

Polish CPI inflation falls; a rate cut is surely coming

The decline in Polish CPI inflation is set to continue, supported by a rapid unwinding of external supply shocks. And that should allow the central bank to cut rates by 50-75bp in 2023. However, the slow decline in core inflation compared with the rest of the region suggests that the second stage of disinflation will be difficult. (RESEND WITH CORRECTION)



Inflation is falling in Poland. Pictured: a supermarket in Gdansk

Polish CPI inflation for July came in at 10.8% YoY, compared to 11.5% YoY the previous month. This is what's behind that 0.7pp:

- **Seasonal falls in food prices**, which subtracted 0.6pp from annual CPI inflation
- **Energy**, which subtracted 0.2pp
- **Base inflation** was slightly below our and market expectations at 10.6% YoY, but subtracted only 0.2pp from CPI
- **Fuels** added 0.2pp to CPI

Compared to the CPI peak in February (18.4% YoY), CPI inflation has already fallen 7.6pp. This

reduction in price pressures is mainly due to the decline in external supply shocks. The biggest contributors to this change were fuels (subtracting as much as 3pp from the CPI since February), food prices (subtracting 2.3pp), and energy (-1.7pp). In contrast, core inflation, which is the most important from the central bank's point of view, had by far the smallest impact as it only subtracted 0.6pp.

Importantly, international comparisons within the central European region also show that disinflation in Poland has the least sustainable basis, as since the peak, core inflation has already decreased by a third in Hungary (8.1pp), about 40% in the Czech Republic (7.2pp), but in Poland only by one-sixth (1.8pp).

Why do we expect a rate cut after the holidays, possibly even in September?

According to our current assumptions, CPI inflation could be close to 10% Year-on-Year in August, but it's unlikely to be lower. We will provide a more precise estimate at the end of August. Single-digit inflation (or the certainty that it will be achieved soon) is a condition for the NBP President to cut rates.

Even if August's inflation rate were still in double digits (around 10% YoY), we believe that the NBP will decide to cut rates as early as September. We see at least two reasons for this:

1. The course of inflation in the second half of this year will be either similar to or slightly lower than that indicated by the NBP's July projection (10.3% YoY in 3Q23 and 7.8% Y/Y in 4Q23), and that's where the MPC will be content that the expected disinflation scenario has run its course.
2. Data on economic activity in Poland and Europe suggest a postponement of the economic rebound until the fourth quarter of this year, so the state of the economy in 2H23 will still be weak.

In the short term, the MPC's plans are supported by strong disinflationary trends in global supply chains, which result in a large drop in inflation expectations of companies, indicated, among other things, by the latest National Bank of Poland's economic survey. These trends are still stronger than the rebound in oil and wheat prices. Therefore, the NBP will cut rates by 50-75bp this year, and the easing cycle may continue into 2024.

However, we still point out that the beginning of disinflation, when supply shocks reverse and CPI falls to single-digit levels, is the easier stage in the fight against inflation. The second stage is more difficult and socially costly; that's when inflation has to be brought down to the 2.5% YoY target. And here, the slow decline in core inflation in Poland compared to the region is concerning.

This may suggest that the restrictiveness of the policy mix in Poland is not sufficient. In addition, we are now seeing a rapid improvement in disposable income associated with fiscal loosening. So, rate cuts currently combined with new spending on the fiscal side and increases in the minimum wage will mean it will take a long time for inflation to return to target. Once the current disinflationary impact of the receding supply shocks is exhausted, the fight against inflation will be more difficult.

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