04 September 2024

Economic Comment

2025 Budget: Kicking consolidation down the road

The draft budget for 2025 shows a continuation of expansionary fiscal policy, leading to a rapid increase in public debt and high borrowing needs. What is noteworthy is not so much the record-high state budget deficit (PLN289bn), which is incomparable to previous years due to the shifts in revenues and expenditures within the public finance sector, but the balance of the entire general government sector (GG), which is planned at -5.5% of GDP in 2025 (c. PLN219bn) compared to -5.7% of GDP this year (previously planned to be -5.1% of GDP in 2024). The macro assumptions have been changed to less cautious, and the forecast of tax revenues is optimistic, which means that – as in the case of the project from a year ago – we see a risk that the implementation of the budget will be worse than planned.

A loose fiscal policy should, first of all, be supportive for economic growth, secondly, be less supportive for containing inflation, thus discouraging the central bank from rapid interest rate cuts, and thirdly, it may be worrying for rating agencies, which have pointed to the dangerously fast debt increase even before.

Poland is entering the excessive deficit procedure (EDP), which suggests that after 2025 the fiscal consolidation should accelerate, in order to bring the deficit to 3% of GDP. However, the deficit reduction in the following years may be hindered by high military spending from previous years, impacting the GG balance with a delay (along with the actual supply of equipment), and by the next election campaign before the parliamentary elections in 2027.

Public debt (in EU definition) is expected to rise to 59.8% of GDP in 2025 from 54.6% of GDP this year, so Poland will be on the edge of the 60% of GDP threshold resulting from the EU's fiscal criteria. The budget's borrowing needs will grow to a record level of PLN553bn gross and PLN367bn net. The latter should be adjusted down by PLN60bn due to the repayment of PFR and BGK debt by the budget and up by PLN27bn due to the redemption of bonds from the NBP portfolio – in total, after such an adjustment, the planned net issue of local currency market debt securities is to be 60% higher than this year. However, financing large borrowing needs, as in previous years, should not be a big problem, and investor demand should be supported by the looming prospect of interest rate cuts and a rapid increase in the excess liquidity of the domestic banking sector.

The government has approved a draft budget act for 2025 with a state budget deficit at exceptionally high level of PLN289bn (equivalent to c.7.3% of GDP), compared to PLN184bn of the plan for 2024. However, the very strong increase in the central deficit is to a large extent the result of structural changes – shifts in revenues and expenditures within the public finance sector, including the repayment of PFR and BGK bonds by the state budget (approx. PLN63bn in total) and the effects of the reform of local governments' financing, increasing the budget deficit by PLN24.8bn. As a result, comparing directly next year's budget deficit with previous years makes little sense, as does assessing the state of public finances on its basis. **In both cases, the balance of the entire general government sector (GG) is much more useful, which according to the document is expected to reach -5.5% of GDP in 2025 (c.PLN219bn) compared to -5.7% of GDP forecast for 2024.**

Main budget parameters

	2023 realisation	2024 expected realisation	2025 draft
Revenues (PLNmn)	573 958	642 381	632 618
Expenditure (PLNmn)	659 586	826 381*	921 618
Balance (PLNmn)	**-85 629**	**-184 000**	**-289 000**
GG balance (% GDP)	**-5.1%**	**-5.7%****	**-5.5%**
GG debt (% GDP)	**49.6%**	**54.6%**	**59.8%**

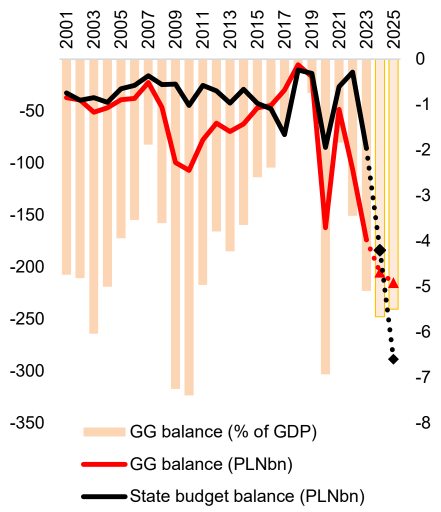
*Source: Ministry of Finance, Santander, * Value from 2024 Budget Law adjusted for the expected realisation of revenues and deficit, ** Value given by the Minister of Finance during the press conference on 28.08.2024.*

Macroeconomic forecasts for 2025

	Budget	Bloomberg	Santander
GDP level, PLN bn	3973.1	-	3912.6
GDP growth, %	3.9	3.8	3.5
Consumption, %	4.3	3.5	2.9
CPI inflation, %	5.0	4.5	5.1
Employment, %	0.4	-	0.4
Unemployment, %	4.9	4.9	4.9
Wages, %	7.1	-	7.8

Source: Finance Ministry, Bloomberg, Santander

Central budget and General Government balance



Source: Finance Ministry, Eurostat, Santander

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An analysis of the draft budget leads us to several observations:

(1) This year's fiscal balance will be significantly worse than the previously planned 5.1% of GDP, which is actually what we have expected (although on a slightly smaller scale). Around 0.2pp of the difference can be attributed to lower nominal GDP forecast, the rest to new spending, not included in the budget act. **The government does not rule out the need to amend the 2024 budget** due to the shortfall of c.PLN40bn on the revenue side, but does not assume an amendment in the baseline scenario, hoping to generate savings on the expenditure side by the end of the year. If the amendment is indeed necessary, the fiscal deficit in 2024 would become even larger.

(2) The scale of the deficit reduction in 2025 is surprisingly modest – until recently, the forecasts of the EC, rating agencies and analysts assumed consolidation by at least 0.5 pp.

