POLAND

Highlights

- **GDP growth remains robust but has slowed slightly.** In the first half of 2016 the economy expanded by 2.7 per cent, below the 2015 growth rate of 3.9 per cent. Private consumption was the main growth driver, but gross fixed capital formation dropped in the first half of the year, as the new disbursements of EU funds had not really emerged yet and as banks began to tighten credit standards and corporate lending slowed, affected by banking tax and a spectre of the anticipated foreign currency mortgage conversion.
- **A new development plan has been announced.** The new plan, unveiled in February 2016, envisages a reduction in business obstacles, along with a considerable strengthening of state institutions.
- **Substantial cash transfers to families with children were introduced.** This programme is designed to raise fertility rates, thereby helping to address long-term labour market pressures and alleviate extreme poverty.

Key priorities for 2017

- **Financial stability should be carefully preserved.** Any scheme to alleviate pressure on households with foreign-currency-denominated mortgages should consider carefully the impact on the health of the financial sector.
- **A gradual diversification into a combination of gas and renewables could significantly reduce the carbon footprint of the Polish economy.** As yet, not much progress has been made in applying the new support framework for renewables (away from a green certificate system towards an auction-based system), which in practice may lead to a dearth of new installations in 2016 and possibly 2017 and beyond.
- **A sustainable and widespread pension scheme needs to be developed.** Given recent curtailments of the private pension sector, a long-term vision is needed to encourage private savings, promote good governance of state bodies set up to manage savings pools, and elicit support for the system from employers.

Main macroeconomic indicators %

	2012	2013	2014	2015	2016 proj.
GDP growth	1.6	1.4	3.3	3.9	3.0
Inflation (average)	3.7	0.8	0.1	-0.7	-0.3
Government balance/GDP	-3.7	-4.1	-3.4	-2.6	-2.8
Current account balance/GDP	-3.7	-1.3	-2.1	-0.6	-0.4
Net FDI/GDP [neg. sign = inflows]	-1.2	-0.8	-2.4	-2.1	-2.3
External debt/GDP	73.7	73.3	65.1	69.4	n.a.
Gross reserves/GDP	21.8	20.2	18.4	20.0	n.a.
Credit to private sector/GDP	50.4	50.4	49.8	51.4	n.a.

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Macroeconomic performance

GDP growth has slowed slightly in 2016. At 2.7 per cent in the first half of 2016, GDP growth is below the 3.9 per cent registered in 2015. Private consumption remained the key driver for growth, underpinned by rising disposable incomes, persistent deflation and an improving labour market. At the same time, investment growth turned negative, down by 3.6 per cent over the first six months of 2016. Similar to other EU member states that joined in 2004, the investment cycle in Poland is highly reliant on the effective management and disbursement of EU funds, and the end of 2015 was the deadline for utilising EU funds from the previous budget period.

Exports have been supported by the depreciated zloty. Export volumes increased by 6.5 per cent in the first half of 2016, partially supported by a favourable exchange rate as well as somewhat recovered exports to Russia. Export growth to the eurozone also remained positive, although the pace of growth has slowed somewhat this year. Despite strong import demand, low commodity prices have helped to narrow the current account deficit to just 0.6 per cent of GDP in 2015, down from 2.1 per cent of GDP in the previous year.

Unemployment has reached record low levels. In August 2016 the unemployment rate dropped to just 5.9 per cent, compared with 6.9 per cent at the end of 2015 and above 10.0 per cent in 2013. This trend is expected to continue, amid a rising number of vacancies and improving employment opportunities. In the first quarter of 2016 the employment rate among the working age population (ages 20-64) stood at 69.2 per cent, though the gap of 14 percentage points in employment rates between men and women remains high.

Weak investment will likely weigh on this year's growth. Due to poor investment performance we expect GDP growth to reach 3.0 per cent this year, before it accelerates somewhat to 3.2 per cent in 2017. Consumption is likely to remain the key driver, while net exports and investment pose a risk to that outlook.

Major structural reform developments

A new development strategy has been proposed. In August 2016 the government submitted the complete "Strategy for Responsible Development" for public consultation. The final document is expected to be adopted by the end of 2016. The document identifies five pillars of economic development: reindustrialisation, innovative companies, mobilisation of capital for development, foreign expansion of domestic companies, and social and regional development. Special attention is being paid to innovation, as Poland scores poorly among EU countries in the 2016 European Innovation Scoreboard.

