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Poland: Strong fiscal push in 2022; timid MPC response to CPI

The government's 2022 budget proposal shows a fiscal support widening to 5.2-5.5% GDP from c.4.5% this year. As the output gap is already closed, it should result in CPI remaining high next year. The Monetary Policy Council is unlikely to decisively respond and may under deliver hikes vs elevated market expectations

The updated 2022 budget project assumes a higher general government debt at 56.6% of GDP vs 55.5% before, without changing the deficit. That may reflect a mechanism of spending outside the central government by sending Polish government bonds (POLGBs) to public institutions outside the central government. See our full note here.

The budget proposal suggests that currently the government aims to rely more on POLGBs, rather than agency debt next year. This may reflect the lacklustre demand for BGK bonds seen this quarter, and the National Bank of Poland may phase out its QE programme soon. Some MPC members, including the chairman, said that QE may not continue alongside rate hikes. This supports our scenario of higher POLGBs' yields in the remainder of 2021 and 2022.

Recent MPC members' comments point that even hawks call for a 15bp hike in November. We find a September motion for a 190bp rate hike (out voted) that indicates rather a polarization of members' view that indication of tightening similar to CNB. The Council retains a strong bias for a weak PLN, as a measure to bolster exports. QE tapering is a major unknown. Some central bankers admit the end of QE after initial hikes. But the government seems to be preparing for tapering, as seen mentioned above. Although we stick to our long-standing non-consensus call for a November hike, we worry the NBP may under-deliver (+15bp) vs elevated hikes expectations (priced +40bp). We rather see NBP catching up with hikes to 1.25% next year (above consensus but still below what the curve is pricing).

FX and Money Markets

In October some temporary PLN recovery is likely after the sell-off in September, €/PLN may reach 4.55. According to our estimates the zloty is still significantly undervalued. Investors seem to agree as massive €/PLN put options were opened lately. 4Q21 PLN prospects largely hinge on the November MPC meeting. The market is pricing more than a 25bp hike. The MPC may deliver less, or even postpone tightening to 2022. This could bring €/PLN even up to 4.80.

Domestic Debt and Rates

The market already priced in possibly excessive monetary policy normalisation. A further rise in POLGBs' yields now hinges on core markets. This suggests limited scope for a further rise in October. Monetary policy is a major risk around the November MPC meeting. Disappointment over the policy reaction scale will raise concerns over the CPI target. In emerging markets this typically results in asset swap widening.

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