NARODOWY
BANK POLSKI

Monetary Policy Council

Monetary Policy Guidelines for 2022

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Warsaw, 2021

In setting the *Monetary Policy Guidelines for 2022*, the Monetary Policy Council, hereinafter the "Council", fulfils the requirements of Article 227 Section 6 of the Constitution of the Republic of Poland, which obligates it to formulate monetary policy guidelines and present them to the Sejm on an annual basis.

In the *Monetary Policy Guidelines for 2022* the Council has maintained the monetary policy strategy pursued by Narodowy Bank Polski, hereinafter "NBP", so far. Price stability remains the main statutory objective of monetary policy. At the same time, monetary policy will be conducted in a way that helps maintain sustainable economic growth and financial stability.

NBP will continue to pursue the strategy of a medium-term inflation target at 2.5%, with a symmetric band for deviations of +/-1 percentage point. NBP's interest rates will remain the principal instrument of monetary policy. Monetary policy will continue to be implemented under the floating exchange rate regime. However, NBP does not rule out interventions in the foreign exchange market. The scope, manner and scale of using monetary policy instruments by NBP will take into account in a flexible way the determinants of monetary policy implementation, including in particular market conditions and economic consequences of the Covid-19 pandemic.

The *Monetary Policy Guidelines for 2022* is a translation of the publication of Narodowy Bank Polski entitled *Założenia polityki pieniężnej na rok 2022*. In case of discrepancies, the original prevails.

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Chapter 1. Monetary policy strategy

According to Article 227 Section 1 of the Constitution of the Republic of Poland (Journal of Laws of 1997, item 483, as amended), "Narodowy Bank Polski shall be responsible for the value of Polish currency". The Act on Narodowy Bank Polski of 29 August 1997 (Journal of Laws of 2020, item 2027 and 2021, item 1598) states in Article 3 Section 1 that, "The basic objective of the activity of NBP shall be to maintain price stability, while supporting the economic policy of the Government, insofar as this does not constrain the pursuit of the basic objective of NBP."

Fulfilling the main obligations of NBP laid down in the Constitution of the Republic of Poland and in the Act on Narodowy Bank Polski, the Council strives to maintain price stability. At the same time, monetary policy is conducted in a way that helps maintain sustainable economic growth and financial stability.

The Council has been pursuing the price stability objective by using inflation targeting strategy. Under this strategy, since 2004 the monetary policy objective has been to keep inflation – understood as the annual change in the consumer price index – at 2.5% with a symmetric band for deviations of +/-1 percentage point in the medium term. In countries pursuing inflation targeting strategy, inflation rate is lower than in other countries, on average. Since 2004 the average annual growth in CPI in Poland has been 2.2%, i.e. close to the NBP's target.

The medium-term nature of inflation target means that due to macroeconomic and financial shocks, inflation may temporarily deviate from the target and even run outside the band for deviations from the target. The response of monetary policy to shocks is flexible and depends on their causes and the assessment of persistence of their consequences, including the impact on inflation developments. Each time inflation deviates from the target, the Council flexibly determines the desirable time necessary to bring it back to the target, as bringing inflation rapidly back to the target may entail significant costs to macroeconomic and financial stability. When deciding on the changes of monetary policy parameters, the Council takes into consideration the need to accommodate price adjustments that are mostly related to the return of the economy to the sustainable growth path after the COVID-19 pandemic shock, to the process of Poland's convergence to the more advanced economies and to the consequences of the structural changes taking place in the economy, including the energy transition.

The monetary policy strategy pursued by the Council assumes flexibility of the instruments applied. This means that the range of instruments used by NBP can be adapted to the nature of disturbances observed in the economy and market conditions. The flexible use of monetary policy instruments is conducive to effective functioning of the transmission mechanism as well as macroeconomic and financial stability.

While taking monetary policy decisions, the Council considers the time lags in the transmission mechanism of monetary policy. The time lag between a decision on monetary policy parameters and its peak impact on real variables (such as output or employment) and on inflation takes several quarters and may change over time. Moreover, monetary policy is conducted under uncertainty, in particular about future economic developments.

