Minutes of the Monetary Policy Council decision-making meeting held on 8 July 2015

Members of the Monetary Policy Council discussed monetary policy against the background of the current macroeconomic developments in Poland and abroad as well as the results of the July projection of inflation and GDP.

Analysing economic conditions abroad, the Council emphasised the consolidation of the euro area recovery. It was observed that the sustained growth in economic activity in the euro area was supported by a further decline in unemployment, the earlier strong depreciation of the euro and positive business and consumer sentiment. It was pointed out that as the economic activity improved and financing became more available, lending growth gained momentum. Good economic performance and favourable GDP forecasts for Germany – which is Poland's main trading partner – were also brought to attention. Moreover, some Council Members pointed to the temporary nature of the 2015 Q1 economic slowdown in the United States. Those members observed that the favourable outlook for the US economy was good labour market conditions, improving real estate market and the increasingly robust retail sales growth.

Some Council members emphasised that economic activity in the euro area – despite recovery – remained relatively weak. It was also indicated that the continuation of the euro area recovery may be jeopardised by Greece's possible default and the country's exit from the common currency area. It was emphasised that the response of the financial markets to the situation in Greece had been moderate so far. At the same time, it was pointed out that should Greece's negotiations with its creditors fail, this might hurt sentiment and economic activity in the euro area and worldwide. Certain Council members believed that the impact of a Greek default would probably be weaker now than if it had happened in the previous years.

Some Council members also highlighted the continued weakness of business activity in the largest emerging economies as a considerable risk to global economic growth. It was argued that the relatively subdued output growth in these economies was dragging on export growth in the developed countries, including Germany. Particular attention was paid to the weaker than in the previous years economic activity in China and the effects of excessive investment in the real estate market in this country. In this context, certain Council members considered that the developments in China – as well as the sentiment in the global financial markets – might also suffer from the slump in share prices on stock exchanges in this country.

With regard to global inflation developments, the Council pointed to the recent pick-up in price growth in many economies. It was emphasized, however, that amidst the merely modest global economic recovery and the persistence of relatively low commodity prices, inflation pressure in the global economy remained very weak, with

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price growth in the euro area, the United States, and – on average – the countries of Central and Eastern Europe hovering barely above zero.

While analysing the situation in the global commodity markets, it was observed that oil prices had edged down recently. In turn, agricultural commodity prices had risen sharply on the back of concerns about poor harvest due to unfavourable weather conditions.

When discussing monetary policy in Poland's external environment, it was pointed out that the main central banks were keeping interest rates close to zero. At the same time, while the ECB had announced the continuation of asset purchases until at least September 2016, the Fed had signalled the commencement of interest rate hikes as early as this year. Certain Council members emphasised, moreover, that some central banks in Poland's most immediate environment, i.e. in Sweden, Norway and Hungary, had eased their monetary policy in the recent period, as well as banks of the largest emerging economies – India, Russia and China.

While analyzing the situation in the real sphere of the Polish economy, some members expressed the opinion that GDP growth in 2015 Q2 might have continued close to the previous quarter's level. Members of the Council assessed that consumption, fuelled by further increase in real income of households and their positive sentiment, was likely to have remained the key driving force behind growth in economic activity. It was pointed out that growth in economic activity in 2015 Q2 was also supported by a further rise in investment. It was argued that corporate investment activity was driven by good financial conditions of corporations, enabling them to finance investment projects with their own funds. At the same time, some Council members pointed to a slowdown in both industrial production at the beginning of 2015 Q2 and sales in construction and assembly production in May 2015, as well as a merely moderate increase in retail sales. Certain Council members assessed that this might indicate a stabilization of economic growth in the coming quarters at the level close to that in 2015 Q1, or even its slight weakening.

In the opinion of the Council members situation in the labour market remained good. In particular, employment continued to rise and unemployment was still falling. Some members of the Council emphasized, however, that employment growth in the enterprise sector had levelled off, while the nominal wage growth in the sector had slowed down in the recent period. Nevertheless, certain Council members pointed that the real wage growth remained high and exceeded labour productivity growth. In the opinion of those members this situation, if continued – as indicated in the July projection – might bring about adverse structural changes in the economy; in particular, it might inhibit further increase of the share of industry in value added. Other Council members were of the opinion that the relatively rapid growth in real wages was justified given a relatively modest ratio of wages to GDP in Poland. Those members were of the opinion that high real wage growth did not necessarily have a negative impact on the economy,

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as labour productivity would increase with growing technological advancement and innovation.

