NARODOWY BANK POLSKI

Monetary Policy Council

Monetary Policy Guidelines for 2024

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Warsaw, 2023

In setting the *Monetary Policy Guidelines for 2024*, the Monetary Policy Council, hereinafter the "Council", fulfils the requirements of Article 227 Section 6 of the Constitution of the Republic of Poland, which obligates it to formulate monetary policy guidelines and present them to the Sejm on an annual basis.

In the *Monetary Policy Guidelines for 2024* the Council has maintained the monetary policy strategy pursued by Narodowy Bank Polski, hereinafter "NBP", so far. Price stability remains the main statutory objective of monetary policy. At the same time, monetary policy will be conducted in a way that helps maintain sustainable economic growth and financial stability.

NBP will continue to pursue the strategy of a medium-term inflation target at 2.5%, with a symmetric band for deviations of +/-1 percentage point. NBP's interest rates will remain the principal instrument of monetary policy. Monetary policy will continue to be implemented under the floating exchange rate regime. However, NBP does not rule out interventions in the foreign exchange market. The scope, manner and scale of using monetary policy instruments by NBP will take into account in a flexible way the determinants of monetary policy implementation, including in particular market conditions as well as economic consequences of the severe global shocks of the recent years, including consequences of the COVID-19 pandemic and Russia's military aggression against Ukraine.

The *Monetary Policy Guidelines for 2024* is a translation of the publication of Narodowy Bank Polski entitled *Założenia polityki pieniężnej na rok 2024*. In case of discrepancies, the original prevails.

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Chapter 1. Monetary policy strategy

According to Article 227 Section 1 of the Constitution of the Republic of Poland (Journal of Laws of 1997, item 483; Journal of Laws of 2001, item 319; Journal of Laws of 2006, item 1471; Journal of Laws of 2009, item 946), "Narodowy Bank Polski shall be responsible for the value of Polish currency". The Act on Narodowy Bank Polski of 29 August 1997 (Journal of Laws of 2022, item 2025) states in Article 3 Section 1 that, "The basic objective of the activity of NBP shall be to maintain price stability, while supporting the economic policy of the Government, insofar as this does not constrain the pursuit of the basic objective of NBP."

Fulfilling the main obligations of NBP laid down in the Constitution of the Republic of Poland and in the Act on Narodowy Bank Polski, the Council strives to maintain price stability. At the same time, monetary policy is conducted in a way that helps maintain sustainable economic growth and financial stability.

The Council has been pursuing the price stability objective by using inflation targeting strategy. Under this strategy, since 2004 the monetary policy objective has been to keep inflation – understood as the annual change in the consumer price index – at 2.5% with a symmetric band for deviations of +/-1 percentage point in the medium term.

The medium-term nature of inflation target means that due to macroeconomic and financial shocks, inflation may temporarily deviate from the target and even run outside the band for deviations from the target. The response of monetary policy to shocks is flexible and depends on their causes and the assessment of persistence of their consequences, including the impact on inflation developments. Each time inflation deviates from the target, the Council flexibly determines the desirable time necessary to bring it back to the target, as bringing inflation rapidly back to the target may entail significant costs to macroeconomic and financial stability. When deciding on the changes of monetary policy parameters, the Council takes into consideration price adjustments taking place in the economy, whose sources are beyond the impact of domestic monetary policy. In current conditions, these adjustments are mostly related to the severe global economic shocks of recent years caused by the COVID-19 pandemic and Russia's military aggression against Ukraine as well as to the effects of the structural changes taking place in the economy, including the energy transition, and to the process of Poland's convergence to the more advanced economies.

The monetary policy strategy pursued by the Council assumes flexibility of the instruments applied. This means that the range of instruments used by NBP can be adapted to the nature of disturbances observed in the economy and market conditions. The flexible use of monetary policy instruments is conducive to effective functioning of the transmission mechanism as well as macroeconomic and financial stability.

