Poland Macro Weekly

Macro Research

16 September 2022

Bank Polski | Centrum Analiz

Energy prices frozen for this winter?

TOP MACRO THEME(S):

- **Are inventories swinging the CAB? (p. 2): The rapid deterioration of the current account balance (by 7pp of GDP) is unprecedented. We argue that apart from terms of trade shock it results from the unusually strong inventory cycle, that is likely to reverse.**

WHAT ELSE CAUGHT OUR EYE:

- **CPI inflation in August was 16.1% y/y vs. 15.6% y/y in July** (in line with flash figure). The monthly data showed an acceleration in food prices, a strong increase in prices of energy carriers (especially solid fuel; we remind that gas and electricity prices are administratively regulated). Core inflation rose to 9.9% y/y from 9.3% y/y in July, with growths cumulated in a few categories. For the remainder of year we expect CPI inflation to be relatively stable, at around 16% y/y (with the biggest uncertainty surrounding fuel and energy prices). In early 2023, we expect inflation to rise above 17% y/y with the entry into force of higher energy tariffs and a higher minimum wage. By the end of 2023, CPI inflation should return to single-digit regions.
- **The Government plans to freeze electricity prices for households** for consumption up to 2,000 kWh/year. Price hikes (with still no indications about their potential level) would then impact only the consumption above this level (which by the way is close to the yearly consumption for an average household). Additionally, a mechanism to encourage energy saving will be introduced. The cost should be partly covered by the windfall taxes on energy companies (>0.5% GDP). The ministry in charge of energy plans to reform the market to stabilize and lower prices for end-users.
- **The minimum wage in 2023 will be raised by 19.6% (the 2nd highest increase since 2005).** The increase will be stepwise – to PLN 3490 since Jan 1 and PLN 3600 since Jul 1. In result the minimum wage will account for app. 50% of the average wage in the business economy. This is a GDP and fiscal position positive news, but might extend the time needed to bring the CPI inflation back to the target.

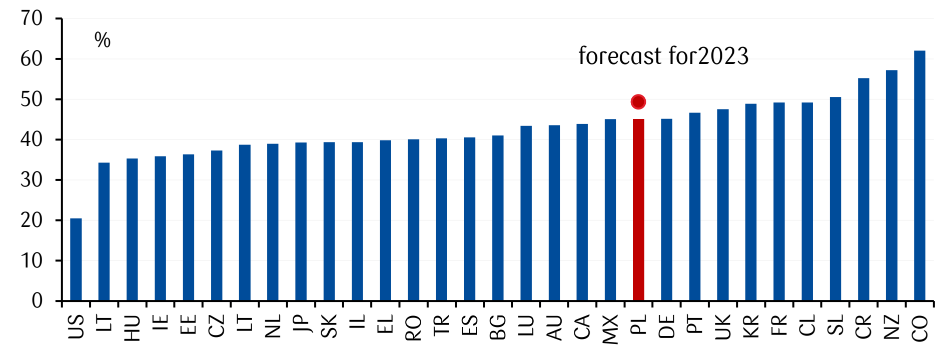
THE WEEK AHEAD:

- A series of data from the real economy for August (labour market, industrial output, retail sales) should confirm, that the economy is only in a slow-down, not a sudden-stop mode.

NUMBER OF THE WEEK:

- **51.6% GDP** – public debt to GDP ratio decreased in 2q22 from 52.1 in 1q22.

Chart of the week – minimum wage as a % of average wage in 2021



Source: OECD, PKO Bank Polski.

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	2021	2022†
Real GDP (%)	5.9	4.5
Industrial output (%)	15.6	9.4
Unemployment rate# (%)	5.4	4.9
CPI inflation** (%)	5.1	13.8
Core inflation** (%)	4.1	8.5
Money supply M3 (%)	8.9	5.8
C/A balance (% GDP)	-0.7	-4.5
Fiscal balance (% GDP)*	-1.9	-2.8
Public debt (% GDP)*	53.8	50.8
NBP reference rate## (%)	1.75	7.00
EURPLN‡##	4.60	4.66

Source: GUS, NBP, MinFin, †PKO BP Macro Research team forecasts;‡PKO BP Market Strategy team forecasts; *ESA2010, **period averages; #registered unemployment rate at year-end; ##at year-end.

Are inventories swinging the CAB?

- **The rapid deterioration of the current account balance is a fact. Its scale (7pp of GDP) is unprecedented in the history of the Poland. However, we can observe similar trends in other countries in our region.**
- **The current account deficit is the result of the terms of trade shock in goods, which applies to energy, raw materials and intermediate goods.**
- **In our opinion, the deterioration of the trade balance in intermediate goods is also a result of the extraordinary accumulation of inventories by domestic enterprises. The likely reversal of the inventory cycle and the visible easing of supply constraints in global trade might trigger an improvement in the trade balance in the coming quarters.**
- **A profound deficit in the primary income account is in 60% "self-financing" thanks to re-invested profits under FDI. However, we can see a deepening deficit in compensation of employees, resulting from the short-term nature of migration to Poland and the influx of war refugees from Ukraine.**

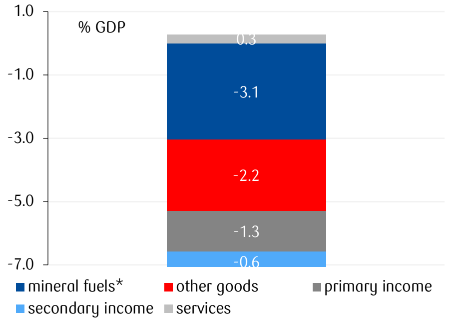
Current account deficit in July widened to EUR 1.735 billion vs. EUR 1.468 billion in June. In 12m terms the deficit increased to 4% of GDP from 3.9% of GDP after June. The current and capital account in July was positive, for the first time in 7 months, and the 12m rolling sum stabilized at 2.9% of GDP, indicating that the demand for external financing has not increased as compared to June. The external deficit is still easily financed by the inflow of FDI, the main component of which are reinvested profits (at the level of approx. 60%) of enterprises with foreign capital.

