MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 30 SEPTEMBER 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 abroad and in Poland, the medium-term inflation outlook, fiscal policy and the situation in the banking sector.

The Council paid considerable attention to the external conditions affecting the Polish economy. It was emphasised that the data on the United States, including the growth in industrial output and retail sales, improved situation in the real estate market and a further rise in economic sentiment indicators signal recovery in the US economy. While addressing the situation in the euro area, it was pointed out that despite some improvement in economic sentiment indicators, data on the real economy indicated that recovery in the euro area would likely materialise with a certain time lag with respect to the US economy.

Some members of the Council argued that rising unemployment in the United States and in the euro area remained a risk factor to the sustainability of the recovery in the world economy. In this context, attention was drawn to the unfavourable outlook for recovery in private consumption amid deteriorating situation in the labour market in those economies and the expected fading out of fiscal stimulus packages at the end of 2010 as well as the possibility of central banks moving to the so-called exit strategy from expansionary monetary policy. Other members of the Council pointed out that additional factors having a negative bearing on the outlook for consumption in the United States included rising household savings and the private sector’s limited access to mortgage loans due to the considerable decline in real estate prices in the US that triggered the crisis in the banking sector. In turn, while discussing the situation in the euro area, those members emphasised that rising imports of investment goods to China might have largely contributed to the easing of recessionary tendencies in the euro area in 2009 Q2. In the opinion of those Council members, a possible weakening of external demand following the fading out of the stimulus package in the Chinese economy was a source of risk to the sustainability of the recovery in the euro area.

While addressing the outlook for global economic growth, some members of the Council pointed out that although private consumption in the United States and in the euro area might prove weak, the rise in demand in major emerging economies, undergoing the process of real convergence and recording significantly higher GDP growth than developed countries, would translate into a sustainable recovery in the external environment of the Polish economy. Those Council members also argued that the recovery in economic activity both in the United States and the euro area would be accompanied by a gradual rise in labour productivity which might be expected in view of the fact that the crisis affecting both economies had stemmed from problems in the financial sector rather than from real economy developments. In the opinion of those Council members, GDP growth of the major economies was likely to return to their potential growth level relatively fast.

While discussing the outlook for inflation in the world economy, some members of the Council emphasised that the difficult situation in the labour market affecting major developed economies and a relatively low demand pressure, combined with the weakening of the upward trend in oil prices in August 2009, would be curbing inflation in the coming quarters.

While discussing the situation in the Polish economy, it was pointed out that data on GDP in 2009 Q2 proved slightly better than expected. At the same time it was emphasised that GDP growth mainly resulted from the positive contribution of net exports due to a smaller decline of exports than imports, amid a fall in domestic demand following from further consumption deceleration and lower investment and inventories. While addressing the data for August 2009, it was stressed, on the one hand, that the growth of industrial output and retail sales had fallen short of expectations and, on the other hand, that economic sentiment indicators had further improved.

Some Council members pointed out that the growth of exports was still negative, while the expected slight recovery in euro-area activity would probably fail to immediately translate into a significant rise in the external demand for Polish products. It was argued that a possible further appreciation of zloty exchange rate, through worsening the price competitiveness of domestic goods, might be conducive to weakening the positive contribution of net exports to GDP growth in the coming quarters. Those Council members also pointed to the persistent unfavourable situation in the labour market as a factor contributing to lower consumption and, consequently, weaker economic activity. In the opinion of those members, considering the still unfavourable outlook for private investment growth and the risk of public investment cuts in the face of public finance sector deterioration, there persisted considerable uncertainty as to the perspectives of economic growth in the Polish economy.

Other Council members, however, argued that the expected recovery in the world economy would be a factor supporting domestic GDP growth. Moreover, in the opinion of those members, the scale of labour market deterioration would not be as strong as previously anticipated, in particular due to the fact that the employment decline should be curbed by lower real wages. They assessed – as a result – that the impact of the unfavourable labour market situation on consumption would be rather limited.

While analysing inflation developments, it was pointed out that the slight inflation increase in August 2009 was primarily due to a weaker seasonal drop in food prices amid an unchanged level of core inflation net of food and energy prices. Some Council members argued that in line with the majority of available forecasts, in the next few months inflation may temporarily remain at a heightened level, yet in 2010 inflation could be expected to fall even below the inflation target. A significant drop in inflation in 2010 would be driven – in the opinion of those members – by the delayed effects of labour market deterioration resulting both in reduced consumption demand of households and slower growth of costs in enterprises. The same Council members indicated that the inflation decrease would also be supported by the recent exchange rate appreciation and the stabilisation of commodity prices in the world markets.

