MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 28 APRIL 2010

During its meeting the Monetary Policy Council discussed primarily the situation in the external environment of the Polish economy, including the possible consequences of the fiscal crisis in Greece, and the outlook for economic growth and inflation in Poland.

While addressing the situation abroad, it was pointed out that the economic activity abroad was gradually rising, although the scale of the recovery varied strongly between the regions. It was indicated that in March – for the first time since the beginning of the recession brought about by the financial crisis – a marked rise in employment in the United States was observed, which further boosted consumer demand in that economy. At the same time, it was emphasised that further improvement in the labour market would be achieved gradually. Moreover, it was assessed that the persistently limited scale of lending in the United States contributed to curbing demand in this economy in the months to come.

In the discussion about the euro area some members of the Council pointed at further increase in industrial output and improvement in business confidence indicators. Those members pointed out that rapid economic growth in the developing Asian countries leads to growing demand of these countries for euro area exports, thus contributing to GDP growth in the euro area. Other members of the Council emphasised, however, that the revival in the economic activity in the euro area was significantly weaker than in the United States, whereas, in the opinion of some Council members, this was mostly the effect of a relatively larger scale of fiscal and monetary expansion in the US economy in the preceding period. Those members also pointed out that the persistently unfavourable situation in the euro area labour market contributed to curbing consumer demand, which was reflected in the decline in retail sales in the first months of 2010. Yet, it was emphasised that unfavourable weather conditions were also an important factor behind this decline.

The Council paid much attention to the fiscal situation in the major developed economies. It was assessed that public debt accumulation in the United States and in the euro area, being the effect of the previously introduced stimulus packages, constituted the main risk factor for their economic growth. On the one hand, reduction of budget deficits, although likely to support economic growth in the longer run, could lead to another decline in activity in those economies in the short run. On the other hand, maintenance of the loose fiscal policy would be a factor limiting economic growth due to the ensuing increase in long-term interest rates.

While addressing the situation in Greece, some members of the Council pointed out that the fiscal crisis in that country would trigger tensions in the international financial markets and a rise in the market interest rates also in other economies, in particular, in the euro area countries with distinctly strong fiscal imbalances. The differences in the public finance situation and in capacity for its improvement amplify the diversity in the outlook for growth in particular euro area economies. In the opinion of those Council members, a contingent insolvency of the Greek government would entail losses for financial institutions operating in Europe that hold Greek government securities, which might contribute to a repeated limited access of European enterprises to bank credit. This would also significantly increase agents' uncertainty about the future economic situation, leading to a decline in the economic activity. At the same time, some members of the Council argued that although granting financial aid to Greece by other euro area countries would mitigate the current crisis, it might, in the longer run, translate into a decline in the confidence of financial market participants in the fiscal policy pursued in the euro area countries. This would, in turn, on the one hand, contribute to a rise in the market interest rates in those economies, and, on the other hand, weaken the euro exchange rate and increase the volatility of exchange rates of other currencies, including the zloty.

While analysing the situation in the Polish economy, a slight upward revision of GDP in 2009 Q4 and better than expected data on industrial output and retail sales were indicated. It was also stressed that economic recovery was observed mainly in industry. Some members of the Council pointed out that in March 2010 the sold production of industry reached higher level than before the economic slowdown, and its growth in the recent period was observed in the majority of the sections. They emphasised the improvement in enterprises' expectations about their economic situation and future demand as well as the fact that, although economic recovery had not translated yet into a rise in corporate investment activity, a higher than in the previous quarters percentage of firms surveyed by the NBP continued the already started investment projects. Those members also emphasised that the change in inventories might have a positive contribution to GDP growth in the subsequent quarters, which was signalled by a decreasing percentage of the surveyed enterprises reporting excessive levels of inventories of finished products and by an increasing percentage of firms assessing their inventory levels as too low. Yet, other members of the Council pointed at the deepening decline in the annual growth of corporate investment in 2009 Q4 as well as the decline in construction and assembly output and still low growth of retail sales in the whole of 2010 Q1. The Council also emphasised that the outlook for economic growth in Poland depended largely on the developments in the external environment, including the way the fiscal crisis in Greece will be contained and the fiscal problems of other economies solved.

Some members of the Council argued that the possible persistence of weak economic activity in the euro area, which is Poland's main trading partner, would limit the growth in Polish exports, thus slowing down GDP growth. Other members of the Council pointed out that – despite low economic activity in the euro area – in the past months Polish exports increased steadily, which was driven by the growing demand of Asian countries for European goods, produced with the use of Polish intermediate goods. They also pointed out that in the light of the NBP surveys, the situation of Polish exporters was improving and profitability of exports was high despite the appreciation of the zloty.

