MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 24 JUNE 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 outlook for economic growth abroad and in Poland, fiscal policy, zloty exchange rate developments and the situation in the credit market and the banking sector. The Council discussed the impact of those factors on future inflation in Poland against the background of the June projection of inflation and GDP.

While discussing the domestic economic growth, it was pointed out that decline in industrial output and very low growth of construction and assembly production in May 2009 confirmed the subdued economic activity in Poland. Some members of the Council pointed out that many macroeconomic indicators released recently, including the output data, were better than expected and some economic activity indicators pointed currently at a possible improvement in the outlook for growth in Poland. Other members of the Council argued, however, that worsening economic indicators in retail trade might signal further shrinking of consumption demand, which is driven i.a. by the decline in real aggregate wage in the enterprise sector. Those members also pointed out that according to the NBP preliminary assessments investment in the Polish economy might have strongly declined in 2009 Q2. Those members also emphasized that the June projection of the NBP pointed at further considerable decline in GDP growth in the coming quarters. Moreover, some members of the Council emphasized that the decline in economic activity in Poland might be stronger than indicated by the projection.

While discussing the external environment of the Polish economy, the successive signs of improvement in the outlook for world economic growth and stabilization of the situation in the global financial markets were pointed at. Yet, some members of the Council assessed that recession in the global economy might last longer that currently expected, and improvement of the situation in the financial markets might only be temporary. Those members emphasized that macroeconomic data did not univocally suggest that the downward trend in economic growth in the United States had been reversed. In the opinion of those members, recovery of the American economy would proceed gradually, which might delay the recovery of the euro zone and other developed economies. Those members indicated that 2009 was expected to bring a further strong decline in economic activity in the euro area and some forecasts pointed to the risk of GDP fall in this region also in 2010.

While analyzing the situation in the public finance sector, it was pointed out that a low growth rate of budget income in the first five months of 2009, including a considerable decline in tax revenues, which, given the persistently high expenditure growth, had led to a rapid increase in budget deficit. Some members of the Council pointed out that in order to limit the decline in tax revenues in 2009, the government would strive to increase non-tax revenues, including dividends from companies with State Treasury participation, which, given the restricted access to loans, might be conducive to additional cuts in investment expenditure by those enterprises. At the same time, those members assessed that – despite possible increase in the proceeds from dividends – the decline in budget income in 2009 would probably exceed the government announced growth in the planned deficit, which would suggest the need of cuts in some expenditure areas. Those members emphasized that the cuts in budget expenditure already announced by the government as well as possible further cuts would be conducive to a fall in domestic demand. The possible rise in taxes in 2010 might also lead to curbing domestic demand. It was also pointed out that the uncertainty about the scale of the actual expenditure cuts and the areas likely to be affected by these cuts, including the uncertainty resulting from some expenses being shifted from the central government budget to other units of the general government sector, makes it difficult to assess the impact of the changes in fiscal policy on the outlook for domestic economic growth.

While assessing the impact on inflation of changes in the situation of the general government sector and in the fiscal policy, the risk of a rise in inflation resulting from possible increases of regulated prices and indirect taxes in 2010 was indicated. Some members of the Council assessed that the rise in excise and VAT rates might be conducive to the CPI remaining at an increased level in 2010. Other members of the Council pointed out, however, that the possible tax increases and the government announced cuts in budget expenditure would be conducive to curbing domestic demand and, as a result, inflationary pressure. Those members also indicated that the rise in the budget deficit results mainly from the deteriorating economic conditions rather than from fiscal policy easing.

While analyzing the changes in current inflation it was pointed out that CPI inflation had fallen to 3.6% in May 2009, remaining, however, above the upper limit for deviations from the inflation target, set at 3.5%. It was emphasized that the inflation decline in May 2009 had mainly been driven by the negative base effect related to a strong rise in gas and energy prices in the corresponding period of the previous year. Some members of the Council indicated that the growth rate of consumer prices in the first few months of 2009 exceeded the average from the last eight years, which, by means of a base effect, might be conducive to a decline in the year-on-year inflation rate at the beginning of 2010. Those members also pointed out that in 2009 inflation was likely to remain at an increased level which would be driven i.a. by the positive base effect connected with a sharp fall in fuel prices in the second half of 2008.

While discussing the current inflation, some members of the Council also pointed out that inflation remaining above the upper limit for deviations from the inflation target was mainly connected with the previously effected increases in regulated prices and rising unprocessed food prices. Other members of the Council indicated that inflation was also driven – and would probably continue to be driven – by the persistence of inflationary processes. Moreover, they assessed that despite declining inflationary pressure some sectors of the economy continued to observe demand pressure as suggested i.a. by rising prices of market services.

The meeting also focused on HICP inflation developments in Poland. Some members of the Council pointed out that the difference between the 12-month moving average HICP inflation in Poland and the reference value for the price stability criterion increased in May 2009 to 1.0 percentage points. Yet, other members of the Council emphasized that inflation in Poland was higher than in Western European countries mainly due to considerable rises in regulated prices, which were beyond the direct impact of monetary policy. The difference in inflation levels might also be driven by the previously observed depreciation of the zloty exchange rate and a smaller scale of economic slowdown in Poland.

