

Poland's CPI at 20-year high; NBP to hike - possibly in November

CPI rose to 5.4% year-on-year in August, underlining the National Bank of Poland's credibility issue. We expect an initial MPC hike in November, alongside new projections. The guidance on QE has not been transparent; tapering began without warning. The end of QE should coincide with the beginning of the rate hiking cycle, if not stated otherwise



Factors behind the elevated CPI are clearly more lasting than the National Bank of Poland had expected. December inflation should near 6% year-on-year, while the 2022 average should fall to 3.9% YoY from 4.5% YoY in 2021, due to base effects in food and energy. But core inflation should stay above the upper bound (CPI 2.5% \pm 1%), due to cost and demand pressures as well as the long-term hurdles of the GDP structure (including a consumption boom and investment slack for several years).

This outlook should be confirmed in the November inflationary projection, stripping the MPC of any hope of a prompt return to the CPI target. So far, 4 out of 10 MPC members openly support a tightening in 4Q21 - we hope others may join, given expected high CPI in the second half of this

year and the diminishing impact of Covid-19 on GDP. In his recent interview, the governor set the tone for the September meeting. He is still against immediate tightening but made another small step in this direction, recognising short-term demand pressure now and the risk of sustainable pressure in 2022. He is leaving the door open for an earlier hike.

With a November rate hike already in prices, the fate of the NBP's QE should now be in the market's focus. In recent months, we've had conflicting opinions from the MPC about sequencing. The NBP governor said that tapering has already started, but the end of QE should coincide with the beginning of the rate hike cycle, if not stated otherwise. The government should continue to partially finance the investment part of the Polish Deal via agency debt (eg, of BGK) so as not to hit local govie limits. Agency debt requires NBP support.

FX and Money Markets:

After Jackson Hole EUR/PLN reached almost 4.50 in early September, but the NBP governor's soft tone and the deterioration in Poland's trade balance should prompt profit taking. Based on our models, the zloty is still significantly undervalued against the euro. We expect the EUR/PLN upside potential to be capped at around 4.60. A Supreme Court ruling on FX mortgages was a non-event – the ruling was again postponed but supports a sense that mass loan conversions are unlikely.

Domestic Debt and Rates:

Short term, in September we expect the POLGB rate curve to steepen. Long end bonds should follow core yields up, although POLGBs offer virtually no net supply in the remainder of the year (plus expectations for limited issuance in 2022 as well). Short end should slightly strengthen, given the NBP governor's dovish interview and call against hikes, supported by solid GDP growth and the outlook for CPI nearing 6% YoY in December. A more meaningful rise in yields is expected in 4Q21, tracking core markets. Long POLGBs may tighten in spreads against the Bund though.

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