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Economic Comment

One big rate cut instead of three small ones?

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The Monetary Policy Council cut the main interest rate by 75bp, to 6.00%. The much larger-than-expected cut (none of the analysts had predicted a change of more than 25bp, we were betting that a 25bp cut will take place in October) caused an immediate weakening of the zloty (EURPLN jumped to 4.56 from 4.50) and a steepening of the yield curve (2L -15bp, 10L initially slightly lower, but then increased).

The press release after the MPC's decision hinted that the rate cut was motivated by weaker-than-expected economic activity data, which, in the MPC's view, 'signalled a lower-than-expected demand pressures', which in turn would bring inflation faster to the target. 2Q23 GDP growth equalled -0.6% y/y vs. -0.1% in the NBP's July projection, whereas domestic demand was -4.1% vs. -2.2% y/y in the projection. Furthermore, weakness was also seen in the first economic data for the third quarter, as well as in the latest PMI reports. The disappointment must have been big enough to justify not only departing from the cut-enabling condition formulated by the NBP president in July, but also applying a very aggressive move straight away. Please recall that in July the NBP President stated that CPI inflation must reach a single-digit level in order for the rate cuts to commence. In August, the rate of inflation was close, but still above 10% y/y. Moreover, Glapiński assured that the Council would not change the rates abruptly, and would instead move in small steps of 25 bps.

The MPC wrote in the statement that it had “adjusted” interest rates, which will support the inflation's return target in the medium term, and that the Council's subsequent decisions will depend on incoming data. The use of the phrase about “adjusting” rates (which has not been used in recent years) could theoretically suggest a “one-and-done” action rather than the start of an easing cycle. However, we would not draw any strong conclusions from the content of the MPC's official statement. More informative about the policy outlook will probably be tomorrow's NBP Governor's conference. Let us recall that in July, the official statement did not mention the end of the rate hike cycle at all; this was only announced by Adam Glapiński at the conference.

We assume that the rate cut delivered in September was a one-and-done decision, consumming of the scale of monetary easing priced in by the financial market for this year and will allow the MPC to pause in the following months. In October, the MPC will be on hold, claiming that it needs to wait for more data and the new inflation projection. In November, the new projection, which will take into account the impact of today's rate cut, the weaker zloty, higher oil prices, expansionary fiscal policy in 2024, should not, in our view, provide arguments for further monetary easing, showing that the return of inflation to the target is not getting closer, but perhaps further away. In the following months, the economic recovery that we anticipate and the deceleration of the downward trend in inflation will be increasingly evident, in our view. Therefore, we maintain our earlier assumption that the main NBP reference rate will end this year at 6.0% and will remain there in the following months at least until mid-2024.

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MPC statement (changes vs. July)

The global economic conditions remain weakened. At the same time, uncertainty about ~~global economic~~ the activity outlook in the largest economies persists. In the euro area, ~~following the contraction of the economic activity in the previous quarters,~~ annual GDP growth slowed down again in 2023 Q2 ~~probably stayed low~~, while in Germany it was negative. Data incoming in 2023 Q3 indicate a further deterioration of economic conditions in the euro area.

This is accompanied by ~~globally declining~~a further decline in inflation in many economies, however, in most ~~economies~~countries annual price growth remains elevated. ~~The fall in~~Lower commodity prices together with the easing of global supply chain disruptions reduce price pressures, which is reflected in ~~the significant decrease of growth in~~ falling producer prices in many economies. At the same time, core inflation in most economies is still elevated, although it gradually declines.

Amid the ~~weakening of~~weakened global economic ~~growth around the world~~conditions, activity growth also ~~slowed down~~declined in Poland. According to Statistics Poland preliminary estimate, the annual GDP growth in 2023 Q2 stood at -0.6%, amid a further reduction in consumption demand. At the same time, investment continued to rise. Retail sales~~,~~ and industrial output ~~as well as construction and assembly output~~ decreased in annual terms in ~~May~~July 2023. Despite the slowdown in activity growth, the labour market situation remains good and unemployment is low. ~~The~~Although the number of working persons continues to be high, ~~although this is accompanied by the low~~the annual growth in employment in the enterprise sector decelerates.

According to Statistics Poland flash estimate, annual CPI inflation in August 2023 markedly declined again, falling to a level of ~~11.5~~10.1% y/y ~~in June 2023~~ (compared to ~~13.0~~10.8% y/y in ~~May~~July 2023). At the same time, ~~for the second consecutive month~~in monthly terms, the overall consumer price level did not change~~.~~ in August, following a decline by 0.2% in July. The decrease in inflation in annual terms was driven mainly by a fall in annual price growth of ~~energy, and – although to a lesser extent – of~~ food and non-alcoholic beverages ~~and of some other categories of goods.~~ .

Taking into account the ~~available~~ data by Statistics Poland, it can be estimated that core inflation decreased again in ~~June~~August, as well. ~~At the same time,~~In July 2023 the producer ~~price growth is still decreasing strongly~~prices were lower than a year before, which ~~signals a further easing~~confirms the fading of ~~2/2~~ external supply shocks and a reduction of cost pressures. Together with the lower economic activity growth, it will support a further decline in consumer price inflation in the coming quarters. The significant fall in inflation is accompanied by decreasing inflation expectations, which contributes to an increase in the restrictiveness of monetary policy.

~~The Council became acquainted with the results of the July projection of inflation and GDP based on the NECMOD model. In line with the projection, prepared under the assumption of unchanged NBP interest rates and taking into account data available until 22 June 2023, there is a 50-percent probability that the annual price growth will be in the range of 11.1 – 12.7% in 2023 (against 10.2 – 13.5% in the March 2023 projection), 3.7 – 6.8% in 2024 (compared to 3.9 – 7.5%) and 2.1 – 5.1% in 2025 (compared to 2.0 – 5.0%). At the same time, the annual GDP growth – according to this projection – will be with a 50-percent probability in the range of -0.2 – 1.3% in 2023 (against -0.1 – 1.8% in the March 2023 projection), 1.4 – 3.3% in 2024 (compared to 1.1 – 3.1%) and 2.1 – 4.4% in 2025 (compared to 2.0 – 4.3%).~~

~~The Council assesses that the weakening of the external economic conditions, together with a decline in commodity prices, will continue to curb global inflation, which will still contribute to lower price growth in Poland. The decline in domestic inflation will be supported by a weakening of GDP growth, including consumption, amid a significant decrease in credit growth. The Council assesses that the strong monetary policy tightening undertaken by NBP is leading to a decline in inflation in Poland towards the NBP inflation target. At the same time, given the strength and persistence of the earlier shocks, which remain beyond the impact of domestic monetary policy, the return of inflation to the NBP inflation target will be gradual. The~~In the Council's assessment, recently incoming data point to a weaker demand pressure than previously expected, which will contribute to a faster return of inflation to the NBP inflation target. Considering these circumstances – and taking into account the time lags in the monetary policy transmission to the economy – the Council adjusted NBP interest rates, which will be conducive to meeting the NBP inflation target in the medium term. The Council upheld the assessment that the decrease in inflation would be faster if supported by an appreciation of the zloty exchange rate, which~~, in the Council's assessment,~~ would be consistent with the fundamentals of the Polish economy.

Further decisions of the Council will depend on incoming information regarding prospects for inflation and economic activity.

NBP will continue to take all necessary actions in order to ensure macroeconomic and financial stability, including above all to bring inflation down to the NBP inflation target in the medium term. 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.~~.