

# Poland Central Bank Preview: December 2021

## Details:

**Monetary policy decision:** Wednesday, December 8<sup>th</sup>, 2021. Governor Glapinski to discuss economic situation in online press conference on Thursday (2pm London time).

## MNI Point of View

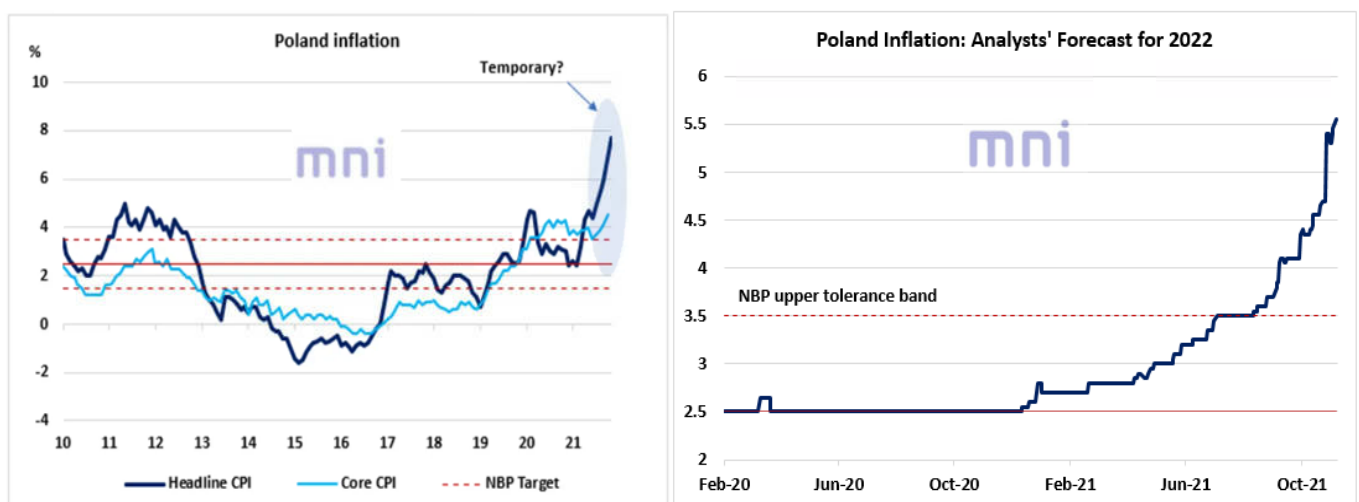
### NBP likely to surprise again with 75bps hike

The National Bank of Poland is likely to keep the pace of its tightening cycle and hike the policy rate by 75bps on December 8<sup>th</sup> to curb the inflationary pressures. Even though the rise in uncertainty over the economic outlook keeps weighing on growth expectations, inflation continued to surprise positively in November, therefore pressuring NBP policymakers to act. Market consensus expects a 50bps hike.

In a recent interview, Governor Glapinski changed his view on inflation, saying that it is 'burdensome' (not 'transitory' anymore). Given the recent development and the ongoing economic uncertainty, a rising number of policymakers in the CEE region now expect the convergence back towards the inflation target to be much slower than previously expected. Figure 1 (right frame) shows that analysts' inflation forecasts for 2022 have been constantly rising in recent weeks; they now expect inflation to be around 5.6% in the end of next year (vs. 3.5% in the beginning of September). In its November forecast, NBP increased its inflation outlook and now expects inflation to rise to 5.8% in 2022 before declining to 3.6% in 2023.

Poland CPI inflation came in higher than expected in November at 7.7% YoY (vs. 7.3% exp.), up from 6.8% the previous month. Figure 1 (left frame) shows that inflation in Poland has diverged significantly from the NBP 3.5% upper tolerance band. The upside surprise continues to be mainly driven by food and energy items, with analysts expecting inflation to peak in December 2021/January 2022 at around 8%.

