POLAND

Highlights

- **Domestic demand continues to drive strong economic growth.** Robust household consumption, underpinned by rising disposable incomes, has been the key driver of growth since 2016, while investment growth accelerated in 2018 and in the first half of 2019.
- **A massive fiscal package has been announced.** The cost of the proposed five measures, including pre-election tax cuts and social spending increases, is estimated at 1.8 per cent of GDP annually.
- **The Occupational Pension Scheme (PPK), a new voluntary retirement savings scheme, began in June 2019.** As part of the pension system changes, the government has published a bill that liquidates the second pillar pension funds (OFEs) from 2020.

Key priorities for 2020

- **Controversies related to judicial reform remain to be resolved.** A satisfactory resolution would have a positive effect on business sentiment and could help increase private-sector investment. In related business environment news, Poland fell seven spots to 40th position (out of 190 economies) in the World Bank *Doing Business 2020* report, which makes a total loss of 16 places relative to the 24th position in 2016.
- **The increasing role of renewables should be further reinforced.** In the draft National Energy and Climate Plan (NECP) the country proposed a 21 per cent target for the renewables share in final energy consumption by 2030.
- **National capital markets should be further strengthened.** The draft capital market strategy, adopted by the government in October 2019, sets out two primary goals for the Polish capital market: (i) break down the barriers preventing accessible finance; and (ii) further develop infrastructure that will allow for more agile market development and innovation.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	3.8	3.1	4.9	5.1	3.9
Inflation (average)	-0.7	-0.2	1.6	1.2	2.3
Government balance/GDP	-2.6	-2.4	-1.5	-0.2	-1.7
Current account balance/GDP	-0.6	-0.5	0.1	-1.0	-0.9
Net FDI/GDP [neg. sign = inflows]	-2.1	-0.9	-1.4	-2.5	-2.2
External debt/GDP	71.8	76.4	67.0	63.9	n.a.
Gross reserves/GDP	19.9	24.3	21.4	20.0	n.a.
Credit to private sector/GDP	51.1	52.4	52.1	51.0	n.a.

CONTINUES

Macroeconomic performance

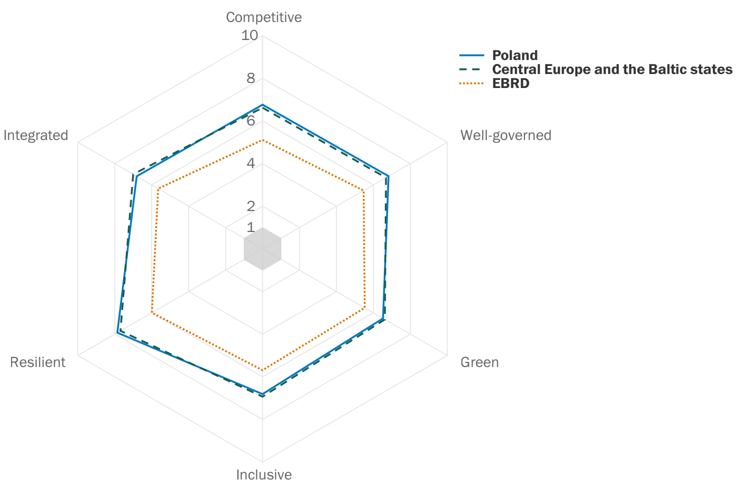
Government spending is providing a substantial boost to GDP growth. Poland's economy grew by 5.1 per cent in 2018, the highest growth rate in central Europe and the Baltic states, then slowed to 4.6 per cent in the first half of 2019. Domestic demand was the principal engine of growth, driven by recovered investment, continuously robust household consumption and especially by strong government consumption, at 4.5 per cent growth in the first half of 2019. A significant wage increase in the economy, averaging 7.1 per cent in the first half of 2019, substantial government transfers and favourable labour market trends have all contributed to increases in household disposable incomes and consumer confidence.

