MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 29 APRIL 2009

During the meeting the Monetary Policy Council discussed the outlook for inflation in the context of the past, current and, primarily, anticipated economic situation.

The discussion at the meeting focused on the outlook for economic growth in Poland and abroad, situation and outlook for public finance, inflation developments in Poland, zloty exchange rate developments and credit market situation.

While discussing the domestic economic growth, it was noted that the decline in exports, industrial output and retail sales in the first months of 2009 confirm a considerable slowdown in the economic activity in Poland. Yet, some members of the Council pointed out that better than expected macroeconomic data and a slight improvement in some business climate indicators in March 2009 might be a sign of a low-level stabilization of the activity in the Polish economy. Other members argued that a minor decline in industrial output and higher than expected rise in wages in March 2009 might be linked to a different than in 2008 holiday calendar, and some business climate indicators continue to indicate a further deterioration in the activity in the enterprise sector and a decline in demand in the Polish economy.

While addressing the outlook for domestic economic growth it was pointed out that due to a considerable – albeit not so high as in the majority of other countries of Central and Eastern Europe – openness of the economy, the global economic situation and related changes in demand for Polish exports are the factor of uncertainty to the economic situation in Poland. In this context, attention was paid to the deepening recession in the euro area and activity in the United States continuing at low level as well as to further downward revision of growth forecast for the global economy. The forecasts of considerable decline in GDP in 2009 in the German economy and in non-EU economies being Poland's major trading partners were indicated. However, at the same time, attention was also paid to a slight improvement in the situation in global financial markets and some signs suggesting that an intensification of unfavourable developments in the global economy had been halted.

Some members of the Council pointed out that improvement in exports might, in the later part of the year, constitute a factor driving recovery of the Polish economy which would, however, depend on zloty exchange rate developments. Other members of the Council assessed that changes in foreign demand might be of higher importance for the outlook for Polish exports than zloty exchange rate developments.

While analyzing the exchange rate developments, it was pointed out that the previously observed depreciation of the zloty had been halted. Yet, at the same time it was indicated that developments in exchange rates of currencies of emerging economies, including the zloty exchange rate, currently depended largely on changes in risk aversion in the international financial markets. Moreover, some members of the Council emphasized that postponement of the zloty joining the ERM II might be conducive to its depreciation. They also pointed out that worse than previously expected situation of the public finance sector might be another factor increasing the risk of zloty depreciation.

While discussing the situation in the public finance sector it was pointed out that the sector's deficit in 2008 was considerably higher than the one assumed by the government in the December 2008 Convergence Program. In this context, reference was made to the factors which contributed to considerably higher than anticipated deficit level. Some members of the Council emphasized that amidst the strong slowdown of economic activity it was likely that the budget deficit would exceed the level assumed for 2009 or budget expenditures would be cut. Some Council members also pointed out that possible implementation of additional anti-crisis measures might contribute to a rise in the budget deficit in the coming years. It was indicated that uncertainty about the fiscal situation, both of the central government and other entities of the public finance sector, hindered the assessment of its impact on the outlook for inflation in Poland.

While addressing the prospects of compliance with the Maastricht fiscal criterion it was assessed that as a result of strong deterioration in the economic situation in Poland, the deficit of the public finance sector in relation to GDP might increase considerably in the years 2009 and 2010. In this context, it was pointed out that fulfillment of the Maastricht fiscal criterion in the coming years might be impeded.

While discussing the current inflation developments, it was indicated that a rise in consumer price index in March 2009 up to 3.6% i.e. above the upper limit for deviations from the NBP inflation target set at the level of 3.5% had mostly been driven by a rise in food prices. It was also pointed out that the growth in regulated prices, including, in particular, rises in the prices of energy and prices related with maintenance of dwellings continued to be the factor boosting inflation. It was stressed that a rise in inflation had been driven by the previously observed zloty exchange rate depreciation and that exchange rate developments continued to be the main risk factor for price stability. Some members of the Council assessed, at the same time, that – taking into account the zloty appreciation observed since the middle of February 2009 – the impact of the previously observed depreciation of the zloty exchange rate on inflation may be rather short-lived. Other members of the Council argued that higher than expected rise in inflation in March 2009 indicated that even amidst strong economic slowdown, exchange rate depreciation translates significantly into a rise in consumer prices in Poland.

