NBP

National Bank of Poland

Monetary Policy Council

MINUTES OF THE MONETARY POLICY DECISION-MAKING MEETING HELD ON 3 OCTOBER 2012

At its meeting, the Monetary Policy Council discussed the current and future monetary policy decisions against the background of the external and domestic macroeconomic conditions, including inflation developments.

While analysing external conditions for economic activity in Poland, the Council members pointed out that data released since the September meeting confirm a slowdown in global economic activity, including ongoing recession in the euro area, merely moderate growth in the United States and economic slowdown in emerging economies. In this context, attention was drawn to the fact that the unfavourable outlook for economic growth had prompted the central banks of the largest developed economies to further ease their monetary policy, which improved sentiment in the global financial markets. However, according to some Council members, the improvement may prove to be temporary. In particular, the European Central Bank announced the launch of new programme of purchasing government bonds issued by countries most severely affected by the sovereign debt crisis, withdrawing its previous bond purchase programme at the same time. In turn, the Federal Reserve shifted the declared date of the first interest rates increases from the end of 2014 to mid-2015, and implemented a new MBS purchase programme. Some Council members were of the opinion that measures undertaken by major central banks should support revival of economic activity in Poland's external environment, in particular, in the euro area, where improvement in consumer and investor confidence about the prospects for overcoming the crisis may be expected.

While analysing economic situation in Poland, the Council members pointed out that the deceleration of industrial production, a further decline in construction output and weaker retail sales growth indicate that Poland's GDP growth continues to decrease. This is also signalled by worsening of business sentiment indicators, including deteriorating forecasts of demand and orders. At the same time, some Council members pointed to the data that could indicate a limited scale of further economic slowdown. These include some improvement of liquidity position of enterprises in 2012 Q3 and only slightly weaker growth in lending to the private sector (visible in data adjusted for exchange rate changes).

When discussing the current business conditions in Poland and their outlook, some Council members highlighted that the situation in the labour market was deteriorating faster than expected. They pointed to a decrease in employment and slow wage growth in the corporate sector, as well as to the gradually rising unemployment. In their opinion, weak growth in households' real disposable income will constrain consumption, especially since there is no room for further significant reduction in savings rate and availability of consumer loans is limited. Considering that at the initial stage of the global financial crisis, consumption was one of the factors spurring domestic economic activity, the currently observed deceleration in consumption – according to those Council members – points to the risk of a significant economic slowdown in the coming quarters. At the same time, deteriorating outlook for demand dampens investment prospects, already undermined by rising spare capacity utilisation. Those Council members also argued that the coming quarters might be expected to see lower net exports contribution to GDP and further fiscal tightening. The impact of the above mentioned factors is reflected in the downward revision of the 2013 economic growth forecasts for Poland released by external institutions.

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Some Council members deemed however, that at present it is difficult to assess the scale of further economic slowdown, which – according to few of them – may prove moderate and relatively short-lived. Consequently, GDP growth is likely to run only slightly below the potential output growth. Furthermore, few Council members pointed out that consumption and investment may be expected to pick up gradually as early as 2013, boosting GDP growth. In their opinion, this scenario will be supported by the improvement of business conditions in Poland's external environment, that may be larger than had been expected before the announcement of additional expansionary monetary policy measures by major central banks. Few Council members also pointed out that the intended relaxation by the Polish Financial Supervision Authority of recommendations related to household loans will positively influence domestic activity. Moreover, the reduction of fiscal deficit may be lower than anticipated for in the *Convergence Programme, 2012 Update*.

While discussing inflation developments, it was emphasised that price growth is decelerating while inflation still remains above the NBP inflation target as well as above the upper limit of deviations from the target. It was pointed out that the elevated inflation level results largely from supply-side factors which are beyond the direct influence of domestic monetary policy, amidst gradually declining core inflation. Some Council members stressed that weakening economic activity accompanied with decline in wage pressure and employment, significantly limits the risk of second-round effects, and thus, should support inflation decline over the next few quarters.

