Minutes of the Monetary Policy Council decision-making meeting held on 14 January 2016

At the meeting, members of the Monetary Policy Council discussed monetary policy against the background of current and future macroeconomic developments in Poland and abroad.

When discussing the economic situation abroad, Council members pointed to the sustained recovery in the euro area and in the United States. At the same time, it was noted that euro area economic activity growth remained moderate, and price growth in this currency area was still close to zero. It was observed that economic conditions in the United States continued to be favourable, although GDP growth would probably rise only slightly this year. At the same time it was emphasised that given the steady output growth in this economy since 2010, core inflation was markedly higher than consumer price growth, and the unemployment rate was running relatively low. Council members highlighted, that under these circumstances, monetary policy stances of the ECB and the Federal Reserve diverged further. The Federal Reserve had raised policy interest rates after keeping them close to zero for seven years. In this context, some Council members expressed the opinion that any further tightening of monetary policy by the Federal Reserve would be only gradual and contingent upon the incoming information on the economic conditions. In contrast, the ECB had eased the monetary policy again by extending the period for its asset purchases and decreasing the deposit rate. However, the extent of the easing was smaller than expected by the financial markets.

While discussing economic conditions in emerging economies, Council members judged that these continued to be weak. Council members pointed to the continued recession and the persistently high inflation in Russia and Brazil. It was assessed that economic conditions in these countries were likely to deteriorate even further. While discussing the situation in China, Council members stressed that the recently released data had not been conclusive: while some of it had indicated stabilisation of economic activity growth, there had also been signs of an even deeper slump. Certain Council members held the view that economic growth in China might decelerate further, and high debt levels of economic agents in this country posed a risk of a sharp weakening of growth. Other Council members pointed out that China's economic policy would continue to aim for maintaining the stability of economic growth and financial system, which should mitigate the impact of any further weakening of the Chinese economy. Council members assessed that the economic outlook for China continued to be the main source of uncertainty for the global economy.

The Council also pointed to developments in commodity prices, including oil prices, as another major source of uncertainty about the global economic outlook. It was stressed that in the recent period the price of this commodity had plunged to a very low level, which would dampen global consumer price growth in the subsequent quarters. At the

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same time, it was underlined that amidst the mounting conflict between two major oil producers, i.e. Saudi Arabia and Iran, heightened uncertainty prevailed as to the expected output level, and hence also future prices of this commodity.

Council members emphasised the fact that sharp declines in oil prices, changes in the expectations about the future decisions of major central banks and continued concerns about economic activity in China had recently boosted asset price volatility in the financial markets. It was observed that some of these factors had increased investors risk aversion. This was reflected in declining asset prices and weakening currencies of emerging economies, including Poland.

While discussing the situation in Poland's real economy, Council members pointed to the continued stable economic activity growth. Retail sales data were judged to indicate sustained consumer demand expansion, at a rate close to that observed in the previous quarters. Consumption growth continues to be supported by rising employment and robust consumer sentiment. With regard to investment, it was observed that its growth was being fuelled by the high degree of capacity utilisation in companies amidst stable industrial output growth. At the same time, it was pointed out that firms' propensity to invest may be undermined by heightened uncertainty about the domestic and external environment of their activity. Certain Council members believed that consumption and investment growth remained merely moderate.

Council members pointed out that GDP growth in the following quarters would be supported by further decline in oil prices. At the same time, it was underlined that lower prices of this commodity would have an adverse impact on some businesses, especially mining sector companies and firms whose production was aimed at oil net exporting countries.

With reference to the situation in the labour market, sustained employment growth and declining unemployment were highlighted. Certain Council members observed that improving labour market conditions had not yet generated any tangible increase in nominal wage growth in the economy. At the same time, wage growth had recently accelerated somewhat in the corporate sector, and the share of firms planning pay rises had increased, which may signal a gradual rise in wage pressure in the economy, which - if it materialised - would support the return of consumer price growth towards the inflation target.

