Poland Macro Weekly

Macro Research

2 September 2022

Bank Polski | Centrum Analiz

Inflation sparked investments?

TOP MACRO THEME(S):

- **Inflation is back in town (p. 2)**: CPI inflation in August unexpectedly rose to 16.1% y/y from 15.6% y/y. All main categories except for fuels contributed for the rise in inflation.
- **Investment demand revival (p. 4):** GDP growth in 2q22 slowed down to 5.5% y/y from 8.5% y/y in 1q22 due to significantly reduced increase in inventories and to a lesser extent negative net exports. Deep quarterly GDP decline (-2.1% q/q sa) was a "payback" of previously borrowed growth from future. That said, it is likely that investment demand revived as a remedy to inflated corporate costs.

WHAT ELSE CAUGHT OUR EYE:

- **The government has passed a draft state budget for 2023, with a deficit of PLN 65 bn.** The macroeconomic assumptions for the next year include CPI inflation at 9.8% and GDP growth at 1.7%, both close to our forecasts. The projected deficit of the entire public sector in 2023 (in ESA methodology) in the budget draft law is 4.4% GDP, which is the same as the European Commission's latest (May) forecast. Significant spending increases are assumed, among others, in the defence area and public debt service. Additional spending (as yet unspecified in the bill) will include mitigating the costs of the energy crisis for households and companies as well as the likely extension to 2023 of anti-inflationary shields.
- **The manufacturing PMI in August fell for the sixth consecutive month, to 40.9 pts** (vs 42.1 pts in July). This is the weakest result since May 2020. The decline was again a result of the slump in the production and new orders sub-indices. It is the fastest and steepest downward episode of the PMI index below the 50-point level excluding April 2020. The PMI index probably overestimate the scope of manufacturing downturn, same as in the pandemic.

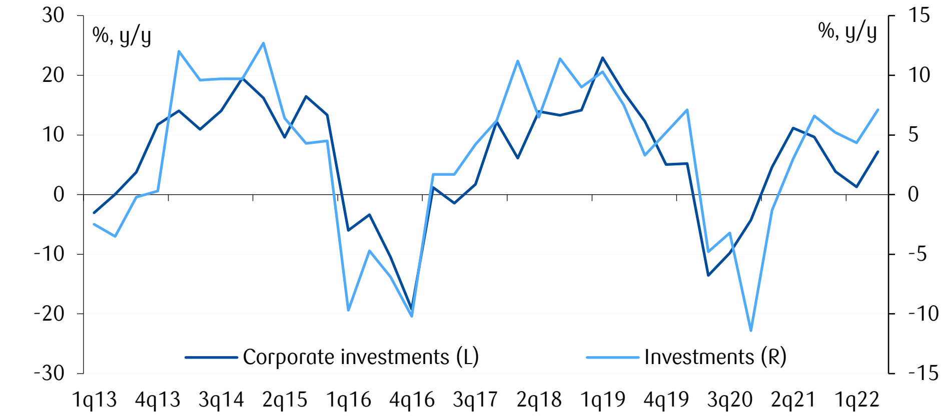
THE WEEK AHEAD:

- **MPC should increase the reference rate** (on Wed, 7 Sep) by 25bp to 6.75%. From the one hand, the Council should react on CPI inflation spike, but incoming weak data from the economy should make them more cautious.

NUMBER OF THE WEEK:

- **7.1% y/y – investments growth rate in 2q22** as previously signalled by corporate investment demand data.

Chart of the week – Corporate vs total investments



Source: GUS, PKO Bank Polski.

Chief Economist

Piotr Bujak
piotr.bujak@pkobp.pl
tel. +48 22 521 80 84

Macro Research Team

@PKO_Research

Marta Petka-Zagajewska
Senior Economist
marta.petka-zagajewska@pkobp.pl
tel. +48 22 521 67 97

Urszula Krynska
Economist
urszula.krynska@pkobp.pl
tel. +48 22 521 51 32

Kamil Pastor
Economist
kamil.pastor@pkobp.pl
tel. +48 22 521 81 08

Michal Rot
Economist
michal.rot@pkobp.pl
tel. +48 22 580 34 22

	2021	2022†
Real GDP (%)	5.9	4.9
Industrial output (%)	15.4	11.0
Unemployment rate# (%)	5.4	4.9
CPI inflation** (%)	5.1	13.3
Core inflation** (%)	4.1	8.3
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.

Inflation is back in town

- **CPI inflation in August unexpectedly jumped to 16.1% y/y from 15.6% y/y. All main categories except for fuels contributed for the rise in inflation.**
- **The core inflation most likely increased to 9.9% y/y from 9.3% y/y in July.**
- **MPC should be forced to increase rates in next week – probably by 25bp to 6.75%. The space for further rate hikes is severely limited, as even the biggest hawks from MPC admit (L.Kotecki, see Monetary Policy Monitor).**

CPI inflation in August jumped to 16.1% y/y in flash reading (cons: 15.4% y/y, PKOe: 15.5% y/y) from 15.6% y/y in July. All the main categories but for fuels contributed to the rise in inflation. The previously fading momentum of core inflation got strong again. As a result, the CPI index excluding food and energy (core inflation) most likely increased to 9.9% y/y from 9.3% y/y in July.

In August, after three months of deceleration, food price growth rate accelerated again (+ 1.6% m/m). The growth was stronger than our estimates, which could have resulted from the higher scale of sugar price increases (an aftermath of “a sugar rush” in August). In annual terms, food became more expensive by 17.4%, and taking into account further increases in agricultural commodity prices, energy and labor costs as well as disruptions in supply chains, further increases of food prices can be expected in the reminder of the year, even up to approx. 20% y/y.

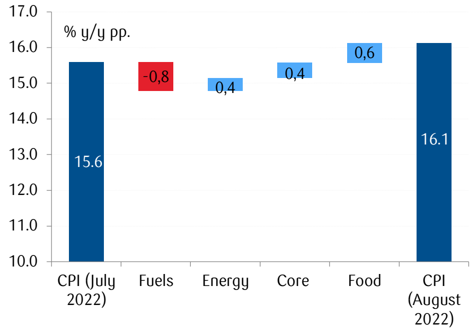
Prices of energy increased the most since March (by 3.7% m/m), which was probably due to strong increases in solid fuel prices and, to a lesser extent, heat. Prices in the remaining categories (gas, electricity, heat) are predominantly regulated by the Energy Regulatory Office, which for the time being does not allow for sudden increases. In the following months, heat bills may increase, and at the turn of the year, the scale of the increases in electricity and gas tariffs will be known.

Fuel prices were the only "big" category to record price drops in August (-8.3% m/m). Fuels lowered the inflation rate by 0.8pp y/y, but the remaining categories more than offset this decline.

In August, the rise in prices in the core categories picked up again. According to our estimates, core inflation increased to 9.9% y/y from 9.3% y/y in July, and its momentum (averaged m/m sa change) started to rise again. This indicates that companies are continuing to pass on rising costs to consumers and the persistence of the inflation shock.

