Poland Macro Weekly

Macro Research

12 August 2022

Bank Polski | Centrum Analiz

Inflation seems to be losing steam

TOP MACRO THEME(S):

- **Inflation seems to be losing steam (p. 2):** CPI inflation in July rose to 15.6% y/y but in m/m terms was the weakest since August 2021. Inflationary trends seem to be losing steam and MPC seems to be losing arguments in favour of further hikes.

WHAT ELSE CAUGHT OUR EYE:

- **The average wage in the national economy in 2q22 grew by 11.8% y/y,** weaker than in the enterprise sector (13.5% y/y), the tightest segment of the labour market. Despite high nominal growth, **real wages in 2q22 declined both in the corporate sector (by 0.4% y/y) and in the national economy (by 2.1% y/y, the first decline since 2012).** Wages nominal growth rate has most likely peaked in 2q22 as the ongoing economic slowdown will reduce wage pressures and prevent a price-wage spiral. This means that even deeper decline in real wages should be expected. While it has a negative impact on consumer sentiment and spending it is worth to recall, that tax changes introduced in 2022 are positive for disposable income and should reduce the negative impact of high inflation on real income. The ongoing economic slowdown will reduce wage pressures and prevent a price-wage spiral.
- **C/A deficit** in June barely changed (EUR 1.5 bn), indicating that 12-month rolling C/A deficit hit 3.9% of GDP. That said, the scale of C/A deterioration visibly slowed pointing at turning point ahead (around 3q/4q22).

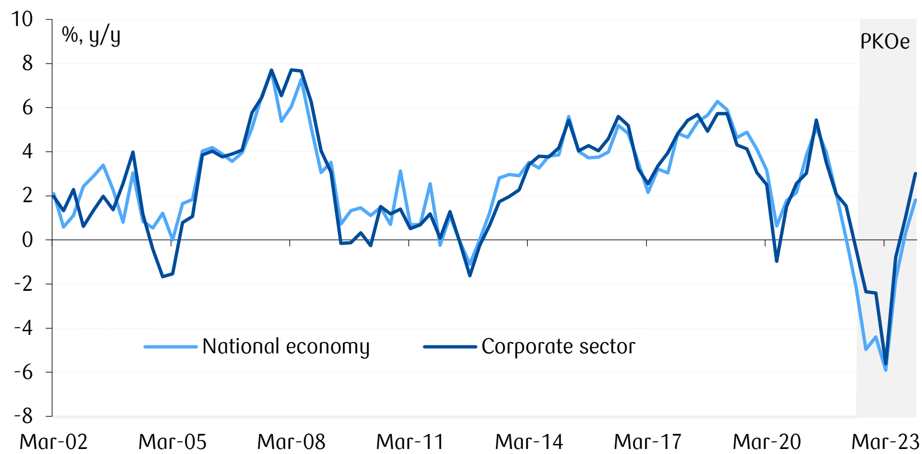
THE WEEK AHEAD:

- **GDP growth in 2q22** slowed down in our view to 7.4% y/y with still high "carry-over" effect but with risks skewed to the down side. **Data for July** should confirm that the **industrial sector** is slowing down (PKOe: 6.5% y/y), which will likely put some pressure on employment. Don't get misguided by **wages** (PKOe 14.9% y/y) which will be likely boosted by some extra payments in the mining sector (one off). **July core inflation** increased only marginally, to 9.2% y/y from 9.1% y/y, on our estimate.

NUMBER OF THE WEEK:

- **176bp** –decline of expected NBP rates increases (FRA 9x12) since Jun 20.

Chart of the week – Real wages growth rate*



Source: GUS, PKO Bank Polski. *deflated using CPI.

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	2021	2022†
Real GDP (%)	5.9	4.9
Industrial output (%)	15.4	11.0
Unemployment rate# (%)	5.4	4.9
CPI inflation** (%)	5.1	13.1
Core inflation** (%)	4.1	8.1
Money supply M3 (%)	8.9	5.8
C/A balance (% GDP)	-0.7	-4.5
Fiscal balance (% GDP)*	-1.9	-2.8
Public debt (% GDP)*	53.8	50.8
NBP reference rate## (%)	1.75	7.00
EURPLN‡##	4.60	4.62

Source: GUS, NBP, MinFin, †PKO BP Macro Research team forecasts;‡PKO BP Market Strategy team forecasts; under revision; *ESA2010, **period averages; #registered unemployment rate at year-end; ##at year-end.

Inflation seems to be losing steam

- **CPI inflation in July rose to 15.6% y/y but in m/m terms was the weakest since August 2021. Inflationary trends seem to be losing steam.**
- **Taking into account the strong volatility in the headline CPI which will be driven by administrative factors, the MPC will most likely focus on core inflation trends.**
- **In our opinion core inflation will peak in July-August and then enter a slow but sustainable downward trend. This will be a strong argument in favour of (at least) a pause in the tightening cycle.**
- **The regional context supports the scenario of Poland's MPC concluding its aggressive, the strongest ever, tightening cycle. We expect the final 50bp hike in September with risks rather skewed to the (!) downside.**

CPI inflation for July was revised to 15.6% y/y against 15.5% y/y in the flash estimate and compared to 15.5% y/y in June. Prices increased by 0.5% on the monthly basis - the least since August 2021 (excluding February 2022, when prices declined on VAT cuts). We estimate that core inflation rose marginally, to 9.2% y/y compared to 9.1% y/y in June, and by 0.5% m/m (the least since December 2021). **As the moderating rate of m/m changes both in the headline and in the core inflation shows, inflation trends seem to be losing steam**.

Energy remains the key source of inflationary pressure. In July prices of all energy carriers increased by 1.6% m/m (37.0% y/y), stronger than initially estimated. Thus energy was the key driver of the upward CPI revision compared to the flash estimate. As gas and energy prices are regulated (new tariffs will be announced at the end of 2022), the upward trend is mainly driven by liquid and solid fuels, where prices are already higher by over 130% y/y.

