Minutes of the Monetary Policy Council decision-making meeting held on 4 March 2020

During the meeting, attention was drawn to the deteriorating economic climate in the immediate environment of the Polish economy. In the euro area, as the recession in the industrial sector unfolds, the annual GDP growth rate decreased in 2019 Q4. Economic conditions remained weak, in particular, in the major countries of this economy: in Germany quarterly GDP growth stood at zero, and in France and Italy it was negative. In the United States, GDP growth remained stable in 2019 Q4, despite weaker activity in industry. However, at the beginning of 2020 the economic climate in the United States deteriorated slightly. Attention was drawn to a marked slowdown in economic activity in China at the beginning of 2020.

The Council members assessed that due to the spread of coronavirus, uncertainty about the global economic outlook had risen substantially in the recent period. In China, production had been halted in certain companies, causing disruption in some of the global value chains, and a number of global firms had suspended production. At the same time, many countries had seen a drop in demand for tourism and transportation services. Against this background, global growth forecasts had been revised downwards, and sentiment in the global financial markets had slumped. There had been a sharp fall in equity prices, and a decline in government bond yields.

The Council members pointed out the sharp fall in the prices of oil and liquified natural gas. At the same time, it was underlined that prices of many food commodities were persisting at a high level. As a result, inflation in the global economy, including the external environment of the Polish economy, had risen in the past few months.

Due to the deteriorating economic outlook, some central banks had cut their interest rates or announced an easing of the monetary policy stance. In particular, interest rates had been cut by the US Federal Reserve (Fed). It was emphasised that the European Central Bank (ECB) was keeping the deposit rate below zero while conducting asset purchases and signalling the maintenance of loose monetary policy in the coming quarters. The Council members stressed the fact that the financial markets were expecting the ECB to loosen monetary policy further and the Fed to continue cutting interest rates.

Certain Council members were of the opinion that the potential for counteracting the economic effects of coronavirus by loosening monetary policy was limited. In their view, this resulted in part from the supply-side nature of the shock and high economic uncertainty pertaining to it. These Council members also pointed out the restricted room for further interest rate cuts in some of the economies. In contrast, other Council members argued that interest rate cuts in many countries would limit a further deterioration in sentiment and mitigate the effects of the economic losses, thus helping to support the economy in the longer run.

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The Council members judged that economic conditions in Poland remained good, despite slowing economic growth. In 2019 Q4, real GDP growth stood at 3.2% y/y. GDP growth was supported by steady consumption growth, albeit slightly slower than in previous quarters, fuelled by favourable labour market conditions, strong consumer confidence and social benefit payments. It was pointed out that investment continued to grow, and the contribution of net exports to GDP growth was positive. Certain Council members highlighted the drop in demand growth below its long-term average.

Some Council members assessed that the data incoming at the beginning of 2020 suggested potentially slower growth in 2020 Q1 than in the preceding years. This was indicated by moderate industrial output growth, slower retail sales growth and somewhat weaker – although still upbeat – household sentiment. However, these Council members also stressed that construction and assembly output picked up in January, which might have been partially due to the favourable weather conditions in that month. While discussing current data, certain Council members pointed out the persistence of the PMI index below 50 points and a deterioration in some of the other confidence indicators.

It was observed that conditions in the labour market remained favourable, even though employment growth in enterprises had slowed down somewhat. On the other hand, wage growth in the corporate sector had risen slightly in January 2020 (possibly in part due to the increased minimum wage), while staying close to the level observed in the past two years. Certain Council members pointed out that the slight increase in the registered unemployment rate in recent months might signal worse prospects for the labour market.

According to preliminary Statistics Poland (GUS) data, in January 2020 inflation exceeded the upper limit of deviations from the NBP inflation target. The majority of Council members underlined that the rise in inflation above the NBP target level had been driven by regulatory and supply-side factors that remained beyond the influence of the domestic monetary policy. These factors comprised, in particular, higher electricity and fuel prices, the increase in waste disposal charges and excise tax on alcoholic beverages and tobacco products as well as a further rise in the prices of unprocessed food, related to the spread of the African Swine Fever epidemic in many countries and to last year's drought. It was emphasised that the upward pressure on prices was also the result of demand factors related to favourable financial situation of households, yet these alone were not the reason why the inflation target had been exceeded. It was pointed out that the growth in the prices of non-food products and market services, i.e. prices which were largely determined by demand and not by regulatory factors or supply shocks, had not exceeded 2.5% y/y.

Certain Council members drew attention to the fact that some measures of business and consumer inflation expectations had risen recently. Yet the majority of the Council members shared the opinion that the increase was attributable to the adaptive nature of these expectations and the increase in current inflation. In this context, it was underlined

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that the medium-term inflation expectations of market analysts remained anchored at the level of the inflation target.

Some Council members pointed out that higher inflation was not the result of excessive lending growth. These Council members emphasised that the total growth in lending to the non-financial sector had decreased in the past few months and remained slower than nominal GDP growth. They also drew attention to the slower consumer credit growth and the still moderate housing credit growth. In addition, they pointed out that corporate lending growth remained slow, which – in the opinion of certain Council members – might result from companies financing operations from sources other than bank credit.

