POLAND

Highlights

- **Domestic demand further supported GDP growth recovery in 2014.** Following weak growth in 2013, GDP growth accelerated to 3.3 per cent in 2014, backed by strong private consumption and investments. Improvements in public finances allowed Poland to exit the European Union's (EU's) Excessive Deficit Procedure in 2015.
- **A new law on corporate restructuring and insolvency was adopted.** The new law should help with the financial restructuring of distressed enterprises, which up to now has often been slow and ad hoc.
- **Financial stability should be strengthened through a new law on covered bond issuance.** Covered bonds are a superior mechanism for financing mortgage lending as they can reduce the potential mismatch between the term, currency and interest rate exposure of a mortgage finance intermediary. Institutional investors could benefit from greater diversification of their fixed income exposures.

Key priorities for 2016

- **EU Structural Funds should be used in a market-friendly way.** This includes establishing sustainable and market-based financial instruments and strengthening the commercial orientation of state-funds such as Bank Gospodarstwa Krajowego (BGK).
- **A predictable regulatory regime is essential to support continued bank lending.** Corporate and household lending by the banking sector is expanding robustly, supporting economic growth, but this could be threatened by proposals for a greater state role in the sector; a bank tax; or by the restructuring of foreign exchange-denominated mortgages.
- **Reforms aimed at unlocking innovation in the economy should be continued.** Whereas the adoption of the amendment law on tax relief for companies investing in innovation, signed by the president in October 2015, is expected to increase the business research and development (R&D) expenditures, further measures to enhance commercialisation of university research will be essential, also through establishing early-stage financing mechanisms.

Main macroeconomic indicators %

	2011	2012	2013	2014	2015 proj.
GDP growth	5.0	1.6	1.3	3.3	3.4
Inflation (average)	3.9	3.7	0.8	0.1	-0.7
Government balance/GDP	-4.9	-3.7	-4.0	-3.3	-2.8
Current account balance/GDP	-5.2	-3.7	-1.3	-2.0	-0.6
Net FDI/GDP [neg. sign = inflows]	-2.6	-1.2	-0.8	-2.0	-0.9
External debt/GDP	61.9	74.2	73.0	64.6	n.a.
Gross reserves/GDP	18.7	21.9	20.2	18.3	n.a.
Credit to private sector/GDP	47.3	50.8	50.2	49.6	n.a.

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Macroeconomic performance

Sustained GDP growth has been underpinned by robust private consumption and revived private investment. With a GDP growth rate of 3.3 per cent in 2014, Poland's economy recovered from the slow-down of 2012-13. Real output growth continues to be supported by strong domestic demand, backed by higher household disposable income as well as corporate investments amid falling oil prices and historically low interest rates. These trends continued in the first half of 2015, when the economy grew by 3.6 per cent in annual terms. In 2014, gross fixed capital formation grew by 9.8 per cent, following a contraction of 1.1 per cent registered in 2013. On the back of accommodative monetary policies and eased bank lending standards, higher investment volumes benefited from better credit availability. Further infrastructure investments are expected on the back of EU Structural Funds due to be implemented from late 2015.

The economy has benefited from low prices of oil and other commodities. The impact on the current account balance is somewhat negated by accelerating domestic demand and imports. Export volumes (expressed in euros) grew at 7 per cent in 2014 and saw only a fractional slow-down when compared with the 8 per cent growth observed in 2013. The value of exports to Russia dropped by 30 per cent during the first half of 2015 compared with the same period in the previous year. However, Polish exporting companies successfully managed to redirect sales to other markets. For instance, exports to the neighbouring Czech Republic saw growth of above 14 per cent, and exports to the euro area countries grew at impressive rates last seen in 2011.

The labour market has benefited from a recovery in industrial production and investment. The unemployment rate continued to fall to 7.2 per cent in August (according to LFS, Eurostat), significantly reduced from the post-crisis peak of 10.6 per cent in April 2013 and the lowest among the central Europe and the Baltic states (CEB) economies. Until now wage growth has been in line with growing labour productivity, which has increased by 6 per cent since 2010.

The government has corrected a long-standing fiscal deficit, which will fall to below the threshold of 3 per cent of GDP this year. Public debt similarly dropped to its current level of 51 per cent of GDP, albeit facilitated by a transfer of private pension assets back into the state social security system in 2014. The reduction of the fiscal deficit below 3 per cent of GDP allowed Poland to exit the EU's Excessive Deficit Procedure in 2015.

Current forecasts envisage GDP growth to strengthen further. Regardless of external headwinds, GDP growth in 2014 of 3.3 per cent was among the strongest in the EU and is expected to remain around that level in 2015 and 2016, respectively. Domestic demand will likely predominate, bolstered by improving labour market conditions and rising disposable incomes.