(3) … Which can be partly attributed to the increase in spending on national defence, and partly to other new spending (incl. "active parent" program, widow's pension, more money for healthcare). Military spending will grow strongly in 2025 from 4.3% to 4.7% of GDP, but mainly in cash terms, which is reflected in the state budget deficit and the increase in debt. Yet, after adjustment for the value of equipment, which will be delivered after 2025, they increase from 3.0% to 3.2% of GDP, so they add c.0.2pp more to the GG deficit than in 2024.

(4) We again see the risk that the actual budget performance during the year will be worse than the forecast from the budget draft. Until the Covid-19 pandemic, the rule was that budget outcomes were better than planned in the budget laws. However, in the last few years, the final deficit has been 0.6-0.7% of GDP larger than the original plan. It seems to us that this is due to two issues: less conservatism in the adopted macroeconomic assumptions and the change in the budget planning process introduced last year to include a correction for the so-called "natural savings" on the expenditure side.

Therefore, the draft budget indicates the continuation of expansionary fiscal policy (the deficit above 5% of GDP for the third year in a row), leading to a rapid increase in public debt and high borrowing needs. Such a policy should, firstly, support economic growth, secondly, it may make it more difficult to stop inflation and thus discourage the central bank from quick interest rate cuts, and thirdly, it may raise worries of rating agencies, which have pointed to the high deficit and dangerously fast growth of debt even before. **However, we do not expect to see any negative rating action against Poland anytime soon**.

Forecasts of GG balance and public debt acc. to various documents and institutions (% GDP)

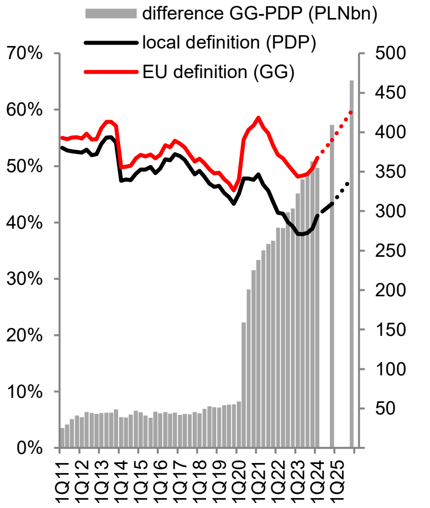
	GG balance		Public debt	
	2024	2025	2024	2025
Budget draft 2025	**-5.7**	**-5.5**	**54.6**	**59.8**
Multiannual Fin. Plan 2024-2027	-5.1	-4.4	53.4	57.3
EC, May 2024	-5.4	-4.6	53.7	57.7
Fitch, May 2024	-5.3	-4.8	53.2	55.5
S&P, May 2024	-5.1	-4.3	51.2	52.4
Moody's, Mar 2024	-5.1	-4.2	53.9	55.1
Bloomberg median, Aug 2024	-5.3	-4.5	-	-

Source: MF, EC, Bloomberg, rating agencies

It seems rational to assume that **in the coming years Poland will have to increase the pace of fiscal consolidation** due to the fact that it has been placed under the excessive deficit procedure (EDP). The draft budget for 2025 does not take into account the recommendations from the EU on the expenditure reduction path, as these have not yet been approved. In the fourth quarter, Poland is to present a medium-term budgetary plan, in which it is to show the path of the excessive deficit reduction and the most important reforms related to it. The Minister of Finance suggested at a press conference that he was inclined towards Poland adopting a 4-year path of reducing the to 3% of GDP. However, rapid consolidation in the coming years may be hindered by high military spending from previous years, which will appear in the GG balance with a delay (along with the actual delivery of the equipment).

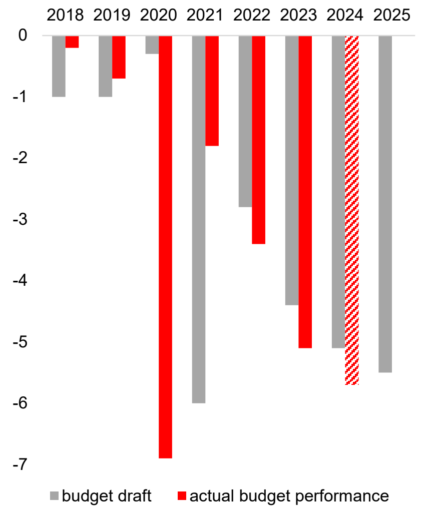
Public debt measured according to the EU definition is expected to increase to 59.8% of GDP in 2025 from 54.6% of GDP this year. Next year, Poland will therefore be at the brink of the 60% of GDP threshold resulting from the EU fiscal criteria. Debt measured according to the national methodology is to increase to 47.9% of GDP from 43.3% of GDP expected in 2024. This is still clearly below the fiscal prudence threshold of 55% of GDP, resulting from the Public Finance Act.

Public debt according to domestic methodology (PDP) and EU's general government (GG), as % of GDP



Source: Finance Ministry, Santander

GG balance shown in budget drafts vs. actual budget performance (% GDP)



For 2024, MF's expected budget realisation was used instead of actual performance
Source: Finance Ministry, EC, Santander

The difference between the value of debt in the two definitions grows next year to a record PLN470bn, which means an increase in the debt of off-budget funds by about PLN63bn. Most of it can be attributed to the financing of the Armed Forces Support Fund (FWSZ).

Macroeconomic assumptions – in line with the consensus, but are they prudent?

The macroeconomic assumptions presented in the draft budget act differ from those adopted by the government in June. However, the direction and the size of the revision are in line with the shift in the market expectations for 2025 which has taken place in the meantime. The Ministry of Finance increased its forecast of 2025 GDP growth from 3.7% to 3.9%. Between the end of May and the end of August, the median market forecast (according to Bloomberg) changed from 3.5% to 3.8%, and our forecast remained at 3.5%. The median market forecast for the euro area remained at 1.4%, and in the case of Germany, it fell from 1.2% to 1.0%.