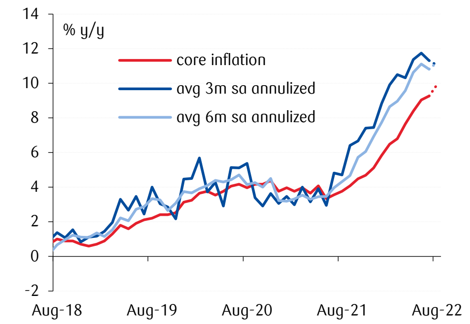
The expected by us "inflation plateau" will move up - until the end of the year, CPI inflation will remain at the level of approx. 15-16% y/y. At the beginning of the year, the political decision on the scale of dividing the costs of the increase in energy prices between households, energy companies and the state budget will be of key importance for inflationary processes. Today's data (especially an increase in core inflation) shift the balance of risk for a change in the NBP interest rate from 0-25 bp to 25-50 bp at the September meeting. **We expect the MPC to opt for a cautious 25bp move at next week's meeting, given the less inflationary structure of GDP growth and the sharp deceleration in manufacturing signaled by the PMI.**

Inflation change decomposition between August 2022 and July 2022



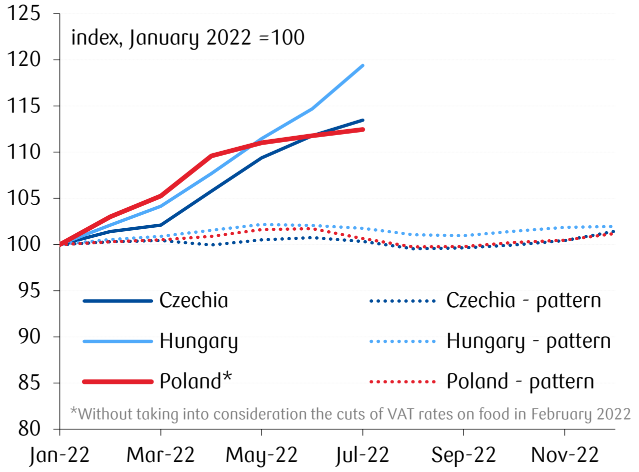
Source: GUS, PKO Bank Polski.

Estimated core inflation and annualized momentum

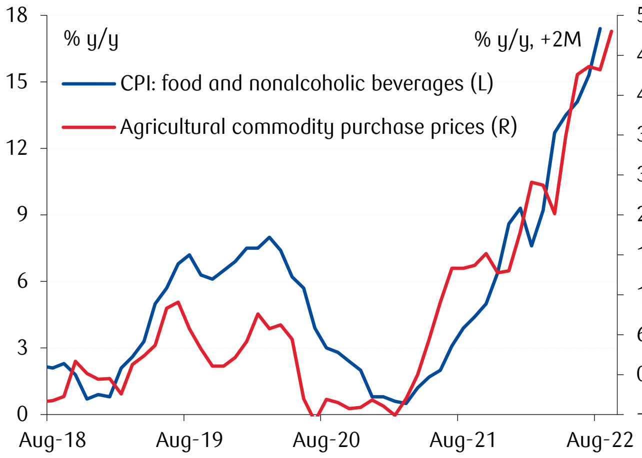


Source: GUS, PKO Bank Polski.

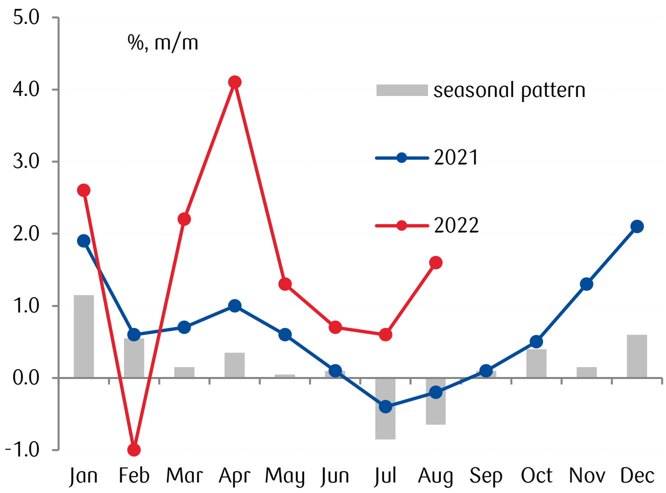
Food prices in CEE vs. seasonal pattern*



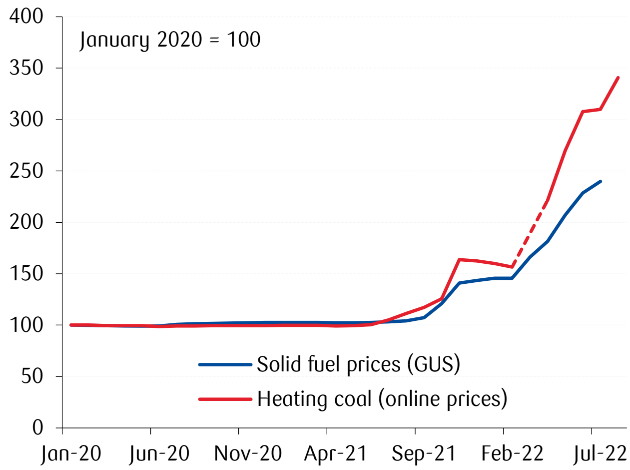
Agricultural commodity purchase prices vs. food price inflation



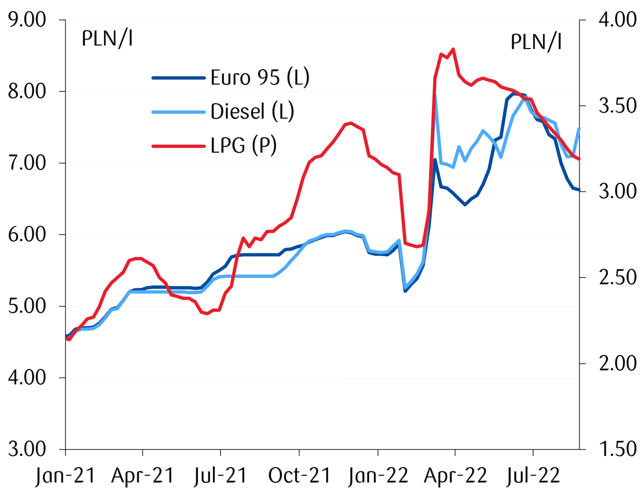
Change in food prices vs. seasonal pattern



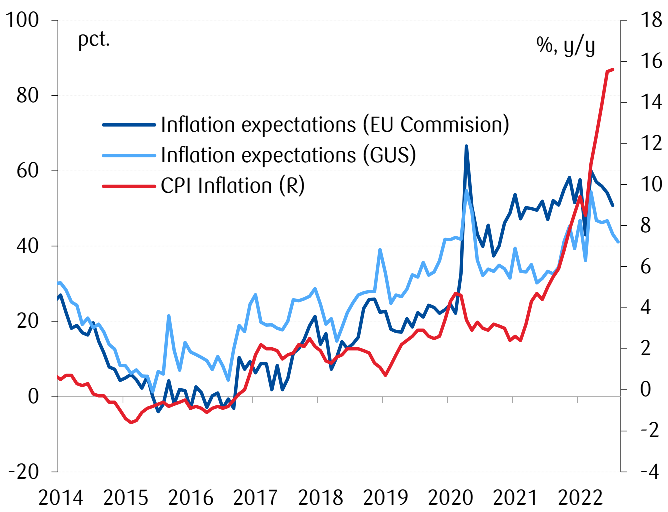
Average prices of heating coal vs. solid fuel prices according to GUS



Fuel prices change



Inflation expectations vs CPI inflation



Source: NBP, GUS, Eurostat, FAO, Macrobond, jakiekogroszek.pl e-petrol, PKO Bank Polski; own calculations.

