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Republic of Poland: Arrangement Under the Flexible Credit Line—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director the Republic of Poland

In the context of the arrangement for the Republic of Poland under the Flexible Credit Line, the following documents have been released and are included in this package:

- The staff report on the arrangement for the Republic of Poland under the Flexible Credit Line, prepared by a staff team of the IMF, based on information available as of June 22, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff supplement of June 24, 2010 on the assessment of the impact of the proposed Flexible Credit Line arrangement on the Fund's finances and liquidity position.
- A Press Release summarizing the views of the Executive Board as expressed during its July 2, 2010 discussion of the staff report that completed the review.
- A statement by the Executive Director for the Republic of Poland.

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

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INTERNATIONAL MONETARY FUND

REPUBLIC OF POLAND

Arrangement Under the Flexible Credit Line

Prepared by the European Department
(In consultation with other departments)

Approved by Anne-Marie Gulde and Aasim Husain

June 22, 2010

Executive Summary

Background: Poland is the only EU country to have escaped a recession in 2009. This enviable performance was due to its limited reliance on exports, well-capitalized and profitable banking system, flexible exchange rate, and limited pre-crisis imbalances that afforded policy-makers room to undertake timely and effective counter-cyclical policies.

Outlook: Growth is expected to pick up as the global environment improves, domestic sentiment strengthens, bank lending resumes, and the absorption of EU funds accelerates. However, despite its very strong fundamentals, Poland's near-term outlook is subject to downside risks stemming from the still-fragile external environment, especially in Europe.

FCL: The authorities believe that access under a successor FCL arrangement in the amount of SDR 13.69 billion (1000 percent of quota), which they intend to treat as precautionary, would help to safeguard the economy against downside risks during the current period of renewed uncertainty. Staff concurs and believes that, given Poland's regional importance, the FCL may provide insurance not only to Poland, but to the region more broadly. In staff's view, Poland fully meets the criteria for access under the FCL arrangement.

Fund liquidity: The impact of the proposed commitment of SDR 13.69 billion on the Fund's finances and liquidity position would be manageable.

Process: An informal meeting to consult with the Executive Board on a possible FCL arrangement for Poland was held on June 15, 2010.

Publication: The authorities have consented to the publication of the staff report.

Team: The report was prepared by a staff team led by James Morsink and comprising Natan Epstein and Delia Velculescu (all EUR), Ricardo Llaudes (SPR), and Erlend Nier (MCM).

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I. CONTEXT

A. Very Strong Fundamentals and Institutional Policy Framework

1. **Poland's macroeconomic performance was very strong in the decade leading up to the global crisis**. Real GDP growth during 1999–2008 averaged about 4 percent and was well balanced. Inflation was successfully brought down from double digits in the 1990s, averaging about 2½ percent during 2002–08. While Poland experienced an EU-accession-related surge in capital flows, these were smaller than in other Central and Eastern European countries, and, consequently, did not lead to significant macroeconomic imbalances. At end-2008, government and external debt levels were below 50 percent of GDP. Meanwhile, the banking system was profitable and well-capitalized.

2. **Underpinning this performance was a sustained track record of implementing sound economic policies.** Poland's commitments to the EU Stability and Growth Pact helped lower the fiscal deficit and limit government debt. A determined anti-inflationary focus—in the context of an effective inflation targeting regime and a floating exchange rate policy—built confidence in monetary institutions and anchored inflation expectations. Poland's strong financial supervisory framework helped foster a well-capitalized banking system. Finally, structural policies have been increasingly focused on boosting Poland's low labor participation rate and accelerating the privatization agenda.

3. **Poland's achievements and policies have been repeatedly recognized by the Executive Board, most recently in the 2010 Article IV Consultation, concluded on May 7, 2010** (SM/10/88 and SUR/10/40). Directors commended the authorities for their swift and timely response to the global crisis. They noted that this response—anchored in a strong macroeconomic framework and financial system and buttressed by the FCL arrangement in place from May 6, 2009 to May 5, 2010—enabled Poland to escape a recession in 2009. Directors also welcomed the announced package of consolidation measures aimed at reducing the fiscal deficit, as well as the recent recommendations aimed at strengthening lending standards for household loans.

B. Crisis Impact and Policy Response

4. **Poland weathered the global crisis well, being the only EU economy to avoid recession in 2009.** This was due, in part, to Poland's large domestic market, stable private consumption, and limited reliance on exports, which—coupled with a well-capitalized and profitable banking system—contained the negative spillovers from the global crisis through both the real and financial channels. In addition, the flexible exchange rate regime helped to buffer the external shocks and allowed the real exchange rate to adjust. Capital flows to Poland were less volatile than elsewhere (Box 1).

5. **The authorities responded in a timely and effective manner to the downturn.** Their policy response was facilitated by the room for maneuver afforded by Poland's limited external and internal imbalances. Specifically:

- **Fiscal policy provided appropriate counter-cyclical stimulus.** The combination of tax cuts (enacted in 2006 and 2007) coming into effect and the government's decision in mid-2009 to allow automatic stabilizers to work on the revenue side was key in mitigating the growth slowdown. But, as a result, the general government deficit rose from just under 2 percent of GDP in 2007 to about 7 percent of GDP in 2009. General government debt (on an ESA95 basis) increased to 51 percent of GDP at end-2009; on the national definition (which excludes the debt of the Road Fund), government debt amounted to just under 50 percent of GDP. Market reaction to the higher deficit and debt remained positive, helped by the authorities' decision to avail themselves of the FCL on a precautionary basis.

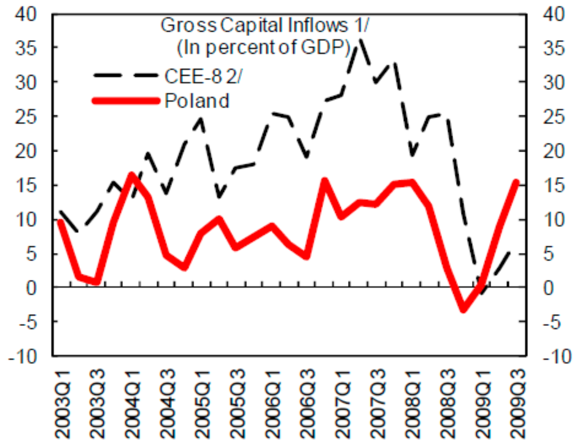
- **Monetary policy was accommodative.** In the context of falling inflationary pressures, the Monetary Policy Council (MPC) cut the policy rate through the first half of 2009 to 3.5 percent. It maintained a loosening stance until October 2009, when it changed its informal bias to neutral, reflecting an improved outlook. The new MPC that took office in early 2010 preserved the neutral bias.

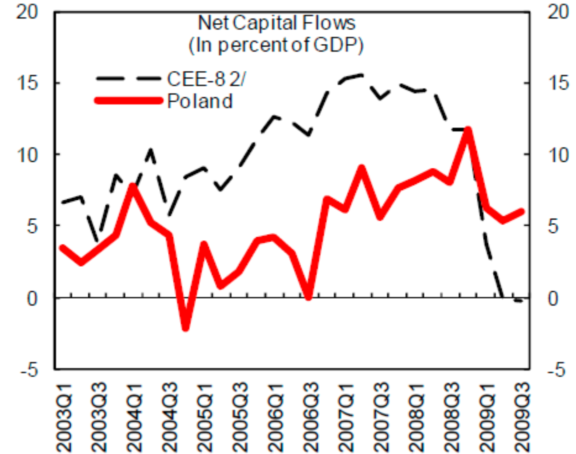
- **Facilities for exceptional liquidity support were put in place.** In early 2009, the National Bank of Poland (NBP) lowered reserve requirements, extended the maturity of repo operations, broadened the range of accepted collateral, and engaged in foreign-exchange repos with the European Central Bank (ECB) and the Swiss National Bank (SNB). Given the improved market conditions, the NBP has limited the use of the 3 and 6 month repos, and allowed the repo agreement with the SNB to expire in early 2010. Separately, the authorities have offered a credit-guarantee scheme through the state-owned BGK bank aimed at boosting corporate lending, though demand for such guarantees has been limited.

- **Additional measures were taken to safeguard financial stability.** The recommendation by the Financial Supervision Commission (KNF) last year that all banks retain 2008 profits was instrumental in quickly restoring capital adequacy ratios to pre-crisis levels. The quality of capital is generally high, and the KNF has encouraged the weaker tier of banks to retain a large share of 2009 profits. KNF also continued to monitor quantitative liquidity standards, introduced in 2008. Finally, the KNF has introduced a new regulation—Recommendation T—which tightens credit assessments on household lending.

Box 1: Capital Flows to Poland—A Retrospective Look

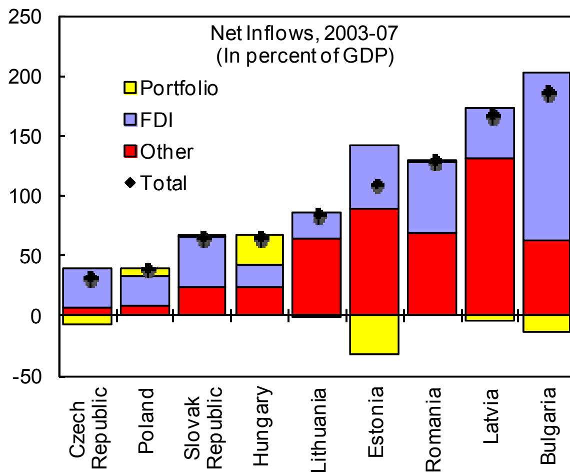
Capital inflows have been less volatile than in other emerging economies in Europe. During the boom years, the magnitude of capital inflows (as a share of GDP) was smaller than the average of the other new EU member states, reflecting in part the timely introduction of counter-cyclical macro-prudential measures—notably on foreign exchange-denominated mortgages. During 2008-09, capital inflows fell, but less sharply than in neighboring countries, and gross inflows have already rebounded.

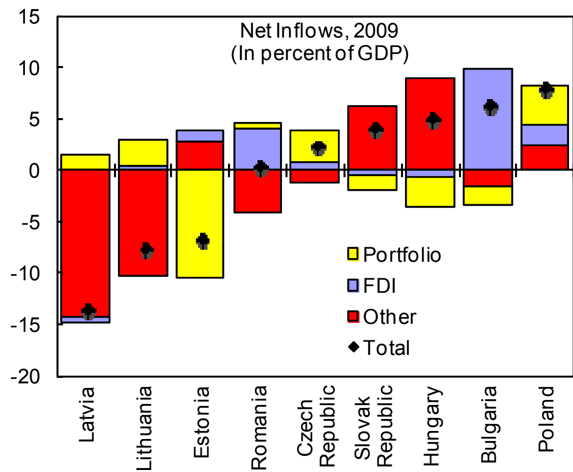




Source: Eurostat.
1/ Total FDI, portfolio debt and equity, other investment liabilities of banks and corporates (loans and currency & deposits).
2/ Includes Bulgaria, Czech Republic, Slovak Republic, Estonia, Hungary, Latvia, Lithuania, and Romania.

The resilience of capital inflows during the crisis was broad based. Poland was the only country among the new EU member states that experienced positive growth in both net portfolio and net other investment flows in 2009, reflecting in part the repatriation of foreign assets by the private sector and increased issuance of government securities. The low level of portfolio and other investment inflows during the boom period may be explained by the relatively subdued credit growth in Poland.





C. Outlook and Risks

6. **Economic growth is expected to pick up gradually.** The global environment is improving, and balance-sheet adjustment in the Polish banking system appears to have run its course, suggesting that banks are ready to cautiously expand credit. Recent economic indicators point to a steady upturn, largely driven by domestic demand (Figure 1). Private consumption and inventory accumulation were strong in the first quarter, while more recent monthly industrial production data, especially in manufacturing, show signs of a modest rebound in investment. At the same time, labor market conditions are improving, with private sector employment growing again. On the external side, the current account deficit has remained subdued, with export growth outpacing import growth. In the financial account, both FDI and portfolio flows have picked up. Against this background, staff has revised up its real GDP growth projections to 3.1 percent in 2010 and 3.5 in 2011. The output gap is expected to close over the next two years.

