Macroeconomic environment

Polish economy returned on the path of solid economic growth after the slowdown on the turn of 2012 and 2013. Gross domestic product was, in real terms, by 3.3% higher than in 2003 when it grew by 1.7%. The dynamics of domestic demand looks even better, in real terms it equalled 4.6% versus only 0.2% in 2013 and was the highest since 2008. Domestic demand was supported by both solid private consumption growth (by 3.0% vs 1.1% last year) and investment (9.4% vs 0.9% a year ago). The improvement of labour market conditions accompanied by low inflation or even falling prices supports real disposable income of households. It is however worth noting that there are no signs of the deflationary spiral, i.e. postponing of the consumption as a response to decreasing prices. Investment was growing in 2014 at the pace similar to 2011, however at that time booming public infrastructure investment financed by the EU funds was observed. Nowadays one can rather observe increasing private investment aimed to rebuilt capacity and modernize existing equipment. Negative contribution from net exports, equal to -1.3 pp, resulted from diminishing trade surplus, while growth of both exports and imports was sustained. The consequences of limited access to eastern markets for Polish exporters were smaller than feared at the beginning of the year thanks to high flexibility of the Polish companies that are actively seeking new markets. The Bank assesses that the economic growth in 2014 was balanced and the GDP data show no sign of macroeconomic imbalances.

Registered unemployment rate was equal to 11.5% in December 2014 and was by 1.9 pp lower than in the corresponding month of 2013. At the same time it was the lowest reading for December since 2008. The decline of unemployment observed since the second quarter was much stronger than seasonal pattern and represented improved standing of the companies. Mean employment in the enterprise sector in December 2014 was by 1.1% higher than in December 2013. During the year 2014 stable increase of nominal wages was observed. In December average wage in the enterprise sector increased by 3.7% in nominal terms which translates into real growth of 4.7%.

In the second half of the year Polish economy recorded deflation. In July Consumer Price Index fell below zero in year-on-year terms and the decrease has been deepening in the months that followed. to reach -1.0% in December. The persistence of negative inflation resulted from supply-side shocks on food and fuel markets. Demand pressure in the economy is very low as core inflation excluding food and energy was equal to just 0.5% yoy. Average annual inflation equalled to 0.0% in 2014 as compared with 0.9% in 2013. Cost and demand pressures in the economy remain extremely low and inflation is still much below the NBP target (2.50% +/-1%)

Leading indicators suggest further improvement of business sentiment. The Bank expects that in 2015 domestic demand will remain strong and the economic growth will be equal to 3.5%. The Bank expects that high dynamics of private consumption, supported by improved labour market conditions including unemployment falling to 10.7% in December, 2015 will be maintained. The Bank forecasts that the investment is likely to growth further but at a slightly slower pace than last year. Investment will still be supported by high capacity utilization and growing new orders in manufacturing as well as good financial standing and liquidity of the companies. Despite growth acceleration we do not expect fast return of the inflation.

In the environment of the lack of inflation pressures MPC kept loose monetary policy stance. In the first three quarters of the year reference rate was equal to 2.50%. In October the Council assessed that incoming information show slowing economic activity and increasing risk of inflation running below the target in medium term and decided to loose monetary policy. Reference rate was cut by 50 bps to record low of 2.00%, however lombard credit rate was cut by as much as 100 bps to 3.00%. It means that the maximum interest on consumption loans (stated by law as a quadruple of lombard rate) decreased from 16% to 12%. MPC does not rule out further policy adjustments if incoming information confirms significant risk of inflation running below the target in the medium term. The Bank does not currently see much space for rate cuts and expects one more cut by 25 bps. The rationale for that forecast is ongoing economic recovery and the fact, that negative inflation stems from supply-side shocks on fuel and food markets rather than from weak demand in the economy.

In coming quarters the activity of banking sector, including Bank Millennium, will be influenced by the following external factors:

- On 15th January 2015, the Swiss National Bank (SNB) announced that it was discontinuing maintaining the minimum exchange rate of CHF 1.20 per euro. At the same time, SNB announced that it was lowering the interest rate on sight deposit account balances to −0.75%. As a reaction, the EUR and the PLN depreciated versus the CHF.
  The Bank does not expect significant worsening of the loans repayment as the influence of the Swiss franc appreciation against the Polish zloty will be partly offset by the decrease of CHF LIBOR3M

rate. At the same time Polish banks have pledged to take measures against hypothetical problems with fx-loans repayment including non-increase of obligations (collateral, new insurances) and decrease of servicing of the debt by a customer (prolongation of the loan maturity, “holidays” in instalment repayment, temporary reduction of fx spread).
However, taking into consideration the structure of the CHF denominated mortgage loan portfolio, temporary higher instalments may increase the level of impaired loans and cost of risk. Additionally, proposals put forward by different polish authorities may trigger, if enforced losses for the Bank.

- Introduction from 2015 significant increases of obligatory fees for Banking Guarantee Fund will cause increase of costs in 2015.
- The need of compliance to the new Supervision’s recommendation “U”, which will implement new rules and some restrictions to sale of insurances by banks (to be in force since 1 April 2015), may cause decrease of bancassurance commission revenue. Also change of this commission amount recognized up-front and accrued over time may cause decrease of current revenue (compensated by increases in the next years).
- Record low interest rates and expected further cuts limit the size of interest margin and may temporarily restrain interest result of the Bank.
- Growth acceleration resulting mainly from private consumption recovery and investment may support growth of households and corporate loans.
- The improvement of business sentiment, including good financial standing of the companies and further unemployment decrease will support the quality of loans portfolio.

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