Poland Macro Weekly

Macro Research

17 March 2023

Centrum Analiz

Bank Polski

Inflation never ceases to surprise

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TOP MACRO THEME(S):

- **Both January and February CPI inflation turned out lower than expected (p.2)**, with the record high scale of revision to the former one due to annual changes in the CPI basket. Yet the momentum of core inflation remains strong.
- **We took a closer look at the Polish banking sector (p.3)** to see how its position differs from the SVB's.

WHAT ELSE CAUGHT OUR EYE:

- **Trade balance in January equalled 1.4 bn. EUR and the surplus was recorded for the first time since June 2021**, reflecting a reversal of inventories cycle and normalisation in prices of raw materials. In nominal terms exports grew by 12.0% y/y, in particular to the Czech Republic (31.8% y/y) and France (15.1% y/y), accompanied by slightly lower growth of foreign sales to Germany (8.2% y/y). Imports increased by 5.6% y/y, most significantly from the USA (73.1% y/y).
- Better trade balance translated into (already expected by us) **improvement in the current account, which saw a surplus of 1,429 bn. EUR**, being the best result since 2020. In 12-months rolling basis current account deficit in relation to GDP declined to 2.7% from 3.1% and was the lowest since March 2022.
- **Fitch Ratings revised downwards Poland's GDP forecast for 2023 from 1.1% to 0.7%, while keeping the forecast for 2024 at 2.6%.** Slightly worse growth outlook this year stems from weakening domestic demand and negative credit growth for households. Inflation should fall to 10.5% y/y by the end of 2023, while interest rates should remain stable. **Chief analyst of Polish economy from S&P Global Ratings said that risk factors regarding the rating both in the short-term and in the long-term remain balanced.**

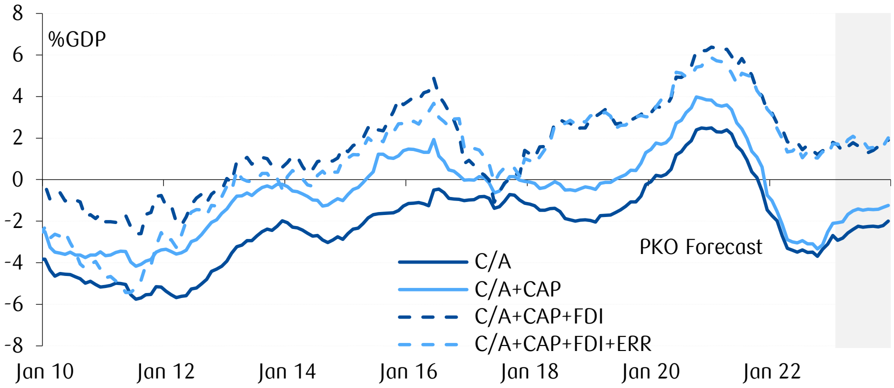
THE WEEK AHEAD:

- **Next week will bring a solid dose of monthly economic data (more details in the calendar)** enabling to assess the condition of Polish economy in February. In particular, retail sales data is likely to show a deepening fall in consumer spending, while another decline in PPI should reinforce the disinflationary outlook on the producers' side.

NUMBER OF THE WEEK:

- **11.8%** - core HICP inflation in February (down from 11.9% y/y)

CHART OF THE WEEK: External balance indicators



Source: Statistics Poland. NBP, PKO Bank Polski.

	2022	2023†
Real GDP (%)	4.9	0.1
Industrial output (%)	10.4	3.9
Unemployment rate# (%)	5.2	5.4
CPI inflation** (%)	14.3	11.9
Core inflation** (%)	9.0	9.7
Money supply M3 (%)	5.4	6.4
C/A balance (% GDP)	-3.1	-2.2
Fiscal balance (% GDP)*	-3.0	-6.0
Public debt (% GDP)*	51.5	53.6
NBP reference rate## (%)	6.75	6.25
EURPLN‡##	4.69	4.62

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.

Inflation is letting go, but not the inflationary pressure

- **Revised CPI inflation in January stood at 16.6% y/y, while inflation in February equaled 18.4% y/y, both lower than expected. As usual, the Statistics Poland updated weights in the CPI basket, whose revision added 0.6pp to January inflation figure (the most in history).**
- **We expect that inflation has passed its peak and disinflationary process will be driven by statistical base effects and a lagged impact of decline in real incomes. CPI inflation should fall to around 8% in December 2023.**

Revised CPI inflation in January equaled 16.6% y/y (against preliminary estimate at 17.2% y/y), while inflation in February (considered to be the peak) was 18.4% y/y, slightly lower than both the consensus and our estimate. Data includes an updated consumer basket that reflects changes to structure of purchases made by households. The scale of revision to January data (0.6pp) was the highest in history. Core inflation in January and February stood at 11.5% y/y and 12.0% y/y respectively (against 11.5% in December), while its momentum remains strong at 1% m/m sa and corresponds to y/y (saar) inflation at 12-13%.

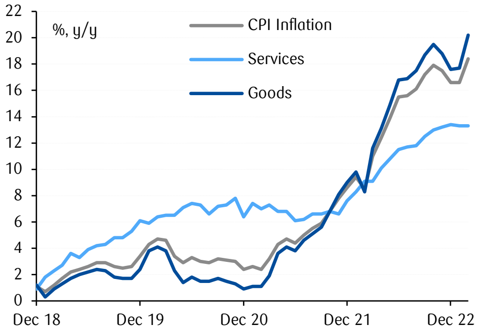
Food and beverages as well as transport saw the strongest increase of weight in the inflation basket (0.4 pp), followed by housing (0.3pp). In turn, the weight of spending on furnishings and household equipment as well as communication declined (by 0.4 pp), with the first one being under negative impact of the cool-down in the housing market and the latter one seeing on average lower yearly price growth in 2022. As far as the update to basket weights seems intuitive, its impact on the overall figure is not obvious. Prior to data release we estimated that it will add around 0.2-0.3pp to inflation.

It is worth noting that energy price growth (which caused the biggest surprise in the January flash estimate) was revised upwards from 10.4% m/m to 12.6% m/m, meaning that the impact of consumption basket revision on CPI inflation must have been even higher than 0.6pp, as higher energy prices boosted inflation. Nevertheless, the scale of increase in energy prices is lower than expected, considering that in January VAT rates on electricity, gas and heat returned to 23% from 0/5%, while their m/m growth stood at 22.3%, 18.2% and 8.2% respectively. Price growth in the energy category is being dragged down by the normalization in the solid fuels market. Its yearly growth stands at 31%, and this should be one of the main forces driving disinflation.

