MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 5 OCTOBER 2011

At its meeting, the Monetary Policy Council discussed the impact of external developments on the situation in the Polish economy, the present and future trends in domestic economic activity, the likely shape of fiscal policy in the coming year as well as the outlook for inflation's return to the target. In this context, the Council discussed the current and possible future monetary policy decisions.

While addressing conditions in the external environment of the Polish economy, Council members highlighted the recent signs of a further weakening of economic activity in the United States, the euro area and in some emerging market economies, particularly in China. It was pointed out that the deteriorating outlook for global economic growth was reflected in the fact that international financial institutions considerably downgraded GDP growth forecasts for major advanced and developing economies. The weaker outlook for global economic activity combined with the fiscal problems of some euro area countries resulted in higher risk aversion in the international financial markets, leading, as a consequence, to a depreciation in the exchange rates of emerging market currencies, including the zloty.

While discussing the longer-term outlook for the global economy, some Council members highlighted the fact that the reduction of private sector debt is a significant challenge currently facing economic policy in the United States, while in the euro area the challenge is to solve the sovereign debt crisis. These Council members maintained that given the above one may expect a protracted economic slowdown in both economies. Some Council members pointed out, however, that due to the structural differences between these economies the United States will see a recovery sooner than the euro area. In the opinion of some Council members, in the longer term weaker economic activity can also be expected in China, where the limited possibilities of further export growth mean that domestic demand's role will have to increase, which, considering demographic factors and the absence of a social security system, will be difficult. All in all, according to those Council members, the debt crisis, and, in the longer term, the structural factors (mainly of demographic nature), may result in a prolonged period of slower growth of the global economy. Growth may also be less stable, especially given the limited options to stabilize the economy. Moreover, in this context some members of the Council highlighted the strongly expansionary monetary policy conducted by the major central banks as an additional drag on economic growth in the developed countries in the longer term. In the opinion of those members, such a policy delays the restructuring of these economies by hampering an effective re-allocation of resources.

While assessing the situation in the Polish economy, some Council members underlined the fact that despite its relatively sound fundamentals, the expected deterioration of external economic conditions – mainly in the euro area, including, in particular, in Germany – increases the risk of slower growth of Polish exports, and, hence, of slower GDP growth in the coming quarters. In the opinion of these Council members, despite a larger resilience of the Polish financial system in comparison to the other countries of the region, the links between financial systems in Europe may amplify the negative impact of external developments on economic activity in Poland. However, other members of the Council argued that despite markedly slower economic growth in the euro area, Polish exports have been rising relatively fast. Therefore, it may be expected that domestic GDP growth will not slow down significantly amidst an expected deterioration in the external environment of the Polish economy. While discussing economic activity in Poland, some Council members pointed to August 2011 data showing a marked increase in corporate deposits and somewhat slower lending to this sector, which may signal that enterprises' propensity to invest is decreasing in a situation of a deteriorated outlook for domestic growth.

With regard to the impact of developments in the public finance sector on economic growth in Poland, some Council members pointed to the likely significant reduction of the sector's deficit in 2011 and to the announcements of continued fiscal tightening in 2012. In this context, it was pointed out that although a further reduction of fiscal imbalances will hamper GDP growth in the short term, abandoning it would be viewed negatively by financial markets, which would increase both the cost of public debt servicing and the risk of macroeconomic destabilization. Some Council members emphasized that the way in which fiscal imbalances are contained is important. If it is to be achieved by limiting expenditure, it may contribute to increasing the propensity of enterprises to invest by reducing concerns about a future rise in the tax burden and by easing the wage pressure. According to other Council members, fiscal tightening in 2012 may be significantly smaller than this year and smaller than that assumed by the government in the state's *Multi-year financial plan*.

