

National Bank of Poland
Monetary Policy Council

Monetary Policy Guidelines for 2013

Warsaw, September 2012

In setting the *Monetary Policy Guidelines for 2013* the Monetary Policy Council fulfills the requirements of Article 227 of the Constitution of the Republic of Poland which obligates it to present monetary policy guidelines to the Sejm annually, concurrently with the submission of the draft Budget by the Council of Ministers. Pursuant to Article 53 of the Act on the National Bank of Poland, *Monetary Policy Guidelines* are published in the Official Gazette of the Republic of Poland "Monitor Polski".

The *Guidelines* present the basic elements of the monetary policy strategy pursued by the National Bank of Poland and an outline of macroeconomic conditions that may have an impact on this policy in 2013. In addition, the *Guidelines* comprise a description of monetary policy instruments.

Monetary Policy Guidelines for 2013 take into account information available up to 10 September 2012.

Monetary Policy Guidelines for 2013 is a translation of the National Bank of Poland's *Założenia polityki pieniężnej na rok 2013* in Polish. In case of discrepancies, the original prevails.

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Chapter 1

Monetary policy strategy

The Monetary Policy Council decided to maintain the key elements of the NBP monetary policy strategy that had been presented in the *Monetary Policy Guidelines for 2012*. In 2013 the monetary policy strategy will be pursued according to the following rules.

According to Article 227 section 1 of the Constitution of the Republic of Poland “the National Bank of Poland shall be responsible for the value of Polish currency”. The Act on the National Bank of Poland of 29 August 1997 states in Article 3 section 1 that “the basic objective of NBP activity shall be to maintain price stability, and it shall, at the same time, act in support of Government economic policies, insofar as this does not constrain the pursuit of the basic objective of the NBP”.

Nowadays central banks understand price stability as inflation so low as not to negatively affect decisions taken by economic agents, including investment and savings decisions. Ensuring price stability is a fundamental way in which the central bank contributes to high and sustainable economic growth. In pursuit of the task of maintaining price stability, central banks respond both to inflationary and deflationary threats.

Since 1998 the Monetary Policy Council, hereinafter “the Council”, has based its monetary policy on inflation targeting (IT). Beginning 2004, the Council adopted a permanent inflation target of 2.5% with a symmetrical tolerance band for deviations of ± 1 percentage point. The Council pursues the strategy under a floating exchange rate regime. However, the floating exchange rate regime does not rule out foreign exchange interventions should they turn out necessary to ensure domestic macroeconomic and financial stability, which is conducive to meeting the inflation target in the medium term.

The experience of the National Bank of Poland, hereinafter “the NBP”, and other central banks shows that the IT strategy is an effective tool to ensure price stability in the medium term. It also allows central banks for a flexible response to external shocks.

Over recent years, the global economy has experienced strong shocks which – amidst ongoing economic integration and free movement of capital – affected the macroeconomic conditions and inflation developments in most countries, including Poland. Escalation of the global financial crisis, which in Europe took also the form of a sovereign debt crisis, triggered a significant increase in risk aversion in the global financial markets followed by its periodic fluctuations later on. Swings in risk aversion were accompanied by volatility of asset prices, including foreign exchange rates, and strong

fluctuations in global commodity prices. At the same time, a considerable rise in public debt and its service costs forced governments in many countries to curb fiscal imbalances. As an important part of fiscal tightening, indirect tax rates were increased in many countries.

The abovementioned factors related to the global crisis contributed to a rise in inflation in many economies. Yet, given the nature of shocks to prices and to economic conditions, the risk of inflation persisting at a heightened level in the longer term could be assessed as limited. The impact of foreign exchange rate on inflation is relatively short-lived. Moreover, in emerging economies, the shocks which had led to exchange rate depreciation in recent years were driven mostly by an escalation of the crisis abroad and weakening in the global economic activity, i.e. factors which at the same time deteriorated outlook for exports and – as a result – for domestic economic growth, helping to mitigate a risk of inflation stabilizing at a heightened level in those economies. Similarly, although rises in commodity prices and increases in indirect tax rates translated into a higher inflation in a short-term, at the same time they reduced the risk of inflation persisting at a heightened level through their negative impact on economic activity.

