Minutes of the Monetary Policy Council decision-making meeting held on 5 February 2020

During the meeting, the Council noted that incoming data from the global economy indicated a stabilisation of economic growth at a relatively low level. Despite a recent improvement in sentiment, economic conditions in some economies remained weakened, while available forecasts pointed to a stabilisation in global GDP growth or its merely marginal pick-up in 2020 as compared to the previous year. At the same time, uncertainty persists about the global economic outlook, related, among others, to the spreading-out of coronavirus, whose impact on economic activity is hard to assess.

In the euro area, economic growth declined in 2019 Q4, amid the ongoing downturn in industry. It was observed that the situation in the industrial sector remained unfavourable, despite some rise in the PMI indicators. This has a negative impact on the outlook for growth in the euro area, and current forecasts suggest that GDP growth in 2020 will be slightly lower in that area than in the previous year. In the United States, economic conditions are still relatively strong compared to other advanced economies. GDP in 2019 Q4 progressed at a pace close to that of the previous quarter, although it continued to be held back by flagging activity in industry. Certain Council members judged that the economic climate in this economy might deteriorate, which, in their opinion, was indicated by the negative yield differential between short- and long-term Treasury securities. In China, GDP growth stabilised in 2019 Q4 at a lower level than in previous years.

In the recent period, global oil prices have fallen sharply, following their prior rise. This was assessed to have been driven by concerns about a decline in demand for this commodity in the subsequent quarters due to the potential adverse effect of the coronavirus on economic activity growth in China. These concerns also brought about a fall in the prices of natural gas and industrial metals. At the same time, the prices of many food commodities have risen in recent months, and the food commodity price index is running high at the moment. The increasingly expensive food and the previous rise in oil prices contributed to higher inflation in the external environment of the Polish economy.

The European Central Bank is keeping the deposit rate below zero, while conducting asset purchases and signalling the maintenance of loose monetary policy in the coming quarters. The US Federal Reserve, after the interest rate cuts of 2019, is keeping the rates unchanged. Moreover, a number of central banks in large emerging market economies have eased their monetary policy.

When analysing the situation in the Polish economy, it was observed that economic conditions remained strong, although economic growth had slowed down. According to preliminary GUS data on GDP in 2019, GDP growth in 2019 Q4 may be estimated to have fallen by more than expected. GDP growth is supported by the rising consumption, which, however, has probably slowed down notwithstanding the strong financial position of households. Some Council members assessed that this could have followed from a slight weakening of household sentiment. Certain Council members expressed the view that slower

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

real consumption growth might also have been driven by higher price growth than at the beginning of 2019.

It was observed that preliminary GDP estimates suggested a possible pick-up in investment growth in 2019 Q4. In this context, some Council members pointed to the uncertainty about the pace of investment growth in 2019 Q4 related to weaker readings of some sectoral data over the past few months.

According to preliminary estimates, export growth also continued in 2019 Q4, albeit probably at a slower pace than in the preceding quarter. It was pointed out that export growth was benefiting from strongly rising exports of services. Growth in external sales of goods, on the other hand, had probably halted. It was judged that this was a sign of the increasing impact of the weakened conditions in the external environment of the Polish economy on external sales and domestic economic activity.

The Council members judged that given the slower than expected implied GDP growth in 2019 Q4, economic growth in 2020 might also prove weaker than previously forecast and slower than the estimated potential output growth. In this context, some Council members drew attention to a recurring decline – following a few months of improvement – in the PMI index and the results of the NBP surveys of enterprises signalling weaker expectations of financial performance of firms and lower forecasts of their investment activity in 2020. They also pointed out that the outlook for economic activity in Poland's immediate environment remained a significant source of risk of slower growth in the domestic economy.

When referring to inflation processes, it was observed that annual CPI inflation stood at 3.4% y/y in December 2019. An increase in price growth was driven, above all, by higher food prices related to the spread of the ASF epidemic, combined with a rise in fuel prices on the back of prior increases in global oil prices. At the same time, the rises in waste disposal charges, insurance premiums and air fares were reflected in higher service price growth. High growth of administered prices was also noted. As a consequence, core inflation also rose, although it runs at moderate level. Some Council members expressed the opinion that faster than in previous years growth in service prices was a natural and expected response of the economy to several quarters of the ongoing expansion in consumer demand and income. At the same time, it was pointed out that the prices of non-food products were still rising slowly, rendering a still moderate total growth in goods and services prices excluding the impact of supply-side and regulatory factors.

The Council members noted that according to current forecasts, inflation would rise in the coming months and might exceed the upper limit of band for deviations from the inflation target. It was observed that the rise in inflation was to be primarily the effect of supply-side and regulatory factors, which were beyond the direct influence of domestic monetary policy. These included the increase in the prices of electricity, further rises of waste disposal charges, increase in excise taxes and rising meat prices resulting from the ASF epidemic spreading out further and the related strongly rising demand from China for European pork. The majority of the Council members pointed out that the rise in inflation would be driven by supply shocks that negatively affect aggregate demand growth. In effect, these Council members judged that the rise in inflation above the upper limit for deviations

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

from the inflation target would only be temporary, and as the impact of those factors faded, and amid the anticipated weakening of economic growth, inflation would subside and return close to the inflation target over the monetary policy horizon.

