15 April 2024

Economic Comment

Headline CPI to rise from a slightly higher bottom

Cezary Chrapek, CFA, tel. 887 842 480, cezary.chrapek@santander.pl
Marcin Luziński, tel. 510 027 662, marcin.luzinski@santander.pl
Grzegorz Ogonek, tel. 609 224 857, grzegorz.ogonek@santander.pl

The statistical office revised upwards the inflation reading for March to 2.0% y/y from 1.9% y/y, compared to 2.8% y/y in February. Revision came from slightly smaller decline in food prices (-0.1% m/m vs. -0.2% m/m previously). Our core inflation estimate has not changed since the release of statistical office flash CPI estimate and we still see core CPI rate falling to 4.6% y/y from 5.4% y/y.

Inflation declined below the inflation target for the first time since 2Q19 and in our view has set a local low in March. Decline in CPI versus February was mostly due to a drop in goods inflation to 0.4% y/y from 1.4% y/y, while the still elevated inflation in services declined to 6.6% y/y from 7.0% y/y.

We expect a gradual increase in headline inflation to 5.2% y/y in December 2024 (we assume electricity and natural gas prices to go up by 15% y/y in July) and a gradual decline in 2025. Meanwhile, in our view core inflation will remain elevated, in the 4-5% range until the end of 2025 with strong influence of the tight labour market. In our view, high core inflation will be a key argument for the MPC to keep rates unchanged until mid-2025.

The GUS revised upward the inflation reading for March to 2.0% y/y from 1.9% y/y versus 2.8% y/y in February. Revision came from slightly smaller decline in food prices (-0.1% m/m vs. -0.2% m/m previously). Inflation declined below the inflation target for the first time since 2Q19 and in our view has set a local low in March. Decline in CPI versus February was mostly due to a drop in goods inflation to 0.4% y/y from 1.4% y/y, while the still elevated inflation in services declined to 6.6% y/y from 7.0% y/y. A more detailed breakdown shows CPI was dragged lower by developments in food and core prices, while fuels and energy contributed positively to the headline index.

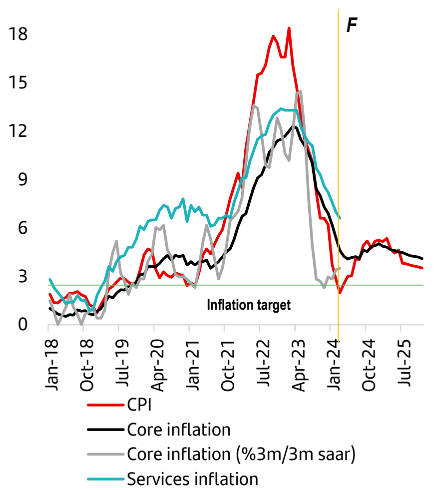
Food inflation to rebound from bottom amid VAT hike

Food and non-alcoholic beverage prices rose 0.3% y/y (-0.1% mm) in March, compared to 2.7% y/y in February. Annual and monthly price growth turned out to be 0.1 pp higher than in the preliminary reading. The rapid decline in annual food inflation is due to both the unusually strong upward price movements in this category in 1Q23 (monthly changes then diverged from the seasonal pattern by an average of +0.9 pp) and their unusually low path in 1Q24 (an average of 1.0 pp below the pattern). In March alone, particularly large price declines occurred in sugar (-2.0% m/m), fruits and vegetables (-1.2% and -0.8%, respectively, instead of the normal March increases of 1.4% and 0.9%, respectively, in these products), as well as oils and fats (-1.1%), milk (-0.7% m/m), rice and flour (-0.6% each). Significant price increases were seen in fruit and vegetable juices (1.2% m/m), tea (1.3%), poultry meat (1.2%) and pasta (0.9%).

The faster-than-forecast decline in food inflation is, in our view, the result of earlier declines in global markets and continued intensified price competition among large market chains, which may have also forced downward price adjustments by the rest of the market. According to the NBP's latest projection estimates, the price war may have subtracted about 0.1-0.2 percentage points from the CPI in recent months.

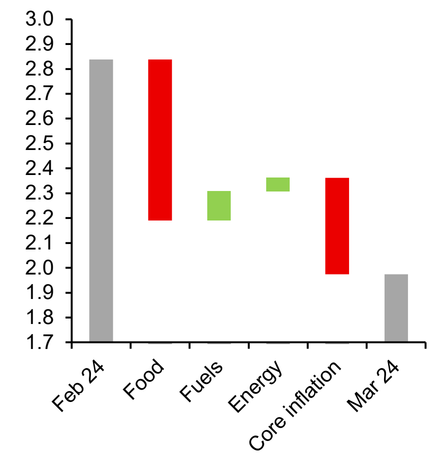
In our view, the return of the 5% VAT rate on food will translate into a solid price increase in this category, despite the announcement that some retail chains will maintain fixed prices. According to our estimates, food will become more expensive in April by about 2% m/m with upward risk. We assume that some retailers will absorb the higher VAT for some time, at the expense of their margins. However, the overall low profitability of retail trade will not allow for such a solution to be maintained for long. Thus, we assume that the effect of the VAT

Inflation in Poland, %y/y



Source: GUS, Santander

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



Source: GUS, Santander

Economic Analysis Department:

al. Jana Pawła II 17, 00-854 Warszawa
email: ekonomia@santander.pl
website: santander.pl/en/economic-analysis
Piotr Bielski +48 691 393 119
Bartosz Białas +48 517 881 807
Cezary Chrapek, CFA +48 887 842 480
Marcin Luziński +48 510 027 662
Grzegorz Ogonek +48 609 224 857

change hike will be spread out over time, while the accumulated effect of the VAT hike on the annual inflation path will amount to about +0.8 pp.

