INTERNATIONAL MONETARY FUND

IMF Country Report No. 12/162

REPUBLIC OF POLAND

2012 ARTICLE IV CONSULTATION

July 2012

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 2012 Article IV consultation with Poland, the following documents have been released and are included in this package:

- **Staff Report** for the 2012 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 16, 2012, with the officials of Poland on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 15, 2012. 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.
- **Informational Annex** prepared by the IMF.
- **Staff Statement** of July 2, 2012.
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its July 2, 2012 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Poland.

The document listed below has been or will be separately released.

Selected Issues Paper

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

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REPUBLIC OF POLAND

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

June 15, 2012

KEY ISSUES

Context. Poland's economy performed well throughout the crisis, reflecting very strong fundamentals and decisive counter-cyclical policies. After robust growth last year, the economy is expected to slow in 2012 as heightened uncertainty and tighter credit conditions weigh on private consumption and investment. Fiscal space to respond to new adverse shocks is now more limited than in the past, suggesting that the policy mix would need to rely more heavily on monetary policy.

Interconnectedness. Trade and financial linkages with Europe are significant, including cross-border vertical integration of non-financial corporations and foreign ownership of the banking system.

Fiscal policy. The fiscal deficit is set to decline to 3.1 percent of GDP in 2012, from 5.1 percent of GDP in 2011. Over the medium term, additional measures of ¾-1 percent of GDP will be needed to achieve the authorities' medium-term fiscal objective. In the event of an adverse shock, automatic stabilizers should be allowed to operate.

Monetary policy. Policy interest rates should remain on hold on account of the slowing economy and projected decline in inflation. If the economy were to slow significantly, and the outlook for inflation were to weaken, policy rates should be cut given the ample scope to do so. The NBP is prepared to provide liquidity support in both zloty and foreign currency, if needed.

Financial sector policy. Recent supervisory measures are helping to further improve the resilience of the banking system. Increased capital and liquidity buffers, as well as stricter prudential standards, are helping to address risks associated with foreign-currency denominated mortgages, but a more proactive approach to addressing non-performing loans is desirable. Work to strengthen the supervisory framework, improve prospects for long-term bank funding, establish a macro-prudential framework, and design a specific bank resolution regime is underway.

Structural reforms. Continued reforms—notably on improving the functioning of the labor market, easing administrative burdens, and advancing privatization—would boost potential growth.

Approved By
Mahmood Pradhan and Vivek Arora

Ms. Kozack (Head), Ms. Lu, Ms. Ho, and Mr. Vazquez (all EUR), Ms. Nedelescu (MCM), and Mr. de Imus (SPR) visited Warsaw between May 8–16, 2012. The mission met with senior government and central bank officials, and representatives from trade unions and the business community. Mr. Allen (Resident Representative) and Mr. Sierhej (Resident Representative Office) participated in the discussions. Poland is an Article VIII country and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions, except for those solely for the preservation of national or international security. (Informational Annex: Fund relations). Data provision is adequate for surveillance (Informational Annex: Statistical Issues).

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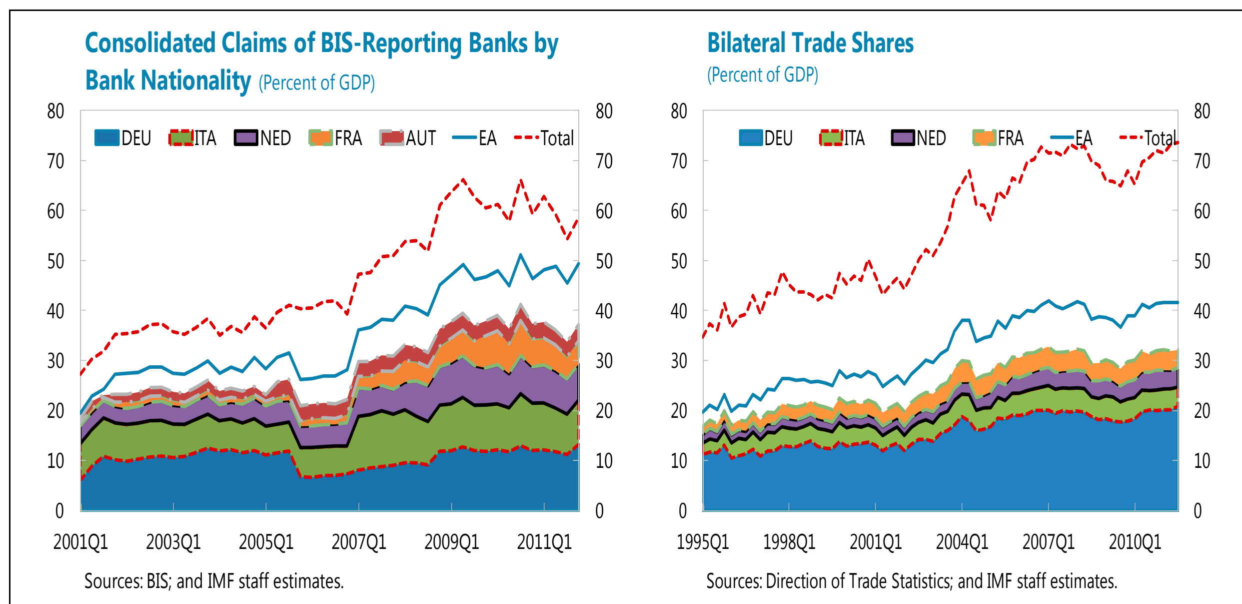
CONTEXT

1. **Poland's economy performed well throughout the crisis,** reflecting very strong fundamentals and decisive counter-cyclical policies. The floating exchange regime played a stabilizing role, while broadly adequate international reserves and the precautionary FCL arrangement boosted market confidence. The banking system remained largely shielded from external turmoil despite substantial foreign ownership and a high share of foreign-currency denominated mortgages. But, policy space to respond to new adverse shocks is now more limited and there remain some vulnerabilities associated with large gross external financing needs and a high share of mortgage portfolios denominated in foreign currency.

2. **The ruling coalition was reelected in late 2011.** The center-right Civic Platform (PO) and the agrarian Polish People's Party (PSL) have a slim parliamentary majority and a fresh four-year window to complete their policy and reform agenda.

3. **Trade and financial linkages with Europe are significant.** Polish manufacturing firms are highly integrated in the cross-border production chain of core euro area countries (notably Germany), and bilateral trade with the euro area accounts for more than half of Poland's total trade. In part reflecting this integration, the non-financial corporate sector relies heavily on intracompany lending, which covers about 54 percent of external funding needs. Around 60 percent of Poland's banking system is owned by European banks, but overall reliance on parent funding is moderate (Box 1).



Box 1. Cross-Border Linkages of the Polish Banking System[1]

Poland's banking system is highly interconnected with the European financial system. Foreign-owned banks and branches—with parents mostly based in the euro area—account for about two-thirds of the Polish banking system. BIS consolidated data shows that foreign banks' claims on Poland amounted to 59 percent of GDP at the end of 2011, reflecting the openness of Poland's financial system.

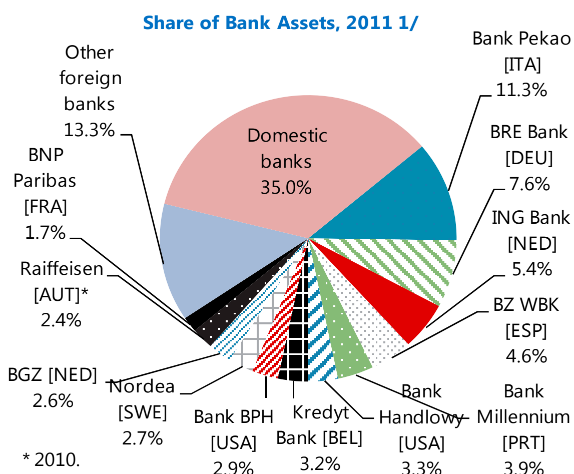
The banking sector's negative net foreign asset position largely reflects banks' liabilities to foreign financial institutions, over 90 percent of which is parent bank funding. Though, traditionally, parent funding has proved stable and Poland requires parent banks to commit to support their subsidiaries, deleveraging remains a risk. At the same time, the moderate overall loan to deposit ratio of 113 percent and an average loan to deposit ratio of just under 100 percent for banks with parents in European economies under stress help to mitigate this risk. About 80 percent of parent funding to Polish subsidiaries is denominated in foreign currency, and is the main source of funding for foreign currency credit to non-financial corporations and households, particularly mortgages. As a result, banks with higher loan-to-deposit ratios have a larger share of foreign currency loans in their loan portfolio.

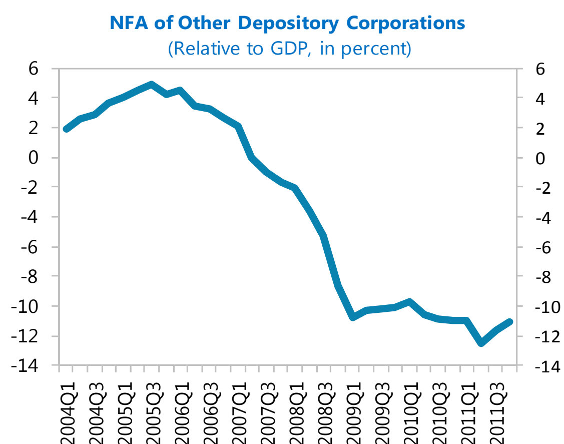
Foreign financial institutions are also important counterparties in foreign currency derivative transactions. Polish banks have large long foreign currency positions on their balance sheets—the currency mismatch amounted to about 4¾ percent of GDP (and 5½ percent of banks' balance sheet) in Q1 2012. Most of this open position is closed by off-balance sheet foreign currency hedging instruments, mainly FX swaps and, to a lesser extent, cross-currency interest rate swaps. Foreign financial institutions are the main counterparties in these markets: transactions between foreign and Polish banks account for about 90 percent of the total FX swap market turnover. Polish banks are therefore vulnerable to a reversal of sentiment by the foreign banks, either through a tightening of credit limits or an increase in prices.

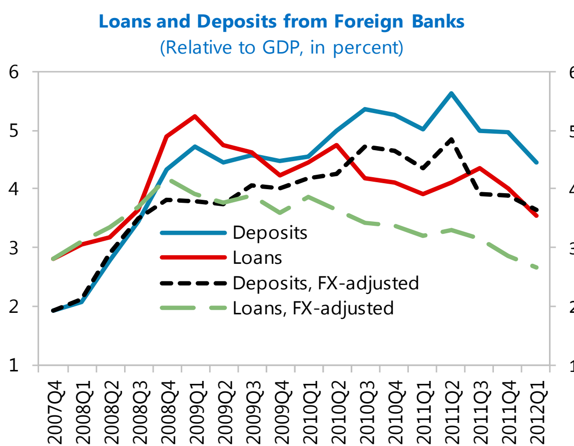
These cross-border linkages make Poland vulnerable to potential spillovers from escalating financial and sovereign stress in the euro area. Parent bank deleveraging or funding withdrawal would worsen the Polish banking system's liquidity situation, with potential adverse effects on credit and growth (see Box 3). In addition, banks' large foreign currency hedging needs—which tend to increase when the zloty depreciates—could subject Polish banks to liquidity strains and rollover problems during times of market stress.

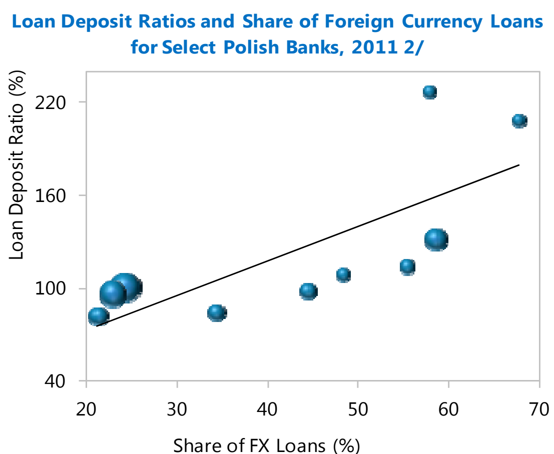
[1] Prepared by Yinqiu Lu.

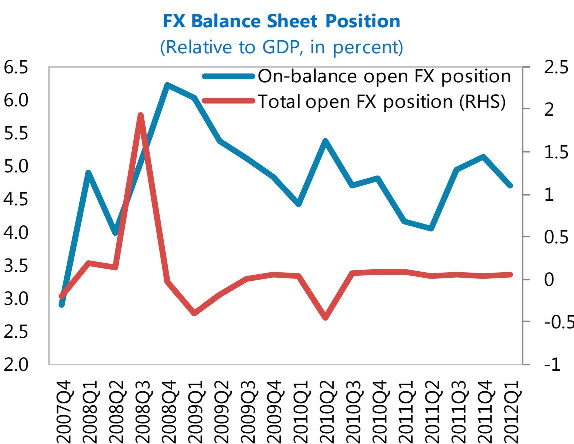
Box 1. Cross-Border Linkages of the Polish Banking System (Cont'd)

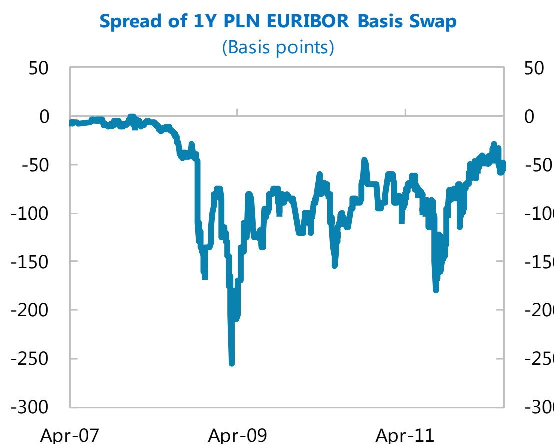












Sources: Bloomberg; KNF; NBP; Haver; IMF, IFS SNL; and IMF staff estimates.
1/ Kredyt Bank is to be acquired by Santander and merged with BZ WBK.
2/ The size of the bubble represents the bank's share of system assets.

RECENT ECONOMIC DEVELOPMENTS

A. The Economic Expansion is Slowing

4. Economic activity in 2011 was strong and well balanced, but has weakened recently (Figure 1)**.** Despite substantial fiscal consolidation, real GDP growth posted a solid 4¼ percent in 2011, helped by a rebound in investment and net exports (boosted by zloty depreciation towards the end of the year), and steady private consumption growth. The expansion slowed modestly in the first quarter of 2012. More recently, however, the economy has started to lose steam: the latest data releases suggest that industrial production and retail sales are slowing more substantially.

5. Labor market conditions have softened (Figure 2)**.** After declining through most of the year, the unemployment rate climbed to 9.7 percent toward the end of 2011—only about 1 percentage point lower than its crisis peak. While this partly reflected the increase in labor participation, it was also due to weaker job creation as increased uncertainty about the economic environment and the phase-out of government-funded active labor market programs led firms to curtail new hiring. Wage growth was relatively muted and unit labor costs declined.

6. Inflation declined recently, after peaking at 4.8 percent in November. Headline inflation remained above the upper bound of the NBP's inflation target in 2011, mostly driven by higher food and energy prices, a VAT hike, robust domestic demand, and zloty depreciation (later in the year). Since November, it has declined steadily, falling to 4 percent in April 2012. The decline reflects the slowing economy, base effects of the VAT hike, and moderating food price increase. Core inflation has also fallen amid modest wage pressures.

7. The current account deficit narrowed, but its financing shifted to more volatile sources (Figure 3)**.** The current account deficit improved to 4.3 percent of GDP in 2011, somewhat better than its average since Poland joined the European Union (EU). The weaker zloty in the second half of the year—amid renewed global financial market turbulence—helped boost net exports, offsetting strong imports in the first half (Figure 4). The current account was mostly financed by EU transfers and net FDI inflows. However, the relative importance of portfolio inflows has increased, reflecting growing foreign investment in the government bond market. Other investment flows, particularly to the banks, were more volatile, as parent firms became more cautious about their liquidity positions in the second half of the year. Net errors and omissions were -2.0 percent of GDP, near the EU average, reflecting the improvements to the balance of payments compilation system completed last year. Poland's external position is broadly in line with medium-term fundamentals and appropriate policies (Box 2).

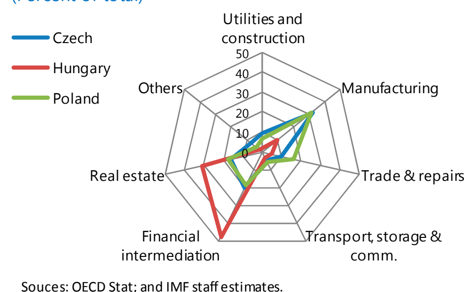
Box 2. External Sector Assessment[1]

Consistent with the recommendation of the 2011 Triennial Surveillance Review, the assessment of the external sector has been expanded.[2] In addition to the real effective exchange rate (REER), the current account, capital flows, international reserves, and the country's international investment position are assessed.

Poland's external position is broadly consistent with medium-term fundamentals and appropriate policies, but with some potential vulnerabilities.

- Model-based estimates support the result that the current account and the REER are broadly consistent with fundamentals. Nonetheless, the new External Balances Assessment (EBA) approach suggests that a narrowing of the current account of ½-1 percentage point of GDP would be warranted over the medium term.[3] This can be achieved by adhering to the planned fiscal consolidation path. Both EBA and CGER analysis suggests that the REER is in line with fundamentals.[4]
- Net IIP liabilities are large, but are mostly comprised of diversified FDI liabilities and intra-company lending. In contrast to some other countries in Central and Eastern Europe, FDI liabilities in Poland are more diversified and reached both tradable and non-tradable sectors. Recent IMF research suggests that the composition of FDI matters and that excessive inflows into the non-tradable sector can contribute to external imbalances.[5]
- Despite factors that mitigate the potential risks from a high net IIP liability position, rising foreign investment in the government bond market and banks' foreign currency financing needs (including foreign currency swaps) increase Poland's vulnerability to a reversal of investor appetite.

Industry Composition of FDI Position, 2009
(Percent of total)



Souces: OECD Stat; and IMF staff estimates.

- International reserves are broadly adequate, exceeding most indicators of reserve adequacy. They fall within the recommended bounds of the IMF reserve adequacy metric,[6] but remain short of 100 percent of short-term debt at remaining maturities plus the current account deficit. The FCL arrangement with the IMF also serves as a precautionary buffer against external shocks.

---

[1] Prepared by Phil de Imus.

[2] International Monetary Fund, "2011 Triennial Surveillance Review - Overview Paper", August 2011.

[3] The EBA approach builds on CGER and will be explained in the forthcoming International Monetary Fund External Sector Report.

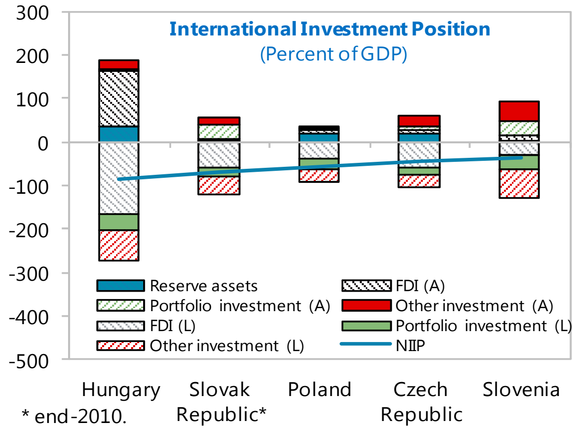
[4] For an explanation of the CGER methodology, see Lee, Jaewoo, et al. "Exchange Rate Assessments: CGER Methodologies", International Monetary Fund, Occasional Paper No. 261, April 2008.

[5] Kinoshita, Yuko. "Sectoral Composition of FDI and External Vulnerability in Eastern Europe", International Monetary Fund, Working Paper 11/123, 2011.

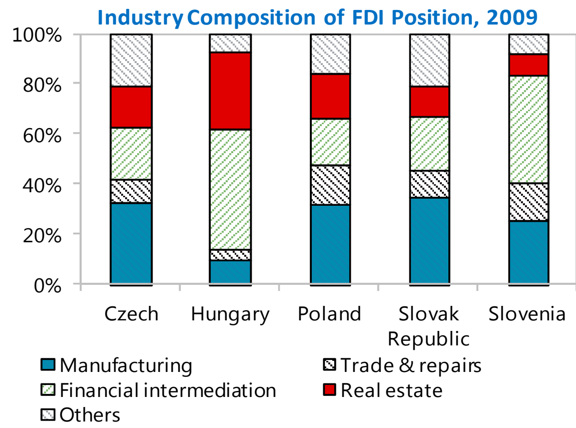
[6] International Monetary Fund, "Assessing Reserve Adequacy", February 2011.

Box 2. External Sector Assessment (Cont'd)

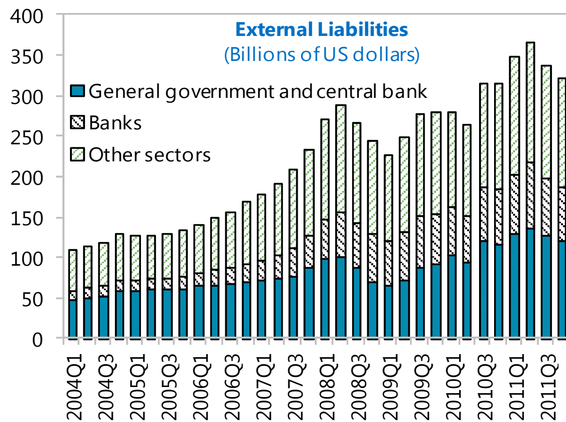
Poland has large net IIP liabilities, but in line with peers.



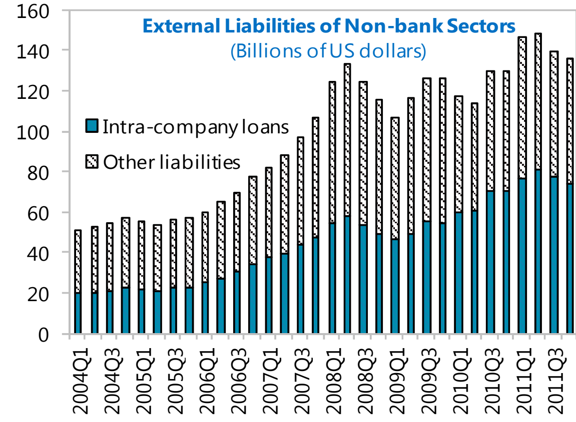
FDI is diversified.



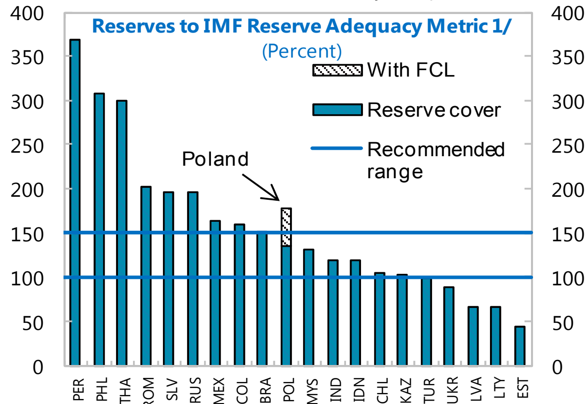
External liabilities eased since record Q2 2011 level.



