

## **MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 24 FEBRUARY 2010**

---

At the meeting, the Monetary Policy Council discussed primarily the interaction of the outlook for economic growth and inflation abroad and in Poland in the light of the February projection of the NBP, and the situation in the labour and credit markets.

It was pointed out that the better than expected GDP data for 2009 Q4 as well as the rise in industrial output and retail sales in January 2010, signalled further improvement in the economic activity in the United States. It was pointed out that increase in inventories might indicate an improvement in the assessment of future demand. A gradual deceleration of the unfavourable tendencies in the American labour market was also stressed. At the same time, some Council members listed the following factors likely to pose risk for sustainable recovery in the American economy: weakening of upward trends in the real estate market, further curbing of bank lending to the private sector and persistently high budget deficit.

While analyzing the situation in the euro area, the contrast between GDP growth in this economy as compared to GDP growth in the American economy was emphasized. A marked decline in industrial output in December 2009 and a low GDP growth in the euro area in 2009 Q4, including the stagnation in Germany, was stressed. Considerable differences in the situation of particular euro area countries were noted and it was argued that fiscal problems of Greece, Ireland, Italy, Portugal and Spain is an important risk factor for sustainable recovery in this economy. At the same time, further improvement in the business confidence indicators in the euro area was noted. Additionally, high growth in Asian economies whose demand might constitute a factor stimulating recovery in the economies being Poland's major trading partners was stressed.

Moreover, some Council members pointed out that an important risk factor for sustainable recovery in the global economy and, as a result, in the Polish economy, were the effects of the expected unwinding of stimulus packages in many countries. Other Council members indicated that deterioration in economic activity abroad and, consequently, in the Polish economy, might occur, among other things, due to a difficult fiscal situation in the developed countries. Some members of the Council argued that – despite weak GDP growth in the euro area, and in particular in Germany – a gradual increase in the Polish exports and imports had been noted, which resulted from Polish trade being more strongly connected with exports of Poland's main trading partners than with domestic demand in those countries. Additionally, some Council members indicated that in the case of considerable weakening of economic growth in the external environment of the Polish economy, depreciation of the nominal zloty exchange rate would be more likely than its appreciation. Combined with decreasing unit labour costs in industry this would increase price competitiveness of enterprises as compared with foreign countries, supporting positive contribution of net exports to GDP growth.

While discussing the situation in the Polish economy, the Council pointed at higher than expected growth in industrial output, continued improvement in business confidence indicators and further upward revision of GDP growth forecasts for 2010, prepared by external analysts. In the opinion of some Council members the released data indicate faster than previously expected acceleration of

GPD growth. Some members of the Council assessed that retail sales growth in December 2009, being lower than anticipated in majority of forecasts, had resulted primarily from unfavourable weather conditions and was not a sign of weakening demand. Members of the Council pointed at a difficult situation in the public finance sector, including worse – as compared with the previous years – situation of the local government entities. Some Council members argued that the decrease in the number of employed in the public sector, as indicated by the BAEL data for 2009 Q4, and the possibility of this decrease being continued in view of the necessary reduction of public finance imbalance, might translate into lower income of some households, and, as a result, lower domestic demand. Yet, other Council members – pointing at difference between the growth of income from employment in the enterprise sector and the growth of income from employment in total – argued that the public finance sector, so far, had been increasing wage pressure rather than easing it.

While analyzing labour market data, majority of the Council members assessed that gradual stabilization of employment in the enterprise sector observed in the past few months might signal some deceleration of the unfavourable labour market tendencies. Yet, in the opinion of some Council members further rise in unemployment rate, driven by increased labour force participation amidst low labour demand, should support maintaining low wage pressure in the coming months. However, other Council members pointed at the negative impact of demographic factors on labour supply which would stimulate the wage pressure in the coming years.

While discussing the outlook for bank lending, some members of the Council assessed that banks' credit policy towards enterprises continued to be restrictive. This may have a negative impact on enterprises' activity the more so as persistently high share of companies has low liquidity. Those Council members indicated that Recommendation T issued in February 2010 by the Polish Financial Supervision Authority would contribute to reduced loan availability for households. According to those Council members the possible further weakening of bank lending to the private sector will be a factor curbing economic growth in Poland, which may – in the opinion of some Council members – speak in favour of the central bank taking additional measures stimulating indirectly bank lending.

