

INFOCUS

MACRO COMMENT

JANUARY 2022



Monetary policy in Poland: An overview

DISCIPLINED BY NATURE. FLEXIBLE BY DESIGN.

The icons alongside represent our investment process. Through a disciplined provision of investment policy and security selection at the global level, regional portfolio management teams have the flexibility to construct portfolios to meet the specific requirements of our clients.

HIGHLIGHTED IN THIS PUBLICATION:

 GLOBAL STRATEGIC
ASSET ALLOCATION

 GLOBAL SECURITY
SELECTION

 REGIONAL
ASSET ALLOCATION

 REGIONAL PORTFOLIO
CONSTRUCTION

MONETARY POLICY IN POLAND: AN OVERVIEW

The National Bank of Poland responded quickly to the Covid pandemic with interest rate cuts and ample liquidity provision to the banking sector. With inflation picking up rapidly and strong economic growth, it is now in tightening mode. In this issue of *Infocus*, EFG chief economist Stefan Gerlach looks at Polish monetary policy.

The National Bank of Poland (*Narodowy Bank Polski*, NBP) is one of the few central banks that has already started tightening monetary policy and is doing so rapidly. Since October, the NBP has raised interest rates four times by a cumulative 2.15% to 2.25%. Further increases in the near term appear likely.

These developments raise the issue of how monetary policy is conducted in Poland and how it may evolve in the coming months. In this context, it is useful to look at the NBP's policy framework and review recent policy developments during the Covid pandemic and the start of the NBP's tightening cycle.

The monetary policy set-up in Poland

The main objective of the NBP is to maintain price stability and, since 1999, inflation targeting has been used. From 2004, when Poland joined the European Union, the target has been for 2.5% annual inflation with a tolerance band of +/- 1 percentage point.

Policy is set by the Monetary Policy Council and the principal policy instrument, as in many countries with inflation targeting, is a short-term interest rate: the minimum yield on seven-day NBP money market bills.

A corridor system is used to control money market interest rates more closely. The ceiling is given by the Lombard rate and the floor is given by the NBP deposit rate. Thus, if money market rates rise sharply, banks can borrow from the NBP using government securities as collateral. And if money market rates fall too low, they can deposit funds overnight with the NBP. The NBP uses required reserve ratios to smooth the impact of fluctuations in banking sector liquidity on interbank interest rates.

While Poland is a member of the European Union and has undertaken to join the eurozone at some future date, the zloty exchange rate has been freely floating without restrictions since 2000, although the NBP may decide to intervene if necessary to achieve the inflation target.

However, when Poland decides to join the euro, it will have to maintain a stable zloty against the euro for at least two years according to the rules of ERM II. The NBP's monetary policy will change fundamentally at that stage from targeting

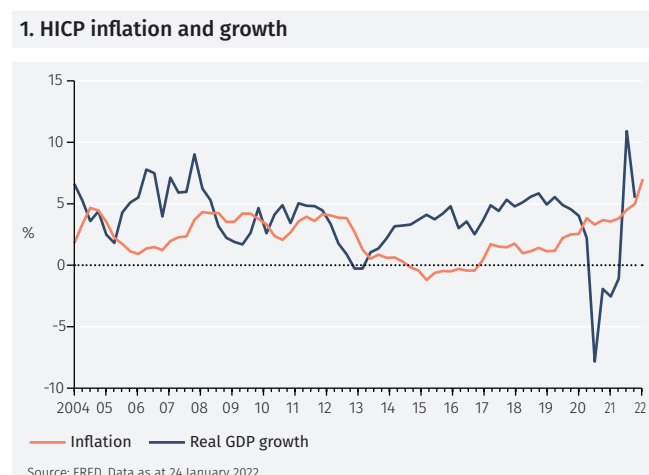
inflation to keeping the exchange rate broadly stable against the euro.

Macroeconomic performance before Covid

Poland's macroeconomic performance in the 2004-2019 period was good, with real GDP growth averaging 4.1% and inflation averaging 2.1%. Of course, the high growth rate has much to do with Poland's economic transition from socialism to a market economy that started following the appointment of Prime Minister Mazowiecki in 1989. With low wages, greater integration in the international trading system and accession to the EU in 2004, growth has been strong, not least due to sizeable fiscal transfers received from the EU.

