Warsaw, 15th December 2021

Memorandum of the Union of Entrepreneurs and Employers on inflation

Inflation crisis

The economies of Poland and the European Union are going through hard times. Since the beginning of March 2020, the world has been struggling with a pandemic, and in spite of a pronounced recovery in 2021, the new COVID-19 variants keep the global economy from healing completely. To boot, the pandemic is one of the sources of yet another problem that we have fallen victims to in recent months: soaring inflation. According to Eurostat data, inflation in the European Union amounted in October 2021 to 4.4% year-on-year, and to 4.1% (HICP) in the euro area. It was lowest in Malta (1.4%), Portugal (1.8%) and Greece (2.8%), and highest in Lithuania (8.2%), Estonia (6.8%) and Hungary (6.6%). Poland too recorded one of the highest inflation rates (6.4%), thus taking 5th place in the entire EU[1]. Eurostat also analysed inflation in the euro area in November 2021, and as it turns out, it increased to 4.9% year-on-year[2]. Data Statistics Poland are not optimistic either. From the beginning of 2021, inflation has been growing steadily, reaching the level of 2.6% year-on-year in January, 4.3% in April, 5% in July, 5.9% in September, and 6.8% in October[3]. To make matters worse, according to their data, in November inflation might have amounted to 7.7% [4][4]!

[chart]

Source: Statistics Poland, https://stat.gov.pl/wykres/1.html

Reasons behind growing inflation in Poland and in Europe

A number of factors contribute to such a significant increase in inflation in Europe. One of them is the economic recovery of 2021 following a year of restrictions and lockdowns back in 2020. The fact that in the Q3 2021, according to a preliminary estimate of the Statistics Poland, the Polish GDP went up by

[1] Flash estimate – October 2021, Euro area annual inflation up to 4.1%, https://ec.europa.eu/eurostat/documents/2995521/11563351/2-29102021-AP-EN.pdf/70e9c60b-8bca-12cc-859e-41af561b5a08 (date of access 15th December 2021)
[2] https://ec.europa.eu/eurostat/documents/2995521/11563387/2-30112021-AP-EN.pdf/8072b1c7-4379-7fbe-af36-ec2300c42265 (date of access 15th December 2021)
[3] Statistics Poland (Główny Urząd Statystyczny), https://stat.gov.pl/wykres/1.html (date of access 15th December 2021)
[4] Statistics Poland (Główny Urząd Statystyczny), https://stat.gov.pl/obszary-tematyczne/ceny-handel/wskazniki-cen/szybki-szacunek-wskaznika-cen-towarow-i-uslug-konsumpcyjnych-w-listopadzie-2021-roku,8,67.html (date of access 15th December 2021)

5.1%[5] proves this assumption, and so does the fact that the average wage in the enterprise sector in October 2021 increased by nearly PLN 500 since October 2020[6]. Consumption is largely responsible for the increase in GDP, which in Q2 2021 increased by as much as 13.3% year-on-year[7]. These data are certainly good news for the economy, but in terms of inflation, they are hardly neutral. Especially in the case of the Polish economy, which based its model of recovery from the pandemic crisis on generating consumer demand instead of stimulating investments, the impact of the above-mentioned factors on the increase in inflation, one of the highest in Europe, is the more visible.

One of the key reasons for inflation in the European Union is without any doubt the increase in energy prices related to rising gas prices. Demand for gas has been steadily increasing in recent months as a result of the economic rebound. Consequently, the prices of this raw material on global markets have gone up. Political uncertainty in the context of European-Russian relations (the latter being one of the largest natural gas suppliers to the European Union and its member states, including Poland) further aggravates the situation. Moreover, the CO_2 emission allowance within the EU ETS trading system comes to minds as well, as it has become the object of interest of speculators who purchase allowances with the intent to resell. For example, on the ICE and EEX exchanges, the prices of allowances increased by approximately 200% from the level of EUR 25 per tonne of CO_2 in November 2020 to almost EUR 75 a year later.

