INTERNATIONAL MONETARY FUND

Staff Country Reports

May, 2010
IMF Country Report No. 10/118

Republic of Poland: 2010 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Poland.

The following documents have been released and are included in this package:

- The staff report, prepared by a staff team of the IMF, following discussions that ended on March 15, 2010, with the officials of Republic of Poland on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 13, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A Public Information Notice (PIN).
- A statement by the Executive Director for the Republic of Poland.

The document(s) listed below will be separately released.

Republic of Poland: Selected Issues Paper

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

International Monetary Fund
Washington, D.C.

This page intentionally left blank

INTERNATIONAL MONETARY FUND

REPUBLIC OF POLAND

Staff Report for the 2010 Article IV Consultation

Prepared by the Staff Representatives for the 2010 Consultation with the Republic of Poland

Approved by Marek Belka and Aasim Husain

April 13, 2010

Executive Summary

Owing to a strong performance before and during the crisis, Poland is well positioned for an advanced recovery. It is the only EU country to have escaped a recession in 2009 due to its limited reliance on exports, well-capitalized and profitable banking system, flexible exchange rate, and limited pre-crisis imbalances that afforded policy-makers room to undertake counter-cyclical policies. Looking forward, growth is expected to pick up as the global environment improves, banks' risk appetite reemerges, and the inflow of EU funds to Poland accelerates.

Fiscal policy should aim to gradually withdraw the large fiscal stimulus. Policies for how to reduce the deficit remain to be fully specified. In staff's view, striking an appropriate balance between short-term cyclical and medium-term consolidation objectives would call for a reduction in the overall government deficit to 3 percent by 2013-14. To help anchor confidence in medium-term targets, the fiscal framework should be strengthened, including by introducing a permanent counter-cyclical expenditure rule.

Monetary policy should not be tightened prematurely. Given the subdued outlook for inflation, policy rate hikes are not warranted any time soon. If upward pressures on the zloty persist, there could be scope for policy rate cuts, provided inflation remains contained. Under the current outlook, the central bank could also consider limited foreign-exchange interventions without jeopardizing the inflation-targeting framework.

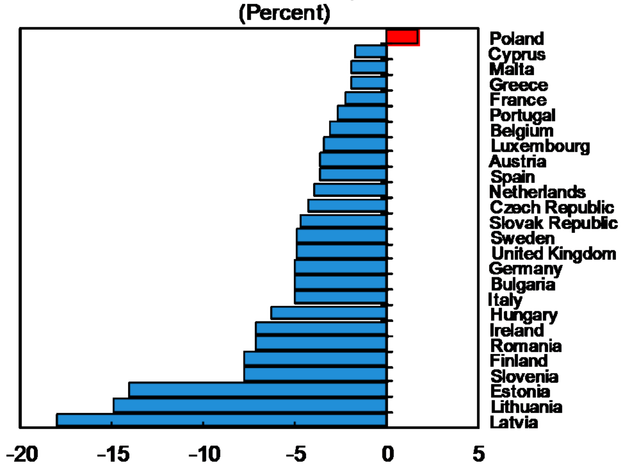
The banking sector is well buffered, but risks related to foreign-exchange lending should be curbed. With balance-sheet adjustment having run its course and banks poised to begin lending again, there is a risk of renewed build up of foreign-exchange exposures. The authorities should take forceful steps to prevent a rapid growth of foreign-exchange mortgage lending.

Contents Page

I. Context and Recent Economic Developments[1]

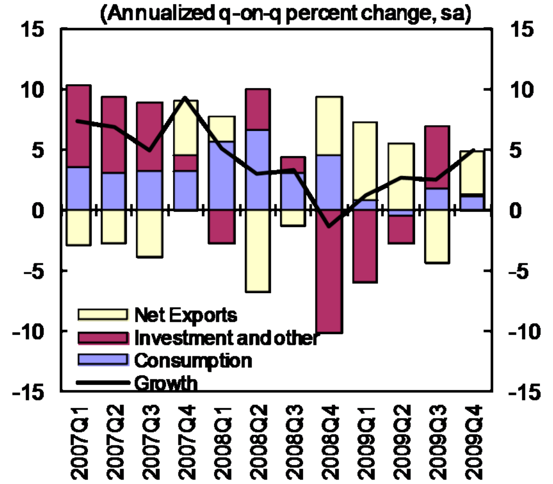
1. **Poland is the only EU economy to have escaped a recession in 2009.** Like its regional peers, it experienced spill-overs from the crisis through both real and financial channels, in particular the latter, as an abrupt slowdown in capital inflows caused a credit crunch and a sharp decline in investment. However, consumption held up relatively well, and the foreign balance began to contribute positively to growth from the onset of the crisis. This reflected the large domestic market and attendant modest reliance on exports; a flexible exchange rate policy (the zloty depreciated by 30 percent in real effective terms during the initial phase of the crisis); and, not least, significant fiscal stimulus and monetary easing, as policymakers took full advantage of the room for maneuver afforded by Poland's contained external and internal imbalances on the eve of the crisis. GDP growth amounted to 1.7 percent in 2009, and a negative output gap of only some 1 percent of GDP had opened up by end-2009 (Box 1).

EU27: GDP Growth, 2009
(Percent)



Source: Eurostat.

Poland: Contributions to GDP Growth
(Annualized q-on-q percent change, sa)



2. **Inflation has fallen close to the National Bank of Poland's (NBP) target of 2½ percent.** Headline inflation declined from close to 5 percent in mid-2008 to 2.9 percent in February 2010, helped by a renewed strengthening of the zloty. Core inflation followed a similar path, declining to 2.2 percent in February.

3. **The zloty is recovering.** The rapid contraction in the trade balance led to a decline in the current account deficit from 5 to about 1½ percent of GDP in 2009. In the financial account, FDI has fallen notably, although higher retained earnings have cushioned the fall. After an initial sharp contraction, trade credits are again increasing. Portfolio inflows have

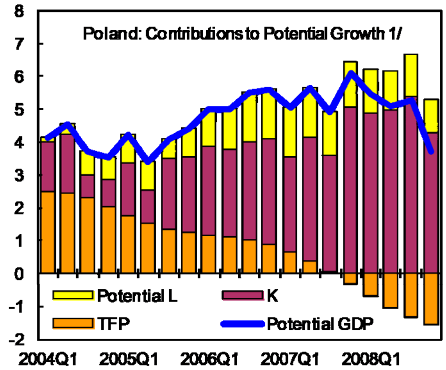
[1] A mission comprising Messrs. Thomsen (head) and Epstein and Ms. Velculescu (all EUR) and Messrs. Nier (MCM) and Llaudes (SPR) visited Warsaw during March 2-25, 2010. Messrs. Allen and Sierhej, from the Warsaw Regional Office, supported the work of the mission. Mr. Morsink (EUR, future mission chief) attended the key policy meetings. Poland is an Article VIII country (Informational Annex, Appendix I). Data provision is adequate for surveillance (Informational Annex, Appendix II).

performed particularly well, especially since the middle of last year, driven by renewed external appetite for zloty-denominated government debt.[2] As a result, after its initial sharp fall, the zloty has been recovering steadily, although it remains some 18 percent below its pre-crisis peak level in real effective terms.[3]

Box 1. Estimating Poland's Potential Output

In the run-up to the global financial crisis, Poland was growing above its potential. In view of the weakness of statistical methods, such as the HP filter, in identifying boom-bust turning points, a recent IMF working paper provides new estimates of Poland's potential output using a standard production-function approach.[1] The methodology concentrates on obtaining a robust estimate of the labor input by deriving Poland's natural rate of unemployment and the corresponding unemployment gap. The paper finds that, prior to the recent global financial crisis, Poland's output and employment were both growing above their respective potential levels. This finding is consistent with the upward trend in inflation and the emergence of capacity constraints seen in Poland during the pre-crisis period.

Indeed, the rapid investment-led output growth in 2006-07 was unsustainable. By disaggregating the contributions to potential growth, the paper finds that the contribution of TFP growth was steadily rising through the first half of the decade, remaining positive until 2007, when it turned negative—largely coinciding with the trend-reversal in potential output growth. At the same time, the contribution of capital was steadily increasing, as investment growth stayed robust, but it was insufficient to prevent the growth in potential output from declining throughout 2008.



1/ Contributions are computed as year-on-year percentage changes.

In the aftermath of the current downturn, Poland is not expected to experience a sizable and persistent negative output gap. While Poland avoided an outright recession, economic growth slowed down sharply, resulting in a small negative output gap in 2009. According to the production function methodology, the gap is projected to bottom out at around minus 1 percent this year, and gradually close by 2011-12. This contrasts somewhat with the experience of other European countries, many of which currently have negative output gaps that are large and expected to persist for a number of years.

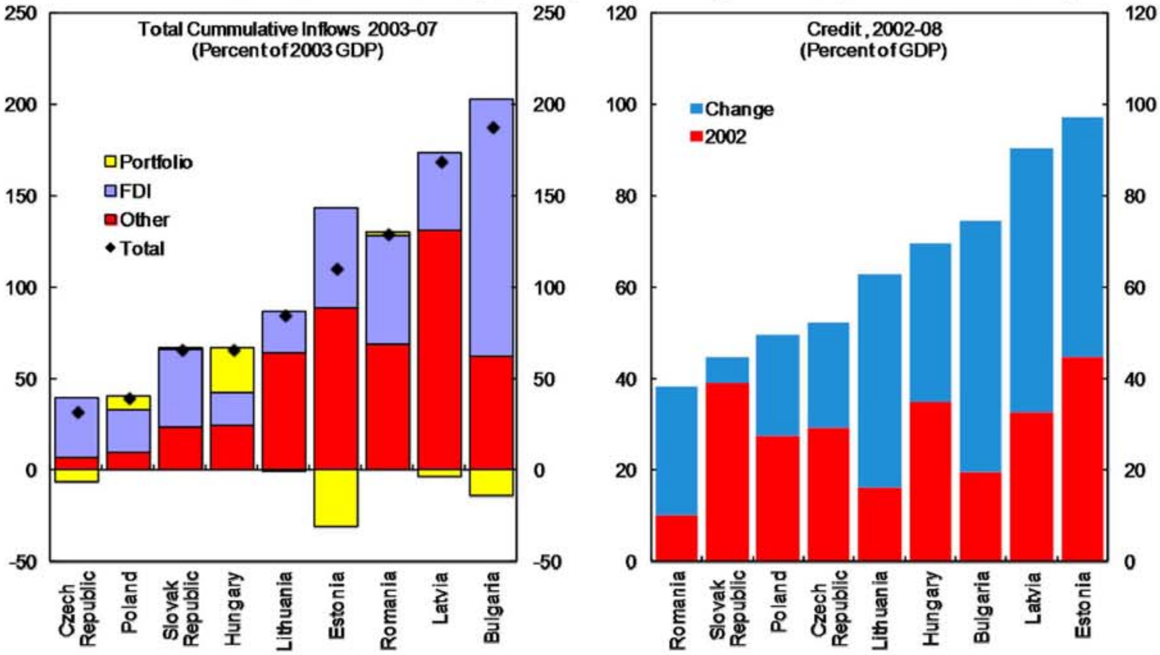
[1] See Epstein N. and Corrado Macchiarelli (2010), *IMF Working Paper* No. 10/15 "Estimating Poland's Potential Output: A Production Function Approach" http://www.imf.org/external/pubs/cat/longres.cfm?sk=23528.0

[2] Poland's Balance of payments (BoP) accounts show relatively large errors and omissions for 2007-09. An IMF technical assistance mission visited Poland in July 2009 to investigate these statistical discrepancies and concluded that they appear to be primarily concentrated in selected financial accounts. The NBP has been following up on several areas identified by the mission and is working on adopting a new BoP compilation system in the course of 2010, which is expected to solve many of these discrepancies.

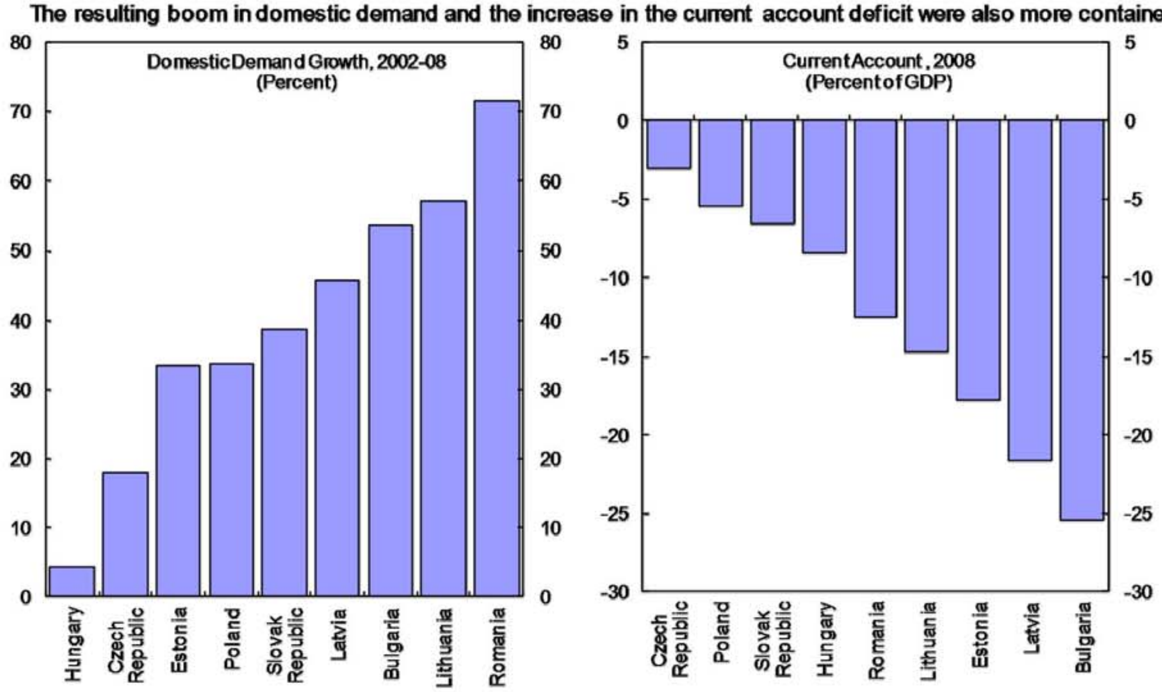
[3] The zloty is currently classified as free floating.

Figure 1. New Member States: The Boom Years

Total inflows into Poland were limited compared to peers, resulting in relatively more modest credit growth.

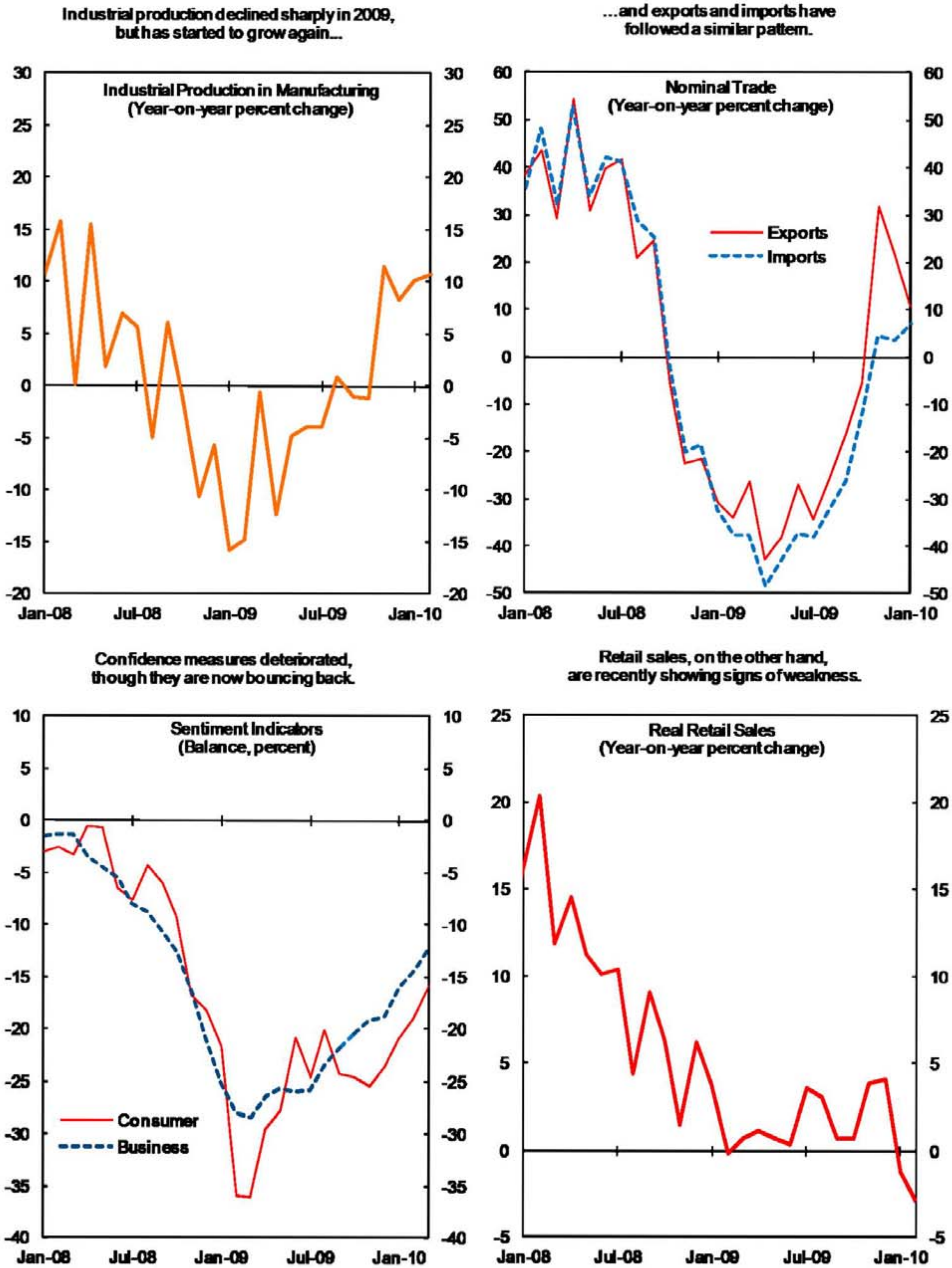


The resulting boom in domestic demand and the increase in the current account deficit were also more contained.