Some Council members assessed however, that inflation returning to the target is subject to risk posed by global commodity prices, whose further growth may be supported by strongly expansionary monetary policy conducted by major central banks. These Council members argued that this factor may limit the scale of inflation decline, as inflation is expected to decrease largely on account of slower growth in food and energy prices, i.e. price categories closely related to developments in global commodity prices. This was reflected in some upward revision of some short-term inflation forecasts prepared by the NBP. These Council members also pointed out that short-term forecasts (with horizon of 12 months) do not point to the risk of inflation falling significantly below the target within their horizon.

Other members of the Council argued that global commodity price growth should decelerate, as growth in demand for commodities from the largest emerging economies is weakening. Gradually slowing down economic growth in those countries makes commodity prices, which are already high, unlikely to continue to rise at the present pace. Therefore, according to these Council members, the developments in global commodity prices will support inflation decline in 2013. Moreover, it was pointed out that all the available macroeconomic forecasts, including the NBP July projection, suggest that inflation is to decline. The July NBP projection expects inflation to reach a level close to 2.5% in the first half of 2013, and subsequently fall below the target. Those Council members emphasised that the risk of inflation falling significantly below 2.5% is at the moment greater than assessed in July, due to a more severe than anticipated worsening of economic outlook and labour market conditions.

During the discussion, Council members also highlighted exchange rate developments. Some members argued that the zloty exchange rate is currently determined mainly by investors' assessments of the outlook for domestic economic growth. Other Council members pointed out that exchange rate movements may be also affected by interest rate disparity between Poland and the euro area.

While considering monetary policy decisions, some Council members argued that the NBP interest rates should be lowered at the current meeting. In the opinion of those Council members, the anticipated slowing of economic growth to levels significantly below potential output growth poses a risk of inflation falling below the target in the longer term, which justifies monetary policy easing. Moreover, the forecast decline in inflation to level consistent with the inflation target in the coming quarters will keep real interest rates deflated by the expected inflation – even if NBP rates are lowered – clearly positive, while at the moment real interest rates in Poland are high relative to other countries. In the assessment of these Council members, monetary policy easing is also justified by the likely persistence of low economic activity abroad and further fiscal tightening in Poland in 2013. Few Council members additionally observed that a serious economic slowdown might impede the process of reducing the general government deficit, which could, in turn, weaken the zloty and increase inflation. Hence, in their opinion, monetary policy should be eased relatively fast to limit the risk of strong economic downturn.

Other members of the Council concluded that a potential interest rate cuts should take into account the outlook for medium-term economic growth and inflation that will be presented in the November projection of the NBP. Some Council members pointed out that the current interest rates level might be appropriate to enable inflation returning to the target over the next few quarters, while interest rate cuts amidst continuing weak economic climate abroad might have limited impact on the domestic economic activity. Few Council members assessed that one should still take into consideration a risk of strong negative shock in the external environment of the Polish economy, whose accommodation through increase in private consumption or expansionary fiscal policy depends on the amount of savings in the economy. Given the currently observed very low household savings rate and still excessive fiscal deficit, interest rate cuts would further undermine propensity to save. This would, in turn, weaken the economy's ability to accommodate any negative shock in the future.

The majority of Council members were of the opinion that the NBP interest rates should be kept unchanged at the current meeting. Yet, should the incoming data, including the November inflation projection of the NBP, confirm that economic slowdown would become protracted, while the risk of increase in inflationary pressure be limited, the Council will ease monetary policy.

A motion to lower the basic NBP interest rates by 0.50 percentage point was submitted at the meeting. The motion did not pass. A motion was also submitted to lower the basic NBP interest rates by 0.25 percentage point. The motion did not pass. The Council left the basic interest rates unchanged at the following levels: reference rate at 4.75%, lombard rate at 6.25%, deposit rate at 3.25%, rediscount rate at 5.00%.

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