Food prices growth exceeded the seasonal pattern (2.0% m/m and 1.8% m/m in January and February respectively), with vegetables and bread standing out. In many categories, however, monthly price dynamics gradually normalize and we expect that following global tendencies (FAO) food price growth should slow down to 10% by the end of 2023.

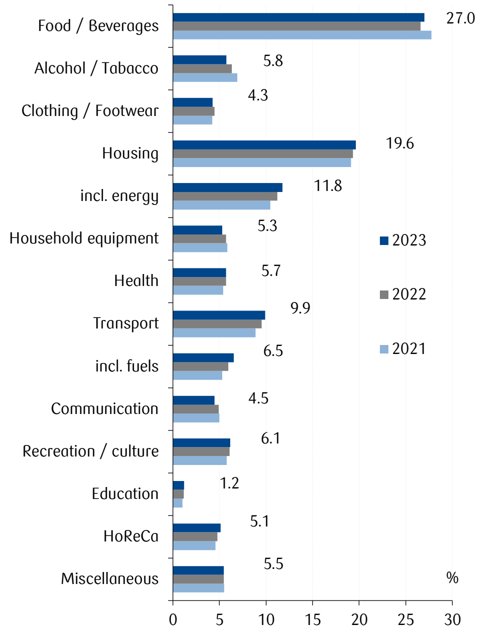
Persisting inflationary pressure, reflected in m/m price growth exceeding the seasonal pattern in most base categories, casts a shadow on favorable inflation data (lower peak of inflation, better outlook on energy prices). So far disinflation process is grounded mainly on statistical base effects, however, we do not change our assumption of gradual fall in inflation to around 8% in December, although latest data show that bringing inflation down is not going to be an easy process.

CPI inflation vs goods and services price growth



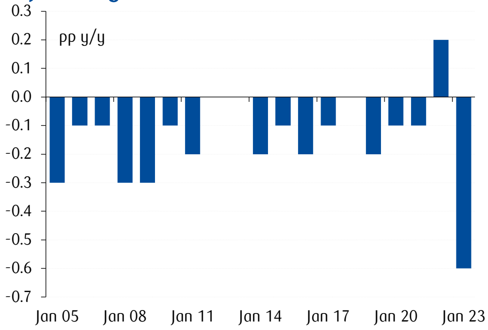
Source: Statistics Poland, PKO Bank Polski.

Changes to the structure of consumption basket



Source: Statistics Poland, PKO Bank Polski.

Impact of basket changes on CPI inflation in January



Source: Statistics Poland, PKO Bank Polski.

No SVB double in the Polish banking sector

- **In the context of the recent turmoil related to the collapse of Silicon Valley Bank due to inadequate liquidity amid falling bond prices and problems of other banks in the USA (but also in Europe), we took a closer look at the Polish banking sector and its resilience to similar challenges.**
- **In our view the resilience of domestic banking sector is based on diversified deposit base, robust liquidity position and relatively higher exposure to short-term government securities rather than long-term ones.**

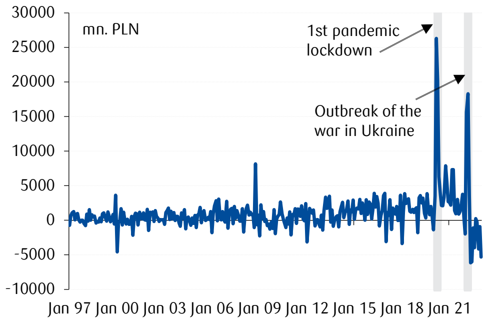
The collapse of Silicon Valley Bank has triggered a panic market reaction and a discussion on the resilience of the global banking sector amid relatively vivid memories of the GFC. In this context, we decided to assess any potential risks of such a scenario in the Polish banking sector and identify key strengths that should prevent its materialization.

Regardless of how much has already been said about the root causes of SVB's collapse, it is worth recalling that its asset structure relied heavily on investing deposits of tech companies into long-term government bonds, which did not come under mark-to-market accounting principle, giving an illusion of a better capital position. News of insufficient liquidity to meet the needs of the clients, which forced SVB to sell bonds at a loss, caused a classic "run on the bank" that revealed the weaknesses of this institution and caused the drainage of liquidity.

With regard to the Polish banking sector, one of the mitigating factors constitutes a fundamentally different deposit base compared to SVB, which is diversified and focused around retail. Liabilities to households account for nearly 50% of overall liabilities, while corporates correspond to nearly 16%. In addition, since the start of the interest rate hiking cycle, the structure of the banking sector liabilities has become favorable in terms of mitigating liquidity risk. Higher interest rates have been encouraging saving and led to a shift of households and company funds from (highly liquid) current deposits to term ones, which means that the structure of the banking sector liabilities has become less prone to run on banks.

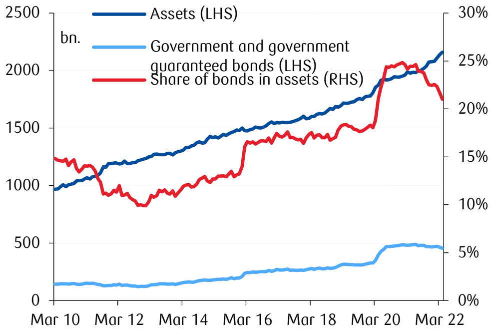
Despite strong fundamentals, serious market distortions sometimes triggered by external environment may put a stress on any banking system. **As a matter of fact, Poland experienced two "run on the bank" periods in the course of the last three years, that both proved resilience of the financial system.** The first period started at the end of February 2020, right before the introduction of the first pandemic lockdown, and lasted until May 2022. Households, being afraid of mobility restrictions, especially in the regions where the banking network was rather poor, made precautionary cash payouts. As a result, cash in circulation increased by 23% at that time. The second one took place exactly two years later in response to the outbreak of the war in Ukraine. By the end of March 2022 cash in circulation was 10% higher than in the beginning of the year. As it turned out, both of those episodes posed no threat to continuity of the banking sector operations nor did they lead to liquidity constraints thanks to significant liquidity surpluses. Resilience of the banking sectors was based on robust levels of macro-prudential indicators, including liquidity coverage ratios

Cash in circulation (m/m change)



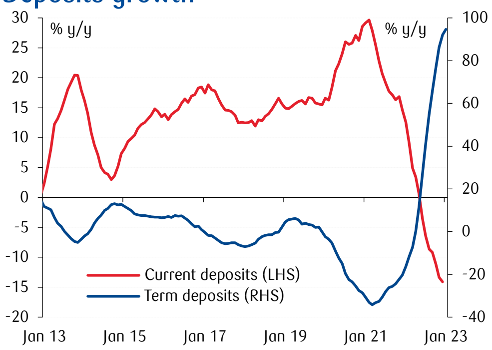
Source: NBP, PKO Bank Polski.

