MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 27 MAY 2009

During the meeting the Monetary Policy Council discussed the outlook for inflation in the context of the past, current and, primarily, anticipated economic situation.

The discussion at the meeting focused on the situation in the credit market and in the banking sector as well as on the outlook for economic growth and inflation in Poland and abroad.

The Council paid a lot of attention to the situation in the domestic credit market. It was pointed to a strong decline in the growth of corporate and mortgage loans. On the other hand, attention was paid to a still high growth in consumption loans. It was pointed out banks might give preference to consumer loans market as the average volume of this type of loan is lower and the average maturity shorter, whereas interest rate significantly higher than in the case of other loan categories. Yet, some members of the Council paid attention to the growing risk of the loan portfolio deterioration related with granted consumption loans and, as a result, possible reduction of lending also in this segment.

It was emphasized that reduction in lending has a negative impact on economic activity in Poland. It was also pointed at the risk of unfavourable feedback between deteriorating situation in the real economy and situation of the financial sector.

While discussing measures that could support lending growth, the lowering of the required reserve rate was considered. It was emphasized that lowering of the reserve requirement was one of the expectations stated by banks during the preparation of the Pact on Credit Action Development in Poland. In the opinion of the Council, the reduction of the required reserve rate should be conducive towards increasing banks' lending. While analysing the scale of the reduction in reserve requirement, it was pointed out that lowering of this rate should be implemented gradually, and potential further adjustments should depend on the impact of this reduction on bank lending and interest rate developments in the interbank market.

Some members of the Council argued that high credit risk assessment was a more important reason for banks' limiting their lending than liquidity situation. In this context it was assessed that implementation of the guarantees and warranties of the Bank Gospodarstwa Krajowego introduced under the governmental Stability and Development Plan would favour the growth of corporate lending.

While discussing the outlook for bank lending in Poland, the capital position of the banking sector was also addressed. It was pointed out that solvency ratio for the whole banking sector had recently stabilized, yet the capital position of different banks was diverse. The risk of decline in capital adequacy ratios may – in the case of some banks – reduce their lending.

It was also pointed out that amidst the low limits for interbank transactions – in their attempt to acquire deposits from non-financial sector – banks had offered, for several months now, relatively high interests rate on deposits, considerably exceeding interest rates on loans in the interbank market. In the opinion of some members of the Council, banks undertake such measures in order to change the structure of their balance sheets to improve the relation between the value of granted loans and the value of acquired deposits. Those members also pointed out that relatively high costs of financing of banks' activity were coupled with falling yields on previously granted loans whose interest rate was largely based on variable WIBOR 3M rate.

While analyzing the money market interest rate developments, it was pointed at the recent rise in WIBOR 3M rate which occurred amidst NBP interest rates being kept unchanged. Attention was also paid to the fact that WIBOR 3M rate was now considerably higher than the interest rate on repo transactions with the same maturity. According to some members of the Council, decline in banks' income on granted loans being the result of falling interest rates in the interbank market accompanied by high costs of acquiring deposits induces those banks to undertake measures aimed at maintaining WIBOR 3M rate at a heightened level, while limiting their interbank transactions.

While discussing the external environment of the Polish economy, it was pointed to the signs of easing of downward trends in the global economy. At the same time, it was emphasised that the uncertainty about the starting point and sustainability of a possible recovery in the world economy remains high. In this context, attention was paid to the data suggesting stabilization of economic activity in the United States, while, at the same time, it was pointed out that some recently released data on American economy was worse than expected.

While analysing the outlook for economic growth in Poland's major trading partners, it was assessed that due to relatively lower flexibility of product and labour markets, the recession in Western Europe might be longer than in the United States. It was emphasized that a strong drop in GDP growth in euro area economies in 2009 Q1 might suggest that decline in economic activity in this region in 2009 – despite recent improvement in some economic indicators – would be deeper than expected. Some members of the Council also indicated that good economic situation in Western European economies in the past few years was largely driven by the boom in real estate markets and high demand for investment goods in the world. Those members argued that amidst current slump in real estate markets the recovery might take relatively long time both in the countries where the real estate bubble had burst and in the countries which had not reported any significant disequilibrium in these markets but whose exports were largely dependent upon high demand in the global economy. At the same time, those members pointed out that persisting low level of production capacity utilization in Western European economies might lead to a decline in the inflow of foreign direct investment to the countries of Central and Eastern Europe, including Poland, which might negatively affect productivity and economic growth in this region.

While analysing the situation in the Polish economy, it was indicated that the released data suggested a possibility of GDP growth remaining positive in 2009 Q1. At the same time, it was assessed that subsequent quarters would see a downward trend in GDP growth which was suggested by macroeconomic data for April 2009 and economic indicators remaining at a low level despite a certain improvement in recent period. Some members of the Council assessed that GDP would probably grow in 2009, albeit the risk of its slight decline could not be excluded. Moreover, other members of the Council assessed that recovery in the Polish economy might come later than expected and the GDP growth might remain at a relatively low level for a longer period of time, should the recession in Poland's major trading partners prove long-lasting.

