NBP Narodowy Bank Polski

Monetary Policy Council

July 2019

Inflation Report

The Inflation Report presents the Monetary Policy Council's assessment of the macroeconomic developments influencing inflation. The projection of inflation and GDP presented in Chapter 4 was prepared at the Economic Analysis Department of Narodowy Bank Polski (NBP). In terms of the contents, works on the projection were supervised by Piotr Szpunar, Director of the Economic Analysis Department. 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 projection of inflation and GDP is one of the inputs to the Monetary Policy Council's decision-making process.

The time frame 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 19 June 2019, but the *Report* includes also data on industrial output in May 2019 published on 21 June 2019, as well as data on retail sales and construction and assembly output in May 2019 published on 24 June 2019.

This *Inflation Report* is a translation of NBP *Raport o inflacji* in Polish. In case of discrepancies, the original prevails.

Contents

Summary

GDP growth in many economies worldwide remains relatively low. Economic activity is adversely affected by heightened uncertainty about global economic outlook. This is partly related to changes in the trade policies of the major economies, accompanied by a significant slowdown in goods trade and still fairly weak sentiment in manufacturing sector. By contrast, relatively good situation in the services sector, in particular in services closely associated with household consumption, has a positive effect on the activity in some of the major economies.

Inflation in the global economy stands at a moderate level. A slight increase in inflation in emerging market economies – mainly related to an acceleration in food price growth – is accompanied by a continued relatively low price growth in advanced economies.

As the outlook for global economic growth has deteriorated and uncertainty about the future business conditions heightened, in recent months the major central banks have markedly toned down their rhetoric on future monetary policy, which has been accompanied by increased expectations of its loosening. The European Central Bank is keeping the deposit rate below zero (at the level of -0.40%) and in recent months has extended the period of maintaining interest rates unchanged through the first half of 2020. The US Federal Reserve has been keeping interest rates unchanged since December 2018 (at present the target range for the fed funds rate is 2.25-2.50%), yet the likelihood of an interest rate cut in the quarters to come has markedly increased of late.

Against this backdrop, the recent months have seen a significant decline in bond yields worldwide. At the same time, share prices – which have been subject to considerable fluctuations in the past few quarters – were close to record highs in advanced economies, while in emerging market economies they stood only slightly above their long-term averages.

Consumer price growth in Poland, following a decline over the second half of 2018, has increased in recent months, but remains moderate (CPI inflation in May 2019 stood at 2.4% y/y). Some acceleration in consumer price growth was driven by faster food price growth on the back of rising global agricultural commodity prices, as well as by growth in core inflation related to still relatively strong domestic consumer demand. At the same time, consumer price growth was dragged down by the fall in domestic administered electricity prices, along with high competition in global and domestic markets.

Economic growth in Poland continues to be relatively high, despite a slight weakening at the beginning of the year (GDP growth posted 4.7% y/y in 2019 Q1). Private consumption as well as investment, public consumption and net exports all make positive and significant contributions to GDP growth. Private consumption is supported by a favourable situation of employees in the labour market, including systematic wage growth, accompanied by consistently high consumer confidence and rising consumer credit. While public investment growth remains relatively strong, despite some slowdown in 2019 Q1, corporate investment – particularly in medium-sized and large companies – picked up markedly in 2019 Q1. At the same time, public consumption growth accelerated, partly driven by a rise in the wage fund of the local governments and the uniformed services. In turn, the positive contribution of net exports to GDP growth in 2019 Q1 reflected still higher growth in exports than in imports.

In 2018, a further improvement was seen in the financial performance of the general government sector. According to the spring fiscal notification, the general government deficit (in ESA2010 terms) stood at 0.4% of GDP as against 1.5% of GDP in 2017, and thus was historically low.

Favourable economic conditions are conducive to a further rise in employment, although some data signal its stabilisation. Concurrently, the unemployment rate is running at a very low level. As a result, the position of employees in wage negotiations remains strong, and nominal wage growth in the national economy has stabilised at around 7%. At the same time, labour productivity growth accelerated slightly. As a consequence, growth in unit labour costs decreased in 2019 Q1 and remains moderate.

Against the background of falling bond yields in global markets, the yields on Polish 5-year and 10-year government bonds have declined to close to historic lows in the recent period. Equity prices in Poland, following considerable fluctuations related to changes in global equity prices, stabilized at a similar level to that of January 2019. At the same time, the exchange rates of the zloty against major currencies remained stable.

Annual broad money growth in the economy continued to increase in 2019 Q1. As in previous periods, growth in household deposits made the largest contribution to the change in the M3 aggregate. In 2019 Q1, the growth in broad money was mainly the result of a pickup in credit for the non-financial sector. For the past few quarters, total lending growth has been close to the nominal GDP growth.

External imbalance indicators evidence that the Polish economy is well balanced. In 2018, Poland's net international investment position continued to improve and the external debt to GDP ratio was on the decline. In 2019 Q1, the current account balance increased and was positive, although measured as a four-quarter rolling sum it remained slightly negative.

Taking into account the above developments, the Monetary Policy Council keeps the NBP interest rates unchanged, including the reference rate at 1.50%. Market interest rate expectations suggest that the NBP interest rates will remain stable in the coming quarters.

The *Report* is structured as follows: Chapter 1 presents the analysis of economic conditions in the external environment of the Polish economy in terms of their impact on inflation developments in Poland. These developments and the domestic factors that might affect them have been described in Chapter 2. Chapter 3 includes *Minutes of the Monetary Policy Council decision-making meetings* held between March and June 2019, together with the *Information from the meeting of the Monetary Policy Council* in July 2019. *Minutes* of the MPC meeting held in July will be published on 22 August 2019 and so will be included in the next *Report*. Chapter 5 presents the Monetary Policy Council voting records from the meetings held between February and mid-May 2019. Furthermore, the *Report* includes a box: *Toning down the rhetoric on future monetary policy by the US Federal Reserve and the European Central Bank*.

Chapter 4 of the *Report* presents the projection for 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 projection – prepared under the assumption of unchanged NBP interest rates and taking into account data available until 18 June 2019 – there is a 50-percent probability that the annual price growth will be in the range of 1.7–2.3% in 2019 (against 1.2–2.2% in the March 2019 projection), 1.9–3.7% in 2020 (compared to 1.7–3.6%) and 1.3–3.5% in 2021 (against 1.3–3.5%). At the same time, the annual GDP growth – according to this projection – will be with a 50-percent probability in the range of 3.9–5.1% in 2019 (against 3.3–4.7% in the March 2019 projection), 3.0–4.8% in 2020 (compared to 2.7–4.6%) and 2.4–4.3% in 2021 (against 2.4–4.3%).

1. External developments

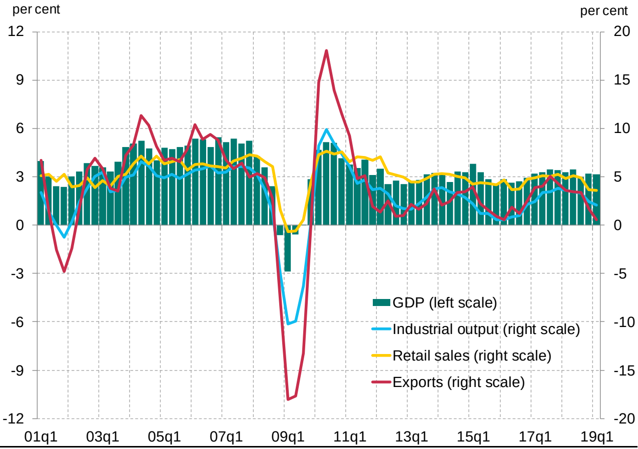
1.1 Economic activity abroad

GDP growth in many economies worldwide remains relatively low (Figure 1.1). Economic activity is adversely affected by heightened uncertainty about global economic outlook. This is partly related to changes in the trade policies of the major economies accompanied by a significant slowdown in trade in goods, as well as continued fairly weak sentiment in manufacturing sector. In turn, still relatively good situation in the services sector, in particular in services closely associated with household consumption, has a positive effect on some of the major economies.

In 2019 Q1, the annual growth rate in the euro area stabilised at a lower level compared to recent years (1.2% y/y; Figure 1.2).[1] This was supported by stable growth of consumer demand driven by rising employment and wages, a decline in tax burden and an increase in public transfers for households in some of the major economies of the euro area. Against this background, good performance of the services sector continued. At the same time, investment growth increased. Yet industrial sentiment remained weak, reflecting the impact of flagging demand for exports from the euro area, as well as heightened uncertainty about the trade policies of the major economies.

In Central and Eastern Europe, despite subdued growth in the external environment, economic conditions remained favourable. In 2019 Q1, the average GDP growth for the region increased to

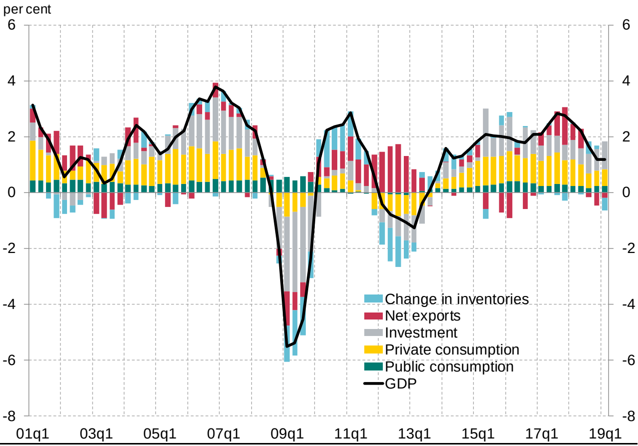
Figure 1.1 GDP growth and global economic activity indicators (y/y)



Source: Bloomberg, Centraal Planbureau, Eurostat, IMF data, NBP calculations.

GDP, industrial output and retail sales – average annual growth in economies comprising 80% of global GDP in 2017, weighted by GDP. Exports – global export growth rate estimated by Centraal Planbureau.

Figure 1.2 GDP growth in the euro area and its components (y/y)



Source: Eurostat data, NBP calculations.

[1] In quarterly terms, GDP in the euro area grew by 0.4% q/q in 2019 Q1, after an increase of 0.1% and 0.2% respectively in 2018 Q3 and Q4 (data seasonally adjusted).

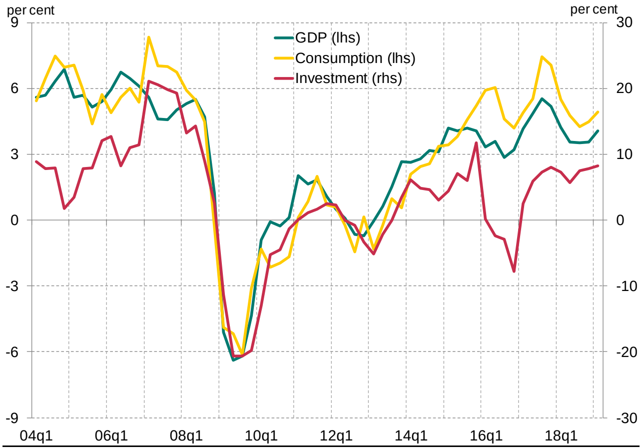
4.1% y/y from 3.6% y/y in 2018 Q4 (Figure 1.3). Domestic demand continued to be its main driver. Consumption growth was still backed by rising wages and employment as well as a significant pickup in consumer loans. Investment growth, in turn, stemmed from high capacity utilisation and a marked acceleration in absorption of EU structural funds in the second half of 2018. In addition, in recent months, the impact of disruptions in automobile production – among others, due to the introduction of new fuel emission standards (WLTP) – has waned, which was conducive to an increase in export growth in the majority of countries in the region.

In the United States, annual GDP growth in 2019 Q1 rose slightly (to 3.2% y/y from 3.0% y/y in 2018 Q4[2]; Figure 1.4) as a result of a marked increase in the contribution of net exports and inventories. At the same time, domestic demand growth declined, which was partly due to the United States federal government shutdown. However, the majority of determinants of domestic demand growth are still favourable: situation in the labour market remains very good and the effects of the tax reform continue to support growth.

In the United Kingdom, annual GDP growth increased in 2019 Q1 to 1.8% y/y from 1.4% y/y in 2018 Q4, partly under the impact of a temporary rise in consumption and accumulation of inventories in fear of disruptions in supply from abroad in the case of a no-deal Brexit.[3] The strong growth in public investment and the first in five quarters slight growth in corporate investment, also had a positive effect on GDP growth. However, corporate investment plans remain constrained, mainly due to uncertainty related to the country's political situation.

In China, the decline in GDP growth came to a halt, and continued at a pace of 6.4% y/y in 2019 Q1

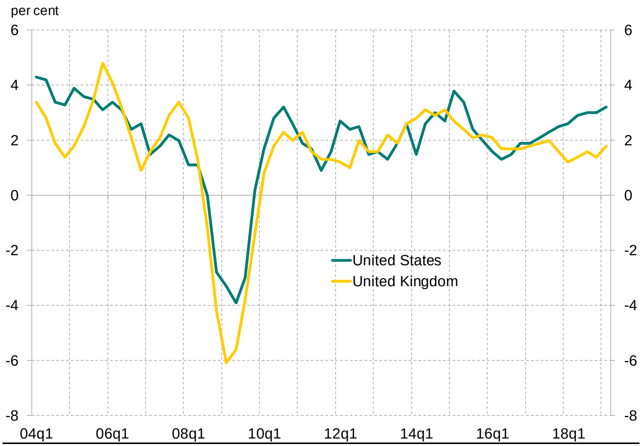
Figure 1.3 Economic growth and its selected components in countries of Central and Eastern Europe (y/y)



Source: Eurostat data, NBP calculations.

GDP-weighted annual growth rate of the total GDP, private consumption and gross fixed capital formation in non-euro area Central and Eastern European EU member states (excluding Poland): Bulgaria, Czech Republic, Croatia, Hungary and Romania.

Figure 1.4 Economic growth in selected advanced economies (y/y)



Source: Bloomberg data.

[2] In quarterly terms, GDP growth in the United States rose to 3.1% in 2019 Q1 from 2.2% in 2018 Q4 (annualised data).

[3] Initially, the date for the United Kingdom's withdrawal from the European Union was 29 March 2019. However, in March and April 2019 this deadline was twice postponed and is currently set for 31 October 2019.

(Figure 1.5). The loosening of economic policy, which supported the growth of public investment as well as investment in the real estate sector, had a positive effect on economic activity. In turn, GDP growth in Russia slowed down significantly in 2019 Q1. Apart from the high statistical base effect in the agricultural sector, this was attributable to a rise in inflation, which negatively affected real household income.

1.2 Inflationary developments abroad

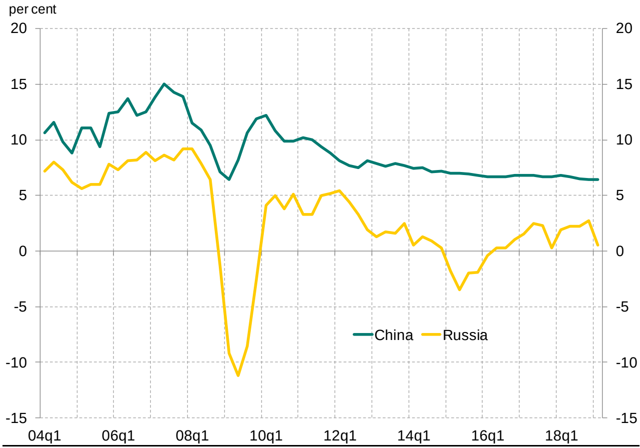
Inflation in the global economy stands at a moderate level (Figure 1.6). A slight increase in inflation in emerging market economies – mainly related to an acceleration in food price growth – is accompanied by a continued relatively low price growth in advanced economies (see Chapter 1.3 *Global commodity markets*).

HICP inflation in the euro area is still running significantly below the level consistent with the definition of price stability by the European Central Bank (ECB; inflation below, but close to 2%). In May 2019, HICP inflation stood at 1.2% y/y. Continuously low core inflation has a curbing effect on overall price growth (Figure 1.7). At the same time, HICP inflation is boosted by the relatively fast energy price growth.

In the United States, consumer price growth, in particular core inflation, remains slightly higher than in many other advanced economies (in May 2019, CPI inflation stood at 1.8% y/y, while core inflation was 2.0% y/y). The persistence of core inflation at a level higher than in comparable economies is supported by the relatively fast growth in services prices related to the economic recovery lasting for several years and reflected in a very good situation of employees in the labour market.

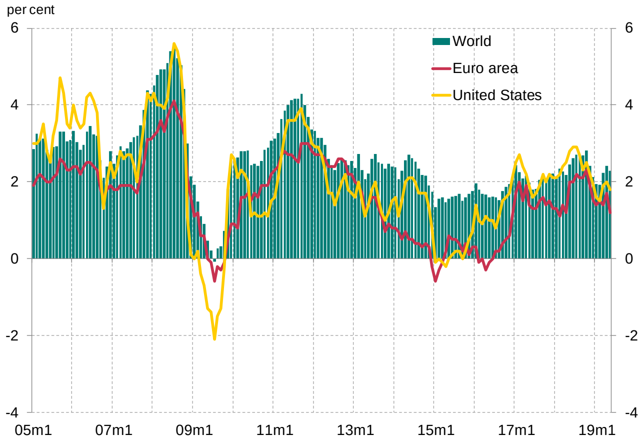
CPI inflation in the region of Central and Eastern Europe has increased significantly since the beginning of 2019, mainly under the impact of higher energy and food price growth (Figure 1.8).

Figure 1.5 Economic growth in selected emerging market economies (y/y)



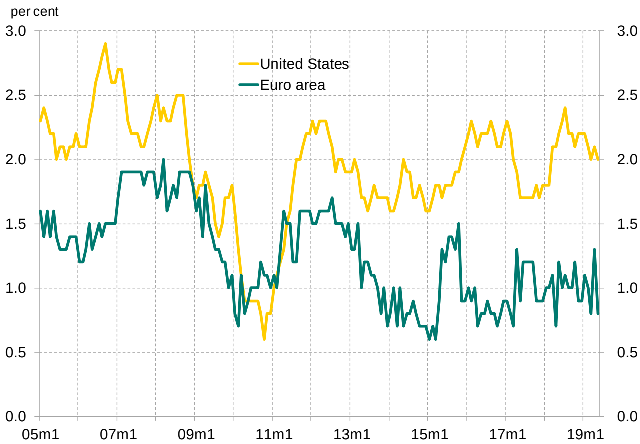
Source: Bloomberg data.

Figure 1.6 CPI inflation globally and in selected economies (y/y)



Source: Bloomberg data, NBP calculations.
World – average consumer price inflation in economies comprising over 80% of global GDP, weighted by GDP (2017). United States – annual CPI inflation. Euro area – annual HICP inflation.

Figure 1.7 Core inflation in United States and the euro area (y/y)



Source: Bloomberg and Eurostat data.
United States – annual CPI inflation less food and energy. Euro area – HICP inflation excluding energy, food, alcohol and tobacco.

In Romania and Hungary, core inflation has also increased, supported by strong wage growth and high growth in consumer demand in these economies.[4]

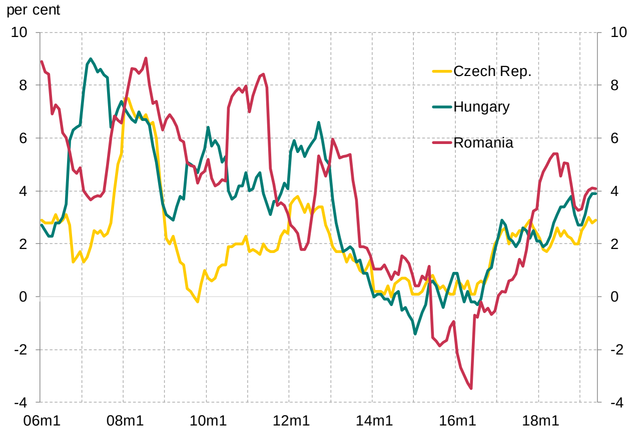
1.3 Global commodity markets

In global energy commodity markets, oil prices – following a significant rise at the beginning of 2019 – fell in the recent period below the level seen a year ago. This was accompanied by a further marked decline in the prices of gas and coal (Figure 1.9). At the same time, the average prices of agricultural commodities increased.

After a significant rise in the first months of 2019, oil prices fell again and run below the level of a year ago (the price of Brent crude oil in mid-June 2019 stood at approx. USD 62 per barrel, or almost 20% less than a year earlier). The rise in oil prices at the beginning of 2019 was mainly driven by cuts in oil supply resulting from the decision of the so-called OPEC+ countries (i.e. OPEC members and some other oil exporters) to reduce production. It could also be linked to political factors in some oil exporting countries, such as sanctions imposed by the United States on Iran and Venezuela (where the fall in production results additionally from the tense situation in the country) and the escalation of the conflict in Libya. However, since the end of April, the impact of factors decreasing oil prices has intensified. Above all, uncertainty about the future demand for oil has grown reflecting a deterioration in global growth outlook, which was accompanied by an increase in oil stocks in the United States (see Chapter 1.1 *Economic activity abroad*).

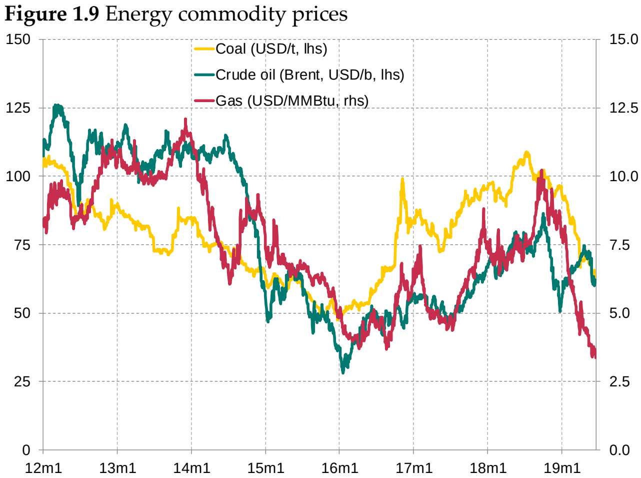
Prices of natural gas, in turn, continued to fall strongly (in mid-June 2019 they were approx. 50% lower than a year ago) and ran at the lowest level for 10 years. The main reason for the fall in these prices was the limited demand for natural gas as a

Figure 1.8 Inflation rate in the Czech Republic, Romania and Hungary (y/y)



Source: Bloomberg data.
Annual CPI inflation.

Figure 1.9 Energy commodity prices



Source: Bloomberg data, NBP calculations.
USD/b – price expressed in US dollar per barrel of oil. USD/t – price expressed in US dollar per metric tonne. USD/MMBtu – price expressed in US dollar per million of British Thermal Unit, i.e. unit representing a quantity of energy required to raise the temperature of 1 pound (approx. 0.45 kg) of water by 1°F (slightly more than 0.5°C).

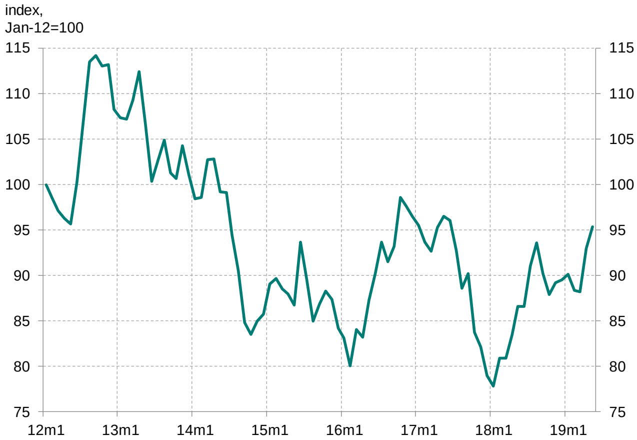
[4] National measures of core inflation in the economies of Central and Eastern Europe were: in the Czech Republic 2.5% y/y (in May 2019), in Hungary 4.0% y/y (in May 2019), and in Romania 2.7% y/y (in March 2019).

result of higher temperatures in the winter period than the average in previous years. The relatively high level of stocks of this commodity also added to lower gas prices.

Similarly, global prices of hard coal continued to decline (in mid-June 2019 they were approx. 40% lower than a year ago) due to higher temperatures in winter time than the average in previous years. The increase in the prices of CO2 emission allowances, which reduced competitiveness of energy production from coal, and consequently demand for this commodity, worked in the same direction.

Agricultural commodity prices, in contrast, rose since the beginning of 2019 and run approx. 10% higher than in the same period a year ago (Figure 1.10). The increase in the agricultural commodities index was mainly a result of the significant rise in pork prices. This was caused by the African swine fever (ASF) epidemic in China, which is expected to lead to a significant reduction in the pig population in China and a sharp rise in Chinese demand for meat in global markets. Also vegetable prices rose as a consequence of drought in Europe. Global wheat prices, in turn, declined since the beginning of the year due to the high level of production and stocks of this commodity.

Figure 1.10 Index of agricultural commodity prices



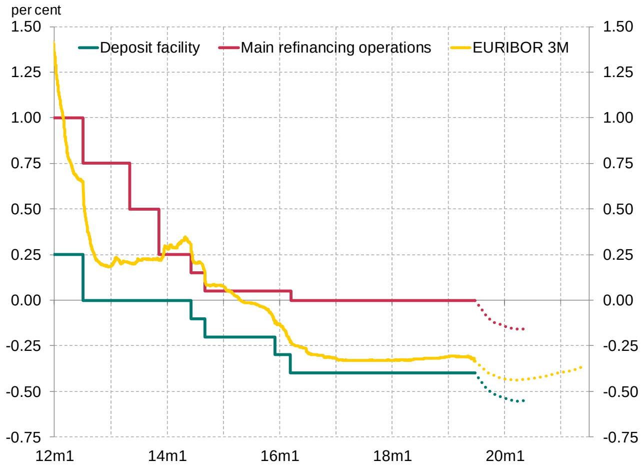
Source: Bloomberg data, NBP calculations.
Index of agricultural prices includes prices of wheat, colza, pork, potatoes, sugar, cocoa, coffee, skimmed milk powder, butter and frozen concentrated orange juice. The weights reflect the consumption structure of Polish households.

1.4 Monetary policy abroad

As the outlook for global economic growth has deteriorated and uncertainty about the future business conditions heightened in recent months, the major central banks have markedly toned down their rhetoric on the future monetary policy, which has been accompanied by increased expectations of its loosening (see *Box: Toning down the rhetoric on future monetary policy by the US Federal Reserve and the European Central Bank*).

The European Central Bank (ECB) is keeping the deposit rate below zero (at the level of -0.40%). As a result, the short-term interbank lending rates in the euro area remain negative. In recent months,

Figure 1.11 Historical and expected interest rates in the euro area

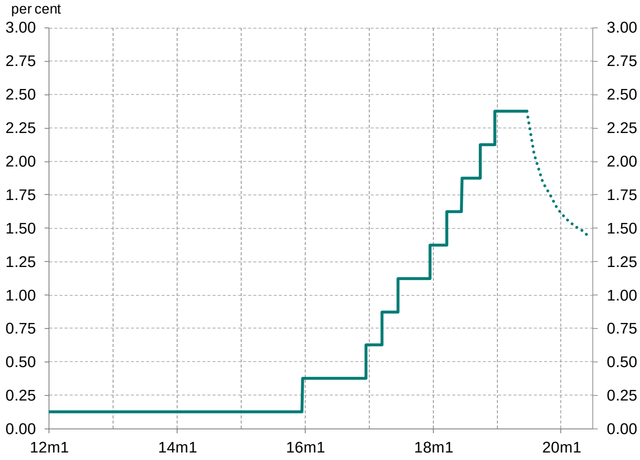


Source: Bloomberg data.
Expectations as of 21 June 2019. Expected interest rates based on the overnight index swaps for the rates on the deposit facility and the main refinancing operations; expected EUROIBOR 3M based on options.

the ECB has twice extended the period in which it announced that it would keep interest rates unchanged, and currently expects their stabilisation at least through the first half of 2020.[5] At the same time, the prices of financial instruments indicate that market participants expect interest rates to run at the current or slightly lower levels at least through the first half of 2021. Besides, the market probability of a cut in interest rates has increased significantly in the recent period (Figure 1.11). In addition, the ECB has announced the launch of the third series of Targeted Longer-Term Refinancing Operations (TLTRO-III) in September 2019.[6] Concurrently, the ECB keeps reinvesting in full the principal payments from securities purchased within the asset purchase programme and is signalling that it will continue this process for an extended period of time.[7]

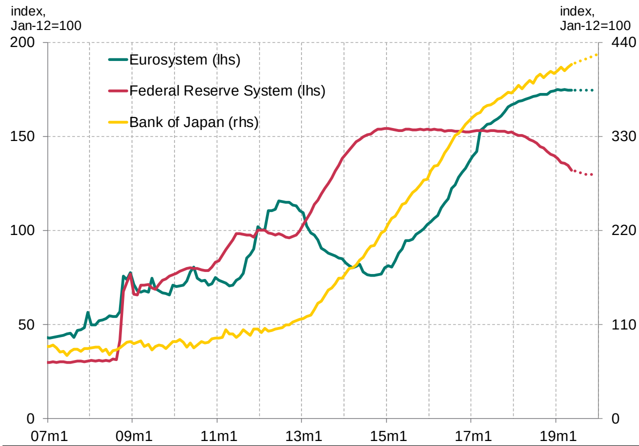
The Federal Reserve of the United States (the Fed) has been keeping interest rates unchanged since December 2018. The target range for the fed funds rate is 2.25-2.50%. At the same time, the Fed, while indicating heightened uncertainty about economic outlook, declares its readiness to change monetary policy in order to sustain relatively high economic activity. A large number of members of the Federal Open Market Committee (FOMC) is forecasting an easing of monetary policy in the coming quarters. Market expectations also indicate a high likelihood of an interest rate cut in the quarters to come (Figure 1.12). Moreover, in accordance with its earlier announcements, in May 2019 the Fed

Figure 1.12 Historical and expected interest rates in the United States (midpoint of the target range for the fed funds rate)



Source: Bloomberg data.
Expectations as of 21 June 2019 based on fed funds futures contracts.

