Minutes from the Monetary Policy Council decision-making meeting held on 5 November 2014

Members of the Monetary Policy Council discussed the monetary policy decisions against the background of macroeconomic developments in Poland and abroad, as well as the November projection of inflation and GDP.

Some Council members emphasized that current and expected economic conditions in Poland's external environment had deteriorated in recent months. It was noted that forecasts for global economic growth prepared by external institutions had been again revised downwards. This included also forecasts for growth in the euro area, which is expected to remain stagnant in the coming quarters. It was emphasized that concerns about a prolonged stagnation in the euro area were rising. Some Council members also pointed to economic slowdown in major emerging market economies. It was indicated that growth in China was weakening and economic stagnation was likely to have occurred in Russia, while recession in Ukraine was deepening. Some Council members assessed that slower economic growth in emerging market economies would affect GDP growth in the euro area. This concerns in particular Germany, Poland's main trading partner, whose export share to these economies is large. However, other Council members pointed to signs of improvement in industry, including in the euro area and Germany, that were appearing irrespective of unfavourable external conditions. Attention was also drawn to ongoing moderate economic recovery in the United States. Moreover, according to these Council members, economic growth in the euro area next year may be slightly faster than this year.

While discussing inflation developments abroad, it was highlighted that inflation in many economies was still low, including countries with relatively robust growth. Council members pointed out that inflation in the euro area was very low and still declining. Few Council members observed that in some countries strongly linked to the euro area, price growth was negative. It was emphasized that low global inflation resulted from a decline in commodity prices in global markets and relatively weak global economic growth, which – according to few Council members – indicates that attempts to accelerate price growth by means of domestic monetary policy would prove ineffective.

While discussing monetary policy abroad, it was noted that it remained strongly expansionary in the case of major central banks. Particularly, although the Federal Reserve had concluded its financial asset purchases, it would continue to roll over maturing debt securities. Few Council members pointed out that the Federal Reserve was signalling interest rate increases in the following year. On the other hand, the European Central Bank started purchasing securities in October, whereas the Bank of Japan increased financial asset purchases to a significant extent. In this context, it was highlighted that the European Central Bank intended to continue purchasing securities for at least two years, and the interest rates in the euro area might stay close to zero even over a longer term. Attention was also drawn to interest rate decreases in countries strongly linked to the euro area,

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including economies which were still growing at a relatively fast pace. Moreover, few Council members pointed out that the expansionary monetary policy of the major central banks had resulted in an increased upward pressure on currencies of some countries with a significant interest rate differential to the major economies.

While discussing economic conditions in Poland, the Council members emphasized that in 2014 Q3 the economic growth had probably continued to decelerate. Some Council members indicated the slowdown in economic growth could be shallow. It was noted that the slowdown had been caused mainly by weaker external demand, which was translating into slower export growth, and declining sentiment of economic agents, which resulted in a deceleration in private investment outlays. These factors of economic slowdown are reflected in the incoming data, which show that export growth has almost come to a halt and export orders have decreased, while industrial production in 2014 Q3 grew slower than a quarter before, on average. However, some Council members pointed out that recent data readings might indicate recovery in economic activity in the coming quarters. In particular, in September both industrial production and construction output increased, while sentiment improved after several months of decline. Moreover, a gradual acceleration of corporate lending and stable growth of housing loans suggest that growth in investment demand in 2014 Q3 might remain moderate. Some Council members also pointed to still favourable consumer confidence, stable retail sales growth and a steady increase in employment. They indicated that the probability of finding a job had increased, while the probability of losing a job remained stable.

While discussing the economic outlook for Poland, Council members highlighted that the November projection pointed to lower GDP growth than in the previous round. However, some Council members emphasized that in accordance with the central projection path, i.e. the most likely outcome, the annual GDP growth would start to slightly accelerate in 2015 Q2. Economic growth should then stabilise above 3%, i.e. will grow at a pace close to potential output growth. This underpins the view expressed by these Council members that – notwithstanding the adverse external conditions – economic outlook for Poland remains favourable. Furthermore, these members cited external forecasts, which also suggested that moderate recovery of the Polish economy could resume in the following quarters. At the same time, some Council members stressed that the probability of economic growth being weaker than indicated by the central projection path was significant. This is demonstrated in strong asymmetry of the probability distribution in GDP projection, associated mainly with the risk of prolonged weak economic growth in the euro area. These members also highlighted that several external institutions had revised their forecasts for economic growth in Poland downwards and that the uncertainty related to global economic conditions continued.

