Minutes from the Monetary Policy Council decision-making meeting held on 3 December 2014

Members of the Monetary Policy Council discussed the monetary policy decisions against the background of macroeconomic developments in Poland and abroad.

While discussing business conditions in Poland's external environment, Council members pointed out that global activity growth remained moderate. It was emphasized, that the business conditions in the United States remained favourable. Few Council members also noted that the economic situation in the euro area had slightly improved. However, some Council members pointed out that economic growth in the euro area remained sluggish and business climate indicators point to low activity growth probably continuing in the following quarters. Slow GDP growth in Germany – Poland's main trading partner – was highlighted, along with the decline in the PMI index for that country. With regard to the situation in the largest emerging economies, it was observed that also in these countries economic activity remained relatively slow, with growth weakening further in China.

While discussing monetary policy abroad, it was stressed that major central banks continued to pursue highly expansionary monetary policy. In particular, the European Central Bank was keeping its interest rates at a historically low level, while simultaneously running an asset purchase programme; the European Central Bank does not exclude the possibility that the programme might be expanded to include more instruments. According to few Council members this could limit the risk of deflation in the euro area.

While discussing economic situation in Poland, Council members observed that GDP growth in 2014 Q3 had weakened only slightly and was higher than expected. Some Council members also highlighted the favourable structure of GDP growth. They pointed to flagging external demand as the principal source of weaker economic growth. Domestic demand, in turn, remained relatively robust, supported by a stable expansion in consumer demand and steeper growth in investment spending. Some Council members also pointed to rising business climate indicators, faster than a year ago credit growth and a further improvement in labour market conditions. Other Council members emphasized that retail sales growth and industrial output growth had remained low in October, while construction and assembly output had declined, which might signal further growth weakening in 2014 Q4. Few Council members believed that this enhanced the risk of slower growth in investment expenditures in the Polish economy. Some Council members also drew attention to the fact that nominal GDP growth – due to GDP deflator having sunk almost to zero – was running at one of the lowest levels in the past decade. Slow nominal growth hampers the process of reducing the debt in relation to GDP – both public and private. In the opinion of those Council members, moderate real GDP growth coupled with core inflation running close to zero, corroborate the existence of negative output gap in Poland. Yet, other Council members believed that despite a slight slowdown, GDP growth was running close to that of the potential output, with domestic demand growing even faster. According to those Council members, should robust expansion in domestic demand be sustained, it might boost the current account deficit, currently being contained by the declining commodity prices.

While discussing the prospects for economic growth in Poland, some Council members stressed that both the baseline scenario of the November projection and internal short-term forecasts pointed to only slight weakening of GDP growth in the coming quarters, with a subsequent return of moderate recovery. Council members pointed out that since the current weakening of GDP growth had mainly been driven by external factors, future economic growth in the euro area would be of particular significance to economic activity trends in Poland. Few Council members argued that a slight rise in economic growth expected in the euro area over the next few quarters would support GDP growth in Poland. Yet, other Council members highlighted the continued risk of prolonged low economic growth in the euro area, which might adversely affect GDP growth in Poland in the longer term.

With regard to inflationary processes at home, it was pointed out that the annual consumer price growth fell yet again in October and was running below the forecasts. Consumer prices deflation was accompanied by a further decline in producer prices in industry. Some Council members emphasized that inflation in Poland was currently driven mainly by external factors bringing about, above all, a decrease in energy and food prices. Few of the Council members were of the opinion that such sources of negative price growth were indicated by sound – despite a rapid rise in the corporate wage bill – financial performance of enterprises, as well as a decline in corporate operating costs, in particular costs of materials. Some Council members, in turn, emphasized the absence of demand pressure as a factor, which, along with external factors, contributed to lower inflation. In the opinion of those Council members this was indicated by a further decline in core inflation indices, whose average – for the first time on record – sank below zero.