Contrary to the seasonal pattern, food prices increased in July by 0.6% m/m (15.3% y/y). While the divergence between food prices changes and seasonal regularities is diminishing, high soft commodities prices combined with expensive energy will likely keep food inflation relatively high.

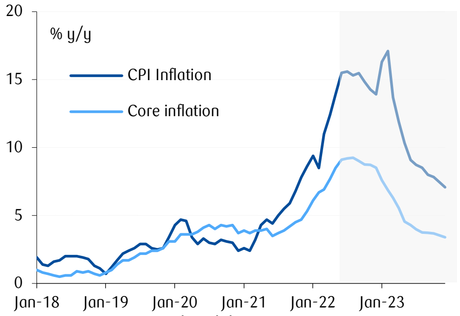
Fuel prices declined by 2.6% m/m, at a smaller scale than indicated by market data. It is worth to underline, that GUS does not include in its statistics a special offer introduced by all key fuel distributors late June, which gives a discount of 0,30 PLN/l (app. 4,5%) to all customers with a loyalty card (which is available under no preconditions). The declines in fuel prices has continued in August (so far). Prices for the first 10 days of August suggest a decline by around 6% m/m, which should help to push CPI inflation down.

Core inflation increased marginally, to 9.2% y/y from 9.1% y/y on our estimate. Declining monthly changes in core inflation suggest, that the core inflationary pressures are losing steam which fits well to the environment of weakening demand and declining price setting power of enterprises. In our opinion core inflation will peak in July-August and then enter a slow but sustainable downward trend.

We forecast, that the headline CPI inflation has already reached its local peak for this year, and will start to decline in August, to around 13-14% at the end of the year. The final peak of inflation will be most likely reached in February 2023 (we recall the very low base driven by VAT cuts). Currently we estimate the level of this peak for around 17%. Its size will be mainly determined by administrative decisions on: (1) taxes (will the anti-inflationary shield be prolonged for 2023? – in our opinion yes) and (2) tariffs (how much from the increases in market gas and electricity prices will be passed over to households? – in our view bills will rise by around 30-40%).

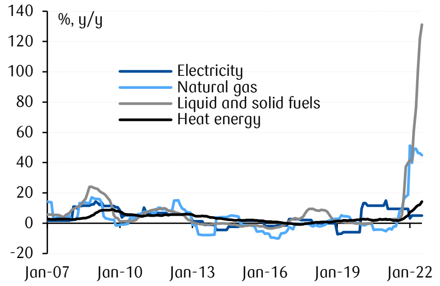
Taking into account the strong volatility in the headline CPI which will be driven by external factors, the MPC will most likely focus on core inflation.

CPI inflation and core inflation forecast



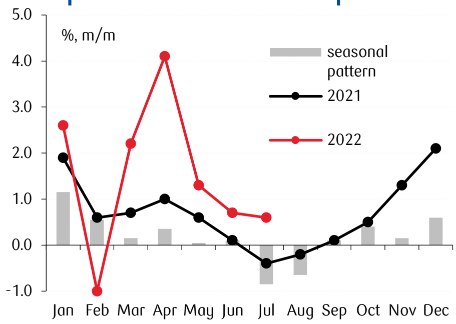
Source: GUS, PKO Bank Polski.

Energy prices



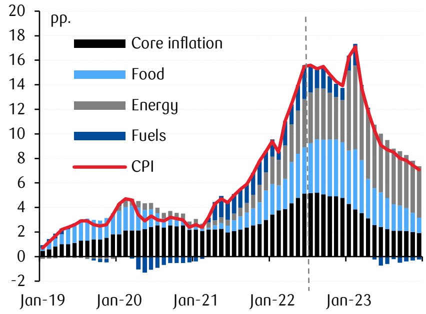
Source: GUS, PKO Bank Polski.

Food prices vs the seasonal pattern



Source: GUS, PKO Bank Polski.

The structure of CPI inflation



Source: NBP, GUS, PKO Bank Polski.

Should our forecast of first declines in the core CPI already this autumn come true, the MPC will get a strong argument against further interest rate hikes.

In July inflation processes in the CEE region diverged. Hungarian CPI surpassed expectations and grew in July to 13.7 % y/y from 11.7% y/y in June. Figures for next few months will be likely far higher due to unfreezing of gas and electricity bills (frozen since 2015) and due to cost of new “windfall taxes” being passed on to consumers. Thus MNB will likely have no other choice than to continue raising interest rates above the current level of 10.75%.

In Czechia the picture is different. Although CPI inflation in July grew, to 17.5% y/y from 17.1 % y/y, it was significantly below the recent CNB forecast (18.8% y/y) with the difference deriving mainly from food prices and (in lesser extent) from some moderation in core prices momentum. The reading will likely strengthen the CNB Board in its dovish pivot and supports our expectation, that with the key rate at 7.00% the tightening cycle has been already concluded. In Romania inflation seem to be already behind its peak, which will most likely open the space for the NBR to further reduce the pace of tightening.

The regional context supports the scenario of Poland’s MPC concluding its aggressive, the strongest ever, tightening cycle. In recent comments (see Monetary Policy Monitor, p. 5) the majority of MPC members suggested there is not much space left for further hikes, underlined first signs of economic slowdown and expected that inflation should start falling in the autumn. The final CPI reading for July, which – in our view – will be followed by a CPI decline in August, is a good argument to at least pause the tightening cycle. Should the upcoming publications on real activity (retail sales, output) disappoint (which in our view is highly likely, mainly on the spending side), we would even consider to revise our call of the final 50pb hike in September into a smaller hike by 25pb or even into a flat rates scenario.

