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Economic Comment

Rates on hold despite higher inflation

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Polish MPC kept interest rates on hold (main reference rate at 6.75%) despite the big surprise from September's inflation (17.2% y/y), better than expected real activity data for August, the progressing currency weakness, and the earlier pledge from the NBP governor that the next decisions will be data-driven. We were expecting a rate hike by 50bp after the recent inflation surprise. It seems we made a "school error" when we assumed that the NBP president will not stick to his words from one month ago (choice between 0 and 25bp in October) and earlier declarations from the Sopot pier. It seems that the inflation outlook is not that important in the central bank's reaction function and worries about the economic growth outlook became the prime issue. The official post-meeting statement is similar to the previous one, but the MPC added the sentence reading "due to the scale and persistence of current shocks, which are beyond monetary policy control, return of inflation towards inflation target will be gradual". We interpret it as admitting the MPC's acceptance for the fact that the inflation's significant deviation from the target will be long-lived. However, the statement neither closes the door to further hikes, nor signals a possible continuation of the cycle.

The decision caused an immediate currency reaction (EURPLN up from 4.79 to 4.835; it seems that the BGK has stopped a further move), and we think the zloty weakening may continue as the market may be increasingly concerned that the central bank is falling behind the curve and downplaying the inflationary risks. The yield curve steepening should follow.

NBP president's conference tomorrow will be an important event. The more dovish rhetoric is, the more pronounced the FX market reaction may be. What could offer market some support would be a declaration that it was just a pause in the cycle, in anticipation of the November's inflation projection and new data.

Given that the recent data offered evidence of higher than anticipated inflation's persistence and more fiscal easing aimed at spurring consumption, we are no longer convinced that main interest rate near 7% will be enough to stabilize the economy. It seems that risks about future rate hikes are symmetric – if inflation starts to decline, then the hiking cycle can be easily stopped with closer prospects of its reversal; but the premature attempt to stop the tightening cycle can result in a zloty sell-off and higher and more persistent inflation. We think that rates cuts in 2Q23, suggested by governor Glapiński recently, are becoming a fantasy. Even if the MPC decides to pause in the nearest month(s), it may be forced to resume the cycle if/when inflation refuses to go down and/or the currency weakens significantly. The longer the central bank waits, the higher the terminal rate could be.

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Changes versus September's statment

~~In 2022 Q2, annual GDP growth slowed down in major economies. At the same time, incoming~~Incoming data signal a deterioration of global economic conditions in 2022 Q3, ~~although~~accompanied, however, by continued favourable labour market situation in the largest ~~advanced~~ economies ~~remains very good~~. Activity in the global economy and its prospects are under the negative impact of high prices of commodities and production components, ~~disruptions in the functioning of global supply chains and~~ the repercussions of Russia's military aggression against Ukraine as well as the tightening of monetary policy around the world. Meanwhile, there persists uncertainty regarding further impact of these shocks on economic conditions, including the impact of the situation in energy commodity markets on activity in the European economy in the coming quarters. The weakening outlook for the global economy has been accompanied by a deterioration in sentiment and a rise of volatility across the global financial markets.

Inflation in ~~most~~many economies ~~continues to rise, reaching in many countries~~is at the highest levels in decades. ~~At the same time, inflation forecasts for the coming quarters continue to be revised upwards. The main~~Significant source of ~~growing~~high inflation continue to be high commodity prices, driven partly by the repercussions of Russia's military aggression against Ukraine, as well as persistent – despite ~~signs of~~ their gradual easing – disruptions in global supply chains. In some economies, rising prices are also driven by demand factors and increasing labour costs. ~~As a consequence, core inflation is also increasing~~These factors, combined with the passing of earlier rises in production cost into the consumer goods prices, also lead to an increase in core inflation.

Amidst ~~a strong increase in~~high inflation, ~~many~~major central banks continued to tighten their monetary policy in the recent period. In ~~July 2022~~September, the US Federal Reserve ~~increased interest rates once again. In turn,~~ and the ECB increased interest rates ~~for the first time since 2011~~once again.

~~In Poland – according to Statistics Poland preliminary estimate – GDP growth in 2022 Q2 amounted to 5.5% y/y, compared to 8.5% y/y in Q1. A slowdown in activity growth in year-on-year terms, resulted mainly from a significantly lower contribution of inventories to GDP growth and – to a much lesser degree – from slower consumption growth. At the same time, investment growth accelerated.~~

~~Monthly~~In Poland, available monthly data, including data on industrial production, construction and assembly output and retail sales, signal that ~~economic activity~~in Q3 GDP growth, in year-on-year terms, ~~in Q3 will also decelerate~~decelerated again. A further slowdown of GDP growth is forecast for the coming quarters, while the economic outlook is subject to significant uncertainty. Despite weakening of economic conditions, labour market situation remains very good, which is reflected in a record low unemployment rate ~~and in a further noticeable rise in wages~~.

Inflation in Poland – according to Statistics Poland flash estimate – increased in ~~August~~September 2022 to ~~16.1~~17.2% y/y. High inflation results mainly from an earlier strong rise in global energy and agricultural commodity prices – driven, to a large extent, by the repercussions of Russian military aggression against Ukraine – and earlier increases in regulated domestic tariffs on electricity, natural gas and thermal energy. ~~Consequences of disruptions in global supply chains and passing~~ Inflation is also boosted by enterprises passing rising costs on to the final goods prices ~~also boost inflation~~and consequences of the earlier disruptions in global supply chains, simultaneously adding also to higher core inflation. In turn, a curbing impact on inflation has been exerted by a reduction in some tax rates as part of the Anti-inflationary Shield.

~~In the coming quarters, it is expected~~ The Council assessed, that the ~~impact of factors currently amplifying price growth will persist, including those related to the Russian military aggression against Ukraine. Meanwhile, the NBP interest rates increases, fading of the impact of shocks currently boosting prices together with~~ hitherto significant monetary policy tightening by NBP and the expected economic activity growth ~~slowing down~~slowdown, which in part stems from external shocks, will contribute to curbing demand growth in the Polish economy, which will support a ~~gradual~~ decline in inflation in ~~the coming years~~Poland towards the NBP inflation target. At the same time, given strength and persistence of the current shocks that remain beyond the impact of domestic monetary policy, a return of inflation towards the NBP inflation target will be gradual. The decrease in inflation would also be supported by appreciation of zloty exchange rate, which, in the Council's assessment, would be consistent with the fundamentals of the Polish economy.

~~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.~~

Further decisions of the Council will depend on incoming information regarding perspectives for inflation and economic activity, including 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 inflation remaining elevated. NBP may intervene in the foreign exchange market, in particular to limit fluctuations of the zloty exchange rate that are inconsistent with the direction of monetary policy.

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