 7. Poland: Banking Sector Capital and Asset Quality, 2007–13

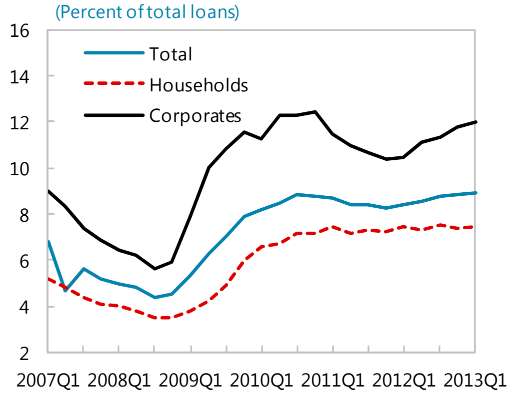
Bank profitability and capital adequacy remained high...

...while asset quality deteriorated slightly.

Banking Sector Net Profits and Capital Adequacy Ratio



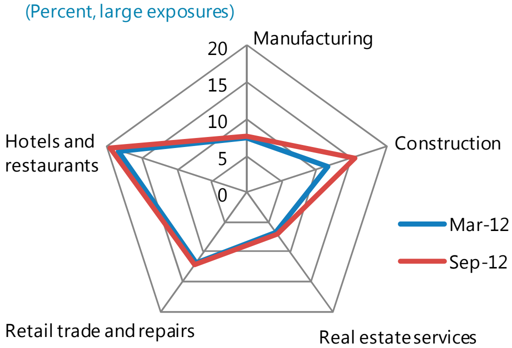
Non-Performing Loans by Sector
(Percent of total loans)



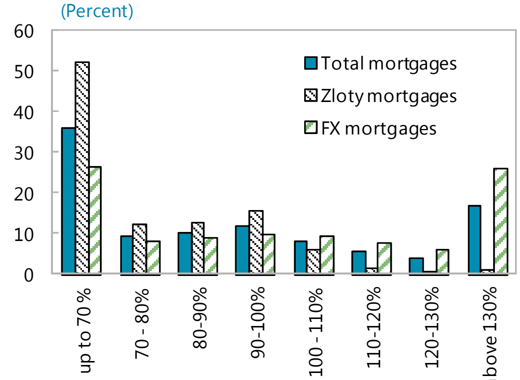
The quality of construction loans deteriorated ...

... and one third of the mortgage portfolio has LTV ratios above 100 percent.

Impaired Loan Ratio in Select Economic Sectors
(Percent, large exposures)



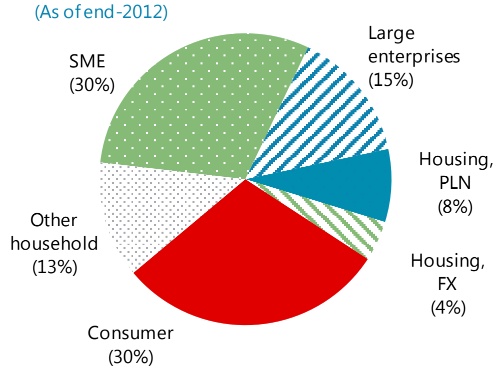
Mortgage Portfolio by LTV ratio
(Percent)



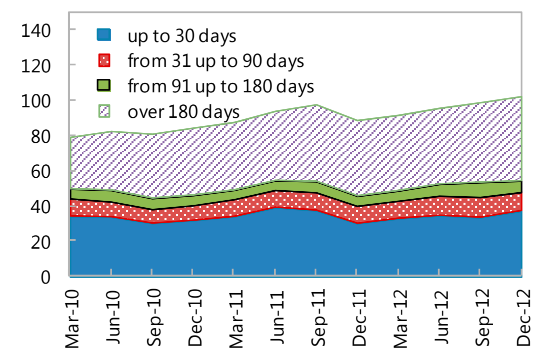
Impaired consumer and SME loans constitute the majority of impaired assets...

...and a significant portion of impaired loans is over 180 days past due.

Impaired Loans by Sector
(As of end-2012)



Poland: Total Past Due Loans
(Billion zloty)

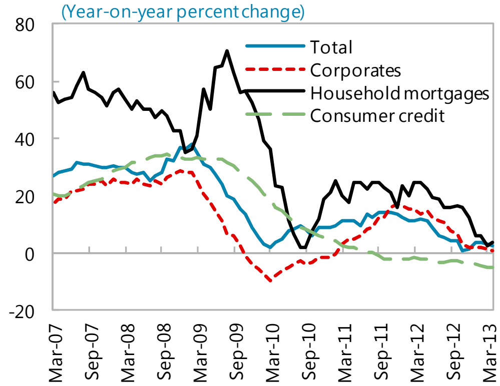


Sources: NBP; KNF; and IMF staff calculations.

Figure 8. Poland: Banking Credit Growth and Funding, 2005–13

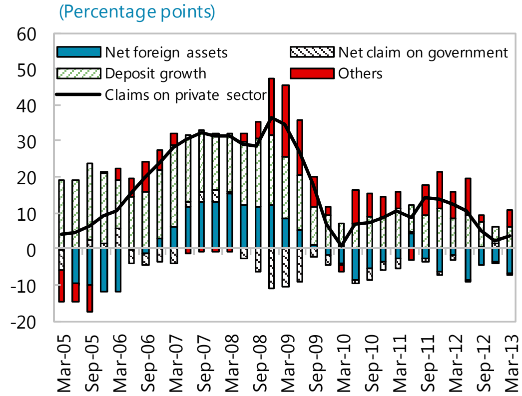
Private sector credit expansion slowed...

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



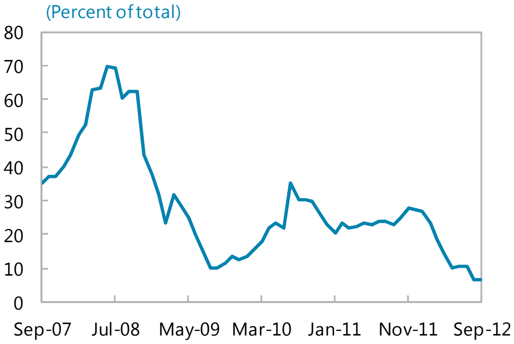
...and is supported by domestic funding.

Contribution to Private Sector Credit Growth
(Percentage points)



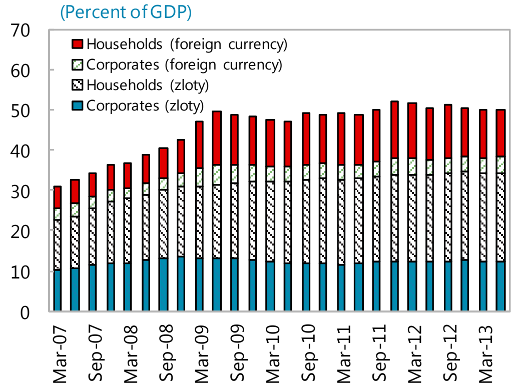
The share of new FX mortgage lending has declined considerably...

Foreign Currency Share of New House Purchase Loans
(Percent of total)



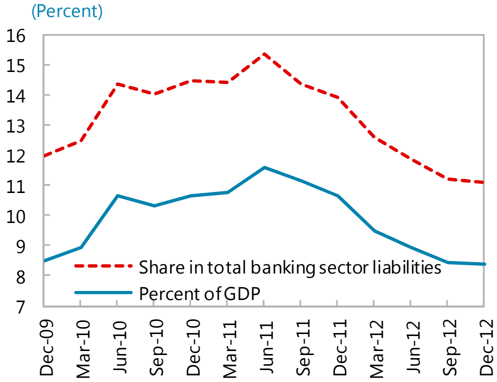
...contributing to a gradual reduction in household FX loans.

Poland: Private Sector Credit
(Percent of GDP)



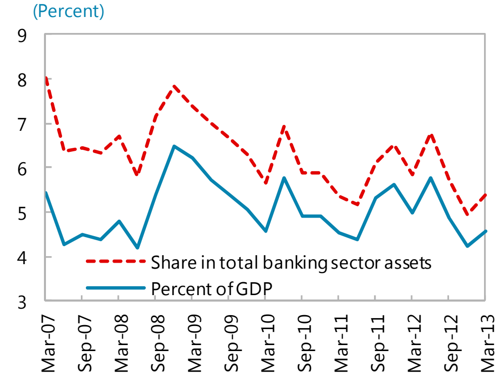
The banking sector is less reliant on parent funding...

Bank Liabilities to Parent Banks
(Percent)



...with reduced FX hedging needs.

On-balance Sheet Open FX Position at the Banking Sector
(Percent)

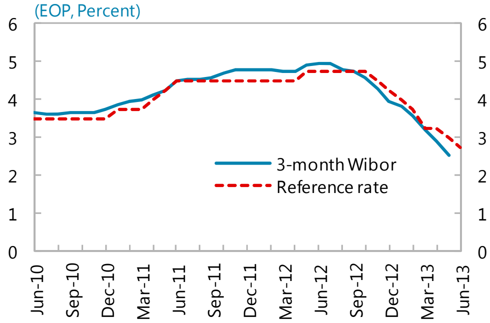


Sources: NBP; KNF; Haver; and IMF staff calculations.

Figure 9. Poland: Interest Rate Developments, 2010–13

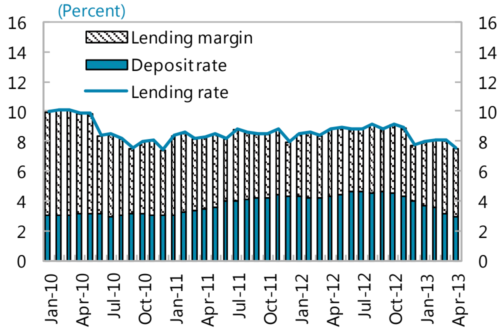
Changes in the key policy rate were transmitted relatively quickly to the key interbank market rate...

Interest Rates
(EOP, Percent)



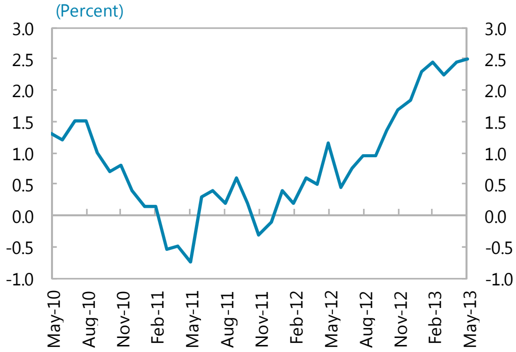
...but the transmission to lending rates was somewhat slower.

Lending and Deposit Rates
(Percent)



The key policy rate adjusted for actual inflation rate is high...

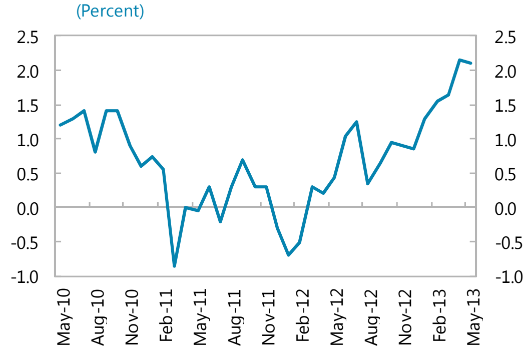
Ex-post Real Policy Rate
(Percent)



* Ex-post real policy rate is the difference between the policy rate and realized year-on-year inflation rate.

...as is the ex-ante real policy rate.

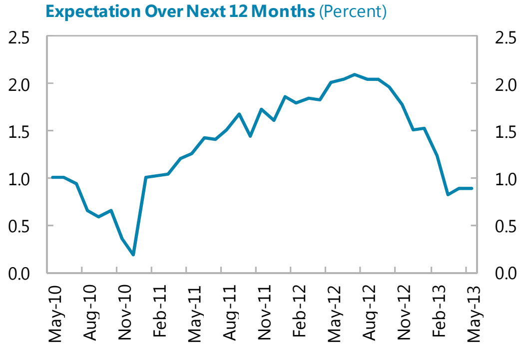
Ex-ante Real Policy Rate
(Percent)



* Expected inflation rate is the mean of the household inflation expectation over next 12 months.

But other measures suggest that real policy rates have declined...

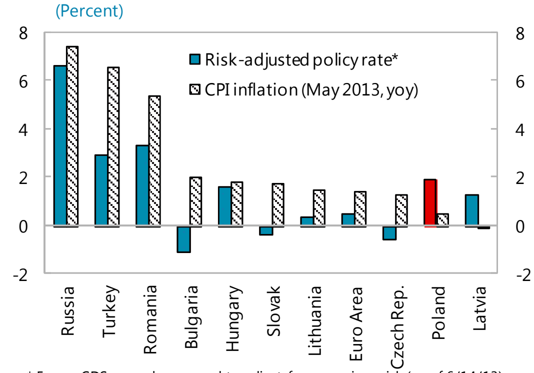
Real Policy Rate Based on Consensus' Inflation Expectation Over Next 12 Months (Percent)



* Averaged forecasts from Capital Economics, Citigroup, EIU, Goldman Sachs, IHS Global Insights and UBS.