Figure 1.13 Total assets of the major central banks with a forecast



Source: FRED data, NBP calculations.
Forecast until December 2019: for the Eurosystem under an assumption of no change, for the Bank of Japan under an assumption of extrapolation of the average growth observed in the period from June 2018 to May 2019, for the Federal Reserve System under an assumption of a decline until September 2019 in accordance with the Fed's reinvestment policy principles, and a stabilisation since October 2019.

[5] Excerpt from the ECB press release following the meeting of the Governing Council of 6 June 2019: "The Governing Council now expects the key ECB interest rates to remain at their present levels at least through the first half of 2020, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term."
[6] Under TLTRO-III, banks will be able to borrow at the ECB for two years funds to the value of 30% of the portfolio of loans granted to the non-financial sector in the euro area (except for, among others, housing loans) as of 28 February 2019, while the size of the available funding will be reduced by the current value of loans for the given bank under TLTRO-II. The interest rate in the TLTRO-III operations will be set at a level between 0.1 percentage points above the average ECB deposit rate during the period of the loan and 0.1 percentage points above the average ECB refinancing rate during this period – depending on the growth of the portfolio of loans granted by the given bank to 31 March 2021.
[7] Excerpt from the ECB press release following the meeting of the Governing Council of 6 June 2019: "The Governing Council intends to continue reinvesting, in full, the principal payments from maturing securities purchased under the asset purchase programme for an extended period of time past the date when it starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation."

limited the pace of reduction of its balance sheet and announced it would stop the unwinding in October 2019 (Figure 1.13).

Interest rates of central banks in the remaining advanced economies continue to run at very low levels, and in Japan, Switzerland, Sweden, and Denmark they are negative. In addition, the Bank of Japan is continuing its financial asset purchase programme, while the Bank of Switzerland has announced that it is prepared to conduct exchange rate interventions in order to prevent excessive appreciation of the Swiss franc. Moreover, in some advanced economies, the central banks have recently lowered interest rates (Australia, New Zealand).[8]

Faced with the toning down of rhetoric by the major central banks and the deteriorating economic outlook, central banks in some of the emerging market economies have eased monetary policy in the recent period (among others, in China, India and Russia).

Box: Toning down the rhetoric on future monetary policy by the US Federal Reserve and the European Central Bank

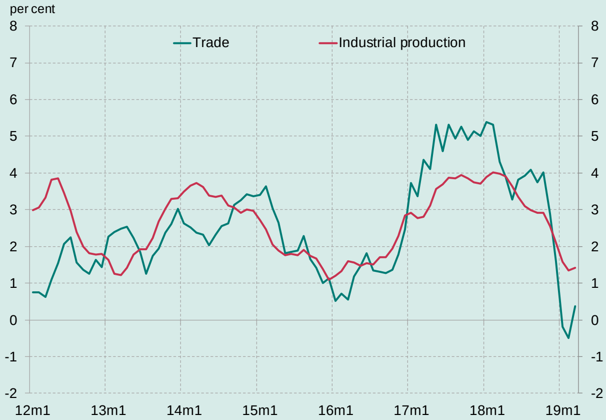
After a marked acceleration in 2017 and in the first half of 2018, growth in global economic activity slowed down in the following quarters. Both global and local factors in some of the largest economies contributed to this development. Global factors most relevant in this respect included a decline in global trade growth related to changes in the trade policy of the largest economies,[9] a deterioration in sentiment in the financial markets that contributed to a tightening in financial conditions,[10] and an increase in uncertainty due to, among others, the protracted process of Brexit. Against this backdrop, since mid-2018, global industrial output growth has declined and business sentiment has deteriorated, both considerably (Figure B.1, Figure B.2).

[8] In recent months, from among the European economies, interest rates have been raised in Norway and the Czech Republic. At the same time, the Czech National Bank has signalled a stabilisation of interest rates, while Norges Bank has indicated the possibility of further small interest rate increases in the coming quarters in view of inflation, including core inflation, persisting above the central bank's target and the forecast significant pickup in economic growth related to higher activity in the oil sector.

[9] Changes in trade policies in the form of increasing import duties on selected products have been introduced by the United States since January 2018, mainly against China (to a lesser extent against the EU countries), which has been most often met with reciprocal actions by the US trade partners. In total, in 2018 the United States raised tariffs on approx. USD 250 billion worth of imports from China, followed in May 2019 by additional tariffs on approx. USD 200 billion of goods imported from this country, while at the same time began preparing to target further over USD 300 billion worth of Chinese products. In response, in 2018 China retaliated with import duties on USD 60 billion worth of products from the United States and raised them in June 2019.

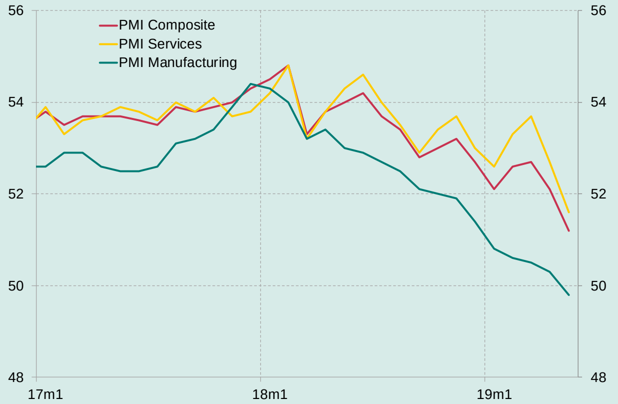
[10] Some of the emerging market economies saw a substantial outflow of capital in 2018 Q2 and Q3 accompanied by a weakening of their currencies, a fall in share prices and a rise in Treasury bond yields. In developed markets, in turn, sentiment deteriorated significantly in 2018 Q4, as reflected, among others, in a marked fall in share prices.

Figure B.1 Annual growth in the volume of global trade and industrial production (3-month moving average)



Source: Centraal Planbureau World Trade Monitor data.

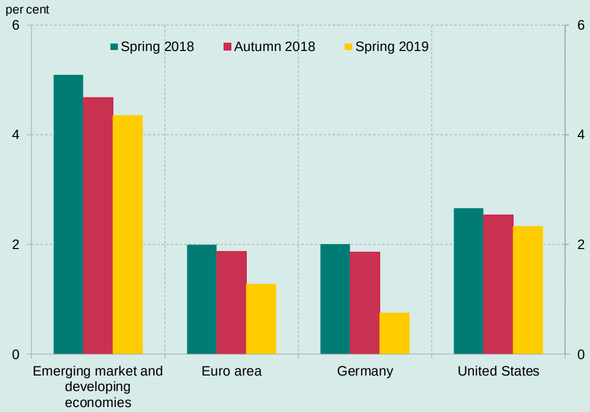
Figure B.2 Global PMI



Source: IHS Markit data.

Consequently, medium-term GDP growth forecasts for a number of economies were revised down (Figure B.3).[11] This concerned in particular the euro area, notably Germany, and several large emerging market economies (including Argentina, Brazil, India, Indonesia, Mexico and Turkey). At the same time, expectations about the pace of growth in the United States – where economic conditions remained relatively favourable – were revised to a smaller degree. In turn, growth forecasts for China – largely unchanged in recent quarters – pointed to a further gradual slowing of activity growth over the medium term.

Figure B.3 International Monetary Fund forecasts of GDP growth for 2019



Source: IMF data.

The deterioration in economic growth outlook, occurring amid continued moderate inflation, in the first half of 2019 prompted major central banks to significantly tone down their rhetoric on future monetary policy. This entailed a rise in expectations of its loosening.

The Fed, after increasing the target range for the fed funds rate four times in 2018 (the last time in December, to 2.25%-2.50%), from January 2019 softened its communication on future monetary policy. In particular, for the first time in four years, the Fed decided not to signal further gradual monetary policy tightening in its statement, declaring that it would be "patient" when determininig future interest rate adjustments. Amid the consistently favourable economic conditions in the United States, the Fed justified its softer stance by referring to developments in the global economy and financial markets, as well as the limited domestic inflationary pressure. Subsequently, in June 2019, the Fed pointed out that uncertainties about future economic growth had increased and underlined its readiness to "act as appropriate to sustain the expansion".[12]

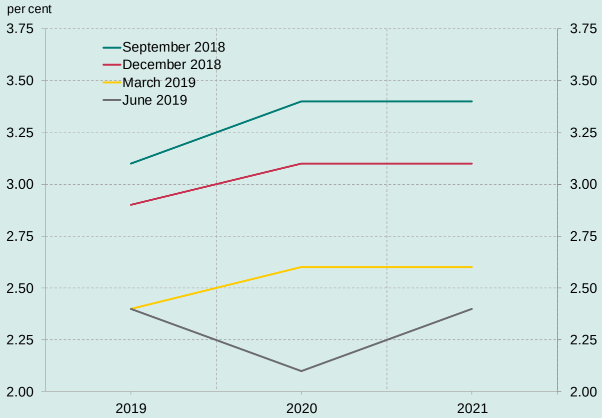
[11] Global economic growth forecasts for 2019 were revised down by the International Monetary Fund (IMF) from 3.7% (in October 2018) to 3.3% (in April 2019), the European Commission from 3.5% (in November 2018) to 3.2% (in May 2019), the Organisation for Economic Co-operation and Development (OECD) also from 3.5% (in November 2018) to 3.2% (in May 2019), and the World Bank from 2.9% (in January 2019) to 2.6% (in June 2019).

[12] The press release from 19 June stated that: „(…) *the Committee will closely monitor the implications of incoming information for the economic outlook and will act as appropriate to sustain the expansion* (…)".

As a result, whereas at the end of 2018 the median expectation of the members of the Federal Open Market Committee (FOMC) about interest rates still suggested two more rate hikes in 2019, in the subsequent projection rounds the expected path of interest rates was being lowered. The most recent FOMC members projection from 19 June assumes keeping interest rates unchanged until the end of 2019 (however, 8 out of 17 FOMC members expect an interest rate cut in 2019, out of which 7 members – a cut by 0.5 percentage points) and their cut in 2020 (Figure B.4). Furthermore, in March 2019 the Fed announced the phasing out of the process of the balance sheet reduction, which takes form of not reinvesting the part of maturing securities, and had been in progress since October 2017. From May 2019, the scale of the reduction was limited to USD 15 billion at most per month (from USD 30 billion previously), and from October 2019, in line with its announcement, the Fed would stop the unwinding of the balance sheet. The stabilisation of the balance sheet after its previous downsizing should contribute to an easing in financial conditions.

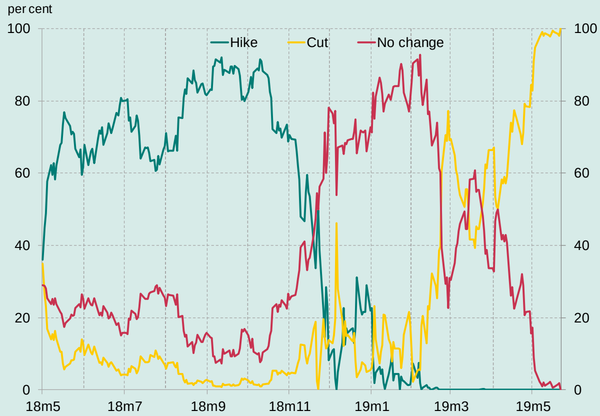
In response to the change in the Fed's rhetoric, the expectations of the analysts surveyed by Bloomberg have also changed. Currently, they expect the interest rates to stabilize in the coming quarters, while in December last year they were foreseeing two hikes in the fed funds rate by the end of 2019, in total by 0.50 percentage points.[13] At the same time, the fed funds futures show that, according to financial market participants, an interest rate cut in 2019 is highly likely, while as recently as in October 2018 they considered the probability of such a scenario as close to zero (Figure B.5).

Figure B.4 The median projection of FOMC members about the midpoint of the fed funds rate at the end of each year



Source: Fed data.

Figure B.5 Likelihood of changes to the fed funds rate by the end of 2019, determined on the basis of fed funds futures

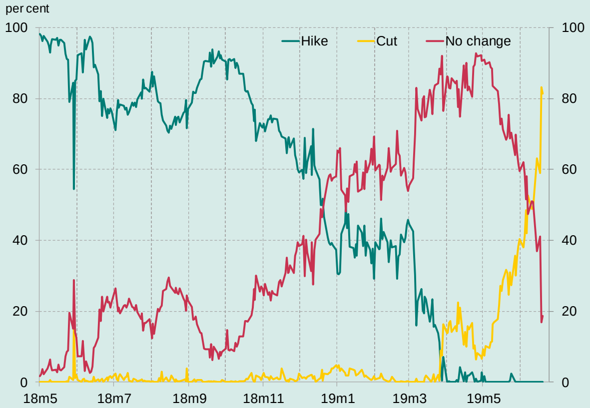


Source: Bloomberg data.

The ECB wound up its net asset purchase programme at the end of 2018, yet already in January 2019 it lowered its assessment of the balance of risks for economic growth in the euro area from neutral to negative, pointing, among others, to the lingering risks in the global economy. In March 2019, the ECB revised down substantially its forecasts of economic growth and inflation. According to the ECB's most recent forecast (of June 2019), inflation will run below the level consistent with the ECB's definition of price stability (i.e. below, but close to 2%) until the end of the projection horizon, i.e. till 2021. Since the beginning of this year, the long term inflation expectations in the euro area have also declined substantially (Figure B.7).

[13] According to the surveys conducted by Bloomberg on 13 June 2019 and 14 December 2018.

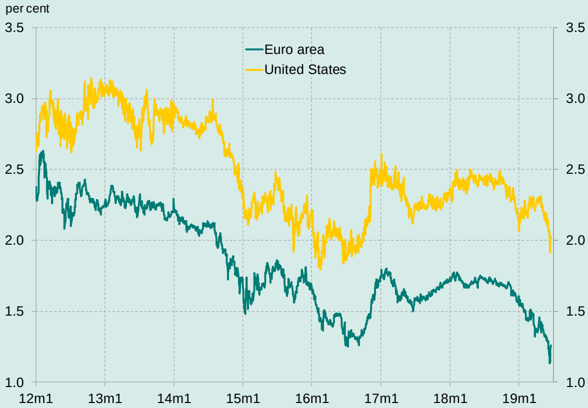
Figure B.6 Likelihood of market changes or stabilisation of the ECB deposit rate by the end of 2019



Source: Bloomberg data.

Likelihood determined on the basis of overnight index swaps.

Figure B.7 Long-term market inflation expectations in the euro area and in the United States



Source: Bloomberg data.

Expected average inflation in 5 years for the next 5 years determined on the basis of the forward inflation-linked swap rate.

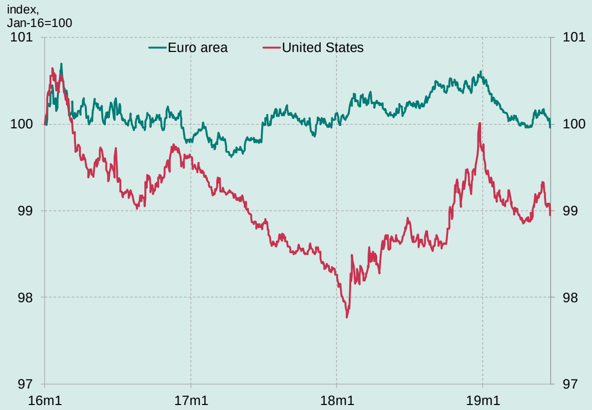
Against this background, in recent months, the ECB's Governing Council has twice extended its forward guidance about maintaining interest rates at their present level and is currently announcing a stabilisation of the rates at least through the first half of 2020 (previously it communicated that it would keep interest rates unchanged at least through the summer of 2019). At the same time, the Council adopted the decision to launch, from September 2019, a new series of Targeted Longer-Term Refinancing Operations (TLTRO), aimed at supporting lending in the euro area by ensuring favourable financial conditions for banks.[14] Moreover, at the June press conference, president M. Draghi indicated that some members of the Governing Council had hinted at the possibility of the ECB cutting interest rates or relaunching the net asset purchase programme.[15]

Owing to the ECB softening its tone, the anticipated period of interest rate stabilization in the euro area has lengthened. Analysts surveyed by Bloomberg are currently expecting the ECB refinancing rate to remain unchanged until the end of 2020.[16] Likewise, the option-implied expectations about the path of the 3-month EURIBOR rate in the interbank market have declined since the beginning of the year and they are currently showing this rate will remain at present or even slightly lower level at least through the first half of 2021 (whereas at the turn of 2019 market expectations pointed to an increase in this rate to close to zero by the end of 2020). At the same time, overnight index swaps point to a marked rise in the probability of a deposit rate cut by the end of 2019 (Figure B.6).

[14] The details of the new series of TLTRO operations announced by the ECB were presented in Chapter *1.4 Monetary policy abroad*.
[15] Furthermore, in his speech at the ECB conference in Sintra on 18 June 2019, President M. Draghi indicated that "In the absence of improvement, such that the sustained return of inflation to our aim is threatened, additional stimulus will be required". He also pointed out that the ECB was able to adjust all instruments from its monetary policy toolkit (including forward guidance, interest rates and asset purchase programme).
[16] According to the survey conducted by Bloomberg on 14 May 2019.

The softer tone of the Fed's and ECB's rhetoric about their future monetary policies has contributed to a decrease in market interest rates. Yields on government bonds in both the United States and the euro area have declined significantly since the turn of the year, with yields on 10-year German government bonds hitting an all-time low (of approx. -0.3%). At the same time, equity prices in these economies have risen since the beginning of 2019, following a sharp fall at the end of 2018. In effect, after the 2018 tightening, financing conditions in the United States and the euro area have improved (Figure B.8).

Figure B.8 The Financial Conditions Index for the United States and the euro area (an increase represents a tightening of financial conditions)



Source: Bloomberg data.

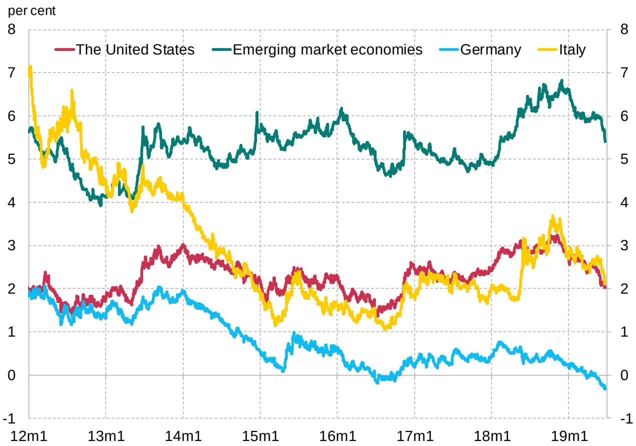
The index (the Goldman Sachs Financial Conditions Index) is computed as the weighted average (with the weights set according to the estimated impact of the individual variables on GDP) of risk-free interest rates, the spread of yields on corporate bonds, stock prices and the exchange rate.

1.5 International financial markets

As the major central banks have markedly toned down their rhetoric faced with the deteriorating outlook for global economic growth, the recent months have seen a significant decline in bond yields worldwide (see Chapter 1.4 *Monetary policy abroad* and *Box: Toning down the rhetoric on future monetary policy by the US Federal Reserve and the European Central Bank*). At the same time, share prices – which have been subject to considerable fluctuations in recent quarters – were close to record highs in advanced economies, while in emerging market economies they stood only slightly above their long-term averages.

Bond yields in advanced economies have fallen significantly in recent months (Figure 1.14). 10-year Treasury bond yields in the United States were at around 2.0% in mid-June 2019 (compared to an average of 2.7% in January 2019), while in Germany – for the first time since 2016 – yields of 10-year government bonds have fallen to below zero and reached a record low of around -0.3%. The difference between the bond yields of these economies stems from the interest rate disparity of their central banks and the lower long-term inflation expectations in Germany. Also in many emerging market economies bond yields have declined since the beginning of 2019. Among the

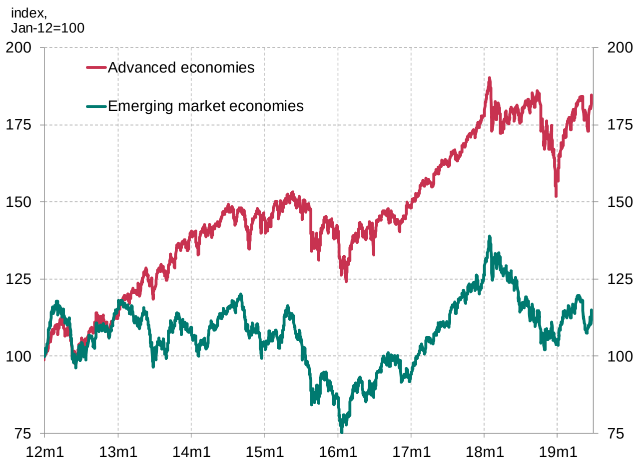
Figure 1.14 Government bond yields



Source: Bloomberg data.

The United States, Germany and Italy – 10 year government bond yield; emerging market economies – Bloomberg Barclays Emerging Markets Sovereigns.

Figure 1.15 Equity prices



Source: Bloomberg data.

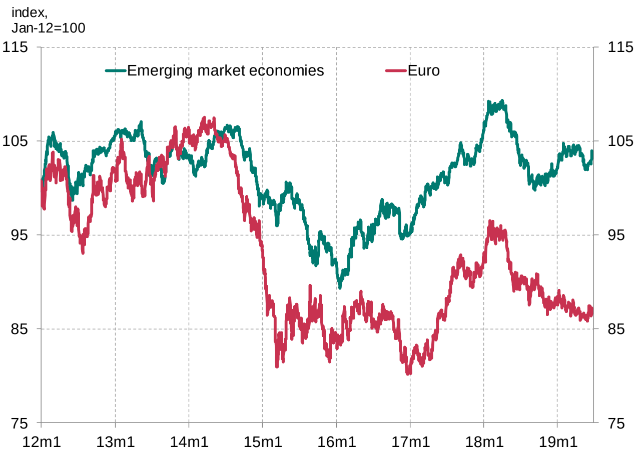
Advanced economies – MSCI World Equity Index; emerging market economies – MSCI Emerging Markets Equity Index.

major economies of the euro area, Italian sovereign bond yields remain at an elevated level due to continued uncertainty about the future fiscal policy in this country.

In turn, equity prices in advanced economies were close to their record levels (Figure 1.15), boosted by the major central banks' rhetoric significantly toned down. Acting in the opposite direction was a deterioration in global growth outlook, including periodically intensifying fears about the adverse impact of changes in the trade policies of the major economies. This factor also had a negative impact on equity prices in emerging market economies, particularly in China. As a result, share prices in these economies remained moderate and run only slightly higher than the long-term average.

In the FX market, the euro has weakened marginally against the US dollar since the beginning of 2019, against the background of a more favourable growth outlook for the United States than for the euro area (Figure 1.16). The currencies of the emerging market economies have, in turn, strengthened somewhat against the US dollar due to the Fed significantly toning down its rhetoric on future monetary policy.

Figure 1.16 Exchange rates against the US dollar (rise indicates appreciation)



Source: Bloomberg data, NBP calculations.
Emerging market economies – MSCI Emerging Market Currency Index.

2. Domestic economy

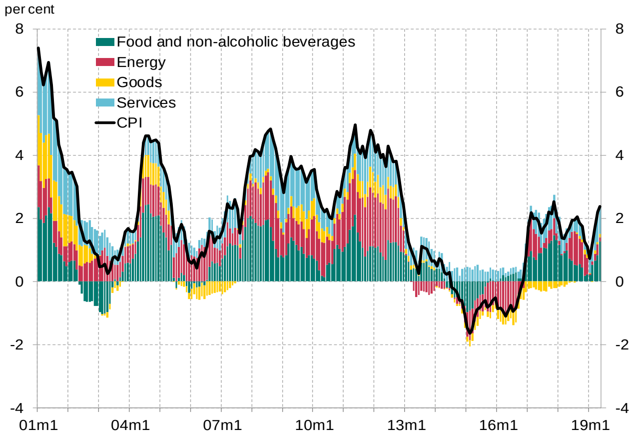
2.1 Consumer prices

Following a decline over the second half of 2018, consumer price growth in Poland has increased in recent months, but remains moderate (CPI inflation in May 2019 stood at 2.4% y/y; Figure 2.1). Some acceleration in consumer price growth was driven by faster food price growth on the back of rising global agricultural commodity prices, as well as by growth in core inflation related to still relatively strong domestic consumer demand. At the same time, consumer price growth was dragged down by the fall in domestic administered electricity prices as well as high competition in global and domestic markets.

Food price growth has accelerated in recent months (to 5.0% y/y in May). This development was largely accounted for by the declining supply of some agricultural produce, notably pork meat and vegetables (see Chapter 1.3 *Global commodity markets*). The food price growth was also pushed up by rising production costs (e.g. of bread and confectionery).

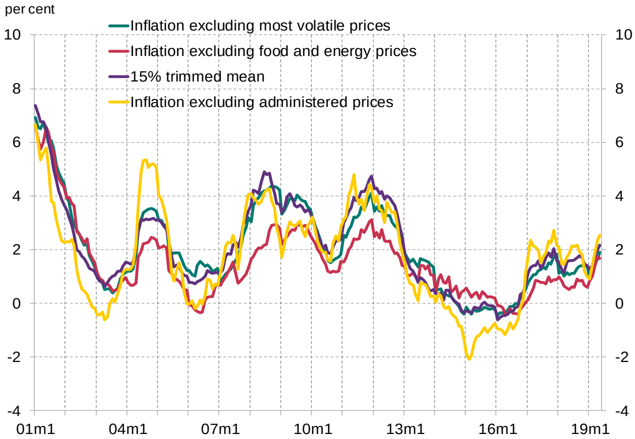
Since the beginning of the year, all measures of core inflation moved up, including inflation net of food and energy prices (which stood at 1.7% y/y in May; Figure 2.2). This was the effect of accelerating service price growth (3.1% y/y in May), coupled with a slight increase in non-food goods price growth (0.4% y/y in May). The acceleration of service price growth since the beginning of the year was spurred primarily by faster price growth of mobile telephony and Internet services, higher administered prices of housing-related services (garbage collection fees and rents) and a rise in

Figure 2.1 Composition of CPI inflation (y/y)



Source: Statistics Poland (GUS) data, NBP calculations.

Figure 2.2 Core inflation indices (y/y)



Source: Statistics Poland (GUS) data, NBP calculations.

prices of international holidays packages. Apart from good domestic economic conditions, the accelerating service price growth was due to the fading of one-off factors, which had limited price growth earlier on.[17]

After a marked fall at the turn of 2019, the growth of energy prices remained relatively low (0.8% y/y in May). The main factor curbing this growth since the beginning of the year was the drop in electricity prices (Figure 2.3). This drop was due to the coming into force of an act of Parliament freezing the prices of electricity (as a commodity) for end-users in 2019 at the level of 2018 and reducing the excise tax and the transitional fees on electricity.[18]

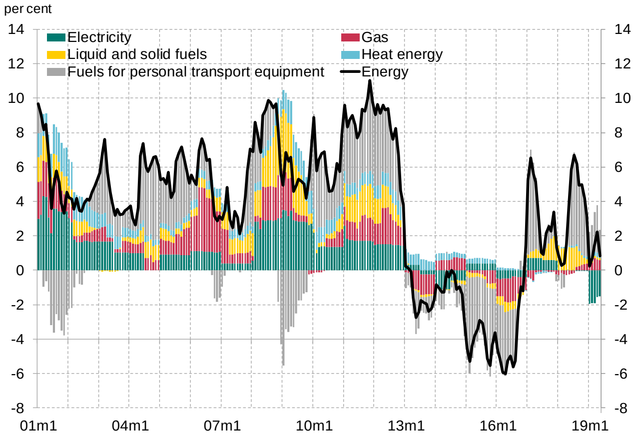
Following a slight acceleration at the beginning of 2019, growth in producer prices has recently slowed down markedly (to 1.4% y/y in May) on the back of lower global oil prices than a year ago (Figure 2.4).

