Poland

Highlights

- **Economic activity has slowed sharply, as higher prices are affecting households' purchasing power.** Following strong gross domestic product (GDP) growth of 5.3 per cent in 2022, the economy shrank in annual terms during the first half of 2023 amid still high, though falling, inflation.
- **Child benefits and pensions have been increased.** The per-child allowance was raised from PLN 500 (€110) to PLN 800 (€180) per month from January 2024, while pensioners will now benefit from payments of 13th and 14th month pension bonuses, which are set to be paid on a permanent basis in the future.
- **A subsidised mortgage loan programme for first-time house buyers has been launched.** The subsidised loans have an interest rate of just 2 per cent, plus the bank's margin, for the first 10 years, with the state covering the difference between the average fixed market rate and 2 per cent.

Key priorities for 2024

- **Investments in renewable energy and energy storage should be scaled up.** More investment in grid infrastructure, including grid connections, grid strengthening and cross-border electricity interconnections, is required to align with the requirements of a modern energy system that can accommodate a high share of intermittent renewable energy sources, such as offshore and onshore wind or solar.
- **Transport and logistics infrastructure in eastern Poland needs to be developed.** Better intermodal transport infrastructure, including road, rail and shipping, would improve connectivity, increase capacity and ensure smoother border crossings. Together with increased warehouse space in eastern Poland, investment in infrastructure will be critical for Polish companies wishing to expand eastwards once Ukraine's post-war reconstruction is under way.
- **Social support should be targeted at the most vulnerable groups only.** The current fiscal position highlights the need to avoid making commitments to untargeted and costly social programmes.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	4.4	-2.0	6.9	5.3	0.6
Inflation (average)	2.1	3.6	5.2	13.2	12.0
Government balance/GDP	-0.7	-6.9	-1.8	-3.7	-5.3
Current account balance/GDP	-0.2	2.4	-1.3	-2.4	1.0
Net FDI/GDP [neg. sign = inflows]	-2.0	-2.4	-3.8	-3.7	-3.5
External debt/GDP	58.9	60.7	56.5	53.0	n.a.
Gross reserves/GDP	21.6	25.6	24.4	24.2	n.a.
Credit to private sector/GDP	50.3	47.7	45.2	39.2	n.a.

Macroeconomic developments and policy response

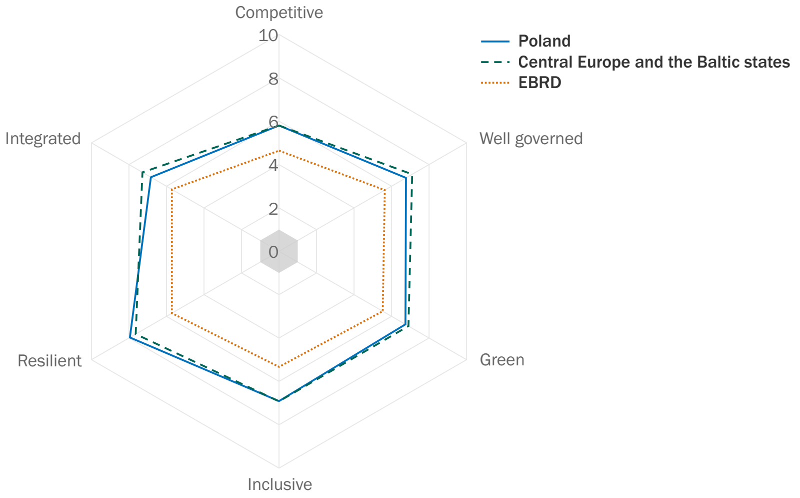
High inflation and tighter financing conditions are weighing on GDP growth. Economic activity remained robust in 2022, with GDP growing by 5.3 per cent, but it dropped sharply to -1 per cent year on year in the first half of 2023. The high growth in inventories has been the key economic driver for the last two years, amid uncertainty related to disrupted value chains and weakening household consumption. Subdued external demand has negatively affected exports, but recently stabilised energy prices have provided some relief to the economy, helping to turn the current account into a surplus in the first half of 2023. Investment remains robust, recovering to 8 per cent year on year in the first half of 2023, but the high financing costs weigh mostly on housing investments.

Inflation is coming down and real wage growth has turned positive again. The harmonised index of consumer prices (HICP) peaked in February 2023 at 17.2 per cent and has fallen since then, settling at 7.7 per cent in September 2023. As a result, the economy-wide real wage growth turned positive in June 2023 for the first time since the end of 2021. While the average household budget is expected to gain amid double-digit nominal wage growth and decelerating inflation, household purchasing power is expected to rise only slightly in 2023. Structurally, labour market pressures have been eased to some extent by the inflows of refugees and migrants, counterbalancing unfavourable demographic trends. However, this effect has not endured, as some Ukrainian refugees have been conscripted into Ukraine's army.

The general government deficit remains high. Substantial energy support measures, estimated at 2.4 per cent of GDP, remaining anti-Covid expenditures (0.7 per cent of GDP) and the costs of supporting Ukraine's refugees (0.5 per cent of GDP) all contributed to a general government deficit of 3.7 per cent of GDP in 2022. Further, increased defence spending, expected at 4.2 per cent of GDP in 2023, and possible enhanced energy support measures (depending on energy prices), are expected to substantially increase government spending this year and in 2024. As a result, the budget law was amended in July 2023 to include a "defence clause" to reflect the discrepancy between prepayments for the purchase of military equipment and actual deliveries of equipment. Poland is likely to find itself operating under the European Union's (EU) excessive deficit procedure in 2024, based on the deficit out-turn of 2023. The European Commission forecasts Poland's general government deficit at 5 per cent and 3.7 per cent of GDP in 2023 and 2024, respectively.