Investment growth improves. Overall, investment rose by 8.7 per cent in 2018. In the first half of 2019, it accelerated further to 10.5 per cent year-on-year, with non-financial corporate investment registering an increase of 19.0 per cent. In particular, companies have been investing strongly in buildings and structures, transport equipment, followed by machines and technical devices. A more intense inflow of European Union (EU) funds has provided a boost to corporate investment, amid mounting needs for greater automation as a result of labour shortages and higher labour costs. The stock of credit to the private sector remains stable, slightly above 50.0 per cent of GDP in the middle of 2019, whereas foreign direct investment inflows slowed from almost 4.0 per cent of GDP in 2016 to 2.8 per cent in 2018.

Fiscal deficits are improving on the back of strong nominal growth, one-off measures and extra taxes. The general government deficit narrowed to 0.2 per cent of GDP in 2018. A sharp increase in fiscal expenditures, such as the child benefit programme or the reduction in the pension age, was largely offset by improvements in tax compliance, including higher revenues derived from the economy's buoyant cyclical position and the introduction of a tax on assets of financial institutions. New social security contributions and one-off revenues, mostly gained from the conversion of the second pension pillar assets and CO2 emission rights, will counterbalance some of the new fiscal measures, with the budget draft forecasting a 0.3 per cent general government deficit (and a 1.3 per cent deficit without one-offs) in 2020. The general government debt to GDP ratio continues to fall and is estimated to drop below 48 per cent by the end of 2020.

Robust growth will continue but the weakening external environment constitutes a negative risk. The Polish economy will likely continue to grow robustly in 2019 and 2020, at 3.9 and 3.5 per cent, respectively. Rising household disposable incomes will drive further strong consumption, which will be only marginally trimmed by rising inflation. For the time being, investment will remain supported by substantial inflows of funds from the EU and government-led investments, including those financed by savings in the Occupational Pension Scheme. Nevertheless, the approaching slowdown in Poland's key trading partners in the EU represents an important risk to that scenario.

Assessment of transition qualities (1-10)



CONTINUES

Major structural reform developments

The government has adopted a new capital market strategy. The new strategy, drafted with support from the EBRD and the EU and adopted in October 2019, aims to help Poland's economy to compete successfully in rapidly changing and challenging international markets. The strategy is one of the tools for developing Polish capital markets and is in line with the Strategy for Responsible Development adopted by the Polish government in February 2017. The document sets out 90 steps including measures to improve the regulatory environment by creating a frictionless marketplace, and to develop market infrastructure and introduce new products and services.

A massive fiscal package has been announced. In February 2019, the government announced a package of pre-election tax cuts and social spending increases. They amount to about 1.8 per cent of GDP annually. Among other measures, an expanded (non-means tested) child subsidy increase of about €4 billion a year almost doubles the child subsidy programme introduced in 2016, which ultimately amounts to 1.7 per cent of GDP annually. A "13th" old-age pension disbursement adds an additional 0.4 per cent of GDP in both 2019 and 2020. A uniform reduction of the labour tax wedge for regular contracts adds another 0.2 per cent of GDP. The elimination of personal income tax for those under 26 years old (leaving the social security contribution unchanged) constitutes another 0.04 per cent of GDP and 0.06 per cent of GDP in 2019 and 2020, respectively. Subsidies to public transport for underserved regions are expected to cost 0.03 per cent of GDP. Also, from 1 January 2018, all entrepreneurs conducting research and development (R&D) activities (regardless of their size) can benefit from an additional deduction of 100 per cent of eligible costs, and research and development centres up to 150 per cent. Along with the increase of deductions for R&D tax relief, the catalogue of eligible costs was extended. Furthermore in 2019, preferential taxation of income generated on the basis of intellectual property rights (IP Box) entered into force with a 5 per cent rate. IP Box relates to income obtained from the commercialisation of entrepreneurs' intellectual property rights.

