MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 29 SEPTEMBER 2010

During its meeting the Monetary Policy Council discussed issues related to economic growth and inflation, situation in the labour market and in the public finance sector, changes in monetary and credit aggregates and developments in the zloty exchange rate.

While considering external conditions the Council members pointed to the continuation of moderate economic activity abroad. It was emphasised that after strong GDP growth observed in the euro area in 2010 Q2, the pace of recovery in this economy would most probably decelerate slightly. It was indicated that the recent period saw a deterioration in the outlook for GDP growth in the United States, even though it was assessed that the risk of a double dip in the US economy was rather low. Some members of the Council pointed out that economic growth abroad was to a large extent associated with stimulus packages and that the persisting uncertainty as to the sustainability of the recovery was urging central banks in the largest developed economies to continue with expansionary monetary policy. Other Council members emphasised that the weakening of GDP growth in developed economies was consistent with the expected lower potential output growth in those economies following the financial crisis. They pointed out that this weakening was also driven by a deep fiscal imbalance and the ensuing uncertainty as to the outcome of economic decisions. Those Council members also claimed that the effects of expansionary monetary policy, including the effects of unconventional measures undertaken and envisaged by the major central banks, are another important uncertainty factor for global economic growth and inflation.

While discussing the outlook for economic activity in Poland, some Council members assessed that both the available forecasts and the incoming data, including data on GDP in 2010 Q2 and on industrial output and retail sales in 2010 Q3, suggested that GDP continued on an upward trend. Those members assessed that the economic growth expected in the coming quarters, even though low in relation to the period before the global financial crisis, will be relatively strong as compared to the potential output growth that was lowered – in their opinion – due to the crisis. Other Council members argued that GDP in Poland had been positively affected by stimulation packages introduced in other countries that are currently expiring and they assessed that economic growth would remain moderate. At the same time, these Council members pointed to the worsening business tendency indicators.

While addressing the outlook for consumption growth, some deterioration in consumer sentiment indicators over the recent period was emphasised. Some members of the Council argued that this was to a large extent connected with the worsening assessment of the overall economic situation in the country and, to a lesser degree, with the worsening assessment of the financial standing of households, which meant – in the opinion of those Council members – that the deterioration of consumers' sentiment did not unequivocally signal a gloomy outlook for consumption growth. They pointed to the positive impact of the improving situation in the labour market on the future consumption growth. Other Council members stressed that the good data on consumption in Q2 and retail sales in Q3 might have resulted from a transitory rise in demand connected with the replacement of durable goods in the areas affected by floods, increased car purchasing due to the abolition of VAT discounts on the purchase of cars with goods vehicle approval certificates which is scheduled for the end of 2010 and the transfer of some expenses related to the VAT rate increase to be introduced at the beginning of 2011.

The Council paid considerable attention to the prospects of investment growth. It was argued that the level of production capacity utilisation had once again increased in 2010 Q3, which in combination with the very good financial results of enterprises in the first half of 2010 should support the revival of investment activity. In turn, the persisting uncertainty about future demand is likely to deter enterprises from expanding their production capacity, even though – according to some Council members – the relative importance of this factor will be rather decreasing in relation to the effect of rising production capacity utilisation and the very good financial situation of enterprises. At the same time, those members emphasised that the rapidly growing revenue from exports could be conducive to boosting investment of exporters. The possibility of such a revival is supported by NBP analyses which suggest that in Q2 the negative investment growth had been halted in this group of companies. Other Council members emphasised that GUS data on investment activity of enterprises had not confirmed so far any investment recovery.

While referring to the labour market situation, it was pointed out that the number of the employed in the economy increased in 2010 Q2 and employment in the enterprise sector continued to rise gradually in Q3. On this occasion, some Council members emphasised that, due to the limited scale of redundancies in 2008-2009, the number of the employed in the economy was close to the level recorded in the period before the economic slowdown. At the same time, the average monthly employment increases in the enterprise sector range at a relatively high level, lower only to that in 2007. Some Council members pointed out that rising employment was accompanied by increases in the number of the economically active, which weakened tensions in the labour market and the rise of wage pressure. Other Council members, however, argued that a further increase in labour supply was likely to be constrained by demographic factors which decelerated the growth of working-age population. Some Council members pointed out that an additional factor that could adversely affect the supply of labour in Poland was the abolition of restrictions on Polish citizens in accessing the labour market in Germany and Austria starting from May 2011.

Some Council members argued that the current wage increase was not large, and that the NBP economic climate survey showed that the percentage of enterprises planning to raise wages remained moderate, which might be indicative of wage discipline being maintained in the enterprise sector. Other Council members stressed that the percentage of employees who, according to declarations of companies, were to be covered by pay rises in Q4 approached its long-term average. Those members assessed that the dampening effect of low growth of unit labour costs on inflation may begin to wane, as evidenced by the first – since 2008 Q2 – acceleration in unit labour cost growth in the economy in 2010 Q2. Moreover – according to those Council members – raising the minimum wage in 2011 might be a factor increasing the wage pressure.

