MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 30 JUNE 2010

The Monetary Policy Council discussed primarily the outlook for economic growth and inflation in the Polish economy, the economic situation in the global economy with emphasis on the euro area, and the situation of the public finance sector.

While discussing the situation in Poland's real economy, it was emphasised that the latest data indicated a stabilisation of economic growth. Some members of the Council pointed out that the structure of economic growth in 2010 Q1, including the high share of inventory build-up, might signal slower GDP growth in the months to come. Moreover, some members of the Council indicated that the flood may also have had a negative impact on GDP in 2010 Q2.

While analysing the outlook for economic growth in Poland, some members of the Council expressed an opinion that its considerable acceleration was currently very unlikely. They emphasized that low economic activity in the euro area would be a factor curbing GDP growth in Poland. Special attention was paid to the risks to the outlook for German exports, and, consequently, for Polish exports, brought about by a growing macroeconomic imbalance in China due to fast economic growth observed in that country. Some members of the Council pointed to the need to take a different look at the link between economic growth in Western Europe and the growth of Polish exports to that region. They emphasized that it was necessary to accept the new reality, namely that in the years to come growth in the Western European countries would reach approx. 1-1.5% annually, which, however, should not prevent Polish exports from growing by 6-10% per year. At the same time they pointed out that in the period from 2004 till the outbreak of the crisis Polish exports had grown 14-23% yearly despite the fact that GDP of the Western European countries grew by a mere 2-2.5% per year.

Some members of the Council emphasized that intensified financial-market turmoil driven by fiscal imbalances in some Western European countries and potential problems faced by financial institutions from European countries could be a more significant threat to domestic economic growth than the absence of clear signs of economic recovery in the euro area. Yet members of the Council pointed out that the hitherto observed zloty exchange rate depreciation might support GDP growth in Poland. Some members of the Council also pointed to the possibility of faster than currently anticipated revival in domestic demand, which might be supported by the good financial condition of enterprises.

While discussing the investment activity of enterprises it was pointed out that corporate investment was being curtailed due to low production capacity utilization, relatively low demand growth and high uncertainty about the outlook for global economic growth as well as about changes in public finances. In the opinion of some members of the Council, corporate investment might thus remain low in the coming years. Other members of the Council assessed, however, that an increase in corporate investment in response to revived demand might be equally as fast as its decline during the crisis. In the opinion of those members of the Council a fast revival of corporate investment might be supported by enterprises’ very good financial condition, including the liquidity condition.

Some members of the Council assessed that limited bank lending would have a negative impact on investment, especially that of SMEs whose financial condition was not as good as the situation of large enterprises. Other members of the Council argued, however, that almost 2/3 of enterprises in Poland did not use bank loans to finance their investment; therefore, the banks' lending policy will not significantly limit their investment activity. Moreover, some members of the Council indicated that the currently low growth in corporate lending was a result of low demand for credit, which was connected with low investment activity and was characteristic of an early stage of economic recovery.

While analysing the results of the June GDP projection based on the NECMOD model some members of the Council assessed that the strong acceleration of public investment and absorption of EU funds in the period preceding the 2012 UEFA European Football Championship anticipated in the projection was very unlikely. For this reason and due to slower economic growth abroad, in the opinion of those members of the Council the year 2011 might be expected to bring lower investment and GDP growth than assumed in the projection.

While analysing the inflationary processes in Poland, some members of the Council judged that the current stage of economic recovery had a non-inflationary character. They pointed out that the negative output gap and slow growth of unit labour costs in the economy would contribute to keeping inflation low. At the same time, some members of the Council assessed that the hitherto observed zloty exchange rate depreciation would be conducive to a rise in inflation. Other members of the Council emphasized, however, that the impact of the zloty exchange rate depreciation on inflation in Poland might be limited by a large share of intra-corporate trade in imports.

