INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/37

# REPUBLIC OF POLAND

February 2019

## 2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE ALTERNATE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF POLAND

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2018 Article IV consultation with the Republic of Poland, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 18, 2019 consideration of the staff report that concluded the Article IV consultation with the Republic of Poland
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 18, 2019, following discussions that ended on October 30, 2018, with the officials of the Republic of Poland on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 3, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Alternate Executive Director** for the Republic of Poland

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

Selected Issues
Financial Stability System Assessment

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

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

Press Release No. 19/30
FOR IMMEDIATE RELEASE
February 6, 2019

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**IMF Executive Board Concludes 2018 Article IV Consultation with the Republic of Poland**

On January 18, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of Poland.

The Polish economy experienced a strong upswing in growth during the past two years. Three coincident cycles—a rebound in euro-area activity, a substantial increase in EU transfers, and new large social benefit programs—boosted GDP growth from 3.1 percent in 2016 to more than 5 percent during 2018. The resulting gains in employment were achieved by reducing unemployment to a record low and attracting inflows of foreign workers. Recent data suggest that the economic cycle has now begun to moderate alongside slowing external demand. For 2019, growth is projected to be a still-strong 3½ percent, underpinned by buoyant private consumption and continued absorption of EU funds. Over the medium term, the economy is projected to expand by around 2¾ percent per year, reflecting the dampening effects of a shrinking working-age population, subdued private investment and tepid productivity gains. While headline inflation has been persistently below the mid-point of the target, core inflation is expected to edge up gradually from the current very-low level. The current account balance has shifted from a surplus in 2017 to a small deficit in 2018, and is expected to widen gradually over the medium term, while remaining broadly in line with medium-term fundamentals.

In recent years, macroeconomic policies have facilitated a further narrowing of fiscal and external imbalances, while also supporting growth. The policy interest rate has been on hold at a historically-low level for more than three years amid persistently low inflation. Substantial fiscal adjustment has been achieved through strengthened revenue administration and automatic savings from low rates of expenditure indexation, with part of these savings used to fund new social spending programs. Credit continues to grow at a moderate pace, although unsecured consumer lending is expanding strongly. Profitability of Polish banks compares favorably with systems in other European countries, despite a tax on financial institutions' assets. New legislation to amend the governance structure of the financial supervisor gives representatives of ministries and the President a primary position on the Board, while potentially improving budgetary independence.

[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.

Looking ahead, the Polish economy faces important challenges in the near term and beyond. On the external side, an escalation of global trade tensions or a disruptive Brexit could impact Poland's trade and financial flows and dent growth. Renewed turbulence in global financial markets could abruptly tighten financial conditions in Poland and lead to exchange rate depreciation that feeds into inflation. Poland could also face severe labor shortages if foreign workers were to leave in response to new opportunities elsewhere in the region. On the domestic front, a larger footprint of the state in the economy could slow productivity growth, while investors' risk appetite could be lowered in the event of slippage from prudent policies and sound governance principles, or if relations with the European Union were to deteriorate.

**Executive Board Assessment[2]**

Executive Directors commended the Polish authorities for the economy's strong and sustained expansion, low imbalances, improved social outcomes, and the smooth graduation from the FCL. They noted that solid macroeconomic fundamentals have helped to insulate the economy from volatile global financial markets. Going forward, Directors expected growth to moderate gradually in 2019, but noted that ongoing global trade tensions and reduced availability of foreign workers could cloud the outlook. Directors underscored the need for prudent, market-based policies and sustained reforms to raise productivity and ensure continued robust growth.

Amid continued low inflation, Directors supported the current accommodative monetary policy stance. While inflation is expected to rise gradually toward the mid-point of the target, the outlook is uncertain. Directors recommended that monetary policy remain data-dependent and respond to persistent inflation developments.

Directors welcomed the impressive fiscal adjustment of recent years, supported by improved tax compliance. However, they noted that some of the measures taken have reduced the quality of the budget. Directors accordingly recommended implementing sustainable and growth-friendly measures to support further efforts to create room for aging- and health-related spending and replacing part of EU funds with national resources. Measures could include enhancing tax administration and better targeting social benefits. Directors supported the authorities' plan to increase the effectiveness and efficiency of spending and develop a medium-term budget framework.

Directors welcomed the finding of the Financial System Stability Assessment that the aggregate banking sector is resilient to adverse shocks, but noted that weaknesses are present in a few small and mid-sized banks. Directors called for close monitoring of unsecured consumer credit, which has grown rapidly, and many suggested that the financial institutions asset tax be reexamined to make it less distortive. Given the sharp decline in foreign currency-denominated mortgages, Directors did not consider them a systemic risk and recommended that any restructurings proceed through voluntary bilateral agreements. Directors underscored the importance of

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

ensuring sufficient resources and operational independence for the Financial Supervision Authority.

Directors emphasized the need for further structural reforms to maintain income convergence amid the declining working-age population. They stressed that expanding the workforce and boosting labor productivity is key. In this regard, they encouraged facilitating more reliable access to skilled labor, removing investment barriers, providing education and training to workers, and ensuring policy predictability. Directors noted that the significant state presence in the financial and nonfinancial sectors underscores the need for a level playing field. They recommended protecting the rights of minority shareholders, maintaining a competitive environment, limiting the state footprint in the economy and increasing the role of the private sector, and ensuring that price signals reflect economic costs.

## Republic of Poland: Selected Economic Indicators, 2013–22

| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | Projections | | | | | |
| **Activity and prices** | | | | | | | | | |
| GDP (change in percent) | 3.8 | 3.1 | 4.8 | 5.1 | 3.6 | 3.0 | 2.8 | 2.8 | 2.8 |
| Domestic demand | 3.3 | 2.3 | 4.9 | 5.9 | 4.4 | 3.5 | 2.7 | 2.7 | 2.7 |
| Private consumption growth | 3.0 | 3.9 | 4.9 | 4.3 | 4.0 | 3.5 | 3.0 | 3.0 | 3.0 |
| Public consumption growth | 2.3 | 1.9 | 3.5 | 3.0 | 2.7 | 2.7 | 2.6 | 2.4 | 2.2 |
| Domestic fixed investment growth | 6.1 | -8.2 | 3.9 | 8.7 | 8.6 | 4.8 | 2.5 | 2.5 | 2.5 |
| Inventories (contribution to growth) | -0.2 | 1.2 | 0.5 | 1.1 | -0.2 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net external demand (contribution to growth) | 0.6 | 0.8 | 0.1 | -0.7 | -0.6 | -0.5 | 0.1 | 0.1 | 0.1 |
| Output gap | -0.5 | -0.5 | 0.2 | 0.5 | 0.5 | 0.3 | 0.1 | 0.0 | 0.0 |
| CPI inflation (percent) | | | | | | | | | |
| Average | -0.9 | -0.6 | 2.0 | 1.7 | 2.3 | 2.6 | 2.5 | 2.5 | 2.5 |
| End of period | -0.5 | 0.8 | 2.1 | 1.2 | 2.6 | 2.6 | 2.5 | 2.5 | 2.5 |
| Unemployment rate (average, according to LFS) | 7.5 | 6.2 | 4.9 | 3.7 | 3.5 | 3.4 | 3.4 | 3.4 | 3.4 |
| **Saving and Investment** (percent of GDP) | | | | | | | | | |
| Saving | 20.5 | 19.3 | 20.1 | 20.7 | 21.0 | 21.0 | 20.7 | 20.5 | 20.2 |
| Investment | 20.5 | 19.5 | 19.7 | 21.1 | 21.6 | 21.8 | 21.7 | 21.7 | 21.6 |
| Saving-Investment | 0.1 | -0.3 | 0.5 | -0.4 | -0.6 | -0.8 | -1.0 | -1.2 | -1.4 |
| **Public finances** (percent of GDP) 1/ | | | | | | | | | |
| General government revenues | 39.0 | 38.9 | 39.7 | 40.9 | 41.1 | 40.4 | 40.0 | 39.7 | 39.5 |
| General government expenditures | 41.7 | 41.1 | 41.1 | 41.4 | 41.9 | 41.7 | 41.6 | 41.6 | 41.6 |
| General government net lending/borrowing | -2.7 | -2.2 | -1.4 | -0.6 | -0.8 | -1.3 | -1.7 | -1.9 | -2.1 |
| General government structural balance | -2.4 | -2.3 | -2.0 | -1.6 | -1.7 | -1.7 | -1.8 | -1.8 | -1.9 |
| General government debt | 51.3 | 54.2 | 50.6 | 48.6 | 46.1 | 44.7 | 44.1 | 43.7 | 43.6 |
| National definition 2/ | 48.7 | 51.9 | 48.4 | ... | ... | ... | ... | ... | ... |
| **Money and credit** | | | | | | | | | |
| Private credit (change in percent, end-period) 3/ | 7.5 | 4.9 | 3.4 | 6.2 | 7.4 | 7.4 | 6.4 | 5.9 | 5.5 |
| Credit to GDP (percent) | 56.9 | 57.8 | 56.0 | 55.5 | 55.8 | 56.6 | 57.3 | 57.7 | 57.9 |
| Deposits (change in percent, end-period) | 8.8 | 8.4 | 3.8 | 7.2 | 6.8 | 6.2 | 5.5 | 5.5 | 5.5 |
| Broad money (change in percent, end-period) | 9.1 | 9.6 | 4.6 | 7.1 | 6.7 | 6.2 | 5.4 | 5.4 | 5.3 |
| Policy Rate (percent) 4/ | 1.6 | 1.5 | 1.5 | 1.5 | ... | ... | ... | ... | ... |
| **Balance of payments** | | | | | | | | | |
| Current account balance (billion U.S. dollars) | -2.7 | -2.5 | 0.6 | -4.4 | -5.4 | -7.1 | -8.8 | -10.3 | -12.1 |
| Percent of GDP | -0.6 | -0.5 | 0.1 | -0.8 | -0.9 | -1.1 | -1.3 | -1.4 | -1.5 |
| Exports of Goods (billion U.S. dollars) | 191.0 | 196.3 | 228.0 | 254.2 | 273.7 | 292.4 | 308.7 | 323.8 | 338.1 |
| Export volume growth | 7.7 | 8.8 | 9.5 | 6.0 | 5.7 | 5.2 | 5.2 | 4.9 | 4.5 |
| Imports of Goods (billion U.S. dollars) | 188.6 | 193.1 | 226.5 | 259.6 | 281.3 | 302.5 | 320.6 | 336.6 | 351.3 |
| Import volume growth | 6.6 | 7.6 | 10.0 | 8.0 | 7.4 | 6.5 | 5.2 | 4.8 | 4.3 |
| Terms of trade (index 1995=100) | 105.2 | 106.3 | 107.0 | 106.0 | 107.0 | 107.6 | 107.3 | 107.0 | 106.9 |
| Official reserves (billion U.S. dollars) | 94.9 | 114.4 | 113.3 | 113.7 | 114.0 | 114.6 | 115.3 | 115.9 | 116.5 |
| In percent of short-term debt plus CA deficit | 85.5 | 88.5 | 97.6 | 101.6 | 98.0 | 98.2 | 98.4 | 98.1 | 100.8 |
| In percent of IMF ARA metric | 111.2 | 126.5 | 112.7 | | | | | | |
| Total external debt (billion U.S. dollars) | 330.0 | 335.9 | 378.6 | 378.0 | 383.0 | 389.9 | 398.8 | 409.5 | 424.6 |
| In percent of GDP | 69.4 | 71.7 | 72.1 | 68.2 | 64.6 | 60.5 | 57.5 | 54.8 | 52.7 |
| **Exchange rate** | | | | | | | | | |
| Exchange rate regime | | | | | Freely floating | | | | |
| Zloty per USD, period average | 3.8 | 3.9 | 3.8 | ... | ... | ... | ... | ... | ... |
| Zloty per Euro, period average | 4.2 | 4.4 | 4.3 | ... | ... | ... | ... | ... | ... |
| Real effective exchange rate (INS, CPI based) 5/ | 105.5 | 100.9 | 104.3 | ... | ... | ... | ... | ... | ... |
| Appreciation (percent change) | -3.4 | -4.4 | 3.4 | ... | ... | ... | ... | ... | ... |
| *Memorandum item:* | | | | | | | | | |
| Nominal GDP (billion zloty) | 1800.2 | 1861.1 | 1988.7 | 2125.4 | 2270.8 | 2404.7 | 2528.4 | 2658.6 | 2795.9 |

Sources: Polish authorities and IMF staff calculations.

1/ According to ESA2010.
2/ The difference from general government debt reflects different sectoral classification of certain units.
3/ Credit defined as in IFS: "Claims on other sectors."
4/ NBP Reference Rate (avg).
5/ Annual average (2000=100).

INTERNATIONAL MONETARY FUND

# REPUBLIC OF POLAND

## STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

January 3, 2019

## KEY ISSUES

**Context.** The strong growth upswing since 2017 was supported by three coincident cycles—a rebound in euro-area activity, a substantial increase in EU transfers, and new large social benefit programs. Unemployment was reduced to a record low and Poland has attracted large inflows of foreign workers. Slowing external demand, however, is projected to moderate real GDP growth in 2019, while medium-term prospects are more subdued against a shrinking working-age population, modest private investment and tepid productivity gains. Increased state control of the financial sector raises challenges for sound supervision, and a larger state footprint in the economy could slow productivity growth. Risks to the outlook for the Polish economy from external developments are elevated, while any slippage from prudent policies and sound governance principles could dent investors' risk appetite.

**Monetary policy.** The current accommodative stance is appropriate amid inflation persistently below the mid-point of the target. However, policy should be data dependent, responding to sustained inflation developments to guide inflation to the mid-point of the target.

**Fiscal policy.** Substantial adjustment in recent years has brought the medium-term objective within reach. Remaining adjustment should rely on sustainable, growth-friendly measures. Narrowing the VAT policy gap, better-targeting social benefits, raising the pension age, and further strengthening revenue administration would generate sufficient savings.

**Financial sector policy.** Independent and well-resourced financial supervision is essential for effective and evenhanded oversight, particularly in a state-dominated financial system. While the banking sector is sound overall, rising risks in unsecured consumer credit warrant close monitoring. The financial institutions asset tax should be redesigned to avoid distorting credit allocation. Any conversion of legacy foreign-currency mortgages should be based on bilateral agreements between the debtor and the creditor, rather than relying on a centralized approach.

**Structural reforms.** Sustaining rapid income convergence as working-age population declines calls for durable increases in investment and productivity. Reforms should focus on removing existing barriers to investment, facilitating more-reliable access to skilled labor, enhancing predictability of policy changes, and providing a level playing field for all investors by protecting the rights of minority shareholders and ensuring competition.

Approved By
**Thanos Arvanitis and Mahmood Pradhan (EUR), and Martin Sommer (SPR)**

Mmes. van Elkan (head), Bi (both EUR) and Korniyenko (SPR) visited Warsaw during October 18–30, 2018. Messrs. Ilahi (Senior Regional Resident Representative), Sierhej and Krogulski (both Resident Representative Office) participated in the discussions. Mr. Trabinski (Alternative Executive Director) also joined the mission. Mr. Moore (MCM) and Mr. Diez (RES) joined for part of the mission. The mission met with senior officials from the government, central bank and financial supervision agency, as well as representatives from trade unions and the business and financial community. Ms. Xu (EUR) supported the mission from headquarters, and Mmes. Jung and Nguyen (both EUR) provided administrative and analytical support.

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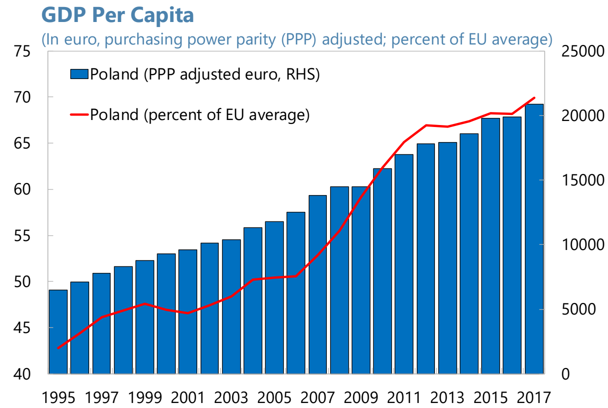
## TABLES



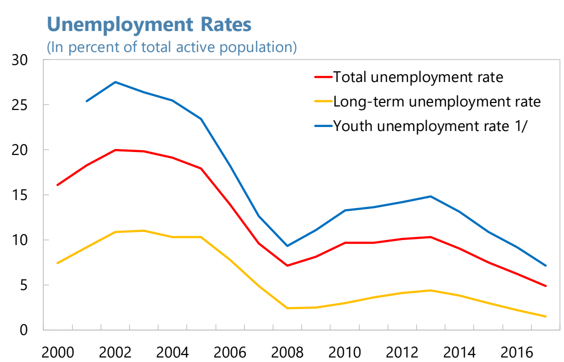
## ANNEXES

# CONTEXT

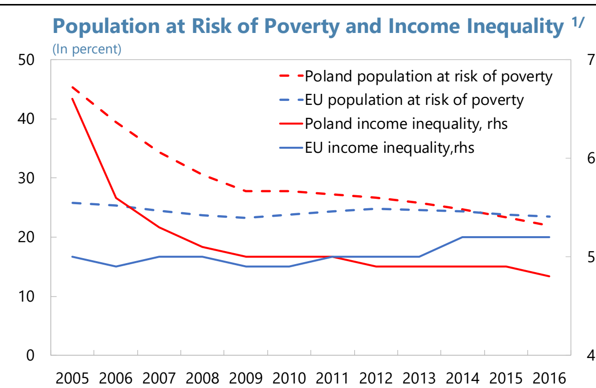
1. **Poland has continued to enjoy strong and inclusive growth.** The economy has experienced one of the longest stretches of continuous expansion in the world, which has been ongoing for 25 years. Moreover, Poland was the only European Union (EU) member to avoid a recession during the Global Financial Crisis (GFC), and its subsequent growth rebound has been among the most rapid. These trends helped to sharply reduce unemployment to a low level and boost PPP-based per capita income to 70 percent of the EU average. Strong growth coupled with redistribution policies helped improve social welfare, with Poland comparing favorably to EU peers in terms of the incidence of poverty and income inequality. These impressive economic and social achievements are the dividends of earlier institutional and governance reforms and sustained prudent management of the macro-economy, and which have made Poland an attractive destination for foreign investment.



Source: Eurostat.



Source: Eurostat.
1/ The share of young population (15-34) neither in employment nor in education and training relative to total population of the same age group.

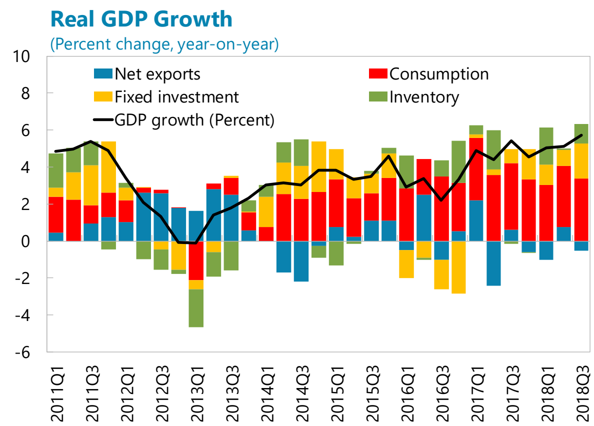


Source: Eurostat.
1/ Income of the top 20th percentile relative to the bottom 20th percentile.

2. **Nonetheless, further reform efforts are needed to ensure continued robust growth.** Poland is at an advanced stage of demographic transition, with the working-age population already shrinking and forecast to decline at an annual rate of over 1 percent through the middle of the century—among the fastest in the world. In addition, the possible opening of labor markets in neighboring countries to non-EU workers could make Poland less attractive as a destination for foreign workers. As a result, the current labor-intensive growth model will become increasingly difficult to sustain and should be replaced with one focused on boosting productivity and moving further up the value chain. Moreover, adhering to prudent principles of economic governance and avoiding sustained reliance on policy stimulus are essential to keep macroeconomic imbalances in check and to maintain resilience in the face of adverse shocks.

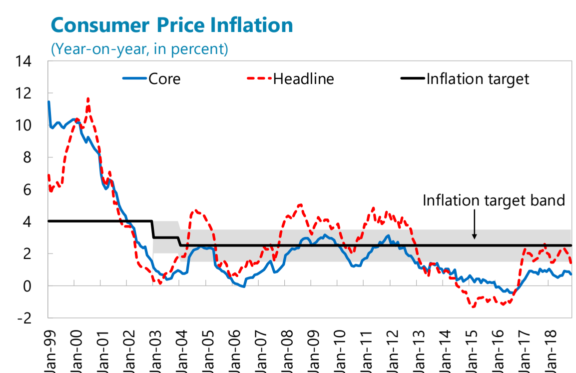
# RECENT DEVELOPMENTS

3. **Following several years of very strong growth, Poland's economic cycle likely peaked in late 2018.** Since 2017, growth has benefitted from three coincident cycles—a rebound in euro-area activity, a substantial increase in EU transfers, and new large social benefit programs. As a result, GDP growth accelerated from 3.1 percent (year-on-year) in 2016 to more than 5 percent during the first three quarters of 2018. Private consumption has been buoyed by strong growth in earned incomes, generous new child benefits, expanding consumer credit and a surge in foreign workers that also raised the number of consumers. Investment by local governments and state-owned enterprises (SOEs) has been boosted by EU capital transfers of about 2 percentage points of GDP during 2017–18.[1] Private investment has remained lackluster. The contribution from the external sector has turned marginally negative as rising imports on account of robust domestic demand has outpaced the increase in exports. Recent high-frequency indicators suggest that growth may have moderated in late-2018 amid a drop in external demand—especially in the automotive sector.



Sources: Poland Statistical Office; and IMF staff calculations.

4. **After rising from very-low levels, inflation has stabilized below the mid-point of the target during the past year, despite rapid GDP growth and a tight labor market**. Headline inflation has hovered between 1.3–2.5 percent (year-on-year) since early 2017, but was generally below the mid-point of the target (2.5 percent). It dropped further to 1.3 percent in November 2018. Core inflation has remained low at just-under 1 percent, and fell to 0.7 percent in November 2018. The recovery from overall deflation in recent years has been accompanied by a growing share of the core consumer price basket (by weight) with inflation exceeding the lower bound of the target (1.5 percent). Nonetheless, about half of the core consumer price basket remains firmly in very-low inflation or even deflation territory, and

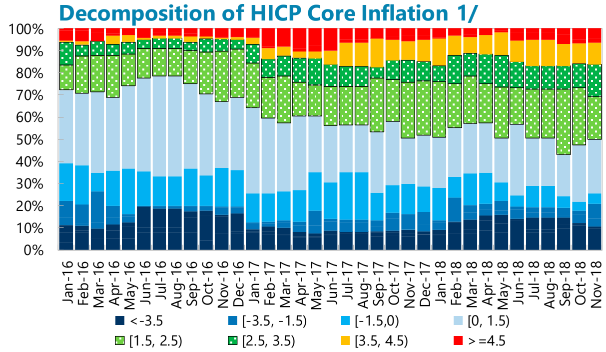


Sources: National Bank of Poland; Poland Central Statistical Office; and Haver Analytics.

[1] Poland is the largest net recipient of EU funds in nominal terms (€86 billion) during the current 2014–20 Multiannual Financial Framework, and at 18 percent of 2018 GDP, among the largest recipients relative to the size of its economy. As with previous EU budget cycles, inflows and their absorption tend to be bunched toward the latter part of the budget period.

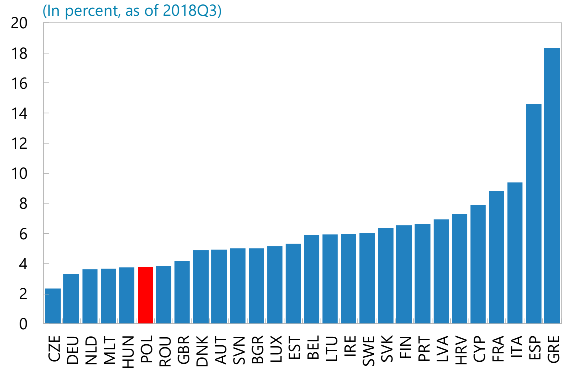
the share in deep deflation has risen in 2018, thereby dampening the pickup in overall inflation. Inflation persistently below the mid-point of the target reflects a combination of: (i) participation in regional supply chains, which restrains domestic costs and prices in the tradable sectors; (ii) large price declines across several categories, most notably for financial services in February 2018;[2] (iii) some dampening of wage growth from the influx of foreign workers, the estimated stock of which has risen from 1 percent of employment in 2014 to around 5 percent in 2017 (Box 1);[3] and (iv) strong price competition from “big-box” retailers and e-commerce sites. Nonetheless, capacity utilization rates are high, and unemployment is 3.8 percent, near its record low, suggesting the economy is operating just-above potential, with the output gap estimated at around 0.5 percent in 2018.[4]

**Decomposition of HICP Core Inflation 1/**



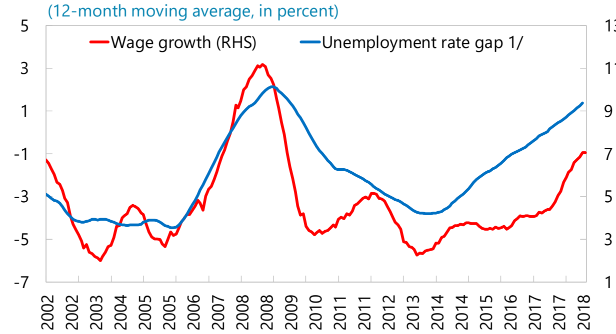

Sources: Eurostat; and IMF staff calculations.
1/ Based on HICP 4-digit decomposition, where core is defined as the overall HICP excluding energy, food, alcohol and tobacco. Framed cells represent the share of the consumers' core basket with inflation within the NBP's inflation tolerance band (2.5 +/- 1%), although the latter is based on national definition that differs slightly from the HICP.

**Unemployment Rate in EU**
(In percent, as of 2018Q3)



Sources: Eurostat and Haver Analytics.

**Unemployment Rate and Wage Growth**
(12-month moving average, in percent)




Sources: Statistical Office of Poland; and IMF staff calculations.
1/ Defined as the difference between the non-accelerating inflation rate of unemployment (NAIRU) and the actual unemployment rate. An increase indicates a tighter labor market.

5. **The external current account deficit has narrowed considerably in recent years.** The current account balance has risen by 6½ percentage points of GDP since the pre-GFC low in 2007–08, reaching a modest surplus in 2017, underpinned by rising corporate net saving—amid low

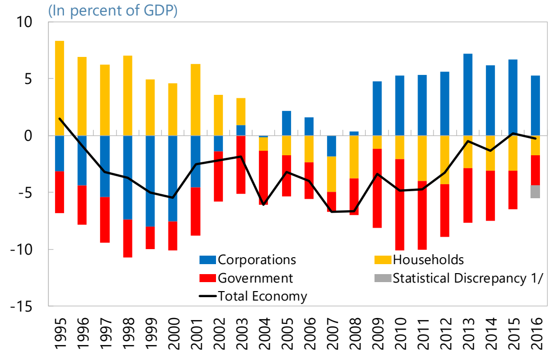
[2] In early 2018, prices of the category “banking and postal charges” dropped by around 15 percent, reducing CPI inflation by around ½ percentage point.

[3] In addition to the dampening effect of foreign workers on wages of Polish workers (see the accompanying selected issues), foreign workers may also earn less than the average wage. In a recent survey of foreign workers from Ukraine, more than 40 percent reported earning around the minimum wage (which is less than half the Polish average wage), with an additional third earning slightly more. Anecdotal evidence suggests that monthly wages for foreign workers in the formal sector are similar to those for Polish workers, but they tend to work additional hours.

[4] Given the very large wage gap between Poland and Ukraine (the main source of foreign workers) and the large Ukrainian labor force, the supply of foreign workers can be considered to be highly elastic. As a result, actual and potential output tend to co-move relatively closely, thereby limiting the size of the output gap.

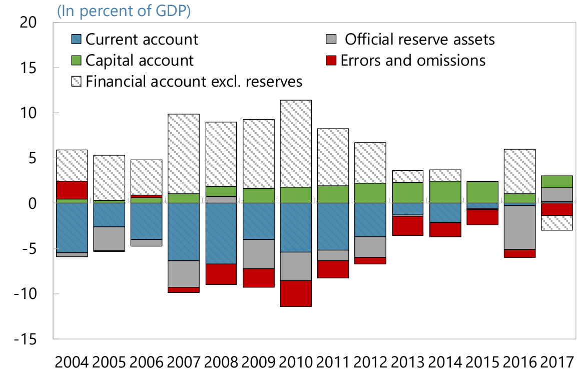
investment—while the government and household sectors have remained net dissavers. In 2018, the current account is estimated to have returned to a deficit (around ¾ percent of GDP). Poland's negative net international investment position—largely reflecting FDI (including intercompany loans)—moderated to an estimated 58 percent of GDP in Q3:2018. With the exchange rate serving as a shock absorber, the real effective exchange rate has tended to fluctuate, but its level is broadly unchanged from the mid-2000s. Poland's external sector position in 2018 is assessed to have been broadly in line with medium-term fundamentals and desirable policies (Annex VIII). At about 100 percent of the Fund's reserve adequacy metric, the level of reserves is broadly adequate to guard against external shocks and disorderly market conditions.[5]

**Sectoral S-I**
(In percent of GDP)




Source: Eurostat.
1/ Reflects historical data revisions in 2016.

**Summary Balance of Payments**
(In percent of GDP)




Source: National Bank of Poland.

