7 November 2023

Opinion of the Monetary Policy Council on the *2024 Draft Budget Act*

At its meeting on 28 September 2023, the Council of Ministers adopted the *2024 Draft Budget Act*. Pursuant to the Act on Narodowy Bank Polski (Article 23, Journal of Laws 2022, item 2025, consolidated text), the Governor of NBP submits, on behalf of the Monetary Policy Council (MPC), the Council's opinion concerning the draft budget act to the Council of Ministers and the Ministry of Finance.

While drawing up the *Opinion*, the MPC pays particular attention to the macroeconomic assumptions of the *Draft Act*, the expected impact of fiscal policy on the economy, including, in particular, demand growth and the outlook for fiscal sustainability.

As in the previous years, the *Draft Act* covers only some of the revenue and expenditure of the general government sector in ESA2010 terms. From the *Draft Act* and its *Justification*, as well as other acts in force, it follows that some of the government measures implemented in 2023 and planned for 2024 will be financed from extra-budgetary funds. Therefore, in addition to the *Draft Act*, this opinion is based on other documents, including, in particular, regulatory impact assessments of draft laws, as well as NBP estimates and projections of the revenue and expenditure of the general government in ESA2010 terms.

When considering the potential impact of fiscal policy on macroeconomic developments in 2024, it is important to take into consideration that due to the parliamentary elections held on 15 October 2023 and the ongoing process of government formation, the final shape of the fiscal policy to be implemented in 2024 is subject to uncertainty.

I. Macroeconomic assumptions of the *Draft Budget Act*

In the *Justification* to the *2024 Draft Budget Act*, Poland's real GDP growth is assumed to rise to 3.0%, from 0.9% in 2023. According to the macroeconomic assumptions adopted in the *Draft Act*, economic growth in 2024 will be mainly driven by domestic demand, whose

Narodowy Bank Polski ul. Świętokrzyska 11/21 00-919 Warszawa tel. +48 22 185 28 88 sekretariat.rpp@nbp.pl

growth in 2023 will be negative. The *Justification* states that private consumption will rise in 2024 due to the assumed improvement in labour market conditions. At the same time, real household disposable income will be positively affected by the declining inflation. Consumer demand in 2024 will be further supported by the indexation of the child benefit and the increase in the minimum wage. The *Draft Act* assumes that real growth in gross fixed capital formation in 2024 will pick up compared to 2023. According to the *Justification*, investment growth will be primarily supported by public investment. The *Draft Act* also assumes that the change in inventories will have a neutral impact on GDP growth in 2024, and the contribution of net exports will decline, also nearing zero.

In the opinion of NBP, real GDP growth assumed for 2024 is consistent with the path of this variable anticipated by the "Inflation and GDP Projection" from November 2023. On the other hand, GDP growth in the current year may decline by more than assumed in the *Draft Act* due to slower growth in Poland's external economic environment, as envisaged in the November 2023 "Inflation and GDP Projection". This is due to a more severe deterioration in economic activity in euro area countries, as expected in the NBP projection. At the same time, the November inflation and GDP projection envisages a greater cyclical adjustment of inventories by businesses.

The *Draft Act* assumes that average annual consumer inflation in 2024 will decline markedly on its 2023 level and will run at 6.6%. The CPI inflation path assumed in the *Justification* is consistent, in terms of direction of changes, with NBP forecasts, which indicate that the decline in inflation in 2024 will be driven by a fall in all of its main components – core inflation and energy and food price growth. The factors acting to dampen inflation will include weaker demand pressure and the expiry of the impact of the previous powerful cost stimuli stemming, among others, from the Russian armed aggression against Ukraine.

The situation in Poland's economic environment is a risk factor for the scenario assumed in the *Justification*. In this context, the most important risks are those related to economic developments in Poland's main trading partners, including Germany. The economic climate in the environment of the Polish economy may also be affected by the geopolitical situation, among others, through its potential impact on international trade and commodity prices. At the same time, domestic economic developments and the path of inflation processes in 2024 are subject to high uncertainty due to potential fiscal policy adjustments and further developments in the labour market.