Given the prolonged stagnation in Germany, we view the revision of forecasts made by the Ministry of Finance as not very cautious. On the other hand, the revisions made by the Ministry are supported by the latest data on GDP in 2Q, as well as their structure, which look solid and allow to argue that the Polish economy is resilient to the economic problems of the euro area. Moreover, next year's economic recovery is to be based, both in our opinion and according to the Ministry of Finance, on an acceleration of investments based on EU funds, and the government may have a better insight in this matter than we do. Growth is also expected to be supported by private consumption, which is projected to continue its rapid growth. It is noteworthy in this respect that the Ministry of Finance revised downwards the investment forecast for both 2024 (from 2.9% to 0.4%) and 2025 (from 10.2% to 6.4%), while raising the forecasts for private consumption from around 3.5% to over 4% in both years and increasing that of public consumption. We doubt that the pace of growth of over 4% will be sustainable for private consumption next year, given that real incomes will grow more slowly. The Ministry of Finance revised downwards the growth rate of employment in the national economy projected for 2025 by 0.3 pp, as well as that of real wages by 0.9 pp to 2.0% (although the Ministry simultaneously increased the rate of wage growth projected for 2024 from 6.4% to 9.2%). The increase of the economic growth forecast was also supported by a larger downward revision of imports than exports. For 2024, the Ministry of Finance maintained a GDP forecast of 3.1%, more or less consistent with our estimate and the market consensus of 3.0%.

CPI inflation was assumed to average 3.7% this year and 5.0% next year. Compared to the June document, the average for 2024 has been moved down by 1.5 pp, and next year's by 0.9 pp. Both numbers are close to our forecasts, and the direction of their revision is consistent with the evolution of the market consensus. The market expects average inflation to equal 3.7% this year (in May, the consensus stood at 3.9%), and 4.5% next year (in May: 4.0%). Next year's inflation rate will be largely determined by the solutions adopted by the government with regard to energy prices. The draft budget only mentions "possible actions taken in the field of economic policy". In our forecast, which is close to that from the draft budget act, we assume that energy prices will increase in January by c. 1%, which could be achieved by restoring the power surcharge, keeping the remaining components of electricity bills unchanged, introducing a slight reduction of the gas tariff, as well as through a further gradual adjustment of heat prices upwards to the new limit. It seems, therefore, that the government is thinking about further control of energy prices, although perhaps not about their full freeze.

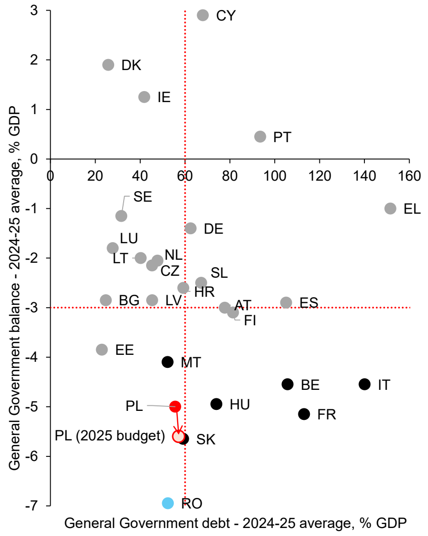
Budget revenues: too optimistic

2025 budget revenues in 2025 were assumed at PLN632.6bn, i.e. 1.5% less than in 2024. **In our opinion, the forecasts for PIT and VAT revenues are too optimistic, which raises a risk of PLN10-20bn for the central budget and PLN15-30bn for public finances in general**.

It is worth noting that the Ministry of Finance has strongly **revised its expectations regarding budget revenues in the current year**. Currently, they are expected at PLN632.4bn compared to PLN682.4bn in the Budget Act. The downward adjustment was applied mainly to VAT revenues (PLN17.1bn), CIT revenues (PLN8.5bn), revenues of state budget entities (PLN6.3bn), NBP profit (PLN6.0bn) and customs duty (PLN1.8bn). In our view, there is still room for a downward revision of these forecasts, especially in the case of VAT.

The decrease in budget revenues in 2025 compared to 2024 is mainly the result of the planned reform of local government revenues (we estimate that it subtracts about PLN95bn from central budget revenues), which is intended, among other things, to increase the share of local governments in **PIT** (personal income tax) revenues. In connection with these measures,

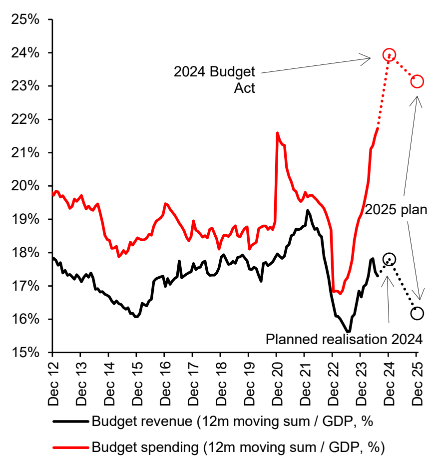
GG debt and balance according to EC forecasts and the 2025 budget draft



In grey – countries not under the EDP
In black – countries under the EDP since 2024
In red – Poland (under the EDP since 2024)
In blue – Romania, under the EDP since 2020

Source: EC, Finance Ministry, Santander

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



Source: Finance Ministry, Santander

central budget revenues from PIT are to decrease to PLN31.2bn from PLN106.7bn in 2024. At the same time, the total amount of PIT revenues of the public finance sector is forecast at PLN205.3bn compared to PLN179.6bn expected in 2024, which means an increase of 14.3%, which in our opinion looks very optimistic compared to the assumed increase in the wage fund by 7.5% (wage growth in the public sector is expected to be 5%) and the pension fund by 9.3%. We would rather expect revenues in the range of PLN190-200bn for the entire GG sector.

