5 November 2024

Opinion of the Monetary Policy Council on the *2025 Draft Budget Act*

At its meeting on 28 September 2024, the Council of Ministers adopted the *2025 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 ESA 2010 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 2024 and planned for 2025 will be financed from extra-budgetary funds. Therefore, in addition to the *Draft Act*, this opinion is based also on other government documents, including, in particular, regulatory impact assessments of draft laws, statements of government officials as well as NBP estimates and projections of the revenue and expenditure of the general government sector in ESA2010 terms.

I. Macroeconomic assumptions of the Draft Budget Act

In the *Justification* to the *2025 Draft Budget Act*, Poland's real GDP is assumed to increase by 3.9% in 2025, following a rise of 3.1% in 2024. According to the assumptions of the *Draft Act*, economic growth in 2025 will continue to be driven by private consumption, whose growth will be close to that observed in 2024. The *Justification* indicates that consumption growth will be underpinned by the lagged effect of the legislative changes substantially boosting household disposable income in 2024. These changes have included pay rises for teachers, civil servants and the uniformed services, as well as the increase of the "Family 500 Plus" child benefit to PLN 800. The launch of the "Active Parent" programme, the

payment of widow's pension and the favourable labour market conditions are expected to work in the same direction. The *Draft Act* assumes that in 2025 real growth in gross fixed capital formation will accelerate compared to its 2024 pace. According to the *Justification*, the main factors supporting investment growth will include additional demand on the back of an economic rebound at home and abroad, the interest rate cuts assumed by the government, cumulation of inflows under the National Recovery Plan (NRP) and defence spending. The *Act* further assumes that the impact of inventory changes on GDP growth will be close to neutral in 2025 and the contribution of net exports to growth will be slightly negative.

In the opinion of NBP, real GDP growth in 2024 and 2025 may be slightly lower than assumed in the *Act*. In particular, the November "Inflation and GDP Projection" indicates slower household consumption growth on the back of a marked decline in the growth rate of disposable income in real terms expected over this horizon. This scenario is substantiated by retail sales growth data for July-September 2025 pointing to a high likelihood of a decline in annual growth in this category relative to 2024 Q2. Similarly to the *Draft Act*, the November NBP projection assumes a significant increase in investment growth. Net exports, however, will be significantly negative according to NBP, due to their counter-cyclical nature and the persistently weak momentum of economic activity in the euro area.

The *Draft Act* assumes that average annual consumer price inflation in 2025 will pick up to 5.0% (compared to 3.7% in 2024), which is largely due to the assumed increase in energy prices. However, the *Justification* points out that energy price forecasts are subject to a very high degree of uncertainty. At the same time, statements of government officials suggest that an extension of the relief measures on energy prices is being considered. Another upward factor for inflation in 2025 will be the increase in excise duty rates on alcohol and tobacco products provided for in the *Draft Budget Act*.

The risk factors for the macroeconomic scenario listed in the *Justification* include primarily the possibility of slower growth in Poland's external environment amid the heightened uncertainty, as well as exacerbation and protraction of war in Ukraine. Economic developments abroad, including risks associated with the prolonged economic stagnation in Germany and the geopolitical situation are also major sources of uncertainty for NBP

forecasts. At the same time, the pace and extent of absorption of funds from the National Recovery Plan also constitute a risk factor.

II. Situation of public finances in 2024

The starting point for the assessment of the *Draft Act* is the fiscal policy pursued in 2024. According to the fiscal notification published by Eurostat on 22 October 2024, the general government deficit in relation to GDP amounted to 5.3% in 2023. In the *Justification* to the *Draft Act*, the Ministry of Finance expects the deficit to increase to 5.7% of GDP in 2024. According to NBP, the level of the deficit in 2024 may turn out to be somewhat higher. This is indicated by, among other things, the currently available general government data released by Eurostat – in the first half of 2024 the deficit in ESA terms amounted 3.9% of GDP, compared to a deficit of 2.2% in the corresponding period of 2023.[1]