**6. Credit growth remains moderate and the banking sector is sound.** Indebtedness of corporates and households is relatively low from a cross-country perspective. Credit continues to grow more slowly than nominal GDP, but its composition is skewed toward unsecured consumer credit, with an NPL ratio of 10.9 percent (against a system-average of 7.3 percent). Zloty-denominated mortgage growth has slowed on the step-wise decrease in the loan-to-value ceiling during 2014–17, but growth remains around 11 percent.[6] Current strong housing demand is financed to a greater extent than before the GFC with buyers' own resources. Rising construction costs have slowed the supply of new housing, and nominal house prices in some regions have risen to pre-GFC levels. Nonetheless, affordability remains comfortable owing to strong growth of household incomes. While bank lending to the corporate sector is subdued, leasing activity—often provided by bank affiliates—is large and expanding rapidly, and is heavily utilized by SMEs, which dominate the corporate sector. Banks are well-capitalized, liquid, mostly deposit-funded and the NPL ratio continues to edge down.[7] Profitability has recovered somewhat from a dip in early 2016 following the introduction of the financial institutions asset tax (FIAT). Profitability of Polish banks

[5] Based on net reserves, which excludes repurchase operations, which are conducted by the NBP for asset management purposes. Gross reserves are about 113 percent of the reserve adequacy metric.

[6] This may partly reflect the replacement of FX mortgages, which are being steadily amortized by around 8 percent annually. Issuing FX mortgages to unhedged borrowers has been prohibited since 2013.

[7] The NPL ratio rose by about 1 percentage point at the beginning of 2018 due to a change in NPL accounting rules with the introduction of IFRS9, but with no underlying deterioration in asset quality. The downward trend of NPLs resumed thereafter.

compares favorably with systems in other European countries. Following the sale of part of a large foreign bank to state-controlled entities in 2017, about half of banking assets are domestically controlled—predominantly by the state (Annex III).

**7. Solid economic fundamentals shielded Poland from the financial turbulence that beset several major emerging markets (EMs) during the first half of 2018.** Adherence to EU policy frameworks as well as reductions in fiscal and external vulnerabilities—including in the context of the IMF's Flexible Credit Line (terminated in late 2017)—kept Poland less-affected relative to other EMs during the recent sell-off than during the 2013 taper tantrum (Annex IV). However, foreign holdings of zloty-denominated government bonds have gradually declined as the interest rate differential with US dollar-denominated assets has narrowed. Moreover, there is little evidence that investors have been perturbed by Poland's ongoing disputes with the EU (including on the rule of law) or with the government's platform of "re-Polonization" and increased state ownership of key sectors. While spreads on sovereign bonds have widened relative to lows in 2015, they have been stable in recent years and new FDI continues to flow in. Reflecting solid macroeconomic fundamentals, credit rating agencies have maintained or raised their strong ratings for Poland.

# REPORT ON THE DISCUSSIONS

## A. Outlook and Risks

**8. GDP growth is expected to moderate to a more sustainable pace on softening external demand and tighter supply bottlenecks.** Slowing external demand is projected to lower GDP growth to a still-strong 3.6 percent in 2019, underpinned by buoyant private consumption and absorption of EU funds (including carry-over of unspent amounts from 2018). At the same time, new foreign worker arrivals are expected to slow amid decelerating growth and the partial opening of labor markets in higher-income EU countries. Over the longer term, a shrinking working-age population, subdued private investment and tepid productivity gains are projected to gradually moderate GDP growth to around 2¾ percent by 2023. The current account deficit is forecast to widen gradually to around 1½ percent of GDP on declining household net saving (rather than a more-desirable increase in corporate investment).

**9. Risks to the outlook are two-sided in the near term, although they are tilted down in the longer run.** Faster absorption of EU funds could provide additional demand stimulus and raise near-term growth relative to the forecast, although the effect would be limited owing to supply bottlenecks. Downside risks could arise if global trade tensions were to escalate further or in the event of a disruptive Brexit, or if turbulence in global financial markets were to resume. Also, Poland could face more severe labor shortages if foreign workers were to leave in response to more attractive opportunities in other countries. On the domestic front, a larger footprint of the state in the economy could slow productivity growth, while investors' risk appetite could be dented in the event of slippages from prudent policies and sound governance principles, including in the context of Poland's electoral calendar,[8] or a deterioration in relations with the EU.

***Authorities' Views***[9]

**10. GDP growth is expected to slow gradually in the coming years, with risks originating mainly from abroad.** Based on data for the first three quarters, GDP growth for 2018 is expected to exceed the previous year's outturn. Beginning in late 2018, the pace of growth is expected to moderate on more subdued activity in the euro area and a tight labor market, with growth reaching 3.8 percent in 2019 and 3.7 percent in 2020. However, uncertainty about the scale of the anticipated global GDP slowdown, and with consequences for Poland, is high. Reflecting the absence of external or internal imbalances in Poland, developments abroad pose the most significant risk to Poland's growth trajectory. These include: (i) a possible escalation of international trade disputes that could disrupt global supply chains; (ii) adverse conditions for the UK's departure from the EU; and (iii) changes to immigration policy by other EU countries, which could intensify existing labor shortages.

## B. Policy Discussions

### Monetary Policy: Keeping Inflation Expectations Anchored

**11. Inflation is expected to edge up gradually toward the mid-point of the target, but increasingly-unpredictable price developments add considerable uncertainty to the forecast.** The tight labor market and some pass-through of higher electricity prices for firms are projected to gradually lift inflation, although strong supply-chain links with the region are expected to continue to limit increases in costs and prices in the tradable sectors. As a result, once the temporary effect of the large decline in financial services prices has dissipated in early 2019, inflation is projected to edge up gradually toward the mid-point of the target on modest growth in unit labor costs and potential second-round effects from energy price increases for firms.[10] In addition, strong corporate profitability would allow firms to absorb much of the rising labor and energy costs without raising output prices. However, this baseline forecast is subject to considerable uncertainty as regards the evolution of the cyclical position, the size of foreign worker inflows and its impact on wage dynamics, as well as the extent of second-round effects from energy price increases. Moreover, increasingly-unpredictable consumer price developments—including large idiosyncratic declines for

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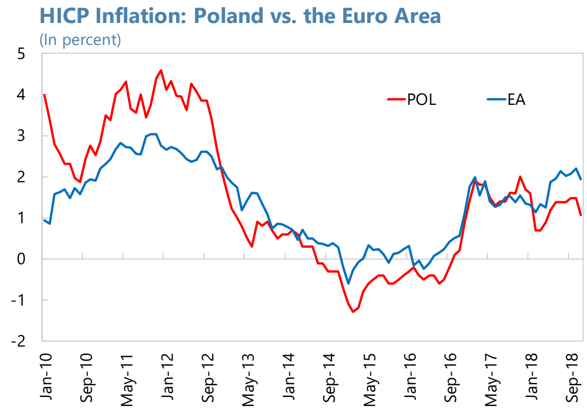
[8] Following local elections in October-November 2018, several other elections are scheduled during the next two years: European parliament (mid 2019), parliament (late 209), and presidential (mid 2020).

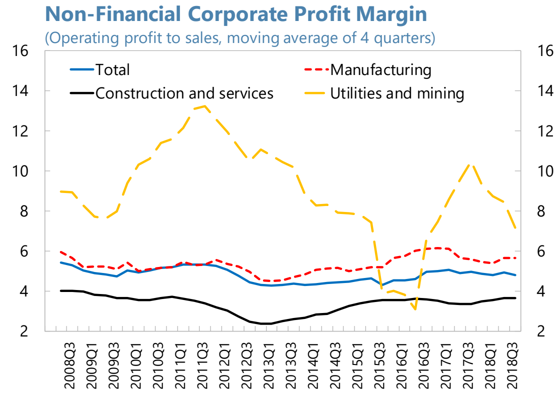
[9] Also reflects views in the National Bank of Poland's November 2018 Inflation Report, which was released after the mission.

[10] Energy prices for firms are unregulated and agreed bilaterally between suppliers and users under staggered contracts with durations of one year or longer. Anecdotal evidence indicates that prices for firms are rising by about 60 percent on average. However, because energy accounts for about 2 percent of firms' total costs—on average—second-round effects are expected to be limited.

some items,[11] and lack of clarity on changes in administered electricity prices and a possible compensation scheme for households and SMEs—are key risks for the inflation forecasts.[12]



Sources: Haver Analytics; and Statistical Office of the European Commission.



Source: Poland Central Statistical Office.

**12. Monetary policy should follow a data-dependent approach, and respond only to sustained inflation developments.** A stable nominal policy rate of 1.5 percent—consistent with a marginally-negative real rate—in recent years has been appropriately accommodative in the context of inflation persistently below the mid-point of the target. With inflation projected to edge up only gradually toward the mid-point of the target, interest rates should be raised if inflation is approaching the mid-point of the target on a sustained basis. The pace of monetary policy tightening should be attuned to the momentum of inflation and to the stance of other policies, with a faster tightening than otherwise if fiscal policy were to turn expansionary.

***Authorities' Views***[13]

**13. According to the majority view of the Monetary Policy Council, slowing growth would ensure that any cost-push increase in inflation is short-lived and, in any event, monetary policy should not react to temporary, supply-side shocks.** For 2019, headline inflation is forecast to increase on account of rising unit labor costs and higher electricity prices (assuming new tariffs for households are introduced) but to stay well-within the tolerance band, while core inflation will remain below 2.5 percent. Headline inflation is generally seen as returning close to the mid-point of the target by 2020 without the need to raise the policy rate on account of intense competition among companies and slowing GDP growth, notwithstanding a still-sizeable positive output gap. Thus, it is generally expected that inflation will be close to the mid-point of the target at the horizon of monetary policy transmission. Raising the policy rate in response to exogenous price shocks that

[11] In addition to the 15 percent decline in banking and postal services prices in February 2018, prices for communication services declined several times since the beginning of 2018, reducing inflation by around 0.2 percentage point.

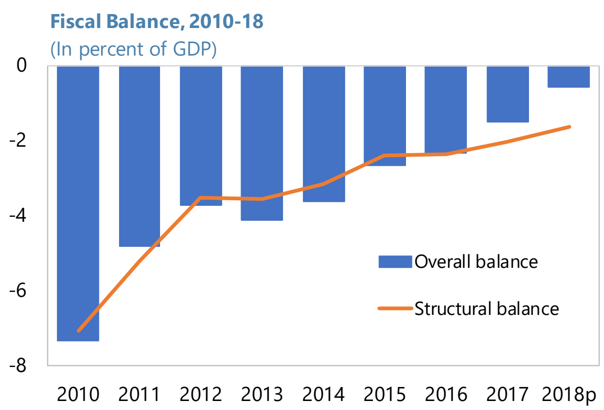
[12] Based on public statements by government officials in late December, staff assumes that end-user electricity prices for households and SMEs will remain unchanged notwithstanding increases in carbon emission levies and world coal prices.

[13] Incorporates views in the NBP's November 7, 2018 Inflation Report and minutes of recent MPC meetings.

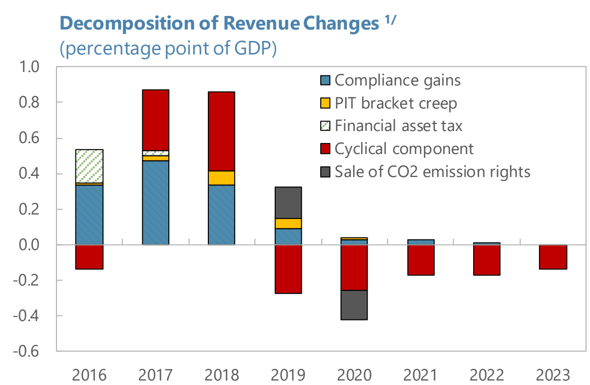
are beyond the influence of the NBP's monetary policy would exacerbate the growth slowdown triggered by the adverse effect of higher prices and wages on the financial situation of households and firms. Therefore, measures other than monetary policy should be used to address supply shocks.

## Fiscal Policy: Securing Previous Gains

**14. Following several years of narrowing imbalances, further substantial reductions in the headline and structural deficits are expected in 2018.** In recent years, the cost of several new initiatives (including a generous child benefit program and a reduction in the pension age) was largely offset by revenue from the introduction of a tax on assets of financial institutions and improvements in tax compliance, with little net effect on headline or structural balances. However, the structural position did improve on account of the autonomous effect of indexing some tax thresholds and expenditure items below the rate of nominal GDP growth. The headline balance also benefited from temporary revenue derived from the economy's buoyant cyclical position and the sharp increase in the number of foreign workers. Including an anticipated year-end acceleration in spending, the headline deficit is on track to reach a record low of 0.6 percent of GDP in 2018 (about 0.8 percentage point below the previous year's), with the structural deficit declining to around 1½ percent of GDP.[14] Public debt is projected to fall below 50 percent of GDP. For 2019, much of the previous structural improvement is expected to carry forward, although the headline deficit is forecast to increase on account of slowing cyclical revenue. New pre-election measures in 2019–20, including to offset higher electricity costs for additional groups of users, present a risk.[15]



Sources: Poland Ministry of Finance; and IMF staff calculations.



Source: IMF staff estimates.
1/ General government revenue net of EU funds.

[14] This would imply significant underspending of budgeted amounts of EU-funded and own-financed public investment in 2018, reflecting the significant supply constraints that exist in the infrastructure sector.

[15] Staff's forecast assumes that electricity prices for households and SMEs only will be kept unchanged.

**15. While the magnitude of past adjustment has been impressive, the quality of the budget has deteriorated over time.** Consolidation has relied on measures that will be hard to sustain, notably the compression of wages and social benefits relative to GDP that will depress future living standards.[16] The rising share of nondiscretionary spending, mainly for social transfers, has increased budget rigidity, making future adjustment within the expenditure ceiling more difficult. The proposal to use extrabudgetary funds (which fall outside the budget process and are not covered by the expenditure rule), including to compensate end-users for electricity price increases in 2019, reduces the transparency of the budget process and the usefulness of the rule as a planning and disciplining tool. In addition, such compensation will be difficult to terminate and could foster expectations of similar subsidies in response to future price increases.[17] Earmarking revenue from narrowly-based taxes and levies for financing new spending can create distortions and cause revenue yields to be overestimated. Moreover, public investment is driven by the EU funds cycle, leading to capacity constraints, inefficiencies and procyclical fiscal stimulus.[18]

**16. Despite the recent structural improvement, additional adjustment is needed, relying on well-specified and sustainable measures.** Although public debt remains sustainable (Annex V), fiscal space is at risk under the national expenditure rule and the medium-term objective (MTO)—a structural deficit of one percent of GDP—agreed with the European Commission. While there is some room excluding these fiscal rules, the rapidly-aging population nonetheless constrains space. Reaching and then maintaining the MTO would create room for additional aging-related and health spending, replacing part of declining EU funds with national resources, and providing stimulus in the event of a sustained economic downturn. This would likely require a further adjustment of close to 1 percentage point of GDP, which could be frontloaded because the economy is operating above potential, even though growth is moderating. While Poland's expenditure stabilizing rule sets nominal spending limits consistent with reaching the MTO and reducing debt to prudent levels, adjustment should be underpinned by clearly-identified and sustainable measures. These could include reducing the proliferation of preferential VAT rates, better-targeting social benefits (including means-testing currently universal programs), eliminating electricity subsidies to households and SMEs, raising the pension age (consistent with past gains in life expectancy), and phasing out generous special pension schemes, while avoiding excessive reliance on further tax compliance gains.[19] A comprehensive review of expenditure and strengthening the medium-term

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[16] The pension-wage replacement rate is expected to fall from the current 60 percent to around 40 percent by 2030, which will increase spending on supplementary minimum pensions.

[17] Staff assumes that the electricity subsidy will have an annual cost of about 0.2 percent of GDP, and will be financed in 2019 by auctioning unused CO2 emission rights. Beyond 2019, the subsidy is assumed to continue, and result in a larger general government deficit.

[18] Receipt and spending of EU funds is neutral for the fiscal balance (excluding the domestically co-financed component). However, because these funds are financed from abroad—rather than from withdrawal of domestic purchasing power (e.g., through taxation)—their spending provides a demand stimulus. In addition, part of VAT compliance gains reflects preventing payment abroad of fraudulent refunds, and hence spending this revenue also adds to aggregate demand.

[19] The 2017 Article IV staff report finds that the package of recommended fiscal measures could generate sufficient savings to finance costly structural reforms, while also meeting medium-term debt and deficit targets.

budget framework would help to identify other potential savings from low-priority or less-efficient spending, while also increasing the achievability of the expenditure ceiling and the MTO.

**Effect of Selected Structural Measures[1]**
(Relative to counterfactual; percent of GDP)

| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|---|
| | **Previously Implemented** | | | | | | | |
| **Revenue** | **0.6** | **1.1** | **1.5** | **1.6** | **1.7** | **1.7** | **1.7** | **1.7** |
| Tax compliance gains | 0.4 | 0.8 | 1.2 | 1.2 | 1.3 | 1.3 | 1.3 | 1.3 |
| Financial institutions asset tax | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| PIT gains from bracket creep | 0.0 | 0.0 | 0.1 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| **Expenditure** | **-0.9** | **-0.8** | **-0.5** | **-0.4** | **-0.2** | **-0.1** | **-0.1** | **0.1** |
| Child benefits program | -0.9 | -1.3 | -1.1 | -1.0 | -1.0 | -0.9 | -0.9 | -0.8 |
| Retirement age cut | 0.0 | -0.2 | -0.5 | -0.7 | -0.7 | -0.7 | -0.7 | -0.7 |
| Indexation of social spending | 0.0 | 0.6 | 1.0 | 1.2 | 1.4 | 1.4 | 1.4 | 1.5 |
| Real public wage bill freeze | 0.0 | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| | **Newly Announced (Included in staff's baseline)** | | | | | | | |
| **Revenue -** Sale of CO2 emission rights | 0.0 | 0.0 | 0.0 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Expenditure** | **0.0** | **0.0** | **-0.1** | **-0.5** | **-0.7** | **-0.9** | **-1.1** | **-1.3** |
| Increase health spending | 0.0 | 0.0 | 0.0 | 0.0 | -0.2 | -0.4 | -0.6 | -0.8 |
| Benefits for disabled, schoolkids and mothers | 0.0 | 0.0 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 |
| Pension saving plans (PPK) | 0.0 | 0.0 | 0.0 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 |
| Boost of minimum pensions | 0.0 | 0.0 | 0.0 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 |
| Compensation for electricity price increases | 0.0 | 0.0 | 0.0 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 |

Sources: IMF staff calculations.

1/ A positive value indicates higher revenue or lower expenditure.

### *Authorities' Views*

**17. Prudent policymaking and a robust fiscal framework will ensure that public debt stabilizes at a prudent level.** Permanent revenue gains from narrowing the compliance gap on VAT, which also benefited direct taxes—will help reduce the 2018 headline deficit to around 0.5 percent of GDP, substantially lower than the original deficit target of 2.7 percent of GDP. For 2019, considerable overperformance relative to the headline deficit target of 1.7 percent of GDP is likely due to underspending and conservative revenue forecasts. Thereafter, existing policies and debt-adjustors in the national expenditure rule will lower debt to about 43 percent of GDP by 2022.[20] In the event of new spending pressures or a permanent cut to revenue, compliance with the rule necessitates that savings be identified and implemented. Ideally, this should occur within the context of a medium-term budget framework, which has yet to be developed. Pensions do not present a fiscal risk under the notional defined contribution system because payouts are linked to each individual's own contributions,[21] and while this implies a declining pension-to-wage replacement rate, the system incentivizes working beyond the minimum pension age to continue to contribute and raise one's future benefits. In addition, social spending as a share of GDP is on a declining path because pension benefits are indexed well-below nominal GDP and some other social

[20] When public debt is above 48 or 43 percent of GDP, the expenditure ceiling grows less than nominal GDP by 2 or 1.5 percentage points, respectively.

[21] The EU's Aging Working Group estimates that Poland's pension spending will remain at around 11 percent of GDP through 2060, despite a 1 percentage point annual increase in the pension-age population.

benefits are fixed in nominal terms. This welfare system is fiscally sustainable and also meets the social needs of a population that is aging, but also growing wealthier and more equal.

**Financial Stability: Ensuring Sound Supervision**

**18. The financial system is broadly robust, although pockets of vulnerability exist.** As discussed in the accompanying Financial System Stability Assessment (FSSA), stress tests conducted on end-2017 data indicate that, in the aggregate, commercial banks are resilient to sizable-but-plausible macroeconomic, market and liquidity shocks, despite pockets of vulnerability. Introduction of the FIAT prompted banks to shift their asset allocation toward government bonds (which are tax exempt) and to more profitable-but-riskier unsecured consumer credit at the expense of less-profitable, but potentially more-productive, corporate lending (although demand may have shifted to leasing). Replacing the FIAT with a tax on banks' profits and remuneration (proxying a VAT from which the financial sector is exempt) would be less distortionary for credit allocation and reduce banks' risk profiles. Moreover, the rapid growth of consumer credit, accompanied by the increasing size and lengthening maturity of individual loans, warrant close monitoring, and targeted macroprudential measures should be deployed if systemic risks arise. The sustained low double-digit growth in zloty-denominated, variable-rate mortgages in recent years occurred in the context of low borrowing costs at origination, and their quality has not been tested under higher interest rate conditions. However, risks are mitigated by the LTV limit and improved affordability. The legacy portfolio of foreign currency-denominated (FX) mortgages has declined to 6½ percent of GDP, loan quality is high, and they do not pose a systemic risk. As with any other loan category, a distressed FX mortgage should be restructured based on a voluntary bilateral agreement between the creditor and the debtor, and mandatory centralized approaches should be avoided. Integration and harmonization of cooperative bank networks should continue, and a re-thinking of the business model for the credit union sector is needed.

**19. Strengthening the structure of financial sector oversight would enhance supervision, particularly in the context of tightened bank-sovereign linkages.** The Polish Financial Supervision Authority (PFSA) faces severe resource constraints—both budgetary and staffing—and lacks independence over its operational decisions. This impedes the effectiveness of oversight, including of—among others—compliance with AML/CFT requirements. Legislation approved in late-November 2018 may allow better resourcing of the PFSA, which would enable it to better calibrate supervision to institution-specific risks, rather than relying on across-the-board regulatory measures. The amendment, however, gives the government and the president of the Republic a blocking majority on the PFSA's Board (five of the nine voting-members), exacerbating concerns about the potential for political interference raised by staff in connection with the previous PFSA Board structure (four of the eight voting-members). The further weakening of the PFSA's independence occurred while state ownership and control of domestic systemically-important banks have risen to 14 percent and 42 percent of assets, respectively (Annex III). While the uniform framework for regulation and supervision may mitigate concerns, the increase in sovereign-bank linkages could lead to "self-regulation" of state-controlled financial intermediaries and compromise sound oversight. Given their significance in the sector, any weakening of supervisory standards for state-controlled banks could have systemic implications. While an over-sized PFSA Board could promote better information sharing,[22] it may hinder the efficiency and timeliness of decision making.

**20. Addressing shortcomings in the operational independence of supervision and protecting the rights of minority investors are priorities.** An appropriate budget and governance structure would ensure: (i) a well-resourced financial supervisor with a robust supervisory capacity; (ii) a structure and composition of the PFSA board that is insulated from undue political influence; (iii) a governance arrangement that allows for efficient operations and timely decision making, while delegating the more technical supervisory tasks to the PFSA chair and staff; and (iv) some formal role for the PFSA in setting regulatory policies and priorities. These principles assume additional importance in view of the significant state control of the financial sector so as to ensure that state-controlled institutions operate on commercial terms, and that supervision across the financial sector is evenhanded and free from conflicts of interest with the government. Absent these safeguards, state ownership of the financial sector should be reduced over time.

***Authorities' Views***

**21. The banking sector is resilient, although some new risks are emerging.** The FSAP stress test finding of system-wide resilience of the banking sector, but with pockets of vulnerability, is realistic. Strong growth of consumer credit, by itself, is not a concern given that household incomes are growing quickly. These loans should be closely monitored, but no supervisory or regulatory action is needed at this time. The FIAT has created only limited and temporary distortions to the interbank market and there is no evidence of credit diversion away from corporate lending. While banks adjusted deposit margins and operating costs after the tax was introduced, their profitability is still lower than before the introduction of the tax. There are no plans to revise the tax. The potential risks from strong growth in zloty-denominated mortgages are being monitored. On FX mortgages, this portfolio does not constitute a significant risk to financial stability.

**22. Broad agreement exists on the need to amend the governance structure of the PFSA, although views differ as to the appropriate direction of the reform.** The government's position, subsequently supported by parliament, is that having additional members on the PFSA Board would increase coordination and facilitate information sharing across government agencies and with the Prime Minister, thereby enabling a more-timely and better-targeted response in the event of emerging financial sector risks.[23] The increased government representation on the PFSA Board is appropriate given that any payout of insured deposits is ultimately a fiscal responsibility. On the other hand, the NBP is of the view that the PFSA should be reintegrated into the central bank (it was separated out in 2006) so that it would inherit the independence and protections afforded by the central bank law. The recent increase in state ownership of the financial sector reflects the withdrawal of some foreign shareholders and acquisition by the state. As a result, there is a better

[22] The new law also adds three non-voting members to the PFSA Board, increasing total membership to 12.

[23] The Ministry of Finance indicated that the proposal was partly motivated by the GetBack failure in Spring 2018. The government believed that information sharing between the PFSA and the PM was insufficient, delaying an effective response.

balance between domestic and foreign ownership of the sector as foreign-owned banks are more likely to withdraw funding during episodes of external stress, thereby creating spillovers to the domestic economy from external financial shocks. On the other hand, state banks tend to be more countercyclical in their lending practices. The government does not intend to reduce its holdings in the financial sector.

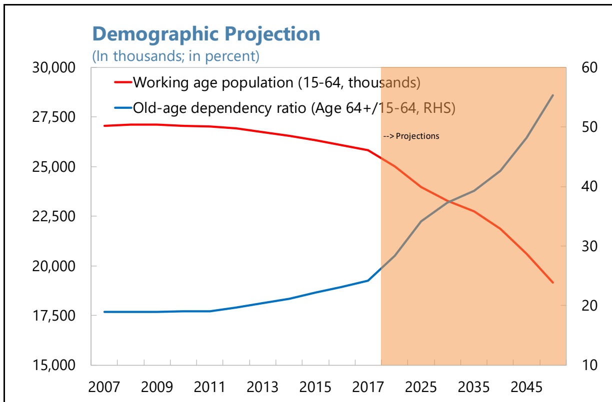
**Structural Policies—Revving-up potential growth**

**23. Growing the effective workforce and boosting labor productivity are key to sustaining rapid and inclusive growth**. Lowering the pension age and providing generous child benefits encouraged large numbers of workers to withdraw from the workforce at a time of severe labor shortages.[24] Raising the labor force participation of women and older cohorts and continuing to attract foreign workers by permitting longer-term stays would help alleviate near-term constraints on labor supply and real activity.[25] However, shifting from labor-intensive production in order to accelerate output per worker is essential to tackle Poland's severe demographic headwind and to raise per capita income, but is held back by persistently subdued private investment. A 2017 survey of Polish firms finds that skilled labor shortages and an unpredictable tax and regulatory environment are the main barriers to investment.[26] Given the complementarity between skilled labor and capital, durably lifting the investment rate requires greater access to high-quality education and job training, a wider international search for well-qualified foreign workers, as well as longer lead-times before new regulations and taxes are implemented and with greater advance-consultation with the business community. With access to EU funds expected to decrease over the medium-to-long run, economy-wide investment should decouple from these flows. Moreover, removing barriers to investment is a prerequisite for the new pension scheme (PPK) to deliver high returns over the longer term (Box 2); otherwise, any new savings—mostly likely modest, and limited to lower-wage workers—would temporarily inflate financial asset prices. The PPK will also increase the wedge between gross and net wages, and in the current tight labor market, the incidence would likely be borne by employers.

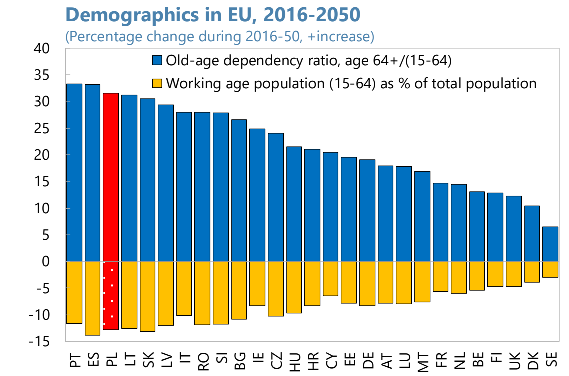
[24] The Polish Institute for Structural Research estimates that the participation rate of mothers dropped by 2.4 percentage points by mid-2017 as a result of the 500+ benefit program, implying withdrawal of about 100 thousand women from the workforce. Labor force survey data suggest that the participation rate of older workers eligible for retirement benefits (women aged 60+ and men aged 65+) dropped by about 0.5 percentage point in mid-2018 following the entry into effect of the lower eligibility age, implying withdrawal of about 40 thousand workers.

[25] Staff's estimates in the 2017 Article IV report (see paragraph 42) suggest that closing structural gaps (e.g., labor-force participation, infrastructure and R&D) could lead to notably higher output over the long term.

[26] European Investment Bank, "2017 Investment Survey for Poland."

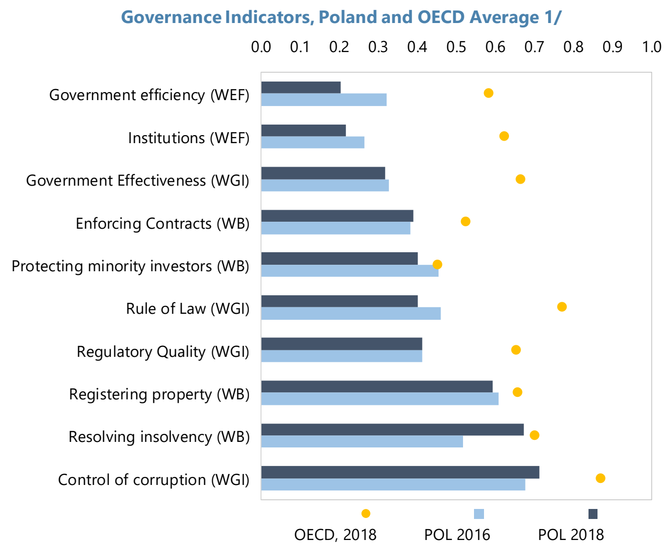


Source: European Commission Aging Report 2018.



