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"IN 2024, THE POLISH ECONOMY IS ONE OF THE MOST SUCCESSFUL IN THE REGION."

ECONOMIC RESEARCH

BNP PARIBAS

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A SOLID ECONOMY WITH NEARSHORING OPPORTUNITIES

Cynthia Kalasopatan

Poland's economy has generally shown resilience during periods of turbulence since the financial crisis of 2008-2009. For instance, in 2009, the country was able to avoid a recession in contrast to neighbouring countries. Since 2020, successive shocks have constrained GDP growth momentum, but strong fiscal buffers enabled the authorities to implement generous supportive measures. The country remains amongst the best performing economies in the region in the early months of 2024, with its GDP above 11% in Q12024 compared to its pre-COVID levels. Overall, the country reinforced its position in Europe, judging from the increase of Poland's economic weight in the EU (measured by GDP in purchasing power parity) and gains in market share. Since its entry in the European Union in 2004, Poland has seen its GDP per capita in volume more than double within 20 years. Such performance was facilitated by substantial EU funds in favour of Poland. The country remains an attractive destination in terms of nearshoring opportunities in the short and medium term. The deterioration in fiscal accounts and the longstanding issue of CHF loans are the key weaknesses but are not as acute and should not jeopardise the country's strong fiscal and banking metrics.

A SOLID ECONOMY WITH NEARSHORING OPPORTUNITIES

Poland's economy has generally shown resilience during periods of turbulence since the financial crisis of 2008-2009. For instance, in 2009, the country was able to avoid a recession in contrast to neighbouring countries. Since 2020, successive shocks have constrained GDP growth momentum, but strong fiscal buffers enabled the authorities to implement generous supportive measures. The country remains amongst the best performing economies in the region in the early months of 2024, with its GDP above 11% in Q12024 compared to its pre-COVID levels. Overall, the country reinforced its position in Europe, judging from the increase of Poland's economic weight in the EU (measured by GDP in purchasing power parity) and gains in market share. Since its entry in the European Union in 2004, Poland has seen its GDP per capita in volume more than double within 20 years. Such performance was facilitated by substantial EU funds in favour of Poland. The country remains an attractive destination in terms of nearshoring opportunities in the short and medium term. The deterioration in fiscal accounts and the longstanding issue of CHF loans are the key weaknesses but are not as acute and should not jeopardise the country's strong fiscal and banking metrics.

POLITICAL CHANGE AND NORMALISATION OF THE RELATIONSHIP WITH EU

The last parliamentary elections, on 15 October 2023, brought a shift in the political landscape and led to a normalisation of Poland's relationship with EU institutions. The outgoing government, affiliated with the PiS party, obtained the most votes (35.4% of votes) but was not able to secure a majority via a coalition with other parties. Donald Tusk's Civic platform, alongside with its coalition with two other parties - Third Way and The Left - obtained 53.7% of the votes (Civic Platform: 30.7%; Third Way: 14.4% and The Left: 8.6%). In Parliament, the three-party coalition represents 248 seats out of a total of 460.

Following a two-month post-electoral process, Donald Tusk's administration was officially sworn in office in December 2023. One key hurdle for the government concerns the absence of a super majority (60% of votes) in Parliament, meaning that the government's decisions may be subject to President Duda's potential veto. Policy-making may be complicated for another year with the next presidential elections to be held in 2025. For example, the approval of the budget in early January was not a smooth process.

The 100 policies outlined in Tusk's election campaign, targeted to be implemented in his first 100 days in power, is taking longer than initially anticipated. The 100 policies earmarked in the government's agenda include the release of EU funds, reforms of the judicial system and in state media and a higher threshold for tax-free income.

While the target is far from being achieved, there are nonetheless some key developments. EU funds, worth EUR 75.5 bn under the 2021-2027 budget and EUR 59.8 bn under the National Recovery and Resilience Plan (EUR 25.3 bn in grants and EUR 34.5 bn in loans) were rapidly unlocked. As a reminder, in April 2022, EU funds were frozen by the European Commission due to concerns related to rule of law and judicial independence. At the end of May, the European Commission announced its intention to end the legal process related to the rule of law pursuant to Article 7 on the basis of the government's commitment to pursue ongoing and future reforms.

