Bank Zachodni WBK
Grupa Santander

POST-MPC COMMENT

6 July 2016

Lower growth forecast, but not (yet?) refi rate

At the first meeting chaired by the new NBP governor Adam Glapiński the Monetary Policy Council kept interest rates on hold. The new NBP projection assumes inflation mid-point lower by 0.3pp this year and GDP growth lower by 0.6pp. Inflation is still assumed to rise gradually and the mid-point of the projection for 12M CPI in 2018 is at mere 1.5%. This means that the central bank expects inflation to be below the target (of 2.5%) for more than two years ahead. As regards GDP growth, the NBP head underscored that all the MPC members have more optimistic view on GDP outlook than suggested by the NBP model. Glapiński said that UK referendum creates some uncertainty, which in theory can be negative for foreign direct investments in Poland, but in his view the impact of Brexit on Poland is "nearly zero" and there are no significant threats for economic growth on the horizon. At the same, the official communique states that: "uncertainty about economic conditions abroad, including the effects of the UK referendum, is a risk factor for domestic economic activity". The MPC still believes that 'wait and see' is the best policy option. The NBP governor emphasized the MPC is unanimous in this regard, which was confirmed during the press conference, as the most dovish MPC member Jerzy Żyżyński said that there were no reasons to change policy until there are signs of economic slowdown or acceleration of growth.

The MPC is downplaying risks stemming from the UK's Brexit vote and it repeated in the statement that GDP growth slowdown in 1Q16 was temporary. Meanwhile, we argue that the economic outlook for the next quarters was deteriorating already before the UK referendum (recent monthly data suggested that GDP growth in 2Q16 could be not much better than 1Q16) and the Brexit vote created additional negative impulse. We have just revised our GDP forecasts for Poland by 0.3-0.4 pp in 2016-17. If next economic data confirm that significant acceleration of growth is not very likely, market expectations for rate cuts will be growing. The next MPC meeting in September will be already after 2Q GDP data release but we do not think a change in interest rates is possible just after the summer break. In November, however, the new projection of the NBP will be available and if it confirms a weaker growth scenario (in line with our forecast), the MPC might consider an easing then, given no-inflation environment. This will also depend on the situation on the FX market, especially in the context of a great unknown connected with the CHF-loans.

Inflation and GDP projections

	GDP growth				CPI inflation			
	Jul 15	Nov 15	Mar 16	Jul 16	Jul 15	Nov 15	Mar 16	Jul 16
2015	3.0÷4.3	2.9÷3.9	-	-	-1.1÷-0.4	-0.9÷-0.8	-	-
2016	2.3÷4.5	2.3÷4.3	3.0÷4.5	2.6÷3.8	0.7÷2.5	0.4÷1.8	-0.9÷0.2	-0.9÷-0.3
2017	2.5÷4.7	2.4÷4.6	2.6÷4.8	2.4÷4.5	0.5÷2.6	0.4÷2.5	0.2÷2.3	0.3÷2.2
2018	-	-	2.1÷4.4	2.1÷4.3	-	-	0.4÷2.8	0.3÷2.6

