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Economic Comment

Inflation down to 4.0% in May

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Inflation in May was 4.0% y/y, lower than the initial estimate of 4.1% y/y, which in turn was lower than analysts' expectations. Core inflation most likely fell to 3.3% y/y in May. We can expect a further strong decline in inflation in July-August, but its scale will be determined, among other things, by the behaviour of fuel prices and the exchange rates. The conflict in the Middle East generates the risk of spike in oil prices and weakening of the zloty. If it was not to happen, we would be increasingly convinced that the inflation rate during the summer will touch the inflation target of 2.5% and remain significantly below 3% for several quarters. In our opinion, in the current conditions, the central bank will not rush to reduce interest rates and another rate cut is only possible after the summer.

May inflation even lower than the lower-than-expected flash reading

May CPI inflation reached 4.0% y/y, even lower than indicated by the flash release which pointed to 4.1% y/y (versus market expectations at that time at 4.3% y/y). The monthly price change was confirmed at -0.2% m/m. Goods prices slowed down to 3.3% y/y from 3.5% y/y in April (the lowest print since June 2024), services prices grew 6.0% y/y against 6.3% y/y in April, which is the fourth consecutive month of its slowdown and the lowest print since January 2020).

In June the CPI inflation should remain close to 4%, according to our estimate, but in July it is very likely to go down sharply amid the reduction of gas tariff and a negative base effect. Under the assumption of Brent oil price stable near \$70 p/b and USDPLN stable near 3.70, we estimate CPI at 2.8% in July and 2.6% y/y in August. However, those assumptions may prove invalid, given the escalating conflict in the Middle East. Every \$10 move in Brent price moves CPI by 0.15pp, according to our estimate, while every 10% move in PLN exchange rate can move CPI by up to 1pp, according to NBP research.

Our baseline scenario still assumes that inflation rate would hover in 2.6-2.9% y/y range between July and December, and it may go down even lower in early 2026. However, the potential sharp rise in oil price and the possible PLN weakness under global risk aversion could move inflation trajectory higher, accordingly.

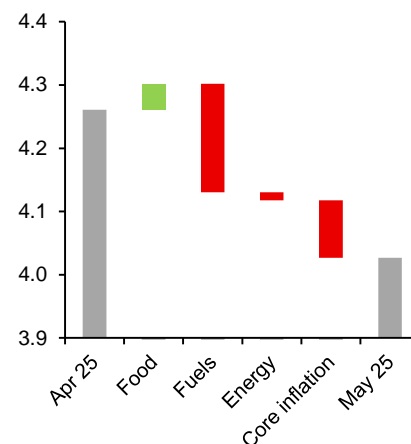
Core inflation continued to go down

Core inflation went down – according to our estimates – to 3.3% y/y from 3.4% y/y in April. We estimate supercore inflation (ex administered prices) at 2.7% y/y compared to 2.8% y/y in April.

Lower annual growth rate of prices was visible in many categories, while the most significant downward contribution was delivered by communication, which saw prices going down by 0.3% m/m, mostly thanks to cheaper internet services (-1.6% m/m). Moreover, core inflation was dragged lower by health (prices up 0.7% m/m, but less than a year ago) and by culture and recreation, where prices fell 1.8% m/m, mostly thanks to a decline in television and radio fees and subscriptions (-3.6% m/m). Transport saw another decline of passenger car prices in monthly terms – for the 20. month in a row.

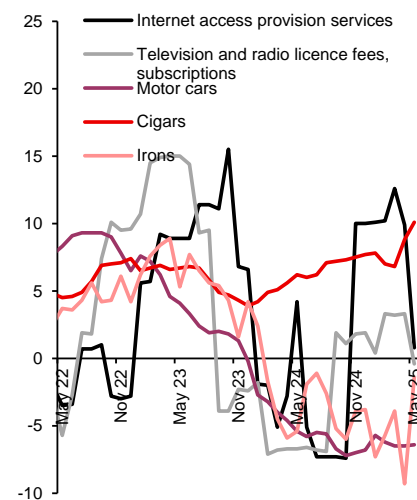
An opposite, positive contribution to core inflation was provided by household furnishings, as it went up by 0.2% m/m, with detailed data showing a reversal of declines in household appliances, that had occurred in April. For example, iron prices jumped by 7.8% m/m in May after falling by 6.6% m/m in April. Moreover, core inflation was dragged higher by alcoholic beverages and tobacco, with tobacco products up by 1.9% m/m (especially cigars).

