MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 26 JANUARY 2010

At the meeting, the Monetary Policy Council discussed primarily the outlook for economic growth and inflation abroad and in Poland, the situation in the labour and credit markets and zloty exchange rate developments.

While addressing the outlook for global economic growth, it was pointed out that the latest data on US and euro-area economies indicated the continuation of positive tendencies in industry and a further improvement of enterprises' sentiment. At the same time, it was argued that the still difficult situation in labour markets in those economies could negatively affect consumption, which may be signalled by unfavourable data on retail sales. The Council stressed that high uncertainty as to the scale of recovery in the world economy continued. Some Council members pointed primarily to the expected phasing out of stimulus packages in many countries as a source of uncertainty related to the sustainability of the recovery. According to other Council members, the persistently high fiscal deficit and fast rising public debt remain to be important risk factors. At the same time, the Council assessed that economic activity in developing economies, whose demand may prove important in supporting the recovery in developed economies, would be of great significance for global economic growth.

While discussing inflation abroad, it was pointed out that an increase in the annual price indices of consumer goods and services in the United States and in the euro area in December 2009 had resulted mainly from the positive base effect connected with a strong drop in energy prices a year before. Some Council members emphasised that according to most forecasts inflation in those economies would remain at a relatively low level in the coming years, which would be conducive to lower inflation in the world economy. Other Council members, however, pointed to the rising inflation expectations in the United States. Moreover, they argued that the output gap in the largest developing economies was closing, which could limit the decline in the prices of goods imported from those countries and its disinflationary influence on inflation both in the world and in Poland.

At the meeting the Council also discussed the situation in the world commodity markets. It was assessed that commodity prices in the years to come may be relatively high. In this context, some Council members pointed out that commodity markets may see long price cycles, as supply can only be increased as a result of significant investments, and so it adjusts to a demand rise with a considerable lag. Moreover, other Council members argued that commodity prices were not only affected by demand and supply in the underlying market but also by the situation in the markets of financial instruments tied to commodity prices, including, among others, by the purchases of those instruments by foreign pension funds. In the assessment of those Council members, the lack of limits on open positions may be conducive to high commodity prices despite relatively sluggish growth in the world economy.

While discussing the situation in the Polish economy, it was emphasised that the released data, and in particular the gradual stabilisation of employment in the enterprise sector and improved indicators of economic climate, including output forecasts, as well as good liquidity and financial standing of enterprises, signalled a gradual recovery in economic activity. Yet, some Council members pointed out that the data on industrial output in December 2009 fell significantly short of expectations. While addressing the outlook for economic growth in Poland, the majority of the Council argued that GDP growth in subsequent quarters may be stronger than previously assessed. At the same time some Council members stressed that, while assessing the pass-through of the expected GDP growth acceleration to inflation, one should consider a possible slowdown in the growth of potential output, stemming in particular from the decline in total factor productivity growth started in 2004. Moreover, it was pointed out that according to the NBP survey the share of non-profitable exports in total exports was very low, which means that enterprises may be able to sustain their price competitiveness even in the case of zloty appreciation. On the other hand, it was emphasised that the impact of the exchange rate on the profitability of exports was currently lower than it used to be due to the strengthening of international ties among enterprises and a considerable import intensity of exports. Some Council members indicated, however, that a potential zloty appreciation might – in the short run – have a strong negative impact on GDP growth as it could trigger the build-up of inventories of imported goods. Other Council members pointed to the expected continuation of relatively weak economic growth in Poland's main trading partners, which may curb export growth and, consequently, GDP growth. In the opinion of those Council members, due to the significance of external demand and international ties among enterprises, economic growth in Poland at the moment was much more dependent on economic activity abroad as compared to the period of the previous economic slowdown.

While addressing the factors affecting investments, some Council members emphasised that since production capacity utilisation in the enterprise sector was still low and – as during recovery from the previous economic slowdown – investments respond to improvement in economic activity with some delay, no quick investment recovery should be expected. It was also argued that investment in the coming period would depend on spare production capacities not only in Poland but also in other countries with strong ties with Polish enterprises, and particularly in Germany. This means that despite the positive sentiment of investors towards emerging countries, including Poland, the inflow of foreign direct investment in the coming years may – in the opinion of those Council members – prove significantly lower than it had been before the global crisis. Other Council members, however, pointed out that according to the NBP survey on economic climate the utilisation of production capacities in 2009 Q4 was close to that observed in 2003-2004, when after the previous economic slowdown investments rebounded, which could signal a faster than expected investment recovery.