While taking monetary policy decisions, the Council considers the time lags in the transmission mechanism of monetary policy. The time lag between a decision on monetary policy parameters and its peak impact on real variables (such as output or employment) and on inflation takes several quarters and may change over time. Moreover, monetary policy is conducted under uncertainty, in particular about future economic developments.

Stabilising inflation at a low level is an important, yet insufficient condition to maintain balance in the economy, which, in turn, supports price stability in the long term. Imbalances in the financial sector may pose a threat to long-term price stability. Those imbalances should be counteracted mainly by macroprudential policy aimed at reducing systemic risk and in that manner supporting long-term, sustainable economic growth. This is important especially amid the free movement of capital and highly integrated financial markets. Monetary policy conducted by the Council supports macroprudential policy and in particular is conducive to financial system stability and mitigates the risk of imbalances building up in the economy by taking into account developments in asset prices (including real estate prices) and lending growth, insofar as this does not constrain the pursuit of the basic objective of NBP.

Besides monetary and macroprudential policy, fiscal policy plays an important role in maintaining macroeconomic stability. A fiscal policy which mitigates the impact of economic shocks, while ensuring long-term stability of public finance, is necessary to maintain macroeconomic stability.

The Council implements the inflation targeting strategy under the floating exchange rate regime. The floating exchange rate regime does not rule out interventions in the foreign exchange market whenever it is warranted by market conditions or conducive to ensuring the country's macroeconomic or financial stability.

Monetary policy communication is an important element of the Council's inflation targeting strategy. Thus, the Council's decisions together with their determinants are presented in the press releases (*Information from the meeting of the Monetary Policy Council*), as well as in the *Minutes of the Monetary Policy Council decision-making meetings*, *Inflation Reports*, *Monetary Policy Guidelines* and the *Report on Monetary Policy*. Furthermore, the Council's decisions and their determinants may be explained by the Governor of NBP at the press conferences and in the individual statements by the Governor of NBP or the members of the Council.

In line with the adopted strategy, in 2024 monetary policy parameters, including NBP interest rates, will be adjusted to the economic situation so as to ensure long-term price stability and, at the same time, support sustainable economic growth and financial stability.

Chapter 2. Monetary policy instruments in 2024

Determinants of monetary policy instruments

In 2024 the scope, manner and scale of use of monetary policy instruments by NBP will take into account the factors associated with its conduct. As in previous years, monetary policy instruments may be used in a flexible manner to account for the changing macroeconomic and market conditions.

The persistence of liquidity surplus in the domestic banking sector, expected by the central bank, will have a significant impact on the manner and scope of use of monetary policy instruments by NBP in 2024. Against this background, as in previous years, NBP's monetary policy instruments will on balance be of a liquidity-absorbing nature. Banking sector liquidity in 2024 will be boosted by the purchase of foreign currencies by NBP, mainly from the Ministry of Finance. The NBP sale of foreign currencies to the European Commission, related to the currency conversion of the EU membership fee, and a rise in currency in circulation, will have a curbing effect on the level of banking sector liquidity.

The operational target of NBP's monetary policy in 2024 will be to keep the POLONIA rate running close to the NBP reference rate. Depending on the market conditions, the POLONIA rate may deviate from the NBP reference rate within the corridor set by the NBP lombard rate and deposit rate.

Interest rates

The key instrument of monetary policy in 2024 will be the NBP interest rates.

The NBP reference rate will determine the yield obtainable on the NBP main open market operations, while at the same time affecting the level of short-term market interest rates.

The NBP lombard rate will determine the interest on the lombard credit offered by NBP, allowing to obtain funds from the central bank on an overnight basis.

The NBP deposit rate will determine the interest rate on deposits, allowing to deposit funds with NBP on an overnight basis.

The discount rate will determine the interest on the bill discount credit.

Open market operations

Main operations will be the key instrument by means of which NBP will strive to achieve the operational target of monetary policy. Through its main operations, NBP will affect liquidity conditions in the banking sector, and consequently – the level of the POLONIA rate. These operations will normally be carried out on a regular basis, typically with a 7-day maturity. During tenders for main operations, NBP will apply a fixed-rate tender procedure with the rate at the level of the NBP reference rate. Due to the expected further persistence of liquidity surplus in the banking sector in 2024, these operations will be carried out in the form of NBP bills issuance. The manner in which main operations are conducted may be modified if justified by a change in market conditions or parameters of NBP's monetary policy.

