MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 22 DECEMBER 2010

At the meeting, the Monetary Policy Council discussed issues related to developments in the external environment of the Polish economy, the outlook for domestic economic growth and inflation, and the situation in the public finance sector.

While addressing the external developments it was pointed out that the recovery in the global economy continued, with a slight acceleration of GDP growth in 2010 Q3 in the United States and slower GDP growth in the euro area. At the same time, a deepening divergence in the economic situation among EU Member States was stressed, in particular, favourable economic conditions observed in Germany, Great Britain and France, the main recipients of Polish exports, contrasted with the intensification of problems in the EU peripheral countries. Some Council members emphasized that positive economic developments in major trading partners of Central and Eastern European countries translated into higher economic growth forecasts for those countries, including Poland.

Members of the Council pointed out that tensions connected with the deep fiscal imbalance gradually spread to other countries and in the future might affect major developed economies. In this context it was argued that further turmoil in the financial markets is possible, which might limit the scale of the capital inflow to the emerging economies, including to Poland. At the same time some Council members emphasized that the necessary reduction of the fiscal imbalance in the euro area countries in the short term would contribute to the decline of GDP growth in those countries. Other members of the Council pointed to the possibility of non-Keynesian effects of the planned fiscal tightening in the euro area countries.

Some members of the Council indicated that the expansionary monetary policy, including non-standard measures undertaken by major central banks, coupled with improved sentiment in the financial markets contributed to a strong rise in commodity prices in the global markets, thus intensifying long-term tendencies. This, in turn, boosted the cost pressure and thereby also inflationary pressure in the emerging economies, which translated into high PPI growth in Central and Eastern European countries, including Poland. In the longer term, the expansionary monetary policy and long-term upward trends in commodity prices might lead to an inflation rise also in the developed economies. Those Council members argued that those conditions should be taken into account in the conduct of monetary policy. In particular, monetary policy should take into account that the growing demand for commodities from developing countries would support further rises in their prices in the medium and long term. Other members of the Council reasoned that the rise in the world prices would be a factor beyond the impact of the monetary policy conducted by central banks of countries regarded as small open economies.

Members of the Council pointed to a gradual acceleration of economic growth in Poland which in 2010 Q3 exceeded expectations. Yet, some Council members assessed that subsequent quarters were not likely to witness a marked increase in economic growth which was indicated by the lack of significant improvement in leading indicators of business sentiment. GDP growth might also be curbed by the announced tightening of the fiscal policy. Those Council members emphasized that there was persistent uncertainty about the sustainability of GDP growth acceleration, connected with a possible weakening of households' consumption growth at the beginning of 2011, when factors which strengthened it on a temporary basis would fade away. Yet, other members of the Council assessed that factors weakening consumption growth would be offset by a gradual improvement in the labour market situation, including growing employment, which would have a positive impact on the consumer sentiment.

Among the factors increasing the uncertainty about the sustainability of economic growth acceleration some members of the Council mentioned the hitherto observed absence of recovery in corporate investment. They pointed out that the investment activity of enterprises might be curbed by the uncertainty about the situation in the external environment of the Polish economy, limited lending, relatively high fiscal burden, as well as by administrative and legal barriers. However, other members of the Council pointed out that the level of production capacity utilization in the economy had been growing steadily and at that time slightly exceeded the long-term average which should support the recovery in investment demand. The good liquidity situation of enterprises, especially large ones that invest more than small and medium-sized companies, may also be a factor contributing to a rise in investment.

While addressing inflation, some members of the Council emphasized that although CPI inflation declined slightly in November 2010 it was still running above the inflation target of 2.5%. Moreover, due to a rise in the majority of VAT rates and an increase in the prices of energy the coming months may be expected to bring a rise in inflation. While analyzing the risk that heightened inflation persists those members of the Council pointed out that this risk was enhanced by the gradually increasing GDP growth which, in their opinion, was likely to exceed potential output growth in the subsequent quarters. According to those members of the Council, a factor which, on the one hand, boosts demand and, on the other hand, is likely to weaken potential output growth are zloty exchange rate developments. Some Council members also pointed out that heightened inflation might be supported by adaptive inflation expectations. Other members of the Council argued that the hitherto observed rise in inflation was mainly driven by supply-side factors, that are to a large extent beyond the impact of monetary policy. In the opinion of those Council members, the absence of a clear demand pressure is indicated by the still low and stable level of core inflation net of food and energy prices. Those members also emphasized that the moderate scale of the expected inflation rise in the coming quarters would reduce the risk that heightened inflation persists.