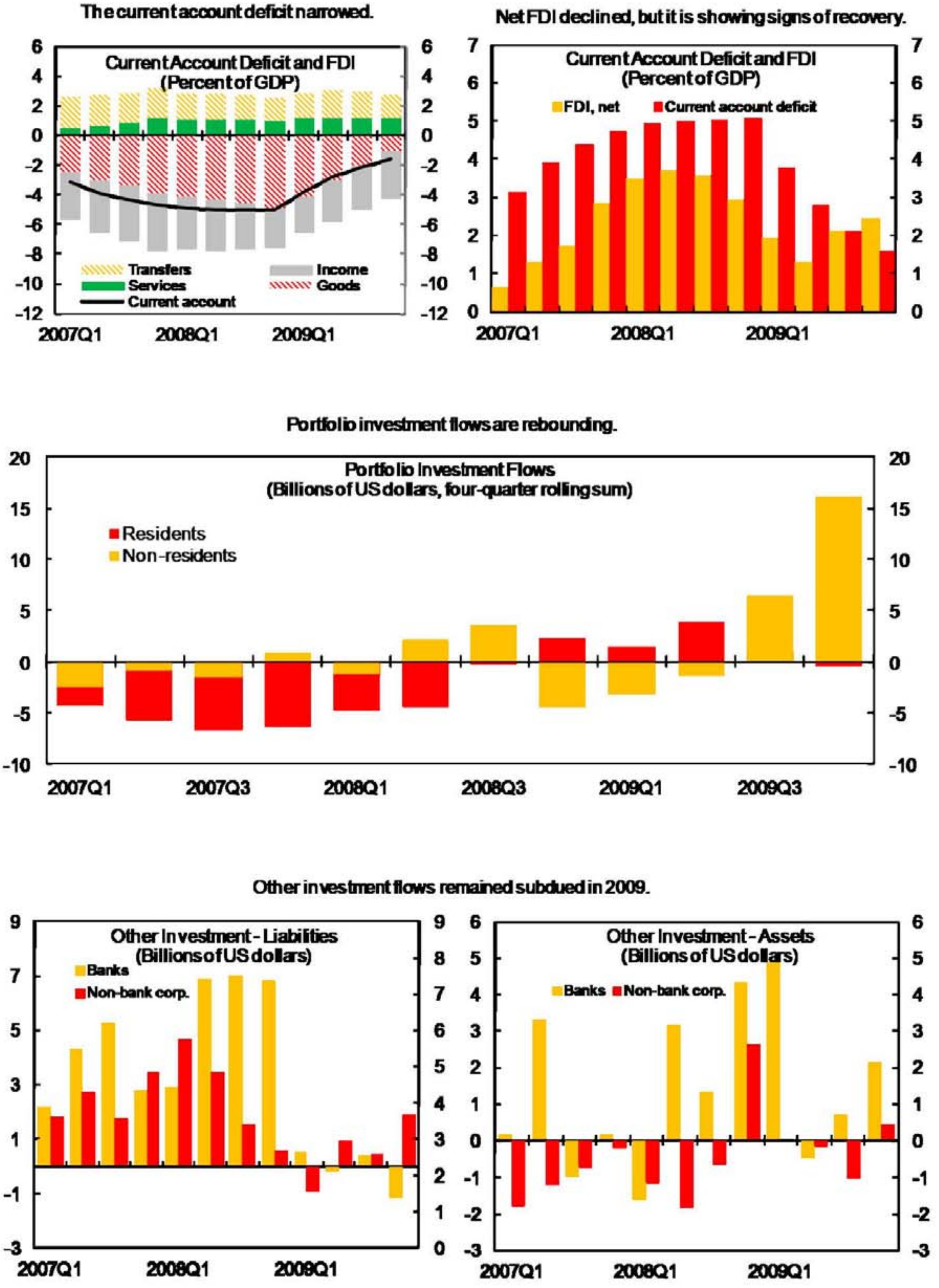
Sources: IMF, *World Economic Outlook*; IMF, *International Financial Statistics*; and IMF staff estimates.

Figure 2. Poland: Recent Economic Developments, 2008-10



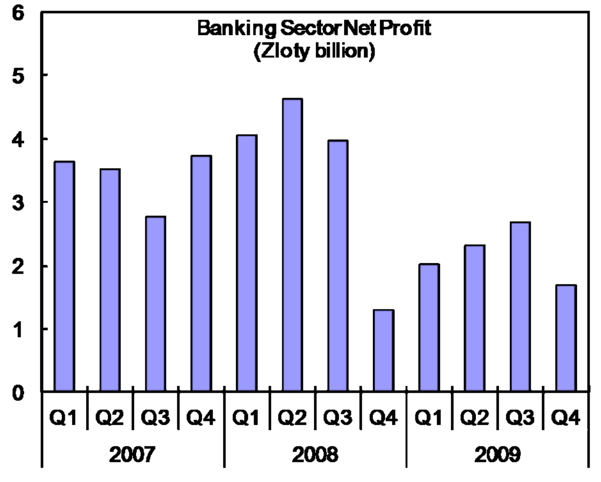
Sources: European Commission; and Polish Statistical Office.

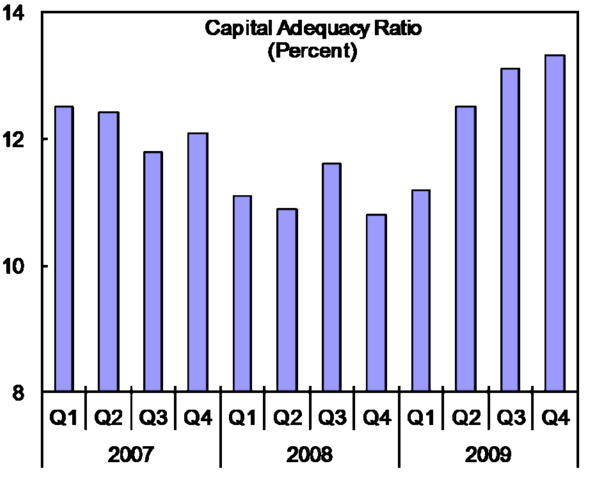
Figure 3. Poland: Balance of Payments Developments, 2007-09



Source: National Bank of Poland.

4. **The banking system has withstood the crisis relatively well.** Capital adequacy ratios (CARs) have risen to over 13 percent at end-2009, from 11 percent a year ago. Moreover, profits remained robust in 2009, reaching about two thirds of the record-high level of the preceding year. While nonperforming loans (NPLs) rose from around 4½ percent in 2008 to about 7½ percent in 2009 as economic activity declined, their growth appears to be slowing. Banks' balance-sheet restructuring is coming to an end. They have recently started to ease lending policies for housing loans and short-term corporate credits and resumed foreign-currency lending, especially for Euro-denominated mortgages (Box 2).





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

Box 2. Recent Developments in the Banking Sector

The banking system entered the crisis from a position of relative strength. Polish banks were not exposed to toxic products and relied on international funding sources to a lesser extent than regional peers. Moreover, foreign subsidiaries—representing about 70 percent of the Polish banking system—continued to receive significant liquidity and capital support from their parent institutions.

Credit quality has deteriorated as the economy slowed. The increase in NPLs to 7.6 percent at end-2009 was mainly due to worsening corporate credits. More recently, household consumer loans have started to deteriorate at a faster rate, though mortgages (both in domestic and foreign currencies) have remained relatively stable. With unemployment on a rising trend, non-performing consumer loans are expected to increase further and then stabilize. The quality of corporate credits is expected to gradually improve, as non-performing loans linked to foreign-exchange (fx) derivative contracts have been declining as contracts have expired and the zloty has appreciated. Overall, the system remains resilient to adverse macroeconomic shocks, as shown by recent stress tests by the NBP.

Capital adequacy ratios have risen, and profits remained robust. Capital adequacy ratios have reached over 13 percent at end-2009. Some of the increase, however, is due to banks' holding significant amounts of government paper, which reduces risk-weighted assets. Moreover, the zloty appreciation has also led to a decline in risk-weighted assets associated with fx-denominated mortgages. Profits remained strong in 2009, reaching about two thirds of the record-high 2008 levels.

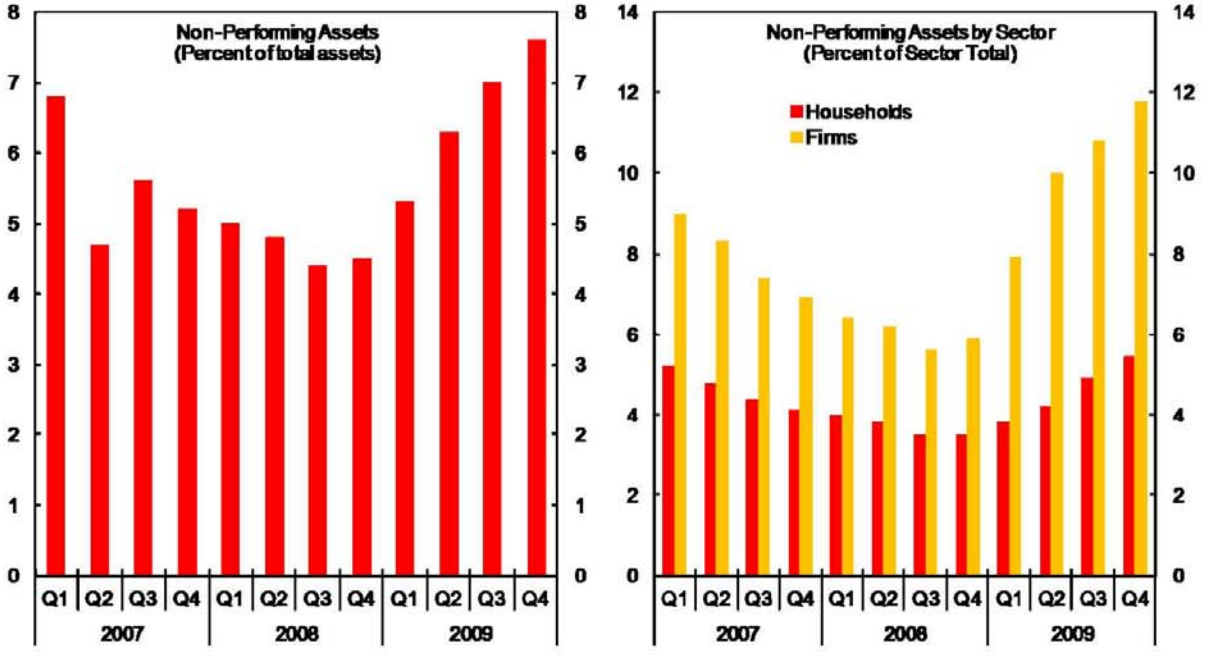
Banking-system liquidity is gradually improving. As elsewhere, the interbank market froze in late 2008. While the market resumed functioning in 2009, it has not fully normalized. The spread between the 3-month WIBOR and the policy rate declined and remained stable in the last quarter of 2009. But it still remains above its pre-crisis level and higher than comparable euro area spreads, with transactions at maturities longer than one week still rare. However, swap markets are normalizing, and demand for the NBP's facilities in Swiss franc, euro and dollar has been negligible since November last year. In addition, inflows of EU funds are increasing banking-system liquidity, pushing overnight interbank rates close to the floor of the NBP's corridor and prompting the NBP to absorb liquidity through the issuance of bills. Finally, deposit growth has held up well, underpinned by rising corporate deposits. Though still high, rates on retail deposits appear to be softening.

The decline in credit growth has stopped. Annual credit growth declined to 10 percent in 2009 from 36 percent in 2008. This was due mainly to slowing corporate credit, as enterprises ran down inventories and reduced demand for loans to finance fixed capital formation. In contrast, the growth of household credit remained robust, especially in the mortgage segment. The latest senior loan-officer survey suggests that in Q4 2009 banks stopped tightening overall lending policies and lowered spreads, based on a more positive economic outlook for 2010. While banks eased policies for housing loans and short-term corporate credits, they still tightened them somewhat for consumer and long-term corporate lending. Looking forward, the survey reports an expected increase in demand, a slight softening of the lending criteria on short-term credit, and a slight tightening of long-term credits.

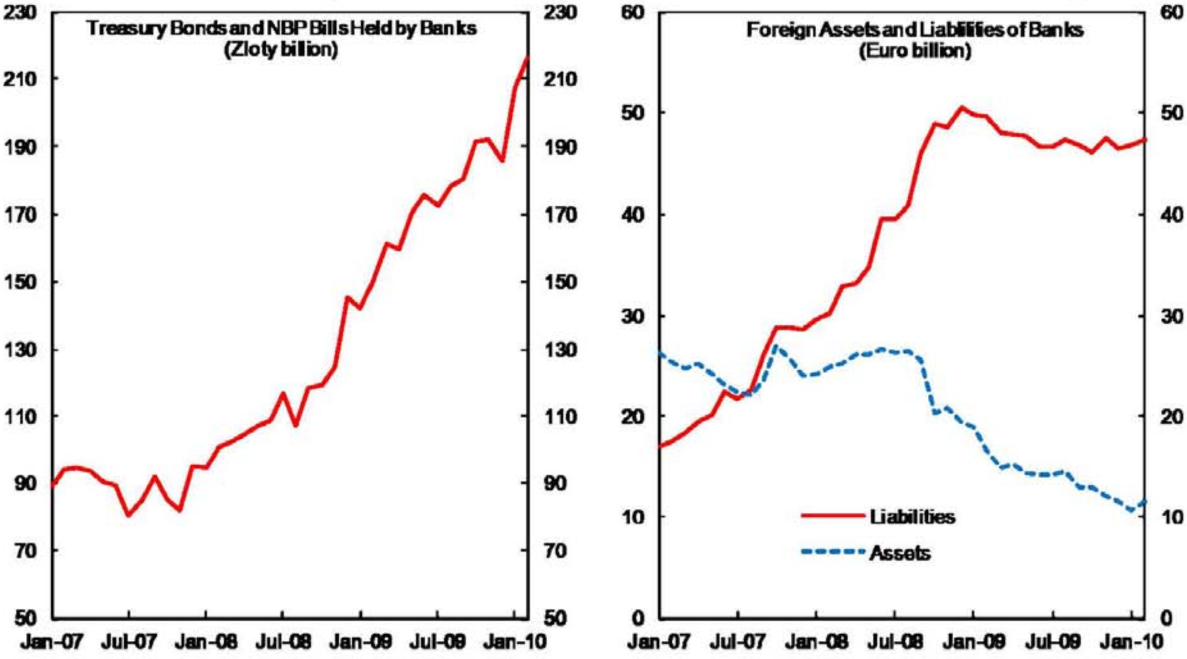
Banks have started to increase foreign-currency lending. The introduction of Recommendation S in 2006, imposing tight lending standards on mortgages, including those denominated in foreign currency, was helpful—together with favorable developments in interest rates—in limiting credit risks during the downturn. Nevertheless, this measure was not able to prevent a sizable build-up of fx-denominated mortgages. The stock of fx-denominated mortgages now stands at 65 per cent of total mortgage assets, most of which is denominated in Swiss francs. Since Q3 2008, the share of new fx-denominated loans has fallen, as banks faced difficulties in hedging the associated foreign-exchange risk in wholesale swap markets. But, more recently, there has been an uptick in fx-denominated mortgages, especially in euros.

Figure 4. Poland: Banking Sector Developments, 2007-10

Nonperforming loans are still rising both in the corporate and household sectors, though their growth is slowing.



