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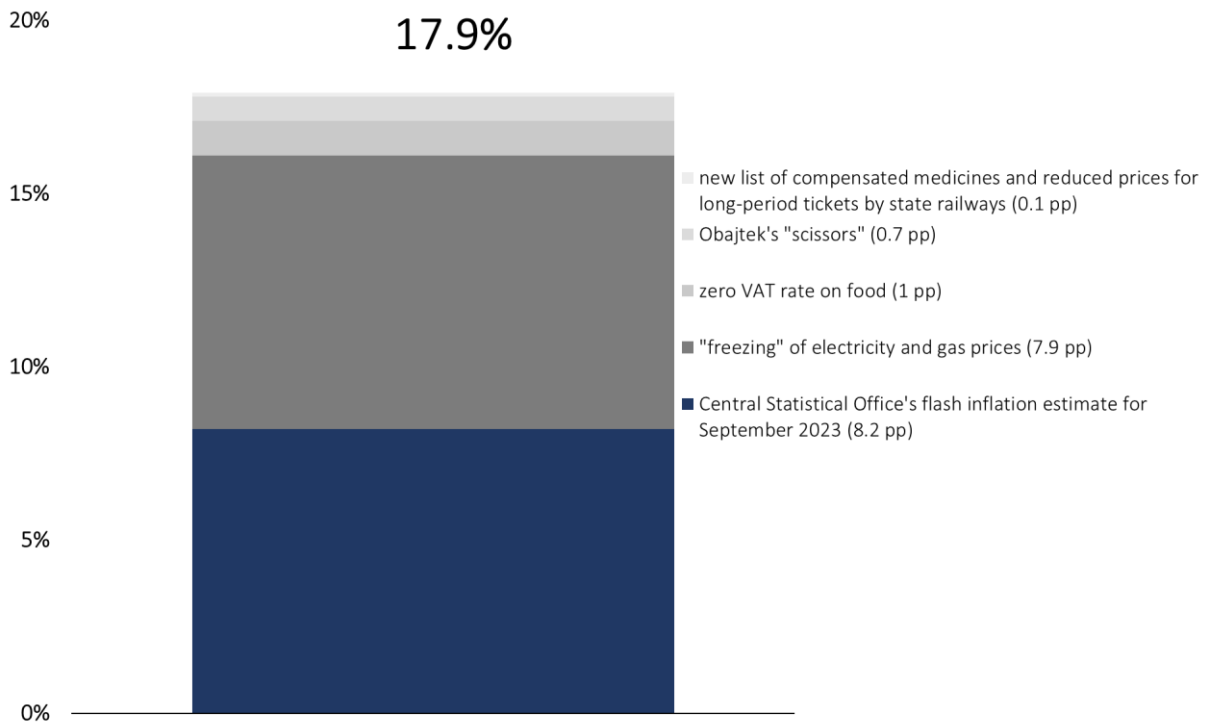
FOR Communication 24/2023:

Will inflation return to double digits after the elections?

The Central Statistical Office's flash estimate for September, pointing to an inflation rate of 8.2%, offers little reason for optimism – inflation remains over three times above the target. It's important to remember that the PiS government allocated tens of billions of zlotys this year to "freeze" prices. Without these highly expensive manipulations, made to mask inflation during the election year, prices would still be rising at a double-digit rate – we estimate that in September the price level would have surged by as much as 17.9% YoY. Just because the government "freezes" prices before elections doesn't mean that post-election inflation won't sharply increase – no country can afford to perpetually maintain suppressed prices, and next year Poland will have one of the highest public finance deficits in the European Union.

Thanks to the zero VAT rate on food, this year's inflation is lower by about 1 percentage point. The "freezing" of electricity and gas prices results in an inflation that's approximately 7.9 percentage points lower. Pre-election fuel price manipulations by Orlen (Obajtek's "scissors") reduced inflation by about 0.7 percentage points, while the new list of compensated medicines and reduced prices for long-period tickets by state railways – by about 0.1 percentage point. If we add these values to the flash inflation estimate for September (8.2% YoY) published by the Central Statistical Office, it turns out that without the government's inflation management, the price level would have increased by 17.9% YoY.

