Poland: Macro Outlook, Budget Performance and Policy Challenges

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Outline

The macro outlook in the face of the global twin crisis
  • growth
  • inflation
  • external balance

Budget performance: sources and prospects

Policy challenges
The slowdown in the US and Europe is affecting the region.

Source: WEO April 2008.
Global food and energy prices are on the rise

As a result inflation is on the rise throughout the region.

Source: WEO April 2008.
Food and energy have contributed to much consumer price inflation in Poland but recently core inflation is up as well.

Contribution to HICP
(YoY, p.p.)

Source: Eurostat.
Rising wages threaten the inflation outlook and competitiveness

Wages, unit labor cost and productivity (percent)

Source: NBP inflation report.
Higher inflation rates are a natural by-product of convergence

Relative price level vs. relative GDP per capita (PPP), 1995-2006, (EU25=100)

Source: Eurostat.
Higher commodity prices are also contributing to a widening of the current account

Unlike in some other new member states, Poland’s current account deficit has been consistent with fundamentals.
Poland’s fiscal adjustment during the past three years has been impressive, reversing earlier lapses.

**NMS: Fiscal consolidation**
*(ESA95, percent of GDP)*

Source: Eurostat.
This was achieved despite a (much criticized) lack of measures to reduce the deficit

- **Hausner Plan (2004-07)**; approved measures would have reduced deficit by 2.4 pp of GDP, but about ½ were reversed in 2008
- **Post accession tax increases (2004)**: effect was likely small
- **Lowering of disability contributions (2007-08)**: ceteris paribus *increased* the deficit by about 2 pp of GDP

So what explains the sharp reduction in the structural deficit?
Fiscal outcomes have consistently exceeded budget targets

General government balance
(percent of GDP, cash basis)

Source: MoF.
* budget guidelines
Both the revenue and expenditure side of the budget have overperformed.

General government:
Composition of fiscal overperformance 2004-07
(cash basis, percent of total)

Source: MoF.
Aggregate expenditures have been on or below target, reflecting binding spending limits (albeit on the central government level only).

General government:
Composition of expenditure overperformance 2004-07
(cash basis, percent of GDP)

Source: MoF.
Overperformance, especially on the revenue side, reflects very cautious macro assumptions.

Differences between actual and projected GDP and CPI 2004-07

(percentage points)

Source: MoF.

*Actual = latest projection by MoF
Looking further back, revenue projections in Poland tend to be too optimistic during slowdowns and too conservative during upswings.

GDP growth and precision of revenue projections

\[ R^2 = 0.6899 \]

Source: Eurostat, MoF.
Without structural fiscal measures, the cyclically adjusted deficit is likely to fluctuate in the 2-3 percent of GDP range.

Cyclically adjusted fiscal deficit 2000-07
(in percent of GDP)

Source: MoF, IMF staff estimates.
Structural fiscal adjustments should start on the spending side.

Source: AMECO.
Policy challenges

• **Securing fiscal consolidation**: strengthen the fiscal framework (medium-term budget, reform of public institutions), focus on expenditure-based adjustment (e.g. indexation formula for social benefits)

• **Taming inflation**: head off second round effects by tightening monetary and fiscal policy, wage restraint, structural reforms (agriculture) to increase the supply response

• **Boosting long-term growth**: Increase labor participation, especially among the elderly, by reforming early retirement provisions and reducing the tax wedge

• **Euro adoption**: Prepare by not only meeting the Maastricht criteria but also by making the economy more flexible
Thank you!

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