VAT revenues were assumed at the level of PLN349.4bn, i.e. 16.7% higher than the planned realisation in 2024. In our opinion, compared to the nominal GDP growth of 9.2% and even assuming that the effective tax rate increases during good economic conditions, this increase is too optimistic. We would rather assume VAT revenues in the range of PLN330-340bn.

Thanks to changes in the system of assigning revenues to local governments, **excise duty** has moved up to the second place in terms of share in total budget revenues. Excise tax revenues are expected to increase by 9.3% or PLN8.4bn. A large part of this increase (approx. PLN6.5bn) is due to the increase in excise duty rates resulting from the 2022 roadmap and the additional increase in rates on tobacco products, which is currently the subject of the legislative process. Therefore, we assess the assumptions regarding this tax as realistic and conservative.

Budget revenues (PLN mn)

	2023 realisation (1)	2024 expected realisation (2)	2025 draft (3)	2025 change (3) - (2)
Total revenues	**573 957**	**642 380**	**632 618**	***-9 763***
1. Tax revenues	**506 866**	**577 414**	**570 545**	***-6 869***
VAT	244 267	299 300	349 400	*50 100*
Excise	84 798	90 311	98 676	*8 365*
Gambling tax	4 475	4 900	5 300	*400*
CIT	67 883	61 500	70 665	*9 165*
PIT	91 665	106 681	31 195	*-75 486*
Mining tax	3 912	3 700	3 500	*- 200*
Bank tax	5 910	6 520	6 910	*390*
Retail sales tax	3 952	4 502	4 897	*395*
2. Non-tax revenues	**63 709**	**61 966**	**57 940**	***-4 027***
Dividends	3 009	4 629	4 791	*162*
Payment from NBP profit	0	0	0	*0*
Custom duties	6 159	6 849	7 541	*692*
Budgetary units revenues and other non-tax revenues	50 859	45 500	45 608	*108*
Payments of local governments	3 680	4 988	0	*-4 989*
3. Non-refundable funds from the EU and from other sources	**3 381**	**3 000**	**4 132**	***1 132***

Source: Finance Ministry, Santander

CIT (corporate income tax) budget revenues are expected to increase by 14.9% and PLN9.2bn. The reform of local government revenues also has an impact on this tax, and the total revenues of the sector are estimated at PLN98.9bn in 2025 compared to PLN87.9bn in 2024, so the increase is 12.5%. This time, double-digit growth does not seem controversial to us. In our opinion, the improvement in the economic situation and results of companies (slightly outlined already in the 2Q24 data) should translate into higher CIT revenues, especially since the statistical base for 2024 will be quite low.

Non-tax revenues are expected to fall to PLN57.9bn from PLN62.0bn, i.e. by 6.5%. This is again primarily the result of the local government reform, as the contribution made by local governments that generated above-average revenues (in 2024 it is expected to be PLN5.0bn) disappears from the budget. For other non-tax revenues, a slight increase was assumed, which we assess as realistic. The bill assumes zero payment from the NBP's profit.

Spending: rising slower than GDP

The expenditure limit set by **the Stabilising Expenditure Rule (SRW)** is PLN1896.4bn, compared to PLN1704.0bn in 2024. In nominal terms, the increase in the expenditure limit sits at 11.3%, and in relation to GDP it increases to 47.7% from 46.8% of GDP. This will be the highest limit compared to GDP since the beginning of the expenditure rule (first applied in the 2015 budget). The expenditure limit excluding local governments, the National Health Fund and other distinguished units amounted to PLN1401.1bn compared to PLN1311.2bn a year earlier.

Budget expenditures are expected to increase to PLN921.6bn from PLN866.4bn in the 2024 Budget Act, i.e. by approx. 6.4%. Compared to GDP, spending will slightly decrease to 23.2% from 23.8% in 2024. On the other hand, if the expenditure for 2025 were adjusted for the effect of the reform of local governments and the repayment of PFR bonds and the difference in subsidies to the COVID-19 Prevention Fund, the expenditures would amount to approx. PLN935bn, i.e. 23.5% of GDP. The increase in budget expenditure is therefore slower than the nominal GDP growth (which, however, cannot be said about the increase in expenditure of the entire GG sector). The 2025 budget is much less generous than the 2024 budget when it comes to supporting consumption: we would like to remind you that the previous one assumed a double-digit indexation of pensions (currently: 5.5%), a high increase in salaries in the public sector (currently: 5.0%) and an increase in the child benefit to PLN800 from PLN500. It all translated into a total of additional PLN100bn for households. In the current budget, these items will add about PLN60bn to personal budgets (including the new "Active Parent" benefits and widow's pension).

According to the breakdown of expenditure by the main economic groups, **current expenditure of budgetary units** grew the most, by PLN16.4bn and 10.4% (PLN173.6bn vs PLN157.2 bn in 2024), including by PLN4.3bn in the "miscellaneous settlements" category (mainly as a result of an increase in the amount for special reserves), by PLN3.2bn in national defence, and by PLN3.2 bn in the judiciary, PLN2.2bn in public security and PLN2.0bn in public administration.

Transfers to households are set to increase to PLN159.0bn from PLN145.3bn, i.e. by PLN13.7 bn or 9.4%. This includes a rise in expenditures on the family to PLN76.6bn from PLN68.4bn, i.e. by PLN8.3bn (the effect of the introduction of the "Active Parent" benefit – PLN8.3bn and additional support benefits in the amount of PLN4.1bn). On the other hand, expenditure on compulsory social insurance was increased to PLN72.9bn from PLN69.1bn, i.e. by PLN3.8 bn. The increase is visible primarily in the "internal affairs" category (PLN2.2bn) and mainly concerns the pension benefits of police officers. PLN62.8bn has been allocated for the 800+ benefit, and PLN31.5bn for the 13th and 14th pensions.