Figure 1



Source: Bloomberg/MNI

## NBP 'Dilemma': slower growth or rising inflation?

We have seen that the current environment puts Polish policymakers in a difficult position:

- On one hand, NBP should continue to hike rate 'aggressively' to curb the inflationary pressure as CPI inflation keeps diverging from the 3.5% NBP upper tolerance band.
- On the other hand, raising rates sharply when uncertainty is surging could lead to further deceleration in the economic activity and increases recession risks.

Figure 2 (left frame) shows that the sharp flattening of the yield curve has been pricing in a significant slowdown in the economic activity. While the rising uncertainty limits the downside risks in LT bonds (investors 'fly to quality' to government bonds when economic outlook worsens), the aggressive tightening cycle led by CEE central banks has led to a significant increase in ST rates, resulting in a sharp flattening of the 'traditional' 2Y10Y yield curve. The yield curve inverted in Poland in November before trading back into positive territory in the past two weeks; historically, inverted yield curves have generally led to a moderate to significant recession in the next 6 to 24 months.

## Major risks for PLN and Polish risky assets

1. **Ongoing dispute with EU bloc:** We have seen that Poland has been under EU's radar in recent months, first on the on-going backlash over primacy law and second on the ECJ financial punishment of 500K EUR for each day Poland continues to extract lignite at the Turow mine close to the border with the Czech Republic and Germany. The EU have decided to delay the 36bn EUR in pandemic aid, which could lead to a significant downward revision in growth expectations, pausing a threat to Polish risky assets.
2. **FX Loan Settlement:** Even though Polish Supreme Court has repeatedly failed to provide guidance and constantly been delaying the process in the past 6 months, it could continue to weigh on bank's valuations in the medium term.
3. **Significant rise in LT interest rates:** The elevated inflationary pressures in the CEE region has led to a sharp increase in LT bond yields, with Poland 10Y yield trading at its highest level since May 2019. However, domestic banks are highly sensitive to rising interest rates due to their long duration exposure. According to the Finance Ministry, local banks now hold more than a third of the country's sovereign bonds (103bn USD), and NBP study recently showed that a 15% decline in the value of government bonds could lead to breaches in T1/T2 capital buffers in some institutions.

## Market Analysis

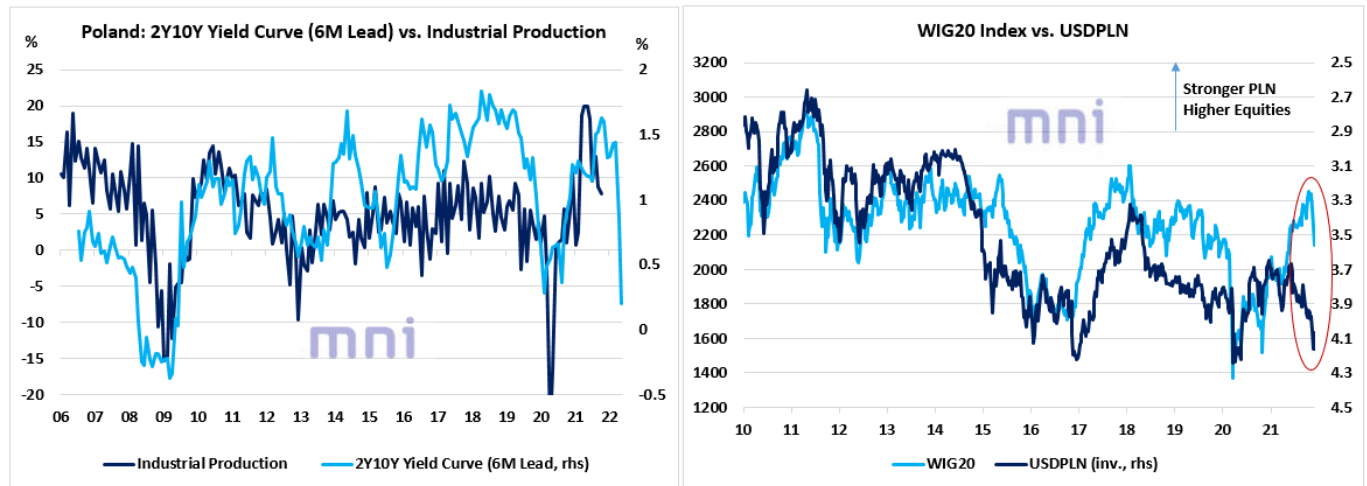
Volatility on the long end of the curve has remained elevated in the past 2 months, with the 10Y yield breaking above the 3% level last month to reach a local high of 3.43% in the end of November before edging lower. With a current rate of inflation of 7.7%, Poland currently offers the second lowest 10Y real yield among the EM world (currently standing at -4.6%) after China (PPI-adjusted). Next key resistance to watch on the topside on the 10Y yield stands at 4% (January 2017 highs). On the downside, ST key support stands at 3%; a break below that level would open the door for a move down to 2.79%.

