

## Poland: High inflation projection based on unrealistic assumption on energy

The central bank projection of average CPI in 2019 adjusted for a more realistic view on retail electricity prices should be close to the 2.6-2.7% YoY we presented before the last Monetary Policy Council meeting. We stick to our call on no hikes in this cycle. The next move should be a cut rather than a hike



The main point to focus on from November's Monetary Policy Council (MPC) meeting last week was how the new National Bank of Poland (NBP) projections would affect the MPC bias. In our comment on the MPC decision last week we said that the MPC remains less confident but still dovish and we hold our view on flat rates.

On Tuesday the NBP released the November Inflation Report with new projections and assumptions. It turns out that the main driver behind the strong upward revision of the CPI trajectory (average CPI for 2019 was raised from 2.7% YoY expected in the previous July forecasting round to 3.2% YoY) are electricity prices. The NBP has not released all details but based on available assumptions and our models we estimate that the NBP assumed an 18% increase in regulated retail electricity prices.

The assumption regarding the hike of regulated energy prices seems to be politically neutral (in a sense that this is the rise of retail prices implied by a contemporaneous increase of wholesale energy prices by 50% YoY in the last weeks) but unrealistic. In an election year, we assume that retail electricity prices should rise by 5-7%, a level mentioned by Prime Minister Morawiecki and the minister of energy.

The NBP also left unchanged projections of core inflation for 2019-20 (ie, 2.1% and 2.7% YoY average). In our opinion, the lower-than-expected trajectory of core in 2018 called for some downward revision, but on the other hand the inflationary effects of higher wholesale electricity prices were added to core, so finally, both 2019 and 2020 core projections stayed unchanged. Again we don't know what level of wholesale electricity price increases the NBP assumes. Nevertheless, the NBP research said that second-round effects caused by electricity price increases should be limited due to ongoing labour market softening (and stabilisation of wages hikes plans) as well as downside risks for GDP and the lower output gap. Other important CPI drivers stayed almost unchanged ie 2019-2020 food prices and unit labour costs.

The NBP is also more pessimistic on economic growth and revised down its GDP path for 2019-20 to 3.6% and 3.4% YoY respectively (from 3.8% and 3.5% YoY). The driver behind that was lower investment growth by 2 percentage points for 2018 and 1 percentage point for 2019. The NBP also said among others the negative factors was a cost pressure caused by higher electricity prices at the time when economic activity is subsiding. The global and Eurozone negative sentiment was also mentioned as having a limited impact at this stage. The next NBP projection will probably show a further decline in the GDP path in 2019-20 due to the deterioration of the economic situation among Poland's trading partners not included in this projection.

According to our estimates, the NBP projection of average CPI in 2019 adjusted for a more realistic view on retail electricity prices should be close to the 2.6-2.7% YoY we presented before the last MPC meeting. Also, even that number assumes a rather conservative (high) core inflation trajectory for 2019 (2.1% YoY average). We rather see average core at 1.7% YoY, but we expect higher food prices so overall we forecast the same level of average CPI in 2019 (2.6-2.7% YoY).

## Author

### Rafal Benecki

Chief Economist, Poland

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

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