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Monetary Policy Council

MINUTES OF THE MONETARY POLICY COUNCIL DECISION-MAKING MEETING HELD ON 30 MAY 2007

During the meeting, the Monetary Policy Council discussed the outlook for inflation in the context of the past, current and, primarily, expected economic situation.

The Council addressed the prospects of economic growth and their impact on inflation.

Some Council members emphasised that the structure of the current economic growth is favourable to low inflation. They pointed out that the robust growth in investment and its structure, characterised by a relatively low share of construction projects, will contribute to fast growth in potential output, thus curbing inflationary pressure. Strong growth in potential output will also be facilitated by a large inflow of foreign greenfield investment supporting increase in productivity. Furthermore, some Council members indicated that the April data concerning industrial production and retail sales as well as business indicators in manufacturing, construction and retail sales might suggest a possible minor slowdown in economic growth in 2007 Q2.

Other members of the Council emphasised that GDP is still rising faster than potential output, leading to a widening of the output gap and a rise in inflationary pressure. In their opinion, in the subsequent quarters the high economic growth will be sustained, primarily due to fast increase in domestic demand supported by rapid growth in the wage fund and lending activity. Those members emphasised that investment growth will boost potential output only in the longer term. They assessed that there is a considerable risk that in the medium term the GDP growth exceeding the growth of potential output will lead to a rise in inflation above the inflation target. Moreover, they argued that although the increase in imports and price competitiveness related to globalisation will limit the influence of domestic output gap on inflation, the scale of the impact of those factors might be insufficient to maintain inflation at the target level.

During its meeting, the Council discussed the situation in the labour market. Council members agreed that the developments in the labour market were the main risk factor for inflation increase. However, they differed in their interpretation of the inflowing data and their assessment of the impact of the current situation in the labour market on inflation.

Some Council members assessed that GUS data concerning the growth of wages in the corporate sector in April 2007 and wages in the economy as a whole in 2007 Q1 confirmed that wage growth has been accelerating. They pointed out that dynamic wage growth was observed in all major groups of enterprises. Some members of the Council signalled that strong wage growth in enterprises was accompanied by increasing wage pressure in the public sector, which is reflected in numerous industrial actions. They indicated that the rapid growth of wages was driving a considerable - and significantly higher than suggested by the NBP April projection - increase in unit labour costs in the economy. Moreover, some Council members pointed at a very fast - and higher than suggested by the April projection - decline in the unemployment rate recorded in the BAEL data, which may fuel further wage growth. Council members assessed that rapid wage growth, by raising costs and disposable income, improving consumer sentiment and increasing demand, may contribute to acceleration in price growth.

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Other Council members emphasised that April saw a decline in the growth rate of wages in the corporate sector. They pointed out that for a few years the share of labour costs in the costs of large and medium enterprises has been decreasing and that in 2007 Q1 the rapid wage growth was accompanied by considerable improvement in the profitability of enterprises amidst stable inflation. Those members also observed that despite a considerable fall in unemployment, it still remains relatively high, which suggests the presence of significant 'free' labour force in the economy. Some members of the Council noted that accelerating wage growth does not necessarily have to lead to a rise in inflation due to increase in competitive pressure driven by globalisation and a very good financial standing of enterprises allowing them to partially absorb wage increases without the need to change their goods and services prices. Furthermore, they pointed out that inflationary pressure might also be constrained by rising efficiency related to high investment growth and enterprises' restructuring.

Referring to current inflation indicators, some Council members assessed that the April decline in net inflation and in the growth rate of producer prices in industry, which accompanied the decrease in CPI inflation, might signal low inflationary pressure. However, other members of the Council noted that the April decline in net inflation was mainly the result of the statistical base effect. They also emphasised that given the growing importance of global factors in determining domestic inflation developments, an important indicator of domestic inflationary pressure is the growth rate of services prices, which has been gradually rising since mid-2006 and which now significantly exceeds the growth rate of prices of consumer goods and services. Some Council members pointed out that the increase in inflation expectations is a risk factor for inflation. They observed that in April inflation forecasts of bank analysts exceeded the level of the inflation target for the first time for more than two years.

Some discussants emphasised that domestic inflation is to an increasing extent determined by global factors. They pointed out that due to high credibility of monetary policy conducted by major central banks, global inflation can be expected to remain at a low level which would be conducive to the stabilisation of domestic inflation. However, they also indicated that a possible increase in the world food prices resulting from supply factors is a new global risk factor for inflation.

One of the issues discussed at the meeting was the impact of the zloty exchange rate on inflation. In this context, the influence of fundamental factors as well as trends in the international financial markets was considered.

One of the issues addressed at the meeting was the situation in the public finance sector. Some Council members assessed that lower than expected general government deficit will partly offset rising demand in the private sector and mitigate its effect on inflation. Yet, other members of the Council argued that the observed improvement of the situation in public finances is a cyclical phenomenon and as such is not a factor which will limit price growth in the monetary policy transmission horizon.

At its meeting the Council also discussed developments in monetary and credit aggregates. Some Council members assessed that the persistently high growth in lending will support strong increase in private consumption, and consequently, in aggregate demand and inflation. They pointed out that as a result of the pro-cyclical nature of credit growth, in the coming months a further rapid increase in household and corporate indebtedness in the banking sector can be expected. Those members also indicated that for a few months the share of consumer loans in the credit structure has been rising and that those loans might be directly translated into growing demand and inflationary pressure. Other members of the Council assessed that apart from a slight, in their opinion, change in the lending structure, the monetary and credit developments are a continuation of the hitherto observed trends and should not constitute a risk for inflation growth.

During the meeting the Council also discussed the levels of real interest rates and their impact on inflation. Some Council members noted that the economic recovery observed in Poland started and has been reinforced in a situation when real interest rates were markedly higher than today. They therefore assessed that the current level of interest rates probably does not prevent widening of the output gap and rise in inflationary pressure. Moreover, those members pointed out that amidst the globalisation-related weakening of a short-term link between economic activity and inflation, the cost of a monetary policy tightening aimed at bringing inflation back to the target would be considerably higher than the cost of preventing inflation growth. However, other members of the Council pointed out that the level of real interest rates is still relatively high, especially when compared to other countries in the region. In this context, Council members exchanged their opinions concerning the future path of the NBP interest rates.

At the meeting a motion to raise the key NBP interest rates by 25 basis points was put forward and rejected. The Council kept the interest rates unchanged: the reference rate at 4.25%, the lombard rate at 5.75%, the deposit rate at 2.75% and the rediscount rate at 4.50%.