MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 30 JANUARY 2008

During the meeting, the Monetary Policy Council discussed the outlook for inflation developments in the context of the past, current and, primarily, anticipated economic situation.

The discussion at the meeting focused on: current inflation developments, including food price changes, situation in the labour market, the outlook for economic growth and the level of interest rates in Poland and abroad. The Council discussed the influence of these factors on the future inflation in Poland.

While discussing current inflation, the Council analysed the causes of the annual growth of consumer prices in December increasing and remaining both above the NBP inflation target of 2.5% and the upper limit for deviations from the target set at 3.5%. It was pointed out that CPI growth in December was primarily driven by the further acceleration of food and fuel prices growth that resulted from global developments. It was emphasized that those developments were beyond the control of domestic monetary policy and that a rise in inflation driven by accelerating growth of food and fuel prices was also observed in many other countries. It was pointed out that in December net core inflation recorded a minor rise and remained relatively low. At the same time, it was emphasised that the remaining four core inflation measures also increased in December. In the opinion of some Council members, the upward trend in net core inflation recorded in the last months of 2007 reflected rising demand pressure. It was also indicated that the rise in inflation in December 2007 resulted also, among other things, from continuing high growth of prices of some services.

While discussing food price developments, some members of the Council indicated that the scale of food price acceleration and the ensuing rise in CPI inflation in Poland and in many other countries significantly exceeded expectations. It was pointed out that accelerating food price growth was driven by external factors, mainly by increased demand for food on the part of rapidly developing emerging economies and a rise in production of biofuels. Some Council members assessed that increased growth of food prices might continue over a longer period due to, among other things, persistently growing demand for food and limited possibilities to augment food supply in the short term. They pointed to the fact that changes in the growth rate of food prices were previously treated as temporary shocks. In the present situation they might prove to be relatively permanent and act asymmetrically, i.e. leading to persistently relatively high inflation. In the opinion of those members, net core inflation is currently less useful an indicator of inflationary pressure than in the situation when shocks on the food markets are relatively short-lived and symmetrical. Other members of the Council indicated that it was difficult to assess the sustainability of the increased growth rate of food prices.

While addressing the future inflation, some members of the Council assessed that in the months to come a rise in net core inflation should be expected, primarily as a result of growth of regulated prices, in particular energy prices, as well as accelerating growth of prices of certain services. Those members assessed that the rise in net core inflation and the continuing high growth of food prices will probably result in CPI inflation remaining above the inflation target throughout 2008. In this context, some Council members pointed out that accelerating inflation resulting from increased growth of food prices and a rise in regulated prices is beyond the scope of domestic monetary policy. Other members, however, emphasized that a rise in CPI inflation might boost inflation expectations. Moreover, they indicated that certain deterioration in inflation expectations had already been observed. Attention was drawn to the fact that the deterioration in inflation expectations had come about amidst low unemployment rate and tight labour market, which might increase the likelihood of the so-called second round effects.

Some members of the Council assessed that Poland is likely to cease fulfilling the Maastricht price stability criterion within a short time. Other members, however, pointed out that meeting the price stability criterion would become relevant only after the scheduled date of Poland's joining the euro area had been fixed.

While discussing the labour market situation, it was pointed out that wage growth in the corporate sector in December 2007 was lower than in the preceding months, and its decline as compared with November 2007 was stronger than it might result from the statistical effect of the dates of bonus payments in certain sectors being different than in 2006. In the opinion of some Council members, this might suggest that wage pressure in the corporate sector was likely to diminish. Moreover, those members assessed that labour productivity growth in the enterprise sector should follow an upward trend in the coming period due to investments made in the past as well as employment growth lower than in 2007, which would be conducive to reducing unit labour costs in this sector. They also argued that high wage growth did not have to lead to growing inflationary pressure given the good financial standing of enterprises. In this context, they pointed out that, as suggested by the findings of enterprise surveys, the scale of wage increases scheduled for 2008 Q1 in the enterprise sector was moderate and that the wage rises would lead to price increases only in a small part of the surveyed enterprises. They also estimated that considerable pay rises in the public finance sector were rather unlikely as this would require amendments to the Budget Act for 2008.

Other members of the Council pointed out that in December the annual wage growth in the corporate sector continued to outpace labour productivity growth, which was conducive to rising consumption demand and inflationary pressure. Moreover, some members indicated that the recent period had been marked by intensifying wage demands in the public finance sector. They emphasised that a considerable rise in wages in this sector would lead to increasing domestic demand as well as demands of wage increases in other sectors of the economy, which would be conducive to growing inflationary pressure.

In the opinion of some members of the Council, tight labour market reflected in the rapid decline in unemployment rate and a swift labour demand growth would not diminish significantly in the time to come due to economic emigration of Poles and persisting differences in the level of wages between Poland and Western European countries. Other members argued that the expected slowdown in the economic growth in Western European countries might result in certain emigrants returning to Poland, which would be conducive to diminishing wage pressure.