Decomposition of the CPI inflation change, % y/y



Source: GUS, Santander

CPI inflation, selected categories, %/y



Source: GUS, Santander

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We assume that core inflation may continue to decline in the coming months. These will not be dynamic declines, but inflation excluding food, energy and fuel prices may fall slightly below 3% y/y.

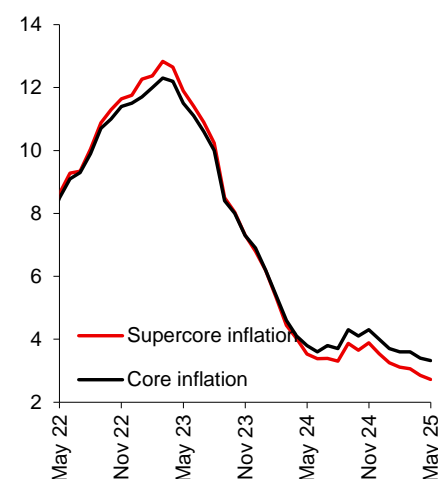
Moderate rise in food prices, fuel much cheaper in May

Food and non-alcoholic beverages prices were higher in May by 5.5% y/y, after 5.3% y/y in April. Their monthly increase was 0.4%. Such a monthly change is 0.2pp lower than the multiannual median for May. So far this year all m/m readings in this category except April proved lower than the historical seasonal pattern. In the following months, food price inflation should continue to decline and head below 4% y/y by the end of the year. The upside risk is linked to this year's adverse weather, which could affect the supply of fruit and vegetables. The conflict in the Middle East also poses the risk of more expensive fuel for agriculture. As a result, the deceleration in food price inflation might be slower than we assume. On the other hand, forecasts of a good cereal harvest in Europe may lead to lower prices on the domestic market, which would have an impact on other food categories.

On a monthly basis, the biggest price increases were in poultry meat (3.6% m/m, translating into +12.4% y/y), eggs (1.7% m/m), as well as fruit (2.7% m/m), juices and coffee (1.5% m/m each). Flour price also went up 1.5% m/m. There was also a relatively large (for May) fall in vegetable prices (-2.4% m/m). On an annual basis, the price of butter was up 20.1%, egg prices were 17.9% higher and sugar was nearly 30% cheaper.

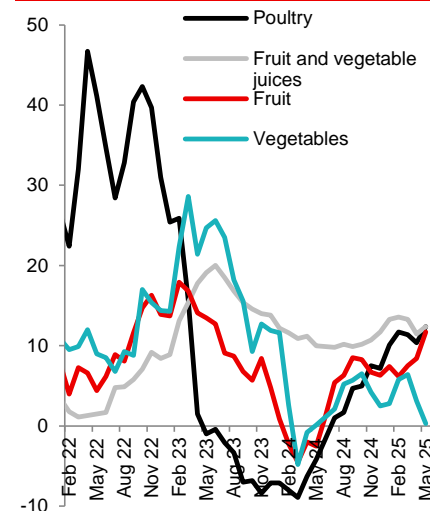
The final CPI data for May confirmed the 3.7% m/m drop in fuel prices shown in the preliminary information from GUS. The price of LPG fell by 4.3% m/m, diesel by 4% and petrol by 3.4%. The scale of the annual fall in fuel prices extended to 11.4% from 8.3%. The current uncertainty about the development of oil prices makes it difficult to forecast the behaviour of fuel prices in the coming months, but m/m increases rather than decreases are to be expected, in our view. Overall, the year-on-year prices of energy were 13.0% higher in May, but unchanged from April, despite 1% decrease in the price of system heat and 0.8% decrease in the price of solid fuels.

Core and super-core inflation, %y/y



Source: GUS, Santander

CPI inflation, selected categories, %y/y



Source: GUS, Santander

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