MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 8 JUNE 2011

At the meeting, the Monetary Policy Council analyzed the current and anticipated economic growth and inflation, including the prospects for inflation returning to the target, and discussed future decisions on the NBP interest rates.

While addressing external conditions of economic growth and inflation in Poland, some members of the Council pointed out that although the global economy was recovering, there were signs of a possible weakening of economic conditions abroad in the coming quarters. In particular, attention was paid to the negative effects of the large fiscal imbalance in some euro area countries, including worsening consumer sentiment in the peripheral countries of the euro area and the risk of increasing financial market turmoil related to the fiscal problems of Greece. At the same time, some members of the Council pointed to the limited impact of the so-called quantitative easing of monetary policy on economic activity in the United States. They also emphasized that given the risk of a further weakening of economic conditions in the United States, the Fed might undertake additional measures supporting economic growth in the United States despite rising inflation.

Other members of the Council argued that from the perspective of business conditions in Poland, it was particularly important to take into account the economic situation in Germany, whose prospects remained good, as indicated, among other things, by a favourable structure of GDP growth. The growing role of domestic demand, including investment and private consumption, in Germany's economic growth means lower sensitivity of this economy to fluctuations in external demand. Moreover, some members of the Council emphasized that economic activity in Poland might increase relatively fast even in the case of moderate GDP growth abroad.

While addressing the situation in the commodity markets, it was pointed out that the worsening of investor sentiment due to concerns about economic growth in the United States translated into a halt of commodity price growth in the world markets. Members of the Council emphasized, however, that considering the prospects for growing demand for commodities amidst limited supply growth, the observed slowdown in price growth might be temporary. Moreover, some members of the Council indicated that unfavourable agro-meteorological conditions in certain regions key to global food supply (i.e. protracted drought in China) might contribute to a further rise in the prices of agricultural commodities. At the same time, members of the Council argued that the anticipated good crop in Russia would limit the growth in food prices.

While discussing the outlook for economic growth in Poland, some members of the Council argued that subsequent quarters might see GDP growth decline as compared to 2011 Q1, which was signalled, among other things, by a halt in the upward trend in industry and construction. In the opinion of these members of the Council the growth inhibiting factors will include weaker growth of public investment which, most likely, will not be accompanied by a proportionally strong acceleration in corporate investment growth, and a slowdown in private consumption growth. In their opinion, the slowdown in private consumption growth will be connected with a weak – amidst heightened inflation - growth of real disposable income. Those members also pointed out that the acceleration in annual retail sales growth in April was largely due to a statistical base effect.

Other members of the Council assessed, however, that economic growth might continue at a relatively high level due to a favourable outlook for growth of both external and domestic demand. In the opinion of those members of the Council, export growth was supported by good conditions in the German economy, investment growth was supported by good financial results of enterprises and growing productive capacity utilization, and the rise in consumption was driven by increasing employment which might continue as a result of growing investment. While referring to the factors that may weaken consumption growth, those members pointed out that maintaining private consumption growth in 2011 Q1 at a level close to that recorded in 2010 Q4 – despite the already heightened inflation at that time, a simultaneous decline in consumer loans and the bringing forward of purchases to the end of 2010 due to changes in VAT rates scheduled to take effect in 2011 – might attest to the fact that the impact of these factors was limited, and improvement in the labour market was crucial for consumption prospects.

While addressing the impact of growing economic activity on inflation, members of the Council were of the opinion that the implemented fiscal tightening combined with the more restrictive monetary policy would limit the risk of too rapid growth of aggregate demand and of intensifying inflationary pressure. Furthermore, the rebound in corporate investment should boost potential output growth, which is a factor supporting the return of inflation to the target in the medium term. At the same time, some members of the Council emphasized that, in their view, the potential growth rate was now lower than before the financial crisis, which should be taken into consideration in the analysis of the output gap and inflationary pressure. Other members of the Council assessed that the impact of the global financial crisis on potential output growth in Poland was not significant.