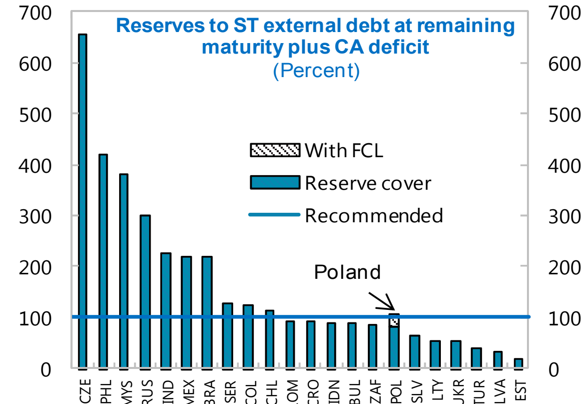
Corporate liabilities primarily are intra-company loans.



International reserves are broadly adequate...



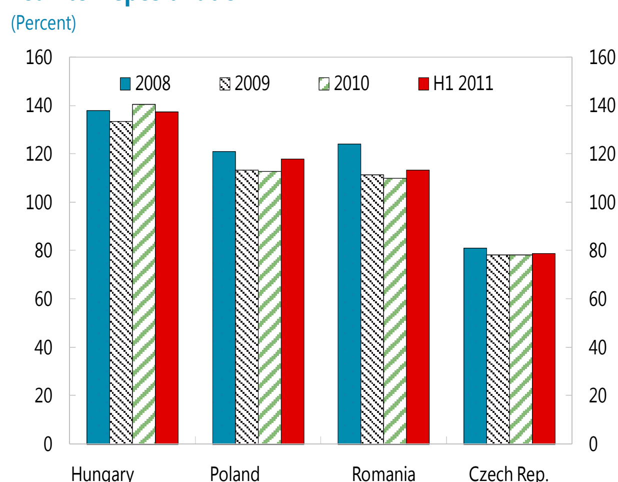
...but below ST debt plus the CA deficit, excluding the FCL.



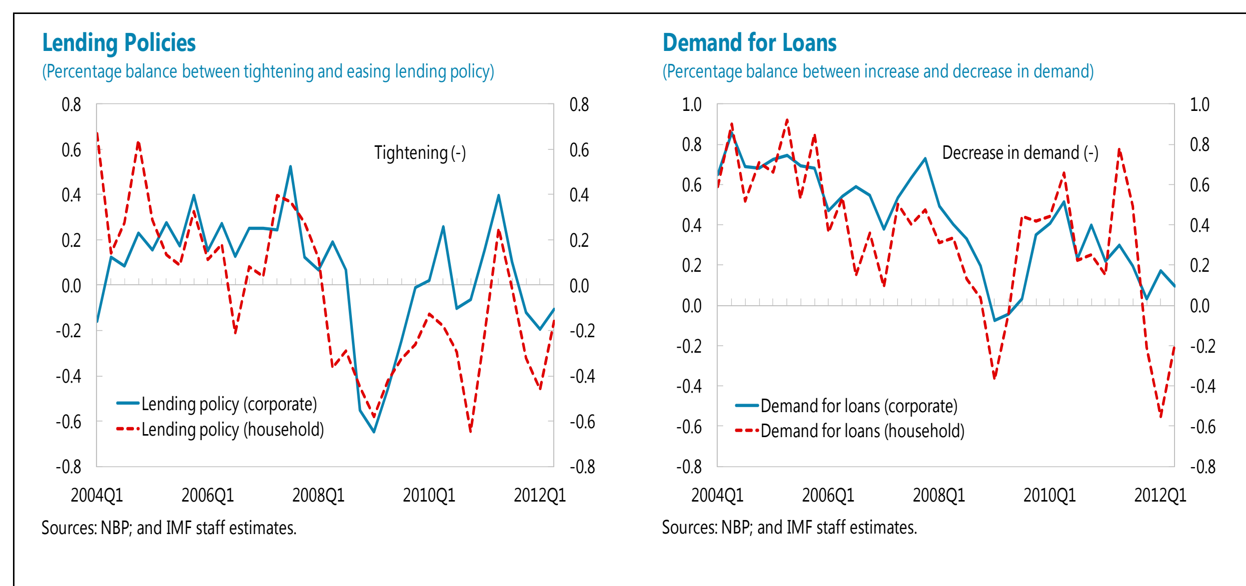
Sources: NBP; OECD; and IMF staff estimates.
1/ Coverage between 100 and 150 percent of the metric is regarded as adequate for an emerging market country.

B. The Banking System Has Been Resilient

8. The banking system has remained profitable, well capitalized, and liquid (Figure 5)**.** Profitability increased by 37 percent compared to the previous year, driven to a large extent by strong net interest income and declining provisioning. The average capital adequacy ratio remained high at around 13 percent, with Tier 1 capital representing 90 percent of total capital. In the latest European Banking Authority exercise, Poland's largest bank exceeded the capital adequacy target by more than 2 percentage points. Liquidity indictors remained generally robust. The loan-to-deposit ratio edged up, in particular for some institutions already exposed to funding risks, and stood at 113 percent in aggregate.

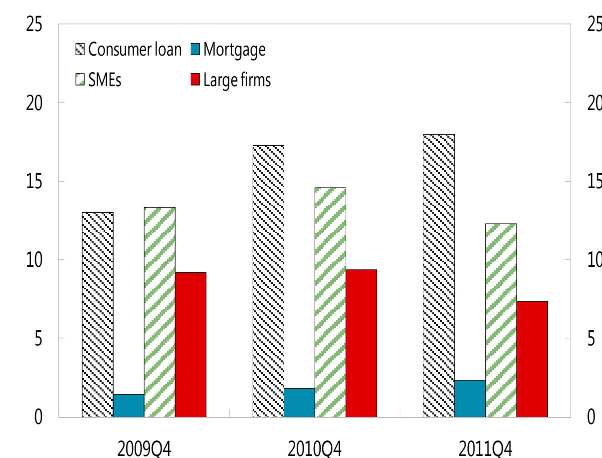


9. Credit expanded at a healthy pace, but conditions are tightening. Overall bank lending grew by 12¾ percent annually in the first quarter of 2012, led by strong corporate credit growth. But lending standards are tightening, likely reflecting moderate deleveraging by parent institutions and uncertainty about the economic outlook. Indeed, household credit growth is moderating amid supply constraints and lower demand.



10. Further regulatory and supervisory actions were undertaken to contain risks associated with foreign currency mortgages (Figure 6)**.** Almost two-thirds of all mortgages are denominated in foreign currency (mainly Swiss francs). To help address the flow of new foreign currency mortgages, prudential rules were further tightened in 2011: debt service-to-income ratios were set at 42 percent and risk weights were increased to 100 percent (to be implemented by June 2012). Nonetheless, one-quarter of all new mortgages issued in the first quarter of 2012 were denominated in foreign currency. To address the outstanding stock of foreign-currency denominated mortgages, the KNF requested that banks boost their capital and liquidity buffers.

11. The evolution of asset quality, however, has been weaker. The overall non-performing loan (NPL) ratio leveled-off at around 8.2 percent at the end of 2011, but partly on the back of strong credit growth, as absolute impairments grew in both the corporate and household sectors. NPL ratios are uneven across loan types, with high levels on consumer credit, moderate but persistent levels in the corporate portfolio, and relatively low—but increasing—levels on mortgages. Banks have started disposing some of their non-performing consumer portfolios, but have taken fewer measures to address corporate nonperforming loans.



OUTLOOK AND RISKS

12. The economic expansion is expected to slow in 2012. Baseline GDP growth is projected to moderate to 2½ percent, as heightened external uncertainty weighs on private investment, adding to the effects of a reduction in EU-funded public investment. Household consumption is expected to remain subdued on account of tight credit conditions (driven by general concerns about risks and deleveraging by some parent banks), persistent unemployment, and slow wage growth. Lower growth in trading partners is expected to reduce exports, although the contribution of net exports would remain positive as softening domestic demand dampens imports. The pace of job creation is likely to remain insufficient to significantly reduce unemployment in the near future. On current policies, inflation should continue to decline toward the NBP's target of 2½ percent on the back of the slowing economy and moderate wage pressures.

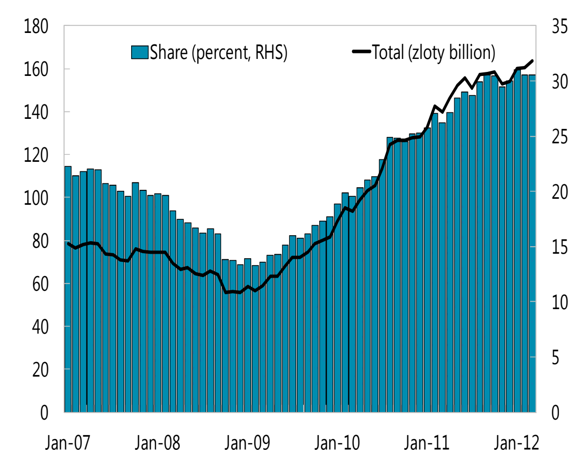
13. Over the medium term, the economy is expected to gradually gather steam. Growth is expected to recover to 3 percent in 2013, rising to 3¾ percent by the end of the projection period, led by domestic demand. Even under the baseline assumption of further gradual reductions in banks'

loan-to-deposit ratios and lower reliance on parent funding, deposit growth should be sufficient to provide a basis for continued moderate credit expansion. Robust private investment and an eventual rebound in private consumption are expected to offset declines in EU-funded public investment (which is expected to fall from peak levels reached in 2011). Private investment is largely financed by retained earnings, and thus a period of moderate credit availability should not undermine prospects. The contribution from net exports will shift over time, and turn negative in the outer years.

14. Risks to the outlook are on the downside, emanating mainly from external sources (Appendix V)**.** The near-term outlook remains characterized by heightened uncertainty about the external environment. A deeper-than-expected recession or an intensification of the crisis in Europe would give rise to adverse spillovers into Poland through several channels (Box 3):

- ***Trade and FDI.*** Nearly 60 percent of Poland's exports are to core euro area countries and Poland is heavily integrated into the German manufacturing supply chain. The euro area also accounted for over 75 percent of Poland's foreign direct investment liabilities in 2010.
- ***Confidence.*** A deterioration in confidence arising from an external shock would have an adverse impact on domestic demand though lower private consumption and investment.
- ***Banking system.*** About 60 percent of Poland's banking system is owned by euro area banks, exposing it to deleveraging by parent institutions. Although the banking system's moderate loan-to-deposit ratio helps mitigate this risk, there are wide differences among banks.
- ***Investor appetite.*** Poland's large share of nonresident holdings of government bonds, sizable gross external financing needs (estimated at 30 percent of GDP in 2012), and high external debt (64.8 percent of GDP at end-2011) increase its vulnerability to a reversal of investor risk appetite. Significant pre-funding of the government's financing needs and a large liquidity cushion help mitigate these risks.

Foreign Investor Purchases of T-Bonds and Bills



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

- ***Foreign-currency denominated mortgages.*** These mortgages constitute about ⅔ of total mortgages and pose risks to bank and household balance sheets. Sharp zloty depreciation could erode asset quality and give rise to liquidity strains for banks that rely on derivatives to hedge currency mismatches in their balance sheets. These risks are mitigated, however, by the low level of credit relative to the size of the economy: foreign currency mortgages amounted to 13 percent of GDP and 21 percent of household disposable income at end-2011.

Box 3. Economic and Financial Linkages With the Euro Area[1]

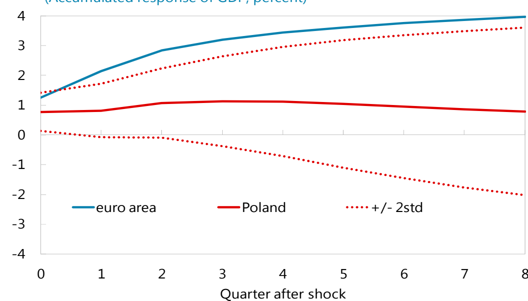
Poland Business Cycle Synchronization with the Euro Area

Cross correlation	1995-2011	Post-2004
Real GDP growth	0.52	0.81
Band-pass filtered output gap	0.61	0.69
Multivariate filtered output gap	0.18	0.72

Poland's business cycle co-moves strongly with that of the euro area. The correlation of real GDP growth rates and output gaps between Poland and the euro area is high and has risen recently. This likely reflects Poland's increasing trade and financial integration with core euro area countries, in particular Germany.

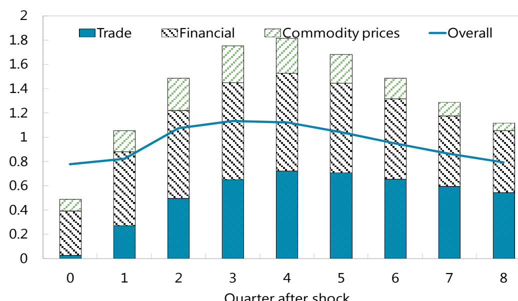
Econometric analysis confirms that trade and financial channels play a key role in the transmission of shocks from the euro area to Poland. Based on a VAR analysis, the cumulative response of Poland's growth to a euro area shock is estimated at 60 percent of the original shock on impact, declining to 30 percent after two years. Financial conditions in the euro area explain a major part of the overall spillovers, especially during the first two quarters immediately after shock. While the trade channel plays a limited role in the initial shock transmission, its contribution increases over time.

Growth Spillovers from Euro Area to Poland
(Accumulated response of GDP, percent)



Source: IMF staff estimates.

Decomposition of Spillover Channels
(Percent)

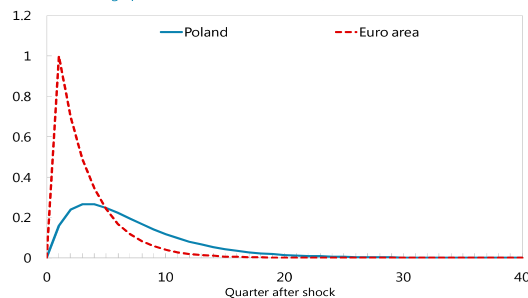


Source: IMF staff estimates.

A Global Projection Model with cross-country financial linkages is used to simulate a scenario of intensified financial stress in the euro area. In particular, a 100 bps increase in the euro area's external finance premium, measured as the spread between the risk-free rate and the lending rate for firms and households, leads to an increase in Poland's premium of 25 bps roughly three quarters after shock. As a result of higher financing costs and weaker foreign demand, Poland's output gap widens by 0.2 percentage points relative to baseline, with the accumulated output loss amounting to 1.5 percentage points over three years. The downturn would be significantly more severe if monetary policy in Poland were constrained by the need to support the exchange rate. A historical shock decomposition exercise shows that demand and financial shocks from the euro area played a major role in driving Poland's business cycle fluctuations, particularly in the 2008–09 crisis.

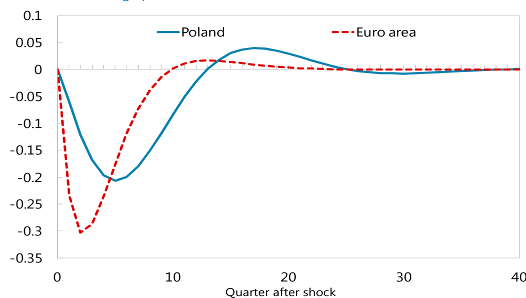
Responses to a Financial Shock in Euro Area

External Finance Premium
(Percentage point deviation from baseline)



Source: GPM simulation.

Output Gap
(Percentage point deviation from baseline)



Source: GPM simulation.

[1] Prepared by Giang Ho. Roberto Garcia-Saltos and Michal Andrle (RES) provide inputs for the Global Projection Model. See also the forthcoming Selected Issues Paper ,"*Economic and Financial Linkages with the Euro Area.*"

Authorities' views

15. The authorities broadly shared staff's views on the near-term outlook. The central bank's GDP growth projections for 2012–13 differ slightly from staff's in terms of timing. While staff projects a sharper slowdown in 2012 and a moderate recovery in 2013, the central bank expects somewhat higher growth in 2012 and a deceleration in 2013. There are also some differences in the path for public investment.

16. The authorities also agreed that risks emanated mainly from external sources, and emphasized that confidence effects stemming from uncertainty about the situation in the euro area were a critical spillover channel. They also underscored the wide range of actions undertaken by the KNF to reduce the flow of foreign-currency denominated mortgages.

POLICY DISCUSSIONS

17. In the face of the difficult external environment, Poland's near-term challenge is to balance continued adjustment and support for the economy. This means further reducing the fiscal deficit in line with current plans to ensure that public debt is put firmly on a downward path, keeping policy interest rates on hold to cushion demand, and continuing to strengthen the resilience of the financial system. If downside risks were to materialize, there is some space for counter-cyclical fiscal policies, but it is narrower than in the past. The policy mix would therefore need to rely on monetary policy as the first line of defense. Poland has generally been receptive to past Fund advice (Box 4).

Box 4. Implementation of Past Fund Advice

Past Fund advice has been well-received, with action taken in several important areas:

- **Fiscal policy:** The authorities have embarked on an ambitious fiscal consolidation, in line with past Fund advice. The authorities also plan to introduce a permanent fiscal rule to strengthen the fiscal framework, anchoring it firmly at MTO.
- **Financial sector:** The authorities took steps to strengthen the financial sector, including supervisory measures to tighten standards on foreign currency lending to households. They share the Fund's views on the importance of developing the resolution and the macro-prudential frameworks, with work in these areas pending.
- **Structural reforms:** Fund advice focused on three main areas: increasing labor force participation, reinvigorating privatization, and eliminating barriers to economic activity. The authorities took actions on all fronts, including the recent initiative to increase and equalize of retirement age for men and women. Despite unfavorable market conditions, privatization was accelerated, with above 700 state companies privatized in 2008-2011. Reducing red-tape barriers has been a priority, with two de-regulation laws, limiting documentation/licensing requirements approved in 2011.

A. Monetary and Exchange Rate Policies

18. Monetary policy responded to shifting inflation risks in 2011. The NBP raised the policy rate by a cumulative 1 percentage point to 4½ percent in the first half of 2011 as inflation pressures mounted. In the second half of the year, the tightening cycle was suspended on concerns about the intensification of the crisis in Europe and potential spillovers to Poland. In response to zloty depreciation in late 2011, the NBP carried out sporadic interventions in the foreign exchange market to curb excessive volatility. Heightened uncertainty about external and domestic liquidity conditions has led banks to increase liquidity holdings, affecting the functioning of the interbank market as evidenced by an interbank interest rate (POLONIA) persistently below the policy interest rate (Box 5).

19. Monetary policy should remain on hold. In May, the Monetary Policy Council (MPC) increased policy interest rates by 25 bps, citing the need to respond to inflation that was persistently above its 2½ percent target and forecasted to decline only slowly in the coming quarters, to preserve credibility. Staff was of the view that, in light of the slowing economy, the projected decline in inflation, and muted wage pressures, monetary tightening was not warranted. It also noted the absence of second-round effects from the earlier increases in commodity prices (which contributed ⅔ of the increase in inflation), slowing credit growth, declining core inflation, and market expectations that inflation will fall within the target band by 2013. In June, the MPC left rates unchanged.

20. The authorities' decision to increase the level of international reserves will further boost adequacy. Staff reiterated that, while international reserves have grown substantially and are broadly adequate under most metrics, they failed to cover short-term debt on a remaining maturity basis plus the current account deficit. In light of external risks and large gross external financing needs, additional reserve accumulation would boost adequacy—despite the floating exchange rate and the contingent balance of payments support provided by the FCL arrangement. Staff also suggested that a clearly-specified strategy on the pace of reserve accumulation would improve transparency.

21. Monetary policy should be the first line of defense in the face of an adverse external shock. In the face of a deeper downturn, the policy rate should be cut and the cushioning role of the flexible exchange rate should be exploited to the maximum extent possible. However, given the stock of foreign-currency denominated mortgages, careful attention would need to be paid to the effects of zloty depreciation on bank liquidity, and bank and household balance sheets. In this regard, the NBP's readiness to provide liquidity both in zloty and foreign currency is welcome. At the same time, staff recognized that, in the event of a severe shock, particularly if Poland faces capital outflows, monetary policy options may be constrained by the need to avoid excessive zloty depreciation.

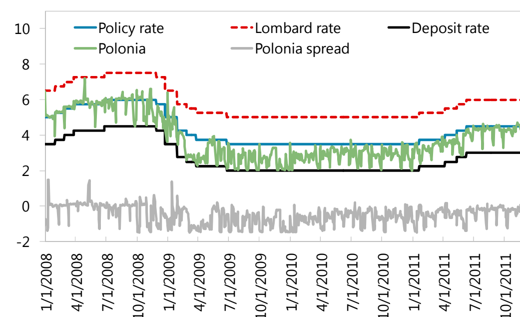
Box 5. What Drives the POLONIA Spread?[1]

The Polish central bank implements monetary policy by conducting open market operations to keep the Polish Overnight Index Average (POLONIA) in close proximity to the policy rate. The ability to do so, as an initial step in the monetary policy transmission mechanism, can transmit the monetary policy signal to the cost of funding for banks and lending rates. The POLONIA movement has closely followed the tightening and easing cycles of the monetary policies. However, since 2009, the POLONIA has often stayed below the policy rate and has done so persistently.

Several potential candidates that could influence the spread between the POLONIA and the policy rate, or the "POLONIA spread", are explored. The interaction of liquidity supply and demand determines the liquidity situation in the interbank market and hence the spread. This could be influenced by the NBP's FX purchases from the MOF, banks' liquidity demand as reflected in their participation in NBP's OMOs, and frontloading of the fulfillment of the reserve requirement. The stress in euro area and domestic interbank markets could also contribute to the movements of the spread. In addition, the NBP's repo and fine-tuning operations may affect the liquidity situation and influence the spread.

An empirical analysis confirms the persistently negative POLONIA spread since 2009. This is related to the existence of the structural liquidity in the banking system—NBP's FX purchases—and banks' underbidding due to unwillingness to lock up liquidity in the seven-day NBP bills. The frontloading of banks' fulfillment of the reserve requirements also plays a role, particularly during the last few days of the maintenance period. In addition, external market sentiment also has some influence on the spread.

Policy Rate, POLONIA, Corridor, and POLONIA Spread
(Percentage points)



Sources: NBP; Reuters; and IMF staff estimates.

NBP's response to the fluid liquidity situation has been effective. The repo operations initiated as a response to the financial crisis have played a positive role in steering the POLONIA towards the policy rate. The liquidity-absorbing fine-tuning operations seem to be successful in reducing both the level and volatility of the POLONIA spread, particularly in the case of the regular fine-tuning operations introduced recently. However, the persistently negative spread may have weakened the monetary policy transmission mechanism.

It is challenging to keep the POLONIA in close proximity to the policy rate. It requires a stable external environment that reduces banks' incentive to hoard liquidity. In the short term, the NBP should be provided with the necessary information to forecast liquidity. In this regard, it is important for the NBP to have advanced information regarding MOF's anticipated FX exchanges. In the medium to long term, enhancing the activities of interbank market and developing long-term local currency funding could help banks to conduct better asset and liability management, a conduit for the improvement of the monetary policy transmission mechanism.

[1] Prepared by Yinqiu Lu. See also the forthcoming Selected Issues Paper, "*What Drives the Spread between the POLONIA and the Policy Rate?*"

Authorities' views

22. The authorities agreed that monetary policy should remain accommodative. Even with the recent rate hike, they felt that monetary policy would still provide support to the economy. They also agreed that there was scope to cut policy rates in the event of a deeper downturn and a weaker outlook for inflation.

