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Economic Comment

2022 Budget: deficit under control

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Draft budget for 2022 assumes the central budget deficit at PLN30bn (slightly above 1% of GDP) and the general government deficit at 2.8% of GDP. It seems that the public finance imbalance will be curbed markedly as early as this year, mostly thanks to a fast rebound in revenues (central deficit could be even below PLN13bn and we are expecting the GG deficit at c2.5% of GDP), and the following year can also prove better than assumed in the draft bill, which was based on quite cautious macroeconomic assumptions. The spending rule is effectively enforcing a fiscal consolidation amid high nominal growth of GDP and revenues, even though it was temporarily loosened during the pandemic. This is a positive piece of news for investors and rating agencies.

Government approved [the 2022 budget draft](#). **The macroeconomic assumptions underlying the budget are quite cautious**, in our view, at least compared to current forecasts: both ours and the market consensus. The government is expecting the economy to grow by 4.6% in 2022 after expanding by 4.9% in 2021. Nominal GDP growth was assumed at 7.7%. Private consumption at 5.7%, investment at 6.6% (in real terms). Labour market forecasts include a slight growth of employment and moderately fast wage growth.

Budget deficit ceiling was set at PLN30bn – twice as much as the expected budget realisation in 2021 (PLN13bn), but objectively this is a rather low level of imbalance (near 1% of GDP). Obviously, the central budget deficit is less and less informative about the entire public finance sector, as a major part of spending has been pushed away to special funds and units not covered by the central budget bill.

The General Government deficit in 2022 was assumed at 2.8% of GDP. In our view the actual realisation, similarly as in the previous years, could turn out lower, as revenues, based on conservative macroeconomic assumptions, are likely to surprise to the upside. The government did not reveal its estimates of GG deficit in 2021. The 2021 budget act assumed this number to be at 6% of GDP, but in our view it will actually be much lower. **Our estimates of both 2021 and 2022 GG deficits sit at 2.5% of GDP.** This year's deficit realisation could be, in our view, even better, but we think that the government will not try to push the gap as low as possible, in order to make realisation of 2022 budget a bit easier. Anyway, it looks that the public finance is quickly being disciplined after a temporary deficit rise to 7% of GDP in 2020 and the debt-to-GDP ratio is expected to be slowly declining. For investors and rating agencies this is positive news, and in our view the pace of consolidation is a positive surprise vs earlier expectations.

Main parameters of the budget

	2020 realisation	2021 expected realisation	2022 draft
Revenues (PLNm)	419 796	473 797	475 625
Expenditures (PLNm)	504 776	486 783	505 635
Balance (PLNm)	-84 980	-12 986	-30 010
GG balance (% GDP)	-7,0%	-6,0%*	-2,8%
GG debt (% GDP)	57,5%	56,8%	55,5%

* value from the 2021 budget act – the deficit is highly probable to be markedly lower

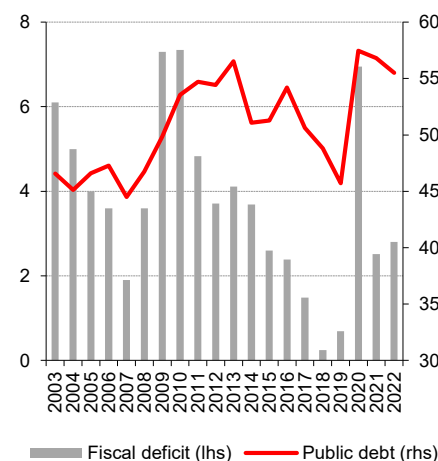
Source: Ministry of Finance, Santander

Macroeconomic forecasts for 2022

	Budget	Bloom berg	Santan der
GDP level, PLN bn	2 722.9	-	2 790.2
GDP growth, %	4.6	5.1	5.0
Consumption, %	5.7	5.4	6.7
CPI inflation, %	3.3	3.5	4.3
Employment, %	0.7	-	2.4
Unemployment, %	5.9	5.5	5.8
Wages, %	6.7	-	7.1

Source: Ministry of Finance, Bloomberg, Santander

General government debt and deficit, % of GDP



Values for 2020 and earlier: actual data

Deficit in 2021: our forecast

Deficit in 2022, debt in 2021 and 2022: 2022 budget bill

Source: Finance Ministry, Eurostat, Santander

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Budget revenues: in line with macro assumptions

2022 budget incomes are planned at PLN475.6bn, which is just 0.6% above the expected realisation for 2021.