The amount allocated for **grants and subsidies** increases to PLN384.9bn from PLN373.0bn (+PLN11.8bn). The largest increase in this category is visible in the "Debt servicing": to PLN34.7bn from PLN0 in 2024. This is the amount allocated for the redemption of PFR bonds maturing in 2025. In addition, the amount allocated to health care is increasing by PLN10.4 bn. On the other hand, the amount in the "miscellaneous settlements" category is decreasing: to PLN108.5bn from PLN161.1bn. This is caused by a reduction in general subsidies for local governments to PLN49.8bn from PLN117.9bn (the effect of the reform of local government revenues) and an increase in the contribution to the COVID-19 Prevention Fund to PLN28.4bn from PLN12.0bn in 2024 – these are funds intended for the repayment of BGK bonds maturing in 2025.

Debt servicing expenditures are expected to increase to PLN75.5bn from PLN66.5bn this year (+PLN 9.0 billion), i.e. to 1.9% of GDP from 1.8% of GDP. In our view, this is consistent with the growing value of debt in nominal terms with a slight decline in average yields.

Capital expenditure rises to PLN77.4bn from PLN73.2bn (+PLN4.2bn). Including PLN3.4bn in the "miscellaneous settlements" (mainly as part of the special reserve) and PLN1.8bn for transport and communication, including PLN0.9bn for railway infrastructure and for national public roads each. On the other hand, capital expenditure on national defence is slightly decreasing, to PLN51.0bn from PLN51.4bn.

National defence expenditures included in the central budget in section 752 increase to PLN109.6bn from PLN104.6bn (+PLN5.0bn) in 2024, including current expenditure by PLN3.2bn. On the other hand, the total expenditure in the national defence chapter is expected to amount to PLN124.3bn (i.e. including the costs of social security, pensions, etc.) compared to PLN118.1bn in

Budget expenditures in 2025 by sections (PLNmn)

	2024 Budget Act (1)	2025 Draft (2)	change (2) - (1)
Budget expenditures	866 376	921 618	*55 242*
Agriculture and hunting	10 423	10 973	*549*
Forestry	10	8	*-2*
Fisheries	121	137	*16*
Mining	2 379	3 670	*1 291*
Manufacturing	1 742	2 209	*467*
Trade	1 615	1 536	*-79*
Hotels/restaurants	71	61	*-10*
Transport, Communication	19 146	24 878	*5 732*
Tourism	109	111	*2*
Housing	2 616	2 950	*334*
Services	885	940	*55*
IT	140	287	*147*
Higher education	37 967	39 667	*1 700*
Public administration	27 346	29 934	*2 587*
Offices of supreme state authorities, control and protection of law and the judiciary	4 079	4 719	*639*
Defence	104 648	109 613	*4 965*
Social security	169 000	184 061	*15 061*
National security and fire protection	29 563	31 407	*1 843*
Justice	24 531	27 732	*3 201*
Debt servicing	66 500	110 162	*43 662*
Various expenditures	218 581	173 732	*-44 849*
Education	3 699	4 309	*610*
Health	30 721	40 453	*9 732*
Social aid	4 978	5 930	*955*
Other tasks of social policy	5 136	5 337	*201*
Educational care	267	294	*27*
Family	89 175	97 137	*7 962*
Communal services and environment protection	2 447	2 576	*129*
Culture and heritage protection	5 777	5 634	*-143*
Botanical and zoological gardens, areas and items of nature protection	188	228	*40*
Physical education	2 518	932	*-1 585*

Source: Finance Ministry, Santander

2024. **Together with the expenditures of the Armed Forces Support Fund (FWSZ), the expenditures are expected to amount to PLN186.6bn compared to PLN158bn planned for 2024 (an increase of PLN28.6bn) and reach a record level of 4.7% of GDP**. On the other hand, according to the task-based budget, expenditure on external security and the defence of borders increases to PLN107.84bn from PLN103.29bn. Expenditure on the purchase of military equipment is expected to amount to PLN98.1bn compared to PLN81.0bn in 2024. Equipment deliveries are expected to amount to PLN37.5bn compared to PLN31.9bn in 2024 (+17.6% y/y). The latter item translates into investments recorded in national accounts, but most of this expenditure comes from imports, so the effect of this expenditure on GDP is neutral.

Military spending will grow in 2025 from 4.3% to 4.7% of GDP, but mainly in cash terms, and after adjusting for expenditure on equipment that will be delivered in following year, will increase to PLN126.0bn from PLN108.9bn (to 3.2% from 3.0% of GDP). Thus, **higher military spending adds about 0.2 percentage points more to the deficit in GG terms than in 2024.**

The costs of the Social Insurance Fund increase to PLN471.5bn from PLN428.0bn (+PLN43.5bn or 10.2%), including expenditure on pensions to PLN413.9bn from PLN375.2bn (+PLN38.7bn or 10.3%).