B. Entrenching Fiscal Consolidation

23. The fiscal deficit was reduced significantly in 2011. With public debt close to an important legal threshold, deficit reduction was essential.[1] The fiscal deficit dropped from 7¾ percent of GDP in 2010 to 5.1 percent in 2011 on the back of buoyant tax collections, a redirection of pension contributions from the second to the first pillar, and fiscal consolidation measures. The latter included an increase in VAT rates, a freeze in PIT thresholds, and a temporary expenditure rule that included a public wage freeze. Public debt (ESA95 basis) increased to about 56 percent of GDP (53.5 percent of GDP based on the national definition and below the preventive constitutional threshold).

24. Further substantial consolidation is underway. Fiscal measures of 1¼ percent of GDP—equally balanced between revenue and expenditure—were included in the 2012 budget (text table). A narrowing of local government's deficits, the full-year effect of the redirection of pension contributions, and increased dividends from state-owned enterprises are expected to generate an additional 0.9 percent of GDP in deficit reduction. Staff expects the deficit to decline to 3.1 percent of GDP in 2012, while public debt (ESA95 definition) would drop to around 55 percent of GDP. In light of uncertain market conditions going forward, the authorities have frontloaded the financing of the 2012 deficit, with 70 percent of financing needs met by mid-May.

Poland: Fiscal Policy Measures, Staff Estimates, 2012
(in Percent of GDP)

Revenue	
Excise tax increases	0.2
Freeze PIT thresholds	0.1
Disability contribution increase	0.2
Extraction tax	0.1
Other	0.1
Total Revenue Yield	0.7
Expenditure	
CPI+1 rule	-0.2
Abolition of early retirement scheme	-0.4
Total Expenditure Yield	-0.6
Total Consolidation Measures	1.3
Pension contribution changes	0.5
Improvement in local goverments' balances	0.3
Increases in dividends from state-owned companies	0.1
Total Measures	2.2

[1] The Public Finance Act establishes two preventive debt thresholds that apply to the national definition of public debt (excluding the debt of the National Road Fund that is included in the ESA95 definition). The first threshold, at 50 percent of GDP is mainly indicative. The second threshold, at 55 percent of GDP, requires the implementation of fiscal measures to curb the increase in debt, including a nominal wage freeze, increases in VAT rates, and a limit on pension indexation. The Constitution caps public debt at 60 percent of GDP.

25. Reducing public debt is a key medium-term priority. A much lower public debt ratio would rebuild buffers and give policymakers flexibility to respond to future shocks. In this regard, the authorities' medium-term objective (MTO) of a 1 percent of GDP structural fiscal deficit by 2015 is appropriate. Based on current policies, staff estimates that additional measures of about ¾-1 percent of GDP would be necessary to achieve the MTO. In this regard, staff noted the sizable cuts in public investment in the authorities' fiscal program and saw merit in a broad review of expenditures to identify priorities and areas where low-priority spending can be reduced. This will help avoid excessive cuts in public investment, which is crucial to meeting Poland's still-significant infrastructure needs. In addition, there is scope to simplify and eliminate inefficiencies in the tax system and to reduce tax preferences.

26. Staff supports the authorities' intention to introduce a permanent fiscal rule. The authorities are considering an expenditure-based rule with a debt brake, which would limit increases in public debt while still allowing for counter-cyclical fiscal policy. Staff underscored the need for appropriate flexibility in the rule, notably an escape clause, to ensure that the authorities have sufficient flexibility to deal with severe shocks. The proposed rule would be anchored on the MTO, which is sensible. Staff also welcomed the proposed fiscal rule for the local government, which would limit their debt and deficits.

27. The recent pension reform will contribute to Poland's long-term fiscal sustainability. In May, the parliament passed legislation that will gradually increase and equalize the retirement age to 67 for men and women (from 65 and 60, respectively). The increase will take place over 8 years for men and 28 years for women. While the short-term fiscal impact of the reform will be minimal, the long-term effect would be more substantial. Although Poland's public pension system is already a defined contribution scheme, the increase in the retirement age will support higher pensions in the longer-term and reduce reliance on social benefits, which should help strengthen public finances. Staff also welcomed the authorities' initiatives to reform the special pension regimes and suggested that these could be aligned with the main pension system over time.

28. In the event of a significant deterioration of the external environment, there is scope for some counter-cyclical fiscal response. This scope is more limited than in the past, given the level of public debt and its closeness to the constitutional debt limit. Nonetheless, staff recommended that automatic stabilizers be allowed to operate to support the economy and that a credible medium-term strategy to reduce the deficit and debt over time be developed. Given the authorities' impressive track record of policy implementation, the latter should be straightforward.

Authorities' views

29. The authorities broadly agreed with staff's assessment, but believed that the 2012 fiscal deficit and public debt ratio would be slightly lower than staff's projection. On the medium-term path, the authorities were of the view that the enacted measures, alongside lower public investment, would be sufficient to achieve the MTO by 2015. They recognized the need to protect public investment but viewed the rapid decline of public investment in their projections as

consistent with the drop off in EU structural funds after 2011. They noted that additional fiscal measures could be considered, if needed, and reiterated their commitment to the fiscal consolidation. The authorities also saw merit in conducting an expenditure review to identify priority spending, but were less persuaded on the need for revenue measures. At the same time, they underscored their efforts to improve the efficiency of the tax system. The authorities also emphasized that adopting a permanent fiscal rule would further strengthen Poland's finances in the longer term.

C. Safeguarding Financial Stability

30. The banking system appears well prepared to withstand an adverse scenario. Stress tests conducted by the NBP—which use a sufficiently severe set of macroeconomic assumptions—indicate that overall the system can withstand adverse shocks. At the same time, banks financed mainly by foreign funds or that hold large portfolios of foreign currency denominated loans would be the most affected. Staff therefore supports the measures undertaken by KNF to strengthen the banks' capital and liquidity buffers which are necessary to cope with adverse market and macroeconomic developments. The authorities' work to develop a more comprehensive framework for long-term bond issuance is an important step toward improving banks' funding profiles in line with regulatory requirements outlined in the Basel III framework.

31. Recent supervisory measures to address the high level of foreign currency mortgages are welcome. Increased capital and liquidity requirements have boosted buffers to deal with credit and liquidity risks that could arise if the zloty depreciates. Staff urged the KNF to continue to maintain close supervisory oversight of banks and implement targeted actions to contain FX lending risks (i.e. restrictions of activities or, if needed, Pillar 2 measures). While these measures should lead to a reduction in new foreign currency mortgages, staff suggested that a further tightening of prudential regulations (i.e. imposing more conservative loan-to-value ceilings) should not be excluded.

32. Staff favored a more proactive approach to address the outstanding stock of non-performing loans. While higher capital buffers and tighter lending standards provide safeguards against risks to asset quality, a more proactive approach to address NPLs should be explored, as this would help ensure that NPLs are addressed at an early stage and do not undermine credit and growth prospects going forward. This could include increased *voluntary* out-of-court debt restructuring by banks under strict prudential rules (i.e. conservative prudential treatment for loan restructuring) and supervisory scrutiny (active onsite oversight with emphasis on loan classification and provisioning).

33. Recent and proposed improvements in Poland's supervisory framework are welcome. The KNF stepped up the intensity of its supervisory processes in line with the recommendations of the 2011 Report on Observance of Standards and Codes, which is commendable. More frequent onsite examinations, targeted and timely supervisory actions, and a close dialogue with home supervisors are essential for monitoring and containing risks in the banking sector. Additional

supervisory resources may be needed to ensure that the KNF can effectively increase the scope and intensity of supervision, including of the credit union sector (SKOK).

34. A specific bank resolution regime would enable the authorities to resolve financial institutions promptly and in an orderly manner. Work on such a framework, led by the Bank Guarantee Fund (BFG) and with the engagement of the World Bank, should provide a diversified toolkit and a clearly identified resolution authority, taking into consideration the Financial Stability Board's *Key Attributes for Effective Resolution Regimes* and evolving European legislation. Conclusion of this work and passage of relevant legislation are priorities.

35. Staff supports the authorities' intention to establish a macro-prudential framework under the aegis of a multi-agency Systemic Risk Board. In line with the recommendations of the European Systemic Risk Board, the framework should aim to identify, monitor, and contain systemic risks and to become fully operational by end-June 2013.[2] Close cooperation among relevant authorities is necessary in the process of developing the proposed legislative and operational frameworks and IMF technical assistance was provided in this area.

Authorities' views

36. The authorities emphasized that they are implementing forward looking reforms to further strengthen the financial sector. They noted that key initiatives, including developing an effective resolution regime, a well articulated macro-prudential framework, and a deeper market for long-term bond issuance, all aim at improving the resilience of the financial sector. The authorities welcomed the Financial Sector Assessment Program (FSAP) Update scheduled for 2013 as an opportunity to engage in in-depth discussions on financial sector issues, including in the areas of supervisory framework, crisis management and resolution, and macro-prudential policies.

D. Deepening Structural Reforms and Euro Adoption

37. Deepening structural reforms is crucial for long-term growth. The remaining structural rigidities appear high, as suggested by the still low labor participation rates compared to the EU average, or the low place in cross-country rankings of business climate. Despite continued privatization efforts, the share of the public sector has stabilized around 20 percent of GDP in recent years. Pushing forward structural reforms is vital to boost growth potential in the long-term.

38. Further progress was made in eliminating structural bottlenecks over the past year. The recently passed pension reform should improve labor participation. Measures to reduce

[2] Recommendation of the European Systemic Risk Board of (12/22/2011) on the macro-prudential mandate of national authorities http://www.esrb.europa.eu/pub/pdf/ESRB_Recommendation_on_National_Macroprudential_Mandates.pdf?87d545ebc9fe76b76b6c545b6bad218c.

administrative burdens enacted last year broadened the use of electronic documents, simplified one-stop-shop regulations, and replaced many documentation requirements with declarations. Privatization was continued despite unfavorable market conditions: roughly 200 firms were sold in 2011, yielding receipts of around 1 percent of GDP.

39. Possible reforms include:

- **Labor market:** The labor market would benefit from better job-matching services, and the pilot project to address regional disparities in employment conditions by targeting services to local needs is welcome. Given high youth unemployment, efforts to reduce skill-mismatches by better aligning the education system to job needs should continue. Anti-crisis employment provisions, including flexible rules on short-term contracts, could be made permanent.

- **Product markets:** Given the large number of licensed professions, plans to ease access to them are welcome. Streamlined rules for construction permits and land use would also improve the business climate. Privatization should be continued, guided by the authorities' goal to reduce the public sector's role in the economy, and the government's program covers 300 firms in 2012–13.

40. Euro adoption remains an important long-term objective. The authorities continue to make progress toward convergence, fulfilling the entry criteria, and preparing necessary changes to the Constitution. No target date has been announced.

Authorities' views

41. The authorities expressed their strong commitment to continuing structural reforms. They concurred with the staff on the importance of reforms for long-term growth. They pointed to measures taken in the education system, including a greater focus on, and financial support for, math and hard sciences. They also noted increased access to pre-school facilities, which should improve the quality of education and facilitate women's labor force participation. Reforms of the tax and social security systems for farmers—to better align them with the main system—are being considered.

STAFF APPRAISAL

42. Poland has performed even better than expected in the face of a challenging external environment. This has reflected very strong fundamentals, robust domestic demand, and sound macroeconomic management. Poland's precautionary Flexible Credit Line arrangement with the IMF has helped maintain confidence in the country's policies. Fiscal space to respond to adverse shocks is now more limited, and there remain some vulnerabilities.

43. The economy is slowing and external risks are rising. Uncertainty, confidence effects, lower external demand, and tighter lending conditions are weighing on growth. Risks are to the downside, and emanate mainly from the possibility of an intensification of the euro zone crisis. Poland's high interconnectedness with Europe would give rise to adverse spillovers through trade, FDI, and financial channels. Shifts in investor risk appetite could also have an impact, given Poland's large external financing needs. Recent actions by the authorities—including frontloaded public debt issuance and supervisory actions to further strengthen banks' buffers—help mitigate these risks.

44. The fiscal adjustment has been impressive and should continue. After declining by nearly 3 percentage points of GDP in 2011, the deficit is expected to decline by a further 2 percentage points of GDP—reaching 3.1 percent of GDP—in 2012. This should start to put public debt firmly on a downward path. If the growth outlook were to deteriorate significantly, automatic stabilizers should be allowed to operate to support the economy.

45. Public debt should be further reduced over the medium term to rebuild fiscal buffers. The authorities' MTO of achieving a structural fiscal deficit of 1 percent of GDP by 2015 is appropriate and should allow for sustained reductions in public debt. Additional permanent fiscal measures of about ¾-1 percent of GDP will be needed to achieve the MTO. Although some decline in EU-funded public investment is appropriate given its very high current levels, excessive cuts should be avoided given Poland's still-significant infrastructure needs. The proposed permanent fiscal rule, anchored on the MTO, should strengthen public finances while still providing flexibility to deal with unexpected shocks. The recent pension reform will contribute to long-term fiscal sustainability.

46. Monetary policy should remain on hold. Given the economic slowdown, the projected drop in inflation, and muted wage pressures, hikes in policy interest rates do not appear warranted. If the economy were to slow significantly and the outlook for inflation to weaken, rates should be cut. In the event of an external shock that gives rise to liquidity strains, the NBP should provide emergency liquidity support in both zloty and foreign currency, as was the case during past episodes of financial turbulence. International reserves have grown substantially in recent years, and the decision to increase them will further boost adequacy.

47. The banking system has continued to perform well, and recent supervisory measures are helping to contain risks. The banking system has remained highly profitable, well capitalized, and liquid. Nonetheless, mortgage portfolios denominated in foreign currency and non-performing loans (NPLs) continue to pose risks. Higher capital and liquidity buffers are helping to mitigate these risks, and the KNF's regulatory tightening and increased supervisory oversight should lead to a deceleration of new foreign currency mortgage lending. A more proactive approach to addressing NPLs would further strengthen the resilience of the banking system.

48. Recent and proposed improvements to the frameworks for financial sector supervision, funding, resolution, and stability are commendable. More frequent on-site supervision, targeted and timely supervisory action, and a close dialogue with home supervisors are essential to monitor

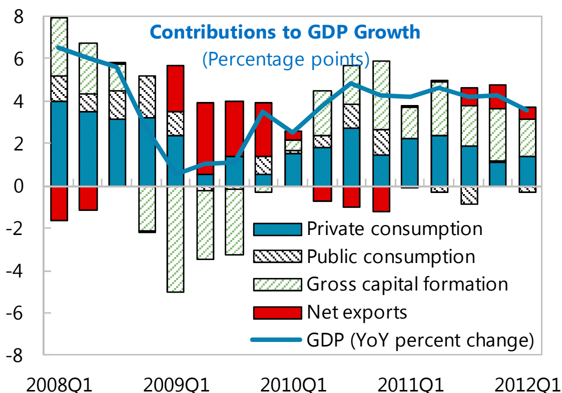
and contain risks in the banking sector. The work to develop more comprehensive framework for long-term bond issuance will help improve bank funding profiles. A specific bank resolution regime is needed to enable the authorities to resolve financial institutions promptly and in an orderly manner and work in this area should be given high priority. The authorities' intention to establish a macro-prudential framework to identify, monitor, and contain systemic risks is welcome.

49. Long-term economic prospects will depend crucially on structural reforms. Continued reforms would further unleash growth potential, and are especially important given Poland's adverse demographic trends. Strengthening the functioning of the labor market, improving the business climate, and advancing privatization plans are key areas of reform.

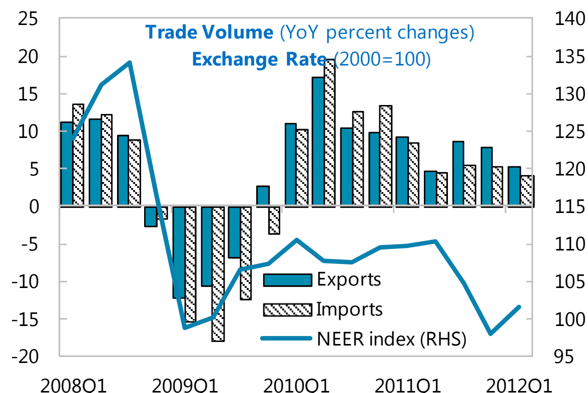
50. It is recommended that the next Article IV consultation remain on a 12-month cycle.

Figure 1. Poland: Recent Developments in Economic Activity, 2007–12

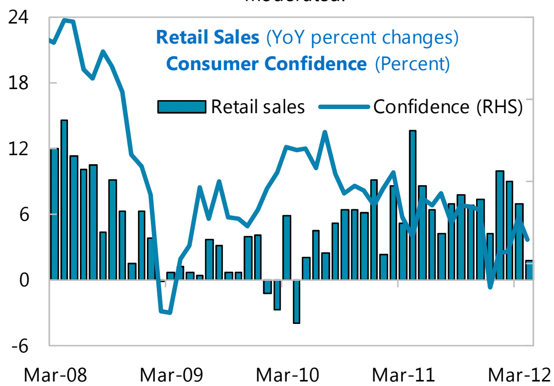
GDP growth moderated in Q1, on the back of weakening domestic demand...



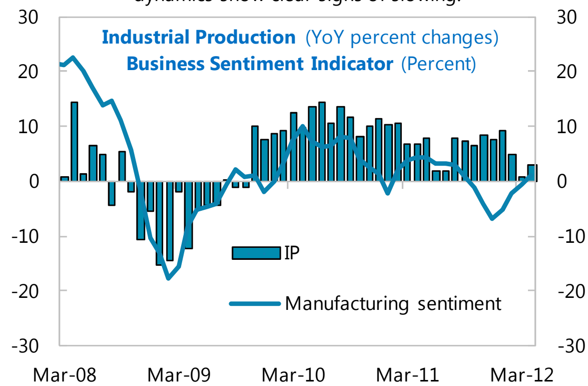
...while net exports have benefited from the weak currency.



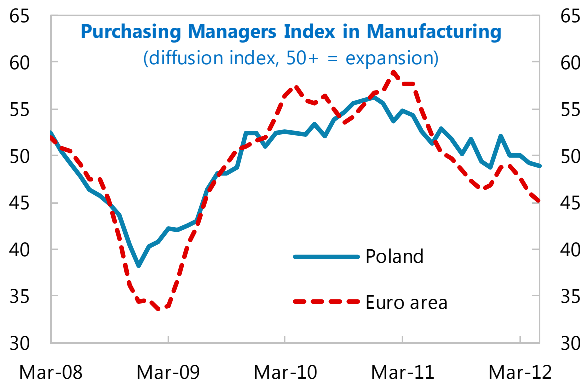
As consumer confidence deteriorates, retail sales growth has moderated.



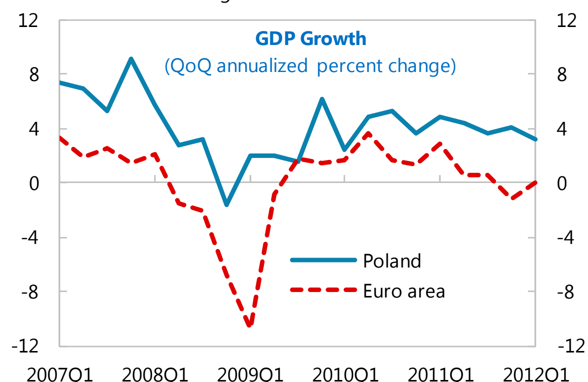
Business sentiment is weak, and industrial production dynamics show clear signs of slowing.



Manufacturing PMI in Poland and euro area are highly correlated...

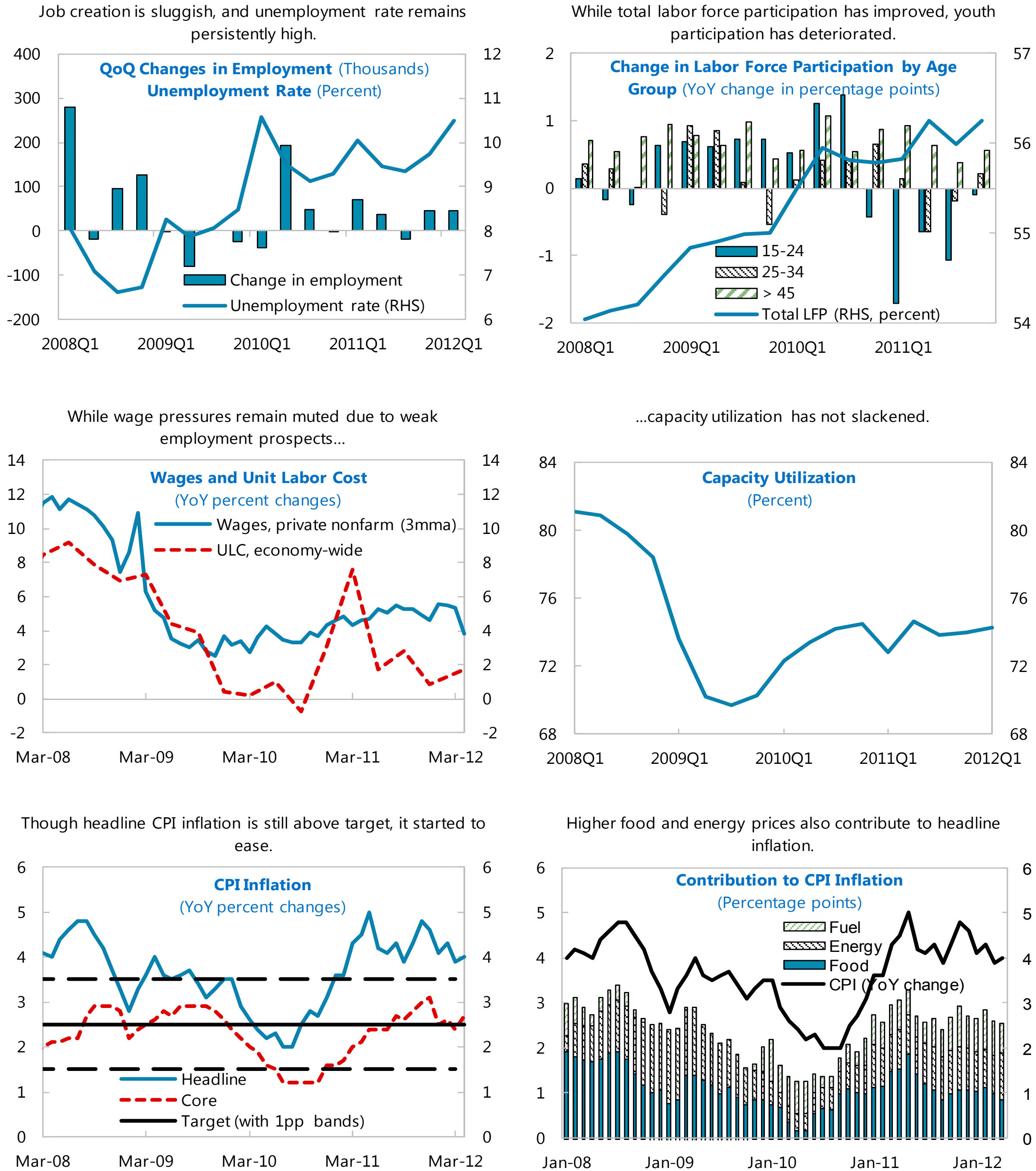


...but growth in Poland was relatively robust despite the weakening outlook in the euro area.



