Primer on Poland

What you need to know about Poland

This note is intended to provide key information on Polish economy, its institutional framework and the political system. The report should be most useful to investors who are looking for one source of information on the country or for whom Poland is a relatively new market.

Structure of the economy — In the note we present key information on the structure of the Polish economy, its key export markets, demographic changes and labour market trends. We try to present data in comparison other EU countries, in particular Central European peers.

Institutional framework — We present details on Polish monetary authorities, their goals, how members of the Monetary Policy Council are appointed and how often the central bank intervenes in the FX market. We describe also the fiscal policy framework, fiscal rules and the budget adoption process.

Political landscape — Our note provides also information on who is who in Polish politics and how a path to early elections/government formation looks like.

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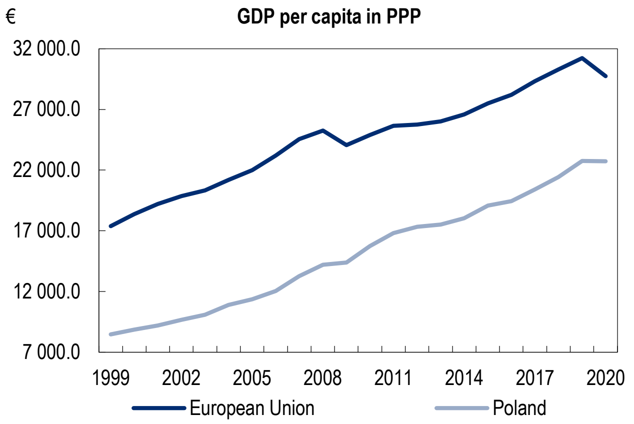
Primer on Poland

Economic structure

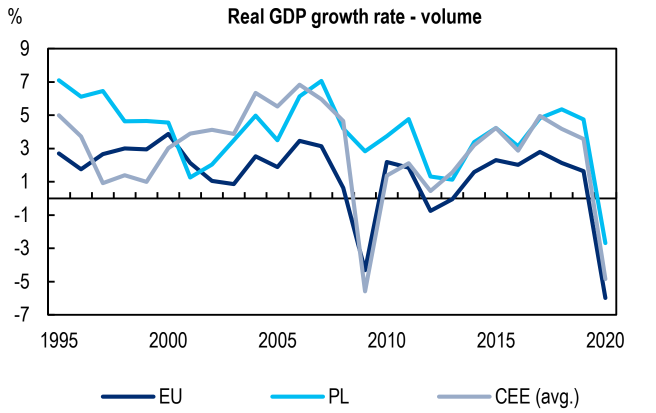
In recent years Poland has been one of fastest growing economies in Europe, gradually catching up with its Western European peers. In 2020 GDP per capita (PPS) reached 76.1% of the EU average, vs. only 43.6% in 1995. Poland's economic growth over last two decades was not only higher than on average in the EU, but it was also significantly less volatile. The economy showed surprising resilience in face of Global Financial Crisis (2008-2009), euro area sovereign debt crisis (2011-2012) and the COVID shock (2020). As Figure 3 shows, Poland fares much better than most EU countries in terms of average growth adjusted for its volatility – a kind of 'macroeconomic Sharpe ratio'.

Figure 1. Poland has been gradually catching up with the euro area, closing the gap in GDP per capita



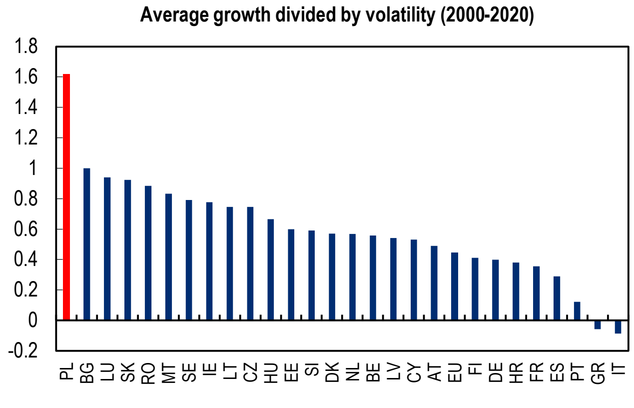
Source: Eurostat, Citi Handlowy

Figure 2. Growth remained – on average – higher than in the region or the EU



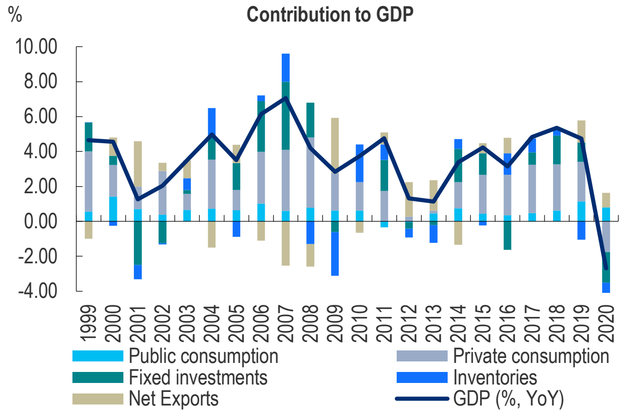
Source: Eurostat, World Bank, Citi Handlowy

Figure 3. Poland has the highest volatility-adjusted growth in the EU



Source: Eurostat, Citi Handlowy

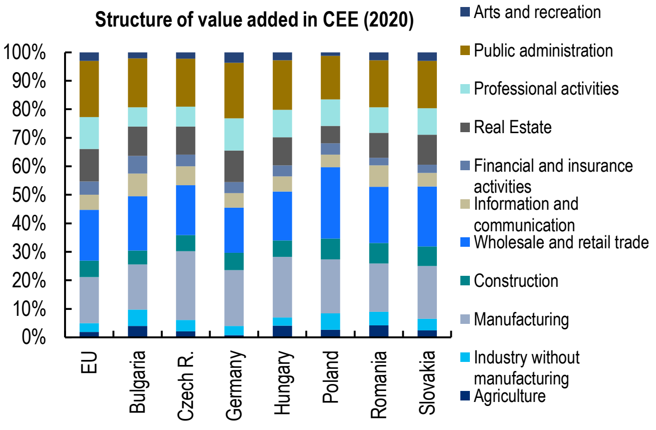
Figure 4. Key drivers of economic growth



Source: Eurostat, Citi Handlowy

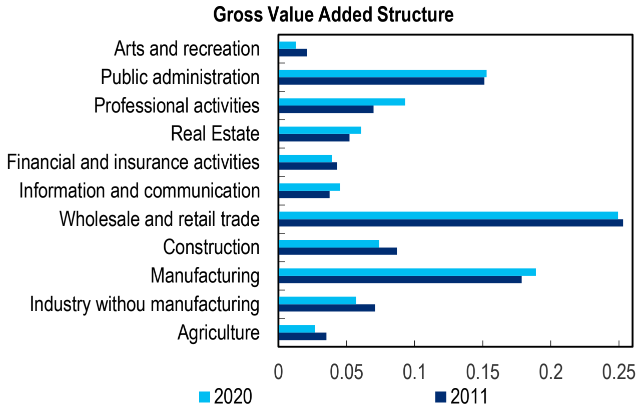
Poland's resilience to external shocks can be attributed to its economic structure. As compared to other CEE economies the Polish economy is more diversified. It has a relatively higher share of trade (wholesale and retail) in value added and lower share of manufacturing (Figure 5), which reflects a larger domestic market. More importantly, manufacturing is also more diversified, with significantly higher share of food and beverages production, while smaller share of transport equipment. Given the lower sensitivity of food industry to cyclical swings, its prominence in manufacturing helps to lower the overall volatility of Poland's GDP. Also, smaller importance of the car industry (Figure 8) explains why the Polish industrial output was able to quickly recover after the pandemic shock, while regional peers with bigger share of the automotive industry faced more serious supply chain disruptions

Figure 5. Value added structure by country



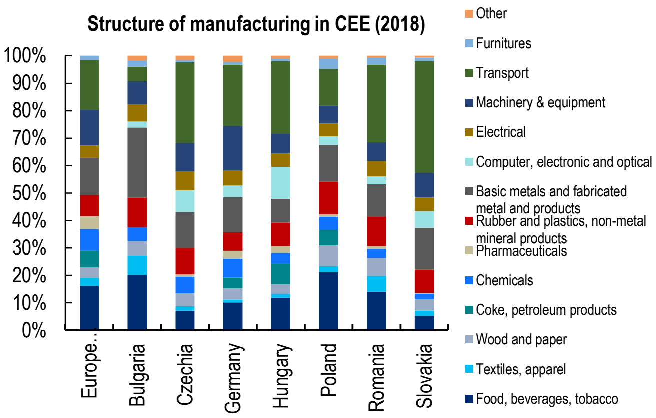
Source: Eurostat, Citi Handlowy

Figure 6. Trade and manufacturing have the biggest share in gross value added in Poland



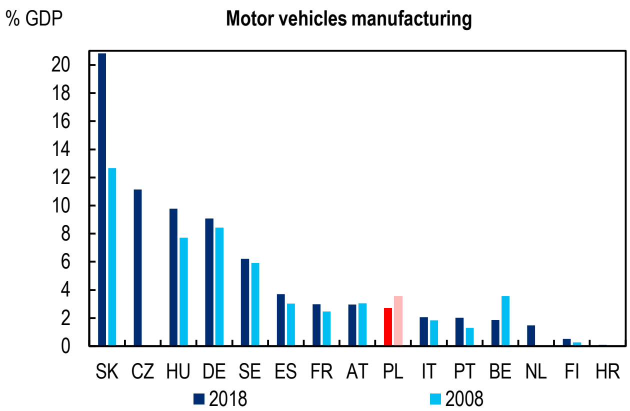
Source: Eurostat, Citi Handlowy

Figure 7. Poland's manufacturing structure is more diversified than elsewhere in the region….



