

POST-MPC COMMENT

11 March 2016

New MPC continues old policy

The Monetary Policy Council left rates unchanged (reference rate at 1.5%), despite the fact that new projection showed a significantly lower inflation path as compared with the previous one. Mid-point of 12M CPI for 2016 was lowered by over 1pp, while for 2017 by 0.2pp. Inflation is not expected to reach the lower-end of band around the inflation target (of 2.5% +/-1pp) until the end of 2017. For 2018 mid-point of projection is at a mere 1.6%. The MPC maintained the view that “the current level of interest rates is conducive to keeping the Polish economy on the sustainable growth path and maintaining macroeconomic balance”. At the same time, the NBP Governor Marek Belka confirmed the continuation of direct inflation targeting strategy in Poland. In our opinion, two factors, which might drive a policy change (rate cut) in future are: 1. a significant slowdown of the economy (Belka: “in case of a global crisis we might need an ammunition”); 2. consequences of ECB’s decision on the Polish market (stronger zloty, as this would revise further down inflation prospects). As we continue to expect a solid GDP growth (in line with projection) and we see rather limited room for further zloty appreciation, we therefore do not expect the MPC to change their stance in the following months. We think also that the market should price-out monetary policy easing in 2016. The next projection will be available in July, when the new NBP Governor will take the position. However, given the fact that the projection was not important this time and most of new members are reluctant to change policy stance, we do not think these factors should be game changers in July.

Inflation and GDP projections

| | GDP growth | | | | CPI inflation | | | |
|-------------|------------|---------|---------|---------|---------------|-----------|-----------|----------|
| | Mar 15 | Jul 15 | Nov 15 | Mar 16 | Mar 15 | Jul 15 | Nov 15 | Mar 16 |
| 2015 | 2.7÷4.2 | 3.0÷4.3 | 2.9÷3.9 | - | -1.0÷0.0 | -1.1÷-0.4 | -0.9÷-0.8 | - |
| 2016 | 2.2÷4.4 | 2.3÷4.5 | 2.3÷4.3 | 3,0÷4,5 | -0.1÷1.8 | 0.7÷2.5 | 0.4÷1.8 | -0,9÷0,2 |
| 2017 | 2.4÷4.6 | 2.5÷4.7 | 2.4÷4.6 | 2,6÷4,8 | 0.1÷2.2 | 0.5÷2.6 | 0.4÷2.5 | 0,2÷2,3 |
| 2018 | - | - | - | 2,1÷4,4 | - | - | - | 0,4÷2,8 |

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 February statement)

~~In the euro area~~ **Global economic recovery continues, yet activity growth remains moderate and the uncertainty about its outlook has recently increased. Economic recovery is under way in the euro area, yet driven mainly by consumer demand amid weak investment and export growth.** In the United States ~~—despite slightly weaker recent data—~~ **good economic conditions prevail and GDP growth in 2016 is expected to be close to last year's level slowed down in the second half of 2015, following several years of recovery, and there is a risk of further economic weakening.** In turn, **economic growth continues to decelerate** in China, while Russia and Brazil remain in ~~a deep~~ recession. Concerns ~~have increased~~ that **economic growth activity** in the emerging market economies might weaken further **and the threat that this might translate into lower activity in the advanced economies currently pose the greatest**, ~~—which is a key downside risk to~~ for global economic conditions. ~~In consequence, prices of many financial assets have declined in the global markets. This was accompanied by a weakening of emerging market currencies, including the zloty.~~

Uncertainty about the global economy has affected financial market sentiment abroad, leading to a decline in the prices of many financial assets in recent months. Prices of oil and other ~~energy~~ **commodities, including agricultural commodities, also remain low.** In ~~effect consequence,~~ **inflation consumer price growth** in many economies, including the euro area, ~~—stays is~~ close to zero, **and inflation forecasts for the coming years are being revised down.** At the same time, ~~in some advanced economies —including the United States—~~ **core inflation is markedly higher than headline consumer price growth.**

~~The European Central Bank lowered interest rates in March and increased the scale of quantitative easing. Against this background, the monetary policies~~ **In the United States, and the euro area are diverging, despite an increase in interest rate in December and indications of a further increase in the coming quarters, uncertainty about the future direction of monetary policy has risen.** ~~The ECB continues its financial asset purchases and indicates that the scale of monetary expansion might be increased in the coming months. At the same time, the Federal Reserve's interest rates are still expected to increase.~~

~~In Poland, preliminary estimate of national accounts for 2015 suggests that GDP growth likely increased in~~ **stable economic growth continues and data for 2015 Q4 has even confirmed a slight acceleration in GDP growth.** Domestic demand continues to be the key driver of GDP growth, supported by stable consumption growth and rising investment. ~~Growth~~ **The rise in demand** is supported by favourable labour market conditions, positive consumer sentiment, sound financial standing of enterprises and high capacity utilisation, **as well as lending growth.**

As the output gap remains negative and **nominal wage growth** is only moderate, ~~currently there are~~ **is no inflationary pressures** in the economy. Annual **consumer price growth** in both consumer and producer prices **growth** remain negative. Yet, the persistence of deflation results mainly from the strong fall in global energy commodity prices in recent quarters. Inflation expectations are still very low. ~~However,~~ **The persisting deflation has not yet adversely affected decisions of economic agents.**

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 March projection based on the NECMOD model – prepared under the assumption of unchanged NBP interest rates and taking into account data available until 23 February 2016 (projection cut-off date) – there is a 50-percent probability that the annual price growth will be in the range of -0.9 – 0.2% in 2016 (against 0.4 – 1.8% in the November 2015 projection), 0.2 – 2.3% in 2017 (compared to 0.4 – 2.5%) and 0.4 – 2.8% in 2018. At the same time, the annual GDP growth – in line with this projection – will be with a 50-percent probability in the range of 3.0 – 4.5% in 2016 (against 2.3 – 4.3% in the November 2015 projection), 2.6 – 4.8% in 2017 (compared to 2.4 – 4.6%) and 2.1 – 4.4% in 2018.

In the Council's assessment, ~~CPI-inflation~~ **price growth** will remain negative in the coming ~~months~~ **quarters** due to the ~~depressed prices~~ **earlier strong fall in** of global ~~energy-commodities~~ **commodity prices.** At the same time, a gradual increase in core inflation is expected ~~and~~. It will be supported by stable economic growth, **including an anticipated rise in consumer demand growth driven by rising employment, forecasted acceleration of wage growth and an increase in social benefits. This notwithstanding, the downside risks to the global amid improving economic activity in the euro area and favourable labour market conditions are a source of uncertainty for the domestic economy.**

The Council ~~decided to keep the NBP interest rates unchanged, assessing~~ **continues to assess** 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 **ensure maintaining** macroeconomic balance.

The Council adopted Inflation Report – March 2016.

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