The sharp PLN depreciation has been weighing on Polish equities in recent weeks; figure 2 (right frame) shows that Polish equities (WIG20 Index) have been very sensitive to the dynamics of the PLN in the past cycle; periods of PLN weakness have been associated with bearish equity markets. Hence, the chart shows that the two times series, which had been diverging significantly in recent months, have been consolidating lower (i.e. lower WIG20 index and weaker PLN).

## Conclusion

To conclude, NBP is likely to continue the pace of its tightening cycle (hiking by 75bps) despite the central bank's unclear communication over the policy outlook. Consensus is currently pricing in a 50bps hike, which could disappoint the market and therefore lead to further PLN depreciation and selling pressure on the long end of the interest rate curve.

Figure 2



Source: Bloomberg/MNI

## Poland National Bank Watch

### mni Central Bank Watch - NBP

December 07, 2021

MNI NBP Data Watch List						2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
<b>Inflation</b>										
HICP	% y/y	7.7	5.5	↑	4.7	↑				2.63
Core Inflation	% y/y	4.5	3.7	↑	3.9	↑				1.82
PPI	% y/y	11.8	8.4	↑	5.5	↑				1.51
NBP Inflation Expectations	Index	36.3	41.8	↓	41.8	↓				-1.07
<b>Economic Activity</b>										
Poland PMI (Manuf)	Index	54.4	56.0	↓	57.2	↓				0.61
Sold Industrial Output	% y/y	7.8	9.5	↓	44.2	↓				-0.87
Exports (Mn)	EUR	24537	23654	↑	24703	↓				1.20
Construction Output	% y/y	4.2	3.2	↑	-4.2	↑				0.34
<b>Monetary Analysis</b>										
Money Supply (M3)	% y/y	8.6	8.8	↓	11.2	↓				-1.10
Consumer Credit	% y/y	4.5	4.0	↑	1.4	↑				1.00
Credit to Non-Fin Corps	% y/y	0.9	-2.2	↑	-7.8	↑				1.40
Credit to Households	% y/y	4.4	4.0	↑	1.4	↑				0.98
<b>Consumer / Labour Market</b>										
Retail Sales	% y/y	14.4	8.9	↑	25.7	↓				0.98
Unemployment Rate	%	5.5	5.9	↓	6.3	↓				-1.42
Ave Monthly Gross Wages	% y/y	8.4	8.7	↓	9.9	↓				-0.94
Employment	% y/y	0.5	1.8	↓	0.9	↓				-0.46
<b>Markets</b>										
Equity Market (WIG)	Index	68796	70930	↓	66285	↑				1.17
10-Year Bond Yield	%	3.09	1.83	↑	1.87	↑				1.77
Yield Curve (10s-2s)	bps	20.0	142.1	↓	158.3	↓				-2.12
PLN TWI	Index	89.11	91.46	↓	93.14	↓				-1.78

Source: MNI, Bloomberg

## Sell-side Views

### Barclays: Expecting a 50bps to 1.75%

- Barclays analysts expect the NBP to deliver 50bp hike to 1.75% but risks are to the upside following recent upside surprise in CPI.