Source: Eurostat, Citi Handlowy

Figure 8. … partly due to smaller exposure to automotive industry

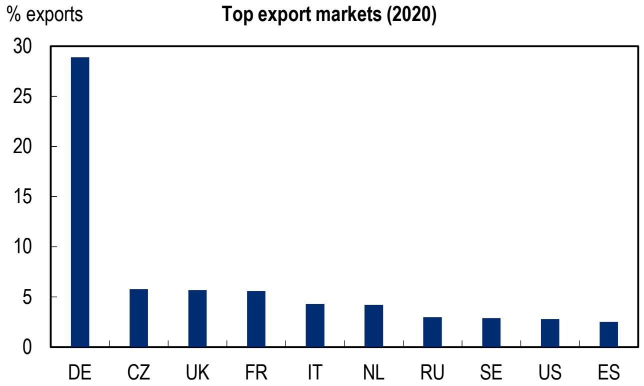


Source: Eurostat, Citi Handlowy

Poland is an open economy, well integrated into European supply chains. Exports-to-GDP ratio increased in previous years, reaching 45.3% in 2020. Most of exports goes to the euro area and Germany remains the biggest trading partner, accounting for 28.9% of exports of goods in 2020. Some of goods sold to Germany are used there as inputs in the production process and are then re-exported to other countries. When looking only at final demand data (and thus eliminating re-exports), Germany still remains the most important destination for Polish goods, with its share at 18.2% (based on OECD TiVA data – see Figure 13). Using these statistics, the US final demand has 6.6% share, while China accounts for 3.4%.

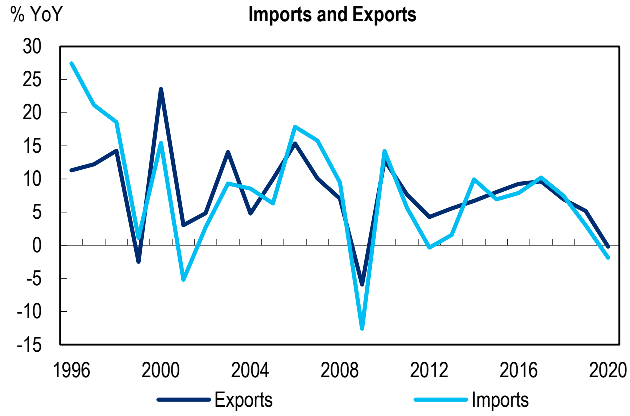
Improvement in trade balance was one of the factors that contributed to current account surplus in recent years. The role of shared service centres in Poland increased after the Brexit vote in 2016, leading to higher exports of business services (Figure 11). Additionally, exports of goods continued to grow at a fast pace due to a mix of factors, including: weak currency, well-educated labour force, proximity to final export markets (euro area) and the EU membership.

Figure 9. Germany remains the biggest trading partner



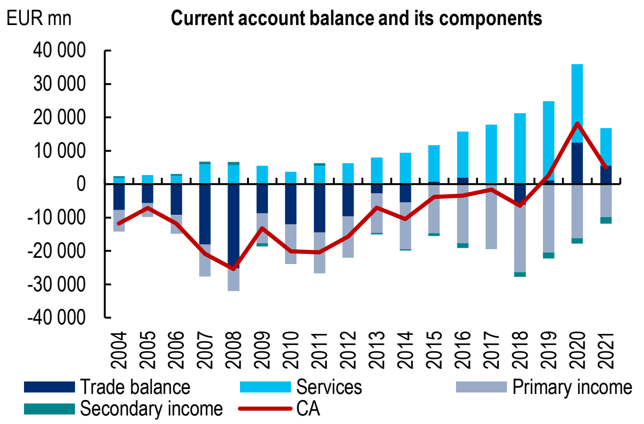
Source: IMF, OECD, Citi Handlowy

Figure 10. Trends in foreign trade



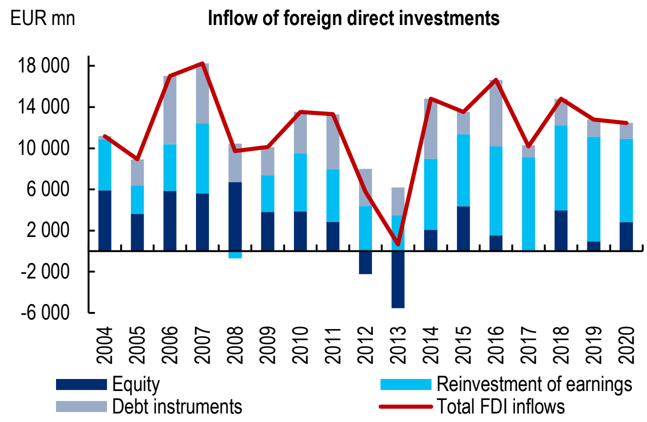
Source: Eurostat, Citi Handlowy

Figure 11. Poland has been running current account surpluses, mostly due to surplus in services and goods trade



Source: NBP, Citi Handlowy

Figure 12. FDI fluctuates around EUR10bn, but more recently it was mostly in the form of reinvested earnings



Source: NBP, Citi Handlowy

Figure 13. CEE Top 10 export markets - TiVA: share of final demand in domestic value added (2015)

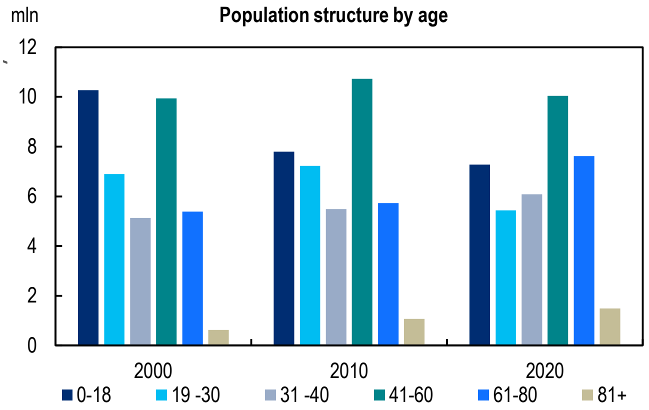
	Czech R.		Hungary		Poland		Romania		Slovakia		Slovenia	
1.	Germany	19.0%	Germany	15.3%	Germany	18.2%	Germany	11.9%	Germany	14.5%	Germany	11.9%
2.	US	6.9%	US	9.7%	UK	7.1%	France	9.4%	US	6.9%	Italy	11.3%
3.	France	5.8%	UK	5.1%	US	6.6%	Italy	8.5%	Czech R.	6.5%	Austria	7.3%
4.	UK	5.8%	France	4.8%	France	6.4%	US	6.7%	France	6.3%	US	5.6%
5.	Poland	5.1%	Italy	4.8%	Italy	4.4%	UK	4.6%	China	5.4%	Croatia	5.4%
6.	China	4.2%	Austria	4.6%	China	3.4%	China	4.1%	Poland	5.4%	France	4.9%
7.	Slovakia	4.1%	China	4.6%	Czech R.	2.9%	Austria	3.8%	UK	5.1%	Russia	3.6%
8.	Italy	4.0%	Romania	3.7%	Russia	2.6%	Turkey	3.5%	Italy	4.9%	UK	3.1%
9.	Austria	3.7%	Spain	2.9%	Sweden	2.6%	Spain	2.5%	Austria	4.9%	China	3.1%
10.	Russia	2.7%	Poland	2.8%	Spain	2.5%	Hungary	2.5%	Hungary	4.0%	Hungary	2.5%
	RoW	26.7%	RoW	32.3%	RoW	34.1%	RoW	34.4%	RoW	24.6%	RoW	31.0%

Source: Citi Research, OECD TiVA

Demographic trends and labour market

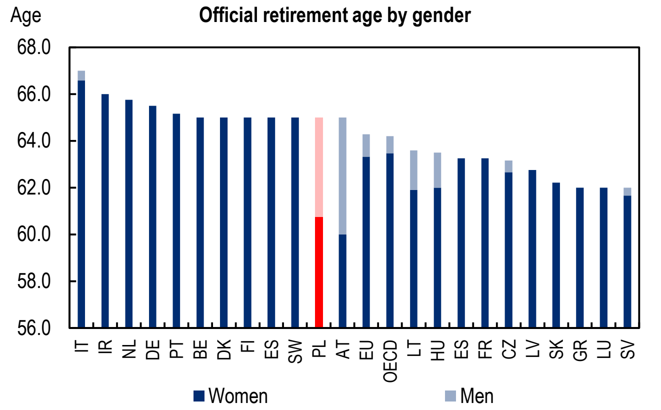
Unfavourable demographic trends are one of key challenges faced by the Polish economy. In recent years the share of people aged 60+ years increased significantly and this trend is set to continue due to ageing of people currently in 41-60 age group (Figure 14). This trend may put pressure on the labour market, contributing to a drop in the labour force, as the official retirement age in Poland is 60 years for women and 65 years for men. Falling working age population can lead over time to substantially lower trend GDP growth

Figure 14. Population ageing remains one of Poland's most serious challenges



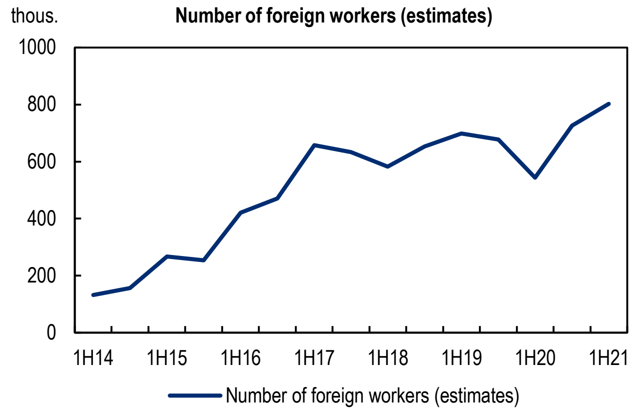
Source: Eurostat, Citi Handlowy

Figure 15. Official retirement age in Poland is 60 years for women and 65 years for men



