Minutes of the Monetary Policy Decision-Making Meeting held on 14 January 2015

Members of the Monetary Policy Council discussed monetary policy decisions against the background of macroeconomic developments in Poland and abroad.

While discussing business conditions in Poland's external environment, Council members emphasized the continued recovery in the United States. In particular, they highlighted the upward revisions of GDP data for 2014 Q3 and the strength of macroeconomic data for 2014 Q4, including, in particular, the sustained employment growth and a further decline in the unemployment rate. A few Council members observed that the recovery in the United States would support global economic activity. Yet, in some Council members' assessment, the economic situation in countries which are Poland's main trading partners continued to be unfavourable. In the euro area, including Germany, the average level of the PMI index in 2014 Q4 had been lower than in the previous quarters. It was argued that in some economies of the euro area, activity growth was being hampered by the measures aimed at reducing the public debt. Furthermore, uncertainty surrounding the outlook for euro area growth was emphasised. A few Council members observed that a recovery in this currency area was delaying, citing the recent downward revisions of GDP growth forecasts for this economy, including those by the European Central Bank. Yet, other Council members were of the opinion that despite the persistently heightened uncertainty in the euro area, driven, among others, by the nearing elections in Greece, GDP growth should accelerate gradually in the following quarters supported by the considerable decline in oil prices. Council members also pointed to the halt in economic growth in Russia in 2014 Q4 and the likelihood of a marked GDP decline in this economy in 2015. On the other hand, a few Council members emphasised that economic activity in many other countries of the Central and Eastern European region remained stable.

Members of the Council highlighted further substantial decline of oil prices observed in the recent period, leading to lower inflation and inflation forecasts in many economies. It was noted that deflation was observed in the euro area in December and the ECB had markedly revised downward its inflation forecasts for 2015. It was assessed that under these circumstances the announcement of new quantitative easing programmes by the ECB was likely as early as in January 2015. Council members also pointed to the likelihood of forthcoming interest rate rise in the United States, which would probably support an inflow of portfolio capital to the US economy.

Heightened risk aversion that had prevailed recently in the financial markets was pointed out. As expectations of an interest rate rise in the United States had been mounting, the US dollar had gained considerably, while emerging market currencies, including the zloty, had weakened. Yet, it was emphasised that the decline in the zloty exchange rate vis-à-vis the euro was much smaller than that vis-à-vis the dollar. A few

ul. Świętokrzyska 11/21 00-919 Warszawa, Poland phone +48 22 185 28 88 sekretariat.rpp@nbp.pl

members of the Council argued that the zloty had weakened partially on the back of the slump of the rouble. It was further pointed out that the currencies of Poland's other trading partners had depreciated much more than the zloty. As a result, the nominal effective exchange rate of the zloty had been stronger in December than in the month before.

While analysing the conditions in the real economy in Poland, Council members assessed that GDP growth could have weakened somewhat in 2014 Q4. Yet, some Council members were of the opinion that despite this likely slowdown, GDP growth remained stable and forecasts pointed to its gradual rebound in the following quarters. Against this background, those Council members argued that the observed decline in global oil prices would support domestic demand as well as – through higher GDP growth abroad – Polish exports. As a result, economic growth in Poland might prove to be stronger than previously forecasted. Other Council members believed that GDP growth in the second half of 2015 would be propped up by higher inflow of European Union funds. Pointing to the relatively strong outlook for demand in the Polish economy, a few Council members observed that the financial situation of enterprises continued to be sound, fuelled by low oil prices. Investment kept on rising at a robust pace, supported by low credit cost, while forecasts of orders and production were above their long-term average. They also argued that corporate lending was rising, and money supply in the real terms expanded at the highest pace since the onset of the global financial crisis. They also assessed that corporate business climate indicators had stabilised and that household sentiment was improving.

However, some Council members pointed out that the pace of GDP growth did not ensure fast closure of the output gap and there were no signs of a marked pick-up in the economic activity in the following quarters. A few Council members emphasised the risk of a substantial slowdown in GDP growth. In this context, it was argued that industrial production growth had decreased close to zero in November, while construction and assembly output had continued to contract and retail sales growth had weakened. Some Council members pointed out that domestic economic conditions were being adversely affected by the delay of recovery in the euro area and by the slump in activity in Russia. It was emphasised that a further tightening of the macroprudential policy at the beginning of this year would probably limit mortgage lending growth. A few Council members also drew attention to the fact that in recent quarters, domestic demand had been supported by a considerable rise in inventories, which could have resulted from shortage of demand for already produced goods. This could result in lower production growth in the future.

While analysing labour market conditions, sustained corporate employment growth was highlighted, as well as the declining seasonally adjusted unemployment rate. A few Council members also pointed to business climate surveys suggesting further growth in corporate employment. At the same time it was pointed out that no signs of wage

ul. Świętokrzyska 11/21 00-919 Warszawa, Poland phone +48 22 185 28 88 sekretariat.rpp@nbp.pl

pressure had been observed in the corporate sector, and that wage growth in the government sector was being curbed by the wage fund freeze in this sector.

