Inflation Report
July 2013

National Bank of Poland
Monetary Policy Council

Warsaw, July 2013

The *Inflation Report* presents the Monetary Policy Council's assessment of the current and future macroeconomic developments influencing inflation. The projection of inflation and GDP presented in Chapter 4 was prepared at the Economic Institute of the National Bank of Poland. In terms of the contents, works on the projection were supervised by Andrzej Sławiński, General Director of the Economic Institute. The projection was prepared with the use of the NECMOD macroeconomic model. The NBP Management Board approved the submission of the projection to the Monetary Policy Council. The inflation projection is one of the inputs to the Monetary Policy Council's decision-making process.

The time horizon of the analysis presented in the *Report* is conditioned by the availability of macroeconomic data. In turn, the periodisation of the analysis (breakdown into sub-periods) is conditioned by the development of particular variables. The cut-off date for the data in this *Report* was 20 June 2013.

This *Inflation Report* is a translation of the National Bank of Poland's *Raport o inflacji* in Polish. In case of discrepancies, the original prevails.

CONTENTS

SUMMARY

While global economic activity persisted at low levels in 2013 Q1, growth rates continued to vary across both developed and emerging economies. The euro area saw further recession in 2013 Q1 and probably also in 2013 Q2. Among the largest euro area economies, positive growth in 2013 Q1 was only recorded in Germany. At the same time, activity in the United States accelerated, though fiscal tightening might have reduced demand growth in this economy in 2013 Q2. In some major emerging economies GDP growth accelerated in 2013 Q1, however in China it decreased slightly.

Low economic activity across the world has helped maintain inflation at a moderate level. Further inflation decline in developed countries was supported by both low demand and falling global commodity prices, the latter translating into slower food and energy price growth. In turn, in many emerging economies demand pressure did not intensify, and the temporary increase in inflation was related to faster food price growth, which, however, has slowed down recently.

Since the March *Report,* the major central banks have continued highly expansionary monetary policy, with some of them extending the scale of quantitative easing. The ECB reduced the rate on main refinancing operations by 0.25 percentage points and retained the readiness to implement the programme of purchasing sovereign bonds of countries most severely affected by the debt crisis. The Bank of England increased the scale of its Funding for Lending Scheme announced in June 2012 and extended its duration, while Bank of Japan announced a new asset purchase programme. At the same time, the Fed upheld its declaration of leaving the short-term interest rates close to zero and kept the pace of its asset purchases unchanged indicating, however, in mid-May and mid-June 2013 that the pace of asset purchases could be reduced later in the year. Many central banks in the emerging economies and small advanced economies continued to ease monetary policy or left their interest rates unchanged.

Since the previous *Report,* sentiment in the international financial markets was highly volatile. Before mid-May 2013, the financial markets experienced improving sentiment on the back of continued quantitative easing by the major central banks and expected gradual improvement in economic conditions in developed countries. However, in many emerging economies the sentiment improvement was constrained by worse than expected economic data. The deteriorating sentiment in financial markets since mid-May 2013 was triggered by signs of earlier than expected slowdown in quantitative easing in the United States. This translated into a sharp drop of share and bond prices in majority of the markets, in particular in the emerging markets. Deteriorating sentiment in international financial markets since mid-May has been reflected in a significant depreciation of the emerging market currencies.

In Poland, the annual growth in the prices of consumer goods and services kept declining. In May 2013, it reached 0.5%, i.e. it ran below the lower limit for deviations from the NBP inflation target. Decline in inflation was primarily supported by lower growth in energy prices, which translated into further reduction in the cost pressure in the economy. Another factor reducing inflation in the analysed period was the weakening of the growth in food prices. At the same time, declining inflation was attributable to the lack of demand and wage pressures. Individual consumption was in stagnation and wage growth kept weakening. Most measures of inflation expectations declined, including expectations of firms and households.

Following a substantial slowdown in 2012, in 2013 Q1 the annual GDP growth edged down (to 0.5% y/y in 2013 Q1 against 0.7% y/y in 2012 Q4). In 2013 Q1, economic activity was dampened by further decline in domestic demand, though less pronounced than in 2012 Q4. The fall in domestic demand was due to persistently negative growth of investment, slight drop in total consumption and negative contribution of inventories to GDP growth. At the same time, GDP growth was supported by positive, though significantly lower than in 2012 Q4, contribution of net exports.

Further slowdown in domestic demand in 2013 Q1 translated into employment decline. A fall in the number of working persons in the economy contributed to a further increase in the unemployment rate. At the same time, a modest growth in the number of economically active persons was observed. Data on wage growth and unit labour costs suggest a lack of wage pressure. In 2013 Q1, both annual wage and unit labour cost growth in the economy declined in comparison with 2012 Q4.

In recent months, the Monetary Policy Council continued to reduce the NBP interest rates. Since early March 2013, interest rates have been decreased three times, by a total of 1 percentage point. As a result, the NBP reference rate stands currently at 2.75%[1]. Having reached their historical lows in May 2013, Polish sovereign bond yields increased driven mainly by global factors. At the same time major Polish stock exchange indices fell as well.

Following a period of stabilization from September 2012, in mid-May 2013 the zloty depreciated notably, similarly to other emerging market currencies. Initially, the zloty was adversely affected by weaker than expected data on domestic economic growth. Since late May, however, deteriorating sentiment in international financial markets and related capital outflows from emerging markets have also taken their toll. In June 2013 the NBP sold a certain amount of foreign currency for zlotys. Foreign exchange interventions are compliant with the monetary policy strategy pursued by the NBP as presented in *Monetary Policy Guidelines for 2013*.

Since the previous *Report*, lending growth continued on a downward trend. In 2013 Q1 and in April-May 2013, corporate debt increased only slightly. At the same time growth of mortgage loans to households gradually decreased, while debt resulting from consumer loans – despite some revival in this market segment – kept declining. Growth in broad money – despite some acceleration since February – remained at a relatively low level. The value of corporate deposits, after a drop in 2013 Q1, in April-May 2013 increased considerably. In turn, the value of household deposits at the end of the analysed period decreased, which could have been driven by change in a structure of households' financial assets (in particular increased exposure to investment funds and shift to deposits with longer maturity).

In 2013 Q1, the current account deficit narrowed substantially driven by an improvement in the trade in goods account. At the same time a higher deficit in the income account was a main factor adding to the current account imbalance. Income deficit persists at high levels due to substantial income receipts of foreign direct investors, supported by strong financial performance of Polish businesses. In 2013 Q1,

[1] This section covers the situation in the market between 1 March 2013 and 20 June 2013 and does not include the decision of the Council of July 2013. The decision of the Council from July has been presented in Chapter 3 in the "Minutes of the Monetary Policy Council meeting held on 2-3 July 2013."

the surplus in the capital account decreased on the year before as a result of, among others, lower EU investment transfers. In turn, the surplus in the financial account rose in 2013 Q1 compared with the corresponding quarter of 2012, though portfolio investment flows to Poland weakened.

The *Inflation Report* is structured as follows: in Chapter 1 economic developments in the external environment of the Polish economy are presented in the context of their impact on inflationary developments in Poland. Those developments as well as domestic factors affecting them are discussed in Chapter 2. *Minutes of the Monetary Policy Council decision-making meetings* held in March-June 2013 together with the *Information from the meeting of the Monetary Policy Council* in July 2013 are presented in Chapter 3. Minutes from the MPC meeting held in July will be published on 22 August 2013 and so will be included in the next *Report*. MPC voting records in the period February-May 2013 can be found in Chapter 5. Moreover, Chapters 1 and 2 of this *Report* include two boxes: "Loan refinancing programmes of selected central banks" and “The impact of fiscal tightening on GDP growth under present conditions”.

Chapter 4 of the *Report* presents the projection of inflation and GDP based on the NECMOD model, which is one of the inputs into the Council's decision-making process on the NBP interest rates. In line with the July projection based on data available up to 13 June 2013 (cut-off date for the projection) – under the assumption of constant NBP interest rates – there is a 50-percent probability of inflation running in the range of 0.6-1.1% in 2013 (compared to 1.3-1.9% in the March projection) and 0.4-2.0% in 2014 (as against 0.8-2.4%) and 0.7-2.4% in 2015 (as against 0.7-2.4%). In turn, with a 50-percent probability the July projection sees the annual GDP growth in the range of 0.5-1.7% in 2013 (compared to 0.6-2.0% in the March projection), 1.2-3.5% in 2014 (as against 1.4-3.7%) and 1.6-4.2% in 2015 (as against 1.9-4.4%).

Chapter 1

EXTERNAL ENVIRONMENT OF THE POLISH ECONOMY

1.1. Global economic activity

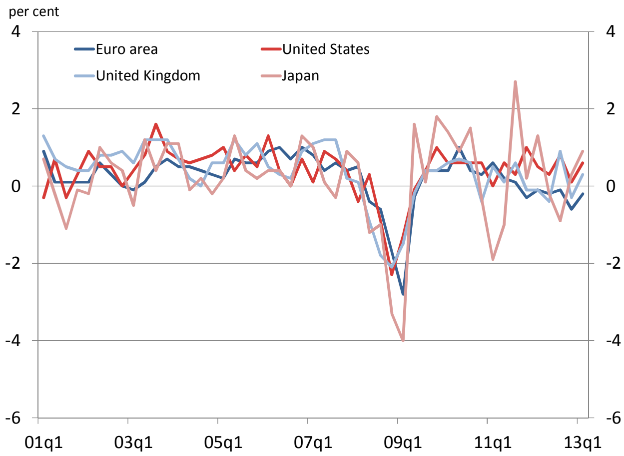
While global economic activity persisted at low levels in 2013 Q1 (Figure 1.1), growth rates continued to vary across both developed and emerging economies.

In the United States and Japan, output growth accelerated in 2013 Q1. By contrast, the euro area saw further recession. At the same time, growth in China declined slightly in the discussed period, while picking up in some other emerging economies (Figure 1.9). Business climate indicators pointed to a certain decrease in global economic sentiment at the beginning of 2013 Q2 (Figure 1.2).

GDP growth in the United States accelerated in 2013 Q1, reaching 0.6% q/q (as compared to 0.1% q/q in 2012 Q4; Figure 1.1)[2]. Output growth was supported by robustly expanding consumption, change in inventories and rising investment, especially housing investment. On the other hand, GDP growth was stemmed by falling government spending, in particular on defence, and a negative contribution of net

Figure 1.1

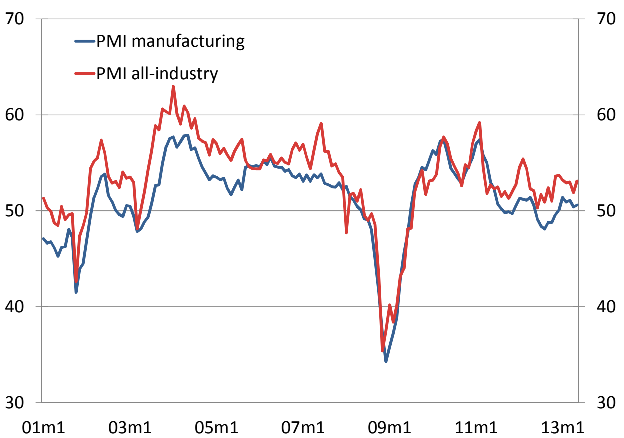
Economic growth in selected developed economies (q/q)[3]



Source: Eurostat data.

Figure 1.2

Global PMI index



Source: Bloomberg data.

[2] In annualised terms, GDP growth in 2013 Q1 amounted to 2.4 %q/q as against 0.4% q/q in 2012.

[3] The quarterly growth figures presented in this chapter are seasonally adjusted.

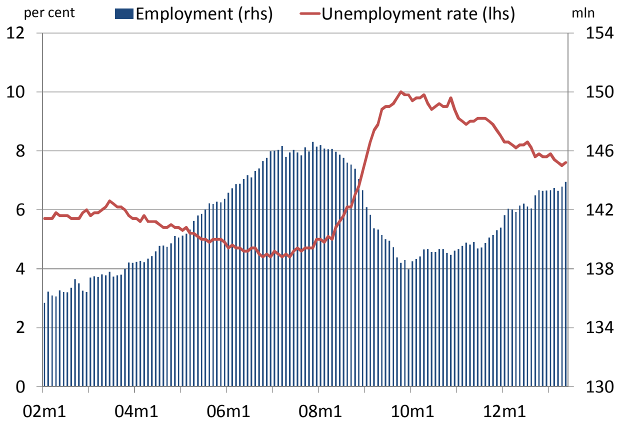
exports due to imports gaining more than exports.

Latest monthly data indicate that the fiscal tightening implemented in the United States could have somewhat depressed demand growth in 2013 Q2. Slightly weaker activity in this period is reflected in contracting industrial output and a decrease in business sentiment. In turn, retail sales data suggest that despite tax hikes, consumption continued to increase. This may be attributed to a drop in households saving rate as well as a further improvement in labour market conditions (including lower unemployment rate; Figure 1.3). Yet another contributor to demand growth has been a further rise in real estate prices.

In the euro area, GDP 2013 Q1 growth remained negative at -0.2% q/q (as against -0.6% q/q in 2012 Q4; Figure 1.4). This output decline was mainly driven by a fall in investment, which was responding adversely to considerable uncertainty prevailing in some countries and the resultant high financing cost as compared to long-term average. At the same time, household consumption stagnated as labour market conditions – and hence consumer confidence – deteriorated (Figure 1.6). Equally, public consumption growth was close to nought, stemmed by the public sector deficit reduction process. A positive contribution to GDP growth came from net exports, as imports had flattened more than exports.

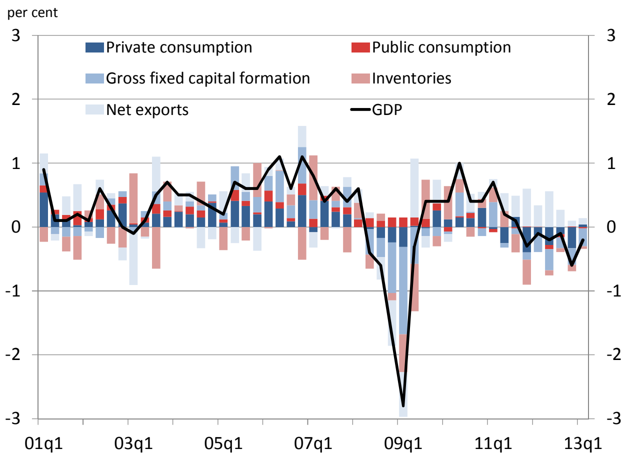
Monthly euro area data also indicated slow activity growth in the region in 2013 Q1 and early Q2. Although industrial output, following a substantial decline in 2012 Q4, in 2013 Q1 and early Q2 posted a marginal growth, corporate sentiment – despite improvement – indicated persistent recessionary trends (Figure 1.5). Continued decline in retail sales in April showed that household demand remained weak amidst further increase in the unemployment rate.

Figure 1.3
The registered unemployment rate and employment levels in the United States



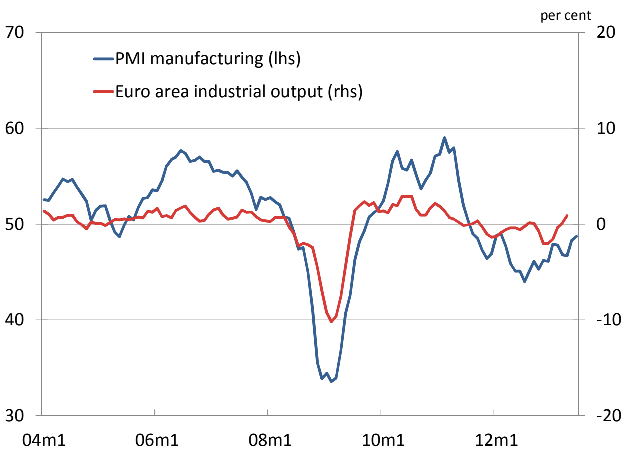
Source: BLS data.

Figure 1.4
GDP growth in the euro area (q/q)



Source: Eurostat data.

Figure 1.5
Industrial output growth* and PMI index in manufacturing in the euro area



Source: Eurostat data, Markit.
*Change in the 3-month moving average of the industrial output as against the average of three months before.

Among the largest euro area economies, positive growth in 2013 Q1 was recorded only in Germany (0.1% q/q as against -0.7% q/q in 2012 Q4). GDP growth in this economy was dragged by the protracted winter, which hampered activity in construction and transportation. Demand growth observed in this country in 2013 Q1 was mainly supported by household consumption rising on the back of favourable labour market trends, including low unemployment rate and sustained employment growth, amidst falling inflation. Yet, GDP growth was adversely affected by a further decline in investment.

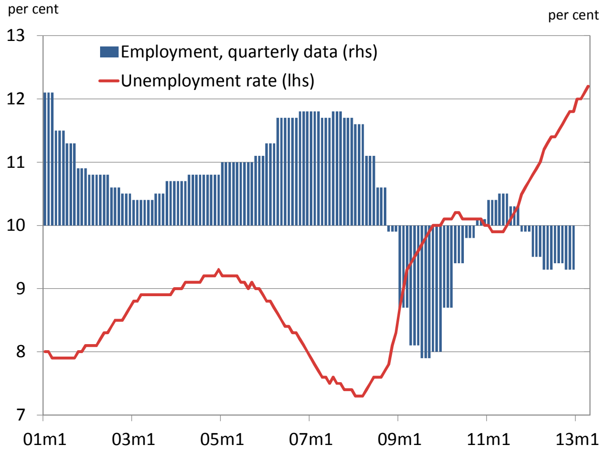
In France, GDP growth in 2013 Q1 remained negative at -0.2% q/q (as against -0.2% q/q in 2012 Q4). Factors with an adverse effect on output growth included a decline in investment and consumption demand coupled with – as exports were falling amidst stagnant imports – a negative contribution of net exports.

In Italy and Spain, two economies severely hit by the debt crisis and loss of competitiveness, GDP data confirmed further recession in 2013 Q1. Demand in these economies was hampered by decreasing consumption spending by households (related, in particular, to steadily rising unemployment rate) and falling investment (due to, in particular, bleak demand prospects, high cost of financing and its restricted availability). The impact of net exports on GDP growth was negative in Italy and positive in Spain, although in both these economies exports and imports were contracting. Moreover, in Spain, demand was continuously dragged down by a fall in public consumption related to fiscal consolidation.

In new EU member states outside the euro area, GDP growth in 2013 Q1 was also diversified (Figure 1.7, Figure 1.8) In the Czech Republic, recession continued, while in Hungary - following four quarters of decline – activity rebounded. Against the rest of the region, GDP growth remained high in Lithuania and Latvia.

Figure 1.6

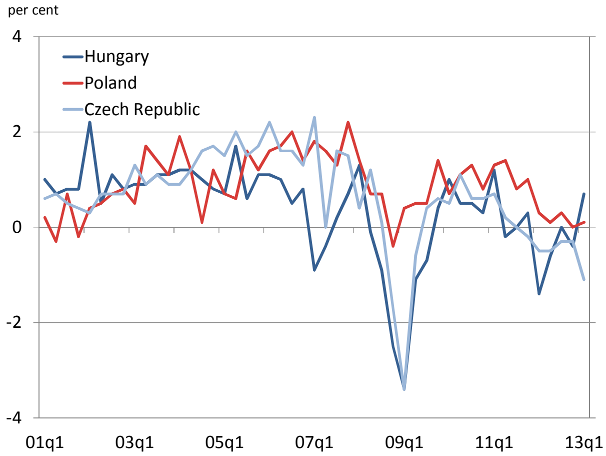
Employment (y/y) and unemployment rate in the euro area



Source: Eurostat data.

Figure 1.7

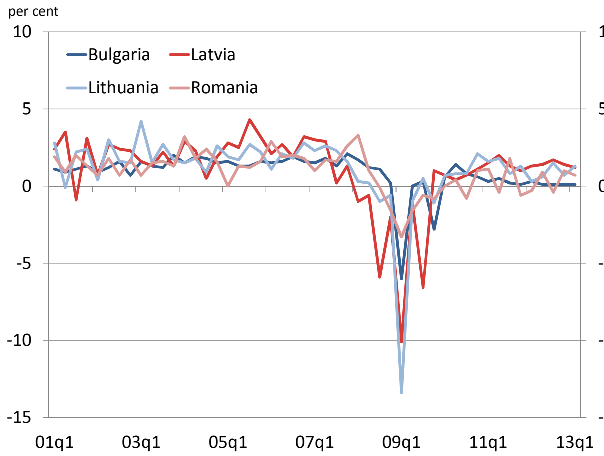
GDP growth in the Czech Republic, Hungary and Poland (q/q)



Source: Eurostat data.

Figure 1.8

GDP growth in Bulgaria, Lithuania, Latvia and Romania (q/q)

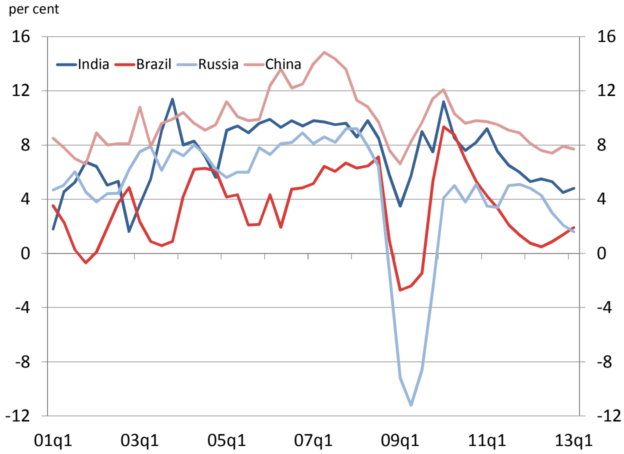


Source: Eurostat data.

In China, GDP growth in 2013 Q1 was close to that observed in the previous quarter and amounted to 7.7% y/y (as against 7.9% y/y in 2012 Q4; Figure 1.9). Output growth was supported by rising consumption and – albeit to a lesser extent than in the previous quarter – an increase in investment. Equally, net exports made a positive contribution to GDP growth. Available data show that among the largest emerging economies, GDP growth continued to decline in Russia, while in Brazil – and to a smaller degree, in India – it accelerated.

Figure 1.9

Economic growth in China, India, Brazil and Russia (y/y)



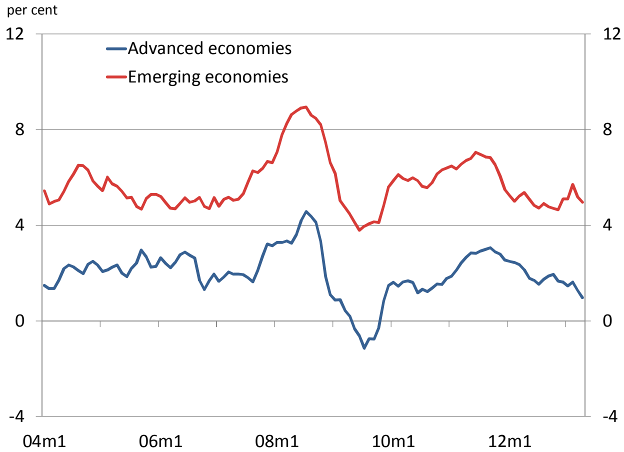
Source: Ecowin data.

1.2. Inflation developments abroad

Low economic activity across the world has helped maintain inflation at a moderate level, although in the last few quarters, price growth showed some divergence among groups of countries. In 2013, inflation continued on a downward trend in the developed economies, while in the emerging economies – after a period of rising inflation starting in mid-2012 – in March and April 2013 a significant decline in inflation was recorded (Figure 1.10).

Figure 1.10

Inflation in major advanced and emerging* economies (y/y)



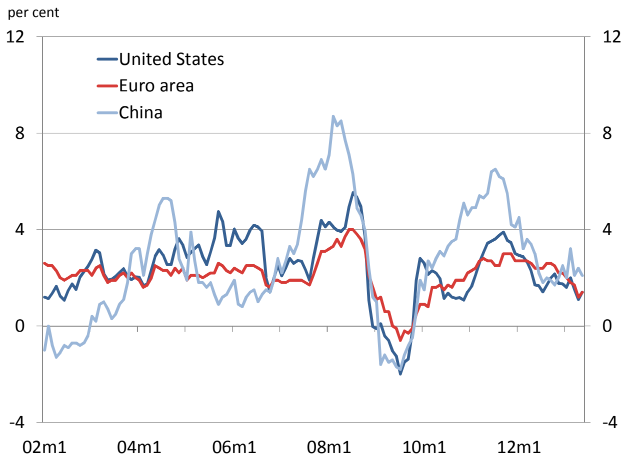
Source: IMF, OECD, Bloomberg data, NBP calculations.

*Weighted average inflation in the developed and the largest emerging economies (accounting for 80% of the GDP in this group of countries in 2011). Country groups in accordance with the IMF division. Weights adopted for the respective countries are based on their GDPs.

Further inflation decline in developed countries was supported by both low demand and falling global commodity prices, the latter translating into slower food and energy price growth. At the same time, in many emerging economies demand pressure did not intensify, and the temporary increase in inflation was related to faster food price growth, which, however, has slowed down recently.

Figure 1.11

CPI inflation in the United States and China and HICP inflation in the euro area (y/y)



Source: OECD, Eurostat data

Since the publication of the previous Report, inflation in the United States and the euro area continued to decline (Figure 1.11). In the United States CPI inflation stood at 1.4% y/y in May 2013 (compared with 1.7% y/y on average in 2013 Q1). Similarly, in the euro area, according to preliminary data, HICP inflation reached 1.4% y/y (against 1.8% y/y on average in 2013 Q1). In both economies, inflation decline resulted primarily from slower energy price growth; and in the United States – also from some deceleration of food price growth. Simultaneously, the negative output gap persisting in both the United States and the euro area was conducive to lower core inflation[4].

In turn, in some of the emerging economies, including China, inflation – after a temporary rise in the early months of 2013 – has recently decreased. The decrease in inflation followed a slowdown in food price growth, after a prior rise in food prices resulting from unfavourable weather conditions (Figure 1.11) At the same time, inflation in China was being fuelled in recent months by a slight rise in core inflation, which, however, remains at a level close to the average of the last two years.

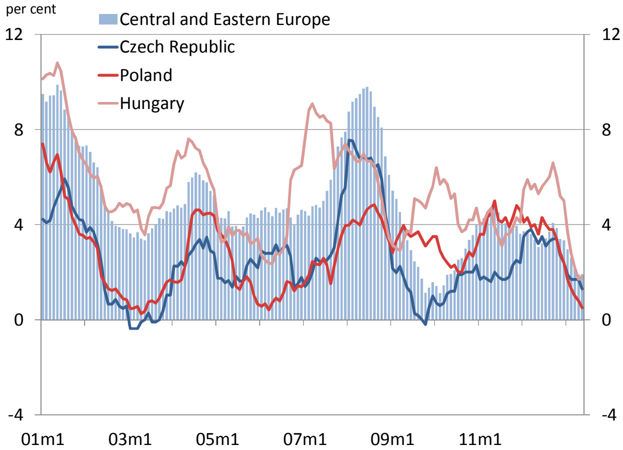
Turning to Central and Eastern European countries, inflation in that region has declined significantly in recent months (Figure 1.12), which resulted from a considerable fall in energy prices and a slightly smaller decrease in food prices. At the same time core inflation fell, as business conditions were weak. In some countries (the Czech Republic and Hungary) lower inflation this year resulted also from the waning base effect related to the VAT rise at the beginning of 2012.

1.3. Monetary policy abroad and international financial markets

Over recent period, the major central banks have continued highly expansionary monetary policy, with some of them extending the scale of quantitative easing (Figure 1.13, Figure 1.14).

Figure 1.12

CPI inflation in the Central and Eastern Europe region* and its major economies (y/y)

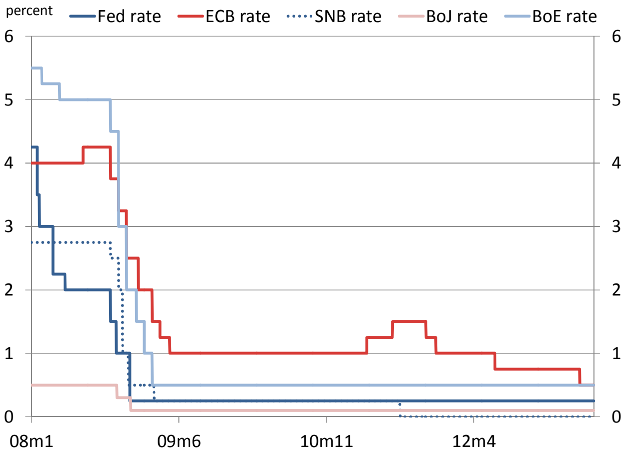


Source: Bloomberg data.

*The average of inflation indices in Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania and Slovakia.

Figure 1.13

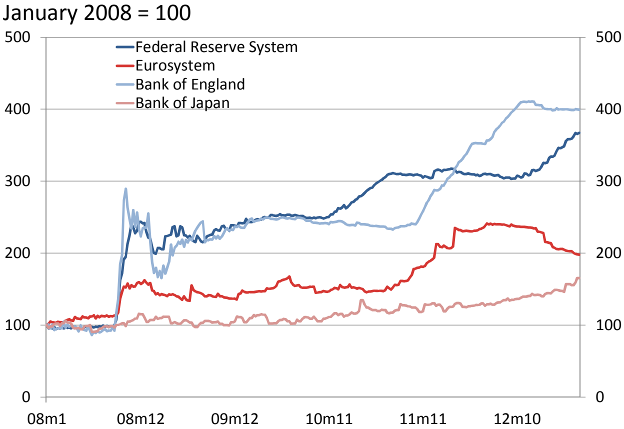
Interest rates of major central banks



Source: Bloomberg data.

Figure 1.14

Balance sheets of major central banks, January 2008 = 100



Source: NBP calculations based on Bloomberg data.

[4] In the United States core inflation dropped to 1.7% in May 2013 (as against the average of 1.9% in 2013 Q1), whereas in the euro area it decreased to 1.3% in May 2013 (as against the average of 1.5% in 2013 Q1).

The Fed upheld its declaration of leaving the short-term interest rates close to zero (0.00-0.25%) as long as the unemployment rate remained above 6.5%, inflation forecast for the next 1-2 years stayed below 2.5%, and long-term inflation expectations remained anchored. It kept the pace of its asset purchases unchanged at USD 85 billion a month, indicating, however, in mid-May and mid-June 2013 that the pace of asset purchases could be reduced later in the year.

In turn, the ECB reduced the rate on main refinancing operations by 0.25 percentage points and the marginal lending rate by 0.50 percentage points, bringing them to 0.50% and 1.00%, respectively, while leaving the deposit rate unchanged at 0.00%. Moreover, the ECB retained the readiness to implement the programme of purchase of sovereign bonds of countries most severely affected by the debt crisis.

The Bank of England left its short-term interest rates unchanged, with the official bank rate at 0.50%. It increased the scale of its Funding for Lending Scheme announced in June 2012 and extended it from January 2014 to January 2015 (see Box 1 *Loan refinancing programmes of selected central banks*).

The Bank of Japan kept its short-term interest rates unchanged (0.00-0.10%), announcing at the same time a new asset purchase programme. This programme is aimed to double the monetary base within two years and to help in reaching inflation target of 2%. Within this programme, the Bank of Japan committed to double the worth of treasury bonds and private sector financial assets in its portfolio. As a result, the Bank of Japan will be buying asset worth of JPY 51 trillion a year. This means a more than threefold increase in the scale of asset purchase by the Bank of Japan in comparison to its previous programme.

The Swiss National Bank (SNB) maintained the band for the 3-month LIBOR rate fluctuations at 0.00-0.25%. Moreover the SNB declared its readiness to further carry out unlimited currency interventions aimed to protect the Swiss franc exchange rate ceiling at 1.20 EUR/CHF.

Many central banks in the emerging economies and small advanced economies continued to ease monetary policy or left their interest rates unchanged[5]. At the same time, the National Bank of Hungary announced a lending support scheme (see Box 1 *Loan refinancing programmes of selected central banks*).