Chart 1. Inflation without government's price manipulations



Source: FOR's own analysis

The government and entities controlled by it, have lowered inflation by approximately 0.8 percentage points through actions taken in the last two months alone. Without these pre-election manipulations, inflation would have been at 9% YoY in September.

All these manipulations are extremely costly and ineffective in the long run. The "freezing" of electricity and gas prices will cost PLN 66 billion this year alone. Maintaining zero VAT rate on food results in state revenues being PLN 11 billion lower. This is happening in a year when Poland has the third-highest public finance deficit in the European Union and pays the most after Hungary for public debt servicing. In essence, these extremely costly programs are only about hiding inflation before the upcoming elections, after which prices will start to rise again. Next year, according to forecasts from the European Commission, Poland is expected to be the inflation leader in the European Union.

Freezing electricity and gas prices

At the end of 2022, the government "froze" electricity and gas prices for 2023. The total cost of freezing electricity and gas prices this year is PLN 66 billion, which is over three-quarters of the average annual

cost of conducting the energy transformation in Poland (PLN 85.7 billion)¹. Without this "freezing," inflation would have been higher by 7.9 percentage points, and the government wouldn't have been able to brag about supposedly effective "fighting" inflation.

The maximum prices (net) of electricity for households at the 2022 level were set up to the limit of 2000 kWh per year (2600 kWh per year for people with disabilities and 3000 kWh for large families and farms)². Since January 1, 2023, the exemption of electricity from excise duty has ended, and the standard VAT rate (23%) has been reintroduced. As a result, the price paid by consumers increased by just over 17%, to a level of PLN 0.5101 gross per 1 kWh. The government also regulated prices above the limit – at the level of PLN 0.8585 gross per 1 kWh (almost a 100% increase compared to the previous year). Meanwhile, the average rate reported to the Energy Regulatory Office in the most popular tariff for households G11 (87% of consumers) is PLN 1.4573 gross per 1 kWh this year³ (a 235% increase compared to 2022).

The indicated limits also "froze" net distribution fee rates from 2022, meaning they increased in gross terms by just over 17%. Above the limit, rates resulting from tariffs apply, and these have increased on average by 45.3% net⁴, or about 70% in gross terms.

According to the Central Statistical Office (GUS), electricity prices increased by 22.3% this year. GUS also states that in the G11 tariff, the rate for 1 kWh, including fixed fees, increased from PLN 0.77 in 2022 to PLN 0.92 this year (19.5% increase). According to the Energy Regulatory Office, after exceeding the limit, the bill will increase additionally by almost 60% on average⁵, which would mean a total increase compared to the previous year of over 90% – to PLN 1.47 per 1 kWh. Meanwhile, without the "freezing," the rate for 1 kWh would have increased, as estimated by the Energy Forum, to PLN 1.89⁶, or by 145%. This means that thanks to the "freezing" of electricity prices alone, inflation on a year-to-year basis is lower by approximately 5.2 percentage points compared to the result given by GUS⁷.

¹ 600 miliardów złotych w 7 lat – transformacja energetyczna w Polsce wymaga gigantycznych nakładów, Polski Komitet Energii Elektrycznej, May 26, 2023, <https://pkee.pl/aktualnosci/600-miliardow-zlotych-w-7-lat-transformacja-energetyczna-w-polsce-wymaga-gigantycznych-nakladow/>.

² On August 21, 2023, Andrzej Duda signed an amendment to the law raising the limits, to which the 2022 net rates apply by 1000 kWh: to 3000 kWh for households, 3600 kWh for people with disabilities, and 4000 kWh for large families and farms. The new limits are set to take effect from October.

³ Own calculations based on data collected from the website: <https://www.rachuneo.pl/taryfy-pradu/g11>.

