Poland: Rates unchanged despite a more hawkish statement

The main reference rate was left at 6.75%, against the consensus of a 25 basis point hike. The Monetary Policy Council argued that the expected economic slowdown and monetary tightening, local and elsewhere, should gradually bring inflation back to target

After the MPC decision, tomorrow's conference by National Bank of Poland President Glapiński is even more important. Thus far, Glapiński has clearly held back on declaring the end of the tightening cycle and that should remain so tomorrow. Otherwise, the Polish zloty may suffer even more. The MPC's decision doesn't help to rebuild investor confidence in Polish government bonds. In our view, the strong weakening of Polish debt, with 10-year yields peaking at 9% in October, was not only due to investor concerns about the high borrowing needs of the budget in 2023, but also was caused by the belief that inflation will remain persistently high, necessitating future hikes.

The MPC statement sounded more hawkish and CPI projections were revised up

The tone of the November post-meeting statement is relatively hawkish given the lack of a decision on a rate hike. In the passage on inflation, attention was drawn not only to commodity shocks, but in first instance the second-round effects (the transmission of high corporate costs to final prices) and demand pressures are mentioned as CPI drivers. Both of these factors increase core inflation.

The second important change is in the projections. The NBP's expected economic growth in 2023-2024 has been slightly lowered, while the inflation path was revised up, above the July scenario. It is worth bearing in mind, however, that the July projection assumed the expiration of the Anti-Inflation Shield (VAT and excise tax cuts on electricity, gas, heating, fuel and food, among others) in October of this year. According to NBP Deputy Chairman M. Kightley, the November projection assumes the freezing of energy prices announced by the government and the maintenance of the Inflation Shield in 2023. Despite such assumptions and lower GDP growth, the inflation path went up.

Still, the MPC's conclusion has not changed. The Council believes that the rate hikes made so far, as well as the slowdown of the economy, should support a decline in inflation, towards the NBP's inflation target. The MPC also hopes that low inflation should be supported by an external slowdown and rate hikes by major central banks. At the same time, it acknowledged that inflation should remain high in the short term, with a gradual return to the target.

Comparison of NBP projections

	2022	2023	2024	2025
GDP				
NBP Jul'22 projection	4.7	1.3	2.3	-
NBP Nov'22 projection	4.6	0.7	2.1	3.1
ING	4.3	1.5	3.3	3.5
CPI				
NBP Jul'22 projection*	14.2	12.3	4.1	-
NBP Nov'22 projection	14.5	13.2	5.9	3.5
ING	14.5	14.1	11.6	6.5

**) Inflation shield (lower VAT on energy & food) until end-Oct'22*

**) Inflation shield (lower VAT on energy & food) until end-2023*

Source: NBP, ING.

We do not know the quarterly backdrop of the CPI projections, but the average of the ranges for the annual data suggest that inflation will not approach the target until 2025, so an extended period of elevated inflation lies ahead. The fact that inflation is unlikely to return to the NBP's target within the monetary policy horizon (4-7 quarters) suggests that there is still room for tightening.

NBP rates remained unchanged for the second consecutive month, but this does not look like the formal end of the hike cycle. In its statement, the MPC said that further decisions should depend on incoming information on inflation and economic activity. At tomorrow's conference, the NBP president should rather refrain from declaring the end of the tightening cycle.

Our inflation and rates view

Inflation risks remain high, and the peak in inflation is still ahead of us. In our view, it will occur in February 2023 at around 20%. Also, the NBP is no longer talking about inflation stabilisation in the second half of 2022, but sees CPI peaking in early 2023, as do we.

Over the course of 2023, CPI is expected to drop from 20% year-on-year to below 10%, but in 2024, inflation should remain stubbornly high. Our models indicate that even a slowdown in GDP to around 1-1.5% YoY in 2023 will not bring inflation even close to the NBP's target of 2.5% YoY. We see strong second-round effects (easy pass-through of corporate costs to retail prices), high inflation expectations of companies and households. The experience of other countries where inflation expectations were "deanchored" and the price spiral was set in motion shows that in order to combat stubbornly high inflation, a decisive tightening of the policy mix, i.e. monetary and fiscal policy, was necessary.

Therefore, either further rate hikes or strong fiscal tightening await us in 2024. The ultimate cost of fighting long-term high inflation will be higher than if the tightening of the policy mix were greater today.

The post-meeting statement indicates that the NBP rather targets a reversal of the inflation trend and want to facilitate a soft landing for the economy rather than bring inflation down to 2.5% as quickly as possible. Such a strategy raises the risk of perpetuating high inflation expectations, and this could entail higher costs of containing CPI in the future.

Author

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Adam Antoniak
Senior Economist, Poland
adam.antoniak@ing.pl