Stabilising inflation at a low level is an important, yet insufficient condition to maintain balance in the economy, which, in turn, supports price stability in the long term. Imbalances in the financial sector may pose a threat to long-term price stability. Those imbalances should be counteracted mainly by macroprudential policy aimed at reducing systemic risk and in that manner supporting long-term, sustainable economic growth. This is important especially amid the free movement of capital and highly integrated financial markets. Monetary policy conducted by the Council supports macroprudential policy and in particular is conducive to financial system stability and mitigates the risk of imbalances building up in the economy, by taking into account in its decisions developments in asset prices (including real estate prices) and lending growth insofar as this does not constrain the pursuit of the basic objective of NBP.

Besides monetary and macroprudential policy, fiscal policy plays an important role in maintaining macroeconomic stability. A fiscal policy which mitigates the impact of economic shocks, while ensuring long-term stability of public finance, is necessary to maintain macroeconomic stability.

The Council implements the inflation targeting strategy under the floating exchange rate regime. The floating exchange rate regime does not rule out interventions in the foreign exchange market whenever it is warranted by the market conditions or conducive to ensuring the country's macroeconomic or financial stability.

Monetary policy communication is an important element of the Council's inflation targeting strategy. Thus, the Council's decisions together with their determinants are presented in the press releases (*Information from the meeting of the Monetary Policy Council*), as well as in the *Minutes of the Monetary Policy Council decision-making meetings*, *Inflation Reports*, *Monetary Policy Guidelines* and the *Report on Monetary Policy*. Furthermore, the Council's decisions and their determinants may be explained by the Governor of NBP at the press conferences and in the individual statements by the Governor of NBP or the members of the Council.

In line with the adopted strategy, in 2022 monetary policy parameters, including NBP interest rates, will be adjusted to the economic situation so as to ensure long-term price stability and, at the same time, support sustainable economic growth and financial stability.

Chapter 2. Monetary policy instruments in 2022

Determinants of monetary policy instruments

In the first half of 2021, NBP continued most of the measures taken in response to the COVID-19 pandemic. Those measures included, among others, keeping the NBP interest rate unchanged, conducting – alongside the main open market operations – structural operations involving purchase on the secondary market of government securities and government-guaranteed debt securities, as well as offering bill discount credit.

In 2022, the scope, manner and scale of use of monetary policy instruments by NBP will take into account factors determining the conduct of monetary policy, in particular the economic fallout of the COVID-19 pandemic. As in the previous years, monetary policy instruments may be used in a flexible manner to account for the changing macroeconomic and market conditions. In view of the above, depending on the direction and strength of the changes, it will be possible to either limit or broaden the scope of monetary policy instruments used in 2022 as compared to the current state.

NBP envisages that monetary policy in 2022 will be conducted amid surplus of the banking sector liquidity. This will be affected by, among others, changes in the way monetary policy instruments are used, which NBP introduced in 2020. Moreover, in 2022 banking sector liquidity will be boosted by the purchase of foreign currencies from the Ministry of Finance. The NBP sale of foreign currencies to the European Commission, related to the currency conversion of the EU membership fee, and a rise in currency in circulation, will have a curbing effect on the level of banking sector liquidity.

The operational target of NBP's monetary policy in 2022 will be to keep the POLONIA rate running close to the NBP reference rate. Depending on the market conditions, the POLONIA rate may deviate from the NBP reference rate within the corridor set by the NBP lombard rate and the NBP deposit rate.

Interest rates

The key instrument of monetary policy in 2022 will be the NBP interest rates.

The NBP reference rate will determine the yield obtainable on the main open market operations conducted by NBP, while at the same time affecting the level of short-term market interest rates.

The NBP lombard rate will determine the interest on the lombard credit offered by NBP, allowing to obtain funds from the central bank on an overnight basis.

The NBP deposit rate will determine the interest rate on deposits, allowing to deposit funds with NBP on an overnight basis.

The discount rate will determine the interest on the bill discount credit.

Open market operations

Main operations will be the key instrument by means of which NBP will be striving to shape liquidity conditions in the banking sector, and consequently – the level of the POLONIA rate. These operations will normally be carried out on a regular basis, typically with a 7-day maturity. During tenders for main operations, NBP will apply a fixed-rate tender procedure with the rate at the level of the NBP reference rate. Due to the expected further liquidity surplus in the banking sector in 2022, these operations will be carried out in the form of NBP bills issuance. The manner in which main operations are conducted may be modified where justified by a change in market conditions or parameters of NBP's monetary policy.