Other members of the Council argued that high net profitability of enterprises coupled with high depreciation write-offs, and, as a result – in the opinion of those Council members – good liquidity situation of companies enables them to finance both their current and investment activities with their own funds, which limits their demand for loans. Those Council members also stressed a continued decline in the number of companies with very low liquidity and no liquidity problems being reported by majority of enterprises. They also pointed at the accelerating quarterly increases in household debt, including, in particular, a relatively high growth in housing loans. Those Council members indicated that the amount of housing loan instalments depended primarily on the level of interest rates in Poland. In their opinion, too late tightening of monetary policy aimed at stabilizing inflation at the target might require considerably stronger increases of the NBP interest rates in the future which would be conducive to significantly higher housing loan instalments.

While discussing the inflation developments it was pointed out that a slight rise in inflation above the upper limit for deviations from the inflation target in January 2010 was most probably a temporary phenomenon. Majority of the Council members emphasized that subsequent months were expected to bring a strong decline in inflation, even close to the lower limit for deviations from the inflation target. In the opinion of those Council members the strong decline in inflation would be driven primarily by base effects connected with high increases in regulated prices at the beginning of 2009 and by a decline in import prices being the result of the hitherto observed zloty appreciation, which will also contribute to the decline in core inflation. In the opinion of some Council members this effect will be additionally supported by the limited demand and wage pressures. Those Council members also pointed out that, on the basis of the currently available data, no increases in certain taxes, including exercise duty, should be expected this year. Increases in

those taxes were previously assessed as a risk factor for decline in inflation. Other Council members stressed that despite strong decline in economic growth, inflation in Poland continued at a relatively high level.

While discussing the outlook for inflation in the medium term, some Council members emphasized that factors supporting low inflation would include: stable inflation expectations, relatively low production capacity utilization, possible tightening of fiscal policy resulting from the need to reduce public finance sector deficit and low demand pressure connected with a slow recovery in the global economy. Those Council members also pointed out that future decline in inflation was additionally signalled by continuously decreasing growth in M3 aggregate. Other Council members indicated, however, that higher inflation in the coming years might be driven by higher energy prices connected with further growth in oil prices. Those Council members argued that limited possibilities of increasing the supply of energy commodities justified the expectations of their price increases in response to the slowly rising demand in the global economy. At the same time – in the opinion of those Council members – attempts to increase the production of biofuels would also result in the rise of food commodity prices in the world markets.

The Council discussed the outlook for inflation in the light of the results of the February NBP projection. It was pointed out that the central projection path, under the assumption of constant NBP interest rates, indicated a gradual rise in inflation from 2010 Q4 – above the upper limit for deviations from the inflation target at the end of 2012, with core inflation in the years 2011-2012 expected to continue markedly above 2.5%. Some Council members argued that headline inflation remaining below the inflation target until mid-2011 would be driven by a strong decline in the growth of food and energy prices, i.e. categories likely to be affected by shocks, whose forecasts might be subject to considerable error. In the opinion of those Council members higher than assumed in the projection might also be, on the one hand, the growth in unit labour costs and, on the other hand, growth in private consumption (according to the projection, the latter should remain markedly below the average level for the years 2000-2009). They assessed the situation in which until the end of the projection horizon the negative output gap widens as very unlikely. As a result, according to those Council members, inflation in the medium term may run above the central projection path. Other members of the Council argued, however, that different than assumed in the projection developments in zloty exchange rate may translate into more favourable than presented in the February projection assessment of risk for stabilizing inflation at the target in the medium term.

The discussion at the Council's meeting also focused on issues connected with Poland's monetary integration with the euro area, including participation of the zloty in the Exchange Rate Mechanism II. The Council discussed the conditions to be fulfilled for Poland to join the euro area. The Council agreed that Poland should join the ERM II and the euro area at the earliest possible date, after meeting the necessary legal, economic and organisational conditions.

While discussing the outlook for monetary policy in the coming months, some Council members emphasized that in line with the February projection the probability of inflation running in the medium term above the inflation target was higher than the probability of inflation running below the target which – in their opinion – justified signalling in the Information from the MPC meeting that the balance of risks for inflation might soon change. Other members of the Council argued, however, that the uncertainty related to macroeconomic developments in the global economy, and in particular, in the euro area, does not allow to assess clearly whether the risk for inflation in the medium term running above the inflation target had considerably increased.

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

# NBP

While considering the decisions on the NBP interest rates in the future, some Council members agreed that the expected rise in inflation in the years 2011-2012 might indicate the need of tightening of the monetary policy in 2010, although the timing of possible interest rate increases would depend on the current developments. Some Council members noted that further stabilization in the international financial markets might translate into a decline in risk premium accounted for in market interest rates, which – under constant NBP interest rates – would mean some easing of monetary conditions. In the opinion of other Council members too early tightening of monetary policy might, however, be conducive to an excessive appreciation of the zloty exchange rate.

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%.

*Publication date: 18 March 2010*