Poland announces new anti-inflation measures

Poland's government has declared VAT cuts on food and gas as part of its 'anti-inflation shield 2.0'

Poland is cutting the VAT on gas and diesel to 8%

Poland has announced new inflation-busting measures including cutting the value-added tax (VAT) on petrol and diesel to 8%, and the VAT on food, gas and fertilisers to 0%. The base VAT rate in Poland is 23%, while food is typically taxed at a lower 5% rate.

Prime Minister Mateusz Morawiecki made the announcement at a press conference on Tuesday and said the temporary rate reduction will be in force for six months starting from February. The Premier expressed hopes that the Polish zloty will continue to strengthen, curbing inflation pressure. According to Morawiecki, the annual average Consumer Price Index (CPI) in 2022 may reach 6-7% or more.

We estimate that the VAT rate cut on gas from 8% to 0% will have a moderate impact on average inflation in 2022 (0.2 percentage points). The reduction of VAT on gasoline from 23% to 8% is more potent as a way to ease inflationary pressure. It may lower 2022 inflation by some 0.3 percentage points. The biggest potential in hammering inflation is in the VAT rate reduction on food from ~5% to 0%, as it may knock off 0.4-0.8 percentage points from the average CPI. However, the final impact is highly uncertain. We are not convinced that retailers will be eager to pass lower VAT to customers given rising costs and buoyant demand.

As a result of these measures, the CPI increase in the first half of 2022 will be lower than previously projected, but the local peak will be pushed forward to August when lower VAT rates expire. In mid-2022 annual inflation may approach double-digit levels. Will the government announce "Anti-Inflation Shield" 3.0, 5.0, ... 10.0 in order to push the inflation peak further ahead?

> *Proposed cuts in indirect taxes are like a painkiller rather than a permanent cure*

Proposed cuts in indirect taxes are like a painkiller rather than a permanent cure for inflation. They temporarily ease the negative impact of high inflationary pressure, but do not reduce price growth over the long term. We expect inflation to remain higher for longer, even after supply-side shocks recede, as elevated inflation in Poland is also fueled by domestic factors. External price shock is amplified by the inflationary structure of GDP, i.e. consumption boom. The surge in consumer prices is also driven by demand pressure as well as a wage-price spiral that will become more pronounced in 2022. High inflation cannot be contained without some form of demand cooling policies.

It looks like Poland will become increasingly dependent on temporary solutions targeted at an “artificial” reduction in inflation accompanied by policies targeted at stimulating consumer demand. Such an approach is unsustainable and sooner or later some inflation curbing policies will need to be implemented, even if they lead to a temporary economic slowdown. Interest rate hikes serve such a purpose.

The disadvantage of the current anti-inflation policy is in its broad-based approach. The International Monetary Fund (IMF) recommends more focused and targeted actions, such as aid for households that are pushed into poverty, rather than to all consumers. An anti-inflation shield prolongs the surge of demand accompanying a consumption boom.

The government estimates that all planned VAT reductions will cost the budget some 15-20 billion zloty and grants households and public utilities suffering from elevated gas prices another 10 billion zloty. Proposed measures are becoming increasingly costly for public finances, but do not change the mid-term inflationary patch. It could only be justified if the surge in food and energy prices is temporary, but we do not think this will be the case.

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