...nevertheless, policy rates adjusted for risk remain high in Poland.

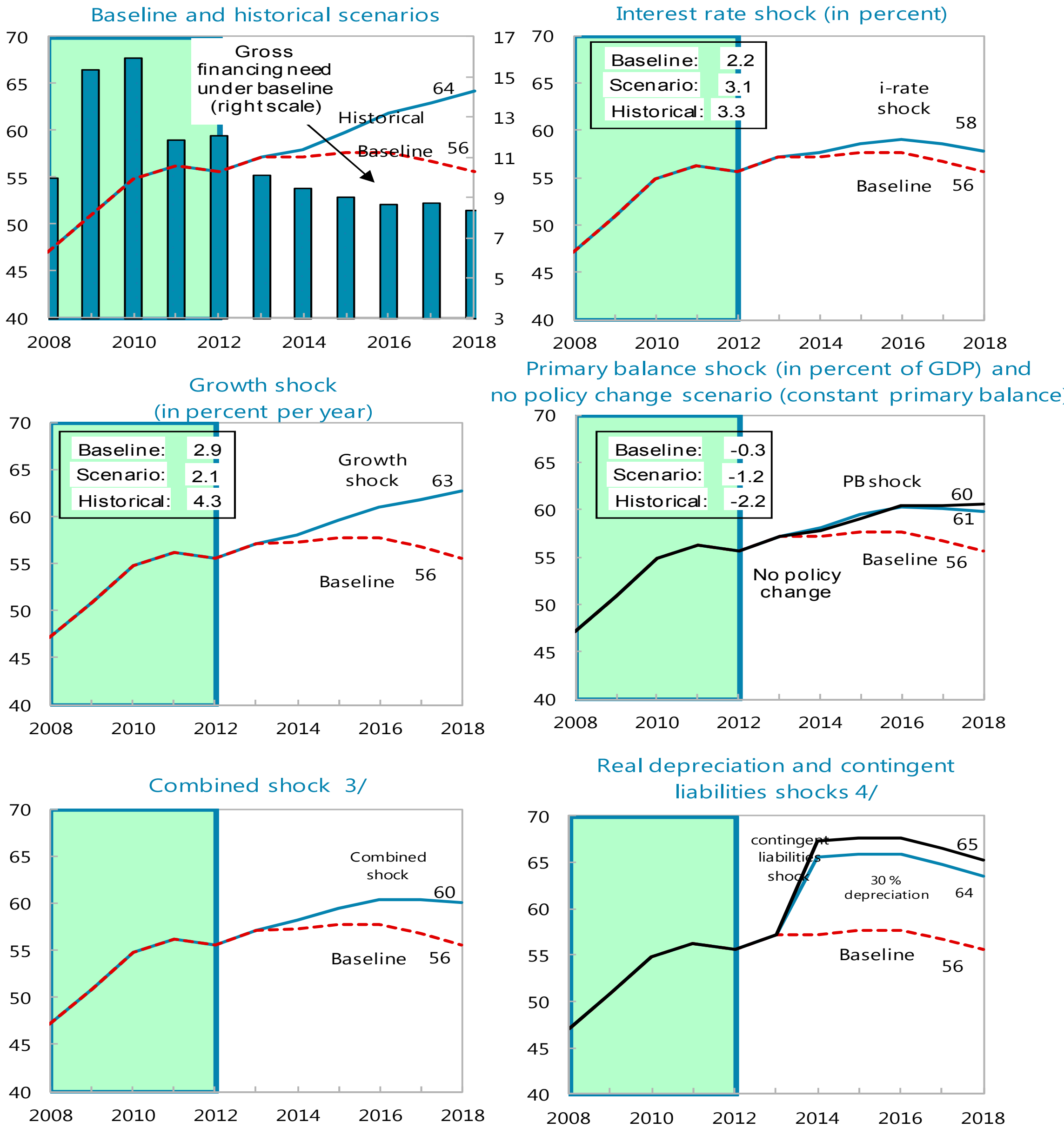
Risk-adjusted Policy Rates
(Percent)



* 5-year CDS spreads are used to adjust for sovereign risk (as of 6/14/13).

Sources: Bloomberg; Haver; and IMF staff estimates.

Figure 10. Poland: Public Debt Sustainability: Bound Tests 1/ 2/
(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/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
4/ 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).

Table 1. Poland: Selected Economic Indicators, 2009–18

	2009	2010	2011	2012	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
Activity and prices										
GDP (change in percent) 1/	1.6	3.9	4.5	1.9	1.1	2.2	2.5	3.0	3.3	3.5
Domestic demand	-1.1	4.6	3.6	-0.2	-0.1	2.2	3.0	3.3	3.5	3.5
Private consumption growth	2.0	3.1	2.6	0.8	0.1	1.6	2.5	2.8	2.9	3.0
Public consumption growth	2.1	4.1	-1.7	0.0	0.7	0.9	2.7	3.0	3.5	3.5
Domestic fixed investment growth	-1.2	-0.4	8.5	-0.8	-2.6	2.8	4.7	4.8	4.9	4.9
Inventories (contribution to growth)	-2.5	2.0	0.7	-0.6	0.3	0.5	0.1	0.1	0.1	0.1
Net external demand (contribution to growth)	2.8	-0.8	0.8	2.0	1.1	0.3	-0.4	-0.2	0.0	0.0
Output gap	-0.9	-0.2	0.9	-0.4	-1.7	-1.5	-1.6	-1.2	-0.5	0.0
CPI inflation (percent)										
Average	3.5	2.6	4.3	3.7	1.4	2.0	2.1	2.4	2.5	2.5
End of period	3.5	3.1	4.6	2.4	1.9	2.0	2.3	2.5	2.5	2.5
Unemployment rate (average, according to LFS)	8.2	9.6	9.6	10.1	11.0	11.3	11.1	10.7	10.1	9.3
Public finances (percent of GDP) 2/										
General government revenues	37.2	37.6	38.4	38.4	37.8	37.6	37.9	38.2	37.9	38.0
General government expenditures	44.6	45.4	43.4	42.3	41.8	41.0	40.7	40.7	40.6	40.4
General government balance	-7.4	-7.9	-5.0	-3.9	-4.0	-3.3	-2.9	-2.5	-2.7	-2.4
Structural primary balance adjusted for pension changes	-4.4	-5.1	-2.7	-1.4	-1.0	-0.6	-0.1	0.2	-0.2	-0.3
Public debt	50.9	54.8	56.2	55.6	57.1	57.2	57.7	57.7	56.7	55.6
national definition 3/	49.8	52.8	53.4	...	...	...	...	...	...	...
Money and credit										
Private credit (change in percent)	7.0	8.5	13.9	2.4	3.7	...	...	...	...	...
Broad money (change in percent)	8.1	8.8	12.5	4.5	4.5	...	...	...	...	...
Policy Rate 4/	3.8	3.5	4.3	4.6	2.8	...	...	...	...	...
Balance of payments										
Current account balance (transactions, billion U.S. dollars)	-17.2	-24.0	-25.0	-17.2	-16.9	-17.7	-19.7	-21.5	-23.4	-25.3
Percent of GDP	-4.0	-5.1	-4.9	-3.5	-3.3	-3.3	-3.4	-3.5	-3.6	-3.7
Exports of Goods (billion U.S. dollars)	142.1	165.7	195.2	188.4	197.6	207.0	219.6	234.5	252.5	271.9
Export volume growth	-6.8	12.1	9.1	2.8	4.9	5.1	6.0	6.5	6.9	6.9
Imports of Goods (billion U.S. dollars)	149.7	177.5	209.2	195.3	201.6	209.0	223.1	239.0	257.3	277.0
Import volume growth	-12.4	13.9	7.6	-1.8	2.4	4.7	7.2	7.2	7.1	7.1
Net oil imports (billion U.S. dollars)	12.5	16.6	22.8	23.4	23.2	22.5	22.1	22.0	22.3	22.8
Terms of trade (index 1995=100)	98.7	97.7	96.3	95.0	94.2	94.8	95.2	95.6	95.8	96.1
FDI, net (in percent of GDP)	2.0	1.5	2.2	0.7	1.5	1.5	1.5	1.5	1.5	1.5
Official reserves (billion U.S. dollars)	79.6	93.5	97.9	108.9	121.6	135.7	147.6	158.0	163.0	166.6
In percent of short-term debt plus CA deficit	79.7	73.7	84.9	91.0	108.7	123.9	139.9	141.9	141.5	139.9
Total external debt (billion U.S. dollars)	280.2	315.3	320.6	364.2	376.3	389.6	405.9	422.4	435.4	448.9
Percent of GDP	65.0	67.1	62.2	74.4	73.5	71.7	70.5	69.3	67.4	65.6
Exchange rate										
Exchange rate regime					Floating					
Zloty per US$, period average 5/	3.12	3.02	2.96	3.26	3.32	...	...	...	...	...
Zloty per Euro, period average 5/	4.33	4.00	4.12	4.19	4.33	...	...	...	...	...
Real effective exchange rate (INS, CPI based) 6/	105.5	112.1	110.4	107.8	...	...	...	...	...	...
percent change	-15.1	6.3	-1.5	-2.4	...	...	...	...	...	...
Memorandum items										
Nominal GDP (billion zloty)	1,344.5	1,416.6	1,528.1	1,595.3	1,638.1	1,710.7	1,795.0	1,891.1	1,999.8	2,116.4

Sources: Polish authorities; and IMF staff estimates.

1/ Real GDP is calculated at constant average prices of previous year.
2/ According to ESA95 (inc. pension reform costs). Including 2013 budget.
3/ Excluding debts of the National Road Fund.
4/ NBP Reference Rate (avg). For 2013, as of July 1.
5/ For 2013, exchange rate as of July 1.
6/ Annual average (2000=100).

Table 2. Poland: Balance of Payments on Transaction Basis, 2009–18
(Millions of US dollars)