Sectoral taxes are being introduced. The first tax, on certain financial institutions, came into effect in February 2016. Under this tax banks, insurance companies and lending institutions are charged a tax equivalent to 0.44 per cent of assets (annualised) above a certain limit (net of own funds, and sovereign exposure). This tax is not unusual in the European context, although the rate is relatively high. The second tax, on retail trade, entered into force in September 2016. However, its progressive structure was questioned by the European Commission (EC) in the third week of its implementation, as it gives an unfair advantage to companies with low turnover, which would breach EU state aid rules. The tax has been suspended until the EC finishes its investigation. Revenues from the new taxes are supposed to be one of the ways of financing the additional social spending introduced by the government, such as child benefit or free medication for the elderly. However, revenues to date from the tax on certain financial institutions have been below the authorities' expectations.

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Tax collection measures have been strengthened. A new package to fight VAT and excise fraud in fuel sales was adopted by parliament in August 2016. In future, fuel importers will have to pay VAT on fuel from another EU country within five days of its entry into Poland, and fuel trade permits will be granted to local-based firms or foreign firms with a registered unit in Poland. These measures should eliminate the middleman in fuel trade and contribute to closing the VAT gap, which, according to this year's EC estimates, was equal to 2.3 per cent of GDP in 2014 – the seventh highest VAT gap in the European Union. Further measures to improve tax collection have been announced, including a consolidation of customs, tax chambers and tax control offices into one body from January 2017. Also, the planned unification of personal income tax (PIT) social security (ZUS) and health (NFZ) contributions that will take place no earlier than 2018, amid greater collection efficiency and a more progressive structure, would make the tax system friendlier for enterprises.

The government has launched a new child benefit scheme. The "Family 500+" scheme, introduced in April 2016, is a tax-free, unconditional child allowance of PLN 500 (about €115) per month for every second and subsequent child under the age of 18. Under certain criteria the first child can also be eligible for this benefit. According to a recent World Bank study, the new programme may significantly reduce extreme poverty. The government puts the annual cost of the scheme at 1.3 per cent of GDP.

The retirement age is to be reduced. In July 2016 the government approved a plan to cut the retirement age to 60 for women and 65 for men, from the current level of 67 for all. The bill needs the approval of parliament and is expected to come into force in late 2017. This means reversing previous increases passed in 2012, which had assumed a gradual increase in the retirement age to 67 for all. The project could still be altered to contain minimum contribution or work periods, an idea that was initially presented by the finance ministry but then rejected during the approval process.

Further wide-ranging pension reforms were announced. Under the so-called Capital Accumulation Plan, presented by the government in July 2016, 25 per cent of OFE (Open Pension Funds) assets will be transferred into the Demographic Reserve Fund, and the remaining 75 per cent into fully private accounts by 2018. Based on a default enrolment for all employees and the self-employed, a total of 5.5 million additional occupational and individual accounts are to be set up, which will initially be managed by the Polish Development Fund, with private managers gradually obtaining licences. Matching payments by employers and tax discounts are designed to prevent employees from exercising their right to opt out of the system. The transition to a system of essentially voluntary employer-based accounts is ambitious and follows the template set by recent reforms in the United Kingdom.

The minimum wage has been raised. The minimum wage in long-term contracts was increased by 8 per cent to PLN 2,000 (about €465) in gross terms starting from January 2017. In addition, the government introduced a minimum hourly rate of PLN 13 (about €3.50) for short-term contracts and for the self-employed. Short-term employment is designed to be more expensive, which should encourage employers to gradually shift towards regular contracts. The labour market remains heavily segmented between permanent and temporary employees, whereas a quarter of all employees are on fixed-term contracts, which is one of the highest such rates among the OECD countries.

The government supports the idea of re-Polonisation of the banking sector. The Ministry of Treasury is interested in purchasing a part of UniCredit's stake in Bank Pekao S.A. and Raiffeisen's shares in its Polish subsidiary, Raiffeisen Bank Polska. The expected buyers are the leading state-controlled financial institutions, such as Grupa PZU in a consortium with the Polish Development Fund, for the first transaction, while for the latter: PKO Bank Polski. Thanks to an amendment to the law enacted in July 2016, additional state funds could come from the privatisation fund, as otherwise such an acquisition would be too costly for the government amid already distressed finances. Such actions would increase the state's presence in the economy, which is already widespread. As seen by the OECD product market regulation indicators, state control over enterprises in Poland is the second highest among all 33 OECD countries. Currently, foreign ownership in the banking sector amounts to about 60 per cent.