NARODOWY BANK POLSKI

II. Situation of public finances in 2023

The starting point for the assessment of the *Draft Act* is the fiscal policy pursued in 2023. In the *Justification* to the *Draft Act* and the autumn fiscal notification, the Ministry of Finance estimates the general government deficit to rise from 3.7% of GDP in 2022, to 5.6% of GDP in 2023, which, in the opinion of NBP, is a realistic forecast. A key determinant of change in the general government balance in 2023 is the economic slowdown observed in 2023, which has translated into weaker tax revenue growth, and hence a deterioration in the cyclical component of the fiscal balance. According to NBP estimates, the extent of this deterioration is close to 1 percentage point of GDP and is the primary source of the expected increase in the general government deficit in ESA terms. In contrast, the estimated structural deficit of the general government has been expanding at a moderate rate, with interest payments accounting for the bulk of the increase. This in turn means that the estimated primary structural deficit in 2023 remains at a level similar to the previous year.

The level of the 2023 general government balance described above is the result of a range of fiscal policy adjustments, some of which act to improve the balance, while others worsen it. The first group includes lower than in 2022 costs of the protective measures launched in connection with the extraordinary growth in commodity prices, in particular energy prices (the so-called Anti-Inflation Shield). In 2022, those measures included, among others, reductions in VAT rates on electricity, fuels and food, subsidies on natural gas prices, payment of energy and heating cost allowances, coal allowances and support for farmers. According to NBP estimates, their total cost amounted to 1.9% of GDP. In 2023, VAT rates returned to their previous levels (except for the VAT rate on staple foods), and the main instrument mitigating price growth are electricity and natural gas price subsidies, with these expenses being partly financed by write-offs by energy and gas producers. The net cost of these measures can be estimated at 1.1% of GDP. The absence of one-off resolution costs incurred by the Bank Guarantee Fund in 2022 (0.2% of GDP) is another factor acting towards an improvement of the general government balance.

On the other hand, the reduction in the lower personal income tax rate in mid-2022, which resulted in high refunds during the annual settlement of this tax for 2022, will work towards a higher deficit in 2023. As a result of these changes, total PIT receipts in 2023 can be estimated at around 0.2 percentage points of GDP less than a year earlier. On the expenditure side of public finance, there is a marked growth in old age and disability pensions (of approx. 0.6 percentage points of GDP), as a result of a high indexation of benefits (a rise of 14.8%) and the Council of Ministers' decision to increase the amount of the so-called 14th pension in 2023.

III. Fiscal policy in 2024

The issue of extension of the shielding measures aimed to protect businesses against the impact of the steep growth in energy and food prices (the so-called Anti-Inflation Shield) is a substantial source of uncertainty related to fiscal policy in 2024.

It can be concluded from the provisions of the *Draft Act* and the *Justification* that the *Draft* assumes the termination of the main measures comprising the Anti-Inflation Shield at the end of 2023. The lower VAT rate on basic foodstuffs, reduced in 2022 from 5% to 0%, is still in force in 2023. The *Draft Act* does not provide information on a potential extension of this reduction to 2024, but the assumed increase of 20.4% in the VAT income in 2024 takes into account – according to the statements by the Ministry of Finance officials – the restoration of the previous rate. Given that according to the NBP projection the nominal growth of private consumption (which constitutes the bulk of the VAT tax base) is to stand at 8.9% y/y, even including the higher VAT rate on food, which could boost VAT revenue growth by approx. 4 percentage points, it may be difficult for this forecast to be fulfilled. The *Justification* to the *Draft Act* indicates that the VAT revenue forecast takes into account the positive impact of the measures contained in the Act of 16 June 2023 amending the Act on Goods and Services Tax and some other acts (Journal of Laws, item 1598), introducing regulations concerning compulsory invoicing in the National e-Invoice System. Those changes should be conducive to an increase in tax discipline, yet taking into account the significant narrowing of the so-called VAT gap, the scale of further improvement in tax collection in the years 2016-2018 is uncertain.

Alongside the above-mentioned VAT reduction, the other key element of the Anti-Inflation Shield in 2023 are the subsidies on electricity and natural gas prices for households and other selected entities. According to the acts introducing these measures, these will remain in force until the end of 2023. Although the situation in the markets for energy commodities has stabilised this year, market prices of electricity remain significantly above the levels observed before the onset of the Russian armed invasion of Ukraine. Consequently, it cannot be ruled out that in order to avoid a sudden leap in household tariffs, the measures mentioned above will continue into 2024. However, no legislative work on a potential extension of the measures in force for 2023 has begun as yet, nor is there any reference to it in the *2024 Draft Budget Act*.

The expiry of the above measures would act significantly towards an improvement in the general government balance in 2024 – as mentioned above, the net cost of these measures in 2023 can be estimated at around 1.1% of GDP.

