

Economic interview

We will not let higher inflation gain a foothold

There can be no dithering where national security is at stake
– says Professor Adam Glapiński, Governor of Narodowy Bank Polski,
the winner of the 2021 edition of the Polish Compass (Polski Kompas) award.

Maciej Wośko and Stanisław Koczot talk to
Professor Adam Glapiński, Governor of Narodowy Bank Polski,

How do you assess the present state of the European Union? Do you believe that its current crisis is merely temporary, resulting from the present alignment of political forces, and therefore could be resolved after the next elections? Or is the crisis possibly structural, independent of the current political situation, and primarily results from the changing concept of the EU?

Professor Adam Glapiński: Let me start by saying that the efficient functioning and good condition of the European Union is in Poland's interest. The country has benefited from its membership in the European Union, and other European countries have benefited from Poland's participation. And in this regard it is worth thinking in broader terms than the inflow of European funds, which supported the modernization of Polish infrastructure and Polish agriculture, but were not the most important. The most important benefit of Poland's membership in the EU is the access to the common European market of 450 million people, thanks to which exports have been a key factor in the country's economic growth over the last two decades. Obviously, foreign companies also have access to the Polish market, and they also reap great benefits from Poland's membership in the EU, also from the inflow of EU funds. Therefore, the benefits of the common market and Poland's membership in the EU are mutual.

However, one reason for concern is the tendency to increasingly shift competences from the national level to the EU level, that is, the process of the federalization of the European Union. This leads to conflicts and disagreement between the democratically elected governments of the member states and the technocratic European institutions, which often try to impose their decisions. This applies, for example, to the climate policy, which is designed at the EU level and is largely imposed on the individual member states, including Poland. This often leads to discontent in the countries concerned and causes social resistance.

I believe that it is in the long-term interest of the European Union to halt this process, and to return to the “Europe of Nations,” in which a greater degree of sovereignty of individual member states would be preserved and competences would be clearly distributed in line with the principle of subsidiarity. It seems that the societies of the EU member states are increasingly aware of the problems associated with the federalization of the EU and sooner or later this will be reflected in the results of elections in the individual countries.

How do you see the role of the central bank in Poland in the current economic situation? NBP has contributed greatly to Poland’s smooth handling of the pandemic crisis. Are we now finally in recovery? What will or should change in this situation in terms of monetary and fiscal policy? What threats do you see? What are the existing and emergent sources of risk?

In 2020 we faced an unprecedented shock to the economy – both at home and abroad – caused by the outbreak of the pandemic. At that time, NBP took many decisive, swift measures in order to mitigate the economic effects of COVID-19 to the greatest extent possible, i.e. in the first place to protect jobs, prevent bankruptcies of companies, and maintain the stability of the financial system. The government’s anti-crisis programmes directed at enterprises and households, whose launch was supported by the activities of NBP, had similar goals.

As a result, Poland handled the crisis very well. The recession in our country was relatively shallow and short-lived, and unemployment hardly increased at all, making it among the lowest in the European Union. Consequently, it was possible to quickly make up for the pandemic losses, and our GDP already exceeded the pre-pandemic levels in the second quarter of this year, which is something many European countries haven’t yet managed to achieve. Overall, we have been able to protect the incomes of Poles and Polish companies, paving the way for the continuation of Poland’s economic development in the coming years. In this way, we also supported the stability of the financial system.

This success – that is, ensuring good economic conditions and low unemployment, combined with simultaneous very sharp increases in global commodity prices and protracted pandemic disruptions in global supply chains – caused inflation to rise as well. Importantly – and few people mention this – inflation has increased in most countries, including the world’s wealthiest ones such as the United States and Germany, reaching the highest levels in several decades. Therefore, at present, preventing high inflation from becoming entrenched has become the main challenge for the economic policy of many countries.

The major central banks in the world have not responded to this challenge so far. This includes the ECB, which is keeping interest rates negative and continues to buy assets on a large scale. Fortunately, NBP is independent and so we took decisive measures in order to reduce inflation. We have already raised interest rates twice and we will pursue further action if necessary. Just as we were determined to protect the Polish economy during the pandemic, we will not let higher inflation gain a foothold. Of course, we will do this while also ensuring sustainable growth in the economy. We should keep in mind that inflation will remain elevated until the first quarter of 2022, because – as I’ve said – it is currently being boosted by increases in the global prices of fuels and commodities, a spike in gas

prices in Europe, the effects of the EU climate policy influencing electricity prices, and by various other factors. However, our actions will prevent these shocks from increasing inflation permanently. As a result, after several quarters inflation will start to decline.