Share of bonds in the assets of the banking sector



Source: NBP, PKO Bank Polski.

Deposits growth



Source: NBP, PKO Bank Polski.

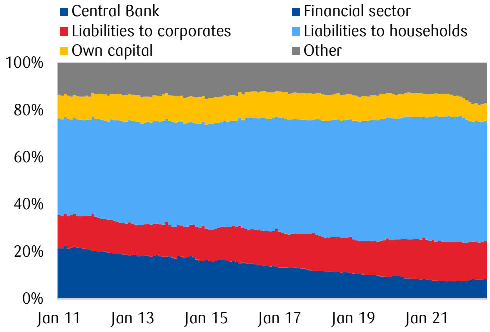
(LCR) way above minimum requirements. **As of December 2022 NBP assessed that the liquidity position of commercial banks remains favorable and the median LCR remains noticeably higher than the minimum requirement, although it should be noted that the situation of particular banks is diversified.**

Global monetary tightening cycle has put some pressure on financial institutions through its impact on the valuation of assets, in particular government bonds. In case of Poland share of bonds in the banks' assets have seen two noticeable periods of increase, first in 2016, when the tax on bank's assets exempting government bonds was introduced, and later in 2020 with the launch of NBP's asset purchase program. **As a result, government bonds constitute around 20% of the banks' balance sheet.** Since October 2021, when the NBP begun to raise interest rates, the value of bonds in the bank's portfolio went down. According to the NBP's Financial Stability Report, market value of the banking sector bonds portfolio declined by 50 bn PLN, which corresponded to a decline of liquidity surplus from 210 bn PLN in December 2021 do 167 bn in August 2022.

Apart from liquidity, bonds also affect capital position of banks, although this effect is constrained by accounting principles. A rise in yields by 700 bp beginning in 4q21 translated into a 3% decline in value of bonds portfolio for the entire sector, amid 10% decline of its market value – the difference stemming from attributing bonds into different accounting categories. Around 48% of bonds held by the banking sector are accounted for at fair (market) value, whereas around 50% is priced by an amortized purchase cost with an intention to be held to maturity. **Average duration of the entire bonds portfolio equals two years, whereas among those valued at market value dominate bonds with shorter duration that are less prone to interest rate changes. Therefore, in the NBP assessment, in the short-term perspective, a fall in the value of bond portfolio should be counterbalanced by an increase in prices of these securities as they get closer to redemption date. Furthermore, since the peak on October 2022 yields on Polish government bonds declined by 3bp (nearly one third), resulting in an improvement in valuation of these securities in 2023, in contrast to the US bond market, where yields were on an upward path.**

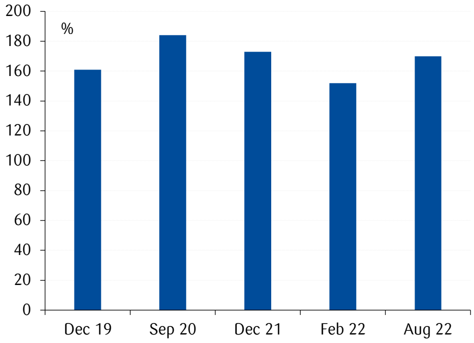
To conclude, the resilience of the Polish banking system with regard to the challenges faced by the SVB stems from three main factors: more diversified deposit base, robust liquidity position which stood the test of two "run on banks" and a relatively higher exposure on short-term government securities which better corresponds to the term structure of its liabilities.

Liabilities structure of the banking sector



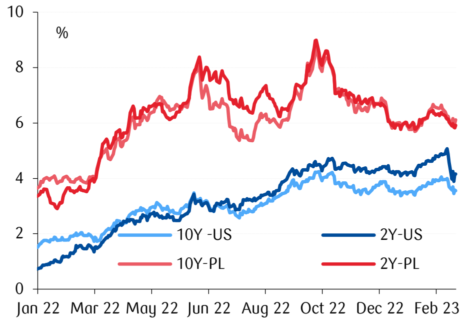
Source: NBP, PKO Bank Polski.

Median LCR of domestic commercial banks



Source: NBP, PKO Bank Polski.

Government bond yields



Source: Bloomberg, PKO Bank Polski.

Weekly economic calendar

Indicator	Time (UK)	Unit	Previous	Consensus*	PKO BP	Comment
Monday, 20 March						
GER: PPI inflation (Feb)	7:00	% y/y	17.8	--	--	--
POL: PPI inflation (Feb)	**9:00**	**% y/y**	**18.5**	**17.8**	**18.1**	**PPI should continue to decline, based on disinflation in energy prices, amid further slowdown in industrial production.**
POL: Industrial production (Feb)	**9:00**	**% y/y**	**2.6**	**1.1**	**0.2**	
POL: Wages (Feb)	**9:00**	**% y/y**	**13.5**	**12.0**	**11.9**	**We maintain our view that labour market adjustment will take place through declining wage growth and modest changes to employment.**
POL: Employment (Feb)	**9:00**	**% y/y**	**1.1**	**1.0**	**1.0**	
EUR: Trade balance (Jan)	10:00	--	--	--	--	--
Tuesday, 21 March						
POL: Construction output (Feb)	**9:00**	**% y/y**	**2.4**	**1.2**	**1.3**	**Minor growth in the construction sector reflects a cool down in the property market.**
POL: Retail sales (Feb)	**9:00**	**% y/y**	**-0.3**	**-1.4**	**-3.8**	**Consumer spending continues to be dragged down by falling real income of consumers.**
GER: ZEW Economic Sentiment (Mar)	10:00	pts.	28.1	17.5	--	--
USA: Existing home sales (Feb)	14:00	mln	4.0	4.15	--	--
Wednesday, 22 March						
POL: Consumer Confidence (Mar)	**9:00**	**pts.**	**-36**	**--**	**-36**	**Slightly better economic outlook amid further decline in spending can result in the stabilisation of consumer confidence.**
POL: Money Supply M3 (Feb)	**13:00**	**% y/y**	**6.9**	**6.5**	**6.5**	**Monetary processes continue to reflect slowing economy.**
USA: Fed meeting ()	**18:00**	**%**	**4.75**	**5.00**	**5.00**	**Fed will deliver a 25pb hike, though problems of the banking sector may make its narrative less hawkish.**
Thursday, 23 March						
SWI: SNB meeting ()	8:30	%	1.00	--	1.25	--
NO: Norges Bank meeting ()	9:00	%	2.75	3.00	3.00	--
POL: Unemployment Rate (Feb)	**9:00**	**%**	**5.5**	**5.5**	**5.5**	**Labour market remains stable, as adjustment takes place mainly via wages channel.**
UK: BoE meeting ()	12:00	%	4.00	4.25	4.25	--
USA: Current account balance (4q)	12:30	USD bn.	-217.1	-213.2	--	--
USA: Initial Jobless Claims ()	12:30	thous.	192	--	--	--
USA: New home sales (Feb)	14:00	thous.	670	650	--	--
EUR: Consumer Confidence (Mar, flash)	15:00	pts.	-19	-18.9	--	--
Friday, 24 March						
GER: Manufacturing PMI (Mar, flash)	8:30	pts.	46.3	47.5	--	--
GER: Services PMI (Mar, flash)	8:30	pts.	50.9	51.3	--	--
EUR: Manufacturing PMI (Mar, flash)	9:00	pts.	48.5	48.8	--	--
EUR: Services PMI (Mar, flash)	9:00	pts.	52.7	52.5	--	--
USA: Durable goods orders (Feb, flash)	12:30	% m/m	-4.5	1.7	--	--
USA: Manufacturing PMI (Mar, flash)	13:45	pts.	47.3	47.3	--	--

