Bank Zachodni WBK

Post-MPC comment

Still waiting. But what for?

5 September 2012

After the summer break the Monetary Policy Council has left main interest rates unchanged and decided only to change the tone of the official statement. NBP Governor Marek Belka said that this change has opened door for possible interest rate cut, however the MPC did not precisely suggest that the cut would take place in October (at least not as clearly as May's rate hike was heralded in April). The decision next month will most likely depend on the upcoming data and it cannot be ruled out that a rate cut will be postponed until November, when the MPC will see the new projections of CPI and GDP. In our view, interest rate cut right now would be a correct move, justified by current and expected economic situation regarding GDP and inflation. Apparently the MPC prefers gradual changes in monetary policy parameters, disregarding the fact that economic outlook has deteriorated substantially since the previous meeting that took place in July (which was confirmed by NBP President at the conference). We maintain forecast that NBP rates will be trimmed by 50bps in fourth quarter (first cut by 25bps probably in October – we expect weak data), and at the start of next year the reference rate will drop to 4%. This will be supported by scenario of further economic slowdown and decrease in inflation.

The Monetary Policy Council kept interest rates on hold, with reference rate still at 4.75%. The decision was in line with expectations of economists (no one was forecasting a cut in Parkiet and Reuters surveys), but the financial market was pricing-in a possibility of cut already at today's meeting. As regards recent comments by the NBP President Marek Belka that the Council will not surprise with its decision, one can say that such a declaration was difficult to be realised. As a result of today's decision, interest rate market saw a correction by a couple of basis points on the shorter end of the curve (FRA), while the zloty gained against the euro. These trends continued also after release of the statement and we think they will be in place also tomorrow, at least until the ECB press conference.

The Council eased tone of its communiqué. Well, maintaining July's statement about a possibility of further hikes would be rather ridiculous. As the NBP President Marek Belka said, change in today's communiqué "opened possibility of interest rate cuts", but the tone of the statement did not suggest nor pre-announce a cut in October (at least not as clearly as May's rate hike was heralded in April). Next meeting's decision will probably depend on the upcoming data. In our view these data will be rather weak and will confirm slowdown, so we find a cut more probable at the upcoming meeting in October. However, the first cut cannot be ruled out in November, when the MPC will see the new GDP and CPI projection. September's figures released ahead of the November's meeting will be so miserable that the Council will have no other option but to cut (maybe even by 50bps). In our view, a rate cut already at today's meeting would have been fully accepted and justified by current and expected GDP and CPI developments. Apparently, for the majority of the MPC current inflation is vital obstacle in voting for a rate cut. Still, taking into account comment of NBP Governor that the Council withes to maintain positive real interest rates, it is worth to notice that there was a room for rate reduction and meeting this target at the same time – reference rate at 4.75%, inflation at 4%. The MPC again proved it is following a backward-looking rule even though most forecasts (including the NBP projection) point to lower CPI in the medium term. However, we think the MPC cannot escape from economic reality any longer so thus we maintain our forecast of a rate cut, of cuts by 50bps in Q4 and by further 25bps in 2013Q1.

Apparently the MPC prefers gradual changes of parameters regardless considerable change of economic outlook since July's meeting (and that was confirmed by NBP governor during the press conference). Marek Belka said also that one of pursued characters of monetary policy is its stability, foreseeability and lack of sudden swings. Well, the MPC may find itself in hot water over the rate hike decision taken in May and finally will have to cut rates. Any postponing of this move will not make it more pleasant, rather quite the opposite. We do not think it is necessary to prepare observers of monetary policy for decisions everybody broadly expect. Or maybe the MPC wants to prepare itself for such move. We would like to stress "most important character" of the monetary policy mentioned by the NBP Governor today – "taking decisions relying on medium-term outlook". We can't resist an impression that there is a lack of this element lately.

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The last important element mentioned during the press conference was the exchange rate. The NBP's governor said that monetary policy decisions should be adjusted to situation on the FX market, of course not in a context of influencing the level of the zloty (it would be probably very difficult), but in the context of possible market destabilisation. Well, perhaps the recent zloty weakening has discouraged the MPC from cutting interest rates at today's meeting due to worries about further zloty depreciation. The agenda for September in terms of political events and central banks' activity is quite heavy, including tomorrow's ECB's decision, which could affect the zloty more than a possible official NBP rate reduction by 25bps.

