Ministry
of Finance

Republic
of Poland

THE PUBLIC FINANCE SECTOR DEBT MANAGEMENT STRATEGY in the years 2021-2024

Ministry of Finance

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I. INTRODUCTION

Pursuant to Article 75 of the Public Finance Act of 27 August 2009, the Minister of Finance is obliged to develop annually a 4-year strategy on managing the State Treasury (ST) debt and influencing the public finance sector debt. This document is presented by the Minister of Finance to the Council of Ministers for approval, and then it is submitted by the Council of Ministers to the Sejm, together with the justification to the draft Budget Act.

Public debt management is conducted at two levels:

- in a broader sense, debt management is a part of the fiscal policy and covers decisions on what portion of State expenditure is to be financed through debt, accordingly, what the level of public debt should be (this aspect is discussed in documents updated on an annual basis, dedicated to the government economic programme, especially in the justification to the draft Budget Act and the Convergence Programme Update);
- in a narrower sense, debt management means the way of financing the State borrowing requirements and designing the debt structure, in particular by selecting markets, instruments and dates of issuance.

The macroeconomic and fiscal assumptions adopted in the Strategy are compliant with the assumptions of the draft Budget Act for 2021.

Table 1. Public debt and debt servicing costs – summary of the Strategy forecasts

Item	2019	2020	2021	2022	2023	2024
1. Public debt						
GDP %	43.6%	50.4%	52.7%	51.4%	49.9%	48.1%
2. The amount specified in the article 38a (3) of the Public Finance Act*						
GDP %	42.1%	48.5%	51.4%	50.2%	48.8%	47.0%
3. General government debt						
GDP %	46.0%	61.9%	64.1%	63.1%	61.9%	59.5%
4. State Treasury debt servicing costs**						
a) PLN bn	27.3	29.8	28.0	24.1 - 24.5	22.0 - 22.3	20.9 - 21.1
b) GDP %	1.20%	1.33%	1.19%	0.97% - 0.98%	0.84% - 0.85%	0.75% - 0.76%

**) The amount of public debt recalculated using the yearly average of foreign currency exchange rates for the year concerned and reduced by the value of State budget liquid funds raised to finance the borrowing requirements for the following budget year.*
***)Forecasts of the debt servicing costs for the years 2022-2024 account for the exchange rate risk provisions.*

Under the adopted assumptions, at the end of 2020 the public debt-to-GDP ratio will amount to 50.4% and then increase to 52.7% at the end of 2021. In the subsequent years covered by the Strategy forecast, the public debt-to-GDP ratio will be decreasing, reaching 48.1% at the end of 2024.

The ratio of the amount specified in Article 38a(3) of the Public Finance Act to GDP will reach 48.5% in 2020 and 51.4% in 2021, i.e. above the threshold of 48% included in the stabilising expenditure rule. In the following years it will be decreasing to 47.0% in 2024. Due to the fulfilment of the conditions specified in Article 112d of the Public Finance Act, in 2020 the escape clause of the stabilising expenditure rule, as stipulated in the Public Finance Act, shall apply. At the same time, in line with the return mechanism and the presented macroeconomic forecasts, in the second fiscal year since the suspension of the rule (i.e. in 2022), its application will be resumed in accordance with the original formula provided for in Article 112aa of the Public Finance Act.

The general government debt-to-GDP ratio (according to the EU definition) will amount to 61.9% in 2020 and 64.1% in 2021, and then fall to 59.5% within the *Strategy* timeframe. According to the

forecasts, in the years 2020-2023, the Maastricht Treaty reference value of the debt-to-GDP ratio at 60% will be exceeded. However, due to the serious economic slowdown caused by the coronavirus pandemic throughout the European Union, the European Commission has launched the general escape clause provided for in the Stability and Growth Pact. The clause allows Member States to temporarily depart from the Ecofin Council recommendations on the medium-term budgetary objective. The EU flexible approach does not suspend the EU fiscal rules or exclude the excessive deficit procedure, but is intended to facilitate a coordinated response to the crisis.

In nominal terms, the limit of ST debt servicing costs assumed in the draft Budget Act for 2021 will be lower than that provided for in the draft amendment to the Budget Act for 2020 (PLN 29.8bn in 2020 compared to PLN 28.0bn in 2021). In relation to GDP, debt servicing cost limits will decrease from 1.33% in 2020 to 1.19% in 2021. It was assumed that in the *Strategy* timeframe, the debt servicing cost-to-GDP ratio will decrease to 0.75%-0.76%.

This *Strategy* is a continuation of the strategy developed last year, despite the fact that the environment have changed and the *Strategy* implementation will be impacted by increased public spending on measures aimed at preventing the effects of the COVID-19 pandemic. The Strategy objective, i.e. minimizing the long-term debt servicing costs, subject to the adopted risk constraints, has remained unchanged. The tasks aimed at implementation of the Strategy objective, associated with the development of the financial market, i.e. ensuring liquidity, efficiency and transparency of the Treasury Securities (TS) market, as well as the task related to the effective management of the State Budget liquidity have been maintained.

The following has been assumed for the accomplishment of the *Strategy's* objective in the years 2021-2024:

- the flexible approach towards shaping the financing structure in terms of selecting the market, currency and instruments shall be maintained, to the extent that cost minimization is achieved, subject to the assumed risk level limitations;
- the domestic market shall remain the main source of financing the State budget borrowing requirements;
- the share of foreign currency debt in ST debt will be maintained below 25%;
- building large and liquid fixed rate issues, both in the domestic, as well as the euro market, shall be a priority of the issuance policy;
- the average maturity of the domestic ST debt shall be maintained around 4.5 years, and that of the total ST debt – around 5 years, subject to possible temporary deviations resulting from market and budgetary conditions related to the effects of the COVID-19 epidemic.

The *Strategy* comprises four annexes, including the glossary of terms.

II. VOLUME OF PUBLIC DEBT AND COSTS OF ITS SERVICING

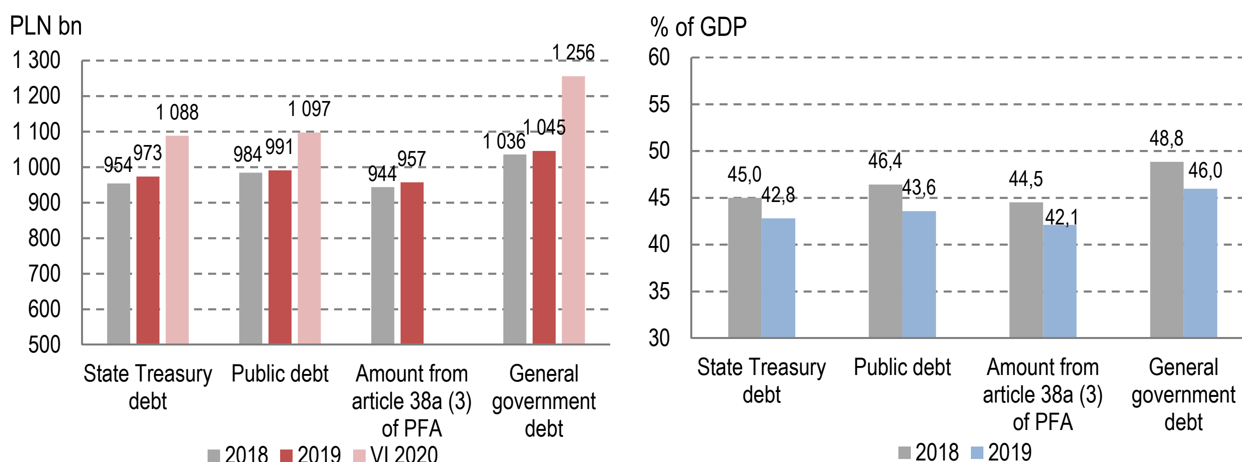
In 2019 the public debt (i.e. public debt according to the domestic definition) amounted to PLN 990.9 billion, which represented increase by PLN 6.6 billion. The general government debt (EDP debt, i.e. public debt according to the EU definition) amounted to PLN 1,045.4bn and was higher by PLN 9.7bn compared to the end of 2018.

In 2019 the public debt-to-GDP ratio decreased:

- the public debt-to-GDP ratio stood at 43.6% compared to 46.4% at the end of 2018 (a decline by 2.8 pp);
- the general government debt-to-GDP ratio amounted to 46.0 compared to 48.8% at the end of 2018 (a decline by 2.9 pp) and was much lower than the ratio for the European Union (79.3% of GDP) and the euro area (84.1% of GDP)[1];
- the ratio of the amount specified in Article 38a(3) of the Public Finance Act (public debt recalculated using average exchange rates, reduced by the value of funds for financing of borrowing requirements for the following budget year) at the end of 2019 reached a level of 42.1% of GDP, i.e. below the threshold of 43% defined in the stabilising expenditure rule, as compared to 44.5% of GDP at the end of 2018.

The policy pursued in recent years resulting in a consistent reduction in the public debt-to-GDP ratio has created of a large safety buffer to be used in a crisis situation, with no concerns about debt reaching excessive levels.

Chart 1. Volume of public debt

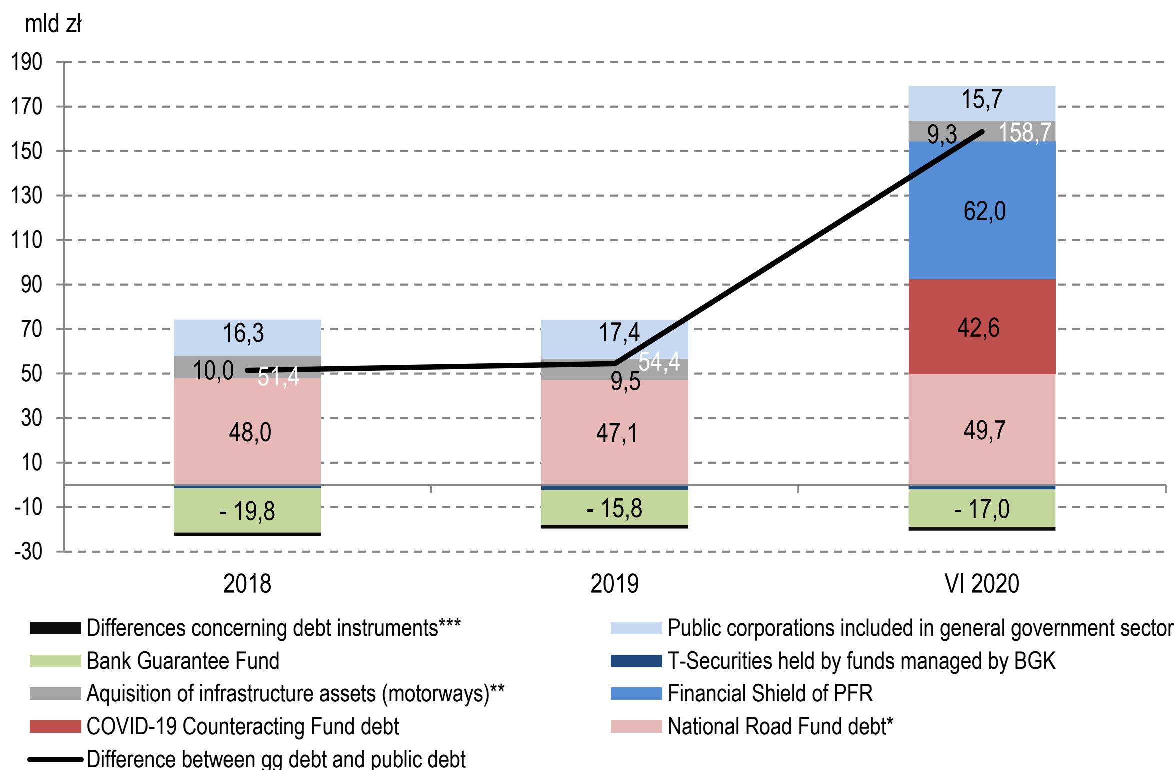


The differences between public debt and the general government debt are due to the following factors:

- different scope of public finance sector, i.a. recognising the National Road Fund (KFD) and the COVID-19 Counteracting Fund (FPC) in the general government sector (the indebtedness of these two funds increases the debt of the sector) and the Bank Guarantee Fund - BFG (TS held by it reduce the debt of the sector);
- rerouting of transactions to the general government sector, including the Financial Shield of the Polish Development Fund (PFR) – bonds issued to finance the Shield increase EDP debt;
- differences related to liabilities (mainly matured payables) treated as public debt according to the national definition and not included therein in the EU definition.

[1]) Deficit and the general government debt for EU Member States are presented in Annex 4.

Chart 2. Differences between general government debt (gg) and public debt



**) Debt consolidated within gg sector, i.e.: decreased by the nominal value of T-bonds held by Demographic Reserve Fund (FRD).*
***) In compliance with Eurostat guidelines on sector classification, general government debt figures include capital expenditures of certain infrastructure projects.*
****) Matured payables, debt assumption – activation of guarantee, CIRS transactions, restructured/refinanced trade credits, sale-lease-back operations.*

The detailed description of differences between the public debt according to the domestic and the EU definition is included in Annex 3.

Changes in the volume of public debt are mainly due to changes in the ST debt that accounts for ca. 92% of public debt, while those in the general government debt are additionally due to the issue of bonds of the Polish Development Fund as part of the Financial Shield and the COVID-19 Counteracting Fund since April 2020.

The increase in the State Treasury debt in 2019 (by PLN 19.1 billion) was mainly due to factors not resulting from the borrowing requirements, but primarily from the transfer of TS pursuant to acts other than the Budget Act (PLN 5.9 billion) and the increase in the other ST debt: deposits of public finance sector entities (PLN 5.7 billion) and loans granted to the Solidarity Fund (FS) by the Demographic Reserve Fund (FRD; PLN 8.7 billion). In 2019, the State budget net borrowing requirements were negative and amounted to PLN -0.2 billion and comprised mainly the State budget deficit (PLN 13.7 billion) and the balance of EU funds management (PLN 5.2 billion), but also items reducing borrowing requirements, including the balance of deposits of public finance sector entities and court deposits (PLN -15.2 billion) and the surplus of the EU funds budget (PLN -2.6 billion).

In the first half of 2020, the increase in ST debt (by PLN 114.9 billion) was mainly due to:

- borrowing requirements (PLN 8.3 billion), being mainly the result of the State budget deficit of PLN 17.1 billion, a decrease in the balance of deposits of public finance sector entities and court deposits by PLN 8.8 billion, and the balance of EU funds management (PLN -15.7 billion);
- increase in the balance of funds on the State budget account for financing borrowing requirements (PLN 69.8 billion);

- FX rates movements (debt increase by PLN 13.4 billion);
- transfer of bonds pursuant to acts other than the Budget Act (PLN 17.0 billion);
- increase in the other ST debt: mainly a loan granted to the Solidarity Fund by the Demographic Reserve Fund (PLN 11.5 billion).

As at the end of August 2020, the level of financing of the 2020 gross borrowing requirements assumed in the draft act amendment to the 2020 Budget Act was 97%.

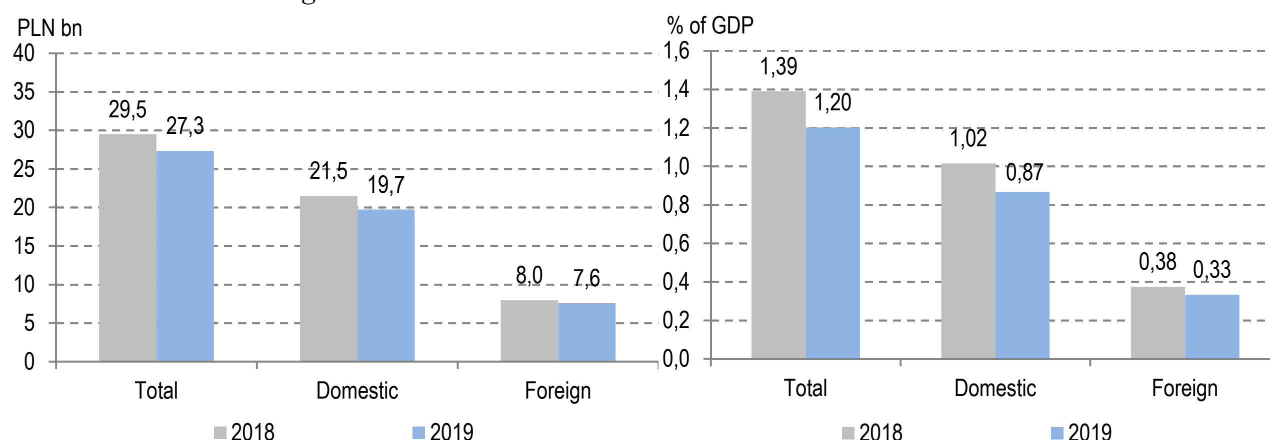
Table 2. Factors affecting change in ST debt in 2019 and the first half of 2020 (PLN billion)

Item	2019	I-VI 2020
Change in ST debt	**19.1**	**114.9**
1. State budget borrowing requirements:	**-0.2**	**8.3**
1.1. State budget deficit	13.7	17.1
1.2. EU funds budget deficit	-2.6	0.0
1.3. Balance of deposits from public finance sector entities and court deposits	-15.2	8.8
1.4. European funds management	5.2	-15.7
1.5. Granted loans balance	0.0	0.1
1.6. Other borrowing requirements [1)]	-1.3	-2.0
2. Changes not resulting from State budget borrowing requirements:	**3.9**	**99.7**
2.1. FX rates movements	-1.2	13.4
2.2. Changes in budget accounts balance	0.0	69.8
2.3. Other factors [2)]	5.1	16.5
- transfer of TS pursuant to acts other than the Budget Act	*5.9*	*17.0*
3. Change in other State Treasury debt:	**15.3**	**6.9**
3.1. Deposits from public finance sector entities [3)]	5.7	-4.8
3.2. Other deposits [4)]	0.9	0.2
3.3. Loans granted by PFS entities [5)]	8.7	11.5
3.4. Other ST debt	0.0	0.0

1) Pre-financing balance of tasks co-financed with EU funds, shares in international financial institutions (IFIs) and other domestic and foreign settlements.
2) TS discount, TS indexation, sell-buy-back transactions, transfer of T-bonds under acts other than the Budget Act.
3) Deposits accepted from PFS entities with legal personality and court deposits from PFS entities with legal personality - their value does not affect the level of public debt.
4) Deposits from general government sector entities outside the PFS, court deposits from entities outside the PFS and collateral deposits connected with CSA agreements.
5) Loan granted to the Solidarity Fund by the Demographic Reserve Fund, without any impact on public debt due to the elimination of mutual liabilities of public finance sector entities.

