

Warsaw, 26 July 2006

## INFORMATION FROM THE MEETING OF THE MONETARY POLICY COUNCIL

held on 25-26 July 2006

**The Council decided to keep the NBP interest rates unchanged, i.e.:**

- **reference rate 4.00% on an annual basis;**
- **lombard rate 5.50% on an annual basis;**
- **deposit rate 2.50% on an annual basis;**
- **rediscount rate 4.25% on an annual basis.**

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Since the Council's meeting in June 2006, the forecasts of inflation and economic growth for 2006-2007 in the euro area have been slightly revised upwards. In the United States the inflation forecasts for 2006 have been slightly revised upwards, while the economic growth forecasts for 2007 have been revised downwards. In June, the annual growth of consumer prices remained at an increased level both in the euro area (2.5% in June and May) and in the United States (4.3% against 4.2% in May). Since the June meeting of the Council current crude oil price has increased by USD 4.9 (i.e. by 7%), while the price of this commodity forecast for 2006-2007 has remained largely unchanged.

The June data on industrial output, construction and assembly output and retail sales in Poland indicate a continuing fast economic growth in 2006 Q2, close to that recorded in 2006 Q1. The rise in industrial output in June 2006 was higher than expected both by the NBP and external forecasters, reaching 12.4% y/y (compared with 19.1% y/y in May). In seasonally adjusted terms, the growth in industrial output in June amounted to 13.8% y/y (compared to 15.6% y/y in May). Also significantly higher than expected proved the increase in construction and assembly output, reaching 15.7% y/y against 13.4% y/y in May, which in seasonally adjusted terms corresponds to 10.8% y/y, compared to 7.0% y/y. Retail sales saw a continued high increase (10.7% y/y in nominal terms as compared to 13.7% y/y in May).

The growth of household lending has continued at a robust pace: the growth in consumer loans in June accelerated to 22.6% y/y (as compared with 19.2% y/y in May), while the growth rate of housing loans stepped up to 53.0% y/y (as compared with 48.2% y/y in May), which might have been related to the announced introduction of more stringent criteria of granting foreign currency loans. Corporate lending growth saw an increase (from 4.1% y/y in May to 5.1% y/y in June), though it remains moderate.

The fast economic growth increases the demand for labour. Since December 2004 the growth of corporate sector employment has been constantly accelerating. In June 2006, employment

growth in enterprises reached – as in May 2006 – 3.1% y/y. According to labour office data, in June 2006 the registered unemployment rate slid to 16.0% compared with 18.0% a year before.

In June 2006, the growth in the corporate sector's nominal wages amounted to 4.5% y/y (compared to 5.2% y/y in May). According to NBP estimates after adjustment for the impact of shifts in one-off components of wages in certain sections, the wage growth in enterprises equalled 4.9% y/y. The signals of wage pressure in the public sector persist. It should be emphasised that a necessary condition for a sustained acceleration of economic growth which would not pose a threat to the achievement of the inflation target is that the growth in wages does not outpace the growth in labour productivity. This requires strong and productivity-oriented corporate governance in enterprises.

The annual growth of consumer prices in June was slightly below the expectations of external forecasters and the NBP, and reached 0.8% (against 0.9% y/y in May). This slight decrease in the annual inflation rate in relation to May 2006 was mainly driven by the fall in prices of food and non-alcoholic beverages, mainly fruit and vegetable prices. Core inflation indicators remained low (in June core inflation indicators ranged between -0.5% y/y and 1.0% y/y). The low level of all core inflation indices indicates that inflationary pressure remains contained. July brought a slight increase of the inflation expectations of households (to 0.8% y/y from 0.6% y/y in June). According to GUS business tendency surveys, the expected prices of industrial and construction & assembly output have been gradually increasing since the beginning of 2006.

In June 2006 the growth in producer prices in industry (PPI) saw a marked acceleration to 2.8% y/y from 2.3% y/y in May, i.e. 0.8% m/m against 0.4% m/m in May, which resulted to a large extent from increased growth of producer prices in manufacturing. The rise in annual growth of PPI occurred despite the 1.1% (y/y) stronger effective exchange rate of the zloty.

The inflation and GDP projections, which are presented in *Inflation Reports*, are one of the inputs to the monetary policy decisions.

According to the NBP staff projection of inflation and GDP, which will be presented in the July *Inflation Report*, with 50% probability the annual GDP growth will be in the range of 4.7-5.3% in 2006 (against 3.9-5.0% in the April projection); 3.6-5.9% in 2007 (against 3.4-5.8%) and 4.0-6.6% in 2008 (against 3.5-6.2%).

The July inflation projection indicates that inflation will be higher throughout the whole projection horizon than was expected in the April *Report*. With the assumption of unchanged interest rates, with 50% probability inflation will be within the range of 1.0-1.9% in 2006 Q4 (against 0.5-2.0% in the April projection), 1.5-3.5% in 2007 Q4 (against 1.3-3.4%) and 1.7%-4.3% in 2008 Q4 (against 1.2-3.9%).

It should be emphasised that, in the opinion of the authors of the projection, the inflation projection presented in the *Report* does not account for all sources of uncertainty. This primarily applies to the scale of the future impact of globalisation on inflation, the impact of global imbalances on the world economic growth, the growth of workforce, the effect of drought in Poland on food prices, the shape of economic policy in the coming years, in particular, the effect of increased wage pressure on public finance in Poland and the exchange rate developments. Besides, the projection was prepared on the basis of data available until 23 June 2006 and thus does not account for crude oil prices, which are higher than those assumed in the projection, higher estimates of GDP in 2006 Q2 and slightly lower than forecast CPI in 2006 Q2. However, net inflation in 2006 Q2 was consistent with the July projection.

Having considered the latest data and the July inflation projection, the Council confirms the view expressed at its meeting in June that the probability of inflation running, in the monetary policy transmission horizon, above the level assessed in the April projection has increased.

In the Council's opinion, the current fast economic growth creates favourable conditions for reducing the public finance imbalance, which would reinforce the long-term economic growth at a

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high level. The Council maintains its view that implementing an economic strategy focused on creating conditions which ensure the introduction of the euro at the earliest possible date would be most favourable for Poland and would contribute to higher long-term economic growth.

The next meeting of the Council will be held on 29-30 August 2006.