Poland: Reassuring but hawkish comments from the central bank governor

We are facing a more expansionary fiscal and restrictive monetary policy, which explains why the National Bank of Poland focuses more on inflation and less on GDP than before. The target interest rate will be higher than the previously expected 4.5%, and increases may also take place in 2023

Bank of Poland governor, Adam Glapinski

Source: Narodowy Bank Polski

We reiterate our view that the interest rate hike by 75bp is a balanced decision and the weakening of the zloty is temporary. History and the current situation indicate that the war brings higher inflation, budget spending and interest rates. The main message from the press conference following the Monetary Policy Council decision in March is that rate hikes will follow and the MPC is strongly determined to contain inflation and bring it to the target already in 2024. The terminal rate will be much higher than the 4.5% expected so far.

1 Curbing inflation is a clear priority for the MPC, GDP less so than before

- NBP governor A. Glapiński clearly set a priority for the MPC – bring inflation to the target reasonably quickly. He stressed the determination of the Council to deliver such an outcome. Despite an outbreak of military conflict in Ukraine the NBP is not particularly concerned about prospects for economic growth.
- The MPC will continue hiking rates in order to bring inflation to the NBP target, even at the cost of somewhat slower growth. A. Glapiński said that policymakers should act in a “swift and decisive manner”, which is exceptionally hawkish given his policy bias in the past.
- Professor Glapiński signalled that the Council may meet more often (eg, twice a month) if needed.

2 War will boost inflation

- In the NBP's view, war in Ukraine is yet another supply-side shock that will translate into higher inflation in Poland and elsewhere. As a result, Polish CPI inflation will be some 2 percentage points higher than projected earlier. In particular, the central bank expects further rapid growth of energy and food commodities on the global markets and continued supply chains disruptions.
- The new NBP economic staff projection envisages that inflation will be above the upper bound of acceptable deviations from the target until at least 2024 and Governor Glapiński hopes to reduce it to the target until that time.
- Over the medium term the NBP forecasts inflation to moderate as a result of (a) softer demand, (b) expiring energy shock, (c) supply chains normalisation and (d) expected PLN firming.
- Still, this seems to be wishful thinking, Poland entered a pandemic with almost 5% inflation, due to a very expansionary policy mix in the previous era of low rates. The pandemic shock brought new inflationary shocks and the war in Ukraine is bringing an additional inflation shock. We are facing higher global inflation and persistently higher inflation in Poland, in the coming two years close to 9% year-on-year.

3 Zloty remains undervalued

- Chairman Glapiński underlined that the recent PLN depreciation has no fundamental backing and is fully inconsistent with NBP policy. He added that the central bank is determined to support the zloty.
- Previous statements of the chairman suggested that prior to the war in Ukraine appreciation of the zloty was to be used to combat inflation quickly. This indicates that the central bank may be forced to raise interest rates higher than it previously expected. We

also expect NBP to occasionally conduct FX interventions. However, Glapiński said that such operations were so far relatively ineffective, so it should not be conducted on a larger scale.
- We expect a change in Ministry of Finance FX conversion policy to be the main tool to support the zloty. The Ministry and the central bank already announced that all such funds will be converted on the market, so, ie, EU funds will be sold for PLN. This will be particularly important when Poland receives support from the Recovery Fund, or international aid to support refugees from Ukraine.

Conclusions

Poland will face a looser fiscal policy and more restrictive monetary. This shows why the NBP is more concerned with CPI than with GDP growth. Previously, the NBP followed a dual mandate. We expect a strong fiscal impulse both in Poland and the euro area, aimed at military, energy transition and softening of the energy price shock. We underline that high CPI is not only a result of the recent shocks, but also an expansive policy mix in recent years. The cumulation of both local and external factors demands more decisive policy actions. Therefore, the NBP terminal rate should be much higher than 4.5% we expected beforehand. We see the terminal rate rather between 5-10%, which would make the real rate less negative or even close to zero, given that the coming two years should bring average CPI close to 9%YoY. The current very negative real rate is non-sustainable given that policy mix will be suboptimal, ie, expansionary fiscal and tight monetary. The rate hikes are likely to continue in 2023.

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