Minutes from the Monetary Policy Council Decision Making Meeting held on 4 September 2013

At its meeting, members of the Monetary Policy Council discussed the current and future monetary policy decisions in the context of macroeconomic developments in Poland and abroad.

While referring to economic conditions abroad, Council members drew attention, on the one hand, to a gradual economic recovery in the United States and in the euro area, and, on the other hand, to a certain weakening of economic activity in the major emerging markets. At the same time, according to a few Council members, looking ahead, global economic growth might be supported in particular by recovery in the developed economies, as without institutional reforms, a number of emerging economies would not be able to grow at the rate observed so far. Yet, other Council members argued that GDP growth in such countries as China would be driven by low – comparing to productivity – labour cost for still a long time to come.

With reference to the United States it was emphasized that GDP growth had accelerated in that economy in 2013 Q2, as well as that the incoming monthly data for Q3 pointed to a further improvement in business sentiments and declining unemployment rate, which should support the recovery also in the second half of the year. It was emphasized that forecasts indicated a further slight increase in GDP growth in the American economy in 2014. Some Council members believed, however, that the anticipated phasing out of the Federal Reserve from the quantitative easing programmes might put the US recovery into question as the increase in interest on mortgage loans might curb the real estate market revival.

While discussing economic climate in the euro area it was emphasized that whereas GDP growth in that economy remained negative in annual terms, it grew in quarterly terms in 2013 Q2. It was pointed out that economic growth accelerated in particular in Germany – Poland's main trading partner – and the decline in GDP continued to slow down both in Italy and in Spain. Attention was also paid to the continuous improvement in business climate indicators in the euro area in Q3 signaling further recovery in the euro area economy. A few Council members also emphasized the decreasing external imbalances in some euro area countries as to a factor having a positive effect on the economic prospects of that economy. Some Council members assessed, however, that the subsequent quarters would most likely see a gradual recovery and GDP growth in the euro area would be markedly lower than in the United States. Those Council members viewed the persistently high debt in both public and private sector, low competitiveness of the economy, high unemployment rate and restrictive lending policies of commercial banks as inhibitors of economic growth in some euro area countries. Moreover, a few Council members assessed that the incomplete restructuring of the banking sector posed additional risk to recovery in some euro area countries.

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Some Council members pointed out that the recent hikes in global oil prices might contribute to higher inflation worldwide. Meanwhile, other members of the Council emphasized that recently observed hikes in oil prices reflected political tensions stemming form the civil war in Syria, whereas a slowdown in global demand growth, primarily attributed to lower growth in activity in major emerging economies, had a dampening effect on oil prices. In effect – as argued by those Council members – oil price hikes might prove to be a temporary phenomenon. At the same time, a few Council members pointed out that hikes in commodity prices might be supported by a certain recovery in the advanced economies.

While assessing the global economic situation, Council members also pointed to the fact that the Federal Reserve had announced its intention to limit the scale of quantitative easing. As a result, in the recent months the capital had fled from the emerging economies and most of their currencies had suffered a marked depreciation. It was assessed that the Federal Reserve's withdrawal would most likely remain the source of tensions in the global financial market also in the quarters to come.

While examining the impact of tensions in the global financial markets on the Polish economy, the Council members noted a significant growth in yields on Polish bonds, following their previous considerable decline, as well as change in the share of non-residents holdings. At the same time, a few Council members assessed that there was persistently high – in their opinion – risk of global economic shocks, likely to cause fluctuations in yields on Polish bonds. In that context it was also indicated that most of the government's borrowing requirements for 2013 had already been met. This moderates the impact of higher secondary market bond yields on debt servicing costs. Some Council members also declared that the increase in yields in the secondary market did not have to translate, in its entirety, into a rise in yields in the primary market.

At the same time, it was stressed that mounting tensions in the global financial markets had not contributed to a considerable – as compared to the exchange rates of other currencies of the emerging markets – depreciation of the zloty. In the opinion of the Council members this primarily reflected the lack of significant imbalances in the Polish economy and a positive current account balance.

