Minutes of the Monetary Policy Council decision-making meeting held on 7 September 2016

At the meeting, the Council members discussed monetary policy against the background of macroeconomic developments in Poland and abroad.

The Council reviewed the developments abroad, which are relevant for economic conditions in Poland. It was recognised that global economic growth remained moderate, but the uncertainty about its outlook continued. It was noted that economic growth in the euro area was stable and emphasised that in Germany – Poland's main trading partner – in 2016 Q2 it was higher than expected despite a certain slowdown. GDP growth in this country has been supported by stable rise in consumption driven by improving labour market conditions and high public expenditure growth. A number of factors, which had a negative impact on economic activity in the euro area, particularly on investment expenditure, were cited. Attention was drawn to weak economic conditions in non-European emerging market economies, low growth in global industrial production and trade, and the uncertainty regarding the situation in the banking sector in several euro area member states. It was underlined that – contrary to previous concerns – the uncertainty related to the United Kingdom’s withdrawal from the European Union had not yet had a significant impact on economic activity in Britain or the euro area.

With reference to developments in the United States, it was noted that conditions in the US labour market had improved, which had eased concerns about persistent deterioration in economic conditions in this country. However, it was highlighted that GDP growth in the United States was lower than in previous years due to a fall in investment, particularly in the oil extraction industry, related to earlier sharp fall in oil prices, and to slower export growth amid moderate global economic growth and relatively strong US dollar.

Regarding the emerging market economies, the Council members noted that the economic activity indicators pointed to further slowdown in China. At the same time, it was assessed that temporary stabilisation of GDP growth in China in 2016 Q2 had been achieved thanks to significant fiscal expansion and an acceleration in lending growth, which had perpetuated long-term risks for the Chinese economy. It was pointed out that the recession in Russia was gradually receding, though economic conditions in this country would most likely stay weak.

The Council members emphasized that the prices of oil and many other commodities remained lower than in previous years. It was indicated that low commodity prices, along with moderate global economic activity, were the main factors behind the low consumer price growth in many economies.

The Council members pointed out that against this background, the European Central Bank was keeping interest rates close to zero, including the deposit rate below zero, and

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continued financial asset purchases. It was pointed out that although the Federal Reserve had indicated a possible interest rate increase in the future, there was a considerable uncertainty about its timing. An opinion was expressed that this uncertainty had a negative impact on financial market sentiment. However, it was highlighted that global financial asset prices had risen since the previous Council meeting, which was due to lower concerns regarding the United Kingdom's withdrawal from the European Union.

When discussing developments in Poland's real economy, the Council members pointed to a slight increase in GDP growth in 2016 Q2. It was noted that economic growth – although somewhat lower than in 2015 – was close to potential output growth, which does not result in imbalances building up in the economy. It was stressed that the main factor behind the growth in 2016 Q2 had been still a steady increase in consumer demand, supported by favourable consumer sentiment and gradual improvement in the labour market, translating into an acceleration in wage growth in 2016 Q2. It was recognised that higher growth in consumption could also be driven by the launch of the "Family 500 plus" programme, although the scale of its impact on consumption growth was hard to assess at the time of the meeting. Another factor contributing to higher GDP growth in 2016 Q2 was significant acceleration in exports. However, the Council members observed that GDP growth had been contained by the fall in investment, caused mainly by temporarily lower EU funds absorption after the previous EU financial framework had expired. As some Council members argued, the same factor stood behind a fall in investment in other Central and Eastern European economies. In addition, some Council members pointed out that the uncertainty regarding the legal environment of business could also be contributing to weaker investment growth.

While discussing the economic outlook in Poland, the Council members judged that stable economic growth would continue in the coming quarters and – in the opinion of some Council members – it could even accelerate slightly. The Council members assessed that consumption would remain the major driver of economic growth. It was stressed that although in early 2016 Q3 retail sales growth was still moderate, incoming data, including data on wages, and also the growth in consumer sentiment indicators, suggested that consumption was likely to accelerate further. Growth in consumption in the coming quarters should also be driven by emerging effects of an acceleration in disbursement of the child benefits.