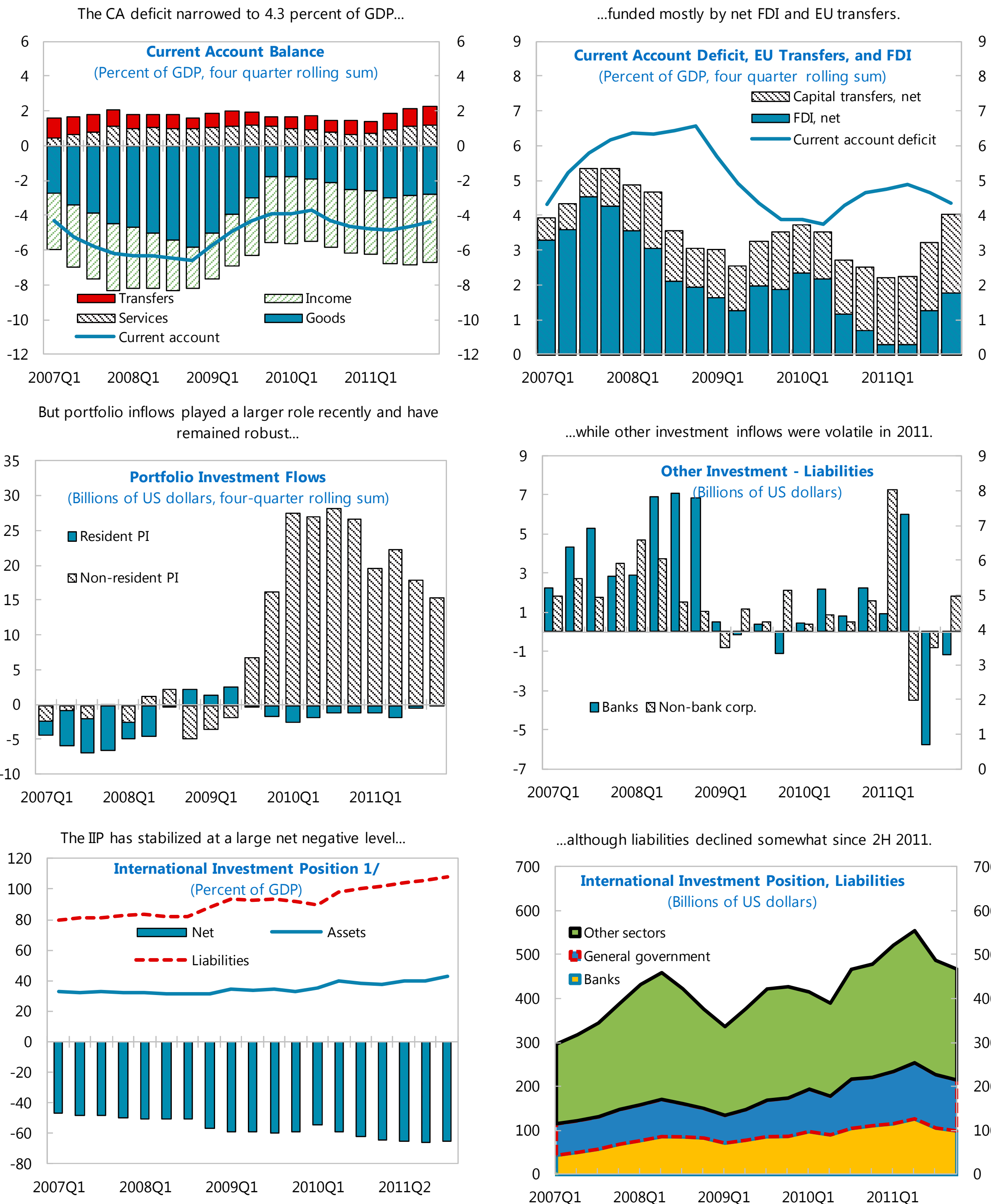
Sources: Haver; and IMF staff estimates.

Figure 2. Poland: Labor Market, Capacity Utilization, and Inflation, 2008–12



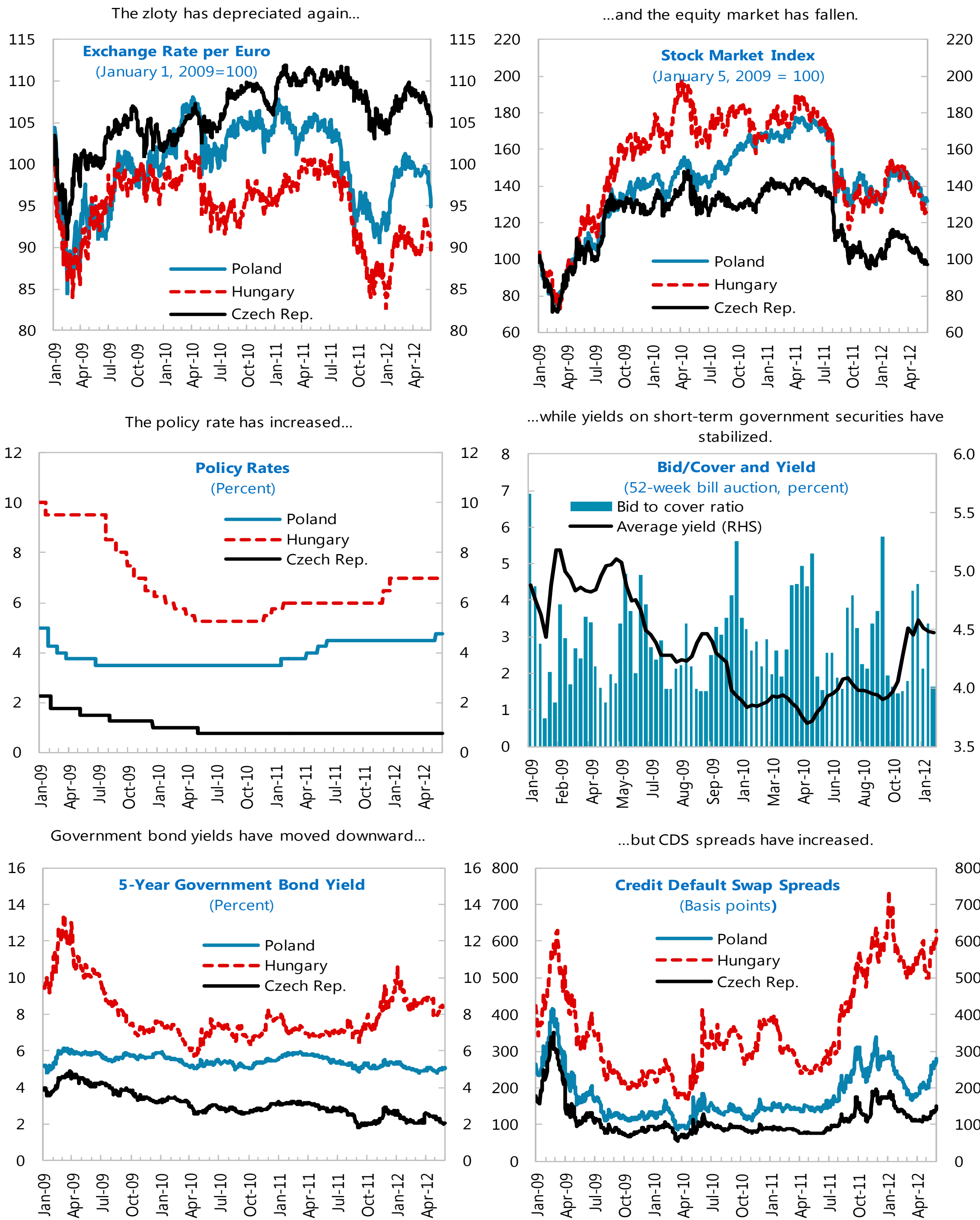
Sources: Haver; Poland Statistics Office; and IMF staff estimates.

Figure 3. Poland: Balance of Payments Developments, 2007–11



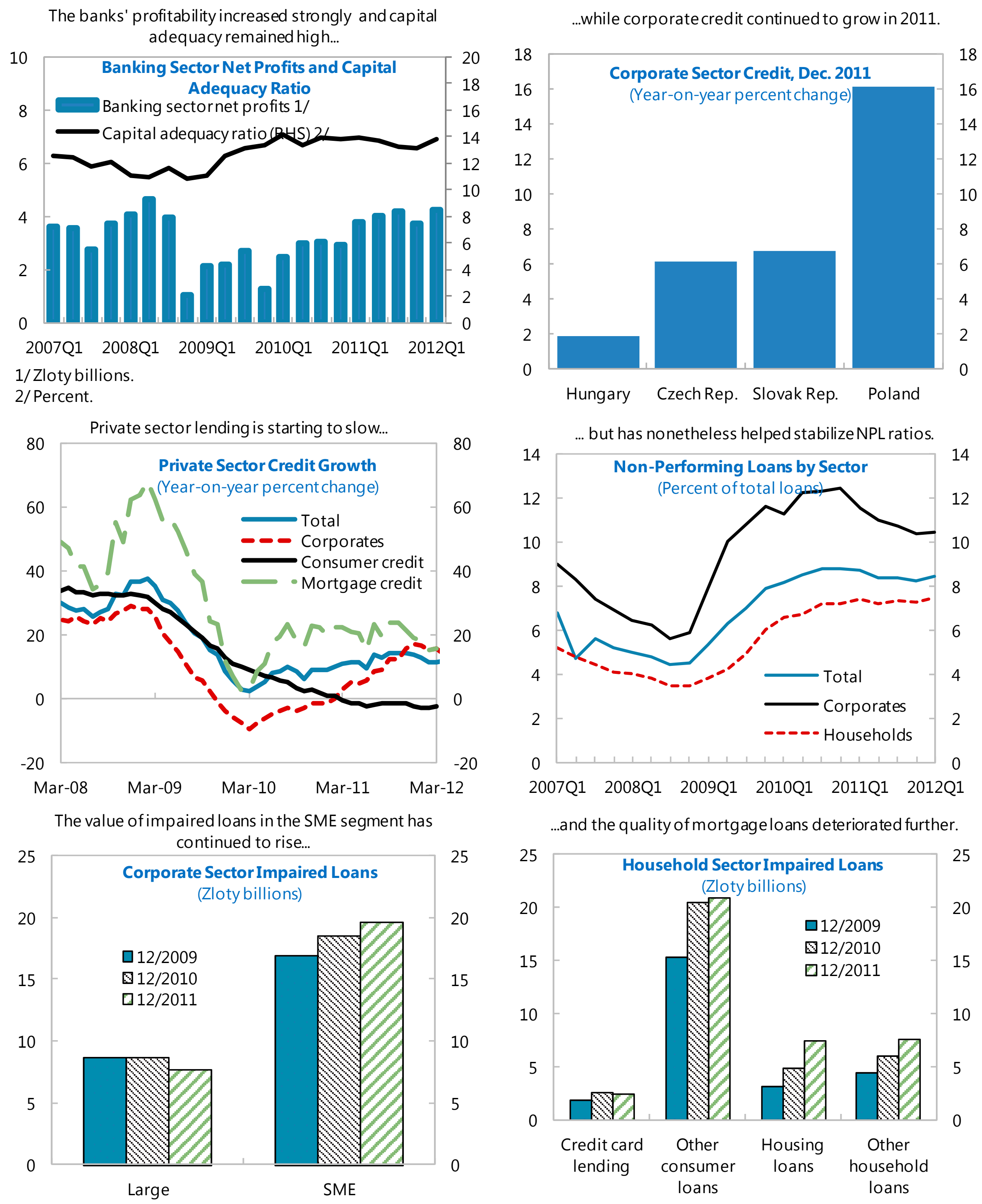
Sources: National Bank of Poland and IMF staff estimates.
1/ Excludes NBP.

Figure 4. Poland: Monetary and Financial Developments, 2009–12



Sources: Bloomberg; and Polish Ministry of Finance.

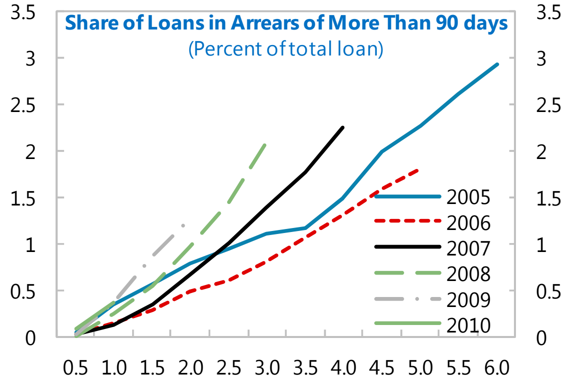
Figure 5. Poland: Banking Sector Developments, 2007–12



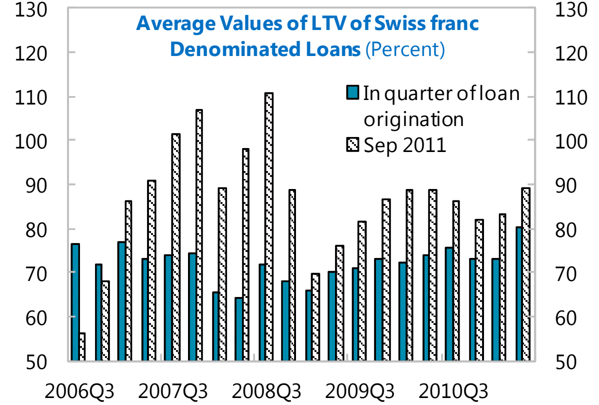
Sources: National Bank of Poland; KNF; Bloomberg; and IMF staff estimates.

Figure 6. Poland: Residential Real Estate Lending, 2006–12

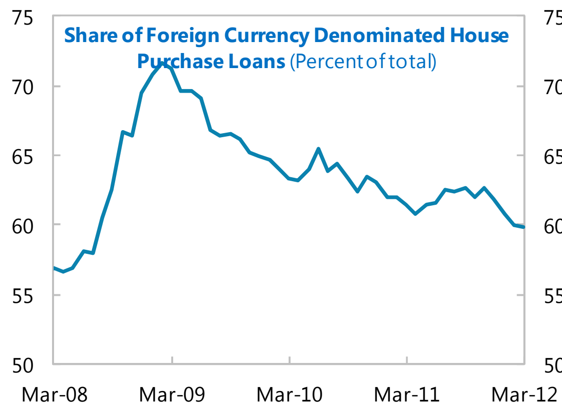
Vintages of mortgages provided in the credit boom period started displaying higher NPLs ...



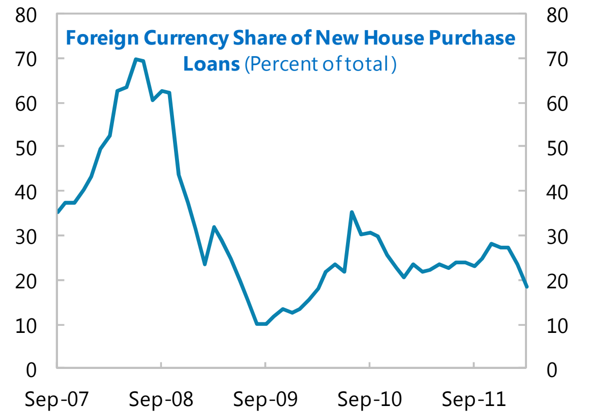
... and the LTVs of Swiss franc-denominated loans have deteriorated.



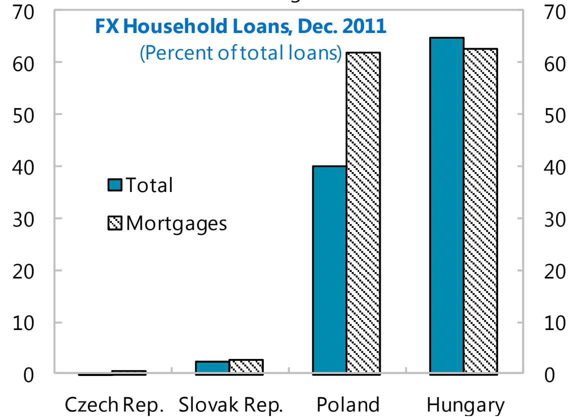
The share of FX mortgage loans in total is high...



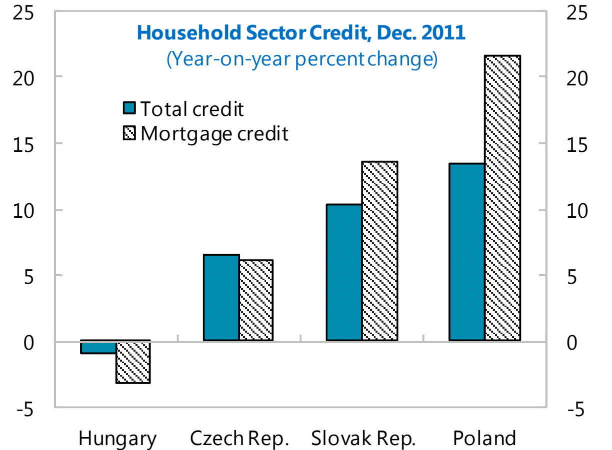
... and the share of new FX mortgage lending has started to decline.



Compared to peers, the share of FX Household Loans remains high ...

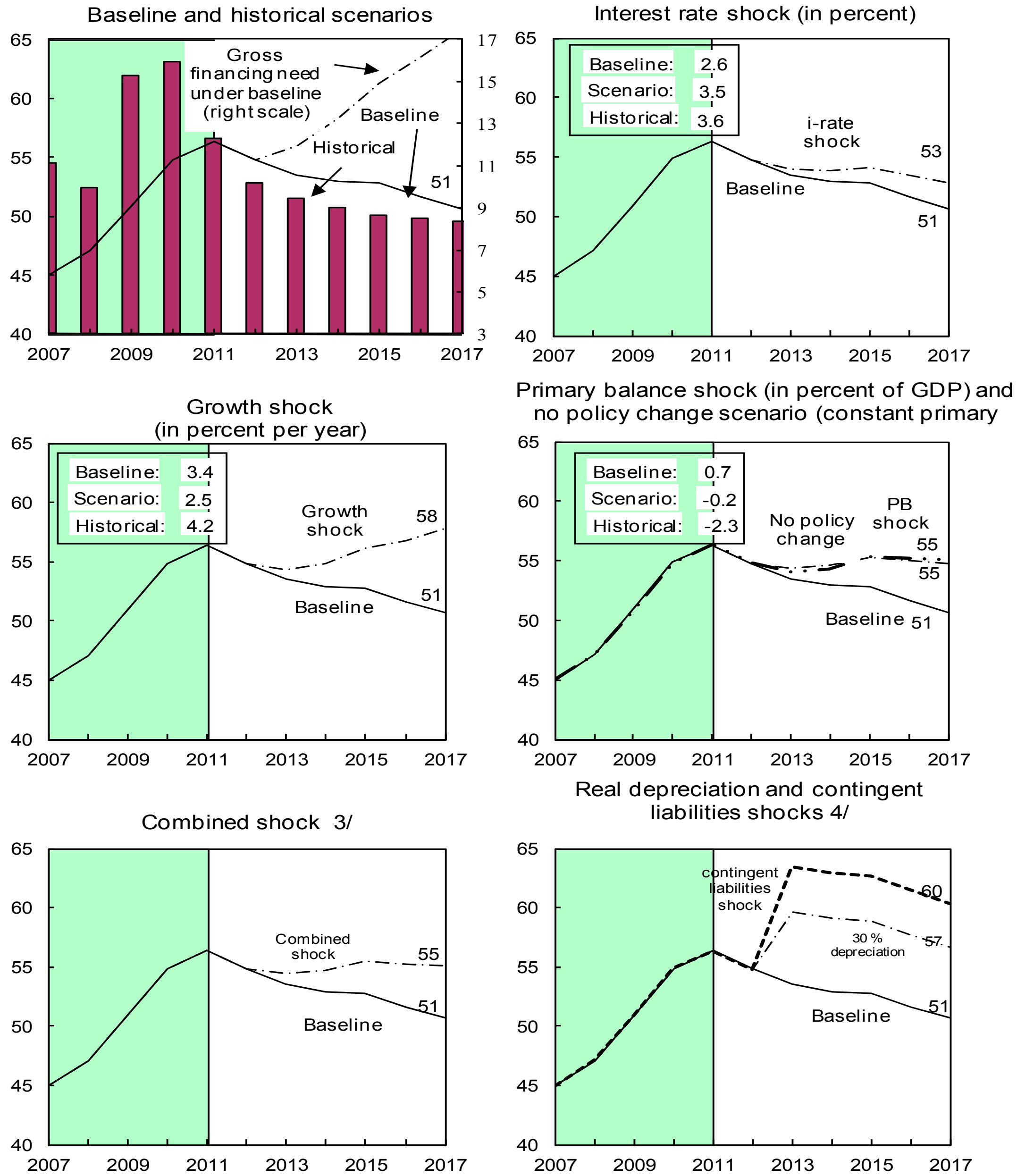


...and is substantially driven by mortgages.



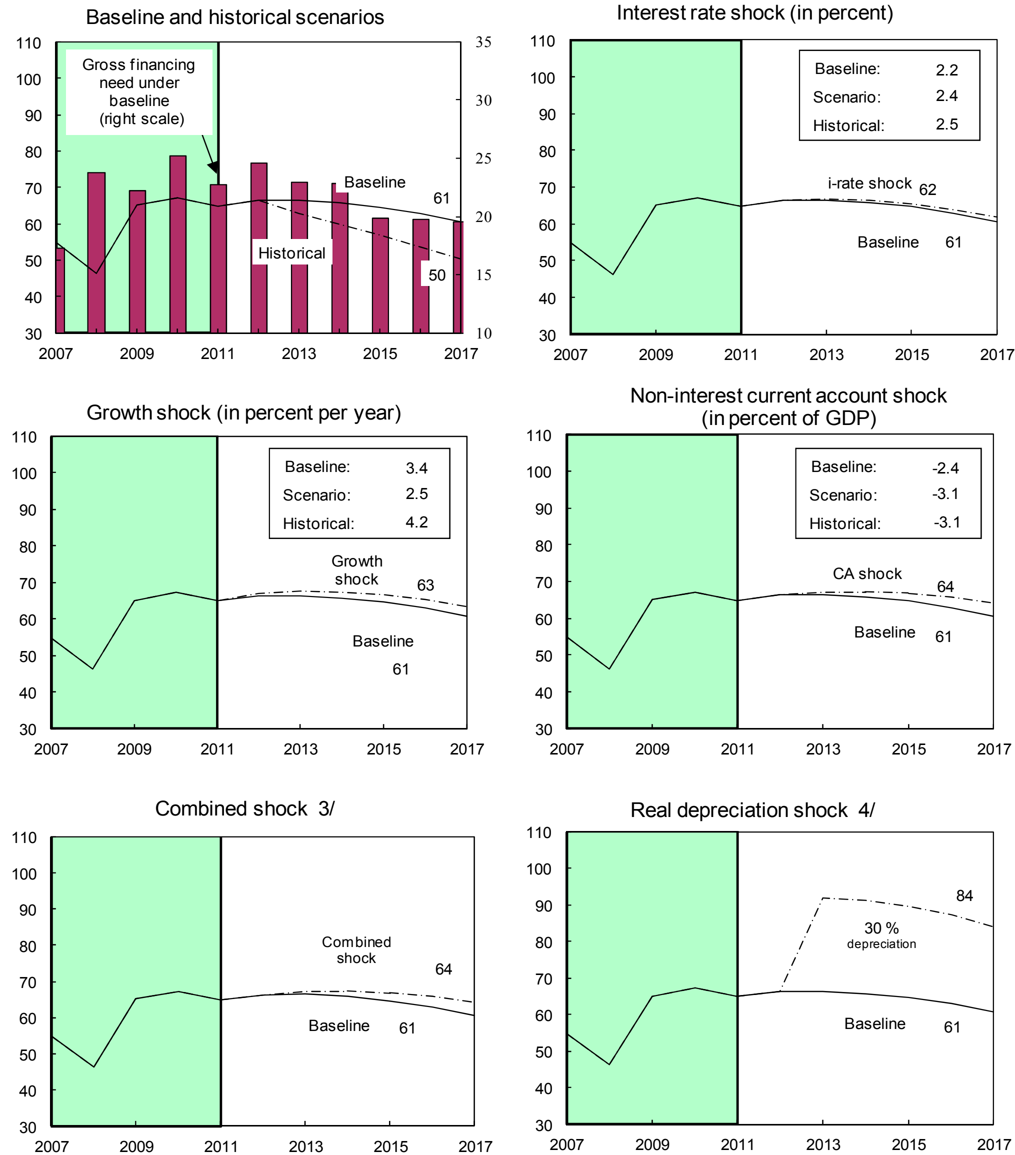
Sources: National Bank of Poland; KNF; Bloomberg; and IMF staff estimates.

