EMEA FX Insights

Poland: NBP begins monetary easing with a sharp 75 bp cut, beating market expectations

September 8, 2023 | **Masayuki Nakajima, Senior Currency Strategist**

Summary

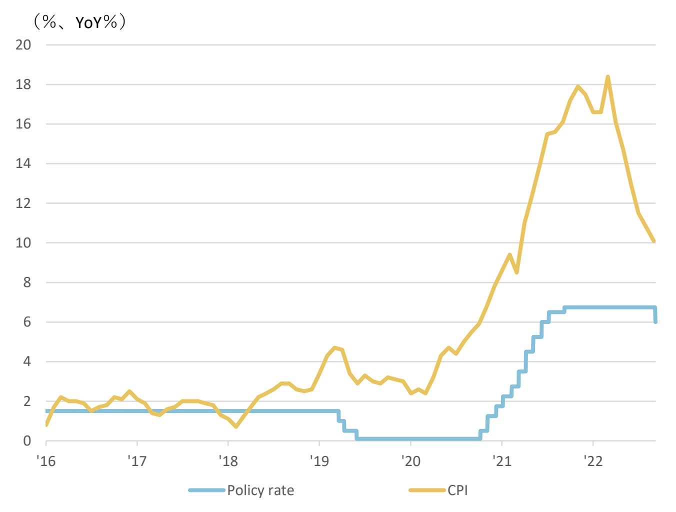
- Poland National Bank cut interest rates by 75bp, larger than market expectations(25bp cut).
- The larger than expected rate cut, concerns that monetary policy is being skewed by political considerations, and an attitude to tolerate weaker PLN, are significant downside risks for the currency.
- Previously, our forecast of EURPLN at the end of December 2023 was 4.50, but we revised it up to 4.74, reflecting the risk of a sharp deterioration of rate advantage to the euro zone.

The National Bank of Poland (NBP) cut interest rates by 75 basis points to 6.00% on September 6. This is the first time the NBP has eased monetary policy since May 2020. The rate cut was a double negative surprise. (1)"*We can start a rate cut at the September 2023 meeting*" governor Glapinski said at a news conference after the July meeting, citing single-digit inflation as one of the conditions for the rate cut. However, the preliminary CPI figures for August released on August 31 showed a year-on-year CPI inflation rate was 10.1% (Chart 1). The Bloomberg consensus survey showed 16 out of 36 economists expecting NBP to keep its policy rate stable. (2)Economists who expected a rate cut were all expecting a rate cut of 25 bp. PLN fell nearly 2% against the euro from 4.50 to 4.57 shortly after the surprise 75 basis point cut.

Expanding fiscal policy and looser monetary policy will make fight to inflation harder

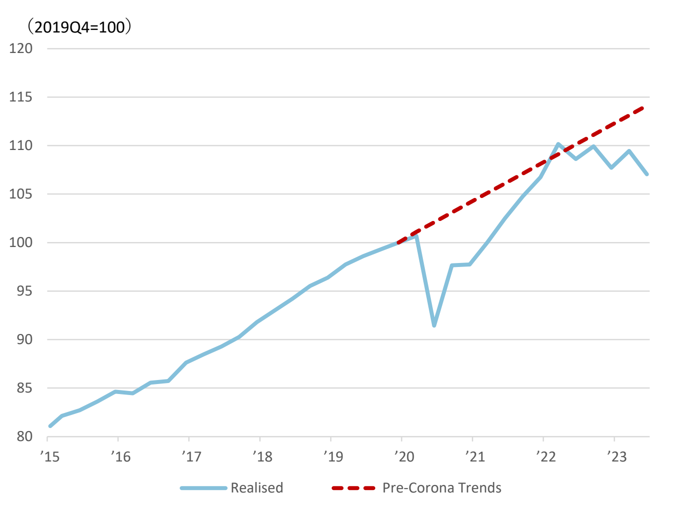
The NBP said in a statement that the slowdown of economic activity was worse than expected. The real GDP growth rate for the April-June period of 2023, which was announced at the same time as the CPI on August 31, was down 0.6% from the same period of the previous year, down from the previous forecast of 0.5% announced on August 16. Looking at the breakdown by demand items, household consumption and total capital formation declined 2.7% and 14.3%, respectively, showing a significant decline in both consumption and investment (Chart 2).

