POST-MPC COMMENT

4 December 2013

Nihil novi… Will this be the case until mid-2014?

The Monetary Policy Council's meeting did not surprise – the main interest rates remained unchanged in December, and the Council repeated the suggestion that they will remain on hold in the first half of 2014. NBP Governor, asked about factors that will be important for future decisions, mentioned domestic demand and labour market situation. According to the Council, gradual economic recovery is likely to continue in the coming quarters, however, inflationary pressures will remain subdued. In our view, inflation may be higher than predicted in NBP's inflation projection, and taking into account comments from today's press conference about desired positive real interest rates, we expect the first rate hike by 25bp in the autumn of 2014.

The Monetary Policy Council kept interest rates unchanged. The most important fragment of the official statement did not change: the MPC "maintains its assessment that NBP interest rates should be kept unchanged at least until the end of the first half of 2014". It means that the reference rate will stay at record-low level of 2.5% until mid-2014. There were no factors that could change such approach of the MPC in the last month nor do we expect such factors to appear in the foreseeable future. Before today's press conference we believed the MPC might decide to address one of interesting topics from the previous conference when the NBP Governor Marek Belka said that the Council will work on defining and specifying "symptoms of changes in the economy, which could change their perception". This would be helpful in assessing a probability of future MPC's decisions and could lead to a less diversified view on the market as regards the timing of the first rate hike (making the Polish monetary policy continuously boring). However, at today's press conference Governor Belka disappointed a bit in this regard. Talking about factors observed the most carefully by the Council, he mentioned domestic demand, labour market and research on demand elasticity of different CPI basket components. What is more, he stated that he was not sure if the MPC is ready to present and whether it would present in public a list of metrics (thresholds), which would be important for future changes in rates. Well, we understand very well that a conditional forward guidance would be difficult to implement in Poland, but it is a bit confusing why the Governor mentioned this a month ago.

We still think that the closer we get to the middle of 2014, the bigger will be the question mark when to start monetary policy tightening. Not so long ago, some MPC members have seen no signs of economic recovery, while currently only incurable pessimists do not see an acceleration of GDP growth. Furthermore, there are rising odds that the recovery will be fuelled increasingly by domestic demand amid improvement of labour market conditions. In our opinion, core CPI may get closer to – or even rise above – 2% in the first half of the next year. Consequently, the recent correction of the inflation path presented in November's Inflation report may appear to be insufficient and we may see a next revision in early 2014. Thus, the first interesting MPC meeting may be in February when updated CPI and GDP projections will be released. Next revision will take place in July 2014, which is already after the declared period of stable interest rates.

In the second half of 2014 the Council will have to answer the question whether in a different macroeconomic environment (faster economic growth, higher inflation) the main interest rates should be maintained at such a low level. At the press conference today the MPC's Andrzej Rzońca (who was trying to speak in the name of the entire Council) said that the MPC wants to conduct a conventional monetary policy, which is characterised by positive real interest rates. It is worth to remind that already in the minutes of the November's MPC meeting there was a mention that according to some MPC members inflation growth may by higher than predicted in the NBP projection, if wage pressure is stronger than assumed or in case of negative supply-side shocks in commodity markets. The same MPC members noticed that possible inflation rise may cause a drop in real interest rates. In the same minutes there is also a statement that according to some MPC members possible zloty appreciation amid improving economic climate may slow the growth of inflation, thus probably curbing the inclination to raise interest rates. Still we expect official interest rate to be raised in the second half of 2014. We predict two hikes by 25bp each, with the first one in autumn. The period of stable rates might be prolonged due to the lower path of inflation CPI and the likely increase in number of the Monetary Policy Council's members. Apart from replacing prof. Zyta Gilowska (one of the most hawkish member), another three members might join the MPC in 2014 (if an amendment to the bill of the National Bank of Poland will be approved). The uncertainty as regards the MPC's members constitutes an additional risk factor from the monetary policy perspectives.