A **significant decline in non-tax incomes** (by PLN20.6bn, almost by 40% vs 2021) contributed negatively to a modest total revenue growth. This is because of lower assumptions for NBP profit which is supposed to be smaller (by PLN 8.0bn than this year) as well as lower incomes of budgetary units (by PLN12.9bn less than in 2021). It is worth noting that similar assumptions were made while planning the budget for 2021 and then later on both items turned out much higher than expected. This time, however, generating such a positive surprise from the NBP profit might be difficult. This year's NBP profit will be positively influenced by the weak zloty (we expect 2021 average EURPLN exchange rate near 4.56 vs 4.44 in 2020), and possibly by the FX reserves management during the year, however the QE program works in the opposite direction: we expect that by the end of the year the bond prices will be noticeably lower than the prices at which NBP was purchasing them – as a result NBP might record a loss on this PnL component. Incomes of national budgetary units include revenues from sales of CO₂ emission rights. Because their prices remain in an upward trend, it is possible that the revenues in this category would surprise to the upside. The government has also assumed an increase in custom duties by as much as 16.9% y/y – this is partly a result of keeping EURPLN forecasts at the elevated levels (in 2020 on average 4.54). The forecast for this category seems too high, though: comparing to the budgetary act for 2021, the custom duties are higher by as much as 42% despite stable custom rates (1.03%) and a tiny increase of imports from non-EU countries by just 9%.

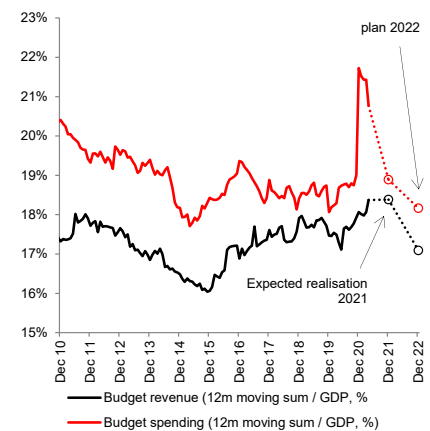
Budget revenues (PLNmn)

	2020 realisation (1)	2021 expected realisation (2)	2022 draft (3)	2022 change (3) - (2)
Budget revenues	419 796	472 797	475 625	2 828
1. Tax revenues	370 262	418 603	440 770	22 167
VAT	184 552	211 000	231 400	20 400
Excise	71 787	74 700	77 800	3 100
Gambling tax	2 338	3 000	3 300	300
CIT	41 293	48 000	51 000	3 000
PIT	63 797	71 275	66 900	-4 375
Mining tax	1 672	3 000	2 200	-800
Bank tax	4 822	5 170	5 400	230
Retail sales tax	0	2 458	2 770	312
2. Non-tax revenues	47 402	52 756	32 110	-20 646
Dividends	469	1 678	899	-779
Payment from NBP profit	7 437	8 877	844	-8 033
Custom duties	4 558	5 373	6 283	910
Budgetary units revenues and other non-tax revenues	32 001	33 682	20 796	-12 886
Payments of local governments	2 937	3 145	3 288	143
3. Non-refundable funds from the EU and from other sources	2 132	2 438	2 746	308

Source: Ministry of Finance, Santander

The tax incomes are supposed to go higher by 5.3%. The key element of the income are the incomes from VAT tax, which are supposed to rise by 9.7%/y/y (+PLN 20.4bn) vs the 2021 expected realisation. If we adjust the growth rate by the assumed by government effects of further improvement in the VAT compliance as well as changes to the VAT act, then the adjusted figure is at 7.7% and in our opinion is pretty realistic especially in the context of macroeconomic forecasts (nominal GDP growth at 7.7%, nominal private consumption growth of 9.2%) – in the periods of accelerated economic growth the VAT

Budget revenue and spending in relation to GDP (12M moving sum, % of GDP)



Source: Ministry of Finance, Santander

incomes usually increase at a faster pace than the tax base. The increase of the CIT incomes is assumed at 6.3%, which is rather a cautious number, while the excise duties are expected to rise by 4.1% (also conservatively). As for the PIT tax the incomes are assumed to fall by 6.1% which is a function of tax changes, especially those assumed in the Polish Deal (Polski Ład) programme, which would take away as much as PLN8.1bn. The PIT change adjusted for the factor is up 5.2% - which is also a conservative figure taking under consideration an increase in the wage bill at 7.4%. It is worth underscoring that the legislation regarding the tax changes proposed in the Polish Deal is still in the making (the final version is not yet known) and in particular the case of health contribution is uncertain. For example, the gradual limiting of the possibility of deducting the health contribution from the PIT tax will remain a downside risk for the PIT tax incomes.

