21. POLAND

Underlying fiscal deficit on the rise in times of strong economic growth

Economic growth in Poland is expected to remain robust and stable, driven by domestic demand. Private consumption is expected to benefit from a strong labour market and a fiscal stimulus but price pressures are set to remain subdued. The government deficit is projected to remain just below 3% of GDP in 2016 but may exceed it in 2017, unless additional measures are taken.

GDP and jobs on the rise

In the second half of 2015, the Polish economy continued to follow a path of strong and remarkably stable growth. For the year as a whole, real GDP is expected to have increased by 3.5%, on the back of robust private consumption, investment, and a small positive contribution from net exports. The outlook remains favourable as real GDP is projected to increase by 3.5% in both 2016 and 2017.

Private consumption is set to remain the dominant growth driver, supported by further improvements in the labour market as well as by an increase in government transfers, notably a new child benefit. Private investment is expected to grow moderately as a result of an already high degree of capacity utilisation, strong corporate profits and low interest rates. On the other hand, a new tax on the assets of financial institutions is likely to weigh on investment if banks respond by adjusting their lending rates. Public investment is set to accelerate in 2017, as projects co-financed with EU-funds from the new programming period enter the implementation phase.

Contained unit labour costs and the projected gradual improvement in external demand in 2016 and 2017 should support export growth. However, net exports are forecast to contribute slightly negatively to overall growth as strong domestic demand fuels imports.

Employment growth is expected to slow to 0.5% annually in 2016 and 2017 due to a shrinking working age population and stagnating labour force participation. Labour migration, especially from Ukraine is set to become an increasingly important element of the Polish labour market. Most new jobs are expected to come with permanent contract types leading to a decline in the share of atypical contracts from the currently very high level. The unemployment rate is forecast to decline to 6.5% in 2017, below the historical

low observed in 2008, and should contribute to faster nominal wage growth.

Graph II.21.1: **Poland - Real GDP growth and contributions, output gap**
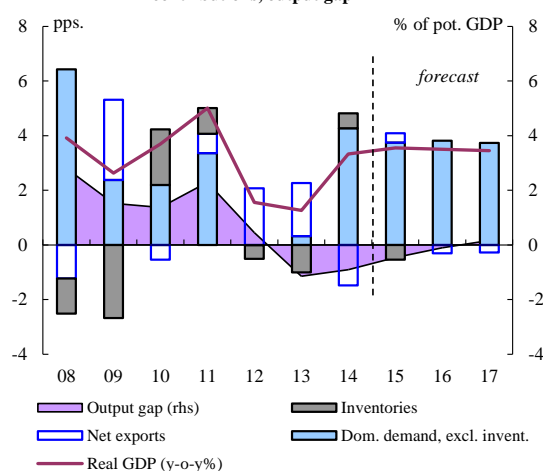
Inflation to remain low

Inflation is projected to turn positive in early 2016, but price pressures are set to remain subdued as energy prices are expected remain low for longer than previously assumed. Consumer prices are forecast to rise by 0.6% in 2016 and by 1.7% in 2017.

The risks to the macroeconomic forecast are broadly balanced. On the downside, some of the economic policy decisions taken or announced since the last general elections can affect business confidence. On the upside, public investment may turn out to be stronger than currently projected.

Government deficit at and close to 3% of GDP in 2015 and 2016

The general government deficit is projected to turn out at 3% of GDP in 2015, down from 3.3% in 2014, yet up from 2.8% of GDP expected in the autumn 2015 forecast. The upward revision reflects effects working in opposite directions. Originally planned for 2015, one-off revenues of

around 0.5% of GDP from the sale of mobile internet frequencies were moved to 2016, while expenditure has been revised slightly downward.

The general government deficit is expected to decrease somewhat in 2016, to 2.8% of GDP. The new child benefit (with estimated budgetary cost at 0.9% of GDP) is set to enter into force in the second quarter of the year. Offsetting measures include the one-off revenue from the sale of mobile internet frequencies and new taxes on the assets of financial institutions and on the retail sector.

