Republic of Poland: 2020 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for the Republic of Poland

INTERNATIONAL MONETARY FUND

IMF Country Report No. 21/35

REPUBLIC OF POLAND

February 2021

2020 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF POLAND

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2020 Article IV consultation with the Republic of Poland, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its February 3, 2021 consideration of the staff report that concluded the Article IV consultation with the Republic of Poland.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 3, 2021, following discussions that ended on November 19, 2020, with the officials of the Republic of Poland on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 14, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Republic of Poland.

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

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Washington, D.C.

PRESS RELEASE

PR21/34

IMF Executive Board 2020 Article IV Consultation with the Republic of Poland

FOR IMMEDIATE RELEASE

Washington, DC – **February 8, 2021:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of Poland on February 3, 2021.

Following a long period of strong growth, the pandemic triggered a recession in 2020, though the estimated contraction of 3.4 percent would be among the least severe in the European Union. The second wave of the virus in the winter appears to have again lowered economic activity, delaying the start of a durable recovery. Economic growth in 2021 is projected at 2.7 percent, likely limited by ongoing restrictions early in 2021 but expected to rebound later in the year as vaccine access improves, with a further acceleration in growth expected in 2022. Over the medium term, sizeable new grants from the EU should facilitate strong investment and boost growth.

Poland entered the pandemic with substantial fiscal buffers, which have permitted a strong fiscal response to the crisis. Key policy actions have focused on preserving jobs and incomes through wage subsidies and benefits for self-employed and unemployed workers and partially forgivable loans for companies. The implementation of these measures has generally been frontloaded and robust. Driven by pandemic-related spending, the general government fiscal deficit is estimated to have increased to 8.4 percent of GDP in 2020, with general government debt increasing to 59 percent of GDP. Over the medium term, the fiscal deficit is projected to stabilize around 3¼ percent of GDP, with debt stable around 58 percent of GDP.

Monetary policies have also been significantly eased during the crisis. The policy interest rate has been reduced to near zero, while the central bank has implemented an asset purchase program. Inflation increased in early 2020 to above the target, driven by tight labor markets and regulated price increases. Headline inflation has recently declined to the target, though core inflation remains more elevated. Inflation is projected to fall further in 2021 while remaining near the target over the medium term.

The authorities have implemented macro-prudential measures to mitigate the impact of the crisis on the banking sector. While banks earnings have declined, asset quality has

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. Typically, a staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. Following that visit, the staff prepares a report, which forms the basis for discussion by the Executive Board. In 2020, owing to the pandemic, the consultation discussions were conducted virtually.

deteriorated only modestly, and banks remain well capitalized. Legal risks stemming from foreign-currency denominated mortgages remain a source of uncertainty and potential losses for banks.

Executive Board Assessment[2]

Directors welcomed the authorities' effective policy support during the pandemic-induced recession, which has contributed to the resilience of the corporate sector and labor market and should limit long-term economic damages. Given Poland's strong fundamentals and available policy space, as well as the sizeable new grants expected from the EU, Directors concurred that Poland is well positioned for a durable recovery. Nevertheless, the unusually high uncertainty calls for continued vigilance and flexibility in the near term.

Directors welcomed the extension of more targeted fiscal support in response to the second wave, while at the same time encouraged the authorities to ensure adequate coverage for those sectors that are more indirectly affected. Directors concurred that, once the recovery is firmly underway, a gradual reduction of the fiscal deficit would be needed over the medium term to replenish fiscal buffers, including through improved revenue administration and expenditure efficiency.

Directors agreed that, with inflation projected to remain near the target, the accommodative monetary policy stance remains appropriate until a recovery is well established. They also stressed that continued clear policy communication would support the effectiveness of the asset purchase program, which should also limit the need for foreign exchange interventions.

Directors welcomed the supervisory actions to mitigate the impact of the crisis on the banking sector. They called for continued vigilance, particularly on cooperative banks, given the higher credit risk and lower earnings brought on by the pandemic. Directors recommended proactively addressing the implications of court rulings on foreign exchange mortgage lawsuits. They also considered that redesigning the bank asset tax could support private credit during the recovery. Directors welcomed the enhanced autonomy of the Financial Supervisory Authority and its increased focus on AML/CFT compliance.

Directors emphasized the importance of advancing structural reforms that minimize the scarring effects of the crisis. They recommended prioritizing labor market reforms that encourage participation and foster the reallocation of labor in the post-pandemic economy. Directors also stressed the opportunity to boost public investment, including through digitalization and green investments, supported by the Next Generation EU funds. In this

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

regard, they encouraged steps to enhance absorptive capacity and coordination among government entities for effective use of these funds.

Table 1. Poland: Selected Economic Indicators, 2019–25

	2019	2020	2021	2022	2023	2024	2025
		Est.		Projections			
Activity and Prices							
GDP (change in percent)	4.5	-3.4	2.7	5.1	4.2	2.9	2.6
Output gap (percent of potential GDP)	0.9	-2.7	-2.5	-0.8	0.0	0.0	0.0
CPI inflation (percent)							
Average	2.3	3.4	2.6	2.2	2.3	2.5	2.5
End of period	3.4	2.3	2.2	2.1	2.5	2.5	2.5
Unemployment rate (average, according to LFS)	3.3	3.3	4.9	4.6	4.5	4.5	4.5
Public Finances (percent of GDP) 1/							
General government net lending/borrowing 2/	-0.7	-8.4	-5.1	-2.5	-3.2	-3.2	-3.2
General government primary balance	0.6	-7.1	-4.1	-1.6	-2.2	-2.2	-2.2
General government debt	45.7	58.6	59.1	57.4	56.8	57.0	57.5
Balance of Payments							
Current account balance, percent of GDP	0.5	3.3	1.9	0.4	0.2	0.0	-0.1
Total external debt, percent of GDP	59.4	59.9	58.5	51.2	45.5	42.4	39.4
Memorandum item:							
Nominal GDP (billion zloty)	2287.7	2285.2	2418.7	2599.3	2775.8	2926.8	3076.4

Sources: Polish authorities; and IMF staff calculations.

1/ According to ESA2010.

2/ One-off revenues from the Pillar II pension conversion are assumed for 2022.

INTERNATIONAL MONETARY FUND

REPUBLIC OF POLAND

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION

January 14, 2021

KEY ISSUES

Background: After a long period of uninterrupted growth, Poland is experiencing a pandemic-induced recession, though strong policy actions have limited the damage. The economy rebounded strongly in the third quarter of 2020, but the second wave of the virus has delayed the recovery. A strong and effective policy response has supported economic activity and prevented destructive losses of employment and bankruptcies.

Outlook and risks: Following the recession in 2020, Poland is well positioned for recovery. The pandemic will remain a constraint until the assumed administration of vaccines over the course of 2021. Resiliency in the corporate sector and labor markets, aided by strong policy support, should foster a strong rebound. Sizeable new EU grants would also facilitate an increase in investment and boost growth. The course of the pandemic and ultimate success of vaccines remains a fundamental risk.

Policy Recommendations

Fiscal policy: Fiscal space should be used to support the economy during the pandemic. To minimize scarring, programs should err on the side of providing broad-based sectoral support, with additional support for health care and vulnerable households. Over the medium term, the fiscal deficit should be gradually reduced as the recovery takes hold.

Monetary policy: The accommodative monetary policy stance remains appropriate until a recovery is well established. Continued clear policy communication and transparency will support the effectiveness of the asset purchase program going forward.

Financial sector policy: While asset quality remains sound, earnings have declined, and credit risk is likely to increase after the expiration of policy support for the real sector, necessitating close monitoring of non-performing loans going forward. Cooperative banks should further consolidate and increase service sharing within affiliating banks to improve cost efficiencies. Supervisors and banks should continue to adapt strategies to stay ahead of implications of court rulings on foreign exchange mortgages. The bank asset tax should be redesigned to avoid distorting credit allocation.

Structural reforms: To mitigate the long-term effects of the crisis, the authorities should bolster investment and adjust labor market policies to support participation and ease the reallocation of labor in the post-pandemic economy.

Approved by
Jörg Decressin (EUR) and Martin Sommer (SPR)

Discussions were held remotely on November 2–19, 2020. The team comprised Alfredo Cuevas (head), William Lindquist, and Marzie Taheri Sanjani (all EUR). Nadeem Ilahi (Senior Resident Representative) and Robert Sierhej and Krzysztof Krogulski (both Resident Representative Office) also participated in the discussions. Mr. Trabinski (Executive Director) also joined the mission. The mission met with senior officials from the government, central bank, and financial supervision agency, along with representatives of trade unions, businesses, and the financial community. Hannah Jung, Rafaela Jarin, and Shituo Sun (all EUR) provided administrative and analytical support.

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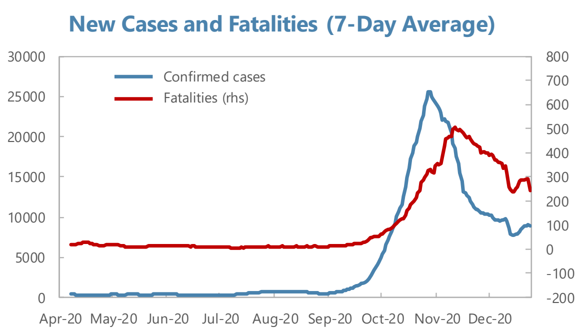
CONTEXT

1. Poland has been hit hard by a second wave of the COVID-19 pandemic. Poland's moderate initial outbreak—with cases and deaths among the lowest in the EU—permitted an early phased removal of restrictions in the late spring, with an impressive rebound in economic activity during the summer. However, cases and deaths began to increase sharply in late September, building to a peak in November that dwarfed the outbreak in the spring. In response to the second wave, the authorities progressively reintroduced restrictions, with broad national restrictions implemented in early November. These restrictions, more moderate than in the spring, included the closure of shopping malls, in-person dining in restaurants, and schools. With cases apparently peaking, in late November the authorities eased some retail restrictions from November 28 through December 27. However, to prevent a resurgence in cases, in mid-December the authorities again tightened restrictions for December 28–January 17, including the closure of shopping malls, hotels, and ski resorts.

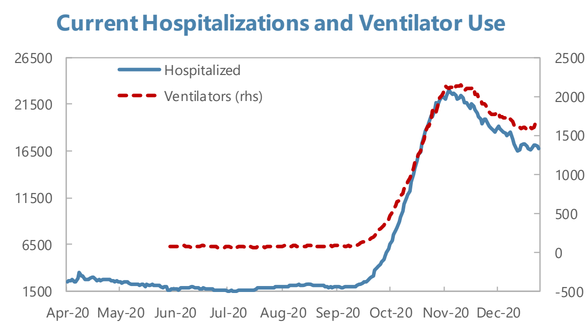
Figure 1. Poland: COVID-19 Second Wave

(As of January 7, 2021)

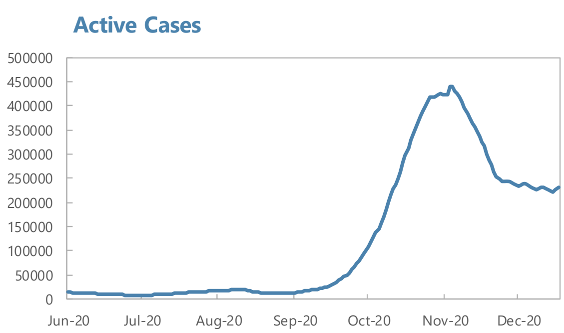
New cases peaked in early November…



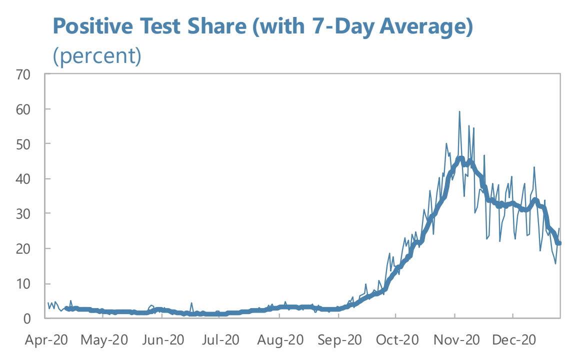
…along with hospitalizations and the use of ventilators.



The number of active cases has declined but remains elevated…



…while the positive test share has trended down.

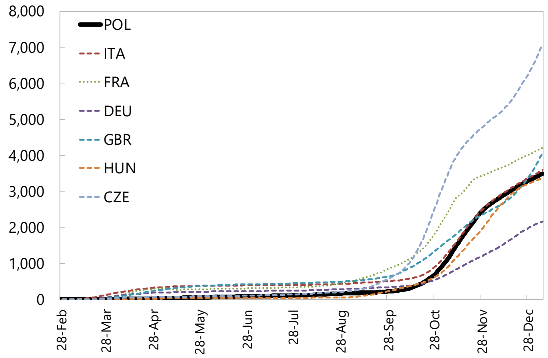


Sources: Poland Ministry of Health; and IMF staff calculations.

Figure 2. Poland: COVID-19 Cumulative Cases and Mobility Restrictions

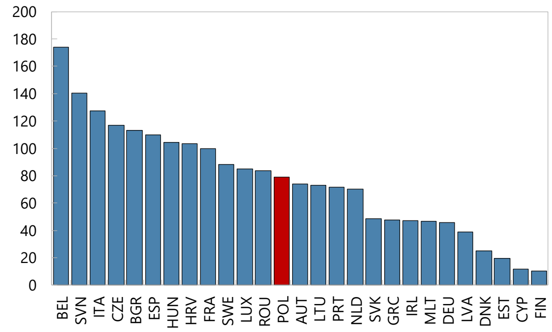
With the second wave, cumulative cases per capita have reached levels similar to other European countries …

COVID-19: Cumulative Reported Cases
(7-day moving average, per 100,000 residents, as of January 6)



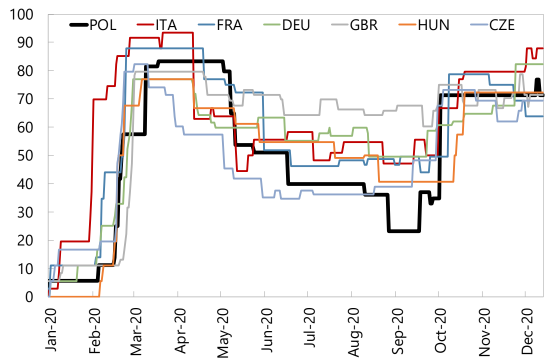
…and the initial very low death rate has increased to the European median.

EU Countries: COVID-19 Deaths
(Per 100,000 residents, as of January 3, 2021)



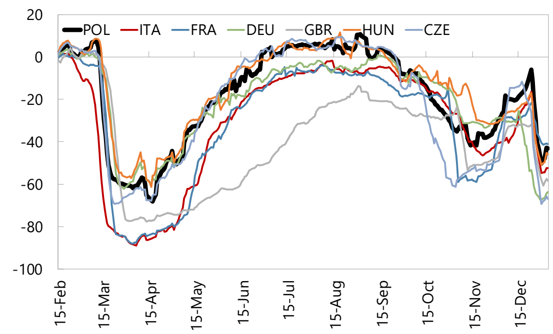
Restrictions increased significantly in the fall after easing during the summer months…

Covid-19 Government Response Stringency Index
(Index: 100=most restrictive)



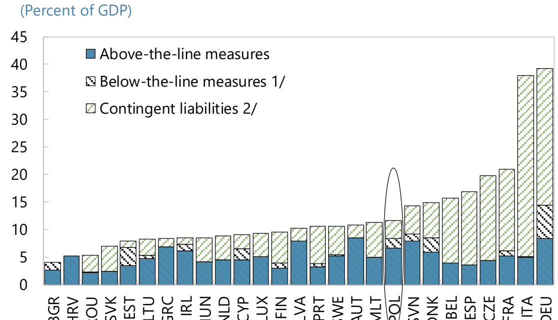
…and mobility has again declined after a strong rebound in the middle of the year.

Retail and Recreation Mobility
(Percent change from baseline; as of January 3)



Sources: Bloomberg; JHU; Blavatnik School of Government at University of Oxford; and Google.

EU-27: Fiscal Response to COVID-19 Pandemic
(Percent of GDP)



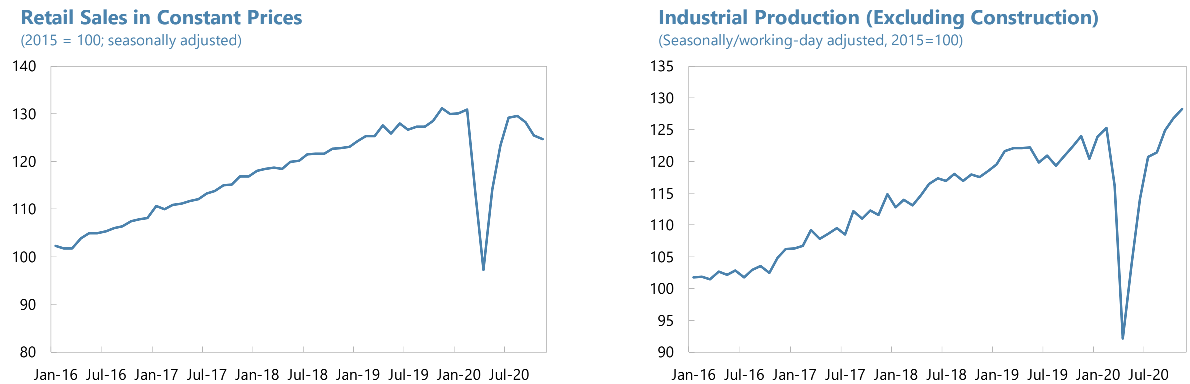
1/Loans, equity injections, asset purchases, and debt assumptions.
2/Guarantees and quasi-fiscal operations.
Source: October 2020 Fiscal Monitor

2. **Policy support offered during the pandemic has been sizeable.** A favorable pre-crisis fiscal situation has provided scope for a large fiscal response, which has aimed to maintain employment and support corporates' liquidity and equity, helping prevent bankruptcies. The fiscal package of support for the first wave—worth up to 11½ percent of GDP, including about 6½ percent of GDP in above-the-line measures—was larger than in most of the EU. Policy support during the second wave has been more modest, given the still abundant liquidity left from first round measures, less severe mobility restrictions in the second wave, and the authorities' desire for support to be more targeted to sectors most directly affected by new restrictions.

RECENT ECONOMIC DEVELOPMENTS

3. **Economic activity rebounded in Q3 after a historic drop.** Output contracted 0.3 percent quarter-on-quarter (q/q) in Q1:2020, followed by an 9.0 percent drop (q/q) in Q2, driven by plummeting private consumption and investment. Monthly data indicate that a rebound started in May as the economy began to reopen, leveling off by August (Figure 3). The economy expanded 7.9 percent (q/q) in Q3:2020, with output only 2 percent below the pre-crisis peak, driven primarily by private consumption. As the second wave built during October and November, industrial production continued to expand while retail sales declined, though much less severely than during the spring lockdown.

Figure 3. Poland: Monthly Economic Indicators



Source: Statistics Poland

4. **Labor markets have shown resilience, benefiting from significant policy support, though women and youth have been more affected.** After reductions in employment and participation in Q2, there was a broad-based recovery in labor markets in Q3, though the full impact of the pandemic remains to be seen. The unemployment rate (labor force survey) has increased modestly from 3.1 percent in Q1 to 3.3 percent in Q3, while the number of unemployed increased by 5.5 percent y/y in Q3.[1] The National Bank of Poland (NBP) estimates that policy measures to preserve employment benefitted some 2.4 million workers at the peak of the crisis. A tight pre-crisis labor market may also help explain firms' decisions to hoard labor. The participation rate of women sharply declined in Q2 but recovered in Q3. The activity rate of youth (15–24 years) remains below pre-crisis levels, while their unemployment rate remains higher at 12.5 percent (see Annex III). Average wage growth has slowed from nearly 8 percent pre-crisis to about 5 percent.[2]

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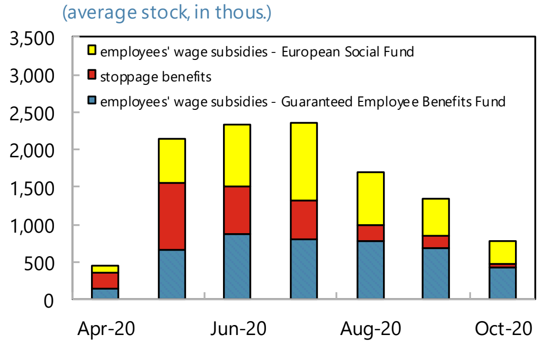
[1] The role of state-owned enterprises in preserving employment has been modest, given the small footprint of SOEs in the labor market (see page 7, IMF WP/17/221).

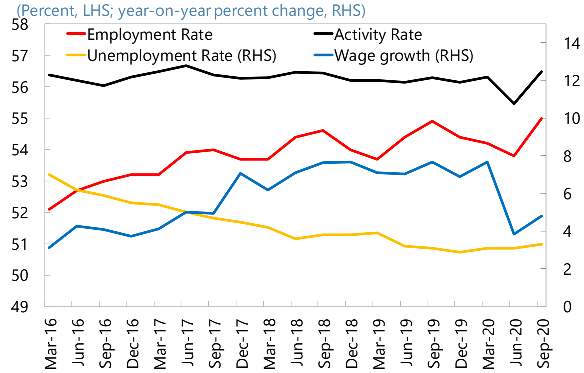
[2] In 2018, the minimum wage as a ratio to the median wage was broadly in line with the European average. In 2019, the authorities increased the minimum wage for 2020 by nearly 16 percent and announced plans for a further increase of 15 percent in 2021. Post-pandemic, the proposed minimum wage increase for 2021 has been lowered to 8 percent.

Number of Employees Benefiting from the Anti-Crisis Shield by Type of Measure
(average stock, in thous.)



Source: NBP estimates

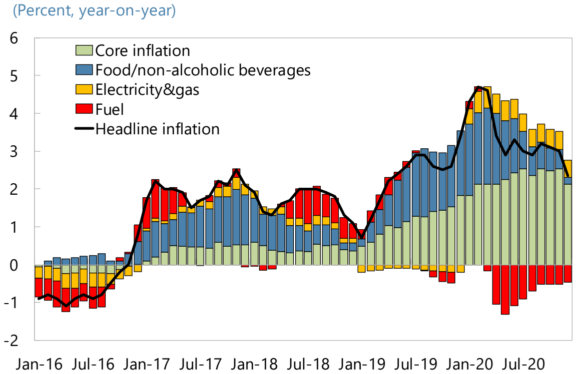
Employment, Unemployment, Activity, and Wage Growth
(Percent, LHS; year-on-year percent change, RHS)



Sources: Central Statistical Office; and Haver Analytics.

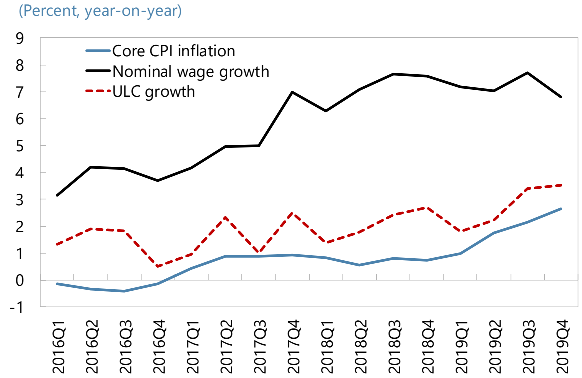
5. Inflation increased steadily in 2019 and peaked above the target's tolerance range in early 2020. Core inflation had remained below the 2.5 percent target since 2012 but increased during 2019 as a result of labor market tightening accompanied by increased wage and ULC growth. Regulated price increases—such as waste disposal fees—also contributed to the increase in core inflation, while increases in food and household electricity prices in early 2020 temporarily drove headline inflation to peak at 4.7 percent February. The pandemic-driven collapse in international fuel prices and lower food prices reduced headline inflation to 3.0 percent on average in H2:2020. Core inflation (CPI excluding food/energy), however, remained higher, averaging 4.1 percent in the same period, pressured by base effects and large one-off price increases by high-contact services and bank fees.

Contributions to Headline CPI Inflation
(Percent, year-on-year)



Sources: Central Statistical Office; NBP; and IMF staff calculations.

Pre-Pandemic: Core Inflation and Labor Costs
(Percent, year-on-year)

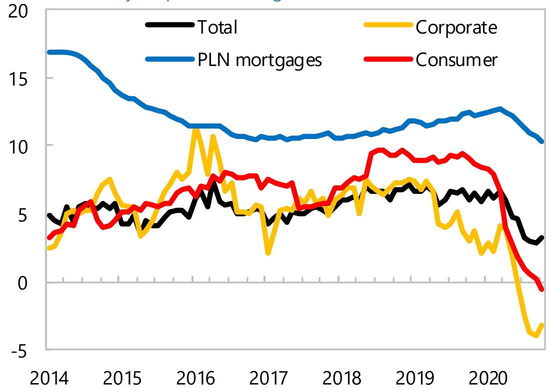


Sources: NBP; GUS; and IMF staff calculations.

6. Banks have become more cautious as profits have recently suffered. Private sector credit growth was moderate at 5 percent in 2019, with a stable credit/GDP ratio around 55 percent. The lockdown prompted banks to tighten lending standards. The combination of low credit demand, weak economic activity, and large anti-crisis support dampened private sector credit growth in 2020. Banks moved into safe assets (Treasury and state-guaranteed securities) and

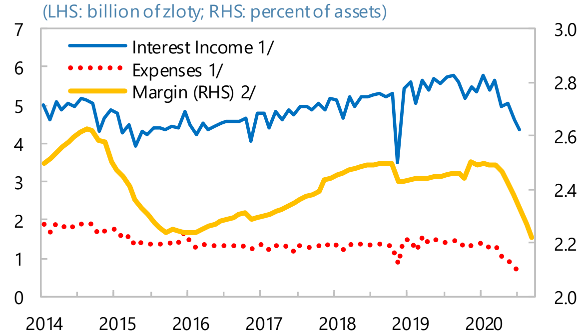
placed excess liquidity in short-term NBP bills. Compared to the same period in 2019, profits halved in Q1–Q3 due to lower interest margins and increasing provisioning.

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



Sources: NBP.

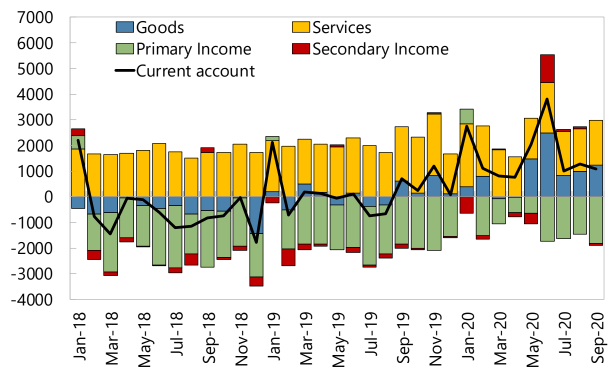
Interest Income, Expenses, and Margin
(LHS: billion of zloty; RHS: percent of assets)



1/ Monthly income and expenses.
2/ 12-month sum in percent of assets.
Sources: KNF.

7. Poland's current account balance increased further in 2020. As in 2019, the external position in 2020 is preliminarily assessed to be stronger than the level implied by medium-term fundamentals and desirable policies (Annex IX). Reflecting the current crisis, import compression raised the goods trade balance, while the primary income deficit declined, reflecting temporarily lower earnings of foreign companies in Poland. As a result, the current account is estimated to have increased to 3.3 percent of GDP in 2020 from 0.5 percent in 2019. The sizeable financial outflows observed at the onset of the crisis receded promptly (Figure 4). At about 160 percent of the Fund's reserve adequacy metric, the level of gross reserves is adequate to guard against external shocks and disorderly market conditions.

Components of Current Account Balance
(Billions of euros, monthly)



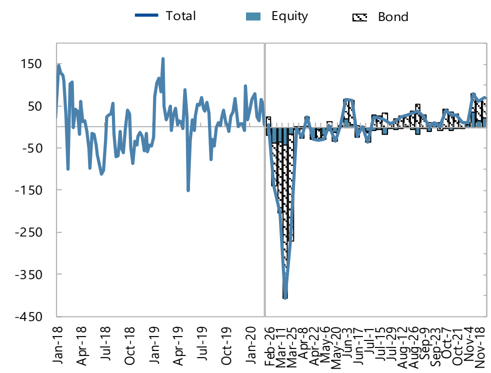
Sources: Haver from NBP.

8. The Polish zloty (PLN) has depreciated modestly during the pandemic. From end-February through November, the NEER and the REER depreciated 1.3 and 0.5 percent, respectively. As of early January, the PLN is 3.7 percent weaker against the euro since end-February, but there have been larger swings during this period. From end-February through late October, the PLN had depreciated 6.9 percent against the euro, but it subsequently appreciated 4.3 percent in November/early December. In the second half of December, the National Bank of Poland (NBP) intervened by purchasing foreign exchange (FX), its first intervention since 2013 (when it sold FX). In the days following the intervention, the PLN depreciated nearly 4 percent but has since pared some of the losses.

Figure 4. Poland: Capital Flows and Exchange Rate Developments

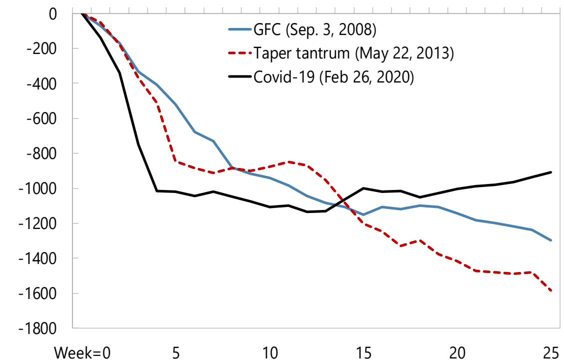
Poland: ETFs/Mutual Funds

(Millions of US dollars)



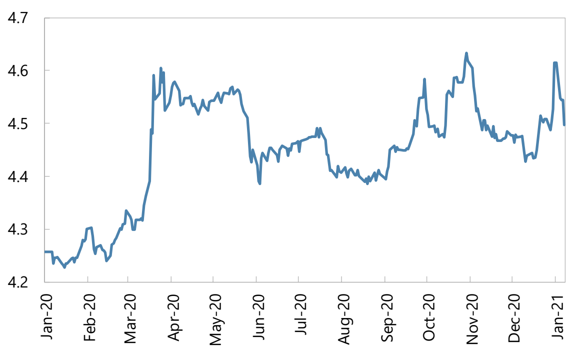
Poland: Cumulative Weekly Bond + Equity Flows

(Millions of USD, t=0 at time of event)



PLN/EUR Exchange Rate

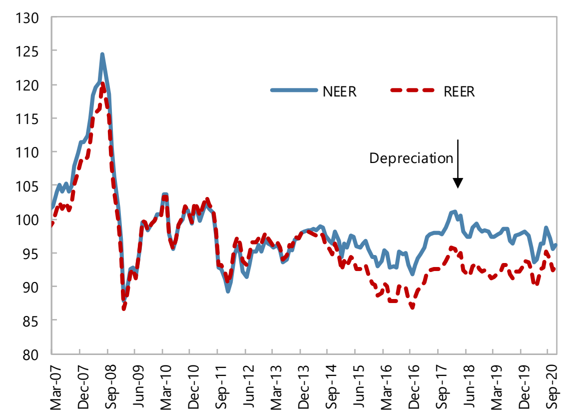
(Polish zloty per euro)



Sources: Haver from NBP

Nominal / Real Effective Exchange Rate

(2010=100)

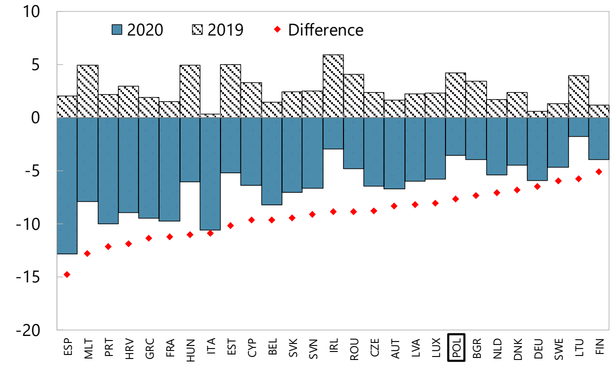


Sources: Haver from EPFR; and INS.

OUTLOOK AND RISKS

9. The economy is estimated to have contracted 3.4 percent in 2020. Although with a drop in growth from 2019 of about 8 percentage points, Poland's 2020 contraction is likely to be one of the least severe of EU countries. The baseline assumes that GDP contracted about 2 percent (q/q) in Q4, a much less severe contraction than in Q2, based on the lower level of mobility restrictions and the absence of international supply chain disruptions, both of which appear to have permitted the industrial sector to operate more normally, cushioning output from the likely decline in consumption.