Another factor which, according to the provisions of the *Draft Act*, will have a downward effect on the headline deficit in 2024 is changes in the level of personal income tax receipts. This is because the one-off effect of high tax returns observed in the course of the annual settlement of the 2022 tax is to expire and – with tax brackets remaining unchanged – the effective tax rate will rise. According to NBP estimates, in sum this will contribute to an increase in the sector's revenue of at least 0.6 percentage points of GDP in 2024.

On the other hand, the sector's 2024 deficit will be boosted by the changes in the expenditure on social benefits in cash. According to NBP estimates, the ratio of this expenditure to GDP will rise by 1.0 percentage point in 2024. The increase will be driven mainly by the rise in the child benefit from PLN 500 to PLN 800, which will raise the abovementioned ratio by approx. 0.6 percentage points of GDP. Moreover, amid the expected disinflation, the indexation rate of old age and disability pensions in 2024 will be higher than the projected inflation, as well as the expected nominal GDP growth. As a result, spending on pensions will contribute to an increase in the above-mentioned expenditure of around 0.3 percentage points of GDP.

The next category of public expenditure to put upward pressure on the sector's deficit is compensation of employees. The amount of spending on remuneration in the central government sector envisaged in the *Draft Act* is 13.4% higher than in the *2023 Budget Act* as amended. Based on the provisions of the *Draft Act*, according to NBP estimates the sector's expenditure on wages and related expenses will rise by 0.3 percentage points of GDP.

In line with NBP forecasts, the remaining categories of revenue and expenditure of the general government will not be subject to any significant changes in 2024. At the same time, it can be estimated that the impact of the economic cycle on the size of the fiscal balance will be limited, but still negative.

To sum up all the changes described above, assuming that the *Draft Act* adopted by the government is implemented and that the protective fiscal measures launched in 2022-2023 in response to external price shocks expire, the general government deficit can be expected to decline in relation to GDP, including in structural terms.

However, due to the previously mentioned likelihood of fiscal policy adjustments, including ones related to the Anti-Inflation Shield, the expected improvement in the sector's balance is subject to uncertainty.

IV Public debt and financing of the borrowing requirement

According to the estimates contained in the *Public Finance Sector Debt Management Strategy in the years 2024-2027*, the ratio of state public debt (SPD) to GDP is set to decline at the end of 2023 compared to the previous year (from 39.4%[1] do 37.9%). In turn, the general government debt as a percentage of GDP in ESA2010 terms is to remain unchanged relative to the level at the end of 2022 (49.3%), which will be the product of relatively high nominal GDP growth and a deterioration in the general government balance (of 1.9 percentage points of GDP) as well as the planned increase in the debt of the Armed Forces Support Fund (1.0 percentage points of GDP)

In line with the *Justification*, the net borrowing requirement of the State Treasury will run at PLN 224.5 billion in 2024 (6.0% of GDP), which, against the backdrop of previous years is a high level. The value of the net funding raised in the market through bond issue and loans is to be PLN 197.8 billion (5.2% of GDP), while the remaining borrowing requirement is to be funded mainly from EU loans (PLN 28.6 billion). Significant borrowing needs of other entities of the general government sector are to be maintained, albeit on a smaller scale than in 2023. In particular, the *Strategy* envisages an increase in the outstanding debt of funds operated by Bank Gospodarstwa Krajowego, i.e. the COVID-19 Counteracting Fund, the Armed Forces Support Fund, the Aid Fund and the National Road Fund, which is expected to rise by PLN 78.9 billion (2.1% of GDP, compared to 2.1% of GDP assumed for 2023). Also in the following years covered by the *Strategy*, an increase is anticipated in the public debt-to-GDP ratio in ESA terms. Within the horizon of its forecast (i.e. until 2027), this ratio is to rise to 58.7% of GDP.

[1] Value recalculated after the revision of GDP data for 2022 published by Statistics Poland in October 2023 and not covered by the *Strategy*.

NARODOWY
BANK POLSKI

In the years 2022-2023, the average interest rate on public debt increased considerably, as a result of a rise in short- and long-term interest rates in Poland and other developed countries. The level of average interest rate on public debt in ESA terms increased from just over 2% in 2021 to nearly 5% in 2023. Assuming the current expectations of the financial markets as to the further course of market interest rates, the average interest rate on the debt may be expected to stabilise in 2024.

Available forecasts show that despite the above-mentioned rise in the average interest rate on public debt, in real terms it will remain below the potential growth rate of the Polish economy. This will be a mitigating factor for risks to the sustainability of the public debt in the longer term. At the same time, however, in view of the forecasts of an increase in the public debt-to-GDP ratio, it is desirable to take measures aimed at reducing the general government primary structural deficit in order to curb this trend.