Minutes of the Monetary Policy Council decision-making meeting held on 4 March 2015

Members of the Monetary Policy Council discussed current and future monetary policy decisions against the background of recent macroeconomic developments in Poland and abroad as well as the March projection of GDP and inflation.

While discussing developments in Poland's external environment, the Council members pointed to a recent decline in price volatility for most instruments in the international financial markets. However, some Council members indicated that uncertainty in the financial markets prevailed due to geopolitical situation in Ukraine and the risk of Greek debt restructuring. Also weak economic outlook in the euro area, Japan and in the largest emerging market economies, particularly China, remained a source of uncertainty.

Referring to economic conditions abroad, the Council members drew attention to the stable economic growth in the United States. They noted nonetheless that, despite a slight acceleration, economic growth in the euro area remained low. It was emphasised that lending growth in the euro area was still close to zero. Some Council members noted that GDP growth forecasts for the euro area had been revised upwards. It was mentioned that an acceleration in economic growth in Germany, a fall in oil prices, a reduction in fiscal tightening, a launch of the European Commission's strategic investment plan and an increase in the pace of quantitative easing by the ECB starting from March 2015 could all contribute to higher economic growth in the euro area.

Discussing about the potential efficiency of the ECB's quantitative easing, few Council members pointed out that over the course of similar programmes in the United States and Great Britain the bond yields had been falling. The resultant decline in credit costs and depreciation of the currencies had in turn translated into an increase in economic growth. Few Council members also underlined that the pace of recovery of the US and British economies had been much faster than in economies where monetary policy had been more restrictive at that time, including the euro area. They also noted that in case of the countries of significant interest rates spread to the euro area, the risk of portfolio capital inflows and an appreciation of their currencies had increased due to the ECB's quantitative easing. Few Council members underlined that the additional liquidity from quantitative easing programmes in the United States and Great Britain, had been passed onto the real economy only to a limited extent. Therefore, in their opinion, the programmes had failed to stimulate economic activity. According to these Council members, quantitative easing in the United States had distorted asset prices, and thus resulted in re-emergence of imbalances in this economy. They indicated that despite quantitative easing programmes, the recovery of the US economy, though faster than in the euro area, was still the slowest since the World War II. They pointed out that it was

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

greater flexibility of the US and British economies that contributed to the relatively fast recovery in these countries following the global financial crisis.

With reference to monetary policy in other economies, some Council members pointed out that it had recently been eased in many economies, particularly in Europe. They also noted that the Fed had been indicating that it might not start to tighten its monetary policy soon, as inflation had fallen, there was no wage pressure in the economy and the US dollar had strengthened.

While discussing inflationary developments abroad, it was highlighted that the price growth had fallen in many countries over the recent months, and it was negative in the majority of European Union member states. Few Council members were of the opinion that the fall in oil prices could have come to an end. At the same time, the majority of Council members assessed that oil prices would remain markedly lower than in previous years. Moreover, due to the structural changes in oil supply, the upward pressure on its price will likely remain low. The Council members also noted that prices of many non-energy commodities, particularly agricultural commodities, had continued to fall.

While discussing the business climate in Poland, it was pointed out that GDP growth in 2014 Q4 had decelerated slightly, but remained above 3%. It was highlighted, that GDP growth in 2014 Q4 had been still supported mainly by domestic demand, as consumption growth had been stable while investment growth in spite of a slight deceleration, had been high. However, some Council members stressed that the uncertainty about demand prospects prevailed, particularly in relation to external demand. These members also highlighted that data on the economic activity in January and the indicators of economic conditions in February had been mixed. It was pointed out that industrial production and retail sales growth had slowed down in January. At the same time, in February, indices of sentiment in industry were above expectations and suggested a pick-up in activity and an increase in employment in this sector. Some Council members also noted that the NBP business climate surveys were indicating a favourable outlook for corporate investment, demand and employment. They pointed to sound financial position of the enterprise sector, which had been allowing enterprises to finance their investments with their own funds. In the opinion of few Council members, reliance on own funds in investment financing could lead to some decline in lending to enterprises in early 2015, despite easier corporate lending conditions. In the assessment of some Council members, the fall in oil prices in the previous months could have improved the financial position of enterprises. In addition, they pointed out that the fall in oil prices had supported real disposable personal income and private consumption, in addition to further improvement in the labour market conditions, including continued growth in employment. Few Council members indicated that the improvement in the outlook for household finances also had been translating into ongoing recovery in the housing market in Poland and, consequently, an increase in activity in the housing construction sector. Few Council members assessed, however, that domestic demand

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

growth caused by an improvement in terms of trade related to the fall in oil prices might lead to greater external imbalances if oil prices increase.

Discussing the economic growth outlook in the context of the March projection, it was noted that in line with the projection GDP growth was to remain stable in the following quarters, increasing slightly, while in the whole projection horizon it should run between 3 and 4%. Stable GDP growth should result – in light of the projection – from stable increase in consumption and investment growth staying high, despite some weakening in 2016. In the opinion of few Council members, investment growth could, however, be lower than the central projection path due to weak industrial production growth in recent months and uncertainty about the economic outlook abroad. The lower than expected investment growth could, in turn, translate into weaker than currently expected GDP growth in the coming quarters or even further economic slowdown. However, other Council members stressed that the March GDP projection was slightly higher than the November projection. They assessed that investment growth could be faster than the central projection path due to more efficient absorption of EU funds than assumed in the projection.