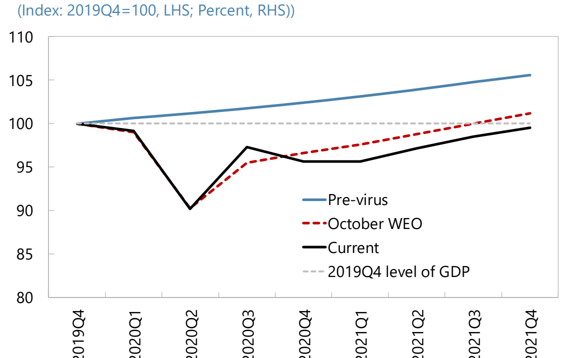
EU Countries: 2020 vs 2019 GDP Growth Projections
(Percent)



Source: World Economic Outlook

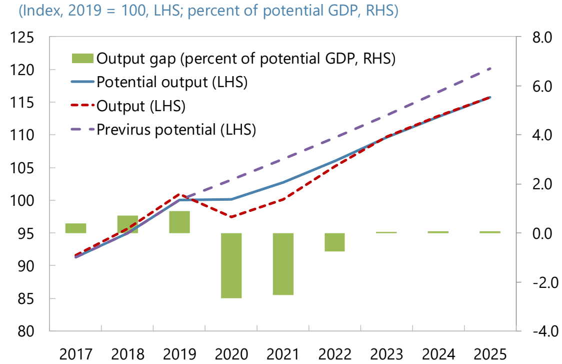
10. A durable economic recovery is projected to begin in 2021. The baseline conservatively assumes that GDP will remain flat in Q1:2021, as the higher severity of the second wave may require a longer period of restrictions, especially in the context of winter. A rebound would begin in Q2, with strong growth the rest of the year as increasing access to a vaccine is assumed, though the weak start to 2021 would limit annual GDP growth to 2.7 percent.[3] Growth is projected at 5.1 percent in 2022 before averaging about 3¼ percent annually over 2023–25. The level of GDP is projected to reach the pre-virus peak in Q4:2021 and be about 2½ percentage points lower in 2025 than the pre-pandemic baseline, indicating some permanent loss of output from the crisis.

Poland: Real GDP
(Index: 2019Q4=100, LHS; Percent, RHS))



Sources: GUS; and IMF staff projections.

Potential Output and Output Gap
(Index, 2019 = 100, LHS; percent of potential GDP, RHS)



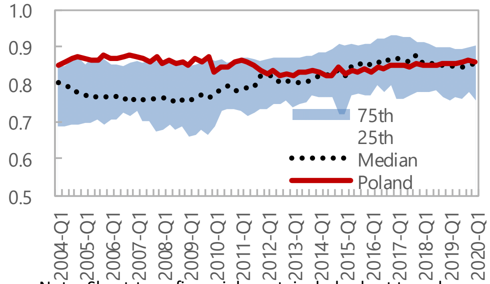
Sources: IMF staff projections

[3] Poland's national vaccination program has begun, with 92,000 persons receiving the vaccine by early January. The authorities expect to vaccinate nearly 3 million people by end-Q1 (about 10 percent of the adult population).

Figure 5. Poland: Non-Financial Corporates

Non-financial corporates entered the pandemic with stronger liquidity….

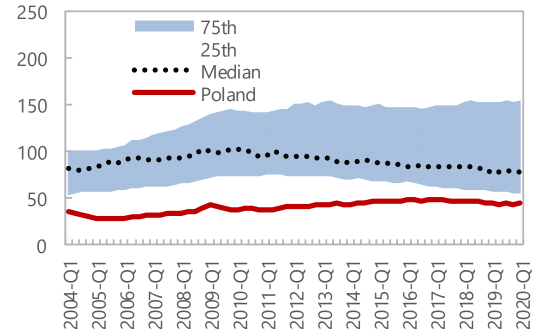
NFC: Short-term Financial Assets to Short-term Financial Liabilities (Ratio)



Note: Short-term financial assets include short-term loans, short-term debt, accounts receivable, currency and deposits.
Note: Sample include 22 EU countries and UK.

…less leverage…

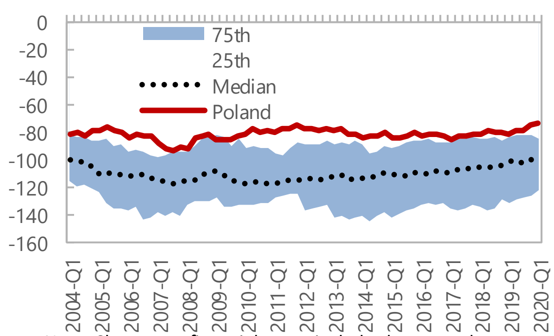
NFC: Debt+ Loans (% GDP)



Note: Sample include 22 EU countries and UK.

…and net worth above most EU peers.

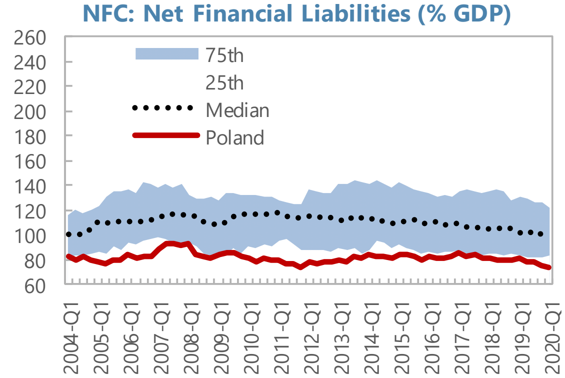
NFC: Net Worth (% GDP)



Note: Short-term financial assets include short-term loans, short-term debt, accounts receivable, currency and deposits.
Note: Sample include 22 EU countries and UK.

Net financial liabilities are below peers…

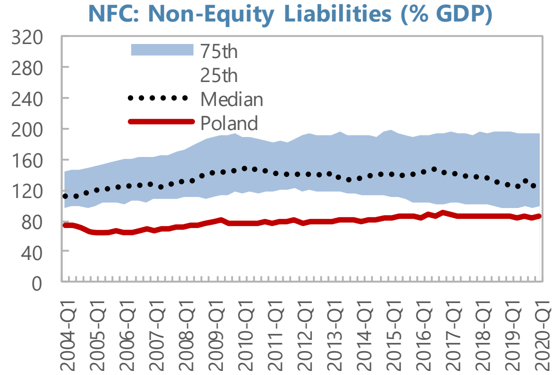
NFC: Net Financial Liabilities (% GDP)



Note: Sample include 22 EU countries and UK.

…particularly non-equity liabilities.

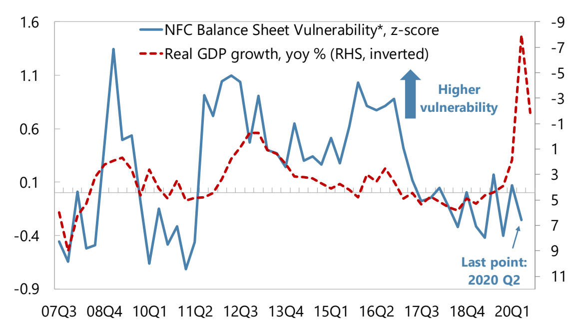
NFC: Non-Equity Liabilities (% GDP)



Note: Sample include 22 EU countries and UK.

Policy support averted a deterioration in balance sheets, despite the historic drop in GDP growth.

Poland: Corp. Balance Sheet Vulnerability and GDP Growth



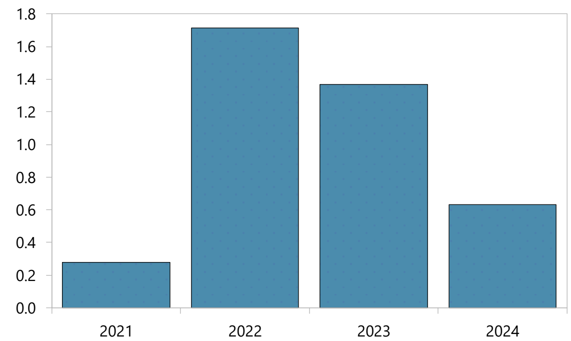
* Corp. vulnerability indicator is average of z-score of leverage and short-term liabilities-to-asset ratio.

Sources: ECB; WEO; and IMF staff calculations.

Box 1. Impact of Next Generation EU on Medium-Term Growth

Poland stands to benefit from sizeable new grants from the EU. The proposed "Next Generation EU" recovery package aims to distribute €390 billion in grants to member states, of which Poland may receive some €23 billion, 4.5 percent of 2020 GDP. The funds are to be distributed over 2021–23, though staff assumes that given limited near-term absorptive capacity, the funds would not be spent in full until 2024, with the bulk of the funds spent in 2022–23. Staff assumes that half of the funds would be spent by the general government and that 25 percent of the funds finance capital expenditures that would have already occurred without the new funds, with a small proportional reduction in the fiscal deficit.

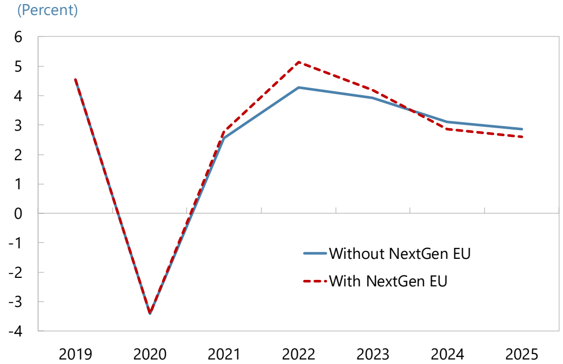
Estimated Next Generation EU Funds Spending
(Percent of GDP)



Sources: IMF staff projections.

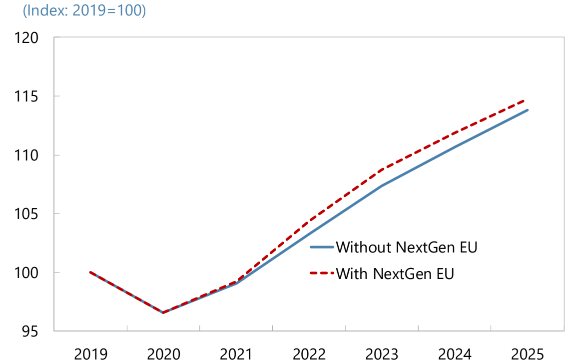
These expenditures are projected to raise GDP growth over 2021–23. The spending is assumed to carry a multiplier of 1.0 in 2021 (when there is still a significant output gap), declining to 0.5 by 2025 as the output gap closes. The increased output persists by a factor of 0.8, meaning that the effect on the level of GDP dissipates after about five years. Versus the previous baseline, GDP growth increases marginally in 2021 (2.7 versus 2.4 percent) but more significantly in 2022 (5.1 versus 4.3 percent) as spending scales up. GDP in 2023 is projected to be 1.3 percent higher than without the new spending. Growth over 2024–28 would be below the previous baseline due to base effects as the additional spending tapers and the effect on output eventually dissipates.

Real GDP Growth
(Percent)



Sources: GUS; and IMF staff projections.

Real GDP
(Index: 2019=100)



Sources: IMF staff projections.

11. **Corporate sector resilience and Next Generation EU grants position Poland well for a robust recovery.** The corporate sector entered the pandemic with comparatively strong balance sheets, with low levels of debt and strong liquidity, which positions Poland well for the recovery (Figure 5). Significant policy support has been provided to corporates during the crisis, including liquidity loans subject to partial forgiveness. The "Next Generation EU" recovery package would distribute sizeable new grants, worth some 4.5 percent of 2020 GDP for Poland. The increase in investment spending would boost growth over the next few years (Box 1).

12. The current account surplus is projected to decline over the medium term as the economy normalizes. The surplus of 3.3 percent of GDP in 2020 is projected to return to balance by 2025 as private net saving returns to a lower level, more than offsetting an anticipated improvement in government net saving. Recovering earnings of foreign direct investors in Poland starting 2021 will also increase the primary income deficit back to pre-pandemic levels. Next Generation EU transfers will, meanwhile, increase the capital account surplus, contributing to a projected reduction in external debt from 59 percent of GDP in 2019 to 38 percent of GDP by 2025.

13. Uncertainty about the outlook is historically large. The second wave could reduce economic activity more significantly in the near term, particularly if the virus proves more difficult to control during the winter. Delays in the administration of vaccines could postpone the beginning of a durable recovery. Conversely, improved confidence in vaccine efficacy and availability might boost consumption and investment and drive a faster recovery in 2021. In addition, possible delayed effects from the crisis on employment and bankruptcies are hard to anticipate, as are the medium-term impact on productivity of reduced investment during the crisis. This significant uncertainty requires the authorities to maintain vigilance and flexibility, both on public health and economic support measures.

Authorities' Views

14. The authorities broadly agreed with the baseline scenario and balance of risks. The Ministry of Finance noted that budget projections assuming -4.6 percent growth in 2020 and 4.5 percent growth in 2021 had not benefited from the better-than-expected Q3:2020 GDP print and were made before the materialization of the second wave. There was agreement that the reduction in output in Q4:2020 would likely be less severe than in Q2, despite the higher infection rate, based on fewer disruptions to global supply chains and the possibility that some areas of the economy would continue to operate at a higher level in line with the absence of a full lockdown. The authorities noted that comprehensive support for enterprises during the first wave had improved their liquidity situations. The National Bank of Poland (NBP), as noted in the November Inflation Report, projected -3.5 percent GDP growth in 2020 and 3.1 percent growth in 2021. The NBP agreed that the current account surplus was likely to moderate over the medium term. While the freely floating exchange rate tends to operate as a shock absorber in large economic downturns, the NBP has noted that the lack of a visible and more durable exchange rate adjustment could reduce the pace of economic recovery.

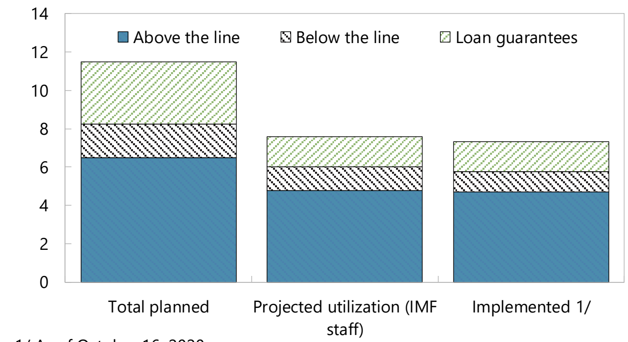
POLICY DISCUSSIONS

Policy discussions focused on the fiscal and monetary policy response to the crisis, the evolution of policy support in the period ahead, banking sector risks, and structural policies to support the recovery.

A. Fiscal Policies

15. The authorities appropriately provided substantial support for workers and companies during the first wave of the crisis (Table 1). In addition to an increase in pandemic-related health spending, key policy actions focused on preserving jobs and incomes through wage subsidies and benefits for self-employed/unemployed workers, the postponement or cancellation of social contributions, and an allowance for parents. Companies were offered loan guarantees, forgivable micro loans, and liquidity loans, with up to 75 percent of loans under the largest program being eligible for later forgiveness subject to conditions such as the maintenance of employment for 12 months. The implementation of these measures has generally been frontloaded and robust, with approximately 4.8 percent of GDP implemented out of a total envelope of 6.5 percent of GDP in above-the-line measures.

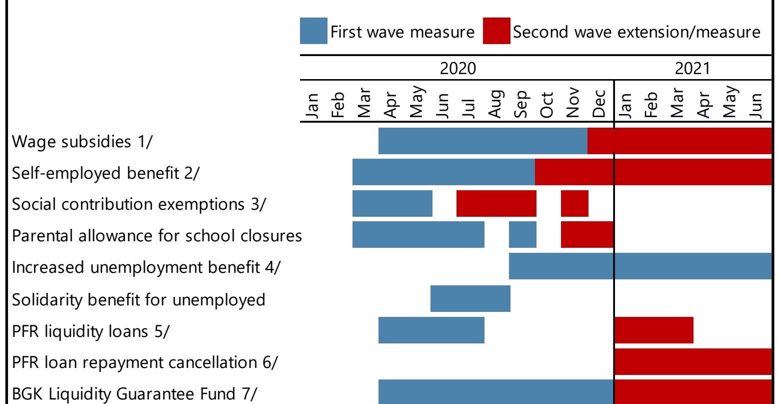
Implementation of First Wave Fiscal Measures
(Percent of GDP)



1/ As of October 16, 2020.
Sources: Government of Poland; Ministry of Finance; Ministry of Development; and IMF staff proejctions.

16. With initial crisis programs winding down, the authorities have extended some measures, with sectoral targeting. In early November, the authorities announced additional support for the second wave, with eligibility limited to companies in sectors most impacted by the partial lockdown. These measures include the write-off of the repayable portion of liquidity loans for affected SMEs (subject to continued adherence to conditions), the extension of several existing measures (including liquidity loans, guarantees, wage subsidies, and social security exemptions), and some incentives for firms to reorient their lines of business. These measures are worth an estimated 1.5 percent of GDP, including about 1 percent of GDP in above-the-line spending, to be implemented mostly in 2021. The support provided through these measures comes on top of some resources from the first wave of relief measures that remained in the coffers of some corporates.

Timeline for Duration of "Anti-Crisis Shield" Fiscal Measures



1/ Wage co-financing measures extended during second wave for targeted sectors.
2/ Extended beginning in October during second wave for industries subject to restrictions, with applications allowed to be filed up to 3 months after the lifting of the pandemic state.
3/ Sectors most affected by second wave eligible for refunds of July-September contributions and can apply for exemption from November contributions.
4/ Unemployment benefit increased 35 percent from Sep-Nov 2020; increase in benefit will be smaller for an additional 6-12 months. This measure will be permanent.
5/ PFR liquidity loan applications must have been filed by end-July. Program extended for second wave for affected companies in targeted sectors, with applications due by March 31.
6/ Repayable portion of PFR liquidity loan cancelled for micro and SMEs in targeted sectors, subject to cumulative decline in revenues from March 2020-March 2021 of at least 30 percent.
7/ Liquidity guarantee programs for large firms extended, subject to EC consultation.
Source: Government of Poland

Table 1. Poland: Summary of First Wave Fiscal Response to COVID-19 Pandemic

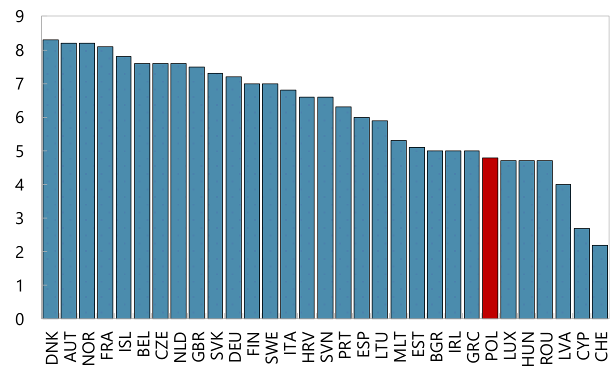
Measure	Description	Planned Amounts PLN billion	Planned Amounts Percent of GDP
Wage subsidies	Payment of up to 40 percent of average salary for affected firms.	12.7	0.6
Micro loans for micro enterprises	For entrepreneurs; up to PLN 5,000 with possibility of write-off if operations continue 3 months after loan matures	8.6	0.4
Benefits for self employed	One-time benefit for self-employed at 80 percent of minimum wage; benefit for those on civil law contracts	16.1	0.7
Exemption from social contributions	Exemption from social contributions by up to 3 months	13.5	0.6
Allowance for parents	Care allowance to parents with children under 8	11.0	0.5
Additional unemployment benefits	Increase in unemployment benefit for 90 days, and "solidarity benefit" for those who lost jobs after March 15	2.3	0.1
Tourism vouchers	Internal tourism vouchers, valid until 2022	4.0	0.2
PFR liquidity loans	"Financial Shield" -- partially non-repayable loans for micro, small, medium, and large firms, financed by Polish Development Fund. Up to 75 percent subject to forgiveness, provided that firms operates and maintains average employment for 12 months.	100.0	4.4
BGK credit guarantees	Expansion of BGK de minimis guarantee program for SMEs to cover up to 80 percent of loans up to PLN 3.5 million.	74.0	3.2
Capital injections for PFR, ARP	Increase in capital to allow them to expand balance sheets	7.7	0.3
ARP support	Industrial Development Agency to refinance existing leasing agreements, to benefit transport companies	0.9	0.0
Health care funding	Additional funding for health care sector	7.5	0.3
Other		4.3	0.2
Total above-the-line	Measures impacting fiscal deficit	**148.6**	**6.5**
Total below-the-line	Projected repayable PFR loans	**40**	**1.8**
Total contingent liabilities	Loan guarantees	**74**	**3.2**
Total of all support measures		**262.6**	**11.5**

Sources: Ministry of Finance; Ministry of Development; Government of Poland

17. **Substantial fiscal space exists for additional discretionary fiscal support.** Poland entered the pandemic with significant fiscal buffers, with a general government deficit of 0.7 percent of GDP and general government debt at 46 percent of GDP in 2019. The general government deficit and

debt are estimated to have increased, respectively, to 8.4 percent and 59 percent of GDP in 2020. Not considering fiscal rules, the absence of concerns about fiscal sustainability, combined with low financing costs, suggest no significant constraints on additional temporary measures. National fiscal rules, especially the 60 percent of GDP constitutional debt limit, impose some constraints, but because part of crisis spending has occurred off budget, additional space remains under national debt limits. The authorities project that debt, as defined in the Public Finance Act, will reach 49 and 51 percent of GDP in 2020 and 2021, respectively, well below the 60 percent limit.

General Government Health Expenditures
(Percent of GDP, 2018)



Sources: Eurostat.

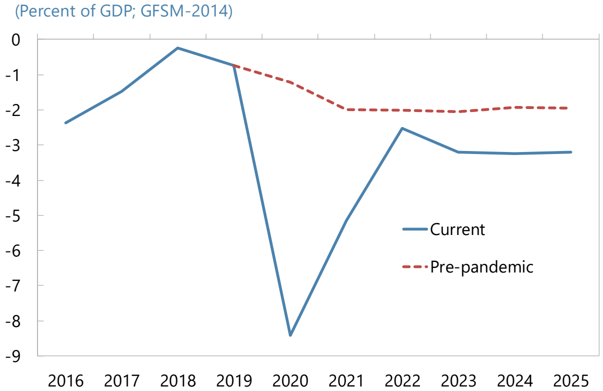
18. **Targeted fiscal support to confront further waves of the pandemic should also be flexible enough to support indirectly affected sectors.** The extension of fiscal support during the second wave is welcome. The targeting of additional support to the sectors most affected by the second wave public health restrictions can make more efficient use of public resources. However, this approach risks leaving out some businesses with linkages to affected sectors and should thus be complemented with support for other firms experiencing strains. With fiscal space available and favorable prospects for vaccine availability in 2021, to minimize scarring further programs should maintain flexibility to provide support, if needed, beyond a narrow set of sectors. Additional support for health care—where spending is lower than in most of Europe—and vulnerable households should be provided. As the pandemic ebbs and the recovery is entrenched, policies should evolve towards facilitating the retraining of workers and easing the transition to new jobs and other policies to stimulate investment and expedite the restructuring, liquidation, and opening of firms.

19. **Anti-crisis fiscal programs include governance safeguards to prevent waste and fraud.** Programs have mainly targeted micro firms and SMEs, which largely defuses the risk of a bias towards SOEs. The establishment of objective eligibility criteria (revenue losses, production stoppages, and work time/wage cuts) limits discretion. Only entities established before the lockdown were eligible, addressing the risk of establishing new firms only to receive aid. Applications have been subject to ex-ante verification based on data from the social security and tax administrations. The most significant support (PFR liquidity loans) has been distributed through commercial banks, facilitating not only their rapid disbursement but also AML safeguards and bank account verification. The PFR liquidity loan program also envisages ex-post checks using data mining to identify potential fraud. While support for large firms is more discretionary, criteria are objective, and decisions are subject to European Commission notification. A list of the 2,000 largest beneficiaries has been published. Agencies implementing crisis programs will be subject to ex-post audit, either through normal budgetary processes or by the Supreme Chamber of Audit (NIK) in the case of the PFR.

20. The general government fiscal deficit is projected to decline from 8.4 percent of GDP in 2020 to 5.1 percent of GDP in 2021. The reduction in the deficit would stem from the decline in crisis-related fiscal measures, which under current policies would be much smaller in 2021. A further expansion of support in 2021 to increase the coverage of support beyond the most affected sectors would appropriately increase the fiscal deficit. The modified escape clause of the stabilizing expenditure rule provides scope for additional spending, increasing the expenditure limit for 2021 by up to half of anti-crisis expenditures for 2020, providing scope to increase the deficit up to around 8 percent of GDP (Annex IV). General government debt (under ESA-2010/GFSM-2014) is projected to stabilize around 58 percent of GDP in the medium term.

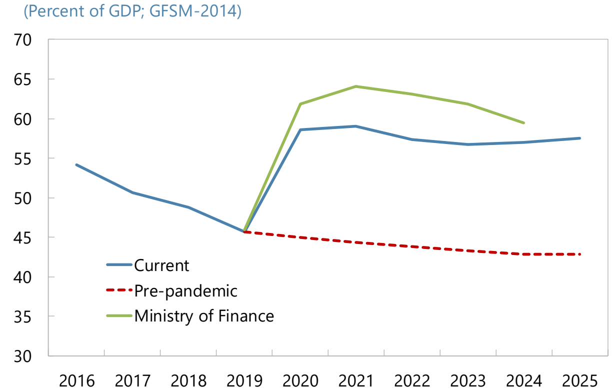
21. Over the medium term, the fiscal deficit should be gradually reduced as the recovery takes hold. Under current policies, the fiscal deficit is projected to stabilize around 3¼ percent of GDP, versus pre-pandemic projections of about 2 percent of GDP, based on an incomplete recovery of GDP to the pre-crisis trend. Debt is assessed to be sustainable, though it would increase steadily over the medium term under various shock scenarios (Annex VI). When the recovery is well underway, the deficit should be gradually reduced to replenish buffers against both unpredictable shocks and long-term budget pressures, including from population aging, with the magnitude and pace of consolidation guided by the strength of the recovery. An improvement to expenditure policies, including increasing the pension age and better targeting of social benefits, together with narrowing the VAT policy gap and further strengthening revenue administration, should contribute to an eventual consolidation. In a downside scenario, fiscal space exists for postponement of fiscal consolidation to avoid premature fiscal drag.

General Government Net Lending/Borrowing
(Percent of GDP; GFSM-2014)



Sources: Ministry of Finance; and IMF staff projections.

General Government Gross Debt
(Percent of GDP; GFSM-2014)



Sources: Ministry of Finance; IMF staff projections.

Authorities' Views

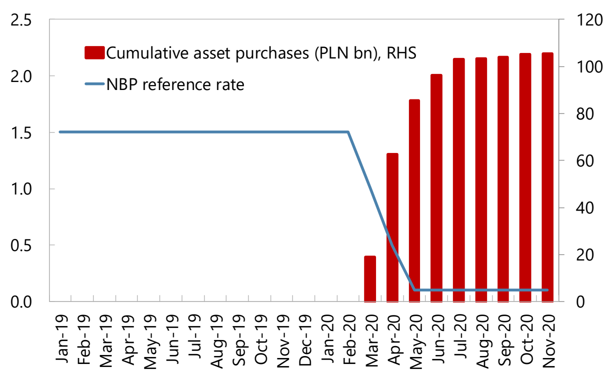
22. The authorities believed that fiscal measures had been effective in supporting the economy during the lockdown but should be more targeted going forward. Fiscal support had been large and frontloaded, with about 6.5 percent of GDP in support, of which nearly half had come from PFR liquidity loans, which reached as many of half of SMEs. The retention of employment and liquidity provided to corporates would prevent a significant decline in the growth potential of the economy. The eventual write-off of much of the support to corporates would also prevent a

deterioration of corporate balance sheets. The frontloading of support had created buffers for the economy, as evidenced by the increase in corporate deposits. The new round of support would be targeted to sectors most affected by the new restrictions, which are less extensive than in the spring, and the corporate sector broadly would be able to draw on buffers built up earlier in the crisis. The authorities believed that further support would entail a significantly lower fiscal cost than earlier measures. The Ministry of Finance projected the general government deficit at 11.8 percent of GDP in 2020, though it acknowledged that the deficit could be smaller in line with lower utilization of some fiscal support than earlier projected. The general government deficit is projected to decline to 6 percent and 3.3 percent of GDP in 2021 and 2022, respectively.

B. Monetary and Exchange Rate Policies

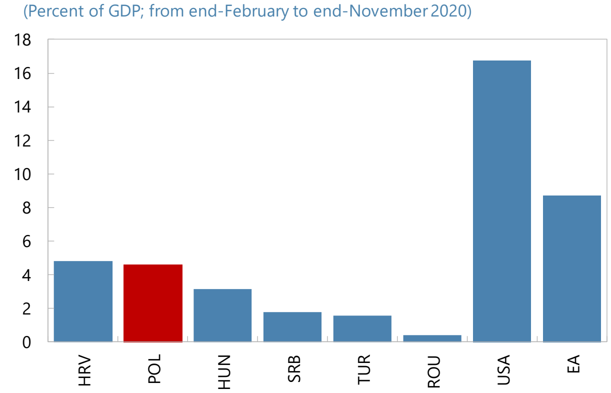
23. The National Bank of Poland (NBP) quickly and appropriately eased monetary policies as the government introduced social distancing measures. The NBP reduced the policy interest rate, which had been held at 1.5 percent since 2015, to 0.1 percent. To support bank liquidity, the required reserve ratio was lowered from 3.5 to 0.5 percent. The NBP has implemented an asset purchase program, purchasing Polish Treasury and government-guaranteed securities (issued by the PFR and BGK) in the secondary market. The NBP also announced a program to provide funding for bank lending to the non-financial private sector, though it has barely been used.

NBP: Policy Rate and Asset Purchases
(Percent)



Sources: NBP

Central Bank Asset Purchases
(Percent of GDP; from end-February to end-November 2020)

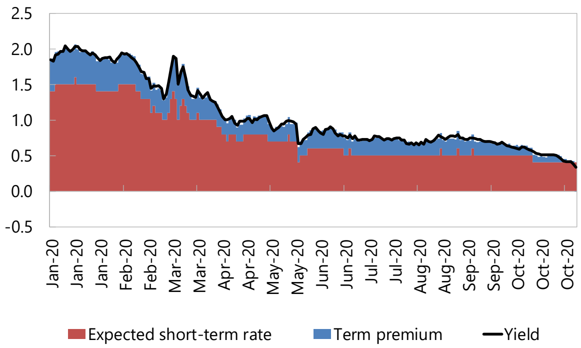


Sources: IFS; Haver; national central banks.

24. The NBP's asset purchase program (APP) has met its stated goals of providing liquidity to government bond markets and strengthening monetary policy transmission. The NBP's purchase of 4.6 percent of GDP in securities, split roughly equally between Treasury and government-guaranteed securities, has been one of the largest among EM central banks during the pandemic. The NBP has not announced limits for its purchases, which were concentrated in April/May and have tapered significantly since July. The APP has absorbed in secondary markets about 40 percent of the gross issuance of Treasury and government-guaranteed securities during the crisis and cushioned the outflow of foreign investors from the local Treasury market. The APP may have also supported a decline in yields and the term premium (see Annex V). In line with the NBP's monetary policy framework, the liquidity created by the asset purchases has been sterilized

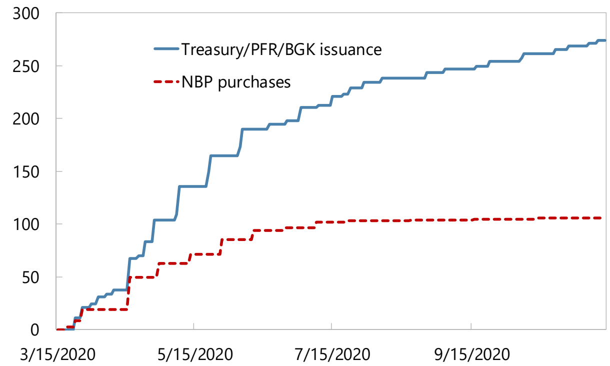
through the issuance of 7-day NBP bills. Transparency of the APP has been high, with full information published on the NBP's purchases and securities holdings.

Decomposition of Five-Year Polish Gov't Bond Yield
(Percent)



Sources: Bloomberg; and IMF staff calculations.

Cumulative Issuance of Securities and NBP Purchases
(PLN billion)



Sources: NBP; MoF; PFR; and BGK.

