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Economic Comment

Policy of uneven steps

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Polish Monetary Policy Council again surprised the market, yet this time raised rates less than expected (75bp vs forecasts at 100bp). Reference rates is currently at 5.25%. The zloty weakened by nearly 1% after the decision.

Key elements in the MPC statement remained unchanged: future decisions still depend on incoming data and there is no indication that the end of the cycle is nearing. Thus, alike earlier documents, this statement does not help us much with understanding the MPC's way of thinking and reaction function. Maybe we will get more colour during tomorrow's conference of MPC president at 15:00.

In our view the lower scale of rate hikes may be showing higher NBP's sensitivity for potential signs of economic downturn than the markets had previously anticipated. Although the recent economic data releases proved to be better than the forecasts, the NBP seems to more conscious that the economic slowdown in on the horizon. Simultaneously, inflation acceleration in April was much lower than one month before, and the zloty remained stable. The return to a slightly smaller scale of rate hikes may signal the MPC's hope that the target interest rate can be set at a level that would not harm economic growth and cause unemployment. Inflation in the coming months is likely to be the key factor in judging if it is possible. Does the May 75bp rate hike prohibit the return to larger steps in the months that follow? In our view the answer is: no. While it seems this would damage the central bank's credibility, such scenario cannot be excluded if CPI rise goes way above expectations once again. However, currently we assume that the rise of inflation in the next months will be of smaller scale than in the recent readings and our base scenario envisages rates going up by other 75bp in June and 50bp in July. If, in line with our scenario, inflation reaches the peak in the middle of the year, the rate hiking cycle may end in July at 6.50%. There is no meeting in August, and after summer holidays the deterioration of economic environment may already be clearly visible in the data, in our view. The FRA market is pricing in a rise of interest rates to around 7.50% by the end of the year.

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Changes versus April statement

~~At the beginning of~~In 2022 Q1, conditions in the global economy remained relatively favourable although the activity growth slowed down in some economies. Prolonged disruptions in international trade and high commodity prices had a negative impact on the global economic situation. Russian military aggression against Ukraine contributed to an intensification of these factors and to a substantial rise in uncertainty surrounding further global macroeconomic developments ~~and~~as well as led to a ~~significant~~ deterioration in economic sentiment. ~~At the same time, prices of commodities continued to increase and disruptions in international trade intensified.~~ Consequently, in the recent months GDP growth forecasts for some economies have been revised downwards.

Many economies ~~continued~~continue to see a surge in inflation, which reached the highest levels in decades. High commodity prices as well as prolonged disruptions in global supply chains and international transport remain the main source of ~~price growth.~~growing inflation. In some economies, rising prices are also driven by growing labour costs. As a consequence, core inflation is also increasing. ~~Due to~~At the ~~economic effects of Russian aggression~~same time, inflation forecasts for the coming quarters ~~have been~~are being significantly revised upwards.

Amidst a strong increase in inflation, many central banks are ~~withdrawing~~tightening their monetary ~~accommodation. In March, the~~policy. The US Federal Reserve concluded net asset purchases and ~~increased~~increases interest rates~~ for the first time in 3 years~~. The ECB keeps negative interest rates, although it has been reducing the scale of asset purchases. At the same time, central banks in the Central-Eastern Europe region continue to increase interest rates.

Following the strong GDP growth in 2021 Q4, available data point to continuing high economic activity growth in 2022 Q1~~, as indicated by data on~~. In March, despite the weakening in sentiment of economic entities due to the Russian military aggression against Ukraine, the growth of retail sales, industrial production ~~and~~as well as construction and assembly output~~.~~ remained high. Meanwhile, employment continues to increase accompanied by a marked rise in wages. ~~The Russian military aggression against Ukraine has contributed to weakening sentiment of economic entities and constitute a significant uncertainty factor for future economic activity in the world and in Poland. Nevertheless, due to, among other factors, modest share of exports to Russia and Ukraine in Polish foreign sales, a~~A continuation of favourable ~~domestic~~ economic conditions may be expected in the coming quarters~~.~~, although a gradual slowdown of economic growth is forecast, while both the domestic and global outlook is subject to significant uncertainty stemming from the impact of Russian military aggression against Ukraine.

Inflation in Poland – according to Statistics Poland flash estimate – increased in ~~March~~April 2022 to ~~10.9~~12.3% which was mainly driven by a strong growth in the food prices ~~of fuels and other energy carriers,~~ due to a rise in global agricultural commodity prices amid Russian military aggression against Ukraine. ~~Earlier significant rise in~~High global energy ~~and agricultural~~ commodity prices ~~and~~as well as earlier increases in regulated tariffs on electricity, natural gas and thermal energy have continued to contribute to markedly elevated inflation. At the same time, the ongoing economic recovery, including an increase in demand driven by rising household incomes, has had also a positive contribution to the price growth. In turn, a curbing impact on inflation has been exerted by a reduction in some tax rates as part of the Anti-inflationary Shield. In ~~2022~~the coming quarters, inflation will remain markedly elevated~~, which – apart from~~ due to a further impact of the factors ~~previously~~currently amplifying ~~inflation – will be due to the economic consequences of the~~ price growth, including those related to the Russian military aggression against Ukraine. In the coming years, together with fading of the impact of shocks currently boosting prices, inflation will decrease. The decrease in inflation should also be supported by appreciation of zloty exchange rate, which, in the Council's assessment, will be consistent with the fundamentals of the Polish economy.

The Council assessed, that there persists a risk of inflation running above the NBP inflation target in the monetary policy transmission horizon. In order to reduce this risk, i.e. striving to decrease inflation to the NBP target in the medium term, the Council decided to increase NBP interest rates again. The increase of the NBP interest rates will also curb inflation expectations.

Further decisions of the Council will depend on incoming information regarding perspectives for inflation and economic activity, including the impact of the Russian military aggression against Ukraine on the Polish economy.

NBP will take all necessary actions in order to ensure macroeconomic and financial stability, including above all to reduce the risk of inflation remaining elevated. NBP may intervene in the foreign exchange market, in particular to limit fluctuations of the zloty exchange rate that are inconsistent with the direction of monetary policy.