While discussing current data on inflationary processes in Poland, Council members pointed to the rise in both CPI and core inflation in August 2011. Some Council members also emphasized the concurrent acceleration in producer prices and faster-than-expected wage growth in the enterprise sector as factors that may signal higher-than-anticipated inflation in the future. On the other hand, the persistently elevated unemployment rate and the weaker growth of household disposable income were mentioned as factors conducive to curbing inflationary pressure. In the opinion of some Council members, the somewhat slower growth of lending to the private sector in August 2011 may also point to the absence of mounting inflationary pressure.

The Council members argued that in light of the NBP' internal short-term forecasts one may expect heightened inflation till the end of the year, followed by inflation's return close the NBP inflation target in the first half of 2012. This will be facilitated by the subsiding effects of earlier rises in food and energy prices as well as the VAT increase at the beginning of 2011, despite the forecasted concurrent sustained fast growth in administered prices. It was emphasized that the easing of inflationary pressure in the coming quarters will be fostered by an expected decrease in GDP growth amidst monetary policy tightening implemented in the first half of 2011 and the ongoing tightening of fiscal policy, as well as the expected weakening of economic activity in the external environment of the Polish economy. In the context of the inflation outlook, it was also pointed out that the latest results of business activity surveys show that the number of enterprises intending to reduce employment is larger than that of enterprises that intend to increase it, and that the percentage of enterprises planning to increase wages has fallen, which suggests that that wage pressure in the economy remains limited.

At the same time, Council members indicated that considering the persisting tensions in international financial markets the weakening of the zloty exchange rate may be an important risk factor for the fall of CPI inflation to the inflation target. Some Council members emphasised that if there was a slump in economic activity abroad, the zloty might depreciate further, which would keep inflation at an elevated level, despite a slowdown of domestic GDP growth. Some Council members also indicated that high inflation expectations of individuals may jeopardise the decline in inflation. Although in the past these expectations were strongly adaptive and they decreased in August 2011, they have remained above the inflation target most of the time since the end of 2007.

While discussing the NBP interest rates, the Council members agreed that these should remain unchanged. Arguments in support of this stance included the expected decline in inflation in Poland, particularly in the context of a weakening outlook for growth in the global economy, and, as a consequence, also in Poland. It was also indicated that currently the main risk factor for price stability in Poland is the impact of the unstable situation in international financial markets on the zloty exchange rate. Some Council members emphasized that the NBP interest rates may now be maintained at a lower level than would be justified before the global financial crisis. In their opinion, this is the effect of, on the one hand, the existing financial market frictions increased by the crisis, and, on the other hand, the probable decline in factor productivity growth leading to a decline in the natural rate of interest.

While discussing future monetary policy the Council was of the opinion that given the currently expected macroeconomic scenario which assumes some economic slowdown and a concurrent gradual decline in inflation, the interest rates could remain at the present level in subsequent quarters. It was indicated that the stabilisation of monetary policy parameters is conducive, particularly given increased uncertainty, to maintaining macroeconomic stability. At the same time some Council members argued, however, that in subsequent quarters the likelihood of interest rate increases is larger than that of interest rate cuts, especially if inflation – due to the depreciation of the zloty triggered by the turmoil in the international financial markets – remains above the target for a period longer than currently anticipated. Some Council members indicated that a potentially significant slowdown of GDP growth in Poland in response to significantly weaker economic activity abroad may, given the expected decline in inflation, justify a reduction of the NBP interest rates at some point in the future.

The Council also discussed the long-term challenges to economic policy. The Council members pointed to the need to take measures aimed at enhancing macroprudential policy, including the development by the central bank and other institutions responsible for the financial system of new instruments mitigating systemic risk in the financial sector. The need to coordinate regulatory and macroeconomic policies in order to maintain macroeconomic stability, including the stability of the financial system, was also emphasized.

The Council kept the interest rates unchanged at the following levels: reference rate at 4.50%, Lombard rate at 6.00%, deposit rate at 3.00%, rediscount rate at 4.75%.

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