Poland

Highlights

- **The economy has rebounded in 2024, helped by a robust labour market and rising wages.** Despite increases in domestic demand and the tax base, the soaring budget deficit poses a major challenge for the government. Growing revenues are accompanied by rising expenditures, including on defence, with military expenditures set to reach the highest level relative to gross domestic product (GDP) among North Atlantic Treaty Organization (NATO) members.
- **The government is shifting resources to local authorities.** A recent reform is enhancing financial autonomy for local governments by directly linking their income to taxpayer revenues, thus reversing centralisation and bolstering governance at the local level.
- **Poland's revised Recovery and Resilience Plan (RRP) has gained European Commission approval, but calls for further reforms continue.** While fund disbursements are proceeding, the European Commission has stressed the need for improvements in judicial independence and anti-corruption measures.

Key priorities for 2025

- **The government should adopt firm measures to reduce the fiscal deficit while prioritising essential national needs.** One of the key directions of the considered changes should be a better and more selective targeting of social spending. The European Union's excessive deficit procedure highlights the challenge of maintaining this discipline amid rising defence and healthcare costs.
- **Military spending should be channelled where possible into building domestic industrial capabilities, fostering innovation and creating high-tech jobs.** Investing in local research and development and advanced manufacturing will drive productivity growth and generate economic spillovers beyond the defence sector.
- **The authorities should swiftly invest in grid upgrades and energy storage capacity to meet the government's 2030 goal of 50 per cent renewable electricity.** Granting essential connection rights is crucial to boosting private-sector production.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-2.0	6.9	5.3	0.1	3.2
Inflation (average)	3.6	5.2	13.2	10.8	3.8
Government balance/GDP	-6.9	-1.8	-3.4	-5.1	-5.7
Current account balance/GDP	2.4	-1.4	-2.3	1.8	0.8
Net FDI/GDP [neg. sign = inflows]	-2.5	-4.0	-4.2	-2.4	-2.3
External debt/GDP	60.8	56.6	53.7	51.9	na
Gross reserves/GDP	25.6	24.4	24.2	25.1	na
Credit to private sector/GDP	47.7	45.2	39.1	35.9	na

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Macroeconomic developments and policy response

Higher household spending is powering a rebound in the economy. After a sluggish 0.1 per cent real GDP growth rate in 2023, the economy surged to 2.9 per cent year-on-year growth in the first half of 2024. Real wages leapt by 12 per cent over the same period, buoyed by easing inflation and a sharp rise in nominal wages. Although household consumption has surged, as shown by higher spending on services, the recovering disposable incomes have also been channelled towards rebuilding savings, which were depleted to some extent by high inflation. Corporate investment remains low, due to falling net returns on turnover, weak export conditions as well as high debt-financing costs. At the same time, public investment is performing well. This is largely due to a significant uptick in defence spending, which is set to become the highest among NATO members relative to GDP.

The labour market is in robust health, with foreign workers bolstering the economy. Despite last year's economic slowdown, unemployment in Poland remains at historically low rates, at 2.9 per cent in July 2024, among the lowest rates in the European Union (EU). Foreign workers are filling gaps in sectors such as transportation, logistics, industry, construction and agriculture, and contributed an estimated 2.3 per cent to GDP growth in 2015-23 – an average annual increase of 0.24 percentage point, according to a recent Centre for Social and Economic Research report.[1] By January 2024 the number of foreign workers registered in Poland represented 6.5 per cent of the total workforce. Nearly 70 per cent of these workers are from Ukraine, according to the Polish Statistical Office.