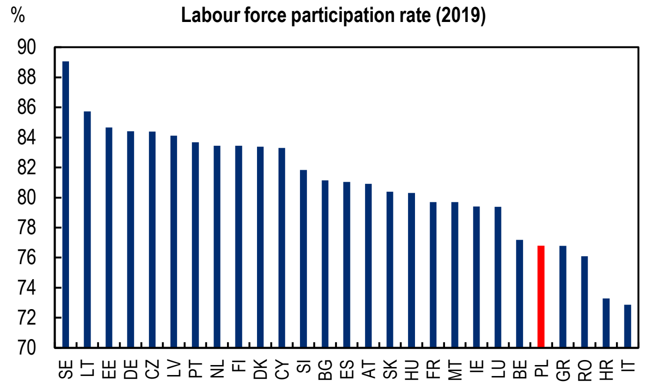
Source: OECD, Citi Handlowy

Figure 16. Rising number of immigrant workers helped alleviate some of labour market pressures



Source: Citi Handlowy estimates based on MRiPS

Figure 17. Boosting labour force participation could reduce the impact form population ageing on growth



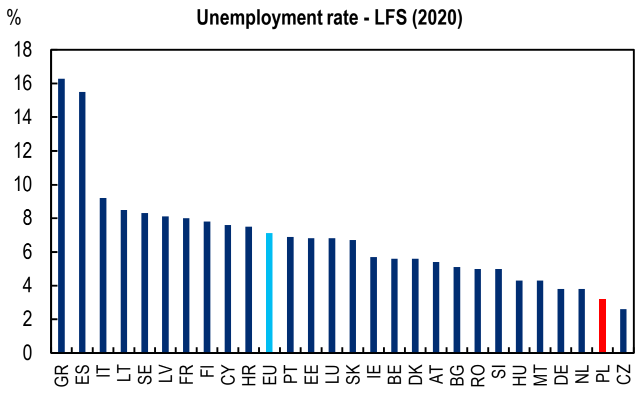
Source: OECD, Citi Handlowy

One of factors that has helped to cushion the impact of population ageing was an increase in immigration, especially from Ukraine. After a brief drop due to the COVID shock, the number of foreigners applying for job permits in Poland increased again and according to our estimates the effective number of (legal) foreign workers probably fluctuates around 800 thousands, up from ~160 thousand in 2014 (Figure 16). This implies that immigrants in Poland constitute approx. 5% of the labour force. Large immigration probably has significant impact on overall growth potential – for example according to our estimates between 2014 and 2018, additional labour supply related to immigration contributed on average 0.5% to GDP growth. Immigration is expected to continue also in following years but given the pace of population ageing it is unlikely to be enough to stabilize the working age population.

The decline in working age population could be slowed in case of an increase in labour market participation of women. Poland, along with other ex-communist countries, shows a relatively low labour activity among women. This seems to be partly due to inadequate supply of child care infrastructure that makes engagement in work life difficult. The issue is exacerbated by relatively low popularity of part-time work in Polish firms.

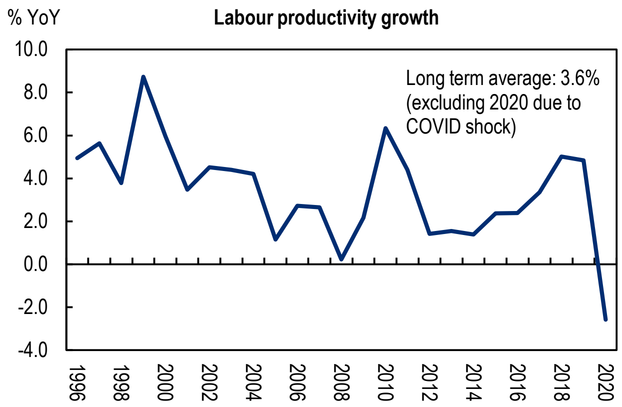
Polish labour market has seen a substantial improvement over last fifteen years. At the time of Poland's entry to the EU in 2004, the unemployment rate was equal to around 20% and was among the highest in the European Union. However, over time unemployment declined - it has remained below the EU average since 2012 and currently is one of the lowest in the EU. Also, following the outbreak of the COVID-19 epidemic, unemployment rate in Poland has hardly budged compared to other member states that have experienced a more significant increase in unemployment figures. This was largely thanks to fiscal policy measures aiming at stabilization of the labour market.

Figure 18. Poland has seen a remarkable decline in unemployment rate in recent years, to one of the lowest levels in the EU



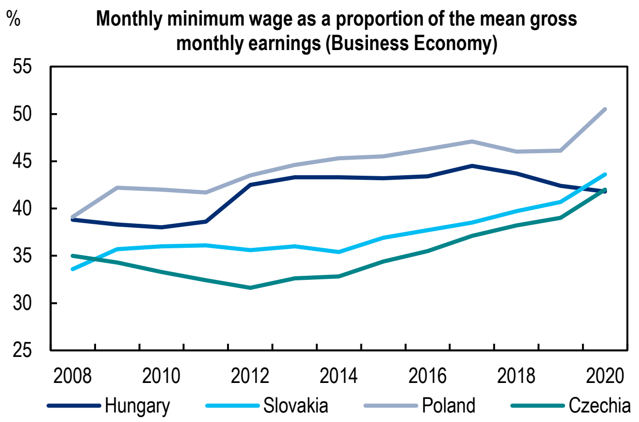
Source: Eurostat, Citi Handlowy

Figure 19. Labour productivity growth remains high, reaching on average 3.6% in 1996-2019 period



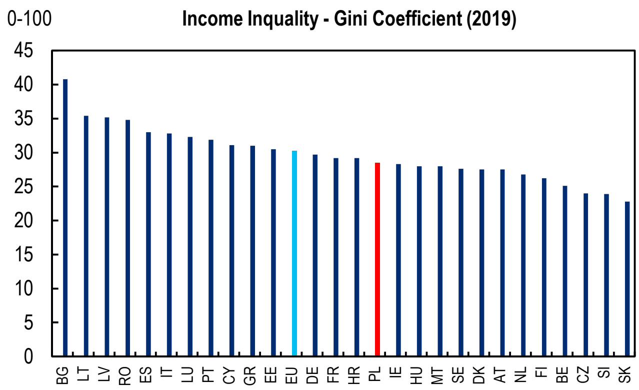
Source: GUS, Citi Handlowy estimates

Figure 20. Government stepped up efforts to increase minimum wage



Source: Eurostat, Citi Handlowy

Figure 21. Poland's income inequality relatively close to EU average

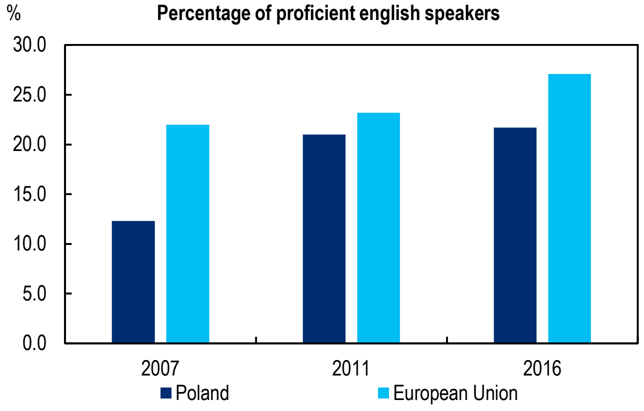


Source: OECD, Citi Handlowy

Labour productivity growth has remained high over the recent years, excluding the COVID shock (Figure 19). This might result from a decrease in the share of workers in low-productivity sectors, as well as from general efficiency gains and advances in new technologies.

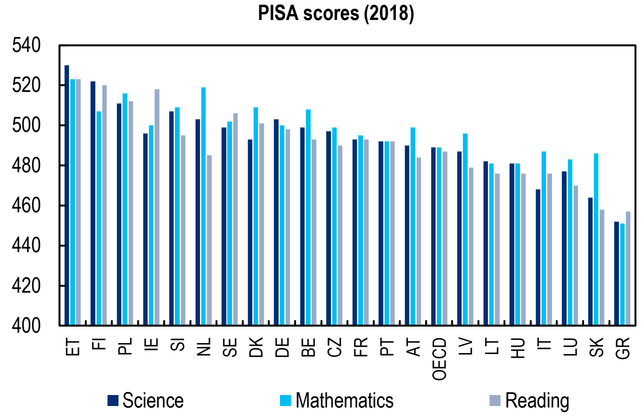
Minimum wage increased considerably in recent years as a result of a series of hikes conducted by the government (Figure 20). Although in nominal terms the minimum wage is relatively low versus other EU countries (in 2021 approx. EUR 620 per month), in purchasing-power adjusted terms it is comparable to Western European levels (Figures 48-49).

Figure 22. Share of English speakers rose but remains below EU average



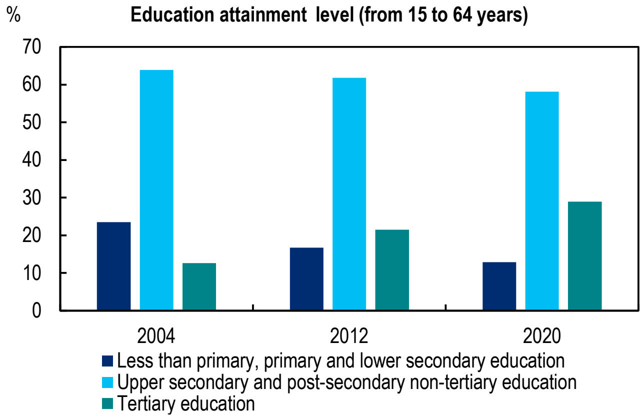
Source: Eurostat, Citi Handlowy

Figure 23. Programme for International Student Assessment (PISA) ranking



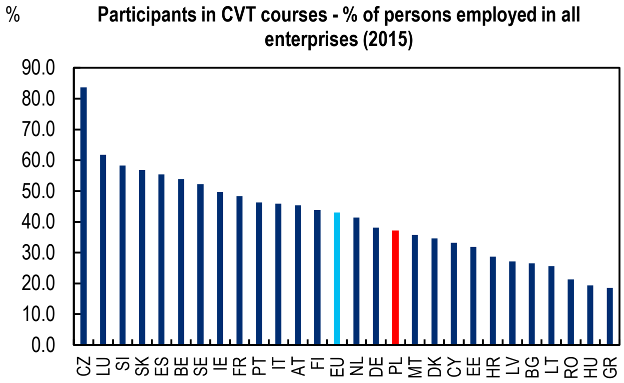
Source: OECD, Citi Handlowy

Figure 24. Continued increase in share of workers with tertiary education



Source: Eurostat, Citi Handlowy

Figure 25. Participation in continuing vocational training



Source: Eurostat, Citi Handlowy

As far as quality of labour is concerned, Poland has experienced an expansion of tertiary education after the accession to the European Union. The share of those obtaining university degrees has doubled since 2004 and at the same time the share of population with only basic education (Primary and Lower Secondary) has decreased significantly. Poland is one of highest scoring European counties in PISA education rankings published by the OECD. In 2018 Polish 15-year olds have been ranked fourth best in Europe at reading comprehension, and third best at both science and math.