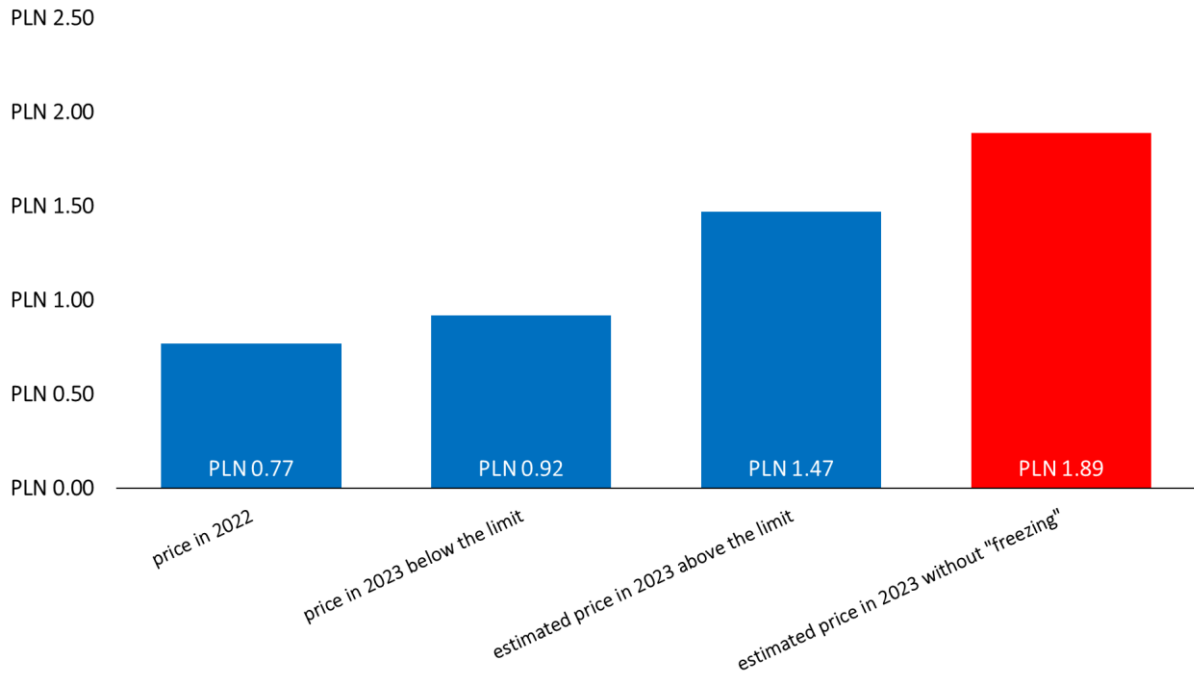
⁴ Ile zapłacimy za energię elektryczną od stycznia 2023 roku? Urząd Regulacji Energetyki, December 17, 2022, <https://www.ure.gov.pl/pl/urząd/informacje-ogolne/aktualnosci/10718,ile-zaplacimy-za-energie-elektryczna-od-stycznia-2023-roku.html>

⁵ Ile zapłacimy za energię elektryczną od stycznia 2023 roku?

⁶ B. Sawicki, Bez interwencji czekają nas potężne podwyżki cen prądu, Energianews, September 14, 2023 <https://energia.rp.pl/ceny-energii/art39106081-bez-interwencji-czekaja-nas-poteczne-podwyzki-cen-pradu>.

⁷ Of course, this doesn't imply that inflation will increase by that much next year if the government "unfreezes" electricity prices. Market prices for electricity have fallen this year. Therefore, Energy Forum estimates that in 2024, the rate for 1 kWh will be PLN 1.53. Compared to this year's price, it would mean an increase of 66%, translating to inflation higher by approximately 1.9 percentage points.