In recent months, consumer survey opinions about future inflation have not changed significantly and, following a temporary surge in December 2019, they are again running close to the average level from the second half of 2018. At the same time, enterprises' inflation expectations – despite some decline in the first half of 2019 – remain slightly elevated in comparison with the average of 2018 (Figure 2.5). Alongside that, economists surveyed by NBP continue to expect inflation to run close to the NBP target in the coming quarters (Table 2.1).

2.2 Demand and output

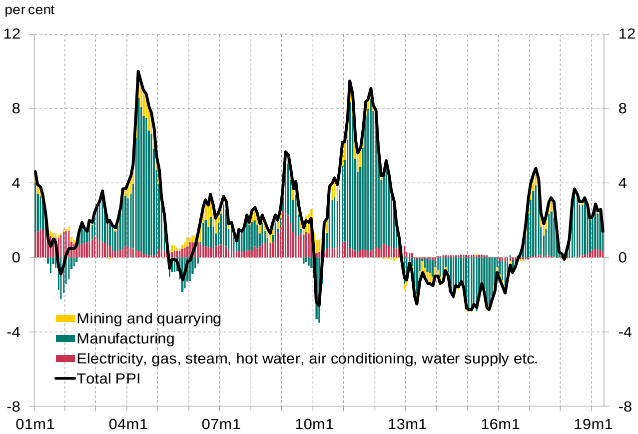
In year-on-year terms, economic growth in Poland continues to be relatively high, despite a slight weakening at the beginning of the year (Figure 2.6). In 2019 Q1, GDP growth posted 4.7% y/y (compared to 4.9% y/y in 2018 Q4). Private consumption as well as investment, public consumption and net exports all make positive and

Figure 2.3 Energy price growth and its components (y/y)



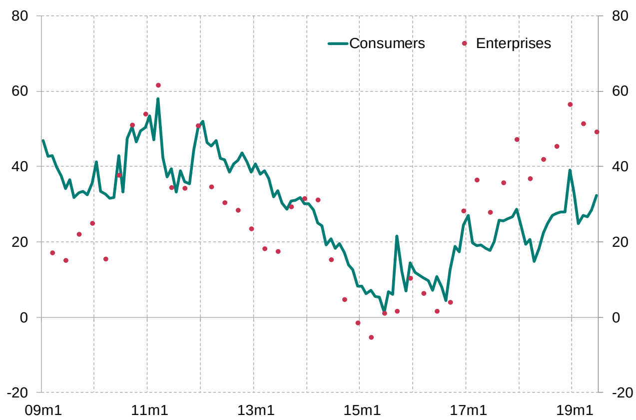
Source: Statistics Poland (GUS) data, NBP calculations.

Figure 2.4 Composition of PPI inflation (y/y)



Source: Statistics Poland (GUS) data, Eurostat.

Figure 2.5 Balance statistics of consumer and enterprise inflation expectations



Source: Statistics Poland (GUS) and NBP data, NBP calculations.
Balance statistics is defined as a difference between a fraction of respondents expecting rise in prices and the fractions of respondents expecting no change or fall in prices (with respective weights). A rise in balance statistics should be interpreted as a shift in opinions towards higher rise in prices.

[17] The beginning of 2019 saw the expiry of promotions concerning the prices of mobile telephony, Internet and TV services.
[18] *The Act amending the Excise Duties Act and certain other acts* of 28 December 2018 (Journal of Laws 2018, item 2538, as amended).

significant contributions to GDP growth (Table 2.2).

Despite rising somewhat more slowly than in the first half of 2018, consumption demand has continued to act as the main growth driver. Consumption is supported by a favourable situation of employees in the labour market, including systematic wage growth, accompanied by consistently high consumer confidence and rising consumer credit (see also Chapter 2.6 *Money and credit*).

Investment, both public and corporate, is also a very important factor behind GDP growth. Public investment growth remains relatively strong, despite some slowdown in 2019 Q1. In turn, corporate investment – particularly in medium-sized and large companies – picked up markedly in 2019 Q1 on the back of infrastructure projects co-financed from EU funds, and other corporate investments, which benefit from a high degree of capacity utilisation (see also Chapter 2.2.2 *Investment*).

Another factor adding substantially to GDP growth is public expenditure on goods and services. In 2019 Q1, public consumption growth picked up, partly driven by a rise in the wage fund of the local governments and the uniformed services.

Also, the contribution of net exports to GDP growth was positive in 2019 Q1, as real export growth continued to outpace that of imports. At the same time, import growth slowed down. In particular, it declined for intermediate goods, especially fuel, and consumption goods, which probably resulted from a later date of Easter than last year.

2.2.1 Consumption

Consumption continues to be the key driver of economic growth in Poland. Household consumption growth remains relatively high, although it has been decreasing over the past few

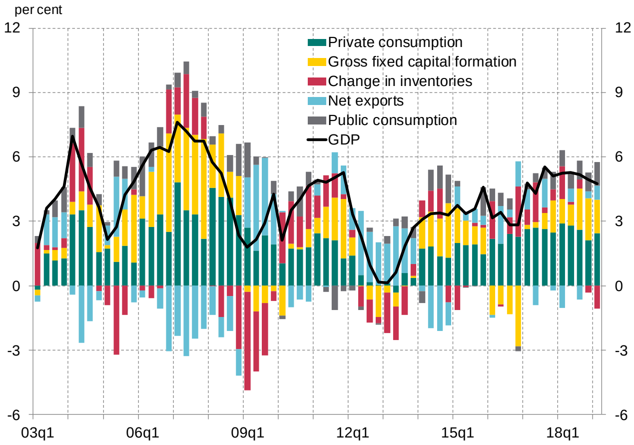
Table 2.1 Inflation expectations of bank analysts and participants to to the *NBP Survey of Professional Forecasters* (per cent)

	Survey conducted in:				
	18q2	18q3	18q4	19q1	19q2
Thomson Reuters Survey, inflation expected in 4 quarters	2.1	2.4	2.3	2.4	2.6
NBP Survey, inflation expected in 4 quarters	2.2	2.3	2.3	2.3	-
NBP Survey, inflation expected in 8 quarters	2.5	2.4	2.6	2.3	-

Source: NBP and Reuters data.

Inflation expectations of the financial sector analysts are proxied by the median forecast of the analysts surveyed by Thomson Reuters in the last month of a given quarter.
Inflation expectations of the participants to the *NBP Survey of Professional Forecasters* reflect the median probability distribution obtained from the aggregation of probability forecasts of the experts surveyed by NBP.

Figure 2.6 GDP growth and its components (y/y)



Source: Statistics Poland (GUS) data.

Table 2.2 GDP growth and its contributions (y/y, per cent)

	2017				2018				2019
	q1	q2	q3	q4	q1	q2	q3	q4	q1
GDP	**4.8**	**4.3**	**5.5**	**5.1**	**5.2**	**5.3**	**5.2**	**4.9**	**4.7**
Private consumption	2.6	2.7	2.7	2.5	2.9	2.8	2.6	2.1	2.5
Public consumption	0.3	0.4	0.5	0.8	0.8	0.8	0.9	0.9	1.1
Gross fixed capital formation	0.2	0.3	0.7	1.5	1.1	1.0	1.9	2.0	1.6
Change in inventories	0.7	1.8	0.3	0.5	1.5	0.1	0.4	-0.3	-1.1
Net exports	0.9	-0.9	1.3	-0.2	-1.0	0.6	-0.6	0.3	0.7

Source: Statistics Poland (GUS) data.

quarters (Figure 2.7). In 2019 Q1, it stood at 3.9% y/y as against 4.2% y/y in 2018 Q4.

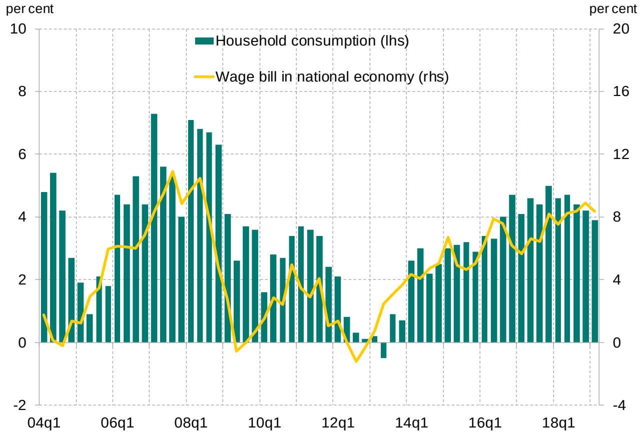
Factors conducive to consumption growth include the strong financial situation of households, underpinned by favourable labour market conditions for employees, notably rising wages, as well as very strong consumer sentiment and relatively high growth in consumer loans (Figure 2.8; see Chapter 2.6 *Money and credit*). Households' optimism is backed by the anticipated increase in disposable income, related, among others, to wage growth and the package of fiscal measures announced by the government (see Chapter 2.4 *Labour market* and Chapter 2.2.3 *Public finance*).

2.2.2 Investment

In 2019 Q1, there was a significant pickup in investment growth (to 12.6% y/y, against 8.2% y/y in 2018 Q4; Figure 2.9). According to NBP estimates, for the first time in several years, corporate investment made the largest contribution to the growth of gross fixed capital formation. At the same time, public investment growth remains relatively robust, despite a slight slowdown in 2019 Q1.

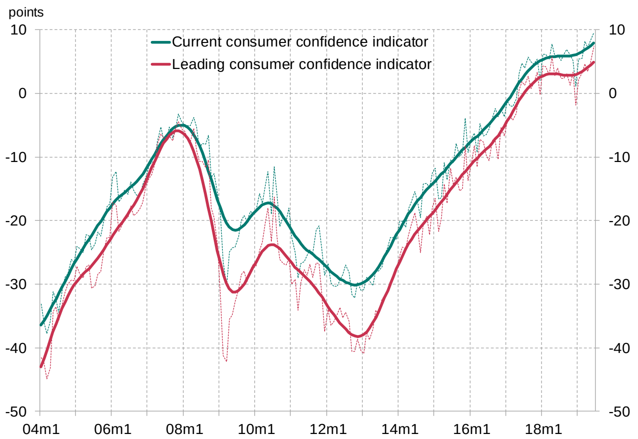
Growth in corporate investment outlays accelerated in 2019 Q1, amid high capacity utilisation and favourable business conditions in industry (Figure 2.10; see Chapter 2.2.5 *Output*). Real growth in investment of the large and medium-sized enterprises rose markedly (to 22.2% y/y in 2019 Q1, compared to 12.7% in 2018 Q4).[19] Investment growth was seen across all the main sectors of corporate activity (Figure 2.11). Enterprises significantly increased outlays on buildings and structures, which benefited from the rising utilisation of EU funds earmarked for corporate infrastructure investment, while growth in their machinery and equipment outlays

Figure 2.7 Real growth in household consumption and wage bill in national economy (y/y)



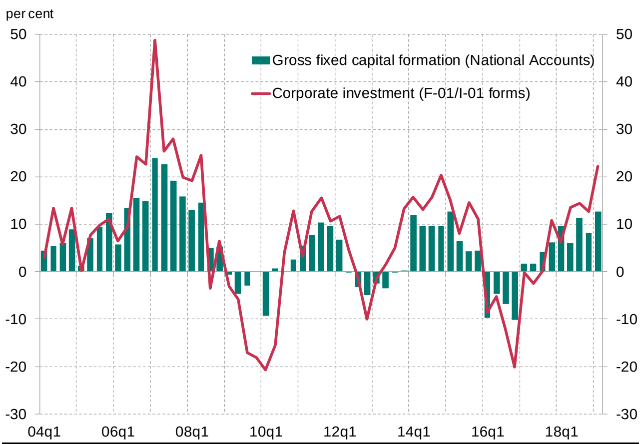
Source: Statistics Poland (GUS) data, NBP calculations.

Figure 2.8 Consumer confidence indicators



Source: Statistics Poland (GUS) data, NBP calculations.
The dashed line denotes raw data, while the solid line denotes HP filtered data.

Figure 2.9 Growth in investment (y/y)



Source: Statistics Poland (GUS) data, NBP calculations.
Data on corporate investment from the survey conducted by Statistics Poland (GUS) on revenues, costs and financial results as well as gross fixed capital formation (based on F-01/I-01 forms).

[19] NBP calculations based on data from the F-01/I-01 forms.

remained relatively high (amounting to 12.2% y/y in 2019 Q1 in nominal terms).

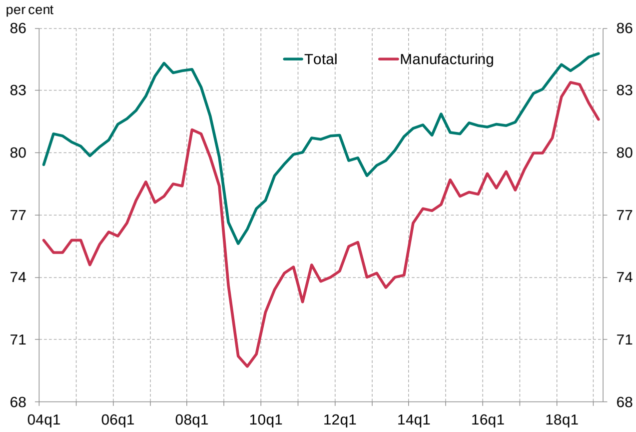
Substantial public investment growth also continues, yet its pace in 2019 Q1 was slower than in previous quarters. Weaker public investment growth largely reflected slower growth in the outlays of local government units, following their sharp rise in 2018, related, among others, to the realization of numerous investment projects before the local elections (this sector's outlays grew by 13.8% y/y in 2019 Q1, against 37.8 y/y in 2018 Q4).[20]

2.2.3 Public finance

In 2018, a further improvement was seen in the financial performance of the general government sector. According to the spring fiscal notification, the general government deficit (in ESA2010 terms) stood at 0.4% of GDP as against 1.5% of GDP in 2017, and thus was running at a historically low level (Figure 2.12).[21] The improvement was the result of the robust growth of both revenue and social insurance contributions (by 10.2% y/y and 8.3% y/y, respectively), which was supported by favourable economic conditions and very strong position of employees in the labour market, combined with further improvement in the VAT collection.[22] At the same time, the overall increase in the general government expenditure (excluding EU funds) in 2018 was moderate (5.9% y/y).

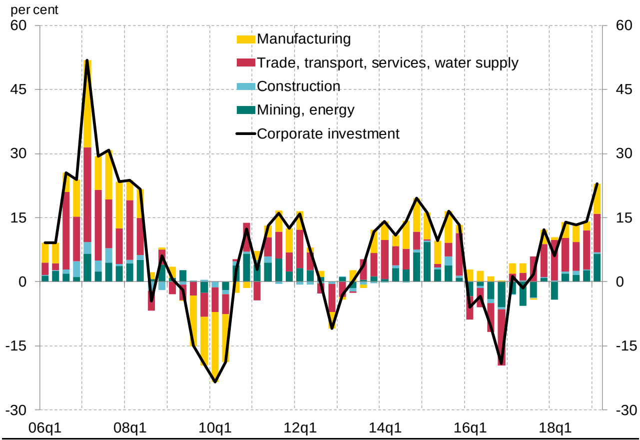
In 2019, the general government sector balance (ESA 2010) may be expected to deteriorate, mainly due to the launch of the fiscal package presented by the government in February 2019 and the introduction of regulations aimed at preventing a rise in electricity prices charged to recipients. In line with the government's forecasts, (the Convergence Programme update of April 2019), and those of the European Commission (May

Figure 2.10 Corporate capacity utilisation (seasonally adjusted)



Source: *NBP Quick Monitoring Survey. Economic climate in the enterprise sector* (total) and Statistics Poland (GUS) data (manufacturing).

Figure 2.11 Corporate investment by sectors (y/y, current prices)



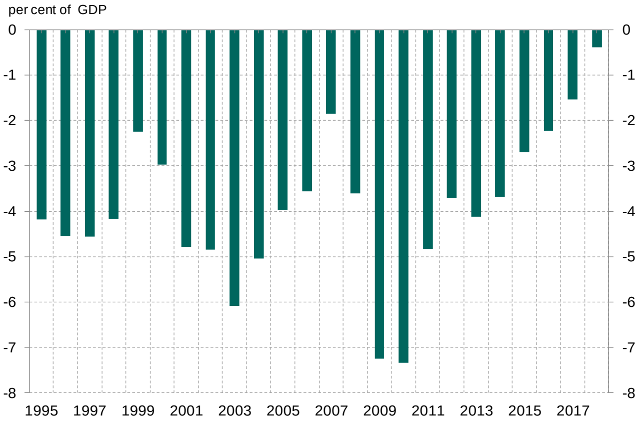
Source: Statistics Poland (GUS) data (F-01/I-01 forms), NBP calculations.

[20] Data on an accrual basis, elaborated by NBP in accordance with the Statistics Poland (GUS) methodology.
[21] *General government deficit and debt in 2018*, Statistics Poland (GUS), 23 April 2019.
[22] The Ministry of Finance estimates that the effect of improvement in the VAT collection amounts to 0.3% of GDP. See also: *Convergence Programme 2019 Update*, Republic of Poland, Warsaw, April 2019.

2019), the sector's deficit should not exceed 2% of GDP this year, and for 2020 the same forecasts envision an improvement of fiscal balance.

The increase in expenditure related to the fiscal package will amount to approx. 0.9% of GDP in 2019. This growth will stem chiefly from the one-off payment of the so-called "thirteenth pension" (in April-June 2019)[23] and the broadening of the Family 500 plus programme to cover the first child in the family irrespective of the household’s income (from July 2019).[24] In accordance with the Convergence Programme update of April 2019, in 2020, the adverse effect of these measures on the general government balance is to be partially compensated for by changes on the revenue side (including among others abolition of the limitation of the annual base for the assessment of pension and disability benefit contributions, indexation of excise rates on alcoholic beverages and cigarettes, and the introduction of the digital tax), as well as one-off factors (the "transformation" fee charged on funds accumulated in Open Pension Funds on their transfer to Individual Retirement Accounts; part of the proceeds from the auction of carbon dioxide emissions allowances).

Figure 2.12 Balance of general government sector (ESA2010)



Source: MF data, NBP calculations.

The balance of the general government in 2019 will also be affected by the slowdown in public investment growth, in particular, local government investment. Local governments' financial plans suggest that following a sharp rise in their investment spending in 2018 (by 58.6% y/y[25]), investment growth will lose much of its pace in 2019.

[23] The benefit, in the amount of PLN 1100 before tax disbursed to old age and disability pensioners, persons receiving bridging pensions, teacher's compensation benefit, pre-retirement allowances and benefits, and social assistance benefits.
[24] The fiscal package also includes measures in support of local bus services (draft law being processed by the Sejm; planned to take effect in 2019) and a reduction in the PIT burden (affecting public finance sector from 2020 onwards; including exemption from taxation for persons under 26 years of age, a decrease in the lower PIT rate to 17% from 18%, and a doubling of the tax deductible costs for employees).
[25] On an accrual basis, elaborated by NBP in accordance with the Statistics Poland (GUS) methodology.

2.2.4 External trade[26]

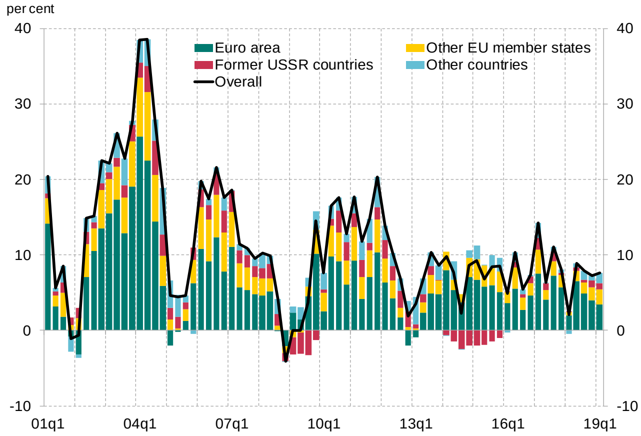
Despite weakness of global trade, the annual growth in the value of exports increased slightly in 2019 Q1 as compared to 2018 Q4. This was accompanied by a decline in import growth, which was lower than export growth for the first time in several quarters.[27]

The slight acceleration in export growth was the result of higher export growth to EU countries outside the euro area and to non-EU countries (excluding former USSR countries), above all, China (Figure 2.13). At the same time, a further slowdown of export growth to the euro area, where economic conditions remain relatively weak, limited the increase in export growth by (see Chapter 1.1 *Economic activity abroad*). In terms of commodity groups, higher growth was seen primarily in the intermediate goods, mainly industrial supplies and parts and accessories of transport equipment, while exports of both consumer and capital goods slowed down.

The slight increase in export growth occurred against the background of a stable exchange rate of the zloty (Figure 2.14). The nominal exchange rate of the zloty against both the euro and the US dollar was running above the export profitability exchange rate as declared by the surveyed enterprises. At the same time, the exchange rate of the zloty did not pose a barrier to import profitability.[28]

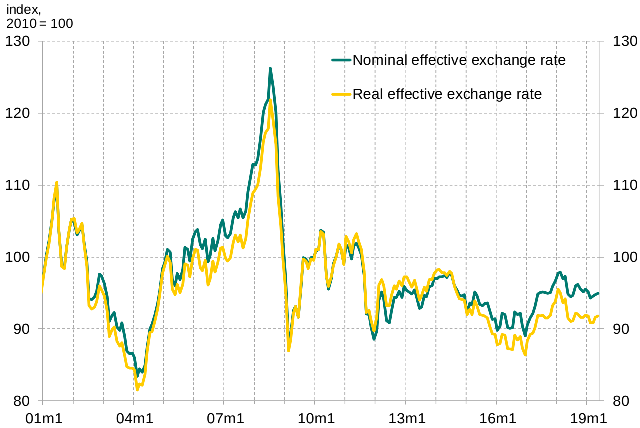
In 2019 Q1, annual import growth declined compared to 2018 Q4, mainly due to weaker import growth of intermediate goods, including industrial supplies and fuels (Figure 2.15). This decline was partly offset by the acceleration of imports of capital goods and other goods – including

Figure 2.13 Contribution to export growth by destination (y/y)



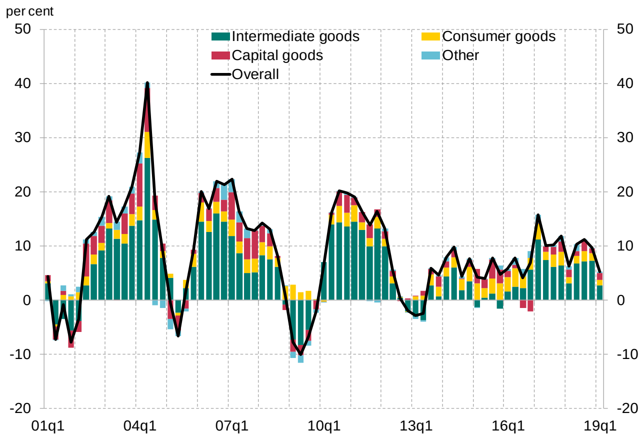
Source: Statistics Poland (GUS) data, NBP calculations.

Figure 2.14 Nominal and real effective exchange rate (rise indicates appreciation)



Source: BIS data.

Figure 2.15 Contribution to import growth by commodity (y/y)



Source: Statistics Poland (GUS) data, NBP calculations.
Data based on Statistics Poland (GUS) classification of the main product categories for the value of Polish exports and imports in zlotys. "Other" comprises passenger cars, motor gasoline and goods else not classified.

[26] In this chapter, Statistics Poland (GUS) data on the nominal value of exports and imports expressed in PLN terms are analysed. Trends in trade of services are not described, as no detailed data are available on the breakdown of the value of this trade by type of service and country of destination.
[27] In April the growth in the value of exports amounted to 6.8% y/y against 7.6% y/y in 2019 Q1, whereas the growth in the value of imports in the corresponding periods was 6.5% y/y against 5.3% y/y.
[28] *NBP Quick Monitoring Survey. Economic climate in the enterprise sector*, NBP, April 2019.

passenger cars – whose share in total imports is, however, relatively small.

2.2.5 Output

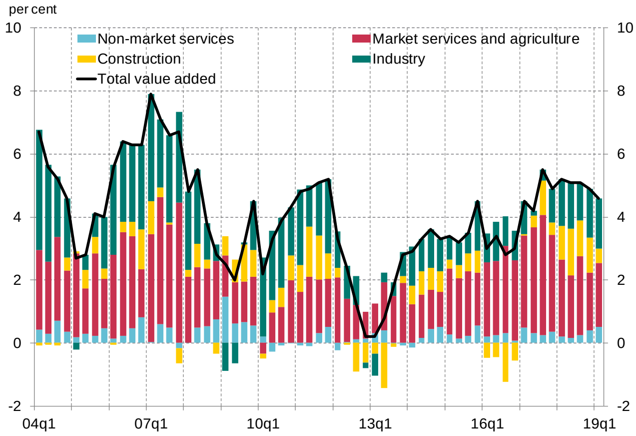
Activity growth is observed in all sectors of the economy (Figure 2.16). However, in 2019 Q1, value added growth was predominantly generated by services and industry, with a relatively low – and markedly lower than in the previous quarter – contribution from construction.

Good business conditions in industry continue, supported by strong domestic demand. In 2019 Q1, as the fall in industrial output decelerated in the euro area, growth in Polish export production increased. As a result, industrial output growth in Poland accelerated to 6.1% y/y in 2019 Q1 from 5.5% y/y in 2018 Q4 (Figure 2.17; see Chapter 1.1 *Economic activity abroad*). Data available for 2019 Q2 indicate it continues to grow at a similar pace.[29]

In market services, value added in 2019 Q1 increased at a rate comparable to that in 2018 Q4 (Figure 2.18). Activity growth in trade decelerated further, which was related to a later date of Easter than a year ago.[30] At the same time, value added in information and communication fell, whereas in financial and insurance activity its growth accelerated.

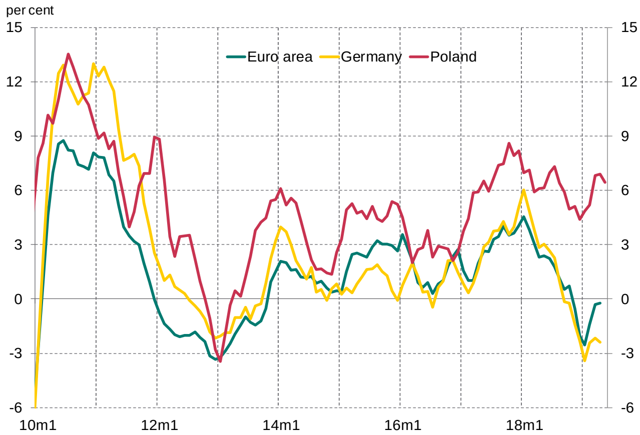
In turn, output growth in construction in 2019 Q1 decreased (to 9.9% y/y from 16.8% y/y in 2018 Q4), although it remains relatively high. The slowdown took place predominantly in commercial construction, though growth in residential construction also decelerated, which in both cases could have been related to supply-side constraints (see also Chapter 2.5.2 *Real estate market*). Output growth in infrastructure construction remained high – albeit lower than in the first half of 2018 –

Figure 2.16 Growth of gross value added by sectors (y/y)



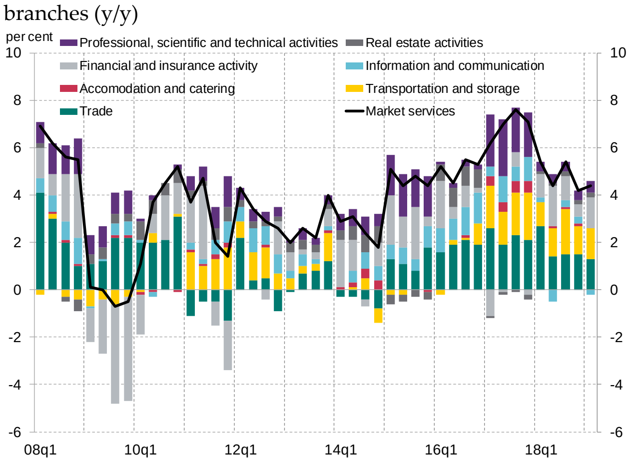
Source: Statistics Poland (GUS) data, NBP calculations.

Figure 2.17 Industrial output growth in the euro area, Germany and Poland (y/y, seasonally-adjusted data, 3-month moving average)



Source: Statistics Poland (GUS) and Eurostat data, NBP calculations.

Figure 2.18 Growth of gross value added in market services by branches (y/y)



Source: Statistics Poland (GUS) data, NBP calculations.