Trade balance was the main factor behind the monthly CAB deficit, it has been negative for 14 months now. In July, as compared to June, the dynamics of both exports and imports of goods decelerated - exports increased by 19.9% y/y against 25.8% y/y a month ago, while imports by 23.5% y/y vs. 31.5 % y/y in June. The NBP noted that July has brought the first significant increase in exports in the automotive industry since many months, which suggests the unblocking of global value chains. On the other hand, attention is drawn to the weakening of the upward trend in imports of intermediate goods, which - apart from the normalization of prices - may be related to the reversal of the cycle (decline) of import-intensive inventories, which is indicated, among others, by PMI's and anecdotal evidence from the enterprise sector.

Looking at the CAB in a wider perspective we see that the balance has deteriorated by an unprecedented 7pp of GDP in just 19 months. Similarly strong changes have been observed in the joint current and capital account balance, indicating an increased need for external financing. The CAB deterioration since the beginning of 2021 was caused mainly by worse trade tbalance (by 5.4pp), but some worsening has also occurred in the primary income (by 1.2pp) as well as in the secondary income (by 0.7pp). The surplus in services has increased by 0.3pp of GDP.

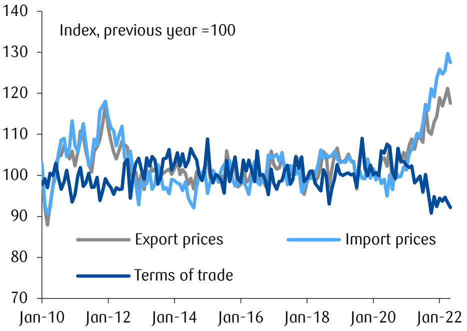
The occurrence of trade deficit is the result of terms of trade shock, i.e. a much faster increase in import prices than in export prices, which is also observed in other economies in the region The sharp increase in import prices of energy commodities is responsible for more than half of the deterioration in the Polish trade balance over the last 6 quarters. However the sharp increase in trade deficit during last year also applies to the category of intermediate goods. Less fluctuations were observed in investment goods (with a slight deficit) and consumer goods (with a solid trade surplus). In our opinion, the growing deficit in intermediate goods may be related to supply constraints with which the global economy struggled during the post-pandemic recovery. It resulted in, on the one hand, a marked increase in component prices, and on the other, it has forced a change in the style of inventory management among enterprises from just-in-

Change of CAB vs. Jan'21



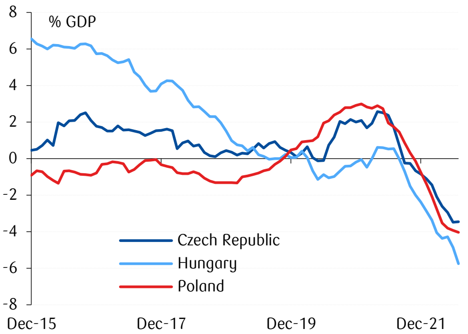
Source: NBP, Eurostat, GUS, PKO Bank Polski. *corrected by classified part, as of June 2022

Import and export prices



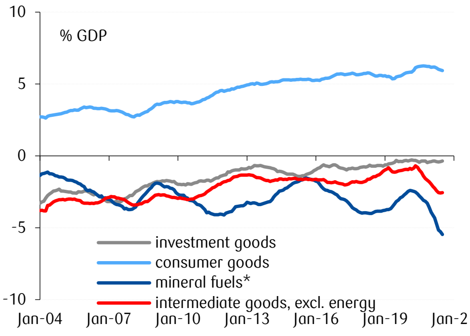
Source: NBP, PKO Bank Polski.

CAB in the region



Source: Macrobond, PKO Bank Polski.

Trade balance by category



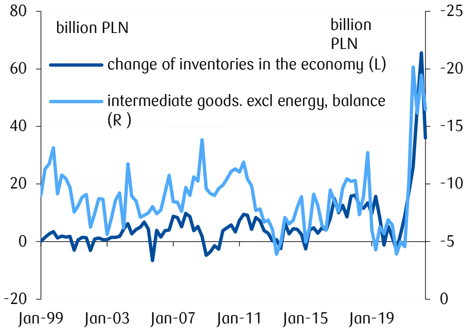
Source: Macrobond, PKO Bank Polski. . *corrected by classified part time to just-in-case deliveries. As a result inventories in the economy have increased at a very rapid and unprecedented pace.

The reasons for the deterioration in the trade balance described above mean that it is not of a structural nature and in the medium/long term the situation should improve, thanks to the decline in commodity prices and lower demand for components due to the reversal of the inventory cycle/decline of inventories.

The deficit on the primary income account after July amounted to 4.9% of GDP. The bulk of it came from the negative balance in income from investment, but an increasingly negative balance of compensation of employees has also been observed. The deeply negative balance of investment income mainly reflects the profits of direct investors achieved in domestic entities. Almost 60% of these gains are re-invested and return to the Polish economy as an FDI inflow - the deficit in investment income is therefore largely and increasingly self-financing. The increase in the deficit of compensation of short-term employees is less spectacular, but in our opinion it may have some more serious consequences. Short-term workers from Ukraine have been coming to Poland since 2014 and for several quarters their earnings have surpassed earnings of Polish workers abroad. This balance will probably worsen even more due to the influx of war refugees, most of whom have probably already started to work in Poland.