While discussing the outlook for inflation in Poland, attention was paid to the forecasted considerable decline in inflation in the projection horizon. Yet, some members of the Council pointed out that the situation in commodity and food futures markets pointed at the risk of a continuing upward trend in commodity and food prices, which might be conducive to rising inflation in Poland. Moreover, the decline in inflation might be curbed in the longer term by structural changes in the Polish economy boosting demand for market services. Those members also pointed out that in line with the projection in the years 2010-2011 CPI inflation should run below inflation net of food and energy prices which had not been observed since 2003.

Other members of the Council emphasized, however, that the June projection of the NBP pointed at the considerable widening of the negative output gap leading to a strong decline in inflationary pressure over the monetary policy transmission horizon. Moreover, some members of the Council assessed that in the medium term inflation might run below the central path of the projection due to the risk of economic growth abroad being lower than assumed in the projection. They also pointed out that due to the relatively slow adjustment of employment in the first stage of the economic slowdown, employment growth, and consequently also the growth of unit labour costs, might in the longer term be lower than accounted for in the projection. Those members also assessed that amidst low demand the impact of rising unit labour costs on inflation might be relatively weak. Moreover, in the opinion of those members of the Council, the zloty exchange rate is currently significantly weaker than the medium-term equilibrium rate which suggests that it might be stronger than accounted for in the projection.

While analyzing the developments in the exchange rate of the zloty, its relative stabilisation in the past few months was emphasized. On the other hand, it was pointed out that in May and June 2009 the zloty exchange rate had depreciated. It was stressed that at present zloty exchange rate fluctuations were impacted mainly by regional factors, in particular the unfavourable macroeconomic situation in some countries of Central and Eastern Europe. At the same time, attention was paid to the uncertainty about the impact on the zloty exchange rate of the worsening fiscal situation and the changing outlook for economic growth in Poland. On the other hand, some members of the Council assessed that the risk of zloty depreciation had considerably decreased as a result of improved sentiment in the global financial markets and was further mitigated by the relatively strong fundamentals of the Polish economy.

While discussing the impact of zloty exchange rate fluctuations on the economy, it was pointed out that the previously observed zloty exchange rate depreciation contributed to inflation persisting at an increased level. Some members of the Council assessed, however, that amidst low demand the impact of zloty depreciation on inflation would gradually decline. Those members emphasized that the current level of the zloty exchange rate increased the competitiveness of Polish products in foreign markets and in the domestic market, which is reflected in the improved current account balance and curbs the decline in domestic production.

While discussing the level of interest rates in Poland and abroad, it was pointed out that in the current situation the interest rate disparity between Poland and the euro area had a limited impact on zloty exchange rate developments. Yet, some members of the Council indicated that in the case of further decline in risk aversion in the international financial markets the currently observed disparity might boost the inflow of short-term capital to Poland. Other members of the Council pointed out, however, that this risk was mitigated by a still high level of risk premium prevalent in emerging economies. In the opinion of those members of the Council, the currently observed disparity was consistent with the higher natural interest rate and more favourable economic situation in Poland than in the euro area. Moreover, those members of the Council pointed out that ex post real interest rates (deflated with current headline inflation) in Poland were lower than in the euro area.

While analyzing the situation in the credit market, further strong decline in the growth of lending to the private sector was indicated. Some members of the Council pointed at the growing credit risk both with regard to corporate loans and household loans. Those members indicated that a considerable increase in lending might take place only after banks' concerns about the quality of their credit portfolios have abated. Moreover, they pointed out that limited lending was also driven by banks' high liquidity preference connected with their focusing on the improvement of their balance sheet structure through increasing the share of liquid assets. Other members of the Council emphasized that the strengthening of banks' capital base might support the increase in lending activity. In this context they assessed that the possible dividend payment by PKO BP would likely lead to a reduction in the supply of loans by this bank. Moreover, those members pointed out that if other banks also decided to pay out dividends, the financial stability risk might increase.

While considering the decision on interest rates, some members of the Council argued that the considerable decline in inflation over the monetary policy transmission horizon anticipated in the June projection, further economic slowdown in Poland, the risk of long-lasting low economic activity abroad and the relatively tight fiscal policy stance, justified lowering the NBP interest rates at the current meeting. Other Council members argued, however, that the low level of real interest rates, current inflation remaining at a heightened level and the uncertainty about the outlook for inflation in Poland amidst growing commodity prices in the world markets and the still high volatility of the zloty exchange rate as well as risks connected with the future fiscal policy justified keeping the interest rates unchanged at the current meeting.

A motion to lower the NBP interest rates by 25 basis points was put forward and passed. The Council decided to lower the NBP interest rates to the level: the reference rate to 3.50%, the lombard rate to 5.00%, the deposit rate to 2.00% and the rediscount rate to 3.75%.

Publication date: 23 July 2009