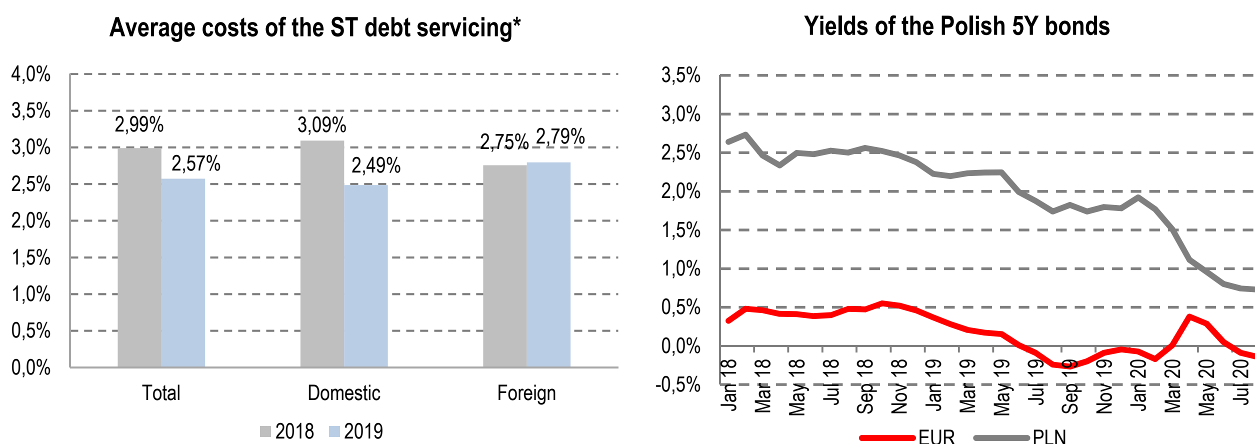
In 2019, ST debt servicing costs decreased in nominal terms to PLN 27.3 billion from PLN 29.5 billion in 2018. The debt servicing cost-to-GDP ratio also fell to 1.20% in 2019 from 1.39% in 2018. Foreign debt servicing costs were lower than those of domestic debt, which was mainly due to a smaller share of foreign debt in ST debt.

Chart 3. ST debt servicing costs



The average debt servicing costs in 2019 decreased to 2.57% from 2.99% in 2018, as a result of reduction in domestic debt servicing costs. This level is higher than the current cost of market financing, which results from servicing of debt incurred in the past at higher yields.

Chart 4. Market interest rates and average ST debt servicing costs

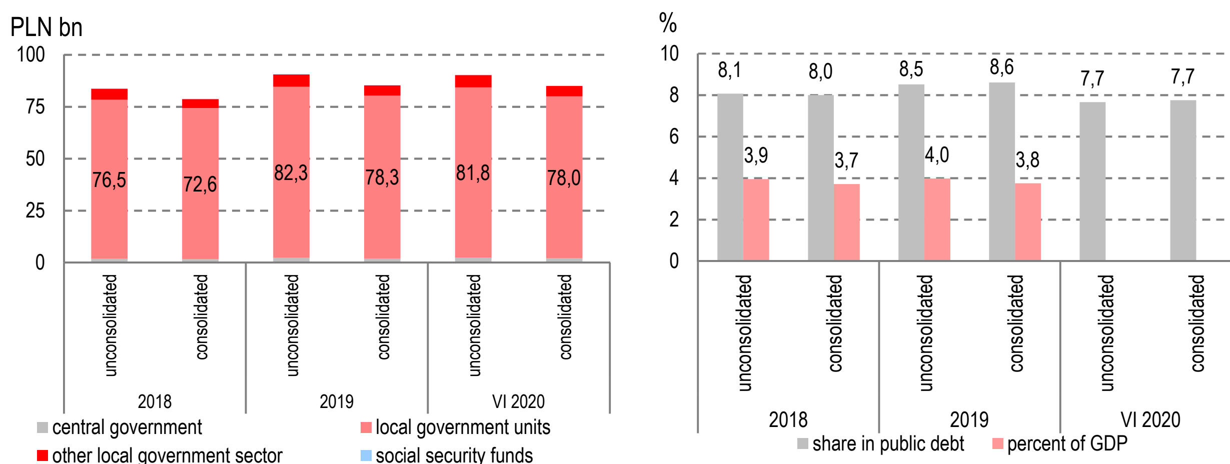


**) Average debt servicing costs were calculated as a ratio of the difference between debt servicing expenses and income in a particular year to the arithmetic mean of the ST debt volume at the end of 13 consecutive months.*

At the end of 2019, debt of entities other than ST accounted for 8.5% of public finance sector debt prior to consolidation (8.6% after consolidation), compared to 8.1% prior to consolidation (8.0% after consolidation) at the end of 2018. At the end of the second quarter of 2020, these figures were in both cases at the level of 7.7%.

The debt of the local government sector, in particular, the debt of local government units (LGU) and their associations, accounted for the largest share in this part of the debt.

Chart 5. Volume and structure of debt of public finance sector entities other than the ST



After 3 years of decline in unconsolidated debt, in 2018 and 2019, the debt of local government units and their associations increased by PLN 7.2 billion and PLN 5.9 billion, respectively, to PLN 82.3 billion, with its relative stabilisation in relation to GDP. The decrease in liabilities of local government units in 2015-2017 was related mainly to the end of the eligibility period for funds spent under projects co-financed with EU funds. The increase in debt of local governments is usually related to capital expenditure. Capital expenditure is directly related to various types of investments that are co-financed with EU funds. For this reason, subsequent eligibility periods for expenditure co-financed with EU funds are vital for the development of the debt of local government units.

In 2018, there was a dynamic increase in capital expenditure, which translated into an increase in liabilities. Capital expenditure made by local government units and their associations in 2018-2019 amounted to PLN 53.1 billion and PLN 51.4 billion, compared to PLN 35.5 billion in 2017.

In 2019, the debt of local government units and their associations, consolidated within the public finance sector, increased by PLN 5.7 billion and amounted to PLN 78.3 billion. In the first half of 2020, the debt of local government units and their associations before and after consolidation decreased by PLN 0.6 billion and PLN 0.4 billion, respectively.

III. EVALUATION OF IMPLEMENTATION OF THE STRATEGY OBJECTIVE IN 2019 AND IN THE FIRST HALF OF 2020

In 2019 and in the first half of 2020, debt management was conducted in accordance with *The Public Finance Sector Debt Management Strategy in the years 2019-2022*, adopted by the Council of Ministers in September 2018 and *The Public Finance Sector Debt Management Strategy in the years 2020-2023*, adopted by the Council of Ministers in September 2019 and its amendment adopted in December 2019.

Both documents defined the same debt management objective, i.e. long-term minimization of debt servicing costs, with the adopted constraints related to risk levels. Minimization of debt servicing costs was understood in terms of two aspects: selection of instruments and ensuring the effectiveness of the TS market.

III.1. Minimization of debt servicing costs - selection of instruments

In accordance with the assumptions of the *Strategy*, the domestic market remained the main source of financing borrowing requirements. In 2019, TS with a face value of PLN 134.8 were issued in the domestic market, and these were exclusively Treasury bonds. Funds with a face value of PLN 11.7 billion were raised in foreign markets, including PLN 3.1 billion from loans granted by international financial institutions (IFIs), and PLN 8.6 billion from bond issues. In the first half of 2020, funds in the amount of PLN 149.9 billion (including T-bills) were raised in the domestic market, and PLN 8.6 billion was raised in foreign markets (mainly from issues of foreign bonds).

Table 3. TS sales in the domestic and foreign markets and loans from IFIs at face value

Instruments	2018		2019		January - June 2020	
	PLN bn	%	PLN bn	%	PLN bn	%
Domestic TS	124.5	93.2	134.8	92.0	149.9	94.5
Foreign TS	4.2	3.1	8.6	5.9	7.2	4.6
IFIs loans	4.9	3.7	3.1	2.1	1.4	0.9

Among the instruments issued in the domestic market, securities offered to institutional investors prevailed (in 2019, these accounted for 87.2% of the total sales value, in the first half of 2020 - 90.2%), while the share of savings bonds, after reaching a record high level in 2019 (12.8%), fell to 9.8% in mid-2020.

Medium- and long-term securities (with maturities of over 4 years) prevailed in the sale structure of marketable TS offered on the primary market in 2019 and in the first half of 2020. In April 2020, T-bills (with maturities of 9-52 weeks) became available again after a three-year break. They were sold at the beginning of the COVID-19 pandemic and used both for the ongoing management of the State budget liquidity, and partially for financing borrowing requirements of State budget. The yields achieved at auctions were the lowest in history (the average yield at tenders in the first half of 2020 was 0.69%).

Table 4. Sale of marketable TS on the domestic market by maturity

Instruments	2018	2019	January - June 2020
T-bills	0.0%	0.0%	13.1%
T-bonds with maturity up to 4 years (incl.)	15.3%	11.1%	15.5%
T-bonds with maturity over 4 years up to 6 years (incl.)	50.9%	51.9%	40.6%
T-bonds with maturity over 6 years	33.8%	37.0%	30.8%

Fixed rate securities held the largest share in the structure of domestic marketable TS, with a decreasing share of floating rate instruments (a decrease from 32.8% in 2018 to 14.5% in the first half of 2020) and zero-coupon bonds (from 10.0% in 2018 to 7.5% in mid-2020).

Table 5. Sale of marketable TS on the domestic market by type of interest rate

Instruments	2018	2019	January - June 2020
Fixed rate bonds	57.2%	51.2%	64.9%
Zero-coupon bonds	10.0%	11.1%	7.5%
Floating rate bonds	32.8%	37.7%	14.5%
Inflation-linked bonds	0.0%	0.0%	0.0%
T-bills	0.0%	0.0%	13.1%

In the analyzed period, five issues of euro-denominated bonds with the total value of EUR 5.7 billion were conducted in foreign markets. In March 2019, Poland for the third time in history issued euro-denominated Green bonds with a maturity of 10 and 30 years. Strong demand allowed to achieve high issuance values , especially in the case of 10-year bonds. The proceeds from the issues of Green bonds are allocated to financing projects related to the environment. In the first half of 2020, 3- and 5-year benchmark bonds with high issuance amounts and a 1-year private placement bonds were issued. All three issues brought a negative yield, with a 0% coupon.

Table 6. Issues of bonds on foreign markets in 2019 and in the first half of 2020

Period	Maturity (years)	Currency	Face value (in millions)	Yield
2019	10	EUR	1 500	1.057%
	30	EUR	500	2.071%
January - June 2020	1	EUR	200	-0.310%
	5	EUR	1 500	-0.102%
	3	EUR	2 000	-0.110%

In total, in 2019 and in the first half of 2020, loans from IFIs worth EUR 1.04 billion were drawn, including EUR 1.0 billion from the European Investment Bank (EIB).

The main factors that influenced the course and structure of financing borrowing requirements in 2019 and in the first half of 2020 included:

1) external factors, in particular:

- monetary policy carried out by the main central banks in the world, including:
  - **in the USA:** three interest rate cuts by 25 bp in 2019 (at the end of the year, the federal funds rate was in the range of 1.50-1.75%) and the completion of the Fed balance sheet reduction process (in September 2019), two interest rates cuts by a total of 150 bp (in March 2020), as a result the federal funds rate ranged in 0.00-0.25%, and the expansion of the Fed balance sheet by at least USD 700 billion in the following weeks to limit the negative impact of the coronavirus epidemic on the economy; measures to enable the free flows of funds to US corporations, banks and local governments; introduction (on 23 March 2020) of 7-day swap operations in cooperation with other central banks (Bank of Canada, Bank of Japan, Switzerland, England and the ECB); launch of unlimited bond purchases to keep loan financing costs low; corporate, state and local government loan financing programs of up to USD 300 billion, and a business loan program for small and medium-sized enterprises; launch of a new loan program worth USD 2.3 trillion to ensure liquidity of, *inter alia*, small and medium-sized enterprises and local governments and state governments;
  - **in the euro area:** keeping the main repo rate at 0.00% and reduction in the deposit rate by 10 bp to -0.50% (in September 2019), announcement of the third tranche of long-term loans for banks (from September 2019), and the re-launch of the asset purchase program of EUR 20 billion per month (from November 2019); measures to mitigate the effects of the COVID-19 epidemic: the launch of a new ultra-cheap bank loan program (worth EUR 109 billion) and a new asset purchase program worth EUR 750 billion (in March 2020) to

counteract the negative impact of the coronavirus pandemic on the European economy (PEPP), planned to continue by the end of 2020 and covering different asset classes from the public and private sectors, as well as additional asset purchases under the APP in the amount of EUR 120 billion by the end of 2020;

- **in China:** two cuts in the reserve ratio in 2019 (by a total of 150 bp, in January and September) and another three cuts in the first half of 2020 (by 50 bp in January, 50-100 bp in March and another 50 bp in April); two cuts in the 1-year lending rate, by a total of 10 bp to 4.15% (in September and November 2019), a reduction in the 5-year lending rate by 5 bp to 4.80% (in November 2019) and in the reverse repo rate by 5 bp to 2.50% (in November 2019); announcement (in February 2020) of liquidity-providing operations of CNY 1.2 trillion and the introduction of other monetary policy tools to ensure liquidity of and support for companies affected by the epidemic, lowering the 1-year lending rate by 10 bp to 4.05% and the 5-year one by 5 bp to 4.75%, as well as interest on 1-year loans for financial institutions by 10 bp to 3.15% (in February 2020); further reductions in the 1-year and 5-year lending rates by 20 bp (from 4.05% to 3.85%) and 10 bp (from 4.75% to 4.65%), respectively, in April 2020, and a reduction in the cost of medium-term financing for financial institutions (MLF rate) by 20 bp to 2.95% (the lowest level in history);
- **in Japan:** continuation of accommodative monetary policy: treasury bond purchase program worth JPY 80 trillion per annum, the key interest rate at -0.1%, the yield curve control (by purchasing government bonds to maintain the 10-year benchmark yield at ca. 0.0%) and the announcement to keep interest rates at the current or lower level until the 2% inflation target is achieved; extending the buy-back program with ETF equity funds at the level of JPY 6 trillion annually (from January 2020), and increasing this limit to JPY 12 trillion (in April); announcement to increase purchases of corporate debt securities to JPY 20 trillion;
- **in the United Kingdom:** two interest rate cuts in March 2020, by a total of 65bp (the main interest rate of 0.10%), increasing the asset purchase program by GBP 200 billion to GBP 645 billion and introducing a small business financing scheme (in March 2020); in April the Bank of England agreed temporarily to finance directly government borrowing requirements in the face of difficulties in raising funds in the financial markets; in June 2020, the asset purchase program implemented by the Bank of England was increased to GBP 745 billion;

- geopolitical situation in the world affecting the risk appetite in global financial markets, including:
  - continuation of the US protectionist trade policy towards its key partners, reaching a preliminary agreement with China (in January 2020) and a new free trade agreement with Canada and Mexico; escalation of action in this area led to deteriorated market sentiment and concerns about the impact of trade wars on the global economy;
  - uncertainty as to the conditions on which the UK is to leave the European Union and concerns about the implementation of the EU exit scenario without a deal, the Brexit deadline was set for 31 October 2019, and then postponed till 31 January 2020;
  - growing concerns about future trade relations between the EU and the UK due to the lack of progress in the negotiations and the approaching end of the transition period;
  - temporary growth in geopolitical tensions between the USA and Iran in January 2020, which resulted in a decline in bond yields on core markets and an increase in oil prices;

- concerns about the impact of the coronavirus epidemic in China on the global economy and then about global recession due to the spread of the pandemic worldwide and the lockdown in many sectors of the economy; growing concerns about a second wave of infections related to the acceleration of COVID-19 spread around the world;
- non-standard actions undertaken by governments and international institutions aimed at reducing negative effects of the pandemic on the global economy, including:

- adoption of an aid package for the economy worth EUR 750 billion by the German government (in March 2020) and another one worth EUR 130 billion to support the economy after the crisis related to the pandemic (in June), including VAT reduction, aid for local governments and one-time payments for each child in the family;
- adoption of a stimulus package for the economy worth over USD 2 trillion by the US government in March 2020 (the largest financial aid for the economy in the history of the USA). The package includes USD 500 billion for sectors in a difficult situation, USD 350 billion for loans to small businesses, USD 250 billion for aid for the unemployed, and USD 100 billion for hospitals. It was also resolved to pay one-time cash transfers of USD 1,200 for each citizen earning less than USD 75,000 per annum and an additional USD 500 per child. USD 4 billion was allocated to aid for the homeless;
- adoption of a new USD 500 billion aid program for the economy by the US Senate (in April 2020), including USD 332 billion to supplement the small business loan program;
- announcement of an epidemic effect mitigation program worth EUR 37 billion and loans for 100,000 companies in the amount of EUR 8 billion by the European Commission (in March 2020);
- launch (in March) by the European Commission of the general escape clause in connection with the severe economic slowdown in the European Union caused by the coronavirus pandemic. The clause allows Member States to depart in 2020 from the Ecofin Council recommendations regarding the desired rate of expenditure increase;
- decision of the leaders of the G20 countries to grant financial aid to the global economy for counteracting the effects of the pandemic in the amount of at least USD 5 trillion;
- announcement to mobilize up to EUR 40 billion by the EIB for counteracting the crisis;
- increasing the aid package for companies by 100% to CHF 40 billion by the Swiss government, including guaranteed loans for enterprises with a 0.0% interest rate;
- Austrian government aid program for businesses, including state guarantees for corporate loans of up to EUR 120 million or the equivalent of three times monthly turnover (the plan covers 90% of corporate loans) and the introduction of a compulsory moratorium on the repayment of loans granted to consumers and small businesses affected by the pandemic;
- adoption by EU countries of legislation amending the rules for using cohesion policy funds to facilitate their spending on counteracting the coronavirus pandemic. The new regulations make it possible to use all reserves of structural funds for 2020 to counteract the effects of the pandemic;
- draft EU budget for 2021-27 (27 May 2020) and the draft recovery fund for economies affected by the pandemic, in which the EU budget would amount to EUR 1.1 trillion and another EUR 750 billion would be allocated to an additional economic recovery instrument, of which EUR 500 billion would be in the form of non-repayable grants and EUR 250 billion in the form of loans. An agreement on the budget and the recovery fund in the total amount of EUR 1.8 trillion was reached at the EU summit in July. This amount includes EUR 750 billion for the recovery fund (EUR 390 billion in grants and EUR 360 billion in loans). Under the EU agreement, Poland will receive over EUR 124 billion in direct subsidies, and together with low-interest loans – EUR 160 billion;

2) local factors, including mainly:

- monetary policy of the Monetary Policy Council (RPP), the situation in the financial market and in the domestic economy, including:
  - continuation of the policy of stable interest rates (including the repo rate at a level of 1.5%) and the wait-and-see stance in monetary policy in 2019, and a marked loosening of the monetary policy in the first half of 2020 to limit the negative economic consequences related to the coronavirus pandemic: lowering interest rates for the first time since March 2015 (the repo rate by a total of 140 bp to 0.1% in May, the Lombard rate by a total of 200 bp to

0.50% in May and the deposit rate by 50 bp to 0.0% in April); lowering the required reserve ratio from 3.5% to 0.5% (from 30 April), introducing a bill discount credit to refinance new loans granted to enterprises by banks, and starting (in March) liquidity-providing (repo) operations and purchasing Treasury bonds on the secondary market, and then extension of the purchase program to include bonds guaranteed by the State Treasury (PFR and BGK bonds) and T-bills (from April 2020);

