Minutes of the Monetary Policy Council decision-making meeting held on 8 March 2017

Members of the Monetary Policy Council discussed monetary policy against the background of macroeconomic developments in Poland and abroad and the results of the March projection of inflation and GDP.

The Council reviewed the developments abroad which affect economic conditions in Poland. It was assessed that global economic growth remained moderate, with signs of economic recovery strengthening in many economies. It was emphasised that the euro area economic growth was stable, yet in 2016 Q4 it had been slower than previously estimated. Attention was also drawn to very good sentiment in the European industry. However, a decline in export orders in Germany was also cited. It was indicated that the available forecasts suggested a deceleration of economic growth in the euro area in 2017. In addition, the Council members mentioned a likely increase in uncertainty associated with upcoming elections in several euro area member states.

While discussing economic activity in the environment of the Polish economy, it was noted that in the United States economic conditions were favourable, supported by a rise in investment as well as labour market improvement in the last few years. It was stressed that in line with the available forecasts, economic growth in the United States should accelerate in 2017. At the same time, a deterioration in residential real estate market conditions was not excluded given higher mortgage interest rates. As to emerging market economies, a recent stabilisation in economic conditions in China was cited. It was also mentioned that Russia had recovered from recession.

While discussing price developments abroad, it was emphasised that commodity price growth had recently come to a halt. It was stressed that oil prices had been stable for several months. As certain Council members assessed, the stabilisation in oil prices resulted from higher investment in shale oil extraction industry in the United States on the one hand and production cuts in many oil net exporters on the other. It was therefore highlighted that even though inflation in the environment of the Polish economy had increased again in February, reaching inflation targets in many countries, its pace had been weaker than a month earlier. In addition, it was stressed that in many economies, including the euro area, demand pressure stayed weak, and core inflation was still low as a result.

Some Council members assessed that oil prices were unlikely to follow an upward trend in the coming quarters, thus limiting the rise in global inflation. However, certain Council members were of the opinion that the signs of global economic recovery observed in recent quarters could translate into higher demand pressure in many economies, resulting in a rise in inflation. In the opinion of certain Council members, a likely rise in wage growth associated with upcoming elections in some euro area member states was posing an additional upside risk to inflation in this economy.

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Referring to monetary policy abroad, it was pointed out that the Federal Reserve had indicated a further rise in interest rates in 2017. It was pointed out that the probability of a hike in fed funds rate in March had increased of late. At the same time, it was assessed that tighter monetary policy in the United States had been translating into higher government bond yields in many countries, including in Poland. Yet, it was underlined that the rise in yields had been contained by ongoing quantitative easing and negative interest rates in the euro area.

While discussing the developments in Poland's real economy, it was emphasised that GDP growth in 2016 Q4 had been slightly higher than a quarter earlier. It was indicated that economic growth had been mainly driven by increasing consumer demand, supported by improving labour market, very good consumer sentiment as well as child and social benefit payments. It was underlined that in 2016 Q4 a fall in investment had narrowed due to higher absorption of EU funds. Certain Council members mentioned in addition an ongoing expansion in housing investment.

Council members stressed that recent economic data had been indicating further recovery. Attention was drawn to an acceleration in industrial output and retail sales growth in January 2017. It was highlighted that construction and assembly output had posted a growth in annual terms in January for the first time in over a year. It was emphasised, however, that sentiment in manufacturing had weakened somewhat in February 2017. In addition, it was noted that better data readings in January had resulted to some extent from statistical effects. Some Council members also drew attention to a slowdown in corporate lending over recent months, suggesting that this might indicate still weak investment demand. In this context, certain Council members pointed to spare capacity in the economy.

While discussing the labour market conditions, attention was drawn to accelerating employment and wage growth in the enterprise sector in January 2017. At the same time, it was indicated that data for the entire economy was suggesting rather weak rise in the number of working persons and a slower increase in wages in 2016 Q4, translating into slower growth in unit labour costs.

Regarding the Poland's macroeconomic outlook, it was emphasised that – according to the March GDP projection – economic growth in 2017 should pick up markedly, supported by a significant rise in investment amid higher inflow of EU funds, as well as ongoing robust consumption growth. Certain Council members indicated that a substantial acceleration in gross fixed capital formation in 2017 would result mostly from a stronger rise in infrastructural investment, with only a moderate increase in corporate investment. These Council members were of the opinion that such composition of the increase in gross fixed capital formation might be less supportive of economic growth over the medium term. Other Council members assessed, however, that corporate investment growth might be aided by lower legal uncertainty.

It was indicated that NBP's GDP projection for 2017 was higher than external forecasts. Yet, it was stressed that GDP growth, having picked up considerably in 2017, might weaken slightly in the coming years and should not exceed potential output growth to a large extent. Some Council members pointed to downside risks to economic activity in the coming years, i.a. a likely negative impact of higher commodity prices on household consumption growth.

While analysing price developments in Poland, it was highlighted that annual consumer price growth had picked up considerably over recent months. It was stressed that price growth had resulted mainly from higher global commodity prices translating into a rise in energy prices, as well as from increase in agricultural commodity prices reflected in higher food price growth. It was emphasised that core inflation was still low, indicating ongoing weak demand pressure. It was pointed out that wage pressure was also limited, which was reflected in still moderate unit labour costs.

The Council members underlined that – in line with the March inflation projection – following a considerable increase in the first months of the year, inflation would stabilise at a moderate level in the following quarters. Certain Council members judged that in the coming quarters inflation might be higher than envisaged in the March projection. On the one hand, these Council members did not exclude stronger demand pressure, and on the other hand, they pointed to upside risks to wage growth related to a possible decline in labour force participation after the reduction of the statutory retirement age in Poland. They also drew attention to stronger cost pressure in recent months, reflected in rising PPI, which may translate into higher consumer price growth. Other Council members indicated, however, that as the effects of higher global commodity prices dissipated, cost pressure should be fading out. Moreover, some Council members assessed that domestic inflationary pressure would grow only gradually, as economic growth was to run close to potential product growth in the coming years and there was still spare capacity in the economy. In addition, certain Council members expressed an opinion that wage pressure in the Polish economy would probably stay subdued due to weak bargaining position of Polish employees.

While discussing NBP's monetary policy, the Council decided that the interest rates should be left unchanged at the current meeting. In the opinion of the Council, given the current data and forecasts, including the March inflation projection, the risk of inflation running persistently above the target in the medium term was limited. At the same time, the decline in the real interest rates, related to higher inflation, would support the acceleration of economic growth in 2017. The Council confirmed its assessment that the stabilisation of the nominal interest rates helped to keep the Polish economy on a sustainable growth path and maintain macroeconomic balance.

The majority of the Council members judged that in light of available information stabilisation of the NBP interest rates was likely also in the following quarters. Yet, certain Council members were of the opinion that should incoming data and forecasts suggest stronger inflationary pressure than assumed in the March projection, it might be justified to consider an increase in the NBP interest rates. According to certain Council members, the interest rate decisions ought to reflect the impact of real interest rates on

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asset prices and savings in Poland. However, other Council members emphasised that the level of the real interest rates was not the main factor determining the savings rate and asset prices in the Polish economy. Moreover, certain Council members stressed that the interest rate increases might adversely affect corporate investment growth. Certain Council members underlined that in the coming months the analysis of the robustness and scale of the recovery and the resulting price developments should factor in the impact of the negative real interest rates on macroeconomic developments and asset prices. Other Council members pointed out that a more comprehensive assessment of the monetary policy outlook would be possible after the following projections of inflation and GDP.

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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