Bank Zachodni WBK
Grupa Santander

POST-MPC COMMENT

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Cuts cannot be ruled out, but unlikely

Poland's Monetary Policy Council kept official interest rates unchanged, however it changed the rhetoric of the statement towards more dovish. The Council upheld its declaration of stable rates till the end of the third quarter of 2014, but the NBP's governor did not rule out rate cuts in the medium term. In our opinion, to see monetary policy easing we would need a series of disappointing data on economic activity, lower than predicted inflation rate and significant zloty appreciation in months ahead. Meanwhile, GDP growth is expanding and zloty stays in not very wide range of fluctuation. Therefore we agree with the MPC that the scenario of rate cuts is neither baseline nor possible one.

Poland's Monetary Policy Council, in line with expectations, kept monetary conditions unchanged at its June's meeting – the reference rate has remained at its record low level of 2.50% since July 2013. However, press conference after the meeting was not unexciting, in contrast to what the NBP's governor Marek Belka suggested a month ago.

The tone of the final MPC's statement changed noticeably – in the last paragraph the Council declared keeping official rates unchanged till the end of the third quarter of 2013 (previously it was "for a longer period of time, i.e. at least until the end of the third quarter of 2014") and announced that the full assessment of the monetary policy outlook and possible rates adjustment would be available after release of a new NBP's projection. At the same time, the Council more strongly than previously highlighted that inflation pressure will be very low in upcoming quarters (last month: "will remain subdued"). On the other hand the Council noticed the GDP growth acceleration, and MPC member Jerzy Osiatyński said during the press conference that the breakdown of growth (in particular the strength of investment revival) is a positive surprise for the board members.

The NBP governor Marek Belka said during the post-meeting press conference that changes in the statement suggest adjustment of interest rates cannot be ruled out even in 2014. At the same time, he did not specify which direction of adjustment he meant, but only said that this is dependent on incoming news and NBP projection. Later during the conference Belka admitted that interest rate cuts cannot be ruled out given current circumstances, especially in a longer perspective than end of Q3. On the other hand, Belka stated the Council does not plan any cuts and policy easing is neither a baseline scenario nor a probable one, so the change in the statement should not be viewed as a suggestion of cuts. In his view "there are no reasons for speculations about interest rate cuts right now". Belka, when asked if he would stick to his statement from the last month that interest rate cuts under current circumstances (accelerating economic growth) would be a "mortal sin", responded that pro-cyclical policy should be avoided as a rule, but inflation keeps surprising on the downside and the mortality of this sin seems less severe right now. At the same time, Belka noted that inflation is running way below the target and this is mainly imported inflation, which does not endanger the economic growth. The central bank does not rule out that CPI can temporarily fall below zero (partially due to base effects), but this does not mean a persistent deflation and conditions for interest rate cuts.

Summing up, the signal sent by the MPC this month was not very clear. On one hand, the statement and comments at the press conference seemed more dovish than previously. On the other hand, rate cuts are still neither a base-case scenario, nor a likely one for the Council. It is worth to think for a while what could change this situation. The NBP's new projection, available in July, may show slightly lower CPI in the short run, but probably also continuation of economic recovery, which should favour a return of inflation towards the target in the medium run. We think that in order to change the base-case scenario the MPC would need a set of surprisingly weak data about activity (probably not only from one month), lower than forecast inflation, and clear strengthening of the zloty. One way or another, in our view the scenario of interest rate cut in July is implausible (the MPC maintained declaration that rates should be stable until the end of Q3). In July the Council is likely to decide whether to extend the horizon of the current forward guidance. If it is extended until the end of 4Q14, it would signal that chances for monetary easing are fading away. But perhaps the declaration of stable rates would not be extended, which will be interpreted by the market as a hint of rising probability of a rate cut. After July the MPC next time meets in September. In our opinion, the data available by then will show more clearly to continuation of economic recovery, based on reviving domestic demand, and probable inflation rebound after the summer holidays. Such environment will not, in our view, favour interest rate cuts in Poland.

