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FOR Communication 10/2023:

IMF: The biggest challenge for Poland is the fight against inflation.

Synthesis:

- The International Monetary Fund's mission carried out an assessment in Warsaw on 14-24 March under art. IV of the IMF's Articles of Agreement. The mission pointed to the most important problems of the Polish economy and presented recommendations related to them.
- The IMF advises the Polish government to tighten fiscal policy, and in particular, to abolish common energy subsidy programs and credit holidays. It also calls for an increase in the retirement age.
- The Monetary Policy Council should be ready to further increase interest rates if it proves to be necessary to bring inflation down to the target by the end of 2025.
- IMF's findings and recommendations remain consistent with FOR's analyzes and postulates.

The International Monetary Fund's mission carried out an assessment in Warsaw on 14-24 March under Art. IV of the of the IMF Articles of Agreement. The mission pointed to the most important problems of the Polish economy and presented related recommendations.

The Fund's delegation pointed out that the most important challenge is to bring inflation down to the target (which upper band of deviations is 3.5%). Therefore, it becomes necessary to tighten fiscal policy this year. Thanks to the "Polish Deal" and the so-called anti-inflation shields (the effectiveness of which is questionable - see, for example, FOR 6/2022 announcement), the public finance deficit increased from 1.9% of GDP in 2021 to 3.1% of GDP in 2022, and the forecasted deficit for 2023 amounts to 4.5% of GDP. The reasons for the projected increase in the public finance deficit are strong slowdown in economic growth and rising cost of public debt maintenance, which we pointed out in FOR 6/2023 and 9/2023 announcements - the Polish economy is expected to grow only by 0.3% this year, and the state will pay the highest interest rate of any European Union member state.

The IMF calls for a government's responsible fiscal policy that would support the Monetary Policy Council in the fight against inflation. The Fund forecasts that the public finance deficit will remain at the level of approx. 3% of the GDP in the medium term, pointing out at the same time, that a consistent reduction of public debt would be very beneficial for the Polish economy, as it would create an appropriate reserve in fiscal policy to respond to possible shocks and tensions arising from an aging population, energy transition and an increase in defense spending. Here, the Fund recommends raising the retirement age and limiting social benefits so that only people in real need of support can benefit from them. Raising the retirement age – by limiting the outflow of working people from the market – would also strengthen future economic growth. We have pointed this issue out in, for example, the FOR's report: Poland: stagnation or growth? Work, rule of law, investment, innovation.

The solution to rising defense spending is not to push it out the budget into funds at Bank Gospodarstwa Krajowego. As recommended by the IMF, all expenses made through such funds should be transferred back to the budget. This would increase the transparency of public finances and enable parliamentary and public assessment of spending. We have pointed this issue out, for example, in the FOR 11/2022 announcement.

The Fund also issued recommendations regarding monetary policy, pointing to high core inflation, caused mainly by domestic factors, which we recently wrote about in FOR 4/2023 announcement. The IMF forecasts that core inflation will remain very high for a long time – 11% in 2023 and over 7% in 2024. The Monetary Policy Council should be ready for further interest rate increases if it proves to be necessary to bring inflation down to the target by the end of 2025. Consistently, like other international institutions in their reports on Polish monetary policy, the IMF pointed to the importance of clear and predictable central bank's communication – it is too early to talk about interest rate cuts.

The IMF drew attention to the threats to the stability of the banking sector resulting from decisions on foreign currency loans, as well as the costs of general credit holidays borne by banks. The fund recommends that the government investigate the possibility of a statutory solution to the problem of loans issued in foreign currencies and to stop the costly program of widespread credit holidays. Support should be limited to those debtors who are actually in difficult situation. We indicated this necessity in the FOR 16/2022 announcement.

The Fund also indicated the need for further action to integrate refugees from Ukraine, pointing to the opportunities for the Polish economy arising from the influx of new potential employees. The IMF recommends removing administrative barriers towards employment of Ukrainian citizens and facilitating the possibility of requalification and learning the Polish language. This is in line with the postulates of FOR and the Polish-Ukrainian Chamber of Commerce presented in the report Unleash Potential: Opening Regulated Professions to Ukrainian Citizens.

In its conclusions after the visit in Warsaw, the IMF forecasts the GDP growth at the level of 0.3% and persistently elevated inflation until 2025, which are primarily a consequence of incorrect fiscal and monetary policies. The Fund calls for responsible actions on both sides of Świętokrzyska Street in Warsaw, which lies between the headquarters of the Ministry of Finance and the National Bank of Poland. IMF's findings and recommendations remain consistent with FOR's analyzes and postulates.