Source: European Commission Aging Report 2018.

**24. Ensuring a level playing field is essential in the context of significant state ownership of key industries.** Government ownership is high in banking and insurance, energy and transport, and the main Warsaw stock index (WIG20) is dominated by state-controlled enterprises. Firm-level data suggest that state ownership in nonfinancial sectors is associated with lower total factor productivity (TFP) than is private domestic or foreign ownership. Staff estimates that converting all nonfinancial state-owned firms in Poland to private ownership could increase the level of TFP and real GDP by nearly nine percent, while future TFP growth would also be faster.[27] This result may reflect the broader mandates of SOEs relative to private firms, and which can also create negative spillovers for other incumbent firms.[28] Moreover, state control of financial firms is potentially more problematic than control of nonfinancial firms as it risks politicizing credit allocation and crowding out more-efficient investment projects. As a result, productivity may be lowered across the whole economy. Evenhanded and independent oversight is critical to maintain competition between SOEs and private firms, to protect the property rights of minority shareholders in SOEs, and to safeguard the efficiency of investment. State acquisitions of equity positions in private companies should be limited to cases where market failures are present,



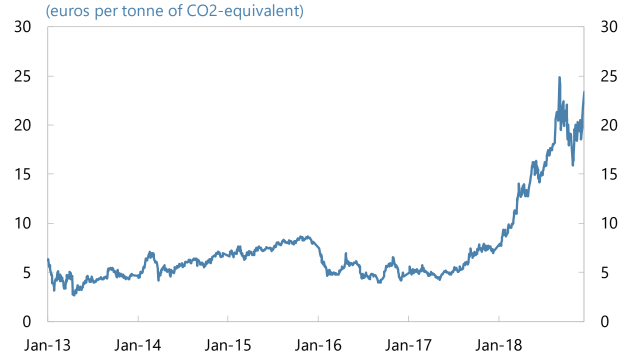
Note: All indicators are normalized to take values between 0 (min) and 1 (max), with higher values indicating better outcomes. "OECD average" is the simple average of normalized values for OECD members.
Sources: World Bank, "Doing Business 2018"; World Governance Indicators: Kaufmann, Kraay, and Mastruzzi, "The Worldwide Governance Indicators: Methodology and Analytical Issues"; World Economic Forum, "The Global Competitiveness Report 2018"; and IMF staff calculations.
1/ Most of these indicators are perception based and thus more subjective than other economic indicators. Nevertheless, economic decisions are based on agents' subjective perceptions of many factors, including governance, effectiveness of the judiciary, and property rights protection. These indicators and data sources are chosen for their timeliness and wide coverage of peer countries. Similar indicators from different sources point to the same general trends for Poland in recent years.

[27] See the accompanying Selected Issues Paper "Structural Characteristics and Firm-Level TFP: Evidence from Poland and Emerging Europe."

[28] Staff's empirical estimate of TFP gains from converting firms from state to private ownership does not capture any additional benefits that could accrue to already-private firms from removing negative externalities.

and should not be used to prop up—directly or indirectly—industries in decline. Social and macroeconomic objectives are best addressed transparently through the budget, rather than through the operations of SOEs. Despite progress in controlling corruption and resolving insolvency, other indicators generally point to some weakening in the governance framework and adherence to the rule of law in recent years.

**EU Carbon Emissions Price 1/**
(euros per tonne of CO2-equivalent)




Source: European Energy Exchange.
1/ In the primary auction for emissions allowances.

**25. Compensating end-users for environmental taxes circumvents their purpose.** Taxes on carbon and other emissions are intended to reduce demand for electricity and deter generation using heavily polluting sources. Poland generates around 80 percent of its electricity from coal, and carbon emissions fees saw a nearly five-fold increase in the EU-wide market during 2018. Environmental fees are generally seen as falling disproportionately on lower-income segments of the population. The government's intention to neutralize the impact of these higher fees on electricity prices paid by households and SMEs will insulate end-users' real incomes, but fail to achieve the environmental goals.[29] Already Poland has 33 of the 50 EU cities with the worst air quality, according to the World Health Organization, including Katowice, which hosted the UN's climate summit in December 2018. Poor air quality carries significant economic costs through reduced labor productivity, additional medical expenditures, and early retirement and premature death. To achieve the environmental goals while avoiding the regressive nature of environmental fees, a preferred approach would be to raise end-user electricity prices, and to rebate users with the revenue collected from the fees or with the proceeds from selling emissions rights.

***Authorities' Views***

**26. Ongoing implementation of the Strategy for Responsible Development will help to correct mis-steps from earlier decades and support the economy's future dynamism.** Less cumbersome business regulation and lower taxes for SMEs will improve the business climate and encourage entrepreneurship. Changes to the system of vocational training (including greater coordination with enterprises) and incentives for innovation and R&D aim to ensure appropriate skills and technologies to support a digital-based economy. Increasing the still-low rate of labor force participation and encouraging return-migration of the more than 2 million Poles who emigrated since the turn of the century will help to resolve labor shortages in the coming years. Geographical proximity and language similarities are expected to preserve Poland's attractiveness to foreign workers from neighboring countries, even if higher-income countries were to open their labor markets. While foreign investment has been an important driver of growth, innovation and supply-chain integration, a more-balanced structure of ownership between foreign and domestic

[29] Electricity prices for firms other than SMEs are assumed to reflect the higher emissions fees.

capital is now appropriate. Increased state ownership is intended to unwind some of the previous extensive privatizations of major financial and nonfinancial companies that left Poland without any national champions in strategic industries able to compete internationally. An extrabudgetary fund, managed by the PM's office, and financed by SOE dividends, is being established to acquire stakes in private companies. The PPK scheme is designed to increase household saving to augment individual incomes in retirement, especially in view of the projected decline in the pension-wage replacement rate. At the aggregate level, higher national savings from the PPK will help to deepen Poland's capital markets and reduce dependence on foreign saving as a source for investment financing. While the scheme may not raise the savings of wealthier employees substantially, savings of low-wage employees are expected to increase owing to government subsidies to encourage their participation.

# STAFF APPRAISAL

**27. The Polish economy has expanded rapidly alongside narrowing imbalances and improving social indicators.** Growth benefited from the euro-area rebound, inflows of EU funds and new social transfers. Amid historically-low unemployment, potential output expanded on the influx of foreign workers, which helped to dampen inflation pressures. Adherence to sound policy frameworks has gradually lowered fiscal and external vulnerabilities and safeguarded financial stability, helping to cement investor confidence and insulate Polish financial markets from the turbulence that beset several emerging economies during the first half of 2018. The level of reserves is broadly adequate, and the external position is assessed to be broadly in line with medium-term fundamentals and desirable policies.

**28. The economic outlook is now facing several cross winds.** Growth has peaked and is expected to moderate to a more sustainable pace during the next few years on slowing trading-partner demand. Nonetheless, with a still-tight labor market and high capacity utilization, the economy will continue to operate above capacity. Worsening global trade tensions and reduced access to foreign workers are key risks. Over the longer run, and absent structural reforms, potential output will be restrained by population aging, subdued private investment and weak productivity gains.

**29. Monetary policy should remain data dependent, in light of increasingly unpredictable price fluctuations and the lack of clarity on the impact of electricity price increases.** The current accommodative stance of a negative real policy rate has been appropriate in the context of headline and core inflation persistently below the mid-point of the target. Looking ahead, inflation is forecasted to rise gradually toward the mid-point of the target on account of rising wages and possible second-round effects from energy price increases. However, the increasing unpredictability of large price fluctuations during the past year, as well as the lack of clarity on future electricity price increases and the associated compensation scheme for households and SMEs, give rise to considerable uncertainty regarding the inflation outlook. In these circumstances, monetary policy should remain data dependent and concentrate on guiding inflation to the mid-point of the target.

If the momentum of underlying inflation pressures were to accelerate, a faster increase in the policy rate would be warranted to keep the inflation outlook and expectations squarely within the target.

**30. Substantial fiscal adjustment was achieved in recent years, bringing the medium-term objective within reach, although the structure of the budget has weakened.** Improvements in revenue administration and automatic savings from low rates of indexation are expected to reduce the structural deficit to a historical low in 2018, despite numerous initiatives introduced in recent years that have been funded with new taxes and levies. Similar fiscal outturns are expected for 2019 in the absence of new unfunded spending initiatives. Nonetheless, compressing wages and social benefits relative to GDP may be difficult to sustain over the longer term, while the increasing share of nondiscretionary spending makes the budget more rigid. Spending financed from extrabudgetary funds reduces transparency, while relying on narrowly-based taxes and levies introduces distortions.

**31. Sustainable and growth-friendly measures should support the remaining adjustment needed to reach the MTO.** Adhering to the ceilings in the expenditure rule would achieve the MTO within the next few years and lower public debt to a moderate level. Specific measures will be needed to deliver this adjustment while also making room for new spending priorities. Continuing to strengthen revenue administration, narrowing the VAT policy gap, more-targeted social benefits and raising the pension age would generate sufficient savings.

**32. Overall, the banking sector is sound, although pockets of risk are present.** Stress tests conducted in the context of the FSSA reveal that, in the aggregate, the banking sector is resilient to sizable-but-plausible macroeconomic, market and liquidity shocks, but with weaknesses present in a few small and mid-sized banks. Introduction of the FIAT encouraged banks to shift into higher-yielding, but riskier, unsecured consumer lending to help defray the cost of the tax. Replacing the FIAT with one on profits and remuneration would avoid these distortions and the potential increase in systemic risks. Sustained rapid growth in zloty-denominated variable-rate mortgages should be monitored to ensure borrowers have adequate debt-service capacity if interest rates were to increase. Legacy foreign-currency mortgages do not pose a systemic risk, and any conversion into zloty should be on terms agreed bilaterally between the creditor and the debtor.

**33. Independent and well-resourced financial supervision is essential for effective and evenhanded oversight, particularly in the context of a state-dominated financial system.** The PFSA faces severe resource constraints and lacks autonomy over its budget and operations. Recent legislation does not rectify these concerns and may even increase scope for political interference. The resulting de facto "self-regulation" of state-controlled financial corporations has the potential to create systemic risks when these corporations dominate the financial sector. An over-sized supervisory board may also slow decision-making when there is a premium on taking timely action.

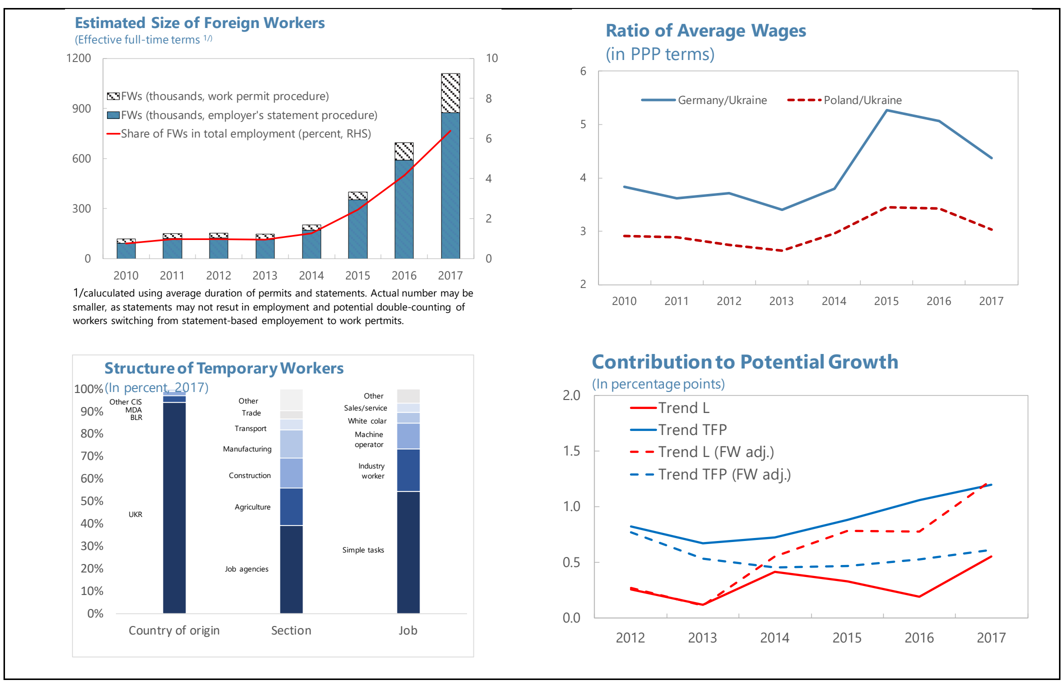
**34. Further reforms would help to boost long-term potential growth to overcome the drag from a declining working-age population.** Raising labor force participation and remaining attractive to foreign workers even as other countries open their labor markets would provide short-term relief from labor shortages. However, sustaining rapid income convergence calls for raising output per worker through a durable increase in investment. This requires more-reliable access to skilled labor and greater predictability as regards changes in business regulation and taxes. Moreover, providing a level playing field for all investors by protecting the rights of minority shareholders, maintaining a competitive environment in industries with a significant state presence, avoiding inefficient and distortive lending by state-controlled banks and gradually reducing state ownership of the financial sector, and ensuring that price signals reflect economic costs are needed to ensure a wide investor base. Removing existing barriers to investment would allow any savings accumulated under the new pension scheme to support productive investment that, in turn, would deliver higher returns in retirement and support continued income convergence.

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

## Box 1. Foreign Workers and Some Implications for the Polish Economy

**The number of foreigners working in Poland has surged since 2014, reflecting both push and pull factors**. The rapidly-expanding economy and a shrinking labor force on account of population aging and past emigration has resulted in low unemployment and large numbers of unfilled job openings. To help alleviate labor shortages, simplified procedures for the short-term employment of foreign workers from selected CIS countries were introduced in 2007.[1] On the supply side, the conflict in Eastern Ukraine and its adverse effects on economic activity and the exchange rate made working in Poland an attractive option. In PPP terms, average wages in Poland are three times higher than in Ukraine.[2] Staff estimates that foreign workers rose from around 1 percent in 2014 to about 5 percent (adjusted for double-accounting) of total employment at end-2017, with more than 90 percent coming from Ukraine.[3] However, uncertainty surrounding the number of foreign workers is significant as the ease of hiring makes tracking their number more difficult.[4] The majority of foreign workers are concentrated in relatively low-skill sectors, and are performing basic tasks.

**Adjusting for foreign workers indicates that the recent economic expansion has been labor intensive.** Adding effective foreign workers to the labor force survey (LFS)-based employment data suggests that employment grew by 2.8 percent in 2017, notably faster than the 1.4 percent reported in the LFS. Thus, for 2017, the adjusted labor contribution to potential GDP growth doubles to 1.2 percent, with a corresponding 0.6 percentage point downward adjustment to the contribution from TFP. In terms of their effect on domestic demand, the sharp increase in number of foreign workers has contributed to the rapid growth of household consumption, even though foreign workers are thought to repatriate the majority of their earnings as remittances abroad.

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[1] An individual foreign worker is permitted to work for up to 6 months within any 12-month period under the "employer's statement" procedure.

[2] At market exchange rates—arguably the more relevant comparison as many foreign workers repatriate a large share of their income—the difference rises to five times.

[3] This is measured in effective terms (i.e., adjusted for within-year limits on length of work). Thus, the number of foreign workers is halved to obtain the number of effective foreign workers employed.

[4] Estimates are adjusted downward to account for possible double-counting and employers not filling their work-permits.

## Box 2. A New Private Pension Scheme

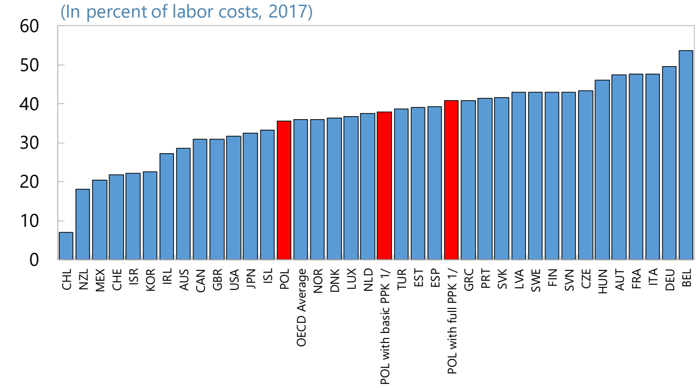
According to the government's Responsible Development Strategy, higher domestic saving and investment—together with a well-developed capital market—are prerequisites for strong and sustainable long-term growth. Given the projected decline in replacement rates under the notional defined-contribution pension system, higher savings are also needed for households' financial safety in retirement. The recently-approved "Employee Capital Plan" (PPK) is a long-term savings scheme intended to achieve these goals.

PPKs are private, outside the public pension system, and fully-owned by the employee. Participation is automatic for all employees up to 55 years of age, but with the possibility of voluntary opt-out. Official projections envisage that 75 percent of employees (8.6 million persons) will join PPK. The scheme will be rolled-out in stages, beginning in July 2019 with large firms (250+ employees), those with 50–250 employees (January 2020), 20–50 employees (July 2020), and micro-firms and government entities (January 2021).

The total standard contribution is set at 3½ percent of the employees' gross wage, plus a "welcome bonus" from the state budget for the first year of eligibility to encourage participation. The employee's standard contribution is 2 percentage points, but reduced to 0.5 percentage points for those earning less than 1.2 times the minimum wage. Employees may voluntarily top-up to 4 percentage points. Employers' standard contribution is 1.5 percentage point—with voluntary top-up to 4 percentage points. These contributions will increase the wedge between net and gross wages and, given the tight labor market, much of the cost is likely to be borne by employers. Contributions are treated as income of employees and taxed under the PIT, but exempted from social contributions. The state budget will pay a one-time bonus to each new member of PLN250 (about €55), and a yearly bonus of PLN240 if contributions exceed a certain threshold (which is lower for low-wage employees). The authorities project annual private contributions to the PPK of 0.7 percent of GDP by 2021 (1.4 percent of GDP with full top-up), and a fiscal cost of 0.16 percent of GDP. Income on PPK assets is exempted from capital gains tax.

**Labor Cost Wedge in OECD Countries**

(In percent of labor costs, 2017)



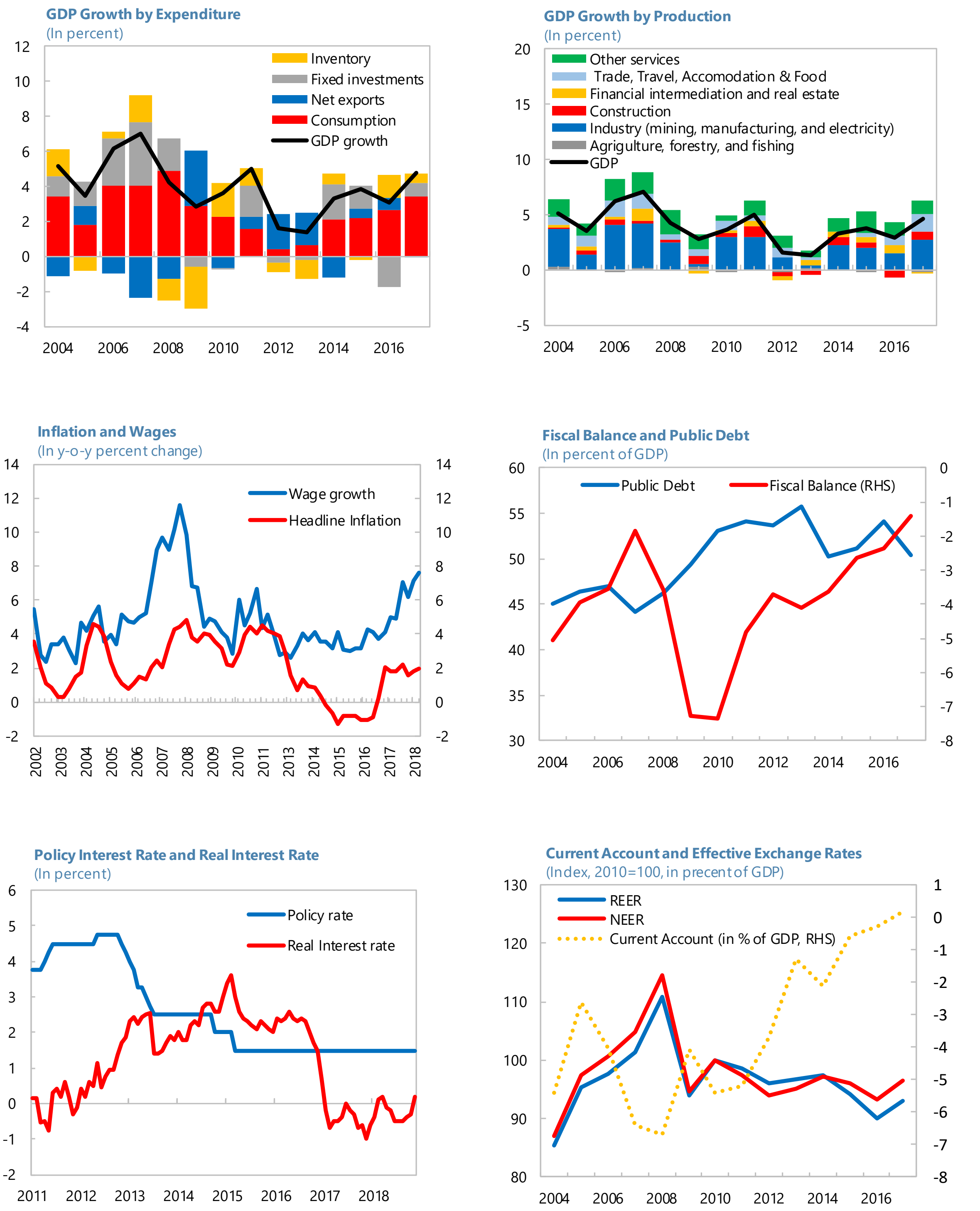

Source: OECD.

1/ Poland data adjusted for the voluntary opt-out private pension scheme (PPK), with contributions to the basic plan of 3.5 percent of net wage, and full plan up to 8 percent. Data of other countries do not reflect similar scheme.

Savings in PPKs will be managed by investment funds, within specific guidelines and with no guaranteed minimum return. Employers will either select an authorized investment fund or, otherwise the savings will be invested by the state-owned Polish Development Fund (PFR). Management fees are capped at 0.5 percent of assets, plus a 0.1 percent "success fee." Initially, 60–80 percent of assets must be held in equities (of which at least 40 percentage points in WSE quoted blue-chips (WIG20)), although this share will diminish gradually to 15 percent—with a corresponding increase in fixed-income assets—as individual beneficiaries approach retirement. Allowable investments in debt instruments must be issued or guaranteed by the Polish or other EU governments, local authorities, central banks, the EIB, or IFIs. Foreign currency assets may comprise no more than 30 percent of the portfolio.

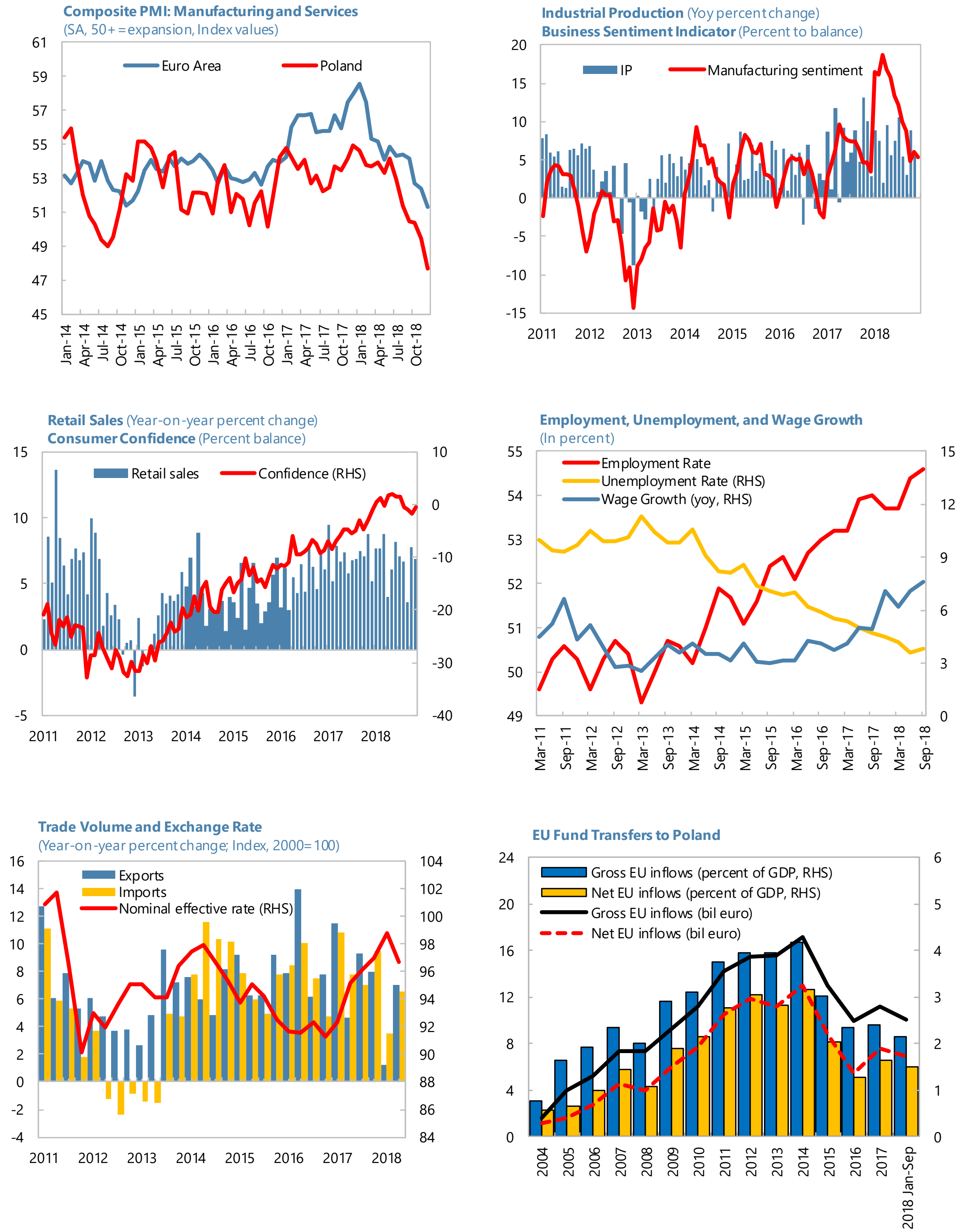
Payouts will commence when participants reach the age of 60. The first payout will be up to a quarter of assets, with the rest paid as 120 or more monthly installments. No annuities will be offered. Early withdrawal of a quarter of assets is allowed, and full early withdrawal is possible for mortgage down-payment, but must be replenished. Otherwise, early withdrawals will be subject to capital gains tax and social contributions on employer payments at a 30 percent rate.

## Figure 1. Republic of Poland: Selected Indicators, 2004–18



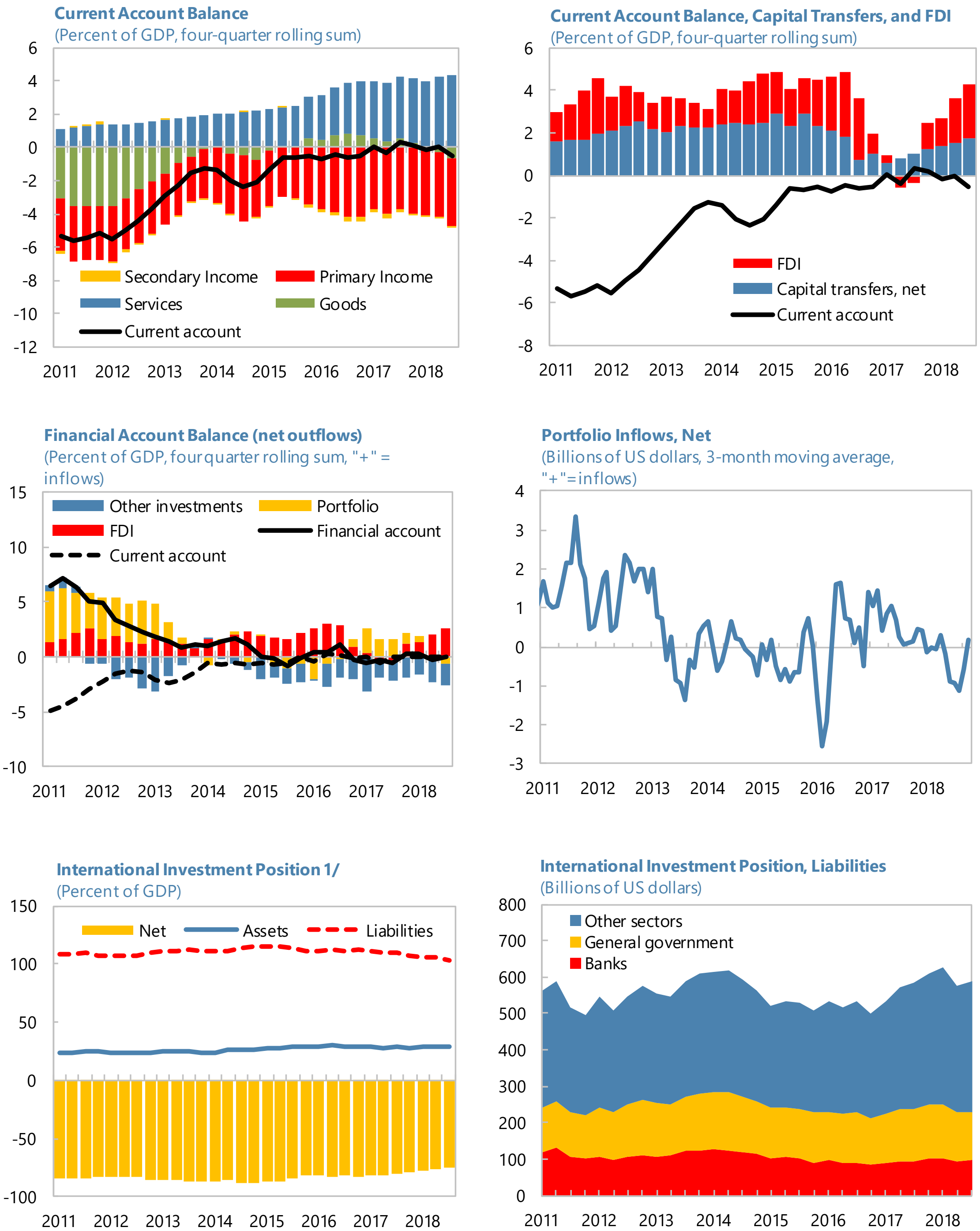

Sources: Haver Analytics; Poland Central Statistical Office; Poland Ministry of Finance; National Bank of Poland; and IMF staff calculations.

