

08 January 2020

Economic Comment

2020 Budget: virtual zero

Piotr Bielski, +48 22 534 18 87, piotr.bielski@santander.pl

Wojciech Mazurkiewicz, +48 22 534 18 86, wojciech.mazurkiewicz@santander.pl

Shortly before Christmas, the government approved the new 2020 budget draft. The central state budget is still balanced but this was achieved thanks to some accounting tricks, including reallocation of PLN15bn expenditures outside the central state budget and beyond the reach of the stabilising spending rule. Also, the change in the central bank's accounting rules also proved helpful and the government assumed PLN7bn of profit transfer from the NBP. The public finance balance for 2020 deteriorated to -1.2% of GDP (in April the government assumed +0.2% and in September -0.3%). This is still comfortably below the EU 3% threshold but one should remember that without the one-off revenues (OFE transformation fee, sale of carbon permits), some of which look uncertain, the balance would have been by 1pp weaker. Condition of state finances should not concern investors this year provided that the economic slowdown does not turn out to be deeper than expected. The net bond supply on the domestic market would be double the value of 2019 but this will be still moderately low amount in historical perspective. Domestic investors – mainly banks – should absorb the lion share of issuances.

Briefly before the Christmas Eve, the government approved the new 2020 budget draft. After the changes, the budget is still balanced and should have a deficit of zero. However, the budget seems to be balanced only on paper and thanks to a few bookkeeping tricks: outsourcing the expenditures related to the 13th pension, funeral allowance and social pension to the Solidarity Fund. Two main changes to the financial policy in 2020 as compared to the forecasts from before the elections relate to: (a) introduction of a yearly payment of the 13th pension; (b) keeping the upper limit for ZUS contributions (at 30 times the average wage). Both items generate costs for the public finances, but do not lead to the increase in the central budget. However, **as a result of the introduced changes the balance of the public sector (General Government) according to EU methodology worsened in 2020 to -1.2% GDP, by c1.0pp versus September forecast** (see below). If one-off revenues (sale of CO2 permits, OFE transformation fee) were excluded, the fiscal deficit would equal to 2.2% of GDP. This is still significantly below the EU limit of 3% GDP, however it is worth reminding that in April's CPU (Convergence Programme Update) the government assumed the GG sector balance for 2020 at +0.2% GDP. The new budget draft de facto admits that the April's assumption was purely a pre-election marketing trick.

Budget main parameters – September draft vs December draft

	September draft		December draft	
	2019 EO (2)	2020 plan (3)	2019 EO (2)	2020 plan (3)
Revenues (PLNm)	404 248	429 480	401 828	435 340
Expenditures (PLNm)	416 235	429 480	416 235	435 340
Balance (PLNm)	-11 987	0	-14 407	0
GG balance (% GDP)		-0.3%		-1.2%
GG balance (% GDP) without one-off revenues		-1.3%		-2.2%
GG debt (% GDP)	47.7%	46.3%	47.0%	46.5%

EO – expected outcome according to the Ministry of Finance
Source: Ministry of Finance

Solidarity Fund – 13th pension and more

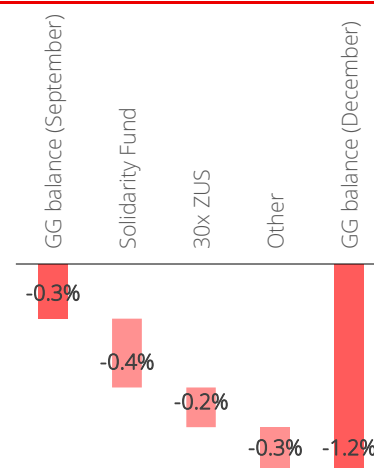
One of the key “innovations” allowing the deficit to stay at zero is assigning new aims to the Solidarity Fund: according to the budget amendment agreed at the end of 2019, the fund is to – apart from aims that it was initially thought to follow, i.e. supporting

Macroeconomic forecasts for 2020

	Budget draft	Santander	BGG
GDP, PLNbn	2 373.3	2 403.1	
GDP, %	3.7	3.1	3.3
Consumption, %	3.8	4.1	3.9
CPI, %	2.5	3.4	2.8
Employment, %	0.5	0.3	
Unemployment, %	5.1	5.0	5.4
Wages, %	6.0	6.2	