25. **Core inflation currently remains elevated, partly driven by one-off factors, but is projected to decline in 2021 (Figure 6).** While headline inflation declined to 2.4 percent in December, with fuel and food prices contributing to disinflation since the spring, at 3.6 percent, core inflation remained above the 2.5 percent target and ±1 percent tolerance range. However, core inflation in the months after re-opening has been influenced by large monthly price increases which are likely to be one-off, including for high-contact services (dentists/hairdressers) and bank fees. Staff projects core inflation to decline to 1.9 percent (end of period) in 2021 (averaging 2.5 percent), driven by slower wage growth, higher unemployment, and subdued core inflation in the Euro Area, lowering imported price inflation. A closing output gap and EU grant-assisted expansion are projected to raise end-of-period core inflation back to the target beginning in the second half of 2022. Headline inflation is expected to remain within the target range over the projection period.

26. **The NBP should maintain its current policy stance until a recovery is well established.** Considering the significant uncertainty of a recovery and a projected decline in inflation, the NBP's accommodative policy stance is appropriate. Additional near-term supply-induced inflation, if it materializes, should be tolerated in view of the negative output gap, which should lower underlying inflation pressures. In an adverse scenario with an additional interruption of economic activity or heightened market volatility, the NBP could increase the pace of asset purchases. Continued clear policy communication will support the effectiveness of the asset purchase program.

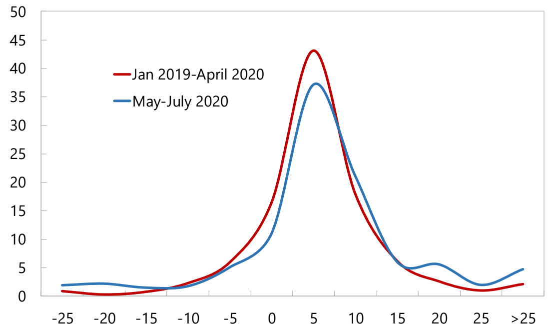
27. **Beyond smoothing excess volatility, FX intervention may be appropriate for monetary policy purposes if it is part of a well-specified and clearly communicated strategy.** The recent intervention occurred in the context of short-term appreciation pressures, which, the authorities considered, could have led to an undesirable tightening of monetary conditions. In the staff's view, further support for monetary easing would be best achieved through expanded asset purchases. With the REER assessed to be undervalued on average in 2020, intervention for monetary-policy purposes could be justified if additional purchases failed to adequately pass through to prices,

leaving achievement of monetary accommodation in doubt. In such circumstances, FX intervention would also need to be supported by clear communication, including on an exit strategy, to avoid creating the appearance of an exchange rate objective or blurring the inflation-targeting objectives of monetary policy.

Figure 6. Poland: Inflation Outlook

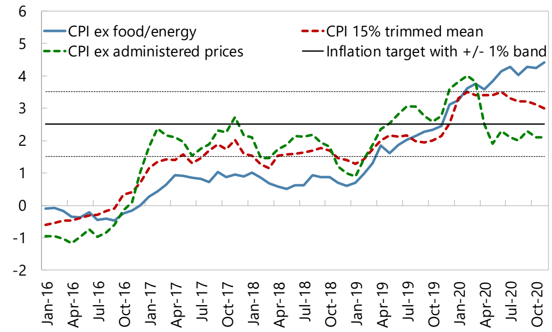
The distribution of monthly core inflation has seen an unusual number of large increases post-reopening....

Distribution of Core HICP Inflation By Item
(Percent monthly change in seasonally adjusted core items, annualized)



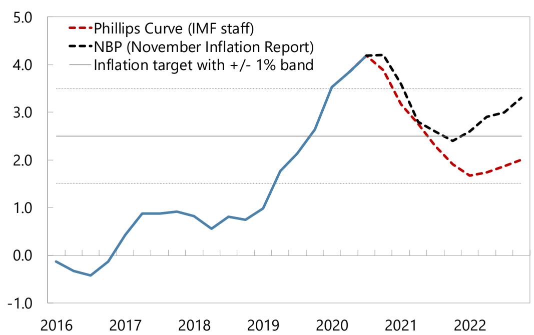
...and a trimmed mean measure suggests that core inflation may now be declining.

Measures of Core Inflation
(Percent y/y)



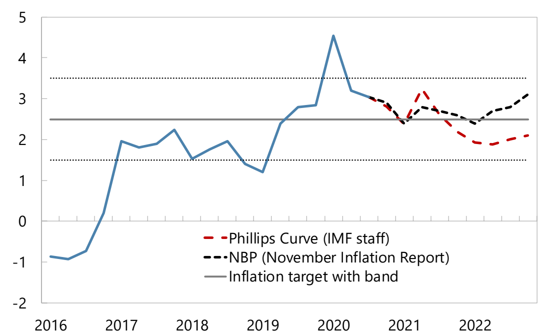
Core inflation is projected to decline in 2021 before recovering in 2022...

Core Inflation Projections: CPI Ex Food and Energy
(Percent change, y/y)



...while oil price base effects should temporarily boost headline inflation in 2021.

Headline CPI Inflation Projections
(Percent, year-on-year)



Sources: GUS; NBP; Eurostat; and IMF staff calculations and projections.

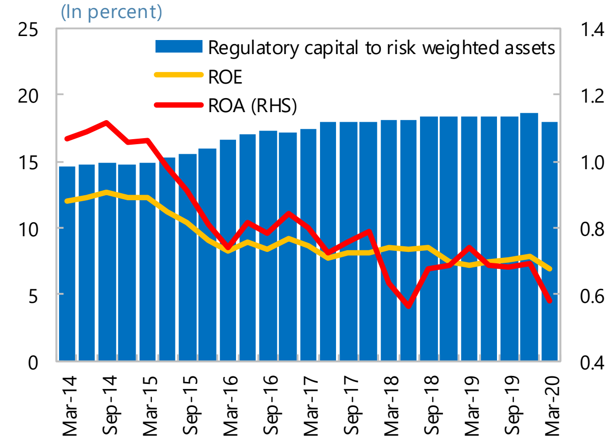
Authorities' Views

28. **The NBP believed that monetary policy easing had appropriately supported economic activity during the crisis.** Monetary policy actions—including interest rate cuts and asset purchases—would support consumption and investment in part by lowering financing and debt service costs in the Polish economy, including on installments of many household and corporate loans. The NBP believed that asset purchases had a stabilizing effect on the government bond market and contributed to the fall in bond yields and reduction of bond price volatility, as well as increasing market liquidity, particularly during the period of heightened stress in March. The authorities stressed that this policy instrument had been managed transparently and was well understood. The timing and scale of asset purchases would depend on market conditions. The NBP highlighted the

role of additional costs borne by companies to adjust to the pandemic conditions in maintaining inflation at a higher level in the near term. Inflation is projected to decline in 2021 in line with the decline in demand and the fading of one-off factors currently boosting inflation. The NBP projects headline inflation to average 2.6 percent in 2021 and 2.7 percent in 2022. The NBP has noted, including in an interview given by its President, that FX intervention in December aimed to limit the mounting risks of a pro-cyclical appreciation of the PLN in the context of global monetary easing and strengthen the impact of the NBP's monetary easing on the economy in view of low inflation pressures projected for 2021.

C. Financial Sector Policies

Banking Sector Profitability and Capital
(In percent)



Sources: FSI database; and NBP.

29. Actions to mitigate the impact of the crisis on the banking sector have been comprehensive and welcome. The banking sector entered 2020 with positive profits and a capital adequacy ratio of 19 percent. While fiscal and monetary policy measures have supported credit quality, specific macroprudential policy actions—including the reduction in reserve requirements, repeal of the systemic risk buffer, and recommendation to retain profits—were taken to help preserve bank liquidity, maintain the supply of credit, and prepare banks to absorb inevitable credit losses (Table 2). These actions were appropriate, clearly communicated, and presented as a response to the crisis. Given pandemic uncertainties, time horizons were not specified for some measures, with decisions on their duration conditional on economic developments. Maintaining the repeal of the systemic risk buffer and the recommendation to retain profits would help absorb potential losses, without impeding credit expansion. To smooth provisioning for possible credit losses over time, the Financial Supervision Authority (KNF) recommended that rescheduled loans should not be reclassified as irregular if serviced according to the new schedule. This measure is time bound, covering pandemic credit moratoria from April until end-2020. According to early signals from banks, the quality of credit for which the moratoria has already expired remains good.

30. The crisis will increase challenges for banks. Asset quality has deteriorated only modestly so far. The overall NPL ratio increased only 0.4 p.p. from end-2019 to 7.1 percent in September, with credit quality supported by fiscal programs and credit holidays.[4] Going forward, credit risk and

[4] Poland's NPL definition is strict in international comparison; as defined in the FSI database, NPLs were 3.8 percent of gross loans at end-2019.

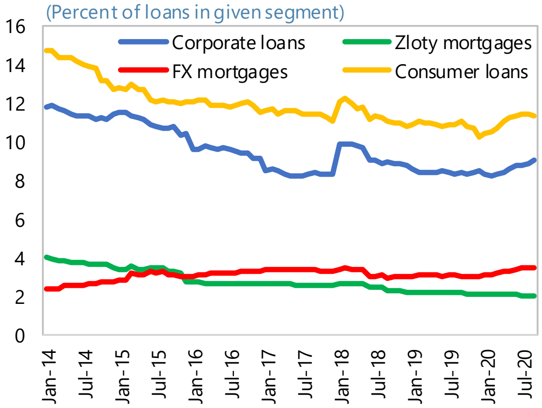
Table 2. Poland: Main Anti-Crisis Measures in the Financial Sector

Measure	Description
Reduced reserve requirements	Mandatory bank reserve requirement reduced from 3.5 to 0.5 percent; increased banking sector liquidity by PLN 41 billion.
Repeal of systemic risk capital buffer	Ministry of Finance - on recommendation of Financial Stability Committee - repealed 3 percent systemic risk buffer to free up PLN 30 billion in capital for banks
Profit retention	Financial Supervisory Authority (KNF) recommended banks and insurance companies retain profits from 2019 and undistributed profits from previous years; meant to strengthen capital bases.
Lower risk weights for loans collateralized by real estate	Financial Stability Committee recommended lowering risk weight for credit collateralized by commercial real estate from 100 to 50 percent. This will not apply to businesses involved in the rental or sale of commercial real estate. MoF estimates that it will release PLN 0.5 billion in capital, allowing up to PLN 10 billion in new credit with the reduced risk weight.
Longer deadline for MREL	Bank Guarantee Fund (BFG) decided that intermediate MREL targets could be met by Jan 2022 instead of end-2020. Deadline for meeting final MREL target will be postponed from 2023 to 2024. Expect to lower costs and facilitate credit expansion.
NBP asset purchase program	NBP purchase of Treasury bonds and government-guaranteed debt securities provides liquidity to banks and has helped stabilize Treasury bond market and improve monetary policy transmission.
Discount credit facility	NBP has introduced discount credit to refinance bank loans extended to firms, similar to the ECB's LTRO, but this tool has been used only marginally (PLN 50 million so far) due to weak demand from banks.
Repo auctions	NBP introduced repo transactions to provide liquidity to banks, with only one transaction (PLN 7.3 billion 4-day repo on March 16)
Credit moratoria	Upon recommendation of Association of Polish Banks, banks offered credit holidays to households and firms affected by the crisis. Terms differ by bank but usually involve 3-6 month suspension of interest and/or principal. Covered about 1 million loans worth PLN 80 billion (7 percent of non-financial loan portfolio) as of end-May.
Credit guarantees	State-owned BGK changed existing de minimis credit guarantee scheme for SMEs to increase guarantee from 60 to 80 percent of credit and amount from EUR 200,000 to EUR 800,000. BGK also introduced credit guarantees for large firms with new Liquidity Guarantee Fund.

Sources: NBP; KNF; and ZBP.

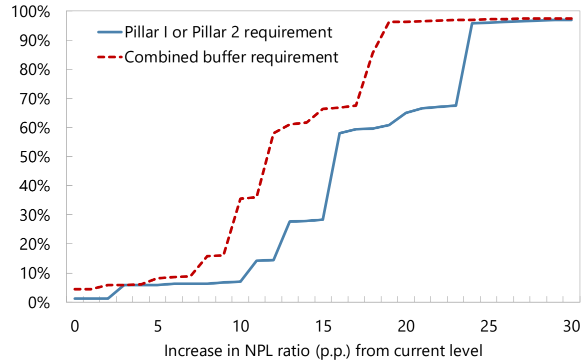
provisions for credit losses are likely to increase. Most banks can absorb significant increases in NPLs without breaching capital requirements.[5] Increased provisioning and compressed interest margins will reduce already-low earnings, possibly a significant problem for cooperative banks that depend more on net interest income[6]. So far, cooperative banks have substantially reduced deposit rates which, along with modest provisioning, has limited reductions in profitability in 2020. Nevertheless, cooperative banks will need to change their business model over the medium term through further consolidation and greater sharing of services within affiliating banks to improve cost efficiency.

Non-Financial Sector NPLs
(Percent of loans in given segment)



Sources: KNF.

Breach of Capital Requirements Due to Increased NPLs
(Cumulative system assets in banks that are in breach of capital requirements)



Sources: NBP July 2020 Financial Stability Report.

31. Maintaining credit to the private sector will be crucial for a post-pandemic recovery. Banks flush with liquidity have significantly increased their holdings of government bonds, reflecting a tightening of lending conditions and subdued credit demand, but also the pre-existing exemption of Treasury securities from the bank asset tax. To support credit during the recovery, the authorities should redesign the tax in favor of a less distortionary instrument, such as a quasi-VAT on banks' profits and remuneration.

32. Enhanced financial independence for the Polish Financial Supervisory Authority (KNF) has permitted strong supervisory oversight and increased focus on AML/CFT compliance. The KNF's budget was delinked from the state budget in 2019, increasing its financial independence. KNF spending roughly doubled from 2018, and employment increased by a fifth, enabling intensified and better calibrated financial sector oversight. A department responsible for compliance with AML/CFT requirements was created. The authorities support efforts to enhance AML/CFT cooperation within the EU, while stressing that country-specific solutions also need to be preserved.

[5] At end-2020, the Bank Guarantee Fund (BFG) resolved the small Idea Bank (0.6 percent of the sector), which had been under BFG curatorship since 2019. With an audit revealing negative capital, the BFG arranged for most assets and liabilities to be taken over by a larger bank for a lower-cost resolution than bankruptcy. Holders of equity and subordinated debt were bailed-in.

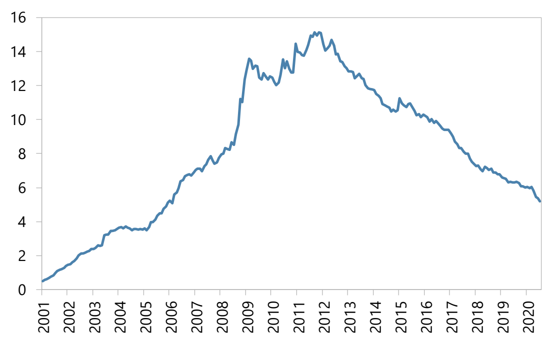
[6] Cooperative banks are numerous (533 cooperative banks versus 30 commercial banks) but small, accounting for about 6 percent of banking sectoral capital.

33. Legal risks from foreign-currency denominated (FX) mortgages remain a source of uncertainty for banks. The 2018 FSAP concluded that credit risk from legacy FX mortgages did not represent a systemic threat, as this portfolio was steadily shrinking (now below 6 percent of GDP) and well performing. After an ECJ ruling sparked a growing wave of borrower lawsuits in late 2019 based on allegedly abusive practices when the loans were originated, however, banks began to increase provisioning for legal risks. While the value of disputed loans is still a small fraction of outstanding FX mortgages, the number of lawsuits has more than doubled in the last year, and FX mortgage risk accounts for about 1/3 of banking sector provisioning in 2020. The range of potential losses will depend on final court decisions and the volume of dispute loans, and possibly on out of court settlements. While the sector as a whole should be able to generate adequate provisions for FX mortgages out of current profits, legal risks pose a larger challenge for some small and medium-size banks with large exposures to FX mortgages. While this risk is well identified by the authorities and banks, both should remain vigilant, continuing to adapt their strategies to stay ahead of possible implications of court rulings. In particular, banks should proactively work with borrowers to reach voluntary agreements to settle legal disputes.

Figure 7. Poland: FX Mortgages

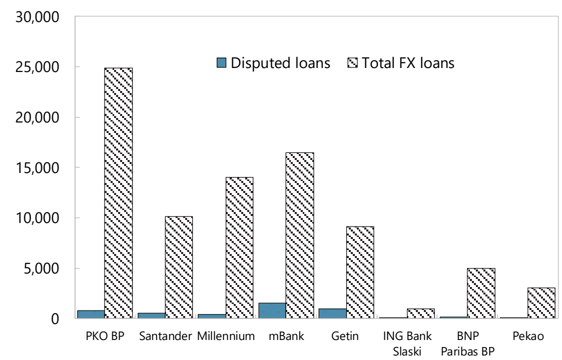
New FX mortgages have been effectively banned since 2013.

FX Mortgages
(Percent of bank assets)



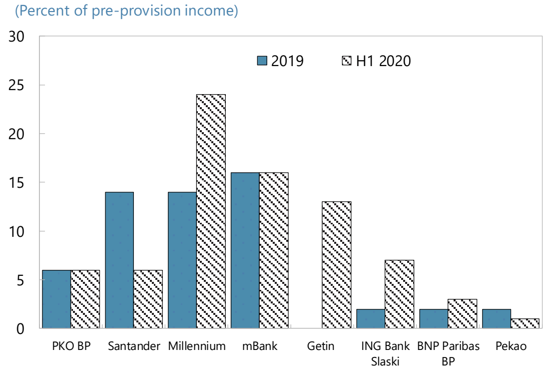
Only a small fraction of total FX mortgages has been challenged in court so far.

Value of Disputed and Total FX Mortgages
(PLN million)



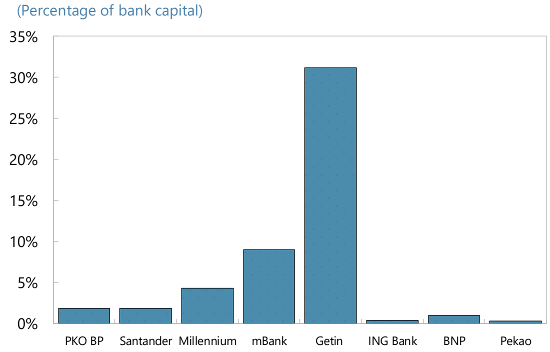
Banks began to increase provisioning for legal risk in 2019.

Bank Provisions for FX Mortgages
(Percent of pre-provision income)



The value of disputed FX mortgages is small for most banks as a percentage of capital.

Value of Disputed FX Mortgages
(Percentage of bank capital)



Sources: KNF; and Moody's from bank financial statements.

Authorities' Views

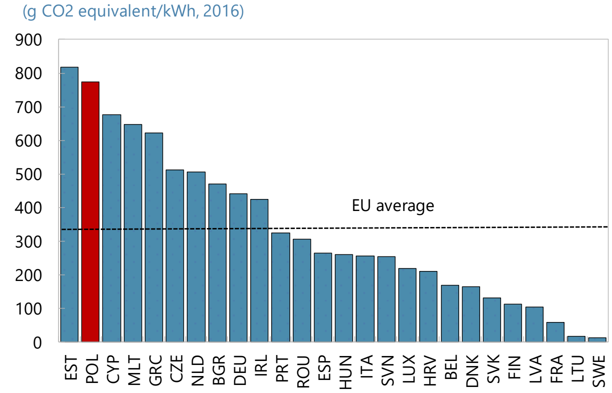
34. The authorities highlighted the resilience of the banking sector to the pandemic. They believed that strong capital buffers would allow the sector to weather an increase in credit risk from the pandemic. Subdued private sector credit growth, particularly for working capital loans, stemmed from weak demand for credit. They tied the weak demand for credit in part to companies' strong liquidity after receiving liquidity loans from the official sector. With credit expansion expected to resume after the crisis, the authorities were not contemplating changes to the design of the bank asset tax to make it neutral across asset classes. While cooperative banks rely more heavily on interest income than commercial banks, the authorities believed that the current low interest rate environment was not an immediate threat for cooperative banks. The authorities believed that cooperative banks needed to change their business models over the medium term, through consolidation and increased sharing of services to reduce operating costs.

35. The authorities recognized that legal risks from FX mortgages represented a source of major uncertainty for some banks. Increasing litigation and borrower-friendly verdicts could pose a significant challenge for some banks. The authorities require banks to hold additional capital against FX mortgage risks, which provides a cushion against potential costs, and banks are increasing provisioning against legal risks, as required by auditors. While the authorities are closely monitoring legal developments, they stressed that banks should actively promote voluntary bilateral restructuring of FX mortgage loans.

D. Structural Policies to Support the Recovery

36. Post-crisis structural reforms can support the recovery and help mitigate the long-term effects of the crisis. Despite effective policy support, the crisis is still likely to leave some scarring, with long-term effects on the level of output. To minimize the effect of the crisis on longer-term output, the authorities should aim to bolster investment and adjust labor market policies to foster participation and facilitate the reallocation of labor in the post-pandemic economy.

Greenhouse Gas Emission Intensity of Power Generation
(g CO2 equivalent/kWh, 2016)



Sources: European Environment Agency.

37. Effective use of EU funds can help boost public investment and help tackle infrastructure gaps and the energy transition. If current proposals for the EU multiannual financial framework and EU Recovery and Resilience Facility are adopted, Poland would receive annual capital transfers from the EU worth close to 2½ percent of GDP over the next five years. EU funds will support public investment, with an emphasis on modernization (digitalization, health, and R&D) well aligned with Poland's needs. At least 30 percent of EU funds is earmarked for climate change. Poland has significant space to increase investment in cleaner energy, with the authorities'

draft energy strategy calling for substantial changes in energy generation and efficiency. Decarbonization targets are ambitious and costly, with the share of coal-powered energy planned to decline from 69 percent in 2020 to 28 percent in 2040. Effective coordination between the central government, which owns the majority of coal mines, and local authorities will be key to productive utilization of EU financing and ensuring successful transition to a clean energy economy.

38. As the recovery proceeds, the authorities should promote a smooth sectoral reallocation of labor and provide support for disadvantaged groups. While the authorities' response has been effective in reducing the impact of the pandemic on the labor market, certain groups including youth and women have suffered disproportionally. While there was a broad-based recovery in labor markets in Q3:2020, the full impact of the pandemic remains to be seen. Post-pandemic, labor market policies should transition to providing support for workers, not particular jobs or sectors. Active labor market policies should be enhanced to help workers acquire the skills needed to adapt to the post-pandemic economy. The planned transition from coal energy will necessitate a strategy to transition workers employed in the industry to other sectors to avoid disproportional impacts on coal-rich regions. The higher impact of the pandemic on employment for women has underscored practical barriers to greater female labor force participation, such as the availability of childcare.

Authorities' Views

39. The authorities plan to use future EU funds to support the energy and digital transformations and to reform labor market regulations to confront future challenges. The authorities are preparing a Recovery and Resilience Plan, required to access proposed EU funds, based on over 2000 project proposals submitted by agencies and regional governments. The plan will cover a broad range of issues, including the energy transition, upskilling of the labor force, digitalization, and regional integration, and include a governance component to promote the transparent use of the funds. The authorities acknowledged that aging, migration, digitalization, and the climate transition also posed challenges for labor markets. They are preparing an action plan for employment policies to address these challenges, in addition to placing a greater emphasis on lifelong learning and the regulation of remote work.

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40. Policy actions have limited the damage from the pandemic-induced recession. Following a long period of strong growth, Poland experienced a recession in 2020, though one that is estimated to be among the least severe in the European Union. Strong and effective policy support protected workers and firms during the lockdowns and bolstered a significant rebound in activity after the initial phase of the pandemic, preventing destructive losses of employment and bankruptcies. The second wave of the virus is likely to have again lowered economic activity, delaying the start of a durable recovery. Actions by Polish and global authorities have supported financial and foreign exchange market stability after the initial period of turmoil in the spring. The external position is preliminarily assessed to be stronger than the level implied by medium-term fundamentals and desirable policies.

41. Poland is well positioned for an economic recovery, though pandemic uncertainty remains a fundamental risk. Economic growth in 2021 is likely to be limited by ongoing restrictions during the winter but is expected to rebound later in the year with expected vaccine access. The corporate sector entered the pandemic with comparatively strong balance sheets and has benefited from ample policy support, which combined with resilient labor markets should foster a strong recovery. The level of external reserves is adequate, providing protection against external shocks. Over the medium term, sizeable new grants from the EU would facilitate an increase in investment and boost growth. The significant uncertainty regarding the course of the pandemic requires the authorities to maintain vigilance and flexibility, both on public health and economic support measures.

42. Fiscal policy actions have provided significant support to companies and workers during the pandemic. Key actions have incentivized firms to maintain employment through wage subsidies, while income support for self-employed and unemployed workers has been provided. Companies have received guarantees and loans, with the possibility for substantial forgiveness. This combination helps preserve equity while providing access to liquidity. The implementation of these programs has generally been fast and robust, which should help limit long-term damage to the economy.

43. The authorities should continue to utilize substantial fiscal space available to support the economy as needed during the pandemic. The reduction in public debt in past years has positioned the government well to respond to the crisis, and the extension of fiscal support during the ongoing second wave is welcome. To minimize scarring, programs should err on the side of providing broad-based sectoral support. Additional support for health care and vulnerable households should continue. Over the medium-term, the fiscal deficit should be gradually reduced to replenish fiscal buffers against unpredictable shocks and foreseeable long-term budget pressures. The pace of the eventual consolidation should be determined once the recovery is firmly under way.

44. The accommodative monetary policy stance remains appropriate until a recovery is well established. At the onset of the pandemic, monetary policies were quickly and appropriately eased. The central bank's asset purchase program has been effective in providing liquidity to government securities markets and strengthening monetary policy transmission. Core inflation remains above the target range, partly driven by pandemic-related one-off factors, but is projected to decline next year given continued slack in the economy. Additional near-term supply-induced inflation, if it materializes, should be tolerated in view of the negative output gap. Continued clear policy communication and transparency will support the effectiveness of the asset purchase program going forward.

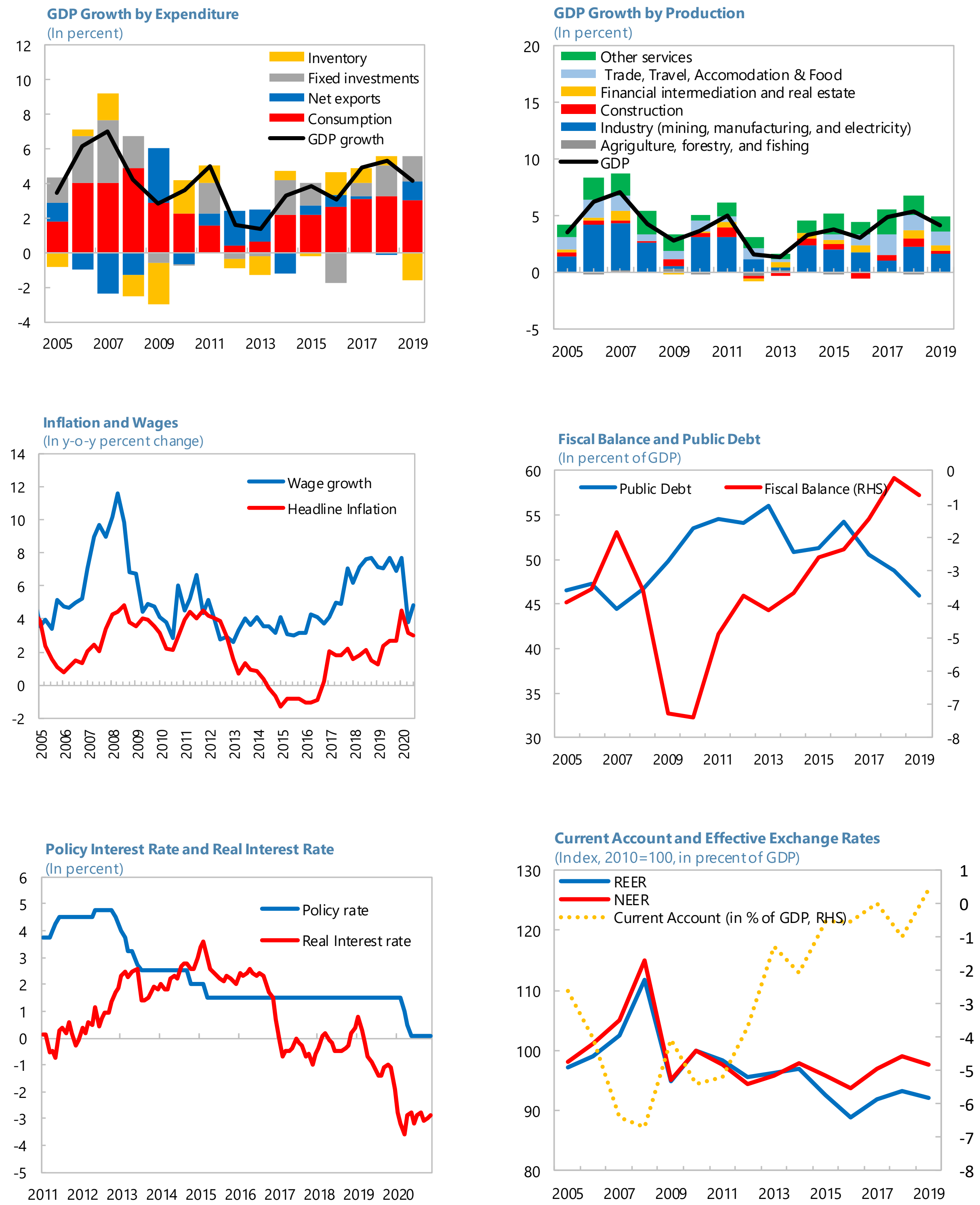
45. Supervisory actions have mitigated the impact of the crisis on the banking sector, but challenges remain. While asset quality remains sound, earnings have declined, and credit risk and provisioning for losses are likely to increase going forward. To confront the challenges of lower interest margins, cooperative banks will need to further consolidate and increase service sharing within affiliating banks to improve cost efficiencies. Foreign exchange mortgage lawsuits remain a source of significant uncertainty for banks. Supervisors and banks should continue to adapt their

strategies to stay ahead of possible implications of court rulings. To support credit to the private sector during the recovery, the authorities should redesign the bank asset tax, which incentivizes banks to hold government securities.

46. Post-crisis structural reforms can help mitigate the long-term effects of the crisis. Despite effective policy support, some scarring is still likely, with long-term effects on economic output. The authorities should bolster investment and adjust labor market policies to encourage participation and facilitate the reallocation of labor in the post-pandemic recovery. Proposed Next Generation EU funds provide an opportunity to boost public investment, while their focus on digitalization and a green recovery would help Poland advance with the modernization of its economy.