Bank Polski

Weekly economic calendar

Indicator	Time (UK)	Unit	Previous	Consensus*	PKO BP	Comment
Tuesday, 16 August						
GER: ZEW Economic Sentiment (Aug)	10:00	pts.	-53.8	--	--	--
EUR: Trade balance (Jun)	10:00	bn EUR	-26.3	--	--	--
POL: Core inflation (Jul)	**13:00**	**% y/y**	**9.1**	**9.2**	**9.2**	**Core inflation should has likely peaked. A downward trend should start in the autumn.**
USA: Building Permits (Jul)	13:30	mln	1.696	1.650	--	--
USA: Housing starts (Jul)	13:30	mln	1.559	1.550	--	--
USA: Industrial production (Jul)	14:15	% m/m	-0.2	0.2	--	--
Wednesday, 17 August						
POL: GDP growth (2q)	**9:00**	**% y/y**	**8.5**	**6.0**	**7.4**	**Monthly indicators (retail sales, industrial and construction output) indicate slowdown in q/q terms. However, the strong "carry-over effect" and continued stockpiling should mitigate the scale of GDP growth (y/y) braking, but risks are skewed to the downside.**
EUR: Employment (2q)	10:00	% y/y	2.9	--	--	--
EUR: GDP growth (2q)	10:00	% y/y	4.0	5.0	--	--
USA: Retail sales (Jul)	13:30	% m/m	1.0	0.2	--	--
USA: Retail sales excl. autos (Jul)	13:30	% m/m	1.0	0.0	--	--
USA: Minutes Fed (Jul)	19:00	--	--	--	--	--
Thursday, 18 August						
POL: Consumer Confidence (Aug)	**9:00**	**pts.**	**-41.7**	**--**	**--**	**Consumer confidence remains close to historical lows due to negative impact of real income drop, rising costs of energy and inflation fears.**
NOR: Norges Bank meeting	9:00	%	1.25	--	--	--
EUR: HICP inflation (Jul, final)	10:00	% y/y	8.6	--	--	--
EUR: Core inflation (Jul, final)	10:00	% y/y	4.0	--	--	--
TUR: Central bank meeting	13:30	%	14.0	14.0	--	--
USA: Initial Jobless Claims	13:30	ths.	--	--	--	--
USA: Existing home sales (Jul)	15:00	mln	5.12	4.85	--	--
Friday, 19 August						
GER: PPI inflation (Jul)	7:00	% y/y	32.7	33.9	--	--
POL: Wages (Jul)	**9:00**	**% y/y**	**13.0**	**12.9**	**14.9**	**Wages in the corporate sector should be boosted (by app. 1.5pp y/y) by extra bonuses in the mining sector.**
POL: Employment (Jul)	**9:00**	**% y/y**	**2.2**	**2.1**	**2.2**	**Economic surveys show that the demand for employees is already falling, but for the time being it is mainly visible in the declining number of vacancies.**
POL: Industrial production (Jul)	**9:00**	**% y/y**	**10.4**	**7.8**	**6.5**	**Most likely July will show a fourth consecutive decline in output in m/m sa terms.**
POL: PPI inflation (Jul)	**9:00**	**% y/y**	**25.6**	**25.2**	**25.7**	**PLN depreciation and cost pressure in manufacturing should prevail over some commodity prices declines. The peak of PPI inflation is very close.**

Source: GUS, NBP, Parkiet, PAP, Bloomberg, Reuters, PKO Bank Polski. Parkiet for Poland, Bloomberg, Reuters for others.

Monetary policy monitor

MPC Members	Hawk-o-meter*	Recent policy indicative comments^
L. Kotecki	4.8	“I voted for a 100bp hike (PKO: eventually the MPC raised by 75bp) in May, because I am in favor of raising rates faster. I think we should act much faster, but shorter. It is better not to stretch out the increases over time. It would send a much stronger signal that fighting inflation is a priority. Perhaps we could have finished the cycle already in May." (5.08.2022, TVN24, PAP, PKO transl.)
H. Wnorowski	4.2	“It seems that we still have perhaps one or a few interest rate hikes ahead of us, but they seem to be minor already. (...) It has been said that perhaps (inflation - ed.) will exceed even 20 percent. I personally do not consider such a scenario, I do not see such a threat. We're at 15.5 percent, and I think, we're still ahead of the July reading, which I think will maybe still be about 1 point, maybe less than 1 point, higher. (...) The highest will be the August reading and we will start to go down the other way.” (20.07.2022, TVP Bialystok, PAP)
A. Glapinski	3.4	**“However, the impact of these risk factors (PKO: energy tariffs and timing of return to higher VAT rates) - although important for the development of inflation in the forthcoming months - does not change the medium-term outlook for inflation, which will decline as a result of the slowdown in economic activity around the world and in Poland, with the tightening of monetary policy by central banks. From this perspective, it can be concluded that the Council's actions to date have been correct and effective, and that ensuring medium-term price stability - in light of current data and forecasts - will not require further strong monetary tightening. (12.08.2022, SuperExpress)**
I. Dąbrowski	3.1	“In my opinion, if there will be another rate hike, it will be rather small - on a comparable scale to the last one (50bp - ed.) or even lower. If the decision depended solely on me, I would not raise rates at all anymore, or at most once by 25 bps.“ (19.07.2022, PAP)
C. Kochalski	3.1	"The room for rate hikes is in July, possibly also in September. (...) 50-75 bps are the very likely ranges of the pace of change of interest rates. (...)We expect inflation peak to take place in Q3.” (10.06.2022, PAP).
P. Litwiniuk	2.9	“"The hike like the one from April, when [interest rates] were raised by 100 bps in hope that it would solve the FX issue, was excessive. (...) I think that it had the attributes of a hysterical hike, which instead of building trust in the zloty reduced it, and in this way we failed to achieve any effects related to such drastic move, while suffering . . . considerable costs." (22.07.2022, TVN24, PAP)
W. Janczyk	2.4	“The coming months, I hope, will bring no particular reasons to continue the interest rate hike cycle, although the impact of energy prices in the upcoming autumn-winter season on the economy and consumers is hard to predict right now. (...) "The council will act adequately to situation in our economy. In my opinion, it will strive to keep the lowest possible interest rate levels [while] targeting a realistic return to the inflation target.” (21.07.2022, PAP).
(Vacant places (3))	--	--