Chart 1: Policy interest rates and consumer price index (CPI)



Source: National Bank of Poland, Statistics Poland, Bloomberg, Mizuho Bank

Chart 2: Real GDP Results and Pre-Coronavirus Trends

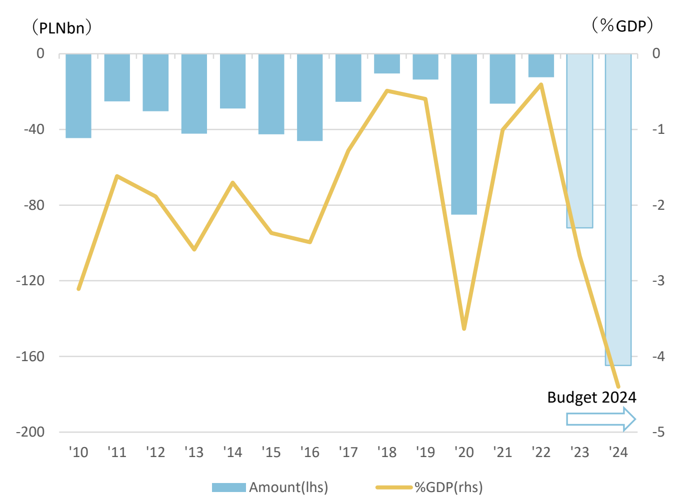


Source: Statistics Poland, Bloomberg, Mizuho Bank

To be sure, there is no doubt that a slowdown in the economy could reduce inflationary pressures on the demand side, but there are still unconvincing points. (1)In late August, the Polish government approved a fiscal expansionary 2024. If monetary policy also moves toward easing amid expansionary fiscal policy, it will provide a strong boost to the domestic economic recovery, contradicting the logic that inflation pressures will fade as the economy slows. (2)In Poland, as in other major European countries, the labour market is still tight despite the economic slowdown, and the wage growth rate was as high as 10.4% year-on-year in July 2023 (Chart 4). The risk of an inflationary spiral in wages and service prices is still high.

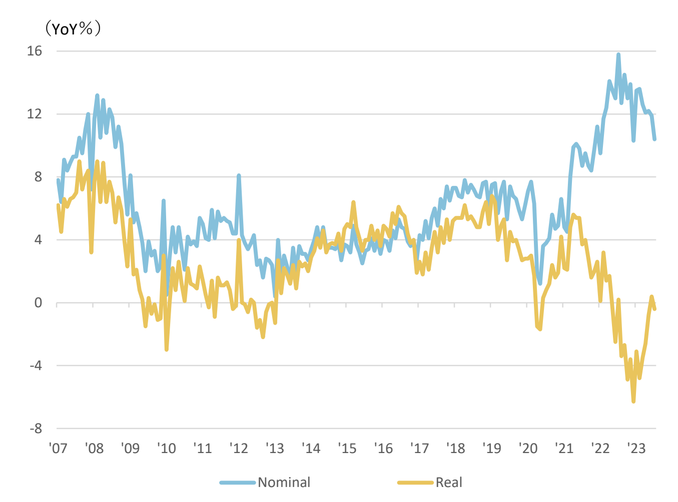
Main opposition party leader and former prime minister Tusk slammed a steep rate cut as risky and said there was no doubt governor Glapinski was taking part in the ruling party’s pre-election campaign. General election will be held on 15 October.