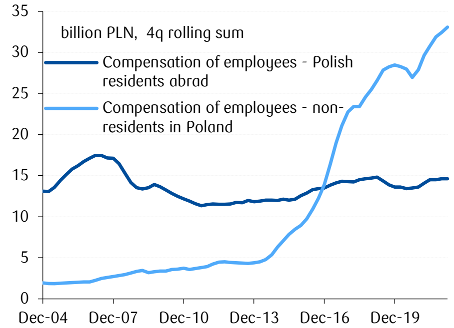
The capital account currently shows a surplus of 1% of GDP, which is almost two times less than at the beginning of 2021 and three times less than in the best period of 2015. The deterioration of the capital account results from two factors - on the one hand, we have lower revenues from capital transfers, which include EU structural funds allocated to the development of infrastructure. On the other hand, there is an increase in expenditures in the category of purchase/sale of non-financial assets. This category includes the purchase and sale of patents, copyrights, licenses and trademarks. The lack of inflow of funds under the Polish Development Fund will prevent/delay the previously expected improvement in the capital account. In addition, aid provided by Poland free of charge to the fighting Ukraine may be recorded as an outflow on the capital account. Therefore, the surplus on the capital account could be expected to decline in the near future

Inventory cycle vs. trade balance



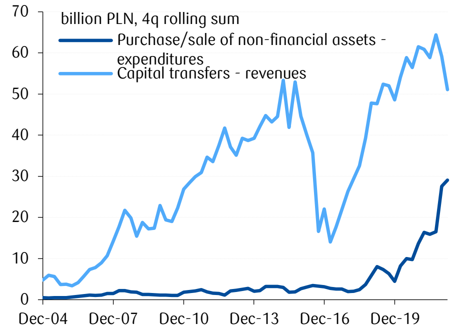
Source: GUS, Eurostat, PKO Bank Polski

Compensation of employees



Source:, NBP, PKO Bank Polski

Capital account



Source:, NBP, PKO Bank Polski

Weekly economic calendar

Indicator	Time (UK)	Unit	Previous	Consensus*	PKO BP	Comment
Tuesday, 20 September						
GER: PPI inflation (Aug)	7:00	% y/y	37.2	37.4	--	--
SE: Riksbank meeting (Sep)	8:30	%	0.75	1.50	**1.50**	--
POL: Wages (Aug)	**9:00**	**% y/y**	**15.8**	**13.9**	**13.5**	**Wages growth rate in enterprises should come back to app. 13-14% y/y after one-off spike at 16% y/y triggered by bonus payments in some branches.**
POL: Employment (Aug)	**9:00**	**% y/y**	**2.3**	**2.4**	**2.4**	**We expect a steady growth of employment in enterprises due to still strong demand on the labour market.**
POL: Industrial production (Aug)	**9:00**	**% y/y**	**7.6**	**9.7**	**9.9**	**We expect a continuation of fast growth in investment goods production (e.g. machinery) and further rebound in the automotive sector.**
POL: PPI inflation (Aug)	**9:00**	**% y/y**	**24.9**	**24.8**	**24.6**	**PPI inflation peaked in recent months and now, due to falling energy commodities prices should slowly decline.**
USA: Building Permits (Aug)	13:30	mln	1.685	1.615	--	--
USA: Housing starts (Aug)	13:30	mln	1.446	1.433	--	--
Wednesday, 21 September						
POL: Consumer Confidence (Sep)	**9:00**	**pts.**	**-44.9**	**--**	**--**	**Moods are likely to be undermined by soaring prices and high uncertainty**
POL: Construction output (Aug)	**9:00**	**% y/y**	**4.2**	**4.3**	**2.0**	**Hampering housing market as well as the delay of EU funds influx means lower demand for the construction sector.**
POL: Retail sales (Aug)	**9:00**	**% y/y**	**2**	**3.0**	**3.9**	**Our internal card expenses data indicate that in August the consumer spending was still high.**
USA: Existing home sales (Aug)	15:00	mln	4.81	4.62	--	--
USA: Fed meeting (Sep)	19:00	%	2.5	3.25	3.25	--
Thursday, 22 September						
SWI: SNB meeting (Sep)	8:30	%	-0.25	0.50	0.50	--
NO: Norges Bank meeting (Sep)	9:00	%	1.75	--	**2.25**	--
UK: BoE meeting (Sep)	12:00	%	1.75	2.25	2.25	--
POL: Money Supply M3 (Aug)	**13:00**	**% y/y**	**6.2**	**6.2**	**6.3**	**Dynamics of M3 should stabilize in August near 6.3% y/y.**
USA: Current account balance (2q)	13:30	bln USD	-291.4	-273.5	--	--
USA: Initial Jobless Claims (Sep)	13:30	ths.	213	--	--	--
EUR: Consumer Confidence (Sep, flash)	15:00	pts.	-24.9	-26.0	--	--
JP: BoJ meeting (Sep)	--	%	-0.1	-0.1	-0.1	--
Friday, 23 September						
GER: Manufacturing PMI (Sep, flash)	8:30	pts.	49.1	48.5	--	--
GER: Services PMI (Sep, flash)	8:30	pts.	47.7	47.2	--	--
EUR: Manufacturing PMI (Sep, flash)	9:00	pts.	49.6	48.7	--	--
POL: Unemployment Rate (Aug)	**9:00**	**%**	**4.9**	**4.9**	**4.9**	**MinLab fast estimate should be confirmed by GUS, leaving the unemployment rate unchanged for the 3rd month.**
EUR: Services PMI (Sep, flash)	9:00	pts.	49.8	49.0	--	--
USA: Manufacturing PMI (Sep, flash)	14:45	pts.	51.5	52.0	--	--

Source: GUS, NBP, Parkiet, PAP, Bloomberg, Reuters, PKO Bank Polski. Parkiet for Poland, Bloomberg, Reuters for others.