Some Council members also pointed to very low inflation expectations of households and businesses, and declining inflation expectations of professional forecasters. At the same time, it was emphasized that inflation forecasts had been once again revised downwards, indicating that deflation was likely to persist somewhat beyond the end of 2014. In the opinion of few Council members, CPI growth in Poland might remain relatively low in the longer term, due to the persistent downward trend in commodity prices in the global markets. Yet, other members of the Council argued that the impact of lower commodity prices on inflation should be short-lived. While discussing the outlook for inflation, attention was also drawn to a significant impact of future exchange rate of the zloty on price developments.

While referring to the possible effects of deflation in Poland, it was emphasized that considerable uncertainty remained as to its impact on decisions of economic agents, in particular enterprises. In addition, it was noted that economic consequences of deflation would depend on its level, sources and duration. Some Council members pointed out that extended period of negative price growth increased the risk of inflation expectations remaining at low levels and – as a consequence – adverse effects of deflation on the economy. Other Council members argued, however, that no negative effects of deflation on decisions of businesses and households had been observed so far. They pointed out that 2014 Q3 brought an acceleration in growth of consumption and investment, and enterprises continued to post good financial results. Financial results of enterprises were supported by declining production costs driven by falling commodity prices. In the opinion of few members of the Council, deflation in the coming months would not adversely affect economic growth; on the contrary, it could rather support consumption and investment, as its main driving force was the decline in agricultural and energy commodity prices.

While discussing the interest rate decision, most members of the Council believed that at the current meeting interest rates should remain unchanged. Some Council members indicated that the decline in GDP growth was slight, and its growth prospects in the coming quarters remained relatively favourable. According to those Council members, the weakening of GDP growth and deflation were mainly driven by external factors and therefore the impact of domestic monetary policy on economic processes was limited. Few members of the Council pointed out that – considering current inflation forecasts – the level of real interest rates ex ante was at present relatively low, while other Council members stressed that the real interest rates deflated with current CPI were higher than the nominal interest rates. According to few members of the Council, further interest rate cuts could lead to external imbalances and excessively boost credit growth in the economy, including lending to households, which did not finance investments supporting growth of potential output. Those members were also of the opinion that low interest rates weakened the selection of economic agents and – consequently – inhibited productivity growth. In this context, they pointed to the recent years' very low contribution of the movement of production factors between sectors to productivity growth. Other Council members indicated that without growing consumption and with flagging external demand also private investment would decelerate.

Few Council members also argued that interest rates if kept unchanged at the current meeting would leave room for possible easing of monetary policy in the event of a significant economic downturn or disturbances in the financial system.

Some Council members who were in favour of keeping interest rates unchanged at the current meeting emphasized that they did not rule out the possibility of a further adjustment of interest rates. In the opinion of those members, lowering of interest rates could be justified by longer periods of price declines, increasing the risk of adverse effects of deflation on the economy. Interest rate adjustment would also be justified if the incoming data confirm that the slowdown in domestic economic activity would prevail and that weak growth in the environment of the Polish economy was likely to continue. Some Council members also pointed out that persisting significant spread in interest rates between Poland and its environment would increase the risk of appreciation of the zloty, which, in turn, could delay the return of inflation to the target. Few members argued that interest rate cuts would reduce the spread between the deposit rate and the expected rates of return on investment, which would, in turn, support growth in investment outlays and limit the negative impact of deflation on businesses' propensity to invest.

Few Council members were of the opinion that amidst persistently negative price growth and moderate GDP growth, as well as the high likelihood of inflation remaining below the target in the event of low probability of significant acceleration of economic growth in the coming quarters, it was justified to lower interest rates considerably already at the current meeting. According to those members of the Council, such decision was also supported by the fact that interest rate cuts in the absence of inflation risk would reduce the public debt servicing costs and thus support the government's economic policy. These members also believed that interest rate cuts – reducing their spread between interest rates in the environment of the Polish economy – would minimize the risk to the country's financial stability related to the potential inflow of speculative capital and its subsequent outflow.

At the meeting a motion was submitted to lower the NBP interest rates by 1.00 percentage point. The motion did not pass. The Council decided to keep the NBP interest rates at the following levels: the reference rate at 2.00%, the lombard rate at 3.00%, the deposit rate at 1.00%, the rediscount rate at 2.25%.

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