

Economic Comment

2021 Budget: Another year with high spending

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Draft budget 2021 assumed a central deficit at PLN82.3bn and general government deficit at 6% of GDP (as compared to 12% of GDP in 2020). The relatively high gap in public finance stems mostly from high spending of the central sector, which is expected to reach 20.6% of GDP, i.e. 2 percentage points less than in 2020, but still by about 2 percentage points more in 2018-2019. High spending in 2021 cannot really be blamed on the pandemic, especially as even in 2020 the lion share of Covid-related expenditure was pushed away from the budget. It is mostly due to changes in fixed spending, like rising social transfers, healthcare and defence. Incomes, based on conservative macroeconomic assumptions, seem to be quite realistic. Even though the deficit is expected to be lower than in 2020, 2021 borrowing needs are going slightly up. Still, the planned bond issuances are to decline with a major part of financing secured in external sources, like loans from EU SURE instrument.

The government presented [draft 2021 budget](#). Macroeconomic assumptions are in our view conservative, at least as compare to our and market forecasts. The government is expecting the GDP to rise by 4.0% after falling by 4.6% in 2020 (i.e. in 2021 the economy will not be back at 2019 level). Private consumption is expected to go up by 4.4%, investment by 4.0%. As for the labour market, the government has assumed a slight decline in employment and a slow growth of wages. The budget deficit was outlined at PLN82.3bn, i.e. a bit lower than in 2020 (PLN109.3bn). The decline was actually possible thanks to shift of some spending items back from 2021 to 2020, e.g. subsidies for Social Security Fund (FUS) or Solidarity Fund (FS) or infrastructure investments (we pointed that out in [our comment to 2020 budget amendment](#)).

The spending rule allowed for a rise in spending to PLN976.6bn in 2021. The new formula of gradual return to spending limit was applied: for 2021 the limit was increased by half of discretionary financial effects connected to the epidemic, estimated at PLN86.3bn. A regular formula will be used for 2022 budget.

General government deficit was estimated at 12% of GDP in 2020 (all-time high) and at 6% of GDP in 2021. Such a high deficit in 2020 is partially due to the fact the Eurostat will qualify the entire Covid-19 spending programme as 2020 expenditure. The rise of general government debt will be unprecedented: by almost 20 percentage points in two years, from 46.0% in 2019 to 62.2% in 2020 and 64.7% in 2021. The rise of state public debt (not accounting for PFR, e.g.) will be less spectacular: from 43.6% of GDP in 2019 to 50.7% in 2020 and 52.9% in 2021.

Main parameters of the budget

	2019 realisation	2020	2021
Revenues (PLNm)	400 535	398 672	403 728
Expenditures (PLNm)	414 273	508 019	486 028
Balance (PLNm)	-13 738	-109 348	-82 300
GG balance (% GDP)	-0,7%	-12,0%	-6,0%
GG debt (% GDP)	46,0%	62,6%	64,7%

Source: Ministry of Finance, Santander

Budget incomes: in line with macro assumptions

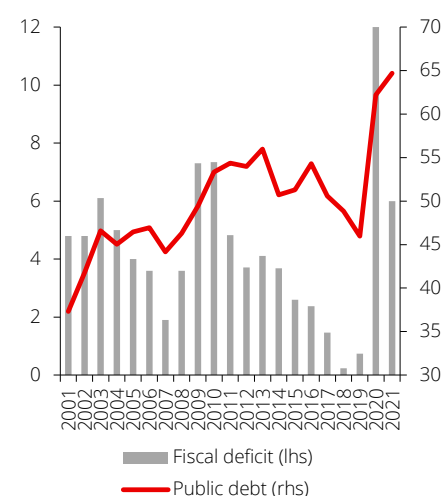
Central budget incomes were planned at PLN403.7bn, i.e. only 1.3% more than plan for this year (after amendment).