– relatively high GDP growth in 2019 (4.1% despite the slowdown in Q4) and a significant decline in the GDP growth rate in Q1 and Q2 2020 (+ 2.0% y/y and -8.2% y/y, respectively), with inflation remaining within the inflation target limits (2.5% ± 1%) and its temporary increase in the first quarter of 2020;
– maintaining Poland's rating by the main rating agencies (A- by S&P and Fitch and A2 by Moody's) with a stable rating outlook;
– outflow of foreign capital from the domestic TS market (by PLN 34.1 billion in 2019 and PLN 19.7 billion in the first half of 2020) as a result of normalization of the Fed monetary policy, changes in the investment policy of some large holders of domestic TS and increased demand for safe assets due to the pandemic;
– depreciation of the zloty against the euro and the dollar in 2019 with lower volatility of both currencies (the volatility of the EUR/PLN exchange rate was 3.4% compared to 4.7% in 2018, the annual average market rate was 4.2955 compared to 4.2590 on average in 2018; in the case of USD/PLN, volatility amounted to 6.5% compared to 9.8% in 2018, and the average exchange rate was 3.8387 compared to 3.6125 on average in 2018), and further depreciation of the zloty against both currencies in in the first half of 2020, with an increase in volatility of the EUR/PLN exchange rate and lower volatility of the USD/PLN exchange rate (EUR/PLN: volatility: 5.8%, average exchange rate: 4.41, USD/PLN: volatility: 5.8%, average exchange rate: 4.00);
– high volatility in the domestic Treasury bond market in 2019 and in the first half of 2020, with a significantly lower level of interest rates, especially medium- and long-term ones (average yields on 2-, 5- and 10-year bonds in 2019 were 1.55% (1.6% in 2018), 2.0% (2.5%) and 2.4% (3.2%), respectively, and in the first half of 2020, these figures were 0.97%, 1.35% and 1.75%, respectively;

- favourable execution of the State budget in 2019, as a result of which net borrowing requirements were much lower than those assumed in the Budget Act;
- launch of a government rescue program – "Anti-Crisis shield" (in March 2020) to support the economy and counteract the negative effects of the coronavirus epidemic, with a total value of PLN 212 billion, including government expenditure of PLN 66 billion (State budget, social security and earmarked funds), government liquidity support worth PLN 74.5 billion and the NBP liquidity package worth PLN 70 billion. The program comprises five pillars, i.e. employee security, funding for businesses, healthcare, reinforcing the financial system, and a public investment program. The scale and range of the Anti-Crisis Shield instruments within government spending were expanded in the following months. In order to finance them, COVID-19 Counteracting Fund was established in BGK;
- launch of a government Financial Shield program (in April 2020), aimed at companies that suffered during the coronavirus pandemic, with a total value of up to PLN 100 billion. Under the program, PLN 25 billion is to be allocated to micro-enterprises, PLN 50 billion to small and medium-sized enterprises, and PLN 25 billion to large enterprises through the Polish Development Fund (PFR). Entities that take advantage of the program and meet certain conditions will receive a total of non-returnable PLN 60 billion;
- issue of PFR bonds guaranteed by the State Treasury under the Financial Shield program: by the end of August 2020, the PFR issued a total of PLN 62.0 billion in bonds with a maturity of 4-10 years. These bonds were issued as part of a program worth PLN 100 billion;

- issue of bonds of Bank Gospodarstwa Krajowego guaranteed by the State Treasury to supply the COVID-19 Counteracting Fund: by the end of August, BGK issued a total of PLN 77.2 billion in bonds with maturities from 5 to 13 years. The Bank may supply the COVID-19 Counteracting Fund with a total amount of PLN 112.5 billion;
- deterioration of the budgetary situation in the first half of 2020 (in the period from January to June, the deficit amounted to PLN 17.1 billion) and the announcement of an amendment to the 2020 Budget Act whose draft was adopted by the Council of Ministers in August 2020;
- enactment by the Sejm, on 28 May 2020, of the act amending the Public Finance Act (government project), that extends the catalogue of events that exclude the application of the stabilising expenditure rule by a state of epidemic, and defines the paths of automatic return to the application of this rule. As a result of the application of the Act provisions, the application of the expenditure rule in 2020 has been suspended;
- increase in borrowing requirements of the State budget due to the high budget deficit and the implementation of the government aid program.

III.2. Minimization of debt servicing costs – ensuring the effectiveness of the TS market

The most important measures aimed at minimization of debt servicing costs in terms of ensuring the effectiveness of the Treasury securities market include:

- issuance policy assuming the creation of liquid benchmark bond series. In mid-2020, the value of 16 issues exceeded PLN 25 billion, whereas at the end of 2019, there were 15 such issues (13 issues at the end of 2018). Issues exceeding PLN 25 billion accounted for 76.6% of the face value of medium- and long-term fixed rate bonds, compared to 74.2% at the end of 2019 (71.5% at the end of 2018). A high value of an issue has a significant positive effect on the liquidity level in the secondary market;
- issues of bonds with a value ensuring their liquidity in the EUR market (in 2019 and in the first half of 2020, there were three issues of bonds with a value exceeding EUR 1 billion);
- flexible adjustment of the TS supply to the current market situation and conducting a transparent information policy;
- extension of the offer of saving bonds to include premium bonds: the second issue of 10-month premium bonds in June 2019 (the first one took place in June 2018). These are fixed-rate instruments with an additional premium that can be won by drawing lots. Premium bonds were issued as part of measures encouraging savings growth and building saving culture, in accordance with the Strategy for Responsible Development;
- sell-buy-back (SBB) transactions between TS primary dealers (PD) and PD candidates and BGK under special terms (the mechanism was introduced in February 2014 in order to support clearing in the circumstances of temporary and significantly limited availability of bonds of a given series in the secondary market). In 2019 and in the first half of 2020, transactions with a face value of PLN 20.2 billion, accounting for 0.2% of all SBB transactions in the TS market, were concluded;
- replacement, since January 2019, of supplementary auctions for Treasury bonds and, since June 2019, for T-bills with additional sales. This allows buyers of TS at a main auction to buy additional TS on the same day at the price set at a sale auction. They can purchase any TS from the auction offer, with the maximum purchase value being determined by the product of the face value of bonds purchased at the auction and the percentage multiplier corresponding to the position of a given TS dealer in the current TSD ranking. The introduction of additional sales was to increase sales of TS and enable investors to additionally purchase any TS offered at a sale auction, regardless of which TS they purchased at the sale auction. It also gave rise to a

mechanism that, by linking the dealer's position in the TSD ranking with the volume of additional sales, should have a positive impact on the level of competition among TSDs;

- introduction (in January 2019) of the global single price model (all sold securities with a given maturity are purchased by investors at the same price, regardless of the bond to be bought back) at switching auctions.

III.3. Constraints on the risk level

Table 7. Assessment of implementation of the Strategy objective constraints related to the level of risk

Constraints of the *Strategy* objective						
Constraint	Implementation level*	Implementation method	Measure	Value		
				2018	2019	June 2020
Refinancing risk	Satisfactory	• High share of medium- and long-term bonds sale in 2019 and its significant decline in the first half of 2020 (88.9% and 71.4%, respectively, of all TS sold at sale and switching auctions); • Significant role of switching auctions: - 55.7% of the initial debt in bonds maturing in the period from January 2019 to June 2020 was bought back; - in 2019 and in the first half of 2020, bonds with a total face value of PLN 107.4 billion were bought back; • Maintaining the average maturity of domestic debt at the level set in the *Strategy*, i.e. close to 4.5 years, and its slight decrease in the first half of 2020; • Maintaining the average maturity of ST debt at the level set in the *Strategy*, i.e. close to 5 years, and its slight decrease in the first half of 2020; • Issue of Treasury bills in April 2020.	ATM (in years) - domestic - foreign - total	 4.49 6.05 4.97	 4.53 6.06 4.97	 4.39 6.09 4.82
			Share in domestic TS: - TS up to 1Y - T-bills	 9.6% 0.0%	 6.2% 0.0%	 12.0% 2.3%
Foreign exchange risk	High	• Decreasing the share of foreign currency debt in ST debt below the level of 30% set in the *Strategy* for 2019-2020, and below the level set in the *Strategy* for 2020-2023, i.e. 25%; • Maintaining the effective share of euro denominated debt in foreign debt (including derivative transactions) significantly above the minimum level set in the *Strategy* (70%).	Share of foreign debt in ST debt	29.3%	26.4%	23.3%
			Share of euro denominated debt in foreign debt	78.5%	81.5%	80.1%
Interest rate risk	High	• Maintaining ATR of domestic debt in the range of 2.8-3.8 years set in the *Strategy* 2019-2022, and 2.8-3.6 years set in the *Strategy* for 2020-2023; • Maintaining interest rate risk for foreign debt at a safe level that does not pose a constraint on cost minimization.	ATR (in years) - domestic - foreign - total	 3.27 4.69 3.71	 3.18 4.82 3.64	 3.29 4.86 3.69
			Duration (in years) - domestic - foreign - total	 3.03 4.32 3.45	 3.10 4.71 3.58	 3.21 4.85 3.64

Constraints of the *Strategy* objective		
Constraint	Implementation level*	Implementation method
Liquidity risk	High	The main instruments used in liquidity risk management included: • interest-bearing PLN-denominated deposits at the NBP – deposits with a total value of PLN 116.7 billion were made in 2019, while those made in the first half of 2020 amounted to PLN 88.9 billion; • PLN denominated deposits made through BGK (as an intermediary) – in 2019, transactions with a total value of PLN 1,899.2 billion were concluded, whereas those concluded in the first half of 2020 amounted to PLN 1,244.8 billion; • PLN denominated buy-sell-back (BSB) deposits hedged by Treasury securities – in 2019, transactions with a total value of PLN 285.6 billion were concluded, whereas those concluded in the first half of 2020 amounted to PLN 232.6 billion; • FX deposits – in 2019, deposits for a total amount of EUR 7.9 billion were made, whereas those made in the first half of 2020 amounted to EUR 4.5 billion; • sale of consolidated FX assets at the NBP and on the market; in 2019, foreign currencies equivalent of EUR 10.6 billion were sold at the NBP, with no sales made on the market; in the first half of 2020, EUR 5.3 billion were exchanged at the NBP and the equivalent of EUR 0.04 billion on the market. As part of consolidation of liquidity management, deposits of liquid funds on the accounts of the Minister of Finance in BGK amounted as at the end of 2019 and the end of June 2020 to PLN 70.1 billion and PLN 61.4 billion, respectively. The level of State budget liquid assets in 2019 and in the first half of 2020 ensured smooth execution of budgetary flows.
Credit risk	High	• PLN denominated BSB deposits hedged by Treasury securities did not generate credit risk; • For unsecured deposits in BGK, a system of credit limits is in place; • Risk connected with transactions involving derivatives is limited by selection of counterparties with high credit rating; • A system of collateral on derivative transactions through blocking TS or mutual collateral in the form of cash deposit is in place. Collateralized transactions do not generate credit risk; • Credit risk generated by uncollateralized derivative transactions is diversified through limits imposed on the total value of transactions made with particular partners. Creditworthiness of potential partners is monitored on an on-going basis.
Operational Risk	Satisfactory	• Adequate technical infrastructure for concluding market transactions, security of data and information related to debt management and the integrated database of ST debt help maintain operational risk at a safe level; • Adequate technical infrastructure enabling work from home office; • The situation in the labour market is a source of risk related to recruiting and maintaining qualified staff.
Distribution of debt servicing costs over time	High	• Coupons of new issues were set at a level slightly below their forecasted yields. Yields of both domestic and foreign bonds at levels allowing for the issue of debt with coupons lower than those for maturing instruments had a positive impact on the level of debt servicing costs. The level of debt servicing costs was affected by swap transactions concluded in 2018 and 2019 to distribute this expenditure over time by using current savings. As a result of those transactions, costs incurred in 2019 decreased by PLN 2.7 billion, whereas those incurred in 2020 were lower by PLN 1.3 billion.

**) In accordance with the scale: high, satisfactory, moderate and low.*

IV. ASSUMPTIONS OF THE STRATEGY

The following subchapters present the main macroeconomic assumptions of the *Strategy* and the market conditions that affect debt management. The issues discussed include the role of both domestic and foreign investors in the domestic TS market as well as possible developments in the major international markets.

IV.1. Macroeconomic assumptions of the *Strategy*

The assessment of the macroeconomic situation and directions of the fiscal policy was presented in the rationale for the draft Budget Act for 2021. Table 8 contains the key macroeconomic assumptions of the *Strategy*, consistent with the assumption of the draft Budget Act.

Table 8. Macroeconomic assumptions adopted in the Strategy

Item	2019	2020	2021	2022	2023	2024
Real GDP growth (%)	4,1	-4,6	4,0	3,4	3,0	3,0
GDP at current prices (PLN bn)	2 273,6	2 234,6	2 356,1	2 490,5	2 625,5	2 772,3
Average CPI (%)	2,3	3,3	1,8	2,2	2,4	2,5
USD/PLN - end of period	3,7977	3,9603	3,9603	3,9603	3,9603	3,9603
EUR/PLN - end of period	4,2585	4,4545	4,4545	4,4545	4,4545	4,4545

IV.2. International conditions

The most important international conditions in terms of ST debt management include:

- economic situation of the EU countries – the July forecasts of the European Commission indicate a profound recession in the euro area in 2020, and a gradual recovery of economic activity in the second half of 2020 and in 2021. The degree of GDP decline in the euro area in 2020 is estimated at 8.7%, while next year, GDP is expected to increase by 6.1%. This means deterioration in the forecasts compared to the European Commission's publication of May 2020, when the projected changes in real GDP in 2020-2021 amounted to -7.7% and 6.3%, respectively. At the end of 2021, the projected level of GDP in the euro area will remain ca. 2% lower than before the outbreak of the crisis caused by the COVID-19 pandemic. The fiscal impulse in the euro area countries will make public consumption a factor limiting the degree of GDP decline this year. In turn, in 2021, the recovery of private investment and consumption should be the main driver of growth;
- the situation in the interest rate markets for the currencies in which liabilities will be incurred, mainly in the euro market, and actions undertaken by major central banks affecting the level of yields in the domestic debt market:
  - announcement that the ECB will maintain a very mild monetary policy stance for a longer time; in June this year, the bank announced an increase in the PEPP program by an additional EUR 600 billion, to EUR 1.35 trillion, and the extension of the program duration at least until June 2021, along with a declaration to reinvest assets maturing under the PEPP program at least until the end of 2022. The ECB also announced that it would make loans secured with marketable assets in EUR available to central banks from outside the euro area (this instrument will be available by the end of June 2021);
  - ultra-soft monetary policy pursued by the Fed – according to the latest projections, Fed members expect interest rates to remain at the current record-low level at least until the end of 2022. The bank announced that the current rate of asset purchases would be maintained at USD 120 billion per month, kept up swap lines with central banks from other countries to ensure liquidity in USD, and extended some loan programs for companies, state authorities and individuals until the end of 2020. The Fed has declared its readiness to go ahead and use its full range of tools, if necessary, to support the economy; In August 2020, the Fed

changed the inflation target from a point to an averaged one at the level of 2% over the longer run. This means that inflation may temporarily exceed 2% after periods in which the price growth was below the target;

  - continuation of the asset purchase program by the Bank of Japan and keeping the benchmark interest rate negative for as long as necessary to meet the inflation target; the central bank has increased its special program for companies to support them due to the coronavirus pandemic from JPY 75 trillion to JPY 110 trillion (USD 1 trillion), and has kept up its position that the economy would gradually recover from the coronavirus pandemic, suggesting that the bank had already taken sufficient action to support the economy;
  - maintaining expansionary monetary policy and negative interest rates (the reference rate and the deposit rate of -0.75%) by the Swiss National Bank and its interventions in the foreign exchange market to counteract CHF excessive appreciation; possible additional steps in the event of deterioration in the liquidity of the banking system;
  - further easing of monetary policy by the People's Bank of China and the announcement of purchasing from banks loans granted to small companies in the amount of CNY 400 billion, to make it possible to grant new bank loans worth ca. CNY 1 trillion;
- perception of Poland's credit risk and liquidity preferences of Polish bonds' buyers operating in global markets, affecting the amount of the premium relative to core markets;
- concerns about global recession caused by the coronavirus pandemic and its further course due to information from the WHO about the acceleration of the spread of the pandemic around the world, and concerns about a second wave of coronavirus infections.

IV.3. Domestic TS market

The level of development of the domestic financial market, including the domestic investor base, as well as the involvement of foreign investors in this market are significant determinants of debt management. In the conditions of free capital flow, a well-developed and deep domestic market allows for absorption of external shocks and outflows of foreign capital.

Entities investing in the domestic TS market can be divided into three main groups: the domestic banking sector, domestic non-banking sector and foreign investors. From the end of 2018 until the first half of 2020, the following changes in the holders' structure of domestic TS debt were observed:

- a significant increase in domestic banks' holding, in particular in the first half of this year (by a total of PLN 175.3 billion, including that of the NBP by PLN 50.8 billion since April this year) and maintaining their prevailing share in the debt holders' structure (56.0% as at the end of June 2020);
- an increase in the involvement of domestic non-banking investors by a total of PLN 16.9 billion;
- further reduction in the involvement in domestic TS by foreign investors, by a total of PLN 53.8 billion. Their holding has decreased by 12.1 pp to 17.5%.

*Chart 6. Structure of domestic TS portfolios held by main groups of investors**

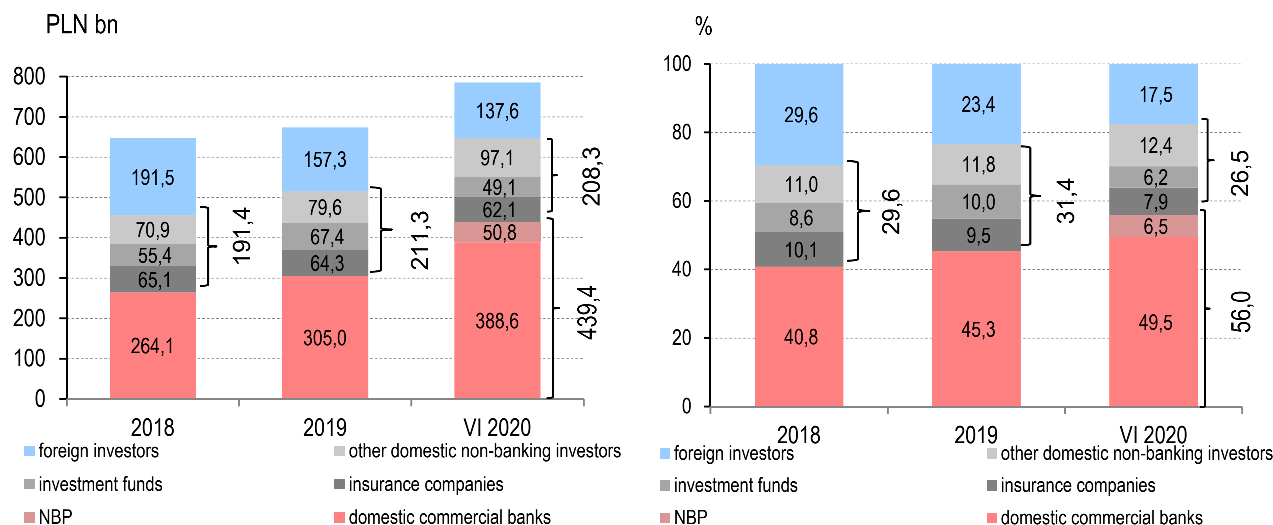
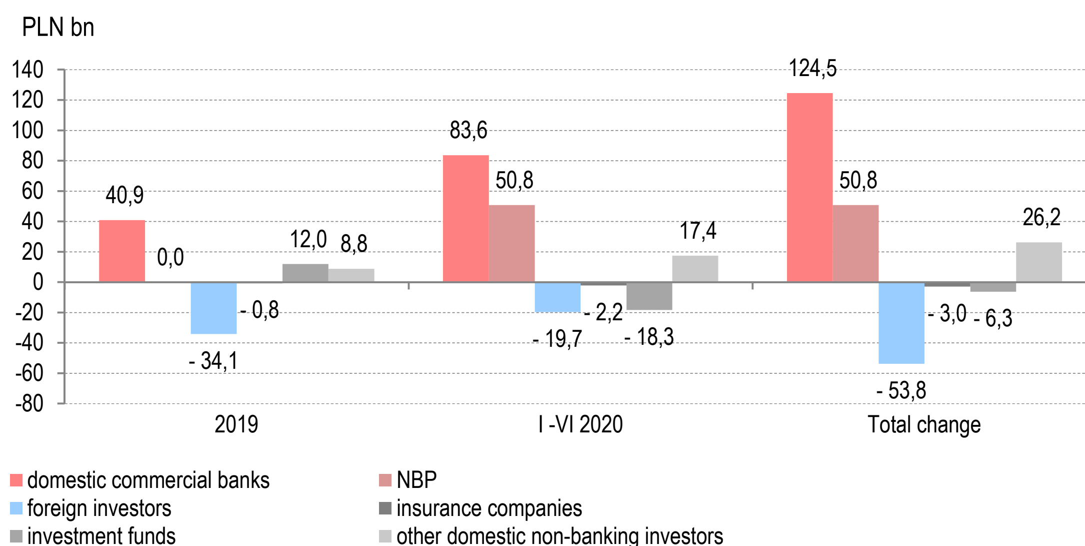


*Chart 7. Changes in domestic TS portfolios held by main groups of investors**



**) By face value.*

As at the end of June 2020, domestic investors held 82.5% of domestic TS debt, which represents an increase by 12.1 pp compared to the end of 2018. Institutional investors prevailed among domestic investors, however, over the recent year, a significant growth in the TS portfolio held by individual investors has been observed. Since the end of 2018, their holdings have increased to PLN 35.3 billion, i.e. by 76.2%, which resulted mainly from growing interest in the offer of saving bonds.