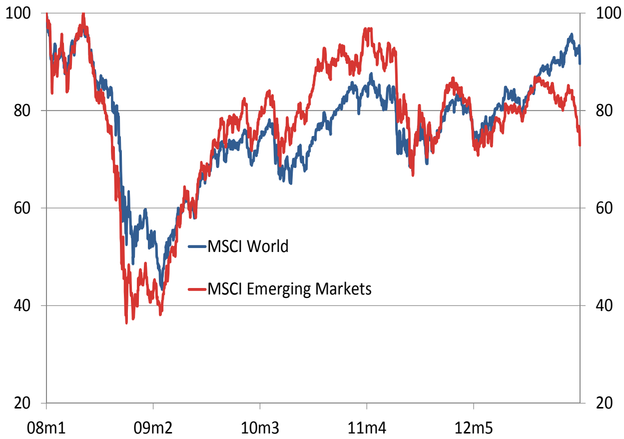
Since the previous *Report,* sentiment in the international financial markets was volatile, with divergent trends observed in developed and emerging markets (Figure 1.15).

Before mid-May 2013, the financial markets in advanced economies experienced improving sentiment on the back of continued quantitative easing by the major central banks and expected gradual improvement in economic conditions in these countries. In turn, in many emerging economies, particularly in Central-Eastern Europe and Latin America, the sentiment improvement was constrained by worse than expected economic data.

Improvement in financial market sentiment before mid-May 2013 resulted in a further reduction of credit risk perception for the majority of euro area member countries most severely affected by the debt crisis. The sentiment was further supported by continued measures aimed at reducing the imbalances of the public financial sector in these countries. This was reflected in further reduction of CDS rates for sovereign bonds in these countries, which temporarily hit a record low for the last two years (Figure 1.17). Developments that could potentially have affected this trend, such as

Figure 1.15

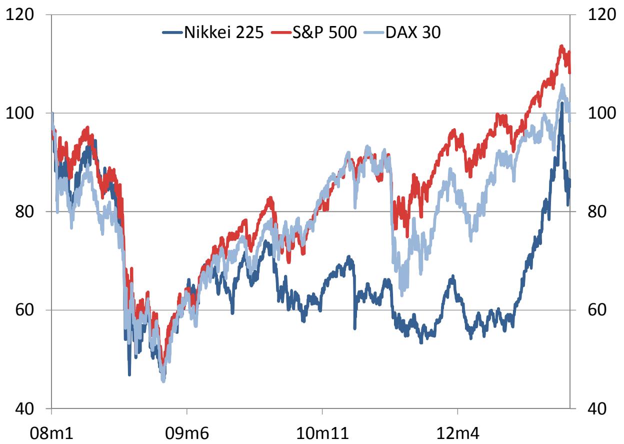
Global and emerging market stock indices, January 2008 = 100



Source: NBP calculations based on Bloomberg data.

Figure 1.16

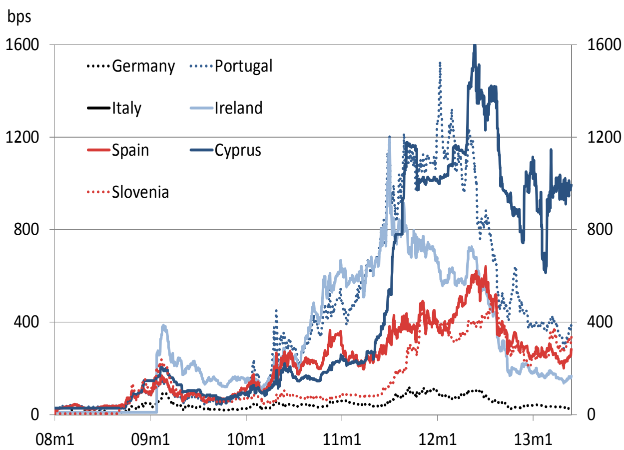
Stock market indices in Germany (DAX 30), Japan (Nikkei 225) and the United States (S&P 500), January 2008 = 100



Source: NBP calculations based on Bloomberg data.

Figure 1.17

CDS spreads in selected euro area countries



Source: Bloomberg data.

[5] With the exception of the central bank of Brazil, which raised interest rates by the total of 0.75 percentage points in April and June 2013, as well as the central bank of Indonesia, which raised interest rates by 0.25 percentage points in June 2013.

increased political risk in Italy, intensification of the financial crisis in Cyprus and Slovenia as well as deteriorating sentiment since mid-May did lead to some increase in CDS rates but did not have a significant impact on credit risk perception for the majority of euro area member countries most severely affected by the debt crisis. This was mainly due to readiness of the ECB to implement the purchase programme of sovereign bonds of these countries.

The deteriorating sentiment in financial markets since mid-May 2013 was triggered by signs of earlier than expected slowdown in quantitative easing in the United States. This translated into a sharp drop of share prices in stock exchanges globally, in particular in the emerging markets. This development intensified in late June 2013, as Fed's announcement indicated that the probability of a reduction in the scale of asset purchase programme could rise.

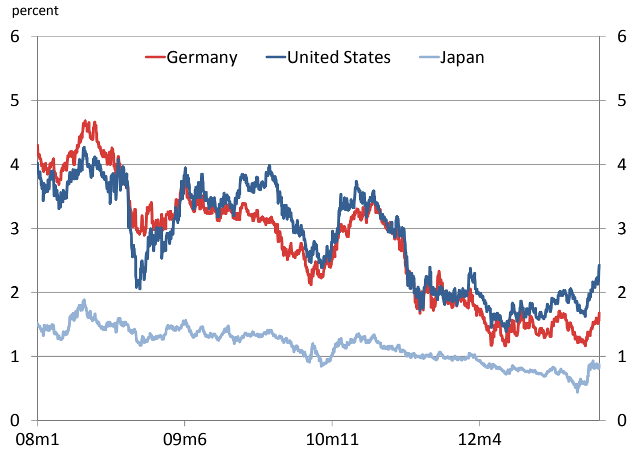
A particularly strong increase in volatility of share prices took place in Japan (Figure 1.16). By mid-May 2013 sentiment in the financial markets in that country had improved significantly, as the market participants expected that the measures taken by the central bank and the government would stimulate domestic economic growth. However, since mid-May 2013, Japanese stock exchange indexes have fallen following the release of details of the government stimulation programme and amidst deteriorated sentiment in global markets.

Following the signals that the FED could slow down the asset purchases, the sovereign bond yields have increased globally since mid-May, particularly in the emerging economies.

Deteriorating sentiment in international financial markets since mid-May has been reflected in a significant depreciation of the emerging market currencies, which had been appreciating since September 2012 (Figure 1.20). Some central

Figure 1.18

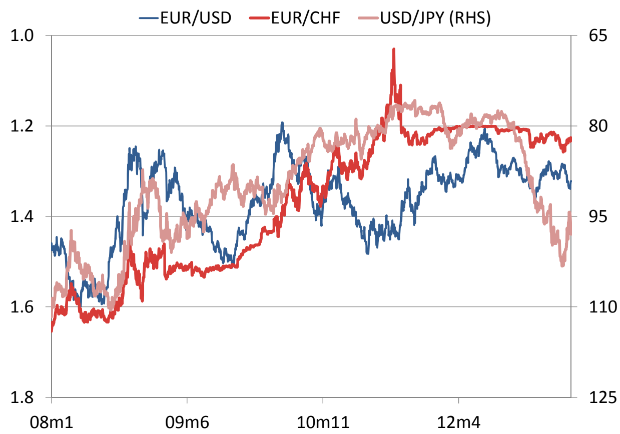
10-year German, Japanese and United States bond yields



Source: Bloomberg data.

Figure 1.19

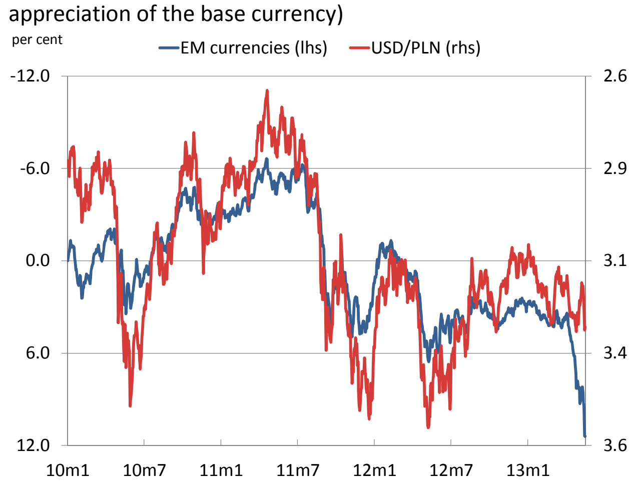
The EUR/USD, EUR/CHF, and USD/JPY exchange rates (increase denotes an appreciation of the currency)



Source: Bloomberg data.

Figure 1.20

Cumulative change in the emerging economies (EM) exchange rate index vis-à-vis the USD/PLN rate (increase denotes appreciation of the base currency)



Source: NBP calculations based on Bloomberg data.

Note: The EM currency index comprises the currencies of the following countries: Argentina, Brazil, Chile, Colombia, Mexico, Peru, Korea, Thailand, Indonesia, the Philippines, South Africa, Russia, Israel and Turkey.

banks intervened in order to contain the scale of depreciation of their currencies.

Box 1. Loan refinancing programmes of selected central banks

Over recent months, the Bank of England (BoE), the Bank of Japan (BoJ) and the National Bank of Hungary (MNB) have announced new programmes of liquidity support to the financial sector aimed explicitly at boosting lending to households and businesses (BoE, BoJ), or exclusively to small and medium-sized enterprises (MNB). The programmes are of a considerable scale which may correspond to as much as 8% of GDP. The BoE programme has been operating since August 2012, while the remaining schemes were launched in June 2013 (for details see Table B.1.1).

Design

Under the programmes, the central banks grant loans to financial institutions (MNB, BoJ) or offer a temporary exchange of assets of lower quality (such as loan portfolios) for Treasury securities (a so-called collateral swap, BoE). The long-term funding (up to ten years in the case of the MNB programme) is offered at a very low interest rate ranging from 0% (MNB, with the central bank base rate at 4.50%) to up to 1.50% (BoE). The maximum amount of, and – in the case of the BoE programme – the maximum cost of the refinancing under the schemes depend strictly on the amount of loans extended.

Table B.1.1
Details of the individual programmes to fund lending

Name	**Bank of England** Funding for Lending Scheme (FLS)	**Bank of Japan** Stimulating Bank Lending Facility (SBLF)	**National Bank of Hungary** Funding for Growth Scheme (FGS)
Objective	To expand lending by reducing the cost of funding to the banking sector	To expand lending by reducing the cost of funding to the banking sector	To facilitate lending to SMEs by reducing the cost of loan servicing through preferential interest rates.
Participats	Commercial banks and building societies	All financial institutions	Commercial banks
Target	Households and enterprises	Households and enterprises	SMEs
Start	August 2012	June 2013	June 2013
End	January 2015[6]	June 2014	Not specified
Estimated amount of available funds	GBP 135bn (approx. 8% of GDP)	JPY 15bn (approx. 3% of GDP)	HUF 425bn (approx. 1.5% of GDP)
Form of transactions	Collateral swap	Loan	Loan
Maturity	4 years (early repayment possible)	1-3 years, with the option to roll over into the fourth year	Up to 10 years
Eligible collateral	The broadest range of assets, including government and private sector bonds, mortgage bonds, ABSs and CMBSs, shares in multinational corporations, eligible foreign currency-denominated securities; loan portfolios with A3/A- or higher rating,	Broad range of assets, including government and private sector bonds, eligible foreign currency-denominated securities	Not specified
Central bank payment	9-month Treasury bills	Cash	Cash
Maximum quantity available to participant	Dependent on the amount of loans extended Sum of 5% of the loans existing as at June 2012 and the lending extended to households and large enterprises from July 2012 till the end of 2014. From 2014 on – with respect to lending to SMEs – 10 times net lending in 2013 and 5 times net lending in 2014; equal to net lending in case of other entities.	Equal to the amount of loans extended in the quarter preceding the quarter in which the tranche is allocated (a total of 4 tranches, of which the first one in June 2013 and the fourth one in June 2014).	Refund of the entire new loan extended by a commercial bank to an SME, provided that the interest does not exceed 2.5% pa.
Cost	From 0.25% to 1.5%, depending on the size of lending	0.1% (Bank of Japan's reference rate)	0%

Source: Own compilation based on information posted at the central banks' websites.

[6] On 24 April 2013, the planned termination date was moved from January 2014 to January 2015.

Mechanism

The purpose of the programmes is to reduce the costs (BoE, BoJ), and increase the availability of funding to banks, and in effect, to the non-financial sector. The MNB programme is addressed exclusively to small and medium-sized enterprises (SMEs), which face particular obstacles in accessing credit while their activities are – according to MNB – of key importance to potential output and employment in the Hungarian economy. The MNB expects the scheme to contribute to lower credit risk in the Hungarian banking sector through a reduction in interest cost to corporates and an improvement in financial results of banks.

By linking directly the terms of funding with the amount of loans extended by banks, monetary authorities strive to provide strong incentives for banks to increase the supply of credit to the non-financial sector (the more lending banks provide, the more they will benefit from the programmes). In the case of the BoE programme, in September 2012, the British financial supervisor introduced an additional incentive in the form of an allowance for new loans,. In line with it any net expansion of lending will not result in an increase in capital requirements.

Effectiveness

The effectiveness of the programmes will primarily depend on:

- participation of banks: availability of high-quality assets from BoE or BoJ may not prove a strong enough incentive to the otherwise very liquid British or Japanese banks (the share of liquid assets in British banks' total assets is currently at its highest since the late 1970s). Also pressure from the supervisory authorities, forcing banks to seek long-term, stable sources of loan funding and to improve capital adequacy ratios might adversely affect the lending figures under the programme. Another issue is the change in the business model of the banking sector; banks may strive to structurally scale back their activities (BoE, BoJ) or be reluctant to grant loans – which are harder to assess – to SMEs (MNB).

- willingness of banks to pass easier funding terms on to clients (instead of e.g. to improve the financial result or restore capital buffers): BoE's preliminary data on performance of its programme – the only one implemented so far – indicate that – despite a slight reduction in the cost of credit to households – the scheme has failed to boost lending in the United Kingdom. It has probably contributed somewhat to lowering interest rates on household and corporate deposits, thus being conducive to higher profitability of the banking sector. In order to prevent misuses by banks, in the MNB programme the ceiling of spread for the loans extended under the programme amounts to 2.5 pps, which may, however, prove insufficient to cover the cost of credit risk in the SME sector.

- demand from the real economy: lending may be constrained due to low demand resulting from the protracted economic stagnation. In the United Kingdom, for example, the surveys of enterprises indicate that a key barrier to implementing investment plans is uncertainty of future demand rather than the availability of credit[7].

[7] According to Investment Intentions Survey by Confederation of British Industry, the most important investment factor is demand, followed by technical constraints and financial constraints being the third important factor. In particular, 64% small and medium enterprises stated that demand uncertainty was the main factor behind low investment outlays.

1.4. Global commodity markets

Since the previous *Report,* the rise in the majority of global commodity prices has come to an end, which has been largely related to the deteriorating global economic outlook. Moreover, lower commodity prices were attributable to the appreciation of the US dollar.

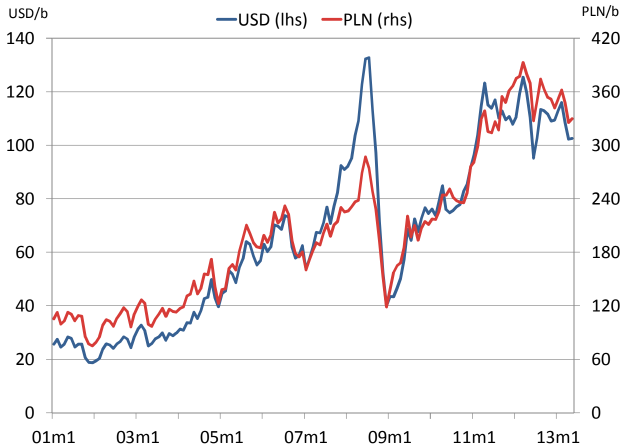
Since the beginning of 2013, despite significant fluctuations, oil prices have remained high in comparison with their long-term average (Figure 1.21). High oil prices were supported by increasing demand for liquid fuels in the emerging economies, in China in particular, as well as the persistent disruptions in the production of this commodity in non-OPEC countries[8]. At the same time, the decline in oil prices was driven by increasing fears about the perspectives of global demand for commodities, following the release of worse than expected data from some of the major economies.

Since the previous *Report*, coal prices – which react strongly to signals indicating the deterioration of global economic climate – declined slightly (Figure 1.22). At the same time, gas prices did not change significantly[9].

Food prices, on the other hand, remained high, though they fluctuated markedly (Figure 1.23)[10]. At the beginning of the analysed period, food prices increased on the back of the drought in New Zealand, in particular. Their subsequent

Figure 1.21

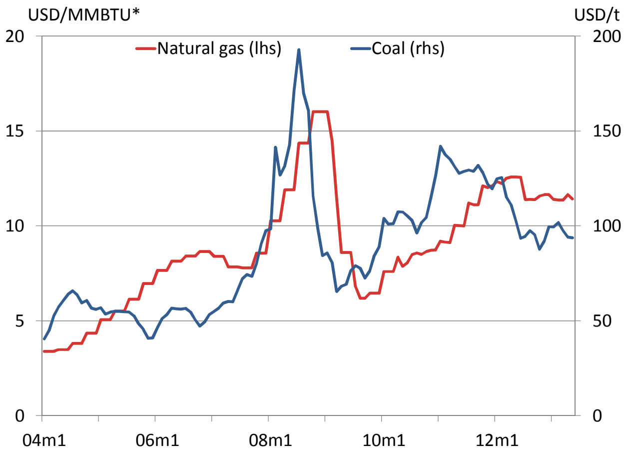
Brent oil prices in USD and PLN



Source: US Energy Department data, NBP calculations.

Figure 1.22

Gas and coal prices in the global markets



Source: IMF data.

* MMBTU - Million British Thermal Unit; 1 BTU is the amount of energy needed to raise the temperature of one pound of water by one degree Fahrenheit.

[8] Crude oil supplies in 2013 Q1, similarly as in 2012 Q4, were primarily disturbed by the developments in Syria and South Sudan. In the meantime, the scale of these disturbances did not change significantly. At the beginning of 2013 Q2 South Sudan resumed the production of oil on a small scale. Nevertheless, the uncertainty related to the political situation in that country as well as technical problems may delay the come-back of South Sudanese oil to global markets.

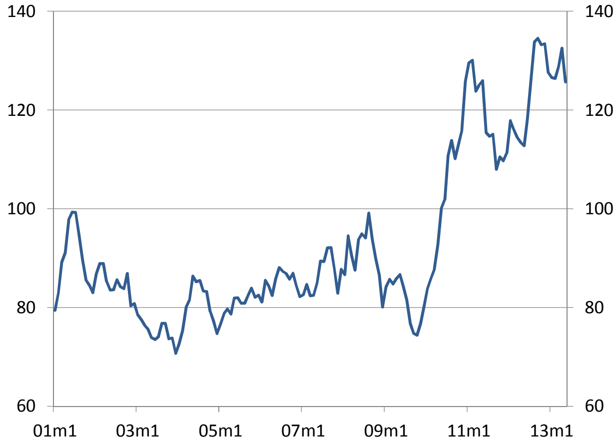
[9] In the absence of data on wholesale gas prices in Poland, gas prices presented in this chapter refer to the prices of Russian natural gas in the German market.

[10] In the current *Report* a new index of food prices has been used, namely the Index of Agricultural Commodity Prices (IACP), which substituted the previously used Index of Agricultural Commodity Prices in the global markets. The IACP reflects better the situation in the European markets of agricultural commodities, which are more strongly linked to the domestic market. The index comprises prices of: wheat, rape, pork, potatoes, sugar, cocoa, coffee, skimmed milk powder, butter, frozen orange juice concentrate. The system of weights used in the IACP reflects the consumption structure of Polish households. The index has been normalized with respect to May 2010, which follows the new methodology of calculating the index starting from May 2010. Earlier observations of the index are those of the Index of Agricultural Commodity Prices conversed into the EUR and normalised against May 2010 observations.

decline was primarily driven by decreasing wheat prices in the face of expected good harvest in the coming marketing year.

Figure 1.23

Index of agricultural commodity prices in the global markets in EUR (May 2010=100)



Source: Bloomberg, Reuters data, NBP calculations.

Chapter 2

DOMESTIC ECONOMY

2.1. Inflation developments

2.1.1. Consumer prices

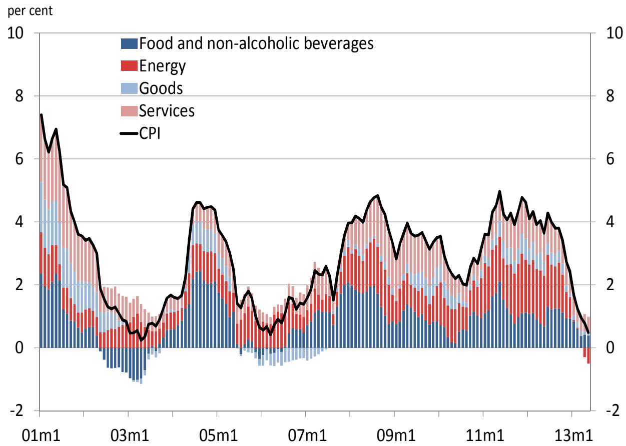
Since the publication of the previous *Report,* the annual growth in the prices of consumer goods and services in Poland kept declining. In May 2013 it reached 0.5%, i.e. it ran below the lower limit for deviations from the NBP inflation target (Figure 2.1).

Decline in inflation was primarily supported by lower growth in energy prices (Figure 2.2), which translated into further reduction in the cost pressure in the economy (see Chapter 2.1.3. *Producer prices in industry*). The decline in energy prices was due to lower administered prices of natural gas for households (a consequence of their cuts in January 2013). Weakening annual growth of gas prices resulted also from the waning of the positive base effect (in April 2013) related to the surge of natural gas prices in 2012. Moreover, lower prices of oil and coal in global markets than in 2012 were also conducive to the decline in energy prices (see Chapter 1.4. *Global commodity markets*). The weakening growth in energy prices was additionally related to smaller than a year before rise in administered prices of electricity in January 2013.

Another factor reducing inflation in the analysed period was the weakening of the

Figure 2.1

Changes in CPI and main price categories (y/y)



Source: GUS data, NBP calculations.

Table 2.1

Changes in CPI and main price categories (y/y)

	2009	2010	2011	2012	2013				
	Yearly average				Jan	Feb	Mar	Apr	May
CPI (%)	3.5	2.6	4.3	3.7	1.7	1.3	1.0	0.8	0.5
Food and non-alkohol beverages (pp)	1.0	0.7	1.3	1.0	0.8	0.6	0.4	0.4	0.4
Energy (pp)	0.8	1.0	1.5	1.4	0.0	0.0	0.0	-0.3	-0.5
Goods (pp)	0.4	0.3	0.5	0.4	0.2	0.2	0.1	0.1	0.1
Services (pp)	1.2	0.6	1.0	0.9	0.6	0.4	0.5	0.6	0.5

Source: GUS data, NBP calculations.

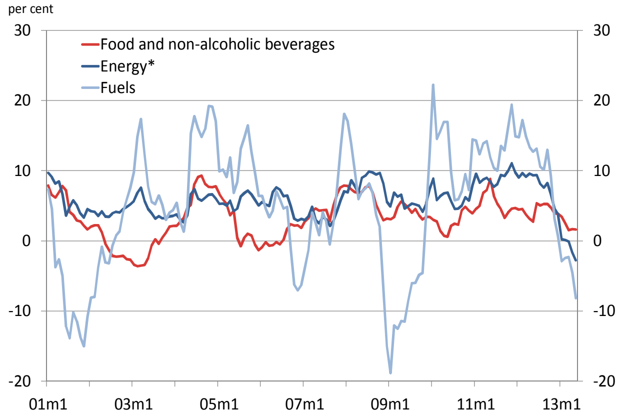
Due to rounding off, contribution of changes in the prices of particular goods and services categories to the CPI may not sum up to the total consumer price growth.

growth in food prices, related to the increase in domestic supply of agricultural products coupled with persistent low growth of retail sales of food (see Chapter 2.2.1. *Consumption demand*)[11].

Declining inflation was attributable to the lack of demand and wage pressures (see Chapter 2.1.2. *Core inflation*). Individual consumption was in stagnation and wage growth kept weakening.

Figure 2.2

Changes in food and energy prices (y/y)



Source: GUS data, NBP calculations.
* The category of *energy* includes energy products (electricity, gas, heating, fuel) and engine fuels (for private means of transport).

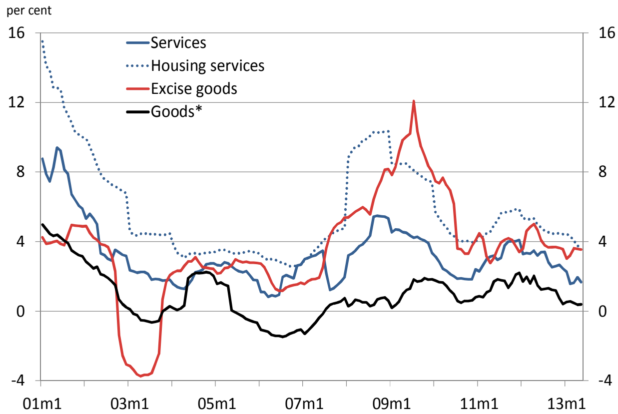
2.1.2. Core inflation

Since the previous *Report*, all core inflation measures declined though their drop was much less pronounced than in the case of CPI inflation (Figure 2.4). The inflation rate net of food and energy prices decreased from 1.4% at the end of 2012 to 1.0% in May 2013.

It was special offers in the mobile phone market that contributed the most to the decline in core inflation in the analysed period. In May 2013, this was pushed further by new offers in the fixed line phone market. At the same time, the increase in prices of entertainment services and cultural broadcasts – related to rise in fees for digital television – was conducive towards increased core inflation amidst a relatively stable growth in non-food goods (Figure 2.3).

Figure 2.3

Changes in the prices of services and goods (y/y)



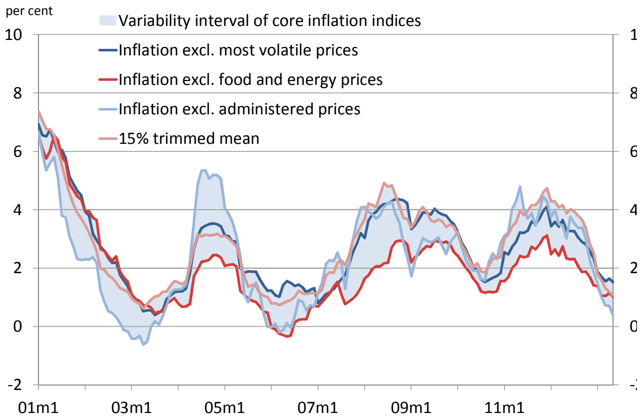
Source: GUS data, NBP calculations.
* The category of *goods* does not include food, non-alcoholic beverages or energy.

2.1.3. Producer prices in industry

In 2013 Q1, a decline in the producer prices in industry (PPI) deepened to -0.7% y/y (from -0.1% y/y in the previous quarter). The fall in the annual PPI index was mainly the result of a further drop in prices of mining and quarrying as well as weakened growth of prices in the energy production sector (Figure 2.6)[12]. Falling PPI was

Figure 2.4

Core inflation measures (y/y)



Source: GUS data, NBP calculations.

[11] High supply persisted i. a. in the meat market, as part of meat initially aimed for export was sent to domestic market (on the back of the ban on the ritual slaughter and the widely publicised cases of horse meat found in exported beef).
The weakening growth of food prices was also driven by waning of the adverse base effect related to a steep rise in egg prices in March 2012 (due to the introduction of new EU regulations on caged egg production).
[12] In April 2013 PPI fell to -2.1% y/y (from -0.7% y/y in the previous month) and in May it dropped further to -2.5% y/y – in both months on the back of an across-the-board price decline in industry, of which the most notable was recorded in manufacturing.

related to declining prices of energy commodities, mainly oil and coal, in global markets [13]. Compounded with zloty being stronger than a year before, the lower prices of oil and coal translated into decreasing prices of fuels and combustibles, which additionally contributed to the decline in producer prices. All this favoured the weakening of cost pressure in the economy.

Producer prices in the domestic market declined in 2013 Q1 by 0.1% y/y, and in the export goods market by 1.6% y/y. A stronger decline in the export sector was driven by the appreciating zloty (in annual terms) and weak external demand.

2.1.4. Import prices

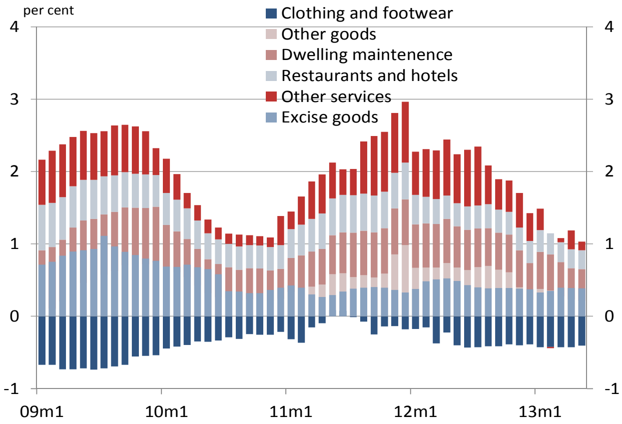
The annual growth in import prices expressed in PLN had been in gradual decline since the beginning of 2012 and in 2012 Q4 prices dropped by 2.7% y/y (Figure 2.7). This decline in prices came on the back of a stronger zloty than a year before combined with the continued negative growth in world trade prices (Figure 2.8).

2.1.5. Inflation expectations

Since the previous *Report,* expectations of financial sector analysts concerning inflation over the 12-month horizon have been running close to the inflation target and amounted to 2.2% y/y in June 2013 (as against 2.2% y/y in February 2013; Figure 2.9). At the same time, the average annual inflation as forecasted by the analysts for 2013 and 2014 dropped (respectively from 1.9% in February 2013 to 1.1% in June 2013, and from 2.6% to 2.1%), with their forecast for 2015 edging down (from 2.7% to 2.6%).

Figure 2.5

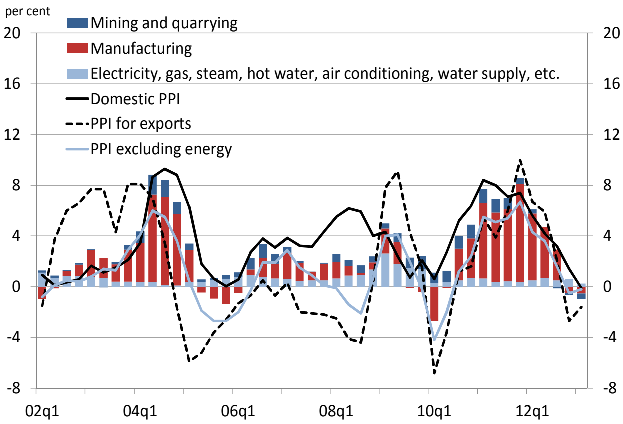
Composition of core inflation (y/y)



Source: GUS data, NBP calculations.

Figure 2.6

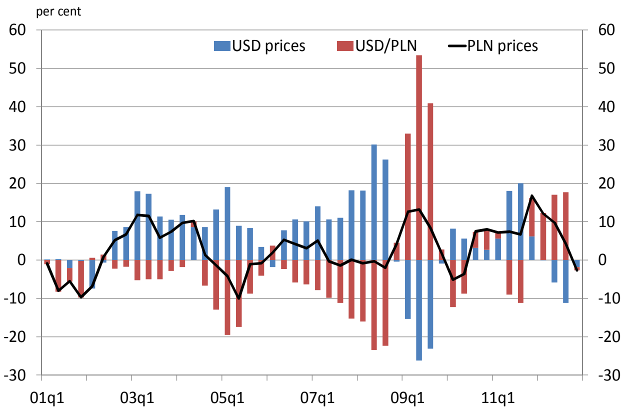
Composition of annual growth of total PPI by sections of industry, domestic PPI, PPI for exports and PPI excluding energy



Source: GUS data.

Figure 2.7

Composition of annual growth of import prices in PLN terms



Source: GUS and CPB data, NBP calculations.

[13] The impact of declining prices of goods related to the production of energy, including the prices of oil, on PPI in 2013 Q1 is confirmed by a simultaneous increase in PPI excluding prices of the goods related to the production of energy, to -0.2% y/y from -0.5% y/y in the previous quarter.