Looking more closely at the economic conditions since 2004, it is notable that Poland was not severely affected by the Global Financial Crisis in 2008-9. However, real growth fell during the eurozone debt crisis in 2011 and real GDP growth over 4 quarters contracted from Q4 2012 - Q1 2013. Inflation fell sharply over this period and Poland experienced a two-year period of deflation starting in late 2014.

Throughout this period, interest rates in Poland fell gradually. The steady decline of interest rates in the eurozone surely played a role. But Poland had also experienced exceptionally high inflation in the 1990s, and inflation expectations appear to have declined only gradually as the NBP's credibility grew (see Figure 1). Over time, policy rates fell from 5.25% in early 2004 to 0.10% during Covid (see Figure 2).



MONETARY POLICY IN POLAND: AN OVERVIEW

2. Interest rates and bond yields

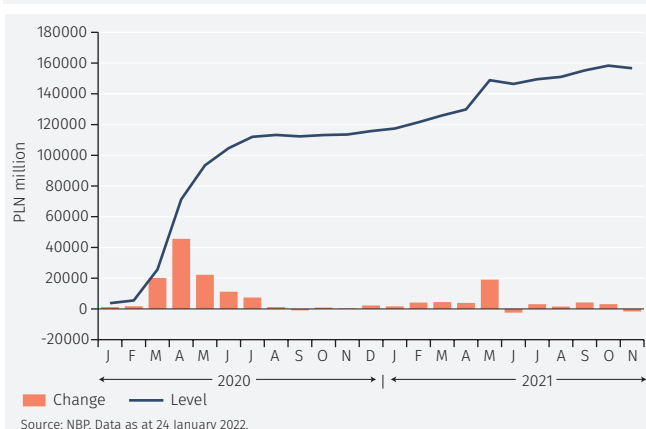


NBP policy during the Covid pandemic

The NBP responded quickly at the start of the Covid pandemic. In three meetings in March, April and May 2020, the Monetary Policy Council cut the policy rate by 140 bps to 10 bps and instituted an asset purchase programme (APP) and a programme allowing banks to fund new loans to enterprises.

The APP was introduced during the severe market tensions in Spring, when Poland experienced rising bond yields and large and unexpected outflows from foreign investors.¹ Purchases were substantial and initially covered Treasury securities but subsequently focused on government-guaranteed bonds issued by the Polish Development Fund and the development bank BGK. As evidenced by the evolution of the NBP's balance sheet, purchases peaked in the second quarter of 2020 and subsequently slowed significantly (see Figure 3). Overall, the presence of the NBP in the bond market had a calming effect with long bond yields declining despite the surge in crisis-related government borrowing. Purchases picked up temporarily in May 2021.

3. NBP assets



In the 14 policy meetings following the interest rate cuts in 2020, the NBP kept interest rate unchanged at 0.10% and kept the various liquidity providing programs on the books even though they had ceased to be of critical importance. (Appendix 1 summarises the NBP's policy meetings that led to interest rate changes from 2020-22.)

A turn to tighter monetary policy

In response to economic activity recovering, labour markets strengthening and with inflation at 5.8% year-on-year, in October 2021 the NBP decided to raise interest rates by 40 bps to 0.50%. Further increases in inflation and stronger economic activity led to additional interest rate increases in November, December and January 2022, when rates reached 2.25%. After the last monetary policy meeting, the NBP signalled that further rate increases will likely be necessary to meet the inflation target.

This raises the question of what the neutral level of the real interest rate is in Poland, that is, when inflation is at the 2.5% target and the business cycle is "in neutral".

One way to estimate this quantity is to look at the average real interest over some period. For instance, between 2005 and 2019, it averaged 1.3%. However, the average inflation rate was 1.9% in that period, that is, below the inflation target. This suggests that interest rates were too high for inflation to rise to the target, implying that the neutral real interest rate is somewhere below 1.3%.

Appendix 2 discusses another method to assess the neutral real interest rate which suggests an estimate of 1.1%. If so, in the longer run as inflation returns and stabilises at the 2.5% target, the policy rate can be expected settle around 3.6%, that is, at least 125 bps above the current level. That suggests that the NBP will engage in several more interest rate increases.

With inflation around 8% in December, the question arises whether rates will rise gradually towards the estimated steady-state level or if they will rise temporarily above that level. That depends on why inflation has risen so sharply.

