8 January 2024

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

At its meeting on 19 December 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.

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% in 2024 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 estimated growth in 2023 was 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, supported by the increased defence spending and the implementation of projects under the National Recovery and Resilience Plan. 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 2023 may have declined more than assumed in the *Draft Act* due to slower growth in Poland's external economic environment occurring on the back of a more severe deterioration in economic activity in euro area countries. 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 uncertainty due to further developments in the labour market, and the potential measures regarding energy pricing.

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*, the Ministry of Finance assesses the general government deficit to have risen from 3.7% of GDP in 2022 to 5.6% of GDP in 2023, which, in the opinion of NBP, is a realistic estimate. A key determinant of change in the general government balance in 2023 was the economic slowdown observed in 2023, which 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 was close to 1 percentage point of GDP and was the primary source of the increase in the general government deficit in ESA terms. In contrast, the estimated structural deficit of the general government expanded 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 remained at a level similar to the previous year.

The level of the 2023 general government balance described above was the result of a range of fiscal policy adjustments, some of which acted to improve the balance, while others to worsen it. The first group included lower than in 2022 costs of the shielding 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 were 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) was another factor acting towards an improvement of the general government balance in 2023.

On the other hand, the reduction in the lower personal income tax rate in mid-2022, which resulted in high returns during the annual settlement of this tax for 2022, worked 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 was 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.

NARODOWY BANK POLSKI

III. Fiscal policy in 2024

As indicated above, the cost of the shielding measures protecting economic agents against the effects of the steep growth in energy and food prices (the so-called Anti-Inflation Shield) was an important factor boosting the general government deficit in 2023. According to the *Draft Act* and other legislation in force, some of these measures are to be terminated. Among others, as of April 2024 the VAT rate on basic food products is to rise from 0% to 5%. On the other hand, in line with the Act on Amending Acts to Support Consumers of Electricity, Gaseous Fuels and Heat and Certain Other Acts, subsidies to the prices of energy carriers are to be retained in the first half of 2024. Moreover, the above Act provides for the payment of shielding allowances to households facing energy poverty, including in respect of the first half of 2024. The total cost of this assistance in 2024 is estimated at PLN 14.6 billion (0.4% of GDP), and part of this cost is to be financed through a one-off gas contribution to the Price Difference Payment Fund. Considering the persistently substantial difference between the end-user prices of electricity and gaseous fuels stipulated in the Act in question and the tariffs approved by the President of the Energy Regulatory Office, it cannot be ruled out that support for households relating to energy costs will also be extended into the second half of 2024. The *Draft Act* does not provide information on the possible funding of such extended support.

Despite the rise in the VAT rate on staple food provided for in the *Draft Act*, the assumed increase in VAT receipts by 24.6% may prove difficult to achieve. Indeed, according to the NBP projection, nominal private consumption growth (private consumption being the bulk of the VAT tax base) is to run at 8.9% y/y, and the above mentioned increase in the VAT rate could boost the average annual VAT revenue growth by approx. 3 percentage points. Whereas it can be expected that a steeper increase in the public sector wage bill than assumed in the November projection will translate into higher nominal growth in household consumption, NBP assesses the scale of this effect to be small. The *Justification* to the *Draft Act* indicates that the VAT revenue forecast takes into account the positive impact of the measures provided for 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 in the years 2016-2018, the scale of further improvement in tax collection is uncertain.

The partial expiry of the shielding measures amid continued funding of the remaining measures with contributions to the Price Difference Payment Fund will have a significantly positive impact on the balance of the general government in 2024. The scale of this impact can be estimated at 0.9 percentage points.

Another factor which, according to the provisions of the *Draft Act*, will have a downward effect on the headline deficit in 2024 are 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 general government revenue of at least 0.6 percentage points of GDP in 2024.

On the other hand, the 2024 fiscal deficit will be boosted by changes in the expenditure on social benefits in cash. According to NBP estimates, the ratio of this expenditure to GDP will rise by 0.9 percentage points 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 ratio 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 *Draft Act* envisages a 20% rise in the wages of state budget sector employees, and a 30% rise in the wages of school, kindergarten and academic teachers. With these provisions of the *Draft* taken into account, NBP estimates that the sector's expenditure on compensation of employees will rise by 0.9 percentage points of GDP in 2024.

