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Economic Comment

Central bank removed the punch bowl

Piotr Bielski, +48 48 22 534 18 87, piotr.bielski@santander.pl

Polish MPC raised the main reference rate from 0.1% to 0.5%, the lombard rate from 0.5% to 1.0% and kept deposit rate at 0.0%. The reserve requirement rate was raised from 0.5% to 2.0%.

We think this is just the beginning of the tightening cycle. We do not expect the pace of rate hikes to be very rapid, as Glapiński was emphasizing many times it is crucial that removal of accommodation must not hamper economic growth. However, a sequence of +25bp rate hikes in the coming months is quite possible, as inflation will be quickly breaching next thresholds – most likely above 6% in October, near 7% at the turn of the year. Some hints about the timing and scale of next moves may be laid out tomorrow at 15:00 at the NBP president's press conference.

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We find the timing of the decision quite surprising as the earlier communication strongly emphasized the need to wait for the new NBP projections (which will be available in November). Even yesterday the NBP governor, while clearly admitting the need for policy adjustment is nearing, stressed that at the moment he believes that inflation is "entirely" driven by supply-side shocks. But in general the decision goes in the right direction and is adequate – we have been arguing for some time the economy needs monetary policy adjustment.

The post-meeting statement is quite short, the MPC says that elevated inflation "mostly" results from exogenous shocks, beyond the monetary policy control (in previous months, and in yesterday Glapiński's speech it was "entirely" exogenous). But at the same time the Council admits that now it sees the risk that inflation may be more persistent amid likely further economic revival and strong labour market. There is no signal about possible continuation of rate hikes whatsoever. The statement says that NBP may continue using FX interventions and "other instruments consistent with monetary policy guidelines" (which possibly includes QE, although earlier it was listed explicitly in the statement). The next NBP auction is planned for October 13.

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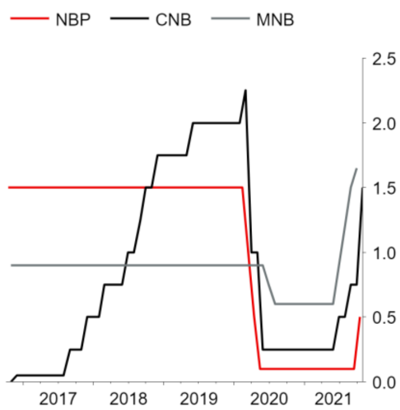
Main interest rates in CEE3



Source: Refinitiv Datastream, Santander Bank Polska

Economic Analysis Department:

al. Jana Pawła II 17, 00-854 Warszawa
email: ekonomia@santander.pl
website: santander.pl/en/economic-analysis
Piotr Bielski +48 22 534 18 87
Marcin Luziński +48 22 534 18 85
Wojciech Mazurkiewicz +48 22 534 18 86
Grzegorz Ogonek +48 22 534 18 84

Changes versus September's statment

~~NBP will continue to purchase government securities and government-guaranteed debt securities on the secondary market as part of the structural open market operations. The timing and scale of the conducted measures will depend on the market conditions. Furthermore, NBP will also offer bill discount credit aimed at refinancing loans granted to enterprises by banks.~~ Moreover, the Council decided to increase the required reserve ratio from 0.5% to 2.0%

~~Over the recent period, as the Delta variant of the coronavirus spread, the pandemic situation around the world has worsened. An~~The activity in global economy continues to recover, yet an increase in the number of infections observed in recent months together with supply-side constraints ~~observed in certain markers hampered~~in some markets, has contributed to the ~~improvement~~weaker activity growth in some ~~economic indicators. At the same time, data on GDP in 2021 Q2 confirmed a significant increase in activity in the major~~ economies~~, which also encompassed a revival of the service sector.~~ in Q3. The global commodity prices ~~of many~~– in particular that of natural gas, but also oil and some agricultural commodities~~, including oil,~~ – have risen markedly in the recent period and are ~~significantly~~now much higher than a year ago. ~~In recent months the global prices of some agricultural products have also risen markedly. Along~~Together with ~~the~~ supply-side ~~disruptions affecting the production of certain industrial goods, this~~constraints in some markets and fast growth in prices of international transport, it has contributed in recent months to ~~a~~ significant ~~rise~~increase in inflation in many economies~~, including in the United States and the euro area. However, due to persistently muted economic activity combined with uncertainty about the economic outlook~~. Nevertheless, major central banks are keeping interest rates low while continuing asset purchases ~~and signalling that loose monetary policy will be maintained in the future~~.