Council members discussed fiscal policy in the context of the 2016 Draft Budget Act. Most members judged that the fiscal policy as set out in the Draft Budget Act did not entail an increase in public finance imbalance in 2016. At the same time, members deemed that due to lags in monetary policy transmission, the shape of the 2017 fiscal policy was of key importance for the current interest rates decisions. In this context, it was pointed out that one-off revenues will make an important source of financing of the new budget expenditure in 2016. Thus, in order to keep the deficit at a moderate level in 2017, new, stable sources of budget revenue would have to be found. Some Council members assessed that the increased spending on social benefits – including the introduction of the

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Family 500+ programme – might stimulate consumption growth. Referring to the impact of the imposition of tax on financial institutions, these members expressed the view that it could lead to an increase in cost of obtaining credit and a slowdown in lending. With reference to the sales tax to be imposed on stores, Council members stated that in the absence of detailed information on this tax, it was difficult to evaluate its consequences; however, it could possibly add to price growth. Certain Council members expressed the opinion that the changes in fiscal policy may diminish the resilience of the Polish economy to external shocks, thus narrowing down the margin for a possible monetary policy easing.

When analysing the situation in the credit market, Council members pointed out that stable, moderate credit growth had been sustained. At the same time, some Council members underlined that lending growth in the following quarters might be hampered, on the one hand, by the lowering of the ceiling on the LtV ratio for mortgage loans, resulting from Recommendation S, and, on the other hand, by a possible rise in the borrowing cost after the imposition of the bank tax.

While discussing inflation developments in Poland, members of the Council indicated that the scale of consumer price deflation in December declined only slightly. Council members assessed that in the coming quarters CPI would continue to rise slowly, yet, due to a further fall in commodity prices, growth of consumer goods and services prices was likely to be significantly lower than previously estimated. It was pointed out that price growth would be supported by the closing of the output gap, amidst the recovery in the euro area and the robust domestic labour market. Council members also pointed out that the continued deflation did not yet have any adverse effect on decisions of economic agents. Some Council members expressed the opinion that it was necessary to closely monitor the impact of negative price growth on decisions of economic agents, in particular on financial situation of enterprises.

While discussing interest rates, the Council decided that they should be kept unchanged. It was assessed that the available data and forecasts suggested that the current level of interest rates helped to keep the Polish economy on a sustainable growth path and to maintain macroeconomic stability. It was argued that in the coming quarters price growth would slowly pick up. It was also noted that the likely slowdown in CPI growth as compared to the previous expectations was driven by declining oil prices in the global commodity markets, a factor beyond the influence of the domestic monetary policy. It was further noted that given the lags in the transmission mechanism of monetary policy, current decisions on interest rates would not affect price growth until the negative impact of declining energy commodity prices on inflation had already diminished. However, in the medium term CPI growth would be supported by steady growth in domestic economic activity. At the same time the rise in price growth may be driven up by the imposition of the sales tax on stores.

Some members of the Council emphasized that one of the arguments in favour of stabilization of interest rates was the continued uncertainty about the external and domestic determinants of monetary policy. It was also pointed out that this uncertainty was reflected in movements of the prices of Polish assets and the zloty. Certain Council members were of the opinion that in these conditions the decisions on interest rates should take into account their impact on the financial markets. Moreover, some Council members assessed that when deciding about the level of interest rates they should factor in their impact on the financial sector stability. In this context, those members pointed out that interest rate cuts could have a negative impact on the performance of the banking sector, a factor which could not be downplayed given the increased financial burden imposed on the sector.

Certain members of the Council were of the opinion that in the coming months it might be justified to consider interest rate hikes. They argued that this would leave more room for monetary policy response to severe external shocks. In contrast, other Council members were of the opinion that it might be justified to cut the interest rates in the coming months. Those members pointed to a merely modest – in their opinion – growth in domestic demand and a relatively high level of real interest rates, as well as forecasted low price growth.

The Council decided to keep the NBP interest rates unchanged: the reference rate at 1.50%, the lombard rate at 2.50%, the deposit rate at 0.50% and the rediscount rate at 1.75%.

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