REAL GDP

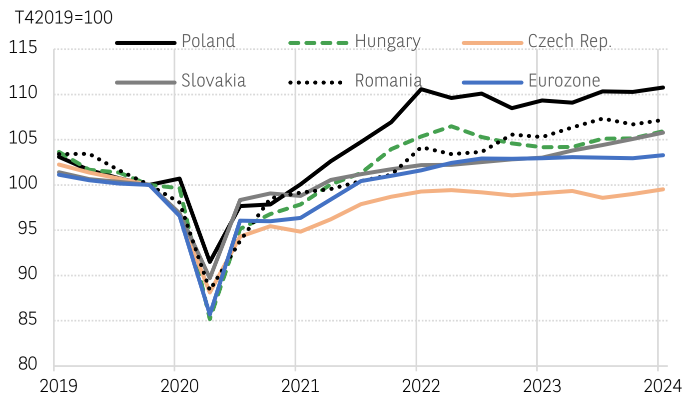

CHART 1 SOURCE: EUROSTAT, BNP PARIBAS

REGIONAL INFLATION

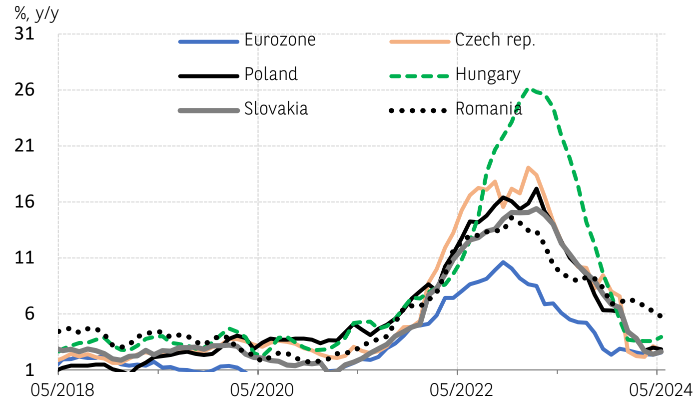

CHART 2 SOURCE: EUROSTAT, BNP PARIBAS

RESILIENCE OF THE ECONOMY

Poland has generally shown resilience in times of turbulence since the 2008-2009 crisis. It was the only country in Central Europe to have avoided a recession in 2009. The region has experienced another round of shocks since then. In 2020, the COVID-19 crisis led to a 2.0% GDP contraction in Poland but its scale was much smaller than that of neighbouring countries. The post-COVID recovery was strong (+6.9% YoY in 2021) as the government was able to implement substantial fiscal support. Poland's economy was able to reach pre-pandemic levels by Q1 2021. Since 2022, the growth path was has been constrained by the war in Ukraine.

In 2023, growth momentum weakened further while again narrowly avoiding a recession. Until H12023, household consumption weakened markedly due to high inflation, negative growth rates in real wages, past monetary policy tightening (which led to a sharp increase in debt servicing) and restrictive credit conditions.

Better growth prospects in 2024 and 2025

From H22023, private consumption picked up, as reflected in the improvement in retail sales and passenger car registrations, induced by the catching up in wages and stronger consumer confidence. Domestic demand should contribute to supporting growth in 2024 and 2025 (projections of 4.0% and 3.5% on average, respectively). The recovery in consumption may still prevail in the short term even if inflation[1] is expected to accelerate in H2. Currently at 2.5% YoY in May, consumer prices may reach 4.1% YoY on average this year after 11.0% in 2023. This may affect households' purchasing power but the impact may be limited due to numerous measures implemented by the government to support consumption. The generous revamp of children's benefits (+60% in 2024) and energy vouchers for lower income households provide some relief. Moreover, strong wages (forecasts of +10.2% in 2024 and 8.1% in 2025) will also be positive for consumption.

Prospects for public investment are positive in the near-term as the European Commission agreed to the release of EU funds under the Resilience and Recovery Fund (EUR 11.4 bn received since the end of 2023). The government has obtained the total unlocking of EU funds in the future. The outlook for private investment and exports remain a mixed bag. With uncertainties related to the election outcome now out of the way, investment projects previously being put on hold, may be implemented and contribute to shoring up investment. However, funding conditions remain an obstacle. Besides, new orders are still subdued, suggesting that exports growth may not gain much momentum in the next few months.

Growth potential is resisting well

In the medium term, GDP growth may converge to its potential of 3.0% as estimated by the IMF. It is lower than the average growth of 3.9% observed during 2000-2009 and 3.8% from 2010–2019. Lower growth potential is mainly explained by unfavourable demographic prospects alongside a shortage of workers. Growth in labour force has slowed significantly despite net positive migration since 2020 (especially from Ukraine). According to OECD projections, the labour force may remain more or less stable at 17.4 mn in 2025.