## Figure 2. Republic of Poland: Economic Indicators, 2011–18




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

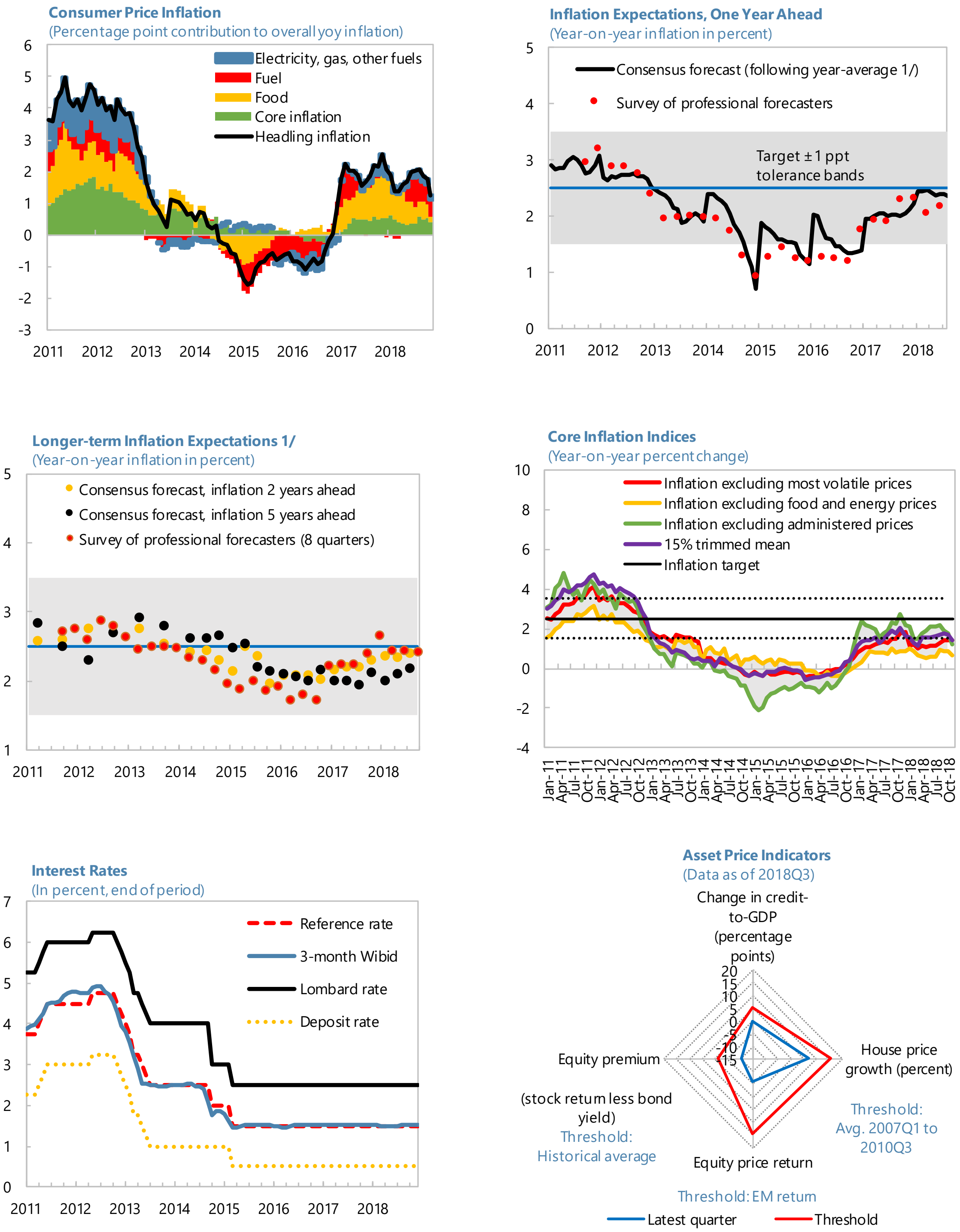
## Figure 3. Republic of Poland: Balance of Payments Developments, 2011–18




Sources: National Bank of Poland; and IMF staff calculations.

1/ Excludes the National Bank of Poland.

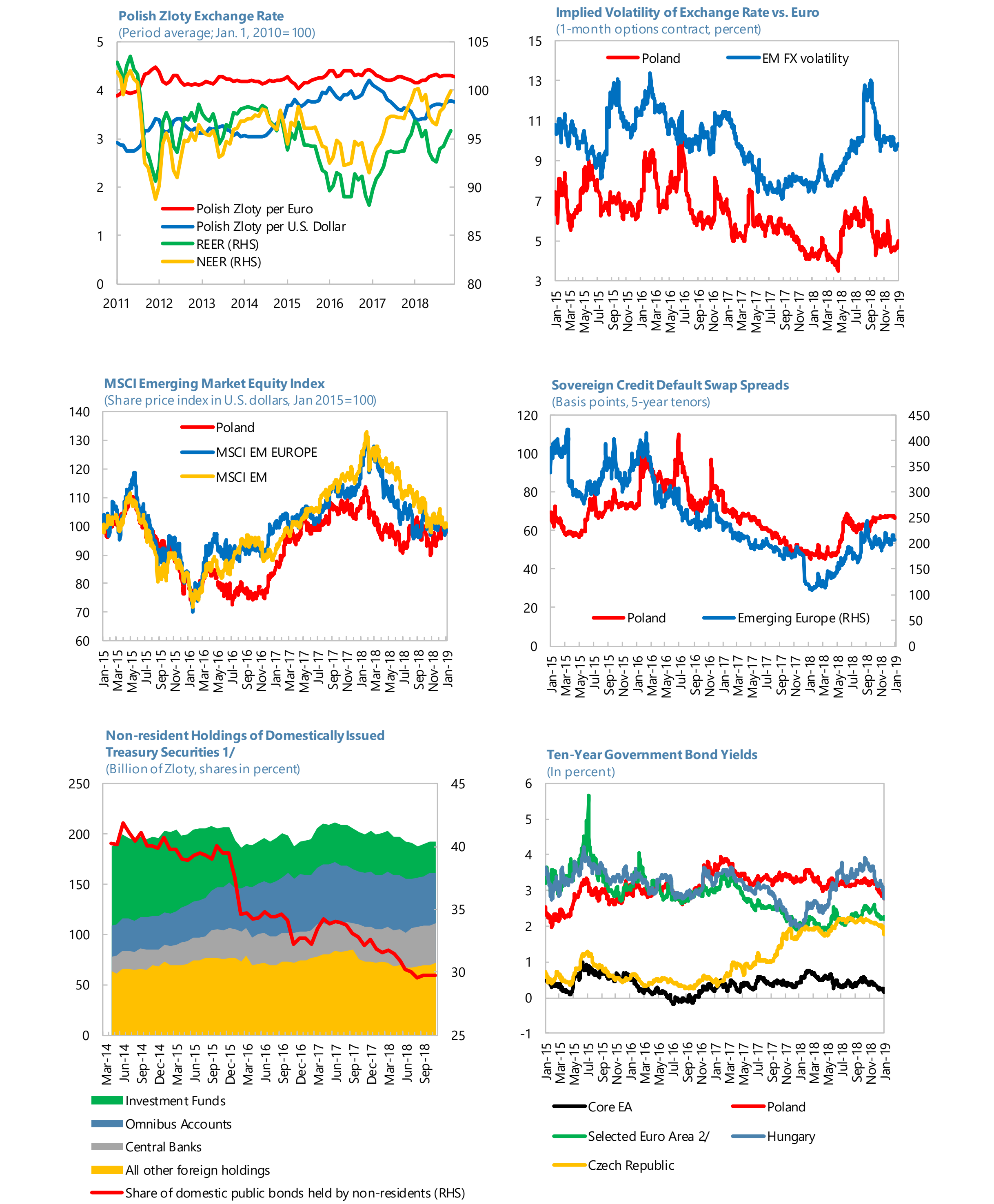
## Figure 4. Republic of Poland: Inflation and Asset Price Indicators, 2011–18




Sources: Consensus Forecast; Haver Analytics; Poland Central Statistical Office; National Bank of Poland; and IMF staff calculations.

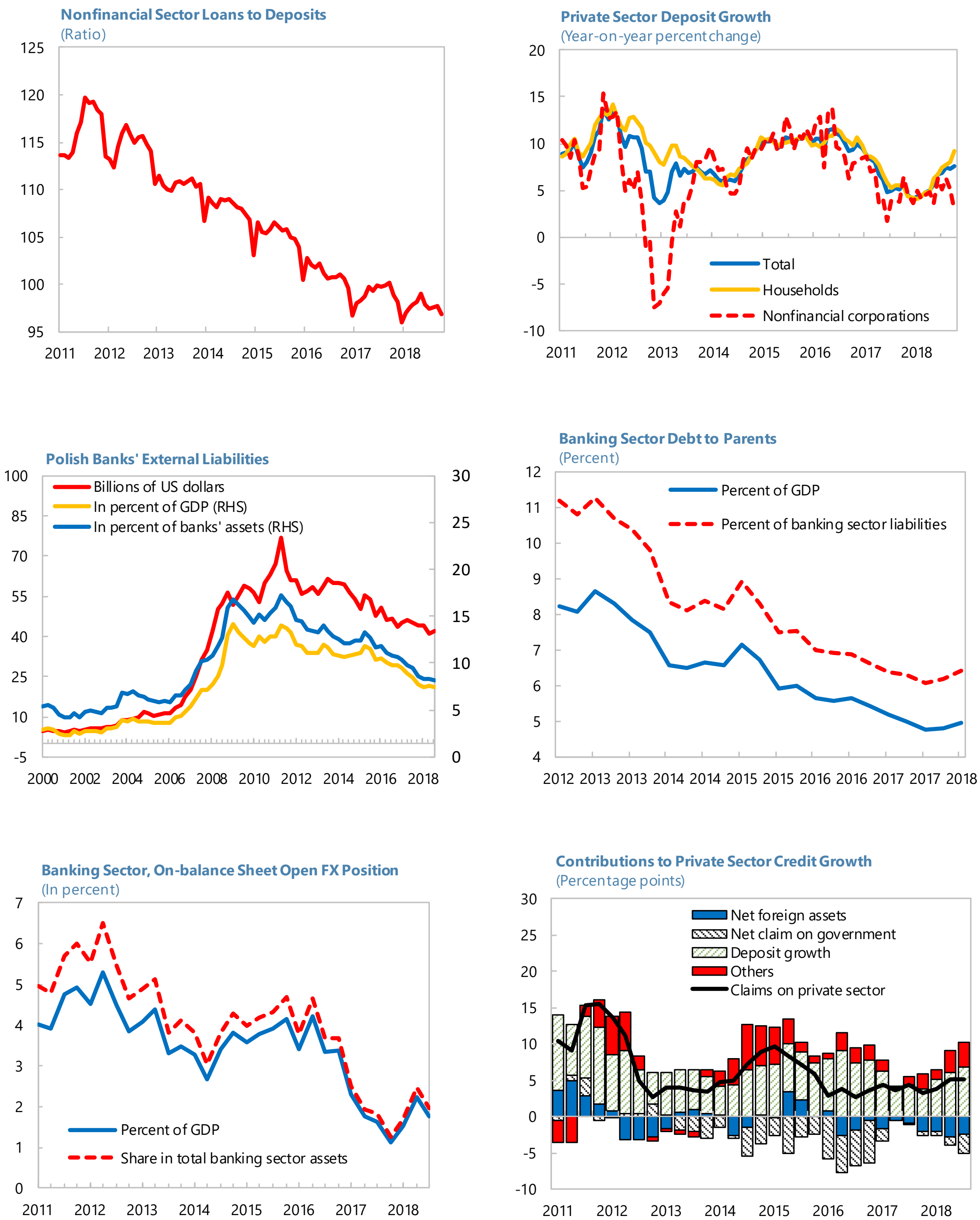
1/ Expectations for the following year's average is affected by breaks when the forecast year changes in January.

## Figure 5. Republic of Poland: Financial Market Developments



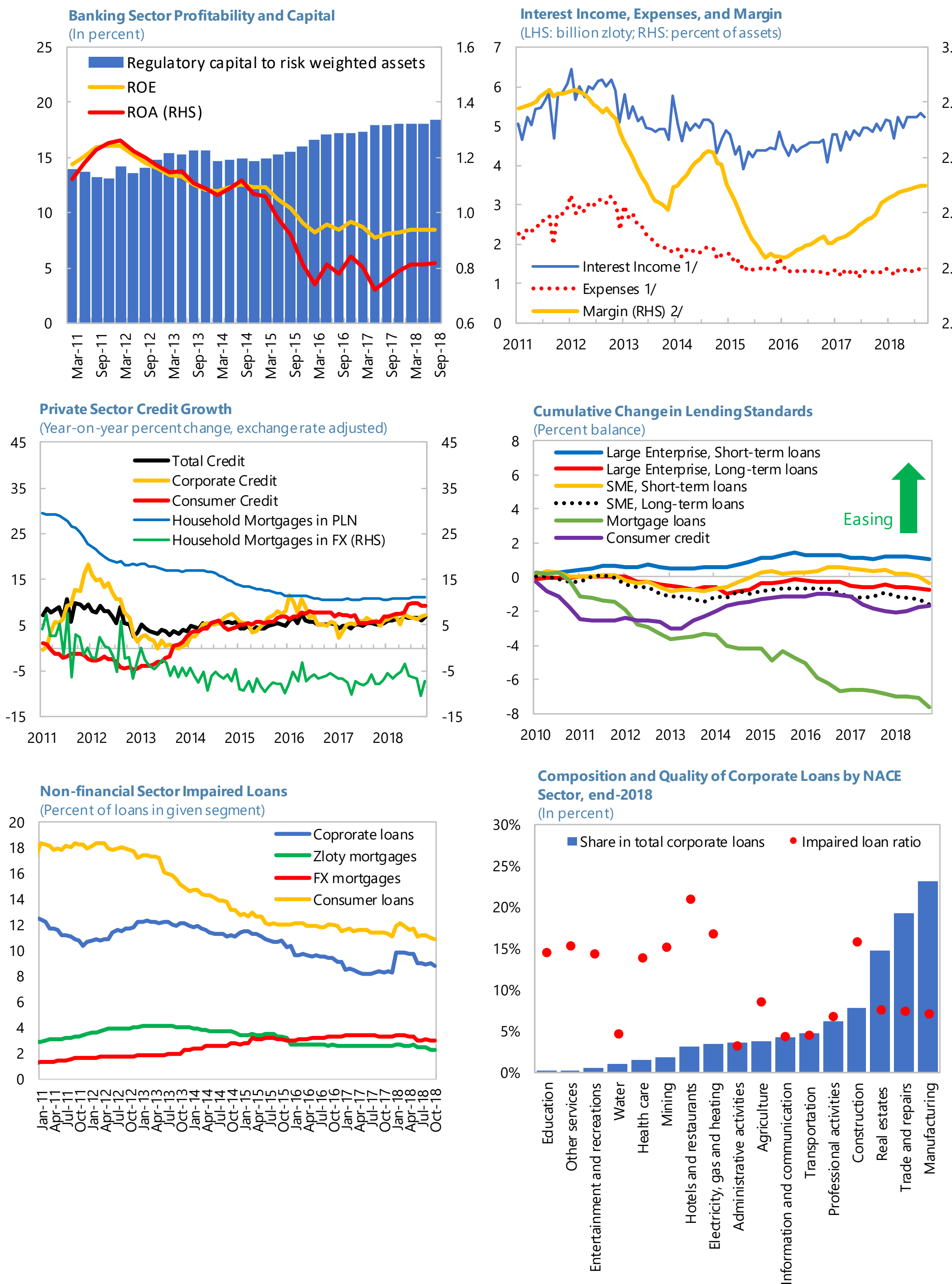

Sources: Bloomberg Finance L.P.; Haver Analytics; Poland Ministry of Finance; and IMF staff calculations.
1/ The government issues Eurobonds externally that are mostly held by non-residents. The total non-resident holdings of government debt amount to around 50 percent.
2/ Selected Euro Area includes Greece, Portugal, Spain, Ireland, and Italy.

## Figure 6. Republic of Poland: Banking Sector Funding




Sources: Haver Analytics; National Bank of Poland; International Financial Statistics; Poland Central Statistical Office; Polish Financial Supervision Authority; and IMF staff calculations.

## Figure 7. Republic of Poland: Banking Sector Credit Developments

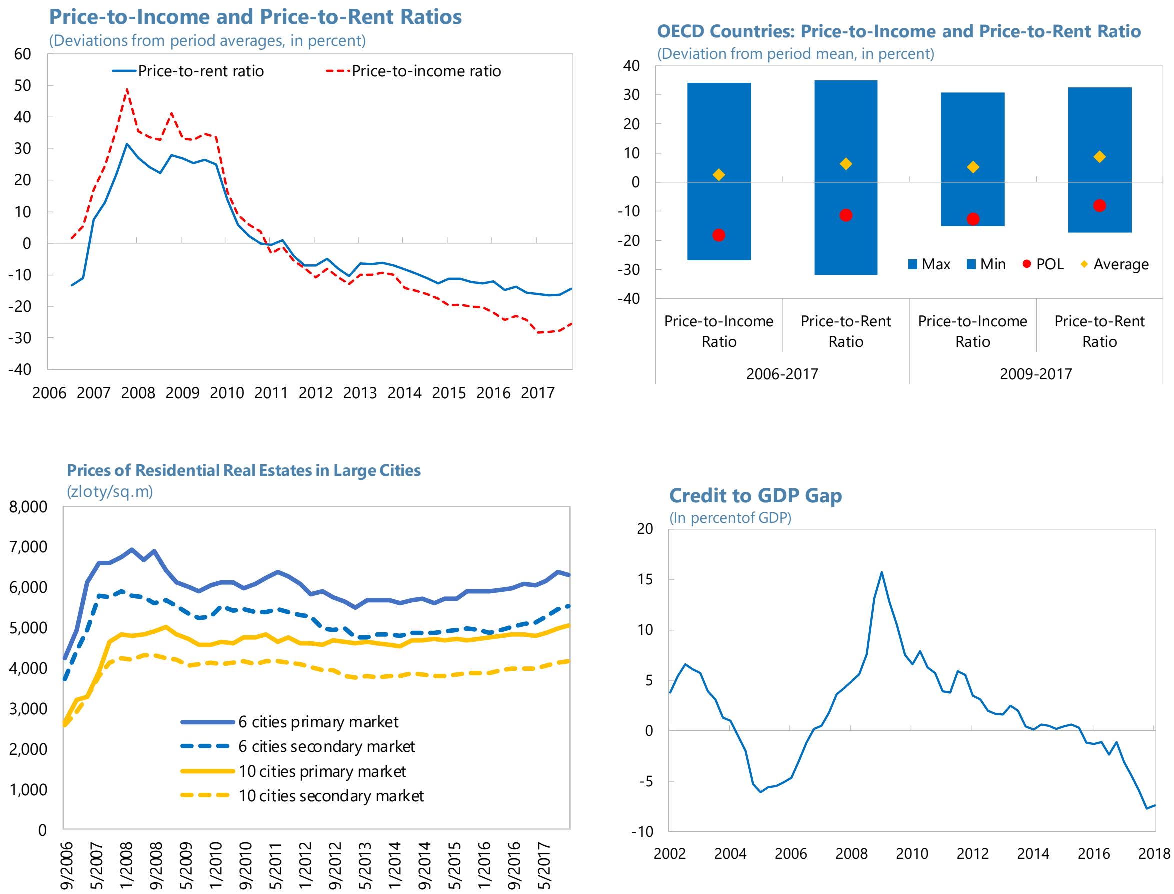



Sources: National Bank of Poland; Polish Financial Supervision Authority; Haver Analytics; KNF; and IMF staff calculations.

1/ Monthly income and expenses.

2/ 12-month sum in percent of assets.

## Figure 8: Republic of Poland: Real Estate Price Indicators and Credit Gap




Sources: IMF Real Estate Markets Module; National Bank of Poland; European Comission; and IMF staff calculations.

## Table 1. Republic of Poland: Selected Economic Indicators, 2015–23

| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Projections | | | |
| **Activity and prices** | | | | | | | | | |
| GDP (change in percent) | 3.8 | 3.1 | 4.8 | 5.1 | 3.6 | 3.0 | 2.8 | 2.8 | 2.8 |
| Domestic demand | 3.3 | 2.3 | 4.9 | 5.9 | 4.4 | 3.5 | 2.7 | 2.7 | 2.7 |
| Private consumption growth | 3.0 | 3.9 | 4.9 | 4.3 | 4.0 | 3.5 | 3.0 | 3.0 | 3.0 |
| Public consumption growth | 2.3 | 1.9 | 3.5 | 3.0 | 2.7 | 2.7 | 2.6 | 2.4 | 2.2 |
| Domestic fixed investment growth | 6.1 | -8.2 | 3.9 | 8.7 | 8.6 | 4.8 | 2.5 | 2.5 | 2.5 |
| Inventories (contribution to growth) | -0.2 | 1.2 | 0.5 | 1.1 | -0.2 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net external demand (contribution to growth) | 0.6 | 0.8 | 0.1 | -0.7 | -0.6 | -0.5 | 0.1 | 0.1 | 0.1 |
| Output gap | -0.5 | -0.5 | 0.2 | 0.5 | 0.5 | 0.3 | 0.1 | 0.0 | 0.0 |
| CPI inflation (percent) | | | | | | | | | |
| Average | -0.9 | -0.6 | 2.0 | 1.7 | 2.3 | 2.6 | 2.5 | 2.5 | 2.5 |
| End of period | -0.5 | 0.8 | 2.1 | 1.2 | 2.6 | 2.6 | 2.5 | 2.5 | 2.5 |
| Unemployment rate (average, according to LFS) | 7.5 | 6.2 | 4.9 | 3.7 | 3.5 | 3.4 | 3.4 | 3.4 | 3.4 |
| **Saving and Investment** (percent of GDP) | | | | | | | | | |
| Saving | 20.5 | 19.3 | 20.1 | 20.7 | 21.0 | 21.0 | 20.7 | 20.5 | 20.2 |
| Investment | 20.5 | 19.5 | 19.7 | 21.1 | 21.6 | 21.8 | 21.7 | 21.7 | 21.6 |
| Saving -Investment | 0.1 | -0.3 | 0.5 | -0.4 | -0.6 | -0.8 | -1.0 | -1.2 | -1.4 |
| **Public finances** (percent of GDP) 1/ | | | | | | | | | |
| General government revenues | 39.0 | 38.9 | 39.7 | 40.9 | 41.1 | 40.4 | 40.0 | 39.7 | 39.5 |
| General government expenditures | 41.7 | 41.1 | 41.1 | 41.4 | 41.9 | 41.7 | 41.6 | 41.6 | 41.6 |
| General government net lending/borrowing | -2.7 | -2.2 | -1.4 | -0.6 | -0.8 | -1.3 | -1.7 | -1.9 | -2.1 |
| General government structural balance | -2.4 | -2.3 | -2.0 | -1.6 | -1.7 | -1.7 | -1.8 | -1.8 | -1.9 |
| General government debt | 51.3 | 54.2 | 50.6 | 48.6 | 46.1 | 44.7 | 44.1 | 43.7 | 43.6 |
| National definition 2/ | 48.7 | 51.9 | 48.4 | ... | ... | ... | ... | ... | ... |
| **Money and credit** | | | | | | | | | |
| Private credit (change in percent, end-period) 3/ | 7.5 | 4.9 | 3.4 | 6.2 | 7.4 | 7.4 | 6.4 | 5.9 | 5.5 |
| Credit to GDP (percent) | 56.9 | 57.8 | 56.0 | 55.5 | 55.8 | 56.6 | 57.3 | 57.7 | 57.9 |
| Deposits (change in percent, end-period) | 8.8 | 8.4 | 3.8 | 7.2 | 6.8 | 6.2 | 5.5 | 5.5 | 5.5 |
| Broad money (change in percent, end-period) | 9.1 | 9.6 | 4.6 | 7.1 | 6.7 | 6.2 | 5.4 | 5.4 | 5.3 |
| Policy Rate (percent) 4/ | 1.6 | 1.5 | 1.5 | 1.5 | ... | ... | ... | ... | ... |
| **Balance of payments** | | | | | | | | | |
| Current account balance (billion U.S. dollars) | -2.7 | -2.5 | 0.6 | -4.4 | -5.4 | -7.1 | -8.8 | -10.3 | -12.1 |
| Percent of GDP | -0.6 | -0.5 | 0.1 | -0.8 | -0.9 | -1.1 | -1.3 | -1.4 | -1.5 |
| Exports of Goods (billion U.S. dollars) | 191.0 | 196.3 | 228.0 | 254.2 | 273.7 | 292.4 | 308.7 | 323.8 | 338.1 |
| Export volume growth | 7.7 | 8.8 | 9.5 | 6.0 | 5.7 | 5.2 | 5.2 | 4.9 | 4.5 |
| Imports of Goods (billion U.S. dollars) | 188.6 | 193.1 | 226.5 | 259.6 | 281.3 | 302.5 | 320.6 | 336.6 | 351.3 |
| Import volume growth | 6.6 | 7.6 | 10.0 | 8.0 | 7.4 | 6.5 | 5.2 | 4.8 | 4.3 |
| Terms of trade (index 1995=100) | 105.2 | 106.3 | 107.0 | 106.0 | 107.0 | 107.6 | 107.3 | 107.0 | 106.9 |
| Official reserves (billion U.S. dollars) | 94.9 | 114.4 | 113.3 | 113.7 | 114.0 | 114.6 | 115.3 | 115.9 | 116.5 |
| In percent of short-term debt plus CA deficit | 85.5 | 88.5 | 97.6 | 101.6 | 98.0 | 98.2 | 98.4 | 98.1 | 100.8 |
| In percent of IMF ARA metric | 111.2 | 126.5 | 112.7 | | | | | | |
| Total external debt (billion U.S. dollars) | 330.0 | 335.9 | 378.6 | 378.0 | 383.0 | 389.9 | 398.8 | 409.5 | 424.6 |
| In percent of GDP | 69.4 | 71.7 | 72.1 | 68.2 | 64.6 | 60.5 | 57.5 | 54.8 | 52.7 |
| **Exchange rate** | | | | | | | | | |
| Exchange rate regime | | | Freely floating | | | | | | |
| Zloty per USD, period average | 3.8 | 3.9 | 3.8 | ... | ... | ... | ... | ... | ... |
| Zloty per Euro, period average | 4.2 | 4.4 | 4.3 | ... | ... | ... | ... | ... | ... |
| Real effective exchange rate (INS, CPI based) 5/ | 105.5 | 100.9 | 104.3 | ... | ... | ... | ... | ... | ... |
| Appreciation (percent change) | -3.4 | -4.4 | 3.4 | ... | ... | ... | ... | ... | ... |
| *Memorandum item:* | | | | | | | | | |
| Nominal GDP (billion zloty) | 1800.2 | 1861.1 | 1988.7 | 2125.4 | 2270.8 | 2404.7 | 2528.4 | 2658.6 | 2795.9 |

Sources: Polish authorities; and IMF staff calculations.

1/ According to ESA2010.

2/ The difference from general government debt reflects different sectoral classification of certain units.

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

4/ NBP Reference Rate (avg).

5/ Annual average (2000=100).

