

## Poland: Inflation will pick up next year but rates won't change

CPI came in below expectations again in October. We see a high probability of the CPI temporarily undershooting the lower band of the central bank's (NBP) target in November and December. But given the strong increase in electrical energy costs, inflation should rebound and flirt with 3% year-on-year in 2Q19



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According to the flash reading, CPI decelerated from 1.9% to 1.7% YoY. A major surprise came from food prices (dropping from 2.3% to 1.7% YoY). Also, core inflation showed no sign of accelerating – based on available data we estimate it was flat at 0.8% YoY. In November and December, CPI will be suppressed by statistical effects on food and fuel prices. The risk of undershooting the lower band of the NBP target (a drop below 1.5% YoY) is significant.

Still, the 4Q weakness should be temporary. A certain increase of the retail electric energy tariff should add 0.2 percentage points to the headline in January (based on comments of the Minister of Energy, we assume 5% growth). The government will also effectively introduce a new emission fee, adding another 0.1 percentage point. As such, we expect CPI to move above 2% YoY no later

than March.

The strongest acceleration should occur in 2Q19 as a result of a strong increase in wholesale energy prices (up to 50% YoY). Based on the structure of manufacturing enterprises' costs (energy accounts for 2.2% operational costs) we expect PPI to increase by about 1.5 percentage points. Our model suggests a PPI increase of 1 percentage point should add 0.15 percentage points to core inflation with a two to three quarter lag and 0.1 percentage point to CPI. Core inflation should increase by 0.2-0.3ppt. Another 0.1ppt should come from public transportation services (railways, trams etc.), where electrical energy constitutes approximately 15% of costs. Therefore CPI should reach a peak of close to 3% YoY by the end of 2Q19.

We expect the Monetary Policy Committee to maintain its dovish bias (but no longer ultra-dovish), despite the expected increase of consumer prices. We think that the new NBP projections should show CPI staying around the target (2.5%+/-1%). The NBP governor is likely to highlight that the CPI changes are caused by supply shocks and the risk of overshooting the inflation target remains under control. Additionally, the economic outlook for the eurozone is worsening. Thus we reiterate our forecast for interest rates to remain flat until the end of 2020. The MPC should not risk a late cycle hike and react to a temporary CPI rise due to the approaching GDP slowdown.

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