	2009	2010	2011	2012	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
Current account balance	**-17,155**	**-24,030**	**-25,023**	**-17,169**	**-16,851**	**-17,708**	**-19,695**	**-21,533**	**-23,381**	**-25,296**
percent of GDP	-4.0	-5.1	-4.9	-3.5	-3.3	-3.3	-3.4	-3.5	-3.6	-3.7
Trade balance	-7,617	-11,810	-14,042	-6,879	-3,994	-1,967	-3,500	-4,485	-4,787	-5,054
percent of GDP	-1.8	-2.5	-2.7	-1.4	-0.8	-0.4	-0.6	-0.7	-0.7	-0.7
Exports										
percentage change in unit values	-20.1	16.0	15.2	1.1	4.9	4.8	6.1	6.8	7.7	7.7
percentage volume growth	-6.8	12.1	9.1	2.8	4.9	5.1	6.0	6.5	6.9	6.9
growth in foreign demand	-15.6	15.4	7.8	0.8	2.4	4.3	4.7	5.0	5.2	5.5
Imports										
percentage change in unit values	-27.4	19.1	15.3	-2.1	3.2	3.7	6.8	7.1	7.6	7.7
percentage volume growth	-12.4	13.9	7.6	-1.8	2.4	4.7	7.2	7.2	7.1	7.1
growth in domestic demand	-1.1	4.6	3.6	-0.2	-0.1	2.2	3.0	3.3	3.5	3.5
Terms of trade percentage change	3.5	-1.1	-1.4	-1.4	-0.9	0.6	0.5	0.3	0.3	0.2
Services balance	4,795	3,098	5,668	6,191	5,513	5,635	5,749	6,018	6,486	7,003
Credit	28,986	32,718	37,562	37,726	38,066	39,384	41,782	44,615	48,032	51,735
Debit	24,191	29,620	31,894	31,535	32,553	33,750	36,033	38,596	41,546	44,732
Net Income	-16,551	-19,080	-22,880	-21,742	-23,352	-25,023	-26,294	-27,885	-29,959	-32,085
Net transfers	2,218	3,762	6,231	5,261	4,982	3,648	4,349	4,819	4,879	4,840
o/w EU receipts	5,603	5,918	8,397	8,529	9,533	8,557	8,249	6,050	7,283	6,988
o/w payment to EU	-4,265	-4,761	-5,004	-4,893	-5,733	-5,898	-6,186	-6,140	-6,096	-6,052
Capital and financial account balance	**41,942**	**49,624**	**40,450**	**31,232**	**34,686**	**37,168**	**37,356**	**38,067**	**34,869**	**35,759**
Capital account balance	7,040	8,620	10,017	10,953	13,920	15,079	12,721	12,594	12,468	12,343
o/w net EU transfers	7,191	6,873	8,890	8,808	13,408	14,515	12,276	9,698	13,801	16,191
Financial account balance	34,902	41,004	30,433	20,279	20,766	22,089	24,635	25,473	22,402	23,416
Foreign direct investment (net)	8,460	6,861	11,552	3,604	7,474	7,976	8,726	9,226	9,726	10,226
by nonresidents	13,022	14,345	18,887	3,092	15,309	16,061	17,061	17,561	18,561	19,561
o/w privatization	1,263	2,699	2,339	2,581	2,581	2,581	2,581	2,581	2,581	2,581
Portfolio investment (net)	14,754	25,538	16,835	19,750	19,261	20,113	15,409	15,247	11,175	11,189
by non-residents	16,202	26,649	16,109	20,182	19,815	20,950	16,267	16,087	12,000	12,000
o/w equities	1,579	7,875	3,052	3,612	3,686	4,682	2,500	2,000	2,000	2,000
Other investment (net)	13,380	9,392	2,608	-5,929	-5,968	-6,000	500	1,000	1,500	2,000
Assets	5,275	-3,901	-3,457	-2,015	-2,000	-3,000	-2,000	-1,500	-1,500	-1,500
Liabilities	8,105	13,293	6,065	-3,914	-3,968	-3,000	2,500	2,500	3,000	3,500
Financial derivatives	-1,692	-787	-562	2,854	0	0	0	0	0	0
Errors and omissions	**-10,045**	**-10,462**	**-9,144**	**-2,862**	**-5,118**	**-5,434**	**-5,758**	**-6,099**	**-6,459**	**-6,845**
Overall balance	**14,742**	**15,132**	**6,283**	**11,201**	**12,717**	**14,026**	**11,902**	**10,435**	**5,029**	**3,617**
Financing										
Reserve assets	-14,742	-15,132	-6,283	-11,201	-12,717	-14,026	-11,902	-10,435	-5,029	-3,617
Memorandum items:										
Current plus capital account (percent of GDP)	-2.3	-3.3	-2.9	-1.3	-0.6	-0.5	-1.2	-1.5	-1.7	-1.9
Official reserves	79,591	93,514	97,866	108,914	121,631	135,657	147,559	157,994	163,023	166,640
in months of imports	6.4	6.3	5.6	6.7	7.2	7.8	7.9	7.9	7.6	7.2
Ratio of reserves to short-term debt 1/	96.3	91.0	108.4	106.2	128.0	147.8	172.1	175.9	177.5	177.6
Ratio of reserves to ST debt plus CA deficit 1/	79.7	73.7	84.9	91.0	108.7	123.9	139.9	141.9	141.5	139.9
Ratio of reserves to IMF ARA metric 2/	122.2	133.9	134.6	139.0	…	…	…	…	…	…
Total external debt (percent of GDP)	65.0	67.1	62.2	74.4	73.5	71.7	70.5	69.3	67.4	65.6
Total external debt (percent of exports) 3/	163.8	158.9	137.8	161.0	159.7	158.1	155.3	151.3	144.9	138.7
External debt service (percent of exports) 3/ 4/	47.4	51.2	43.2	49.3	45.7	42.9	35.5	35.5	34.7	33.9
Gross FDI inflows (percent of GDP)	3.0	3.1	3.7	0.6	3.0	3.0	3.0	2.9	2.9	2.9
Net FDI inflows (percent of GDP)	2.0	1.5	2.2	0.7	1.5	1.5	1.5	1.5	1.5	1.5

Sources: National Bank of Poland; and IMF staff estimates.
1/ Projected reserve level for the year over short-term debt by remaining maturity.
2/ The IMF ARA metric is the sum of 30% short-term debt at remaining maturities, 10% of other liabilities, 5% of broad money, and 10% of exports countries for countries with floating rate currencies.
3/ Exports of goods and services.
4/ Excluding repurchase of debt and including deposits.

Table 3. Poland: Statement of Operations of General Government, 2007–18

(In percent of GDP)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
						Prelim.	Projections					
Revenue	40.3	39.5	37.2	37.6	38.4	38.4	37.8	37.6	37.9	38.2	37.9	38.0
Taxes	22.7	22.8	20.3	20.5	20.8	20.1	19.5	19.6	20.0	20.1	19.7	19.8
Personal income tax	5.2	5.3	4.6	4.5	4.5	4.6	4.3	4.2	4.3	4.4	4.4	4.4
Corporate income tax	2.8	2.7	2.3	2.0	2.1	2.2	2.0	2.0	2.1	2.1	2.1	2.1
VAT	8.2	7.9	7.3	7.6	7.9	7.2	7.0	7.1	7.2	7.2	6.9	7.0
Excises	3.9	4.2	3.6	4.0	3.9	3.8	3.9	3.9	3.9	3.9	3.9	3.9
Other taxes	2.7	2.7	2.5	2.5	2.4	2.4	2.3	2.4	2.4	2.4	2.4	2.4
Social contributions	12.0	11.3	11.3	11.1	11.4	12.3	12.3	12.4	12.4	12.6	12.7	12.6
Other revenue 1/	5.6	5.4	5.6	5.9	6.2	6.0	5.9	5.7	5.5	5.5	5.5	5.5
Capital revenue	0.5	0.4	0.6	1.3	1.8	1.3	1.4	1.2	1.0	1.0	1.0	1.0
Sales of goods and services	2.5	2.5	2.4	2.3	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Other current revenue	2.7	2.5	2.6	2.4	2.4	2.5	2.5	2.4	2.4	2.4	2.4	2.4
Expenditure	42.2	43.2	44.6	45.4	43.4	42.3	41.8	41.0	40.7	40.7	40.6	40.4
Expense	38.0	38.6	39.4	39.8	37.7	37.7	38.0	37.5	37.4	37.4	37.3	37.2
Compensation of employees	9.6	10.0	10.3	10.2	9.7	9.7	9.7	9.6	9.6	9.5	9.5	9.6
Use of goods and services	6.0	6.2	5.7	6.2	5.7	5.6	5.6	5.7	5.7	5.7	5.7	5.7
Interest	2.3	2.2	2.6	2.7	2.7	2.8	2.7	2.5	2.5	2.5	2.5	2.4
Subsidies	0.6	0.6	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Social benefits	16.2	16.1	16.9	17.0	16.2	16.4	16.6	16.4	16.4	16.3	16.2	16.1
Other expense 1/	3.3	3.5	3.3	3.2	2.9	2.9	3.0	3.0	3.0	3.0	3.0	3.0
Of which: Other current expenditure	2.6	2.6	2.3	2.4	2.4	2.5	2.4	2.3	2.3	2.3	2.3	2.3
Capital transfers	0.6	0.9	0.9	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Net acquisition of nonfinancial assets	4.2	4.6	5.2	5.6	5.7	4.6	3.8	3.5	3.3	3.3	3.3	3.2
Gross Operating Balance	2.3	0.9	-2.2	-2.2	0.7	0.7	-0.2	0.2	0.4	0.8	0.6	0.8
Net lending/borrowing (overall balance)	-1.9	-3.7	-7.4	-7.9	-5.0	-3.9	-4.0	-3.3	-2.9	-2.5	-2.7	-2.4
Net financial transactions	-1.9	-3.7	-7.4	-7.9	-5.0	-3.8	-4.0	-3.3	-2.9	-2.5	-2.7	-2.4
Net acquisition of financial assets	1.5	0.4	-1.1	-1.1	-1.3	0.0	-1.6	-0.3	0.4	0.6	-0.4	-0.4
Currency and deposits	1.0	0.5	0.1	-0.6	-1.3	0.9	-1.7	-0.6	0.1	0.3	-0.7	-0.6
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.4	-0.1	0.0	0.2	0.1	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Equity and investment fund shares	-0.1	-0.2	-0.4	-1.6	-1.3	-1.0	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1
Other financial assets	0.3	0.2	-0.7	1.0	1.2	0.1	0.3	0.3	0.3	0.3	0.3	0.3
Net incurrence of liabilities	3.4	4.0	6.2	6.8	3.6	3.7	2.4	3.0	3.3	3.0	2.2	2.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	3.7	2.9	4.5	5.0	2.1	2.6	1.2	1.8	2.1	1.9	1.2	1.0
Loans	-0.7	0.5	1.8	1.5	1.4	0.7	1.0	1.1	1.0	0.9	0.8	0.8
Other liabilities	0.4	0.6	-0.1	0.3	0.1	0.4	0.2	0.2	0.2	0.2	0.2	0.2
Adjustment and statistical discrepancies	*0.0*	*0.0*	*-0.1*	*0.0*	*-0.1*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Memorandum items:												
Cyclically-adjusted balance	-2.2	-4.2	-7.1	-7.8	-5.4	-3.8	-3.3	-2.7	-2.2	-2.0	-2.4	-2.4
Primary balance	0.4	-1.5	-4.8	-5.2	-2.3	-1.1	-1.3	-0.8	-0.4	0.0	-0.2	0.0
Cyclically-adjusted balance adjusted for pension changes	0.1	-2.0	-4.4	-5.1	-2.7	-1.4	-1.0	-0.6	-0.1	0.2	-0.2	-0.3
General government debt	45.0	47.1	50.9	54.8	56.2	55.6	57.1	57.2	57.7	57.7	56.7	55.6
General government liabilities	51.7	54.4	58.2	62.3	63.0	62.6	64.4	64.5	65.0	65.0	64.0	62.9
General government net financial assets	-17.0	-17.2	-22.3	-27.9	-33.0	-34.5	-36.3	-37.4	-38.8	-39.8	-39.9	-39.7
Nominal GDP in billions of Zlotys	1,177	1,276	1,345	1,417	1,528	1,595	1,638	1,711	1,795	1,891	2,000	2,116

Sources: Eurostat and IMF staff projections.
1/ Includes grants.

Table 4. Poland: General Government Financial Balance Sheet, 2011–18

(In millions of Zlotys)

	2011			2012			2013	2014	2015	2016	2017	2018
	Trans-actions	OEF	Closing Opening balance	Trans-actions	OEF	Closing Opening balance	Projections					
Net worth and its changes	**....**	**....**	**....**	**....**	**....**	**....**	**....**	**....**	**....**	**....**	**....**	**....**
Nonfinancial assets	**....**	**....**	**....**	**....**	**....**	**....**	**....**	**....**	**....**	**....**	**....**	**....**
Net Financial Worth:	**-75,242**	**-33,092**	**-503,942**	**-59,843**	**12,826**	**-550,959**	**-593,918**	**-639,553**	**-696,877**	**-753,443**	**-797,052**	**-840,708**
Financial Assets	**-20,593**	**-6,774**	**459,025**	**-284**	**-11,543**	**447,198**	**460,804**	**464,122**	**469,038**	**475,230**	**482,553**	**489,528**
Currency and deposits	-19,323	-572	43,166	14,076	-7,743	49,499	50,829	53,082	55,697	58,678	62,052	65,670
Debt securities	-59	-917	5,772	357	-1,032	5,097	5,234	5,466	5,735	6,042	6,390	6,762
Loans	899	2,073	15,882	-429	-2,879	12,574	13,128	13,710	14,386	15,155	16,027	16,961
Equity and inv. fund shares	-19,822	87	287,195	-16,592	0	270,603	289,679	285,412	281,523	277,679	273,645	268,438
Other financial assets	17,712	-7,445	107,010	2,304	111	109,425	101,934	106,452	111,697	117,675	124,440	131,696
Liabilities	**54,649**	**26,318**	**962,967**	**59,559**	**-24,369**	**998,157**	**1,054,722**	**1,103,676**	**1,165,915**	**1,228,672**	**1,279,605**	**1,330,236**
Currency and deposits	0	0	0	0	0	0	0	0	0	0	0	0
Debt securities	32,315	21,233	719,273	41,865	-18,482	742,656	823,023	861,706	912,024	961,193	996,748	1,030,885
Loans	21,234	7,850	143,197	11,915	-5,887	149,225	112,569	117,559	123,351	129,952	137,424	145,437
Other liabilities	1,100	-2,765	100,497	5,779	0	106,276	119,130	124,411	130,540	137,527	145,433	153,914
Memorandum items:												
Net financial worth (in % of GDP)			-33.0			-34.5	-36.3	-37.4	-38.8	-39.8	-39.9	-39.7
Financial assets (in % of GDP)			30.0			28.0	28.1	27.1	26.1	25.1	24.1	23.1
Liabilities (in % of GDP)			63.0			62.6	64.4	64.5	65.0	65.0	64.0	62.9
GDP nominal prices (in Billion PLN)			1528.1			1595.3	1638.1	1710.7	1795.0	1891.1	1999.8	2116.4

Sources: National Authorities and IMF Staff calculations.