While discussing the outlook for inflation developments in Poland, some members of the Council assessed that due to the persisting low level of production capacity utilization and a high unemployment rate, an acceleration of economic growth did not threaten the stabilization of inflation at the level of the NBP inflation target. Other members of the Council argued, however, that even a moderate acceleration of GDP growth might lead to a rise in demand pressure, since – as a result of the global financial crisis – potential output growth in Poland might have declined. Those members stressed that both the June projection based on the NECMOD model and other forecasts prepared at the NBP pointed at a rise in inflation above the inflation target over the monetary policy horizon. They pointed out that in accordance with the results of the June projection the probability of inflation running above the inflation target over the monetary policy horizon was twice as high as the probability of inflation running below the inflation target. They argued that CPI inflation might run at a level higher than that suggested by the central projection path. This may be driven by both faster growth in food and energy prices and an earlier intensification of the wage pressure in the Polish economy than those assumed in the projection. They expressed an opinion that the possibility of growth in food and energy prices over the next twelve months being faster than assumed in the projection was suggested by short-term forecasts prepared at the NBP. Moreover, in the opinion of those members of the Council, the world prices of energy commodities, and, in consequence, energy prices in Poland, might grow faster than expected in the projection also over a longer horizon.

While addressing the June projection's results concerning wages in the economy, some members of the Council pointed out that the relatively low wage growth in the subsequent quarters resulted from the assumption of incomplete adjustment of employment to the fall in demand during the economic slowdown (the so-called "labour hoarding"). At the same time, they indicated that this "labour hoarding" might be attributed to growing specialization of enterprises which results in higher costs connected with staff rotation and to a decline in the pool of qualified labour force caused by emigration. According to those members of the Council, given such sources of this phenomenon it might be a factor intensifying the wage pressure, unlike in the previous economic recovery period. Those members emphasized that in the quarters to come a higher growth in wages in the economy than that anticipated in the projection might be suggested by: accelerating growth in wages in the corporate sector at the beginning of 2010 Q2, high wage growth in the public sector in 2010 Q1 and a relatively large number of job offers per one unemployed person.

In the opinion of those members of the Council, faster growth of wages might also be driven by a good financial condition of firms, including public sector enterprises, which might reduce their resistance to wage demands of employees. A similar impact may be exerted on the one hand, by regulatory changes increasing the flexibility of wage determination in the public sector, and, on the other hand, by the increase in the minimum wage scheduled for the end of 2010. Those members of the Council assessed that the recently observed high wage growth in the mining industry might boost wage demands in other public sector enterprises. Other members of the Council pointed out, however, that the persisting relatively high unemployment would be a factor limiting wage growth in the economy.

Some members of the Council argued that also the number of persons employed in the economy might be higher than that assumed in the projection. This is suggested by gradually growing employment in the enterprise sector whose changes in the past were indicative of changes in employment in the whole economy. Both a faster wage growth than that anticipated in the projection as well as a higher growth in the number of the employed would mean a stronger inflationary pressure stemming from the labour market and would increase the growth in consumption demand.

While discussing the fiscal imbalance in the Western European countries, members of the Council paid attention to the high uncertainty surrounding the implementation of measures aimed to reduce it. It was emphasised that a fiscal consolidation in some of the euro area countries was necessary as its absence could increase turmoil in the financial markets. Some members of the Council assessed that the fiscal consolidation might have a negative impact on economic growth in Poland's trading partners, and, as a result, on Polish exports. Some members of the Council indicated that the fiscal policy tightening might result in private demand revival and faster economic growth in European countries (i.e. the so-called non-Keynesian effects of fiscal tightening might occur). On the other hand, countries which fail to implement a consolidation of public finances or which continue to pursue expansionary fiscal policy, might see a decline in economic growth caused by the fiscal imbalance's negative impact on private demand. Those members pointed out that the impact of the fiscal consolidation on economic growth would depend largely on the structure of the fiscal adjustment (including, in particular, on whether the deficit would be reduced mainly through tax increases or expenditure cuts, and on which expenditures would be reduced). They also emphasised that the emergence of expansionary effects of a fiscal tightening was dependent upon the credibility of the fiscal policy measures.