While analysing labour market data, the Council members argued that the deterioration of the situation in this market was considerably less pronounced than in the period of the previous slowdown, which was confirmed by a markedly higher current ratio of vacancies to the number of unemployed. Such a situation increases the risk of wage rise acceleration taking place faster than during recovery from the previous economic slowdown. Some Council members assessed that in the coming years demographic developments would negatively affect labour supply, while in the case of the previous economic slowdown they had been conducive to curbing the wage pressure and, consequently, the inflationary pressure. Moreover, the decline in the share of enterprises lowering their margins observed in 2009 Q4, and a probable – in the opinion of those Council members – margin increase in the phase of economic recovery, indicate that inflation may rise even if a low growth rate of unit labour costs was sustained. Other Council members pointed out that, due to the rise in the unemployment rate, moderate (after adjustment for one-off effects) wage growth and good financial conditions in enterprises, no significant inflationary pressure from the labour market should be expected in the coming period. In this context, the so-called labour hoarding on the part of enterprises was being emphasised, which consists in reduced lay-offs during an economic slowdown, which in the period of recovery should allow for increasing labour productivity and meeting rising demand without a significant employment rise, and probably also without significant pay increases. In the opinion of those Council members, this may be a factor easing the inflationary pressure.

Some Council members pointed out that the situation in the credit market was not improving: lending to the enterprise sector continued to shrink, while the rise in loans to the household sector remains considerably lower than in the previous years. Other Council members, however, argued that, according to the preliminary results of the NBP survey of commercial banks, their tendency to tighten credit policy had been halted in 2009 Q4 and in 2010 banks expected to significantly increase lending to the non-financial sector.

While discussing the outlook for lending, some Council members pointed to a significant increase in loans granted in foreign currencies that had been observed prior to the crisis in the world financial markets. Those members emphasised that it was possible that lending in foreign currencies would rise significantly once again, which may be limiting the impact of NBP interest rate changes on the volume of credit in the economy.

While discussing inflation developments, some Council members pointed out that in December 2009 CPI inflation rose to 3.5% (driven primarily by the positive base effect connected with a strong decline in fuel prices in December 2008), and in the coming months inflation might be expected to decrease significantly. At the same time, it was emphasised that core inflation net of food and energy prices had fallen to 2.6% due to the deceleration in prices of services.

While addressing inflation expectations, some Council members pointed to a rise in the majority of indices of individuals' inflation expectations recorded in January 2010 and to the deteriorated structure of responses to the question about expected change of prices in the next 12 months. Those Council members assessed that the slightly widened spread of forecasts by bank analysts and the continuation of a relatively high dispersion of individuals' expectations may reveal some uncertainty as to the assessment of inflationary processes by economic agents. Other Council members argued that inflation expectations in Poland are adaptive in nature, and so they are greatly dependent on past inflation, which should be taken into consideration while interpreting their changes. In the context of inflation expectations and their pass-through to wage developments, the Council also discussed the power of trade unions, which play a significant role in wage negotiations in the public sector, though in the scale of the whole economy they group a relatively small number of employees.

The Council also discussed the zloty exchange rate developments against its equilibrium level. Some Council members argued that a high level of integration of the Polish economy with the euro area should be conducive to reducing the deviations of the real zloty exchange rate from the equilibrium rate. Other members of the Council pointed out that in their decisions on emerging markets foreign investors often rely on a very limited set of information, which may result in exchange rate deviations from the level warranted by fundamental factors. At the same time some Council members indicated that public finance sector imbalances, both in Poland and abroad, was a factor increasing the risk of high zloty exchange rate volatility.

While considering decisions on the NBP interest rates in the months to come, some Council members assessed that the expected economic growth acceleration would be a factor conducive to higher inflation in the medium term. In the opinion of those Council members, this may indicate that a time might be approaching for considering a change in the assessment of probabilities of inflation in the medium term running below or above the inflation target and, possibly, the subsequent monetary policy tightening. Other Council members, however, argued that, taking into account uncertainty as to the sustainability of the recovery in the world and in the Polish economy, as well as the unknown impact of the expected macroeconomic policy tightening abroad on future world economic growth and inflation, the probabilities of inflation running below and above the target in the medium term were still balanced and the NBP interest rates should remain unchanged in the coming period.

The Council assessed that the data on the economic situation in Poland and abroad released since its last meeting warranted maintaining the interest rates unchanged at the current meeting.

The Council kept the interest rates unchanged: the reference rate at 3.50%, the lombard rate at 5.00%, the deposit rate at 2.00%, the rediscount rate at 3.75% and the discount rate at 4.00%.

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