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^
J. Tyrowicz	5.0	**"Maybe we hit the upper band of deviations from the target around 2h2025, assuming unchanged interest rates at 6.75%. (...) Does this projection justify keeping interest rates unchanged? In my opinion it does not. (...) Right now I find it irresponsible to discuss interest rate cuts"(10.03.2023, PAP, PKO transl.)**
L. Kotecki	4.8	**"If we would like to believe in the projection of NBP analysts, there are no conditions for lowering interest rates today, until there are more projections that show that such conditions exist. Today there are no conditions until the end of this projection period, i.e. until the end of 2025, because we still do not reach the inflation target. (...) What raises my concern is that inflation still does not show significant, lasting signs of weakening (...) In my opinion, we are moving away from a certain promise that some Council members make that inflation may be in the single digits in December." (16.03.2023, PAP)**
P. Litwiniuk	3.7	**"The overall projection which was presented has one basic assumption – keeping interest rates constant. If in 2025 we are just about getting close to the inflation target, a reduction of interest rates would undermine all the assumptions, and all the risks that economists talk about would have no meaning anymore. (...) There is and should not be any discussion on interest rate cuts. If anything, changes *in plus* of interest rates are being talked about." (10.03.2023, Money.pl)**
H. Wnorowski	2.7	**"Disinflation of core inflation should accelerate. In several months core inflation should fall at the same speed as the CPI" (10.03.2023, PAP)**
A. Glapinski	2.4	"NBP expects brisk return of inflation to the target. This year it will reach a single-digit figure, by the end of 2023 it will by slightly above 7%. (...) NBP leaves the door open for interest rate hikes. We will begin to cut interest rates, only when there will be certainty that inflation is falling towards the inflation target. (...) In February there will be a peak of inflation at around 18.5% (...) Threats to CPI remain, therefore we do not conclude the tightening cycle. MPC will not tolerate disruptions in the disinflation process. I hope that in the last quarter of 2023 interest rate cuts will be possible."(9.03.2023, NBP press conf., PAP, PKO transl.)
C. Kochalski	2.4	"In the light of the current data the level is adequate. The MPC has not been raising rates since September as we have many cues indicating the impact of previously passed hikes They have already started to work. They lowered inflation by 0.5 pps this year, in 2023 it will be 3 pps." (13.12.2022, Biznes24, PAP).
W. Janczyk	2.0	"The current rates level seems adequate given the information we have today. (...) " in my opinion, in the course of the last few weeks, there has come no information that would prompt resumption of rate hikes in December. Currently, no premises can be seen that would prompt such steps." (2.12.2022, PAP).
I. Duda	2.3	"Considerations about interest rate cuts are in my opinion premature (...) The weakening of global economic conditions will lead to lowering of economic growth rate in Poland, while monetary policy tightening by major central banks will limit inflation, both globally and in Poland (...) However, it is not the moment to formulate expectations as to whether the next MPC move should be a hike or a cut of interest rates." (20.01.2023, PAP)"
G. Maslowska	2.1	"Most likely it is only late 2023/early 2024 that conditions could be met for consideration of rate cuts. One such condition is, in my view, a significant reduction in core inflation" (15.02.2023, radiomaryja.pl, PAP)
I. Dabrowski	1.9	"A strong slowdown in inflation seems to be ahead of us. Therefore, single-digit inflation at the end of the year is very likely(...)" (20.01.2023, TVP Info, PAP, PKO transl.)

*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.

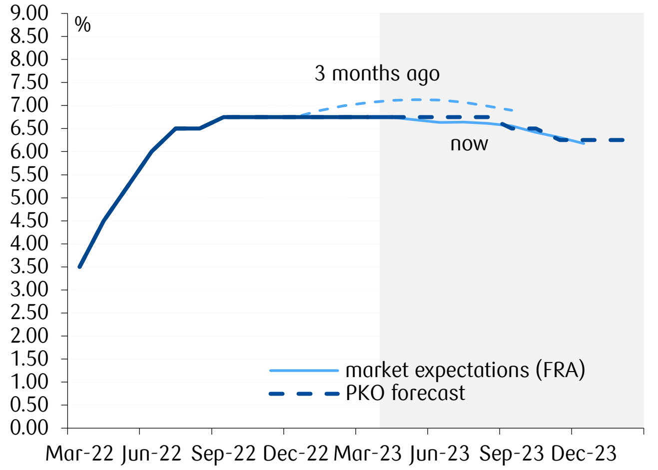
Interest rates – PKO BP forecasts vs. market expectations

		1M	2M	3M	4M	5M	6M	7M	8M	9M
Date	16-Mar	16-Apr	16-May	16-Jun	16-Jul	16-Aug	16-Sep	16-Oct	16-Nov	16-Dec
WIBOR 3M/FRA†	6.92	6.87	6.81	6.74	6.66	6.58	6.48	6.34	6.18	6.05
implied change (b. p.)		-0.05	-0.11	-0.19	-0.26	-0.34	-0.45	-0.58	-0.74	-0.88
MPC Meeting	8-Mar	5-Apr	10-May	6-Jun	6-Jul	-	6-Sep	4-Oct	8-Nov	6-Dec
PKO BP forecast*	6.75	6.75	6.75	6.75	6.75	6.75	6.50	6.50	6.25	6.25
market pricing^		6.70	6.64	6.57	6.49	6.41	6.31	6.27	6.16	6.03

