

# POST-MPC COMMENT

8 July 2015

## Greek turmoil without impact on NBP projection

The Monetary Policy Council did not surprise and kept interest rates on hold, with reference rate at 1.50%. In line with our expectations, paths of both inflation and GDP went up. As regards GDP, change was applied mostly to 2015 (with average growth at 3.7%). As regards inflation, path declined for 2015 (deeper deflation) but went up for the following two years. Realization of such scenario would mean decline of real interest rate to zero and higher chances for interest rate hike in the second half of 2016. This is consistent with our scenario. Still, there is a high uncertainty regarding the line-up of the new MPC, which will decide on monetary policy in 2016. This uncertainty will disappear in a couple of months' time.

Poland's Monetary Policy Council kept NBP rates unchanged, in line with expectations. The reference rate still remains at 1.50%. The MPC's communiqué did not change significantly as compared to previous one, although it is worth noting that now the Council expects GDP growth to stabilise in upcoming quarters, while in June it anticipated its "gradual acceleration". On the other hand, Marek Belka said at the press conference that the central bank expects business climate to consolidate and economic growth to contribute to closing up the output gap. Lack of acceleration of GDP growth is due to the fact that net exports contribution to GDP growth would not be as significant as it was in the first quarter of 2015.

New inflation projection shows, as we expected, higher path of inflation and GDP in the coming years. In case of GDP growth the most considerable change concerns 2015 (current NBP forecast roughly consistent with ours). In case of inflation, the central bank expects slightly deeper deflation this year but in the following years inflation is rising quite clearly. The central point of projection for 2016 is now 1.6%, i.e. 0.7pp higher than previously. Nevertheless, the projection's central point remains below the inflation target until the end of projection horizon (2017), and in 2015 expected inflation is even lower than predicted in March (which was stressed by the NBP governor at the press conference).

Marek Belka said during the press conference that the projection does not take into account the recent developments in Greece and their impact on the situation. However, on Monday, during the detailed presentation of the new projection, an alternative (negative) scenario will be presented. Still, the NBP governor said that even with more severe assumptions, GDP and CPI paths do not differ much from the base scenario.

Realization of inflation projection in 2016 would mean a decline of real interest rate to zero, increasing chances for interest rate hike in 2016. Governor Belka said that lower real rates would be supportive for the economy. However, in our view this is not so certain if the economy would need monetary policy stimulus, given solid GDP growth and good labour market situation, supportive for consumption. We still assume that slight adjustment of the monetary policy can take place at the end of 2016. Interest rate market is currently pricing-in the first hike at the turn of 2016 and 2017 and according to governor Belka "this is more or less valid". Still, there is a high uncertainty about the composition of the new MPC (change of 8 out of 9 members at the start of 2016 and possible change of NBP governor in mid-2016), which will decide on monetary policy in 2016. This uncertainty will disappear in a couple of months' time. Until then, not much will happen in the Polish monetary policy and market participants will be more focused on external factors affecting the PLN and bond yields. Let's hope these factors will not be dynamic enough to make the NBP intervene. Governor Belka reiterated today that "they know what to do" in case of turmoil.

### Inflation and GDP projections

	GDP growth				CPI inflation			
	Jul 14	Nov 14	Mar 15	Jul 15	Jul 14	Nov 14	Mar 15	Jul 15
<b>2014</b>	3.2÷4.1	2.9÷3.5	-	-	-0.1÷0.4	0.0÷0.2	-	-
<b>2015</b>	2.6÷4.5	2.0÷3.7	2.7÷4.2	3.0÷4.3	0.5÷2.1	0.4÷1.7	-1.0÷0.0	-1.1÷-0.4
<b>2016</b>	2.3÷4.5	1.9÷4.2	2.2÷4.4	2.3÷4.5	1.3÷3.1	0.6÷2.3	-0.1÷1.8	0.7÷2.5
<b>2017</b>	-	-	2.4÷4.6	2.5÷4.7	-	-	0.1÷2.2	0.5÷2.2

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)**

Growth of global economic activity remains moderate, although a slight acceleration is expected in 2015. In the euro area a gradual recovery is underway **economic conditions improve gradually**, although activity is still low. In the United States, despite the weakening of economic data in the first months of 2015, the recovery is expected to continue in the coming quarters, **recent data suggest that the slowdown at the beginning of the year was temporary and the economic outlook is favourable**. At the same time, in most major emerging economies activity is weakening, and the economic outlook for Poland's eastern trading partners, i.e. Russia and Ukraine, remains unfavourable. In turn, economic growth in China remains low as for this country, **while recession continues in Poland's eastern trading partners, i.e. Russia and Ukraine**.

**Despite the ongoing recovery in developed economies, the sentiment in the financial markets has recently deteriorated in the wake of growing fears of a Greek insolvency. This was conducive to a fall in prices of some financial assets as well as a weakening of exchange rates of Central and Eastern European currencies, including the zloty.**

Following a sharp and long-lasting fall, oil prices have risen slightly in recent months. This has weakened disinflationary forces in many countries, fuelling increase in price growth in the euro area. However, price growth in the global economy remains very low, and in many European economies it is negative. In these conditions, major central banks are keeping interest rates close to zero and the ECB is continuing its asset purchase programme.

In Poland, ~~real GDP growth accelerated in 2015 Q1 (to 3.6% from 3.3% in 2014 Q4)~~ **GDP growth in 2015 Q2 most likely continued at a previous quarter level**. Increase in domestic demand, including consumption and investment, fuelled by an improving labour market situation, good financial condition of enterprises and ~~stable expansion~~ **rise** in lending has **probably** remained the main driver of economic growth. ~~Economic recovery has been also spurred by accelerating exports, supported by improvement in economic activity in the euro area. April saw, however, a decline in industrial output growth and retail sales growth, although this was most likely temporary.~~ **At the same time, recent data do not indicate acceleration of economic growth in the coming quarters.**

Due to the moderate growth in demand and the continuing negative output gap, there is no ~~demand~~ **inflationary** pressure in the economy. Moreover, low commodity prices and moderate nominal wage growth are contributing to the continued lack of cost pressure. As a result, the annual growth of consumer prices remains negative, although the ~~slight~~ **increase** in **annual growth** fuel and food prices in the recent period has limited the scale of deflation. **The annual growth of producer prices growth** is also ~~markedly~~ **markedly** negative, and inflation expectations remain very low.

**The Council became acquainted with the projection of inflation and GDP prepared by the Economic Institute, which is one of the inputs to the Council's decisions on 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 22 June 2015 (projection cut-off date) – there is a 50-percent probability that the annual price growth will be in the range of -1.1÷-0.4% in 2015 (as compared to -1.0÷0.0% in the March 2015 projection), 0.7÷2.5% in 2016 (as compared to -0.1÷1.8%) and 0.5÷2.6% in 2017 (as compared to 0.1÷2.2%). At the same time, the annual GDP growth rate – in line with this projection – will be with a 50-percent probability in the range of 3.0÷4.3% in 2015 (as compared to 2.7÷4.2% in the March 2015 projection), 2.3÷4.5% in 2016 (as compared to 2.2÷4.4%) and 2.5÷4.7% in 2017 (as compared to 2.4÷4.6%).**

In the opinion of the Council, the annual price growth will remain negative in the coming months, mainly due to the earlier sharp fall in commodity prices. At the same time, the expected ~~gradual acceleration of~~ **stable** economic growth, amidst recovery in the euro area and good situation in the domestic labour market, reduce the risk of inflation remaining below the target in the medium term. **Such an assessment is supported by NBP's July projection.** Therefore, the Council decided to keep NBP interest rates unchanged.