Minutes of the Monetary Policy Council decision-making meeting held on 17 March 2020

While discussing the current economic situation, the Council members drew attention to the fact that the global economic situation had substantially deteriorated as a result of the COVID-19 pandemic and the measures taken by numerous countries to contain its spread. In particular, economic activity in the service sector had slowed down significantly, consumer sentiment had deteriorated, and many companies worldwide had temporarily halted production.

In these conditions, uncertainty about the outlook for global GDP growth has risen sharply and financial market sentiment has deteriorated significantly. The prices of many commodities, including oil, have plummeted, along with a depreciation of some emerging market economies' currencies.

It was pointed out that although according to the official data in China the spread of the coronavirus epidemic had slowed, and following this, activity in the Chinese economy should gradually rebound, the epidemic was spreading in many other countries. As a result, the forecasts of global economic activity had been significantly revised downwards, and a recession was likely in the euro area in 2020. It was judged that, according to current forecasts, there should be an improvement in the economic conditions further ahead; however, the pace of the recovery would depend on the effectiveness of the measures taken to contain the epidemic as well as the long-term impact of the disruptions on the income and sentiment of economic entities.

In order to mitigate the negative economic effects of the pandemic, many countries are implementing or announcing the implementation of strong fiscal stimulus measures. At the same time, many of the world’s central banks, of both developed and emerging economies, are cutting interest rates, are implementing or extending financial asset purchase programmes or pumping liquidity into the banking sector.

The US Federal Reserve has cut interest rates, bringing them close to zero, restarted asset purchases and increased liquidity in the financial market. Due to the permanently negative interest rates, the European Central Bank has not cut interest rates, but it has eased monetary conditions by significantly increasing the scale of asset purchases and liquidity provision to banks. At the same time, many other central banks have eased monetary policy.

The measures of central banks around the world – through providing liquidity to the economy and also reducing the costs of debt servicing – will reduce the negative economic effects of the pandemic. The majority of the Council members judged that the easing of monetary policy around the world would contribute to improving the financial situation and business sentiment. It was also pointed out that it would contribute to lower Treasury bonds yields, which would increase the fiscal space necessary to finance both the measures taken to combat the epidemic and stimulus packages offered. Certain

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Council members were of the opinion that the effectiveness of some of the measures taken by the central banks to support the economic conditions would be limited in a short period due to the supply-side character of the current shocks.

In Poland, the economic conditions in the first months of 2020 had been relatively good, although data indicated a gradual slowdown in economic growth. However, the spread of the coronavirus had caused a deterioration in economic sentiment, and the restrictions on the activity of some sectors, including the service sector, will contribute to lower economic activity. The Council members pointed out that the coronavirus epidemic would constitute a drag on the demand for and supply of many services, and also – through falling incomes – it would reduce demand for a significant number of non-necessity goods. At the same time, the decline of foreign demand would also contribute to lower economic activity. The Council members also drew attention to the supply-side consequences of the spread of coronavirus, including the disruption of some of supply chains and the reduction in the number of employees due to the need for people to stay at home.

The Council members also drew attention to the high level of uncertainty about the further development of economic conditions in Poland. It was underlined that the current forecasts suggested a sharp fall in GDP growth in the short term. It was judged that in the medium term an improvement in the economic conditions could be expected; however, economic activity growth would depend above all on the scale, extent and length of the pandemic.

According to the Statistics Poland (GUS) data, in February 2020 inflation stood at 4.7% y/y. It was pointed out that in the coming months inflation would most likely decline significantly. This would be supported by the expected fall in the prices of many services, which would be most vulnerable to a fall in demand in the current economic conditions. At the same time it was judged that prices of durable goods could also be expected to decline. As a result, core inflation would also fall significantly. It was underlined that the sharp decline in global commodity prices, including oil prices, would be an additional significant factor causing a decline in price growth in the coming quarters. Taking this into account, the majority of Council members judged that in the recent period there was an increased likelihood of a faster decline in inflation in 2020 than assumed in the March projection and of inflation running below the NBP inflation target over the monetary policy horizon.