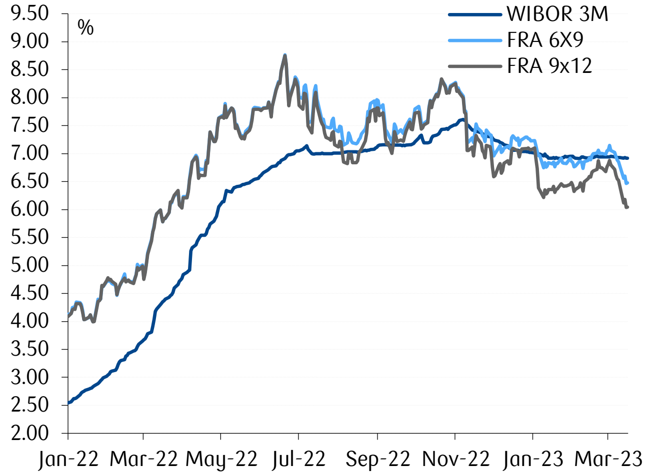
WIBOR 3M from the last fixing, FRA transactions based on WIBOR 3M for subsequent periods, ‡in basis points, *PKO BP forecast of the NBP reference rate.

Poland macro chartbook

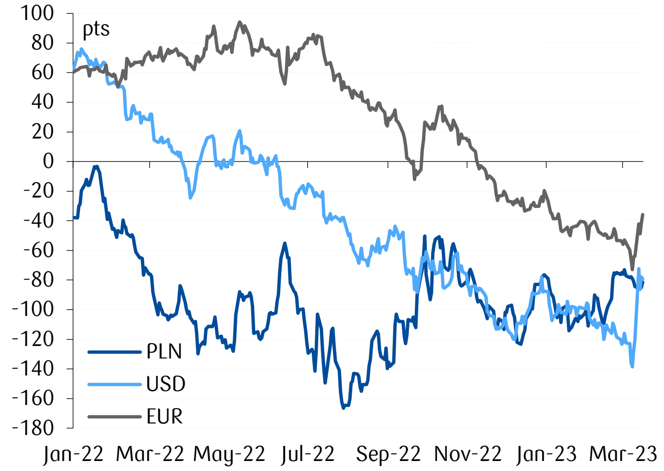
NBP policy rate: PKO BP forecast vs. market expectations



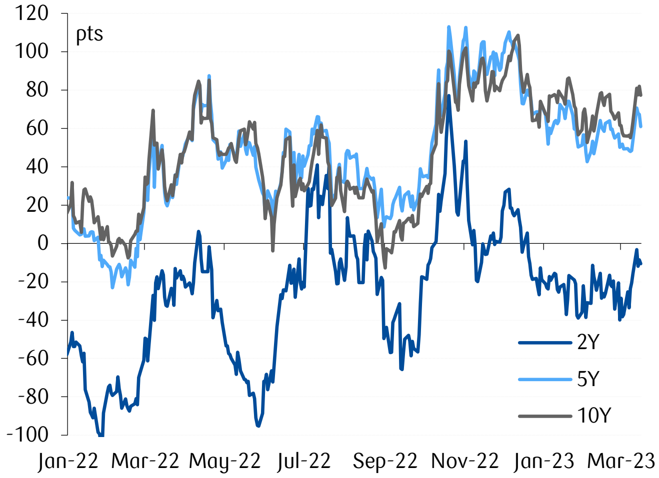
Short-term PLN interest rates



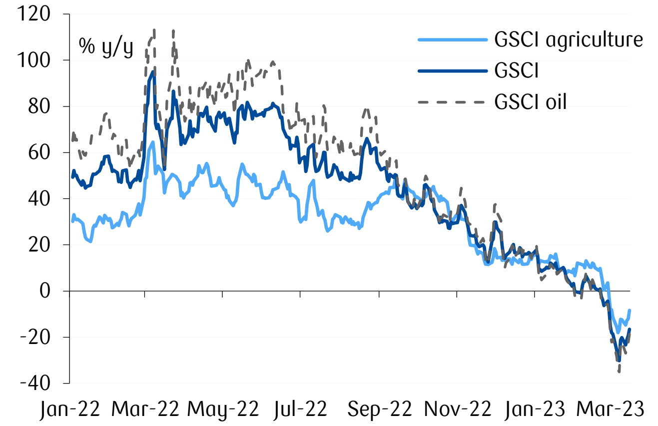
Slope of the swap curve (spread 10Y-2Y)*



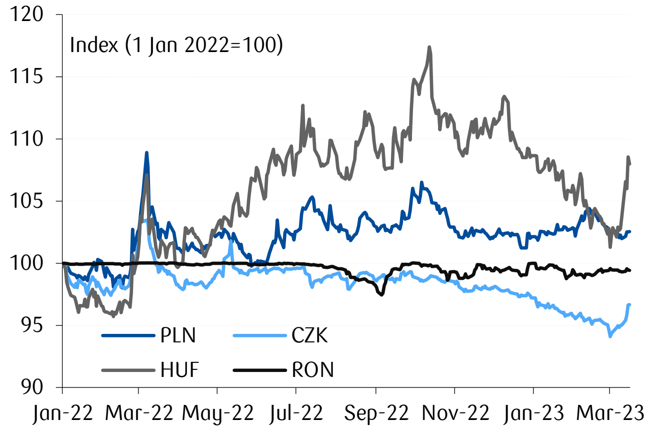
PLN asset swap spread



Global commodity prices (in PLN)