The worsening of the fiscal balance in 2024 results primarily from discretionary decisions of the government and the parliament. In 2024, there have been significant increases in benefits under the "Family 500+" programme, as well as salaries of teachers, university teachers and public administration employees. According to NBP's estimates, the above increases will in total translate into a rise of 1.9 percentage points of GDP in the sector's spending compared to 2023. At the same time, it should be noted that these public sector wage increases contribute to a robust growth in the wage fund in the economy as a whole, which, on the one hand, boosts household income and demand growth in the economy and, on the other, translates into rapidly rising general government revenue from social security contributions. In the first half of 2024, these contributions rose by 14.4% in nominal terms, and over the whole year, they can be expected to increase by 0.9 percentage points in relation to GDP.

In addition to legislative measures, the rise in the sector's deficit observed in 2024 is partially due to the impact of earlier global price shocks, which have had a lagged upward effect on certain categories of public expenditure. This relates to expenditure which is subject to statutory indexation, including, in particular, old-age and disability pensions, which were increased by 12.12% on account of indexation in 2024, i.e. much faster than nominal GDP. Moreover, interest payments on public debt are expected to increase by 0.2 percentage points of GDP in 2024 compared to the 2023 figure.

[1]The balance for the first half of the year related to GDP in the first half of the year, values not seasonally adjusted.

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After a surge in national defence spending in 2023, associated with the raising of the minimum level of defence spending to 3% of GDP, as stipulated in the Homeland Defence Act, this expenditure in relation to GDP increases further in 2024. In particular, this applies to investment expenditure in this area, which, according to the Medium-Term Fiscal-Structural Plan (hereafter: MTP) adopted by the government on 8 October 2024 is expected to amount to 0.7% of GDP on an accrual basis. According to NBP estimates, the domestically-funded investment of general government will rise by 0.2 percentage points of GDP in 2024 year-on-year , while total public investment, including EU funds (which, in line with ESA principles, do not affect the fiscal balance) remains unchanged in relation to GDP.

The above changes adding to the general government deficit are partially offset by a number of factors reducing it. The most important of these is lower spending on government support for households, businesses, public utility companies and farmers related to the high prices of energy commodities as a result of the Russian military aggression against Ukraine. According to NBP estimates, the net cost of these measures (i.e. the cost excluding write-offs to the Price Difference Payment Fund) will decrease by almost 0.5 percentage points of GDP in 2024 relative to the previous year. Another important factor conducive to narrowing the fiscal imbalance in 2024 is the higher PIT revenue, related, among other things, to the expiry of the one-off effect of the increased refunds in the 2023 annual tax settlement. The increase in revenue from this source in 2024 can be estimated at 0.6 percentage points of GDP.

A risk factor for the estimate of the general government deficit in 2024 is the cost of removal of the damages caused by floods in September this year and providing support to those affected. However, it appears that the costs incurred in 2024 will be limited, i.e. will not exceed 0.1% of GDP, and that they can at least in part be financed by shifting funds from other objectives within the state budget.

Altogether – according to NBP's projections – the factors listed above will contribute to an increase in the general government deficit in 2024 to close to 6% of GDP.

III. Fiscal policy in 2025

The *Draft Budget Act* envisages a fall in the general government deficit in ESA terms from 5.7% of GDP in 2024 to 5.5% of GDP in 2025. In NBP's opinion, the deficit of the sector may

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be higher in both years due to factors described below which will affect the revenue and expenditure of the sector.

On the revenue side of public finance, NBP believes that in 2025 the sector's domestic revenue in relation to GDP may decline amid a slight increase in the overall revenue, including EU funds, which are neutral to the fiscal balance. The extent of revenue-side changes due to legislative measures is small. The *Draft Act* provides for a rise in excise tax rates on tobacco products and alcohol, but the overall planned excise tax proceeds as a share of GDP in 2025 will remain close to the 2024 level, hence they will not contribute to an improvement of the fiscal balance. A factor with a downward impact on general government revenue will be the expiry of the gas contribution to the Price Difference Payment Fund, introduced for 2024 to finance energy price subsidies. In line with MTP, revenue from this source in 2024 has amounted to approx. 0.4% GDP.