Major structural reform developments

A new renewable energy law is in place. On 28 February 2015, the new law, which will replace a support system based on tradeable green certificates with one based on auctions and feed-in tariffs was adopted and entered into force in May. The sources of domestic energy generation remain predominantly coal and lignite, which account for about 85 per cent of the total. Renewables accounted for only 11.3 per cent of electricity generation in 2013, although this share is expected to reach 15 per cent by 2020. The heavy concentration of energy generation in the coal-powered sector resulted in an interruption in supply to industry in the summer of 2015, caused by insufficient cooling provided to conventionally fuelled power plants due to low water levels. These shortages were further exacerbated by limited power generation from wind farms due to extreme heat. The coal sector has long suffered from under-investment, rigid labour relations, and has been recording losses as coal prices declined amid the US shale gas boom. A newly established state investment vehicle is set to consolidate loss-making mines but may attract further fiscal risks, if the state-owned energy providers acquire stakes.

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The third package of deregulation of professions was signed into law in August 2015 and encompasses around 100 professions. This has been the third and most extensive deregulation package since 2013, and lowers barriers for professions such as firefighters, miners, patent attorneys, investment advisers or commodity and security brokers. In total the three amendments cover approximately 250 occupations, of which 70 have been fully liberalised, while formal requirements for others were reduced. According to Organisation for Economic Co-operation and Development (OECD) indicators, Poland has some of the most restrictive professional regulations in Europe.

The government has improved vocational training during the academic year 2014-15. Some reforms of vocational education and training have been implemented since 2013. Nevertheless the unemployment rate for graduates of basic vocational schools remains above 40 per cent and cooperation with employers and industry associations still remains poor. Better targeted vocational education would facilitate the absorption of new technologies. The amendment bill on youth employment (which was signed by the president in October 2015) is expected to incentivise companies to employ unemployed youth below the age of 30, as those companies will benefit from a partial reimbursement of the hiring costs from the state budget. The new law is to support 100,000 young people in finding employment in 2016-2019.

New operational programmes under the EU Structural and Investment Funds are being implemented. Poland was allocated €77 billion for the period 2014-2020, equivalent to an annual inflow of nearly 3 per cent of GDP. There will be 16 programmes managed by individual regions and six national programmes, excluding the agricultural ones. Key priorities are infrastructure, environment and innovation. A small portion of these funds is to be channelled into market-based financial instruments as opposed to the traditional grants. State-backed institutions, such as BGK, will be endowed with EU funds and leverage private investment to extend loans, grants and equity participations to final beneficiaries. In addition, Poland pledged €2 billion in co-financing to projects under the European Fund for Strategic Investments.

A new bankruptcy and insolvency law has been adopted. Parliament adopted the law in May 2015 and it will take effect in 2016. The new bill amends the existing law and will provide more opportunities for corporate financial restructuring ahead of a possible liquidation. The law brings relief to distressed corporates by opening new mechanisms for financial restructuring and, where necessary, allows for rapid liquidation. In the World Bank *Doing Business 2016* report, Poland is in 32nd place in terms of the quality of the insolvency framework. The main drawbacks are the protracted time and high costs of the bankruptcy procedures, as well as the relatively low recovery rates. The new law is expected to further decrease the ratio of corporate non-performing loans (NPLs), which stood at 10.9 per cent in mid-2015.

Household indebtedness on Swiss franc mortgages has increased significantly. This follows the sharp appreciation of the Swiss franc in January 2015. Poland has limited the use of foreign currency-denominated mortgages through a number of prudential regulations and directives. Nevertheless, such loans still accounted for about 9.6 per cent of GDP in June 2015. According to an assessment by the central bank (NBP), foreign currency mortgages do not pose a systemic risk to financial stability. The ratio of NPLs in this segment stands at only 3.5 per cent. Borrowers have benefited from strong wage growth, and a reduction in the interest rate on Swiss franc-denominated loans. In September 2015 a law that would assist mortgage borrowers was under discussion. The degree of burden-sharing between banks and households remains controversial and it is unclear to what extent any measure would be targeted at distressed borrowers only. Proposals that would shift the bulk of the costs to banks have created uncertainty over the legal and regulatory environment in the banking sector and have held up ownership changes. It is highly probable that the *Sejm* will pass the law on support for all mortgage borrowers in poor financial standing (whatever the currency of their loan). Such support would be provided by a special fund financed by banks.

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A law on covered bonds was adopted in August 2015 and will enter into force as of January 2016. The law on covered bond issuance should strengthen financial stability and provide options to diversify sources of funding for the banks and investment opportunities for institutional investors, local and international. Covered bonds are a superior mechanism for financing mortgage lending: (i) they can reduce the potential mismatch between the term, currency and interest rate exposure of a mortgage finance intermediary; and (ii) are cost-efficient and safe instruments providing for "dual recourse" – the investor has recourse against the issuer and the collateral, which differs from securitisation. Polish institutional investors could benefit from the possibility of higher diversification of fixed income investments and the creation of a covered bond market will create such an opportunity.