### Goldman Sachs: NBP to Raise Rates Amid Continued Large Inflation Increases

- The Monetary Council of the National Bank of Poland (NBP) will meet on Wednesday, December 8.
- GS analysts expect the Council to hike policy rates by 50bp to +1.75%, in line with consensus, although they think the risks are skewed almost entirely towards a larger move.
- GS thinks that repeated and large upside surprises to inflation, as well as the depreciation in the Zloty over the past two months skew the risks towards a more significant tightening in policy.
- However, given the recent deterioration in the pandemic outlook and a stabilisation in the Zloty, GS has (just) stuck with the view that the NBP will tighten by 50bp this month.
- GS forecast implies that policy rates will reach 3.00% in the coming months – which is more hawkish than current market pricing – and analysts view the risks around this forecast as being tilted to the upside.
- Between hawkish news on the inflation and exchange rate front, and more dovish developments related to the pandemic, NBP Governor Adam Glapinski expressed a relatively hawkish stance this week, stating that the inflation overshoot is no longer transitory and requires further monetary response from the central bank.
- This also raises the possibility that the NBP decision could be coupled with more durable hawkish guidance, in contrast to the last two rate increase.
- Overall, as GS continues to see further increases in inflation (albeit primarily from non-core factors), with only a relatively gradual easing over the course of next year, analysts expect significant additional tightening from the NBP

### JP Morgan: Expecting a 50bps hike

- The NBP is stuck between Omicron and a hard place.
- The emergence of a new COVID-19 variant adds a layer of uncertainty to the outlook, one which the NBP would in normal circumstances likely use to argue for caution in tightening policy.
- But not only is inflation extremely high, experience so far suggests that global responses to the pandemic had, if anything, an inflationary outcome.
- In this setup, arguing *dovishly* would likely not be well received by markets, and JPM analysts think the NBP has no room to pause the tightening cycle.
- Analysts expect it to raise the policy rate by 50bp to 1.75% next week, a compromise between the bigger hike that would be needed to fight inflation, and the dovish preferences of the NBP plus COVID-19 risks.

### Societe Generale: Expecting a 25bps hike this week

- SocGen analysts expect the National Bank of Poland to deliver only a 25bp hike at the meeting on 8 December, which contrasts with the Bloomberg consensus of 50bp.
- The market is poised for another sizeable increase in the reference rate, pricing in north of a 75bp jump.
- Risks are clearly tilted toward sharper tightening, which – in SocGen view – would also be more consistent with domestic fundamentals:
  - although headline inflation is set to slow during 2022, core inflation is likely to remain elevated due to labour market tightening;
  - economic growth will remain strong, little impacted by the winter COVID wave;
  - combined, the risks of second-round inflation pressures materialising is sizeable.
- With that said, analysts don't expect the hawkish policy to prevail until 1Q22, where SocGen pencils in 150bp of rate hikes by the NBP and a terminal rate at 3%.

**TD Securities: Expecting a 75bps hike**

- TD Securities analysts expect the NBP to hike the base rate by 75bps, but think that 50bps is also on the table.
- Inflation yet again surprised notably to the upside and came out at 7.7% y/y in November.
- In TD view, this is a strong argument for another significant rate hike.
- In addition, the NBP's governor was on the wires and acknowledged that inflation is no longer transitory, but "burdensome".

**Unicredit: Expecting a 50bps hike with the risk of rising it higher**

- We expect the NBP to raise the policy rate by 50bp to 1.75%, with the risk of rising it higher, and continue with rate hikes to at least 3% in 2022.
- FX interventions are more likely if EUR-PLN stays above 4.70, threatening corporate margins for producers with high import content, inflation via the FX pass-through and household income via higher debt servicing for FX loans.