Poles to the polls at a crossroad

A tight race in October's elections likely to result in fiscal drift no matter the outcome

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Key points

- The incumbent PiS-led coalition is seeking re-election after eight years in power. Its public support has diminished but it retains a modest lead in the polls
- But polls suggest a stalemate with the incumbent and opposition coalitions likely failing to reach a majority in the lower house of the Parliament. The pre-election debate has drifted towards more fractious social topics
- Fiscal slippage in 2023 is likely after an acceleration in populist measures in the run-up to elections. Any 2024 fiscal consolidation looks questionable given election pledges by all parties. Poland could be under the EU's excessive deficit procedure next year
- Tensions with the EU have been escalating: The ongoing rule-of-law issue blocking the disbursement of EU funds, the EU migration pact, Ukraine grain ban, and military spending on Ukraine are all flash points for the Polish government

Polarised politics translate to stalemate scenario

On 15 October, the Polish people will choose their new political leaders for the following four-year term. They will elect the members of Parliament formed by 460 deputies of the lower house, the Sejm. Each citizen in the 41 electoral districts of the country can vote for a candidate affiliated with a party and/or a coalition. At national level, the electoral commission will then sum up the votes for each party, excluding those which have received less than 5% and coalitions with less than 8%, and will proportionally distribute the seats in the Sejm. President Andrzej Duda will then designate the Prime Minister – usually a person indicated by the parliamentary majority – who will be in charge of forming a government and presenting a programme that requires an absolute majority in a vote of confidence in the Sejm.

The 100 members of the Senate are elected by first-past-the-post voting. The Sejm has more power than the Senate in Poland, although the upper house examines all bills coming from the Sejm and can amend or reject them. Any amendment or rejection by the Senate may in turn be invalidated by an absolute majority vote of the Sejm, but the upper house still retains a key role in appointing the head of independent institutions and in organising referenda put forward by the President.

The political environment in Poland has been largely polarised by two major parties since 2005 – the right-wing national conservative Law and Justice (PiS) party, in power since 2015, and the centre-right liberals Civic Platform (PO) who were in power during the previous eight years. PiS is running for what could be an unprecedented third mandate in a row (Exhibit 1).

Exhibit 1: There's a history of pendulum of power in Poland

Prime minister	Coalition	Period
Mateusz Morawiecki	PiS	2017-2019-present
Beata Szydlo	PiS	2015-2017
Ewa Kopacz	PO	2014-2015
Donald Tusk	PO	2007-2011-2014
Jarosław Kaczyński	PiS	2006-2007
Kazimierz Marcinkiewicz	PiS	2005-2006
Marek Belka	SLD	2004-2005
Leszek Miller	SLD	2001-2004

Source: Chancellery of Prime Minister website, AXA IM, Sept. 2023
PiS (Prawo i Sprawiedliwość) right-wing populist, affiliated to European Conservatives and Reformists (ECR) in the European Parliament
PO (Platforma Obywatelska) affiliated to the European People's Party Group (EPP Group) in the European Parliament
SLD (Sojusz Lewicy Demokratycznej) social democratic party affiliated to the Progressive Alliance of Socialists and Democrats (S&D) in the European Parliament

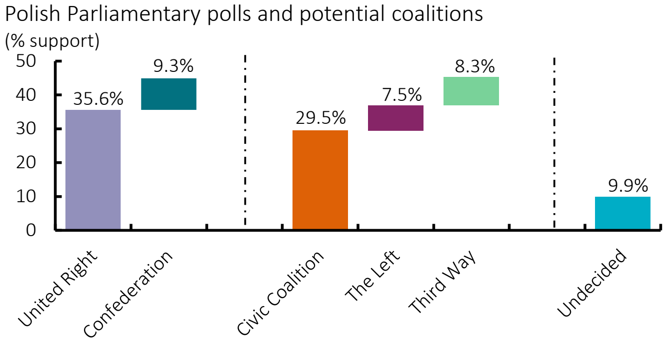
The incumbent PiS remains the favourite in the polls – its alliance with junior allies, known as the United Right (ZP) coalition, receives around 35% of voting intentions, but has been losing support over time. By comparison, it received 43.6% of the popular vote in the 2019 election. The Civic Coalition (KO), gathering several centre-right and centre-left parties around PO, including the Greens, ranks second in the polls with a little less than 30% support on average. Both PiS and PO are led by their respective founders, Jarosław Kaczyński and Donald Tusk.