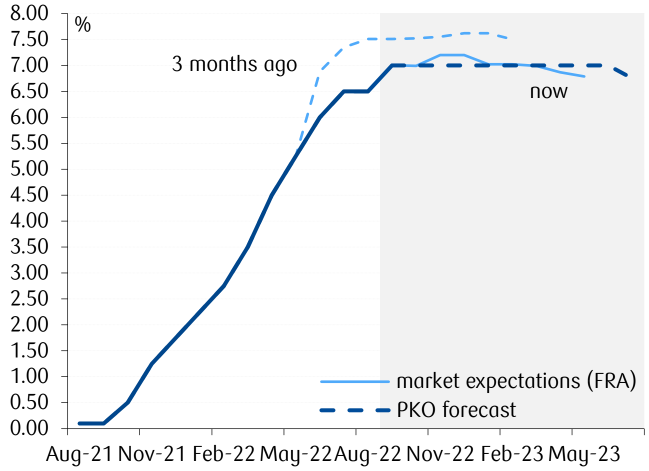
*the higher the indicator the more hawkish views. The positioning has been made based positively on PAP survey conducted among economists at banks in Poland (scale 1-5). ^**Quotes in bold** have been modified in this issue of Poland Macro Weekly.

Interest rates – PKO BP forecasts vs. market expectations										
		1M	2M	3M	4M	5M	6M	7M	8M	9M
Date	11-Aug	11-Sep	11-Oct	11-Nov	11-Dec	11-Jan	11-Feb	11-Mar	11-Apr	11-May
WIBOR 3M/FRA†	7.03	7.21	7.19	7.40	7.40	7.22	7.23	7.19	7.07	6.99
implied change (b. p.)		0.18	0.16	0.37	0.37	0.19	0.19	0.16	0.04	-0.04
MPC Meeting	-	7-Sep	5-Oct	9-Nov	7-Dec	-	-	-	-	-
PKO BP forecast*	6.50	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00
market pricing*		6.68	6.66	6.87	6.87	6.69	6.70	6.66	6.54	6.46

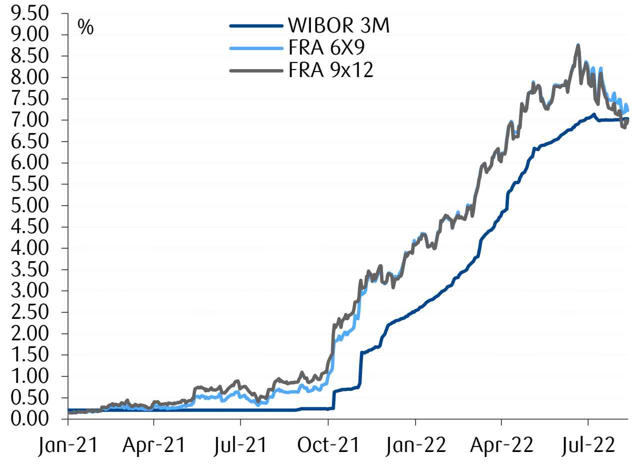
†WIBOR 3M from the last fixing, FRA transactions based on WIBOR 3M for subsequent periods, ‡in basis points, *PKO BP forecast of the NBP reference rate.

Poland macro chartbook

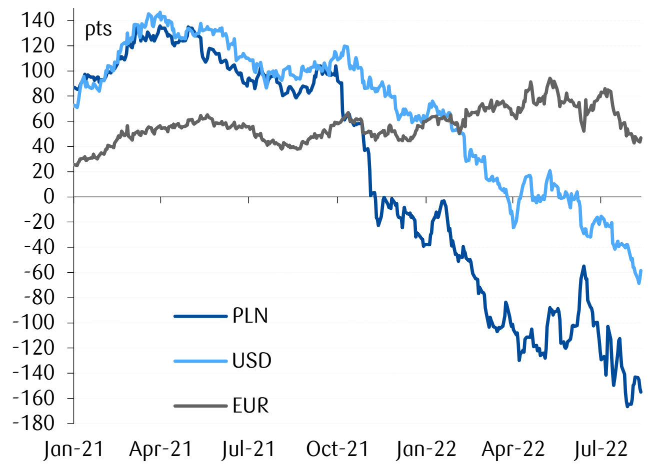
NBP policy rate: PKO BP forecast vs. market expectations



