NBP

National Bank of Poland

Monetary Policy Council

MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 4 APRIL 2012

At its meeting, the Monetary Policy Council discussed the current and future monetary policy decisions against the background of the external and domestic macroeconomic developments, including inflationary processes.

While analysing the external conditions of macroeconomic developments in Poland, some Council members pointed out that GDP growth abroad was likely to remain weak in the coming quarters. In particular, it was emphasised that should there be no substantial improvement in the US labour market, the revival in the United States may slow down, especially amidst the announced fiscal tightening in this economy. Attention was also drawn to the fact that economic activity in the euro area was significantly weaker than in the United States, albeit considerable differences could be seen across countries. Few Council members argued that notwithstanding the slow economic growth in the euro area, the German economy– the main recipient of Polish exports – was in a relatively good condition.

Council members indicated that in many countries inflation persisted at a high level. This largely resulted from rising global prices of energy commodities, which were partly driven by unconventional monetary policy measures undertaken by the major central banks. Some Council members indicated at this juncture that increasing commodity prices would continue to drive up inflation also in the medium term. Increasing commodity prices will be supported by both – rising demand, especially on the part of the major emerging economies, and by expanding production of biofuels.

While discussing the outlook for domestic economic growth in the current year, some Council members assessed that the economic slowdown in Poland was likely to be smaller than previously expected, which might be indicated by strong data incoming over the first few months of 2012. These Council members underlined, in particular, that private consumption would most probably remain to be a factor supporting economic growth in the nearest quarters; yet amidst temporarily slow real income growth, consumption would be financed, to a greater degree, by decrease in savings rate. Few Council members argued at that point that the observed lower propensity to save might be the effect of heightened inflation eroding the real value of savings. In the opinion of some members of the Council, the expected economic slowdown will also be mitigated by a further inflow of EU funds supporting investment growth.

However, few Council members stressed that consumption growth had been gradually decreasing since mid-2011 and it could not be ruled out that its contribution to GDP growth would continue to shrink in the subsequent quarters. Moreover, these members of the Council argued that since firms' propensity to invest highly depends on business conditions abroad, amidst the expected slow global growth, the contribution of private investment to GDP growth might also decrease in the coming quarters. Thus, in the opinion of those Council members, the weakening in economic growth in Poland might turn out significant.

Some Council members argued however that even if economic slowdown in the nearest quarters turned out significant, 2013 might be expected to bring gradual acceleration of GDP growth. In the opinion of those Council members, growth would be supported by rising private sector demand.

Acceleration of consumption in 2013 will be driven by the expected fall in inflation, which will boost real disposable income growth, whereas acceleration of investment will be supported by the anticipated improvement in economic conditions abroad. Improved external conditions should also be conducive to exports expansion in 2013. Moreover, the extent of further fiscal tightening in Poland is likely to be smaller than in 2012, thus its dampening impact on the 2013 domestic demand growth will be limited.

While discussing inflationary developments, Council members stressed the fact that – like in other countries – heightened inflation had been largely driven by external factors, including rising global prices of energy commodities, which translated into higher prices of energy, and in particular into higher prices of fuels. February saw also a rise in domestic prices of tobacco products, following an increase in excise tax, which also increased core inflation rate.

Council members pointed out that over the next few months, elevated inflation would continue to be driven, above all, by fast-growing prices of energy and food. Moreover, in the opinion of few members of the Council, due to European Football Championship, restaurant and hotel prices could be expected to increase in some Polish cities in June 2012; these prices might not fall back to their previous levels immediately after Euro 2012. According to few Council members, an additional risk to inflation in the short term is the likely rise in prices of services and fees that are at the discretion of local government units.

As regards the impact of the exchange rate on inflation, few Council members assessed that the likely appreciation of the equilibrium exchange rate would limit the anti-inflationary influence of the exchange rate appreciation at the beginning of 2012 on domestic prices. At the same time, these Council members pointed out that exchange rate fluctuations were closely connected to shifts in risk aversion in the global financial markets that are hard to predict. In this context, attention was drawn to the persisting uncertainty concerning the situation in the financial markets, especially in Europe.

The Council members emphasised that inflation was now expected to remain above the target levels for longer than previously anticipated, which, according to most members of the Council, increased the risk of inflation persisting at an elevated level and provided grounds for considering monetary policy tightening. Most Council members pointed that – as elevated inflation was largely driven by factors beyond the direct influence of the domestic monetary policy - the increase in the NBP interest rates should primarily prevent persisting heightened inflation expectations, mounting wage pressures and emerging of second-round effects. However, few Council members argued that amid continued elevated unemployment, still moderate wage growth and further fiscal tightening constraining public sector wage growth, the risk of second-round effects was limited.

Referring to the level of interest rates, some Council members emphasised that, notwithstanding the monetary policy tightening of 2011, interest rates were currently at moderate levels, what is reflected – in their opinion – in a relatively fast growth of monetary aggregates. In the opinion of these members of the Council, moderate level of interest rates in Poland was further evidenced by the comparison of inflation deviation from the target and the estimated output gaps in Poland and other countries. However, other Council members assessed that amidst strongly expansionary monetary policies of the world's major central banks, monetary policy easing by central banks in developing countries and persisting uncertainty about the economic outlook abroad, the monetary policy conducted by the NBP was not overly accommodative. Moreover, few Council members also stressed that the transmission of the monetary policy tightening in the first half of 2011 was so far not full. In the opinion of few Council members the impact of the 2011 interest rates increases on economic activity seemed rather small.

Some Council members pointed out that restricted availability of foreign currency loans to households had strengthened the impact of NBP interest rates increases on credit growth, and thus on private demand.

With regard to the decision on the NBP interest rates, the majority of Council members found that – given a likely persistence of factors fuelling inflation that are beyond the direct influence of domestic monetary policy – the limited scale of expected economic slowdown might not decrease inflationary pressure to a degree sufficient for inflation returning to the target in the medium term. The risk of inflation running above the target in the medium term is additionally increased by elevated inflation expectations. In view of the above, the Council members deemed it appropriate to consider monetary policy tightening in the near future. In the opinion of some Council members, the tightening should take place as soon as possible; hence, in their opinion, it was justified to increase interest rates at the current meeting. However, most Council members argued that a possible increase in interest rates should be preceded by a more thorough assessment of the state of the economy and the scale of the expected economic slowdown. This assessment will be feasible after the data on the subsequent months of 2012 has been analysed, since the January and February 2012 data might have been distorted by one-off factors. Therefore they decided that the NBP interest rates should be kept unchanged at the current meeting. Nevertheless, monetary tightening might prove justified in the nearest future, unless signs of considerable economic weakening in Poland appear and the outlook for inflation returning to the target improves.

In the opinion of few Council members, should weakening in the domestic economic growth in the subsequent quarters prove considerable due to low activity abroad, monetary policy tightening might not be necessary.

A motion to raise the NBP interest rates by 25 basis points was put forward at the meeting. The motion did not pass. The Council decided to keep the NBP interest rates unchanged: reference rate at 4.50%, lombard rate at 6.00%, deposit rate at 3.00%, rediscount rate at 4.75%.

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