One of possible issues related to functioning of the labour market refers to work-related adult learning and continuing vocational training (CVT). According to OECD report on skills strategy (2019), participation in adult learning is relatively low in Poland, with the share of employees participating in CVT courses below the EU average. As stated in the report, only 7% of firms have a training budget and use training as a non-financial motivator. Lack of ongoing work-related training can lead to skills imbalances, which can have a negative effect on labour productivity.

EU membership

Poland entered the European Union (EU) in May 2004. Integration with the EU had profound implications on both economic and institutional changes in the country. Opening of borders and elimination of import duties led to a boost in trade flows and thus faster economic growth. EU membership required also changes in law and in key institutions. According to some estimates, without EU entry Poland's GDP could be by one third lower.

One of important consequences of EU entry was that Poland started to receive funds from the EU budget that can be used to finance infrastructure investment or support certain sectors. For example over last three years net inflows of EU funds exceeded 2% of GDP annually (Figure 26). Financial allocations are usually set for seven-year periods and in years 2021-2027 Poland is to receive in total approximately EUR 117bn (in 2018 prices):

- **Cohesion policy funds** - EUR 66.4bn from multiannual financial framework (MFF). This money can be spent to strengthen the economic, social and territorial cohesion of the EU. In particular it can be used to finance infrastructure investment within a country, thus making it better connected with other parts of the EU.

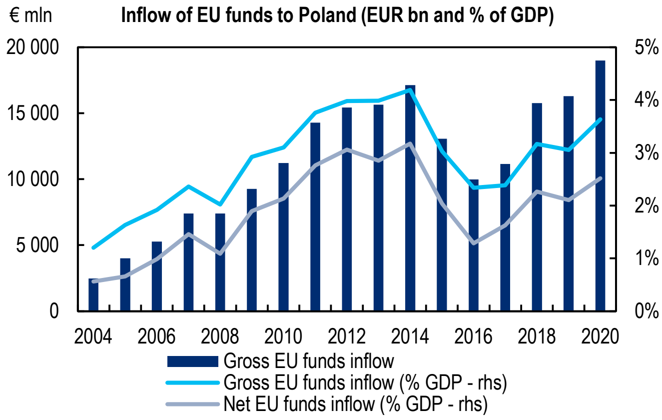
- **Agriculture policy** - EUR 28.8 bn of funds from the seven-year MFF that can be spent to support the agricultural sector and farmers. Taking into account that agriculture plays a bigger role in Poland than (on average) in other EU countries, this source of funds is relatively large.

- **Recovery and Resilience Facility (RRF)** – This is a post-pandemic recovery fund that focuses on digital and green transformation and aims to facilitate a recovery after the 2020 recession. The total amount that Poland wants to use from the RRF is EUR 36bn (in current prices), out of which EUR 23.9bn will be in grants and 12.1bn in loans.

One of factors that needs to be taken into account is that Poland's access to EU funds may be at least temporarily constrained. In 2020 EU states adopted a conditionality mechanism that allows the European Commission to limit access to EU funds for countries that are in breach with EU's rule of law requirements.

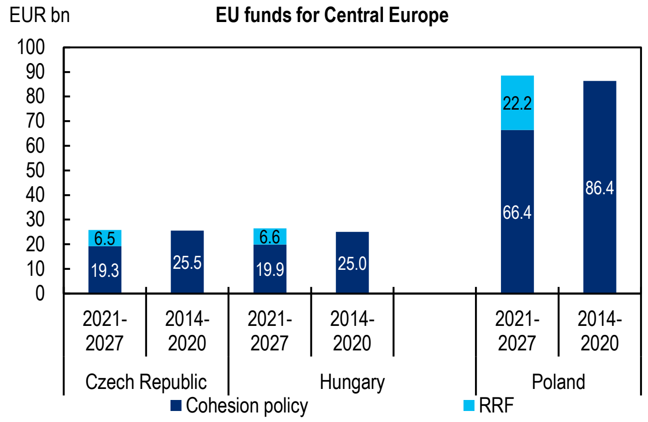
The use of this conditionality mechanism towards Poland cannot be ruled out at some stage, in our view. In recent years Poland has implemented significant changes in its judiciary system, some of which were – according to European Court of Justice – against the EU law. These changes led to a long lasting dispute between Polish government and the European Commission. If the dispute continues sufficiently long, the EC may use the mechanism to limit Poland's access to EU funds.

Figure 26. In recent years inflows of EU funds fluctuated above 2% of GDP in net terms



Source: European Commission, Eurostat, Citi Handlowy

Figure 27. Thanks to the post-pandemic recovery facility (RRF), the pool of EU funds available for 2021-2027 will be higher than in the previous seven year Multiannual Financial Framework



Source: Citi Handlowy, European Commission

Euro adoption prospects

As a member of the European Union, Poland is formally obliged to adopt the euro but there is no official deadline for this to happen. The euro entry is not on the government's agenda anymore and there are no preparatory processes underway.

Before euro entry Poland would need to meet macroeconomic convergence criteria, which put limit on inflation, general government debt, deficit, long term interest rates and require participation in exchange rate stabilization mechanism of ERM2. Since Poland has not applied for ERM2 participation – and in our view the authorities do not seem to have such an intention in the near future – the euro area membership is still at least a few years away.

An even bigger obstacle for euro entry is that Poland would need to fulfil legal conditions and thus would need to amend constitution. For a constitutional amendment, the pro-euro coalition would need to have at least 2/3 majority in the lower house of the parliament (Sejm). This seems impossible at this stage and building of such a strong coalition in the future may be a difficult task, in our view.

Taking into account the above arguments we think the probability of Poland adopting the common currency in the foreseeable future is very low. At the moment we do not even have a forecast when this could possibly happen, as we think euro adoption is unlikely to take place in a horizon that would matter for financial market participants.

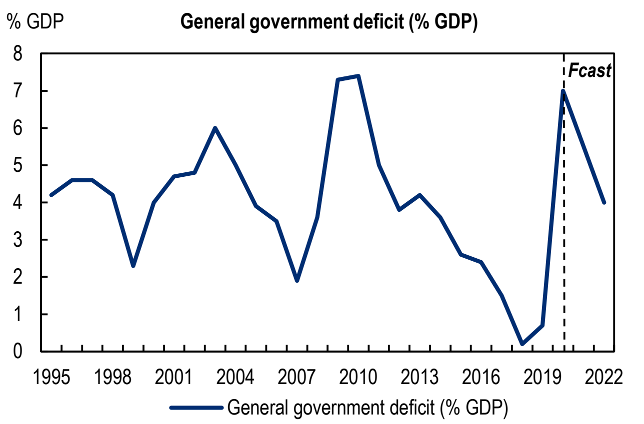
Fiscal policy

Fiscal rules

Polish as well as EU law implies limits on the level of public debt and fiscal deficits. This is likely to have a meaningful impact on the dynamics of fiscal policy in the coming years..

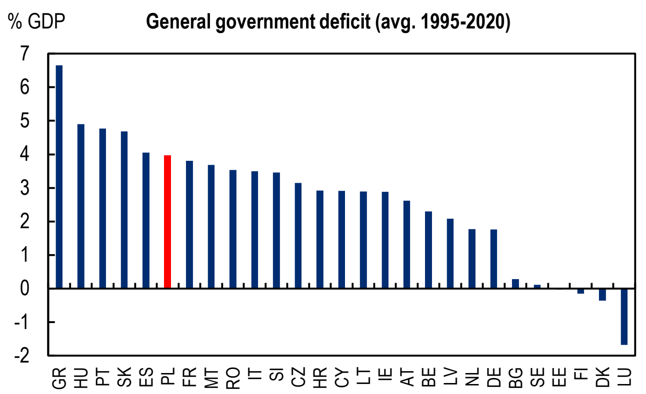
Public debt thresholds. Poland's constitution states that public debt (calculated according to the domestic methodology) cannot exceed 60% of GDP, while the Public Finance Act defines certain actions to be taken by the government if 50%, 55% and 60% thresholds are exceeded. This public debt rule has important implications for the conduct of fiscal policy and suggests that authorities will adjust policy so that to avoid breaching 55% of GDP. If the debt was to exceed this level, the authorities would be forced by existing fiscal rules to balance the budget within two years.