While taking their decisions, central banks consider above all the risk of inflation stabilizing at a heightened level in the medium term. If factors pushing up inflation are accompanied by deterioration of medium-term economic outlook, then a risk of intensifying wage pressures, and thus the risk of second round effects – leading to inflation stabilizing at a heightened level – may be limited. Flexible monetary policy response to shocks, conditional on the assessment of the risk of second round effects, allows to reduce output and inflation volatility.

Both before the crisis and over the course of the most severe crisis-driven tensions in the global economy, the NBP's monetary policy – in line with the adopted IT strategy – responded flexibly to shocks affecting the Polish economy, adjusting the level of interest rates to changing macroeconomic conditions.

The global financial crisis has shown that in order to ensure price stability in the longer term, monetary policy should be pursued in such a way as to – while striving to stabilise inflation at the target level in the medium term – limit the risk of accumulating imbalances in the economy, especially those resulting from the situation in the financial system. The possibility to flexibly set the parameters and adjust implementation of available monetary policy instruments according to the situation in the domestic financial system is a factor, which may mitigate this risk. The IT strategy allows central banks for conducting such flexible monetary policy, especially if it is supported by macroprudential policy (treated as an additional instrument of the central bank's stabilization policy). In this context, it is particularly important that the recommendations issued by the European Systemic Risk Board regarding setting up national institutions responsible for macroprudential policy are implemented, and that the central bank's leading role in pursuing this policy is ensured.

In 2013, the NBP's monetary policy will remain focused on meeting inflation target in the medium term.

While pursuing monetary policy, the Council will be guided by the following principles:

- First, the notion of permanent inflation target means that it refers to inflation measured as a year-on-year change in prices of consumer goods and services in each month compared to the corresponding period of the preceding year. While analysing inflation developments the use of quarterly and annual inflation indices is also justified, such as those applied in the NBP's inflation projection, in the state budget and in the statistics of the European Union, hereinafter "the EU", including the harmonized index of consumer prices – HICP. An important role in the assessment of inflationary pressure is also played by core inflation indices which make it easier to distinguish between temporary changes in the consumer price index from more sustained changes in inflation pressure. Moreover, core inflation indices make it easier to distinguish between impacts of supply or demand shocks on inflation.
- Second, monetary policy is unequivocally focused on maintaining inflation as close as possible to the target of 2.5% and not just within the tolerance band. This is to facilitate the anchoring of inflation expectations and thus to allow the central bank to change monetary policy parameters less frequently in response to potential shocks affecting current inflation. It may also lead to lower volatility of long-term interest rates.
- Third, the occurrence of shocks in the economy is inevitable. Depending on the strength and the direction of the shock and the degree of inertia of inflation expectations, the scale and the duration of inflation deviation from the adopted target may differ. In countries with sustained low inflation, the central bank usually does not respond to deviations from the inflation target if it deems them temporary, even when inflation leaves the tolerance band. When assessing the need for response, the Council will, however, take into account the fact that in Poland low inflation expectations have not been sufficiently anchored. The extent to which inflation expectations are anchored affects the scale and persistence of the impact of supply and demand shocks on inflation. In the case of shocks which, in the Council's opinion, may lead to a relatively permanent increase in inflation expectations and, as a result, to the rise in inflation due to the emergence of the so-called second-round effects, the central bank will adjust its monetary policy parameters accordingly.
- Fourth, the monetary policy response to shocks also depends on their causes and nature. In the case of demand shocks inflation and output move in the same direction. An interest rate increase weakens economic activity in the short term and, subsequently, inflationary pressure.

In the case of supply shocks output and inflation move in opposite directions. The dilemmas of monetary policy in such a case are as follows:

- ◆ An attempt to neutralise the impact of a supply shock on inflation using monetary policy instruments may lead to an even deeper plunge in output growth resulting from supply shock's negative impact on consumption and investment.
- ◆ On the other hand, an attempt to accommodate – by pursuing expansionary monetary policy – the real effects of a supply shock resulting in a rise in inflation and a decline in output growth usually leads to persistently higher inflation. This, in turn, requires far more restrictive monetary policy in subsequent periods. This leads to a stronger deceleration in economic growth than the monetary tightening that prevents inflation from being sustained at a heightened level.