In Poland, ~~according to the preliminary estimate of Statistics Poland, the annual GDP growth in 2021 Q2 increased to 11.1% y/y. The main factor supporting the economic recovery was a strong rise in private consumption and – to a lesser extent – investment. 2/3 At the same time, LFS data suggested an improvement in labour market conditions in 2021 Q2. However, the average paid employment in the national economy is still persistently lower than before the pandemic. In July 2021~~economic activity continues to recover. In August, the annual growth of retail sales, industrial production and of construction and assembly output ~~decreased, which was only partially driven by statistical base effects. This was accompanied by weaker annual increases in average~~ have picked up. At the same time, supply-side constraints in some markets are weighing on business sentiment in the manufacturing sector. Even though the average employment in the enterprise sector ~~and in~~has been still somewhat below the pre-pandemic level, the situation in the labour market is improving which is reflected in substantial average wage growth in this sector. ~~At the same time, some people employed in sections most severely affected by the earlier restrictions still have their remuneration subsidised under anti-crisis measures. Available forecasts indicate that~~In the coming quarters ~~will see a continuation of the recovery in~~, economic ~~activity~~conditions are expected to remain favourable, although ~~its scale and pace are highly uncertain. The further course of the pandemic and its impact on economic situation in Poland and abroad continues to be the main source of~~ there is still an uncertainty~~. The economic policy measures, including the easing of NBP's monetary policy introduced last year, and the expected further recovery in the global economy will have a positive impact~~ regarding an impact of autumn wave of the epidemic on the ~~domestic economic situation. The pace of the economic recovery in Poland will also depend on further developments of the zloty exchange rate.~~economic activity

~~According~~Inflation in Poland, according to the Statistics Poland flash estimate for ~~August~~September 2021, ~~inflation in Poland~~ increased to 5.~~4~~8% in annual terms, and in monthly terms it amounted to 0.~~2~~6%. The elevated inflation resulted, to a great extent, from ~~fuel price growth – related to the significantly~~ factors beyond the control of domestic monetary policy, such as higher ~~global oil prices~~ than a year ago ~~– as well as from food price growth. Additionally, annual inflation rate continued to be pushed up by the~~global prices of energy and agricultural commodities, earlier increase in electricity prices ~~at the beginning of 2021 and the increases~~ and in waste disposal charges, ~~i.e. by the factors that – similarly as growing commodity prices – are beyond the control of domestic monetary policy. The rising costs of running business amidst the pandemic, higher~~as well as disruptions in global supply chains and international transport ~~charges and temporary disruptions in supply chains, also continue to add to inflation~~. The ongoing economic recovery, including rising household income, has also added to the price growth.

~~The above-mentioned factors will probably translate into annual price growth staying above the upper bound for deviations from the inflation target in the coming months. At the same time, in 2022 – after some factors temporarily increasing price growth fade – inflation is expected to decrease. Price developments next year will depend on the robustness of economic recovery, including the situation in the labour market following the phasing-out of the anti-crisis measures. As indicated in Monetary Policy Guidelines for 3/3 2021, due to the macroeconomic and financial shocks, inflation may temporarily deviate from the target and even run outside the band for deviations from the target. The response of monetary policy to the shocks is flexible and depends on their causes and the assessment of persistence of their effects, including their impact on inflation developments. NBP's monetary policy supports the consolidation of economic recovery following the pandemic-induced recession and stabilises inflation at the level consistent with the NBP's inflation target in the medium term.~~Even though the impact of some supply-side factors currently increasing inflation will fade next year, the rise in global prices of both energy and agricultural commodities observed in recent months may still increase price growth in the coming quarters. Amidst probable further economic recovery and favourable labour market conditions, inflation may remain elevated longer than hitherto expected.

~~Taking into account the sources~~Such a situation would generate a risk of ~~currently elevated~~ inflation ~~and the expected temporary nature of higher~~staying above inflation~~, while considering also the uncertainty about the robustness and scale of the economic recovery, NBP is keeping interest rates unchanged. At the same time, NBP will continue to purchase government securities and government-guaranteed debt securities on the secondary market as part of the structural open market operations. These operations are aimed at changing the long-term liquidity structure~~ target in the ~~banking sector, ensuring the liquidity in the secondary markets for the purchased securities and enhancing the impact of the NBP's interest rate cuts on the economy, i.e. strengthening the monetary policy transmission mechanism.~~medium term. In order to ~~strengthen the impact of the NBP's monetary policy easing on the economy,~~decrease the inflation to NBP target in the medium term, the Council decided to increase NBP interest rates. Moreover NBP may ~~also~~still intervene in the foreign exchange market~~.~~ and use other instruments envisaged in the Monetary Policy Guidelines. The timing and scale of the measures taken by NBP will depend on the market conditions~~. Furthermore, NBP will also continue to offer bill discount credit aimed at refinancing loans granted to enterprises by banks.~~