NBP

National Bank of Poland

Monetary Policy Council

MINUTES OF THE MONETARY POLICY DECISION MAKING MEETING HELD ON 6 MARCH 2013

At its meeting, the Monetary Policy Council discussed the current and future monetary policy decisions against the background of macroeconomic data and the March projection of inflation and GDP.

While analysing the external conditions, it was pointed out that in 2012 Q4 economic growth in the United States had come to a halt and economic activity in the euro area had remained weak. It was emphasised that GDP in most euro area countries, including its largest economies, i.e. France and Germany being Poland's main trading partner, had declined in that period. At the same time, attention was drawn to signs of some improvement in economic indicators in several euro area countries in the first months of 2013. However, there were doubts expressed whether this already indicated a recovery in these countries. Some Council members expected the recession in the euro area to abate at a slow pace. In this context, attention was drawn to an increase in political uncertainty in Italy, which could dampen the business sentiment in the euro area and in the financial markets.

While analysing the economic developments in Poland, the Council members emphasised that the GDP data on 2012 Q4 had confirmed a pronounced slowdown in the economy in that period. Attention was drawn to continued weakening in domestic demand, which was driven by both further investment decline and decreasing consumer demand. It was indicated that the monthly data, released since the previous meeting, implied that also in early 2013 the economic activity had remained weak. At the same time, it was noted that the monthly data on industrial output and retail sales were somewhat better than had been expected and some economic indicators had improved of late, which might suggest an increase in economic activity in the coming quarters.

The majority of the Council members were of the opinion that an on-going deterioration in labour market conditions and slow household lending growth were containing demand growth in Poland, in particular with respect to consumer demand. Against this backdrop, some Council members pointed to a continued gradual rise in the unemployment rate observed in recent years. This limits wage pressure in the economy and adversely affects consumption growth. However, a few Council members noted that rising unemployment rate in the past few years had been driven to a large extent by growing labour supply rather than falling employment.

While discussing lending developments, an opinion was voiced that credit policy tightening of banks was an important factor behind weaker lending growth. Against this background, a few Council members pointed out that even if standards for household lending were eased, this would not translate into any marked rebound in household lending due to declining household credit demand. It was pointed out that cuts in the NBP interest rates would contribute to faster lending growth. At the same time, a few Council members emphasised that the recent NBP interest rate cuts had translated into greater decreases in interest rates for bank deposits than for bank loans, while household and corporate lending growth remained low despite monetary policy easing, which was due to lower credit demand. A few Council members pointed out that lower interest rates on bank deposits might weaken household propensity to save.

While discussing the outlook for economic growth against the background of the March projection, the majority of the Council members stressed that, according to the projection, even though the

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GDP growth would probably accelerate gradually in the coming quarters, it would remain low. It was also pointed out that in line with the projection, domestic demand growth would continue to be very slow in 2013, with the output gap remaining negative over the projection horizon. This suggests a limited risk of mounting wage pressure in the coming years. Yet, a few Council members were of the opinion that GDP growth might run slightly higher than projected. These members argued specifically that improvement in the economic situation abroad, as assumed in the projection, should translate into faster GDP growth in Poland. In addition, referring to the data on restructuring in the Polish enterprise sector, these members expressed their doubts on the total factor productivity growth assumed in the projection. In their opinion, this growth could be lower compared to the projection, which would result in potential output growing slower and output gap closing faster than in the projection.

While analysing CPI inflation developments, attention was drawn to its decline in January 2013 close to the lower limit for deviations from the NBP inflation target. It was stressed that in line with the March projection – under the assumption of unchanged interest rates –inflation would remain close to the lower limit for deviations from the inflation target over the projection horizon. In the light of the projection, such CPI inflation developments are to result from low energy price growth in the coming years and a decline in core inflation. The expected decrease in core inflation and unit labour costs growth indicate still low demand and cost pressure in the years to come.

In the opinion of some Council members, inflation might run above the projection path. Those members indicated that the global geopolitical situation remained an important upside risk for energy prices. They also argued that – under the assumption of faster growth in energy prices – inflation might run close to the inflation target in the coming quarters, hence above the projection. A few Council members were of the opinion that, given an acceleration in labour productivity growth as shown in the projection, wage growth should not run close to historical lows. As a result, unit labour costs might, in their opinion, grow faster than in the projection, which would contribute to higher inflation. Also faster than projected growth in private consumption might spark faster price growth. Moreover, it was pointed out that another factor increasing CPI inflation compared to projection path was that VAT rate hike could remain in force in the coming years, should the impact of economic downturn on the public finance sector prove to be stronger than currently assumed.

While discussing the NBP interest rates, the majority of the Council members decided that they should be lowered at the March meeting. However, their opinions differed as to the scale of the NBP interest rate cuts. Some members of the Council assessed, though, that the interest rates should be kept unchanged at the current meeting.

The majority of the Council members assessed that – as the March projection assumed inflation to stay markedly below the NBP inflation target and the output gap to remain negative in the coming years – it was justified to continue to lower the NBP interest rates. In this context, these members argued that, even after interest rate cuts, real interest rates would remain markedly positive at levels ensuring that the risk of a build-up of imbalances in the economy would be contained.

The majority of the Council members were of the opinion that the incoming data and the outlook for the economy as shown in the projection justified stronger interest rate cuts than at previous meetings. However, a few Council members reckoned that the scale of the interest rate cuts at the March meeting should not be larger than at the previous meetings. In the opinion of these Council members, concerns of excessive interest rate cuts leading to a further decline in propensity to save in the banking sector, suggest maintaining the previous pace of monetary policy easing.

On the other hand, a few Council members assessed that the current interest rate level was low as compared to previous periods of the economic slowdown, and that further monetary policy easing was unjustified. Therefore, in their opinion, as the risk of inflation running above the projection was high in the medium term, the current interest rate level was appropriate for inflation to return to the target over this period. They assessed that excessive interest rate cuts would undermine the supply side of the economy, including the restructuring intensity in the enterprise sector, and as a result might have an adverse effect on GDP growth in the longer run.

In the opinion of the majority of the Council members, the interest rate cuts both at the current and at the previous meetings, will help to ease monetary conditions and support higher economic growth, and consequently, help to bring inflation close to the target in the medium term. The majority of the Council members recognised that the decision to lower interest rates at the current meeting complemented the interest rate cut cycle.

However, a few Council members did not rule out the possibility of a further interest rate adjustment, should the incoming data point to weaker economic activity or lower inflation than in the March projection.

At the meeting, a motion was submitted to lower the NBP basic interest rates by 0.50 percentage points. The motion passed. A motion was also submitted to lower the NBP basic interest rates by 0.25 percentage points. As the motion to lower the NBP basic interest rates by 0.50 percentage points had passed, this motion was not voted on. The Council decided to lower the NBP basic interest rates by 0.50 percentage points to the following levels: reference rate to 3.25%, lombard rate to 4.75%, deposit rate to 1.75% and rediscount rate to 3.50%.

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