In 2025, the *Draft Act* envisages a significant increase in VAT revenue – of 16.9% – which represents a rise of 0.6 percentage points in relation to GDP. However, it seems that the legislative changes relating to this tax cited in the *Justification* – including the launch of the National e-Invoice System and the increase from 2024 Q2 onwards of the VAT rate on food – do not warrant expectations of such a large-scale increase in revenue. Indeed, from the *Justification* it follows that the Ministry of Finance expects private consumption in nominal terms, which constitutes the main part of the base for this tax, to grow by 9.5%. Notably, the *2024 Draft Budget Act* also assumed an improvement in VAT collection, yet the Ministry of Finance estimates in the *Justification* that the revenue from this source in 2024 will fall PLN 17.4 billion short of the target.

The sector's revenue in ESA terms in 2025 will also be negatively affected by a decline in receipts from the sale of CO_2 emission allowances (according to NBP estimates, by approximately 0.2 percentage points of GDP relative to 2024), which is associated with a decreasing pool of allowances and a drop in their prices in 2024.[2]

The relation of domestic general government expenditure to GDP may, in NBP's assessment, decline in 2025 on a scale commensurate with the decline in domestic revenue of the sector; however, this relation will be affected by a range of changes acting on in different directions.

An upward factor on public expenditure will be expenses arising from the recently adopted legal acts and new government initiatives. These include the introduction of the

[2] On an accrual basis, income from the sale of allowances is recorded with a lag, which is why the decline in income in 2024 on a cash basis will impact the ESA-terms result in 2025.

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"Active Parent" programme, supplementary benefits addressed to persons with disabilities, a supplement to social pensions, new survivors' pension rules for widows/widowers and funds for a new housing programme included in the *Draft Act*. According to NBP estimates, the changes listed above will add 0.5 percentage points of GDP to the general government deficit in 2025 and will contribute to maintaining expenditure on social benefits in relation to GDP at the previous year's level, i.e. 16.9%.

In 2025, defence spending can be expected to rise further. However, due to the schedule of military equipment deliveries and the principles for their recording in national accounts, the magnitude of the increase on an accrual basis will be smaller than on a cash basis. According to the *Justification* to the *Draft Act*, the expenditure of the state budget and the Armed Forces Support Fund in cash terms will increase from 4.3% of GDP in 2024 to 4.7% of GDP in 2025. On the other hand, in line with the MTP, expenditure on national defence in ESA terms will amount to 2.6% of GDP in 2024 and 2.8% of GDP in 2025.

In addition to expenditure on national defence, the *Draft Act* provides for a relatively steep increase in the current expenditure of budgetary units in other areas – this expenditure, excluding the budget section "National Defence", rises by 11.5% compared to the 2024 *Budget Act*, i.e. at a rate markedly exceeding nominal GDP growth. Such developments in this category are one of the reasons why public consumption in relation to GDP may be expected to rise further in 2025 – in 2023 this relation was 18.6% of GDP, in 2024 – according to NBP estimates – it will reach 20.2% of GDP, and 20.4% in 2025.

The above changes adding to the deficit will largely cancel out the favourable impact on the fiscal balance resulting from a further reduction in the costs of the assistance related to high energy costs. In 2024, subsidies to prices of electricity constituted the largest component of this assistance and according to current legislation these subsidies will remain in force until the end of the current year. Government officials have indicated their possible extension, pointing out that the cost of such an extension is partially factored into the *Draft Act*; yet, no formal decision on this issue has been taken by the closing of the NBP November projection. Therefore the baseline scenario of the projection assumes the absence of energy subsidies in 2025, which means that expenditure on support related to high energy prices will fall by 0.9 percentage points of GDP compared to the 2024 level.