Macroeconomic forecasts for 2021

	Budget	Bloom berg	Santan der
GDP, PLN bn	2 356.1	-	2 442.6
GDP, %	4.0	4.2	5.0
Consumption, %	4.4	4.0	5.4
CPI, %	1.8	2.2	1.5
Employment, %	-0.7	-	0.3
Unemploye nt, %	7.5	6.5	7.7
Wages, %	3.4	-	4.6

Source: Ministry of Finance, Bloomberg, Santander

General government debt and deficit, % of GDP



Source: Ministry of Finance, Santander

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Such a modest increase is an effect of a major gap in non-tax revenues (by PLN13.9bn, by almost 30% versus plans for 2020). This is mostly due to a lower NBP profit (PLN1.3bn in 2021, by PLN6.1bn less than in 2020) and lower incomes of government units (by PLN7.6bn less than in 2020). The latter item was elevated markedly in 2020 budget amendment and we think that the shifts may be due to assumptions about inflows from 5G auctions. We are a bit surprised by assumption of lower import duties (-5.4% or - PLN0.25bn), as we are expecting the demand and economic activity to be rebounding, following higher import of goods.

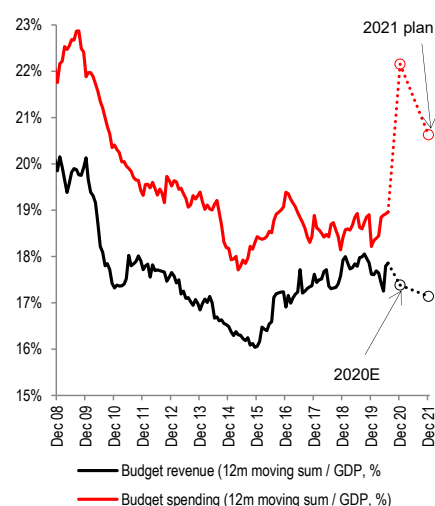
The tax revenues are expected to rise by 5.3% y/y, that is roughly in line with the assumed nominal GDP pace of growth (5.4%). The key source of this rise are VAT revenues that are expected to rise 6.5% (+PLN11bn) vs planned realisation in 2020. Their % change is coherent with the assumed change in households consumption demand: 6.3% in nominal terms. According to the draft, higher tax collection is also expected to be supported by higher efficiency in tax collection and elimination of the grey area. Nevertheless, VAT collection as % of GDP in 2020 (7.6%) and 2021 (7.7%) is expected to be lower than in the previous years (above 8%) which seems to confirm that a rise of tax collection during the period of a fast economic growth was a cyclical phenomenon. The rise of direct taxes revenues (PIT, CIT) does not look controversial. The former will be supported by a moderate improvement on the labour market and rise of the wage bill, the latter will be curbed by, among others, solutions that support investments (the so-called Estonian CIT). In both cases, 2021 revenues will adversely affected by the possibility of reducing the 2019 profit by the 2020 loss.

The budget assumes that the retail sales tax will be implemented and will yield PLN1.5bn of revenues in whole year.

The government included also the sugar tax and introduction of the extra electricity charge but these will not go directly into the central budget. The draft does not include two important measures that were considered in the past: removal of social security contributions limit and changes in the private pension funds (OFE).

Overall, we think the 2021 revenues plan looks workable.

Budget incomes and spending in relation to GDP (12m moving sum, % of GDP)



Source: Finance Ministry, Santander

Budget revenues (PLNm)

	2019 (1)	2020 (2)	2021 (3)	2021 change (3) - (2)
Budget revenues	400 535	398 671	403 728	5 057
1. Tax revenues	367 291	349 740	368 427	18 687
VAT	180 892	170 000	181 000	11 000
Excise	72 396	68 400	71 739	3 339
Gambling tax	2 337	2 300	2 860	560
CIT	39 985	38 500	36 900	-1 600
PIT	65 445	64 100	68 100	4 000
Mining tax	1 536	1 700	1 500	-200
Bank tax	4 700	4 740	4 870	130
Retail sales tax	0	0	1 500	1 500
2. Non-tax revenues	31 379	46 590	32 710	-13 880
Dividends	3 511	500	387	-113
Payment from NBP profit	0	7 437	1 329	-6 108
Custom duties	4 409	4 680	4 428	-252
Budgetary units revenues and other non-tax revenues	20 862	31 034	23 420	-7 614
Payments of local governments	2 598	2 938	3 146	208
3. Non-refundable funds from the EU and from other sources	1 866	2 342	2 591	249