Fine-tuning operations may be conducted to limit the volatility of short-term market interest rates. Their use may be motivated by the need to provide liquidity or to absorb liquidity from the banking sector. As part of liquidity-providing operations, NBP may offer repo transactions and redeem NBP bills before maturity. In the case of liquidity-absorbing operations, the central bank may issue NBP bills or offer reverse repo transactions. The maturity and yield of these operations as well as the way in which they are carried out will be adapted to the purpose of their application.

Structural operations may be conducted in order to change the long-term liquidity structure in the banking sector, to ensure the liquidity of the secondary market for government securities and government-guaranteed debt securities and to strengthen the monetary transmission mechanism. NBP may continue to use structural open market operations involving the purchase of debt securities in the secondary market. Moreover, the central bank may use other types of structural operations, i.e. the sale of debt securities in the secondary market or bond issuance. In particular, NBP may purchase or sell government securities and government-guaranteed debt securities in order to support the liquidity of the market for those securities.

Required reserve system

The main objective of the required reserve system will be to enhance the stability of short-term market interest rates. This is ensured by the averaged reserve requirement, which allows banks to determine the amount of funds held on the account with the central bank throughout the reserve maintenance period, provided that the average level of holdings at NBP does not fall below the value of the required reserve. At the same time, the reserve requirement reduces the scale of NBP open market operations conducted to absorb liquidity surplus.

Changes in the required reserve ratio will depend on the conditions in which monetary policy will be pursued in 2022.

Standing facilities

Standing facilities offered by NBP are designed to limit the scale of overnight market rate fluctuations by stabilising liquidity conditions in the banking sector.

The standing credit facility (lombard credit) will enable banks to obtain overnight credit from the central bank on each trading day. This credit is collateralised with assets accepted by the central bank (including government securities, government-guaranteed debt securities, securities issued by NBP, municipal bonds, covered bonds and corporate bonds with a high credit rating). The interest rate on this credit determines the marginal cost of obtaining funds from the central bank, which will act as a ceiling for the overnight market rate.

The overnight deposit facility will allow banks to deposit their liquidity surpluses with the central bank on an overnight basis on each trading day. The interest on the overnight deposit will fix the floor for the market rate determined for this term.

The width of the corridor between the lombard rate and the deposit rate will be shaped in a way conducive to the smooth functioning of the interbank short-term deposit market.

Bill discount credit

NBP may offer the bill discount credit aimed at refinancing loans granted to enterprises by banks.

Foreign exchange swaps

NBP may carry out foreign exchange swaps. A foreign exchange swap is a transaction in which NBP purchases (or sells) the Polish zloty against a 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

NBP may intervene in the foreign exchange market.

Chapter 3. Monetary policy determinants in 2022

External conditions

In the first half of 2021, global economic activity remained heavily influenced by the pandemic. However, the impact of the successive waves of infections on business conditions was weaker than in 2020, allowing the gradual economic recovery in the global economy to continue. At the same time, business conditions were still highly diversified across the economies. In the euro area, Poland's most important trading partner, following a decline in GDP in 2021 Q1, economic activity recovered in subsequent months. In the United States, on the other hand, economic conditions – supported by direct transfers to households – improved throughout the entire first half of 2021. Apart from the differences between the economies, the situation also continued to vary in the individual sectors of the global economy: while there was a robust recovery in global manufacturing activity, the situation in the service sector was much less favourable.

The recovery in global economic activity contributed to a further sharp rise in the prices of many commodities in the first half of 2021, which – combined with their marked decline at the beginning of the pandemic – resulted in a high annual growth rate of these prices. Annual price growth was particularly high in the crude oil market, which, apart from the above-mentioned factors, was in part the effect of limited supply of oil. The strong growth of the prices of oil and other energy commodities, along with the increase in core inflation observed in some economies, translated into a substantial pick-up in consumer price growth across the world.

Amid the ongoing pandemic and high uncertainty about its further course, economic recovery in most countries was subject to further support of fiscal programmes and loose monetary policy. In some economies, notably in the United States and the European Union countries, fiscal support programmes in 2021 have been extended or expanded in scale.

At the same time, most major central banks continued to pursue strongly accommodative monetary policy. The European Central Bank maintained a negative deposit rate and increased the pace of its monthly asset purchases. The US Federal Reserve kept its interest rates close to zero and continued large-scale asset purchases. Given the rise in inflation in the first half of 2021, these banks argued for the continuation of loose monetary policy by indicating the temporary nature of factors driving up inflation and the high uncertainty about economic outlook. In turn, some central banks in emerging economies embarked on the process of reducing the degree of monetary policy accommodation.