In the case of shocks resulting from shifts in risk aversion (variable factor), premature response of monetary policy to such shocks may – following their abrupt reversal – lead to an excessive interest rate volatility, and consequently to inflation and economic growth rate volatility.

The central bank's response to a shock depends on the assessment of the persistence of its consequences, including the assessment of the risk of the so-called second-round effects. Therefore, when assessing the risk of inflation stabilizing at a heightened level the important factors to be considered include the degree to which inflation expectations have been anchored and the overall macroeconomic conditions, which might either support or mitigate a rise in wage pressures.

As far as response to shocks is concerned, it is of particular importance that the central bank may specify the time horizon of inflation returning to the target flexibly, i.e. conditional on the nature of the shock.

- Fifth, because of the lags in the response of output and inflation to the monetary policy, the impact of monetary policy on the current inflation is limited. Current decisions of the monetary authorities affect price developments in the future, just as the current inflation is influenced by interest rate changes made several quarters before. However, the time lag between an interest rate decision and its strongest impact on real variables (output, employment) and then on inflation is not constant. It depends, to a large extent, on structural and institutional changes in the economy. Those changes mean that central banks can only approximately assess this time lag. Turmoil in the domestic and international financial system may constitute an additional factor disrupting the monetary transmission mechanism.
- Sixth, monetary policy should take into account the need to maintain financial stability which is indispensable to ensure price stability in the longer term and which enables effective functioning of the monetary policy transmission mechanism. In this context, when assessing the balance of risks to future inflation and economic growth, asset price developments are of particular importance. Excessive interest rates cuts and the long-lasting maintaining lowered interest rates amidst low inflation and simultaneous fast economic growth may lead to a rapid asset price growth, thus increasing the risk of the so-called speculative bubbles. Rapid asset price growth is accompanied by the growing likelihood of asset price deviation from the levels justified by fundamentals, which increases the risk of an abrupt and significant decline in asset prices in the future. Rapid increase in asset prices, especially if it is accompanied by a fast rise in lending, poses a threat to the financial system stability, and consequently – in the longer term – to sustainable economic growth and price stability. Monetary policy supporting financial system stability is thus consistent, in the longer term, with the achievement of the basic objective of the central bank's activity i.e. ensuring price stability, although it may occasionally pose a risk of temporary deviation of inflation from the target. In order to maintain consistency between attempting to keep inflation at the target and supporting financial system stability, under certain conditions it may be necessary to lengthen the inflation target horizon.
- Seventh, in assessing the risk of turmoil in the financial system and the inflation outlook in the longer run, it is useful to analyse monetary and credit aggregates. A fast increase in these aggregates may lead to growing macroeconomic imbalances in the economy, including imbalances

in the asset markets. Monetary policy decisions should take into account the risk connected with excessive increase in these aggregates. Regulatory and supervisory policies in the financial sector that have an impact on credit growth and its structure are an important factor influencing monetary policy.

- Eighth, in assessing the degree of monetary policy restrictiveness not only should the level of real interest rates be considered but also the level of the real exchange rate. Thus understood restrictiveness of monetary policy impacts, along with the implemented fiscal policy, the total restrictiveness of macroeconomic policy. Ensuring price stability amidst an overly expansionary fiscal policy may require a tight monetary policy, including keeping interest rates at a higher level.
- Ninth, monetary policy is pursued under uncertainty which excludes strict control of economic processes. This natural uncertainty means that while taking decisions related to monetary policy it is necessary to take into account all available information relevant for inflation developments, rather than the results of inflation projection only. Models used by central banks to forecast inflation may be imperfect in adequately reproducing behaviour of the economy if only because of its ongoing structural changes. In addition, it is not possible to adopt a simple policy rule which could be known ex ante to market participants.
- Tenth, an important input into the monetary policy decision-making process is the balance of factors affecting the probabilities of future inflation running above or below the target. This balance is based on the assessment of the economic developments, including the inflation projection. While assessing the factors affecting future inflation, the Council takes into consideration the past inflation developments since they have a bearing on the anchoring of inflation expectations at the inflation target. In particular, the Council takes into account the length of the period in which inflation remained close to the target and the length of the period in which it deviated from the target.