Source: Ministry of Finance, Santander

Less investments, more social spending

Limit of budget expenditures for 2021 was set at PLN486bn. As we have argued before, in our view the 2020 limit (PLN508bn) was inflated due to transfer of some expenditures from 2021 so we will compare 2021 expenditures to 2019 (PLN414.3bn) to have a better assessment. A noticeable increase of spending was assigned to “compulsory social insurance” (+PLN15.7bn vs 2019, +PLN11.8bn vs 2020), “other settlements” (+PLN39.6bn vs 2019, +PLN5.7bn vs 2020), healthcare (+PLN9.2bn vs 2019, +PLN9.6bn vs 2020). Spending for “transport and communication” was lowered (-PLN3.2bn vs 2019, -PLN171bn vs 2020).

Higher spending on social insurance is due to a rise of subsidy to the FUS (PLN59.5bn), that is nearly twofold of 2020 (PLN33.5bn). This rise stems from higher expenses (indexation of benefits, higher number of pensioners) amid expected slow rise of contributions (2.3% y/y). 2021 FUS deficit will be also covered with a PLN12bn payment included in 2020 budget. A similar case is with the Solidarity Fund as its deficit will be covered with PLN26.5bn subsidy booked in 2020.

Larger expenditures on the healthcare is mainly the effect of PLN8.7bn allotted to the specific reserve account that could probably be treated as a cushion for an unexpected medical issues or simply help to fulfil the government’s commitment of spending 5.3% of GDP on healthcare. Financing of healthcare is mainly the task of the National Healthcare Fund (NFZ) that is not included in the central budget.

Rise in “other settlements” is a result of (1) rising subsidies to local governments (+PLN8.4bn vs 2019, +PLN3.4bn vs 2020) and EU own funds (+PLN6.8bn vs 2019, +PLN2.9bn vs 2020) and (2) utilisation of a specific reserves and transferring them to particular targets. In 2019-2021, the government was allocating cPLN26bn per year to specific reserves and these means are moved from “other settlements” category into particular categories when utilized.

Cut in spending in transport and communication of PLN8.9bn is noticeable. Sizeable reduction of 2021 spending seems to confirm our call that the one-off rise of infrastructural investments in 2020 in the budget amendment from late August is also a transfer of funds from 2021. Total investment spending in 2021 is to reach PLN23.9bn (+PLN5.4bn vs 2019, -PLN9.8bn vs 2020) with a vast majority (PLN15.2bn) on national defence.

Budget expenditures by economic groups (PLNm)

	2019 (1)	2020 (2)	2021 (3)	2021 change (3) - (2)
Budget expenditures	414 135	508 019	486 028	-21 991
Grants and subsidies	233 329	291 348	272 191	-19 157
Transfers to households	28 365	26 743	28 747	2 004
Current expenditure of budgetary units	78 194	88 837	92 963	4 126
Capital expenditure	18 477	33 759	23 924	-9 835
Debt servicing	27 336	29 800	28 000	-1 800
Contribution to the EU	21 720	25 592	28 520	2 928
Co-financing of EU funds-based projects	7 714	11 939	11 683	-256

Source: Ministry of Finance, Santander

Borrowing needs in 2021 higher than in 2020

Net borrowing needs of 2021 budget are supposed to equal PLN113.5bn, by cPLN10.0bn more than in 2020 (after budget amendment). These will be covered mainly by issuance of government bonds: net of PLN77.8bn which will be resulting from the gross supply of PLN192.6bn and buyback/maturities at PLN114.9bn. In 2021 the borrowing needs will also be covered by foreign net borrowing of PLN35.7bn. A major part of foreign financing will be covered by EU borrowing instrument named SURE (loans helping protect jobs and workers). We remind that, according to the Ministry of Finance, the 2020 borrowing needs have been already met in over 90% which implies that any issuances after September will likely be directed towards 2021 borrowing needs (in September there are 2 auctions on 3rd and 17th both of which are switch auctions). We estimate that between October and December 2020 the issuance of POLGBs might reach cPLN20.0bn.