Budget expenditures by economic groups (PLNmn)

	2023 realisation (1)	2024 budget act (2)	2025 draft (3)	2025 change (3) - (2)
Budget expenditures	**659 586**	**866 376**	**921 618**	**55 242**
Grants and subsidies	292 774	373 037	384 851	*11 814*
Transfers to households	81 294	145 280	159 013	*13 732*
Current expenditure of budgetary units	122 469	157 206	173 591	*16 385*
Capital expenditure	59 087	73 204	77 354	*4 150*
Debt servicing	61 710	66 500	75 500	*9 000*
Contribution to the EU	30 313	36 460	35 655	*-805*
Co-financing of EU funds-based projects	11 937	14 689	15 655	*966*

Source: Finance Ministry, Santander

The European funds budget includes revenues of PLN109.9bn (compared to PLN88.2bn in 2024), including PLN34.8bn under the Financial Perspective 2021-2027, PLN52.2bn under the Recovery Plan (NRP) and PLN22.8bn under the CAP. Expenditures are expected to amount to PLN137.9bn (compared to PLN120.7bn), including PLN33.0bn for the Perspective, PLN16.7bn for the CAP, and PLN52.2bn for the Recovery Plan. **The budget of European funds is to close with a deficit of about PLN28bn**. It is worth noting that in recent years, the actual balance of European funds has usually been much better than planned in budget acts (in 2023-24, the difference was around PLN20bn). It is possible that next year it will be similar.

Borrowing needs at a new record

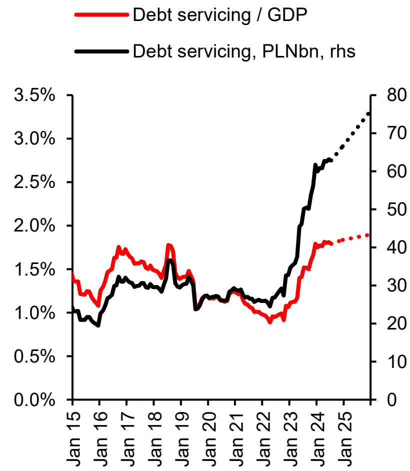
The budget's borrowing needs are growing in 2025 to a record level of PLN553.2bn gross and PLN366.9bn net (by 30% and 70% vs expected levels this year, correspondingly). In relation to GDP, this represents record-high levels of 14.1% and 10.1%, respectively.

Net borrowing needs mainly consist of the central budget deficit (PLN289bn), the deficit of European funds (PLN28bn), plus as much as almost PLN60bn are "loans and credit granted".

In order to assess the actual scale of demand for new funding, the net borrowing needs written in the budget should be adjusted by two factors: (1) down by approx. PLN60bn, i.e. the amount resulting from the repayment by the state budget of the PFR and BGK debt maturing in 2025 (the cost of this repayment for the budget is PLN63.2bn in total, including interest, out of which PLN60bn is the debt repayment). In place of the expiring debt guaranteed by the State Treasury, government debt will be issued, which will potentially find mostly the same buyers, so this can be treated as a "rollover" of debt, not requiring new investor demand. **(2) up by approx. PLN27bn**, i.e. the total value of PFR, BGK and State Treasury bonds, currently remaining on the NBP balance sheet and maturing in 2025 - as the central bank will probably not be interested in rolling them over.

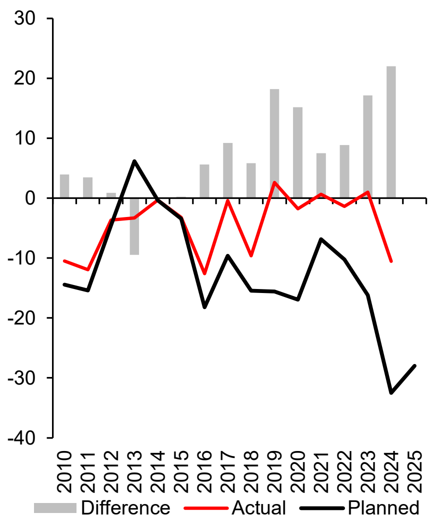
In total: **adjusted net borrowing needs in 2025 are at PLN334bn**, i.e. 55% higher than in 2024.

Debt servicing costs, 12M moving sum



Source: Finance Ministry, Santander

The European funds budget balances, PLN bn



Source: Finance Ministry, Santander

Bonds in the NBP balance sheet maturing in 2025, PLN bn

Series	Nominal value	Coupon payments
PFR0325	4.506	0.073
PS0425	2.288	0.017
FPC0725	3.055	0.038
DS0725	12.299	0.400
PFR0925	5.278	0.086
Total	**27.426**	**0.614**

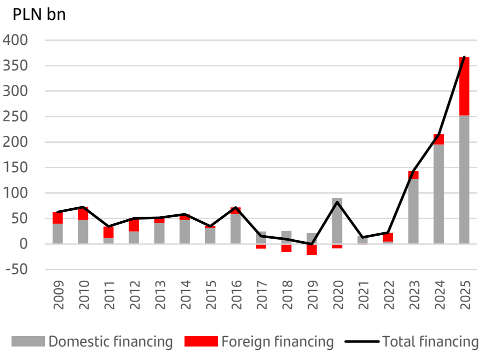
Source: NBP, Santander

Borrowing needs and their financing (PLN mln)

	2024 budget act (1)	2024 expected realisation (2)	2025 draft (3)	2025-24 change (3) - (2)
State budget deficit	184 000	184 000	289 000	*105 000*
EU funds deficit	32 508	10 521	27 985	*17 464*
Loans and advances granted	22 566	18 608	59 986	*41 378*
Pre-financing of tasks from the EU	0	0	-15	*-15*
Payments related to shares in international institutions	1 604	1 675	1 112	*-563*
Liquidity management	0	-12 166	-10 516	*1 650*
European funds management	11 618	13 456	-632	*-14 088*
Other	-24	-443	-26	*417*
Total (net borrowing needs)	**252 272**	**215 651**	**366 893**	***151 242***
Of which:				
1. Domestic financing	148 808	194 876	252 065	*57 189*
1.1 Treasury securities	148 808	150 806	252 065	*101 258*
1.2 Funds on budget accounts	0	44 070	0	*-44 070*
2. Foreign financing	103 463	20 775	114 829	*94 053*
2.1 Treasury bonds	31 013	28 520	42 909	*14 389*
2.2 Loans received	-496	-933	-2 888	*-1 955*
2.3 Loans from SURE	40 015	38 494	25 264	*-13 231*
2.3 Flows related to foreign currency accounts	32 932	-45 306	49 544	*94 850*