[29] Even though in April and May 2019 industrial output growth accelerated to 8.4% y/y on average, this was, however, a result of a favourable difference in the number of working days (after seasonal adjustment, output growth stood at 5.8% y/y).
[30] The same factor (the later date of Easter) has a positive impact on growth of value added in trade in 2019 Q2. An acceleration in retail sales growth (8.8% y/y on average in April and May as compared to 4.5% y/y in 2019 Q1) points to favourable conditions in this sector in 2019 Q2.

underpinned by rising absorption of EU funds. In 2019 Q2 – according to preliminary data – growth in construction gained some momentum, particularly in specialised activities (Figure 2.19).[31]

2.3 Financial situation of enterprises

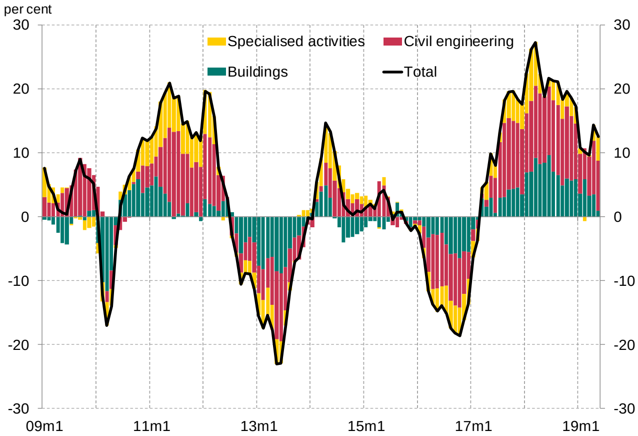
Despite the decline in gross financial result of enterprises in 2019 Q1 compared to 2018 Q1, the financial performance across most sectors remains relatively good. The fall in gross financial result (by 5.0% y/y) was mainly concentrated in the energy sector, whilst profits of the majority of the remaining sectors rose.[32]

The lower gross financial result of enterprises in 2019 Q1 compared to 2018 Q1 largely reflected the fall in profit on other operating activities as a result of establishing reserves for future liabilities in the energy sector (Figure 2.20). This was accompanied by a stabilisation of the result on sales, which was supported by an acceleration in export revenue growth amid stable growth in revenue from domestic sales. Meanwhile, sales revenue growth was somewhat lower than cost growth, which translated into a slight decline in the sales profitability ratio compared to 2018 Q1. Alongside that, sales profitability remains favourable (Table 2.3).

At the same time – although net turnover profitability in 2019 Q1 was lower than in the same period in 2018 – the share of profitable firms rose and the enterprises surveyed by the NBP still assessed both their situation and their profitability forecasts as good.[33]

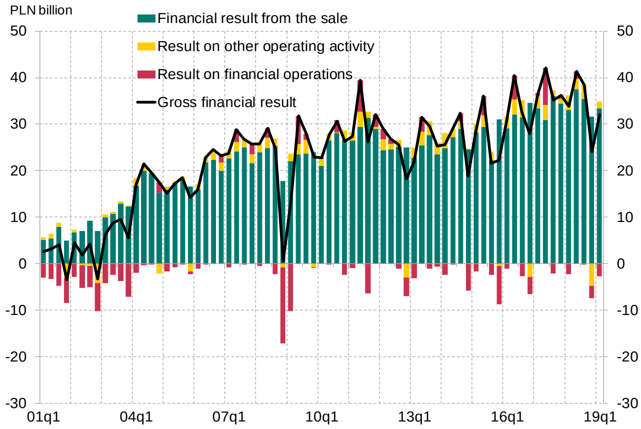
In turn, the liquidity of enterprises remains relatively good, despite deteriorating somewhat, as indicated by the decline in the 1st degree liquidity ratio in annual terms. The percentage of firms that

Figure 2.19 Construction and assembly output growth by construction objects (y/y, 3-month moving average)



Source: Statistics Poland (GUS) data, NBP calculations.

Figure 2.20 Gross financial result of enterprises and its components



Source: Statistics Poland (GUS) data, NBP calculations.
Data from the survey conducted by Statistics Poland on revenues, costs and financial results as well as gross fixed capital formation (based on F-01/I-01 forms).

Table 2.3 Selected financial efficiency ratios in the enterprise sector (per cent)

	2017				2018				2019
	q1	q2	q3	q4	q1	q2	q3	q4	q1
Sales profitability ratio	5.1	4.6	5.2	4.6	4.8	5.1	4.7	3.9	4.5
Net turnover profitability	4.4	5.3	4.1	3.9	3.9	4.6	4.2	2.2	3.4
Percentage of profitable enterprises (sa)	74.9	74.4	74.5	74.7	75.7	75.3	74.9	74.5	76.3
1st degree liquidity ratio	37.4	35.3	36.3	38.4	37.0	36.1	34.8	36.2	34.7

Source: Statistics Poland (GUS) data, NBP calculations.
Data from the survey conducted by Statistics Poland on revenues, costs and financial results as well as gross fixed capital formation (based on F-01/I-01 forms).

[31] Average growth of construction and assembly output in April and May 2019 stood at 13.3% y/y.
[32] In 2019 Q1, the gross financial result of the whole enterprise sector was 1.7 bn PLN lower than in 2018 Q1, while profits in the energy sector alone declined in this period by 2.9 bn PLN. At the same time, in 44 out of 76 sectors financial results rose.
[33] *NBP Quick Monitoring Survey. Economic climate in the enterprise sector*, NBP, April 2019.

declare they have no problems with maintaining liquidity persists high (78% of surveyed firms in 2019 Q1). Moreover, the enterprises experiencing problems in this scope expect an improvement in their liquidity in 2019 Q2.[34]

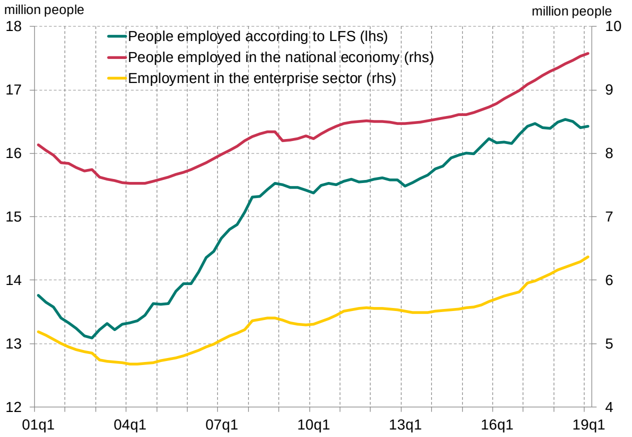
2.4 Labour market

Favourable economic conditions are conducive to a further rise in employment, although some data signal its stabilisation (Figure 2.21). Employment in the enterprise sector and the number of people employed in the national economy continue to rise relatively quickly (2.7% y/y in May and 2.4% y/y in 2019 Q1, respectively).[35] The Labour Force Survey (LFS) data, in turn, indicate a slight decline in the number of people employed (a fall of 0.4% y/y in 2019 Q1).[36]

The rise in some indicators of employment, alongside a slight decline in the number of people employed according to the LFS, takes place amid a slowdown in the growth of labour demand, as signalled by the data on the number of vacancies.[37]

At the same time, employment growth is negatively impacted by the declining size of the economically active population according to the LFS (by 0.7% y/y in 2019 Q1). This decrease results from a fall in the working age population (15-64 years old; by 1.4% y/y in 2019 Q1), which is not offset by the gradual increase in labour force participation of this age group. However, LFS data do not cover temporary employees from abroad, whose average annual number is currently

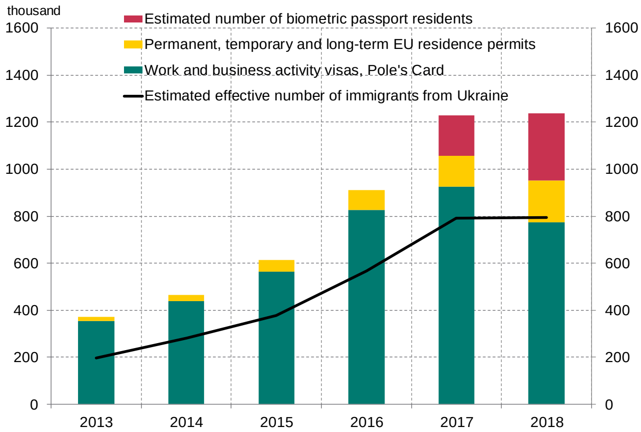
Figure 2.21 The number of people employed and the level of employment, seasonally adjusted data



Source: Statistics Poland (GUS) data, NBP calculations.

People employed according to LFS is a survey-based estimate of the number of employed persons, regardless of employment relationship. These data do not include temporary immigration. People employed in the national economy denotes the enterprise-reported average number of persons performing paid work at the end of each reporting period. These data do not comprise, among others, businesses employing up to 9 persons, individual farmers, persons contributing to a family business free of charge and persons working under civil law contracts. In addition, data on average employment in the enterprise sector do not cover the public sector and sole proprietors.

Figure 2.22 The estimated number of immigrants from Ukraine in Poland



Source: Border Guard, Ministry of Family, Labour and Social Policy, and Statistics Poland (GUS) data, NBP calculations.

Since Ukrainian immigrants work in Poland mostly on a temporary basis, it is assumed that an average Ukrainian immigrant works in Poland for 7 months a year.

[34] *NBP Quick Monitoring Survey. Economic climate in the enterprise sector*, NBP, April 2019.

[35] Annual Statistics Poland (GUS) data on the number of people employed in the whole national economy (apart from those included in quarterly data, they cover i.a. microfirms and individual farmers) also point to a further rise in employment – at the end of 2018 the number of people employed was 2.0% higher than a year earlier.

[36] The lower growth in the number of people employed according to the LFS may result from a fall in the number of individual farmers and the fact that the LFS does not take into account temporary workers from abroad.

[37] According to the Statistics Poland (GUS) survey, the number of newly created job openings rose by 1.7% y/y in 2019 Q1, compared to 14.4% y/y in 2018 Q1. A similar slowdown in job creation is indicated by the Job Offer Barometer, measuring the number of vacancies posted online, which rose in May 2019 by 4.7% y/y, compared to a rise of over 20% annually in 2018 Q1. Concurrently, the number of new vacancies posted at labour offices in May fell by 13.6% y/y. However, this was probably related to changes in the rules on the placement of vacancies in labour offices in the case of an intention to employ foreigners on the basis of a seasonal work permit.

estimated at around 1 million people, including 800,000 Ukrainians (Figure 2.22).

Amid high employment, the unemployment rate has reached a very low level (Figure 2.23). Under these circumstances, many enterprises are signalling recruitment difficulties. Yet, in recent quarters, the scale of these difficulties has stopped increasing – the percentage of firms indicating staff shortages as a barrier to development has stabilised at approx. 9%, while the percentage of firms reporting vacancies has plateaued at just over 40%.[38]

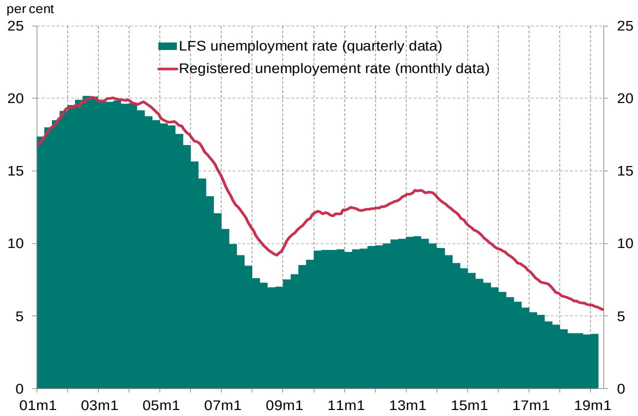
As a result, the position of employees in wage negotiations remains strong, which is reflected in the stabilisation at a high level of the percentage of enterprises reporting wage pressure.[39] Consequently, nominal wage growth in the national economy has stabilised at around 7% (in 2019 Q1 it was running at 7.1% y/y; Figure 2.24).[40]

At the same time, labour productivity growth accelerated slightly (growth in the number of people employed declined by more than the GDP growth rate). Accordingly, unit labour cost growth decreased and remains moderate (in 2019 Q1 it stood at 1.8% y/y against 2.3% on average in 2018; Figure 2.25).

2.5 Monetary policy and asset markets

The Monetary Policy Council keeps the NBP interest rates unchanged, including the reference rate at 1.50%. Market interest rate expectations have not changed significantly since the beginning of 2019 and still suggest that the NBP interest rates will remain stable in the coming quarters (Figure 2.26). This is the effect of current and expected inflation remaining close to the NBP target as well as market interest rates expectations in the euro area running close to the present level or below it

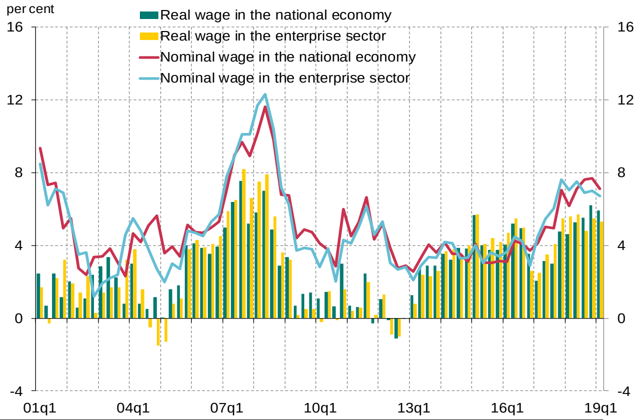
Figure 2.23 Unemployment rate, seasonally adjusted data



Source: Statistics Poland (GUS) data, NBP calculations

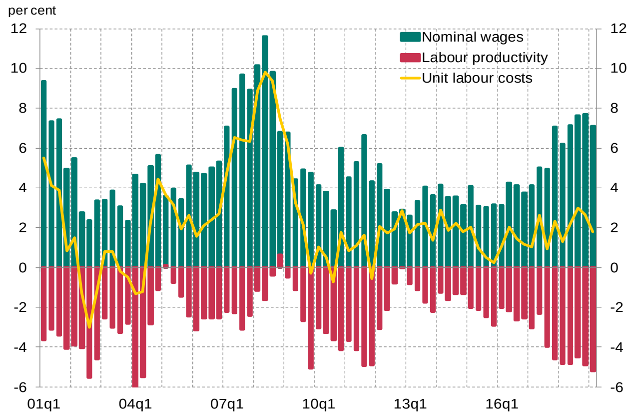
Data adjusted by NBP for seasonal factors and breaks related to the change in Statistics Poland (GUS) methodology in 2012. There are three reasons for the difference between the registered unemployment rate and the LFS rate: 1) the definition of an unemployed person is different, 2) the definition of the population to which the number of the unemployed is referred is different, 3) registered unemployment rate is based on the number of uneployed people registered in labour offices, while LFS unemployment rate is based on survey results.

Figure 2.24 Annual wage growth in the national economy and in the enterprise sector (y/y, nominal and real)



Source: Statistics Poland (GUS) data.

Figure 2.25 Growth of unit labour costs in the economy (y/y) and its determinants



Source: Statistics Poland (GUS) data, NBP calculations.

Unit labour costs are defined as nominal wages in the national economy divided by labour productivity, which is defined as GDP per person employed according to LFS. Therefore, an increase in labour productivity is a factor limiting unit labour cost growth; hence in the graph it assumes negative values.

[38] *NBP Quick Monitoring Survey. Economic climate in the enterprise sector,* NBP, April 2019.
[39] *NBP Quick Monitoring Survey. Economic climate in the enterprise sector,* NBP, April 2019.
[40] In April and May in the enterprise sector wage growth stood at 7.4% y/y on average against 6.7% y/y in 2019 Q1.

(see Chapter 2.1 *Consumer prices* and Chapter 1.4 *Monetary policy abroad*).

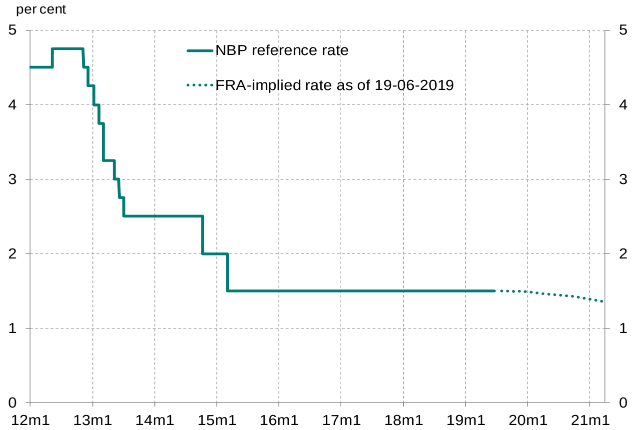
2.5.1 Financial market

Against the background of falling bond yields in global markets, the yields on Polish 5-year and 10-year government bonds have seen a decline to close to historic lows in the recent period (Figure 2.27; see Chapter 1.5 *International financial markets*). The yield on 10-year government bonds in mid-June stood at 2.4%. The decline in yields on Polish Treasury bonds was also due to the fact that this year's government borrowing needs were largely met already in the first months of 2019. Moreover, the market expects NBP interest rates to remain stable at the present level. The lower yields of Polish government bonds, compared to the majority of the emerging market economies, reflect investors' favourable assessment of Poland's economic fundamentals, including the absence of significant macroeconomic imbalances.

Equity prices in Poland, following considerable fluctuations related to changes in global equity prices, stabilized at a similar level to that of January 2019 (Figure 2.28). They remained close to the level seen at the beginning of the year despite continued relatively strong economic growth in Poland (see Chapter 2.2 *Demand and output*).

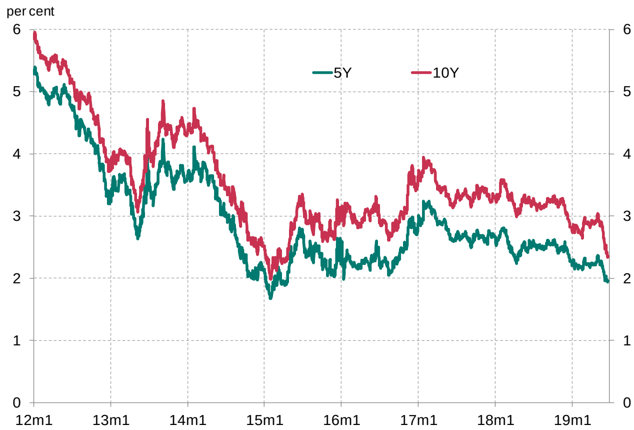
At the same time, the exchange rates of the zloty against major currencies remained stable (Figure 2.29). The 3-month implied volatility of the zloty against the euro has recently fallen to its historic minimum (Figure 2.30). This points to a relative resilience of the Polish currency to global developments, supported by good macroeconomic fundamentals of the Polish economy. As a result, the average exchange rates of the zloty against the euro and the US dollar in mid-June were close to those seen in January 2019.

Figure 2.26 NBP reference rate and 3M FRA-implied interest rate



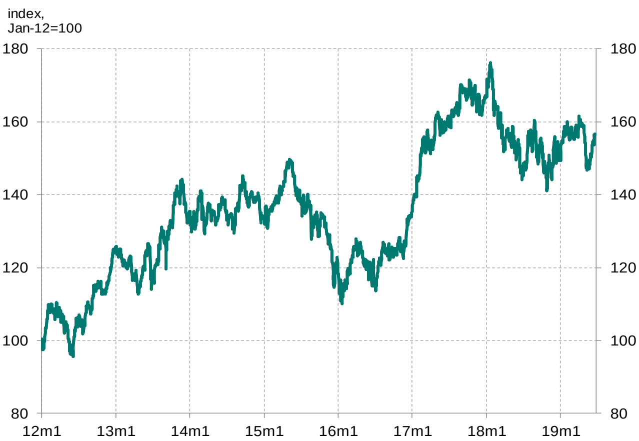
Source: NBP and Bloomberg data, NBP calculations.

Figure 2.27 Yields of Polish government bonds



Source: Bloomberg data.

Figure 2.28 The main stock market index in Poland (WIG)



Source: Bloomberg data.

2.5.2 Real estate market[41]

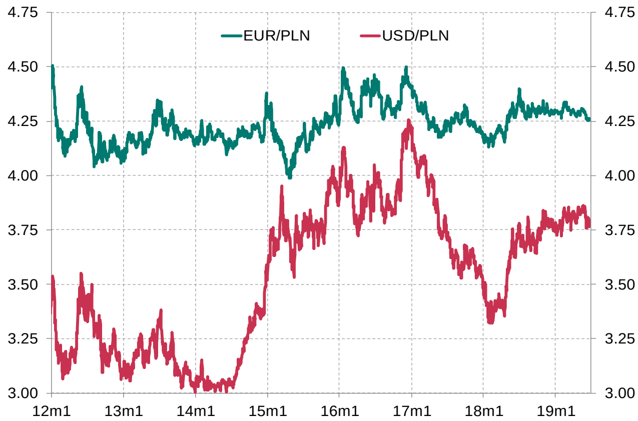
Strong activity in the residential real estate market continues. In 2019 Q1, the number of dwellings sold remained significantly higher than the long-term average, despite a gradual decline in recent quarters (Figure 2.31).

Solid demand for dwellings, both in the primary and secondary market, is underpinned by very good situation of employees in the labour market, resilient consumer sentiment (see Chapter 2.4 *Labour market* and Chapter 2.2.1 *Consumption)* and stable interest rates on mortgage loans.

The high demand for dwellings is accompanied by their growing supply, as evidenced by the increasing number of both construction starts and dwellings completed and made ready for occupancy.[42] In turn, the number of building permits issued has stabilised. Rising supply of dwellings is supported by the still high profitability of development projects. However, a further adjustment of supply to the growing demand may be hindered by rising prices and declining availability of land, as well as growing cost of materials and shortages of workers.

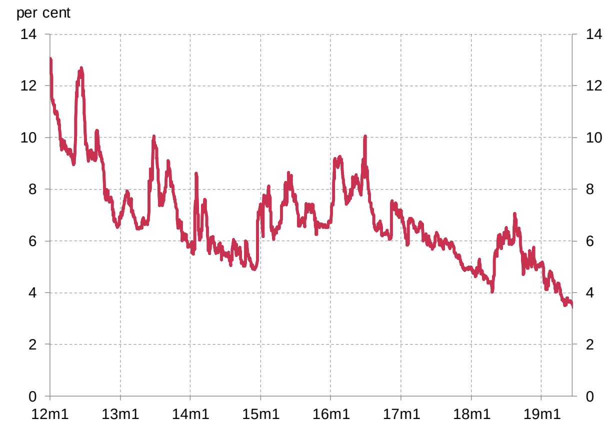
The strong activity in the housing market was accompanied by a further rise in offer and transaction prices of dwellings (Figure 2.32).[43] This was the result of the growing costs of implementing development projects, which developers, faced with persistently high demand for dwellings, have to a large extent passed on to prices. Moreover, prices have been boosted by the increased share of offers and sales of more expensive, better quality dwellings.

Figure 2.29 Nominal exchange rate of euro and US dollar in Polish zloty



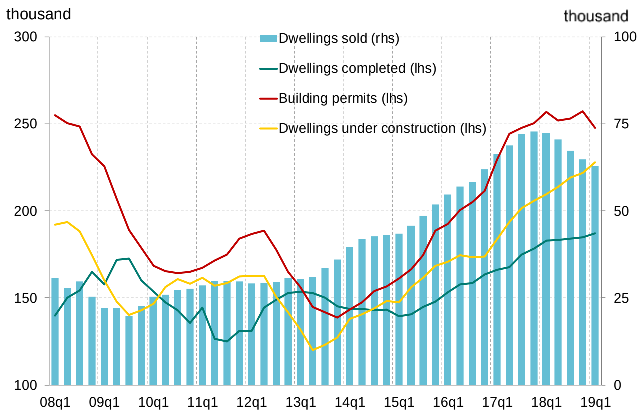
Source: Bloomberg data.

Figure 2.30 Volatility of EUR/PLN exchange rate



Source: Bloomberg data.
3-month volatility implied from market prices of FX options on EUR/PLN.

Figure 2.31 Residential construction in Poland (4-quarter rolling sum)

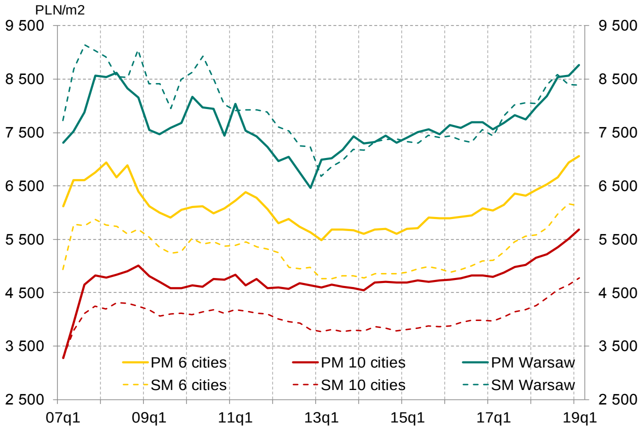


Source: Statistics Poland (GUS) and REAS data, NBP calculations.
Sales data are based on 6 major markets in Poland (Warszawa, Kraków, Trójmiasto, Wrocław, Poznań and Łódź).

[41] For more information on the situation in the real estate market in Poland see the NBP report: *Information on home prices and the situation in the housing and commercial real estate market in Poland in 2019 Q1*, NBP, June 2019.
[42] According to Statistics Poland (GUS) data, in 2019 Q1 the number of construction starts rose by 53,900, i.e. 12.3% y/y, 47,400 completed dwellings were made ready for occupancy, an increase of 5.8% y/y, and 57,200 building permits were issued, a decrease of 13.9% y/y.
[43] The average transaction prices of flats in 17 towns in Poland in the primary and secondary market in 2019 Q1 were 9.3% higher than in 2018 Q1.

In the office real estate market, a further growth in supply was observed in 2019 Q1, backed by higher rates of return on this type of investment in Poland than abroad, as well as the high availability of external funding amidst very low interest rates abroad, including in the euro area (see Chapter 1.4 *Monetary policy abroad*).[44] In view of the significant stock of office space, despite the persistent strong rental demand, the vacancy rate in large cities has risen slightly.[45] In turn, in the retail and service premises only a small increase in new space was recorded in 2019 Q1.

Figure 2.32 Average prices of flats in major cities in Poland

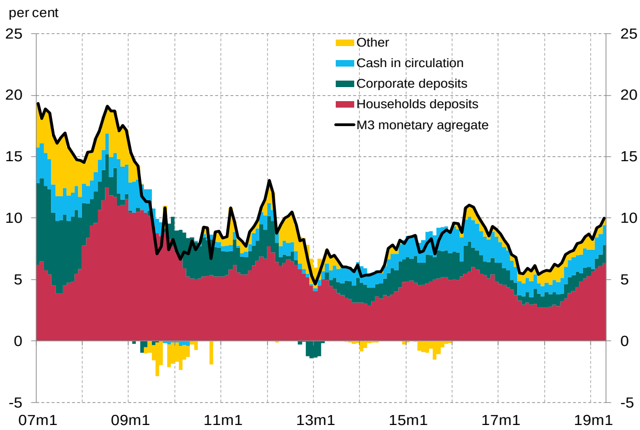


Source: NBP calculations based on the NBP survey.
PM – primary market, SM – secondary market. Transaction prices – an average weighted with the share of the housing stock in a given city in the total housing stock. Aggregate of 6 cities consists of: Gdańsk, Gdynia, Kraków, Łódź, Poznań, Wrocław, whereas of 10 cities: Białystok, Bydgoszcz, Katowice, Kielce, Lublin, Olsztyn, Opole, Rzeszów, Szczecin and Zielona Góra.

2.6 Money and credit

In 2019 Q1, annual broad money (M3) growth in the economy continued to increase (to 9.0% y/y from 8.4% y/y in 2018 Q4).[46,47] As in previous periods, growth in household deposits made the largest contribution to the change in the M3 aggregate (Figure 2.33).

Figure 2.33 Composition of M3 growth (y/y)



Source: NBP data.
The category Other covers deposits of non-monetary financial institutions and local government units, repurchase agreements between banks and non-banking sector as well as debt securities with maturity up to 2 years issued by banks.

In 2019 Q1, the growth in broad money was mainly the result of an increase in credit for the non-financial sector. For the past few quarters, total lending growth has been close to the nominal GDP growth (Figure 2.34). Consequently, the ratio of outstanding loan portfolio of non-financial sector to GDP has remained stable, and at the end of 2019 Q1 stood at 51.7%.

