

## Poland joins CEE central banks with a 40bp rate hike

We had a long held non-consensus view for a November hike, driven by our high CPI forecasts. We see a significant fiscal expansion, rising demand pressure and still high inflation in 2022 – a target rate of around 2.0% vs 1.5% before the pandemic. Should the NBP undermine expectations for a tightening cycle during tomorrow's press conference, PLN may weaken



### Rates hiked

The Monetary Policy Council unanimously raised the reference rate from 0.1% to 0.5%, the lombard rate from 0.5% to 1.0%, the rediscount rate from 0.11% to 0.51% and the discount rate from 0.12% to 0.52%. The reserve requirement ratio increased from 0.5% to 2.0%. Only the deposit rate remained unchanged.

The statement after the MPC meeting is short, but it shows a complete change in the MPC's view on the inflationary situation. New elements in the statement are following:

(1) The MPC admits that its mantra about inflation caused by supply shocks is not an incomplete

picture. They add that high inflation is also driven by demand pressure.

(2) The MPC presents less concerns about the prospects for economic growth in 2022 and the situation on the labour market. The pandemic is still a threat, but less so.

(3) There is an opinion (similar to the Fed) assuming that supply shocks may be more long-lasting, so it will also take longer for inflation to return to lower levels.

(4) Moreover, the MPC indirectly admits that the wage-price spiral is a real threat, when they say that sound economic growth in 2022 and a strong labour market can make elevated inflation sticky.

(5) The purchase of bonds is no longer mentioned in the statement after the meeting, but the MPC refers to Monetary Policy Guidance for 2022. The use of QE is therefore less realistic, but still possible.

The MPC's decision significantly alters the outlook for the zloty. Investors may now expect subsequent rate hikes in Poland, similar to what has happened in the Czech Republic or in Hungary. **Should the National Bank of Poland undermine expectations for a tightening cycle during tomorrow's press conference, PLN may weaken.**

## Press release highlights

Nevertheless, the press release following the Council's meeting suggests that the NBP may use currency interventions to limit the zloty's appreciation. In the short term, the strengthening of the zloty may also be tempered by unfavourable sentiment for the EM currencies. Therefore we expect that by the end of the year EUR/PLN may reach a level close to, but rather below 4.50.

The MPC's decision is consistent with the growing Polish government bond yields and PLN swaps. Although the monetary policy assumptions for 2022 still include purchases of Treasury bonds and bonds guaranteed by the State as instruments at the disposal of the NBP, it seems unlikely that QE will be continued next year in parallel with rate hikes. The draft budget for 2022 adopted by the government, rather points at using government bonds to finance spending outside the state budget instead of, for example, BGK bonds. We find this rather as a preparation for such a scenario.

## Inflation not expected to slow

In our view, today's hike will not slow inflation any time soon. Besides the continuing disruptions in supply chains, rising prices of gas, energy, and food, we also foresee more fiscal stimulus next year (including the Polish Deal, we estimate the scale of fiscal expansion in 2022 at over 5% of GDP), so we see rising demand pressure as an important CPI driver next year. The effects of soaring PPI on CPI have not yet been fully revealed either. We estimate that next year CPI inflation in Poland may still average 4.5% year-on-year versus 4.8% YoY in 2021.

In our opinion, the November NBP projection is likely to show a higher CPI path than in July (the July projection already showed CPI in 2023 close to 3.5%), with GDP growth projected above the potential. Such a scenario would imply inflation remaining above the upper range of acceptable deviations in the forecast horizon, with a widening positive output gap, low unemployment rate, and high wage growth.

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## *We believe the Council will continue with hikes*

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Therefore, we believe that the Council will continue with hikes. Even if such steps do not quickly have a tangible impact on mitigating effects of supply-regulatory shocks, they may reduce the rise in inflation expectations and the risk of wage-setting/price-setting loop. They would also prevent somehow asset bubbles. In addition, due to the reaction of the zloty, there should be less inflation imported from abroad. The rising inflation recently is a global problem, not only a Polish one. We expect that at the end of next year, rates in Poland may be rather around 2%, i.e. higher than 1.5% before the pandemic.

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