Source: Ministry of Finance, Santander, Bloomberg

Change in GG balance between September's and December's drafts (% of GDP)



Source: Ministry of Finance, Santander

Economic Analysis Department:

al. Jana Pawła II 17, 00-854 Warszawa
email: ekonomia@santander.pl
website: santander.pl/en/economic-analysis
Piotr Bielski +48 22 534 18 87
Marcin Luźniński +48 22 534 18 85
Wojciech Mazurkiewicz +48 22 534 18 86
Grzegorz Ogonek +48 22 534 19 23
Marcin Sulewski, CFA +48 22 534 18 84

people with disabilities (PLN5.0bn annually, mostly covered by contributions and taxes) – finance pay-out of the so-called 13th pension (PLN11.0bn annually) as well as social pension and the funeral allowance (PLN4.0bn annually). Thus, PLN15.0bn of expenditure (and thus of deficit) is permanently pushed outside the central budget and beyond the reach of the stabilising spending rule.

New spending, with no corresponding revenues, will be covered by loans. According to the government plans, these will be loans from the Demographic Reserve Fund (already in 2019 the Solidarity Fund borrowed PLN9.0bn from the Demographic Reserve Fund). Later on, the Solidarity Fund is likely to borrow directly from the central budget, as Demographic Reserve Fund does not possess many funds (PLN30bn at the end of 2018).

Cap on social contributions to stay

The September version of budget bill assumed an abandonment of social contributions limit (currently 30x average wage), which would yield PLN5.1bn net for the public sector: ZUS revenues were to grow by PLN7.4bn, while central budget PIT revenues and NFZ (healthcare) contributions were to decline.

Stabilising spending rule pointing to a lower limit

Limit of spending for 2020 resulting from the stabilising spending rule rests at PLN670bn and is by PLN3bn lower than calculated in the September bill. Limit fell due to changes in discretionary actions affecting the public finance revenues. Even though keeping the social contributions cap (-PLN5.1bn) was offset by new “sugar tax” (+PLN2.7bn) and improved compliance in waste management (+PLN2.5bn), there are some changes in other categories as well, e.g. the improved compliance in collection of social contributions was removed (-PLN2.6bn), while extension of the so-called “small ZUS” was added (-PLN1.0bn, reduced social contributions from entrepreneurs with very low turnover). While decrease of spending limit by PLN3.0bn should not be a problem given that PLN4.0bn (social pensions and funeral allowance) was pushed out of the central budget, it seems that some new spending items were put in the bill.

Budget spending up... more than it should?

Central budget spending in 2020 was outlined at PLN435.3bn, i.e. by PLN19.1bn (4.6%) more than planned in 2019 budget act and by PLN5.9bn more than assumed in the September version of 2020 budget. What explains these numbers? Subsidy to Social Security Fund (FUS) goes up by PLN7.4bn as the social security contributions cap is to stay. Outsourcing of social pension and funeral allowance lowers spending by PLN4.0bn. Additionally, debt servicing costs were lowered by PLN0.9bn versus the September plan). Net effect is PLN2.6bn, not PLN5.9bn shown. It seems that additional PLN3.3bn appeared in expenditure. The government documents suggest that this sum could be found in “grants and subsidies” category, more specifically in the “social security” part, but we do not exactly know what stands behind that. Is this a buffer for potential energy prices reimbursements for households? In our view it is unlikely as deputy prime minister Jacek Sasin said recently that costs of the reimbursements, worth PLN3.0bn, will be put only in 2021 budget.

Budget expenditures by economic groups (PLNm)

	2019 bill (1)	2020 September draft (2)	2020 December draft (3)	2020 change (3) - (2)
Budget expenditures	416 235	429 480	435 340	5 860
Grants and subsidies	222 580	225 216	235 817	10 601
Transfers to households	28 476	30 132	26 272	-3 860
Current expenditure of budgetary units	81 440	86 994	87 735	741
Capital expenditure	21 784	24 834	24 112	-722
Debt servicing	29 200	28 500	27 600	-900
Contribution to the EU	22 207	23 328	23 328	0
Co-financing of EU funds-based projects	10 548	10 476	10 476	0

Source: Ministry of Finance, Santander

Central bank's profit saves revenues

Budget expenditures in 2020 by sections (PLNm)

