NBP

National Bank of Poland

Monetary Policy Council

MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 23 DECEMBER 2008

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

The discussion at the meeting focused on: the outlook for economic growth and inflation in Poland, credit market conditions and zloty exchange rate developments.

While addressing the situation in the external environment of the Polish economy, a further deterioration in the outlook for global economic growth, and in particular, the deepening recession in the United States and the euro area, was noted. It was emphasised that the developments in the global economy were conducive to faster than previously expected decline in inflation in many economies, inter alia, as a result of the fall in commodity prices, including oil prices. It was pointed out that those factors urged many central banks, in particular banks of countries that are in recession, to further considerable easing of the monetary policy.

The Council paid a lot of attention to the outlook for economic growth in Poland. It was emphasised that unfavourable developments in the external environment of the Polish economy brought about stronger than previously expected decline in activity in the Polish economy which was corroborated by weaker than anticipated November data on industrial and construction output. Among major channels through which the world crisis affected the Polish economy were listed: the decline in external demand, deteriorating agents' expectations as to the future economic situation of the country and tightening of banks' lending policy. It was pointed out that the coming quarters might be expected to bring about a strong drop in corporate investment being largely the result of economic slowdown and deterioration in the outlook for sales in the domestic and foreign markets as well as a more difficult access of enterprises to loans both in Polish zloty and foreign currencies. Considerable weakening of investment demand will also be driven by such factors as deteriorating financial results of enterprises, limited possibilities of business financing through the capital market and a probable decline in the inflow of foreign direct investment to Poland. It was also stressed that as a result of the tightening of banks' lending policy, small and medium-sized enterprises might face problems with the absorption of EU funds for investment projects due to the need to contribute own funds. It was emphasised that GDP data for 2008 Q3 pointed to a considerably stronger than anticipated fall in investment growth. At the same time, it was pointed out that the annual investment growth in the enterprise sector in 2008 Q3 was negative, and investment growth in the economy resulted from the continued relatively high growth in investment expenditure of the public finance sector and in housing investment. It was assessed that in 2008 Q4 the investment contribution to GDP growth could be close to zero and in the first half of 2009 it might turn negative.

While discussing the future economic situation it was assessed that the slowdown in economic growth would also be driven by a decline in consumption and export growth, and GDP growth in 2008 Q4 and in subsequent quarters would most probably be lower than anticipated in the NBP's October projection. It was pointed out that the decline in the growth of Polish exports might be stronger than the one recorded in the previous periods of economic slowdown in the external environment of the Polish economy due to the fact that in the past few years, the corporate links between Polish and foreign companies intensified and the share of highly processed goods sensitive to business cycle fluctuations in the Polish export production increased. Moreover, it was argued that contrary to previous expectations the consumption demand might also weaken considerably which was suggested by worse than expected November data on retail sales. The decline in private consumption growth will be driven by the anticipated deterioration of the labour market situation indicated by the November data on the declining wage growth and falling employment in the enterprise sector and increasing unemployment as well as tightening of household lending criteria. It was argued that limited access to credit would have a stronger impact on consumption demand than in the previous periods of the economic slowdown as the past few years had been marked by growing importance of credit in financing household consumption. Moreover, deterioration in the housing market situation related, among other things, to the tightening of conditions and criteria of granting mortgage loans, will contribute to the decline in demand for home furnishing goods and services. Among factors having a negative impact on consumption demand were also listed: deteriorating consumer sentiment and decreasing purchasing power of households' incomes driven by increases in administered prices.

While discussing the outlook for inflation it was assessed that in the time to come the growth in consumer prices would continue to decline and would be within the tolerance range for deviations from the inflation target, thus running below the level forecast in the NBP's October inflation projection. Lower than forecast inflation in the near term will be mainly driven by lower than assumed commodity prices in the global markets, including oil and gas prices. In the medium term, the lowering of inflationary pressure will be driven by: stronger than previously expected decline in the global and domestic economic growth, low inflation in the external environment of the Polish economy translating into declining growth in the prices of import goods and faster than anticipated in the projection weakening of wage pressure connected with falling labour demand and increased labour supply, inter alia, as a result of intensified return of Poles from the economic migration. Moreover, some members of the Council indicated that amidst the economic slowdown the previously observed increase in unit labour costs would translate into prices only to a limited extent. Attention was also paid to the stronger than expected decline in CPI inflation in November. Among factors curbing the decline in inflation, in turn, were listed: further rise in administered prices, increases in excise tax on certain products and depreciation of the zloty exchange rate observed in the past few months. Yet, some members of the Council pointed out that the impact of the exchange rate weakening on prices amidst economic slowdown would probably be limited.