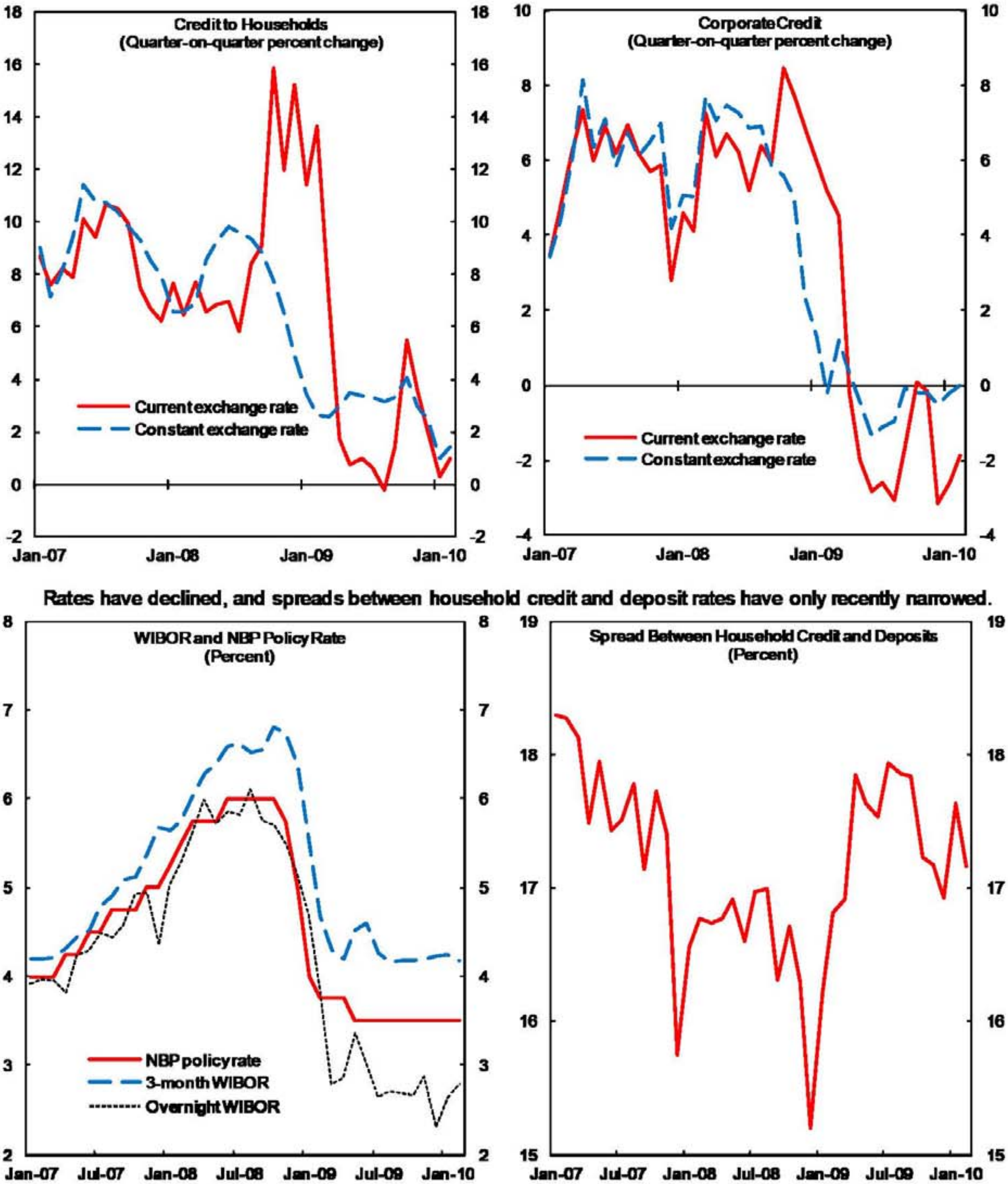
Banks have increased exposure to domestic liquid assets, while their fx liabilities have been rising.



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

Figure 5. Poland: Credit Developments, 2007-10

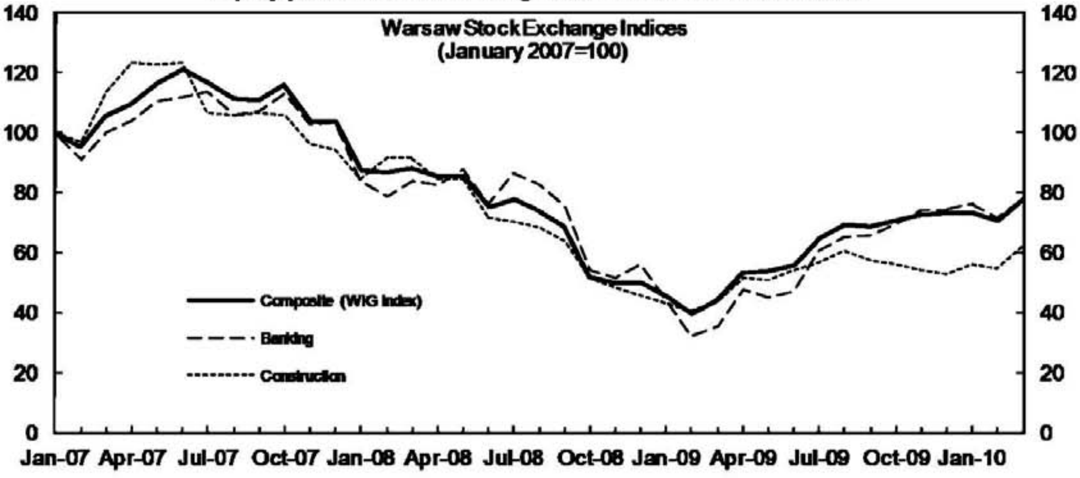
Credit to households and corporates is showing tentative signs of revival.



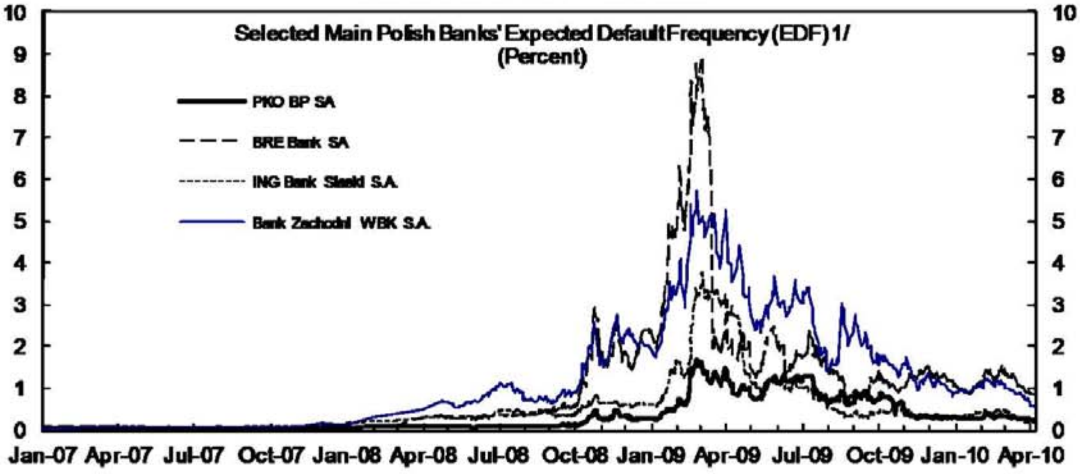
Sources: National Bank of Poland; Bloomberg; and IMF staff estimates.

Figure 6. Poland: Banking Sector Market Indicators, 2007-10

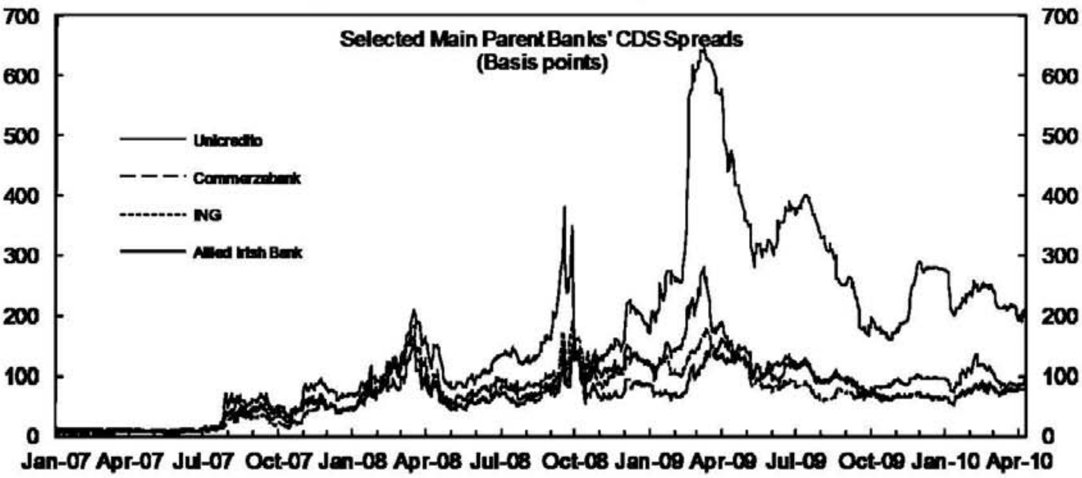
Equity prices for the banking sector recovered somewhat.



Polish banks' EDFs have fallen.



CDS spreads of parent banks have stabilized, except for Allied Irish Bank.



Sources: DataStream; Moody's KMV; and Bloomberg.
1/ Estimated EDF by Moody's KMV constructed with market-based data.

II. Recent Policy Responses

5. **Fiscal policy is providing significant counter-cyclical stimulus.** There was a discretionary fiscal relaxation estimated at 1¾ percent of GDP in 2008 and 2½ percent of GDP in 2009, mainly due to tax cuts enacted in 2007 but coming into effect with a delay. While the government initially intended to offset revenue shortfalls to the extent needed to maintain the state budget deficit below the limit of Zloty 18 billion in 2009—through what would have been highly pro-cyclical expenditure cuts—it appropriately changed such plans at mid-year, when it raised the limit to Zloty 27 billion. As a result, the general government deficit increased from under 2 percent of GDP in 2007 to over 7 percent of GDP in 2009. The strong counter-cyclical stimulus provided by fiscal policy—through a combination of discretionary relaxation and the work of automatic stabilizers—was a major reason for Poland's not falling into recession during the global crisis.

6. **Market reaction to the wider deficits remained positive, helped by the authorities' decision to avail themselves of the FCL.** While the impact of the Flexible Credit Line (FCL) is difficult to disentangle from a broader improvement in sentiment, senior officials and market participants indicated that access to the FCL was helpful to allow the authorities to acknowledge considerably larger fiscal deficits without unsettling markets. Thus, the FCL has been credited, in part, for the increase in demand in the domestic bond market—which saw a return of foreign investors especially after April 2009—and the subsequent decline in yields. Moreover, after the approval of the FCL, the government was able to tap successfully international markets with long-term bond offerings that were significantly oversubscribed. This allowed the authorities in late 2009 to start pre-financing needs for 2010. The positive trend continued this year, with two large issuances of Eurobonds at spreads that were half of those paid a year ago.

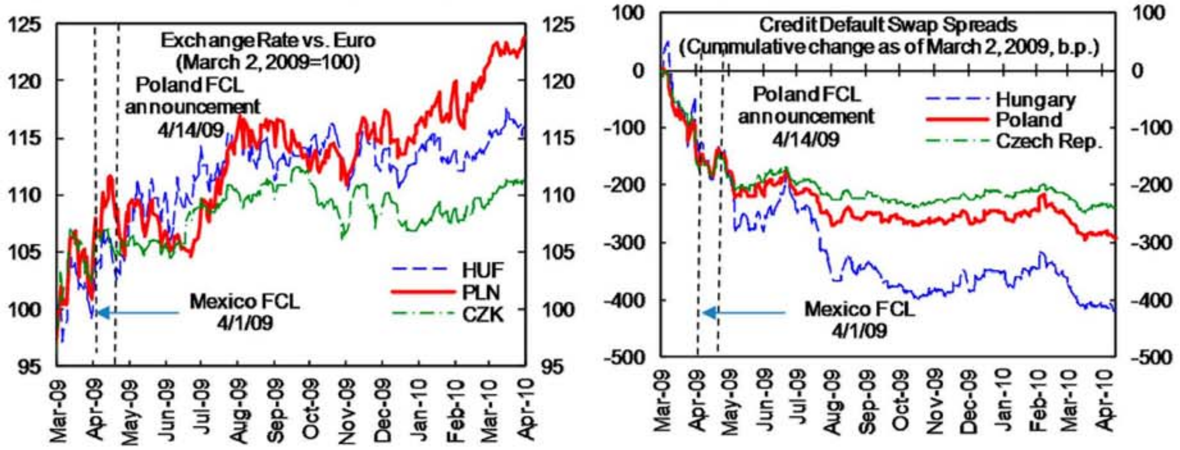
7. **The monetary policy easing cycle has ended.** The Monetary Policy Council (MPC) continued to cut rates through the first half of 2009, to 3.5 percent. It maintained a loosening stance until October 2009, when it changed its informal bias to neutral, reflecting an improved outlook and renewed concern about inflation. The new MPC that took office in February confirmed the neutral bias in its first meeting.

8. **Facilities for exceptional liquidity support are being phased out.** In early 2009, the NBP lowered reserve requirements, extended the maturity of repo operations, broadened the range of accepted collateral, and engaged in foreign-exchange repos with the ECB and the Swiss National Bank (SNB). Given the improved market conditions, the NBP has limited the use of the three and 6 month repos and allowed the repo agreement with the SNB to expire in early 2010. Finally, the authorities have offered a credit-guarantee scheme through the state-owned BGK bank aimed at boosting corporate lending, but demand for such guarantees has been limited so far.

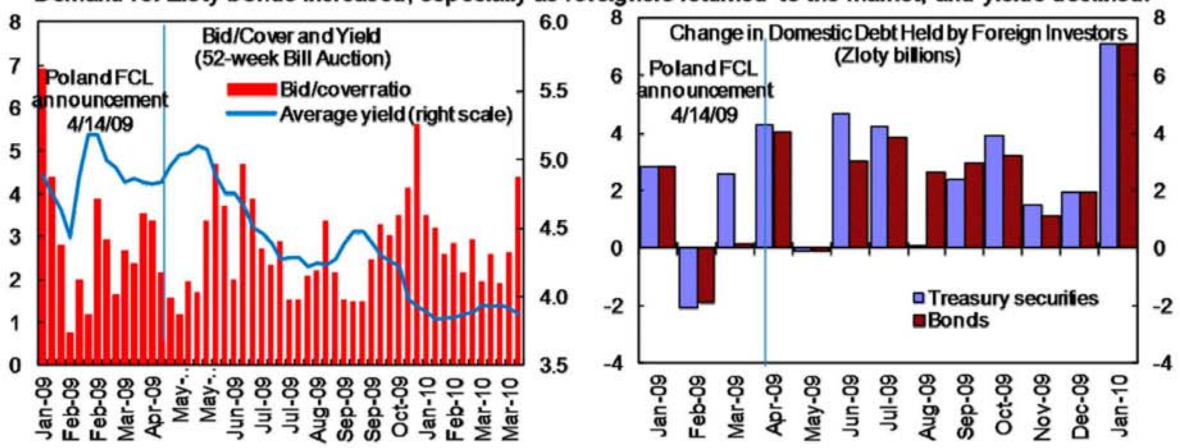
9. **Further measures have been taken to safeguard financial stability.** The recommendation by the Financial Supervision Commission (KNF) last year that all banks retain 2008 profits was instrumental in quickly restoring CARs to pre-crisis levels. With CARs now considered to be at comfortable levels despite the continued increase in NPLs, the KNF has decided not to repeat this general recommendation in 2010, although it intends to encourage weaker banks to retain a large share of their earnings to create buffers above the recommended CAR of 10 percent. While the quality of capital is generally high, the KNF recently allowed banks to count certain convertible and long-term bonds in their own funds for a set period of two years. However, this measure is subject to approval on a case-by-case basis and aimed primarily at the cooperative sector. The KNF has also recently introduced Recommendation T, which tightens credit assessments on household lending, as it considered standards in this segment of the market to be of uneven quality.

Figure 7. Poland: The FCL's Impact on Financial Markets, 2009-10

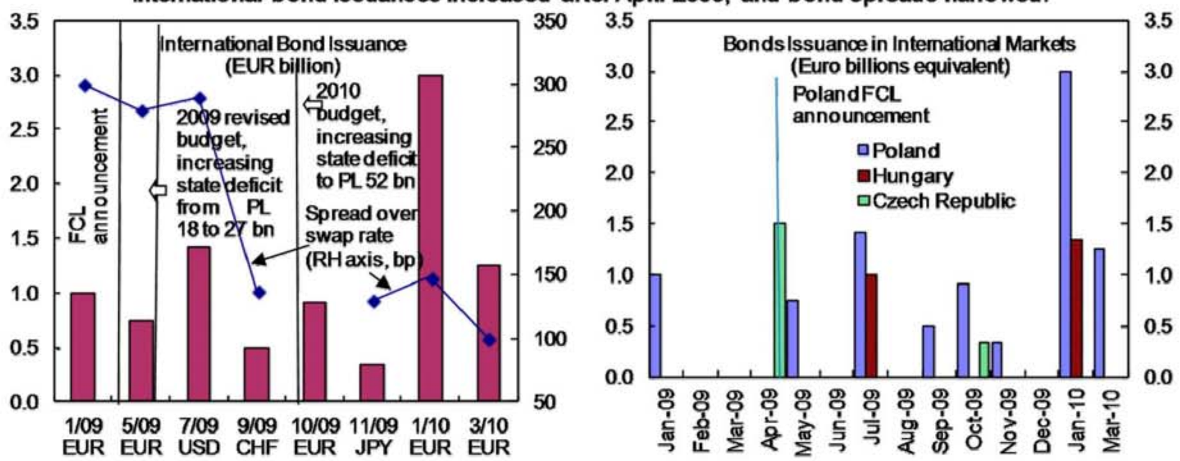
Upon the FCL's announcement, the Zloty reached a four-month high against the Euro, and CDS spreads fell.



Demand for Zloty bonds increased, especially as foreigners returned to the market, and yields declined.



International bond issuances increased after April 2009, and bond spreads narrowed.



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

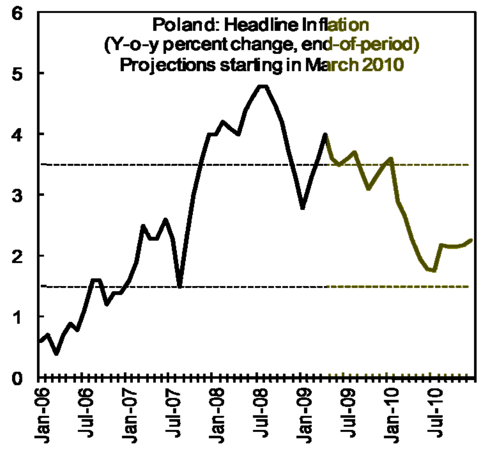
III. Outlook and Risks

10. **The recovery is set to continue to gain strength.** The global environment is improving; the balance-sheet adjustment in the Polish banking system appears to have run its course, with renewed risk appetite suggesting that banks are ready to cautiously expand credit; and, not least, transfers from the EU are expected to almost triple in the next few years. Against this background, staff projects a continued recovery in domestic demand, in particular public investment; a gradual increase in real GDP growth to around 2¾ percent in 2010 and 3¼ in 2011; and closure of the negative output gap by 2011–12. The projection assumes a small negative contribution of the foreign balance to GDP growth, with the current account rising to around 3 percent of GDP in 2010–11.[4] Despite the zloty's sustained appreciation since early 2009, staff assesses the real exchange rate to be broadly in line with fundamentals (Box 3).