Poland is under the excessive deficit procedure (EDP). The European Union launched the EDP for Poland in July 2024, as the general government deficit was 5.1 per cent of GDP in 2023, above the 3.0 per cent threshold. The gradual increase in defence spending – expected to reach 4.7 per cent of GDP by 2025 (up from 2.4 per cent in 2022) – along with rising healthcare expenditures, could further drive up the deficit. Poland will receive €5 billion from pre-allocated EU cohesion grant funds to finance post-flood recovery investments. Nevertheless, the costs of recent floods will impact the already stretched public finances. The general government deficit is projected to soar to 5.7 per cent of GDP in 2024, before easing slightly to 5.5 per cent of GDP in 2025. Following changes to EU fiscal rules in spring 2024, the government chose to chart a course to reduce the deficit to 3.0 per cent of GDP within the next four years.

Investment in the private sector and somewhat weaker private consumption will drive Poland's economic growth. Strong labour market conditions and rising disposable incomes will remain key to the economy's momentum. It will be supported by defence spending and EU-funded projects, including those under the Recovery and Resilience Facility, which should gain pace by 2025. Expected improvements in economic conditions in the EU, particularly Germany, will likely boost Polish exports, especially in manufacturing. This will allow the contribution of net exports to economic growth to be maintained at a similar level to 2024, despite the growing import-intense investment demand. The further expected resurgence of inflation will be mainly driven by the removal of energy bill subsidies, while core inflation will remain elevated due to demand pressures, resulting especially in increasing service-sector prices. This, along with higher savings, will somewhat moderate the rise in consumption next year. In 2025 investment demand will surge, driven by accelerated EU fund absorption under the 2021-27 framework. Additional boosts will come from the need to rebuild capital stocks post-pandemic, Poland's low automation levels and rising labour costs. We therefore project real GDP growth at 3.2 per cent in 2024 and 3.8 per cent in 2025.

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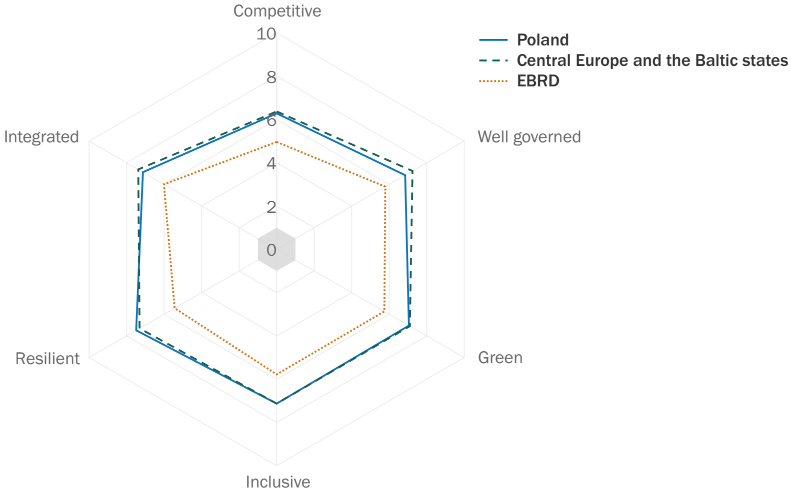
[1] https://for.org.pl/wp-content/uploads/2024/08/raport-fioletowy_znaczenie-imigracji-dla-rozwoju-gospodarczego-Polski.pdf

Assessment of transition qualities (1-10)



Structural reform developments

The government is implementing major reforms to enhance local finance. In September 2024 the government approved a sweeping reform to overhaul local government funding, directing PLN 24.8 billion (€5.8 billion) to local budgets in 2025 and a total of PLN 345 billion (€80.8 billion) over 10 years. This reform links local government income directly to local personal and corporate incomes, instead of it being a share in tax revenues of local people and firms. In this way, the financial autonomy of local governments will be enhanced, as their revenues will no longer depend on tax rates set by the government centrally, at the country-wide level. By replacing parts of the general subsidy with targeted funds for education, development and ecological needs, this move aims to reverse the centralisation policies of the previous government and strengthen local governance.

