**Poland: Staff Concluding Statement of the 2016 Article IV Mission**

May 16, 2016

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| A Concluding Statement describes the preliminary findings of IMF staff at the end of an official staff visit (or ‘mission’), in most cases to a member country. Missions are undertaken as part of regular (usually annual) consultations under [Article IV](http://www.imf.org/external/pubs/ft/aa/aa04.htm) of the IMF's Articles of Agreement, in the context of a request to use IMF resources (borrow from the IMF), as part of discussions of staff monitored programs, or as part of other staff monitoring of economic developments.   The authorities have consented to the publication of this statement. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF’s Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF Executive Board for discussion and decision. |

*Poland continued its convergence with the EU, growing well above most of its peers. However, increased external risks and recent policy initiatives have weakened investor sentiment, and together with long-term structural challenges could slow down growth and convergence. Sound institutions, growth-friendly policies, and structural reforms are critical to achieve sustainable and inclusive growth.*

1. **Poland is enjoying a rapid economic expansion, but external factors continue to weigh on inflation.** Growth reached 3.6 percent in 2015 driven by robust domestic demand, supported by healthy wage and credit expansion. Unemployment has come down rapidly, and the economy is operating at close to full capacity. Yet, low imported inflation has kept headline inflation significantly below the target. Growth is projected to remain strong in 2016 and accelerate to close to 4 percent in 2017, on the back of strong private consumption, opening a positive output gap. This should help gradually nudge inflation toward the lower bound of the target band (1.5 to 3.5 percent) by end-2017.
2. **Downside risks to the outlook have intensified.** External risks include a marked slowdown in emerging markets, accompanied by financial market volatility, and a protracted growth slowdown in the euro area, which could spill over to Poland through trade and financial linkages. Domestically, a weakening of some institutions and policies or fiscal slippages could worsen investor sentiment and hinder economic expansion. Over the longer term, a rapidly aging population poses important challenges to potential growth and fiscal sustainability. At the same time, enduring income disparities between Poland’s prosperous west and the lagging east could undermine the quality of growth.
3. **Strong policies and institutions are essential to mitigate these risks and to support sustainable and balanced growth.** With a closed output gap but continued low inflation, the near-term policy mix should be carefully calibrated to maintain an accommodative monetary policy stance, while continuing gradual fiscal consolidation. Safeguarding financial sector stability and strong institutions, underpinned by market-friendly policies, is a prerequisite for continued stable growth. Structural reforms will be key to securing healthy potential growth and income convergence, while reducing regional disparities. International reserves are broadly adequate. The Flexible Credit Line arrangement with the IMF provides added insurance against external shocks.
4. **The current accommodative monetary policy stance is appropriate.** The key policy interest rate has been kept at a historically low level since March last year. So far deflation appears not to have had adverse balance sheet effects, and longer-term headline inflation expectations remain within the tolerance band. Nonetheless, getting inflation back to the target is important to ensure that inflation expectations do not become unanchored. Hence, further interest rate cuts could be needed in the event of a sharp growth slowdown or if inflation expectations were to disappoint.
5. **The fiscal stance has become procyclical.** In 2016, implementation of election promises is expected to increase the deficit to about 2.8percent of GDP. The new child benefit scheme introduced in April 2016 will be partly financed by one-off revenues and a sectoral tax on financial institutions. Plans to partially reverse the 2013 retirement age increases and to hike the personal income tax-free allowance are under discussion. Depending on the final design and implementation, and in the absence of new offsetting measures, this could push the deficit significantly above 3 percent of GDP already in 2017—at a time when output is above potential—breaching the Excessive Deficit Procedure threshold, and undermining investor confidence. While the authorities plan to start reducing the deficit from 2018 at a pace of about ¾ percent of GDP a year, this would still imply a continued procyclical fiscal stance this year and next.
6. **Fiscal policy should take advantage of strong growth to resume consolidation already in 2017.** The deficit reduction should be underpinned by credible growth-friendly measures and anchored in reaching the government’s medium-term objective of 1 percent of GDP structural deficit by 2020. This would help support market confidence and maintain budget financing on favorable terms. The distortionary tax on financial institutions could reduce credit supply and increase financial vulnerabilities, and should be replaced with a more growth-friendly tax on profits and remuneration. Moreover, in the near term, consideration should be given to maintaining the current VAT rate beyond 2017 and rationalizing discretionary government consumption, drawing on the ongoing expenditure review. Over the medium term, measures could include unification of multiple VAT rates and phasing out of preferential pension regimes for farmers and miners. The mission welcomes the authorities’ efforts to strengthen tax administration, though any revenue gains from these reforms should be budgeted conservatively, since they take time to bear fruit.
7. **The intended partial reversal of the 2013 retirement age increases could undermine public finances and labor force participation, and should be reconsidered.** With a rapidly aging population, preventing the retirement age from increasing gradually as currently envisaged would be a step in the wrong direction. Such a step, without offsetting parametric conditions, would reduce the pension replacement rate, increasing the risk of old-age poverty and associated higher reliance on social benefits, with adverse implications for the budget. Moreover, it would reduce labor force participation at a time when potential growth is already threatened by unfavorable demographic trends.
8. **Maintaining financial sector stability is essential.** The banking sector remains well-capitalized but profitability has declined owing to a prolonged period of low interest rates and higher regulatory costs. A search for yield in a low-interest-rate environment risks shifting lending activity to the less regulated non-bank sector. In this context, recent regulation on non-banks, which limited the non-interest cost of loans and constrained the practice of rolling over credit, is welcome as it should help prevent the buildup of new vulnerabilities. Proposals for blanket conversion of Swiss franc mortgages into zloty, if implemented, risk undermining financial stability, with adverse implications for credit and growth. Instead, the focus should be on supporting distressed mortgage holders on a case-by-case basis. The bank resolution framework should be implemented expeditiously to ensure the availability of state-of-the-art resolution tools.
9. **Structural reforms should focus on addressing demographic challenges and reducing regional disparities.** Aging-related pressures can be tackled by increasing labor force participation, particularly of women and seniors, and boosting productivity. In this respect, the mission welcomes the authorities’ intention to move up the value-added chain by increasing access to vocational training and promoting innovation. Redirecting family cash benefits toward childcare and preschool education would help boost female labor force participation. Maintaining the retirement age increase envisaged by the 2013 pension reforms would encourage participation of seniors. Reducing regional disparities would promote more inclusive growth and speed up convergence. This would require improving educational attainment in the east, reducing skill mismatches, and investing in infrastructure to attract FDI to poorer regions.

*The mission thanks the authorities and other interlocutors for constructive discussions.*