Poland: Spending pledges and the budget impact

The Polish government's spending pledges are higher than expected and while they pose limited risk to the budget in 2019, we worry about 2020 and beyond. After two years of very positive surprises on the fiscal side, there is now more uncertainty and we should end up with quite a different picture. Still the EU threshold, at 3% of GDP, is not under threat so far

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What exactly has the ruling party pledged?

The ruling PiS has announced its spending pledges before the 2019 European and general elections. These include:

- A broadening of the 500+ family support programme to cover first children as well. According to our estimates, this will cost PLN17-18 billion in 2020 and half of that in 2019 as the programme starts midyear.
- 13th pension for retirees (lump-sum PLN1100), paid in 2019 for sure, but possibly also in the following years subject to PiS re-election and fiscal space (yearly costs at about PLN10

billion).

- Cut of personal income tax to zero for young people (below 26). Annual cost at about PLN2-3 billion, to be implemented in 2020.
- Raising of deductible expenses from personal income tax base (cost for budget about PLN4-8 billion), to be implemented in 2020.

We estimate the total cost of the above measures at PLN18 billion in 2019 (0.8% of GDP) and PLN35-40 billion in 2020 (1.7% of GDP, cumulative costs). This is above what we expected (PLN15 billion in 2019 and PLN20 billion in 2020 cumulative). Also PiS wants to provide a more generous package than what was delivered after the 2015 elections, with child benefit and a cut in the pension age costing PLN33 billion).

PLN35-40bn

The fiscal impulse pledged for 2020

Higher than expected

How do we assess the package?

We don't like the fact that three quarters of the package is spent on clear social measures, which are politically effective (supporting PiS's position in the polls), but providing only a transitory boost for GDP (not solving any structural issues). We would prefer to spend three quarters of the package on education or health care or to simply stop the tax system from tightening (more tightening will come when the economy slows to keep the deficit under control). The earlier tightening of the tax system had a very negative impact on private investment, which grew by just 3.5% year-on-year in 2018, below the pace of GDP. As a result, Poland is losing its competitiveness in the region in terms of investment's share of GDP, which undermines long-term growth potential.

Still, the PiS election spending pledges are higher than expected while posing rather moderate risks to budget conditions. We estimate the 2019 public sector deficit at PLN1.6% of GDP and 2020 deficit at PLN2.2-2.5% of GDP.

The fiscal impulse provided should boost GDP by about 0.6% in 2019 and 0.8% in 2020. Thus it shields economic growth in Poland against a potential global slowdown. We see moderate upside risk to our 3.6%YoY GDP forecast for 2019, and 2020 at 2.8%YoY. But the uncertain global picture is the main risk (even after the Trump-Xi agreement we worry about the state of global trade).

How will the financial markets react?

We think the package is neutral for the Polish zloty (PLN) but we expect a further limited widening of the Polish government bond spread over German Bunds as well as the asset swap spread.

PLN suffered recently from a much more dovish bias of the National Bank of Poland than the Czech National Bank and National Bank of Hungary. The fiscal pledges make any rate cuts in 2019-2020 unlikely (in line with our long standing view that we see stable rates until the end of 2020, but possibly cut afterwards).

In terms of the impact on POLGB's, the fiscal picture has changed from very safe to one with higher tail risks.

The near-term outlook for the fiscal side is still safe. The Ministry of Finance has already covered 52% of this year's borrowing needs (effectively more - NBP profits should also be deducted from net borrowing needs) and the 2019 deficit is reasonable (1.6% of GDP). That is why we see a rather limited impact on POLGB's spread over the Bund.

After 2019, however, the picture is more risky. POLGBs may be more sensitive to future signs of slowdown or signals showing that PiS is losing in the polls before elections (European in May 2019 and general in October 2019), which makes further pledges more likely. The momentum on the political scene has changed. The ruling PiS made several mistakes, while the Civic Platform set a coalition of four oppositional parties for European elections, which should provide a turning point in the polls (some of which are showing the coalition above PiS).

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