	Sep'19 draft (1)	Dec'19 draft (2)	Change (2) - (1)
Budget expenditures	429 480	435 340	5 860
Agriculture and hunting	5 586	5 609	23
Forestry	9	9	0
Fisheries	121	124	3
Mining	694	695	1
Manufacturing	818	818	0
Trade	438	441	4
Hotels/restaurants	21	21	0
Transport, Communication	13 804	13 823	19
Tourism	58	58	0
Housing	734	741	7
Services	469	499	30
IT	24	24	0
Higher education	24 804	24 808	4
Public administration	15 686	15 931	244
Offices of supreme state authorities, control and protection of law and the judiciary	3 011	3 011	0
Defence	40 958	40 957	-1
Social security	67 170	78 490	11 320
National security and fire protection	17 434	17 035	-400
Justice	15 095	15 088	-7
Debt servicing	28 500	27 600	-900
Various expenditures	112 263	111 802	-461
Education	2 251	2 276	26
Health	8 975	8 496	-480
Social aid	4 059	4 077	18
Other tasks of social policy	5 219	1 279	-3 940
Educational care	140	141	0
Family	56 795	56 803	8
Communal services and environment protection	1 114	1 151	37
Culture and heritage protection	2 841	3 144	303
Botanical and zoological gardens, areas and items of nature protection	114	114	0
Physical education	273	273	0

Source: Ministry of Finance, Santander

In order to keep the budget in balance, revenues have had to be raised by the same amount as expenditures. This was achieved thanks to assuming that as much as PLN7.2bn from the central bank's profit would be transferred into the budget. This is highly likely linked to the recent change of the central bank's accounting rules regarding creation of the FX reserves. At the same time, it seems that although the macroeconomic assumptions were left unchanged, the expected tax revenues were revised down to more realistic levels (-PLN2.5bn vs September draft). We perceive this change as positive as the earlier assumptions (particularly concerning indirect taxes) seemed too optimistic to us. VAT revenues were corrected down by more than PLN3.5bn while excise and PIT tax were not raised much although the planned rise of excise on alcohol and tobacco would be favourable for the former and keeping social security contributions cap for the latter. The retail sales tax that would be effective since mid-2020 and PLN0.6bn of revenues were included in the new budget draft. The table below summarises detailed changes in revenues assumptions.

Budget revenues (PLNm)

	September draft			December draft			2019 change (3) - (1)	2020 change (4) - (2)
	2019 PR (1)	2020 plan (2)	Difference (2) - (1)	2019 PR (3)	2020 plan (4)	Difference (4) - (3)		
Budget revenues	404 248	429 480	25 232	401 828	435 340	33 512	-2 420	5 860
1. Tax revenues	371 393	392 507	21 114	367 973	390 039	22 066	-3 420	-2 468
VAT	185 400	200 150	14 750	182 000	196 500	14 500	-3 400	-3 650
Excise	71 493	74 905	3 412	71 889	75 083	3 194	396	178
Gambling tax	2 216	2 559	343	2 320	2 660	340	104	101
CIT	40 280	41 800	1 520	40 300	42 000	1 700	20	200
PIT	65 815	66 515	700	65 275	66 555	1 280	-540	40
Mining tax	1 500	1 700	200	1 500	1 700	200	0	0
Bank tax	4 689	4 878	189	4 689	4 878	189	0	0
Retail sales tax	0	0	0	0	663	663	0	663
2. Non-tax revenues	30 768	34 631	3 863	31 768	42 960	11 191	1 000	8 328
Dividends	3 517	1 475	-2 042	3 517	1 546	-1 971	0	71
Payment from NBP profit	0	0	0	0	7 163	7 163	0	7 163
Custom duties	4 488	4 680	192	4 488	4 680	192	0	0
Budgetary units revenues and other non-tax revenues	20 170	25 538	5 369	21 170	26 633	5 463	1 000	1 094
Payments of local governments	2 593	2 938	345	2 593	2 938	345	0	0
3. Non-refundable funds from the EU and from other sources	2 087	2 342	255	2 087	2 342	255	0	0

Source: Ministry of Finance, Santander

Borrowing needs rise twofold vs 2019

According to the December version of the 2020 budget, in 2019 net borrowing needs amounted to PLN12.6bn, that is PLN2.5bn less than planned in September – despite the higher budget deficit and thanks to more effective liquidity management.