Some Council members pointed out that stable consumption growth could be insufficient for keeping GDP growth close to the currently observed level in 2017. For this reason, investment outlays would be crucial for GDP growth remaining close to the level observed at the time of the meeting. Referring to the investment outlook, some Council members judged that in 2017 investment growth would most likely pick up, supported by an increase in the EU funds absorption amid good financial standing of enterprises and growing capacity utilisation of firms. Some Council members pointed out that in the longer run investment growth should be additionally supported by government infrastructure projects, including those implemented under the Responsible

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Development Plan. In the opinion of some Council members, investment growth in the coming quarters is, however, fraught with uncertainty. Certain Council members pointed out that investment could rise slower than expected in the July projection due to i.a. the uncertainty about economic growth outlook for Poland and abroad, the uncertainty about the timing of an acceleration in the EU funds absorption as well as the uncertainty regarding the legal environment of business. Some Council members noted in addition that – due to fiscal convergence criterion on the level of the general government deficit – increasing public spending needed to co-finance investments within the new EU financial framework might prove difficult.

When analysing price developments in Poland, it was stressed that the annual consumer price index remained negative, yet signs of a reversal in deflationary trends had appeared. In particular, attention was drawn to the increase in the GDP deflator and the growth of consumer prices influenced by domestic economic conditions. Attention was also drawn to the signs of cost pressure in the economy, manifested in the positive and rising growth in producer prices excluding energy and an acceleration in unit labour cost growth. The majority of the Council members underlined that there were no visible signs that the current deflation had a negative impact on the activity of economic agents. However, certain Council members pointed out that there was considerable uncertainty regarding the potential effects of deflation. Taking this into account, the Council members underlined that it was necessary to continue to analyse the business conditions of enterprises and consumer behaviour for possible adverse effects of the negative price growth.

Referring to the outlook for price growth, it was pointed out that in the coming months the annual consumer price index would remain negative, although the scale of deflation would be gradually subsiding due to dissipating effects of the earlier drop in global commodity prices. It was emphasised that higher price growth in the coming quarters would also be supported by stable GDP growth and further acceleration in wage growth. As a consequence – in the opinion of the majority of the Council members – in 2017 price growth would be materially positive. However, certain Council members did not rule out that deflation in Poland could last longer. It was stressed that the main source of uncertainty for growth outlook came from a possibility of a deterioration of the global economic conditions and of a fall in commodity prices, which would reduce price growth in the environment of the Polish economy and thus also domestic price growth.

While discussing the NBP interest rates, the Council members judged that they should remain unchanged. The majority of the Council members pointed out that – given the available data at the time of the meeting – deflation was not adversely affecting decisions of economic agents. Moreover, in 2017 price growth should already be clearly positive. The majority of the Council members also pointed out that GDP growth – despite some deceleration compared to the previous year – remained close to the potential growth rate, and in 2017 it was expected to accelerate. The Council members confirmed their assessment that against this background stabilisation of

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interest rates helped to keep the Polish economy on a sustainable growth path and maintain macroeconomic stability. An additional argument for interest rate stabilisation was – in the opinion of the Council members – the elevated uncertainty regarding domestic and external conditions for monetary policy.

At the same time, some Council members assessed that a further slowdown in economic growth, prolonged period of deflation and adverse effects of deflation might be a justification for a decrease in the interest rates in the future. Certain Council members suggested that the interest rate cut could be justified already in the following few quarters. They emphasised that the reduction in the NBP interest rates would be conducive to higher GDP growth, most notably by boosting investment activity growth. However, other Council members judged that the level of interest rates on loans was not currently a factor curbing investment growth in the economy. For this reason – in the opinion of these Council members – the reduction in the NBP interest rates could not have a limited impact on economic activity; however, it could lead to imbalances in the financial and real estate markets. At the same time, some Council members pointed out that should economic growth accelerate markedly and inflationary pressure appear, creating a risk of exceeding the inflation target in the medium term, it could be appropriate to raise the interest rates. However, these Council members indicated that in light of the current forecasts, stabilisation of the interest rates in the future was the most likely scenario.

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%, the rediscount rate at 1.75%.

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