Monetary policy monitor

MPC Members	Hawk-o-meter*	Recent policy indicative comments^
L. Kotecki	4.8	**“It seems to me that it is too early to stop the cycle. (...) Rates should be at a higher level. Core inflation is at 10 percent, so we have an answer as to what level rates should be at. The rate increases are too small." (12.09.2022, PAP, 14.09.2022 Gazeta.pl, TVN24, PAP)**
H. Wnorowski	4.2	**“We expect inflation to stop rising. I personally expect the September figure to be below the August reading (PKO: 16.1% y/y. If indeed such a situation is confirmed, it is highly likely that this September hike would be the last in this cycle, but these are hypothetical divagations.” (12.09.2022, Radio Bialystok, PAP)**
A. Glapinski	3.4	“The summer holiday period is probably the turning point in our inflation, that highest inflation point. This is the plateau, it may be a little higher or lower, but essentially this is the high ceiling from which inflation will gradually decline. (...) As we go down with inflation, there is room to lower interest rates. (...) We have not formally completed the cycle of increases. Our next decisions will depend on incoming data. (...) What about interest rates in October? Either no change in the level of rates, or an increase of 25 bps. - This is what the Council will be considering. (8.09.2022, NBP press conference, PAP)
I. Dąbrowski	3.1	“In my opinion, if there will be another rate hike, it will be rather small - on a comparable scale to the last one (50bp - ed.) or even lower. If the decision depended solely on me, I would not raise rates at all anymore, or at most once by 25 bps.“ (19.07.2022, PAP)
C. Kochalski	3.1	**"The space for further rate hikes has decreased significantly, and the probability of the end of the hike cycle has increased. After the MPC's September decision, the probability of no change in rates in October increased.” (12.09.2022, Reuters).**
P. Litwiniuk	2.9	“I think this (PKO: 25bp hike) is the baseline scenario, it can develop towards a higher hike in September, if confirmed by incoming data up to September 7 (PKO: MPC meeting date).” (1.09.2022, TVN24, PAP)
W. Janczyk	2.4	“The coming months, I hope, will bring no particular reasons to continue the interest rate hike cycle, although the impact of energy prices in the upcoming autumn-winter season on the economy and consumers is hard to predict right now. (...) "The council will act adequately to situation in our economy. In my opinion, it will strive to keep the lowest possible interest rate levels [while] targeting a realistic return to the inflation target.” (21.07.2022, PAP).
J. Tyrowicz	--	**“I am not a betting person. I won't answer what will happen in October, nevertheless I think rates should continue to rise in Poland. In the academic debate - many countries still have negative real interest rates, although in terms of scale Poland is really in the lead. So there is a serious question whether it is possible to get out of the highest inflation in several decades without positive real interest rates.” (TVN24, PAP, 16.09.2022)**
(Vacant places (2))	--	--

*the higher the indicator the more hawkish views. The positioning has been made based positively on PAP survey conducted among economists at banks in Poland (scale 1-5). ^**Quotes in bold** have been modified in this issue of Poland Macro Weekly.

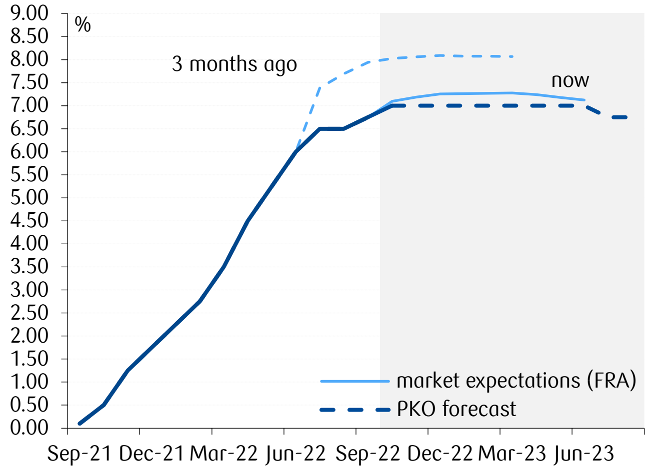
Interest rates – PKO BP forecasts vs. market expectations

		1M	2M	3M	4M	5M	6M	7M	8M	9M
Date	15-Sep	15-Oct	15-Nov	15-Dec	15-Jan	15-Feb	15-Mar	15-Apr	15-May	15-Jun
WIBOR 3M/FRA†	7.15	7.30	7.39	7.46	7.46	7.47	7.48	7.44	7.38	7.33
implied change (b. p.)		0.15	0.24	0.31	0.31	0.32	0.32	0.29	0.23	0.18
MPC Meeting	7-Sep	5-Oct	9-Nov	7-Dec	-	-	-	-	-	-
PKO BP forecast*	6.75	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00
market pricing*		6.90	6.99	7.06	7.06	7.07	7.08	7.04	6.98	6.93

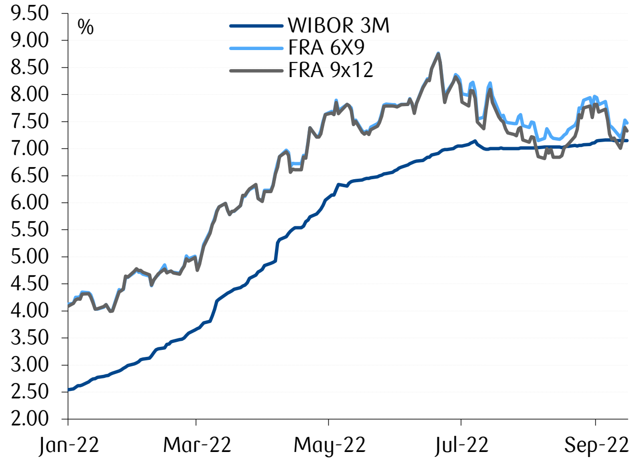
†WIBOR 3M from the last fixing, FRA transactions based on WIBOR 3M for subsequent periods, ‡in basis points, *PKO BP forecast of the NBP reference rate.

Poland macro chartbook

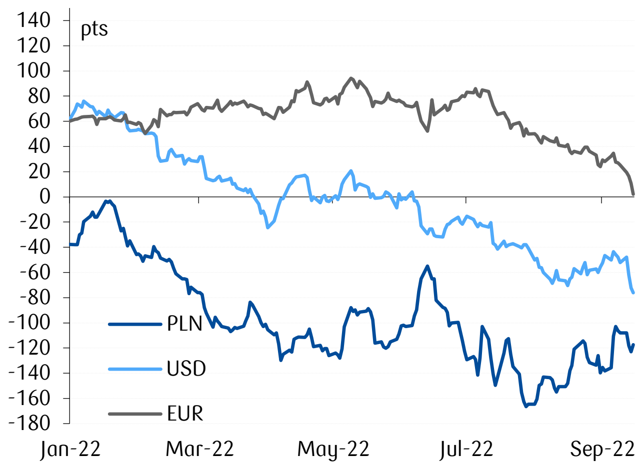
NBP policy rate: PKO BP forecast vs. market expectations



