Bank Zachodni WBK

# Post-MPC comment

## What goes around comes around

3 October 2012

**Even though we have signalled a high risk of keeping interest rates unchanged in our recent reports, we were still betting there would be a majority to support cut at October's meeting. Especially as such a move was fully justified taking into account forecasts of inflation and economic growth. Majority of market participants were of similar opinion so after today's decision to keep rates on hold the money market interest rates climbed and the zloty strengthened. Still, we think that the upcoming macroeconomic data will confirm that economic slowdown is protracted while the risk of increase in inflationary pressure is limited. As cut was made conditional on these two factors, we are expecting such a decision in November (by 25bp) and two more until the end of 1Q2012. This is also when the new NBP's projection of CPI and GDP will be released, which can help some of the MPC members to join the dovish camp. Nevertheless, argument that the cut was postponed to see this document is not really convincing for us. If the NBP projections were so important while taking decision on rates, we would have seen a cut after release of July's report and there would be no hike after release of March's report.**

The Monetary Policy Council left the interest rates unchanged in October (reference rate at 4.75%). The vast majority of analysts (18 out of 21 in Parkiet daily's poll) expected a rate cut by 25bps this month. Such scenario was also priced in by the money market instruments. Consequently, after the announcement of today's decision FRA rates surged by (7-12bps), yields of short term bond increased by 6bps and zloty gained ca. PLN0.03. We were also betting the Council will decide to start the easing cycle already this month (as this would have been obviously justified amid expected developments regarding inflation and pace of economic growth). On the other hand, we mentioned also that there is high risk regarding materialization of such scenario. Despite the interview the NBP governor gave last week – when he suggested soon beginning of monetary easing cycle – we were aware that "it will be difficult to gather a majority for a cut (5 votes), as some MPC members seem clearly unimpressed by recent weak macro data" (see our last Weekly report).

The tone of the statement was more dovish as compared to September's one. The MPC noted further slowdown of economic growth abroad, factors supporting lower inflation globally and signs of deterioration of economic activity in Poland. The MPC expects gradual decline of inflation in coming quarters, despite still high risk from elevated commodities prices on the global market. There was a modification of the last, most important sentence of the statement, where the MPC stated that 'should incoming data, including the November inflation projection of the NBP, confirm that economic slowdown would become protracted, while the risk of increase in inflationary pressure be limited, the Council will ease monetary policy'. This is a very clear announcement that main interest rates will most likely be reduced at the next meeting. NBP governor said during the press conference that the aim of changing this fragment of the statement was to strengthen the signal of possible easing of monetary policy. Marek Belka said also that one of the reasons for which there was no rate cut today was to become sure of tendencies regarding the economic growth and inflation by, among others, receiving new NBP projection.

It is interesting that the MPC emphasised a necessity to know the new NBP inflation projection, while the results of previous two updates of those forecasts seemed not so relevant in the decision-making process. Just to remind, the projection in March showed a significant economic slowdown and inflation reduction in 2013 and the projection in July confirmed this trend even more. Apparently, in the last six months or so the results of the projection were not the most important argument for the MPC. The NBP President said a few times in the past that there are other analyses and forecasts (perhaps better), which are taken into account. So why the importance of this document is growing currently? Possibly, according to some MPC members, a short distance between the hike in May and a rate cut would be too open admission of a mistake. Therefore, there was a need for arguments to postpone unwinding the controversial rate hike.

**Maciej Reluga Chief Economist** 022 586 8363 Email: ekonomia@bzwbk.pl

**Piotr Bielski** 022 586 8333
**Marcin Luziński** 022 586 8362
**Agnieszka Decewicz** 022 586 8341
**Marcin Sulewski** 022 586 8342

During the press conference, the NBP President Marek Belka was asked whether the hike in May was a mistake. And he said: no. From our point of view, it is hard to agree.