Figure 7. Poland: Public Debt Sustainability: Bound Tests 1/ 2/



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 primary balance.
4/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2012, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Figure 8. Poland: External Debt Sustainability: Bound Tests 1/ 2/



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 2012.

Table 1. Poland: Selected Economic Indicators, 2010–17

	2010	2011 Est.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.
Activity and prices								
GDP (change in percent) 1/	3.9	4.3	2.6	3.0	3.3	3.4	3.6	3.7
Domestic demand	4.6	3.6	2.2	2.6	3.1	3.4	4.1	4.2
Private consumption growth	3.1	3.1	2.4	2.8	3.2	3.2	3.3	3.4
Public consumption growth	4.1	-1.3	1.1	1.8	1.6	1.9	2.5	2.9
Domestic fixed investment growth	-0.4	8.1	4.0	2.8	3.5	5.0	7.3	7.3
Inventories (contribution to growth)	2.0	0.4	-0.2	0.0	0.1	0.1	0.1	0.1
Net external demand (contribution to growth)	0.1	0.7	0.4	0.4	0.2	-0.1	-0.5	-0.5
Output gap	-0.2	0.3	-0.4	-0.3	0.0	0.0	0.0	0.0
CPI inflation (change in percent)								
Average	2.5	4.3	3.8	2.7	2.5	2.5	2.5	2.5
End of period	3.1	4.6	3.2	2.5	2.5	2.5	2.5	2.5
Unemployment rate (average, according to LFS)	9.6	9.6	9.4	9.2	9.0	8.8	8.7	8.5
Public finances (percent of GDP) 2/								
General government revenues	37.5	38.5	40.2	39.2	38.7	38.2	38.2	37.6
General government expenditures	45.4	43.6	43.3	41.7	40.9	40.0	40.0	39.4
General government balance	-7.9	-5.1	-3.1	-2.5	-2.2	-1.8	-1.8	-1.8
Structural primary balance adjusted for pension changes	-5.1	-3.1	-1.8	-0.7	-0.5	-0.1	-0.1	-0.1
Public debt	54.8	56.3	54.8	53.5	52.9	52.8	51.6	50.6
national definition 3/	52.8	53.5	…	…	…	…	…	…
Money and credit								
Private credit (change in percent)	9.2	14.5	6.3	...	...	...	...	...
Broad money (change in percent)	8.8	12.5	7.0	...	...	...	...	...
Policy Rate 4/	3.5	4.3	4.75	...	...	...	...	...
Balance of payments								
Current account balance (transactions, millions U.S. dollars)	-21,873	-22,128	-23,142	-21,635	-20,249	-20,265	-22,441	-25,351
Percent of GDP	-4.7	-4.3	-4.4	-4.0	-3.5	-3.4	-3.5	-3.8
Exports of Goods (millions U.S. dollars)	165,709	193,899	201,240	212,160	225,142	239,133	256,006	273,914
Export volume growth	12.1	8.8	3.9	5.5	6.3	6.6	7.1	6.9
Imports of Goods (millions U.S. dollars)	177,519	208,004	215,107	223,718	234,578	248,718	267,842	289,231
Import volume growth	13.9	6.6	3.0	4.5	5.8	6.7	8.0	7.9
Net oil imports (millions U.S. dollars)	16,567	22,744	25,734	25,421	24,522	23,961	23,855	24,122
Terms of trade (index 1995=100)	97.7	96.7	96.2	96.6	97.3	97.5	97.8	97.9
FDI, net (in percent of GDP)	0.8	1.8	1.8	1.9	1.9	2.0	2.2	2.3
Official reserves (millions U.S. dollars)	93,514	97,866	106,832	114,741	123,559	131,938	138,755	143,747
In percent of short-term debt plus CA deficit	75.0	85.7	80.6	89.1	93.0	109.9	110.6	108.9
Total external debt (millions U.S. dollars)	315,339	333,546	349,580	363,170	376,110	387,429	397,559	406,775
Percent of GDP	67.1	64.8	66.3	66.4	65.8	64.6	62.9	60.6
Exchange rate								
Exchange rate regime	Floating							
Zloty per US$, period average 5/	3.02	2.96	3.58	...	...	...	...	...
Zloty per Euro, period average 5/	4.00	4.12	4.41	...	...	...	...	...
Real effective exchange rate (INS, CPI based) 6/	112.1	110.4	...	...	...	...	...	...
percent change	6.3	-1.5	...	...	...	...	...	...
Memorandum items								
Nominal GDP (billion zloty)	1,416.4	1,524.7	1,595.1	1,685.7	1,790.7	1,899.5	2,023.6	2,159.7

Sources: Polish authorities; and IMF staff estimates.

1/ Real GDP is calculated at constant average prices of previous year.
2/ According to ESA95 (inc. pension reform costs). Including 2011 budget and announced measure as of March 2011.
3/ Excluding debts of the National Road Fund.
4/ NBP Reference Rate (avg). For 2012, as of June 1.
5/ For 2012, exchange rate as of June 1.
6/ Annual average (2000=100).

Table 2. Poland: Balance of Payments on Transaction Basis, 2009–17
(Millions of US dollars)

	2009	2010	2011	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.
Current account balance	**-17,155**	**-21,873**	**-22,128**	**-23,142**	**-21,635**	**-20,249**	**-20,265**	**-22,441**	**-25,351**
percent of GDP	-4.0	-4.7	-4.3	-4.4	-4.0	-3.5	-3.4	-3.5	-3.8
Trade balance	-7,617	-11,810	-14,105	-13,867	-11,557	-9,435	-9,586	-11,836	-15,317
percent of GDP	-1.8	-2.5	-2.7	-2.6	-2.1	-1.7	-1.6	-1.9	-2.3
Exports									
percentage change in unit values	-20.1	16.0	15.9	3.8	5.4	6.1	6.2	7.1	7.0
percentage volume growth	-6.8	12.1	8.8	3.9	5.5	6.3	6.6	7.1	6.9
growth in foreign demand	-15.9	15.6	8.1	2.1	4.0	4.7	5.1	5.0	5.0
Imports									
percentage change in unit values	-27.4	19.1	14.8	3.4	4.0	4.9	6.0	7.7	8.0
percentage volume growth	-12.4	13.9	6.6	3.0	4.5	5.8	6.7	8.0	7.9
growth in domestic demand	-1.1	4.6	3.6	2.2	2.6	3.1	3.4	4.1	4.2
Terms of trade percentage change	3.5	-1.1	-1.0	-0.5	0.4	0.7	0.3	0.3	0.0
Services balance	4,795	3,098	6,084	6,429	7,234	8,097	8,665	9,043	10,280
Credit	28,986	32,718	37,037	38,439	40,525	43,005	45,677	48,900	53,321
Debit	24,191	29,620	30,953	32,010	33,291	34,907	37,012	39,858	43,040
Net Income	-16,551	-16,923	-20,172	-20,339	-21,579	-22,565	-22,782	-23,124	-24,333
Net transfers	2,218	3,762	6,065	4,635	4,268	3,654	3,437	3,476	4,019
o/w EU receipts	5,603	5,918	8,397	8,218	8,528	8,074	8,038	7,997	7,953
o/w payment to EU	-4,265	-4,761	-5,004	-4,983	-5,443	-5,425	-5,400	-5,373	-5,343
Capital and financial account balance	**41,942**	**46,433**	**38,503**	**42,201**	**39,635**	**39,160**	**38,735**	**39,351**	**40,434**
Capital account balance	7,040	8,620	11,126	13,825	12,136	11,471	11,408	11,293	11,181
o/w net EU transfers	7,191	6,873	11,546	13,316	11,715	11,090	11,040	10,985	10,924
Financial account balance	34,902	37,813	27,377	28,376	27,499	27,689	27,328	28,058	29,254
Foreign direct investment (net)	8,460	3,574	9,144	9,685	10,174	10,890	11,921	13,730	15,722
by nonresidents	13,022	9,104	14,344	15,135	15,874	16,840	18,121	19,930	21,922
o/w privatization	1,263	2,699	351	131	130	128	126	125	124
Portfolio investment (net)	14,754	25,555	16,037	16,629	15,783	16,297	15,644	15,172	14,798
by non-residents	16,202	26,649	15,377	15,951	15,086	15,577	14,900	14,439	14,076
o/w equities	1,579	7,875	2,873	4,447	5,582	5,763	5,957	6,172	6,402
Other investment (net)	13,380	9,132	2,810	2,062	1,543	501	-237	-844	-1,266
Assets	5,275	-4,114	-2,893	-2,468	-2,542	-2,625	-2,613	-2,708	-2,809
Liabilities	8,105	13,246	5,703	4,530	4,085	3,126	2,376	1,863	1,542
Financial derivatives	-1,692	-448	-614	0	0	0	0	0	0
Errors and omissions	**-10,045**	**-9,426**	**-10,092**	**-10,092**	**-10,092**	**-10,092**	**-10,092**	**-10,092**	**-10,092**
Overall balance	**14,742**	**15,134**	**6,283**	**8,966**	**7,908**	**8,819**	**8,378**	**6,818**	**4,992**
Financing									
Reserve assets	-14,742	-15,134	-6,283	-8,966	-7,908	-8,819	-8,378	-6,818	-4,992
Memorandum items:									
Current plus capital account (percent of GDP)	-2.3	-2.8	-2.1	-1.8	-1.7	-1.5	-1.5	-1.8	-2.1
Official reserves	79,591	93,514	97,866	106,832	114,741	123,559	131,938	138,755	143,747
in months of imports	6.4	6.3	5.6	6.0	6.2	6.3	6.4	6.2	6.0
Ratio of reserves to short-term debt 1/	96.3	91.0	106.3	97.6	107.1	109.7	132.3	134.7	134.7
Ratio of reserves to ST debt plus CA deficit 1/	79.7	75.0	85.7	80.6	89.1	93.0	109.9	110.6	108.9
Total external debt (percent of GDP)	65.1	67.1	64.8	66.3	66.4	65.8	64.6	62.9	60.6
Total external debt (percent of exports) 2/	163.8	158.9	144.4	145.9	143.7	140.3	136.0	130.4	124.3
External debt service (percent of exports) 2/ 3/	47.4	51.2	43.1	45.8	42.5	42.9	37.2	36.7	36.3
Gross FDI inflows (percent of GDP)	3.0	1.9	2.8	2.9	2.9	2.9	3.0	3.2	3.3
Net FDI inflows (percent of GDP)	2.0	0.8	1.8	1.8	1.9	1.9	2.0	2.2	2.3

Sources: National Bank of Poland; and IMF staff estimates.
1/ Projected reserve level for the 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: Statement of Operations of General Government, 2008-17

(In percent of GDP)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
					Projections					
Revenue	39.5	37.2	37.5	38.5	40.2	39.2	38.7	38.2	38.2	37.6
Taxes	22.8	20.3	20.5	20.8	21.0	21.1	21.2	21.5	21.6	21.7
Personal income tax	5.3	4.6	4.5	4.5	4.6	4.7	4.9	5.1	5.2	5.3
Corporate income tax	2.7	2.3	2.0	2.0	2.1	2.1	2.2	2.3	2.3	2.4
VAT	7.9	7.3	7.6	7.7	7.8	7.7	7.3	7.3	7.3	7.3
Excises	4.2	3.6	4.0	4.0	4.1	4.0	4.0	4.0	4.0	4.0
Other taxes	2.7	2.5	2.5	2.5	2.5	2.5	2.8	2.8	2.8	2.8
Social contributions	11.3	11.3	11.1	11.4	12.4	12.4	12.5	12.6	12.6	12.5
Other revenue 1/	5.4	5.5	5.9	6.3	6.8	5.6	5.1	4.2	3.9	3.4
Capital revenue	0.4	0.6	1.3	1.8	2.1	1.7	1.4	1.0	0.9	0.6
Sales of goods and services	2.5	2.3	2.3	2.1	2.0	2.0	2.0	2.0	2.0	2.0
Other current revenue	2.5	2.6	2.4	2.4	2.7	1.9	1.6	1.2	1.0	0.8
Expenditure	43.2	44.5	45.4	43.6	43.3	41.7	40.9	40.0	40.0	39.4
Expense	38.6	39.3	39.8	37.8	37.8	37.0	36.9	36.5	36.5	35.9
Compensation of employees	10.0	10.3	10.2	9.8	9.7	9.5	9.3	9.0	9.0	9.0
Use of goods and services	6.2	5.7	6.2	5.7	5.7	5.7	5.7	5.7	5.7	5.7
Interest	2.2	2.6	2.7	2.8	2.9	2.8	2.7	2.7	2.7	2.6
Subsidies	0.6	0.5	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.4
Social benefits	16.1	16.9	17.0	16.2	16.0	15.5	15.8	15.8	15.7	15.2
Other expense 1/	3.5	3.3	3.2	2.9	3.1	3.0	3.0	2.9	2.9	2.9
Other current expenditure	2.6	2.3	2.4	2.3	2.3	2.3	2.2	2.1	2.1	2.1
Capital transfers	0.9	0.9	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Net acquisition of nonfinancial assets	4.6	5.2	5.6	5.8	5.5	4.7	4.0	3.5	3.5	3.5
Gross Operating Balance	0.9	-2.2	-2.2	0.7	2.4	2.2	1.8	1.7	1.7	1.7
Net lending/borrowing (overall balance)	-3.7	-7.4	-7.9	-5.1	-3.1	-2.5	-2.2	-1.8	-1.8	-1.8
Net financial transactions	-3.7	-7.4	-7.9	-5.1	-3.1	-2.5	-2.2	-1.8	-1.8	-1.8
Net acquisition of financial assets	0.4	-1.1	-1.1	-1.4	-0.9	-0.5	0.2	1.0	0.2	0.4
Currency and deposits	0.4	0.1	-0.6	-1.3	-0.8	-0.5	0.2	0.8	0.2	0.5
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	-0.1	0.0	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Equity and investment fund shares	-0.1	-0.4	-1.7	-1.3	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4
Other financial assets	0.2	-0.7	1.0	1.0	0.3	0.3	0.3	0.5	0.4	0.3
Net incurrence of liabilities	4.1	6.2	6.7	3.7	2.2	2.0	2.4	2.8	2.0	2.2
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	3.0	4.5	5.0	2.2	1.2	0.8	1.2	1.7	1.0	1.3
Loans	0.6	1.8	1.5	1.5	0.8	1.1	1.1	1.0	0.9	0.8
Other liabilities	0.5	-0.1	0.2	0.0	0.2	0.1	0.1	0.1	0.1	0.1
Adjustment and statistical discrepancies	*-8.5*	*-32.4*	*-16.2*	*-36.3*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Memorandum item:										
Cyclically-adjusted balance	-4.7	-6.9	-7.8	-5.2	-2.9	-2.4	-2.2	-1.8	-1.8	-1.8
Primary balance	-1.5	-4.7	-5.2	-2.4	-0.2	0.3	0.5	0.9	0.9	0.8
Structural primary balance adjusted for pension changes	-2.5	-4.3	-5.1	-3.1	-1.8	-0.7	-0.5	-0.1	-0.1	-0.1
General government debt	47.1	50.9	54.8	56.3	54.8	53.5	52.9	52.8	51.6	50.6
General government liabilities	54.4	58.2	62.2	63.3	62.1	60.8	60.2	60.1	58.9	57.9
General government financial assets	-17.2	-22.3	-28.0	-32.7	-30.3	-29.2	-29.6	-30.5	-30.3	-29.3
Nominal GDP in billion Zloty	1,275.4	1,344.4	1,416.4	1,524.7	1,595.1	1,685.7	1,790.7	1,899.5	2,023.6	2,159.7

Sources: Eurostat and IMF staff projections.

1/ Includes grants.

Table 4. Poland: Monetary Accounts, 2006-12

	2006	2007	2008	2009	2010	2011	2012 Proj.
	(In billions of zloty)						
Central Bank							
Net foreign assets	138	141	177	212	257	317	345
Net domestic assets	-51	-38	-51	-74	-117	-179	-200
Net claims on government	-17	-26	-21	-23	-12	-19	-19
Claims on banks	-13	-4	9	-25	-74	-93	-114
Other items, net	-22	-7	-38	-26	-31	-67	-67
Base money	87	103	126	138	140	138	145
o/w Currency issued	75	86	102	100	103	112	116
o/w Banks' reserves	12	17	25	38	37	26	28
Deposit Money Banks							
Net foreign assets	29	-19	-110	-135	-156	-169	-163
Net domestic assets	400	503	685	771	852	948	1,000
Net claims on the central bank	42	39	37	75	121	130	153
Net claims on government	90	88	132	138	137	141	135
Claims on private sector	373	483	651	710	775	888	943
Claims on corporates	140	173	224	217	215	253	276
Claims on households	184	260	376	421	480	537	564
Claims on other	49	49	51	73	81	98	104
Other items, net	-104	-107	-134	-152	-182	-210	-231
Deposits	429	484	575	635	696	780	837
Demand deposits	205	254	253	297	355	365	392
Other deposits	224	229	323	338	341	414	445
Consolidated Banking System							
Net foreign assets	167	121	67	76	101	149	182
Net domestic assets	328	441	599	644	683	733	761
Claims on government (Net)	73	62	111	115	124	122	115
Claims on private sector	373	483	651	710	775	888	943
Other items, net	-117	-104	-163	-182	-217	-277	-298
Broad money (M3)	495	562	666	720	784	882	943
Memorandum items:							
	(Percentage change from the end of previous year)						
Base money	23.1	18.2	23.1	8.8	1.6	-1.1	4.6
Broad money	16.0	13.4	18.6	8.1	8.8	12.5	7.0
Net domestic assets	30.2	34.1	36.0	7.5	6.0	7.3	3.9
Net foreign assets	-4.6	-27.5	-44.6	13.7	32.6	47.2	22.1
Net claim on government	13.0	-15.1	79.0	4.1	7.7	-2.2	-5.1
Claims on private sector	22.9	29.4	34.9	9.1	9.2	14.5	6.3
Deposit growth	13.8	12.7	19.0	10.5	9.5	12.1	7.3
	(In percent of GDP)						
Broad money	46.7	47.7	52.2	53.6	55.3	57.8	59.1
Private sector credit	35.2	41.0	51.0	52.8	54.7	58.2	59.1
Broad money Velocity (GDP/M3)	2.1	2.1	1.9	1.9	1.8	1.7	1.7
Money multiplier (M3/base money)	5.7	5.5	5.3	5.2	5.6	6.4	6.5

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

Table 5. Poland: Financial Soundness Indicators, 2006-12
(In percent)

	2006	2007	2008	2009	2010	2011	2012Q1
Capital adequacy							
Regulatory capital to risk-weighted assets	13.2	12.0	11.2	13.3	13.9	13.1	14.0
Regulatory Tier I capital to risk-weighted assets	12.9	11.8	10.1	12.0	12.5	11.8	12.5
NPLs net of provisions to capital	11.6	11.4	8.3	13.8	11.5	11.6	11.4
Bank capital to Assets	7.8	8.0	7.5	8.1	8.2	7.8	8.1
Asset composition and quality							
NPLs to gross loans (non-financial sector)	7.4	5.2	4.4	7.9	8.8	8.2	8.4
Sectoral distribution of loans to non-financial setor							
Loans to households	56.7	59.3	62.0	65.3	68.3	67.1	66.7
Loans to non-financial corporations	43.0	40.3	37.6	34.3	31.2	32.3	32.7
Earnings and profitability							
Return on average assets (after-tax)	1.7	1.7	1.5	0.8	1.0	1.3	1.3
Return on average equity (after-tax) 1/	22.5	22.4	20.7	11.2	13.3	16.3	16.2
Interest margin to gross income	58.9	59.4	55.7	51.9	53.0	55.7	55.9
Noninterest expenses to gross income	69.6	68.7	58.4	58.5	56.0	54.7	54.4
Liquidity							
Liquid assets to total assets (liquid assets ratio)	20.1	17.1	17.0	20.3	20.8	19.5	19.2
Liquid assets to total short-term liabilities	28.1	24.2	25.3	29.8	31.2	28.8	28.7
Sensitivity to market risk							
Net open positions in FX to capital 1/	-0.1	0.6	0.0	2.7	0.3	-0.3	-0.1

Sources: National Bank of Poland; and KNF.
1/ Data for domestic banking sector.

