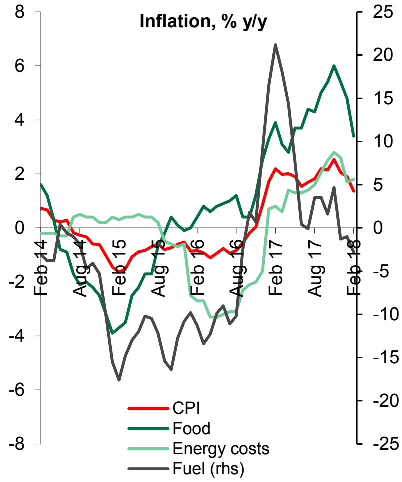
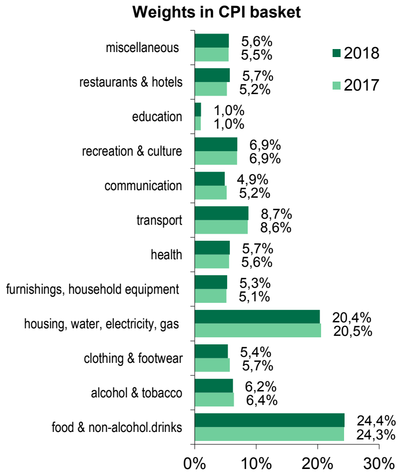
ECONOMIC COMMENT

15 March 2018

Inflation out of the band

Polish inflation in February was only 1.4% y/y, down from 1.9% y/y. The consensus was 1.7-1.8%, we expected 1.6%. Food was the main culprit of the CPI slide - all items that were pushing inflation higher in 2017 subsided in early 2018 (eggs, milk, meat and vegetables - it is quite unusual for this last item to get cheaper in Feb). Goods price growth decreased from 1.5% y/y to 1% while services inflation from 2.8% y/y to 2.3% - despite growing labour costs due to tight labour market. Our rough estimate points to a decrease of core inflation to 0.8% y/y in Feb from 1.0% in January. This only amplifies the downside surprise of the release. The change of weighs in CPI basked did not change the January reading, but in the coming months it should lift inflation very slightly (by no more than 0.03pp at the year-end). It now seems much less likely that CPI could hit the 2.5% y/y inflation target this year. Instead it might remain below 2% for the better part of the year.





Polish inflation in February was only 1.4% y/y, down from 1.9% y/y. The consensus was 1.7-1.8%, we expected 1.6%. This was the first release to include revised CPI weights. Food was the main culprit of the larger-than-expected CPI slide - all items that were pushing inflation higher in 2017 subsided in early 2018, ie eggs, butter, milk, meat, sugar and vegetables (it is quite unusual for this last item to get cheaper in Feb). Food prices dropped 0.4% m/m, while we expected +0.2%, already assuming some decreases in the mentioned items. Fuel prices was the category affecting most negatively the m/m CPI changes (by -0.08pp), but this was expected. A negative surprise, apart from food price behaviour, was also due to prices in telecommunication and 'footwear and apparel' – which enter the core inflation basket.

Our rough estimate points to a decrease of core inflation to 0.8% y/y in Feb from 1.0% in January. This only amplifies the downside surprise of the release as core CPI was expected to rise from 0.9% to 1% in January and stay there in February (the January release for CPI offered limited information and did not allow for calculation of the core measure). Goods price growth decreased from 1.5% y/y to 1% while services inflation dropped from 2.8% y/y to 2.3% - despite growing labour costs due to tight labour market. We still think core CPI will be heading higher in 2018, possibly coming close to 2% y/y at the end of the year.

The change of weighs in CPI basked did not change the January reading, but in the coming months it should lift inflation very slightly (by no more than 0.03pp at the year-end). Hotels and restaurants saw the largest rise of weight, by 0.48pp to 5.71%, food rose only slightly, despite the fact that 2017 inflation was built mostly on price changes in this category. Healthcare weight also went up. The share of household expenditures on shoes and clothes, communication and house maintenance decreased.

It now seems much less likely that CPI could hit the 2.5% y/y inflation target this year, as we expected earlier. Adjusting for the substantial negative surprise in the February reading we now have doubts if inflation could climb back and hold above 2% this year. It still might temporarily exceed 2% in the middle of the year, but base effect could bring it down to about 1.5% in Nov-Dec. The February CPI supports the current MPC rhetoric that interest rates should stay unchanged not only this year but also in 2019, if economic situation would develop in line with the March inflation projection. After all, CPI unexpectedly slipped out of the +/-1pp band of tolerable deviations around the 2.5% target, in which it stayed since the start of 2017. We have recently delayed our expectations for the beginning of monetary tightening to late 2019.

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