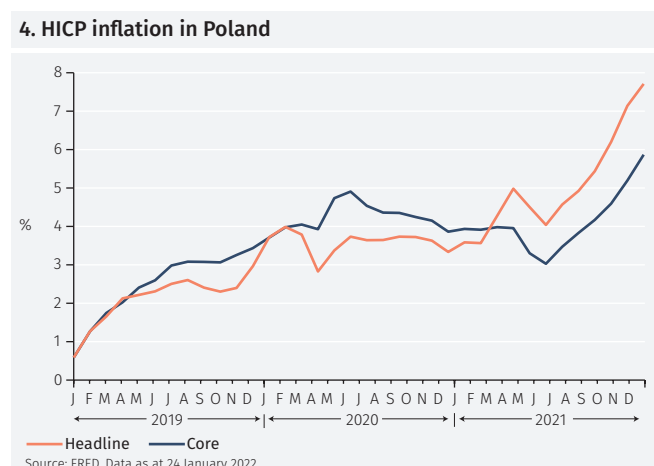
One view is that inflation has risen solely because of higher energy prices and temporary cost increases related to bottlenecks. Under this view, inflation will return to its steady state level on its own, with no need for the NBP to tighten monetary policy. Thus, interest rates can be expected to gradually approach the 3.6% level.

¹ See the IMF's 2020 article 4 consultation with Poland for a discussion: <https://tinyurl.com/53y7xbuz>

MONETARY POLICY IN POLAND: AN OVERVIEW

Another view is that inflation has risen also because of domestic wage and price pressures. In this case, the inflation rate will not return to its steady state level unless these pressures are reversed. This calls for a temporary period of restrictive monetary policy. Thus, in this case interest rates are likely to be raised over the steady state level of 3.6% for some period before being reduced to that level.

Figure 4 below shows headline and core (ex-energy) HICP inflation for Poland. Both measures were weak in early 2019 but have since risen gradually and in December 2021 were far above the 2.5% target. This indicates that the high inflation rate in Poland does not only reflect sharp increases in energy prices but also the economic recovery. This argument suggests that the NBP will increase interest rates above its steady level of 3.6% for a period of time to bring inflation down to target.



Conclusions

Monetary policy in Poland has been conducted successfully with a standard inflation targeting framework for almost twenty years ago. This has led to an average inflation rate since 2005 of 2.2%, which is close to the 2.5% target and well within the permissible fluctuation band 1.5 – 3.5%.

However, in early 2020 inflation rose just above the 3.5% upper limit of the fluctuation band, and in March 2021 it started to rise continuously, reaching 7.7% in December 2021. In response, the NBP started to raise interest rate from 0.1% in October to 2.25% in early January 2022.

It is difficult to know for sure at what level interest rates will stabilise. One estimate of the neutral real interest rate is 1.1%, suggesting that with a 2.5% inflation target interest rates will reach a long run level of around 3.6%. This suggests that recent interest rate increases will continue. Given that both headline and core inflation are far above the 2.5% target it seems likely that interest rates will first be pushed up above that long run level and that they will be reduced subsequently as inflation falls back toward the target.

MONETARY POLICY IN POLAND: AN OVERVIEW

APPENDIX

A1. Meetings of the Monetary Policy Council leading to policy changes

17 March 2020	The NBP reference rate was cut by 0.5 percentage points to 1.00%. The required reserve ratio was decreased from 3.5% to 0.5% and the remuneration rate on required reserves was increased from 0.5% to the level of the reference rate. The MPC decided to provide liquidity to the banking sector using repo transactions, to purchase government bonds on the secondary market dependent on market conditions, and to offer bill discount credit to refinance new bank lending to enterprises.
8 April 2020	The Council decided to cut the reference rate by 0.50 percentage points to 0.50%, and to continue the previously announced bond purchase programmes and refinancing operations of bank lending to enterprises.
28 May 2020	The Council decided to cut the reference rate by 0.40 percentage points to 0.10%, and to continue the previously announced bond purchase programmes and refinancing operations of bank lending to enterprises.
6 October 2021	The Council decided to increase the NBP reference rate by 0.4 percentage points to 0.50% and to increase the required reserve ratio from 0.5% to 2.0%.
3 November 2021	The Council decided to increase the NBP reference rate by 0.75 percentage points to 1.25%.
8 December 2021	The Council decided to increase the NBP reference rate by 0.5 percentage points to 1.75%.
4 January 2022	The Council decided to increase the NBP reference rate by 0.5 percentage points to 2.25%.