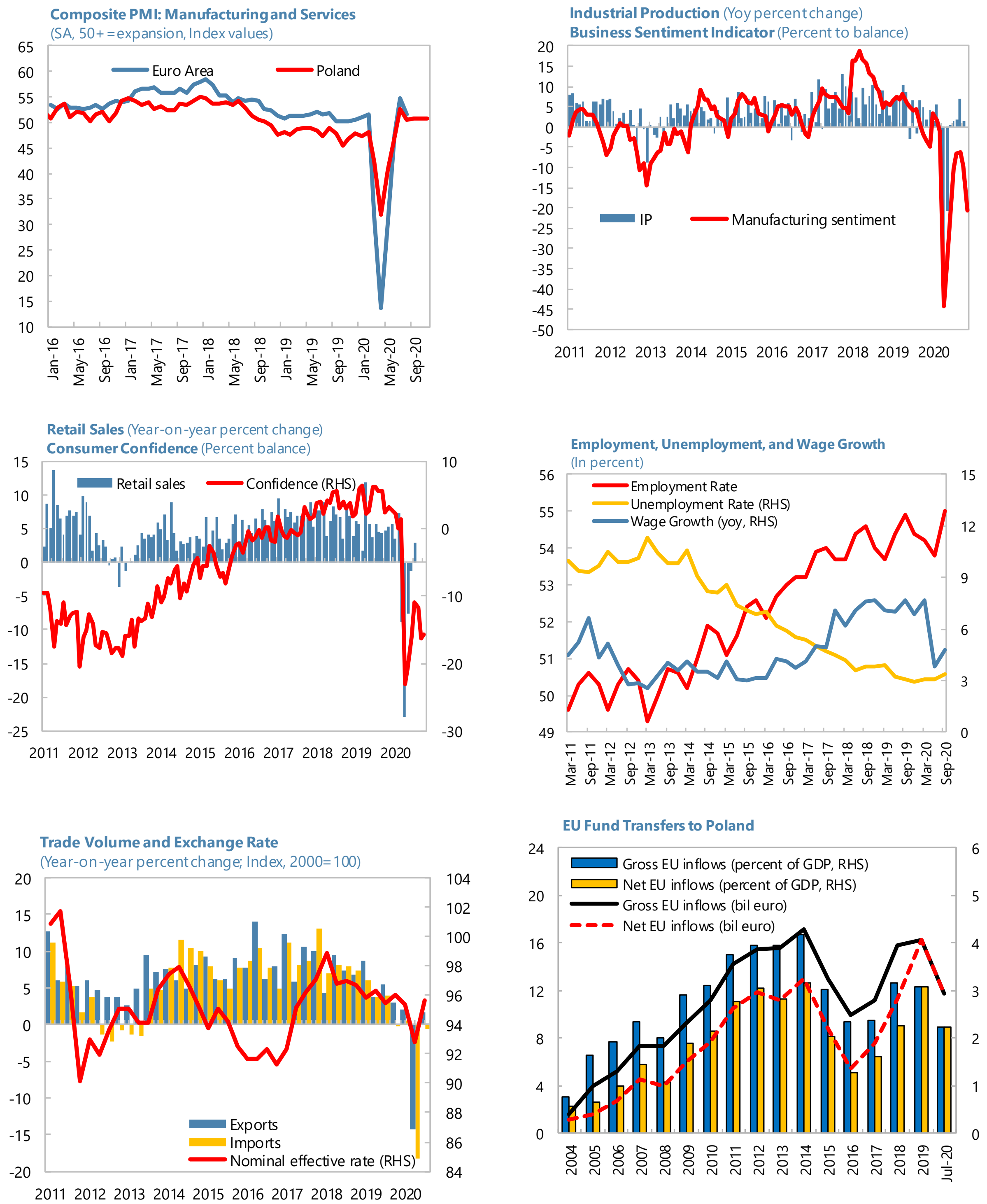
47. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

Figure 8. Poland: Selected Economic Indicators, 2005–20



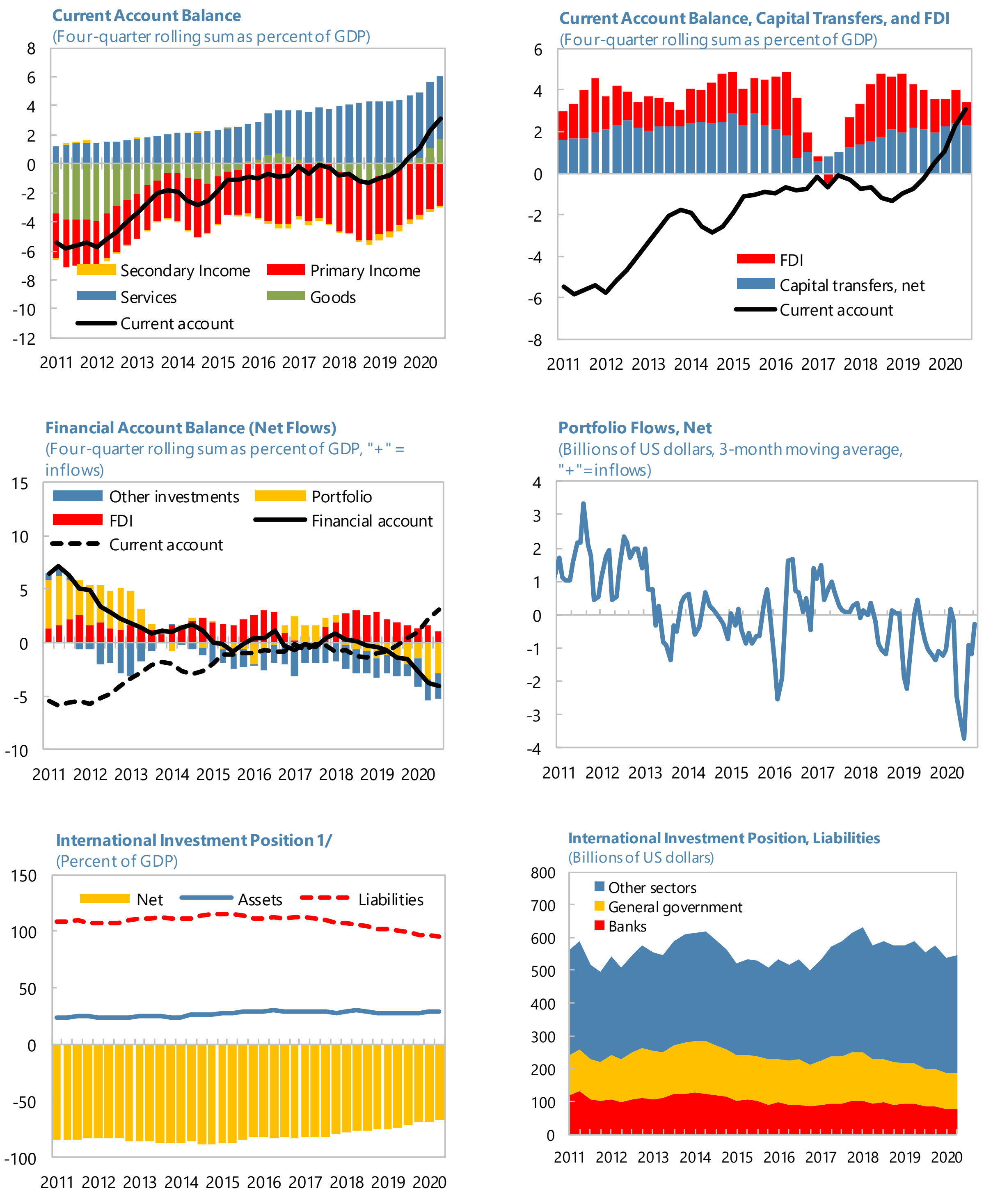
Sources: GUS; Ministry of Finance; NBP; and IMF staff calculations.

Figure 9. Poland: Selected Economic Indicators, 2011–20



Sources: Haver; GUS; IMF staff calculations.

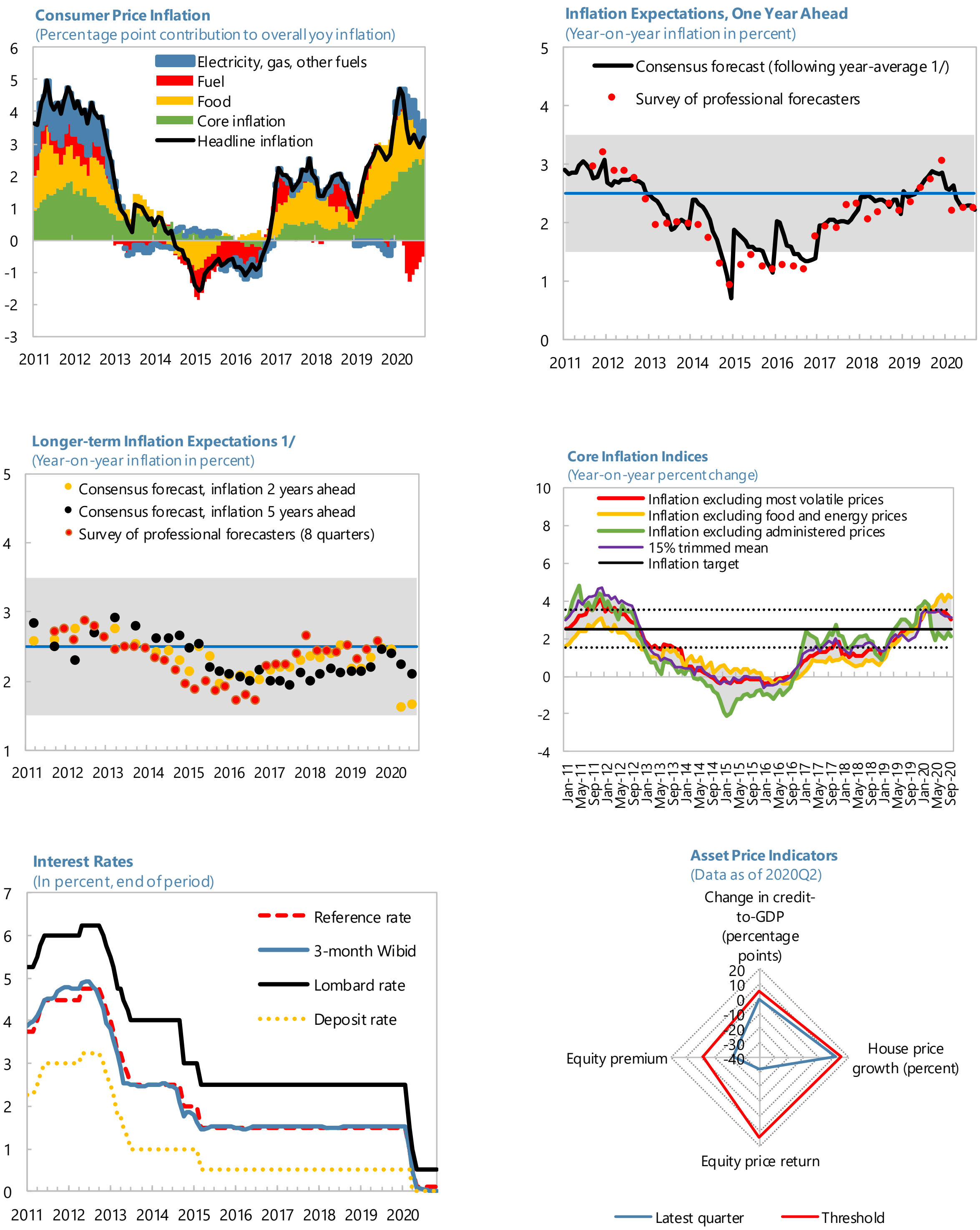
Figure 10. Poland: Balance of Payments Developments, 2011–20



Sources: NBP; and IMF staff calculations.

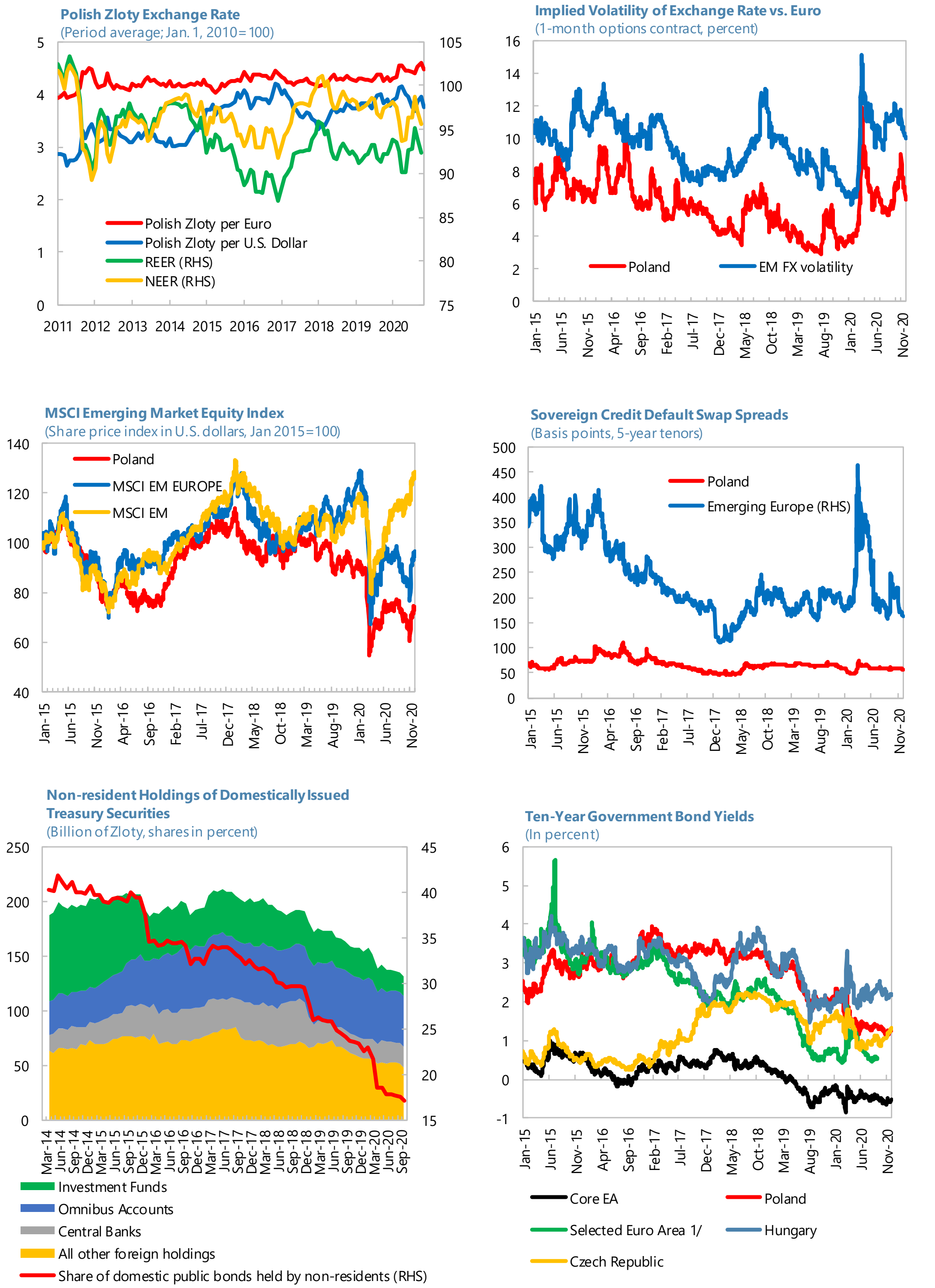
1/ Excludes NBP.

Figure 11. Poland: Inflation and Asset Price Indicators, 2011–20



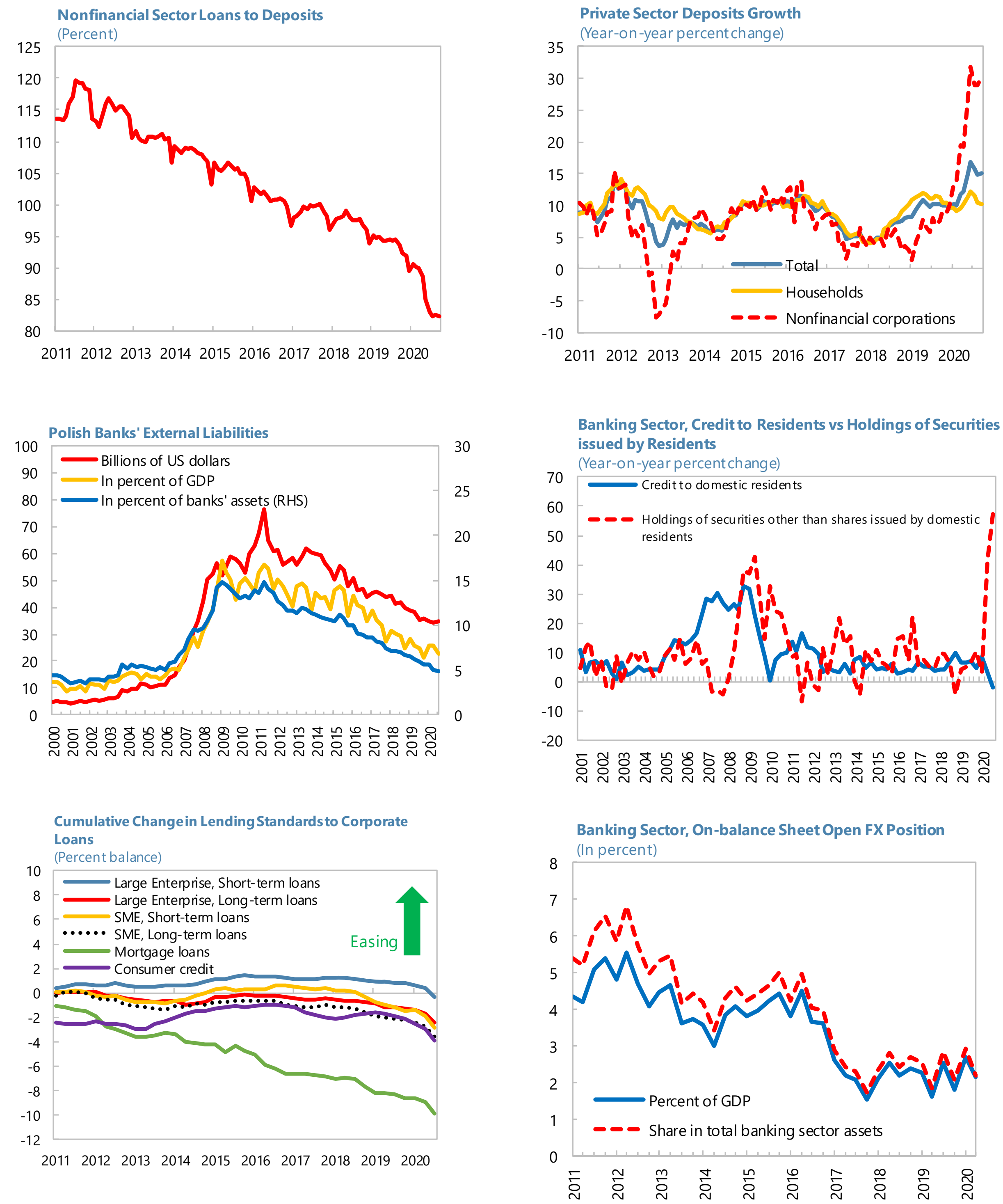
Sources: Haver; Consensus Forecast; GUS; NBP; and IMF staff calculations.
1/ Expectations for the year's average is affected by breaks when the forecast year changes in January.

Figure 12. Poland: Financial Market Developments



Sources: Bloomberg Finance L.P.; Haver Analytics; Poland Ministry of Finance; and IMF staff calculations.
1/ Selected Euro Area includes Greece, Portugal, Spain, Ireland, and Italy.

Figure 13. Poland: Banking Sector Developments



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

Table 3. Poland: Selected Economic Indicators, 2017–25

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Est.			Projections		
Activity and prices									
GDP (change in percent)	4.8	5.4	4.5	-3.4	2.7	5.1	4.2	2.9	2.6
Domestic demand	4.9	5.6	3.5	-4.7	3.7	6.1	4.4	3.3	2.6
Private consumption growth	4.7	4.5	3.9	-2.9	4.1	4.6	3.8	3.3	3.2
Public consumption growth	2.7	3.5	6.2	3.2	4.0	3.5	3.0	2.5	1.5
Domestic fixed investment growth	4.0	9.4	7.2	-7.6	2.1	13.6	7.5	3.8	2.0
Inventories (contribution to growth)	0.8	0.4	-1.3	-1.9	0.0	0.0	0.0	0.0	0.0
Net external demand (contribution to growth)	0.1	0.0	1.2	1.1	-0.8	-0.7	0.0	-0.2	0.0
Output gap	0.4	0.7	0.9	-2.7	-2.5	-0.8	0.0	0.0	0.0
CPI inflation (percent)									
Average	2.0	1.6	2.3	3.4	2.6	2.2	2.3	2.5	2.5
End of period	2.1	1.1	3.4	2.3	2.2	2.1	2.5	2.5	2.5
Unemployment rate (average, according to LFS)	4.9	3.8	3.3	3.3	4.9	4.6	4.5	4.5	4.5
Saving and Investment (percent of GDP)									
Saving	19.5	19.5	20.2	20.3	18.6	18.5	18.9	18.8	18.6
Investment	19.9	20.8	19.7	16.9	16.6	18.0	18.6	18.8	18.7
Saving - Investment	-0.4	-1.3	0.5	3.3	1.9	0.4	0.2	0.0	-0.1
Public finances (percent of GDP) 1/									
General government revenues 2/	39.8	41.3	41.0	41.0	40.7	42.2	41.3	41.0	40.8
General government expenditures	41.2	41.5	41.8	49.4	45.9	44.8	44.5	44.2	44.0
General government net lending/borrowing	-1.5	-0.2	-0.7	-8.4	-5.1	-2.5	-3.2	-3.2	-3.2
General government cyclically-adjusted balance	-1.7	-0.6	-1.2	-7.0	-3.8	-2.1	-3.2	-3.2	-3.2
General government debt	50.6	48.8	45.7	58.6	59.0	57.3	56.7	56.9	57.5
National definition 3/	48.3	46.4	43.3	...	...	...	...	...	...
Money and credit									
Private credit (change in percent, end-period) 4/	3.4	7.1	4.8	0.0	6.1	6.3	6.3	6.4	6.5
Credit to GDP (percent)	55.8	56.1	54.5	54.5	54.6	54.0	53.8	54.3	55.0
Deposits (change in percent, end-period)	3.8	8.2	8.6	13.9	1.0	5.1	4.6	4.2	4.2
Broad money (change in percent, end-period)	4.6	9.2	8.3	16.4	2.0	5.4	5.0	4.4	4.4
Policy Rate (percent) 5/	1.5	1.5	1.5	0.5	...	...	...	...	...
Balance of payments									
International Investment Position, Net (Percent of GDP)	-66.4	-53.7	-50.0	-45.4	-38.7	-32.1	-27.8	-25.4	-23.9
Current account balance (billion U.S. dollars)	-2.1	-7.5	2.9	19.5	12.0	3.0	1.8	-0.2	-0.9
Percent of GDP	-0.4	-1.3	0.5	3.3	1.9	0.4	0.2	0.0	-0.1
Exports of Goods (billion U.S. dollars)	228.3	256.3	260.7	246.3	269.0	282.9	299.5	316.1	333.6
Export volume growth	9.6	6.9	5.1	-3.3	5.6	5.5	4.0	2.7	2.8
Imports of Goods (billion U.S. dollars)	228.8	263.6	259.4	235.5	263.3	280.4	297.6	316.0	334.4
Import volume growth	10.2	7.4	3.3	-5.7	7.8	7.3	4.3	3.3	2.9
Terms of trade (index 1995=100)	106.1	105.0	106.5	108.0	107.7	108.2	108.3	108.2	108.0
Official reserves (billion U.S. dollars)	113.3	117.0	128.4	154.3	160.9	165.1	168.8	172.8	172.7
In percent of short-term debt plus CA deficit	124.2	146.0	179.7	198.6	178.1	188.4	195.7	199.2	200.9
In percent of IMF ARA metric	117.5	123.2	132.8	...	...	...	...	...	...
Total external debt (billion U.S. dollars)	383.0	362.2	354.0	349.0	363.5	348.0	335.1	334.0	331.0
In percent of GDP	72.3	61.7	59.4	59.9	58.5	51.2	45.5	42.4	39.4
Exchange rate									
Exchange rate regime				Freely floating					
Zloty per USD, period average	3.8	3.6	3.8	3.9	...	...	...	...	...
Zloty per Euro, period average	4.3	4.3	4.3	4.4	...	...	...	...	...
Real effective exchange rate (INS, CPI based) 6/	100.2	101.9	100.5	...	...	...	...	...	...
Appreciation (percent change)	3.4	1.7	-1.3	...	...	...	...	...	...
Memorandum item:									
Nominal GDP (billion zloty)	1989.8	2121.6	2287.7	2285.2	2418.7	2599.3	2775.8	2926.8	3076.4

Sources: Polish authorities; and IMF staff calculations.

1/ According to ESA2010.

2/ Revenue projections in 2020-21 do not include one-off revenues from the Pillar II pension refrom.

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

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

5/ NBP Reference Rate (avg).

6/ Annual average (2000=100).

Table 4. Poland: Balance of Payments on Transaction Basis, 2015–25

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

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
						Est.		Projections			
Current account balance	-4,347	-3,719	-1,960	-7,530	2,931	19,484	11,970	2,999	1,778	-206	-932
percent of GDP	-0.9	-0.8	-0.4	-1.3	0.5	3.3	1.9	0.4	0.2	0.0	-0.1
Trade balance	12,954	17,484	19,707	17,794	27,808	31,724	30,955	29,847	31,895	31,816	33,861
percent of GDP	2.7	3.7	3.7	3.0	4.7	5.4	4.9	4.4	4.3	4.0	4.0
Balance on Goods	883	2,262	-463	-7,327	1,339	10,835	5,698	2,485	1,958	33	-749
Merchandise exports f.o.b.	190,202	196,383	228,214	256,230	260,778	246,321	269,010	282,917	299,510	316,071	333,630
Merchandise imports f.o.b.	189,319	194,121	228,677	263,557	259,439	235,486	263,312	280,432	297,552	316,038	334,379
Balance on Services	12,071	15,222	20,170	25,121	26,469	20,889	25,257	27,362	29,937	31,784	34,610
Merchandise exports f.o.b.	44,077	48,712	57,714	67,992	69,903	55,535	69,651	75,362	79,747	83,706	88,226
Merchandise imports f.o.b.	32,006	33,490	37,544	42,871	43,434	34,646	44,394	48,000	49,810	51,922	53,616
Exports of goods and services											
percentage change in unit values	-8.5	4.6	16.7	13.4	2.0	-5.5	9.2	5.2	5.9	5.5	5.6
percentage volume growth	8.0	9.3	9.6	6.9	5.1	-3.3	5.6	5.5	4.0	2.7	2.8
Imports of goods and services											
percentage change in unit values	-11.8	2.8	17.0	15.1	-1.2	-9.2	11.8	6.5	6.1	6.2	5.8
percentage volume growth	6.9	7.9	10.2	7.4	3.3	-5.7	7.8	7.3	4.3	3.3	2.9
Terms of trade (percentage change)	2.7	0.4	0.3	-1.0	1.4	1.5	-0.3	0.4	0.1	-0.1	-0.1
Primary Income balance	-16,334	-19,624	-21,517	-23,647	-22,828	-11,657	-17,913	-25,737	-28,870	-30,669	-32,849
percent of GDP	-3.4	-4.2	-4.1	-4.0	-3.8	-2.0	-2.9	-3.8	-3.9	-3.9	-3.9
Secondary Income balance	-967	-1,579	-150	-1,677	-2,049	-582	-1,072	-1,111	-1,247	-1,353	-1,944
Capital and financial account balance	11,998	6,254	4,125	13,470	20,511	43,828	34,328	42,424	25,773	9,630	-581
Capital account balance (net)	11,331	4,867	6,795	12,148	11,757	12,172	11,179	19,713	11,997	4,918	175
Financial account balance (net)	667	1,387	-2,670	1,322	8,754	31,656	23,149	22,712	13,776	4,712	-757
Foreign direct investment (net)[+ = outflows]	-10,152	-4,398	-7,836	-15,285	-9,627	-5,909	-3,564	-2,767	-2,294	-2,240	-2,571
Assets [Increase = +]	4,913	13,923	3,926	2,339	4,772	2,995	7,967	7,786	7,300	7,200	7,100
Liabilities [Increase = +]	15,065	18,321	11,762	17,624	14,399	8,904	11,531	10,553	9,594	9,440	9,671
Portfolio investment (net)	3,090	-3,726	-4,593	4,413	12,266	13,356	6,761	1,072	-276	-1,181	-1,678
Assets	11,109	-5,827	1,428	625	-289	3,236	2,936	3,164	2,720	2,715	3,138
Liabilities	8,019	-2,101	6,021	-3,788	-12,555	-10,120	-3,825	2,092	2,996	3,896	4,815
Other investment (net)	7,572	-13,334	18,673	6,170	-2,988	2,271	13,316	20,251	12,589	4,156	3,604
Assets	5,153	2,777	6,488	6,215	943	8,166	5,316	5,951	3,589	3,350	3,302
Liabilities	-2,419	16,111	-12,185	45	3,931	5,895	-8,000	-14,300	-9,000	-806	-302
Financial derivatives	-978	184	-1,126	-1,221	-1,072	-3,957	0	0	0	0	0
Errors and omissions	-6,317	239	-7,505	-3,296	-5,934	0	0	0	0	0	0
Financing											
Reserve assets [Increase = +]	1,135	22,661	-7,788	7,245	10,175	25,895	6,637	4,155	3,757	3,978	-112
Memorandum items:											
Current plus capital account (percent of GDP)	1.5	0.2	0.9	0.8	2.5	5.4	3.7	3.3	1.9	0.6	-0.1
International Investment Position, Net (Percent of GDP)	-60.0	-58.1	-66.4	-53.7	-50.0	-45.4	-38.7	-32.1	-27.8	-25.4	-23.9
Gross official Reserve	94,922	114,390	113,278	116,964	128,405	154,300	160,937	165,092	168,849	172,827	172,716
in months of imports	6.0	7.1	5.9	5.3	5.9	7.9	7.3	7.1	6.8	6.6	6.2
Ratio of gross official reserves to short-term debt 1/	157.9	145.9	135.4	140.9	141.2	172.1	172.4	184.7	196.1	201.4	203.1
Ratio of gross official reserves to ST debt plus CA deficit	148.7	142.4	124.2	146.0	179.7	198.6	178.1	188.4	195.7	199.2	200.9
Ratio of gross official reserves to IMF ARA metric	111.2	138.3	117.5	123.2	132.8	...	...	...	...	...	...
Total external debt (percent of GDP)	69.4	72.1	72.3	61.7	59.4	59.9	58.5	51.2	45.5	42.4	39.4
Total external debt (percent of exports)	141.3	138.8	133.2	111.7	107.0	115.6	107.3	97.1	88.4	83.6	78.5
External debt service (percent of exports)	48.4	46.5	46.3	45.5	44.8	50.8	45.4	43.4	39.3	36.4	34.4

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

1/ Short-term debt is on remaining maturity.

Table 5. Poland: Statement of Operations of General Government, 2015–25

(Percent of GDP)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
						Est.		Projections			
Revenue	39.0	38.7	39.8	41.3	41.0	41.0	40.7	42.2	41.3	41.0	40.8
Taxes	19.9	20.5	21.1	21.9	21.8	21.7	22.1	22.1	22.1	22.2	22.2
Personal income tax	4.7	4.8	4.9	5.2	5.1	5.0	4.8	4.8	4.8	4.9	4.9
Corporate income tax	1.8	1.8	1.9	2.1	2.2	2.2	2.0	2.0	2.0	2.0	2.0
VAT	7.0	7.2	7.8	8.1	8.0	7.8	8.0	8.0	8.0	8.0	8.0
Excises	3.5	3.5	3.5	3.2	3.1	3.2	3.3	3.3	3.3	3.3	3.3
Other taxes	2.9	3.1	3.1	3.2	3.4	3.5	3.9	3.9	3.9	3.9	3.9
Social contributions	13.5	13.8	13.9	14.1	14.2	14.8	14.2	14.3	14.4	14.5	14.5
Other revenue	5.7	4.4	4.8	5.3	5.1	4.5	4.5	5.8	4.8	4.3	4.0
Capital revenue	1.1	0.6	0.7	1.2	1.0	0.8	0.7	1.3	1.0	0.5	0.2
Sales of goods and services	2.5	2.4	2.4	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Other current revenue	2.1	1.4	1.7	1.8	1.7	1.4	1.5	2.2	1.5	1.5	1.5
Expenditure	41.7	41.1	41.2	41.5	41.8	49.4	45.9	44.8	44.5	44.2	44.0
Expense	37.3	37.8	37.5	36.8	37.5	45.1	41.5	39.8	39.7	39.7	39.7
Compensation of employees	10.4	10.4	10.2	10.1	10.1	10.8	10.8	10.8	10.9	10.9	10.9
Use of goods and services	5.7	5.5	5.5	5.7	5.5	5.9	5.9	5.9	5.9	5.9	5.9
Interest	1.8	1.7	1.6	1.4	1.4	1.4	1.0	0.9	1.0	1.0	1.0
Subsidies	0.5	0.5	0.5	0.4	0.5	1.8	0.4	0.4	0.4	0.4	0.4
Social benefits	16.2	17.1	17.0	16.7	17.4	19.6	19.4	19.2	18.9	18.9	18.9
Other expense 1/	2.8	2.5	2.7	2.5	2.6	5.6	3.9	2.7	2.7	2.7	2.7
Other current expenditure	2.2	2.0	1.9	2.1	2.1	2.8	2.3	2.3	2.3	2.3	2.3
Capital transfers	0.6	0.5	0.8	0.4	0.4	2.9	1.6	0.5	0.5	0.5	0.5
Net acquisition of nonfinancial assets	4.3	3.2	3.8	4.7	4.3	4.3	4.4	4.9	4.8	4.5	4.3
Gross operating balance	1.7	0.9	2.3	4.4	3.5	-4.1	-0.7	2.4	1.6	1.3	1.1
Net lending/borrowing	-2.6	-2.4	-1.5	-0.2	-0.7	-8.4	-5.1	-2.5	-3.2	-3.2	-3.2
Cyclically-adjusted fiscal balance	-2.3	-2.1	-1.7	-0.6	-1.2	-7.0	-3.8	-2.1	-3.2	-3.2	-3.2
Net financial transactions	-2.6	-2.4	-1.4	-0.3	-0.8	-8.4	-5.1	-2.5	-3.2	-3.2	-3.2
Net acquisition of financial assets	0.0	2.2	0.2	1.5	0.6	3.6	-1.2	0.2	0.2	0.2	0.2
Currency and deposits	-1.0	1.0	-0.1	0.8	0.4	1.8	-1.7	0.1	0.1	0.1	0.1
Debt securities	0.0	0.1	0.2	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.0	0.1	0.0	0.1	-0.1	1.3	0.4	0.0	0.0	0.0	0.0
Equity and investment fund shares	-0.1	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other financial assets	1.0	1.2	0.3	0.7	0.0	0.5	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	2.6	4.5	1.6	1.8	1.4	12.0	3.9	2.7	3.4	3.4	3.4
Currency and deposits	0.2	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	1.8	3.8	1.1	-0.1	0.1	11.6	3.5	2.3	2.9	3.1	3.1
Loans	0.3	-0.1	0.0	0.7	0.4	0.2	0.2	0.3	0.3	0.2	0.2
Other liabilities	0.3	0.9	0.6	1.0	0.8	0.2	0.2	0.2	0.2	0.1	0.1
Adjustment and statistical discrepancies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Cyclically-adjusted balance	-2.3	-2.1	-1.7	-0.6	-1.2	-7.0	-3.8	-2.1	-3.2	-3.2	-3.2
Primary balance	-0.9	-0.7	0.1	1.2	0.6	-7.1	-4.1	-1.6	-2.2	-2.2	-2.2
Cyclically-adjusted primary balance	-0.6	-0.4	-0.1	0.8	0.2	-5.7	-2.8	-1.2	-2.3	-2.2	-2.2
General government debt	51.3	54.2	50.6	48.8	45.7	58.6	59.0	57.3	56.7	56.9	57.5
General government liabilities	70.0	72.9	68.6	66.7	63.2	74.5	75.0	73.3	72.7	72.9	73.4
General government financial assets	27.5	29.1	27.7	27.8	26.5	25.5	24.5	23.5	22.5	21.5	20.5
Nominal GDP in billions of zloty	1,801	1,863	1,990	2,122	2,288	2,285	2,419	2,599	2,776	2,927	3,076

Sources: Eurostat; and IMF staff calculations.