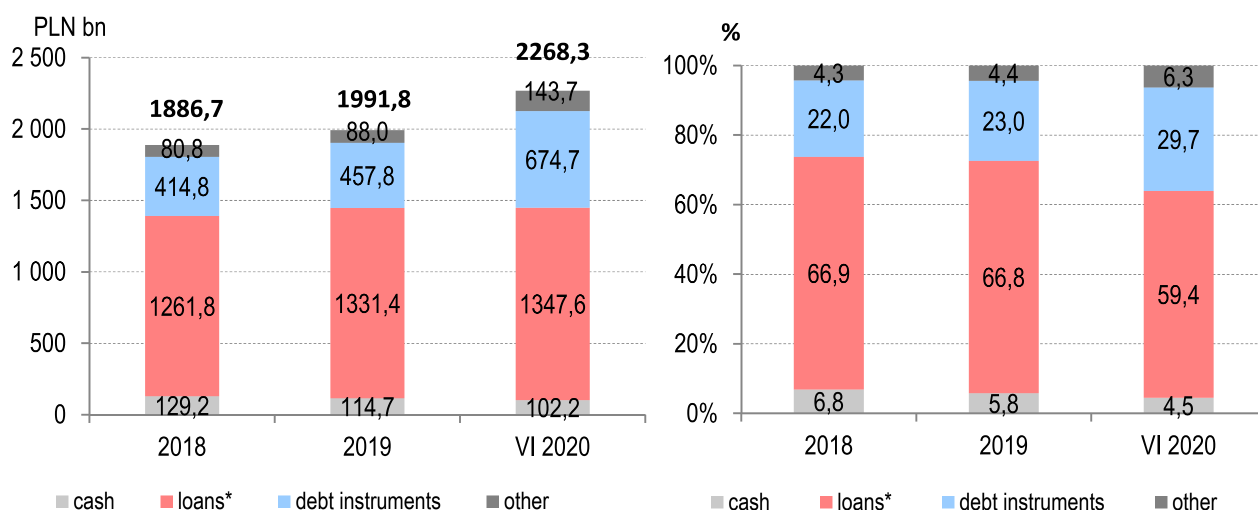
Besides the factors listed in the following subchapters, the share of domestic investors in the holders' structure of domestic TS debt in the coming years will also largely depend on the level of borrowing requirements, determining the volume of the TS supply offered to investors.

IV.3.1. Domestic banks

At the end of June 2020, assets of domestic banks amounted to PLN 2.3 trillion (an increase by 20.2% compared to the end of 2018), with the dominant share of credits and other receivables from domestic entities (ca. 59.4%). Debt instruments were the second largest component of assets – as at the end of June 2020, their share was 29.7%. The prevailing share in the structure of debt instruments had Treasury securities (62.3%) and NBP monetary bills (ca. 20.6%). What contributed to the persistent significant banks' demand for TS was tax imposed on 1 February 2016 on certain

financial institutions, comprising mainly banks[2)] and insurance companies, as well as the current situation in financial markets. In the period of increased borrowing requirements in the first half of 2020, related to the increase in the budget deficit, a significant part of the TS supply was absorbed by commercial banks at historically low yields. In accordance with the announcement of the NBP Management Board, purchases of Treasury securities and debt securities guaranteed by the State Treasury made by the NBP since April 2020 on the secondary market as part of structural open market operations are aimed at changing the long-term liquidity structure in the banking sector and ensuring liquidity of the securities on the secondary market.

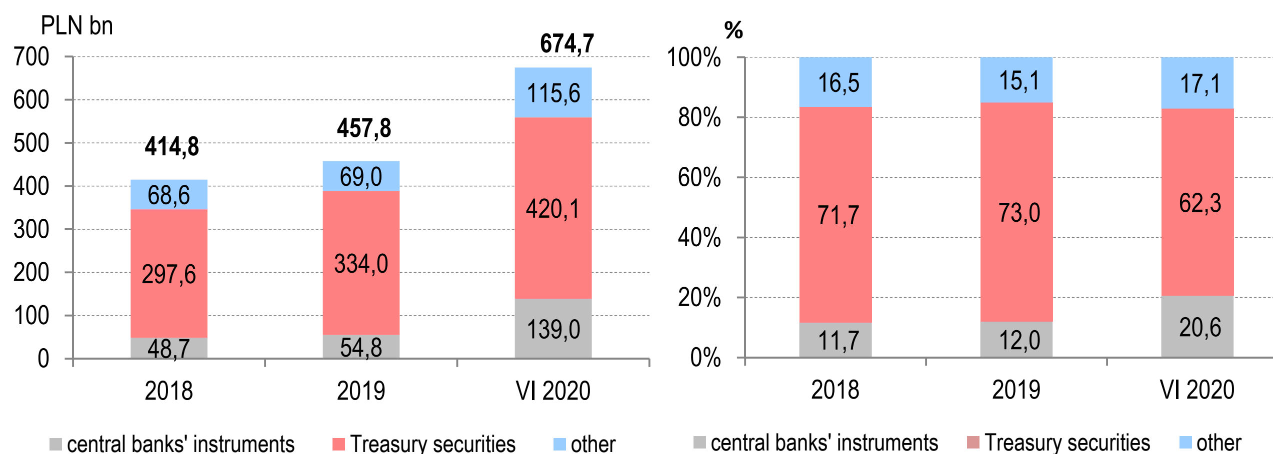
Chart 8. Structure of assets held by domestic commercial banks



** loans and other receivables from domestic entities*

Source: National Bank of Poland, in accordance with the applicable measurement methods.

Chart 9. Debt instruments in assets of domestic commercial banks



Source: National Bank of Poland, in accordance with the applicable measurement methods.

The most significant factors to affect banks' demand for domestic TS in the *Strategy* timeframe include:

- development of the economic situation, affecting the size and structure of assets held by banks;
- the level of over liquidity of the banking sector;
- assumed level of interest rates;

[2)] Tax base – assets decreased by, *inter alia*, own funds and Polish TS.

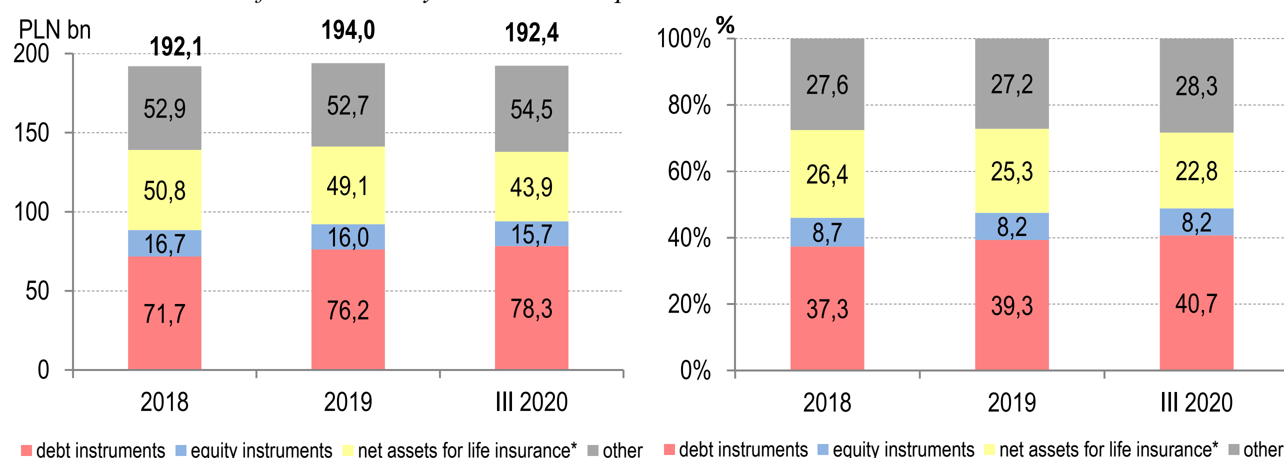
- tax on certain financial institutions.

IV.3.2. Domestic non-banking investors

Domestic non-banking investors include insurance companies, investment funds and other domestic non-banking investors (mainly individual investors and other entities). As at the end of June 2020, insurance companies held 7.9% (decrease in the holding by 2.2 pp compared to the end of 2018), investment funds 6.2% (decrease by 2.3 pp) and other domestic non-banking investors 12.4% (increase by 1.4 pp) of domestic TS. The main factors affecting the value of the TS portfolio held by insurance companies and investment funds include the assets value and the investment policy pursued by those entities.

Assets held by insurance companies as at the end of March 2020 amounted to PLN 192.4 billion, which represents an increase by PLN 0.3 billion compared to the end of 2018, i.e. by 0.2%.

Chart 10. Structure of assets held by insurance companies

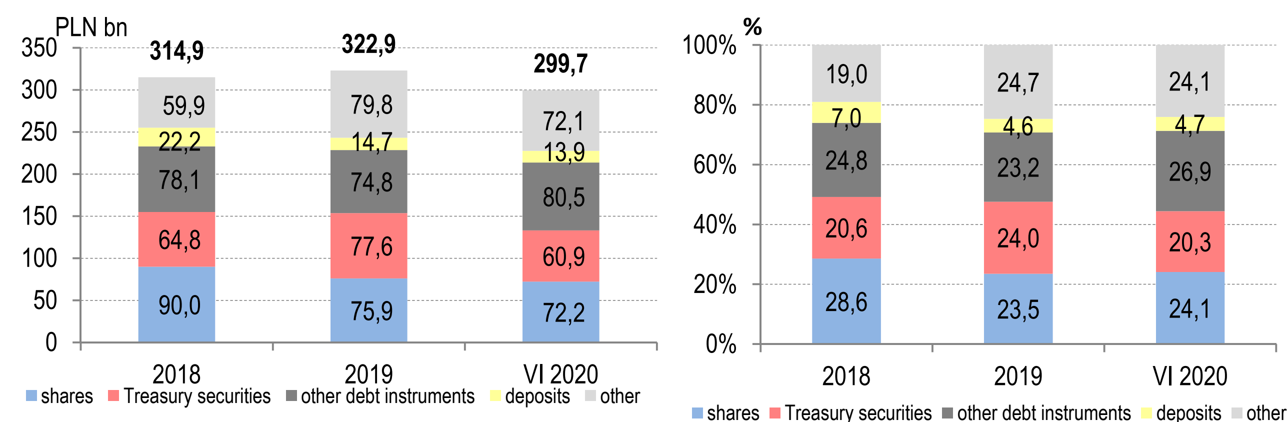


** net assets for life insurance - life insurance net assets where the investment risk is borne by the policyholder.*

Source: Polish Financial Supervision Authority, in accordance with the applicable measurement methods.

As at the end of June 2020, assets held by investment funds fell to PLN 299.7 billion, i.e. by PLN 15.3 billion (4.8%) compared to the end of 2018. The value of T-bonds (issued in the domestic market and foreign ones) held by investment funds decreased by PLN 3.9 billion and their share in assets fell by 0.3 pp.

Chart 11. Structure of assets held by investment funds



Source: National Bank of Poland, in accordance with the applicable measurement methods.

The main factors to determine the value of the TS portfolio in assets managed by non-banking financial institutions in the forthcoming years include:

- further development of the insurance and investment funds markets;

- situation in the stock market, which is one of the determinants of households decisions regarding savings allocation;
- low interest rates, encouraging households to search for capital investment opportunities, alternative to bank deposits;
- changes in the pension system aimed at increasing the scale of households' long-term savings to be paid after the end of professional activity. Changes in the pension system include the establishment of Employee Equity Schemes (PPK) (since July 2019) and the transformation of the Open Pension Fund (OFE) into investment funds maintaining individual retirement accounts (IKE) (due to the coronavirus pandemic, the date of their introduction has been postponed).

IV.3.3. Foreign investors

As at the end of June 2020, the share of foreign investors in domestic TS debt was 17.5% (a decrease by 12.1 pp compared to the end of 2018). In 2019 and in the first half of 2020, foreign investors reduced their holding of domestic TS by a total of PLN 53.8 billion. The decline in the share of non-residents was driven by both local factors (including lower TS supply in 2019 and the continuing high domestic investors' demand) and international factors, primarily the monetary policy pursued by major central banks.

The foreign investors' demand depends, to a large extent, on the international situation, and thus, it is highly volatile. However, the risk of a sudden outflow of foreign capital from Poland is limited due to high diversification, both institutional and geographical, of the non-resident structure. An outflow of part of foreign investors from the domestic TS market has been absorbed by domestic banks. The structure of debt held by non-residents is dominated by institutional investors[3]): central banks and public institutions (22.0% in June 2020), investment funds (21.7%), pension funds (10.4%) and insurance companies (15.7%). The geographical structure of domestic TS holders also proves high diversification – as at the end of June 2018, TS were held in the portfolios of investors from 62 countries.

The most important factors to affect non-residents' demand for Polish TS in the *Strategy* timeframe include:

- actions undertaken by central banks;
- economic developments and the stability of financial markets in the world, which will be significantly affected by the further course of the COVID-19 pandemic worldwide;
- Poland's economic foundations and the assessment of Poland's credit risk;
- functioning of a large liquid financial market in Poland (in particular, the TS market) and its adequate infrastructure (the implementation of the Capital Market Development Strategy is to support the development of the Polish capital market).

Due to free flow of foreign capital, non-residents' investment in domestic TS, as well as raising funds in international markets, may be a source of exchange rate risk for ST debt. Therefore, this factor determines a flexible approach to shaping the financing structure in terms of selection of the market and currency.

[3]) The structure does not include omnibus accounts holding 1/3 of the domestic TS debt to non-residents.

V. OBJECTIVE OF THE STRATEGY

The objective of the *Strategy* will remain **the minimization of debt servicing costs in the long-term horizon subject to the constraints at the level of:**

1) refinancing risk,
2) exchange rate risk,
3) interest rate risk,
4) State budget liquidity risk,
5) other risks, in particular credit risk and operational risk,
6) distribution of debt servicing costs over time.

This objective, determining the debt management, is understood in terms of two aspects, as:

- **selection of instruments**, aimed at cost minimization within the timeframe defined by maturity of the longest maturity instruments and a significant share in debt, through the adequate selection of markets, debt management instruments, structure of financing borrowing requirements and issuance dates;
- **ensuring the efficiency of the TS market**, contributing to the lowering of TS yields. This means striving to eliminate or limit any unfavorable factors in market organization and infrastructure.

The approach to the accomplishment of the objective of the minimization of debt servicing costs has not changed relative to the previous year's Strategy. This means the possibility of a flexible financing structure in terms of selection of the market, currency and type of instruments, also with the use of derivative instruments. The selection of this structure should result from an assessment of market conditions (the level of demand, interest rates and the shape of the yield curve in particular markets) and the financing cost in the long term, taking into consideration constraints resulting from the acceptable risk levels.

Experiences in debt management indicate a significant role of flexibility and diversification of sources of financing borrowing requirements, subject to the market situation. This contributes both to ensuring the security of financing the State budget borrowing requirements and the reduction in its cost, which is particularly important in the period of disruptions in financial markets.

The domestic market will remain the main source of financing the State budget borrowing requirements. The supply of instruments in this market will be developed in a flexible manner, adapted to the current market situation, i.e. the reported demand level, so that the TS supply impact on the yields can be minimized. Financing in international markets will supplement domestic financing and its level should:

- take into account the borrowing requirements of the budget in foreign currencies as well as the inflow of EU funds;
- ensure diversification of funding sources through Poland's access to the investor base in major financial markets;
- maintain Poland's position in the euro market;
- stabilize the domestic market through adjusting the structure of financing the State budget borrowing requirements to the market conditions;
- including the financial instruments offered by the EU to counteract the consequences of the COVID-19 pandemic;

- take advantage of attractive financing in international financial institutions;
- allow for selling currencies at the NBP and in the financial market as a foreign currency management instrument, while taking into account monetary, economic and budgetary policy.

The minimization of long-term debt servicing costs will be subject to constraints related to the ST debt structure. Therefore, the following assumptions have been made with respect to:

1) refinancing risk

- maintaining of the dominant role of medium and long-term instruments in financing the State budget borrowing requirements in the domestic market, subject to the market situation;
- aiming at maintaining the average maturity of the domestic debt at the level close to 4.5 years, subject to possible temporary deviations resulting from market and budgetary conditions related to the effects of the COVID-19 epidemic;
- aiming at maintaining the average maturity of ST debt at the level close to 5 years, subject to possible temporary deviations resulting from market and budgetary conditions related to the effects of the COVID-19 epidemic;
- aiming at an even distribution of redemptions over time;

2) exchange rate risk

- maintaining the share of foreign currency debt in ST debt below 25%;
- possibility to use derivative instruments to develop an adequate debt currency structure;
- maintaining an effective (i.e. taking into account derivative transactions) share of the euro in the foreign currency debt of at least 70% in the *Strategy* timeframe;

3) interest rate risk

- maintaining the average time to re-fixing (ATR) of domestic debt in the range of 2.8-3.6 years;
- separating interest rate risk management from refinancing risk management by using floating-rate bonds and inflation-linked bonds, as well as the possibility to use derivatives;
- maintaining the dominant share of fixed rate instruments in ST debt denominated in foreign currencies;

4) State budget liquidity risk

- maintaining the safe level of State budget liquidity while managing liquid assets in an effective way through FX transactions (including sales of FX funds, derivatives). The level of liquidity will be determined by ongoing budgetary and market situation, including budget seasonality and smoothing of TS supply over the year. The adequate level of liquid assets results in State budget's resilience to market volatility and improves TS valuation on the primary market;

5) other risks, in particular credit risk and operational risk

- concluding derivative transactions with entities with high creditworthiness;
- mitigation of credit risk (through collateral agreements) and its diversification while concluding derivative transactions. In the *Strategy* timeframe, it is possible to conclude further collateral agreements that are in line with the current best practices in the market and enable concluding transactions without bearing credit risk on more favorable terms;
- diversification of credit risk generated by uncollateralized transactions;
- process-based approach to managing the unit responsible for debt management;

- assuring technical infrastructure allowing for running debt management processes from outside of the Ministry of Finance's building, if needed;

6) distribution of debt servicing costs over time

- aiming at an even distribution of debt servicing costs in particular years, including the use of derivative instruments;
- setting bond coupons at a level slightly below their forecasted yield in the issuance period.

