MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 27 JANUARY 2009

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

The discussion at the meeting focused on the outlook for economic growth and inflation abroad and in Poland, zloty exchange rate developments and credit market conditions.

The Council paid a lot of attention to the domestic economic growth. It was pointed out that the recession in the external environment of the Polish economy and the accompanying decline in foreign demand for Polish goods had increasing impact on the activity in the domestic economy which is corroborated, among other things, by further fall in industrial output in December. Considerable reduction in demand, in particular for the products of exporting enterprises, is also signalled by the results of the NBP business climate surveys. It was emphasized that deteriorating outlook for sales translated into investment dampening and, consequently, contributed to faster than previously expected slowdown in GDP growth.

While discussing the outlook for economic growth in Poland it was noted that it was largely dependent on the foreign economic situation. In this context, the deepening recession in the United States and in the euro area was pointed out together with a risk of further downward revisions of economic growth forecasts for Poland's main trading partners. The risk is related to the negative impact of the global financial crisis on the situation in the labour markets in those countries and, consequently, on households' income and consumption. The protracted recession in the external environment of the Polish economy may delay the improvement in the domestic business activity relative to previous assessments. Some members of the Council emphasized that this might translate into even stronger curbing of the investment activity of enterprises; consequently, the contribution of investment to GDP growth in 2009 might be negative. It was argued that economic slowdown in Poland, through decreasing labour demand and declining wage growth, would contribute to limiting households' consumption growth. Another factor curbing domestic demand may be a reduction in general government expenditure, which – if concerning investment outlays – will additionally negatively affect GDP growth in the longer term. Some members of the Council argued that implementation of projects financed with EU funds by local government entities would contribute to maintaining the growth of the general government investment expenditures.

While discussing inflation developments, attention was paid to the slightly stronger than expected decline in inflation in December 2008 to 3.3%, i.e. below the upper limit for deviations from the NBP's inflation target. It was indicated that the decrease in inflation had been largely driven by falling fuel prices, yet, it was emphasized that core inflation had also declined.

While addressing the outlook for inflation, it was assessed that in the coming months inflation should gradually decline to the inflation target (2.5%). At the same time, some members of the Council emphasized that considerable depreciation of the zloty exchange rate observed in the past few months and possible further raises in administered prices would be factors conducive to price increases. In this context, attention was paid, among other things, to possible increases in 2009 of excise tax on fuels aimed at compensating some of the decline in government budget revenues, which would translate into higher prices. Other members of the Council argued that the pass through of exchange rate changes into inflation might be limited amidst economic slowdown, and raises in administered prices are beyond the direct impact of monetary policy. Those members also emphasized that rises in administered prices limited households' purchasing power, which in an economic downturn would additionally curb their demand. During the discussion attention was also paid to uncertainty relating to changes in inflation in the near term connected with commodity price developments in the global markets and with the GUS changing the weights in the households' consumption basket.

The majority of the Council members stressed that amidst declining inflationary pressure, monetary policy should focus more on counteracting excessive slowdown of economic growth, thus contributing to maintaining price stability in the medium term. In the opinion of some Council members, this justified a significant reduction of the NBP interest rates so that – considering the time lags in the transmission mechanism – the effects of such measures could translate, as soon as possible, into strengthening the domestic demand. Some Council members were of the opinion that the easing of the monetary policy should also be accompanied by the implementation of the government loan guarantee system supporting economic growth.

While discussing the exchange rate developments, it was emphasized that the recently observed considerable depreciation of the zloty exchange rate resulted mainly from the increase in risk aversion in the global financial markets leading to capital outflow from the emerging markets, which was reflected in a rise of bond yields and CDS rates. Some Council members pointed out that the scale of zloty depreciation was higher than that of other currencies of the Central and Eastern Europe despite interest rates in Poland had been lowered to a lesser extent than in other countries of the region. In their opinion, this meant that the impact of the interest rate disparity on the exchange rate had recently been limited. At the same time, those Council members indicated that under current circumstances the outlook for economic growth in Poland and the resulting situation of the public finance sector were of higher importance for the zloty exchange rate developments. In the opinion of some Council members, a strong reduction of interest rates aimed at counteracting excessive economic slowdown might therefore contribute to the strengthening of the zloty exchange rate in the medium term. Additionally, they argued that consolidating lowering the NBP interest rates to the level consistent with both maintaining price stability and supporting economic activity, would be conducive to fading of expectations for further NBP interest rates reductions, which should limit the pressure for zloty depreciation. Other members of the Council assessed, however, that too strong lowering of the NBP interest rates might boost expectations of financial market participants as to overall scale of further interest rates reductions. Moreover, they pointed out that the too rapid easing of the monetary policy by the Council might be perceived as a sign of considerable deterioration in the outlook for Polish economy, and thus contribute to further depreciation of the zloty exchange rate. Those Council members also emphasized that the domestic foreign exchange market was at present relatively shallow bringing about the risk of further strong zloty depreciation which should be accounted for while deciding on the scale of the NBP interest rates reduction.