ECONOMIC ANALYSIS DEPARTMENT:
ul. Marszałkowska 142. 00-061 Warszawa fax +48 22 586 83 40
email: ekonomia@bzwbk.pl Web site: http://www.bzwbk.pl

Maciej Reluga (Chief Economist)	+48 22 534 18 88
Piotr Bielski	+48 22 534 18 87
Agnieszka Decewicz	+48 22 534 18 86
Marcin Luziński	+48 22 534 18 85
Marcin Sulewski	+48 22 534 18 84

TREASURY SERVICES:

Poznań	+48 61 856 5814/30
Warszawa	+48 22 586 8320/38
Wrocław	+48 71 369 9400

Fragments of the MPC statement (indication of changes as compared to May statement)

Growth in global economic activity remains moderate, although the economic situation varies across countries. In the United States, ~~GDP growth slowed down in 2014 Q1, yet recent data have indicated an improvement in business conditions in the subsequent months~~ **following a contraction in GDP in early 2014, indicators of economic activity have improved over recent months**. ~~At the same time, recovery i~~In the euro area ~~continues, albeit at a moderate pace~~ **weak recovery continues and GDP growth in 2014 Q1 was slower than expected**. **Monetary policy of the major central banks remains expansionary. The European Central Bank has indicated a possibility of further monetary policy easing in the near future.** ~~In the largest emerging market economies, a~~Activity growth remains slow relative to previous performance **in the largest emerging market economies**, including China **and Russia**, where it weakened ~~in 2014 Q1~~. Moderate growth in global economic activity is conducive to maintaining low inflation in many countries. **In recent months, inflation fell to near zero in the Central and Eastern Europe**.

~~Data on domestic economic activity confirm a continuation of the gradual recovery i~~In Poland, **GDP growth in 2014 Q1 accelerated to 3.4% y/y, close to the March projection**. **An acceleration in economic growth was driven by faster investment growth and a slight acceleration in consumer demand.** In ~~March~~ April, industrial output **growth stabilised, while construction and assembly output decelerated**. ~~and~~ At the same time, retail sales **growth** ~~continued to rise, yet slower than expected. At the same time, construction and assembly output~~ picked up. Business climate indicators – despite some weakening in March – still point to further activity growth in the coming quarters. ~~Gradual acceleration in economic activity is~~ **This was** accompanied by moderate ~~lending growth, both to firms and households~~ **acceleration in lending growth, both to companies and households**.

The recovery ~~is~~ **has been** ~~gradually~~ translating into improvement of labour market conditions. **According to the Labour Force Survey, in 2014 Q1** ~~E~~employment ~~in the enterprise sector is slowly rising~~ **growth in the Polish economy accelerated**. ~~and~~ **This was conducive to a decline in** unemployment**, yet it remains** ~~is gradually falling. However, the unemployment rate is still~~ elevated. **Heightened unemployment** ~~which~~ restricts wage pressure in the economy.

In ~~March~~ **April**, CPI inflation ~~amounted to 0.7%~~ **fell substantially below the March projection, to 0.3%, i.e.** ~~thus remaining~~ markedly below the NBP inflation target of 2.5%. **All** ~~C~~core inflation **measures** also ~~remained low~~ **declined.**~~, and~~ **This was accompanied by a further fall in** producer prices **and decline in** ~~continued to fall. This was accompanied by low~~ inflation expectations.

In the opinion of the Council, gradual economic recovery is likely to continue in the coming quarters, ~~however,~~ **while** inflationary pressures will remain ~~subdued~~ very low. T~~herefore, t~~he Council decided to keep NBP interest rates unchanged. The Council maintains its assessment that 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. **More comprehensive assessment of monetary policy perspectives and potential adjustment of interest rates will be possible after the Council gets acquainted with incoming information, including the July NBP projection.**

~~In the opinion of the Council, lowering interest rates in the first half of 2013 and keeping them unchanged in subsequent quarters supports the recovery of the domestic economy, a gradual return of inflation to the target and a stabilisation in the financial markets.~~