Investment demand revival

- **2q22 GDP slowdown do 5.5% y/y form 8.5% y/y in 1q22 derived from the diminishing contribution from inventories due to inventories cycle reversal and to a lesser extent negative net exports. Deep GDP quarterly loss (2.1% q/q sa) was a "payback" of previously borrowed growth from future.**
- **Strong growth of investment (7.1% y/y vs 4.3% y/y in 1q22) occurred despite war in Ukraine and high geopolitical uncertainty.**
- **Future GDP growth structure (more oriented on investments, less on consumption) can be less inflationary.**

GDP growth in 2q22 was revised upward to 5.5% y/y (from 5.3% y/y in the flash estimate). The main component responsible for the decline in annual GDP growth from 8.5% y/y in 1q22 was inventories, whose contribution declined from a record 7.7pp in 1q22 to 1.9pp in 2q22, signaling the end of a process of non-standard inventory accumulation that had lasted more than a year.

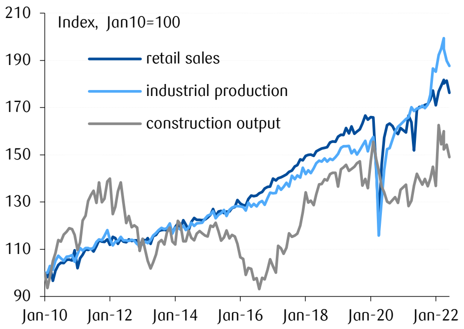
Domestic demand in 2q22 grew by 7.2% y/y (vs. 13.2% y/y in 1q22), and the contribution of net exports to GDP growth was -1.2pp (vs. -3.8pp in 1q22). In the structure of domestic demand itself, what stands out above all is **the strong growth in investment (7.1% y/y vs. 4.3% y/y in 1q22)**, already signaled by data from the enterprise sector. This means that domestic companies have not been frightened by high uncertainty, and their rising investment demand may be an adjusting response to, among other things, high energy prices (more expenditures related to modernization and efficiency gains). Additionally, it could be expansion of own storage space – a prerequisite for just-in-case logistics model – that could prop up investment demand.

Thanks to improved investment demand, the growth rate of domestic sales (i.e., domestic demand excluding inventories) increased slightly to 5.3% y/y (from 5.0% y/y in 1q22). Private consumption grew steadily (by 6.4% y/y vs. 6.6% y/y in 1q22). Exports also improved (up 5.2% y/y vs. 2.0% y/y in 1q22), but the high rate of growth in imports meant (for the record, in real terms, i.e. after adjusting for price changes in energy prices, among other things) that the contribution of net exports to growth was negative. This is probably a sign of strong investment demand, which traditionally has high import intensity.

Later in the year, GDP growth rate will continue to decline, giving back previously borrowed growth in the form of strong inventory accumulation. What is important here is that the structure of GDP becomes less inflationary. Weakening consumption will not support strong price increases. The shock to energy prices so far has probably been able to unleash adjustment processes that will result in productivity gains, particularly on the corporate side.

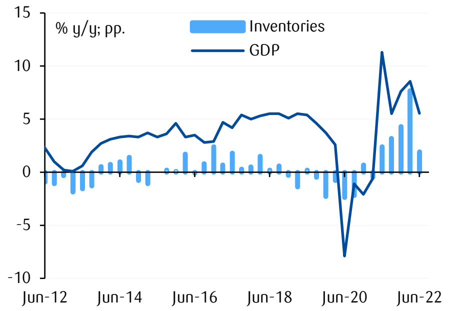
A set of GDP data for 2q22 provides arguments for halting the NBP's interest rate hike cycle in the near term. The picture of the economy that the Council received with the publication of the GDP structure data will, in our view, support the MPC members' cautious approach to domestic monetary policy so far.

Monthly trends in real sector



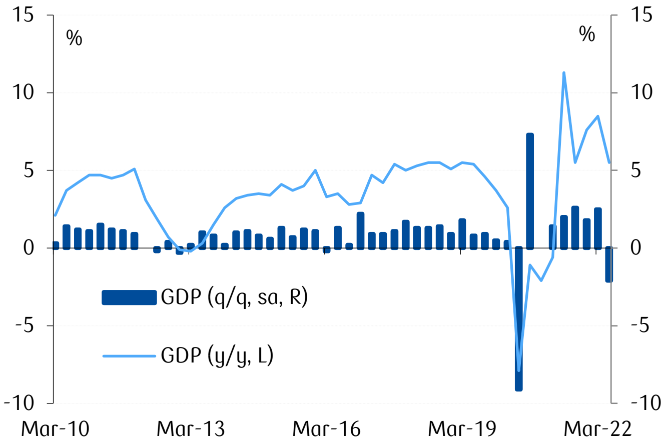
Source: GUS, PKO Bank Polski.

GDP growth and inventories contribution

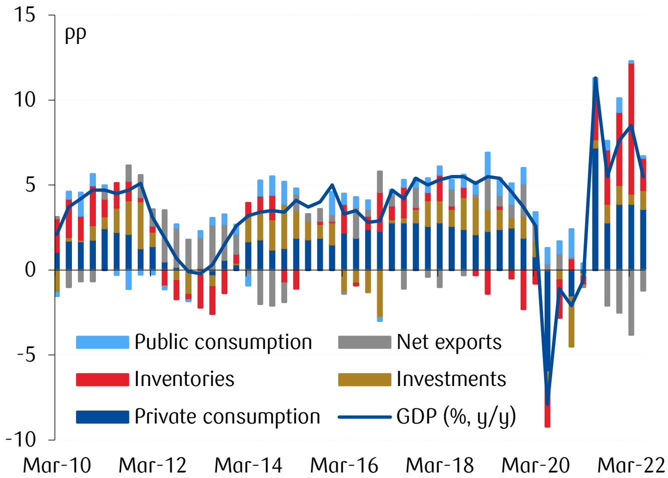


Source: GUS, PKO Bank Polski.