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After the meeting of the Monetary Policy Council in November you spoke about public investment projects that would stimulate the economy as a whole. Could their impact really be that great? Shouldn't they be accompanied by private investment? Have the obstacles that previously blocked them, such as uncertainty concerning the outlook for future economic growth, disappeared? Is the policy of the central bank and the commercial banks currently able to support public and private investments?

Public investment is a key factor of economic growth and poses a challenge for the government, especially now that we know that there may be delays in the availability of EU funds for investment. In this situation, the government should increase domestic spending on public investment. And this is exactly what is happening. As part of the recent amendment to the budget for 2021, an additional amount of PLN 18 billion was allocated for this purpose. In October of this year more than PLN 20 billion was also allocated to support the investment of local government units as part of the first call for funding applications under the Strategic Investment Programme. Moreover, yet another call for applications is due in 2021.

When it comes to private investment, NBP follows it closely as part of the ongoing monitoring of the enterprise sector. We are seeing a clear rebound in corporate investment after the pandemic. In the third quarter of this year, the general index of investment optimism among the surveyed companies increased for the fifth quarter in a row and is now close to the levels recorded during the peak of the last investment cycle in 2018. According to the latest NBP projection, the value of enterprises' gross expenditure on fixed assets will exceed the levels recorded before the outbreak of the pandemic as early as the beginning of 2022.

The government is establishing the Armed Forces Support Fund located at Bank Gospodarki Krajowej. The sources of its financing will include funds obtained from issuance of bonds, including BGK bonds, payments from the state budget and from the profits of Narodowy Bank Polski, as long as the central bank generates a profit. Why did NBP decide to finance the Polish armed forces? Until recently NBP's profits were transferred to the state budget, satisfying a sizable portion of its needs. What is the reason behind this shift? Will this require any statutory changes, especially relating to NBP?

The planned transfer of the contribution from NBP's profits to the Armed Forces Support Fund is, in my opinion, the right decision and I'm very happy about it. The central bank's profit is the income obtained mainly from the management of the NBP reserves, which are classified as national assets. Meanwhile, national defence is one of the most essential functions of the state. I think that, especially in the present times, such a form of emphasizing the importance of this function is deeply justified.

As far as legal changes are concerned, this will require statutory amendments, because at present, in accordance with the Act on Narodowy Bank Polski, payments from NBP's profits are transferred to the state budget. However, I would like to point out on this occasion that such an amendment – if adopted – will not affect the principles relating to the generation of this profit. Just as before, NBP will strive to effectively manage its reserves and costs, which should enable the maximization of the financial result. However, this result cannot be planned in advance because it depends on many factors, including, in particular, the changing situation on the global financial markets.

Why is the modernization of our armed forces so important right now? What has happened that has made it such an important challenge? What will happen if we fail to take up this challenge? What could the consequences be?

When talking about the need to build a strong army, we often repeat the proverb “if you want peace, get ready for war.” I think there is a lot of truth in this sentence. Therefore, I believe that the modernization of the Polish army should be one of the priorities of the Polish state. Especially since it is blatantly obvious that there are increased tensions emerging across the world. It would be naive to think that Poland will not be affected at all, especially considering our geographical location. The current events on the Polish-Belarusian border clearly show how important it is to maintain strong, modern, and immediately deployable military and uniformed services.

Furthermore, it can be expected that these tensions will emerge increasingly more often, as there are tectonic shifts taking place in global geopolitics. Graphically, the centre of gravity is shifting from the Atlantic towards the Pacific. Europe is losing its relative importance, while China and India, which have growing ambitions in the world, are gaining power.

There is much talk about the growing role of the People's Republic of China possibly threatening the military and economic hegemony of the United States in the world, which could create numerous axes of conflict between these two countries. Some political scientists even argue that a conflict between the United States and China is inevitable, just like the conflict between the rising power of Athens and Sparta, the latter trying to maintain its hegemony. Hence, people often refer to this as the so-called “Thucydides' Trap,” which illustrates the supposed inevitability of the rivalry between China and the United States.

Of course, the ongoing tectonic shifts in global geopolitics will have implications for the entire global balance of power, although right now it is difficult to determine how they will affect Poland. We must be prepared for various scenarios and for this purpose we must maintain a strong and modern military. This is also true, because Poland's security is the basic condition for economic stability and prosperity.

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The implementation of the Homeland Defence Act will not be easy. It is based on three foundations: modernization of the Polish Armed Forces, increasing the attractiveness of military service, and implementing the concept of universal defence. Will the possible injection of funds from NBP, provided that the central bank manages to generate a profit, be allocated to specific components of the reform of the Polish Armed Forces, e.g. for the purchase of weapons, for the creation of the Cyberspace Defence Forces? Are these funds allocated to specific goals?