Poland: Real GDP Growth Projections, 2010-11
(Percent)

	2010	2011
GDP	2.7	3.2
Domestic demand	3.0	3.2
Private consumption	1.5	2.5
Public consumption	2.0	2.0
Domestic fixed investment	4.5	6.0
Private fixed investment	0.3	4.8
Public fixed investment	24.4	11.2
Net external demand (contribution to growth)	-0.3	0.0
Output Gap	-0.9	-0.1

Sources: IMF staff projections.



Sources: Polish Statistical Office; and IMF staff projections.

11. **Inflation is expected to remain contained.** In view of the negative output gap, and with no evidence of pressures on wages and commodity prices, staff projects inflation to continue to fall during the first half of 2010, stabilizing at or below the NBP's target, under the assumption of unchanged policies.

12. **Risks to the outlook are balanced, but external uncertainty looms large.** On the upside, developments during 2009 point to the possibility of a stronger-than-expected rebound. Risks in this regard arise mainly from the possibility of larger capital inflows, if ample liquidity and low interest rates in advanced countries, coupled with an accelerated recovery in global risk appetite, were to cause an even stronger demand for assets of well-performing emerging market countries like Poland. An alternative upside risk is a confidence-driven improvement in domestic demand, not least coming from a faster-than-expected expansion of banks' balance sheets. On the downside, the still fragile economic outlook in Europe, including

[4] This takes into account the expiration of car-scrapping programs in Western Europe, which proved useful in sustaining exports during the crisis.

tail risks associated with vulnerabilities of a number of countries with high fiscal deficits within the Euro Area, point to the possibility that global investors might yet decide to retreat.

Box 3. Real Exchange Rate Assessment

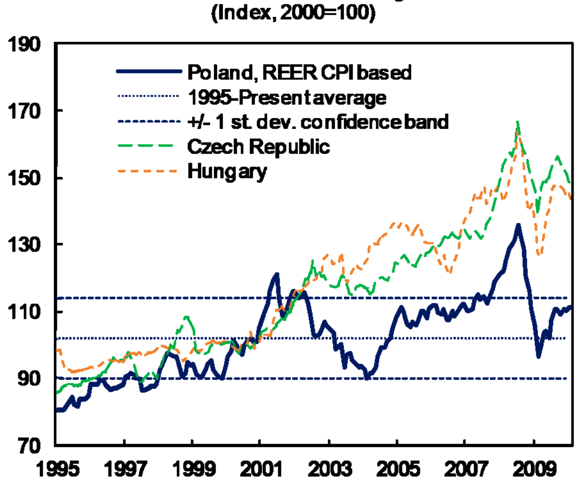
Staff estimates suggest that the real exchange rate is broadly in equilibrium. Preliminary estimates based on the CGER methodology for the latest reference period suggest that the recent appreciation of the zloty has partly offset the real depreciation that had been registered in the earlier part of 2009. Specifically:

CGER Results, 2009-10
(Percent deviation from estimated equilibrium)

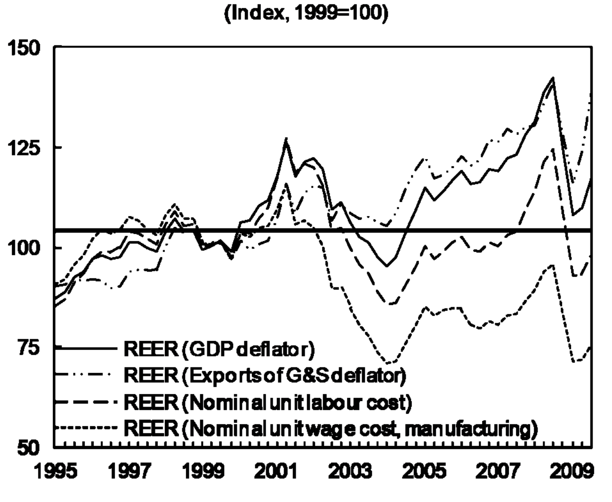
	Spring 2009	Spring 2010
Macrobalance approach (MB)	-5	-3
ERER approach	-12	-3
External stability approach (ES)	-13	-10
Average	**-10**	**-5**
CA norm	-1.7	-2.0
NFA-stabilizing CA at 2009 level	-3.4	-3.0

- The equilibrium real exchange rate (ERER) methodology suggests a balanced assessment. This estimate reflects a strengthened equilibrium level, driven by improvements in relative productivity.
- The projected medium-term current account deficit (including capital transfers) is below the net foreign asset-stabilizing deficit and close to the current account norm, implying a moderately undervalued estimate according to the external-stability (ES) approach and a balanced estimate based on the macro-balance (MB) approach.
- The CPI-based real exchange rate is now slightly above its historical average. However, Poland's real exchange rate is still considerably below that of regional peers, in cumulative terms, as Poland underwent a sharper real depreciation in the earlier part of 2009. Consequently, there is no evidence yet of Poland having become uncompetitive as a result of last year's appreciation.
- As regards other indicators of price and cost competitiveness, ULC-based measures of the REER improved in the course of 2009, as weakening cyclical conditions helped to dampen wage pressures.

Poland: Real Effective Exchange Rate (Index, 2000=100)



Poland: Alternative REER Measures (Index, 1999=100)



Sources: National authorities; European Commission; and GDS.

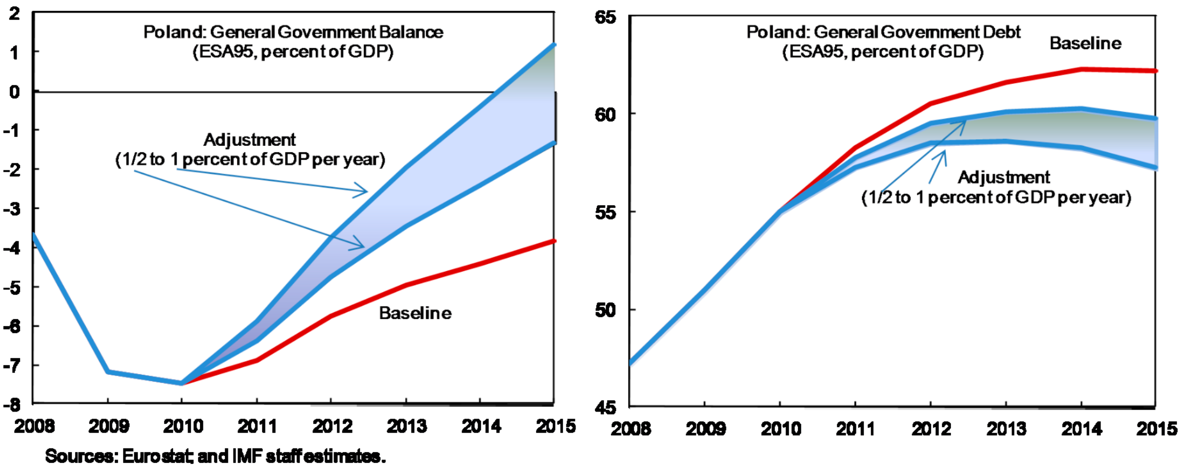
IV. THE POLICY AGENDA

A. Embarking on a Credible Medium-Term Fiscal Consolidation Strategy

13. **The general government deficit is likely to increase further.** The recently approved 2010 budget will, in staff's view, entail an increase in the state deficit to about 4½ percent of GDP, taking into account an expected revenue over-performance. With continued high deficits in the National Road Fund, social security system, and local governments, the general government deficit is set to increase to about 7½ percent of GDP in 2010, or about 7 percent of GDP in cyclically-adjusted terms. Uncertainty around these projections remains high, especially with regard to the deficits of sub-national governments, whose 2009 outturn has not yet been finalized, and whose plans for 2010 can change during the year, as they are not directly under the control of the central authorities.

14. **The authorities have yet to fully specify a plan for how to reduce the fiscal deficit.** Their target is ambitious: a deficit of 3 percent of GDP by 2012, as required under the Excessive Deficit Procedure and outlined in their revised Convergence Programme. However, the recently announced package of fiscal reform proposals, which remains to be implemented, will in the view of staff only bring down the deficit modestly, to just under 7 percent of GDP in 2011 and about 5¾ percent of GDP in 2012 (Box 4). As a result, the general government debt-to-GDP ratio on an ESA95 basis is set to continue to increase, peaking at about 62 percent of GDP by 2014 (including debts of the National Road Fund that are excluded from the national definition of debt).

15. **A consolidation strategy should balance short-term cyclical and medium-term consolidation objectives**. In light of the still incipient and uncertain recovery, staff believes that aiming at a deficit of 3 percent already by 2012 is too ambitious and that a more gradual reduction in the deficit is warranted. Staff suggests additional structural fiscal measures—over and above those announced already—of ½ to 1 percent of GDP annually during the next 4-5 years. With such measures, the deficit would fall below 3 percent of GDP by 2013–14 and the debt-to-GDP ratio would begin to decline from then onward.



Sources: Eurostat and IMF staff estimates.

16. **The substantial fiscal adjustment needed over the medium term will require changes in entitlement programs**. Given that statutory spending represents about ¾ of total expenditures, a durable expenditure reduction is unlikely to be achieved merely by the proposal to introduce a rule limiting the real growth of discretionary spending to one percent per year. Staff agrees, however, that such rules, reinforced by comprehensive expenditure reviews, could prove helpful in controlling discretionary spending. Regarding statutory spending reforms, possible options include tightening pension indexation, rationalizing other benefits (sickness, disability, etc.), and increasing the flexibility of limits on defense spending. These could be complemented with further revenue-enhancing measures, such as better linking contributions to income for the self-employed, extending coverage of the PIT to include farmers, unifying VAT rates at a higher level, improving the targeting of child benefits, and revamping the property tax system.

17. **The medium-term fiscal framework needs to be further strengthened.** The four-year rolling fiscal plans that were introduced as part of the revamped Public Finance Act in late 2009 are useful in providing guidance on medium-term policy goals. However, they are non-binding and remain focused on nominal deficits, retaining the potential pro-cyclical bias in fiscal policy. Hence, there is a need to adopt a permanent, binding expenditure rule with a deficit or debt anchor that is consistent with the authorities' medium-term targets. The framework could be further strengthened by the implementation of the ongoing multi-year performance budgeting reforms at all levels of government.

18. **Poland has been ahead in implementing reforms to ensure the long-term sustainability of its pension system**. This is evident from cross-country comparisons using more comprehensive, intertemporal measures of Poland's net worth.[5] Paradoxically, traditional deficit and debt indicators are worse as a result of these reforms. With the deficit now above the Maastricht limit and debt running against the ceilings imposed under Polish legislation, the authorities have been considering, among other options, lowering transfers to private pension funds (which currently add around 1.5-2 percent of GDP per year to the deficit and debt).[6] Staff is concerned that this could be seen as a more fundamental reversal of pension reforms at a time when the credibility of Poland's commitment to medium-term fiscal consolidation hinges on reforms of entitlement programs. As regards alternative proposals, including redefining the national debt definition and corresponding debt thresholds in the Public Finance Act, this should be done in such a way as not to undermine confidence in the fiscal framework and not to encourage spending pressures.

[5] See accompanying *Selected Issues* Paper entitled: "A Leap Beyond Traditional Fiscal indicators: Measuring Poland's Intertemporal Net Worth and Deriving its Policy Implications."

[6] Under the Public Finance Act, two debt thresholds are established at 50 and 55 percent of GDP (they apply to the national definition of debt): breaching of the first threshold triggers mild policy changes, serving mainly as a warning signal to policymakers; breaching of the second threshold at time t triggers more stringent measures that need to be implemented in the budget of the year t+2 aimed at curbing the growth in debt. A debt limit of 60 percent of GDP is set in the Constitution.

19. **The transparency of fiscal accounts could be increased**. The authorities should consider moving public entities (such as the national Road Fund) within the budget and publishing the intertemporal net worth of the public sector on a regular basis.

20. **The authorities believed that their fiscal consolidation plans were sufficient to achieve a significant reduction in the deficit.** Even under an alternative scenario—with macroeconomic assumptions closer to staff's— they saw the deficit reaching 3 percent of GDP by 2013 under the measures announced so far. Compared to staff, the authorities project higher tax buoyancy and the same growth rate for other expenditure categories as for discretionary expenditures that are covered by the CPI+1 rule. They agreed that strengthening the medium-term fiscal framework is key to anchoring expectations in the sustainability of public finances for the medium and long run. In this regard, they noted that they were working on the details of a permanent fiscal rule and intended to provide a road-map for its implementation later this year.[7] The authorities also noted that a final decision had not been taken regarding the proposal to lower transfers to the private pension funds and acknowledged that any action to this effect would need to be carefully designed and communicated so as not to undermine policy credibility.

[7] A forthcoming IMF fiscal technical assistance mission will be collaborating with the authorities in the development of such a rule.

Box 4. The New Fiscal Consolidation Package

The authorities have unveiled a package of fiscal consolidation and development priorities. While the plan is important, it is not fully specified and is, in staff's view, expected to yield only modest savings, of about 0.1-0.3 percent of GDP per year in the medium-run. It is yet to be approved.

The plan contains concrete measures to broaden the tax base and improve tax collection:
- Rules on VAT reimbursements for company cars and fuel will be tightened.
- Fiscal registers for lawyers and doctors will be introduced.
- E-taxes will be introduced.

It also aims to improve the fiscal framework, including through new fiscal rules:
- A temporary nominal spending limit on discretionary spending, the "CPI+1 rule"—capping its real growth to 1 percent—will be in effect until the medium-term objective (1 percent structural deficit) is attained.
- A permanent fiscal rule will replace the nominal limit. It would apply to a broader scope of public expenditures and rely on a real growth rate in a reference period and an inflation target. The details, including coverage, target, and timing, are yet to be specified.
- An additional measure of public debt will be defined, based on an idea of the public sector's intertemporal net debt.
- Performance budgeting will be helped by the implementation of multi-year budget planning.
- Liquidity management of public resources will be strengthened through a monitoring system of all budgetary funds and obligatory placement of all deposits of selected public-finance sector organizations on Ministry of Finance accounts.

It advances reforms of pensions and disability benefits:
- Disability pensions will be aligned with social security contributions paid.
- Pensions of uniformed personnel will be merged into the general system starting in 2012. With grandfathering, savings will be obtained only after 2030.
- A debate about changing the farmer pension scheme (KRUS) will be restarted.
- The investment efficiency of the private pension system (OFE) will be improved by modifying investment limits, lowering fees, and prohibiting advertisement of pension funds.

It accelerates the privatization agenda:
- Privatization of public enterprises in 2010 will be accelerated, to generate 25 bn zloty. Additionally, arable land would be sold.

But it also includes measures to improve state administration that will require additional spending:
- These measures include improving the judiciary system, increasing teacher salaries, advancing R&D, etc.

Announced Fiscal Measures
(in percent of GDP)

Announced (quantifiable) measures	2010	2011	2012	2013	2014	2015
CPI+1 rule	0.00	0.11	0.11	0.14	0.15	0.15
Reduction VAT exemptions for company cars	0.00	0.12	0.13	0.00	0.00	0.00
Better liquidity management	0.00	0.02	0.02	0.02	0.02	0.01
e-Taxes	0.00	0.05	0.05	0.05	0.04	0.04
Change in disability benefits formula	0.00	0.00	0.01	0.01	0.02	0.02
Development measures (costs to budget)	0.00	-0.23	0.00	0.00	0.00	0.00
TOTAL	0.00	0.08	0.32	0.21	0.23	0.22

B. Maintaining a Flexible Monetary and Exchange-Rate Policy

21. **Staff believes that a rise in policy rates would not be warranted any time soon**. This is in line with its view that inflation, under current policies, is set to stay around the NBP's inflation target of 2½ percent for the foreseeable future. It contrasts with the projection in the NBP's February Inflation Report that inflation is likely to exceed the upper end of the tolerance band in 2012 and with the market's consensus view that policy rate hikes are in the offing before the end of 2010.

22. **If upward pressures on the zloty persist, and inflation remains contained, the policy rate should be cut.** The recovery in global risk appetite, not least in the demand for assets of countries that have weathered the crisis well, suggest that foreign demand for Polish assets could continue to build, resulting in further zloty appreciation. In that case, staff believes that the MPC should revert to an easing bias and cut the policy rate.

23. **In this case, the NBP could also respond by undertaking limited pre-announced foreign-exchange intervention.** The intervention policy should be transparent and well-communicated so as not to compromise the integrity of the inflation-targeting framework. The experience of other countries has shown that such a policy can be successful at a time when the economic cycle permits a looser monetary policy.[8] With subdued inflation and a negative output gap, Poland appears well poised to successfully implement such a policy on a temporary basis if upward pressures on the zloty continue during 2010. Intervention would also boost international reserves, which are still low relative to standard metrics. The limitations on foreign-currency lending for prudential reasons discussed below could have the auxiliary benefit of slowing capital inflows. However, if capital inflows persist and cause overheating, there would be no alternative but to tighten fiscal policy and allow appreciation.

24. **The authorities had mixed views on the monetary policy stance.** While most of the mission's interlocutors believed that the neutral bias remained appropriate, the discussions showed different views regarding the balance of risks going forward: some MPC members stressed the need to signal a possible near-term increase, reflecting the view that risks were dominated by the possibility of a faster absorption of the remaining slack in the economy and attendant increase in inflationary pressures; others, however, agreed with staff that the more likely risk is that the zloty continues to appreciate, driven by capital inflows, while the economy continues to operate below potential, which would call for a renewed loosening bias. In this regard, while policy makers generally saw some scope for further appreciation without jeopardizing competitiveness, there was a growing concern that a rapid zloty appreciation could jeopardize the recovery.

