Monitoring Poland: Hiking cycle is far from over

Inflation in Poland is persistent, signalling further rate hikes from the central bank. Yet GDP has weakened and the outlook is deteriorating. In this article, we look at the current state of the economy and what it could mean for Poland's currency and debt markets

The strong CPI surprise in August underlines that inflation in Poland is persistent, while the energy crisis in Europe intensifies. A strong rise in regulated energy prices should see CPI top out in 1Q23. At the same time, 2Q22 GDP fell short of expectations and confirmed a turning point in activity. The MPC switched to a dovish tone and we revised our terminal National Bank of Poland rate forecast to 7.5% from 8.5%, with smaller steps and a longer cycle. In September, we expect a 25bp rate in line with the NBP governor's pre-announcement. Keeping rates unchanged in September is unlikely given that high August inflation triggered some retreat from dovish comments. On the other hand, the MPC's sensitivity to weaker activity data leaves no room for a 50bp move, in our view. Short-term yields still have room to grow - the inflation outlook remains uncertain, with risks tilted to the upside.

GDP surprised to the downside in 2Q22, expanding by 5.5% year-on-year vs. 8.5% YoY in 1Q22. The main drag was the inventory adjustment, while consumption continued to boom. The 2.1% quarter-on-quarter (seasonally adjusted) decline in activity was among the steepest drops in the last few decades, excluding the pandemic. Consumption and investment should slow in 2H22. The GDP outlook for the second half of 2022 and for 2023 deteriorated sharply.

Despite a slowdown in July economic data, August inflation surprised on the upside and set a new 2022 high at 16.1% YoY. Sequential growth in core inflation also resumed after the summer slowdown. The CPI peak is still ahead, as new tariffs should push inflation higher later this year and towards 20% in early 2023, despite measures to cap the scale of the jump in regulated energy prices in early 2023.

FX and money markets

As the holiday period ends, the Polish zloty may again come under pressure. MPC statements indicate that the September rate hike in Poland will be smaller than the Federal Reserve & European Central Bank (25bp vs 50-75bp). Investors also continue to price in rate cuts as early as 2H23. The war in Ukraine continues, and Russia's actions may yet again hurt Central and Eastern European sentiment. Technically, 4.80 is a likely target. Reaching a higher level remains possible, but would likely require further significant declines in EUR/USD.

Domestic debt and rates

Scope for a further rise in POLGB yields is limited, particularly at the long end. The market has already priced in a terminal rate of 7.5% (in line with our view). We still think that rate cuts are priced prematurely (2H23), particularly given the fiscal loosening we see in 2023. But this should change only gradually, as new spending plans are unveiled. What is more, recent data and price developments suggest that foreign investors continue to enter the market, hurting POLGB yields.

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