

## **MINUTES OF THE MONETARY POLICY DECISION-MAKING MEETING HELD ON 7 NOVEMBER 2012**

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At its meeting, the Monetary Policy Council discussed the current and future monetary policy decisions against the background of the results of the November inflation and GDP projection as well as current and expected macroeconomic developments in Poland and abroad.

While analysing the external conditions, it was noted that data incoming recently pointed to a lack of improvement in macroeconomic developments in the euro area. However, few Council members drew attention to the fact that economic outlook for Germany, Poland's major trading partner, remains favourable compared to other countries of the euro area (owing to strong economic ties between Germany and hitherto faster-growing emerging economies). At the same time, some Council members emphasized that the external conditions influenced the Polish economy not only via trade channel. Accordingly, the adverse conditions in the euro area may have a much stronger dampening impact on the economic activity in Poland than would follow from solely trade channel.

When discussing the current developments in Poland and their outlook, it was highlighted that a decline in industrial output and retail sales as well as a deeper decrease in construction and assembly pointed to more pronounced economic slowdown than previously anticipated.

It was stressed that the NBP November projection implied risk of persistent economic slowdown. It was pointed out that the currently forecast GDP growth for the next years runs below the July projection. This downward revision was due to lower investment and consumption forecast. The Council concluded, in line with the projection, that both factors will contribute to lower than previously expected GDP growth.

According to the Council, low consumption growth will result from tepid household disposable income growth and limited room for a further fall in the savings rate, related i.a. to limited lending. The disposable income growth will be curbed due to the ongoing deterioration in labour market conditions along with lower remittances to Poland from migrants abroad. It was emphasized that, in the previous stage of the global financial crisis, favourable financial conditions of households supported continued growth in their consumption and helped to absorb shock of increased costs of servicing their foreign currency loans resulting from zloty depreciation. It was also highlighted that in 2009 consumption growth was strengthened by fiscal loosening, while in the coming quarters the fiscal tightening will likely continue.

Turning to investment activity, in the Council's opinion, adverse demand outlook, deteriorating business sentiment and termination of EU financial perspective 2007-2013 will hamper investment growth. However, few Council members pointed to currently still favourable liquidity position of enterprises, which could trigger corporate investment growth should the demand outlook improve.

Few Council members assessed that the economic growth in 2012 could be lower than implied in the NBP November projection. At the same time, other Council members stressed that over the previous 20 years similar slowdown episodes had been relatively short-lived and that the magnitude of the current slowdown compared to the previous ones – though stronger than expected – had been so far relatively shallow. Few Council members claimed that the steady improvement in the external environment of the Polish economy, assumed for the coming years in the NBP November projection and in external forecasts, would support a gradual recovery in Polish foreign trade, and consequently a gradual recovery in the domestic economic growth.

While discussing current inflation developments, it was emphasized that price growth continued on a downward trend. Yet, annual inflation remained above the upper limit of deviation from the NBP inflation target. It was pointed out that the elevated annual inflation was driven largely by factors beyond the direct impact of the domestic monetary policy. These developments are accompanied by weakening domestic demand pressure, as indicated by declining core inflation.

While referring to the inflation outlook against the background of the NBP November projection, the majority of the Council members stressed that the projection confirmed a significant decline of risk that the coming quarters would bring intensification of demand pressure. At the same time, the risk of inflation falling below the target over the medium term has increased. In line with the November projection, modest economic growth and deteriorating labour market conditions will support a decline in inflation. According to the majority of the Council members, weakening economic growth along with decreasing wage pressure and employment, substantially reduce the risk of second round effects and should be conducive to a marked fall in inflation in the coming quarters, even despite still elevated commodity prices. Some Council members argued that although changes in prices of commodities, including energy commodities, remain a significant risk factor for global price stability, the recent information on annexation of the Yamal contract reducing the import prices for natural gas to Poland, allows to expect lower energy price growth in Poland.

The majority of the Council members argued that the growth of prices for consumer goods and services over the monetary policy horizon might run below the inflation target, albeit above the November projection path. Some of these Council members assessed that deceleration of unit labour costs could be milder than assumed in the projection, which might reduce the decline in inflation. According to these Council members, higher growth of unit labour costs relative to the path anticipated in the projection will result from lower labour productivity growth than accounted for in the projection and stronger increase in NAWRU due to hysteresis. Those Council members also noted that in the face of the fiscal imbalance it could not be ruled out that the VAT rate will be left unchanged at 23% in 2014.

According to some Council members, food and energy price growth is particularly likely to run above the November projection path. Few of those Council members were of the opinion that, apart from considerable volatility of global food and energy prices, an additional source of uncertainty for inflation in Poland – larger than assumed in the projection – lies in the impact of the EU Energy and Climate Package on energy prices in Poland. In their opinion, it is equally difficult to assess the transmission of new agreements on gas import prices on domestic energy prices.

As regards current and future interest rate decisions, the majority of the Council members decided that the NBP interest rate should be decreased at the current meeting. The incoming economic data had confirmed a marked deterioration in economic conditions in Poland, while the NBP November projection pointed to a risk of a protracted economic slowdown, which will curb demand pressure and pose risk of inflation falling below the target in the medium term. Interest rate cuts will limit the scale of economic downturn, and, consequently, reduce the risk of inflation falling below the target.

However, few Council members were of the opinion that the NBP interest rates should be kept unchanged due to persistently elevated current inflation and remaining uncertainty about global energy commodity prices. Moreover, in their opinion, a decrease in interest rates may have a limited impact on lending amid still tight lending conditions in the banking sector. They also pointed out that a decrease in interest rates could discourage household savings in the banking system. Yet, those Council members did not rule out decreases in the interest rates at subsequent meetings of the Council might be justified, should the impact of the economic slowdown on inflation be more pronounced and the likelihood of further increases in energy prices fall.

# NBP

A motion to lower the NBP interest rates by 0.50 percentage point was submitted at the meeting. The motion did not pass. A motion was also submitted to lower the basic NBP interest rates by 0.25 percentage point. The motion was passed. The Council decided to lower the basic interest rates to the following levels: reference rate to 4.50%, lombard rate to 6.00%, deposit rate to 3.00%, rediscount rate to 4.75%.

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