VI. TASKS OF THE STRATEGY

The following tasks have been recognized as essential for implementing the objective of the *Strategy*:

1) ensuring liquidity of the TS market,
2) ensuring efficiency of the TS market,
3) ensuring transparency of the TS market,
4) effective State budget liquidity management.

The tasks provided for in the Strategy with respect to TS market development are long-term and cover measures implemented on a continuous basis. These tasks are to a large extent interdependent, i.e. particular measures may contribute to the implementation of more than one task at a time. Accordingly, undertaken measures should be mainly aimed at maintaining the proper functioning of the market or its further improvement, in order to contribute to the better implementation of the Strategy objective.

The measures aimed at effective management of the State budget liquidity have been distinguished as an independent task.

VI.1. Ensuring liquidity of the TS market

This task relates to liquidity of both the entire TS market and particular issues, and it is associated with striving to eliminate the premium for insufficient liquidity and to increase the demand of investors interested only in liquid issues. Both these factors contribute to decreasing TS yields and, accordingly, to the minimization of ST debt servicing costs. In the *Strategy* timeframe, it is planned to continue the existing policy providing for:

- building large issues of bonds (benchmarks) in the domestic market – in the case of medium- and long-term bonds with a fixed interest rate their value should be at least PLN 25bn, taking into account the aim for an even distribution of redemption over time;
- large liquid bond issues in the euro market and, subject to market conditions, also in the US dollar market;
- adapting the issuance policy, including sale, switching and buy-back auctions to market conditions.

VI.2. Ensuring efficiency of the TS market

This task is aimed at minimizing debt servicing costs in the second out of the two aspects of implementation of this objective, discussed in Chapter V, and covers the following measures both in the primary and the secondary market :

- adjusting the issuance timing in the domestic and foreign market to the market and budgetary conditions;
- increasing and strengthening the role of the PD system in the development of the TS market and in debt management operations – in the areas where participants of the PD system are at least as competitive as other financial market participants, conclusion of transactions and selection of partners will be carried out taking into account preferences resulting from their participation in the system;
- sustaining relations with domestic and foreign investors, at the time of the COVID-19 pandemic, the main forms of contact include tele- and video-conferences, including through:
  - regular meetings with banks participating in the PD system (within the TS Market Participants' Board),
  - contacts with non-banking sector entities,

- contacts with foreign investors and foreign banks,
- ongoing communication with investors;

- broadening the investor base, including regular contacts with foreign investors in order to promote TS issued on both domestic and foreign markets;
- active participation in conferences and seminars with investors.

VI.3. Ensuring transparency of the TS market

This task is aimed at limiting the uncertainty connected with TS market operation and enables its participants to receive reliable information on current market prices and to formulate expectations concerning developments regarding the TS market. Both predictability of the issuance policy and transparent operation of the secondary market contribute to the transparency of the market. In this respect, the following activities will be continued:

- maintaining transparent issuance policy regarding TS issuance calendars covering the current year, quarter and month;
- promoting the electronic market through:
  - adequate regulations in PD system that ensure competitiveness and transparency, in particular with regard to PD duties related to TS quotations, sustaining adequate spread levels and the share in TS fixing;
  - adjusting rules of the PD system to current requirements stemming from the regulations.

VI.4. Effective State budget liquidity management

This task includes, on the one hand, acquiring and maintaining funds at a level ensuring timely execution of the State's tasks as well as budget resilience to the changing market situation and, on the other hand, investing these funds, so that the net cost of their maintaining is as low as possible. These measures are performed taking into consideration the budgetary and market conditions, and constraints related to risk, including credit and operational risk.

Maintaining an adequate level of liquidity causes direct cost resulting from higher yields of TS sold at auctions in relation to income earned on short-term deposits. However, maintaining the adequate level of liquid funds allows for indirect savings arising from the fact that the issuer has a possibility to adjust the TS sale to the market situation without increasing liquidity risk and debt servicing costs.

The following instruments will support the implementation of the task:

- depositing PLN and FX funds in the NBP and in the financial market via BGK (the State development bank);
- concluding buy-sell-back transactions directly in the financial market, as an instrument of depositing budgetary funds without bearing credit risk;
- sales of FX funds in the NBP and in the FX market;
- FX swap transactions allowing for shaping the currency structure of liquid funds;
- short-term loans in the interbank market.

Additionally, the management of the liquidity of the public finance sector takes place, with liquid funds deposited by public finance sector units, other general government units, and courts on the Minister of Finance account in order to reduce the net borrowing requirements of the State budget.

VII. IMPACT ON THE PUBLIC FINANCE SECTOR DEBT

Pursuant to Article 74 of the Public Finance Act of August 27, 2009, the Minister of Finance maintains control over the public finance sector as regards the rule that the public debt must not exceed 60% of the annual GDP.

In the case of public finance sector debt, including the debt of units other than the State Treasury, which are autonomous in incurring liabilities, the influence on their debt level is indirect and is derived from the provisions of the Public Finance Act. It contains, first of all, restrictions imposed on the way of incurring liabilities by the LGUs as well as prudential and remedial procedures applicable to public finance sector entities when the relation to GDP of both the public debt and the amount referred to in Article 38a(3) of the Act exceeds 55%.

Moreover, the stabilising expenditure rule included in the Public Finance Act sets the thresholds for the ratio of the amount specified in article 38a(3) of the Public Finance Act to GDP at 43% and 48%. Exceeding the thresholds and fulfilment of additional conditions defined in the Act triggers an automatic correction mechanism, subject to the escape clause described in Chapter VII.3, limiting the growth rate of expenditure for a particular budgetary year.

Annex 3 presents constraints related to incurring public debt, provided in the Public Finance Act (arising from prudential and remedial procedures and rules of incurring liabilities by the LGUs), as well as the correction mechanism of the expenditure rule.

VII.1. Medium-term budgetary framework

In the Strategy timeframe – in accordance with the Assumptions of the budget system reform and the Strategy for Responsible Development – work will be continued on organizing the public finance data collection system, as well as linking, and ultimately integrating, multiannual and annual planning processes, and preparing for the introduction of a medium-term budgetary framework.

As part of technical cooperation with the International Monetary Fund, financed through the Structural Reform Support program, work is underway on the preparation and implementation of a uniform multidimensional chart of accounts in public accounting, integrated with the budget classification. This tool will enable the acquisition of standardized, high-quality and consistent data on operations relating to public funds, as well as assets and liabilities of public finance sector units, necessary for budgetary, financial and statistical reporting.

The chart of accounts integrated with the budget classification will provide the basis for further changes in budgeting and accounting, including the implementation of a medium-term budgetary framework. So far, in order to prepare for the stage-based implementation of the framework, the Regulation of the Minister of Finance of 28 January 2019 concerning the detailed method, procedure and deadlines for elaboration of materials for the draft budget act has introduced changes aimed at integrating the process of preparing the draft budget act with work on the Multiannual State Financial Plan (WPFP) and the Convergence Programme Update, as well as the orientation of budgetary planning towards a long-term perspective.

The changes introduced in multiannual planning enable the Minister of Finance to transfer to administrators in the budget process not only the initial amounts of expenditure for the next year, but also preliminary amounts of expenditure for two consecutive years. Work in this area will be continued, taking into account experiences from solutions that have been already implemented.

The designed system changes may bring significant benefits resulting from the improvement in the quality of public finance data, extension of the budget planning horizon and increased reliability of budget forecasts, positively affecting the management of state budget liquidity, ST debt management and the ability to influence public debt.

VII.2. Changes in the regulations relating to local government units

VII.2.1. System changes

2021 will be the last year in which the provisions prior to the amendment to the Public Finance Act of 2018, regarding balancing of the current part of the budget, will apply. From 2022 onwards, the provisions introduced by way of the Act of 14 December 2018 on amending the Public Finance Act and certain other acts will apply in this respect. Planned and executed current expenditure may not be greater than planned and executed current income plus revenue from:

- repayment of loans granted in previous years;
- the surplus of the LGU budget from previous years, less funds within the meaning of Article 217(2)(6) of the Public Finance Act.

As regards the limits determining the ability to repay debt of local government units, the current individual debt ratio will apply during the *Strategy* timeframe. This ratio is based on the arithmetic mean calculated for the last three years of current income increased by income from the sale of assets and reduced by current expenditure, to current income in the LGU budget.

From 2026 onwards, the remaining provisions introduced by the above-mentioned Act of 14 December 2018 will apply, i.e.:

- extending the period based on which the limit of debt repayment is calculated to 7 years;
- excluding income from the sale of assets, as an element improving debt repayment capacity, while calculating the debt ratio.

VII.2.2. Solutions introduced in connection with COVID-19

Due to the outbreak of the COVID-19 epidemic, there have been changes to the fiscal rules applicable to local government units. These are both temporary changes covering only 2020 as well as changes that affect subsequent years.

Pursuant to the Act of 2 March 2020 on special solutions relating to preventing, counteracting and eradicating COVID-19, other infectious diseases, and emergencies caused by them, planning and executing their budgets in 2020, local government units will be allowed to exceed the ratio of balancing current income and expenditure by the amount of a loss in income caused by the COVID-19 epidemic. Thus, current expenditure of LGUs may be greater than their current income by the amount of the loss in their income caused by the COVID-19 epidemic, which means that in 2020, LGUs are allowed to have a deficit in the current part of the budget.

Furthermore, only for 2020, it has been allowed to exceed the ratio regarding balancing current income and current expenditure by the amount of expenditure incurred in order to implement tasks related to counteracting COVID-19.

As regards the rule for LGU debt repayment (Article 243 of the Public Finance Act), the following solutions have been adopted:

- exclusion from the LGU individual debt repayment ratio of loans and bonds, that will be incurred by this LGU in connection with the loss of its income due to the COVID-19 epidemic; liabilities in the amount of the loss of income will be excluded from the ratio, and the exclusion itself will be a long-term one, i.e. the repayment of the borrowed amount (loan or bonds) will not be accounted for in the limit for the entire repayment period;
- reducing current expenditure by current expenditure incurred in 2020 to implement tasks related to counteracting COVID-19 when determining – for 2021 and subsequent years – the ratio limiting the amount of debt repayment.

Moreover, only for 2020, a mechanism in the form of a one-year debt limit at the level of 80% of the LGU income has been introduced to secure the financial situation of LGUs. However, units that will meet the debt repayment limit referred to in Article 243(1) of the Public Finance Act, while not

excluding the repayment of liabilities incurred in connection with the loss of income, will be allowed not to meet the 80% income limit.

Furthermore, the Act of 31 March 2020 amending the Act on special solutions related to preventing, counteracting and eradicating COVID-19, other infectious diseases, and emergencies caused by them, as well as certain other acts, has accelerated for 2020 the exclusion of expenditure on debt servicing from current expenditure from the unit's budget when determining the ratio limiting the amount of its debt repayment.

VII.3. Stabilising expenditure rule

Proposed in March 2020 by the European Commission and approved by the Ecofin Council, the general escape clause, enshrined in the EU Stability and Growth Pact, has allowed for a temporary departure from the EU Council recommendations regarding budgetary policy. The escape clause allows in 2020 for a coordinated fiscal impulse to support the economy. A similar approach has been adopted in the amended Public Finance Act – Article 112d of the Act allows for suspension the stabilising expenditure rule (SER) and applying the escape clause in the event of an epidemic and a simultaneous significant deterioration in the macroeconomic situation (i.e. if the projected growth rate in 2020 is lower than the 6-year historical average less 2 pp). This has enabled mobilization of additional funds as part of the anti-crisis measures taken by the government (i.e. Anti-Crisis Shield, Financial Shield).

In the following years, a return clause will be activated to enable an automatic, gradual return to the stabilising expenditure rule within 2-4 years. The rate of return to the SER depends on the macroeconomic situation, i.e. the nominal GDP level and the economic growth rate in the year following the declaration of the epidemic. The amount of the adjustment (additional expenditure) in particular years after the suspension of the SER will depend on the total amount of financial effects of discretionary measures aimed directly at counteracting and eliminating consequences of the epidemic. Therefore, the scale of the departure from the original SER path in particular years will be proportional to the ultimate total cost of measures related to the COVID-19 epidemic, incurred in 2020 by entities covered by the rule. According to the current macroeconomic forecasts, the return clause will cover a period of two years.

VII.4. Multiannual State Financial Plan

Pursuant to Article 76 of the Act of 31 March 2020 amending the Act on special solutions related to preventing, counteracting and eradicating COVID-19, other infectious diseases, and emergencies caused by them, as well as certain other acts, no multiannual state financial plan providing grounds for a draft budget act for the next budget year has been developed in 2020.

VIII. EXPECTED EFFECTS OF IMPLEMENTING THE STRATEGY

The expected effects of the *Strategy* implementation include forecasts of:

- the volume of public debt and the costs of its servicing,
- changes in risk related to public debt,
- the level of debt of public finance sector entities other than ST.

These are the expected results of the implementation of the *Strategy* objectives under the adopted macroeconomic, budgetary and market assumptions. Moreover, the most important threats to the implementation of the *Strategy* objectives are specified in subchapter VIII.4.

VIII.1. Debt volume and its servicing costs

Under the adopted assumptions, at the end of 2020 the public debt-to-GDP ratio will amount to 50.4% and then increase to 52.7% at the end of 2021. In the subsequent years covered by the Strategy forecast, the public debt-to-GDP ratio will be decreasing, reaching 48.1% at the end of 2024.

The ratio of the amount specified in Article 38a(3) of the Public Finance Act to GDP will reach 48.5% in 2020 and 51.4% in 2021, i.e. above the threshold of 48% included in the stabilising expenditure rule. In the following years it will be decreasing to 47.0% in 2024. Due to the fulfilment of the conditions specified in Article 112d of the Public Finance Act, in 2020 the escape clause of the stabilising expenditure rule, as stipulated in the Public Finance Act, shall apply. At the same time, in line with the return mechanism and the presented macroeconomic forecasts, in the second fiscal year since the suspension of the rule (i.e. in 2022), its application will be resumed in accordance with the original formula provided for in Article 112aa of the Public Finance Act.

The general government debt-to-GDP ratio (according to the EU definition) will amount to 61.9% in 2020 and 64.1% in 2021, and then fall to 59.5% within the Strategy timeframe. According to the forecasts in the years 2020-2023, the Maastricht Treaty reference value of the debt-to-GDP ratio at 60% will be exceeded. However, due to the serious economic slowdown caused by the coronavirus pandemic throughout the European Union, the European Commission has launched the general escape clause provided for in the Stability and Growth Pact. The clause allows Member States to temporarily depart from the Ecofin Council recommendations on the medium-term budgetary objective. The EU flexible approach does not suspend the EU fiscal rules or exclude the excessive deficit procedure, but is intended to facilitate a coordinated response to the crisis.

Apart from the factors influencing the public debt according to the domestic definition, the increase in the general government debt results primarily from the financing of government programs aimed at counteracting the COVID-19 epidemic by the COVID-19 Counteracting Fund established at Bank Gospodarstwa Krajowego and by Polish Development Fund. The COVID-19 Counteracting Fund and the Financial Shield implemented by Polish Development Fund are included in the general government sector, but are not included in the public finance sector defined in the Public Finance Act.

In nominal terms, the limit of ST debt servicing costs assumed in the draft Budget Act for 2021 will be lower than that provided for in the draft amendment to the Budget Act for 2020 (PLN 29.8 bn in 2020 compared to PLN 28.0 bn in 2021). In relation to GDP, debt servicing cost limits will decrease from 1.33% in 2020 to 1.19% in 2021. It was assumed that in the *Strategy* timeframe, the debt servicing cost-to-GDP ratio will decrease to 0.75%-0.76%.

Table 9. Forecasts of the level of debt and debt servicing costs

Item	2019	2020	2021	2022	2023	2024
1. State Treasury debt*						
a) PLN bn	973.3	1 117.8	1 217.0	1 257.9	1 293.9	1 318.4
- domestic	716.5	846.6	924.0	964.0	1 010.2	1 037.9
- foreign	256.9	271.2	293.0	293.9	283.7	280.5
b) GDP%	42.8%	50.0%	51.7%	50.5%	49.3%	47.6%
2. Public debt						
a) PLN bn	990.9	1 126.5	1 241.6	1 279.4	1 311.4	1 334.2
b) GDP%	43.6%	50.4%	52.7%	51.4%	49.9%	48.1%
3. The amount specified in the article 38a (3) of the Public Finance Act**						
a) PLN bn	957.4	1 083.3	1 211.5	1 249.2	1 281.1	1 303.9
b) GDP%	42.1%	48.5%	51.4%	50.2%	48.8%	47.0%
4. General government debt						
a) PLN bn	1 045.4	1 384.0	1 510.8	1 572.7	1 624.7	1 650.8
b) GDP%	46.0%	61.9%	64.1%	63.1%	61.9%	59.5%
5. State Treasury debt servicing costs (cash basis)***						
a) PLN bn	27.3	29.8	28.0	24.1 - 24.5	22.0 - 22.3	20.9 - 21.1
- domestic	19.7	22.8	21.5	19.1	17.8	16.9
- foreign	7.6	7.0	6.5	5.0 - 5.4	4.2 - 4.5	3.9 - 4.2
b) GDP%	1.20%	1.33%	1.19%	0.97% - 0.98%	0.84% - 0.85%	0.75% - 0.76%

**) The amount of the State Treasury debt includes, in accordance with the financial plan of the Solidarity Fund, the liabilities of the Fund which do not affect the public debt due to the elimination of mutual liabilities of entities belonging to the sector.*
***) The amount of public debt recalculated using the yearly average of foreign currency exchange rates for the year concerned and reduced by the value of State budget liquid funds raised to finance the borrowing requirements for the following budget year.*
****) Forecasts of the debt servicing costs for the years 2022-2024 account for the exchange rate risk provisions.*