Other Council members emphasised that a gradual recovery of economic growth should translate into higher demand, while the negative output gap might close up earlier than anticipated. Moreover, the heightened level of inflation, including the continuing growth in the prices of services, did not confirm – in the opinion of those Council members – a significant easing of demand pressure, which could be expected considering the strong weakening of GDP growth. While addressing forecasts, those members argued that inflation in 2009 Q2 and Q3 proved markedly higher than expected in the June projection. In the opinion of those members of the Council it could also be expected that the forecast inflation decrease below the target in 2010 may prove short-lived. Those members argued that in line with the current short-term forecasts the expected inflation decrease in 2010 to a large extent was to result from a strong deceleration of food price growth, which is rather unlikely considering the average price growth in this group of goods over the past few years. Moreover, while discussing the outlook for inflation, the Council pointed to the risk of an increase of regulated prices and indirect taxes in 2010 which, on the one hand, directly translate into a rise of the general price level and, on the other hand, bring about a reduction in the purchasing power of households and an easing of the demand pressure curbing inflation.

During the discussion on the public finance sector, some Council members pointed out that the rise of the deficit and public debt in relation to GDP resulted, to a large extent, from a strong slowdown in economic growth. It was argued that other EU countries also experienced a significant increase in public finance imbalances whose scale was even greater than in Poland. Other Council members, however, emphasised that of importance to foreign investors would be the comparison of the ratios of the deficit and public debt to GDP in countries of Central and Eastern Europe, including Poland, to the respective ratios in emerging countries characterised by lower fiscal imbalances. In this context it was argued that the deteriorating fiscal stance could be contributing to a weakening of the zloty exchange rate.

While addressing the planned increase of the public finance imbalance in 2010, some discussants pointed out that a strong rise in the deficit of the public finance sector could justify monetary policy tightening. At the same time, those members pointed out that even though a rise in public spending amid low economic activity supports GDP growth, the dominant effect triggered by a recovery could be the so-called crowding out effect where private sector demand is crowded out by public expenditure. Other Council members argued that the anticipated increase in the deficit of the public finance sector would primarily be the effect of automatic stabilisers rather than anticyclical measures introduced in the fiscal policy, which did not restrict the possibility of maintaining an accommodative monetary policy.

At the meeting, the Council also discussed issues related to the banking sector. Some Council members argued that the tightening of banks' credit policy towards the corporate sector was very strong, which could lead to a considerable reduction of economic growth. In this context the Council had a discussion on improving the access to bank loans for the corporate sector by introducing new monetary policy instruments by the central bank, similarly as it is done by the world's major central banks. In the opinion of some Council members, introducing new instruments, i.e. bill discount credit and the central bank's purchase of bonds issued by commercial banks, would allow banks to increase their lending. Those members argued that the launching of new instruments could make it easier for enterprises to obtain both short-term loans, which would limit the risk of enterprises experiencing liquidity shortage, and long-term loans, which would limit the scale of investment reductions. In the opinion of those Council members, the way of implementation and the character of new instruments reduced the risk of excessive interference of the central bank in banks' credit risk management system.

Other members of the Council, however, emphasised that the reduction in bank lending was a typical phenomenon accompanying economic slowdown and resulted not only from the rationing of credit supply and the increased cost of credit but also from diminished demand for credit on the part of enterprises. During the discussion it was also pointed out that the scale of lending reduction in Poland was smaller than in other countries of Central and Eastern Europe. While addressing the measures implemented by other central banks, those Council members argued that Poland was in a better economic situation as compared to countries, which were introducing unconventional monetary policy measures. At the same time, those members emphasised that introducing the proposed instruments could in fact contribute to widening the financing gap of banks (i.e. the difference between the collected deposits and granted loans). Those members also argued that easier access to central bank funds might demotivate banks to properly assess their credit risk. Moreover, in the opinion of those Council members, the central bank should not increase the capital base of banks by issuing money, and investments in the economy should be financed primarily from savings. In the opinion of those Council members, introducing new instruments would pose the risk of excessive money creation in the economy.

While considering the decision on the interest rates, the Council assessed that the information on economic developments released since the last MPC meeting justified keeping the rates unchanged at the current meeting. Some members of the Council believed that available data – including higher than expected GDP growth in 2009 Q2 and inflation remaining above the target and above the June projection – as well as further improvement in the outlook for economic activity justified the assessment that the probabilities of inflation running above and below the inflation target in the medium term were roughly equal. Other Council members argued, however, that the uncertainty about the scale and durability of economic recovery abroad and in Poland was still high and a more comprehensive assessment of the macroeconomic situation would be possible once the Council got acquainted with the October projection of inflation and GDP. At the meeting, the prevailing view was 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. At the same time, the majority of the Council members assessed that the probability of inflation running below the inflation target in the medium term had decreased in recent months.

The Council kept the interest rates unchanged: the reference rate at 3.50%, the lombard rate at 5.00%, the deposit rate at 2.00% and the rediscount rate at 3.75%.

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