In 2025, public investment can be expected to increase by approx. 0.2 percentage points of GDP relative to 2024. However, in NBP's opinion, this increase will not negatively affect the fiscal balance owing to its structure. This is because the increase will be driven primarily by EU-funded investment, as take-up of cohesion policy funds accelerates

following a significant decline in 2024 linked to the ending of the 2014-2020 multiannual financial framework. Simplified procedures for the deployment of funds redirected to restore the infrastructure destroyed during the September 2024 flood may be expected to further boost the absorption of these funds in 2025. Moreover, investment funded under the National Recovery Plan may be expected to rise in 2025, but as indicated above, the scale of uptake of funds from this programme is subject to significant uncertainty, as project selection under various components of the NRP is still ongoing or only planned, while investment within the grant component of the NRP must be completed by August 2026. Domestic investment, in turn, will probably see only a slight rise in 2025, despite the above-mentioned planned increase in military equipment deliveries. This is because, in 2025 a decline can be expected in local government investment financed from the Government Polish Deal Fund: Strategic Investment Programme, as indicated by the financial plan for the COVID-19 Counteracting Fund (CRF) enclosed with the *Draft Act*.[3]

A particular factor of risk to the general government balance will be posed by the situation within the health care system. In 2024, spending in this area has turned out to be well above the planned level – the financial plan for the National Health Fund (NHF), adopted in September 2023, envisaged costs of healthcare services of PLN 157.6 billion and an NHF surplus of PLN 0.8 billion, whereas after the most recent amendment to this plan in September 2024, the scheduled level of these costs is PLN 177.1 billion, rendering a Fund deficit of PLN 12.3 billion. This shows that the costs of healthcare services of PLN 183.6 billion assumed in the National Health Plan for 2025 (from July 2024) may again prove too low, thus generating a negative balance in the Fund in 2025. The planned cut in the health care contribution for entrepreneurs poses another risk to the National Health Fund's financial position.

In light of the above potential developments in the revenue and expenditure of the general government, NBP projections suggest that the fiscal deficit in 2025, including the structural deficit, may remain very high. Meanwhile, a marked reduction in the deficit in 2025, including the structural deficit, would be desirable in light of the large fiscal imbalance and the launching of the excessive deficit procedure against Poland in July 2024; it would also be conducive to curbing inflationary pressures. Consequently, the envisaged shape of fiscal policy limits the space for potential monetary easing. The absence of a marked

[3] The CRF plan for 2024 - according to a release by Bank Gospodarstwa Krajowego (BGK) - envisages investment expenditure of PLN 36.8 billion under this programme in 2024, while the plan for 2025 attached to the *Justification* for the *Draft Act* provides for expenditure of PLN 22.5 billion.

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reduction of the structural deficit is only to a small extent due to the increase in expenditure on national defence and in part results from recent legislative changes resulting in increased expenditure in other areas, the scale of which is greater than of the measures taken to reduce the excessive deficit of the general government.

IV. Public debt and financing of the borrowing requirement

According to the estimates presented in the *Public Finance Sector Debt Management Strategy in the years 2025-2028*, the ratio of state public debt (SPD) to GDP is set to rise sharply at the end of 2024 compared to the previous year (from 39.0%[4] do 43.3%.) The public debt-to-GDP ratio in ESA2010 terms is also set to rise to a similar extent, albeit at a faster pace (from 49.7%[5] to 54.6%). Such a significant increase in the ratio is primarily a result of the large deficit of the sector – but also the planned rise in the debt of funds held at the state owned-bank BGK[6] (by 1.2 percentage points of GDP, including of the Armed Forces Support Fund by 0.8 percentage points of GDP) and the debt resulting from loans under the Recovery and Resilience Facility (by 0.5 percentage points of GDP).[7]

In line with the *Justification*, both the net and gross borrowing requirement of the State Budget are expected to rise substantially in 2025. The net borrowing requirement is to amount to PLN 366.7 billion (9.2% of GDP), compared to the expected execution of PLN 215.6 billion in 2024 (5.9% of GDP). However, the cited amount of the net borrowing requirement is distorted by the inclusion in the state budget expenditure of subsidies to the COVID-19 Counteracting Fund and the Polish Development Fund (the government programme of "Financial Shields") earmarked for the redemption of the maturing debt of these entities with a total nominal value of PLN 59.0 billion. When adjusted for this factor, the planned net borrowing requirement would amount to PLN 307.7 billion (7.7% of GDP), which, however, by historical standards still represents an exceptionally high figure. In turn, the planned level of gross borrowing requirement is PLN 553.0bn (13.9% of GDP) against the forecast execution of PLN 425.2 billion (11.7% of GDP) in 2024.