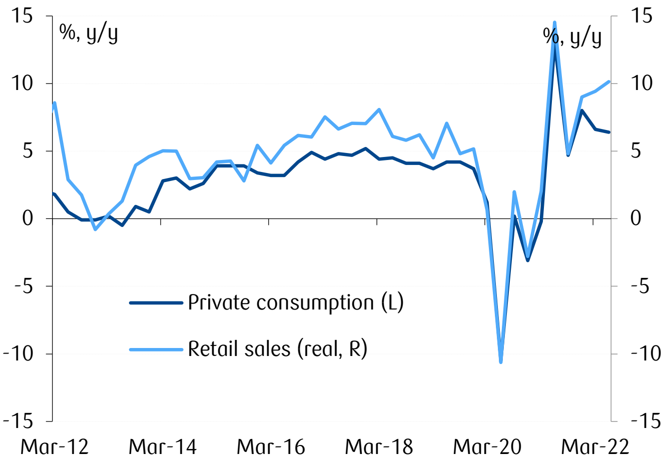
GDP growth



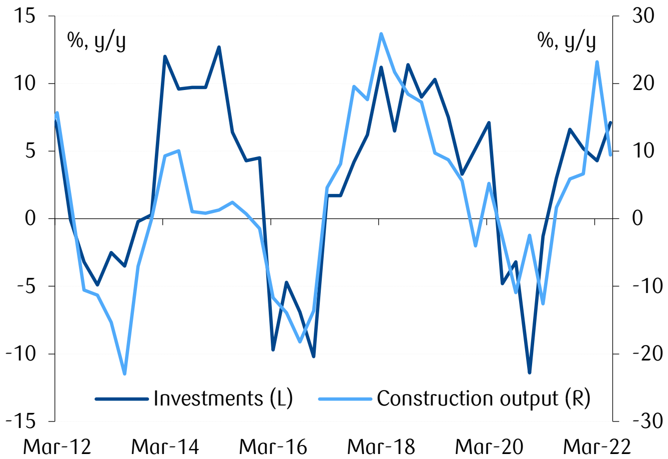
GDP growth structure



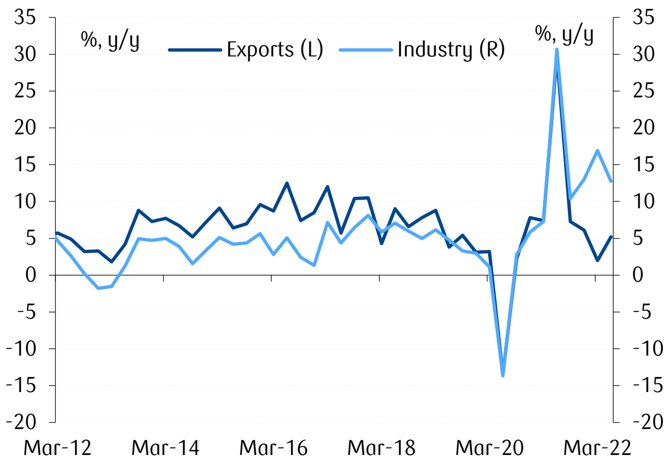
Retail sales vs. consumption



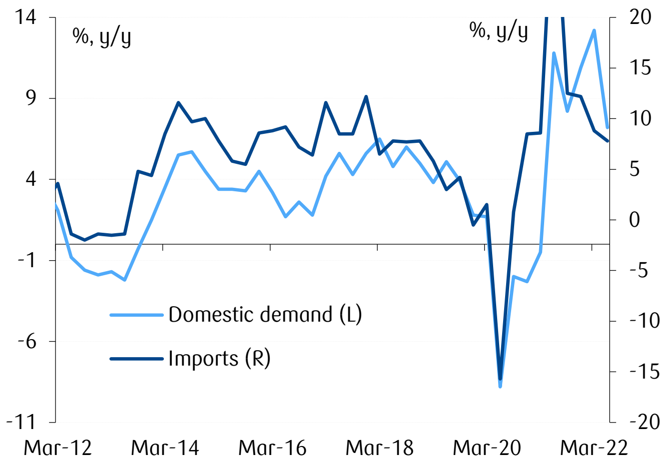
Construction production vs. investments



Industrial production vs. export



Domestic demand vs. import



Source: GUS, PKO Bank Polski.

Weekly economic calendar

Indicator	Time (UK)	Unit	Previous	Consensus*	PKO BP	Comment
Monday, 5 September						
GER: Services PMI (Aug, final)	8:55	pts.	49.7	48.2	--	--
EUR: Services PMI (Aug, final)	9:00	pts.	51.2	50.2	--	--
EUR: Sentix Index (Sep)	9:30	pts.	-25.2	-24.7	--	--
EUR: Retail sales (Jul)	10:00	% y/y	-3.7	-0.3	--	--
Tuesday, 6 September						
GER: Factory orders (Jul)	7:00	% m/m	-0.4	-0.5	--	--
GER: Factory orders (Jul)	7:00	% y/y	-9.0	-13.5	--	--
Wednesday, 7 September						
GER: Industrial production (Jul)	7:00	% m/m	0.4	-0.3	--	--
GER: Industrial output (Jul)	7:00	% y/y	-0.5	-1.0	--	--
EUR: Employment (2q)	10:00	% y/y	2.4	2.6	--	--
EUR: GDP growth (2q)	10:00	% y/y	3.9	5.1	--	--
USA: Trade balance (Jul)	13:30	bn USD	-79.60	-72.30	--	--
POL: NBP base rate (Sep)	**--**	**%**	**6.50**	**6.75**	**6.75**	**We expect that MPC will decide to raise rates by 25bp. This move is preferred by majority of MPC members according to their public speeches. We also think this would be the most appropriate decision in environment of decelerating economy.**
Thursday, 8 September						
HUN: CPI inflation (Aug)	8:00	% y/y	13.7	--	--	--
EUR: ECB Refinancing Rate	13:15	%	0.50	1.25	1.25	--
EUR: EBC deposit rate	13:15	%	0.00	0.75	0.75	--
USA: Initial Jobless Claims (Sep)	13:30	ths	232	--	--	--
Friday, 9 September						
CHN: PPI inflation (Aug)	2:30	% y/y	4.2	3.1	--	--
CHN: CPI inflation (Aug)	2:30	% y/y	2.7	2.8	--	--

