Minutes of the Monetary Policy Council Decision-Making Meeting held on 4 February 2015

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

While discussing business conditions in Poland's external environment, some Council members pointed to the lack of significant improvement in the economic situation of Poland's main trading partners. It was noted that in the euro area economic activity remained weak compared with other developed countries. In addition, some Council members assessed that an upturn in the euro area economy would be limited by sluggish growth in investment, partly driven by the forecasted weakening of demand growth in the emerging markets. These Council members also highlighted the deteriorating situation of Poland's eastern trading partners. In particular, it was noted that in Russia economic growth had slowed down to near zero in 2014 Q4, with recession forecasted in 2015, which might be further deepened by the renewed escalation of the conflict in Ukraine. Yet, other Council members pointed out that in the euro area GDP growth was forecasted to speed up in 2015. They expressed the opinion that accelerating consumer demand – supported additionally by the fall in oil prices – would translate into a more marked recovery in the euro area economy in the next quarters than previously observed. It was also pointed out that GDP growth in the United States – despite a slowdown in 2014 Q4 – remained high compared to other developed countries, and that the prospects for the US economy were favourable. It was noted that economic activity there would most likely remain markedly stronger than in the euro area, which was primarily the result of smaller scale of regulation and lower taxes in the US economy. At the same time, few members of the Council expressed the opinion that the expected acceleration of GDP growth in the United States in 2015 might fail to materialize, as indicated by the slowdown in GDP growth in 2014 Q4.

Members of the Council highlighted the fall in prices of a large group of commodities in the recent period, which – amidst moderate global economic growth – had resulted in a decline in inflation in many countries. At the same time, it was emphasised that the fall in commodity prices would help to stimulate economic activity in countries that are net commodity importers. Few Council members pointed out that oil prices had increased somewhat in recent days and noted that the changes in commodity prices were an important source of uncertainty about economic activity and inflation developments in the global economy.

With regard to monetary policy in Poland's external environment, it was highlighted that – in response to the deepening deflation and persistently slow economic growth in the euro area – the European Central Bank (ECB) had significantly extended its asset purchase programme by adding sovereign bonds. When discussing the possible effects of the ECB's quantitative easing, some of the Council members expressed the opinion that its impact on the real economy might be limited. According to them, an increase in liquid reserves in banks in the euro area might fail to significantly stimulate lending activity, including loans for investment purposes. They noted that the low growth in corporate lending was related to the continued uncertainty about the future economic situation in the euro area and – therefore – the financing cost had little influence on demand for credit. This was indicated, according to few Council members, by persistently falling value of corporate loans in the euro area despite decreasing interest rates on corporate loans in recent months. Some of the Council members assessed that declining yields on debt instruments in the euro area would be the main effect of the ECB's activities. Few Council members expressed the opinion that declining yields on assets and interest rates on deposits in the euro area could increase the propensity of some households to save, so that the growth in savings, and thus future consumption, would remain at a constant level, which, consequently, might limit current consumption. At the same time, some Council members pointed out that the ECB's quantitative easing might increase the inflow of portfolio capital to non-euro area economies, including Poland, causing exchange rate appreciation pressures.

Council members also discussed the decision of the Swiss National Bank to remove the Swiss franc asymmetric peg against the euro and reduce its interest rates. In this context, it was pointed out that currently it is not possible to assess in full the consequences of the Swiss franc appreciation for Polish economic agents with franc-denominated liabilities, due to the high volatility of the zloty against the franc and the unknown reaction of the banking sector and supervisory and regulatory authorities to this situation. Few Council members noted, that persisting weak exchange rate of the zloty against the Swiss franc would exacerbate the problems with repayment of the franc-denominated debt and would deteriorate banks' asset structure.

While discussing the business climate in Poland, Council members pointed out that GDP growth in 2014 Q4 had slowed down slightly, remaining above 3%. Members of the Council emphasised a higher growth of industrial production, construction and assembly, and retail sales in December, as well as an increase in some business climate indicators and a further improvement in labour market conditions. Some Council members assessed that despite a slight slowdown, GDP growth was at a level similar to that of the potential output. Few Council members pointed out that growth in domestic demand in 2014 Q4 – despite the negative contribution of inventories to GDP growth – was above the expectations and higher than the growth of the whole GDP. In the opinion of these Council members, the continued high growth of domestic demand contributed to the widening of the current account deficit, the size of which is currently lowered by the fall in commodity prices and the related improvement in the terms of trade. Other Council members assessed, however, that although GDP continued to grow at around 3%, the output gap in Poland remained negative.

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While discussing the prospects for economic growth, some Council members emphasised that in the following quarters economic growth in Poland would gradually pick up. These members argued that a further increase in employment, amidst moderate growth in wages and an improvement in consumer confidence indicators, would be conducive to continued high growth in consumer demand. According to these Council members, investment demand would, in turn, be supported by a further fast growth in investment expenditure of enterprises, and in the second half of 2015 also by an acceleration in infrastructure investment financed from EU funds. Few Council members emphasised that the favourable prospects for corporate investment activity were largely the result of a growing propensity of enterprises to invest driven by falling perceived uncertainty in their environment, increasing capacity utilisation and an improvement in the demand forecasts, alongside favourable financing conditions. Some Council members pointed to the forecasted acceleration in GDP growth in the euro area as an additional source of the economic upturn in Poland.