[8] See accompanying *Selected Issues* Paper entitled: "Coping with Capital Flows under An Inflation Targeting Regime: Lessons for Poland."

C. Ensuring Financial System Resilience and Enhancing Prudential Regulations

25. **Efforts to strengthen financial system resilience are continuing.** The recent introduction by the KNF of Recommendation T is expected to strengthen what are considered to be uneven lending standards as far as household credits are concerned. Moreover, in view of international efforts to tighten liquidity and capital standards, the KNF continues to closely monitor and enforce quantitative liquidity requirements, and it plans to ensure that the weaker tier of banks rebuild their capital buffers. It is also working on bottom-up stress tests of banks, complementing the NBP's top-down tests. In response to what is widely perceived to be a potentially serious financial sector vulnerability, a law has recently been approved that subordinates cooperative credit unions (SKOKs) to supervision by the KNF and makes them eligible for lender-of-last resort support from the NBP, although the law is currently subject to a review by the Constitutional Tribunal. Finally, the authorities are advancing legislation allowing the government to recapitalize financial institutions in emergency situations.

26. **Risks stemming from un-hedged foreign-exchange exposures should be curbed.** With liquidity problems having eased and domestic risk appetite returning, regulators and market participants expect banks to increase foreign-exchange lending, not least euro-denominated mortgages. In view of this, staff believes that the KNF should take forceful steps to limit such lending. The KNF should ensure that foreign-exchange lending is funded and hedged on a longer-term basis, and capital requirements on foreign exchange-denominated mortgages should be raised decisively to reflect the higher credit and valuation risks in the event of a sudden depreciation. These measures could be calibrated so as to reduce the attractiveness of such mortgages. If prudential measures were ineffective in slowing the growth of these mortgages, the government should consider legislating constraints.

27. **The authorities agreed with the thrust of staff's recommendations.** The KNF has been recently using moral suasion to stop banks from offering yen-denominated mortgages. Moreover, it indicated that it was now working on a formal recommendation that would require long-term funding and hedging for all currencies. The KNF stressed, however, that the effectiveness of higher capital requirements would hinge on the cooperation of the home regulatory authorities of parent banks, to prevent these banks from providing foreign currency-denominated mortgages directly to local borrowers. An alternative was to place constraints at the product level, which could then be enforced locally, using the KNF's existing consumer-protection powers or new legislation. Finally, the authorities indicated that discussions are underway on how to permanently improve crisis management and resolution processes, building on the strong resolution powers on the part of the KNF. They welcomed the prospect of an FSAP update.

D. Adopting the Euro and Increasing Structural Flexibility

28. **Delaying euro adoption is appropriate at the current juncture.** The authorities have played down prospects for early euro adoption. In staff's view, the large adjustment needs in the next few years and the continued uncertainty in the external outlook suggest that early ERM-II entry would be risky. More important, in determining when to adopt the euro, the authorities should be mindful of the fact that exchange-rate flexibility has served Poland well, providing a shock absorber that significantly facilitated adjustment to the global crisis; such flexibility was an important reason for Poland's having avoided a recession in 2009. Staff believes that a higher degree of synchronization between Poland and the Euro area as far as external shocks are concerned should be achieved before giving up an independent exchange-rate policy. The credibility of Poland's monetary policy framework, not least what has proven to be a well-functioning inflation-targeting framework, also suggests that there is no urgency to Euro adoption. Nevertheless, Euro adoption should remain an important goal.

29. **There is considerable scope for boosting potential growth through structural reforms.** Priority should be given to increasing Poland's exceptionally low labor participation, especially among those above 50 years of age. With significant population aging expected in the coming decades, this bottleneck will likely hamper competitiveness and weigh heavily on its long-run growth. The authorities have taken important steps to address this concern, including by strengthening active labor market policies, reducing the tax wedge, and tightening eligibility criteria for early retirement. But more should be done, especially on reforms with a complementary long-term fiscal impact, such as pension reforms aimed at gradually increasing and equalizing the retirement age between men and women and unifying special pension schemes within the general system. Such efforts should be complemented by actions to enhance product-market flexibility, including vigorously pursuing the ambitious privatization agenda and further reducing administrative barriers to business activity.

30. **The authorities confirmed that increasing labor participation remained an over-arching priority.** In this regard, they noted that work was underway on advancing labor supply-enhancing reforms, including on unifying special pension schemes within the general system and reforming the tax system for farmers. These efforts are in line with their objectives established in their Solidarity 50+ and Poland 2030 plans. The authorities also pointed out that privatization efforts were on track, with more than one fifth of the total planned receipts for 2010 already achieved by end-March, and more revenues expected later in the year from the privatization of several key public energy companies.

V. Staff Appraisal

31. **Poland has adjusted its economic policies in a timely and effective manner in response to the global crisis.** It weathered the crisis well, being the only EU country not to have fallen into recession in 2009. This is due, in part, to Poland's large domestic market and attendant limited reliance on exports, which—coupled with a well-capitalized and profitable banking system—limited the negative spill-over from the crisis through both the real and financial channels. But it also reflects sound economic policies prior to the crisis, which contained macroeconomic imbalances and allowed considerable room for maneuver when the crisis struck. Policy-makers took full advantage of this room to provide significant monetary and fiscal stimulus. Looking forward, with the relative cyclical position continuing to advance, but the recovery still feeble and uncertainty high, the challenge facing policy-makers now is when and how to begin withdrawing fiscal and monetary stimuli, i.e. how to adjust the policy mix as circumstances evolve.

32. **With inflation falling steadily and the economy operating below potential, staff sees no case for an increase in policy interest rates at this juncture.** Indeed, in view of the steady recovery in capital inflows and attendant upward pressures on the zloty, staff believes that the decision last October to end the loosening cycle and adopt a neutral bias might have been premature. If such inflows persist, and if inflation remains contained, the MPC should reduce policy rates further. Staff also sees a case for transparent interventions in the foreign-exchange market at the current juncture, without fuelling inflation expectations or undermining confidence in the inflation-targeting framework.

33. **The highly counter-cyclical fiscal policy has been a main reason for Poland's having avoided a recession.** The large discretionary relaxation was fortuitous in as much as it reflected the delayed coming-into-effect of measures adopted well before the crisis. Be that as it may, the government's decision in mid-2009 to abandon plans to offset the revenue shortfall—through what would have been severe pro-cyclical spending cuts—was a much welcomed change of heart. In this regard, the availability of the FCL enhanced the policy space at this sensitive juncture, as it allowed policy-makers to recognize significantly higher deficits going forward without unsettling markets. Indeed, spreads fell notably even as announced deficits widened.

34. **The government now needs to be clearer about its fiscal exit strategy.** With the economy continuing to recover, the fiscal stimulus should be gradually withdrawn. The government's official objective—meeting the SGP target of 3 percent of GDP by 2012—is ambitious, yet its plan for achieving it is unclear. In staff's view, the measures announced by the authorities so far will only slowly and modestly lower the deficit in the next few years to slightly below 6 percent of GDP by 2012. This is too slow, and staff suggests taking additional measures of about ½ to 1 percent of GDP annually. This would reduce the deficit to 3 percent by 2013–14. Staff believes that its proposal strikes a more appropriate balance

between short-term cyclical and medium-term consolidation objectives: going faster—as envisaged under the SGP—is too risky in view of the still feeble recovery in Poland and abroad, but going as slow as implied by the government's announced measures would limit the ability to react to unforeseen changes.

35. **Thus, a reduction in the deficit is important for the authorities' ability to adjust the policy mix in a timely manner as circumstances change.** In the near team, there appears to be little risk that the slow withdrawal of the stimulus implied by the government's announced measures might be a source of inflationary pressures in the event of a stronger-than-expected recovery in private sector demand. However, this risk increases as the time horizon is extended and the output gap closes. In this regard, considering that it could prove difficult for the authorities to tighten fiscal policy in a timely manner during what will be a prolonged cycle of presidential, parliamentary, and local elections in 2010-11, staff is concerned that the slow fiscal adjustment implied by current plans could force the authorities to adopt an inappropriate policy mix, with excessive reliance on monetary policy to contain inflationary pressures, and attendant upward pressures on the zloty. For now, the MPC has room to respond to the upward pressures on the zloty associated with the large public sector borrowing need by lowering policy rates, but as inflationary pressures gradually reemerge, such room will disappear, and continued large public sector borrowing could be a source of excessive zloty appreciation.

36. **The KNF has responded effectively during the crisis.** Its proactive move to encourage banks to retain the record-high 2008 profits and its recent recommendations aimed at strengthening lending standards for household loans speak to the effectiveness of its supervision. Looking forward, the KNF should take forceful steps to counter what appears to be a renewed appetite for foreign-exchange lending, not least the extension of foreign currency-denominated mortgages. In this regard, the authorities should be mindful of the experience of regional peers during the 2008–09 crisis that large un-hedged foreign-exchange liabilities significantly curtailed policy options, in effect exacerbating the recession through pro-cyclical policies. Foreign-exchange lending should be funded and hedged on a longer-term basis, and capital requirements on foreign exchange-denominated mortgages should be raised decisively to reflect higher credit and valuation risks. If such prudential measures were ineffective in slowing foreign currency-denominated mortgages, the government should consider legislation imposing explicit constraints.

37. **Staff does not support early euro adoption**. While this should remain an important goal, entering ERM2 any time soon would not be advisable in view of the uncertain global outlook and the rigidities in the macroeconomic policy mix discussed above. More importantly, the crisis has underscored the importance of being able to use the exchange rate to facilitate adjustment to external shocks. In staff's view, the swift change in the real exchange rate was one of the key reasons for Poland's not falling into recession in 2009.

38. Overall, staff believes that Poland's enviable performance during the global crisis owes much to good and timely economic policies—before and during the crisis—including a sound institutional framework. This augurs well for the authorities' ability to meet the challenges ahead.

39. It is recommended that the next Article IV consultation remain on a 12-month cycle.

Table 1. Poland: Selected Economic Indicators, 2007-11

	2007	2008	2009 Est.	2010 Proj.	2011 Proj.
Activity and prices					
GDP (change in percent)	6.8	5.0	1.7	2.7	3.2
Domestic demand	8.7	5.5	-0.9	3.0	3.2
Private consumption growth	4.9	5.9	2.3	1.5	2.5
Public consumption growth	3.7	7.5	1.2	2.0	2.0
Domestic fixed investment growth	17.6	8.2	-0.3	4.5	6.0
Net external demand (contribution to growth)	-2.1	-0.6	2.7	-0.3	0.0
CPI inflation (change in percent)					
Average	2.5	4.2	3.5	2.3	2.4
End of period	4.0	3.3	3.5	2.3	2.5
Unemployment rate (average, according to LFS)	9.6	7.1	8.0	9.5	10.8
Public finances (percent of GDP) 2/					
General government revenues	40.3	39.6	37.4	39.4	39.7
General government expenditures	42.2	43.3	44.6	46.8	46.6
General government balance	-1.9	-3.7	-7.2	-7.5	-6.9
Public debt	45.0	47.2	51.0	55.0	58.3
national definition 3/	44.8	47.0	49.9	52.8	...
Money and credit					
Private credit (12-month change)	29.5	36.3	10.0	...	...
Broad money (12-month change)	13.4	18.6	8.1	...	...
Policy Rate 4/	5.0	5.0	3.5	3.5	...
Balance of payments					
Current account balance (transactions, millions U.S. dollar:	-20,253	-26,909	-7,080	-13,354	-16,018
Percent of GDP	-4.8	-5.1	-1.6	-2.8	-3.2
Exports of Goods (millions U.S. dollars)	145,337	178,427	139,529	155,087	169,114
Export volume growth	9.1	7.1	-11.7	5.2	6.9
Imports of Goods (millions U.S. dollars)	162,394	204,399	144,331	166,933	182,086
Import volume growth	13.7	8.0	-16.9	5.9	6.6
Net oil imports (millions U.S. dollars)	13,438	19,251	12,465	16,229	17,671
Terms of trade (index 1995=100)	98.9	97.3	101.8	98.5	98.2
FDI, net (in percent of GDP)	4.2	2.2	1.9	2.4	2.4
Official reserves (millions U.S. dollars)	65,746	62,180	79,591	88,156	90,526
months of imports (goods)	4.9	3.7	6.6	6.3	6.0
Total external debt (millions U.S. dollars)	234,052	243,477	264,512	282,779	298,831
Percent of GDP	55.0	46.1	61.5	59.0	58.9
Ratio of reserves to short-term debt	103.3	72.4	80.0	88.0	99.2
Exchange rate					
Exchange rate regime		Floating			
Zloty per US$, period average 5/	2.77	2.41	3.12	2.88	...
Zloty per Euro, period average 5/	3.79	3.52	4.33	3.84	...
Real effective exchange rate (INS, CPI based) 6/	144.7	159.3	133.7	...	...
percent change	3.8	10.0	-16.0	...	

Sources: Polish authorities; and IMF staff estimates.

1/ Derived as total savings minus the current account minus capital transfers.

2/ According to ESA95 (including pension reform costs). Including the authorities' recent fiscal consolidation package.

3/ Excluding debts of the National Road Fund.

4/ NBP Reference Rate (eop). For 2010, latest.

5/ For 2010, exchange rate as of April 5.

6/ Annual average (1995=100).

Table 2. Poland: Balance of Payments on Transaction Basis, 2007-15
(In millions of US$)

	2007	2008	2009 1/ Est.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
Current account balance	-20,253	-26,909	-7,080	-13,354	-16,818	-18,456	-18,654	-19,263	-18,598
percent of GDP	-4.8	-5.1	-1.6	-2.8	-3.2	-3.4	-3.2	-3.1	-2.9
Trade balance	-17,057	-25,972	-4,802	-11,846	-12,972	-14,325	-15,640	-16,929	-18,098
percent of GDP	-4.0	-4.9	-1.1	-2.5	-2.6	-2.6	-2.7	-2.8	-2.8
Exports									
percentage change in unit values	26.2	22.8	-20.6	11.2	9.0	7.3	6.5	6.5	6.5
percentage volume growth	9.1	7.1	-11.7	5.2	6.9	6.6	5.9	6.0	6.0
growth in foreign demand	8.7	3.5	-16.7	5.2	5.7	6.0	6.2	6.3	6.3
Imports									
percentage change in unit values	29.3	26.0	-28.6	15.7	9.1	7.5	6.7	6.6	6.5
percentage volume growth	13.7	8.0	-16.9	5.9	6.6	6.1	6.1	6.1	6.0
growth in domestic demand	8.7	5.5	-0.9	3.0	3.2	3.8	4.1	4.0	4.1
Terms of trade percentage change	1.7	-1.6	4.6	-3.2	-0.4	-0.6	-0.1	0.0	0.0
Services balance	4,758	5,016	5,382	4,899	5,033	5,080	5,069	5,100	5,267
Credit	28,914	35,577	29,406	32,685	35,341	37,661	39,819	42,141	44,713
Debit	24,156	30,561	24,024	27,786	30,308	32,581	34,750	37,041	39,446
Net income	-16,448	-14,210	-14,306	-14,798	-15,002	-15,945	-15,654	-14,672	-13,800
Net transfers	8,494	8,257	6,646	8,392	6,923	6,734	7,572	7,239	8,033
o/w EU receipts	4,523	3,885	4,610	5,306	5,268	6,055	6,913	6,658	7,054
o/w payment to EU	-3,630	-3,926	-5,194	-4,867	-5,066	-5,035	-5,003	-4,972	-4,941
Capital and financial account balance	43,650	46,501	40,485	40,602	37,871	39,582	39,282	40,104	39,324
Capital account balance	4,771	6,118	7,028	11,175	9,041	10,405	11,890	11,437	10,360
o/w net EU transfers	4,660	5,828	6,911	10,286	8,742	10,049	11,472	11,050	10,035
Financial account balance	38,879	40,383	33,457	29,427	28,031	29,177	27,392	28,667	28,965
Foreign direct investment (net)	17,987	11,747	8,372	11,473	12,302	15,433	15,042	16,503	17,934
by nonresidents	23,651	14,849	11,645	12,473	13,552	16,933	16,792	18,503	20,184
o/w privatization	95	100	1,263	2,736	413	138	138	137	134
Portfolio investment (net)	-5,415	-2,082	16,266	12,854	8,402	6,828	5,250	5,319	4,813
by non-residents	925	-4,439	16,330	14,254	9,848	8,331	6,814	6,945	6,505
o/w equities	-470	564	1,428	2,870	2,964	3,081	3,045	3,166	3,295
Other investment (net)	28,353	31,512	10,300	5,100	7,326	6,916	7,100	6,845	6,218
Assets	-1,771	5,426	4,167	-1,783	-1,842	-1,914	-1,991	-2,071	-2,155
Liabilities	30,124	26,086	6,133	6,883	9,168	8,830	9,091	8,916	8,373
Financial derivatives	-2,046	-794	-1,481	0	0	0	0	0	0
Errors and omissions	-10,360	-21,556	-18,683	-18,683	-18,683	-18,683	-18,683	-18,683	-18,683
Overall balance	13,037	-1,964	14,722	8,565	2,371	2,443	1,946	2,158	2,043
Financing									
Reserve assets	-13,037	1,964	-14,722	-8,565	-2,371	-2,443	-1,946	-2,158	-2,043
Memorandum items:									
Current plus capital account (percent of GDP)	-3.6	-3.9	0.0	-0.5	-1.4	-1.5	-1.2	-1.3	-1.3
Official reserves	65,746	62,180	79,591	88,156	90,526	92,969	94,915	97,072	99,116
In months of imports	4.9	3.7	6.6	6.3	6.0	5.7	5.5	5.2	5.0
Ratio of reserves to short-term debt 2/	103.3	72.4	80.0	88.0	99.2	98.3	94.6	97.9	100.1
Ratio of reserves to ST debt plus CA deficit 2/	72.2	55.8	73.3	76.7	84.0	81.9	79.5	81.7	84.0
Total external debt (percent of GDP)	55.0	46.1	61.5	59.0	58.9	57.5	56.5	55.3	55.0
Total external debt (percent of exports) 3/	134.3	113.8	156.6	150.6	146.2	142.8	139.8	136.6	132.8
External debt service (percent of exports) 3/ 4/	29.8	45.5	48.6	50.2	48.7	46.7	47.8	45.1	42.8
Gross FDI inflows (percent of GDP)	5.6	2.8	2.7	2.6	2.7	3.1	2.9	3.0	3.2
Net FDI inflows (percent of GDP)	4.2	2.2	1.9	2.4	2.4	2.8	2.6	2.7	2.8

Sources: National Bank of Poland; and IMF staff estimates.
1/ Preliminary estimate based on quarterly national accounts data for 2009Q1-Q3 and monthly preliminary data for 2009Q4.
2/ Reserve level at end of previous year over short-term debt by remaining maturity.
3/ Exports of goods and services.
4/ Excluding repurchase of debt and including deposits.