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	**“However, it should certainly be assumed that there is still, in September or October, room for an interest rate hike. The increase does not necessarily have to be very high, but the Council should send a reminder that the level of inflation after the summer is not acceptable to the MPC. Especially since the zloty has weakened sharply. (...) In my opinion, there is still no way to definitively end the cycle. (...) Rate hikes on the one hand, but on the other hand it's probably worthwhile - because here the room for maneuver may be getting smaller and smaller in terms of interest rates, we can't cause a disaster for borrowers and institutions - to consider the idea of anti-inflationary bonds issued by the NBP.." (1.09.2022, PAP, 31.08.2022 TVN24, PAP)**
H. Wnorowski	4.2	**“This Wednesday we have a decision-making meeting. We can rule out a rate cut, and a small hike or holding rates are equally likely. At the moment, however, it can be said that we are slowly approaching the end of this uphill road, but when we start to cut interest rates depends on a number of factors..” (31.08.2022, TVP Białystok, Kurier Poranny, PAP)**
A. Glapinski	3.4	**“A scenario may emerge from the MPC's discussions in which we raise interest rates one more time by 25 bps or twice by 25 bps each. However, it also cannot be ruled out that we will end raising interest rates for the time being, but at the same time we are not tying our hands and announcing the end of the hike cycle. (PKO: If inflation were to come to a halt over the vacations) then we would not raise interest rates further. On the other hand, I assume that we will not have such a comfortable situation. So a scenario comes into play, in which we decide on a small hike in September and announce a break in the cycle, but do not declare the end of it. It is also possible that the MPC will do nothing more with rates in September, but will not make a declaration of the end of hikes. (29.08.2022, Business Insider)**
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	**"I still see space for possible further interest rate hikes, although on a smaller scale than before. I expect inflation to decline next year. I see greater uncertainty with regard to economic growth, more specifically, as to the extent of the economic slowdown. This leads me to conclude that the prospect of rate cuts in 2023 cannot be ruled out.” (1.09.2022, PAP).**
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).
(Vacant places (3))	--	--

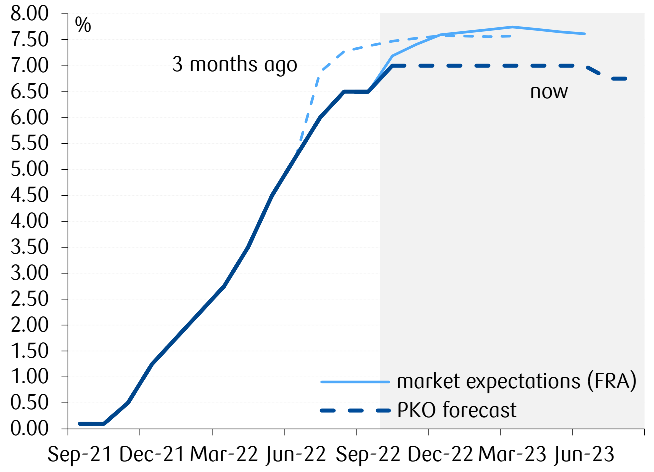
*the higher the indicator the more hawkish views. The positioning has been made based positively on PAP survey conducted among economists at banks in Poland (scale 1-5). ^**Quotes in bold** have been modified in this issue of Poland Macro Weekly.

Interest rates – PKO BP forecasts vs. market expectations										
		1M	2M	3M	4M	5M	6M	7M	8M	9M
Date	1-Sep	1-Oct	1-Nov	1-Dec	1-Jan	1-Feb	1-Mar	1-Apr	1-May	1-Jun
WIBOR 3M/FRA†	7.14	7.39	7.61	7.80	7.84	7.90	7.95	7.90	7.85	7.82
implied change (b. p.)		0.25	0.47	0.66	0.70	0.76	0.81	0.76	0.71	0.68
MPC Meeting	7-Sep	5-Oct	9-Nov	7-Dec	-	-	-	-	-	-
PKO BP forecast*	6.50	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00
market pricing*		6.75	6.97	7.16	7.20	7.26	7.31	7.26	7.21	7.18

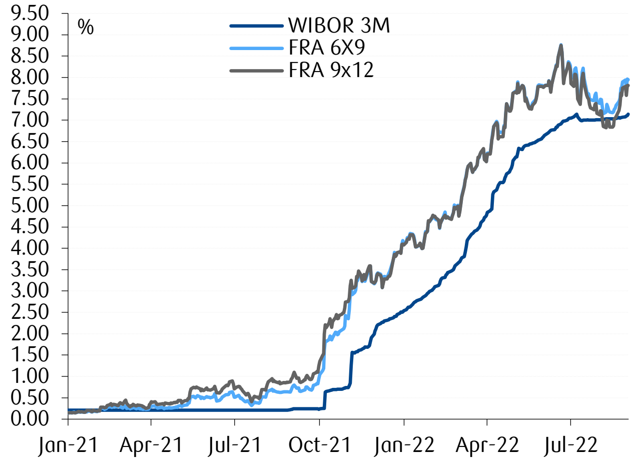
†WIBOR 3M from the last fixing, FRA transactions based on WIBOR 3M for subsequent periods, ‡in basis points, *PKO BP forecast of the NBP reference rate.

Poland macro chartbook

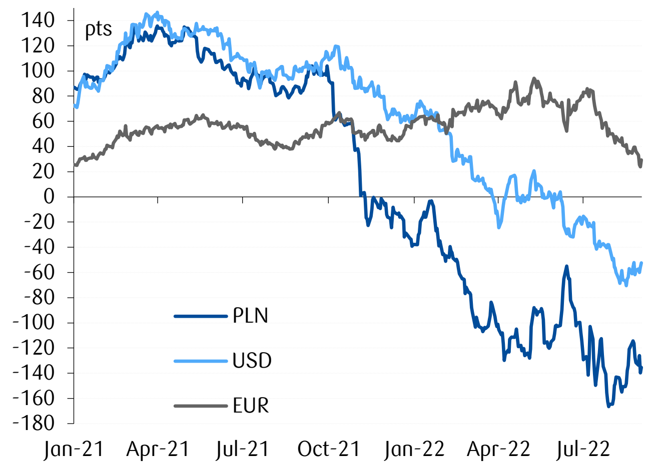
NBP policy rate: PKO BP forecast vs. market expectations



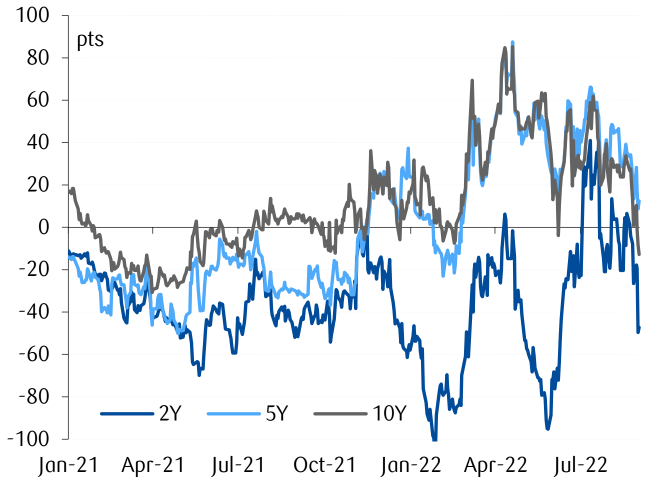
Short-term PLN interest rates



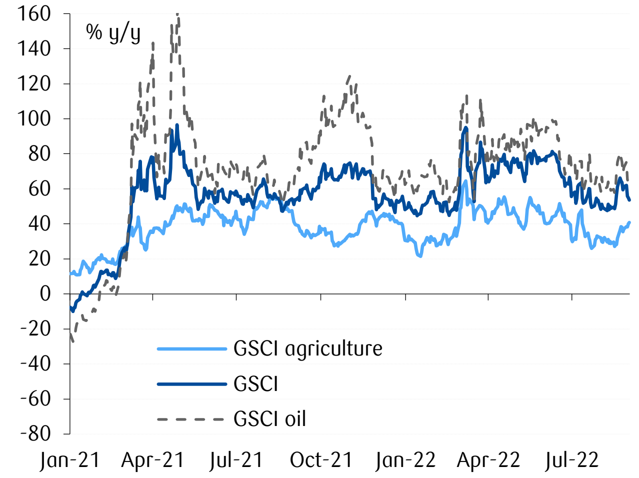
Slope of the swap curve (spread 10Y-2Y)*