In sum, the 2022 budgetary income plan seems pretty cautious and in our opinion the realized incomes might turn out higher than the assumed ones yet again.

Spending rising slower than GDP

In 2022 the temporary escape clause from the spending rule, introduced in the aftermath of the pandemic, has been applied: the spending limit has been increased by the one third of the discretionary expenditures on fighting effects of the pandemic, estimated at PLN67.1bn. It is worth noting that in 2023 the return to the spending rule in its original formula is likely.

The limit for public spending resulting from the (augmented) spending rule has been set at PLN1058.2bn. The limit of central budget spending is PLN505.6bn, vs. PLN486bn in 2021. **Thus, budget expenditure is rising 3.9%, at much slower pace than nominal GDP.**

The spending category that is rising the most is "various expenditure" (+PLN12.6bn). Within this bucket the biggest rise is in the reserves: to PLN33.4bn from PLN27.0bn in 2021, which includes the new reserve for "systemic changes in education" worth PLN3bn. Also, the EU own funds are to rise PLN1.9bn and the general subsidy for local governments is planned to rise PLN1.5bn. It is worth noting that the total subsidies for local governments go up to PLN207.0bn from PLN203.9bn in 2021, i.e. by mere 1.5% - much slower than the total budget expenditure. Also, we did not find any sign of the investment subsidy for local governments, which has been promised in the Polish Deal programme to compensate for the PIT losses.

Spending on national defence is rising by PLN5.5bn, including PLN4.8bn on the purchase of new tanks (the whole program in 2021-2026 will cost PLN23.3bn). Spending on family is up by PLN3.5bn, including PLN3.2bn on new child benefit (Rodzinny Kapitał Opiekuńczy). Spending on higher education, agriculture, public administration, transport and communication is also rising.

Lower expenditure was planned in social insurance category (-PLN12.4bn). The subsidy for FUS (social security fund) goes down to PLN44.7bn from PLN59.5bn in 2021 budget bill. It should be noted that the FUS spending is rising to PLN304.6bn from PLN282.4bn in 2021, and reduction of subsidy is possible due to the assumed higher contributions: PLN245.8bn vs PLN204.1bn in 2021. The budget does not include plans of Open Pension Funds (OFE) liquidation, which was earlier mulled by the government. Expenditure of the Solidarity Fund is also planned at a lower level (PLN21.6bn vs PLN33.4bn in 2021). We think it implies that in 2022 there were no funds planned for the so-called "14th pension". The debt servicing cost was estimated at PLN2bn lower level than in 2021.

Budget expenditures by economic groups (PLNm)

	2020 realisation (1)	2021 expected realisation (2)	2022 draft (3)	2022 change (3) - (2)
Budget expenditures	504 776	486 784	505 635	18 851
Grants and subsidies	295 768	272 213	266 517	-5 696
Transfers to households	26 413	28 645	34 389	5 744
Current expenditure of budgetary units	85 438	93 634	105 756	12 122
Capital expenditure	33 396	23 889	28 590	4 701
Debt servicing	23 900	28 000	26 000	-2 000
Contribution to the EU	24 828	28 520	30 376	1 856
Co-financing of EU funds-based projects	9 634	11 883	14 007	2 124

Source: Ministry of Finance, Santander

Budget expenditures in 2022 by sections (PLNm)