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 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 fiscal shielding measures introduced in 2022-2023 in response to external price shocks remain in force for the time specified in the current legislation, the general government deficit can be expected to remain at a level close to the previous year (in relation to GDP).

The *Draft Act* adopted by the Council of Ministers does not account for the funding of some of the legislative changes which were declared to come into force in 2024 in the Prime Minister's exposé, or announced by other members of the Council of Ministers. These changes include the introduction of the "holidays" from payment of social security contributions for entrepreneurs, the introduction of senior citizen's vouchers to finance support for the elderly and supplements to survivors' pensions (the so-called widow's pensions). It appears that the forecast of the general government deficit stipulated in the *Justification* to the *Draft Act* also does not account for the cost of these measures. Therefore, there is a risk that the implementation of these changes will increase the general government deficit. Moreover, as pointed out above, it cannot be ruled out that support for households towards energy costs will be extended into the second half of 2024, which would also add to the deficit.[1]

With regard to the payment from the NBP profit assumed in the *Draft Act*, it has to be pointed out that the 2023 financial result of NBP will not be known until the end of 2024 Q1, i.e. until the NBP Annual Report has been examined by an external auditor. Taking into account the market conditions prevailing in 2023 Q4, no payment from the NBP profit is expected in 2024.

In light of the estimated financial results of companies with State Treasury ownership, including banks, and the dividend policy of the Polish Financial Supervision Authority, income from dividends from the Treasury holdings in companies and payments from profit of state-owned enterprises may be higher than assumed in the *2024 Draft Act.*

IV. Public debt and financing of the borrowing requirement

According to the estimates contained in the *Public Finance Debt Management Strategy in the years 2024-2027*, as updated, the ratio of state public debt (SPD) to GDP is to stand at 39.4% at the end of 2023, compared with 39.1% at the end of 2022. The general government debt

[1] It seems unlikely at this point that contributions to the Price Difference Payment Fund will remain in force, in light of, among others, the provisions of Council Regulation (EU) 2022/1854 of 6 October 2022 on emergency intervention to tackle high energy prices, according to which the so-called solidarity contribution from EU companies and permanent establishments operating in the oil, gas, coal and refining sector should only apply until fiscal year 2022 or 2023.

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 combined result 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 assumed increase in the debt of some other entities of the sector.

In line with the *Justification*, the net borrowing requirement of the State Treasury will run at PLN 252.3 billion in 2024 (6.7% of GDP), and the gross borrowing requirement at PLN 449.0 billion (11.9% of GDP), which, against the backdrop of previous years, is a high level (in the *2024 Draft Budget Act* adopted by the Council of Ministers in September 2023, these figures were, respectively: PLN 225.4 billion, or 6.0% of GDP, and PLN 421.6 billion, or 11.2% of GDP). The value of the net funding raised in the market through bond issue and loans is to reach PLN 179.3 billion (4.8% of GDP), while the remaining borrowing requirement is to be funded mainly from EU loans (PLN 40.0 billion). Significant borrowing needs of other entities of the general government sector are to be maintained. The *Strategy* assumes that in 2024 the debt of entities which are included in the sector in ESA2010 terms, but not according to the national definition, will rise by PLN 89.3 billion (2.4% of GDP).[2]

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 public debt in the longer term. At the same time, however, in view of the forecasted increase in the public

[2] The 2024 expenditure on national defence (i.e. spending under Budget section 29 "National Defence") was planned at an almost identical amount (PLN 117.5 billion) as in the *Draft Budget Acts* of September and December 2023. At the same time, the September *Draft* was appended with the *Public Finance Debt Management Strategy*, according to which, in 2024, the debt of the Armed Forces Support Fund (AFSF) was to increase by PLN 39.6 billion (to PLN 86.6 billion). In contrast, the December *Draft* Act does not contain a new *Public Finance Debt Management Strategy*, but only a so-called update of the previous *Strategy*. The update does not provide information on the planned debt of AFSF.

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.