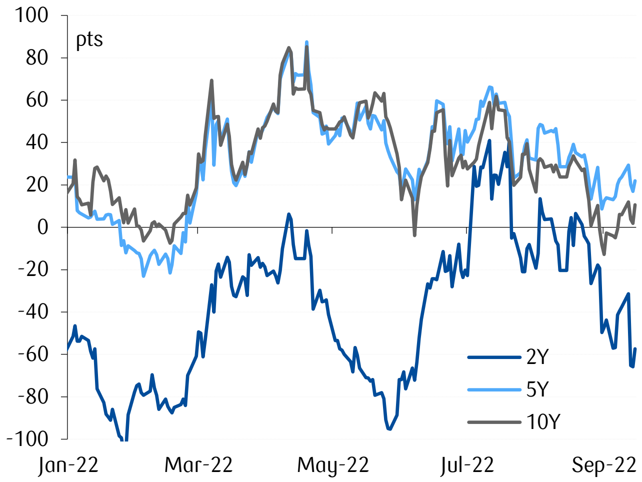
Short-term PLN interest rates



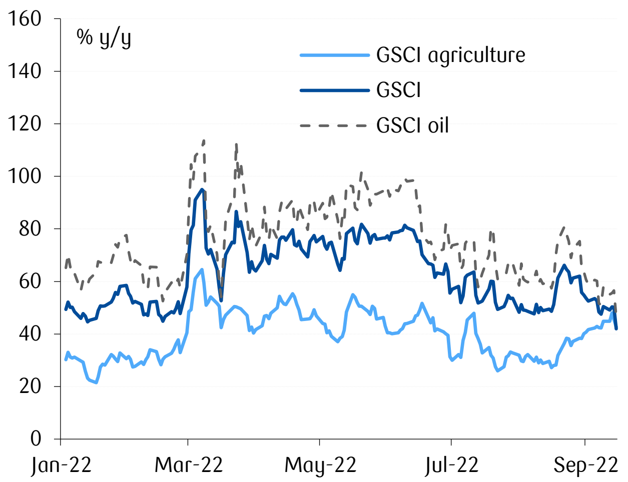
Slope of the swap curve (spread 10Y-2Y)*



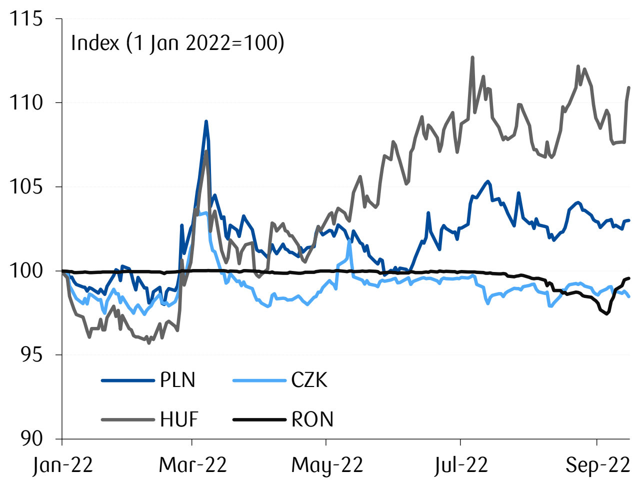
PLN asset swap spread



Global commodity prices (in PLN)

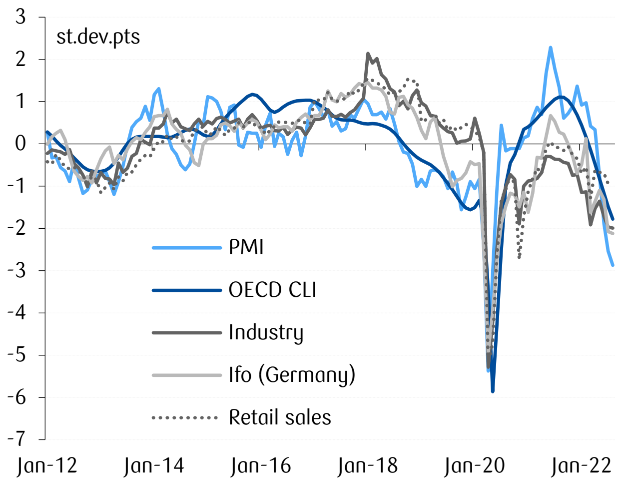


Selected CEE exchange rates against the EUR

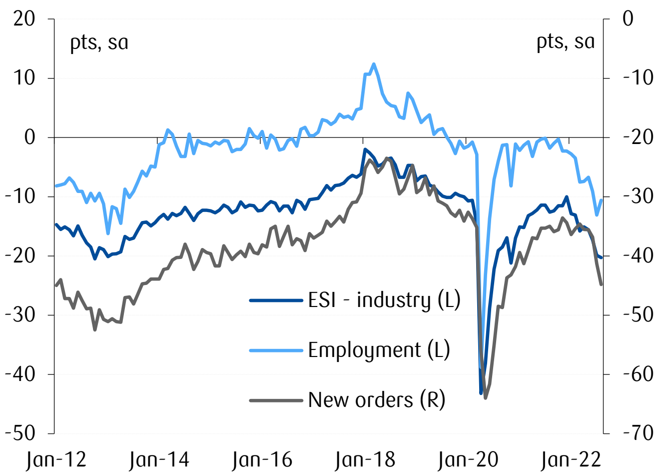


Source: Datastream, NBP, PKO Bank Polski. *for PLN, and EUR 6M, for USD 3M.