7. **The macroeconomic policy stance remains appropriate.** Macroeconomic policies during 2010 are being geared at supporting domestic demand until the recovery is self-sustained:

- **Fiscal policy aims to withdraw stimulus over the medium term.** The 2010 general government deficit is projected to be about 7 percent of GDP, taking into account the recently-approved transfer of central bank profits to the budget and a better-than-budgeted revenue performance due to an improved macroeconomic outlook. Looking ahead, on staff's macroeconomic projections and announced policies—including a temporary fiscal rule limiting the growth of discretionary spending to CPI inflation plus 1 percent, expected to be implemented starting with the 2011 budget—the deficit is projected to fall to about 3½ percent of GDP by 2015, while debt would stabilize at about 60 percent of GDP. With additional measures triggered by the debt thresholds under Poland's Public Finance Act, the deficit would be sharply curtailed in 2013 and would decline to about 2 percent over the medium term, with debt remaining below 60 percent of GDP.[1] The authorities plan to further strengthen their medium-term framework by introducing multi-year budgets and performance-based budgeting later this year, as well as by eventually implementing a permanent fiscal rule anchored in their medium-term objectives.[2]

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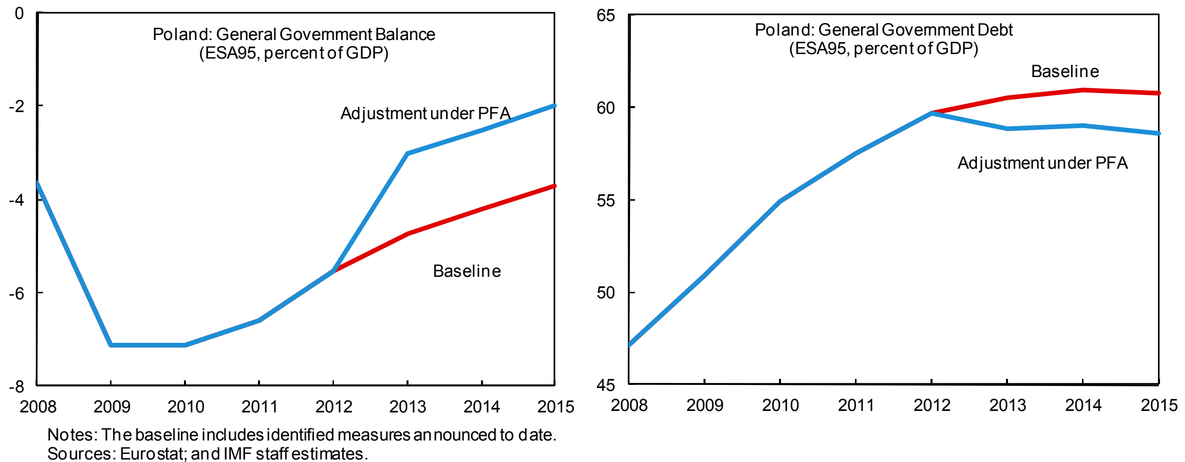
[1] The Public Finance Act establishes two debt thresholds, which apply to the national definition of debt (excluding debts of the National Road Fund), at 50 and 55 percent of GDP: breaching of the first threshold triggers mild policy changes, serving mainly as a warning signal to policymakers; breaching of the second threshold requires more stringent measures that need to be implemented in the budget for the second year after the breach, aimed at curbing the increase in debt. A Constitutional debt limit is set at 60 percent of GDP.

[2] At the authorities' request, an IMF fiscal technical assistance mission visited Poland in April 2010 and advised the Ministry of Finance on the development of a permanent fiscal rule and attending institutions. The details of this rule are yet to be defined.



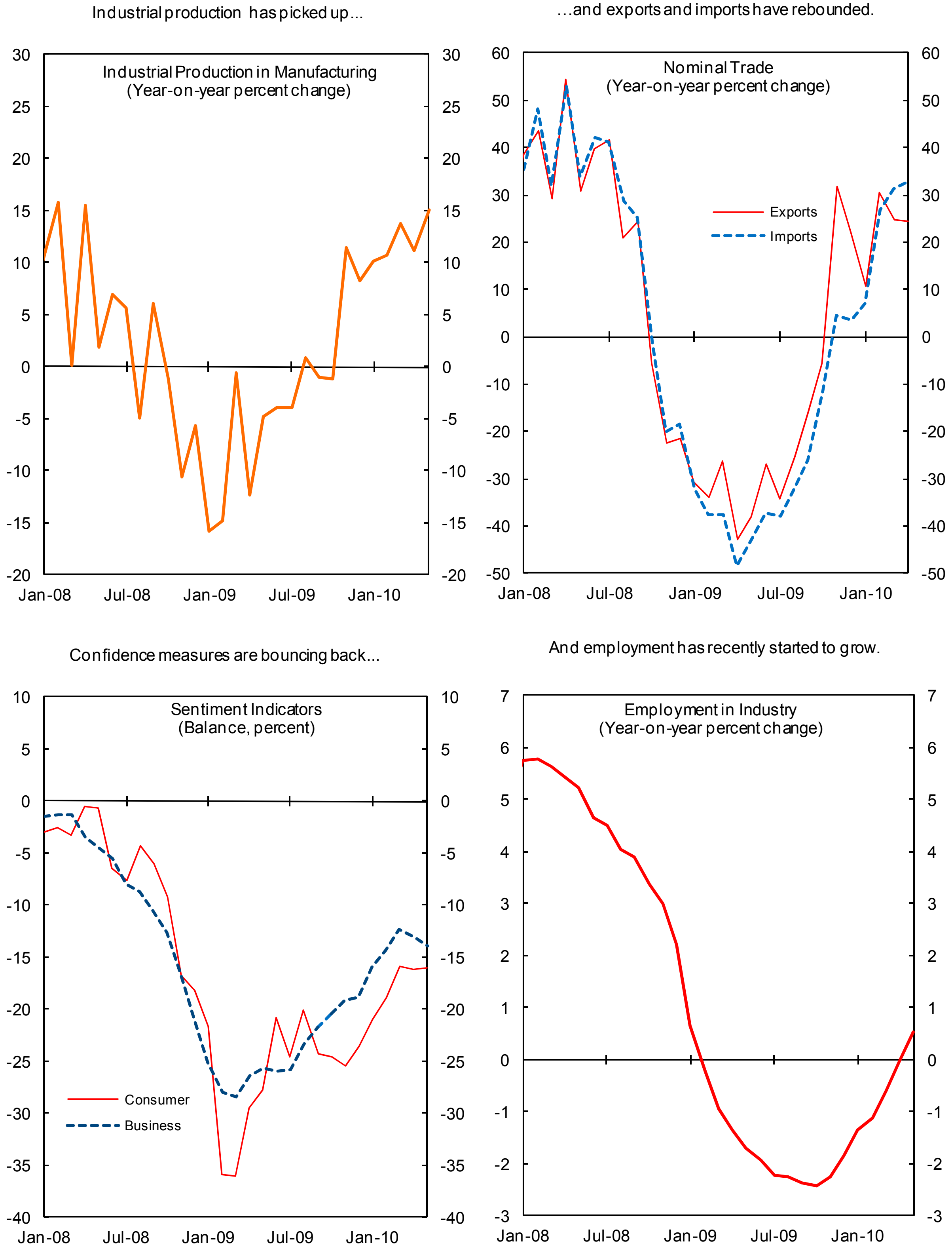
Notes: The baseline includes identified measures announced to date.
Sources: Eurostat; and IMF staff estimates.

- **Monetary policy is expected to remain on hold in the near term.** Inflation is close to the central bank's target of 2½ percent and is projected to remain at about the target over the coming 12 months. Given the uncertainties in the economic outlook and subdued inflationary pressures, the policy rate will likely stay on hold in the coming months.

- **Financial sector policies are geared toward limiting risks as credit is set to start expanding again.** Credit demand is likely to pick up over the coming year, driven by inventory restocking on the corporate side and continued robust demand for household loans. The banking system is ready to accommodate this demand as liquidity conditions have eased, capital ratios are over 13 percent, and the quality of capital is high. Given a potential build-up of liquidity risks from new foreign currency denominated lending, the KNF plans to a take measures to ensure that new mortgages are funded and hedged on a longer term basis. Non-performing loans, which reached 7.9 percent in the first quarter of 2010, are expected to start declining later this year, as economic growth picks up.

8. **Risks to the outlook are tilted to the downside, as external uncertainty looms large.** The main downside risks stem from the still-fragile economic outlook in the euro area and the possibility of further spillovers from financial strains in other parts of Europe (Figure 2). Poland has strong economic links with the euro area, and a potential slowdown in some of its main trading partners—such as Germany, which accounts for around 25 percent of Poland's exports—could dampen its growth prospects. Poland is also closely integrated into Europe's banking system—which holds about 80 percent of total external claims on Polish banks—and Poland's relatively deep financial markets allow global investors to take a regional view by buying or selling Polish securities. Moreover, large sovereign debt issuance by advanced economies could intensify funding pressures and increase financing costs for emerging economies. In recent weeks, exchange rate volatility and CDS spreads have increased. On the upside, if global risk appetite were to improve, capital inflows to Poland could accelerate, attracted by Poland's relatively better economic performance during 2009.

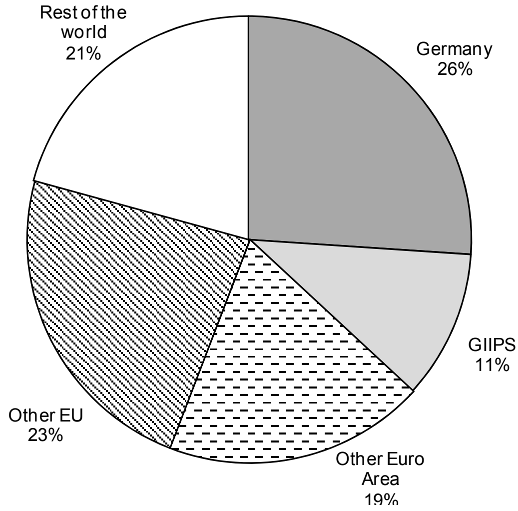
Figure 1. Poland: Recent Economic Developments, 2008-10

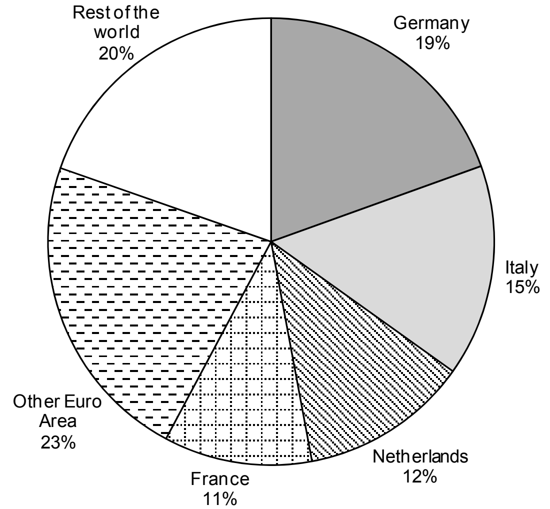


Sources: European Commission; and Polish Statistical Office.

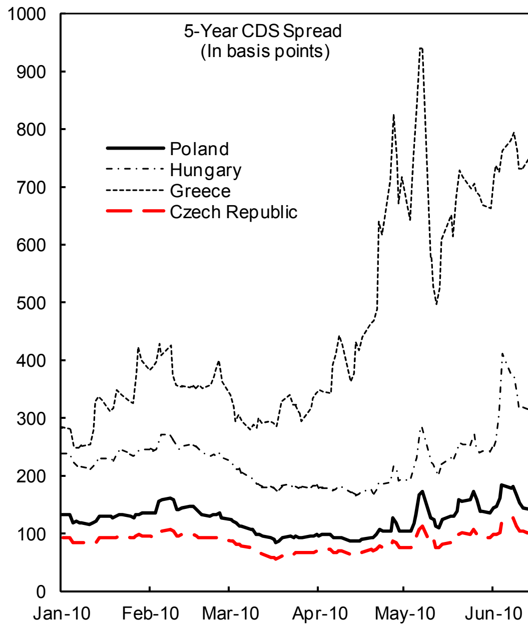
Figure 2. Poland: Linkages and Spillovers

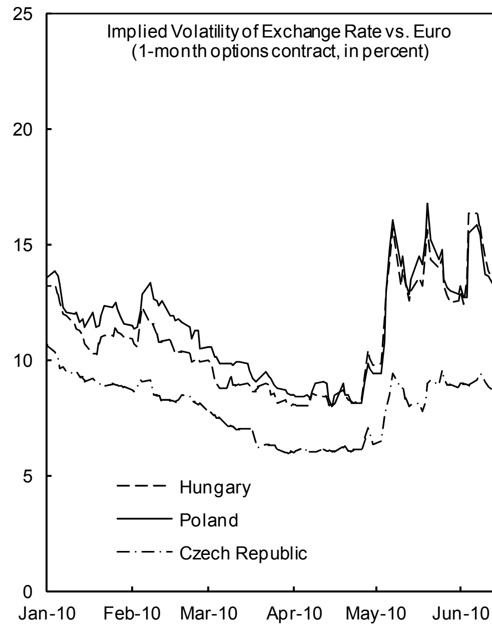
Poland is closely linked with the euro area both through trade and financial channels.





CDS spreads and exchange rate volatility have risen since April.





Source: IMF Direction of Trade Statistics; BIS; CMA; Bloomberg; and IMF staff estimates.

II. ROLE OF THE FLEXIBLE CREDIT LINE

9. **The authorities believe that the recently expired FCL arrangement has served Poland's economy well.** They indicated that access to the FCL was helpful to allow a more flexible policy response, including the acknowledgement of considerably larger fiscal deficits, without unsettling markets. Thus, the FCL has been credited, in part, for the increase in demand in the domestic bond market—which saw a return of foreign investors especially after April 2009—and the subsequent decline in yields. Moreover, after the approval of the FCL arrangement, the government was able to tap successfully international markets with long-term bond offerings that were significantly oversubscribed. The positive trend continued this year, with two large issuances of Eurobonds at spreads that were half of those paid a year ago (Figure 3).

10. **A successor one-year FCL arrangement, which they again intend to treat as precautionary, would provide useful insurance against renewed downside external risks.** The authorities believe that, while the process of global recovery is encouraging, Poland's economy remains exposed to possible external shocks that are beyond their control. In particular, risks remain, related to a fragile economic and financial environment in Europe, which represents Poland's major trade and financial partner. While international reserves are at a comfortable level, access to the FCL on a precautionary basis would help strengthen Poland's resilience to external shocks. This is expected to also have positive effects for other economies of Central and Eastern Europe.

