INSTANT COMMENT

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Belka stays . . . and the bad taste as well

The so-called "tape scandal" has dominated the Polish media this week. The financial market was also concerned, as the NBP Governor was involved in controversial talks that covered, among other things, possible changes to the NBP Act. After official statements from the NBP and the Monetary Policy Council, and following the press conferences of Prime Minister Donald Tusk and Finance Minister Mateusz Szczurek, we sum up the main threads. In this note we also present and interpret the main amendments to the NBP Act proposed by the government.

Background

Over the weekend, the weekly magazine *Wprost* published recordings of talks (held in July 2013) between the Internal Affairs Minister Bartłomiej Sienkiewicz and the NBP Governor Marek Belka. The talks covered, among other issues, the possible support of the NBP in financing the budget deficit in the event of a crisis. For Minister Sienkiewicz, a crisis would not only mean a difficult economic and market situation but could also affect the state's financial stability and politics (given high support for PiS, the main opposition party, prior to the election mixed with budgetary problems). The possible support of the NBP was also discussed in the context of amendments to the NBP Act and a change of finance minister (with Minister Rostowski being replaced by a "technical" minister).

Belka remains in place

During the weekend, the tapes triggered a political storm and numerous comments, followed by a negative market reaction on Monday. In the end, Prime Minister Tusk decided not to dismiss Internal Affairs Minister Bartłomiej Sienkiewicz. Still, the minister himself stated that he had no political future. PM Tusk said it was not his role to assess the central bank's governor.

The NBP issued a special statement saying that the publication covered only a few short fragments of a two-hour long conversation and that this was a manipulation aimed at presenting talks about the financial system's stability as an abuse of power by Governor Belka. Also, the Attorney General stated that these talks did not warrant the launch of an investigation of the interlocutors. The NBP Governor assured there was no "deal" with the government and that he would not step down from his post. On Tuesday morning, the NBP Governor met with President Bronisław Komorowski, probably to hear his assessment of the situation. Comments after this meeting stated only that the president was concerned about the safety of the zloty and stability of the Polish economy.

Conclusion: Governor Belka remains in place.

What does the amendment to the National Bank of Poland Act consist of?

It is worthwhile to look at the proposed changes to the National Bank of Poland (NBP) Act. On Tuesday, June 17, the government adopted an outline for amendments to the law as submitted by the Finance Ministry. Below we present the most important proposals. It is worth keeping an eye on these issues, which refer to the role of the Management Board of the NBP and the Monetary Policy Council (MPC). The main changes proposed in the NBP Act are:

1. Implementing the possibility of acting in the secondary market of Treasury Securities

   Following other central banks' lead, the Polish authorities want to be prepared for a possible worst-case risk scenario on financial markets and to enable the purchase (and sale) of Treasury Securities (TS) by the central bank apart from open market operations. While at present the NBP can take collateral for TS from commercial banks, ensuring liquidity or to buy them with a repurchase commitment, the amendment to the law would allow the central bank to purchase T-bonds on the secondary market. In itself, this does not give rise to great controversy. Specifically, European Union treaty restrictions prohibit the direct and indirect financing of a budget deficit (EBC monitoring). Purchasing T-bonds on the secondary market by the NBP would be acceptable to fulfil the NBP's statutory tasks, particularly in conducting monetary policy and working towards the stability of the domestic financial system.

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2. Monetary policy and stability of the domestic financial system – tools

In this context, the second change in the NBP Act is more surprising. It differentiates between measures for providing stability to the domestic financial system and instruments for monetary policy. On the one hand, it is obvious that the central bank should use appropriate legal instruments to enable it to respond with agility to the current conditions in the financial system and economy. On the other hand, however, there is no need to reallocate responsibilities between the MPC and the Management Board of the NBP as a result of the differentiation between monetary policy measures and measures to stabilise the domestic financial system. In our opinion, collegial decision-making by the MPC regarding the activity of the central bank in the T-bonds secondary market would reduce the risk of the improper use of such instruments. What is more, it would also limit possible political pressure. The most important argument, however, is the interdependence between measures for monetary policy and financial system stabilisation. Because the monetary policy could influence stability (e.g., excessively low interest rates could trigger a credit boom) and debt purchases in the secondary market aimed at stabilizing the financial system could influence monetary policy (impact on interest rates along the curve), it would be reasonable to keep all of these instruments at the MPC's disposal.