In 2020, net borrowing needs are expected to rise to PLN23.5bn, that is PLN4.1bn more than expected in September. The biggest increase was assumed in the category of “liquidity management in the public sector finances”. We think that higher financing needs related to the first loan for the Solidarity Fund is hidden behind this term.

According to the government assumptions, in 2020 the net issuances on the domestic market will rise substantially (to 46.2bn, twice the amount in 2019) while the nominal value of the FX-bonds outstanding would be reduced (-PLN23bn). When compared to the September draft, planned issuance of fixed-coupon bonds was raised by PLN11bn. In historical terms, the bond issuances should be relatively low (gross financing on the domestic market is expected to reach PLN87.5bn while in 2016-2017 it stood at

cPLN180bn per year). However, the absorption of this amount by Polish financial sector may not be that smooth as is was so far.

Borrowing needs and their financing (PLNmnn)

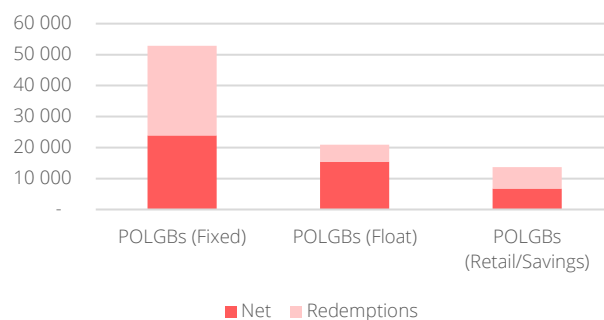
	September draft			December draft			2019 change (3) - (1)	2020 change (4) - (2)
	2019 PR (1)	2020 plan (2)	Difference (2) - (1)	2019 PR (3)	2020 plan (4)	Difference (4) - (3)		
Central budget deficit	11 987	0	-11 987	14 406	0	-14 406	2 419	0
EU funds deficit	6 684	16 954	10 270	6 684	16 954	10 270	0	0
Loans granted	1 058	1 105	47	891	1 889	998	-167	784
Pre-financing from EU	-104	-76	28	-104	-76	28	0	-1
Pre-financing from international institutions	201	1 361	1 160	196	716	520	-5	-645
Liquidity management	-9 811	-	9 811	-14 000	4 000	18 000	-4 189	4 000
Management of EU funds	5 754	56	-5 698	5 754	56	-5 698	0	-
Other	-694	-22	672	-1 250	-22	1 228	-556	-1
TOTAL (net borrowing needs)	15 074	19 378	4 304	12 577	23 517	10 940	-2 498	4 139
Of which:								
1. Domestic financing	31 462	35 539	4 077	26 284	46 386	20 102	-5 178	10 847
1.1 State Treasury debt	26 426	35 539	9 113	21 422	46 210	24 788	-5 004	10 671
1.2 Budget current accounts	5 037	0	-5 037	4 861	175	-4 686	-176	175
2. Foreign financing	-16 388	-16 161	227	-13 707	-22 868	-9 161	2 681	-6 707
2.1 Government bonds	-15 716	-14 766	950	-16 790	-14 790	2 000	-1 074	-24
2.2 Credit received	-963	-1 635	-672	-5 057	-1 230	3 827	-4 094	405
2.3 Cash flow linked to the fx account	291	241	-50	8 139	-6 847	-14 986	7 848	-7 088

Source: Ministry of Finance, Santander

POLGBs issuance in 2020 r. as assumed in the budget draft (PLN mn)

Numbers in PLN mn	Net	Redemptions	Gross
POLGBs (Fixed)	23 963	28 916	52 879
POLGBs (Float)	15 484	5 458	20 942
POLGBs (Retail/Savings)	6 763	6 902	13 665
Total	46 210	41 276	87 486

Source: Ministry of Finance, Santander



Source: Ministry of Finance, Santander

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Additional information is available on request. Please contact Santander Bank Polska S.A. Financial Management Division, Economic Analysis Department, al. Jana Pawła II 17, 00-854 Warsaw, Poland, phone +48 22 534 18 87, email ekonomia@santander.pl, http://www.santander.pl.