MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 25 NOVEMBER 2009

During the meeting the Monetary Policy Council discussed the outlook for future inflation developments 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, inflationary processes in Poland and the situation in the labour and credit markets.

While assessing the situation in developed economies, it was pointed out that following several quarters of decline 2009 Q3 brought a rise in GDP in the United States and in the euro area, including Germany, Italy and France, i.e. major markets for Polish exports. Yet, it was emphasised that the recovery in those economies was, to a large extent, the effect of government stimulus packages. It was assessed that the prospective discontinuation of these measures was accompanied by a risk of decline in economic activity in those countries, mainly due to a possible fall in private consumption growth. It was pointed out that economic growth in the United States and in the euro area was also negatively affected by a decline in corporate loans and, in the longer term also by the deteriorating situation of the public finance sector.

While analysing the situation in emerging economies, some members of the Council pointed out that the recovery in those economies might not be sufficient to boost global GDP growth considerably. Those members also noted that although private consumption in China might be expected to accelerate in the coming period this would be unlikely to compensate for the impact of a possible consumption decline in the United States on global economic growth due to a low level of private consumption in China relative to global demand. An important factor curbing growth in consumption expenditure in this country is the absence of a universal social security system, as a result of which an important part of household income is saved.

While discussing the outlook for domestic economic growth, it was assessed that the Polish economy had already entered the phase of recovery, which was confirmed, among other things, by increasing industrial output growth and very good financial results of enterprises in 2009 Q3. It was also indicated that the recovery abroad (particularly in the euro area) contributed to growth in Polish exports in 2009 Q3, as indicated by the data for the past three months. Some members of the Council believed that the recovery would be relatively slow, and argued that in the coming period economic growth in Poland might likely be curbed by a renewed deterioration in global economic climate. In the opinion of those Council members, GDP growth in Poland would be negatively affected also by such factors as: the deteriorating situation in the labour market, including rising unemployment and the fall in real wages in the enterprise sector, the decline in corporate loans and lending to households growing more slowly than in the last years, as well as the difficult situation of the public finance sector.

In the opinion of other members of the Council, GDP growth in Poland dropping notably again was very unlikely even in the event of a considerable deterioration in the global economy. They argued that the scale of GDP growth decline in Poland due to the global financial crisis was considerably smaller than in other European Union countries, and emphasised that despite the absence of government stimulus packages of a scale comparable to those implemented abroad GDP growth in Poland remained positive. It was assessed that the relatively high resilience of the Polish economy to unfavourable external shocks – the turmoil in the global financial markets and the recession abroad – was, among other things, the result of a low credit-to-GDP ratio and the economy's lower degree of openness as compared to other EU countries, as well as of the dynamic development of the service sector (less dependent on global economic developments) observed in the past few years. It was also emphasised that the relatively small scale of economic slowdown was largely due to a marked decrease in the NBP interest rates as well as the depreciation of the zloty exchange rate.

While addressing the labour market situation, members of the Council pointed to persisting unfavourable trends, including in particular the growth in registered unemployment and the continuing negative annual employment growth, as well as the decline in real wages in the enterprise sector in October 2009. Some members of the Council pointed out that in the light of the October projection of the NBP, nominal wage growth in subsequent quarters would decline further. Moreover, some members of the Council argued that due to lags in the adjustment of employment to the pace of economic growth and a likely increase in labour supply, unemployment could increase further in the coming period despite economic recovery. They assessed that rising unemployment would be conducive to lowering the inflationary pressure through weaker consumer demand and limited wage pressure. At the same time, some members of the Council pointed out that rising unemployment might, due to the hysteresis effect, negatively affect the potential GDP growth in the coming period.

While analysing the relationship between inflation and labour market developments, some members of the Council emphasised that elevated inflation contributed to lowering real wages, facilitating their adjustment to falling labour productivity growth. In the opinion of those Council members, relatively high flexibility of real wages helped to reduce the scale of decline in Poland's GDP growth amid the global recession. They also pointed to the so-called labour hoarding, consisting in incomplete adjustment of employment (i.e. reduced lay-offs) during an economic slowdown. On the other hand, they emphasised that via indexation increased inflation contributed to wage growth in the public finance sector as well as to growth in disability and old-age pension benefits, which, in the short term, is conducive to deepening the deficit of the public finance sector. In the opinion of those members of the Council, rising social benefits driven by indexation amid a concurrent decline in wage growth in the economy reduced work attractiveness and might negatively affect the economic activity of Poles. They also made reference to the data on wages in the national economy which in the first three quarters of 2009 – unlike in the previous period – showed higher annual growth than wages in the enterprise sector. According to those Council members, this might indicate that the share of this sector in the national economy was declining and, consequently, that the changes in wages in the enterprise sector – where wages are largely dependent on cyclical conditions – might in the future affect wage developments in the economy to a lesser extent than previously had been the case.

