

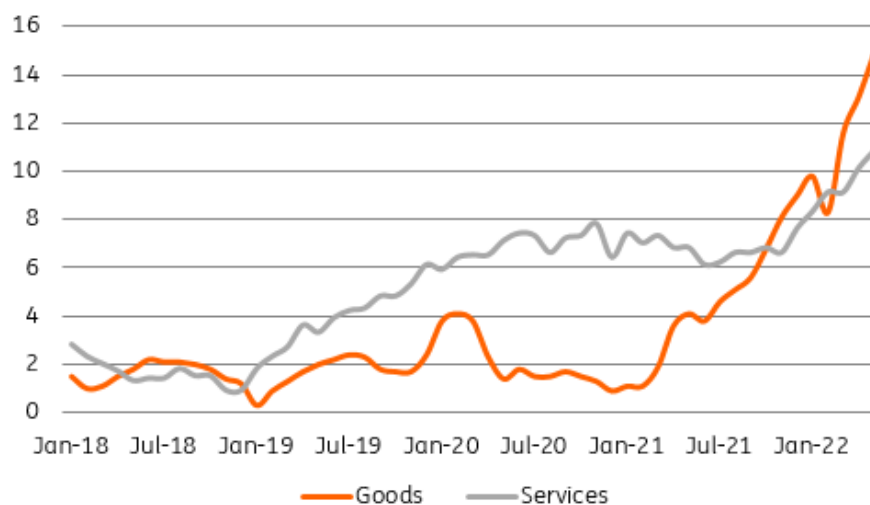
## Poland: Strong inflation points to longer rate hike cycle

Poland's statistical office confirmed its May flash inflation estimate at 13.9% year-on-year. External factors still play important role in driving inflation, but rising core inflation is increasingly worrying as it points to strong second-round effects. The risk of double-digit rates is rising, although this is not a baseline scenario, yet



In May, CPI inflation amounted to 13.9% YoY with prices of goods jumping by 14.9% YoY and services 10.8% higher than in May 2021. External factors continue to play a significant role in inflation. The increase in prices of food and non-alcoholic beverages (13.5% YoY), energy (31.4%YoY) and fuel (35.4%YoY) accounted for about two-thirds of the annual increase in total prices. However, a much more worrying development is the further significant increase in core inflation, which points to intensifying second-round effects. We estimate that core inflation, excluding food and energy prices, increased in May to around 8.5% YoY from 7.7% YoY in April. In a favourable economic environment (robust consumer demand), companies have no major problem in passing on higher energy, transport, material, and labour costs to the prices of their products and services.

## Prices of consumer goods and services, %YoY



Source: GUS.

The outlook for the coming months suggests that significant risks to further strong price growth remain. In June, we may witness a double-digit increase in fuel prices on a monthly basis and continued pressure from food prices and core categories. The second half of 2022 is likely to be marked by consumer price increases of 15-20% YoY, with a peak in 4Q22. Autumn may bring renewed increases in energy prices, especially for heating fuel. In turn, at the beginning of 2023, we should expect a marked increase in regulated prices, including electricity and gas. As a result, we do not share the view of the NBP governor Adam Glapiński that we are nearing the end of the interest rate hike cycle and that the conditions for interest rate cuts may emerge towards the end of next year. Of course, the inflation outlook is subject to extremely high uncertainty, but the distribution of risks is strongly tilted towards still high inflation. Moreover, it is worth noting that the ECB is yet to start its rate hike cycle, and market expectations for terminal rates in the euro area and the US have shifted markedly upwards in recent days.

We have already been pointing out for some time that the decade of low interest rates is over, and the MPC may have to raise interest rates close to 10%. The risk has increased in recent weeks that containing inflation may require an increase in NBP rates to double-digit levels, but this is not our baseline scenario. Global inflation expectations and fears of a more decisive tightening of monetary policy by the major central banks are mounting. The policy mix continues to be a domestic factor hampering the fight against inflation. Increasingly restrictive monetary policy is accompanied by increasingly expansionary fiscal policy. Fiscal stimulation amid a significant positive output gap leads to a build-up of internal (rising inflation) and external (rising current account deficit) imbalances.

## Author

**Adam Antoniak**

Senior Economist, Poland

[adam.antoniak@ing.pl](mailto:adam.antoniak@ing.pl)

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