While analyzing the situation in the financial sphere of the Polish economy, members of the Council remarked that the increase in lending to the private sector had slowed down somewhat in the recent period. It was pointed out that the rise in current account deposits was accompanied by a decline in term deposits. At the same time, growth of cash in circulation picked up. Certain members of the Council assessed that sustained high growth in mortgage lending in PLN, combined with a rising share of households whose income net of interest payment had fallen below the subsistence level, might be a source of risk to financial stability. Those members also expressed the opinion that the rising percentage of companies unable to cover interest expenses out of their profits was a negative phenomenon. Yet, the majority of Council members concluded that the financial sector showed no sign of imbalances or any tangible risk of their occurrence in the future. Some of those members of the Council emphasized that the growth of housing loans in transaction terms, had fallen to its lowest level in more than a decade. They also pointed out that the risk of excessive growth in housing loans in the future would be limited by the steady tightening of macro-prudential policy as the ceiling on the LtV ratio was progressively reduced. Referring to the ability of enterprises to repay their loan obligations, those members pointed out that the share of loans with payment delays was not increasing and remained at a moderate level.

When discussing the outlook for economic growth in the context of the July projection, it was indicated that GDP growth would be relatively stable at close to 3.5% over the whole projection horizon. Certain members of the Council pointed out that the central path of the July projection was slightly above that of the March projection. According to the current projection, economic growth throughout the projection horizon would be primarily supported by rising consumption, as well as the still relatively high – despite a certain weakening in the second half of 2016 – investment growth. Some Council members emphasized that given the projected GDP growth, the output gap would close in 2015 and would remain near zero in the subsequent years.

In the opinion of certain members of the Council, economic growth may, however, be stronger than indicated by the central projection path. According to these Council members, higher GDP growth may result from a slightly weaker exchange rate of the zloty than that accounted for in the projection. In this context, the above Council members indicated that the political risk related to the parliamentary elections and also the beginning of interest rate increases by the Fed might lead towards depreciation of the zloty.

In turn, some Council members highlighted downside risks to the forecasted path of economic growth. In particular, it was pointed out that Greece's possible default and its exit from the euro area might enhance risk aversion in the financial markets. This in turn, according to these Council members, could result in a rise in debt servicing costs, an outflow of portfolio capital from Poland and a depreciation of the zloty, which would

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increase the charges on economic entities resulting from foreign currency denominated loans. Unfavourable developments in Greece could also weigh down on business conditions in the euro area, which in turn would have an adverse impact on economic activity in Poland. However, the majority of Council members were of the opinion that the impact of turmoil related to the situation in Greece on the Polish economy would probably be limited.

Some Council members pointed to the shape of fiscal policy next year as a factor of uncertainty. These Council members emphasized that there was a risk of fiscal policy easing, particularly as the excessive deficit procedure against Poland had been lifted.

Discussing inflation developments in the economy, the Council members drew attention to the gradual increase in price growth. However, some Council members stressed that the weakening of deflation resulted exclusively from the increased growth of food and energy prices. At the same time, the majority of Council members assessed that given the moderate growth in demand and nominal wages as well as the persistently negative output gap, there was no inflationary pressure in the economy. In the opinion of these Council members, this was indicated by the still very low core inflation and continued decline in producer prices in annual terms. The Council members also drew attention to inflationary expectations remaining at a very low level.

Addressing the outlook for inflation, it was emphasized that in accordance with the July projection, assuming unchanged interest rates, price growth in 2015 Q4 would increase above zero and in the coming years would gradually move towards the inflation target. However, certain Council members were of opinion that price growth might be lower than indicated by the central projection path. In turn, other Council members assessed that price growth would be higher than indicated in the July projection, which could be caused by a weaker exchange rate of the zloty than that accounted for in the projection as well as a higher than assumed growth in food and energy prices.

Referring to the decision on interest rates, the majority of Council members acknowledged that in the coming years inflation was likely to gradually rise towards the target, but there was no risk of exceeding the target in the medium term. At the same time, the projection and external forecasts indicate that economic growth in the coming years would be around potential and should not lead to imbalances in the economy. Moreover, favourable conditions in the labour market continue, yet not entailing growth in wage pressure. In such a situation, and also taking into account that real interest rates will decline along with the forecasted increase in price growth, it is justified to stabilise nominal interest rates at the present level.

Certain Council members pointed out, however, that with nominal interest rates unchanged amidst gradually accelerating price growth, real interest rates might approach zero next year. Moreover, these Council members expressed the opinion that weak growth in food and energy prices was concealing wage pressure in the economy and increasing the current account balance. As a result, with shocks leading to low food and commodity prices waning, macroeconomic imbalances could build up in the economy. For these reasons, it may be justified – in their opinion – to consider in the coming quarters an increase in interest rates.

Yet, other Council members indicated that currently it was difficult to determine the direction of future interest rate decisions, particularly taking into account the uncertainty of the situation in Poland's external environment and its impact on the Polish economy.

The Council decided to keep the basic NBP interest rates unchanged: the reference rate at 1.50%, the lombard rate at 2.50%, the deposit rate at 0.50% and the rediscount rate at 1.75%.

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