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MACRO MORNING BRIEFING

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Strong Household, Late ECB Constrain NBP

Strength of Poland's labour market means rate cuts need to wait

- Despite some cooling, labour market continues to boost household cashflows
- Wage differentials keeping PLN REER elevated
- ECB cuts in Q2 could provide additional policy space for NBP

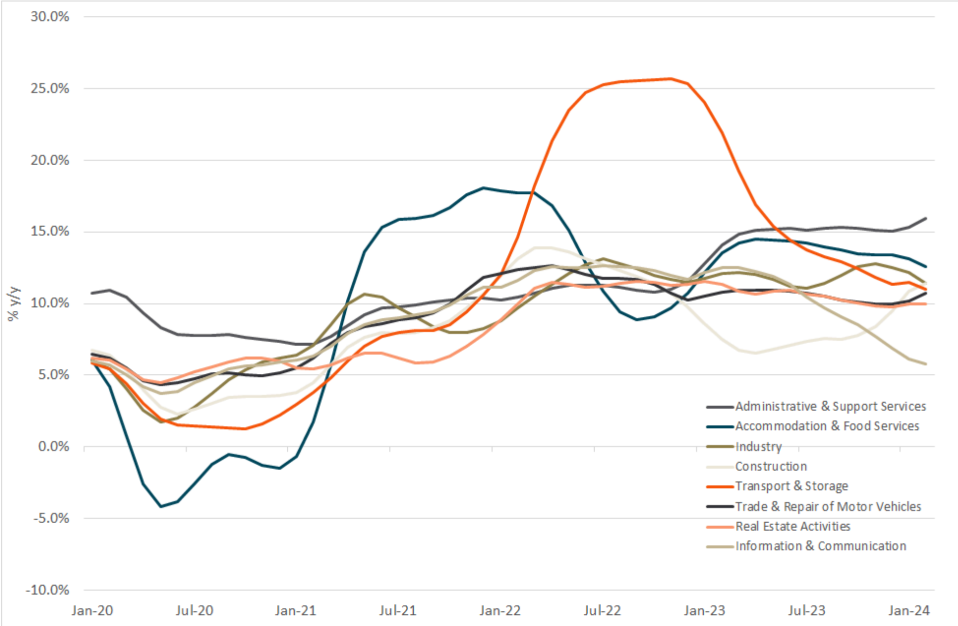
Softer inflation belies underlying price risks from domestic demand

Markets unanimously expect the National Bank of Poland (NBP) to remain on hold this week. Sequential headline inflation in Poland in recent months has been relatively soft and, as the NBP put it, income CPI numbers “will run at the level consistent with the NBP inflation target”. Nonetheless, prospects for a restart of easing are not looking bright. Using core CPI as the deflator, real rates are barely positive. And like many central banks in the region, the NBP is not shy about warning that fiscal impulse represents upside risk to inflation, rendering the overall balance of risks as highly asymmetric.

Like its peers in Western Europe, we expect the NBP focus squarely on household balance sheets to guide inflation trajectories. On the income front, the wage outlook still requires vigilance. The NBP acknowledged in its previous meeting that annual wage growth continued to rise and over the medium term, “demand pressure in the economy will be stimulated by wage growth, stemming i.a. from wage increases in the public sector.” This is not dissimilar to the situation in the Eurozone, where the European Central Bank has been frustrated by wage growth in the public sector for some time. This has inhibited the ECB's ability to ease rates early to provide stimulus to other sectors, where the labour and wage outlook is not as promising. However, the difference in Poland is that nominal wage growth is generally robust across most sectors.

Exhibit #1 shows wage growth by sector over the past five years. Based on the latest data (as of February 2024), wage growth is running at 5% y/y or higher in all but Information & Communication. Wage growth is rising again in Administration & Support Services – a sector where the fiscal aspect is likely stronger, supporting the NBP’s assessments on how government spending is pushing up inflation through the demand channel.