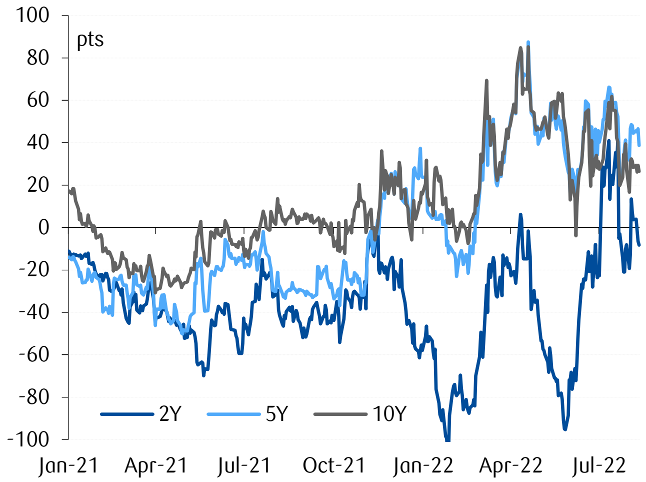
Short-term PLN interest rates



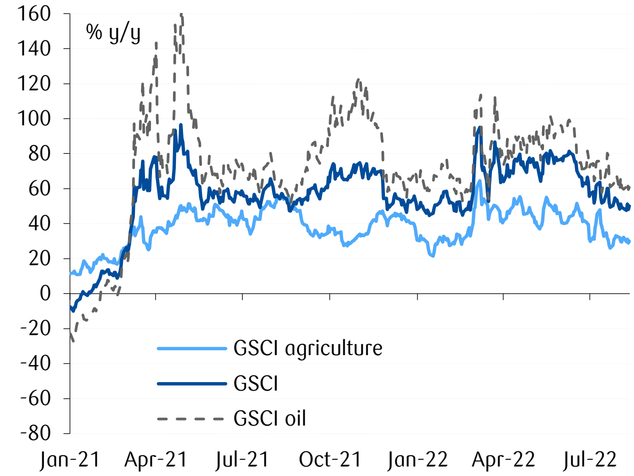
Slope of the swap curve (spread 10Y-2Y)*



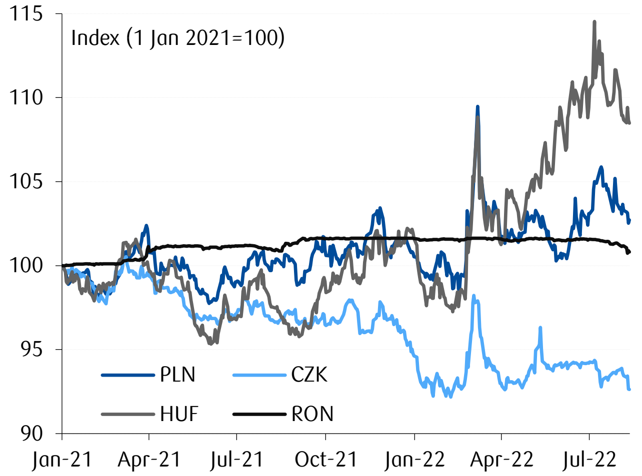
PLN asset swap spread



Global commodity prices (in PLN)

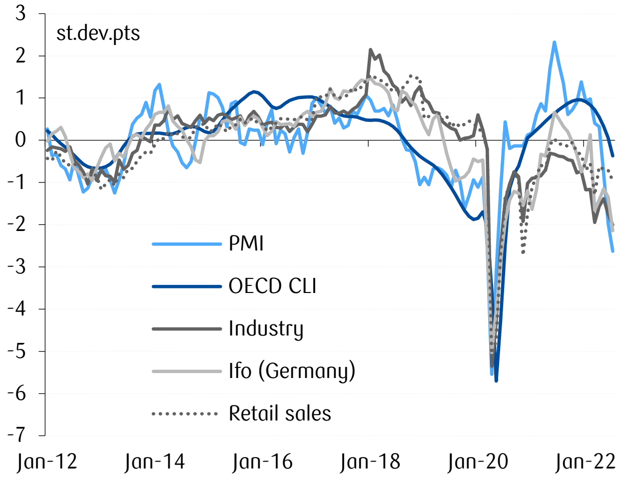


Selected CEE exchange rates against the EUR

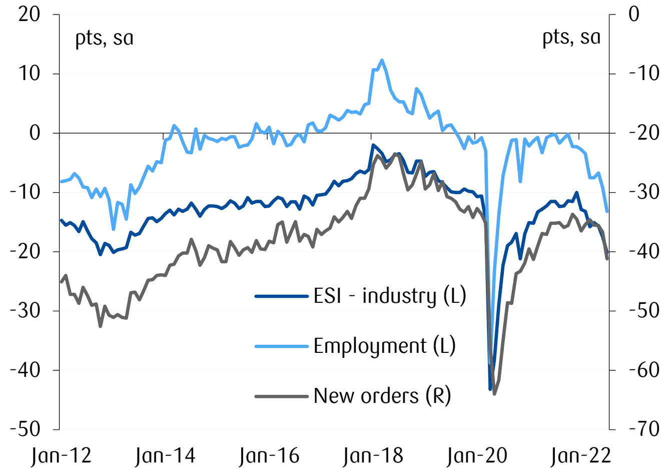


Source: Datastream, NBP, PKO Bank Polski. *for PLN, and EUR 6M, for USD 3M.

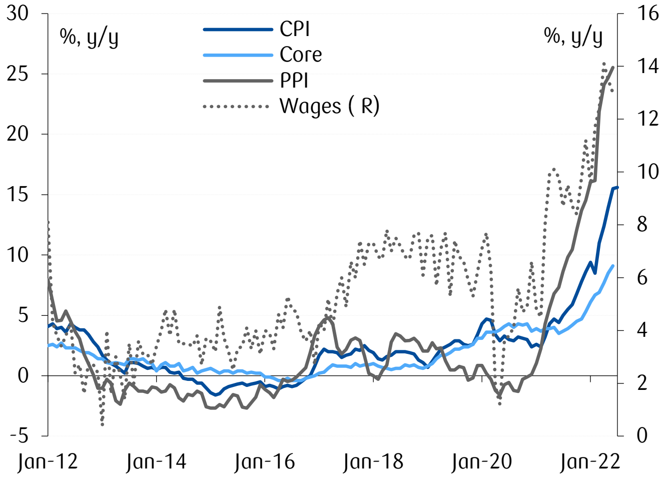
Economic sentiment indicators



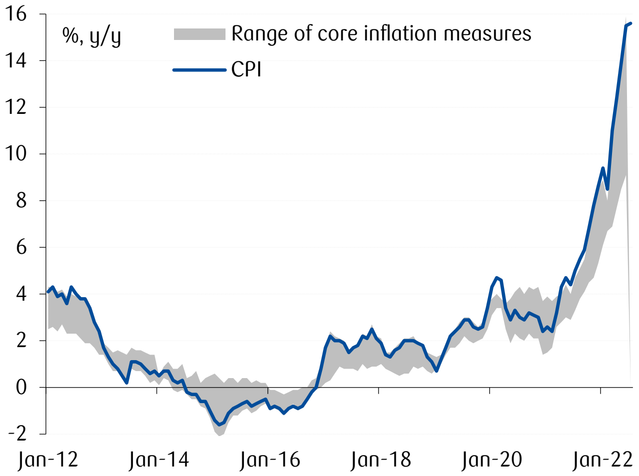
Poland ESI for industry and its components



