Bank Zachodni WBK
Grupa Santander

POST-MPC COMMENT

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Door to rate cut open a bit wider?

The Monetary Policy Council kept main interest rates on hold for the second straight month, as expected. The central bank president said that latest data “slightly” improved Polish economic outlook. But at the same time the official communique was tweaked a little bit, in a way that, in our view, opens the door to a rate cut a bit wider than last month. In the previous statement the MPC suggested it may cut rates only if next data confirm rising risk of deterioration of economic outlook. This time, the final sentence of the communique says that further adjustment of monetary policy cannot be excluded should the incoming data confirm slowdown of economic activity in Poland and low economic growth abroad. Those two conditions are quite likely to be fulfilled in the nearest months, as we predict GDP growth to slow down to slightly below 3%, and it may also take some time before a rebound of economic growth in the euro zone takes place. Meanwhile, inflation will keep running below zero in the nearest months (in our view even until mid-2015). We still think that slight reduction of main interest rates in Poland is possible in 1Q15, possibly even in January if industrial production data comes well below consensus, as we predict.

The Monetary Policy Council did not surprise this time and left interest rates unchanged. The main refinancing rate is still at 2.0%, lombard rate at 3.0% and deposit rate at 1.0%.

Interesting change took place in the final, key paragraph of the statement. Last month the MPC suggested that more rate cuts could follow if next data increase the risk of the deterioration of the economic outlook. We already know that last data releases not only did not deteriorate, but in fact improved the outlook for the economic growth. The NBP governor Marek Belka admitted this during the press conference, but he said that the improvement was only “marginal”. This month, however, the final sentence says that more monetary policy easing cannot be excluded should the coming data confirm weakening in the economic growth and the economic activity abroad remains subdued. So the condition for a rate cut in Poland is no longer the deterioration of outlook, but only a confirmation that domestic economic growth decelerates and growth abroad remains weak. And that is exactly what we are expecting, as we forecast a slowdown of GDP growth in Poland to 2.8-2.9%YoY at the turn of 2014 and 2015 and still low economic activity in the euro zone in the upcoming two quarters. Marek Belka said during the press conference that in Council’s opinion “GDP growth in Q4 will be close to Q3, maybe slightly lower” and that this is an optimistic scenario, but deterioration of external environment can cause a slowdown of domestic growth. At the same time, according to our forecasts, inflation rate will remain below zero in the upcoming months and deflation period will last longer than expected currently by the central bank (even until mid-2015, in our view, while Marek Belka did not rule out it may last until February-March).

What is interesting, the NBP governor admitted during the press conference, that in the previous month there was a problem with a “communication disruption” and therefore the Council decided to recapitulate its stance this month, pointing out in the communique that further monetary policy easing is still possible in specific situation. They did it also in order “not to surprise themselves”.

Overall, we think that the change in the MPC communique is signalling that the door to a rate cut is open a bit wider. In our opinion, slight interest rate cut in Poland is still likely in 1Q15 as upcoming macro data should indicate lower pace of economic growth at the end of this year. The decision on rate cut is available even in January, particularly if growth of the industrial output will be negative, in line with our forecast.

Neither the MPC decision nor the press conference triggered a significant market reaction (domestic bonds weakened today, but prior to information on meeting’s outcome). Further data releases (especially CPI, output) may cause that the market will again start pricing-in rate cuts, yet in limited scale.

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

~~Growth in~~ global economic activity remains moderate, although the ~~economic~~ situation varies across countries. In the United States, economic growth in 2014 Q3 stayed relatively robust. In the euro area, ~~economic activity is still low and the projections for economic growth in the euro area have been revised downwards~~. **in turn, GDP growth – notwithstanding slight acceleration – remained weak, and business climate indicators point to low activity growth probably continuing in the following quarters.** ~~At the same time, the economic growth in the euro area next year is expected to be higher than this year.~~ This is accompanied by ~~a slowdown in GDP growth in China and growth in economic activity in Russia coming to a halt~~. **relatively slow GDP growth in the largest emerging economies, with a recent weakening observed in Russia and China.**

~~Commodity prices, including for crude oil, have been recently falling.~~ **In the past month, oil prices continued to decline**. Along with moderate global economic growth, this contributes to **very** low inflation in many countries. In Poland's immediate environment – including the euro area and Central and Eastern Europe – inflation remains close to zero.

Major central banks continue their expansionary monetary policy, **with interest rates at historically low level, while the ECB and the Bank of Japan run asset purchase programmes.** ~~However, as the economic situation varies across major economies, monetary policies in these economies are also diverging. While the Federal Reserve has concluded its asset purchases, the European Central Bank has 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. 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.~~ **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. According to data for October, industrial production and retail sales growth remained weak, while construction and assembly output decreased. This was accompanied by a stable growth in bank lending to both enterprises and households.**

~~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, wages increase in a pace close to real GDP growth. 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.~~ **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. At the same time, wage pressure remains limited, as indicated by continued moderate wage growth in the economy.**

In ~~September~~ **October**, CPI inflation ~~remained negative at~~ **declined to -0.6% y/y**. The decline in prices, in annual terms, was mostly due to falling 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. **This was accompanied by a decrease in core inflation indices, 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 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 NBP interest rates unchanged. 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.~~ **If the incoming data confirm a slowdown in economic activity, and 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 03.12.2014 has been prepared by:

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