A2. Estimating the neutral real interest rate

The neutral real interest rate is what one would expect to observe when inflation (INF) is equal to the 2.5% target and when the change in inflation over twelve months (Δ INF) is zero. One way to estimate it is to regress the policy rate, RATE, minus inflation, on a constant, the deviation of inflation from 2.5% and the change in inflation over a year:

$$\text{RATE} - \text{INF} = \alpha + \beta \times (\text{INF} - 2.5\%) + \delta \times \Delta \text{INF} + \text{error}$$

The neutral real interest rate is the expected level of real interest rates when $\text{INF} - 2.5\% = \Delta \text{INF} = 0$, that is, α . Estimating the above equation on monthly data for the period 2005-2019 yields an estimate of α of 1.1% ($t = 14.3$).

Important Information

The value of investments and the income derived from them can fall as well as rise, and past performance is no indicator of future performance. Investment products may be subject to investment risks involving, but not limited to, possible loss of all or part of the principal invested.

This document does not constitute and shall not be construed as a prospectus, advertisement, public offering or placement of, nor a recommendation to buy, sell, hold or solicit, any investment, security, other financial instrument or other product or service. It is not intended to be a final representation of the terms and conditions of any investment, security, other financial instrument or other product or service. This document is for general information only and is not intended as investment advice or any other specific recommendation as to any particular course of action or inaction. The information in this document does not take into account the specific investment objectives, financial situation or particular needs of the recipient. You should seek your own professional advice suitable to your particular circumstances prior to making any investment or if you are in doubt as to the information in this document.

Although information in this document has been obtained from sources believed to be reliable, no member of the EFG group represents or warrants its accuracy, and such information may be incomplete or condensed. Any opinions in this document are subject to change without notice. This document may contain personal opinions which do not necessarily reflect the position of any member of the EFG group. To the fullest extent permissible by law, no member of the EFG group shall be responsible for the consequences of any errors or omissions herein, or reliance upon any opinion or statement contained herein, and each member of the EFG group expressly disclaims any liability, including (without limitation) liability for incidental or consequential damages, arising from the same or resulting from any action or inaction on the part of the recipient in reliance on this document. The availability of this document in any jurisdiction or country may be contrary to local law or regulation and persons who come into possession of this document should inform themselves of and observe any restrictions. This document may not be reproduced, disclosed or distributed (in whole or in part) to any other person without prior written permission from an authorised member of the EFG group.

This document has been produced by EFG Asset Management (UK) Limited for use by the EFG group and the worldwide subsidiaries and affiliates within the EFG group. EFG Asset Management (UK) Limited is authorised and regulated by the UK Financial Conduct Authority, registered no. 7389746. Registered address: EFG Asset Management (UK) Limited, Leconfield House, Curzon Street, London W1J 5JB, United Kingdom, telephone +44 (0)20 7491 9111.

If you have received this document from any affiliate or branch referred to below, please note the following:

Information for investors in Australia:

This document has been prepared and issued by EFG Asset Management (UK) Limited, a private limited company with registered number 7389746 and with its registered office address at Leconfield House, Curzon Street, London W1J 5JB (telephone number +44 (0)20 7491 9111). EFG Asset Management (UK) Limited is regulated and authorized by the Financial Conduct Authority No. 536771. EFG Asset Management (UK) Limited is exempt from the requirement to hold an Australian financial services licence in respect of the financial services it provides to wholesale clients in Australia and is authorised and regulated by the Financial Conduct Authority of the United Kingdom (FCA Registration No. 536771) under the laws of the United Kingdom which differ from Australian laws. This document is confidential and intended solely for the use of the person to whom it is given or sent and may not be reproduced, in whole or in part, to any other person.

ASIC Class Order CO 03/1099

EFG Asset Management (UK) Limited notifies you that it is relying on the Australian Securities & Investments Commission (ASIC) Class Order CO 03/1099 (Class Order) exemption (as extended in operation by ASIC Corporations (Repeal and Transitional Instrument 2016/396) for UK Financial Conduct Authority (FCA) regulated firms which exempts it from the requirement to hold an Australian financial services licence (AFSL) under the Corporations Act 2001 (Cth) (Corporations Act) in respect of the financial services we provide to you.

