NBP

National Bank of Poland
Monetary Policy Council

# MINUTES OF THE MONETARY POLICY DECISION MAKING MEETING HELD ON 3 JULY 2013

At its meeting, members of the Monetary Policy Council discussed the current and future monetary policy decisions in the context of macroeconomic developments in Poland and abroad.

While assessing economic conditions abroad, some members of the Council emphasised that although the situation in the United States was improving steadily, even though slowly, (as evidenced, in particular, by growing employment), global economic growth remained weak. In this context, it was pointed out that the euro area recession – which probably persisted in the first half of 2013 – had been accompanied by further downward revision of GDP growth forecasts for this economy and postponement of its recovery. Moreover, some members of the Council pointed to the signs of deteriorating economic climate in some major developing countries, including China, which negatively affected activity in the euro area, and, indirectly, also in Poland. At the same time, members of the Council observed that the second half of 2013 was expected to bring a gradual improvement in the global economic conditions and, in particular, an end to the euro area recession. A few members of the Council assessed that even amidst low GDP growth in the euro area, a relatively fast growth in Polish exports to that economy was possible, especially if economic activity in Germany remained considerably higher than in other euro area countries.

It was pointed out that the recent signals from the Federal Reserve that it might start QE tapering caused a deterioration of the financial market sentiment. The deterioration of the global financial sentiment resulted in some outflow of capital from the emerging markets and a depreciation of their currencies. When assessing the impact of the situation in the international markets on the domestic financial market, some members of the Council emphasized that, as compared to other emerging economies, the change in prices of Polish assets (including an increase of yields on Treasury bonds and zloty depreciation) was limited. In the opinion of those Council members, this might be a sign of favourable perception by investors of the Polish economy fundamentals. Yet, a few Council members assessed that the risk of renewed rise in financial market uncertainty in emerging markets, including Poland, should be taken into account. They also pointed to the recent outflow of portfolio capital from Poland, related to lower relative attractiveness of investing in Polish Treasury bonds.

Referring to the July NBP projection, some members of the Council emphasized that the central paths of GDP and inflation in Poland were slightly lower than those in the March projection; yet, this was mainly visible for the coming quarters. In the medium term, both projections were very similar and pointed to a gradual recovery in economic growth and a slow rise in inflation.

When analysing the current economic situation in Poland, some Council members pointed to the signs of persistently weak domestic conditions, including further fall in industrial output in May 2013 and deepening decline in construction output, as well as continued slow growth in retail sales. Those members of the Council stressed that economic climate indicators did not clearly signal trends in economic activity, and the continued low level of lending to the private sector suggested that the possible strengthening of GDP growth in the coming quarters was likely to be gradual and moderate.

Some members of the Council argued that the significant decrease in the NBP interest rates implemented since November 2012 supported economic recovery, although it cannot completely offset the negative impact of external conditions, fiscal tightening and deteriorating corporate sentiment on domestic GDP growth. According to those members of the Council, economic growth is negatively influenced, in particular, by concerns about a prolonged recession or stagnation in the euro area, discouraging enterprises from investing. In such a situation, if the outlook for demand cease to deteriorate and if enterprises start to expect economic recovery in the coming quarters, lower cost of financing could become a significant factor supporting investment. In the opinion of a few Council members, increasing production capacity utilization and some rise in the total cost estimate value of newly launched investment were among signs of a possible recovery in investment activity in the near future. Low interest rates also encourage consumption, in particular by reducing households' loan repayment burden of zloty denominated loans.

In the opinion of some Council members, in the longer term, domestic demand might also be supported by the launch of the new EU Financial Perspective for 2014-2020. At the same time, the expected recovery in consumption would reduce the contribution of net exports to GDP growth. A few Council members also pointed to the uncertainty about the scale of further fiscal tightening, which might be significantly smaller than currently declared.

When addressing the situation in the labour market, attention was paid to slower decline in employment in the enterprise sector in May 2013, as expressed in annual terms. Yet, it was emphasised that, at that moment, it was difficult to assess the sustainability of the observed changes. At the same time, it was pointed out that unemployment continued at a relatively high level, further supporting low wage growth.

