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Economic Comment

Inflation entered the target range

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CPI inflation fell in February to 2.8% y/y from 3.7% in January (after a downward revision from 3.9%). Again, the result was below the market consensus of 3.2% and our forecast of 3.1% y/y. It appears that the effect of change in CPI weights have trimmed inflation rate by 0.1-0.2pp at the start of the year. Our estimate of core inflation net of food and energy prices for February is 5.4-5.5% y/y and 0.4-0.5% m/m, showing that price momentum in the core components (mainly services) is still high and inconsistent with the inflation target. In March, inflation may fall to 2.3% y/y. In our view the February CPI surprise, mainly stemming from food prices and the effect of the change in weights, should be ignored by the MPC, which is now focusing primarily on inflation risks in the medium term.

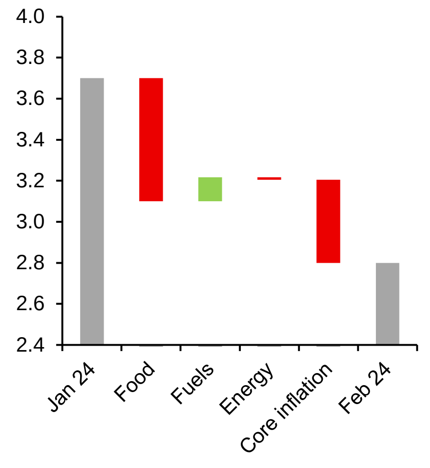
CPI inflation fell in February to 2.8% y/y from 3.7% in January (revised downwards from 3.9%). Again, the result was below the market consensus of 3.2% and our forecast of 3.1% y/y. It appears that the effect of change in CPI weights have trimmed inflation rate by 0.1-0.2pp at the start of the year. Consumer prices rose by 0.3% m/m in February, while we had expected a 0.4% m/m increase. The main sources of the downward surprise in this regard were alcohol and tobacco prices (which rose by 0.5% m/m, while we had been betting on a much larger increase in a lagged response to the increase in excise tax at the start of the year; we are still assuming that this increase will occur, but most likely in March), food prices (-0.4% m/m), furnishing and housing costs (-0.3% m/m). At the same time, most of the core components of inflation surprised to the upside compared to our assumptions, mainly in services (recreation, communication, healthcare, others). Total services prices rose by 1.0% m/m in both January and February, while goods prices increased by 0.2% m/m in January and 0.1% m/m in February.

The decline of the annual inflation rate resulted in part from the effect of the high base in food prices, which grew unusually strongly in the first months of 2023, at around 2% per month. This effect was probably augmented by the price war between retail chain stores, judging by the number of food categories in which price reductions were recorded. Prices for food and non-alcoholic beverages fell by 0.4% m/m, which is exceptionally low for February, as the median m/m change in recent years equals +0.4%. Sugar (-6.4% m/m), rice (-3.8% m/m), meat (-0.8% m/m, including pork -3.0% m/m) saw particularly large declines. Eggs (-1.9% m/m), oils and fats (-1.1% m/m) as well as fruit and vegetables (-1.0% m/m and -1.5% m/m, readings clearly below the seasonal pattern) were also significantly cheaper. In contrast, an unusually large increase occurred in fruit juices (1.7% m/m). The return of the 5% VAT rate on food in April will disrupt the downward trend in food inflation and will, in our view, result in an average price increase in this category of around 3% this year.

The prices of energy fell by 0.1% m/m in February, of which liquid and solid fuels fell by 1.7% m/m (the same as in January) and heat energy rose by 0.9% m/m (against +1.0% m/m in January). On annual basis, this corresponds to a 3.0% drop in the price of energy. The government has still not settled on the level of energy prices in the second half of the year. In line with signals from the government, we have assumed that there will be a 15% increase in household bills for electricity and gas. Fuel prices increased by 3.2% m/m in February, slightly more than we had assumed.

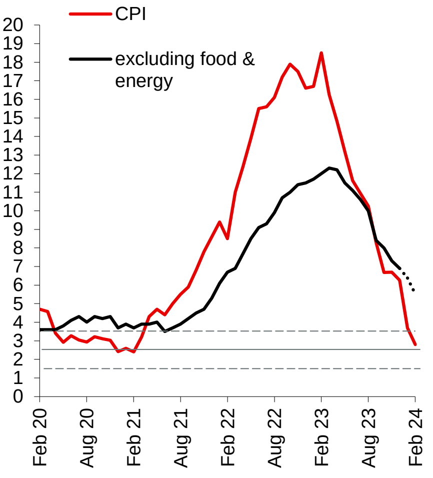
Alcohol and tobacco prices rose by 0.5% m/m, after an increase of 0.6% in January, which means that the effect of the excise tax increase on these goods has still not materialised in February. From March, only goods subject to the new excise tax rates can be sold, so we expect a rebound in this category of close to 1.5% m/m.

