Poland: A pause in hikes but not yet the end of the cycle

The Monetary Policy Council took a pause in the rate hike cycle but did not to close it, although the end of the cycle is near. The MPC hopes monetary tightening so far will moderate domestic demand pressure and lead to disinflation in 2023. Given upside risks to price developments we see one or two more hikes in this cycle, but further hikes may be needed in 2024

President of the National Bank of Poland, Adam Glapiński

Rationale behind the pause in the rate hike cycle

National Bank of Poland President Glapiński outlined four reasons for stopping the rate hike cycle:

1. The scale of monetary tightening to date, which has strongly reduced demand for housing and consumer credit.
2. The gradual easing of initial shocks (energy, disruptions in supply chains).
3. Waiting for the effects of past increases due to delays in the transmission mechanism.
4. More decisive policy actions by major central banks (Fed, European Central Bank), which will have an impact on global disinflation.

In our view, none of these factors are likely to change in the near future, so effectively we are approaching the end of cycle. Moreover, President Glapiński assessed that it is possible that monetary policy in Poland has already reached its limits. In fact, this reasoning stems from the fact that the NBP is concerned that further tightening could negatively impact economic and financial stability.

MPC too optimistic about future inflation

In our opinion, the governor's view on the future situation mainly contained arguments in favour of a decline in the CPI. We are concerned that the NBP president spoke too little about upside risks to inflation.

Professor Glapiński outlined a scenario in which rate hikes by major central banks (Fed, ECB) and the economic downturn limits upward pressure on global prices, including commodity prices. At the same time, the rate hikes in Poland to date will dampen domestic demand pressures and limit local inflationary pressures. Glapiński believes that the Polish economy is not at risk of recession or a significant increase in unemployment. If the anti-inflationary shields and measures limiting the growth of regulated prices are maintained, inflation should gradually decrease in the course of 2023. According to the governor, the decline in demand pressures will make it more difficult to pass on higher costs to final prices, reducing the secondary effects of past shocks on core inflation.

Referring to the changes in the MPC's post-meeting communiqué, which now mentions a decline in inflation "towards the target" rather than "to the target", the central bank governor acknowledged that the inflation outlook for 2024 is deteriorating.

Future decisions

A decision on whether to end the cycle will be taken at the November meeting, after reviewing the newest macroeconomic projections. At that time, the Council may decide to communicate the formal end of the cycle or it may wait until 1Q23 when the scale of the increase in administered prices is known.

For now, the Council is leaving the door open for further increases. This probably stems from the experience of recent months, when inflation kept surprising to the upside, but also from the experience of other central banks in the region, which declared the end of the cycle but the situation forced them to continue.

Main takeaways from the NBP governor conference

- The MPC de facto allows further weakening of the zloty as it argues that the monetary tightening of the major central banks allow the NBP to hold off on increases in domestic rates. President Glapiński argued that the weakening of the PLN has a relatively small impact on inflation (low scale of the pass-through effect). But the domestic currency came under pressure after the decision and the move continued during the press conference. Since the MPC's decision, the zloty has lost almost 2% against the euro.
- In our view, the inflation picture over the next two years may be worse than indicated by the NBP president. Global interest rate rises and the domestic downturn will not completely halt the so-called second-round effects. The demand barrier will appear, but in the short term the process of passing on costs to prices will be continued due to the large scale of the

shock. Therefore, upward pressure on core inflation will continue in the next 2-3 quarters.

- CPI inflation is indeed expected to fall significantly in 2023 (from around 20% at the beginning of 2023 to below 10% by the end of 2023), but our models indicate that core inflation will be stubbornly high. In addition, the removal of temporary cuts in indirect taxes and caps on regulated energy prices will unleash 'deferred inflation' and add 4pp to CPI in 2024.
- The November MPC policy meeting and the contents of the newest macroeconomic projection will be of key importance in assessing the monetary policy outlook for the coming quarters. We believe the MPC will opt for one-two more rate hikes – in November and possibly early 2023. During 2023, cosmetic cuts are possible, while 2024 will see a renewed fight against persistently high inflation and another tightening of the policy mix, either through rate hikes or a large tightening of fiscal policy will be needed to curb price pressure.

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