As far as I know – and the legislative initiative in this matter belongs to the government – the payment from NBP’s profit is not to be assigned to specific aspects of the Polish Armed Forces’ reform. I certainly wouldn’t want to suggest that some of these aspects are more important than others. The most important thing from the point of view of the country’s security is that such a reform has been proposed, and it should now be implemented. Poland will secure considerable funds for this purpose through the Armed Forces Support Fund. Although we know that even before the establishment of this Fund, over the last several years, very substantial and much needed military investments were launched, such as the purchase of the Patriot missile batteries and the F-35 fighter jets.

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Is the provision of additional sources of financing for the armed forces a necessary condition for the introduction of this law and these changes? Does the success of its implementation also depend on other – political or social – factors? The draft law is already facing resistance and is strongly contested by the opposition parties. Why is that? Is it possible to achieve agreement in this matter if it proves impossible even in matters as important as the defence of Poland’s eastern border? Don’t you think that the strength and efficiency of the army depends not only on its equipment and technical capabilities, but also on the morale and determination of the soldiers to defend national borders, which is being undermined by some circles?

It should be obvious to anyone who considers themselves a patriot that – regardless of the natural differences of opinion – unity is absolutely necessary in matters of national security. When it comes to the morale of Polish soldiers, it is certainly strengthened in a situation in which they feel that national defence forces are important to the state, adequately financed, equipped, organized and trained, and therefore effective. The introduction of the Homeland Defence Act will certainly be a valuable contribution in this regard.

Are you concerned that the reform of the army might be put on hold or curtailed if it is necessary to choose between military spending and increased taxation? Such situations have already taken place in Poland's contemporary history.

There can be no dithering where national security is at stake. The Homeland Defence Act, in combination with the provisions already in force – under which we allocate over 2 per cent of GDP to national defence and will allocate at least 2.5 per cent of the GDP for that purpose in the future – create a solid financial foundation for the development of the Polish army. I'm convinced that the Polish state can afford to finance the implementation of this plan. When it comes to the possible impact of the economic turmoil on public finances, it is worth noting that last year we experienced the first recession in 30 years in the Polish economy, but nevertheless the budgeted expenditure on national defence was almost fully implemented.

Another extremely important challenge for Poland and its economy is the energy transformation. Does the central bank also anticipate any forms of support in this case?

Energy transformation, and above all ensuring the country's energy security, is undoubtedly a challenge not only for Poland, but also for many other states. This is clearly demonstrated by the current situation on the European gas market. At the same time, it should be pointed out that the term "transformation" is a euphemism. The changes we are facing will have a very strong impact on the economy for the coming decades.

Relying solely on energy from renewable sources will not be enough to solve this problem, but nuclear energy provides a real alternative or a necessary complement to our current energy mix. In my opinion a shift towards nuclear power is inevitable and necessary. Poland can afford to finance the construction of nuclear power plants, and NBP is ready to indirectly support such activities, of course, within the confines of the instruments at our disposal. In the long term, this is also consistent with the mandate of the central bank, i.e. with the goal of maintaining medium-term price stability, because limiting energy price increases will be conducive to lower inflation. This is mainly due to the importance of energy in the consumer basket, but also the costs of energy for the entire economy. Moreover, this also relates to Poland's competitiveness in the international arena, which we also have to protect. Meanwhile, the European Union's climate policy, in the currently proposed and forced formula, is becoming a self-imposed burden. Additionally, despite all the efforts and declarations, many other countries will also try to exploit it in order to attract new investments at the expense of EU member states.

As for the details on what NBP support could look like, it's simply too early for such deliberations, especially considering that Poland is just getting ready to take action in this

matter. However, in my opinion, a shift towards nuclear energy is a change in the right direction and everyone should support it.

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How do you assess the European Commission's activities regarding climate policy? Does it take into account the specific conditions of individual countries, including Poland, in its "Fit for 55" programme?

"Fit for 55" is a programme that will be very problematic for our country, which uses coal for energy production to the greatest extent among all EU member states, thereby recording higher-than-average greenhouse gas emissions. In the past, EU regulations supported countries in which energy transition generated higher costs, for example through additional allocations of free emission allowances. As part of the newly submitted proposals, the European Commission offered some solutions, such as making emissions reduction requirements dependent on the level of economic development. However, taking into account the costs and the challenges faced by Poland in connection with the energy transformation, the level of the proposed support seems insufficient and should be increased in the course of negotiations.

As I've said, the European Union's climate policy is a burden on the competitiveness of European industry, in particular on the international stage. On the other hand, from the perspective of the central bank, one additional important consequence of that policy is its impact on inflation. The proposed changes mean that in many years to come, these carbon footprint taxes will be driving up prices, which from our point of view will constitute a long-term negative supply shock.

Any actions taken in the coming years should be well-considered so as not to overburden the economy and the people with the costs of the energy transformation.