Poland: Strong GDP in 2Q; Core CPI drop is temporary

Second-quarter GDP was revised upwards slightly. Election transfers have extended the consumption boom while investment slowed a little. CPI decelerated in August but the risk of overshooting the National Bank of Poland's target in the first quarter of 2020 is significant

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GDP

GDP growth for the second quarter came in at 4.5% year-on-year, slightly above the flash figure (4.4%). The election transfers extended a consumption boom - private consumption accelerated by 4.4% YoY vs 3.9% YoY in 1Q19. In 2Q19, the retiree lump sum was paid out, which shifted the dynamics of household income from about 6% YoY to 9% YoY and prompted a reacceleration of consumer spending. We think services were a strong contributor, which has boosted inflation.

Investment decelerated from 12.9% to 9% YoY as the contribution from the energy sector diminished in 2Q. The slow down in construction production and a reduction of EU money suggests a further slowdown of public outlays. Private investment recovered but with a strong lag (i.e. after two years of near 5% YoY GDP growth).

Net exports remained neutral despite lower demand from Germany and the eurozone.

In the third quarter, we expect slightly lower GDP growth (4.1-4.3%YoY). The extension of child benefits (another pre-election transfer) should further boost private consumption to 5% YoY. On the other hand, worsening sentiment in construction does not bode well for investment. We expect a deceleration of investment to 5-6% YoY.

All in all, we expect the annual GDP figure to reach 4.4% YoY. The major risk lies on the external side. The risk of a protracted US-China trade war suggests a more severe global slowdown. Polish exports have been almost untouched so far, but when eurozone domestic demand suffers, it should hit production here, too. The sensitivity of the Polish economy to the global slowdown should rise strongly in the second half of 2020 when the impact of pre-election transfers has passed.

CPI

According to the August flash reading, CPI decelerated slightly from 2.9% to 2.8% YoY, in line with the consensus. The drop was caused by fuel prices and core inflation. We estimate the latter dropped from 2.2% to 2%. The weaker core CPI figure reflects the lower contribution from medication after a temporary shortage shock in July. But food prices accelerated again from 6.7% to 7.2% YoY.

Looking ahead, the major focus should be on the first quarter figure. We expect CPI to overshoot the upper boundary of the NBP's inflation target (3.5% YoY) due to strong core inflation (reflecting sound demand, rising labour costs and a recent depreciation of the Polish zloty) as well as electrical energy price increases.

Still, the monetary policy committee is unlikely to react and should maintain stable rates. The overshoot should be temporary – after the first quarter of 2020, CPI is likely to return to 3%. Furthermore, an increasingly negative outlook for the global economy and prospective policy loosening amongst major central banks should offset the effects of higher inflation. MPC hawks may be more vocal in coming months but given the global backdrop, they should remain in the minority, with rates staying on hold next year.

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