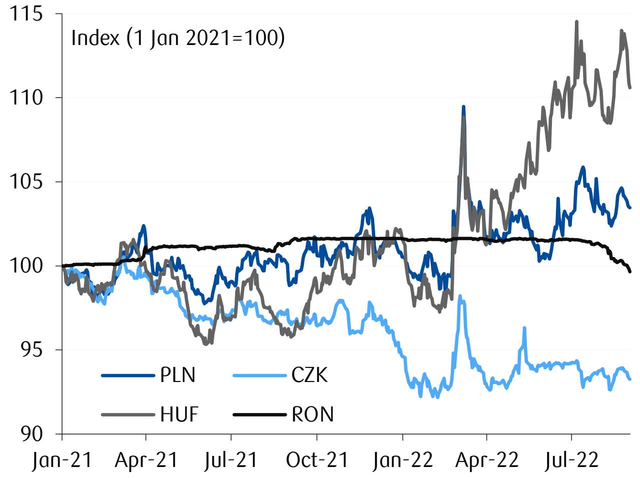
PLN asset swap spread



Global commodity prices (in PLN)

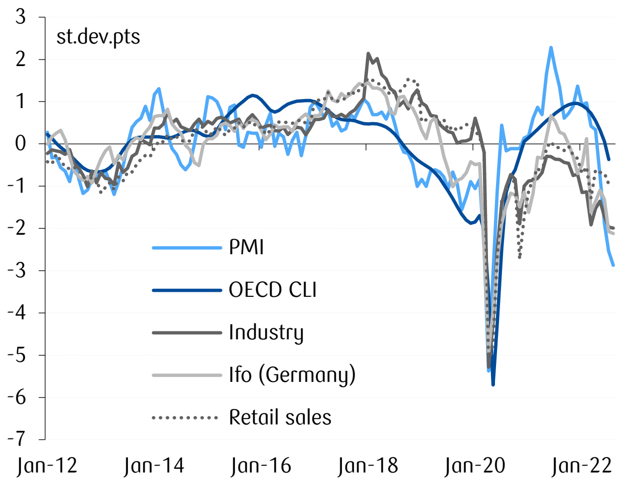


Selected CEE exchange rates against the EUR

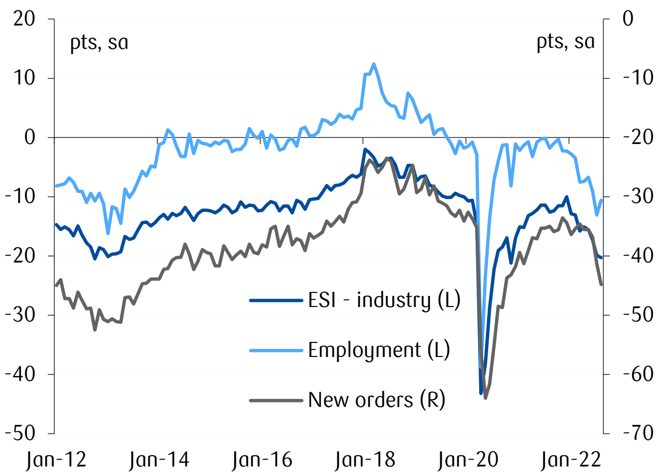


Source: Datastream, NBP, PKO Bank Polski. *for PLN, and EUR 6M, for USD 3M.

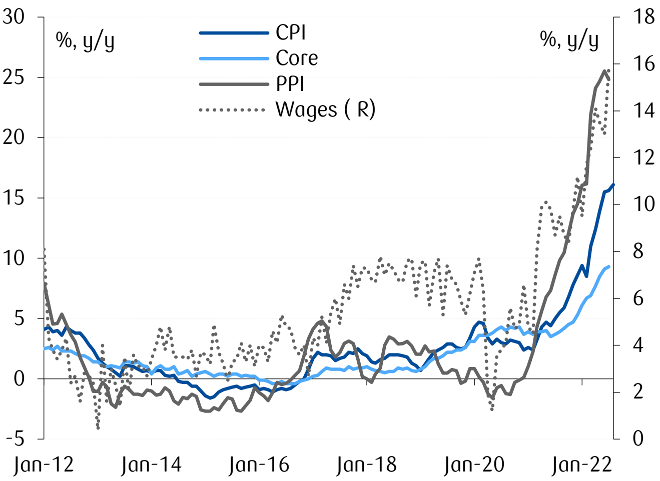
Economic sentiment indicators



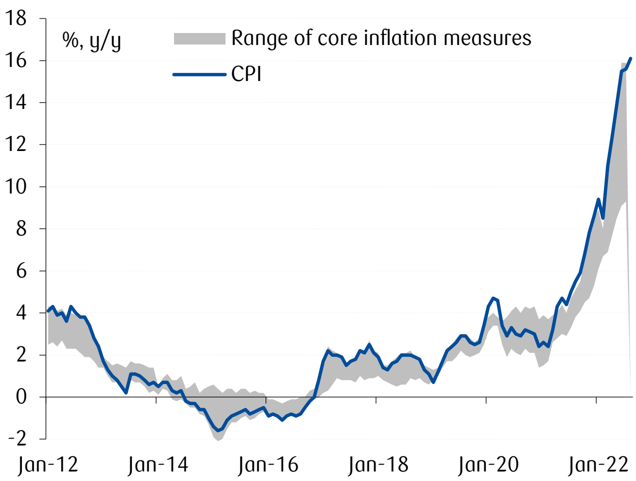
Poland ESI for industry and its components



