Bank Zachodni WBK
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POST-MPC COMMENT

5 November 2014

Which button did they press, pause or stop?

The Monetary Policy Council kept rates on hold today. This was against our forecast of a 25bp cut, which also represented the consensus among market economists. Nevertheless, the bias of forecasts was towards an even more significant monetary easing, and the financial market priced in more than a 25bp reduction. Therefore, we saw bond yields higher after the decision. We still see room for one more cut by 25bp (perhaps in December), which is supported by the NBP's new projections and will be confirmed by the next data releases. We think the correction observed in the bond market today could be halted by the release of a very low inflation figure next week (-0.5%YoY).

Poland's Monetary Policy Council decided to leave interest rates unchanged. This came in contrast to our forecast of a 25bp cut, which also represented the consensus among market economists. However, it should be noted that the bias was towards an even more significant monetary easing, and the financial market priced in more than a 25bp reduction. Therefore, the immediate market reaction to the announcement was a bond sell-off (yields up by almost 10bp across the curve). According to a Reuters opinion poll conducted last week, the probability attached to the scenario of no rate cut was very small (c20%). At first glance, it is difficult to assess whether such a decision means a pause in the easing cycle or the end of easing after just one move by 50bp in October.

Unfortunately, during the press conference there was no clear indication of future moves or even a clear justification of today's decision. The statement says that "the Council does not rule out further adjustment of monetary policy, should the incoming data point to a risk of deterioration in economic growth outlook". At the same time, the new projection of GDP growth (details in the table below) showed a path significantly lower than the previous one with the mid-point of growth in 2015 below 3%. During the press conference, however, the NBP Governor stated that, according to the view presented by the majority of the MPC, growth prospects are better than those outlined in the projection. This would suggest that a materialisation of a growth scenario in line with the projection (or probably even slightly higher – our scenario) might be a convincing argument for some members to cut rates again.

In our opinion, this applies particularly to Professor Elżbieta Chojna-Duch, who probably voted against the rate cut today (while she most likely supported a 50bp move in October). Why do we think she voted against the cut? During the press conference, the NBP Governor was clearly unhappy with today's decision and confirmed that it was "obviously not unanimous". When asked about monetary policy prospects, he deferred to Chojna-Duch to reply to the audience. Today she said that growth in 4Q14 should accelerate compared to 3Q14. We think it will be lower and the next flow of macroeconomic data should confirm this. We also have a dovish call for the next CPI reading (next week) of -0.5% YoY, which might also be a convincing argument for an additional cut.

After today's decision it is hard to have a convincing call for the December meeting. Especially since the MPC was not consistent on a number of points. For example, the NBP Governor said that "it is not a risk that inflation will be below the target, this is certain". This is consistent with the new inflation projection (mid-point of CPI in 2016 at c1.5% against the target of 2.5%!). However, at the same time, the statement reads "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". So, it would appear that the majority of the MPC does not believe in the projection's results. However, during the press conference Belka stated that there was a consensus within the MPC that inflation will be below the target in the medium term. So, why didn't they cut interest rates today?

Before today's decision, our forecast for the additional scale of monetary adjustment (after 50bp in October) was an additional 25bp. We still think the reference rate will reach 1.75%, although it is hard to say whether the data to be released in November will be enough to convince (those unconvinced today) already in December. In any event, the market will probably price in additional monetary easing in the coming months (if not December, 1Q15). Therefore, the correction observed today (and possibly the next few days) may prove temporary, especially if our forecast for a low CPI reading materialises. Still, it should be recalled that the day after the CPI publication there will be a flash GDP for Q3, which may be just as important (the MPC suggested today that GDP is even more important). Nevertheless, if the market starts to price in very aggressive easing –exceeding additional 50bp– as has been the case in the last few weeks, we would still find this excessive.

When asked about communication with the market (given the surprising decision), the NBP Governor replied that it was not about the art of communication, which was at the highest level, but about the decision, which was taken. This is probably the best summary of today's MPC meeting – decision not in line with the previous communication.

