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Tough choices for the National Bank of Poland: Our MPC and NBP projections preview

Inflation may be losing momentum in Poland, but the risk of it persisting is high. The country's central bank has tough choices to make amid looming stagflation, especially when you look at the collapse of the PMI figures. We're expecting a strong response from the NBP: a 75 basis point rate hike accompanied by somewhat dovish rhetoric



National Bank of Poland Governor Adam Glapinski at a press conference in June

We're looking at a technical recession later this year

Inflation in Poland is losing momentum but is still setting new multi-year highs. Long-term challenges remain, namely strong second-round effects and very high inflation expectations. The PMI collapse in June supports our expectation of a technical recession in 2022. The National Bank of Poland has a tough choice amid looming stagflation. Additionally, large CE bank rate hikes raise expectations for an NBP response. The July MPC meeting is a test of the National Bank of Poland's determination. PLN fundamentals have also deteriorated. A hike of 50bp would weaken PLN, 75bp would be slightly negative (dependent on rhetoric), and 100bp positive. We see a 75bp hike

accompanied by dovish rhetoric and a terminal rate at 8.5% this year. 10Y yields to trade sideways until the CPI peaks in 4Q22.

In 2Q22, Poland's GDP kept sound momentum at 7% YoY, marginally weaker than the cyclical peak of 8.5% YoY in 1Q22. Industry is growing at a double-digit rate, and consumption even accelerated. But the PMI collapse in June was the most severe in the region, with the index reaching a 25-month low. Output and new orders posted drops only seen during the pandemic and the Global Financial Crisis. This supports our call for a technical recession in 2H22. On the other hand, consumption doesn't show any signs of a slowdown despite very poor consumer confidence. The aggressive fiscal stimulus helps (c.3% of GDP) as does spending on refugees. Still, this year's growth should reach a sound 4.7% YoY. We downgrade 2023 growth to 2.5% YoY.

The inflation projections are critically important

CPI reached 15.6% YoY in June. While CPI is losing momentum, the index has set a new 28-year high and is far from its peak. We see CPI plateauing in the summer but then reaching local peaks in October and 1Q23, when a new wave of regulated prices and minimum wage hikes appear. The long-term challenges remain, namely strong second-round effects and very high inflation expectations.

In July, the NBP will release new projections. We don't expect much change in the GDP growth numbers (previously NBP at 4.4% YoY, now ING 4.7%YoY. We do, however, see a somewhat downward revision of 2023 GDP expectations (from 3.0 to about 2.5%YoY or lower). The 2022 profile encompasses a technical recession and a very slow recovery in 2023. More important will be the inflation projections. We expect a 3pp upward revision for 2022 and a 2pp for 2023 as we now see average CPI at 13.8%YoY and 11.3%YoY.

The 2024 inflation projections are also important for the markets. Back in March, the NBP saw CPI returning to a range around the target (2.5%YoY +/-1%) for that year, but we don't subscribe to this view. The new projection will provide a reflective choice for the central bank as to whether it should keep tightening to address the risk of persistent inflation, despite the looming economic slowdown and technical recession.

Market implications

FX and money markets: We see the prospects for the zloty as mixed. Interest rate disparity against the euro is large, but at the same time, Poland's trade balance has deteriorated drastically – a CA surplus of 3% of GDP in 2020 is set to flip into a deficit of 5% this year. PLN prospects also largely hinge on general EM sentiment, including Russia triggering more market tensions. We're changing our end of 2022 €/PLN forecast to 4.65 vs 4.50 before, assuming that a weak PLN in the short term may force the NBP to keep hiking despite signs of a GDP slowdown – otherwise, PLN weakening may intensify.

Domestic Debt and Rates: We expect POLGBs to enter a wide sideways trend in 3Q22. Poland is yet to reach a CPI peak (expected in 4Q22 and 1Q23). June swap rates have priced in our NBP policy scenario (terminal rate of 8.5%), so we do not expect bond rates to markedly exceed 8%. Inflows from the Recovery Fund are a major uncertainty as well (payments likely delayed to 2023), as numerous milestones need to be reached first.

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