Table 5. Poland: Monetary Accounts, 2006–13

	2006	2007	2008	2009	2010	2011	2012	2013 Proj.
				(In billions of zloty)				
Central Bank								
Net foreign assets	138	141	177	212	257	317	321	361
Net domestic assets	-51	-38	-51	-74	-117	-179	-153	-189
Net claims on government	-17	-26	-21	-23	-12	-19	-16	-16
Claims on banks	-13	-4	9	-25	-74	-93	-100	-136
Other items, net	-22	-7	-38	-26	-31	-67	-37	-37
Base money	87	103	126	138	140	138	167	172
o/w Currency issued	75	86	102	100	103	112	113	115
o/w Banks' reserves	12	17	25	38	37	26	54	56
Deposit Money Banks								
Net foreign assets	29	-19	-113	-135	-156	-169	-143	-131
Net domestic assets	392	496	679	762	842	939	953	981
Net claims on the central bank	42	39	37	75	121	130	167	205
Net claims on government	109	107	153	171	177	191	177	169
Claims on private sector	353	464	633	677	735	838	858	889
Claims on corporates	140	173	224	217	215	253	257	271
Claims on households	188	260	376	421	480	537	538	553
Claims on other	25	31	33	40	41	47	63	65
Other items, net	-112	-114	-143	-161	-191	-219	-249	-282
Deposits	421	477	566	627	687	771	810	850
Consolidated Banking System								
Net foreign assets	167	121	64	76	101	149	178	230
Net domestic assets	328	441	602	644	683	733	744	733
Net claims on government	93	80	131	148	164	172	161	152
Claims on private sector	353	464	633	677	735	838	858	889
Other items, net	-117	-104	-162	-182	-217	-276	-275	-308
Broad money (M3)	495	562	666	720	784	882	921	963
Memorandum items:								
				(Percentage change from end of previous year)				
Base money	23.1	18.2	23.1	8.8	1.6	-1.1	21.0	2.7
Broad money (M3)	16.0	13.4	18.6	8.1	8.8	12.5	4.5	4.5
Net domestic assets	30.2	34.1	36.6	7.0	6.0	7.4	1.5	-1.4
Net foreign assets	-4.6	-27.5	-46.9	18.8	32.6	46.9	19.6	29.3
Net claim on government	11.4	-13.4	63.4	12.8	11.0	4.5	-6.6	-5.1
Claims on private sector	24.0	31.5	36.4	7.0	8.5	13.9	2.4	3.7
Deposit growth	14.9	13.1	18.9	10.6	9.6	12.2	5.1	4.9
				(In percent of GDP)				
Broad money (M3)	46.7	47.7	52.2	53.6	55.3	57.7	57.8	58.8
Private sector credit	33.3	39.4	49.6	50.4	51.9	54.8	53.8	54.3
Broad money velocity (GDP/M3)	2.1	2.1	1.9	1.9	1.8	1.7	1.7	1.7
Money multiplier (M3/base money)	5.7	5.5	5.3	5.2	5.6	6.4	5.5	5.6

Sources: National Bank of Poland; IFS; Haver; and IMF staff estimates.

Table 6. Poland: Financial Soundness Indicators, 2007–13
(In percent)

	2007	2008	2009	2010	2011	2012	2013Q1
Capital adequacy 1/							
Regulatory capital to risk-weighted assets	12.0	11.1	13.3	13.9	13.1	14.7	15.4
Regulatory Tier I capital to risk-weighted assets	11.8	10.0	12.0	12.5	11.7	13.1	13.8
NPLs net of provisions to capital	11.4	8.3	13.8	11.5	11.6	12.9	12.5
Bank capital to assets	8.0	7.5	8.1	8.2	7.8	8.7	9.0
Asset composition and quality							
NPLs to gross loans (non-financial sector)	5.2	4.4	7.9	8.8	8.2	8.9	8.9
Sectoral distribution of loans to non-financial setor							
Loans to households	59.3	62.0	65.3	68.0	66.4	65.7	65.8
Loans to non-financial corporations	40.3	37.6	34.3	31.5	33.1	33.7	33.7
Earnings and profitability							
Return on average assets (after-tax)	1.7	1.5	0.8	1.0	1.3	1.2	1.1
Return on average equity (after-tax) 1/	22.4	20.7	11.2	13.3	16.1	14.1	13.3
Interest margin to gross income	59.4	55.7	51.9	53.0	55.8	54.8	54.5
Noninterest expenses to gross income	68.7	58.4	58.5	56.0	54.5	54.6	55.3
Liquidity							
Liquid assets to total assets (liquid assets ratio)	17.1	17.0	20.3	20.8	19.5	21.1	21.6
Liquid assets to total short-term liabilities	24.2	25.3	29.8	31.2	28.8	31.4	32.3
Sensitivity to market risk							
Net open positions in FX to capital 1/	0.6	0.0	2.7	0.3	-0.3	0.1	-0.1

Sources: National Bank of Poland; and KNF.
1/ Data for domestic banking sector.

Table 7. Poland: Public Sector Debt Sustainability Framework, 2009–18

	Actual				Projections						
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	**Debt-stabilizing primary balance 9/**
Baseline: Public sector debt 1/	50.9	54.8	56.2	55.6	**57.1**	**57.2**	**57.7**	**57.7**	**56.7**	**55.6**	**-0.8**
o/w foreign-currency denominated	13.6	15.2	18.0	17.6	17.0	16.5	16.0	15.3	15.0	14.7	
Change in public sector debt	3.8	4.0	1.4	-0.6	1.5	0.1	0.4	0.0	-1.0	-1.1	
Identified debt-creating flows (4+7+12)	6.6	3.4	0.2	2.4	2.4	0.8	0.1	-0.5	-0.6	-0.8	
Primary deficit	4.8	5.2	2.3	1.1	1.3	0.8	0.4	0.0	0.2	0.0	
Revenue and grants	37.2	37.6	38.4	38.4	37.8	37.6	37.9	38.2	37.9	38.0	
Primary (noninterest) expenditure	42.0	42.7	40.8	39.5	39.1	38.4	38.3	38.2	38.1	38.0	
Automatic debt dynamics 2/	2.2	-0.2	-1.3	2.4	1.3	0.1	-0.2	-0.5	-0.7	-0.7	
Contribution from interest rate/growth differential 3/	0.2	0.1	-1.3	0.5	1.3	0.1	-0.2	-0.5	-0.7	-0.7	
Of which contribution from real interest rate	1.0	2.0	1.0	1.5	1.8	1.3	1.1	1.2	1.1	1.1	
Of which contribution from real GDP growth	-0.7	-1.9	-2.3	-1.0	-0.6	-1.2	-1.4	-1.6	-1.8	-1.9	
Contribution from exchange rate depreciation 4/	2.0	-0.3	0.0	1.9	...	...	...	...	...	...	
Other identified debt-creating flows	-0.4	-1.6	-0.9	-1.0	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	
Privatization receipts (negative)	-0.4	-1.6	-0.9	-1.0	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	
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	
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	
Residual, including asset changes (2-3) 5/	-2.9	0.5	1.2	-3.1	-0.8	-0.7	0.4	0.6	-0.4	-0.3	
Public sector debt-to-revenue ratio 1/	136.8	146.0	146.3	144.8	151.1	152.2	152.3	151.0	149.5	146.3	
Gross financing need 6/	15.3	15.9	11.8	12.1	10.1	9.4	9.0	8.6	8.7	8.3	
in billions of U.S. dollars	66.0	74.9	61.0	59.0	51.7	51.3	51.9	52.6	56.1	57.0	
Scenario with key variables at their historical averages 7/					**57.1**	**58.0**	**59.9**	**61.9**	**63.0**	**64.2**	**-0.8**
Scenario with no policy change (constant primary balance) in 2013-2018					**57.1**	**57.7**	**59.1**	**60.4**	**60.5**	**60.6**	**-0.9**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline											
Real GDP growth (in percent)	1.6	3.9	4.5	1.9	1.1	2.2	2.5	3.0	3.3	3.5	
Average nominal interest rate on public debt (in percent) 8/	5.9	5.6	5.3	5.3	5.0	4.6	4.5	4.5	4.5	4.5	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	2.2	4.1	2.1	2.8	3.4	2.5	2.2	2.2	2.2	2.2	
Nominal appreciation (increase in US dollar value of local currency, in percent)	3.9	-3.8	-13.3	10.3	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	3.7	1.4	3.2	2.5	1.6	2.1	2.3	2.3	2.3	2.3	
Growth of real primary spending (deflated by GDP deflator, in percent)	4.0	5.8	-0.3	-1.3	0.2	0.5	2.1	2.8	3.1	3.1	
Primary deficit	4.8	5.2	2.3	1.1	1.3	0.8	0.4	0.0	0.2	0.0	

1/ General governement 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 - π (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution between 2007-11 is according to official estimates; afterward is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 8. Poland: External Debt Sustainability Framework, 2009–18

	Actual						Projections						
	2009	2010	2011	2012			2013	2014	2015	2016	2017	2018	Debt-stabilizing non-interest current account 6/
Baseline: External debt	65.0	67.1	62.2	74.4			**73.5**	**71.7**	**70.5**	**69.3**	**67.4**	**65.6**	**-4.3**
Change in external debt	18.8	2.1	-4.9	12.2			-0.8	-1.8	-1.2	-1.2	-1.9	-1.8	
Identified external debt-creating flows (4+8+9)	9.9	-5.0	-5.7	3.8			-1.2	-2.1	-1.7	-1.7	-1.8	-1.7	
Current account deficit, excluding interest payments	3.4	4.0	3.8	2.1			2.0	1.8	1.9	1.7	1.4	1.1	
Deficit in balance of goods and services	0.7	1.9	1.6	0.1			-0.3	-0.7	-0.4	-0.3	-0.3	-0.3	
Exports	39.7	42.2	45.1	46.2			46.0	45.3	45.4	45.8	46.5	47.3	
Imports	40.4	44.1	46.8	46.3			45.7	44.7	45.0	45.5	46.3	47.0	
Net non-debt creating capital inflows (negative)	-3.4	-4.7	-4.3	-1.4			-3.7	-3.8	-3.4	-3.2	-3.2	-3.1	
Automatic debt dynamics 1/	9.9	-4.2	-5.2	3.1			0.5	-0.1	-0.2	-0.2	0.0	0.4	
Contribution from nominal interest rate	0.6	1.1	1.1	1.4			1.3	1.4	1.6	1.8	2.2	2.6	
Contribution from real GDP growth	-0.9	-2.3	-2.7	-1.2			-0.8	-1.6	-1.7	-2.0	-2.2	-2.2	
Contribution from price and exchange rate changes 2/	10.2	-3.0	-3.5	2.9			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	8.9	7.1	0.7	8.4			0.4	0.3	0.5	0.5	-0.1	-0.2	
External debt-to-exports ratio (in percent)	163.8	158.9	137.8	161.0			159.7	158.1	155.2	151.3	144.9	138.7	
Gross external financing need (in billions of US dollars) 4/	95.7	120.3	120.0	121.7			117.8	115.7	103.5	109.4	113.2	117.1	
in percent of GDP	22.2	25.6	23.3	24.8	10-Year	10-Year	22.7	21.1	17.9	17.8	17.5	17.1	
Scenario with key variables at their historical averages 5/							**73.5**	**70.5**	**67.4**	**64.2**	**60.4**	**56.8**	**-7.8**
Key Macroeconomic Assumptions Underlying Baseline					Historical Average	Standard Deviation							
Real GDP growth (in percent)	1.6	3.9	4.5	1.9	4.3	1.7	1.1	2.2	2.5	3.0	3.4	3.5	
GDP deflator in US dollars (change in percent)	-20.9	5.6	5.9	-6.2	5.6	11.7	4.6	3.5	3.1	2.7	2.3	2.4	
Nominal external interest rate (in percent)	1.0	1.9	1.8	2.2	2.4	0.7	1.9	2.0	2.3	2.8	3.4	4.1	
Growth of exports (US dollar terms, in percent)	-20.1	16.0	17.3	-2.9	15.9	15.8	4.2	4.6	6.1	6.8	7.7	7.7	
Growth of imports (US dollar terms, in percent)	-27.4	19.1	16.4	-5.9	15.2	18.4	3.2	3.7	6.8	7.1	7.6	7.7	
Current account balance, excluding interest payments	-3.4	-4.0	-3.8	-2.1	-3.3	1.4	-2.0	-1.8	-1.9	-1.7	-1.4	-1.1	
Net non-debt creating capital inflows	3.4	4.7	4.3	1.4	3.9	1.5	3.7	3.8	3.4	3.2	3.2	3.1	

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

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

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

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

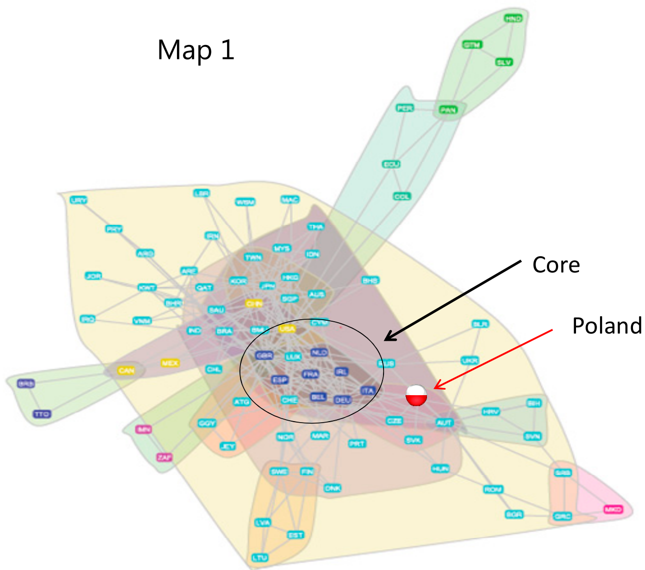
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

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

Appendix I. Poland's Interconnectedness[1]

1. This annex highlights the application of the Fund's work on interconnectedness to Poland, as recommended by the Triennial Surveillance Review.[2, 3] In particular, network analysis is used to map Poland's cross-border trade and financial linkages, which provides a framework to formulate hypotheses about economic relationships and spillovers.[4] The resulting network maps provide a useful overview of Poland's integration into the global economy, and a first step toward assessing the implications of Poland's role in the German supply chain. Delving deeper is crucial to better understand the functional characteristics of the relationships and to provide context.[5]

2. The network map has three key features (Map 1).



- First, a core set of globally important economies such as Germany, Italy, and the US are at center. These countries are directly linked to a large number of other countries and several links pass through them.[6] Poland is more in the periphery (right side) to the core, linked to core European countries.