Discussing inflationary developments in Poland, it was highlighted that in January annual growth in consumer prices had fallen again. Some Council members expressed an opinion that deflation in Poland was mainly driven by external factors, including, above all, the fall in commodity prices. Therefore, deflation will not have negative economic consequences, but rather will support GDP growth, as it will improve the purchasing power of households and financial position of enterprises. At the same time, some Council members were of the opinion that low price growth in Poland resulted not only from external factors, but also from subdued domestic demand pressure, as indicated by a negative level of most core inflation measures, an extended period of a fall in producer prices and a negative GDP deflator in 2014 Q4.

Discussing the outlook for inflation, it was stressed that according to the March projection, under an assumption of constant interest rates, CPI inflation – despite steady increase in the following quarters – would not return to the target over the projection horizon. Similarly, core inflation, net of food and energy prices, was forecasted to run below the inflation target at the end of the projection horizon. In addition, some Council members pointed out that the output gap would most likely remain negative over the projection horizon. The Council members also noted that the March projection indicated no wage pressure, as labour productivity was expected to increase faster than wages. However, few Council members indicated that falling prices in the global commodity markets could temporarily mask the wage pressure, as they increased real wage growth and disposable household income. In their opinion, a steady increase in the relation of job vacancies to the number of the unemployed shows that nominal wages may accelerate when the impact of falling oil prices fades out.

Referring to the level of interest rates in Poland, some Council members emphasised that deepening deflation and further downward revisions of price growth had resulted

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

in an increase in real interest rates. Few of them pointed out that the high level of real interest rates could contain investment projects in the real economy due to a lower rate of return compared to capital investments. Other Council members emphasised that in connection with the real convergence of the Polish economy with the euro area, the level of interest rate consistent with the macroeconomic equilibrium in Poland had most likely declined over the recent years.

However, few Council members indicated that the level of real interest rates in the economy was consistent with the current pace of economic growth and macroeconomic equilibrium, helping to prevent external imbalances and excessive credit growth, or might be even too low for current conditions. In the assessment of few Council members, the level of real and nominal interest rates could be too low also according to the March projection of GDP and inflation, which indicates that the current account deficit should grow under an assumption of constant interest rates. Moreover, these members stressed that nominal rates in Poland were at historical lows, also compared to the advanced economies before the global financial crisis. They also emphasised that the real interest rates would decline as the price growth resumes to increase in accordance with the projection.

Discussing the decision on NBP interest rates, the majority of the Council members judged that they should be lowered at the current meeting. They pointed out that since the previous meeting, volatility in the financial markets, including the currency markets, had diminished. They underlined that the results of the March projections of inflation and GDP confirmed the assessment that the level of interest rates was too high to support a return of inflation to the target in the following years. They pointed out that in the light of the March projection, assuming that interest rates remained unchanged, inflation would not return to the target, while the output gap would remain negative over the projection horizon. They also pointed to the growth in interest rate spread in relation to Poland’s immediate environment, which could be conducive to an increase in foreign capital inflows and an appreciation of the zloty. This would amplify deflation and delay the return of inflation to the target. Few Council members underlined that the interest rate cut would also reduce costs of public debt service, thus supporting the government’s economic policy.

While discussing the scale of interest rate reduction and their desired level in the current cycle, the majority of Council members judged that interest rates should be adjusted on a single occasion so that the scale of the reduction would be significant and enough to contain the uncertainty about future monetary policy. These members were also of the opinion that a significant one-off reduction in interest rates should come along with an announcement that this decision concluded the monetary policy easing cycle. The majority of Council members judged that such an announcement would not prevent an adjustment in interest rates in an event of unexpected strong shocks in the Polish economy or its environment.

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

In turn, some Council members were of the opinion that interest rates should remain unchanged. These members argued that deflation in Poland resulted mainly from supply factors and, consequently, did not impair the economy, while monetary policy currently had a limited impact on inflationary processes. They pointed out that according to the March projection, a reduction in interest rates in the first half of 2015, in line with the market expectations, would not result in such an increase in inflation that would be sufficient to ensure its return to the target. At the same time, according to the March projection, a reduction in interest rates could widen external imbalances. In addition, in the opinion of Council members who were in favour of keeping the monetary policy parameters unchanged, a reduction in interest rates could lead to an increase in financing of unprofitable investments. In such an event, a relatively high percentage of non-performing loans in Poland could lead to a deterioration in the financial situation of the banking sector.

At the meeting a motion to cut NBP interest rates by 0.50 percentage points was submitted. The motion passed. A motion was also submitted to reduce NBP interest rates by 0.25 percentage points. This motion was not voted on due to the adoption of the motion to reduce NBP interest rates by 0.50 percentage points. The Council decided to reduce the key NBP interest rates by 0.50 percentage points to the following levels: the NBP reference rate to 1.50%, the lombard rate to 2.50%, the deposit rate to 0.50%, the rediscount rate to 1.75%.

Publication date: 19 March 2015

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