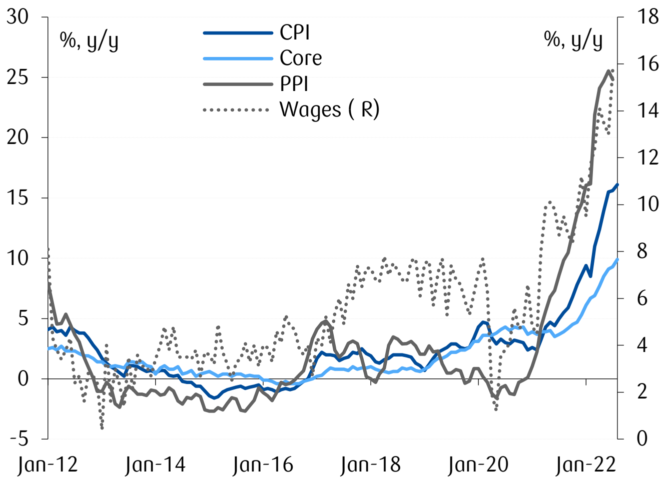
Economic sentiment indicators



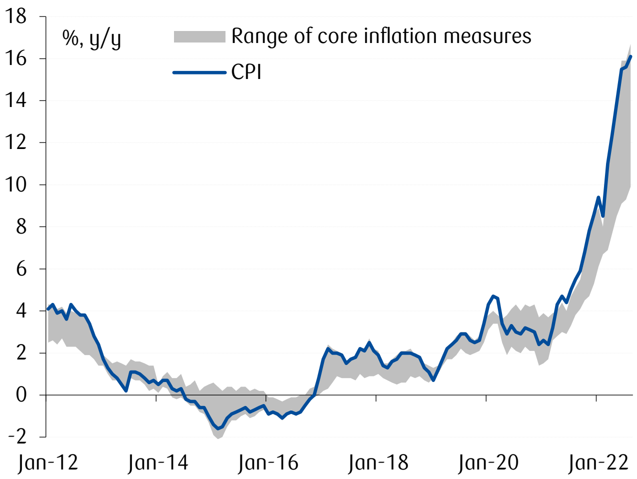
Poland ESI for industry and its components



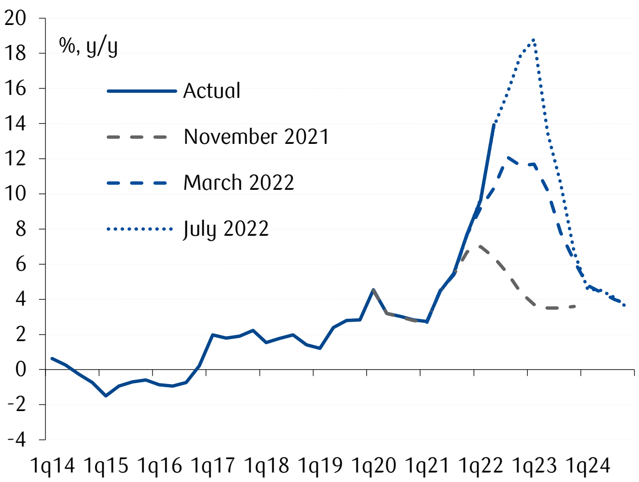
Broad inflation measures



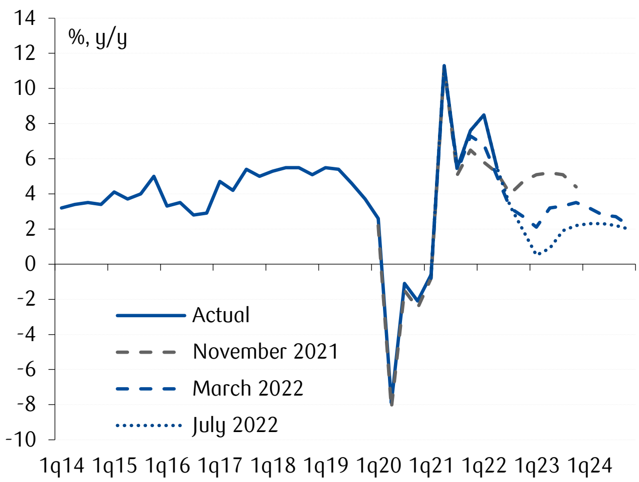
CPI and core inflation measures



CPI inflation – NBP projections vs. actual



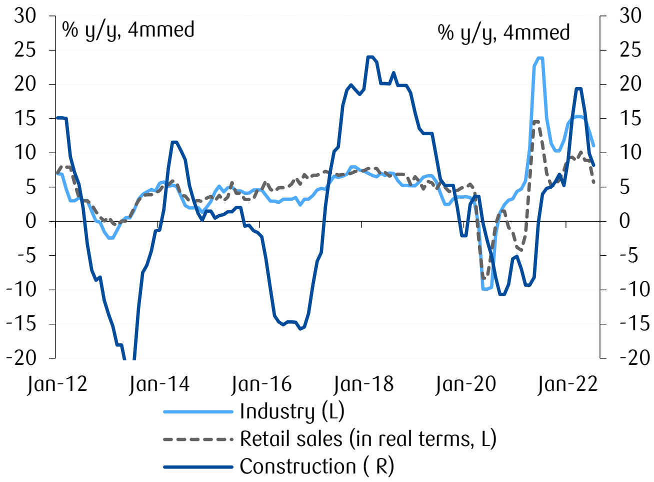
Real GDP growth – NBP projections vs. actual



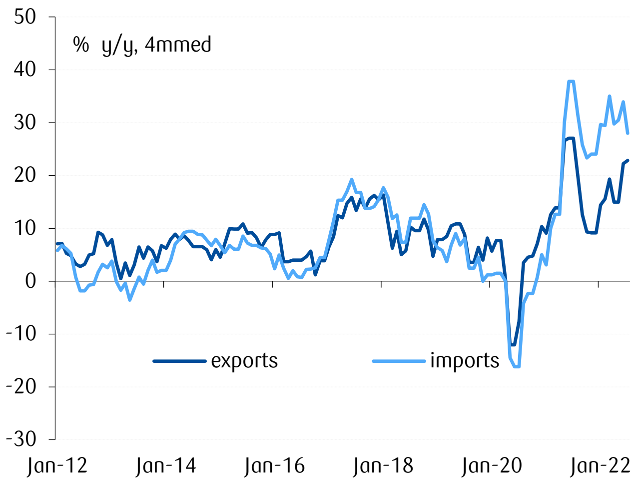
Source: Datastream, GUS, EC, NBP, PKO Bank Polski.