In the opinion of some members of the Council factors curbing the decline in GDP growth in subsequent quarters might include – similarly to 2009 Q1 – consumption and net exports. It was pointed out that consumption growth slowed down gradually due to still relatively high wage growth, income tax cuts implemented in 2009 and continuation of relatively high growth in consumption loans. On the other hand, it was emphasized that growing unemployment and anticipated decline in wage growth as well as worse consumer sentiment - despite certain recent improvement – as compared with the previous years constituted factors that might be conducive to limiting future consumption demand. Moreover, some members of the Council pointed to the risk of decline in real wages in the economy which might lead to further reduction in consumption.

While addressing investment in the Polish economy, it was pointed out that further decline in private investment would be driven by unfavourable outlook for economic growth in Poland and abroad amidst production capacity surplus connected with high level of investment in the previous years. It was also emphasized that factors acting towards decline in investment expenditure would in addition include limited possibility of financing private investment in Poland caused by falling inflow of foreign direct investment, reduced bank lending and deteriorating financial condition of enterprises. On the other hand, it was pointed out that investment decline in the Polish economy might be curbed by investment projects co-financed with EU funds.

While analysing current inflation developments, it was indicated that in April 2009 inflation exceeded expectations and remained above the upper limit for deviations from the inflation target. At the same time, it was pointed out that the rise in inflation in that month was caused by rising food prices, regulated prices and traded goods prices which was driven by the previous zloty exchange rate depreciation. Some members of the Council emphasized that developments of consumer price index net of prices largely beyond the direct control of monetary policy signalled that inflationary pressure in Poland had not eased considerably yet.

While discussing the outlook for inflation in Poland, some members of the Council pointed out that short-term forecasts of the NBP suggested inflation might decline in the coming months below the upper limit for deviations from the inflation target. Those members also pointed out that the structure of inflation expectations had not deteriorated despite the rise in current inflation. In the opinion of those members of the Council in the medium term decline in inflation should be driven by the slowdown in economic growth and further widening of the negative output gap in Poland. Other members of the Council also pointed out that at the initial stage of recovery in the Polish economy inflationary pressure should not increase considerably due to faster labour productivity than wage growth and, consequently, favourable changes in unit labour costs.

Some members of the Council also argued that amidst persisting considerable negative output gap inflation in Western European countries might run, for a longer time, at a low level, which – through import prices – would be conducive to easing inflationary pressure in Poland. Yet, some members of the Council pointed at the risk of growth in agricultural and energy commodity prices in the case of revival of economic activity in the United States and China, likely to occur earlier than in Europe. Those members argued that continuing relatively low growth in the Polish economy connected with persisting recession observed in Poland's major trading partners might be then accompanied by inflationary pressure resulting from increase in commodity prices in the global markets.

At the meeting, it was also pointed out that the rise in inflation in the medium term might in addition be driven by a possible rise in indirect and local taxes as well as fees and prices regulated by local governments, connected with considerable deterioration in the situation of the general government sector. At the same time, some members of the Council pointed at high uncertainty about future tax policy of central government and about taxes, fees and prices decided by local authorities.

While discussing the impact of exchange rate on inflation, some members of the Council assessed that exchange rate developments remained the main risk factor for price stability. Those members also argued that – in the absence of current inflation growth translating into rising inflationary expectations and assuming exchange rate stabilization in the future – the impact of exchange rate depreciation on inflation might be expected to fade off gradually. Other members of the Council pointed out, however, that the pass-through of the previous exchange rate developments on inflation might be stronger than assessed earlier.

Moreover, some members of the Council argued that the risk of deterioration in the outlook for growth in the Polish economy as a result of longer-than-expected slowdown in the economic activity in the euro area and a fall in the inflow of direct investment might be conducive to zloty exchange rate depreciation in the medium term. Those members also pointed out that the risk of exchange rate depreciation might result from deteriorating situation in the general government sector in Poland. Deteriorating fiscal situation increases uncertainty about the moment of zloty entering the ERM II.

At the meeting the prospects of Poland meeting the Maastricht price stability criterion were also addressed. It was indicated that 12-month moving average HICP inflation in Poland exceeded in April 2009 by 0.7 percentage point the reference value for price stability criterion and that the difference between those indicators increased considerably.

Members of the Council agreed that current inflation developments, uncertainty about the prospects of economic recovery in Poland and abroad and uncertainty about the situation in the public finance and its impact on inflation justified keeping the NBP interest rates unchanged at the current meeting. Some members of the Council indicated also that also very low level of real interest rates spoke in favour of leaving the NBP interest rates unchanged. The majority of the Council members decided that a more comprehensive assessment of the medium-term outlook for inflation would be possible after getting acquainted with the results of the June projection of inflation and GDP. Moreover, the Council decided that strong contraction in lending justified lowering the required reserve rate by 50 basis points at the current meeting.

A motion to lower the required reserve rate by 50 basis points was put forward and passed. The Council lowered the required reserve rate from 3.5% to 3%, keeping, at the same time, the interest rates unchanged: the reference rate at 3.75%, the lombard rate at 5.25%, the deposit rate at 2.25% and the rediscount rate at 4.00%.

Publication date: 18 June 2009