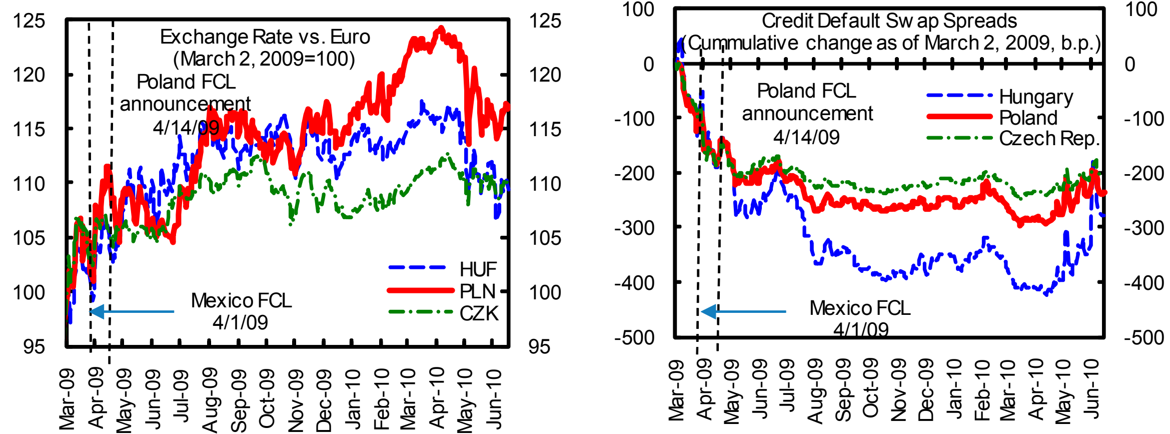
A. Access

11. **Access under the successor arrangement is proposed at the level of SDR13.69 billion ($20.1 billion, 1000 percent of quota).** Notwithstanding Poland's very strong fundamentals and sustained track record of implementing very strong policies, the uncertain external environment justifies the need for a sufficiently large buffer against tail risks. Moreover, by increasing usable reserves, the FCL arrangement would signal policy credibility and help to preserve investor confidence.

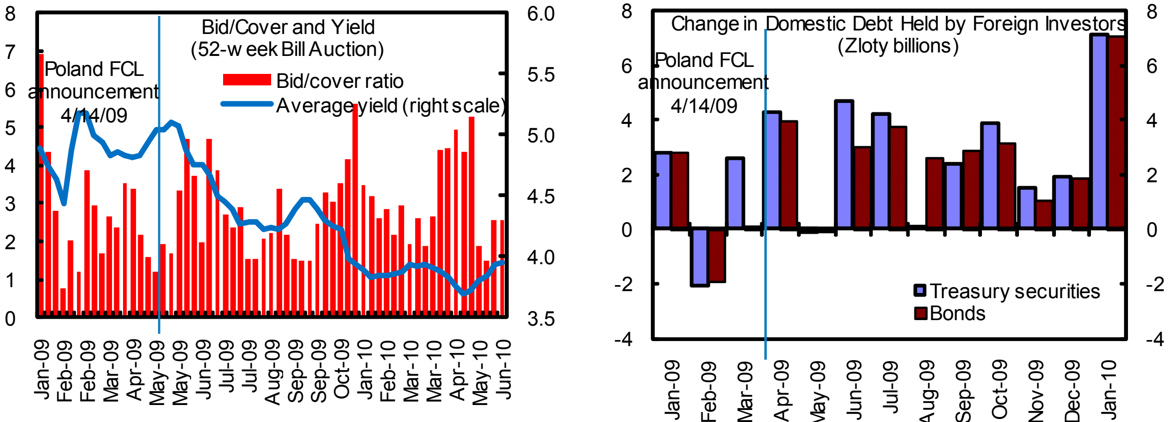
12. **Staff believes that risks to the balance of payments justify access in the requested amount.** Poland's projected external financing requirements in 2010 and 2011 are about $100 billion per year, which are expected to be fully covered under the baseline scenario. However, a decline in rollover rates, including outflows of portfolio and other investments, and a fall in foreign direct investment could lead to the emergence of a financing gap. Indeed, potential financing gaps of $17.1 billion in 2010 and $19.2 billion in 2011 arise under plausible but not extreme financing assumptions (Box 2). Therefore, continued high access under the FCL arrangement will be key in maintaining market confidence.

Figure 3. Poland: The FCL's Impact on Financial Markets, 2009-10

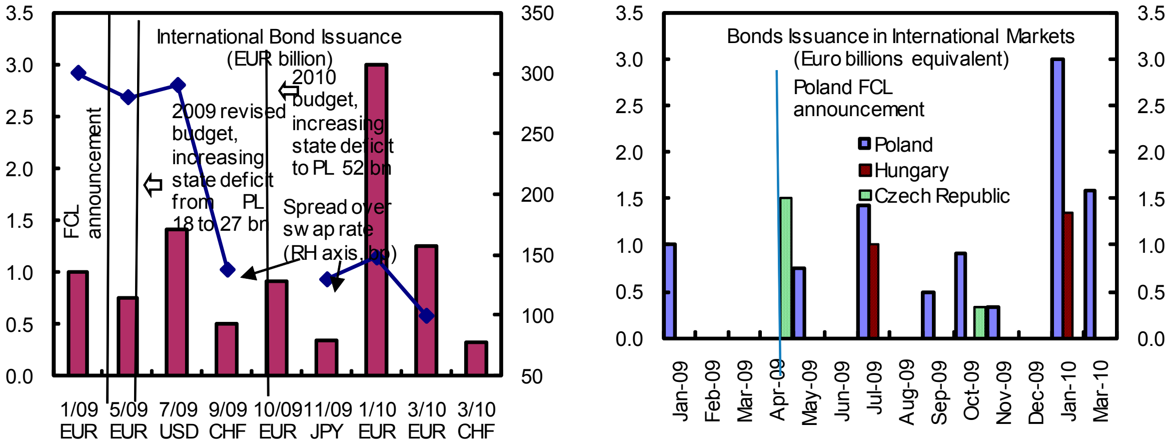
Upon the FCL's announcement, the Zloty reached a four-month high against the Euro, and CDS spreads fell.



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



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



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

Box 2. Adverse Scenario

Under an illustrative adverse scenario developed by staff, Poland's average annual external financing gap during 2010-11 could be on the order of $18.1 billion (about 900 percent of quota; see Table 3). This scenario assumes concurrent shocks to various components of Poland's balance of payments, similar to the assumptions underlying the request for the last FCL arrangement. This plausible but not extreme adverse scenario takes account of the uncertainties and risks surrounding the recovery in advanced economies in Europe and the potential spillovers, both direct and indirect, from the financing problems of some European sovereigns.

The scenario assumes that the buildup in reserves over 2010-11 envisaged in the baseline is partly maintained so as to ensure that appropriate coverage of liabilities is sustained. The proposed access level allows for a cushion of about $2 billion, covering additional potential risks.

The main assumptions underlying the adverse scenario relative to the baseline are as follows:

- A fall in FDI inflows of 15 percent relative to the baseline for 2010 and 2011. This decline is smaller than that observed in 2009 with respect to 2008.
- Equity portfolio outflows of around 5 percent of total non-resident equity holdings.
- A decline in rollover rates of 10-20 percentage points relative to the baseline assumptions that average private and government rollover rates will be around 110 percent and 185 percent, respectively, in 2010-11. The adverse scenario reflects a shortening of maturities as well as potentially higher financing pressures on locally-owned banks, corporates, and the government.
- Other investment outflows, mostly from non-resident deposits, of $2 billion.

13. **The access being requested under the FCL arrangement is consistent with other recent high-access cases**. The table below compares the access level being requested by Poland under the FCL to other high-access cases using a wide array of metrics. The various measures confirm that access for Poland at the 1,000 percent level is at or below the median of all recent high access cases, including as a share of GDP (5 percent), trade (<20 percent of exports or imports), and external debt (7 percent).

Poland: Proposed Access, 2010

					High-Access Cases 1/			
	Proposed Arrangement	Mexico FCL March 25, 2010	Colombia FCL May 7, 2010	Poland FCL May 6, 2009	Proposed Arrangement (Percentile)	20th Percentile (Ratio)	80th Percentile	Median
Access								
In millions of SDRs	13,690	31,528	2,322	13,690	80	1,424	13,557	6,023
Average annual access (percent of total)	1,000	1,000	300	1,000	94	168	551	255
Total access in percent of: 3/								
Actual quota	1,000	1,000	300	1,000	78	300	1,000	559
Gross domestic product	5	5	1	5	31	2.9	8.9	5
Gross international reserves	22	44	13	34	14	27	87	49
Exports of goods and nonfactor services	13	17	10	11	27	11.0	39.2	20.9
Imports of goods and nonfactor services	12	16	10	11	26	10.0	34.0	20
Total debt stock								
Of which: Public	9	12	5	10	23	8	32	12
External	7	24	7	8	26	7	20	12
Short-term 4/	21	105	33	21	27	20	84	33
M2	8	8	4	11	26	8	29	13

Source: Executive Board documents, MONA database, and Fund staff estimates.

1/ High access cases include available data at approval and on augmentation for all the requests to the Board since 1997 which involved the use of the exceptional circumstances clause or SRF resources. Exceptional access augmentations are counted as separate observations. For the purpose of measuring access as a ratio of different metrics, access includes augmentations and previously approved and drawn amounts.
2/ Based on scenario analysis (Scenario I) from Review of the Adequacy of and Options for Supplementing Fund Resources, EBS/09/7.
3/ The data used to calculate ratios is the actual value for the year prior to approval for public and short-term debt, and the projection at the time of program approval for the year in which the program was approved for all other variables
4/ Refers to residual maturity.

B. Qualification Criteria

14. **Staff believes that Poland fully meets the qualification criteria identified in ¶2 of the FCL decision** (Figure 4). Poland's very strong economic fundamentals and institutional policy framework, together with its sustained track record of implementing very strong policies, have allowed the authorities to adjust economic policies in a timely and effective manner in response to the global crisis. Furthermore, the authorities remain committed to maintaining very strong policies as the economic recovery gains strength. As to the relevant criteria for the purpose of assessing qualification for a successor FCL arrangement identified in ¶2 of the FCL decision, staff's assessment is as follows:

- **A sustainable external position:** The current account deficit is projected to remain at a moderate level that is close to its equilibrium norm over the medium term. The increase in external debt to around 65 percent of GDP in 2009 largely reflected currency movements; looking forward, external debt as a share of GDP is expected to gradually decline over the medium term. Moreover, the sustainability of the external debt position is generally robust to a range of standard stress scenarios.

- **A capital account position dominated by private flows:** The bulk of external debt flows in Poland's financial accounts are from private creditors, with official creditors accounting for less than 10 percent of these flows in 2009.

- **A track record of steady sovereign access to international capital markets at favorable terms:** Poland has continued to enjoy one of the highest credit ratings among emerging markets, which it has maintained despite the financial crisis in the region. From January 2009 to May 2010, the government successfully issued about €9 billion sovereign debt in international capital markets—a record among peers—at declining spreads.

- **A reserve position that is relatively comfortable when the FCL is requested on a precautionary basis:** Reserves remain broadly adequate when compared to standard metrics, with coverage of short-term external debt at remaining maturity having increased from around 70 percent at end-2008 to 80 percent at end-2009 (Figure 5).

- **Sound public finances, including a sustainable public debt position:** Fiscal policy has provided appropriate counter-cyclical support to the economy during the downturn. Looking forward, the authorities are committed to maintaining fiscal sustainability, as reflected by their announced package of fiscal consolidation measures and their updated Convergence Program. Important safeguards in this regard are the debt thresholds under the Public Finance Act and the constitutional limit on government debt. On staff's current baseline scenario, assuming no additional measures beyond those announced to date, general government debt is expected to stabilize at about 60 percent of GDP. If additional measures are taken, the debt-to-GDP ratio is projected to fall below 60 percent.

- **Low and stable inflation, in the context of a sound monetary and exchange rate policy framework**: Poland's credible and transparent inflation targeting framework allowed for significant cuts in the policy rate during the crisis. With inflation expectations well anchored, headlined inflation is projected to remain within the NBP's tolerance range for the foreseeable future.

- **The absence of bank solvency problems that pose an immediate threat of a systemic banking crisis:** Poland's banking system remains liquid, well capitalized, and profitable. There are no bank solvency problems that pose an immediate systemic threat. Stress tests undertaken by the NBP continue to show that overall the system remains resilient to adverse macroeconomic shocks.