Other Council members expressed the opinion that even if GDP growth accelerated gradually in the following quarters, it would not lead to a build-up of imbalances in the economy. Few Council members also pointed to the risk of a slowdown in growth at the end of 2015 and at the beginning of 2016. It was noted that the rise in consumer demand would be limited by an increase in the Swiss-franc denominated debt of households. In turn, in the opinion of few Council members, growth in investment outlays of enterprises might be adversely affected by continued uncertainty about demand and their low expected profitability compared to the yields on alternative forms of savings allocation. Against this background, few Council members pointed to the persistence of the low contribution of investment to GDP growth and the small percentage of enterprises planning to start new investments. Some Council members were of the opinion that the main source of risk for acceleration of economic activity in Poland was the possibility of lower than expected GDP growth in the euro area. Few Council members also noted that the possible appreciation of the zloty could adversely affect GDP growth.

While discussing the inflationary processes in Poland, it was pointed out that in January the annual consumer price index had fallen once again and was below the expectations. At the same time, the short-term inflation forecasts had been significantly revised downwards, and the expected period of deflation had been extended. In addition, an acceleration in the decline in producer prices was noted. Some Council members expressed the opinion that the deflation in Poland was mainly driven by external factors, primarily the decline in commodity prices. They noted that the extension of the expected period of deflation was the result of a downward revision of the forecasted paths for energy and food prices. In the opinion of these Council members, the deflation – as it was supply driven – would not have adverse economic effects. On the contrary, it would support GDP growth, by stimulating an increase in the purchasing power of incomes. Few Council members noted that there are currently no signals indicating a risk of deflationary spiral. Few Council members also expressed the opinion that the low price growth – amidst moderate economic growth in Poland's external environment and a fall in commodity prices – was a normal phenomenon, and taking into account the expected persistence of these developments, inflation would most likely remain low also in the long-term.

Some Council members, in turn, were of the opinion that the decline in prices in Poland was not only a result of external factors, but was also due to low demand pressure in the domestic economy. In their opinion, this was indicated by both the further decline in the majority of core inflation measures and the fact that producer prices had been decreasing for almost three years, thus much longer than the fall in commodity prices in the global markets. These Council members also emphasised that against the background of a sustained fall in prices, inflation expectations of households and enterprises remained very low, while the expectations of analysts had recently been significantly revised downwards. Moreover, these Council members were of the opinion that the longer the period of deflation, the higher the risk of its adverse effects for the economy.

Referring to the level of interest rates, some Council members emphasised that although nominal interest rates had been lowered in 2014 Q4, deepening deflation and the strong downward revision of price growth forecasts had led in recent months to an increase in interest rates in real terms, driving them to relatively high levels. They also pointed to the record low yields on long-term bonds, indicating that in the long-term inflation or the equilibrium real rate would be markedly lower than to date. However, other Council members noted that nominal rates were at record lows, and real rates would decline along with forecasted rise in price growth.

While discussing the decision on NBP interest rates, the majority of the members of the Council judged that they should remain unchanged at the current meeting.

Some of the Council members pointed out that GDP growth was currently close to that of the potential output and its acceleration was forecasted in the following quarters. Moreover, these members argued that deflation in Poland was mainly supply driven and – as a consequence – did not have a negative impact on the economy, while the influence of monetary policy on inflation processes was limited. Few Council members were of the opinion that against the background of sustained high growth in domestic demand, a lowering of interest rates could result in a build-up of external imbalances and lead to excessive growth of credit, including housing credit, and expose the borrowers to significant rise in debt servicing costs in case of interest rates increase. Excessive credit growth could also create the risk of real estate bubble. These Council members expressed the opinion that further adjustment of interest rates – while reducing the cost of servicing the public debt only temporarily – could lead to increased instability of public finance in the future. At the same time, in the opinion of these Council members, maintaining nominal interest rates at low levels has an adverse effect on the process of selection of economic agents and thus limits the productivity growth in the economy.

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However, some Council members pointed out that deepening deflation and its longer duration increased the risk of inflation remaining below the target in the medium term and therefore justified interest rate cuts. In addition, they noted that the risk of negative consequences of deflation for the economy rose along with its duration. These members judged that the persistence of a significant interest rate differential between Poland and its external environment, amidst a strong easing of monetary policy by the ECB, increased the risks of an inflow of portfolio capital and excessive strengthening of the zloty exchange rate, which would additionally hinder the return of inflation to its target and could weaken GDP growth. Few members of the Council also emphasised that interest rate cuts – in the absence of inflation risk – would lead to a reduction in public debt servicing costs, and thus support the government's economic policy. Moreover, few members noted that the adjustment of interest rates would make the deleveraging of economic agents easier and could also support the process of currency conversion of housing loans. However, some Council members judged that due to the significant volatility in the financial markets in the recent period, it was justified to leave interest rates unchanged at the current meeting. Yet, these members did not rule out an adjustment of monetary policy in the nearest future, when evaluation of inflation prospects in the medium-term would be possible, taking into account NBP's March projection.

Few Council members assessed that despite a significant volatility in the financial markets, the extension of the period of falling prices and the low likelihood of significant GDP growth in the coming quarters, posing the risk of macroeconomic imbalances, justified the lowering of interest rates already at the current meeting. These members indicated that in view of the above developments, the lack of a decision on easing monetary policy might lead to growing uncertainty in the economy.

At the meeting a motion to cut 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%.

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