GROWTH OF LABOUR PRODUCTIVITY AND WAGES

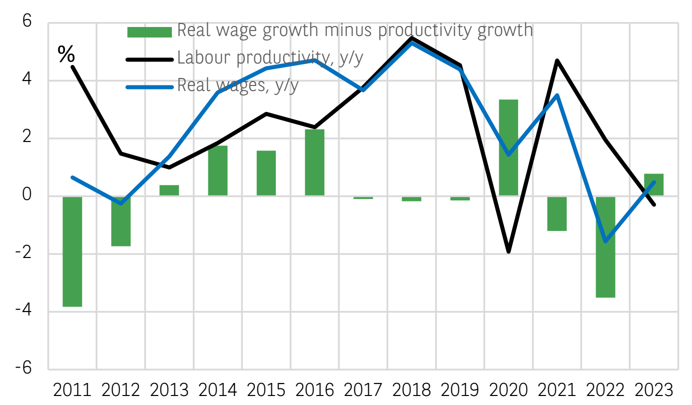

CHART 3 SOURCE: EUROPEAN COMMISSION, STATISTICS POLAND, BNP PARIBAS

GDP PER CAPITA IN VOLUME

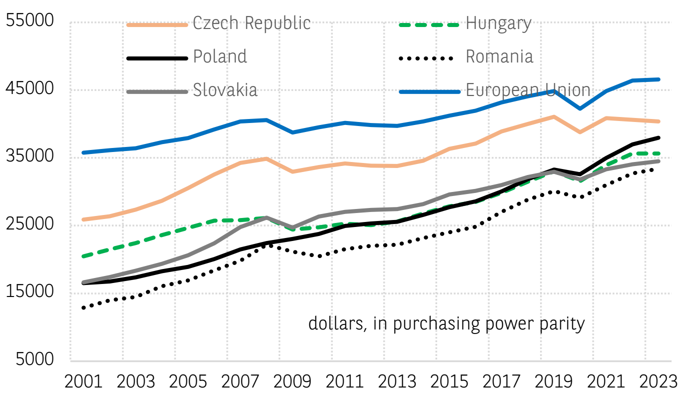

CHART 4 SOURCE: MOF, IMF, BNP PARIBAS

The population has been decreasing since 1999 (-1.6% from 2000 to 2023) to 37.6 mn in 2023 and the declining trend will continue in the future. According to official projections, the population may fall further to 37.0 mn in 2030 and to 35.3 mn in 2040.

Some measures have been implemented to reverse the demographic trend, including family support schemes (increase in child benefit, etc.) Meanwhile, the negative effects of the recent demographic trend can be counterbalanced by enhanced competitiveness of the economy. The strong growth in labour productivity has compensated high real wage increases in recent years and could improve further with EU funds and foreign direct investment (FDI) flows.

1 Inflation is expected to accelerate in the near term due to the increase in the VAT rate of food prices. It was brought to 5% in April 2024 (0% from February 2022 to March 2024). The price cap related to electricity prices has been raised slightly in H2 2024 (the maximum price is currently 500 zlotys compared to 412 zlotys previously.

NEARSHORING IS GAINING MOMENTUM

The recent developments related to EU funds and rule of law matters are positive signals for the business environment and should reinforce the country's attractiveness for investment opportunities and accelerate the reorganisation of production in nearby locations (nearshoring).

Strong momentum in FDI flows since 2021

Since Poland's entry in the European Union in 2004, the country has experienced three different phases of capital flows. The first period, between 2004 and 2010, was marked by a strong increase in net inflows, with a peak at EUR 33.9 bn in 2010. This was followed by a second phase (2011–2020) of stagnation and low inflow. Following the European debt crises in 2012, capital flows struggled to recover the following years. The COVID-19 shock led to a sudden stop of net capital inflows in 2020. The third phase, since 2021, marks a turning point with a boost in net FDI flows.

Since 2021, the strong dynamics in capital flows can be explained by several factors. First, a catching-up effect of postponed projects may have been at play following the post-COVID-19 shock. Secondly, the war in Ukraine and international sanctions against Russia and Belarus have led to partial or total plant closures in those countries while creating opportunities in Central Europe, including Poland. Finally, nearshoring/friend shoring[2] opportunities have emerged. Indeed, securing supply chains and reorganising production have become priorities following protectionist measures imposed by the United States against China since 2018 and more recently supply shocks induced by the COVID-19 pandemic.

Reorganisation of production activities by companies in Eurozone

Amongst emerging markets, Asia and Latin America have traditionally been the principal recipients of FDI inflows since 1990. Not surprisingly, many Asian and Latin American countries such as Vietnam and Mexico have a large manufacturing base and stand to benefit from nearshoring activities.

Many assets also play in favour of nearshoring or friendshoring activities in Poland and other Central European countries. Geographical proximity to the Eurozone alongside with a developed network in infrastructure present advantages in terms of delivery costs and delivery times. Furthermore, regulations related to FDI are generally favourable compared to other emerging countries. Indeed, EU countries (including Poland) are amongst the most open economies according to OECD's FDI Restrictiveness Index and World Bank's Ease of Doing Business Index. Poland also has a diversified industrial base. For instance, food processing represents 8.4% of value added of industry. Other sectors including automotive, chemical, and machinery and electrical equipment are also well represented with respective shares of 7.0%, 3.7%, and 7.7% of value added. Meanwhile, the presence of many multinational companies' R&D segment in Poland contributes to innovation. Additionally, EU funds in favour of Poland as part of its membership in the European Union also play a key role in innovation.