While discussing the situation in the labour market, it was emphasised that the data for March 2010 signalled possible deceleration of unfavourable tendencies in that market: acceleration in the annual wage growth and some stabilisation of employment in the enterprise sector, stabilisation of the employment rate (adjusted for seasonal factors) and a rise in the number of new job offers. Some Council members argued that a certain improvement in the labour market situation in 2010 Q1 was also indicated by the results of NBP survey studies of enterprises which pointed to a probable acceleration of wage growth in the following quarter. Other members of the Council assessed that the situation in the labour market will be improving only gradually and the improvement may not occur in some sectors of the economy, particularly construction.

In the discussion about current inflation it was pointed out that in March 2010 the annual CPI inflation fell to a level close to the NBP inflation target; all measures of core inflation and the HICP had also declined, while the PPI remained negative. Some Council members, however, argued that the decline in CPI inflation in March was largely driven by lower annual growth of the prices of food and Internet services, which – according to these Council members – are not sensitive to shifts in demand pressure. In this context, they assessed that demand pressure might be better reflected by the growth of prices in the category *restaurant and hotel services* which remains relatively high.

Those members also pointed out that Poland had not complied with the Maastricht price stability criterion for many months.

While analysing the outlook for inflation, some members of the Council pointed out that in line with the available forecasts the CPI inflation in the coming months would be running below the NBP inflation target. This would primarily result from a moderate demand pressure reflected in low production capacity utilisation, recently observed zloty appreciation and low growth of labour costs in the economy, including their decline in industry. In the opinion of those Council members, demand pressure should be curbed by a relatively high unemployment rate and low growth of lending to the private sector, including in particular the decline in loans granted to enterprises. At the same time, it was assessed that inflation decline may be limited by rises in commodity prices in the world markets (though this effect may be offset by the so-far zloty appreciation) and by the persistently elevated growth of some administered prices. Other members of the Council assessed that the scenario of the annual CPI inflation running markedly below the inflation target for an extended period was rather improbable as the recovery in the Polish economy and an improvement in the labour market situation (which was probable in the light of the latest data), including in particular a possible acceleration of wage growth, will lead to a gradual build-up of demand and cost pressures. They argued that a decline in unit labour costs was typical of the current phase of the business cycle and it may be expected that further recovery in the economic activity would be accompanied by their faster growth. Moreover, in view of those Council members, the drop in lending to enterprises may be reflecting low credit needs on the part of companies due to their good financial situation. It was emphasised, however, that in the assessment of banks the decline in the demand for credit mainly applied to large enterprises, while the demand of small and medium-sized enterprises was rising.

Some Council members pointed to the data on industry which indicated that in comparison to the situation before the economic slowdown the highest increase in output was recorded in the case of consumer goods. In view of those Council members, this may suggest that the utilisation of production capacity in enterprises producing consumer goods was higher than in the industrial sector on average, which may be relevant for the assessment of the future price growth of those goods. Other members of the Council, however, emphasised that consumer goods were internationally tradable goods, which should be curbing their price growth even amid high utilisation of production capacity in their producers.

The members of the Council also referred to the unfavourable public finance situation. It was pointed out that the loose fiscal policy was contributing, through the large issue of Treasury securities, to increased involvement of non-residents in the bond market. This raises the vulnerability of the Polish economy to a possible turmoil in the global financial markets leading to capital outflows from emerging market economies. Some Council members assessed that in the event of no public finance consolidation the costs of financing the public debt would continue to rise due to, among others, a possible ensuing increase in the inflation expectations of economic agents. They also pointed out that the yields on Treasury securities in Poland were currently higher then in some other countries of the region. Other members of the Council believed that the current fiscal imbalance did not pose a direct risk of higher inflation amid the currently low inflation pressure, though they shared the opinion that the continuation of such imbalance in the longer term would be a factor limiting the GDP growth.

While addressing the exchange rate issues, some Council members assessed that zloty exchange rate developments might have been affected by expectations of future changes in the interest rate disparity between Poland and the euro area. Other members of the Council, however, argued that changes in zloty exchange rate were to a large extent driven by factors other than the current and expected interest rate disparity, including in particular shifts in the sentiment in the global financial markets.

The Council assessed that the low inflationary pressure over the monetary policy transmission horizon and the uncertainty as to the impact of the situation in the external environment on the outlook for economic growth in Poland justified keeping the NBP interest rates unchanged at the current meeting.

The Council kept the interest rates unchanged: the reference rate stands at 3.50%, the lombard rate at 5.00%, the deposit rate at 2.00%, the rediscount rate at 3.75% and the discount rate at 4.00%.

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