Fine-tuning operations will be an instrument supplementing main operations with regard to the achievement of the operational target of monetary policy. Their use may be motivated by the need to provide liquidity to, or absorb liquidity from the banking sector. As part of liquidity-providing operations, NBP may offer repo transactions or redeem NBP bills before maturity. In the case of liquidity-absorbing operations, the central bank may issue NBP bills or offer reverse repo transactions. The maturity and the yield of these operations as well as the manner to conduct them will be aligned with the purpose of their application.

Structural operations may be conducted in order to change the liquidity structure in the banking sector in the long term, as well as to ensure the liquidity of the secondary market for debt securities or to strengthen the monetary transmission mechanism. As part of structural operations, NBP may purchase or sell debt securities in the secondary market, as well as issue bonds.

Required reserve system

The main objective of the required reserve system will be to enhance stability of short-term market interest rates. This is ensured by the averaged reserve requirement, which allows banks to determine the amount of funds held on the account with the central bank throughout the reserve maintenance period, provided that the average level of holdings at NBP does not fall below the value of the required reserve. At the same time, the reserve requirement reduces the scale of NBP open market operations conducted to absorb liquidity surplus.

Changes in the required reserve ratios will depend on the conditions in which monetary policy will be pursued in 2024.

Standing facilities

Standing facilities offered by NBP are designed to limit the scale of the POLONIA rate fluctuations by stabilising liquidity conditions in the banking sector.

The lombard credit will enable banks to obtain overnight credit from the central bank on each trading day. This credit is collateralised with assets accepted by the central bank, including, among others, government securities, government-guaranteed debt securities, securities issued by NBP, municipal bonds, covered bonds and corporate bonds with a high credit rating. The interest rate on this credit, determining the marginal cost of obtaining funds from the central bank, in principle acts as a ceiling for the rates on the overnight interbank market transactions.

The deposit facility will allow banks to deposit their liquidity surpluses with the central bank on an overnight basis on each trading day. The interest on the overnight deposit in principle determines the floor for the rates on the overnight interbank market transactions.

The width of the corridor between the NBP lombard rate and the NBP deposit rate will be shaped in a way conducive to the effective transmission of monetary policy, taking into account the smooth functioning of the interbank short-term deposit market.

Bill discount credit

NBP may offer the bill discount credit aimed at refinancing loans granted to entrepreneurs by banks.

Foreign exchange swaps

NBP may carry out foreign exchange swaps. A foreign exchange swap is a transaction in which NBP purchases (or sells) the Polish zloty against a foreign currency in the spot market and, at the same time, resells (or repurchases) it under a forward contract at a specified date.

Foreign exchange interventions

NBP may intervene in the foreign exchange market.

Chapter 3. Monetary policy determinants in 2024

External conditions

In the first half of 2023, the economic climate in the external environment of the Polish economy remained subdued. Annual GDP growth in the euro area slowed down markedly relative to 2022. At the same time, GDP growth in the United States remained close to its long-term average, while the recovery in GDP growth in China – following the country's departure from its restrictive epidemic policy – was moderate. Factors with a downward effect on global economic conditions included the consequences of the prior sharp rise in commodity prices and the global monetary tightening. In contrast, economic activity was supported by ceasing of supply chains disruptions and the still favourable labour market situation in many countries.

Inflation in the global economy – following a sharp rise in 2022 to the highest levels in decades – was on the decline in the first half of 2023. Slower price growth was supported by the decline in commodity prices and by the ending of supply chains tensions, as well as by the global monetary policy tightening. In these circumstances, producer price growth slowed down markedly. At the same time, core inflation in most economies declined gradually while remaining elevated, which reflected the secondary effects of previous supply shocks and the recovery in the services sector. As a result, in mid-2023 consumer price growth in many economies remained significantly above central banks' inflation targets.

