INTERNATIONAL MONETARY FUND

**Poland—Concluding Statement of the 2013 Staff Visit**

Warsaw, November 22, 2013

*Economic activity is starting to strengthen after a cyclical downturn. As the recovery takes hold, fiscal consolidation should continue at a moderate pace in order to put the public debt ratio firmly on a downward path. Monetary policy should remain on hold to help support the recovery. While the proposed changes to the pension system will improve the fiscal aggregates, further reform of the social security system is still needed. The financial sector has been resilient in the face of weak growth, but more should be done to address impaired loans and boost oversight of bank credit risk management policies.*

1. **After a sharp slowdown, the economy is starting to recover.** The Polish economy weakened considerably in 2012 and the first half of 2013 as a result of slow growth in key trading partners, confidence effects which weighed on private consumption and investment, and a decline in public investment. A recovery is underway and is expected to continue in 2014, driven by domestic demand. However, the pickup is expected to be gradual, given the weak labor market and tepid credit expansion, with growth rising from 1.3 percent this year to 2.7 percent next year. On the upside, domestic demand could recover more quickly than projected as confidence returns, boosting growth by more than currently expected. Downside risks arise from possible turbulence in global financial markets or a prolonged period of slower growth in Europe. Poland’s Flexible Credit Line arrangement with the IMF provides insurance against these risks.
2. **The monetary policy stance is appropriate.** Following significant and welcome cuts in the policy interest rate, the MPC has kept rates on hold since July and also indicated that it intends to maintain rates at their current level through mid-2014. This is appropriate given expectations that inflation will rise slowly toward its target as the recovery gains traction. Should the recovery falter and inflation fail to pick up as expected, there would be scope for further rate cuts.
3. **Fiscal policy is balancing the need to support the economy with further fiscal consolidation**. Automatic stabilizers were allowed to operate around a structural consolidation path in 2013, but revenue shortfalls proved larger than anticipated. Thus, the general government deficit is expected to reach 4.6 percent of GDP in 2013. For 2014, we estimate that fiscal consolidation measures will yield ½ percent of GDP, which is appropriate for this stage of the economic cycle. Assuming some cyclical recovery in VAT revenues as the economy improves, as well as increased social contributions and lower interest payments (on account of the planned changes to the pension system), the general government deficit should reach 3.5 percent of GDP next year. At the same time, it will be important to continue to contain expenditures, avoid further cuts to public investment, and implement planned measures to strengthen tax administration.
4. **Over the medium term, moderate further fiscal consolidation will be needed to put the public debt ratio firmly on a downward path**. The planned changes to the pension system should lead to a reduction in public debt of some 9 percentage points of GDP and a decline in the deficit of about 1 percentage point of GDP. Despite these near-term gains from the proposed changes to the pension system, it is essential that fiscal policy remains prudent and that public debt is reduced further over time. In this context, additional measures of ½-1 percent of GDP would be needed by 2016 to approach the authorities’ Medium-Term Objective of a 1 percent of GDP structural deficit. The proposed fiscal rule—with reductions in the debt thresholds to reflect the pension changes—should help support this objective.
5. **While the planned changes to the pension system will improve the fiscal aggregates, further reform of the social security system is needed**. Legacy deficits remain in the social security system. Making the system more equitable and improving its financial strength will require further reforms of the special occupational pensions and better alignment of disability and survivor pensions with the core pension system. Given the expected decline of replacement rates under the defined-contribution system, additional voluntary pension savings would help reduce the risk of old age poverty. As the planned changes to the pension system are implemented, careful attention will need to be paid to potential implications for the government bond and equity markets.
6. **The authorities’ regulatory and supervisory efforts have helped further bolster the resilience of the financial system.** Bank capital and liquidity buffers have been reinforced, new foreign currency mortgage lending has effectively halted, and reliance on foreign funding has declined. The strong capitalization of the banking sector also provides a basis for sound credit expansion as the economy recovers. Although the impaired loan ratio has fallen recently, it remains elevated. In this context, further work is needed to remove legal and tax obstacles to impaired loan resolution. The Polish Supervisory Authority (KNF) should intensify its oversight of banks’ credit risk management policies, to help ensure that prudent lending standards are maintained as credit growth revives. The authorities should also advance legislation to establish effective macroprudential and bank resolution frameworks, as these are essential tools for crisis prevention and resolution and would also complement initiatives at the EU level. The credit union sector is weak, although it represents a small share of the financial system. The KNF should continue to require credit unions with weak financial conditions to adopt rehabilitation plans.