Poland: Staff Concluding Statement of the 2020 Article IV Mission

FOR IMMEDIATE RELEASE

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 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.

Washington, DC – November 20, 2020:

An International Monetary Fund mission conducted a virtual visit during November 2-19 in the context of the 2020 Article IV consultation.

The crucial challenge facing policy makers is to control the pandemic and prevent lasting damage to the economy. The economic policy response to the first wave of infection has been powerful. To confront the ongoing second wave, Poland has policy space to provide additional support to impacted firms and households and to further increase health spending. Policy makers should err on the side of offering broad support through the coming year. Once the pandemic is under control and the economic recovery entrenched, policies will need to be increasingly geared toward bolstering labor supply and fostering the reallocation of resources that is needed to return to the strong pre-pandemic growth. In this regard, Next Generation EU transfers provide a major opportunity to boost activity and progress on digitalization and the transition to a future green economy.

A near term slowdown of activity, owing to a surge of virus infections and associated sanitary restrictions, is expected to make way to a recovery in the course of 2021, but the risks are to the downside. Activity is projected to decline in the current quarter, meaning that output could end up contracting by 3.4 percent in 2020. Weakness may well carry into early 2021, but should then give way to a strong rebound, with growth projected at 2.7 percent for the year as a whole. The possibility of further waves of virus outbreaks, especially as the winter begins, is a clear downside risk, while the early availability of a vaccine could prompt a more rapid rebound in 2021.

Overall, Poland is well positioned for a recovery, with a corporate sector that entered the pandemic with comparatively strong balance sheets and benefiting from ample fiscal and monetary policy support during the first wave. Key policy actions have incentivized firms to maintain employment through wage subsidies, while income support for self-employed and unemployed workers has been provided. Companies have been offered loan guarantees, forgivable micro loans, and liquidity loans, with up to 75 percent eligible for forgiveness subject to conditions such as the maintenance of employment. The implementation of the policy support programs has generally been fast and robust, and this should help limit long-term damage to the economy. Accordingly, we project that the economy would rebound further by 5.1 percent in 2022. Economic growth over 2023–25 is expected to average about 3 ¼ percent. External reserves are adequate to insulate against external shocks and disorderly market conditions.

Substantial policy space exists for further fiscal support as the evolution of the pandemic may demand. The reduction of public debt ratios in past years positioned the government well to respond vigorously to the crisis, as it has done. Moreover, the government has built a large cash reserve and enjoys favorable access to capital markets. Room continues to exist under Poland's constitutional debt limit, and the level of debt remains sustainable. Under the modified escape clause of the expenditure rule, room has been created for additional fiscal support in 2021. Thus, government programs can and should be extended as needed in the coming year, continuing to prioritize the preservation of employment/incomes and viable firms. In a downside scenario of a more prolonged crisis, fiscal consolidation can be postponed to help prevent damage to the economy.

The ongoing second wave represents a major challenge, and the recently announced measures are welcome. Many firms retain a liquidity buffer from the initial round of support (the PFR's financial shield). This buffer will be helpful during the second wave of the pandemic. But some firms in the most affected activities may have used fully the support from the initial shields and face a difficult time in the second wave. Thus, the extension of additional support to firms and workers during the second wave is appropriate. An approach based on sectoral targeting can make efficient use of resources. However, it risks leaving out some businesses with linkages to affected sectors and should thus be complemented by support for firms experiencing strains. With fiscal space available and favorable prospects for a vaccine, further programs should err on the side of providing broad-based support. Additional support for health care and vulnerable households should continue to be provided.

Even after the substantial fiscal measures deployed are considered, public debt is projected to remain sustainable in the medium term. Crisis-related expenditures are projected to increase the general government fiscal deficit to 8.9 percent of GDP in 2020. Over the medium term, the deficit is projected to decline to around 3 ¼ percent of GDP. General government gross debt is projected to increase to 59 percent of GDP in 2020 and stabilize around this level in the medium term. When the recovery is well underway, the deficit should be gradually reduced to replenish fiscal buffers, with the magnitude and pace of consolidation guided by the strength of the recovery. An improvement to expenditure policies, including increasing the pension age and better targeting of social benefits, along with further strengthening of revenue administration, should contribute to an eventual consolidation.