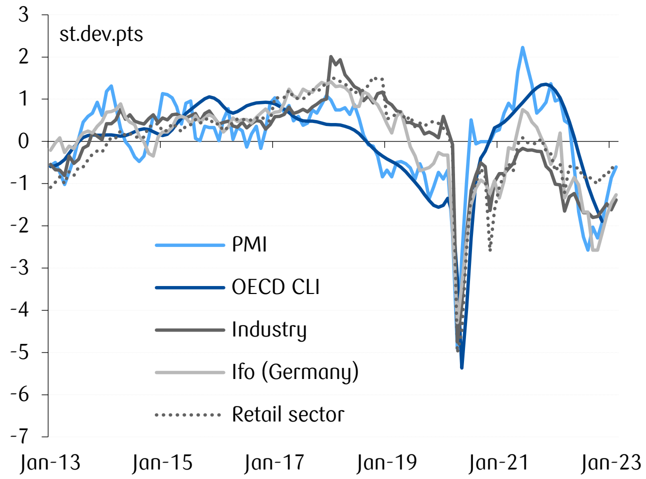


Selected CEE exchange rates against the EUR

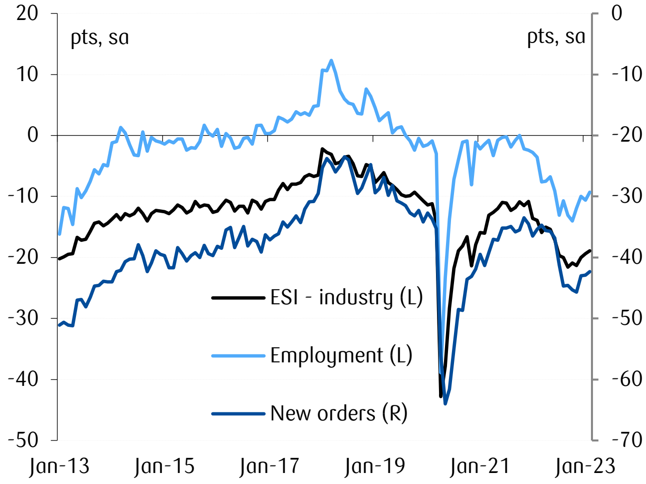


Source: Datastream, NBP, PKO Bank Polski. *for PLN, and EUR 6M, for USD 3M.

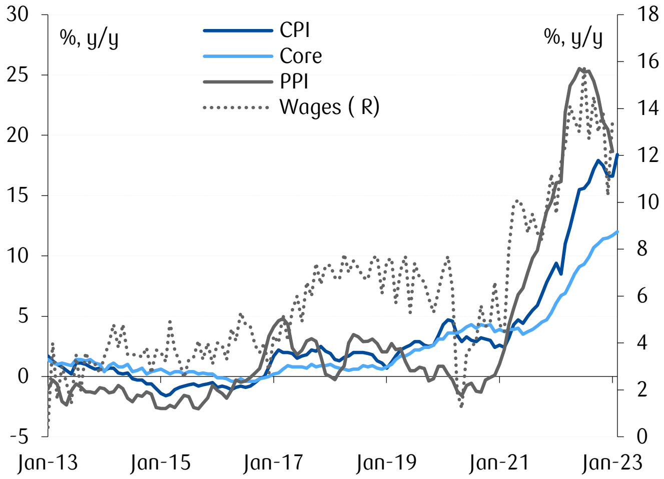
Economic sentiment indicators



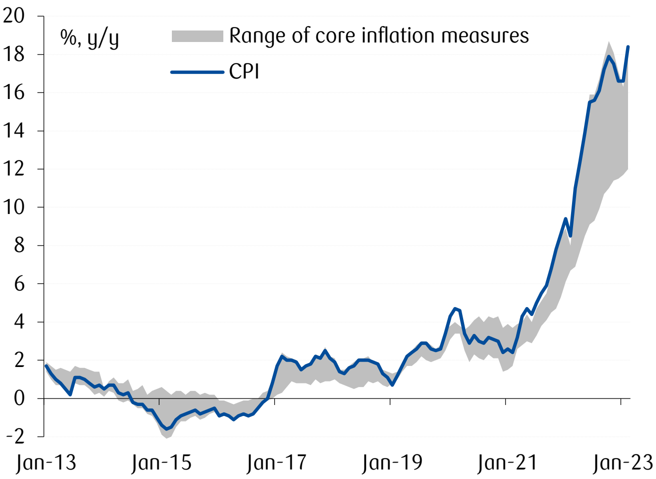
Poland ESI for industry and its components