CAPITAL FLOWS IN POLAND

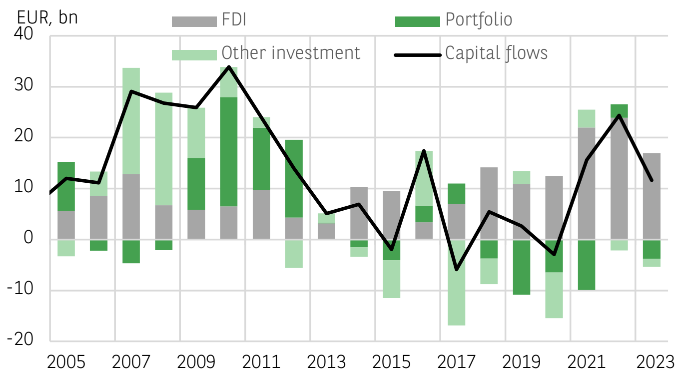

CHART 5

SOURCE: NBP, BNP PARIBAS

SOURCES OF FDI INFLOWS

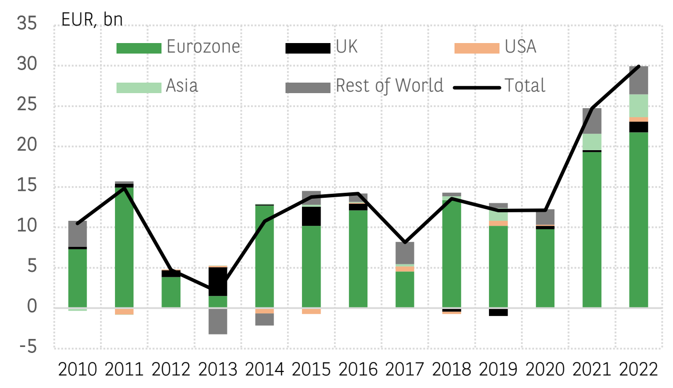

CHART 6

SOURCE: NBP, BNP PARIBAS

Overall, Central Europe remains competitive compared to developed Eurozone economies with a skilled workforce along with a comparative advantage in terms of labour costs. The average wage is still lower compared to Eurozone countries (14.5 EUR per hour for Poland, 41.3 EUR per hour for Germany) despite strong wage pressures observed in Central Europe over the past years as a result of labour scarcity.

Regulations on the carbon border adjustment mechanism (CBAM), which aims to tax non-EU goods with a high carbon content, may reinforce Poland's attractiveness as regards nearshoring activities, at least in the medium term. The CBAM has been implemented in the EU since the 1st October 2023 in its transitory phase and is expected to fully enter in force in 2026.

2 Near shoring consists in reorganising part or all activities in countries with a geographical proximity. Friend shoring is a similar concept which aims to reorganise activities in countries considered as an economic or political ally while reshoring (a term which usually leads to confusion) is a different concept which is the process of bringing back all or part of the activity in the country of origin.

In the transitory phase, the tax would only apply to commodities and would barely concern transformed products. In practice, the carbon tax may penalise production costs in Europe in the short term, where such commodities are imported and transformed to produce finished goods. In the medium term, efforts towards green transitioning in Poland should maintain the country as an attractive destination for investment, especially with more stringent regulations on carbon emissions. As for green transition, huge investments would be necessary in the medium term to achieve climate goals. Poland will continue to receive funds from Europe within the resilience and recovery funds and the cohesion funds to reduce carbon emissions in the industrial sector.

A strengthening in nearshoring activities already visible

Since 2018, the need to secure supply chains and accelerate the reorganisation of production activities has become more pressing. Hence, one question that arises is whether nearshoring activities are already materialising.

Gauging nearshoring activity is a difficult task as reorganising production lines takes time, and the process can span many years. As of now, there is not enough historical perspective to measure the phenomenon and some data are published with delays. However, some basic indicators such as FDI flows and greenfield projects can be used to assess nearshoring activities. The degree of trade integration can complete the two principal indicators. R&D and more qualitative data such as surveys of companies' intentions to reorganize their production activities could be relevant as well.

Looking at the basic set of indicators for Poland, such as FDI flows and greenfield projects, tends to support evidence of nearshoring activities. The stock of inward FDI represented EUR 313 bn in 2023, well above other Central European economies. Net FDI flows reached a record at EUR 23.9 bn in 2022 (3.7% of GDP compared with the 1.9% average between 2015 and 2019) despite geopolitical uncertainties induced by the war in Ukraine. In 2023, net FDI flows remained overall resilient at EUR 17 bn. More granular data show that most of the foreign investment comes from Europe (90% of the total in 2022) with Germany amongst the main investors in the country (16.7% of total FDI inflows). It is interesting to note that, FDI flows from Asia were also observed in 2022. Greenfield projects in Poland have also increased significantly since 2017. They averaged USD 20.8 bn over the past six years compared to USD 9.7 bn from 2010 to 2016. The number of greenfield projects has seen similar trends.

Not surprisingly, Poland's economy remains highly integrated with Germany. Poland's imports of German's products represented 20.2% of the total in 2023. Similarly, sales of Polish products to Germany amounted 28% of Poland's total exports in 2023. Poland's gains in market share in the Eurozone do not appear clearly over the recent period; however, they were reinforced well before the acceleration of nearshoring activities.

Gross domestic investment in R&D is amongst the highest in Central Europe even if the share of R&D in GDP has remained more or less stable in recent years (1.4% of GDP in 2021) and remains below the EU average of 2.1%. Since Poland became part of the European Union in 2004, R&D expenditure experienced around a five-fold increase in volume, with stronger momentum since 2015.

