MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 19 DECEMBER 2007

During the meeting, the Monetary Policy Council discussed the outlook for inflation developments in the context of the past, current and, primarily, anticipated economic situation.

The discussion at the meeting focused on: current inflation developments, including food price changes, situation in the labour market, the outlook for economic growth and the level of interest rates in Poland and abroad. The Council discussed the influence of these factors on the future inflation in Poland.

While discussing current inflation, the Council analysed the causes of the annual growth of consumer prices in November running above the NBP inflation target of 2.5% and exceeding the upper limit for deviations from the target set at 3.5%. It was pointed out that CPI growth in November was primarily driven by the accelerated growth of food and fuel prices; while net core inflation recorded just a minor rise and remained at a relatively low level. In the opinion of some Council members, low level of net core inflation indicated low inflationary pressure driven by demand. At the same time, it was emphasised that high growth of food and fuel prices and the ensuing growth in CPI inflation were related to global developments which are beyond the scope of the domestic monetary policy. In turn, some discussants, pointed out at the continuing price increases of some services and at falling disinflationary impact of declining prices of goods imported from low-cost countries.

While addressing food price developments, the Council discussed the sustainability of their increased growth. Some members of the Council believed that high growth of food prices was a temporary phenomenon as it was, to a large extent, driven by supply shocks in the global markets. It was also pointed out that high prices of certain agricultural commodities might be partly related to speculation of financial institutions in the futures markets and that there had already been signals of a decline in the prices of some of commodities. Other discussants assessed that high growth of food prices may be sustained over a longer period, as it is largely determined by the persistently growing world’s demand for food, while the supply shortages on the global scale may be more frequent than before, among other things, due to climate changes. The possible impact of abandoning the Russian embargo on Polish food exports on the growth of food prices in Poland was also discussed.

Some discussants assessed that the forecasted rise in net core inflation and the continuing high growth of food and fuel prices might result in CPI inflation remaining above the inflation target at the end of 2008. At the same time they emphasised that, due to the specific nature of shocks leading to price increases, CPI inflation was likely to stay above net core inflation over a longer period. It was also pointed out that considerable uncertainty persisted about the scale of the declared increases in gas and energy prices in 2008. Other members of the Council argued that future inflation might be lower than in the October projection due to higher level of zloty exchange rate than accounted for in the projection.

It was pointed out that even though Poland continued to meet the Maastricht price stability criterion in November 2007 the rise in inflation might pose risk of inflation exceeding the reference value in the coming future.

Some members of the Council indicated that the rise in current CPI inflation was likely to boost inflation expectations. They emphasised that the risk of rising inflation expectations is particularly high when inflation increase is driven by a strong growth in the prices of food, i.e. frequently purchased goods having high share in the CPI basket. It was pointed out that rising inflation expectations might add to wage pressure. Moreover, some discussants argued that the rise in current inflation – unlike in 2004 – took place amidst strong economic growth and tight labour market which increased the likelihood of rising inflation expectations and of the so-called second-round effects. Other Council members, however, believed that the risk of second-round effects was moderate due to institutional changes that had taken place in the labour markets in Poland and in other countries.

While discussing the labour market situation, it was pointed out that wage growth in the economy in 2007 Q3 had exceeded the level accounted for in the October projection, wage growth in the corporate sector in November had been very high and the pressure on significant wage increases in the public sector persisted. It was indicated that wage growth continued to exceed labour productivity growth, which was conducive to growing inflationary pressure. Some discussants argued that high wage growth was likely to be sustained also in the months to come due to labour shortage in the domestic market, and that wages would grow faster than assumed in the October inflation projection. Those discussants assessed this would further boost unit labour costs which would, in turn, lead to worsening the financial results of enterprises and to reducing investment in the economy. In the opinion of those discussants, tensions in the labour market reflected in the plunge of unemployment rate and the rising current inflation resulted in the risk of second-round effects being higher than in 2004. They also argued that the scale of economic migration would not decrease significantly in the years to come due to persisting high differences in income levels between Poland and Western European countries.