While addressing the exchange rate developments, it was stressed that the considerable zloty depreciation against the euro and the US dollar and increased exchange rate volatility observed in the past few months resulted mainly from the increase in risk aversion in the global financial markets leading to capital outflow from the emerging markets. Some members of the Council argued that the appreciation of the zloty exchange rate in the first half of 2008 and its subsequent depreciation could be reinforced by Polish enterprises concluding structured foreign exchange contracts. In this context, it was pointed out that the exchange rate depreciation in the second half of 2008 contributed to the deterioration of the financial situation of certain enterprises which might additionally limit the investment of these enterprises. Some members of the Council pointed out that the exchange rate depreciation resulted in increasing the value of public debt denominated in foreign currencies and, consequently, the relation of debt to GDP which, due to statutory restrictions, might make it necessary to limit the expenditure of the public finance sector in the coming years. Yet, other members of the Council pointed out that the share of debt denominated in foreign currencies in the total public debt was considerably lower than the share of debt in Polish zloty. On the other hand, as the favourable consequence of the zloty exchange rate depreciation it was noted that it was increasing the competitiveness of Polish products on foreign markets which would limit the impact of recession in countries being Poland's major trading partners on the growth of Polish exports.

While analysing the situation in the credit market it was pointed out that the tightening of banks' lending policy and continued increased level of market interest rates as compared with the NBP rates were related to liquidity disturbances in the banking system being the result of the crisis in the global financial markets. It was argued that commercial banks' operations aimed at increasing the liquidity – reduction of lending and offering of high interest rates on deposits – would contribute to limiting the domestic demand in the time to come. It was also pointed out that too high interest rates on deposits might result in deteriorating financial results of banks and, consequently, constitute a factor limiting future lending. It was pointed out that this effect was not yet observed in the monetary data showing that loans continued to grow relatively fast in November. Some members of the Council argued that the continued growth in corporate loans in November might be driven by the fact that enterprises, fearing the further tightening of banks' lending policy, tried to use the available credit lines.

The Council also discussed the actions of the NBP and the government that could counteract the reduction of banks' lending. It was argued that this objective would be supported by the government loan guarantee system, concerning in particular corporate loans, including loans taken for projects financed with UE funds. It was pointed out that due to liquidity problems faced by banks possible lowering of the NBP interest rates might not fully translate into reductions of market interest rates. In the opinion of some discussants this was an argument speaking in favour of considerable decreases in the NBP interest rates. Other members of the Council argued that even strong decreases in the interest rates would not increase loan availability or reduce credit costs since those depend on banks' liquidity situation and households' and entrepreneurs' expectations as to the future situation of the Polish economy.

While discussing the decision on interest rates, the Council assessed that the signs of stronger and faster than expected decline in the global and Polish economic activity combined with considerable lowering of the inflationary pressure in the medium term speak for decreasing the NBP interest rates. Some members of the Council expressed the opinion that easing of the monetary policy should be implemented gradually, inter alia, due to the high uncertainty about the outlook for the global and Polish economy and about the impact of cuts in the NBP interest rates on market interest rates and domestic demand. They argued that too strong a lowering of the NBP interest rates might negatively affect the expectations of the financial market participants as regards the outlook for the Polish economy, thus driving further exchange rate depreciation. Some members of the Council assessed, however, that in the current situation the impact of the interest rate disparity on the exchange rate was limited. The majority of the Council members assessed that the scale of economic slowdown in Poland and the increased credit cost resulting from market interest rates continuing well above the level of the NBP reference rate combined with the marked weakening of the inflationary pressure justified a considerable easing of the monetary policy at the December meeting. Those members argued that insufficient response of the monetary policy to the unfavourable developments in the Polish economy might contribute to intensifying those developments and, as a result – through deteriorating expectations of the financial market participants – be conducive to the weakening and increased volatility of the zloty exchange rate. They assessed that a more significant lowering of the NBP interest rates would counteract the reduction of bank lending and, consequently, the excessive weakening of domestic demand, and that it would also reduce the cost of credit, including the cost of servicing the previously contracted loans, which could additionally reduce the share of the so-called bad debts, thus contributing to increased stability of the financial system. They also pointed out that maintaining the public finance discipline despite the economic slowdown declared by representatives of the government constituted an additional factor favouring the easing of the monetary policy. The Council also discussed the scale of possible further lowering of the NBP interest rates.

A motion to lower the NBP interest rates by 50 basis points and a motion to lower the NBP interest rates by 75 basis points were put forward. The motion to lower the NBP interest rates by 75 basis points was passed, therefore the motion to lower the NBP interest rates by 50 basis points was not put to voting. The Council decided to lower the NBP interest rates to the level: the reference rate to 5.00%, the lombard rate to 6.50%, the deposit rate to 3.50% and the rediscount rate to 5.25%.

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