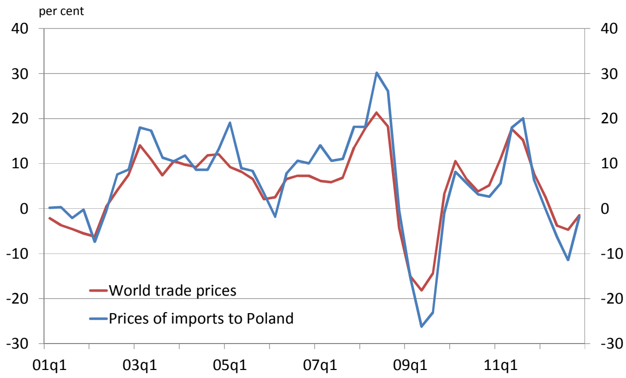
Similar expectations of the average annual inflation in the coming years are suggested by the findings of the March 2013 Macroeconomic survey of the NBP[14]. The median of the aggregated probabilistic forecast for 2013 stands at 1.5%, for 2014 at 2.2%, and for 2015 at 2.7%[15]. At the same time the likelihood of the average annual inflation running within the bands of deviations from the inflationary target, i.e. 1.5%-3.5%, in 2013 changed substantially in comparison with December 2012 survey and stands at 48% (against 81% previously), whereas in the subsequent two years, the probability of inflation running within this interval increased to 74% (from 67% previously) and 69%, respectively (Table 2.2)[16].

In 2013 Q1, inflation expectations of enterprises over the 12-month horizon, which in 2012 Q4 stood at the level of inflation target, i.e. 2.5%, were revised downwards to 1.1%, i.e. the lowest level in the history of the study. The drop in inflation expectations was mainly attributable to the change in current inflation as known to enterprises at the time of the survey[17].

Since the previous *Report,* inflation expectations of individuals also continued on a downward trend. In May 2013 they decreased to 0.9% (against 2.2% in February 2013). Similarly as in the case of enterprises, the decline in inflation expectations of individuals in the analysed period was mainly due to the decreasing current inflation.

Figure 2.8

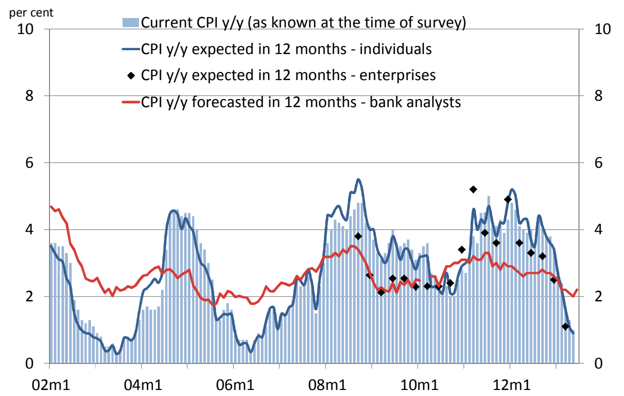
World trade prices and prices of imports to Poland (in USD)



Source: GUS and CPB data, NBP calculations.

Figure 2.9

Inflation expectations of individuals and enterprises and inflation forecasts of bank analysts



Source: Ipsos, Reuters and GUS data, NBP.
For individuals and enterprises – objectified measure.

Table 2.2

Forecasts of CPI inflation derived from individual interval forecasts (in %)

Horizon	Median	50% probability	90% probability	Probability of 1.5-3.5% range
2013	1.5	1.2-1.9	0.6-2.9	48%
2014	2.2	1.7-2.7	0.5-3.9	74%
2015	2.6	2.0-3.2	0.6-4.7	69%

Source: NBP Survey of Professional Forecasters, March 2013.

[14] *The NBP Survey of Professional Forecasters* is conducted once a quarter. It involves experts from financial institutions, research centres as well as employee and employer organisations. Their forecasts are formulated in probabilistic terms, which allows to take account of various economic development scenarios and asses the compatibility of forecasts. Detailed presentation of the survey results – see http://amakro.nbp.pl

[15] The median of the probabilistic aggregate forecast is derived from the aggregation of individual interval forecasts provided by the surveyed experts.

[16] The survey of December 2012 did not cover the year 2015.

[17] The survey question addressed to enterprises is formulated in relation to current inflation. In the last survey its wording was as follows : "In January 2013, the CPI indicator (inflation) stood at 1.7% in annual terms. According to your enterprise, in the coming 12 months the prices: (1) will rise at a faster pace than before, (2) will rise at the same pace, (3) will rise at a slower pace, (4) will remain unchanged, (5) will fall, (6) I don't know".

2.2. Demand and output

Following a substantial slowdown in 2012, in 2013 Q1 the annual GDP growth edged down. According to GUS estimates, GDP growth amounted to 0.5% y/y in 2013 Q1 (against 0.7% y/y in 2012 Q4; Figure 2.10, Table 2.3). NBP estimates show quarter-on-quarter GDP growth remaining low in 2013 Q1 as well, and amounting to 0.1% (against 0.2% in 2012 Q4; data seasonally adjusted).

In 2013 Q1, GDP growth was dampened by further decline in domestic demand, though less pronounced than in 2012 Q4. The fall in domestic demand was due to persistently negative growth of investment, slight drop in total consumption and negative contribution of inventories to GDP growth. At the same time, GDP growth in 2013 Q1 was supported by positive, though significantly lower than in 2012 Q4, contribution of net exports.

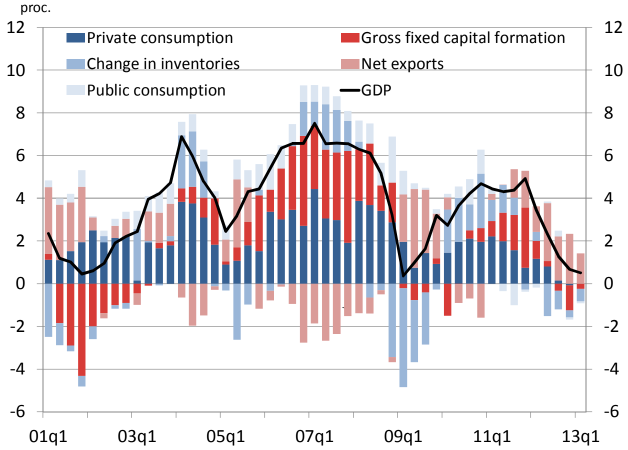
2013 Q1 saw a continued decline in investment, attributable to slowdown in corporate investment, which had been supporting the total investment demand before, and a marked downturn in public and household investment. The reduced investment was related to the persistent uncertainty about the future economic situation, unfavourable forecasts for demand and output and continuing fiscal tightening.

At the same time, total consumption growth weakened slightly and amounted to -0.1% y/y (against -0.3% y/y in 2012 Q4), which was due to a drop in public consumption coupled with stagnation of private consumption.

In 2013 Q1 export growth declined significantly (to 1.3% y/y against 3.2% y/y in 2012 Q4), which might have been attributed to persistently low economic activity abroad, and in particular to

Figure 2.10

Contribution of aggregate demand components to GDP growth



Source: GUS data.

Table 2.3

GDP growth (y/y)

	2008	2009	2010	2011	2012 q1	2012 q2	2012 q3	2012 q4	2013 q1
GDP (%)	5.1	1.6	3.9	4.3	3.4	2.3	1.3	0.7	0.5
Private consumption (%)	5.7	2.1	3.2	2.5	1.7	1.3	0.2	-0.2	0.0
Public consumption (%)	7.4	2.1	4.1	-1.7	-1.0	0.4	1.6	-0.6	-0.5
Gross fixed capital formation(%)	9.6	-1.2	-0.4	9.0	6.8	1.4	-1.7	-4.1	-2.0
Inventory increase (percentage points)	-1.1	-2.4	2.0	0.4	0.4	-1.5	-0.9	-0.3	-0.5
Net exports (percentage points)	-0.6	2.7	-0.7	0.9	1.2	2.7	2.1	2.4	1.4

Source: GUS data.

recession in the euro area[18]. At the same time, a certain moderation of the decline in imports (its growth amounted to -1.7% y/y in 2013 Q1 against -2.4% y/y in 2012 Q4), translated into smaller positive contribution of net exports to GDP growth, which amounted to 1.4 percentage points in 2013 Q1 (as compared to 2.4 percentage points in 2012 Q4).

2.2.1. Consumption demand

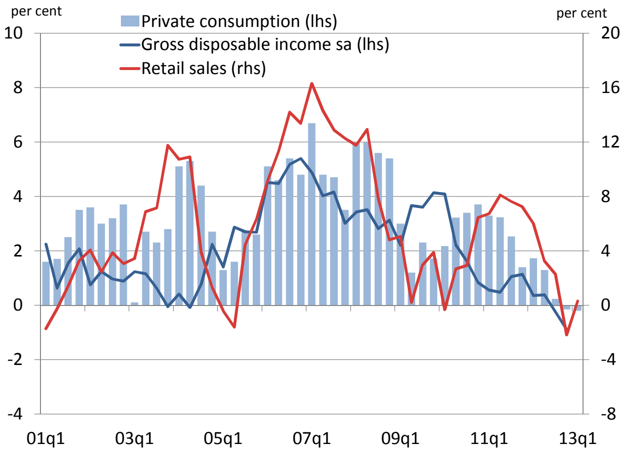
In 2013 Q1 stagnation in consumer demand continued. Individual consumption growth amounted to zero (as compared to -0.2% y/y in 2012 Q4; Figure 2.11). According to NBP estimates, individual consumption in quarterly terms remained the same as in 2012 Q4 (as against a drop of 0.1% in 2012 Q4; data seasonally adjusted).

Stagnation in consumer demand in 2013 Q1 was reflected in low growth of retail sales in that period[19]. In particular, the growth in food sales and fuels remained weak[20].

Stagnant consumption in 2013 Q1 was related to slower wage growth and decreasing employment (see Chapter 2.4 *Labour market*), and somewhat slower growth in household credit (see Chapter 2.6 *Credit and money*) amidst persistently negative consumer sentiment (Figure 2.12). At the same time, the assessment of consumer economic situation in the next 12 months improved somewhat[21].

Figure 2.11

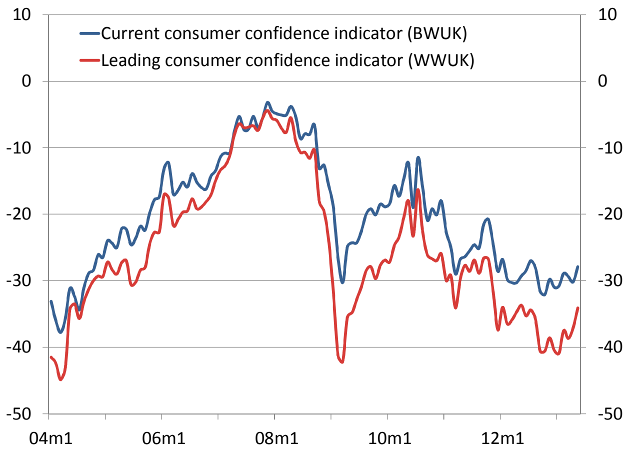
Growth of private consumption, gross disposable income and retail sales (y/y, constant prices)



Source: GUS data, NBP calculations.

Figure 2.12

Consumer confidence indicators



Source: GUS and NBP data.

[18] The data on exports and imports growth are based on the National Accounts as compiled by GUS (in PLN) and may differ from those quoted in Chapter 2.2.4 *Exports and imports*, which takes into account seasonally adjusted GUS data on external trade (in EUR).

[19] The data on retail sales published on a monthly basis refer to sales by firms with a workforce of more than 9 persons. Total retail sales data (which also include sales by firms employing 9 persons or less) are published only on an annual basis. Available on a monthly basis are also data on turnover in retail trade, covering all businesses. Yet, these data are less correlated with consumption than retail sales. Hence, this *Report* refers to the monthly retail sales data.

[20] Based on seasonally adjusted data.

[21] In particular there was improvement in the assessment of the financial situation of households as well as the general domestic economic situation in a 12-month perspective, which found reflection in a certain growth of the indicator of consumer confidence.

2.2.2. Investment demand

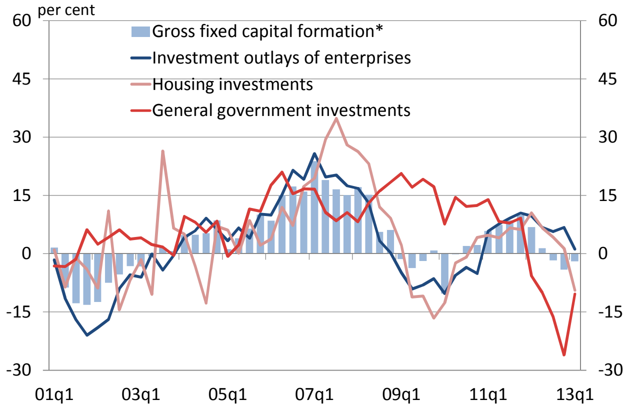
In 2013 Q1 the decline in investment in the economy eased off. The annual growth in gross fixed capital formation amounted to -2.0% y/y against -4.1% y/y in 2012 Q4. In quarterly terms, according to NBP estimates, investment growth accelerated (to 0.1% q/q in 2013 Q1 from -0.9% q/q in 2012 Q4; data seasonally adjusted).

According to NBP estimates, further drop in investment in the economy in 2013 Q1 was attributable to a significant slowdown in the growth of corporate investment and a decline in housing investment (Figure 2.13). Reduced housing investment could have resulted from the termination of the government facility for first-home buyers *Rodzina na swoim (Family on their own)* and the postponement of the start of the *Mieszkanie dla Młodych (Flats for the young)* programme until 2014 as well as deteriorating economic condition of households. In 2013 Q1, amidst fiscal consolidation continued, public sector investment kept declining (see Chapter 2.2.3. *Government demand*).

In 2013 Q2, according to NBP economic climate surveys, enterprises envisage corporate investment to remain low, in spite of certain increase in their optimism with respect to this issue (Figure 2.14)[22]. The continuously unfavourable outlook for corporate investment is reflected by the new investment index running low (below the long-term average) as well as persistently negative balance of planned changes in the amount of total outlays. Low investment activity may also be vindicated by a further drop in the total cost estimate value of newly launched investment[23].

Figure 2.13

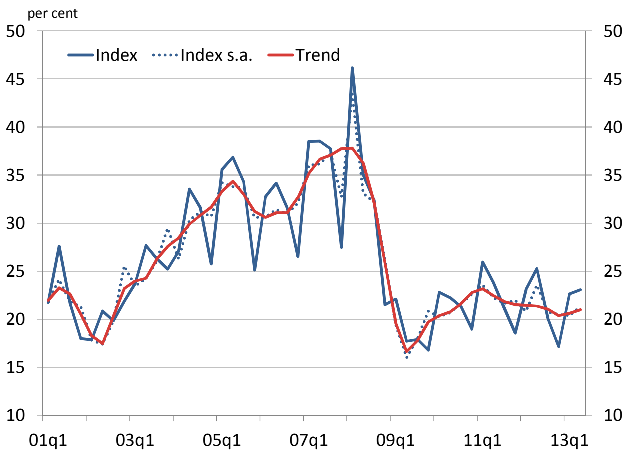
Investment in the economy (y/y, NBP estimates for the benefit of the NECMOD model; data seasonally adjusted)



Source: NBP estimates.
*GUS data (not seasonally adjusted).

Figure 2.14

New investment index (percentage of enterprises planning to start new investments within a quarter)



Source: NBP economic climate survey.

[22] In particular higher business optimism is reflected in a slight increase in the share of enterprises planning to launch new investment projects and to continue the already commenced projects. *Economic climate in the enterprise sector in 2013 Q1 and forecasts for 2013 Q2.*

[23] Last available GUS data concerning the cost estimate value of newly launched investment date to 2012.

According to NBP economic climate survey, the main factor reducing the enterprises' propensity to invest is the uncertainty regarding future economic conditions. Low investment activity is also related to unfavourable forecasts of demand and output, particularly against the background of moderate capacity utilisation (Figure 2.15).

Among the inhibitors to investment activity, financing problems were of less importance. Low significance of this barrier, despite a certain tightening of lending conditions by banks, may be due to the low scale of planned investment, allowing their financing from firms' available own funds (see Chapter 2.3. *Financial situation in the enterprise sector*).

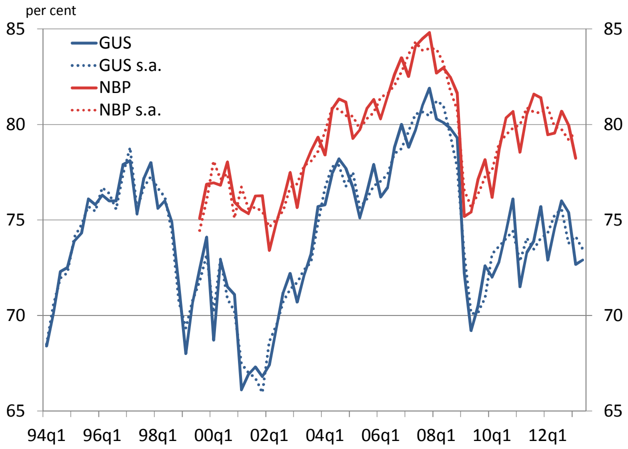
2.2.3. Government demand

The situation of public finance remains strongly affected by economic slowdown and the necessity to reduce fiscal imbalance as required by domestic and European fiscal rules. Consequently, public spending is being cut both at the central and local levels, which weighs on the decline of public consumption growth and public investment.

In January-May 2013, the central budget deficit amounted to PLN 30.7 billion, i.e. was higher than that recorded in the corresponding period of 2012 (when it stood at PLN 27.0 billion). The ratio of actual deficit to the planned annual deficit amounted to 86.4% (at the end of May 2012 the deficit amounted to 88.7% of the annual plan). Total revenue of the state budget in January-May 2013 was by 4.9% lower than in the corresponding period of 2012, of which tax revenue declined by 7.7% y/y. The negative growth in revenue affected most of tax revenues, VAT revenue in particular. Government spending was also lower than a year before (by 1.3%), which was mainly attributable to exceptionally low subsidies to

Figure 2.15

Production capacity utilisation in industry (GUS) and in the corporate sector (NBP)



Source: GUS data, NBP economic climate survey.

The degree of capacity utilisation based on GUS business tendency survey is significantly lower than the one quoted by NBP surveys. However, trends in both indicators are similar in both surveys. The difference in the values results from the difference in the enterprise sample each survey is based on. The difference may also result from large enterprises being overrepresented in the NBP sample, while the GUS sample is representative in terms of enterprise size.

the Social Insurance Fund (offset by a loan to the Fund from the state budget) – expenditure to this end amounted to PLN 14.7 billion against PLN 20.4 billion in the corresponding period of 2012.

In 2013 Q1, local government units posted a surplus of PLN 7.9 billion, which was PLN 1.8 billion higher than in 2012 Q1. This improvement was due to high growth in revenue from the share in personal and corporate income tax, resulting from temporary factors, as well as maintaining a low pace of growth in total expenditure by local government units (2.3%)[24]. Data on state budget revenue indicate that in the subsequent months growth in the tax revenue of local government units, in particular with regard to CIT revenue, will be lower than in Q1[25].Local government debt at the end of 2013 Q1 amounted to PLN 66.7 billion and was slightly lower than at the end of 2012 (PLN 67.8 billion).

Due to lower subsidies from the state budget, the debt of the Social Insurance Fund in the form of loans from the state budget increased. Amidst deteriorating situation in the labour market, in the first three months of the year also the Labour Fund posted a larger deficit due to higher expenditure.

According to the *Convergence Programme. The 2013 update*, in 2013 the government is planning to tighten the fiscal policy further in structural terms in order to reduce the general government deficit (ESA95) from 3.9% of GDP in 2012 to 3.5% of GDP in 2013. However, the ongoing economic slowdown will lead to increase in the cyclical component of the budget deficit. In such circumstances the fulfilment of the target set out in the *Convergence*

[24] Strong growth in tax revenue in 2013 Q1, both with regard to PIT and CIT, resulted from the change in the deadline for settlement of December tax advances by companies – in the case of CIT and by the self-employed – in the case of PIT.

[25] Slower annual growth in state budget revenue from corporate income tax in April resulted from, in particular, lower annual tax settlement balance. In 2012, this balance was boosted by extraordinary income related to the sale of shares in the Polkomtel company.

Programme. The 2013 update is burdened with risk.

2.2.4. Exports and imports

In 2013 Q1, Polish foreign trade activity faltered[26]. The slowdown in export growth (to 5.6% y/y in 2013 Q1 from 6.4% y/y in 2012 Q4) was accompanied by decrease in imports (by 2.3% y/y against the increase by 1.5% y/y in 2012 Q4; Figure 2.16)[27].

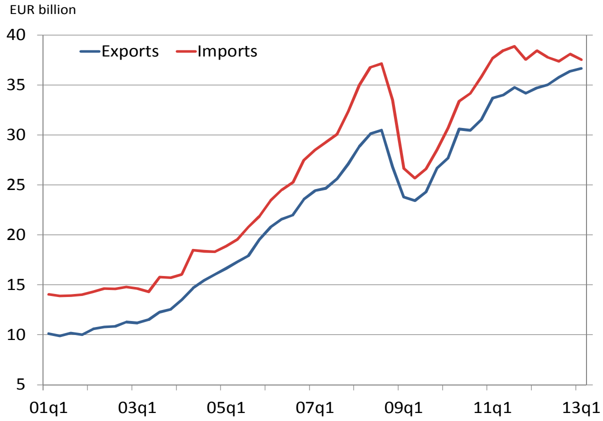
In 2013 Q1, exports were weakened mainly by significant slowdown in the growth of sales to EU countries outside the euro area (Figure 2.17). Also a further decline in exports to the euro area was conducive to the same effect, although to a smaller extent. This development could be attributed to the persistent recession in the euro area and lower activity of its exporters (particularly pronounced was a slowdown in the pace of Polish exports of intermediate goods). At the same time, growth in sales to countries outside the EU remained robust despite a marked decline in export growth to the CIS countries.

Following an increase in 2012 Q4, in 2013 Q1 the value of imports decreased again. That was due to a persistent decline in domestic demand and slowing growth of exports. The decrease in the value of imports was also a consequence of lower prices in international trade, which was reflected in a marked drop in the value of imports of fuels and raw materials.

In 2013 Q1, nominal and real (CPI deflated) effective zloty exchange rates depreciated slightly (Figure 2.18). At the same time, according to NBP economic climate survey[28], market exchange rate of the zloty remained

Figure 2.16

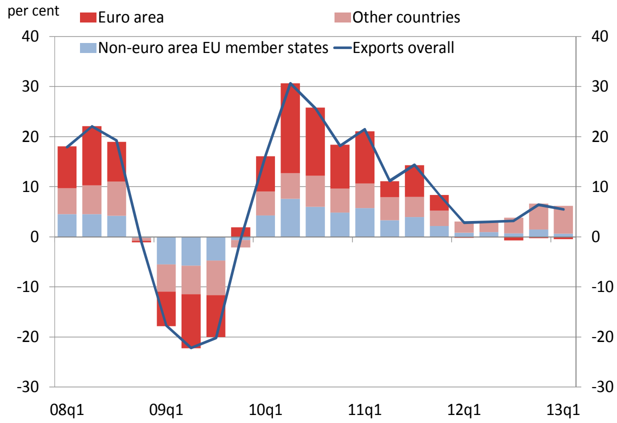
Value of Polish exports and imports (in EUR billion)



Source: NBP calculations based on GUS data (seasonally adjusted).

Figure 2.17

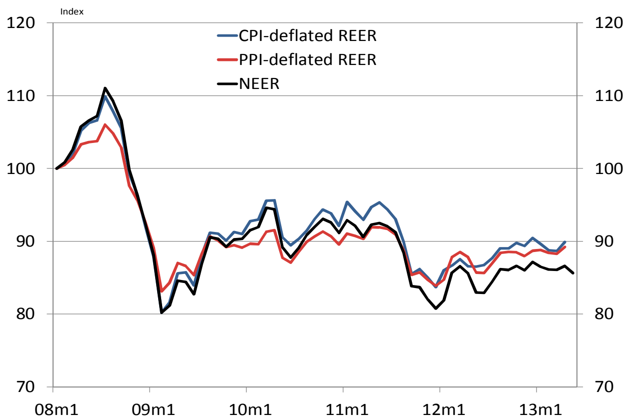
Geographic composition of Polish exports growth



Source: NBP calculations based on GUS data (seasonally adjusted).

Figure 2.18

Zloty real and nominal effective exchange rate (increase denotes appreciation; January 2008=100)



Source: NBP and European Commission data.

26 The analysis of the value of Polish exports and imports in 2012 Q4 and 2013 Q1 in this subsection is based on the seasonally adjusted preliminary GUS data on external trade (expressed in EUR).

27 GUS data on external trade (not seasonally adjusted) indicate an acceleration in exports growth in April 2013 (to 9.7% y/y), which is accompanied by further decrease in imports (by 2.1% y/y).

28 *Economic climate in the enterprise sector in 2013 Q1 and forecasts for 2013 Q2*, NBP.

significantly lower than the threshold exchange rate as declared by enterprises (Figure 2.19). As a result, the price competitiveness of Polish exports remained high. At the same time, the percentage of enterprises indicating the exchange rate as a barrier to growth dropped to an all-time low.

2.2.5. Output

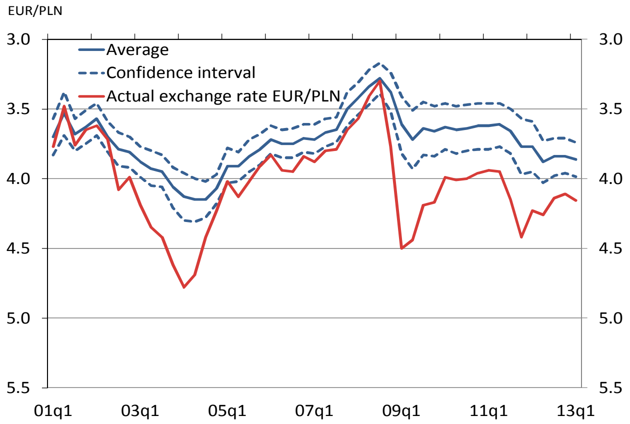
In 2013 Q1, the growth in gross value added remained at the level from 2012 Q4 (0.6% y/y), which was the effect of a drop in value added in construction and industry coupled with a certain growth in services (Figure 2.20)[29].

Since the beginning of 2013, the growth in industrial output hovered around zero, and the PMI persisted at low levels. This suggests a protracted weak business conditions in this sector. At the same time, the order book in industry has recently increased slightly, which may indicate the possibility of certain improvement in economic conditions in the coming quarters (Figure 2.21) .

Data concerning construction indicate a further considerable weakening of activity in this sector. Moreover, a marked slump in construction and assembly output is accompanied by continued decline in the order book in construction (Figure 2.22) .

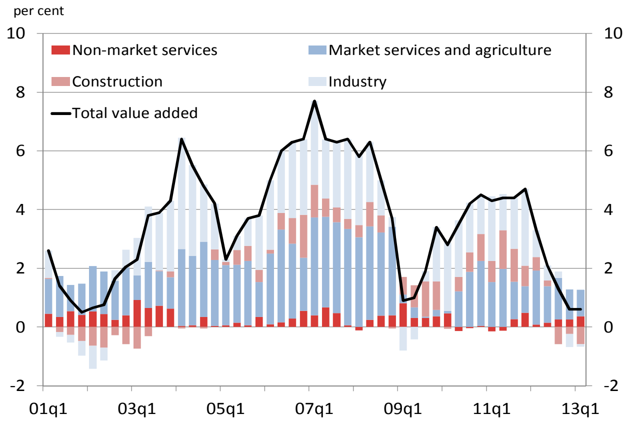
Unfavourable economic climate is also visible in services, although in some segments of this sector the situation is improving slightly. Growth in wholesale sales (in nominal terms) accelerated somewhat and amounted to 0.3% y/y in 2013 Q1 against -0.9% y/y in 2013 Q4[30]. At the same time, the growth in retail sales remains subdued in businesses employing more than 9 persons (see Chapter 2.2.1 *Consumption*

Figure 2.19
Average threshold exchange rate (EUR/PLN) of exports profitability declared by enterprises



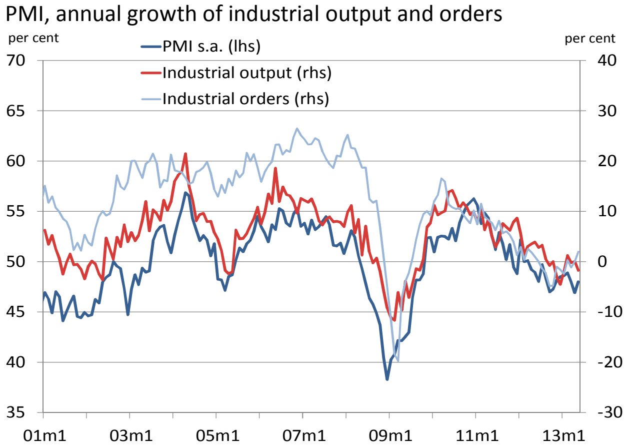
Source: NBP data and estimates.
The threshold exchange rate at which exports become profitable is determined as the average of responses to a question (see below) included in the survey of NBP quick monitoring addressed at enterprises (*Economic Climate in the Enterprise Sector).* Survey question: "What is the threshold level of the foreign exchange rate at which exports will become (is) unprofitable (in PLN)?"

Figure 2.20
Sector contribution to annual growth of gross value added



Source: GUS data, NBP calculations.

Figure 2.21
PMI, annual growth of industrial output and orders



Source: GUS data (seasonally adjusted), NBP calculations.

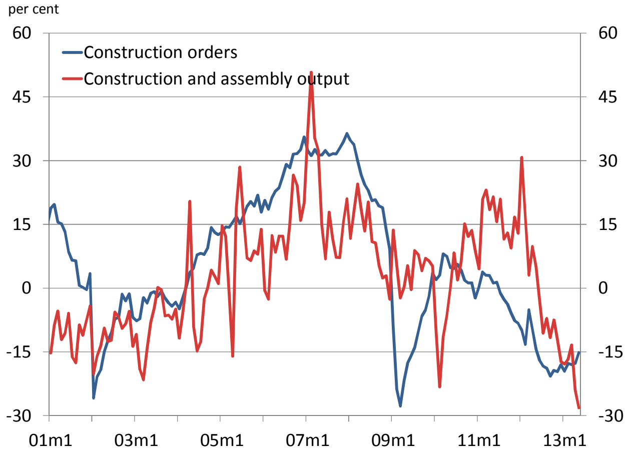
[29] Data on industrial output and orders, PMI, construction and assembly output and orders in construction sector are seasonally adjusted (NBP calculations).
[30] In April the growth of wholesale sales accelerated to 5.2% y/y.

demand)[31]. Meantime, the growth in sales of transport services slowed down slightly, though it remained positive and amounted (in real terms) to 3.7% y/y in 2013 Q1 against 4.6% y/y in 2012 Q4[32].

The GUS forward-looking business climate indicators suggest a stabilisation of assessments of the economic outlook by businesses. However, most indicators of future business conditions in the respective sections are still running below their long-term averages (Figure 2.23).

Figure 2.22

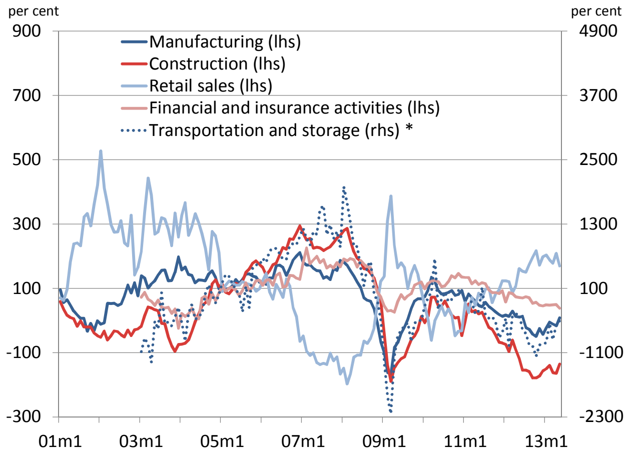
Annual growth of construction and assembly output and construction orders



Source: GUS data. NBP calculations (seasonally adjusted).

Figure 2.23

Forecast of economic situation in relation to the long-term average (long-term average=100)



Source: GUS business tendency survey, NBP calculations.

*As the value of the indicator of transportation and storage is close to zero, the Figure presents its level instead of its changes against its long-term average.

