Minutes of the Monetary Policy Council decision-making meeting held on 11 March 2016

At the meeting, the Council members discussed monetary policy against the background of macroeconomic developments in Poland and abroad as well as the results of the March projection of inflation and GDP.

When discussing economic activity abroad, the Council members recognized that global economic activity remained moderate and that the uncertainty about its outlook had recently increased. It was noted that in the major advanced economies, i.e. in the United States and the euro area, consumer expenditure growth remained stable, as labour market conditions continued to improve. It was pointed out, however, that GDP growth in both economies was constrained by low investment growth and a slowdown in exports. It was underlined that slower export growth, particularly in the case of the euro area, resulted from weaker conditions in the major emerging market economies, particularly China. It was added that conditions in global industry were very volatile and deteriorating. Exports had weakened also in Germany, and – in association with this – conditions in German industry had ebbed. This might be conducive to lower growth in Polish exports and industrial production, as Polish and German industries cooperate closely within global supply chains. At the same time, it was stressed that in spite of weaker exports, German economy continued to recover, supported by ongoing domestic demand growth, partly stimulated by increased public expenditures.

The Council members judged that the uncertainty about the global economic outlook had particularly increased in recent months. This uncertainty results from the risk of a stronger deterioration in economic conditions in China and other emerging market economies, as well as the extent to which this weakening would translate into activity in the advanced economies. In this context, it was pointed out that many international institutions had revised their forecasts for global economic growth downwards. Certain Council members expressed the opinion that these revisions could be associated with the downtrend in financial asset prices in the advanced and emerging market economies which had been observed for several months.

The Council members stressed that energy and agricultural commodity prices – in spite of their recent rebound – were still low, which is the main reason for low consumer and producer price growth worldwide. Certain Council members pointed to factors which could contribute to lower commodity prices over the longer run. It was noted i.a. that gas prices might decline further, as several producers of this commodity suggested an increase in its exports. Some Council members, in turn, drew attention to geopolitical tensions, arguing that their increase could lead to higher prices of commodities, particularly of crude oil.

It was highlighted that the uncertainty about the global economy was affecting financial market sentiment, which in recent months had been reflected by capital outflows from many emerging market economies and the resultant fall in financial asset prices in these

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countries as well as the depreciation of their currencies. Attention was drawn to the significant depreciation of the zloty, the fall in share prices on the Polish stock exchange and the outflow of capital from the government bond market. This notwithstanding, the Council members underlined that investor sentiment had improved in recent weeks, which resulted i.a. in an appreciation of the zloty.

It was pointed out that the likelihood of the major central banks maintaining their expansionary monetary policy for longer than previously expected had increased over recent months. It was noted that the ECB had again expanded its monetary policy, in particular by lowering the deposit rate to a more negative level and significantly increasing the scale of its monthly asset purchases. It was also outlined that in the United States, in spite of an increase in interest rates in December 2015, the uncertainty about the direction of the Fed's monetary policy had risen of late.

The Council members pointed to likely consequences of further monetary easing by the ECB on the Polish economy. It was highlighted that it might be conducive to a decline in Polish government bond yields and an appreciation of the zloty. However, as certain members pointed out, the zloty was broadly stable over the course of the ECB's asset purchase programme. Some Council members expressed the opinion that the reduction in the ECB deposit rate to a more negative level might create a risk of higher foreign capital inflow to the Polish banking sector, although the extent of the risks associated with this is hard to assess for the time being.

While analysing the current domestic economic conditions, it was highlighted that – in spite of the rise in external risks – stable economic growth in Poland continued and in 2015 Q4 GDP growth had even accelerated slightly. It was also stressed that domestic demand continued to be the key driver of GDP growth. It was highlighted that investment expenditure had accelerated in 2015 Q4, which had been accompanied by stable growth in consumption. Consumer expenditures are supported by improving labour market conditions, reflected particularly in rising employment and a fall in the unemployment rate, which had reached the lowest level since 2008. Moreover, as certain Council members underlined, consumer demand growth was also supported by an improvement in consumer sentiment. Investment demand, in turn, is propped up by sound financial standing of enterprises and the capacity utilization above the long-run average. It was also outlined that Polish exports continued to grow and sentiment in Polish industry remained positive, even though German exports and industrial conditions had weakened of late. It was also pointed out that moderate loan growth also contributed to stable domestic demand growth. Certain Council members noted in addition that surveys of the Polish enterprise sector did not point to limited access to external financing as a major hurdle for corporate investment.

