Minutes of the Monetary Policy Council decision-making meeting held on 6 October 2015

Members of the Monetary Policy Council discussed monetary policy against the background of the current and expected macroeconomic developments in Poland and abroad.

When discussing economic activity abroad and its outlook, the Council members indicated that since the previous meeting, external forecasts for global and euro area economic growth had been revised downwards. They also noted that in China industrial production and investment demand growth had deteriorated further, but highlighted that consumer demand growth in this country remained relatively stable. At the same time, they pointed to a significant uncertainty about the economic growth outlook for China. Certain Council members argued that the decline in growth in China resulted mainly from economic growth rebalancing into a more consumer-based economy, which – in the longer term – might support conditions in exporters of consumer goods and services providers and firms providing them.

The Council members were of the opinion that the slowdown in China and other emerging market economies had so far had a limited impact on economic activity in Poland’s main trading partners but highlighted that this impact might increase in the future. In the euro area, a moderate recovery continues, supported mainly by an improvement in labour market conditions and consumer demand growth, though economic conditions vary across euro area member states. In Germany, which is Poland’s main trading partner, growth in economic activity is stable and the surveys indicate high export orders in this country. However, certain Council members pointed out that the slowdown in China – led by lower growth in investment and production of goods for investment purposes – might prove a substantial headwind to growth in Germany, since capital-intensive goods were important to German exports.

Moreover, certain Council members pointed out that even though data on economic activity in the United States had been recently somewhat worse than expected, GDP growth in this economy was still higher than in other major advanced economies, driven by a further improvement in labour market conditions. However, they highlighted that the labour force participation rate in the United States was the lowest since the 1970s, which could indicate limited resource utilization in this economy.

While discussing price developments abroad, Council members emphasized that the renewed fall in commodity prices in recent months had translated into lower inflation in many economies, also in the euro area, where price growth in September remained negative. They also indicated that inflation expectations in the euro area had declined and inflation forecasts had been revised downwards in many advanced economies.

The Council members also pointed to uncertainty about monetary policy abroad. They stressed that the Federal Reserve was expected to delay the interest rate increase. In turn, the European Central Bank did not rule out an extension of its asset purchase programme. In the opinion of certain Council members, such a decision might be beneficial for the Polish

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economy, as it could support economic activity in the euro area member states, including Germany. Certain Council members pointed also to still elevated volatility in the financial markets and a further depreciation of many emerging market currencies, including the zloty, albeit to a considerably lesser degree.

In this context, certain Council members judged that loose monetary conditions in major advanced economies had contributed to a strong rise in financial asset and real estate prices in previous years. As a result, a sharper market correction than recently observed, amplified by low liquidity in certain markets, should be expected in their opinion. They emphasized that the expected monetary policy tightening in the United States could be a trigger for a debt crisis in many emerging market economies, particularly where the issuance of debt securities denominated in the United States dollar had increased in previous years. According to these Council members, due to strong economic ties, such a crisis could spread to other economies, also to some euro area member states.

Discussing economic conditions in Poland, the Council members judged that, despite external risks, they remained favourable, supported by good labour market conditions, improved financial standing of enterprises, high capacity utilization, stable lending growth, as well as high price competitiveness of the Polish economy combined with ongoing economic recovery in Poland's main trading partners. Some Council members, however, pointed out that industrial production and retail sales had grown less than expected in summer months, and sentiment in industry had reached its one-year low in September, which might point to a weakening in economic growth in Poland. Some of these members were of an opinion that the slowdown in Polish industry was cyclical; however, others believed that it rather resulted from adjustment in industrial output to lower demand for durable and capital goods in the global economy.

While discussing the labour market conditions, the Council members pointed to further growth in employment and a gradual decline in the unemployment rate, as well as to moderate wage growth. Certain Council members expressed an opinion that ongoing employment growth coupled with only moderate wage growth indicated a rather positive assessment of Polish enterprises regarding future economic conditions. However, other Council members pointed to labour market tensions resulting from difficulties in finding suitably skilled workers. As a result, the pace of improvement in labour market conditions, measured by employment growth, had levelled off in recent months.