The other opposition parties or coalitions each attract less than 10% of voting intentions. Tusk has pushed for a united opposition coalition to stand as a single candidate, but this project failed. The Left and the Third Way – an alliance of the agrarian Polish People's Party (PSL), and the centrist Poland 2050 party – have decided to run separately, taking the risk of not reaching the 8% threshold to enter Parliament. This has potential significant implications in the future distribution of the Parliament and the formation of the next government. Current polls show that neither the PiS-led coalition's indicative voting intentions tally nor the three opposition coalitions taken together would obtain enough votes to achieve the majority needed in Parliament to govern independently (Exhibit 2). This is a very tight race.

The two political blocs could be tempted to bring in the far-right coalition, the Confederation, to form a majority-led government. The Confederation appears today in the polls as the third-strongest political power in Poland, gathering at present around 10% of voting intentions. It was more popular last summer, but has seen a loss of support since, although it is still considered as the kingmaker in these elections. However, local polls indicate that a large majority of PO's electorate is opposed, or strongly opposed, to such an alliance, and even in PiS ranks, there is a very narrow majority that approves of a political alliance with the Confederation. Moreover, there is not much appetite among the Confederation's supporters themselves to form a coalition with any other party – a recent poll showed 57% rejected any form of coalition. The anti-establishment and ultra-liberal views of Confederation supporters make these alliances seem quite unlikely.

It is therefore a distinct possibility that the formation of a government fails to receive the Sejm's approval after several attempts, and that new elections need to be called, prolonging political uncertainty into year-end. At least there would be no policy uncertainty as the incumbent PiS government would rule in the interim.

Exhibit 2: So far, polls are hinting at a stalemate



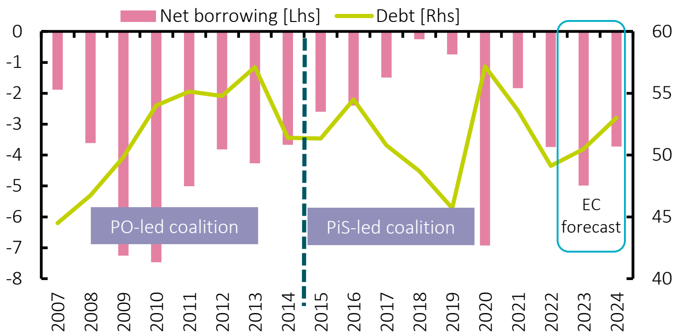
Source: multiple opinion polls among which IPSOS, IBRiS, IBSP, CBOS etc and AXA IM

Fiscal drift no matter the outcome

Given the uncertainty surrounding this very tight race, one stark certainty appears to be a drift towards fiscal loosening. All political parties and coalitions have pledged more spending, to various degrees and on different items, but there is a clear populistic flavour in all of their programmes.

PiS full steam on spending. Unsurprisingly, in the run-up to elections, the incumbent PiS has increased the pace of expansionary policies: Another sizeable increase in the minimum wage; higher healthcare spending; prolonging the mortgage payment holidays through 2024 for people under certain income criteria; and increased child benefits into 2024. The "Polish model of the welfare state", the official PiS document presented ahead of elections consisting of over 200 pages, described the current state of affairs in Poland and detailed the various reforms implemented during their terms in power as well as measures they would introduce in the future if they retain power. Higher minimum wages, higher pensions, achieving the full liquidation of the open-ended pension funds and aiming for stable fuel prices thanks to the merger of several state energy firms (oil refiners Orlen and Lotos with oil and gas producer PGNiG) are just a few of their pledges. The projected general government deficit of 4.7% of GDP in 2023, reducing to 3.4% in 2024 – as per the Convergence Programme submitted by the Polish government to the European Commission (EC) back in April 2023 – will need to be adjusted higher. The EC sees deficits higher by an additional 0.3 percentage points (ppt) for both 2023 and 2024 (Exhibit 3). We see the risk of more significant slippage given most recent policy announcements.