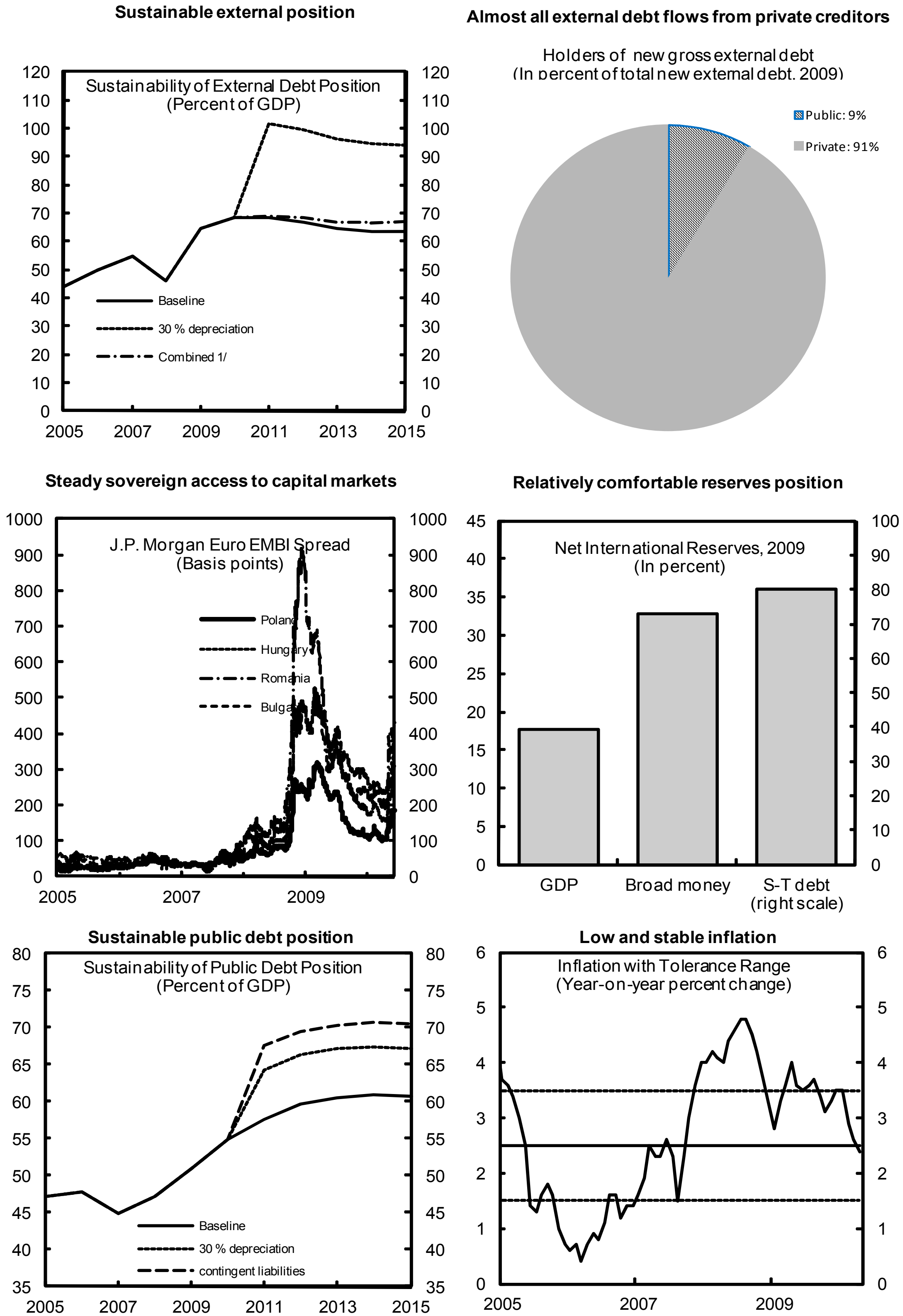
- **Effective financial sector supervision:** Poland's supervisory framework remains strong, as shown by the KNF's effective response during the crisis. The KNF continues to monitor and enforce quantitative liquidity requirements and works to ensure that all banks maintain adequate capital buffers. It is also developing bottom-up stress tests of banks to complement the NBP's top-down tests. The recent introduction of Recommendation T will strengthen lending standards.

- **Data transparency and integrity:** The overall quality of Poland's macroeconomic data is good, as acknowledged by the 2003 data ROSC. Poland subscribed to the SDDS in 1996, and the authorities provide all relevant data to the public on a timely basis. The NBP is introducing a new BoP compilation system, which will be in place with the 2010Q1 BoP release.[3]

15. **The authorities' letter (Attachment) highlights their continued commitment to implementing very strong economic policies.** The authorities' priorities are to support the ongoing recovery while maintaining macroeconomic and financial stability. They remain committed to the budgetary policy framework under the EU Stability and Growth Pact, in line with the latest Convergence Program for Poland, and to further strengthening their medium-term fiscal framework in order to maintain the sustainability of public debt. Monetary and exchange rate policies will continue to be underpinned by an inflation targeting framework and a floating exchange rate regime. They stand ready to continue to respond to shocks in a timely and effective manner, as necessary.

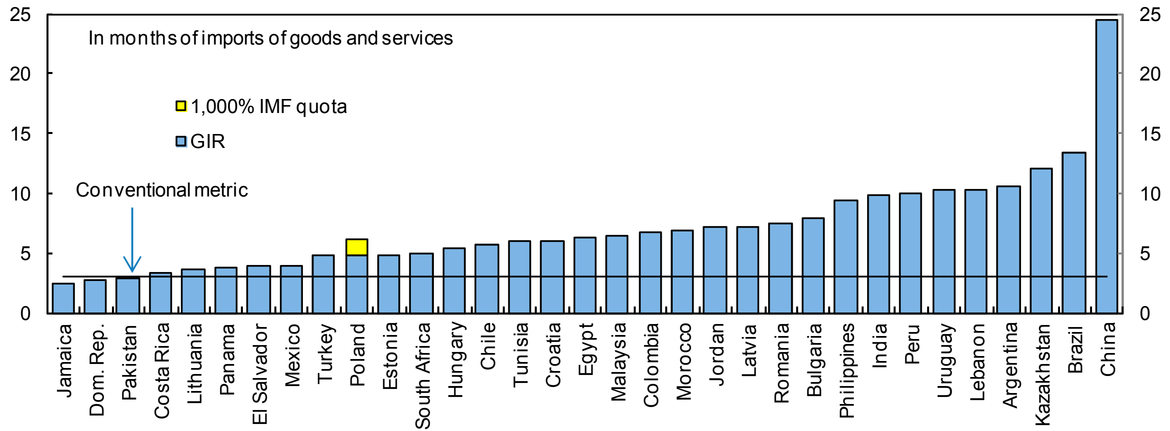
[3] The introduction of the new system is motivated, in part, by the relatively large errors and omissions in the BoP. The new system will more properly capture financial flows, in particular those related to the transactions of enterprises with nonresident enterprises within their own group. Furthermore, reconciliation of trade in goods data across sources (EU's Intrastat reporting system data and data for Poland's trading partners' exports to Poland) may result in higher Polish imports. The new system will also provide more comprehensive information on portfolio investment (especially assets) and derivatives, possibly resulting in higher measured outflows. In addition, staff have urged the authorities to continue looking into the quality of data derived from surveys of banks.

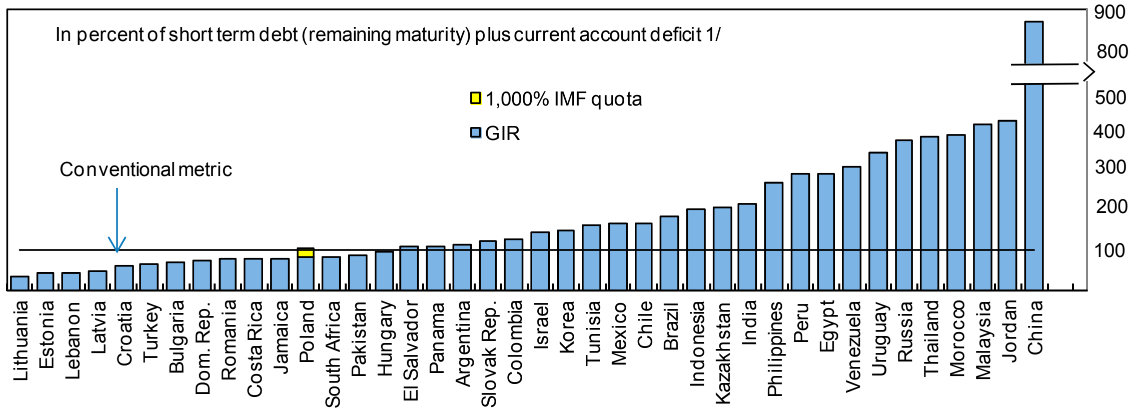
Figure 4. Poland: Qualification Criteria

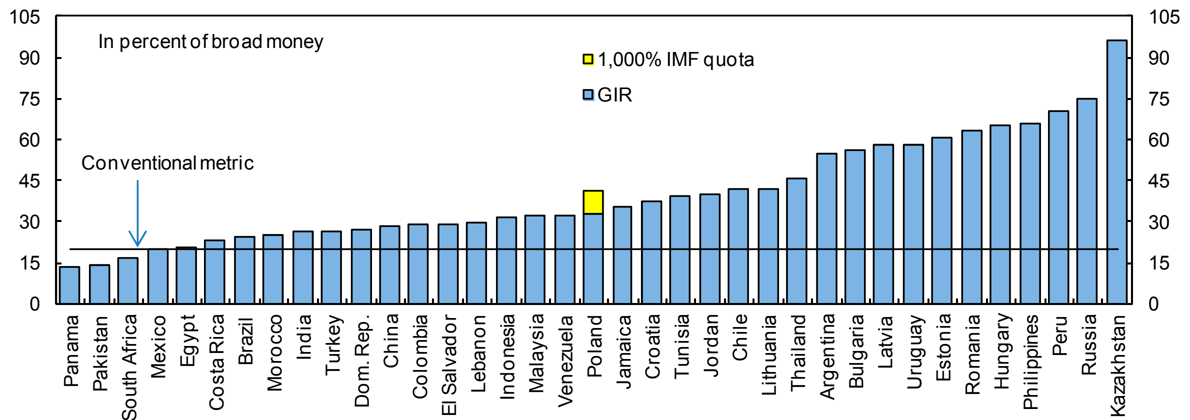


Sources: Bloomberg; Poland authorities; and IMF staff estimates.
1/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

Figure 5. Poland: Reserve Coverage in International Perspective, 2009





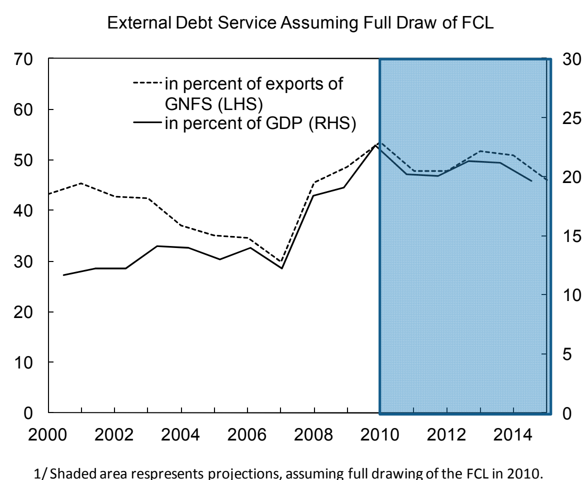


Sources: Haver Analytics; World Economic Outlook; and Fund staff estimates.
1/ Gross international reserves at end 2009 in percent of external debt at remaining maturity in 2009, plus the current account deficit projected for 2010.

III. IMPACT ON FUND FINANCES, RISKS, AND SAFEGUARDS

16. **The Fund's liquidity position is expected to remain adequate after approval of an FCL arrangement for Poland**. The impact of the proposed FCL arrangement in the amount of 1000 percent of quota (SDR 13.69 billion) on the Fund's finances and liquidity position would be manageable (see Supplement I).

17. **Poland's capacity to repay the Fund is strong**. The authorities have indicated that they intend to treat the arrangement as precautionary. Nevertheless, even if a full drawing under the FCL arrangement were made, Poland's capacity to fulfill its financial obligations to the Fund would not be an issue. Poland has an excellent track record of meeting its obligations to the Fund, the government has a deep commitment to macroeconomic stability and prudent fiscal policies, and the economy's medium-term growth prospects remain strong. Moreover, even if the adverse scenario were to materialize, Poland's external debt would stay on a sustainable medium-term path, with debt service remaining manageable.



1/ Shaded area respresents projections, assuming full drawing of the FCL in 2010.

Poland: Indicators of Fund Credit, 2010-15

	Projections					
	2010	2011	2012	2013	2014	2015
Stocks from prospective drawings 1/						
Fund credit in millions SDR	13,690	13,690	13,690	10,268	3,423	0
in percent of quota	1,000	1,000	1,000	750	250	0
in percent of GDP	5	4	4	3	1	0
in percent of exports of goods and services	11	10	10	7	2	0
in percent of gross reserves 2/	23	21	21	15	5	0
Flows from prospective drawings 3/						
GRA Charges	58	170	170	168	109	26
Level Based Surcharge	65	192	192	220	141	5
Service Charges	68	0	0	0	0	0
Principal	0	0	0	3,423	6,845	3,423
Debt Service due on GRA credit (millions SDR)	191	361	362	3,810	7,095	3,454
in percent of quota	14	26	26	278	518	252
in percent of GDP	0	0	0	1	2	1
in percent of exports of goods and services	0	0	0	3	4	2
in percent of gross reserves 2/	0	1	1	5	10	5
Memo Item:						
Total external debt, assuming full drawing (in percent of GDP)	73	73	71	68	65	63

Sources: IMF Finance Department; Polish authorities; and IMF staff estimates.

1/ End of Period. Assumes full drawing under the FCL upon approval. The Polish authorities have expressed their intention to treat the arrangement as precautionary. At an SDR/USD rate of 0.679994 as of June 22, 2010.
2/ Excludes IMF purchases.
3/ Based on the rate of charge as of mid-June 2010. Includes surcharges under the system currently in force and service charges.

