

MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 24 SEPTEMBER 2008

During the meeting the Monetary Policy Council discussed the outlook for the future inflation developments in the context of the past, current and, above all, anticipated economic situation.

The discussion at the meeting focused on: the outlook for inflation and economic growth in Poland and in the world economy, situation in the labour market in Poland and the prospects of Poland's entry to the euro area.

When analysing the economic growth developments in Poland, it was pointed out that GDP growth in 2008 Q2 had been much higher and in 2008 Q3 would probably be also higher than expected in the June projection. Some Council members, however, pointed to the rise in contribution of gross fixed capital formation and a drop in contribution of total consumption to GDP growth in 2008 Q2, which might indicate easing the upward pressure on consumer prices. These members argued as well that the drop in industrial output, bigger than expected reduction of growth in construction and assembly output and marked deterioration of economic climate indices in the corporate sector in August 2008 signalled significant weakening of economic activity in Poland in the coming quarters. They also pointed out that a lowering of the demand for Polish exports, due to the significant deterioration of economic growth in countries which are Poland's main trading partners, would be conducive to the decline in GDP growth. The similar impact would be exerted by the appreciation of the zloty observed in the first half of the year, which reduces the competitiveness of Polish producers in foreign markets and in the domestic market, and the weakening of consumption demand related to the probable deterioration of situation in the labour market.

While discussing the situation in the external environment of the Polish economy, further marked deterioration of outlook for economic growth in the United States and the euro area was noted. The fall in industrial output in these economies as well as further deterioration of economic climate indices were underscored. Some members of the Council pointed out that the crisis in the housing market and financial markets would contribute to a significant drop in consumer demand in the US economy. These members also emphasized that the support granted to financial institutions by the government of the United States would reduce the possibility of further demand stimulation by means of fiscal policy. Demand might be further reduced by regulations tightening criteria for granting loans, which were likely to be introduced in the United States. It was pointed out that the intensification of turmoil in financial markets in the United States would probably translate to the situation in the banking sector of some of the EU economies and would be an additional factor dampening economic activity in these countries.

With respect to the situation in the labour market in Poland, attention was drawn to the continuous decline in employment growth since the beginning of the year and the decline in wage growth in the corporate sector in August 2008. Some members of the Council argued that it might indicate that declining economic activity in Poland would be accompanied by relatively fast easing of wage pressure. These members also pointed out that the growth in labour supply in Poland related to possible increased returns of Poles from EU countries in which the current and anticipated economic situation had significantly deteriorated might also be conducive to the decline in wage growth. Other members of the Council, however, emphasized that wage growth remained strong

and might remain at a heightened level due to the lag between the weakening of economic activity and deterioration of the situation in the labour market. In their assessment, that effect, coupled with decreasing GDP growth, might lead in the nearest future to further drop in labour productivity and consequently to the increase in unit labour costs. Other members of the Council also pointed out that the decline in wage growth might be reduced by the process of convergence of the Polish economy to more developed EU economies where the share of compensations in GDP is much higher than in Poland. Furthermore, some members emphasized that a fast rise in unit labour costs might in the longer horizon significantly reduce the competitiveness of Polish enterprises, including exporters.

The development of monetary aggregates in Poland was also discussed during the meeting. Some members of the Council drew attention to a still very strong growth in consumer credits, emphasizing that it would probably support continuously high demand pressure. At the same time, these members pointed out that the high growth of broad money supply observed for the last several years might indicate the persistence of inflationary pressure in the economy. Other members of the Council, however, noted that credit growth might be reduced by possible tightening of criteria for granting loans, as well as by the decrease in creditworthiness of households related to their deteriorating financial situation as a result of a significant drop in value of their assets.

