Polish central bank cuts rates close to zero as the zloty appreciates

The Polish policy response to battle the economic fallout from Covid-19 has been large but even then the central bank slashed rates close to zero in spite of the potential negative side effects. The recent PLN appreciation has forced the central bank to follow the Hungarian approach despite many committee members calls for flat rates

Today, the Polish central bank slashed the reference rate by 40 basis points to 0.10%, the lombard rate by 50bp to 0.5%, the rediscount rate by 0.44bp to 0.11% and the discount rate by 0.48bp to 0.12%. The deposit rate was unchanged at zero. This is in contrast to consensus expectations and many MPC members' calls for flat rates.

So far, the government and the central bank have delivered strong easing as the base rate has been reduced by 140bp while the required reserve rate by 300bp.

The central bank has also launched a large asset purchase program, which we believe amounts to 8-10% of GDP and is already 40-46% implemented.

The Polish quantitative easing program allowed the government to launch a very large anti-crisis program - direct support without loans and guarantees amounts to 6.5% of GDP, making it the largest program in the EU. But if you take into account loans and guarantees, Germany has a much larger program - about 30% of GDP against a total of about 11% of GDP in Poland.

So why were rates slashed to zero?

The mood of the press release is rather grim.

The central bank flags the severe slowdown of GDP in 2Q20, and warns that return to the pre-crisis level of economic activity will take a long time. Also, it believes there may be a risk of CPI undershooting the inflation target, which partly explains the bold action.

We also think the recent strengthening of PLN was an important factor behind the cut. It seems the central bank has adopted the Hungarian approach.

The Hungarian central bank reduced rates to this level and increased its balance sheet by running various non-standard easing programs. On the one hand, they aimed to revive credit for small-medium-enterprises and provide local financing for the budget deficit. On the other hand, they aimed at maintaining a weak forint to support the Hungarian economy, which was losing competitiveness significantly. We think the argument to prevent further PLN appreciation is quite important here.

Our view

We think this rate cut has entered the area of increasing side effects of low rates, mainly threatening the stability of the financial sector. Also, the experiences of other countries show that near-zero rates likely result in credit availability deteriorating rather than improving. So we don't expect the central bank to test negative interest rates.

The press release highlights that the central bank will maintain asset purchases, which in our view should reach 8-10% of GDP, and 40-46% have already been delivered.

In the coming days, the zloty may ease somewhat, as €/PLN recorded a major decline recently, so profit-taking is possible after such a big move. However, the global risk-on mood should largely offset domestic events.

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