MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 24 AUGUST 2010

During its meeting the Monetary Policy Council discussed the economic growth and inflation in Poland, situation in the labour market and in the public finance sector, both in Poland and abroad, and the outlook for GDP growth in the external environment of the Polish economy.

While discussing the outlook for economic growth in Poland, some members of the Council assessed that the recently released data were indicative of a stabilising rate of economic growth. They pointed out that domestic economic activity might be limited by potentially weakening growth in the external environment of the Polish economy. At the same time, these members pointed to the persistently weak investment demand of the private sector. It was emphasised that most enterprises do not intend to carry on investments increasing their production capacity given their expectations of economic growth stabilising at the current level. Moreover, some Council members pointed out that the announced change in VAT rates would be mitigating household consumption growth in 2011. Those members also emphasised that demand in the Polish economy would be curbed by the tightening of banks' lending policy with respect to households' loans resulting from Recommendation T entering into force.

However, forecasts indicating the possibility of a marked GDP acceleration in Poland were also invoked. It was pointed out that GDP growth in the coming quarters would be driven by inventories being rebuilt by enterprises. In turn, growing employment will be conducive to private consumption rising faster than so far observed. In the opinion of some members of the Council further recovery in economic activity will also be supported by growing exports. Those members argued that given the current exchange rate of the zloty, high export growth would be a driving force behind improvement in the financial condition of exporters, and, consequently, behind an increase of employment and wages by those entities. Growing aggregate wages in the sector of exporters will be, in turn, conducive to growing consumption which may lead to a rapid revival of investment in the private sector given the level of capacity utilization currently exceeding the long-term average.

While discussing the situation in the labour market, it was pointed out that growing employment in the enterprise sector was accompanied by low wage growth. It was emphasized that such improvement in the labour market situation was favourable from the point of view of inflationary developments as it curbed the risk of a simultaneous increase in demand and cost pressure. Some members of the Council pointed out that neither data concerning planned changes in wages in enterprises nor wage expectations were indicative of the risk of considerable acceleration in wage growth.

Other members of the Council emphasized, however, that some information from the labour market pointed to the wage pressure possibly rising in the subsequent quarters. The accelerating wage growth in enterprises in 2010 Q2 and the possibility of a rise in public sector wage growth in 2010 Q3 as a result of increases in teacher wages were highlighted. Those members also drew attention to improving forecasts of employment in enterprises, in particular, in microenterprises, the most likely to yield to wage pressure. At the same time, some members of the Council argued that with the economic growth strengthening further in Poland the risk of rising wage pressure is increased by a relatively high and still growing level of wage expectations of the unemployed, adversely affecting their readiness to take up employment. Some members of the Council also indicated that lifting of restrictions on the access to the labour market in Germany and Austria for citizens of EU member states from Central and Eastern Europe in 2011 might lead to a drop in the number of the economically active in the Polish economy, and, in consequence, contribute to increase in wage pressure.

While analysing the inflationary processes in Poland, some members of the Council pointed out that, as anticipated, CPI inflation was running at a relatively low level. Those members also pointed at a continuing decline in all core inflation measures. At the same time, they emphasised that despite previously expressed concerns about the developments in domestic food prices, in the past few months changes in those prices were acting towards inflation decline. Yet, other members of the Council indicated that CPI inflation was currently higher than indicated by some of the forecasts made at the beginning of 2010.

Referring to inflation developments, some members of the Council pointed out that according to the available forecasts, inflation was running close to the NBP inflation target in the monetary policy horizon. They assessed that inflation would be curbed by moderate economic growth. In their opinion, low growth of unit labour costs in the economy, including their continuing decline in industry, is also a factor limiting the rise in inflation. Other members of the Council emphasised, however, that in the past the growth rate of unit labour costs in industry had not been a good leading indicator of inflationary pressure in the economy. Since inflation fell to a low level, this growth rate was positive only at the peak of the boom and during the economic slowdown. They assessed also that amidst likely acceleration of economic growth, increasing demand pressure would contribute to a rise in inflation. At the same time, they pointed out that in the case of a considerable slump in economic growth, zloty exchange rate depreciation resulting from a possible worsening of the public finance situation could constitute a risk for price stability.

Some members of the Council emphasized that a marked increase in the growth of producer prices might be indicative of the risk of inflation acceleration. They also pointed out at rising cereal prices in the global markets. Some members of the Council argued that despite unfavourable demand situation in some countries, the global cereal supply should not be significantly reduced, which – given high stocks of these commodities – should limit the rise of their prices. Yet, other members of the Council pointed out that given still significant liquidity surplus in the global financial markets there was a risk of considerable rise in food prices.

Referring to the change in VAT rates scheduled for the beginning of 2011, members of the Council pointed out that the increase in the price level driven by this change should be rather insignificant, and given stable inflation expectations, its impact on CPI inflation might be expected to be only temporary. Some members of the Council emphasized, however, that changes in VAT rates might boost inflation expectations. In the opinion of those members of the Council, the risk of rising inflation expectations was also increased by growing prices of some food commodities in the world markets and the possibility of a rise in administered prices resulting from the need to reduce high public finance deficit. At the same time, some members of the Council assessed that inflation expectations were currently running at an increased level.