Available forecasts point to further economic recovery in the second half of 2021, and continued rebound of global GDP in 2022. This will be accompanied by elevated inflation in 2021, which, however, will probably decline in 2022, as factors temporarily boosting price growth fade. At the same time, the sustainability and pace of the recovery, as well as the inflation outlook are burdened with very high uncertainty. In particular, this uncertainty concerns the persistency of the currently elevated level of global inflation.

Domestic determinants

The epidemic situation in Poland in the first half of 2021 had a high impact on domestic economic conditions, in particular in the service sector and trade. At the same time, the impact of the successive waves of infections was smaller than in the initial stage of the pandemic. Polish industry demonstrated considerable resilience to the periodic deterioration of the epidemic situation, and activity in this sector in the first half of 2021 was on an upward trend. This was accompanied by a further recovery in trade, amid disruptions observed in international supply chains. At the same time, the situation in the labour market, supported by economic policy measures, was relatively favourable, as indicated in particular by the low unemployment rate.

At the beginning of 2021 inflation was running at a level consistent with the NBP inflation target. In the subsequent months, consumer price growth in Poland accelerated markedly, driven mainly by supply-side and administrative factors beyond the control of domestic monetary policy. This included in particular a sharp growth in fuel prices, resulting from the rising global oil prices and a strong base effect related to their decline in the corresponding period of last year, as well as higher electricity prices and still rapidly rising waste disposal charges. Significant upward pressure on inflation came also from higher costs of running business amid the pandemic and higher international transport charges, as well as temporary disruptions in the global supply chains.

In order to further support economic recovery, most anti-crisis measures introduced in 2020, which were aimed at mitigating the adverse effects of the pandemic along with the related restrictions on economic activity, were preserved in the first half of 2021.

As part of fiscal measures, financial support was again extended to economic agents, albeit its scope was restricted to the sectors most heavily hurt by the tightening of anti-pandemic restrictions. This support was primarily targeted at reducing the adverse impact of the pandemic on the financial and liquidity situation of businesses as well as on household budgets, thus protecting jobs.

With regard to monetary policy, the Council kept the NBP interest rates unchanged, including the reference rate at 0.1%. Furthermore, NBP continued to purchase government securities and government-guaranteed debt securities. NBP also offered to banks refinancing of loans granted to enterprises by banks in the form of bill discount credit.

In the second half of 2021 and in 2022, economic conditions are expected to improve further, supported by the economic policy measures and the anticipated economic recovery in the external environment of the Polish economy. At the same time, a substantial uncertainty remains regarding the scale and pace of the economic recovery, resulting primarily from the risk of a new surge in infections and the need to introduce sanitary restrictions, both in Poland and its external environment. The previously mentioned supply and administrative factors will most likely result in annual price growth staying above the upper bound for deviations from the inflation target in the second half of 2021. In 2022, after some of the factors temporarily increasing price growth fade, inflation is expected to decrease somewhat. Yet the scale of the decline will depend on the scale and robustness of the economic recovery, including the future situation in the labour market. Factors with an upward pressure on inflation will include the likely further increases in the prices of energy charged to individual recipients, forced by the market response to the climate policy of the European Union.

Uncertainty factors

The evolution of the COVID-19 pandemic around the world and in Poland is the main uncertainty factor for domestic economic conditions and price developments. In particular, in the case of a deterioration in the epidemic situation, repeated periodic tightening of restrictions is possible. This risk may be increased by the possible spread of new coronavirus strains. It is also difficult to predict the further pace and effectiveness of the vaccination programmes, particularly in the emerging countries.

There is also uncertainty about the scope of possible further economic policy measures aimed at mitigating the negative effects of the pandemic and the durability of the effects of the support provided so far. Another significant uncertainty factor is the final scope of tax changes to be introduced under the Polish Deal, and thus their impact on shaping consumption and wage growth.

There is also uncertainty about the outlook for global trade. In this context, the pace of eliminating disruptions in the global supply chains continues to be an uncertainty factor.

Another uncertainty factor is the future development of global asset and commodity prices. In particular, the unpredictable development of global prices of energy and agricultural commodities remains a source of uncertainty. The scale of the further impact of climate policy measures on price developments, including energy prices, continues to be a significant uncertainty factor. In turn, in the case of food prices, agrometeorological conditions in Poland and abroad, which are volatile and hard to foresee, pose a significant risk factor.

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