Table 6. Poland: Public Sector Debt Sustainability Framework, 2007-2017
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	**Debt-stabilizing primary balance 9/**
Baseline: Public sector debt 1/	45.0	47.1	50.9	54.8	56.3	**54.8**	**53.5**	**52.9**	**52.8**	**51.6**	**50.6**	**-1.0**
o/w foreign-currency denominated	10.8	11.7	13.0	13.3	14.7	13.4	12.8	12.6	12.3	12.0	11.7	
Change in public sector debt	-2.8	2.1	3.8	4.0	1.5	-1.5	-1.3	-0.6	-0.1	-1.1	-1.0	
Identified debt-creating flows (4+7+12)	-4.7	2.3	4.2	4.2	2.4	0.1	-0.8	-1.4	-1.6	-1.8	-1.9	
Primary deficit	-0.4	1.5	4.7	5.2	2.4	0.2	-0.3	-0.5	-0.9	-0.9	-0.8	
Revenue and grants	40.3	39.5	37.2	37.5	38.5	40.2	39.2	38.7	38.2	38.2	37.6	
Primary (noninterest) expenditure	39.9	41.0	41.9	42.7	40.9	40.4	38.9	38.2	37.4	37.3	36.8	
Automatic debt dynamics 2/	-4.1	1.0	-0.2	0.6	0.9	0.4	-0.2	-0.4	-0.4	-0.6	-0.6	
Contribution from interest rate/growth differential 3/	-2.4	-1.3	0.2	0.1	-1.1	0.4	-0.2	-0.4	-0.4	-0.6	-0.6	
Of which contribution from real interest rate	0.5	0.9	1.0	2.0	1.1	1.8	1.4	1.2	1.3	1.2	1.1	
Of which contribution from real GDP growth	-2.9	-2.1	-0.7	-1.9	-2.2	-1.4	-1.6	-1.6	-1.7	-1.8	-1.8	
Contribution from exchange rate depreciation 4/	-1.6	2.3	-0.4	0.5	2.0	...	...	...	...	...	...	
Other identified debt-creating flows	-0.2	-0.2	-0.4	-1.6	-0.9	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4	
Privatization receipts (negative)	-0.2	-0.2	-0.4	-1.6	-0.9	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4	
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/	1.9	-0.1	-0.4	-0.3	-0.9	-1.6	-0.5	0.8	1.5	0.7	0.8	
Public sector debt-to-revenue ratio 1/	111.6	119.2	136.9	146.1	146.3	136.3	136.6	136.7	138.0	135.3	134.6	
Gross financing need 6/	11.1	9.9	15.3	15.9	12.3	10.2	9.4	9.0	8.6	8.5	8.4	
in billions of U.S. dollars	47.3	52.6	65.9	74.8	63.1	53.8	51.7	51.6	51.7	53.7	56.2	
Scenario with key variables at their historical averages 7/						**54.8**	**55.9**	**58.2**	**61.3**	**63.5**	**65.8**	**-0.8**
Scenario with no policy change (constant primary balance) in 2012-2017						**54.8**	**54.1**	**54.3**	**55.3**	**55.2**	**55.1**	**-1.1**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	6.8	5.1	1.6	3.9	4.3	2.6	3.0	3.3	3.4	3.6	3.7	
Average nominal interest rate on public debt (in percent) 8/	5.4	5.4	5.9	5.6	5.4	5.4	5.4	5.4	5.4	5.4	5.4	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	1.4	2.3	2.2	4.1	2.2	3.4	2.8	2.5	2.7	2.6	2.5	
Nominal appreciation (increase in US dollar value of local currency, in percent)	19.5	-17.8	3.9	-3.8	-13.3	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	4.0	3.1	3.7	1.4	3.2	2.0	2.6	2.9	2.6	2.8	2.9	
Growth of real primary spending (deflated by GDP deflator, in percent)	3.3	8.0	3.9	5.8	-0.2	1.4	-0.8	1.3	1.2	3.4	2.4	
Primary deficit	-0.4	1.5	4.7	5.2	2.4	0.2	-0.3	-0.5	-0.9	-0.9	-0.8	

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

Table 7. Poland: External Debt Sustainability Framework, 2007-17

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Debt-stabilizing non-interest current account 6/
Baseline: External debt	54.9	46.2	65.1	67.2	64.8	**66.3**	**66.4**	**65.8**	**64.6**	**62.9**	**60.6**	**-5.9**
Change in external debt	5.2	-8.6	18.8	2.1	-2.4	1.5	0.1	-0.6	-1.1	-1.8	-2.3	
Identified external debt-creating flows (4+8+9)	-8.4	-6.4	9.8	-4.2	-4.7	-1.0	-1.9	-2.5	-2.7	-2.8	-2.6	
Current account deficit, excluding interest payments	5.0	5.4	3.4	3.5	3.4	3.7	3.3	2.7	2.2	2.0	1.9	
Deficit in balance of goods and services	3.4	4.8	0.7	1.9	1.6	1.4	0.8	0.2	0.2	0.4	0.8	
Exports	41.0	40.4	39.7	42.3	44.9	45.5	46.2	46.9	47.5	48.2	48.7	
Imports	44.3	45.3	40.4	44.1	46.4	46.9	47.0	47.1	47.7	48.6	49.5	
Net non-debt creating capital inflows (negative)	-5.5	-2.9	-3.4	-3.6	-3.3	-3.7	-3.9	-4.0	-4.0	-4.1	-4.2	
Automatic debt dynamics 1/	-8.0	-8.8	9.8	-4.1	-4.8	-1.0	-1.2	-1.2	-0.9	-0.7	-0.3	
Contribution from nominal interest rate	1.2	1.2	0.6	1.1	0.9	0.7	0.7	0.9	1.2	1.5	1.9	
Contribution from real GDP growth	-2.7	-2.3	-0.9	-2.4	-2.6	-1.6	-1.9	-2.1	-2.1	-2.2	-2.2	
Contribution from price and exchange rate changes 2/	-6.5	-7.8	10.1	-2.9	-3.1	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	13.6	-2.3	9.1	6.3	2.4	2.5	2.0	1.9	1.6	1.0	0.4	
External debt-to-exports ratio (in percent)	133.9	114.4	163.8	158.9	144.4	145.9	143.7	140.3	136.0	130.4	124.3	
Gross external financing need (in billions of US dollars) 4/	73.5	125.8	95.7	118.1	117.1	129.4	125.2	130.5	119.2	124.6	131.2	
in percent of GDP	17.3	23.8	22.2	25.2	22.8	24.6	22.9	22.8	19.9	19.7	19.5	
Scenario with key variables at their historical averages 5/						**66.3**	**63.0**	**60.0**	**56.9**	**53.7**	**50.4**	**-7.6**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	6.8	5.1	1.6	3.9	4.3	2.6	3.0	3.3	3.4	3.6	3.7	
GDP deflator in US dollars (change in percent)	16.6	18.4	-20.0	5.0	5.0	-0.1	0.7	1.2	1.4	1.9	2.3	
Nominal external interest rate (in percent)	3.0	2.8	1.0	1.9	1.5	1.0	1.1	1.4	1.9	2.5	3.2	
Growth of exports (US dollar terms, in percent)	26.2	22.8	-20.1	16.0	16.4	3.8	5.4	6.1	6.2	7.1	7.3	
Growth of imports (US dollar terms, in percent)	30.3	27.1	-27.4	19.1	15.4	3.4	4.0	4.9	6.0	7.7	8.0	
Current account balance, excluding interest payments	-5.0	-5.4	-3.4	-3.5	-3.4	-3.7	-3.3	-2.7	-2.2	-2.0	-1.9	
Net non-debt creating capital inflows	5.5	2.9	3.4	3.6	3.3	3.7	3.9	4.0	4.0	4.1	4.2	

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.

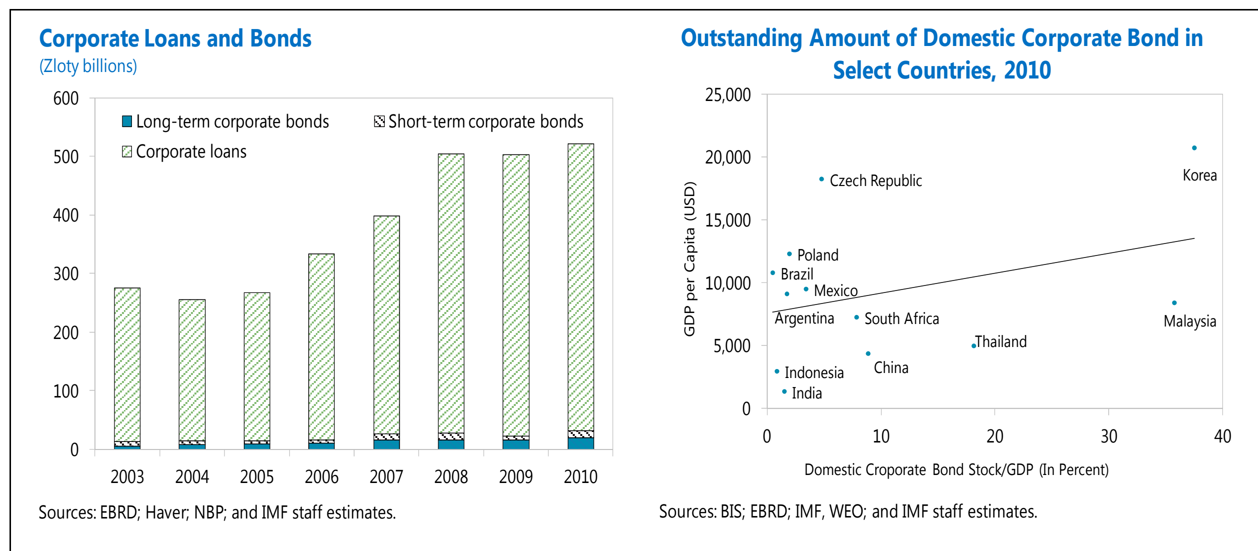
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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.

Appendix I. Corporate Bond Market Development and Local Currency Funding

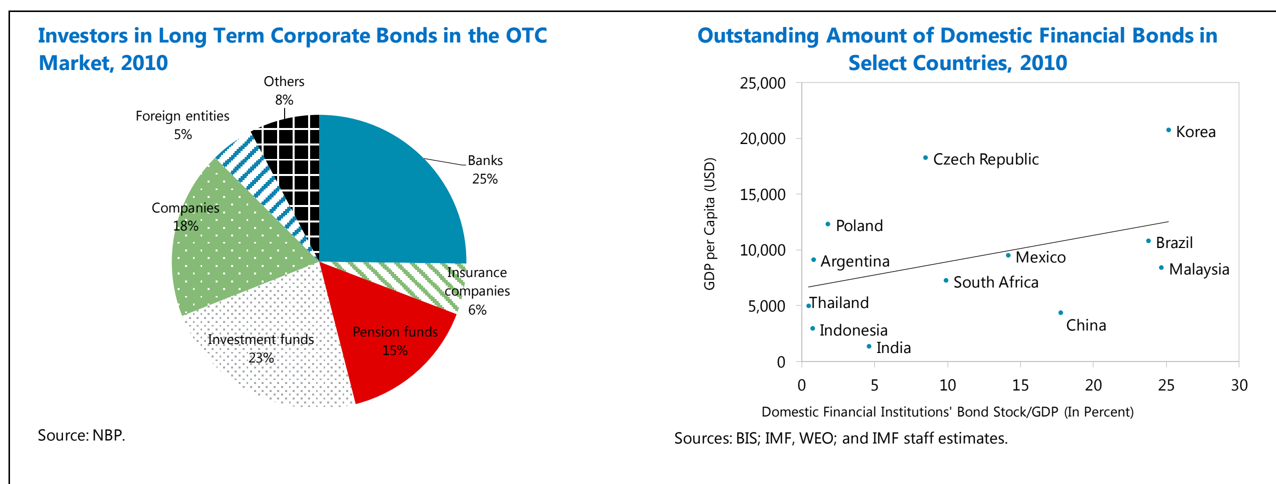
The Polish domestic corporate bond market is underdeveloped. The Polish corporate sector relies mainly on bank loans for financing as only a few large companies are able to tap the corporate bond market. The corporate bond market is eclipsed by the marketable treasury securities market in both the size and liquidity. At end-2010, the outstanding amount of corporate bonds was about 2 percent of GDP—relatively low compared with other emerging economies—while the size of marketable treasury securities reached 33 percent of GDP. Short-term corporate bonds accounted for about 37 percent of the total stock of corporate bonds, which may indicate the limited availability of long-term funding for the corporate sector. The main investors for long-term corporate bonds are domestic banks and investment funds, with limited participation by pension funds.

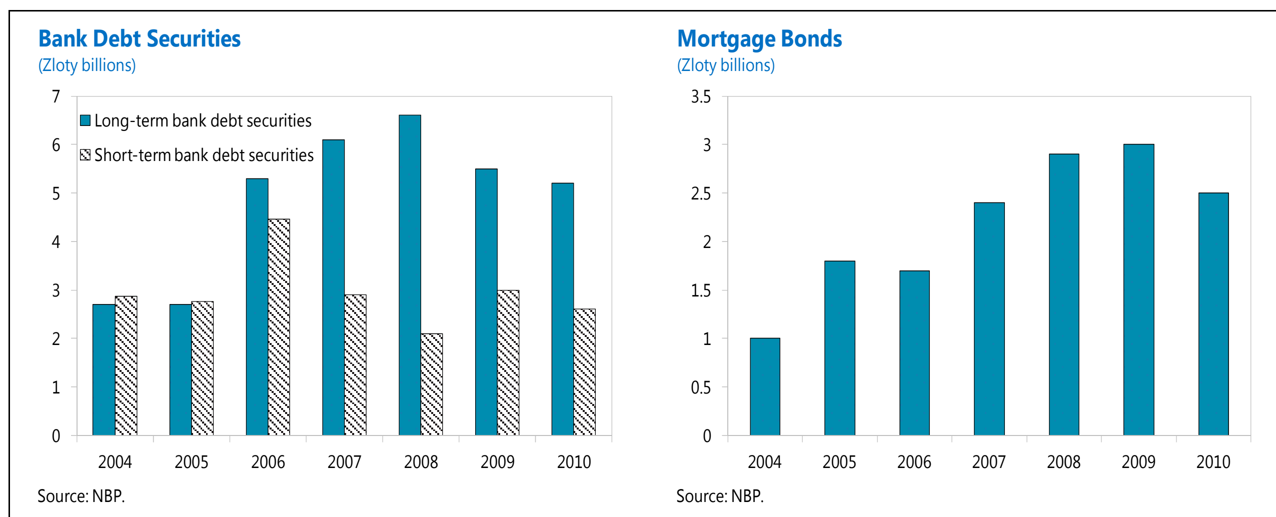


Barriers to growth in the corporate bond market arise from both the supply and demand sides. Raising funds by issuing bonds is too expensive for small and medium enterprises, while large companies with foreign capital have alternative sources of financing, such as borrowing funds from intra-company capital markets. As a result, only about 180 companies have long-term bonds currently listed in the market. The majority of bonds and issuers have not been rated, leaving investors to assess the risk. Furthermore, the low volume of issues and low liquidity in the secondary market dampen the demand for corporate bonds. The dominance of OTC transactions hinders the development of the secondary market, while the newly-introduced Catalyst still needs time to take off.[1]

[1] CATALYST, launched in September 2009, is the first organized debt exchange in Poland for listing and trading corporate, mortgage, and municipal bonds.

Polish financial institutions issue limited amounts of bonds domestically. The outstanding amount of domestic financial bonds was about 2 percent of GDP—low compared with some emerging economies. Given the structural liquidity surplus in the banking system, banks prefer to earn interest margins from deposits and have little incentive to issue bonds. Long-term bank debt securities were only 5.2bn zloty at end-2010, representing only 0.5 percent of banking sector liabilities.





The mortgage bond market remains very small. In 2010, the outstanding amount was only 0.2 percent of GDP. This is insufficient to meet the needs of banks that wish to reduce reliance on parent funding or foreign exchange derivatives to finance their foreign currency mortgage loan portfolios (13 percent of GDP at end-2011). Notably, there are legal impediments to issuing

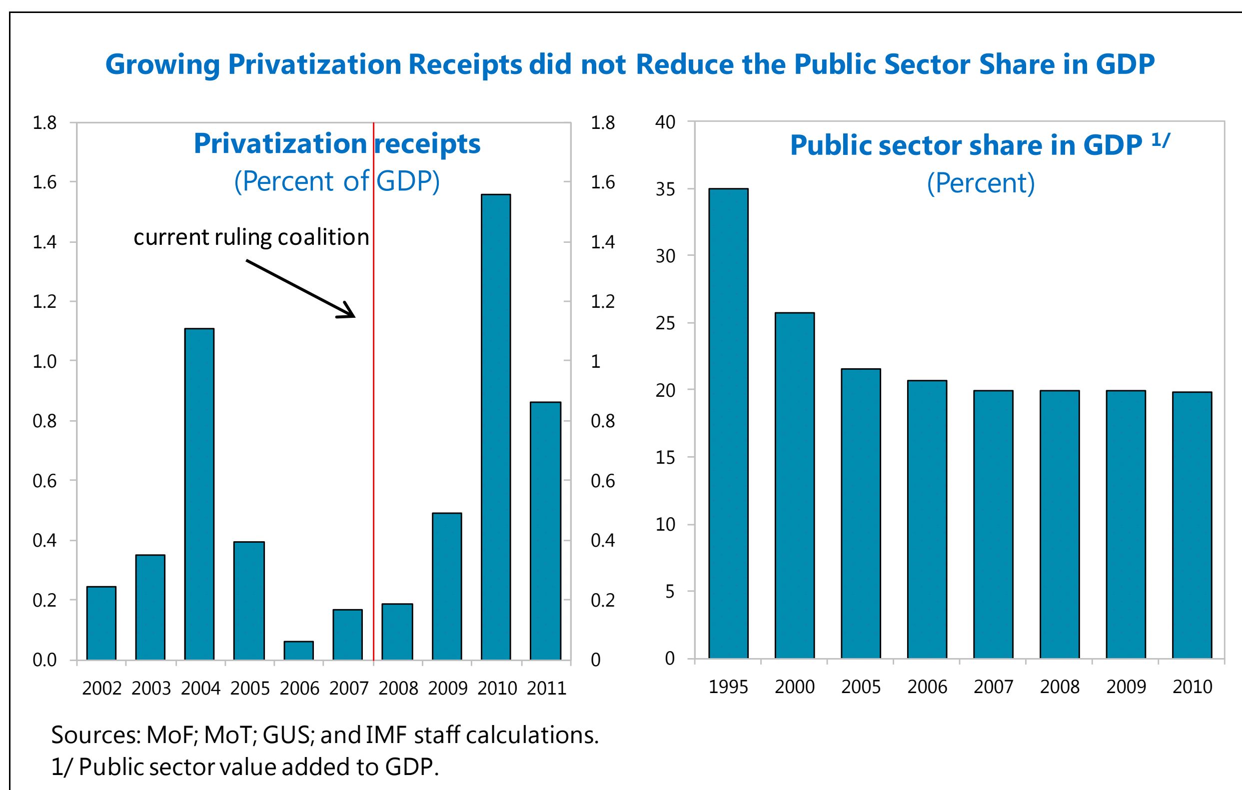
mortgage bonds[2], for example, concerns for asset encumbrance issues. In addition, due to zloty depreciation, according to the KNF, about one third of foreign currency mortgages had an LTV ratio above 100 percent at 2011Q3, increasing the difficulty of issuing mortgage bonds.

Much needs to be done to further develop non-government bond markets and reduce the banking sector's maturity mismatch. From the supply side, the government's commitment to reducing the public debt ratio is welcome, as it will reduce competition with corporate bond investors. Regulatory incentives, such as liquidity requirements aimed at narrowing maturity gaps would encourage banks to gradually lengthen funding maturity. Recent steps to develop the framework for long-term bond issuance are also helpful. From the demand side, pension funds, with 15 percent of GDP in assets under management, should be encouraged to play an important role in providing steady demand for long-term zloty assets. Moving the trade of corporate and bank bonds from the OTC to an exchange platform, such as the newly created Catalyst, and improving its institutional support could enhance the transparency and efficiency of secondary market transactions.

[2] European Bank for Reconstruction and Development, *Local Currency and Local Capital Markets Initiative—Initial Assessment Report Poland* (2011).

Appendix II. Privatization of State-Owned Enterprises

Privatization efforts have continued in recent years, despite deteriorating market sentiment. These accelerated visibly after 2008 (left panel), with the strategy for 2008–11 envisaging ownership changes in about 800 enterprises. The goal was almost met, with some 750 firms subject to privatization in the last four years, of which 200 in 2011. Privatization receipts amounted to PLN13.1 billion (0.9 percent of GDP) last year, somewhat below the budgeted PLN15 billion. The receipts could have been higher, but deteriorating market sentiment prompted a delay in sale of a minority stake in Polish largest bank (PKO BP).



Sources: MoF; MoT; GUS; and IMF staff calculations.
1/ Public sector value added to GDP.

Most privatization receipts in 2011 reflected large transactions, but without a shift of control to the private sector. Around 200 firms were covered by privatization in 2011, and more than 80 percent of receipts reflected six largest deals. However, the state retained control, as these firms were deemed to be strategically important (Table 1). For some of them, notably those listed on the Warsaw Stock Exchange, revisions to corporate statutes restricted the voting power of private investors. This enables the government to maintain strategic control without having a majority stake (Table 2).It also illustrates that even substantial receipts do not necessarily imply a growing role of the private sector. Indeed, despite a visible pickup in receipts, share of the public sector in GDP has remained stable in recent years (right panel).

Table 1. Privatization Revenues in 2011

Company	Revenue (PLN billion)	Sold stake	Method	Strategic control
Total	13.1	***	***	***
o/w				
JSW	4.8	59.3	IPO	Public
PZU	3.2	35.2	Sold on stock exchange	Public
Tauron	1.3	30.1	Sold on stock exchange	Public
Energa-Operator	0.6	14.6	Sold to state controlled Energa	Public
Police	0.5	52.3	Sold to state controlled Tarnów	Public
WZK Wikoria	0.4	85.0	Sold to state controlled JSW	Public

For 2012, the full-year privatization goal looks achievable. Receipts are budgeted at PLN10 billion (0.6 percent of GDP) in 2012, of which 30 percent was collected in the first four months. Most of this reflected sale of a minority stake in Polish largest energy firm (PGE). Barring a major deterioration in market sentiment, the full-year goal appears achievable. Receipts could be, for example, generated by possible sale of shares in the largest insurer (PZU SA) and the largest bank (PKO BP). Despite having only minority stakes, the government will maintain control in these systemically important financial firms.

Table 2. Privileged Role of the Government in Listed Companies

Company	State's stake	Capitalization (PLN billion)	Statutory provisions:
PKO BP (banking)	40.99 (51.24*)	52.48	Only State and state-owned BGK can exercise more than 10 percent rights.
PGE (energy)	68.26	45.42	Only State can exercise more than 10 percent of rights.
KGHM (copper)	31.8	37.8	State Treasury can call general meeting. The quorum at general meeting was lowered from 1/3 to 1/4.
PZU (insurance)	35.18	32.72	Only State can exercise more than 10 percent of rights.
PGNIG (natural gas)	73.5	25.07	New deals, significant changes in in gas trade agreements and strategic investment plans requires State approval.
Orlen (oil)	27.5	21.81	Only state and bank which emits company's depository receipts may exercise more than 10 percent rights. One member of management board is nominated by Minister of Treasury.
JSW (coal)	59.28	12.5	Only State can exercise more than 10 percent of rights.
Tauron (energy)	30.06	11.81	Only State can exercise more than 10 percent of rights.
Lotos (oil)	53.19	5.73	As long as State holds more than 20 percent of voting rights, no other share holder can exercise more than 20 percent of rights.
GPW (stock exchange)	35	2.13	State holds privileged shares totaling 51.5 percent of voting rights. Only state can exercise more than 5 percent of rights.
Tarnów (chemical)	52.5	1.33	As long as State holds more than 20 percent of voting rights, no other share holder can exercise more than 20 percent of rights.

Source: Rzeczpospolita.
*Including the stake of state-owned BGK.

While continued privatization is envisaged in 2013, the receipts are set to decline. The recently approved strategy for 2012–13 assumes that 300 firms will be covered privatization, in most cases involving sale of majority stakes. If completed, this would leave the Ministry of Treasury as an owner of about 100 firms. However, the overall public ownership will remain much broader, as it currently covers above 2,500 companies, many of them owned by local authorities. The strategy assumes that privatization receipts will be PLN5 billion (0.3 percent of projected GDP) in 2013, half of the amount budgeted this year.

The authorities intend to improve corporate governance in public firms. The recently issued code of good practices for strategic companies requires, inter alia, that the management selection will be contracted to headhunting agencies. There is also a plan to enact a law on ownership oversight, which would set common standards for all public companies.

Appendix III. Credit Growth and Non-Performing Loans—Recent Developments and Outlook

Like many other countries, Poland experienced rapid expansion of bank credit in the years leading to the global financial crisis. This trend was driven by common factors: relatively low credit-to-GDP ratios and rising per capita incomes at the outset, ample liquidity in global capital markets, and extensive foreign bank entry. In this setting, internationally active banks used their group structures to exploit arbitrage opportunities, funding a rapid expansion of domestic retail credit via cross-border intra-group funding supported by the issuance of wholesale liabilities abroad.

Credit growth declined in the aftermath of the crisis, following somewhat different trajectories across segments. Credit market dynamics after the outbreak of the crisis reflected demand and supply factors. On the demand side, the deceleration of economic activity caused a concomitant reduction in the financing needs of households and enterprises. On the supply side, the deterioration in borrower's creditworthiness during the downturn, combined with a more challenging environment for parent banks and the application of more conservative lending standards—also in response to regulatory changes—caused a retrenchment in credit supply. The latter was more pronounced in segments with a history of rapid credit growth, and toward borrowers deemed to be riskier.