At the same time, other members of the Council assessed that the scale of the planned fiscal tightening in the Western European countries was not large. Therefore, in the opinion of those members of the Council the impact of the fiscal consolidation on economic growth would be small. They emphasized that amidst low interest rates the occurrence of strong non-Keynesian effects of the fiscal tightening was very unlikely.

The Council paid significant attention to the public finance situation in Poland. It was pointed out that high liquidity in the international financial markets at the moment facilitated the financing of the state budget deficit, and the public finance situation in Poland was hitherto more favourable than that observed in many European countries. Some members of the Council indicated that together with the progressing economic recovery in Poland the general government deficit to GDP ratio, an important indicator used by investors to assess a country's credit risk, would improve as well. Yet, the majority of Council members emphasized that economic recovery alone would not be sufficient to reduce the deficit of the general government sector in Poland to a low level, and that it was necessary to undertake measures aimed at rationalizing public expenditure. It was pointed out that if the other European economies consolidated their public finances and Poland ran a persistently high general government deficit, the costs of its financing might increase.

At the same time, some members of the Council assessed that a considerable reduction in the public finance imbalance in Poland was rather unlikely in the coming months. Those members pointed out that no drafts of legal acts had hitherto been presented which would allow for a considerable reduction of the state budget deficit in the next few years. Some members of the Council indicated that due to some expenditures being transferred outside the state budget, current data on state budget implementation did not allow for an assessment of the situation in the general government sector as a whole. It was emphasised that should the general government deficit remain high it might be necessary to pursue a more restrictive monetary policy.

While analysing the monetary policy abroad and in Poland, it was pointed out that given the absence of clear signs of economic recovery in the euro area, interest rates in this region might be expected to run at a low level for a longer period of time. In the opinion of some members of the Council this was one of the factors to be taken into account while deciding about the monetary policy parameters in Poland. Other members of the Council argued, however, that due to the differences in business cycles in Poland and in the euro area, observed over the past few years, the adjustment of monetary policy parameters in Poland might be needed earlier than in the euro area.

While discussing the impact of the interest rate disparity on the exchange rate, some members of the Council indicated that at the moment this disparity did not have any significant impact on exchange rate developments, as suggested by similar exchange rate developments observed in emerging economies regardless of whether they had already embarked on a monetary policy tightening or not. Those members emphasized that should many countries continue to observe tensions in the public finance sector, the exchange rate’s sensitivity to interest rate changes might remain limited.

While discussing developments in the Polish zloty exchange rate some members of the Council pointed out that due to the real convergence process the real zloty exchange rate should appreciate in the long run. At the same time those members of the Council indicated that in the past few years the exchange rate of the zloty had been highly volatile. It was pointed out that currently changes in international financial market sentiment had a considerable impact on zloty exchange rate. In the opinion of those members of the Council, given the likelihood of risk aversion remaining high in the financial markets, the exchange rate of the zloty will not be a factor curbing inflation in the Polish economy. Yet, some members of the Council assessed that the currently observed zloty depreciation might be temporary.

While discussing the current level of interest rates in Poland, it was assessed that the uncertainty concerning the situation in the external environment and its impact on the Polish economy, including the zloty exchange rate developments, justified keeping the NBP interest rates unchanged.

At the same time, some members of the Council indicated that interest rates in Poland were running at a level lower than the natural rate for the Polish economy. According to those Council members further economic recovery and a growing risk of inflation running above the NBP inflation target might speak in favour of raising the interest rates. Yet, other members of the Council assessed that the absence of clear signs of economic recovery in the euro area, limited investment activity of enterprises and no signs of revival in bank lending to firms might justify the continuation of the existing monetary policy.

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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