Bank Zachodni WBK

# Post-MPC comment

## Strong ending

6 March 2013

**The Monetary Policy Council trimmed interest rates by 50bps, which was a surprise for us and for the market. We expected a move by 25bps and simultaneous announcement of the end of rate cuts. As regards the latter, the Council confirmed that the decision "complements" the monetary easing cycle. Apparently the majority of MPC members agreed on the scale of necessary cuts and decided there is no point in delaying it. Such move was also supported by the new projection of GDP and inflation. Overall, today's decision and the communiqué are fully justified in our opinion. As the saying goes: it doesn't matter how you start, it's where you end up.**

The Monetary Policy Council surprised market players today, cutting main interest rates by 50bps. As a result, the NBP reference rate will fall tomorrow to 3.25%, the lowest level in history. Although in one of our recent reports we wrote that "we think that a deep one-off cut as an ending move would be a good decision", we doubted if such a motion would gain majority, and thus we expected that there will be a compromise yielding another small rate cut and a shift to 'wait-and-see' mode. Please recall that some MPC members wanted to end the easing cycle earlier, and comments of others did not suggest clearly that a rate cut by 25bp in March is warranted. The official MPC statement and press conference suggested that indeed the MPC decided to make a strong move at the end of the easing cycle (details below). In reaction to the decision the zloty depreciated to 4.16 versus euro, while the yield curve went down by ca. 10bps at the short end and ca. 5bps at the long end. After the release of the MPC statement, there was a partial reversal of this move, as we expected.

Interestingly, after the MPC has been convincing in recent months (both in statements, as well as in individual comments of the Council members) that the end of the easing cycle is nearing, today they decided to cut rates more deeply than in previous moves. And simultaneously the MPC clearly announced that a cycle of reductions is completed. The latter could have been expected, however we predicted a rate cut by 25bps. Apparently, the MPC stated that the new projections of inflation and GDP had justified deeper reduction of official interest rates and there was no reason to continue gradual cuts. Too bad that the Council has not decided for such aggressive reductions earlier. We have argued for a long time that the economic situation had justified rate reduction to around 3.00%.

The statement clearly suggests the termination of rate cuts. The key sentence says: "**The March decision complements the monetary policy easing cycle commenced in November 2012**". Additionally, the MPC wrote that "considerable monetary policy easing in recent months and at the March meeting will allow inflation to run close to target in the medium term and at the same time supports recovery of the Polish economy". During the press conference NBP governor Marek Belka confirmed that by cutting the rates by 50bps the Council wanted to end the easing cycle. Meanwhile, in his view the new projection (details in the table below) justified such approach and made room for safe reduction of rates on a more significant scale than before. Inflation is predicted to run below the official target in the medium term and a gradual pick-up in economic activity poses no risk to price developments.

Still, it cannot be excluded that some market participants will not take this statement seriously and will conclude that upcoming weak data from the real economy and further fast decline of inflation may trigger next rate cut. Although Marek Belka said today that the MPC left the door open for a possible continuation of monetary easing (switching to the 'wait-and-see' mode), he also stressed that moods among the Council's members indicate that it would require such an inflow of data that would change the scenario presented in the projection. It does not seem very likely to happen. In our opinion, the cycle of rate cuts is over and at least until the end of the year rates will remain at current level.

**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

### Inflation and GDP projections in the subsequent *Inflation reports*

| | GDP growth | | | | CPI inflation | | | |
|---|---|---|---|---|---|---|---|---|
| | **Mar 12** | **Jul 12** | **Nov 12** | **Mar 13** | **Mar 12** | **Jul 12** | **Nov 12** | **Mar 13** |
| **2013** | 1.1-3.5 | 1.0-3.2 | 0.5-2.5 | 0.6-2.0 | 2.2-3.6 | 2.0-3.4 | 1.8-3.1 | 1.3-1.9 |
| **2014** | 1.9-4.4 | 1.7-4.2 | 1.1-3.5 | 1.4-3.7 | 1.2-3.0 | 1.0-2.7 | 0.7-2.4 | 0.8-2.4 |
| **2015** | | | | 1.9-4.4 | | | | 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 February's statement)

