Poland’s central bank expects rapid disinflation, rate cut discussion premature

At today's press conference, National Bank of Poland President Glapiński outlined a scenario of rapid disinflation after the first quarter, but stressed that at the current juncture any talks about rate cuts would be premature. At the same time Glapiński gave many arguments to show he accepts single-digit CPI that is far from the target

President of the National Bank of Poland, Adam Glapinski

Current inflation

President Glapiński repeated his earlier assessment that January and February will bring increases in inflation. He also stated that inflation remains high, although its average level in the first quarter will be slightly lower than the NBP expected in its November projection. According to the NBP, the main reason for the currently high inflation is expensive energy. On the top of that, the jump in costs is spilling over into other categories of the inflation basket causing core inflation to rise.

External environment

President Glapiński noted that the global economic situation is deteriorating and GDP growth in the world economy in 2023 will be significantly lower than in 2022. The weakening is due to high energy and commodity prices. At the same time, the risk of gas shortages in Europe has clearly decreased. The most pessimistic scenarios have not materialised and the economic outlook for the European economy has improved somewhat.

Global inflation remains high, although it has started to decline in many countries. The decline in inflation is taking place thanks in part to easing tensions in global supply chains, falling commodity prices and softer demand demand. The purchasing power of firms and companies is declining, reducing inflationary pressures.

Domestic inflation outlook

In Glapiński's view, there will be a rapid decline in inflation after the first quarter, to around 8% on average in the fourth quarter. According to the NBP president, headline inflation may fall to 6% year-on-year in December and that would be close to levels that are hardly noticed by consumers. Glapiński pointed out that this is not the final policy target and that in the following years the NBP will aim to bring inflation as close as possible to 2.5% (NBP official target).

Monetary policy outlook

On the one hand, during the press conference, the NBP president said that the current level of NBP interest rates (6.75%) is adequate to bring inflation down to the target. He also reiterated on a couple of occasions that it is too early to talk about rate cuts and that the Council has not closed the hiking cycle, not least because there is uncertainty as to how prices will behave in January and February. He also stressed that the NBP's target for inflation is 2.5% +/-1 percentage point.

On the other hand, the rest of the communication on the NBP's inflation target was vague and unconvincing. The NBP president has stated several times that single-digit inflation is acceptable. At the same time, he pointed out that countries wishing to have a rapid GDP growth must accept higher inflation. In our view, this communication indicates that a fall in CPI inflation alone, even if core inflation remains stubbornly high, could be a serious argument for starting a discussion on cuts within the Monetary Policy Council. In Glapinski's view, more on this subject could be discussed in May or June. We see increasing odds of the first rate cuts before the end of 2023.

Summary

In our view, the launch of easing cycle before the end of 2023 would be a premature action with the risk of entrenching high inflation expectations, which can effectively delay the timing when CPI reaches the 2.5% YoY target.

The decline in inflation over the course of 2023 and the recent improvement in the inflation outlook are caused by the reversal of two major shocks – pandemic and war/energy. The domestic inflation outlook is still far from satisfactory. We see several compelling arguments against rate cuts in 2023: (1) at the end of 2023, core inflation should still be a couple of times higher than the target, (2) history shows that lowering inflation from 20% to 10% is much easier than from 10% to 2.5%. A drop in CPI to single digits in the fourth quarter should be caused by the reversal of supply shocks, which, after all, are out of the NBP's control. Moreover, the structure of inflation at the end of 2023 indicates, with the largest contribution of high core inflation being risky for price stability, that high core inflation reflects domestic demand pressure and lower CPI may require more painful measures to reach the 2.5% YoY target, (3) Poland has a very strong labour market despite the GDP slowdown – a record-high percentage of companies are planning to raise wages, and (4) we see an overhang of high energy prices, which were frozen in 2023.

Still, given the MPC's current reaction function, we don't rule out the possibility of small rate cuts in the second half of the year, as external disinflationary processes intensify (large improvements in supply chains, falling commodity inflation, falling commodity prices), which should strongly reduce CPI inflation globally and in Poland. Also, the majority of the MPC is looking mainly at the headline CPI inflation rate and is targeting a soft landing (or want to facilitate a prompt GDP recovery), while paying less attention to the persistence of core inflation.

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