Poland: Large QE-backed fiscal stimulus leaves the zloty unaffected

The Polish fiscal stimulus is the largest in Europe and heavily dependent on the central bank's QE measures. Surprisingly, the zloty remains stable against other major and CEE currencies. Market fragmentation and a major share of currency liquidity controlled by MinFin, central bank and state-owned development fund/bank help to explain its strength

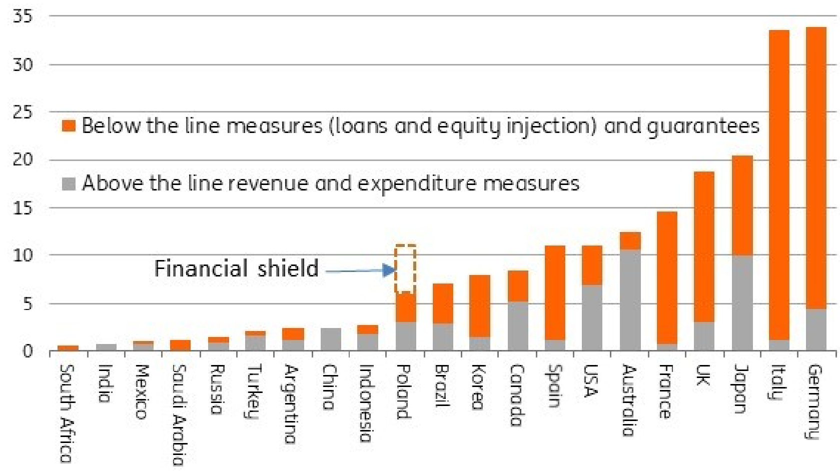
Poland launches the largest fiscal anti-crisis program in Europe

The initial Polish anti-crisis program, called Anti-crisis Shield 1.0, announced in mid-March was modest, amounting to just 6% of GDP.

It covered both above-the-line (direct budget spending) and below-the-line fiscal measures (not burdening budget immediately etc.) in equal proportions. The first included public revenue and expenditure measures, the latter public loans and equity injections and public guarantees. These measures were aimed at protecting jobs and firms' liquidity, and boosting public investment and financing health care. The Polish package was heavily skewed towards micro-enterprises that employ one to nine workers.

Relative to GDP, it put Poland close to the G20 median – between Indonesia and Brazil.

Poland's anti-crisis package as % of GDP in comparison to G20 countries



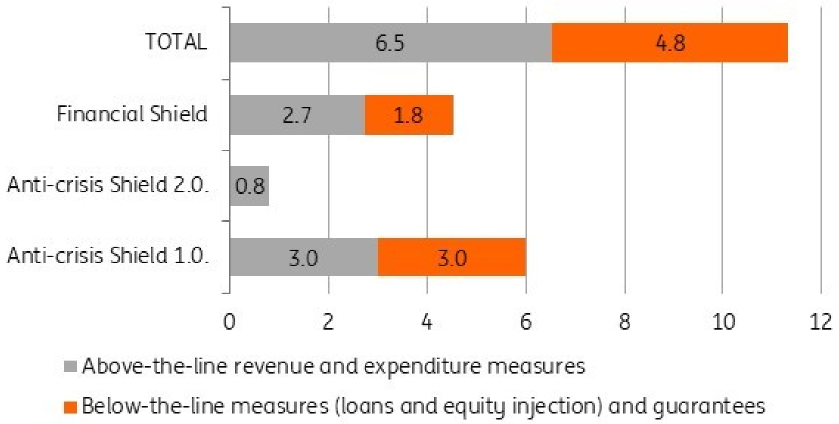
Source: IMF Fiscal Monitor, April 2020, and ING

However, later measures including Shield 2.0. (0.8% of GDP) and in particular, the recently announced financial shield of 4.5% of GDP, increased the size of the package to 11.3% of GDP. It is now comparable to measures undertaken by Spain or the US. Breaking it down, we assumed that public spending amount to 60% of the total value of this program. This is because the liquidity loans to all size enterprises, guaranteed by the Treasury, will be remitted after meeting the required criteria of keeping firms afloat and employment unchanged.

Because we expect that Eurostat will classify the remitted loans as public spending, this amount will increase this year's fiscal gap according to ESA2010. However, they will not be reflected as cash expense in this year's budget but rather spread over 2021 and the next few years, according to the maturity structure of bonds issued by the Polish Development Fund (PFR). Its inaugural issuance of 4-year bonds of PLN16.3bn was placed on 27 April and purchased by local banks.

Poland's central bank cuts rates and raises implicit QE

Poland's anti-crisis shields, as % of GDP



Source: ING estimates

Hence, the discretionary fiscal component of 6.5% of GDP is now the largest in Europe. Only Australia, Japan, and the US announced bigger packages.

Together with other automatic stabilisers on the spending and revenue side and doubtful one-off revenues budgeted for 2020, it will push Poland's fiscal deficit above 11% of GDP and the public debt towards 60% of GDP in 2020, from 46% of GDP only in end 2019 (ESA 2010).

If Eurostat classified the "financial subsidy" of 2.7% of GDP from the shield outside the general government, then the fiscal deficit would amount to around 8.4% of GDP and the debt would hover around 55% of GDP (ESA 2010, the local debt threshold at 55% of GDP is set based on local debt definition).

