NBP

National Bank of Poland
Monetary Policy Council

MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 26 AUGUST 2009

During the meeting the Monetary Policy Council discussed the outlook for inflation in the context of the past, current and, primarily, anticipated economic situation.

The discussion at the meeting focused on the outlook for economic growth abroad and in Poland, medium-term inflation outlook, zloty exchange rate developments and credit market conditions.

While discussing the external environment of the Polish economy it was pointed out that the data on the United States and the euro area, including the GDP data for 2009 Q2, indicate easing of recessionary tendencies in those economies. In particular, it was emphasised that GDP in quarterly terms grew in Germany and France, i.e. in countries being the most important markets for Polish exports. It was pointed out that GDP growth might have been driven by growing demand for exports of those countries reported by the Chinese economy, which was connected with the fiscal stimulus programme supporting public sector investment in China. It was indicated that since the July meeting of the Council, the majority of economic sentiment indicators had further improved and GDP growth forecasts for 2010 in the United States and in the euro area had been slightly revised upwards.

At the same time, it was emphasised that the global economic activity had continued at a low level and at present it was difficult to assess whether the easing of recessionary tendencies would prove permanent and what would be the scale of a possible recovery. Considerable uncertainty about the outlook for the global economy is primarily connected with the next year’s finalising of stimulus programmes which are now significantly contributing to mitigating recessions in major economies. The unfavourable situation in the labour market, strong rise in savings and decline in consumption in the United States together with further deterioration in euro-area labour market all indicate that the stimulus programmes may have only a limited bearing on reviving private demand. Another important factor affecting global economic growth will be GDP growth in China. The assessment of the growth outlook is additionally hindered by persisting problems in the banking sector.

Some members of the Council argued that the above mentioned factors, after a temporary recovery driven by direct effect of stimulus programmes, might bring about another decline in the global economic growth. In particular, those members argued that the expected recovery in the euro area might not prove long-lived. In this context, they pointed out that despite certain improvement in the financial markets conditions the majority of commercial banks operating in the euro area continued to tighten their lending policies. Other Council members assessed that despite considerable uncertainty persisting, the incoming information indicated an improvement in the outlook for the global economic growth, which might suggest that the global recession would be less severe than anticipated. Those members also pointed out that the growing role of Asian countries in the global economy might contribute to the recovery in the euro area despite weak domestic demand in this economy.

While analysing the inflationary processes abroad, it was pointed out that despite growing commodity prices the decline in overall price level in the United States and in the euro area had

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further deepened, amidst further decrease in positive core inflation indicators. Some members of the Council argued that these trends indicated that possible global inflationary threats would be probably of a longer-term nature and in the coming quarters major central banks should not be expected to start tightening their monetary policy. In the opinion of those Council members, the persisting pressure on price decline in the global economy would be, through import prices, curbing inflation in Poland. Other members of the Council pointed out that due to an unprecedented scale of stimulation measures introduced in the largest economies, the credibility of the so-called exit strategy from the expansionary macroeconomic policy would be of key importance for permanent anchoring of inflationary expectations and, as a result, for stabilising inflation at a low level.

While addressing the situation in Poland, the members of the Council pointed out that the data on the domestic economic climate were ambiguous. On the one hand, further decline in Polish exports and persisting negative annual growth in industrial output (including the output of intermediate and investment goods), deepening fall in employment in the corporate sector, growing unemployment rate and further decline in bank lending all pointed to the continuation of low activity in the Polish economy. On the other hand, the majority of economic sentiment indicators rose, which may indicate an improvement in the economic situation in the months to come.

While discussing the outlook for economic growth, it was stressed that it largely depended on economic situation abroad and the related external demand for Polish products. It was pointed out that factors supporting economic growth in Poland included the continuing, albeit lower than in the previous quarters, consumption growth and a positive contribution of net exports, connected with both the improvement in the price competitiveness of the Polish products in relation to imports driven by the depreciation of the zloty in the second half of 2008 and at the beginning of 2009, and also by the effect of stimulus packages introduced in the major world economies. In this context it was argued that uncertainty related to GDP growth in Poland included how permanent would be the easing of recessionary tendencies in Poland's main trading partners and exchange rate developments. Some Council members pointed out that the zloty appreciation observed over the recent months, through lowering the price competitiveness of Polish products, may be conducive to reducing the contribution of net exports to GDP growth and to extending the slowdown in the Polish economy. Those Council members argued that the same effect may be brought by the deterioration of labour market situation, including the lowering of the real aggregate wages, which may translate into curbing consumer demand. It was pointed out that another factor that had a negative impact on GDP growth was the reduction in the supply of bank loans.