Another key factor influencing inflation is the increase in fuel prices – not only because fuels are part of the so-called inflation basket, but also (as is the case of energy prices) the increase in fuel prices translates into higher prices of virtually all goods and services in the economy. One ought to look for reasons for the increase in fuel prices (same goes for natural gas) in growing demand for this raw material, which in turn means higher prices on markets around the world. At the end of 2020, the price of a barrel of brent crude oil amounted approximately USD 50, whereas in November 2021 to USD 85. In recent days, we can observe a drop in oil prices to USD 69-73 per barrel due to uncertainty sparked by the emergence of a new variant of the coronavirus: "Omikron". Besides, the weakening Polish zloty has an impact on the growing fuel prices too. On this very day, the US dollar costs

[5] https://stat.gov.pl/obszary-tematyczne/rachunki-narodowe/kwartalne-rachunki-narodowe/szybki-szacunek-produktu-krajowego-brutto-za-iii-kwartal-2021-roku,1,35.html (date of access 15th December 2021)

[6] https://stat.gov.pl/sygnalne/komunikaty-i-obwieszczenia/18,2021,kategoria.html (date of access 15th December 2021)

[7] https://www.money.pl/gospodarka/polskiej-gospodarce-mogla-wyrosnac-nowa-kula-u-nogi-do-tej-pory-byl-to-nasz-atut-6702642264578912a.html (date of access 15th December 2021)

PLN 4.10[8], while a year ago it cost PLN 3.69[9], which means that today one must pay over 10% more for the same amount of oil on international markets.

Of course, the policy pursued by Polish authorities is not without significance for inflation. Numerous social programmes, costs related to aid programmes aimed at mitigating the effects of the COVID-19 pandemic, or the re-purchase of Treasury bonds have all led to a surplus money supply on the market. Poland also decided relatively late (compared to other countries)to tighten its monetary policy and raise interest rates. According to the National Bank of Poland, inflation was supposed to be temporary. This approach has rather changed over the last three months. At the moment, the President of the Polish central bank is of the opinion that inflation may stay with us for a longer time, and the Monetary Policy Council is systematically raising rates. One can expect this trend to continue next year.

And finally, one must speak up that a further increase in inflation in Poland will be driven by the "Polish New Deal". As part of this package, the real public burden on entrepreneurs will increase considerably. Ergo, the increase in the costs of economic activity will inevitably lead to an increase in the prices of goods and services, which will do nothing but increase inflation in 2022.

The risk of stagflation

Increasingly often, the media warn about the possibility of stagflation. Under normal market conditions, GDP growth is usually followed by an increase in inflation, and when GDP falls or its growth decelerates, inflation decreases. However, in the case of stagflation, economic stagnation is accompanies by high inflation. As we have indicated above, in Q3 of 2021, in line with the preliminary estimates of Statistics Poland, GDP increased by 5.1%. Still, one must not forget that this was primarily fuelled by consumption, not by investing in the economy. What this means is that our economy is not becoming more effective or competitive and may therefore lag behind other European countries and the world in general in the long run. High energy prices, problems related to supply chains, rising prices of raw materials and a number of other factors mentioned above translate not only into soaring inflation, but also into an industrial slowdown, already elaborated on in the Markit PMI Purchasing Managers' Index. In recent months, the index, albeit still favourable for Poland, was disappointing (53.4 points in September, 53.8 points in October and 54.4 points in November, respectively)[10].

---

[8] https://www.nbp.pl/Kursy/KursyA.html (date of access 15th December 2021)
[9] https://www.nbp.pl/home.aspx?navid=archa&c=/ascx/tabarch.ascx&n=a239z201208 (date of access 15th December 2021)
[10] https://businessinsider.com.pl/stagflacja-w-polsce-jest-mozliwa-boja-sie-ekonomisci-wszystko-przez-kryzys/7869s03; https://300gospodarka.pl/news/pmi-indeks-markit-przemysl-sierpien-2021;

Economists also predict a decline in GDP, and the latest estimates say that the GDP will increase in 2022 in the range of 4-5%[11].

While the risk of stagflation is still moderate, the very risk of its occurrence makes the need to combat rising inflation all the more urgent.

Europe in the face of inflation

In November 2021, inflation in Germany increased by 5.2% year-on-year – the highest surge in 29 years, since 1992. One of the main reasons for this was the significant rise in energy prices, which increased by over 22%. In this case, fuel is also included in the energy price growth index. Prices of food (4.5%) and services (2.8%) were also higher[12]. Nevertheless, these are not the only factors related to skyrocketing inflation. Just as in Poland, a number of measures were undertaken in Germany to counteract the COVID-19 pandemic, among them a temporary reduction in VAT. When it returned to its original value, increases in the prices of goods and services became an additional factor leading to higher inflation.