While addressing the outlook for inflation in Poland, some members of the Council assessed that in the medium term inflation should decline to the inflation target which was also suggested by the February inflation projection and short-term forecasts prepared by the NBP. This might be favoured by declining domestic demand and falling labour demand translating into a gradual fall in wage pressure and by the commodity prices continuing at relatively low levels. Those members also argued that a fall in inflationary expectations of households should contribute to a decline in inflation. Other members of the Council pointed, however, to the risk of inflation persisting at an increased level in the case of shocks affecting food and energy commodity markets. Moreover, some members of the Council indicated that considerable worsening in the situation of the public finance sector might urge the government to increase budget income through rises of indirect taxes, including excise tax, and local governments – to increase the prices of services depending on their decisions, which would, in turn, contribute to higher inflation.

The Council also discussed the prospects of Poland's compliance with the Maastricht price stability criterion. Some Council members indicated that amidst inflation in some EU countries falling to very low levels the reference value for price stability criterion in 2010 might run considerably below the 12-month moving average HICP inflation in Poland. In the opinion of those members fast disinflation in Poland that would enable to fulfill again the Maastricht criterion might then require considerable tightening of the monetary policy. At the same time, some members of the Council pointed out that the developments of HIPC inflation in Poland against the reference value for price stability criterion in the coming years would largely depend upon changes in regulated prices.

While discussing the credit market situation, some members of the Council pointed out that banks in Poland currently focused their lending activity on consumer loan market. Interest rates on consumer loans slightly increased despite NBP interest rate cuts implemented since November 2008. Moreover, they argued that excessive rise in households' burden resulting from servicing consumer loans might – through rising value of irregular loans – lead to deterioration in banks' capital adequacy ratios and, in consequence, result in limiting future lending. Other members of the Council pointed out, however, that the rise in the value of consumer loans was lower than last year, and the share of consumer loans in the total loans was relatively small.

Members of the Council also discussed strong reduction in corporate lending in 2009 Q1. It was pointed out that banks' tightening of their lending conditions, partly connected with persisting uncertainty about future economic developments hindering the assessment of the credit risk, constituted the factor limiting corporate lending. Some members of the Council assessed that in order to intensify corporate lending further modifications of the monetary policy instruments might be necessary.

At the meeting, the Council also addressed the possibility of Poland obtaining the IMF flexible credit line. It was emphasized that the flexible credit line is aimed at countries with strong economic fundamentals which used to pursue a responsible macroeconomic policy in the past and which are likely to continue such a policy in the future. It was pointed out that Poland's access to the IMF funds might favour the exchange rate stabilization and indirectly facilitate obtaining the funds to finance the budget deficit and public debt in foreign markets as well as to reduce debt service costs. The Council analysed also the impact of Poland's access to the flexible credit line on the outlook for inflation in Poland.

The meeting also focused on dilemmas connected with the interest rate policy in the longer term. It was pointed out that recovery in the global economy would require considerable tightening of macroeconomic policy in many countries, which might be difficult both due to the scale of the implemented anti-crisis instruments and uncertainty about the sustainability of such economic recovery. In this context, some members of the Council pointed out that lowering the NBP interest rates currently to excessively low levels might later on require a relatively faster and stronger tightening of the monetary policy in order to stabilize inflation at the level of the inflation target. Moreover, it was pointed out that excessive interest rate cuts might – in the situation of further deterioration of the economic climate or economic stagnation – limit the possibility of lowering interest rates in the future in order to support economic growth in Poland.

Some members of the Council indicated that the real *ex post* interest rate (deflated with current headline inflation) in Poland was lower than in the euro area. Besides, it was pointed out that – according to the short-term forecasts prepared at the NBP – in April 2009 inflation might exceed the current level of the NBP reference rate, and, as a result, the real interest rate would be negative. Yet, it was also indicated that amidst the unfavourable economic climate and persisting uncertainty about future economic developments, a fall in real interest rates to the negative levels might have a limited impact on households' propensity to save. In this context, attention was paid to considerable decline in the monetary policy restrictiveness, which was driven – apart from interest rate cuts – also by the previously observed significant weakening of the zloty exchange rate.

Members of the Council agreed that uncertainty about the outlook for economic recovery in Poland and abroad, the situation in the public finance sector and zloty exchange rate developments and their impact on inflation justified keeping the NBP interest rates unchanged at the current meeting. Moreover, some members of the Council indicated that also very low level of real interest rates spoke in favour of leaving the NBP interest rates unchanged. The majority of the Council members maintained the opinion that the probability of inflation running below the inflation target in the medium term was higher than the probability of inflation running above the target.

The Council kept the interest rates unchanged: the reference rate at 3.75%, the lombard rate at 5.25%, the deposit rate at 2.25% and the rediscount rate at 4.00%.

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