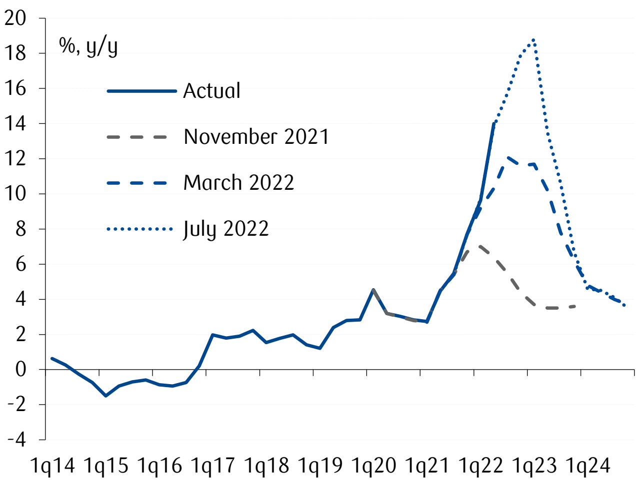
Broad inflation measures



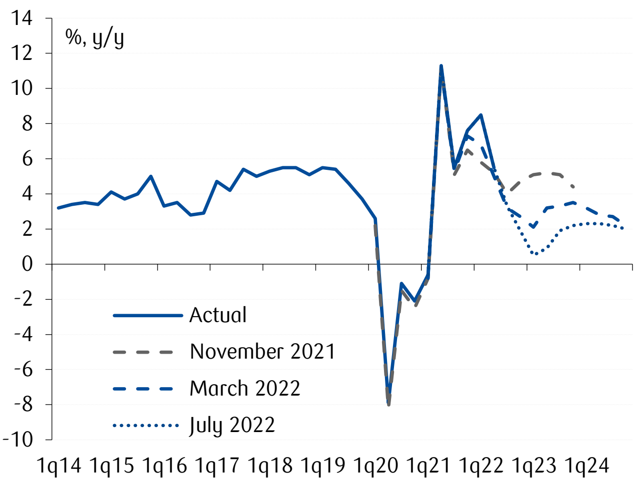
CPI and core inflation measures



CPI inflation – NBP projections vs. actual

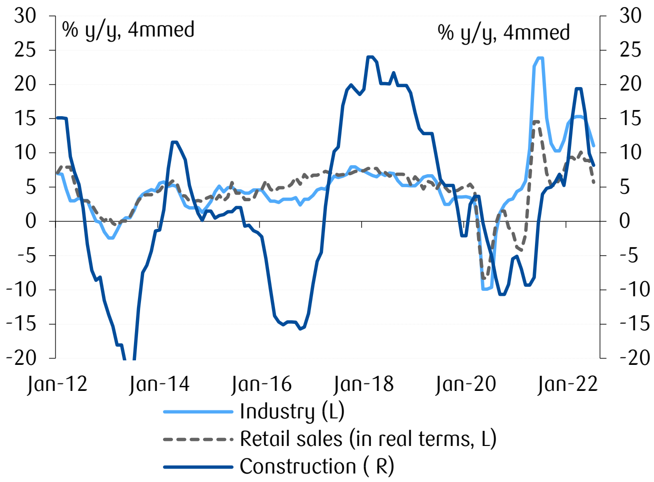


Real GDP growth – NBP projections vs. actual

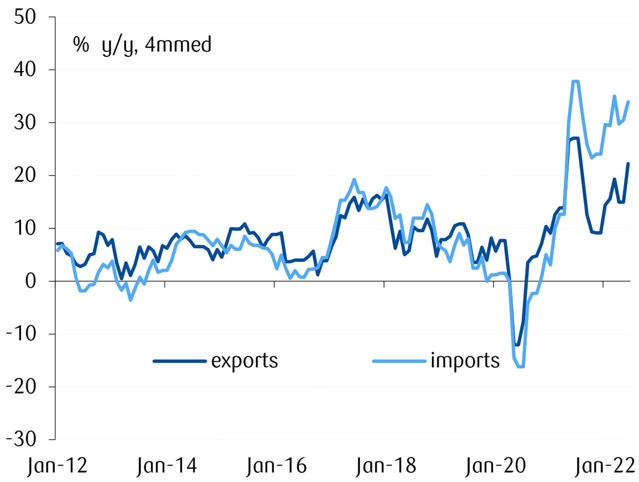


Source: Datastream, GUS, EC, NBP, PKO Bank Polski.

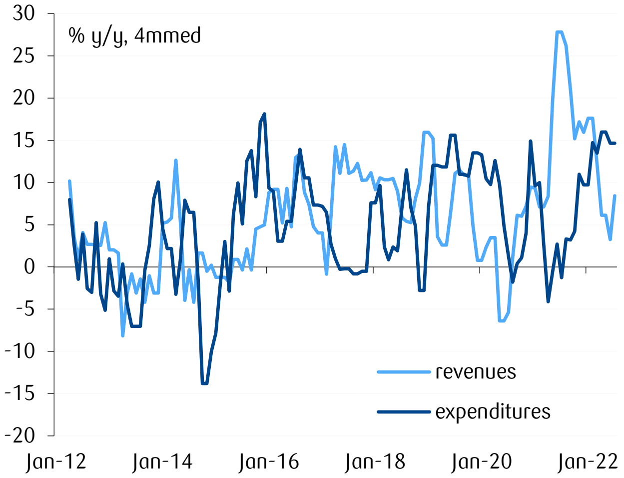
Economic activity indicators



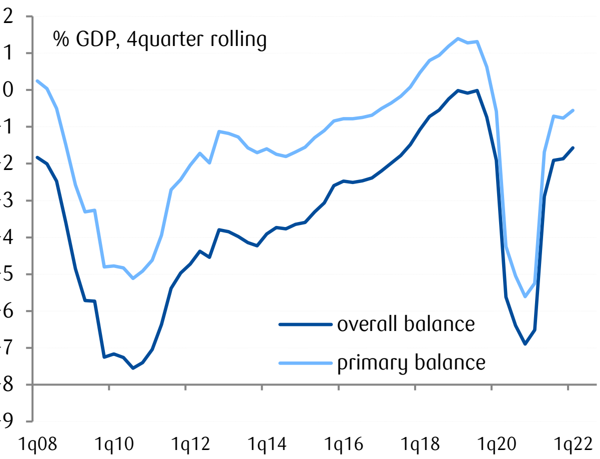
Merchandise trade (in EUR terms)



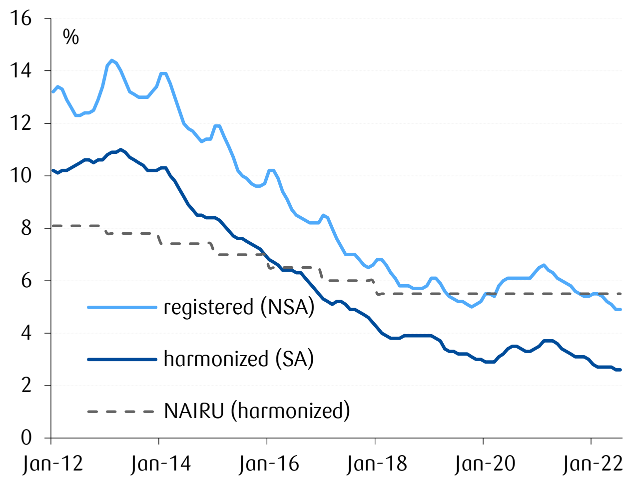
Central government revenues and expenditures*