Box 2. The impact of fiscal tightening on GDP growth under present conditions

In many countries, the global economic crisis led to deterioration in their public finance performance, or revealed fiscal problems which had already been building up over some time. As a consequence, for the first time since the 1940s, the average public debt to GDP ratio in developed countries exceeded 100%. Strongly negative primary budget balances combined with weak growth prospects meant that without fiscal adjustments this ratio would continue to deteriorate, posing a threat to the stability of public finance. Against this background, in most advanced economies measures had to be taken to curb the public finance imbalance. The scale of these measures was unprecedented and the circumstances in which they were taken ,in many respects, unique:

Fiscal adjustments occurred simultaneously in almost all developed economies. With the 2013 plans taken into account, 27 out of the 30 OECD countries, for which relevant data are published, are expected to see fiscal tightening between 2011 and 2013 (Figure B.2.1).

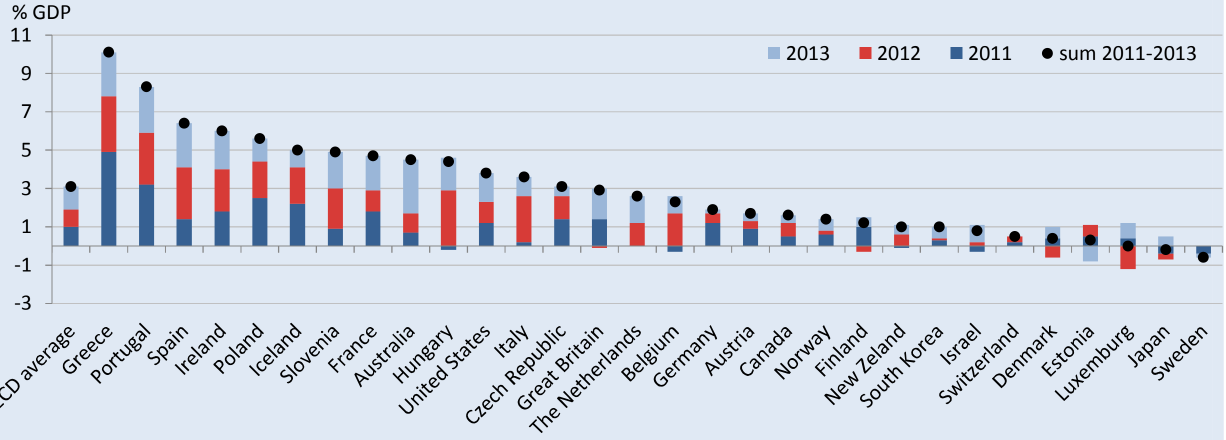
[31] Monthly data on retail sales do not fully reflect total retail sales growth. See footnote 19.

[32] The growth in sales of transport services accelerated to 6.3% y/y in April.

Developed countries have implemented significant fiscal adjustments amidst slow economic activity, which was adversely affected, in particular, by the private sector deleveraging and sluggish growth in the external environment, the latter not allowing to compensate for weak domestic demand with exports growth. Although in 2011-2013 the average real GDP growth in the OECD countries did not exceed 2%, the primary balance of the public finance improved, on average, by 1 percentage point of GDP a year. By comparison, available data for the previous 50 years do not provide a single instance of primary balance improvement under such weak growth conditions (Figure B.2.2).

Figure B.2.1

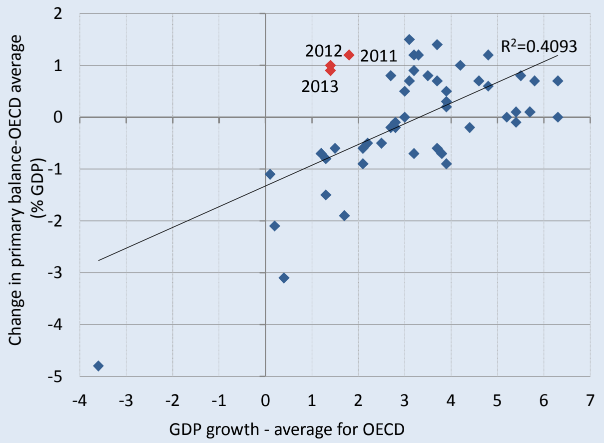
Fiscal adjustments implemented in the years 2011-2012 and planned for 2013 in the OECD countries (change in the primary structural balance)



Source: OECD data.

Figure B.2.2

Average economic growth and average change in budget balance for all OECD countries in a particular year (1960-2013)



Source: OECD data.

The unprecedented scale and the global character of the current fiscal adjustments have aroused economists' interest in the impact of fiscal tightening on GDP growth in the short term, in other words, in the value of the so-called short-term fiscal multipliers[33]. Before the crisis, opinions on this issue in literature – both theoretical and empirical – differed considerably. Most research concluded that the multipliers were positive, i.e. fiscal tightening contributes to economic slowdown. Yet, the range for the estimated multiplier values was very wide. Gechert and Will (2012) made an overview of literature comprising 89 studies, in which the multipliers ranged between -2 and 4, with 87% of the results contained within the range 0 to 2.

In the recent years, a number of new studies have been conducted, enabling a better identification of factors determining the level of fiscal multipliers and at least partial explanation of the sources of the discrepancies described above. Some of these studies indicate that current levels of fiscal multipliers in the developed countries are exceptionally high.

[33] The fiscal multiplier is defined as the impact of a 1-percent change in government expenditure or revenue (related to GDP) on the change in the annual GDP growth rate (in percentage points).

- According to latest research, the value of the fiscal multiplier is largely determined by the **initial state of the economy** embarking on fiscal adjustment path. According to numerous publications, the multiplier may be higher in crisis time, than in boom time (e.g. Auerbach, Gorodnichenko 2012a; 2012b; Batini et al. 2012; Baum, Koester 2011)[34]. The same conclusion follows from all of the studies mentioned above, despite various methods used to identify the stage of the business cycle. Baum and Koester (2011) identify phases of business cycle in the analysed period based on the presence of a negative or a positive output gap, Batini et al. (2012) – look at positive or negative economic growth, while Auerbach and Gorodnichenko (2012) – use deviations of GDP growth from the long-term trend, calibrating the model so that the economy is in recession for 20% of the time.

  The suggested reason why the value of the multiplier is higher during economic downturn is the fact that during recessions the effect of crowding out private spending by public spending does not work. It can be expected that fiscal tightening implemented amidst capacity underutilisation will not be offset by an increase in private spending. Moreover, lower government demand may undermine consumer confidence (Bachmann, Sims 2011). Under such circumstances, the fiscal multiplier may be higher than one. Financial crises have a similar effect as economic downturns: as credit institution are reluctant to extend loans, current consumption depends more on current income than on the expectations of future income (Gali et al. 2007; Corsetti et al. 2010).

- Further, the value of the fiscal multiplier depends on the conditions in which monetary policy is implemented. Available economic models indicate that when the short-term **nominal interest rate is close to zero** (the so-called zero lower bound), the fiscal multiplier may turn out to be significantly higher than one (Woodford 2011; Christiano et al. 2011; DeLong, Summers 2012)[35]. This results from the limited scope for offsetting government spending cuts with further monetary easing. The authors pointed out that the value of the multiplier depended on the persistence of fiscal impulse. Moreover, the value of the multiplier, amidst nominal interest rates close to zero, might be also influenced by the level of indebtedness of economic agents (Mertens and Ravn 2011).

- **The degree of openness** of a given economy also has a substantial impact on the value of fiscal multiplier. On the one hand, fiscal multipliers in more open economies are lower, as part of the demand effect of fiscal impulses is shifted abroad. On the other hand, the greater the openness of the economy, the stronger the effect of fiscal tightening implemented by its trading partners (e.g. Corsetti, Mueller 2012). Auerbach and Gorodnichenko (2012c) show that also in this case, the value of fiscal multiplier depends on the phase of business cycle. The multiplier reaches the highest levels when country implementing the fiscal adjustments and its trading partner affected by such adjustments are both in recession. This leads us to the conclusion that fiscal tightening conducted simultaneously in several countries that are trading with each other, will result in a stronger slowdown than would have been the case if each country had reduced its deficit at a different point in time.

- Another factor influencing the value of the fiscal multiplier is **the structure of fiscal adjustment**. The impact of fiscal tightening on GDP is greater where the implemented measures directly affect the level of aggregate demand rather than the income of economic agents. A rise in taxes only partially translates into a drop in consumption. In contrast, cuts to public investment or government spending directly affect the aggregate demand. This has been evidenced e.g. by the studies of Roeger and in't Veld, 2010, and Coenen et al. 2012. In addition, the studies distinguish various values of the multiplier for the respective kinds of budget expenditure. Amongst them, the investment spending multiplier is the highest, reaching

[34] Auerbach and Gorodnichenko (2012b) arrive at a crisis-time multiplier ranging from 1 to 1.5, and boom-time multiplier 0-0.5 (in another specification, the multipliers amount to 2.2 and -0.3, respectively); Batini et al. (2012) quote multiplier values of 2.2 and 0.3 respectively.

[35] Before the current crisis the cases of decreasing the central bank rates to zero were extremely rare (except for Japan), which made it difficult to conduct empirical studies on the value of fiscal multipliers in such a situation.

on average 1.2 (amongst the studies analysed by Gechert and Will, 2012). A high value of the public investment multiplier follows from the fact that this kind of fiscal impulse fully translates into lower aggregate demand. Moreover, beside the fact that public investment directly affects the level of demand, a decline in public investment has an adverse effect on the supply side of the economy (Coenen et al. 2012).

- The value of the fiscal multiplier also depends on the **initial state of the public finance**. Some studies suggest that high public debt negatively affects expectations of economic agents, brings down consumption and, in effect, results in a lower fiscal multiplier (Perotti 1999; Corsetti et al. 2012). In such circumstances, fiscal adjustment – through reducing private agents' concerns about the future fiscal policy stance – may help restore confidence and boost private demand, thus reducing the negative impact of fiscal consolidation on growth. The related stream of research shows that under certain conditions fiscal tightening may be accompanied by economic recovery, which implies negative values of the fiscal multiplier (e.g. Giavazzi and Pagano, 1990; Alesina and Perotti, 1995; Alesina and Ardagna, 1998). Such an effect, which is called a non-keynesian effect, results among other things from improvement in expectations of economic agents related to stabilisation of the public finance situation. According to Corsetti et al. (2012), this effect may render the value of fiscal multiplier negative even in case of an aforementioned lack of possibility to accommodate fiscal tightening by monetary policy.

  Yet, according to other authors, growth recovery observed in the discussed situation may be caused by factors other than fiscal policy. Perotti (2011) analysed the best known instances of non-keynesian fiscal policy effects and found that major sources of economic growth included depreciation of domestic currency against the currencies of trading partners, declining interest rates and limited wage growth resulting from wage agreements with trade unions. As the author points out, this means that under present conditions, economic activity is unlikely to respond positively to fiscal tightening in the short term. As in most developed countries fiscal consolidation is conducted simultaneously, it is not possible that in all of them fiscal tightening is accompanied by currency depreciation or improvement in wage competitiveness vis-a-vis trading partners.

Poland, like many other countries, has implemented a considerable fiscal tightening in the recent years. After the general government sector recorded a deficit of 7.9% of GDP in 2010, measures were taken to reduce the primary deficit of the public finance and curb public debt accumulation. Fiscal tightening was triggered by the fact that running such a high deficit could result in breaching the limit of public debt set by the Constitution as well as might create a risk of financial markets' negative reaction leading to a risk of increased debt service cost. The scale of fiscal tightening in Poland was one of the largest in the OECD countries (Figure R.2.1). Fiscal consolidation – although necessary for long-term stability of public finances – was one of the factors responsible for the presently observed economic slowdown. When considering the impact of fiscal tightening on the Polish economy, it is crucial to look at its structure, which changed over time. The adjustment effected in 2011 was, to a great extent, based on revenue-side measures combined with cuts in current expenditure, while public investment expenditure – characterized by the highest values of multiplier – rose by nearly 10% in nominal terms. In 2012, fiscal tightening was largely related to expenditures and involved cuts to public investment by over 15%.

The planned scale of deficit reduction in 2013 is smaller than in the previous two years, yet according to the *Convergence Programme, 2013 Update*, investment spending is to be further significantly reduced. Combined with the anticipated decrease in EU structural fund absorption, as mentioned in the *Programme*, it will be a factor limiting demand growth in Poland in the coming quarters. In addition, the Polish economy is being adversely affected by fiscal adjustments implemented in other countries. On the other hand, Monetary Policy Council has eased monetary policy considerably in the recent quarters, which is likely to mitigate the negative impact of fiscal tightening on business conditions.

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2.3. Financial situation in the enterprise sector

Following several quarters of deteriorating financial situation in the enterprise sector, 2013 Q1 saw part of indicators illustrating it improve compared with the previous quarter. In particular, the upturn included financial performance and profitability. Despite that, the overall financial performance of enterprises remained worse than in 2012 Q1.

Although in 2013 Q1 a decline in aggregate annual revenue of enterprises continued (on the back of reduced revenues from domestic sales amidst weakening domestic demand and a decline in other operating revenue), it was accompanied by falling costs in all the main categories (Figure 2.24). As a result, gross financial result of enterprises in 2013 Q1 improved as compared to 2012 Q4.

The improved financial performance was primarily due to better result on other operating activity (related, in particular, to a substantial reduction in losses on the sales of fixed assets)

Table 2.4

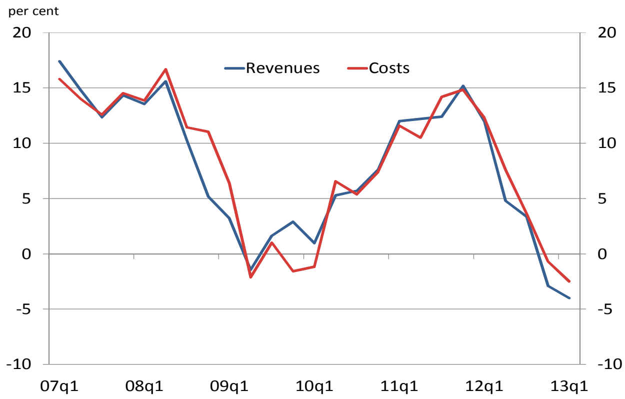
Selected financial efficiency ratios in the enterprise sector

Per cent	2008	2009	2010	2011	2012 q1	2012 q2	2012 q3	2012 q4	2013 q1
Sales profitability ratio	5.0	5.0	5.2	5.3	4.4	4.3	4.3	4.2	4.3
Net turnover profitability ratio	3.3	4.1	4.4	4.5	4.1	3.9	3.5	2.4	3.2
Total debt ratio (s.a.)	47.5	46.9	47.1	48.8	48.5	48.6	48.6	48.4	48.3
Gross profit to interest ratio (s.a.)	5.9	7.1	7.8	7.4	6.9	5.8	5.7	5.5	5.5
	end of period data								
Liquidity ratio of the first degree	0.34	0.39	0.40	0.38	0.34	0.32	0.31	0.34	0.33

Source: GUS data.

Figure 2.24

Rates of growth of revenues and costs



Source: F-01/I-01 form GUS data. NBP calculations.

offset slightly by weaker result on sales (Figure 2.25).

The improved financial performance of enterprises, combined with reduced revenues translated into a marked increase in the net turnover profitability ratio. Yet, profitability of sales, remained close to the 2012 Q4 level.

In 2013 Q1 the liquidity ratio of the first degree dropped slightly, yet the liquidity position of the corporate sector remained sound. This is corroborated by the NBP survey results, according to which in 2013 Q1 the percentage of enterprises which did not report any liquidity problems increased and the percentage of enterprises reporting insufficient liquidity as a barrier to growth declined[36]. A slight decline in the liquidity ratio of the first degree was entirely due to deteriorating liquidity among large firms, which were previously characterized by higher liquidity. As a result, cash liquidity of large companies and the SME sector converged to a similar level.

2.4. Labour market

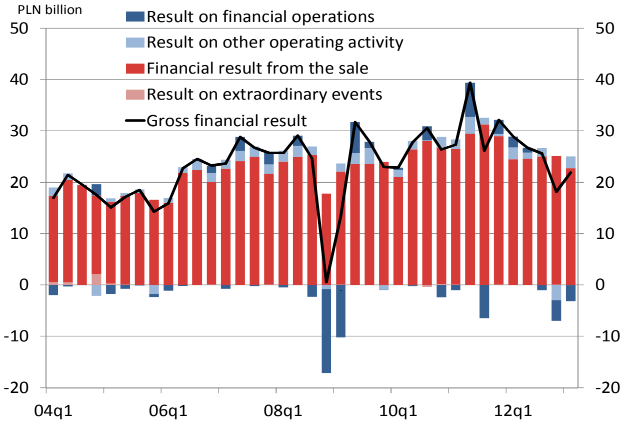
2.4.1. Employment and unemployment

Further slowdown in domestic demand in 2013 Q1 translated into employment decline (Figure 2.26). A fall in the number of working persons contributed to a further increase in the unemployment rate. At the same time, a modest growth in the number of economically active persons was observed.

According to Labour Force Survey (LFS) data, in 2013 Q1 the number of working persons decreased by 0.7% y/y (as compared with a rise of 0.1% y/y in 2012 Q4). The number of working persons employed in the service sector – where economic activity remained higher than in other

Figure 2.25

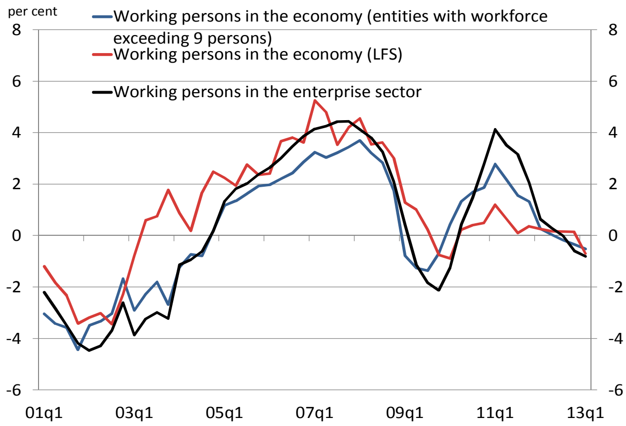
Enterprises' gross financial result and its components



Source: F-01/I-01 form GUS data. NBP calculations.

Figure 2.26

Change (y/y) in the number of persons working in the economy according to the LFS data and reports of entities with a workforce of over 9 employees (GN); change in the number of persons employed in the enterprise sector

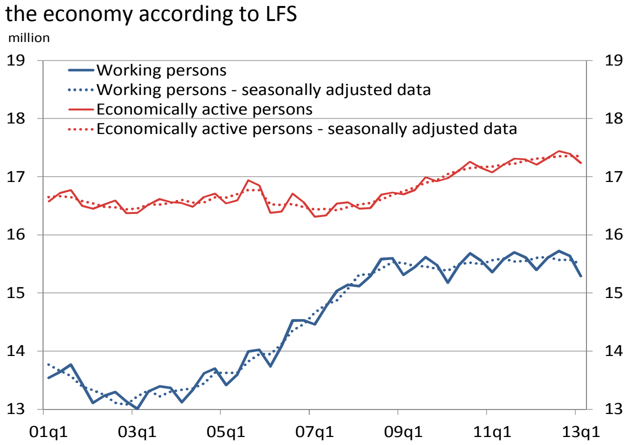


Source: GUS data, NBP calculations.

*LFS data adjustment for the findings of the 2011 National Census in GUS publications refers to the period starting in 2010 Q1. In order to preserve data comparability, earlier data in the graphs presented in this Chapter have been corrected by the NBP.

Figure 2.27

Number of working persons and of the economically active in the economy according to LFS



Source: GUS data, NBP calculations.

[36] *Economic climate in the enterprise sector in 2013 Q1 and forecasts for 2013 Q2.*

sectors of the economy – continued to grow, albeit at a slower pace than before (0.8% y/y in 2013 Q1 as opposed to 1.2% in 2012 Q4). In industry, on the other hand, as output continued to decline, the drop in the number of working persons was steeper than in the previous quarter and amounted to 2.0% y/y (as against a drop of 0.9% y/y in 2012 Q4). At the same time, the number of persons employed in agriculture continued to fall (by 4.5% y/y in 2013 Q1 as compared with a 2.3% y/y fall in 2012 Q4), which was in line with the long-term trend.

In 2013 Q1, the decline in corporate sector employment deepened (to 0.8% y/y as against a drop of 0.6% y/y in 2012 Q4). The April and May 2013 data point to employment being further restrained by companies, however in May the drop stabilised.

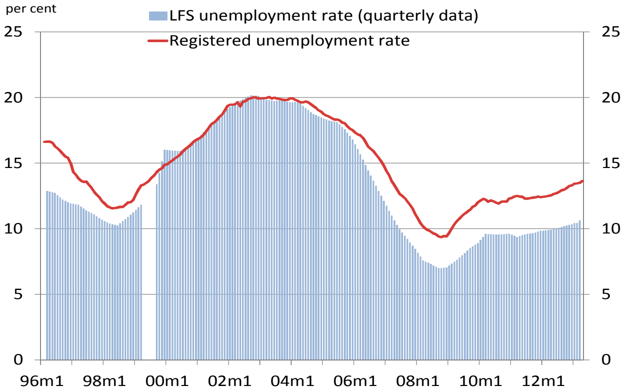
According to the NBP business climate survey, in Q2 2013 still more enterprises planned to reduce employment, (and their share in the group of the surveyed firms has risen on the previous quarter) rather than increase it[37].

In 2013 Q1, the number of economically active persons continued to grow (in year-on-year terms), although at a considerably slower rate. The number of economically active persons in Q1 2013 edged up by a mere 0.2% y/y (as against 0.5% in 2012 Q4; seasonally-adjusted data; Figure 2.27).

The decline in the number of persons working in the economy amidst only a slight rise in labour supply translated into a further increase in the LFS unemployment rate, which was running at 10.6% in 2013 Q1 (as compared to 10.3% in 2012 Q4; seasonally adjusted data; Figure 2.28; Figure 2.32).

Figure 2.28

Registered unemployment rate and unemployment rate according to the Labour Force Survey

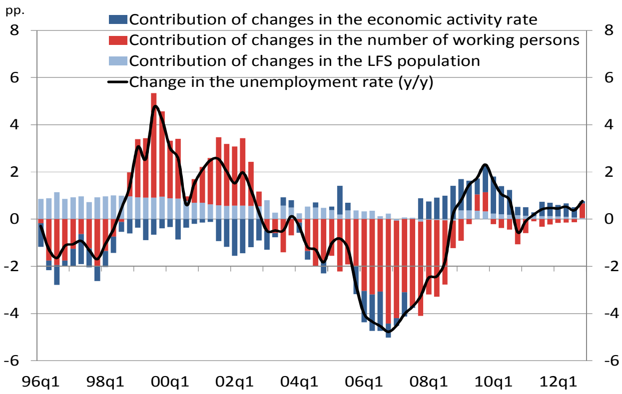


Source: GUS data (seasonally adjusted).

There are two reasons for the differences between the unemployment rate according to LFS and the registered unemployment rate: 1) different definition of an unemployed person, 2) different definition of the population to which the number of the unemployed relates.

Figure 2.29

Breakdown of change in the unemployment rate in q/q terms according to LFS data

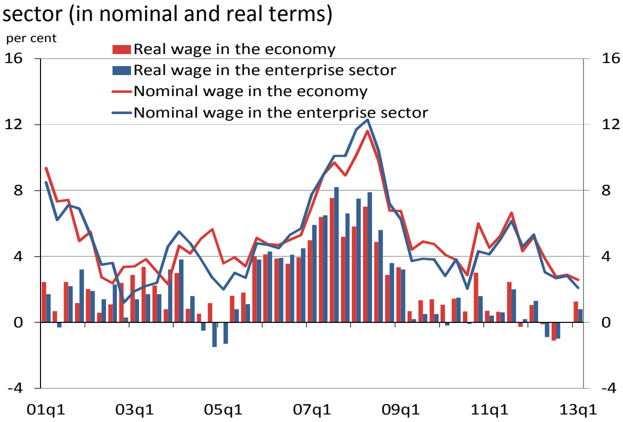


Source: GUS data, NBP calculations.

Change in the unemployment rate can be further broken down into changes resulting from: 1) change in the size of working age population (in the graph, change in the population in LFS terms), 2) change in economic activity of productive-age persons (change in the economic activity rate, 3) change in labour demand in LFS terms). Change in the population in LFS terms may depend on demographic trends or migration.

Figure 2.30

Annual wage growth in the economy and in the enterprise sector (in nominal and real terms)



Source: GUS data.

[37] *Economic climate in the enterprise sector in 2013 Q1 and forecasts for 2013 Q2.*

Also labour office data show a continued rise in the unemployment rate in recent months (after adjustments for seasonal factors), amounting to 14.0% in April 2013 (as compared to 12.9% in April 2012).

2.4.2. Wages and labour productivity

Data on wage growth and unit labour costs suggest a lack of wage pressure in the economy. In 2013 Q1, wage growth declined again in comparison with 2012 Q4, both in the corporate sector and in the entire economy. Also, unit labour cost growth, following a rise at the end of 2012, in 2013 Q1 fell.

Weak economic activity, feeding through to low demand for labour, caused wage growth to slow down further at the beginning of 2013. In 2013 Q1, nominal wage growth in the Polish economy amounted to 2.6% y/y (versus 2.9% y/y in 2012 Q4), and in the corporate sector – to 2.1% y/y (as against 2.8% y/y in 2012 Q4; Figure 2.31). The April and May corporate sector data show that weak wage growth continued into 2013 Q2.

The absence of wage pressure is also indicated by NBP business climate data. They show that in 2013 Q2, the share of enterprises planning pay rises has remained at a level observed in the previous quarter and continued to run significantly below the long-term average[38]. At the same time, the average increase envisaged by the enterprises decreased on the previous quarter's level. Moreover, the market tension index (number of vacancies per one unemployed) declined somewhat recently, limiting the risk of wage demands building up (Figure 2.31).

Growth in unit labour costs in the economy accelerated slightly in 2013 Q1, as employment was adjusted to slowing GDP growth (Figure 2.32). Faster productivity growth combined with

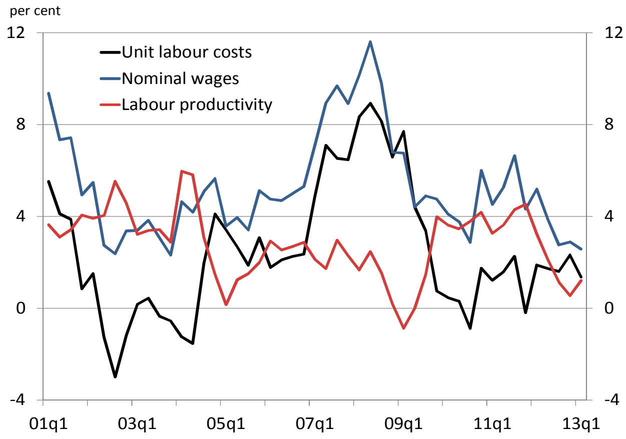
Figure 2.31

Market tension index (number of vacancies per one unemployed)

Source: GUS data, NBP calculations.

Figure 2.32

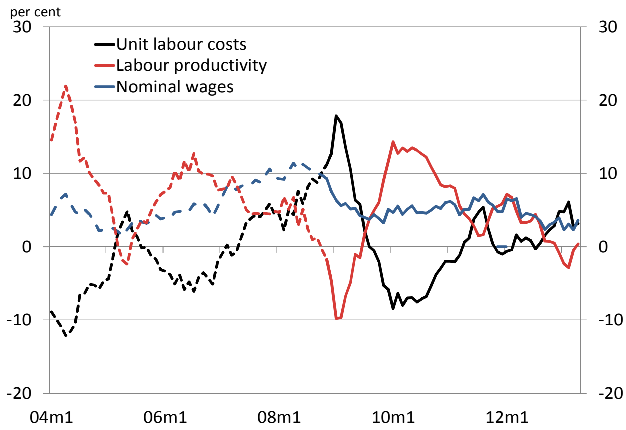
Annual growth in labour productivity, wages and unit labour costs in the economy



Source: GUS data, NBP calculations.

Figure 2.33

Annual growth in labour productivity, wages and unit labour costs in industry (moving 3M averages)



Source: GUS data, NBP calculations.

Since January 2009, new PKD classification (PKD 2007) has been used, due to which the growth rates of wages and employment in industry from January 2008 (dashed line in the graph) are not fully comparable with the subsequently recorded rates.

[38] *Economic climate in the enterprise sector in 2013 Q1 and forecasts for 2013 Q2.*

increasingly weaker nominal wage growth in the economy halted growth in unit labour costs, which amounted to 1.4% y/y in 2013 Q1 (as against 2.3% y/y in 2012 Q4).

Monthly data on industrial enterprises show unit labour cost growth to decelerate in recent months, following a certain acceleration at the turn of 2012. Slower unit labour cost growth in the economy resulted from both slight rise in labour productivity and slower wage growth (Figure 2.33).

2.5. Financial markets and asset prices

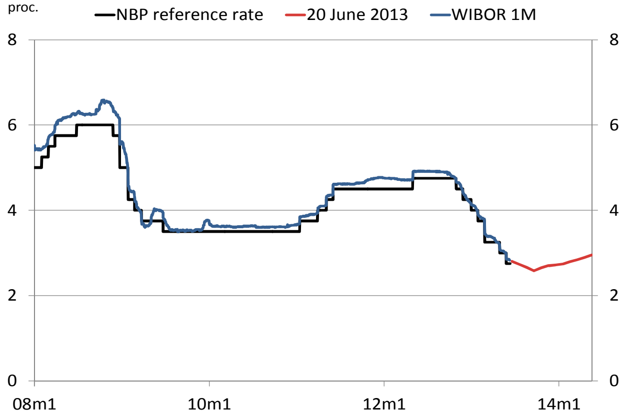
2.5.1. Interest rates and financial asset prices

In recent months the Monetary Policy Council continued to reduce the NBP interest rates. Since early March 2013 interest rates have been decreased three times, by a total of 1 percentage point. As a result, the NBP reference rate stands currently at 2.75% (Figure 2.34)[39].

Having reached their historical lows in May 2013, Polish sovereign bond yields increased (Figure 2.35) driven mainly by global factors. Before May 2013, the demand of foreign investors for Polish sovereign bonds continued to rise as a result of search for yield amidst highly expansive monetary policy of the major central banks, which was conducive to falling Polish sovereign bond yields (Figure 2.35). However, since mid-May 2013, the Polish sovereign bond yields increased following the rise in yields in the major markets (see chapter 1.3 *Monetary policy abroad and international financial markets*). Increased risk aversion reflected in higher CDS rates for the emerging

Figure 2.34

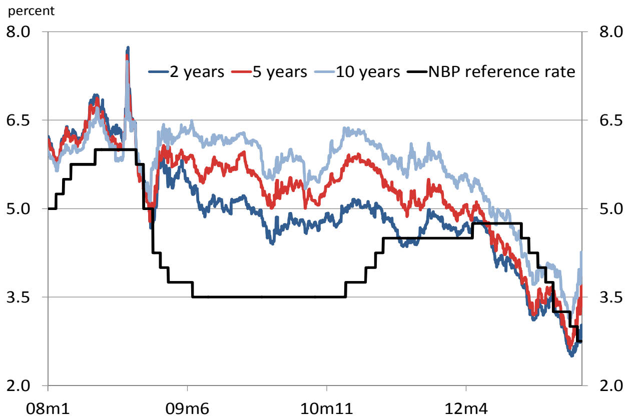
NBP reference rate, WIBOR 1M and 1M interest rate implied by FRAs



Source: NBP calculations based on Bloomberg data.

Figure 2.35

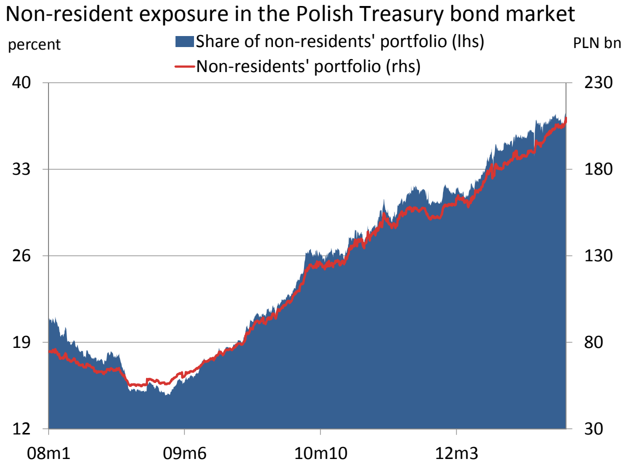
Yields on Polish Treasury bonds



Source: Bloomberg data.

