MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 5 SEPTEMBER 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 conditions, especially including inflation developments.

While analysing external conditions for economic activity in Poland, Council members pointed out that the global activity remained low. In this context, it was indicated that economic growth in the United States was moderate and conditions in the euro area had weakened significantly, with continued recession and adverse outlook for this economic region. At the same time, it was pointed out that – despite the on-going recession in many euro area countries – the German economy, Poland's key trading partner, continued to grow, albeit at a slower pace. Economic slowdown in major emerging economies, which were hitherto relatively resilient to deteriorating economic growth outlook in advanced economies, was also emphasised.

With regard to the situation in the global markets, Council members pointed to a sharp rise in energy and agricultural commodity prices, caused by disruptions on the supply side, and a further improvement in investor sentiment resulting from expectations for further monetary policy easing by the major central banks.

Referring to the situation in Poland, Council members emphasised that recent data on economic activity, including GDP, as well as economic conditions indicators, pointed to a sharper deceleration in domestic economic growth this year than was assumed in the July projection and anticipated by external forecasters. Addressing the national accounts data for 2012 Q2, it was highlighted that economic slowdown was mainly attributable to a decline in domestic demand. Demand contraction was driven by both slower consumption growth as well as a sharp deceleration in investment spending growth in private sector and a decrease in general government investments. It was emphasised that the positive contribution of net exports to economic growth resulted from a fall in imports – on the back of a decrease in domestic demand – rather than a rise in exports.

While discussing current conditions indicators, few Council members pointed out that retail sales growth in July was faster than in 2012 Q2 on average. Yet, other Council members highlighted that the monthly retail sales indicators, based solely on data from larger companies, i.e. with more than 9 employees, are not a good indicator for total household consumption expenditure. It was pointed out that also industrial production rose faster in July than in 2012 Q2 on average. However, at the same time construction and assembly production declined and downward trend in most leading indicators continued. Attention was also drawn to increasingly sluggish growth in lending, including investment loans, a rise in the number of entities lacking creditworthiness as well as deteriorating financial performance of companies, including falling revenues and deteriorating liquidity indicators.

With reference to economic growth outlook in the subsequent quarters, some Council members emphasised that the structure of GDP growth in 2012 Q2 pointed to a possible further slowdown ahead. Downward revisions of external forecasts for economic growth also point to a higher probability of slower GDP growth next year. In the opinion of few Council members, there is a risk that economic growth in Poland in the second half of 2012 and 2013 may be substantially lower than forecast in the July projection and by the external forecasters. Yet, few Council members assessed that the observed slowdown may be only temporary and its scale will depend, to a large extent, on the situation in the external environment, which according to most forecasts will improve in 2013.

In the opinion of Council members, economic growth will be particularly dampened by further weakening in domestic demand, which was the key driver of economic growth over recent years. Weaker domestic demand will probably result not only from a reduction in investment but also from a slowdown in private consumption growth. Investment will be reduced in the public sector amidst the fiscal tightening in place and – most likely – in the private sector due to weaker corporate expectations of future economic conditions. Consumption growth may be affected by lower disposable income growth triggered by deteriorating labour market conditions. In this context, it was pointed out that in 2012 Q2 and in July the unemployment rate was higher than a year before, and employment growth continued to slow down. With further reference to consumption outlook, it was observed that private consumption may also be adversely affected by deteriorating consumer confidence, decelerating household lending as well as the saving rate running close to zero. Few Council members pointed to an unfavourable phenomenon of a decrease in household deposits growth in the banking sector.

While discussing inflation developments and short term inflation outlook, few Council members pointed out that – following a temporary rise in June – the CPI inflation in July had decreased more steeply than had been expected. Council members highlighted that the annual CPI may decline further in the coming months, in part due to a statistical base effect. At the same time, limited wage pressure reflected in moderate wage growth will drag on inflation. In the opinion of some Council members, towards the end of 2012, CPI inflation will run below the upper limit for deviations from the target. Yet, few Council members pointed out that despite a decrease expected by the end of 2012, inflation would probably remain elevated, while the pace at which the inflation would decrease in 2013 remained uncertain.

In the opinion of some Council members, the increase in food commodity and oil prices observed over the past few months may pose an upside risk to inflation. At the same time, it was highlighted that the future levels of the zloty exchange rate and consequently its impact on inflation developments were highly uncertain. Few Council members pointed to a reduction in lending by foreign parent banks from their Polish subsidiaries.

With regard to inflation trends in longer run, some Council members pointed out that the inflation could return to the target sooner than had been previously expected, which may be supported by deeper than envisaged economic slowdown. In the opinion of few Council members, despite a recent oil price increase, the annual CPI may be reduced in 2013, owing to a statistical base effect relating to a relatively high level of fuel prices in the first half of 2012. In the opinion of some Council members, in the first half of 2013, inflation will be probably close to the NBP inflation target (2.5%). Yet, other Council members pointed to substantial uncertainty regarding the magnitude of the impact of the economic slowdown on inflation, as well as the fact that despite the downward revision of the economic growth forecasts many external forecasts continue to expect inflation to stay above 2.5% in 2013.

While considering monetary policy decisions, the majority of Council members judged that the NBP interest rates should be kept unchanged at the current meeting. In their opinion, this decision was justified by the uncertainty about the scale and duration of the economic slowdown, which would determine inflation developments over the monetary policy horizon. It was also highlighted that there was a risk of inflation persisting at heightened level in the subsequent months, which would be attributable to the observed rise in commodity prices in the global markets.

At the same time, most Council members concluded that the information received since the previous meeting, i.e. about the deteriorating growth outlook in the euro area and sharper than expected deceleration in Polish GDP growth in 2012 Q2, had changed the view on the economic conditions, including the assessment of whether inflation would be above or below the target over the medium term.

In the opinion of few Council members, data received since the previous meeting do not indicate that the NBP interest rates should be increased. However, they do not warrant their reduction either, as the real interest rate is tailored to the expectations of inflation returning to the target and expected moderate economic growth. However, in the opinion of some Council members, the risk of a deeper and longer than expected economic slowdown, along with the prospect of inflation returning to the target in 2013, may provide an argument in favour of lower interest rates in the subsequent months.

Few Council members, in turn, were of the opinion that amidst the probably further substantial weakening business conditions and the resulting risk of inflation dropping below the target within the monetary policy horizon, and given a limited room for fiscal policy easing and persisting uncertainty about the situation in the euro area, monetary policy easing was justified already at the current meeting.

As a result, the Council decided to consider a monetary policy adjustment, should the incoming data confirm a further slowdown and the risk for inflationary pressure mounting remain limited. The assessment of whether any interest rate adjustment was justified should take into account the data incoming in the coming period, as well as – in the opinion of some Council members – the results of the November NBP projection.

A motion to decrease the basic NBP interest rates by 0.50 percentage point was submitted at the meeting. The motion was rejected. A motion was also submitted to decrease the basic NBP interest rates by 0.25 percentage point. The motion was rejected. The Council left the basic interest rates unchanged at the following levels: reference rate at 4.75%, lombard rate at 6.25%, deposit rate at 3.25%, rediscount rate at 5.00%.

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