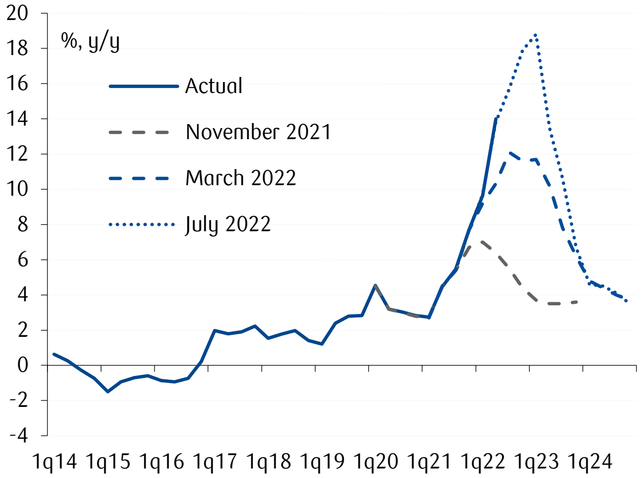
Broad inflation measures



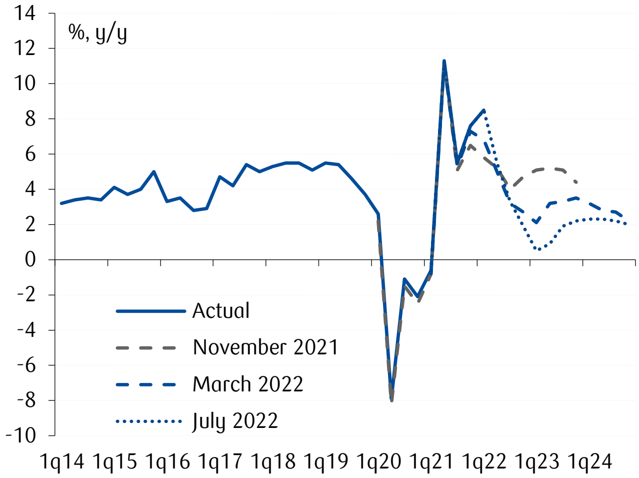
CPI and core inflation measures



CPI inflation – NBP projections vs. actual

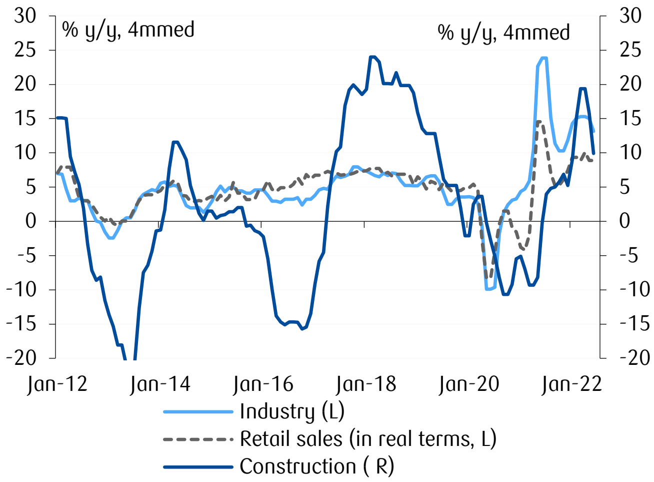


Real GDP growth – NBP projections vs. actual

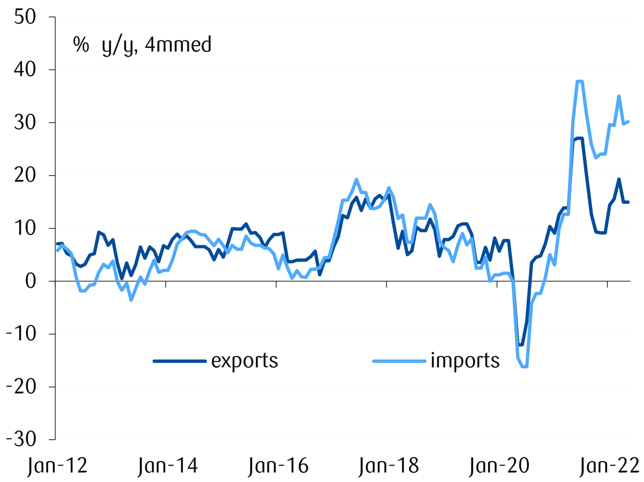


Source: Datastream, GUS, EC, NBP, PKO Bank Polski.