- Second, groupings or *clusters* of countries, which have the strongest mutual inter-linkages considering both trade and financial links (shaded in the same color below), are identified.

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[1] Prepared by Phil de Imus (SPR).

[2] Enhancing Surveillance: Interconnectedness and Clusters, International Monetary Fund (IMF) Policy Papers, March 2012. http://www.imf.org/external/np/pp/eng/2012/031512.pdf

[3] Triennial Surveillance Review-Overview Paper, August 2011 http://www.imf.org/external/np/spr/triennial/

[4] There are different algorithms to perform network analysis. We use the Clique Percolation Method proposed by Palla, G., Derenyi, I., Farkas, I., Vicsek, T. in a 2005 paper in the journal *Nature*. It has the beneficial feature of mapping overlapping relationships between clusters and chains of clusters to hypothesize about the direct and indirect interconnections.

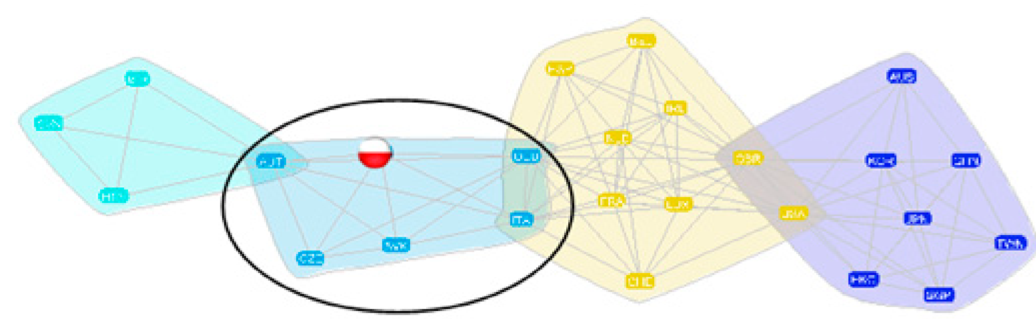
[5] The existing literature does not find any consistent prediction about the relationship of interconnectedness and macroeconomic outcomes, such as output synchronization or volatility. See chapter 1 of the Enhancing Surveillance Background Paper, http://www.imf.org/external/np/pp/eng/2012/031612b.pdf

[6] This version of the map is constructed using 2011 IMF direction of trade, BIS bank (both consolidated and locational), and the IMF coordinated portfolio and direct investment surveys. The Enhancing Surveillance paper used 2009 data.

Poland is in a cluster with Germany, Italy, Austria, and the Czech and Slovak Republics (see black oval).

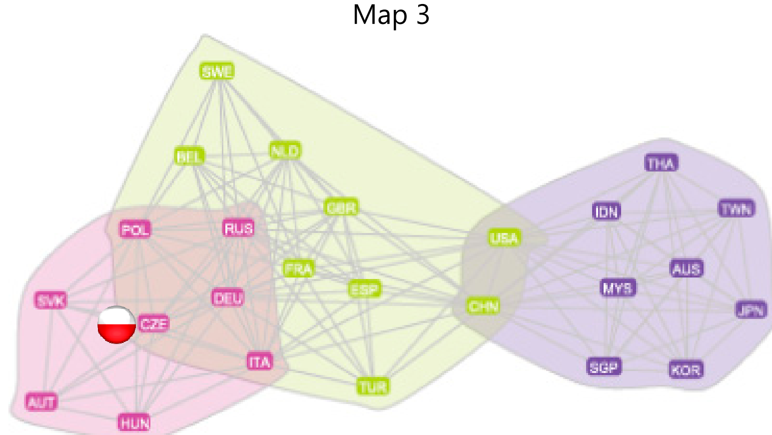
- Third, *gatekeeper economies* are defined as those that belong to more than one cluster and connect a cluster to others or to the core cluster (Map 2). In Poland's cluster, Germany and Italy are gatekeepers to the core cluster (right side of the Poland cluster). Austria is also a gatekeeper (left side of the Poland cluster) to a cluster containing Croatia, Bosnia-Herzegovina, and Slovenia.

Map 2



3. Gatekeepers are important in potentially propagating or cushioning shocks. For example, a shock in Germany affects Poland and other countries in the same cluster.[7] Moreover, that shock can affect the core economies (at the center of the map above), particularly core Europe. While the crisis has focused attention on negative shocks, they could also be positive. German policies, for example, could have positive spillovers, dampening the propagation of shocks to its clusters.

Map 3



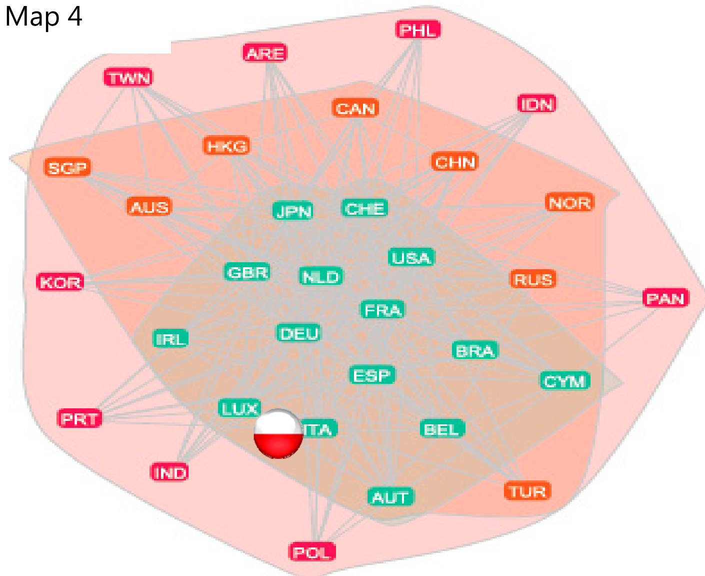
4. Chains of clusters help to hypothesize about the channels through which indirect links operate (Map 3). It is a commonly held view that Poland benefits from being in the German supply chain in part because Polish exports can ultimately find their way to fast growing economies like China. The network analysis documents this indirect link to hypothesize how shocks in China (right side Asian cluster) affect Poland. They are

[7] The forthcoming IMF Board Paper on "The German-Central European Supply Chain" analyzes the propagation of shocks from Germany to Central and Eastern Europe in more detail.

likely to pass through the U.K. and U.S. first, which are the gatekeepers of that cluster to the core. The shock is then transmitted via Germany or Italy to the Poland cluster.

5. Trade linkages more closely define the Polish cluster, rather than financial ones Map 3 more closely resembles Map 2 which combines both trade and financial linkages. This is because the CPM algorithm[3] takes in to account the mutual trade relationships consistent with a supply chain. For example, Poland imports upstream goods that are then exported as downstream products in the German and Italian auto supply chain. In contrast, financial linkages (e.g. consolidated BIS banking exposures) are similar to concentric circles with Poland in the periphery, outer ring connected to core banking systems in the inner ring like those of Italy, Spain, and Austria, which own subsidiaries in Poland (Map 4).

Map 4



Appendix II. Does the Current Economic Slowdown Hide Some Structural Features?[1]

1. The Polish economy is experiencing a sharp demand-driven economic slowdown. Real GDP growth slowed from 4.5 percent in 2011 to 1.9 percent in 2012, driven by a contraction in domestic demand and a slowdown in export growth. The economy is expected to slow further in 2013, followed by a gradual recovery over the medium term.

2. Staff considers that the slowdown is mainly cyclical, given limited evidence of structural features at the household, corporate, and labor market levels:

- The sharp slowdown in household consumption appears to be related to the effects of fundamentals (disposable income and moderated wealth effects) and the buildup of precautionary savings. Staff econometric work suggests that the bulk of the variation in real household consumption growth in Poland is explained by dynamics in household disposable income and macroeconomic uncertainty (approximated by the change in the unemployment rate) whereas wealth effects appear limited. The slowdown in private consumption thus reflects the cumulative decline in households' disposable income and heightened uncertainties associated with a rising unemployment rate (around an already high structural unemployment level).[2] Those factors are not irreversible and appear highly dependent on the economy's position in the business cycle. Moreover, relatively low household indebtedness (about 36 percent of GDP as of end 2012) limits the risk of financial stress and protracted slowdown in consumption.

Poland. Correlates of Real Household Consumption Growth

Period: 2004Q1-2012Q4	(1) ECM	(2) ECM
Log difference of:		
Disposable income	0.187***	0.133**
	(3.109)	(2.502)
Households' net assets	-0.00952	
	(-0.469)	
Housing wealth		0.0186*
		(1.720)
Financial wealth		0.0476
		(1.646)
Change in unemployment rate	-0.359**	-0.358**
	(-2.320)	(-2.460)
Error correction term	-0.423**	-0.374**
	(-2.592)	(-2.370)
Observations	32	32
R-squared	0.419	0.515

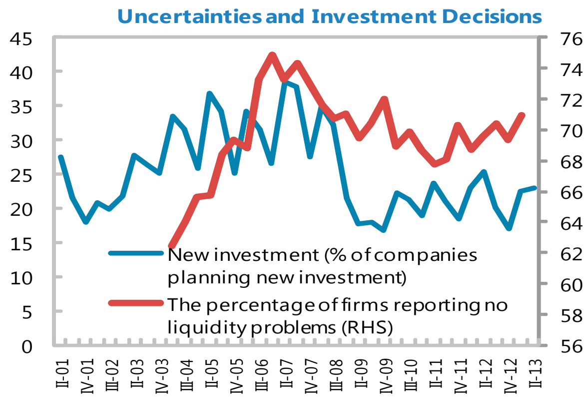
T-statistics in parentheses. ECM: Error correction model.
*** p<0.01, ** p<0.05, * p<0.1
Source: IMF Staff estimates.

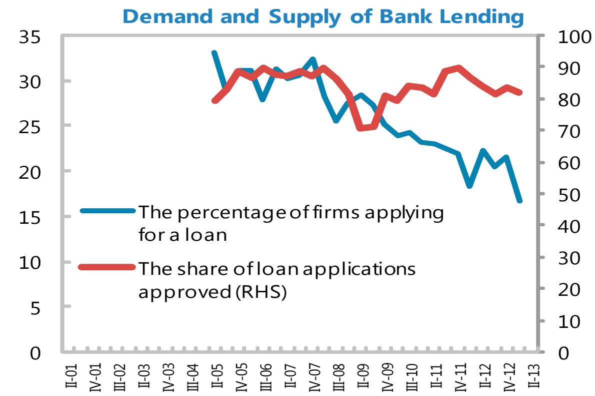
- A recent NBP survey (*2013 Enterprise Sector Survey*, National Bank of Poland) on the economic and financial conditions in the corporate sector reveals the sizeable effect of macroeconomic

[1] Prepared by Christian Ebeke (EUR).

[2] Staff calculations indicate that, regardless of the econometric method used (Okun's law, Phillips curve and augmented Phillips curve coupled with a Kalman filter), the level of structural unemployment (NAIRU) in Poland stands at around 10 percent as of end 2012.

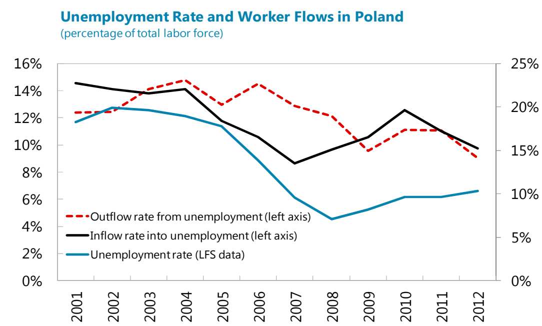
uncertainties on investment plans. Firm expectations regarding the general outlook are depressed and the number of new exports contracts secured in the first half of the year has plummeted. The NBP survey also reveals a declining path of the number of enterprises reporting new investment plans and applying for new bank loans.





