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Economic Comment

Compromise solution

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Monetary Policy Council decided to hike main interest rates by 75bp, the main reference rate to 3.50%. The consensus among analysts (including us) was +50bp, while the financial market was clearly betting for a bigger move. The Council opted for a move that one can see as a compromise solution, on one hand trying to support the currency and to respond to quickly worsening inflation outlook with a slightly bigger move than previously (+50bp), while on the other hand possibly trying to avoid excessive tightening. In the initial reaction the zloty has weakened (EURPLN from c. 4.86 to 4.93), FRA rates also corrected briefly.

The press release revealed the main results of the new NBP projections with CPI growth staying very high until the end of forecast horizon and GDP growth trimmed vs previous edition (especially in 2023), but still far from economic stagnation – see details in the table below. We do not know the exact assumptions about the government's anti-inflation shield but we guess that the projection was based on the currently binding law, i.e. the shield existing until July (while we think it is increasingly likely it will be extended at least until year-end). The projection's cut-off date is March 7, which means that the central bank tried to capture the effects of Russian invasion on Ukraine.

The projected inflation trajectory in the next two years is stunningly high, which – amid GDP growth slowing but still not far from the potential – could justify a meaningful monetary tightening, in our view. Last month, the NBP president Adam Glapiński said that the road towards 4.0% reference rate is "paved", and stressed that the scale of tightening will depend heavily on the economic growth outlook. The latter is obviously deteriorating due to the war in Ukraine. However, after today's move the 4.0% level is only 50bp away, so we think it is increasingly likely that the reference rate may get even higher, especially if the pressure on the currency continues. We find little signals in the statement about moving up the target NBP rate in this policy cycle, but it is not particularly surprising as the MPC official statements in the recent years have not been very informative as regards the MPC intentions. Much more important could be tomorrow's press conference of the NBP governor (scheduled at 15:00 CET). We think that even if he resists signalling bigger room for rate hikes above 4.0%, the market will continue pricing-in such scenario, recognizing that it may be necessary in the environment of very high inflation, widening current account and fiscal deficits, and undervalued currency.

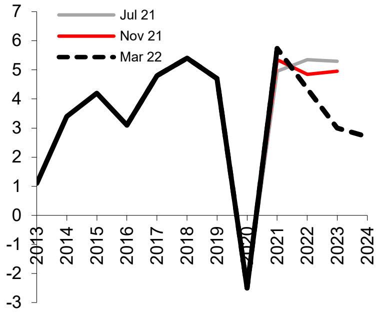
Inflation and GDP projections in subsequent Inflation reports

Middle points of GDP and CPI growth paths and width of 50-percent probability ranges.

	GDP growth			
	Nov 20	**Mar 21**	**July 21**	**Mar 22**
2022	5.45 (±1,45)	5.35 (±1.15)	4.85 (±1.05)	4.35 (±0.95)
2023	5.4 (±1,4)	5.3 (±1.2)	4.95 (±1.15)	3 (±1.1)
2024	-	-	-	2.7 (±1.3)
	CPI inflation			
2022	2.8 (±0,8)	3.3 (±0.8)	5.8 (±0.7)	10.75 (±1.45)
2023	3.2 (±1)	3.35 (±0.95)	3.65 (±0.95)	9 (±2)
2024	-	-	-	4.25 (±1.45)

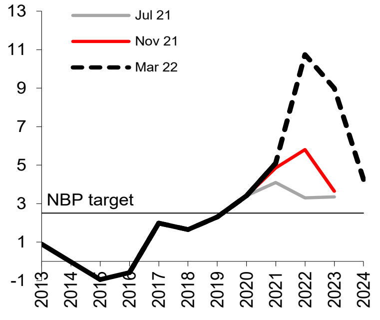
Source: NBP, Santander

GDP growth according to NBP projections (projection mid-points)



Source, NBP, Santander

CPI growth according to NBP projections (projection mid-points)



Source, NBP, Santander

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Changes versus February's statment

~~Incoming data indicate that after a strong growth in global economic activity in 2021 , in recent period economic conditions in some economies have deteriorated. Global economic activity is under a negative impact of supply-side constraints in some markets, high commodity prices and re-escalation of the pandemic. Latest forecasts indicate that global GDP growth in 2022 will be lower than in 2021, however, it will remain relatively robust, supported by an increase in consumption in many countries taking place amid good situation on the labour market and continued recovery in activity after the pandemic crisis. Further epidemic and geopolitical situation, as well as developments in economic policy in the biggest countries remain an uncertainty factor for further course of the global economic conditions.~~

~~Energy commodity prices – in particular prices~~After a strong growth of global economy in 2021, at the turn of the year economic activity has softened somewhat in some economies. At the same time, amidst improving epidemic situation in the United States and the euro area in recent period, economic condition indicators have improved in these economies.

