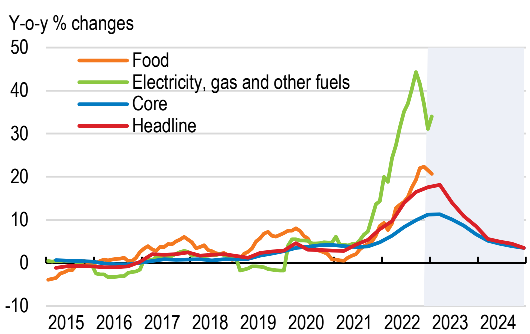
Executive Summary

The impact of Russia's war of aggression against Ukraine is overshadowing the outlook

Poland recovered quickly from the COVID-19 pandemic, but economic growth is stalling following Russia's war of aggression against Ukraine. Inflation has soared against the backdrop of high global energy and food prices and domestic labour market pressures (Figure 1). While Poland's energy supply remains reliant on coal and use of gas is limited, imports of both Russian coal and gas have been replaced and overall trade links with Russia and Belarus are relatively small. Inflation has been rising in the course of 2022 largely driven by higher energy prices, but also reflecting domestic factors, with consumer price inflation up 17.2% in January.

Figure 1. Inflation has soared



Source: OECD MEI database; Statistics Poland; and OECD Economic Outlook database.

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The labour market enjoyed a strong recovery from the COVID-19 pandemic. With skill shortages and strong wage growth already prior to the pandemic, labour market tightness has increased markedly. The employment and unemployment rates have regained pre-pandemic levels and have now posted their best performances in the past three decades.

Poland has successfully managed a large inflow of refugees. Around one and a half million refugees are living in Poland, mostly women with children, following Russia's war against Ukraine. A substantial amount of both public and private resources has been mobilised and the refugees are well-supported. Many have integrated into the labour market with some 60% working already, although often taking up temporary and low skilled jobs. In contrast, only around one-third of Ukrainian children attend local classes, the rest most likely following Ukrainian curricula on-line. The uncertainty about the duration of the conflict complicates the appropriate policy response. Nevertheless, the experience of OECD countries has shown that early interventions have large payoffs in terms of integration.

Table 1. Economic growth will slow

(Annual growth rates, %, unless specified)

	2021	2022	2023	2024
Gross domestic product (GDP)	6.8	4.9	0.9	2.4
Private consumption	6.3	3.0	2.0	2.5
Gross fixed capital formation	2.1	4.6	1.2	3.5
Exports	12.5	4.8	1.2	1.5
Imports	16.1	6.4	1.8	1.5
Unemployment rate (%)	3.4	2.9	3.5	3.8
Consumer price index	5.1	14.4	12.7	4.6
Current account balance (% of GDP)	-1.5	-2.9	-3.5	-2.8
Government fiscal balance (% of GDP)	-1.8	-3.5	-4.9	-4.0
Government gross debt (% of GDP)	53.8	51.8	53.2	54.9

Source: OECD Economic Outlook database.

The economy is expected to remain weak over the first half of 2023 due to high energy prices, weak domestic demand and high uncertainty. Economic growth is expected to slow to 0.9% this year before it recovers to 2.4% in 2024. Inflation is anticipated to peak in early 2023 and fall to 3.5% at the end of 2024, still above the central bank's target. After a small increase, the unemployment rate should stabilise at 3.8% in 2024. Consumption and investment growth should recover in 2024, but the high level of energy prices is likely to lead to a permanent loss of output (Table 1).

The downturn would be deeper in case of an escalation of Russia's war against Ukraine or further disruptions to energy supply. A more sustained increase in underlying prices could hamper the recovery and lead to higher interest rates. Another downside risk is the impact of tighter global financial conditions. While new COVID-19 cases remain limited so far, the arrival of a more virulent and harmful coronavirus variant remains a risk.

Macroeconomic policy needs to strike a fine balance

Both monetary and fiscal policies should ensure that higher inflation does not become

entrenched. Monetary policy has tightened considerably since October 2021, with the key policy interest rate raised to 6.75% by September 2022. Given the sustained rise in both headline and core inflation in 2022, there are risks that this becomes entrenched in higher domestic inflation. The central bank should continue to ensure that currently elevated inflation expectations do not become entrenched and stand ready to increase interest rates further if necessary.

Fiscal policy continues to support the economy in managing higher energy prices. Following comprehensive pandemic-related packages in 2020-21, substantial policy support is being provided to manage the current cost of living crisis. In 2022, households and businesses benefitted from a temporary lowering of VAT taxes on energy and food, as well as energy allowances. This year, electricity and gas price caps and zero VAT rate on food are in place. Temporary policy support softening the blow of the energy crisis should continue as needed. There is scope to improve targeting of any future supports to avoid adding to inflationary pressures.

