

## **MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 28 OCTOBER 2009**

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

The discussion at the meeting focused on the outlook for economic growth in the world and in the Polish economy, on current inflationary processes in Poland and the situation in the credit market. The Council discussed the influence of these factors on future inflation in Poland against the background of the October projection of inflation and GDP.

While assessing the global economic situation, some members of the Council emphasised that the improvement in economic climate in the euro-area economy was relatively small and the forecast economic growth in the region remained considerably below potential. Those members also pointed out that the improved economic climate in the United States and in China was to a large extent rooted in the stimulus packages, and that the prospective gradual removal of such measures kept up the uncertainty about the sustainability of global economic recovery. In particular, those members stressed the uncertainty surrounding private consumption recovery in the United States amid the still deteriorating situation in the US labour market. Moreover, some Council members assessed that the drop in private consumption in the United States connected, among others, with households' limited possibilities of taking out loans, including mortgage loans incurred to finance consumption, will not be offset by a rise in household consumption in emerging countries, even if the revived growth in these economies was sustained. In this context, those members pointed to the risk of slow economic growth persisting worldwide.

Other Council members assessed that the recovery in emerging economies, including, in particular, Asian countries, may be an important factor conducive to an economic revival all over the world. Those members indicated that the accelerated growth in emerging economies will be feeding through into the world economy mainly through the rise in those countries' demand for investment goods, exported, to a large extent, by the developed countries of Western Europe. In the opinion of those Council members, the current recovery in Asia may be marking the beginning of these economies' return to the potential growth path which may run at a relatively high level due to the ongoing process of real convergence in these economies.

While discussing the outlook for economic growth in Poland, some Council members assessed that the Polish economy had already entered the phase of recovery, although some of them emphasised that this recovery may prove relatively slow. At the same time it was pointed out that the October projection forecast only a slight acceleration of growth in 2010. It was emphasised that the relatively low GDP growth may be the result of a drop in real disposable income of households connected with a rise in unemployment and a decline in real wages as well as more difficult access to credit. Some Council members assessed that the latest macroeconomic data, including those on exports, output and retail sales, did not indicate unambiguously the beginning of a sustainable recovery in the Polish economy.

While discussing current inflation developments, it was pointed out that, despite the fact that in September 2009 inflation had fallen to 3.4%, i.e. below the upper limit for deviations from the inflation target (3.5%), it might nevertheless continue at a heightened level in the near future. This high level of inflation would be driven primarily by the positive base effect connected with a strong drop in fuel prices at the end of 2008. Some members of the Council pointed to the continuation of the relatively high level of core inflation, including the persistently high growth of prices of services. It was pointed out that Poland was one of the three EU countries with highest inflation. Other Council members argued that the difference in the levels of inflation in Poland and in other EU countries was connected with a smaller scale of economic activity weakening in Poland and with the process of price convergence of the Polish economy to price levels recorded in developed Western European economies.

While discussing the outlook for inflation in Poland, the Council addressed the projection and the short-term inflation forecasts of the NBP which foresee inflation declining below the inflation target of 2.5% in the middle of 2010. In the opinion of some members of the Council this course of future inflation will follow from weaker consumption demand, persistently low wage pressure and the appreciation of nominal zloty exchange rate so far. Those members also pointed out that the October projection indicated a higher risk of inflation declining in 2010 below the lower limit for deviations from the inflation target of the NBP (1.5%) than the June projection.

Other Council members indicated that the discrepancy between the short-term forecasts of core inflation, food and energy prices and their forecasts in the October projection pointed to a significant uncertainty as to the path of inflation in the coming quarters. In particular, some Council members assessed that the growth of food prices in the nearest future may prove higher than in the October projection. Those members additionally pointed to recently observed oil-price rises in the world markets and to the uncertainty about natural gas prices in Poland. Moreover, some Council members argued that the recovery in emerging economies, where economic growth raises the demand for raw materials, may be conducive to a resurgence in the prices of agricultural and energy commodities in the world markets, especially in a situation where no limits exist on open investment positions in some forward commodity markets. In the opinion of those Council members, this may lead to higher inflation around the world and in Poland. At the meeting the Council also discussed the risk of increases of administered prices in 2010, including the prices decided by local authorities, resulting from the unfavourable situation of the public finance sector.