France boasts a relatively low inflation. In November 2021, it amounted to 2.8% year-on-year. Notwithstanding its relatively low level, authorities decided, amongst other, that a large part of the society be awarded vouchers EUR 100 worth to compensate for the effects of fuel price increases. One should keep in mind, however, that both France and Germany are part of the so-called Eurozone, and therefore their fiscal policy depends on the actions of the European Central Bank.

A similar level of inflation to that of Poland was observed in Hungary (6.6% in October). Budapest made up its mind to slightly increase the country's base rate, to 1.8% in October and 2.1% in November. The last one was the sixth increase in interest rates in recent months, and their value is 0.35% higher than in Poland.

The problem of inflation affects the entire European Union to a greater or lesser extent. For instance, in France, where inflation is not too high, measures undertaken are rather insignificant, in the form of one-off social transfers. In the case of Germany, inflation is above the EU average and has reached levels unseen in years. And yet it is still much lower than in Poland. The situation most similar to our

https://www.money.pl/gospodarka/pmi-nowy-raport-o-polskim-przemysle-coraz-mocniej-ciaza-opoznienia-w-dostawach-6678454486424384a.html (date of access 15th December 2021)

[11] https://businessinsider.com.pl/gospodarka/makroekonomia/pkb-w-2022-r-ekonomisci-obnizaja-prognozy/654mxb2 (date of access 15th December 2021)

[12] https://businessinsider.com.pl/gospodarka/inflacja-w-niemczech-padl-29-letni-rekord-do-polski-im-jednak-jeszcze-daleko/neszq2y (date of access 15th December 2021)

country can be observed in Hungary. However, lest we forget, the fiscal policy of this country is a bit more determined than in Poland.

Anti-inflation shield

The fiscal policy pursued by the National Bank of Poland and the Monetary Policy Council is not the only measure to combat inflation. On 25th November 2021, the government decided to introduce an "Anti-Inflation Shield". This programme assumes a number of changes aimed at curbing inflation. Draft projects have already been submitted to the Sejm (the lower house of the Polish parliament).

The first step to be implemented as part of this "Shield" is a reduction in excise duty on fuels to the minimum level permitted in the European Union, which is to apply from 20th December 2021 to the end of May 2022. Then the "tax on emissions" is to be abolished. According to the government's assumptions, this reduction will result in a drop in fuel prices by approximately PLN 0.2-0.3 per litre. Also noteworthy is the fact that there have been declines in oil prices in recent days worldwide in the light of the emergence of "Omicron". Should this trend continue, lowering wholesale oil prices may contribute to a dip in fuel prices. Reductions in taxes and wholesale prices of raw materials may translate into a noticeable drop in prices at petrol stations.

The "Shield" also postulates a reduction of VAT on natural gas from 23% to 8% from January until the end of March 2022 and 0% excise tax for households. In this period, VAT will also be reduced from 23% to 5% on electricity and households will be exempt from excise duty on electricity. January to March 2022, VAT on heat energy for households is also to change from 23% to 8%. However, let us not forget that next year we will face further, already approved increases in electricity and gas prices, which will fully "absorb" the above-mentioned tax cuts. Furthermore, these reductions are only temporary, while the increases to come will stay with us for good.

Another element of the "Shield" to be introduced are further social transfers in the form of "shield allowances", which, depending on the number of people in the family and the income earned, is to range from PLN 400 to PLN 1,150. According to estimates, up to 7 million households will be eligible for these allowances.

In the opinion of the Union of Entrepreneurs and Employers, the "Anti-Inflation Shield" may in the short term slow down inflation, but will fail to stop it. Tax cuts are only of a temporary nature, therefore, when they are gone, we may deal with yet another sharp increase in inflation. The VAT cut in Germany had a similar effect. Another thing is the further development of the system of social transfers in the form of a "shield allowance", which will further boost consumption and thus fuel inflation. While our Union supports tax cuts, we believe that such measures should be more systemic, long-term, and in line with national fiscal policy. The government announced that it would allow some solutions of the "Anti-Inflation Shield" to be extended, and for other solutions to be introduced as well. Should this come to fruition, these measures may help us mitigate the effects of the inflation crisis. At the same time, we must point out that additional social transfers are not the answer to our problems. They will only contribute to exacerbating the situation in Poland. Above all else, it is necessary to change the approach to the economy itself and create conditions for entrepreneurs to develop, to be more effective, innovative and, consequently, more competitive.