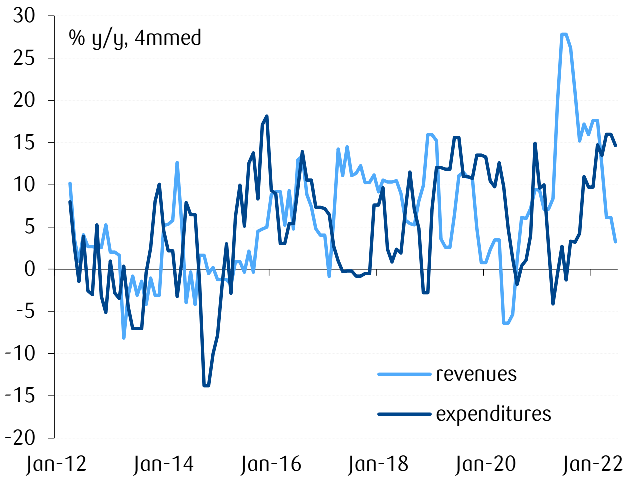
Economic activity indicators



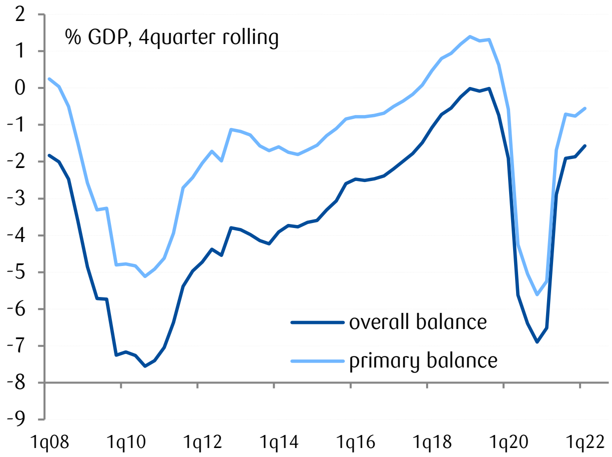
Merchandise trade (in EUR terms)



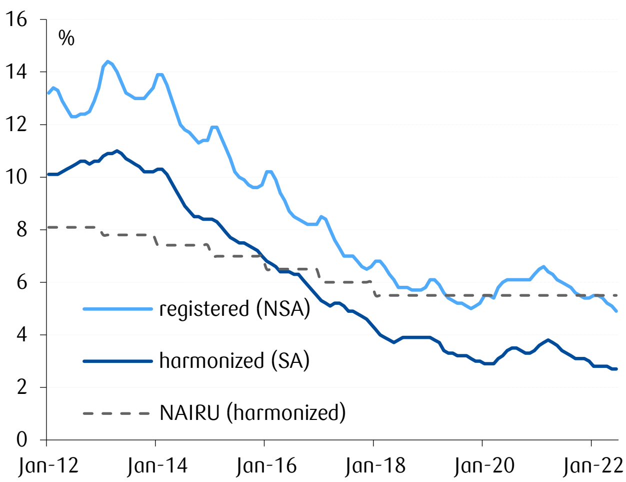
Central government revenues and expenditures*



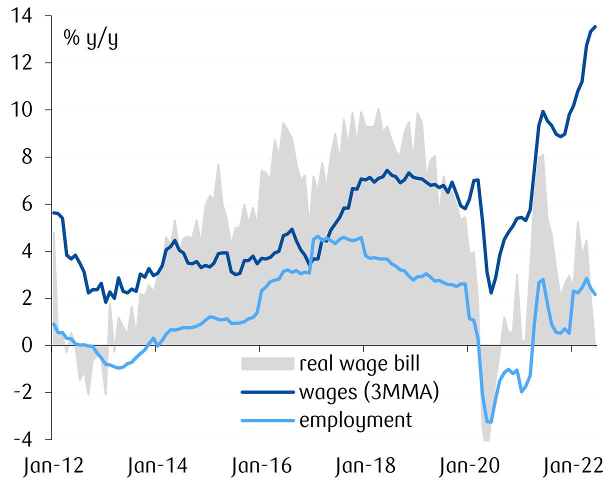
General government balance (ESA2010)



Unemployment rate

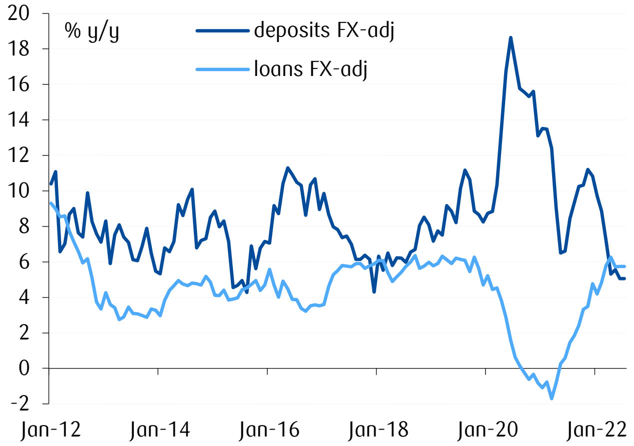


Employment and wages in the enterprise sector

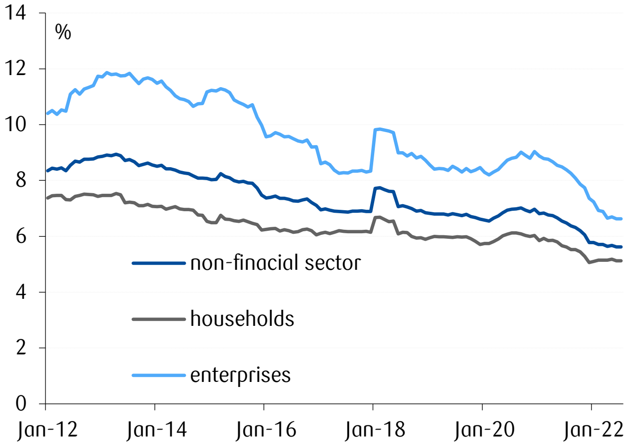


Source: NBP, Eurostat, GUS, MinFin, PKO Bank Polski. *break in series in 2010 due to methodological changes.