While discussing inflation developments, it was pointed out that in October 2009 annual CPI decreased to 3.1%, which was primarily the result of slower growth of food and energy prices; at the same time, core inflation (net of food and energy prices) remained at 2.9%. Some Council members emphasised that core inflation continuing at a heightened level was the effect, among other things, of steady growth in the prices of services. Those members assessed that the gradual increase in the demand for services observed over the recent years, which resulted in a growing share of this spending category in the basket of consumer goods and services, would also continue in the coming years, and so the prices of services would be exerting a growing impact on CPI developments. They emphasised that core inflation had not been falling despite a clearly negative output gap and pointed out that the current level of annual core inflation rate could still be to some extent influenced by the high demand pressure observed in the previous period. Other members of the Council stressed, however, that elevated CPI inflation was to a considerable degree driven by unfavourable price shocks, including in particular the administered price increases implemented in 2009. Some Council members also pointed to the reduced scale of decline in the prices of goods strongly affected by globalisation recorded in the recent months, which was partially connected with the earlier zloty exchange rate depreciation.

While discussing the outlook for inflation, it was pointed out that in the near term the annual CPI would develop largely under the influence of statistical base effects: first, a positive one – connected with a strong decline in fuel prices at the end of 2008, and then, a negative one – connected with considerable increases in administered prices and food price rises at the beginning of 2009 (provided the lack of equally strong administered price increases in 2010). Due to the former effect inflation would rise temporarily in the nearest future, while the latter effect would be conducive to its decrease next year. Some Council members indicated that in 2010 a drop in CPI inflation below the NBP inflation target could be expected as the negative output gap would likely persist. Another factor conducive to decreasing inflation could be the appreciation of the zloty so far. Other Council members pointed out that the inflation decline might be curbed by indirect tax and administered price increases. They also argued that inflation might prove higher than currently expected in the event of unfavourable price shocks in the commodity or food markets, or zloty exchange rate depreciation. In the opinion of those Council members in the longer term the inflationary pressure would be largely determined by labour and credit market situation.

While addressing the current situation in the domestic credit market, its further deterioration was highlighted, including especially the negative annual growth of lending to enterprises (adjusted for the impact of zloty exchange rate fluctuations) observed in October for the first time since 2004, and the fact that the growth of lending to households was persistently slower than in the preceding years. Some Council members argued that the reduction in the supply of credit to enterprises contributed to curbing corporate investment, which in turn adversely affected GDP growth. Other Council members, however, assessed that reduced lending was to a large extent attributable to the limited demand for credit resulting from the economic slowdown. They emphasised that in view of the data on financial results of enterprises in 2009 Q3, the liquidity of this sector remained relatively high, allowing firms to finance their current operations to a large extent with their own funds, and thus constrained their borrowing needs. They also pointed out that lending to households was still growing.

The Council also analysed the development of the credit market in the longer-term perspective. Some members of the Council emphasised that the credit-to-GDP ratio in Poland in the period preceding the global financial crisis had been among the lowest in the EU. Other Council members underlined that in the past few years this ratio had increased significantly. They argued that, even though the rapid credit expansion in the years preceding the global crisis had largely resulted from the convergence process, in the longer term sustaining such fast lending growth could lead to growing credit market imbalances. They assessed that the current slowdown in lending was to a large extent a cyclical phenomenon and that it would be conducive to a more balanced lending growth. Those members argued that the recovery in economic growth would give a new momentum to lending growth in connection with the convergence process and due to demographic changes leading to a rising demand for mortgage loans. In the assessment of those Council members, the current situation in the credit market did not necessitate the introduction of any additional instruments to support lending growth.

While discussing the policy mix abroad and in Poland, some Council members pointed out that expansionary fiscal policies in many countries led to rising public debt levels which – amid efforts to sustain price stability – could only be halted by strong fiscal tightening. At the same time, however, low real interest rates around the world, driven by loose monetary policy, limited the current costs of financing public debt, thus weakening the incentives to implement reforms aimed at the improvement of the primary balance of the public finance sector. In this context, those members emphasised the need for introducing measures that would curb the expansion of public debt in Poland.

The Council assessed that the data on the economic situation in Poland and abroad released since its last meeting warranted maintaining the interest rates unchanged at the current meeting.

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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