When discussing inflationary processes in Poland, Council members pointed to the possibility of deflation continuing longer than previously expected. It was also emphasized that price growth forecasts for the following quarters had been revised downwards in the recent period. As a result, deflation might persist for another few months, and the horizon of inflation returning to the NBP inflation target might get longer.

Some members of the Council emphasized, however, that deflation was primarily due to lower prices of commodities. Those members assessed that for this reason deflation was conducive for domestic demand growth, as it supported wage growth in real terms and increased the ability of economic agents to service debt, thus supporting the economic upturn. They pointed to the fact that the decline in energy prices boosted the sentiment of most economic agents. A few members of the Council emphasized that an extended period of slow price growth was currently a feature of many economies.

Some members of the Council highlighted, however, that the observed decline in prices was not only driven by falling commodity prices, but also by negative output gap in the economy. In their opinion, this was reflected by the lowest in history and negative average of core inflation measures as well as the continued negative growth rate of producer prices. Those members of the Council also indicated that most retail sales deflators were negative, and the growth of prices of services – which were most responsive to domestic demand pressure – had followed a downward trend for many quarters. It was pointed out that deflation led to expectations of households and enterprises running consistently at very low levels, and that inflation expectations of analysts for the following two years were below the inflation target.

While discussing the NBP interest rates, the majority of the members of the Council judged that they should remain unchanged at the current meeting. The majority of the members of the Council expressed the opinion that leaving interest rates unchanged at the current meeting was justified by the heightened risk aversion in the international financial markets, resulting, inter alia, from the foreign exchange crisis in Russia.

Some members of the Council who were in favour of keeping the interest rates unchanged pointed out that the prolonged deflation resulted from supply shocks, hence was beyond the direct impact of the domestic monetary policy. It was also pointed out that the observed decline in commodity prices supported economic activity. A few Council members assessed that a further reduction in interest rates – amidst domestic demand growth exceeding, in their opinion, potential GDP growth – could lead to excessive lending growth and an increase in the current account deficit, which was currently curbed by a significant drop in import prices. They also argued that a possible increase in interest rates abroad might worsen the income balance on the current account. Those members of the Council also pointed out that currently the NBP interest rates were at historically low levels, and their further lowering would inhibit corporate

ul. Świętokrzyska 11/21 00-919 Warszawa, Poland phone +48 22 185 28 88 sekretariat.rpp@nbp.pl

restructuring and curb potential economic growth. Some of the members of the Council observed that slow price growth was typical for many economies, and the experience of other central banks showed that under the current conditions interest rate cuts might fail to bring inflation to the target. Some members of the Council also judged that the expected acceleration in the growth of prices would bring about a decline in real interest rates.

Yet, some Council members assessed that it might be justified to adjust the NBP interest rates in the coming months. Those members emphasized that the period of deflation and the time horizon of inflation returning to the target were extending. They also assessed that the incoming data pointed to a risk of a slowdown in economic activity, and sluggish economic growth persisted in the external environment of the Polish economy. They indicated that continuing deflation boosted real interest rates, which were now relatively high in Poland both in historical terms and when compared with other economies. The possibility of the ECB's further easing of its monetary policy was also emphasized. A few of those members of the Council also pointed out that interest rates on loans to the private sector were higher than the nominal GDP growth. In real terms they were higher than the profitability of enterprises, and so – in the opinion of those Council members – did not pose a risk of excessive debt growth nor inhibit corporate restructuring. Those members also pointed out that due to the limited array of monetary policy tools, corporate restructuring should be supported primarily by structural policy. A few members of the Council who did not rule out an adjustment of interest rates in the coming months, underlined that the potential need to adjust monetary policy could be assessed better after the possible measures of the ECB had been evaluated and the new projection of inflation and GDP had been released.

A few Council members assessed that due to the continuing decline in prices, extended period of inflation returning to the target as well as the risk of a slowdown in GDP growth in the coming quarters, interest rates should be cut already at the current meeting. In their view, lower NBP interest rates would not only boost economic activity, but also – in the absence of inflationary threats – would help to reduce the cost of public debt servicing, which would support the government's economic policy. Given these arguments, a few of those members of the Council were in favour of a considerable cut in interest rates.

At the meeting a motion to cut the NBP interest rates by 1.00 percentage point was submitted. The motion was rejected. A motion to lower the NBP interest rates by 0.25 percentage points was submitted. The motion was rejected. The Council decided to keep the key interest rates at the following levels: the NBP reference rate at 2.00%, the lombard rate at 3.00%, the deposit rate at 1.00%, the rediscount rate at 2.25%.

Publication date: 22 January 2015

ul. Świętokrzyska 11/21 00-919 Warszawa, Poland phone +48 22 185 28 88 sekretariat.rpp@nbp.pl