Bank Zachodni WBK
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POST-MPC COMMENT

5 February 2014

Will it get more interesting only in July?

Today's meeting did not bring much important information regarding monetary policy outlook. Surely, March's meeting will be more important and interesting as the new inflation and GDP projection will be available and it is likely to show higher indicators for 2014-15 (and forecast for 2016, for the first time). However, we do not rule out that March's meeting will not be crucial and the MPC will wait even until July, in order to see the next projection. And after July's meeting the relatively long (as for Poland) *forward guidance* would be abandoned to the benefit of "meeting to meeting" analysis of the situation. We maintain our forecast that the first hike will be implemented in the autumn.

In line with broad consensus, the Monetary Policy Council left the interest rates unchanged, reference rate is still at 2.50%.

Main elements of the MPC statement did not change significantly (details on the next page) and the NBP President, Marek Belka, called this press release as a sound copy of last month's statement. According to him, this is a strong signal for the market that the Council feels comfortable with current macro conditions.

Marek Belka refrained from answering a question on extension of the current *forward guidance*. At the same time, he again stressed the importance of March CPI and GDP projection, which may shed more light on longer horizon (forecasts for 2016 will be presented for the first time). Some slight changes regarding the assessment of economic conditions to more optimistic may be found in the statement. This is particularly visible in case of the labour market. Last month the MPC wrote that the gradual recovery is contributing to an improvement in labour market conditions only to a limited extent and employment growth remains too weak to bring down the still elevated unemployment rate. In February this fragment reads: "the gradual recovery is contributing to an improvement in labour market conditions (…) signs of employment growth have been observed, which should be conducive to a decrease in unemployment." Similar opinion, stressing subdued improvement on the labour market and still negative demand gap was also expressed during today's press conference. Additionally, the MPC noted some acceleration in lending.

As regards current economic situation – economic growth is accelerating and inflation is running low – President Belka stated that a central banker "dreams about such a situation". Belka stressed that the economy has started to recover from a low level (output gap will not be closed soon) and external inflationary conditions are favourable, especially as regards commodities.

In the statement the Council acknowledged the recent development of situation in the emerging markets (capital outflow). During the press conference President Belka stated that there were no events, which could have potentially encouraged the NBP to intervene on the FX market.

It has been known for some time already that March's MPC meeting will be the most interesting in 1Q 2014 due to release of the new GDP and CPI inflation projection. We would like to point out that possibly even after March's meeting we will not know more than currently. The new projection will probably show a higher path of both CPI and GDP (which can influence expectations about future interest rate outlook), but it is not obvious that the MPC will suggest anything about the forward guidance. We can imagine that in April-May period the Council will stick to its current rhetoric, while in May-June period the Council will state that it would like to wait for the new projection in July. In such a scenario, in July (when suggested period of stable rates will end) the MPC will have to say what it is going to do next. We agree with the MPC member Andrzej Bratkowski, who said that extension of the *forward guidance* by one quarter will yield nothing. On the other hand, extension by 6 months will be unreasonable, given inflation and economic growth prospects. In other words, after July's meeting the relatively long (as for Poland) *forward guidance* might be abandoned to the benefit of "meeting to meeting" analysis of situation.

We do not change our forecast that the first hike will be implemented in the autumn.

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

Growth in global economic activity remains moderate, **although the situation varies across countries.** .~~As business conditions~~ in the United States, **economic conditions** have improved ~~markedly~~, **which has prompted** the Federal Reserve ~~has decided~~ to reduce the scale of quantitative easing starting ~~from January 2014~~. At the same time, the euro area ~~is slowly recovering, yet the pace of the recovery is limited and highly diversified across member countries~~. **has been experiencing a slow, yet somewhat limited recovery. Against this background, the European Central Bank continues its highly accommodative monetary policy.** In turn, activity **growth** in the largest emerging economies – despite some improvement – continues to ~~grow relatively slowly as for these countries~~ to **be weak in comparison with their previous performance**. Moderate growth in global economic activity is conducive to maintaining low inflation in many countries.

The reduction of asset purchases by the Federal Reserve has had an adverse effect on the sentiment in the international financial markets, in particular with regard to some emerging market economies.

Data on domestic economic activity ~~in November 2013~~ indicate a continuation of the gradual recovery in Poland. **Preliminary 2013 GDP figures show that economic growth in 2013 Q4 exceeded that seen in 2013 Q3, with net exports still contributing substantially to GDP growth. The gradual economic revival is confirmed also by** ~~In particular,~~ data on industrial output and retail sales, **and leveling off the decline in construction and assembly output** ~~(in seasonally adjusted terms) suggest that activity in industry and retail sectors has remained on an upward trend. At the same time, decline in construction and assembly output has narrowed, which is indicative of some improvement in this sector.~~ **Activity growth in the subsequent quarters is signaled by** business climate indicators ~~also signal further growth in economic activity~~. **The gradual** ~~Ongoing economic~~ recovery ~~translates into~~ **is contributing to** an improvement in labour market conditions ~~only to a limited extent~~. ~~Employment growth remains too weak to bring down the still elevated unemployment rate.~~ **Signs of employment growth have been observed, which should be conducive to a decrease in unemployment.** ~~High unemployment reduces wage and demand pressures in the economy, while wage growth in the corporate sector remains low.~~ **Yet, unemployment persists at elevated levels, which is hampering wage pressure in the economy.**

CPI inflation ~~declined to 0.6% in November 2013 (from 0.8% in October)~~ **amounted to 0.7% in December 2013**, ~~continuing well~~ **thus remaining markedly** below the NBP inflation target of 2.5%. ~~This was accompanied by a decrease in most core inflation indices~~. **Also core inflation measures remained low, which confirms that demand pressure continues to be weak.** ~~At the same time, producer prices in industry continued to fall, which indicates low cost pressure in the economy. Inflation expectations stayed low as well.~~ **In turn, weak cost pressure in the economy is manifested in a further decline in producer prices. This is accompanied by low inflation expectations.**

~~Growth in lending to the private sector remains limited.~~ **In the recent period, lending to the private sector has accelerated slightly while remaining limited.** In ~~November~~ **December** 2013, the annual growth in lending to enterprises and households was still low. At the same time, since mid-2013, there has been a gradual acceleration in consumer loans.

In the opinion of the Council, gradual economic recovery is likely to continue in the coming quarters, however, inflationary pressures will remain subdued. 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 subsequent quarters supports recovery of the domestic economy, gradual return of inflation to the target and stabilisation in the financial markets.