Chart 12. Debt-to-GDP ratio

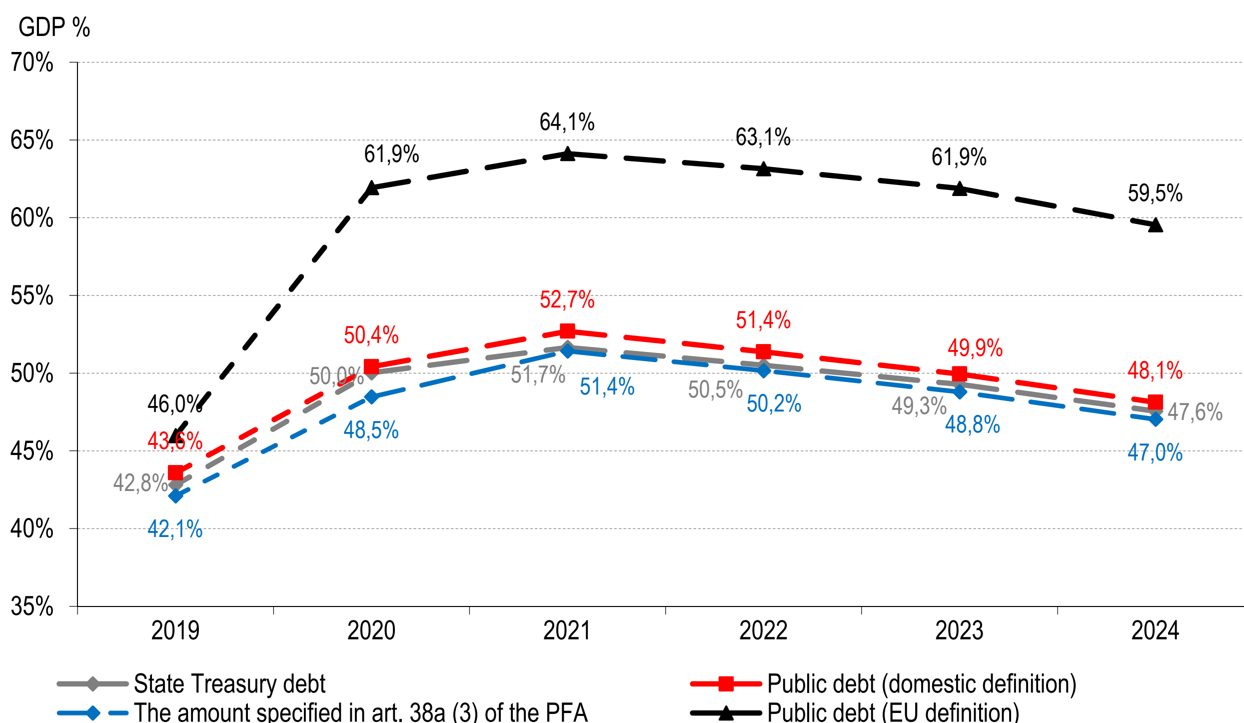


Chart 13. ST debt servicing costs-to-GDP ratio

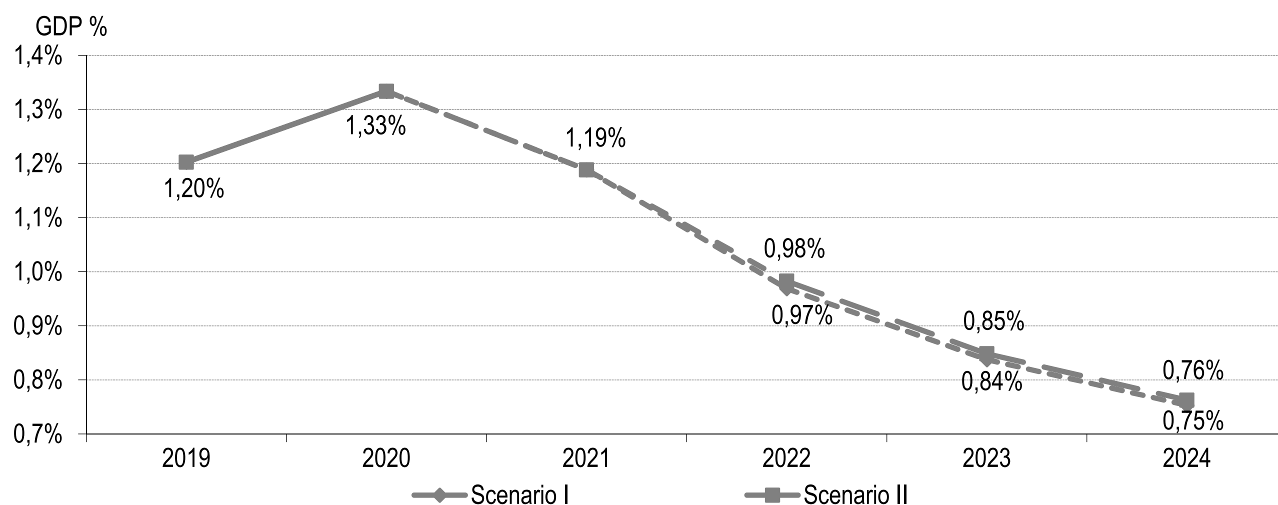
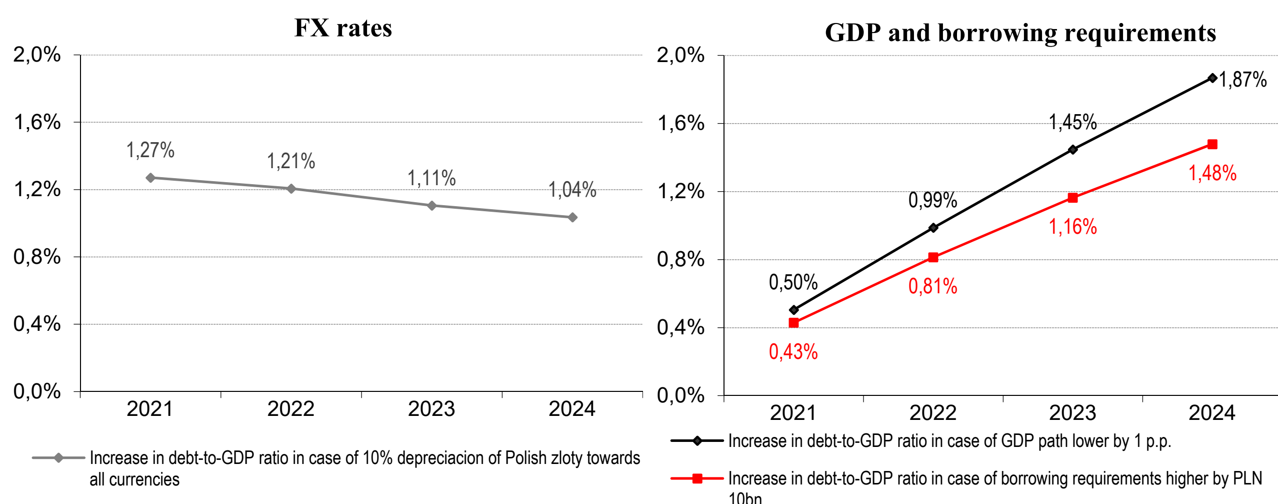
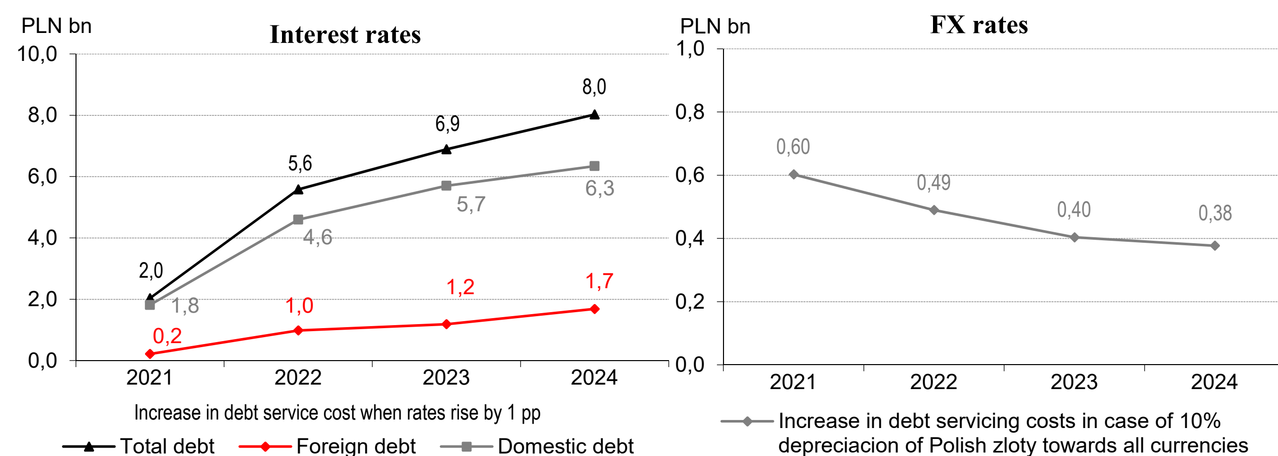


*Chart 14. Sensitivity of public debt-to-GDP ratio to changes in assumptions**



**) Assuming the change of paths since 2021, partial sensitivities without changes in other assumptions.*

Chart 15. Sensitivity of ST debt servicing costs-to-GDP ratio to changes in assumptions



VIII.2. Structure of the State Treasury debt

It is expected that in the timeframe of the *Strategy*:

- regarding the refinancing risk – the direction of changes in the average time to maturity of domestic TS will depend on market conditions, so that the average maturity in 2024 may reach a

value in the range of 4.3-4.8 years, and for the total ST debt – 4.8-5.1 years compared to, respectively, 4.3 and 4.8 years at the end of 2020;

- the interest rate risk will remain within the range set in the *Strategy*, depending on the adopted financing structure, the ATR of the domestic marketable debt will remain within the range of ca. 3.0-3.4 years compared to 3.2 years at the end of 2020, and for the total debt – ca. 3.3-3.6 years compared to ca. 3.5 years at the end of 2020, whereas the duration of the domestic marketable debt will be in the range of ca. 2.9-3.3 years compared to ca. 3.2 years at the end of 2020, while that of the total debt – in the range of ca. 3.2-3.6 years compared to 3.6 years at the end of 2020;
- the share of FX debt will be reduced, and it will fall in the *Strategy* timeframe to ca. 21.3% in 2024.

Chart 16. ATM of the ST debt

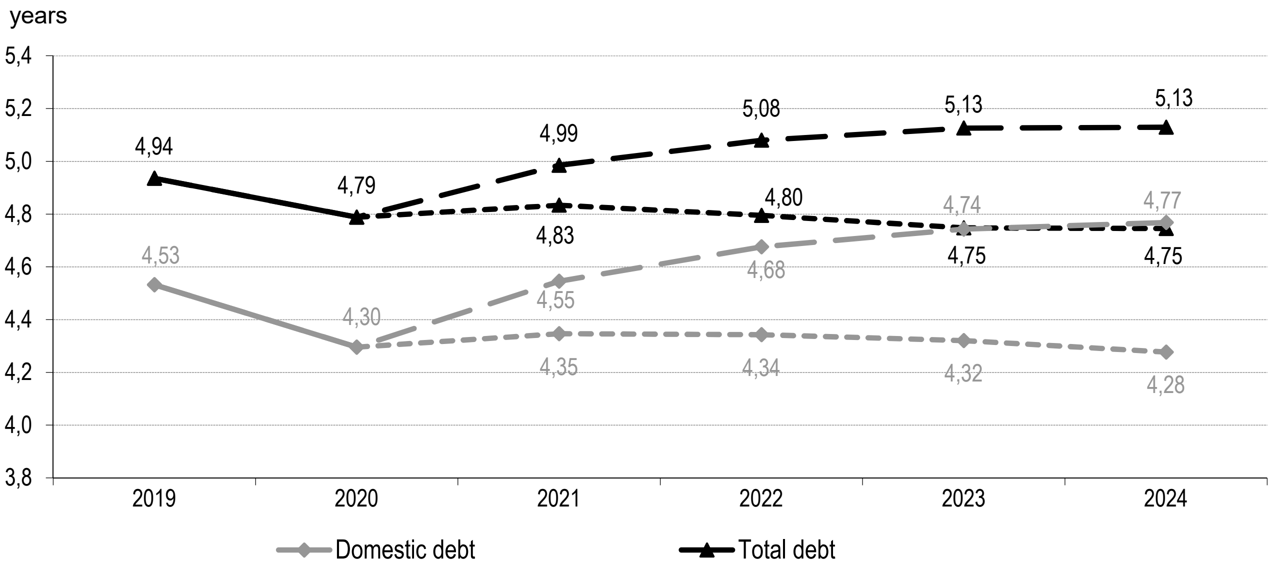


Chart 17. ATR of the ST debt

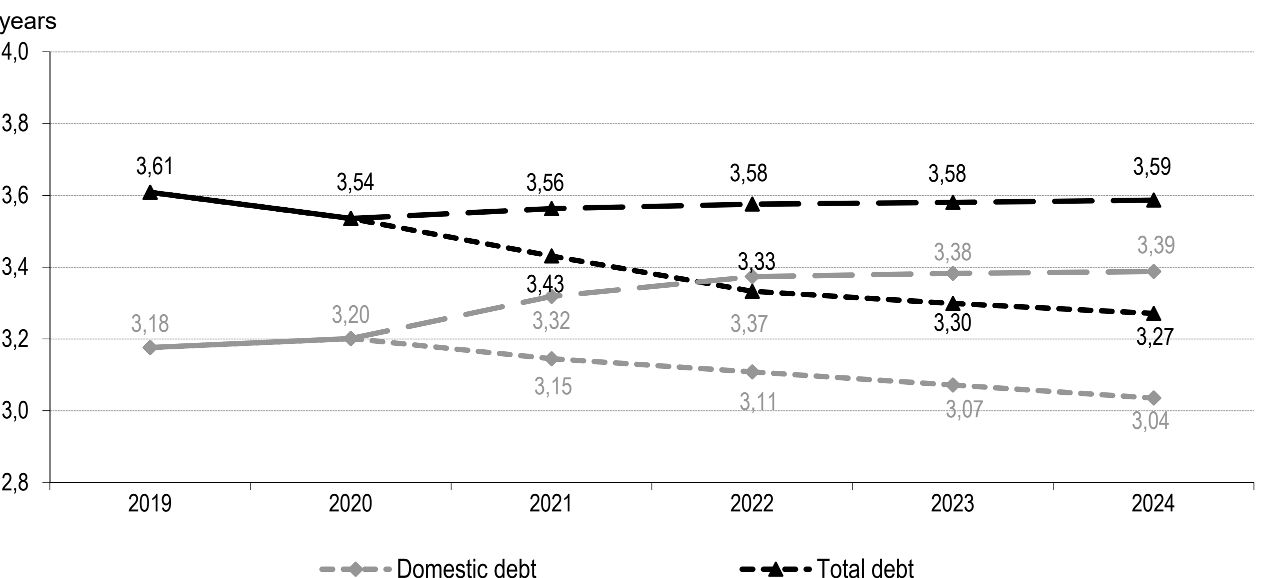


Chart 18. Duration of the ST debt

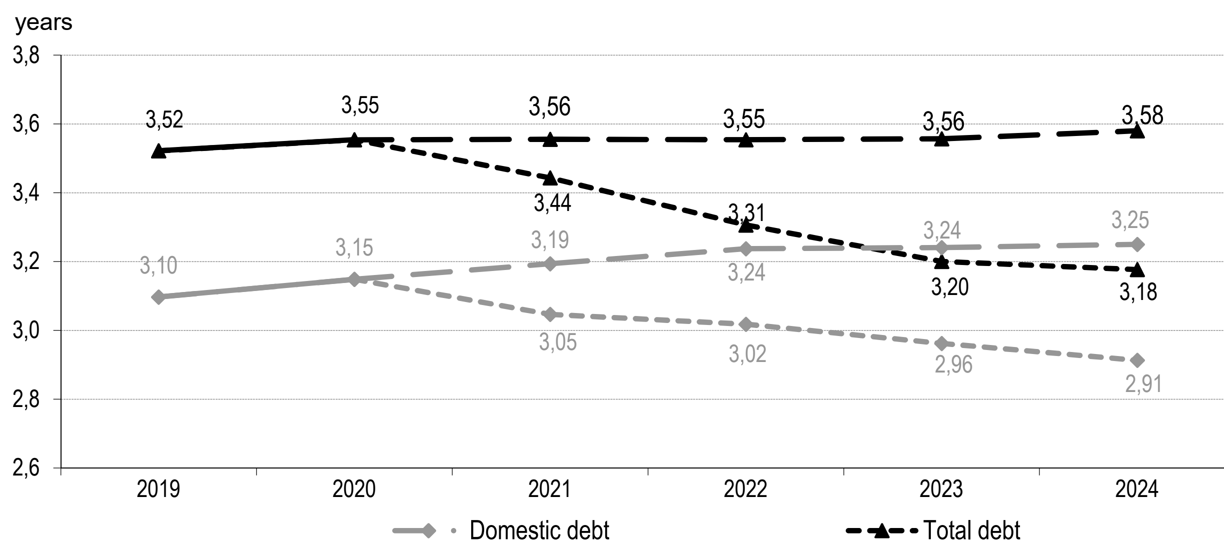
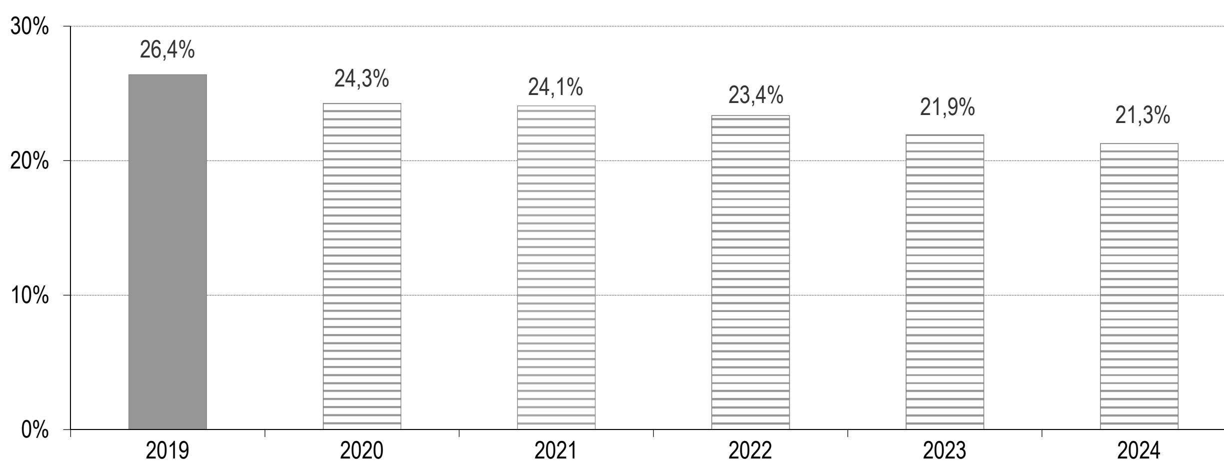


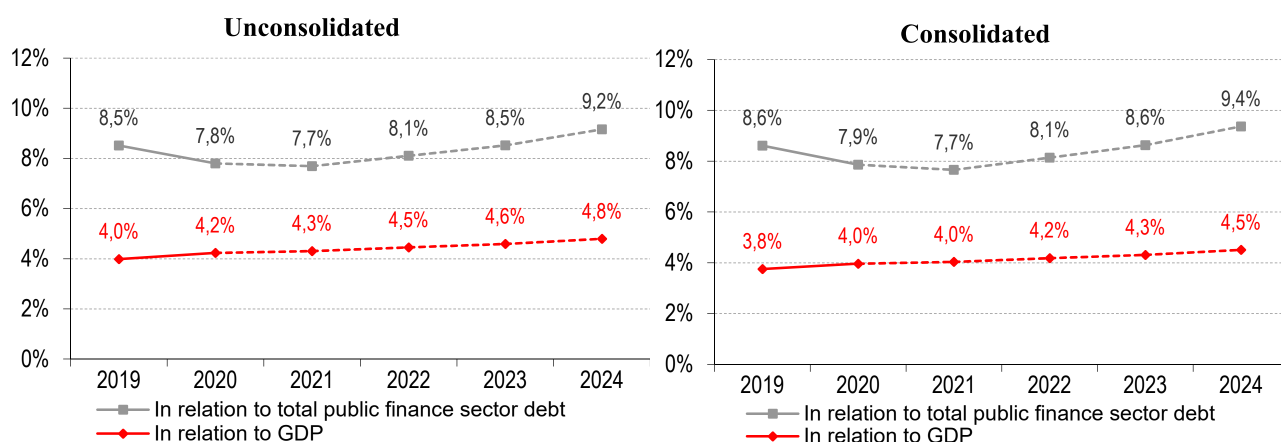
Chart 19. Share of foreign currency debt in the total ST debt



VIII.3. Debt of public finance sector entities other than the State Treasury

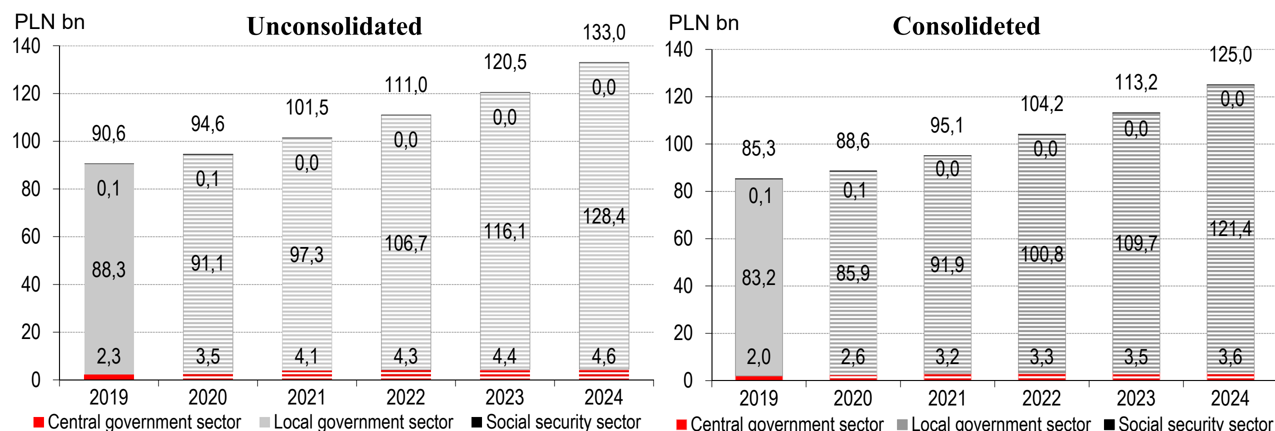
Under the adopted assumptions, in the timeframe of the *Strategy*, the unconsolidated-debt-to-GDP ratio of the remaining PFS units will increase from 4.2% to 4.8%, whereas the consolidated debt - from 4.0% to 4.5%. The share of this group of entities in the consolidated public finance sector debt will grow from 7.9% in 2020 to 9.4% in 2024.