In turn, certain Council members argued that considering the persistence of some of the factors increasing inflation, price growth might be higher than currently forecast. At the same time, in those Council members' opinion, the scale of economic slowdown would be limited and thus would not weaken demand pressure substantially. Those Council members assessed that in the face of the current heightened inflation there was a risk of mounting wage pressure and the occurrence of second-round effects. As a consequence, although price growth in the second half of 2020 will probably be lower than in the first half of the year, according to these Council members it might continue above the inflation target over the monetary policy horizon. Those Council members also observed that some measures of inflation expectations of households and businesses had risen recently. They judged that the rising inflation expectations of enterprises, amid lower profitability of their operations than in previous years, might increase the propensity of firms to raise prices.

Yet the majority of the Council members noted that households' and enterprises' inflation expectations were adaptive and their rise mainly reflected higher current inflation. It was indicated that given the expected economic slowdown, the propensity and ability of firms to raise prices would be limited. Furthermore, it was observed that financial analysts forecast inflation to decline to around 2.5% next year.

The majority of the Council members pointed out that in the current global economic conditions, real interest rates were at negative levels in many countries, including in all the economies of Central and Eastern Europe, and that their level in Poland was among the highest in the region. At the same time, these Council members noted that although the NBP reference rate in Poland was negative in real terms, the real interest rate on loans to households and corporations was significantly positive. They also emphasised that the average interest rate on new loan agreements for households in Poland was currently one of the highest of all the economies of the European Union. These Council members additionally highlighted the recent marked slowdown in lending growth in the economy. They also underlined that in 2019 the loan-to-GDP ratio had further declined.

However, certain Council members pointed out that – with no NBP interest rate increases – the forecast rise in inflation would cause the NBP reference rate to decline in real terms to a more negative level. Those Council members judged that the negative level of real interest rates, in their opinion, was conducive to rapid lending growth, including in particular lending growth in consumer loans to households. They also expressed the view that the low level of real interest rates was responsible for the high growth in current deposits and also increased demand for other, more risky assets, including real estate.

Taking into account current information and forecasts, the majority of the Council members decided that interest rates should remain unchanged. In their opinion, the outlook for the domestic economy remained favourable, yet GDP growth would be lower than in previous years. At the same time, the Council assessed that uncertainty as to the scale and duration of the economic slowdown abroad and its impact on domestic economic activity

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persisted. The Council observed that according to current forecasts, in the coming months inflation might exceed the upper limit for deviations from the inflation target. At the same time, the factors that would most likely boost CPI inflation in the coming months were mainly of a supply-side and regulatory nature. Therefore they would have only a temporary impact on inflation, while at the same time they would put a drag on economic activity. As a result, along with the expected slowdown in economic growth, inflation would decline and return close to the target over the monetary policy transmission horizon. In the opinion of the majority of the Council members, the current level of interest rates would hence be conducive to keeping the Polish economy on a sustainable growth path and maintaining macroeconomic stability, and would at the same time allow meeting the inflation target in the medium term.

The majority of the Council members also expressed an opinion that, taking into account current information, interest rates were likely to remain stable in the coming quarters. These Council members pointed out that their assessment was supported by current forecasts indicating that inflation would remain in line with the NBP inflation target over the monetary policy horizon amid a more pronounced slowdown in GDP growth than previously forecast. In the opinion of these Council members, considering lags in the monetary policy transmission mechanism, any interest rate increase under the current conditions would not prevent a temporary rise in inflation in 2020, but at the same time could deepen the economic slowdown and cause inflation to fall below the target over the monetary policy horizon.

However, certain Council members judged that over the monetary policy horizon inflation might be higher than indicated by the current forecasts. They pointed out that such a risk was related to the possible persistence of some of the factors currently raising price growth. In the opinion of these Council members, should incoming data and the projection indicate an increase in this risk, it might be justified to raise interest rates in the coming period.

In turn, certain Council members pointed to the increased risk of a sharper and more lasting global economic slowdown, as well as to further signs indicating the transmission of the weak global economic conditions into economic growth in Poland. At the same time, the risk of inflation deviating from the NBP target over the monetary policy transmission horizon was limited. As a result, a view was maintained that it was justified to lower interest rates now and that – in the longer run – it might be justified to consider further cuts in interest rates or the introduction of unconventional monetary policy instruments.

At the meeting, a motion to cut the basic NBP interest rates by 0.25 percentage points was submitted. The motion was rejected. 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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Narodowy Bank Polski ul. Świętokrzyska 11/21 00-919 Warszawa, Poland phone +48 22 185 28 88 sekretariat.rpp@nbp.pl