Figure 28. COVID shock led to a rise in deficit but the fiscal balance is expected to improve in the following years



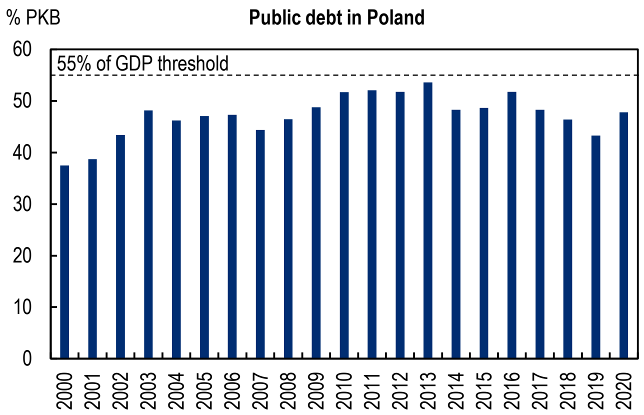
Source: Eurostat, Citi Handlowy

Figure 29. Historically Poland used to run high deficits but introduction of fiscal rules helped to improve fiscal balances



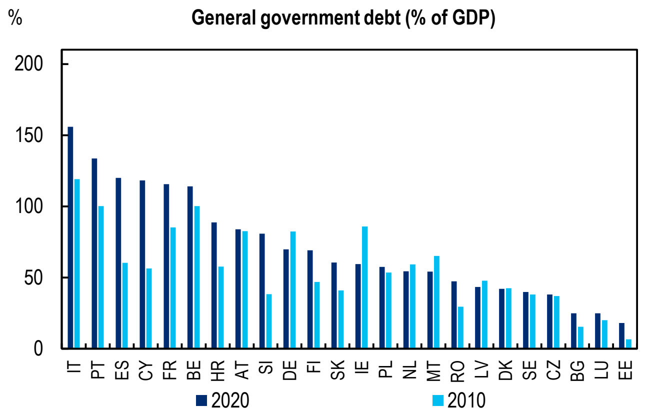
Source: Eurostat, Citi Handlowy

Figure 30. Fiscal rules help to keep the public debt at a relatively low level



Source: CSO, Citi Handlowy

Figure 31. Poland's general government debt remains relatively low as compared to other EU economies



Source: Eurostat, Citi Handlowy

Expenditure rule. In 2013 the stabilizing expenditure rule (SER) was adopted and it has come to force with the 2015 budget. The rule's aim is to safeguard the stability of the public finances by maintaining the general government balance at the medium term budgetary objective level (MTO), which is defined as 1% of GDP in terms of structural deficit. This aim is achieved by ensuring that spending growth does not exceed long term nominal GDP growth (with some adjustments depending on how high fiscal deficit or debt are).

This approach should ensure that the budget deficit does not exceed 3% of GDP, a limit set by the EU. Moreover, SER has replaced the previous ‘temporary expenditure rule’ set in 2011. The former rule concerned only about 10-12% of the general government sector, consisting of discretionary and new “legally mandated” spending, whereas current SER covers almost the entire general government sector (about 90%).

Local government rule. Starting from 2011, local governments are obliged to balance the current budget. This allows municipalities to continue investment projects but puts limits on their ability to increase current spending.

European fiscal limits. Due to the EU regulations, Poland is obliged to keep the general government deficit below 3% of GDP and if this threshold is breached, the European Commission can start Excessive Deficit Procedure (EDP) against the country. This procedure includes various steps and if neglected it can potentially lead to sanctions. Its goal is to encourage and provide guidance for a member state to limit its budget deficit. Furthermore, member states that have not reached their MTOs are required to implement yearly reduction of a structural deficit equal to at least 0.5% of GDP. The deficit rule excludes budget expenditure from European funds and expenditure financed with funds originating from state aid granted by EFTA. The last time Poland was subject to EDP was in years 2009-2015.

In 2020 as a result of the pandemic-induced recession fiscal rules have been suspended temporarily by the EU (suspension will probably be in place until the end of 2022) in order to create space for an active fiscal response.

Budget approval process

Usually works on a new budget act start in late spring and the government submits the Budget Draft as well as the debt Management Strategy to the Parliament by the end of September. The Parliament can modify expenditure and revenue plans but is not allowed to change the deficit limit as compared to what was initially proposed by the government. The Parliament has four months to finish works on the budget and send the document to the President. If this deadline is breached, the President has a right to dissolve the Parliament and thus call new elections.

When signed by the President, the Budget Act becomes binding and the government is not allowed to exceed the central budget deficit during the fiscal year. If for some reasons the deficit needs to be increased above the limit, the government is required to go through a formal process of amending the Bill in the parliament, which can be time consuming and costly in political terms. For this reason budget amendments are rare in Poland and Budget Acts are usually prepared in a way that leaves some safety buffer in case the economic growth and revenues disappoint. For example between 2010 and 2019 the actually realized spending was on average by 2.4% lower than planned. In most years spending significantly accelerates only in final months of the year when it is clear how big the fiscal space is.

Monetary Policy

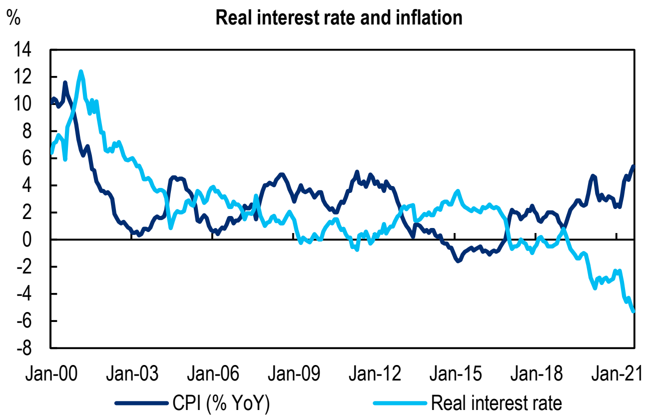
Monetary policy framework

According to Polish law '*the basic objective of the activity of the NBP shall be to maintain price stability, while supporting the economic policy of the Government, insofar as this does not constrain the pursuit of the basic objective of the NBP*' (The Act on the National Bank of Poland, 29 August 1997).

The NBP has pursued the direct inflation targeting strategy since 1999 and currently the ongoing inflation target is 2.5% for the headline CPI with +/-1% point band of permissible fluctuations. In order to meet the inflation target, the NBP adjusts the level of reference rate and by doing this it tries to affect money market rates as well as lending rates.

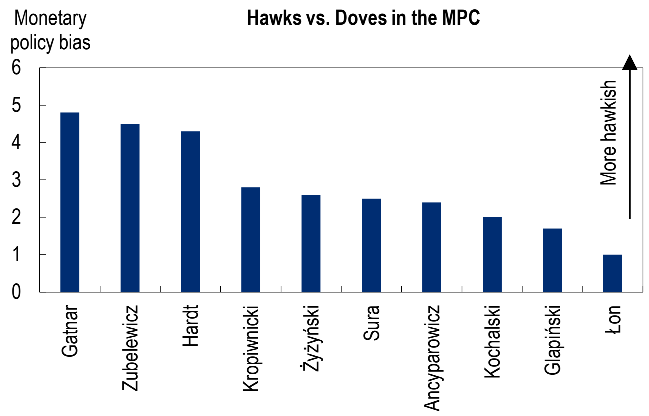
In response to the COVID-shock and lockdowns the National Bank of Poland launched its first ever Quantitative Easing programme (Structural Open Market Operations – SOOR). In March 2020 the NBP announced its plan to buy an unspecified amount of government bonds while in April 2020 the size of purchases was increased and the list of eligible instruments was extended. Since then the central bank has been buying (on the secondary market) treasury bonds and government-guaranteed debt instruments.

Figure 32. Since 2015 real rates have been on a downward path



Source: European Commission, Eurostat, Citi Handlowy

Figure 33. Relative hawkishness of MPC members (based on PAP survey)



Source: PAP, Citi Handlowy

According to the central bank '*the aim of these operations is to change the long-term liquidity structure in the banking sector, ensure liquidity in the secondary securities market and strengthen the impact of the NBP interest rate cuts on the economy, i.e. strengthen the monetary policy transmission mechanism*'. Unlike most other central banks conducting QE operations, the NBP did not commit to any monthly size of purchases, nor did it announce any target level of purchases. Instead, the bank has been adjusting the scale of monthly QE operations in response to changes in market sentiment. The biggest purchases were conducted in the period of largest bond issuances. Taking this into account, the QE program in Poland has been not only a monetary policy instrument but also an important factor facilitating fiscal expansion during the pandemic.

Since 2004, when the current ongoing inflation target was set at 2.5%, the inflation rate was on average at 2.8%. The simple average hides the fact that in this period inflation fluctuated significantly, sometimes persistently deviating from the mid-point of the central bank's target. Since 2009 the CPI stayed within the target band for only approx.40% of time.

Overshooting of the target in recent years can be, however, attributed partly to energy and food prices (due to high weight of these categories in the inflation basket). The core inflation rate excluding these two components generally remained lower than headline CPI.

How is the MPC appointed?

Monetary policy is conducted by the Monetary Policy Council (MPC). The MPC consists of ten members, including the NBP governor who is its chairman and who has a casting vote in case of a deadlock. The Council meets on regular monthly meetings when it takes decisions on interest rates and other key monetary policy parameters.

Nine members of the MPC (excluding NBP governor) are appointed for six-year terms that cannot be repeated, nor extended. The condition a candidate for MPC member needs to fulfil is 'to be a specialist in the field of finance'. Three members are appointed by the lower house of the parliament (Sejm), three members by the upper house (Senate) and three members by the President of Poland. Figure 34 shows a calendar of upcoming changes in the MPC line-up. Terms of nine out of ten members will end in 2022 which might imply a significant change in the way monetary policy is conducted.

Historically among MPC members there were ex-central bankers, ex-finance ministers, politicians, academic economists or lawyers.

Figure 34. Calendar of changes in the Monetary Policy Council

	Nominated by:	End of term
Rafał Sura	Upper House	15-Nov-22 (likely to resign earlier in order to be appointed to Administrative Court)
Eugeniusz Gatnar	Upper House	12-Jan-22
Jerzy Kropiwnicki	Upper House	12-Jan-22
Grażyna Ancyparowicz	Lower House	29-Jan-22
Eryk Łon	Lower House	29-Jan-22
Łukasz Hardt	President	16-Feb-22
Kamil Zubelewicz	President	16-Feb-22
Jerzy Żyżyński	Lower House	17-Mar-22
Adam Glapiński	Lower House	20-Jun-22
Cezary Kochalski	President	20-Dec-25

Source: Citi Research, PAP

Monetary policy reaction function

There is no automaticity in how the NBP responds to inflation shocks. Official documents of the NBP (Monetary Policy Guidelines for 2020) clearly state that the MPC can flexibly adjust monetary policy instruments and can accept periods of CPI deviating from the target in order to avoid excessive costs of policy adjustment.

The MPC reaction function depends on who sits in the rate-setting Council and therefore it can change over time. Below we try to summarize the most important factors that play a role at the moment of writing:

- **Current inflation** — Historically Polish MPC tended to be more reactive than proactive. It usually responded to past inflation developments rather than to inflation forecasts.

- The MPC has **no official employment/GDP target**. However, over time the economic activity started to play a bigger role in policymaking and in our view its weight in the reaction function is currently probably at least as high as inflation's weight.