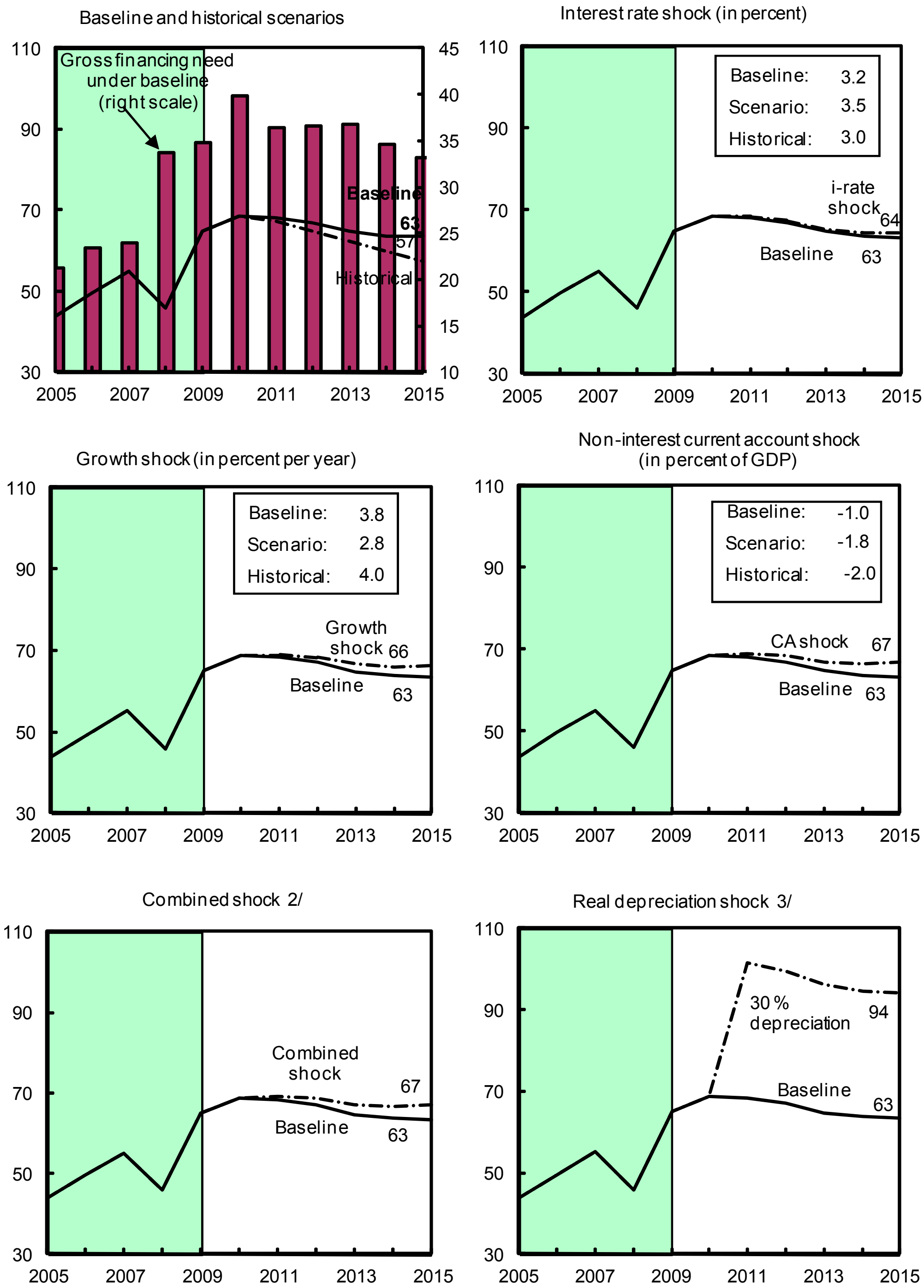
18. **Staff has completed the safeguard assessment procedures required for an FCL arrangement.** Safeguards procedures applicable to FCL arrangements require Fund staff to review the most recently completed external audit of the member's central bank. An authorization for staff to communicate directly with the NBP's external auditor, PricewaterhouseCoopers (PwC) Warsaw, has been provided by the authorities. Staff has reviewed the audited information provided by PwC for 2009 and discussed the results of the audit with the audit partner on June 21. No significant safeguards issues emerged from the conduct of these procedures. PwC issued an unqualified audit opinion on the NBP's 2009 financial statements on March 29, 2010.

IV. Staff Appraisal

19. **A successor FCL arrangement for Poland would play an important role in supporting the government's economic policy strategy.** Although Poland's underlying fundamentals and medium-term prospects remain very strong, uncertainties about the recovery in the euro area and the possibility of spillovers from financial strains in other parts of Europe—in the context of Poland's large and open capital markets—present risks to the near-term outlook. A successor FCL arrangement for 1,000 percent of quota, which the authorities intend to treat as precautionary, would provide Poland with additional protection against a possible deterioration of external conditions and help to maintain confidence in the authorities' capacity to withstand external shocks without jeopardizing macroeconomic stability.

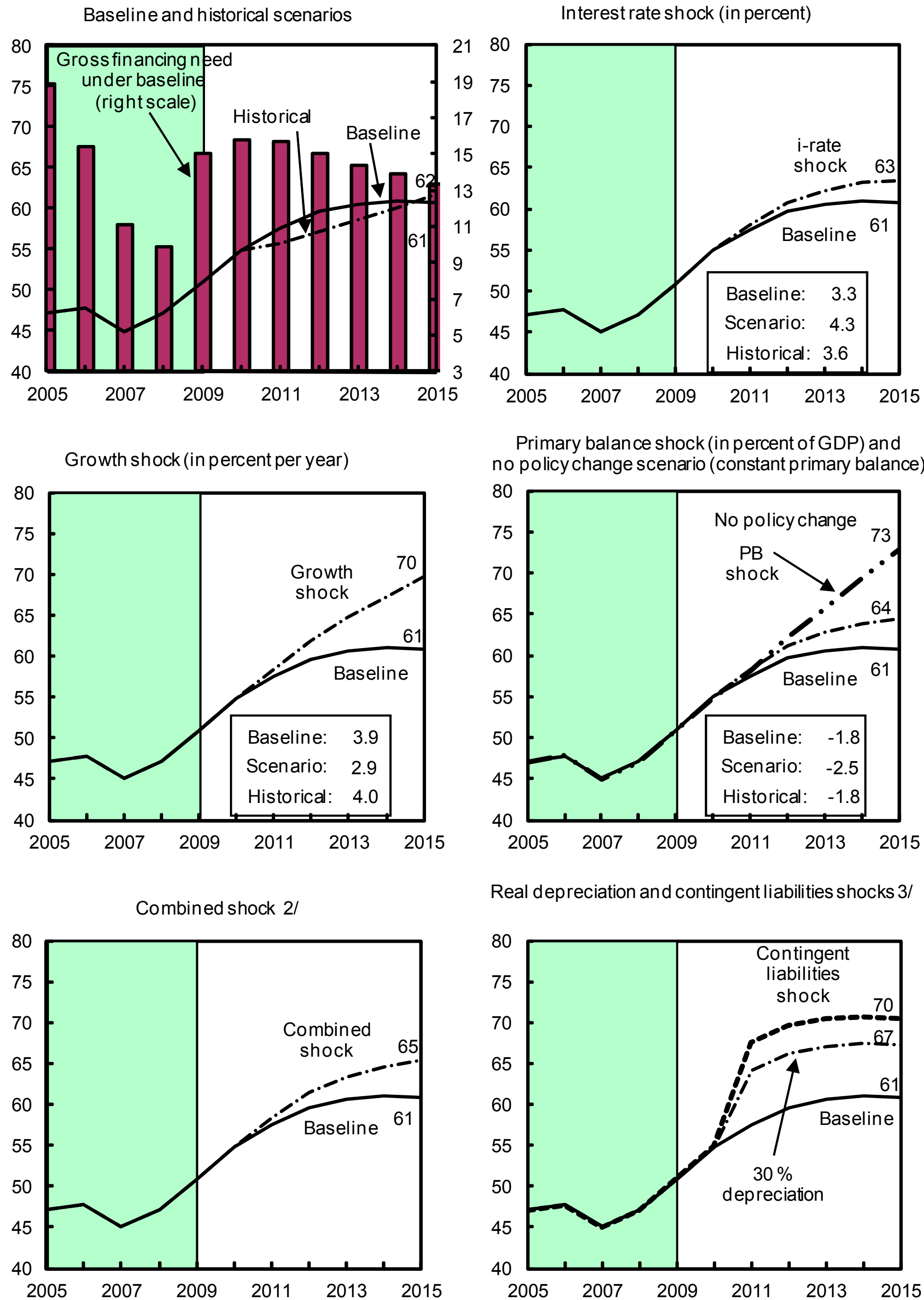
20. **The staff assesses that Poland meets the qualification criteria for access to FCL resources and recommends approval of a one-year FCL arrangement for SDR 13.69 billion (1,000 percent of quota).** The authorities' policy response to the global crisis was appropriate. Their sustained track record of maintaining very strong economic policies and their letter reaffirming a commitment to maintaining such policies in the future together provide very strong reassurance that they would react appropriately to any future balance of payments difficulties. Risks to the Fund are contained by the very strong policy setting, the authorities' intent to treat the FCL arrangement as precautionary, and Poland's very strong debt-servicing record and manageable external debt-service profile. As discussed above, Poland fully meets the qualification criteria for use of GRA resources under the FCL, and this is consistent with the very positive assessment of policies by the Executive Board in the context of the recently concluded Article IV Consultation.

Figure 6. Poland: External Debt Sustainability: Bound Tests, 2005-15 1/
(External debt in percent of GDP)



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

Figure 7. Poland: Public Debt Sustainability: Bound Tests, 2005-15 1/
(Public debt in percent of GDP)



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

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

	2007	2008	2009	2010 Proj.	2011 Proj.
Activity and prices					
GDP (change in percent)	6.8	5.1	1.8	3.1	3.5
Domestic demand	8.7	5.6	-1.0	2.6	3.8
Private consumption growth	4.9	5.7	2.3	2.0	3.2
Public consumption growth	3.7	7.4	1.9	2.1	3.0
Domestic fixed investment growth	17.6	9.6	-0.8	-0.5	6.0
Net external demand (contribution to growth)	-2.1	-0.6	2.9	0.5	-0.4
CPI inflation (change in percent)					
Average	2.5	4.2	3.5	2.5	2.5
End of period	4.0	3.3	3.5	2.5	2.5
Unemployment rate (average, according to LFS)	9.6	7.1	8.2	9.9	9.6
Public finances (percent of GDP) 2/					
General government revenues	40.3	39.5	37.3	39.6	39.8
General government expenditures	42.2	43.2	44.4	46.7	46.4
General government balance	-1.9	-3.7	-7.1	-7.1	-6.6
Public debt	45.0	47.1	50.9	54.9	57.5
national definition 3/	44.8	46.9	49.8	53.4	…
Money and credit					
Private credit (12-month change)	29.5	36.3	10.0	. . .	. . .
Broad money (12-month change)	13.4	18.6	8.1	. . .	. . .
Policy Rate 4/	5.0	5.0	3.5	3.5	. . .
Balance of payments					
Current account balance (transactions, millions U.S. dollars	-20,253	-26,909	-7,207	-10,366	-12,322
Percent of GDP	-4.8	-5.1	-1.7	-2.4	-2.6
Exports of Goods (millions U.S. dollars)	145,337	178,427	139,956	153,474	163,024
Export volume growth	9.1	7.1	-11.4	4.8	5.5
Imports of Goods (millions U.S. dollars)	162,394	204,399	144,432	162,743	173,901
Import volume growth	13.7	8.0	-17.2	3.4	6.3
Net oil imports (millions U.S. dollars)	13,438	19,273	12,485	15,659	16,665
Terms of trade (index 1995=100)	98.9	97.3	101.8	97.8	97.9
FDI, net (in percent of GDP)	4.2	2.2	2.0	2.4	2.4
Official reserves (millions U.S. dollars)	65,746	62,180	79,591	89,441	94,095
months of imports (goods)	4.9	3.7	6.6	6.6	6.5
Total external debt (millions U.S. dollars)	234,052	243,477	279,528	300,236	317,881
Percent of GDP	55.0	46.0	64.9	68.7	68.3
Ratio of reserves to short-term debt	103.3	72.4	80.0	83.5	100.6
Exchange rate					
Exchange rate regime		Floating			
Zloty per US$, period average 5/	2.77	2.41	3.12	3.29	. . .
Zloty per Euro, period average 5/	3.79	3.52	4.33	4.05	. . .
Real effective exchange rate (INS, CPI based) 6/	114.2	125.7	106.5	115.8	. . .
percent change	3.8	10.0	-15.3	8.7	

Sources: Polish authorities; and IMF staff estimates.
1/ Derived as total savings minus the current account minus capital transfers.
2/ According to ESA95 (including pension reform costs). Including the authorities' recent fiscal consolidation package.
3/ Excluding debts of the National Road Fund.
4/ NBP Reference Rate (eop). For 2010, latest.
5/ For 2010, exchange rate as of June 22.
6/ Annual average (2000=100); for 2010, January-April average.