The bulk of bank credit is toward domestic residents, but about two-thirds of the mortgage portfolios are denominated in foreign currency. Loans to resident firms and households account for virtually the entire the loan book. But, the mortgage portfolio is predominantly denominated in foreign currency, reflecting bank lending practices in the run up to the crisis. At end-2011, about half of the mortgage loans were denominated in Swiss francs, and an additional 10 percent in other currencies, with zloty-denominated mortgages accounting for 37 percent.

Loan impairments increased sharply in recent years and, despite some improvement of late, have remained at relatively high levels. After peaking to about 8¾ percent of gross loans in 2009, non-performing loans (NPLs) declined to 8¼ percent in 2011, partly owing to the strengthening of credit growth. Loan quality, however, was heterogeneous across categories. In the corporate book portfolio, NPLs averaged about 11 percent in 2011. Impairment ratios were generally higher for loans to SMEs, and for firms operating in some segments of construction and real estate, where NPL ratios surpassed 20 percent in 2011. Concentration in corporate credit portfolios was also significant, as large exposures (i.e., above half-million PLN) represented 6 times banks' capital. Large exposures to corporate firms in some sectors (particularly construction and real estate, retail trade, and food processing), need to be closely monitored due to their size and high impairment ratios. Regarding credit to households, the value of impaired loans increased throughout 2011, albeit at a slower pace than credit expansion, resulting in a mild stabilization of NPL ratios. The latter have remained above 18 percent for consumer and credit card loans, albeit the size of these portfolios is not material from the systemic perspective. On the other hand, credit quality in mortgage portfolios extended a mild deterioration, with NPLs surpassing 2 percent in 2011.

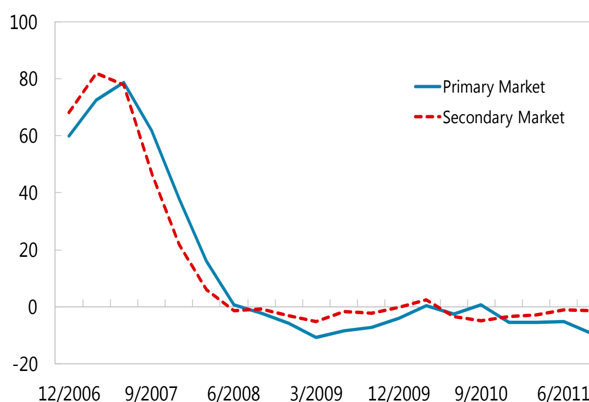
Against this background, the two main sources of credit risk originate from mortgage portfolios in foreign currency and loan concentration to real estate and other highly cyclical sectors. System-wide, a source of credit risk stems from legacy mortgages in foreign currency, which exposes unhedged borrowers to zloty depreciation—particularly vis-à-vis the Swiss franc. While the prevalence of floating interest rates in these mortgages offers some relief (as lower interest rates have helped keep debt servicing costs manageable), high loan-to-value ratios—in some cases above 100 percent—expose lenders and borrowers to risks of a further downward movement in housing prices. The effects of zloty depreciation on loan quality may also be non-linear beyond specific thresholds. Another important source of risk stems from concentration in some banks' corporate portfolios, particularly to real estate developers and building companies—where non-performing loans have remained high—and to firms operating in highly cyclical sectors, such retail trade.

Given the slowing economy, loan quality may erode in the period ahead. Economic activity and labor market dynamics, combined with exchange rate movements, are likely to be the key driving factors of loan quality in the period ahead. The slowdown in economic activity is expected to have an adverse impact on loan quality in the corporate loan portfolio. In turn, credit quality in the mortgage book is likely to be affected by labor market conditions, which are expected to remain weak. In addition, credit quality in the mortgage portfolio is likely to erode as recent vintages mature (i.e., about 45 percent of total mortgages were originated in 2007–08). While staff's baseline forecast does not envisage downward pressure on house prices, further declines cannot be ruled out, particularly if economic growth were to slow by more than expected amid already high inventory levels.[1]

In this context, supervisory actions to strengthen bank lending practices should be complemented with a more proactive approach to existing NPLs. The increased supervisory focus on bank lending origination practices, particularly in the area of FX-denominated mortgages, is an important step in the right direction. These efforts may need to be complemented by a more proactive approach to address the level of NPLs, particularly in the corporate sector. This could include voluntary out-of-court loan restructuring, subject to strict prudential supervision on loan classification practices by banks.

Average Growth Rates of Residential Property Prices

(Year-on-year percent change)



Sources: NBP; and IMF staff estimates.
Note: Ask prices in the largest cities.

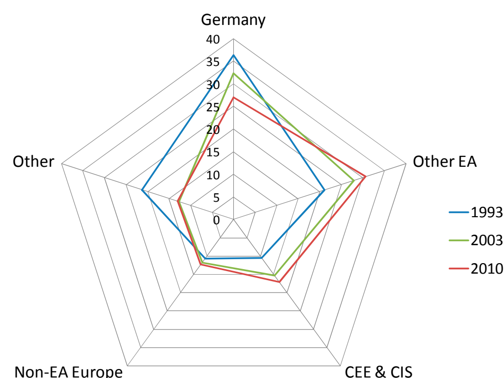
[1] The existing stock of apartments available for sale in major cities is the largest since 2007 and projected to rise further as ongoing construction projects are completed.

Appendix IV. Poland's Export Structure

This appendix highlights some key features of Poland's export structure, complementing Box 4 on financial and trade linkages. It also provides some observations about Poland's role in the German supply chain, reflecting recent IMF research on the changing pattern of global trade[1].

Poland's exports are predominantly to the European Union, particularly Germany. Germany remains Poland's dominant export destination, but its direct share has diminished since the early 1990s. Germany now makes up about a quarter of exports, but the shares of core Euro area countries, the UK, and Central and Eastern European countries (in particular the Czech and Slovak Republics) have risen. To some extent, the latter also represents vertical specialization in the German supply chain, with Poland providing components for goods whose final destination within Europe is Germany. In contrast, exports to Latin America have not changed significantly and those of other destinations have declined.

Destination of Polish Exports
(Percent)



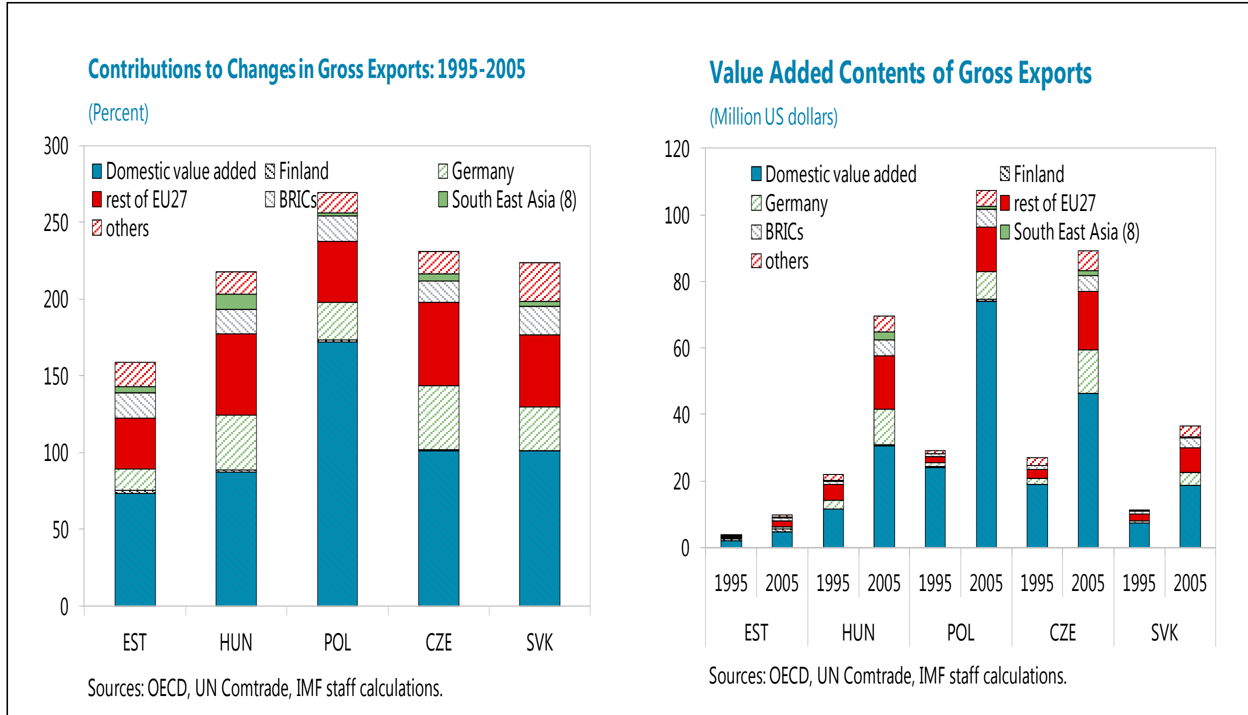
Sources: Direction of Trade Statistics; and IMF staff estimates.

The structure of Poland's exports may provide indirect access to Asia. While the EU remains Poland's main trading partner, a heavier reliance on Germany is viewed by many as a gateway to non-European markets, particularly Asia. Exports to China, for example, make up 5 percent of German exports, and these are concentrated in automobiles and related parts. While it is difficult to measure, CEE inputs (including those of Poland) into German cars suggest indirect linkages to Asian demand. This trade contributed to the relative outperformance of the German economy within the Euro Area since 2009 and is therefore a contributor to the resilience of Polish economy.

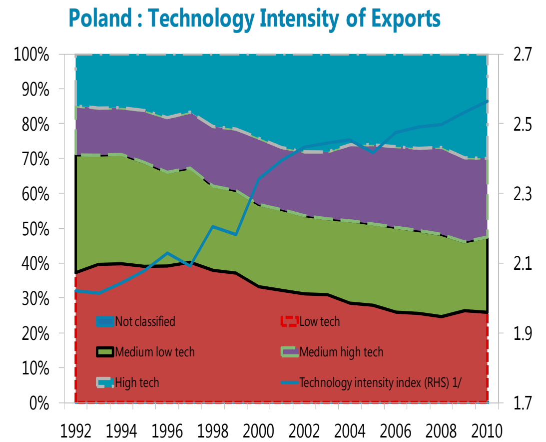
Poland is vertically specialized in the German supply chain. T he foreign value added (FVA) in Polish exports has increased dramatically since the mid-1990s[2]. The FVA accounts for about half of the growth of Polish exports over this period, with the largest contributors being Germany and the other EU countries. However, relative to some regional peers, foreign input has not played as much of a role. A closer look at the sectoral distrbution of exports indicates that Poland provides both intermediate goods (particulary auto components and assembly of washing machines and dryers) as well as final goods such as food, wood, and furniture.

[1] Riad, Nagwa et al., "The Changing Patterns of Global Trade", IMF 2012. The paper highlights the rise of emerging market economies as important trading partners and their role in global supply chains.

[2] The valued added is derived from OECD input-output data, which is only available for these periods.



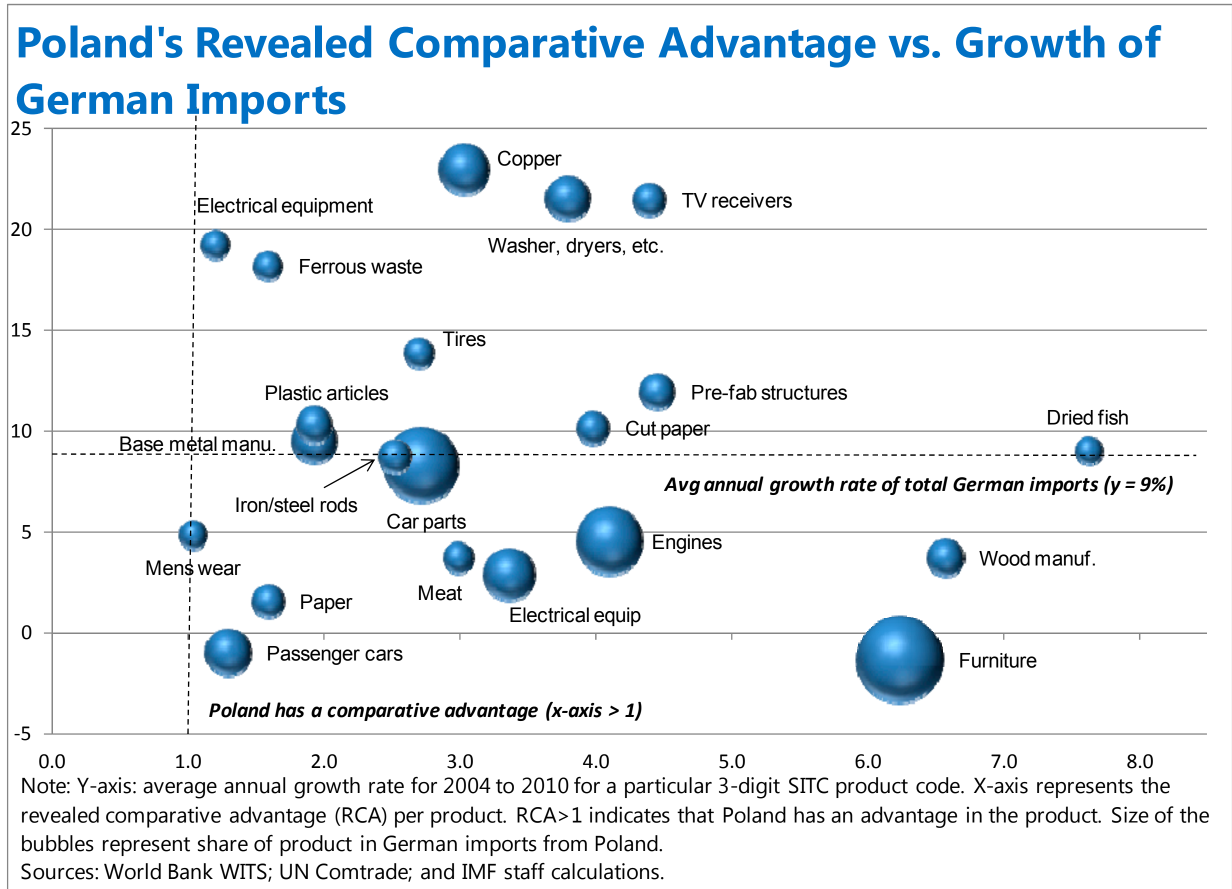
Integration into the supply chain supports an increasing technological intensity of exports. The technological intensity of exports has risen, as integration into the supply chain has strengthened through the years. The share of hi-tech and medium-high tech products in exports rose from about 40 percent in 2000 to 50 percent in 2010. These gains also reflect an increasing technology intensity in imports, more so than domestically produced and developed componets.



However, it is not clear whether Poland is taking full advantage of the potential knowledge transfers from its trade relationship with Germany. The issue of knowledge spillovers is an on-going debate in Poland, and would be a fruitful area of further research. OECD data shows that Poland has among the lowest levels of research and development expenditures in the Europen Union and is low relative to other European countries.

Poland has an advantage in products where German demand is growing. Poland has a revealed comparative advantage (RCA)[3] in many of the products in which German imports have been growing since Poland joined the EU. Looking at the top 20 product classes that Germany imports from Poland, most have an RCA index above 1, indicating that Poland has an advantage. The highest RCA's are in furniture and wood produts and dried fish. For most of the products, the value of total world imports to Germany are also growing, except in furniture and passenger cars. About half of the products are also experiencing above average German import growth, especially in copper, washers and dryers, and TV receivers.

Poland's Revealed Comparative Advantage vs. Growth of German Imports

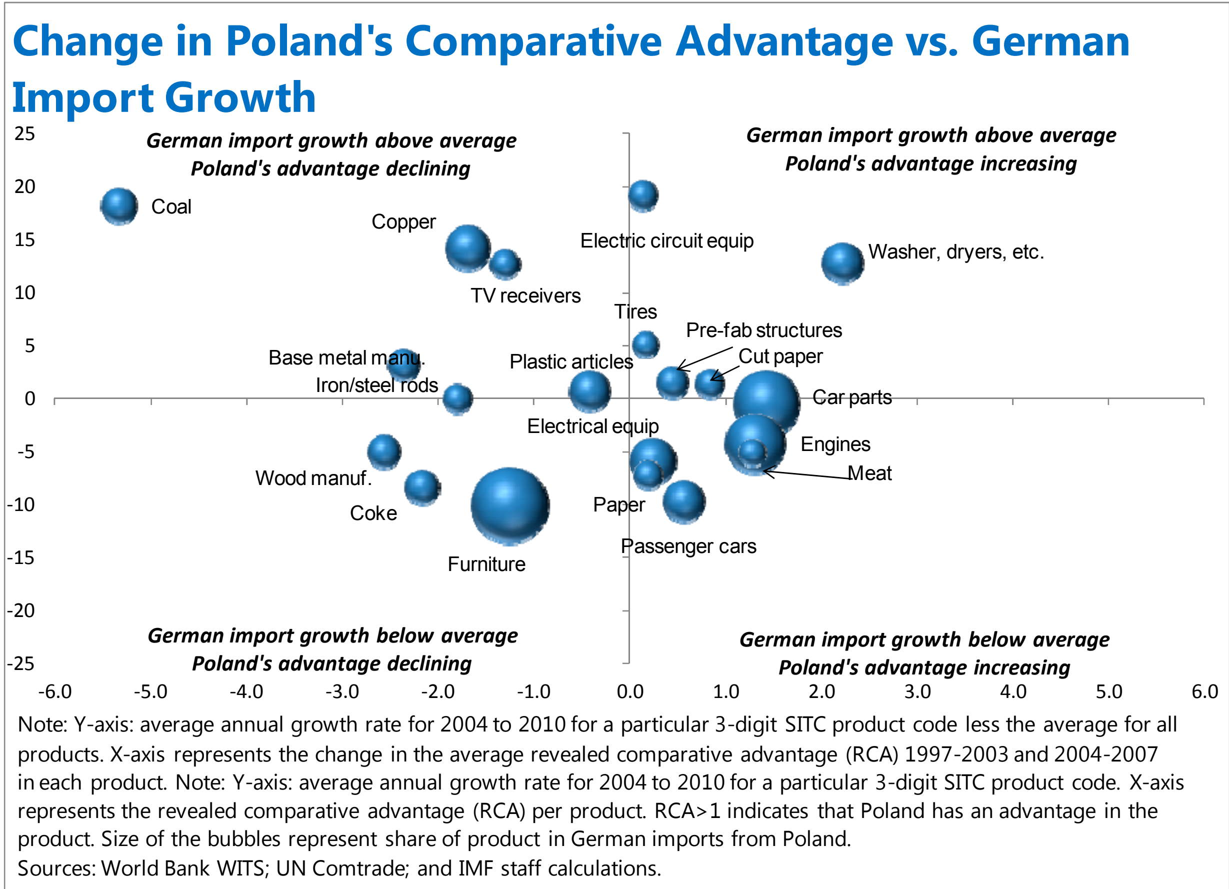


Note: Y-axis: average annual growth rate for 2004 to 2010 for a particular 3-digit SITC product code. X-axis represents the revealed comparative advantage (RCA) per product. RCA>1 indicates that Poland has an advantage in the product. Size of the bubbles represent share of product in German imports from Poland.
Sources: World Bank WITS; UN Comtrade; and IMF staff calculations.

But Poland's advantage is falling in a number of products. Trends in Poland's export structure are more balanced, from the perspective of changes RCA between the pre- and post-EU assession periods. Roughly a quarter of product classes are in each of the 4 quadrants of the chart below, which are divided by products in which Germany import growth from the world is above average (on the y-axis) and those in which Poland's RCA is increasing (on the x-axis). There are 5 products that are in the top, right quadrant with the most favorable characteristics of above average German import growth and an increase in RCA – washers and dryers stand out. Looking at the 3 products

[3] RCA = (Xij / Xit) / (Xwj / Xwt), where Xij and Xwj are the values of Poland's and world exports of a product j (using 3-digit SITC product classes), and Xit and Xwt are the values of Poland's and the world's total exports. Balassa, B. (1965), Trade Liberalisation and Revealed Comparative Advantage, The Manchester School, Vol. 33, pp. 99-123.

with the highest share of Polish exports to Germany (furniture, engines, and car parts), the first has RCA falling and significantly below average import growth. The latter 2 have increasing RCA, but have experienced average or below average German import growth.



Change in Poland's Comparative Advantage vs. German Import Growth

Note: Y-axis: average annual growth rate for 2004 to 2010 for a particular 3-digit SITC product code less the average for all products. X-axis represents the change in the average revealed comparative advantage (RCA) 1997-2003 and 2004-2007 in each product. Note: Y-axis: average annual growth rate for 2004 to 2010 for a particular 3-digit SITC product code. X-axis represents the revealed comparative advantage (RCA) per product. RCA>1 indicates that Poland has an advantage in the product. Size of the bubbles represent share of product in German imports from Poland.

Sources: World Bank WITS; UN Comtrade; and IMF staff calculations.

Appendix V. Risk Assessment Matrix[1]

(Scale—high, medium, or low)

Nature/ Source of Main Threats	Overall Level of Concern Relative Likelihood of Threat	Expected Impact if Threat is Realized
1. Strong intensification of the euro zone crisis.	**Medium** • Adverse feedback loops between sovereigns and banks pose significant risks to euro area economic activity going forward. • Episodes of strong market pressure on euro zone economies are likely to reverberate across financial markets and asset classes including a significant depreciation of the zloty.	**High** • Substantial trade and financial linkages with Europe entail a direct channel of contagion. External distress can affect Poland through its large gross external financing needs, including the substantial share of foreign investors in the government bond market. • Significant zloty depreciation would lead to liquidity strains and credit losses (including possibly higher NPLs) in some banks with FX denominated mortgage portfolios. But the stock of these mortgages is low relative to the size of the economy (13 percent of GDP). • Sound public debt management, significant pre-financing, and the government's large liquidity cushion help mitigate risks to government financing.
2. Protracted slowdown in economic activity in Europe.	**High** • Fiscal consolidation in euro area countries could have stronger-than-expected adverse effects on growth. • Prolonged uncertainty could have dampening effects on growth.	**Medium** • Substantial trade linkages with Europe would weaken growth in Poland through lower exports. • Banks' asset quality would deteriorate, with implications for capital adequacy and credit supply. • The space for counter-cyclical fiscal policy is narrower than in the past. • Poland's economy is relatively closed (exports are 40 percent of GDP), so domestic demand could offset.
3. Excessive pace of parent bank deleveraging.	**Medium** • European banks are expected to engage in substantial deleveraging in the period ahead, including via balance sheet contraction. • Excessive or uncoordinated deleveraging by these banks would have adverse effects on credit supply and economic activity.	**Medium** • Excessive deleveraging could result in a credit squeeze, with adverse implications for growth in Poland. • The modest size of domestic credit markets, moderate loan-to-deposit ratio, and high capitalization, profitability and liquidity of the banking system help to mitigate risks. • Strong corporate balance sheets, the reliance of the corporate sector on retained earnings to finance investment, and the ability of domestic banks to extend credit help to cushion the impact of a credit squeeze on the economy.
4. Substantial and prolonged increase in oil prices.	**Medium** • A protracted increase in oil prices could result from global demand outpacing supply. • Geopolitical tensions involving major oil exporters could cause periods of sharp increases in oil prices.	**Low** • An oil price shock would have adverse implications for growth and inflation in Poland. • Still high unemployment may dampen second-round effects. • Poland's energy intensity declined rapidly in the past decade, although it remains above the EU average.
5. Excessive decline in public investment.	**Medium** • A substantial cut in EU-transfers would affect the government's capacity to fund investment in public infrastructure. • Without additional fiscal consolidation measures to reach the medium-term fiscal objective (MTO), excessive cut-backs in public investment may materialize.	**Medium** • Near-term growth would be lower than under the baseline. • Potential growth would be adversely affected, given Poland's still significant infrastructure needs.

