Minutes from the Monetary Policy Council Decision-Making Meeting held on 2 July 2014

At its meeting, members of the Monetary Policy Council discussed the current and future monetary policy decisions against the background of macroeconomic developments in Poland and abroad and the July projection of inflation and GDP.

While discussing business conditions abroad, Council members underlined that global activity growth remained moderate. It was emphasised that the recovery in the euro area continued at a slow pace, despite a certain improvement in the business climate in the peripheral economies of the monetary union. Some Council members also pointed out that following the data revision in the United States, 2014 Q1 GDP growth had been negative and weaker than originally estimated. Other Council members underlined, that the fall in GDP had been related to weather conditions and the second quarter should see a considerable rebound in GDP growth. With reference to the situation in major emerging economies, including Russia, it was indicated that economic activity growth in these countries remained slow. However, it was emphasised that recovery continued in countries of Central and Eastern Europe.

At the meeting monetary policy in the external environment of the Polish economy was discussed. Attention was drawn to the easing of monetary policy by the European Central Bank (including interest rates cut and the introduction of a new liquidity provision to the banking system programme, conditional upon increased lending) and by some banks in emerging economies. It was emphasised that the ECB might announce further quantitative easing programmes in the subsequent quarters. Some Council members pointed out that the easing of monetary policy by the ECB increased the interest rate differential between Poland and majority of the countries in its environment as well as the importance of this differential for exchange rate developments.

While discussing the effectiveness of the non-standard measures undertaken by the major central banks, some Council members were of the opinion that those measures allowed to meet the rising demand for liquidity from economic entities. It was argued that in the absence of those measures, the growth in economic activity in the largest economies would probably have been slower. Some Council members argued, however, that the effectiveness of the non-standard measures taken by the major central banks is low. Amidst still not fully restructured balance sheets in the banking sector and uncertainty persisting in the economy, this measures fail to boost lending and aggregate spending while producing an undesirable effect of excessive growth in the prices of some assets. Those members also pointed out that although quantitative easing provided liquidity to the economy and gave banks and enterprises time to restructure, the maintenance of interest rates close to zero undermined the incentives for restructuring.

 ul. Świętokrzyska 11/21 00-919 Warszawa, Poland phone +48 22 185 28 88 sekretariat.rpp@nbp.pl

Council members also observed that the strongly expansionary monetary policy of the major central banks had not, as yet, driven up inflation to any significant degree, and that inflation in Poland's immediate environment remained very low. A few members argued that low inflation in the global economy might persist for a longer time, considering the limited demand growth and the absence of commodity price growth in the global markets.

While discussing the economic situation in Poland, Council members emphasised that economic activity growth might have slowed down in the past few months, which might be partly – and in the assessment of a few Council members primarily – the effect of the conflict between Ukraine and Russia. The slowdown in economic activity growth was reflected in lower growth in industrial output, construction and assembly output as well as in retail sales. It was highlighted that some business climate indicators declined and employment growth in the corporate sector ground to a halt. The Council also underscored considerable uncertainty concerning the permanence of the recent slowdown in economic activity. A few Council members presented the view that the accelerating growth in lending suggested a continuation of the recovery in domestic demand in the subsequent months. At the same time they emphasised that as economic recovery continues, lending might accelerate further and exceed nominal GDP growth markedly.

With reference to current inflation, it was observed that in May the annual consumer price growth had decreased again and was significantly below expectations. It was also emphasised that producer prices in industry in year-on-year terms continued to fall and that inflation expectations of households and enterprises remained low. It was argued that low inflation resulted not only from supply shocks (including the decline in fruit and vegetable prices), but also from moderate demand growth reflected in low levels of core inflation. Some members of the Council also pointed to a negative growth in import prices as an important source of low inflation in Poland. Some members of the Council noted that the lower than expected inflation was conducive to a rise in real interest rates.

While analyzing the July projection of inflation and GDP, members of the Council pointed out that, although in the subsequent quarters GDP growth was not likely to accelerate significantly, it might exceed potential GDP growth. As a result, the output gap, which is now negative, should be gradually closing within the projection horizon. Some Council members underlined, however, that at the end of the projection horizon GDP growth would be close to potential output growth. Council members also pointed out that – in line with the projection – all the components of domestic demand as well as exports were supposed to rise and that a certain slowdown in investment growth at the end of the projection horizon might be driven by a reduction in the EU-financed public investment. It was emphasized that in line with the projection, economic recovery in the coming quarters would, to a certain extent, boost wage growth in the economy, which should, however, remain below the long-term average. It was pointed out, however, that wage growth is expected to outpace labour productivity growth, which would lead to a gradual increase in unit labour costs growth. Some Council members underlined that in the long-term projection horizon, the growth of unit labor costs could exceed the NBP inflation target.

While analyzing the inflation projection, members of the Council emphasized that in the coming quarters inflation would be lower than expected in the March projection. They indicated that inflation might fall below zero in the coming months, and in the subsequent few quarters would continue to be very low. It was pointed out that inflation would rise close to the target at the end of the projection horizon. It was argued that, in line with the projection, the increase in inflation would be supported by the projected improvement in the labour market as well as a certain rise in food and energy prices. A few Council members pointed out, however, that a growth in those two price categories should be – according to the projection – lower than long term average.

Referring to the possible effects of the expected temporary fall in inflation below zero in the coming months, a few members of the Council were of the opinion that it would boost the real purchasing power of consumers and expand consumer demand. Other members of the Council believed that the likely fall in inflation below zero could prompt households to postpone consumption. Those members were of the opinion, that present interest rates level under current macroeconomic developments could deepen deflation.

Members of the Council pointed to the risks associated with the projection of inflation. Some of them emphasized that the distribution of risks in the projection was asymmetric and the probability of inflation running below the central path was higher than the probability of inflation running above the path. However a few members of the Council were of the opinion that higher than assumed energy prices, possibly being the result of the Middle East conflict, might be a risk factor for higher inflation. Other Council members argued that core inflation in the projection rose to a level which in the past had occurred only when CPI inflation had been higher than the upper limit for deviations from the inflation target.

The Council decided that the NBP interest rates should remain unchanged at the current meeting. The rationale for this decision was the ongoing economic recovery, which should contribute to inflation rising close to the NBP inflation target over the projection horizon. Yet, Council members were of the opinion that there persisted uncertainty regarding a possible deterioration in the business climate and the pace of return of inflation to the target. Therefore, a few Council members pointed out that interest rate decrease could be necessary in the near future. The Council was of the opinion, that decisions in the coming months should depend on the assessment of incoming data from the point of view of the prospects for further economic recovery and inflation developments in the medium term.

Publication date: 21 August 2014

ul. Świętokrzyska 11/21 00-919 Warszawa, Poland phone +48 22 185 28 88 sekretariat.rpp@nbp.pl