When analysing inflation developments in Poland, it was noted that the harmonized index of consumer prices (HICP) in Poland in August 2008 was still the lowest among the countries of the region and also lower than in the majority of the countries of the euro area. Attention was also drawn to the lower than expected CPI inflation in August 2008 and to the decline in food and oil prices in global markets, which should be conducive to lowering inflation over the following few months. Some members of the Council pointed, however, to a significant rise in core inflation net of food and energy prices in August 2008. At the same time, it was emphasised that this measure of core inflation had been lower till July 2008 due to the promotional Internet price reduction last year, and its level observed since August 2008 better reflects price processes in the economy. Some members of the Council drew attention to the risk of core inflation remaining in the coming quarters above the NBP inflation target and the CPI inflation above the upper limit for deviations from the target due to possible increases of administered prices. Other members of the Council, however, pointed out that in the light of the probable resignation from the earlier announced deregulation of energy prices for households since the beginning of 2009, the energy price growth might be lower than earlier expected, and therefore the risk of inflation remaining at a heightened level might decline.

An important factor taken into account during the discussion was the result of the meeting between the Prime Minister and representatives of the government with the Monetary Policy Council held on 16 September 2008 concerning the perspectives of Poland's accession to the euro area. At the Council's meeting some members of the Council pointed out that complying with the Maastricht inflation criterion in 2011 may require a more restrictive monetary policy than in a situation when Poland were to meet the convergence criteria in a later period. Some of the members observed that the need to meet this criterion in 2011 and by implication to stabilise inflation at an adequate level in 2010-2011 justified the tightening of monetary policy at the current meeting. According to other members of the Council the slowdown in the Polish economy would contribute to bringing inflation down to a level enabling meeting the Maastricht inflation criterion. Moreover, some members of the Council noted that due to the uncertainty with respect to obtaining the support of the required parliamentary majority for changes in the constitution necessary from the point of view of introducing euro in Poland, there was no need to consider the possible adjustment of the monetary policy to the necessity of meeting the inflation criterion at the current meeting.

The impact of the prospects of Poland's entry to the euro area on the zloty exchange rate was also discussed during the meeting. Some members of the Council pointed out that Poland's preparations

towards joining the euro area might be accompanied by the appreciation of the nominal zloty exchange rate, which would be conducive to reducing inflation. Other members of the Council observed, however, that there was a risk of the zloty depreciation if the political consultations mentioned in the joint press release of the Prime Minister and the Monetary Policy Council, did not succeed, particularly in the context of increased global risk aversion due to the turmoil in financial markets.

While discussing the decision on interest rates, some members of the Council pointed out that the scale of economic slowdown might be insufficient to reduce inflation to the target over the monetary policy horizon. Moreover, according to these members of the Council, the risk of inflation remaining above the upper limit for deviations from the target in the longer run, the risk of the exchange rate depreciation related to the turmoil in global financial markets and the possibility of revising the assessments concerning the perspective of Poland's entry to the euro area, the risk of inflation expectations remaining at an elevated level and the decreasing - despite the already implemented interest rate increases - real interest rates justified rising interest rates at the current meeting. In the assessment of these members of the Council, such decision was warranted also by perspectives of Poland's entry to the euro area outlined after the meeting with the Prime Minister and by the ensuing necessity of meeting the Maastricht inflation criterion. Furthermore, these members also pointed out that delaying interest rate increases might raise the costs of bringing inflation down to the target. According to other members of the Council, significant weakening of the economic activity in the external environment of the Polish economy, signs of economic slowdown in Poland, the already implemented interest rate increases, as well as the fall in the prices of agricultural and energy commodities in global markets would support the return of inflation to the target in medium term. These members also indicated that interest rate increases might be conducive to excessive curbing of domestic demand and – by supporting the renewed appreciation of the zloty exchange rate – to decreasing the price competitiveness of exports, and as a consequence might create the risk of a significant weakening of economic activity in Poland. According to these members of the Council, the uncertainty related to turmoil in global financial markets and the lack of political consensus regarding the date of adopting the euro warranted abstaining from the possible adjustment of the monetary policy to the necessity of meeting the inflation criterion. Moreover, they argued that a more comprehensive assessment of the risk of inflation remaining in the medium term at an elevated level would be possible after analysing the October projection of inflation and GDP and the data released in the coming months.

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: the reference rate at 6.00%, the lombard rate at 7.50%, the deposit rate at 4.50% and the rediscount rate at 6.25%.

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