1/ Includes grants.

Table 6. Poland: Monetary Accounts, 2015–21

	2015	2016	2017	2018	2019	2020 Est.	2021 Proj.
	(Billions of zlotys)						
Central bank							
Net foreign assets	349	390	356	393	435	549	566
Official reserve assets	370	478	394	440	488	602	619
Net domestic assets	-213	-252	-223	-103	-135	-200	-195
Net claims on government	-16	-30	-26	-34	-39	16	26
Claims on banks 1/	-74	-81	-94	-115	-80	-55	-31
Other items, net	-122	-141	-102	-11	-11	-11	-11
Base money	212	220	232	292	304	349	371
Currency issued	163	187	198	219	238	314	335
Bank reserves	49	33	34	73	65	35	36
Deposit money banks							
Net foreign assets	-162	-156	-123	-102	-90	-81	-30
Net domestic assets	1,150	1,226	1,235	1,305	1,396	1,569	1,532
Net claims on the central bank 1/	51	36	38	76	69	39	39
Net claims on government	241	297	302	317	328	455	502
Claims on private sector	1,023	1,074	1,111	1,189	1,246	1,246	1,322
Claims on corporates	324	340	358	381	386	386	409
Claims on households	633	665	676	723	766	766	813
Claims on other	67	69	76	85	94	94	100
Other items, net	-165	-181	-216	-278	-248	-171	-331
Deposits	988	1,070	1,111	1,202	1,306	1,487	1,502
Consolidated banking system							
Net foreign assets	187	234	233	290	345	468	536
Net domestic assets	968	1,031	1,092	1,156	1,221	1,355	1,323
Claims on government	224	267	277	283	290	471	528
Claims on private sector	1,023	1,074	1,111	1,189	1,246	1,246	1,322
Other items, net	-280	-310	-296	-317	-316	-363	-528
Broad money (M3)	1,155	1,266	1,324	1,446	1,566	1,823	1,859
Memorandum items:	(Percentage change from end of previous year)						
Base money	10.7	3.9	5.2	25.9	4.0	14.9	6.1
Broad money (M3)	9.1	9.6	4.6	9.2	8.3	16.4	2.0
Net domestic assets	9.2	6.6	5.9	5.9	5.6	11.0	-2.4
Net foreign assets	8.2	25.2	-0.7	24.8	18.8	35.7	14.6
Net claim on government	15.1	19.0	3.5	2.5	2.3	62.6	12.1
Claims on private sector	7.5	4.9	3.4	7.1	4.8	0.0	6.1
Deposit growth	8.8	8.4	3.8	8.2	8.6	13.9	1.0
	(Percent of GDP, unless otherwise noted)						
Broad money (M3)	64.1	67.9	66.6	68.2	68.4	79.7	76.8
Private sector credit	56.8	57.6	55.8	56.1	54.5	54.5	54.6
Broad money Velocity (GDP/M3)	1.6	1.5	1.5	1.5	1.5	1.3	1.3
Money multiplier (M3/base money)	5.4	5.7	5.7	4.9	5.2	5.2	5.0

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

1/ The difference between deposit money bank claims on the central bank and central bank claims on banks relates to banks' reserves and currency in vault.

Table 7. Poland: Financial Soundness Indicators, 2012–20

	2012	2013	2014	2015	2016	2017	2018	2019	2020Q1	2020Q2
Capital adequacy 1/										
Regulatory capital to risk-weighted assets	14.8	15.7	14.7	16.0	17.2	18.0	18.3	18.6	17.9	19.1
Regulatory Tier I capital to risk-weighted assets	13.1	14.1	13.5	14.6	15.6	16.2	16.3	16.4	15.8	16.9
NPLs net of provisions to capital 2/	12.9	12.1	12.1	10.2	9.2	8.1	9.4	8.9	9.1	8.9
Bank capital to assets 3/	8.7	9.1	8.9	9.4	9.5	10.0	9.8	9.6	9.1	9.2
Asset composition and quality										
NPLs to gross loans (nonfinancial sector)	5.2	5.0	4.8	4.3	4.0	3.9	3.9	3.8	3.8	3.8
Sectoral distribution of loans to nonfinancial sector										
Loans to households	50.2	51.2	50.6	51.0	51.6	50.6	50.2	51.1	50.1	51.8
Loans to non-financial corporations	25.0	24.8	25.1	25.6	26.0	26.6	25.3	24.9	24.9	24.7
Earnings and profitability										
Return on average assets (after tax)	1.2	1.1	1.1	0.8	0.8	0.8	0.7	0.7	0.6	0.4
Return on average equity (after tax) RORC 1/	14.0	12.1	12.3	9.1	9.2	8.2	7.5	7.9	7.0	5.2
Interest margin to gross income 4/	55.0	56.1	58.2	57.2	56.9	61.2	62.8	62.8	63.5	63.8
Noninterest expenses to gross income 5/	54.5	57.2	54.9	61.9	59.3	59.8	60.2	60.0	60.5	61.3
Liquidity										
One month liquidity gap to assets 6/	-46.4	-46.1	-46.7	-47.7	-47.9	-49.2	-42.7	-42.6	-41.2	-36.1
Loans to deposits 7/	110.5	106.7	103.1	100.5	96.7	95.9	94.0	89.5	89.9	83.0
Sensitivity to market risk										
Net open positions in FX to capital 1/	0.2	-0.1	0.3	0.8	0.8	0.4	0.1	0.2	0.1	0.1

Note: 2020Q2 is the latest data available shown for 2020. Data according to Financial Soundness Indicators (FSI), except for asset composition and quality (indicators not part of FSI reporting template).

Sources: IMF FSI Database; KNF.

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

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

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

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

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

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

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

Annex I. Implementation of Past IMF Recommendations

2018 Article IV Recommendations	Policy Actions
Monetary Policy	
Monetary policy should follow a data dependent approach. Interest rates should be raised if inflation approaches the mid-point of the target on a sustained basis.	Inflation reached and remained within the upper end of the target range starting in mid-2019. The policy interest rate remained on hold until the pandemic, when it was reduced from 1.5 to 0.1 percent.
Fiscal Policy	
Sustainable and growth-friendly fiscal measures should support the remaining adjustment needed to reach the Medium-Term Objective.	The fiscal deficit increased modestly in 2019 to 0.7 percent of GDP, up from 0.2 percent of GDP in 2018.
Continuing to strengthen revenue administration, narrowing the VAT policy gap, more-targeted social benefits, and raising the pension age would generate fiscal savings.	Efforts to strengthen revenue administration continue. An expansion of excise taxation has raised revenues but been more than offset by other tax changes, special pension payments (13^{th}/14^{th} pensions), and extending the coverage of child benefits without more precise targeting.
Financial Sector Policy	
Replace the bank asset tax with one on profits and/or renumeration.	No changes to the design of the tax have been made.
Conversion of legacy foreign-exchange mortgages into zloty should be on terms bilaterally agreed between the creditor and the borrower.	No government-designed central solution to this issue has been legislated. Banks continue to pursue bilateral agreements, while lawsuits have increased following an ECJ ruling in 2019.
Ensure independent and well-resourced financial sector supervision.	Legislation has changed the governance structure of the PFSA, increasing budgetary autonomy and allowing for an increase in resources and personnel.
Structural Reforms	
Maintain a level playing field for all investors by protecting the rights of minority shareholders. Avoid inefficient and distortive lending by state-controlled banks and reducing state ownership. Ensure that price signals reflect economic costs. Reforms should also focus on removing existing barriers to investment and facilitating access to skilled labor.	No significant policy actions taken. So far, there has been no evidence of different lending behavior by state-owned banks versus private banks during the pandemic.

Source: IMF staff.

Annex II. Implementation of 2018 FSAP Recommendations

Recommendations	Agency[1]	Time[2]	Progress
Risk Analysis			
Address weaknesses in medium-sized banks, including the affiliating banks for cooperative banks, given their systemic importance in the banking system.	PFSA	I-NT	**In Progress** Affiliating banks are limiting business activity to improve apex functions and focus on service provision for cooperative banks. The use of IPS support funds allowed safe repair of member banks at risk. IPSs have made progress in performing internal control among members.
Replace the asset tax on financial institutions with a tax on profits and/or remuneration.	MoF	I-NT	**Not Done** There are no legal initiatives to modify the tax.
Pursue bilateral negotiations to restructure distressed FX loans instead of law changes	PFSA, MoF	I	**In Progress** Parliamentary work on a law promoting bilateral conversion of FX loans was discontinued. After EU Court of Justice verdict in 2019, a growing number of clients are filing lawsuits, while banks try to encourage voluntary bilateral restructuring.
Close data gaps and improve data for credit risk and interconnectedness analysis.	PSFA	I-NT	**In Progress** The NBP started a project to build a central credit registry (KRK), with PFSA participation. KRK will allow to monitor loans of a single debtor and a group of affiliated entities at bank-level, as well as at the level of the banking sector. It will also provide a basis for sampling loans for on-site examination. The first reporting is planned in 2023.
Financial Sector Oversight			
Reform and strengthen arrangements for supervision, based on the principles that the PFSA should have (i) sufficient staffing and resources, (ii) operational independence, (iii) effective governance, and (iv) appropriate formal status in the determination of regulatory priorities.	MoF, PFSA, NBP	I	**Done** In line with FSAP recommendations, legal changes were made to grant the PFSA status of state legal person in 2019, which gave freedom in managing budget and reduced the risk of under-financing. PFSA spending and staffing have increased. Organizational changes were made to improve efficiency of supervisory activities, and new units were established.
Bank			
Provide missing essential enforcement powers including (i) those to ease rigidities constraining prompt corrective action due to Administrative Code procedures; and (ii) power to dismiss both management and supervisory board members	MoF, PFSA	NT	**In Progress** Amendments to the Banking Law are currently processed to grant PFSA the authority to dismiss members of management board and supervisory board of banks in a situation where they no longer meet the necessary requirements.
Increase sampling of loans across the supervisory and business cycle	PFSA	NT	**Done** On-site Inspection Department modified approach to inspections, which resulted in increase of examined samples in commercial and cooperative banks in the last two years. The number of loans in the samples increased between 2018 and 2019 by over 20 percent (with higher increase in cooperative banks). In case of significant irregularities, the sample is appropriately modified.

Recommendations	Agency[1]	Time[2]	Progress
Insurance			
Implement approach to supervision of the insurance-led financial conglomerate	PFSA	I	**Done** Repealing the waiver issued by the PFSA in 2018 and three administrative decisions on capital adequacy calculation, intragroup transactions (IGT) and significant risk concentration (RC) issued in 2019. Capital adequacy, IGT and RC reports, as well as recovery plan (incl. banks) regularly assessed as a part of on-going supplementary supervision process; organizational changes (dedicated employees, improved cooperation).
Review approach to insurance conduct of business supervision across the relevant agencies to increase preventative work, especially by the PFSA	MoF, PFSA	NT	**In Progress** Additional reporting for unit-linked products since 2019, incl. on mismatched cases and on underwritten insurance contracts. New methodology in Risk Assessment Framework since 2018, based on stages of the product lifecycle, focus on customer protection and micro-prudential risk. Customer protection inspections, including POG (product oversight and governance) to verify implementation of recommendations by (re)insurers. Change in analyzing complaints against insurance companies, considering market practices and potential impact on financial situation of the insurance company. Organizational changes in the PFSA to enhance conduct of business supervision and increased staffing. Thematic reviews, inspections and development of insurance intermediaries register. Market analysis and thematic reviews, e.g., continuous professional development requirements under Insurance Distribution Act 2017 (IDD implementation), or quality of sales. In Q3:2020, the PFSA introduced additional reporting for selected entities to enhance market monitoring. Inspections to assess management of mis-selling risk in unit-linked products, or in claim settlement on MTPL (motor third party liability) to verify compliance of insurers with the law.
Capital Markets			
Review and clarify regulations on private placements, market conduct supervision	MoF, PFSA	I	**Done** MoF and the PFSA closed the loophole exempting from the prospectus private placements for less than 150 people, used to conduct multiple offers at short time intervals. A new regulation was implemented in 2019, requiring to prepare information memorandum for PFSA approval when number of persons to whom the offer is addressed and persons to whom the issuer offered securities of the same type in previous 12 months is at least 150 persons. **In Progress** With respect to market conduct supervision, the PFSA introduced an internal plan to conduct on-site inspections of market infrastructure entities on a regular basis. Given current staff supervising market infrastructure (six persons) and number of infrastructure entities (six companies that mostly have several different licenses), there is one on-site inspection per year. The PFSA works on improving off-site tools by collecting information on sale of investment products by banks, digitalized reporting of the correspondence and automating the supervisory process.

Recommendations	Agency[1]	Time[2]	Progress
Conduct periodic assessments of the enforcement functions	PFSA	I	**Done** The PFSA introduced internal policy, which allows Enforcement Department to focus on significant cases, where hard supervisory tools are used. Less significant cases are dealt with by the PSFA supervisory departments authorized to use soft tools. The PFSA maintains a register of administrative proceedings and monitors the stage of progress by the employee conducting the case, the manager and the director.
Strengthen criminal law enforcement	PFSA	NT-MT	**Done** Legal amendments from November 2018 expanded the KNF's Board to include inter alia the Minister responsible for special services coordination to ensure immediate identification of criminal risks at the financial market. Moreover, the amended law allows effective exchange of information (including classified information) among the PFSA, Internal Security Agency, Central Anti-Corruption Bureau, National Tax Revenue Administration, Police, and the Competition and Consumer Protection Office. **In Progress** Recently the PFSA proposed to broaden the above catalogue of institutions by adding the National Prosecutor's Office to facilitate and accelerate exchange of information between PFSA and National Prosecutor's Office.
Macroprudential Policies			
Include vulnerability assessments of payment and settlement systems in the FSR and overall systemic risk monitoring	NBP	I	**Partially Done** After analyzing internally in the NBP, it was decided not to include the assessment of risks related to the payment system in the Financial Stability Report but present them to the NBP Board and Financial Stability Committee (FSC-M) in a separate report. The FSC-M takes a note of the *Polish Payment System Oversight Report,* presented for the first time in Dec. 2019. FSC-M noted in *Macroprudential Policy Strategy in Poland* (2019) that one of the systemic risk dimensions is the resilience of financial infrastructure.
Ensure the timely and substantive vetting of all use of macroprudential instruments by the FSC-M, in order to confirm the FSC-M's overall responsibility in this field	Members of the FSC-M	I	**In Progress** The NBP proposed to formalize in the "Macroprudential Strategy" a requirement for FSC-M to discuss changes to macroprudential instruments prior to implementation, but this did not gain support from other institutions. A permanent working group in FSC-M has been assigned with this task, but operationalization stalled due to the Covid-19. There is a growing number of cases, where member institutions consult intended measures within the FSC-M prior to implementation.
Crisis Management and Bank Resolution			
Propose legal amendments to provide for (i) more timely petitions for bank bankruptcy; (ii) harmonize the triggers for bankruptcy and use of resolution powers both; (iii) address the need for third-party opinion on solvency; (iv) conduct P&A transactions in lieu of a deposit payout; and (v) BGF independence	MOF with KNF & BGF	NT	**Partially Done** (i) Timely petitions for bank bankruptcy are a matter of a proper application of the law, and not additional rules. Triggers for payouts of covered deposits and resolution have been used in each case three times, without problems with provisions describing the triggers. (ii) Triggers for bankruptcy and use of resolution powers are compatible. Bankruptcy triggers have been used 11 times for credit unions and three times for banks, and PFSA had no problems identifying the

Recommendations	Agency[1]	Time[2]	Progress
			triggers. (iii) Legal provisions necessitate audited financial statement to confirm insolvency before PFSA's filing a bankruptcy petition. While this may delay the process, such serious decisions must be based on verified data. (iv) Banking Law was amended to add a provision that an insolvent bank can be taken over by another bank, and amendments was added to the Act on Bank Guarantee Fund (BGF) to allow financial assistance in such takeovers. (v) The BGF is a part of public finance sector, which justifies MoF supervision based on the criteria of legality. MoF may request BGF Council to dismiss Management Board member in certain cases (e.g., violation of law), but cannot dismiss BGF Board member on its own.
Require recovery plans for affiliating banks, significant credit unions, and banks undergoing rehabilitation	PFSA	I	**Partially Done** Affiliating banks, as participants of IPSs, can be a part of the group recovery plan. Cooperative banks under rehabilitation are under regime of recovery plans or IPS' group plans. Credit Unions (CUs) are not obliged by the law to prepare resolution plans. CUs recognized by the BGF as intended for resolution may be obliged to prepare such plans. SKOK Stefczyka (largest CU) is in the process preparing a resolution plan, monitored by the BGF. Other CUs are designed for standard insolvency process, and each CU, in case of loss, is obliged to prepare and present rehabilitation program for PFSA approval. Major CUs were obliged to prepare such programs, and are revising them to reflect new circumstances (COVID19, or EU Court of Justice verdict on consumer loans).
Cooperative Banks and Credit Unions			
Strengthen the supplementary internal control and resolution arrangements to address elevated risk and develop strategies to promote further integration/consolidation	PFSA, MoF, ABs, IPS	I	**In Progress** Cooperative banking sector is undergoing consolidation, helped by IPSs, with 17 mergers since 2018. IPSs are strengthening internal control and the PFSA reviews its quality. The PFSA promotes integration, including sharing of services and products, and cooperation among cooperative banks is gaining importance.
Develop and implement a restructuring strategy to (i) consolidate viable and resolve non-viable credit unions through exit; and (ii) revisit whether a stand-alone credit union sector remains appropriate	PFSA, MoF	I	**In Progress** Restructuring and consolidation of credit unions is ongoing. CUs initiate mergers within the sector, but there are problems with inability to generate funds and lack of interested external stakeholders. (i) In result of mergers, takeovers by banks and insolvencies, number of CUs decreased from 30 at end-2018 to 23 in Sep. 2020. (ii) Balance sheet of the sector is steadily declining. Share of CUs in the Polish financial sector is very small, but they serve almost 1.5 million customers, providing basic services important for financial inclusion. To the extent possible, the priority is to maintain activity of the sector with restructuring and recovery. A working group has been created in the Financial Stability Committee to develop relevant proposals.

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

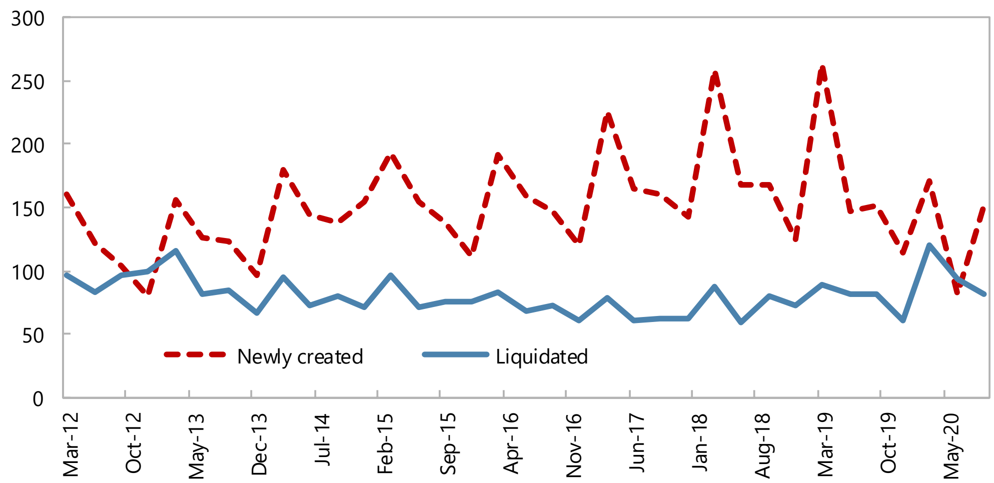
[2] Time Frame: C = continuous; I (immediate) = within one year; NT (near term) = 1–3 years; MT (medium term) = 3–5 years

Annex III. Labor Market Developments During COVID-19

1. **While the unemployment rate has not increased significantly in Poland during the pandemic, additional indicators point towards a broader impact on labor markets.** The unemployment rate has been stable around 3 percent (with a modest increase in Q3:2020 to 3.3 percent), but the creation of new jobs slowed significantly in Q2:2020 relative to Q4:2019, while the number of liquidated jobs increased in the first half of 2020. While there was a broad-based recovery in labor markets in Q3:2020, the full impact of the pandemic remains to be seen, including because of the reintroduction of restrictions in Q4:2020. Comparing Q3 with Q1 data shows that contact-intensive jobs have been the hardest hit by pandemic restrictions, and the quarterly variation in labor force participation rates points to larger swings in activity among women[1] and the young. Larger employment losses were observed in urban areas, the private sector, the industrial sector, part-time workers, and family workers, with some increase noted in self-employment. From a different perspective, youth, low-skilled workers, and those without rights to receive social benefits experienced the largest employment losses. While the number of unemployed youth declined in Q3, the level is still elevated. Average wage growth has also slowed from nearly 8 percent pre-crisis to around 5 percent year-on-year. After declining in Q2, job creation rebounded in Q3.

Figure 1. Newly Created and Liquidated Jobs in Poland

(Thousands, not seasonally adjusted)



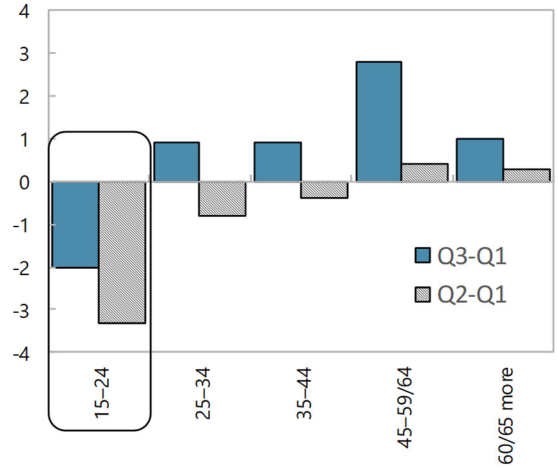
Sources: Statistics Poland

[1] While labor force participation and employment of women recovered in Q3, the decline in female employment and the large flow into inactivity in Q2 suggest that women are more loosely attached to the labor market (possibly due to unequal childcare responsibilities or lower wages). Women also dominate the sectors most affected by the pandemic.

Figure 2. Labor Force Survey: Developments in Employment and Unemployment

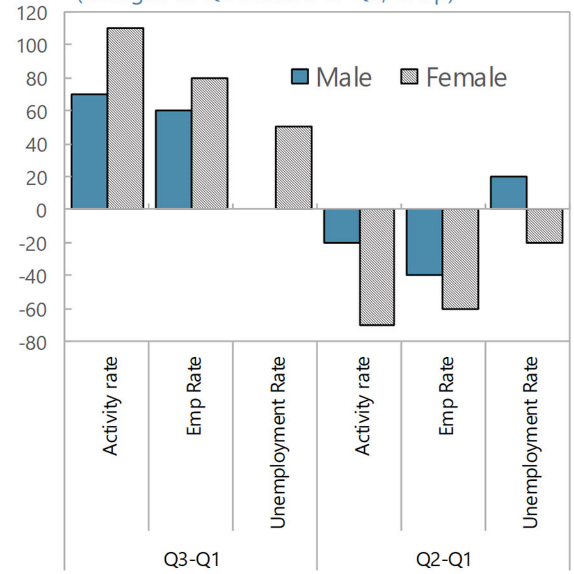
Age Gap in Activity Rates

(Changes relative to Q1, In percent)



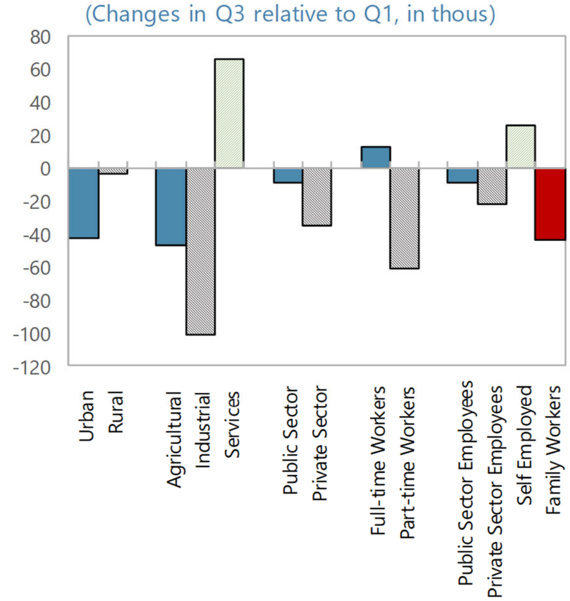
Gender Gap

(changes in Q3 relative to Q1, in bp)

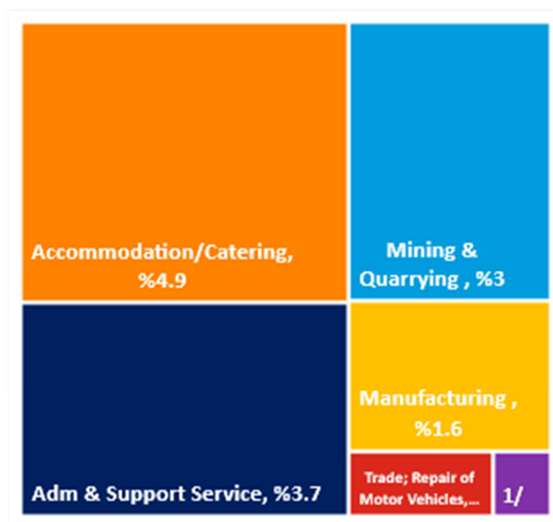


LFS Employment

(Changes in Q3 relative to Q1, in thous)



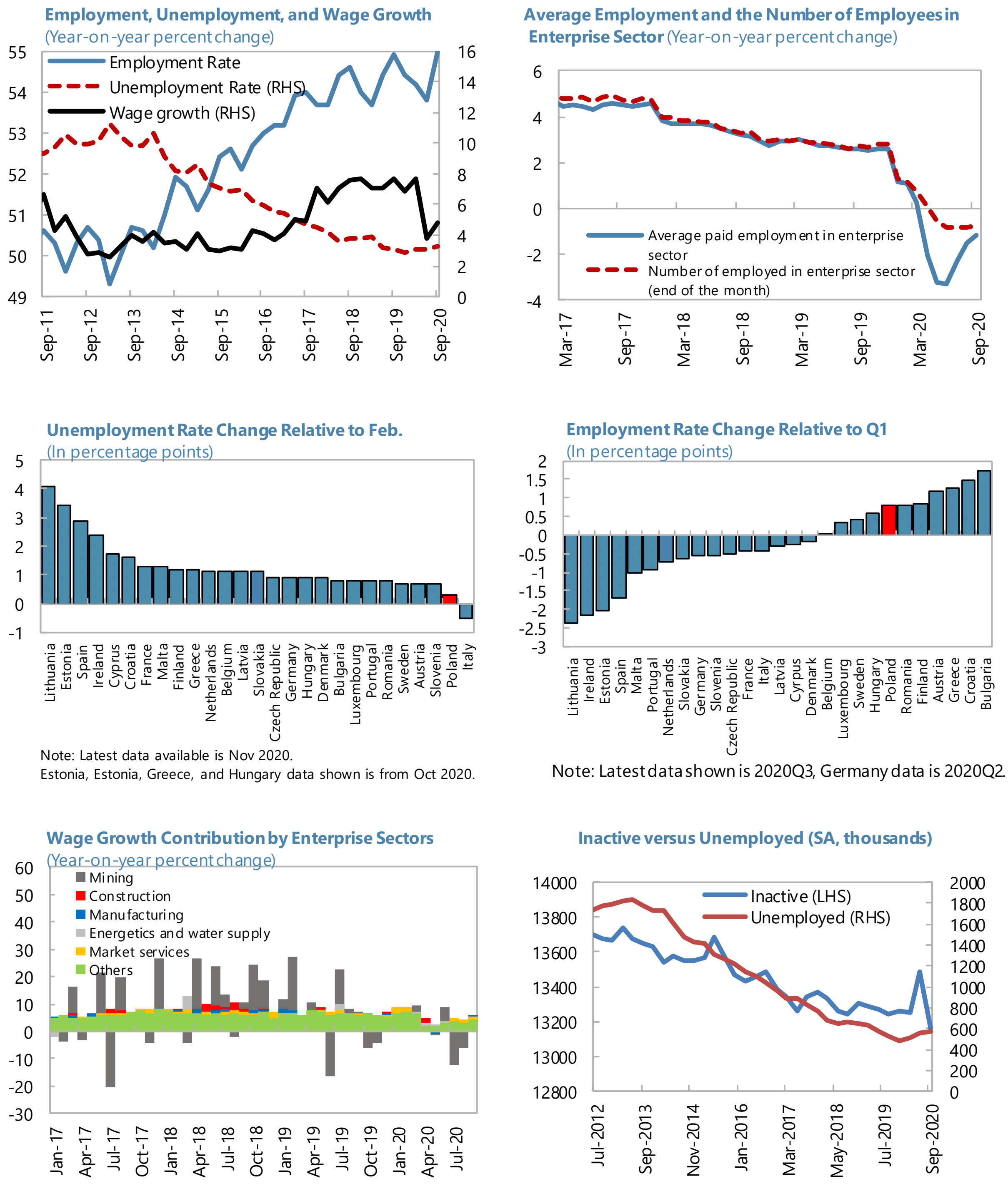
Sectoral job loss (percentage changes in Sep. employment relative to Feb.)



