Bank Zachodni WBK

Post-MPC comment

Correction of March cut, not the last one

8 May 2013

The MPC trimmed interest rates by 25bps because recent data have worsened the MPC's assessment of economic situation and lowered its expected inflation path. Marek Belka underlined that this is not the beginning of the new easing cycle but only a correction of March decision (when the MPC cut rates by 50bps and announced that it "complemented the cycle"). In our opinion, today's move still does not mark the end of easing cycle and until July rates may be trimmed further by 25-50bps. Such scenario will be supported by next macro data (lower and lower inflation, lack of visible revival in the economy). However, we still think the market is pricing-in further policy easing (by nearly 100bps) too aggressively.

The Monetary Policy Council trimmed interest rates by 25bps in May, which dragged the main NBP refinancing rate to the new record low level of 3.0%.

The Council pointed in the statement that incoming economic data confirmed sluggish economic growth in Poland and deeper decline of inflation, as well as higher uncertainty regarding the outlook for a rebound in economic activity abroad. Consequently, the risk of CPI's staying clearly below NBP target in the medium term increased. According to NBP governor Marek Belka, after the recent data the MPC assessed that inflation may sustain at very low level, even below forecasts presented in the last NBP projection, and this has opened the door for a rate cut this month. Still, NBP governor stressed several times that May's rate cut should not be treated as the beginning of new easing cycle, but as a "correction of what the MPC has announced two months ago". He added that Council does not intend to signal a high probability of further monetary policy easing – either a rate cut or leaving rates unchanged in June is in his opinion equally likely. He said also that the disparity of interest rates between Poland and other countries is still considerable and one cannot say that we are already approaching "ultra-low" level of interest rates (which – as he stressed in the previous month – the MPC would like to avoid). According to Belka, the MPC remains in the easing bias.

In the last, crucial sentence of the MPC's statement (see table below), the Council has deleted a piece, suggesting that further decisions in upcoming months will be strongly dependent on the assessment "regarding economic activity". The NBP's Governor Marek Belka highlighted that it was no accidence, showing that the Council would shift its focus even more to inflation outlook from GDP outlook. At the same time, Belka has devoted much attention to the uncertainty concerning the pace and the scale of possible economic rebound as well as pointed out that the structure of the GDP growth is also very important. He said that the Council does not expect the Polish economy to slow down further, but de facto the scale of predicted improvement will be rather subdued. What is more, in Belka's opinion, the structure of GDP growth, which is alarming, is more important. In particular, in the opinion of the Council "Polish economy will not be able to grow in the long run solely on one engine, which is net exports".

When asked why then the MPC decided to cut rates only by 25bps, NBP governor said that the MPC did not want to surprise with its decisions. Recent decisions of the MPC (including today's) would actually miss market expectations quite often. Investors are still pricing-in further monetary easing in coming months quite aggressively. Recently, we have altered our forecast for the central bank interest rates – from flat rates to 50bps cut this year. We did not expect the first cut be delivered already in May. Because June's rate cut cannot be excluded and next may take place in July (due to further deep decline of inflation) there is a downward risk to our forecast. However, we still think the market is too aggressively pricing-in possible scale of monetary easing.

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Fragments of the MPC statement (indication of changes as compared to April's statement)

~~Despite a gradual improvement~~, global economic activity remains ~~low~~ **weak**. **Despite an acceleration in economic growth in the United States in 2013 Q1, consumer and corporate confidence weakened somewhat in March 2013.** ~~In the euro area~~, recession probably continued ~~into 2013 Q1~~ **in the euro area**, ~~although the situation varied across countries. In~~ **and in** Germany, ~~following a decline in GDP in 2012 Q4, economic activity rebounded at the beginning of the year; nevertheless, corporate sentiment has deteriorated most recently.~~ – **despite expected positive growth rate – the sentiment of economic agents weakened. A weakening of economic growth was also observed in China.** ~~In other major economies of the euro area, recessionary trends persisted. In contrast to that, incoming data point to acceleration in economic growth in the United States, supported by improving labour and real estate markets. At the same time, economic activity growth in some of the major emerging economies has probably increased slightly.~~ **Weak global economic activity has contributed to a decline in inflation in many countries. The recent decrease in commodity prices in the global markets is also conducive to lower inflation.**

In Poland, ~~GDP growth in 2013 Q1 probably remained~~ **the incoming data confirm that economic growth is** low. **In 2012 Q4, GDP growth was weaker than previously estimated.** ~~This is indicated by a decline in~~ **Data on** industrial and construction output ~~observed in the first months of 2013, amidst a merely marginal increase in retail sales.~~ **as well as retail sales in the first months of 2013 show that economic activity growth remained weak also in 2013 Q1. Subdued** ~~Low~~ economic activity ~~in 2013 Q1~~ is also ~~reflected~~ **confirmed** ~~in low levels of~~ **by weak** business climate indicators. ~~Weak economic activity in the first months of 2013 was accompanied by falling employment in the corporate sector and rising unemployment, which continued to constrain wage growth.~~ **In 2013 Q1 employment in the enterprise sector declined, while the seasonally-adjusted unemployment rate rose.** ~~While a certain increase in annual wage growth in February was registered in the corporate sector, this may have largely resulted from statistical base effects.~~ **Wage growth continued t decrease.** At the same time, lending – both to the corporate and household sector – remained low.

In ~~February~~ **March**, CPI inflation decreased again, reaching **1.0% y/y**, i.e. a level markedly below the NBP inflation target of 2.5%. **The decline in inflation was mainly driven by a decrease in food price growth.** There was also a decline in core inflation measures, which confirms a weak demand pressure prevailing in the economy. This was accompanied by a further decline in inflation expectations of households ~~and enterprises~~.

In the opinion of the Council, the incoming data ~~confirm~~ **indicate** ~~low~~ **that** economic growth in Poland **remains weak, while inflation decline is stronger than forecasted in the March projection.** ~~as well as no wage and inflationary pressures. Economic activity may gradually improve in the coming quarters. However, GDP growth will probably remain moderate, which will continue to contain inflationary pressure.~~ **At the same time, uncertainty about the pace and timing of the expected recovery in the euro area has increased, which can adversely affect economic activity in Poland. Hence, the risk of inflation staying markedly below the target in the medium term has risen.**

The Council decided to ~~keep~~ **lower** the NBP interest rates ~~unchanged~~. The Council's decisions in the following months will depend on the assessment of the incoming data with regard to the probability of inflation remaining markedly below the NBP inflation target in the medium term ~~and regarding economic activity.~~

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