Bank Zachodni WBK

Post-MPC comment

Better late than later

7 November 2012

Finally the Monetary Policy Council has done what seemed unavoidable – cut interest rates. Reduction amounted only to 25bps, which means that the reference rate returned to level seen before controversial hike in May. The statement pays much attention to economic slowdown, also reflected in the new NBP projection. Apart from downward revision of economic growth, inflation path was also lowered, even below the target in the medium term. The communiqué reads that "should the incoming information confirm a protracted economic slowdown, and should the risk of increase in inflationary pressure remain limited, the Council will further ease monetary policy". In our view, this will surely happen and another cut by 25bps will be delivered already in December. High probability of such a scenario was also signalled by the NBP president Marek Belka. Elevated inflation still remains the main factor preventing the MPC from a more considerable easing of monetary policy. As we are predicting a further decline of inflation (to or below target in February), while the economic slowdown will continue, we will see further monetary policy easing in 2013. Even though the MPC members were trying to dent expectations for a more significant easing during the conference, we see some risk that rates will be cut more than our forecast of 75bps, given our scenario of economic developments in the upcoming months.

The Monetary Policy Council trimmed interest rates by 25bps and since 8 November NBP reference rate will amount 4.50%. The decision was in line with expectations and the MPC fulfilled its conditional pledge from the October's statement. The monetary policy was eased as in the view of the MPC economic data "confirm a considerable economic slowdown in Poland, which contains wage and inflationary pressure". Furthermore, November's projection prepared by the NBP confirm that GDP growth will decelerate and in coming years will be below potential level, while inflation is expected to return to the target in nearest months and in the medium term may even decline below 2.5%.

Tone of the MPC's statement is currently more dovish in comparison with the previous months. Apparently, last series of negative macroeconomic data and the new NBP's projection have convinced the majority of the MPC members that – as we have been suggesting for a while – the economic scenario for coming quarters will be much less optimistic than the Council predicted thus far. The statement also includes a clear signal that November's rate cut is probably the beginning of the monetary easing cycle (if further macro data confirm a protracted economic slowdown, and should the risk of increase in inflationary pressure remain limited, which is in our opinion very likely). The NBP's governor M.Belka said that probability of interest rate cut in December is relatively high. How the stance of the MPC's view has changed is showed by the sentence that rate reduction "should support economic activity and thus **reduces the risk of inflation falling below the target** in the medium term." So far a major concern for the MPC was risk of inflation running persistently above the NBP's target, now the Council is trying to lower the risk of CPI falling inflation below the reference level.

On the other hand, during the press conference MPC members tried to cool down expectations regarding the depth of possible rate cuts. Marek Belka underlined that current inflation remains elevated. Andrzej Rzońca pointed that in view of the majority of the MPC members the difference between the probability of inflation being below the target and probability of staying above it is not big. Andrzej Kaźmierczak said that cost of disinflation has already been suffered and it is easy to damage the effect. He added that careful approach of the MPC towards easing as there are still "risks outstanding". Apparently, it is seems that current level of inflation is still crucial factor influencing MPC decisions (despite clearly dovish conclusions of the projection). Nevertheless, according to forecasts CPI will be falling quickly in coming months (just below 2.5% already in February), so the Council's approach may become more dovish and the scale of total rate cuts may be slightly bigger than we currently expect. If MPC cuts rates in December, the next one may take place in January, and then the Council will wait for the next March update of the NBP projections, which will determine future moves. If our scenario materialises, assuming GDP growth bottoming out in Q1-2013, then more monetary easing than three more rate cuts by 25bps (total of 100bp in cycle) seems unlikely.

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Inflation and GDP projections in the subsequent *Inflation reports*

	GDP growth				CPI inflation			
	Nov 11	Mar 12	Jul 12	Nov 12	Nov 11	Mar 12	Jul 12	Nov 12
2012	2.0-4.1	2.2-3.8	2.3-3.6	2.0-2.6	2.5-3.9	3.6-4.5	3.6-4.2	3.7-3.9
2013	1.5-4.0	1.1-3.5	1.0-3.2	0.5-2.5	2.2-3.7	2.2-3.6	2.0-3.4	1.8-3.1
2014	x	1.9-4.4	1.7-4.2	1.1-3.5	x	1.2-3.0	1.0-2.7	0.7-2.4

According to the NBP projections, the GDP and CPI growth will fall in the ranges given above with probability of 50%.

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

~~Available~~ **Incoming** data indicate that global economic activity in 2012 Q3 remained ~~low~~ **subdued**~~. Recession~~ in the euro area ~~was accompanied by merely moderate growth~~ **economic growth was probably close to zero**, and in the United States, **despite some rebound, remained moderate.** At the same time, **following several quarters of economic slowdown, growth in the largest** ~~many~~ emerging economies probably **stabilised at a relatively low level** ~~saw further slowdown in economic growth~~. ~~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. level.~~ **Even though weak economic activity across the world contributes to a decline in inflation, still relatively high commodity prices are conducive to inflation remaining elevated in many countries. Following the earlier improvement, the international financial market sentiment has deteriorated slightly. At the same time, some central banks have lowered their policy rates.**

~~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.~~ **In Poland, both industrial output and retail sales (in real terms) declined in September, while the fall in construction and assembly output deepened. Economic activity data were worse than expected and reflected further economic slowdown in 2012 Q3.** ~~Also data on~~ **Furthermore,** labour market ~~developments~~ **figures**, including ~~fall~~ **continued decline** in employment, ~~and low~~ **slower** wage growth in the corporate sector and gradually rising unemployment rate, ~~signal~~ **point to a lack of wage pressure and** ~~possible slowdown~~ **likely further weakening** in private demand. This is also confirmed by deteriorating of most business indicators. Economic slowdown is accompanied by a gradual deceleration in lending to households, including a further decrease in the consumer loans, as well ~~as continued moderate rise~~ **slower growth** corporate lending.

In ~~August~~ **September**, CPI inflation ~~fell again to~~ **was** 3.8%, remaining above the NBP's inflation target of 2.5%. At the same time, **both** core inflation **and producer price growth continued to decline, which confirms that demand pressure is weakening**. Household and corporate inflation expectations also declined in the recent months .

In the opinion of the Council, **incoming data confirm a considerable economic slowdown in Poland, which contains wage and inflationary pressure. At the same time, in line with the November projection prepared under the assumption of constant NBP interest rates, GDP growth will remain below potential in the coming years. According to the projection, inflation will return to the target in the coming quarters, and might fall below the target in the medium term** ~~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. In the medium term, the slowdown in economic growth will contribute to inflation returning to the target while high commodity prices in the global markets remain an upward risk to inflation decline.~~ Therefore, the Council decided to ~~keep~~ **lower** the NBP interest rates ~~unchanged~~.

Should the incoming information~~, including the November inflation projection of the NBP~~, confirm ~~that economic slowdown would become protracted~~ **a protracted economic slowdown, and should** ~~while~~ the risk of increase in inflationary pressure ~~be~~ **remain** limited, the Council will **further** ease monetary policy.

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