Since joining the EU, Poland has been obliged to strive for full participation in the third stage of the Economic and Monetary Union (EMU), which has to be preceded, in the first place, by joining the ERM II. If a decision is taken on Poland joining the ERM II, the Council will make all necessary adjustments to the monetary policy strategy and – in consultation with the Council of Ministers – to the exchange rate policy to conditions ensuing from the necessity of meeting the convergence criteria required for the euro adoption. In the opinion of the Council, Poland's participation in the ERM II and the euro area should be considered after the financial crisis in the euro area countries has been overcome, under the conditions that would allow for the maximization of benefits offered by currency integration and minimization of its costs.

An important factor affecting the monetary policy is the situation of public finances. In order to maintain macroeconomic stability, including price stability, it is necessary to conduct fiscal policy ensuring the long-term stability of public finances. Monetary policy focused on price stability also supports public finance stability.

Chapter 2

Monetary policy instruments

Interest rate

The principal instrument of monetary policy is the short-term interest rate - the NBP's reference rate. Changes in the level of this rate result from the course of the monetary policy implemented. The levels of NBP deposit and lombard rates set the corridor for overnight interest rate fluctuations in the interbank market.

The NBP's reference rate determines the yield obtainable on the main open market operations, while at the same time affecting the level of short-term interest rates in the market.

The NBP's lombard rate determines the cost of liquidity obtainable at the NBP. It sets the ceiling for the overnight market rate.

The NBP's deposit rate determines the interest on deposits made with the NBP. It determines the floor for the fluctuations of the overnight market rate.

Open market operations

Open market operations are used by the central bank to influence banking sector liquidity conditions in a way allowing to maintain short-term market interest rates at a level consistent with a binding inflation target as set by the Monetary Policy Council. In particular, the central bank will conduct open market operations on such a scale as to enable the POLONIA rate to settle close to the NBP's reference rate.

Main operations will be carried out on a regular weekly basis typically with a 7-day maturity. A fixed rate at the level of the NBP's reference rate will be binding during tenders. Due to the expected persistence of liquidity surplus in the banking sector in 2013 these operations will be carried out in the form of NBP bills issue.

Fine-tuning operations may be conducted with the aim for limiting the volatility of short-term market interest rates. They may involve liquidity-absorbing operations (issue of NBP bills, reverse repo transactions) or liquidity-providing ones (redemption of NBP bills before maturity, repo transactions). The maturity and yield of these operations as well as the exact manner in which they are carried out will be dependent on the situation in the banking sector.

Structural operations may be conducted in order to affect long-term liquidity structure in the banking sector. If required, the central bank may carry out the following structural operations: bond issue, purchase or sale of securities on the secondary market.

Reserve requirement

The system of required reserves contributes to the stability of the shortest-term market interest rates in the reserve maintenance periods. The fact that banks are required to maintain reserve holdings under the arrangement facilitates interbank settlements, as they always have the necessary funds at their disposal. At the same time, the averaged reserve requirement system allows banks to determine the amount of funds held on current account with the central bank over the maintenance period.

The reserve requirement also reduces the amount of surplus funds at banks' disposal. This means that the reserve requirement – amidst liquidity surplus in the banking sector – contributes to lower level of liquidity absorbing open market operations.

Changes in the required reserve ratio depend on the liquidity level within the banking sector as well as on conditions prevailing in the interbank market.

Standing facilities

Standing facilities are aimed at limiting the scale of overnight market rate fluctuations. Banks participate in these facilities at their own initiative.

Standing deposit facility enables banks to deposit their liquidity surpluses with the central banks on an overnight basis. The interest on the facility constitutes the lower limit for the market rate quoted for this period.