Budget expenditures in 2021 by sections (PLNm)

	2020 (1)	2021 (2)	change (2) - (1)
Budget expenditures	508 019	486 028	-21 991
Agriculture and hunting	5 627	5 813	186
Forestry	12	13	1
Fisheries	124	114	-10
Mining	2 020	409	-1 611
Manufacturing	824	1 008	184
Trade	442	469	27
Hotels/restaurants	21	20	-1
Transport, Communication	25 997	8 862	-17 135
Tourism	58	62	4
Housing	741	380	-361
Services	500	517	17
IT	24	23	-1
Higher education	25 440	25 399	-41
Public administration	16 037	16 357	320
Offices of supreme state authorities, control and protection of law and the judiciary	2 751	2 892	141
Defence	43 957	42 197	-1 760
Social security	91 922	103 767	11 845
National security and fire protection	18 674	16 812	-1 862
Justice	15 088	15 965	877
Debt servicing	29 800	28 000	-1 800
Various expenditures	119 157	124 891	5 734
Education	2 319	2 418	99
Health	10 499	20 087	9 588
Social aid	4 077	4 172	95
Other tasks of social policy	27 793	1 405	-26 388
Educational care	140	150	10
Family	58 557	58 769	212
Communal services and environment protection	1 440	1 522	82
Culture and heritage protection	3 579	3 136	-443
Botanical and zoological gardens, areas and items of nature protection	114	112	-2
Physical education	283	288	5

Source: Ministry of Finance, Santander

Detailed look at the government papers issuance in 2021 shows that the total number for T-bills stands at cPLN20bn, with expected net issuance at PLN9.1bn (maturities of cPLN 11.0bn). As for the government bonds, the gross issuance in 2021 might stand at PLN158.0bn (fixed coupon PLN114.0bn, floaters PLN43.4bn), around PLN95.3bn of bonds will mature (PLN82.4bn and PLN12.9bn respectively) which will result in the abovementioned net issuance at PLN77.8bn (split into PLN32.0bn for fixed coupon bonds and PLN30.5bn for floaters). The retail bonds gross issuance is planned at PLN15.0bn, while the net at PLN6.2bn (cPLN8.8bn of retail bonds will mature in 2021).

Comparison of the planned issuance of 2021 vs the plans for the 2020 (after the amendment) shows an increase of issuance of floating bonds. The supply of retail bonds will be lower than in the current year.

Borrowing needs and their financing (PLNmn)

	2020 (1)	2021 (2)	2021 change (2) - (1)
Central budget deficit	109 348	82 300	-27 048
EU funds deficit	16 954	6 865	-10 089
Loans granted	1 887	691	-1 196
Pre-financing from EU	-75	65	140
Pre-financing from international institutions	769	1 723	954
Liquidity management	-23 600	21 900	45 500
Management of EU funds	-52	6	58
Other	-1 889	-19	1 870
TOTAL (net borrowing needs)	103 340	113 531	10 191
Of which:			
1. Domestic financing	115 022	77 782	-37 240
1.1 State Treasury debt	104 718	77 782	-26 936
1.2 Budget current accounts	10 304	0	-10 304
2. Foreign financing	-11 682	35 748	47 430
2.1 Government bonds	-589	-9 062	-8 473
2.2 Credit received	-2 491	33	2 524
2.3 SURE credit	4 395	31 181	26 786
2.4 Cash flow linked to the fx account	-12 997	13 596	26 593

Source: Ministry of Finance, Santander

POLGB issuance in 2021 assumed in the draft budget (PLNmn)

	2021 plan			Difference vs 2020		
	Net	Redemptions	Gross	Net	Redemptions	Gross
T-bills	9 116	10 846	19 962	-1 727	10 846	9 119
POLGBs (fixed coupon)	31 960	82 370	114 330	-51 549	47 750	-3 798
POLGBs (floating coupon)	30 462	12 888	43 350	31 306	-17 634	13 672
POLGBs (retail/savings)	6 244	8 756	15 000	-4 966	2 694	-2 272
Total	77 782	114 860	192 642	-26 936	43 657	16 721

Source: Ministry of Finance, Santander

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