Poland: MPC hopes economic slowdown will tame inflation – will it?

National Bank of Poland president Adam Glapinski's press conference unveiled that the MPC has a lot of faith in the disinflationary impact of an economic slowdown. In practice, it may prove difficult given the nature of current inflation and the scale of the external energy shock impact on business costs that are still likely to be passed on to consumers

President of the National Bank of Poland, Adam Glapinski

In line with our expectations, Poland's Monetary Policy Council (MPC) decision to hike rates by 25bp was an attempt to find the balance between necessary tightening to tame persistent inflation and responding to deteriorating GDP growth. National Bank of Poland (NBP) president Adam Glapinski suggested that the hike was a reaction to continuing high inflation, and the smaller increment reflected the worsening economic outlook.

Comments on inflation and GDP

Glapinski added that he was not expecting an economic recession (understood as a decline in GDP year-on-year terms – a fall on a quarter-by-quarter basis may happen). He also pointed to the solid condition of the domestic labour market (record-low unemployment and robust wage growth). At the same time, however, leading indicators point to a deceleration in economic activity in 3Q22, the baseline scenario for the NBP economic soft landing.

With concerning price developments in the near term, the NBP president said that inflation will remain high in the coming months, although it should decline somewhat before the end of 2022 as a result of a lower annual rate of growth in energy prices. President Glapinski believes that the summer holiday period was a turning point from which inflation should start to decline.

In our view, however, this is a plateau on which new highs may emerge. The president added that the beginning of 2023 could see inflation rise again due to expected increases in regulated price rises (gas and electricity). In our view, this new peak may be around 20%YoY.

We do not share the NBP's optimism on the relationship between price developments and economic activity. In particular, given the magnitude of the external energy shock and its impact on companies' costs, we are concerned that the GDP downturn will not significantly reduce inflation. Even in an environment of weakening demand, companies will be forced to pass on higher costs to the prices of their products, which raises the risk of a prolonged episode of elevated inflation. An additional upside risk to inflation comes from a potential further significant fiscal expansion in 2023.

Conclusion

We assess that the overall tone of the NBP president's conference was marginally softer than the one in July. Glapinski's opinion about the end of the tightening cycle was cautious, restating that the tightening cycle is not over yet. In October, the MPC may leave rates flat or hike by 25bp. But overall the central bank's president showed high sensitivity to slowing economic growth.

According to the NBP, the ideal scenario is a gradual economic slowdown, with no increase in unemployment, which will cause inflation to decline, further supported by government anti-inflation shields and the freeze of regulated energy prices.

We see the following risks to this scenario:

1. Strong fiscal expansion in 2023 – the inflationary effects of a similar one can still be seen in Hungary today
2. We already have a loose policy mix, so the pro-inflationary spillover effects from the needed and justified protection of firms and families to energy shocks will be greater than abroad
3. The president admitted that inflation is persistent. In our opinion, the NBP is losing the battle against inflation on the grounds of inflation expectations and second-round effects. The soft landing scenario may not be enough to prevent long-term inflation
4. The Polish zloty will remain weak as the NBP is less hawkish than other central banks in the region (i.e. the National Bank of Hungary) and is refraining from FX interventions (like the Czech National Bank).

In our view, the tightening cycle is about to end, but it is not the end of the fight against inflation. We see rates in this cycle reaching 7.5% in late 2022 or early 2023.

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