HOURLY LABOUR COSTS IN 2023

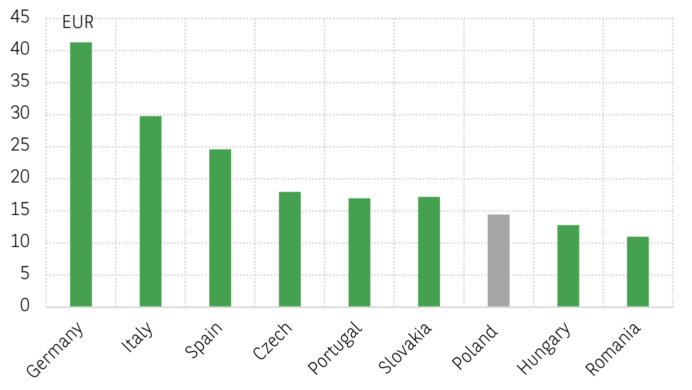

CHART 7 SOURCE: EUROSTAT, BNP PARIBAS

CURRENT ACCOUNT AND ITS COMPONENTS

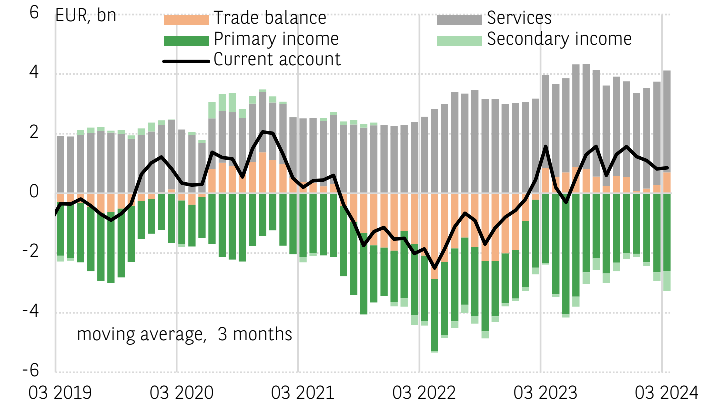

CHART 8 SOURCE: CENTRAL BANK, BNP PARIBAS

The number of entities in R&D has also seen a nearly two-fold increase since 2015 (7431 in 2022).

Current account surplus is temporary

Poland's current account balance has posted a deficit for many years, mainly due to a structural trade deficit. The surplus recorded in 2020 and in 2023 remains an exception. Last year, the current account surplus was mainly attributed to a trade surplus (induced by a lower energy and food import bill) and a slight increase in the balance of services, in structural surplus. In the near term, Poland's trade balance should revert towards a deficit owing to higher imports attributed to military expenditures planned over the next few years.

Moreover, significant public investments in areas related to green transition, digital transformation and innovation in the years to come will maintain imports at high levels. The expected current account deficit should not be a major issue for Poland as in previous years. The funding of the deficit has mostly been covered by non-debt-generating flows, including FDI and EU funds.

External liquidity is comfortable

External solvency indicators and financial vulnerability indicators are sound. Foreign exchange reserves have been increasing steadily in recent years, reaching EUR 191.8 bn in May 2024 after EUR 175.4 in Dec 2023, EUR 156.5 in 2022 and EUR 146.6 bn in 2021. As a result, the import coverage ratio is comfortable, well above 5 months. External debt-to-GDP was moderate at 49.5% in 2023 and should fall further in the next three years. Excluding intercompany loans, the ratio fell further to 34.8% in 2023. The share of short-term external debt is moderate at around 19% of the total in 2023. Moreover, the short-term debt to foreign exchange reserves ratio is moderate, at 36.8% in 2023.

DETERIORATION OF PUBLIC FINANCES

Pronounced budget deficit since Covid-19 shock

Strong fiscal buffers enabled the Polish government to implement generous stimulus measures to support the economy from successive shocks since 2020. A large package consisting of an anti-crisis shield and a financial shield, worth around 5% of GDP (plus 3.3% related to contingent liabilities, according to IMF estimates) was introduced during the COVID-19 crisis. The measures aimed at protecting jobs and cushioning social contribution payments (employee security programmes, enterprise financing, healthcare, financial system, public investment). In 2022, a broad set of measures, including an anti-inflation shield and an energy shield (around 3 % of GDP), was put forward to alleviate the consequences of the war in Ukraine. Since 2022, higher defense spending and debt servicing costs also affected the budget on top of supportive measures. Overall, since 2020, the budget deficit widened (-6.9% of GDP in 2020, -3.7% of GDP in 2022 and -5.1% in 2023 after a short-lived improvement to -1.8% of GDP in 2021).

Towards an excessive deficit procedure in 2024

Fiscal deficit is expected to remain elevated in the near term and in 2024, it will likely exceed the 3% target earmarked in the Stability and Growth Pact. This year's budget, voted in August 2023 by the previous government, anticipated a deficit of 4.5% of GDP in 2024. It was further revised by the new government and voted by the Parliament in January 2024 with a deficit above 5% of GDP. Various factors will exert pressure on spending in the near term. Supportive measures such as price caps on food and energy bills for households and SMEs were still in place in the early part of the year. Moreover, generous social spending, including the 60% rise in the child benefit scheme alongside with wage hikes for teachers (+30%) and for other civil servants (+20%) will increase the burden. To a lesser extent, the government has allocated PLN 500 mn (0.01% of GDP) in the 2024 budget to support first-time buyers and replaced the 2%-loan scheme introduced[3] in H2 2023.

