MINUTES OF THE MONETARY POLICY DECISION-MAKING MEETING HELD ON 4 JULY 2012

At its meeting, the Monetary Policy Council discussed current and future monetary policy decisions against the background of external and domestic macroeconomic developments, including inflationary processes and also the results of the July 2012 inflation projection.

While analysing the external conditions of macroeconomic developments in Poland, the Council members pointed to the recently observed signs of weakening of the global economic activity. When addressing the economic developments in the United States, the Council members highlighted that the US GDP growth was moderate and might slow down in the subsequent quarters. When discussing the situation in the euro area, attention was drawn to the stagnation in this economy and the persisting uncertainty related to resolving the sovereign debt crisis faced by some euro area member states. Council members stressed that economic activity weakening – apparent in the euro area – was also observed in Germany, driven by economic slowdown in the largest emerging economies, which are major recipients of German exports.

During the discussion, the Council pointed out that weakening of external economic activity, in particular in Germany, translated into a pronounced deceleration in Polish exports growth. At this point, few Council members argued that the situation of Polish exporters was diversified, as some exporting companies reported increasing sales.

When discussing the situation in the financial markets, it was pointed out that growing concerns about the global economic activity had boosted investor expectations of further monetary policy easing by major central banks. At the same time, some Council members assessed that as a result of uncertainty about the scale and consequences of increased monetary expansion in major economies, improvement in sentiment observed recently in the global financial markets might be short-lived. Attention was also drawn to the continuing decline in commodity prices in the global markets.

While analysing the situation in Poland, some Council members pointed out that the current data on economic activity as well as business climate indicators pointed to further slowdown in domestic economic growth. Those Council members stressed that growth in both industrial output and retail sales in 2012 Q2 had been significantly slower than in the previous quarters, and the above-expectations retail sales results in May could have been partly driven by the Euro 2012 football championship. According to those members of the Council, weaker business climate indicators about the expected economic conditions, in particular regarding outlook for demand, orders and production, were a sign of adverse prospects for domestic economic activity. Yet, few members of the Council expressed an opinion that the recently incoming data indicated rather a slight economic downturn. Those Council members pointed to some strengthening of industrial output and retail sales growth in May (that could be driven not only by one-off factors), a sustained strong financial standing of firms and an improvement in liquidity indicators in the corporate sector in 2012 Q2 – as showed by the NBP surveys. Few Council members argued that the relatively sound business conditions in Poland were reflected in further growth in lending, although credit supply might be adversely affected by worsening situation in the euro area.

While assessing the GDP growth outlook in the subsequent quarters against the NBP July projection, some Council members emphasised that the projection envisaged further economic slowdown – deeper than forecast in the March projection. Growth is supposed to be dampened by further weakening in domestic and external demand. In the opinion of some Council members, weaker domestic demand will result from slower investment and private consumption growth, driven by the lack of improvement in the labour market, tighter lending conditions and earlier sharp fall in savings rate. Fiscal tightening and lower inflow of EU funds, the latter related primarily to cuts in public investment, may also contribute to weaker growth. At the same time, few Council members deemed economic growth in the coming years likely to run markedly below the levels assumed in the NBP projection.

Other members of the Council assessed, however, that the impact of lower inflow of EU funds on GDP growth in 2013 would be relatively small. In their opinion, the effect of further fiscal tightening is also likely to be limited. At the same time, a simultaneous decline in inflation may – by increasing real disposable income – support consumption growth. As a consequence, following a marked slowdown this year, GDP growth may gradually pick up in the course of 2013. In this context, few Council members noted that the majority of currently available forecasts of external institutions suggested – in contrast to the NBP July projection – that the 2013 GDP growth might be higher than that observed in 2012.

While discussing the risk of an increase in wage pressures, some Council members pointed out that the risk was limited, as evidenced by still moderate wage growth in the enterprise sector. The continued high unemployment rate was also highlighted as a factor preventing potential escalation of wage pressure. Yet, few Council members were of the opinion that amidst elevated inflation and the resulting growth in living costs, there was a risk of a rise in wage demands.

While discussing inflationary developments, it was pointed out that CPI inflation in May was running substantially below the forecasts and approached the upper limit for deviations from the NBP target. Decline in core inflation was also highlighted. Yet, few Council members stressed that as compared with other EU countries – where inflation is influenced by similar external factors – inflation in Poland remained relatively high.

While discussing short-term outlook for inflation, the members of the Council pointed to a likely rise in the CPI in the nearest months, resulting from the statistical base effect in food prices. In the immediate future, inflation may be also heightened by steeply rising administered prices, partially due to increases in charges and prices set by general government units. At the same time, it was noted that considerable uncertainty was related to the zloty exchange rate changes and its impact on inflationary processes.

While discussing long-run inflation trends, some Council members pointed out that the July inflation projection was lower than the March projection, which means a faster than expected return of inflation to the target. According to the July projection, at the end of 2012 CPI inflation will be running below the upper limit for deviations from target, and may come close to the inflation target of 2.5% in the first half of 2013. Few Council members noted that towards the end of the inflation projection horizon, CPI inflation may even fall below 2.5%, though remaining within the limit for deviations from the target. Moreover, those Council members pointed that external forecasts are also suggesting a decline in inflation in 2013, down to a level close to the inflation target.

Few Council members argued that in line with the July projection, however under the assumption that VAT rates are not reduced in 2014, core inflation will remain at a relatively high level, which might impede the return of CPI inflation to the target. Besides, in the opinion of these Council members, the economic slowdown is likely to be moderate and therefore no substantial decrease in inflationary pressures should be expected.

While considering monetary policy decisions, the majority of Council members presented the opinion that – given the economic slowdown and the return of inflation to the target within a few quarters, as assumed in the July projection – the current level of the NBP interest rates is appropriate. Those Council members also argued that the interest rates adjustment implemented in May 2012 – being conducive to lower inflation – contributed to sustained macroeconomic stability of the domestic economy. In the opinion of those Council members, data and forecasts which had been released since the previous meeting of the Council did not provide grounds for further NBP interest rate increases, though they did not completely rule out the possibility of raising the NBP interest rates. According to those Council members, current or forecast macroeconomic situation did not justify interest rate cuts. In turn, few Council members assessed that the current level of the NBP interest rates – given the signs of a possible significant economic downturn and the risk of inflation falling below the target in the medium term – is too high and thus may lead to excessive deceleration of economic growth. These Council members also argued that interest rate reduction, by mitigating the slowdown in GDP growth, would support the currently implemented fiscal policy tightening.

At the meeting, a motion to lower the NBP interest rates by 0.50 percentage point was put forward. The motion did not pass. Also a motion to lower the NBP interest rates by 0.25 percentage point was put forward. The motion did not pass. The Council decided to keep the NBP interest rates unchanged at the following levels: reference rate at 4.75%, lombard rate at 6.25%, deposit rate at 3.25%, rediscount rate at 5.00%.

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