Standing credit facility (Lombard credit) enables banks to take overnight credit. The Lombard credit is collateralized with assets accepted by the central bank. The interest on this credit expresses the marginal cost of obtaining funds from the central bank, which constitutes the upper limit for the overnight rate.

Intraday credit facility involving both zloty- and euro-denominated non-interest bearing loans offered by the NBP is an important element of the NBP settlement system, as the source of funds to be obtained during the trading day. These loans are collateralised with assets accepted by the central bank.

Foreign exchange swaps

The NBP may carry out foreign exchange swaps. This is a transaction in which the NBP purchases (or sells) Polish zloty for foreign currency in the spot market, and, at the same time, resells (or repurchases) it under a forward contract at a specified date.

Foreign exchange interventions

The monetary policy instrument that may be used by the NBP are foreign exchange interventions.

Should Poland join the ERM II, interventions in the foreign exchange market may also be used for stabilising the zloty exchange rate in order to meet the currency stability requirement.

Chapter 3

Monetary policy and its determinants in 2013

Macroeconomic conditions in 2012

In the first half of 2012, concerns about the persistence of the consequences of the global financial crisis intensified, which contributed to global economic activity continuing at a low level. Stagnation in the euro area was accompanied by a certain slowdown in economic growth in Germany, Poland's main trading partner. At the same time, economic growth in the United States remained moderate with signs of its possible weakening as compared with the previous quarters. Along with weaker demand from developed economies, also the major emerging economies saw their economic growth decelerate.

In some developed economies demand growth was negatively affected by the ongoing adjustments in the balance sheets of the financial and non-financial sectors, the tightening of the fiscal policy and unfavourable developments in the labour and real estate markets. High commodity prices were another factor curbing global economic growth.

In the first half of 2012, inflation in developed economies, and, to a slightly lesser degree, in emerging economies, was on the decline and was lower than in 2011. Decelerating growth of energy prices and, in some economies, also food prices, were the key factors bringing down inflation.

In the analysed period, the financial market remained impacted by swings in sentiments and changing outlook for global economy. In 2012, fluctuations in risk aversion in the global financial markets influenced direction of capital flows, leading to fluctuations in foreign exchange rates and financial asset prices. At the beginning of 2012, investors' sentiment improved which reduced the yields on bonds issued by countries most severely affected by the debt crisis and contributed to the capital inflow to emerging economies resulting in appreciation of their currencies. Although in the subsequent months, amid growing concerns about the global economic conditions, including the intensification of the crisis in the euro area, the sentiment in the global financial markets deteriorated, it improved somewhat at the beginning of the second half of 2012.

In the first half of 2012, the main central banks increased the scale of monetary expansion, keeping short-term interest rates at historically low levels and carrying on quantitative easing programmes. The Federal Reserve (Fed) maintained its short-term interest rates at a level close to zero and

extended the period during which the rates are expected to remain close to zero. Additionally, in June 2012 the Fed increased the scale and extended the period in which it will sell short-term and buy long-term bonds aiming to further reduce the long-term interest rate (the so-called Operation Twist). In turn, the European Central Bank (ECB) conducted additional operations providing liquidity to euro area financial institutions and announced that unlimited longer-term refinancing operations would be conducted until the end of 2012. Moreover, in July 2012, the ECB cut its main interest rate by 0.25 percentage point, down to 0.75%, and in September 2012 it announced the decision to allow unlimited purchase of government bonds issued by the euro area countries affected by the sovereign debt crisis.

In Poland, growth in economic activity in the first half of 2012 was lower than in 2011. Weaker economic growth was a result of both lower investment and consumption growth. Decline was also recorded in exports growth which was largely driven by falling demand from the EU countries. At the same time, decline in imports growth was stronger than that in exports which in turn resulted from slower rise in domestic demand. As a consequence, contribution of net exports to GDP remained positive.

Deteriorated business conditions were accompanied by lower employment growth, which combined with further growth in economic activity of the population contributed to a gradual rise in unemployment. Rise in labour supply, in excess of labour demand, limited wage growth in the economy, which remained moderate.