During a discussion on household sector conditions, it was highlighted that the voluntary household savings rate had recently risen. According to some Council members, the increase in the propensity to save could limit consumption growth in the coming quarters. Most of these members noted that the rise in the savings rate was a positive development in the Polish economy in longer term, but some of them were of the opinion that it might prove a drag for economic growth in Poland, both in shorter and longer run. Certain Council members also pointed to a some acceleration in lending to households in the recent months.

The Council members also pointed to an improvement in financial standing of enterprises, in particular to renewed growth in company profits. Moreover, certain Council members

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noted that corporate lending had accelerated of late, driven by faster growth in current loans and stable increase in investment loans.

The Council members judged that the financial system in Poland was functioning in a stable manner. However, they maintained their assessment that a possible currency conversion of some foreign currency loans posed a significant risk to banking sector stability in Poland.

Assessing the outlook for economic growth in the coming quarters, the Council members judged that it should be close to the NBP's July projection. At the same time, they underlined that since that projection the risks for economic growth had shifted to the downside, mainly due to recent developments abroad. The Council members pointed to a risk of more expansionary fiscal policy in the coming quarters that could result from the implementation of the draft budget law for 2016 as well as the election promises. If effected, fiscal expansion could support economic growth in the coming quarters, but – according to some Council members – might also undermine fiscal stability in the longer run.

Analysing the possible impact of weaker growth outlook in China on economic conditions in Poland, the majority of the Council members judged it should be limited given a small share of this country in Polish exports and the ongoing economic recovery in the euro area. However, certain Council members were of the opinion that already observed and possible further external shocks might have a strong negative impact on Polish economy. They argued that the capacity for anti-cyclical economic policy was limited due to substantial – in their assessment – fiscal imbalances and low interest rates.

While discussing price developments in Poland, it was noted that deflation had deepened slightly in September due to further decline in global commodity prices. Certain Council members also pointed to a sharper fall in producer prices. Along with slow growth in unit labour costs, this contains a risk of rising cost pressure. Yet, in the opinion of the Council members, in the coming months inflation should gradually increase. However, the majority of the Council members emphasized that inflation would probably rise at a somewhat slower pace than expected in the July projection. They stressed that starting from 2016 Q1, the rise in inflation might come to a halt, and following that, inflation could remain slightly below the lower band for deviations from the target. However, certain Council members pointed to upside risks to inflation in the coming quarters, resulting from growing tensions in the domestic labour market, relatively high wage increases planned by enterprises and a likely – in their opinion – rise in food prices caused by adverse weather conditions in some parts of the world.

Referring to interest rate decisions, the majority of the Council members were of the opinion that it was justified to keep nominal interest rates at the current levels, as the risks in the environment of the Polish economy were not having a clear impact on economic growth and inflation was expected to rise gradually towards the target. Some Council members emphasized that stable interest rates support the resilience of the Polish economy to shocks, particularly amidst considerable uncertainty about the global economic outlook. Certain Council members judged that a further reduction in interest rates would fail to translate into a significant lending growth, at the same time resulting in lower voluntary household savings.

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However, certain Council members expressed an opinion that the Council should consider the possibility of a reduction in interest rates in the coming months. In their view, lower interest rates would support domestic demand and therefore contain the scale of a possible economic slowdown driven by worse economic conditions abroad. They also argued that monetary policy easing in Poland would reduce the interest rate differentials between Poland and abroad, including the euro area, where monetary conditions might be loosened over a longer period than previously expected.

In turn, according to certain Council members, the Council should consider interest rate increases in the coming months. These members argued that the interest rate increases are justified by a faster acceleration in price growth than assumed in the July projection expected by them and a high risk of severe external shocks. In their opinion, interest rate increases would provide more room for monetary policy easing in the event of adverse shocks.

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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