Other members of the Council argued that there might arise factors that would be curbing wage and unit labour cost growth. They believed that wage growth in the corporate sector might be restrained by concerns about deteriorating financial results of enterprises. These members pointed out that significant pay rises in the public finance sector were rather unlikely as they had not been provided for in the draft Budget Act for 2008. Attention was drawn to the fact that the growth of unit labour costs in the economy outside private farming in 2007 Q3 was lower than assumed in the October projection. It was also pointed out that the unemployment rate in Poland continued to exceed levels recorded in other countries and that tensions in the labour market might soon diminish as wage growth in Poland and zloty appreciation should reduce the scale of Polish labour migration.

While discussing the outlook for economic growth in Poland, some members of the Council pointed out that GDP growth in 2007 Q3 had been higher than assumed in the October projection and that economic growth in 2007 Q4 had probably continued at a high level. It was also indicated that a continued growth in demand would be supported by the fast growth in lending. Other members of the Council pointed to the expected decline in world economic growth, which might impede the growth of Polish exports and the inflow of foreign direct investment and, as a result, weaken the economic growth of Poland. Moreover, some members of the Council argued that despite high GDP and wage growth the structure of GDP did not suggest increased demand pressure: growth in total consumption, private consumption and imports in 2007 Q3 were slower than assumed in the projection, whereas exports were rising faster. It was emphasised that stronger than projected investment growth in 2007 Q3 suggested the possibility of faster growth in potential output and weakening inflationary pressure in the medium term.

The Council paid a lot of attention to assessing the monetary policy conditions in Poland. Some members of the Council pointed out that NBP interest rate increases in 2007 combined with the appreciation of zloty exchange rate contributed to maintaining high level of monetary policy restrictiveness. Those members also indicated that the level of the real interest rate in Poland was relatively high as compared to other countries of the region. Other discussants pointed out that the level of the real interest rate had fallen in 2007 as a result of CPI inflation rising stronger than the nominal interest rates. They argued that the differences in the level of real interest rates between countries resulted, among other things, from the differences in the level of their natural interest rate. Those discussants also pointed out that the assessment of changes in the level of monetary policy restrictiveness should take into account the appreciation of the equilibrium exchange rate related to the convergence process. They also indicated that it was difficult to assess the sustainability of factors behind the recent appreciation of the zloty.

Some members of the Council argued that certain central banks had decided to lower their interest rates in the recent period. Other members, however, pointed out that interest rate cuts had taken place mainly in countries directly affected by the financial market turmoil and that some banks had tightened their monetary policy at that time.

The majority of the Council members argued that high level of current inflation and the ensuing risk of rising inflation expectations, as well as tight labour market, constituted a major risk to price stability. Some members of the Council believed that counteracting inflation risk within the monetary policy horizon would require interest rates to be raised at the Council meeting in December. Those members argued that globalisation processes in the past few years had led to weakening the impact of monetary policy on domestic inflation, thus requiring stronger response of central banks to the growing inflationary pressure. They assessed that rises of interest rates should not lead to any significant slowdown of economic growth in Poland, yet it would help to stabilise it at a level consistent with the potential growth.

Other members of the Council pointed out that it was difficult to assess inflationary inertia. They also argued that a monetary policy tightening would increase interest rate disparity between Poland and the euro area and the United States. This could encourage the inflow of short-term capital to Poland and contribute to the appreciation of zloty exchange rate, which would, in turn, weaken the competitiveness of the Polish economy and led to further increase of external imbalance. Moreover, those members pointed out that the pace of monetary policy tightening so far was sufficient from the point of view of stabilising inflation at the target level in the medium term. It was indicated that at its December meeting the Council had at its disposal less information on economic developments than usual and that a more comprehensive assessment of the risk of inflation remaining at a high level would be possible at the Council's next meeting.

A motion to raise the key NBP interest rates by 25 basis points was put forward. The motion did not pass. The Council kept the interest rates unchanged: the reference rate at 5.00%, the lombard rate at 6.50%, the deposit rate at 3.50% and the rediscount rate at 5.25%.

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