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Economic Comment

The tightening cycle continues

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Polish Monetary Policy Council decided to hike main interest rates by 50bp (the reference rate up to 1.75%), in line with market consensus and slightly less than we had anticipated (+75bp).

In the press release the Council confirmed earlier assessment of the NBP president Adam Glapiński that elevated inflation may be not as transitory as earlier thought. They also acknowledged that some central banks abroad started withdrawing monetary accommodation and CEE peers are raising interest rates. The communique leaves the door open for further rate hikes by saying that future decisions will remain focused on bringing inflation to the target in the medium run and the assessment will take into account the new incoming information. At the same time, the MPC signals it wants to secure balanced economic growth, so the outlook for GDP and unemployment will be also important in the decision-making process.

After today's hike, the main interest rate in Poland is still among the lowest in the region (on par with Romania). We think the monetary tightening will continue, both in Poland and most likely also in CEE peers. We assume the next rate hike by 50bp is possible in January, after December CPI tops 8% y/y, and then a pause is likely until March, when the new NBP projection will be released. By March, six of the existing MPC members will be replaced by the successors (two nominated by the Sejm, two by the Senate, two by the Poland's president), which adds some uncertainty to the predictions about next movements. We still assume the peak NBP rate in this cycle at 3.0%, which should be achieved in 1H22.

The zloty, which gained shortly before the decision, weakened in reaction to the announcement to c.4.61 per euro, while FRA rates and bond yields declined slightly. The NBP governor's press conference is scheduled for Thursday, 15:00 CET, and may deliver more hints on the policy outlook.

Changes versus November's statment

The activity in global economy continues to recover, yet ~~a difficult pandemic situation persisting in many countries together with~~economic conditions are under a negative impact of supply-side constraints in some markets~~ and a strong increase in ~~, high commodity prices~~, have a negative impact on economic situation~~ and re-escalation of the pandemic in ~~some~~certain countries~~. Still, latest~~, including the euro area. Latest forecasts indicate ~~a further increase in global GDP next year~~that GDP growth in 2022 will remain relatively robust, although lower than in 2021. The emergence of a new variant of coronavirus contributed to higher uncertainty regarding further course of the global epidemic and economic developments, and hence to some deterioration of sentiment in the global financial markets and an increase in risk aversion.

~~At the same time a markedly higher than a year ago commodity~~Commodity prices – in particular prices of natural gas, ~~but also of ~~oil~~ and~~, coal, as well as of some agricultural commodities – ~~together with ~~remain markedly higher than a year ago. Together with continued global supply chain disruptions and ~~significant increase in ~~still high international shipping costs, ~~contribute~~and amid recovery in demand, this contributes to a marked rise in inflation ~~in many economies and an upward shift in its ~~globally, which in many countries has reached highest levels in decades. Moreover, also inflation forecasts for the ~~next year. In many economies, including in the USA and euro area, inflation significantly exceeds the ~~coming quarters have been revised up, which points to the risk of longer than previously judged impact of pandemic shock on inflationary processes.

Against this background some central banks ~~targets, staying at the highest levels in many years~~are withdrawing monetary accommodation, however, decisions of monetary authorities are not homogenous and take into account conditions for conducting monetary policy in particular economies. Central banks in the Central-Eastern Europe region have been increasing interest rates. The ECB, despite inflation being the highest in the euro area history, keeps negative interest rates and continues big scale asset purchases. In turn, the US Federal Reserve keeps interest rates close to zero, but at the same time signals the possibility of a more rapid deceleration of asset purchases, which together with an increase in risk aversion leads to an appreciation pressures on the US dollar in global markets.

