CONCLUDING STATEMENT

Poland: Staff Concluding Statement of the 2021 Article IV Mission

FOR IMMEDIATE RELEASE

Washington, DC – December 14, 2021:

An International Monetary Fund mission conducted a virtual visit during November 29-December 13 in the context of the 2021 Article IV consultation.

While the virus has taken a significant toll on people's lives, vigorous policy support and strong fundamentals have enabled Poland to weather the economic impact of the pandemic and embark on a notable recovery. The challenge now for economic policy is to continue the exit from extraordinary policy support, preserve macroeconomic stability amid emerging pressures, and manage risks related to the pandemic and other factors. Rising energy prices, supply chain disruptions, and buoyant demand are spurring inflation, calling for some further tightening of monetary policy in the period ahead. At the same time, fiscal policy should avoid an expansionary stance as output moves above potential, and fiscal buffers should be gradually restored to make room for adverse surprises and foreseeable long-term spending needs. Policy efforts to strengthen the skills of the workforce and advance the decarbonization of the economy, both supported by the EU, are key to help Poland remain competitive and extend its impressive track record of strong growth.

As elsewhere, the virus has taken its toll on people's lives and livelihoods, but the Polish economy has weathered the pandemic comparatively well. After contracting 2½ percent in 2020, the economy has already surpassed the pre-recession peak and is projected to grow 5.2 percent in 2021. In the near term, the fourth wave of the pandemic may slow economic growth over the winter months, though growth is projected to remain strong in 2022 at 4.5 percent. The Polish economy has displayed increasing resilience to successive waves of the pandemic, and industry and exports have withstood supply chain disruptions better than most of the EU. The authorities should nevertheless consider strategies to increase vaccination coverage in Poland to reduce health risks and mitigate the potential for further pandemic-related economic disruptions.

The outlook for the Polish economy over the medium term remains favorable, with minimal scarring expected from the pandemic. Economic growth is projected to average 3¼ percent over 2023-26. Fiscal policy has supported employment during the pandemic and bolstered corporate balance sheets, which provide a strong foundation for further private investment. Next Generation EU grants should deliver a significant boost to public investment, underscoring the importance of resolving outstanding disputes with the EU and improving public investment efficiency. The current account is projected to return to deficit at 0.3 percent of GDP in 2021 and is preliminarily assessed to be moderately stronger than the level implied by medium-term fundamentals and desirable policies. Foreign exchange reserves are adequate to insulate against external shocks and disorderly market conditions.

Fiscal support for the economy appropriately became more targeted as the pandemic evolved. Many of the initially broad-based measures were appropriately extended with greater targeting to support the sectors most impacted by the second and third waves of the pandemic. Driven mainly by the reduction in pandemic-related fiscal support, the general government fiscal deficit is projected to decline from 7.1 percent of GDP in 2020 to 2.9 percent of GDP in 2021. Considering the risk of a prolonged winter wave that could weigh on some sectors, substantial fiscal space exists to extend targeted support, if necessary, with general government gross debt projected at 56 percent of GDP in 2021

As fiscal policies transition past the pandemic in 2022, the authorities should avoid an expansionary fiscal stance in the context of overheating risks. The “Polish Deal” initiatives are estimated to cost around 1 percent of GDP, and their impact on the deficit is only partly offset by other factors. The PIT reform increases tax progressivity and could increase labor supply for the working age population, with a less clear impact on those near retirement age. Additionally, in the context of elevated energy price inflation, the authorities have announced an “anti-inflation shield” consisting of tax and excise reductions on fuels and electricity and vouchers for lower income households. While tax reductions can provide some relief, they are inefficient and should be temporary, lest they mount in cost and come to be seen as a substitute for broader policy adjustments to address inflation. Energy poverty risks are better addressed through targeted instruments such as the vouchers.

A modest further reduction in the fiscal deficit over the medium term would help prepare for future fiscal challenges. Based on current and announced policies, over the medium term, general government debt is projected to stabilize around 50 percent of GDP, with the general government deficit around 2½ percent of GDP. Some additional reduction in the deficit towards the medium-term objective of 1 percent of GDP—similar to its pre-pandemic level—would create more policy space to address future shocks and help prepare for long-term pressures related to population aging and the energy transition. An improvement to expenditure policies, including by reversing the previous reduction in the pension age and improved targeting of social benefits, could be considered to contribute to further deficit reduction over the medium term. Moreover, the availability of ample fiscal space to deal with the unexpected has served Poland well in this pandemic.

Inflation has increased substantially in 2021 and is projected to remain elevated in 2022. The increase in headline inflation to 7.7 percent in November has primarily been driven by external factors, including energy prices. Nevertheless, core inflation has also increased in recent months and has become broader based. Headline inflation is projected to peak in late 2021 and decline over the course of 2022, assisted in the near term by “anti-inflation shield” measures projected to temporarily reduce inflation by about 1 percentage point in early 2022, and by base effects as energy prices stabilize. After averaging 5.6 percent in 2022, inflation is projected to return close to the target by the end of 2023, also supported by a slow moderation of core inflation.