While addressing the changes in external factors affecting the Polish economy, the discussants pointed at further deterioration in the outlook for economic growth in the United States. It was indicated that this increased the likelihood of a slowdown in the world economy, in particular in Great Britain and, consequently, the euro area. Attention was drawn to the simultaneous increase in the uncertainty about the outlook for growth in the world economy. It was argued that considerable drops in equity prices in the global financial markets might – similarly to 2001 – become one of the factors contributing to a deterioration in investor expectations and weakening economic growth in Europe.

While discussing the outlook for economic growth in Poland, it was pointed out that December data on industrial output and retail sales were significantly below expectations. In the opinion of some

Council members, those data might point at a gradual decline in the economic growth in Poland, which would ease the demand pressure and, consequently, inflationary pressure. Those members pointed out that the likely slowdown in the world economy might lead to a slowdown in economic growth in Poland. They indicated that the turmoil in the global financial markets in January 2008 also affected the Warsaw Stock Exchange and emphasised that the resulting possible deterioration in investor expectations might contribute to weakening the economic growth in Poland.

Other members of the Council thought it was currently difficult to assess whether the December data suggested a decline in economic activity in Poland and that only the data referring to the subsequent months would allow an assessment whether there was a decline in GDP growth. Those members pointed out that in 2007 Q3 domestic demand continued to grow faster than GDP suggesting an increase in inflationary pressure. In the opinion of those members, the increase in domestic demand was driven by high growth in lending. Moreover, they assessed that high growth in corporate lending indicated that investment growth might be sustained at a high level, which would be conducive to maintaining fast economic growth. Some discussants pointed out that the fast growth in bank deposits might possibly result in increased lending growth and stronger demand pressure. Moreover, some members of the Council indicated that the slowdown in economic growth in the United States would affect the economic activity in the euro area, and consequently in Poland, after a certain time lag. Those members assessed that the economic slowdown in emerging economies will have a smaller scale than in the United States and the euro area and that the weakening economic growth in Poland would not significantly reduce the labour market tensions.

While discussing exchange rate developments, some Council members pointed out that in 2007 the zloty exchange rate both against the US dollar and against the euro had appreciated, and that in January 2008 the nominal effective exchange rate had been stronger than accounted for in the October projection, which was conducive to diminishing inflationary pressure. It was emphasised that despite the turmoil in the international financial markets observed in January the zloty exchange rate remained stable. On the other hand, some discussants indicated that zloty appreciation might stem from the appreciation of the real equilibrium exchange rate related to the convergence process. Moreover, it was pointed out that it was currently difficult to assess the sustainability of factors which had led to zloty appreciation in the previous period. It was also argued that slump in the global financial markets might increase the likelihood of capital outflow from emerging markets which might be conducive to zloty exchange rate depreciation.

While addressing monetary policy, it was pointed out that in January 2008 interest rates were lowered considerably in the United States and further lowering of interest rates was expected, and that, as anticipated by financial markets, interest rates in the euro area would probably also be reduced. Some Council members indicated that certain central banks eased monetary policy despite high inflation being observed in those countries.

Some members of the Council emphasised that the real interest rate in Poland was high as compared with other countries of the region, and that interest rate increases by the NBP in 2007 were accompanied by zloty appreciation. They pointed out that in January 2008 zloty exchange rate continued to be stronger than accounted for in the October inflation projection. In the opinion of those members, as compared with other countries of the region, monetary conditions in Poland remained tight. They argued that monetary policy tightening increased interest rate disparity between Poland and the United States and the euro area, which might encourage the inflow of short-term capital to Poland and be conducive to zloty exchange rate appreciation. In the opinion of those members, this would weaken the competitiveness of the Polish economy and lead to further increase of external imbalance. Moreover, they pointed out that increasing interest rate disparity would lead to a growing share of loans denominated in foreign currency in total loans, which might weaken the impact of domestic monetary policy on domestic demand. Other Council members argued that as compared with other countries of the region, the share of foreign currency denominated loans in total loans in Poland remained relatively low.

On the other hand, the discussants pointed out that in 2007 the rise in CPI inflation in Poland was stronger than the growth of nominal interest rates, and thus the real interest rate decreased. Some of them also emphasised that in certain countries real interest rates were currently higher than in Poland. At the same time, it was pointed out that the reason for monetary policy easing by certain central banks was the expected economic slowdown and the financial market turmoil of January 2008.

While discussing the interest rates decision, the majority of the Council members believed that it was necessary to contain the risk of sustained increased CPI inflation and curb the expected growth in net core inflation and a possible boost in inflation expectations. In the opinion of some Council members, the inflation outlook justified a significant increase in interest rates at the January meeting. In the opinion of the majority of the Council, monetary policy tightening should be measured and proceed gradually due to, among other things, the increased uncertainty about the outlook for economic growth in Poland and abroad as well as uncertainty about the potential impact of interest rate increases on zloty exchange rate. In this context, the future path of interest rates in Poland was also discussed.

A motion to raise the key NBP interest rates by 50 basis points was put forward. The motion did not pass. A motion to raise the key NBP interest rates by 25 basis points was put forward and passed. The Council raised the interest rates to the following levels: the reference rate to 5.25%, the lombard rate to 6.75%, the deposit rate to 3.75% and the rediscount rate to 5.50%.

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