The current drop in GDP growth should ease in 2024. GDP is forecast grow by just 0.6 per cent in 2023. However, further positive real wage growth, low unemployment, an improvement in consumer sentiment and a slight easing in monetary policy are expected to fuel a recovery in GDP growth in 2024, forecast at 2.7 per cent. Further delays in Recovery and Resilience Facility (RRF) transfers and uncertainty about potential increases in energy prices constitute the main risks to that scenario.

Assessment of transition qualities (1-10)



Structural reform developments

The government is pre-financing some RRF-related programmes. In March 2023 the wind farm bill, which liberalises where onshore windfarms can be located, was passed into law. The bill was one of two milestones that Poland had to pass to unlock RRF transfers. The other milestone concerns judicial reform (see below), but an unresolved dispute means this has stalled. As a result, the Polish Development Fund (PFR) started to pre-finance RRF programmes using its own resources. Poland's Recovery and Resilience Plan (RRP) was approved by the European Commission in June 2022 and is based on €23.9 billion in grants and €33.5 billion in loans. The government boosted the latter amount in April 2023 to enable greater investments in the energy system, the green transition of cities, gas infrastructure and the healthcare sector.

EU concerns about the rule of law are not yet resolved. In February 2023 the parliament passed an amended law on the Supreme Court, which was meant to address a key European Commission milestone to unlock RRF funds. However, the bill was not signed by the president and it is currently with the Constitutional Tribunal for examination. Meanwhile, the Court of Justice of the European Union (CJEU) ruled in June 2023 that the Polish justice reform of December 2019 "infringes EU law".

Poland's first offshore wind farm is expected to support the country's renewable energy generation and help it reach its decarbonisation targets. In October 2023 Baltic Power, a special purpose vehicle jointly owned by ORLEN, the Polish multi-utility company, and Northland Power, a Canadian independent power producer, received a final investment decision to construct the wind project in the Baltic Sea. Once fully operational, the wind farm, which will have a capacity of up to 1.2 GW, is expected to generate electricity equivalent to 4,000 GWh or approximately 2-3 per cent of Poland's current electricity generation.

Coal mining companies need to pay a windfall tax. In July 2023 parliament approved a 33 per cent windfall tax on coal-mining companies, to be levied on profits exceeding 120 per cent of 2018-21 average profits. The expected revenues amount to PLN 2 billion (around €450 million) in 2023. At the same sitting, a bill was approved that raises the maximum amount of household energy consumption covered by capped prices (at 2022 levels) by 1,000 kWh annually. Price caps will likely remain as such until the end of 2023, when all electricity subsidy schemes are set to expire. The cost of these energy subsidy schemes, including those for gas bills, is expected to be partially covered by windfall tax revenues, as well as temporary levies imposed on firms engaged in production and distribution of electricity and gas, which were legislated on in October 2022.

Price-suppressing measures on food have been extended. In June 2023 the government extended a zero VAT rate on most food products until the end of the year. The measure is expected to cost PLN 11 billion (€2.5 billion) in 2023. According to government estimates, this measure should cut about 0.3-0.5 percentage points from headline inflation.

Child benefits and pensions have been increased. In August 2023 the government increased the current per-child monthly payment of PLN 500 (€112) to PLN 800 (€180) from January 2024. The programme is effectively an indexation of the Family 500+ scheme introduced in April 2016. The total cost of the programme is expected to be PLN 63.7 billion annually (€14.3 billion, 1.9 per cent of GDP), or about 1 per cent of GDP higher than the existing costs of the scheme. In addition, in May 2023 the government approved payment of a permanent 14th-month pension bonus (according to ESA 2010 not classified as pension expenditures), after approving a (13th-month) pension bonus in 2019. The total cost of the indexed pension expenditures, including the two pension bonus payments, is estimated at PLN 80 billion (€18 billion), which brings total spending on pensions to PLN 320 billion (€71.7 billion, 9.7 per cent of GDP) in 2023.

A subsidised mortgage loan programme has been launched. The "Safe Credit 2 per cent" subsidised mortgage loan scheme started in July 2023 and is expected to attract up to 50,000 first-time house buyers by the end of 2024, according to the government. The subsidised mortgage loan has a reduced interest rate of 2 per cent, plus the bank's margin and commission (if it is charged), for the first 10 years, with the state covering the difference between the average fixed market rate and the 2 per cent rate. The programme is limited to those aged 45 or younger with loans up to PLN 600,000 (€134,000), and can be used for a first-time purchase, with PLN 200,000 (€45,000) as the maximum down payment. According to the Polish Bank Association (ZBP), the number of total mortgage loans is estimated to drop by 30 per cent in 2023 amid increased interest rates. The subsidised mortgage loan programme offsets that decrease to a large extent.

The banking sector remains profitable but legal risks related to Swiss franc mortgages have risen. The CJEU ruled in June 2023 that banks could not seek remuneration for invalidated Swiss franc loans, although borrowers might be able to. As a result, banks with significant Swiss franc loan portfolios now need to increase provisions in case of legal action, which would reduce their ability to finance the economy. According to the central bank, additional provisions needed to cover the cost of legal risk materialisation of Swiss franc housing loans would be about PLN 40 billion to PLN 50 billion (€9 billion to €11 billion) in 2023-25, depending on the number of out-of-court settlements signed. In 2022 Poland's banks increased their net profits to PLN 10.7 billion (€2.4 billion), from PLN 6.1 billion (€1.4 billion) in the previous year, largely due to high interest rates and strong economic activity.