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Economic Comment

Falling service prices helped reduce inflation

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Final October CPI inflation data confirmed its decline to 2.8% y/y from 2.9% in September. Full data revealed that service prices fell by 0.2% m/m for the second consecutive month, and their annual growth slowed from 5.8% to 5.6% – the lowest since November 2019. Goods prices slowed from 1.9% to 1.7% y/y. The continued deceleration in inflation was also driven by an unusual lack of food price increases. Fuel prices rose by 1% m/m, while energy prices increased by 0.6% m/m (mainly due to a 2.5% m/m rise in heating prices). We estimate that core inflation fell in October to 2.9% y/y from 3.2% previously. The next CPI reading may be around 2.5–2.6% y/y. However, such a move seems largely anticipated by the MPC, which, we still believe, will wait with the next rate cut until January.

GUS confirmed October CPI inflation at 2.8% y/y and 0.1% m/m. In line with the preliminary estimate, food prices remained stable m/m (an unusually low reading for this category for this time of year), fuel prices rose by 1% m/m, and energy prices increased by 0.6% m/m (mainly due to a 2.5% m/m rise in heating prices). Our estimate of core inflation excluding food and energy currently points to 2.9% y/y, which would be the lowest reading since November 2019.

Full CPI data revealed that service prices were at least as important in reducing the overall inflation rate in October as goods prices. The former fell by 0.2% m/m for the second consecutive month, and their annual growth slowed from 5.8% to 5.6%, the lowest since November 2019. Goods prices slowed from 1.9% to 1.7% y/y, marking the fourth month in which their growth rate has remained within the range set by these values.

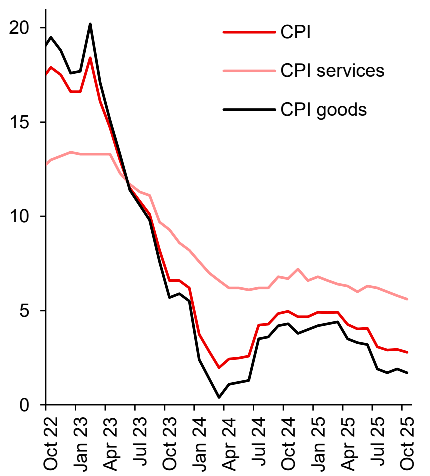
Today's inflation data looks favourable from the central bank's perspective. The next CPI reading will likely show inflation slowing again, to 2.5–2.6% y/y. However, such a move seems largely anticipated by the Monetary Policy Council (the NBP Governor suggested at the last press conference that a drop in CPI to 2.5% in November would not surprise him). In 2026, we expect inflation to stabilise within the 2.5–3.0% y/y range, with core inflation close to 3% y/y. We still believe the MPC is inclined to wait with the next rate cut until January, when the decision on the 2026 electricity tariff will be known.

Core inflation: downward pressure from imported goods, slowing services

Core inflation, instead of remaining close to previous values of around 3.2% y/y, apparently fell below 3% y/y. The largest downward deviation from our forecasts formulated before the preliminary October inflation data was seen in transport prices (mainly due to lower car and transport service prices), recreation and culture (lower prices of consumer electronics, sports services, and especially domestic and foreign package holidays), and the "other" category (particularly due to lower prices of cosmetics and insurance). Only education prices surprised us on the upside.

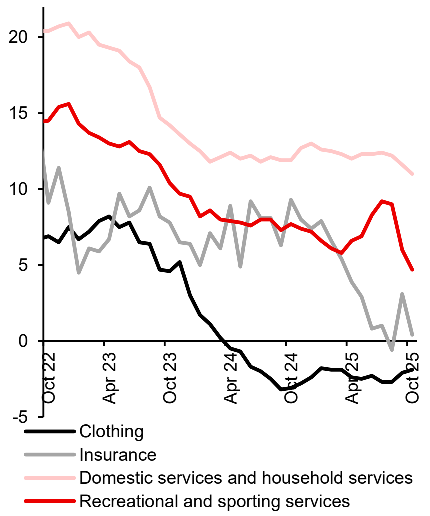
We feel that the decline in electronics and car prices may be intuitively attributed to growing disinflationary pressure from imported goods from China (or more broadly Asia), partly in the context of trade tensions with the US. This process will likely continue in the coming months and quarters, especially under conditions of a strong PLN exchange rate. We have more doubts about the scope for further significant disinflation in services. Wage growth is slowing, but at a fairly gradual pace; in the coming quarters, we expect rather an improvement than a weakening in labour demand due to continued economic recovery, while productivity growth in services is likely much more modest than in manufacturing, which in our view may keep price dynamics in this category elevated.

CPI inflation, % y/y



Source: GUS, Santander

CPI, selected categories, % y/y



Source: GUS, Santander

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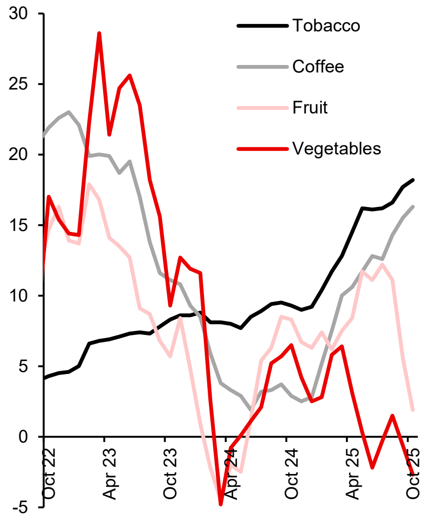
Unusual lack of food price increase for October

In October, food prices deviated sharply downward from their natural seasonal pattern – remaining stable instead of rising by around 0.6% m/m. A similar situation occurred in September, when the deviation from the pattern was around -0.4 pp. This translated into a further marked slowdown in food price growth expressed in y/y terms, to 3.1% from 3.9% in September and 4.7% in August. The relatively low trajectory of food prices is driven by good domestic harvests of fruit and vegetables this year and downward pressure on grain prices from strong global supply. These factors should continue to push food price inflation down in the coming months, probably bringing it below 3% y/y in November and perhaps even below 2.5% y/y in spring next year.

Flour prices fell by 1.7% m/m and 5.4% y/y, while pasta prices dropped by 0.8% m/m. Fruit prices were 1.9% higher than a year earlier, though in August this increase exceeded 10% y/y. In October alone, fruit prices fell by 1.5%, whereas the natural pattern for this month is an increase of around 0.8%. Vegetables did rise by 0.7% m/m, but usually in October these prices rebound by around 2% m/m. On an annual basis, vegetable prices fell by 2.7%. The relatively stable behaviour of overall meat prices was due to a further marked increase in beef (+1.9% m/m) and veal, and falling pork (-1.3% m/m) and poultry prices. Milk prices slowed to 0.7% y/y from 2.4% y/y in September, and butter prices to 0.1% y/y from 7.2% y/y. Sugar remained much cheaper than a year ago (-16.3% y/y), tea prices were also lower (-2.8% y/y), while coffee prices increased further the high pace of growth (16.3% y/y, previously 15.5%) as did cocoa and powdered chocolate (17.0% y/y, previously 16.4%).

CPI, selected categories, % y/y



Source: GUS, Santander