# MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 25 MAY 2010

During its meeting the Monetary Policy Council discussed primarily the situation in the external environment of the Polish economy, zloty exchange rate developments and the outlook for economic growth and inflation in Poland.

While addressing the developments abroad, strengthening recovery in the United States was emphasized, in particular an improvement in the labour market and restoring consumer demand. Some Council members assessed that the recovery in the US economy may persist even after withdrawal of fiscal stimuli, although the scale of improvement in economic activity may be curbed by still limited access to loans and the appreciation of the US dollar against the euro. At the same time a gradual increase in euro area economic activity and improving economic conditions in Central and Eastern Europe, a region with a substantial share in Polish exports, were pointed at. In particular, attention was drawn to positive data from the German economy. Some Council members emphasized positive impact of a rapid economic growth in China on short-term prospects of German exports, and consequently, on the exports of Central and Eastern European countries. At the same time those members pointed out that the growing macroeconomic imbalances in China, reflected in the rising inflation in the country, generated a risk to global economic growth in the longer term.

During the discussion on the economic outlook for the euro area, the risks associated with the fiscal problems of many countries of the region were highlighted. Some Council members argued that in order to contain growing public debt in these countries, substantial fiscal consolidation must be conducted. If combined with the rise in market interest rates and more difficult access to loans it could have a dampening impact on economic growth in the euro area in the short- and medium-term. Some Council members pointed, however, to uncertainty regarding the possibility of carrying out significant fiscal adjustments in some euro area countries. At the same time other members of the Council deemed the possibility of limiting spending of households and enterprises as a result of the increased uncertainty associated with the fiscal imbalances and curbing of public spending in some euro area countries to be a downside risk to a medium-term economic growth of this region. They argued that this constitutes more important downside risk to the euro area economic growth than the increase in the long-term interest rates.

On the other hand, some Council members indicated that the recently observed euro depreciation, increasing the price competitiveness of euro area exports could favourably affect the economic growth in this region. Other Council members argued, however, that the euro exchange rate fluctuations had a moderate impact on the competitiveness of euro area exports due to the structure of exports of major euro area economies.

While analysing global price developments, the rise in inflation in the major emerging economies was emphasized. At the same time, some Council members indicated that inflationary pressures remained low in the major developed economies, where core inflation fell in April 2010 to historically low levels. They made a point that a drop in oil prices in the world markets in May 2010 could contribute to a decline in headline inflation in the world. Other Council members, however, assessed that the recent fall in oil prices had been associated with the appreciation of the US dollar, and therefore its disinflationary impact would be limited. Furthermore, they also pointed out that a strong growth in euro-denominated commodity prices observed until April 2010 may be conducive towards an increase in inflation in the euro area.

While analysing the situation in the Polish economy, it was highlighted that the persistent upward trend in industrial output, further increase of economic indicators, and improving situation on the labour market confirmed the continued recovery. Some Council members indicated that the low level of investment in the corporate sector may limit future economic growth in Poland. Other Council members argued that the low level of investment was typical of the current phase of the business cycle.

While discussing the impact of the national mourning and the flood on the Polish economy, some Council members believed that those events would have a minor impact on the economic growth in Poland. Other Council members assessed that the national mourning could significantly affect consumer demand, and therefore April 2010 was likely to bring lower growth of retail sales. Moreover, some Council members pointed out that the flood had not yet come to an end, so there was considerable uncertainty regarding the scale of its impact on the economy. They made a point that the increase in investment (including public investment) as a result of the necessary removal of flood-related damage may be conducive to higher growth in subsequent quarters. At the same time, some Council members referred to uncertainty about the impact of flood on the inflationary developments in Poland, noting that the flood can contribute towards the growth in some prices, including those of unprocessed food and insurance.

In the discussion on inflationary developments, some Council members assessed that inflationary pressures in the Polish economy remain moderate at the current juncture. More specifically, those members highlighted a clear decline in core inflation rates observed in recent months, which - besides statistical effects - largely reflected an earlier appreciation of the zloty exchange rate and easing of cost and demand pressures. In their view, these factors should be determining inflation also in the coming months. Moreover, as those Council members claimed, continued relatively low growth in unit labour costs – characteristic of the current phase of the business cycle - and stable inflation expectations of economic agents should favour inflation running at the level which would pose no risk to meeting the inflation target over a one-year horizon. In addition, some Council members indicated that subdued lending and low capacity utilization in the economy would also have a dampening impact on the inflation in Poland. It was emphasized that most available forecasts implied the persistence of low inflation in coming months.

