Poland's CPI is declining, but core inflation remains persistently high

Consumer price inflation in Poland eased to 13.0% year-on-year in May, but the mid-term prospects are still uncertain amid the expected economic rebound, fiscal expansion and robust growth of wages due to the tight labour market and a sizable increase in the minimum wage

Further decline in headline inflation

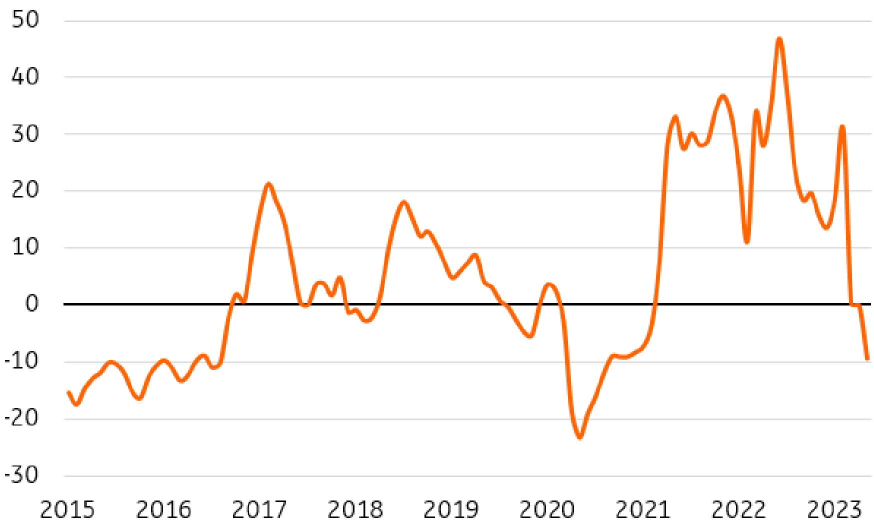
Consumer price inflation eased to 13.0% year-on-year in May from 14.7% YoY in April. Prices did not increase in month-on-month terms for the first time since February 2022. Goods inflation (which is normally closely linked to external factors) is falling faster than services price inflation (which is associated more with domestic developments). In May, goods prices increased by 13.3% YoY compared to 15.1% YoY a month earlier, while services prices rose by 12.3% YoY compared to 13.3% YoY a month earlier.

Energy prices continue to normalise

The gradual normalisation of energy markets has been a significant contributor to disinflation, knocking off one percentage point from annual inflation in May compared with April. Gasoline and diesel prices fell by 9.5% YoY, while the increase in the price of energy for households slowed last month to 20.4% YoY from 23.5% YoY in April. Since February, we have seen a decline in the price level of energy carriers, which has been driven primarily by cheap fuel (mainly coal) and liquefied petroleum gas. Food prices rose more slowly in May than in the corresponding month of the previous year.

Fuels for passenger cars lower than last year

Gasoline and diesel prices, %YoY



Source: GUS.

Core inflation has finally started to ease

May brought a substantial decline in core inflation. According to our estimates, cor inflation fell last month to 11.5-11.6% YoY from 12.2% YoY in April. After months of stabilisation, we also saw a decline in services inflation. Still, the underlying core inflation picture in Poland's economy is less favourable than in the Central and Eastern European region, especially in the Czech Republic. In Poland, core CPI has declined from its peak by just 0.7pp, compared to 6.1pp in the Czech Republic, 2.8pp in Hungary and 1.8pp in Romania.

Mid-term upside risks to inflation even higher

The downward trend in CPI will continue and it should reach single-digit levels in September. Chairman of the National Bank of Poland, Adam Glapinski, suggested last week that this might prompt the Monetary Policy Council to cut interest rates. In our view, such a move would be premature.

In Poland, the pace of disinflation will visibly slow in the fourth quarter and a further decline to target cannot be taken for granted. Especially in the context of the expected rebound in economic activity and expansionary fiscal policy. The government has increased this year's state budget deficit to PLN92bn (by PLN24bn) and will boost 500+ child benefits to PLN800 in 2024. In addition, the minimum wage will increase by more than 20% next year. In our view, this will translate into continued double-digit growth in average wages in the economy, keeping core inflation elevated.

In this context, a possible rate cut at the end of 2022 is more likely to be a one-off move, while the regular monetary easing cycle is likely to start in the third quarter. We note that Poland's core inflation picture is the least favourable in the CEE region. Yesterday's Fed decision to leave interest rates unchanged, and today's 25bp hike by the ECB, suggest that central banks in developed countries want to maintain expectations of hikes because they see upside risks to inflation.

In our view, to bring inflation down to the target requires a decline in the wage growth rate below 5% YoY and a paradigm shift in economic policy, i.e. less consumption and more investment. The recent fiscal loosening raises concerns about whether the favourable GDP composition seen in the first quarter will continue in the following quarters.

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