While addressing the situation in the real sphere of the Polish economy, the Council members pointed out that 2013 Q2 had seen a certain acceleration in GDP growth, this resulting however from higher contribution of net exports to GDP growth, coupled with steeper decline in domestic demand. It was noticed that the recently incoming monthly data indicated the continuation of economic recovery in 2013 Q3. While discussing the economic outlook for Poland, Council members agreed that the subsequent quarters would see further improvement in business conditions, yet they differed as to scale of the anticipated economic recovery. Some Council members believed that economic activity would be accelerating slowly, and that the nearest quarters would see GDP growth below its potential level. At the same time, a few Council members anticipated that the economic recovery would be relatively rapid, and, in effect, the negative output

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gap would start to close gradually. The scale of further fiscal tightening was also indicated as a factor increasing uncertainty about GDP growth in 2014.

Members of the Council who expect moderate recovery in the economy, pointed to the deepening decline in investment and stagnation in private consumption in 2013 Q2. Some Council members underlined, however, that decline in investment is typical of the current phase of the business cycle. A few Council members also noted that GDP growth in the coming quarters might be negatively affected by the situation in the banking sector, which, on the one hand, had posted a weaker growth in household deposits, and, on the other hand, rising share of non-performing loans. They also drew attention to decrease in loans to enterprises growth.

Members of the Council expecting somewhat faster GDP growth in the coming quarters, however, pointed to rising retail sales and industrial production and weakening decline in construction in the recent months, as well as signs of a possible rebound in investment over the subsequent quarters (rise in the estimated cost and number of newly started investment). According to those Council members, further economic recovery will be driven by a growth in disposable income of households and improved performance of corporates, including a rise in their liquidity.

During the discussion attention was paid to the signs of labour market stabilization. In particular, it was noted that although employment in the economy in 2013 Q2, was falling in annual terms, the incoming data from the corporate sector showed slight increases in month-over-month employment. A few Council members argued, however, that despite the economic recovery no significant increase in employment should be expected as during the slowdown enterprises strove to limit layoffs. Council members also pointed out that despite a certain wage growth recorded in 2013 Q2, growth in unit labour costs remained stable due to a concurrent growth in labour productivity. Council members emphasized that persistently heightened unemployment rate was a factor limiting wage growth. A few Council members argued, however, that the strikes announced for the coming months might put further upward pressure on wages in the economy.

While discussing inflation developments, Council members emphasized that despite a significant rise in July, inflation continued to run below the lower limit for deviations from the target. At the same time, it was pointed out that the rise in inflation recorded in July resulted from increased waste disposal fees, changes in the seasonal pattern of potato prices as well as higher fuel prices, and therefore did not signal the emergence of demand pressures.

Most of the Council members assessed that inflation was likely to remain below the target in the coming quarters due to the lack of demand pressure. Some Council members pointed to the fact that base effect related to a significant rise in inflation in July 2013 would exert a downward pressure on inflation in the second half of 2014. Other members believed that even though inflation was likely to remain below the target, the increase in oil prices posted in the recent period and the previously observed moderate

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depreciation of the zloty could be driving inflation up. A few Council members in turn were of the opinion that as it was possible for GDP growth to rebound faster (above potential output growth) the subsequent quarters might see demand pressure, which would be an additional factor contributing to inflation acceleration.

In the context of the expected rise in inflation, a few Council members emphasized that higher inflation supported lower real interest rates. Other Council members, however, pointed out that the medium-term inflation forecasts of economists and bank analysts – despite fluctuations in inflation – remained relatively stable, which currently stabilized the ex-ante real interest rate.

Council members agreed that interest rates should be kept unchanged at the present meeting, and the current and expected economic situation spoke in favour of keeping interest rates unchanged until the end of 2013. In the opinion of the Council, further ahead the level of interest rates would depend on the scale and structure of recovery and the resulting inflationary pressure.

The Council decided to keep NBP's interest rates unchanged: the reference rate at 2.50%, the lombard rate at 4.00%, the deposit rate at 1.00% and the rediscount rate at 2.75%.

Publication date: 19 September 2013

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