Figure 2.36

Non-resident exposure in the Polish Treasury bond market



Source: National Depository for Securities (KDPW) data.

[39] This section covers the situation in the market between 1 March 2013 and 20 June 2013 and does not include the decision of the Council of July 2013. The decision of the Council from July has been presented in Chapter 3 in the "Minutes of the Monetary Policy Council meeting held on 2-3 July 2013."

economies, including Poland, was another factor behind the increase in sovereign bond yields (Figure 2.37).

In March and in the first half of April 2013, major Polish stock exchange indices fell, which was triggered by worse than expected data on economic growth and concerns about the considered institutional changes in the Polish pension system. Along with other countries in the region, stock exchange indices in Poland had been going up by mid-June 2013. Afterwards, they fell following the global trend. In total, since the beginning of March 2013 the WIG index has decreased by 1.0%, and the WIG 20 – by 6.3% (Figure 2.38).

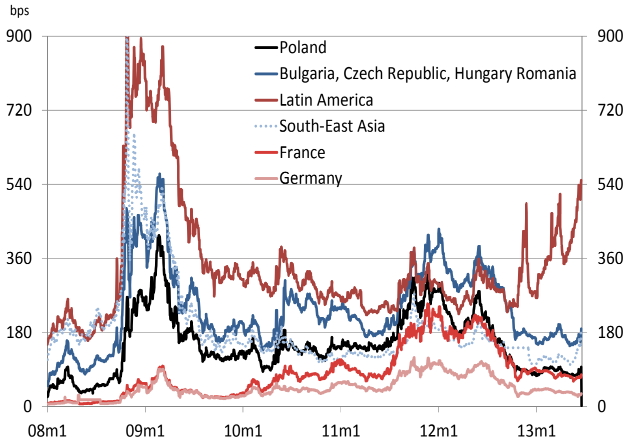
2.5.2. Exchange rate

Following a period of stabilization from September 2012, in mid-May 2013 the zloty depreciated notably, similarly to other emerging market currencies. Initially, the zloty was adversely affected by weaker than expected data on domestic economic growth. However, since late May deteriorating sentiment in international financial markets and related capital outflows from emerging markets have taken their toll as well. In June 2013 the NBP sold a certain amount of foreign currency for zlotys. Foreign exchange interventions are compliant with the monetary policy strategy pursued by the NBP as presented in *Monetary Policy Guidelines for 2013*.

Since the beginning of March 2013 the nominal zloty exchange rate has weakened by 5.0% against the euro, 5.2% against the Swiss franc and 3.4% against the US dollar (Figure 2.39).

Figure 2.37

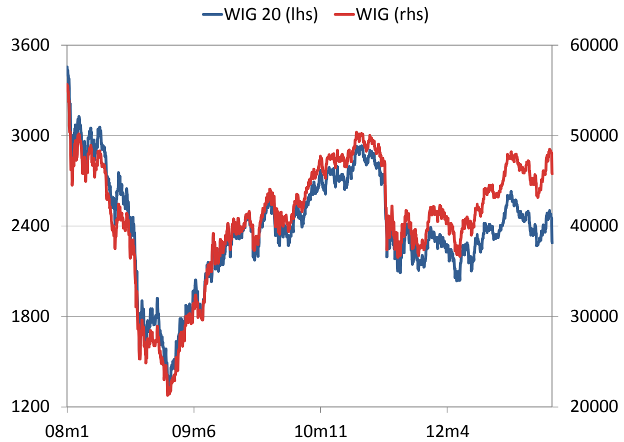
CDS rates for Polish bonds against emerging countries and peripheral countries of the euro area



Source: NBP study based on Bloomberg data.
Presented indices are weighted GDP aggregates.

Figure 2.38

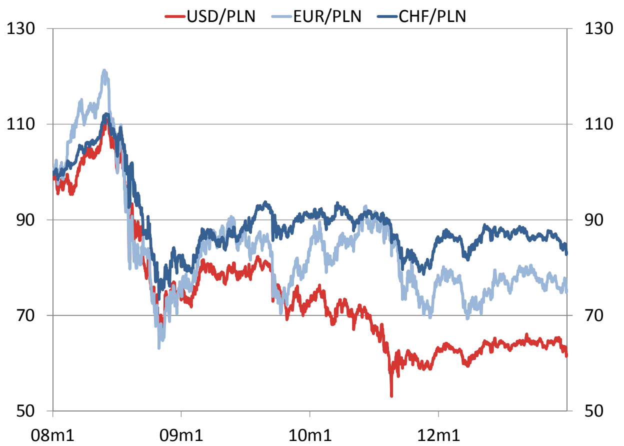
WIG and WIG 20 stock exchange indices



Source: Bloomberg data.

Figure 2.39

Nominal exchange rate of the Polish zloty (January 2008 = 100, increase denotes appreciation)



Source: Bloomberg data.

2.5.3. Housing prices

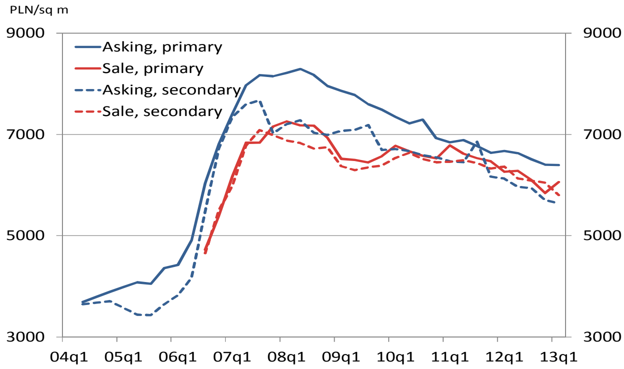
In 2013 Q1, there was a divergence in trends between the primary and secondary housing markets. Prices in the secondary market kept falling, while the decline in prices in the primary market drew to a halt[40]. The divergence between the primary and secondary market was triggered by an increase in share of higher end units sold in the primary market in Warsaw and Poznan (Figure 2.40).

At the same time, a fall in demand resulting from a deterioration in the financial position of households, as well as termination of the facility for first-home buyers *Rodzina na swoim (Family on their own)* in 2012 Q4 were conducive to declining prices both in the primary and secondary market (though some applications for subsidies submitted in late 2012 Q4 were processed also in 2013 Q1, which cushioned the fall in demand)[41]. Also decelerating growth of mortgage loans extended to households indicates that the demand for housing is weakening.

Reduced demand for housing was accompanied by a visible decline in the number of units introduced on the market, which for the third consecutive quarter was lower than the number of units sold. As a result, the number of units on offer kept decreasing (Figure 2.42). At the same time, the number of launched investment projects and housing permits was at the lowest level since 2006 (Figure 2.42). This was due to lower profitability of new investment projects during economic slowdown. A decline in investment in the housing sector suggests a

Figure 2.40

Average* prices of flats in Poland's 7 big cities (Gdansk, Gdynia, Krakow, Lodz, Poznan, Warsaw, Wroclaw)

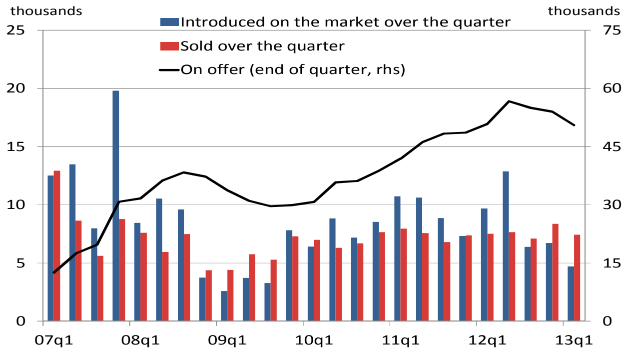


Source: NBP calculations on the basis of sale price data from the NBP survey and PONT Info Nieruchomości asking price data.

* Asking prices – average weighted by the number of offers; sale prices in the primary market – average weighted by the share of the housing stock in a given city in the total housing stock of all 7 cities; sale prices in the secondary market – average adjusted for differences in the qualities of flats.

Figure 2.41

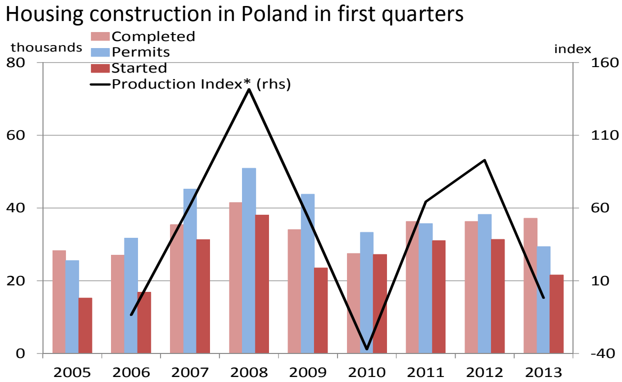
Number of units introduced on the market, sold and on offer



Source: REAS.

Figure 2.42

Housing construction in Poland in first quarters



Source: NBP calculations on the basis of GUS data.

* Production index is a synthetic measure reflecting the condition of construction companies in the housing sector it is a twelve-month moving value of work in progress, i.e. the number of flats whose production was commenced net of completed flats introduced to the market. The index includes single-family housing. Increase in work in progress assets may point to future problems for the construction sector when investors will not be able to meet commitments with regard to the already completed facilities. This may translate into investment freeze and irregular payments.

[40] More information on the condition of the Polish housing market may be found in *Report on home prices and the situation of the residential market in Poland in 2013 Q1*, and *Report on the situation in the Polish residential and commercial real estate market in 2011*, available on the NBP website (www.nbp.pl).

[41] Despite the formal termination of the *Rodzina na Swoim (Family on their own)* housing scheme in 2012, the processing of requests submitted at the end of its validity period resulted in disbursements in 2013 Q1 amounting to approx. 70% of disbursements of 2012 Q4.

likely drop in the supply of new housing in the years to come.

2.6. Credit and money

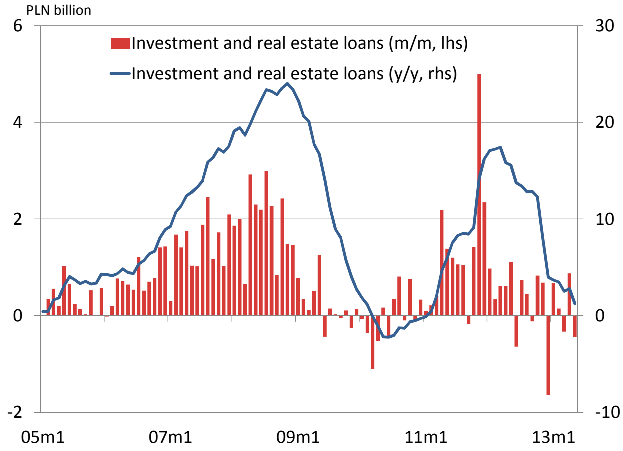
2.6.1. Loans

Since the previous *Report*, lending growth continued on a downward trend[42]. In 2013 Q1 debt of the non-financial sector, non-monetary financial institutions, local government units and social insurance funds increased by an average of PLN 2.3 billion monthly, posting a slower growth than in the corresponding period of the previous year, when the average monthly debt growth reached PLN 3.3 billion[43]. As a result, the average debt growth in 2013 Q1 declined to 4.4% y/y from 5.1% y/y in 2012 Q4[44]. In April-May 2013, increase in debt of the analysed entities was lower again and amounted to PLN 1.3 billion, while debt growth slowed down to 3.5% y/y.

In 2013 Q1, corporate debt edged up to reach PLN 258.3 billion in March. Corporate debt growth was significantly lower than in the corresponding period of 2012 (growth averaged PLN 0.2 billion per month as compared to an average monthly growth of PLN 2.5 billion in 2012 Q1). Average growth in corporate debt continued on a downward trend and amounted to 2.9% y/y in 2013 Q1 as compared to 6.9% y/y in 2012 Q4 (Figure 2.43, Figure 2.44). Slowdown in corporate debt was driven by a concurrent slowdown in short-term and investment loans[45].

Figure 2.43

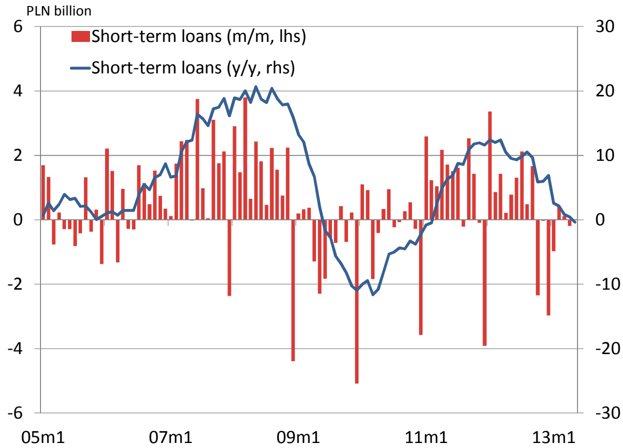
Investment and real estate loans to enterprises



Source: NBP data.

Figure 2.44

Short-term loans to enterprises



Source: NBP data.

[42] Data concerning growth in receivables and liabilities presented in this chapter refer to transactional changes. In the case of corporates, the volume of both corporate lending and deposits is subject to strong seasonal variations (in December and January, in particular), therefore average monthly increases in corporate loans and deposits are compared against those in corresponding periods of subsequent years.

[43] Changes in the volume of lending in 2013 Q1 remained strongly influenced by changes in debt of financial institutions which declined in February after a significant rise posted in January.

[44] In this chapter, average growth shall be understood as the average of 12-month increases.

[45] In April-May 2013, short-term loans to enterprises declined slightly (by 0.1 PLN billion a month on average as compared with an average monthly increase of PLN 0.5 billion in corresponding period of 2012), and their growth slowed down to 0.0% y/y. Investment loans, in turn, increased by PLN 0.2 billion and their growth decreased further as compared to 2013 Q1 and stood at 1.6% y/y (as compared to 2.5% y/y) .

Deceleration in corporate debt also continued in April-May 2013, when average growth in debt was close to zero[46].

Weakening in corporate lending in 2013 Q1 could have been driven, on the one hand, by tightening of lending conditions in this segment as declared by banks, accompanied by further increase in the number of uncreditworthy companies[47]. On the other hand, corporate debt growth was curbed by weak – amidst declining economic activity – demand for corporate loans. Yet, the scale of slowdown in corporate lending was limited by the effected interest rate cuts which – in the absence of significant changes in credit margins – translated into a 0.8 percentage point decline in the average interest rate on loans in 2013 Q1 as compared to the 2012 Q4 level (Figure 2.45, Figure 2.46)[48].

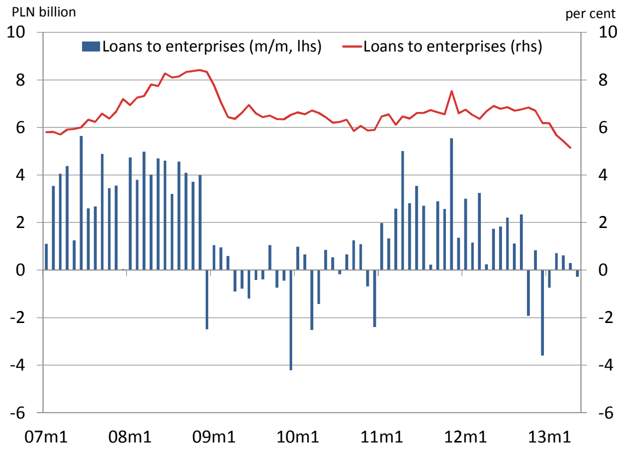
Given the size of enterprises, in 2013 Q1 – as declared by banks – demand for loans from the SME sector remained relatively stable, while demand from large businesses declined somewhat. Moreover, banks slightly tightened their lending criteria for large enterprises. As a result, the slowdown in lending to large businesses was slightly stronger than in the case of the SME sector.

In 2012 Q4, the total foreign debt of enterprises edged down as compared to 2012 Q3 (by EUR 0.2 billion) and amounted to EUR 109.1 billion (Figure 2.47). Debt decline was observed despite a certain increase in the value of loans granted to corporates by their foreign direct investors and resulted mainly from falling value of commercial loans and other loans.

The total household debt increased somewhat in 2013 Q1 and reached PLN 542.5 billion in March 2013, with mortgage loans to households accounting for its largest part (PLN 327.5

Figure 2.45

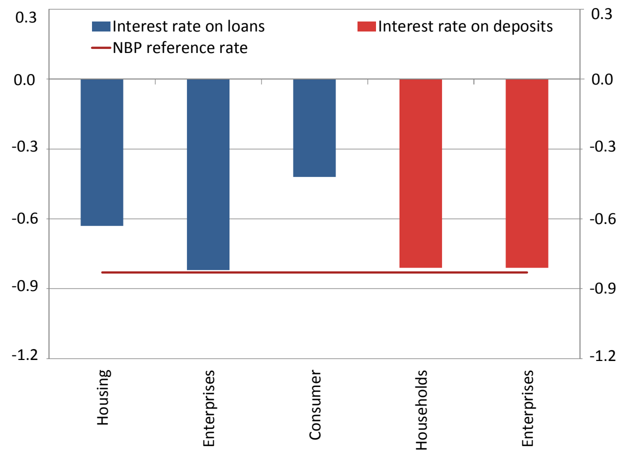
Monthly increases and average interest charged on newly granted loans to enterprises



Source: NBP data.

Figure 2.46

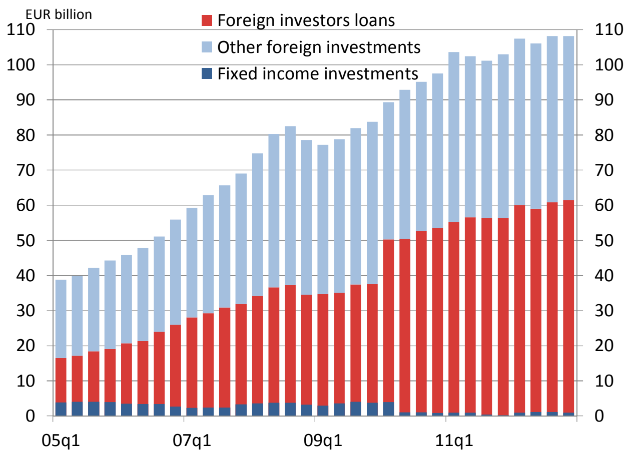
Change of the average interest rates on loans and deposits and of NBP reference rate in 2013 Q1 as against 2012 Q4



Source: NBP data.

Figure 2.47

Total foreign debt of enterprises



Source: NBP data.

[46] In April-May 2013 the corporate debt growth was lower than in 2013 Q1 on average and amounted to 1.7% y/y.

[47] *Situation in the credit market. Results of the Senior Loan Officer Opinion Survey, 2013 Q2, NBP*

[48] In April 2013, the interest rate on corporate loans continued to decrease (by 0.3 percentage points as compared to March 2013).

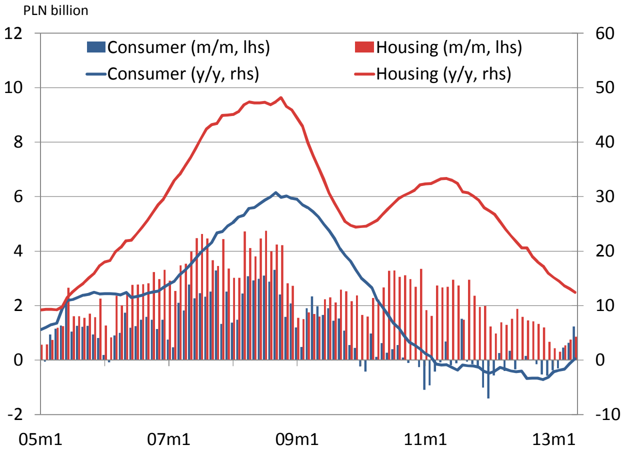
billion). In 2013 Q1, monthly increases in mortgage loans declined significantly - their average level stood at PLN 0.4 billion as compared to the average monthly increase of PLN 1.1 billion in 2012 Q4 (Figure 2.48). Consequently, growth in those loans continued to slow down gradually and in 2013 Q1 averaged 4.6% y/y (as compared to 5.5% y/y in 2012 Q4). In April-May 2013, average growth in housing loans exceeded that registered in 2013 Q1 (reached PLN 0.8 billion), which could have been driven by seasonal increase in demand for this type of loans. At the same time, growth in mortgage lending continued on a downward trend (and amounted to 4.0 y/y).

Lower growth in housing loans in 2013 Q1 was related to falling credit demand, which might have been driven by the termination of the Government's housing scheme *Family on their Own* and deteriorating financial situation of households (see Chapter 2.2.1 *Consumption demand* and Chapter 2.5 *Financial markets and asset prices*)[49]. At the same time, interest rates cuts implemented in 2013 Q1 resulted in a decline in the average interest rate on mortgage loans by 0.6 percentage points as compared to 2012 Q4, despite a certain rise in credit margins during this period (by 0.2 percentage points; Figure 2.46; Figure 2.49)[50].

In 2013 Q1, household debt resulting from consumer loans dropped. However, the decline in loans was lower than in 2012 Q4 (PLN -0.1 billion as against PLN -0.4 billion), which was largely driven by the increase in lending from March 2013 onwards (Figure 2.48)[51]. Slower decline in consumer loans in 2013 Q1 was largely related to a significant rise in the volume of loans from credit unions (SKOKs), which

Figure 2.48

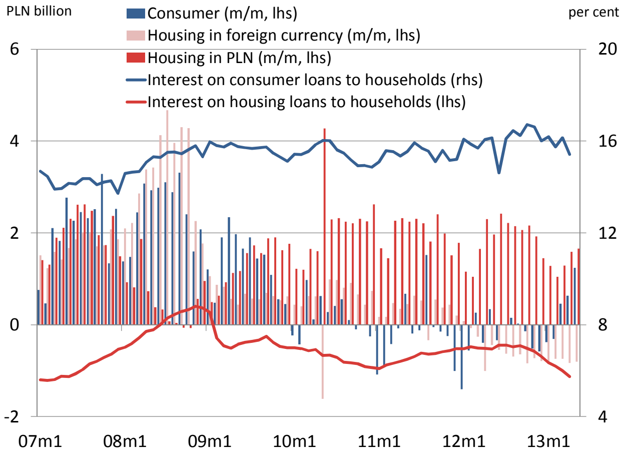
Loans to households



Source: NBP data.

Figure 2.49

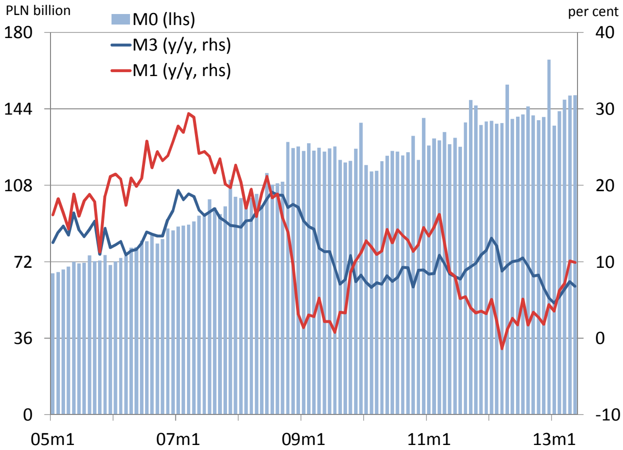
Monthly growth of loans and average interest charged on newly granted PLN loans to households



Source: NBP data.

Figure 2.50

Currency in circulation and annual growth rate of M1 and M3



Source: NBP data.

[49] *Situation in the credit market. Results of the Senior Loan Officer Opinion Survey, 2013 Q2, NBP*

[50] In April 2013, the interest rate on housing loans fell by 0.3 percentage points as compared to March 2013.

[51] In April-May 2013, consumer loans increased by PLN 0.9 billion on average and their growth continued to accelerate (to -0.1% y/y).

might have resulted from a reclassification of loans granted by SKOKs. At the same time, the recovery in consumer loans has been increasingly driven by accelerating growth in bank lending.

As declared by banks, demand for consumer loans, amidst poor economic situation of households, remained low. Concurrently, the impact of lower interest rates on consumer loans was curbed by further increase in credit margins (Figure 2.46; Figure 2.49)[52].

2.6.2. Deposits and monetary aggregates

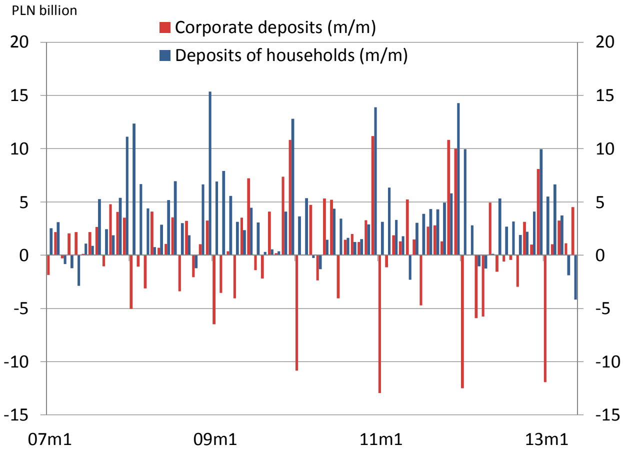
In 2013 Q1, growth in broad money– despite some acceleration since February – remained at a relatively low level (5.5% y/y; Figure 2.50)[53].

The value of corporate deposits in 2013 Q1 declined to reach PLN 180.1 billion in March. The decline in corporate deposits in 2013 Q1 – characteristic for the beginning of the year – was, however, significantly lower than in the corresponding period of the previous year (the average monthly decline of PLN 2.5 billion against a fall of PLN 6.1 billion in 2012 Q1). As a result, even though corporate deposit growth in 2013 Q1 remained negative (average monthly decline of 4.4% y/y), it gradually increased over the quarter (Figure 2.51; Figure 2.54). In turn, in April-May 2013 corporate deposits increased by PLN 2.8 billion against a decline of PLN 0.4 billion in the corresponding period of the previous year. Consequently, deposit growth picked up again and reached 2.7% y/y.

In 2013 Q1, the total value of household financial assets increased to PLN 837.6 billion in March, and their growth accelerated again to reach 7.3% y/y (as compared to 6.7% y/y in

Figure 2.51

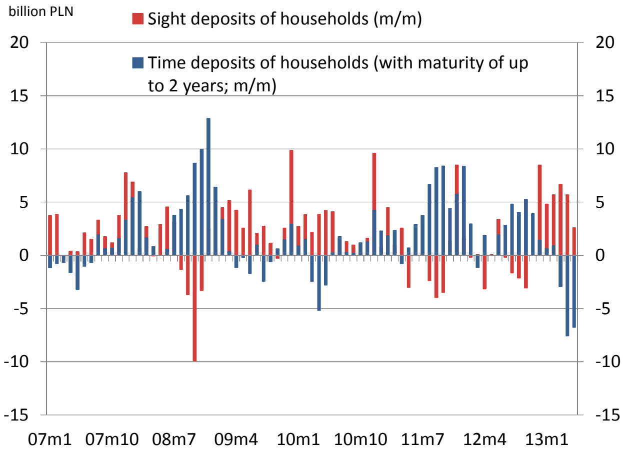
Monthly growth of household and corporate deposits



Source: NBP data.

Figure 2.52

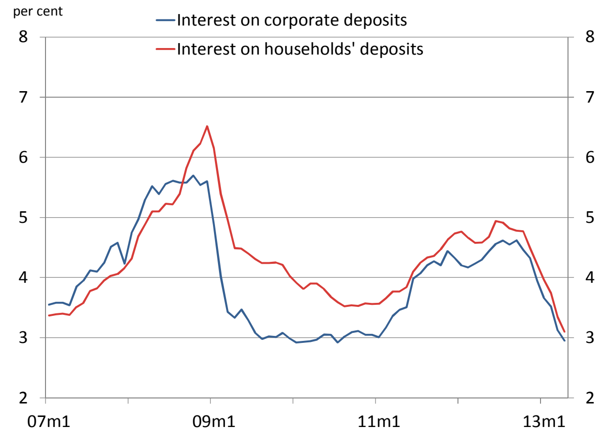
Monthly growth of sight and time deposits of households



Source: NBP data.

Figure 2.53

Interest charged on household and corporate deposits



Source: NBP data.

[52] The observed increase in credit margins did not corroborate the results of the surveys, in which net percentage of 14.8 banks declared to lower their margins in 2013 Q1. In April, loan margins were reduced (by 0.5 percentage points as compared to March 2013), leading to further decline in interest rates on loans.

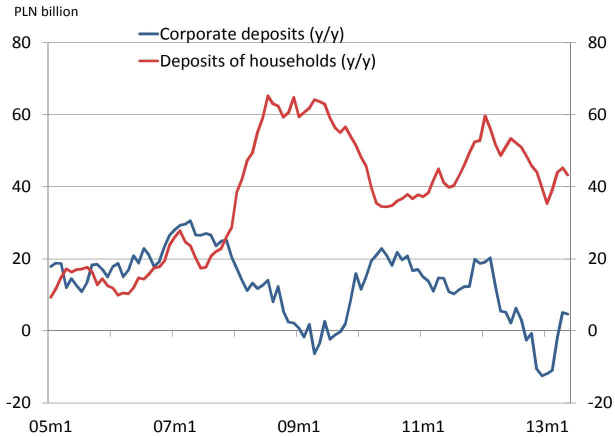
[53] In April-May 2013, it accelerated to 7.1% y/y.

2012 Q4)[54]. Higher value of financial assets was mainly due to a rise in the value of household deposits, whose average monthly growth reached PLN 5.3 billion (Figure 2.51; Figure 2.52)[55]. The scale of deposit growth was larger than in the corresponding period of the previous year (when the average monthly increase amounted to PLN 3.9 billion), which – amidst concerns about unemployment – was probably due to a slowdown in household spending. The decline in deposit growth, in turn, was driven by a significant reduction in the interest rate on deposits (by an average of 0.8 percentage points as compared to 2012 Q4), which could also boost the inflow of assets to investment funds (which in 2013 Q1 reached PLN 2.9 billion as compared to PLN 2.1 billion in 2012 Q4)[56].

In April-May 2013, household deposits with maturity up to 2 years decreased, and the scale of the decline was considerably larger than in the corresponding period of the previous year (a decrease of PLN 3.0 billion and PLN 0.6 billion, respectively). Deeper decline in deposits with maturity up to 2 years could have been driven – apart from further inflow of assets to investment funds and lowering of the interest rate on deposits – by households shifting to deposits with longer maturity due to an offer made by one of the banks.

Figure 2.54

Annual growth of household and corporate deposits at banks



Source: NBP data.

[54] The given value of financial assets includes both deposits with maturity up to 2 years and deposits with maturity exceeding two 2 years, the latter not included in the M3 aggregate. In April 2013, the increase in the value of household assets continued to accelerate, reaching 8.3% y/y.

[55] It concerns deposits with maturity up to 2 years. Household deposits are subject to strong seasonal variations, they increase quickly at the beginning of the year, in particular. The increase in deposits in January and February 2013, was driven by the payment of annual bonuses and awards to employees and direct farming subsidies.

[56] In April 2013, the interest rate on household deposits decreased by 0.2 percentage points as compared to March 2013.

2.7. Balance of payments[57]

In 2013 Q1, the current account deficit narrowed substantially, reaching EUR 2.6 billion (as against EUR 4.5 billion in 2012 Q1). The reduction in the current account imbalance was driven by an improvement in the trade in goods account in 2013 Q1 (Figure 2.55). The improvement was the effect of falling imports amidst a modest growth in exports.

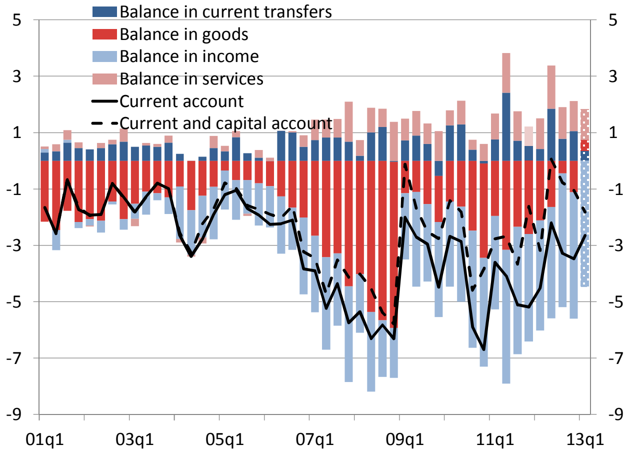
Factors adding to the current account imbalance included a higher deficit in the income account coupled with slightly reduced surpluses in the services and current transfer accounts. Income deficit persists at high levels due to substantial income receipts of foreign direct investors, supported by strong financial performance of Polish businesses.