UK Regulatory Requirements

The financial services that we provide to you are regulated by the FCA under the laws and regulatory requirements of the United Kingdom which are different to Australia. Consequently any offer or other documentation that you receive from us in the course of us providing financial services to you will be prepared in accordance with those laws and regulatory requirements. The UK regulatory requirements refer to legislation, rules enacted pursuant to the legislation and any other relevant policies or documents issued by the FCA.

Your Status as a Wholesale Client

In order that we may provide financial services to you, and for us to comply with the Class Order, you must be a 'wholesale client' within the meaning given by section 761G of the Corporations Act. Accordingly, by accepting any documentation from us prior to the commencement of or in the course of us providing financial services to you, you:

- warrant to us that you are a 'wholesale client';
- agree to provide such information or evidence that we may request from time to time to confirm your status as a wholesale client;
- agree that we may cease providing financial services to you if you are no longer a wholesale client or do not provide us with information or evidence satisfactory to us to confirm your status as a wholesale client; and
- agree to notify us in writing within 5 business days if you cease to be a 'wholesale client' for the purposes of the financial services that we provide to you.

Bahamas: EFG Bank & Trust (Bahamas) Ltd. is licensed by the Securities Commission of The Bahamas pursuant to the Securities Industry Act, 2011 and Securities Industry Regulations, 2012 and is authorised to conduct securities business in and from The Bahamas including dealing in securities, arranging deals in securities, managing securities and advising on securities. EFG Bank & Trust (Bahamas) Ltd. is also licensed by the Central Bank of The Bahamas pursuant to the Banks and Trust Companies Regulation Act, 2000 as a Bank and Trust company.

Bahrain: EFG AG Bahrain Branch is regulated by the Central Bank of Bahrain with registered office at Bahrain Financial Harbour, West Tower – 14th Floor, Kingdom of Bahrain.

Bermuda: EFG Wealth Management (Bermuda) Ltd. is an exempted company incorporated in Bermuda with limited liability. Registered address: Thistle House, 2nd Floor, 4 Burnaby Street, Hamilton HM 11, Bermuda.

Cayman Islands: EFG Bank is licensed by the Cayman Islands Monetary Authority for the conduct of banking business pursuant to the Banks and Trust Companies Law of the Cayman Islands. EFG Wealth Management (Cayman) Ltd. is licensed by the Cayman Islands Monetary Authority for the conduct of trust business pursuant to the Banks and Trust Companies Law of the Cayman Islands, and for the conduct of securities investment business pursuant to the Securities Investment Business Law of the Cayman Islands.

Chile: EFG Corredores de Bolsa SpA is licensed by the Comisión para el Mercado Financiero ("Ex SVS") as a stock broker authorised to conduct securities brokerage transactions in Chile and ancillary regulated activities including discretionary securities portfolio management, arranging deals in securities and investment advice. Registration No: 215. Registered address: Avenida Isidora Goyenechea 2800 Of. 2901, Las Condes, Santiago.

Cyprus: EFG Cyprus Limited is an investment firm established in Cyprus with company No. HE408062, having its registered address at Kennedy 23, Globe House, 6th Floor, 1075, Nicosia, Cyprus. EFG Cyprus Limited is authorised and regulated by the Cyprus Securities and Exchange Commission (CySEC)

Dubai: EFG (Middle East) Limited is regulated by the Dubai Financial Services Authority with a registered address of Gate Precinct Building 05, Level 07, PO Box 507245, Dubai, UAE.

Guernsey: EFG Private Bank (Channel Islands) Limited is licensed by the Guernsey Financial Services Commission.

Hong Kong: EFG Bank AG is authorised as a licensed bank by the Hong Kong Monetary Authority pursuant to the Banking Ordinance (Cap. 155, Laws of Hong Kong) and is authorised to carry out Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management) regulated activity in Hong Kong.

Jersey: EFG Wealth Solutions (Jersey) Limited is regulated by the Jersey Financial Services Commission in the conduct of investment business under the Financial Services (Jersey) Law 1998.

Liechtenstein: EFG Bank von Ernst AG is regulated by the Financial Market Authority Liechtenstein, Landstrasse 109, P.O. Box 279, 9490 Vaduz, Liechtenstein.