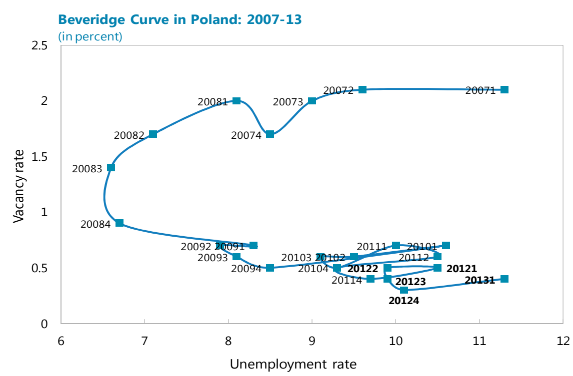
Source: NBP 2013 Corporate Sector Survey.

- Tensions in the labor market seem to be mainly explained by cyclical sectoral shocks having affected labor intensive sectors in a context of elevated structural unemployment rate (NAIRU). The unemployment rate has risen continuously over the years due to weaker outflows of workers from unemployment as opposed to inflows into unemployment, while the NAIRU stayed at a high level. The bulk of employment destruction took place in the construction export-oriented sectors.



Sources: OECD Stat.; and IMF Staff estimates based on Elsby et al. (2013).

- Labor market adjustments took the form of a modest slowdown in nominal wages, a steady increase in the share of short-term contracts, and significant reduction in job vacancy rates. These stylized facts are confirmed using an analysis of the Beveridge curve and econometric investigations using Polish labor market data.[3]



Sources: Haver analytics; IMF Staff estimates.

[3] The recent movements along the Beveridge curve do not only imply an improvement in the "matching process" in the labor market. They could also suggest that unfilled positions are shrinking consistent with the observed erosion in household disposable income which has strongly reduced "voluntary" unemployment.

- Staff estimates also uncover two important results: (i) the unemployment rate (and the unemployment gap) is significantly and negatively correlated with the business cycle position of the economy but in an asymmetric way: the responsiveness of the unemployment gap to the output gap is stronger during upturns, suggesting a significant adjustment of the labor market through prices (wages) during downturns; and (ii) the responsiveness of manufacturing wages also exhibits this asymmetrical behavior: manufacturing real wages are on average, positively correlated with productivity shocks but the correlation is stronger when productivity shocks are negative.

Cyclicality of Labor Market Indicators in Poland.
Dynamic Ordinary Least Squares Results.

Period 2002Q1-2012Q4	U (1)	U gap (3)	U gap (4)	ln (Manuf. wage) (5)	ln (Manuf. wage) (6)	ln (Manuf. wag (7)
Output gap	-2.763*** (-5.974)	-0.974*** (-7.709)				
Output gap (+)			-1.265*** (-5.177)			
Output gap (-)			-0.665** (-2.595)			
Unemployment rate (U)				-0.174** (-2.504)		
Productivity shock					0.234* (1.788)	
Productivity shock (+)						0.139 (1.085)
Productivity shock (-)						0.865** (2.136)
ln (Manuf. wage) lagged				-0.105*** (-2.988)	-0.0134 (-0.980)	-0.0124 (-0.881)
Observations	44	44	44	43	43	43
R-squared	0.459	0.586	0.604	0.175	0.066	0.084

Robust t-statistics in parentheses. U gap refers to the difference between unemployment rate and its HP trend value.
*** p<0.01, ** p<0.05, * p<0.1
Source: IMF Staff estimates.

Appendix III. Risk Assessment Matrix[1]

(Scale—high, medium, or low)

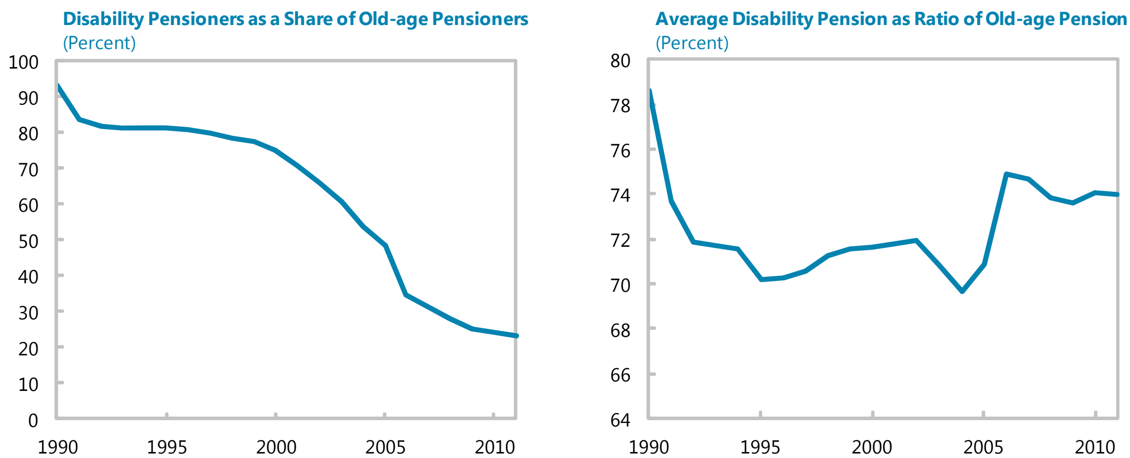
Risk	Relative Likelihood	Expected Impact if Realized
1. Protracted period of slower European growth.	**High** • The adverse impact of public and private sector deleveraging on the real economy in Europe may be larger than expected in the medium-term, leading to sizable output gaps and potentially spurring debt-deflation dynamics. • Job skills could become obsolete due to long unemployment spells and subdued investment, reducing potential output.	**Medium** • Significant trade linkages with Europe would weaken growth in Poland through lower exports. • The effects could be partly offset by domestic demand, as Poland's economy is relatively closed. • Monetary policy should be further eased, especially as fiscal space is limited.
2. Financial stress in the euro area re-emerges	**Medium** • As a result, financial stress could reemerge in the short-term and bank-sovereign-real economy links could re-intensify as a result of stalled or incomplete delivery of policy commitments in some peripheral countries. • Strong market pressure on euro area economies are likely to reverberate across financial markets and asset classes.	**Medium** • Significant zloty depreciation could lead to liquidity strains and credit losses in some banks with FX-denominated mortgage portfolios. • The effects would be mitigated by the strong and high quality capital position in the banking sector, and by the moderate stock of these mortgages relative to GDP (11 percent of GDP). • The exchange rate should be allowed to float freely, but intervention could be used to avoid abrupt movements. The NBP should provide liquidity support if needed.
3. Excessive pace of parent bank deleveraging.	**Medium** • Excessive or uncoordinated deleveraging by parent banks would have adverse effects on credit supply and economic activity.	**Medium** • Excessive deleveraging could result in a credit squeeze, with adverse implications for growth. • The effects could be mitigated by reduced reliance on parent funding, strong balance sheet and liquidity of the banking system, and the reliance of the corporate sector on retained earnings to finance investment. • The NBP should provide liquidity support.
4. Emerging Markets capital flow reversal	**Medium** • Growing demand from foreign investors of domestic government bonds could lead to asset overvaluation and result in a sharp unwinding of foreign investors' positions in the short and medium terms. • An unanticipated rise in global interest rates could cause investors to reallocate assets away from EMs. For example, this could result from distortions from unconventional monetary policy or a fiscal shock in the U.S.	**Medium** • The sudden reversal could lead to higher funding costs for the government. • The unwinding of foreign investors' hedging positions would reduce the liquidity in the FX derivatives market, increasing banks' hedging costs. • The risk could be mitigated by a relatively stable investor base, prudent public debt management, strong liquidity positions in the banking sector, and banks' more prudent approach to hedging FX risks. • The exchange rate should be allowed to float freely, but intervention could be used to avoid abrupt movements. The NBP should provide liquidity support if needed.
5. Stronger than expected domestic slowdown, higher unemployment, and declining real estate prices	**Low** • Continued uncertainty could further depress confidence, leading to a decline in domestic demand and higher unemployment. • This could cause less appetite for new borrowing, which could depress housing demand and lead to further declines in residential real estate prices.	**High** • A stronger than expected domestic slowdown and higher unemployment could cause larger bank losses and reduced bank profitability. • The effects could be mitigated by strong capital buffers in the overall banking system. • Monetary policy should be further eased, especially as fiscal space is limited.

[1] The RAM shows relatively low probability events that could materially alter the baseline discussed in this report. The relative likelihood of risks listed is the staff's subjective assessment of risks surrounding this baseline.

Appendix IV. Addressing Inconsistency Between Disability and Old-Age Pensions[1]

1. In the early 1990s, the number of non-farm disability pensioners was almost equal to those receiving old-age pensions, reflecting generous criteria for granting disability rights. The rules were tightened in 1997 by defining disability as inability to work (instead of as a health condition), shifting medical assessment to doctors authorized by the Social Insurance Institution (ZUS), and granting disability rights for limited time (except in extreme cases). This reduced the inflow of new disability pensioners, who now account for about ¼ of old-age pensioners (Chart). The ratio of average disability benefits to old-age pension benefits stabilized around ¾ in recent years.

Pensions and Disability Pensions in Poland



Source: ZUS

2. There is an inconsistency between the current formulas used to calculate disability versus old-age pensions. After the comprehensive pension reform in 1999, a defined contribution (DC) system was adopted for old-age pensions so that they would better reflect individual contributions and life expectancy at retirement. In contrast, disability pensions have remained under a defined benefit (DB) system, with a weaker link to contributions paid (Box 1).

[1] Prepared by Robert Sierhej (Poland Res Rep Office).

Box 1. Old-Age and Disability Pension Formulas

In the reformed DC system, the old-age pension ***(P)*** *is derived as:* $\boldsymbol{P=K/L_E}$ *(where* ***K*** *is the capital accumulated on individual pension accounts, and* $\boldsymbol{L_E}$ *is average life expectancy at retirement). This formula marks a departure from the previous DB scheme, where benefits included also lump-sum and non-contribution elements. Replacement rates are lower in DC system than they would have been in DB scheme for the same work career.*

Despite the reform, the disability pension $\boldsymbol{(P_d)}$ *remained on a DB basis defined as:*

$$P_d = 0.24*AW_t + 0.013*Yc* W_{10} + 0.007* Yn* W_{10}$$

where: $\boldsymbol{W_{10}}$*—best earnings for 10 consecutive years during 20 years before retirement, divided by the average wage in the economy during the same period, and multiplied by average wage in the economy at the year of retirement (*$\boldsymbol{AW_t}$*);* ***Yc—****years with pension contributions paid;* ***Yn—****non-contribution years including disability years to reach the retirement age, maternity, or education.*

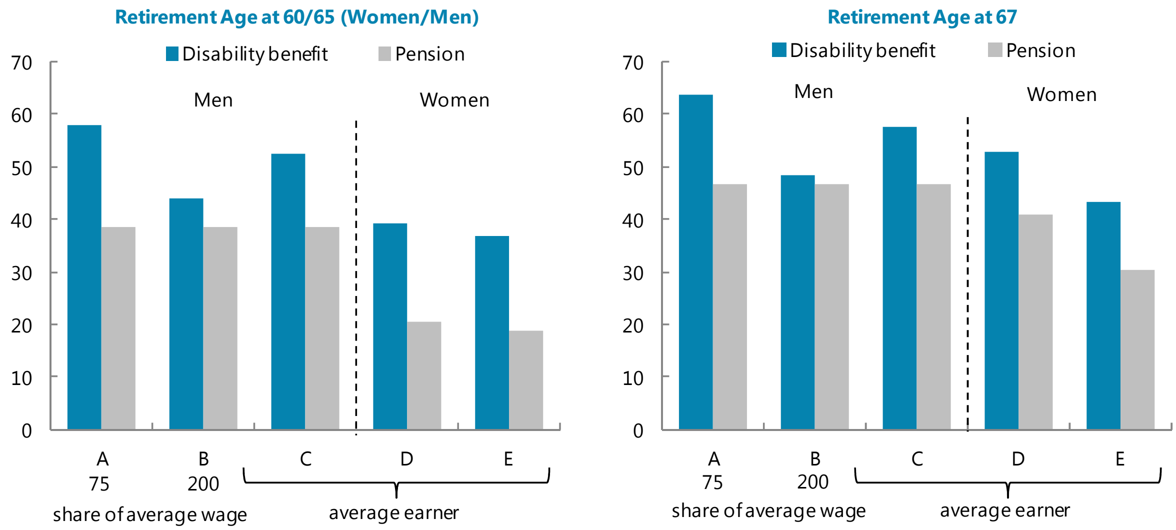
If a benefit based on this formula falls below the legal minimum disability pension, the minimum would apply. The disability formula, like pre-reform old-age pensions, includes a lump-sum factor based on the average wage in the economy, is based on the 10 best years of pre-retirement income, and covers non-contribution periods. It does not have a link to life expectancy.

