# Minutes from the Monetary Policy Council Decision Making Meeting held on 5 March 2014

At its meeting, members of the Monetary Policy Council discussed the current and future monetary policy decisions against the background of global and domestic macroeconomic developments and the March projection of inflation and GDP.

Referring to the situation abroad, the Council pointed out that the recovery in the global economy is still moderate. It was emphasised that activity growth in the United States may recently have lost some momentum, and GDP growth in 2013 Q4 has been revised downward. At the same time, it was assessed that a certain deterioration in the US data may be partly due to unfavourable weather conditions. Council members highlighted further improvement in the business climate in the euro area, where economic growth is nevertheless unstable and much weaker than that in the United States. It was also observed that inflation in the euro area has remained low.

Referring to the situation in the emerging economies, some Council members observed that business climate indicators for China, the largest emerging economy, point to a slowdown in activity growth at the beginning of 2014. Yet, a few Council members argued that activity growth in many Central and Eastern European countries has been accelerating.

Council member expressed the opinion that heightened uncertainty related to future developments in Ukraine poses a risk to the economic situation in Poland's external environment. It was indicated that possible escalation of the conflict between Ukraine and Russia may undermine Poland's trade with the Eastern markets and dampen business sentiment and firms' propensity to invest. At the same time, it was judged that the potential weakening in Poland's exports to the Eastern markets, particularly food exports, could curb price growth in the domestic market. Yet, a few Council members argued that the risk related to future developments in the East may support the recently observed slight increase in global commodity prices and deterioration of the sentiment in the financial markets. In this context, other Council members observed that the recent hike in commodity prices may have been a temporary phenomenon, while the slowing demand in China could contribute to lower commodity prices in the longer term.

Addressing economic conditions in Poland, Council members underlined accelerating GDP growth in 2013 Q4. As expected, output growth was supported by higher domestic demand growth, primarily in terms of consumption, and – to a very small extent – investment. Yet, it was net exports that continued to be the main driver of GDP growth. Council members emphasised that monthly data from the beginning of the year point to a continued gradual recovery in the economy. In particular, retail sales and industrial production continued to rise, however a fall in construction and assembly output was also mentioned. Council members assessed that economic recovery is not accompanied by accumulation of any significant macroeconomic imbalances; the current account balance is improving. A few Council members also highlighted that the economic rebound has been accompanied by a stable growth in lending to the private sector.

While analysing the situation in the labour market, the signs of improvement, albeit a sluggish one, were observed. It was mentioned, that according to LFS, the number of working persons rose slightly in 2013 Q4, which contributed to a certain decline in the unemployment rate (in annual terms). It was, however, pointed out that in January employment growth in the corporate sector was halted. A few Council members, on the other hand, pointed to a rising number of job offers and falling likelihood of losing a job, which suggests continued improvement in the situation in this market in the following quarters. However, it was emphasised that the unemployment rate has persisted at elevated levels, thus hampering wage pressure in the economy. The absence of wage pressure is confirmed by a slowdown in both wage and unit labour cost growth in 2013 Q4.

Council members emphasised that the observed gradual recovery is not translating into higher inflationary pressure in the economy. It was observed that in January inflation remained stable and well below the target, while core inflation decreased. The absence of inflationary pressure is also signalled by negative growth of producer prices, amidst low inflation expectations of economic agents. A few Council members pointed out at this point that the annual consumer price growth is boosted, at the beginning of the year, by the statistical base effects.

While analysing the outlook for economic growth, Council members assessed that in the next few quarters economic recovery will probably continue at the pace envisaged in the March projection. It was emphasised that GDP growth will be supported by the revival in consumer demand. It was pointed out that in line with the projection, investment may be expected to pick up, especially in terms of corporate investment. Yet, a few Council members argued that corporate business activity may be weakened by the growing tax burden imposed on businesses by local government units.

Council members expressed the opinion that despite stronger economic growth, inflation – in light of the March projection – will return to the target only gradually, and will remain below the target at least throughout this year. Some Council members also invoked external forecasts pointing to the same scenario. In this context, those members highlighted the fact that – according to the projection – the expected gradual return of inflation to the target will be related to the narrowing of the output gap and its subsequent stabilisation at a positive, yet close to zero level. Council members observed that in line with the projection, wage and unit labour costs will accelerate, yet their growth will not be strong enough to jeopardise the inflation target in the medium term.

A few Council members also observed that the March projection – in comparison with the November one – expects lower inflation this year, coupled with higher forecasts

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of GDP growth. They argued that the persistence of inflation below the target during this year will result, to a large extent, from the impact of factors beyond the direct influence of the domestic monetary policy, including slow energy price growth. As a result, in the case of higher than assumed in the current projection energy price growth in subsequent quarters, inflation may return to the target faster than anticipated in the projection. Those members also highlighted that resulting from the projection increase in ratio of labour costs to corporate revenues may contribute to lower price competitiveness of Polish enterprises in the international markets. In this context, they pointed out that the recovery may be conducive to the inflow of capital and appreciation of the exchange rate, which would further limit price competitiveness of Polish enterprises. As a result, factors of production might be shifted towards the non-tradable sector – including residential construction – posing, amidst low interest rates, a risk of imbalances arising in this sector. Therefore, a few Council members were of the opinion that an interest rate increase may be justified, even if inflation remains below the target.

Yet, other Council members held the view that a significant interest rate rise aimed at curbing the risk of imbalances in the real estate market may come at a higher cost to the economy as a whole than the application of macroprudential instruments. They also underlined that the gradual decrease of the LtV ratio in mortgage loans this year and in the following years applied by the Financial Supervision Authority should limit the risk of accumulation of significant imbalances in the real estate market.

The Council decided that the NBP interest rates should remain unchanged at the current meeting. The Council discussed the indicated period of the probable maintenance of the NBP interest rates at an unchanged level. Some Council members were of the opinion that, given the March projection, which pointed to a very gradual return of inflation to the target, it may be justified to keep the interest rates unchanged until the end of 2014. One of the factors justifying the extended period of interest rate stabilisation was – in the opinion of some Council members – the need to limit economic uncertainty under mounting international risk related to the tensions emerging in the East.

Some Council members emphasised that owing to the uncertainty about future macroeconomic developments abroad, including in Ukraine, the indicated period of the probable maintenance of NBP interest rate should not be longer than before. A few of these Council members also believed that a shorter indicated period of no interest rate change may also be justified by the ongoing economic recovery and the risk of an earlier than projected return of inflation to the target.

As a result of the discussion, the Council assessed that the current and expected economic situation, including the results of the March projection of inflation and GDP justify maintenance of the NBP interest rates at an unchanged level over a longer period of time, i.e. at least until the end of the third quarter of 2014.

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The Council left the basic interest rates unchanged at the following levels: reference rate at 2.50%, lombard rate at 4.00%, deposit rate at 1.00%, rediscount rate at 2.75%.

Publication date: 20 March 2014


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