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Article

# Poland: PMI at critical level and core inflation disappoints, again

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## PMI close to 50 threshold

The PMI manufacturing index fell from 51.4 to 50.5 in September, following a softer reading in the eurozone and German indexes. A deceleration occurred in all major components with new orders falling below the key 50-point threshold. What's more, managers' forecasts for production in the coming months also worsened.

The deterioration in momentum has been visible in nearly all Polish sentiment surveys (e.g. European Commission indicators, NBP survey). Among trading partners, only Germany has seen signs of optimism, with the Ifo survey showing an improvement in expectations.

If we are to trust the PMI, industrial production (IP seasonally adjusted) should slow sharply in the fourth quarter to about 2-3% year-on-year, around half the 6.4% YoY average of the first half of the year. Production should maintain decent momentum of close to 5% YoY seasonally adjusted in September but we expect a slowdown to be seen in 4Q18 figures.

## Another disappointment from core inflation

According to the flash estimate, CPI decelerated in September from 2% to 1.8% YoY, below the market consensus (1.9%) and in line with our forecasts. The negative surprise was due to another disappointment in core inflation. Based on available data, we estimate a 0.1 percentage point drop to 0.8% YoY vs. expectations close to 0.9-1%. On the other hand, food prices rose 2.3% YoY, likely due to higher prices for vegetables and cereal products.

We expect the deceleration in annual inflation to continue in the coming months. The October reading should remain close to the September estimate, as the recent increase in oil prices should boost the contribution from fuel. A bigger drop should occur in November – when we expect food prices to reach a nadir. With oil prices remaining at $80 per barrel, we think the CPI will bottom out at close to 1.5% YoY in November.

The slowdown in 4Q18 is likely to be temporary though. A return above 2% YoY should occur in 1Q19 (to 2.5-2.7% YoY) supported by the regulatory increase of electrical energy tariffs, and as effects which previously held down core inflation in 2018 (e.g. a fall in financial and insurance services prices) are exhausted. The trajectory of oil prices is a wild card but with Brent prices staying close to $80 per barrel, we think CPI will reach a peak in mid-2019 at close to 3% YoY, before moderating back to 2% YoY in the second half.

## MPC reaction: no change in dovish bias

The big picture coming from today's data is that we'll see inflation temporarily moderate in 2H18 before peaking at 3% in mid-2019 (still below upper bound of target) with core inflation remaining very subdued. Additionally, if we trust the PMI, industrial production should slow very sharply in 4Q18, meaning GDP growth should decelerate as well. This should keep the central bank on its dovish course. We don't expect a rate increase next year or the year after.

Some MPC members have signalled that they no longer subscribe to Governor Adam Glapinski's view that rates should stay flat until 2020 due to new inflation risks (e.g. higher prices of oil and electric energy and wage pressures in the public sector before elections). But we still think this is an opinion of the minority.

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