## Table 2. Republic of Poland: Balance of Payments on Transaction Basis, 2013–23

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

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Projections | | | | | |
| Current account balance | -6,744 | -11,444 | -2,659 | -2,458 | 602 | -4,404 | -5,430 | -7,137 | -8,777 | -10,338 | -12,078 |
| percent of GDP | -1.3 | -2.1 | -0.6 | -0.5 | 0.1 | -0.8 | -0.9 | -1.1 | -1.3 | -1.4 | -1.5 |
| Trade balance | 9,692 | 7,755 | 14,575 | 18,721 | 21,843 | 18,705 | 18,896 | 18,806 | 19,020 | 19,479 | 20,538 |
| percent of GDP | 1.8 | 1.4 | 3.1 | 4.0 | 4.2 | 3.4 | 3.2 | 2.9 | 2.7 | 2.6 | 2.5 |
| Balance on Goods | -453 | -4,291 | 2,464 | 3,263 | 1,539 | -5,410 | -7,626 | -10,129 | -11,832 | -12,815 | -13,207 |
| Merchandise exports f.o.b. | 198,107 | 210,628 | 191,023 | 196,340 | 228,046 | 254,181 | 273,661 | 292,393 | 308,733 | 323,804 | 338,092 |
| Merchandise imports f.o.b. | 198,560 | 214,919 | 188,559 | 193,077 | 226,507 | 259,591 | 281,288 | 302,523 | 320,565 | 336,619 | 351,299 |
| Balance on Services | 10,145 | 12,046 | 12,111 | 15,458 | 20,304 | 24,115 | 26,522 | 28,936 | 30,851 | 32,294 | 33,746 |
| Merchandise exports f.o.b. | 44,629 | 48,723 | 45,098 | 49,713 | 58,738 | 66,452 | 71,545 | 76,771 | 81,062 | 85,018 | 88,770 |
| Merchandise imports f.o.b. | 34,484 | 36,677 | 32,987 | 34,255 | 38,434 | 42,337 | 45,022 | 47,836 | 50,210 | 52,725 | 55,024 |
| Exports of goods and services | | | | | | | | | | | |
| percentage change in unit values | 9.2 | 6.8 | -9.0 | 4.2 | 16.6 | 11.5 | 7.7 | 6.8 | 5.6 | 4.9 | 4.4 |
| percentage volume growth | 6.1 | 6.7 | 7.7 | 8.8 | 9.5 | 6.0 | 5.7 | 5.2 | 5.2 | 4.9 | 4.5 |
| Imports of goods and services | | | | | | | | | | | |
| percentage change in unit values | 3.5 | 8.0 | -11.9 | 2.6 | 16.5 | 14.6 | 8.4 | 7.5 | 6.0 | 5.0 | 4.4 |
| percentage volume growth | 1.7 | 10.0 | 6.6 | 7.6 | 10.0 | 8.0 | 7.4 | 6.5 | 5.2 | 4.8 | 4.3 |
| Terms of trade (percentage change) | 1.2 | 1.8 | 1.8 | 1.1 | 0.6 | -0.9 | 1.0 | 0.6 | -0.4 | -0.2 | -0.1 |
| Primary Income balance | -15,896 | -18,649 | -16,284 | -19,645 | -21,112 | -22,868 | -24,055 | -25,517 | -27,224 | -29,015 | -32,404 |
| Secondary Income balance | -540 | -550 | -950 | -1,534 | -129 | -242 | -272 | -426 | -572 | -803 | -212 |
| Capital and financial account balance | 5,946 | 6,955 | 12,084 | 6,285 | 5,415 | 5,191 | 2,906 | -13 | -3,160 | -6,089 | -15,645 |
| Capital account balance (net) | 11,964 | 13,305 | 11,331 | 4,884 | 6,798 | 8,515 | 7,886 | 7,279 | 6,526 | 5,842 | 1,934 |
| Financial account balance (net) | -6,018 | -6,350 | 753 | 1,401 | -1,383 | -3,325 | -4,980 | -7,292 | -9,686 | -11,931 | -17,579 |
| Foreign direct investment (net)[+ = outflows] | -4,206 | -12,977 | -10,152 | -4,398 | -6,463 | -13,797 | -10,657 | -10,464 | -10,180 | -10,179 | -10,170 |
| Assets [Increase = +] | -3,411 | 6,799 | 4,913 | 13,923 | 4,210 | 1,700 | 4,500 | 4,875 | 5,119 | 5,233 | 5,416 |
| Liabilities [Increase = +] | 795 | 19,776 | 15,065 | 18,321 | 10,673 | 15,497 | 15,157 | 15,339 | 15,299 | 15,412 | 15,586 |
| Portfolio investment (net) | -237 | 2,250 | 3,176 | -3,712 | -4,797 | 4,162 | 873 | 114 | -1,114 | -2,777 | -6,928 |
| Assets | 2,162 | 5,866 | 11,035 | -5,936 | 1,217 | 1,300 | 3,350 | 3,518 | 3,588 | 3,660 | 3,733 |
| Liabilities | 2,399 | 3,616 | 7,859 | -2,224 | 6,014 | -2,862 | 2,477 | 3,404 | 4,702 | 6,437 | 10,661 |
| Other investment (net) | -1,810 | 4,137 | 7,572 | -13,334 | 18,862 | 7,269 | 4,435 | 2,463 | 980 | 400 | -1,100 |
| Assets | 1,559 | 4,453 | 5,153 | 2,777 | 6,408 | 6,569 | 4,500 | 3,600 | 2,980 | 2,500 | 1,200 |
| Liabilities | 3,369 | 316 | -2,419 | 16,111 | -12,454 | -700 | 65 | 1,137 | 2,000 | 2,100 | 2,300 |
| Financial derivatives | -710 | -64 | -978 | 184 | -1,197 | -1,350 | 0 | 0 | 0 | 0 | 0 |
| Errors and omissions | -11,238 | -8,211 | -7,919 | -1,025 | -8,783 | -7,435 | -7,435 | -7,435 | -7,435 | -7,435 | -7,435 |
| Financing | | | | | | | | | | | |
| Reserve assets [Increase = +] | 945 | 304 | 1,135 | 22,661 | -7,788 | 391 | 369 | 594 | 628 | 626 | 619 |
| *Memorandum items:* | | | | | | | | | | | |
| Current plus capital account (percent of GDP) | 1.0 | 0.3 | 1.8 | 0.5 | 1.4 | 0.7 | 0.4 | 0.0 | -0.3 | -0.6 | -1.3 |
| Gross official Reserve | 106,220 | 100,438 | 94,922 | 114,391 | 113,279 | 113,670 | 114,039 | 114,634 | 115,262 | 115,887 | 116,506 |
| in months of imports | 6.4 | 5.6 | 6.0 | 7.1 | 6.0 | 5.3 | 4.9 | 4.5 | 4.3 | 4.1 | 4.0 |
| Gross official Reserve (euro) | 79,976 | 75,583 | 85,544 | 103,371 | 100,322 | … | … | … | … | … | … |
| Net Reserves (USD) 1/ | 95,535 | 93,050 | 86,805 | 91,820 | 97,661 | 99,253 | 100,622 | 101,716 | 102,544 | 103,170 | 103,789 |
| Ratio of gross official reserves to short-term debt 2/ | 72.7 | 89.3 | 87.4 | 88.1 | 101.5 | 106.8 | 104.4 | 106.2 | 107.9 | 109.3 | 110.7 |
| Ratio of gross official reserves to ST debt plus CA deficit 2/ | 67.4 | 87.2 | 85.5 | 88.5 | 97.6 | 101.6 | 98.0 | 98.2 | 98.4 | 98.1 | 100.8 |
| Ratio of gross ofiicial reserves to IMF ARA metric | 105.6 | 110.6 | 111.2 | 126.5 | 112.7 | … | … | … | … | … | … |
| Ratio of net official reserves to IMF ARA metric | 95.0 | 102.5 | 101.7 | 101.5 | 97.6 | | | | | | |
| Total external debt (percent of GDP) | 73.2 | 65.4 | 69.4 | 71.7 | 72.1 | 68.2 | 64.6 | 60.5 | 57.5 | 54.8 | 52.7 |
| Total external debt (percent of exports) | 158.2 | 137.5 | 140.2 | 137.2 | 132.0 | 117.9 | 111.0 | 105.6 | 102.3 | 100.2 | 99.5 |
| External debt service (percent of exports) | 57.0 | 56.2 | 49.0 | 55.3 | 47.7 | 37.8 | 35.3 | 32.8 | 31.0 | 29.5 | 28.3 |

Sources: National Bank of Poland; and IMF staff calculations.

1/ Net reserves are calculated as a difference between gross reserves (official and other FX reserves) and FX liabilities.

2/ Short-term debt is on remaining maturity.

## Table 3. Republic of Poland: Statement of Operations of General Government, 2013–23

(Percent of GDP)

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Projections | | | | | |
| **Revenue** | 38.5 | 38.7 | 39.0 | 38.9 | 39.7 | 40.9 | 41.1 | 40.4 | 40.0 | 39.7 | 39.5 |
| Taxes | 19.6 | 19.6 | 19.8 | 20.6 | 21.2 | 21.9 | 21.9 | 21.7 | 21.6 | 21.6 | 21.5 |
| Personal income tax | 4.6 | 4.6 | 4.7 | 4.8 | 4.9 | 5.2 | 5.2 | 5.1 | 5.0 | 5.0 | 4.9 |
| Corporate income tax | 1.8 | 1.7 | 1.8 | 1.8 | 1.9 | 2.1 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| VAT | 7.0 | 7.1 | 7.0 | 7.1 | 7.8 | 8.0 | 8.0 | 8.0 | 8.0 | 8.0 | 8.0 |
| Excises | 3.7 | 3.6 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 |
| Other taxes | 2.5 | 2.6 | 2.8 | 3.3 | 3.1 | 3.1 | 3.1 | 3.1 | 3.1 | 3.1 | 3.1 |
| Social contributions | 13.4 | 13.2 | 13.5 | 13.8 | 13.9 | 14.1 | 14.0 | 14.0 | 13.9 | 13.8 | 13.7 |
| Other revenue | 5.5 | 5.8 | 5.6 | 4.4 | 4.7 | 4.9 | 5.2 | 4.7 | 4.5 | 4.3 | 4.3 |
| Capital revenue | 1.0 | 1.2 | 1.1 | 0.6 | 0.7 | 0.9 | 1.1 | 0.8 | 0.5 | 0.4 | 0.3 |
| Sales of goods and services | 2.4 | 2.5 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 |
| Other current revenue | 2.2 | 2.1 | 2.1 | 1.4 | 1.6 | 1.6 | 1.8 | 1.6 | 1.6 | 1.6 | 1.6 |
| **Expenditure** | 42.6 | 42.4 | 41.7 | 41.1 | 41.1 | 41.4 | 41.9 | 41.7 | 41.6 | 41.6 | 41.6 |
| Expense | 38.8 | 38.1 | 37.3 | 37.9 | 37.4 | 37.2 | 37.2 | 37.3 | 37.6 | 37.7 | 37.8 |
| Compensation of employees | 10.4 | 10.4 | 10.2 | 10.2 | 10.2 | 10.1 | 10.1 | 10.2 | 10.3 | 10.4 | 10.4 |
| Use of goods and services | 5.8 | 5.9 | 5.9 | 5.7 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 |
| Interest | 2.5 | 1.9 | 1.8 | 1.7 | 1.6 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 |
| Subsidies | 0.7 | 0.7 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| Social benefits | 16.4 | 16.3 | 16.2 | 17.2 | 17.0 | 16.8 | 16.9 | 16.9 | 17.1 | 17.1 | 17.2 |
| Other expense 1/ | 3.0 | 2.9 | 2.8 | 2.5 | 2.7 | 2.7 | 2.7 | 2.7 | 2.7 | 2.7 | 2.7 |
| Other current expenditure | 2.3 | 2.1 | 2.2 | 2.0 | 1.9 | 1.9 | 1.9 | 1.9 | 1.9 | 1.9 | 1.9 |
| Capital transfers | 0.6 | 0.7 | 0.6 | 0.5 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 |
| Net acquisition of nonfinancial assets | 3.8 | 4.2 | 4.2 | 3.2 | 3.8 | 4.2 | 4.6 | 4.4 | 4.1 | 3.9 | 3.8 |
| **Gross operating balance** | -0.3 | 0.6 | 1.6 | 0.8 | 2.3 | 3.7 | 3.8 | 3.1 | 2.4 | 2.0 | 1.7 |
| **Net lending/borrowing** | -4.1 | -3.6 | -2.7 | -2.2 | -1.4 | -0.6 | -0.8 | -1.3 | -1.7 | -1.9 | -2.1 |
| **Structural fiscal balance** | -3.6 | -3.1 | -2.4 | -2.3 | -2.0 | -1.6 | -1.7 | -1.7 | -1.8 | -1.8 | -1.9 |
| **Net financial transactions** | -4.2 | -3.7 | -2.7 | -2.3 | -1.5 | -0.6 | -0.8 | -1.3 | -1.7 | -1.9 | -2.1 |
| Net acquisition of financial assets | -1.2 | 0.8 | 0.0 | 2.0 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Currency and deposits | -1.1 | 0.6 | -0.9 | 0.9 | -0.2 | -0.4 | -0.4 | -0.5 | -0.4 | -0.3 | -0.3 |
| Debt securities | 0.2 | -0.2 | 0.0 | 0.1 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Loans | 0.0 | 0.2 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Equity and investment fund shares | -0.6 | 0.2 | -0.1 | -0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other financial assets | 0.4 | 0.0 | 1.0 | 1.1 | -0.1 | 0.4 | 0.4 | 0.5 | 0.4 | 0.3 | 0.3 |
| Net incurrence of liabilities | 2.9 | 4.4 | 2.6 | 4.3 | 1.4 | 0.6 | 0.8 | 1.4 | 1.7 | 2.0 | 2.2 |
| Currency and deposits | 0.0 | 0.0 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Debt securities | 2.1 | -5.9 | 1.7 | 3.8 | 1.1 | 0.1 | 0.4 | 1.0 | 1.4 | 1.6 | 1.8 |
| Loans | 0.7 | 0.9 | 0.6 | -0.1 | -0.1 | 0.3 | 0.3 | 0.2 | 0.1 | 0.1 | 0.2 |
| Other liabilities | 0.1 | 9.3 | 0.0 | 0.7 | 0.5 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| *Adjustment and statistical discrepancies* | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| *Memorandum items:* | | | | | | | | | | | |
| Cyclically-adjusted balance | -3.6 | -3.1 | -2.4 | -2.3 | -2.0 | -1.6 | -1.7 | -1.7 | -1.8 | -1.8 | -1.9 |
| Primary balance | -1.6 | -1.7 | -0.9 | -0.6 | 0.1 | 0.9 | 0.7 | 0.2 | -0.2 | -0.5 | -0.7 |
| Cyclically-adjusted primary balance | -1.1 | -1.2 | -0.6 | -0.6 | -0.5 | -0.1 | -0.2 | -0.2 | -0.3 | -0.3 | -0.4 |
| General government debt | 55.7 | 50.4 | 51.3 | 54.2 | 50.6 | 48.6 | 46.1 | 44.7 | 44.1 | 43.7 | 43.6 |
| General government liabilities | 65.0 | 70.1 | 69.4 | 72.1 | 67.8 | 64.0 | 61.6 | 60.2 | 59.6 | 59.2 | 59.1 |
| General government financial assets | 27.4 | 28.0 | 27.4 | 29.0 | 27.1 | 24.4 | 23.4 | 22.4 | 21.4 | 20.4 | 19.4 |
| Nominal GDP in billions of zloty | 1,657 | 1,720 | 1,800 | 1,861 | 1,989 | 2,125 | 2,271 | 2,405 | 2,528 | 2,659 | 2,796 |

Sources: Eurostat; and IMF staff calculations.

1/ Includes grants.

## Table 4. Republic of Poland: Monetary Accounts, 2013–18

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 Proj. |
|---|---|---|---|---|---|---|
| | (Billions of zlotys) | | | | | |
| **Central bank** | | | | | | |
| Net foreign assets | 297 | 332 | 349 | 390 | 356 | 397 |
| Official reserve assets | 320 | 352 | 370 | 478 | 394 | 436 |
| Net domestic assets | -134 | -142 | -139 | -171 | -128 | -148 |
| Net claims on government | -8 | -21 | -15 | -28 | -22 | -22 |
| Claims on banks 1/ | -117 | -85 | -74 | -81 | -94 | -114 |
| Other items, net | -9 | -36 | -50 | -62 | -11 | -11 |
| Base money | 164 | 192 | 212 | 220 | 232 | 249 |
| Currency issued | 126 | 143 | 163 | 187 | 198 | 213 |
| Bank reserves | 38 | 49 | 49 | 33 | 34 | 36 |
| **Deposit money banks** | | | | | | |
| Net foreign assets | -154 | -159 | -162 | -156 | -123 | -96 |
| Net domestic assets | 990 | 1,067 | 1,150 | 1,226 | 1,235 | 1,286 |
| Net claims on the central bank 1/ | 40 | 49 | 51 | 36 | 38 | 60 |
| Net claims on government | 178 | 216 | 241 | 297 | 302 | 300 |
| Claims on private sector | 886 | 952 | 1,023 | 1,074 | 1,111 | 1,180 |
| Claims on corporates | 275 | 298 | 324 | 340 | 358 | 381 |
| Claims on households | 562 | 593 | 633 | 665 | 676 | 719 |
| Claims on other | 49 | 61 | 67 | 69 | 76 | 81 |
| Other items, net | -113 | -150 | -165 | -181 | -216 | -253 |
| Deposits | 836 | 908 | 988 | 1,070 | 1,111 | 1,191 |
| **Consolidated banking system** | | | | | | |
| Net foreign assets | 143 | 173 | 187 | 234 | 233 | 301 |
| Net domestic assets | 836 | 886 | 968 | 1,031 | 1,092 | 1,117 |
| Claims on government | 170 | 195 | 226 | 269 | 280 | 277 |
| Claims on private sector | 886 | 952 | 1,023 | 1,074 | 1,111 | 1,180 |
| Other items, net | -220 | -261 | -281 | -312 | -299 | -340 |
| Broad money (M3) | 979 | 1,059 | 1,155 | 1,266 | 1,324 | 1,419 |
| *Memorandum items:* | (Percentage change from end of previous year) | | | | | |
| Base money | -1.9 | 16.8 | 10.7 | 3.9 | 5.2 | 7.4 |
| Broad money (M3) | 6.2 | 8.2 | 9.1 | 9.6 | 4.6 | 7.1 |
| Net domestic assets | 11.1 | 6.0 | 9.2 | 6.6 | 5.9 | 2.3 |
| Net foreign assets | -15.5 | 20.9 | 8.2 | 25.2 | -0.7 | 29.6 |
| Net claim on government | 26.6 | 14.9 | 15.8 | 19.1 | 4.0 | -0.9 |
| Claims on private sector | 4.4 | 7.5 | 7.5 | 4.9 | 3.4 | 6.2 |
| Deposit growth | 6.9 | 8.6 | 8.8 | 8.4 | 3.8 | 7.2 |
| | (Percent of GDP, unless otherwise noted) | | | | | |
| Broad money (M3) | 59.1 | 61.6 | 64.2 | 68.1 | 66.8 | 66.8 |
| Private sector credit | 53.5 | 55.4 | 56.9 | 57.8 | 56.0 | 55.5 |
| Broad money Velocity (GDP/M3) | 1.7 | 1.6 | 1.6 | 1.5 | 1.5 | 1.5 |
| Money multiplier (M3/base money) | 6.0 | 5.5 | 5.4 | 5.7 | 5.7 | 5.7 |

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

## Table 5. Republic of Poland: Financial Soundness Indicators, 2012–18

(In percent)

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017Q1 | 2017Q2 | 2017Q3 | 2017Q4 | 2018Q1 | 2018Q2 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Capital adequacy 1/** | | | | | | | | | | | |
| Regulatory capital to risk-weighted assets | 14.8 | 15.1 | 14.7 | 16.0 | 17.2 | 17.4 | 18.0 | 18.0 | 18.0 | 18.1 | 18.1 |
| Regulatory Tier I capital to risk-weighted assets | 13.1 | 13.5 | 13.5 | 14.6 | 15.6 | 15.9 | 16.5 | 16.5 | 16.2 | 16.2 | 16.1 |
| NPLs net of provisions to capital 2/ | 25.7 | 24.4 | 23.9 | 21.7 | 20.5 | 19.3 | 18.9 | 19.0 | 17.6 | 18.6 | 18.0 |
| Bank capital to assets 3/ | 10.9 | 10.9 | 11.2 | 10.7 | 10.5 | 10.2 | 9.9 | 9.9 | 10.0 | 9.8 | 9.9 |
| **Asset composition and quality** | | | | | | | | | | | |
| NPLs to gross loans (nonfinancial sector) | 8.8 | 8.5 | 8.1 | 7.5 | 7.1 | 6.9 | 6.9 | 6.9 | 6.8 | 7.7 | 7.3 |
| Provisioning coverage for nonperforming loans (nonfinancial sector) | 54.3 | 55.0 | 54.8 | 54.3 | 53.5 | 54.4 | 54.5 | 54.5 | 55.9 | 58.2 | 56.9 |
| Sectoral distribution of loans to nonfinancial sector | | | | | | | | | | | |
| Loans to households | 65.7 | 66.1 | 65.7 | 65.3 | 65.1 | 64.6 | 64.4 | 64.1 | 64.2 | 63.9 | 64.2 |
| Loans to non-financial corporations | 33.7 | 33.3 | 33.7 | 34.1 | 34.2 | 34.8 | 34.9 | 35.2 | 35.2 | 35.4 | 35.2 |
| **Earnings and profitability** | | | | | | | | | | | |
| Return on average assets (after tax) | 1.2 | 1.1 | 1.1 | 0.8 | 0.8 | 0.8 | 0.7 | 0.8 | 0.8 | 0.8 | 0.8 |
| Return on average equity (after tax) RORC 1/ | 13.8 | 12.1 | 12.4 | 9.1 | 9.2 | 8.7 | 7.8 | 8.1 | 8.2 | 8.5 | 8.6 |
| Interest margin to gross income 4/ | 60.3 | 62.5 | 64.4 | 63.2 | 64.0 | 65.0 | 68.1 | 68.6 | 68.7 | 69.3 | 69.4 |
| Noninterest expenses to gross income 5/ | 51.6 | 54.4 | 51.8 | 59.8 | 58.6 | 59.6 | 60.8 | 59.5 | 57.9 | 58.0 | 57.7 |
| **Liquidity** | | | | | | | | | | | |
| One month liquidity gap to assets 6/ | -38.7 | -42.1 | -41.3 | -43.6 | -46.4 | -47.0 | -47.8 | -47.8 | -48.4 | -48.1 | -46.0 |
| Loans to deposits 7/ | 108.8 | 104.6 | 100.8 | 98.2 | 94.5 | 96.3 | 97.9 | 98.2 | 93.9 | 96.0 | 96.9 |
| **Sensitivity to market risk** | | | | | | | | | | | |
| Net open positions in FX to capital 1/ | 0.1 | -0.1 | 0.1 | 1.0 | 0.3 | 0.1 | -0.1 | 0.0 | 0.2 | 0.1 | -0.1 |

Source: NBP, received on September 18, 2018.

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

1/ Data for domestic banking sector (Bank Gospodarstwa Krajowego excluded). Since 2014: data on capital in accordance with CRDIV/CRR.

2/ "NPLs net of provisions to capital" calculated as impaired loans net of provisions (non- financial sector) to total regulatory capital.

3/ "Bank capital to assets" calculated as Tier I capital to assets.

4/ "Interest margin to gross income" calculated as interest income (interest revenues minus interest expenses) to net income from banking activity

5/ "Noninterest expenses to gross income" calculated as operating cost (the sum of banks's general expense and amortisation) to net income from banking activity.

6/ "One month liquidity gap to assets" calculated as (1M assets - 1M liabilities)/assets.

7/ "Loans to deposits" include non-financial sector only.

# Annex I. Implementation of Past Fund Advice

| 2017 Article IV Recommendations | Policy Actions |
|---|---|
| **Monetary Policy** | |
| Hold the policy rate steady for now | The policy interest rate remains on hold amid inflation persistently below the mid-point of the target. |
| Tighten if accelerating core inflation threatens the inflation objectives. | |
| Provide clear forward guidance based on timely updates of inflation outlook, flagging the key triggers for a rate change | Recent MPC communication is more conditional on inflation outlook. |
| **Fiscal Policy** | |
| Start consolidation as soon as possible | Consolidation advanced in 2017–18, with the structural deficit reaching a historically-low level. |
| Comprehensive fiscal structural reforms to support consolidation, including keeping the VAT rate at the current level beyond 2018, eliminating preferential VAT rates and exemptions, rationalizing current spending through expenditure reviews and gradually phasing out preferential pension regimes. | The VAT rate remains unchanged in 2018, while conditions for a rate cut are now explicitly linked to the debt level and deficit deviations from the MTO; Costs of the child benefit program declined in 2018 due to efforts to reduce fraud; No changes to preferential VAT rates, exemptions or preferential pension regimes. |
| **Financial Sector Policy** | |
| A case-by-case approach to FX mortgage restructuring is preferable. | Legislative action on the legacy portfolio of FX mortgages has so far been avoided. |
| Continue to monitor the impact of the bank asset tax and stand ready to revise its design if adverse effects become apparent. | No changes on the design of the tax have been made. |
| Maintain strong and independent supervision and a robust macroprudential framework | A new legislation has been approved to change the governance structure of the PFSA, likely further damaging the financial supervisor's independence and operational efficiency. |
| **Structural Reforms** | |
| Prioritize and implement the Responsible Development Strategy, focusing on streamlining product market regulations, more effective labor market policies, efficient public investment in upgrading the infrastructure and targeted R&D support. | Guided by the Responsible Development Strategy, initiatives have been adopted or planned to improve the business climate, especially for smaller firms and startups, and to incentivize innovation and R&D. EU-funded infrastructure investment increased sharply in 2018. |
| *Source: IMF staff.* | |

# Annex II. Summary of FSAP Recommendations

## Table 1. Poland FSAP 2018: Key Recommendations

| Recommendations | Agency[1] | Time[2] |
|---|---|---|
| ***Risk Analysis*** | | |
| Address weaknesses in medium-sized banks, including the affiliating banks for cooperative banks, given their systemic importance in the banking system | PFSA | I-NT |
| Replace the asset tax on financial institutions with a tax on profits and/or remuneration | MoF | I-NT |
| Pursue bilateral negotiations to restructure distressed FX loans instead of law changes | PFSA, MoF | I |
| Close data gaps and improve data for credit risk and interconnectedness analysis. | PSFA | I-NT |
| ***Financial Sector Oversight*** | | |
| Reform and strengthen arrangements for supervision, based on the principles that the PFSA should have (i) sufficient staffing and resources, (ii) operational independence, (iii) effective governance, and (iv) appropriate formal status in the determination of regulatory priorities | MoF, PFSA, NBP | I |
| ***Bank*** | | |
| Provide missing essential enforcement powers including (i) those to ease rigidities constraining prompt corrective action due to Administrative Code procedures; and (ii) power to dismiss both management and supervisory board members | MoF, PFSA | NT |
| Increase sampling of loans across the supervisory and business cycle | PFSA | NT |
| ***Insurance*** | | |
| Implement approach to supervision of the insurance-led financial conglomerate | PFSA | I |
| Review approach to insurance conduct of business supervision across the relevant agencies to increase preventative work, especially by the PFSA | MoF, PFSA | NT |
| ***Capital Markets*** | | |
| Review and clarify regulations on private placements, market conduct supervision | MoF, PFSA | I |
| Conduct periodic assessments of the enforcement functions | PFSA | I |
| Strengthen criminal law enforcement | criminal law enforcement | NT-MT |
| ***Macroprudential Policies*** | | |
| Include vulnerability assessments of payment and settlement systems in the FSR and overall systemic risk monitoring | NBP | I |
| Ensure the timely and substantive vetting of all use of macroprudential instruments by the FSC-M, in order to confirm the FSC-M's overall responsibility in this field | Members of the FSC-M | I |
| ***Crisis Management and Bank Resolution*** | | |
| Propose legal amendments to provide for (i) more timely petitions for bank bankruptcy; (ii) harmonize the triggers for bankruptcy and use of resolution powers both; (iii) address the need for third-party opinion on solvency; (iv) conduct P&A transactions in lieu of a deposit payout; and (v) BGF independence | MOF with KNF & BGF | NT |
| Require recovery plans for affiliating banks, significant credit unions, and banks undergoing rehabilitation | PFSA | I |
| ***Cooperative Banks and Credit Unions*** | | |
| Strengthen the supplementary internal control and resolution arrangements to address elevated risk and develop strategies to promote further integration/consolidation | PFSA, MoF, ABs, IPS | I |
| Develop and implement a restructuring strategy to (i) consolidate viable and resolve non-viable credit unions through exit; (ii) revisit whether a stand-alone credit union sector remains appropriate | PFSA, MoF | I |

[1] Agencies: MoF=Ministry of Finance; NBP=National Bank of Poland; PFSA=Polish Financial Supervision Authority; BGF=Bank Guarantee Fund; FSC-M=Financial Stability Committee-Macroprudential

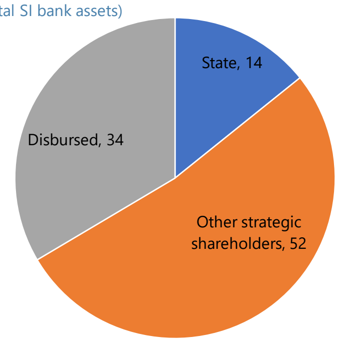
[2] Time Frame: C = continuous; I (immediate) = within one year; NT (near term) = 1–3 years; MT (medium term) = 3–5 years

# Annex III. The Role of State in the Polish Financial Sector

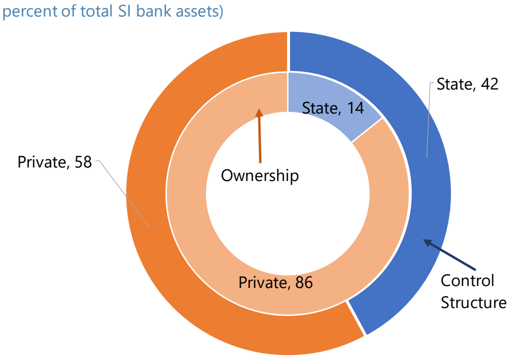
**1. State ownership of the financial sector has risen significantly since 2015, with the adoption of the "re-Polonization" strategy.** In Poland's early stage of transition (late 1990s to early 2000s), large scale privatization toward foreign investors led to predominantly foreign ownership of the financial sector. At its peak in 2008, the share of foreign investment in the banking sector amounted to about three-quarters of total assets.[1] Since the global financial crisis, domestic ownership of the banking sector has risen, and in recent years, this has been driven by increased state ownership.[2] Following the sale of some foreign shareholdings, including in the second-largest Polish bank, Pekao, to state-controlled nonbank institutions, state ownership in the domestic systemically-important banks (SIBs) has risen from 7 percent at end-2014 to 14 percent in 2018.[3,4]

**2. The Polish state's influence over individual banks, and the sector as a whole, is considerably larger than suggested by its ownership share.** While the state owns about 14 percent of total banking assets, it does not have a majority stake in any individual domestic SIB. Nonetheless, the dispersed structure of private shareholding in several banks allows the state—as a minority shareholder—to have disproportionate influence and control. Notably, the state holds minority-but-controlling stakes in the two-largest commercial banks and the largest insurance-led group (which, in turn, owns shares in banks), giving it control of three SIBs (accounting for 42 percent of total SIB assets). The share of state-controlled SIBs is larger in Poland than in the euro-area (EA) on average, but smaller than in those EA countries where governments acquired banks during post-banking crisis cleanups.[5]

**Ownership Structure of Domestic SI Banks**
(In percent of total SI bank assets)




**SI Banks: Ownership vs. Control**
(In percent of total SI bank assets)




Sources: GPW Group; Marketscreener.com; Wall Street Journal; and Bloomberg L.P.
Note: Latest data available as of November 15, 2018.

