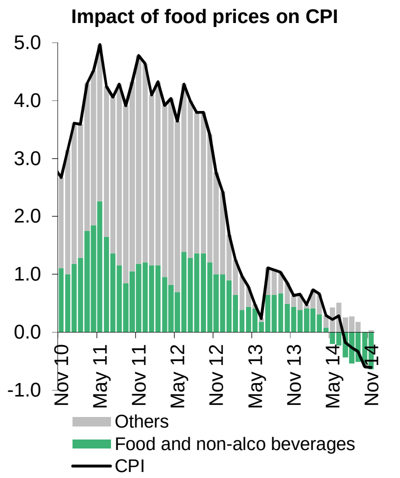
INSTANT COMMENT

15 December 2014

Deflation is here to stay for longer

CPI inflation remained at -0.6%YoY in November, below market consensus. Main sources of surprise were lower prices of communication, transport and healthcare. We think CPI will drop further, even to -1%YoY in 1Q15, largely due to continued slump of fuel prices, passing through to other sectors. We estimate that average fuel price plummeted in December by further 4%MoM, after c.3%MoM drop in November, and in 2015 it may be at least 10% lower on average than in 2014, reducing CPI inflation by c.0.5 pp. It seems highly likely to us that deflation is here to stay at least until the middle of 2015, and maybe even until the end of 3Q15, which will surprise the central bank. Lower CPI and some disappointment from real activity data (our forecasts for November industrial output are clearly below market consensus) may trigger another interest rate cut by 25bp, in our view.

Current account balance reached -€435m in October, and was lower than expected by the market. Exports and imports were higher than we had predicted, which confirmed signals from the CSO data. It is important to note that the latter suggested some revival of export growth to some euro zone countries, which may be good news for Poland's economic outlook.



Falling fuel prices push CPI lower

Inflation rate came in at -0.6%YoY in November, unchanged versus October. We expected -0.5%YoY, while the market consensus was between -0.4% and -0.5%, depending on the source. Surprise came mainly from more pronounced decline of prices of communication (-0.7%MoM, among others thanks to lower prices for internet and phone services), transport (-2%MoM, with fuels cheaper by 3%MoM) and lower healthcare costs (-0.1%MoM, while we expected a rise). Prices of food and non-alcoholic beverages declined only slightly (-0.1%MoM), while we forecasted a stabilization.

The drop in both food and fuel prices is still pushing the headline CPI downwards and in our opinion this situation will not change substantially in the nearest months. On the contrary, the pressure from cheaper fuels will deepen due to recent slump in world crude oil prices (which are positively correlated with global food prices). Our estimates show that in December the average fuel price on Polish pump stations fell by 4%MoM (vs decline by c.3% in November), while in 2015 we are expecting fuels prices to be lower by at least 10% on average than this year. It will deduct from the headline CPI in 2015 at least 0.5 pp (even disregarding indirect effects).

In our view, the "deflation trough" has not been reached yet and the annual CPI may fall further to around -1% in 1Q15. Furthermore, deflation may last longer than assumed so far – currently we estimate that it may be at least until mid-2015, and possibly even until the end of 3Q15. This is likely to surprise the central bank. Please recall that NBP governor Marek Belka mentioned during the last MPC press conference that deflation could last until February 2015.

According to our estimates, core CPI after excluding food and energy prices reached 0.5%YoY vs. 0.2%YoY in October. This inflation measure may move very slowly up in the coming months, but we do not expect it to exceed 1.5%YoY before the end of 2015.

Surprise in deeper and longer sub-zero inflation and some disappointing economic activity data (including negative growth of industrial and construction output for November expected by us) should, in our opinion, allow the MPC to cut rates by 25bp in 1Q 2015.

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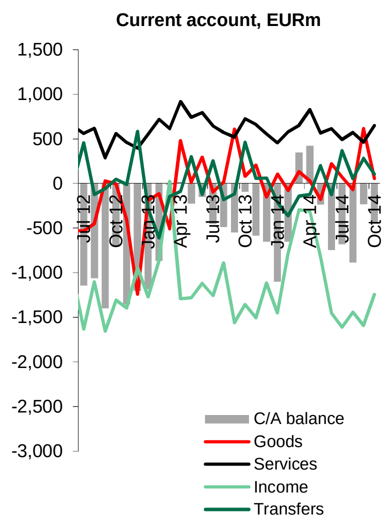

Foreign trade volumes higher than expected

Current account balance showed -€435mn in October, slightly below market expectations (-€356mn) and above ours (-€783mn). Foreign trade volumes were higher than we and the market expected, both as regards exports (growth by 3.2%YoY) and imports (growth by 3.4%YoY). Both statistics showed some slowdown as compared to September, but let us remind that September was positively affected by working days effect. The better-than-expected data suggest that in Q4 both foreign and domestic demand may be in better shape than we thought previously. Upward risk for our forecast was indicated by the CSO data, which showed a revival of exports to such important receivers of Polish products as Germany or France. Confirmation of these tendencies after release of revised data (at the end of the month) can be a strong positive signal for prospects of domestic exports and industry in the upcoming quarters.

Current account deficit was made of: goods surplus worth €56mn, services balance surplus worth €548mn, primary income deficit worth €1244mn and secondary income deficit worth €105mn. According to our estimates, 12-month current account deficit amounted to 1.3% of GDP.

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