Certain Council members indicated that higher inflation contributed to lower real interest rates, which supported fast, in their assessment, lending and higher demand for riskier assets and real estate. On the other hand, some Council members underlined that lower real interest rates than in the past was a phenomenon typical for many of the world's economies these days. These Council members also pointed out that the decrease in real interest rates resulted primarily from negative supply shocks, which curtailed households' real income and their ability to service debt. Therefore, these shocks would have a hampering effect on lending in the economy. Hence, the situation was different than in a case when real interest rates decline due to price growth resulting from excessive demand in the economy.

Discussing the results of the March projection, the Council members indicated that according to its central path, GDP growth in 2020 and 2021 would remain close to 3%. Economic growth was to be further supported mainly by consumption, although consumption growth would be slower than in previous years due to the expected weakening of wage growth and the decrease in total employment forecast for 2021. Simultaneously, it was pointed out that investment growth might slow down in the projection horizon due to weaker growth in the absorption of EU funds. It was also emphasised that export growth might be slower than in the previous years. The Council members were of the opinion that in these circumstances, GDP growth would probably remain below its long-term average in the subsequent quarters.

Attention was drawn to the fact that risks to the forecast GDP growth in Poland were on the downside. The main source of risk was the further spread of the coronavirus, which might cause a sharper drop in economic activity growth in Poland's immediate environment, and, as a result, a more pronounced weakening in export growth. At the same time, further expansion of the coronavirus might lead to a slump in business and consumer sentiment at home.

The Council members pointed out that the central path of the March inflation projection indicated a possibility of inflation in 2020 running slightly above the upper limit of deviations from the inflation target due to the supply-side and regulatory factors. However, the majority of Council members stressed that as the influence of those factors faded, the anticipated GDP growth weakening materialised and the output gap narrowed, inflation would return close to the inflation target in 2021. Another factor with a dampening effect on inflation would be the recently observed decline in global oil prices. In this context it was noted that inflation returning close to the inflation target in 2021 was suggested not only by the central path of the March projection, but also by external forecasts.

In turn, certain Council members emphasised that in line with the central path of the projection, in the coming quarters inflation would continue to exceed the inflation target, temporarily even exceeding the upper limit of deviations from the inflation target. These Council members observed that unit labour cost growth – which was high in their opinion – would exert upward pressure on inflation. It was also pointed out that the further development of energy and unprocessed food prices was subject to uncertainty. The interruptions of the global supply chains as a result of the spread of the coronavirus were also noted as possibly having an inflationary impact.

The majority of Council members decided that the NBP interest rates should remain unchanged at the current meeting. In their opinion, the outlook for the domestic economy remained favourable, yet GDP growth in the coming quarters would be lower than in the previous years. At the same time, the Council assessed that recently uncertainty as to the scale and duration of the economic slowdown abroad and its impact on domestic economic activity had increased. The majority of the Council members underlined that although in the coming quarters the annual inflation rate might remain above the upper limit of deviations from the inflation target, it would be the result of the impact of supply-side and regulatory factors and would therefore remain beyond the direct influence of domestic monetary policy. In the opinion of these Council members, as the impact of those factors faded, and amid the anticipated slowdown in GDP growth, inflation would subside and return close to the inflation target over the monetary policy horizon. Such an assessment was supported by the results of the March inflation and GDP projection.

The Council members pointed out that due to the increased uncertainty about the global growth outlook and the further development of the economic situation and inflation in Poland, uncertainty about the further development of the NBP interest rates had, however, increased recently.

Certain Council members assessed that over the monetary policy horizon inflation might be higher than indicated by the current forecasts. They pointed out that such a risk was related to the possible persistence of some of the factors currently raising price growth. However, these Council members judged that the NBP interest rates should remain unchanged at the current meeting of the Council due to the increased uncertainty about the further economic situation around the world and its impact on the business climate and inflation in Poland.

In turn, other Council members emphasised that recently the risk of a sharper and longer-lasting global economic slowdown had continued to increase, and at the same time further signs had appeared indicating the transmission of the weak global business conditions into economic growth in Poland. In this context, these Council members drew attention to the additional risks related to the spread of the coronavirus. At the same time, these Council members judged that in the medium term inflation would be in line with the NBP target. As a result, a view was maintained that it was justified to lower the NBP interest rates now and that – in the longer run – it might be justified to consider further cuts in interest rates or the introduction of unconventional monetary policy instruments. Certain Council members pointed out that the assessment regarding the possible justification of monetary policy easing going forward would be possible after more information had become available regarding the situation in the global and domestic economy.

At the meeting, a motion to cut the basic NBP interest rates by 0.25 percentage points was submitted. The motion was rejected. The Council decided to keep the NBP interest rates unchanged: the reference rate at 1.50%, the lombard rate at 2.50%, the deposit rate at 0.50% and the rediscount rate at 1.75%.

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