[1] "*Financial System in Poland 2014,*" National Bank of Poland, 2014.

[2] State ownership includes both direct and indirect (through state-controlled entities) shareholdings held by the government.

[3] The 2018 list of SIBs is based on the PFSA's notification to the European Systemic Risk Board in August 2018.

[4] This excludes the state-owned development bank, BGK (with around 8 percent of total banking assets).

[5] According to Veron (2017), for the aggregate EA SIBs, public ownership (i.e., where the public sector is the majority shareholder) accounted for 9.8 percent of EA SIB assets; nationalized SIBs (i.e., those rescued by the public sector following banking crises) were 5.9 percent; and public control (i.e., where the public sector is the single largest minority shareholder) were 13.8 percent at end-2015.

**Table 1. Poland: Governance Structure of Domestic Systemically-Important Banks**

| Systemically Important Banks [1] | Assets 2018 [2] (mn zloty) | Largest Single Shareholder (in percent) *Ultimate Shareholder* | Other Strategic Shareholders [3] (in percent) | Dispersed Investors (in percent) | Entity in Control [4] |
|---|---|---|---|---|---|
| PKOBP | 295 | Government of Poland (29) | 16 | 55 | State |
| PEKAO | 183 | PTE PZU SA (20), PFR (13) [5] *(Government of Poland)* | 11 | 56 | State |
| SANPL | 169 | Private majority owned (69) | 5 | 26 | Private Investor |
| MBANK | 134 | Private majority owned (69) | 6 | 25 | Private Investor |
| ING BANK SLASKI SA | 127 | Private majority owned (75) | 8 | 17 | Private Investor |
| Bank Polskiej Spółdzielczości | 77 | Cooperatives owned (100) | … | … | Cooperatives |
| BNP PARIBAS | 72 | Private majority owned (84) | … | 17 | Private Investor |
| ALIOR | 71 | PTE PZU SA (32) *(Government of Poland)* | 19 | 49 | State |
| Deutsche Bank Polska S.A. | 63 | Private majority owned (100) | … | … | Private Investor |
| HANDLOWY W WARSZAWIE | 45 | Private majority owned (75) | … | 25 | Private Investor |
| SGB-Bank S.A. | 20 | Cooperatives owned (100) | … | … | Cooperatives |

Sources: GPW Group; Marketscreener.com; Wall Street Journal; and Bloomberg L.P.

1/ As of August 2018.

2/ Latest available on Marketscreener.com as of November 15, 2018.

3/ Include investors with 5% or more shareholdings.

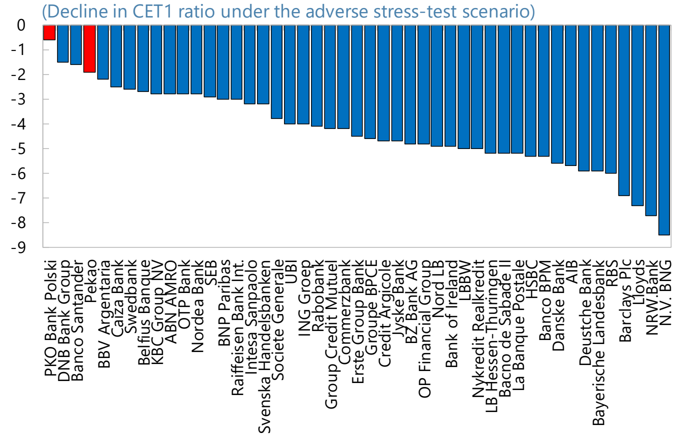
4/ "Entity in Control" refers to the shareholder with controlling stakes in the institution.

5/ The largest two shareholders of Pekao have the same ultimate shareholder (government of Poland) and hence are both included.

**3. The state-controlled banks are strong, with the two-largest among the best-performing of all systemic EU banks in the 2018 EBA stress tests.** The 2018 EBA stress tests (based on end-2017 data) cover the 48 largest European banks. The two largest Polish banks (both state-controlled) were found to be the most resilient, even though the adverse scenario applied to Poland in the stress test was one of the most severe among all countries included. These results confirm that the partial divestment by the foreign bank of its holdings in Pekao was not motivated by concerns about the health of the bank or the Polish banking system. The FSAP stress tests confirm the resilience of state-controlled banks in general, and the largest two banks in particular. Bank-level data also shows that large state-controlled and foreign banks are very profitable, although medium-sized and smaller banks are less so, especially those owned or controlled by the state.

**2018 EBA Stress Test Results**

(Decline in CET1 ratio under the adverse stress-test scenario)



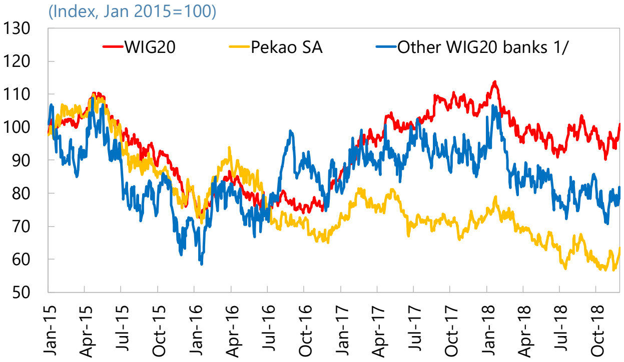

Source: European Banking Authority (2018).

**Table 2. Return-on-Equity (ROE) by Bank Size and Control Structure, 2016**
(in percent)

| | State-controlled | Domestic Private-controlled | Foreign-controlled |
|---|---|---|---|
| **Large** | 1.74 | … | 1.89 |
| **Medium** | 0.48 | 0.71 | 0.98 |
| **Small** | 0.20 | 0.50 | 0.80 |

1/ Each cell presents the weighted (by assets) average of bank-level ROE.
Source: Fitch Connect and IMF staff calculations.

**Equity Prices of Pekao and Other WIG20 Banks**
(Index, Jan 2015=100)




Sources: Bloomberg L.P.; and IMF staff calculations.
1/ Weighted-average (by market capitalization) of the equity prices of other large banks included in the WIG20 index.

**4. However, some unease among minority investors about increased state control may exist.** In mid-2016, when the prospective buyers of Pekao became known, the bank's equity price decoupled from those of other large banks included in the WIG 20 index of the 20-largest companies listed on the Warsaw Stock Exchange, and the gap from the weighted average of other WIG20 banks' equity prices now stands at around 25 percent. With Pekao very profitable, and among the most resilient in the EU, the decoupling may be in response to the new management's announcement that the bank would curtail dividends to build-up capital to support faster credit expansion.

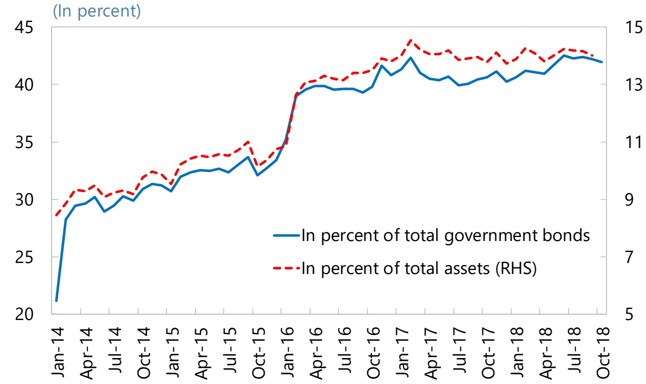
**5. Another aspect of the state's role in the banking sector is the increase in banks' holdings of government bonds.** The introduction of the FIAT, which exempts government bonds, induced holdings to rise from 11 percent of total bank assets at end-2015 to just below 15 percent in October 2018.[6] This is consistent with the government's goal of securing more-stable financing and lower rollover risk for the public sector; however, banks have become more exposed to any decline in government bond prices, as confirmed by the 2018 FSAP simulations.

**6. A large state footprint in the financial sector increases the need for sound and independent supervision.** The fact that the large state-controlled financial institutions are publicly-listed could improve transparency over their operations and policies as listing requires compliance

[6] This corresponds to 33 percent of zloty-denominated government bonds at end-2015 and 42 percent in October 2018.

with strict disclosure requirements. However, the co-existence of several large state-controlled banks could reduce competition if their operations were coordinated, even without a legal merger. Also, state-controlled banks may be perceived as having a stronger implicit government guarantee, which could adversely affect other banks. Therefore, supervision should focus on maintaining competition and ensuring a level playing field across banks. In addition, protecting the rights of minority shareholders within state-controlled financial institutions should be a priority.

**Banks' Holdings of Government Bonds**
(In percent)




Sources: Ministry of Finance; Polish Financial Supervision Authority; and IMF staff calculations.

# Annex IV. Strengthened Resilience to EM Turbulence

**1. During the EM sell-off that began in mid-April 2018, the extent of pressure on individual EMs has varied.** Countries that were most affected are those with weak fundamentals, although more-generalized contagion remains a future possibility. With the escalation of global trade tensions, markets are also focusing on vulnerabilities posed by trade links and participation in supply chains, as well as some country-specific considerations.

**2. While Poland was affected by the sell-off in 2018, it weathered the episode relatively well, both in comparison to other EMs and to previous episodes of financial market turbulence:**

- In 2018, the zloty had depreciated by 8 percent against the US dollar and 3 percent against the euro; equity prices had declined by 10 percent and spreads on government bonds had edged up and international reserves had declined marginally. These effects were considerably smaller than for the EM average.

- During the "taper tantrum" episode (in May 2013), the magnitude of the effects on Poland's currency, asset prices and reserves were closer to those for the average EM.

**3. Poland's increased resilience during the recent EM sell-off likely reflects its strengthened macro-financial fundamentals.** Lower fiscal and external imbalances have reduced indebtedness and, together with more conservative debt management practices, lowered refinancing needs. As a result, nonresident holdings of government debt and banks' reliance on foreign financing have declined sharply. These improvements, which began even before the GFC, reflect sound macro policies and the sustained accumulation of international reserves in the context of the FCL. Poland's recent resilience occurred despite its exit from the FCL in November 2017.[1]

**4. Poland scores better than most other EMs on all-but-one key indicator, viz, gross external financing needs, which remains above the EM median.** The large size and persistence of this indicator reflects the significant share of inward FDI in the form of intercompany loans. This debt comprises more than 40 percent of total private gross external debt and tends to have a short maturity (about 40 percent has a maturity of less than one year, although in effective terms, these loans tend to be automatically rolled over).

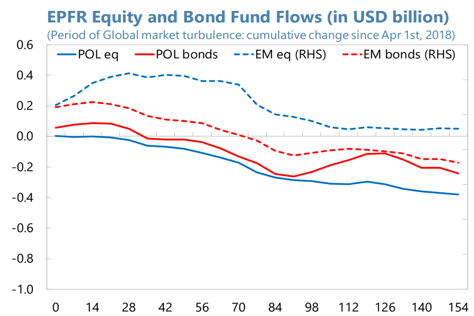
**5. Reflecting the relatively modest selling pressure during the 2018 episode, Poland's policy response has been muted.** No changes were made to interest rates or reserve requirements. There is no indication that the NBP provided liquidity support to banks or intervened in the spot FX market.

[1] In May 2009, the IMF approved a SDR13.69 Flexible Credit Line (FCL) for Poland, which the authorities treated as precautionary. The FCL was aimed at mitigating the risk of spillovers from the global crisis and supporting the authorities' policy frameworks

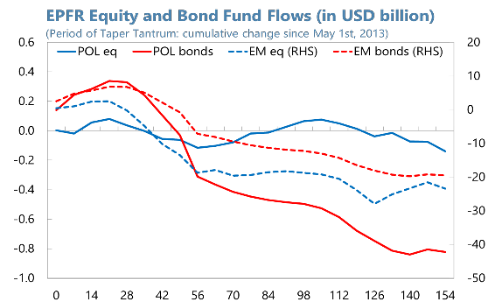
## Figure 1. Poland Assets Performance since mid-April 2018 and Relative to 2013 "Taper Tantrum" Event

**Since April 1st, 2018** | **Since May 1st, 2013**

*EM Fund Flows (billions of US dollars cumulative change)*

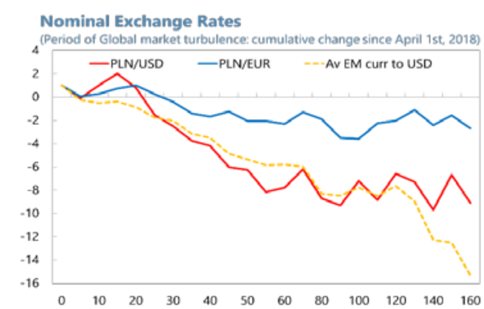



Source: Haver Analytics.

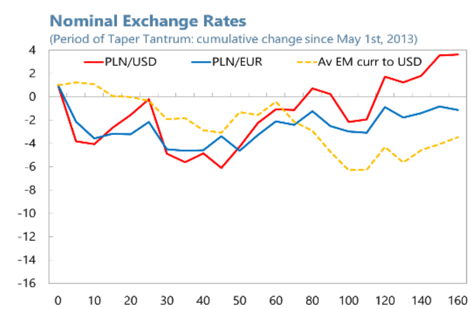



Source: Haver Analytics.

*Currencies vs USD and EUR (indexed to the start of the period)*

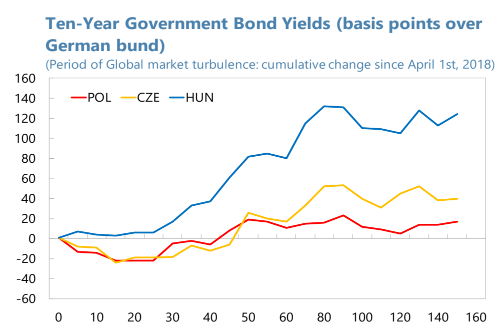



Source: Haver Analytics.

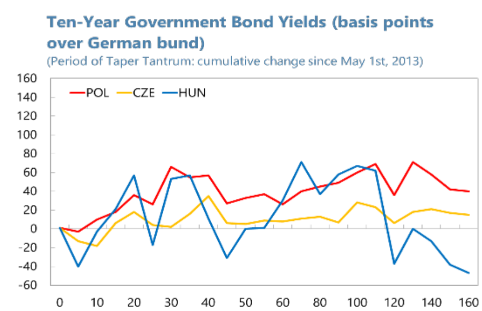



Source: Haver Analytics.

*Sovereign Government Bond Spreads (cumulative change in basis points)*

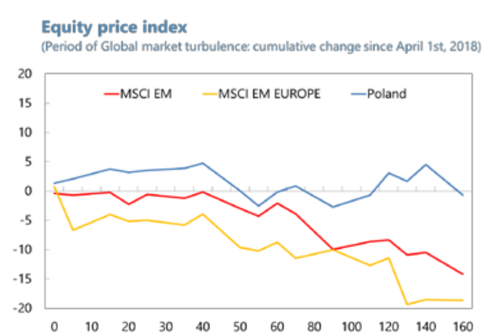



Source: Haver Analytics.

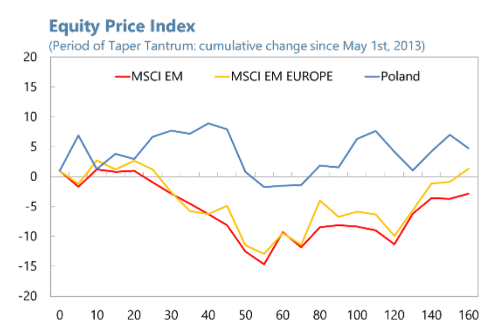



Source: Haver Analytics.

*Equity Price Indices (cumulative change in percent)*




Source: Bloomberg.




Source: Bloomberg.

## Table 1. Selected Vulnerability Indicators: Poland vs. Other Emerging Markets

| | Current Account 2017 Balance (Percent of GDP) | Estimated External Debt Refinancing Needs in 2018 (Percent of GDP) | Gross International Reserves, 2017 (Percent of the IMF's Reserve Adequacy Metric) | Loan to Deposit, 2017 Ratio (Percent) | Cyclically Adjusted Primary Balance, 2017 (Percent of GDP) | Public Debt 2017 (Percent of GDP) | Estimated Public Gross Financing Requirement in 2018 (Percent of GDP) |
|---|---|---|---|---|---|---|---|
| | (I) | (II) | (III) | (IV) | (V) | (VI) | (VII) |
| Poland (most recent data) | 0.1 | 20.2 | 113.0 | 93.9 | -0.5 | 50.6 | 5.9 |
| Poland (2013) | -1.3 | 27.8 | 106.0 | 104.6 | -1.1 | 55.7 | 10.9 |
| Poland (2008) | -6.8 | 23.6 | 95.5 | 124.5 | -1.9 | 46.3 | 9.8 |
| | | | | | | | |
| Average emerging Asia | 1.3 | 13.5 | 153.6 | 88.1 | -1.0 | 52.5 | 9.9 |
| Average emerging Europe | -1.2 | 25.4 | 120.8 | 89.0 | 0.9 | 48.0 | 8.9 |
| Average Latin America | -2.4 | 17.4 | 113.9 | 106.3 | -2.2 | 51.1 | 11.8 |
| Average Middle East & North Africa | -8.4 | 34.7 | 139.6 | 83.4 | -2.4 | 68.9 | 21.6 |
| Average all EMCs | -2.6 | 23.1 | 126.1 | 92.8 | -1.1 | 54.5 | 12.8 |
| | | | | | | | |
| *Median* | *-1.9* | *14.0* | *110.3* | *91.5* | *-0.6* | *53.4* | *10.6* |
| 25th percentile | -4.8 | 8.6 | 80.1 | 71.1 | -2.0 | 38.3 | 6.4 |
| 75th percentile | -0.2 | 25.6 | 160.1 | 104.2 | 1.2 | 67.5 | 14.8 |

Sources: IMF Monetary and Financial Statistics; IMF World Economic Outlook; and IMF staff calculations.

# Annex V. Public Sector Debt Sustainability Analysis

*Public debt is moderately high, but remains sustainable. The profile of public debt appears robust to GDP growth, interest, rollover, and foreign currency shocks. A large—though declining—share of foreign investors in the domestic debt market entails some risk, although the well-diversified investor base is a mitigating factor.*

## A. Baseline and Realism of Projections

1. **Debt levels.** Reflecting improved fiscal performance and strong GDP growth, public debt is expected to drop below 50 percent of GDP in 2018. Public debt remains on a declining path over the medium term, reaching about 43.5 percent of GDP by 2023, driven by a favorable differential between projected GDP growth and the real interest rate.

2. **GDP growth.** Real GDP grew by 4.8 percent in 2017 and is expected to further accelerate to around 5.1 percent in 2018. Over the medium term, growth is projected to slow down to 2.8 percent by 2023 as actual output trends back toward long-run potential. In recent years, staff's growth projections have been somewhat pessimistic, with a modest forecast bias relative to other countries.

3. **Fiscal adjustment.** Under the baseline, some deterioration in headline and structural deficits is expected over the medium term, owing to new spending initiatives. Risks of larger increases in deficits exists on account of possible additional pre-election spending. However, recent staff forecast errors for the primary deficit are more conservative than other countries.

4. **Sovereign yields.** The effective interest rate on public debt has been on a declining path since the global financial crisis, reflecting Poland's strong fundamentals and favorable external financial conditions. The effective interest rate is projected at around 3.2 percent in 2018, gradually rising to around 3.5 percent over the medium term, reflecting some tightening of international financial conditions. However, the expected increase in the effective interest rate is small, as most existing debt is long-term borrowing with fixed rates. Yields on 10–year bonds dropped by 48 base points in 2018, and are now close to 2.8 percent, while spreads of Polish euro-denominated bonds relative to German bonds (both with remaining maturity of around 10 years) increased by 13 basis points to 80 base points as of end-December 2018. CDS spreads increased by 19 base points to 67 basis points.

5. **Maturity and rollover risks.** Rollover risks are well managed. The average maturity of outstanding debt is estimated at 5.3 years, and the share of short-term debt in total government debt is under 1 percent. As of end-November, 15 percent of gross borrowing requirements for 2019 had been pre-financed. Domestic banks have further increased their holdings of treasury securities, which are exempt from the financial institutions' asset tax, by about 5 percent of GDP since the introduction of the tax in early 2016. Consequently, the overall share of external debt in total public debt has declined from 57 percent in 2015 to 49 percent in 2018:Q2. In addition, the share of foreign currency debt in state debt is about 31 percent. In line with the authorities' debt

management strategy, the baseline assumes the share of foreign currency debt in total debt will remain at 30 percent and external debt in total debt at 50 percent in the medium term.

6. **Debt sustainability analysis (DSA) risk assessment.** The heat map highlights risks associated with the relatively large economy-wide external financing requirements (about 20 percent of GDP in 2017), and the share of public debt held by non-residents. The former includes a high level of intra-company FDI loans, which tend to be more stable than other sources of external debt. The latter is influenced by the large participation of foreign investors in the domestic market for government bonds. However, the well-diversified foreign investor base, dominated by institutional investors (over 50 percent are long term investors), is a mitigating factor.

7. **Fan charts.** The symmetric fan charts, which assume symmetric upside and downside risks, indicate that the debt-to-GDP ratio could drop to around 40 percent by 2023 with a 25 percent probability. On the other hand, the upper bands indicate that the debt ratio could stay around 50 percent by 2023 with a 25 percent probability. In a more stringent exercise, assuming only downside shocks to interest rates and GDP growth, debt-to-GDP would still remain below 60 percent over the medium term. This result highlights that the risk of debt breaching the debt threshold is limited.

## B. Shocks and Stress Tests

8. **Primary balance shock**. Under an assumed deterioration in the primary balance by 0.8 percentage points relative to the baseline during 2018–19, public debt would remain on a declining path to about 45 percent of GDP in 2023. Gross financing needs would peak at about 7 percent of GDP in 2020 and converge to the baseline in the outer years.

9. **Growth shock**. The stress scenario assumes a drop in GDP growth by about 1.2 percentage points for two consecutive years (2019–20) relative to the baseline, combined with a 0.3 percentage points drop in inflation and deterioration in the primary balance by 0.6 percentage points in 2019 and further by 1.2 percentage points in 2020. Under these assumptions, public debt is still projected to remain on a declining path to about 47 percent of GDP by 2023. Gross financing needs increase to about 8 percent of GDP in 2020, but then converge toward the baseline in the outer years.

10. **Interest rate shock.** A permanent 352 bps increase in the nominal interest rate beginning in 2020 leads to an increase in the effective interest rate by 49 bps in 2020 (compared to the baseline) and further gradual increases to 182 bps by 2023. Under this scenario, the public debt-GDP ratio is about 2 percentage points higher than under the baseline by 2023.

11. **Exchange rate shock.** This scenario assumes a nominal exchange rate depreciation of about 26 percent in 2019 (from 3.84PLN/US$ to 4.88 PLN/US$), calibrated to emulate the maximum historical movement of the exchange rate over the last 10 years. Under this scenario, gross public debt increases by 0.5 percentage point in 2019 before trending down to baseline by 2023. The resilience reflects the predominance of public debt in local currency (70 percent of total).

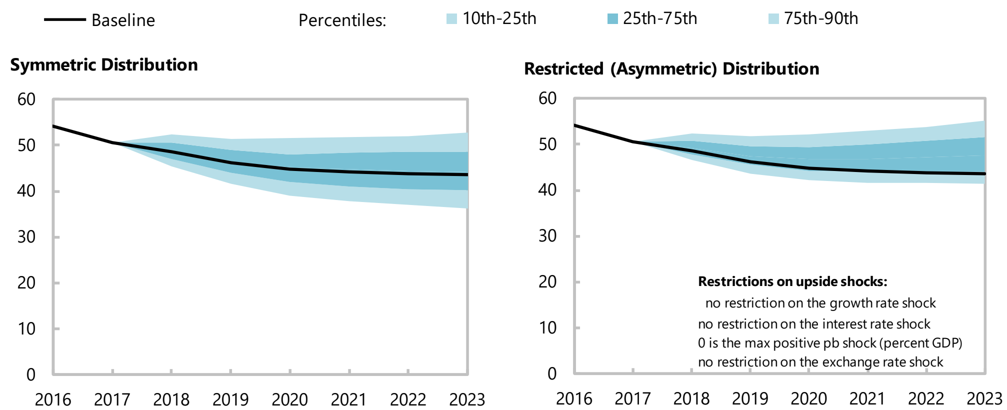
**12. Combined shock**. Under the combined shock, the public-debt-to-GDP ratio jumps to 52 percent in 2020 and remains around that level in outer years. In turn, gross financing needs increase to 8 percent of GDP in 2020 before trending down to around 6.5 percent of GDP by 2023.

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

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

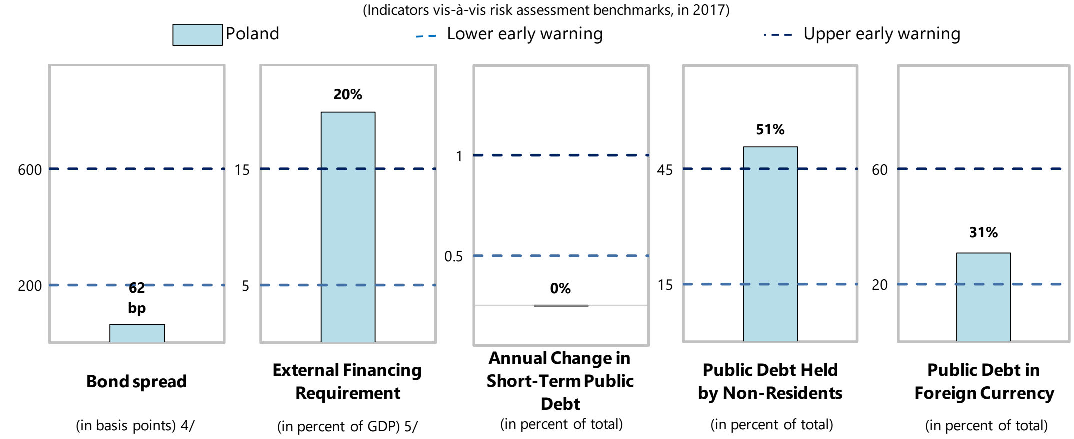
### Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)




### Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2017)




Source: IMF staff.

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

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

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

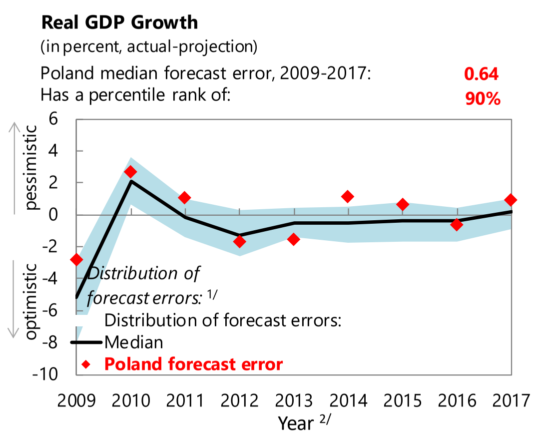
200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

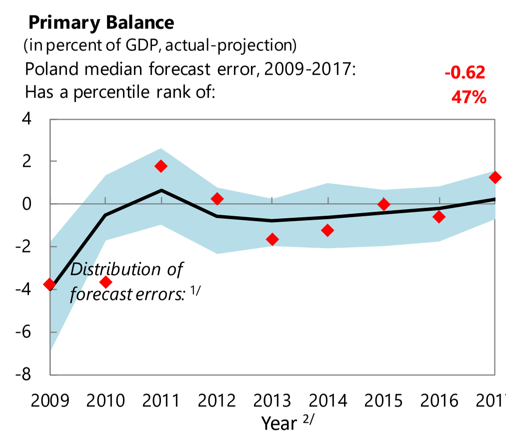
4/ Long-term bond spread over German bonds, an average over the last 3 months, 04-Sep-18 through 03-Dec-18.