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

	2007	2008	2009	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
Current account balance	**-20,253**	**-26,909**	**-7,207**	**-10,366**	**-12,322**	**-15,443**	**-16,653**	**-17,851**	**-18,041**
percent of GDP	-4.8	-5.1	-1.7	-2.4	-2.6	-3.1	-3.1	-3.1	-3.0
Trade balance	-17,057	-25,972	-4,476	-9,269	-10,877	-13,111	-14,765	-16,442	-17,862
percent of GDP	-4.0	-4.9	-1.0	-2.1	-2.3	-2.6	-2.7	-2.9	-3.0
Exports									
percentage change in unit values	26.2	22.8	-20.0	9.7	6.2	6.1	6.8	7.0	7.0
percentage volume growth	9.1	7.1	-11.4	4.8	5.5	6.2	6.6	6.7	6.6
growth in foreign demand	8.7	3.1	-16.4	4.5	4.0	4.9	5.5	5.6	5.6
Imports									
percentage change in unit values	29.3	26.0	-28.6	12.7	6.9	7.0	7.2	7.3	7.1
percentage volume growth	13.7	8.0	-17.2	3.4	6.3	6.6	6.9	6.9	6.9
growth in domestic demand	8.7	5.6	-1.0	2.6	3.7	3.7	4.1	4.2	4.2
Terms of trade percentage change	1.7	-1.6	4.6	-4.0	0.1	-0.5	-0.1	0.0	0.2
Services balance	4,758	5,016	4,834	4,873	5,704	5,790	5,781	5,825	6,386
Credit	28,914	35,577	28,945	32,041	34,735	36,854	39,081	41,555	44,653
Debit	24,156	30,561	24,111	27,168	29,031	31,064	33,301	35,729	38,267
Net Income	-16,448	-14,210	-14,137	-14,159	-14,022	-14,722	-15,162	-14,408	-14,509
Net transfers	8,494	8,257	6,572	8,190	6,873	6,601	7,493	7,173	7,945
o/w EU receipts	4,523	3,885	4,610	4,881	4,846	5,570	6,489	6,251	6,622
o/w payment to EU	-3,630	-3,934	-5,194	-4,574	-4,673	-4,649	-4,624	-4,600	-4,577
Capital and financial account balance	**43,650**	**46,501**	**43,071**	**41,338**	**38,097**	**40,421**	**41,906**	**42,860**	**42,631**
Capital account balance	4,771	6,118	7,026	10,270	8,307	9,561	11,153	10,727	9,715
o/w net EU transfers	4,660	5,828	6,911	9,463	8,043	9,245	10,770	10,374	9,420
Financial account balance	38,879	40,383	36,045	31,068	29,790	30,860	30,753	32,133	32,916
Foreign direct investment (net)	17,987	11,747	8,622	11,364	12,184	14,555	15,941	17,493	19,208
by nonresidents	23,651	14,849	11,546	12,364	13,434	16,055	17,691	19,493	21,458
o/w privatization	95	100	1,263	2,517	380	128	129	128	125
Portfolio investment (net)	-5,415	-2,082	15,869	12,854	8,403	6,574	4,945	5,012	4,528
by non-residents	925	-4,439	16,220	14,254	9,850	8,072	6,504	6,634	6,217
o/w equities	-470	564	1,568	2,870	2,966	3,072	3,035	3,158	3,289
Other investment (net)	28,353	31,512	12,932	6,850	9,203	9,731	9,867	9,628	9,180
Assets	-1,771	5,426	5,318	-2,475	-1,558	-1,613	-1,678	-1,746	-1,818
Liabilities	30,124	26,086	7,614	9,324	10,761	11,345	11,544	11,374	10,998
Financial derivatives	-2,046	-794	-1,378	0	0	0	0	0	0
Errors and omissions	**-10,360**	**-21,556**	**-21,122**	**-21,122**	**-21,122**	**-21,122**	**-21,122**	**-21,122**	**-21,122**
Overall balance	**13,037**	**-1,964**	**14,742**	**9,850**	**4,654**	**3,857**	**4,132**	**3,887**	**3,469**
Financing									
Reserve assets	-13,037	1,964	-14,742	-9,850	-4,654	-3,857	-4,132	-3,887	-3,469
Memorandum items:									
Current plus capital account (percent of GDP)	-3.6	-3.9	0.0	0.0	-0.9	-1.2	-1.0	-1.2	-1.4
Official reserves	65,746	62,180	79,591	89,441	94,095	97,952	102,083	105,970	109,438
in months of imports	3.9	5.2	5.9	6.2	6.1	5.9	5.7	5.5	6.1
Ratio of reserves to short-term debt 1/	103.3	72.4	80.0	83.5	100.6	102.2	99.3	104.7	108.7
Ratio of reserves to ST debt plus CA deficit 1/	72.2	55.8	73.2	75.3	88.4	87.5	84.9	88.5	91.7
Total external debt (percent of GDP)	55.0	46.0	64.9	68.7	68.3	67.1	64.8	63.7	63.4
Total external debt (percent of exports) 2/	134.3	113.8	165.5	161.8	160.7	159.3	156.1	152.2	147.6
External debt service (percent of exports) 2/ 3/	29.8	45.5	48.6	53.4	47.5	47.6	49.2	46.6	44.1
Gross FDI inflows (percent of GDP)	5.6	2.8	2.7	2.8	2.9	3.2	3.3	3.4	3.6
Net FDI inflows (percent of GDP)	4.2	2.2	2.0	2.6	2.6	2.9	3.0	3.1	3.2

Sources: National Bank of Poland; and IMF staff estimates.
1/ Reserve level at end of previous year over short-term debt by remaining maturity.
2/ Exports of goods and services.
3/ Excluding repurchase of debt and including deposits.

Table 3. Poland: External Financing Requirements and Sources, 2008-11
(In million of U.S. dollars)

	2008	2009	2010	2010	Contribution to	2011	2011	Contribution to
		Est.	Proj.	Adv. scenario	gap	Proj.	Adv. scenario	gap
GROSS FINANCING REQUIREMENTS (A)	**109,481**	**82,550**	**100,780**	**100,780**		**101,223**	**101,223**	
Current account deficit	26,909	7,207	10,366	10,366		12,322	12,322	
Medium and long-term debt amortization	29,982	12,675	26,243	26,243		20,349	20,349	
Public sector	2,660	697	6,821	6,821		4,187	4,187	
Banks	4,453	3,202	6,637	6,637		7,745	7,745	
Non-bank Corporates	22,869	8,776	12,785	12,785		8,417	8,417	
Short-term debt amortization	52,590	62,668	64,172	64,172		68,552	68,552	
Public sector	6	213	1,917	1,917		1,725	1,725	
Banks (inc. s.t. deposits)	17,482	29,189	29,100	29,100		29,631	29,631	
Non-bank Corporates	35,102	33,266	33,155	33,155		37,196	37,196	
o/w trade credit	29,234	27,296	27,205	27,205		30,521	30,521	
SOURCES OF FINANCING (B)	**107,517**	**97,292**	**110,631**	**88,636**		**105,876**	**84,392**	
Foreign direct investment (net)	11,747	8,622	11,364	9,660	**1,705**	12,184	10,356	**1,828**
o/w inward (net)	14,849	11,546	12,364	10,510		13,434	11,419	
Equities (net)	2,021	802	2,564	1,426	**1,138**	2,651	1,512	**1,138**
by nonresidents	564	1,568	2,870	1,732		2,966	1,828	
New borrowing and debt rollover	97,867	93,501	108,724	91,572		104,997	88,479	
Medium and long-term borrowing	35,199	29,329	40,172	33,127		29,740	24,350	
Public sector	-9,019	16,711	19,791	16,823	**2,969**	11,157	9,484	**1,674**
Banks	12,628	3,842	6,957	5,565	**1,391**	8,735	6,988	**1,747**
Non-bank Corporates	31,590	8,776	13,424	10,739	**2,685**	9,848	7,878	**1,970**
Short-term borrowing	62,668	64,172	68,552	58,445		75,257	64,129	
Public sector	213	1,917	1,725	1,725		1,639	1,639	
Banks	29,189	29,100	29,631	25,103	**4,528**	30,520	25,856	**4,664**
Foreign subsidiaries to parent banks	20,454	20,945	21,327	18,128		21,967	18,672	
Other	7,964	8,155	8,304	6,975		8,553	7,185	
Non-bank Corporates	33,266	33,155	37,196	31,616	**5,579**	43,098	36,633	**6,465**
EU transfers	5,828	6,911	9,463	9,463		8,043	8,043	
Other investment	-9,946	-12,544	-21,485	-23,485	**2,000**	-21,998	-23,998	**2,000**
GROSS RESERVES ACCUMULATION (C)	**-1,964**	**14,742**	**9,850**	**4,925**	**-4,925**	**4,654**	**2,327**	**-2,327**
FINANCING GAP (B - A - C)	**0**	**0**	**0**	**-17,069**	**17,069**	**0**	**-19,157**	**19,157**
In millions of SDR					11,607			13,027
In percent of quota					848%			952%

Sources: National authorities; and IMF staff estimates .

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

(In percent)

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

Sources: National Bank of Poland; and KNF.

1/ Data for domestic banking sector.

2/ Data are from KNF and for 2009Q3.

Table 5. Poland: General Government Revenues and Expenditures, 2008-15
(In percent of GDP, ESA95 basis)

	2008	2009 Est.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
General government revenue	39.5	37.3	39.6	39.8	40.4	40.8	40.8	40.9
Taxes	22.8	20.3	20.9	21.2	21.5	21.6	21.6	21.7
Indirect taxes	14.2	12.8	13.4	13.5	13.7	13.7	13.7	13.7
Direct taxes	8.6	7.4	7.5	7.7	7.8	7.9	7.9	8.0
Capital taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social contributions	11.3	11.3	11.3	11.2	11.3	11.4	11.5	11.6
Other current revenue	5.0	5.1	5.4	5.2	5.1	5.1	5.0	5.0
Capital revenue	0.4	0.6	2.0	2.1	2.4	2.7	2.7	2.6
General government expenditure	43.2	44.4	46.7	46.4	46.0	45.5	45.1	44.6
Goods and services	6.2	5.6	6.0	6.0	6.0	6.0	6.0	6.0
Compensation of employees	10.0	10.2	10.0	10.0	9.7	9.5	9.2	8.9
Interest payments	2.2	2.6	2.9	3.0	3.1	3.2	3.3	3.3
Subsidies	0.6	0.5	0.6	0.6	0.6	0.5	0.5	0.5
Social benefits	16.1	17.0	17.1	16.6	16.2	15.7	15.6	15.5
Other current expenditure	2.6	2.3	2.3	2.2	2.2	2.1	2.1	2.0
Capital transfers and investment	5.5	6.3	7.9	8.1	8.2	8.5	8.4	8.4
General government balance	-3.7	-7.1	-7.1	-6.6	-5.5	-4.7	-4.2	-3.7
Memorandum items:								
Structural balance	-4.5	-6.9	-6.8	-6.4	-5.4	-4.7	-4.2	-3.7
Primary balance	-1.5	-4.5	-4.2	-3.6	-2.4	-1.5	-0.9	-0.4
Structural primary balance	-2.3	-4.3	-3.9	-3.4	-2.3	-1.5	-0.9	-0.4
Public debt	47.1	50.9	54.9	57.5	59.6	60.5	60.9	60.7

Sources: Eurostat; and IMF staff estimates.

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

Table 6. Poland: Monetary Accounts, 2004-10 (eop)

	2004	2005	2006	2007	2008	2009	Mar-10
			(In billions of zloty)				
Monetary Survey							
Net foreign assets	148	180	167	121	67	76	95
Net domestic assets	369	384	469	573	816	887	850
Claims on Central Government (Net)	69	65	73	62	104	101	94
Claims on Other Resident Sectors	279	303	373	483	658	724	719
Broad money	378	427	495	562	666	720	722
Money	182	221	276	335	350	389	390
Quasimoney	196	206	219	226	317	331	332
Capital accounts	91	96	99	106	122	169	174
Accounts of the NBP							
Net foreign assets	114	138	138	140	177	212	227
Net domestic assets	-24	-47	-41	-39	-22	-49	-91
Net claims on government	-14	-16	-17	-26	-21	-23	-25
Claims on government	0	0	0	0	0	0	0
Liabilities government	14	16	17	26	21	23	25
Claims on Other General Govt.	0	0	0	0	0	0	0
Claims on Other Resident Sectors	0	0	0	0	0	0	0
Net claims on banks	-11	-31	-24	-13	0	-27	-67
Other items, net	17	16	5	-9	18	5	1
Base money	69	71	87	103	126	138	115
o/w Currency in circulation	56	63	75	86	102	100	97
NBP Capital	3	3	3	4	5	19	19
Deposit Money Banks							
Net foreign assets	34	42	29	-19	-110	-136	-132
Net domestic assets	394	432	510	613	838	936	941
Domestic credit	361	384	462	571	783	847	838
Net claims on government	83	81	90	88	125	123	119
Claims on Other Resident Sectors	278	303	373	483	658	724	719
Banks' reserves	18	14	18	26	36	48	27
Other claims on NBP	14	34	29	16	18	41	77
Deposit	334	377	429	484	575	635	638
Demand deposits	124	162	205	254	253	298	300
Other deposits	210	215	224	229	323	338	338
Liabilities to the NBP	3	2	5	3	18	14	11
Banks' capital	88	92	96	102	117	150	155
Memorandum items:							
Nominal GDP	925	983	1,060	1,177	1,273	1,273	
Nominal GDP growth	9.7	6.4	7.8	11.0	8.2	0.0	
		(Percentage change from end of previous year)					
Base money	4.3	1.9	23.1	18.2	23.1	8.8	-7.7
Broad money	5.5	13.1	16.0	13.4	18.6	8.1	5.5
Net domestic assets	14.0	4.0	22.1	22.3	42.3	8.6	0.0
Net foreign assets	8.9	21.7	-7.5	-27.5	-44.5	13.4	34.5
Net claim on government	-7.2	-6.5	12.8	-14.9	67.9	-3.2	-15.4
Credit to other resident sectors	17.7	8.9	22.9	29.4	36.3	10.0	3.7
Deposit growth	8.3	12.8	13.8	12.7	19.0	10.5	7.7
Demand deposits	47.5	30.7	26.4	24.0	-0.6	17.8	16.1
Other deposits	-6.4	2.2	4.4	2.4	40.7	4.7	1.2
			(In percent of GDP)				
Broad money	40.8	43.4	46.7	47.7	52.3	56.6	
Domestic credit	40.0	39.1	44.2	48.7	64.1	69.7	
Private sector credit	30.1	30.9	35.2	41.0	51.7	56.9	
Velocity	2.4	2.3	2.1	2.1	1.9	1.8	
Money multiplier	5.5	6.1	5.7	5.5	5.3	5.2	

Sources: IFS and staff estimates and projections.

