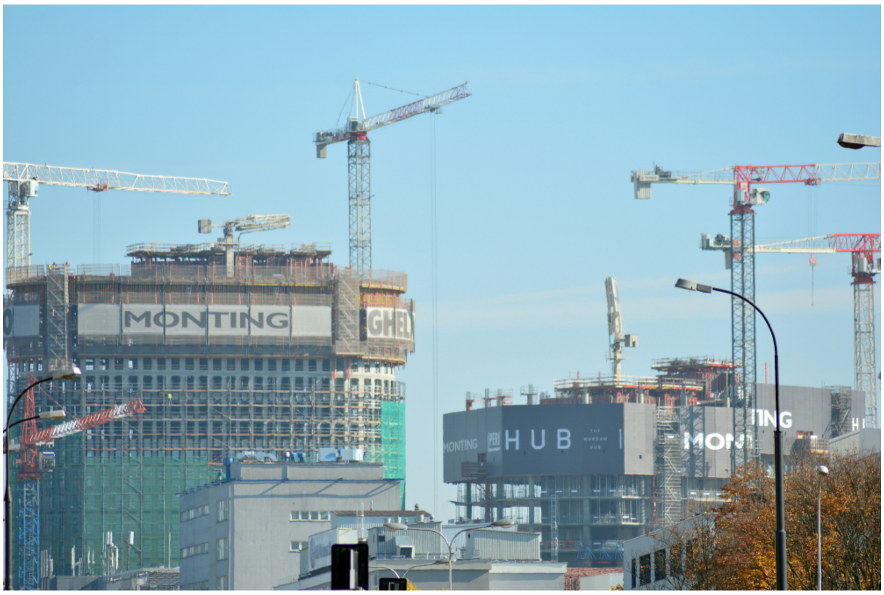
Poland: Weaker than expected production and higher PPI

The momentum in production is weakening. For the time being, disruptions in supply chains are being offset by the diversified nature of production. Cost pressures remain high and should be passed on to finished goods prices amid strong demand



Construction of the 'Warsaw Hub', Poland

+18.4%

Lower than expected

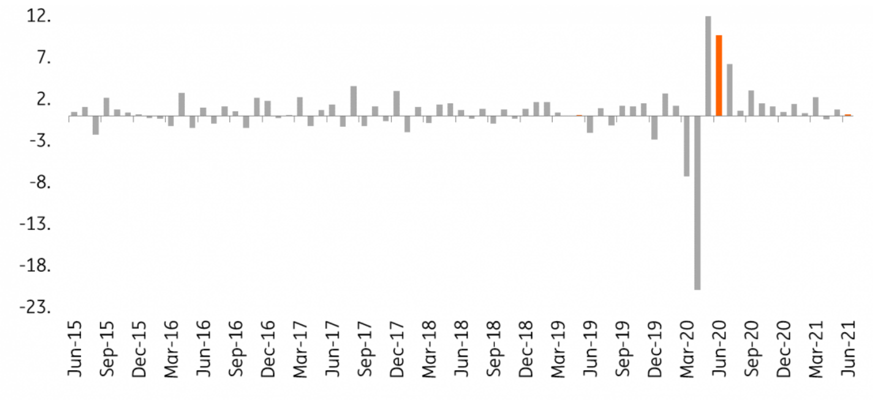
Industrial production in June (YoY)

compared to the consensus at +19.0%

In June, industrial production increased by 18.4% year-on-year after 29.8% growth in May. The production of motor vehicles rose by 17.4% YoY (103.9% in May), computer output was up 47.5% (70.2% in May), and furniture production grew 13% (41.8% in May). Production of durable consumer goods was higher by 24.7% YoY, capital goods rose by 18.8% and intermediate goods were up 23.9%.

These high annual rates still reflect last year's low base. This factor, however, is gradually fading. Monthly growth rates, net of seasonal factors, are more informative. In June, industry grew by 0.2% MoM compared to 0.8% in May. This clearly shows the slowing momentum of production growth. So far, manufacturers have managed to mitigate supply disruptions due to the diversified nature of production.

Industrial production (%MoM, seasonally adjusted)



Source: CSO

The breakdown of production growth suggests that domestic demand is playing a stronger role. This was also indicated by business surveys, which showed a strong increase in domestic orders, as the reopening effect continues.

In our opinion, a strong rebound in domestic demand should close the negative output gap in Poland at the turn of 2021/2022. The July projection from the National Bank of Poland is even more optimistic. According to central bank experts, the positive output gap will start to accumulate from 3Q21.

This is a pro-inflationary factor. This year it is not expected to generate high pressure, as inflation should still be mostly driven by supply/regulatory factors. However, it should become more evident from next year, supported by a double fiscal stimulus (investment from the Recovery Fund and tax changes from the Polish Deal).

Disruption in supply chains generates increasing cost pressures

Increasing demand faces barriers on the supply side, causing rising costs of production components, transport and labour. High cost pressures accompanied by sustained demand leads to an increase in the prices of finished goods. In June, PPI inflation in Poland accelerated to 7.0% YoY from 6.6% in May (after adjustment from 6.5%). Prices in manufacturing continued to grow strongly, at 6.9% YoY vs. 6.4% in the previous month.

This is the second factor, besides the rebound in demand, that should generate upward pressure on CPI next year. Our models indicate that the statistically strongest impact of PPI changes on CPI has a lag of about two to three quarters.