

Warsaw, 25 October 2006

INFORMATION FROM THE MEETING OF THE MONETARY POLICY COUNCIL

Held on 24-25 October 2006

The Council decided to keep the NBP interest rates unchanged:

- **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.**

Since the meeting of the Council in September 2006 the forecasts of economic growth in the euro area for 2006 have been raised, while the forecasts for 2007 have remained unchanged. In the United States the economic growth forecasts for 2006 have not changed, while the forecasts for 2007 have been slightly lowered. The forecasts of inflation in the euro area for 2006-2007 have not changed significantly. The forecasts of inflation in the United States for 2006 have remained unchanged while the forecasts of inflation for 2007 have been slightly revised downwards. September marked a decrease in the annual growth of consumer prices: to 1.7% (from 2.3% in August) in the euro area and to 2.1% y/y (from 3.8% y/y) in the United States. The decline of inflation in the euro area and the United States has been largely driven by a decrease in crude oil prices. Since the September meeting of the Council the price of crude oil has decreased by USD 4.0 (i.e. 6.6%), while the oil price forecast for 2006-2007 has not changed significantly (according to the analysts polled by the Reuters).

GUS data for July-September 2006 on industrial output, construction and assembly production and retail sales indicate that high economic growth continued in 2006 Q3. The rise in industrial output in September 2006 was consistent with the expectations of the NBP and reached 11.7% y/y (as compared with 12.6% y/y in August). In seasonally adjusted terms, the growth in industrial output in September amounted to 13.8 % y/y (as compared to 12.9% y/y in August). The growth in construction and assembly production accelerated to 21.1% y/y as compared to 15.3% y/y in August, and to 20.9% y/y as compared to 14.8% y/y in seasonally adjusted terms, thus exceeding the NBP's expectations. The growth of retail sales increased (to 14.5% y/y in nominal terms, as compared with 11.5% y/y in August). According to the preliminary assessments of GUS GDP growth in 2006 Q3 should not be lower than in 2006 Q2 (i.e. reached at least 5.5% y/y).

Growth of lending to households has accelerated: in September growth of consumer loans accelerated to 20.4% y/y (against 19.6% y/y in August), while growth of housing loans rose to 55.9% y/y (as compared with 51.2% y/y). Growth of corporate lending has been accelerating since April (to 9.5% y/y in September from 3.4% y/y in April). The acceleration of corporate lending growth, which came despite the fact that enterprises held substantial own funds resulting from their very good financial results, may point to a further rise in investment growth.

Strong economic growth is accompanied by a rapid increase in labour demand. Since December 2004 the employment growth in the corporate sector has been accelerating – in September the growth of employment in enterprises amounted – similarly to August - to 3.5% y/y. According to the labour office data, in September 2006 the registered unemployment rate slid to 15.2% from 17.6% a year before.

Economic growth is accompanied by a high growth of wages. In the enterprise sector, in September 2006 nominal wages rose by 5.1% y/y as compared with 5.3% y/y in August. Strong economic growth which would not pose a threat to the achievement of the inflation target can only be sustained on the condition that the growth in wages does not outpace the growth in labour productivity. This requires strong and productivity-oriented corporate governance in enterprises, which is usually more easily attained under private ownership. This also requires wage discipline in the public sector.

In September the annual growth of consumer prices stood – similarly to August – at 1.6% and was slightly lower than expected by external forecasters and the NBP. Thus, inflation stayed slightly above the lower limit for deviations from the inflation target. Acceleration in the annual growth of prices of food and non-alcoholic beverages coupled with a decline in fuel prices were the main drivers behind the unchanged against the previous month annual growth of consumer prices. Core inflation indicators remained similar as in the previous month. In September core inflation indicators ranged between 1.0% y/y and 1.4% y/y, and net inflation stood at 1.4%. October was another consecutive month which marked a rise in inflation expectations of households (1.6% y/y against 1.3 % y/y in September and 0.8% y/y in August). In October, inflation in 11 months as forecasted by commercial bank economists was 2.2% against 2.3% a month before. According to GUS business tendency survey, the expected prices in retail sales, prices of industrial production as well as construction and assembly output have been gradually increasing since the beginning of 2006.

In September 2006 the annual growth of producer prices in industry amounted to 3.6% y/y compared with 3.3% y/y in August (i.e. -0.1% m/m, similarly to August), while the growth of producer prices in manufacturing reached 1.7% y/y against 1.5% in August. The nominal effective exchange rate of the zloty in September was close to the level a year ago.

The Monetary Policy Council got acquainted with the projection of inflation and GDP prepared by the NBP staff, which will be presented in the October *Inflation Report*. According to the projection, there is a 50% probability that the annual growth of GDP will be within the range of 5.2-5.5% in 2006 (against 4.7-5.3% in the July projection); 4.1-6.2% in 2007 (against 3.6-5.9%) and 4.5-7.0% in 2008 (against 4.0-6.6%).

The October inflation projection indicates that over the whole projection horizon inflation will be higher than forecasted in the July *Report*. Assuming unchanged interest rates, there is a 50% probability that inflation will be within the range of 1.8-2.2% in 2006 Q4 (against 1.0-1.9% in the July projection), 1.9-3.8% in 2007 Q4 (against 1.5-3.5%) and 2.2%-4.6% in 2008 Q4 (against 1.7-4.3%).

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 possibility of markedly higher than expected in the projection wage increase and the shape of economic policy in the coming years. Besides, the October projection was prepared on the basis of the data available until 28 September 2006 and thus does not account for crude oil prices, which are lower than those assumed in the projection. The estimates of both GDP and CPI inflation in 2006 Q3 were close to those assumed in the projection, while net inflation in 2006 Q3 was consistent with the projection.

The latest data have confirmed that in 2006 Q3 both headline and “net” inflation were higher than expected in the July inflation projection. In this way, headline inflation was close to the lower limit for deviations from the inflation target. New data and the October inflation

projection suggest that in the medium-term inflation may prove higher than assessed in the previous meeting.

In the opinion of the Council, the currently observed strong economic growth creates favourable conditions for the implementation of reforms which would permanently contain the public finance imbalance. The Council maintains its belief that it would be the most favourable for Poland to adopt an economic strategy focused on creating conditions that would guarantee the introduction of the euro at the earliest possible date. The restraining of public finance imbalance would per se and by creating conditions for the introduction of the euro contribute to higher long-term economic growth.

At its meeting on 19 October 2006 the Council decided that starting from the next *Inflation Report* (January 2007) the format of the chapter "*Monetary Policy*" (chapter III of the *Inflation Report*) will be modified. The new format of the chapter will make it possible to present in greater detail the views expressed at the Council's meetings against changing economic developments, thus bringing it closer to the practice of many central banks (*minutes*).

The Council approved *The Balance of Payments of the Republic of Poland in 2006 Q2*.

The next meeting of the Council will be held on 28-29 November 2006.