Breakdown of change in annual CPI rate, % y/y



Source: GUS, Santander

CPI and core inflation, % y/y



Source: GUS, NBP, Santander

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The increase in housing rental rates was quite low at the beginning of the year (0.5% m/m in January, 0.2% m/m in February), especially considering that the cost of some utility services increased significantly at that time (water supply +2.9% m/m in January, +0.7% m/m in February, similar increases applied to sewerage services). Durable goods such as furniture, household appliances, AV/IT equipment recorded relatively low price growth (-1.9% m/m, -0.2% m/m, -2.1% m/m respectively). On the other hand, quite strong growth, both in January (2.2% m/m) and February (1.8% m/m), was seen in recreation and culture due to rising prices of tourist services. The prices in restaurants and hotels also continued to go up (0.8% m/m in January and February each). This pattern suggests that consumers are generally becoming more interested in collecting experiences (e.g. through the use of leisure services like tourism and dining out) rather than accumulating durable goods.

Our estimate of core inflation net of food and energy prices for February is 5.4-5.5% y/y and 0.4-0.5% m/m, showing that price momentum in the core components (mainly services) is still high and inconsistent with the inflation target.

However, the lower-than-expected CPI in the early months of the year means that the March CPI inflation print, which will be the lowest point of this year's inflation path, will also be lower than we have assumed so far. We now estimate March inflation rate at 2.3% y/y (vs. our earlier estimate of around 2.5% y/y).

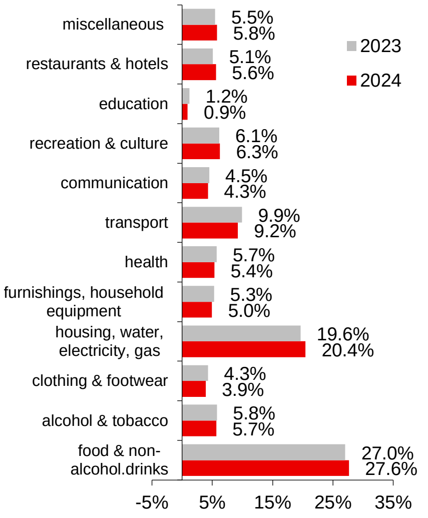
The impact of the revision of the CPI weights on the path of inflation later in the year is not entirely clear at this point (we will be able to say more once the stats office releases more detailed data recalculated according to the new CPI basket weights), but we estimate that the revision of the weights will raise the annual inflation rate slightly in the second half of the year (by 0.1-0.2 pp).

The clearly lower-than-expected inflation data have prompted the market to again raise expectations of monetary policy loosening later this year, but in our view the surprise, mainly stemming from food prices and the effect of the change in weights, should be ignored by the MPC, which is now focusing primarily on inflation risks in the medium term.

Revision of CPI weights

The revision of the CPI basket resulted in an increase in the weight of the 'housing and energy use' category by 0.80 pp to 20.4% (which is the strongest increase since 2014, when the weight of this category increased by 0.86 pp to its historical peak of 21.7%), the 'food and non-alcoholic beverages' category by 0.62 pp to 27.63%, and the 'restaurants and hotels' as well as 'recreation and culture' categories by 0.49 pp (to 5.60%) and 0.12 pp (to 6.26%), respectively. The weight of the 'miscellaneous goods and services' category was also increased, by 0.29 pp to 5.77%. The weights of the other categories were reduced. The strongest reduction affected the fuel-containing 'transport' category, whose weight was reduced by 0.68 pp to 9.24% (a stronger decrease took place only in 2021). In addition, decreases of 0.35 pp affected the categories 'clothing and footwear' (to 3.92%) and 'health' (to 5.36%), by around 0.3 pp the categories 'home furnishings' (to 4.95%) and 'education' (to 0.91%), and by 0.21 pp and 0.09 pp the categories 'communications' (to 4.27%) and 'alcoholic beverages and tobacco products' (to 5.66%), respectively.

Weights in the CPI basket



Source: GUS, Santander