- **ECB decisions** — Although Poland's economic cycle is correlated with Germany's, the MPC in Poland usually doesn't blindly follow interest rate decisions of the ECB.

- According to Monetary Policy guidelines, **financial stability and asset prices** are factors that are taken into account by the MPC. However, these factors have played little practical role in policymaking so far.

- **Currency** — Historically Polish central bankers tried to avoid any comments on FX market and although in 2020 the NBP intervened in the FX market, in our view there seems to be no particular level that the central bank would like to defend.

FX interventions

Since April 2000, the zloty (PLN) has been a floating currency and for years the Polish central bank preferred to stay away from the FX market while most policymakers expressed the view that the exchange rate should be a reflection of market forces. This changed in 2011 when the central bank adopted a somewhat more active role in the market and intervened several times in order to limit currency volatility in a period of rising depreciation pressures due to intensification of the euro area crisis.

Figure 35. Dates of foreign exchange interventions of the NBP

Date	NBP activity in the FX market
9-Apr-10	Purchasing FX
23-Sep-11	Selling FX
30-Sep-11	Selling FX
3-Oct-11	Selling FX
23-Nov-11	Selling FX
7-Jun-13	Selling FX
18-Dec-20	Purchasing FX
29-Dec-20	Purchasing FX
30-Dec-20	Purchasing FX
31-Dec-20	Purchasing FX

Source: NBP announcements, PAP, Citi Research Estimates

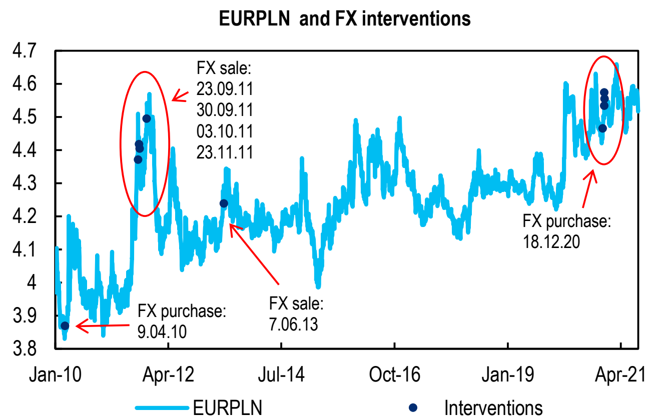
In December 2020 Poland's central bank again intervened in the foreign exchange market, this time to weaken the zloty. The NBP informed that the intervention's objective was to strengthen the impact of the monetary policy loosening on the economy. In addition, intensified upward pressure on zloty was seen by the NBP as particularly harmful for the GDP and export growth. So far, there has been no further interventions in 2021, though the central bank did say that it is prepared to act if necessary.

Central bank officials claim there is no target FX rate they would like to defend and interventions aim to decrease currency volatility, especially in periods when FX moves are large and are not caused by fundamental factors. Although decisions on interest rates are taken by the MPC, the FX interventions decisions are taken by senior management of the NBP. The central bank is not obliged to publish data on the size of interventions and therefore usually the NBP informs only that it conducted an FX operation on the market. Analysis of changes in the stock of FX reserves of the central bank is usually of limited use, unless interventions are particularly large. This is because the increase in FX reserves in previous years reflected mostly inflow of EU structural and cohesion funds to Poland, most of which were exchanged in the central bank.

Finance Ministry on the FX market

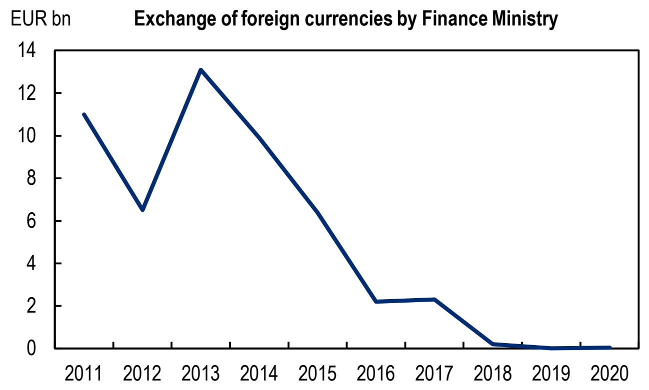
Apart from central bank interventions also the Finance Ministry can be active on the market, usually using state owned bank BGK as its agent. The Finance Ministry does not have FX reserves but is responsible for exchanging EU funds into zlotys and given that annual inflow of such funds to Poland amounted to around EUR 19bn in 2020, it potentially could have noticeable impact on the market.

Figure 36. FX interventions are relatively rare in Poland



Source: Reuters, Citi Handlowy

Figure 37. Finance Ministry is now exchanging most of EU funds in the central bank



Source: MF, Citi Handlowy

Before 2011 these funds were exchanged in the central bank, thus leading to substantial build-up of FX reserves, but having no direct impact on the market. In 2011 the Ministry started to exchange the vast majority of these funds on the market in order to counteract depreciation pressure related to rising risk aversion. However, in recent years the scale of currency transactions conducted by the Ministry of Finance has been again significantly reduced. In 2020, the currency exchange transactions amounted to as little as 0.19% of gross EU funds. By comparison, it was close to 84% in 2013, along with an average of around 50% between 2011 and 2017.

Key facts on Polish politics

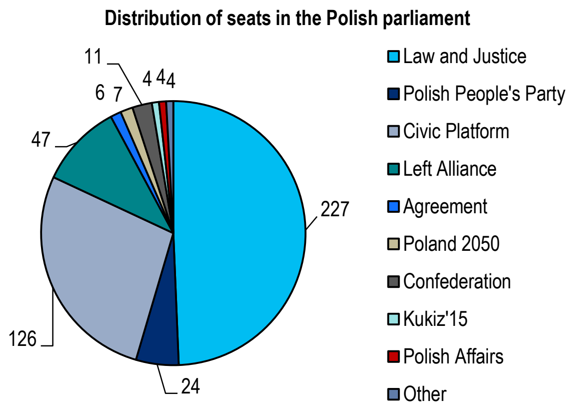
Political Structure

Poland is a republic with a President as a head of state and a Prime Minister as head of the government. The President is elected in general elections for a maximum of two five-year terms and currently this position is held by Andrzej Duda (first term started in 2015, the second one in 2020). According to Polish constitution, the President's role is mostly representative and although he/she has right to veto legislation, the Parliament can reject this with a 3/5 majority.

Prime Minister (currently Mateusz Morawiecki) is head of the government and usually is a representative of the party that formed the ruling coalition. The government coordinates works of the country's administration, conducts domestic and foreign policies and has also the right to propose new legislation that needs to be approved by the parliament.

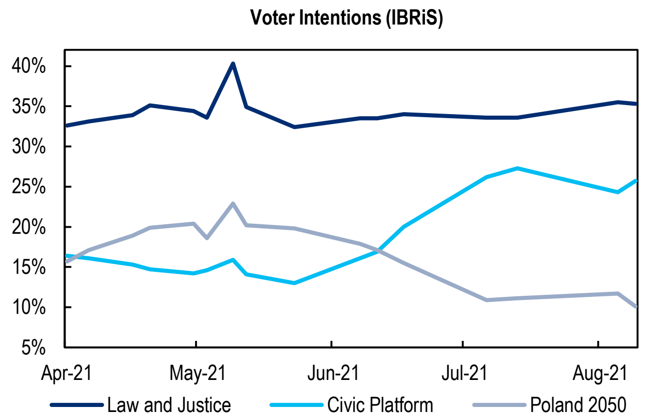
The lower house of the parliament (Sejm) has 460 members that are elected for four-year terms in general elections. Parties enter the Sejm if they get more than 5% of votes. In the Polish electoral system the method used to allocate seats in the Sejm is relatively more favourable for biggest parties. The upper house of parliament (Senat) consists of 100 members that are also elected for four year terms.

Figure 38. Parties present in the lower house of the parliament (Sejm)



Source: Sejm, Citi Handlowy

Figure 39. Trends in opinion polls



Source: Bloomberg, Citi Handlowy

The incumbent government has been formed by the United Right coalition, which includes the Law and Justice (PiS) and a junior coalition partner United Poland (Solidarna Polska). For more on Polish parties and their programs – see next section

The coalition won elections in 2015 and then was re-elected in 2019, receiving nearly 44% of the vote. A government reshuffle took place in September 2020, which included a reduction in the number of ministries from 20 to 14. The next election is scheduled for autumn 2023 but rising tensions between coalition partners and falling public support for the government increase a risk of snap polls.

Who is who and who thinks what in Polish politics?

Law and Justice (PiS) is a right wing and conservative party that won the 2015 parliamentary elections and is currently in power after winning again in 2019. At the European Union level it is a member of the eurosceptic European Conservatives and Reformists Party and domestically a member of United Right alliance.

The PiS stood behind changes in the judiciary system in Poland which triggered international criticism and led to a political dispute with European Commission. The party has embraced economic interventionism and after 2015 elections it gained popularity thanks to a generous program of money transfers to families with children. More recently it has announced a plan to lower taxes for low income households. The party's program puts emphasis on fighting corruption, is against a quick privatization process and against quick euro adoption.

Civic Platform (PO) is a centre-right party that was in power in 2007-2015. Party leader Donald Tusk is a former prime minister, who has returned to domestic politics in 2021, after his term as the president of the European Council ended in 2019. Since 2018 the PO is a member of the alliance called Civic Coalition. It is also a member of European People's Party (EPP).

The PO is a liberal-conservative party and has been described as Christian-democratic in the past. However, in recent years it has gradually moved to somewhat more liberal position on social issues. Regarding its economic program the party is in favour of low taxation and business friendly policies, but after the success of PiS child benefit program, it is also now more open to active fiscal policy. As far as foreign policy is concerned the Civic Platform is in favor of Poland's participation in the structures of the EU and in its view the EU membership, along with NATO membership, is the basic tool for realizing the interests of the state. It is considered a pro-EU party but given the challenges faced by the euro area, the PO leaders suggest Poland should not be in a hurry to adopt the common currency but reiterate a commitment to do it at some future point.