3. **If this inconsistency remains unaddressed, it will create incentives for retirement via disability (instead of old-age) benefits**. These incentives would increase over time, as the old-age pension gradually shifts to the DC scheme, leading to a decline in replacement rates. Indeed, stylized estimates suggest that in the reformed system, pensioners will be better-off with disability instead old-age pensions (Chart). While the relative advantage of disability has diminished following last year's increase in the statutory retirement age to 67 years (since replacement rates under the DC will rise), it has not disappeared. The incentives to prefer disability will be particularly strong for those with low earnings and those who were dropped off the social security system during work career. The latter may be the case of the youth working on short-term contracts. Growing incentives to choose disability poses a risk of a renewed inflow of "disabled" into the system, possibly undermining achievements in this area.

4. **The authorities are aware of this problem, but a solution remains elusive**. The authorities proposed a solution in 2008, mandating that disability benefits be based either on the DC formula, similar to old-age pensions, or equal the legally binding minimum pension if it was higher than calculated DC benefit. The proposal was, however, vetoed by the President and no alternative has been put forth. To ensure consistency in the pension system and to avoid adverse incentives, aligning disability benefits with DC system will be essential.

Replacement Rates

(Benefit as a percent of the final wage)



A, B, C - retired at 65 after 40 years of work
D - retired at 60 after 35 years in the system,
o/w 10 years of non-contributing period
E - retired at 60 after 30 years in the system,
o/w 5 years of non-contributing period

A, B, C - retired at 67 after 42 years of work
D - retired at 67 after 42 years in the system,
o/w 10 years of non-contributing period
E - retired at 67 after 30 years in the system,
o/w 5 years of non-contributing period

Source: IMF staff calculations.

INTERNATIONAL MONETARY FUND

REPUBLIC OF POLAND

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 2, 2013

Prepared By | European Department

CONTENTS

FUND RELATIONS

(As of May 31, 2013)

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

General Resources Account

	SDR Million	Percent Quota
Quota	1,688.40	100.00
Fund Holdings of Currency	1,168.45	69.20
Reserve Tranche Position	519.97	30.80
Lending to the Fund		
New Arrangement to Borrow	314.80	

SDR Department

	SDR Million	Percent Allocation
Net Cumulative Allocation	1,304.64	100.00
Holdings	1,050.50	80.52

Outstanding Purchases and Loans: None

Latest Financial Arrangements

In Millions of SDR

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

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

	Forthcoming				
	2013	2014	2015	2016	2017
Principal					
Charges/Interest	0.08	0.16	0.16	0.16	0.16
Total	0.08	0.16	0.16	0.16	0.16

Exchange Arrangements:

The zloty has floated freely since April 12, 2000.

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

Article IV Consultation:

The last Article IV consultation was concluded on July 2, 2012. In concluding the consultation, Directors noted the good performance of the Polish economy in 2011 despite the challenging environment, and commended the authorities for their sound macroeconomic management. At the same time, they observed that Poland's strong economic links to the rest of Europe and large external financing needs could give rise to adverse spillovers. Directors broadly supported the on-going fiscal adjustment, which they deemed necessary to rebuild fiscal buffers. They noted that, over the medium term, additional permanent fiscal measures would be needed to achieve the authorities' medium-term objective, avoiding excessive cuts in public investment. They welcomed the ongoing work on a permanent fiscal rule and the recent pension reform, which they viewed as important steps to strengthen public finances. Given the absence of inflationary pressures, Directors agreed that monetary policy should remain on hold. They noted the resilience of Poland's banking system, but underscored that vulnerabilities remain owing to households' foreign currency exposure and nonperforming loans (NPLs). They welcomed recent supervisory measures to contain foreign currency lending and encouraged a more proactive approach to addressing NPLs. Directors commended the recent and proposed improvements to the oversight of the financial sector, including plans to establish a macro-prudential framework, and underscored the need to develop a bank resolution regime. They also encouraged the authorities to continue structural reforms in order to boost the growth potential.

Resident Representative:

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

POLAND: Technical Assistance from the Fund, 1992–2013

Department	Subject/Identified Need	Action	Date	Counterpart
MAE-Coordinated	Periodic visits by experts from central banks cooperating in providing technical assistance to the NBP under the coordination of MAE	Experts' visits	1992–94	NBP
MAE	Payments system, banking supervision, monetary research and analysis	Mission	May 1992	NBP
MAE	Review of progress in the modernization of operational functions	Mission	October 1992	NBP
MAE	Resident expert-Advisor to President of NBP		November 1991–92	NBP
MAE	Additional steps in the modernization process of the NBP	Mission	April 1993	NBP
MAE	Monetary programming and operations, and payments system	Mission	November 1993	NBP
MAE	Central bank modernization	Mission	August 1994	NBP
MAE/LEG	Review of the exchange and payments system	Mission	February 1995	NBP/MoF
MAE	Exchange rate system	Mission	March 1995	NBP
MAE	Review of government securities market, payments system and public debt management	Mission	August 1995	NBP/MoF

POLAND: Technical Assistance from the Fund, 1992–2013 (cont'd)

Department	Subject/Identified Need	Action	Date	Counterpart
MAE	Asset consolidation exercise Visits	Expert	Late 1995	NBP
FAD	Tax administration (VAT) short-term assignments of field experts	Nine	August 1992–October 1994	MoF
FAD	Tax administration	Mission	November 1992	MoF
STA	Framework for monetary statistics	Mission	February 1993	NBP
STA	Framework for monetary statistics (follow-up)	Mission	November 1993	NBP
STA	Government finance Statistics	Mission	August 1995	NBP/ MoF
STA	Money and banking statistics	Mission	January 1996	NBP
STA	Government finance statistics	Mission	July 1996	NBP/ MoF
STA	Balance of payments statistics	Mission	November 1996	NBP/ MoF
STA	Balance of payments statistics Mission	Follow-up	April 1997	NBP/ MoF
STA	Review of progress in implementing the SDDS	Visit	February 1998	
FAD	Public expenditure management	Mission	April 1998	MoF
MAE	Operational aspects of monetary and exchange rate policy	Mission	September 1998	NBP
FAD	Tax administration	Mission	October 1998	MoF

POLAND: Technical Assistance from the Fund, 1992–2013 (cont'd)

Department	Subject/Identified Need	Action	Date	Counterpart
FAD	Examination of impact on revenues of proposed tax reform	Mission	November 1998	MoF
FAD	Discussion of tax administration	Mission	March 1999	MoF
FAD	Tax administration seminar	Mission	April 1999	MoF
STA	Government Finance Statistics	Mission	October 1999	MoF/Local
FAD	Tax administration—Introduction of expert	Mission	November 1999	MoF
FAD	Administering Social Security	Mission	March 2000	MoF
IMF/IBRD	FSAP	Mission	May/Sept 2000	MoF NBP
MAE	Monetary Operations	Mission	July 2001	NBP
FAD	Expenditure restructuring	Mission	December 2001	MoF
MAE	Stress testing	Mission	January 2002	NBP
STA	Data ROSC	Mission	January 2003	CSO/ MoF/ NBP
STA	Government finance Statistics (GFSM 2001)	Mission	October 2003	MoF
STA	Government finance Statistics (GFSM 2001)	Mission	January 2005	MoF
IMF/IBRD	FSAP Update	Mission	April/May 2006	MoF NBP
FAD	Developing a Multi-annual Fiscal Framework	Mission	June 2008	MoF
STA	Errors and Omissions in Balance of Payments Accounts	Mission	July 2009	NBP

POLAND: Technical Assistance from the Fund, 1992–2013 (concluded)

Department	Subject/Identified Need	Action	Date	Counterpart
FAD	Medium-term fiscal framework	Mission	April 2010	MoF
MCM	Detailed Assessment of Observance of BCP For Effective Banking Supervision	Mission	Feb/March 2011	KNF
STA	Errors and Omissions in Balance of Payments Accounts	Mission	June 2011	NBP
FAD	Developing the Fiscal Regime for Oil and Gas	Mission	April 2012	MoF
MCM	Macroprudential Framework	Mission	May 2012	NBP
IMF/WB	FSAP Update	Mission	Feb/March 2013	MoF/ KNF/NPB

STATISTICAL ISSUES

General: Data provision is adequate for surveillance.

National Accounts: The Central Statistical Office (GUS) compiles and disseminates annual and quarterly GDP at current and constant prices following 1993 SNA and ESA 1995. Moreover, a full set of accounts, including financial accounts by institutional sectors are compiled too. There are inconsistencies between annual and higher frequency data reflecting differences in weights and in coverage. Electronic retrieval of the data is challenging. The sub-annual data are collected on a cumulative rather than on a discrete basis, and plans to introduce proper benchmarking have been delayed. Seasonal adjustment on relatively short interval leads to frequent and large backward revisions.

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

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

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

Monetary and Financial Statistics: Beginning with data for January 2004, the NBP compiles monetary accounts in accordance with the ECB's framework for monetary statistics using the national residency approach. An earlier ROSC mission recommended that the NBP, in cooperation with the MoF, reconcile monetary and government finance statistics and carry out a reconciliation exercise on a regular basis.

Balance of Payments: Largely to improve data accuracy, the NBP reduced its reliance on International Transactions Reporting System (ITRS) data and increased its reliance on survey-based source data, starting in the first quarter of 2010; however, the size of errors and omissions remained unacceptably high. In 2009 and 2010, errors and omissions were larger than the current account deficit. STA undertook an evaluation mission to Poland in July 2009 (prior to the implementation of the new compilation system) to examine possible causes of the large and growing net errors and omissions. Among those potential sources were financial account transactions (by banks and nonbanks), goods imports, and weaknesses in data capture through the ITRS.

During the 2011 IMF Spring Meetings, the NBP informed of data improvements work that the NBP and GUS had undertaken, and revisions that it anticipated incorporating in the external sector accounts at end-June 2011. A STA mission followed up on these issues during June 6-10, 2011. The mission concluded that the intended revisions to the Polish data are based on appropriate compilation techniques. The revisions would affect the estimates from 2004 forward.

Poland has conducted much research into trade in used cars (imports of used cars from Germany may have been missed); remittances (incoming private transfers may be overstated and outgoing private transfers may be understated); repurchase agreements (a limited amount of double counting of financial transactions in repos may have occurred); and overseas assets of non-financial corporations (these may be misreported or missed). Further, the NBP's new survey-based compilation system has had an overall positive impact on data quality.

The mission also advised that research may usefully be conducted into the valuation of exports and imports of goods and the coverage of derivatives transactions.

POLAND: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE—AS OF (As of June 30, 2013)

	Date of latest observation	Date received	Frequency of data[7]	Frequency of reporting[7]	Frequency of publication[7]	Memo Items:	
						Data Quality – Methodological soundness[8]	Data Quality Accuracy and reliability[9]
Exchange Rates	6/30/2013	6/30/2013	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	5/2013	6/07/2013	M	M	M		
Reserve/Base Money	5/2013	6/07/2013	M	M	M	O, LO, O, LO	O, O, O, O, O
Broad Money	5/2013	6/07/2013	M	M	M		
Central Bank Balance Sheet	5/2013	6/07/2013	M	M	M		
Consolidated Balance Sheet of the Banking System	5/2013	6/14/2013	M	M	M		
Interest Rates[2]	6/30/2013	6/30/2013	D	D	D		
Consumer Price Index	5/2013	6/13/2013	M	M	M	O, O, O, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q4/2012	5/24/2013	A	A	A	LO, O, O, O	O, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	4/2013	6/20/2013	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	4/2013	6/20/2013	M	M	M		
External Current Account Balance	Q1/2013	6/28/2013	M	M	M	O, O, O, LO	O, O, O, O, LO
Exports and Imports of Goods and Services	4/2013	6/11/2013	M	M	M		
GDP/GNP	Q1/2013	5/29/2013	Q	Q	Q	O, LO, O, O	LO, LO, O, O, LO
Gross External Debt	Q1/2013	6/28/2013	Q	Q	Q		
International Investment Position[6]	Q1/2013	6/28/2011					

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

INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No. 13/271
FOR IMMEDIATE RELEASE
July 23, 2013

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes 2013 Article IV Consultation with the Republic of Poland

On July 17, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Poland.[1]

Despite its resilience in recent years and very strong fundamentals, the Polish economy has slowed markedly. Real GDP growth moderated to 1.9 percent in 2012 from 4.5 percent in 2011. A slowdown in Poland's main export markets, combined with uncertain prospects for euro area growth and a sharp drop in public investment, weighed on demand. Household consumption was affected by adverse confidence effects, sluggish disposable income, falling real wage growth, and rising unemployment. Credit growth decelerated sharply to 3.5 percent in the first quarter of 2013 (down from 11 percent a year before), on the back of weak credit demand and tight lending policies by banks.

Reflecting the slowdown, as well as lower fuel and energy prices, CPI inflation has fallen sharply and stood at 0.5 percent (year-on-year) in May. A monetary easing cycle was started in November 2012, and the policy rate was cut by a cumulative 200 basis points to 2.75 percent in June 2013.

