NBP

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Monetary Policy Council

MINUTES OF THE MONETARY POLICY DECISION-MAKING MEETING HELD ON 5 DECEMBER 2012

At its meeting, the Monetary Policy Council discussed the current and future monetary policy decisions against the background of the domestic and external macroeconomic conditions, especially including inflation developments.

While analysing the external conditions, the Council observed that the persistently unfavourable economic climate in the external environment of Poland has an adverse impact on domestic economic activity. At the same time, the Council members pointed to the scale of fiscal tightening in the United States in 2013 as a factor posing uncertainty to the global economic growth in the nearest term. However, some Council members emphasised that in the second half of 2013 GDP growth may accelerate somewhat in Western European economies, including Germany, Poland's main trading partner. Also, a few Council members drew attention to the structural adjustments in the peripheral economies of the euro area, which in the longer term should contribute to higher growth in these countries and bring an improvement in the economic situation of the entire euro area.

While addressing economic conditions in Poland, a further slowdown in the economy was pointed out, confirmed by the 2012 Q3 GDP data. It was emphasised that the slowdown is driven not only by external but also domestic factors. While analysing factors behind the decline in domestic demand in 2012 Q3, the Council members highlighted a decrease in investment and consumption growth deceleration. They observed that household consumption is adversely affected by a decline in real disposable income. As households strive to smooth consumption, it is accompanied by savings rate declining to its historical low. It was pointed out that a decrease in disposable income is in particular related to deteriorating labour market conditions.

While analysing the incoming labour market data, it was pointed out that wage growth decelerated in 2012 Q3, which was accompanied by a further decrease in unit labour costs growth rate. At the same time, some Council members argued that the rising unemployment rate does not indicate a risk of higher wage demands. A few Council members argued that higher unemployment rate may be partially linked to rising equilibrium unemployment rate, which, in their opinion, is suggested by the growth in the number of vacancies and rising employee recruitment costs.

With reference to the outlook for economic growth in Poland, the Council members pointed out that GDP growth will remain weak in the subsequent quarters. Consumption will continue to be hampered, in particular, by deteriorating labour market conditions. Another factor negatively affecting consumption is households' limited capacity to increase consumption through further reduction in the savings rate. In the opinion of the Council, investment growth in the subsequent quarters will continue to be negative, as indicated, in particular, by further decline in the cost estimate value of newly launched investment projects. It was pointed out that declining public investment, including projects co-financed with EU funds, will remain a factor dampening investment. A few Council members observed that the scale of decline in investment may be curbed by the "Polish Investment" government programme, whose effects, however, will be noticeable in the second half of 2013 at the earliest. At the same time it was anticipated that economic growth will continue to be driven by net exports. Yet, in this context, future demand from the euro area and the zloty exchange rate developments constitute a risk factor. Some Council members argued that as the economic conditions abroad are expected to improve, economic growth in Poland may also accelerate in the second half of 2013. Other Council members observed, in turn, that despite possible economic climate improvement in Poland in the second half of 2013, current data indicate considerable weakening in economic activity and rising risk of recession.

According to some Council members, the observed slowdown in GDP growth partially reflects a decline in potential economic growth due to the fact that factors hitherto enhancing competitiveness of the Polish economy are on the wane. Therefore, these Council members were of the opinion that the negative output gap in the Polish economy may be moderate. Yet, other Council members indicated that potential GDP growth may have declined only slightly in the aftermath of the crisis, and consequently, given the current GDP growth rate, the output gap in the economy is widening.

While addressing inflation developments, the Council members drew attention to the fact that both CPI and core inflation has recently declined. A downward revision in households' inflation expectations was also emphasised. At the same time, the majority of the Council members expressed an opinion that the subsequent quarters will see a considerable decline in inflation. According to the Council members, lower inflation will be supported by supply factors, including cuts in the prices of natural gas as of January 2013, as well as the widening output gap and the lack of wage pressure in the economy. At the same time, some Council members pointed to uncertainty about future inflation developments. The uncertainty is related, in particular, to the developments in the zloty exchange rate which is affected by investors' volatile sentiment. These factors may lead to a reversal in capital flows and increased volatility of the zloty exchange rate. At the same time, a few Council members pointed to the risk related to the strongly expansionary monetary policy of major central banks, which may eventually result in inflation rising significantly across the global economy.

Yet, some Council members presented the opinion that given the persistence of the factors hitherto increasing inflation, inflation is unlikely to decline significantly in the nearest years. In this context, some Council members pointed out that decline in inflation expected in the subsequent quarters will be driven by supply factors and hence will not have any significant impact on wage and inflationary pressures in the economy. These members also pointed to a possible acceleration in economic growth in the second half of 2013, which may somewhat increase inflationary pressure.

It was assessed that the NBP interest rates should be lowered at the current meeting, which should support economic activity and reduce the risk of inflation falling below the target in the medium term. The Council members differed in their opinions as to the scale of the NBP interest rate cuts, both at the current meeting and during the entire cycle.

Most Council members pointed out that given the persistence of inflation and the risks related to price growth within the horizon of the strongest monetary policy impact , the reduction in the NBP interest rates should not be significant. A few of these members additionally indicated that interest rate cuts may weaken the zloty exchange rate, and thus negatively affect inflation, as well as prompt households to deposit savings outside the banking system. At the same time, a few Council members argued that deep interest rate cuts may bring further decline in the savings rate, thus contributing to building imbalances in the economy.

Other Council members, in turn, considered that in the current economic conditions, even a somewhat deeper interest rate reduction would not lead to inflationary and wage pressure in the subsequent quarters. In the opinion of those Council members, considering the degree of economic downturn and growing risk of inflation falling below the NBP's inflation target in the coming quarters, it was advisable at the current meeting to reduce the NBP interest rates more than previously, and according to a few Council members – far more than previously. Those members observed that the arguments in favour of a relatively prompt monetary policy easing include, in particular, the length of lags in the monetary policy transmission mechanism. In the opinion of those Council members, when making decisions concerning interest rates in Poland it was also necessary to consider the level of interest rates across the world, including in the main developed economies.

At the meeting, a motion was submitted to lower the basic NBP interest rates by 1.50 percentage point. The motion did not pass. A motion was also submitted to lower the basic NBP interest rates by 0.50 percentage point. The motion did not pass. At the meeting, a motion was also submitted to lower the basic NBP interest rates by 0.25 percentage point. The motion was passed. The Council decided to lower the basic interest rates by 0.25 percentage point, to the following levels: reference rate at 4.25%, lombard rate at 5.75%, deposit rate at 2.75%, rediscount rate at 4.50%.

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