At the meeting, the Council also discussed current and expected inflation developments. It was indicated that the inflation rise in July 2009 to 3.6%, i.e. above the NBP's inflation target of 2.5% and slightly above the upper limit for deviations from the target set at 3.5%, was primarily driven by a strong surge in prices of tobacco resulting from changes in the excise tax and by a further increase in fuel prices. Some Council members argued that despite the fact that inflation could remain at a heightened level in the coming period – mainly due to the relatively high annual growth of food and regulated prices – the available forecasts point to its decline in the second half of 2010, which should be supported by the negative output gap connected with the still weak external and domestic demand, continuing low wage pressure and the previous appreciation of the zloty.

Other Council members emphasised that CPI inflation in Poland is characterised by a relatively high persistence and subsequent projections were extending the horizon of inflation returning to the target, which does not support the anchoring of inflation expectations. Those members also pointed out that in line with the June projection, in 2010-2011 CPI inflation should be running below core inflation net of food and energy prices, which has not been observed since 2003. Moreover, some members of the Council argued that the slowing potential output growth combined with the improving outlook for economic growth may cause the negative output gap to close earlier than anticipated. It was also emphasised that currently both inflation and GDP growth in Poland were significantly higher than in most countries of the European Union.

The Council paid a lot of attention to the exchange rate developments, emphasising the zloty appreciation in the recent period. Some Council members indicated that the improved sentiment in the world financial markets, relatively favourable economic situation in Poland as compared to other EU countries and the access to a flexible credit line of the International Monetary Fund lowered the risk of strong zloty depreciation. At the same time, the persistently heightened volatility of the zloty exchange rate was emphasised.

Some members of the Council indicated that one factor affecting the zloty exchange rate could be the disparity of nominal interest rates between Poland and the euro area and the United States favouring – especially amidst stabilising financial market situation – the inflow of capital, which was reflected in the growing share of foreign investors in the market of Polish Treasury securities. Other Council members, however, assessed that the perspectives of capital inflow to the Central and Eastern European countries were to a greater extent influenced by the sentiment of foreign investors towards the region and by the disparity in real terms, which was significantly lower than that calculated in nominal terms.

While addressing the situation in the banking sector, on the one hand – the further reduction of lending to the corporate sector was emphasised, and on the other – the still stable increases in consumer loans to households. In this context, some Council members pointed out that banks were increasing their profit margins, which meant that lowering of the costs of newly granted loans was smaller than the scale of the implemented cuts in the NBP interest rates. In the opinion of those Council members, the monetary policy should account for shifts in profit margins resulting from the business cycle. Other members of the Council argued that in the current situation the effectiveness of the credit channel was limited, which meant that possible further interest rate cuts would have only minor effect for the supply of credit.

While analysing the situation in the banking sector, the Council also discussed the situation of cooperative banks. It was emphasised that those banks have a large local significance, among others, due to the preferential loans they offer for investments and development projects in agriculture as well as their contribution to financing local governments. It was pointed out that cooperative banks were characterised with a surplus of deposits over extended loans and a lower share of irregular loans in their credit portfolios than commercial banks, which gave cooperative banks considerable potential for lending expansion. However, in the opinion of some Council members, an increase in lending by cooperative banks called for the adoption of measures aimed at raising regulatory capital of this sector.

While discussing interest rates, some members of the Council pointed out that the real ex ante rates, i.e. rates deflated with expected inflation, remained positive, which combined with the output gap remaining negative, could justify further NBP rate cuts. Other members of the Council, however, argued that amidst large uncertainty accompanying inflation forecasts and, at the same time, its high persistence, economic agents in their decision making would to a larger extent consider the real ex post interest rates, i.e. rates deflated with current inflation, which were currently close to zero and could be expected to run at a very low level also in the months to come.

While considering the decision on interest rates, the Council assessed that the uncertainty about the outlook for inflation and economic growth in the world and in Poland justified keeping the rates unchanged at the current meeting. Some Council members believed that the risk of economic growth continuing at a low level in the longer run combined with the forecasted significant inflation decline in 2010 might justify further easing of the monetary policy in the future. Moreover, it was argued that the anticipated increase in the deficit of the public finance sector would be primarily the effect of automatic stabilisers rather than anticyclical measures introduced in the fiscal policy, which – in the opinion of those Council members – did not restrict the possibility of further monetary policy easing. Other members of the Council pointed out that the incoming data suggested that the recession in the world economy and the slowdown of growth in Poland might prove milder than previously expected. Those members argued that signs of economic recovery justified the assessment that the probabilities of inflation running above or below the inflation target in the medium term were roughly equal, while the NBP's interest rates should be kept unchanged also in the coming months.

At the meeting, the prevailing view was that the probability of inflation running below the inflation target in the medium term was higher than the probability of inflation running above the target.

The Council kept the interest rates unchanged: the reference rate at 3.50%, the lombard rate at 5.00%, the deposit rate at 2.00% and the rediscount rate at 3.75%.

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