Discussing the economic outlook for Poland, it was highlighted that in line with the March GDP projection, GDP growth should remain stable in the coming years. It was noted that consumer demand growth was forecasted to accelerate, propped up by rising employment and an increase in wage growth, as well as a boost to government transfers to households resulting from the introduction of the "Family 500+" programme. Certain

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Council members expressed the opinion that higher consumer demand growth could translate also into an acceleration in investment. Rising investment, in turn, should increase the productive capacity of the Polish economy, which could alleviate inflationary pressure that might appear in the medium term due to an increase in consumer demand growth. These members also outlined that an acceleration in domestic demand might lead to wider current account deficit and greater external imbalances, particularly given moderate growth in economic activity abroad.

Reviewing price developments in Poland, attention was drawn to still negative price growth, which – similarly to other countries – was mainly due to the fall in commodity prices in recent quarters. Low inflation in Poland's major trading partners is another factor behind lower consumer price growth. It was highlighted that consumer price growth in the Polish economy was also lowered by a lack of wage pressure, which persists in spite of a notable improvement in the labour market. In this context, some Council members noted that unit labour cost growth had been slow for some time. In addition, certain Council members expressed the opinion that embargo imposed by Russia on Polish food products had been conducive to lower food prices in Poland. These members also pointed to an ongoing fall in apparel prices, which – in their opinion – might be further exacerbated by softer demand of foreign consumers caused by i.a. recession in Russia and Ukraine as well as a sharp depreciation of their currencies.

During the discussion on the results of the March inflation projection, it was highlighted that, according to this projection, price growth should turn positive in 2016 Q4 and return to the tolerance band within two years. At the same time, it was noted that core inflation was projected to gradually increase, supported by an acceleration in domestic demand, an expected rise in wage growth as well as higher consumer expenditure of households resulting from the introduction of the "Family 500+" programme. Certain Council members underlined in addition that the negative impact of the fall in commodity prices should be fading out, which would be conducive to higher CPI inflation later in the projection horizon. According to some Council members, an acceleration in price growth, stemming from faster growth in consumer demand and good labour market conditions, might prove faster than forecasted in the projection.

Discussing the effects of negative price growth in Poland, some Council members emphasized that no negative developments associated with deflation had been observed so far. In particular, households and enterprises do not hold off their consumption and investment expenditures. Certain members outlined that the risk of a prolonged period of deflation in Poland was low due to very good labour market conditions, which result in stable nominal price growth. Other Council members assessed in turn that the risk that economic agents will start to postpone their expenditures increases as the period of negative price growth extends. Therefore, the Council members decided that the impact of low price growth on the behaviour of economic agents in Poland should be monitored further.

Referring to the interest rates in the context of direct inflation targeting, the Council decided that they should remain unchanged at the current meeting. The Council members

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indicated that the currently observed low price growth was mainly due to factors beyond the influence of domestic monetary policy. However, in the coming quarters, CPI growth would be supported by a steady increase in domestic economic activity. This assessment is backed by the results of the March projection of inflation and GDP.

The Council members confirmed their assessment that – given the available data and forecasts – the current level of interest rates helped to keep the Polish economy on a sustainable growth path and to maintain macroeconomic stability. The Council members stressed that the elevated uncertainty regarding external conditions, more notably persisting risks to global economic activity and volatile financial market sentiment, also spoke in favour of a stabilization of the interest rates. Other important monetary policy determinant was the uncertainty about the outlook for fiscal policy beyond 2016. The Council members also judged that decisions on the interest rates should take into account their potential impact on the stability of the domestic financial sector.

The majority of the Council members expressed the opinion that under these conditions keeping interest rates at the current level ensured room for monetary policy easing in the event of negative shocks, which would result in a deterioration in economic conditions and lower price growth. Certain Council members did not rule out a necessity for lowering the interest rates should indications of negative developments associated with deflationary processes occur, even though they assessed their probability as low.

Certain Council members indicated in turn that in the coming quarters it might be justified to consider the circumstances under which the monetary policy stance could be re-examined. This could be justified if inflationary pressure appeared as a result of favourable labour market conditions and expected acceleration in consumer demand.

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%, the rediscount rate at 1.75%.

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