

## Poland: CPI inflation unlikely to come down before 2023

Core inflation in Poland rose again last month due to pressure from the weak zloty, rising wages, and high energy prices



According to the Central Statistical Office of Poland's final estimate, CPI inflation rose to 16.1% year-on-year in August from 15.6% YoY in July, in line with the flash reading. The year-on-year growth in both the CPI and core continue to rise.

CPI in year-on-year terms accelerated, as increases in the prices of food (+1.6% month-on-month), energy carriers (+3.8%MoM) and core (+0.8%MoM) overshadowed a significant fall in transport fuel prices (-8.3%MoM). The large increase in food prices is not only due to the jump in sugar prices but also in other categories (meat, bread, dairy). There was also no typical seasonal drop in the total food price (-0.8%MoM average in the last decade). In August, food and beverages grew 1.6%MoM, as discounts for fruit and vegetables were dominated by growth in other categories.

The large jump in energy prices was mainly driven by heating fuel (+12%MoM) – making it the largest single contribution to the August CPI increase – and municipal heating. Both increases have come earlier than usual from a seasonal perspective, and show the impact of the energy shock and the shortage of coal for domestic purposes of households.

The details of August inflation show price pressures in many categories of goods and services. This is the effect of rising wages, high gas and electricity prices (as shown by jumps in categories such as paper, chemicals, and cosmetics), and the weak zloty. The strong holiday season has pushed up the prices of tourist and catering services, compared to last year.

## CPI drop in the coming months seems unlikely

We are less optimistic than the National Bank of Poland (NBP) about the evolution of inflation in the coming months. It will be difficult to see a decline in the year-on-year CPI before the end of the year. The economy still has to absorb the energy shock over the next few months. We expect price rises in categories that escape regulation (such as fuel, bottled gas etc), but also await new price lists for the turn of 2022-23, which will determine what level inflation will peak at in February 2023.

We also note that the annual inflation rate (CPI, %YoY) may fall over the course of 2023, on base effects, among other things, or thanks to large-scale measures to rein in energy prices. However, our models show persistent high core inflation, which is more domestic in nature. We see very high inflation expectations of firms and households, which are triggering strong second-round effects (firms are passing most of the new costs on to retail prices, and this effect will be seen in the coming months because the slowdown in domestic demand is too small). In turn, a significant increase in the minimum wage acts as a wage-price spiral.

## There may be no more interest rate hikes

However, the cycle of interest rate hikes is coming to an end. Recent comments show that the NBP is rather targeting a decline in annual CPI (possibly by the end of 2023) and a 'soft landing' of the economy, while a "de jure" target of CPI at 2.5% YoY is seemingly forgotten. An important factor that reduces the effectiveness of the rate hikes is fiscal expansion. Currently, the total policy mix is only slightly restrictive despite inflation at 16.1% YoY.

With such a definition of NBP targets, we can envisage rate cuts in 2023. With that in place, we should face another cycle of rate rises in 2024. The way to fight inflation differs from the approach of other countries, where central banks and governments communicate that what is needed is to cool down the economy, and the labour market, with slower wage growth than the rate of inflation. All of this is to avoid a repeat of the 1970s scenario in the US when it took three cycles of interest rate hikes to fight inflation. The ultimate cost of this fight was much greater than the cost of cooling the economy at the start of a period of high inflation.

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