MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 2 MARCH 2011

At the meeting, the Monetary Policy Council discussed the outlook for growth and inflation in Poland, the situation in the domestic labour market and in the external environment of the Polish economy.

With regard to the developments in Poland's real economy, it was pointed out that GDP growth was likely to remain close to the previous year's level. Some Council Members drew attention to the fact that there were still no signs of a visible recovery in corporate investment. They emphasised that at the current rate of economic growth there was a limited risk of deep macroeconomic imbalances building up. At the same time, those Council members pointed out that recent data increased the uncertainty about the short-term outlook for output growth. In particular, a further rise in (seasonally adjusted) unemployment rate was mentioned, along with a relatively slow growth of construction and assembly, a slowdown in retail sales growth in January 2011, a deterioration in some economic climate indicators and a markedly slower expansion in lending than in the corresponding periods of previous years.

At the same time, it was pointed out that much of the December 2010 and January 2011 data could have been influenced, to a significant degree, by one-off factors (economic and statistical), which made their assessment more difficult. In this context, some Council members assessed that slow growth in construction and assembly was primarily due to unfavourable weather conditions and thus did not constitute a negative signal for recovery in corporate investment. Equally, in the opinion of these Council members, the weaker retail sales growth did not reflect a strong decrease in individual consumption, as it resulted mainly from the slump in car sales, affected largely by the abolition, as of 2011, of VAT rebates for cars with goods vehicle approval certificates. At the same time, they pointed out that while advance purchases of cars in 2010 increased the growth of domestic demand they simultaneously deepened the negative contribution of net exports to GDP.

With regard to GDP growth in 2012 and 2013, it was pointed out that the March NBP projection expected it to slow down, and individual consumption and gross fixed capital formation growth were weaker than in the previous projection. It was emphasised that the slower rise in investment resulted from the envisaged postponement of the absorption of some EU funds from 2012 till subsequent years as well as the adverse impact of commodity price rises on enterprises' investment activity. However, some members drew the Council's attention to the significant uncertainty regarding the developments of investment projects co-financed from EU funds. In addition, some members were of the opinion that the developments in the labour market would act against a deceleration in individual consumption. In those members' opinion, investment might also rise faster than in the projection. Factors pointing to such a scenario include the rising production capacity utilisation and enterprises' good financial results, enabling them to self-finance investment projects as well as facilitating access to external financing.

While discussing inflationary pressures in the economy, it was emphasised that the pronounced rise in CPI was driven mainly by the rise in agricultural and energy commodity prices in the world markets, increases in VAT rates and administered prices, i.e. primarily factors unrelated to domestic monetary policy. It was pointed out that the increase in headline inflation feeds into higher inflation expectations of households and enterprises as well as expectations implied by yields on long-term Treasury securities. At the same time, it was indicated that while the available forecasts point to a possible further rise in inflation in the coming months, the impact of the factors contributing to its elevated level will dissipate in the second half of 2011 and – according to some Council members – inflation will subside. Notwithstanding that, it was pointed out that over almost the whole horizon of the March projection – assuming no change in the NBP policy rates – inflation remains above the inflation target. According to the assessment of some Council members the risk of inflation running above the central path of the March projection was higher than the risk that it would be running below this path.

While addressing wage pressures in the economy, some Council members stressed the fact that the current situation in the labour market did not indicate that these pressures should escalate. They pointed out that the marked acceleration in wage growth in Q4 2010 was probably temporary, as it had been driven by a sharp rise in government sector wages preceding a wage freeze in 2011. Those Council members stated that wage growth in enterprises remained moderate, especially against the background of labour productivity growth, and was consistent with inflation stabilising at the inflation target. However, other Council members pointed to the fact that the acceleration in wage growth at the turn of 2010 and 2011 was indicative of uncertainty as to whether that growth would continue to be moderate and thus might signal the risk of mounting wage pressures within the monetary policy transmission horizon. Those members also expected a gradual deterioration in the relationship between wage and labour productivity growth, stronger than the one signalled by the March projection of inflation and GDP.

Amongst the factors pointing to a limited risk of intensifying wage pressure – including a limited risk of elevated inflation and inflation expectations feeding into wage growth – some Council members listed the rising unemployment rate and the fall in the number of jobs offered, resulting in a significant decrease in the labour market tensions index. Those members highlighted the fact that the weaker labour demand, while resulting mainly from the reduction in the number of subsidised jobs, should mitigate wage growth demands. However, other Council members assessed that while subsidised jobs had fallen, surveys suggest rising reservation wage. This reduces the likelihood that rising unemployment will significantly weaken wage pressures. These Council members also pointed to the March projection, according to which unemployment rate will gradually decrease and in the second half of 2011 will go below the steadily rising NAWRU unemployment rate. In the opinion of these Council members, good financial results of enterprises were another factor conducive to a possible fast build-up of wage pressures.