In 2013 Q1, the surplus in the capital account decreased on the year before as a result of, among others, lower EU investment transfers (Figure 2.55).

The surplus in the financial account rose in 2013 Q1 compared with the corresponding quarter of 2012, fuelled primarily by higher FDI inflow to Poland. However, the 2013 Q1 rise in the FDI inflow on its 2012 Q1 level resulted largely from the base effect relating to a one-off transaction causing an outflow of capital in 2012 Q1. At the same time, portfolio investment flows to Poland weakened.

Figure 2.55

Current account balance (in EUR bn)

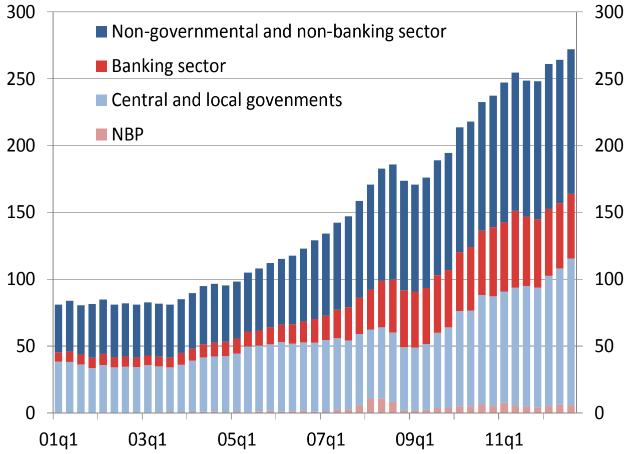


Source: NBP data and estimates.

2013 Q1 data refer to preliminary data for the period January - March 2013

Figure 2.56

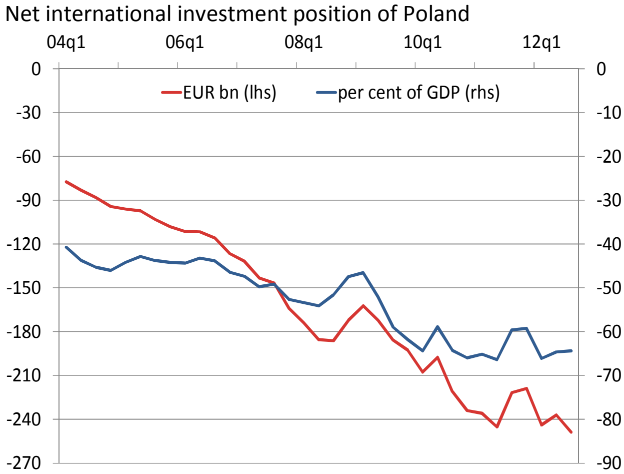
External debt of Poland (in EUR bn)



Source: NBP data.

Figure 2.57

Net international investment position of Poland



Source: NBP data.

[57] Balance of payments figures are based on quarterly data up to and inclusive of 2012 Q4 and monthly data relating to the period of January-March 2013. The quarterly data for 2013 Q1 were published after the cut-off date.

In 2013 Q1, Poland's external imbalance indicators improved (Table 2.5)**.** In particular, the current account deficit as well as the combined current and capital account deficit in relation to GDP decreased.

Table 2.5
Selected indicators of external imbalances

	2008	2009	2010	2011	2012 q1	2012 q2	2012 q3	2012 q4	2013 q1
Current account balance/GDP (in %)	-6.6	-3.9	-5.1	-4.9	-5.1	-4.6	-4.1	-3.5	-3.0
Current and capital account balance/GDP (in %)	-5.4	-2.3	-3.3	-2.9	-3.0	-2.3	-1.5	-1.3	-0.9
Trade balance/ GDP (in %)	-5.8	-1.7	-2.5	-2.7	-2.8	-2.4	-1.8	-1.4	-0.7
Gross foreign direct investment /current account deficit (in %)	43	77	58	76	34	36	22	20	57
Gross foreign direct investment/current and capital account deficit (in %)	51	132	90	127	58	72	60	54	185
Official reserve assets in terms of monthly imports of goods and services	3.3	5.3	5.4	5.2	5.1	5.6	5.6	5.6	5.8
Foreign debt/ GDP (in %)	48	62	67	67	71	72	74	72	
Short-term foreign debt /official reserve assets (in %)	106	88	83	73	75	70	69	64	
Net international investment position/GDP (in %)	-48	-62	-66	-59	-66	-65	-67	-67	
Foreign debt with maturity up to one year / official reserve assets (in %)*	167	152	123	119		145	123	118	117

Source: NBP data.
*Data available on a 6 month basis until the first half of 2012.

Chapter 3

MONETARY POLICY IN MARCH - JULY 2013

At the meeting in March 2013 the Monetary Policy Council decreased NBP interest rates by 0.50 percentage points. At the meeting in April 2013 the Council decided to keep the NBP interest rates unchanged. At the meeting in May, June and July 2013 the Council decided to decrease the NBP interest rates by 0.25 percentage points on each occasion to the level: reference rate to 2.50% on an annual basis, lombard rate to 4.00% on an annual basis, deposit rate to 1.00% on an annual basis, rediscount rate to 2.75% on an annual basis.

What follows in the next part of the chapter are the previously published *Minutes of the Monetary Policy Council decision-making meetings* held in March, April, May and June 2013 as well as the *Information from the meeting of the Monetary Policy Council* in July 2013. *Minutes of the MPC decision-making meeting* in July will be published on 22 August, and after that included in the next *Report*.

Minutes of the Monetary Policy Council decision-making meeting held on 6 March 2013

At its meeting, the Monetary Policy Council discussed the current and future monetary policy decisions against the background of macroeconomic data and the March projection of inflation and GDP.

While analysing the external conditions, it was pointed out that in 2012 Q4 economic growth in the United States had come to a halt and economic activity in the euro area had remained weak. It was emphasised that GDP in most euro area countries, including its largest economies, i.e. France and Germany being Poland's main trading partner, had declined in that period. At the same time, attention was drawn to signs of some improvement in economic indicators in several euro area countries in the first months of 2013. However, there were doubts expressed whether this already indicated a recovery in these countries. Some Council members expected the recession in the euro area to abate at a slow pace. In this context, attention was drawn to an increase in political uncertainty in Italy, which could dampen the business sentiment in the euro area and in the financial markets.

While analysing the economic developments in Poland, the Council members emphasised that the GDP data on 2012 Q4 had confirmed a pronounced slowdown in the economy in that period. Attention was drawn to continued weakening in domestic demand, which was driven by both further investment decline and decreasing consumer demand. It was indicated that the monthly data, released since the previous meeting, implied that also in early 2013 the economic activity had remained weak. At the same time, it was noted that the monthly data on industrial output and retail sales were somewhat better than had been expected and some economic indicators had improved of late, which might suggest an increase in economic activity in the coming quarters.

The majority of the Council members were of the opinion that an on-going deterioration in labour market conditions and slow household lending growth were containing demand growth in Poland, in particular with respect to consumer demand. Against this backdrop, some Council members pointed to a continued gradual rise in the unemployment rate observed in recent years. This limits wage pressure in the economy and adversely affects consumption growth. However, a few Council members noted that rising unemployment rate in the past few years had been driven to a large extent by growing labour supply rather than falling employment.

While discussing lending developments, an opinion was voiced that credit policy tightening of banks was an important factor behind weaker lending growth. Against this background, a few Council members pointed out that even if standards for household lending were eased, this would not translate into any marked rebound in household lending due to declining household credit demand. It was pointed out that cuts in the NBP interest rates would contribute to faster lending growth. At the same time, a few Council members emphasised that the recent NBP interest rate cuts had translated into greater decreases in interest rates for bank deposits than for bank loans, while household and corporate lending growth remained low despite monetary policy easing, which was due to lower credit demand. A few Council members pointed out that lower interest rates on bank deposits might weaken household propensity to save.

While discussing the outlook for economic growth against the background of the March projection, the majority of the Council members stressed that, according to the projection, even though the GDP growth would probably accelerate gradually in the coming quarters, it would remain low. It was also pointed out that in line with the projection, domestic demand growth would continue to be very slow in 2013, with the output gap remaining negative over the projection horizon. This suggests a limited risk of mounting wage pressure in the coming years. Yet, a few Council members were of the opinion that GDP growth might run slightly higher than projected. These members argued specifically that improvement in the economic situation abroad, as assumed in the projection, should translate into faster GDP growth in Poland. In addition, referring to the data on restructuring in the Polish enterprise sector, these members expressed their doubts on the total factor productivity growth assumed in the projection. In their opinion, this growth could be lower compared to the projection, which would result in potential output growing slower and output gap closing faster than in the projection.

While analysing CPI inflation developments, attention was drawn to its decline in January 2013 close to the lower limit for deviations from the NBP inflation target. It was stressed that in line with the March projection – under the assumption of unchanged interest rates –inflation would remain close to the lower limit for deviations from the inflation target over the projection horizon. In the light of the projection, such CPI inflation developments are to result from low energy price growth in the coming years and a decline in core inflation. The expected decrease in core inflation and unit labour costs growth indicate still low demand and cost pressure in the years to come.

In the opinion of some Council members, inflation might run above the projection path. Those members indicated that the global geopolitical situation remained an important upside risk for energy prices. They also argued that – under the assumption of faster growth in energy prices – inflation might run close to the inflation target in the coming quarters, hence above the projection. A few Council members were of the opinion that, given an acceleration in labour productivity growth as shown in the projection, wage growth should not run close to historical lows. As a result, unit labour costs might, in their opinion, grow faster than in the projection, which would contribute to higher inflation. Also faster than projected growth in private consumption might spark faster price growth. Moreover, it was pointed out that another factor increasing CPI inflation compared to projection path was that VAT rate hike could remain in force in the coming years, should the impact of economic downturn on the public finance sector prove to be stronger than currently assumed.

While discussing the NBP interest rates, the majority of the Council members decided that they should be lowered at the March meeting. However, their opinions differed as to the scale of the NBP interest rate cuts. Some members of the Council assessed, though, that the interest rates should be kept unchanged at the current meeting.

The majority of the Council members assessed that – as the March projection assumed inflation to stay markedly below the NBP inflation target and the output gap to remain negative in the coming years – it was justified to continue to lower the NBP interest rates. In this context, these members argued that, even after interest rate cuts, real interest rates would remain markedly positive at levels ensuring that the risk of a build-up of imbalances in the economy would be contained.

The majority of the Council members were of the opinion that the incoming data and the outlook for the economy as shown in the projection justified stronger interest rate cuts than at previous meetings. However, a few Council members reckoned that the scale of the interest rate cuts at the March meeting should not be larger than at the previous meetings. In the opinion of these Council members, concerns of excessive interest rate cuts leading to a further decline in propensity to save in the banking sector, suggest maintaining the previous pace of monetary policy easing.

On the other hand, a few Council members assessed that the current interest rate level was low as compared to previous periods of the economic slowdown, and that further monetary policy easing was unjustified. Therefore, in their opinion, as the risk of inflation running above the projection was high in the medium term, the current interest rate level was appropriate for inflation to return to the target over this period. They assessed that excessive interest rate cuts would undermine the supply side of the economy, including the restructuring intensity in the enterprise sector, and as a result might have an adverse effect on GDP growth in the longer run.

In the opinion of the majority of the Council members, the interest rate cuts both at the current and at the previous meetings, will help to ease monetary conditions and support higher economic growth, and consequently, help to bring inflation close to the target in the medium term. The majority of the Council members recognised that the decision to lower interest rates at the current meeting complemented the interest rate cut cycle.

However, a few Council members did not rule out the possibility of a further interest rate adjustment, should the incoming data point to weaker economic activity or lower inflation than in the March projection.

At the meeting, a motion was submitted to lower the NBP basic interest rates by 0.50 percentage points. The motion passed. A motion was also submitted to lower the NBP basic interest rates by 0.25 percentage points. As the motion to lower the NBP basic interest rates by 0.50 percentage points had passed, this motion was not voted on. The Council decided to lower the NBP basic interest rates by 0.50 percentage points to the following levels: reference rate to 3.25%, lombard rate to 4.75%, deposit rate to 1.75% and rediscount rate to 3.50%.

Minutes of the Monetary Policy Council decision-making meeting held on 10 April 2013

During the meeting, members of the Monetary Policy Council discussed the current and future monetary policy decisions against the background of macroeconomic developments in Poland and abroad.

While addressing the external conditions it was pointed out that in 2013 Q1 the euro area had probably remained in recession and the outlook for recovery in this economy continued to be highly uncertain. In this context, Council members emphasised that in the recent period GDP forecasts for the euro area in 2013 had been revised downward, and economic indicators, after a certain improvement at the beginning of the year, deteriorated. Against this background attention was also drawn to weak business climate indicators in France. Yet, it was argued that in Germany, Poland's main trading partner, business conditions in 2013 Q1 were better than in the entire euro area. Moreover, it was indicated that Germany was expected to see a certain acceleration in economic activity growth in 2013 and 2014, which might be related to rising domestic demand supported by high employment and low unemployment. Attention was also drawn to a relatively favourable outlook for demand in the United States and in Japan. Yet, concerns were expressed that economic growth in some advanced economies in the subsequent years would remain relatively low – in the opinion of a few Council members also due to large share of government expenditure in GDP.

The Council members emphasised that strongly expansionary monetary policy pursued by major central banks, including the announcement of considerable quantitative easing by the Bank of Japan, might lead to intensified inflow of portfolio capital to the emerging economies, including Poland. As a result, those factors support Treasury bonds price increases, yet, in the longer term, might increase volatility of those prices and of the zloty exchange rate, in particular amidst sudden shift in risk aversion in the global markets. Yet, a few Council members remarked that the inflow of portfolio capital observed in the recent period had not been accompanied by any significant appreciation of the zloty. In turn, other Council members pointed out that recurring intensification of banking sector problems in some euro area economies might be a risk factor for Poland's financial sector.

While discussing the economic developments in Poland, Council members indicated that in 2013 Q1 economic activity had remained weak without signs of recovery. In this context, it was emphasised that industrial output in February had declined following its merely slight increase in January, whereas construction output growth continued to be negative. The Council members also pointed out that consumer demand had remained low, despite a certain improvement in consumer sentiment observed in the recent period, which was reflected in negative annual growth in retail sales in February 2013. According to the Council members, weak economic activity in Poland in 2013 Q1 was also suggested by weak business climate indicators, despite a certain improvement in some of those indicators in the recent period. Attention was also drawn to financial results of corporations which had deteriorated in 2012 Q4. At the same time, it was emphasised that financial condition of corporations exporting their output continued to be better than that of companies selling their goods in the domestic market.

While analysing the situation in the labour market, lack of wage pressure was emphasised. Acceleration in annual growth in enterprise sector wages observed in February was probably driven by the statistical base effect and was one-off in nature. Some Council members observed that low demand in the economy contributed to a further rise in the unemployment rate, which, in their opinion, might have an adverse effect on human capital, and, consequently, the economy's potential product. Yet, a few Council members expressed an opinion that the observed rise in the unemployment rate was largely the result of growing labour supply and adjustments in employment in enterprises, following the previously observed excessive employment growth. Those members argued that the labour market situation should improve with a rebound in production. The Council members also pointed to the structural features of the labour market, including its elasticity as regards employment contracts. A few of them argued that this elasticity favoured low labour remuneration which, on the one hand, helped enterprises to maintain their competitive advantage, but, on the other hand, had a negative impact on household savings and consumption. Yet, other Council members emphasised that weak geographical mobility of working population, resulting from poorly developed home rental market, was a considerable problem affecting the labour market.

Members of the Council emphasised that weak economic activity was accompanied by a decline in corporate lending growth both as regards current and investment loans and a low growth in lending to households. A few Council members also pointed to falling value of new household deposits in February. Other Council members indicated, however, that despite interest rate decrease in the recent period – the annual growth in household deposits observed in February exceeded the January growth.

While assessing the outlook for demand growth in Poland, the majority of the Council members believed that in the coming quarters GDP growth should accelerate, albeit would remain moderate. Slightly higher GDP growth would be, in the opinion of some Council members, the result of somewhat accelerating export growth driven by improving conditions in the German economy in the subsequent quarters. A few Council members also pointed out that declining inflation would stimulate purchasing power of consumer income which would, in turn, support domestic demand. Yet, some Council members were of the opinion that recovery in the Polish economy might be delayed, and the moment and scale of GDP growth acceleration were subject to uncertainty, especially given the uncertainty about recovery in the euro area. Other Council members, however, argued that GDP growth acceleration in the subsequent quarters might be stronger than indicated by the March projection of the NBP.

With reference to inflationary processes, Council members highlighted the fact that the CPI index had decreased below the lower limit for deviations from the target – as well as the level envisaged in the March projection. In this context they pointed to a decline in all core inflation measures, confirming low demand pressure prevailing in the economy. Yet, a few Council members were of the opinion that the recently observed decline in inflation had largely been the result of supply shocks. Most Council members believed that CPI inflation would continue to run below the lower limit for deviations from the NBP inflation target, whereas core inflation would remain low and stable. However, some Council members pointed to factors that might drive future inflation higher than forecasted. It was pointed out that amidst low tax revenues, there was a significant likelihood of the VAT rate being kept at the elevated level into 2014, which would shift up the CPI inflation path for 2014 indicated by the March NBP projection. Yet, other Council members argued that higher-than-assumed VAT rate would curtail the purchasing power of households' income, thus limiting demand pressures in the economy. In addition, some Council members indicated short-term upward risks to prices, relating to the prolonged winter, which could contribute to increase in the prices of food and municipal services. A few Council members also observed that the current and forecast core inflation was running at levels which in the past had allowed to keep CPI inflation within the symmetrical tolerance band of deviations from the target.

While discussing the level of the NBP interest rates it was agreed that these should be kept unchanged at the present meeting, in particular amidst ambiguous signs of a possible economic recovery in the subsequent quarters. At the same time, while addressing future decisions, some Council members were of the opinion that another interest rate cut in the coming months might be justified should there be no clear signs of rebound in the Polish economy, and should the likelihood of inflation persisting below the NBP target in the medium term rise. In the opinion of these Council members, an argument in favour of a further rate cut would be that real interest rates remained relatively high due to sharper than forecast inflation decline combined with decreasing inflation expectations, and the absence of clear signs of recovery in the Polish economy. At the same time, some Council members emphasised the fact that the relatively large interest rate disparity vis-a-vis advanced economies might fuel the inflow of portfolio capital to Poland, particularly in the environment of high liquidity in the global markets which received an additional boost from a marked increase in monetary expansion by the Bank of Japan.

Some Council members believed, however, that the NBP interest rates should not be lowered further, as GDP growth was anticipated to accelerate in the subsequent quarters and CPI inflation in 2014 was likely to run above the level envisaged by the projection. A few of those Council members argued that further interest rate cuts might limit the scale of restructuring of unprofitable enterprises, hampering reallocation of resources towards more productive enterprises. At the same time, in their opinion, further NBP interest rate cuts would not support demand in the economy, as the current downturn was mainly caused by weak sentiment of economic agents and low external demand growth. These members also believed that interest rate cuts might lead to an excessive rise in Treasury bond prices, which could increase the macroeconomic risk in the event of a sudden outflow of capital in the future. Other Council members argued that keeping real interest rates at a relatively high level would stimulate deposit growth, thus supporting the stability of the banking sector, in particular amidst the uncertainty about the stability of the banking sector persisting in some euro area countries.

The Council decided to keep the basic interest rates unchanged at the following levels: reference rate at 3.25%, lombard rate at 4.75%, deposit rate at 1.75%, rediscount rate at 3.50%.

Minutes of the Monetary Policy Council decision-making meeting held on 8 May 2013

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

Referring to external conditions, it was emphasized that signs of renewed weakening in the global economic conditions had appeared in recent months. It was indicated that in Q1 GDP growth in the United States had been lower than expected by market participants and the sentiment of the local economic agents had deteriorated. It was further argued that continued measures to reduce the general government sector imbalances in the United States might contain the economic growth in the coming quarters. Meanwhile, the euro area is likely to have remained in recession and a renewed deterioration in leading indicators in most of its member states, including Germany, may imply that the economic recovery may be delayed. A few Council members indicated at the same time that, according to external forecasts, economic conditions in Germany, the main trading partner of Poland, were set to improve gradually in the second half of the year. Referring to the recent data on economic activity abroad, it was also pointed out that the deteriorating economic conditions in developed countries translated into weaker growth in major emerging market economies.

While discussing price developments abroad, it was noted that inflation had declined in many economies, including the euro area. A few Council members emphasized, however, that core inflation in the euro area had remained stable, whereas lower price growth in the region, as in other economies, had largely resulted from a decrease in commodity prices, including food and energy, observed in recent months.

While referring to the monetary policy of the major central banks, it was highlighted that the European Central Bank had decreased interest rates in May, which had led to an increase in the spread between the interest rates in Poland and the euro area. Council members emphasized that highly expansionary monetary policy of major central banks may continue to contribute to stronger portfolio capital inflows to emerging economies, including Poland. This contributes to a rise in sovereign bond prices. However, this can lead to an increase in the volatility of sovereign bond prices over time, in particular amid rapid changes in risk aversion in global markets.

While discussing the recent data on the Polish economy, Council members pointed out that estimate of GDP in 2012 Q4, including investment expenditure, had been revised down. It was assessed that in 2013 Q1 economic growth had probably remained low, as indicated by a decline in industrial and construction output and real retail sales growth, which had been close to zero. Council members also emphasized that economic indicators in April – after a temporary improvement in previous months – had weakened again.

Council members expressed a view that the labour market conditions were not conducive to accelerating consumer demand growth. In particular, the employment in the corporate sector continues to decline, while the seasonally-adjusted unemployment rate increases, which translates into a weak wage growth. In this context, it was pointed out that the wage growth in the enterprise sector had been low and the real wage fund had declined. A few Council members noted, however, that the decline in inflation, in particular resulting from lower energy price growth, was conducive to strengthening the purchasing power of household incomes and to improving the financial position of enterprises.

While discussing the monetary developments, some Council members pointed out that the household and corporate loan growth had weakened further. At the same time, it was indicated that household and corporate deposits had increased in March. According to some Council members, the growth in household deposits could have been caused by an increase in the propensity to save amid economic slowdown and deterioration of the labour market. Against this backdrop, falling deposit interest rates do not contain the propensity to save. In this context, it was also noted that the decreases of NBP interest rates to date had been passed on into deposit rates to a greater extent than rates on loans, including in particular consumer loans.

While assessing the outlook for the economic activity in Poland, some Council members recognized that the uncertainty over the pace and timing of economic recovery had recently increased. This results in particular from deteriorating economic outlook abroad, which may translate into a lower contribution of net exports, the key demand factor of economic growth in the previous quarters, to GDP growth. Furthermore, some Council members emphasized no signals of a possible significant increase in domestic demand in the coming quarters. Some Council members also indicated that – due to higher than scheduled general government deficit in relation to GDP in 2012 and the likely upholding by the EU of excessive deficit procedure imposed on Poland – further fiscal tightening should be expected in the coming years, which would continue to contain demand growth. A temporary reduction in the investment co-financed with EU funds may be also conducive to lower economic activity. However, other Council members were of the opinion that the expected improvement in economic activity in Germany in the second half of 2013 should translate into a recovery in the Polish export sector. It was also noted that capacity utilization in the economy had grown in 2013 Q1, and that – in line with available forecasts – GDP growth should not decrease further and it is expected to accelerate gradually over coming quarters.

With reference to price developments, the majority of the Council members highlighted a further decrease of the CPI annual index, which has been running below the lower limit for deviations from the NBP inflation target since February 2013. Hence, the CPI inflation declined below the March projection. It was also stressed that core inflation had continued to decline, which confirms low demand pressure in the economy. At the same time it was indicated that a decline in food and energy price growth had significantly contributed to a decrease in inflation over recent months.

While assessing the outlook for inflation, the majority of Council members were of the opinion that in the coming quarters the CPI inflation was likely to stay below the March projection, which – along with the uncertainty over the pace of economic recovery in Poland – increases the risk of inflation running below the target in the medium term. Low inflation will also result from a decline in commodity prices in the global markets. Low inflation expectations of economic agents also point to no risk of a significant acceleration in the price growth. However, some Council members pointed out that given an expected global recovery in the second half of 2013, commodity prices in global markets may increase back in one-year time horizon. These members also emphasized that the March projection did not account for the impact of the maintaining heightened VAT rate on the level of inflation in 2014. However, other Council members noted that, even if no decrease in VAT rate was taken into account, inflation should remain below the March projection.

While discussing the level of the NBP interest rates, the majority of Council members assessed that they should be lowered at the current meeting. However, their opinions differed as to the scale of the decrease. In turn, other Council members were of the opinion that the interest rates should be kept unchanged.

The majority of Council members were of the opinion that an adjustment of monetary policy easing cycle was justified, as the incoming data did not indicate any clear signs of economic recovery in the Polish economy and its environment, while the decline in inflation was stronger than in the projection, which raised the risk of inflation staying below the target in the medium term. Moreover – despite the lowering of interest rates to date – faster than previously forecasted decline in inflation and inflation expectations had translated into an increase in real interest rates. At the same time, some Council members pointed out that – amid ample liquidity in global markets – a relatively high interest rate spread between Poland and developed economies might excessively intensify the portfolio capital inflows into Poland. According to a few Council members, the NBP interest rates should be adjusted as fast as possible, which supports the greater scale of their reduction at the current meeting.

However, other Council members believed that due to expected acceleration in the GDP growth in the coming quarters and upside risks to inflation, the NBP interest rates should not be lowered at the current meeting, and furthermore, a few of those Council members argued that the cycle of the monetary policy easing should be terminated. In their opinion, the NBP interest rates were already at their historical lows and further decreases in the NBP interest rates would not support demand in the economy to a significant extent. In their opinion, the current slowdown was attributable mainly to weak sentiment of economic agents and a low external demand growth. Moreover, a few Council members were of the opinion that further lowering of interest rates could also adversely affect the restructuring in the Polish corporate sector, which influences economic growth over longer run. Low interest rates might also boost excessively risky investment projects.

With reference to future decisions, some Council members reckoned that further interest rate decreases could be justified in the coming months if the probability of inflation running below the NBP target over the medium term rose. In the opinion of a few Council members, the results of the next inflation projection should be considered when assessing whether it could be justified to decrease the interest rates.

At the meeting, a motion was submitted to lower the NBP basic interest rates by 0.50 percentage points. The motion did not pass. A motion was also 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 3.00%, lombard rate to 4.50%, deposit rate 1.50%, rediscount rate to 3.25%.

Minutes of the Monetary Policy Council decision-making meeting held on 5 June 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 the conditions in the external environment of the Polish economy it was noted that data on the euro area GDP in 2013 Q1 had proven to be weaker than expected and confirmed continuing recession in the euro area. Some members of the Council pointed to the fact that although business condition indicators for the euro area had improved somewhat, as observed in the recent period, they continued to suggest persisting recessionary trends in that economy, further delaying the prospects for economic recovery. Factor having an adverse effect on economic activity in the euro area – according to those members of the Council – was the on-going process of deleveraging in the private sector and tightening of the fiscal policy. This translated, in particular, into further deterioration of the labour market situation in many countries, which, combined with unresolved capital shortfall of some euro area banks, hampered growth of the euro area economy.

At the same time, it was pointed out that GDP growth in the United States accelerated in 2013 Q1. An important factor supporting activity in the U.S. economy was revival of consumption, observed amidst gradually declining unemployment. Some members of the Council pointed out that, in the opinion of market participants, improving situation in the labour market and continued economic recovery might urge the Federal Reserve to limit the scale of asset purchases over the next few quarters. The signs of a possible reduction of monetary policy expansiveness by the Fed had strongly effected the sentiment in the global financial markets. Consequently, the emerging markets, including Poland, saw some outflow of its portfolio capital, which was reflected in the weakening of the zloty exchange rate and rising yields on Polish bonds.

While addressing domestic economic activity in early 2013, it was indicated that GDP growth in the first quarter was significantly weaker than expected. It was also stressed that although investment decline had slowed down somewhat, domestic demand continued to decline amidst stagnation in consumption. Moreover, lower contribution of net exports to GDP growth confirmed that low activity abroad, in particular, the recession in the euro area, was adversely affecting the Polish economy. It was also emphasized that the monthly macroeconomic data (stagnation of industrial output and retail sales and further decline in construction output in April) signalled continued weak economic activity at the beginning of 2013 Q2.

Some members of the Council assessed that also the coming quarters might be expected to see persistently low economic activity in Poland, and that recovery might start later than previously assumed. In their opinion, economic activity would continue to be negatively affected by deteriorating situation in the labour market, low credit growth and on-going fiscal tightening (including the decline in public investment). Economic growth would further be curbed – in the opinion of those Council members – by the lack of a significant recovery in the euro area.

Other members of the Council assessed, however, that subsequent quarters might be expected to bring gradual recovery in economic growth. In this context, they pointed to positive signals from the national accounts data, i.e. a less steep investment decline in 2013 Q1 and acceleration in GDP growth, added value and exports in quarter-on-quarter seasonally adjusted terms. Moreover, in their opinion, the approaching economic recovery might be suggested by the improvement in some business condition indicators, halting the decline in the number of new orders in industry and accelerating growth in monetary aggregates observed at the beginning of Q2.

While analysing inflation developments it was pointed out that April 2013 saw another decline in inflation (to 0.8%), which remained markedly below the NBP inflation target. Some members of the Council emphasized that the fall in inflation in the past few months has been stronger than expected in the March projection, and that some of the latest short-term forecasts indicated possible further decline in inflation in subsequent months and its remaining below the lower limit for deviations from the NBP target over the coming year. When discussing inflationary processes, the steepening fall in producer prices (PPI) and continued lack of wage pressure were also noted. According to the majority of the Council members, when taking into account the lack of cost and wage pressures and weak growth prospects, the risk of inflation running below target in the medium term was still greater than the risk of inflation exceeding the target, despite the monetary policy easing implemented so far and some depreciation of zloty exchange rate observed recently. A few members of the Council emphasized, however, that inflation could return to the NBP target within a few quarters, as suggested by forecasts of financial analysts and Assumptions for 2014 budget law adopted by the Ministry of Finance.

While addressing the situation in the labour market, a few members of the Council pointed out that although wage growth remained slow, the lowest wages were rising faster than the average ones, which was due to the currently implemented and planned increases of the minimum wage. This contributed to rising unemployment among the young and the low-skilled workers. A few members of the Council argued, however, that an excessively low minimum wage would discourage labour participation, and the current ratio of minimum wage to average wage did not seem high.

While analysing the situation in the banking sector, a few members of the Council pointed out that the recently implemented monetary policy easing had so far not contributed to a revival in lending, which – in their opinion – showed that further interest rate cuts offered only limited potential to boost economic activity. At the same time, those Council members pointed out that falling interest on term deposits, driven by NBP interest rate cuts, discouraged households from this form of saving; whereas term deposits are a relatively stable source of bank financing. Yet, other members of the Council emphasized, that the NBP interest rate cuts had been vastly passed through into interest rates on bank loans and deposits. They also stressed that as monetary policy transmission mechanism was characterised by considerable time lags, interest rate cuts should not be expected to translate immediately into lending and economic growth. In turn, as regards reduced volume of term deposits, those Council members indicated that withdrawn funds were transferred to current and savings accounts, and therefore only maturity structure of banks' liabilities changes.

In assessing the current interest rate level, some members of the Council emphasized that the scale of the monetary policy easing implemented so far was significant, and the NBP interest rates were currently low. According to a few Council members, excessively low interest rates might bring negative effects, namely: undermine the incentives for corporate restructuring, change the structure of bank lending (increase role of mortgage loans, while limiting lending to corporates), spur unprofitable in the long-term investment projects, and lead to asset price bubbles. Those members of the Council also pointed out that some of those factors might translate into lower potential growth. Other members of the Council argued that corporate restructuring was hampered to a much larger extent by institutional and legal factors, and given banks' current attitude to lending, the risk of financing unprofitable investment was not high enough to justify keeping interest rates at – what they assessed to be – an excessively high level. Moreover, in the opinion of those Council members, declining current and forecasted inflation was increasing real interest rates above the level adequate to the current macroeconomic conditions. At the same time, as regards the risk of decreasing potential output growth, a few Council members pointed out that it might also be driven by a prolonged economic downturn, which, causing heightened unemployment might have a lasting negative impact on human capital and increase the level of equilibrium unemployment.

