Continued disinflation in Poland supports prompt central bank easing

We expect a gradual economic recovery in Poland during the second half of the year. Real wages are finally on the rise despite weakening employment. However, further disinflation and relatively soft industrial production seem to be more than enough to trigger the central bank to cut rates as soon as September

The labour market

Average wages in the corporate sector increased by 11.9% year-on-year last month (consensus of 12.1%), following a 12.2% YoY increase in May. Average employment, on the other hand, increased by just 0.2% YoY (consensus of 0.4%), down from 0.4% a month ago. This means that nearly five thousand jobs were lost over the month.

The labour market situation remains tight, although further signs of a slowdown are evident. Employment levels have declined slightly in recent months but remain historically low due to deteriorating demographics. Moreover, there are reports that an outflow of Ukrainians has begun (although this has not yet been confirmed by official data). Demand for workers from some manufacturing sectors has declined, but amid record-low unemployment, the pool of potential workers remains limited.

As a result, despite the drop in inflation and the downturn (e.g. in industry), nominal wage growth is stabilising at low double-digit levels. In June, real wages (i.e. adjusted for price growth) increased for the first time since July 2022, and are likely to accelerate gradually in the coming months as inflation decelerates. In addition to low unemployment, real wage growth will be supported by an average annual increase in the minimum wage of more than 20% next year. This means that the second half of ths year will likely see a rebound in consumer spending after a weak first half of the year. However, given the deceleration in employment and the potential outflow of refugees, these increases may prove limited.

Construction

In June, construction output rose by 1.5% YoY, following a 0.7% YoY decline a month earlier. This was close to expectations of a 1.8% YoY increase.

The weak construction performance is mainly the result of the still poor situation in building construction (-5.7% YoY, after a strong 12.2% YoY decline a month earlier). The number of housing units under construction has been falling sharply since mid-2022 but is still historically at a relatively high level. Developers continue to rush to complete current projects, contributing to oversupply, but are not starting new ones. In June, 807,000 housing units were under construction (-8.5% YoY).

However, the number of construction starts has fallen by more than 28.5% YoY. At the same time, more apartments were completed in the first half of 2023 (2.5% YoY) than in the same period in 2022. The apartments currently on offer should cover demand for about a year. Therefore, the "2% Safe Credit" programme launched by the government is unlikely to significantly improve the construction situation this year, although it will likely translate into rising property prices. Similarly, interest rate cuts by the National Bank of Poland (NBP), which we believe will begin in September, should be supportive.

Infrastructure investments continue to perform relatively better. Civil engineering construction increased by 5.9% YoY in June, following an increase of 9.1% YoY in May, and specialised works increased by 3.8% YoY, following an increase of 0.9% a month earlier. The situation in infrastructure construction is determined by the completion of projects financed by the "old" EU budget. We believe that this category will remain the main driver of construction this year. Works related to the erection of warehouse halls or logistics centres should also continue to make a positive contribution.

Industrial output

Industrial output fell 1.4% YoY in June (consensus: -1.6%), the fifth monthly consecutive decline. The seasonally-adjusted data, however, finally showed an increase in month-on-month terms, after declines in the previous three months. Manufacturing output fell by 0.7% YoY, following a 2.3% YoY decline in May. The deepest declines were in coal mining (-31.6% YoY) and the chemical industry (-20.4% YoY). Against this backdrop, production in export industries looks good: automobiles (+19.7% YoY), electrical equipment (+9.7% YoY), and machinery and equipment (+7.1% YoY). Growth in the production of capital goods continues (+11.0% YoY), which allows us to optimistically look at the performance of investments.

PPI inflation eased to 0.5% YoY in June (consensus: 0.7%) vs. 2.8% in May (revised). Compared to May, producer prices fell 0.7% MoM, and prices in manufacturing fell 0.6% MoM. In the case of manufacturing, the decline in price levels has been observed since last November.

Low activity in domestic manufacturing continues, and the PMI suggests a further decline in new orders in manufacturing. However, we are seeing signs of gradual stabilisation.

Data for May were revised down from -3.3% YoY to -2.8% YoY, and June's industrial performance was slightly better than our expectations. While we still can't rule out the possibility that the second quarter still saw a decline in GDP in year-on-year terms (our current baseline scenario is 0.0% YoY), the second half of the year should be slightly better for the Polish economy than the first half. We are counting on a gradual recovery in consumption and a slightly smaller negative impact of inventory adjustments on GDP.

The weakening demand for Polish industrial production is being accompanied by rapid disinflation of producer prices. PPI inflation has fallen from 25.6% YoY in mid-2022 to near zero today, and the coming months are likely to bring deflation. This is supported by the normalisation of energy prices, which also reduces the pressure on prices of products other than energy. For example, the rise in the price of food production has clearly slowed down. This will promote further disinflation of consumer prices, with this process less dynamic, and CPI inflation will remain clearly above the NBP target (2.5% +/-1 percentage point) for an extended period. Slower price growth and a weakened economy make the Monetary Policy Council ready to cut interest rates after the summer holidays.

The Council officially ended the interest rate hike cycle in July, and the market is gambling on a rapid and significant easing of monetary policy. Our baseline scenario assumes two 25bp interest rate cuts before the end of this year (most likely in September and October). At the same time, with the inflation profile presented by the NBP in its July projection, the space for rate cuts is clearly lower than the market is currently pricing in.

Author

Piotr Poplawski
Senior Economist, Poland
piotr.poplawski@ing.pl

Leszek Kasek
Senior Economist, Poland
leszek.kasek@ing.pl