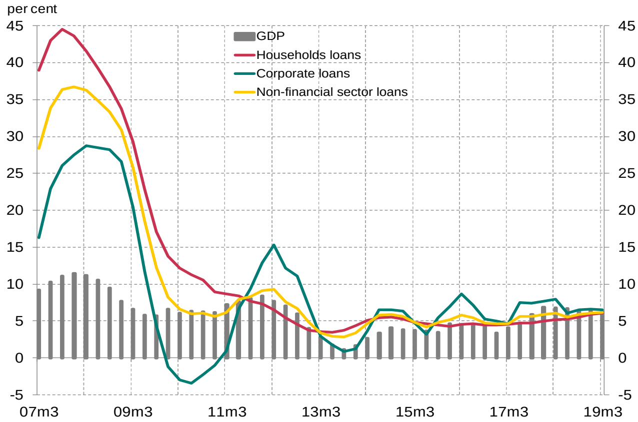
Household loans continued to be the main source of lending growth for the non-financial sector. These loans have been rising gradually for over two years and in 2019 Q1 reached 6.0% y/y (Figure 2.35). Growth in household loans picked up in 2019 Q1, largely reflecting increased growth in housing loans (to 5.1% y/y from 4.8% y/y in 2018 Q4), coupled with stabilisation of growth in consumer

[44] The expected rate of return of investment in office real estate was, however, reduced by rising costs of maintenance of this this type of real estate.
[45] The vacancy rate is the ratio of non-leased space to the total space for rental.
[46] In this chapter, growth in the broad money aggregate M3 and loans is defined as the three-month average of the annual growth in the stock of the given category resulting from transaction changes in the given quarter. The data refer to monetary financial institutions.
[47] In April 2019, M3 growth amounted to 10.0% y/y.

loans at relatively high level (9.4% y/y against 9.3% y/y in 2018 Q4).[48] In turn, the rise in the value of housing loans in 2019 Q1 was the result of the increase in zloty denominated loans (by 11.7% y/y), while the value of FX housing loans continued to decline (a fall of 8.0% y/y). Household lending growth was supported, among others, by stable interest rates, favourable situation of employees in the labour market and strong consumer sentiment (see Chapter 2.5 *Monetary policy and asset markets*, 2.4 *Labour market* and 2.2.1 *Consumption*). However, some tightening of the credit standards for housing loans in the second half of 2018 may have contained their growth. In 2019 Q1, in turn, the credit standards and terms of granting of consumer loans were tightened slightly.[49]

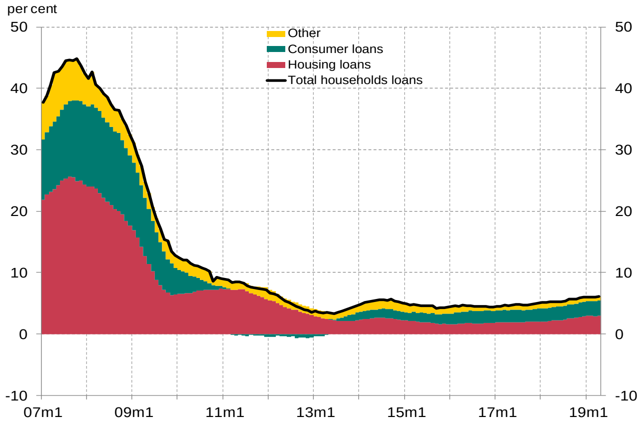
Corporate loans also continued to account for a substantial part of total growth in lending to the non-financial sector. In 2019 Q1, these loans were rising at a pace similar to that recorded in the previous quarter (6.5% y/y in 2019 Q1; Figure 2.36).[50] High growth of operating loans continued (12.3% y/y), while growth of investment loans remained relatively low (2.7% y/y). Business surveys suggest that the reason for the relatively low growth of investment loans was that firms prefered to finance new investments with their own funds.[51] The growth in corporate loans was also contained by the further tightening of credit standards and lending terms, above all, with regard to long-term loans to large enterprises and short-term loans to small and medium-sized enterprises.

Figure 2.34 Nominal GDP and loans to non-financial sector growth (y/y)



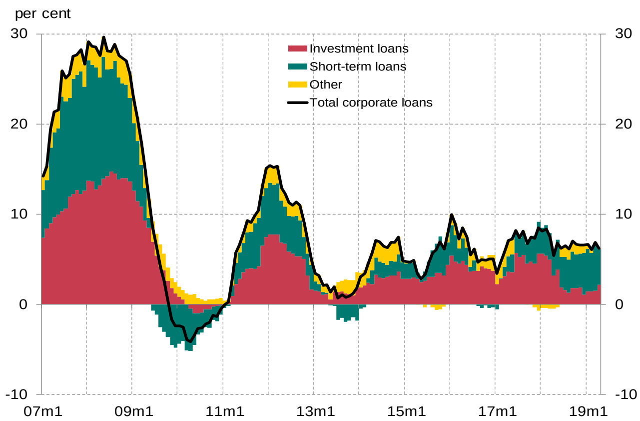
Source: NBP data.
Loans - loans and other claims, annual growth rate, 3-month moving average.

Figure 2.35 Composition of growth in household loans (y/y)



Source: NBP data.
The category *Other* covers loans connected with credit cards, loans to individual entreprenuers, loans to individual farmers and other receivables.

Figure 2.36 Composition of growth in corporate loans (y/y)



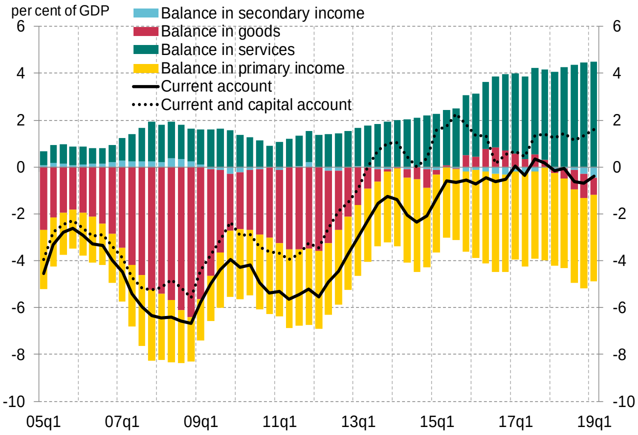
Source: NBP data.
The category *Investment loans* covers loans for investments and real estate purchases. The category *Other* covers car loans, loans for security purchases and other receivables.

[48] In April 2019, growth of household loans stood at 6.1% y/y, with growth in consumer loans amounting to 9.6% y/y and growth in housing loans 5.2% y/y.
[49] *Senior loan officer opinion survey on bank lending practises and credit conditions. 2019 Q2*, NBP, April 2019.
[50] In April 2019, growth of corporate loans to non-financial enterprises amounted to 6.2% y/y.
[51] *NBP Quick Monitoring Survey. Economic climate in the enterprise sector*, No 02/19, NBP, April 2019.

2.7 Balance of payments

In 2019 Q1, the current account balance increased and was positive, although measured as a four-quarter rolling sum it remained slightly negative (-0.4% of GDP against -0.7% of GDP in 2018 Q4; Figure 2.37).[52]

Figure 2.37 Current account balance (4-quarter rolling sum)

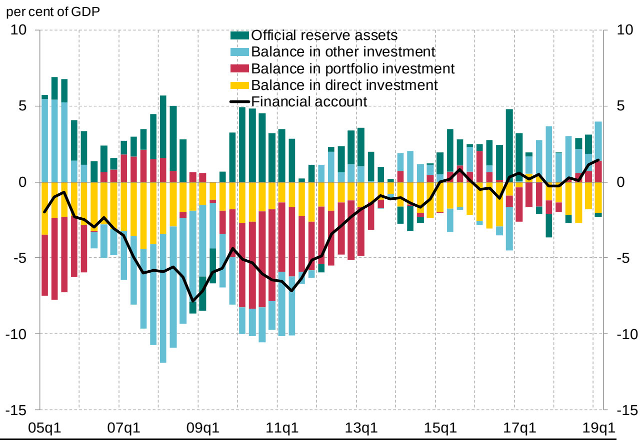


Source: NBP data.
Data for 2019 Q1 are based on estimated monthly data for January, February, March 2019.

The increase in the current account balance was primarily the effect of a narrower deficit of the trade in goods, which was seen for the first time in several quarters and resulted from a pickup in export growth (see also 2.2.4 *External trade*). This was coupled with a surplus in the trade in services, which remained high at a level close to the previous quarter's. At the same time, the primary account balance stayed substantially negative due to the high income of foreign direct investors in Poland.

The surplus on the capital account was running at a level close to 2018 Q4 and amounted to 2.0% of GDP. The combined current and capital account balance rose (to 1.6% of GDP in 2019 Q1 from 1.3% in 2019 Q4), which reflected the higher current account balance.

Figure 2.38 Financial account balance (4-quarter rolling sum)



Source: NBP data.
A positive value of the balance means an increase in Polish net assets (net outflow of capital from Poland). Data for 2019 Q1 are based on estimated monthly data for January, February, March 2019.

The financial account balance increased in 2019 Q1 (to 1.5% from 1.1% of GDP in 2018 Q4; Figure 2.38), which was driven by a rise in the balance of other investment, above all, NBP transactions.[53] Another upward impact on the financial account balance came from an increase in the balance of portfolio investment, reflecting a further reduction in the involvement of foreign investors in the Polish sovereign bond market. A factor working in the opposite direction was a decrease in the balance of the official reserve assets.[54] The direct investment balance, in turn, remained close to the level observed in the previous quarter.

[52] In this chapter, data on the balance of payments are presented in terms of a 4-quarter rolling sum.
[53] NBP reduced its liabilities, mainly those resulting from repo transactions.
[54] The decrease in the official reserve assets was caused by NBP's own transactions, including repos, and transactions concluded on behalf of NBP clients.

External imbalance indicators evidence that the Polish economy is well balanced (Table 2.4). In 2018, Poland's net international investment position continued to improve and the external debt to GDP ratio was on the decline.

Table 2.4 Selected external stability indicators (4-quarter rolling sum in per cent, unless indicated otherwise)

	2017				2018				2019
	q1	q2	q3	q4	q1	q2	q3	q4	q1
Current account balance/GDP	0.0	-0.4	0.3	0.2	-0.2	-0.1	-0.6	-0.7	-0.4
Current and capital account balance/GDP	0.7	0.4	1.3	1.4	1.2	1.4	1.1	1.3	1.6
Trade balance/GDP	4.0	3.9	4.2	4.1	3.9	3.8	3.5	3.4	3.8
Official reserve assets (in monthly imports of goods and services)	5.7	5.2	5.0	4.7	4.8	4.7	4.7	4.9	4.7
Foreign debt/GDP	72	71	69	67	67	67	65	64	-
Net international investment position/GDP	-62	-63	-62	-61	-59	-57	-57	-56	-
Official reserve assets/short-term foreign debt and forecast current account balance	115	107	100	102	104	99	96	108	-
Official reserve assets/short-term foreign debt	116	108	103	106	107	103	99	112	-

Source: NBP data.

The last two indicators include foreign debt and the level of official reserves at the end of the period. Data for 2019 Q1 are based on estimated monthly data for January, February, March 2019.

3. Monetary policy in March – July 2019

At the meetings held between March and July 2019 the Monetary Policy Council kept the NBP interest rates unchanged at the following levels: reference rate 1.50%, lombard rate 2.50%, deposit rate 0.50%, rediscount rate 1.75%.

This chapter includes the previously published *Minutes of the Monetary Policy Council decision-making meetings* held between March and June 2019 as well as the *Information from the meeting of the Monetary Policy Council* in July 2019. *Minutes* of the MPC meeting held in July 2019 will be published on 22 August, and thus included in the next *Report*.

Minutes of the Monetary Policy Council decision-making meeting held on 6 March 2019

During the meeting, the Council noted that incoming data pointed to weaker economic conditions in some of the largest economies, and assessed that uncertainty about the outlook for global activity in the coming quarters had increased. The majority of the Council members indicated that GDP growth in the euro area in 2018 Q4 had remained low, and forecasts pointed to its further deterioration in 2019. They also highlighted the markedly, in their view, weaker economic growth, and the drop in business climate indicators in the German economy, Poland's most important trading partner. Certain Council members voiced the opinion that the weakening of the economic conditions observed in the immediate environment of the Polish economy was not significant and probably of temporary nature, while the drop in economic climate indicators resulted partly from political uncertainty. With reference to the economic situation in the United States, it was observed that it remained strong, although GDP growth was expected to decelerate somewhat during the year. Attention was also drawn to the continued gradual decline in activity growth in China.

It was noted that although oil prices had risen since the beginning of the year, they were still lower than in 2018 Q3. The increase in oil prices was, to a large extent, driven by lower oil production in Iran and Venezuela and the announcement of a further reduction in oil supply from Saudi Arabia. Meanwhile, the scale of the rise in oil prices was limited by the deteriorating outlook for demand for oil related to weaker global economic conditions and tensions between the United States and China.

When analysing price growth abroad, it was indicated that lower than in 2018 Q3 oil prices were having a downward effect on inflation in many countries. It was noted that currently core inflation abroad, including the euro area, was low.

Referring to monetary policy abroad, it was observed that the ECB had been keeping interest rates close to zero, including the deposit rate below zero for 4.5 years. At the same time, the ECB is reinvesting funds from the maturing securities. Some Council members assessed that in light of the deteriorating economic outlook in the euro area, the ECB programme of liquidity provision to the banking sector might be expanded, while the indicated period of keeping ECB interest rates at the current level might be extended. It was pointed out that the US Federal Reserve was keeping interest rates unchanged while signalling that its further decisions would depended on the incoming data. Some Council members expressed the opinion that the US economy also might not see further interest rate increases, and that already this year the Federal Reserve might halt the process of balance sheet reduction.

Discussing the developments in Poland's real economy, it was underlined that GDP growth in 2018 Q4 had remained relatively robust. It was noted that activity growth had continued to be driven by consumption, which had been rising further – albeit at a slightly slower pace than in previous quarters – fuelled by increasing employment and wages as well as very strong consumer sentiment. It was emphasised that this was accompanied by growing investment.

While discussing the outlook for economic growth, it was stressed that the recently received data pointed to a likely lower activity growth in 2019 Q1 compared to previous quarters. The results of the March NBP projection indicated that economic growth may gradually decline also in the subsequent quarters, although the economic conditions this year will remain favourable. It was emphasised that weaker economic conditions in Poland's immediate environment would have a negative impact on domestic GDP growth. At the same time, according to the March projection, the scale of the economic slowdown in Poland would be smaller than previously forecast due to the expected positive impact of the fiscal measures announced by the government on domestic demand. Certain Council members expressed the opinion that GDP growth in 2019 might be higher than projected. These members emphasised that given the announced fiscal stimulus and the stabilization of electricity prices, robust growth in consumer demand would probably continue. Moreover, the adverse impact of the weaker economic conditions abroad on the domestic activity would probably be mitigated by Polish firms' high capability to adapt to the changing market environment. The Council members judged that the outlook for the economic growth would continue to be subject to significant uncertainty, with developments in the global economy constituting the key risk factor for the expected GDP growth path.

When analysing labour market performance, it was noted that, while according to the LFS data, the increase in the number of working persons in the economy had flattened in 2018 Q4, corporate sector data for January 2019 pointed to further employment growth in the corporate sector. At the same time, wage growth in the economy in 2018 Q4, and in the corporate sector in January 2019 remained close to 7%. It was indicated that according to the March projection, a similar rate of wage growth was to be expected also in the subsequent quarters. Certain Council members judged that wage growth might be higher due to the possible further increase in wage pressure in the public sector and a decrease in labour supply. Some Council members emphasised at that point that a potential rise in wage growth in the economy would support consumer demand and – given the expected economic activity slowdown – would have a stabilising effect on economic conditions. At the same time, other Council members argued that in the light of the anticipated economic slowdown and after two years of a robust wage growth, the likelihood of a further acceleration in wage growth was relatively low.

Turning to inflation developments in Poland, it was pointed out that – notwithstanding relatively high economic growth and wages rising faster than in previous years – annual consumer price growth had declined in recent months and was currently running low. It was remarked that inflation net of food and energy prices also continued to be low, despite a likely pick-up in January.

While discussing the outlook for inflation, it was emphasised that in line with the March projection, price growth in 2019 would continue at a pace close to that of 2018 and thus was expected to be markedly lower than envisaged in the November projection. The downward revision of the expected inflation resulted from the freeze on electricity prices as well as lower levels of global oil prices than in 2018 Q3. The likely remaining of core inflation at relatively low levels, despite its expected gradual increase, would be another factor curbing price growth. It was pointed out that according to the March projection, CPI inflation in subsequent years would exceed this year's level while remaining moderate and close to 2.5%. Some Council members were of the opinion that price growth in the years to come might be higher than currently forecast. They noted that in the medium term price growth might be boosted by a range of factors, including stronger effects of the announced fiscal measures than suggested by the projection – especially if high capacity utilisation should continue and energy price growth and wage growth should accelerate. Certain Council members assessed that the path of global oil prices posed another risk factor for inflation. However, other Council members argued that the expected economic slowdown, which reduced the likelihood of higher wage momentum in the economy, would hamper price growth. These members also emphasised that under weak economic conditions, firms' propensity to raise prices would probably be limited, especially amid the continuously favourable – although varying across industries – average profitability of their operations.

The Council decided that interest rates should remain unchanged. In the Council's assessment, the outlook for economic conditions in Poland remains favourable. It was pointed out that in line with the results of the March NBP projection, a gradual slowing in GDP growth was expected in the quarters ahead. At the same time, inflation will continue at a moderate level and will remain close to the inflation target in the monetary policy transmission horizon. Thus, the Council judged that the current level of interest rates was conducive to keeping the Polish economy on a sustainable growth path and maintaining macroeconomic and financial system stability.

The majority of the Council members expressed the opinion that, taking into account current information, interest rates were also likely to remain stable in the coming quarters. These Council members pointed out that this assessment was supported by the results of the March NBP projection indicating a limited risk of a lasting deviation of price growth from the inflation target. They emphasised that another argument in favour of keeping interest rates stable was the heightened uncertainty about the scale and duration of the slowdown in the global economy, along with its feeding through to domestic economic conditions.

Certain Council members stressed that there were factors which, in the medium term, could push inflation to higher levels than assumed in the projection. They remarked that should the announced fiscal measures or a potential pick-up in wage growth result in a marked rise in inflation that would jeopardise meeting the inflation target in the medium term, it might be justified to consider an increase in the NBP interest rates in the coming quarters.

A view was also expressed that in the hypothetical event of a slump in economic activity accompanied by a marked deterioration in consumer and corporate sentiment, in the longer run it might be justified to consider a decrease in interest rates or the introduction of unconventional monetary policy instruments.

The Council decided to keep the NBP interest rates unchanged: the reference rate at 1.50%, the lombard rate at 2.50%, the deposit rate at 0.50%, the rediscount rate at 1.75%.

Minutes of the Monetary Policy Council decision-making meeting held on 3 April 2019

During the meeting, the Council noted that incoming data confirmed weaker growth in some of the largest economies, which was particularly visible in world trade and industrial sector activity. It was also underlined that the outlook for global economic conditions in the coming quarters remained uncertain.

The majority of the Council members indicated that growth in the euro area had most probably remained low at the beginning of the year, after sluggish GDP growth in 2018 Q4. This is suggested by the latest output data and confidence indicators, which turned out to be weaker than expected. The Council members pointed out that the deteriorating economic conditions were particularly visible in the German economy, which recorded a further fall in export orders and a continued slowdown in automotive industry. At the same time, it was underlined that favourable conditions for consumption growth, including an ongoing employment and wage growth, and in 2019 also an easing of fiscal policy in Germany, have a stabilising effect on the European and German economy.

It was noted that in the United States economic conditions remained good, although GDP growth probably slowed down in 2019 Q1. This was partly due to temporary factors, but forecasts for the whole year point to a lower growth of the US economy than that recorded in 2018.

In China, activity growth continues to decline gradually. However, it was noted that this was accompanied by measures undertaken by the Chinese authorities aimed at mitigating the scale of the slowdown.

The Council members underlined that the deterioration of the global economic conditions was reflected in the change of monetary policy stance of the major central banks. In view of the downward revisions of GDP and inflation forecasts for the coming years in the euro area and the United States, both the ECB and the Fed have softened their communication on future monetary conditions.

In particular, it was noted that the ECB had extended the expected period of keeping interest rates unchanged, including the deposit rate below zero, and had announced the launch of additional operations providing liquidity to the banking sector. At the same time, the ECB continues to reinvest the funds from the maturing securities.

In turn, the Fed has stopped signalling further interest rate hikes in 2019 and has announced it will stop reducing the size of its balance sheet in the coming quarters. Certain Council members pointed out that the US bond yield curve inverted at the end of March 2019, which might be related to deteriorating expectations of financial market participants regarding the US economic conditions and, in effect, the emergence of expectations of monetary policy easing by the Fed.

It was also noted that although oil prices had risen since the beginning of the year, they were still lower than in 2018 Q3, which was keeping inflation at a moderate level in many countries. It was indicated that core inflation in the environment of the Polish economy, including the euro area, remained low.

Discussing the developments in Poland's real economy, it was underlined that economic conditions remained favourable in Poland, although incoming data indicated lower GDP growth in 2019 Q1 than in 2018 Q4. The Council members noted that activity growth was driven by rising consumption – albeit at a slightly lower rate than in previous quarters – fuelled by increasing employment and wages, as well as very high consumer sentiment. It was stressed that this was accompanied by a rise in investment.

While discussing the growth outlook, some Council members pointed out that in the first months of the year data on output and retail sales proved better than expected, which could result in somewhat higher GDP growth in 2019 Q1 than estimated in the March projection. However, some Council members pointed out that corporate sentiment indicators remained relatively low, which – in the opinion of these Council members – might indicate that there is a risk that in the coming months the slowdown abroad could have a stronger impact on the situation in the Polish industrial sector. It was noted that the major source of risk for the performance of the Polish economy was the scale and duration of the slowdown in its main trading partners. Certain Council members underlined that so far Polish exports had proven to be relatively resistant to the slowdown abroad, and indicated that in the recent period GDP growth forecasts for Poland had even been revised upwards somewhat. At the same time, attention was drawn to the improvement in consumer sentiment in March, which may have been boosted by the announced increase in fiscal expenditures. In the opinion of some Council members, along with further growth in employment and wages, this will act as a factor supporting consumption. The Council members expressed the view that GDP growth in 2019 might be higher than indicated in the March projection.

When analysing labour market performance, it was pointed out that employment growth in the corporate sector was still close to 3% at the beginning of 2019, while wage growth in enterprises in January and February 2019 amounted to approx. 7.5%. Certain Council members indicated the persistent tensions in the labour market, reflected in the reported recruitment problems, as well as the continued wage demands of various occupational groups. Some Council members emphasised that despite this, the labour market had not generated significant inflationary pressure so far. Other Council members expressed the opinion that in the future the situation in the labour market might begin to translate more strongly into inflationary pressure and, as a result, lead to higher price growth than currently predicted.

Turning to inflation developments in Poland, it was underlined that notwithstanding an increase in the recent period, annual consumer price growth remained low. Likewise, inflation net of food and energy prices is still low, despite some rise in recent months. Some Council members judged that taking into account the current forecasts, inflation in 2019 might remain close to the lower limit for deviations from the inflation target. Certain Council members pointed out that there had been a revision of the weights of individual expenditures in the CPI index. The revision of the weights reflected changes in the consumption structure of households, indicating an increase in the share of expenditures on higher-order goods. Other Council members, in turn, drew attention to the increase in growth of prices of services and industrial producer prices in the recent period, which might indicate growing domestic inflationary pressure. Certain Council members pointed to developments in electricity prices in the coming years as to an uncertainty factor.

When analysing changes in inflation expectations, it was noted that in the recent period expectations of enterprises had declined, while households' expectations had increased slightly. Certain Council members underlined that the decline in expectations of enterprises was the result of the freezing of electricity prices. Other Council members pointed out that long-term inflation expectations of market participants remained anchored close to the inflation target.

While discussing monetary policy, the Council decided that interest rates should remain unchanged. In the Council's assessment, the outlook for economic conditions in Poland remains favourable, although the coming quarters may see a gradual slowdown in GDP growth. At the same time, inflation will continue at a moderate level and will remain close to the target in the monetary policy transmission horizon. Thus, the Council judged that the current level of interest rates was conducive to keeping the Polish economy on a sustainable growth path and maintaining macroeconomic stability.

The majority of the Council members expressed the opinion that, taking into account current information, interest rates were also likely to remain stable in the coming quarters. These Council members pointed out that their assessment was supported by current forecasts indicating a limited risk of a lasting deviation of price growth from the inflation target. They emphasised that another argument in favour of keeping interest rates stable was the heightened uncertainty about the scale and duration of the slowdown in the global economy, along with its feeding through to domestic economic conditions.

Some Council members stressed that there were factors which, in the medium term, could push inflation to higher levels than suggested by the current forecasts. They remarked that should the announced fiscal measures, a potential pick-up in wage growth, or a possible increase in energy prices result in a marked rise in inflation that would jeopardise meeting the inflation target in the medium term, it might be justified to consider an increase in the NBP interest rates in the coming quarters.

A view was also expressed that in the hypothetical event of a slump in economic activity accompanied by a marked deterioration in consumer and corporate sentiment, in the longer run it might be justified to consider a decrease in interest rates or the introduction of unconventional monetary policy instruments.

The Council decided to keep the NBP interest rates unchanged: the reference rate at 1.50%, the lombard rate at 2.50%, the deposit rate at 0.50%, the rediscount rate at 1.75%.

Minutes of the Monetary Policy Council decision-making meeting held on 15 May 2019

During the meeting, the Council stated that global economic growth had probably continued at a relatively slow pace in 2019 Q1, although economic conditions had improved slightly in some of the largest economies. It was observed that industrial confidence indicators were still weak, while more upbeat signs were coming from the services sector. Some Council members judged that there was persistent uncertainty about the global economic outlook, which stemmed, most notably, from changes in the trade policy of the largest economies.

The Council members pointed out that economic activity growth in the euro area, including Germany, remained rather weak, despite a pick-up in quarterly GDP growth in 2019 Q1. With regard to economic conditions in the United States, it was noted that they remained good, and quarterly GDP growth in 2019 Q1 had been higher than in the previous quarter. At the same time, it was stressed that this owed much to a sharp rise in inventories, amid flagging imports. It was also noted that the stabilisation of economic activity growth in China was a positive sign, which probably, to a large extent, resulted from the stimulus implemented by the country's authorities.

It was indicated that although no tangible pick-up in global economic growth had been observed, oil prices continued to rise gradually. The Council members judged that this was primarily the result of supply-side factors. It was pointed out that the rise in global oil prices had translated into somewhat higher inflation in many countries. At the same time, it was underlined that core inflation in the environment of the Polish economy, including the euro area, had also increased slightly.

Referring to monetary policy abroad, it was observed that following a considerable easing of its rhetoric in March, the communication of key central banks regarding future monetary conditions had not changed, which reflected the persistence of concerns about the economic outlook.

In particular, it was pointed out that the European Central Bank was keeping interest rates close to zero, including the deposit rate below zero, and was reinvesting maturing securities bought under the asset purchase programme. The ECB also reiterated its forward guidance about the expected period of interest rates remaining at the current level until at least the end of the year, and about additional TLTRO operations to be launched in September. In the recent period, the Federal Reserve also kept interest rates unchanged, while the markets started to expect interest rate cuts in the United States in the quarters to come. Meanwhile, the Fed began to gradually limit its balance sheet reduction.

While assessing developments in Poland's real economy, it was observed that economic conditions remained favourable, although – according to the GUS flash estimate – GDP growth in 2019 Q1 had been somewhat weaker than in previous quarters. The Council members pointed out that activity growth continued to be supported by consumption, which had been rising further – albeit at a slightly slower pace than in previous quarters – fuelled by increasing employment and wages, as well as very strong consumer sentiment, and which had been accompanied by investment growth.

While discussing the outlook for economic growth in the coming quarters, the Council members voiced the opinion that GDP growth in 2019 might be higher than suggested by the March projection. Some Council members pointed out that GDP growth in 2019 Q1 had proved higher than expected and that business sentiment had recently improved, which was also a sign of a favourable outlook for domestic economic activity. It was observed that the very strong position of employees in the labour market and the government's fiscal programmes worked consistently in the same direction. However, these Council members pointed out that the PMI in industry remained below the 50 point threshold, which signalled uncertainty about further activity growth in this sector, including the risk of the slowdown abroad possibly affecting the situation in Poland more strongly. It was emphasised that the key source of risk for the domestic economy was the scale and persistence of the activity slowdown in Poland's main trading partners.

When analysing labour market performance, it was indicated that robust employment growth was sustained in the corporate sector, and that the unemployment rate had continued to decline, hitting further historical lows. Certain Council members suggested that this translated into persistent tensions in the labour market, reflected in the reported recruitment problems, and wage demands of various occupational groups. Yet it was observed that despite this, wage growth across the economy had slowed down to 7.1% in 2019 Q1 (compared with 7.7% in 2018 Q4), which was in part the effect of somewhat weaker wage growth in the corporate sector. Certain Council members expressed the concern that in future the situation in the labour market might start to translate, in a more pronounced way, into price pressure.