Weaker economic growth in the first half of 2012 was partly driven by measures aimed at reducing imbalances in the public finance sector. In 2011, the deficit of the general government sector declined to 5.1% of GDP (from 7.8% of GDP in 2010) and is supposed to narrow further in 2012. According to the *Convergence Programme. The 2012 Update*, in 2012 the deficit was to be reduced to 2.9% of GDP. However, as a result of lower than anticipated tax receipts it may not be possible to achieve this target and the deficit may amount to approx. 3.5% of GDP.¹ The reduction in the general government deficit is to be supported, in similar proportions, by higher revenues of the sector (i.a. as a result of a rise in disability pension contribution by 2 percentage points as of February 2012) and lower expenditure (i.a. as a result of the introduction of a temporary expenditures rule and wage freeze in the public finance sector).

In the first half of 2012, lending in the economy slowed down. Declining growth in lending to households was driven, on the one hand, by tightened standards and terms of granting loans and, on the other hand, by the concurrent weakening of demand for loans. Growth in housing loans slowed down and the value of consumer loans declined. Decline was also recorded in the growth of corporate lending, which, in the absence of significant changes in lending policy for enterprises, might have been driven by weaker demand for loans.

In the analysed period, along with falling growth rate in prices of all main categories of goods and services, including, in particular, food prices, inflation was declining gradually, yet remained above the NBP's inflation target. Heightened level of inflation was largely driven by persistently high growth

¹ According to the statement of the Minister of Finance of 5 September 2012.

of energy prices and administered prices. At the same time, the influence of demand factors on inflation was limited, as indicated by the gradual slowdown in economic activity in the first half of 2012, including low consumption growth. In the first half of 2012 – as in the second half 2011 – the Council assessed that weaker economic growth would support inflation decline. However, the Council judged that due to persistently negative impact of factors beyond the influence of domestic monetary policy, the expected scale of economic slowdown may prove insufficient for inflation returning to the target in the medium term. At the same time, the risk of inflation stabilizing at a heightened level was increased by inflation expectations persisting at a relatively high level. Therefore, in May 2012 the Council increased the NBP interest rates by 0.25 percentage point, continuing its monetary policy tightening started in the first half of 2011. As a result, the reference rate was increased to 4.75%.

Monetary policy in 2013

In 2013 the main objective of monetary policy will be to stabilize inflation in the medium term at the level of $2.5\% \pm 1$ percentage point, which will support balanced economic growth.

Similarly to the previous years, monetary policy parameters, including the level of the NBP interest rates, will be flexibly adjusted to the changing economic situation and the ensuing assessment of the likelihood of inflation running in the medium term at a level consistent with the inflation target. In its decisions, the Council will also take into consideration the condition in the financial sector whose stability is the precondition for price stability in the longer term.

In case of fierce escalation of the crisis in Poland's external environment and serious turmoil in the domestic financial market, the Council allows for the possibility to flexibly adjust the monetary policy instruments, in particular, to use open market operations with various maturities as well as to adjust the type of collateral in open market operations to the situation in financial markets.

In 2013 monetary policy is likely to be conducted amidst changing sentiment and fluctuations in risk aversion in the world economy. The outlook for growth in the global economy will probably continue to be an important source of uncertainty. This uncertainty is connected with high public and private debt in some euro area countries and in the United States, as well as with the conditions in the banking sector. Uncertainty about the outlook for growth in the global economy also concerns the effects of strongly expansionary monetary policy pursued by major central banks, resulting in considerable liquidity surplus persisting in the international financial markets. Shifts in risk aversion amidst strongly expansionary monetary policy may contribute to significant volatility in commodity prices and exchange rates, which may continue to have a strong impact on domestic economic developments, including inflation.