Other Council members stressed, however, that April 2010 was a consecutive month of a marked hike in inflation on a monthly basis, and also noted that the level of consumer prices rose by 1.6% in the first four months 2010 as a result of those increases. They emphasized that the balance of risks for short-term NBP inflation forecasts was asymmetrical and pointed to a greater risk of higher inflation than would follow up from the central path. Those members also drew attention to the hikes observed in recent months in prices of certain goods imported from countries with low production costs and to the stabilisation of China's share of Polish imports. According to those Council members it may indicate that while recovering from the current economic slowdown, inflation would not be reduced by the increasing share of these goods in consumption, as was the case during the previous downturn. Moreover, some Council members pointed out that the recent weakening of the zloty exchange rate, increases in administered prices and strengthening economic recovery should contribute towards higher inflation in Poland.

While discussing the zloty exchange rate and its impact on inflation, the Council considered that the current exchange rate of the zloty was marked by high volatility. In view of the Council, changes in investors' sentiment in global financial markets, largely determined by changing perception of fiscal risk in Greece and some other euro area economies, significantly influenced short-term zloty exchange rate fluctuations. Some Council members pointed out that in line with the convergence of the Polish economy, the appreciation of the zloty exchange rate may be expected in the longer term, and that the current disturbances were not of a permanent character. Uncertainty on financial markets may, however, impact zloty exchange rate developments in the short term.

In the discussion on the labour market situation, a gradual increase in employment in the corporate sector and a decline in the seasonally-adjusted unemployment rate in April 2010 were pointed at. Some Council members took note that employment growth in the corporate sector had not been so far accompanied by a significant increase in wage pressure. Other Council members, however, emphasized that the growth rate of social security and health contributions indicated that the increase in wages in the economy may be stronger than in the corporate sector, whereas a rapid growth in disposable income in Q4 2009 may reflect a fast growth in income from other sources than labour. Moreover, those members assessed that the growing ability of enterprises to finance spending may make them more willing to increase wages or employment. At the same time, those members pointed out that April 2010 was the second consecutive month of increase in the annual real wages in the corporate sector.

While analysing credit market developments, it was pointed at further decline in the value of corporate loans, in particular in investment loans, and low growth of loans to households. Some Council members argued that low level of lending to the corporate sector was typical of the current phase of the business cycle. They emphasized that the demand for credit may also be limited by favourable liquidity conditions of enterprises, as evidenced by the liquidity ratios which rose in Q1 2010 to their historical heights and by a robust growth in corporate deposits. Other Council members pointed out, however, that the data on the liquidity of enterprises covered relatively large companies, whereas limited access to loans adversely affects the development prospects of small and medium-sized enterprises, which have higher demand for external financing in the form of bank loans.

Referring to the prospects of lending, some Council members pointed out that thanks to their strong capital position banks could increase the supply of loans. According to those members of the Council, at the time being the turmoil in international financial markets limits the increase in the supply of housing loans denominated in foreign currencies by creating obstacles to their refinancing. If the turmoil recedes, this segment of the credit market may show a rapid expansion.

While addressing the fiscal policy, some Council members assessed that fiscal policy tightening in the short term would result in a slower economic growth in Poland. However further fiscal consolidation is required to reduce the general government deficit.  Moreover, those members assessed that postponing Poland's accession to the euro area would reduce incentives for early fiscal reforms.

While referring to Poland’s compliance with the price stability criterion of the Maastricht Treaty, some Council members pointed out that countries with negative twelve-month average HICP inflation rates had been included to determine the reference value for the price stability criterion in the May 2010 *Convergence Reports* of the European Commission and European Central Bank, which resulted in a very low level of the reference value. According to these members, regarding the countries with negative twelve-month average HICP inflation rates as the best-performing countries in terms of price stability may complicate the prospective fulfilment of this criterion by Poland.

While analysing monetary policy abroad and at home, some Council members indicated that the central banks from Central and Eastern Europe had further eased their monetary policies and, according to market expectations, the ECB should raise interest rates at the earliest in the following year. Other Council members argued, however, that the parameters of monetary policy in Poland may change earlier than in the developed economies. Some Council members assessed at the same time that the increase in *ex post* real interest rate (CPI-deflated) in April 2010 was indicative of a more restrictive monetary policy.

The Council assessed that the uncertainty concerning the impact of the situation in the external environment on the outlook for economic growth in Poland and on the zloty exchange rate justified keeping the NBP interest rates unchanged at the current meeting. Moreover, some Council members argued that a more comprehensive assessment of the outlook for inflation and economic growth in Poland will be possible after considering the June inflation and GDP projection.

The Council kept the interest rates unchanged: the reference rate at 3.50%, the lombard rate at 5.00%, the deposit rate at 2.00%, the rediscount rate at 3.75% and the discount rate at 4.00%.

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