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Warsaw, October 6, 2023

FOR Communication 23/2023:

Stagflation: The legacy of PiS's economic policy

The data published by Eurostat reveals an alarming situation in which the Polish economy is now. In comparison to other economies in the European Union, it appears to be very weak in terms of economic growth and, simultaneously, particularly affected by inflation.

In the second quarter of this year, compared to the same quarter last year, Poland's GDP declined by 1.3%. This result not only significantly lags behind Ireland, which has been the leader of European growth for many quarters, with its GDP continuing to grow (by 2.8%), but also the EU average, which, although moderate (0.5%), remained positive. In a quarter-to-quarter comparison, Poland's GDP decreased by a staggering 3.7%, marking the worst result among all EU countries.

In August 2023, Poland's inflation, while slightly decreasing, remained in single digits (9.5%). Only three countries had higher inflation rates. In the vast majority of EU countries, inflation has been in single digits for several months, with the EU average for August standing at 5.9%. Denmark, the leader in inflation control, had a rate of 2.3%.

Among various potential macroeconomic scenarios that may unfold, the combination of a contracting economy and high inflation constitutes the worst-case scenario, and this is precisely what is emerging in Poland today. This is not a sudden or surprising phenomenon but rather the consequence of errors in economic policy made in recent years.

Errors in monetary policy were sequentially committed since spring 2020:

- Interest rates' cuts in March, April, and May 2020, bringing rates close to zero (0.1%).
- A six months' delay - until October 2021, to start a tightening cycle.
- Interruption of rates hikes in September 2022 at 6.75%, leaving the real interest rates deeply negative.

The fact that inflation in September 2023 (8.2%) was lower than the peak in February 2023 (18.4%) is not a result of NBP's policy but rather a consequence of stabilization in the prices of food and energy resources globally. Many countries experienced similar slight decreases in inflation during the same period. Regardless of the propaganda banners displayed at the NBP headquarters in Warsaw and the propaganda rants delivered at press conferences by President A. Glapiński, the failures in monetary policy cannot be concealed, and the solid evidence lies in the core inflation. This indicator, calculated by excluding food and energy prices, was 9.3% in July 2022, reached a peak of 12.3% in March 2023, and stood at 10% in August 2023. This means that core inflation, which is the main area where monetary policy can and should have an impact, has frozen at a level close to 10% for several quarters. This will significantly hinder the return of the CPI inflation rate to the target (2.5% ± 1 p.p.), which becomes even more challenging due to two unwarranted and premature interest rate cuts made during the election campaign. If monetary policy in recent years had been managed in accordance with the rules rather than dictated by the expectations of the ruling party, the CPI inflation rate could now be much closer to the European average - almost half of today's.

Low economic growth was already evident in the fourth quarter of 2022 (0.6%), it was zero in the first quarter of 2023, and a decline of GDP occurred in the second quarter. The causes of weakening growth are complex. Primarily, in the years 2021-2022, growth was driven by consumption, stimulated by social transfers and minimum wage increases. High inflation reduced this consumption effect, which was reflected in the economic growth rate.

Concurrently with the shift in economic policy towards consumption, there was a profound weakening of its investment element. Entrepreneurs exposed to legal instability and tax chaos (Polish Deal) reduced the scale of new ventures, and the investment rate (the ratio of investment expenditure to GDP), which was 20.6% in 2015, has now decreased to about 16%. Few remember that, according to the last slide presented in the so-called Morawiecki's Plan in 2016, Poland's investment rate was supposed to reach 25%. With its current, real result, Poland is only better than Greece.

The notion that private business' investments could be replaced by investments from state-owned companies and government-funded projects turned out to be an illusion. Not only were these investments insufficient in scale, but many of them turned out to be complete failures despite significant expenditures. A prime example of this is the construction of a coal power block at the Ostrołęka Power Plant. After spending 1.35 billion zł, it ended with the demolition of its erected components (famously dubbed the "two PiS towers"), costing millions more. Additionally, the attempt to revive the shipbuilding industry resulted in significant losses. A symbolic moment occurred when a commemorative plaque was randomly welded onto ship plates, pretending to be the keel of a ferry. ElectroMobility Poland SA, established in 2016, keeps postponing its production launch of Polish electric cars (now slated for the fourth quarter of 2025). Construction of the plants has not even begun, and the location remains undecided. The recently launched Warsaw-Radom airport may turn profitable in over a decade, while the Central Communication Port, which exists only on paper, has already generated operational costs in the hundreds of millions of zł. Out of the promised 100 bypass roads, only two have been completed, with a combined length of just over 6 km. Instead of cargo ships heading to the port of Elbląg, yachts and sailboats pass through the Mierzeja Wiślana canal.

Lacking success in economic growth and inflation management, PiS has recently been highlighting its achievements in maintaining low unemployment rate. Indeed, the numbers are low. At the end of November 2015, when PiS took over the government, the number of unemployed individuals was 1.53 mln - a rate of 9.6%. By the end of May 2023, these numbers dropped to 0.8 mln and 5.1%, respectively. In May 2023, Poland's unemployment rate was also low by Eurostat's methodology at 2.7%, compared to the EU average of 5.9%. Only the Czech Republic had a slightly lower rate at 2.5%, while Germany's rate was marginally higher at 3.0%.

However, a closer look at these figures reveals that Poland's low unemployment rate should be a source of concern rather than celebration. It is primarily a result of adverse demographic trends. Older generations, born between the 1950s and 1960s, are leaving the workforce (over 700,000 births annually), and the incoming generations from the early 21st century are fewer in number (below 400,000 births annually). The number of Poles of working age is declining (from 23.5 million in 2016 to 22.3 million in 2022), while the number of pensioners is increasing. In 2015, the Polish Social Insurance Institution (ZUS) paid just over 5 million pensions, a number that rose to 6.1 million by March 2023. The low unemployment rate can be attributed to the decreasing workforce, rather than effective employment policies. Contrarily, the PiS party's decision to reverse the retirement age reform aggravated the workforce shortage. Only the influx of foreign workers saved many companies from significant staffing issues. At a time when many countries are focusing on the "silver economy," emphasizing the economic activity of seniors, the employment strategy pursued in recent years appears to be another missed opportunity.

The true picture of the Polish economy in mid-2023 is marked by a declining GDP (the worst result in the EU), high inflation (one of the worst rates in the EU), and a labor market under significant stress. This scenario could have been far more optimistic if the potential of the Polish economy hadn't been compromised by wrong policies.

Civil Development Forum (FOR)

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