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

Growth in global economic activity remains moderate. In 2013 Q3, GDP growth ~~in the euro area was probably similar to a quarter before, while growth~~ **accelerated slightly** in the United States ~~was negligibly slower~~ **while in the euro area it slowed down to a level somewhat above zero.** At the same time, **economic activity growth** in ~~a few~~ **the** major emerging market economies, ~~including China, economic growth stayed~~ **continued to run at a** low **–** as for these economies **– level**. Moderate **growth in** global economic activity **and decline in energy prices** ~~has been~~ **were** conducive to ~~low~~ inflation **decrease** in many countries. ~~Following a temporary deterioration of sentiment due to uncertainty about fiscal policy in the United States, prices of some financial assets, including the zloty, have risen of late.~~ **The monetary policy of major central banks remains highly expansionary. In November, the European Central Bank lowered its main policy rate, whereas other major central banks maintained the current scale of their monetary expansion.**

In Poland, ~~industrial and construction output as well as retail sales in~~ **GDP data for** 2013 Q3 confirm**ed** ~~low, yet accelerating economic growth. At the same time, improving leading indicators point to~~ **the continuation of** gradual **economic** recovery**.** ~~continuing into quarters to come.~~ **After several quarters of declining, domestic demand increased somewhat in 2013 Q3, driven by rising consumption and a slight increase in investment. This was accompanied by lower positive contribution of net exports and still negative contribution of change in inventories to GDP growth. October saw a minor slowdown in the annual growth of industrial output and retail sales. Construction and assembly output continued to fall, albeit at a slower pace. Yet, business climate indicators suggest a further gradual recovery in the coming quarters. The** gradual improvement in economic conditions is ~~coupled with a minor increase in corporate employment, yet it is still lower than a year ago~~ **accompanied by fading negative trends in the labour market. According to the Labour Force Survey, in 2013 Q3 the number of persons working in the economy was slightly higher than a year before. This contributed to a small decline in the** unemployment rate **in annual terms, which however remains** ~~is still~~ elevated, ~~which contributes to slow wage growth~~. **In 2013 Q3 wage growth in the economy increased somewhat.** Growth in lending to the private sector remains limited. In ~~September~~ **October**, annual ~~growth~~ **increase** in ~~loans~~ **lending** to enterprises and households ~~stayed~~ **persisted at** low **level.** ~~while~~ **However** since mid-~~year~~**2014 growth in** consumer ~~credit~~ **loans** ~~growth~~ has been gradually gathering pace.

Demand and cost pressures in the economy remain low. ~~In September,~~ CPI inflation **in October** ~~edged down~~ **fell to 0.8% y/y (from** 1.0% y/y **in September)**, ~~i.e. remaining markedly~~ **continuing well** below the ~~NBP~~ inflation target **of** ~~(~~2.5%~~)~~. ~~At the same time,~~ **This was accompanied by persistently low** core inflation ~~measures stabilized or declined slightly. Annual growth in~~ **and a fall in** producer prices in industry ~~stayed negative~~. ~~Recent developments of inflation indices along with low~~ **At the same time,** inflation expectations ~~confirm that demand and cost pressures in the economy~~ remain**ed** low.

In the opinion of the Council, gradual economic recovery is likely to continue in the coming quarters, however, inflationary pressure**s** will remain subdued. ~~November projection of GDP and inflation confirms this assessment.~~ **Therefore,** the Council decided to keep the NBP interest rates unchanged**. The Council maintains its assessment that NBP interest rates should be kept unchanged at least until the end of the first half of 2014.** In the opinion of the Council, lowering interest rates in the first half of 2013 and keeping them unchanged in the ~~second half of the year~~ **subsequent levels** supports recovery of the domestic economy, gradual return of inflation to the target and stabilisation in the financial markets.

~~Considering the current statistical data as well as the projection of GDP and inflation that confirm low inflationary pressure and the expected moderate economic recovery, the Council assesses that NBP interest rates should be kept unchanged at least until the end of the first half of 2014.~~

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