Table 7. Poland: External Debt Sustainability Framework, 2005-2015
(In percent of GDP, unless otherwise indicated)

	Actual				**Estimate**	**Projections**						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	43.7	49.6	55.0	46.0	64.9	**68.7**	**68.3**	**67.1**	**64.8**	**63.7**	**63.4**	**-4.2**
Change in external debt	-7.6	5.9	5.4	-9.0	18.9	3.8	-0.4	-1.2	-2.3	-1.1	-0.3	
Identified external debt-creating flows (4+8+9)	-11.2	-7.1	-10.5	-8.6	9.2	-3.0	-3.0	-3.0	-3.2	-3.3	-3.6	
Current account deficit, excluding interest payments	0.1	1.5	3.6	3.8	0.7	1.5	1.6	1.5	1.0	0.7	0.4	
Deficit in balance of goods and services	0.7	1.8	2.9	4.0	-0.1	1.0	1.1	1.5	1.7	1.9	1.9	
Exports	37.1	40.4	41.0	40.4	39.2	42.4	42.5	42.1	41.5	41.8	43.0	
Imports	37.7	42.2	43.9	44.4	39.1	43.4	43.6	43.6	43.2	43.7	44.9	
Net non-debt creating capital inflows (negative)	-3.8	-5.0	-5.5	-2.9	-3.0	-3.5	-3.5	-3.8	-3.8	-4.0	-4.2	
Automatic debt dynamics 1/	-7.5	-3.6	-8.6	-9.6	11.5	-1.0	-1.1	-0.7	-0.3	0.0	0.1	
Contribution from nominal interest rate	1.1	1.2	1.2	1.2	1.0	0.9	1.1	1.6	2.1	2.5	2.6	
Contribution from real GDP growth	-1.5	-2.4	-2.7	-2.3	-1.0	-1.9	-2.2	-2.3	-2.5	-2.5	-2.5	
Contribution from price and exchange rate changes 2/	-7.1	-2.4	-7.1	-8.6	11.5	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	3.6	13.0	15.8	-0.4	9.7	6.8	2.7	1.8	1.0	2.2	3.4	
External debt-to-exports ratio (in percent)	118.0	122.9	134.3	113.8	165.5	161.8	160.7	159.3	156.1	152.2	147.6	
Gross external financing need (in billions of US dollars) 4/	64.7	80.0	101.7	178.6	150.0	174.7	169.8	182.8	198.0	198.0	198.2	
in percent of GDP	21.3	23.4	23.9	33.7	34.8	39.8	36.3	36.5	36.5	34.4	33.1	
Scenario with key variables at their historical averages 5/						**68.7**	**67.1**	**65.0**	**62.5**	**59.9**	**57.4**	**-7.4**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	3.6	6.2	6.8	5.1	1.8	3.1	3.5	3.7	4.0	4.1	4.1	
GDP deflator in US dollars (change in percent)	15.9	5.8	16.6	18.4	-20.0	-1.3	3.0	3.4	4.0	1.9	0.1	
Nominal external interest rate (in percent)	2.5	3.0	3.0	2.8	1.8	1.4	1.7	2.5	3.4	4.0	4.2	
Growth of exports (US dollar terms, in percent)	18.2	22.5	26.2	22.8	-21.1	9.8	6.6	6.1	6.7	6.9	7.1	
Growth of imports (US dollar terms, in percent)	13.7	25.8	29.3	26.0	-28.3	12.7	6.9	7.0	7.2	7.3	7.1	
Current account balance, excluding interest payments	-0.1	-1.5	-3.6	-3.8	-0.7	-1.5	-1.5	-1.5	-1.0	-0.7	-0.4	
Net non-debt creating capital inflows	3.8	5.0	5.5	2.9	3.0	3.5	3.5	3.8	3.8	3.9	4.1	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

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

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

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

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

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

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

	Actual					Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	**Debt-stabilizing primary balance 9/**
Baseline: Public sector debt 1/	47.1	47.7	45.0	47.1	50.9	**54.9**	**57.5**	**59.6**	**60.5**	**60.9**	**60.7**	**-0.5**
o/w foreign-currency denominated	10.6	10.1	10.3	11.2	11.4	13.9	13.5	13.0	12.5	12.2	2.6	
Change in public sector debt	1.4	0.6	-2.8	2.1	3.8	3.9	2.6	2.1	0.9	0.4	-0.2	
Identified debt-creating flows (4+7+12)	2.2	-0.9	-4.4	2.3	4.0	3.9	2.6	2.1	0.9	0.4	-0.2	
Primary deficit	1.3	1.0	-0.4	1.5	4.5	4.2	3.6	2.4	1.5	0.9	0.4	
Revenue and grants	39.4	40.2	40.3	39.5	37.3	39.6	39.8	40.4	40.8	40.8	40.8	
Primary (noninterest) expenditure	40.6	41.2	39.9	41.0	41.8	43.8	43.4	42.8	42.3	41.8	41.2	
Automatic debt dynamics 2/	1.0	-1.9	-4.0	0.9	-0.2	1.0	-0.3	-0.1	-0.5	-0.5	-0.6	
Contribution from interest rate/growth differential 3/	0.1	-0.8	-2.4	-1.3	0.2	1.0	-0.3	-0.1	-0.5	-0.5	-0.6	
Of which contribution from real interest rate	1.6	2.0	0.5	0.9	1.0	2.6	1.5	1.9	1.8	1.8	1.8	
Of which contribution from real GDP growth	-1.6	-2.7	-2.9	-2.1	-0.8	-1.5	-1.8	-2.0	-2.3	-2.3	-2.4	
Contribution from exchange rate depreciation 4/	0.9	-1.1	-1.5	2.1	-0.4	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	-0.3	-1.3	-0.7	-0.1	-0.1	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	-0.3	-1.3	-0.7	-0.1	-0.1	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	-0.8	1.5	1.6	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	119.6	118.6	111.6	119.2	136.5	138.5	144.5	147.5	148.4	149.3	148.7	
Gross financing need 6/	18.9	15.4	11.1	9.9	15.0	15.8	15.7	15.0	14.4	13.9	13.4	
in billions of U.S. dollars	57.5	52.6	47.3	52.6	64.8	69.5	73.6	75.3	77.9	80.2	80.3	
Scenario with key variables at their historical averages 7/						**54.9**	**55.8**	**57.2**	**58.6**	**60.2**	**61.7**	**-0.2**
Scenario with no policy change (constant primary balance) in 2010-2015						**54.9**	**58.1**	**62.1**	**65.7**	**69.3**	**72.9**	**-0.6**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	3.6	6.2	6.8	5.1	1.8	3.1	3.5	3.7	4.0	4.1	4.1	
Average nominal interest rate on public debt (in percent) 8/	6.5	6.1	5.4	5.4	5.8	5.9	5.8	5.8	5.8	5.8	5.8	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	3.9	4.6	1.4	2.3	2.3	5.3	3.0	3.5	3.3	3.3	3.2	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-8.3	12.1	19.5	-17.8	3.9	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	2.6	1.5	4.0	3.1	3.6	0.6	2.8	2.3	2.5	2.5	2.6	
Growth of real primary spending (deflated by GDP deflator, in percent)	5.6	7.7	3.3	8.0	3.9	8.0	2.5	2.2	2.8	2.8	2.9	
Primary deficit	1.3	1.0	-0.4	1.5	4.5	4.2	3.6	2.4	1.5	0.9	0.4	

1/ General government gross debt, ESA95 definition.

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

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

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

Warsaw, June 15, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431, USA

Dear Mr. Strauss-Kahn,

The recently expired FCL arrangement has served Poland's economy well. The FCL proved to be helpful in increasing the flexibility and the room for maneuver in Poland's macroeconomic policy without unsettling markets. During the last year, the FCL was instrumental in helping Poland weather the negative impact of the deterioration in investors' confidence towards emerging Europe, where several economies have been hard hit by the global financial crisis. In 2010 Poland remains resilient with regard to the growing stress in EU sovereign debt markets, and that can also be partly attributed to the positive impact of the FCL. As a result Poland has continuously maintained access to international markets at favorable spreads. Given the role of Poland's economy in emerging Europe, the positive effects of the FCL also extended to the region more broadly.

During the past 12 months Poland was able to weather the global crisis relatively well. Poland was the only EU economy to avoid recession in 2009. Economic growth was underpinned by strong macroeconomic policies which avoided acute imbalances as well as by a firm institutional policy framework, which was effective in strengthening confidence in these policies. The policy response to the impact of the global crisis was timely and appropriate. It is highly likely that in 2010 Poland will also be among the fastest growing economies in the EU.

Economic fundamentals remain strong. The external position is relatively well balanced. Access to international markets is permanently maintained, while the level of foreign exchange reserves remains comfortable. Poland's current policy stance demonstrates our commitment to macroeconomic stability.

In particular, we remain committed to the budgetary policy framework under the EU Stability and Growth Pact (and in line with the latest Convergence Program for Poland). In addition, we will continue strengthening our medium-term fiscal framework towards maintaining the sustainability of public debt.

On the monetary policy front, over the past decade Poland has applied a disciplined and transparent inflation-targeting framework. This framework, combined with the floating exchange rate regime, has worked satisfactorily, helping build credibility and anchor long-

term inflation expectations. It will continue to underpin Poland's monetary policy also during the next 12 months.

Poland's banking system was able to withstand the crisis well, partly due to the tools designed to safeguard its stability. In line with FSAP recommendations, the surveillance of banks has been stepped up, including strengthened stress tests and data reporting. Banks' profits remain robust, capital adequacy ratios have risen, whereas the level of non-performing loans remains manageable. Current perspectives for the banking sector have improved as compared to the first half of 2009, while the sector of non-bank financial institutions does not pose material threats to the stability of the financial system.

Despite strong fundamentals and sound policies, Poland's economy remains exposed to possible external shocks that are beyond our control. The process of global recovery is encouraging. However, several downside risks remain. These risks relate, in particular, to European economies which are the major trade and financial partners of Poland. More specifically, even though a strong and coordinated international response to the Eurozone fiscal crisis has reduced the downside risks for our economy, these risks have not been eliminated. In this context, the FCL would help strengthen Poland's resilience to external shocks, with positive effects also for other economies of Central and Eastern Europe.

Therefore, we request that the Fund approve a Flexible Credit Line (FCL) arrangement for Poland in the amount of SDR 13.69 billion (1000 percent of quota) covering a period of 12 months.
Should the arrangement be approved, it is Poland's intention that the FCL remain a precautionary facility. In particular, NBP does not intend to draw on the facility to replenish its foreign exchange reserves.

Referring to the Article IV consultation approved by the Executive Board on May 7, 2010, Poland remains committed to pursuing strong policies based on strong institutions, with timely and appropriate responses to shocks as necessary.

Sincerely Yours,

/S/
Minister of Finance
Jan Vincent-Rostowski

/S/
President of the National Bank of Poland
Marek Belka

INTERNATIONAL MONETARY FUND

Poland—Assessment of the Impact of the Proposed Flexible Credit Line Arrangement on the Fund's Finances and Liquidity Position

Prepared by the Finance and Strategy, Policy and Review Departments

(In consultation with other Departments)

Approved by Andrew Tweedie and Aasim Husain

June 24, 2010

1. **This note assesses the impact of the proposed Flexible Credit Line (FCL) arrangement for Poland on the Fund's finances and liquidity position, in accordance with the policy on the FCL.**[1] The proposed arrangement would cover a 12-month period, be in an amount of SDR 13.69 billion (1,000 percent of quota), and succeed the FCL arrangement of an identical amount that expired on May 5, 2010. The full amount of access proposed would be available throughout the arrangement period, in one or multiple purchases.[2] The authorities intend to treat the arrangement as precautionary.

I. Background

2. **Against the backdrop of a global economic and financial crisis, a one-year precautionary FCL arrangement equivalent to SDR 13.69 billion was approved on May 6, 2009.** The authorities' effective policy responses to the global crisis have been successful in maintaining stability, and no drawings were made under the previous FCL arrangement. Poland has a history of strong performance under Fund arrangements and an exemplary record of meeting its obligations to the Fund.[3]

3. **Total external and public debt levels are significant but sustainable.** External debt, which was in the range of 44–55 percent of GDP in the years preceding the recent crisis, increased to about 65 percent of GDP in 2009 owing to the effects of depreciation of

[1] See *GRA Lending Toolkit and Conditionality—Reform Proposals* (SM/09/69, 3/13/09), *GRA Lending Toolkit and Conditionality—Reform Proposals* (SM/09/69, Sup. 2, 3/24/09), and *Flexible Credit Line (FCL) Arrangements,* Decision No.14283-(09/29), adopted March 24, 2009.

[2] If the full amount is not drawn in the first six months of the arrangement, subsequent purchases are subject to a review of Poland's continued qualification for the FCL arrangement.

[3] See *Republic of Poland—Assessment of the Impact of the Proposed Flexible Credit Line Arrangement on the Fund's Finances and Liquidity Position* (EBS/09/57, Sup. 1, 04/28/2009).

the zloty. However, with the recovery in growth, external debt is projected to decline slightly to around 63 percent of GDP over the medium term. Short-term debt on a residual maturity basis is projected at about a third of total external debt in 2010 and to decline to about a quarter over the medium term. Public external debt, which increased to about 21½ percent of GDP in 2009, is estimated to reach about 23 percent of GDP by end-2010. Gross public debt (on an ESA95 basis), which had stabilized at just under 50 percent of GDP before the crisis, is projected to increase to around 55 percent of GDP by end-2010, and to stabilize around 60 percent of GDP in the coming years. Sustainability analyses show both external and public debt remaining manageable under a range of scenarios, with no significant contingent liabilities incurred during the crisis.[4]

4. **The substantial access under the proposed arrangement could add significantly to the Fund's credit exposure.** If the full amount available under the FCL arrangement—which the authorities intend to treat as precautionary—were drawn, Poland's outstanding use of GRA resources would reach SDR 13.69 billion, among the highest of individual country exposures.[5]

5. **If the full amount available under the proposed FCL arrangement is purchased in 2010:**

- **Fund credit would represent a modest part of Poland's external debt.** Total external debt would rise to over 73 percent of GDP initially, and public external debt would rise to about 27½ percent of GDP, with Fund credit being some 4½ percent of GDP (Table 1). At its peak, Poland's outstanding use of GRA resources would account for about 6½ percent of total external debt, almost 17 percent of public external debt, and about 18½ percent of gross international reserves.

- **External debt service would increase over the medium-term, but this would likely be manageable assuming a continued recovery in global financial markets**. Poland's projected debt service to the Fund would peak in 2014 at just over SDR 7 billion, or about 2 percent of GDP.[6] In terms of exports of goods and services, external debt service to the Fund would peak at about to 4½ percent, and would then account for slightly over 40 percent of total public external debt service.

[4] A more detailed description of external and public debt is provided in the staff report.

[5] The largest GRA credit exposure has been SDR 23.359 billion to Brazil in 2003.

