

Post-MPC comment

This is the end

3 July 2013

The MPC cut interest rates by 25bps and declared that it has ended the monetary policy easing cycle. The Council assessed that “the significant reduction of NBP interest rates implemented since November 2012 supports economic recovery and limits the risk of inflation running below the NBP target in the medium term”. Even though we were expecting July’s cut to be the last in the cycle, we thought that the Council will keep the door ajar for further adjustment in autumn, acknowledging the scale of economic uncertainty. In our view such a stance would be supported by new projection of inflation and GDP (lower than in March). Apparently, most MPC members decided that the total scale of rate cuts brought the official rates to adequate level, given current and expected economic situation. We hope that it will not turn out, like after March decision, that the cycle has to be reopened, if the upcoming data confirm the scenario from the NBP projection or even worse. However, this is not our baseline scenario, so we are expecting that we will see no more rate cuts this year. Next move will be a rate hike... at some point in future.

In line with expectations of most analysts, Poland’s Monetary Policy Council cut interest rates by 25 bps, trimming the reference rate to a new historical low level of 2.50%. What is more, the MPC unambiguously said that it has ended the easing cycle in monetary policy. Justifying a shift to neutral mode in monetary policy, the NBP governor Marek Belka during the press conference listed a number of factors: improvement of outlook for Polish economy (“the worst is already behind us”), expected growth of CPI inflation (the low level of CPI inflation is caused by one-off factors) and the fact that the MPC already made considerable reductions in rates in this cycle and there is no room for further rate cuts taking into account current level of real interest rates. According to Belka the official rates should remain unchanged “for a couple of months”, “at least till year-end”.

The MPC’s statement included the main conclusions from the NBP projections of inflation and GDP (see table below). They show paths of both indicators lower than predicted in March (not much, but still). This may imply that majority of MPC members have more optimistic views on economic outlook than predicted in the projection. This was confirmed at the press conference, when NBP President Marek Belka said that “conclusion of monetary easing cycle is the exhibit of some optimism of the MPC and I would like it to be treated as a signal sent to the economy that the door to recovery is open”.

It was stressed during today’s conference that the Council aimed at „putting the expectations in order”. However, it seems that both analysts and the market were expecting that the Council will end the cycle at ca. 2.5%. Today’s decision and the statement will probably anchor these expectations. After the press conference the zloty strengthened by 0.02PLN against the euro, while the bond market ended the day stable versus Tuesday’s session, FRA and short-term IRS (1-2Y) climbed by ca. 10bps.

Inflation and GDP projections in the subsequent *Inflation reports*

	GDP growth				CPI inflation			
	Jul 12	Nov 12	Mar 13	Jul 13	Jul 12	Nov 12	Mar 13	Jul 13
2013	1.0-3.2	0.5-2.5	0.6-2.0	0.5-1.7	2.0-3.4	1.8-3.1	1.3-1.9	0.6-1.1
2014	1.7-4.2	1.1-3.5	1.4-3.7	1.2-3.5	1.0-2.7	0.7-2.4	0.8-2.4	0.4-2.0
2015			1.9-4.4	1.6-4.2			0.7-2.4	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%.

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

Global economic activity remained weak in 2013 Q1. **Available data indicate that global economic activity in the first half of 2013 remained low.** However, economic growth differed significantly across economies. **GDP growth acceleration A markedly better situation** in the United States is accompanied by **persisting probably on-going** recession in the euro area and **some decline in GDP growth the lack of visible rebound** 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 activity growth, and the previously observed fall in commodity prices, **has supported further decline in are conducive to low** inflation in many countries.

Signals of a possible tapering of monetary expansion by the Federal Reserve have recently led to a deterioration of sentiment in financial markets. This, in turn, resulted in some outflow of capital from emerging markets and depreciation of their currencies, including the zloty.

In Poland, preliminary data on GDP in 2013 Q1 point to a slightly stronger than expected weakening in economic growth. **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. In Poland** The April data on industrial and construction output and retail sales **in April and May indicate that growth in economic activity in Q2 remained weak,** as well as the majority of business climate indicators show that weak economic growth continued at the beginning of Q2. **This development is also suggested by a number of economic climate indicators, though some of them have improved lately.**

The continuing low economic activity supports weak wage growth. 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 **At the same time, May 2013 saw a halt in the decline of employment in the corporate sector** accompanied by rising registered unemployment rate (in seasonally adjusted terms) and a slight decrease in the registered unemployment rate (in seasonally adjusted terms).

In April 2013, growth in lending to the private sector remained limited. Both growth in loans to households and enterprises continued to be low.

CPI inflation in April 2013 declined again **in May 2013**, reaching **0.8% y/y 0.5% y/y**, i.e. a level markedly below the NBP inflation target of 2.5%. The decline in inflation was mainly driven by **a lower growth further deceleration in the growth** of energy prices, including prices of fuels. **At the same time**, low level of core inflation, as well as a stronger decline in producer prices, confirm persistently low demand and cost pressure in the economy. This is accompanied by a further decline in inflation expectations of households.

The Council got acquainted with the inflation and GDP projection prepared by the Economic Institute, being one of the inputs to the Council's decisions on the NBP interest rates.

In line with the July projection based on the NECMOD model – prepared under the assumption of unchanged NBP interest rates and taking into account data available until 13 June 2013 (i.e. not encompassing the July decision of the Council) – there is a 50-per cent probability of inflation running in the range of 0.6-1.1% in 2013 (as compared to 1.3-1.9% in the March projection), within 0.4-2.0% in 2014 (as against 0.8-2.4%) and within 0.7-2.4% in 2015 (as against 0.7-2.4%). At the same time, the annual GDP growth – in line with the July projection – will be, with a 50-per cent probability, contained within 0.5-1.7% in 2013 (as compared to 0.6-2.0% in the March projection), within 1.2-3.5% in 2014 (as against 1.4-3.7%) and within 1.6-4.2% in 2015 (as against 1.9-4.4%).

In the opinion of the Council, incoming data point to weaker than expected **confirm continued low** economic growth in Poland and a stronger than forecasted in the March projection **decline in inflation accompanied by lack of wage and inflation pressures.** At the same time, uncertainty about the scale and timing of the expected economic recovery in the euro area persists, which can adversely affect economic activity in Poland. **The July projection, however, indicates that from the second half of 2013 – together with the expected improvement of global economic activity – a gradual acceleration of GDP growth can be expected, which will be conducive to rising inflation in the coming years. However, despite this, a risk of inflation running below the target in the medium term persists. Therefore, Taking this into consideration, the Council decided to lower the NBP interest rates again.**

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. **The Council assesses that the significant reduction of NBP interest rates implemented since November 2012 supports economic recovery and limits the risk of inflation running below the NBP target in the medium term. The decision to lower NBP interest rates made at the current meeting ends the loosening cycle of monetary policy.**

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