Chart 20. Unconsolidated and consolidated debt of public finance sector entities other than the State Treasury – in relation to GDP and as a share of total public finance sector debt



In the *Strategy* timeframe, the unconsolidated debt of public finance sector entities other than ST will increase from PLN 94.6 billion to PLN 133.0 billion, mainly as a result of increased debt of the local government sector. In 2020-2024, the debt of LGUs and their associations will increase due to the projected budgetary deficits. The level of the debt of LGUs will be also affected by the rules for incurring liabilities by those entities, including the individual debt ratio.

Chart 21. Debt of public finance sector entities other than the State Treasury before and after consolidation by sector



VIII.4. Threats to the Strategy implementation

The main threats to the implementation of the presented *Strategy* are primarily associated with:

- a macroeconomic and budgetary situation in Poland varying from the assumed scenario, in particular due to the consequences of the COVID-19 epidemic, slower GDP growth, volatility in foreign exchange rates, and a possible increase in interest rates;
- international conditions, including:
  - a slower than expected growth rate in the global economy, in particular, in Europe, resulting mainly from the COVID-19 pandemic;
  - monetary policy of major central banks, including the ECB and the Fed;
  - capital outflow towards core markets or other markets as a result of, inter alia, possible turmoil in financial markets;
- the risk of excessive growth of the public debt-to-the-GDP ratio, in connection with:
  - higher State budget borrowing requirements, depending, among others, on the scale of measures related to the effects of the COVID-19 epidemic and the situation in the Polish economy;
  - depreciation of the Polish zloty as compared to the assumptions of the *Strategy*;
  - issuance of TS and their transfer due to the implementation of acts other than the budget act;
  - considerable increase in the debt of public finance sector entities other than ST;
  - the necessity to execute sureties or guarantees granted by public finance sector entities.

IX. GUARANTEES AND SURETIES GRANTED BY PUBLIC FINANCE SECTOR ENTITIES

IX.1. Assumptions of the strategy of granting guarantees and sureties

In order to limit the risk associated with granting ST guarantees and sureties while preserving the advantages of using them as an instrument of the State economic policy, the following principles should be maintained:

- granting sureties and guarantees mainly to support development-oriented projects, in particular, in the area of infrastructure, environmental protection, creating new jobs and regional development, financed, *inter alia*, with the EU funds, as well as to support other investment tasks arising from any new support programs stipulating granting sureties and guarantees;
- sureties and guarantees may be also used to support measures undertaken in case of any deterioration in the Polish financial system;
- possible continuation, in so far as necessary, of using guarantees and sureties to counteract the effects of the COVID-19 pandemic.

The value of sureties and guarantees granted in a given year is limited under the Budget Act. Pursuant to Article 31 of the Act of 8 May 1997 on sureties and guarantees granted by the State Treasury and certain other legal persons, each year the Budget Act stipulates the total amount up to which the ST may grant guarantees and securities. The limit for 2021 in the draft Budget Act has been set at PLN 500 billion. The extent of the use of this limit will result primarily from the continuation of infrastructure projects. Moreover, a substantial part of the limit has been planned to secure any measures that may be undertaken in case of deterioration in the Polish financial system. The proposed limit of ST sureties and guarantees is also intended to ensure any use of this instrument to counteract the negative economic and social effects of the COVID-19 pandemic.

A considerable impact on the increase in any liabilities due to ST sureties and guarantees, besides ST guarantees for liabilities incurred by PFR S.A. and BGK in order to counteract the effects of COVID-19, will be exerted by sureties and guarantees granted to the following entities:

- BGK – for issuance of bonds and the repayment of loans incurred for the National Road Fund to co-finance the construction of road infrastructure;
- PKP Polskie Linie Kolejowe S.A. – for the repayment of loans incurred to co-finance the modernization of the railway infrastructure and rolling stock.

IX.2. Analysis and forecasts of the level of guarantees and sureties

Contingent (undue) liabilities arising from guarantees and sureties granted by public finance sector entities as at the end of the first half of 2020 amounted to PLN 234.3 billion, compared to PLN 114.9 billion (5.1% of GDP) in 2019 and PLN 112.4 billion (5.3% of GDP) as at the end of 2018.

Liabilities due to guarantees and sureties granted by the ST had a dominant share in the contingent liabilities. As at the end of the first half of 2020, their amount was PLN 230.9 billion, and as at the end of 2019 – PLN 111.4 billion (4.9% of GDP), as compared to PLN 108.8 billion (5.1% of GDP) in 2018. A significant increase in the above-mentioned potential liabilities in the first half of 2020 was due to granting new guarantees related to counteracting the effects of COVID-19. As at the end of the first half of 2020, these guarantees amounted to PLN 116.3 billion, i.e. approximately half of the total amount of contingent liabilities.

The hitherto ST operations related to sureties and guarantees has not posed significant risks to public finance. As at the end of 2019, ca. 88% of contingent liabilities due to sureties and guarantees granted by the ST belonged to the low-risk group. At the same time, the structure of financing guarantees related to COVID-19 minimizes the risk of payments under these guarantees.

The biggest amounts of ST contingent liabilities (as at 30 June 2020) were due to:

- guarantees granted to BGK PLN 85.6 bn
  of which for support of the National Road Fund PLN 84.8 bn
- guarantees granted for Polski Fundusz Rozwoju S.A. for the implementation of government programs under the PFR Financial Shield to counteract the effects of COVID-19 PLN 67.3 bn
- guarantees granted for Bank Gospodarstwa Krajowego to support the COVID-19 Counteracting Fund PLN 49.0 bn
- guarantees granted for PKP Polskie Linie Kolejowe S.A. PLN 14.3 bn

- guarantees of payments from the KFD for Gdańsk Transport Company S.A. PLN 7.2 bn
- guarantees of payments from the KFD for Autostrada Wielkopolska II S.A. PLN 5.9 bn
- guarantees granted for PKP Intercity S.A. PLN 1.5 bn

Table 10. Contingent liabilities under guaranties and sureties granted by the ST and the public finance sector units

	2018	2019	2020	2021	2022	2023	2024
Contingent liabilities under guaranties and sureties granted by:							
a) Public finance sector							
- PLN bn	112.4	114.9	371.3	400.6	421.1	437.8	451.6
- in relation to GDP	5.3%	5.1%	16.6%	17.0%	16.9%	16.7%	16.3%
b) State Treasury							
- PLN bn	108.8	111.4	367.9	397.2	417.8	434.5	448.4
- in relation to GDP	5.1%	4.9%	16.5%	16.9%	16.8%	16.6%	16.2%

Annex 1. Abbreviations and glossary

A. Abbreviations used in the Strategy

ATM – average time to maturity
ATR – average time to refixing
BFG – the Bank Guarantee Fund
CIRS – currency interest rate swap
EBC – European Central Bank
Fed – the Federal Reserve System in the USA
FRD – Demographic Reserve Fund
FPC - the COVID-19 Counteracting Fund
FUS – Social Security Fund
IFIs – international financial institutions
IKE – individual pension accounts
JSFP - public finance sector entities
KFD – National Road Fund
OFE – open pension funds
LGUs – local government units
NBP – National Bank of Poland
TSD – Treasury Securities Dealers
PDP – public debt
PFS – Public Finance Sector
PFR – Polish Development Fund
PPK - the Employee Equity Schemes
SPZOZ – independent public health care units
ST – State Treasury
TS – Treasury securities

B. Glossary

Average maturity *(*also *ATM – average time to maturity)* – the measure of public debt refinancing risk. Average maturity is the average period, expressed in years, after which the issued debt would be redeemed. The further the maturity dates, the lower the refinancing risk and the higher the average maturity. Average maturity of domestic marketable TS is calculated according to the following formula:

$$ATM = \frac{\sum_{t \in T} t N_t I_0}{\sum_{t \in T} N_t I_0}$$

where:
t – maturity date,
T – set of all maturity dates,
N_t – face value paid at time *t*,
I_0 – current indexation coefficient of inflation-linked instruments' face value (for non-indexed TS I_0 =1).

ATR (*average time to refixing*) – the measure of interest rate risk related to the public debt. *ATR* is interpreted as the average period, expressed in years, for which the debt servicing costs are set. The larger the share of short-term and floating rate instruments, the higher the interest rate risk and the lower ATR. The *ATR* of domestic marketable TS is calculated according to the following formula:

$$ATR = \frac{\sum_{r \in R} rNZ_r + \sum_{t \in T} tNS_t + \sum_{j \in J} \frac{1}{12} NI_j I_0}{\sum_{r \in R} NZ_r + \sum_{t \in T} NS_t + \sum_{j \in J} NI_j I_0}$$

where:
r – payment date of the nearest fixed coupon for floating rate instruments.
t – maturity date for fixed rate instruments.
j – maturity date for inflation-linked instruments.
R – set of all payment dates of the nearest fixed coupons for floating rate instruments.
T – set of all maturity dates for fixed rate instruments.
J – set of all maturity dates for inflation-linked instruments.
NZ_r – face value of floating rate instruments.
NS_t – face value of fixed rate instruments.
NI_j – (non-indexed) face value of inflation-linked instruments.
I_0 – current indexation coefficient of inflation-linked instruments' face value.

Benchmark

1. (*issue*) the large amount of TS issue with a liquid secondary market. Yield of benchmark bond is the reference point for yields in a given maturity segment. Benchmark issues subject to trading on the electronic market Treasury BondSpot Poland are TS issues defined by the Minister of Finance, in particular fixed rate bonds, with maturity of at least one year and total face value of at least PLN 10bn or on-the-run issues with total face value of at least PLN 2bn. When setting benchmarks on the Polish yield curve in Reuters and Bloomberg the criterion of time to maturity is applied.

2. *(portfolio)* target characteristics of the public debt portfolio, which constitutes a reference portfolio for the existing portfolio and determines the direction of public debt management. The characteristics of the reference portfolio may include the share of particular currencies, interest rates and types of instruments, as well as the values of synthetic indicators which most often constitute the risk measures, e.g. the average maturity or duration.

Buy-sell-back – transaction which consists of two agreements: spot purchase and forward sale of securities at a price set upfront at the day of the transaction.

Credit risk – associated with the risk that the other party of the transaction will fail to meet its obligations in whole or in part. The risk occurs as a result of transactions with receivables. For the debt management unit such a situation occurs with financial transactions on derivatives. Credit risk also occurs in management of liquid assets, e.g. through making deposits with banks and purchase of securities. Credit risk is managed mainly by choosing partners with high creditworthiness (measured by their ratings) and by setting limits for total transaction size for partners, dependent on their credit credibility and type of transaction.

Duration – the measure of vulnerability of debt servicing costs to changes of interest rates and thus the measure of interest rate risk related to public debt. Duration is interpreted as the average period (expressed in years) of debt servicing costs adjustment to the change of interest rate levels. The higher the level of interest rates and the larger the share of short-term and floating rate instruments, the higher the interest rate risk and the lower duration.

$$Duration = \frac{\sum_{r \in R} \left[r \sum_{s \in S_r} \frac{CFZ_s}{(1+i_s)^s} \right] + \sum_{s \in S} \frac{sCFS_s}{(1+i_s)^s}}{\sum_{s \in S} \frac{CFZ_s}{(1+i_s)^s} + \sum_{s \in S} \frac{CFS_s}{(1+i_s)^s}}$$

where:
s – payment date (of interest or face value),
S – set of all payment dates (of interest or face value),
r – payment date of the nearest fixed coupon for floating rate instruments,

R – set of all payment dates of the nearest fixed coupons for floating rate instruments,
S_r- set of all payment dates for these floating rate securities which the nearest fixed maturity is r,
CFZ_s - payment (of interest or face value) for floating rate instruments,
CFS_s – payment (of interest or face value) for fixed rate instruments,
i_s – zero-coupon interest rate for term s.

Duration of total debt of ST is a weighted average of appropriate duration coefficients for every currency, where weights are market value of debt in particular currency.

Exchange rate risk – arises from the vulnerability of the foreign currency denominated debt level and its servicing costs to exchange rate fluctuations. The Polish zloty appreciation or depreciation against a given foreign currency results in a proportional increase or decrease (in the Polish zloty terms) of debt volume and debt servicing costs denominated in this currency.

Interest rate risk – risk that payments related to the debt servicing costs will change as a consequence of a change in interest rates. It stems from the necessity to finance the debt maturing in the future at unknown rates and from volatility of coupon payments of the floating rate debt.

Operational risk – risk associated with the threat that the costs related to the debt management or to the level of other types of risk will increase due to infrastructure, organization and supervision of the debt management, that is inadequate to the scope of tasks. Operational risk the most difficult risk to be measured. Limiting the operational risk can be achieved by integration of public debt management procedures in one organizational entity, having its structure, infrastructure and procedures adjusted to efficient operations in the environments of government administration and financial markets.

Place of issue criterion – the criterion of the division of public debt into domestic and foreign debt, according to which the domestic debt is the debt issued on the domestic market.

Treasury Securities Dealers – a group of institutions (banks) selected through a competition that have specific rights and obligations related to the participation in the primary and secondary TS market. The dealers act as intermediaries between the issuer and other entities in TS trading and have the exclusive access to the primary market.

Private placement – an issuance addressed to a selected investor or group of investors.

Refinancing risk – associated with debt issuance in order to finance the State borrowing needs resulting from the redemption of the existing debt. The risk applies to both the ability to redeem maturing debt and conditions on which it is refinanced (including in particular servicing costs generated by newly issued debt). The larger the payment related to the redemption of maturing debt and the closer the date of redemption, the larger the risk related to refinancing of this debt. Refinancing risk is influenced by the level of outstanding debt and its maturity profile. An extension of the debt maturity and an even distribution of debt redemption over time contribute to the reduction of refinancing risk.

Residency criterion - the criterion of the division of public debt into domestic and foreign debt, according to which the domestic debt is the debt owned by domestic investors (i.e. investors with the place of residence or registered seat in Poland).

Spread – the difference between yields of two debt securities. In narrower sense credit spread (also credit margin) – the difference between yields of two securities with all the characteristics (especially maturity date) except for issuer identical (or almost identical). Spread is often understood as a difference between yields of credit risk-burdened and credit risk free (or characterized by the lowest risk in the class) security.

State budget liquidity risk – risk associated with the loss of the state budget's ability to meet the current obligations and to timely execute budget expenditures. In order to reduce this risk the State budget should have an access to the adequate amount of liquid financial assets, enabling the

independence from temporary disruptions which prevent or make difficult financing borrowing needs on the financial market at rational cost.

State budget liquidity risk is managed, on one hand, by keeping safe reserve of funds at the lowest possible level (by improving the process of state budget liquidity planning and monitoring) and on the other hand, by the management of liquid assets in a way that they generate budget revenues which in the highest possible extent compensate for costs of keeping a given level of liquidity.

Swap – a derivative contract through which two parties exchange cash flows based on a notional principal amount with rules of calculating their value specified in advance. Swap may be a separate financial instrument or it may accompany other instruments.

Annex 2. Cyclical publications of the Ministry of Finance regarding public debt and TS market

- Annual report
- State Treasury debt, monthly bulletin
- Public debt, quarterly bulletin
- Monthly information on TS supply and its background
- Monthly information on investors structure on domestic TS market
- Monthly information on transaction on secondary TS market

Publications available on the Ministry of Finance website:
https://www.gov.pl/web/finance/public-debt

Annex 3. Legal regulations applied to public debt in Poland and the EU

Table 1. Public debt – basic legal regulations

Polish regulations	EU regulations
1. Constitution of the Republic of Poland • ban on incurring loans and granting guaranties and sureties resulting in the public debt exceeding 3/5 of GDP (Article 216(5));	1. Treaty on the functioning of the European Union • level of general government debt and restrictions applied to general government deficit constitute the criterion on the basis of which the Commission examines the compliance with budgetary discipline in Member States (Article 126) – specifies the Excessive Deficit Procedure (EDP);
2. Public Finance Act • regulations on public debt: definitions, basic principles of issuing public debt and debt management, prudential and remedial procedures applied to public debt levels; • definition of the scope of the public finance sector.	2. Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community and the Treaty on the functioning of the European Union • definition of general government debt and reference value of debt to GDP ratio at 60%;
	3. Council Regulation (EC) No 479/2009 of 25 May 2009 on the application of the Protocol on the Excessive Deficit Procedure annexed to the Treaty establishing the European Community • definition of general government debt with specification of categories of liabilities which constitute it;
	4. Regulation (EU) No 549/2013 of the European Parliament and of the Council of 21 May 2013 on the European system of national and regional accounts in the European Union (ESA 2010) • definition of categories of financial liabilities; • definition of general government sector.