Bank Polski

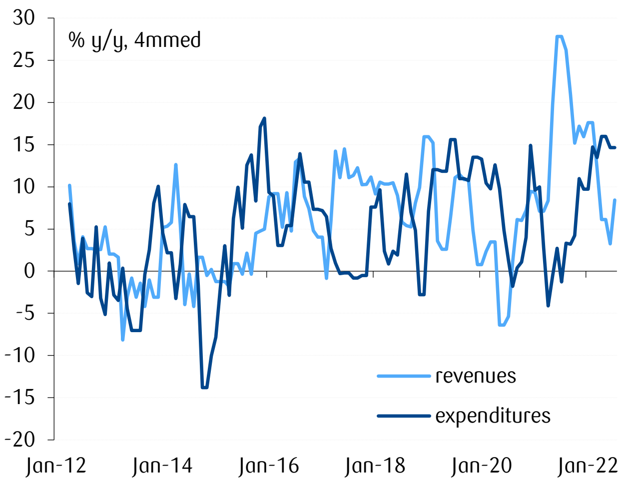
Economic activity indicators



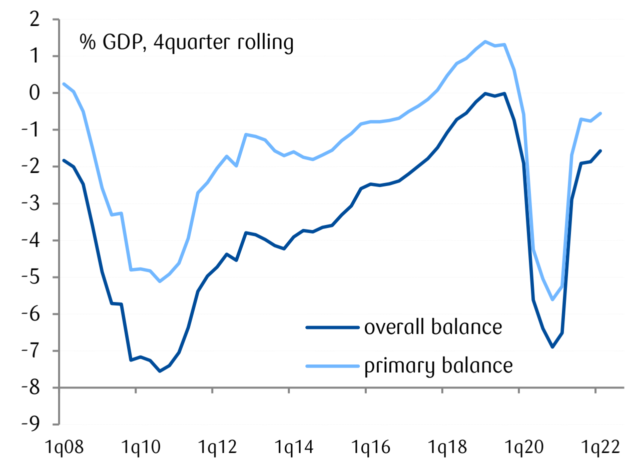
Merchandise trade (in EUR terms)



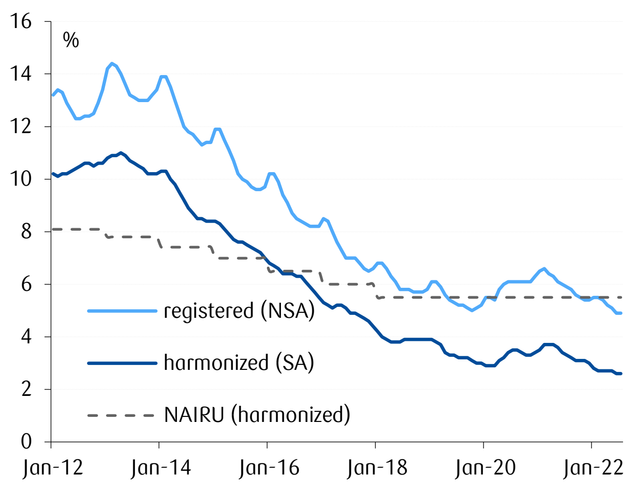
Central government revenues and expenditures*



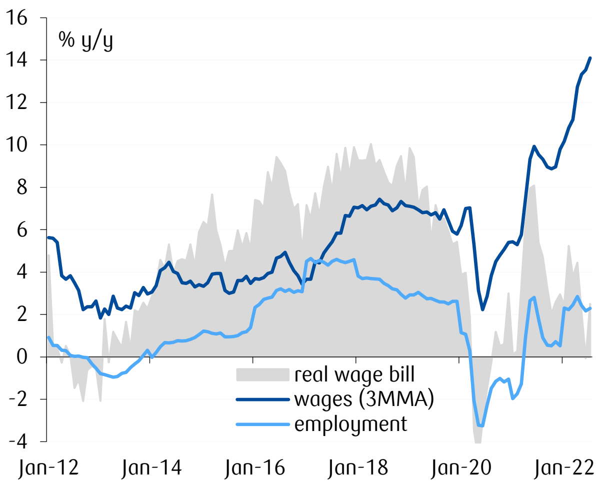
General government balance (ESA2010)



Unemployment rate

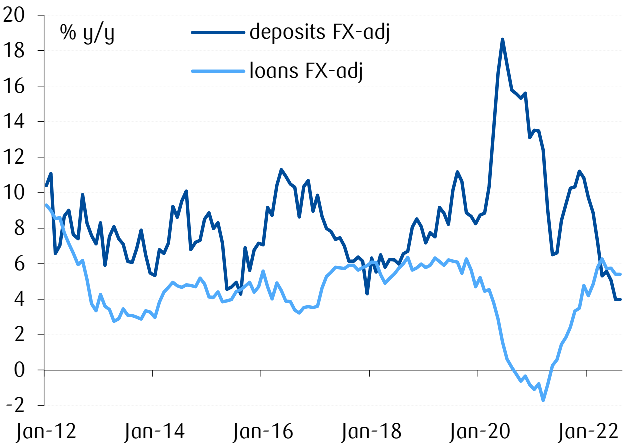


Employment and wages in the enterprise sector

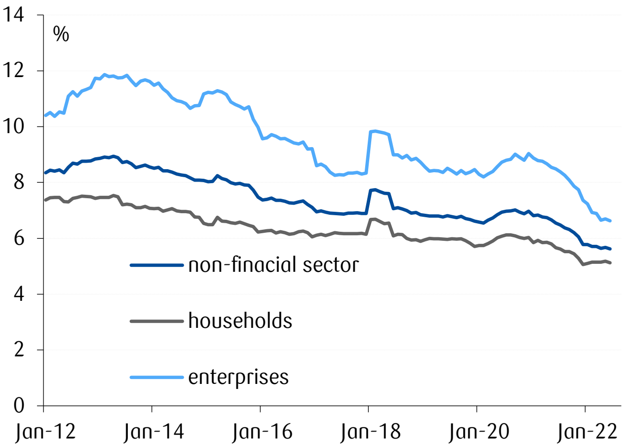


Source: NBP, Eurostat, GUS, MinFin, PKO Bank Polski. *break in series in 2010 due to methodological changes.