Fiscal consolidation has continued, albeit at a slower than envisaged pace. The fiscal deficit declined from 5 percent of GDP in 2011 to 3.9 percent in 2012. The latter was somewhat larger than expected, as the economic slowdown dented on indirect tax collections, especially the VAT. Public debt (ESA95 definition) dropped to 55.6 percent of GDP in 2012.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

The banking sector remained well-capitalized, profitable, and liquid. Reliance on foreign currency funding has declined. But the impaired loan ratio inched up to 9 percent mainly due to deterioration in the corporate loan portfolio, reflecting rising bankruptcies (notably in the construction sector). Stress tests conducted as part of the recent IMF-World Bank Financial Sector Assessment Program update confirm the sector's resilience: bank capital and liquidity buffers can withstand large shocks and contagion risks are limited.

Executive Board Assessment

Executive Directors emphasized that Poland's sound macroeconomic management, strong fundamentals, resilient financial system, and adequate international reserves have helped preserve confidence in the country's policies. The precautionary Flexible Credit Line arrangement has provided insurance against external risks. However, Directors noted that slower growth will require balancing support for the economy with the need to further build up policy buffers.

Directors observed that Poland's high trade and financial interconnectedness with Europe and open capital account make it susceptible to shocks. In this regard, Directors welcomed actions by the authorities, notably the large pre-funding of government financing needs, to mitigate these risks.

Directors commended the authorities' commitment to fiscal sustainability. For 2013, most Directors agreed that automatic stabilizers should be allowed to operate fully around budgeted measures. A few others, however, considered that further consolidation measures could be necessary. Directors broadly agreed that the medium-term objective of a structural deficit of 1 percent of GDP by 2016 remains appropriate. However, additional fiscal measures of about 1 percent of GDP would be needed to put the public debt ratio firmly on a downward path. They called for a broad expenditure review to identify areas where non-priority spending can be reduced, while protecting investment spending. They looked forward to the implementation of a simple and transparent expenditure rule which should allow for countercyclical fiscal policy.

Directors noted that the recent review of the pension system will have significant implications for the functioning of the second pillar. They emphasized that the fiscal and financial market implications should be carefully assessed.

Directors agreed that the accommodative monetary policy stance is appropriate in a context of muted inflationary pressures and narrow fiscal space. However, a number of Directors advised a cautious approach to further easing, given risks associated with a low rate environment. Directors agreed that the exchange rate should be allowed to float freely, but that interventions could be used to limit excessive volatility. They urged the National Bank of Poland to provide liquidity support if needed.

Directors welcomed the findings of the Financial System Stability Assessment that the banking system is well capitalized, profitable and liquid. They commended efforts to further strengthen banking system resilience, including the reduced reliance on foreign funding. Directors underscored that safeguarding asset quality will be essential, especially given the economic slowdown. They encouraged broadening the areas where the Financial Supervision Authority (KNF) can issue effective supervisory guidance, as well as increasing its resources, budgetary autonomy, and flexibility. They looked forward to the establishment of macroprudential and bank resolution frameworks in the near future.

Directors encouraged continued structural reforms to boost potential growth and maximize the benefits of integration into global supply chains. They recommended reducing administrative barriers, improving access to certain regulated professions, and advancing reforms to increase labor force participation and labor market efficiency. Directors noted the launch of the new investment fund and recommended that its corporate governance and operations follow best international practices.

Poland: Selected Macroeconomic and Social Indicators, 2010–13

	2010	2011	2012	2013 Proj.
National income, prices and wages				
GDP (billion zloty)	1416.6	1528.1	1595.3	1638.1
Real GDP growth (year-on-year in percent) 1/	3.9	4.5	1.9	1.1
Average CPI (year-on-year change in percent)	2.6	4.3	3.7	1.6
GDP deflator (year-on-year change in percent)	1.4	3.2	2.5	1.6
Average monthly wage (year-on-year growth in percent)	4.3	6.5	3.7	3.0
Unemployment rate (average in percent, according to LFS)	9.6	9.6	10.1	11.0
Average nominal ULC (year-on-year growth in percent)	-2.1	2.5	2.0	1.5
Saving-investment balances (in percent of GDP)				
National saving	15.9	17.2	17.2	17.1
Private	18.1	16.7	16.7	17.3
Public	-2.2	0.5	0.4	-0.2
Domestic investment	21.0	22.1	20.7	20.4
Private	15.4	16.3	16.0	16.6
Public	5.6	5.7	4.6	3.8
Foreign saving	5.1	4.9	3.5	3.3
General government (ESA95 basis; percent of GDP) 2/				
Revenue and grants	37.6	38.4	38.4	37.8
Expenditure and net lending	45.4	43.4	42.3	41.8
Fiscal balance	-7.9	-5.0	-3.9	-4.0
External sector (in percent of GDP)				
Trade balance	-2.5	-2.7	-1.4	-0.8
Service balance	0.7	1.1	1.3	1.1
Income balance	-4.1	-4.4	-4.4	-4.6
Current account	-5.1	-4.9	-3.5	-3.3
Gross international reserves (billion U.S. dollars)	93.5	97.9	108.9	121.6
In months of imports	6.3	5.6	6.7	7.2
In percent of gross short-term debt	91.0	108.4	106.2	128.0
In percent of base money	198.4	242.3	201.9	226.7
Gross external debt/GDP (in percent)	67.1	62.2	74.4	73.5
Net external debt/GDP (in percent)	51.5	47.2	57.8	56.9
General government external debt/GDP (in percent) 3/	22.8	26.2	27.9	28.5
Exchange rate (zloty/US$ - period average) 4/	3.0	3.0	3.3	3.3
Money and credit (year-on-year growth in percent)				
Domestic credit to nongovernment	8.5	13.9	2.4	3.7
Base money	1.6	-1.1	21.0	2.7
Broad money	8.8	12.5	4.5	4.5

Sources: Polish authorities; and IMF staff estimates.
1/ Real GDP is calculated at constant average prices of previous year.
2/ According to ESA95 (inc. pension reform costs). Including 2013 budget.
3/ National definition.
4/ For 2013, exchange rate as of July 1.

Statement by Mr. Dominik Radziwill, Alternate Executive Director
and Ms. Joanna Osinska, Advisor to Executive Director
July 17, 2013

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

Economic Outlook

While the Polish economy continued its upward trend in 2012, it entered a phase of cyclical GDP slowdown. Economic growth moderated last year to slightly less than 2 percent. This year, it is expected to reach 1.1percent, the lowest figure since 1991. Key factors behind the weak GDP growth in 2013 include unfavourable economic situation in the euro area, falling household consumption dynamics (driven by a difficult situation in the labor market and a gradual recovery in household savings), as well as fiscal tightening, and falling public investment financed with EU structural funds. Still, Poland remains one of the fastest growing EU economies.

Over the medium term, however, the economic outlook should improve, due to a rebound in domestic and external demand. Given strong trade, financial and confidence channels between Poland and its external environment, risks are on the downside. The unemployment rate remains high at 10.7 percent (reflecting, among other factors, an increase in participation rate). Until domestic consumption improves, net exports are expected to remain a positive contributor to growth on the account of higher dynamics of exports than imports. In the first four months of 2013 Polish exports grew by more than 7 percent, notably due to a partial reorientation toward less-traditional—i.e., non-EU—markets. In April the current account recorded an all-time high monthly surplus, while narrowing to 2.5 percent in 12-month terms of GDP.

Similarly to recent developments observed elsewhere, June witnessed an outflow of portfolio investments from the sovereign debt market. The dynamics for July, however, are more balanced, showing a positive perception of the country's risk by foreign investors. The authorities decided to abstain from holding bond sales in July and August after they managed to pre-fund almost 90 percent of the yearly borrowing needs by end-June owing to highly favorable financing conditions.

Poland continues to benefit from the precautionary Flexible Credit Line arrangement with the Fund which provides an additional reserve buffer against external shocks and helps strengthen investor confidence.

Fiscal Policy

The Polish authorities remain fully committed to reducing the remaining fiscal imbalance and ensuring long-term fiscal sustainability. Mindful of the fragile economic outlook, they carefully design the range of measures in a way that would not pose a threat to the country's medium-term growth perspectives. The 2010-12 sizeable consolidation package, combining both revenue and expenditure measures, helped to cut the nominal deficit from 7.9 percent of GDP in 2010 to 3.9 percent in 2012. In structural terms, the reduction took place at a pace even exceeding the one recommended by the EU Council (in 2012 alone, the structural balance was improved by 1.7 percentage points of GDP). As expected, in 2012 the share of general government expenditure in GDP (after excluding budget co-financing of projects financed with the EU structural funds) reached its lowest level in the last two decades. In the same year the authorities managed to put the public debt ratio on the downward path to 55.6 percent of GDP (ESA95 definition).

Nonetheless, the adverse economic circumstances had a major negative impact on the government finances and led to deterioration of its cyclical component. In effect, the decrease of the nominal deficit-to-GDP ratio reached in 2012 turned out to be too small to enable abrogation of the Excessive Deficit Procedure (EDP). However, in recognition of Poland's significant structural effort, the EU Council granted a two-year extension of the deadline for correction of the excessive deficit situation, from 2012 to 2014. The authorities are committed to further improving the structural balance in the coming years in line with the recommendation and with the aim to reach the medium-term budgetary objective (MTO) of 1 percent of GDP in 2016.

Simultaneously, our Polish authorities continued efforts to strengthen the fiscal framework. Work on the design of a stabilizing permanent fiscal rule reached the final stage. The overarching aim of the prospective rule is to reduce and—subsequently—stabilize the deficit and public debt. To this end, the rule will set an expenditure limit based on the medium-term GDP growth and be equipped with an appropriate correction mechanism. The latter will take into account business cycle developments and thereby will ensure avoiding a risk of fiscal procyclicality. Our authorities appreciate the collaborative work with staff on the analysis of alternative variants of fiscal rules.

Monetary Policy

After persistently exceeding the upper limit for deviations from the NBP's target of 2.5 percent in the recent years, in the fourth quarter of 2012 the inflation rate began to decrease rapidly. In early 2013, headline CPI reached levels below the lower limit of the permissible fluctuation band. Also, PPI continued its downward trend and fell into negative territory. Low inflation rate stems from a negative output gap and weak demand pressure related to the weak labor market.

In response, the Monetary Policy Council (MPC) commenced a monetary policy easing cycle. Cumulative interest rate cuts of 225 bps—including the July MPC's decision which is supposed to end the cycle—resulted in an all-time low reference rate of 2.50 percent. This significant reduction of rates, implemented since November 2012, should support economic recovery and limit the risk of inflation running below the NBP target in the medium term. Moreover, the level of official reserves remains largely adequate, covering about 5.6 months of imports.

Financial Sector

The ongoing slowdown in GDP growth and the sovereign debt crisis in the euro area did not adversely affect resilience of the Polish financial sector. Polish banks maintain low leverage ratios, remain liquid, well-capitalized and highly profitable.

Despite weaker macroeconomic conditions and falling interest rates, the net profits of Polish banks have been stable since they reached record high levels in 2011. In line with recommendations issued by the Financial Supervisory Authority (KNF), banks increased their capital buffers with the capital adequacy ratio reaching 15.4 percent at the end of the first quarter of 2013 and Tier 1 capital representing around 90 percent of total capital. At the same time, the liability structure of Polish banks improved as the parent-based funding was, to some extent, substituted with deposits from non-financial residents. In spite of the impact of the financial crisis on some of the foreign parent institutions, there was no evidence of disorderly deleveraging in the Polish banking sector.

After a strong credit growth over the last two years, the expansion slowed this year. Although the overall credit to non-financial sector grew by 2.2 percent y/y (after exchange rate adjustment) as of the first quarter of 2013, further tightening of banks' lending policies is expected—particularly for SMEs. With a view to mitigating credit constraints they face, a new government-sponsored initiative was launched. The "De Minimis" program is aimed at providing government guarantees for loans for SMEs, enabling them to raise funding for their working capital needs and taking some of the risk burden away from the commercial banks.

Simultaneously, the authorities take further measures to strengthen the financial sector and improve supervision, including new macroprudential and bank resolution frameworks. Regulatory and supervisory actions to reduce the share of FX loans in new mortgage lending proved successful. Although the overall NPLs level slightly increased on the account of economic slowdown and rise in unemployment—with most pronounced deterioration in the corporate loan portfolio, it remains well provisioned.

Structural Reforms

Mindful of the importance of structural reforms for long-term growth, the authorities are further advancing the structural reforms agenda. They maintain efforts to implement labor and product market reforms, with focus on further increasing the labor participation rate and reducing youth unemployment. Important steps were taken to ease access to regulated professions, with the first deregulation act (easing access to 51 professions) expected to soon enter into force, the second deregulation (91 professions) recently approved by the Council of Ministers and the third tranche (104 professions) currently under consultations. In addition, the authorities remain committed to further improving the business environment and moving forward with privatization of state-owned enterprises.

To provide a stimulus for greater activation of private capital in the Polish economy, the authorities have launched the "Polish Investments" Program. It aims to support long term and commercially-viable infrastructure projects. Importantly, the program's design ensures that public debt will not be increased.