Minutes of the Monetary Policy Council decision-making meeting held on 2 December 2015

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

When discussing economic activity abroad, Council members drew attention to the continued moderate recovery in developed countries. They underlined that consumer demand continued to be the main growth factor in the euro area. In turn, investment growth in this economy was still relatively low. It was pointed out that the pace of recovery was also hampered by the low demand in the emerging markets. This factor was most likely responsible for the slight drop in GDP growth in the euro area in 2015 Q3 and also the marked fall in German export growth. However, Council members judged that in the coming quarters the economic conditions in the euro area would probably continue to gradually improve. Growth in economic activity in this economy – in the opinion of the Council members – could additionally be supported by an increase in consumption and housing investment connected with the influx of immigrants. The possibility of a further slowdown in growth of the emerging economies remained a risk factor for the economic situation in the euro area.

In the United States the economic outlook remains moderately favourable. It was pointed out that the slowdown in GDP growth in 2015 Q3 resulted mainly from the drop in inventory and was probably temporary. However, it was underlined that the low growth in industrial output and retail sales suggested that the pick-up in GDP growth in the coming quarters might be moderate. Certain Council members were of the opinion that also in the long term economic growth in the United States might remain moderate due to the slow growth in productivity in the US economy. In this context, they underlined that in comparison with previous phases of the recovery, GDP growth in the United States is currently low.

Council members drew attention to the continued weak economic situation in the emerging economies. However, it was pointed out that in some of these economies there are signals of economic activity stabilising. In this context, attention was drawn to the reduction in scale of the GDP decline in Russia in 2015 Q3 and slower contraction in Russia's industrial output, as well as the slightly better PMI in China.

Certain Council members judged that the risk of severe shocks in the global economy remained, and that the likelihood of their materialisation is increased by the imbalances in many asset markets. In the opinion of these Council members, significant risk is posed by the possibility of financial crises in the emerging markets related to the considerable currency debts of these countries' enterprises. These Council members assessed that the occurrence of disturbances in the emerging markets - accompanied by relatively low GDP growth in the United States - could lead to deterioration in global economic conditions.

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Referring to monetary policy of the major central banks, Council members emphasised that in the near future the divergence between the monetary policies of the Federal Reserve and the ECB would grow. The Federal Reserve announced the beginning of the cycle of interest rate hikes in the next months. In turn, the ECB signalled further easing of monetary policy. Council members emphasised that the divergence of monetary policy between the major central banks could lead to periodic increase in financial market volatility, particularly considering the continued uncertainty as to the scale and timeline of the Fed's interest rate hikes. Risk aversion in the financial markets could also increase in reaction to a renewed rise of fears about the economic situation of the emerging economies.

Certain Council members judged that global factors would strongly affect the asset prices and exchange rates of the emerging economies, including Poland. At the same time, it was underlined that the exchange rate of the zloty - despite a certain weakening in the recent period - remained relatively stable. In the opinion of some Council members, the volatility of the zloty is limited by the positive assessment of Poland by foreign investors, the effect of which is a significant share of long-term investors in structure of Poland's foreign debt.

While analysing the situation in Poland’s real economy, Council members pointed to the continued stable GDP growth, and even its’ slight acceleration in 2015 Q3. The main growth factor continued to be consumer demand, supported by growing employment and positive household sentiment. At the same time, in the view of some of the Council members, growth of consumer spending remained moderate due to the relatively low nominal wage growth and a higher rate of voluntary saving than earlier. It was pointed out that the growth in investment also contributed to GDP growth, although it had slowed down in 2015 Q3 -. Certain Council members judged that the investment slowdown in the economy could be connected with the lower absorption of EU funds. In turn, according to some Council members, the corporate propensity to invest could be reduced by the uncertainty regarding the economic situation abroad. It was pointed out that net exports also had a positive contribution to GDP growth in 2015 Q3. However, certain Council members underlined that growth of Poland's foreign trade had slowed down, while import growth had decelerated more than exports.

While discussing the situation in the labour market, Council members pointed out that the level of employment was high and that the unemployment rate was close to the pre-crisis level. Certain Council members emphasised that, despite the very favourable situation in the labour market, nominal wage growth in the economy remained relatively low. Other Council members also stressed that wage levels in Poland remained low compared to West European countries and pointed out that their growth required an increase in innovation and technological advancement of Polish production.