While discussing the level of the NBP interest rates, the majority of Council members assessed that they should be lowered at the current meeting. However, their opinions differed as to the scale of the decrease. In turn, other Council members were of the opinion that the interest rates should be kept unchanged.

When discussing the NBP interest rate decision, the majority of the Council members pointed out that the incoming data confirmed stronger – than expected in March – economic slowdown in Poland and abroad, and a deeper than anticipated decline in inflation. Given the above and considering the uncertainty about the scale and timing of economic recovery in the euro area and the risk of prolonged period of weak economic activity in Poland, the scale of monetary policy easing should be expanded. Further interest rate cuts would support recovery in the Polish economy, and thus the return of inflation to the NBP target in the medium term. At the same time, some of those Council members assessed that the scale of interest rate cuts at the June meeting should be moderate in order to reduce their negative impact on households' propensity to save in the banking sector. In the context of the decision about the scale of interest rate cuts, those Council members also pointed to the issue of interest rate differential between Poland and major developed economies, which may be important for portfolio capital flows. Some Council members argued, however, that due to time lags in the monetary transmission mechanism, the monetary policy easing should be more decisive and the scale of interest rate cuts in June larger.

Other members of the Council assessed that the coming quarters should be expected to bring a gradual recovery in economic activity and a rise in inflation over the coming year (partly due to statistical base effect), which justified keeping the NBP interest rates unchanged. At the same time, expectations that the Federal Reserve would reduce the scale of quantitative easing could translate into the risk of increased capital outflows from the emerging markets, which – in the opinion of those Council members – also spoke in favour of keeping the NBP interest rates unchanged.

At the same time, in the opinion of the majority of the Council members, given the significant scale of the already implemented cuts in the NBP interest rates, the current cycle of monetary easing was coming closer to an end. The Council members pointed out that a more comprehensive assessment of the medium-term outlook for economic growth and inflation – allowing the discussion on the monetary policy stance in the coming months – would be possible in July, after the Council had got acquainted with the new NBP projection and information about a possible amendment to the budget law.

At the meeting, a motion was submitted to lower the NBP basic interest rates by 0.50 percentage points. The motion did not pass. A motion was also 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 2.75%, lombard rate to 4.25%, deposit rate to 1.25%, rediscount rate to 3.00%.

Information from the meeting of the Monetary Policy Council held on 2-3 July 2013

The Council decided to decrease the NBP interest rates by 0.25 percentage points: reference rate to 2.50% on an annual basis, lombard rate to 4.00% on an annual basis, deposit rate to 1.00% on an annual basis, rediscount rate to 2.75% on an annual basis.

Available data indicate that global economic activity in the first half of 2013 remained low. However, economic growth continued to differ significantly across economies. A markedly better situation in the United States is accompanied by probably on-going recession in the euro area and the lack of visible rebound in some major developing countries, including China. Low global economic activity as well as the previously observed fall in commodity prices are conducive to low inflation in many countries.

Signals of a possible tapering of monetary expansion by the Federal Reserve have recently led to a deterioration of sentiment in financial markets. This, in turn, resulted in some outflow of capital from emerging markets and depreciation of their currencies, including the zloty.

In Poland, data on industrial output, construction and assembly output as well as retail sales in April and May indicate that growth in economic activity in Q2 remained weak. This development is also suggested by a number of economic climate indicators, though some of them have improved lately.

The continuing low economic activity supports weak wage growth. At the same time, May 2013 saw a halt in the decline of employment in the corporate sector and a slight decrease in the registered unemployment rate (in seasonally adjusted terms).

Growth in lending to the private sector remained limited. Growth in loans to both households and enterprises continued to be low.

CPI inflation declined again in May 2013, reaching 0.5% y/y, i.e. a level markedly below the NBP inflation target of 2.5%. The decline in inflation was mainly driven by further deceleration in the growth of energy prices, including fuel prices. Low level of core inflation as well as a stronger decline in producer prices, confirm persistently low demand and cost pressures in the economy. This is accompanied by a further decline in inflation expectations of households and enterprises.

The Council got acquainted with the inflation and GDP projection prepared by the Economic Institute, being one of the inputs to the Council's decisions on the NBP interest rates.

In line with the July projection based on the NECMOD model – prepared under the assumption of unchanged NBP interest rates and taking into account data available until 13 June 2013 (i.e. not encompassing the July decision of the Council) – there is a 50-per cent probability of inflation running in the range of 0.6-1.1% in 2013 (as compared to 1.3-1.9% in the March projection), within 0.4-2.0% in 2014 (as against 0.8-2.4%) and within 0.7-2.4% in 2015 (as against 0.7-2.4%). At the same time, the annual GDP growth – in line with the July projection – will be, with a 50-per cent probability, contained within 0.5-1.7% in 2013 (as compared to 0.6-2.0% in the March projection), within 1.2-3.5% in 2014 (as against 1.4-3.7%) and within 1.6-4.2% in 2015 (as against 1.9-4.4%).

In the opinion of the Council, the incoming data confirm continued low economic growth in Poland accompanied by lack of wage and inflation pressures. The July projection, however, indicates that from the second half of 2013 – together with the expected improvement of global economic activity – a gradual acceleration of GDP growth can be expected, which will be conducive to rising inflation in the coming years. However, despite this, a risk of inflation running below the target in the medium term persists. Taking this into consideration, the Council decided to lower the NBP interest rates again.

The Council assesses that the significant reduction of NBP interest rates implemented since November 2012 supports economic recovery and limits the risk of inflation running below the NBP target in the medium term. The decision to lower NBP interest rates made at the current meeting ends the loosening cycle of monetary policy.

The Council adopted the *Inflation Report – July 2013*.

Chapter 4

PROJECTION OF INFLATION AND GDP

This inflation and GDP projection was prepared by the Economic Institute of the National Bank of Poland and presents a forecast of economic developments under the assumption of constant NBP interest rates. In terms of the contents, work relating to the creation of this projection was supervised by Andrzej Sławiński, Director of the Economic Institute. The process was coordinated by the Bureau of Macroeconomic Forecasts of the Economic Institute. Using the macroeconomic model NECMOD[58], the projection was prepared as the outcome of an iterative process, in the course of which the paths of some variables were adjusted if they diverged from NBP experts' economic intuition based on their knowledge of economic processes. The Management Board of the NBP approved the projection to be submitted to the Monetary Policy Council. The projection constitutes one of the inputs to the Monetary Policy Council's decision making process concerning NBP interest rates.

The July projection based on the NECMOD model covers the period from 2013 Q2 to 2015 Q4. The starting point for the projection is 2013 Q1.

The cut-off date for the projection was 13 June 2013 (i.e. the projection does not take into account the MPC's decision to lower the NBP interest rates by 0.25 percentage points on 3 July 2013).

[58] Current version of the documentation of the model is available at the NBP website.

4.1. Summary

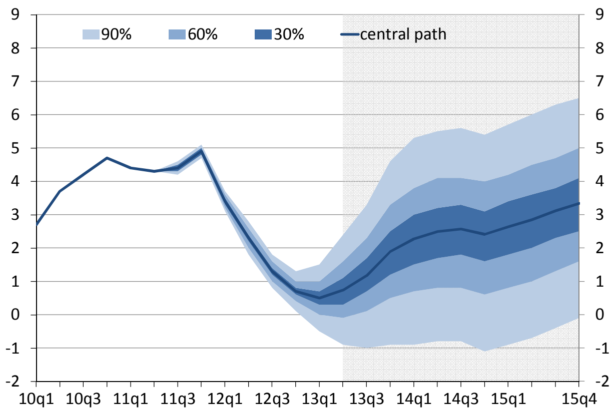
According to the preliminary estimates by the Central Statistical Office (GUS), GDP growth in 2013 Q1 in Poland slowed down to 0.5% from 2.0% in 2012, which suggests the continuation of the economic slowdown scenario outlined in the previous *Projection of inflation and GDP*. This downturn is largely driven by unfavourable developments in the external environment of the Polish economy. The euro area, with debt problems and loss of competitive advantage of some member countries, has been in recession again since 2011 Q4.

Economic slowdown abroad has been accompanied by the fading impact of positive factors supporting domestic economic growth at a relatively high level until 2012 Q1. As 2015 is the end date for settlements under the current EU financial framework, growth in the EU funds absorption and related public investments has declined. At the same time, with global trade weakening, so far relatively favourable situation in the German economy, being Poland's main trading partner, has deteriorated. In the short-term projection horizon, it is expected that fiscal policy tightening will have a negative impact on economic growth. Consumption growth will remain at a historically low level over the projection horizon due to moderately increasing wages and a decline in employment observed until the first half of 2015, curbing growth in disposable income, and inability to continue to finance consumption at the expense of falling savings rate.

As a result of the above mentioned factors, economic growth in Poland in 2013 will slow down to 1.1%. In the longer projection horizon, along with the improving situation abroad and the inflow of EU funds under the newly agreed EU financial strategy for 2014-2020, GDP growth will accelerate to exceed potential GDP growth in

Figure 4.1

GDP (y/y, %)



Source: NBP (if not otherwise stated, this concerns all the figures and tables in this Chapter).

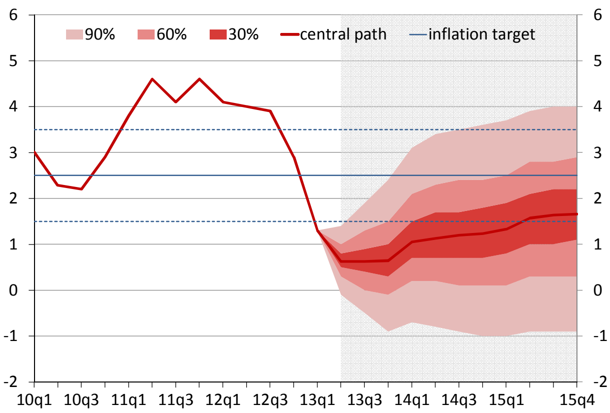
2015. As a result, the output gap will narrow gradually, still remaining negative at -1.6% of potential GDP in 2015 Q4.

In 2013, inflation will see a considerable decline as compared to its 2012 level, followed by a gradual rise. Yet, it will remain at the level below the NBP target throughout the projection horizon (Figure 4.2) and below the lower band for deviations from the target until 2015 Q1. The decline in inflation over the short-term projection horizon is a result of both regulatory factors (decrease in gas prices, close to zero increase in electricity prices) and a slowdown in domestic economic growth which – by curbing demand pressure – will hamper wage growth and, as a result, will drag down growth in unit labour costs. In the medium- and long-term projection horizon, inflation will pick up, yet remaining at a relatively low level. Moderate inflationary pressure will continue as a result of low domestic economic growth. Consequently, GDP will remain below its potential level. Stable prices of agricultural and energy commodities in the global markets, being the consequences of the situation in the global economy, and, in particular, low growth in global demand, will constitute another factor behind moderate inflationary pressure.

Uncertainty surrounding inflation and GDP forecast is mainly related to possible developments in the euro area and the ensuing trends in exchange rate of the Polish zloty as well as the scale of future changes in fiscal policy. In our assessment, due to the likelihood of economic downturn persisting in the euro area and the scale of fiscal tightening exceeding the one assumed in the central projection, the balance of risk factors is negative for GDP growth in the projection horizon. Over 50% probability of lower GDP growth as compared to the assumptions made in the central projection is reflected in the fan chart for this variable (Figure 4.1). The risk of inflation running above and below the central path is similar (Figure 4.2).

Figure 4.2

CPI inflation (y/y, %)



Should GDP growth be lower than expected and should the labour market situation deteriorate, CPI inflation will also decrease. Yet, should fiscal adjustments involve effective tax rates increases, inflation will increase. Higher than expected rise in commodity prices in the global markets may also push up inflation.

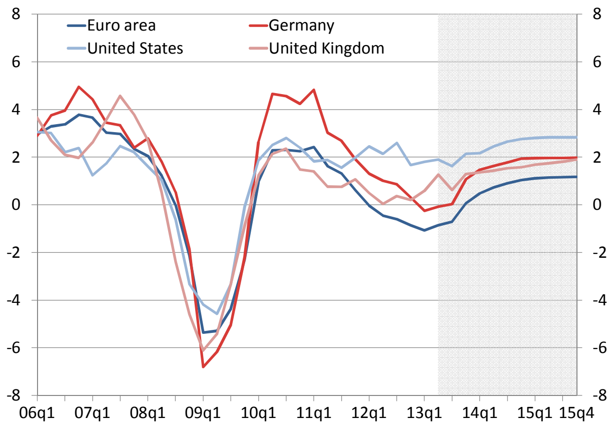
4.2. External environment

In the current forecasting round, the assumptions of economic growth abroad [59] have been revised downward in the short- and medium-term projection horizon (among other things, due to weaker than anticipated GDP estimates for 2013 Q1 and further worsening in the euro area labour market) and continue at a low level throughout the whole projection horizon (at an average of 0.8% y/y).

Economic growth in the euro area continues to be inhibited by the effects of fiscal tightening and persistently pessimistic household expectations related, among other things, to unfavourable situation in the labour market and deleveraging of the private sector (net repayments of the previously granted loans). Weak growth is also the result of unfavourable situation in part of the banking sector and businesses' limited access to lending in the euro area peripheral countries (see Chapter 1.1 *Global economic activity*). In addition, the German economy, being Poland's major trading partner, is especially affected by weakening global trade. Due to these reasons, the current projection assumes that the euro area will remain in recession in 2013, whereas a positive, albeit still low economic growth is expected in 2014, with the fading of the negative impact of fiscal tightening and a gradual recovery of the emerging economies (Figure 4.3).

Figure 4.3

GDP abroad (y/y %)



[59] In the NECMOD model, the foreign sector is represented by four economies (with their respective weights): Germany (43%), the euro area excluding Germany (43%), Great Britain (8%) and the United States (6%).

The outlook for growth in the U.S. economy, as indicated by the declining unemployment rate, positive growth in industrial production and improving situation in the property market seems better than the growth outlook in the euro area (see Chapter 1.1 *Global economic activity*). However, the prospects of economic growth in the U.S. have also been slightly revised downward as compared with the previous forecasting round due to the worse-than-expected GDP data for 2012.

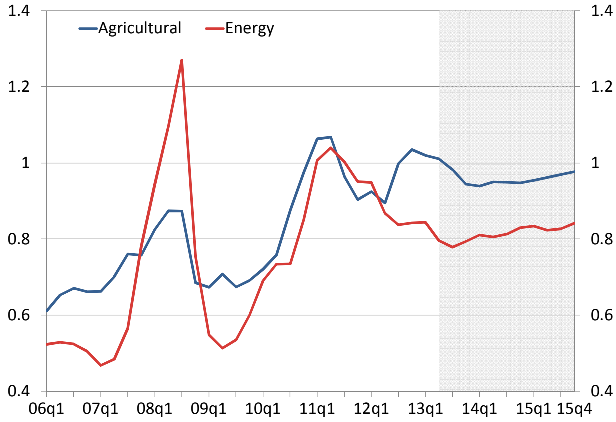
The energy commodity price index over the projection horizon stabilizes at a level lower than expected in the previous forecasting round, which is due to a downward revision of the projected global demand (Figure 4.4). As a result of moderate growth in the global economy and a low supply elasticity of coal, coal prices will gradually increase over the projection horizon. Rising coal prices, with stable prices of natural gas, will partly offset the decline in oil prices, driven by larger supply resulting from growing extraction of shale oil in the United States.

In the period from January to April 2013, the agricultural commodity price index exceeded the expectations of the previous forecasting round[60], which was driven by adverse supply-side conditions in the potato, cocoa, coffee and dairy products markets, coupled with increased demand for some of these products (see Chapter 1.4 *Global commodity markets*). In the forecast horizon, due to moderate demand pressures in the global markets and assumptions that weather conditions will be similar to their long-term average, agricultural commodity prices are expected to fall and then stabilise (Figure 4.4).

Merely moderate economic recovery abroad and relatively stable commodity prices over the projection horizon should help to maintain low

Figure 4.4

Index of commodity prices in the global markets (USD, 2011=1)



[60] Since the current forecasting round there has been a methodological change in the construction of the agricultural commodity price index. Previously, it was based on IMF's data and forecasts. The current methodology is consistent with the construction of the energy commodity price index. An agricultural commodity price index is a weighted average of selected commodity prices on European markets where the weights reflect the structure of the domestic demand. The forecast is based on agricultural commodities' futures prices.

inflation in the euro area and in the United States (Figure 4.5). The projection assumes that the ECB will maintain the current level of interest rates in the coming quarters with a possibility of interest rate increase as late as 2015 (Figure 4.6). Also monetary policy in the United States is expected to remain accommodative and interest rates are anticipated to remain unchanged until the end of 2014 (see Chapter 1.3 *Monetary policy abroad and international financial markets*).

The prospects of lower growth in the euro area than in the United States suggest that the euro may weaken against the US dollar to a 1.26 level in 2014, and then, along with stabilising situation in the euro area, appreciate slightly.

Figure 4.5

Inflation abroad (y/y, %)

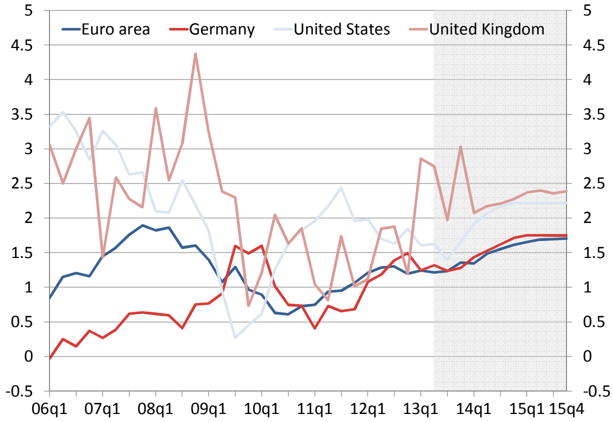
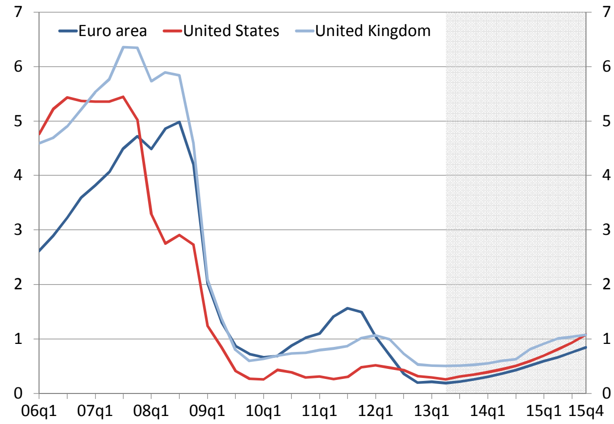


Figure 4.6

Interest rate abroad (%)



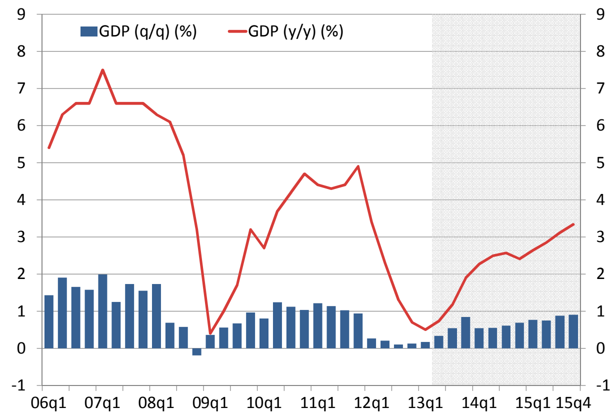
4.3. Polish economy in the years 2013-2015

Aggregate demand

According to the preliminary GUS estimates of GDP in 2013 Q1, Poland is undergoing a significant downturn. GDP growth slipped for the fifth consecutive time, down to 0.5% y/y. In accordance with the central scenario of the current projection, the coming quarters are expected to bring a merely moderate improvement in business conditions. As a result, economic growth in 2013 will amount to 1.1%, the lowest figure since 1991 (Figure 4.7). In 2014-2015, GDP growth will follow a gradual upward trend, yet will remain below the potential growth level until the end of 2014.

Figure 4.7

Economic growth



Key factors behind weak GDP growth in 2013 include unfavourable economic situation abroad, in particular, in the euro area, falling household consumption (driven by a difficult situation in the labour market and a gradual recovery in household savings) as well as fiscal tightening and falling public investment financed with EU structural funds. Amidst negative growth rate of gross fixed capital formation in the corporate sector and close-to-zero contribution of change in inventories to GDP, net exports' contribution, still positive despite its decline as compared to 2012, will be a factor easing the scale of GDP downturn in 2013.

In the years 2014-2015, amidst moderate improvement in business conditions abroad, growth in domestic demand will accelerate, yet, will remain lower than the previous rebound in the years 2010-2011. It will be supported by gradually rising private consumption and corporate investment as well as termination of fiscal policy tightening along with rebuild of inventories. In 2015, GDP growth will rise to 3.0%, which will be additionally fuelled by the inflow of funds under the new EU financial framework for the years 2014-2020.

As a result of weak growth in household disposable income, private consumption growth in 2013 will remain close to the 2012 rate, that is considerably lower than its long-term average (Figure 4.9). Household disposable income will be adversely affected by deteriorating situation in the labour market, reflected in lower wage growth and falling employment. Furthermore, after a series of cuts initiated at the end of 2012, the NBP reference rate is now at a historically low level which will indirectly result in falling household income on bank deposits and bonds. As a result of consolidation measures in the public finance sector (i.e. wage freeze in the public sector in the years 2012-2013 and fiscal rules currently in effect), it is expected that in 2013 public consumption growth rate will remain close to zero.

In the years 2014-2015 gradually rising household disposable income will have a boosting effect on private consumption. The income of households will be affected, with a certain delay, by improvement in the domestic business conditions, which will first halt and then reverse the negative trends in the labour market, thereby

Figure 4.8

GDP growth (y/y, %) – breakdown

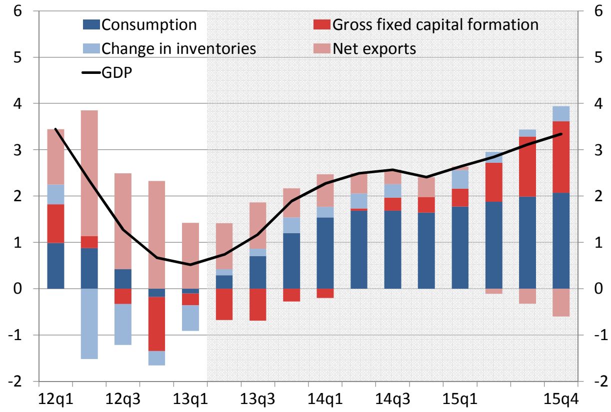
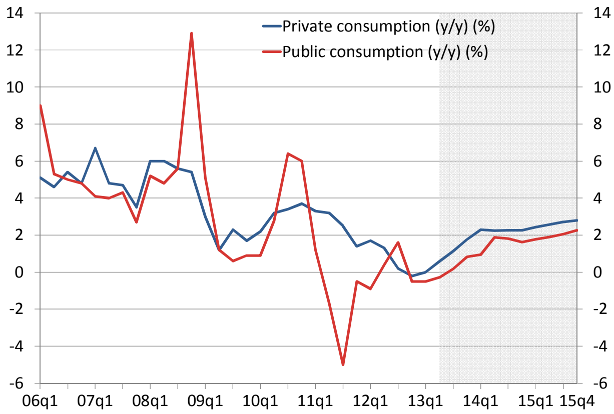


Figure 4.9

Private and public consumption



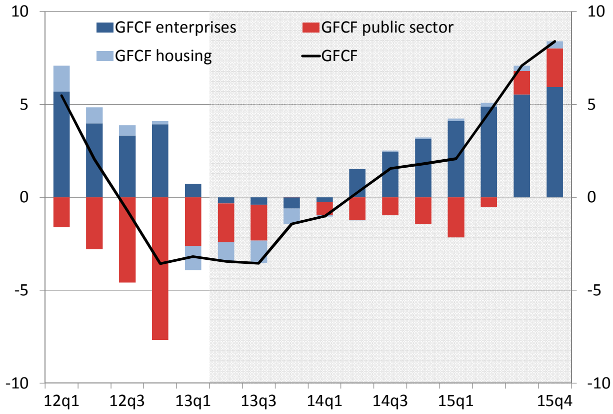
contributing to an increase in wage growth and a decline in the unemployment rate in the long-term projection horizon. Along with improving economic situation income from self-employment will rise as well. In the long-term projection horizon growth in public consumption will also rise (albeit remaining at historically low levels), which will be driven by the assumed rises of the previously frozen wages in the public sector, i.a., in tertiary education.

In 2013 three main components of gross fixed capital formation will decrease: corporate public and housing investment (Figure 4.10). Starting from the second half of 2014, as a result of improving business conditions, corporate and housing investment will begin to recover. At the end of the projection horizon, public investment financed with EU structural funds under the new EU financial framework for the years 2014-2020 will also increase.

In 2013, the persistently unfavourable situation in the euro area and the slowdown in the domestic economy will bring about a decline in corporate investment. This scenario is supported by deteriorating situation of corporates, tightening lending criteria of banks as well as the observed reduction in new investment, in particular cuts in expenditure on modernization of the existing fixed assets and replacement investment.[61] In the years 2014-2015, along with economic recovery abroad, growing domestic demand and persistently high absorption of EU funds used to finance private sector capital expenditure, corporate investment will start to rebound again. Corporate investment growth will be further fuelled by rising replacement investment following capital depreciation and the currently observed, relatively high level of production capacity utilization, close to its long-term average[62].

Figure 4.10

Gross fixed capital formation (y/y, %) - breakdown



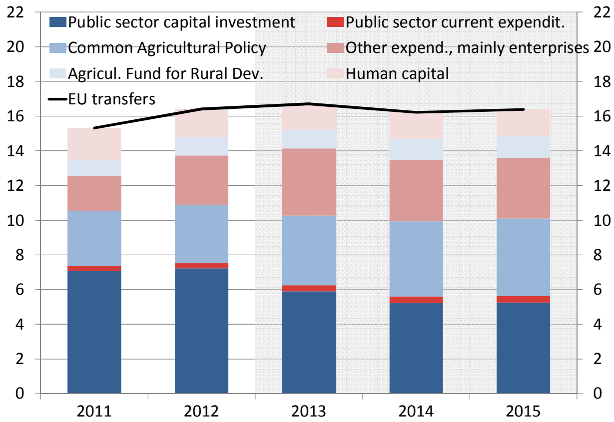
[61] See *Financial situation of the corporate sector* – 2012 Q4, NBP;

[62] See *Economic climate in the enterprise sector in 2013 Q1 and forecasts for 2013 Q2*, NBP.

In the years 2013-2014 public investment will significantly decrease. This will be caused by falling absorption of EU structural funds used to finance investments of the general government sector under the National Cohesion Strategy 2007-2013, which ends in 2015. Furthermore, local government units will be reducing their investment in the coming years, due to the fiscal rules adopted at the local government level (Figure 4.11). The end of the projection horizon may be expected to bring positive growth in public investment as a result of the newly agreed EU financial framework for the years 2014-2020 and subsequent increase in the inflow of EU funds to Poland.

Figure 4.11

EU transfers (in bn. EUR) – breakdown



In line with the projection scenario, spending on housing investment will be on a decline until the first half of 2014, due to falling household demand. This results from both the expectations of persisting, in the coming months, unfavourable economic conditions at home and abroad, curbing households' propensity to incur long-term obligations, and banks' tightening of mortgage lending criteria[63].

As a result, financing of housing investment with bank loans is reduced (according to the data from the banking sector, the value of newly signed loan agreements has hit the lowest figure for the past three years whereas growth in housing loan receivables has reached its lowest level for the past seven years[64]). As a consequence of falling demand, the number of new real estate investments and building permits is on the decline despite still relatively high rates of return on real estate development projects [65] (although prices and related profit margins have decreased recently).

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[63] .See *Senior Loan Office Opinion Survey on Bank Lending Practices and Credit Conditions* 2013 Q1, NBP

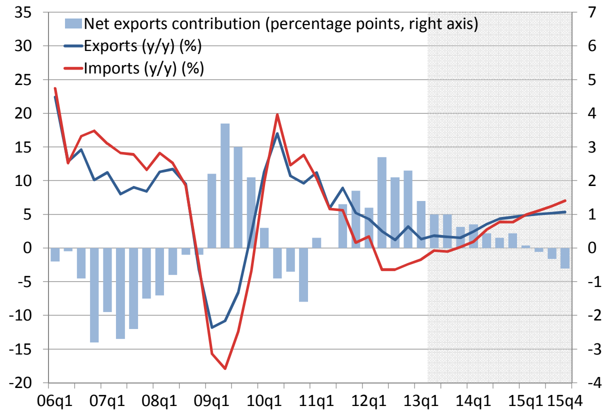
[64] See *Information on home prices and situation in the residential and commercial real estate market in Poland, 2012 Q4,* NBP.

[65] Ibidem.

As a result of weakening economic growth abroad and stagnating domestic demand, in 2013 growth in the external trade volume, similarly to 2012, will be at an very low level, close to zero (Figure 4.12). Contribution of net exports to GDP growth will remain positive due to the fact that imports are more sensitive than exports to changes in the domestic and global economic situation and a relatively sound economic situation of Germany, Poland's main trading partner. In the long-term projection horizon, along with recovery abroad and rebound in domestic demand, imports growth is expected to outpace exports growth. Thus, contribution of net exports to GDP growth will gradually decline (to -0.6 percentage points in 2014 Q4).

Figure 4.12

Foreign trade

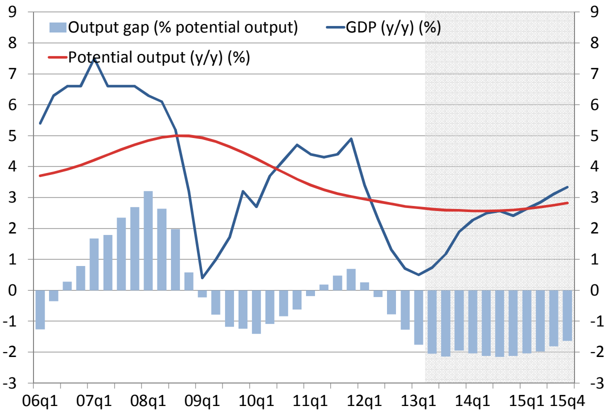


Macroeconomic equilibrium

Potential GDP growth, which fell in the aftermath of the global financial crisis, will remain close to 2.6% y/y over the projection horizon and below its long-term average. Due to the slowdown in economic activity (reflected in GDP decline below its potential level), the output gap, negative since 2012 Q3, will widen to -2.2% of GDP in 2014 Q3. From 2014 Q4, the output gap starts to close gradually, reaching the level of -1.6% of potential GDP growth in 2015 Q4 (Figure 4.13).

Figure 4.13

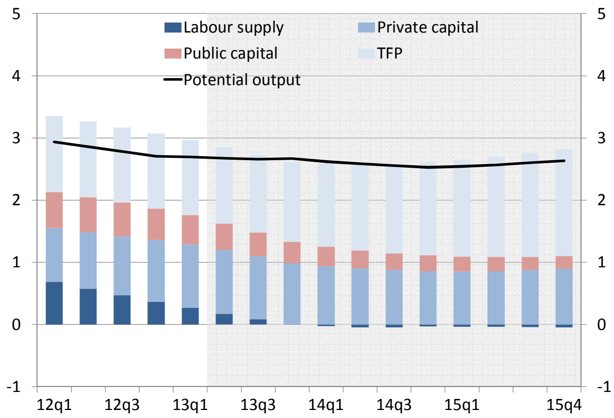
Output gap



Potential output growth remains stable over the projection horizon as a result of the positive impact of total factor productivity (TFP) growth returning to the level observed before the global financial crisis and the concurrent decline in productive capital growth reflecting the fall in public investment, and, to a lesser extent, corporate investment (Figure 4.14).

Figure 4.14

Potential output (y/y, %) - breakdown



Long-term growth in labour supply will have a neutral effect on potential growth in the short-term projection horizon, as the advantages and disadvantages of structural changes in the labour market during this period are offset. In the long-term projection horizon the impact of negative structural changes in the labour market will gradually intensify and the value of the labour supply equilibrium will reduce potential growth.