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

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

Global economic growth remains moderate. ~~while~~ **At the same time**, uncertainty remains about ~~its outlook~~. **future economic conditions in the global economy, associated additionally with the implications of the referendum on the United Kingdom's membership in the European Union**. **The result of the referendum has increased risk aversion in the global financial markets, which was reflected in a depreciation of currencies and a decline in asset prices in many countries**. **A modest recovery continues** in the euro area~~, a gradual recovery continues, although~~ **despite the negative impact** of weak economic conditions in ~~emerging countries have a negative impact on the region's economic outlook~~ **in developing countries. The expected slowdown in growth in the United Kingdom is a risk factor for economic conditions in the euro area**. In the United States~~, despite a slowdown in GDP growth in 2016 Q1, moderate~~ economic growth **remains moderate** ~~is expected to continue~~. **However, weaker data from the labour market impedes clear assessment of future economic conditions in the US**. In ~~turn, in~~ China ~~incoming data indicate a further deceleration of~~ the economic growth **has probably decelerated further**, while Russia and Brazil remain in recession.
Despite some increase in recent months, prices of oil and many other commodities in the global markets ~~– despite some increase in recent months – are still~~ **remain** markedly lower than in previous years. **This development –** combined with moderate global economic activity – is the main ~~factors~~ driver behind very low consumer price growth in a ~~many~~ number of economies~~ are low commodity prices~~.
The European Central Bank is keeping its interest rates ~~at a very low level~~ **close to zero**, including the deposit rate below zero, and continues financial asset purchases. **In the United States, data from financial markets suggests a delay of further interest rate increases**. At the same time, **uncertainty about further decisions of** the Federal Reserve ~~– after increasing the interest rates in December is keeping the rates unchanged, while indicating a possible interest rate rise in the future~~ **has increased**.
In Poland, **incoming data shows that economic activity has accelerated after a** GDP ~~growth~~ slowdown in 2016 Q1. ~~This was driven primarily by the fall in investment, which was partly related to the completion of projects co-financed with EU funds under the previous financial framework.~~ **A relatively strong increase in the wage bill and** ~~At the same time, growth of consumer demand remained stable, supported by growing employment, improving~~ **favourable** consumer sentiment ~~and growth in lending to households. Taking into account the continuing~~ as well as sound financial ~~standing~~ **position** of enterprises and their high capacity utilization~~, the fall in investment and thus also the weakening of economic growth at the beginning of 2016 was most likely temporary~~ **have a positive influence on domestic economic conditions**. **This is accompanied by a stable growth of credit to the non-financial sector. An increase in disposal income of households resulting from** ~~The increase in consumer spending resulting from the launch of~~ the "Family 500+" programme will ~~also~~ contribute to GDP growth in the coming quarters. Yet, the uncertainty about economic conditions abroad, **including the effects of the UK referendum, is** ~~continues to be~~ a risk factor for domestic economic activity.
With negative output gap and a moderate growth of average nominal wages, currently there is no inflationary pressure in the economy. Annual consumer price growth and producer price growth remain negative. External factors – particularly the earlier sharp fall in global commodity prices and the low price growth in the environment of the Polish economy – continue to be the main sources of deflation. This is accompanied by very low inflation expectations. The persisting deflation has not adversely affected decisions ~~of~~ **taken by** economic agents so far.
The Council became acquainted with the projections of inflation and GDP prepared by the Economic Institute, which is one of the inputs to the Council's decisions on the NBP interest rates. In line with the July projection based on the NECMOD model – prepared under the assumption of unchanged NBP interest rates and taking into account data available until the projection cut-off date of 24 June 2016 – there is a 50-percent probability that the annual price growth will be in the range of -0.9 ÷ -0.3% in 2016 (compared to -0.9 ÷ 0.2% in the March 2016 projection), 0.3 – 2.2% in 2017 (compared to 0.2 – 2.3%) and 0.3 – 2.6% in 2018 (compared to 0.4 – 2.8%). In turn, the annual GDP growth rate – in line with this projection – will be with a 50-percent probability in the range of 2.6 – 3.8% in 2016 (compared to 3.0 – 4.5% in the March 2016 projection), 2.4 – 4.5% in 2017 (compared to 2.6 – 4.8%) and 2.1 – 4.3% in 2018 (compared to 2.1 – 4.4%).
In the Council's assessment, **the CPI** ~~price~~ growth ~~will stay~~ **remain** negative in the coming quarters due to the earlier substantial decline in the global commodity prices. At the same time, GDP growth is expected to remain stable in the coming quarters, following a temporary deceleration ~~early this~~ **at the beginning of the** year. Consumer demand will continue to be the main driver of economic growth, supported by rising employment, the forecasted acceleration of wage growth and an increase in social benefits. This notwithstanding, the downside risks to the global economic conditions, **aggravated by the uncertainty about the effects of the UK's EU referendum**, and the volatility of commodity prices, remain the sources of uncertainty for the ~~domestic~~ economy and the price developments.
The Council maintains its assessment that – given the available data and forecasts – the current level of interest rates is conducive to keeping the Polish economy on the sustainable growth path and maintaining macroeconomic balance. **The Council adopted Inflation Report – July 2016.**

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