GENERAL GOVERNMENT DEBT TO GDP

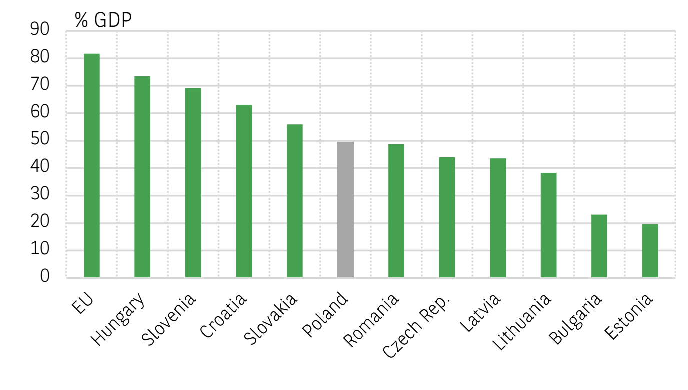

CHART 9 SOURCE: NBP, BNP PARIBAS

GENERAL GOVERNMENT DEBT IN POLAND

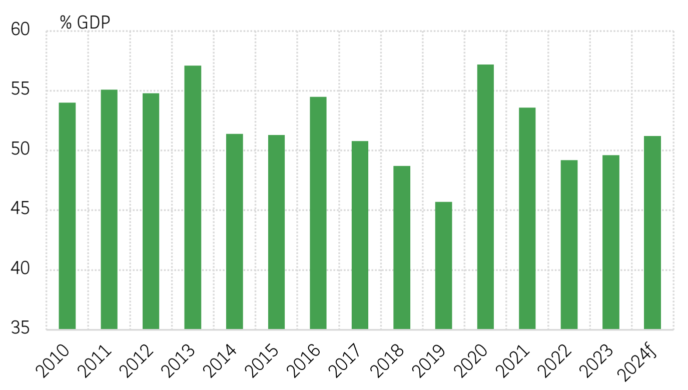

CHART 10 SOURCE: EUROSTAT, BNP PARIBAS

Other factors will also push up government spending in the medium term. The aim of modernising military forces since the war in Ukraine will keep defense spending elevated. It is one of the highest amongst NATO members, at 4% of GDP in 2023 after 2.4% of GDP in 2022. This type of spending will weigh on government accounts in the near term (probably around 3% of GDP in the next few years). Moreover, funding costs for new issuance of debt securities have increased for the government due to the rise in sovereign bond yields throughout 2022 and 2023. The government's interest payments-to-revenue ratio rose to 5.1% in 2023 from 3.6% in 2022 and 2.9% in 2021, though overall debt servicing still remains affordable. Going forward, funding costs are expected to tone down but not significantly.

3 The maximum amount for borrowing is PLN 500 000 for 1 person and PLN 600 000 for a married couple or parents with one child. The government subsidised the difference from the market rate.

Five and ten-year bond yields have eased from the peak observed in 2022 but are still well above 2019 levels and should not drop significantly in the short term. Indeed, monetary authorities will likely adopt a prudent policy as inflation could accelerate in the second half of the year.

Fiscal deficit will inevitably exceed 3% of GDP this year, hence fiscal consolidation measures may accelerate from 2025 onwards. In the meantime, Poland may face an excessive deficit procedure in 2024 as the escape clause pertaining to the Stability and Growth Pact, temporarily introduced during the COVID-19 pandemic, ended on the 31 December 2023. Moreover, the European Commission announced the opening of a procedure for excessive deficit in its latest report of June 2024. Meanwhile, reforms related to the Stability and Growth Pact[4] recently adopted by the EU in December 2023 are welcome overall. They now include some flexibility with a 4-year fiscal adjustment path which could be extended to 7 years for countries with a fiscal deficit above 3% of GDP or with a ratio of government debt above 60% of GDP. Within the 4-year adjustment plan, member states would need to commit to reducing their deficit by 0.5 pt of GDP per year until the fiscal deficit falls below 3% of GDP.

Fiscal buffers and safeguards

Despite a pronounced fiscal deficit, public finances are not at risk as the country has strong fiscal buffers and safeguards. Fiscal discipline measures are reflected in Poland's constitution to maintain the government's debt-to-GDP ratio below 60% of GDP. Moreover, as part of the debt management strategy for 2024–2027, Poland plans to keep the share of the government's foreign currency debt below 25% of the total (23.3% in March 2024). Additionally, as part of EU's commitments, Poland needs to comply with the Stability and Growth Pact, which means putting into place a medium-term fiscal adjustment path.

Along with fiscal safeguards, debt metrics are overall strong. The government has a solid revenue base above 40% of GDP and close to the average of Central European countries. The tax-to-GDP ratio, at 35.2% of GDP, is slightly above its neighbours and above OECD average of 34 % but below developed economies (France: 46.1%; Germany 39.3%), and Nordic countries (Norway: 44.3%; Finland 43% Denmark: 41.9%). Meanwhile, income/profit tax and property taxes are below the OECD average. As for government expenditure, it has increased three-fold since Poland's entry in the EU but as share of GDP, it remained more or less stable, close to 40% of GDP until 2022, followed by a turning point in 2023, with a slight increase. Compensation of employees and social spending account for the bulk of expenditure. The latter has seen its share rise significantly over the past 10 years and is currently well above than OECD average.

