

POST-MPC COMMENT

14 January 2015

NBP governor still in minority

The Monetary Policy Council kept interest rates on hold in January, with the reference rate still at 2.0%. However, changes in the official statement and comments of the NBP governor during the press conference suggest, in our view, that the majority of the Council members could vote for more policy easing should new data confirm deeper and longer deflation and weaker economic growth. This is exactly the scenario that we anticipate. In our base scenario, we assume that the rate cut will take place in March when new central bank projections will be available. However, if the coming data will be clearly below consensus, we do not exclude that the MPC may act already in February.

The Monetary Policy Council kept interest rates unchanged, for the third time in a row. Reference rate is still at 2.0%, deposit rate at 1.0% and lombard rate at 3.0%.

There were quite considerable changes in the official statement. First of all, the last paragraph omitted the sentence stating that October's adjustment in monetary policy and stable economic growth limit the risk of inflation staying below target in the medium term. Second, the last sentence of the current MPC statement did not rule out further adjustment of rates, "if the expected period of deflation extends, which would increase the risk of inflation remaining below the target in the medium term, and incoming data confirm a slowdown in economic activity as well as weak growth in the environment of the Polish economy persists". Thus, the last month's phrase was extended by a new condition: longer period of expected deflation. Even though, based on pure logic, it could be interpreted as less dovish stance (more conditions to be met, thus lower probability of rate adjustment), we view it a signal that monetary easing is actually getting more likely. By adding fragment about longer period of deflation, the MPC wanted, in our view, to point out that this factor will be key in determining changes in monetary policy in upcoming months. Such interpretation seems to be supported by comments of the NBP governor Marek Belka during the press conference. He stated, among others, that for majority of the MPC members the longer period of deflation is very important and could be the decisive factor in further action of the Council. He also added that that in his opinion upcoming macro data might allow some members to support further adjustments in monetary policy in months to come.

Asked about reasons of keeping NBP rates unchanged in January, the NBP governor highlighted, among others, elevated volatility on financial markets in recent weeks, which, in his opinion, make it not a good moment to adjust interest rates. He added that the hawkish majority now opposing further monetary easing has very serious argument in their concern that easing could be a factor undermining financial stability in Poland. Ultra-low interest rates globally triggered unpredictable, significant capital flows and some MPC members are afraid that further rate cuts in Poland could mean entering non-conventional monetary policy zone, which could destabilize behaviour of domestic entrepreneurs. Marek Belka hinted that in his personal opinion there is still room for more rate cuts in Poland, but the Council is divided on this subject.

Changes in the MPC's statement and comments during the press conference seem to confirm our forecasts regarding the pattern the Council could follow in the coming months. In our view, coming data will confirm that deflation will be deeper and longer than the central bank expects (CPI below -1%YoY in 1Q15 and below zero until the end of 3Q15) and that pace of the economic growth decelerated at the turn of the year. This should convince the MPC to cut rates. In our base scenario, we assume that the rate reduction will take place in March when fresh CPI and GDP projections will be available. However, if the coming data will be clearly below consensus, we do not exclude that the MPC will take action already in February.

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

Global economic activity remains moderate, although the situation varies across countries. ~~In the United States, economic growth in 2014 Q3 stayed relatively robust~~ **observed continued recovery in 2014 Q4, and the data on GDP in 2014 Q3 have been revised upwards.** In the euro area, in turn, GDP growth ~~notwithstanding slight acceleration~~ remained weak, and business climate indicators point to low activity growth probably continuing in the following quarters. **In contrast, activity growth in the euro area has continued to be slow, and the 2015 growth forecasts have been revised downwards in the recent months.** This is accompanied by relatively slow GDP growth in the largest emerging economies, with a recent weakening observed in Russia and China. **In the largest emerging economies, economic activity growth has also remained weak as for these countries. Russia's output growth has probably decreased close to zero.**

In the past month, oil prices continued to decline **sharply**. Along with the moderate global economic growth, this has been conducive to inflation persisting at very low levels in many countries, **and contributed to deflation occurring in the euro area.** In Poland's immediate environment ~~including the euro area and the Central and Eastern Europe~~ inflation remains close to zero. Major central banks continue their expansionary monetary policy and keep interest rates at historically low levels. The ECB and the Bank of Japan are running asset purchase programmes. **At the same time, expectations of a gradual interest rate increase in the United States have strengthened which have contributed to a depreciation of the emerging market currencies, including the zloty. Heightened risk aversion in the international financial markets persists.**

~~In Poland, in 2014 Q3 annual GDP growth decreased to 3.3% y/y (from 3.5% in 2014 Q2). Stable growth in consumption was accompanied by some acceleration in investment growth. Alongside that, exports and imports growth slowed down. As a consequence, the contribution of net exports to GDP growth stayed negative.~~ **In Poland, economic activity growth in 2014 Q4 may have slowed down slightly.** According to data for October, industrial production and retail sales growth remained weak, while construction and assembly output decreased. **November, industrial output growth decreased to near-zero levels, while construction and assembly output continued to fall. At the same time, retail sales growth decreased.** Growth in bank lending – both to enterprises and households – continued at a steady pace.

~~LFS data show an acceleration in the number of working persons in the economy in 2014 Q3, which was conducive to further reduction in the unemployment rate.~~ **Labour market data point to a further rise in corporate employment, which supports the decline in seasonally-adjusted unemployment.** At the same time, wage pressure remains limited, as indicated by continued moderate wage growth in the economy.

~~In October~~ **November**, CPI inflation ~~declined to~~ **remained negative and was below expectations at -0.6% y/y.** This was accompanied by a decrease in **the majority of** core inflation indices, which confirms the absence of demand pressure in the economy. The ~~continued~~ decline in producer prices **points has also continued, in turn, to indicating** a lack of cost pressure. This is accompanied by very low inflation expectations of enterprises and households.

~~In the opinion of the Council, the October adjustment of monetary policy and the stable, despite some slowdown, economic growth limit the risk of inflation remaining below the target in the medium term. Therefore, the Council decided to keep the NBP interest rates unchanged. However, the Council highlights that uncertainty regarding economic conditions in the environment of the Polish economy persists. If~~ **the expected period of deflation extends, which would increase the risk of inflation remaining below the target in the medium term, and** incoming data confirm a slowdown in economic activity as well as weak growth in the environment of the Polish economy persists, the Council does not rule out further adjustment of monetary policy.

This analysis is based on information available until 14.01.2015 has been prepared by:

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