NBP

National Bank of Poland

Monetary Policy Council

MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 31 MARCH 2010

During its meeting the Monetary Policy Council discussed primarily the outlook for economic growth and inflation in the world and in Poland, zloty exchange rate developments, the situation of the public finance sector and the future monetary policy.

While discussing the situation in the external environment of the Polish economy, a further rise in economic activity in the United States, particularly noticeable in industry, was emphasised. It was assessed that the stabilisation in the unemployment rate combined with an employment decline slower than in the previous period may signal a gradual deceleration of unfavourable tendencies in the labour market. At the same time, it was stressed that February brought a deterioration in US consumer sentiment, which could have been connected with the still high unemployment level and a worsening situation in the real estate market. Some members of the Council argued that a limited scale of lending to the private sector and the bad situation in the real estate market, on the one hand, and the persistently high budget deficit, on the other, constitute risk factors to a permanent recovery of economic growth in the United States.

While analysing the situation in the euro area, it was pointed out that the economic climate there was improving at a markedly slower pace than in the United States, although – similarly to the US economy – the decelerating decline in employment and the stabilisation of the unemployment rate might be signalling that negative tendencies in the labour market were slowing down gradually. It was also argued that in the coming period economic activity in the euro area would be supported by a growing demand from developing economies, particularly Asian ones. Some Council members, however, pointed out that the outlook for euro-area exports may be negatively affected by their geographical structure and a weakening competitiveness of the German economy, connected with the recent rise in unit labour cost in this economy. It was also assessed that the latest monthly data, including a drop in retail sales and a deterioration of some economic climate indicators in January might point to a continuation of weak internal demand in the euro area. In the view of some Council members, the data on GDP for 2009 Q4 and the latest monthly data may indicate that the improvement of activity in this economy was only transitory and, to a large extent, resulted from government stimulus programmes.

In this context it was pointed out that the sustainability of the global economic recovery remained subject to uncertainty. In the opinion of some Council members this uncertainty is connected primarily with tensions in the financial markets caused by financial problems of some euro-area countries, notably Greece, and with macroeconomic policy in the largest European economies and in the United States being gradually less and less expansionary. Other members of the Council believed that this uncertainty mainly results from the build-up of public debt in many countries. While analysing the factors raising the uncertainty as to the outlook for economic growth in the world, some Council members also pointed to the faster growth of retail sales as well as of CPI and PPI inflation in China, which may indicate a growing imbalance in this economy. Those members argued that due to strong trade links between China and the euro area a possible weakening of economic activity in China would have negative effects on economic growth in the euro area and, consequently, also in Poland.

00-919 Warszawa, ulica Świętokrzyska 11/21, phone (22) 826 99 55, fax (22) 826 37 51,
telex 81 46 81 nbp.pl, www.nbp.pl

While addressing the monetary policy of major central banks it was emphasised that they were gradually withdrawing non-standard monetary policy measures. At the same time, it was assessed that due to the still weak economic recovery in the world and low inflationary pressure in major developed economies, interest rate hikes in those economies should not be expected in the coming period. It was also pointed out that the monetary policy in some countries of the region had been further eased in the recent period. On the other hand, some Council members emphasised that in certain developed economies the interest rate hiking cycle had already begun.

While discussing the situation in the Polish economy it was pointed out that in 2009 Q4 the annual growth of domestic demand was still relatively slow and GDP growth was primarily driven by net exports. At the same time, it was assessed that in the light of the latest monthly data the economic recovery primarily concerned industry, i.e. the sector most deeply affected by the economic downturn. It was also pointed out that retail sales data were lower than expected and that the construction and assembly output had fallen strongly in the first months of 2010, though – at the same time – it was assessed that those data could have been distorted by unfavourable weather conditions and in subsequent months some improvement could be expected. Some Council members suggested that the decline in the growth of retail sales may point to a delayed adjustment of the households' demand to the conditions of economic downturn. Moreover, some Council members argued that the fact that lending to the enterprise sector was markedly lower than a year ago could signal slow growth of this sector's investment. Other members of the Council, however, assessed that the rising trend of some consumer sentiment indicators observed in the past few months may be signalling a recovery in consumer demand in the coming period. They also argued that a low growth of loans to enterprises reflected their low demand for credit due to their very good financial results and high liquidity. In the opinion of those Council members, such assessment could be supported by the results of NBP economic climate surveys, according to which in 2009 Q4 the percentage of enterprises applying for loans declined, while the share of approved loan applications increased. Moreover, they assessed that in the coming period the rise in housing loans to households may accelerate once again, which was indicated by commercial banks' forecasts.