Chart 2. Electricity price per 1 kWh in the G11 tariff

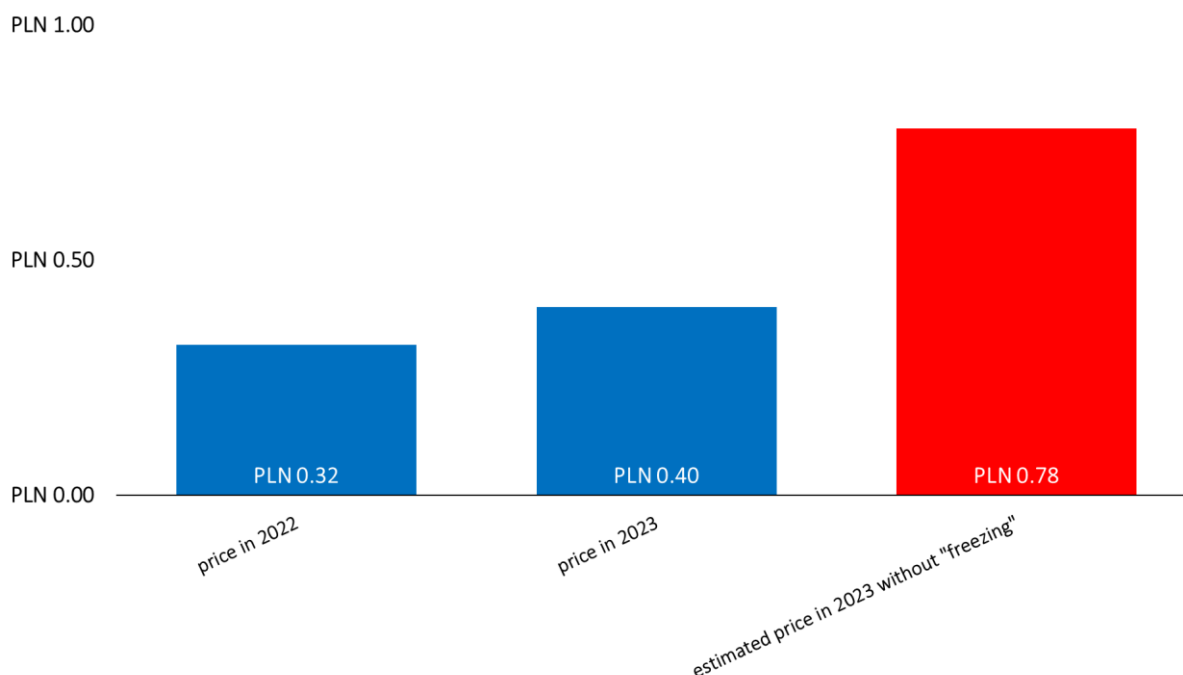


Source: FOR's own analysis based on data and information from GUS, URE, and the Energy Forum

The PiS government has also "frozen" natural gas prices at the level of PLN 200.17 net per 1 MWh. As a result, gas prices have only increased by the amount of VAT rate, which, as of January 1, 2023, is back to 23% (instead of 0%). Meanwhile, the tariff rate at the beginning of this year was PLN 649.92 net per 1 MWh, although later, on February 10, it was lowered to PLN 516.73 net per 1 MWh.

According to GUS, the price for 1 kWh in tariff W-1.1 with distribution fees and fixed charges increased from PLN 0.32 at the end of 2022 to PLN 0.40 this year (taking into account rounding, the same as the VAT on gas – 23%). If the tariff approved on February 10 were in effect (PLN 516.73 net per 1 MWh), gas would cost PLN 0.78 gross per 1 kWh (an increase of 144.7%), and inflation would be higher by approximately 2.7 percentage points.

Chart 3. Gas price per 1 kWh in tariff W-1.1



Source: FOR's own analysis based on data and information from GUS and URE

Obajtek's "scissors"

In recent weeks, the average price of 95 octane gasoline and diesel has been just over 6 PLN, despite the fact that the price of a crude oil barrel on world markets has been rising and was the highest since November 2022. Additionally, since July, the Polish złoty has weakened against the dollar (by 11% at the end of September compared to the July base). As a result, the price of a barrel of Brent crude oil expressed in złotys has increased by over 30% since the beginning of July.