While discussing the situation in the public finance sector in Poland, some members of the Council pointed out that despite relatively favourable data concerning realization of the state budget and revenues from social insurance contributions, there was a risk of a significantly higher deficit in the public finance sector in 2010 than previously anticipated. In the opinion of those members of the Council, budgetary situation of local governments might be a factor contributing to an increase in public finance deficit. Yet, some members of the Council drew attention to the uncertainty about the growth of local governments' debt in 2010 and assessed that a potential rise in the public finance deficit in relation to GPD did not have to be significant.

While analysing medium-term risks for economic growth and inflation, the Council also discussed the Long-term Financial Plan for the State. It was emphasized that consolidation measures presented in this Plan were not sufficient to significantly limit the public finance deficit and halt the fast growth of public debt. Some members of the Council also pointed out that there was a risk of higher level of expenditure, as compared to the level anticipated in the Plan, being adopted in the Budget Act for 2011. At the same time, some members of the Council claimed that continuation of loose fiscal policy would increase the risk of growing inflationary pressure in the Polish economy, in particular, in the case of reversal of capital flows in the global financial markets. Yet, other members of the Council argued that fiscal policy should not boost inflationary pressure given the planned tightening of the fiscal policy in 2011, although the scale of this tightening would not be considerable. It was emphasised that a more comprehensive assessment of the implications of fiscal environment for the monetary policy would be possible after getting acquainted with the draft state budget for 2011.

While discussing the external environment of the Polish economy, members of the Council pointed at a decline of GDP growth in 2010 Q2 in the United States and China and acceleration of GDP growth in the euro area, driven mainly by a strong rise in economic activity in Germany. In the opinion of some members of the Council, incoming information suggests that recovery in the American economy begins to falter which is likely to have a negative impact on the global economic outlook. Other members of the Council assessed that decline in GDP growth in the United States was in line with the expectations of lower potential output growth in major developed economies after the financial crisis. On the basis of the above and based on the past recession experience they insisted that the likelihood of double dip in the global economy was minor.

Referring to the fiscal situation abroad, some members of the Council argued that, although the tensions in financial markets related to high imbalance of public finance in some euro area member states had subsided, the problem of excessive debt remained unsolved. Those members emphasized that it was at present impossible to rule out another wave of tensions related to high indebtedness which would adversely affect the global economic outlook. At the same time, some members of the Council pointed out that persisting high imbalance of public finance in major developed economies might have a negative effect on their potential growth.

During the meeting the uncertainty about the current potential output growth in Poland was also addressed. Some members of the Council assessed that potential output growth declined as a result of the global financial crisis and also due to other factors, not related with the crisis. Other members of the Council maintained that moderate rise in unemployment in Poland during the economic slowdown and still growing number of economically active persons reduced the likelihood of decline in potential output growth.

During the discussion about interest rates in Poland and abroad, some Council members pointed to the continuation of expansionary monetary policy by major central banks in developed countries. According to those members, under such circumstances, increase in interest rate disparity relating to a potential rise in the NBP interest rates could contribute to increased capital inflow to the Polish economy and to an excessively rapid zloty appreciation. Other Council members argued, however, that the impact of the increased interest rate disparity on the zloty exchange rate might be limited. In this context, those members indicated that a few central banks in developed and developing countries had recently increased interest rates. According to those members of the Council, the impact of the increased interest rate disparity on the zloty exchange rate might also be limited by other factors affecting the exchange rate, including the situation in the public finance sector. It was further indicated that amidst strong inflow of portfolio capital connected with high borrowing needs of the government, changes in investor attitudes to emerging economies could constitute a major risk for the zloty exchange rate developments.

Monetary aggregate developments were also discussed at the meeting. Some members of the Council emphasised that the growth of M3 remains low. In particular, some of those members pointed out that there was no revival in lending and the growth of loans to enterprises stabilised at a low level. Other members of the Council indicated that the growth of M3 had increased in past few months and was higher than during the recovery from the previous economic slump. They also drew attention to the rise in demand for most loan types, as signalled by banks.

While considering the decision on interest rates, some Council members argued that the present GDP growth, with a possibility of its acceleration and a likely reduced potential output growth, could contribute to a rise in inflationary pressure in the monetary policy transmission horizon. Those members emphasized that the current level of interest rates was adequate for a situation of strong slowdown in the growth of the Polish economy and the recession in its environment, and that given recovery gaining strength in Poland it was justified to increase the NBP interest rates. Moreover, according to those members of the Council, the increase in interest rates would contain the risk of a rise in inflation expectations and favour the growth in savings rate in the economy, and would, in consequence, contribute to maintaining sustainable economic growth in a longer period. In addition some Council members argued that in order to tighten monetary policy an increase in the required reserve rate might be justified.

Other Council members pointed to the continuing adverse growth outlook in the external environment of the Polish economy and the lack of clear signals of further acceleration in the domestic economic growth. Those members emphasized that the currently low inflationary pressure and weakening of factors contributing to a rise in inflationary pressure in the recent period justified keeping the NBP interest rates unchanged. They also indicated that a rise in interest rates could increase the risk of a too quick zloty exchange rate appreciation. Some Council members argued that an increase of interest rates could weaken the recovery of economic growth in Poland too much.

A motion to raise the required reserve rate by 50 basis points was put forward. The motion did not pass. A motion to raise NBP interest rates by 50 basis points was also put forward. The motion did not pass. 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%, the rediscount rate at 3.75% and the discount rate at 4.00%.

Publication date: 23 September 2010