While analyzing the factors affecting exchange rate developments specific for the Polish economy, some members of the Council argued that the zloty depreciation might have been strengthened by Polish enterprises having to conclude previously signed options contracts by purchasing foreign currency at the market. On the other hand, some Council members pointed out that declarations of the Government about its commitment to meet the timetable of Poland's euro area accession could have contributed to limiting the scale of zloty depreciation. In this context, it was noted that a possible postponement of euro adoption might have a negative impact on zloty exchange rate developments.

While discussing the impact of zloty depreciation on the economy it was indicated that exchange rate depreciation negatively affected the financial condition of enterprises engaged in options contracts and increased the zloty value of debt of economic entities (enterprises, households and public finance sector) denominated in foreign currencies, which would be conducive to curbing their expenditures. Moreover, it was pointed out that rising import prices driven by weaker exchange rate would – through higher costs of imported commodities and intermediate goods – negatively affect the economic activity in Poland. On the other hand, it was noted that improved competitiveness of Polish products on foreign markets, related to zloty depreciation, would limit the negative impact of recession in the external environment on Polish exports. It was argued that depreciation would also lead to rising zloty value of EU funds which – combined with a possible fall in prices of construction and assembly works, signaled by the results of the GUS business condition surveys – might constitute a factor supporting the implementation of investment projects financed with EU funds. It was emphasized that depreciation bringing about a rise in the prices of imported goods, would favour the growth of domestic demand for domestic goods to the detriment of imported goods which would contribute to reducing the imbalance of Polish trade.

While analyzing the credit market situation it was pointed out that although monetary data had not as yet signaled strong slowdown in credit growth, in 2008 Q4 banks considerably tightened their lending policy and some of them retreated from granting housing loans denominated in foreign currencies. In this context, some Council members argued that decisions about lowering the NBP interest rates were of considerable importance for bank lending as they contributed to decreasing the costs of zloty denominated loans. It was also pointed out that since the beginning of the process of the NBP interest rates lowering in November 2008, the 3-month WIBOR rate decreased by more than 100 basis points which confirmed that despite market interest rates remaining at an elevated level relative to the reference rate, the Council's decisions had a considerable impact on market interest rates.

While analyzing the situation in the banking sector it was pointed out that offering high interest rates on term deposits was accompanied by rising loan margins by banks. Some Council members argued that by the time the previously opened deposits terminate, banks might tend to maintain the cost of newly granted loans at an increased level even despite reduction in the NBP interest rates. Moreover, in the opinion of those Council members too deep lowering of the interest rates through decreasing banks' incomes from servicing previously granted loans – provided their interest depends directly on interest rates in the interbank market – might result in deteriorating financial results of banks and, consequently, constitute a factor limiting lending. Those members argued that easing the monetary policy should be implemented in such a pace as to allow banks to gradually adjust to changing business conditions.

While discussing the level of interest rates it was pointed out that considering the rapid downturn in the economy and decline in inflationary pressure many central banks had recently continued to ease their monetary policy. Some members of the Council argued that provided there were no or small reductions in the interest rates in Poland, this would lead to a rise in interest rate disparity. Other Council members noted, however, that at present it was difficult to assess the impact of the considerable monetary policy easing introduced by major central banks on the economy and financial system stability; therefore, changes in interest rates in other countries should not be followed automatically.

While discussing the decision on interest rates, the Council assessed that the signs of stronger and faster than expected slowdown in the global and Polish economic activity combined with further decline in inflationary pressure spoke of lowering the NBP interest rates. In the opinion of some Council members reduction of the interest rates should be implemented gradually and its scale at the January meeting should be smaller than in December 2008, especially in view of the easing of the monetary conditions resulting from considerable depreciation of the zloty exchange rate.

According to those members of the Council, too strong lowering of the NBP interest rates at the current meeting posed a risk of further depreciation of the exchange rate which favoured gradual adjustment of interest rates. Moreover, those members pointed out that too strong lowering of interest rates at the current meeting might excessively boost market expectations as to the total scale of interest rate reduction. Other members of the Council emphasized, however, that in view of the fast deteriorating outlook for domestic economic growth, it was necessary to lower, as soon as possible, the interest rates to the level supporting the economic activity in Poland. In the opinion of those Council members considerable reduction of the NBP interest rates would counteract limiting of banks' lending, and consequently, too strong decline in domestic demand. They argued that the Council's decisions aimed at supporting GDP growth in view of the falling inflationary pressure might lead to strengthening of the zloty exchange rate. The Council also discussed the scale of possible further lowering of the NBP interest rates.

Motions to lower the NBP interest rates by 25 basis point, by 50 basis points and by 75 basis points were put forward. The motion to lower the NBP interest rates by 75 basis points was passed, therefore the motions to lower the NBP interest rates by 25 basis points and by 50 basis points were not put to voting. The Council decided to lower the NBP interest rates to the level: the reference rate to 4.25%, the lombard rate to 5.75%, the deposit rate to 2.75% and the rediscount rate to 4.50%.

Publication date: 19 February 2009