While discussing inflation developments, it was stressed that both the annual CPI and core inflation remained at low levels, even though a rise in the CPI close to the target could be expected as early as in September 2010. It was pointed out that inflation would be raised by strong increases in the prices of agricultural commodities in the world observed in recent months. At the same time, however, some Council members argued that the growth of food prices in Poland was lower than previously anticipated, considering both domestic (negative impact of floods on crops) and external factors (high growth of world food prices). On this occasion, some Council members claimed that, due to the size of the domestic agricultural market, also in the future the transmission of price increases in the world markets on the prices in Poland may be limited. Other Council members pointed out that, due to the links between agricultural markets at an international level, the growth of domestic food prices might be expected to accelerate in the coming period, bringing about higher inflation than it had been previously assessed. Some members also indicated a strong increase in the annual growth of producer prices in industry, which may signal an acceleration of cost pressure.

While analysing changes in inflation expectations, it was pointed out that in the case of households the expectations had fallen in September, yet some Council members emphasized that they continued to run above the current inflation. It was also stressed that the forecasts of financial sector analysts had stabilized above the NBP inflation target. At the same time, some Council members pointed out that the stabilisation of inflation forecasts of bank analysts was accompanied by rise in their expectations of NBP interest rate hikes. In this context, those Council members argued that the lack of monetary policy tightening might pose a risk of an upward revision of these forecasts. In their opinion, another factor that could be conducive to raising analysts' forecasts and inflation expectations (especially those of enterprises) was the continuing recovery in economic activity and the associated rise of cost pressure as well as diminishing of demand barriers.

While discussing the situation in the public finance sector, some Council members pointed out that some of the measures announced in the budget draft for 2011 were one-off, which meant that they would not contribute to any permanent deceleration in the rate of public debt accrual. Other members emphasised that although the fiscal imbalance in Poland was large, it did not differ significantly from the average in EU countries. According to those Council members, the relatively favourable assessment of Poland's economic situation and the reduction of new issues of Treasury securities by some countries characterised with currently largest fiscal imbalance might be helpful in sustaining high demand for Polish Treasury securities. This should facilitate the financing of the public finance deficit, unless investor sentiment deteriorated strongly and capital flows in global financial markets reversed. While addressing the impact of fiscal policy on inflation, some Council members argued that the announced wage freeze in the public sector, the abolition of certain tax reliefs and exemptions, and rises in VAT rates, once effective, would reduce the demand pressure in 2011 to some extent.

While analysing the developments of monetary and credit aggregates, some Council members pointed out that M3 growth was still moderate, similarly to the growth of lending to the private sector, which resulted, on the one hand, from stable growth in lending to households and, on the other hand, from the lack of revival in lending to the corporate sector. Other Council members stressed that August 2010 brought further acceleration of M3 growth, and the growth of housing loans was significantly faster than the growth of disposable income of households. Some members of the Council pointed out that despite NBP interest rates being maintained unchanged the interest charged on loans to households decreased. Moreover, some Council members argued that since May 2010 the value of loans to enterprises (after adjusting for exchange rate fluctuations) had been gradually increasing, and that the slow growth of these loans resulted primarily from enterprises' limited demand for credit. A limited growth in corporate demand for credit is indicated by NBP survey results, where the percentage of enterprises applying for loans remains low, with a clear increase in the share of loan applications approved by banks.

While referring to the zloty exchange rate, some Council members argued that the recently observed appreciation of the zloty would be conducive to curbing inflation. The Council also discussed factors that could affect the zloty exchange rate in the future, including the equilibrium exchange rate, the role of interest rate disparity, the risk of changes in investor attitude to emerging economies and surplus liquidity in global financial markets. In particular, some Council members pointed out that under expansionary monetary policy continuously pursued by central banks in major developed economies a possible NBP interest rate hike could be conducive to an excessively rapid zloty appreciation. Other Council members, however, argued that the impact of the interest rate disparity on the zloty exchange rate might be offset by other factors affecting the exchange rate, including the situation of the public finance sector in Poland and abroad, and high uncertainty persisting in global financial markets.

While considering the decision on interest rates, some members of the Council argued that GDP growth in 2010 Q2 and the possibility of its acceleration in subsequent quarters under the likely reduced potential output growth, combined with further improvement in the labour market situation, could – in the absence of an NBP interest rate hike – contribute to a rise in inflationary pressure in the monetary policy transmission horizon. Similarly to the Council meeting held in August, those members also emphasised that the current level of interest rates was adequate for the situation of turmoil in global financial markets and the ensuing severe slowdown observed in the Polish economy. In the opinion of those Council members, a hike in interest rates, despite the expansionary monetary policy pursued by major central banks in the world, would mean adjusting the rates to the change of the conditions. According to those Council members, such an adjustment of interest rates would also limit the risk of a rise in inflation expectations.

Other members of the Council argued that the moderate rate of economic growth and the accompanying limited wage and inflationary pressures, along with the risk of weakening global economic growth in the subsequent quarters, justified keeping the NBP interest rates unchanged. Moreover – they argued – an NBP interest rate hike, amidst major central banks maintaining the expansionary monetary policy, could increase the risk of an overly rapid zloty exchange rate appreciation.

A motion to raise the NBP interest rates by 50 basis points was put forward at the meeting. The motion did not pass. 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%, the rediscount rate at 3.75% and the discount rate at 4.00%.

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