Poland's government debt-to-GDP ratio (49.6% in 2023) is well below the EU average of 81.7% and below the 60% target. Since Poland's entry into the EU, the debt-to-GDP ratio increased mildly to reach a peak of 57% of GDP in 2013, then fell gradually to 45.7% of GDP in 2019. The declining trend has temporarily halted since 2020. In the next five years, the government's debt-to-GDP ratio is expected to increase as the country may still post a primary deficit. Debt service is also expected to contribute to the burden.

INTEREST PAYMENTS IN % OF REVENUES OF THE CENTRAL GOVERNMENT

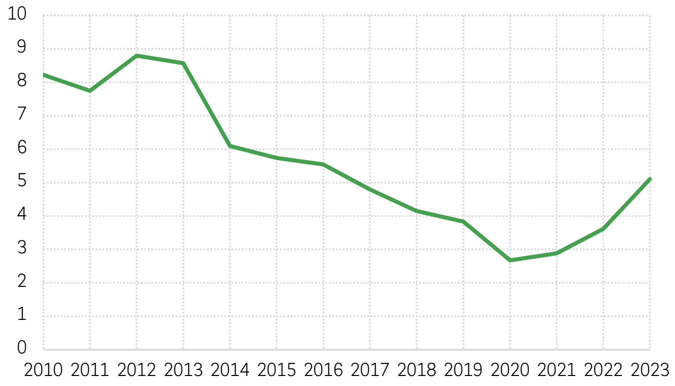

CHART 11 SOURCE: MINISTRY OF FINANCE, BNP PARIBAS

GOVERNMENT BOND YIELDS

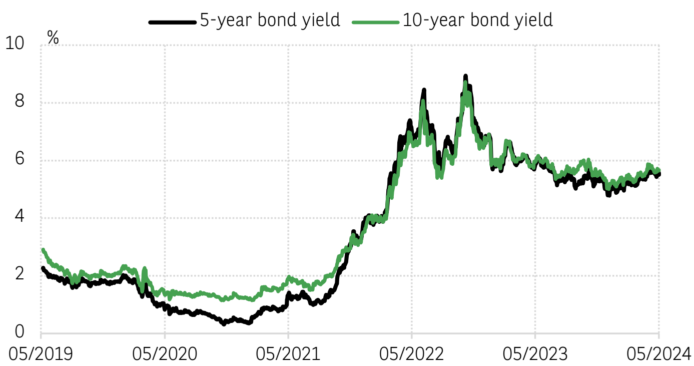

CHART 12 SOURCE: BLOOMBERG, BNP PARIBAS

The debt profile is sound as most of public debt is denominated in domestic currency (76.7% of the total in PLN in March 2024). The rest accounts for a marginal share (EUR 17.6%, USD 5%, and other currencies 0.7%). Domestic government debt (treasury securities) held by foreign investors reached 12.8% of the total in March 2024. The interest rate risk is rather low as most of the debt is contracted at fixed interest rates (share of floating rate debt: 29.4% of the total in March 2024). Meanwhile, total debt servicing remains generally affordable with a relatively low interest-to-revenue ratio. Refinancing risk is also contained due to a debt structure composed mainly of bonds with a residual maturity of over 5 years (38% of the total in March 2024).

4 Initially, the Stability and Growth Pact was enforced to ensure fiscal discipline amongst EU members but has reached its limits. Hence reforms have become necessary to provide flexibility for EU members and to account for their specific situation. Rigid fiscal rules would limit public investment, especially in a context where climate investment needs are huge. Moreover, military spending has increased markedly following the war in Ukraine.

Public debt remains sustainable in the medium term. Poland has numerous fiscal safeguards and presents a sound debt profile. Future challenges will weigh on the budget; hence, the priority will be to consolidate fiscal buffers.

THE BANKING SECTOR IS STRONG

The banking sector remains strong even if it has been subject to numerous shocks since 2020. The loan moratorium introduced in 2020 to support the private sector had limited impact on the non-performing loan ratio once it ended. The ratio of non-performing loans remained close to figures observed in previous years (3.7% in December 2020). In Q4 2023, it even improved to 2.3%. Solvability ratios remain well above prudential standards. In December 2023, the average tier-1 capital adequacy for the banking system remained very strong, at 20.1%. Similarly, profitability indicators measured by return on assets (ROA) or return on equity (ROE) bounced back quickly.

Return-on-equity and return on asset ratios improved markedly to 11.9% and 1.5% on average in Q4 2023 and have largely overtaken levels observed before the COVID crisis. Note that in 2020, the drop in ROE and ROA ratios were mainly attributed to loan provisioning related to legal risks related to CHF denominated mortgages and to the loan moratorium implemented by the authorities during the pandemic.

Overall, credit risks related to households are contained due to supportive measures in their favour, strong real wage growth and a resilient labour market. In the short term, mortgage loans in Swiss francs consitute the main risk but it is far from being systemic.

Supportive measures are targeted towards the mortgage market

Between 2018-2021, housing loans grew at a moderate pace (around 6%) and were the main driver of household credit growth. 2022 was a turning point as monetary tightening led to higher interest rates in the credit market. Additionally, households and non-financial corporations faced a significant rise in credit costs for old loans as they were mostly contracted at variable rates. Until 2021, variable rate loans accounted for more than 90% of total new household loans. The average rate for mortgage loans (for a maturity above 5 years) reached 6.7% on average in 2023 from 5.2% on average in 2022, compared to 2.4% in 2021. As a result, new transactions fell markedly in 2022.

