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Monetary Policy Council

MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 9 MAY 2012

At its meeting, the Monetary Policy Council discussed the current and future monetary policy decisions against the background of external and domestic macroeconomic developments, including inflationary processes.

While analysing the external conditions of macroeconomic developments in the Polish economy, members of the Council pointed to the continued uncertainty about the situation in the euro area. Some members of the Council argued that the results of the elections held in France and Greece suggested the possibility of changes in economic policy of those countries and hence a weaker support for restrictive fiscal policy in some euro area countries. In this context, some members of the Council pointed to the risk of intensification of the crisis in some euro area countries which would, in turn, translate into further economic weakening. At the same time, some members of the Council argued that notwithstanding economic stagnation in the euro area, in Germany – Poland's main trading partner – a gradual recovery in economic activity is expected.

Members of the Council emphasized that uncertainty in the external environment of the Polish economy had remained elevated for a long time and could be expected to continue at a high level in the coming quarters. Some members of the Council assessed that heightened uncertainty about economic developments in the euro area and in other developed countries was becoming a permanent feature of the balance of risks for inflation and GDP; therefore, it should not be the key factor in the conduct of monetary policy in Poland. Other members of the Council argued, however, that such a high uncertainty limited the possibility of interest rate adjustments.

While discussing the economic activity in Poland, some members of the Council pointed out that March had seen a significant slowdown in manufacturing and construction production. Yet, the data released in the previous months suggest that in 2012 Q1 economic growth remained relatively robust in Poland. At the same time, those members emphasised that according to the NBP's business climate surveys, in 2012 Q1 economic situation of enterprises remained sound, with production capacity utilization improved and the number of companies planning to boost production and employment in 2012 Q2 increased. Also corporate lending rose rapidly in the first few months of 2012 and a relatively high growth in zloty housing loans to households continued, although total growth in housing loans was still decreasing. In the opinion of those members of the Council this might mean that the scale of the expected economic slowdown would be smaller than previously expected. Good financial situation of enterprises might additionally support this scenario.

Few members of the Council argued, however, that weak economic activity abroad would translate into lower contribution of net exports to GDP growth in Poland, whereas heightened inflation and lower employment growth would undermine consumer demand. It was pointed out that decline in consumer loans was another factor conducive to weaker consumer demand. Those members also argued that uncertainty about the outlook for both export demand and domestic demand posed a risk of slump in corporate investment, and, consequently, sharper decline in GDP growth in Poland in the coming quarters.

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While analysing inflationary processes, some members of the Council pointed out that although CPI and core inflation declined slightly in March, subsequent months were likely to see, once again, higher price growth. The rise in inflation may be primarily fuelled by gas price increases and temporary rise in the prices of restaurant and hotel services (the impact of the European Football Cup in Poland).

On the other hand, while addressing the outlook for inflation in the medium-term, some members of the Council emphasized that the coming quarters were likely to see continued upward pressure of external factors on inflation in Poland. Those factors included high commodity prices in the global markets, being largely the result of both rising demand for energy and food in the rapidly growing emerging markets and strongly expansionary monetary policy in the main developed countries. In the opinion of those members of the Council, as a result of the above factors inflation is expected to remain above the target for a longer time.

Other members of the Council pointed out that should the recently observed decline in oil prices continue – especially amidst zloty strengthening – inflation might fall considerably by the end of 2012. In the opinion of those members of the Council, such a possibility was also indicated by considerably weaker producer price growth, suggesting that companies did not increase their margins.

While addressing inflation expectations, it was emphasised that although one-year ahead inflation forecasts by financial sector analysts were consistent with the NBP's inflation target, expectations of households and enterprises were largely based on current inflation. As a result, private sector's expectations have continued, for a long time, well above the inflation target. Few members of the Council also argued that, notwithstanding still elevated unemployment rate, high inflation expectations persisting in the longer term increased the risk of their impact on contracts concluded by enterprises and consequently on the dynamics of the costs of production, including labour costs. In this context, attention was also paid to the announced minimum wage increase in 2013 as a factor likely to boost wage pressure.

Other members of the Council emphasized that high inflation expectations had not so far translated into higher wage demands, which is evidenced by lowering growth in the wage bill. Few members of the Council pointed out that wage freeze in the public sector was conducive to limiting wage pressure in the whole economy.

While discussing monetary policy stance, some members of the Council argued that despite the fact that heightened inflation was largely the result of factors beyond the impact of domestic monetary policy, when considering its negative consequences for the economy, efforts should be made to stabilise price growth at a low level. Those members pointed out that monetary policy should be pursued in such a way so as to support lowering of inflation expectations. Moreover, members of the Council emphasised that interest rate decisions should take into account, in the first place, expectations about macroeconomic developments over the period of 6-8 quarters. In the opinion of few members of the Council, over that horizon an acceleration in economic growth may be expected.

Other members of the Council emphasised, however, that considering the fact that the currently heightened inflation was driven by supply factors, in order to curb inflation economic activity would have to fall below potential. On the other hand, excessively high interest rates might not only put a strong downward pressure on GDP growth over the next several quarters but also adversely affect domestic economic activity in the longer term.

With regard to the decision on the NBP interest rates, the majority of Council members argued that the limited scale of the expected economic slowdown amidst heightened inflation persisting for over a year and its forecasted only slow decline over the coming quarters justified the NBP interest rate increase at the May meeting. In the opinion of those members of the Council, the outlook for inflation returning to the target had not improved since the last meeting, especially considering the persistently strong inflationary impact exerted by factors beyond the influence of domestic monetary policy and continuously heightened inflation expectations. At the same time, signals coming from the real economy did not clearly point to significant slowdown in economic activity in Poland. The majority of the Council members also emphasized that NBP interest rate increase was an adjustment to the current and anticipated macroeconomic situation in Poland and was aimed to ensure that real interest rates are kept above zero. At the same time, some members of the Council assessed that it might be necessary to adjust the NBP interest rates again in order to affect inflation expectations.

Other members of the Council argued that it was still difficult to assess the scale of the anticipated economic slowdown and the decision about a possible adjustment of the NBP interest rates should be postponed. In the opinion of those members of the Council, only the data released in the coming months will enable the assessment whether economic slowdown in Poland will be strong or limited. Those members assessed that amidst high uncertainty about Poland's external environment and continued fiscal tightening, it was justified to keep interest rates unchanged at the current meeting.

A motion to raise the NBP interest rates by 25 basis points was put forward at the meeting. The motion was passed. The Council decided to increase the NBP interest rates to the following levels: reference rate to 4.75%, lombard rate to 6.25%, deposit rate to 3.25%, rediscount rate to 5.00%.

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