While assessing wage growth developments, it was emphasized that the acceleration in wage growth in the enterprise sector in April could largely have resulted from the postponement of the payment of bonuses and awards in the mining and energy sectors, and therefore it was difficult to assess the sustainability of this phenomenon. At the same time, some members of the Council pointed out that factors such as rising current inflation, elevated inflation expectations, weaker than in previous years growth in the number of the economically active, good financial condition of enterprises, particularly in industries with a strong presence of labour unions where wage demands intensified in the recent period, as well as an increase in the minimum wage, could put an upward pressure on wages. Those members also stressed that although growth in unit labour costs in the economy declined in 2011 Q1, the service sector – constituting the largest share of value added in the economy – saw labour productivity growth significantly below wage growth. They also pointed to lags between wage bargaining and real wage growth. Other members of the Council argued, however, that the still high unemployment rate reduced the risk of a mounting wage pressure. This risk, according to members of the Council, is also limited by the already implemented substantial tightening of the monetary policy of the NBP.

While analyzing the developments in lending to the corporate sector, some members of the Council pointed out that the already observed monetary policy tightening did not hamper growth in loans to businesses, although it translated into rising credit costs, which might be indicative of a favorable outlook for lending to this sector. Other members of the Council assessed that rising credit costs could have a dampening effect on growth in corporate lending.

While addressing the outlook for inflation it was pointed out that the acceleration in price growth was observed in most categories of goods and services, and hence affected core inflation. It was also emphasized that an important change as compared to previous years was the fading of the anti-inflationary effect of falling prices of goods imported from countries with low production costs. Some members of the Council assessed, at the same time, that the downward trend in prices of these goods coming to a halt might be a lasting phenomenon, resulting from changes in the labour markets of the largest emerging economies. It was also stressed that the rapid growth in prices was accompanied by heightened inflation expectations.

While assessing the prospects for inflation returning to the target, some members of the Council pointed out that by the end of 2011 inflation was likely to remain above the upper limit for deviations from the inflation target, as suggested by the short-term forecasts prepared at the NBP. It was argued, at the same time, that in line with these forecasts, inflation was soon to start declining gradually and to come close to the inflation target of 2.5% in 2012.

While discussing the NBP interest rates, the majority of Council members agreed that a fast growth in prices in most groups of goods and services and a high level of inflation expectations combined with the risk of rising wage demands justified raising the NBP interest rates further at the current meeting. In their opinion, the low level of the real interest rate was another factor speaking in favour of an interest rate increase.

Some members of the Council assessed, however, that it was not necessary to increase the NBP interest rates at the current meeting, particularly in view of the expectations of ECB interest rates being kept unchanged in June 2011 as well as considering the external nature of the shocks driving up current inflation in Poland.

At the same time, the majority of Council members indicated that the substantial tightening of monetary policy implemented since the beginning of 2011 should enable inflation to return to the target in the medium term, and further tightening of monetary policy would be justified should the prospects of inflation returning to the target deteriorate. An assessment of these prospects will be possible after data released in subsequent months have been analysed. Some members of the Council assessed that in subsequent months further tightening of monetary policy was more likely than monetary policy easing. Yet, other members of the Council argued that from the perspective of stabilizing inflation at the target, the current level of the NBP interest rates might be appropriate in the longer term.

The issue of the POLONIA rate running below the NBP reference rate was also addressed at the meeting. In the opinion of some members of the Council, it would be justified to symmetrically narrow the corridor between the NBP deposit rate and the NBP lombard rate which would lead to a lowering of the deviation of the POLONIA rate from the NBP reference 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 4.50%, lombard rate to 6.00%, deposit rate to 3.00% and rediscount rate to 4.75%.

At the meeting a motion to symmetrically narrow the corridor between the NBP deposit rate and the NBP lombard rate by a total of 50 basis points was put forward. The motion did not pass.

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