Long-term fiscal pressures need to be addressed. A structural budget deficit has opened up and spending pressures from population ageing, healthcare and increased defence spending weigh on long-term fiscal sustainability, although the public debt-to-GDP ratio remains at around 50%. The low replacement rate envisaged for the public pension system could lead to additional fiscal pressures. To this end, working lives should be extended, including by aligning gradually male and female statutory retirement ages and increasing the pension age in line with life expectancy gains in good health.

Broadening the revenue base and improving spending efficiency would help improve fiscal sustainability. Reduced VAT rates and exceptions can be streamlined further and property taxation increased. Both the healthcare system and infrastructure are receiving considerable new public financing, so ensuring efficient spending will be key.

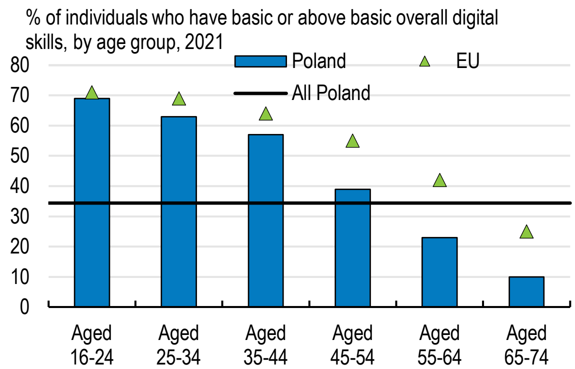
The government is making frequent use of off-budgetary funds and special vehicles to fund temporary support programmes. These funds are part of the general government sector but are not included in the state budget that is at the centre of the fiscal policy debate and approved by Parliament. Strengthening the budgetary framework by reviewing the fiscal rules in the context of European Union (EU) governance reforms and establishing a fiscal council could help maintain fiscal credibility and support better and more transparent management of public finances.

Reforms are needed for living standards to improve further in an ageing society

Digitalisation offers new growth opportunities but requires adequate skills. Prior to the pandemic, Poland made rapid economic progress, with living standards reaching around 80% of the OECD average. This was largely thanks to labour productivity gains, which averaged 3% per year from 2010 to 2020. The Polish economy has benefited significantly from inward investment and strong participation in global value chains. It is increasingly shifting towards higher valued-added activities and digitalisation provides valuable opportunities to advance productivity convergence.

Further digitalising the economy can help unleash the entrepreneurial potential of Polish businesses at home and in global markets. This requires the government to take a comprehensive approach across several policy areas. Adoption of digital technologies is relatively low among firms, particularly small to medium-sized enterprises (SMEs), and could be facilitated through expanded and proactive consultancy and technical support. Managerial skills, key to implementing digitalisation in firms, are often lacking. Information and communications technology (ICT) innovation has been growing and should be supported further. Lower regulatory barriers in services could spur more competition and innovation. Digital skills, essential to ensuring an inclusive digital transition, can be improved, particularly among older adults (Figure 2). The authorities should focus on addressing skills gaps among the working age population, while further education can be made more practical and flexible. Targeted awareness campaigns and scholarships could encourage more women in ICT.

Figure 2. Digital skills lag behind



Source: Eurostat.

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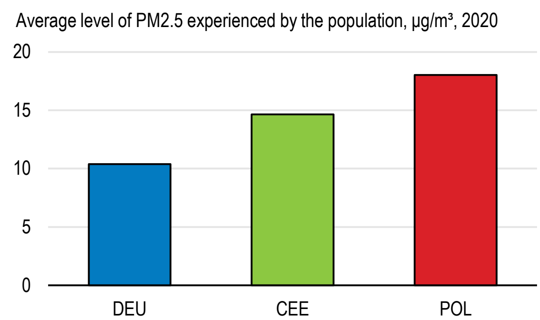
In an ageing society and in the current context of a very tight labour market, increasing the skills of workers and better integration of vulnerable groups into the labour market are key. Encouraging longer working lives, facilitating migration and removing barriers to young parents working would all help draw more people into the workforce. Expansion of childcare capacities is under way and should enable more women to participate in the labour market. The authorities are incentivising pensioners to work, which is welcome.

Well-designed policies are needed to reduce greenhouse gas emissions

Poland has made progress in transitioning to net zero emissions by 2050, but the rate of decarbonisation needs to accelerate significantly. With improvements in industrial energy efficiency and continued expansion of services, energy demand and economic growth have decoupled since 2010. Nevertheless, the carbon intensity of the economy remains high – Poland remains the fifth most carbon intensive economy in the OECD- and people continue to suffer from poor local air quality (Figure 3).

Poland remains heavily reliant on coal. The long-term strategy, *Energy Policy of Poland to 2040*, adopted in 2021, provides welcome policy direction for the energy sector. Gas was to play a major role in the green transition, with a gradual build-up of renewables and nuclear. Given the recent developments, the authorities are reviewing the strategy, adding energy security as a key objective. The revised policy should continue to accelerate the development of renewables, diversify technologies and improve energy efficiency, while minimising the increased reliance on coal in the near term.

Figure 3. The population is heavily exposed to air pollution



Source: OECD Environmental risks and health database.

