NBP

National Bank of Poland

Monetary Policy Council

MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 7 DECEMBER 2011

At its meeting, the Monetary Policy Council discussed the external environment of the Polish economy and the outlook for economic growth and inflation in Poland. In this context, the Council discussed the current and future monetary policy decisions.

While discussing the external environment of the Polish economy, the Council pointed to weak GDP growth in the euro area in 2011 Q3 and high probability of recession affecting the euro area economy in the subsequent quarters, which might be driven by the problems connected with the sovereign debt crisis. In the United States, in turn, GDP growth in 2011 Q3 accelerated slightly. In the opinion of some members of the Council, the US economy could be gradually returning to equilibrium, albeit at higher unemployment rate and weaker potential output growth. At the same time it was emphasized that despite relatively sound economic conditions, the probable recession in the euro area could also translate into a slowdown in economic activity in the United States.

With regard to the euro area sovereign debt crisis, members of the Council pointed out that mere announcements of economic reforms including, in particular, the tightening and coordination of fiscal discipline in the euro area, if not supported with rapid adjustments, might be insufficient to improve financial market sentiment.

It was highlighted that worsening sentiment in the global economy, largely triggered by the euro area crisis and the accompanying tensions in the financial markets, had been translating into the zloty depreciation observed in recent months. Some members of the Council assessed that the resulting higher price competitiveness of domestic output would contain the deceleration in the growth of Polish exports stemming from the anticipated global economic slowdown, particularly in the euro area. The weaker zloty coupled with worsening price competitiveness of imports would be conducive to higher growth of domestic output and improvement in Poland’s current account balance.

At the same time, members of the Council indicated that, since a large share of Polish corporate debt was foreign held, depreciation of the zloty would deteriorate the financial account of the balance of payments. Depreciation of the zloty would also result in higher value of domestic debt denominated in foreign currencies which, especially in the case of households, might exacerbate difficulties with debt repayment. This would, in consequence, lead to deteriorating banking sector conditions and curb credit supply. Some members of the Council also highlighted the risk of Poland facing elevated capital outflows, driven by the euro area crisis and unfavourable capital position of European banks, and, as a result, limited credit supply to Polish entities. Other members of the Council argued, however, that weaker economic growth would lead to lower credit demand.

Some members of the Council pointed out that in the case of improving sentiment in the global financial markets gradual appreciation of the zloty was possible, given “undervaluation” of the zloty and the expected reduction of both external imbalance (i.e. improving current account balance) and domestic imbalance (i.e. narrowing public finance deficit) of the Polish economy. It was noted, however, that amid shocks abroad and growing risk aversion that would increase risk premium, volatility of the zloty might remain elevated.

While analysing current situation in Poland, it was pointed out that the GDP data for 2011 Q1 confirmed that relatively high growth had been sustained in that period. Some members of the Council also assessed that the anticipated deceleration in economic growth in Poland would be largely due to growing uncertainty triggered by external factors. In their opinion, it was supported by business condition surveys that pointed to a relatively high capacity utilization. Against this background, some members of the Council noted that concerns about the impact of the current crisis on domestic economic developments in the coming quarters affected considerably stronger business activity than consumers' behaviour, as could be concluded from persistent high growth of retail sales.

As regards the outlook for economic growth in Poland, the members of the Council assessed that despite slight slowdown in GDP growth anticipated for 2012, the growth rate would remain relatively high, especially against significant slowdown in the global economy. Some members of the Council also indicated that GDP growth in 2012 might exceed 3% in year-on-year terms, with private consumption being an important factor supporting it. In the opinion of some members of the Council, the key risk to GDP growth would be private investment growth, with the scope of public investment co-financed with the EU funds likely to diminish.

While discussing inflation developments in Poland, it was pointed out that the currently observed heightened inflation was mainly driven by factors beyond the direct impact of domestic monetary policy decisions, i.e. high commodity prices in the global markets, depreciation of the zloty stemming from growing risk aversion in the global financial markets and a rise in administered prices. The first two of these factors were reflected in high PPI growth. Some members of the Council also indicated that inflation remaining markedly above the target for a longer time was not conductive to anchoring inflation expectations. This, in turn, was reflected in both the worsening perception of inflation and response structure of individuals to the surveys questions on inflation expectations. Factors behind increasing inflation, albeit to a lesser extent, also included demand pressure, stemming mostly from continued relatively high growth of private consumption, translating into rising core inflation. At the same time, some members of the Council pointed to the labour market conditions, in particular to persistently high unemployment rate, declining employment in the corporate sector and moderate wage growth, which contained cost pressure, and, consequently, inflationary pressure. Some members of the Council were of the opinion that inflation was likely to return to the target in the second half of 2012. Among other factors contributing to lower inflation some members of the Council indicated a rise in saving rate in the enterprise sector.

In the opinion of the Council, the key factor containing inflationary pressure in the coming quarters would be a weaker GDP growth, stemming from slower global economic growth. The members of the Council were also of the opinion that lower domestic activity would additionally result from further fiscal tightening. Yet, as regards the impact of fiscal tightening on inflation, some members of the Council assessed that its structure might boost inflation in the short term, as it would largely consist of rises in tax burdens.

At the same time, further pass-through of the zloty depreciation observed over the past few months into domestic prices, coupled with inflationary expectations unanchored at the target level, posed, in the opinion of some members of the Council, the risk of inflation persisting at a heightened level. The Council also pointed to the expected rise in administered prices, excise tax and charges imposed by local governments in 2012, as factors prolonging the return of inflation to the target.

While discussing the NBP interest rates, the Council agreed they should remain unchanged. When justifying the decision, the Council pointed to the currently high uncertainty regarding economic activity and inflation developments both in global and domestic markets. This made it difficult to explicitly assess the probability of inflation remaining above or below the target over the period of the strongest impact of monetary policy on the economy. Moreover, some members of the Council argued that stabilization of monetary policy parameters is conducive, particularly given increased uncertainty, to maintaining macroeconomic stability.

In the opinion of some members of the Council, current inflation persisting at a heightened level and a relatively long period of its expected return to the target might be supportive of an increase in the NBP interest rates. On the other hand, however, the likely global and domestic economic slowdown, should be easing inflationary pressure in the medium term. In these circumstances, in the opinion of some members of the Council, the tightening of monetary policy might additionally weaken domestic economic growth and increase the risk of inflation remaining below the target in the long run.

While discussing future monetary policy, some members of the Council upheld their assessment that the persisting relatively balanced risks to the future inflation justify stabilization of interest rates at present level in the following quarters. The macroeconomic scenario they expected assumed smooth slowdown in economic growth along with a gradual decline in inflation. Yet, according to some members of the Council, it might be justified to tighten monetary policy in the future. In their opinion, this would be due to a high probability of inflation remaining at a heightened level in the coming quarters despite the expected slowdown in economic growth, as supported by lower responsiveness of inflation to the negative output gap, stronger exchange rate pass-through on inflation amidst large and one-directional exchange rate fluctuations and a relatively strong rise in money supply.

Some members of the Council, however, highlighted macroeconomic scenarios justifying future reduction in the interest rates. In their opinion, this would be advisable amidst strong slowdown in economic growth combined with inflation declining to the target.

The Council kept the NBP interest rates unchanged at the following levels: reference rate at 4.50%, lombard rate at 6.00%, deposit rate at 3.00%, rediscount rate at 4.75%.

Publication date: 22 December 2011