While discussing inflation developments in Poland, attention was drawn to a further decline in inflation in May 2013, down to 0.5%, i.e. a level significantly below the NBP's inflation target of 2.5%. Some members of the Council emphasized that the available forecasts pointed to the possibility of inflation running at a very low level in the coming months. Those Council members argued that also in the coming quarters inflation was likely to continue well below the NBP target. In their opinion, this was evidenced by the deepening decline in producer prices and low wage growth, indicating the absence of cost pressure in the economy, as well as stagnation in consumption in the 2013 Q1 and only a minor increase in retail sales in 2013 Q2, signalling the lack of demand pressure.

When analysing the July inflation projection, some members of the Council emphasized that such factors as the gradual acceleration of economic growth and the probable persistently negative output gap until the end of the projection horizon would curb price growth in the coming quarters. Similarly, slow growth in unit labour costs and the expected – amidst low global demand – stabilization of commodity prices in the world markets should be conducive to low inflation. That meant, in the opinion of those Council members, that the return of inflation to the target would be gradual. Yet, other members of the Council pointed out that according to the July projection growth in food and energy prices, including oil prices, as well as growth in wages would remain below the level recorded in past, while zloty exchange rate was anticipated to be slightly stronger than currently observed. According to those Council members, should these variables develop more in line with previously observed values, it is likely that the rise in inflation will be faster than indicated by the July projection. In this context, a few members of the Council emphasized that some of the available forecasts, including forecasts by financial analysts, indicate the possibility of inflation returning to the target already in 2014. Those Council members also emphasized that the estimates of the current output gap, as being a non-observable variable, were always uncertain. According to the opinion of those Council members output gap may be less negative than indicated in the July projection.

While discussing monetary policy decisions, some members of the Council assessed that interest rates were at very low levels, and their further reduction might discourage households from holding funds on bank accounts. A few Council members also emphasized that excessive interest rates cuts would create an incentive to accept greater risks, e.g. by undertaking low-productivity projects that eventually may prove unprofitable, and would lead to changes in the structure of bank lending (rising role of mortgage lending amidst reduced lending to companies). According to those Council members, for the above reasons it would be justified to keep the interest rates unchanged.

Most of the Council members assessed, however, that the prolonged economic slowdown and the lack of inflationary pressure, together with the medium term outlook for the economy, as indicated, among others, by the July projection of inflation and GDP – spoke in favour of lowering interest rates at the current meeting. Further monetary policy easing was expected to support economic recovery and the return of inflation to the target.

Most of the Council members agreed that the decision to cut interest rate taken in July should mark the end of the loosening cycle of monetary policy started in November 2012. Members of the Council pointed out that the gradual recovery in demand expected in the second half of the year should translate into a slightly stronger economic growth. However, in their opinion, in view of the persistently negative output gap, inflation was likely to remain at very low levels for several quarters ahead. Yet, according to those members of the Council, economic activity should steadily improve, which – combined with the effects of a significant monetary policy easing – would encourage the return of inflation to the target in the medium term. In the opinion of the majority of the Council members, the current level of interest rates, including the July cut, would support economic recovery and the return of inflation to the target, while, at the same time, it would reduce the risk of adverse effects of excessive interest rates cuts for the financial system and the economy. In addition, those Council members pointed out that signalling the end of the loosening cycle would contribute to reducing the uncertainty about monetary policy in the future.

A few Council members pointed out, however, that no declarations as to probable future course of monetary policy should be made. They claimed that at present it was difficult to assess the impact of the government’s planned changes in public expenditure and revenue on economic activity and inflation in Poland. In the opinion of those Council members, another reason against declaring probable future course of monetary policy was the persistent uncertainty about financial markets' response to the signals of limiting monetary expansion in the United States and to the assessment of the economic and institutional reforms in the euro area.

At the meeting, a motion was submitted to lower the NBP basic interest rates by 0.25 percentage points. The motion passed. The Council decided to lower the NBP basic interest rates by 0.25 percentage points to the following levels: reference rate to 2.50%, lombard rate to 4.00%, deposit rate to 1.00%, rediscount rate to 2.75%.

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