United Poland (Solidarna Polska, or SP) is a right-wing, socially conservative party, and is a junior member of the currently ruling United Right alliance. Party leader Zbigniew Ziobro is also the current Minister of Justice. United Poland supports a bigger role of the state in the economy, supporting higher taxes on large/foreign companies. On social issues the United Poland party takes a conservative stance and simultaneously is vocally euro skeptical.

Agreement (Porozumienie) is a social conservative and economic liberal party. Its leader Jarosław Gowin is a former Deputy Prime Minister, Minister of Science and Higher Education. The party puts strong emphasis on the reduction of bureaucracy, pro-business policies and is in favour of low taxation. In 2021, J. Gowin was dismissed from the position of deputy prime minister, due to his skeptical stance on the '*Polish Deal*' proposal (economic recovery plan after COVID-19-induced recession) and media law changes. This has caused a major reshuffling in the Sejm, as the Agreement left the United Right alliance, which led to a loss of absolute majority by the ruling coalition.

The Left (Lewica) is an alliance of a number of left-wing parties, formed ahead of the 2019 parliamentary elections. The economic program includes a bigger role of state in the economy, higher minimum wage, significantly more progressive tax system, focus on renewable energy sources, increasing spending on healthcare and R&D. Politicians of The Left support measures to increase gender equality.

Polish People's Party (PSL) is an agrarian, centrist party, which is the fourth force in the Polish parliament and a member of the European People's Party. PSL's economic program includes elimination of income tax on retirement benefits, higher minimum wage, investment in renewable energy sources. Since Poland joined EU, the party has supported strong European integration and expanding cooperation with the member states. Traditionally the party was mainly supported by farmers and rural voters, however, recently it has started to lose their support at the same time gaining voters in smaller cities.

Poland 2050 is a centrist party, established in 2021 as a result of a social movement that was initiated by its leader Szymon Hołownia after he finished 3rd in 2020 presidential elections. Poland 2050 is considered a pro-European party and plans to promote closer cooperation with Germany and France (within so called Weimer Triangle). Regarding its economic program the party puts environmental issues as one of priorities and plans to achieve carbon neutrality by 2050. It also puts attention on fostering entrepreneurship, supporting Polish companies and Poland's participation in the global production chain.

Confederation is a far-right party with nationalist, conservative and Eurosceptic views. Its economic program includes a general tax relief (PIT reduction to 0%), voluntary social security contributions (ZUS) and elimination of excise duty on petrol. Other than that the party is in favour of maintaining zloty as a domestic currency, eliminating income tax and decentralization of the state. Its candidate Krzysztof Bosak received higher than expected support in 2020 presidential elections, coming in fourth among candidates.

How the government is formed

The process of government formation in Poland can be long and split into several steps. The whole process begins with the first sitting of the new parliament that should take place no later than 30 days after elections. The President first nominates a new prime minister and then — within 14 days of the first sitting — appoints a PM and ministers. The head of the newly appointed government has another 14 days from his appointment to submit a programme of activity together with a motion requiring a vote of confidence. The Sejm (Lower House) shall pass such vote of confidence by an absolute majority of votes.

If unsuccessful, the second stage begins and the initiative is passed to the Parliament. The Lower House shall, within 14 days, choose a Prime Minister as well as members of the Council of Ministers, by an absolute majority of votes.

If this attempt also proves unsuccessful, the initiative returns to the President. Just like in the first stage, the President has 14 days to appoint a new Prime Minister. If within the next 14 days the Premier is unable to win a confidence vote (with an ordinary majority of votes), the President dissolves Parliament. All in all this means that the whole process to form a new government can take 1.5-2 months if the process is smooth or could take up to 3 months or more if the whole process is problematic.

Non-confidence votes

The Sejm can also pass a vote of no confidence for the Council of Ministers by the majority of votes. The motion has to be submitted by at least 46 Deputies and if passed the President shall accept the resignation and appoint a new Premier and Council of Ministers as chosen by the Sejm. Moreover, it can also pass a vote of no confidence for an individual minister. Such a motion needs to be submitted by at least 69 Deputies and if passed the President shall recall the minister.

The road to early elections

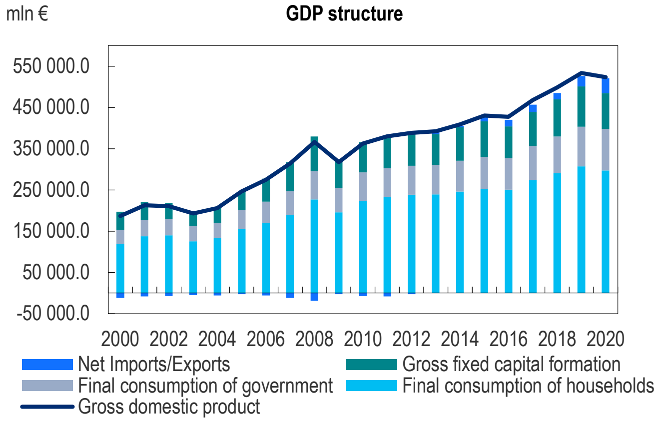
The Sejm may shorten its term by a resolution passed by a majority of at least two-thirds of the votes (i.e. 307 votes) of the statutory number of Deputies.

President may also order shortening of Sejm's term, after consultation with the Marshall of the Sejm and the Marshall of The Senate. However, he may do so only in certain instances specified in the Constitution. Currently there are two situations in which such a decision is allowed. Obligatory one, when as previously described, a vote of confidence in the "third step" of appointing a government is not obtained, and the optional one, in the case of a failure to approve the budget act within 4 months from the date of submitting its draft (usually the budget is submitted in September and the four months period ends by the end of January).

In such an event President shall simultaneously order elections to the Sejm and Senate, which have to take place within 45 days from the announcement of Parliament dissolution. Consequently the first sitting of the newly elected Sejm shall be summoned no later than on the 15th day after the elections were held. Moreover, shortening of the term of office of the Sejm simultaneously means a shortening of the term of office of the Senate.