The anticipated increase in the equilibrium unemployment rate (NAWRU), largely driven by hysteresis in unemployment, is a particularly adverse structural change observed in the projection horizon. This phenomenon is manifested, among other things, by a gradual increase in the percentage of the long-term unemployed, among the unemployed, observed until the second half of 2012. The equilibrium unemployment rate will also be boosted by growth in the effective labour taxation in recent years (growth in disability contribution rate, freezing of personal income tax thresholds) and an increase in the minimum to average wage ratio. However, the increase in the equilibrium unemployment rate will be negligible due to considerable flexibility of wages in the domestic labour market, resulting from the adjustment of variable components of wages in the corporate sector in response to the weakening of the economic climate, and the beneficial role of flexible forms of employment[66].Labour supply over the whole projection horizon will be adversely affected by the expected decrease in population due to emigration especially of the professionally active. Also, labour force participation rate will be negatively affected, especially in the long-term horizon, by deteriorating age structure, driven by growing number of post-working age population.

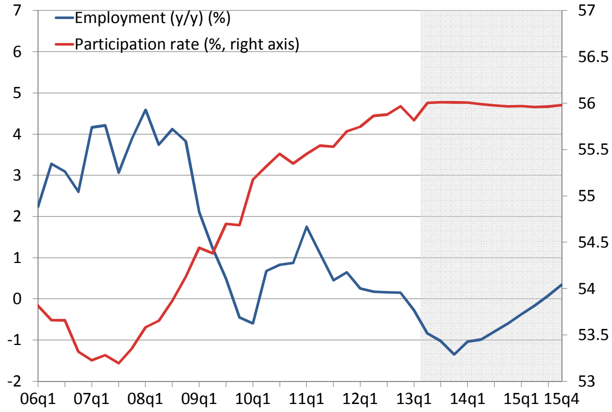
Legal changes limiting pension eligibility before the attainment of the retirement age (the so-called bridging pensions introduced in 2009) and the raised retirement age (as of the beginning of 2013) will positively impact labour force participation rate. The total estimated impact of those changes is the rise in the number of the economically active by approx. 170 thousand persons over the projection horizon.

[66] See *Labour market survey* – report 2012, NBP.

Weaker economic activity affects the labour market, whereas, given labour market rigidities, economic slowdown is first seen in declining wage growth, and then in falling number of working persons (Figure 4.15, Figure 4.16, Figure 4.17). The years 2013-2014 are expected to bring a decline in the number of working persons, with the lowest growth in 2013 Q4, which means a three-quarter lag in respect to changes in economic activity as measured with GDP growth. In the long-term projection horizon, with GDP growth exceeding 3% y/y, the number of the working persons should be on the rise again. The labour force participation rate, declining over the projection horizon, will help to limit the scale of unemployment in the years 2013-2014 and bring about its decline in 2015. As a result, unemployment gap widens to 1.9 percentage point in 2014, and then lowers considerably. Unemployment gap continuing at a positive and relatively high level translates into low wage pressure. Therefore, throughout the projection horizon, real wage growth, despite a certain improvement in the long-term projection horizon, will be significantly below labour productivity growth. As a result, until the end of 2015, aggregate wage contribution to GDP will continue to fall, whereas growth in unit labour costs will stand at a low, level close to zero. Current account deficit continuing throughout the projection horizon will be largely offset by the inflow of EU funds. External imbalances, as measured by the ratio of current and capital account deficit to GDP over the projection horizon will improve in 2013 and 2014 (to 0.1% - 0.2%). This will be driven by improving trade and transfers balance (positive contribution of net exports in 2013-2014), amidst slightly deteriorating income balance. In 2015 the current account balance will decrease (to 0.9% of GDP) as a result of declining positive trade balance and further deepening deficit in the balance of income.

Figure 4.15

Employment and activity in the labour market



Note (applies also to Figures 4.16 and 4.17). LFS data for the period prior to 2010 has been adjusted to ensure consistency with the National Populations Census 2011.

Figure 4.16

Unemployment

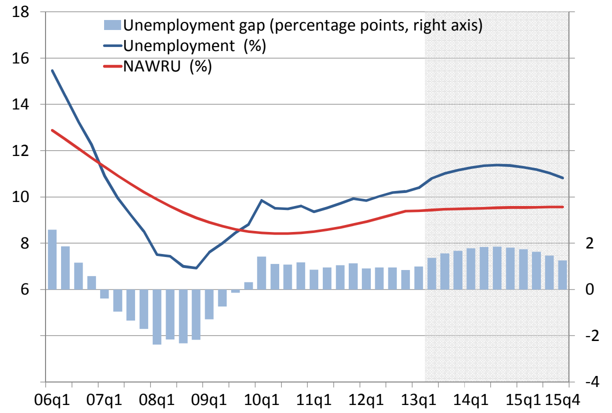
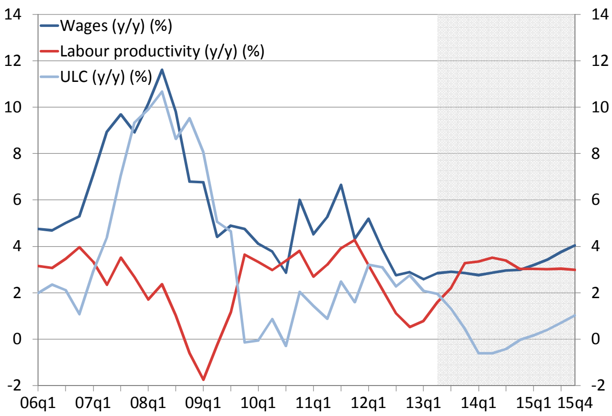


Figure 4.17

Unit labour costs



Foreign exchange rate and inflation

Following zloty depreciation in 2013 Q2, the factors strengthening and weakening the Polish currency will be, to a large extent, offset in the long-term projection horizon. As a result, the nominal effective exchange rate of the zloty will remain relatively stable in the medium and long term. On the one hand, the zloty exchange rate continues to run below the level determined by fundamental factors, which will support gradual appreciation of the currency towards the equilibrium level in the projection horizon. On the other hand, weak economic growth in the domestic and foreign economies may limit the inflow of direct and portfolio investment into the Polish market. Additionally, the narrowing interest rate disparity, resulting from the assumption of a constant NBP reference rate adopted in the projection, will weaken the zloty exchange rate.

As a result of modest economic growth and stable exchange rate, core inflation will be driven down to 0.8% in 2014 and to rise again to 1.1% in 2015 along with closing output gap (Figure 4.19). Low core inflation over the projection horizon results largely from weak growth in unit labour costs, which is, in turn, the effect of declining employment and a relatively low wage growth. Low inflationary pressure is also supported by a stable nominal zloty exchange rate and moderate inflation abroad, and, consequently – lower growth in import prices (Figure 4.18).

On account of the expected stabilization in food commodity prices in the global markets in the coming quarters, curbing food price growth abroad, Poland will also record a low level of food price inflation, close to 1.5% y/y. In the long-term projection horizon, growth in domestic food prices will gradually rise, however, not exceeding 2% y/y (Figure 4.20). Apart from prices of agricultural commodities in the global markets following a downward trend in the short-term

Figure 4.18
Terms-of-trade

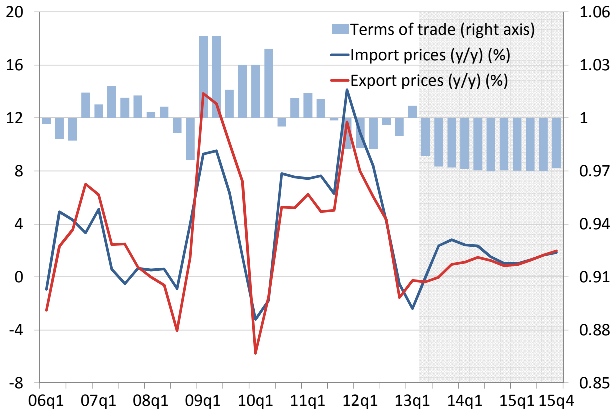


Figure 4.19
CPI and core inflation (y/y, %)

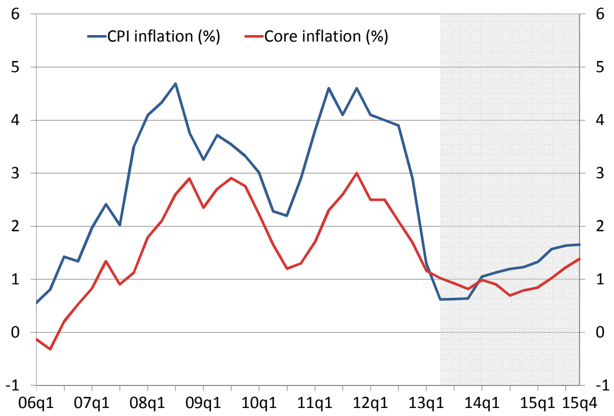
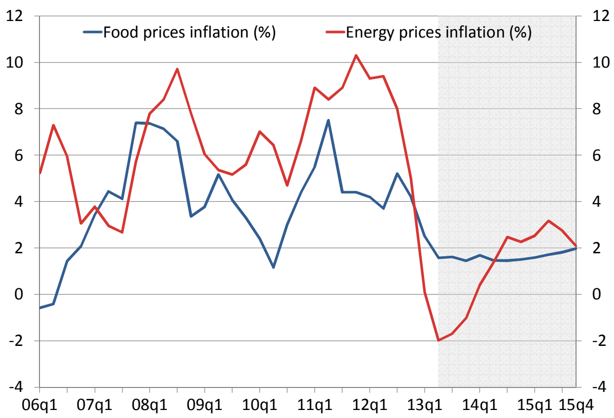


Figure 4.20
Inflation of food and energy carrier prices (y/y, %)



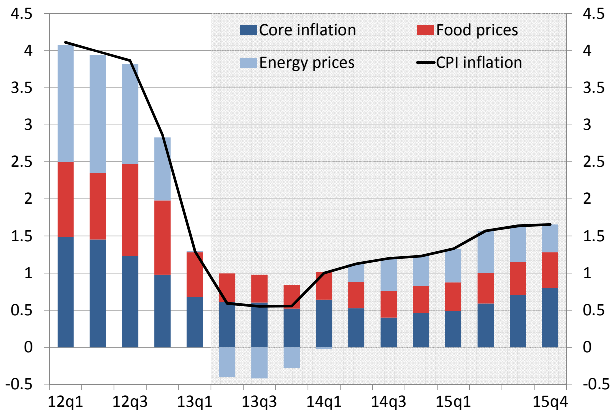
projection horizon and remaining stable over the long-term, food price growth will also be curbed by a moderate growth in the domestic economy and a stable exchange rate of the zloty.

Energy price inflation in the short-term projection horizon will rapidly decline (from 7.9% in 2012 to -1.1% in 2013) which will be primarily the result of decrease in the price of natural gas for households as of 1 January 2013, negative fuel price growth and decrease in electricity prices for households since 1 July 2013. Domestic energy prices will also be affected by growing costs of the power sector resulting from purchases of CO_2 emission allowances, albeit this impact will be moderate and lower than previously expected. This is caused by economic slowdown in the EU countries and, consequently, downward revision in the forecasted prices of CO2 emission allowances in the recent period[67]. In the long-term horizon, energy price inflation will rise, still remaining at a relatively low level. Gradually declining crude oil prices in the global markets and relatively low growth in the prices of other energy commodities will have a downward effect on energy price growth.

As a result of these developments, CPI growth in 2013 will run considerably below last year's level (0.8% y/y). The relatively low inflation level in 2013 is the consequence of regulatory factors (decrease in gas prices, close to zero increase in electricity prices) and low demand pressure. In 2014, despite decline in unit labour costs, curbing inflationary pressure, CPI inflation will slightly increase (to 1.2%) as a result of markedly higher, as compared to the previous year, energy price inflation (Figure 4.21). In 2015, the improved economic situation will translate into a rise in main CPI components (core inflation, food and energy prices), nevertheless the growth of consumer prices over the projection horizon will remain below the NBP inflation target. Despite

Figure 4.21

CPI inflation (y/y- %) - breakdown



[67] See. *Short-term Macroeconomic Impact of the Energy and Climate Package in the Polish Economy*, NBP, 2012. Since the release of the above report, current and forecasted prices of emission allowances have fallen significantly.

economic recovery, demand gap, being a synthetic measure of inflationary pressure in the economy, will remain negative until the end of 2015. Stable commodities prices in the world markets maintained by slowly increasing global demand will contribute to moderate inflationary pressure. Under the assumption of a constant NBP interest rate throughout the projection horizon, the probability of the average annual inflation ranging from 1.5%-3.5% will gradually increase to 42% in 2015 Q4 (Table 4.2).

4.4. Current versus previous projection

In the current prognostic round, GDP growth envisaged for the years 2013-2015 has been revised downwards by an average of 0.1 percentage point vis-a-vis the March projection (Table 4.1). Thus, factors exerting downward and upward pressure on the projection are largely balanced. On the one hand, GDP growth, especially over the short- and medium-term projection horizon has been adversely affected by the downward revision of forecasts for economic growth abroad and larger than assumed in March scale of fiscal tightening. On the other hand, domestic economic activity will benefit from the 100-basis point cut in the NBP interest rates effected since the last prognostic round (the projection is drawn up under the assumption of constant NBP reference rate).

Weaker economic activity resulting in a wider negative output gap, combined with a slower wage growth, will translate into smaller inflationary pressure over the short- and medium-term projection horizon. Inflation decline will be enhanced in 2013 by regulatory changes leading to a decrease in energy prices, coupled with improved supply conditions in the domestic food market and lower than expected levels of oil prices. Towards the end of the projection horizon, the impact of the factors

Table 4.1
July projection versus March projection

	2013	2014	2015
GDP (y/y, %).			
VII 2013	1.1	2.4	3.0
III 2013	1.3	2.6	3.1
CPI inflation (y/y, %).			
VII 2013	0.8	1.2	1.5
III 2013	1.6	1.6	1.5

curbing CPI inflation wanes and consumer price growth returns to the path of the March projection.

GDP

The GDP growth has been revised downwards in the current year on the account of a lower, by 0.3 percentage point, forecast of GDP growth abroad and slightly weaker than expected GUS's GDP estimates for 2013 Q1. Furthermore, public consumption is expected to grow more slowly, which will result from cutbacks in current spending by public finance sector entities due to lower tax revenues (Figure 4.23). On the other hand, stronger than assumed in the March projection real effective zloty exchange rate has negatively weighed on the forecasts of net exports. The downward revision of GDP growth this year has been mitigated by slightly stronger than expected data on private consumption in 2013 Q1.

In the long-term projection horizon, the scale of the downward revision of economic growth forecasts for Poland's key trading partners diminishes (GDP growth abroad has been adjusted down by 0.2 percentage point in 2014 and remained unchanged in 2015). At the same time, owing to lags in the monetary transmission mechanism, domestic GDP growth will be increasingly boosted by monetary policy easing reflected in the 100 basis points cut in the NBP reference rate as compared with the previous projection. Lower interest rates will provide the strongest stimulus to investment demand, and, to a lesser extent, consumption demand, at the same time affecting adversely the contribution of net exports. In 2014-2015, GDP growth will, in turn, be moderated by slower public consumption growth, which will result from adjustments on the expenditure side of the public finance sector related to the extension of the Excessive Deficit Procedure.

Figure 4.22

July projection versus March projection: GDP growth (y/y, %)

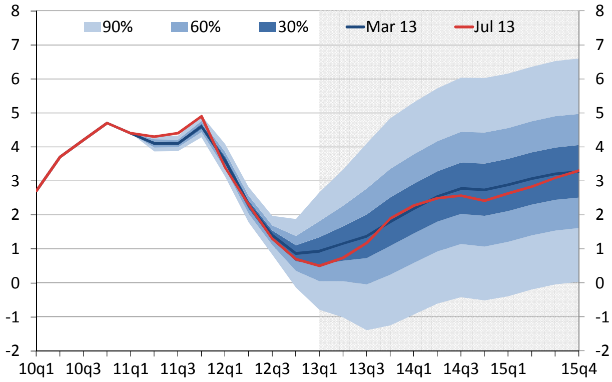
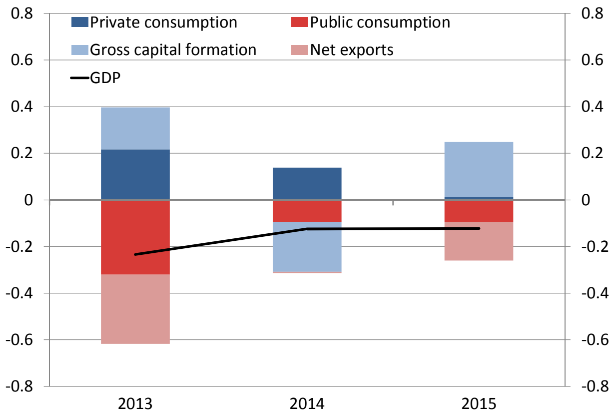


Figure 4.23

Decomposition of deviations between July and March projection: GDP growth (percentage points)



Inflation

Lower forecasts of food and energy prices in the current projection round are instrumental in the downward revision of CPI inflation in the short- and medium-term projection horizon (Figure 4.25).

The decline in energy prices in 2013-2014 is driven by favourable conditions in the wholesale energy market (Polish Power Exchange), which have resulted in lower energy tariffs for individual customers as of July 2013. Energy price growth was additionally hampered by lower than assumed in March crude oil price forecasts and a stronger zloty exchange rate, bringing down domestic fuel prices. This was combined with lower than the expected in the previous prognostic round forecasts of coal prices, which have a lagged effect on fuel and energy prices.

The decline in food price inflation in comparison with the March projection is, in turn, the result of flagging consumer demand (except for March retail sales of food, beverages and tobacco products have been falling in recent months) and a stronger exchange rate than assumed in the previous forecasting round. In addition, in the short term, a downward revision of food prices will be supported by an improved supply situation resulting from favourable weather conditions, in particular, in the fruit and vegetables market.

Apart from the specific factors listed above, all having a curbing effect on domestic food and energy prices, inflationary pressure, especially in the short- and medium-term projection horizon, will be alleviated on the March projection levels by a widening negative output gap and slower wage growth. Factors with an upward effect on inflation include, in 2014 – and, to a lesser extent, in 2015 – the change in the assumptions

Figure 4.24

July projection versus March projection: CPI inflation (y/y, %)

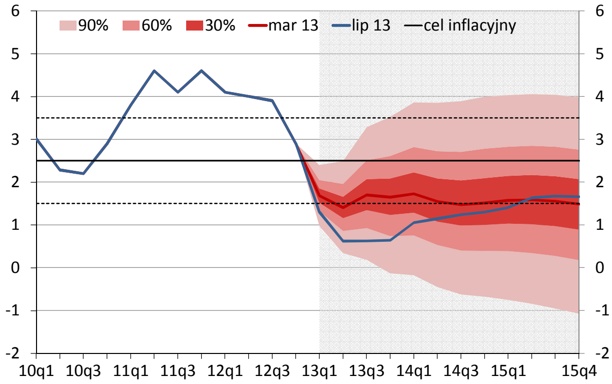
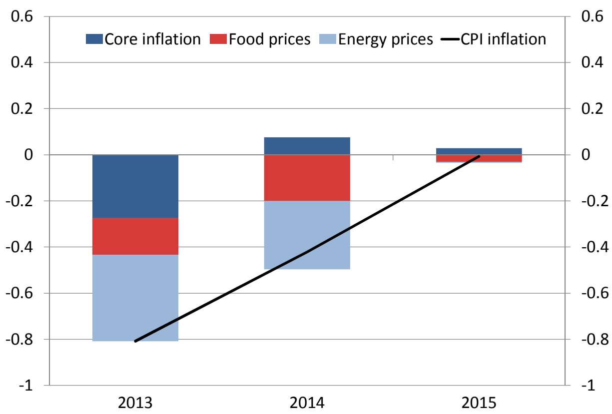


Figure 4.25

Decomposition of deviations between July and March projection: CPI inflation (percentage points)



concerning the level of indirect taxes (the March projections envisaged a return to the 22% VAT rate in 2014).

4.5. Forecast uncertainty sources

It is assessed that over the projection horizon, the balance of risk factors is distributed symmetrically around the central inflation projection path (Table 4.2). The risk of GDP running below the central path is slightly higher in the medium and longer term. This results from possible adjustments of fiscal policy aimed at complying with fiscal rules and lower economic growth than assumed in the baseline scenario in the euro area in the subsequent years. Key sources of projection uncertainty are presented below.

External environment and exchange rate

The external environment, especially the persistence of recession and the scale of future recovery continues to be the most important source of uncertainty for the inflation and GDP forecast. Incoming euro area data indicate a slightly worse than expected outlook for economic growth and a delayed recovery. Despite improved sentiment in the global financial markets and banks' better liquidity situation – resulting from the ECB's OMT programme – conditions in part of the euro area banking sector continue to be tight. In effect, access to bank credit by the private sector is constrained. The impact of a potentially deepening recession in the euro area may be mitigated, in terms of domestic economic growth, by zloty depreciation, a development which had been observed during the financial crisis at the turn of 2008. At the same time, weaker domestic currency would prop up inflation which otherwise would be lower on the back of a negative demand shock. Another thing that remains hard to predict is the response of central banks to uncertainty about future

Table 4.2

Probability of inflation running:

	below 1.5%	below 2.50%	below 3.50%	below the central projection	In the range (1.5-3.5)
13q2	0.97	1.00	1.00	0.48	0.03
13q3	0.87	0.99	1.00	0.47	0.13
13q4	0.78	0.96	1.00	0.47	0.21
14q1	0.61	0.87	0.97	0.46	0.36
14q2	0.58	0.83	0.96	0.46	0.38
14q3	0.56	0.81	0.94	0.47	0.38
14q4	0.56	0.80	0.94	0.48	0.38
15q1	0.55	0.80	0.94	0.50	0.39
15q2	0.49	0.75	0.91	0.51	0.42
15q3	0.48	0.74	0.91	0.52	0.42
15q4	0.48	0.73	0.90	0.52	0.42

economic situation in the developing countries; in particular, it is difficult to evaluate the consequences of cutbacks in quantitative easing programme in the United States.

Fiscal and regulatory policy

Fiscal and regulatory policy may be a material uncertainty factor for the projection of future inflation and GDP, in particular, towards the end of the projection horizon. The 2011-2012 measures to increase the general government revenues and curb expenditures were aimed, on the one hand, at reducing the 2012 deficit down to the level allowed by EU regulations, thus allowing for the lifting the excessive deficit procedure against Poland, and on the other, maintaining the public debt below the 2nd prudential threshold specified in the *Public Finance Act*. Given the expected economic slowdown, keeping the deficit of the general government sector at a level ensuring compliance with the national and European fiscal rules may require additional adjustment measures over the projection horizon. A major source of uncertainty is the degree of EU fund absorption in the nearest years and the pace of utilisation of EU funds under the 2014-2020 EU Financial Framework. There is also uncertainty related to the planned changes in the Polish pension system and the lack of final decisions regarding its future shape.

Domestic demand

A major source of uncertainty of the projection is the households' and the corporate sector's response to developments abroad as well as the austerity programme. The effects of the fiscal tightening reflected in a lower general government sector deficit will probably improve the assessment of Poland's creditworthiness. Yet, at the same time, this assessment is to a great extent determined by the short-term outlook for economic growth, which will be hampered by the fiscal tightening. Moreover, favourable domestic and international trends may translate into better perception of Poland by foreign investors, resulting in more capital inflows, including FDI. On the other hand, protracted recession in the euro area amidst low savings and limited access to credit may result in persistently sluggish growth in consumption and investment.

Food and energy prices in Poland

Another source of uncertainty of the projection is the hard-to-predict impact of regulators' policies and the situation on the global commodity market upon the level of domestic energy and food prices. In this respect, considerable uncertainty relates to the impact of future EU environmental policies, which is difficult to estimate. This concerns, i.a. the Climate and Energy Package, currently under implementation, aimed at reducing CO_2 emissions. In particular, prices of the future CO_2 emission allowances are not known. These will depend on both the demand for these allowances as well as a possible ceiling on CO_2 emission rights. Uncertainty is further boosted by the lack of precise provisions concerning the designation of the proceeds from the sale of emission rights and the magnitude of investment in low-emission technologies and renewable energy sources. Major sources of uncertainty continue to include regulatory activities in the food and energy markets (the package of energy bills drafted by the Ministry of Economy) as well as future tariff policy by the Energy Regulatory Office. The situation on the global agricultural and energy commodity markets continues to be affected by the uncertainty about future economic growth in the largest economies. Agricultural and energy commodity prices will additionally be affected by supply conditions. In the case of agricultural production these include weather conditions and the prices of energy commodities – crude oil in particular – will be contingent on the scale of disruptions to supply in the non-OPEC countries and the response of OPEC member countries to changes in oil production in the United States.

Table 4.3
Central path of inflation and GDP projection

	2011	2012	2013	2014	2015
Consumer Price Index CPI (% y/y)	4.3	3.7	0.8	1.2	1.5
Food prices (% y/y)	5.4	4.3	1.8	1.5	1.8
Energy prices (% y/y)	9.1	7.9	-1.1	1.6	2.6
Core inflation net of food and energy prices (% y/y)	2.4	0.8	1.0	0.8	1.1
GDP (% y/y)	4.5	1.9	1.1	2.4	3.0
Domestic demand (% y/y)	3.6	-0.2	0.1	2.0	3.3
Individual consumption (% y/y)	2.6	0.8	0.9	2.3	2.6
Public consumption (% y/y)	-1.5	0.1	0.3	1.6	2.0
Gross fixed capital formation (% y/y)	8.5	-0.8	-2.9	0.6	5.5
Contribution of net exports (percentage point y/y)	0.9	2.1	1.0	0.5	-0.2
Exports(% y/y)	7.7	2.8	1.6	3.7	5.1
Imports (% y/y)	5.5	-1.8	-0.6	2.8	5.9
Gross wages (% y/y)	5.2	3.7	2.8	2.9	3.6
Total employment (% y/y)	1.0	0.2	-0.9	-0.9	0.0
Unemployment rate (%)	9.6	10.1	10.8	11.3	11.1
NAWRU (%)	8.6	9.2	9.4	9.5	9.6
Labour force participation rate (%)	55.6	55.9	56.0	56.0	56.0
Labour productivity (% y/y)	3.6	1.8	2.1	3.3	3.0
Unit labour costs (% y/y)	1.6	2.8	1.4	-0.4	0.6
Potential output (% y/y)	3.2	2.8	2.6	2.6	2.7
Output gap (% of potential GDP)	0.3	-0.5	-2.0	-2.1	-1.9
Index of agricultural commodity prices (USD; 2010=1.00)	1.00	0.96	0.99	0.95	0.97
Index of energy commodity prices (USD; 2010=1.00)	1.00	0.87	0.80	0.81	0.83
Price level abroad (% y/y)	1.0	1.3	1.4	1.6	1.8
GDP abroad (% y/y)	1.9	0.1	-0.2	1.2	1.5
Current and capita account balance (% GDP)	-2.9	-1.3	-0.1	-0.2	-0.9
WIBOR 3M (%)	4.54	4.91	3.17	2.96	2.96

Source: LFS data is the data source for total employment, labour force participation rate and unemployment rate. From the July projection index of agricultural commodity prices is based on futures quoted mainly on European stock exchanges. Index includes prices of wheat, oilseed, pork, potatoes, sugar, cocoa, coffee, skimmed milk powder, butter and frozen concentrated orange juice allowing for weights reflecting the consumption structure of Polish households. The index of the prices of energy commodities includes the prices of crude oil, coal and natural gas allowing for the consumption structure of these commodities in Poland.

Chapter 5

THE VOTING OF THE MONETARY POLICY COUNCIL MEMBERS IN FEBRUARY - MAY 2013

- **Date:** 6 February 2013

Subject matter of motion or resolution:
Motion to lower the NBP interest rates by 1.0 percentage point.

MPC decision:
Motion did not pass.

Voting of the MPC members:

For: A. Bratkowski
E. Chojna-Duch

Against: M. Belka
A. Glapiński
J. Hausner
A. Kaźmierczak
A. Rzońca
J. Winiecki
A. Zielińska-Głębocka

Z. Gilowska was absent.

- **Date:** 6 February 2013

Subject matter of motion or resolution:
Motion to lower the NBP interest rates by 0.50 percentage points.

MPC decision:
Motion did not pass.

Voting of the MPC members:

For: A. Bratkowski
E. Chojna-Duch
A. Zielińska-Głębocka

Against: M. Belka
A. Glapiński
J. Hausner
A. Kaźmierczak
A. Rzońca
J. Winiecki

Z. Gilowska was absent.

- **Date:** 6 February 2013

Subject matter of motion or resolution:
Resolution no 2/2013 on reference rate, refinancing credit rate, deposit rate and rediscount rate at the NBP.

MPC decision:
The MPC lowered the NBP interest rates by 0.25 percentage points.

Voting of the MPC members:

For:		Against:	
	M. Belka		A. Rzońca
	A. Bratkowski		J. Winiecki
	E. Chojna-Duch		
	A. Glapiński		
	J. Hausner		
	A. Kaźmierczak		
	A. Zielińska-Głębocka		

Z. Gilowska was absent.

- **Date:** 6 March 2013

Subject matter of motion or resolution:
Resolution no 3/2013 on reference rate, refinancing credit rate, deposit rate and rediscount rate at the NBP.

MPC decision:
The MPC lowered the NBP interest rates by 0.50 percentage points.

Voting of the MPC members:

For:		Against:	
	M. Belka		Z. Gilowska
	A. Bratkowski		A. Glapiński
	E. Chojna-Duch		A. Kaźmierczak
	J. Hausner		A. Rzońca
	A. Zielińska-Głębocka		J. Winiecki

- **Date:** 6 March 2013

Subject matter of motion or resolution:
Motion to lower the NBP interest rates by 0.25 percentage points.

MPC decision:
Motion was not voted.

● **Date:** 9 April 2013

Subject matter of motion or resolution:
Resolution No. 4/2013 on approving the Annual Financial Report of the National Bank of Poland prepared as of 31 December 2012.

Voting of the MPC members:

For:		Against:
	M. Belka	
	A. Bratkowski	
	E. Chojna-Duch	
	A. Glapiński	
	J. Hausner	
	A. Kaźmierczak	
	A. Rzońca	
	J. Winiecki	
	A. Zielińska-Głębocka	

Z. Gilowska was absent.

● **Date:** 8 May 2013

Subject matter of motion or resolution:
Resolution No. 5/2013 on approving the report on monetary policy implementation in 2012.

Voting of the MPC members:

For:		Against:
	M. Belka	
	A. Bratkowski	
	E. Chojna-Duch	
	Z. Gilowska	
	A. Glapiński	
	J. Hausner	
	A. Kaźmierczak	
	A. Rzońca	
	J. Winiecki	
	A. Zielińska-Głębocka	

• **Date:** 8 May 2013

Subject matter of motion or resolution:

Resolution No. 6/2013 on the evaluation of the activities of the NBP Management Board as regards the implementation of the monetary policy guidelines for the year 2012.

Voting of the MPC members:

For:		Against:	
	M. Belka		
	A. Bratkowski		
	E. Chojna-Duch		
	Z. Gilowska		
	A. Glapiński		
	J. Hausner		
	A. Kaźmierczak		
	A. Rzońca		
	J. Winiecki		
	A. Zielińska-Głębocka		

• **Date:** 8 May 2013

Subject matter of motion or resolution:

Motion to lower the NBP interest rates by 0.5 percentage points.

MPC decision:

Motion did not pass.

Voting of the MPC members:

For:		Against:	
	A. Bratkowski		M. Belka
	A. Zielińska-Głębocka		E. Chojna-Duch
			Z. Gilowska
			A. Glapiński
			J. Hausner
			A. Kaźmierczak
			A. Rzońca
			J. Winiecki

• **Date:** 8 May 2013

Subject matter of motion or resolution:

Resolution no 7/2013 on reference rate, refinancing credit rate, deposit rate and rediscount rate at the NBP.

MPC decision:

The MPC lowered the NBP interest rates by 0.25 percentage points.

Voting of the MPC members:

For:		Against:	
	M. Belka		Z. Gilowska
	A. Bratkowski		A. Glapiński
	E. Chojna-Duch		A. Kaźmierczak
	J. Hausner		A. Rzońca
	A. Zielińska-Głębocka		J. Winiecki

● **Date:** 8 May 2013

Subject matter of motion or resolution:
Resolution no 8/2013 on approving the report on the operations of the National Bank of Poland in 2012.

Voting of the MPC members:

For:	**Against:**
A. Bratkowski	
E. Chojna-Duch	
Z. Gilowska	
A. Glapiński	
J. Hausner	
A. Kaźmierczak	
A. Rzońca	
J. Winiecki	
A. Zielińska-Głębocka	

M. Belka was absent.