According to available forecasts, global economic activity growth will remain low in 2024, as some recovery in GDP growth in the euro area will be accompanied by its slowdown in the United States. Despite the fading of the previous supply shocks, GDP growth will be adversely affected by tighter global financing conditions.

Current forecasts of inflation abroad, including the euro area and the United States, indicate that inflation will be gradually decreasing, although in 2024 it may still exceed many central banks' inflation targets. Core inflation is to gradually decline as well.

Domestic determinants

Against the background of the previous severe supply disruptions and a decline in global economic growth, economic activity growth in Poland also saw a slowdown in the first half of 2023. In this period GDP declined in annual terms, with a fall in consumer demand and a negative contribution of inventory change to GDP growth. In turn, economic growth was supported by the sustained relatively high growth in gross fixed capital formation and a positive contribution of net exports to GDP growth. At the same time, the situation in the labour market remained favourable, as reflected in the low unemployment rate, high employment levels and a marked rise in nominal wages.

In the first half of 2023, inflation in Poland declined significantly. According to the Statistics Poland's flash estimate, annual consumer price growth dropped to 10.1% y/y in August 2023 (compared to 16.6% y/y in January 2023 and 18.4% y/y in February 2023). Factors contributing to the decline in inflation included the fall in global prices of commodities – including energy and agricultural commodities – and the ending of supply chain tensions, as well as the previous significant monetary policy tightening by NBP. The fall in inflation occurred in all major categories of goods, with energy price growth declining at the quickest pace. Given the slowdown in demand growth in the economy, including reduced consumption, core inflation also decreased in the first half of 2023, although its decline was slower than in the case of headline inflation. In addition, producer price growth fell sharply, which points to a marked weakening of cost pressures in the economy.

According to current forecasts, the fading of negative supply shocks will be conducive to a recovery in economic activity growth in Poland in the second half of 2023; yet, GDP growth will run below its long-term average until 2025. The sustained fairly high nominal wage growth in 2023-2024, coupled with the falling inflation, will help curb the decline in consumption in the second half of 2023 and contribute to its growth in the following years. Higher consumption growth will also be supported by the rise in the amount of childcare benefit at the beginning of 2024. In contrast, factors constraining the scale of recovery in GDP growth will be the relatively slow GDP growth abroad and the end of the use of EU funds under the 2014-2020 financial framework. Against this background, investment growth may decrease somewhat in the second half of 2023 and in 2024, and the contribution of net exports to GDP will gradually decline.

Available forecasts suggest that inflation will continue to decline in the second half of 2023 and in subsequent years, which will follow from the effects of the previous significant monetary policy tightening by NBP, including a marked slowdown in lending growth. The sluggish demand in the economy, with weakening cost pressures and declining inflation abroad, will translate into a gradual reduction in core inflation. In turn, the fading of earlier global supply shocks in the commodity markets will further dampen domestic food and energy price growth. At the same time, due to the scale and persistence of the impact of the previous shocks – which were beyond the impact of domestic monetary policy – the return to the NBP inflation target will be gradual.

Main uncertainty factors

The outlined macroeconomic scenario is subject to uncertainty. The main factor of uncertainty for the economic activity and inflation in Poland in 2024 is the future geopolitical situation, including above all the further course of Russia's armed aggression against Ukraine and the geopolitical tensions in other regions of the world.

There is also uncertainty about the impact of the considerable monetary policy tightening by major central banks on global economic growth and inflation, as well as on the financial sector.

Likewise, the path of global energy and food commodity prices is a significant factor of uncertainty for the development of the economic situation in Poland, including the course of inflation processes. Global commodity prices will depend, among other things, on the global economic activity, supply of these commodities and temperatures in the winter season as well as the course of the war in Ukraine along with its impact on the export of food commodities from this country. Uncertainty is also associated with the repercussions of climate policy measures on price developments.

The scale and scope of the government's protective fiscal measures to mitigate the adverse effects of high commodity prices and inflation on households will continue to be another factor of uncertainty for price developments and economic activity growth.

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