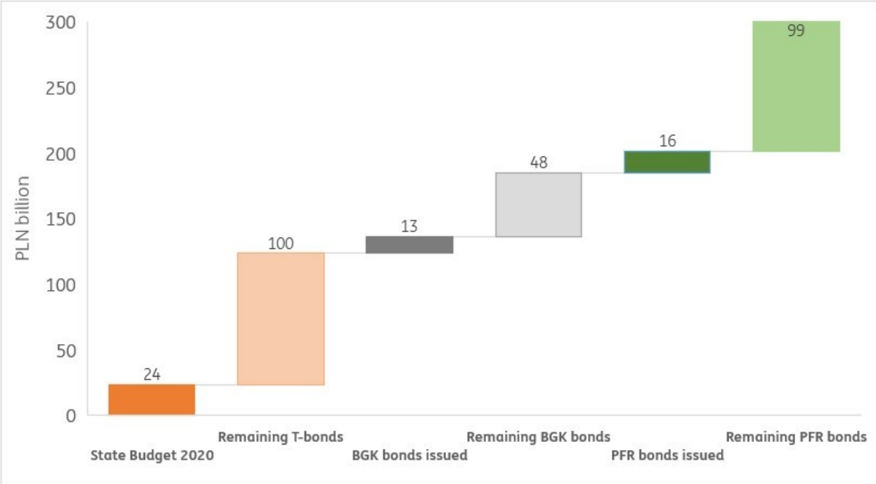
Financing these packages depends on QE

In our macro-fiscal projections, we estimated net borrowing needs of the State Budget to increase from around PLN24bn in the previous 2020 budget bill to PLN185bn now.

But based on the anti-crisis package, state bank BGK will substitute around PLN60bn of the anti-pandemic expenses borrowing needs, and provide financing from its new BGK bonds program. The finance ministry has already secured funding for around 100% of the pre-Covid 19 budget, we expect additional T-bonds of around PLN100bn. On top of this, the Polish development fund is to collect additional PLN115 to fund its financial shield.

In total, we estimate that net borrowing needs of the widely-defined public sector (State Budget + BGK + PFR) should reach PLN300bn. Out of that amount, the domestic banks should cover around PLN70bn. Part of the purchases of domestic banks should be covered from PLN40bn of liquidity released by the cut in mandatory reserve from 3.5% to 0.5% effective from late April.

Poland's public net borrowing needs to reach PLN300bn



Source: ING estimates

But the core funding for the record-high anti-crisis fiscal programme should come from the quantitative easing launched by the National bank of Poland.

The central bank should purchase T-bonds and BGK & PFR bonds, guaranteed by the Treasury, of PLN185-230bn (8.4%-10.4% of GDP). The exact amount will depend on the amounts bought by foreign investors and domestic non-financial investors. On 29 April, the NBP started purchases of BGK & PFR bonds of about PLN12.5bn under its QE program.

We expect the ultimate size of Poland's QE puts it in line with the Federal Reseve's initial QE plans of around 9% of GDP. Through 29 April, NBP purchased T-bonds and bonds guaranteed by the Treasury of PLN68bn already, of which PLN40bn apparently came from the precedent private placements made by the ministry of finance in the state-owned development bank BGK.

The substitution of financing of some pandemic-related expenditures of the Budget by the BGK bonds will reduce the issuance of new T-bonds in 2020. This won't change the deficit figures either in the ESA2010 or domestic methodologies. Also, this will not affect the QE amount to be purchased by the NBP. The central bank will purchase fewer T-bonds but more bonds with T-guarantee. This will result in lower public debt according to the Polish methodology, and reduce the risk of crossing 55% of GDP threshold in 2020-21.

According to the Polish fiscal rules, crossing it triggers painful fiscal adjustments in the following years.

Zloty's stability is positively surprising

Given that the central bank cut interest rates aggressively and launched a large-scale QE, the recent PLN performance is a positive surprise, particularly its stability against the euro and CEE currencies.

Three-month rates are now lower than in Hungary or the Czech Republic despite the central bank's balance sheet expanding pretty quickly.

In our view, the zloty’s strength is driven by external and internal factors. In contrast to other emerging markets, the whole CEE region is perceived positively by investors. The three Visegrad countries have fiscal space and –as net oil importers- benefit from plunging crude oil prices. Emerging market investors are now focused on oil-exporting countries, whose currencies face severe depreciation pressures as cheap oil undermines their growth prospects.

Pre Covid-19, the stellar performance of the Polish economy, sustainable GDP growth, the decline in public debt-to-GDP ratio all support the currency. In this context, the country has fiscal space for a record-high fiscal stimulus (and large QE) in these extraordinary times when many countries struggle to minimise the effects of deep recessions.

But what is concerning is the lack of transparency around QE and its size, which is not officially clear.

Market fragmentation prevents speculative actions

Technical factors are behind the zloty's stability.

Investors might find it difficult to borrow and short the zloty, probably because of the fragmentation of the money market in Poland. The majority of debt issuance and asset purchases are made between the ministry of finance, the state-owned development fund/bank (PRF/BGK) and the central bank, rather than on the open market. The liquidity created in PLN through quantitative easing is in the hands of BGK rather than the interbank market. This makes funding positions against the zloty more difficult which protects the currency.

However, we see a risk that some depreciation pressure on the PLN to emerge in the coming months as the market realises QE is high. The insufficient transparency of financing public borrowing needs might add some risk premium to PLN as well. The negative impact of large QE might result in zloty weakening relative to other CEE currencies or slower PLN recovery when the Polish economy rebounds from the recession.

Therefore, to prevent the side effects of large QE, authorities should schedule a credible exit strategy from this record-high fiscal deficit and QE. Even though this is not possible just yet, given that the second wave of contagion cannot be ruled out. However, as soon as this health crisis comes under control, the extraordinary measures in the macroeconomic policy should be phased out in a healthy economy like Poland.

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