After the outbreak of the Russian military aggression against Ukraine, uncertainty regarding further course of global macroeconomic situation has increased significantly, including in Europe. This has been reflected in a marked deterioration of sentiment in financial markets and a depreciation of some currencies. Prices of natural gas, oil and coal~~ –~~, as well as prices of some agricultural commodities ~~remain markedly higher than a year ago~~have increased again. At the same time, global supply chain disruptions continue and international shipping costs are still elevated. This ~~contributes~~will probably contribute to a ~~marked~~further rise in inflation worldwide, which in many countries ~~has~~had reached ~~highest~~high levels ~~in decades. At~~even before the ~~same time inflation forecasts have been revised up and indicate that in many economies inflation in 2022 will remain higher than central banks' targets~~Russian military aggression against Ukraine.

Amidst a marked increase in inflation many central banks are withdrawing monetary accommodation. Central banks in the Central-Eastern Europe region have been increasing interest rates. The ECB keeps negative interest rates, although it has been reducing the scale of asset purchases. The US Federal Reserve signals a termination of asset purchases in March and a start of interest rate increases.

~~In Poland, economic activity continues to recover. According to Statistics Poland preliminary estimate, GDP growth in 2021 amounted to 5.7%, and in 2021 Q4 there was a significant acceleration in annual GDP growth. The situation in the labour market continues to improve, which is reflected in decreasing unemployment, rising employment and a marked increase in average wages. In the coming quarters economic situation is expected to remain favourable. However, there are uncertainty factors related to among others the impact of the pandemic on global and domestic economic conditions, as well as to the effects of supply-side constraints and high energy commodity prices on the economy.~~

Available data indicate that economic conditions in Poland remain favourable. GDP growth in Q4 2021 stood at 7.3% according to preliminary estimate by Statistics Poland. Data on retail sales, industrial production and construction and assembly output in January point to economic conditions remaining favourable also at the beginning of 2022. Meanwhile, employment continues to increase accompanied by a marked rise in wages. The Russian military aggression against Ukraine and related economic sanctions constitute a significant uncertainty factor for future economic activity in the world and in Poland. Nevertheless, due to, among other factors, modest share of exports to Russia and Ukraine in Polish foreign sales, a continuation of favourable domestic economic conditions may be expected in the coming quarters.

Inflation in Poland ~~in December 2021~~ – according to Statistics Poland flash estimate – increased ~~to 8.6% in annual terms, and in monthly terms it amounted to 0.~~in January 2022 to 9~~%. A significant contribution to an increase in inflation in 2021 was made by the rise in global prices of commodities – including~~ .2%. Significant rise in energy and agricultural ~~commodities – record high increase in prices of CO2 emission allowances, rising prices of goods whose supply has been constrained by global pandemic disruptions as well as~~ commodity prices and increases in regulated tariffs on electricity~~ and~~, natural gas ~~prices introduced in 2021. Ongoing~~and thermal energy have been the main factors behind markedly elevated inflation. At the same time, the ongoing economic recovery, including an increase in demand driven by rising household ~~income~~incomes, has had also ~~added~~a positive contribution to ~~an increase in~~ inflation. ~~These factors, together with a rise in regulated tariffs on electricity, natural gas and thermal energy will contribute to inflation remaining at an elevated level also in 2022.~~ In turn, a curbing impact on inflation has been exerted by a reduction in some tax rates as part of the so-called Anti-inflationary Shield~~ will have a curbing impact on inflation~~. In 2022, inflation will remain markedly elevated, which – apart from factors amplifying inflation so far – will be due to the economic consequences of the Russian invasion of Ukraine. In the coming years, together with fading of the impact of shocks currently boosting prices, inflation will decrease. The decrease in inflation should also be supported by appreciation of zloty exchange rate, since, in the Council's assessment, the recently observed market pressure on zloty depreciation is not in line with the fundamentals of the Polish economy.

~~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, as well as probably more lasting impact of external shocks on price dynamics,~~The Council became acquainted with the results of the March 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 7 March 2022, there is a 50-percent probability that the annual price growth will be in the range of 9.3–12.2% in 2022 (against 5.1–6.5% in the November 2021 projection), 7.0-11.0% in 2023 (compared to 2.7-4.6%) and 2.8–5.7% in 2024. At the same time, the annual GDP growth – according to this projection – will be with a 50-percent probability in the range of 3.4–5.3% in 2022 (against 3.8–5.9% in the November 2021 projection), 1.9-4.1% in 2023 (compared to 3.8-6.1%) and 1.4–4.0% in 2024.

The Council assessed, that there persists a risk of inflation 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~~Further 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~~ depend on incoming information ~~on~~regarding perspectives for inflation and economic ~~growth~~activity, including ~~situation in the labour market. Zloty appreciation would be consistent with the direction~~the impact of the Russian military aggression against Ukraine on the Polish economy.

NBP will take all necessary actions in order to ensure macroeconomic and financial stability, including above all to reduce the risk of ~~monetary policy conducted by the~~inflation remaining elevated. NBP~~.~~

~~NBP~~ may ~~still~~ intervene in the foreign exchange market~~ and use other instruments envisaged in the Monetary Policy Guidelines. The timing and scale~~, in particular to limit fluctuations of the ~~measures taken by NBP will depend on the market conditions~~zloty exchange rate that are inconsistent with the direction of monetary policy.

The Council adopted the Inflation Report – March 2022.

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