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[4] Figure taking into account the revision of GDP data for 2023 published by Statistics Poland in October 2024 and not included in the *Strategy*.
[5] Figure taking into account the revision of GDP data for 2023 published by Statistics Poland in October 2024 and not included in the *Strategy*.
[6] COVID-19 Counteracting Fund, Assistance Fund, National Road Fund, Armed Forces Support Fund.
[7] Due to the relatively small advancement of investment under the National Recovery Plan and the large share of the enterprise sector in the investment funded from the loan part, it seems that the NRP loans will only marginally finance the general government deficit.

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In both 2024 and 2025, external financing is expected to account for a relatively large share of the Treasury's borrowing requirement, due to, among other things, the availability of the loan part of the EU Reconstruction and Resilience Facility. Notwithstanding that, the scale of the net borrowing requirement to be financed in the domestic market is to rise again. In 2023, the net issuance of Treasury securities in this market was PLN 82.5 billion (2.4% of GDP), in 2024 it is to stand at PLN 156.0 billion (4.3% of GDP) while in 2025 it will reach PLN 246.2 billion, and adjusted for the above-mentioned redemption of the maturing bonds guaranteed by the State Treasury– PLN 187.2 billion (4.7% of GDP).

The *Strategy* appended with the *Draft Act* is the first one which anticipates the public debt-to-GDP ratio in ESA terms exceeding 60% (this is expected to happen in 2026). This ratio is not scheduled to stop growing until 2028. On the other hand, the state public debt[8], to which the restrictions contained in the national law, including the Constitution of the Republic of Poland, apply, is also supposed to grow gradually until 2027, when it is to reach 47.5% of GDP. An additional important factor accounting for the increase in the debt ratio in ESA terms is the planned continuation of the significant borrowing requirement of the Armed Forces Support Fund (AFSF). The debt of this fund is to rise faster in 2025-2027 than in 2024. At the end of 2028, the *Strategy* assumes the AFSF debt at the level of 6.0% of GDP (compared to 1.6% of GDP at the end of 2024).

The prerequisite for the implementation of the path of public debt-to-GDP ratio presented in the Strategy, and in particular the halting of further growth of this ratio, will be a large-scale fiscal adjustment. In line with the MTP, the adjustment planned in the horizon of the Strategy is to be hinged – on the revenue side – mainly on freezing the PIT tax parameters and additional excise tax hikes. In turn, on the expenditure side, apart from phasing out relief measures related to high energy costs and the nominal freeze of social benefits, public consumption is to be reduced (by 0.2 percentage points of GDP per annum in 2026-2028), which is not substantiated by an announcement of specific measures to reduce spending. In line with the provisions of the *Plan*, the specification of the consolidation path on the expenditure side is to be presented as the subsequent budget bills are drawn up.

In sum, according to the information presented in the *Strategy*, there will be a significant increase in the public debt-to-GDP ratio in the coming years, which is only partly due to

[8] The figure referred to in Article 38a(3) of the Act on Public Finance (liabilities expressed in foreign exchange converted at the arithmetic mean of the average exchange rates of each foreign currency; it also takes into account a reduction of the State Public Debt by the amount of free funds aimed at funding the borrowing requirement of the state budget in the following financial year).

the need to incur increased expenditure on national defence. In the longer term, a steady increase in the public debt ratio may give rise to risks to macroeconomic stability. Therefore, in order to halt this tendency and preserve the resilience of the Polish economy to external shocks, it is desirable to take measures aimed at curbing the general government deficit.