While discussing developments in consumer prices of goods and services, a marked decline in annual CPI inflation in February 2010 was pointed to, driven by a fall in annual price indices of fuel, energy commodities and food, and by a decline in core inflation. Some members of the Council emphasised that in the light of available forecasts inflation in the coming months would continue to decline, driven mostly by statistical base effects connected with a strong rise of administered prices in 2009, the appreciation of the zloty observed so far, moderate growth of unit labour costs and the currently low demand pressure. They indicated that the demand pressure was low due to the still unfavourable situation in the labour marked, reflected in a fall in the number of working persons according to the BAEL in 2009 Q4 and in a limited wage increase, and also due to the slow growth of loans to the non-financial sector. Other members of the Council indicated that an inflation decline in the coming period may be curbed by a rise in the prices of energy commodities in the world markets and the prices of natural gas for individual subscribers in the domestic market. In the opinion of some Council members, in the longer run the inflationary pressure would be rising due to the growing demand pressure connected with the economic recovery and the public finance sector imbalance, as well as due to a possible rise in wage pressure in a part of this sector. Some Council members also pointed out that despite the decline, in the recent period inflation had been higher than previously forecasted.

The prospects for Poland's compliance with the Maastricht price stability criterion were also addressed at the meeting. Some Council members stressed that the 12-month average HICP inflation, considered while assessing the compliance with the Maastricht price stability criterion, exceeded significantly the estimated reference value for this criterion. Those members also pointed out that a continuation of the positive differences between the Harmonised Index of Consumer Prices and the Consumer Price Index observed over the past year and a possible future inclusion of the prices of owner-occupied housing services in the HICP could affect the outlook for Poland's meeting of the price stability criterion.

The Council paid much attention to developments of the zloty exchange rate, which had strengthened significantly in the recent period. Some Council members assessed that the pace of zloty appreciation might have been excessive, arguing that since February 2009 the zloty had strengthened more than other currencies of the region. They pointed out that the zloty appreciation increased the restrictiveness of monetary conditions in Poland and might adversely affect the competitiveness of Polish exports decelerating the pace of economic recovery. It was also stressed that a fast appreciation of the exchange rate raised the risk of its increased volatility in the future. Other members of the Council assessed that the movements of the zloty exchange rate and of other currencies of the region were largely influenced by the situation in international financial markets and that the recent strengthening of the zloty was associated with a fall in global risk aversion. They also pointed out that the zloty appreciation was supported by the inflow of foreign capital into the Polish Treasury securities market, which was associated with large borrowing needs of the state budget. Those members argued that due to the higher scale of the earlier zloty depreciation connected with the financial crisis than in the case of other currencies of the region, the exchange rate of the zloty did not exceed the estimated equilibrium exchange rate despite the recently observed appreciation. According to these members of the Council, the current level of the zloty exchange rate did not significantly reduce the competitiveness of Polish exports, which was confirmed – in their view – by NBP studies showing improvement in exporting companies' assessments of their current and expected situation. Moreover, those members pointed out that the competitiveness of exports was positively affected by a decline in unit labour costs in industry. They also assessed that the growth of Polish exports was more dependent on trade growth in countries that are Poland's major trading partners than on the exchange rate level, although at the same time they stressed that the high exchange rate volatility may have an adverse effect on the development in the sector producing internationally tradable goods compared to the non-tradable goods sector.

Council members pointed to the unfavourable situation in the public finance sector, as evidenced by the very high cumulative budget deficit recorded by local government units in 2009 and a central budget deficit reaching a relatively high level relative to the full-year plan in the first two months of 2010. Some Council members assessed that a possible continuation of weak consumer demand would be conducive to reducing VAT revenues and increasing the budget deficit. According to those Council members, in the light of available data the consolidation measures planned by the government may prove insufficient to reduce the public finance sector imbalances in line with the objectives outlined in the *Convergence Programme – 2009 Update*. At the same time, those members emphasised that in case these problems aggravated, an outflow of foreign capital could occur that would be conducive to a weakening of the zloty.

The Council assessed that a moderate inflationary pressure over the monetary policy transmission horizon and uncertainty as to the outlook for economic growth in the world and in Poland, combined with the appreciation of zloty exchange rate so far, justified keeping NBP interest rates unchanged at the current meeting.

While addressing future decisions on the NBP interest rates, some members of the Council declared that in view of a risk of an excessive zloty appreciation leading to a surge in the restrictiveness of monetary conditions, their temporary easing by lowering the NBP interest rates could be considered. Some Council members argued that in the current situation an interest rate cut was unjustified and it could contribute to higher volatility of prices in the financial markets. Moreover, in the assessment of the majority of the Council, a temporary reduction of the NBP interest rates would necessitate a stronger monetary tightening in the longer term.

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: 22 April 2010