Referring to inflation developments in Poland, Council members noted that in September the annual growth of consumer price index was still negative. It was emphasized that although deflation in Poland had been caused largely by external factors (reflected, in particular, in a decline in food and energy prices), the price growth in Poland

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had been also dampened by no demand pressure, as most core inflation indicators were at zero. In this context, it was highlighted that wage and cost pressures in the economy were still low, as shown by the weak growth of unit labour costs and the continued decline in producer prices on an annual basis.

With regard to the outlook for inflation, it was emphasized that in the November projection the inflation path was below the July projection, and stayed below the NBP inflation target throughout the projection horizon. At the same time, some Council members highlighted that, like for the GDP projection, the asymmetry in the balance of risks for the inflation forecast was significant. This points to a relatively high probability of inflation staying below the central path. These members pointed out that, in contrast with the July projection, the output gap would remain negative throughout the November projection horizon. Therefore, the period of low demand pressure will be longer than envisaged in the previous projection. They also argued that external forecasts supported the view that inflation in Poland would remain low. On the other hand, other Council members emphasized that, in line with the central projection path from November, inflation should rise gradually, to return to the band for deviations from the target by the end of the projection period. According to these Council members, inflation might be slightly higher than in the November projection, returning close to target within the monetary policy horizon, as indicated by several forecasts.

While discussing the interest rate decision, some Council members assessed that the monetary policy adjustment should be continued at the November meeting. In their opinion, factors in favour of further interest rate adjustment included ongoing deflation, very low inflation expectations and the forecasts indicating that inflation would remain below the target in the following years. Further monetary policy adjustment was also justified by a deceleration in domestic economic growth and a risk of further slowdown due to the weakening economic growth outlook in the external environment of the Polish economy. In the opinion of these Council members, further decrease in interest rates would cushion the adverse impact of weakening external demand on domestic economic activity growth. Moreover, they emphasized that the persistence of the significant interest rate differential between Poland and its external environment might result in later return of inflation to its target through upward pressure on the zloty. Few Council members noted that interest rate decreases would reduce the public debt servicing costs and therefore support the economic policy of the Government.

Nonetheless, the majority of Council members were of the opinion that the interest rates should remain unchanged at the November meeting. These members argued that the slowdown in GDP growth could be temporary and shallow. They also emphasized that the decrease in inflation and the weakening in economic activity were mainly driven by factors beyond the impact of domestic monetary policy, including significant uncertainty undermining the growth of spending by private agents. Few Council members stressed that after the NBP reference rate had been decreased in October, another large cut would imply that the real interest rates deflated by inflation expected over the monetary policy

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horizon would be near zero or even negative, which could result in emergence of economic imbalances. In the opinion of some Council members, further interest rate decreases could stimulate excessive credit growth in the economy and weaken the incentives to restructure enterprises. In the assessment of the Council members who were in favour of keeping interest rates unchanged, given the current level of interest rates there is still space for monetary policy easing, should it become necessary in case of significant turbulence in global financial markets.

Some of the Council members who supported keeping interest rates unchanged assessed that the October adjustment of interest rates provided sufficient monetary policy impulse to support the return of inflation to close to the target within the monetary policy horizon, in the light of the current data and the November projection results. Few of them also emphasized a need for an assessment period to analyse the impact of the October interest rate cut. They also highlighted that prudent monetary policy was a value which should be preserved in order to maintain macroeconomic and financial stability. However, these members indicated that uncertainty over economic conditions in the future had recently increased. Hence, they did not exclude a possibility of further monetary policy adjustment if economic conditions deteriorate in Poland and abroad, particularly in the euro area.

At the meeting a motion was submitted to lower NBP interest rates by 1.00 percentage point. The motion did not pass. A motion was also submitted to lower NBP interest rates by 0.50 percentage points. The motion did not pass. A motion was also submitted to lower NBP interest rates by 0.25 percentage points. The motion did not pass. The Council decided to keep NBP interest rates at the following levels: the reference rate at 2.00%, the lombard rate at 3.00%, the deposit rate at 1.00%, the rediscount rate at 2.25%.

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