Turning to inflation developments in Poland, it was observed that consumer price growth had increased in recent months. The Council members emphasised that despite this, inflation continued to run at moderate levels. It was pointed out that the rise in inflation was partially caused by the increase in fuel and food prices, resulting, to a great extent, from an increase in global oil prices, as well as the effects of reduced supply of pork in China, combined with the adverse influence of last year's drought on the prices of certain vegetables – i.e. factors beyond the impact of monetary policy. At the same time, it was underlined that core inflation had risen as well. It was noted that the increase in core inflation was partially driven by the strong performance of the Polish economy, although it was also the effect of the expiry of one-off factors curbing its growth so far.

Certain Council members pointed out that inflation net of food and energy prices had exceeded 1.5%, thus the NBP reference rate deflated with that index turned mildly negative.

However, other Council members emphasised that real interest rates on loans from commercial banks and credit institutions remained significantly positive.

Some Council members observed that inflation should stabilise in the following months at a level close to that recorded in April and would remain moderate. In the opinion of certain Council members, favourable demand conditions, which still prevailed in the Polish economy, as reflected in rising service prices, would drive inflation up. These Council members pointed out that amid high resource utilisation in the economy, it was difficult to assess how long companies would be able to keep narrowing the profit margins in order to avoid passing the rising costs through to prices. According to these Council members, inflation in the subsequent quarters might also be propelled by increased social expenditure, even if growth in other expenditure of the general government sector was to slow down. Other Council members judged that the inflationary effect of higher social spending should be relatively small, especially in view of its potential allocation to savings. These Council members also remarked that strong price competition and the weakening GDP growth anticipated in the following quarters would curb inflationary pressures. Some Council members underscored that developments in global oil prices and domestic energy prices in the subsequent years constituted an uncertainly factor.

While analysing inflation expectations, it was remarked that the structure of responses to questions in the surveys of both companies and households had not changed markedly of late. The Council members emphasised that market participants' long-term inflation expectations remained anchored close to the inflation target.

While discussing monetary policy, the Council decided that interest rates should remain unchanged. In the Council's assessment, the outlook for economic conditions in Poland remains favourable, although the coming quarters may see a gradual slowdown in GDP growth. At the same time, inflation will continue at a moderate level and will remain close to the target in the monetary policy transmission horizon. Thus, the Council judged that the current level of interest rates was conducive to keeping the Polish economy on a sustainable growth path and maintaining macroeconomic stability.

The majority of the Council members expressed the opinion that, taking into account current information, interest rates were also likely to remain stable in the coming quarters. These Council members pointed out that their assessment was supported by current forecasts indicating a limited risk of a lasting deviation of price growth from the inflation target. They emphasised that another argument in favour of keeping interest rates stable was the heightened uncertainty about the scale and duration of the slowdown in the global economy, along with its feeding through to domestic economic conditions.

Some Council members stressed that there were factors which, in the medium term, could push inflation to higher levels than suggested by the current forecasts. They remarked that should the announced fiscal measures, a potential pick-up in wage growth, or a possible increase in energy prices result in a marked rise in inflation that would jeopardise meeting the inflation target in the medium term, it might be justified to consider an increase in the NBP interest rates in the coming quarters.

A view was also expressed that in the hypothetical event of a slump in economic activity accompanied by a marked deterioration in consumer and corporate sentiment, in the longer run it might be justified to consider a decrease in interest rates or the introduction of unconventional monetary policy instruments.

The Council decided to keep the NBP interest rates unchanged: the reference rate at 1.50%, the lombard rate at 2.50%, the deposit rate at 0.50%, the rediscount rate at 1.75%.

Minutes of the Monetary Policy Council decision-making meeting held on 5 June 2019

During the meeting, the Council stated that global economic growth continued at relatively slow pace. It was noted that industrial confidence indicators remained weak and the volume of world trade was declining. However, this was accompanied by relatively good business conditions in services. Attention was also drawn to the heightened uncertainty about the global economic outlook for the coming quarters, to a large extent a result of further possible changes in the trade policy of the largest economies. It was also judged that the risk prevails of a stronger weakening of global economic activity than predicted by current forecasts.

The Council members pointed out that economic activity growth in the euro area, including Germany, remained weak. It was stated that although GDP growth in the German economy was higher in 2019 Q1 than at the end of 2018, this was partly the result of temporary factors. It was underlined that in view of the still weak business conditions in German industry, the available forecasts point to a low growth rate for this economy in 2019. Referring to economic conditions in the United State, it was indicated that they currently remain good. When analysing economic situation in China, it was pointed out that although GDP growth stabilised in this economy in 2019 Q1, recent data indicate the risk of some weakening in economic conditions in the current quarter.

It was indicated that in the recent period the heightened uncertainty about the outlook for global economic growth had contributed to a fall in global oil prices following their earlier significant rise. At the same time, it was pointed out that in recent months there had been a marked increase in the prices of certain food products.

When referring to inflation abroad, attention was drawn to some increase in price growth in many countries in April. It was underlined that core inflation had also risen somewhat in the external environment of the Polish economy, including in the euro area. Some Council members judged that the increase in price growth was probably temporary. Certain Council members pointed out that inflation in emerging market economies remained higher than in advanced ones.

Referring to monetary policy abroad, it was pointed out that the major central banks – in view of concerns about a deterioration in economic conditions – were easing their rhetoric regarding future monetary policy. The European Central Bank was keeping interest rates close to zero, including the deposit rate below zero, and also reiterated its forward guidance about keeping interest rates at the current level in the coming quarters. Moreover, the ECB continued to reinvest maturing securities bought under the asset purchase programme and had announced additional TLTRO operations to be launched in September. The Federal Reserve also kept interest rates unchanged, amid growing expectations of interest rate cuts this year. Meanwhile, the Fed began to gradually limit its balance sheet reduction.

While discussing developments in Poland's real economy, it was observed that economic conditions remained favourable. It was pointed out that in 2019 Q1 annual GDP growth reached 4.7% and was higher than the forecast. The Council members underlined that activity growth continued to be supported by consumption, which had been rising further – albeit at a slightly slower pace than in previous quarters – fuelled by increasing employment and wages, as well as very strong consumer sentiment. At the same time, it was stated that in 2019 Q1 investment in the economy had risen significantly. Attention was also drawn to the high growth in investment outlays among medium-sized and large enterprises, which suggested a significant recovery in investment in the enterprise sector. It was emphasised that despite the weakening of economic conditions in Poland's immediate environment, marked export growth continued in 2019 Q1, and net exports made a positive contribution to GDP growth. Export growth was supported by the recovery in foreign sales to countries outside the euro area, which – in the opinion of some Council members – might indicate that enterprises were adjusting to the weakening economic conditions in their immediate environment and shifting some production to other markets.

The Council members also drew attention to the continued sound financial situation of the enterprise sector. They noted that some decline in net profits in 2019 Q1 was mainly the result of a deterioration of the situation in the energy and mining sectors. However, in the overwhelming majority of the remaining sectors financial results had improved. It was also emphasised that the positive financial situation of companies was reflected in the stable level of their profit on sales.

While analysing the outlook for economic growth, the Council members judged that GDP growth in 2019 might be slightly higher than expected in the March projection. It was noted that economic growth would continue to be driven by growth in consumer demand, which is supported by the very optimistic consumer sentiment in view of the favourable labour market conditions for consumers and the social benefits already introduced and announced by the government. Some Council members judged that the scale of the impact on the Polish economy of the slowdown abroad might be weaker than previously expected – as was the case so far. However, other Council members noted that there was a risk of a weakening of activity in the industrial sector over the coming months. This was indicated by the PMI index staying below the 50 point level and the results of other business surveys, suggesting that activity growth in industry had thus far been sustained by the clearing of previously accumulated production arrears. It was emphasised that the key source of risk for the domestic economy was the scale and persistence of the activity slowdown in Poland's main trading partners and the strength of its pass-through to the Polish economy.

When analysing labour market performance, it was indicated that unemployment remained very low. Alongside that, employment in the enterprise sector continued to grow at a relatively fast pace. In turn, according to the LFS, the number of working persons in 2019 Q1 was slightly lower than a year earlier. In the opinion of the Council members, the discrepancies between the data of the enterprise sector and the LFS might partly result from the growing share of employees from the East among the newly employed, and also from changes in the forms of employment. Some Council members judged that the recent data from the labour market – including about the number of new job offers – might suggest that growth in demand for labour was weakening. Concurrently, wage growth – both in the enterprise sector and in the whole economy – remained stable at close to 7%. Certain Council members expressed the opinion that the stabilisation of wage growth was backed by the social programmes that had been introduced, raising household disposable income and thus limiting wage pressure.

Turning to inflation developments in Poland, it was observed that in recent months consumer price growth had risen, yet remained at a moderate level. It was pointed out that the rise in inflation was partially caused by the increase in fuel and food prices. It was emphasised that core inflation had also risen, which reflected a marked pick-up in growth in the prices of services amid continued favourable situation of Polish consumers. Certain Council members pointed out that the price growth observed by some households might be higher than CPI inflation calculated for the average household.

Some Council members observed that inflation in the coming months should remain close to the level seen in May. It was also emphasised that uncertainty existed regarding inflation developments at the beginning of 2020. It was pointed out that in the case of an adjustment of electricity prices for households to market conditions, consumer price growth in 2020 Q1 might increase. Certain Council members judged that such an increase might lead to higher inflation expectations. Other Council members observed, however, that the increase in inflation at the beginning of 2020 – should it occur – would be short-lived, and later in 2020 inflation would probably run close to the target. Some Council members emphasised that global developments in oil and food prices in the coming years posed a factor of uncertainty.

Certain Council members pointed out that the NBP reference rate deflated with both CPI and inflation net of food and energy prices was currently negative. These Council members judged that this contributed to an increase in lending to households amid high – in their opinion – indebtedness of these entities. Other Council members, in turn, emphasised that the real interest rates on household loans were still significantly positive. At the same time, these Council members expressed the opinion that the growth in lending to households was supported by their good financial situation, which improved their creditworthiness. In the opinion of these Council members, growth in claims of the banking sector on households remained moderate. Attention was also drawn to the relatively low growth in corporate investment loans, which – in the opinion of certain Council members – might be the effect of limited supply on the part of banks. Yet some Council members judged that growth in these loans was limited by low demand, resulting from the significant scale of investment being self-financed by enterprises.

While discussing monetary policy, the Council decided that interest rates should remain unchanged. In the Council's assessment, the outlook for economic conditions in Poland remains favourable, and GDP growth in 2019 may be slightly higher than expected in the March projection. At the same time, inflation will continue at a moderate level and will remain close to the target in the monetary policy transmission horizon. Thus, the Council judged that the current level of interest rates was conducive to keeping the Polish economy on a sustainable growth path and maintaining macroeconomic stability.

The majority of the Council members expressed the opinion that, taking into account current information, interest rates were also likely to remain stable in the coming quarters. These Council members pointed out that their assessment was supported by current forecasts indicating a limited risk of a lasting deviation of price growth from the inflation target. They emphasised that another argument in favour of keeping interest rates stable was the heightened uncertainty about the scale and duration of the slowdown in the global economy, along with its feeding through into domestic economic conditions.

Some Council members stressed that there were factors which, in the medium term, could push inflation to higher levels than suggested by the current forecasts. They remarked that should the announced fiscal measures, a potential pick-up in wage growth, or a possible increase in energy prices result in a marked rise in inflation that would jeopardise meeting the inflation target in the medium term, it might be justified to consider an increase in the NBP interest rates in the coming quarters.

A view was also expressed that in the hypothetical event of a slump in economic activity accompanied by a marked deterioration in consumer and corporate sentiment, in the longer run it might be justified to consider a decrease in interest rates or the introduction of unconventional monetary policy instruments.

The Council decided to keep the NBP interest rates unchanged: the reference rate at 1.50%, the lombard rate at 2.50%, the deposit rate at 0.50%, the rediscount rate at 1.75%.

Information from the meeting of the Monetary Policy Council held on 2-3 July 2019

The Council decided to keep the NBP interest rates: the reference rate at 1.50%, the lombard rate at 2.50%, the deposit rate at 0.50%, the rediscount rate at 1.75%

Incoming data suggest that global economic growth continues at a relatively slow pace, amid heightened uncertainty about the global economic outlook in the coming quarters. In the euro area, despite still good situation in the services sector, the pace of economic activity growth remains relatively slow. In the United States, economic conditions stay strong, but recent indicators signal a possible weakening of activity in the coming quarters. In China, incoming data indicate a deterioration in economic conditions in 2019 Q2.

In the recent period there has been an increased volatility of global oil prices; which are still lower than a year ago. This has been accompanied by an increase in the global prices of some food products. At the same time, inflation in many countries remains moderate.

The European Central Bank is keeping interest rates close to zero, including the deposit rate below zero, and reinvests maturing securities bought under the asset purchase programme. At the same time, the ECB has extended the period that it intends to keep interest rates unchanged. The US Federal Reserve is keeping interest rates unchanged. The Fed is gradually limiting the pace of its balance sheet reduction, signalling the possibility of loosening monetary policy in the coming quarters.

In Poland, economic conditions remain good, despite weaker growth abroad. Activity growth is driven by rising consumption, fuelled by increasing employment and wages, very high consumer sentiment, and social benefit payments. Incoming data also indicate a continuation of significant growth in investment and exports.

In recent months, consumer price growth has increased, which was driven by rising fuel and food prices as well as higher core inflation. Nonetheless, inflation continues to run at moderate levels.

The Council became acquainted with the results of the July projection of inflation and GDP, prepared under the assumption of unchanged NBP interest rates. The July projection takes into account data and information published up to 18 June 2019. In line with the July projection based on the NECMOD model, there is a 50-percent probability that the annual price growth will be in the range of 1.7-2.3% in 2019 (against 1.2-2.2% in the March 2019 projection), 1.9-3.7% in 2020 (compared to 1.7-3.6%) and 1.3-3.5% in 2021 (compared to 1.3–3.5%). At the same time, the annual GDP growth – according to this projection – will be with a 50-percent probability in the range of 3.9-5.1% in 2019 (against 3.3-4.7% in the March 2019 projection), 3.0-4.8% in 2020 (compared to 2.7-4.6%) and 2.4-4.3% in 2021 (compared to 2.4-4.3%).

In the Council's assessment, the outlook for economic conditions in Poland remains favourable, and GDP growth will continue at a relatively high level in the coming years. At the same time, inflation will remain moderate and, in the monetary policy transmission horizon, will stay close to the target. Such an assessment is supported by the results of the July NBP projection.

The Council judges that the current level of interest rates is conducive to keeping the Polish economy on a sustainable growth path and maintaining macroeconomic stability.

The Council adopted the *Inflation Report – July 2019*.

4. Projection of inflation and GDP

This inflation and GDP projection was prepared by the Economic Analysis Department of Narodowy Bank Polski and presents a forecast of economic developments under the assumption of the unchanged NBP interest rates. In terms of the contents, works on this projection were supervised by Piotr Szpunar, Director of the Economic Analysis Department. The process was coordinated by the Macroeconomic Forecasts Division of the Economic Analysis Department. Using the macroeconomic model NECMOD, 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 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 the NBP interest rates.

The July projection based on the NECMOD model covers the period from 2019 Q2 to 2021 Q4. The starting point for the projection is 2019 Q1.

The cut-off date for the data used in this projection is 18 June 2019.

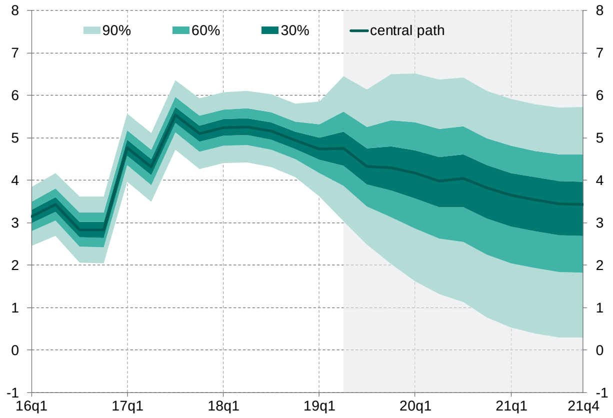
4.1 Summary

In 2019 Q1 the Polish economy continued its strong recovery underpinned by still high growth of private and public consumption and rapid increase in gross fixed capital formation. Export growth was at a relatively high level and proved so far to be considerably resilient to the marked slowdown in GDP growth in the euro area, in particular in the German economy.

Over the projection horizon domestic GDP growth will gradually decline, affected by the ongoing weak business conditions in Poland's main trading partners. At the same time, after a rapid increase in the absorption of EU funds last year, which financed both public and – to a lesser extent – private investment outlays, the absorption rate will slow down in the coming years covering the final phase of the EU financial framework 2014-2020. These determinants will have a negative effect on gross fixed capital formation growth, which will fall from the current high level. The scale of the slowdown will be mitigated by the fiscal stimulus already introduced and planned by the government. The fiscal measures include an increase in social benefits and a decrease in the tax burden, boosting private consumption growth. The low level of interest rates and the resulting low cost of credit will have a favourable impact on domestic demand.

Rapid economic growth in 2019 Q1 was accompanied by relatively low consumer price growth. Domestic inflationary pressure was mitigated by moderate price growth in Poland's main trading partners and a low level of crude oil and other energy commodities prices in the global markets. Additionally, in December 2018 legislative changes were enacted aimed at freezing electricity prices to end-users. Also a significant number of immigrants, especially Ukrainian citizens, on the domestic labour market, has a dampening effect on inflation. The presence of

Figure 4.1 GDP (y/y, %)



Source: Statistics Poland (GUS) data, NBP calculations.

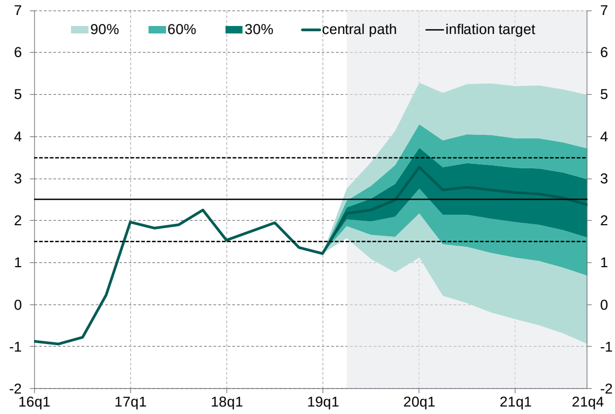
Fan charts depict the probability distribution of possible outcomes of GDP growth (Figure 4.1) and inflation rate (Figure 4.2). The part of the chart in the grey background illustrates forecast uncertainty of these variables over the projection horizon; additionally, for GDP growth there exists the uncertainty of past values due to possible data revisions by Statistics Poland (GUS). It was assumed that the probability distribution of the possible outcomes of a variable at each forecast horizon belongs to the family of two-piece normal (TPN) distributions. This distribution is determined by three parameters: mode, variance and a measure of skewness. The mode of the distribution is the central path of the projection, while the variance is determined based on historical forecast errors for each of the horizons adjusted for the impact of the current uncertainty of exogenous variables. The skewness of the distribution is obtained on the basis of an analysis of several alternative scenarios together with the assigned probabilities of their realisation. On the chart, the distribution of the realisation of a given variable is illustrated by 30%, 60% and 90% probability intervals around the central projection path, which were constructed in such a way as to minimize the width of the bands (for more information see: Pońsko P., Rybaczyk B., 2016, Fan Chart – A Tool for NBP's Monetary Policy Making, Narodowy Bank Polski Working Paper, No 241.).

foreign workers increases the productive potential of the Polish economy and lowers labour cost growth.

Under the assumption of unchanged NBP interest rates, consumer price inflation will pick up over the projection horizon, remaining within the band of deviations from the inflation target. Higher CPI inflation will be the result of growing labour costs and relatively strong demand pressure in the Polish economy, which will reach its peak in 2020. The escalation of the ASF epidemic in China, boosting meat and cold meat prices, will be another supply-side factor increasing inflation in 2019, but then its impact will gradually fade away. In the longer-term projection horizon CPI growth will be dampened, apart from the aforementioned merely moderate inflation in Poland's main trading partners, by high competition in retail trade and the gradual closing of the output gap in the wake of slowing domestic economy.

However, whether the projection scenario will materialise or not largely depends on future activity in the global economy. The risk factors for economic growth and inflation include the possible escalation of trade disputes and protectionist measures restricting world trade. Developments in global oil and other energy commodity prices as well as future regulatory changes in Poland and their pass-through to energy prices will also be an important risk factor. A significant domestic source of risk will also be the size of the net inflow of immigrants onto the domestic labour market, in particular from Ukraine. The balance of risks for GDP growth as well as – to a lesser extent – for CPI inflation suggests they are more likely to run below the central scenario, which is reflected in the fan charts for these variables (Figure 4.1, Figure 4.2).

Figure 4.2 CPI inflation (y/y, %)



Source: Statistics Poland (GUS) data, NBP calculations.

The methodology of construction of fan charts is discussed in the note under Figure 4.1.

4.2 External environment

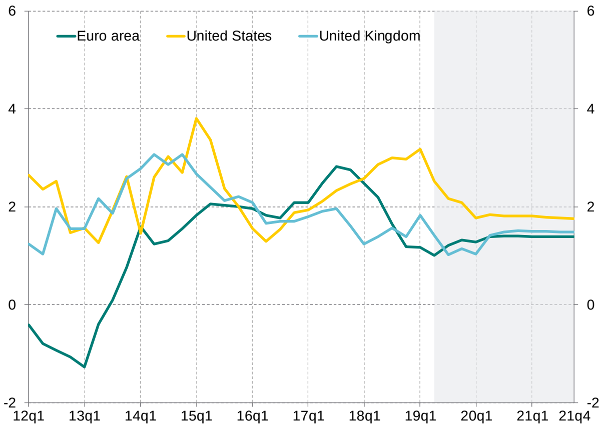
Economic growth

In the coming years, amid escalation of trade disputes limiting global trade growth, GDP growth in the euro area will be subdued (Table 4.1, Figure 4.3). Also, unresolved structural problems in certain member states, including mounting supply barriers in the labour market, will curb GDP growth in the euro area. Private consumption will continue to be the main source of GDP growth in the euro area economy, supported by growing wages and expansionary fiscal policy in some of the euro area countries.

In the coming years, economic activity in the United States will develop more favourably than in the euro area. US GDP growth observed in 2019 Q1, considerably exceeding the expectations formulated in the March projection, was partially driven by one-off factors. In the subsequent quarters of 2019 and in the whole of 2020, given the escalating tensions in trade policy, the slowdown of economic growth in the United States is expected to be more pronounced than assumed in the previous forecasting round. Growth in the US economy will be driven by robust private consumption, supported by rising employment and wages, the high net wealth of households and lower tax burdens. The favourable economic impact of the tax reforms introduced by the US administration will gradually fade throughout 2019. Combined with labour supply limitations, this will gradually curb GDP growth, which may be partly offset by the Fed's interest rate cuts expected by financial markets. The baseline scenario is subject to heightened uncertainty, above all, due to a possible further escalation of trade disputes after the US increased import duties on Chinese imports in May 2019 and China's response in the form of increased tariffs on certain US imported goods.

In the coming years, economic activity in the United Kingdom will continue to develop at a relatively low level as a result of the uncertainty about the conditions of the UK leaving the European Union. In the July projection, like in the previous forecasting rounds, it was assumed that in the projection horizon economic relations

Figure 4.3 GDP abroad (y/y, %)



Source: Bloomberg, Eurostat data, NBP calculations.

Table 4.1 GDP abroad - July projection versus March projection

	2019	2020	2021
GDP in Euro Area (y/y, %)			
July 2019	1.2	1.4	1.4
March 2019	1.2	1.5	1.4
GDP in United States (y/y, %)			
July 2019	2.5	1.8	1.8
March 2019	2.5	2.0	1.8
GDP in United Kingdom (y/y, %)			
July 2019	1.4	1.4	1.5
March 2019	1.3	1.5	1.5

Source: NBP calculations.

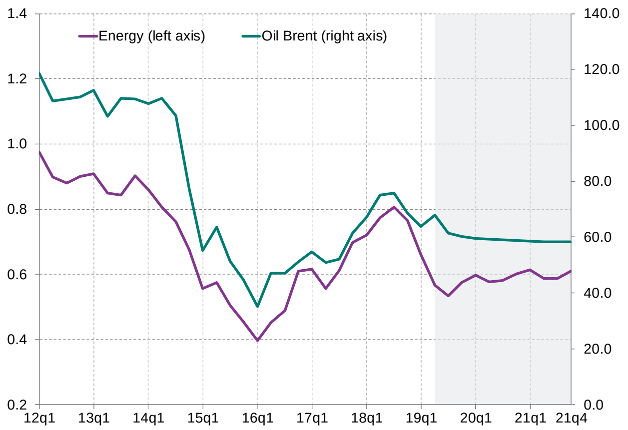
between the UE and the United Kingdom will remain largely unchanged. Such a scenario would be consistent either with reaching an agreement on Brexit and the implementation of temporary solutions by the end of 2020, or with the extension of negotiations between the British government and the EU. This assumption is reflected in the accelerated GDP growth in the British economy in 2021 after the uncertainty associated with Brexit is resolved. Should the United Kingdom and the EU fail to reach an agreement on the Brexit conditions (a no-deal Brexit), this could result in lower growth in the projection horizon, both in the United Kingdom and – to a lesser extent – in the euro area, which constitutes a significant risk factor for the projection.

Inflation and interest rates

Following a fall in coal and natural gas prices in 2019 Q2, which was sharper than expected in the March projection, the energy commodity price index will rise steadily over the next year, while still remaining below the assumptions of the previous forecasting round (Figure 4.4). In the longer projection horizon, the index will stabilise and will undergo only slight fluctuations.

The index decline observed in the first half of 2019 resulted from lower coal and natural gas prices in the global markets. On the other hand, higher oil prices worked in the opposite direction. This results from oil price growth observed in 2019 Q1 and Q2 driven by the OPEC+ countries policy, focused on limiting oil supply. The rise in oil prices is also related to the political and economic crisis in Venezuela, the escalation of the internal conflict in Libya, and the sanctions imposed on Iran by the United States. In line with the futures contracts quotations, starting from the second half of 2019, oil prices will decline. In the years 2020-21 they will run below the path assumed in the March projection. This scenario is supported by growing oil production in the United States and the

Figure 4.4 Energy commodities price index (in USD, 2011=1) in global markets and Brent oil prices (USD/b)



Source: Bloomberg data, NBP calculations.

The index of the prices of energy commodities includes the prices of crude oil, coal and natural gas, taking account of the consumption structure of these commodities in Poland.

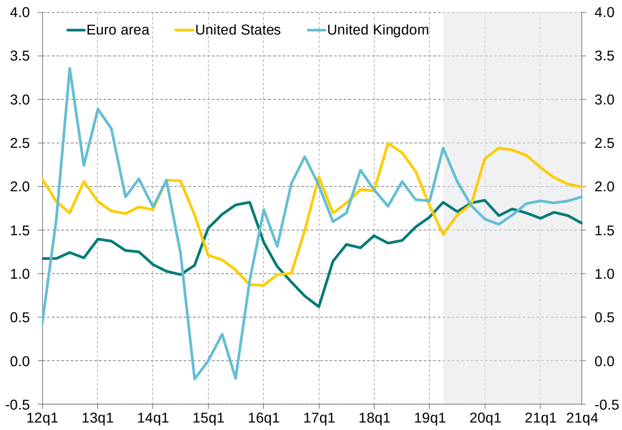
concerns about the condition of the global economy, related to mounting trade disputes.

This year's warm winter, in particular in China, contributed to the decline in coal prices in the global markets in the first half of the year. In line with the futures quotations, situation in the coal market will normalise in the coming years. Thus, coal prices in the projection horizon will gradually increase, although they will not reach the 2018 level. The growth of coal prices, as in the case of oil, is limited by concerns about the global economic activity and the climate policy of the developed countries, focusing on a reduction in the use of coal as a source of energy.

As a result of warm winter and high supply in the European market, natural gas prices fell considerably in the first half of 2019, running below the expectations of the previous forecasting round. In the subsequent years, when the conditions in the gas market normalise, its prices will rise, yet still they will run slightly below the March projection level.

