Inflation in Poland continues unabated, could near 7% in December

Inflation is set to continue to rise in the coming months, approaching 7% by December 2021. We see average CPI in 2021 at 4.75% YoY and at 4.5% YoY in 2022. It is quite likely that the NBP may under-deliver with tightening vs elevated market expectations, which should send PLN weaker

5.8% YoY

CPI in September

consensus at 5.5-5.6%

Higher than expected

According to the flash estimate, CPI in September rose to 5.8% YoY from 5.5% in August (consensus at 5.5-5.6%YoY, ING 5.6%YoY). The strong price pressure in Poland is due to the continued high pace of fuel prices (28.6% YoY) and further increases in food prices (to 4.4% from 3.9% in August). Energy prices were 7.2% up, and should accelerate further due to the already announced natural gas price hike, starting from October.

Besides supply-regulatory factors, persistently high core inflation contributes to the high headline as well. We estimate that the core rose to 4.1% YoY from 3.9% in August. We do not know the details yet, the CSO will publish them mid-month. In our view, prices of goods continued to rise as producers passed on rising costs onto consumers amid sustained demand. Prices of services are also likely to have remained high. Rising wages are driving up costs, while households are keen to use services following the relaxation of sanitary restrictions.

In our opinion, inflation in Poland should continue to rise, and by the end of the year it could be close to 7% averaging 4.75%YoY in 2020. We expect it to average 4.5% next year, 1pp higher than the MPC's upper bound for deviations above the inflation target.

The excessive and persistently high inflation in Poland polarizes opinions in the MPC. The minutes from the last MPC meeting showed that in September there was a proposal (without achieving a majority) to raise the reference rate from 0.1% to 2%. The MPC majority continues to indicate that monetary policy changes will be justified if: (1) uncertainty regarding the pandemic and its impact on the economy decreases, (2) forecasts point to the continuation of a favorable economic conditions, (3) there is a risk of inflation rising above the NBP inflation target in the coming years. In this context, November's NBP inflation projection may be important, as it should show an even higher inflation path than in July (that projection was already edging towards 3.5%), with GDP growth projected above the potential.

The market is pricing in a +40bp rate hike this year. We see a risk that the hike may be under deliver vs market expectations, hike would be lower or even postponed to 2022. The fourth wave of the pandemic in Poland is ongoing and its peak may come around the November MPC meeting. Moreover, the balance of payments is deteriorating. After a data revision for 2Q21, the current account surplus fell from nearly 3% of GDP in December-20 to about 0.8% of GDP in 3Q21.

The Council has repeatedly stressed the importance of the zloty exchange rate for GDP growth. The MPC may interpret the decrease in the current account surplus as a threat to GDP growth rather than the second red light (after record high inflation) signaling an overheating of the economy.

Should this reduce the propensity to tighten monetary policy, a weakening of the zloty in November is possible. Admittedly, the zloty gained on Friday, as foreign investors believe that the proposal (rejected) of a 190bp rate hike at the September MPC meeting means that the NBP will follow the Czech CNB (which raised rates by 0.75pp yesterday). In our view, however, there could be a disappointment - MPC can under deliver with the scale of tightening (we see a hike by about 15bp).

The low scale of NBP tightening in November (October hike out of discussion) may push the EUR/PLN to 4.80 in late 2021. This would only add to inflationary pressure domestically, especially in the context of supply constraints for exporters and high inflation in trading partners: in September, inflation in Germany jumped to 4.1% YoY, the highest in 30 years.

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