Bank Zachodni WBK

Post-MPC comment

Next rate cut, more to come

5 December 2012

As expected, the MPC cut main interest rates for the second straight time by 25bps, maintaining suggestion that monetary easing cycle will continue in coming months. It is likely that the Council will trim rates again by 25bps in January 2013. We expect further reduction in rates after the release of updated inflation and GDP projections by the central bank in March. Consequently, the reference rate might go down to record-low 3.50% in April next year.

The Monetary Policy Council cut interest rates for the second time in a row by 25bps, bringing the NBP's reference rate down to 4.25% starting from tomorrow. The decision was in line with expectations, but some investors were betting for a deeper rate reduction, thus – just as we expected – a correction occurred on the interest rate market and the zloty strengthened just after the release of the decision.

Statement released after the MPC meeting was very similar to the previous one. The Council noted that recent macro data confirmed a marked slowdown of economic activity, weakening price and cost pressures, as well as admitted that it sees a risk that the inflation may decline below NBP target in the medium term. Last sentence from the November's statement was reiterated, i.e. monetary policy will be eased further, should the upcoming data confirm economic slowdown and risk of increase in inflationary pressure remains limited.

Thus, the MPC confirmed the continuation of the monetary policy easing cycle initiated in November. We still expect next rate cut by 25bps in January and our feeling was confirmed somewhat by the NBP governor saying (with tongue in cheek) that the MPC is working so hard it cannot afford to make a pause in easing next month. When asked why the Council did not decide to cut rates by 50bps, Belka said that the majority of members are in favour of gradual movements, unless something dramatic happens. So far, the MPC perceives current situation as serious, which should not be ignored, but not dramatic yet. NBP governor added that the policy of positive real interest rates (which is currently supported by the majority of the Council members) could be abandoned in the event of "exceptionally severe crisis". However, in his opinion the scenario of recession in Poland is rather unlikely.

All in all, neither the decision itself, nor its justification changed considerably our expectations about monetary policy prospects: in our view the Council will decide for a short pause after cutting rates again by 25bps in January and will wait for the results of next CPI and GDP projections (they will be released in March). However, information about further economic slowdown and decline of inflation will most likely convince the Council to continue monetary easing. Currently we predict that by April 2013 the NBP reference rate may return to 3.5%, the record low level, to which it was trimmed by the previous MPC in reaction to global economic crisis in 2009.

Maciej Reluga Chief Economist 022 586 8363 Email: ekonomia@bzwbk.pl

Piotr Bielski 022 586 8333
Marcin Luziński 022 586 8362
Agnieszka Decewicz 022 586 8341
Marcin Sulewski 022 586 8342

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

Incoming data indicate that global economic activity ~~remained subdued in 2012 Q3~~ **continues to be weak**. ~~In the euro area, economic growth was probably close to zero, and in the United States, despite some rebound, remained moderate.~~ **Although economic growth in the United States accelerated in 2012 Q3, recession in the euro area persisted.** At the same time, ~~following several quarters of economic slowdown, growth~~ **economic activity** in the largest emerging economies ~~probably stabilised at a~~ **was** relatively low ~~level~~. Even though weak economic activity ~~across the world contributes to~~ **supports** a decline in inflation, **the previously observed increase in** ~~still relatively high~~ commodity prices ~~are conducive~~ **has contributed** to inflation remaining elevated in many countries. ~~Following the earlier improvement, the international financial market sentiment has deteriorated slightly. At the same time, some central banks have lowered their policy rates.~~ **In the recent weeks, risk aversion in the global financial markets has stabilised and commodity prices have increased slightly.**
A marked economic slowdown in Poland was confirmed by the data on GDP in Q3. A decline in domestic demand deepened, which was driven by decreasing investment and decelerating consumption growth. At the same time, the contribution of change in inventories to GDP growth remained negative. Net exports continued to be the main factor behind GDP growth, which was related to a further decline in imports amidst still positive exports growth. ~~In Poland, both industrial output and retail sales (in real terms) declined in September, while the fall in construction and assembly output deepened. Economic activity data were worse than expected and reflected further economic slowdown in 2012 Q3~~**. Incoming monthly data, including the persistently slow growth in industrial production and retail sales, as well as a decline in the construction output, indicate that at the beginning of 2012 Q4 activity remained low.** ~~Furthermore, labour market figures, including continued decline in employment, slower wage growth in the enterprise sector and gradually rising unemployment rate, point to a lack of wage pressure and likely further weakening in private demand. This is also confirmed by deteriorating of most business indicators.~~ **Weaker business conditions are accompanied by a deteriorating situation in the labour market. In 2012 Q3, employment growth in the economy, including the corporate sector, slowed down. At the same time, the unemployment rate increased. Slower employment growth and higher unemployment rate contributed to wage growth deceleration.** ~~The economic slowdown is accompanied by a gradual deceleration~~ **Simultaneously, in the recent months in** lending to households **continued to weaken**, including a further decrease in **the volume of** consumer loans. ~~as well as slower growth in corporate lending.~~ **Growth in corporate loans slowed down as well.**
In ~~September~~ **October**, CPI inflation ~~was 3.8%~~ **decreased and amounted to 3.4%**, **while** remaining above the NBP's inflation target of 2.5%. At the same time, **most** ~~both~~ core inflation **measures, as well as** ~~and~~ producer price growth continued to decline, which confirms weakening of demand **and cost** pressure**s in the economy**. Household and corporate inflation expectations also declined in the recent months.
In the opinion of the Council, incoming data confirm a considerable economic slowdown in Poland, which ~~contains~~ **results in limited** wage and inflationary pressure. At the same time, ~~in line with the November projection prepared under the assumption of constant NBP interest rates~~, **the Council assesses that** GDP growth will remain ~~below potential~~ **moderate** in the coming years, **which poses a risk of inflation declining below the NBP's inflation target in the medium term.** ~~According to the projection, inflation will return to the target in the coming quarters, and might fall below the target in the medium term.~~ Therefore, the Council decided to lower the NBP interest rates. The decrease in the interest rates should support economic activity and thus reduces the risk of inflation falling below the target in the medium term.
Should the incoming information confirm a protracted economic slowdown, and should the risk of increase in inflationary pressure remain limited, the Council will further ease monetary policy.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division. Economic Analysis Unit. ul. Marszałkowska 142. 00-061 Warsaw. Poland. phone +48 22 586 83 63. email ekonomia@bzwbk.pl. http://www.bzwbk.pl