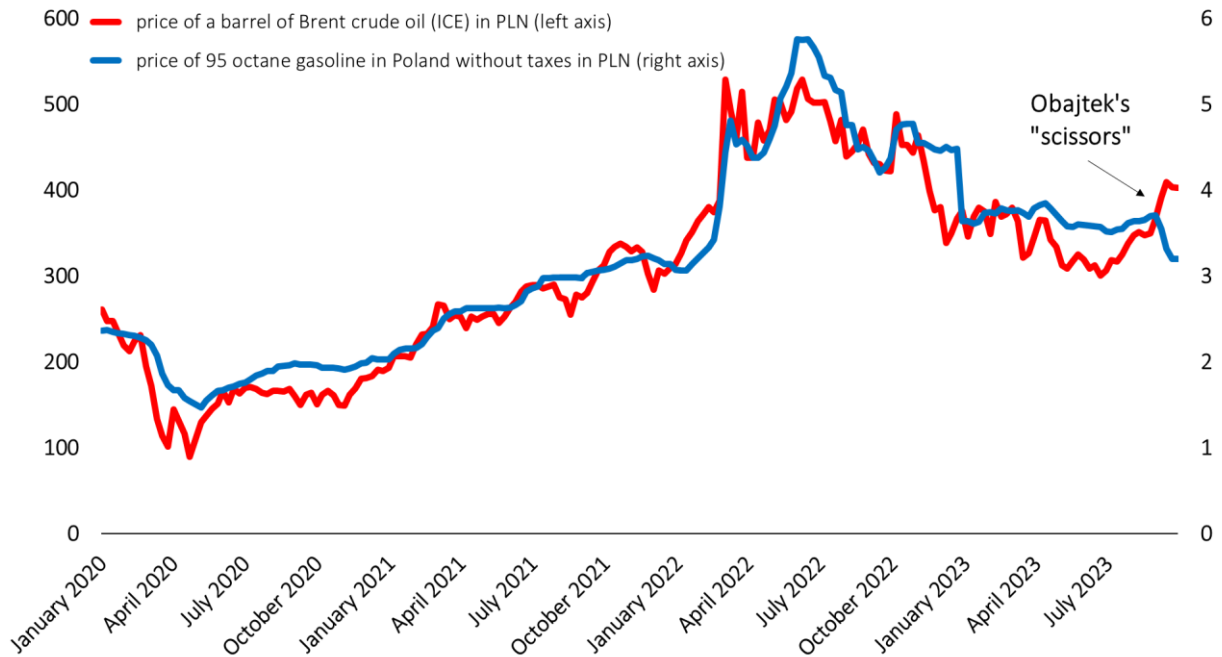
During this time, due to pre-election manipulations by Orlen, the price of 95 octane gasoline at Polish stations decreased by over 7%, and the price of diesel by over 3%. The chart showing the prices of Brent crude oil and gasoline at Polish stations clearly illustrates Obajtek's widening "scissors."

According to Grzegorz Maziak, an analyst at the e-petrol.pl portal, 95 octane gasoline should cost between 6.89 PLN and 6.99 PLN per liter, and diesel – between 6.99 PLN and 7.19 PLN per liter⁸. Based on European Commission's data, we estimate that the average prices of these fuels in September were 6.23 PLN and 6.15 PLN per liter respectively, so they were on average 10.7% and 14.4% lower than the

⁸ *To, dlatego ceny paliw w Polsce są tak drastycznie niskie! Ekspert obliczył, ile naprawdę powinny kosztować diesel i benzyna. Szok!*, WRC, October 1, 2023, <https://wrc.net.pl/mz-to-dlatego-ceny-paliw-w-polsce-sa-tak-dra-stycznie-niskie-ekspert-obliczyl-ile-naprawde-powinny-kosztowac-diesel-i-benzyna-szok>. Even higher price estimates are provided by the money.pl – ranging from 7.29 PLN to 7.59 PLN per liter of diesel and from 6.87 PLN to 7.07 PLN per liter of gasoline.

average of these estimates. Without Orlen's manipulations, inflation in September would be higher by 0.7 percentage points year on year.

