

Warsaw, 21 July 2022

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**Report on the activities
of
Narodowy Bank Polski in 2021**

Speaker of the Sejm, Members of the House!

As every year, I am honoured to present to you the *Report on Monetary Policy* and *Report on NBP Operations*. Both documents present the statutory activities conducted by the central bank last year. I will briefly discuss the most important of these, beginning with monetary policy.

At the outset, let me remind you that Narodowy Bank Polski implements monetary policy in accordance with the Constitution, the Act on NBP and with the *Monetary Policy Guidelines*, which are adopted each year. The main objective of monetary policy is to maintain price stability. At the same time, monetary policy is conducted in such a way as to be conducive to sustained economic growth and financial system stability. For many years, monetary policy strategy has been based on the concept of the medium-term inflation target. The *Monetary Policy Guidelines* explicitly state that:

(...) due to macroeconomic and financial shocks, inflation may temporarily deviate from the target and that The response of monetary policy to shocks is flexible and depends on their causes and the assessment of persistence of their consequences.

This is important because for almost three years the Polish economy has been faced with unprecedented disturbances, initially triggered by the pandemic, and currently by the war in Ukraine. These shocks are an enormous challenge in many fields, including for monetary policy, because they intensify the amplitude of the macroeconomic changes.

Please allow me to recall that in the first quarters of 2021 the Polish economy was only just making up for the pandemic losses, and the uncertainty about the future course of the pandemic was a significant risk factor for the sustainability of the economic recovery. At that time, inflation was running at a level consistent with the NBP target, although in the next quarters – like in other countries – it began to gradually rise.

At that time, the main factors contributing to the rise in inflation were beyond the influence of domestic monetary policy; they were, above all, the increase in global commodity prices and global supply disruptions, as well as regulatory factors. Taking into account the nature of the majority of the factors boosting price growth, in the first three quarters of the year it was rationally judged that following a temporary rise, inflation would decline in 2022. I will repeat this sentence – taking into account the nature of the majority of the factors boosting price growth, in the first three quarters of the year it was entirely rational to judge that following a temporary rise, inflation would decline in 2022. This was indicated by all the available forecasts – not only the forecasts of Narodowy Bank Polski, but also of the most important international institutions, including the International Monetary Fund and its special mission to Poland. In these conditions, from the point of view of the knowledge it possessed at that time, the Monetary Policy Council correctly kept interest rates unchanged. This was correct from the point of view of the knowledge possessed at that time, and not from the point of view of the knowledge we have today, after two years, when we know what happened. This is why the accusations that NBP began the cycle of monetary policy tightening too late are unfounded. In light of the knowledge at the time, this would have been neither correct nor rational.

It was only in the run-up to the meeting of the Monetary Policy Council in October 2021 that the inflation outlook changed significantly.

In particular, global energy commodity prices rose sharply once again, as did prices of agricultural commodities. This pushed up the inflation forecast and extended the expected period of higher price growth. At the same time, incoming information indicated that the next wave of the pandemic would have a limited impact on the economic conditions, that it would not lead to mass lockdowns. Consequently, there was a higher risk that in the medium term – in other words, more or less two years – price growth would persist at a level above the inflation target.

In this situation, in order to reduce the risk, from October 2021 monetary policy has immediately been tightened. In particular, we have raised NBP interest rates significantly. The reference rate has risen by a total of 6.4 percentage points to the current level of 6.5 per cent. Moreover, we have returned the required reserve ratios to the pre-

pandemic level and ended bond purchases on the secondary market. Therefore, in recent quarters we have taken very decisive action to reduce inflation.

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Although monetary tightening limits and will limit inflation, like in other countries it is high today because it has been boosted by sharp rises in global commodity prices and disruptions in global production and international trade. I underline here the word global, because these are factors going beyond our national circumstances – initially connected with the pandemic, and currently exacerbated by the Russian aggression against Ukraine – and causing price rises all around the world. It is worth remembering that in the euro area inflation is currently the highest ever recorded and in the United States and the United Kingdom inflation is the highest in forty years. In most countries in our region inflation is in double digits and is higher than in Poland. In those countries that began to tighten monetary policy earlier and raised interest rates earlier it also turned out not to make a difference. However, it is worth remembering that although inflation is high everywhere, this does not necessarily apply to economic growth. The Polish economy is one of few economies in the region which can boast that it has more than made up for the pandemic losses. To this day, this is not the case in the major European countries, I recall that GDP growth in the first quarter of this year stood at 8.5 per cent, and Polish GDP exceeded by over 8 per cent the pre-pandemic level, with very low unemployment, practically without unemployment and with a favourable situation in the labour market. This is a great success of all Poles. It is a great success that is not appreciated enough on a daily basis, but which is appreciated abroad. Admittedly, in the coming quarters a significant slowdown in GDP growth is forecast, just like everywhere, in the whole of Europe and around the world, but in the second half of next year economic growth is expected to pick up again.

In view of the conditions presented in the current year, NBP has continued to tighten monetary policy, because our priority is the reduce inflation. However, it is worth remembering that a reduction in the inflation triggered by the strong supply shocks must occur gradually – especially since a fundamental economic slowdown is expected – in

order not to generate excessive social costs, and above all significant unemployment. This is why monetary policy continues to be conducted in a responsible manner, namely, in a way that reduces inflation and at the same time is conducive to sustainable economic growth.

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I will now move on to the remaining areas of NBP activities, beginning with supporting financial system stability. The stability of the financial system, in particular the stability of the banking sector, is a necessary condition for meeting the inflation target, as well as maintaining sustainable long-term economic development.