The labor market proved resilient during the first wave of pandemic, benefiting from large policy support. Despite a stable unemployment rate around 3 percent, additional indicators show the impact of the pandemic, including increased use of sick leave, part time work, and short hours of work. Rates of inactivity have also increased. Youth and women have been hardest hit. Continued policy support is needed to limit the impact of the second wave on labor markets. Going forward, policies should aim to facilitate the transition of the affected groups back into the labor market, avoiding a permanent decline in participation and a rise in structural unemployment. In the medium term, policies should facilitate sectoral transitions, close the skill gap, and prepare the post-pandemic economy for decarbonization and digitalization.

The National Bank of Poland (NBP) quickly and appropriately eased monetary policy, and its asset purchase program (APP) has been an effective policy tool. Considering the significant uncertainty of a recovery and a projected decline in average headline inflation from 3.4 percent in 2020 to 2.4 percent in 2021, the NBP's accommodative policy stance remains appropriate going forward. Additional near-term supply-induced inflation, if it materializes, should be tolerated in view of the negative output gap, which should lower underlying inflation pressures. In an adverse scenario with an additional interruption of economic activity or heightened market volatility, the NBP could increase the scale of asset purchases, which have tapered significantly since the summer. Continued clear policy communication will support the effectiveness of the asset purchase program.

Regulatory actions in the banking sector are welcome and in line with EU best practice, but the ongoing crisis presents challenges to the financial system. Provisioning and low interest margins are reducing banking system earnings. Low interest rates may be comparatively more challenging for cooperative banks, because they rely more heavily on interest income, underscoring the importance of improving their business models and economizing costs with the help of affiliating banks. More generally, credit risk is likely to increase after the expiration of anti-crisis liquidity support for the real sector. The increase is expected to be measured, and banks are proactive in provisioning and have strong capital buffers. Nevertheless, it is important to monitor closely the evolution of non-performing loans in 2021.

Foreign exchange mortgage lawsuits are a source of significant uncertainty for banks. Banks have increased their provisioning for legal risks starting in late 2019. However, the range of potential losses for banks will depend on the evolution of court decisions and the volume of loans involved, and could pose a major challenge for some banks. Although the risk seems to be well identified and acknowledged by the authorities and the industry, supervisors and banks should continue to adapt their strategies to stay ahead of the possible implications of court rulings.

Maintaining credit to the private sector will be crucial for a post-pandemic recovery. Banks flush with liquidity have significantly increased holdings of government bonds amid subdued private credit demand. The exemption of Treasury securities from the bank asset tax, however, also incentivizes banks to hold these instruments. To support credit to the private sector during the recovery, the authorities should consider redesigning the tax to make it less distortionary.

Despite effective policy support, the crisis is still likely to leave scarring, with long-term effects on the level of output. Over the medium term, to facilitate the reallocation of labor in the post-pandemic economy, active labor market programs should be expanded. Continued strong and inclusive growth will require gains to labor productivity to offset coming demographic headwinds, which calls for strong public and private investment. Next Generation EU funds provide the opportunity to boost to public investment over the next few years, while their focus on digitalization and a green recovery should help Poland advance with the modernization of its economy.

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

Republic of Poland: Selected Economic Indicators, 2019–25

	2019	2020	2021	2022	2023	2024	2025
		Projections					
Activity and Prices							
GDP (change in percent)	4.5	-3.4	2.7	5.1	4.2	2.9	2.6
Output gap (percent of potential GDP)	0.9	-2.6	-1.7	-0.4	0.0	0.0	0.0
CPI inflation (percent)							
Average	2.3	3.4	2.4	2.2	2.4	2.5	2.5
End of period	3.4	2.5	2.1	2.2	2.5	2.5	2.5
Unemployment rate (average, according to LFS)	3.3	3.9	5.4	4.7	4.5	4.5	4.5
Public Finances (percent of GDP) 1/							
General government net lending/borrowing 2/	-0.7	-8.9	-4.6	-2.7	-3.3	-3.3	-3.3
General government primary balance	0.6	-7.5	-3.6	-1.8	-2.3	-2.3	-2.2
General government debt	45.7	59.3	59.4	57.8	57.3	57.6	58.1
Balance of Payments							
Current account balance, percent of GDP	0.5	3.3	2.3	0.7	0.4	0.1	0.0
Total external debt, percent of GDP	59.4	57.1	55.3	48.2	42.7	39.8	36.9
Memorandum item:							
Nominal GDP (billion zloty)	2287.7	2283.7	2415.1	2596.9	2772.8	2923.6	3072.3

Sources: Polish authorities; and IMF staff calculations.
1/ According to ESA2010.
2/ One-off revenues from the Pillar II pension conversion are assumed for 2022.