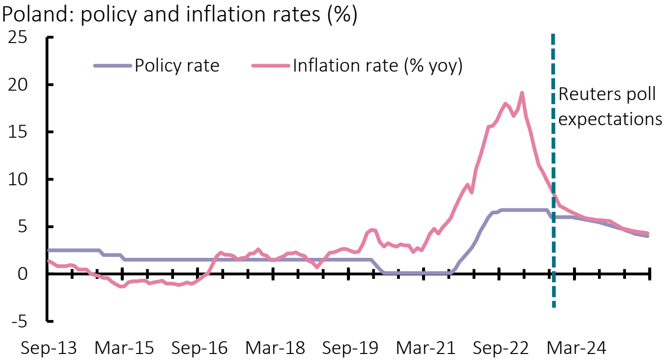
Exhibit 3: Delayed and insufficient fiscal consolidation



Sources: European Commission and AXA IM Research, September 2023

Furthermore, coupled with the premature start of monetary policy easing as per the greater-than-consensus 75 basis-point interest rate cut delivered by the central bank in early September, there is a non-negligible risk of seeing slower disinflation than the consensus envisages if PiS remains in power (Exhibit 4). The currency may thus continue to adjust lower in the absence of foreign exchange interventions.

Exhibit 4: Premature easing could put disinflation at risk



Source: LSEG Datastream, Reuters polls and AXA IM Research, Sept. 2023

Opposition leaning as well towards more social spending. We would caution against any expectations of a faster fiscal consolidation under an opposition-led government given PO's "100 ideas for the first 100 days of governing", which outline more spending at the beginning of a potential mandate. Measures span from increasing tax-free income thresholds to hiking civil servants' wages, particularly for teachers, as well as additional pensions revaluation, 0% mortgage loans for first time buyers and more. Monetary policy should be less politically constrained, which in turn could see a more gradual policy easing than if PiS remain in power. This should see a relatively stronger Polish zloty, further supported by expectations for an improvement in European Union (EU) relations, which may lead to unlocking EU funds: €34bn from the Recovery and Resilience Facility (RRF) – plus another €23bn of loans requested in September – as well as the €77bn allocated under the 2021-2027 EU's Multi-annual Financial Framework. Together this amounts to almost 3% of Polish GDP. Despite Tusk's goodwill, this would not be an easy task with President Duda in power, a long time PiS ally who has been supporting the growing political influence over the judicial, media and education systems that has pushed Poland into a rule-of-law conflict with the EU.

Far right – the third party in Poland. The most spendthrift propositions have stemmed from the extreme right coalition, the Confederation, proposing broad-based lower taxes and limited state intervention in line with their ultra-liberal economic views. Paradoxically, a coalition with the Confederation could see lower public spending. However, this party tends to be known for its various controversial ideological opinions, including anti-EU, pro-Russian, anti-Ukrainian, anti-NATO, anti-Semitic, and global warming scepticism, to name but a few – making it a likely less appealing coalition candidate.

Poland under excessive deficit procedure? All apparently plausible future governments look set to see the general government deficit remain above the 3% of GDP threshold into 2024, which could bring Poland under an excessive deficit procedure. During its latest review of public finances back in May[1], the EC recommended Poland take action by winding down its energy support measures and instead provide more general incentives for energy savings. It also recommended protection for targeted vulnerable households; better targeting of social benefits; ensuring the sustainability of the pension system by increasing the effective retirement age and reforming preferential pension schemes; and fulfilling the milestones agreed with Brussels in order to unlock the frozen EU funds necessary to increase investment in the energy transition. Most of these principles have not been followed by PiS - increased social spending remains largely untargeted and the retirement age was lowered back in 2015, reversing PO's reform. Last but not least, the EC remains seriously concerned over the independence of the judiciary in Poland, with no progress in implementing the six other recommendations concerning the Rule of Law[2]. The EC expects Poland to fully meet the milestones before unlocking the funds.

Yet Poland has a relatively low general government debt ratio (Exhibit 3), which has actually come down since the 2020 pandemic high of 57.2% of GDP, to 53.6% and 49.1% of GDP in 2021 and

[1] Council recommendation on the 2023 National Reform Programme of Poland and delivering a Council opinion on the 2023 Convergence Programme of Poland, European Commission, May 2023

[2] Rule of Law Report 2023 (europa.eu), European Commission, July 2023

2022 respectively, helped primarily by higher nominal GDP. As one of the biggest recipients of EU funding, the Polish government should have massive incentives to unlock this financing in the near future, a non-negligible support to economic growth. A slower fiscal consolidation could push the debt ratio higher, but it should still remain below 60% of GDP over the medium term.