The fiscal outlook for 2017 very much depends on the final outcome of recent government proposals, in particular, a higher tax-free threshold for the personal income tax (PIT) and a lower retirement age. The on-going legislative process is surrounded by a significant degree of uncertainty regarding the key aspects of the proposals, which makes an assessment of the likely budgetary impact very difficult at this stage. As a result, and given that the budget for 2017 will be adopted later in the year, the two proposals are not incorporated in the baseline scenario. This notwithstanding, the no-policy-change forecast for the general government deficit in 2017 exceeds but remains close to 3% of GDP. The deterioration of the headline deficit in comparison to 2016 is mainly due to the full-year effect of the new child benefit, a lower VAT tax rate due to enter into force in 2017, and the lack of additional one-off revenues.

Unless additional measures are taken, plans to increase the tax-free PIT threshold and to lower the retirement age would further worsen the fiscal outlook for 2017.

Poland's structural deficit is projected to have marginally deteriorated in 2015 to about 2¾% of GDP. It is set to widen further, to around 3¼% in 2016 and 3½% in 2017, under a no-policy-change assumption.

The general government debt-to-GDP ratio is set to increase from around 51% in 2015 to close to 54% in 2017. The debt projections for Poland are subject to a considerable degree of uncertainty because of the potential impact of exchange rate fluctuations on the relatively high share of sovereign debt denominated in foreign currencies.

Table II.21.1:

Main features of country forecast - POLAND

		2014			Annual percentage change					
	bn PLN Curr. prices	% GDP	96-11	2012	2013	2014	2015	2016	2017
GDP	1719.1	100.0	4.4	1.6	1.3	3.3	3.5	3.5	3.5
Private Consumption	1033.1	60.1	4.3	0.7	0.2	2.5	3.0	4.0	3.9
Public Consumption	315.6	18.4	3.4	-0.4	2.2	4.9	3.1	3.4	2.7
Gross fixed capital formation	337.5	19.6	6.7	-1.8	-1.1	9.8	7.1	4.1	4.5
of which: equipment	124.4	7.2	7.2	-5.0	5.5	-0.9	8.2	4.8	4.3
Exports (goods and services)	815.6	47.4	8.7	4.6	6.1	6.4	5.8	5.4	6.3
Imports (goods and services)	793.6	46.2	9.3	-0.3	1.7	10.0	5.2	6.4	7.2
GNI (GDP deflator)	1659.1	96.5	4.4	1.4	1.7	3.2	3.1	3.4	3.3
Contribution to GDP growth: Domestic demand			4.7	0.0	0.3	4.3	3.7	3.8	3.7
Inventories			0.0	-0.5	-1.0	0.5	-0.5	0.0	0.0
Net exports			-0.3	2.1	1.9	-1.5	0.3	-0.3	-0.3
Employment			0.3	0.1	-0.1	1.7	1.0	0.5	0.5
Unemployment rate (a)			13.5	10.1	10.3	9.0	7.5	7.0	6.5
Compensation of employees / head			8.4	3.6	1.7	1.6	3.2	3.6	4.3
Unit labour costs whole economy			4.2	2.1	0.3	0.0	0.6	0.7	1.3
Real unit labour cost			-1.0	-0.3	-0.1	-0.4	0.3	-0.2	-0.1
Saving rate of households (b)			8.9	1.5	2.5	1.9	2.4	2.8	1.6
GDP deflator			5.3	2.4	0.4	0.4	0.3	0.9	1.4
Harmonised index of consumer prices			-	3.7	0.8	0.1	-0.7	0.6	1.7
Terms of trade goods			-0.4	-1.3	1.7	2.2	2.0	0.3	-0.5
Trade balance (goods) (c)			-4.4	-2.1	-0.1	-0.8	0.3	0.1	-0.4
Current-account balance (c)			-4.0	-3.3	-0.5	-1.3	-0.2	-0.7	-1.4
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-3.5	-1.2	1.5	0.3	1.4	0.5	0.0
General government balance (c)			-4.5	-3.7	-4.0	-3.3	-3.0	-2.8	-3.4
Cyclically-adjusted budget balance (d)			-4.5	-3.9	-3.4	-2.8	-2.8	-2.8	-3.4
Structural budget balance (d)			-	-4.0	-3.4	-2.6	-2.7	-3.2	-3.4
General government gross debt (c)			44.5	54.0	55.9	50.4	51.4	52.5	53.5

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.