Banks are intensifying efforts to resolve Swiss franc mortgage disputes. In June 2024, the Justice Ministry and the Financial Supervision Authority (KNF) signed an agreement to develop a comprehensive solution for Swiss franc mortgage issues, as borrowers continue to win nearly all court cases. This follows a Supreme Court ruling in April 2024, clarifying that invalid currency clauses cannot be replaced by central bank rates and that both banks and borrowers are entitled to refunds if contracts are voided. According to the central bank's June 2024 financial stability report, the banking sector remains resilient, with high loss-absorption capacity and substantial capital buffers. The legal risks associated with foreign exchange loans continue to be a burden, especially to the most exposed banks, thus creating barriers to their development, but without threatening the stability of the financial system.

Financial benchmark reform has been postponed to allow time for a smooth transition. In August 2024 the KNF confirmed that the deadline for converting from the Warsaw Interbank Offered Rate (WIBOR) to the Warsaw Interest Rate Overnight (WIRON) benchmark would be postponed to 2028, further extending the previous delay from 2025 to 2027. This decision, prompted by concerns over market readiness and technical complexities, follows the national working group's ongoing review of alternative benchmarks. The delay provides additional time to address operational, legal and communication challenges, but prolongs uncertainty in the financial sector. A decisive attitude and cooperation among all government agencies involved in this matter is important, as the benchmark reform might entail legal risks with the potential to adversely impact future financial stability.

Poland's updated RRF plan has secured European Commission approval. The €59.8 billion fund, with €25.3 billion in grants and €34.5 billion in loans, will see payment applications submitted by 2026. The revised plan was necessary after previous rule-of-law infractions delayed disbursements. To address concerns about judicial independence, the government has launched a series of legislative and non-legislative measures. The European Commission decided in May 2024 to close the Article 7(1) of the Treaty on European Union procedure for Poland, launched in December 2017. Despite progress, the European Commission has recommended further steps to strengthen judicial independence and improve effective anti-corruption enforcement.

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Green energy transition is advancing through strategic investments. In August 2024, BGK, Poland's state development bank, initiated a €4.79 billion financing programme for offshore wind farms in the Baltic Sea under the National Resilience and Restructuring Plan, targeting at least 300 MW of capacity. The Ministry of Climate and Environment also announced that Poland's first nuclear power plant, expected to be operational by 2040, will contribute about 19 per cent of the country's electricity by 2050. The recent amendment to onshore investment regulations reduced the required distance between wind turbines and residential buildings from 10 times the height of the turbine to 700 metres, making it easier to find suitable locations for new turbines. In 2023, renewables comprised more than 40 per cent of installed capacity, generating 27 per cent of total electricity, while fossil fuels, primarily coal and lignite, continued to dominate, producing around 73 per cent of Poland's electricity. The government plans to reach 50 per cent of electricity generation from renewables by 2030.

Energy prices are being selectively unfrozen. Poland's energy regulator URE has approved a new natural gas tariff setup, leading to a 20 per cent price increase for households in the second half of 2024. The tariff, set at PLN 239 (€56) per MWh, will remain effective until June 2025, alongside a 27 per cent rise in distribution fees. These adjustments, stemming from the partial lifting of the anti-inflation shield, are expected to add about 0.5 percentage point to inflation. The Ministry of Climate estimates that extending the remaining energy-related anti-inflation measures throughout 2025 will cost PLN 4.4 billion (€1.03 billion), with PLN 2 billion (€468 million) already allocated in the draft budget. The government is exploring additional financing sources as it balances fiscal constraints with the need to manage energy costs amid upcoming elections.

The government has introduced financial incentives for working parents. In April 2024, the government approved a programme providing PLN 1,500 (€350) per month to parents returning to work when their child is aged between 12 and 35 months, costing PLN 8.9 billion (€2.1 billion) annually. Enhanced support of up to PLN 1,900 (€445) a month is available for parents of children with disabilities. This initiative aims to boost labour force participation, particularly among women. However, this costly social programme is unconditional and not targeted, and its overall benefit will depend on balancing fiscal costs with increased workforce inclusion.