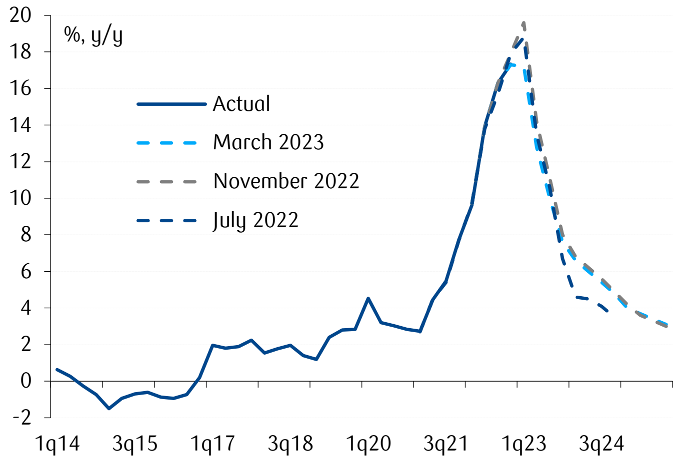
Broad inflation measures



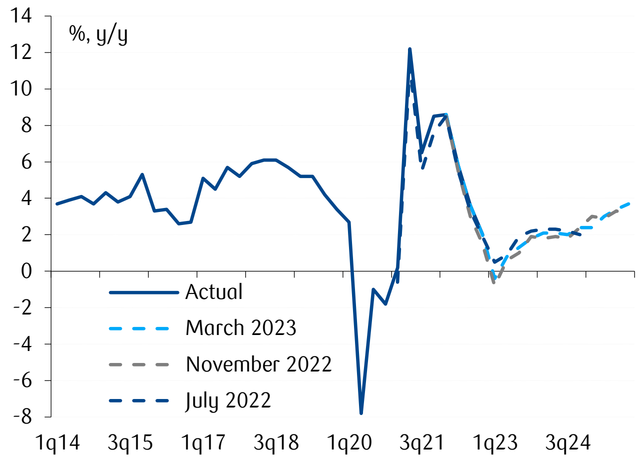
CPI and core inflation measures



CPI inflation – NBP projections vs. actual

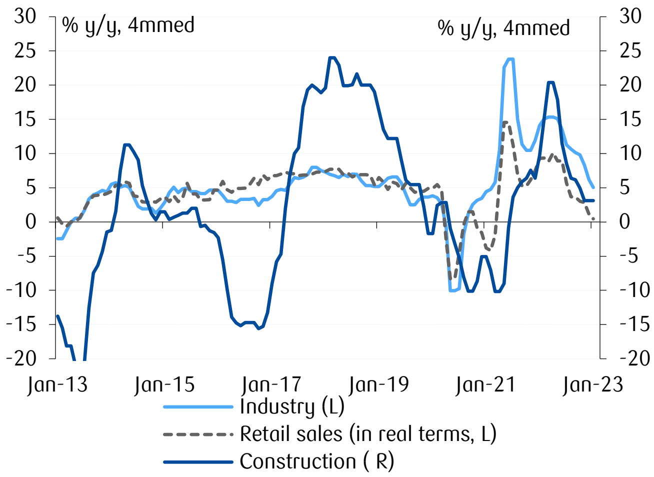


Real GDP growth – NBP projections vs. actual

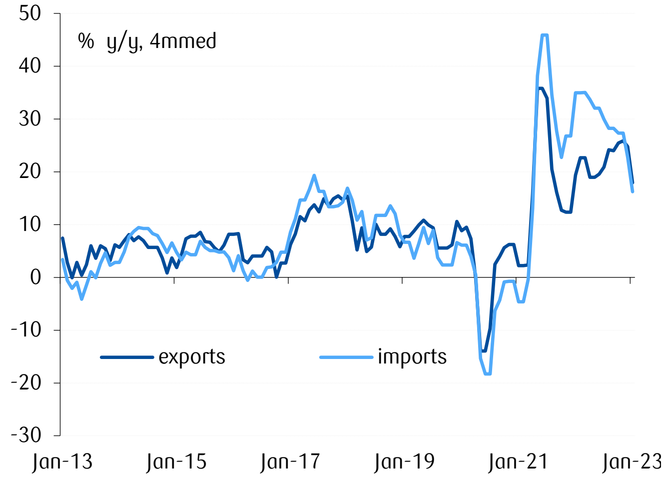


Source: Datastream, GUS, EC, NBP, PKO Bank Polski.

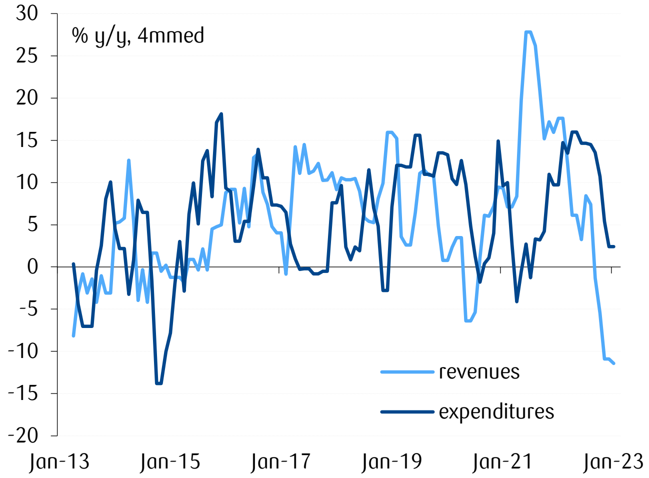
Economic activity indicators



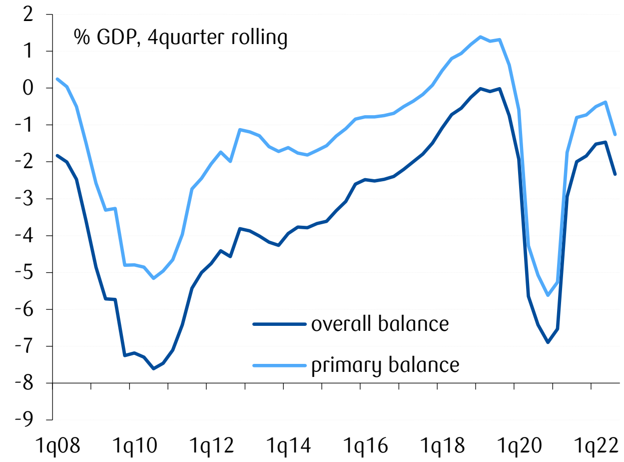
Merchandise trade (in EUR terms)



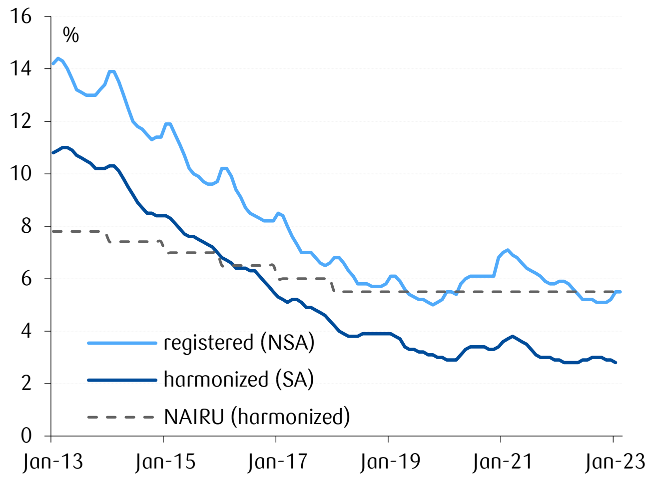
Central government revenues and expenditures*



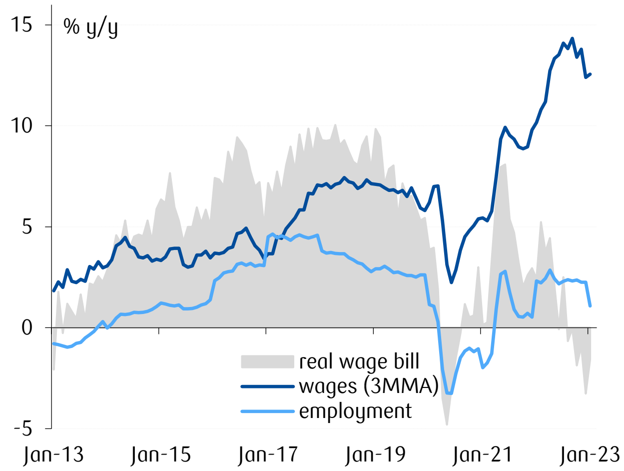
General government balance (ESA2010)



