Minutes of the Monetary Policy Council decision-making meeting held on 2 September 2015

Members of the Monetary Policy Council discussed monetary policy against the background of the current and expected macroeconomic developments in Poland and abroad.

Analysing economic conditions in Poland's environment, the Council pointed to the continued economic recovery of the euro area, which was supported by an improvement in the labour market situation and favourable business sentiment. At the same time, certain Council members emphasised that GDP growth in 2015 Q2 had slowed down somewhat and incoming data for 2015 Q3 did not clearly indicate an acceleration of economic activity. In turn, it was stressed that with the launch of the third assistance programme for Greece, the risk of a Greek default in the near term had receded and thereby the short-term risk of negative effects of the situation in Greece on the euro area economy had been reduced. Some of the Council members also drew attention to the favourable information on the economic situation in the United States, including data on GDP growth in 2015 Q2 and the good labour market situation.

An important issue regarding the situation abroad highlighted by Council members was the further weakening of the economic activity in the major emerging economies and related deterioration of global growth prospects. In this context, Council members pointed to the deepening recession in Russia and Brazil. However, it was noted that the main risk factor for global growth was the possibility of a stronger than expected slowdown in China. It was argued that a further weakening of economic activity in China could limit Chinese demand for products from other countries and reduce global economic growth. Some Council members were of the opinion that the impact of the slowdown in China on the global economy would be amplified by potentially accompanying deceleration in other Asian economies' growth. It was pointed out that slowdown in China could influence Polish economy mainly through possible fall in German exports and GDP growth, which would adversely affect Polish exports growth. However, certain Council members assessed that in view of China's limited share in German exports, the slowdown in China would have little impact on German GDP growth, and consequently, on the economic situation in Poland. Certain Council members also considered that in the longer term there could be – particularly amidst rising real wages – change in the structure of demand growth in China in favour of an increased share of consumer demand in GDP, which would support growth in exports from developed economies to China.

Council members emphasised that the deteriorating economic situation in China and other developing economies also caused a reduction in their demand for commodities. It was considered to be a significant factor driving a renewed decline in prices on global commodity markets in the recent period. It was noted that in the case of some commodities, the fall in price was also supported by rising supply. It was emphasised that even the negative supply shock related to the drought in certain countries had not stopped the fall in agricultural commodity prices. Certain Council members considered that commodity prices were most likely in a long-term downward trend, which might contribute towards an extended period of very low growth in global prices.

Regarding global price developments, it was pointed out that global inflation remains very low. Some Council members emphasised that the renewed fall in commodity prices and the weakening of the yuan and other currencies of emerging countries would be conducive to global inflation remaining low in the coming quarters.

While discussing monetary policy in Poland's external environment, it was pointed out that there was continued uncertainty regarding the timing of the beginning of interest rate increases by the Federal Reserve. In turn, the ECB continued its asset purchase programme and there were some signals indicating a possibility of the programme expansion or extension. It was also pointed out that the People's Bank of China had eased monetary policy, including a devaluation of the yuan. Certain Council members highlighted the fact that in the recent period the Bank of Hungary and Riksbank had once again eased monetary policy.

While discussing the situation in the global financial markets, it was pointed out that many asset prices had fallen and that their volatility had increased in the recent period. Indications of a stronger economic slowdown in China and the sharp fall of share prices in that country were significant factors leading to deteriorating financial market sentiment. This deterioration together with devaluation of the yuan also resulted in a weakening of the currencies of many emerging economies. Certain Council members drew attention to the fact that the upcoming monetary policy tightening by the Fed could increase depreciation pressure on emerging countries' currencies, which, in economies with significant foreign currency denominated corporate debt, would increase the risk of currency crises. As a result, there could be a further deterioration in investors sentiment towards emerging markets. These members pointed out that an additional source of shocks in international financial markets could be the bursting of bubbles in other asset markets, whose formation had been driven – in their opinion – by the unconventional policies of central banks. In this context, they also underlined that due to the strong economic and financial ties, the occurrence of one shock in the external environment of Poland would increase the likelihood of other risk factors materialising. As a result, any possible shocks could have a major adverse impact on the situation in the global economy, including economic activity in the euro area.

While analysing the situation in Poland's real economy, the slight weakening of GDP growth in 2015 Q2 was pointed out. It was emphasised that while consumption growth was stable, investment had lost momentum and the contribution of net exports to GDP growth had fallen. However, certain Council members believed that GDP growth was still faster than the growth of potential output. Some Council members drew attention to the lower than expected growth in output and retail sales in July as well as the fall in the

PMI in August, which could signal weakening growth in activity. It was also pointed out that economic situation in certain sectors in 2015 Q3 might be adversely affected by drought and the temporary restrictions on electricity supply.