[6] The figures on debt service used in this report are calculated assuming that full amount available under the arrangement is purchased upon approval of the arrangement, and that all repurchases are made as scheduled.

Table 1. Poland: Capacity to Repay Indicators 1/

	2009	2010	2011	2012	2013	2014	2015
Exposure and Repayments (In SDR millions)							
GRA credit to Poland	--	13,690.0	13,690.0	13,690.0	10,267.5	3,422.5	--
(In percent of quota)	--	(1,000.0)	(1,000.0)	(1,000.0)	(750.0)	(250.0)	(0.0)
Charges due on GRA credit 2/	--	191.2	361.4	361.6	387.5	250.3	31.3
Debt service due on GRA credit 2/	--	191.2	361.4	361.6	3,810.0	7,095.3	3,453.8
Debt and Debt Service Ratios 3/							
In percent of GDP							
Total external debt	64.9	73.3	72.6	71.1	67.6	64.6	63.4
Public external debt	21.6	27.4	26.9	26.2	24.1	21.8	20.8
GRA credit to Poland	--	4.6	4.3	4.0	2.8	0.9	--
Total external debt service	19.1	22.7	20.3	20.1	21.5	21.3	19.8
Public external debt service	2.4	2.9	2.6	2.6	3.6	4.2	3.2
Debt service due on GRA credit	--	0.1	0.1	0.1	1.0	1.8	0.9
In percent of Gross International Reserves							
Total external debt	351.2	292.4	295.9	300.1	310.9	332.5	345.4
Public external debt	117.0	109.3	109.7	110.5	111.0	112.3	113.3
GRA credit to Poland	--	18.4	17.6	17.0	12.9	4.5	--
In percent of Exports of Goods and Services							
Total external debt service	48.6	53.6	47.8	47.9	51.7	51.0	46.1
Public external debt service	6.0	6.8	6.1	6.1	8.6	10.1	7.4
Debt service due on GRA credit	--	0.2	0.3	0.3	2.5	4.4	2.0
In percent of Total External Debt							
GRA credit to Poland	--	6.3	6.0	5.7	4.1	1.4	--
In percent of Public External Debt							
GRA credit to Poland	--	16.8	16.1	15.4	11.6	4.0	--

Sources: Polish authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

1/ Assumes full drawings under the FCL upon approval. The Polish authorities have expressed their intention to treat the arrangement as precautionary, as balance of payments pressures have not materialized.
2/ Based on the rate of charge as of June 10, 2010. Includes surcharges under the system currently in force and service charges.
3/ Staff projections for external debt, GDP, gross international reserves, and exports of goods and services, as used in the staff report that requests the proposed FCL, adjusted for the impact of the assumed FCL drawing.

6. **Reflecting the high access under the arrangement, the impact on the Fund's liquidity, and on its potential exposure to credit risk, would be substantial:**

- **The proposed arrangement would significantly reduce the Fund's forward commitment capacity (FCC) from its current record level.**[7] Approval of the proposed arrangement would reduce the FCC by SDR 13.69 billion, an 8½ percent reduction in the FCC.

- **If the resources available under the FCL arrangement were fully drawn, GRA credit to Poland as a share of total GRA credit would be about 22½ percent.** As a

[7] The FCC has been greatly bolstered by the supplementary resources available under the bilateral borrowing and note purchase agreements.

result, the concentration of Fund credit among the top five users of Fund resources would decline slightly to 69 percent from 70 percent, currently.

- **Potential GRA exposure to Poland would be almost twice the Fund's current precautionary balances.**

Table 2. FCL Arrangement for Poland—Impact on GRA Finances
(In SDR millions, unless otherwise indicated)

	As of 06/17/10
Liquidity measures	
Current one-year Forward Commitment Capacity (FCC) 1/	161,981
Impact on FCC on approval of FCL	13,690
Prudential measures, assuming full FCL drawing	
Fund credit to Poland	
In percent of total GRA credit outstanding 2/	22.7
In percent of current precautionary balances	193.0
Fund credit outstanding to five largest debtors	
In percent of total GRA credit outstanding, before approval	70.0
In percent of total GRA credit outstanding, upon approval of the FCL 2/	68.9
Memorandum items	
Current precautionary balances (end-April 2009) 3/	7,093
Total FCL commitments, including proposed FCL	47,540
Quota of FTP members with actual and proposed FCLs, in percent of total quota of FTP members	2.9

Sources: Finance Department.

1/ The FCC measures the Fund's capacity to make new credit commitments over the next 12 months. It includes the liquidity effects of resources made available under borrowing and note purchase agreements.
2/ Based on current Fund credit outstanding plus full drawings under the proposed FCL.
3/ Precautionary balances exclude amounts in Special Reserves attributable to profits on gold sales in FY2010.

II. Assessment

7. **The proposed arrangement would have a large but manageable impact on the Fund's liquidity.** While sufficiently strong to accommodate the liquidity impact of the proposed arrangement, the Fund's liquidity position could deteriorate quickly, particularly if there is further demand for large arrangements. This underscores the need for continued close monitoring of liquidity, to continue the efforts to bring new bilateral borrowing agreements on line to supplement the Fund's resources, and to conclude the ratification of the expanded New Arrangements to Borrow in a timely manner.

8. **Poland intends to treat the FCL arrangement as precautionary, but if it did prove necessary to draw, this would feature prominently among the Fund's single credit exposures**. Poland's overall external debt and debt service ratios are expected to remain manageable including should adverse shocks materialize such that a purchase became necessary. Poland's sustained track record of implementing strong policies, including during the global financial crisis, and sound institutional policy framework provide assurances about the future course of policies such that Poland's capacity to repay is expected to remain

strong. Nonetheless, the scale of the Fund's potential exposure to Poland—in conjunction with the recent increase in commitments to other members and the possibility of further credit expansion under already existing or new Fund arrangements—underscores the need to strengthen the Fund's precautionary balances.

INTERNATIONAL MONETARY FUND EXTERNAL RELATIONS DEPARTMENT

Press Release No. 10/276
FOR IMMEDIATE RELEASE
July 2, 2010

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$20.43 Billion Arrangement for Poland Under the Flexible Credit Line

The Executive Board of the International Monetary Fund (IMF) today approved a one-year successor arrangement for Poland under the Flexible Credit Line (FCL)) in the amount equivalent to SDR 13.69 billion (about US$20.43 billion; 1,000 percent of quota). The Polish authorities intend to treat the arrangement as precautionary and do not intend to draw from the FCL.

The FCL was established in the context of a major overhaul of the Fund's lending framework on March 24, 2009 (see Press Release No. 09/85 and Public Information Notice 09/40). The FCL is designed for crisis prevention purposes as it provides the flexibility to draw on the credit line at any time. Disbursements are neither phased nor conditioned on compliance with policy targets as in traditional IMF-supported programs. This flexible access is justified by the very strong track records of countries that qualify for the FCL, which gives confidence that their economic policies will remain strong.

Following the Executive Board's discussion on Poland, Mr. John Lipsky, First Deputy Managing Director and Acting Chair, made the following statement:

"Poland's macroeconomic performance was very strong in the decade leading up to the global crisis, underpinned by a sustained track record of sound economic policies. Inflation was successfully brought down to low single digits under the inflation targeting regime and a flexible exchange rate, the commitment to the EU Stability and Growth Pact helped to lower the fiscal deficit and limit government debt, and the strong financial supervisory framework kept the financial system sound.

"The strong policy frameworks allowed the authorities to undertake countercyclical monetary and fiscal policies in response to the global crisis. Financial sector stability was preserved through liquidity provision and intensified supervision, and Poland secured access to a one-year FCL arrangement. As a result, Poland was the only EU economy to avoid recession in

2009, and the government maintained access to international capital markets on favorable terms.

"On the back of these strong policy measures and improving global economic conditions, GDP growth has picked up and asset prices have recovered from troughs seen at the height of the crisis. Looking forward, GDP growth is expected to rise gradually. The authorities remain committed to very strong macroeconomic policies and intend to continue to react as needed to any future shocks that may arise.

"Nonetheless, sizeable downside risks remain, stemming from the still-fragile economic outlook in the euro area and the possibility of further spillovers from financial strains in other parts of Europe. It is against this background that, at the authorities' request, the Executive Board today approved a one-year arrangement under the IMF's FCL, which the authorities intend to treat as precautionary.

"Poland's very strong policy frameworks and economic fundamentals, together with the additional insurance provided by the successor arrangement under the FCL, put Poland in a very strong position to deal with potential risks and pressures in the event that external conditions deteriorate."

Poland joined the IMF on June 12, 1986; its quota is SDR 1.36 billion (about US$2.06 billion).

Statement by Zajdel-Kurowska, Alternate Executive Director for the Republic of Poland and Pawel Gasiorowski, Advisor to the Executive Director
July 2, 2010

We would like to thank staff for the report that supports Poland's request for an arrangement under the Flexible Credit Line (FCL). The Polish authorities agree with the staff appraisal and their assessment of the benefits provided by the FCL. The previous arrangement played a very important role in restoring investors' confidence towards emerging Europe, and was instrumental in supporting the authorities' economic strategy. So far, Poland has remained resilient to the external shocks, weathering the crisis relatively well. However, given the fragile recovery in the euro area and the rising uncertainty about the potential spillovers from the sovereign debt crisis, the authorities are requesting a renewal of the one-year arrangement, with the same access of 1,000 percent of quota, which they intend to treat as precautionary.

The Executive Board concluded Poland's Article IV consultation on May 7, 2010 with a positive assessment. Since the last Board meeting, policy objectives have not changed but we would like to point to some recent developments.

Outlook

The economic results after the first five months are encouraging; with 3 percent growth in the first quarter, real GDP growth of 3.0 percent in 2010 is achievable. According to the preliminary forecasts of the Finance Ministry, economic growth is expected to accelerate steadily over the medium term (3.5 percent in 2011 and 4.2 percent in 2012), which would be accompanied by muted inflation and falling unemployment. The improved competitiveness of Polish exports and capital investment, partly financed by EU funds, should be the main drivers of economic growth.

Fiscal policy

The government has already begun working on the 2011 Budget Plan. The assumptions of the budget should be unveiled in the coming weeks. Preliminary data on this year's state budget execution indicate that the 2010 deficit might be c.a. 20 percent lower than planned. It would decrease Poland's financing needs by PLN 10 bn.

Moreover, reinforced privatization process provides additional support for budget financing. Only in the first half of the year, privatization receipts reached PLN 11.5 bn, versus PLN 4.9 bn in the entire 2009. In line with improving market conditions, the government foresees an acceleration of the privatization process, which should limit the rise of the public debt.

Despite significant fiscal deficits in 2009 and 2010, the public debt remains at sustainable level, well below the Maastricht criterion of 60 percent of GDP. The structure of the debt's holders (only 30 percent of foreign investors) as well as the debt profile (long maturity and duration) is comfortable from debt management perspective. Through the end of May, the government covered half of this year's borrowing needs while external financing is already secured.

The Polish authorities are committed to the fulfillment of the requirements imposed by the Excessive Deficit Procedure, i.e. to reduce the general government deficit below 3 percent of GDP by 2012. In order to achieve this, a set of measures is contemplated, including:

a) Full implementation of the modernized public finance law that came into effect on January 2010, most of the guiding principles of which have already been used for the construction of the 2010 budget, including performance-based budgeting. Moreover, the new public finance law would require the local governments – starting from 2011 - to have balanced current budgets, and starting from 2014 – would impose a system of individual debt limits depending on the debt repayment capacity.

b) The government is willing to proceed promptly with the approval of the Multiyear Financial Plan, which would include deficit targets for budget laws for the next four years. The Plans would be approved by the Council of Ministers and the first plan is to be approved before July 31, 2010. In parallel, the local governments would have to prepare multiyear financial forecasts for at least three years.

c) The government intends to propose to the Parliament an interim expenditure rule which would limit the increase of the flexible expenditures and new fixed expenditures to CPI+1 percent. Current estimates of the effects of this rule show around PLN 18 bn of accumulated savings until year 2013 (PLN 3 bn in 2011 and accumulated until 2012 PLN 8.5 bn). After reaching the medium term deficit objective of 3 percent of GDP, this interim rule would be changed to a permanent expenditure rule.

d) The government intends to proceed with the reforms of the social security system, including by aligning disability pensions with social security contributions paid, merging of the pension system of the uniformed personnel into the general system starting from 2012, re-initiating the debate on changing the pension and disability scheme for farmers (KRUS). Moreover, the efficiency of the open pension funds will be improved by modifying investment limits and lowering fees.

Monetary policy

The current readings of inflation indicators do not show immediate inflationary pressures and inflation expectations are well anchored. Core inflation is in a decreasing trend for the seventh month in a row. As of end-May, core inflation was at 1.6 percent y/y, the lowest level since January 2008. During its June meeting, the Monetary Policy Council kept the main NBP policy rate at 3.5 percent.

Financial sector

The banking sector remains profitable and well-capitalized. In the first quarter of 2010, net profits surged by more than 18 percent y/y and capital adequacy ratio reached 14.1percent, well above the statutory level. According to macro stress test results, most banks would be able to cover losses even in case of a substantial fall in GDP growth. Consequently, the current macroeconomic developments are not a source of systemic risk.

Due to the largely traditional business model of banks operating in Poland, based on deposit and loan activities, banks' balance sheets are transparent. Their exposure towards bonds issued by the European countries with excessive public deficit is negligible. Furthermore, this business model provides greater stability of profits. In 2009, most Polish subsidiaries of foreign banks recorded higher profitability than their parent companies.

Over the medium term, internal risks to the financial sector should further diminish. The share of non-performing loans to corporates seems to stabilize and non-performing loans to households are expected to pick up within the next few months. Developments in the mortgage market, which has recently seen a modest revival, are closely monitored by the KNF.