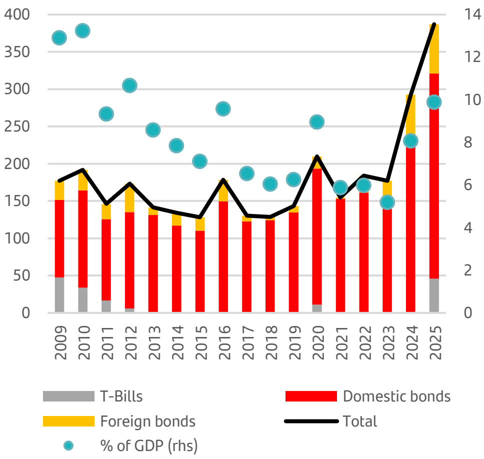
Source: Finance Ministry, Santander

The financing of net borrowing needs, PLN bn



Source: Ministry of Finance, Santander

Issuance by Polish Treasury, PLN bn



Source: Ministry of Finance, Santander

The main source of financing of borrowing needs is to be the record issuance of domestic debt securities worth c. PLN215bn net and PLN321bn gross. Compared to this year's projected issuance value of PLN114bn net and PLN233bn gross, this means an increase of almost 90% and 37%, respectively.

The scale of net Treasury bond issuance, corrected for the two factors mentioned above (repayment of PFR and BGK bonds by the state and maturity of bonds from the NBP portfolio), would be smaller - at **c. PLN180bn**, which is still a record high level (and means an increase of some 60% compared to this year).

The draft budget act assumes an average monthly gross issue of Treasury Securities at the level of approx. PLN27bn, which, under assumption that about 35 auctions would be held as in the current year, would give **c. PLN9-10bn per auction**.

Treasury securities planned issuance 2024-2025 (PLN mn)

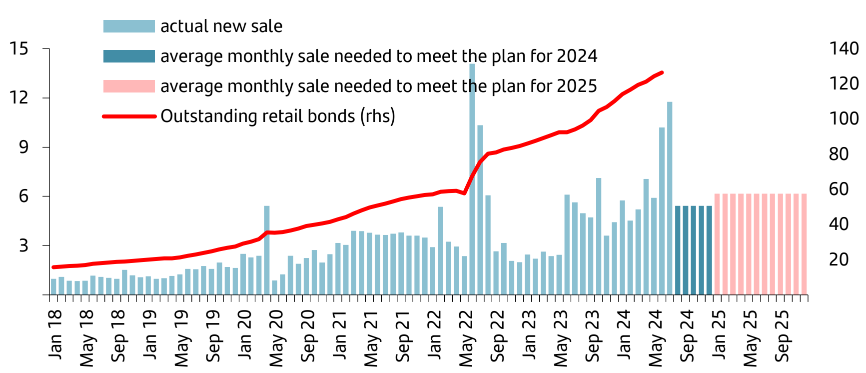
	Net issuance				Gross issuance			
	2024 budget (1)	2024 planned realization (2)	2025 budget draft (3)	2025-24 change (3) - (2)	2024 budget (4)	2024 planned realization (5)	2025 budget draft (6)	2025-24 change (6) - (5)
T-Bills	47 312	0	45 734	*45 734*	47 312	0	45 734	*45 734*
Marketable bonds – fixed coupon	64 594	79 405	106 320	*26 915*	141 437	161 922	191 134	*29 212*
Marketable bonds – floating coupon	22 491	20 568	50 976	*30 407*	50 704	57 853	72 054	*14 201*
Marketable bonds – index-linked	0	13 637	11 825	*-1 811*	0	13 637	11 825	*-1 811*
Retail bonds	14 411	37 197	37 210	*13*	40 817	77 483	73 864	*-3 618*
DOMESTIC Treasuries - SUM	**148 808**	**150 806**	**252 065**	***101 258***	**280 269**	**310 894**	**394 611**	***83 717***
FOREIGN Treasuries - SUM	**31 013**	**28 520**	**42 909**	***14 389***	**62 612**	**59 316**	**66 313**	***6 996***

Source:: Ministry of Finance, Santander

The Ministry of Finance **plans to issue PLN46bn worth of Treasury bills**, just like it used to plan for this year. Whether the ministry actually decides to issue short-term Treasury securities will, in our view, depend on the market situation. This year, the budget act assumed the issuance of T-bills worth PLN47bn, but in the end the Ministry of Finance decided not to use this option due to the satisfactory demand for long-term securities. It is possible that such situation will continue until the end of the year in line with the planned realization of issuance from the budget draft for 2025. Next year, the supply of debt may be large enough to eventually issue at least part of the planned amount of Treasury bills. The potential issuance of T-bills is likely to attract sizeable demand from local banks, which could redirect some of the liquidity invested currently in the short-term NBP bills (as T-bills, in contrast to NBP bills, offer the protection from the banking tax). In case of high demand for bonds, which could be supported by a monetary easing cycle, the supply of T-bills could be correspondingly smaller.

