

## Polish inflation drops, but it's temporary

CPI fell below expectations in September on the back of food prices, but core inflation continued to inch upwards. We expect inflation to reach the highest point in 1Q20 but there is still a lot of uncertainty about what happens in the second half of 2020



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Polish CPI decelerated in September from 2.9% to 2.6% year on year, slightly below the market consensus of 2.7%. The surprise came on the back of food prices, which decelerated from 7.2% to 6.3%YoY, subtracting 0.2 percentage points from the headline figure. Core inflation increased slightly from a low of 2.2%YoY to a level between 2.2% and 2.3%YoY.

We expect relatively stable readings in the next few months but some downward surprises related to food prices are still possible. On the other hand, we expect a further increase in core inflation towards 2.5%YoY in December.

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*There is still a lot of uncertainty regarding the inflation level in the second half of 2020*

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In our view, the underlying growth comes from demand factors such as tight labour market conditions implying higher labour costs, implementation of generous social transfers (e.g. child benefits), and the recent weakening of PLN. Therefore core inflation may even overshoot our forecast, despite weaker dynamics of industrial goods in the eurozone.

We expect Polish CPI to achieve the strongest reading in 1Q20 due to strong core inflation contribution, the low statistical base and a potential energy price increase for households. Recent comments by Deputy finance minister Leszek Skiba suggest the government is working on the latter issue. The substantial drop in food prices compared to our previous expectations and plausible governmental intervention may sustain CPI at 3.5%YoY. Previously, we forecasted an increase to 4%.

There is still a lot of uncertainty regarding the inflation level in the second half of 2020.

According to Governor Adam Glapinski, recent central bank projections suggest deceleration below the Bank's target in 3Q (to approximately 2.3%YoY). Our forecast is less optimistic – however, increased energy cost for enterprises and minimum wage hike should result in an upward trend of core inflation next year too. Therefore even in the case of freezing energy prices for households, we expect CPI to reach an average level of 3%YoY in the first half of 2020 and fall only slightly in the later second half.

Even if our inflation outlook materialises, we still expect the central bank to keep rates on hold. The global context is preventing tightening, while the domestic picture does not allow for easing.

## Author

### Rafal Benecki

Chief Economist, Poland

[rafal.benecki@ing.pl](mailto:rafal.benecki@ing.pl)

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