1/ Construction: 0.2%

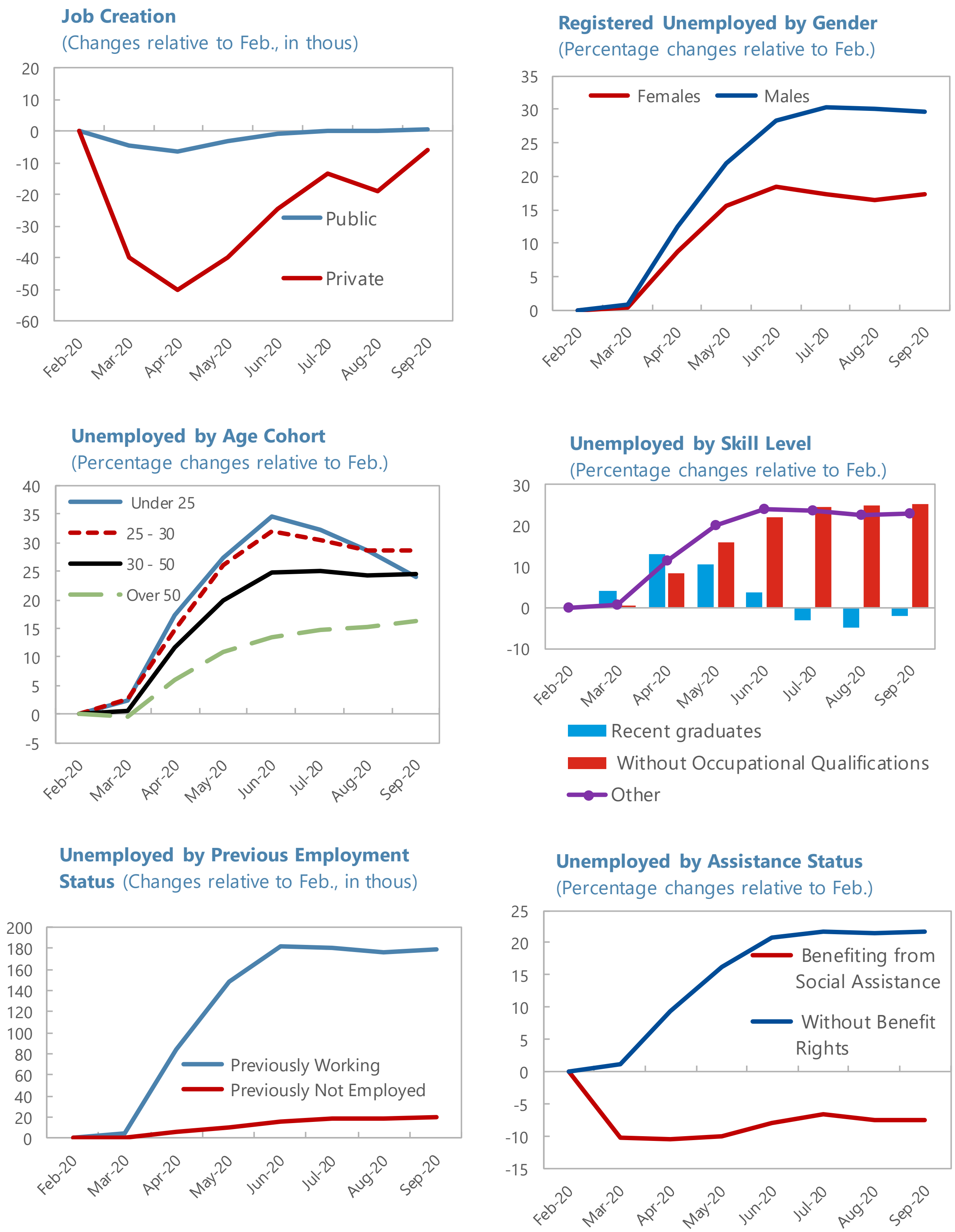
Source: Statistics Poland; Haver

Figure 3. Labor Market Developments



Sources: Haver; Statistics Poland; and Eurostat.

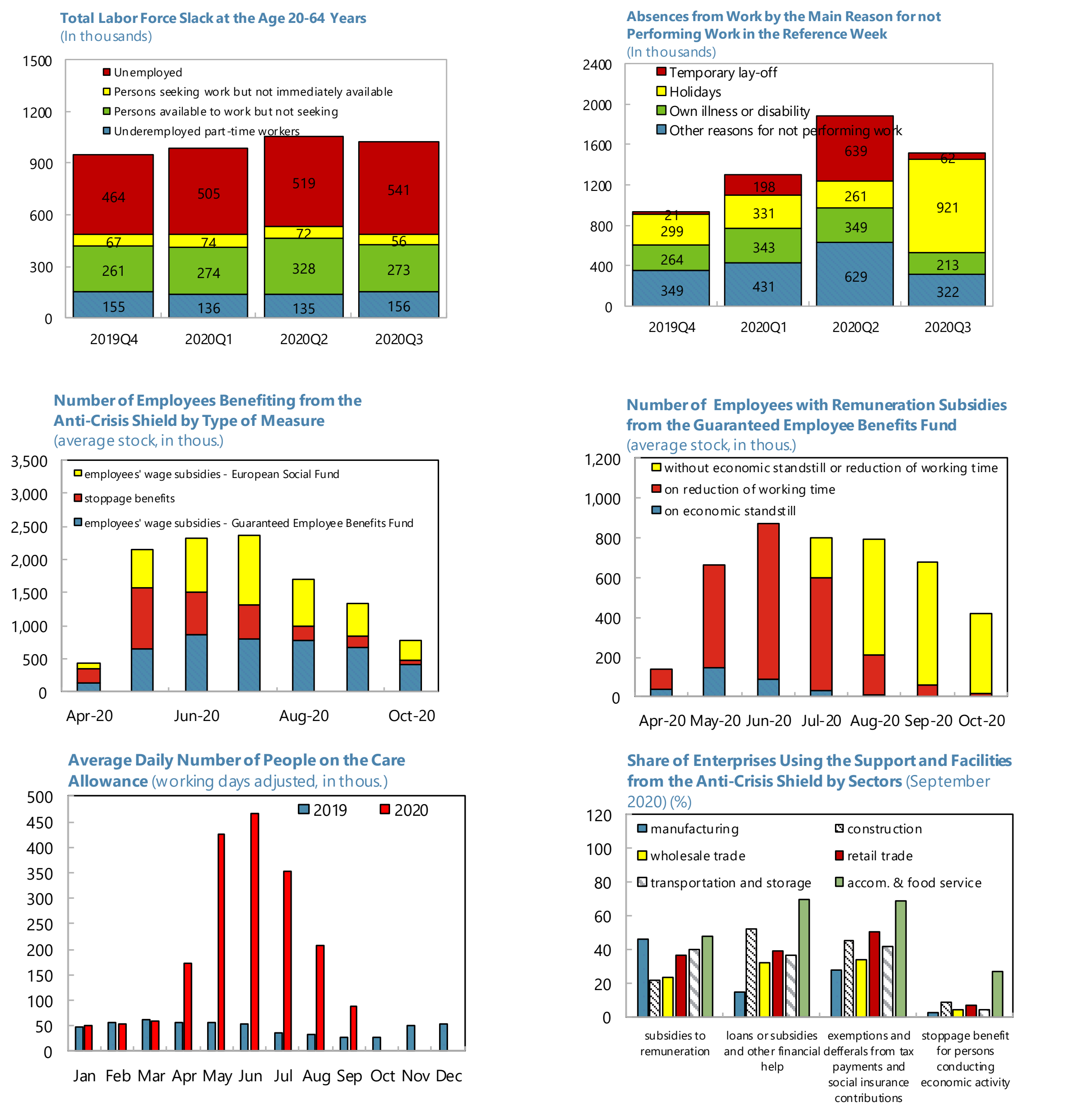
Figure 4. Distributional Impact of COVID-19 Shock on Registered Unemployment



Source: Statistics Poland; Haver; and IMF staff calculations.

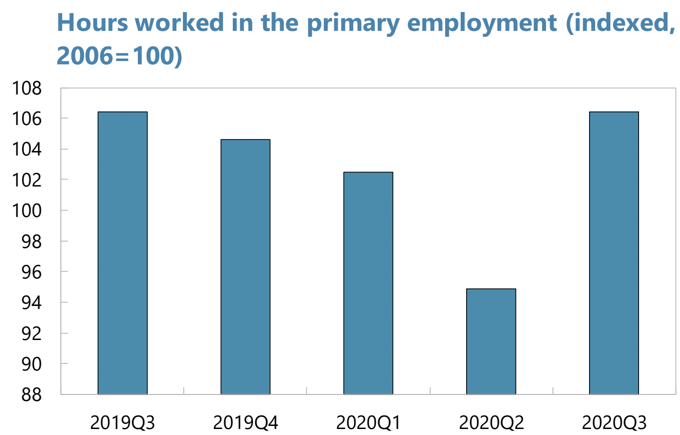
2. Headline (ILO-defined) unemployment figures understate the impact of the pandemic on labor. While there is no single method to construct an augmented measure of slack, various dissections of the data point to increased slack in the second quarter, subsequently reduced in the summer. Comparing the number of beneficiaries of government employment-support policies during the pandemic with changes in registered unemployment (Q2:2020 relative to Q4:2019) illustrates the significant role of government policies in preventing potentially significant additional unemployment (Figure 5). Slack was also visible in the form of more part-time workers, an increase in the population in search of jobs, additional temporary absences from work, and fewer hours of work, all of which were reversed in Q3:2020 (Figures 5 and 6).

Figure 5. Labor Market Slack and Beneficiaries of Emergency Employment Support Policies



Sources: Statistics Poland; ZUS; MRPiPS; MR; and NBP estimates.

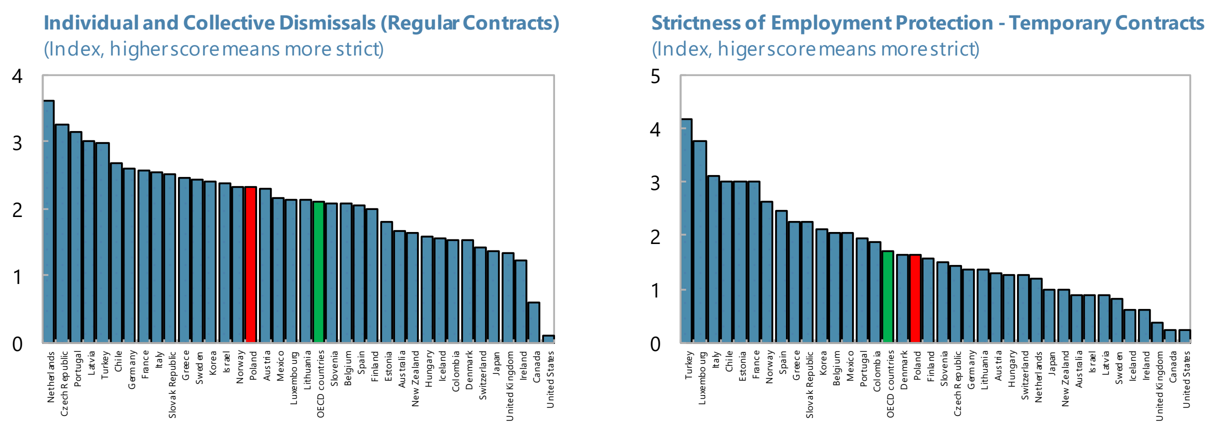
Figure 6. Hours of Work Have Returned to Pre-Crisis Levels



Source: Statistics Poland

3. **Temporary employment contracts carry a higher termination risk compared to regular contracts.** Cross-country data indicate that Poland has stronger employment protection for regular contracts than the OECD average, but protection for temporary contracts is in line with the OECD average. In this context, the inclusion of civil law contracts as beneficiaries of the anti-crisis shield employment support programs has been beneficial in improving the welfare of temporary contract holders.

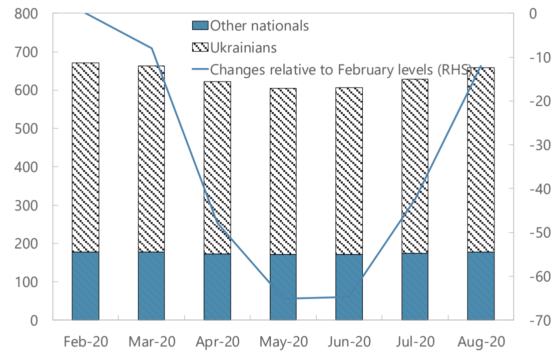
Figure 7. Employment Protection in International Perspective



Source: OECD

4. Employment of foreign workers appears to be returning to the pre-crisis level. Poland hosts about 1 million foreign workers, mostly from Ukraine, that are employed predominantly in contact-intensive and service sectors. However, only about half are registered in the social security database. The social security data show a 10 percent decline in employed foreign workers in May (relative to pre-pandemic levels), followed by a rapid recovery in July and August. Other data show that regular work permits decreased by 9 percent year-on-year in the first half of 2020. Legislation helped to mitigate outflows of foreign workers by automatically extending work permits for migrant workers due to the declared state of epidemic.

Number of Foreign Nationals Contributing to Social Security (in thous)



Source: ZUS

5. As the recovery proceeds, the authorities should promote a smooth sectoral reallocation of labor and provide support for disadvantaged groups. The Polish authorities' policy response has been effective in reducing the impact of the pandemic on the labor market, but impacts beyond the unemployment rate have been observed, albeit temporarily, and the risk of employment interruption or loss has been higher for certain disadvantaged groups. During the pandemic, workers in temporarily depressed sectors (i.e. restaurants and tourism) could be offered training so they can contribute to pandemic response efforts, where feasible. As the recovery proceeds, policies should facilitate the transition of affected groups back into the labor market to avoid a permanent decline in participation and a rise in structural unemployment. In particular, policies should target groups whose employment has been more unstable during the pandemic (youth and women). Active labor market policies (AMLPs), including re-training, should be complemented with other interventions (such as employment services, transportation stipends, job search assistance, and localized investment) to help workers acquire the skills needed to adapt to the post-pandemic economy. The green and digital targets of the EU recovery fund will necessitate sectoral transitions in employment, which underscores the importance of AMLPs to help close skill gaps and prepare the post-pandemic economic for eventual carbon neutrality and digitalization.

Annex IV. Expenditure Rule: Before, During, and After COVID-19

1. Poland's expenditure rule aims to stabilize the fiscal deficit at the medium-term objective (MTO). The Stabilizing Expenditure Rule (SER) sets a government spending path along long-term GDP growth and is anchored at the MTO (fiscal deficit of 1 percent of GDP), which means tightening if the deficit or debt excess specific thresholds.[1] The SER allows revenue measures (including tax administration gains) to be added to spending limits, which exclude EU funds spending. The total ceiling (approximately 90 percent of general government outlays)—which covers local governments and other entities having large budget autonomy—is non-binding, but a sub-limit (about 70 percent of spending) is binding, and a breach implies a violation of fiscal discipline.

2. Pre-crisis performance under the SER was mixed. In general, the rule has proved to be a useful tool to guide the budget toward the medium-term objective. Formally in place since 2015, the SER helped guide expenditures already in 2014. The rule was softened at end-2015, (inter alia, by replacing projected CPI with the NBP inflation target) to create room to launch a new child benefit program. Nevertheless, SER has imposed a consolidation bias so far, as deficit and debt numbers triggered downward expenditure limit adjustments, partly offset by tax measures. Actual spending exceeded the SER path, and the non-binding spending limit was breached in 2018. After new spending materialized in 2019 to fulfill pre-election promises, outlays on the 13th pension were moved to an extrabudgetary fund to avoid breaching the binding ceiling.

3. The COVID-19 crisis prompted a suspension and revision of the rule. While the original law did not provide an escape clause for states of pandemic emergency, this exception was added, allowing the rule to be suspended during a pandemic, provided that economic growth would be projected to be at least 2 p.p. below the six-year historical average. The suspension lasts for one year but could be extended if conditions remain. The revisions also specify a return to the regular spending path within two–four years, with part of anti-crisis spending allowed to be carried over during this period.[2] Investments were excluded from the limit, but only for 2021.

4. The revisions imply a large fiscal space in 2021. While the suspension of the rule in 2020 appropriately allowed large anti-crisis outlays without breaching the SER limits, it is unclear whether the large space for expenditures carved out for 2021 will be necessary, or how exactly it will be used. Nominal GDP is projected to surpass the pre-crisis level, implying a two-year normalization period, with half of anti-crisis spending added to the spending limit in 2021. Compared to the non-crisis limit, this will lift the expenditure ceiling by 1¾ percent of GDP, and allowed spending space will be even larger since investments may be excluded. In turn, returning to the pre-crisis spending path in

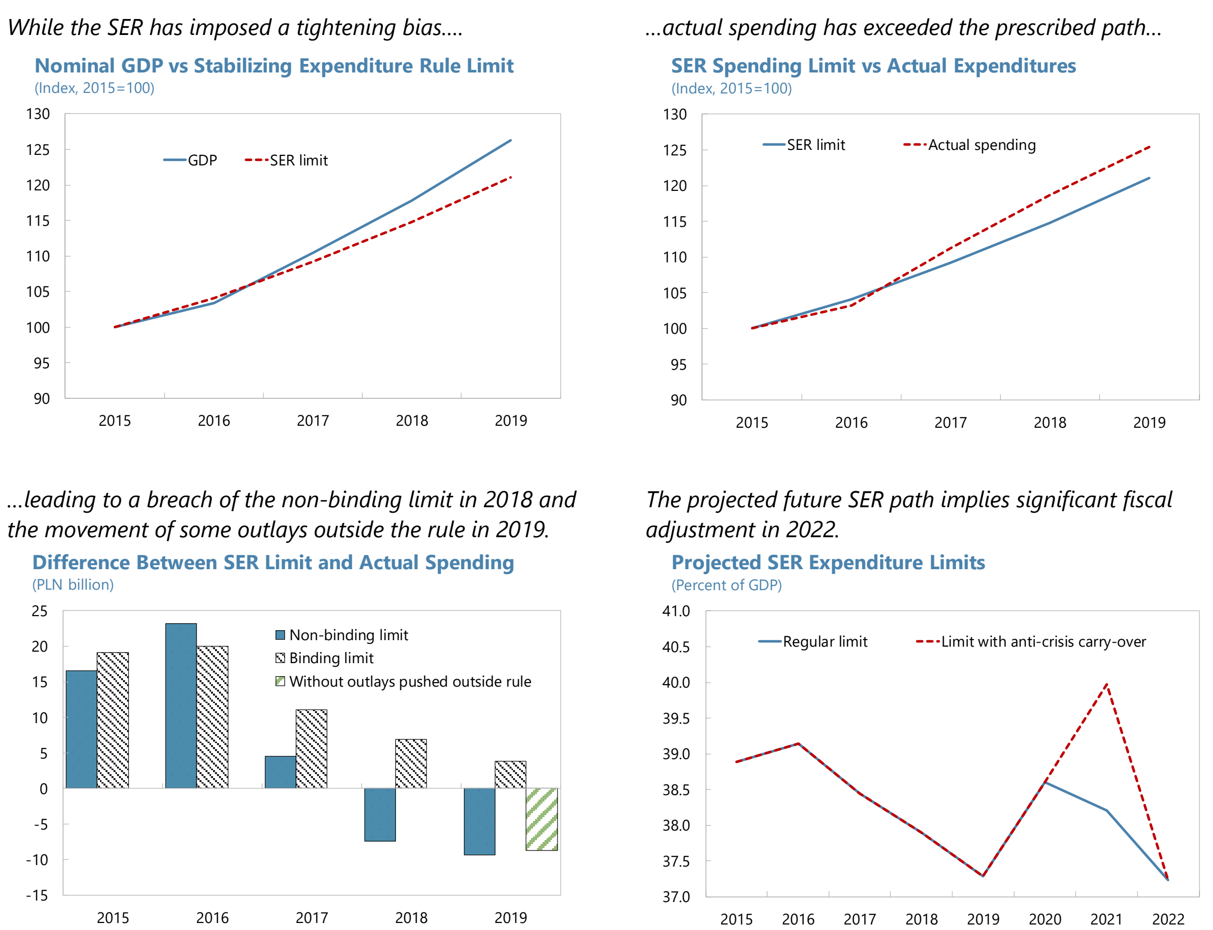
[1] The spending limit is defined as: $E(t)=E(t-1)*(Y'+C)*CPI+\varepsilon$; where the limit E(t) is linked to the previous year's limit E(t-1) and trend growth (Y' is average GDP growth in 8 years with MoF projection for t-1 and t, corrected for a factor depending on deficit and debt (C) and then multiplied by NBP inflation target (CPI), plus an adjustment parameter ε, which depends on revenue measures.

[2] Normalization depends on the pace of recovery: it takes two years if nominal GDP returns to the pre-crisis level in the first post-crisis year, three years if not and GDP growth is less than 2 p.p. below trend, and four years otherwise. In case of a two-year adjustment, half of anti-crisis spending is added to the limit in the first post-crisis year.

2022 will denote close to 3 percent drop of the limit as a ratio of GDP, requiring a significant fiscal adjustment if the fiscal space allowed in 2021 is actually utilized.

5. The path of post-crisis spending may test the adequacy of the SER. The recent reforms to accommodate anti-crisis spending and the establishment of triggers for normalization conditional on economic performance are appropriate. Given the second wave of the pandemic, the carry-over of a portion of anti-crisis expenditures may be utilized for additional fiscal support for the recovery. However, this temporary additional space should not be used to finance new permanent social programs, unrelated to the crisis and difficult to phase out. Returning to the regular spending path may imply a sharp fiscal consolidation in 2022, possibly triggering new measures to avoid such a scenario, including by further modifications of the escape clause. However, adjustments to coverage and legal modifications could hurt the SER's credibility. Considering the experience so far, a broader review and overhaul may be considered to enhance completeness of the rule, while ensuring its flexibility. Sustainability of the rule would be further strengthened by underpinning it with a sound medium-term fiscal framework.

Figure 1. Developments under the Stabilizing Expenditure Rule (SER)

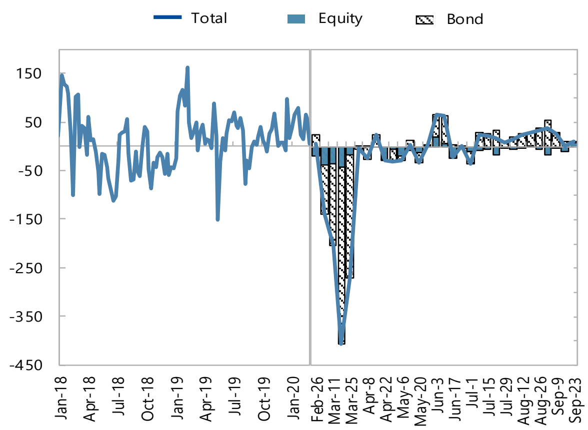


Note: SER anti-crisis limit in 2021 does not include additional space allowed by pushing investments outside the limit.
Sources: Ministry of Finance; and IMF staff calculations.

Annex V. NBP Asset Purchase Program

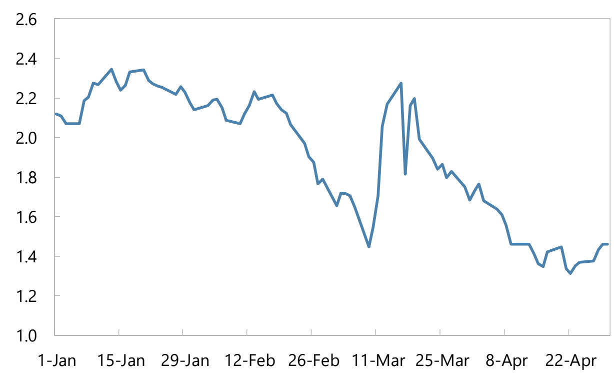
1. The NBP introduced an asset purchase program (APP) at the height of financial market turmoil in March. At the time, Poland's financial markets—along with those of the world—were in tumult, with historically-large and sudden outflows from foreign investors, deteriorating liquidity in the domestic Treasury bond market, and increasing bond yields. Alongside conventional monetary easing, the NBP also announced on March 17 the beginning of purchases of government bonds in the secondary market. The stated objectives of the APP include ensuring liquidity in secondary markets for the purchased securities and strengthening the monetary policy transmission mechanism.

Poland: ETFs/Mutual Fund Flows
(Millions of US Dollars)



Source: EPFR

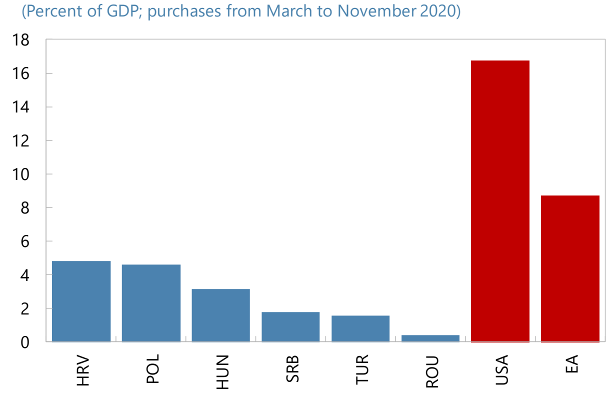
Poland: 10-Year Bond Yield
(Percent)



Sources: Bloomberg

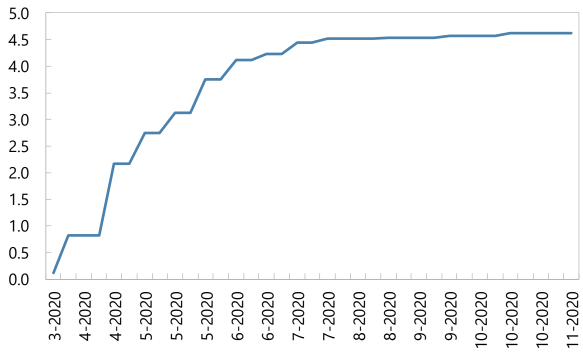
2. The NBP's asset purchases have been large in international comparison. The APP does not have a predetermined limit. Since March, the NBP has purchased PLN 106 billion (4.6 percent of GDP) in securities, the largest in emerging Europe (along with Croatia), though less than the ECB (7 percent of GDP). While purchases initially covered Treasury securities, starting in late April, purchases have been concentrated in government-guaranteed securities issued by the Polish Development Fund (PFR) and development bank BGK. Purchases were significant in March-May but have since slowed significantly. The NBP has been transparent about asset purchases, publishing detailed data on purchases and holdings.

Asset Purchases by Central Banks
(Percent of GDP; purchases from March to November 2020)



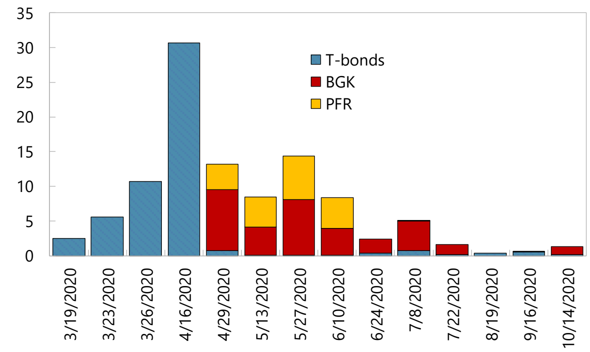
Sources: IFS; Haver; national central banks.

Cumulative NBP Asset Purchases
(Percent of GDP)



Sources: NBP

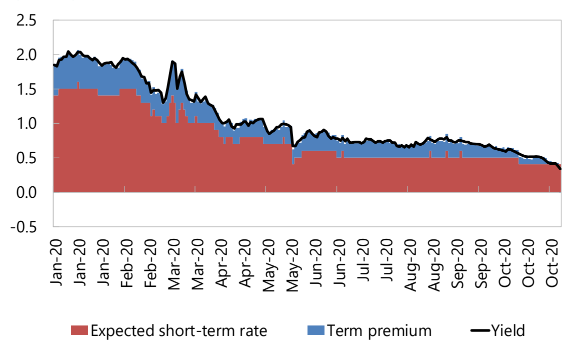
NBP Asset Purchases by Date
(PLN billion)



Sources: NBP

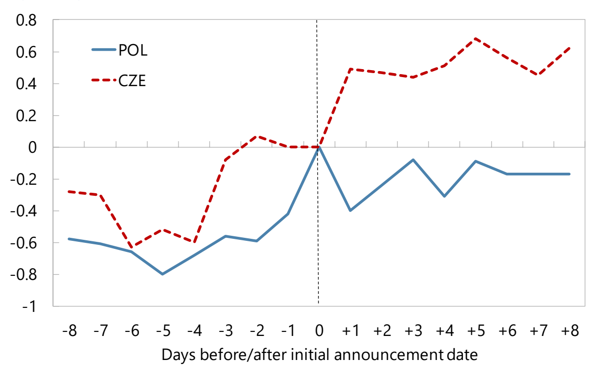
3. The APP appears to have been effective in meeting its stated goals. Despite a significant increase in the government's borrowing needs to finance crisis-related expenditures, the government's cost of financing has declined, with yields falling across the curve, in part due to a reduction in the term premium. The NBP's purchases of Treasury securities appear to have arrested the surge in the term spread (long- minus short-term yield) that occurred during the peak of the crisis in financial markets. For example, while the previously increasing term spread in Polish Treasury markets began to subside in the days following the NBP's March 17 APP announcement, the term spread in the Czech Republic—which did not implement an APP—continued to increase.

Decomposition of Five-Year Polish Gov't Bond Yield
(Percent)



Sources: Bloomberg; and IMF staff calculations.

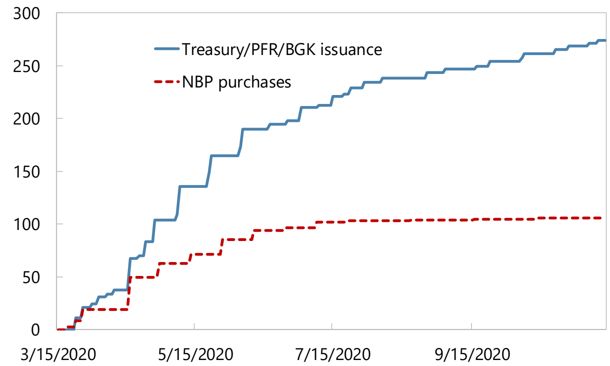
Cumulative Change in Term Spread (10 yr - 2 yr yield)
(Percent)



Sources: Haver; and IMF staff calculations.

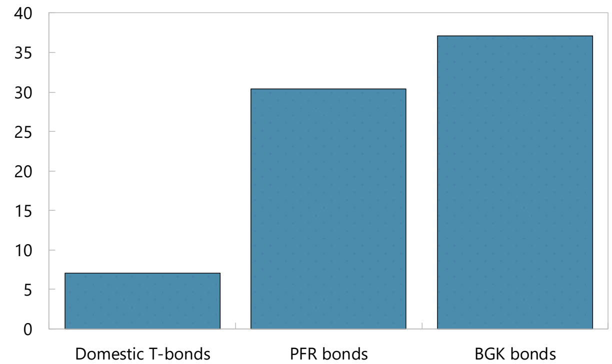
4. The NBP's asset purchases have also facilitated the smooth financing of anti-crisis fiscal expenditures. The NBP has cumulatively purchased about 40 percent of the combined issuance of domestic Treasury bonds/bills and PFR/BGK bonds since March 15. In the Treasury market, the NBP has accumulated a 7 percent share, providing a valuable new source of demand as the share of foreign investors decreased by 6 p.p. (from 23 to 17 percent) during the same period. As the authorities shifted strategies in April to fund the bulk of anti-crisis fiscal measures off budget through the PFR/BGK, the NBP began to concentrate its purchases in BGK and PFR bonds and now holds 30 to 40 percent of their securities issued to finance anti-crisis programs. While these purchases were all made in the secondary market—meaning that other market actors set the initial pricing and demand for these securities—the willingness of the NBP to purchase BGK/PFR bonds in the secondary market has provided a significant backstop for demand and yields.

Cumulative Issuance of Securities and NBP Purchases
(PLN billion)



Sources: NBP; MoF; PFR; and BGK.

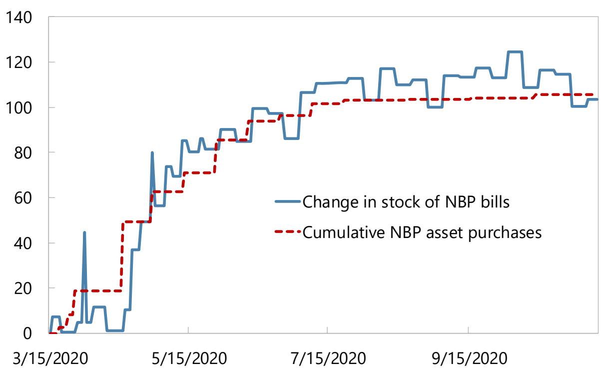
NBP Holdings of Outstanding Marketable Securities
(Percent of total outstanding securities by issuer)



Sources: NBP; MoF; PFR; and BGK.

5. The NBP has sterilized a significant portion of its asset purchases. As banks have sold bonds to the NBP, they have accumulated additional liquidity, which the NBP has broadly sterilized through the expansion of open market operations in which it sells seven-day NBP bills. Sterilization has not been simultaneous and one-for-one with securities purchases, but as needed to keep the overnight interest rate close to the reference rate, in line with the NBP's monetary policy framework. Had the additional liquidity not been sterilized, banks would likely have placed their excess liquidity at the NBP's overnight deposit facility, which currently carries an interest rate of zero, versus the reference rate of 0.1 percent. With rates already close to zero, a decision not to sterilize would likely have little impact on interbank rates, though banks would earn slightly less on excess liquidity through the deposit facility.

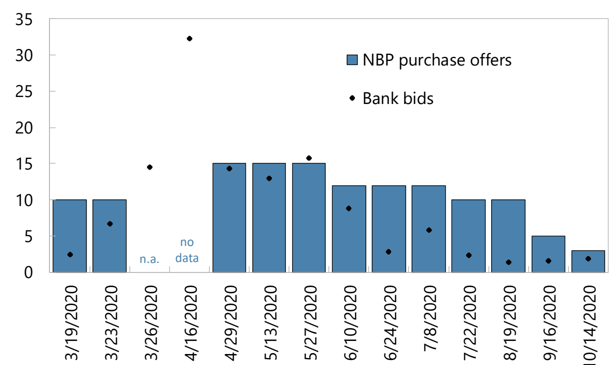
Cumulative Change in NBP Bills/Asset Purchases
(PLN billion; cumulative since March 15)



Sources: NBP

6. The pace of asset purchases slowed significantly in recent months. The NBP has purchased only small amounts in recent auctions. This decrease has been led by a decline in banks' interest in selling bonds to the NBP, as bank bids in the auctions fell well below the NBP's purchase offers beginning in June. The decline in banks' interest appears tied to the slowdown in the pace of Treasury and government guaranteed securities and to banks' preference to hold Treasury securities, which are exempt from the bank asset tax. Should the pace of government securities issuance again accelerate, there remains scope for the NBP to increase the pace of asset purchases.