Chart 3: Fiscal Balance (Annual)



Source: Poland Ministry of Finance, Bloomberg, Mizuho Bank

Chart 4: Wage growth



Source: Statistics Poland, Bloomberg, Mizuho Bank

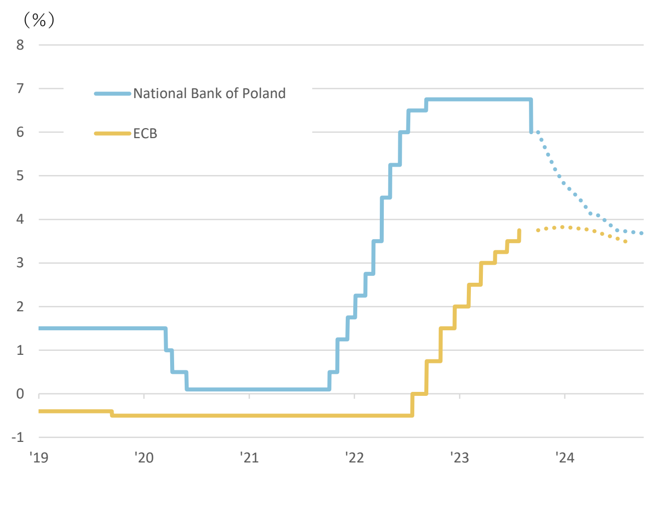
During the Governor’s press conference, PLN continued to fall

Governor Glapinski held a press conference on September 7, one day after the monetary policy announcement, justifying the case for the sharp cut. The governor expressed that rate cut was not political. From the perspective of the foreign exchange market, it is noteworthy that the governor downplayed the negative market reaction to the sharp rate cut, saying, "The 2% depreciation of the currency will not have much impact on the CPI," and that he also noted that NBP would not intervene in the currency. In the end, PLN continued to fall during the governor's press conference, trading 3% lower against the euro than it was before the monetary policy announcement. Given the dovish tone of the Governor's press conference, a further rate cut a the next monetary policy meeting on 4 October is likely unless depreciation pressure against PLN intensifies.

Interest rate advantage of PLN against EUR will likely to fade sharply

A sharper-than-expected rate cut, concerns that monetary policy is being skewed by political considerations, and an attitude to tolerate weaker PLN, are significant downside risks to the currency. Markets have already priced in a rate cut of 40 basis points at the October meeting and the interest rate gap with the euro zone is expected to narrow sharply in the future (Chart 5). Even in light of Poland's strong balance of payments (Chart 6), including a current account surplus, and massive inward FDI inflows, it will be necessary to revise the previous forecast to a weaker euro. Previously, our forecast of EURPLN at the end of December 2023 was 4.50, but we revised it up to 4.74, reflecting the risk of a sharp deterioration of rate advantage to the euro zone (Chart 7).

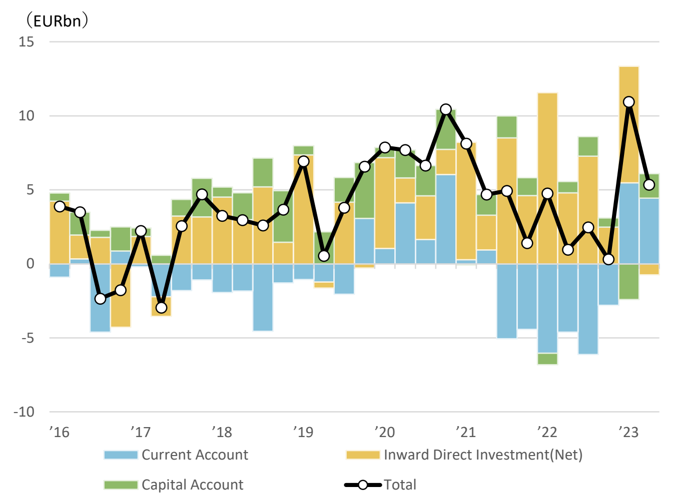
Chart 5: Changes in the National Bank of Poland and European Central Bank policy interest rates



Note: The dotted line indicates market pricing. They are derived from the 3-month WIBAR rate forward and EONIA swap curves, respectively. As of 7 September, 2023.

Source: Bloomberg, Mizuho bank

Chart 6: Current account balance, net direct investment and capital balance



Source: National Bank of Poland, Bloomberg, Mizuho Bank

Chart 7: Polish Zloty Forecast

	9/7	2023		2024		
		September	December	March	June	September
New	4.63	4.68	4.74	4.76	4.78	4.80
Old		4.48	4.50	4.52	4.54	4.56

Note: Bloomberg, Mizuho bank