To cushion for adverse developments related to existing loans for households, the authorities targeted the mortgage segment which accounts for the bulk of household loans (at 61.6% of total household debt in 2023). As a matter of comparison, consumer loans represented a share of 25.8% in 2023. A loan moratorium or "bank holiday" on existing loans introduced in July 2022, enabled households to suspend 4 monthly installments in 2022 and 4 more in 2023. The measure was extended in 2024 but conditions to benefit from the credit holiday are now conditioned on income.

In H22023, the credit market gained some momentum from the first-home purchase program introduced by the government in July 2023.

GOVERNMENT DEBT REPAYMENTS DUE (LOANS AND BONDS)

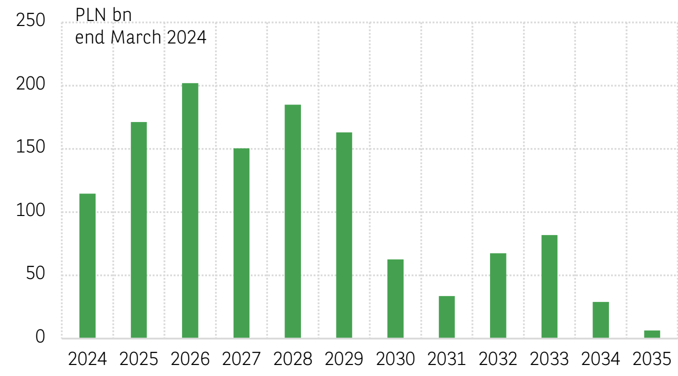

CHART 13

SOURCE: MINISTRY OF FINANCE, BNP PARIBAS

BANK LOANS TO HOUSEHOLDS

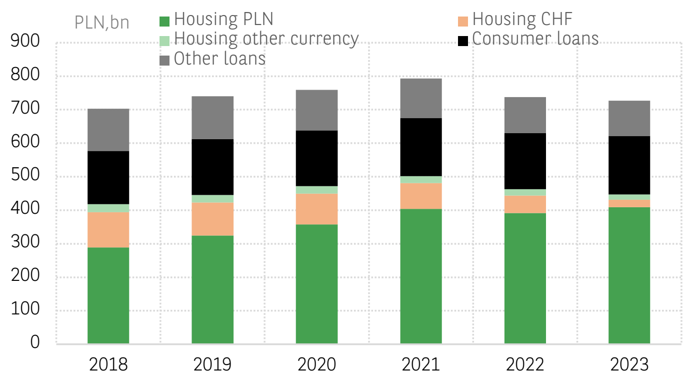

CHART 14

SOURCE: NBP, BNP PARIBAS

The 2% loan scheme enabled first-time home buyers under 45 years old to contract a loan at a fixed interest rate of 2% for 10 years. The government decided to stop the program at the end of 2023 as it became very costly for public finances.

The recovery in the mortgage segment observed in H22023 continued to pick up during first months of 2024[5] despite high mortgage rates (without subsidy) and may be buoyed further in H22024 by the new program for first time home buyers.

5 Financial Stability report - June 2024.

CHF mortgage loans: a long standing issue

In the 2000s, households became heavily indebted in foreign currency, mainly in CHF, to take advantage of a lower interest rates. However, the international environment changed in 2011 with a sharp rise in CHF vis-à-vis the Polish zloty, leading to higher loan service and causing serious burdens for households.

For many years, a gradual process of deleveraging of households' balance sheets has been ongoing but is still unresolved. In December 2023, CHF housing loans represented 3.1% of total household debt (5% of housing loans). In value, outstanding credit in CHF in banks' balance sheets represented PLN 15 bn (0.5% of GDP) in March 2024 compared to PLN 163.5 bn in December 2011. In the meantime, banks have faced legal risks related to CHF mortgage loans and have consequently made significant provisions since 2020 compared to previous years (2022: PLN 6.5 bn, 2021: PLN 8.4 bn). Overall, the accumulated provision of banks represents over PLN 50 bn in December 2023 according to the Central bank's Financial Stability Report of June 2024. Additional provisions would be necessary (estimated around PLN 25-50 bn spanned over a few years) if CHF loans are resolved through settlements or in courts. Moreover, these provisions could be higher for banks in case of a significant exchange rate risk.

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Since Poland became a member of the European Union in 2004, the country has made significant progress in terms of convergence towards developed economies of the region. The gap between the country's GDP per capita in volume and that of EU's developed economies narrowed markedly, reaching 18.5% below the EU average of 37,957 in 2023 (in purchasing power parity) compared to 51.1% in 2004.

Poland is a net beneficiary of EU funds and remains attractive in terms of nearshoring activities. These factors should enable the country to move further in the value chain and contribute to achieve further economic convergence with EU countries.

Fiscal challenges are overall manageable. The country has strong safeguards but would need to implement reforms to consolidate public accounts.

Article completed on 30 June 2024

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