CEE Economics

Poland

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Economic Comment

Headline CPI at local bottom but MPC looks at core

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According to preliminary data from the Central Statistical Office, CPI inflation fell to 1.9% (0.2% m/m) in March from 2.8% in February, below our forecast (2.1% y/y) and the market consensus (2.2-2.3%), reaching its lowest level since 1Q19. The significant drop in inflation is the result of a 0.2% m/m decline in food prices, but the surprise came mainly from lower core inflation. Our estimate shows core inflation falling to 4.6% y/y (vs. our previous estimate at 4.7%) from 5.4% in February, with monthly growth still high at 0.5% (similar as in Jan-Feb vs. our estimate at 0.7%). We think inflation reached a bottom in March and will gradually rise in the coming months (to 2.3% y/y in April on partial VAT increase on food). Administrative decision on electricity prices will have a big influence on the CPI path. In the case of the partial price unfreezing scenario (we assume around 15% increase for electricity and gas in July), inflation is set to increase to 5% y/y by the end of the year (4.5% on average in the second half of the year). In contrast, energy prices unfreezing with reduction in tariffs and implementation of the energy voucher could result in higher inflation path. More important for the MPC will be the path of core inflation, which may remain in the 4-5% range until the end of 2025. This, with the economic recovery, will give the MPC an argument, in our opinion, to keep rates unchanged until 3Q25.

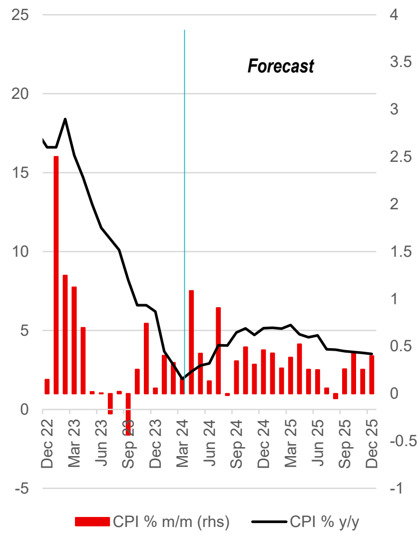
According to preliminary data from the Central Statistical Office, CPI inflation fell to 1.9% in March from 2.8% in February, below our forecast (2.1% y/y) and the market consensus (2.2-2.3%). Inflation fell below target for the first time since May 2019. Such a significant decline was primarily driven by a further 0.2% m/m drop in food prices, close to our estimate (-0.3% m/m), which translated into a slowdown in the annual growth rate of this category to 0.2% y/y from 2.7%. The low dynamics of food prices in recent months is partly the result of price declines on international markets, but also the price war between discounters, which, according to the NBP's latest projection, may have subtracted about 0.1-0.2 percentage points from CPI dynamics in recent months. Prices of energy carriers fell by 0.4% m/m, against our assumed stabilization, and fuel prices rose by 0.1% m/m against our assumed 0.1% decline.

Taking into account preliminary data from the Central Statistical Office, our estimate of core inflation for March fell to 4.6% y/y from 4.7% y/y versus 5.4% in February. This would imply net monthly inflation of 0.5% m/m (0.7% assumed previously) after 0.4% and 0.5% in January and February, respectively, and a stabilization in the momentum of annualized 3m/3m core inflation at around 3.5% near level in Hungary vs. 1% in Czech Republic.

We think CPI inflation peaked in March and will gradually rise in the coming months. We now assume an increase in inflation in April to 2.4% y/y largely due to the increase in the rate on food again to 5%. With declarations from large retail chains that the VAT rate hike will not translate into their grocery prices for some time, we assume a smaller increase in food prices in April than would result directly from the translation of higher VAT rates (about 2% m/m instead of about 3% m/m). However, we estimate that, over time, the tax increase will be almost fully reflected in retail product prices due to the fact that margins in the food industry are relatively low. We have therefore assumed a slight further increase in food prices due to the VAT increase in the following months.

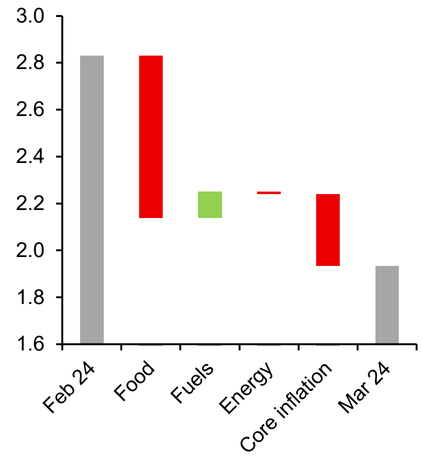
An administrative decision on electricity, gas and heating prices will be key to the path of the CPI in the second half of the year. Minister of Climate and Environment P. Hennig-Kloska announced that a package of bills related to energy prices will be processed by the government after Easter. She also announced that in connection with the prices, the ministry will propose a new calculation of tariffs, for which it sees room for reduction. Nonetheless, the unfreezing of electricity prices and tariff reductions could still mean an increase in energy prices for households, and the announced energy voucher for the poorest is unlikely to be included by the CSO in its inflation estimates. However, we will only be able to speak with more conviction about the details once the government's proposals are published. Our

Inflation in Poland, %y/y



Source: GUS, Santander

Contribution of key components to inflation, %r/r, pp



Source: GUS, Santander

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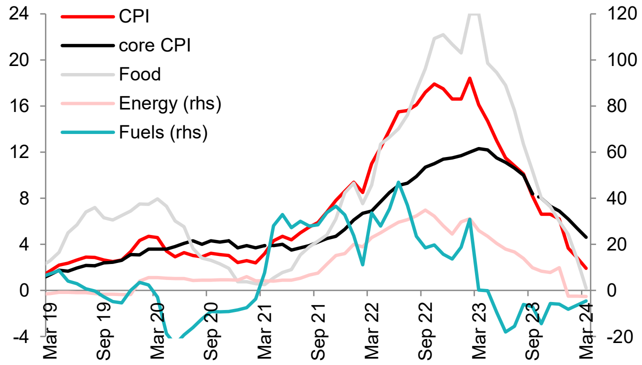
current baseline scenario assumes a partial unfreezing of energy prices in July, which will translate into an increase in prices for electricity and gas in the CPI of about 15% and cause inflation to rebound to about 5% y/y by year-end (4.8% on average in the second half of the year).

From the MPC's perspective, the key issue at the moment seems to be core inflation, which we believe will remain high around 4-5% y/y until the end of 2025. In view of this, today's data does not change our baseline scenario, which assumes that the Monetary Policy Council will remain relatively hawkish in tone for an extended period of time, and that interest rates will not be cut until around the middle of next year (we assume 3Q).

In the market's initial reaction to the data, FRA rates fell a few basis points, and we expect that this movement may continue in the short term. Nevertheless, a deeper decline in FRAs and short-term swaps will come with a few months delay, and the swap curve will begin to permanently steepen closer to the turn of the year as the first rate cut approaches.

Headline CPI and core components, % y/y



Source: GUS, Santander

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