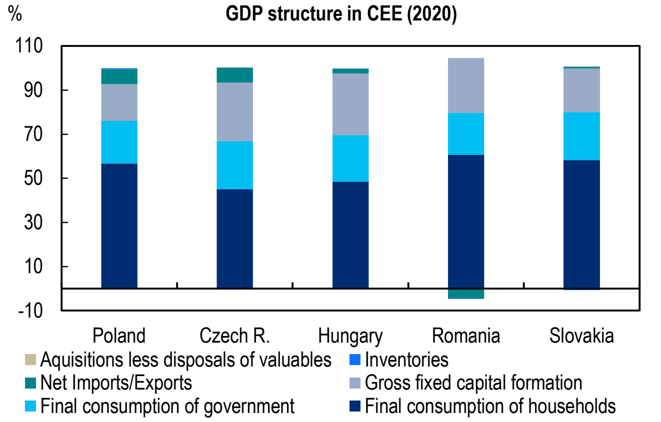
Appendix

Figure 40. GDP Structure in Poland



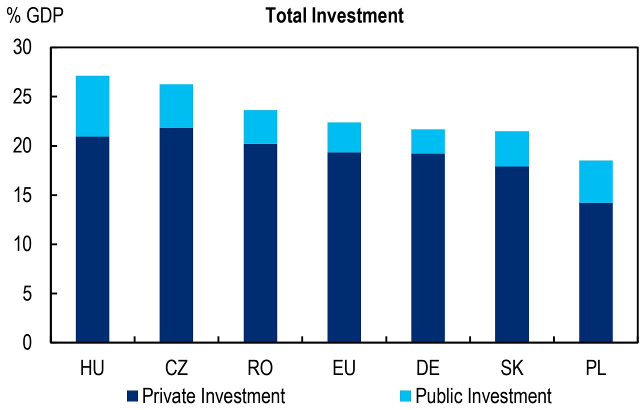
Source: Eurostat, Citi Handlowy

Figure 41. GDP structure in CEE



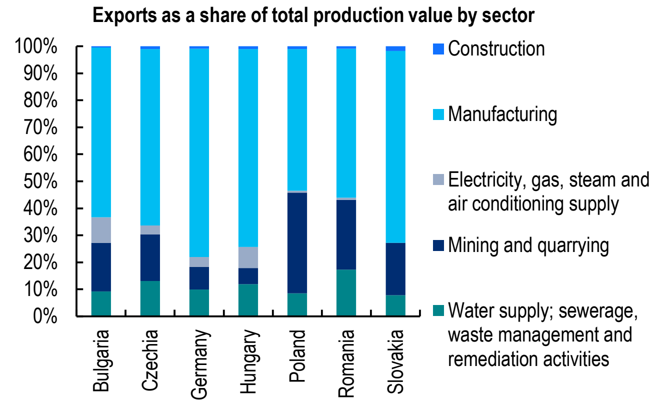
Source: Eurostat, Citi Handlowy

Figure 42. Total investment in CEE, EU and Germany



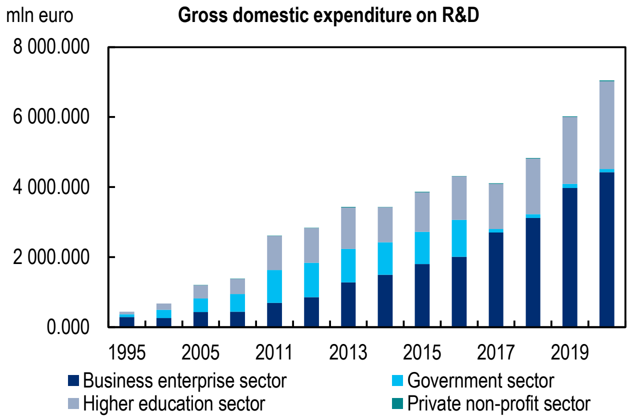
Source: Eurostat, Citi Handlowy

Figure 43. Export breakdown in CEE countries



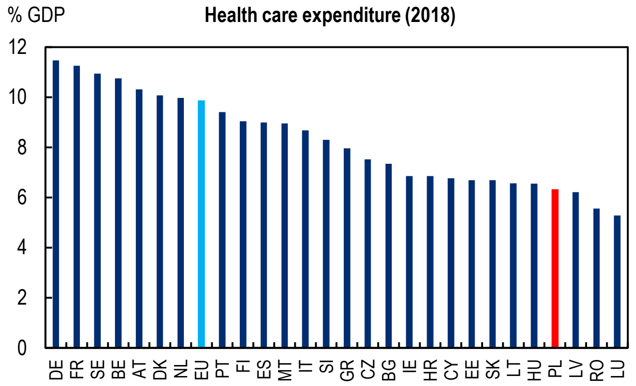
Source: Eurostat, Citi Handlowy

Figure 44. Expenditure on research and development in Poland



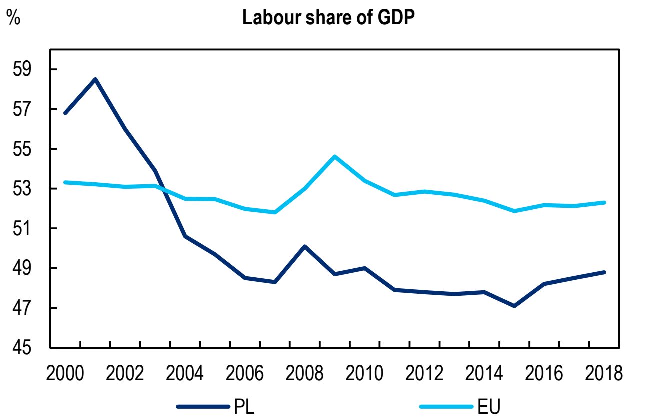
Source: Eurostat, Citi Handlowy

Figure 45. Health care expenditure in European Union



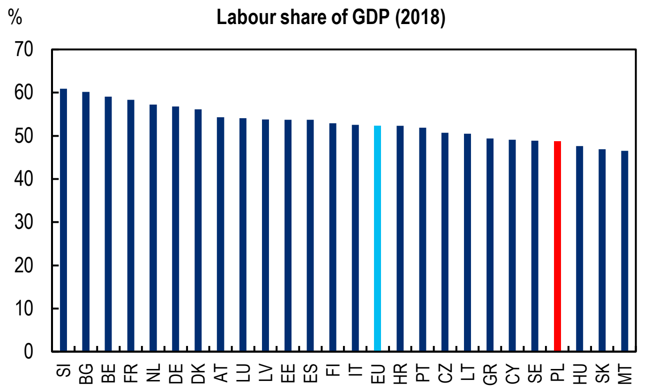
Source: Eurostat, Citi Handlowy

Figure 46. Share of net national income that is received by workers in the form of labour compensation



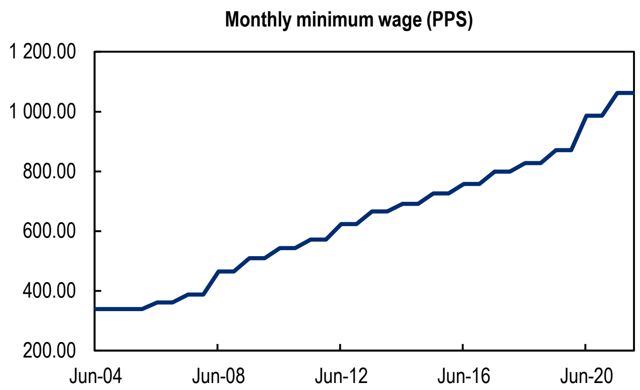
Source: OECD, ouworldindata.org, Citi Handlowy

Figure 47. Share of net national income that is received by workers in the form of labour compensation in EU countries



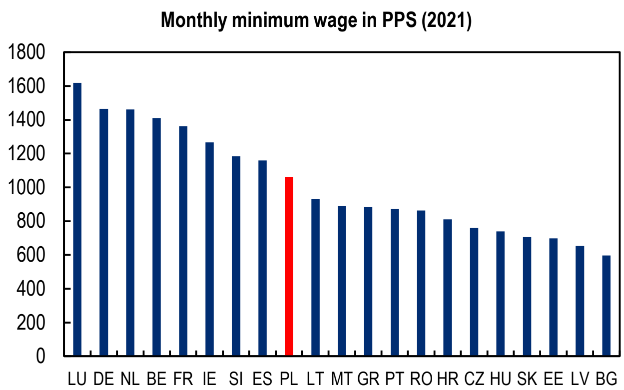
Source: OECD, ouworldindata.org, Citi Handlowy

Figure 48. Monthly minimum wage in Poland



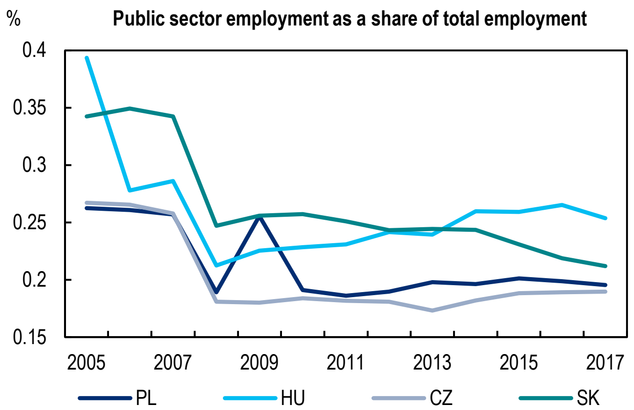
Source: Eurostat, Citi Handlowy

Figure 49. Minimum wage in EU countries



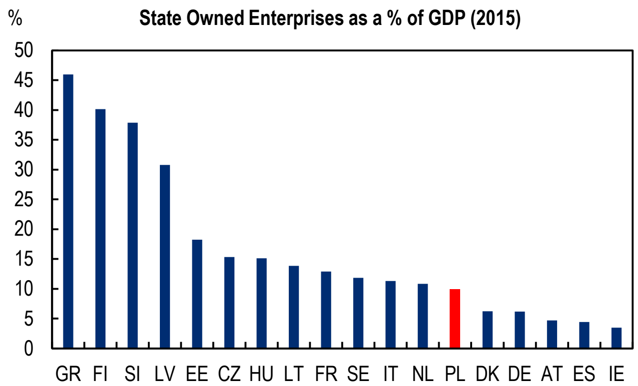
Source: Eurostat, Citi Handlowy

Figure 50. Public sector employment in CEE



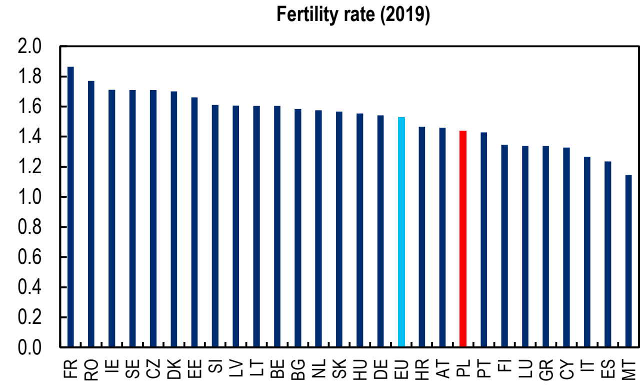
Source: World Bank, Citi Handlowy

Figure 51. State Owned Enterprises as a percentage of GDP



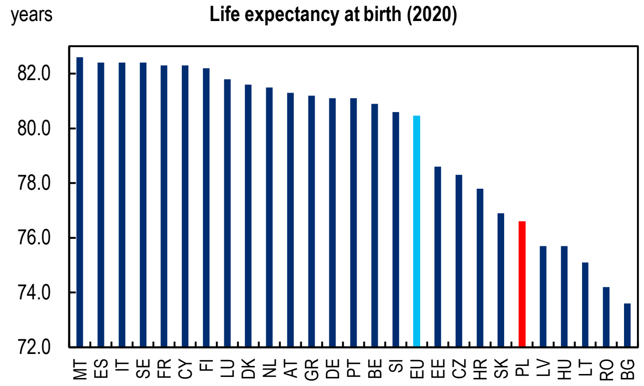
Source: OECD, Eurostat, Citi Handlowy

Figure 52. Fertility rate in EU countries



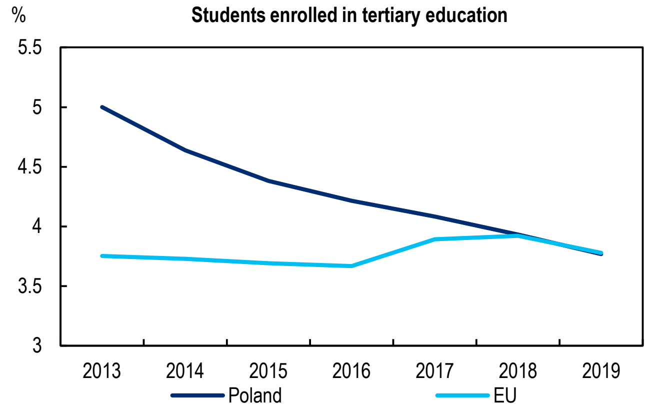
Source: Eurostat, Citi Handlowy

Figure 53. Life expectancy at birth in EU countries



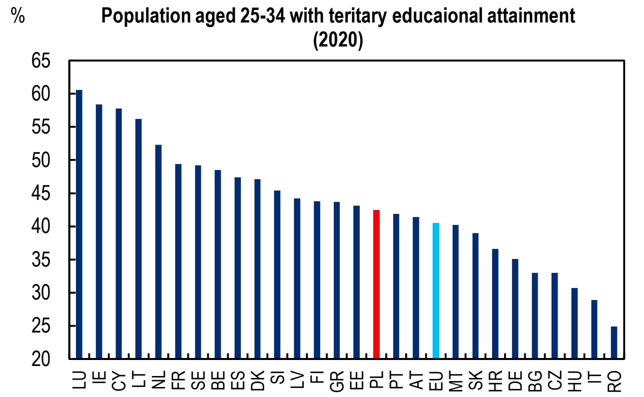
Source: Eurostat, Citi Handlowy

Figure 54. Share of students enrolled in higher education



Source: Eurostat, Citi Handlowy

Figure 55. Share of population with higher education in EU countries



Source: Eurostat, Citi Handlowy

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