Exhibit #1: Poland Wage Growth By Sector

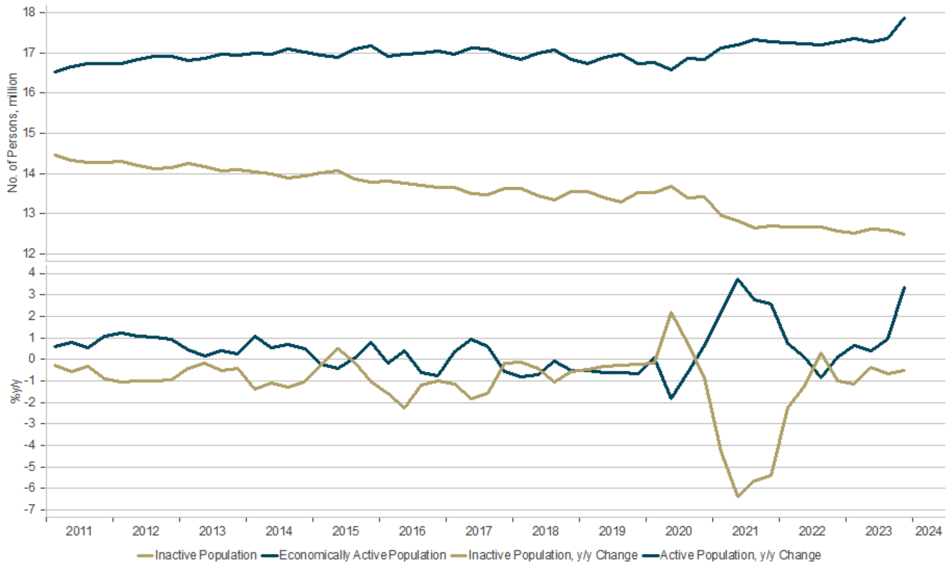


Source: Macrobond, BNY Mellon; monthly data smoothed using HP filter

We should also acknowledge that the conflict in Ukraine has generated a demand shock to Poland's economy; the impact may be felt for years. Defence spending – the funding source may not originate in Poland – will likely have a positive demand impact and lift headline inflation. We would also be cognizant of the productivity aspects which can lift real incomes in directly affected sectors. Note how wage growth in Transport & Storage shows a completely different trend compared to other sectors, where wage growth was slowing, albeit from very high levels. Wages for Industry has also been generally resilient. However, with so many sectors having enjoyed double-digit nominal wage growth for nearly two years but the marginal effects of demand waning, labour supply constraints likely remain a factor.

Labour supply is a challenge in many economies, but how it manifests can differ. For example, the UK labour market is tight because participation rates are falling, with the number of economically inactive adults rising over 8% compared to before the pandemic. In contrast, Poland's corresponding number (exhibit #2) has fallen by 7.7%, or by over 1mn individuals. On an absolute basis, we can also see a material jump in the economically active population in Q4 2023. Wage growth and other incentives have contributed to the gains, but the general improvement in labour force structure since the pandemic is clear. Current openings data suggest labour demand is softening materially, and this has allowed the NBP to assume an easing stance and anticipate softer wage gains. However, the process is likely to be slow without sharp declines in aggregate demand, irrespective of whether the drivers are fiscal or more exogenous.