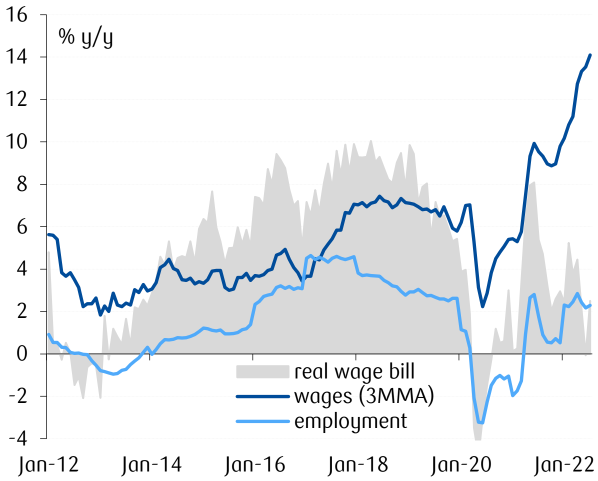
General government balance (ESA2010)



Unemployment rate

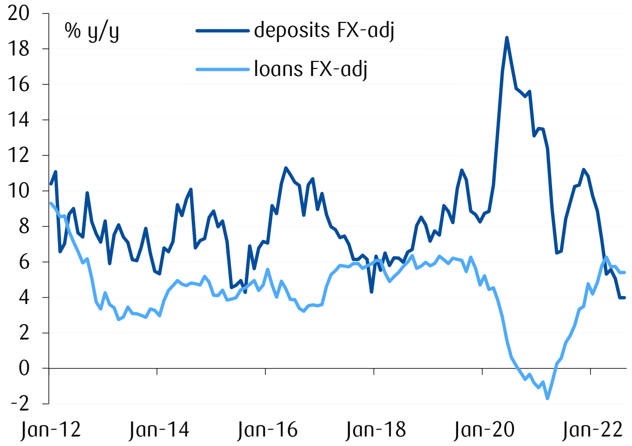


Employment and wages in the enterprise sector

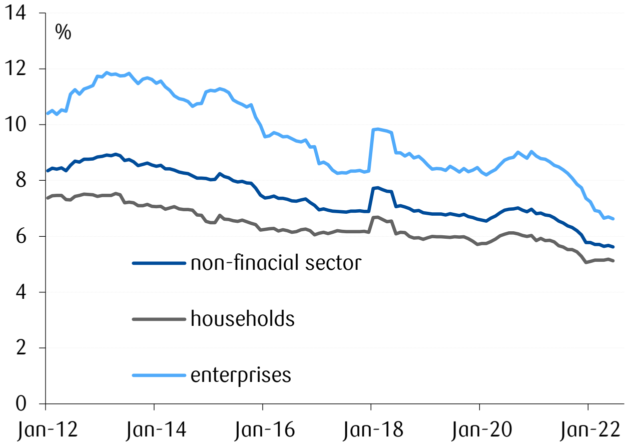


Source: NBP, Eurostat, GUS, MinFin, PKO Bank Polski. *break in series in 2010 due to methodological changes.

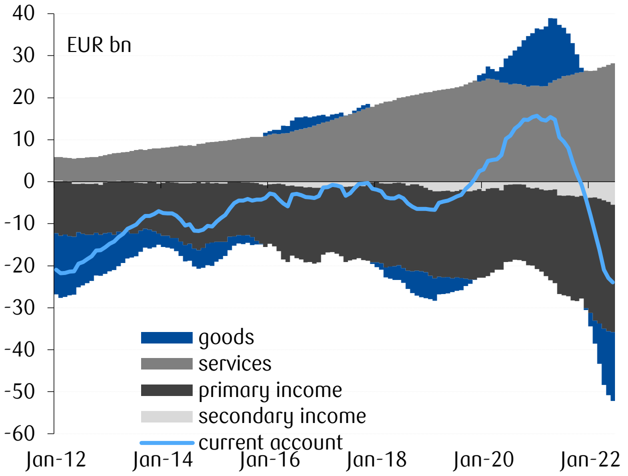
Loans and deposits



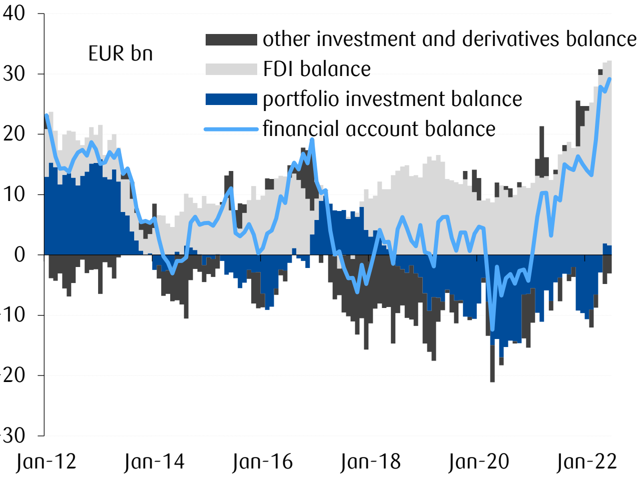
Non-performing loans (NPLs) – by sectors*



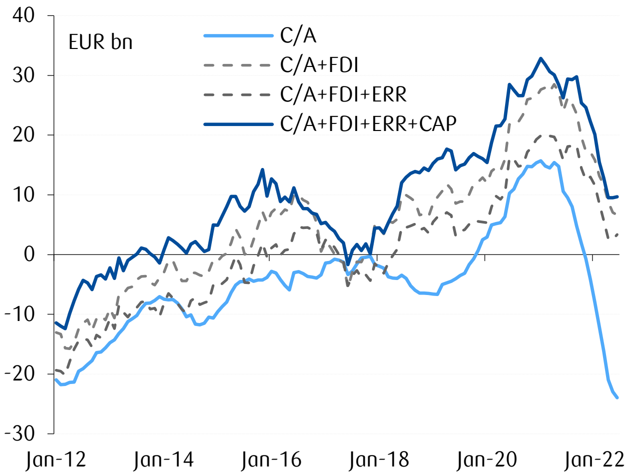
Current account balance



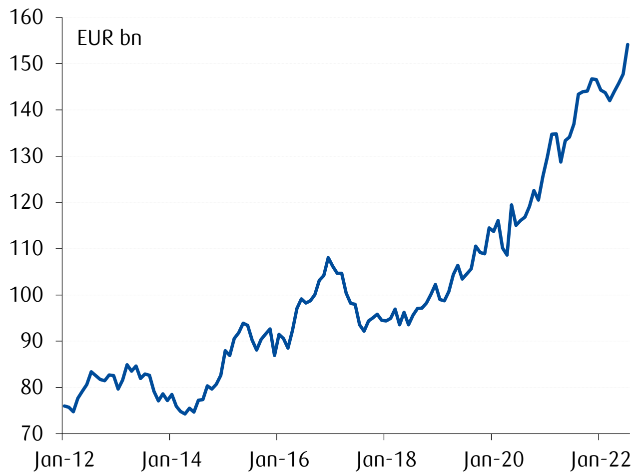
Financial account balance



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:

- 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 dillema (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)
- Inflation's back, policy fights back (Jan 14, 2022)
- Housing market boom is getting over (Dec 17, 2021)