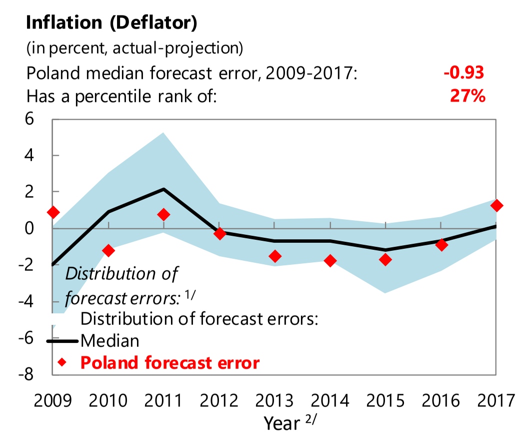
5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

## Public DSA—Realism of Baseline Assumptions

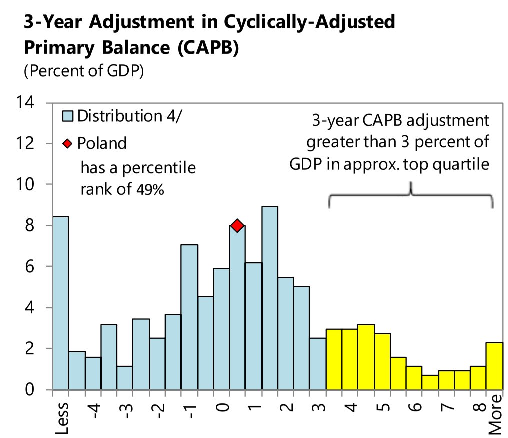
### Forecast Track Record, versus all countries

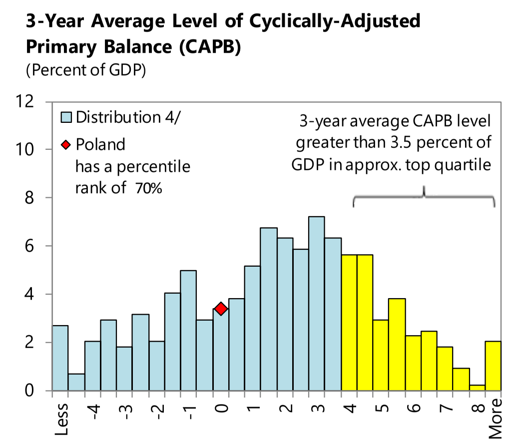



### Assessing the Realism of Projected Fiscal Adjustment




### Boom-Bust Analysis 3/


Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Poland, as it meets neither the positive output gap criterion nor the private credit growth criterion.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

# Public DSA—Baseline Scenario

## (Percent of GDP, unless otherwise indicated)

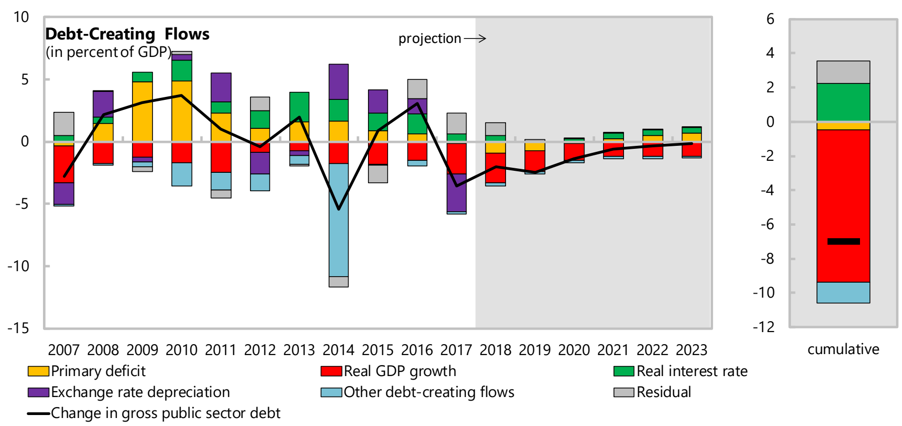
### Debt, Economic and Market Indicators [1/]

| | Actual | Projections | | | | | |
|---|---|---|---|---|---|---|---|
| | 2017 [2/] | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
| Nominal gross public debt | 50.6 | 48.6 | 46.1 | 44.7 | 44.1 | 43.7 | 43.6 |
| Public gross financing needs | 3.7 | 5.9 | 6.5 | 6.3 | 6.2 | 5.2 | 5.3 |
| Net public debt | 50.6 | 48.6 | 46.1 | 44.7 | 44.1 | 43.7 | 43.6 |
| Real GDP growth (in percent) | 4.8 | 5.1 | 3.6 | 3.0 | 2.8 | 2.8 | 2.8 |
| Inflation (GDP deflator, in percent) | 1.8 | 2.1 | 3.1 | 2.8 | 2.3 | 2.3 | 2.3 |
| Nominal GDP growth (in percent) | 6.7 | 7.2 | 6.8 | 5.9 | 5.1 | 5.2 | 5.2 |
| Effective interest rate (in percent) [4] | 3.1 | 3.2 | 3.3 | 3.4 | 3.5 | 3.5 | 3.5 |

| As of January 02, 2019 | | |
|---|---|---|
| Sovereign Spreads | | |
| EMBIG (bp) 3/ | | 87 |
| 5Y CDS (bp) | | 67 |
| Ratings | Foreign | Local |
| Moody's | A2 | A2 |
| S&Ps | A- | A- |
| Fitch | A- | A- |

### Contribution to Changes in Public Debt

| | Actual | Projections | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | cumulative | debt-stabilizing primary balance [9/] |
| Change in gross public sector debt | -3.5 | -2.0 | -2.5 | -1.4 | -0.6 | -0.4 | -0.1 | -7.0 | |
| Identified debt-creating flows | -5.2 | -3.1 | -2.5 | -1.4 | -0.7 | -0.4 | -0.2 | -8.4 | |
| Primary deficit | -0.2 | -0.9 | -0.7 | -0.2 | 0.2 | 0.5 | 0.7 | -0.5 | -0.9 |
| Primary (noninterest) revenue and grants | 39.8 | 40.9 | 41.1 | 40.4 | 40.0 | 39.7 | 39.5 | 241.4 | |
| Primary (noninterest) expenditure | 39.7 | 39.9 | 40.3 | 40.2 | 40.2 | 40.1 | 40.1 | 240.9 | |
| Automatic debt dynamics [5/] | -4.8 | -1.9 | -1.6 | -1.1 | -0.7 | -0.7 | -0.7 | -6.7 | |
| Interest rate/growth differential [6/] | -1.8 | -1.9 | -1.6 | -1.1 | -0.7 | -0.7 | -0.7 | -6.7 | |
| Of which: real interest rate | 0.6 | 0.5 | 0.1 | 0.3 | 0.5 | 0.5 | 0.5 | 2.2 | |
| Of which: real GDP growth | -2.4 | -2.4 | -1.7 | -1.3 | -1.2 | -1.2 | -1.2 | -8.9 | |
| Exchange rate depreciation [7/] | -3.0 | ... | ... | ... | ... | ... | ... | ... | |
| Other identified debt-creating flows | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -1.2 | |
| Privatization (+ reduces financing needs) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | -0.1 | |
| Contingent liabilities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Incurrence in liabilities not included in deb | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -1.1 | |
| Residual, including asset changes [8/] | 1.7 | 1.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 1.3 | |




Sources: Bloomberg Financial L.P. and IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

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

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

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

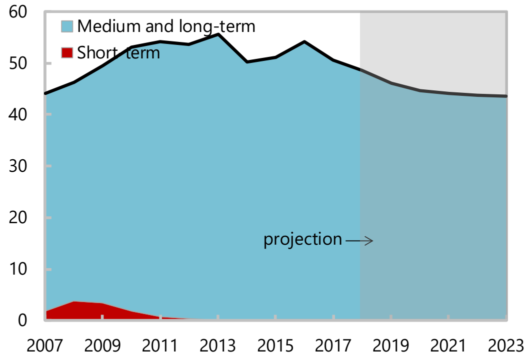
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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.

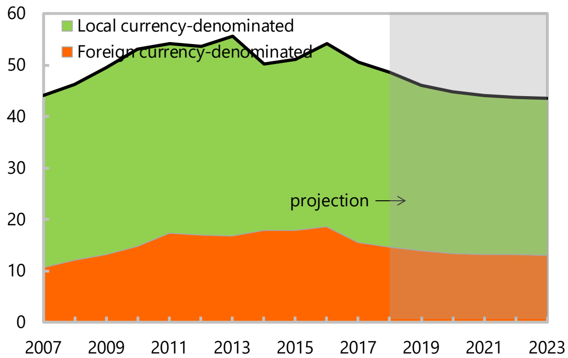
## Public DSA—Composition of Public Debt and Alternative Scenarios

### Composition of Public Debt

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



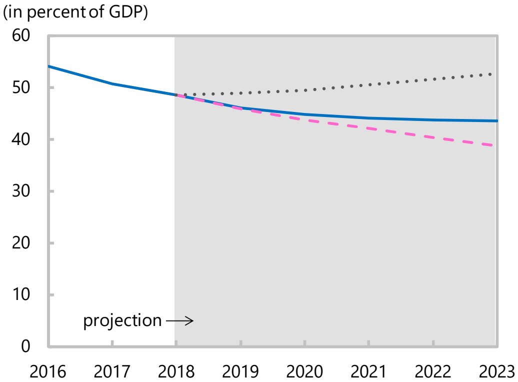

**By Currency**
(in percent of GDP)



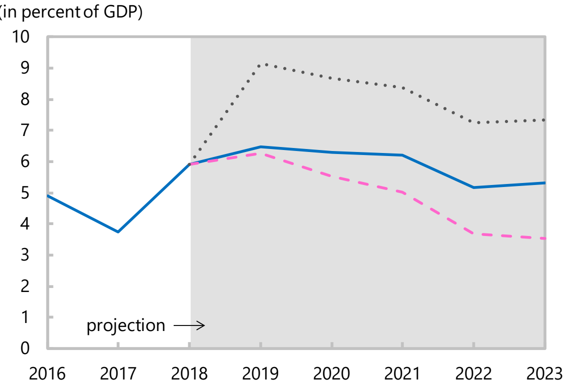

### Alternative Scenarios

Baseline    Historical    Constant Primary Balance

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




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




### Underlying Assumptions
(in percent)

| **Baseline Scenario** | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| Real GDP growth | 5.1 | 3.6 | 3.0 | 2.8 | 2.8 | 2.8 |
| Inflation | 2.1 | 3.1 | 2.8 | 2.3 | 2.3 | 2.3 |
| Primary Balance | 0.9 | 0.7 | 0.2 | -0.2 | -0.5 | -0.7 |
| Effective interest rate | 3.2 | 3.3 | 3.4 | 3.5 | 3.5 | 3.5 |
| **Constant Primary Balance Scenario** | | | | | | |
| Real GDP growth | 5.1 | 3.6 | 3.0 | 2.8 | 2.8 | 2.8 |
| Inflation | 2.1 | 3.1 | 2.8 | 2.3 | 2.3 | 2.3 |
| Primary Balance | 0.9 | 0.9 | 0.9 | 0.9 | 0.9 | 0.9 |
| Effective interest rate | 3.2 | 3.3 | 3.4 | 3.5 | 3.5 | 3.5 |

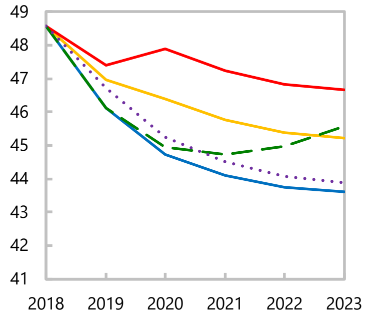
| **Historical Scenario** | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| Real GDP growth | 5.1 | 3.4 | 3.4 | 3.4 | 3.4 | 3.4 |
| Inflation | 2.1 | 3.1 | 2.8 | 2.3 | 2.3 | 2.3 |
| Primary Balance | 0.9 | -1.9 | -1.9 | -1.9 | -1.9 | -1.9 |
| Effective interest rate | 3.2 | 3.3 | 3.8 | 4.1 | 4.3 | 4.5 |

## Public DSA—Stress Tests

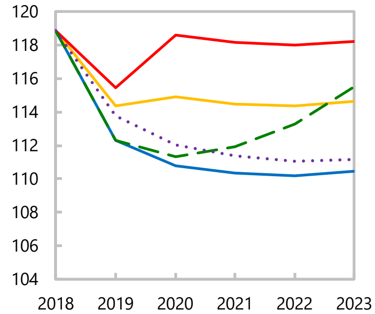
### Macro-Fiscal Stress Tests

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

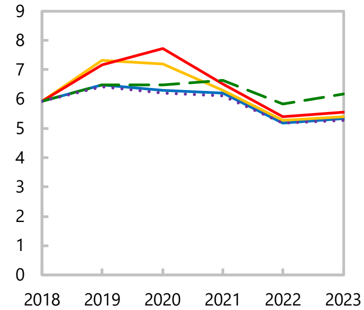
**Gross Nominal Public Debt**
(in percent of GDP)




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



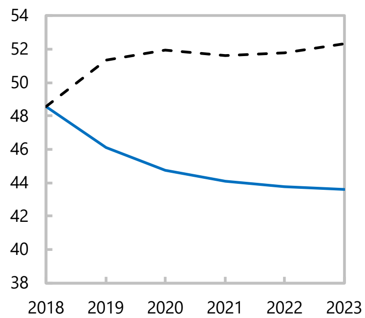

**Public Gross Financing Needs**
(in percent of GDP)



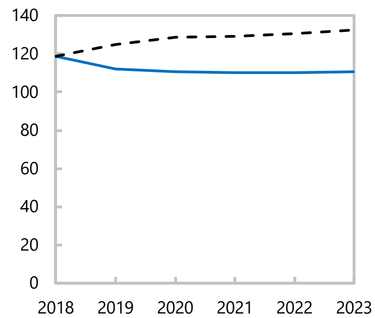

### Additional Stress Tests

Baseline
Combined Macro-Fiscal Shock

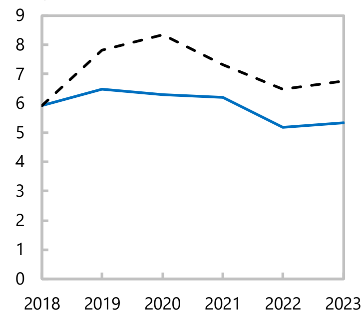
**Gross Nominal Public Debt**
(in percent of GDP)




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




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




### Underlying Assumptions
(in percent)

| **Primary Balance Shock** | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| Real GDP growth | 5.1 | 3.6 | 3.0 | 2.8 | 2.8 | 2.8 |
| Inflation | 2.1 | 3.1 | 2.8 | 2.3 | 2.3 | 2.3 |
| Primary balance | 0.9 | -0.1 | -0.7 | -0.2 | -0.5 | -0.7 |
| Effective interest rate | 3.2 | 3.3 | 3.5 | 3.6 | 3.6 | 3.6 |
| **Real Interest Rate Shock** | | | | | | |
| Real GDP growth | 5.1 | 3.6 | 3.0 | 2.8 | 2.8 | 2.8 |
| Inflation | 2.1 | 3.1 | 2.8 | 2.3 | 2.3 | 2.3 |
| Primary balance | 0.9 | 0.7 | 0.2 | -0.2 | -0.5 | -0.7 |
| Effective interest rate | 3.2 | 3.3 | 3.9 | 4.5 | 4.9 | 5.3 |
| **Combined Shock** | | | | | | |
| Real GDP growth | 5.1 | 2.4 | 1.8 | 2.8 | 2.8 | 2.8 |
| Inflation | 2.1 | 2.8 | 2.5 | 2.3 | 2.3 | 2.3 |
| Primary balance | 0.9 | -0.1 | -1.0 | -0.2 | -0.5 | -0.7 |
| Effective interest rate | 3.2 | 3.5 | 3.9 | 4.5 | 5.0 | 5.3 |

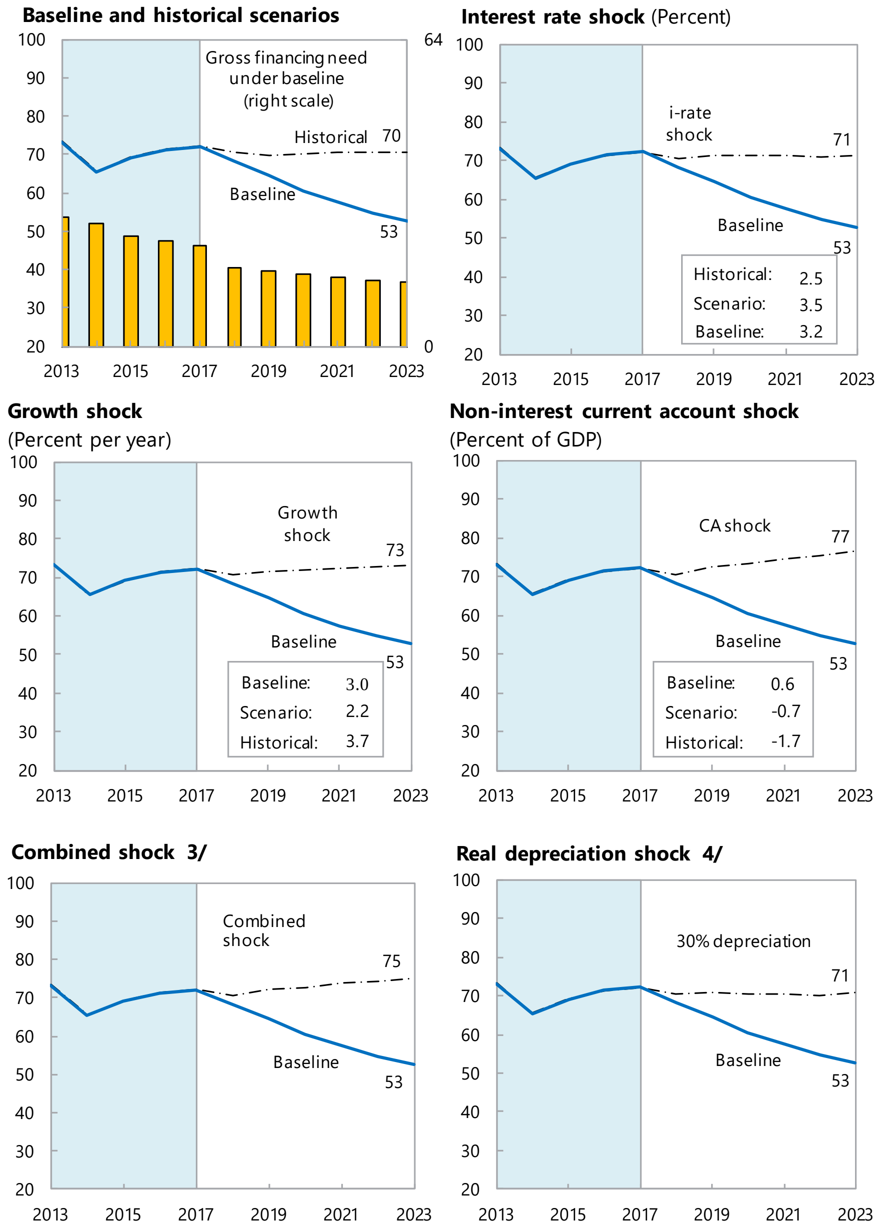
| **Real GDP Growth Shock** | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| Real GDP growth | 5.1 | 2.4 | 1.8 | 2.8 | 2.8 | 2.8 |
| Inflation | 2.1 | 2.8 | 2.5 | 2.3 | 2.3 | 2.3 |
| Primary balance | 0.9 | 0.1 | -1.0 | -0.2 | -0.5 | -0.7 |
| Effective interest rate | 3.2 | 3.3 | 3.5 | 3.6 | 3.6 | 3.6 |
| **Real Exchange Rate Shock** | | | | | | |
| Real GDP growth | 5.1 | 3.6 | 3.0 | 2.8 | 2.8 | 2.8 |
| Inflation | 2.1 | 9.7 | 2.8 | 2.3 | 2.3 | 2.3 |
| Primary balance | 0.9 | 0.7 | 0.2 | -0.2 | -0.5 | -0.7 |
| Effective interest rate | 3.2 | 3.5 | 3.4 | 3.4 | 3.4 | 3.4 |

Source: IMF staff.

# Annex VI. External Debt Sustainability Analysis

## 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 2018.

## External Debt Sustainability Framework, 2013–23
(In percent of GDP, unless otherwise indicated)

| | Actual | | | | | | | Projections | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2013 | 2014 | 2015 | 2016 | 2017 | | | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | |
| | | | | | | | | I. Baseline Projections | | | | | | Debt-stabilizing non-interest current account 5/ |
| 1 **External debt** | 73.2 | 65.4 | 69.4 | 72.2 | 72.8 | | | **68.2** | **64.6** | **60.5** | **57.5** | **54.8** | **52.7** | **-2.8** |
| 2 Change in external debt | -0.4 | -7.8 | 3.9 | 2.8 | 0.6 | | | -4.6 | -3.7 | -4.0 | -3.0 | -2.7 | -2.1 | |
| 3 Identified external debt-creating flows (4+8+9) | -4.2 | -1.8 | -0.3 | -4.1 | -5.1 | | | -3.7 | -4.2 | -5.7 | -4.3 | -3.6 | -3.2 | |
| 4 Current account deficit, excluding interest payments | -0.4 | 0.5 | -0.9 | -0.9 | -1.4 | | | -0.9 | -0.8 | -0.7 | -0.6 | -0.5 | -0.4 | |
| 5 Deficit in balance of goods and services | -1.8 | -1.4 | -3.1 | -4.0 | -4.2 | | | -3.4 | -3.2 | -2.9 | -2.7 | -2.6 | -2.5 | |
| 6 Exports | 46.3 | 47.6 | 49.5 | 52.2 | 54.6 | | | 57.9 | 58.2 | 57.3 | 56.2 | 54.7 | 53.0 | |
| 7 Imports | 44.4 | 46.2 | 46.4 | 48.2 | 50.5 | | | 54.5 | 55.0 | 54.4 | 53.4 | 52.1 | 50.4 | |
| 8 Net non-debt creating capital inflows (negative) | -1.8 | -1.3 | -3.4 | -3.0 | -0.3 | | | -0.3 | -1.3 | -2.4 | -1.8 | -1.6 | -1.5 | |
| 9 Automatic debt dynamics 1/ | -2.0 | -1.0 | 4.0 | -0.1 | -3.3 | | | -2.5 | -2.0 | -2.6 | -2.0 | -1.5 | -1.4 | |
| 10 Contribution from nominal interest rate | 1.7 | 1.6 | 1.5 | 1.4 | 1.3 | | | 1.7 | 1.8 | 1.8 | 1.8 | 1.8 | 1.9 | |
| 11 Contribution from real GDP growth | -1.0 | -2.3 | -2.9 | -2.1 | -3.2 | | | -3.5 | -2.3 | -1.8 | -1.6 | -1.5 | -1.4 | |
| 12 Contribution from price and exchange rate changes 2/ | -2.7 | -0.3 | 5.4 | 0.6 | -1.5 | | | -0.7 | -1.5 | -2.7 | -2.3 | -1.9 | -1.8 | |
| 13 Residual, incl. change in gross foreign assets (2-3) | 3.8 | -6.0 | 4.2 | 6.9 | 5.7 | | | -0.8 | 0.5 | 1.7 | 1.3 | 0.9 | 1.1 | |
| External debt-to-exports ratio (in percent) | 158.2 | 137.5 | 140.2 | 138.2 | 133.2 | | | 117.9 | 111.0 | 105.6 | 102.3 | 100.2 | 99.5 | |
| **Gross external financing need (in billions of US dollars) 3/** | 141.3 | 139.6 | 110.3 | 103.9 | 110.0 | | | 90.4 | 94.0 | 97.1 | 100.3 | 103.2 | 108.8 | |
| in percent of GDP | 26.9 | 25.6 | 23.1 | 22.0 | 21.0 | 10-Year Historical Average | 10-Year Standard Deviation | 16.3 | 15.8 | 15.1 | 14.4 | 13.8 | 13.5 | |
| **Key Macroeconomic Assumptions** | | | | | | | | | | | | | | |
| Real GDP growth (in percent) | 1.4 | 3.3 | 3.8 | 3.1 | 4.8 | 3.7 | 1.6 | 5.1 | 3.6 | 3.0 | 2.8 | 2.8 | 2.8 | |
| Exchange rate appreciation (US dollar value of local currency, percent) | 3.0 | 0.1 | -16.3 | -4.4 | 4.4 | -1.2 | 11.3 | -1.6 | 0.2 | 2.6 | 2.4 | 2.4 | 2.5 | |
| GDP deflator in US dollars (change in percent) | 5.4 | 0.4 | -15.9 | -3.7 | 4.7 | 0.9 | 11.7 | 0.2 | 2.3 | 5.7 | 5.2 | 4.8 | 4.9 | |
| Nominal external interest rate (in percent) | 2.4 | 2.3 | 2.0 | 2.0 | 2.0 | 2.5 | 0.4 | 2.5 | 2.7 | 3.1 | 3.3 | 3.4 | 3.7 | |
| Growth of exports (US dollar terms, in percent) | 9.2 | 6.8 | -9.0 | 4.2 | 16.6 | 8.3 | 14.1 | 11.8 | 7.7 | 6.9 | 5.6 | 4.9 | 4.4 | |
| Growth of imports (US dollar terms, in percent) | 3.5 | 8.0 | -11.9 | 2.6 | 16.5 | 7.5 | 17.6 | 14.0 | 8.1 | 7.4 | 5.8 | 5.0 | 4.4 | |
| Current account balance, excluding interest payments | 0.4 | -0.5 | 0.9 | 0.9 | 1.4 | -1.7 | 2.5 | 0.9 | 0.8 | 0.7 | 0.6 | 0.5 | 0.4 | |
| Net non-debt creating capital inflows | 1.8 | 1.3 | 3.4 | 3.0 | 0.3 | 2.3 | 1.0 | 0.3 | 1.3 | 2.4 | 1.8 | 1.6 | 1.5 | |
| | | | | | | | | II. Stress Tests for External Debt Ratio | | | | | | Debt-stabilizing non-interest current account 5/ |
| **A. Alternative Scenarios** | | | | | | | | | | | | | | |
| A1. Key variables are at their historical averages in 2018-2023 4/ | | | | | | | | **70.5** | **69.7** | **70.3** | **70.5** | **70.3** | **70.4** | **-2.8** |
| **B. Bound Tests** | | | | | | | | | | | | | | |
| B1. Nominal interest rate is at baseline plus one-half standard deviation | | | | | | | | 70.5 | 71.3 | 71.1 | 71.2 | 71.0 | 71.1 | -0.6 |
| B2. Real GDP growth is at baseline minus one-half standard deviations | | | | | | | | 70.5 | 71.7 | 71.9 | 72.4 | 72.6 | 73.1 | -0.3 |
| B3. Non-interest current account at baseline minus one-half standard deviations | | | | | | | | 70.5 | 72.4 | 73.4 | 74.5 | 75.4 | 76.6 | -0.9 |
| B4. Combination of B1-B3 using 1/4 standard deviation shocks | | | | | | | | 70.5 | 72.1 | 72.8 | 73.7 | 74.3 | 75.3 | -0.5 |
| B5. One time 30 percent real depreciation in 2019 | | | | | | | | 70.5 | 70.9 | 70.6 | 70.5 | 70.2 | 70.9 | 0.0 |

Source: IMF staff calculations.

