Minutes of the Monetary Policy Council decision-making meeting held on 6 July 2016

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

During the discussion on external economic conditions, it was observed that global economic growth remained moderate and uncertainty about its outlook remained. It was highlighted that a significant part of this uncertainty came from the voting results of the United Kingdom's (UK's) European Union (EU) referendum. It was noted that in the euro area economic recovery continued and data releases on employment and consumer sentiment were supportive of the outlook for consumption. At the same time, it was stressed that the UK's decision to withdraw from the EU had led to an increase in downside risks to economic outlook in the euro area. Yet, certain Council members argued that the uncertainty arising from the UK's future exit from the EU might be concentrated in the British economy and its immediate environment. It was stated that an in-depth assessment of the impact of the UK's departure from the EU on global economic conditions would be possible only after its conditions and timing had been determined.

Referring to developments in the United States, it was noted that moderate GDP growth in this country continued, but the economic outlook was difficult to assess. In this context, it was underlined that consumer expenditure and retail sales continued to rise, but, at the same time, labour market data were weaker than expected and industrial output continued to decline.

The Council members emphasised that energy commodity prices – despite a recent uptick – remained considerably lower than in previous years. Certain Council members judged that there were no signs of renewed decline in energy commodity prices in the near future. However, they stressed that a falling trend in oil and financial asset prices could not be completely ruled out, which could point to a deterioration in the global economic outlook. It was pointed out that low commodity prices, coupled with moderate global economic activity, were the main factors of extremely weak consumer price growth in many economies, including the euro area.

It was observed that under such circumstances the European Central Bank (ECB) maintained its policy interest rates near zero and had launched a corporate bond purchase programme in June. Some Council members took the view that given an intensification of downside risks to the economic outlook for the euro area, the period in which ECB interest rates are kept very low might be extended. In the United States, in turn, the interest rates had been left unchanged, but mixed signals about economic activity in this economy were adding to the uncertainty about the future decisions of the Federal Reserve.

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

When analysing the developments in global financial markets, the Council members drew attention to an increase in risk aversion following the announcement of the UK's EU referendum results. The rise in risk aversion was demonstrated in depreciation of exchange rates and a decline in asset prices in many economies, including Poland. The Council members pointed out that the market reaction to this event, while relatively strong, was short-lived. Certain Council members underlined that the zloty exchange rate fluctuations in response to external shocks – such as the outcome of the UK vote – might cushion the impact of those shocks on economic conditions in Poland.

While discussing the developments in Poland's real economy, the Council members assessed that GDP growth – having decelerated in 2016 Q1 – had probably picked up slightly in the following quarter. It was assessed that the increase in GDP growth had probably been driven by accelerating consumption, supported by the relatively robust growth of the wage bill, the launch of payments under the "Family 500 plus" programme, as well as higher – compared to the previous quarter – EU's Common Agricultural Policy direct payments. It was observed that while higher disposable income of households had not yet translated into more robust retail sales growth, it might have stimulated consumer expenditure not included in the present data, such as spending on services. Some Council members believed that following a decline in investment in the previous quarter, investment growth in 2016 Q2 was probably slow or even negative, as the uncertainty about future conditions for business activity remained and absorption of EU funds under the new EU financial framework was slow. Referring to longer-term investment trends, certain Council members emphasised the low share of investment in GDP, which – given the prospect of declining labour supply due to the population ageing – might adversely affect economic growth in the future.

The Council members underlined the sound labour market conditions reflected in high employment and a low unemployment rate. Yet, certain Council members noted that despite these favourable developments, the wage share in GDP in Poland was smaller than in most EU member states. With reference to the long-term outlook for the labour market, other Council members judged that this market was being distorted by low labour force participation rate. However, these members observed that the problem might be mitigated by a gradual increase in labour force participation among the oldest cohorts.

When discussing the economic outlook for Poland, the Council members assessed that after a temporary weakening in 2016 Q1, GDP growth would remain stable in the coming quarters, as suggested also in the July projection. At the same time, it was pointed out that GDP growth in the July projection was substantially lower compared to the previous forecasting round. A majority of the Council members expected GDP growth to turn out slightly higher than in the July projection. Certain Council members highlighted the fact that the downward shift in the GDP growth path in the July projection resulted partly from the inclusion of weaker real economy data from 2016 Q1, which – considering their temporary nature – should have little impact on activity

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growth in the quarters to come. In the opinion of the Council members, economic growth will continue to be primarily supported by a rise in consumption, which is likely to accelerate. Increasing consumer demand will be supported by higher disposable income of households resulting from the expanding wage bill and the disbursement of child benefits. The announced rise in the minimum wage might prove another factor supportive of consumption growth in the following years, as – in the opinion of certain Council members – it could translate into higher wages for better-paid employees. Other Council members argued, in turn, that the scale of the impact from the rise in the minimum wage on employment level was uncertain.