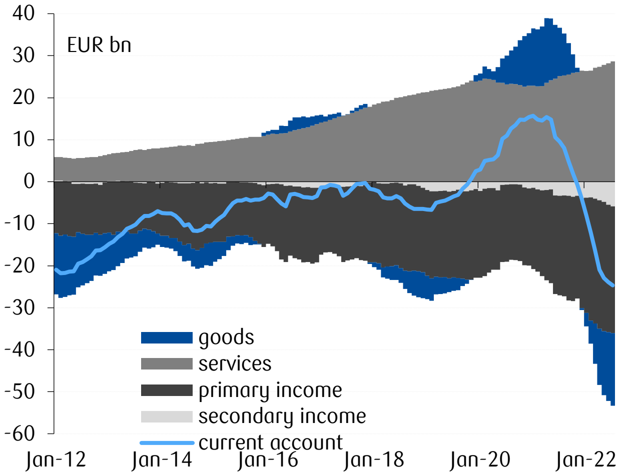
Loans and deposits



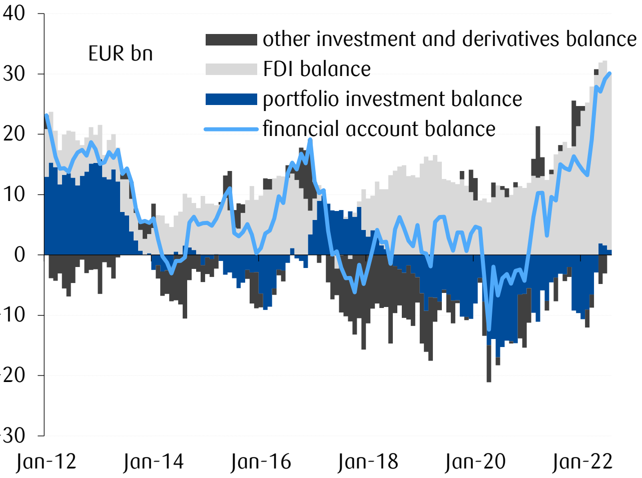
Non-performing loans (NPLs) – by sectors*



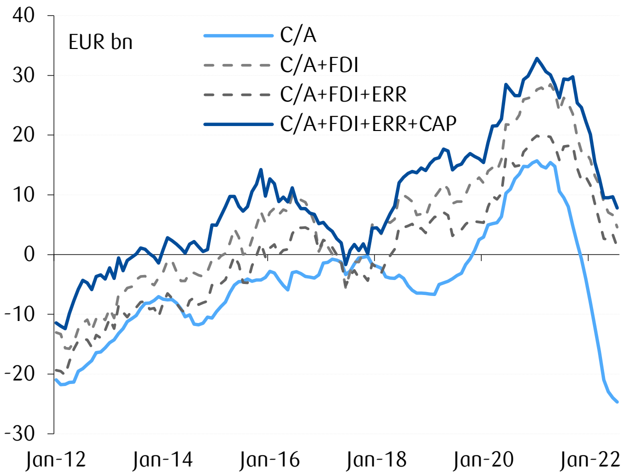
Current account balance



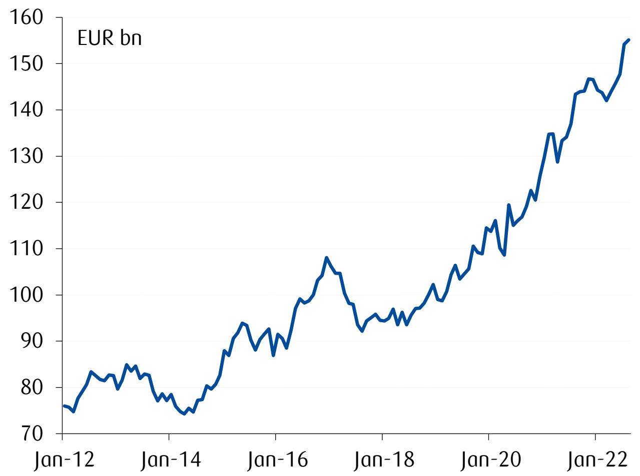
Financial account balance



External imbalance measures



NBP FX reserves (in EUR terms)



Source: NBP, PKO Bank Polski. *break in series in Jan2018 due to methodological changes.

Previous issues of PKO Macro Weekly:

- Awaiting the end of rate hikes (Sep 9, 2022)
- Inflation sparked investments? (Sep 2, 2022)
- Costs jump, deals slow (Aug 26, 2022)
- It's payback time (Aug 19, 2022)
- Inflation seems to be losing steam (Aug 12, 2022)
- Prepare(d) for slowdown (Aug 5, 2022)
- Unemployment at the bottom and inflation plateau (Jul 29, 2022)
- Slowdown just ahead (Jul 22, 2022)
- Turning point? (Jul 15, 2022)
- Inflation vs recession dilemma (Jul 8, 2022)
- NBP rate hikes coming to an end (Jul 1, 2022)
- Dry loan tap has frozen the market (Jun 24, 2022)
- A bitter pill of interest rate hikes (Jun 10, 2022)
- Growth borrowed from the future (Jun 3, 2022)
- Not all gold that glows (May 27, 2022)
- GDP growth rate at 5%? (May 20, 2022)
- Less reliant on Germany? (May 13, 2022)
- MPC is slowing down (May 6, 2022)
- 100bps month by month? (Apr 29, 2022)
- Nothing lasts forever (Apr 22, 2022)
- Deleveraging (Apr 8, 2022)
- The economic whirlwinds of war (Apr 1, 2022)
- Housing sales in gloom, rental market in bloom (Mar 25, 2022)
- The calm before the storm (Mar 18, 2022)
- Hawkish governor in front of a hawkish MPC (Mar 11, 2022)
- #StandWithUkraine (Mar 04, 2022)
- Russian invasion - repercussions for Poland (Feb 25, 2022)
- A moment of relief for the MPC (Feb 18, 2022)
- NBP likes stronger PLN (Feb 11, 2022)
- Can we afford the Anti-Inflationary Shield? (Feb 4, 2022)
- GDP growth surged in 4q21 to end 2021 on a high note (Jan 28, 2022)
- Successful 2021 behind us, challenging 2022 ahead (Jan 21,2022)