Luxembourg: EFG Bank (Luxembourg) S.A. is listed on the official list of banks established in Luxembourg in accordance with the Luxembourg law of 5 April 1993 on the financial sector (as amended) (the "Law of 1993"), held by the Luxembourg supervisory authority (Commission de Surveillance du Secteur Financier), as a public limited company under Luxembourg law (société anonyme) authorised to carry on its activities pursuant to Article 2 of the Law of 1993. Luxembourg residents should exclusively contact EFG Bank (Luxembourg) S.A., 56 Grand Rue, Luxembourg 2013 Luxembourg, telephone +352 264541, for any information regarding the services of EFG Bank (Luxembourg) S.A.

Monaco: EFG Bank (Monaco) SAM is a Monegasque Public Limited Company with a company registration no. 90 S 02647 (Registre du Commerce et de l'Industrie de la Principauté de Monaco). EFG Bank (Monaco) SAM is a bank with financial activities authorised and regulated by the French Prudential Supervision and Resolution Authority and by the Monegasque Commission for the Control of Financial Activities. Registered address: EFG Bank (Monaco) SAM, Villa les Aigles, 15, avenue d'Ostende – BP 37 – 98001 Monaco (Principauté de Monaco), telephone: +377 93 15 11 11. The recipient of this document is perfectly fluent in English and waives the possibility to obtain a French version of this publication.

People's Republic of China ("PRC"): EFG Bank AG Shanghai Representative Office is approved by China Banking Regulatory Commission and registered with the Shanghai Administration for Industry and Commerce in accordance with the Regulations of the People's Republic of China for the Administration of Foreign-invested Banks and the related implementing rules. Registration No: 310000500424509. Registered address: Room 65T10, 65 F, Shanghai World Financial Center, No. 100, Century Avenue, Pudong New Area, Shanghai. The business scope of EFG Bank AG Shanghai Representative Office is limited to non-profit making activities only including liaison, market research and consultancy.

Portugal: The Portugal branch of EFG Bank (Luxembourg) S.A. is registered with the Portuguese Securities Market Commission under registration number 393 and with the Bank of Portugal under registration number 280. Taxpayer and commercial registration number: 980649439. Registered address: Av. da Liberdade, No 131, 6o Dto – 1250-140 Lisbon, Portugal.

Singapore: The Singapore branch of EFG Bank AG (UEN No. T03FC6371J) is licensed by the Monetary Authority of Singapore as a wholesale bank to conduct banking business and is an Exempt Financial Adviser as defined in the Financial Advisers Act and Exempt Capital Markets Services Licensee as defined in the Securities and Futures Act.

Switzerland: EFG Bank AG, Zurich, including its Geneva and Lugano branches, is authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA). Registered address: EFG Bank AG, Bleicherweg 8, 8001 Zurich, Switzerland. Swiss Branches: EFG Bank SA, 24 quai du Seujet, 1211 Geneva 2 and EFG Bank SA, Via Magatti 2 6900 Lugano.

United Kingdom: EFG Private Bank Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority, registered no. 144036. EFG Private Bank Limited is a member of the London Stock Exchange. Registered company no. 2321802. Registered address: EFG Private Bank Limited, Leconfield House, Curzon Street, London W1J 5JB, United Kingdom, telephone +44 (0)20 7491 9111. In relation to EFG Asset Management (UK) Limited please note the status disclosure appearing above.

United States: EFG Asset Management (UK) Limited is an affiliate of EFG Capital, a U.S. Securities and Exchange Commission ("SEC") registered broker-dealer and member of the Financial Industry Regulatory Authority ("FINRA") and the Securities Investor Protection Corporation ("SIPC"). None of the SEC, FINRA or SIPC, have endorsed this document or the services and products provided by EFG Capital or its U.S. based affiliate, EFGAM Americas. EFGAM Americas is registered with the SEC as an investment adviser. Securities products and brokerage services are provided by EFG Capital, and asset management services are provided by EFGAM Americas. EFG Capital and EFGAM Americas are affiliated by common ownership and may maintain mutually associated personnel. This document is not intended for distribution to U.S. persons or for the accounts of U.S. persons except to persons who are "qualified purchasers" (as defined in the United States Investment Company Act of 1940, as amended (the "Investment Company Act")) and "accredited investors" (as defined in Rule 501(a) under the Securities Act). Any securities referred to in this document will not be registered under the Securities Act or qualified under any applicable state securities statutes. Any funds referred to in this document will not be registered as investment companies under the Investment Company Act. Analysts located outside of the United States are employed by non-US affiliates that are not subject to FINRA regulations.