	2021 (1)	2022 (2)	change (2) - (1)
Budget expenditures	486 784	505 635	18 851
Agriculture and hunting	5 876	7 616	1 740
Forestry	13	22	9
Fisheries	114	143	29
Mining	409	385	-24
Manufacturing	1 050	1 373	323
Trade	469	559	90
Hotels/restaurants	20	20	0
Transport, Communication	8 862	10 206	1 344
Tourism	62	62	0
Housing	416	469	53
Services	518	545	27
IT	23	23	0
Higher education	25 450	27 261	1 811
Public administration	16 396	17 840	1 444
Offices of supreme state authorities, control and protection of law and the judiciary	2 753	3 064	311
Defence	42 179	47 656	5 477
Social security	103 741	91 371	-12 370
National security and fire protection	16 812	17 966	1 154
Justice	15 787	17 281	1 494
Debt servicing	28 000	26 000	-2 000
Various expenditures	125 613	138 231	12 618
Education	2 429	2 547	118
Health	20 128	21 025	897
Social aid	4 185	4 208	23
Other tasks of social policy	1 568	1 497	-71
Educational care	152	162	10
Family	58 769	62 297	3 528
Communal services and environment protection	1 568	1 659	91
Culture and heritage protection	3 136	3 539	403
Botanical and zoological gardens, areas and items of nature protection	112	157	45
Physical education	288	453	165

Source: Ministry of Finance, Santander

As regards spending by economic groups, the increase is planned in capital expenditure (by PLN4.7bn, including PLN2.8bn on national defence, PLN0.8bn on healthcare, PLN0.5bn on transport and communication), in current spending (by PLN12.1bn and the rise is seen in many categories, the biggest in healthcare by PLN2.4bn and national defence by PLN2.3bn) and on transfers to households (by PLN5.4bn, including PLN4.4bn in family category).

Borrowing needs

Net borrowings needs for 2022 are expected at PLN48.5bn, by about PLN25bn more than this year's expected realisation. The lion share (PLN40.4bn) is located in domestic financing (T-bond issuance). Gross issuances are expected at PLN169.6bn and redemptions at PLN129.2. Foreign financing is planned at PLN8.0bn, mostly with use of SURE loans (EU instrument dedicated for labour market protections). Positive contribution is also secured by cash flows on FX accounts and a negative by foreign bonds redemptions. The 2021 borrowing needs have been already fully covered, so after September (only two switching auctions were planned for this month), any net bond issuance will be prefinancing the 2022 needs.

A more detailed look into PLN40.4bn net in T-bond financing shows that the Ministry is not planning to use T-bills anymore. The most considerable increase versus 2021 expected realisation is planned in fixed-coupon bonds: by PLN22.7bn to PLN11.7bn net. Net issuance of floaters will remain more or less stable at PLN16.0bn. Net retail bond issuance was set at PLN12.4bn, by PLN4.3bn lower than expected realisation in 2021.

Borrowing needs and their financing (PLNm)

	2021 act (1)	2021 expected realisation (2)	2022 draft (3)	2022-21 change (3) - (2)
Central budget deficit	82 300	12 987	30 010	17 023
EU funds deficit	6 865	6 138	10 222	4 084
Loans granted	691	558	1 124	566
Pre-financing from EU	65	65	69	4
Pre-financing from international institutions	1 723	1 568	1 770	202
Liquidity management	21 900	-5 600	5 300	10 900
Management of EU funds	6	-8 806	-3	-8 809
Other	-19	-997	-18	979
TOTAL (net borrowing needs)	113 531	23 525	48 474	24 949
Of which:				
1. Domestic financing	77 782	26 186	40 406	14 220
1.1 State Treasury debt	77 782	9 864	40 406	30 542
1.2 Budget current accounts	0	16 321	0	-16 321
2. Foreign financing	35 748	-2 661	8 066	10 727
2.1 Government bonds	-9 062	-31 649	-16 060	15 589
2.2 Credit received	33	- 4 891	-1 550	3 341
2.3 SURE credit	31 181	32 899	13 620	-19 279
2.4 Cash flow linked to the fx account	13 596	981	12 056	11 075

Source: Ministry of Finance, Santander

POLGB issuance in 2022 assumed in the draft budget (PLNm)

	Plan for 2022			Expected	Change (2022 -
	Net	Redemptions	Gross	realisation 2021	PER 2021)
T-bills	0	0	0	-10 844	10 844
POLGBs (fixed coupon)	11 701	83 486	95 187	-11 035	22 736
POLGBs (floating coupon)	16 263	31 366	47 629	15 007	1 256
POLGBs (retail/savings)	12 442	14 354	26 796	16 736	- 4 294
Total	40 406	129 206	169 612	9 864	30 542

Source: Ministry of Finance, Santander

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