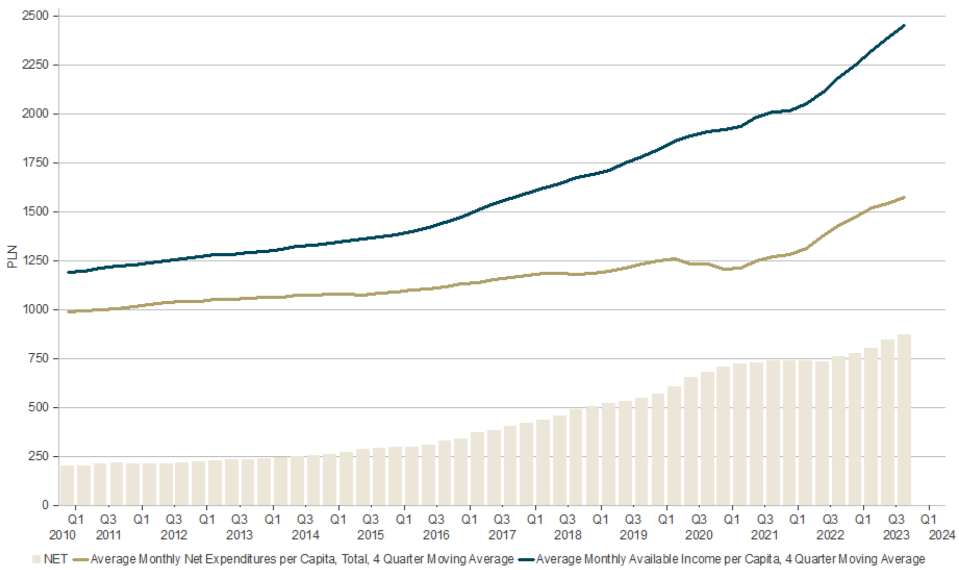
Exhibit #2: Participation



Source: Macrobond, BNY Mellon

Strength in earnings over the past two years has produced a clear improvement in household cashflow. As shown in exhibit #3, since 2020 household disposable income has risen sharply relatively to net expenditures per capita. The gap was broadly stable between 2010 and 2015 before rising sharply at the end of the last decade. Recall that before the pandemic, much of Central and Eastern Europe (CEE) was already facing severe labour market constraints which pushed up wages, and central banks in the region were relatively hawkish before aggressive easing took place. Even during the rounds of higher inflation in 2022 and 2023, the combination of aggressive wage growth and government support for households helped maintain household cashflow, and the last few quarters have registered a strong increase. Expectations may be soft, but there is a very strong income buffer in Poland which will likely support demand for some time. This supports the case for 'higher for longer' in rates to encourage savings and spending constraint.

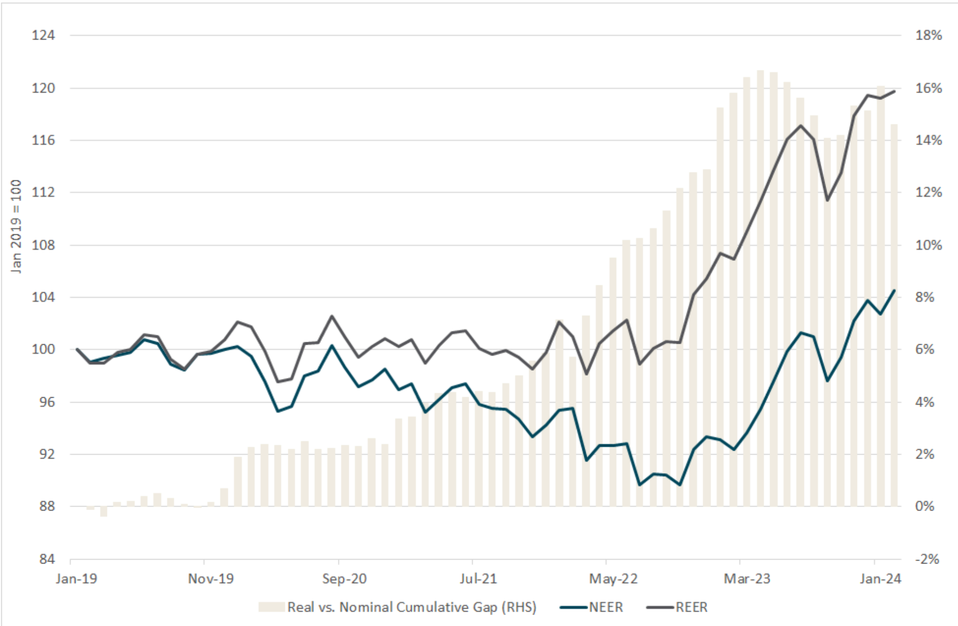
Exhibit #3: Poland Household Cashflows



Source: Macrobond, BNY Mellon

Along with interest-rate policy, CEE central banks have broadly encouraged a strong currency to generate disinflation pass-through. In its March statement the NBP noted that the policy Council "judges that the decrease in inflation is supported by the appreciation of the zloty exchange rate, which is consistent with the fundamentals of the Polish economy." We concur, but the distribution of appreciation is currently heavily skewed in favour of the real effective exchange rate (REER), rather than the nominal (exhibit #4).

Exhibit #4: PLN REER vs. NEER



Source: Bloomberg, BNY Mellon

Credible policy and high real rates during the global tightening cycle helped PLN appreciate on a NEER basis at the end of 2022. Beforehand, pass-through was clearly moving in the opposite direction as imported inflation and domestic wage growth generated material inflation differentials in the zloty's favour. The REER has outperformed the NEER by a cumulative 15% since the beginning of 2019, the bulk taking place in the last two years. As Eurozone inflation begins to decline, we think the risk remains skewed towards inflation differentials staying elevated and requiring even greater adjustment on the nominal lest the PLN REER begin to deviate sharply from fundamentals. This also suggests that productivity growth is not high enough – a consequence of supply constraints. As such, real rates will likely need to remain high and the NBP's current stance is fully justified.

The more aggressive ECB easing cycle we expect will provide relief. But its current guidance suggests the NBP has to wait another quarter before having more policy space.

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