Investment Thermometer – 21 November 2018

Inflation will grow, but the MPC remains dovish

Union Investment

- **Good economy performance, but the peak is over**
- **Inflation rate will grow**
- **Worse performance of variable coupon bonds**

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The economic growth rate in the third quarter surprised us in a very positive way; according to quick estimates of the GDP for the third quarter, the economy grew by 5.1% y/y, clearly above 4.6% expected by the market. In addition, the Polish Central Statistical Office raised GDP growth readings for the last few quarters. We do not know the components of the GDP growth yet, so we do not know which factors have contributed to such a high growth rate.

For now, the GDP figures do not indicate slower growth, however it appears that the peak is already over and in the fourth quarter we may witness a worse reading. This does not mean that something bad is happening in the economy — quite simply, the 5% growth rate is clearly above the potential rate and the growth may slow down naturally.

Inflation rate may also be of interest. The projected consumer inflation rate for this year is 1.8%, but the central path for 2019 already shows 3.2%. The factors that have been indicated for a long time as being likely to contribute to a higher price growth rate, such as fast growth of wages, may finally actually affect inflation with considerable delay. In addition, companies have almost exhausted the possibility of taking over rising costs by reducing margins, which may have a bearing on consumer prices. The President of the NBP continues to present the dovish position, but the inflation rate of ca. 3% may provoke discussions in the MPC concerning interest rate increases.

The inflation rate projection for the years to come may be a source of arguments for keeping interest rates unchanged; in 2020, the consumer price growth is expected to slow down to 2.9%. Due to the period of the monetary policy impact of 4-6 quarters, a high but falling inflation rate may be a strong argument for not raising interest rates. In addition, the data used for the projection did not take into account a portion of the continued downward trend on the oil market.

On the bond market, following the local price peak after the last auction in October, the excitement wore off slightly. In the middle of the month, we observed worse performance of variable coupon Treasury bonds. The Polish market seems to be less liquid than usual, so large transactions on the secondary market have a stronger impact on prices. In mid-November, there was a higher supply of variable-coupon securities, the market was unable to absorb it and, as a result, the prices fell. It does not change the fact that the situation of the state budget is good (the deficit level is lower than in the budget law), which results in smaller current borrowing needs. After the last tender, the Ministry of Finance already pre-finances borrowing needs for 2019 (11%), which may reduce the supply of securities in the first quarter of 2019.

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