NBP Purchase Offers versus Bank Bids
(PLN billion)



Sources: NBP

Annex VI. Public Sector Debt Sustainability Analysis

General government debt is estimated to have increased from 46 percent of GDP in 2019 to 59 percent of GDP in 2020, based on large fiscal support provided during the pandemic. Over the medium term, debt is projected to broadly stabilize around 58 percent of GDP. Debt is assessed to be sustainable, with the impact of larger debt significantly mitigated by the much lower projected effective interest rate, which limits the fiscal resources needed to service the debt. Debt would increase steadily over the medium term under various shock scenarios, suggesting the prudence of pursuing a gradual reduction in the fiscal deficit after the recovery is well established.

Baseline and Realism of Projections

1. **Debt levels.** General government debt is estimated to have increased to 59 percent of GDP in 2020, driven by a fiscal deficit of 8.4 percent of GDP and GDP growth of -3.4 percent. Following an anticipated decline in the fiscal deficit in 2022 under current policies, debt would broadly stabilize around 58 percent of GDP over the medium term, with relatively strong GDP growth not quite outweighing the effects of a continued primary deficit.

2. **GDP growth.** Following a contraction of 3.4 percent in 2020, real GDP is projected to grow 2.7 percent in 2021 and 3.7 percent on average over 2022–25. An anticipated boost in investment spending financed by Next Generation EU grants is projected to increase growth in 2022–23, but the growth rate would decline over 2024–25 due to base effects and the phasing out of additional spending. Since 2011, staff's growth projections have been pessimistic on average, with a fairly large forecast bias relative to other countries.

3. **Fiscal path.** Under current policies, the fiscal deficit is projected to decline from 8.4 percent of GDP in 2020 to 5.1 percent of GDP in 2021, as most crisis-related expenditures are assumed to be phased out. One-off revenues from an anticipated pillar II pension reform would lower the fiscal deficit temporarily in 2022. The deficit would stabilize at about 3.2 percent of GDP over the medium term. Staff projections have been modestly pessimistic in recent years. While the projected adjustment in the primary balance would be large in historical and international context, its realism is boosted by the fact that it would be largely accomplished by letting anti-crisis emergency measures lapse.

4. **Sovereign yields.** The effective interest rate on government debt has been on a declining path since the global financial crisis, reflecting Poland's strong fundamentals and favorable global interest rates. The effective interest rate is estimated at 3.0 percent in 2020 but is projected to decline significantly to 1.7 percent by 2022 as the much lower interest rates observed since early 2020 increase their weight through new issuance to finance significant deficits and maturing debt. The effective interest rate is projected to increase to 1.9 percent over the medium term, reflecting some tightening of domestic and international financial conditions. The lower effective interest rate is projected to reduce the share of tax revenues devoted to interest payments from an average of 7.3 percent over 2015–2020 to 4.5 percent over 2021–2025. Yields on 10-year domestic Treasury

securities have declined by 85 basis points in 2020 and are currently around 1.25 percent. CDS spreads have been broadly stable this year around 57 basis points.

5. **Maturity and rollover risks.** Maturity risks are well managed. The average maturity of outstanding debt is estimated at 4.7 years, and the share of short-term government debt is under 1 percent of the total. By September, the state budget's gross financing requirements for 2020 had already been nearly met. There have been significant shifts in the composition of domestic Treasury investors in 2020, as foreign investors reduced their share from 23 percent at end-2019 to 17 percent in the context of market turmoil early in the year. Domestic banks have significantly increased their share of the market to nearly 50 percent, up from 45 percent at end-2019. The NBP is also a major new presence in the market, having acquired a 6.5 percent share of outstanding Treasury securities this year. The overall share of external debt in general government debt declined from 57 percent in 2015 to 41 percent in 2019. In addition, the share of foreign currency debt in state debt was 26 percent in 2019. In line with the authorities' debt management strategy, the baseline assumes that the share of foreign currency debt in total debt will remain at less than 30 percent and external debt in total debt around 40 percent over the medium term.

6. **Debt sustainability analysis (DSA) risk assessment.** The heat map highlights risks associated with large gross public financing needs, the relatively large economy-wide external financing requirements (about 19 percent of GDP in 2019), and the share of public debt held by non-residents. Gross public financing needs estimated at nearly 14 percent of GDP are large, but financing needs have been comfortably met in 2020. Gross external financing needs are boosted by a high level of intra-company FDI loans, which tends to be more stable than other sources of external debt. While the share of public debt held by non-residents is high, this risk is mitigated by the important role of institutional investors, which tend to be more long-term investors. The willingness of domestic banks and the NBP to step into the Treasury market earlier this year also facilitated the smooth exit of foreign investors amid global capital flow reversals. NBP holdings of government and government-guaranteed securities amount to about 8 percent of end-2020 general government debt.

7. **Fan charts.** The symmetric fan charts, which assume symmetric upside and downside risks, indicate that the debt-to-GDP ratio could drop to around 54 percent by 2025 with a 25 percent probability. On the other hand, the upper bands indicate that the debt ratio could increase to 63 percent by 2025 with a 25 percent probability. In a more stringent exercise, assuming only downside shocks to interest rates and GDP growth, there is a 25 percent chance that debt-to-GDP could increase to 65 percent of GDP in the medium term.

Shocks and Stress Tests

8. **Primary balance shock.** Under an assumed deterioration in the primary balance by more than 3 percentage points (p.p.) in 2021 and 0.5 p.p. in 2022, public debt would increase to 61 percent of GDP in 2021 and to 60 percent of GDP by 2025, about 2 p.p. higher than in the baseline. Gross financing needs would be proportionally larger in 2020 and 2021.

9. **Growth shock.** This scenario assumes a decline in GDP growth by about 1.4 p.p. in both 2021 and 2022 relative to the baseline, along with a 0.3 p.p. decline in inflation and a deterioration in the primary balance by 0.7 and 1.4 p.p. in 2021–22. Under these assumptions, public debt would increase to 62 percent of GDP in 2025, about 4 p.p. higher than in the baseline, while gross financing needs would increase in 2021–22.

10. **Interest rate shock.** A permanent 500 bps increase in the nominal interest rate beginning in 2021 leads to an increase in the effective interest rate and worsens debt dynamics, with public debt increasing to 61 percent of GDP in 2025, 3 p.p. higher than in the baseline. Gross financing needs increase to 8 percent of GDP in 2025 versus 6 percent in the baseline.

11. **Exchange rate shock.** This scenario assumes a 22 percent nominal exchange rate depreciation in 2021, calibrated to emulate the maximum historical movement of the exchange rate over the last 10 years. The impact on the stock of the public debt over the medium term and gross financing needs, however, would be marginal. This resilience reflects the predominance of public debt in local currency (74 percent in 2019).

12. **Combined shock.** Under the combined macro-fiscal shock—which combines lower GDP growth, a larger primary deficit, higher interest rates, and an exchange rate shock—the public debt/GDP ratio increases to 65 percent of GDP in 2021 and increases to 69 percent of GDP in 2025. Gross financing needs also remain above the baseline during the projection period.

Figure 1. Poland: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(in percent of GDP, unless otherwise noted)

Poland Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

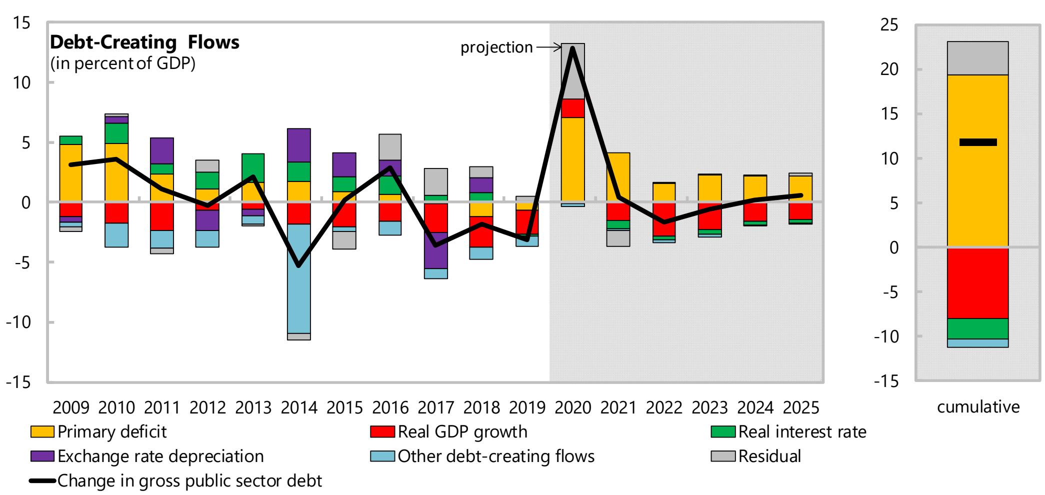
Debt, Economic and Market Indicators [1/]

	Actual		Projections					
	2019 [2/]	2020	2021	2022	2023	2024	2025	
Nominal gross public debt	45.7	58.6	59.0	57.3	56.7	56.9	57.5	
Public gross financing needs	2.4	13.7	9.9	6.0	6.5	6.8	6.3	
Real GDP growth (in percent)	4.5	-3.4	2.7	5.1	4.2	2.9	2.6	
Inflation (GDP deflator, in percent)	3.1	3.4	3.0	2.3	2.5	2.4	2.4	
Nominal GDP growth (in percent)	7.8	-0.1	5.8	7.5	6.8	5.4	5.1	
Effective interest rate (in percent) [4/]	3.0	3.0	1.9	1.7	1.8	1.9	1.9	

As of December 01, 2020		
Sovereign Spreads		
EMBIG (bp) 3/	179	
5Y CDS (bp)	56	
Ratings	Foreign	Local
Moody's	A2	A2
S&Ps	A-	A-
Fitch	A-	A-

Contribution to Changes in Public Debt

	Actual	Projections							
	2019	2020	2021	2022	2023	2024	2025	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-3.1	12.9	0.4	-1.7	-0.6	0.2	0.6	11.8	
Identified debt-creating flows	-3.5	8.3	1.7	-1.8	-0.6	0.2	0.4	8.1	
Primary deficit	-0.6	7.1	4.1	1.6	2.2	2.2	2.2	19.3	-1.8
Primary (noninterest) revenue and grants	41.0	41.0	40.7	42.2	41.3	41.0	40.8	247.1	
Primary (noninterest) expenditure	40.4	48.0	44.8	43.8	43.5	43.2	43.0	266.4	
Automatic debt dynamics [5/]	-2.0	1.4	-2.2	-3.2	-2.7	-1.9	-1.7	-10.3	
Interest rate/growth differential [6/]	-2.2	1.4	-2.2	-3.2	-2.7	-1.9	-1.7	-10.3	
Of which: real interest rate	-0.1	-0.1	-0.7	-0.4	-0.4	-0.3	-0.3	-2.3	
Of which: real GDP growth	-2.1	1.6	-1.5	-2.8	-2.3	-1.6	-1.4	-8.0	
Exchange rate depreciation [7/]	0.1	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.9	-0.2	-0.2	-0.2	-0.2	-0.1	-0.1	-1.0	
Privatization (+ reduces financing needs)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.2	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Incurrence in liabilities not included in debt	-0.8	-0.2	-0.2	-0.2	-0.2	-0.1	-0.1	-0.8	
Residual, including asset changes [8/]	0.4	4.6	-1.3	0.1	0.0	0.0	0.2	3.7	



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

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

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

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

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

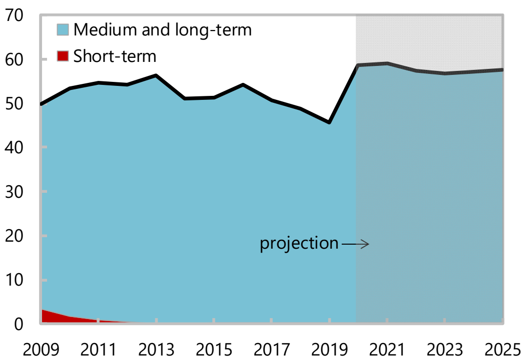
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

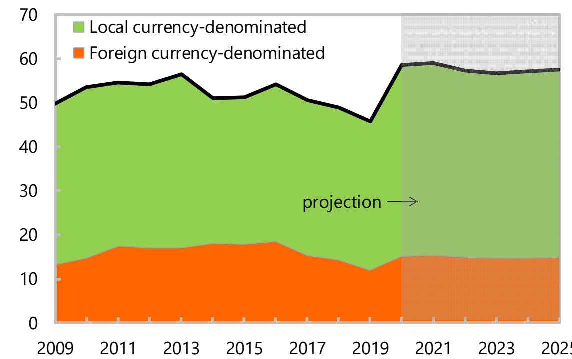
Figure 2. Poland: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



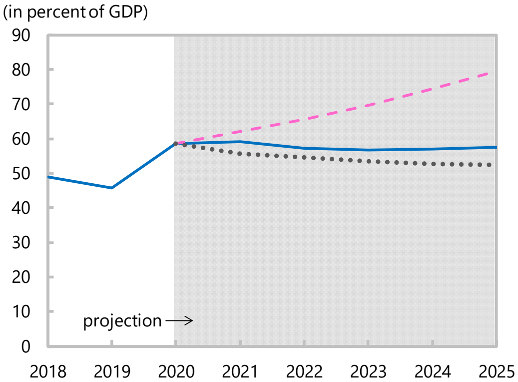
By Currency
(in percent of GDP)



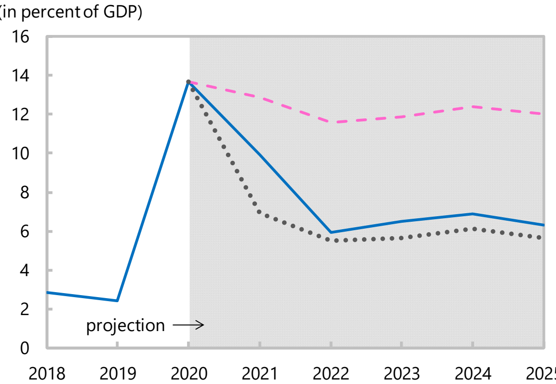
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

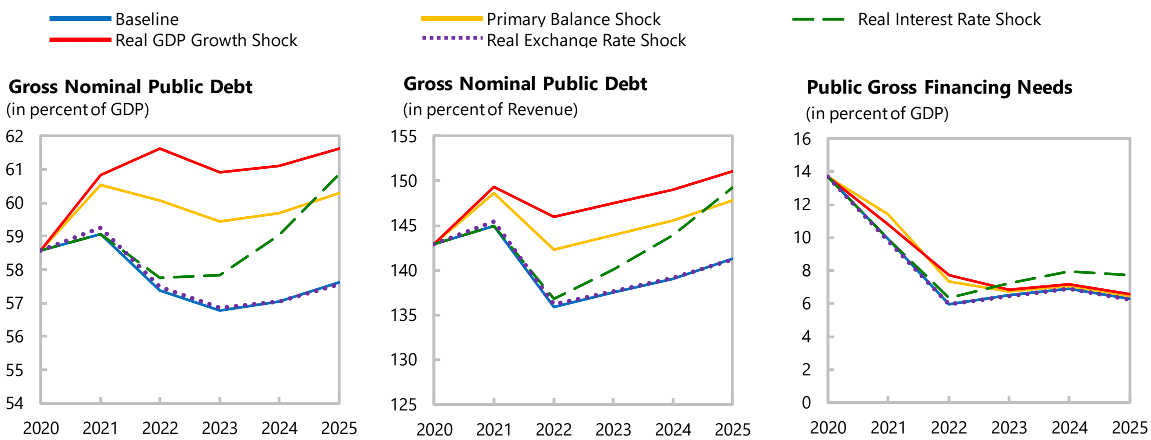
Baseline Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-3.4	2.7	5.1	4.2	2.9	2.6
Inflation	3.5	3.0	2.3	2.5	2.4	2.4
Primary Balance	-7.1	-4.1	-1.6	-2.2	-2.2	-2.2
Effective interest rate	3.0	1.9	1.7	1.8	1.9	1.9
Constant Primary Balance Scenario						
Real GDP growth	-3.4	2.7	5.1	4.2	2.9	2.6
Inflation	3.5	3.0	2.3	2.5	2.4	2.4
Primary Balance	-7.1	-7.1	-7.1	-7.1	-7.1	-7.1
Effective interest rate	3.0	1.9	1.8	2.0	2.2	2.3

Historical Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-3.4	3.6	3.6	3.6	3.6	3.6
Inflation	3.5	3.0	2.3	2.5	2.4	2.4
Primary Balance	-7.1	-1.1	-1.1	-1.1	-1.1	-1.1
Effective interest rate	3.0	1.9	1.9	2.3	2.7	2.9

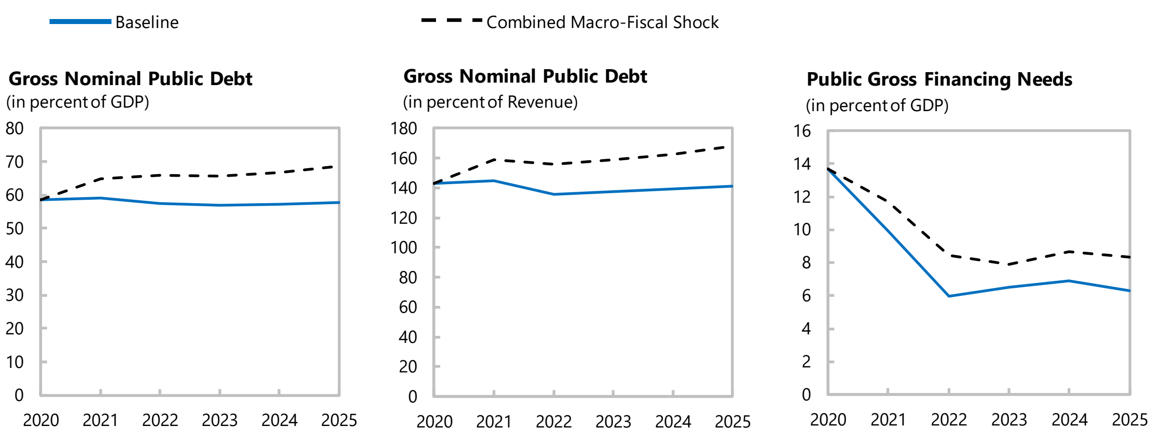
Source: IMF staff.

Figure 3. Poland: Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2020	2021	2022	2023	2024	2025
Real GDP growth	-3.4	2.7	5.1	4.2	2.9	2.6
Inflation	3.5	3.0	2.3	2.5	2.4	2.4
Primary balance	-7.1	-5.6	-2.8	-2.2	-2.2	-2.2
Effective interest rate	3.0	1.9	1.8	2.0	2.1	2.1
Real Interest Rate Shock						
Real GDP growth	-3.4	2.7	5.1	4.2	2.9	2.6
Inflation	3.5	3.0	2.3	2.5	2.4	2.4
Primary balance	-7.1	-4.1	-1.6	-2.2	-2.2	-2.2
Effective interest rate	3.0	1.9	2.4	3.0	3.7	4.3
Combined Shock						
Real GDP growth	-3.4	1.3	3.6	4.2	2.9	2.6
Inflation	3.5	2.7	1.9	2.5	2.4	2.4
Primary balance	-7.1	-5.6	-3.2	-2.2	-2.2	-2.2
Effective interest rate	3.0	1.9	2.5	3.2	3.8	4.4

Real GDP Growth Shock	2020	2021	2022	2023	2024	2025
Real GDP growth	-3.4	1.3	3.6	4.2	2.9	2.6
Inflation	3.5	2.7	1.9	2.5	2.4	2.4
Primary balance	-7.1	-4.9	-3.2	-2.2	-2.2	-2.2
Effective interest rate	3.0	1.9	1.7	1.9	2.0	2.0
Real Exchange Rate Shock						
Real GDP growth	-3.4	2.7	5.1	4.2	2.9	2.6
Inflation	3.5	8.5	2.3	2.5	2.4	2.4
Primary balance	-7.1	-4.1	-1.6	-2.2	-2.2	-2.2
Effective interest rate	3.0	1.9	1.6	1.8	1.9	1.9

Source: IMF staff.

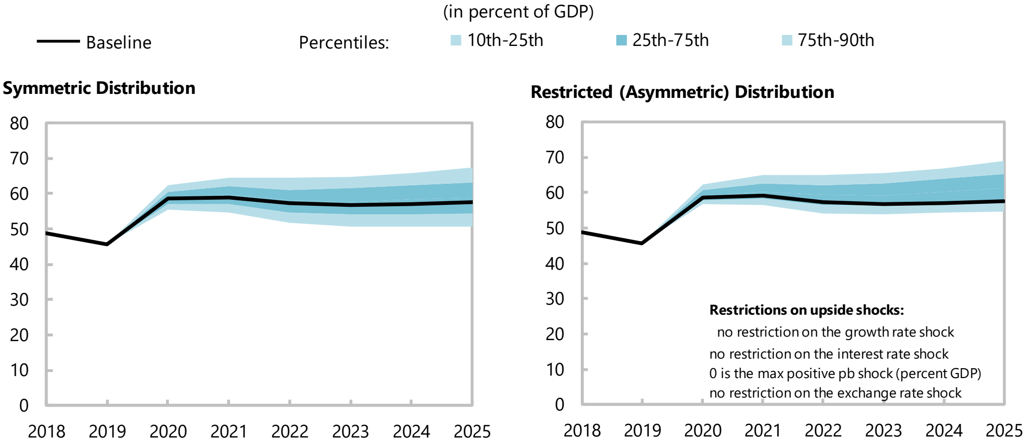
Figure 4. Poland: Public DSA Risk Assessment

Heat Map

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

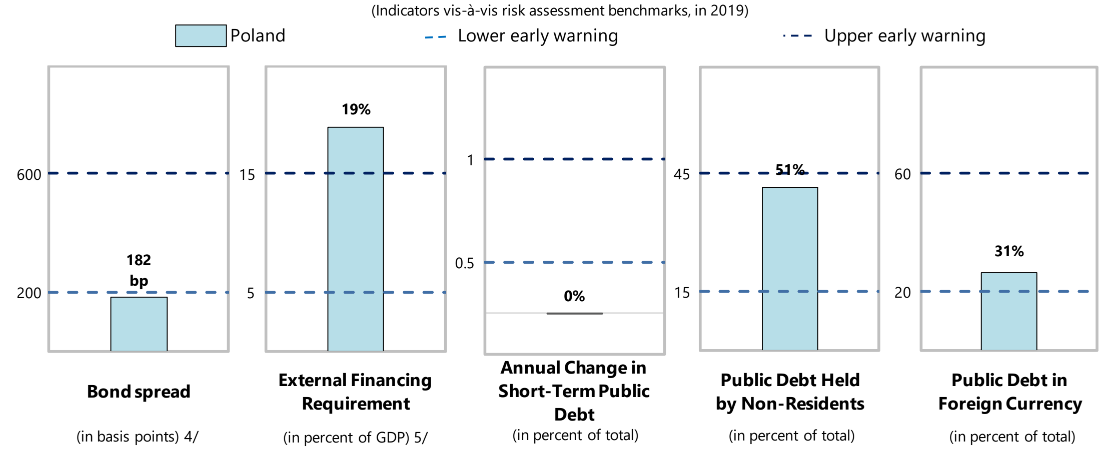
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2019)



Source: IMF staff.

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

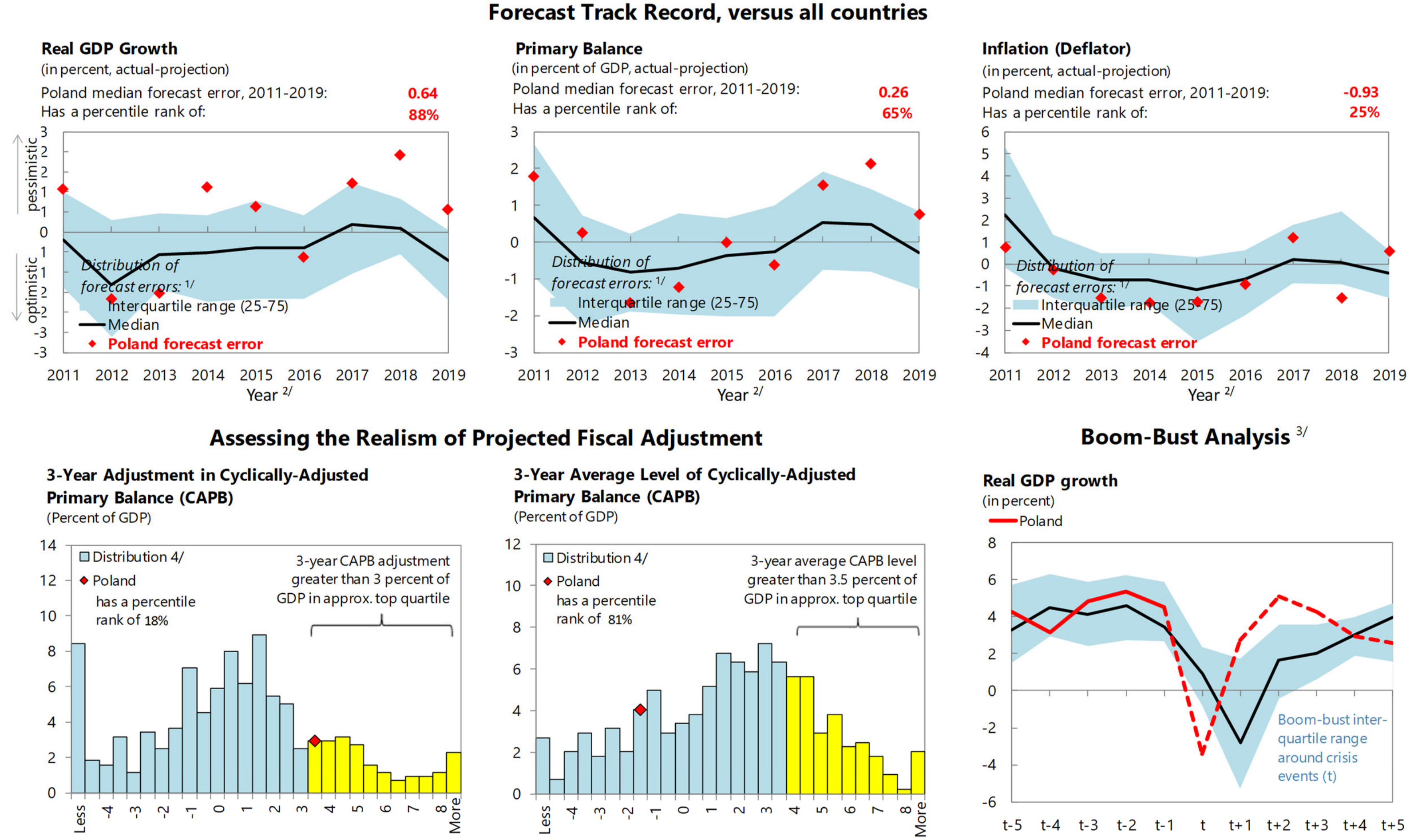
2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less that the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white. Lower and upper risk-assessment benchmarks are: 200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 02-Sep-20 through 01-Dec-20.

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

Figure 5. Poland: Public DSA—Realism of Baseline Assumptions



Source : IMF Staff.

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

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

3/ Poland has had a positive output gap for 3 consecutive years, 2017-2019 and a cumulative increase in private sector credit of 55 percent of GDP, 2016-2019. For Poland, t corresponds to 2020; for the distribution, t corre

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

Table 1. Poland: External Debt Sustainability Framework, 2015–25
(in percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2015	2016	2017	2018	2019			2020	2021	2022	2023	2024	2025	
								I. Baseline Projections						**Debt-stabilizing non-interest current account 5/**
External debt	69.3	72.0	72.7	61.7	59.4			**59.6**	**57.9**	**50.7**	**45.0**	**42.0**	**39.0**	**0.7**
Change in external debt	3.6	2.7	0.7	-11.1	-2.2			0.1	-1.7	-7.2	-5.7	-3.1	-3.0	
Identified external debt-creating flows (4+8+9)	6.8	-2.0	-6.4	-8.2	-2.9			-4.9	-7.6	-7.0	-3.5	-4.5	-4.2	
Current account deficit, excluding interest payments	-0.6	-0.6	-1.0	0.0	-2.0			-4.5	-2.9	-1.4	-1.1	-0.8	-0.7	
Deficit in balance of goods and services	-2.7	-3.7	-3.7	-3.0	-4.7			-5.4	-4.9	-4.4	-4.3	-4.0	-4.0	
Exports	49.1	51.9	54.3	55.2	55.5			51.5	54.0	52.2	51.0	50.2	49.7	
Imports	46.4	48.2	50.6	52.2	50.8			46.1	49.0	47.9	46.7	46.2	45.7	
Net non-debt creating capital inflows (negative)	-3.4	-3.1	-0.4	-1.6	-2.7			-2.8	-1.6	-1.2	0.6	-1.6	-1.7	
Automatic debt dynamics 1/	10.8	1.7	-5.1	-6.7	1.8			2.4	-3.2	-4.4	-3.0	-2.1	-1.8	
Contribution from nominal interest rate	1.5	1.4	1.4	1.3	1.5			1.2	1.0	1.0	0.9	0.8	0.8	
Contribution from real GDP growth	-3.2	-2.2	-3.2	-3.5	-2.8			2.1	-1.5	-2.7	-2.0	-1.2	-1.0	
Contribution from price and exchange rate changes 2/	12.5	2.5	-3.3	-4.5	3.1			-0.9	-2.7	-2.7	-1.9	-1.7	-1.6	
Residual, incl. change in gross foreign assets (2-3)	-3.2	4.6	7.1	-2.9	0.6			5.1	6.0	-0.2	-2.1	1.4	1.2	
External debt-to-exports ratio (in percent)	141.3	138.7	133.9	111.7	107.1			115.6	107.3	97.1	88.4	83.6	78.5	
Gross external financing need (in billions of US dollars) 3/	107.6	132.4	113.2	123.2	112.1			80.2	79.0	85.5	84.7	86.5	86.8	
in percent of GDP	22.5	28.0	21.5	21.0	18.8	10-Year Historical Average	10-Year Standard Deviation	13.7	12.6	12.5	11.4	10.9	10.2	
Key Macroeconomic Assumptions														
Nominal GDP (US dollars)	477.5	472.3	526.6	587.4	595.8			586.0	627.6	686.1	744.1	795.9	849.0	
Real GDP growth (in percent)	4.2	3.1	4.8	5.4	4.5	3.6	1.4	-3.4	2.7	5.1	4.2	2.9	2.6	
Exchange rate appreciation (US dollar value of local currency, percent)	-16.4	-4.4	4.4	4.6	-5.9	-1.8	5.2	-1.5	1.2	1.7	1.6	1.4	1.5	
GDP deflator in US dollars (change in percent)	-16.0	-3.5	4.8	6.6	-4.8	-0.2	7.4	1.6	4.7	4.8	3.8	3.9	4.0	
Nominal external interest rate (in percent)	2.0	2.0	2.1	1.9	2.4	2.3	0.3	2.0	1.8	1.8	1.9	1.9	2.0	
Growth of exports (US dollar terms, in percent)	-8.5	4.7	16.6	13.4	2.0	7.6	8.6	-8.7	12.2	5.8	5.9	5.4	5.5	
Growth of imports (US dollar terms, in percent)	-11.8	2.9	17.0	15.0	-1.2	6.5	10.6	-10.8	13.9	6.7	5.8	5.9	5.4	
Current account balance, excluding interest payments	0.6	0.6	1.0	0.0	2.0	-0.7	2.0	4.5	2.9	1.4	1.1	0.8	0.7	
Net non-debt creating capital inflows	3.4	3.1	0.4	1.6	2.7	0.0	1.0	2.8	1.6	1.2	-0.6	1.6	1.7	
								II. Stress Tests for External Debt Ratio						**Debt-stabilizing non-interest current account 5/**
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2018-2023 4/								**69.2**	**75.2**	**74.9**	**72.6**	**74.0**	**75.2**	**9.5**
B. Bound Tests														
B1. Nominal interest rate is at baseline plus one-half standard deviation								66.1	68.0	60.9	52.4	49.2	46.3	-3.2
B2. Real GDP growth is at baseline minus one-half standard deviations								66.9	69.1	62.2	54.0	51.0	48.3	-3.1
B3. Non-interest current account at baseline minus one-half standard deviations								68.0	70.7	64.3	56.6	54.1	52.0	-3.6
B4. Combination of B1-B3 using 1/4 standard deviation shocks								67.6	70.1	63.6	55.6	52.9	50.6	-3.3
B5. One time 30 percent real depreciation in 2019								63.5	65.0	58.1	49.8	46.6	44.4	-2.6

Source: IMF staff calculations.