As a result of the global supply shock in the pork market, in the current projection the agricultural commodity price index is running above the path assumed in the previous forecasting round. The shock is related to the outbreak of the ASF epidemic in China, both the leading producer and consumer of pork. The expected significant drop in the pig population in China will translate into a strong growth of China's imports of pork and other meats. The scale of reduction of the pork population and the lengthy process of rebuilding the herd imply that the impact of this shock will be long lasting. Quotations of futures contracts for the purchase of pork indicate that in the projection horizon the price of pork, and also other meats, may be expected to rise. At the same time, in the short-term projection horizon, the growth of the agricultural commodity price index will be partially limited by the lower than expected price of wheat in the global markets. This is related to the record high level of global wheat production and

Figure 4.5 Inflation abroad (y/y, %)



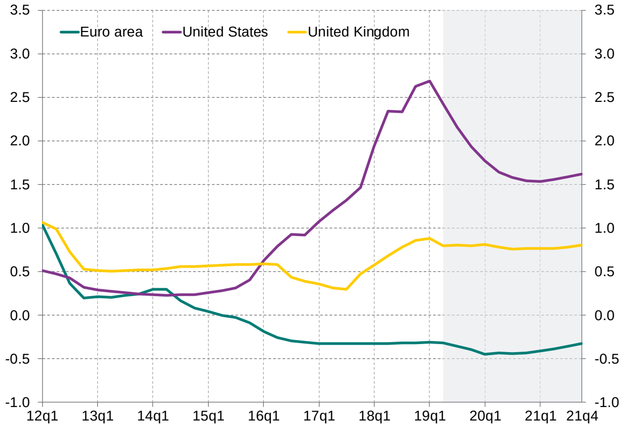
Source: Bloomberg, Eurostat data, NBP calculations.
Inflation as measured by the value added deflator.

inventories, which are growing much faster than the global demand.

The July projection assumes that in the economic environment of Poland, particularly in the euro area, inflation (measured by the change in the value added deflator, see Figure 4.5) will remain at a moderate level. The projected weakening in economic activity, combined with relatively stable energy commodity prices (falling oil prices, slightly growing natural gas and coal prices) will keep inflation in the euro area below 2%. The inflation in the United States will run at a slightly higher level than in the euro area, as a result of the more favourable cyclical position of the US economy.

In the current forecasting round it was assumed, in line with the expectations implied by futures contracts quotations, that the process of monetary policy tightening by the ECB and the Bank of England will be postponed (Figure 4.6). In view of the forecasts of lower economic activity in the euro area than in the previous years and only moderate inflation as well as heightened uncertainty about the global economic outlook, in line with futures quotations no deposit rate hikes by the ECB are expected until the end of the projection horizon; on the contrary, the ECB is rather expected to reduce its deposit rate. As a result, short-term rates on the interbank market will remain negative until the end of the projection horizon (Figure 4.6). At the same time, along with the deteriorating outlook for growth in the US economy in 2020-2021 and heightened uncertainty associated with possible further escalation of trade disputes, futures quotations imply that the Fed will reduce its interest rate in the years 2019-2020, which will subsequently stabilise at a low level.

Figure 4.6 Interest rates abroad (%)



Source: Bloomberg data, NBP calculations.

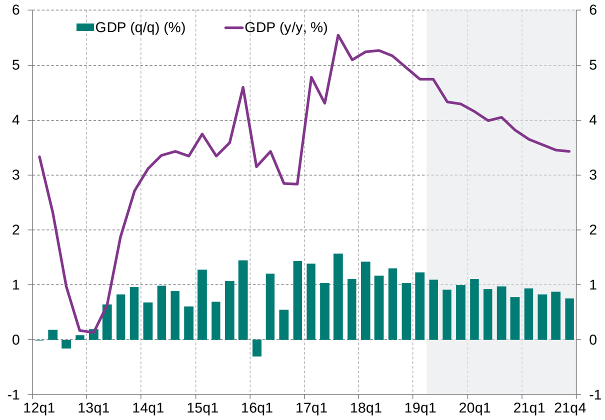
4.3 Polish economy in 2019-2021

Domestic demand

In 2018 the Polish economy remained in the expansion phase, and the growth rate accelerated to 5.1%. Over the projection horizon GDP growth will start to steadily decline in the wake of the weakening economic growth in the euro area observed since mid-2018 and the slowdown in the growth rate of absorption of the EU funds after their high level of utilisation in 2018 (Figure 4.7, Figure 4.8, Figure 4.11). At the same time, the scale of the slowdown in the domestic economy will be mitigated by the legislative package already introduced and planned by the government, which, through boosting disposable income, will have the impact on private consumption in particular.

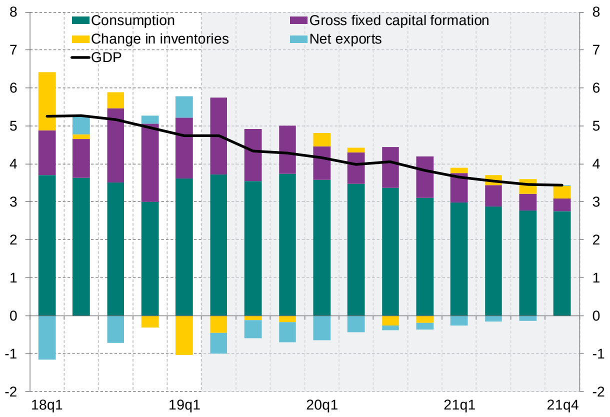
In the years 2019-2021, household consumption will continue to be the main driver of economic growth (Figure 4.8, Figure 4.9). The high consumption growth will be supported by the effect of the legislation package enacted in 2019, which will be spread over time, including, the extension of the "Family 500 plus" programme,[55] as well as the one-off thirteenth pension payment. Moreover, in line with the government's plans, consumption will be further boosted by the introduction of changes in tax legislation concerning personal income tax, resulting in reduced tax burdens.[56] In 2019 household expenditure will also be positively affected by the favourable situation of employees in the labour market, resulting in continued high growth in the wage bill. In the coming years, a gradual decline in wage growth will translate into lower growth in household disposable income; while higher inflation will also have a limiting effect on household purchasing power. Taking into account these trends, as well as the planned fiscal changes which will provide the strongest boost to private consumption in 2020, in the longer projection horizon a decline in household consumption

Figure 4.7 Economic growth



Source: Statistics Poland (GUS) data, NBP calculations.

Figure 4.8 GDP growth (y/y,%) – breakdown



Source: Statistics Poland (GUS) data, NBP calculations.

[55] As of July 2019 the "Family 500 plus" programme will be extended; this will involve payment of family benefits for the first (including the only) child with no income criteria applied.

[56] The July projection takes into account the changes in tax legislation published in "Convergence Programme" in April 2019. The changes concern: the decrease of the first tax threshold to 17%, the increase in the tax deductible costs for employees and the introduction of a zero-rate personal income tax for persons aged under 26.

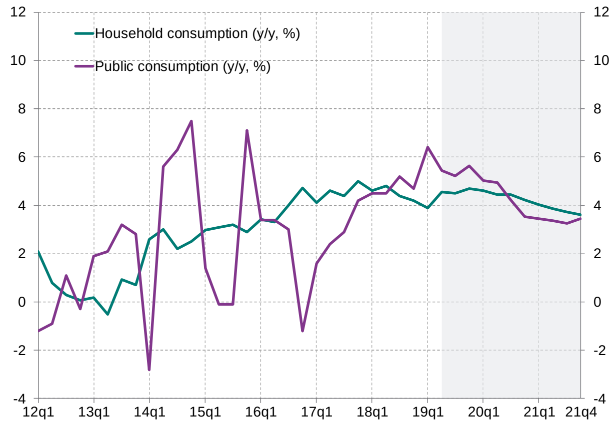
growth is expected; yet, the scale of this decline will be limited.

In the years 2019-2021, there will also be a slowdown in gross fixed capital formation growth, due to a slower growth of general government investment, accompanied by a growing share of private investment (Figure 4.10).

The growth rate of gross fixed capital formation in the general government sector in the years 2019 - 2020 will decline considerably in relation to the high 2018 level, and will be negative in the last year of the projection horizon, curbing investment growth in the entire economy. Such a development of public sector investment will be the result of the absorption of EU funds assumed in the projection, financing this expenditure (Figure 4.11), whose utilisation in 2019 will rise only slightly, and in the following years will begin to decline.

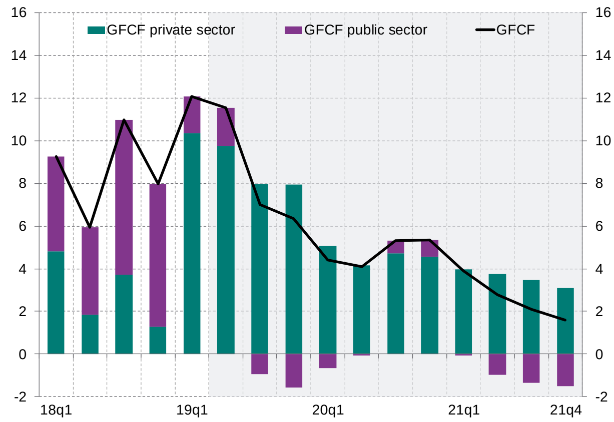
In 2019 the growth rate of gross fixed capital formation of the private sector will pick up considerably, which will result from a high growth rate of corporate investment amidst continued relatively strong household demand for residential real estate (Figure 4.10). Corporate investment is supported by the currently low investment rate accompanied by high capacity utilisation in the corporate sector. The loan-financed purchase of fixed assets will be supported by the record low level of interest rates, although the main source of funding investment of both enterprises and households will continue to be own funds.[57] An additional factor likely to encourage companies to increase capital expenditure and automation of production will be difficulties in finding employees, which constitute the main barrier to their development.[58]

Figure 4.9 Household and public consumption



Source: Statistics Poland (GUS) data, NBP calculations.

Figure 4.10 Gross fixed capital formation (y/y, %) – breakdown

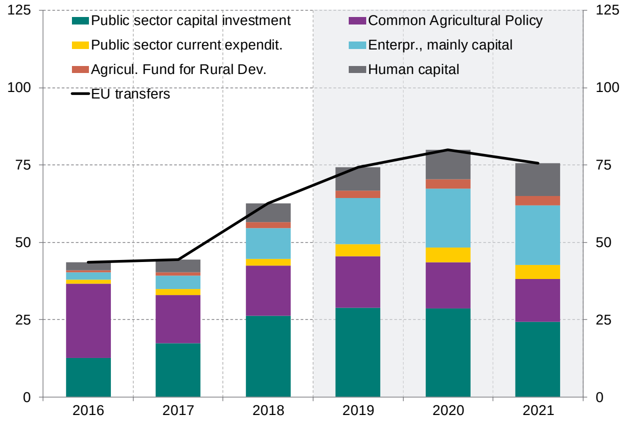


Source: Statistics Poland (GUS) data, NBP calculations.
Private sector investment is defined as gross fixed capital formation according to the national accounts except for the general government sector. It covers gross fixed capital formation of non-financial enterprises, financial and insurance companies, households (both housing and non-housing investment) and non-profit institutions serving households.

[57] *NBP Quick Monitoring Survey. Economic climate in the enterprise sector*, NBP, April 2019. According to the results of these surveys, over 50% of investors finance new investment with own funds. *Information on home prices and the situation in the housing and commercial real estate market in Poland in 2018 Q4*, NBP, March 2019. This study shows that the estimated share of cash purchases of completed housing units in the primary market in the seven analysed cities (Gdańsk, Gdynia, Kraków, Łódź, Poznań, Warsaw, and Wrocław) exceeds 60%.
[58] *NBP Quick Monitoring Survey. Economic climate in the enterprise sector*, NBP, April 2019.

In the years 2020-2021 the outlook for private investment will deteriorate on the back of the slowdown of external demand observed since mid-2018, having a lagged impact on the domestic economy. At the same time, the inflow of EU funds will finance investment expenditure growth of the private sector to a lesser extent (Figure 4.11). The gradual decline in the household disposable income growth will also contribute to slower growth of housing expenditure.

Figure 4.11 Expenditure financed by EU funds (in PLN billion) – breakdown



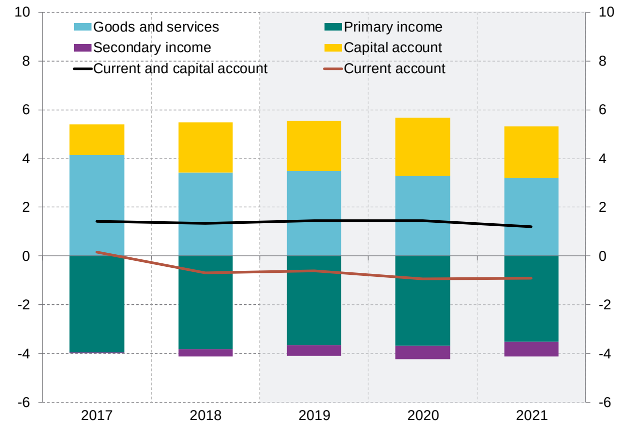
Source: NBP calculations.

In 2019 public consumption growth will pick up, exceeding the growth rate of GDP. According to the 2019 Budget Act, for the first time since 2010 the base salary in the public sector will rise (by 2.3%), which will also determine the lower limit of wage rises in this sector. The relatively greater scale of wage rises will benefit, among others, school teachers, university lecturers, and uniformed services. In 2020 public consumption growth will also exceed the economic growth rate, which will be driven by the government's decision to proceed to the average annual wage increase of 6% in the public sector in 2020. Due to the lack of other detailed information about the expected spending in the general government sector, in 2021 a decline in public consumption growth is assumed to the level close to GDP growth, in line with the assumption of neutral fiscal policy.

Current and capital account balance

Preliminary data on the balance of payments statistics indicate that in 2019 Q1 the current and capital account balance remained positive (1.6% of GDP, 4-quarter rolling sum). Despite the continued slowdown in the euro area at the beginning of 2019, particularly in the German economy, Polish export growth in 2019 Q1 was relatively high, exceeding the growth rate of imports (Figure 4.13). This was underpinned by the structure of Polish exports, characterised by a greater importance of consumer demand in the exported value added than in the other countries of the region. Considering that consumer demand shows less sensitivity to changes in business conditions than investment

Figure 4.12 Current and capital account balance (percent of GDP) - breakdown



Source: Statistics Poland (GUS) data, NBP calculations.

demand, such structural determinants of Polish exports support their resilience to the weakening of global trade. As a result, the trade balance in 2019 Q1 was high and amounted to 3.8% of GDP, amid a record high surplus in trade in services (4.5% of GDP). However, in the coming quarters the trade balance will deteriorate due to the continued high growth in domestic demand along with a simultaneous slow growth in demand for Polish exports. Consequently, the trade balance in 2020 will decline, and at the end of the projection horizon the downward trend will slow down due to the expected weaker growth in consumption and investment.

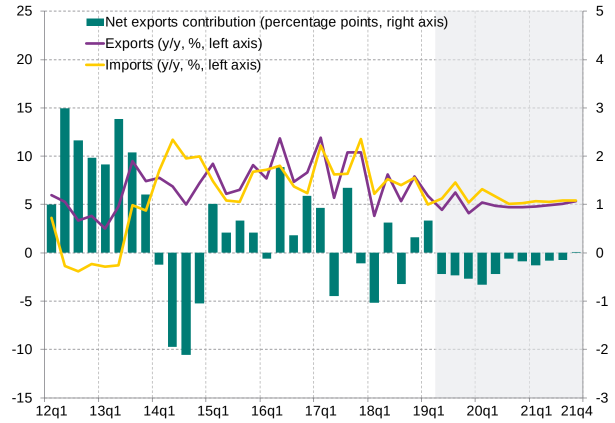
The remaining components of the current account – the balance of primary and secondary income – will be negative over the whole of the projection horizon, while the main source of the deficit of the balance of income will continue to be income of foreign direct investors in Poland. This will be accompanied by a high surplus on the capital account in the years 2019-2021 exceeding 2% of GDP. According to the central scenario of the projection, this surplus will reach its peak during the current EU budget in 2020, after which it will decline in the final phase of the current EU financial framework.

Following the gradual decline of the trade balance in the coming quarters, combined with multi-directional changes in the remaining components, the current and capital account balance will decrease over the projection horizon; however, it will remain positive (Figure 4.12).

Potential output

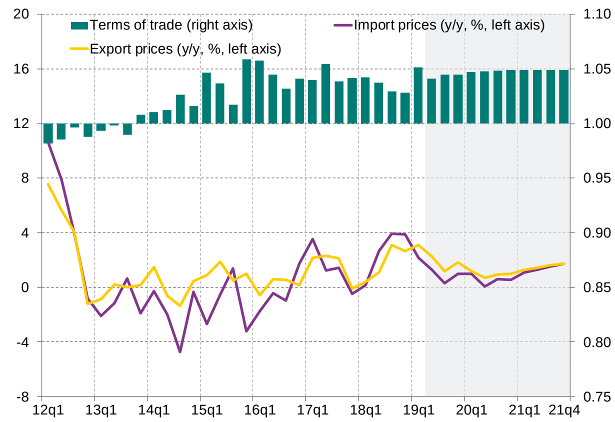
Potential output of the Polish economy grew by 3.7% in 2018 supported by an extension of working time and increased productivity of migrant labour, the continuation of positive structural changes in the labour market and growth in total factor productivity (TFP; Figure 4.15). These factors were balanced by the slower growth of productive capital as a result of the decline in the investment

Figure 4.13 Foreign trade



Source: Statistics Poland (GUS) data, NBP calculations.

Figure 4.14 Export and import prices



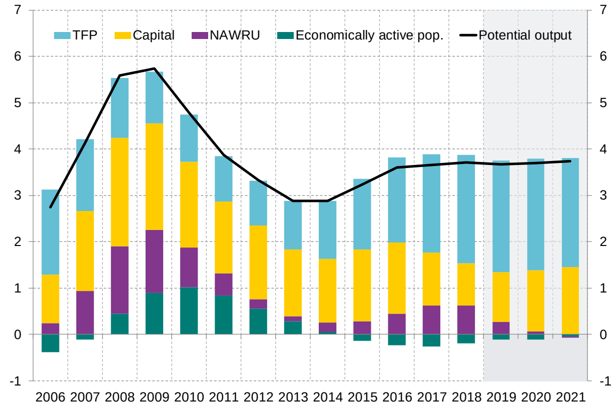
Source: Statistics Poland (GUS) data, NBP calculations.

rate in the years 2016-2017 and the negative impact of demographic changes. Over the projection horizon potential output growth rate will remain close to 3.7% on average. On the one hand, along with the increase in investment rate in the years 2019-2021, productive capital will grow at a faster rate, but on the other hand, the impact of factors positively affecting the labour supply up to now will decline.

The inflow of immigrants (mainly Ukrainian citizens) onto the domestic labour market, which is an additional source of labour force, has had a positive impact on the potential of the Polish economy in recent years.[59] In addition to the growing number of these employees, there is at the same time a systematic increase in their productivity, reflected, among others, in the increase in the employment share of immigrants in high productivity sectors.

Another factor which has had a positive impact on potential output in recent years have been the structural changes in the labour market, resulting in a significant improvement in the match between the demand and supply of domestic employees (Figure 4.16). A reflection of these trends is, among others, the sharp fall in the number of long-term job-seekers (over 12 months). An expression of the favourable structural changes is also the systematic growth in the labour force participation rate of pre-retirees (45-59/64 years old), which, however, is still lower compared to Western European countries. The activisation of people in this age group to a large extent has compensated for the fall in the working age population in recent years (Figure 4.19, Figure 4.17). At the same time, among people aged 45-59/64 years old the percentage of people with higher education is growing, reflecting the

Figure 4.15 Potential product (y/y, %) – breakdown



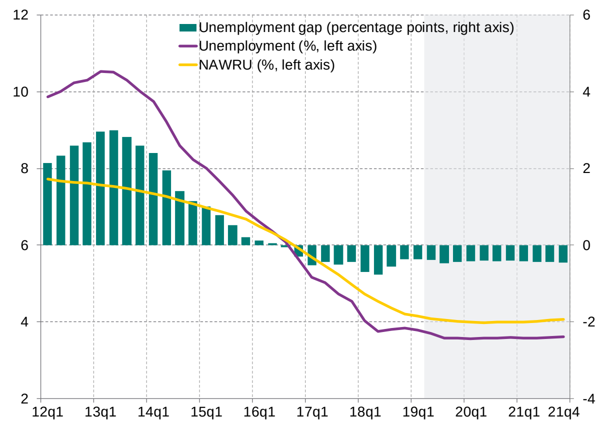
Source: NBP calculations.

Potential output growth is defined as the economic growth rate that does not cause the accumulation of inflationary pressure. It may originate from the growth of labour supply, productive capital or total factor productivity. In the NECMOD model it is estimated on the following Cobb-Douglas production function:

$PKB_t^{pot} = TFP_t^{trend} \cdot \left[LF_t^{trend} \cdot (1 - NAWRU_t)\right]^{0,67} \cdot K_t^{1-0,67}$,

where PKB_t^{pot} is the level of potential output, TFP_t^{trend} – total factor productivity, smoothed by the Hodrick-Prescott (HP) filter extended with an index of capacity utilisation, LF_t^{trend} – the number of economically active people smoothed by a HP filter, $NAWRU_t$ – non-accelerating wage rate of unemployment in the equilibrium, K_t – productive capital. The output elasticity with respect to labour was set at the level of 0.67.

Figure 4.16 Unemployment



Source: Statistics Poland (GUS) data, NBP calculations.

$NAWRU_t$ – non-accelerating wage rate of unemployment in the equilibrium

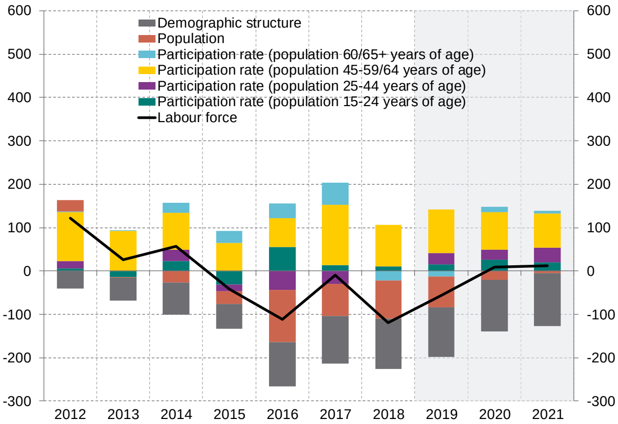
[59] Immigrants have a positive impact on the potential of the Polish economy, but due to the definition of Polish residents used in the LFS survey, they are included in the cohorts of the economically active and employed persons only to a limited extent according to this methodology. In the NECMOD model, immigrants not included in the LFS population do not, therefore, increase the labour supply, but they have an impact on the potential output through their positive impact on total factor productivity (TFP) as well as reducing the equilibrium unemployment rate (NAWRU), because they are characterised by lower wage expectations, which also lower wage pressure among Polish employees. This means that due to the inflow of immigrants, the level of the unemployment rate that does not lead to a strengthening of wage expectations (NAWRU) is lower.

improving quality of human capital that has an impact on productivity growth.

The growing innovative capacity of the Polish economy and improvement in its position in the global value chains, related to the long-term inflow of foreign direct investment and the process of real convergence, also have had a positive impact on total factor productivity growth.

Over the projection horizon potential output growth will remain close to the level of previous years. In particular, a significant increase in the contribution of productive capital to potential output is expected, following the investment rate, which has been growing since 2018. This will compensate for the fading of the positive impact of structural changes in the labour market on the supply side of the economy in the coming years. In particular, due to the planned opening of the German labour market to non-EU citizens, the number of immigrants working in Poland will probably no longer grow. In addition, the long-term unemployment rate[60] is at a record low and it is unlikely to decline as dynamically as in past years. At the same time, other positive trends – the growing innovative capacity of the Polish economy and an improvement in the quality of human capital – are expected to continue over the projection horizon at a similar rate to that of previous years.

Figure 4.17 Changes in the labour force (thous., y/y)



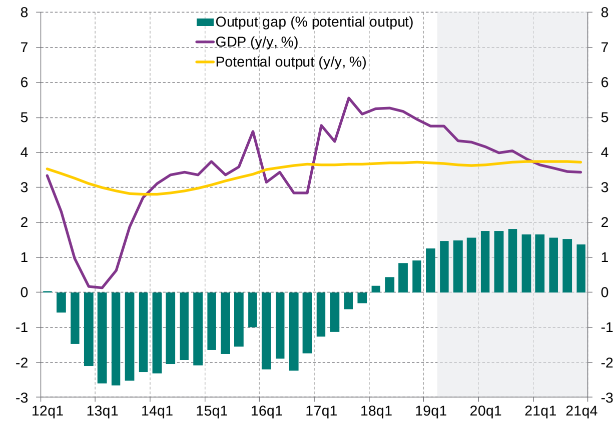
Source: Statistics Poland (GUS) data, NBP calculations.

Changes in the labour force in the chart are decomposed into those resulting from changes in the labour force participation rate in individual age groups, changes in demographic structure and changes in the total population. The impact of demographic structure determines changes in the labour force arising only from changes in the age structure of the population with an unchanged total population and constant labour force participation rate in individual age groups.

Output gap

Economic growth, which will slow down over the projection horizon, will exceed potential output growth to a lesser and lesser extent. This will result in a slowdown in the increasing demand pressure, and at the end of the projection horizon the output gap (which is a synthetic measure of demand pressure) will begin to gradually close (Figure 4.18). Aggregate demand in the Polish economy

Figure 4.18 Output gap



Source: Statistics Poland (GUS) data, NBP calculations.

The output gap is a synthetic measure of demand pressure in the economy. It is expressed as a percentage of the deviation of the actual real level of GDP from the level of potential output.

[60] According to the LFS definition, the long-term unemployment rate is the share of the unemployed seeking work for over 12 months in the economically active population.

will thus give the strongest boost to price growth in 2020.

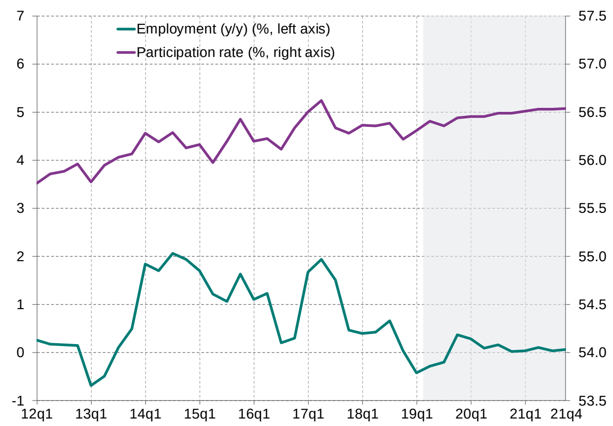
Labour market

Over the projection horizon, the currently strong demand for labour will weaken, following the expected gradual slowdown of domestic economic growth. At the same time, the potential for further growth of employment is being exhausted. The number of the unemployed who could undertake employment is currently small, which is reflected in the record low unemployment rate (Figure 4.16, Figure 4.20). Unfavourable demographic changes, which lead to a fall in the working age population, lower the effective labour supply over the projection horizon (Figure 4.17, Figure 4.19). Such labour market conditions are reflected in business surveys – the percentage of firms reporting job vacancies remains very high and since 2017 Q3 has been running above 40%.[61]

Taking into account demand and supply conditions, the growth rate of employment will decline as compared to the previous years, running at close to zero (Figure 4.19).[62] The stabilisation of the level of employment will be accompanied by moderately high growth of real wages, slightly exceeding the growth rate of labour productivity (Figure 4.21). The results of business surveys fit in with this scenario, indicating that the percentage of firms planning wage rises in 2019 Q2 was higher than a year ago and higher than the long-term average, despite a small decline compared to the previous quarter.[63]

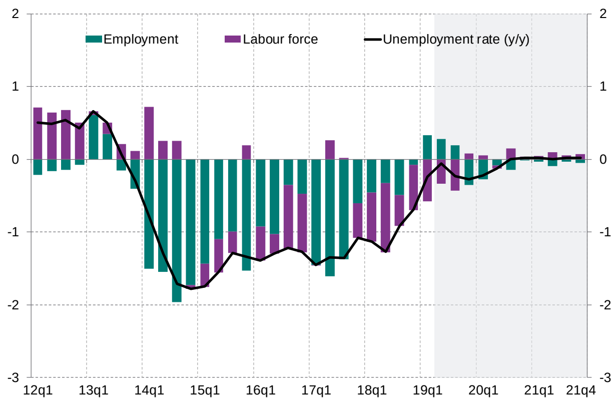
Besides falling demand for labour, over the projection horizon wage pressure will continue to be mitigated by the presence of immigrants, mainly from Ukraine. Their importance for the labour market grows along with the increase in the average length of stay in Poland and their growing

Figure 4.19 Employment and labour force participation



Source: Statistics Poland (GUS) data, NBP calculations.

Figure 4.20 Change in unemployment rate - decomposition



Source: Statistics Poland (GUS) data, NBP calculations.

[61] *NBP Quick Monitoring Survey. Economic climate in the enterprise sector,* NBP, April 2019.
[62] The expected decline in 2019 of the number of employed according to the LFS is to a large extent the result of taking into account the decline of this category in 2019 Q1, which was probably temporary.
[63] *NBP Quick Monitoring Survey. Economic climate in the enterprise sector,* NBP, April 2019.

presence in more and more sectors of the economy. On the other hand, after a partial opening of the labour market in Germany to non-EU citizens in 2020, there is a risk that some of the immigrants will leave Poland and the scale of their favourable impact on the Polish labour market will be reduced. The potential outflow of employees to Germany may, however, be compensated for by a further rise in the inflow of immigrants to Poland from outside Ukraine.