A referendum, and more, to defy the EU

The debates opposing the various contenders have largely focused on more fractious societal issues given their electoral pledges are very similar in economic terms. The EU itself is a divisive topic and has come to the forefront of the debate. The anti-European stance of PiS is not new. Last year, the Polish foreign minister sent a diplomatic note to his German counterpart outlining Poland's demand for war reparations from Germany, estimated to amount to $1.3tn. More recently, the government decided to call for multiple referenda on the same day as the parliamentary elections in an attempt to win back the voters lost since its 2019 victory, polarising the debates on issues conflicting with the EU: Accepting migration, increasing the retirement age and allowing for open competition against national industrial champions.

Migration is the hottest topic of them all. PiS came to power at the height of the 2015 EU migration crisis when over one million migrants from the Middle East and North Africa entered the EU in a single year. Two out of the four questions to be asked at the referendum on 15 October relate to migration. Polish citizens will be asked to give their opinion on whether they support the removal of the recently built fence on Poland's border with Belarus, and whether they support the EU migration pact presented by PiS as a forced relocation of migrants. The European Council recently approved the 'New Pact on Migration and Asylum' meant to improve migration procedures in the EU and balance the collective responsibility and solidarity among European countries. In this new framework, countries can either receive a certain number of migrants or make a 'solidarity' payment for each one they refuse. The pact was adopted by a qualified majority, with Poland and Hungary the only countries to vote against the proposal. The Polish government's vehement reaction is at odds with the fact that Poland is more likely to benefit from the system due to its generous support for Ukrainian refugees.

Ukraine has also become a thorny subject lately. Poland has been one of Kyiv's strongest allies in its fight against Russia, including providing shelter and aid to as many as 1.37 million Ukrainian refugees at the peak in September 2022, but also through military, humanitarian, and financial commitments. According to the Kiel Institute for the World Economy[3], from the start of the war until the end of July 2023, Poland had supported Ukraine with €15.41bn for refugee costs and €4.27bn of aid, of which €3bn constituted the military aid commitment. Altogether, the Polish government's support to Ukraine is estimated at around 3.2% of Polish GDP. However, tensions between Poland and Ukraine have intensified lately.

Central European farmers have had to face an influx of cheap Ukrainian grains, since the sea routes have been blocked by the war. Last April, five countries, including Poland, decided to unilaterally introduce a ban on Ukrainian grains, violating EU single market rules. After negotiations, they reached an agreement with the EU to only allow transit destinations – which the EU decided not to extend beyond September. Poland, Slovakia, and Hungary unilaterally decided to ban food imports from Ukraine, prompting Ukraine to file a complaint with the World Trade Organization. Poland's retaliation was unexpected, with the government announcing a pullback on any further military support to Ukraine, beyond what had been already committed. While the Polish population remains largely supportive of Ukrainian refugees, there was a 10ppt drop in support to 73% in April from the month before, according to a Centre for Public Opinion Research poll, at the time of protests about Ukrainian grains.

Yet, despite all the anti-European rhetoric instilled by PiS since 2015 and exacerbated in the past pre-election months, the Polish population remains among the pro-European nations. In the latest Eurobarometer published by the European Commission in spring, 57% of Poles declared they trusted the EU – 10ppt above the average for the EU's 27 members[4]. The highest score was 73% in Denmark and the lowest was 34% in France. Indeed, after the fall of communism, Poland emerged as one of the most successful economic convergence experiences thanks to the EU accession process: Polish GDP doubled from 2004 when it entered the EU, an outstanding performance when compared with 25% growth in Germany's GDP or 68% for US GDP in euro terms during the same period. Upon becoming a member of the EU, Poland saw rapid development of its institutions, regulations, and infrastructure, which in turn allowed for a massive inflow of capital, an equivalent of 3.6% of GDP per annum since 2005.

As such, the Polish population recognises the benefits of EU integration to their living conditions. Poland has been – and remains – among the biggest recipients of EU funds: 1.4% of GDP on average was spent from the 2014-2020 EU budget (1.9% of GDP planned), which could be as much as 2.7% of GDP per annum for 2021-2027, when accounting for the grants and loans under the RRF on top of the budget. Poland remains the first recipient of the current Cohesion Policy budget with 20% of the total EU envelope allocated. Will Poland really test its growth trajectory absent these funds? Polls will tell.

[3] Ukraine Support Tracker, a Database of Military, Financial and Humanitarian Aid to Ukraine, Kiel Institute for the World Economy, September 2023
[4] Spring Eurobarometer 2023 - Poland, European Commission, June 2023

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