StatLink https://stat.link/7dlcgy

Setting out a clear long-term path for carbon prices would provide more clarity to households and businesses. Over time, price signals should be strengthened and the regulatory framework improved to foster a faster deployment of renewables. Investments in the electricity grid should be expedited and scaled up. Stepping up efforts to save energy in the housing sector would help to decrease air pollution, carbon emissions and energy poverty. Planned vehicle taxation reforms should be brought forward and reflect carbon content and environmental impact.

A just energy transition requires supporting the most affected workers and regions. Poland's hard coal mines, which employ the bulk of the miners, are scheduled to close by 2049. A social contract agreed in 2021 is welcome, even though greater emphasis should be put on re-skilling. Such an agreement is also needed for workers in lignite coal mines, with complementary policies provided for the wider coal value chain. Given the improved state of the labour market compared to earlier transitions, the social costs of this transition are likely to be lower than in the past.

MAIN FINDINGS	KEY RECOMMENDATIONS
Macroeconomic and fiscal policies	
Substantial policy support is being provided to manage the current cost of living crisis.	Ensure that energy-related support measures to households and firms remain temporary and that fiscal policy does not add to inflationary pressure. Any future supports should be better targeted to the most vulnerable.
Inflation is high and price pressures are broadening.	Continue to ensure that currently elevated inflation expectations do not become entrenched and stand ready to increase interest rates further if necessary.
Poland is hosting over 1 million refugees from Ukraine. While adult Ukraine migrants have quickly integrated into the labour market, children participate less in formal education.	Continue efforts to support and integrate refugees and prepare in case of a further influx.
The coronavirus pandemic and energy crisis have increased public debt, while ageing and other spending pressures such as increased defense spending weigh on long-term fiscal sustainability.	To improve fiscal credibility, consider long-term changes to the numerical fiscal rules, taking into account the outcome of the EU economic governance reforms, and establish an independent fiscal council. In the medium-term, undertake fiscal consolidation. Broaden the revenue base by reforming or phasing out ineffective and regressive tax expenditures and revising property taxation. On the expenditure side, improve targeting of social supports and conduct a comprehensive spending review.
Future low pension adequacy increases the risk of old-age poverty and long-term spending pressures.	Extend working lives, including by aligning gradually male and female statutory retirement age and increasing it in line with life expectancy gains in good health.
The health of many Poles remains subpar. Considerable disruptions in healthcare provision during the pandemic and the large influx of Ukrainian migrants have added to the strain in the healthcare system.	Make the healthcare strategy better integrated across the various actors in the system. Over time, increase the remuneration of health workers.
Unleashing the digital potential of the economy and increasing competition	
The adoption of digital technologies is relatively low among SMEs.	Expand consultancy services that offer expert technical advice to facilitate investment in digital technologies among SMEs.
ICT innovation is low.	Increase direct funding for ICT R&D.
Digital skills are low among adults, particularly among older or less educated**,** while managerial skills, which are key to advancing digitalisation, are often lacking.	Increase the flexibility of formal and non-formal education through more modular training, making use of recognition of prior learning and micro-credentials. Adopt individual training accounts and make training rights portable from job to job. Promote lifelong learning, particularly among those working in SMEs and the less educated, the inactive and the older population.
Digital skills among graduates with upper secondary education could be higher.	Provide ICT equipment in schools and training for vocational education and training teachers to teach digital skills.
The share of women in ICT is 15%, below the EU average of 19%.	Continue increasing the number of women studying ICT through targeted awareness campaigns and scholarships.
Regulatory barriers hinder competition in services.	Reduce regulatory barriers to competition for lawyers, notaries, architects and engineers, as well as in occupational licensing.
Public trust in government and business perceptions of effectiveness of investment protection are low. The previous public integrity strategy did not achieve important objectives and no new strategy has been adopted.	Building on the previous anti-corruption strategy, strengthen public integrity by delivering on its past priorities, addressing remaining issues and involving the non-governmental sector in the formulation and evaluation of the new strategy.
Strengthening green and sustainable growth	
Poland's planned transition away from coal relied in part on natural gas. Given the current geopolitical situation and volatile energy prices the Government is reviewing the strategy.	Implement the updated principles of the energy strategy with an emphasis on accelerating development of renewables, diversifying technologies and improving energy security and efficiency, while minimising the increased reliance on coal in the near term.
Increases in renewable energy are hindered by capacity and connection constraints of the electricity grid and the regulatory framework.	Expedite and scale up investments in the electricity grid, while reviewing regulations and other policy constraints hindering further expansion of renewables.
The pricing of the environmental costs of fossil fuels is uneven across the economy.	Set out a clear long-term path for carbon pricing. In the medium term, increase the national emissions fee and eventually align it with the European Union Emissions Trading System (EU ETS).
Poland agreed on the closure of hard coal mines in 2049.	Ensure a just transition through well-targeted retraining, a hiring freeze and inter-sectoral upskilling for the hard and lignite coal sectors. Complementary policies are needed for the wider coal value chain.

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