Macroeconomic determinants of monetary policy in 2013

In 2013 the global economic developments will continue to be an important factor affecting the Polish economy. According to the current forecasts, in 2013 GDP growth in the United States will be moderate, similarly as in 2012. In turn, in the euro area, following a minor decline in economic activity in 2012, in 2013 GDP is expected to post a slight growth; yet, economic activity will continue

to vary across the countries of the region. Following a period of a slight slowdown, economic conditions in Germany, Poland's main trading partner, are likely to improve and remain fairly favourable, whereas the majority of countries most severely affected by the sovereign debt crisis may continue to face recession.

At the same time, according to the current forecasts, global inflation in 2013 will continue on a downward trend, supported by the waning impact of rising commodity prices in the global markets in 2010 and 2011, amidst the expected low economic activity in many economies.

Low economic activity in the euro area is likely to curb GDP growth in Poland. According to the current forecasts, in 2013 economic growth in Poland will be lower than in 2012, which should, in turn, ease inflationary pressure. Considerable reduction in public investment, amidst the expected moderate consumption growth will result in lower than in 2012 economic growth.

In the short- and medium-term, domestic demand will probably be negatively affected by continued fiscal policy tightening, which is, however, necessary to support Poland's sustainable development in the longer-term horizon. In 2013 the so-called temporary expenditure rule and wage freezing in the public finance sector will be continued. Moreover, in line with the *Convergence Programme. The 2012 Update*, lower public spending on investment are projected. Yet, due to deteriorating outlook for growth in the Polish economy observed after the *Programme* was put in place, the anticipated scale of deficit reduction in the general government sector (down to 2.2% of GDP in 2013) may not be achieved.

Inflation developments in 2013 will also be largely affected by the domestic labour market conditions. Low demand for labour may be expected to limit employment growth in the economy and result in unemployment continuing at a heightened level. In this context, given the wage freezing in the budgetary sector, wage growth in the economy is likely to remain moderate.

Moderate GDP growth and uncertainty about the outlook for the economy are expected to have a negative impact on both credit demand and credit supply in 2013, which is likely to limit lending. Restricted lending to some entities may also be the effect of supervisory regulations, which however, support medium-term stability of the financial system.²

Banking sector liquidity in 2013

Similarly to the previous years, it is expected that monetary policy in 2013 will be conducted in conditions of liquidity surplus in the banking sector. The liquidity surplus, that has been stable since the beginning of 2012, may increase in the second half of 2012 and in the subsequent year.

² The recent tightening of supervisory regulations includes the implementation, from the end of 2011, of all provisions of the amended Recommendation S and increasing, from June 2012, of risk weights to 100% for retail currency exposures, which will reduce capital adequacy of some banks that hold a large portion of housing loan portfolios denominated in foreign currency. These banks may be forced to reduce lending growth.

The level of the liquidity surplus will be strongly affected by the decisions of the Ministry of Finance, including the decisions on financing the borrowing needs of the State budget, servicing foreign debt of the Treasury and the use of EU funds.

The funds obtained from the EU that are to be used in the domestic currency need to be exchanged. The way those funds are exchanged has crucial importance for the level of banking sector liquidity. If the central bank purchases the inflowing foreign currency, the liquidity surplus in the banking sector will increase. On the other hand, exchanging EU funds directly in the interbank market has no impact on the level of the liquidity surplus.

Servicing Poland's foreign debt through the use of funds from the foreign currency account of the Ministry of Finance with the NBP, funded primarily by the issue of bonds to foreign markets, has no effect on the level of liquidity surplus. On the contrary, if the Ministry of Finance obtains funds for servicing foreign debt through purchase of foreign currency at the NBP, the liquidity surplus of the banking sector will decline.

The expected growth of the currency in circulation level will contribute to decreasing banking sector liquidity surplus.

Monetary policy communication in 2013

Communication of the central bank with the public is an important element in implementing monetary policy. As part of its communication policy, the Monetary Policy Council presents its assessment of the current and future economic developments. As in previous years, the publication of the *Monetary Policy Council Press Releases* and press conferences held after the MPC meetings, as well as *Minutes of the Monetary Policy Decision-Making Meetings* and voting of the Monetary Policy Council Members, *Inflation Reports*, *Monetary Policy Guidelines* and the *Report on Monetary Policy Implementation* will remain the most important communication tools in 2013.