Certain Council members pointed out that the current macroeconomic shocks were also of a supply-side nature, which could curb the decline of inflation, although these shocks can also reinforce pressure on necessity goods prices increases.

The majority of the Council members judged that at the current meeting the NBP interest rates should be lowered. These Council members were of the opinion that the cut in the NBP interest rates would reduce instalments on loans with a variable interest rate taken out by enterprises and households. The reduction in debt servicing costs would therefore mitigate the losses of enterprises and households caused by production

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stoppages, lower incomes and lower demand for goods and services. At the same time, lower loan instalments would reduce costs for indebted households, including the self-employed or persons working on the basis of civil law contracts, who are to a large extent exposed to the risk of loss of income. As a result, the monetary policy easing would also reduce the risk of insolvency of economic entities. These Council members pointed out that although the banks had announced the possibility of temporarily suspending loan repayments, this measure – which in itself would be desirable – would only mean the postponement of loan repayments. The majority of the Council members also underlined that the interest rate cuts would contribute to lower yields on Treasury bonds and the costs of public debt servicing, which would provide additional room for the necessary fiscal stimulus.

Certain Council members judged that while at the current meeting interest rates should be cut, the scale of the NBP interest rate cuts should be small. These Council members were of the opinion that non-standard monetary policy measures could be a more effective instrument in counteracting the negative economic effects of the coronavirus epidemic at the moment. An opinion was also expressed that the possibility of using such instruments could be constrained by an excessive interest rates reduction.

Certain Council members judged that the NBP interest rates should be kept unchanged at the current meeting. They argued that in the current conditions a cut in the NBP interest rates would have a limited impact on the real economy, because the sources of the economic shock are exogenous, and the barrier to lending was the currently low demand for credit and high level of uncertainty in the economy.

The Council members judged that in order to limit the impact of liquidity shocks caused by the pandemic, it was also advisable to increase liquidity in the banking sector by NBP. This is why it was necessary to reduce the reserve requirement ratio (along with raising the remuneration rate for this reserve to the level of the reference rate) and to conduct repo operations to supply liquidity to the banking sector. It was also underlined that in the face of a significant reduction in liquidity in the Treasury securities market, it was necessary to launch purchases of Treasury securities in the secondary market as part of the structural open market operations. The aim of these operations will be to change the long-term liquidity structure in the banking sector and maintain liquidity in the secondary market of Treasury bonds. It was also underlined that the purchase of Treasury bonds in the secondary market would strengthen the impact of the NBP interest rate cuts on the economy, that is, it would strengthen the monetary transmission mechanism.

The Council members judged that in order to reduce the risk of the impact of the current economic disruptions on the credit supply, it was justified for NBP to also offer bill discount credit, which would enable banks to refinance corporate loans, including those to small and medium-sized enterprises. However, it was also pointed out that the main tool supporting lending to small and medium-sized firms in the current conditions – namely significantly heightened uncertainty and heightened credit risk – should be,

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above all, the extension of the government loan guarantee scheme conducted by Bank Gospodarstwa Krajowego.

The majority of the Council members judged that monetary conditions should be eased in order to mitigate the negative economic impact of the spread of the coronavirus. This will support economic recovery after the period of disruptions and will mitigate the risk of inflation running below the NBP inflation target in the medium term.

At the meeting, a motion was submitted to cut the NBP reference rate by 0.5 percentage points, narrow the symmetrical corridor of standing facility rates to overall 1.0 percentage point around the reference rate, lower the rediscount rate to 1.05% and introduce the discount rate at the level of 1.1%. The motion passed.

At the meeting a motion was submitted to lower the required reserve ratio from 3.5% to 0.5% as well as a motion to raise the remuneration of the required reserve from 0.5% to the level of the NBP reference rate. Both motions passed. At the meeting a motion was also submitted to lower the required reserve ration from 3.5% to 0.25%. The motion did not pass.

The Council set the NBP interest rates as follows: the reference rate at 1.00%, the lombard rate at 1.50%, the deposit rate at 0.50%, the rediscount rate at 1.05%, and the discount rate at 1.10%.

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