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## Polish fiscal performance: a growing challenge

- According to national definition, the public debt in 2010 stood at 53.0% of GDP remaining below the 55% constitutional threshold that would trigger automatic consolidation measures
- Poland's general government deficit widened to 7.9% of GDP in 2010 from 7.3% of GDP in 2009 and 3.7% of GDP in 2008, exceeding the European Union limit of 3.0% of GDP for a third consecutive year

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Poland's general government deficit widened to 7.9% of GDP in 2010 from 7.3% of GDP in 2009 and 3.7% of GDP in 2008, exceeding the European Union limit of 3.0% of GDP for a third consecutive year. The government approved in late-April the updated Euro Convergence report aiming to cut the fiscal deficit to 5.9% of GDP in 2011 and to 2.9% of GDP in 2012. To achieve this target, the government has announced a number of fiscal consolidation measures. Namely, a 1% VAT hike effective from January 2011, a public sector wage freeze and a limit on discretionary spending to headline CPI+1%. However, the government has shown no clear signs to tackle its sizeable structural deficit which amounts currently to around 6% of GDP. Reforms in the labour market are needed and could save up to two thirds of the structural deficit. Abolition of early retirement schemes<sup>1</sup> and privileged farmers pension schemes<sup>2</sup> are some of the pending reforms. But, the government ahead of the October's parliamentary election is most likely to backtrack on applying any non populist measures. Moreover, given the very uncertain global economic environment, the government is not willing to undertake an aggressive fiscal tightening which may weigh heavily on near-term growth. Nonetheless, given that the budget deficit has more than quintupled since 2007 (from 22.1bn PLN in 2007 it climbed to 111.1bn PLN in 2010) and that the economy is now growing at its potential level, this fiscal deficit is clearly too large for this stage in the cycle and has to be tackled in order to secure continued growth and convergence to the Euro-zone over the medium term.

What's more, if the government does not undertake a comprehensive reform programme to cut its fiscal deficit; this would result in Poland facing higher external financing needs. The market will surely be looking for decisive action on fiscal consolidation once the elections have passed. It's worth noting that total external debt accounted for 65.4% of GDP in 2010 up from 59.6% of GDP in 2009 and 48.4% of GDP in 2007. Moreover, public debt denominated in FX accounted for 23.1% of GDP in 2010 up from 18.6% of GDP in 2009 and just 16.4% of GDP in 2007.

<sup>1</sup> Uniformed service workers including the police soldiers and firemen are currently allowed to retire in full after just 15 years of service.

<sup>2</sup> Farmers currently pay reduced social contributions; instead of income tax they pay a lower lump-sum agricultural tax.

This implies that the 43.4% of public debt is FX denominated in 2010 up from 36.5% share in 2009. This is justifying the concerns over a potential zloty (domestic currency) devaluation which would raise the public debt to GDP ratio. To that extend the Polish government announced that it will convert as much as €14bn of European Union funds into zloty this quarter. According to national definition, the public debt in 2010 remained below the 55% of GDP constitutional threshold that would trigger automatic consolidation measures which, in turn, would be politically harmful in the run up to the October's elections. The 53.0% of GDP public debt outturn is slightly better than the September's official projection of 53.2% of GDP (Table).

**Table**  
**Fiscal slippage in recent years**

	2007	2008	2009	2010
<b>GDP nominal, bn PLN</b>	1,176.7	1,275.4	1,343.6	1,415.5
<b>GDP % growth</b>	6.8	5.1	1.7	3.8
<b>Fiscal deficit nominal, bn PLN</b>	22.1	46.8	98.7	111.1
<b>Fiscal deficit % of GDP</b>	1.9	3.7	7.3	7.9
<b>Public debt nominal, bn PLN</b>	529.4	600.8	684.1	778.2
<b>Public debt % of GDP (national definition)</b>	44.8	46.9	49.8	53
<b>Public debt % of GDP (ESA95 definition)</b>	45	47.1	50.9	55
<b>Total External debt</b>	569.9	727.1	801.2	925.4
<b>External Public debt</b>	192.8	200.5	250.1	326.3
<b>Share of public debt in FX</b>	36.4%	33.3%	36.5%	43.4%

Source: National Bank of Poland, Eurostat, National Statistics, Eurobank Research calculations.

All in all, we anticipate the fiscal deficit to narrow this year on the back of suggested consolidation measures but not at the level it is officially projected since backtracking may also appear ahead of October parliamentary elections.

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