Bank Zachodni WBK

Post-MPC comment

Interest rates on hold until year-end

4 September 2013

MPC kept the interest rates unchanged. The decision was a non-event given many earlier comments of Council's members suggesting NBP rates should remain at current levels until the end of the year. What is more, the MPC decided to include this declaration explicitly in the official statement and this means that really exceptional circumstances would be needed to trigger change in Polish monetary policy before the end of December. Our base-case scenario assumes stable interests rates until mid-2014, which is roughly in line with scenario priced-in by the money market.

In line with expectations, the MPC did not change interest rates at its September meeting, keeping the reference rate at all-time low 2.50%. At the same time, the official statement reads that interest rates should remain on hold at least until the end of this year. This means that the communiqué formally repeats a sentence, which was reiterated in comments of many MPC members in recent weeks. According to the NBP governor Marek Belka, it is difficult to imagine that in the upcoming months the economic situation changes so dramatically that the MPC would be forced to change its monetary policy parameters.

Tone of the statement itself remained rather dovish. On one hand the Council acknowledged signals of gradual recovery in developed economies, slight acceleration of economic growth in Poland and signs of easing decline in employment, but on the other it stressed that pace of economic growth in Poland lays considerably below potential, while higher GDP was mainly due to net exports, with deepening decline of domestic demand. NBP governor Marek Belka underlined during the press conference that even though the economic improvement will be continuing, it will be gradual and one should not be overoptimistic about the pace of recovery. He reminded that July's NBP projection assumed acceleration of GDP growth to 2.2% in 4Q2013 and to ca. 3% in mid-2014. At the same time, the MPC sees no important threats for the inflation outlook. The Council noted the factors supporting low inflation globally as well as low demand-side and cost pressures in Poland. The communiqué underlined that rise of CPI and core inflation in July was primarily due to higher waste maintenance fees and changes in food prices. According to Marek Belka, inflation path will be (temporarily) slightly higher than expected in last NBP projection due to July's price developments, but it will fall again in July 2014. This is why, according to Belka, "in base-case scenario inflation does not cause sleepless nights for us".

NBP governor denied to comment on the monetary policy outlook beyond the end of this year. Assuming the inflation behaves just like predicted in recent NBP's inflation projection, interest rates could remain stable for a considerable period of time (NBP's central path for CPI shows inflation at close to 1.5% until 2015). Still, our forecasts show gradual rebound of inflation and thus the MPC may decide to increase interest rates for the first time in around mid-2014.

The MPC approved *Monetary policy guidelines for 2014* that will be published next week. NBP's Belka revealed that no breaking changes in the strategy should be expected but some change of emphasis may be noticed – the need of higher elasticity in implementation of Direct Inflation Targeting policy and stressing the importance of macroprudential policy.

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

~~Available data indicate that global economic activity in the first half of 2013 remained low. However, economic growth continued to differ significantly across economies.~~ **In 2013 Q2 global economic activity growth was somewhat higher than in Q1, yet, persisted at a moderate level.** ~~A markedly better situation in the United States is accompanied by probably on-going recession in the euro area and the lack of visible rebound in some major developing countries, including China.~~ **GDP growth in the United States accelerated and – after a few quarters of decline – GDP in the euro area increased. The incoming data on the economic situation at the beginning of Q3 point to continued gradual recovery in the major developed economies. Major emerging economies in turn saw persistently low – as for those countries – economic activity growth.** ~~Low~~ **Moderate** global economic activity ~~as well as the previously observed fall in commodity prices are~~ **is** conducive to low inflation in many countries.

Signals of a possible tapering of monetary expansion by the Federal Reserve, **observed in the financial markets,** ~~have recently led to a deterioration of sentiment in financial markets. This, in turn, resulted in some~~ **contributed to heightened volatility and the** outflow of capital from emerging markets as well as depreciation of their currencies, ~~including the zloty.~~ **Yet, zloty exchange rate remained relatively stable.**

In Poland, **in 2013 Q2 economic growth, after a period of strong slowdown, slightly accelerated. Yet, GDP growth remained considerably below its potential. GDP growth was supported by substantial contribution of net exports, which was accompanied by further decline in domestic demand. In 2013 Q2 private consumption increased slightly, while decrease in investment was larger than in the previous quarter.** Data on industrial output, construction output and retail sales in ~~April and May~~ **July** ~~indicate that growth in economic activity in Q2 remained weak~~ **point to the possibility of gradual improvement in business conditions at the beginning of 2013 Q3.** ~~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. At the same time, May 2013 saw a halt in the decline of employment in the corporate sector and a slight decrease in the registered unemployment rate (in seasonally adjusted terms).~~ **In 2013 Q2 the number of working persons in the economy was lower than in the corresponding period of last year. Still, month-on-month data from the corporate sector point to a possible halt of job losses in the recent months. The seasonally-adjusted unemployment rate stabilized at a heightened level, which supported low wage growth.**

Growth in lending to the private sector remained limited **in the recent period**. ~~Growth in loans to both households and enterprises continued to be low.~~ **Annual growth in corporate loans declined further. At the same time, growth in household loans continued at a low level, however, growth in consumer loans increased slightly.**

CPI inflation ~~declined again in May 2013~~ **in July increased** and reached ~~0.5~~**1.1**% y/y, ~~i.e. a level~~ **yet remaining** markedly below the NBP inflation target (2.5%). The ~~decline~~ **increase** in inflation was ~~mainly~~ driven by ~~further deceleration in the growth of energy prices, including fuel prices~~ **regulatory factors (i.e. higher waste disposal fees), which also pushed up core inflation, as well as higher growth in the prices of vegetables and fuels.** ~~Low level of core inflation as well as a stronger decline in producer prices, confirm persistently low demand and cost pressures in the economy. This is accompanied by a further decline in inflation expectations of households and enterprises.~~ **Demand and cost pressures in the economy remained low and inflation expectations of households continued to decline.**

In the opinion of the Council, ~~the incoming data confirm continued low economic growth in Poland accompanied by lack of wage and inflation pressures~~ **gradual economic recovery is likely to continue in the coming quarters, however, inflationary pressure will remain subdued.**

~~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. Taking this into consideration, the Council decided to lower the NBP interest rates again.~~

~~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~~.

The Council decided to keep the NBP interest rates unchanged. Given low inflation pressure and a moderate scale of the expected recovery, in the Council's assessment interest rates should be kept unchanged at least until the end of 2013, which will support return of inflation to the target in the medium term.

The Council adopted Monetary Policy Guidelines for 2014.

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