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

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

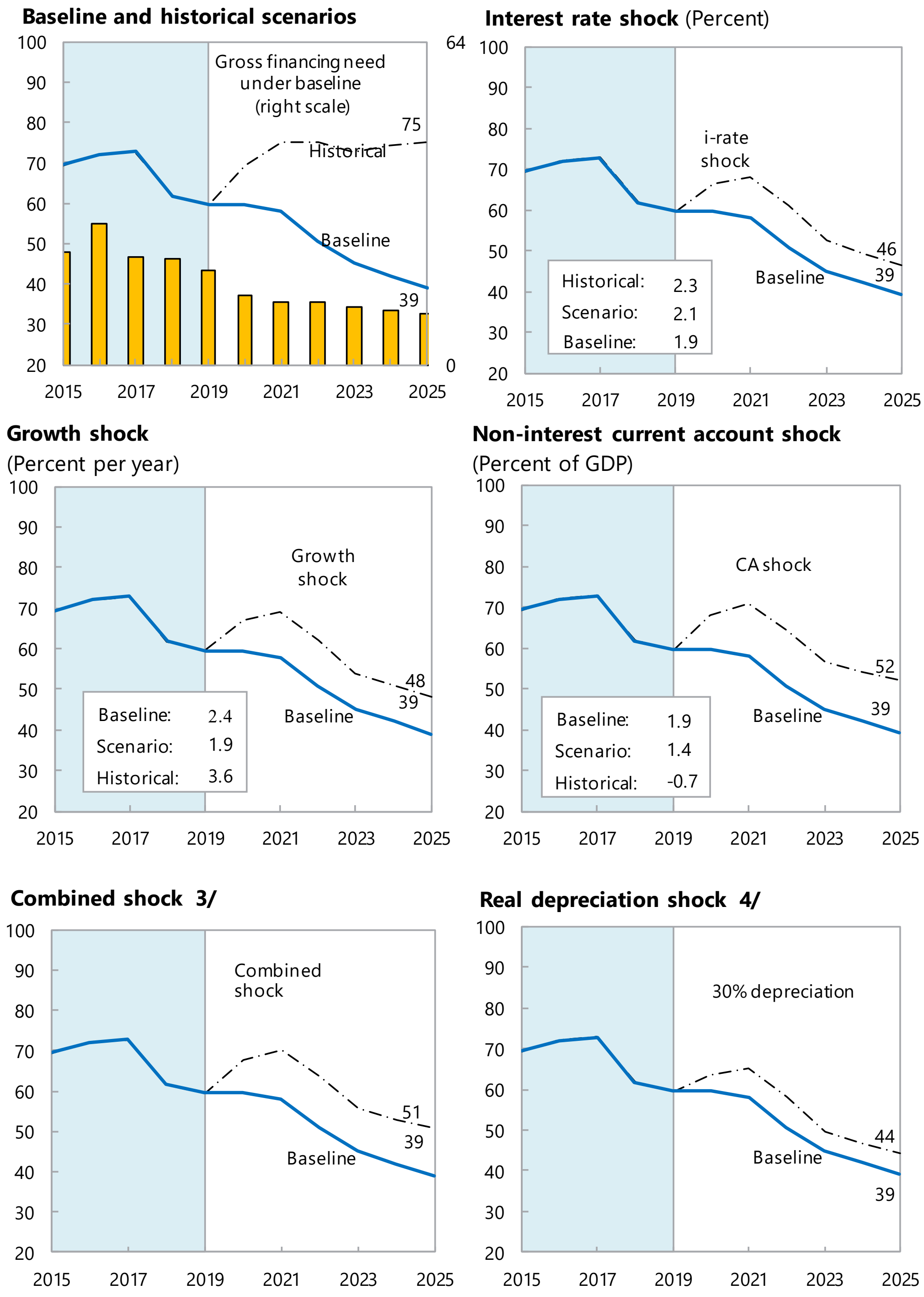
3/ Defined as current account deficit, plus amortization on short-term and medium- and long-term debt.

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

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

Figure 1. Poland: External Debt Sustainability: Bound Tests[1,2]

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

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

4/ One-time real depreciation of 30 percent occurs in 2018.

Source of Risk	Relative Likelihood	Time Horizon	Impact if Realized [1]	Policy Response
Conjunctural Risks				
Unexpected shift in the Covid-19 pandemic.	**Medium** **Downside.** Limited access to, and longer-than-expected deployment of, vaccines in some countries prompt a reassessment of growth prospects. The disease proves harder to eradicate, requiring costly containment efforts and prompting persistent behavioral changes rendering many activities unviable.	**ST**	**High** A prolonged pandemic could cause long-term scarring for the economy and risk reaching the limits of fiscal support for the economy, forcing larger dislocations for workers and companies.	• Allow exchange rate to adjust. • Extend fiscal support measures already in place. • Support affected workers but begin to incentivize reallocation of resources if it appears that the pandemic will be disruptive for a longer period or prompt more permanent changes in behavior. • Extend NBP asset purchase program to support liquidity in bond markets and the transmission of monetary policy. • Provide liquidity support to banks and use regulatory actions to facilitate the absorption of changes in asset quality and encourage private debt resolution.
	Medium **Upside.** Pandemic is contained faster than expected due to the rapid production and distribution of vaccines, boosting confidence and economic activity.		**High** Faster-than-expected recovery would boost confidence and economic activity.	Unwind crisis measures while avoiding a hasty withdrawal of fiscal support that risks undermining the recovery.

Source of Risk	Relative Likelihood	Time Horizon	Impact if Realized	Policy Response
Widespread social discontent and political instability.	**High** Social tensions erupt as the pandemic and inadequate policy response cause socio-economic hardship or due to unequal access to vaccines. Growing political polarization and instability weaken policymaking and confidence.	**ST, MT**	**High** An inadequate policy response and depressed global economy lead to higher unemployment and poverty. Political polarization and instability weaken policy-making and confidence.	Social spending and unemployment support should be extended but should be targeted according to need. Broader fiscal and monetary policies should remain accommodative.
Sharp rise in global risk premia exposes financial and fiscal vulnerabilities.	**Medium** Reassessment of market fundamentals triggers widespread risk-off event. Risk asset prices fall sharply and volatility spikes. Higher risk premia generate financing difficulties, extending to sovereigns with excessive public debt.	**ST, MT**	**High** Financial market volatility and a tightening of financial conditions reduce the impact of monetary policy easing, raising financing costs for the private and public sectors and lowering sentiment, prolonging the downturn.	Allow exchange rate to adjust. Extend NBP asset purchase program to support liquidity in bond markets and the transmission of monetary policy.
Intensified geopolitical tensions and security risks.	**High** Intensification of these risks in response to the pandemic, causing socio-economic and political disruption.	**ST, MT**	**Medium** Lower confidence could increase risk aversion against EMs and result in capital outflows and depreciation pressures.	The flexible exchange rate should be allowed to adjust as a first line of defense. Extend NBP asset purchase program to support liquidity in bond markets and the transmission of monetary policy.
Structural Risks				
Accelerating de-globalization.	**High** Geopolitical competition and fraying consensus about the benefits of globalization lead to further fragmentation, including to a no-deal Brexit.	**ST, MT**	**Medium** In the near term, escalating trade tensions could undermine growth directly and through adverse confidence effects and financial market volatility. In the medium term, de-globalization would give rise to reshoring and less trade. However, should some global value chains become more regional in scope, Poland could benefit (in the nearer term) from some production being moved back to Europe.	Ensure that structural transformation is on track. Facilitate structural reforms, focusing on business climate and labor market reforms, improving education and vocational training, and boosting infrastructure investment and R&D support, to attract investment (including FDI) and boost future productivity and income growth.

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

Annex IX. External Sector Assessment

<table>
<tr><td colspan="7">Overall Assessment: On a preliminary basis, and adjusting for transitory factors, recent developments suggest that the external position in 2020 remained stronger than the level implied by medium-term fundamentals and desirable policies. However, this assessment is highly uncertain given the lack of full-year data for 2020 and the COVID-19 crisis, and a complete analysis will be provided in the 2021 External Sector Report. The current account balance is projected to increase to 3.3 percent of GDP in 2020 from 0.5 percent in 2019, reflecting in large part an abrupt reduction in the primary income deficit arising from lower earnings of foreign companies in Poland during the pandemic. This comes after a decade-long transition from a large deficit to a small surplus in 2019. A CA surplus is deemed excessive given that income convergence is incomplete. In 2021, the CA surplus is projected to decrease as foreign companies' profitability recovers. Uncertainty is high over the medium term due to the COVID-19 pandemic; however, as the economy recovers, the CA surplus is expected to gradually vanish as private net saving returns to a lower level, offsetting an anticipated improvement in government net saving. If approved, Next Generation EU grants should boost investment, contributing to the moderation of the current account balance in the projection horizon. Reserves are adequate to insulate against external shocks and disorderly market conditions.

Potential Policy Responses: In the short term, fiscal policy should bolster the health system, provide businesses with liquidity, and support incomes of vulnerable households, including through preserving employment. Monetary and financial policies should prevent a tightening of financial conditions and enable the financial sector to support firms' liquidity. The tapering of expansionary policies should be gradual once the recovery is in full swing. The Next Generation EU funds should boost public investment, support the recovery, and help tackle infrastructure gaps, digitalization, and climate change. In the medium term, if prior imbalances persist, policies should aim to boost corporate investment and productivity, while active labor market policies should facilitate sectoral transition with structural reforms focused on raising potential growth. The fiscal deficit should be reduced after the crisis has abated. Room should be made for priority fiscal spending, by better targeting social benefits according to need.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="6">Background. The NIIP is projected to decline to –46 percent of GDP in 2020. Gross assets and liabilities are projected to reach 57 and 103 percent of GDP, respectively. The stock of net FDI (equity and debt), accounting for 36 percent of gross external liabilities, remains diversified across sectors and source countries. While gross external debt is sizable (60 percent of annual GDP as of Q3:2020), 29 percent of the debt is liabilities to direct investors via intercompany loans, and 75 percent of the debt is of long-term maturity. Short-term debt (excluding intercompany short-term debt), amounting to 14 percent of total debt (9 percent of GDP) in Q3:2020, is mainly owed by banks (currency and deposits) and the nonfinancial private sector (trade credit). Automatic debt dynamics, helped by the Next Generation EU grants, are projected to continue to reduce the negative NIIP in the medium term.

Assessment. While sizable external debt is a vulnerability, rollover risk is mitigated by the large share of long-term debt as well as intercompany lending that tends to be automatically rolled over. Adequate reserves reduce residual rollover risk from short-term debt (gross reserves are projected at 165 percent of short-term debt in 2020).</td></tr>
<tr><td>2020 (% GDP)</td><td>NIIP: - 46</td><td>Gross Assets: 57</td><td>Res. Assets: 26</td><td>Gross Liab.: 103</td><td colspan="2">Debt Liab.:60</td></tr>
<tr><td>Current Account</td><td colspan="6">Background. The CA has moved toward surplus since the 2008 crisis, from large deficits to close-to-balance in recent years. This reflects a larger trade surplus (mainly services), despite sustained high primary income deficits from reinvested earnings and dividend payments to direct investors and net earnings of foreign workers in Poland. Low investment and high saving by the corporate sector have been partially offset by net borrowing by households and the government. Poland's CA surplus is expected to increase from 0.4 percent of GDP in 2019 to 3.3 percent of GDP in 2020, driven by a larger trade surplus reflecting import compression, and by a lower primary income deficit, reflecting lower foreign companies' earnings. In the medium term as the economy recovers from the pandemic, the CA surplus is expected to vanish as private net saving returns to a lower level, offsetting an increase in government net saving.

Assessment. For 2020, the EBA CA model estimates a norm of –1.9 percent of GDP against a cyclically adjusted CA of 3.6 percent of GDP. The resulting EBA gap of 5.5 percent of GDP includes identified policy gaps (1.6 percent of GDP) and an unexplained residual of 3.9 percent of GDP. However, in view of the pandemic-related decline in the primary income account, judged to be transitory, an adjustment of -1.8 percent of GDP to the cyclically adjusted CA balance has been made. Furthermore, an additional adjustment of +0.3 pp of GDP to reflect the contraction in tourism net exports, and -0.1 pp of GDP to reflect the exceptionally sharp fall in global oil prices and volumes has been made. In summary, the total adjustment of -1.6 would result in a CA gap of 3.9 (±1) percent of GDP.</td></tr>
<tr><td>2020 (% GDP)</td><td>Proj. CA: 3.3</td><td>Cycl. Adj. CA: 3.6</td><td>EBA CA Norm: -1.9</td><td>EBA CA Gap: 5.5</td><td>Staff Adj.: -1.6</td><td>Staff CA Gap: 3.9</td></tr>
<tr><td>Real Exchange Rate</td><td colspan="6">Background. The REER has appreciated by 1.0 percent as of November, compared to the 2019 average. During the pandemic, unlike the GFC, movements in the NEER and REER have been muted. In nominal terms, the zloty depreciated by 4 percent against the dollar but appreciated 5 percent against the euro since end-2019. Over the same period, inflation in Poland has been only slightly higher than in its trading partners. REER depreciated by 3.9 percent between Jan-April but has appreciated 3.3 percent since April.

Assessment. The REER index model suggests a gap of - 2.7 percent. Overall, the IMF staff assesses the 2020 REER gap to be -9 percent (±1.4 percent), consistent with the staff CA gap, assuming an elasticity of 0.43.</td></tr>
<tr><td>Capital and Financial Accounts: Flows and Policy Measures</td><td colspan="6">Background. The capital account, dominated by inflows of EU funds for financing investment projects, has averaged about 2 percent of GDP over the past 10 years and is expected to peak at nearly 3 percent of GDP in 2022 as EU grants increase. At the onset of the pandemic, financial market volatility triggered sizable outflows in bond and equity markets; however, capital flows have broadly stabilized since May. Financial account outflows in Jan–Oct 2020 have amounted to US$13.6 billion (2.3 percent of GDP) and are projected to reach 1.7 percent of GDP for the year.

Assessment. Foreign holdings of domestic government securities have declined significantly since 2016 (in November 2020 they represented 17 percent of the total. Nevertheless, the overall stock remains sizable at 6 percent of GDP, and could pose risks, although the diversified foreign investor base is a mitigating factor.</td></tr>
<tr><td>FX Intervention and Reserves Level</td><td colspan="6">Background. Gross international reserves increased 20 percent to US$154 billion by end-2020. Net reserves, which exclude the central bank's repo operations (part of its reserve management strategy) and government FX deposits, are estimated at US$131 billion at end-2020, reflecting in part the central bank's conversion of a portion of EU funds received by the government to zloty. This is consistent with the central bank's strategy of building an adequate precautionary reserve buffer. The zloty is free floating. The central bank intervened in the FX market in December 2020 by purchasing FX, the first intervention since 2013.

Assessment. At about 159 percent of the Fund's reserve adequacy metric, the projected level of gross reserves is expected to be adequate to guard against external shocks and disorderly market conditions.</td></tr>
</table>

REPUBLIC OF POLAND

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 14, 2021

Prepared By	European Department

CONTENTS

FUND RELATIONS

(As of October 31, 2020)

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

General Resources Account:

	SDR Million	Percent Quota
Quota	4,095.40	100.00
Fund Holdings of Currency	3,201.78	78.18
Reserve Tranche Position	897.59	22.46
Lending to the Fund		
New Arrangement to Borrow	61.38	

SDR Department:

	SDR Million	Percent Allocation
Net Cumulative Allocation	1,304.64	100.00
Holdings	293.01	22.90

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

In Millions of SDR

Type	Approval Date	Expiration Date	Amount Approved	Amount Drawn
FCL	1/13/2017	11/2/2017	6,500.00	0.00
FCL	1/14/2015	1/13/2017	13,000.00	0.00
FCL	1/18/2013	1/13/2015	22,000.00	0.00
FCL	1/21/2011	1/17/2013	19,166.00	0.00
FCL	7/02/2010	1/20/2011	13,690.00	0.00

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

	Forthcoming				
	2020	2021	2022	2023	2024
Principal					
Charges/Interest	0.22	1.03	1.03	1.03	1.03
Total	0.22	1.03	1.03	1.03	1.03

Article IV Consultation:

The last Article IV consultation was concluded on January 18, 2019. Poland is on the standard 12-month consultation cycle.

Resident Representative:

Mr. Nadeem Ilahi has been the Senior Regional Resident Representative for Central and Eastern Europe since August 2018.

Exchange Arrangements and Restrictions:

The zloty is freely floating. In December 2020, the National Bank of Poland intervened in foreign exchange markets for the first time since 2013, purchasing foreign currency. Poland accepted the obligation of Article VIII, Sections 2, 3, and 4 on June 1, 1995. Poland maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions, except for the exchange restrictions imposed by Poland solely for the preservation of national or international security as introduced by the European Union (EU) within the framework of the Common Foreign and Security Policy. The consolidated list of such sanctions is available at: https://sanctionsmap.eu/#/main.

Table 1. Republic of Poland: Technical Assistance from the Fund, 1992–2020

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

Table 1. Republic of Poland: Technical Assistance from the Fund, 1992–2020 (continued)

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

Table 1. Republic of Poland: Technical Assistance from the Fund, 1992–2020 (concluded)

Department	Subject/Identified Need	Action	Date	Counterpart
IMF/IBRD	FSAP Update	Mission	April/May 2006	MoF/NBP
FAD	Developing a multi-annual fiscal framework	Mission	June 2008	MoF
STA	Errors and omissions in balance of payments accounts	Mission	July 2009	NBP
FAD	Medium-term fiscal framework	Mission	April 2010	MoF
MCM	Detailed assessment of observance of BCP for effective banking supervision	Mission	Feb/March 2011	KNF
STA	Errors and omissions in balance of payments accounts	Mission	June 2011	NBP
FAD	Developing the fiscal regime for oil and gas	Mission	April 2012	MoF
MCM	Macroprudential framework	Mission	May 2012	NBP
IMF/WB	FSAP update	Mission	Feb/March 2013	MoF/ KNF/NBP
FAD	Tax administration—Modernization challenges and strategic priorities	Mission	November 2014	MoF
MCM	Bank Resolution	Mission	March 2016	BFG
FAD	Medium-term budget framework	Mission	February/November 2017	MoF
FAD	Tax administration	Mission	April/June 2017	MoF
IMF/WB	FSAP update	Mission	Jan/May 2018	MoF/ KNF/NBP
FAD	Medium-term budget framework (MTBF), developing chart of accounts	Mission	Apr/Dec 2019	MoF
FAD	MTBF developing chart of accounts	Resident advisor	May 2019	MoF

STATISTICAL ISSUES

(As of December 6, 2020)

Assessment of Data Adequacy for Surveillance

General: Data provision is adequate for surveillance.

National Accounts: Statistics Poland (GUS) compiles and disseminates annual and quarterly GDP by production and expenditure approaches, both at current and previous year's prices following the *2008 SNA* and *ESA 2010*. Quarterly financial accounts of general government sector are compiled by the Statistics Poland (GUS). Annual and quarterly financial accounts by institutional sectors are compiled by Narodowy Bank Polski (NBP) following the *ESA 2010* standards and disseminated regularly on its website according to an advance release calendar: the annual financial accounts on the 20th of October the following year and quarterly financial accounts on the 20th calendar day of the 4th month following the end of the reference quarter (i.e., on the 20th of January, April, July, and October). Poland also publishes "flash estimates" of GDP 45 days after the reference quarter.

Price Statistics: The consumer price index does not cover imputed rents of owner-occupied dwellings. The scope of the index covers all resident households. The weights are updated annually and are derived from average annual expenditures primarily taken from the monthly household budget survey. Poland publishes "flash estimates" of CPIs and a monthly Harmonized Indices of Consumer Prices (HICP) according to the uniform methodology of the European Union. The producer price index is disseminated monthly, up to 20 days after reference month and the final data up to 50 days after reference month. When price observation of an item is unavailable in a given month, its price is not imputed. The item is excluded from the producer price index aggregation in that month, and its replacement will be selected during the next month's survey.

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

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

Monetary and Financial Statistics: Beginning with data for January 2004, the NBP provides the European Central Bank (ECB) with monetary accounts in accordance with the ECB's framework for monetary statistics using the national residency approach. The ECB reports monetary data for Poland to the IMF for publication. Data on other financial corporations (OFC) are currently not available. Poland reports data on several series indicators of the Financial Access Survey (FAS) including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).

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

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

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

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

Table 2. Republic of Poland: Table of Common Indicators Required for Surveillance—as of December 3, 2020

	Date of latest observation	Date received	Frequency of data[7]	Frequency of reporting[7]	Frequency of publication[7]	Memo Items: Data Quality – Methodological soundness[8]	Memo Items: Data Quality Accuracy and reliability[9]
Exchange Rates	12/03/2020	12/03/2020	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	10/2020	11/20/2020	M	M	M		
Reserve/Base Money	10/2020	11/24/2020	M	M	M	O, LO, O, LO	O, O, O, O, O
Broad Money	10/2020	11/24/2020	M	M	M		
Central Bank Balance Sheet	10/2020	11/24/2020	M	M	M		
Consolidated Balance Sheet of the Banking System	10/2020	11/24/2020	M	M	M		
Interest Rates[2]	12/03/2020	12/03/2020	D	D	D		
Consumer Price Index	11/2020	12/06/2020	M	M	M	O, O, O, O	O, O, O, O, O
Revenue, Expenditure, Balance, and Composition of Financing[3] – General Government[4]	2019	10/28/2020	A	A	A	LO, O, O, O	O, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	9/2020	11/23/2020	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	9/2020	11/20/2020	M	M	M		
External Current Account Balance	9/2020	11/13/2020	M	M	M	O, O, O, LO	O, O, O, O, LO
Exports and Imports of Goods and Services	9/2020	11/13/2020	M	M	M		
GDP/GNP	Q3/2020	11/30/2020	Q	Q	Q	O, LO, O, O	LO, LO, O, O, LO
Gross External Debt	Q2/2020	9/30/2020	Q	Q	Q		
Balance of Payments	Q2/2020	9/30/2020	Q	Q	Q		
International Investment Position[6]	Q2/2020	9/30/2020	Q	Q	Q		

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

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

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

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

[5] Including currency and maturity composition.

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

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

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

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

Statement by Mr. Piotr Trabinski, Executive Director, and
Mr. Bartosz Piasecki, Advisor to the Executive Director
February 3, 2021

On behalf of the Polish authorities, we would like to thank staff for their engagement during this year's Article IV consultation and the fruitful discussions during the virtual mission hosted from Warsaw. We also thank staff for the well-written report. We broadly share staff's findings which rightly focus on the challenges posed by the Covid-19 pandemic, as well as the authorities' effective policy response. The conclusions will serve as an important point of reference to policy makers.

Economic outlook and crisis response

At the onset of 2020, the economic conditions in Poland were favorable, following a period of strong economic expansion driven by robust domestic consumption, private investment, and exports. Poland achieved a record-long expansion of higher living standards, while unemployment and poverty rates declined to historically low levels. Due to the outbreak of the Covid-19 pandemic, Poland found itself in a new social and economic situation. For the first time since 1991, a recession is forecast for 2020.

The Polish authorities promptly undertook significant measures to prevent the spread of the virus by implementing strict containment measures which helped stabilize the virus outbreak and maintain the population's health during the first wave of infections. The number of Covid-19 cases and deaths were among the lowest in the EU—which permitted an early, but phased removal of restrictions in the late spring. The authorities reintroduced restrictions at the end of 2020 in response to the second wave of the virus, which was more challenging to contain.

The restrictions disrupted supply chains and adversely affected the service and manufacturing sectors. To compensate for the economic effect of the containment measures, the authorities launched a series of support measures to help affected households and businesses. The National Bank of Poland (NBP) has swiftly eased monetary policies, focusing on stabilizing the economy in the short term by providing funding to banks and companies, and overall supporting the financial system. The authorities project GDP to decline by 4.6 percent in 2020, followed by a recovery of 4.0 percent in 2021. In contrast, staff's projections for 2020 are more sanguine and estimate negative 3.4 percent and are more conservative for 2021 with an estimate of 2.7 percent GDP growth.

In the authorities' view, the envisaged faster economic and social recovery hinges largely on the swift distribution of vaccines. As such, the authorities focused on a vaccination strategy, with the main goal of building resilience against the virus throughout 2021. The daily number of

vaccinations is estimated at around 45,000 doses, with an objective of nearly 3 million people vaccinated by end-Q1 (about 10 percent of the adult population).

Fiscal Policies

In the past decade, Poland has prudently managed its public finances. The authorities have built significant fiscal buffers, while decreasing public debt to 46 percent with 0.7 percent deficit in 2019. According to the authorities' projection, the 2020 public debt is estimated to reach 50.7 percent of GDP followed by 52.9 percent in 2021. Poland's fiscal policy is supported by a strong framework and economic fundamentals, including the constitutional debt ceiling of 60 percent of GDP. The expenditure rule's limitations did not apply in 2020; the revised escape clause requires a gradual return to the rule within 2 to 4 years, depending on the speed of economic recovery. The "Next Generation EU" (NGEU) recovery package will benefit country recovery with sizable support. Its main component, the Recovery and Resilience Facility, provides up to EUR 23 billion in grants and EUR 34 billion in loan access, amounting to 4.5 percent of 2020 GDP. The authorities project these expenditures to raise GDP growth over the period of 2021–26.

A substantial rise in the nominal deficit is due to the unprecedented fiscal measures during the pandemic. The authorities introduced social spending and allowances for parents, wage subsidies, and benefits for the self-employed and unemployed. They also offered small- and medium-sized companies' partial non-repayable loans, loan guarantees, and liquidity loans. These support measures account for 11.5 percent of GDP. The support for large enterprises is tailored and includes both debt financing and equity commitment, supervised by the Polish Development Fund (PFR). To face challenges posed by the second wave, the authorities extended additional targeted measures in the amount of 1.5 percent of GDP, focusing on the most affected contact intense sectors.

Despite the authorities' strong fiscal response, public debt is relatively low. Fiscal space remains substantial and could be further utilized, if needed. In order to achieve greater efficiency and control over public spending, the authorities have stepped up their efforts to improve the revenue administration, which will also help maintain the sustainability of public finances. The authorities are also committed to continuing their efforts to improve tax compliance and tax collection efficiency. The ongoing digitalization of customer-facing and back-office operations by AI and machine learning functions will increase the detection rates of tax frauds.

The increasing pension-age population remains the main challenge for the long-term sustainability of public finances. To address this challenge, the Polish authorities adopted a new long-term savings scheme in October 2018, the "Employee Capital Plan" (PPK). Poland continues its work to reform the budgetary framework to increase the effectiveness and efficiency of spending in this regard. The authorities intend to engage with staff and undertake a

PIMA in the second half of 2021, to ensure that the envisaged capital expenditures will be properly supervised at every level.

Monetary Policy

The NBP has responded swiftly and decisively to the COVID-19 pandemic. It has provided an ample degree of monetary accommodation to the economy through, most of all, interest rates cut and asset purchases. To support liquidity in the banking sector, the central bank has lowered reserve requirements, introduced repo operations, and offered bill discount credit aimed at refinancing loans granted to enterprises by banks.

Monetary easing has mitigated the negative economic impact of the pandemic shock. It has contributed to lower debt service costs for both the private sector and government and had a stabilizing effect on the bond market. While supporting economic activity, monetary easing has stabilized inflation at the level consistent with the NBP's medium-term inflation target. In December 2020, inflation stood at 2.4 percent yoy (against the NBP's target of 2.5 percent +/- 1 percentage points) and medium-term inflation expectations remain firmly anchored.

Looking ahead, inflation is expected to remain consistent with the NBP's target. While negative supply side and regulatory forces—including further waste disposal and electricity price hikes — are likely to continue to boost prices in the quarters to come, the negative output gap and low inflation abroad are expected to moderate inflation pressures. Concurrently, although the economy is expected to gradually gain momentum over 2021, it will need some time to fully recover from the shock and firmly return on a sustainable growth path. Uncertainty remains high and risks to growth are tilted to the downside.

Against this background, the authorities agree with the staff assessment that the NBP's accommodative policy stance should be maintained until a recovery is well established. The authorities do not rule out further monetary policy easing should downside risks to growth materialize and risks to inflation fall below the target increase.

In December 2020, the NBP launched foreign currency interventions. They were aimed at limiting the mounting risks of a pro-cyclical appreciation of the PLN in the context of global monetary easing. The interventions have strengthened the impact of the NBP's monetary easing on the economy in view of low inflation pressures projected for 2021.

Financial Sector

The Polish financial sector entered the pandemic with strong capital and liquidity buffers and without significant imbalances.

In order to address unprecedented uncertainty with regard to the impact of the pandemic on banks, the Polish authorities introduced various risk-mitigating and support measures:

- The Financial Stability Committee, responsible for macroprudential policy in Poland, withdrew the 3 percent systemic risk buffer. This move unlocked around PLN 30 bn of capital for new lending or absorbing pandemic-driven credit losses.
- At the same time, the Government provided financial support for enterprises, mainly in the form of subsidies. This move ensured liquidity to firms and reduced their demand for lending. Credit moratoria—introduced by the Government in partnership with banks—made available additional relief for borrowers to reduce the credit risk for banks.
- The Polish Financial Supervision Authority (PFSA) offered a more flexible approach to risk management by banks coupled with actions taken on the EU level under the COVID-19 Quick Fix.
- NBP reduced the interest rate and reserve requirement as well as introduced the purchase of sovereign and sovereign-guaranteed bonds on the secondary market (QE). A discount credit was also offered to banks as a source of refinancing loans to enterprises.

In the course of the COVID-19 period, the banking sector has remained sound and stable. However, the declining profitability of banks has accelerated and mainly on the back of increased credit risk costs. Lending to the non-financial sector has slowed down substantially, though there are no signs of an excessive tightening of credit policies nor credit crunch. The slowdown in lending can be attributed mainly to the weak demand, particularly on the side of enterprises, whose liquidity needs were addressed by the Government's anti-crisis shields. Also, banks have in their disposal sufficient levels of capital and liquidity for developing credit activity.

The authorities are familiar with the legal risks stemming from FX mortgages, which constitute a source of uncertainty for some banks. Following the European Court of Justice (ECJ) ruling in late 2019, consumers can ask courts to convert the loans into the local zloty currency. Since then, there has been a gradually increasing number of borrowers that are challenging their contracts. In response to the current ongoing litigation, banks have been encouraged by the PFSA to launch a voluntary conversion of FX mortgages. Consequently, banks are working on practicalities of this process.

Poland has one of the most developed capital markets in the region, but banks' reliance on the wholesale market remains limited. The main goal of the recently adopted "Capital Market Development Strategy" is to improve access to finance for companies (especially SMEs) by increasing the overall attractiveness of the Polish capital market to domestic and foreign investors. To achieve this goal, the strategy aims to address identified barriers that prevent easy

access to financing. Moreover, strategy puts focus on developing further a competitive infrastructure that would allow more agile capital market and it supports the EU Capital Market Union's objectives. The authorities are also addressing the recommendations of the 2018 FSAP, as indicated in Annex II of staff report.

External Sector

Poland's current account is estimated at a level of +3.3 percent of the GDP in 2020, driven mostly by improved surplus both in goods and services. Poland's external position is record-breaking, stronger than the authorities forecasted. In the short-term, the authorities estimate a reversion to a more balanced current account. Polish trade performed relatively well, both due to export performance and lower imports accompanied by the decrease in oil prices. Europe's relatively well performing industrial sector supports Poland's good export performance and position in the international supply chain.

Structural Reforms

The authorities view the ongoing recovery from the pandemic as an opportunity to foster their structural reform agenda. In line with the ongoing implementation of the "Strategy for Responsible Development", the authorities have been developing a medium-term Recovery Plan for 2021-26 (KPO). The green transformation will be supported under KPO. The road towards climate neutrality is a great challenge for the Polish economy, but it also provides an opportunity to create and use innovative solutions. A new medium-term strategy will be introduced by the authorities to fully utilize the NGEU funds. Strategy will target investment in climate-oriented and digital infrastructure, sustainable transportation, and gradual decarbonization of the economy. Strategy will also aim to reform and improve the capacity and efficiency of the healthcare sector, including through modernization of the healthcare infrastructure, development of human resources, and digitalization of medical services.

While Poland, like other countries will most likely struggle with the pandemic throughout 2021, the authorities are phasing in the recovery strategy, that could be fully accelerated once the pandemic abates. The authorities have initiated the "Governmental Fund for Local Investments", a state-provided funding program for ready-made public and private investment projects, aimed at improvement of infrastructure such as local roads, bridges, education infrastructure and communal facilities.