Table 3. Poland: General Government Revenues and Expenditures, 2008-15
(In percent of GDP, ESA95 basis)

	2008	2009 Est.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
General government revenue	39.6	37.4	39.4	39.7	40.2	40.4	40.5	40.6
Taxes	22.8	20.5	21.2	21.5	21.8	21.8	21.9	21.9
Indirect taxes	14.2	13.0	13.6	13.7	13.9	13.9	13.9	13.9
Direct taxes	8.6	7.5	7.6	7.7	7.9	8.0	8.0	8.0
Capital taxes	<0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social contributions	11.4	11.3	11.1	11.0	11.0	11.0	11.1	11.2
Other current revenue	5.0	5.0	5.0	5.0	5.0	4.9	4.9	4.8
Capital revenue	0.4	0.6	2.0	2.2	2.4	2.7	2.7	2.6
General government expenditure	43.3	44.6	46.8	46.6	45.9	45.4	44.9	44.4
Goods and services	6.2	5.9	6.4	6.4	6.3	6.2	6.1	6.1
Compensation of employees	10.0	10.2	10.0	10.0	9.7	9.5	9.2	8.9
Interest payments	2.2	2.4	2.7	2.8	2.9	3.0	3.1	3.1
Subsidies	0.7	0.7	0.8	0.8	0.7	0.7	0.7	0.7
Social benefits	16.2	17.2	17.1	16.7	16.2	15.7	15.6	15.5
Other current expenditure	2.6	2.5	2.5	2.4	2.4	2.3	2.2	2.2
Capital transfers and investment	5.4	5.7	7.4	7.5	7.6	7.9	7.9	7.8
General government balance	-3.7	-7.2	-7.5	-6.9	-5.8	-5.0	-4.4	-3.8
Memorandum items:								
Structural balance	-4.3	-6.9	-7.1	-6.9	-5.8	-5.0	-4.4	-3.8
Primary balance	-1.4	-4.8	-4.8	-4.1	-2.8	-1.9	-1.3	-0.7
Structural primary balance	-2.1	-4.5	-4.5	-4.1	-2.9	-2.0	-1.3	-0.7
Public debt	47.2	51.0	55.0	58.3	60.5	61.6	62.3	62.2

Sources: Eurostat; and IMF staff estimates.

Notes: The projections include consolidation measures that have beeen announced but not yet implemented. They do not include additional measures that would be triggered under the Public Finance Act if debt (national definition) exceeds the 55 percent-of-GDP threshold.

Table 4. Poland: Financial Soundness Indicators, 2005-09

(In percent)

	2005	2006	2007	2008	2009
Capital adequacy					
Regulatory capital to risk-weighted assets	14.5	13.2	12.0	11.2	13.3
Regulatory Tier I capital to risk-weighted assets	14.4	12.9	10.9	10.1	12.0
NPLs net of provisions to capital	20.3	14.3	11.5	13.8	25.8
Bank Capital to Assets	7.9	7.8	8.0	7.9	9.0
Asset composition and quality					
NPLs to gross loans	11.0	7.4	5.2	4.5	7.6
Sectoral distribution of loans to total loans					
Loans to households	52.3	56.4	58.8	61.4	64.8
Loans to non-financial corporations	47.4	43.3	40.8	38.2	34.7
Earnings and profitability					
Return on average assets (after-tax)	1.6	1.7	1.9	1.5	0.8
Return on average equity (after-tax) 1/	20.5	22.2	24.9	20.5	10.7
Interest margin to gross income 2/	59.0	52.9	68.8	55.8	37.6
Noninterest expenses to gross income 2/	72.3	69.6	68.7	60.6	71.8
Liquidity					
Liquid assets to total assets (liquid assets ratio)	21.2	20.1	17.1	17.0	20.4
Liquid assets to total short-term liabilities	29.3	27.7	24.1	24.7	29.1
Sensitivity to market risk					
Net open positions in FX to capital 1/	2.0	-0.1	0.6	0.0	0.1

Sources: National Bank of Poland; and KNF.

1/ Data for domestic banking sector.

2/ Data are from KNF and for 2009Q3.

Table 5. Poland: External Financing Requirements and Sources, 2008-13
(In million of U.S. dollars)

	2009 Est.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.
GROSS FINANCING REQUIREMENTS	**82,423**	**103,769**	**104,919**	**110,525**	**118,394**
Current account deficit	7,080	13,354	16,018	18,456	18,654
Medium and long-term debt amortization	12,675	26,243	20,349	16,812	17,088
Public sector	697	6,821	4,187	6,355	8,017
Banks	3,202	6,637	7,745	2,792	4,627
Non-bank Corporates	8,776	12,785	8,417	7,665	4,444
Short-term debt amortization	62,668	64,172	68,552	75,257	82,653
Public sector	213	1,917	1,725	1,639	1,475
Banks (inc. s.t. deposits)	29,189	29,100	29,631	30,520	32,046
Non-bank Corporates	33,266	33,155	37,196	43,098	49,132
o/w trade credit	27,296	27,205	30,521	35,364	40,315
SOURCES OF FINANCING	**97,145**	**112,334**	**107,289**	**112,968**	**120,340**
Foreign direct investment (net)	8,372	11,473	12,302	15,433	15,042
o/w inward (net)	11,645	12,473	13,552	16,933	16,792
Equities (net)	733	1,350	1,394	1,449	1,347
by nonresidents	1,428	2,870	2,964	3,081	3,045
New borrowing and debt rollover	93,501	108,724	104,997	106,058	112,624
Medium and long-term borrowing	29,329	40,172	29,740	23,406	21,833
Public sector	16,711	19,791	11,157	10,804	10,904
Banks	3,842	6,957	8,735	3,350	5,552
Non-bank Corporates	8,776	13,424	9,848	9,252	5,377
Short-term borrowing	64,172	68,552	75,257	82,653	90,791
Public sector	1,917	1,725	1,639	1,475	1,328
Banks	29,100	29,631	30,520	32,046	33,328
Foreign subsidiaries to parent banks	20,945	21,327	21,967	23,065	23,988
Other	8,155	8,304	8,553	8,981	9,340
Non-bank Corporates	33,155	37,196	43,098	49,132	56,135
EU transfers	6,911	10,286	8,742	10,049	11,472
Other	-12,372	-19,499	-20,146	-20,022	-20,145
of which: Errors and omissions	-18,683	-18,683	-18,683	-18,683	-18,683
BUFFERS					
Use of official reserves	**-14,722**	**-8,565**	**-2,371**	**-2,443**	**-1,946**
FINANCING GAP	**0**	**0**	**0**	**0**	**0**

Sources: National authorities; and IMF staff estimates .

Table 6. Poland: Medium-Term Scenario, 2008-15

	2008	2009 Est.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
Activity and prices								
GDP (change in percent)	5.0	1.7	2.7	3.2	3.9	4.0	4.0	4.0
Domestic demand growth	5.5	-0.9	3.0	3.2	3.8	4.1	4.0	4.1
Private consumption growth	5.9	2.3	1.5	2.5	3.5	3.4	3.3	3.3
Public consumption growth	7.5	1.2	2.0	2.0	2.0	2.0	2.0	2.0
Domestic fixed investment growth	8.2	-0.3	4.5	6.0	6.0	7.5	7.5	7.5
Nominal GDP (zloty millions)	1,273	1,342	1,402	1,481	1,573	1,676	1,786	1,904
CPI inflation (average change in percent)	4.2	3.5	2.3	2.4	2.5	2.5	2.5	2.5
CPI inflation (end of period change in percent)	3.3	3.5	2.3	2.5	2.5	2.5	2.5	2.5
Unemployment rate	7.1	8.0	9.5	10.8	11.2	11.7	11.2	10.8
Gross domestic saving (ratio to GDP) 1/	18.6	18.5	18.7	19.0	19.3	20.2	21.1	22.1
Private savings	17.7	20.9	19.7	19.2	18.2	18.1	18.5	19.0
Public savings	0.9	-2.3	-1.0	-0.2	1.0	2.1	2.6	3.1
Gross domestic investment (ratio to GDP)	23.7	20.2	21.5	22.1	22.6	23.4	24.2	25.0
Public finances (percent of GDP, ESA95) 2/								
General government revenues	39.6	37.4	39.4	39.7	40.2	40.4	40.5	40.6
General government expenditures	43.3	44.6	46.8	46.6	45.9	45.4	44.9	44.4
General government primary balance	-1.4	-4.8	-4.8	-4.1	-2.8	-1.9	-1.3	-0.7
General government balance	-3.7	-7.2	-7.5	-6.9	-5.8	-5.0	-4.4	-3.8
Public debt	47.2	51.0	55.0	58.3	60.5	61.6	62.3	62.2
Balance of payments (percent of GDP)								
Current account balance	-5.1	-1.6	-2.8	-3.2	-3.4	-3.2	-3.1	-2.9
Capital account, net	1.2	1.6	2.3	1.8	1.9	2.1	1.9	1.6
Financial account, net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total external debt	46.1	61.5	59.0	58.9	57.5	56.5	55.3	55.0

Sources: Polish authorities; and IMF staff estimates.

1/ Derived as total savings minus the current account minus capital transfers.

2/ The projections include consolidation measures that have beeen announced but not yet implemented. They do not inlcude additional measures that would be triggered under the Public Finance Act if debt (national definition) exceeds the 55 percent-of-GDP threshold.

Table 7. Poland: Monetary Accounts, 2004-09

	2004	2005	2006	2007	2008	2009
			(In billions of zloty)			
Monetary Survey						
Net foreign assets	148	180	167	121	67	76
Net domestic assets	369	384	469	573	816	887
Claims on Central Government (Net)	69	65	73	62	104	101
Claims on Other Resident Sectors	279	303	373	483	658	724
Broad money	378	427	495	562	666	720
Money	182	221	276	335	350	389
Quasimoney	196	206	219	226	317	331
Capital accounts	91	96	99	106	122	169
Accounts of the NBP						
Net foreign assets	114	138	138	140	177	212
Net domestic assets	-24	-47	-41	-39	-22	-49
Net claims on government	-14	-16	-17	-26	-21	-23
Claims on government	0	0	0	0	0	0
Liabilities government	14	16	17	26	21	23
Claims on Other General Govt.	0	0	0	0	0	0
Claims on Other Resident Sectors	0	0	0	0	0	0
Net claims on banks	-11	-31	-24	-13	0	-27
Other items, net	17	16	5	-9	18	5
Base money	69	71	87	103	126	138
o/w Currency in circulation	56	63	75	86	102	100
NBP Capital	3	3	3	4	5	19
Deposit Money Banks						
Net foreign assets	34	42	29	-19	-110	-136
Net domestic assets	394	432	510	613	838	936
Domestic credit	361	384	462	571	783	847
Net claims on government	83	81	90	88	125	123
Claims on Other Resident Sectors	278	303	373	483	658	724
Banks' reserves	18	14	18	26	36	48
Other claims on NBP	14	34	29	16	18	41
Deposit	334	377	429	484	575	635
Demand deposits	124	162	205	254	253	298
Other deposits	210	215	224	229	323	338
Liabilities to the NBP	3	2	5	3	18	14
Banks' capital	88	92	96	102	117	150
Nominal GDP	925	983	1,060	1,177	1,273	1,342
			(Percentage change from end of previous year)			
Base money	4.3	1.9	23.1	18.2	23.1	8.8
Broad money	5.5	13.1	16.0	13.4	18.6	8.1
Net domestic assets	14.0	4.0	22.1	22.3	42.3	8.6
Net foreign assets	8.9	21.7	-7.5	-27.5	-44.5	13.4
Net claim on government	-7.2	-6.5	12.8	-14.9	67.9	-3.2
Credit to other resident sectors	17.7	8.9	22.9	29.4	36.3	10.0
Deposit growth	8.3	12.8	13.8	12.7	19.0	10.5
Demand deposits	47.5	30.7	26.4	24.0	-0.6	17.8
Other deposits	-6.4	2.2	4.4	2.4	40.7	4.7
			(In percent of GDP)			
Broad money	40.8	43.4	46.7	47.7	52.3	53.7
Domestic credit	40.0	39.1	44.2	48.7	64.1	66.1
Private sector credit	30.1	30.9	35.2	41.0	51.7	53.9
Velocity	2.4	2.3	2.1	2.1	1.9	1.9
Money multiplier	5.5	6.1	5.7	5.5	5.3	5.2

Sources: IMF, *International Financial Statistics*; and IMF staff estimates.

Table 8. Poland: Public Sector Debt Sustainability Framework, 2005-2015
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	47.1	47.7	45.0	47.2	51.0	55.0	58.3	60.5	61.6	62.3	62.2	-0.7
o/w foreign-currency denominated	10.6	10.1	10.3	11.2	11.5	12.6	12.3	11.9	11.5	11.3	2.4	
Change in public sector debt	1.4	0.6	-2.8	2.2	3.8	4.0	3.3	2.2	1.1	0.6	0.0	
Identified debt-creating flows (4+7+12)	2.2	-0.9	-4.4	2.4	3.8	4.0	3.3	2.2	1.1	0.6	0.0	
Primary deficit	1.3	1.0	-0.4	1.4	4.8	4.8	4.1	2.8	1.9	1.3	0.7	
Revenue and grants	39.4	40.2	40.3	39.6	37.4	39.4	39.7	40.2	40.4	40.5	40.6	
Primary (noninterest) expenditure	40.6	41.2	39.9	41.0	42.2	44.2	43.8	43.0	42.4	41.8	41.3	
Automatic debt dynamics 2/	1.0	-1.9	-4.0	1.0	-0.5	0.5	-0.2	-0.5	-0.7	-0.7	-0.7	
Contribution from interest rate/growth differential 3/	0.1	-0.8	-2.4	-1.2	0.0	0.5	-0.2	-0.5	-0.7	-0.7	-0.7	
Of which contribution from real interest rate	1.6	2.0	0.5	0.9	0.7	1.8	1.5	1.7	1.6	1.6	1.6	
Of which contribution from real GDP growth	-1.6	-2.7	-2.9	-2.1	-0.8	-1.3	-1.7	-2.1	-2.3	-2.3	-2.4	
Contribution from exchange rate depreciation 4/	0.9	-1.1	-1.5	2.1	-0.4	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	-0.5	-1.3	-0.7	-0.1	-0.1	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	-0.5	-1.3	-0.7	-0.1	-0.1	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	-0.8	1.5	1.6	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	119.6	118.6	111.6	119.2	136.1	139.6	147.0	150.6	152.4	153.7	153.4	
Gross financing need 6/	18.9	15.4	11.1	9.9	15.1	16.2	16.2	15.5	14.9	14.5	13.9	
in billions of U.S. dollars	57.5	52.6	47.3	52.4	65.1	79.1	83.8	86.0	89.5	92.2	92.4	
Scenario with key variables at their historical averages 7/						55.0	55.9	57.4	58.8	60.4	62.0	-0.2
Scenario with no policy change (constant primary balance) in 2010-2015						55.0	59.0	63.1	67.1	71.1	75.2	-0.8
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	3.6	6.2	6.8	5.0	1.7	2.7	3.2	3.9	4.0	4.0	4.0	
Average nominal interest rate on public debt (in percent) 8/	6.5	6.1	5.4	5.4	5.4	5.5	5.3	5.3	5.3	5.3	5.3	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	3.9	4.6	1.4	2.3	1.7	3.8	3.0	3.1	2.8	2.9	2.9	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-8.3	12.1	19.5	-17.8	3.9	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	2.6	1.5	4.0	3.0	3.7	1.7	2.3	2.2	2.5	2.5	2.5	
Growth of real primary spending (deflated by GDP deflator, in percent)	5.6	7.7	3.3	8.1	4.7	7.5	2.3	2.1	2.4	2.6	2.7	
Primary deficit	1.3	1.0	-0.4	1.4	4.8	4.8	4.1	2.8	1.9	1.3	0.7	