While addressing the outlook for inflation in 2011, some members of the Council pointed out that, in line with the October projection the probabilities of inflation running below and above the inflation target were similar towards the end of the projection horizon. Moreover, some Council members argued that, following a drop to a low level foreseen in the middle of 2010, inflation would be steadily increasing till the end of the projection horizon. Other Council members, on the other hand, emphasised that for the most part of the projection horizon the probability of inflation running below the target was higher than the probability of its running above the target. Those members indicated that 2011 inflation being higher in the October projection than in the June projection was partially a result of a positive base effect connected with a deeper decline in food prices forecast for 2010. They also emphasised the issue of the optimal forecast horizon in central banks pursuing inflation targeting and stressed that the limited projection horizon increased the uncertainty about the durability of inflation changes in the final period of the forecast horizon.

While discussing the future exchange rate and its impact on inflation in Poland, it was pointed out that the projection assumed a gradual depreciation of the zloty exchange rate, which was connected with a decreasing real interest rate disparity, the persistently high budget deficit and growing public debt. Some Council members, however, pointed to the possibility of zloty exchange rate appreciation, which could be supported by Poland's relatively favourable economic situation as compared to other EU countries and the continuously high surplus liquidity in the global financial

markets. Moreover, in the opinion of those Council members, should the recovery in emerging markets come faster than in developed economies, emerging economies' currencies, including the zloty, could be expected to appreciate. Those members further emphasised that the potential zloty appreciation would be conducive to lower economic growth and lower inflation in the Polish economy than those accounted for in the October projection.

Other Council members, however, assessed that an appreciation of the zloty exchange rate significantly exceeding the appreciation of the equilibrium exchange rate was unlikely in case the growth of the Polish economy remained close to the October projection of GDP. Those members pointed out that the zloty could depreciate due to a possible increase in the risk premium, which in turn might be driven by an unfavourable situation of the public finance sector, a lack of structural reforms in the Polish economy and Poland's postponed adoption of the euro.

While analysing the situation in the credit market, some members of the Council assessed that it was still deteriorating, which was, among others, indicated by a further decline in the growth of credit to households and very low growth of credit to enterprises. Other members of the Council, however, pointed to the fact that in September 2009 the value of granted loans in month-on-month terms had risen for the first time in five months, both in the case of loans to households and to enterprises.

Moreover, some Council members emphasised that the slow growth of loans to enterprises was connected with their relatively good financial results and with their curbing their investment activity, and any recovery in lending to the enterprise sector might come only once the outlook for growth in the Polish economy significantly improved. Other Council members argued that reduced lending was, on the one hand, connected with households being more cautious while incurring liabilities amid slowing economic growth and rising unemployment, and, on the other hand, with an increased credit risk perceived by banks as indicated, among others, by the tightening of loan terms in the segment of consumer loans introduced in 2009 Q3 as well as planned for the future.

While discussing real interest rates in the context of the credit market situation, some Council members indicated that real interest rates remaining at a relatively low level for too long in a country undergoing real convergence may be increasing the risk of a credit boom in the medium term. Those members pointed out that real interest rates were currently lower than the equilibrium interest rate for the Polish economy. At the same time, those members suggested that the expected inflation decrease should translate into an increase in real interest rates, which in turn should be conducive to a rise in household saving following a strong decline in 2009 Q1, as well as to curbing the risk of excessive lending growth.

While considering the decision on interest rates, the Council concluded that the information on the economic situation released since the last meeting warranted keeping the interest rates unchanged at the current meeting. Some members of the Council were of the opinion that in the conditions of continuing uncertainty about the recovery in the world economy and about the outlook for economic growth in Poland, as well as in the light of the October inflation projection predicting inflation to be below the NBP's inflation target for the most part of the projection horizon, it was justified to assess that in the medium term the probability of inflation running below the inflation target was higher than the probability of inflation overshooting the target. Other members of the Council argued that the recovery in the world and Polish economies combined with the risk of commodity price increases in the world markets and administered price rises in Poland, as well as the balanced probabilities of inflation running above or below the inflation target in the final period of the October projection, warranted the assessment that the probabilities of inflation in the medium term running below or above the inflation target were balanced. The majority of Council members judged the probability of inflation running below or above the inflation target to be balanced in the medium term. In the assessment of some Council members balanced risks to future inflation should indicate that the interest rates in the coming months would remain unchanged, which does not rule

out the possibility of their adjustment in case of developments that would significantly affect the outlook for inflation and economic growth.

The Council kept the interest rates unchanged: the reference rate at 3.50%, the lombard rate at 5.00%, the deposit rate at 2.00% and the rediscount rate at 3.75%.

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