Chart 4. Brent crude oil (ICE) and 95 octane gasoline prices in Poland

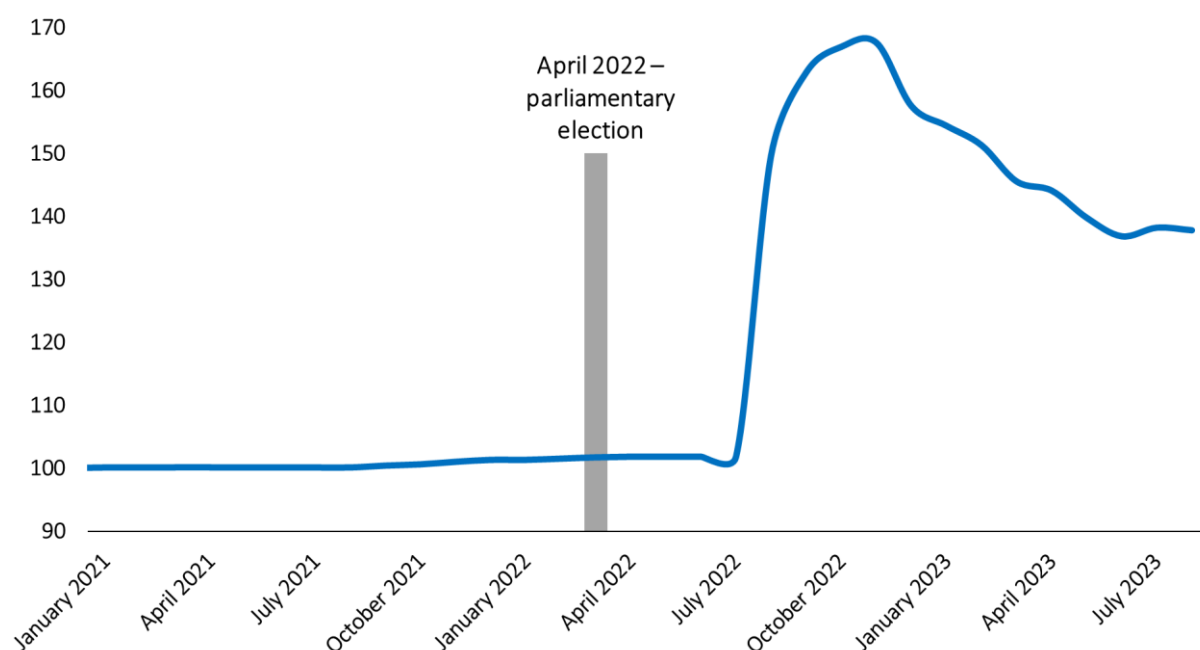


Source: FOR's own analysis based on stooq.pl and European Commission data

Post-election price hikes?

In Hungary, prior to the parliamentary elections held in early April 2022, electricity and gas prices remained stable, and inflation stayed in the single digits. However, in August 2022, energy prices surged by 47%, leading to a substantial 3.7% month-on-month increase in overall prices. By September 2022, inflation had surpassed 20% year-on-year. It only dropped below this level in June of the following year but still maintains the highest position within the European Union.

Chart 5. HICP ELC_GAS Price Level (December 2020 = 100)



Source: FOR's own analysis based on Eurostat data

Sustaining such “inflation-fighting” methods as freezing or artificially lowering prices is ultimately impossible. These highly costly measures can only be employed for a limited period. The clear goal of this tactic is to mislead public opinion about the true state of the economy in order to retain political power. After elections, inflation might once again enter the double digits.

