Bank Zachodni WBK

Post-MPC comment

End of the cycle closer, but not here just yet

5 June 2013

The MPC cut interest rates again, and this decision comes as no surprise given recent macroeconomic data and earlier comments of the MPC members. The Council stated that "monetary policy easing conducted since November 2012 supports economic recovery and limits the risk of inflation running below the NBP target in the medium term". At the same time, the NBP Governor Marek Belka stressed that a statement that the cycle has come to end or that the MPC is in neutral bias would be too far-fetched. We think that new GDP and inflation projection, to be shown in July, will justify another (and the last one, in our view) interest rate cut by 25bps. Despite recent correction, the financial market is still pricing-in a higher scale of monetary policy easing as compared to our scenario.

In line with expectations, the Monetary Policy Council cut interest rates again, bringing the reference rate to new all-time low at 2.75%. As it could have been expected, the Council noted in the statement that the upcoming data are indicating lower-than-expected economic growth in Q1 and stronger-than-expected decline of inflation. If we supplement this information with the fact that recent monthly data are suggesting low economic activity also in Q2, the cut was certain. However, as the Council (but only them) acknowledge uncertainty about scale and timing of expected economic recovery in the euro zone, and this may adversely affect economic activity in Poland, they left the door for further cuts open. This was confirmed during the press conference.

The last sentence of the communiqué ("monetary policy easing conducted since November 2012 supports economic recovery and limits the risk of inflation running below the NBP target in the medium term") may be suggesting that the MPC are adopting a neutral bias. However, the Governor Belka said directly that this would be too far-fetched. Still, the last paragraph of the statement is suggesting that we are close to the end of the cycle, and this is in line with our scenario. As the Governor said during the press-conference, the Council preferred to wait for results of new GDP and inflation projection, as they will help to set the economic picture for the upcoming quarters in a better order and then it would be possible to send an unambiguous signal for the markets. Belka stressed that we are approaching level of interest rates, which can be described (according to most MPC members) as an adequate level.

When addressing the recent zloty weakening, Belka underlined that this development was not due to country-specific factors and, given current economic conditions, it will be supportive for exports. At the same time, Belka stated that even though the effects of zloty depreciation may be similar to these of interest rate cut, it cannot be treated as a substitute of monetary easing (in the past strengthening of the zloty was not treated as a substitute of a hike by the Council). During today's press conference the zloty lost more than 0.02PLN against the euro.

All in all, in our opinion new inflation and GDP projection will give room for one more rate cut by 25bps and this will be the end of the easing cycle. Such a scenario will be supported by next macro data – further decline of inflation accompanied by lack of any signals of economic rebound (our forecasts of main indicators due to be released later in June are below market consensus).

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

Global economic activity remain~~s~~**ed** weak **in 2013 Q1**. **However, economic growth differed significantly across economies.** ~~Despite an acceleration in economic growth in the United States in 2013 Q1, consumer and corporate confidence weakened somewhat in March 2013. Recession probably continued in the euro area, and in Germany – despite expected positive growth rate – the sentiment of economic agents weakened. A weakening of economic growth was also observed in China.~~ **GDP growth acceleration in the United States was accompanied by persisting recession in the euro area and some decline in GDP growth in some major developing countries, including China. In Germany, GDP growth was positive, whereas in other large euro area economies GDP continued to decline. Despite signs of some improvement, recent data on business conditions in the euro area point to persistently negative trends in that economy at the beginning of Q2.** Weak global ~~economic~~ activity **growth, and the previous fall in commodity prices,** has ~~contributed~~ **supported** ~~to a~~ **further** decline in inflation in many countries. ~~The recent decrease in commodity prices in the global markets is also conducive to lower inflation.~~

In Poland, ~~the incoming data confirm that economic growth is low~~ **preliminary data on GDP in 2013 Q1 point to a slightly stronger than expected weakening in economic growth.** ~~In 2012 Q4, GDP growth was weaker than previously estimated.~~ **Decline in GDP growth in Q1 resulted from lower positive contribution of net exports to GDP growth amidst persistently declining domestic demand. The decline in domestic demand – amidst persistent stagnation in consumption – continued to be driven by falling investment, yet, the fall was lower than in the previous quarter. The April** data on industrial and construction output ~~as well as~~ **and** retail sales, **as well as the majority of business climate indicators show that weak economic growth continued at the beginning of Q2** ~~in the first months of 2013 show that economic activity growth remained weak also in 2013 Q1. Subdued economic activity is also confirmed by weak business climate indicators.~~ **The continuing slowdown in demand in 2013 Q1 contributed to further deterioration in the labour market; in particular the number of employed decreased and unemployment rose. Also the April data on the corporate sector point to a continued decline in employment, accompanied by rising registered unemployment rate (in seasonally adjusted terms).** ~~In 2013 Q1 employment in the enterprise sector declined, while the seasonally-adjusted unemployment rate rose. Wage growth continued to decrease.~~ **In April 2013, growth in lending to the private sector remained limited.** ~~At the same time, lending growth, both to corporates and households, slowed down.~~ **Both growth in loans to households and enterprises continued to be low.**

~~In March,~~ CPI inflation **in April 2013** declined again, reaching ~~1.0% y/y~~ **0.8% 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~~ **a lower growth in energy prices, including prices of fuels**. **At the same time, low level of** core inflation ~~measures~~ **as well as stronger decline in** producer prices ~~inflation also declined, which~~ confirm ~~weak demand~~ **persistently low demand** and cost pressures in the economy. This was accompanied by a **further** decline in inflation expectations of households.

In the opinion of the Council, the incoming data ~~indicate that~~ **point to weaker than expected** economic growth in Poland ~~remains weak~~ **and a stronger – than forecasted in the March projection – decline in inflation** ~~while inflation decline is stronger than forecasted in the March projection~~. At the same time, uncertainty about the pace and timing of the expected recovery in the euro area ~~has increased~~ **persists**, which can adversely affect economic activity in Poland. ~~Hence, the risk of inflation staying markedly below the target in the medium term has risen.~~

Therefore, the Council decided to lower the NBP interest rates **again**. ~~The Council's decisions in the coming months will depend on the assessment of the incoming data with regard to probability of inflation remaining markedly below the NBP target in the medium term.~~ **The Council assesses that monetary policy easing conducted since November 2012 supports economic recovery and limits the risk of inflation running below the NBP target in the medium term.**

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