While discussing the developments in the external environment of the Polish economy, the Council pointed to the continued moderate GDP growth in major advanced economies and the accompanying rise in headline inflation, driven by rising global commodity prices. Some Council members pointed out that major central banks kept interest rates low, despite some signals pointing to the possibility that some of them will tighten monetary policy. Those members added that the quickly rising government debt in the advanced economies remains an important uncertainty factor for economic growth, including the situation in the global financial markets. At the same time, continued good business climate in Germany was emphasised, along with the strong synchronisation of business cycles in Germany and Poland. Some Council members were of the opinion that the tightening of monetary policy in China may adversely affect the outlook for German, and consequently also Polish exports. According to those members, other factors with a potentially weakening effect on Polish exports include the fiscal consolidation in the EU countries and a possible tightening of monetary policy in some of these economies.

While discussing the rapid growth of commodity prices, some Council members expressed the opinion that the current commodity shocks were temporary supply shocks. However, it was pointed out that the ample liquidity in the financial markets, coupled with low short-term elasticity of commodity supply may result in a stronger than expected rise in these prices. Furthermore, other Council members expressed the view that a sharp rise in demand for commodities on the part of emerging economies may also have been conducive to commodity price increases and therefore these increases may be more lasting. Those Council members believed that rising commodity prices may also reflect mounting inflation concerns amongst the financial markets participants. It was simultaneously pointed out that the elevated commodity prices could act towards a weakening of global economic activity.

While analysing developments in loan aggregates, some Council members highlighted the continuing fall in consumer loans, along with a deceleration in the expansion of housing loans at the beginning of 2011. At the same time other Council members stated that growth of housing loans remained strong compared to the growth in disposable income achievable in the low inflation environment. Some Council members expressed the view that the sluggish expansion in corporate loans might have a curbing effect on investment growth. They also pointed out that a rise in the number of entities without creditworthiness in Q4 2010 did not bode well for a possible recovery in lending. However, other Council members pointed out that the rise in the number of entities without creditworthiness was accompanied by a drop in the share of liabilities of these entities in the total liabilities to the banking sector.

With regard to public sector demand, some Council members assessed that a significant fiscal tightening was unlikely in the years 2011-2012 given the date of the parliamentary election. Other Council members, however, argued that the need to comply with the requirements relating to the public finance sector deficit resulting from the Excessive Deficit Procedure will translate into a more pronounced fiscal tightening in 2012. In this context, the European Commission decision was invoked, concerning the maintenance of the current approach to accounting for the costs of pension reform in the calculation of the deficit and debt of the sector. Simultaneously, these Council members held the view that a fiscal policy tightening would not curb the build-up of demand pressures in the economy. It was pointed out that a more comprehensive evaluation of the outlook for public finance sector demand would be possible only after the government had presented measures to limit the sector’s deficit in its Convergence Programme update.

While discussing the level of NBP interest rates it was emphasised that their increase in January 2011 initiated the process of a gradual tightening of monetary policy, the scale and pace of which would depend on the incoming data on macroeconomic developments. In the opinion of some Council members, a further interest rate increase at the current meeting was justified, considering the sustained risk that wage and inflation pressure would intensify in the medium term. Such a decision would also limit the risk that the elevated inflation expectations persist. These Council members argued that prompt interest rate increases would reduce the overall scale of increases necessary to stabilise inflation at the inflation target in the medium term. In these members’ opinion, the reduced sensitivity of the zloty exchange rate to the interest rate differential was another argument in favour of prompt interest rate increases.

The majority of Council members represented the view that recent data increased the uncertainty regarding economic growth, including a recovery in investment and sustainability of the acceleration in consumption and thereby substantiated the decision not to change interest rates at the current meeting. Further arguments in favour of this decision included the persistently high unemployment rate and modest wage pressures in the enterprise sector, both reducing the risk that heightened inflation, which up to now has resulted from factors beyond the direct influence of monetary policy, should persist. Furthermore, in the opinion of some Council members, NBP decisions on interest rates should take into account the monetary policy pursued by major central banks, in particular the European Central Bank.

A motion to raise the NBP interest rates by 25 basis points was put forward at the meeting. The motion did not pass. The Council kept the interest rates unchanged: reference rate at 3.75%, the lombard rate at 5.25%, the deposit rate at 2.25%, the rediscount rate at 4.00.%

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