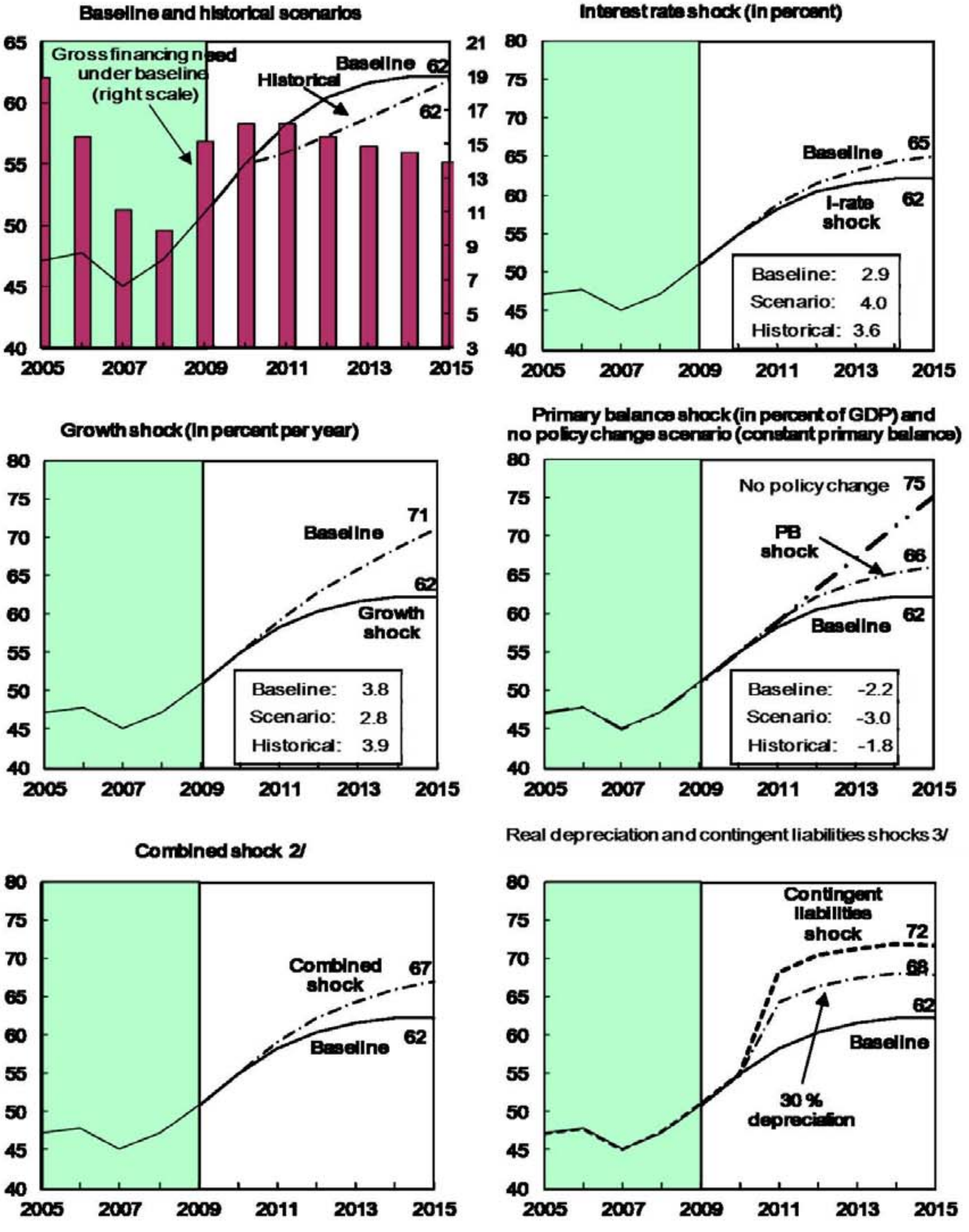
1/ General government gross debt, ESA95 definition.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi$ (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 9. Poland: External Debt Sustainability Framework, 2005-2015
(In percent of GDP, unless otherwise indicated)

	Actual				Estimate	Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Debt-stabilizing non-interest current account 6/
Baseline: External debt	43.7	49.6	55.0	48.1	61.5	59.0	58.9	57.5	56.5	55.3	55.0	-3.4
Change in external debt	-7.6	5.9	5.4	-6.9	15.4	-2.5	-0.1	-1.5	-1.0	-1.1	-0.3	
Identified external debt-creating flows (4+8+9)	-11.2	-7.1	-10.5	-8.6	9.1	-2.0	-1.9	-2.5	-2.4	-2.5	-2.9	
Current account deficit, excluding interest payments	0.1	1.5	3.6	3.8	0.6	2.0	1.8	1.5	1.0	0.7	0.4	
Deficit in balance of goods and services	0.7	1.8	2.9	4.0	-0.1	1.5	1.6	1.7	1.8	1.9	2.0	
Exports	37.1	40.4	41.0	40.5	39.3	39.2	40.3	40.2	40.4	40.5	41.4	
Imports	37.7	42.2	43.9	44.5	39.1	40.6	41.9	41.9	42.2	42.4	43.4	
Net non-debt creating capital inflows (negative)	-3.8	-5.0	-5.5	-2.9	-3.0	-3.2	-3.3	-3.7	-3.4	-3.5	-3.7	
Automatic debt dynamics 1/	-7.5	-3.6	-8.6	-9.5	11.5	-0.7	-0.5	-0.3	0.1	0.3	0.3	
Contribution from nominal interest rate	1.1	1.2	1.2	1.2	1.0	0.8	1.3	1.9	2.3	2.4	2.5	
Contribution from real GDP growth	-1.5	-2.4	-2.7	-2.2	-1.0	-1.5	-1.8	-2.2	-2.2	-2.1	-2.2	
Contribution from price and exchange rate changes 2/	-7.1	-2.4	-7.1	-8.5	11.4	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	3.6	13.0	15.8	-0.4	6.3	-0.5	1.8	1.0	1.4	1.4	2.6	
External debt-to-exports ratio (in percent)	118.0	122.9	134.3	113.8	156.6	150.6	146.2	142.8	139.8	136.6	132.8	
Gross external financing need (in billions of US dollars) 4/	64.7	80.0	101.7	178.6	149.9	167.9	173.5	185.8	190.6	198.9	198.2	
in percent of GDP	21.3	23.4	23.9	33.8	34.8	35.1	34.2	34.1	34.6	32.5	31.2	
Scenario with key variables at their historical averages 5/						59.0	56.7	54.2	51.3	48.5	45.9	-4.7
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	3.6	6.2	6.8	5.0	1.7	2.8	3.3	3.9	4.0	4.0	4.1	
GDP deflator in US dollars (change in percent)	15.9	5.8	16.6	18.3	-19.9	8.3	2.5	3.3	1.9	1.9	0.0	
Nominal external interest rate (in percent)	2.5	3.0	3.0	2.8	1.8	1.5	2.4	3.5	4.2	4.5	4.7	
Growth of exports (US dollar terms, in percent)	18.2	22.5	26.2	22.8	-21.1	11.2	8.9	7.1	6.3	6.4	6.4	
Growth of imports (US dollar terms, in percent)	13.7	25.8	29.3	26.0	-28.3	15.7	9.1	7.5	6.7	6.6	6.5	
Current account balance, excluding interest payments	-0.1	-1.5	-3.6	-3.8	-0.6	-2.0	-1.8	-1.5	-1.0	-0.7	-0.4	
Net non-debt creating capital inflows	3.8	5.0	5.5	2.9	3.0	3.2	3.3	3.7	3.4	3.5	3.7	

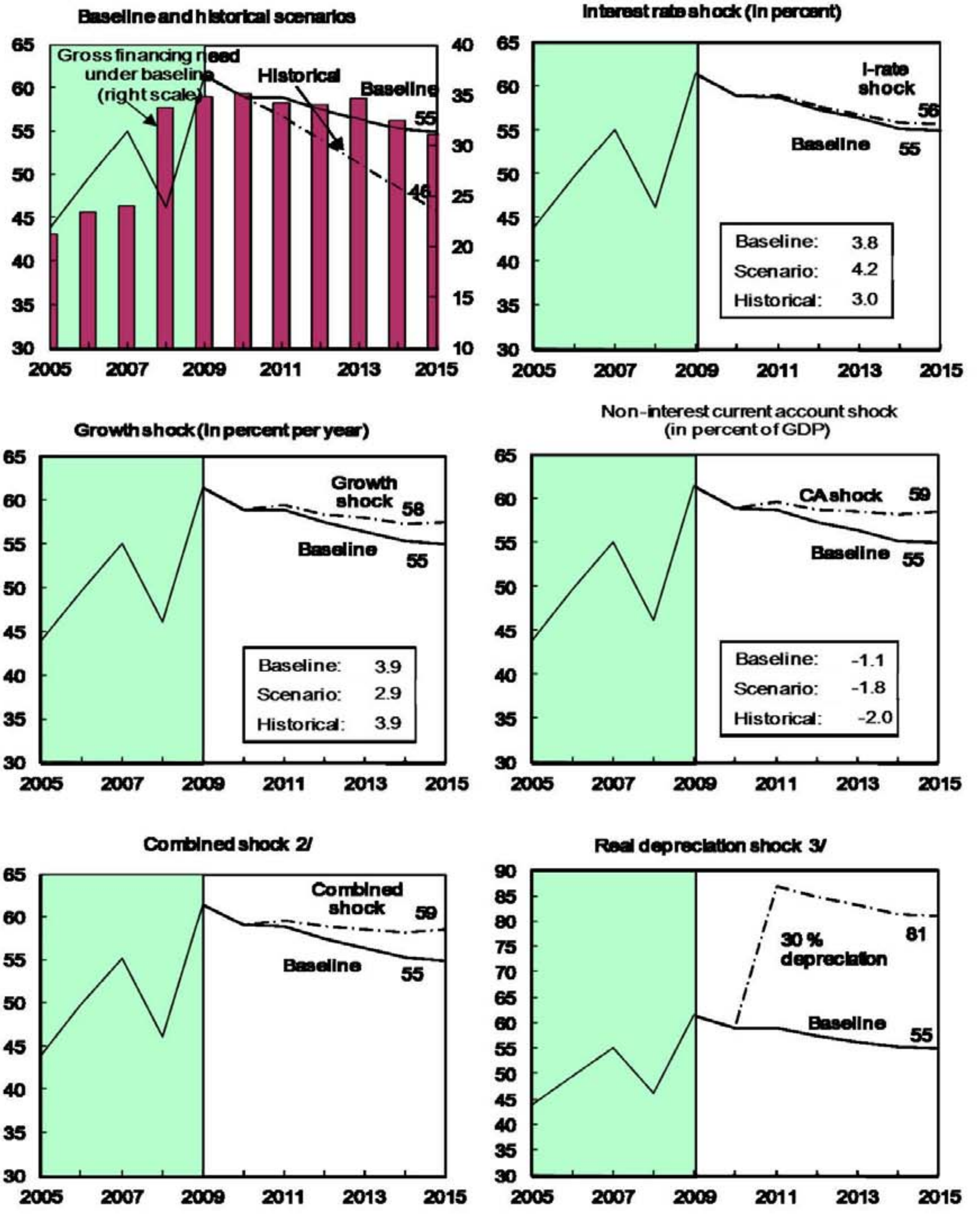
1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate,
ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).
3/ For projection, line includes the impact of price and exchange rate changes.
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 8. Poland: Public Debt Sustainability: Bound Tests, 2005–15 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Figure 9. Poland: External Debt Sustainability: Bound Tests, 2005-15 1/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2010.

INTERNATIONAL MONETARY FUND

REPUBLIC OF POLAND

Staff Report for the 2010 Article IV Consultation—Informational Annex

Prepared by the European Department

April 13, 2010

Contents Page

Appendixes

Appendix I. POLAND: Fund Relations
(As of February 28, 2010)

I. **Membership Status**: Joined 6/12/86; Article VIII

II. **General Resources Account**:

	SDR Million	Percent Quota
Quota	1,369.00	100.0
Fund holdings of currency	1,094.55	79.95
Reserve position in Fund	274.45	20.05

III. **SDR Department**

	SDR Million	Percent Allocation
Net cumulative allocation	1,304.64	100.00
Holdings	1,339.40	102.66

IV. **Outstanding Purchases and Loans**: None

V. **Latest Financial Arrangements**:

	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Flexible Credit Line	5/06/09	5/06/10	13,690.00	0.00
Stand-By	8/05/94	3/04/96	333.30	283.30
Stand-By	3/08/93	4/08/94	476.00	357.00

VI. **Projected Obligations to Fund**: None

VII. **Exchange Rate Arrangement**:

Poland accepted the obligation of Article VIII, Sections 2, 3, and 4 on June 1, 1995. The exchange system is free of restrictions on the making of payments and transfers for current international transactions.

Since April 12, 2000, the zloty has floated freely.

Prior to that, the zloty had been pegged to a currency composite made up of the U.S. dollar, deutsche mark, pound sterling, French franc, and the Swiss franc. As of January 1, 1999, the currency composite was changed to a basket comprised of 55 percent Euro and 45 percent U.S. dollar. From January 1, 1995, the zloty was redenominated, with new Zl 1 equaling old Zl 10,000. The central parity of the zloty was adjusted under a crawling peg policy at a pre-announced monthly rate. On May 16, 1995, a band of ±7 percent was introduced around the central rate. Following the implementation of the new system, the zloty initially appreciated by about 5 percent above the central rate. In September 1995, the exchange rate was allowed to appreciate a further 1 percent within the band. In December 1995, the central parity was raised by 6 percent, and at the same time the authorities allowed the actual exchange rate to

appreciate by 22 percentage points. On January 8, 1996 the monthly rate of crawl was reduced to one percent. On February 26, 1998, with the zloty pushing towards its upper limit, the newly formed Monetary Policy Council (RPP) widened the fluctuation band from ±7 percent to ±10 percent. At the same time, the rate of crawl was reduced from one percent to 0.8 percent per month. On July 17, 1998, the crawling peg's monthly rate of depreciation was cut from 0.8 percent to 0.65 percent. On September 9, 1998, the monthly rate of depreciation was reduced further to 0.50 percent. On October 29, 1998, the zlotys trading band was widened to 12.5 percent. On March 25, 1999, the zloty's trading band was widened to ±15 percent, and the rate of crawl was lowered to 0.3 percent per month. On December 31, 1999, the official rate was PLN 4.08 per US$1. On April 12, 2000, the crawling band regime was abolished and the zloty has since floated freely.

Poland maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions, except for the exchange restrictions imposed by Poland solely for the preservation of national or international security as introduced by the European Union within the framework of the Common Foreign and Security Policy. The consolidated list of such sanctions is available at: http://ec.europa.eu/external_relations/cfsp/sanctions/consol-list_en.htm. These sanctions include freezing of funds and economic resources of selected persons and entities from: Al Qaeda, Usama bin Laden and Taliban, Belarus, Bosnia and Herzegovina, Côte d'Ivoire, Croatia, DRC, Eritrea, Republic of Guinea (Conakry), Iran, Zimbabwe, Burma/Myanmar, Iraq, Democratic People's Republic of Korea (North Korea), Lebanon, Liberia, Somalia, Sudan, Syria, Yugoslavia (Serbia and Montenegro).

VIII. **Article IV Consultation**

The last Article IV consultation was concluded on August 13, 2009. In concluding the consultation, Directors noted that the strength of Poland's fundamentals, policies, and institutions had enabled it to withstand the global crisis better than most of its peers. They noted that a deceleration in economic activity was underway and commended the authorities for the timely, well-focused, and measured policy response. Directors welcomed the accommodative stance of monetary policy. On fiscal policy, Directors noted the need to balance short-term cyclical priorities and longer-term objectives and called for fiscal consolidation to start in 2010 if the recovery materializes as expected. They also stressed the importance of strengthening Poland's medium-term budgetary framework. Directors called for continued vigilance of the financial system and welcomed plans to conduct bottom-up stress tests of the banking system. They encouraged the authorities to reinvigorate their structural reform agenda, including the privatization plan, to help enhance the economy's flexibility, bolster its long-run potential, and facilitate successful euro adoption in the medium run.

IX. Technical Assistance, 1992–2010

Department	Subject/Identified Need Counterpart	Action	Timing	
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	Oct. 1992	NBP
MAE	Resident expert-Advisor to President of NBP		Nov. 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	Nov. 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 visits	Expert	Late 1995	NBP
FAD	Tax administration (VAT) short-term assignments of field experts	Nine	August 1992–October 1994	MoF
FAD	Tax administration	Mission	November 1992	MoF
STA	Framework for monetary statistics	Mission	February 1993	NBP
STA	Framework for monetary statistics (follow-up)	Mission	November 1993	NBP

STA	Government finance Statistics	Mission	August 1995	NBP/ MoF
STA	Money and banking statistics	Mission	January 1996	NBP
STA	Government finance statistics	Mission	July 1996	NBP/ MoF
STA	Balance of payments statistics	Mission	November 1996	NBP/ MoF
STA	Balance of payments statistics Mission	Follow-up	April 1997	NBP/ MoF
STA	Review of progress in implementing the SDDS	Visit	February 1998	
FAD	Public expenditure management	Mission	April 1998	MoF
MAE	Operational aspects of monetary and exchange rate policy	Mission	September 1998	NBP
FAD	Tax administration	Mission	October 1998	MoF
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 MoF/Local	Mission	October 1999	
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	
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

X. Resident Representative

Mr. Mark Allen, the Senior Regional Resident Representative for central and eastern Europe, took up his duties in Warsaw in June 2009.

POLAND—STATISTICAL ISSUES APPENDIX

As of April 12, 2010

I. Assessment of Data Adequacy for Surveillance

General: Data provision is adequate for surveillance.

National Accounts: There are inconsistencies between annual and higher frequency data reflecting differences in weights and in coverage. Electronic retrieval of the data is challenging. The sub-annual data are collected on a cumulative rather than on a discrete basis, and plans to introduce proper benchmarking have been delayed. Seasonal adjustment on relatively short interval leads to frequent and large backward revisions.