3. Annual NBP report and choice of auditor – competence of the NBP Board and MPC

Currently, the MPC accepts the annual financial report of the NBP and this report is investigated by an auditor chosen by the MPC. The proposed change assumes that the NBP Board would take over competence in this matter. This change is explained by two reasons: (1) this issue is not a subject of monetary policy; and (2) should the report be rejected, there are no consequences for transfer of the NBP profit to the public budget (this depends on acceptance of the financial report by the Council of Ministers, not by the MPC). Thus, we may ask: if it does not matter anyway, then why limit the MPC's role?

4. Rotation of MPC members

We have already discussed this issue several times, for example in our December 2013 MACROscope. According to the proposed changes to the NBP Act, after a certain period of time after the bill is accepted, each institution choosing its candidate for the MPC (President, Lower House and Upper House of the parliament) would nominate one additional member and then the Council would consist of 12 members (+ the NBP Governor). In 2016, when the term of the current members ends, three new members would be nominated and the Council would temporarily consist of six members (+ the NBP Governor). After the next two years, three more members would be nominated and then the MPC would reach its target size: nine members + the NBP Governor. The Minister of Finance said on Tuesday that details on the exact dates have yet to be discussed because there is a delay in preparing these changes and that nomination of additional members in 2015 would not lead to a complete rotation every two years. Still, we perceive these amendments as positive and increasing monetary policy stability. At the same time, it is worth noting that nominating three new members in the coming quarters would likely change the balance within the Council, making it more dovish.

Conclusion: Implementing the rotation of MPC members and allowing the option of a potential debt purchase in the secondary market aimed at stabilising the financial system generates no controversies. In our opinion, however, stability tools should be also under the responsibility of the Monetary Policy Council.

Further cooperation on the rate-setting panel may not be easy

Another important issue in the conversation between Interior Minister Bartłomiej Sienkiewicz and NBP Governor Marek Belka is the reference to the Monetary Policy Council. Marek Belka's use of foul language about the interest rate-setting panel and his statement that he would be ready to "play ball" with the Council may make further cooperation more difficult. On Tuesday the MPC held a working meeting, at which the NBP Governor was probably trying to explain the situation and apologise to the MPC members. While two members of the Council (Elżbieta Chojna-Duch and Anna Zielińska-Głębocka) made some reassuring statements before the meeting and positively assessed cooperation with NBP president, Andrzej Kaźmierczak said the Governor's comments were "unfair and disrespectful" to the Council. Apparently, the apologies were accepted, as after the MPC meeting the Council released the statement suggesting that further cooperation is possible (two members were absent at the meeting: Adam Glapiński and Jerzy Hausner). In short, while it is difficult to disagree with Marek Belka that in recent months the MPC managed to reach a broad consensus and cooperation within the authority was satisfactory, the situation may change after recent events. However, the MPC statement suggests that even if that happens, public opinion will not know about it.

Bottom line: Cooperation between the NBP Governor and the MPC members should continue and, while the relations in some cases may be harsh, they will most likely not have a major impact on the substantive responsibilities.

Market implications

The fact that the NBP Governor has not been dismissed should stabilise the market.. If the worries over the future of Marek Belka were the main driver of the recent turmoil in the Polish market, then FI/FX could return to the level seen at the end of the past week. However, it is worth taking into account the global environment, higher tensions in Ukraine and possible market pricing in rising political risk in Poland given the local government elections (scheduled for Autumn 2014) and parliamentary elections (in 2015). It is currently hard to assess the impact of the wiretapping scandal on the ruling party's support. The Attorney General started an investigation against the former Deputy Finance Minister and former Minister of Transport, and the magazine *Wprost* claims there are more tapes with Civic Platform members that could be released.

As far as the monetary policy is concerned, Marek Belka's comments criticising the MPC and its members may make cooperation within the Council more difficult. The current situation should be neutral for official interest rates, but if any pressure is generated, we think these circumstances could limit the MPC's willingness to cut rates in order to avoid being accused of supporting the government.

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