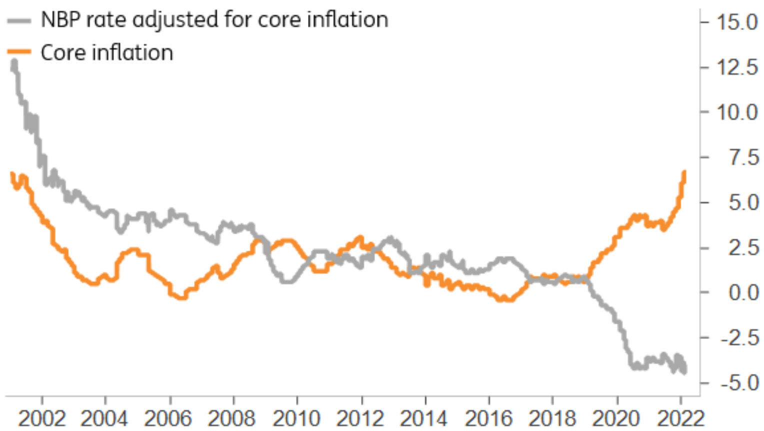
Our warning scenario on terminal rates between 5-10% in Poland

Our point estimate is a terminal rate of 6.5% in 2022 and 7.5% in 2023 in Poland

People in Castle Square, Warsaw

The high gap between core inflation and real NBP rate



Source: ING, Macrobond

Following the Monetary Policy Council meeting in March, we warned that the terminal rate in Poland is 5-10% rather than the 4-4.5% stated by the National Bank of Poland governor during the press conference. Below we present our rationale behind our warning scenario.

Macroeconomic background

We keep our revised GDP forecast for 2022 at 3.2% unchanged.

The downside risk for our forecast comes from further downside revisions for the eurozone. But we think the upside risk prevails given the following:

(1) Real economy data in January and February, ie, before the war, calls for 1Q22 GDP growth of c.7-8% year-on-year. The strong 2022 starting point brings upside risk to our current GDP forecast.

(2) Moreover, the government keeps delivering new spending. So far measures announced for 2022 have reached c.3% of GDP. These include Anti-inflation shields 1.0 and 2.0 and their extension for the second half of 2022, and a cut of direct taxes, ie, Polish Deal 1.0 and 2.0. Hence, the budget spending should significantly cushion the negative impact of the inflation shock on disposable incomes.

(3) On top of that, spending on the hosting of refugees should reach about 0.7-1.4% of GDP (by households and the public sector together) and keep consumption robust despite the inflation and confidence shocks.

Inflation outlook

In 2022 Poland is facing an unusual economic slowdown, with a further strong rise of consumption (c.5-6% YoY vs 6.1% YoY in 2021), while the main hit to GDP should come from net exports and weaker investments. Strong consumption should facilitate second-round effects, ie, companies can pass higher commodity prices to CPI. Given that we revised up our CPI forecast for 2022 to 10.5% on average (with still upside risk) and 8.4% YoY in 2022.

The suboptimal policy mix calls for a tighter monetary response

We do think that the new fiscal spending should continue, on the top of already announced measures of 3% of GDP. The fiscal side should shore up GDP dynamics, while monetary policy should address the high inflation. This is how we read the March change in the MPC reaction function, when the NBP governor announced a very hawkish bias and that it targets CPI and a stronger zloty (PLN).

However, this policy mix does not address long-term inflation risks. The stronger PLN may soften some of the CPI pressure, but this will be more than offset by the recent spike of commodities prices. The strong domestic demand, supported by fiscal stimulus, facilitates the second-round effects (pass-through from higher costs to CPI and wage-price spiral).

Our take on rate prospects

We take Governor Glapinski's comments on his hawkish bias into consideration. Our analysis of the MPC reaction function point that rates should reach about 7.5%, with our GDP and CPI forecasts for 2022-23 and MPC bias getting similar to the Council in years 2010-2016 (it was more hawkish than the MPC in years 2016-2022, but still moderate in historical terms). We see NBP rates at 6.5% in

2022 and 7.5% in 2023 with risks on the upside.

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