

## Poland: Is the PLN weakness a real constraint for further monetary and fiscal stimuli?

New expansionary monetary and fiscal policies have been introduced in Poland to deal with the current crisis. With limited fiscal space a key question is how much the currency may depreciate



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During the debate in the Senate on 30 March, PM Morawiecki declared that undertaking stronger fiscal and monetary policy measures than currently stipulated could result in an undesirable weakening of the zloty. PM Morawiecki said that further monetization of debt, on the top of what has already announced may backfire through currency weakness or the banking channel. Therefore, the government prefers a flexible approach to crisis management.

We argue that this situation is not a choice but a necessity, as the government overused the fiscal space at the top of the business cycle and is now constrained by a high deficit and borrowing needs. As a coincidence, new social programmes introduced in 2019 help protect incomes during the pandemic. However, social programmes like the extension of the Family 500+ to the first child or introduction of the 13th month pension does not necessarily target those who are in the biggest

need during the pandemic. In the short-term crisis management, the role of active monetary policy is critical. And the NBP makes an active use of its instruments.

## NBP launches unorthodox monetary policy

The central bank launched set of unorthodox monetary policy measures aimed at fighting the coronavirus-related economic crisis: in mid-March, the Monetary Policy Council gave the green light to the National Bank of Poland to buy an unspecified amount of Polish government bonds on the secondary market (de jure these are open market operations, de facto quantitative easing), introduced a facility for commercial banks to refinance new loans to enterprises and households (similar to the ECB's targeted longer-term refinancing operations).

The NBP also launched several tools from its standard toolkit: cut the main reference rate by 50 bp to a record-low 1 percent and narrowed the interest rate corridor by cutting the Lombard rate by 100 bp and keeping the deposit rate unchanged, and extended repo operations. Also, the MPC decided to cut the reserve requirement ratio from 3.5% to 0.5% and remunerate the holdings at the reference rate instead of the depo rate. This change will be effective as of end-April and is to release around PLN40bn of liquidity, giving commercial banks the capacity to buy new bonds to cover spiking borrowing needs. The MPC has also increased remuneration of holdings of the required reserve from the current 0.5% to 1% (the reference rate level instead of the depo rate).

In addition, in order to improve banks' liquidity, the Ministry of Finance lowered the systemic risk buffer (part of capital requirements) and extended the deadline with regard to MREL requirements. Commercial banks committed to introduce credit holidays upon the request of debtors, and several banks followed suit already.

## Government adds an apparently large anti-crisis programme

On the fiscal side, the anti-crisis programme of PLN212bn (around 9% of GDP) was announced, which has just passed through the Parliament and entered into force on 1 April. In its final form, the so-called anti-crisis shield contains (1) new public spending of PLN68bn (3.1% of GDP) and (2) liquidity measures of PLN70bn (3% of GDP, that includes also monetary instruments launched by the NBP). The second part (2) of 3% of GDP also constitute public guarantees and liquidity measures from the national development bank BGK and the Polish Development Fund.

At a closer look at the first part of government's programme (1), out of 3.1% of GDP only 1.7% of GDP are new spending, which should put a burden on the budget and provide direct government support for companies and households.

Given that Poland's public debt reached 43.8% of GDP only at the end of 2019, this amount seems to be low compared to the mounting needs of the corporate sector severely affected by the pandemic. A quick survey of employers' organization Konfederacja Lewiatan suggests that around two-thirds of firms plan to cut jobs during the next two months. A report by the Polish thinktank Cenea suggests that almost one-fifth of Poland's households are at risk of losing their incomes.

The second part of (1) i.e. 1.4% of GDP out of 3.1% of GDP are public investments, which should be either spread over 2020-21 (because their implementation may last too long), or already planned or existing investment should be counted there. That should be Keynesian-type new public investment in infrastructure and development in priority areas, such as digitalization, energy transformation, health care, innovation, etc. The fund has not been established yet, and it will be

difficult to scale up public investment during the pandemic given the organizational, logistical or communication challenges. We assume that only one-half of the proposed amount will be utilized this year.

## Mainly a shortage of public revenues drives the fiscal gap

In our view, the sudden increase of public net borrowing needs in 2020, which we currently estimate at PLN154bn (7% of GDP), up from PLN15bn we projected before the pandemic, will be largely driven by a shortage of cyclical and one-off public revenues. This is because we expect the Polish economy to contract by 4.5% this year and the budgeted one-off extra revenues will largely not materialize.

A painful reality check makes the government very cautious about the new spending programmes as it needs to accommodate a forthcoming huge revenue gap. That seems to be main constraint, preventing a further expansion of the anti-crisis programme, and not the risk of PLN weakening as PM Morawiecki mentioned.

Minister of Digitalization M. Zagorski said that new programmes under the anti-crisis shield should be proposed before Easter, but we do not expect any significant public spending.

## NBP covers a part of high borrowing needs

The introduction of the NBP's QE is of a great assistance in the public debt management. We estimate that out of the projected PLN154bn of net borrowing needs, around PLN40bn will be covered by commercial banks, which should utilise the PLN40bn released when the mandatory reserve requirement ratio is cut at the end of April. An additional PLN30bn may come from the commercial bank deposit base expansion (growing faster than bank credits). Assuming the Ministry of Finance will not rely on international markets or loans from international financial institutions to cover new net borrowing needs, the remaining PLN80bn (3.6% of GDP) will need to be funded indirectly by the NBP. In our view – based on international experiences from the developed market economies or Hungary – these amounts can be financed safely by the NBP. During the 2008 financial crisis, the US Fed intervened with a QE programmes reaching around 9% of GDP, and the latest programmes announced by the Fed or ECB are unlimited or a record high, respectively. During the first three operations the NBP already bought T-bonds totalling jointly PLN19bn and has just scheduled the next two operations in the second half of April.

As we expected, the central bank's decision to expand its balance sheet was positive for the bond market but its impact on PLN was limited. Since the Covid-19 outbreak the PLN has lost 6-7% against the euro, but has outperformed its peer CEE currencies by 2%, where QE is not existent.

In our view, the main goal of NBP QE (Polish government bonds were bought on the OTC market) was to stabilise the T-bonds secondary market and support fiscal measures delivered for the economy. The NBP was successful in reducing the risk of the POLGBs sell-off caused by excessive supply. In the meantime, the NBP opened new channels for market intervention. It organized an ad hoc supplementary auction and purchased T-bonds from the BGK development bank, which were just bought from the Ministry of Finance through a private placement. On 30 March, it joined the Treasury BondSpot Poland, a regulated market trading with fixed-income instruments, and will be able to buy T-bonds on this platform in addition to auctions.

## Limited fiscal space is the main constraint for a bigger fiscal stimulus

NBP as a new big player makes a difference on the T-bonds market, but the weaker zloty can be treated as a limited side effect of this intervention. While proposing any new fiscal measures affecting net borrowing needs in 2020, the government faces a balancing act between the size of borrowing needs expansion and the scale of zloty depreciation. We think the real factor constraining further expansion of the anti-crisis programme is rather limited fiscal space and overusing the fiscal side at the peak of the business cycle. The risk of PLN weakening (as a result of NBP balance sheet expansion) is of secondary importance here. Creating fiscal buffers when the economy was booming would have mitigated this dilemma. Today is the tomorrow you worried about yesterday.

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