Table 2. Limits on the public debt to GDP ratio in Public Finance Act

Public Finance Act
I. Legal procedures regarding limits on public debt to GDP ratio
1) the ratio in year *x* is greater than 55% and lower than 60%:
a) it is assumed the lack of deficit or the difference between state budget revenues and expenditures in draft budget act adopted by the Council of Ministers for the year x+2 must ensure the decrease in State Treasury debt to GDP ratio as compared to the ratio announced for the year x;
b) budget deficit of local government unit diminished by cumulated budgetary surplus from previous years and liquid funds in budget resolution for the year x+2 can only derive from expenditures for current tasks co-financed from EU funds or non-returnable financial aid provided by EFTA member countries;
c) in draft budget act adopted by the Council of Ministers for the year x+2: • no increase in salaries of public sector employees is assumed, • revaluation of pensions must not exceed the CPI level in the budgetary year x+1, • ban on granting new loans and credits from the State budget is introduced, • the increase in expenditures of the Sejm (lower house of Polish Parliament), the Senate (upper house of Polish Parliament), Presidential Chamber of the Republic of Poland, Constitutional Tribunal, Supreme Audit Office (NIK), Supreme Court, Primary Administration Court, The National Council Of The Judiciary, common courts of law and provincial administration courts, Spokesman of Citizen Rights, Spokesman of Child Rights, National Board of Radio and Television, President of the Personal Data Protection Office, The Institute of National Remembrance – Commission for the Prosecution of Crimes against the Polish Nation, National Electoral Office, National Labour Inspection must not be higher than expenditures in the government administration;
d) the Council of Ministers make a review of: • State budget expenditures financed by foreign credits, • long-term programs;
e) the Council of Ministers presents a remedial program ensuring the fall in public debt to GDP ratio;
f) the Council of the Ministers make a review of regulations in force to propose possible legal solutions which influence state budget revenues, including VAT rates,
g) State Fund for the Rehabilitation of Disabled Persons receives earmarked subsidies from the state budget for co-financing of disabled workers salaries at the level of 30% of planned funds for that year,

Public Finance Act
h) new liabilities can be incurred by government administration if the investments are co-financed from EU funds or non-returnable financial aid provided by EFTA member countries at the maximum level, set in the rules or procedures for particular type of investment, not lower than 50% of the total costs, however these restrictions do not apply to state road rebuilding or repairs required for road traffic hazard removal, anti-flood infrastructure investments, electronic toll service and compensations for properties taken over for public roads investments;
2) the ratio in year x is equal to or greater than 60%: a) procedures provided in point 1, letters a, c, d, f, g and h in case of the ratio greater than 55%, and lower than 60% are in force; b) budgets of local government units for the year x+2 must at least be balanced; c) a ban on granting new sureties and guarantees by public finance sector entities is introduced; d) the Council of Ministers presents to the Parliament a remedial programme with the main objective to prepare and implement actions aimed at reducing the public debt-to-GDP ratio below 60%;
Procedures provided in point 1 are not applicable if amount of public debt recalculated using the yearly average of foreign currency exchange rates for the year concerned and reduced by the value of State budget liquid funds raised to finance the borrowing requirements for the following budget year does not exceed the threshold of 55%.
II. Principles and limits on incurring liabilities by local government units
a) planned and executed current expenditures must not exceed planned and executed current revenues increased by the revenue arising from: • repayment of loans granted in previous years; • the LGUs' budget surplus from previous years, less the funds indicated below; • unused cash in the current account of the budget, resulting from the settlement of revenue and expenditure financed by linked to specific budget execution rules laid down in separate acts and resulting from the settlement of funds from the EU budget and non-returnable funds from aid granted by the EFTA member States and grants for the implementation of a programme, project or task financed with these funds;
b) executed current expenditures can be higher than executed current revenues increased by budgetary surpluses from previous years only by amounts linked to the current tasks co-financed from EU funds or non-returnable financial aid provided by EFTA member countries if these funds were not forwarded in specified year; **The aforementioned budget balancing rule in the current part will apply from 2022. Changes to the current rule and transitional provisions are described in chapter VII.**
c) Local government units can incur loans and issue securities for: • repayment of previously incurred liabilities resulting from securities and loans; • covering transitional budget deficit of local government within the fiscal year; • financing of planned budget deficits; • financing in advance of the tasks co-financed from EU funds;
d) Loans incurred and securities issued for covering temporary budget deficit of local government have to be paid off or redeemed in the same year as they were incurred or issued;
e) Local government can only incur liabilities of which servicing costs are borne at least once a year, while: • discount of securities issued by local government cannot exceed 5% of their face value, • capitalization of interest is forbidden;
f) For a local government unit, the total ratio of: • instalments of loans and interest payable in a given fiscal year; • redemption of securities and interest (including discount) payable on them; • repayment of instalments of liabilities that have economic effects similar to those of a loan and interest payable in a given year; • potential payments resulting from sureties and guarantees granted to planned current revenues cannot exceed in the budgetary year and any other year following the budgetary year the arithmetical average for last seven years of current revenues minus current expenditures to total revenues ratio; **The above rule will apply in its entirety from 2026. Changes to the current rule and transitional provisions are described in Chapter VII.**
g) Limitations on debt repayments of local government do not apply to: • instalments and interest payable on loans drawn in connection with a programme, project or task co-financed with the EU funds; • redemption and interest (including discount) payable on securities issued in connection with a programme, project or task co-financed with the EU funds; • guarantees and sureties granted to self-government legal persons performing tasks of self-government units within the framework of programmes financed with the participation of funds coming from the EU budget and not subject to reimbursement from the aid granted by the EFTA States. – but no later than 90 days after the end of the programme, project or task and receiving a refund; this cut-off date does not apply to liabilities incurred for national contribution;

Public Finance Act
• instalments of loans and redemption of securities, and interest (including discount) payable on them, incurred or issued to finance national contribution of a programme, project or task with the EU co-financing level exceeding 60%.
h) the restrictions on the repayment of the debt of territorial self-government units shall not apply either to early repayment of liabilities occurring after the financial year for which the budget was adopted and occurring exclusively in the financial year for which the budget was adopted: • resources from a new commitment if this reduces the total cost of servicing the debt over the entire repayment period, • resulting from the possession of free funds as surplus cash on the current account of the local government budget, resulting from the settlement of issued securities, loans and borrowings from previous years, and funds on this account, • funds from other than those mentioned above, in particular from revenues from privatisation of territorial self-government units' assets and repayment of loans granted in previous years, if the entity does not incur liabilities to finance the planned budget deficit.

Table 3. Correction mechanism of the stabilising expenditure rule.

Public Finance Act
The correction amounts of the stabilising expenditure rule pursuant to Article 112aa(4):
1) – 2 percentage points: • the general government deficit in year x-2 exceeds GDP 3% (including costs of pension system reform) or • the amount specified in article 38a point 3 of the Public Finance Act (the amount of public debt recalculated using the yearly average of foreign currency exchange rates for the year concerned and reduced by the value of State budget liquid funds raised to finance the borrowing requirements for the following budget year) exceeds in year x-2 GDP 48%.
2) – 1.5 percentage points: • the general government deficit in year x-2 does not exceed GDP 3% (including costs of pension system reform) and the amount specified in article 38a point 3 of the Public Finance Act exceeds in year x-2 GDP 43% but is not higher than GDP 48% and • the forecasted dynamics of the real GDP for year x (assumed in the draft budget act for the year x) is not lower than the medium term average by over 2 percentage points;
• the general government deficit in year x-2 does not exceed GDP 3% (including costs of pension system reform) and • the amount specified in article 38a point 3 of the Public Finance Act in year x-2 is lower or equal to GDP 43% and • the sum of the differences between the general government nominal balance and the medium-term budgetary objective (MTO) exceeds in year x-2 GDP 6% and • the forecasted dynamics of the real GDP for year x (assumed in the draft budget act for the year x) is not lower than the medium term average by over 2 percentage points;
3) + 1.5 percentage points: • the general government deficit in year x-2 does not exceed GDP 3% (including costs of pension system reform) and • the amount specified in article 38a point 3 of the Public Finance Act in year x-2 is not higher than GDP 43% and • the sum of the differences between the general government nominal balance and the MTO exceeds in year x-2 GDP 6% and • the forecasted dynamics of the real GDP for year x (assumed in the draft budget act for the year x) is not higher than the medium term average by over 2 percentage points
4) in other cases there is no correction element
The escape clause
The provisions of the stabilising expenditure rule do not apply in the case of: • the introduction of martial law; • the introduction of a state of emergency on the entire territory of the Republic of Poland; • introducing a state of natural disaster on the entire territory of the Republic of Poland; • to announce the state of the epidemic on the entire territory of the Republic of Poland - if the annual growth rate of the gross domestic product in constant prices is more than two percentage points lower than the 6-year historical average projected in the budget bill or in the bill amending the budget bill for the year for which the expenditure is calculated.

Table 4. Differences between public debt (Polish definition) and general government debt (EU definition).

Polish regulations	**EU regulations**
public debt	**general government debt**
1) scope of the public finance sector	
• Public Finance Act defines limited catalogue of units included in the public finance sector, i.e.: – bodies of public authority, including bodies of government administration, bodies of state control and legal protection, courts and tribunals; – local government units and their associations; – metropolitan associations; – budgetary units; – local government budgetary entities; – executive agencies; – institutions of budgetary management; – state special-purpose funds; – Social Security Institution and funds under its management; – Agricultural Social Insurance Fund (KRUS) and funds under management of the President of KRUS; – National Health Fund; – independent public health care units; – public universities; – Polish Academy of Sciences and organizational units founded by it; – state and local government cultural institutions; – other state or local government legal persons founded under separated acts in order to execute public tasks, excluding enterprises. research institutes, banks and commercial companies.	• scope of *general government*[1)] sector is defined in ESA 2010[2)]; no limited catalogue of units is defined;
differences in the scope of sector depending on regulations	
a) funds formed within Bank Gospodarstwa Krajowego (BGK), f. ex. : the National Road Fund (KFD), the Railway Fund (FK)	
• are excluded from the public finance sector;	• are included in the general government sector [3)];
b) public corporations that are deemed non-marketable (f. ex. PKP PLK S.A., Port Lotniczy Łódź, health care institutions)	
• are excluded from the public finance sector;	• are included in the general government sector;
c) Bank Guarantee Fund public (including funds for protection of the guaranteed assets)	
• is excluded from the public finance sector;	• is included in the general government sector;
d) rerouting of transactions to the general government sector - transactions carried out by entities not belonging to the general government sector may be treated as a separate, commissioned activity carried out on behalf of the government, which results in the disclosure of these transactions in the accounts of the general government sector, e.g. Financial Shield of the Polish Development Fund	
• are excluded from the public finance;	• are included in the general government;
2) liabilities which constitute public debt	
• securities (excluding shares); • loans (including securities whose disposal is limited); • deposits; • matured payables (i.e. liabilities due but not settled, which have not been lagged nor cancelled);	• securities; • loans; • cash and deposits;
differences in liabilities depending on regulations	
• matured payables;	• [4)] • restructured or refinanced trade credits (including those with original maturity of one year or less) are included in loan category[5)]
3) valuation of liabilities denominated in foreign currencies	
• liabilities denominated in a foreign currency shall be converted into the national currency on the basis of the	• liabilities denominated in a foreign currency, or exchanged from one foreign currency through contractual agreements to

Polish regulations	EU regulations
public debt	**general government debt**
middle exchange rate applicable on the last working day of each period.	one or more other foreign currencies shall be converted into the other foreign currencies at the rate agreed on in those contracts and shall be converted into the national currency on the basis of the representative market exchange rate prevailing on the last working day of each year.
4) contingent liabilities	
differences in treatment of contingent liabilities in debt-to-GDP ratio	
• is not included;	• EU limitations do not take directly into account contingent liabilities generated by issued sureties and guarantees; • when specific criteria are met contingent liabilities should be treated as debt assumed by the entity which issued surety or guarantee;

1) Polish Central Statistical Office (GUS) is responsible for the scope of general government sector (in line with EU regulations). The list of general government sector entities is available on the internet website of GUS: https://stat.gov.pl/download/gfx/portalinformacyjny/pl/defaultaktualnosci/5483/6/8/1/lista_jednostek_sektora_instytucji_rzadowych_i_samorzadowych_s.13.xlsx
2) ESA2010 (Regulation (EU) No 549/2013 of the European Parliament and of the Council of May 21, 2013 on the European system of national and regional accounts in the European Union) states that an entity is classified to the general government sector if it is not a separate institutional unit from government or is a separate institutional unit controlled by general government and it is non-market. The ability to undertake market activity is checked notably through the usual quantitative criterion, i.e. if the ratio of sales revenues to production costs is above 50% , the unit is in principle deemed market. However, in order to decide whether a producer that operates under the control of government is a market unit some qualitative criteria must also be taken into account.
3) In compliance with Eurostat guidelines on sector classification of some infrastructure projects, general government debt figures may, under specified conditions, include capital expenditures of the projects in question (imputed loan)
4) Matured payables are expenditure on accrual basis and thus are included in net borrowing/net lending calculated (balance of general government) in accordance with EU methodology.
5) Pursuant to decision of Eurostat of 31 July 2012 on *The statistical recording of some operations related to trade credits incurred by government units* .

Annex 4. Selected statistical data concerning public finance and credit rating in Poland and EU

Table 5. General government deficit, debt[1)] and yields on 10-year bonds[2)] in the EU countries in 2018-2019

	2018			2019		
	GG balance	GG debt	10Y interest rate	GG balance	GG debt	10Y interest rate
	% PKB	% PKB	%	% PKB	% PKB	%
Greece	1,0	181,2	4,19	1,5	176,6	2,59
Italy	-2,2	134,8	2,61	-1,6	134,8	1,95
Portugal	-0,4	122,0	1,84	0,2	117,7	0,76
Belgium	-0,8	99,8	0,79	-1,9	98,6	0,19
France	-2,3	98,1	0,78	-3,0	98,1	0,13
Cyprus	-3,7	100,6	2,18	1,7	95,5	1,07
Spain	-2,5	97,6	1,42	-2,8	95,5	0,66
United Kingdom	-2,2	85,7	1,41	-2,1	85,4	0,88
Euro area	**-0,5**	**85,8**	**1,12**	**-0,6**	**84,1**	**0,44**
European Union (28)	**-0,7**	**80,4**	**1,39**	**-0,8**	**79,3**	**0,74**
European Union (27)	**-0,4**	**79,6**	**1,38**	**-0,6**	**77,8**	**0,71**
Croatia	0,2	74,7	2,17	0,4	73,2	1,29
Austria	0,2	74,0	0,69	0,7	70,4	0,06
Hungary	-2,1	70,2	3,06	-2,0	66,3	2,47
Slovenia	0,7	70,4	0,93	0,5	66,1	0,28
Germany	1,9	61,9	0,40	1,4	59,8	-0,25
Finland	-0,9	59,6	0,66	-1,1	59,4	0,07
Ireland	0,1	63,5	0,95	0,4	58,8	0,33
Netherlands	1,4	52,4	0,58	1,7	48,6	-0,07
Slovakia	-1,0	49,4	0,89	-1,3	48,0	0,25
Poland	**-0,2**	**48,8**	**3,20**	**-0,7**	**46,0**	**2,35**
Malta	1,9	45,6	1,39	0,5	43,1	0,67
Latvia	-0,8	37,2	0,90	-0,2	36,9	0,34
Lithuania	0,6	33,8	0,31	0,3	36,3	0,31
Romania	-2,9	34,7	4,69	-4,3	35,2	4,54
Sweden	0,8	38,8	0,65	0,5	35,1	0,04
Denmark	0,7	33,9	0,45	3,7	33,2	-0,18
Czechia	0,9	32,6	1,98	0,3	30,8	1,55
Luxembourg	3,1	21,0	0,56	2,2	22,1	-0,12
Bulgaria	2,0	22,3	0,89	2,1	20,4	0,43
Estonia	-0,6	8,4	:	-0,3	8,4	:

[1)] Data on general government balance and debt – Eurostat.

[2)] 10-year interest rate – average of average monthly 10-year T-bond yields from last twelve months from January to December; Eurostat.

Table 6. Long-term government debt rating in foreign currency of EU Member States as of September 14. 2020

Country	**Standard&Poor's**	**Fitch**	**Moody's**
Austria	AA+	AA+	Aa1
Belgium	AA	AA-	Aa3
Bulgaria	BBB	BBB	Baa2
Croatia	BBB-	BBB-	Ba2
Cyprus	BBB-	BBB-	Ba2
Czechia	AA-	AA-	AA3
Denmark	AAA	AAA	Aaa
Estonia	AA-	AA-	A1
Finland	AA+	AA+	Aa1
France	AA	AA	Aa2
Greece	B+	BB	B1
Spain	A	A-	Baa1
Netherlands	AAA	AAA	Aaa
Ireland	AA-	A+	A2
Lithuania	A	A	A3
Luxembourg	AAA	AAA	Aaa
Latvia	A	A-	A3
Malta	A-	A+	A2
Germany	AAA	AAA	Aaa
Poland	**A-**	**A-**	**A2**
Portugal	BBB	BBB	Baa3
Romania	BBB-	BBB-	Baa3
Slovakia	A+	A	A2
Slovenia	AA-	A	Baa1
Sweden	AAA	AAA	Aaa
Hungary	BBB	BBB	Baa3
United Kingdom	AA	AA-	Aa2
Italy	BBB	BBB-	Baa3

Source: Reuters

Table 7. Public debt in Poland in 2009 – VI 2020

Item	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	VI 2020
1. State Treasury debt												
a) PLN bn	631.5	701.9	771.1	793.9	838.0	779.9	834.6	928.7	928.5	954.3	973.3	1 088.2
domestic *	462.7	507.0	524.7	543.0	584.3	503.1	543.3	609.2	644.5	674.4	716.5	835.0
foreign *	168.8	194.8	246.4	250.9	253.8	276.9	291.3	319.5	283.9	279.8	256.9	253.2
b) GDP %	46.0%	48.6%	49.2%	48.7%	50.6%	45.3%	46.4%	49.9%	46.7%	45.0%	42.8%	-
2. Public debt (domestic definition)												
a) PLN bn	669.9	747.9	815.3	840.5	882.3	826.8	877.3	965.2	961.8	984.3	990.9	1 097.3
b) GDP %	48.8%	51.7%	52.0%	51.6%	53.3%	48.1%	48.7%	51.9%	48.3%	46.4%	43.6%	-
3. General government debt (EU definition)												
a) PLN bn	683.6	774.7	856.6	883.5	931.1	873.9	923.4	1 010.0	1 007.2	1 035.7	1 045.4	1 256.0
b) GDP %	49.8%	53.6%	54.7%	54.2%	56.2%	50.8%	51.3%	54.3%	50.6%	48.8%	46.0%	-

**) place of issue criterion*

Table 8. GDP and exchange rates in 2009 – VI 2020

Item	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	VI 2020
1. Gross Domestic Product												
PLN bn	1 372.2	1 445.3	1 566.8	1 629.4	1 656.9	1 720.4	1 800.2	1 861.1	1 989.4	2 120.5	2 273.6	-
2. Exchange rate (end of period)												
a) EUR	4.11	3.96	4.42	4.09	4.15	4.26	4.26	4.42	4.17	4.30	4.26	4.47
b) USD	2.85	2.96	3.42	3.10	3.01	3.51	3.90	4.18	3.48	3.76	3.80	3.98

Source: GUS. NBP