To sum up, the MPC has done today what was a necessary minimum – adjusted its tone to changing economic environment. It seems that contracting domestic demand is still not enough to ease monetary policy and the Council needs more information. In our view, data due for release in the upcoming month may encourage the Council to cut rates in October, but the nearest days can bring a continuation of correction of aggressive cuts priced-in by the market as the communiqué was less dovish than most market participants (especially those pricing-in cuts) were expecting.

The NBP President said during the conference that today MPC discussed Monetary Policy Guidelines for 2013, but issue of changing inflation target did not appear as none of the members mentioned it. MPC's Elżbieta Chojna-Duch commented recently in media about such a possibility.

Fragments of the MPC statement (indication of changes as compared to July statement)

~~Incoming data suggest weakening activity in the global economy~~ **Global economic activity remains low**. ~~Stagnation~~ **Recession** in the euro area is accompanied by moderate growth in the United States. ~~At the same time, economic activity in the major emerging economies is deteriorating~~ **In emerging economies economic growth decreased in Q2 2012**. ~~Weakening growth in the global economy contributes to falling commodity prices. Deceleration in growth of energy prices, and in some countries also food prices, is conducive to the decline in global inflation~~ **Subdued global economic growth supported easing of inflation in many countries**. ~~Despite persisting uncertainty about the situation in the euro area,~~ **Recently** the sentiment in the international financial markets has ~~stabilized in the recent weeks~~ **improved somewhat**. ~~This contributed to appreciation of most emerging economies' currencies, including the zloty~~. **At the same time, global prices of agricultural and energy commodities have risen considerably.**
The data on GDP in Poland point to slower than expected economic growth in 2012 Q2. Growth of consumption and investment expenditures, including corporate investment, decreased. Change in inventories made a significantly negative contribution to GDP growth. Exports growth also slowed down. However, due to a simultaneous decline in imports, net exports were a major contributor to GDP growth. Weaker output growth was accompanied by deteriorating corporate financial results. At the same time, ~~In Poland, data on~~ **industrial** output and retail sales in ~~May~~ **July** ~~were better than expected~~ **rose faster than on average in 2012 Q2**. ~~However, the total growth in output and sales in the first months of Q2 decelerated as compared to the previous quarter, which, amidst leading business indicators persisting at relatively low levels, confirms further gradual slowdown in economic growth~~. **Yet, the decline in construction output continued and business indicators remain unfavourable.** ~~In May employment growth in the corporate sector remained weak and the unemployment rate persisted at elevated level.~~ **According to the Labour Force Survey, in 2012 Q2 employment growth came to a halt and the unemployment rate was higher than a year ago, mainly due to a further increase in the labour force participation. At the same time,** wage growth in the **economy, including the** corporate sector, ~~was still moderate~~ **decelerated.** ~~At the same time, growth in lending to enterprises weakened somewhat~~. **The economic slowdown was accompanied with a gradual deceleration in corporate lending.** Lending to households ~~decelerated further~~ **also continued to slow**, driven by **further** decline in consumer loans and lower growth of housing loans, **including decrease in foreign currency loans**. **Yet, the household savings rate continued to decline in 2012 Q1**
After a temporary rise in June ~~in May~~, CPI inflation fell to ~~3.6%~~ **4.0% in July.** However, it remained above the NBP's inflation target of 2.5%. Inflation net of food and energy prices did not change~~. At the same time, households' inflation expectations stayed elevated.~~ **Decline was also noted in core inflation and inflation expectations of households and corporates.**
In the opinion of the Council, in the coming months inflation ~~is likely to increase temporarily and remain above the upper limit of deviations from the inflation target~~ **will decrease gradually over the coming months, as the statistical base effect wanes amidst slowing demand in the economy. The recently observed increase in global commodity prices poses an upward risk to the expected decrease in inflation.** ~~However, I~~In the medium term, economic slowdown ~~amidst fiscal tightening and interest rates increases implemented in 2011 and 2012~~ will be conducive to inflation returning to the target. ~~This assessment is also supported by the July projection of inflation and GDP~~. The Council decided to keep the NBP interest rates unchanged.
~~The Council does not rule out the possibility of further monetary policy adjustment, should the outlook for inflation returning to the target deteriorate.~~ **Should the incoming data confirm further weakening of economic conditions, and should the risk of increase in inflationary pressure be limited, the Council will consider adjustment of monetary policy.**

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