Macroeconomic data for September, which the MPC will know before the next rate-setting meeting, should be even worse than August's figures, allowing the Council to ease rates in November. We still uphold our stance that the reference rate would fall to 4.00% till the end of Q1 2013. Marek Belka said at the press conference that room for interest rates reductions can be deducted from the Council's intention to leave real interest rates on the positive level. It is consistent with the scope of interest rates cuts assumed by us – currently real interest rates are at ca. 1% (however, one should notice that real rates might rise as a result of the drop in inflation and inflation expectations).

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

| |
|---|
| **Available data indicate that** global economic activity in **2012 Q3** remained low. Recession in the euro area has been accompanied by **merely** moderate growth in the United States. **At the same time**, ~~in~~ **many** emerging economies **saw further slowdown in** economic growth ~~decreased in Q2 2012~~. ~~Subdued global economic growth supported easing of inflation in many countries. Recently, the sentiment in the international financial markets has improved somewhat, which has supported prices of some financial assets and encouraged capital inflows to emerging markets. At the same time, global prices of agricultural and energy commodities have risen considerably.~~ **Taking into account unfavourable outlook for economic growth, central banks of major developed economies further eased their monetary policy in September, primarily, by announcing the expansion or launch of new quantitative easing programs. Stronger monetary expansion pursued by major central banks has brought some improvement in the sentiment in the international financial markets, supporting prices of some financial assets. At the same time, due to the worsening outlook for global economic growth, the rise in commodity prices in the world markets was halted. Although low global economic activity supports inflation decline, still relatively high commodity prices contribute to inflation remaining elevated in many countries.** |
| ~~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~~. **The data on economic activity in Poland in July and August, including ongoing deceleration of industrial production, persisting decline in construction output and further decrease in retail sales growth, point to a continued downturn in economic conditions in 2012 Q3.** ~~At the same time, industrial production and retail sales in July rose faster than on average in 2012 Q2. Yet, the decline in construction output continued and business indicators remain unfavourable~~. **Also data on labour market developments, including fall in employment and low wage growth in the corporate sector and gradually rising unemployment rate, signal a possible slowdown in demand from the private sector. This is also indicated by the worsening of most economic sentiment indicators.** ~~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, decelerated.~~ Economic slowdown is accompanied by a gradual deceleration in lending **to households, including further decline of consumer loans, and continued moderate rise** in corporate lending. ~~Lending to households also continued to slow down, driven by further decline in consumer loans and slower growth in mortgage lending, including decrease in foreign currency loans. Yet, the household savings rate continued to decline in 2012 Q1.~~ |
| ~~After a temporary rise in June~~ **In August**, CPI inflation fell **again** to ~~4.0% in July~~ **3.8%**. However, it remained above the NBP's inflation target of 2.5%. **At the same time, there was a decline in** inflation net of food and energy prices ~~did not change~~. ~~At the same time~~, **and a slight drop in** ~~households'~~ inflation expectations **of households and of corporate sector** ~~stayed elevated~~. |
| In the opinion of the Council, inflation will decrease gradually over the coming months, as the statistical base effect wanes amidst slowing demand in the economy. **However, it will remain above the inflation target of 2.5% until the end of 2012**. ~~The recently observed increase in global commodity prices poses an upward risk to the expected decrease in inflation.~~ In the medium term, economic slowdown will be conductive to inflation returning to the target **while high commodity prices in the global markets remain an upward risk to inflation decline**. The Council decided to keep the NBP interest rates unchanged. |
| Should the incoming data, **including the November inflation projection of the NBP**, confirm ~~further weakening of economic conditions~~ **that economic slowdown would become protracted**, while the risk of increase in inflationary pressure be limited, the Council will ~~consider adjustment of~~ **ease** monetary policy. |

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division. Economic Analysis Unit. ul. Marszałkowska 142. 00-061 Warsaw. Poland. phone +48 22 586 83 63. email ekonomia@bzwbk.pl. http://www.bzwbk.pl