The National Bank of Poland (NBP) should continue to tighten monetary policies to drive inflation back to the target. Beginning in October, the NBP has increased interest rates from 0.1 percent to 1.75 percent. While the recent increase in inflation has been largely driven by factors outside the control of monetary policy, their persistence and the relatively elevated level of core inflation presently suggest that further rate increases will be necessary to minimize second-round effects and stave off overheating risks as output moves above potential. Monetary policy decisions in 2022 will also need to take into account evolving economic and pandemic-related conditions, which pose upside and downside risks to the inflation outlook, to ensure that inflation moves consistently toward the target. The recent conclusion of regular asset purchases is also welcome and consistent with monetary policy tightening. The NBP should provide timely guidance on its intentions regarding its bond portfolio as initial maturity dates approach. Foreign exchange intervention should also be reserved to periods of disorderly market conditions.

Bank asset quality has remained stable through the pandemic, permitting a gradual removal of pandemic-related regulatory relief. Non-performing loan ratios have been broadly stable, and loan performance has not deteriorated even after the end of pandemic payment holiday schemes. Capital adequacy levels improved in 2020 to 20 percent of risk-weighted assets (significantly above the regulatory minimum), largely due to the temporary suspension of dividend payments and to increased holdings of low-risk government bonds. Against this background, the ongoing gradual phasing out of crisis-related financial sector measures has been appropriate. At the same time, the housing market has returned to pre-pandemic robust conditions. While the exit from monetary stimulus is expected to discourage excessive new borrowing, some households could become overstretched as interest rates rise. It is thus important that banks, consistent with regulatory guidance, vigorously test prospective borrowers' ability to service loans in a scenario of significant interest rate increases.

The mission supports the voluntary restructuring of foreign currency denominated (FX) mortgages. The legal risks of FX mortgages represent the main source of risk to the banking system. The severity of this risk to exposed banks appears to have moderated in recent months, as key legal guidance suggests a reduced likelihood of the most adverse outcomes in court, while the underlying profitability of banks has been improving. The Polish Financial Supervisory Authority has proposed that banks take a proactive stance by offering clients to convert their FX mortgages to zloty, while the Financial Stability Committee proposes temporarily lowering FX mortgage risk weights for banks that implement such programs. These are sound proposals, and some banks have launched voluntary mortgage conversion programs. Although conversion will be costly for the banking system, it would allow banks to remove the uncertainty arising from litigation, while current strong capitalization and rising provisions mean that the cost would be manageable for most banks.

Poland adopted an energy policy strategy in 2021 that pledged to significantly reduce coal power by the 2040s. Poland is one the 20 largest emitters of greenhouse gases in the world, with the main contribution to emissions coming from the power sector, where coal accounts for a large share of energy production. Poland participates in the European emissions trading system (ETS), which creates pressure to reduce emissions, especially if the ETS extends its coverage in coming years. The cost of emissions is also likely to make access to clean energy an increasingly important factor in companies' FDI decisions. Poland's energy transition strategy envisages a 30 percent reduction in emissions by 2030 relative to the 1990 level. The transition will demand substantial investments, mostly in power generation, for more than a decade. In fact, large investments would be necessary even without trying to reduce emissions, given aging power generating capacity and the needs of a growing economy. EU financing will support the transition process, but will not be enough by itself, underscoring the need for a long-term financing strategy. The authorities should consider a role for carbon taxation and rebates as part of their overall strategy to further incentivize private sector decarbonization, while shielding the most vulnerable households from the impact of higher carbon prices.

Active labor market policies (ALMP) are needed to help the movement of labor toward expanding sectors. The decline in output in high-contact sectors has far exceeded their declines in employment, while expanding sectors increasingly demand skilled labor. Decarbonization will also present longer-run challenges for coal mining, which represents a small share of overall employment but has some regional concentrations. Against this background, the mission welcomes the authorities' plans to modernize the government's job search assistance services and strengthen access to training, with a special focus on digital skills, including as part of the Recovery and Resilience Plan. It also encourages the authorities to follow through on the implementation of measures to allow longer periods of employment for foreign workers, who over the long term are an important source of labor to offset long-term population dynamics.

The mission is grateful to the authorities and other counterparts for excellent discussions.

Republic of Poland: Selected Economic Indicators, 2020–26

	2020	2021	2022	2023	2024	2025	2026
		Projections					
Activity and Prices							
GDP (change in percent) 1/	-2.6	5.2	4.5	3.9	3.0	3.0	3.0
Output gap (percent of potential GDP)	-2.9	-0.8	0.3	0.7	0.2	0.1	0.0
CPI inflation (percent)							
Average	3.4	5.0	5.6	3.4	2.7	2.6	2.5
End of period	2.4	7.7	3.7	2.7	2.6	2.5	2.5
Unemployment rate (average, according to LFS)	3.2	3.5	3.3	3.0	3.0	3.0	3.0
Public Finances (percent of GDP) 2/							
General government net lending/borrowing	-7.1	-2.9	-2.6	-2.6	-2.6	-2.6	-2.6
General government cyclically adjusted overall balance	-5.6	-2.5	-2.8	-3.0	-2.7	-2.6	-2.6
General government primary balance	-5.8	-1.8	-1.4	-1.3	-1.2	-1.2	-1.2
General government debt	57.4	55.9	52.4	50.4	50.2	50.2	50.2
Balance of Payments							
Current account balance, percent of GDP	2.9	-0.3	-0.6	-0.8	-0.9	-1.0	-1.0
Total external debt, percent of GDP	62.9	62.5	57.3	53.5	50.6	47.8	45.2
Memorandum item:							
Nominal GDP (billion zloty)	2326.7	2585.5	2848.6	3051.1	3229.9	3416.3	3605.6

Sources: Polish authorities; and IMF staff calculations.
1/ Real GDP according to 2015 base year.
2/ According to ESA2010.

#