MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 11 MAY 2011

At the meeting, the Monetary Policy Council discussed the outlook for economic growth and inflation, including the risk of inflation persisting at a heightened level, as well as the pace and possible overall scale of interest rate increases.

While discussing the outlook for domestic economic growth, some members of the Council pointed out that the annual growth rate – after reaching a high level in 2011 Q1 - was likely to decline gradually in the coming quarters, which should reduce the overall scale of interest rate increases necessary to stabilize inflation at the inflation target in the medium term. It was pointed out that GDP growth would be constrained by – somewhat slower than in the first phase of the recovery – growth in external demand, adverse impact of high inflation on private consumption and corporate investment growth, as well as tightening of domestic fiscal policy. Some members of the Council pointed at the persisting risk to GDP growth stemming from the developments in the external environment of the Polish economy, including concerns over the sustainability of economic recovery in the major developed economies associated with an elevated level of unemployment and reduction of high fiscal imbalances.

Other members of the Council, however, assessed that Poland's economic growth might be faster than currently forecast. Good outlook for growth in Polish exports associated with continued rapid growth in exports in Germany and signs of recovery in corporate investment were, in their opinion, indicative of such a possibility. Those members of the Council pointed out that in view of improving expectations of enterprises about demand and future economic performance, sustained growth in production capacity utilization and good liquidity position, corporate investment could be growing faster than currently anticipated, despite increases in the NBP's interest rates. According to these members of the Council, acceleration of investments was likely to be accompanied by continued rapid growth in employment, which would support a rise in private consumption. Growing prices of commodities and materials, which the enterprises started to quote as the main barrier to their development, was seen by these members as the main threat to investment growth. At the same time - in their opinion - good liquidity situation of enterprises reduced the risk of potential interest rate increases curbing investment growth.

While discussing the risk of intensifying wage pressure, including second round effects, some members of the Council assessed that this risk was limited at the moment. They pointed to the continuing moderate wage growth in enterprises, and argued that the risk of second round effects was reduced by increased level of unemployment, freezing of aggregate wages in the public finance sector in 2011 and limited role of trade unions in wage-setting in the Polish economy. Those members also pointed out that until now there were no signs that the opening of the labor market in Germany and Austria had resulted in a growing scale of migration to these countries. Other members of the Council emphasized that the continuing rapid growth of employment in enterprises was indicative of the mounting risk of intensifying wage pressure. They also pointed out that wage demands had soared recently in industries with high trade union density, pointing out that wage growth in enterprises in these industries might put an upward pressure on wages in other enterprises. Those members of the Council pointed out that the risk of accelerating wage growth was boosted by high inflation expectations of households and businesses. They also underlined that starting from 2012, wage growth in the economy would be heightened by the minimum wage increase.

While addressing the situation in the credit market, some members of the Council emphasized that lending to households and businesses continued at a relatively low level. Other members of the Council, however, assessed that a certain upturn in corporate lending could be observed. In particular, they pointed to some signs of recovery in demand for corporate loans, which was an important factor limiting the growth of bank lending to this sector. They also paid attention to the announced easing of lending policy for enterprises in 2011 Q2.

While discussing the NBP interest rate policy, members of the Council agreed that the current assessment of the outlook for economic growth and inflation justified the continuation of monetary policy tightening in a previously assumed scale. The discussion focused on the timing of further tightening of the policy.

According to some members of the Council it was justified to continue with tightening monetary policy by raising interest rates at several month intervals. They pointed out that the recently released data had not fundamentally changed the assessment of the outlook for economic growth and inflation, and emphasized that most participants in the financial markets expected that the current pace of monetary policy tightening would continue. In the opinion of some participants of the meeting, factors speaking in favour of such pace of monetary policy tightening included: supply-side character of an inflation increase reflected in core inflation net of food and energy prices running well below the CPI, absence of signs of second-round effects, forecasts pointing to a slowdown in annual economic growth later in 2011 as well as in commodity prices growth in the world markets and the related projected decline in inflation around the inflation target in 2012. These meeting participants also assessed that the acceleration of interest rate increases might not reduce inflation expectations of households, which are highly adaptive in nature.

Moreover, some members of the Council paid attention to the decision of the Ministry of Finance to exchange some of the European Union funds in the foreign exchange market. They emphasized that a more comprehensive assessment of the impact of this decision on macroeconomic conditions of monetary policy would be possible in the coming months, which – in their view – spoke in favour of keeping interest rates unchanged at the current meeting.

The majority of the Council members decided that acceleration of interest rate increases would be a more effective way to reduce the risk of persisting heightened inflation than interest rate increases implemented at the current pace. According to these members of the Council, the rationale behind more rapid interest rate increases was the need of a pre-emptive response to the growing risk of higher costs of enterprises and heightened inflation expectations translating into price and wage increases. In this context, those members pointed out the data on CPI inflation in March 2011, indicating an acceleration in price growth not only in food and energy but also in most of other categories of consumer goods and services. Those members also stressed that, considering strong shocks in the agricultural and energy commodity markets, core inflation net of food and energy prices might not correctly reflect permanent changes in inflationary pressures. Those members also pointed out that the projected decline in inflation around the inflation target at the beginning of 2012 was connected with base effects and assumed that rapid increases in commodity prices in the global markets would slow down. It was pointed out that this assumption was subject to uncertainty due to persisting political risk in some oil-exporting countries and growing demand for commodities from emerging economies. Some members of the Council also argued that, in view of the likelihood of inflation and inflation expectations continuing at an elevated level in the coming months, factors speaking in favour of accelerating NBP interest rate hikes included also the risk of real interest rates running at very low levels. It was also emphasized that acceleration of interest rate increases would reduce the need for any strong interest rate adjustments in the future.

While arguing in favour of accelerating interest rate hikes, some members of the Council justified it through uncertainty about the developments of the zloty exchange rate.

A motion to raise the NBP interest rates by 25 basis points was put forward at the meeting. The motion passed. The Council decided to increase the interest rates to the following levels: reference rate to 4.25%, lombard rate to 5.75%, deposit rate to 2.75% and rediscount rate to 4.50%.

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