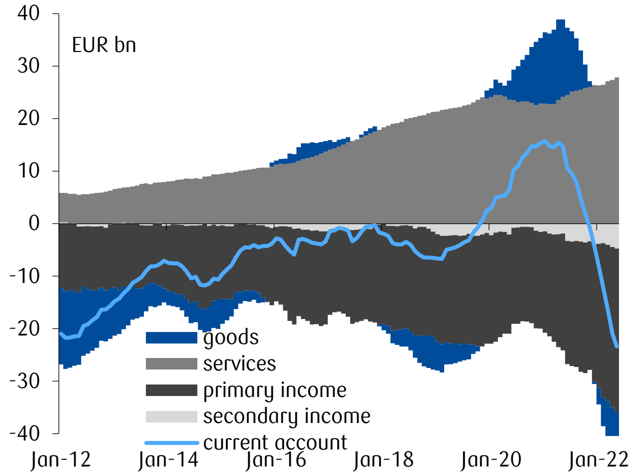
Loans and deposits



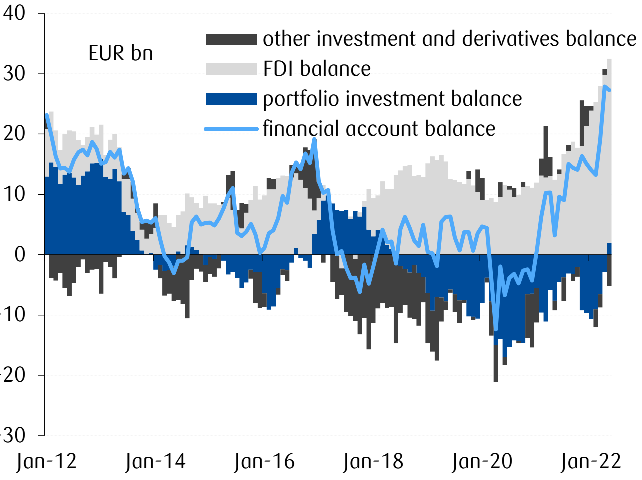
Non-performing loans (NPLs) – by sectors*



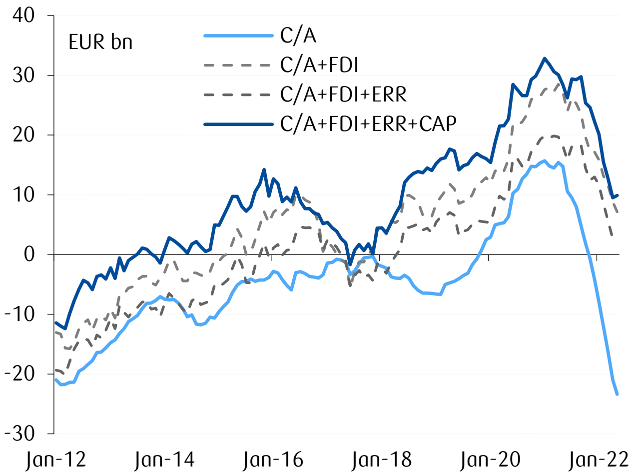
Current account balance



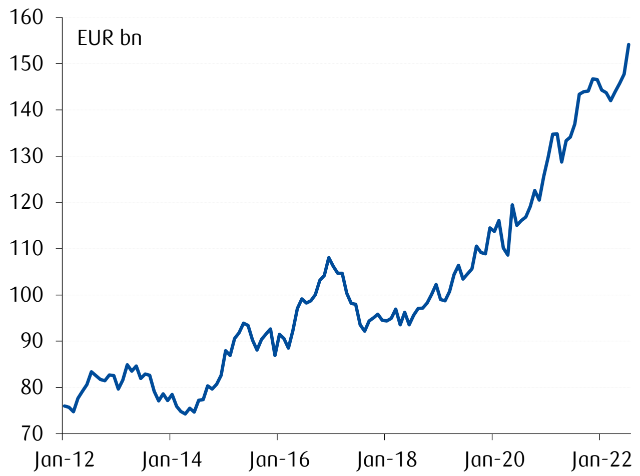
Financial account balance



External imbalance measures



NBP FX reserves (in EUR terms)



Source: NBP, PKO Bank Polski. *break in series in Jan2018 due to methodological changes.

Previous issues of PKO Macro Weekly:

- Prepare(d) for slowdown (Aug 5, 2022)
- Unemployment at the bottom and inflation plateau (Jul 29, 2022)
- Slowdown just ahead (Jul 22, 2022)
- Turning point? (Jul 15, 2022)
- Inflation vs recession dillema (Jul 8, 2022)
- NBP rate hikes coming to an end (Jul 1, 2022)
- Dry loan tap has frozen the market (Jun 24, 2022)
- A bitter pill of interest rate hikes (Jun 10, 2022)
- Growth borrowed from the future (Jun 3, 2022)
- Not all gold that glows (May 27, 2022)
- GDP growth rate at 5%? (May 20, 2022)
- Less reliant on Germany? (May 13, 2022)
- MPC is slowing down (May 6, 2022)
- 100bps month by month? (Apr 29, 2022)
- Nothing lasts forever (Apr 22, 2022)
- Deleveraging (Apr 8, 2022)
- The economic whirlwinds of war (Apr 1, 2022)
- Housing sales in gloom, rental market in bloom (Mar 25, 2022)
- The calm before the storm (Mar 18, 2022)
- Hawkish governor in front of a hawkish MPC (Mar 11, 2022)
- #StandWithUkraine (Mar 04, 2022)
- Russian invasion - repercussions for Poland (Feb 25, 2022)
- A moment of relief for the MPC (Feb 18, 2022)
- NBP likes stronger PLN (Feb 11, 2022)
- Can we afford the Anti-Inflationary Shield? (Feb 4, 2022)
- GDP growth surged in 4q21 to end 2021 on a high note (Jan 28, 2022)
- Successful 2021 behind us, challenging 2022 ahead (Jan 21,2022)
- Inflation's back, policy fights back (Jan 14, 2022)
- Housing market boom is getting over (Dec 17, 2021)
- It's not the last word on the matter (Dec 10, 2021)
- Monetary policy dilemmas (Dec 3, 2021)