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Inflation and GDP projections in the subsequent *Inflation reports*

	GDP growth				CPI inflation			
	Nov 13	Mar 14	Jul 14	Nov 14	Nov 13	Mar 14	Jul 14	Nov 14
2014	2.0-3.9	2.9-4.2	3.2-4.1	2.9-3.5	1.1-2.2	0.8-1.4	-0.1-0.4	0.0-0.2
2015	2.1-4.5	2.7-4.8	2.6-4.5	2.0-3.7	1.1-2.6	1.0-2.6	0.5-2.1	0.4-1.7
2016		2.3-4.8	2.3-4.5	1.9-4.2		1.6-3.3	1.3-3.1	0.6-2.3

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

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

Growth in global economic activity remains moderate, although economic situation varies across countries. ~~Economic recovery in the United States continues and economic outlook remains positive~~ **In the United States, economic growth in 2013 Q3 remained relatively robust**. In the euro area, economic activity is still low and the ~~business climate indicators have recently deteriorated~~ **projections for economic growth in the euro area have been revised downwards. At the same time, the economic growth in the euro area next year is expected to be higher than this year.** ~~In the largest emerging market economies GDP growth is also relatively low and in some of them, including Russia, has been decelerating~~. **This is accompanied by a slowdown in GDP growth in China and growth in economic activity in Russia coming to a halt.**

~~Prices of many agricultural and energy commodities have decreased in recent months~~. **Commodity prices, including for crude oil, have been recently falling.** Along with moderate global economic growth, this contributes to low inflation in many countries. 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. However, as economic situation varies across major economies, monetary policies in these economies are also diverging. While the Federal Reserve has ~~been tapering~~ **concluded** its asset purchase program, the European Central Bank has ~~increased monetary expansion~~ **started purchasing assets and the Bank of Japan increased asset purchase programme significantly.**

In Poland, data on economic activity point to deceleration in economic growth in 2014 Q3. ~~This is indicated by a slowing growth in industrial production, construction and assembly as well as retail sales in recent months. Lower economic activity growth is also indicated by a decrease in business climate indices.~~ **Growth in industrial production, construction and retail sales was lower in 2014 Q3 than in the previous quarter. This was accompanied by a deceleration of exports growth driven by economic slowdown in Poland's major trading partners.**

Despite lower economic activity growth, employment in the corporate sector continues to rise, which is conducive to a gradual decline in unemployment. Yet, the unemployment rate remains elevated, which continues to contain wage pressure. As a result, ~~wage growth in the enterprise sector remains moderate~~ **wages increase in a pace close to real GDP growth**. ~~At the same time, expansion in lending to the corporate sector and households has stabilized.~~ **At the same time, expansion in lending to households has been stable, while the growth in lending to the corporate sector has been increasing gradually.**

In ~~August~~ **September**, the CPI inflation ~~declined again and~~ remained negative at -0.3% y/y. The decline in prices, in annual terms, was mostly due to falling ~~food prices against high supply of agricultural products, lower prices of commodities in the global markets and the Russian embargo on food imports~~ **fuel prices, which resulted from a fall in oil prices in the global markets**. Core inflation remained close to zero, which confirms the absence of demand pressure in the economy. The continued decline in producer prices points, in turn, to a lack of cost pressure. This is accompanied by very low inflation expectations of enterprises and households.

The Council got acquainted with the inflation and GDP projection prepared by the Economic Institute. In line with the November projection based on the NECMOD model – prepared under the assumption of unchanged NBP interest rates and taking into account data available until 20 October 2014 – there is a 50-per cent probability of inflation running in the range of 0.0-0.2% in 2014 (as compared to -0.1-0.4% in the July 2014 projection), 0.4-1.7% in 2015 (as against 0.5-2.1%) and 0.6-2.3% in 2016 (as against 1.3-3.1%). At the same time, the annual GDP growth – in line with the November projection – will be, with a 50-per cent probability, 2.9-3.5% in 2014 (as compared to 3.2-4.1% in the July 2014 projection), 2.0-3.7% in 2015 (as against 2.6-4.5%) and 1.9-4.2% in 2016 (as against 2.3-4.5%). The economic growth and inflation risk distribution points to a greater probability of these variables remaining below the central projection throughout the whole projection horizon than above the central projection.

In the opinion of the Council, ~~the incoming data point to a deceleration in economic growth and an increased risk of inflation running below the target in the medium term~~ **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 ~~lower~~ **keep** NBP interest rates **unchanged**, ~~except for the deposit rate, which remained unchanged, narrowing the spread between lombard and deposit rate.~~ **However, the Council highlights that uncertainty regarding the economic conditions in the environment of the Polish economy persists. Therefore, the Council does not rule out further adjustment of monetary policy, should the incoming data point to a risk of deterioration in economic growth outlook.** ~~The Council does not rule out further adjustment of monetary policy, should the incoming data, including the November NBP projection, confirm a considerable risk of inflation remaining below the target in the medium term.~~

This analysis is based on information available until 05.11.2014 has been prepared by:

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