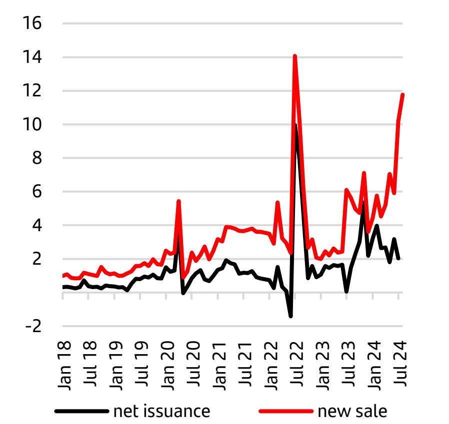
Domestic financing will be complemented by issuance of retail bonds at the net level of PLN37bn and gross value of c. PLN74bn. This means sales of approx. PLN3.1bn and PLN6.2bn on average per month, respectively. This is a similar scale of retail bond issuance as this year and seems realistic. The plan for next year could be jeopardized if the interest rate on retail bonds is reduced to levels much less competitive than interest on bank deposits, along with the expected reduction of interest rates by the NBP. Yet, such scenario does not seem very likely.

Retail bonds sales (PLN bn)



Source: Finance Ministry, Santander

Retail bonds sales (PLN bn)



Source: Ministry of Finance, Santander

Net foreign financing will increase again next year to c. PLN115bn from PLN21bn forecast for 2024, and will include **net bond issuance on foreign markets worth c. PLN43bn compared to almost PLN29bn this year**. After many years of foreign exchange debt reduction, the Ministry of Finance plans to increase it for the second year in a row. The high issuance of foreign currency debt is a response to the demand from both foreign and domestic investors and is partly aimed at reducing the issue of domestic debt, which is already at a record high. Given the high issuance of domestic debt, the share of foreign currency debt in total debt will increase, but will remain relatively low and, according to our estimates, will slightly exceed 25%. In our view, this is still a safe level from the point of view of the rating outlook.

The Ministry of Finance is planning **a loan from the EU under the National Recovery Plan at the level of PLN25bn** compared to PLN38.5bn in 2024. The loans from the NRP will finance the budget item of loans granted by the government to the final recipients of the NRP, present in the budget draft. The amount of loans from the National Recovery Plan for the period 2023-2025 is close to PLN80bn and more or less coincides with the amount of loans granted for the relevant programs in this period.

The Ministry of Finance assumed partial financing of next year's foreign currency borrowing needs (amounting to c. PLN50bn) by utilisation of cash held in government's foreign currency account. This year, the ministry expects inflows on foreign currency account to exceed their utilisation by about PLN45bn, while next year the opposite is assumed – higher use than inflows.

The eventual borrowing needs of the budget may turn out to be lower than assumed if – in accordance with the regularity from previous years – the performance of the European funds budget will be better than expected (in recent years the difference was to the tune of PLN20bn).

Comfort in financing should also be ensured by the high liquidity cushion of the budget (the balance of funds on budget accounts at the end of August this year was +PLN150bn), at least some of which has a chance to be transferred to the next year. According to our estimates, taking into account the redemptions of state debt due by the end of this year (c. PLN40bn), the expected debt issuance in the coming months (c. PLN60-80bn) and the expected increase in the deficit (approx. PLN100bn), at the end of this year the balance of funds on the government accounts may be close to PLN100bn.

Still high demand of local banks, possible return of foreign investors

We estimate that the financing of record high borrowing needs in 2025, as in previous years, should not be a major problem for the government. Investor demand should be supported by, among other things, the looming prospect of interest rate cuts and a rapid increase in excess liquidity in the banking sector.

We assume that domestic banks will expand their government bond portfolios by at least PLN 150 billion. This estimate is based on the assumption of an increase in deposits and total banking sector's balance sheet next year of about 7-10%, partly due to a further increase in the sector's excess liquidity, a further slight increase in the share of Treasury securities in banks' total assets from the current 15.5%, as well as the redemption of BGK and PFR bonds held by banks (around PLN47bn) and the transfer of these funds to government securities.

We think that the **inflow of money to local mutual funds may continue at around PLN30bn** (compared to around PLN22bn for the first seven months of this year), with a slightly larger portion than in the current year going into the domestic debt market.

We assume that in view of the global cycle of interest rate cuts and the upcoming cycle of rate cuts in Poland, **foreign investors may increase their exposure to domestic debt**. This may be supported by relatively low basis swap levels. The start of a positive trend for Polish debt may be indicated by recent data for June and July, which showed a net increase in foreign investors' exposure to domestic Treasury debt of about PLN 13 billion.

Change in domestic government bond holdings, PLN bn (including retail bonds in Households category)

	Banks	NBP	Foreign investors	Mutual funds	Insurers	Households	General government	Others	Total
2016	64.0	0.0	-14.2	3.1	6.9	1.1	4.4	3.3	68.7
2017	8.4	0.0	10.2	6.9	0.8	4.2	2.4	2.8	35.6
2018	20.2	0.0	-11.3	-1.7	5.3	4.1	9.2	9.2	34.9
2019	40.9	0.0	-34.1	12.0	-0.8	7.4	-0.7	-45.3	-20.6
2020	66.9	58.5	-23.6	-18.8	-7.0	13.4	12.6	5.2	107.3
2021	-10.4	28.4	-9.2	-3.3	-1.6	14.4	20.3	-0.1	38.6
2022	-11.7	-8.7	21.6	1.8	3.9	32.8	4.7	2.0	46.5
2023	60.6	-0.7	-17.0	8.0	3.0	13.0	-14.0	10.0	62.9
VI 2024	8.9	0.1	5.0	0.4	0.6	2.2	3.4	0.2	20.8
VII 2024	3.2	-0.6	8.3	3.8	0.1	2.5	-5.2	1.4	13.4
YTD 2024	58.5	-0.5	13.6	6.5	0.6	18.0	-3.6	6.9	100.0
2024F	97.1	-4.5	10.0	8.0	0.0	37.2	-4.0	7.0	150.8
2025F	165.0	-14.6	25.0	20.0	5.0	40.0	7.0	5.0	252.1

Source: Ministry of Finance, Santander forecast

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.