Some Council members pointed out that the slight slowdown in GDP growth was accompanied by a somewhat slower growth in wages and the number of working persons in the economy. Despite this, Council members were of the opinion that the situation in the domestic labour market remained good, resulting in continued robust growth in real wages, a declining unemployment rate and the growing likelihood of finding a job.

While discussing the outlook for economic growth, the majority of Council members emphasised that in the coming quarters GDP growth would most likely continue at a rate close to that observed in the first half of 2015. Further stable GDP growth would be supported by domestic factors, including the good situation in the labour market and the enterprise sector, the high capacity utilization and wide availability and relatively low cost of credit. The increase in activity in most sectors may also have been supported by low commodity prices and a certain weakening of the zloty exchange rate in recent months. Economic recovery in the euro area should also contribute to further stable growth. In turn, the deterioration of the economic situation in China and other emerging countries could have an adverse impact on GDP growth.

At the same time, the majority of Council members highlighted that in view of the weaker outlook for growth in the emerging countries, and also taking into consideration the slightly worse than expected data from the Polish economy in the recent period, the risk of a weakening in domestic activity growth had increased. According to certain Council members, there was increased risk of a strong external shock which – by weakening the economic growth of Poland's trading partners and causing a deterioration in investors sentiment towards the assets of emerging markets – could lead to a slowdown in Polish GDP growth.

Council members drew attention to the fact that in light of such circumstances, it was important to maintain high resilience of the Polish economy to external shocks and support long-term economic growth. Certain Council members also highlighted the need to increase the innovation in the economy and remove barriers to development of small and medium-sized enterprises. In their opinion, this could lead to an increase in labour productivity and, as a result, accelerate wage growth and value added contained in Polish products. However, certain Council members emphasised that due to the upcoming parliamentary elections, proposals for changes in economic policy had been appearing which, if they were to be implemented, would adversely affect the state of public finances and thereby weaken the resilience of the Polish economy to external shocks.

While discussing the situation on the credit market, Council members considered that growth in credit for the private sector remained moderate. It was pointed out that the parliamentary work on the currency conversion of some loans denominated in foreign currencies was a factor of uncertainty for the banking sector, and therefore for credit growth. It was noted that the introduction of the regulatory solutions currently under consideration could contribute to a decline in credit growth and a reduction in tax revenue. Moreover, for some banks it could result in the need to increase their capital.

While discussing inflation developments in the economy, Council members pointed to the fact that despite continued deflation, its scale was gradually diminishing. However, the majority of Council members considered that in view of the output gap remaining negative, moderate growth of nominal wages and the fall in commodity prices on global markets, there was still no inflationary pressure. Some Council members drew attention to the persistence of producer price deflation, which could be prolonged due to the renewed fall of commodity prices. However, these members pointed out that the continued decline in producer prices had not yet had a clearly negative impact on the economic situation of enterprises.

While discussing the outlook for inflation, Council members assessed that in the coming quarters price growth would most likely continue to pick up gradually, as indicated by most forecasts. However, some Council members pointed out that the pace of price growth return to positive territory may be hampered in the coming quarters by the new fall in commodity prices in global markets. Another risk factor to the acceleration of price growth was the marked slowdown of the Chinese economy, which dragged on demand growth in other countries, and the effects of yuan devaluation, reducing the import prices of Chinese products. However, certain Council members stressed that price growth in the near term might be boosted by the growth in the prices of vegetables and fruit due to the drought, which had reduced the domestic output of these products.

With regard to the decision on interest rates, the majority of Council members acknowledged that in view of the expected stable economic growth, which will not result in imbalances in the economy, and at the same time the gradual increase in price growth towards the inflation target, a stabilisation of nominal interest rates at the current level is justified. Some Council members emphasised that the stabilisation of interest rates strengthens the resilience of the Polish economy to shocks, particularly in view of considerable uncertainty with regard to global economic outlook and increased volatility in international financial markets. Certain Council members pointed out, that the real interest rates ex ante, i.e. adjusted for forecasted inflation, were at low levels.

However, certain Council members were of the opinion that in the coming months it could be justified to consider raising interest rates. In their opinion, such a scenario was supported by the prospect of increased price growth amidst probable further improvement in economic conditions. In their opinion, an interest rate hike should also be considered due to the increased risk of strong external shocks, since this would increase room for monetary easing in the event of negative shocks.

The majority of Council members pointed out that due to the possibility of a stronger economic slowdown in China and renewed fall in commodity prices, uncertainty regarding economic activity and price developments in Poland had increased and the balance of risks for economic growth and inflation had shifted downwards. However, these members assessed that the most likely scenario was a stabilisation of interest rates.

The Council decided to keep the NBP interest rates unchanged: the reference rate at 1.50%, the lombard rate at 2.50%, the deposit rate at 0.50% and the rediscount rate at 1.75%.

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