Bank Zachodni WBK
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POST-MPC COMMENT

5 March 2014

Longer period of stable rates

Contrary to our expectations, today the Monetary Policy Council extended its forward guidance until the end of Q3-2014. As it could have been expected, the GDP growth projection was raised – average forecast for 2014 is now at 3.5% (versus 2.5% expected in November), which is in line with our forecast (and considerably above market consensus). A somewhat quicker GDP growth is expected for 2015. What is interesting, the inflation projection assumes that despite economic recovery the CPI growth will stay significantly below the official target in 2014-2015 (similarly as in the previous projection) and will rise towards the target in 2016. The NBP President admitted that the Council was discussing an extension of declared rate stability until the end of the year. However, they decided for shorter horizon due to large uncertainty. After today's meeting we see higher probability of scenario assuming stable NBP interest rates until the end of this year.

In line with expectations, the Monetary Policy Council left interest rates unchanged, with reference rate at 2.50%. Surprisingly, the MPC decided to extend the declared period of stable interest rates (forward guidance) until at least the end of Q3-14 vs. previously declared mid-2014. This decision was taken despite earlier numerous suggestions of the Council's members saying that such step should be considered only in the following meetings and some of them even claimed that extending the forward guidance by just one quarter does not make any sense. Currently, it seems to be clear that interest rates will stay unchanged at least until October. NBP governor Marek Belka said during the press conference that the key paragraph of the statement – that communicates the forward guidance is extended – includes also a new element: "interest rates should be kept unchanged for a longer period of time, i.e. at least until the end of the third quarter of 2014." Belka stressed this is a signal that the market should not expect hikes immediately after the end of Q3. Taking into account the timing of release of next NBP projections (November) it seems that indeed the first rate hike will probably not take place immediately after the third quarter. Even though the MPC president noted that the statement includes no clear mention that the next change in interest rates will be a rate hike, at the same time he suggested that cuts should not be taken under consideration as monetary easing amid robust economic recovery would be a "strange" procyclical behaviour and a mistake (which however was not avoided by the Council in the past). Let us remind that procyclical action is one thing, but preemptive action is something else. Low CPI inflation projection (details below) does actually justify why rates should remain flat for some time, but in our view there is a risk that inflation will edge up higher given observed and expected economic recovery. We hope it does not turn out that monetary policy tightening will come too late if the MPC decides to wait with interest rate hikes until inflation starts going up.

Belka admitted that the MPC was considering whether to extend *forward guidance* until the year-end. However, a shorter period was chosen due to high uncertainty.

Taking into account the MPC's earlier actions (implementing changes after projections – *forward guidance* introduced in July 2013, extension of flat-rate period in November 2013 and again in March 2014), it seems that next interesting MPC meeting may be expected in July. At that time, based on new projection, the MPC will either extend its forward guidance until the year-end or tighten its bias, not ruling out a hike. Obviously, this will depend on the upcoming data, yet after today's meeting we see higher risk of the first scenario (as compared to our forecast the first hike will be implemented in the autumn).

According to president Belka, extension of *forward guidance* was justified by projection results and at the same time there was no reason to keep financial markets in uncertainty. NBP president added also that this decision was accelerated by situation in Ukraine.

As expected, the new GDP projection was revised upwards – mid of forecasted range for 2014 is at 3.5% (vs 2.5% previously estimated), in line with our forecast (which is above market consensus). Slightly higher GDP growth is predicted for 2015. And what is interesting is that CPI projection assumes inflation rate well below NBP's target in 2014-2015 despite solid GDP acceleration and its increase towards target in 2016. Certainly, the release of *Inflation Report* (publication on Monday), which will include details about projections, will be very interesting.

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Inflation and GDP projections in the subsequent *Inflation reports*

	GDP growth				CPI inflation			
	Mar 13	**Jul 13**	**Nov 13**	**Mar 14**	**Mar 13**	**Jul 13**	**Nov 13**	**Mar 14**
2014	1.4-3.7	1.2-3.5	2.0-3.9	2.9-4.2	1.4-3.7	1.2-3.5	2.0-3.9	0.8-1.4
2015	1.9-4.4	1.6-4.2	2.1-4.5	2.7-4.8	1.9-4.4	1.6-4.2	2.1-4.5	1.0-2.6
2016				2.3-4.8				1.6-3.3

According to the NBP projections, the GDP and CPI growth will fall in the ranges given above with probability of 50%.

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

Growth in global economic activity remains moderate, although the economic situation varies across countries. In the United States, economic conditions ~~have improved, which has prompted the Federal Reserve to reduce the scale of quantitative easing~~ **remain favourable despite signs of some weakening observed in the recent period**. At the same time, the euro area 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 be weak as compared with their previous performance. **Some of these economies have seen deterioration in business indicators in the recent period.** 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 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.~~ **In 2013 Q4 economic growth was higher than in 2013 Q3. GDP growth was supported primarily by net exports. At the same time, domestic demand contribution to GDP growth increased. This was related to accelerating consumption and investment growth.**

~~The gradual recovery at the beginning of 2014 is indicated by a further growth in industrial output and retail sales in January 2014. At the same time, growth in construction output was negative. Yet, business climate indicators suggest that recovery will continue in the coming quarters. The gradual economic recovery is contributing to an improvement in labour market conditions. According to the LFS, in 2014 Q4 the number of persons working in the economy was higher than a year before. This helped to reduce somewhat the unemployment rate, which however remained elevated.~~ **The gradual economic revival is also confirmed by data on industrial output and retail sales, and levelling off the decline in construction and assembly output. Activity growth in the subsequent quarters is signalled by business climate indicators. 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.** Unemployment persists at elevated levels, which is hampering wage pressure in the economy.

According to preliminary data, CPI inflation stood at 0.7% in **January 2014**, thus remaining markedly below the NBP inflation target of 2.5%.This was accompanied by a decline in core inflation measures, which confirms that demand pressure continues to be weak. In turn, weak cost pressure in the economy is manifested in a further decline in producer prices. This is accompanied by low inflation expectations.

~~In the recent period,~~ lending to the private sector – while accelerating slightly – remains limited. I**n December 2013, the annual growth in lending to enterprises and households was still low.** In particular, since mid-2013, there has been a gradual acceleration in consumer loans. **The past few months have seen a slight growth in housing and corporate loans from a low level.**

The Council got acquainted with the projection of inflation and GDP prepared by the Economic Institute, being one of the inputs to the Council's decisions on NBP interest rates. In line with the March projection based on the NECMOD model – prepared under the assumption of unchanged NBP interest rates and taking into account data available until 14 February 2014 (projection cut-off date) – there is a 50-percent probability of inflation running in the range of 0.8-1.4% in 2014 (as compared to 1.1-2.2% in the November 2013 projection), 1.0-2.6% in 2015 (as against 1.1-2.6%) and 1.6-3.3% in 2016. At the same time, the annual GDP growth – in line with the March projection – will be, with a 50-percent probability in the range of 2.9-4.2% in 2014 (as compared to 2.0-3.9% in the November 2013 projection), 2.7-4.8% in 2015 (as against 2.1-4.5%) and 2.3-4.8% in 2016.

In the opinion of the Council, gradual economic recovery is likely to continue in the coming quarters, however, inflationary pressures will remain subdued. **Such assessment is confirmed by the March projection of inflation and GDP.** 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 Council's assessment NBP interest rates should be kept unchanged for a longer period of time, i.e. at least until the end of the third quarter 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.

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