With reference to the outlook for investment, some the Council members assessed that investment growth would probably accelerate in the following quarters. In this context, attention was drawn to good financial standing of Polish companies, their high capacity utilisation and a prospect of higher absorption of EU funds under the new EU framework as expected by certain Council members already in the second half of 2016. Certain Council members were of the opinion that, over longer run, investment and, to a lesser extent, consumption might be supported by an announced government scheme for rental housing construction ("Housing Plus"). Other Council members held the view that assessment of investment outlook in the coming quarters was complicated due to the uncertainty regarding the pace of EU funds spending and firms' propensity to invest, as well as the extent of the "Housing Plus" scheme.

When assessing the potential impact of the UK's withdrawal from the EU on the Polish economy, it was underlined this assessment was subject to high uncertainty. Some Council members expressed an opinion that the impact of the UK's exit from the EU on Poland's economic activity would probably be limited. The effects of any changes in the conditions for trade exchange and the access to the UK labour market were also judged limited and extended over time. Certain Council members highlighted the fact that the impact of weaker external economic conditions resulting from the UK's vote on Polish exports would be mitigated by the recently observed depreciation of the zloty. Yet, certain Council members pointed out that should the zloty appreciate, export growth might decelerate, which – given the expected sharp increase in domestic demand, fuelling import growth – might lead to current account imbalance. Other Council members believed that elevated uncertainty related to the UK's decision might encourage investors to redirect capital from the UK to other European economies, including Poland.

While analysing price developments in Poland, it was stressed that price growth remained negative, but deflation had slowed down somewhat in June. It was emphasised that this was accompanied by a slight rise in core inflation measures and a marked weakening in the pace of decline in producer prices. It was also noted that wage growth in the corporate sector had risen recently, which might be a sign of accelerating wage growth in the whole economy.

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The majority of the Council members were of the opinion that the ongoing deflation had not yet adversely affected the decisions of economic agents. Certain Council members additionally expressed the view that due to the stable – though low– inflation expectations of economic agents, the risk of negative effects of deflation materialising in the future was also limited. In turn, certain Council members held the view that the ongoing deflation could be one of the factors dragging on corporate investment activity. These members indicated that due to deflation borrowing costs in real terms were higher than in nominal terms. In their opinion, deflation has been also adding to the uncertainty about future profitability of corporate activity, which might deteriorate the assessment of the outlook for the corporate sector. Other Council members noted, however, that relatively mild deflation might only discourage projects with a low expected rate of return. Yet, certain Council members were of the opinion that the decline in prices might increase firms' propensity to launch modernisation investment projects, as falling sales prices encourage labour productivity improvements and reduction in costs.

With respect to the outlook for price growth, it was observed that in line with the July projection it should increase above zero in the last quarter of 2016 and return near the lower bound for deviations from the target in 2017 Q2. The opinion was expressed that the path for price growth in the July projection – despite the output gap closing more slowly than expected – was only marginally weaker than previously anticipated. It was emphasised that price growth might be boosted by the weaker zloty exchange rate, higher child benefits and the forecasted acceleration in wage growth, additionally supported by the announced rise in the minimum wage.

While discussing decisions concerning the NBP interest rates, the Council judged that they should remain unchanged at the July meeting. A majority of the Council members pointed out that deflation was not adversely affecting decisions of economic agents and within one year and a half price growth was expected to have approximated the lower bound for deviations from the inflation target. Furthermore, in the opinion of the Council members, sustainable economic activity growth would be continued in the coming quarters. It was observed that weakening in external demand, if any, would be offset by expanding domestic demand, additionally supported by looser fiscal policy. The Council members confirmed that against this background stabilisation of interest rates helped to keep the Polish economy on a sustainable growth path and maintain macroeconomic balance. An additional argument for interest rate stabilisation was – in the opinion of the Council members – the elevated uncertainty surrounding domestic and external conditions for monetary policy. Some Council members pointed out that the Council's decision should also take into account the impact of the interest rates level on the stability of the domestic financial sector.

Some Council members did not rule out the possibility of an interest rate decrease in the future should domestic economic growth weaken considerably, or in the event of deeper deflation or signs of its negative impact on the behaviour of economic agents. Certain Council members suggested that an interest rate cut might be justified already in

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the following few quarters. They argued that the interest rate on corporate and household loans remained high in comparison with other European countries, and its reduction – which would be supported by a cut in the NBP interest rates – would be conducive to higher GDP growth, most notably by boosting investment activity growth. In contrast, other Council members judged that the present interest rate on investment lending was already low, with an interest rate cut possibly triggering the launch of projects with a low expected rate of return.

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

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