In 2021, the economic repercussions of the COVID-19 pandemic continued to be a source of threats to financial stability. Ultimately, these threats proved to be less severe for the economy and the banking sector than initially expected. Credit losses last year fell significantly and failed to confirm fears of excessive tightening of lending by banks. The activities of NBP and the government taken in 2020 and continued last year effectively supported the banking sector.

In the past year, the costs of the legal risk related to FX mortgage loans have continued to present a challenge for the banks. NBP positively assesses the approach of the banks – the creation of a reserve for the legal risk of FX housing loans and offering borrowers a settlement. These measures have helped the banking sector to become more resilient to the financial effects of this risk.

This year has seen additional challenges facing the banks in the form of the consequences of the rise in inflation and higher interest rates, strengthened by the possible negative effects of the war in Ukraine. Rising interest rates impact financial stability in a variety of ways. A positive result was observed as early as last year in the form of lower mortgage loan growth, which had earlier been judged by the Financial Stability Committee as a possible source of imbalance in the residential real estate market. Higher interest rates were also conducive to a rebound in the profitability of the banking sector following the pandemic. Thanks to this, the banks increased their ability to absorb future shocks, e.g. the economic repercussions of the war in Ukraine, which are difficult to foresee.

However, the increase in the cost of loan servicing may cause credit risk for banks to materialise. In particular, this concerns people who have long-term housing loans and interest based on a variable interest rate. There is no doubt that the burden on indebted households' budgets has increased. However, I believe the assessments of the related risk that appear in the media, as well as in politics, in the political sphere, are exaggerated: approximately 4/5 of mortgage loans were granted before the period of historically low interest rates, only 1/5 were granted during the period of particularly low interest rates, and all the banks required income buffers from the borrowers safeguarding their debt-servicing capabilities, even in the event of higher interest rates than those in place at the moment. Let's also not forget that since the moment that these loans were taken out there was relatively high wage growth, which to a large extent offsets the effect of higher instalments. This is why the increase in the cost of credit does not have to automatically trigger problems with its repayment, which can be seen in the statistics. Taking into account these circumstances, Narodowy Bank Polski presented an opinion that financial support, government financial support, should be limited to only those borrowers who actually need it – introduced through legislation and financed by the banks. Only for those borrowers who actually need it, and not for everyone, as is the case. We believe the Borrower Support Fund is a suitable mechanism which will ensure this. In the opinion of NBP, better targeting of support would reduce moral hazard, would reduce the costs of banks and would be more favourable for the state budget.

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Despite the persistence of the epidemic in Poland, last year we did not observe a sharp increase in demand for cash, as was the case in 2020. The value of cash in circulation as at the end of 2021 was 355.6 billion zloty, which represents a rise of 10.5% compared to the previous year. The increase in cash in circulation in 2021 was related to the increase in total money supply in the economy.

On the other hand, in 2022 the value of cash in circulation increased more strongly, which was a result of the greater market demand for cash in physical form following Russia's aggression against Ukraine and the emergence of far-reaching concern, or even panic, among the population.

The culmination of withdrawals from NBP, and therefore withdrawals by clients of commercial banks, took place at the end of February and beginning of March, and their scale significantly exceeded the demand for cash that was observed at the beginning of the pandemic. It exceeded it significantly. However, despite the above-average social demand for cash, Narodowy Bank Polski was able to fully satisfy this demand. And this was what I meant when I said publicly that we have an endless supply of cash. This endless supply, of course, is countable – it is endless, but in the sense that there will not be a shortage, so that clients will be able to withdraw money from the banks and will not need to panic. And I stand by this statement.

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At the end of 2021, the official reserve assets of Narodowy Bank Polski were the equivalent of 146.6 billion euro, which allows commonly used indicators of the adequacy of reserves to be kept at an appropriate level and meets the potential needs of the balance of payments in crisis situations. Our reserves are much greater than what is required. A significant part of the FX reserves is currently, as you know, in the form of monetary gold, which at the end of 2021 amounted to 230.8 tonnes, or approximately 8% of the reserve assets.

The priority of NBP in the management of FX reserves is to ensure a high degree of safety of the invested funds and an appropriate level of liquidity. Only after fulfilling these conditions is action taken to increase the long-term profitability of the reserves. Among other things, this is achieved by a diversified currency and investment structure. Above all, they should be safe and liquid, and only then properly invested from the point of view of profitability. In 2021, Narodowy Bank Polski increased the diversification of its reserves, beginning investments in Canadian dollars, and also investing in the equity markets in the USA, the euro area and the United Kingdom. In addition, it was decided to gradually increase exposure to financial instruments serving the fulfilment of the goals of sustainable development, including in green bonds. At the end of 2021, these instruments accounted for approximately 0.6% of the FX reserves. In other words, this was the level expected and accepted by international institutions, including the European Central Bank.

In 2021, the rate of return on the FX reserves calculated in zloty amounted to 4.2%, which was a result of the appreciation of the majority of the reserve currencies against the zloty. On the other hand, amid a fall in the prices of government bonds, which is taking place as a result of inflation, the rate of return of the reserves calculated in the currency of the instruments is minus 1.3%.

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Finally, I am honoured to inform you that in 2021 Narodowy Bank Polski made a profit of 11.0 billion zloty. In accordance with the Act on NBP, on 15 June the central bank transferred to the state budget 95% of this amount, or 10.4 billion zloty. The remaining amount was used to increase NBP's reserve fund.

Thank you for your attention.