~~Major central banks are keeping interest rates low while continuing asset purchases, although some of them signal the reduction in the monetary accommodation scale. At the same time central banks in the Central-Eastern Europe region have been increasing interest rates.~~

In Poland, economic activity continues to recover~~.~~, despite another wave of increase in infections. Robust economic conditions are reflected in preliminary estimate of GDP, according to which annual GDP growth in 2021 Q3 stood at 5.3%, accompanied by a significant acceleration in investment. Data on industrial production, retail sales and construction and

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assembly output for October 2021 point to a solid increase in economic activity also in 2021 Q4. The situation in the labour market ~~is still improving~~likewise continues to improve, as indicated by decreasing unemployment and a marked increase in average wage~~ in the enterprise sector.~~. In the coming quarters~~,~~ economic conditions are expected to remain favourable. However, there are ~~significant risk~~ uncertainty factors related to the impact of ~~autumn wave of~~ the ~~epidemic~~pandemic on ~~the economy~~global and domestic economic conditions, as well as to the effects of ~~supplyside~~supply-side constraints and high energy commodity prices on the ~~global economic conditions~~economy.

Inflation in Poland, according to the Statistics Poland flash estimate for ~~October~~November 2021, increased to ~~6.8~~7.7% in annual terms, and in monthly terms it amounted to 1.0%. The elevated inflation resulted, to a great extent, from external factors beyond the control of domestic monetary policy, such as higher than a year ago global prices of energy and agricultural commodities, earlier increase in electricity prices and in waste disposal charges, as well as ~~disruptions in global supply chains and international transport.~~rising prices of goods, whose supply has been constrained by global pandemic disruptions. The ongoing economic recovery, including demand driven by rising household income, has also added to the price growth.

~~The Council became acquainted with the results of the November projection of inflation and GDP based on the NECMOD model. In line with the projection prepared under the assumption of unchanged NBP interest rates and taking into account data available until 21 October 2021 there is a 50-percent probability that the annual price growth will be in the range of 4.8–4.9% in 2021 (against 3.8–4.4% in the July 2021 projection), 5.1-6.5% in 2022 (compared to 2.5-4.1%) and 2.7–4.6% in 2023 (compared to 2.4–4.3%). At the same time, the annual GDP growth – according to this projection – will be with a 50-percent probability in the range of 4.9–5.8% in 2021 (against 4.1–5.8% in the July 2021 projection), 3.8-5.9% in 2022 (compared to 4.2-6.5%) and 3.8–6.1% in 2023 (compared to 4.1–6.5%).~~

The rise in global prices of both energy and agricultural commodities observed this year, record high increase in prices of CO2 emission allowances, as well as continued global supply chain disruptions have led to ~~an increase of~~significant rise in inflation ~~forecasts for the coming quarters both globally and~~ in Poland~~. Amidst~~, which is going to remain at an elevated level also in the coming period. The so-called Anti-inflationary Shield announced by the government will have a curbing impact on inflation.

In a longer perspective, inflation will decrease, which will be supported by expected fading of some global shocks currently boosting price growth, as well as by an increase in the NBP interest rates. At the same time, amidst further economic recovery and expected continuation of favourable labour market conditions, ~~it would generate~~as well as probably more lasting impact of external shocks on price dynamics, there persists a risk of inflation ~~remaining elevated~~running above the NBP inflation target in the monetary policy transmission horizon. In order to reduce this risk, i.e. striving to decrease inflation to the NBP target in the medium term, the Council decided to increase NBP interest rates~~.~~ again. The increase of the NBP interest rates will also curb inflation expectations.

Decisions of the Council in the coming months will continue to be aimed at reducing inflation to a level consistent with the NBP inflation target in the medium term, while taking into account economic conditions, so as to ensure medium-term price stability and at the same time support sustainable economic growth after the global pandemic shock. The Council's assessment regarding the total scale of monetary tightening necessary for achieving these goals will consider incoming information on perspectives for inflation and economic growth, including situation in the labour market.

NBP may still intervene in the foreign exchange market and use other instruments envisaged in the Monetary Policy Guidelines. The timing and scale of the measures taken by NBP will depend on the market conditions.

~~The Council adopted the Inflation Report – November 2021 as well as the Opinion on the 2022 Draft Budget Act.~~

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