



N a t i o n a l B a n k o f P o l a n d

Monetary Policy Council

Warsaw, 28 July 2004

INFORMATION FROM A MEETING OF THE MONETARY POLICY COUNCIL

Held on 27-28 July 2004

The annual inflation rate rose in June 2004 to 4.4%, significantly surpassing the upper limit of the MPC accepted deviations from the inflationary target. A high growth level of the PPI indicator (9.2%) was maintained. There were also strong increases in all measurements of the inflation base rate from a level of 2.0% - 3.7% in May 2004 to 2.3% - 4.5% in June 2004.

The acceleration of inflation was foremost a result of the increase in the price of fuel and foodstuffs, an increase in tax rates for indirect taxation and other factors connected with Poland's EU entry, including an increase in the demand for Polish foodstuffs. An increase in all the inflation measurements in the last few months is accompanied by a significant increase in household inflationary expectations, of entrepreneurs and traders. It is especially worrisome that there is a strong increase in household inflationary expectations which occurred even before the publication of inflation data for June 2004.

The data on economic activity in June confirms a high economic growth rate. The Central Statistical Office (GUS) study of the July general condition indicate that there is an increase of optimism in industry and construction, large enterprises and exporters are signalling investment increases. Also, July 2004 NBP analyses of the general condition of enterprises confirm a growing trend in investment activity. Moreover, for the first time since 1998, the percentage of enterprises planning an increase in employment exceeded the percentage of entities intending to make reductions. There has also been the appearance of signs evidencing plans for greater foreign direct investments in Poland, which together with the start of funding from EU structural funds and the Cohesion Fund should contribute to the maintenance of a high economic growth rate.

A significant growth in inflationary expectations together with an increasing likelihood of maintaining high economic growth increases the risk of persistent higher inflation. The salaries growth rate in the economy will be a significant factor in the formation of future inflation. Even though up to now an increase in salaries remained at a moderate level, there is an appearance of signs evidencing an increase in salaries demand, which may lead in future to higher salary increases.

Endeavouring that the increased inflation above the upper limit of permissible deviations from the inflationary target has a transitory character and that, after the expiry of transitory factors, inflation should return to a level that is in conformity with the inflationary target of the MPC (2.5%), **the Council has decided to raise the NBP rates by 0.25 percentage point to the level of:**

- **reference rate 6.0% on an annual basis;**
- **lombard rate 7.5% on an annual basis;**
- **deposit rate 4.5% on an annual basis;**
- **rediscount rate 6.5% on an annual basis.**

The Council maintains its restrictive monetary policy stance. The resolutions of the MPC come into force as of 29 July 2004.

I. Factors favouring a low inflation rate:

- There was a lower credit growth rate for enterprises; its annual growth rate in June 2004 was – 2.8% as against –2.3% in May 2004. Credit demand of enterprises may be limited by the high level of their own financial resources at their disposal; enterprises increased in June 2004 the level of their deposits within the banking system by nearly PLN 4 bn.
- High increase in labour efficiency is maintained; in June 2004 it rose in industry as a whole on an annual basis by 15.9% (12.8% in May 2004) and in industrial processing by 17.2% (by 14% in May 2004).
- High level of unemployment is maintained, which in light of the latest data continues to limit the growth rate in salaries.
- There has been a significant strengthening of the zloty exchange rate in the last two months, which as long as it becomes persistent will have an effect in the direction of limiting inflation.

II. Factors giving rise to the risk of inflation growth:

- From the beginning of this year there is an increase in household inflationary expectations. Inflation rate expectations of individuals within the next 12 months, despite an improvement in the structure of expectations, rose in July 2004 to 4%, i.e. by 1.3 percentage point more than in June 2004 due to an increase in the current inflation rate.

There was a substantial increase in the uncertainty of bank analysts across all horizon measurements. The inflation forecast for the next 11 months increased by 0.1 percentage point (2.8%), the average annual inflation forecast in 2005 increased by 0.4 percentage point (3.2%), while the strongest increases were in the short-term forecasts – analysts forecast that the annual inflation rate at the end of 2004 will amount to 4.0%, i.e. by 1 percentage point more than in the previous month. Both surveys were conducted at a time when the level of inflation for June 2004 was still unknown.

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As well, NBP analyses of enterprises for a second quarter show that they are significantly increasing their expectations of price increases in the economy (CPI and PPI); in the course of Q2 the CPI indicator forecast rose by 0.7 percentage point.

There are also further price increase expectations in retail trade. In GUS studies traders are signalling further goods price increases, including further foodstuff price increases.

- Producer price inflation amounted to 9.2% in June 2004 on an annual basis as against 9.6% in May 2004. Producer prices from the beginning of the year are formed chiefly under the influence of oil and metals prices. Inflation is increasing on producer prices for domestic sales.
- June 2004 was a further month of a high growth rate in sold industrial output. Industrial production as a whole rose by 15.7% on an annual basis, while for the processing industry by 17.8%. This confirms persistent economic growth. Maintenance of a growth trend in the economy is also indicated in the GUS July survey of the general condition. There was improvement in the assessment of the general condition in the processing industry in comparison with the previous month and taking into account seasonal fluctuations it was the highest in the entire period studied, i.e. from 1992. There was also an improvement in the assessment of the general condition in construction.

NBP analyses indicate that in Q3 of 2004 the growth rate will be somewhat slower than in Q2 but the general condition will still be maintained at a high level. Large enterprises and exporters are signalling an increase in investment, while entrepreneurs offering their products and services exclusively domestically are expecting further increase in new orders. An impulse for investments, but also increasing inflationary pressure, may become the continually growing level of production capacity utilisation, which at the end of Q2 achieved 80.7%, the highest level in the history of polled studies. According to initial NBP estimates the increase in the 2004 Q2 GNP will amount to about 6.0%.

- Monetary policy is conducted together with a loose fiscal policy and with a lack of clear perspectives as to the scale of reforms, which would lead to a recovery of public finances and a future limitation of the public deficit.
- High oil prices are maintained, while the forecast prices of this raw material have again been raised. The current forecasts of the annual average oil price in 2004 were increased by 0.6 USD/b in comparison with the June 2004 forecast. From September 2003 to July 2004 the forecast prices increased from 26.0 USD/b to 34.9 USD/b.
- Foodstuff prices rose in June 2004 by 2.7%, while inflation for foodstuffs amounted to 8.1% on an annual basis. In the first half of July 2004 the price of foodstuffs did not change in comparison with the first half of June 2004. It is assessed that the seasonal drop in prices will be limited because of a renewed and maintained foreign demand for Polish foodstuff products.

The next meeting of the Council will take place on 24-25 August 2004.