Inflation will rise under the influence of administrative decisions on energy prices

An administrative decision on electricity, gas and heating prices will be key to the path of the CPI in 2H24. Climate and Environment Minister P. Hennig-Kloska announced that a package of laws related to energy prices is to be presented by the end of April, and will cover the 2H24 and 1H25. According to the ministry, energy prices are to be unfrozen and tariffs are to be lowered. At the same time, an energy voucher (worth around PLN300-600 per household) is expected to be introduced for about 3.5 million households.

We still do not know much about the energy voucher. If it proves to be a direct payment for households, then it will not appear in the CPI, in our view. Still, there will be some indirect effect, given that would be a transfer worth about PLN1.5bn, slightly less than 0.1% of private consumption and GDP. The scale of the reduction in electricity and gas tariffs is also still unknown. With a full unfreezing of electricity and gas prices, their prices would increase by about 65% and 45%, respectively. Until the details of the laws are published, our estimates assume an average increase of about 15% in the electricity and gas bills. In such a scenario, inflation in our forecast rises to about and 5.2% y/y by year-end (4.8% on average in the second half of the year).

Fuel prices were roughly stable in March, rising 0.1% m/m, and were 4.5% y/y lower than in March 2023 in the annual comparison. We estimate that fuel prices will rise in April, primarily due to the increase in oil prices on world markets, although the recent strengthening of the dollar may also add its part.

Core inflation is declining, but price momentum remains elevated

We estimate that core inflation fell to 4.6% y/y from 5.4% y/y in February after prices rose by 0.5% m/m – with a similar momentum as in previous months. Core price dynamics remain elevated and, according to our estimates, seasonally adjusted and annualised numbers point to growth above 4% y/y, clearly above the inflation target. We believe that the high nominal wage growth this year, and thus also unit labour costs, will make core inflation remain at elevated levels. The statistical base effect will still pull core inflation down towards 4% y/y in the upcoming months, but in the second half of the year we expect this measure to rise slightly towards 5% y/y.

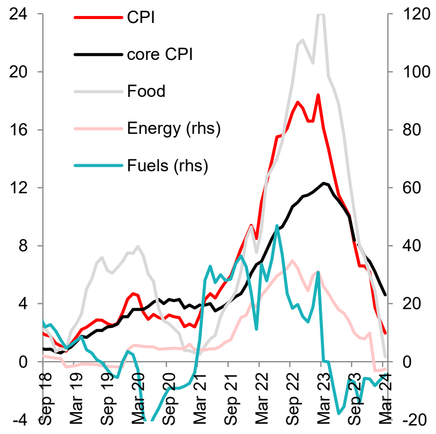
In most of the categories that make up core inflation, the momentum remained similar as in the previous months: clothing and footwear prices rose by 3.3% m/m, health by 0.3% m/m, education by 0.2% m/m, restaurants and hotels by 0.7% m/m, other goods and services by 0.5% m/m. Prices were stable in furnishings and housing. Prices in communications rose more than expected and printed 0.9% m/m (telecommunications services increased by 1.0% m/m). On the other hand, prices in recreation and culture were lower than expected, and fell by 0.7% m/m, mainly due to cheaper audiovisual, photographic and IT equipment (-1.3% m/m) as well as package tourism (-4.0% m/m).

Today's data without impact on monetary policy outlook

We believe core inflation path will be key for MPC future decisions and we expect it will remain high at around 4-5% y/y until the end of 2025. The slow pace of bringing inflation down to the target is also indicated by still elevated services inflation. Therefore, today's data does not change our baseline scenario, which assumes that the Monetary Policy Council will maintain a relatively neutral tone for an extended period of time, and that interest rates will not be cut until around the middle of next year (we assume the first rate cut at the beginning of 3Q25).

FRA rates rose slightly even before the release of the inflation data and mainly in response to movements in the core markets. A similar situation occurred in the swap market. In the short term, we see room for a slight reduction in FRA and swap rates, but over the coming months, rising inflation and sustained high core inflation along with a recovery in GDP will support the maintenance of FRA and 1-2 year swap rates at elevated levels. This is the market behaviour we assume in our no-rate-change scenario until about the middle of next year. We maintain our view that a longer trend of steepening of the swap curve will begin closer to the turn of the year as the first interest rate cut approaches.

Inflation in Poland, %y/y



Source: GUS, Santander

Additional information is available on request. Please contact Santander Bank Polska S.A. Financial Management Division. Economic Analysis Department. al. Jana Pawła II 17. 00-854 Warsaw. Poland. phone +48 22 534 18 87. email ekonomia@santander.pl. http://www.santander.pl.