Unemployment rate

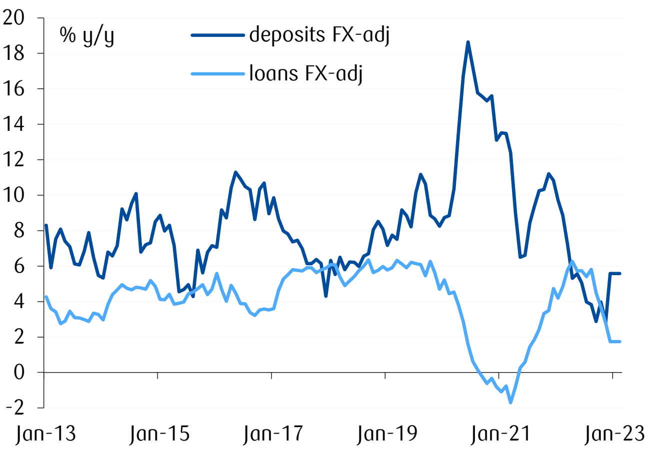


Employment and wages in the enterprise sector

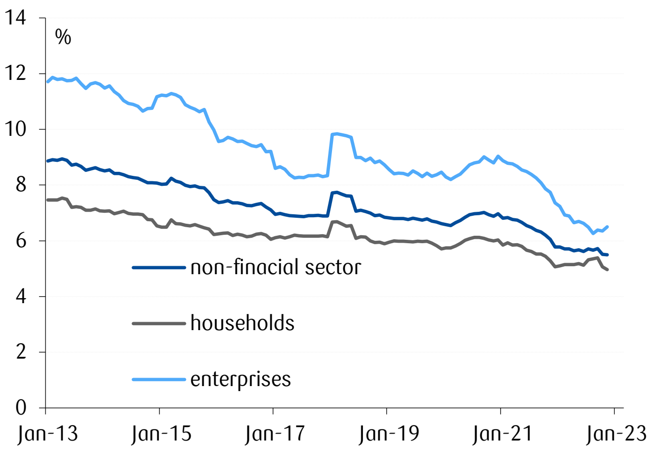


Source: NBP, Eurostat, GUS, MinFin, PKO Bank Polski. *break in series in 2010 due to methodological changes.

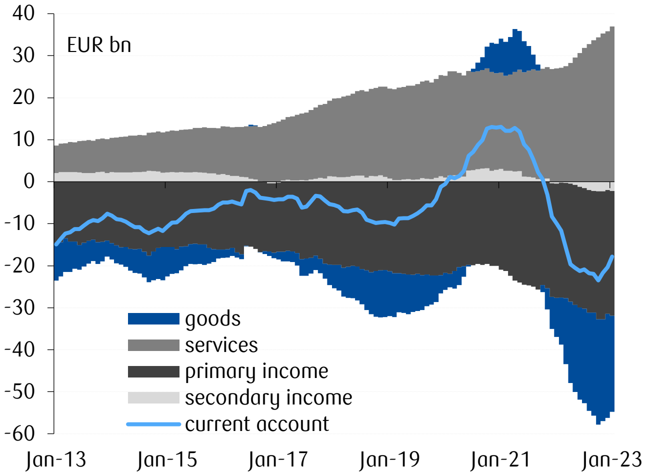
Loans and deposits



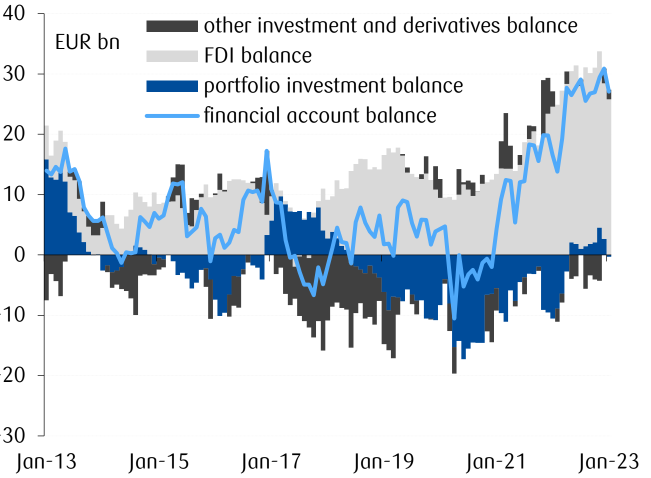
Non-performing loans (NPLs) – by sectors*



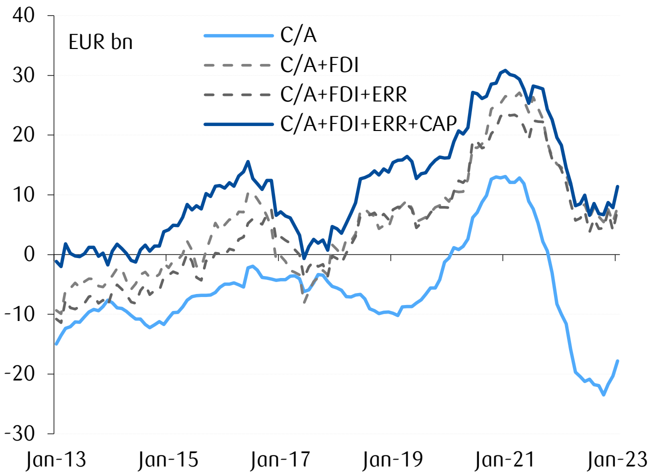
Current account balance



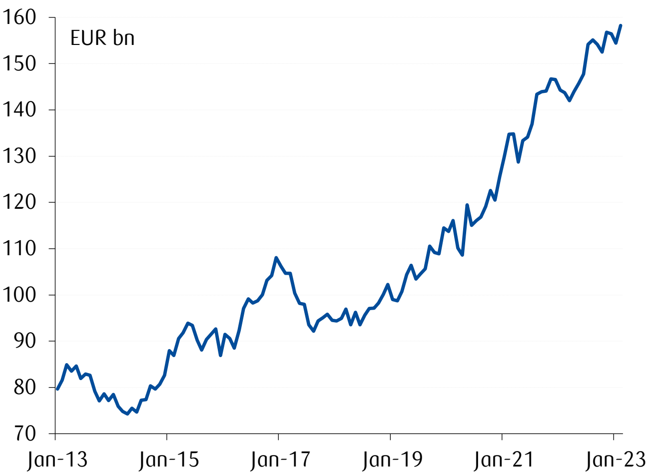
Financial account balance



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:

- Spring is coming after all (Mar 10 2023)
- Consumers under pressure (Mar 3 2023)
- Bumpy road ahead (Feb 24 2023)
- Inflation peak not as scary as feared (Feb 17 2023)
- Nothing to see here (Feb 10, 2023)
- Growth less inflation-prone (Feb 3, 2023)
- GDP growth in 4q22 heading south (Jan 27, 2023)
- This time is different, again (Jan 20, 2023)
- Happy 2023! (Jan 13, 2023)
- 2023 in preview (Dec 23, 2022)
- Housing market: The worst is over (Dec 16, 2022)
- All quiet on the monetary policy front (Dec 9, 2022)
- Disinflation ahead (Dec 2, 2022)
- Corporate profits shrink (Nov 25, 2022)
- A soft patch (Nov 18, 2022)
- Monetary policy dilemmas (again) (Nov 4, 2022)
- Is Poland crisis resilient? (Oct 28, 2022)
- Not great, not terrible (Oct 21, 2022)
- Frozen: the housing market (Oct 14, 2022)
- Is it the end or just a pause? (Oct 7, 2022)
- Wartime interventionism (Sep 30, 2022)
- Will Poland escape a technical recession? (Sep 23 , 2022)
- Energy prices frozen for this winter? (Sep 16 , 2022)
- 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)