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

Government finance statistics: Consolidated general government data are published only on an annual basis, at the time of the budget. The limited breakdown of expenditure by category hinders analysis and identification of priority areas for fiscal consolidation; consequently, the data play a limited role in the public policy debate.

Monetary statistics: The shares and other equity on the asset side of the balance sheets of the NBP and other depository corporations are not valued at market prices. The 2003 data ROSC mission noted material differences between government finance statistics and the corresponding monetary data. It recommended that the NBP, in cooperation with the MoF, reconcile monetary and government finance statistics and carry out a reconciliation exercise on a regular basis. Data based on the SRFs have been published in the February 2008 issue of the IFS Supplement. They provide previously unavailable breakdowns of the claims on and liabilities to the central and general government; the breakdowns are not available for other resident sectors.

Balance of payments: The customs and payment-based trade data compiled by the NBP need to be checked for consistency. The NBP reports net foreign assets rather than the net international reserves previously shown in the monetary survey. The coverage and reporting of the stock of external debt, especially at maturities up to one year, could be improved. The 2003 data ROSC mission recommended: including interest on an accrual basis; making explicit the legal requirement that the NBP disseminate balance of payments statistics; separating insurance from transportation when making the c.i.f./f.o.b. adjustment; publishing on a regular basis a reconciliation table between international merchandise trade statistics and "goods" in the balance of payments; and undertaking periodic revision studies.

II. Data Standards and Quality

Subscriber to the Fund's Special Data Dissemination Standard since April 17, 1996. Uses timeliness flexibility options for general and central government operations.	Data ROSC published on September 15, 2003.

III. Reporting to STA (Optional)

Data for inclusion in the *Government Finance Statistics Yearbook* are reported to the Fund on a regular basis and, since 2004, according to the framework of *GFSM 2001*. Monthly cash data on consolidated core operations of the central government are reported in the *GFSM 2001* cash flow statement for the IFS.

POLAND: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

AS OF APRIL 12, 2010

	Date of latest observation	Date received	Frequency of data[7]	Frequency of reporting[7]	Frequency of publication[7]	Memo Items:	
						Data Quality – Methodological soundness[8]	Data Quality Accuracy and reliability[9]
Exchange Rates	3/2010	4/8/2010	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	2/2010	3/29/2010	M	M	M		
Reserve/Base Money	1/2010	3/11/2010	M	M	M	O, LO, O, LO	O, O, O, O, O
Broad Money	1/2010	3/23/2010	M	M	M		
Central Bank Balance Sheet	1/2010	3/23/2010	M	M	M		
Consolidated Balance Sheet of the Banking System	1/2010	3/15/2010	M	M	M		
Interest Rates[2]	3/2010	4/8/2010	D	D	D		
Consumer Price Index	2/2010	3/6/2010	M	M	M	O, O, O, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q3/2009	2/12/2010	A	A	A	LO, O, O, O	O, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	11/2009	1/25/2010	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	5/2009	6/15/2009	M	M	M		
External Current Account Balance	Q3/2009	1/15/2010	M	M	M	O, O, O, LO	O, O, O, O, LO
Exports and Imports of Goods and Services	Q3/2009	1/15/2010	M	M	M		
GDP/GNP	Q4/2009	3/8/2010	Q	Q	Q	O, LO, O, O	LO, LO, O, O, LO
Gross External Debt	Q1/2009	6/30/2009	Q	Q	Q		
International Investment Position[6]	Q3/2009	1/24/2010					

[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 (state, budgetary funds, extra budgetary funds, and social security funds) and local governments.

[5] Including currency and maturity composition.

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

[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

[8] Reflects the assessment provided in the data ROSC or the Substantive Update published on September 15, 2003, and based on the findings of the mission that took place during January 8–22, 2003. for the dataset corresponding to the variable in each row. 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); not observed (NO); and not available (NA).

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

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 10/55
FOR IMMEDIATE RELEASE
May, 10, 2010

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2010 Article IV Consultation with the Republic of Poland

On May 7, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Poland.[1]

Background

Poland is the only EU economy to have escaped a recession in 2009. Similar to its regional peers, it experienced spill-overs from the crisis through real and financial channels, as an abrupt slowdown in capital inflows caused a credit crunch and a sharp decline in investment. However, consumption held up relatively well, and the trade balance began to contribute positively to growth from the onset of the crisis. This reflected Poland's large domestic market and attendant modest reliance on exports; a flexible exchange rate policy; and, not least, significant fiscal stimulus and monetary easing, as policymakers took advantage of the room for maneuver afforded by Poland's contained external and internal imbalances on the eve of the crisis.

The rapid contraction in the trade balance resulted in a decline in the current account deficit from 5 to about 1½ percent of GDP in 2009. Foreign direct investment has declined notably, although higher retained earnings have cushioned the fall. Portfolio inflows have performed particularly well, especially since the middle of last year, driven by renewed external appetite for zloty-denominated assets, especially government debt. As a result, after its initial sharp fall, the zloty has been recovering steadily.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

Fiscal policy has provided significant counter-cyclical stimulus, with discretionary relaxation estimated at 1¾ percent of GDP in 2008 and 2½ percent of GDP in 2009, mainly due to tax cuts enacted in 2007 but coming into effect with a delay. While the government initially intended to offset revenue shortfalls to the extent needed to maintain the state budget deficit below the limit of zloty 18 billion in 2009—through what would have been highly pro-cyclical expenditure cuts—it appropriately altered such plans at mid-year. As a result, the general government deficit increased from under 2 percent of GDP in 2007 to over 7 percent of GDP in 2009.

The Monetary Policy Council continued to cut rates through the first half of 2009, to 3.5 percent. It maintained a loosening stance until October 2009, when it changed its informal bias to neutral, reflecting an improved outlook and renewed concern about inflation. Nevertheless, helped by subdued wage growth and commodity prices, and renewed appreciation of the zloty, inflation has recently fallen from around 4 percent in mid-2009 to well within the National Bank of Poland’s tolerance range of 1½- 3½ percent. Core inflation followed a similar path, declining to around 2 percent in recent months.

The banking system has withstood the crisis relatively well, while facilities for exceptional liquidity support have been phased out. Capital adequacy ratios have risen to over 13 percent at end-2009, from 11 percent a year ago. Moreover, profits remained robust in 2009, reaching about two thirds of the record-high level of the preceding year. While nonperforming loans rose from around 4 percent in 2008 to about 7½ percent in 2009 as economic activity declined, their growth appears to be slowing. Banks’ balance-sheet restructuring is coming to an end. They have recently started to ease lending policies for housing loans and short-term corporate credits and resumed foreign-currency lending, especially for Euro-denominated mortgages.

Executive Board Assessment

Executive Directors expressed their deepest sympathy to the people and authorities of the Republic of Poland for the death of their President, his wife and many senior country officials in the recent airplane crash.

Directors commended the authorities for their swift and timely response to the global crisis. Anchored in a strong macroeconomic framework and financial system, and buttressed by access to the Flexible Credit Line, this response enabled Poland to escape a recession in 2009.

Directors noted that economic growth is set to increase gradually as the global environment improves, banks’ risk appetite reemerges, and the inflow of EU funds accelerates. Given the still fragile recovery and surrounding uncertainties, the timing and manner of the withdrawal of fiscal and monetary stimuli will have to be carefully managed.

Directors considered that policy interest rates should not be raised at this stage, in view of the contained outlook for inflation and the excess capacity in the economy. If increased capital inflows put persistent upward pressure on the zloty and inflation remains subdued, interest rates could be further cut, possibly complemented by

transparent foreign-exchange interventions. Directors welcomed the authorities' commitment to euro adoption, while not setting a target date at this juncture. This will allow them to continue to take all the steps, including on the structural front, for successful euro adoption at an appropriate time, while preserving exchange rate flexibility in the face of external shocks.

Directors stressed the need to gradually start withdrawing the fiscal stimulus while carefully balancing short-term cyclical priorities and longer-term objectives. They welcomed the steps already taken by the authorities to reduce the deficit and called for further measures, including reform of entitlement programs and revenue enhancements, to meet the deficit target of 3 percent of GDP. A number of Directors endorsed the authorities' intention to achieve this target by 2012, noting that although ambitious, this would be achievable. A number of other Directors, however, were of the view that a somewhat more gradual consolidation would be preferable so as not to stifle the incipient recovery. In order to help anchor confidence in fiscal policy, Directors recommended introducing a permanent fiscal rule with a deficit or debt anchor consistent with the authorities' medium-term targets.

Directors considered that, although the financial sector has been well buffered, continued vigilance is necessary. They welcomed the Polish Financial Supervision Authority's recent recommendations aimed at strengthening lending standards for household loans. Directors noted that the renewed appetite for foreign-exchange lending could pose risks. They encouraged the authorities to ensure that such lending is funded and hedged on a longer-term basis as well as to raise capital requirements on foreign-exchange-denominated mortgages to reflect higher credit and valuation risks. Directors also underscored the importance of cross-border cooperation in this area.

Directors stressed that despite Poland's strong fundamentals, raising its exceptionally low labor participation rate remains critical to boosting long-term growth. They encouraged labor supply-enhancing reforms with complementary measures such as equalizing and gradually increasing the retirement age and merging special pension schemes with the general scheme. This, together with vigorous pursuit of the ambitious privatization agenda, would help to enhance the economy's flexibility and bolster its long-run potential.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Republic of Poland: Selected Economic Indicators, 2006-10

	2006	2007	2008	2009 Est.	2010 Staff Proj.
Real economomly (change in percent)					
Real GDP	6.2	6.8	5.0	1.7	2.7
CPI (end of Period)	1.4	4.0	3.3	3.5	2.3
Unemployment rate (in percent)	13.8	9.6	7.1	8.0	9.5
Public finances (percent of GDP)					
General government balance 1/	-3.6	-1.9	-3.7	-7.2	-7.5
Public debt 2/	47.8	44.8	47.0	49.9	52.8
Money and credit					
Private sector credit (12-month change)	22.9	29.5	36.3	10.0	…
Broad money (12-month change)	16.0	13.4	18.6	8.1	…
Money market rate (eop)	4.1	5.6	5.8	4.2	…
Balance of payments					
Current account balance (percent of GDP)	-2.7	-4.8	-5.1	-1.6	-2.8
Official reserves (billion U.S. dollars)	48.5	65.7	62.2	79.6	88.2
Total external debt (percent of GDP)	49.6	55.0	46.1	61.5	59.0
Exchange rate					
Exchange rate regime			Floating		
Present Exchange rate (April 21, 2010)			PLN 2.89=US$1		
Zloty per US$, period average	3.10	2.77	2.41	3.12	…
Zloty per Euro, period average	3.90	3.79	3.55	4.09	…
Real effective exchange rate (INS, CPI based)3/	139.4	144.7	159.3	133.7	

Sources: Polish authorities; and IMF staff estimates.

1/ ESA95 definition

2/ National definition

3/ Annual average (1995=100)

Statement by Katarzyna Zajdel-Kurowska, Alternate Executive Director for the Republic of Poland and Pawel Gasiorowski, Advisor to the Executive Director
May 7, 2010

On behalf of the Polish authorities, we would like to thank staff for the constructive discussions during the consultation and the comprehensive set of documents that provide an accurate picture of the Polish economy. Our authorities broadly share the staff's assessment.

Economic outlook

Poland has weathered the crisis relatively well. Economic growth slowed down to 1.8 percent in 2009 from an average of 5.4 percent during the previous five years. However, in the last quarter of 2009, the real GDP accelerated to 3.3 percent year-on-year. Further recovery is underway and the preliminary data for the first quarter are encouraging. Industrial output has increased by 9.4 percent in January-March 2010 (year-on-year). However, a sluggish recovery in the euro area poses some risk to the base-case scenario.

Fiscal policy

Significant revenue shortfall, mainly due to discretional fiscal relaxation in 2008 and 2009, has led to the deterioration of the fiscal position. The general government deficit widened to 7.1 percent of GDP in 2009 (despite of the undertaken net expenditure cuts of 1.1 percent of GDP), while debt amounted to 51 percent of GDP. However, a large and timely fiscal stimulus provided strong support for the economy. Employment declined only marginally, and domestic consumption rose by 2.3 percent in real terms.

The authorities consider fiscal consolidation as the most important channel of bringing down the debt-to-GDP ratio. The 2010 budget is based on a conservative macro scenario. In February, the government approved the strategy for fiscal consolidation aimed at reducing and then stabilizing the structural deficit at the medium-term objective level. The fiscal adjustment will involve both quantitative and qualitative measures, including strengthening and streamlining of the fiscal framework by implementing temporary and permanent fiscal rules, comprehensively reviewing expenditures and fully implementing the performance-based medium-term budgeting.

Our authorities remain fully committed to the fulfillment of the Maastricht criteria, as well as the budgetary policy framework under the EU's Stability and Growth Pact. According to the latest Convergence Program update, the general government deficit should be reduced below 3 percent of GDP by the end of 2012, which is a very ambitious but manageable goal.

Monetary policy

The negative output gap and the considerable zloty appreciation keep inflationary pressure contained. The March CPI moved closer to the inflation target of 2.5 percent and amounted to 2.6 percent y/y, compared to 3.5 percent y/y in December 2009. The decrease was mainly

due to the high base of last year, which was, among other reasons, related to the changes in regulated prices (e.g. energy prices) and developments in fuel and energy prices.

During the April meeting of the Monetary Policy Council the reference rates were kept unchanged and the Council maintained its (unofficial) neutral stance.

Since 1999 the direct inflation targeting strategy has been used in the implementation of monetary policy and the National Bank of Poland (NBP) does not aim to set predetermined zloty exchange rates against other currencies. It reserves, however, the right to intervene if it deems it necessary in order to achieve the inflation target. Within this framework, on April 9th, 2010 the NBP purchased a certain amount of foreign currencies at a favorable exchange rate.

Euro adoption

The Government still represents the view that the euro is beneficial for the Polish economy and should be adopted as soon as possible. However, aiming at preserving credibility of the integration strategy, the Government decided not to set a new target date until the economic situation has stabilized, enabling a more plausible assessment of the prospects for the convergence criteria fulfillment. Regardless of the situation, the Government continues preparations for the euro adoption and takes all steps that are feasible under the current circumstances so as to be ready when external conditions improve. In 2009 the Government Plenipotentiary for Euro Adoption and the organizational structure were set up. A document specifying activities that should be undertaken in the process of monetary integration and its timetable (Guidelines for National Changeover Plan) will be published in the 2Q2010.

The Monetary Policy Council maintains the opinion that Poland should join the Exchange Rate Mechanism II and the euro area at the earliest possible date, after meeting the necessary legal, economic and organizational conditions.

Financial sector

The conditions in the economic environment of the domestic financial system have improved, following the developments in global financial markets. Despite that fact, the lower turnover in some segments of the domestic market remains low, also as a result of decreased confidence, in some cases derived from the problems noted by parent banks. As a result, credit activity decreased.

Against this background, liquidity provided to domestic banks by their parent banks, the availability of liquidity providing operations from the NBP and the increase in the value of government’s bonds held by banks helped to considerably reduce short-term risks to banks’ liquidity during the crisis. The use of foreign parent bank funding slightly declined in 2009, and demand for liquidity providing operations of the NBP waned to near zero.

The balance-sheet structure of the domestic banking sector and the structure of banks' revenues curtailed the decrease of banks' earnings in 2009. Owing to this fact, a strong deterioration of operating conditions did not produce losses in the whole banking sector, and only lowered the earnings. Nevertheless, the banking sector in 2009 was highly profitable –

the majority of non-resident-controlled commercial banks reported a higher return on assets than their parent institutions.

Turmoil in the financial markets and the related lower availability of market funding forced banks to compete for stable sources of funding, especially for households' deposits. This led to an increase of the share of non-financial sector deposits in banks' liabilities, which has a favorable influence on banks' funding stability. Therefore, the average funding gap decreased. It should also be noted that the liquidity position of Polish banks and the risk related to liquidity management is subject to supervisory regulation developed before the onset of the crisis.

Retention of a major part of profits generated in 2008 to increase regulatory capital, as well as a lower rate of lending, contributed to the increase of the capital adequacy ratios of the domestic banking sector and the capacity to absorb any credit risk costs. As of December 2009, the average risk-based capital ratio in the banking sector (excluding branches of credit institutions) amounted to 13.3 percent and was higher than at the end of 2008. Macroeconomic stress tests performed by the NBP indicate that a majority of the sector is able to absorb higher than expected costs of credit risk with the revenue it generates and the capital buffer it holds, without threatening its capital adequacy even if the rise in credit risk cost is accompanied by a significant decrease in banks' revenues.

The sector of non-bank financial institutions does not pose material threats to the financial system stability.

While the f/x lending risk has not significantly materialized in Poland, our authorities agree that the f/x exposure to unhedged borrowers should be limited. In this light, the recently approved Recommendation T focuses the risk analysis on the debt repayment capacity of potential household borrowers. Recommendation T was generally welcomed by our interlocutors from the financial sector as leveling the playing field for the banks. Moreover, the current regulations for calculating capital requirements already provide for different risk weights for mortgage loans in local and foreign currencies. The Polish Financial Supervision Authority (KNF) is also working on the amendment to Recommendation S concerning good practices related to credit exposures secured by a mortgage. Nevertheless, it should be noted that foreign currency housing loans are of a much better quality than local currency housing loans.

Our authorities agree that an effective macro prudential framework requires not only a close cooperation between the national authorities but also cross-border cooperation where the host country supervisors maintain sufficient regulatory powers, especially with regard to prudential supervision. While the establishment of the European Banking Authority and European Systemic Risk Board (ESRB) will be a step in the right direction, both frameworks still have to become fully operational and a proper balance between competences and responsibilities (burden sharing) must be achieved.

Our authorities still expect that the FSAP update planned for 2010 will also cover the issues related to the supervision of Poland’s credit unions (SKOKs).