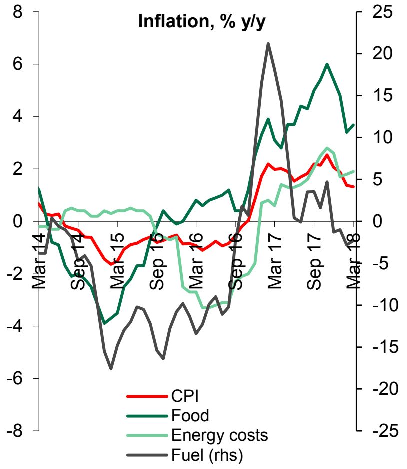
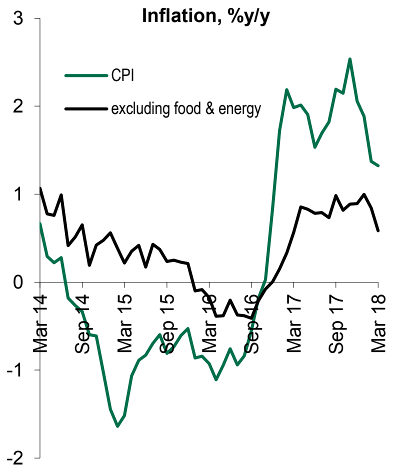
ECONOMIC COMMENT

4 April 2018

Fading inflation, core CPI the lowest in a year

Polish inflation unexpectedly declined in February, from 1.4% y/y to 1.3%. Market consensus was 1.6-1.7% and we expected 1.6%. This is the second big negative deviation from consensus in a row. Unlike in previous periods, Stats office showed some details in the flash release, which allowed us to estimate core CPI. Core inflation most likely dropped to 0.6% y/y from 0.8% while a rise to 0.9% was expected and goes against our view that the measure of price trends should increase due to the tensions on the labour market. This release is another trigger to lower this year's forecasted CPI path. We now feel it may be hard for CPI to return to 2% y/y this year.





Polish inflation unexpectedly declined in February, from 1.4% y/y to 1.3%. Market consensus was 1.6-1.7% and we expected 1.6%. This is the second big negative deviation from consensus in a row. Ahead of the previous release for February, the market expected a small decline from 1.9% y/y to 1.8%, while the actual decline went to 1.4%.

In both the February print and the March flash release there is a negative surprise in food prices (but this was not the only factor responsible for the surpises). In March food prices continued to decline, by 0.1% m/m. We expected some rebound after the February fall by 0.4% m/m which severely deviated downwards from the seasonal pattern of food price changes.

Unlike in previous periods, Stats office showed some details in the flash release, which allowed us to estimate core CPI. Core inflation most likely dropped to 0.6% y/y from 0.8% while a rise to 0.9% was expected. This is the lowest reading in a year and goes against our expectations of rising core inflation this year. We thought that core CPI would be pushed up by tensions in the labor market. When preparing our March CPI forecast we assumed a gas prices cut and decreases of telecomm services prices. However, the flash CPI reading suggests that there were some other factors (inside core CPI) also acting towards lower inflation in March. In our opinion the surprising decrease of the headline and the core measure of inflation did not come from annual revision of CPI basket weights.

The March flash release is another trigger to lower this year's forecasted CPI path. We now feel that given the continued decline of inflation and core inflation in March, it may be hard for CPI to return to even 2% y/y this year (not to mention the 2.5% y/y NBP target). As a result, the MPC may be even more convinced that keeping rates unchanged for at least one more year seems the optimal response to the current macroeconomic setup. There could be more comments sketching scenarios which would permit further monetary policy easing, despite the fact that NBP rates are already at an all-time low.

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