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

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

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

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

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

# Annex VII. Risk Assessment Matrix[1]

| Source of Risk | Relative Likelihood | Time Horizon | Expected Impact | Policy response |
|---|---|---|---|---|
| ***EXTERNAL*** | | | | |
| **Rising protectionism and retreat from multilateralism**. Global imbalances and fraying consensus about the benefits of globalization lead to escalating and sustained trade actions and spreading isolationism. This threatens the global trade system, regional integration, labor mobility, as well as global and regional policy and regulatory collaboration. | High | Short Term, Medium Term | Medium<br>Potential disruption to global supply chains, reduced global trade and FDI, and increased capital flow volatility would adversely impact the Polish economy.<br>However, while Poland is an important participant in European supply chains, its domestic value-added contribution is smaller—relative to GDP—than for many other countries (on the order of 10 percent). The diversified nature of activity would help to cushion the effect on GDP growth. | • Exchange rate flexibility should serve as the first line of defense.<br>• Fiscal policy should allow automatic stabilizers to work, while implementing a gradual growth-friendly fiscal consolidation.<br>• If needed, the NBP should provide liquidity support (including in FX).<br>• Structural reforms to improve the investment climate and encourage labor mobility across sectors can facilitate the establishment or expansion of activities less-affected by protection measures. |
| **Sharp tightening of global financial conditions.**<br>Tightening of financial conditions triggered by a sharper-than-expected increase in U.S. interest rates (prompted by higher-than-expected inflation) or the materialization of other risks amid monetary policy normalization. | High | Short Term, Medium Term | High/Medium<br>Poland has a net external liability position of 63 percent of GDP, and gross external debt is 66 percent of GDP. Nonresidents hold 48 percent of government debt (both zloty and fx-denominated). The share of short-term external debt is high, and financing needs amount to about 20.2 percent of GDP.<br>In the event of a sharp tightening of global financial conditions and/or intensification of the EM sell-off, investors could reallocate assets away from Poland, resulting in capital flow reversals and zloty depreciation. Borrowing costs for the sovereign and the private sector would increase.<br>Mitigating factors:<br>• Banking system is liquid and mostly funded domestically;<br>• A large share (44 percent) of private external debt is intercompany loans, which are relatively stable and part of FDI. | • Exchange rate flexibility should serve as the first line of defense.<br>• If inflation remains well-contained, monetary policy should remain accommodative, but rates should be raised if inflation threatens to breach the top of the target on a sustained basis.<br>• Fiscal policy should allow automatic stabilizers to operate.<br>• The NBP should provide liquidity support (including in FX) if needed.<br>• Sustain prudent macroeconomic policies and sound governance and institutions, supported by enhanced debt-management practices to continue to reduce vulnerabilities associated with high foreign holdings of government debt and large volumes of short-term external debt. |

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

| Source of Risk | Relative Likelihood | Time Horizon | Expected Impact | Policy response |
|---|---|---|---|---|
| | | | • The foreign investor base of domestic government bonds is relatively stable (institutional investors).<br>• The zloty tends to be much more stable relative to the euro than against the US dollar, while the EU is Poland's main trading partner.<br>• International reserves are adequate, as measured by the Fund's ARA metric. | *If the sell-off intensifies*, interest rate hikes combined with FX intervention could be used to stem capital outflow pressures and respond to disruptions in the foreign-exchange market. |
| ***Weaker-than-expected global growth:***<br>Euro Area: Progress on fiscal adjustment, on addressing legacy banking-sector problems, and on other structural reforms slows or reverses, raising debt sustainability concerns, steadily pushing up borrowing costs, and undermining medium-term growth prospects. | Medium | **Medium Term** | Medium<br>• The euro area is Poland's dominant trade partner and source of foreign investment. Weaker than expected growth in the EA would reduce external demand and FDI inflows to Poland, directly affecting growth. Moreover, weaker growth in the EA could affect activity in Poland's other trade partners, indirectly curtailing Polish growth.<br>• About one-third of Poland's banking system is owned by EA banks; weak demand in the EA that lowers loan quality in home markets could increase the cost of capital for their subsidiaries in Poland, although most local capital is generated through profit retention.<br>• A reassessment of the regions' long-term growth prospects could trigger capital outflows, including from Poland, raising the cost of foreign financing, although the zloty is likely to move in line with the euro. | • Monetary policy should be eased.<br>• Allow fiscal automatic stabilizers to operate.<br>• Take advantage of any competitiveness gains vis a vis other region by diversifying trade partners and product specialization to help cushion the impact on the economy. |
| ***DOMESTIC*** | | | | |
| **Domestic uncertainty and policy slippages.**<br>Unsustainable fiscal, monetary and income policies are used to boost near-term activity at the cost of longer-term sustainability, exacerbating underlying vulnerabilities and impairing confidence. Independent institutions essential for the efficient functioning of the economy become less effective. | Medium | **Short to Medium Term** | Medium/High<br>• Reduced capital inflows (or possibly outflows) by residents and foreigners, reinforced by rating downgrades, would push up financing costs and lead to exchange rate depreciation, which would fuel inflation.<br>• Increased risk aversion would also lower growth through higher precautionary saving and weaker investment. Contrary to the intended objective, income convergence slows down.<br>• Interaction of fiscal and financial sector policy mis-steps could result in a vicious cycle of weaker public finances and financial sector health and lower growth amid tightened sovereign-bank nexus.<br>• Consolidating public finances and boosting productivity to prepare for the economic costs of aging are further delayed. | • Preserve the prerequisites for durable and sustainable growth by maintaining prudent policies and sound institutions, including a fiscal policy focused on long-term objectives, and an independent central bank and financial sector supervisor.<br>• Continue gradual fiscal consolidation and resist adopting politically-appealing but economically-costly policies.<br>• Ensure that structural transformation is on track. Facilitate structural reforms, focusing on business climate and labor market reforms, improving education and vocational training, and boosting infrastructure investment and R&D support, to attract investment (including FDI) and boost future productivity and income growth. |

| Source of Risk | Relative Likelihood | Time Horizon | Expected Impact | Policy response |
|---|---|---|---|---|
| **Intensification of labor shortages**<br>Increasing work opportunities in home countries or in higher-income third countries makes Poland less attractive as a destination for foreign workers. | Medium | **Medium Term** | Medium/High<br>• Foreign workers are estimated to account for 5-10 percent of Polish employment, having grown from very low levels as recently as 2015.<br>• Foreign workers have been instrumental in relieving Poland's chronic labor shortages, thereby allowing the economy to expand considerably faster than otherwise, while holding down labor costs and prices.<br>• A sharp decline in the growth of foreign workers would exacerbate labor shortages, slow potential growth, and push up wage and price inflation. | • Tap into under-utilized labor pools of women, younger retirees and encourage reallocation of workers from less- to more-productive occupations by eliminating special pension plans and introducing a regionally-differentiated minimum wage. Target education to the future needs of the labor market.<br>• Allow foreign workers to maintain more-stable and longer-duration employment arrangements, especially for those with skills in high demand. Recognize qualifications earned abroad if they meet appropriate standards.<br>• Relieve barriers to investment to facilitate expansion of labor-saving capital equipment. |

# Annex VIII. External Sector Assessment

## (corresponding to the year of 2018)

<table>
<tr><td>Foreign asset and liability position and trajectory</td><td colspan="10">Background. The net international investment position (NIIP) is estimated to reach a negative 63 percent of GDP in 2018, broadly in line with the average level of recent years. Gross liabilities will decrease to 114 percent of GDP, while gross assets will remain at about 2017 level of (51 percent of GDP). FDI (equity and debt) projected to account for 53 percent of gross external liabilities in 2018, will remain diversified across sectors and source countries. While gross external debt is sizeable (projected at 66 percent of GDP at end-2018), more than a quarter of it is liabilities to direct investors. The share of short-term debt (at remaining maturity) is relatively high (29 percent of total gross debt). Currency mismatch stems from the different shares of euro-, USD- and zloty-denominated instruments in gross assets and liabilities, and therefore, movements in bilateral exchange rates of these three currencies affect the NIIP.<br>Assessment. While sizeable external debt, including short-term debt, presents a vulnerability, rollover risk is mitigated by the large share of debt FDI, which tends to be stable. Sizable reserves also help to mitigate liquidity risk that may arise from rolling over the large amount of short-term debt.</td><td rowspan="6">Overall Assessment:<br>The external position in 2018 was broadly in line with medium-term fundamentals and desirable policies.<br>The cyclically-adjusted CA balance in 2018 was moderately higher than implied by the EBA CA norm. However, full utilization of EU funds, including the deferred amount from 2018, should bring the CA in line with fundamentals and desirable policies in the medium-term.<br>The REER points to a broadly balanced external sector position. Reserves are sufficient against external shocks and disorderly market conditions.<br><br>Potential policy responses:<br>Maintain prudent policies to further reduce macroeconomic vulnerabilities;<br>Reduce barriers to private sector investment to boost potential growth and rebalance the composition of domestic demand.</td></tr>
<tr><td>Current account</td><td colspan="10">Background. Sizable CA deficits during 2004–14 have been replaced more recently by close-to-balance positions, notwithstanding a significant primary income deficit. The improvement in the CA followed a large depreciation during 2014–16 and lower public investment due to the transition to the 2014–20 EU funds cycle, with favorable terms of trade contributing as well. Poland's CA is projected to become negative in 2018. From a saving-investment perspective, the opening of the CA deficit in 2018 is driven by buoyant public investment due to increased EU funds absorption.<br>Assessment. For 2018, the cyclically-adjusted current account, based on nine-month BoP estimates, is expected to record a deficit of 0.7 percent of GDP, with preliminary estimated EBA CA norm at a deficit of 1.9 percent of GDP. The resulting EBA gap of 1.2 percent of GDP reflects the sum of domestic and ROW policy gaps of 1.1 percentage point, and an estimation residual of 0.1 percentage points. EU Funds utilization accelerated in 2018 relative to 2016–17 average, however, full planned absorption for 2018 may not be reached due to capacity constraints in certain sectors, and may be delayed to 2019 (about 0.2 percentage points of the EBA gap). Staff assesses that the CA was broadly in line with fundamentals and medium-term policies in 2018, with a CA gap range centered on 1 (± 1) percent of GDP. [1/ 2/]</td></tr>
<tr><td>CA Assessment 2018</td><td>Actual CA</td><td>-0.8</td><td>Cycl. Adj. CA</td><td>-0.7</td><td>EBA CA Norm</td><td>-1.9</td><td>EBA CA Gap</td><td>1.2</td><td>Staff Adj. 0.2</td><td>Staff CA Gap 1.0</td></tr>
<tr><td>Real exchange rate</td><td colspan="10">Background. The annual-average real effective exchange rate (REER) depreciated by a cumulative 7¾ percent during 2014–16, largely on nominal depreciation vis-à-vis the US dollar and the Swiss franc, as the zloty tends to move in line with the euro. The depreciation is consistent with NBP policy rate cuts in response to deflationary pressures and domestic policy uncertainties in the run-up to and following the 2015 election. The REER remained broadly unchanged in 2017–18 (appreciated by 3.2 percent on average in 2017, while depreciated by about 3.1 percent in 2018). In 2018, the nominal zloty weakened by about 8 percent against the dollar, and by 3 percent against the euro, with no intervention from the NBP.<br>Assessment. The EBA REER and CA models based on nine-month estimates suggest an undervaluation of between 0 and 3 percent for 2018. The REER gap implied by the EBA CA model is -2.6 percent and the REER index model suggests a gap of -2.4 percent.[3/] Overall, staff assesses Poland's REER in 2018 to have been close to the level consistent with fundamentals and desirable policy settings, with a gap in range of -5 to 0 percent.</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td colspan="10">Background. The capital account is dominated by EU funds inflows for financing investment projects, despite a temporary slowdown in EU funds absorption in 2016–17 due to the transition to the 2014–20 EU funds cycle. In 2018, net financial inflows increased relative to the 2016–17 average due to larger FDI inflows.<br>Assessment. The foreign holdings (around 46 percent) of government debt securities indicate potential vulnerabilities, but the ratio continued to decline since 2017 as domestic banks increased their holdings in response to the introduction of the bank asset tax, which exempts government bonds. The diversified foreign investor base is another mitigating factor.</td></tr>
<tr><td>FX intervention and reserves level</td><td colspan="10">Background. Gross international reserves are estimated to have remained stable at US$114 billion at end-2018. Net reserves, which exclude the NBP's repo operations (part of its reserve management strategy) from gross reserves, will increase from US$97 billion at end-2017 to estimated 98 billion at end-2018 as the NBP has continued to build an adequate precautionary reserve position. The zloty has floated freely.<br>Assessment. Net reserves are about adequate, standing at 99 percent of the IMF's composite reserve adequacy (ARA) metric in 2018 (gross reserves are about 113 percent of the ARA metric).</td></tr>
<tr><td>Technical Background Notes</td><td colspan="11">1/ The 1.1 percentage points contribution of identified policy gaps reflects a combination of a domestic fiscal policy gap of -0.6 percentage points that is more than offset by fiscal gaps in trading partners, resulting in a positive 0.46 percentage points contribution of fiscal policies to the current account gap. The credit gap and health spending together contribute an additional 0.66 percentage points to the total policy gap. Capital controls and reserves contribute 0.0 percent of GDP to the total gap.<br>2/ The EBA estimation standard error for the 2018 CA norm is 0.6 percent of GDP.<br>3/ The REER level model for Poland suggests an undervaluation of 16.6 percent. However, the model has residuals of -15.6 percent, and may not adequately capture changes in the equilibrium REER that occurred during the sample period.</td></tr>
</table>

INTERNATIONAL MONETARY FUND

# REPUBLIC OF POLAND

## STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 3, 2019

Prepared By | European Department

## CONTENTS

# FUND RELATIONS

(As of December 3, 2018)

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

**General Resources Account:**

| | SDR Million | Percent Quota |
|---|---|---|
| Quota | 4,095.40 | 100.00 |
| Fund Holdings of Currency | 3,865.82 | 94.39 |
| Reserve Tranche Position | 229.59 | 5.61 |
| Lending to the Fund | | |
| New Arrangement to Borrow | 217.25 | |

**SDR Department:**

| | SDR Million | Percent Allocation |
|---|---|---|
| Net Cumulative Allocation | 1,304.64 | 100.00 |
| Holdings | 298.82 | 22.90 |

**Outstanding Purchases and Loans:** None

**Latest Financial Arrangements:**

**In Millions of SDR**

| Type | Approval Date | Expiration Date | Amount Approved | Amount Drawn |
|---|---|---|---|---|
| FCL | 1/13/2017 | 11/2/2017 | 6,500.00 | 0.00 |
| FCL | 1/14/2015 | 1/13/2017 | 13,000.00 | 0.00 |
| FCL | 1/18/2013 | 1/13/2015 | 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 | | | | |
|---|---|---|---|---|---|
| | 2018 | 2019 | 2020 | 2021 | 2022 |
| Principal | | | | | |
| Charges/Interest | 2.48 | 10.38 | 10.39 | 10.38 | 10.38 |
| **Total** | 2.48 | 10.38 | 10.39 | 10.38 | 10.38 |

**Article IV Consultation:**

The last Article IV consultation was concluded on July 7, 2017. Poland is on the standard 12-month consultation cycle.

**Resident Representative:**

Mr. Nadeem Ilahi replaced Mr. Bas Bakker as the Senior Regional Resident Representative for Central and Eastern Europe, effective Aug 2018.

**Exchange Arrangements and Restrictions:**

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

**Republic of Poland: Technical Assistance from the Fund, 1992–2017**

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

**Republic of Poland: Technical Assistance from the Fund, 1992–2017 (continued)**

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

**Republic of Poland: Technical Assistance from the Fund, 1992–2017 (concluded)**

| Department | Subject/Identified Need | Action | Date | Counterpart |
|---|---|---|---|---|
| IMF/IBRD | FSAP Update | Mission | April/May 2006 | MoF/NBP |
| FAD | Developing a multi-annual fiscal framework | Mission | June 2008 | MoF |
| STA | Errors and omissions in balance of payments accounts | Mission | July 2009 | NBP |
| FAD | Medium-term fiscal framework | Mission | April 2010 | MoF |
| MCM | Detailed assessment of observance of BCP for effective banking supervision | Mission | Feb/March 2011 | KNF |
| STA | Errors and omissions in balance of payments accounts | Mission | June 2011 | NBP |
| FAD | Developing the fiscal regime for oil and gas | Mission | April 2012 | MoF |
| MCM | Macroprudential framework | Mission | May 2012 | NBP |
| IMF/WB | FSAP update | Mission | Feb/March 2013 | MoF/ KNF/NBP |
| FAD | Tax administration—Modernization challenges and strategic priorities | Mission | November 2014 | MoF |
| MCM | Bank Resolution | Mission | March 2016 | BFG |
| FAD | Medium-term budget framework | Mission | February/November 2017 | MoF |
| FAD | Tax administration | Mission | April/June 2017 | MoF |
| IMF/WB | FSAP update | Mission | Jan/May 2018 | MoF/ KNF/NBP |

# STATISTICAL ISSUES

(As of December 3, 2018)

**Assessment of Data Adequacy for Surveillance**

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

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

**Price Statistics**: The consumer price index does not cover imputed rents of owner-occupied dwellings. The scope of the index covers all resident households, except those in some rural areas. The producer price index does not include any estimation for missing prices; quality and seasonal adjustment techniques are also not implemented. Poland publishes "flash estimates" of CPIs, and a monthly Harmonized Indices of Consumer Prices (HICP) according to a uniform methodology of the European Union.

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

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

**Monetary and Financial Statistics**: Beginning with data for January 2004, the NBP provides the European Central Bank (ECB) with monetary accounts in accordance with the ECB's framework for monetary statistics using the national residency approach. The ECB reports monetary data for Poland to the IMF for publication. Data on other financial corporations (OFC) are currently not available.

**Financial Sector Surveillance**: In November 2009, NBP in cooperation with GUS, the Polish Financial Supervision Authority (KNF) and MoF began reporting financial soundness indicators (FSI) in line with the IMF's *Financial Soundness Indicators Compilation Guide*. Poland is currently reporting all core FSIs and 21 of the 28 encouraged FSIs on a quarterly basis with a lag of approximately one quarter. NBP also implemented EU regulation 680/2014, which covers supervisory reporting defined by the Implementing Technical Standards (ITS) prepared by the European Banking Authority. First data were collected with reference date March 2014 for own funds and liquidity related reporting. Financial reporting on a consolidated basis according to the ITS was reported for the first time for September 2014.

**External Sector Statistics**:

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

Poland participates in the Coordinated Direct Investment Survey and Coordinated Portfolio Investment Survey and reports data for the Reserves Data Template to the IMF.

**Data Standards and Quality**

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

## Republic of Poland: Table of Common Indicators Required for Surveillance–as of November 30, 2018

| | 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] | Memo Items: Data Quality Accuracy and reliability[9] |
|---|---|---|---|---|---|---|---|
| Exchange Rates | 12/03/2018 | 12/03/2018 | D | D | D | | |
| International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1] | 10/2018 | 11/21/2018 | M | M | M | | |
| Reserve/Base Money | 10/2018 | 11/23/2018 | M | M | M | O, LO, O, LO | O, O, O, O, O |
| Broad Money | 10/2018 | 11/23/2018 | M | M | M | | |
| Central Bank Balance Sheet | 10/2018 | 11/23/2018 | M | M | M | | |
| Consolidated Balance Sheet of the Banking System | 10/2018 | 11/23/2018 | M | M | M | | |
| Interest Rates[2] | 12/03/2018 | 12/03/2018 | D | D | D | | |
| Consumer Price Index | 10/2018 | 11/18/2018 | M | M | M | O, O, O, O | O, O, O, O, O |
| Revenue, Expenditure, Balance, and Composition of Financing[3] – General Government[4] | Q2/2018 | 10/13/2018 | A | A | A | LO, O, O, O | O, O, O, O, NA |
| Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government | 10/2018 | 10/18/2018 | M | M | M | | |
| Stocks of Central Government and Central Government-Guaranteed Debt[5] | 10/2018 | 10/18/2018 | M | M | M | | |
| External Current Account Balance | 9/2018 | 11/13/2018 | M | M | M | O, O, O, LO | O, O, O, O, LO |
| Exports and Imports of Goods and Services | 9/2018 | 11/13/2018 | M | M | M | | |
| GDP/GNP | Q3/2018 | 11/30/2018 | Q | Q | Q | O, LO, O, O | LO, LO, O, O, LO |
| Gross External Debt | Q2/2018 | 9/30/2018 | Q | Q | Q | | |
| International Investment Position[6] | Q2/2018 | 9/30/2018 | Q | Q | Q | | |

[1] Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Not Available (NA).

[7] Reflects the assessment provided in the data ROSC published on November 6, 2001, and based on the findings of the respective missions that took place during May 10–18, 2001 for the dataset corresponding to the variable in each row. For fiscal data, also takes account of the 2009 Fiscal Transparency ROSC. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

[8] Same as footnote 7, except referring to international standards concerning (respectively) source data, statistical techniques, assessment and validation, and revision studies.

[9] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

**Statement by the Staff Representative on the Republic of Poland**
**January 18, 2019**

This statement provides information that has become available since the issuance of the staff report. The information does not alter the thrust of the staff appraisal.

On December 28, 2018, parliament approved a law freezing electricity prices in 2019 for end-users in all sectors at levels prevailing in mid-2018. The law does not specify what will happen to prices beyond 2019. With electricity generating costs projected to rise by PLN9 billion (0.4 percent of GDP) in 2019—reflecting higher prices for coal and CO2 emissions allowances—these additional costs will be borne by the government. The European Commission is planning to assess compatibility of the law with EU state aid rules.

Based on staff's current understanding of the law, relative to the counterfactual where electricity prices for all end-users increase to fully compensate for the higher generating costs, the price freeze will have the following effects in 2019 (measured as a share of GDP):

- *End-users* will benefit from: (i) lower excises on electricity (0.1); (ii) reduced "transitional fees" on electricity (0.1); and (iii) lower electricity tariffs (0.2), yielding a net gain of 0.4 percent of GDP;

- *Electricity Companies* will receive less revenue owing to lower electricity tariffs (0.2) and be fully compensated by a general government transfer (0.2); and

- *General Government* (including extrabudgetary units) will collect lower revenue from excises (0.1) and transitional fees (0.1), and transfer the proceeds from selling unused CO2 emissions allowances to electricity companies (0.2), yielding an increase in the fiscal deficit of 0.4 percent of GDP.

The staff report factors in a price freeze only for households and SMEs, and while the report notes the risk that the freeze could be expanded to other sectors, this risk is not included in the baseline scenario. Therefore, broadening the scope of the price freeze will affect staff's macroeconomic forecasts in the following way:

- *Higher fiscal costs*. The fiscal deficit will increase relative to that in the staff report by around 0.2 percent of GDP in each year that the scheme remains in place;

- *Lower inflation*. Owing to unchanged electricity prices for non-SME companies, the second-round effect on consumer price inflation assumed in the staff report (about 0.1 percentage point in 2020 and 0.2 percentage point in 2021) will not materialize, lowering the inflation path by these amounts. Given time lags inherent in price pass through, no impact on 2019 inflation is expected; and

- *GDP growth.* Broadening the price freeze will increase growth only slightly. This is because, with already-sizable profits, non-SME companies' marginal propensity to spend out of additional profits is likely to be small, especially if the price freeze is temporary.

**Statement by Mr. Piotr Trabinski, Alternate Executive Director for Republic of Poland and Ms. Agnieszka Urbanowska, Advisor**
**January 18, 2019**

On behalf of the Polish authorities, we would like to thank staff for their candid set of reports and the in-depth and fruitful discussions they had during the Article IV and FSAP missions in Warsaw. The authorities find the reports balanced and staff's views well argued.

## Outlook and risks

Since the last consultation, Poland has significantly improved its macroeconomic position. Economic growth has been strong, driven mostly by private consumption and investment. The harmonized unemployment rate stands around a record-low level of 3.8 percent and the labor market continues to tighten. Nevertheless, inflation remains low at 1.6 percent on average in 2018 and consistent with the NBP inflation target. Consequently, NBP has maintained the interest rates, including the reference rate, unchanged at 1.5 percent. The external position remains broadly in line with fundamentals, and the level of reserves is adequate. Poland's increased resilience to external shocks allowed for a termination of the Fund's Flexible Credit Line in November 2017.

The authorities remain committed to prudent fiscal policy, while implementing the key objectives of Poland's economic development strategy. Public debt has been put on a downward path, and the headline deficit is expected to reach a record-low level of 0.5 percent of GDP in 2018. The structural balance has improved on account of targeted policies aimed at enhancing VAT compliance and strengthening tax administration. Concurrently, the authorities have kept public spending in line with the stabilizing expenditure rule. In conjuncture with fiscal adjustments, the authorities successfully executed the "*Strategy for Responsible Development*", which serves as a primary instrument for a flexible management of development in Poland.

The Polish financial sector remains stable, resilient, and liquid. Banks are profitable and well-capitalized, and the macroprudential framework remains sound. Risks associated with mortgages denominated in foreign currency are abating, as the loan portfolio gradually decreases. Recent changes in the governance of the Polish Financial Supervisory Authority intend to improve coordination across government agencies in order to respond to potential financial risks in a timely and efficient way.

Our authorities concur with staff's views on the near-term outlook and risks. As the current economic cycle is maturing, growth is expected to moderate over the medium-term, reflecting the tight labor market and the projected slowdown in the euro area. Risks to the outlook are primarily associated with external factors, including the escalation of trade tensions, uncertainties on global financial markets, a hard Brexit, and the potential move of foreign labor force participants to other EU countries.

**Fiscal Policies**

The economic upswing and prudent fiscal policy continued to support public finances. Together with higher tax revenues on account of improved revenue administration and the elimination of loopholes, this contributed to substantial reductions in the headline and structural deficits in 2018. Poland's fiscal policy is supported by a strong framework, including the constitutional debt ceiling of 60 percent of GDP, the "safety threshold" of 55 percent of GDP, and the expenditure rule that puts a nominal limit on the growth of public spending. The set of fiscal rules ensures stability and credibility of public finances and responsibility in fiscal policy implementation. In addition, Poland's commitment to the EU's Stability and Growth Pact helped rein in the fiscal deficit and limit government debt.

In 2018, Poland's budget deficit is expected to be at record-low, and public debt remains on a firm downward path on the back of robust growth, further improvements in tax compliance, and favorable domestic conditions. Beyond 2018, the debt trajectory is expected to continue its declining path to 43.4 percent of GDP by 2022. Reaching the medium-term objective—a structural deficit of one percent of GDP—appears feasible. The Polish authorities also remain committed to rebuild fiscal buffers. In this regard, the revenue administration aims at further increasing tax compliance and tax collection efficiency. On the expenditure side, social spending as a share of GDP is on a declining path, as pension benefits are indexed well below nominal GDP, and some other social benefits are fixed in nominal terms. This welfare system is fiscally sustainable in the context of demographic headwinds. In the near term, no major risks to fiscal stability are foreseen.

Measures are needed to maintain the long-term sustainability of public finances in light of the increasing pension-age population. In response to this challenge, the Polish authorities adopted a new long-term savings scheme in October 2018, the "*Employee Capital Plan*" (PPK). Under the PPK, the accumulated assets will be managed by investment funds, pension funds, or insurance companies within a well-defined framework. The goal of the PPK is to increase savings and support productive investment that, in turn, will deliver higher returns in retirement and support continued income convergence.

The Polish authorities agree that more work is warranted to address deficiencies in the process of budgetary planning and procedures. In this context, Poland continues its work to reform the budgetary framework with a view to increasing the effectiveness and efficiency of spending. The completion of the first stage of these efforts is expected by the end-2019.

**Monetary Policy**

In 2018, notwithstanding relatively high economic growth and wages rising faster than in previous years, inflation remained moderate. It reached 1.6 percent on average, and thus was below the midpoint of the NBP's inflation target (2.5 percent +/- 1 percentage point), yet within the target range. This indicates that the monetary policy stance in recent years was appropriate. Price growth was driven mostly by rising energy and food prices, while core inflation remained low at 0.7 percent. Looking ahead, CPI inflation is likely to remain close to the level observed last year. In the medium term, inflationary pressures should be limited due to the projected slowdown of economic activity, both at home and abroad. Furthermore, inflation in Poland in the quarters to come will not be lifted by higher energy prices, since a recently passed law has frozen electricity prices for all economic sectors.

Against this background, while we share the staff's view that high uncertainty about both global economic conditions and future domestic price developments warrants a data-dependent approach for monetary policy, we disagree with the assessment that interest rates might be raised in the near term. In the context of persistently low inflation expected going forward, and amid a looming economic slowdown, the monetary authorities anticipate that interest rates are likely to stay at their current level in the coming quarters. Yet, the central bank stands ready to adjust monetary policy if macroeconomic developments materially deviate from the current forecasts.

**External Sector**

In recent years, favourable macroeconomic conditions have narrowed Poland's external imbalances. In 2017, Poland recorded a current account surplus of 0.2 percent of GDP, compared with a deficit of 0.5 percent in 2016. This was, among other things, due to the nominal surplus in trade of goods and services that reached 4.1 percent of GDP. Polish exports benefited from economic revival in the euro area, especially in Germany, Poland's main trade partner. Looking ahead, the current account balance is projected to deteriorate to -0.6 percent of GDP in 2018, mainly due to stronger dynamics for imports rather than exports. Nevertheless, the Polish external position is in staff's assessment consistent with medium-term policies and fundamentals.

**Financial Sector**

Poland's financial system remains broadly robust, with a sustainable rate of lending growth. Polish banks remain well capitalized and have a relatively low leverage. Banks are the main source of financing for the economy and they have continued to increase their regulatory capital, maintaining its high quality. The average capital adequacy ratio remains at 18.4 percent (16.4 percent for Tier 1), and the average applied risk weight is higher than in most EU countries. This results in a relatively high resilience of banks to shocks. The systemic risk associated with non-credit financial institutions is limited due to their size and business models.

In parallel, the risk associated with foreign currency mortgage loans is abating. The value of portfolio of mortgage loans is decreasing steadily, its quality remains very high, as does the financial situation of most borrowers. Political discussions on certain proposed legal solutions providing for the mandatory conversion of the loans at an exchange rate that differs significantly from the current market rate have calmed down.

Given the predominantly domestic orientation of the Polish banking sector and the well-balanced situation of the Polish economy, the risks to the stability of the domestic financial system are mainly external. They relate to the shocks to the global economy and financial system. The Polish banking system's direct foreign asset exposures is limited, although the foreign funding of the banking sector, the government, and corporations remains important. Nevertheless, the results of the stress tests indicate that banks in Poland—thanks to consistent capital accumulation—remain resilient to adverse shocks, and the banking system would be able to provide continued financing to the economy.

Our authorities' view differs from staff's assessment regarding the increased risks associated with greater participation of the state-controlled institutions in the financial market. Until recently, the share of foreign banks amounted to three-quarters of total assets, creating a risk of potential withdrawal of funding in case of external financial shocks, and thus generating negative spillovers to the economy. The increased state footprint reflects the withdrawal of foreign participants from the market, whose shares were taken over by domestic institutions through their corporate decisions.  This has contributed to a better balance between domestic and external ownership of the sector.

Recent changes in the governance structure of the PFSA are aimed at increasing cross-governmental coordination and a better-targeted response in case of financial shocks, while achieving greater institutional effectiveness through enhanced resource allocation. A legislative amendment improved funding of the PFSA by granting greater budgetary independence. Moreover, in our authorities' view the PFSA board remains sufficiently independent as only four out of nine voting members are designated by the government.

**Structural Policies**

Poland has made a significant progress in reaching the objectives of the "*Strategy for Responsible Development"* (SRD), the government's main policy document, which identifies and specifies key priorities for the country's development until 2030. Strong institutions, efficient administration, and effective processes lay the foundation for the SRD's successful implementation. The overarching goal of these concerted efforts is the continued convergence to higher living standards of the Polish people, along with poverty reduction and social inclusion.

Guided by the SRD, Poland launched various initiatives aimed at strengthening potential growth and ensuring responsible development. One of these initiatives is the higher education reform, adopted by the authorities as "*Constitution for Science*" in November 2018. It increases the quality of education and ensures sustainable development of Polish universities. The education reform, along with further investments in human capital, will increase the job market participation rate in the long term. In view of tight labor market, staff rightly point out that more work is warranted.

A further comprehensive legislative package adopted last year is the "*Constitution for Business*", which enhances the business climate, especially for SMEs and startups. The new law aims at improving relations between business and public administration, as well as simplifying bureaucratic procedures. Clear and simplified regulation is designed to attract foreign capital, increase FDI, and raise productivity.

Furthermore, additional progress has been made towards incentivizing R&D spending through, *inter alia*, R&D tax incentives for innovative startups and the government's emphasis on innovative areas, such as electromobility. EU-funded public R&D and infrastructure projects increased sharply in 2018, while private sector innovation spending is yet to accelerate.

The comprehensive and well-balanced SRD is compatible with the European Commission recommendations, detailed under the Europe 2020 strategy. It is assumed that by 2020 the average gross disposable income of households (per capita, in PPP terms) will increase to 76-80 percent of the EU average and will by 2030 reach the EU level. The authorities are cognizant that more work is needed to improve energy efficiency to improve air quality and make growth sustainable.