[1] The RAM shows events that could materially alter the baseline path—the scenario most likely to materialize in the view of the staff.

INTERNATIONAL MONETARY FUND

REPUBLIC OF POLAND

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

June 15, 2012

Prepared By: European Department

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FUND RELATIONS

As of May 31, 2012

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

II. **General Resources Account**:

	SDR Million	Percent Quota
Quota	1,688.40	100.0
Fund holdings of currency	1,106.29	65.52
Reserve Tranche Position	582.12	34.48
Lending to the Fund		
New Arrangements to Borrow	258.20	

III. **SDR Department**

	SDR Million	Percent Allocation
Net cumulative allocation	1,304.64	100.00
Holdings	1,120.83	85.91

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

V. **Latest Financial Arrangements**:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
FCL	1/21/2011	1/20/2013	19,166.00	0.00
FCL	7/02/2010	1/20/2011	13,690.00	0.00
FCL	5/06/2009	5/05/2010	13,690.00	0.00

VI. **Projected Obligations to Fund (SDR Million; based on existing use of resources and present holdings of SDRs):**

	Forthcoming				
	2012	2013	2014	2015	2016
Principal					
Charges/Interest	0.12	0.25	0.25	0.25	0.25
Total	0.12	0.25	0.25	0.25	0.25

VII. **Exchange Rate Arrangement**:

The zloty is freely floating.

Poland accepted the obligation of Article VIII, Sections 2, 3, and 4 on June 1, 1995. Poland maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions, except for the exchange restrictions imposed by Poland solely for the preservation of national or international security as introduced by the European Union within the framework of the Common Foreign and Security Policy. The consolidated list of such sanctions is available at: http://eeas.europa.eu/cfsp/sanctions/consol-list_en.htm.

VIII. **Article IV Consultation:**

The last Article IV consultation was concluded on July 1, 2011. In concluding the consultation, Directors welcomed the return of Poland's economy to solid growth in 2010, supported by timely and forceful countercyclical policy responses to the global crisis. Directors welcomed the recent increases in the policy interest rate and noted that some further gradual hikes in the policy rate are warranted to bring inflation back to target, while efforts should continue to improve monetary policy communication. On fiscal policy, Directors welcomed the substantial fiscal consolidation that is already under way. Directors supported the authorities' plan to adopt an expenditure-based fiscal rule, complemented by efforts to strengthen budgetary processes, tighten entitlement programs, and streamline the public administration. Directors commended the Polish authorities for the steps already taken to improve the effectiveness of financial sector surveillance policies. They encouraged further efforts to strengthen the resilience to the financial sector. Directors underscored that a further increase in labor participation and a reduction in product market rigidities are key to boosting potential growth. Directors welcomed recent improvements to the balance of payments compilation system, which have reduced errors and omission.

IX. Technical Assistance, 1992–2012

Department	Subject/Identified Need	Action	Timing	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	Oct. 1992	NBP
MAE	Resident expert-Advisor to President of NBP		Nov. 1991–92	NBP
MAE	Additional steps in the modernization process of the NBP	Mission	April 1993	NBP
MAE	Monetary programming and operations, and payments system	Mission	Nov. 1993	NBP
MAE	Central bank modernization	Mission	August 1994	NBP
MAE/LEG	Review of the exchange and payments system	Mission	February 1995	NBP/ MoF
MAE	Exchange rate system	Mission	March 1995	NBP
MAE	Review of government securities market, payments system and public debt management	Mission	August 1995	NBP/ MoF
MAE	Asset consolidation exercise	Expert visits	Late 1995	NBP

IX. **Technical Assistance, 1992–2012 (Cont'd)**

Department	Subject/Identified Need	Action	Timing	Counterpart
FAD	Tax administration (VAT) short-term assignments of field experts	Nine	August 1992–October 1994	MoF
FAD	Tax administration	Mission	November 1992	MoF
STA	Framework for monetary statistics	Mission	February 1993	NBP
STA	Framework for monetary statistics (follow-up)	Mission	November 1993	NBP
STA	Government finance statistics	Mission	August 1995	NBP/ MoF
STA	Money and banking statistics	Mission	January 1996	NBP
STA	Government finance statistics	Mission	July 1996	NBP/ MoF
STA	Balance of payments statistics	Mission	November 1996	NBP/ MoF
STA	Balance of payments statistics mission	Follow-up	April 1997	NBP/ MoF
STA	Review of progress in implementing the SDDS	Visit	February 1998	
FAD	Public expenditure management	Mission	April 1998	MoF
MAE	Operational aspects of monetary and exchange rate policy	Mission	September 1998	NBP
FAD	Tax administration	Mission	October 1998	MoF
FAD	Examination of impact on revenues of proposed tax reform	Mission	November 1998	MoF
FAD	Discussion of tax administration	Mission	March 1999	MoF
FAD	Tax administration seminar	Mission	April 1999	MoF

IX. Technical Assistance, 1992–2012 (Cont'd)

Department	Subject/Identified Need	Action	Timing	Counterpart
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
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
STA	Errors and omissions in balance of payments accounts	Mission	June 2011	NBP

IX. Technical Assistance, 1992–2012 (Concluded)

Department	Subject/Identified Need	Action	Timing	Counterpart
FAD	Developing the fiscal regime for oil and gas	Mission	April 2012	MoF
MCM/LEG	Macroprudential framework	Mission	May 2012	NBP

X. Resident Representative

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

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance
General: Data provision is adequate for surveillance.
National Accounts: The Central Statistical Office (GUS) compiles and disseminates annual and quarterly GDP at current and constant prices following 1993 SNA and ESA 1995. Moreover, a full set of accounts, including financial accounts by institutional sectors are compiled too. There are inconsistencies between annual and higher frequency data reflecting differences in weights and in coverage. Electronic retrieval of the data is challenging. The sub-annual data are collected on a cumulative rather than on a discrete basis, and plans to introduce proper benchmarking have been delayed. Seasonal adjustment on relatively short interval leads to frequent and large backward revisions. **Price Statistics:** The CPI does not cover the imputed rents of owner-occupied dwellings. The scope of the index covers all resident households, except those in some rural areas. The PPI does not include any estimation for missing prices or quality and seasonal adjustments.
Government Finance Statistics: General government data are released on a quarterly basis, and compiled on the same basis as the annual general government data, i.e. derived from detailed ESA accounts (ESA = European System of Accounts). Revenue and expense are available according to the full economic classification and, in addition, expense is also available according to COFOG (Classification of the Functions of Government). Further significant enhancements to government sources of data are necessary to comply with the accrual basis of reporting, and to compile full information on financial and nonfinancial asset stock data for general government.

I. Assessment of Data Adequacy for Surveillance (Cont'd)
Monetary Statistics: Beginning with data for January 2004, the NBP compiles monetary accounts in accordance with the ECB's framework for monetary statistics using the national residency approach. An earlier ROSC mission recommended that the NBP, in cooperation with the MoF, reconcile monetary and government finance statistics and carry out a reconciliation exercise on a regular basis.
Balance of Payments: Largely to improve data accuracy, the NBP reduced its reliance on International Transactions Reporting System (ITRS) data and increased its reliance on survey-based source data, starting in the first quarter of 2010; however, the size of errors and omissions remained unacceptably high. In 2009 and 2010, errors and omissions were larger than the current account deficit. STA undertook an evaluation mission to Poland in July 2009 (prior to the implementation of the new compilation system) to examine possible causes of the large and growing net errors and omissions. Among those potential sources were financial account transactions (by banks and nonbanks), goods imports, and weaknesses in data capture through the ITRS. During the 2011 IMF Spring Meetings, the NBP informed of data improvements work that the NBP and GUS had undertaken, and revisions that it anticipated incorporating in the external sector accounts at end-June 2011. A STA mission followed up on these issues during June 6-10, 2011. The mission concluded that the intended revisions to the Polish data are based on appropriate compilation techniques. The revisions would affect the estimates from 2004 forward. Poland has conducted much research into trade in used cars (imports of used cars from Germany may have been missed); remittances (incoming private transfers may be overstated and outgoing private transfers may be understated); repurchase agreements (a limited amount of double counting of financial transactions in repos may have occurred); and overseas assets of non-financial corporations (these may be misreported or missed). Further, the NBP's new survey-based compilation system has had an overall positive impact on data quality. The mission also advised that research may usefully be conducted into the valuation of exports and imports of goods and the coverage of derivatives transactions.

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

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

POLAND: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(As of May 31, 2012)

	Date of latest observation	Date received	Frequency of data[7]	Frequency of reporting[7]	Frequency of publication[7]	Memo Items:	
						Data Quality – Methodological soundness[8]	Data Quality Accuracy and reliability[9]
Exchange Rates	5/24/2012	5/24/2012	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	4/2012	5/21/2012	M	M	M		
Reserve/Base Money	3/2012	5/10/2012	M	M	M	O, LO, O, LO	O, O, O, O, O
Broad Money	3/2012	5/10/2012	M	M	M		
Central Bank Balance Sheet	3/2012	5/10/2012	M	M	M		
Consolidated Balance Sheet of the Banking System	3/2012	5/10/2012	M	M	M		
Interest Rates[2]	4/2012	5/9/2012	D	D	D		
Consumer Price Index	4/2012	5/15/2012	M	M	M	O, O, O, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q4/2011	4/27/2012	A	A	A	LO, O, O, O	O, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	3/2012	5/31/2012	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	5/2009	6/15/2009	M	M	M		
External Current Account Balance	Q4/2011	4/5/2012	M	M	M	O, O, O, LO	O, O, O, O, LO
Exports and Imports of Goods and Services	Q4/2011	4/5/2012	M	M	M		
GDP/GNP	Q4/2011	3/16/2012	Q	Q	Q	O, LO, O, O	LO, LO, O, O, LO
Gross External Debt	Q1/2009	6/30/2009	Q	Q	Q		
International Investment Position[6]	Q4/2011	4/5/2012	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 (state, budgetary funds, extra budgetary funds, and social security funds) and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
[8] Reflects the assessment provided in the data ROSC or the Substantive Update published on September 15, 2003, and based on the findings of the mission that took place during January 8–22, 2003. for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
[9] Same as footnote 8, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

Statement by the IMF Staff Representative on Republic of Poland
July 2, 2012

This statement provides information that has become available since the Staff Report was circulated to the Executive Board on June 19, 2012. The information does not alter the thrust of the staff appraisal.

1. **The National Bank of Poland (NBP) and Swiss National Bank (SNB) signed a Swiss franc/zloty swap agreement on June 25.** Treated as a precautionary measure, the swap agreement would allow the NBP to provide Swiss franc liquidity to banks in Poland in the event of major Swiss franc funding pressures. In contrast to the Swiss franc/euro swap agreement between the NBP and SNB in November 2008, this one allows the NBP to directly swap zloty into Swiss francs. The term of the swap transactions is one week, and all swap transactions require the SNB's prior approval. The amount and detailed terms have not been disclosed.

2. **With the latest eurobond issue, the Ministry of Finance has met its total foreign currency debt redemption needs for this year.** On June 11, a 10-year eurobond worth EUR1.5 billion was issued. The bond has a fixed coupon of 3.75 percent (a spread of 247bps over similar German Bunds at issuance). This issue, together with a few recent domestic issues and a loan from the World Bank, has allowed the government to meet 80 percent of total gross financing needs thus far, compared with the 70 percent achieved in mid-May.

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 12/70
FOR IMMEDIATE RELEASE
July 5, 2012

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

IMF Executive Board Concludes 2012 Article IV Consultation with the Republic of Poland

On July 2, 2012 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Poland.[1]

Background

The economy fared well throughout the crisis, and growth was robust and well-balanced in 2011. Despite substantial fiscal consolidation and challenging external conditions, real GDP expanded by a solid 4¼ percent, driven by a strong rebound of fixed investment—mainly infrastructure spending—and net exports, which picked up toward the end of the year. The current account deficit improved to 4.3 percent of GDP, and was largely financed by capital transfers from the EU and net FDI inflows.

The fiscal deficit narrowed to 5.1 percent of GDP in 2011, reflecting buoyant tax collections and consolidation measures. The government's financing needs were comfortably met in financial markets (with successful international bond issuance and increasing foreign holdings of domestic government securities) and also helped by privatization receipts. Fiscal consolidation measures amounting to 1¼ percent of GDP are being implemented in 2012. A narrowing of local government deficits and a redirection of pension contributions from the second to the first pillar are expected to generate an additional ¾ percent of GDP in general government deficit reduction.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Throughout 2011, headline inflation remained persistently above the National Bank of Poland's (NBP) target (2½ percent), driven by energy and commodity prices, increases in administered prices and VAT rates, and robust economic activity. In response, the NBP hiked the policy rate by a cumulative 100 basis points to 4½ percent in the first half-of 2011, before pausing for nearly a year. A further rate hike to 4¾ percent took place in May 2012. Meanwhile, wage pressures have remained subdued and there is no compelling evidence of second round effects.

The banking sector remained profitable and well-capitalized. Declining provisioning boosted profitability and the average capital adequacy ratio remained high at around 13 percent. The nonperforming loan ratio reached 8.2 percent at end-2011, helped by a recovery in credit growth. In response to credit risk stemming from foreign currency denominated mortgages, the authorities tightened the prudential framework and asked banks with riskier profiles to retain profits. The latest stress tests by the NBP showed that the majority of banks are resilient to adverse macro scenarios, with some institutions exposed to liquidity risk stemming from the hedging of their foreign exchange positions.

Executive Board Assessment

Executive Directors commended the authorities for sound macroeconomic management, which has underpinned the good performance of the Polish economy in a challenging environment. Directors noted that Poland's precautionary Flexible Credit Line arrangement has contributed to maintaining confidence and the forward momentum of the recovery. However, in light of continued regional turbulence and weakening growth prospects, Directors encouraged the authorities to address remaining vulnerabilities.

Directors observed that Poland's strong economic links to the rest of Europe and large external financing needs could give rise to adverse spillovers. Directors noted, however, that recent actions by the authorities, including frontloading public debt issuance and further strengthening banks' capital and liquidity buffers, should help mitigate these risks.

Directors broadly supported the on-going fiscal adjustment, which is necessary to rebuild fiscal buffers. Most Directors, however, considered that automatic stabilizers should be allowed to operate if growth slows more than anticipated. Over the medium term, additional permanent fiscal measures would be needed to achieve the authorities' medium-term objective, but excessive cuts in public investment should be avoided. Directors welcomed the proposed fiscal rule and the recent pension reform, which should strengthen public finances and contribute to long-term fiscal and external sustainability.

Directors agreed that, given the absence of inflationary pressures, monetary policy should remain on hold. In case the inflation outlook worsens, the National Bank of Poland (NBP) has room to respond while trying to avoid abrupt exchange rate adjustments. Directors concurred that the NBP should stand ready to provide emergency liquidity support if needed. They noted that the decision to increase international reserves could further boost the adequacy of external buffers, although, in the view of a few Directors, the costs of this strategy would need to be considered.

Directors noted the resilience of Poland's banking system, but underscored that vulnerabilities remain owing to households' foreign currency exposure and non-performing loans (NPLs). Directors welcomed recent supervisory measures to contain foreign currency lending and encouraged a more proactive approach to addressing NPLs. Directors commended the recent and proposed improvements to the oversight of the financial sector, including plans to establish a macro-prudential framework, and underscored the need to develop a bank resolution regime.

Directors encouraged the authorities to continue with structural reforms in order to boost the growth potential. In particular, they stressed the importance of strengthening the labor market, improving the business climate, and advancing privatization plans.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2012 Article IV Consultation with Poland is also available.

Poland: Selected Economic Indicators, 2008–12

	2008	2009	2010	2011 Est.	2012 Proj.
Real economy (change in percent)					
Real GDP	5.1	1.6	3.9	4.3	2.6
CPI (end of period)	3.3	3.5	3.1	4.6	3.2
Unemployment rate (in percent)	7.1	8.2	9.6	9.6	9.4
Public finances (percent of GDP)					
General government balance 1/	-3.7	-7.4	-7.9	-5.1	-3.1
Public debt 1/	47.1	50.9	54.8	56.3	54.8
Money and credit					
Private sector credit (change in percent)	34.9	9.1	9.2	14.5	6.3
Broad money (change in percent)	18.6	8.1	8.8	12.5	7.0
Policy rate 2/	5.7	3.8	3.5	4.3	4.75
Balance of payments					
Current account balance (percent of GDP)	-6.6	-4.0	-4.7	-4.3	-4.4
Official reserves (billion U.S. dollars)	62.2	79.6	93.5	97.9	106.8
Total external debt (percent of GDP)	46.2	65.1	67.1	64.8	66.3
Exchange rate					
Exchange rate regime			Floating		
Present exchange rate (June 1, 2012)			PLN 3.58 = US$1		
Zloty per US$, period average	2.41	3.12	3.02	2.96	. . .
Zloty per Euro, period average	3.55	4.35	4.00	4.12	. . .
Real effective exchange rate (INS, CPI based) 3/	124.2	105.5	112.1	110.4	. . .

Sources: Polish authorities; and IMF staff estimates.

1/ ESA95 definition.

2/ NBP Reference Rate (avg). For 2012, as of June 1.

3/ Annual average (2000=100).

Statement by Katarzyna Zajdel-Kurowska, Alternate Executive Director for the Republic of Poland and Beata Jajko, Advisor to the Executive Director
July 2, 2012

On behalf of the Polish authorities, we would like to thank staff for the constructive consultations held in Warsaw and the comprehensive set of papers. Our authorities broadly agree with the staff assessment and policy recommendations.

Economic Outlook

After robust economic growth in 2011, private consumption and investments are slowing. Fiscal consolidation and shrinking availability of EU structural funds weigh adversely on public demand. In addition, developments in Europe weaken external demand and add to uncertainty. As a result, the Polish economy is expected to grow by 2.5 percent in 2012 as opposed to 4.3 percent in 2011.

Over the medium term, the economic outlook should improve, driven by a rebound in domestic demand. But given strong trade and financial linkages with the EU, risks are on the downside. The unemployment rate will likely remain relatively high, at around 12.5 percent on average, before the economy gains momentum and the expected benefits of labor market reforms materialize.

Poland continues to benefit from the Flexible Credit Line arrangement with the Fund which provides an additional reserve buffer and helps strengthen investor confidence.

Fiscal Policy

The Polish authorities are determined to further reduce the fiscal imbalance in order to ensure long-term fiscal sustainability. The measures undertaken—both on the expenditure and revenue sides—aim at bringing the general government deficit in line with the Excessive Deficit Procedure (EDP) in 2012 and narrowing the structural deficit to meet the medium term objective, i.e., 1 percent of GDP, by 2015. Mindful of fragile growth, the authorities carefully design measures to reduce expenditure and boost expenditure effectiveness. They also continue to improve the efficiency of the tax system. A detailed description of the fiscal measures was presented by the authorities in the 2012 update of the Convergence Programme. In addition, the 2013 budget assumptions approved by the Council of Ministers in June 2012 are in line with the fiscal consolidation path.

The 2011–12 consolidation package has already resulted in a strong reduction of the general government deficit—from 7.8 percent of GDP in 2010 to 5.1 percent in 2011. The share of general government expenditure in GDP (after excluding budget co-financing of projects financed with the EU structural funds) has been put on a downward path, and in 2012 it is expected to reach its lowest level in the last two decades. Moreover, the austerity effort is expected to reverse the growth of the general government debt-to-GDP ratio in 2012. Simultaneously, the authorities continue to strengthen the fiscal framework and increase fiscal discipline on all levels of the general government. A temporary expenditure rule on the central level and deficit-reducing rules on the local level are already in place. In addition, the

authorities continue to work on the fiscal responsibility law and a permanent fiscal rule, which are expected to be enacted in 2013. An expenditure review is also in the pipeline.

Monetary Policy

In 2011 despite tightened monetary conditions—a 100 basis point increase in the policy rate in the first half of the year—CPI inflation exceeded the upper limit for deviations from the 2.5 percent target. Inflationary pressures mainly originated from factors beyond the control of the monetary authorities. Since December 2011 inflation has been slowly put on a downward path but small fluctuations have persisted. In May 2012 the headline CPI dropped to 3.6 percent, while core inflation reached 2.3 percent, i.e., the lowest level since April 2011. Slowing economic growth and relatively high unemployment limit the risks of second-round effects.

In May 2012, the Monetary Policy Council increased the policy rate by 0.25 percentage points to anchor inflation expectations and to ensure positive real interest rates. While the current level of interest rates appears to be adequate to maintain price stability in the medium term, the Council remains vigilant to the developments in the economy and stands ready to act accordingly.

The National Bank of Poland ensures that the level of official reserves is adequate. The current account deficit narrowed and was mostly financed by EU funds and FDI inflows. Despite last year's volatility of the exchange rate, an outflow of short term capital was not recorded.

Financial Sector

Despite a large presence of foreign investors, the Polish financial sector remains resilient to the sovereign debt crisis. The banking sector is much less leveraged than EU and global banks and remains liquid, well-capitalized and highly profitable. In 2011, net profit increased by 37.5 percent, reaching a record high level for the Polish banking sector. The capital adequacy ratio remains high (over 13.8 percent in the IQ2012), with Tier 1 capital representing 90 percent of total capital.

There has been limited evidence of bank deleveraging so far. Credit growth rebounded strongly in 2011, rising 11 percent y/y (after exchange rate adjustment), mainly due to strong corporate sector demand. Total corporate lending rose by 19 percent y/y in 2011 with 60 percent of this increase generated by small and medium sized companies (SME). At the same time, credit to households slowed significantly as a result of more restricted lending policies caused by new legal regulations imposed by the Financial Supervisory Authority (KNF) in 2010 (Recommendation T) and 2011 (Recommendation S II).

The stock of FX mortgage loans remains elevated, but the share of FX loans in new mortgage lending has been significantly reduced. Despite a steep depreciation of the zloty in the second half of 2011, FX mortgage loans are still the best performing type of asset with a NPL ratio at 1.7 percent in March 2012, versus 3.6 percent for zloty mortgage loans. The overall loan performance (overall NPLs) has slightly improved during the course of 2011; however, the picture is diverse across the different types of assets: with 10.9 percent in corporate lending

and 17.7 percent in consumer lending.

Structural Reforms

Mindful of the importance of structural reforms for long-term growth, the authorities continue to implement labor and product market reforms. They also remain focused on moving forward with privatization—when market condition allow—and on enhancing the management of public assets.

In order to increase the labor force participation rate—which is still relatively low compared to the EU average—the authorities are implementing pension system reforms. From 2013 onwards, the retirement age for men and women will be gradually raised to reach 67 for both groups—by 2020 for men and by 2040 for women. The length of work required for pension eligibility has also been extended for uniformed services which are regulated by a special law.

Improving conditions for business activity and innovations remains one of the authorities' priorities. The measures undertaken include streamlining the requirements for setting up new businesses by a further reduction of administrative and disclosure requirements and enhancing the effectiveness of legal court proceedings. In addition, the deregulation of the 380 licensed professions is in the pipeline. The process is expected to be implemented in three stages with the first one aiming at improving access to 49 professions