Incoming data show that global economic activity remains low. In 2012 Q4, economic growth in the United States ~~declined~~ **came to a halt**, while the euro area ~~most probably~~ remained in recession. **GDP declined in all major euro area economies, including Germany.** ~~At the same time, recently some business indicators for developed countries have slightly improved. There are also signs that~~ **At the same time**, in some major emerging economies economic growth **probably** accelerated ~~somewhat~~. ~~Weak global economic activity is conducive to a decline in inflation in many countries.~~ **In recent months, economic activity in several developed economies showed some signs of improvement.**

In Poland, ~~incoming data, including GDP data for 2012, show that – as expected – 2012 Q4 saw a further~~ **the GDP data confirmed that in 2012 Q4 there was a marked** economic slowdown. ~~The decrease in~~ **Weakening** consumer demand was accompanied by a smaller decline in investment. Economic growth continued to be supported by a positive – albeit lower than in the previous quarter – contribution of net exports. **Incoming data point to still low economic growth in early 2013.** ~~The economic slowdown is also confirmed by data from the labour market. In December, employment in the corporate sector still decreased, and wage growth remained low. At the same time, the unemployment rate rose again.~~ **Weak economic activity growth is accompanied by falling employment in the corporate sector and rising unemployment, which holds back wage growth.** ~~Over the last months~~ **At the same time**, both household and corporate lending growth ~~continued to weaken~~ **remains subdued.**

In ~~December~~ **January**, CPI inflation declined ~~to 2.4% y/y~~ **more than expected**. **According to the preliminary data, CPI inflation was 1.7% y/y,** running ~~at the level consistent with~~ **below** the NBP inflation target of 2.5%. ~~At the same time, both~~ **Also** core inflation ~~measures~~ remained low ~~and producer price growth continued to decrease,~~ which confirms ~~further weakening of~~ **limited** demand ~~and cost~~ pressure in the economy. **At the same time,** ~~Declining inflation was accompanied by lower inflation~~ expectations of households **decreased further**.

**The Council got acquainted with the inflation and GDP projection prepared by the Economic Institute, which is one of the inputs to the Council's decisions on the NBP interest rates. In line with the March projection based on the NECMOD model – assuming unchanged NBP interest rates – there is a 50-percent probability of inflation running in the range of 1.3-1.9% in 2013 (as compared to 1.8-3.1% in the November projection), within 0.8-2.4% in 2014 (as against 0.7-2.4%) and between 0.7-2.4% in 2015. The annual GDP growth – in line with this projection – will be, with a 50-percent probability, contained within 0.6-2.0% in 2013 (as compared to 0.5-2.5% in the November projection), within 1.4-3.7% in 2014 (as against 1.1-3.5%) and within 1.9-4.4% in 2015.**

In the opinion of the Council, the incoming data confirm ~~a considerable economic slowdown~~ **persistently low economic growth** in Poland, ~~which results in limited~~ **no** wage **pressure** and **low** inflationary pressure. **Economic activity may gradually improve in the coming quarters.** ~~At the same time, the Council assesses that~~ **However,** GDP growth will **probably** remain moderate ~~in the coming quarters, and therefore, the risk of inflation running below the NBP inflation target in the medium term persists~~ **which will continue to contain inflationary pressure. Such an assessment is supported by the March projection of inflation and GDP. Considering the risk of inflation running below the NBP inflation target in the medium term,** the Council decided to lower the NBP interest rates further. ~~The decrease in interest rates should support economic activity and reduces the risk of inflation remaining below the target in the medium term.~~ **The March decision complements the monetary policy easing cycle commenced in November 2012.**

~~Decisions of the Council in the following months will depend on the assessment of the incoming data on economic developments and inflationary pressure, including the results of the March NBP macroeconomic projection.~~ **In the opinion of the Council, considerable monetary policy easing in recent months and at the March meeting will allow inflation to run close to target in the medium term and at the same time supports recovery of the Polish economy.**



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