While analysing the situation on the credit market, Council members pointed to a certain pick-up in growth of corporate loans. Certain Council members judged that the growth of loans to enterprises was only modest, and in the case of SMEs, low. These

Council members pointed out that the corporate loans to GDP ratio in Poland was considerably lower than in the euro area. However, some Council members underlined that currently the growth of corporate loans - amidst low interest rates and their high availability - was not restricted by supply factors. At the same time, certain Council members judged that an increased financial burden imposed on the banking sector could most likely adversely affect the credit supply in the future.

Referring to the outlook for economic growth, the majority of Council members believed that in the coming quarters GDP growth would remain relatively stable. Certain Council members even assessed that, provided GDP growth would not be weakened by external shocks, growth in 2016 could be higher than in 2015. The economic growth would continue to be supported by strong consumer demand and investment. However, it was pointed out that investment growth might slow down. The temporarily reduced inflow of EU funds in the initial phase of the new budget perspective would contribute to this process. In the opinion of certain Council members, corporate investment growth might be restricted by the relatively high level of investment outlays of enterprises in relation to fixed assets, and the moderate growth in demand, which did not create incentives to expand production capacity.

Council members judged that – besides domestic demand – rising exports would also boost economic activity in Poland. Certain Council members were of the opinion that in connection with the current economic recovery in the euro area, export growth would be higher than GDP growth. At the same time, it was pointed out that the weakening of foreign trade related to the further slowdown in emerging economies remained the main risk for domestic economic activity. Certain Council members also judged that possible financial crises in the emerging economies and resulting weakening of the global economy might be the source of negative shocks for the Polish economy.

While discussing inflation developments in Poland, Council members pointed out that the scale of consumer price deflation was gradually declining. Council members argued that in the coming quarters price growth would continue to rise, driven by further stable growth in economic activity and the robust domestic labour market. However, some Council members pointed out that the increase in price growth was slow and weaker than expected. Certain Council members highlighted that if wage growth did not pick up, the return of inflation to the target could lengthen. In this context, certain Council members pointed out that the announced unfreezing of wages in the public sector - in addition to the low unemployment - may contribute to a pickup in wage growth in 2016.

Council members discussed monetary policy conducted in the years 2010-2015. It was assessed that in this period the long-term stability of prices in Poland had been maintained, despite the increased volatility of price growth in certain years. It was pointed out that inflation volatility was mainly the effect of sharp changes in commodity prices in global markets. At the same time is was emphasised that monetary policy supported the stability of the zloty, which during the term of office of the Council was one of the least volatile currencies. It was also underlined that the flexible response of monetary policy to shocks contributed to the maintenance of balanced economic growth and financial stability. In this context, Council members pointed to, above all, the low volatility of the output gap, the current account surplus, and the maintenance of lending growth at a stable level.

While discussing interest rates, the Council assessed that they should remain unchanged. Council members argued that in the coming quarters price growth would pick up slowly, which would be driven by stable economic growth and the gradual closing of the output gap. Council members judged that in the light of available data and forecasts, the current level of interest rates is conducive to keeping the Polish economy on a sustainable growth path and sustaining macroeconomic balance.

Some Council members stressed that the persistence of uncertainty regarding the domestic and external developments also spoke in favour of interest rate stability. In this context, they pointed above all to the persistent risk of sharper weakening of growth in emerging economies and the expected growing divergence of monetary policies of the main central banks, which could contribute to an increase in volatility in financial markets. They also pointed to the uncertainty regarding the shape of future economic policy.

Certain Council members thought that the Council should consider interest rate increases in the nearest months. They argued that this would provide more room for monetary easing in the event of strong external shocks. These Council members argued that in the absence of interest rate hikes, monetary policy would become procyclical, contributing to a deterioration of the current account balance and an increase in Poland's foreign liabilities. The rising dependence of the Polish economy on foreign finance could, in turn, limit the possibility to conduct countercyclical monetary policy in the future, due to the concerns about a sharp change in the zloty exchange rate and flows of foreign capital.

However, certain Council members were of the opinion that although at the current meeting interest rates should remain unchanged, in the coming months – as the uncertainty about the determinants of monetary policy abates - it could be justified to lower them. These Council members pointed out that price growth was slow and inflation forecasts for the coming years were being revised downwards. These Council members also judged that a possible easing of monetary policy would contribute to a recovery of lending to enterprises which – particularly in the case of the SME sector – remained relatively weak. However, the easing of monetary policy could be pursued amid stable exchange rate. Other Council members argued that lowering interest rates would not contribute to acceleration of corporate lending – which was restricted by demand factors – yet it could have an adverse effect on the stability of the financial system.

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The Council decided to keep the basic NBP interest rates unchanged: the reference rate at 1.50%, the lombard rate at 2.50%, the deposit rate at 0.50% and the rediscount rate at 1.75%.

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