According to the July projection the cost pressure stemming from the labour market will slightly increase, as reflected in the acceleration of unit labour cost growth to close to 3% y/y in 2020-2021.

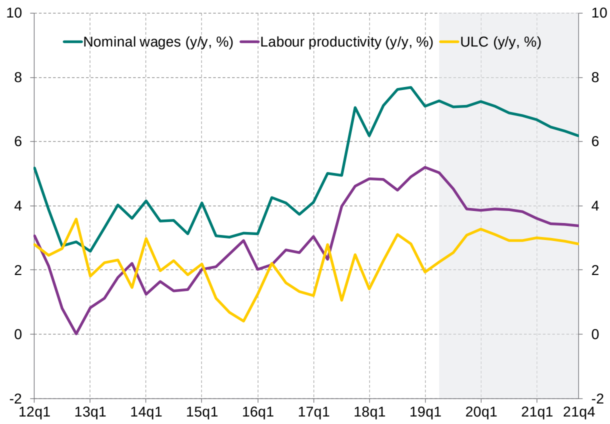
Exchange rate

In recent period the exchange rate of the zloty remained relatively stable against the currencies of Poland's main trading partners, continuing to run below the level resulting from fundamental factors. Therefore, over the projection horizon the real effective exchange rate of the zloty is expected to strengthen and gradually approach the equilibrium exchange rate. Such a scenario is supported by the assumed favourable view of the domestic economy – strong GDP growth compared to the main trading partners, a record high joint current and capital account balance and sound public finances. The growing interest rate disparity will also act in the same direction. This is due to the assumed in the projection unchanged NBP interest rates alongside an expected fall in the US interest rates and the growing likelihood of an deposit rate cut by the ECB.

CPI inflation

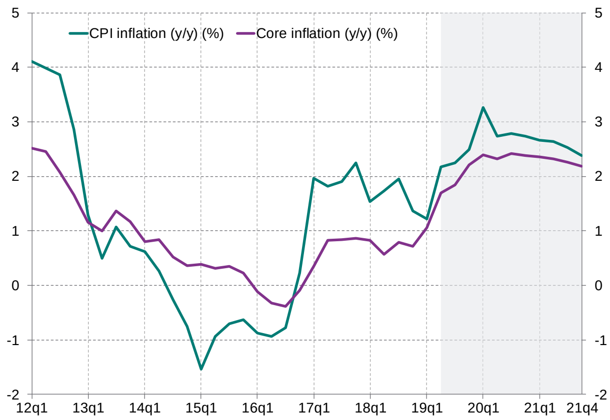
CPI inflation will accelerate compared to last year's low level (1.6%), however, it will remain within the deviation band of the inflation target over the whole of the projection horizon (Figure 4.2, Figure 4.22). Accelerating labour costs and the relatively strong demand pressure in the Polish economy, which will peak in 2020, will boost CPI inflation,

Figure 4.21 Unit labour costs



Source: Statistics Poland (GUS) data, NBP calculations.
Unit labour costs are defined as the average cost of labour per unit of output produced. They are calculated by dividing the total remuneration in the economy by the total GDP. Alternatively, they can be expressed as the quotient of the average wage and labour productivity, in other words, the relation of GDP to the number of the employed persons. Unit labor costs (ULC) presented in the chart include employers' social security contributions.

Figure 4.22 CPI and core inflation



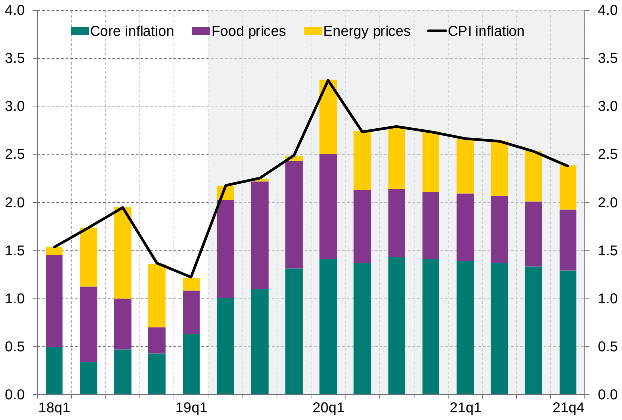
Source: Statistics Poland (GUS) data, NBP calculations.

and core inflation in particular. The scale of the acceleration in inflation will be limited by the low price growth in Poland's main trading partners (Figure 4.5), the reduction of the sensitivity of prices to changes in the domestic economic conditions observed in recent years[64] and the appreciation of the real effective exchange rate of the złoty. At the same time, the inflation path remains strongly influenced by regulatory and supply disruptions that are reflected in the forecast elevated inflation of food prices and lowered growth of energy prices in 2019 (Figure 4.23, Figure 4.24).

The higher path of food prices, particularly in 2019, is to a large extent due to the acceleration of pork prices and prices of cold meats as a result of the escalation of the ASF epidemic in China. At the same time, Statistics Poland (GUS) data indicate a cyclical reduction in the number of pigs in Poland. The fall in the number of pigs in Poland along with an expected increase in import demand from the EU to China, and as a result, from Poland to the EU (Poland cannot export pork directly to China), gives a strong boost to the growth of prices of pork and products processed from pork. While supply disruptions usually result in an increase or decrease in prices in one economic season, the expected depletion of the pig population in China may have an impact on prices in the coming years as well, due to the scale of the reduction and the time needed to rebuild the stock of pigs. Significantly higher meat prices will be accompanied in the coming months by high growth in the prices of vegetables from the last year's low harvests resulting from the drought.

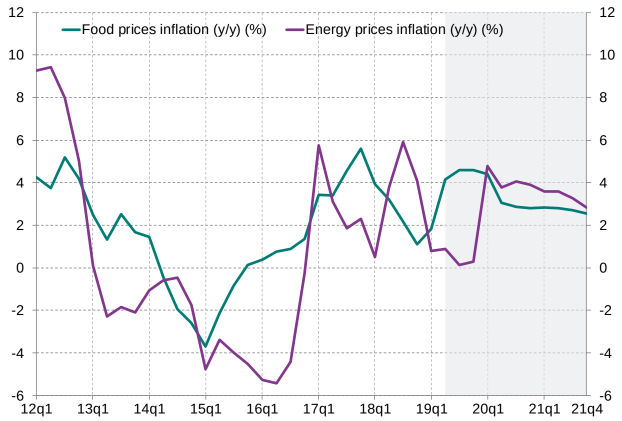
However, in 2019 the CPI inflation path will remain under the influence of the sharp decline in energy price growth, following the fall in global energy

Figure 4.23 CPI inflation (y/y, %) – breakdown



Source: Statistics Poland (GUS) data, NBP calculations.

Figure 4.24 Food and energy price inflation



Source: Statistics Poland (GUS) data, NBP calculations.

[64] The study carried out based on data on the Polish economy from the years 2002-2015 show that after 2011, in the period of low inflation and deflation, the response of CPI inflation to changes in the country's business conditions declined, which may partly be explained by structural changes in the labour market. At the same time, domestic price developments were largely shaped by the impact of external factors, reflecting the growing effect of globalisation, and changes in global commodity prices (Szafranek, Karol, 2017. Flattening of the New Keynesian Phillips curve: Evidence for an emerging, small open economy, *Economic Modelling*, Elsevier, vol. 63(C), pp. 334-348).

commodity prices, mainly oil, compared to 2018 (Figure 4.24). At the same time, inflation will be dampened by the adoption of the "Act of 28 December 2018 amending the Act on excise duty and certain other Acts". This Act aims to freeze electricity prices for end-users (including households, local government units, and enterprises), despite the increase in wholesale electricity prices in the recent period. According to the provisions of the Act, the excise tax rate and transitional fee have been permanently reduced, and a compensation system for power companies has been introduced in 2019. In the longer-term projection horizon, energy price growth will pick up, reflecting the delayed effect of higher electricity production costs, in accordance with model mechanisms and taking into account the reduced excise tax and transitional fee.

4.4 Current versus previous projection

Data released after the cut-off date of the March projection contributed to an upward revision of both the GDP growth forecast and CPI inflation path over the whole of the projection horizon (Table 4.2, Figure 4.25, Figure 4.27).

GDP

According to the results of the July projection, in the years 2019-2020 economic growth in Poland will run above the results of the previous forecasting round. In 2021, the factors that boosted the forecasts in the previous two years will to a large extent fade, and GDP growth will approach the path of the March projection.

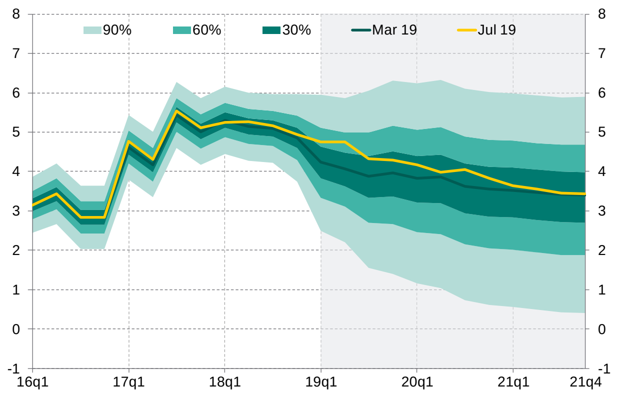
The upward revision of the country's economic growth rate in 2019 was the result of higher than expected growth recorded in 2019 Q1. According to preliminary Statistics Poland (GUS) estimates, gross fixed capital formation accelerated in 2019 Q1 to 12.6% y/y against growth of 5.9% assumed in the March projection. The marked recovery of investment proceeded mainly in the medium and large non-financial companies sector, which was

Table 4.2 July projection versus March projection

	2019	2020	2021
GDP (y/y, %)			
July 2019	4.5	4.0	3.5
March 2019	4.0	3.7	3.5
CPI inflation (y/y, %)			
July 2019	2.0	2.9	2.6
March 2019	1.7	2.7	2.5

Source: NBP calculations.

Figure 4.25 July projection versus March projection: GDP growth (y/y, %)



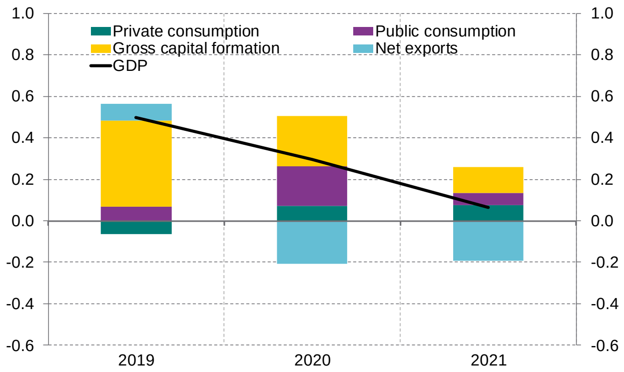
Source: NBP calculations.

21.7% higher in 2019 Q1 than a year ago. Successive figures for industrial output and construction and assembly production served as an evidence that growth of gross fixed capital formation continued at a high pace in 2019 Q2 and, as a consequence, led to an upward revision of this category also in the coming quarters.

In 2019 Q1, the growth rate of public consumption also ran above the assumptions of the March projection, as a result of the slightly stronger than expected pick-up in expenditure of local government and the state budget on wages, as well as the high growth of intermediate consumption. However, the increase in this expenditure was the result of one-off measures which will not affect the path of public consumption in the coming quarters. Similarly, the downward correction of the change in inventories to GDP growth in 2019 was the statistical effect of weaker than expected data for 2019 Q1. It was assumed that this category will return to the path of the March projection in the coming quarters, because the need to increase inventories is indicated by the rapid economic growth in 2019, while enterprises continue to report a shortage of inventories, particularly in relation to inventories of finished products.[65]

According to the results of the July projection, in 2020 GDP growth will slow down, but will continue to run above the path of the March projection. As in 2019, the growth rate of corporate investment was revised upwards, although the scale of the difference between the projections will decline next year. Public consumption growth is also higher than in the previous projection, which is mainly due to the growth in expenditure on wages in central budget currently assumed at 6% in 2020 as a result of the government decision of 11 June. These changes will partly be compensated for by the downward revision of net exports to GDP growth, which is due to faster growth of domestic

Figure 4.26 Decomposition of deviations between July and March projection: GDP growth (percentage points)



Source: NBP calculations.

The data presented in the chart may vary slightly from those in Table 4.2, due to rounding of numbers to one decimal place.

[65] *NBP Quick Monitoring Survey. Economic climate in the enterprise sector,* NBP, April 2019. The percentage of enterprises reporting a shortage of inventories is running above the long-term average.

demand, the slightly weaker macroeconomic conditions in Poland's main trading partners, and the stronger effective exchange rate of the złoty.

Inflation

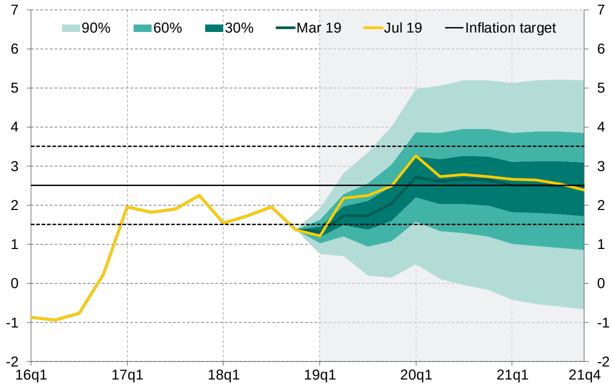
Over the whole of the July projection horizon, consumer price inflation is running above the path of the March projection. This upward revision in 2019 was mainly due to supply factors, which boosted food prices, and in the years 2020-2021, due to stronger demand impacting the growth of all the components of CPI inflation (Figure 4.28).

The upward revision of food price inflation in 2019 is mainly a result of higher meat prices. Global prices of pork have grown rapidly since April 2019 due to the ASF epidemic in China, which is the largest producer of pork in the world, forcing the largest reduction of the pig population in this country for several decades. With limited supply abroad and favourable prices for producers, the export of Polish pork will increase in 2019, leading to an increase in its price also in Poland. More expensive pork translates into higher prices of cold meats, and could also encourage some consumers to change preferences for other kinds of meat, and thus affect their prices too. The upward revision of food price inflation was also affected by the stronger reduction in the supply of vegetables resulting from the underestimation of the effects of last year's drought and losses in storage.

In 2020, taking into account the scale of the ASF epidemy in China, the determinants of supply in the meat market will probably not return to the long-term average (or the assumptions of the March projection) leading to an upward revision of food price inflation in this period as well.

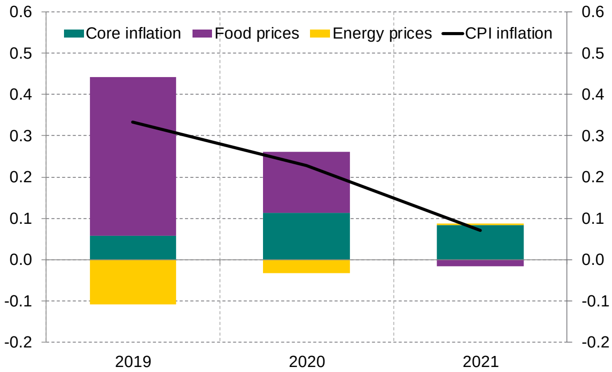
The main driver of faster CPI inflation growth in the years 2020-2021 in the July projection will, however, be the demand pressure. It is stronger than was expected in the March forecasting round, due to the upward revision of the economic growth forecast and it is acting on prices with a delay. The stronger impact of demand pressure will be

Figure 4.27 July projection versus March projection: CPI inflation (y/y, %)



Source: Statistics Poland (GUS) data, NBP calculations.

Figure 4.28 Decomposition of deviations between July and March projection: CPI inflation (percentage points)



Source: NBP calculations.

The data presented in the chart may vary slightly from those in Table 4.2, due to rounding of numbers to one decimal place.

mitigated by lower inflation abroad, curbing the growth of domestic prices and a stronger appreciation of the złoty, reflected in the lower path of import prices. The growth of import prices directly affects trade goods prices and, to a lower extent, other goods and services in the CPI basket.

4.5 Forecast uncertainty sources

The central scenario of the projection, presenting the most likely macroeconomic developments in Poland, is subject to uncertainty reflected in the fan charts (Figure 4.1, Figure 4.2). The most important source of risk for economic activity and inflation in Poland continue to be the global economic conditions. The balance of uncertainty factors in the case of both of these variables indicates a higher probability of outcomes below the central scenario (Table 4.3). With the assumption of no change in the NBP reference rate, the probability of CPI inflation running within the symmetrical band of deviations from the NBP inflation target (defined as 2.5% +/- 1 p.p. in the medium term) gradually declines to approx. 42% at the end of the projection horizon.

Table 4.3 Probability of inflation running:

	Below 1.50%	Below 2.50%	Below 3.50%	Below the central projection	In the range (1.5-3.5%)
19q2	0.03	0.82	1.00	0.50	0.97
19q3	0.15	0.65	0.97	0.51	0.82
19q4	0.18	0.52	0.85	0.51	0.67
20q1	0.09	0.29	0.59	0.52	0.50
20q2	0.22	0.46	0.72	0.52	0.50
20q3	0.23	0.46	0.70	0.53	0.47
20q4	0.26	0.48	0.71	0.54	0.45
21q1	0.28	0.50	0.73	0.54	0.45
21q2	0.30	0.52	0.74	0.55	0.44
21q3	0.33	0.55	0.76	0.55	0.43
21q4	0.37	0.59	0.79	0.56	0.42

Source: NBP calculations.

Growth prospects in the global economy

The risk of GDP growth in Poland running below the central scenario is mainly due to the possible weakening of business conditions in the world economy. Such a scenario is largely related to a further escalation of trade disputes and a decline in growth in the developed countries.

In May 2019 the US administration raised tariffs from 10% to 25% on imports from China valued at USD 200 billion. At the same time, there is an increase in the risk of 25% customs duty being imposed on yet another group of goods imported from China valued at over USD 300 billion. In response, at the beginning of June 2019 Beijing raised tariffs from 5-10% to 20-25% on US goods valued at USD 36 billion. There is also a risk that the United States will introduce customs duty on cars and car parts to a total value of USD 200 billion, which would mainly affect the European Union. Currently, the US side has postponed the decision on this matter until November 2019, provided that trade negotiations will be started in order to reduce the export of cars and car parts to the United States. President Donald Trump has also announced the introduction of customs duty on imports from other countries, including from India. An escalation of the trade conflict might result in disruptions in the global value chains, and thus a reduction in global trade. The growing uncertainty about the conditions for economic activity in the future would restrict domestic investment in countries affected by the disputes and would also lead to the emergence of tensions in international financial markets.

An escalation of trade tensions would adversely impact all parties to the conflict. In the United States the risk of lower growth is related additionally to the possibility of a sharper fall in equity prices on the US stock markets. Given the high share of financial assets in total household assets and the growing scale of issuance of risky debt instruments in the corporate sector, this would lead to a reduction in consumption and private investment through the wealth effect and a deterioration in sentiment.

The introduction of tariffs on cars by the United States would exacerbate the situation in the automobile sector in the euro area, whose value added – as estimated by the ECB – could decline by 4%.[66] Estimates of CESifo for Germany are even more pessimistic and indicate that in the case of the introduction of 25% tariffs, the value of car sales from Germany to the USA could decline by as much as 50%, which would be the equivalent of a fall in total German exports of 7.7%.[67] A weakening of global trade and an increase in uncertainty would also lead to a deterioration in activity in the remaining sectors of industry of the euro area that are geared towards export, resulting in a significant decline in economic growth in the euro area.

On the other hand, should an agreement be reached during the expected negotiations on the imposition of tariffs on cars by the USA, this could lead to an improvement in the economic conditions in the euro area, including in Germany. A better financial situation of the state budget would support the continuation of the fiscal stimulus launched in 2019, leading to further growth of household purchasing power. According to announcements of the minister of finance, in 2019 an increase in spending is planned to the value of 0.5% of GDP, as well as a tax reduction to the value of 0.2% of GDP. There will also be changes to wage growth in the public sector as well as an increase in family allowances and a reduction in health insurance and unemployment insurance contributions. The possible stronger effects of the introduction of the fiscal stimulus in 2019 and the continuation of these measures in coming years might boost private consumption by increasing household disposable income. An increase in consumption would improve sentiment and indirectly rise the remaining components of domestic demand, and as a result, the whole of GDP in the German economy. More favourable business conditions abroad, particularly at Poland's most important trading partner, would support an acceleration of economic growth and a higher inflation path than in the central projection.

Another, this time negative, risk for economic activity in the environment of the Polish economy is a no-deal Brexit. Should this scenario materialise, the immediate establishment of customs controls and a sudden change in the rule for conducting activity would result in an increase in uncertainty and a slowdown in GDP growth, both in the United Kingdom and – to a lesser extent – in the EU.

Labour supply in Poland

One of the sources of risk for the central scenario is the assumed number of immigrants, above all from Ukraine, working in Poland over the projection horizon. Migrant flows will be determined by both the situation in the domestic labour market and the economic situation abroad, as well as changes in the immigration policy of other EU countries, in particular, Germany. In June 2019, the Bundestag passed a bill giving

[66] *Economic Bulletin*, ECB, March 2019.
[67] *Effects of new US auto tariffs on German exports and on industry value added around the world.* IFO Institute 02.2019, http://www.cesifo-group.de/dms/ifodoc/docs/pr/pr-PDFs/201902-Felbermayr-Steininger-Automotive-Tariffs.pdf

skilled workers from outside the EU easier access to the German labour market and sent it to the upper house of parliament. The bill will most likely enter into force at the beginning of 2020, encouraging Ukrainian workers on the territory of Poland to re-emigrate. The potential outflow of Ukrainian migrants to Germany would lead to a reduction in labour supply in Poland and to an increase in wage growth. At the same time, it cannot be ruled out that this outflow might be compensated for by a stronger inflow to Poland of migrants from other countries, including from outside Europe.

Fiscal policy

In the case of a higher path of economic growth abroad than currently projected, which would translate into faster economic growth in Poland, an improvement in the level of general government revenues could also be expected. The favourable impact of these conditions on the balance of the sector may, however, be partly offset by the one-off thirteenth-month pension and disability pension payment in 2020 and subsequent years, which – according to the earlier announcements by the government – is dependent upon the financial situation of the state budget. The government officials' statements indicate that the scale of the reduction in personal income tax may be slightly higher than the estimates presented in the "Convergence Programme" in April 2019, which were included in the baseline scenario of the July projection. A stronger recovery in the domestic economy could also be associated with higher wage pressure, which would translate into higher wage growth in the public sector. Such changes would lead to faster growth of public and private consumption through raised disposable income of the population and improved sentiment of households. This in turn would have an indirect positive effect on investment. The implementation of the above mentioned fiscal changes could positively affect economic growth and contribute to an increase CPI inflation in 2020-2021.

Prices of energy commodities and the impact of determinants of the energy sector on inflation in Poland

Changes in global prices of oil and of other energy commodities, as well as contract prices of natural gas imported from Russia continue to be a significant source of risk for the inflation path in the baseline scenario of the projection. Uncertainty stemming from the changes in the regulations concerning electricity prices for end-users also remains valid.

Currently, uncertainty concerning energy commodity prices in the projection horizon is to a large extent related to the size of demand for these commodities, which, in turn, depends on global economic conditions. The imposition of tariffs on goods imported from China by the United States and its tentative announcements of continued tightening of tariff barriers have already pushed down the prices of oil on global markets. A possible escalation of trade conflicts leading to lower economic growth around the world would entail reduced energy commodities prices also in the coming years. On the other hand, the current statements by OPEC countries' representatives point to a possible reduction in the extraction of oil, and hence a risk of hikes in the prices of this commodity. An escalation of tensions between the US and Iran could also act in the same direction.

As regards the domestic energy market, there persist risks related to the lack of implementing acts to the law freezing the tariffs for electricity, which was passed in December 2018. The need to adopt another amendment to it also cannot be ruled out, due to possible objections by the European Commission possibly considering the compensation system as illegal state aid. Additionally, the government continues working on bill introducing compensation payments for energy-intensive sectors of industry in the event of energy price hikes. The act is likely to come into force before the end of 2019. The above amendments to legislation may change the path of energy prices assumed in the projection, and, indirectly, that of other components of consumer prices.

Another risk factor acting towards a relatively lower path of energy prices in the current projection is the possible conclusion of the negotiations between PGNiG and Gazprom over the reduction of natural gas prices, which started almost 5 years ago. The previous round of negotiations ended in 2012 with a significant price decrease. Currently it is also expected that as a result of the arbitration settlement conducted before the Arbitration Tribunal in Stockholm, the prices of imported natural gas in Poland will decline over the projection horizon. However, due to the lack of a rigid time frame in which the arbitrage should be settled, it is still hard to predict the time as well as the scale of any possible fall in prices.

Table 4.4 Central path of inflation and GDP projection

	2017	2018	2019	2020	2021
Consumer Price Index CPI (%, y/y)	2.0	1.6	2.0	2.9	2.6
Core inflation net of food and energy prices (%, y/y)	0.7	0.7	1.7	2.4	2.3
Food prices (%, y/y)	4.2	2.6	3.8	3.3	2.7
Energy prices (%, y/y)	3.2	3.6	0.5	4.1	3.3
GDP (%, y/y)	4.9	5.1	4.5	4.0	3.5
Domestic demand (%, y/y)	4.9	5.5	4.9	4.4	3.7
Household consumption (%, y/y)	4.5	4.5	4.4	4.4	3.8
Public consumption (%, y/y)	2.9	4.7	5.4	4.4	3.4
Gross fixed capital formation (%, y/y)	4.0	8.7	8.6	4.8	2.6
Contribution of net exports (percentage points, y/y)	0.3	-0.2	-0.2	-0.3	-0.1
Exports (%, y/y)	9.5	6.3	5.4	4.9	5.0
Imports (%, y/y)	9.8	7.1	6.1	5.6	5.4
Gross wages (%, y/y)	5.3	7.2	7.2	7.0	6.4
Total employment (%, y/y)	1.4	0.4	-0.1	0.1	0.1
Unemployment rate (%)	4.9	3.9	3.7	3.6	3.6
NAWRU (%)	5.3	4.5	4.1	4.0	4.0
Labour force participation rate (%, y/y)	56.4	56.3	56.4	56.5	56.5
Labour productivity (%, y/y)	3.5	4.8	4.7	3.9	3.5
Unit labour cost (%, y/y)	1.9	2.4	2.5	3.1	2.9
Potential output (%, y/y)	3.7	3.7	3.7	3.7	3.7
Output gap (% potential GDP)	-0.8	0.6	1.4	1.7	1.5
Index of agricultural commodity prices (EUR; 2011=1.0)	0.90	0.86	0.92	0.94	0.96
Index of energy commodity prices (USD; 2011=1.0)	0.62	0.77	0.58	0.59	0.60
Inflation abroad (%, y/y)	1.3	1.7	1.8	1.8	1.8
GDP abroad (%, y/y)	2.4	1.9	1.2	1.4	1.4
Current and capital account balance (% GDP)	1.4	1.3	1.4	1.4	1.2
WIBOR 3M (%)	1.73	1.71	1.72	1.72	1.72

Source: Bloomberg, Eurostat, Statistics Poland (GUS), NBP calculations.

LFS data on total employment, labour force participation rate and unemployment rate. Index of agricultural 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.

5. The voting of the Monetary Policy Council members in February – mid-May 2019

■ Date: 29 April 2019

Subject matter of motion or resolution:
Resolution No. 1/2019 of the Monetary Policy Council of 29 April 2019 on approving the Annual Financial Report of the National Bank of Poland prepared as of 31 December 2018.

Voting of the MPC members:

For:		Against:	
	A. Glapiński		E. Gatnar
	G. M. Ancyparowicz		Ł. J. Hardt
	E. M. Łon		J. J. Kropiwnicki
	E. J. Osiatyński		K. Zubelewicz
	R. Sura		
	J. Żyżyński		

■ Date: 14 May 2019

Subject matter of motion or resolution:
Resolution No. 2/2019 of the Monetary Policy Council of 14 May 2019 on approving the Report on monetary policy in 2018.

Voting of the MPC members:

For:		Against:	
	A. Glapiński		
	G. M. Ancyparowicz		
	E. Gatnar		
	Ł. J. Hardt		
	E. M. Łon		
	E. J. Osiatyński		
	R. Sura		
	K. Zubelewicz		
	J. Żyżyński		

J. J. Kropiwnicki was absent.

Date: 14 May 2019

Subject matter of motion or resolution:

Resolution No. 3/2019 of the Monetary Policy Council of 14 May 2019 on evaluation of the activities of the NBP Management Board as regards the implementation of monetary policy guidelines for 2018.

Voting of the MPC members:

For:	**Against:**
A. Glapiński G. M. Ancyparowicz E. Gatnar Ł. J. Hardt E. M. Łon E. J. Osiatyński R. Sura K. Zubelewicz J. Żyżyński	

J. J. Kropiwnicki was absent.

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