Pension system reform continues. The Occupational Pension Scheme (PPK), a new voluntary retirement savings scheme, began in June 2019. The main goal of the scheme is to increase the domestic savings rate, as participants will put aside between 0.5 and 4.0 per cent of their income, topped up by an additional 1.5 per cent to 4.0 per cent by the employer and some additional money by the state. The extra money saved by participants is aimed to partially offset the low pension replacement rates. In addition, in May 2019, the government published a bill that liquidates the second pillar pension funds (OFEs) from 2020. The OFEs' assets will be transferred either to the first pillar pension funds or to the Personal Retirement Accounts (IKEs). As the IKE option privatises the pension fund assets, a 15.0 per cent conversion fee will be charged. While the government predicts that 80.0 per cent of future pensioners will choose the IKE option, both options are expected to raise one-off income for public finances. In fact, the remaining 20.0 per cent will be credited to the Social Insurance Fund (FUS), from which pensions are paid out.

"Pro-family" measures have been extended. In March 2019, special pension rights, at the level of the minimum old-age pension, to women giving birth to at least four children. Moreover, the Family 500+ programme was extended to include all children in July 2019. As many beneficiaries of the latter change are mid to high-income, the short-term consumption, income equality or natality effect is likely to be limited. The expected costs of the programmes are 0.03 per cent and 1.7 per cent of GDP, respectively.

Disagreement raised by judicial reform has continued. The European Commission (EC) and the Polish government have continued to engage in the rule-of-law dialogue in the framework of the Article 7(1) procedure triggered by the EC in December 2017. On 3 April 2019, the EC launched an infringement procedure against Poland on the grounds that the new disciplinary regime for Polish judges undermines their judicial independence and does not guarantee to protect judges from political control. The new procedure follows two previous infringement procedures concerning the law on ordinary courts (launched in July 2017) and regarding the law on the Supreme Court (launched in July 2018), both on the grounds of their retirement provisions and their impact on the independence of the judiciary and of the Supreme Court. The Court of Justice of the EU delivered its

CONTINUES

final judgment on the Polish law on the Supreme Court (case C 619/18) in June 2019, having found that lowering the retirement age of judges of the Supreme Court in Poland was contrary to EU law and breached the principle of judicial independence. Prior to the final judgment of the Court of Justice of the EU, Poland adopted a law on 21 November 2018 reinstating the Supreme Court judges previously forced into retirement, thus correcting the effects of the law on the Supreme Court.

Electricity prices have been frozen. Following a sharp increase in electricity prices in 2018 (a 43.0 per cent increase of the average day-ahead electricity price on the Polish power exchange), largely driven by rising coal prices and carbon emission costs, the government adopted a law in January 2019 to keep electricity prices in 2019 at the level registered in the first half of 2018. Following EU objections to this measure, the authorities have been working with the EC to adjust the underlying regulations so that they are consistent with EU regulations, while still temporarily reducing the burden of high electricity prices for end-consumers. These developments have somewhat hindered the liquidity of the electricity market, but, more importantly, have sent a negative signal for the regulatory predictability in the sector. However, with the interim nature of the price freeze, these negative implications are expected to be temporary.

A clear path for change in the energy mix has been set. The first large-scale renewables auctions were successfully conducted in November 2018, attracting a wide range of investors and demonstrating the increasing competitiveness of renewables. The winning projects are expected to add over 1.5 GW of renewable energy capacity to the Polish energy system. Poland has also reconfirmed its long-term ambitions to diversify the energy mix. In the draft NECP the country has proposed a 21.0 per cent target for the renewables share in the final energy consumption by 2030. This translated to a target of approximately 27.0 per cent renewables in net electricity production, which would require a near tripling of renewable electricity generation in the next decade. The final NECP, to be submitted by the end of 2019, may also include an even more ambitious target, following discussions between the EC and the Polish government.