While discussing the situation in the labour market, some members of the Council indicated that the still low wage growth and relatively high unemployment rate – driven, among other things, by a rise in economic activity – would limit the rise in wage pressure, and, in consequence, also inflationary pressure. Those members pointed out that according to the results of the NBP's survey there was a considerable decline in the number of the employed who are to benefit from wage increases in 2011 Q1. Yet, other members of the Council argued that due to the growing number of the long-term unemployed the high level of unemployment rate will curb wage growth to an ever lesser extent.

Some members of the Council also emphasized that the impact of the opening of the labour market in Germany and Austria to Polish citizens in mid-2011 remains an important uncertainty factor with respect to the size of the labour supply. Other members of the Council indicated that as the differences in wages offered in Poland and abroad shrank, incentives to economic migration became weaker and, as a result, the opening of the German and the Austrian labour markets should not result in a considerable outflow of labour from Poland; it should rather lead to the legalization of employment of Poles already working in Germany and Austria.

While addressing bank lending, some members of the Council pointed out that monthly increases in housing loans to households were close to the ones observed during the credit boom of 2007-2008, and the annual growth in those loans markedly exceeded disposable income growth considered neutral with respect to the risk of rising inflation. Moreover, in the opinion of those Council members, the acceleration in economic growth increased the risk of excessive lending growth in the future as, on the one hand, it encourages banks to ease their lending conditions and, on the other hand, it results in increasing private sector demand for credit. Other members of the Council emphasized that the increase in lending to enterprises remained very limited, and a significant increase of irregular loans in banks' portfolio might urge banks to tighten their lending policies, which would counteract the revival in lending. It was also pointed out that the availability of foreign currency loans to households was very important for the efficiency of the domestic monetary policy.

While analyzing the situation in the public finance sector, some Council members pointed out that the scale of the planned fiscal tightening in Poland in 2011-2012 was lower than in other European countries with a similar level of the public finance deficit. In the opinion of those Council members, amidst high borrowing needs of many countries, this may have a negative impact on Poland's ability to raise funds from foreign investors to finance public debt. Other members of the Council assessed that the scale of fiscal tightening in Poland in 2011 would not be lower than in the majority of European countries. Some members of the Council emphasized that apart from a limited reduction of the fiscal imbalance in Poland, also a possible change in the rules of allocating old-age pension contributions between the repartition and the capital funded part of the pension system might contribute to deterioration in investor confidence, increasing, as a result, the volatility of the zloty exchange rate and of financial instruments prices. Yet, other Council members assessed that introducing changes to the pension system might improve the credibility of the Polish economy.

While discussing the level of interest rates in the Polish economy some Council members indicated that the risk of inflation running above the NBP inflation target in the medium term, which increases along with the gradual acceleration of economic growth, justified starting the cycle of gradual tightening of the monetary policy at the current meeting. Those Council members also argued that increasing interest rates before the expected inflation rise would support the stabilization of inflation expectations of economic agents. At the same time some members of the Council emphasized that the lower than in the past zloty exchange rate sensitivity to the interest rate differential raises the costs of a possible too late a reaction of the central bank to the inflationary pressure.

Other members of the Council pointed out that wage and demand pressures continued to be limited, there were no signs of revival in lending and the hitherto observed and expected in the short term rise in inflation resulted mainly from factors beyond the impact of monetary policy. In the opinion of those Council members those arguments justified keeping the NBP interest rates unchanged. At the same time, some of those members of the Council emphasized that a rise in economic growth increasing the risk of inflation continuing above the inflation target in the medium term might require monetary policy tightening in near future. Yet, gradual increasing of the NBP interest rates should start after some improvement in the financial market sentiment.

A motion to raise the NBP interest rates by 25 basis points was put forward at the meeting. The motion did not pass. 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%, the rediscount rate at 3.75% and the discount rate at 4.00%.

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