INTERNATIONAL MONETARY FUND

Republic of Poland: Concluding Statement of an IMF Staff Visit

10/30/2014

Growth is losing momentum and inflation is at historic lows. Following a temporary slowdown, a gradual strengthening of economic activity should resume, supported by Poland's strong economic fundamentals and polices. However, the outlook is clouded by external downside risks. Policies should focus on safeguarding economic stability and growth. This would require bringing inflation back to target, completing fiscal consolidation, and expediting financial sector reforms.

1. **The pace of the recovery is leveling off alongside very low inflation.** Growth is decelerating amid the slowdown in the euro area and adverse confidence effects from geopolitical tensions. Inflationary pressures remain weak, reflecting low imported inflation and second-round effects on core inflation from low food and energy prices. Meanwhile, credit and labor market conditions have improved, and the financial sector remains in good health. The outlook is for a temporary slowdown followed by a gradual strengthening of economic activity, supported by domestic demand. We project growth around 3 percent in 2014 and 2015. On current policies, inflation is expected to enter the official target band by end-2015, albeit with downside risks.

2. **External downside risks remain elevated**. A protracted period of slower growth in the euro area or a generalized slowdown in emerging markets would have large effects on Poland via trade and confidence channels. Other risks include continued geopolitical tensions surrounding Russia/Ukraine and a stronger-than-expected market reaction to the normalization of monetary policy in the US. Poland has remained resilient in the face of recent bouts of financial turbulence, reflecting its strong fundamentals and sound policy frameworks. The Flexible Credit Line arrangement with the IMF also helps mitigate external risks. Policies should focus on safeguarding economic stability and growth.

3. **Additional monetary easing might be needed to bring inflation back to target.** Recent policy interest rate cuts are welcome. Yet, downside risks to inflation persist amid slowing activity and disinflation in the euro area and unresolved geopolitical tensions surrounding Russia/Ukraine. Inflation expectations have been drifting down. With the output gap still open and growth losing momentum, further monetary easing would be needed if inflation expectations continue to decline or if economic activity is projected to slow down further. Meanwhile, high interest-rate differentials with

the euro area and emerging market peers and continued monetary policy easing in the euro area afford space for further policy interest rate cuts.

4. **Moderate reserve accumulation would strengthen Poland's resilience to external shocks.** The foreign exchange reserves are broadly adequate. However, over the medium term and as monetary and external conditions allow, a moderate buildup of reserves would help safeguard against still-elevated external risks.

5. **Fiscal consolidation should continue while allowing automatic stabilizers to operate.** The deficit is projected to narrow to about 3¼ percent of GDP in 2014 and further to about 2¾ percent of GDP in 2015. Public debt is expected to decline from some 55¾ percent of GDP at end-2013 to around 48½ percent of GDP at end-2014, mainly as a result of a one-off impact of the recent pension system changes. If economic activity slows further, automatic stabilizers should be allowed to work around ongoing policy measures. Over the medium term, additional consolidation of about 1 percent of GDP would be needed to attain the authorities' medium-term objective and put public debt on a firm downward path. Strict enforcement of the recently introduced expenditure rule should help ensure that fiscal policy remains prudent.

6. **Expediting key financial sector reforms would buttress financial stability.** Poland's banking system has remained well capitalized, profitable, and resilient to shocks, as confirmed by the recent asset quality review and stress tests conducted by the Polish Financial Supervision Authority (KNF). Reliance on parent bank funding has declined and nonperforming loans (NPL) have started to edge down, although further work to address legal and tax-related obstacles to NPL resolution is needed. Timely and effective implementation of macroprudential and bank resolution frameworks should be a top priority. Restructuring of the weak, but small, credit union segment should be completed.

We thank the authorities and other interlocutors for candid and constructive discussions during this visit.