

Warsaw, 27 April 2005

INFORMATION FROM THE MEETING OF THE MONETARY POLICY COUNCIL Held on 26-27 April 2005

The Council decided to reduce the NBP interest rates by 0.5 percentage point to the following levels:

- **Reference rate 5.5% on an annual basis**
- **Lombard rate 7.0% on an annual basis**
- **Deposit rate 4.0% on an annual basis**
- **Rediscount rate 6.0% on an annual basis,**

The Council adopted a neutral monetary policy bias.

In March 2005, the consumer confidence indicators in the euro area and the United States deteriorated, which resulted mainly from a strong growth of crude oil prices and their persistently high level in February and March 2005. High oil prices contributed also to a worsening of economic climate in the enterprise sector, which was particularly visible in the euro area, and to an increase in the dynamics of producer prices in industry in the United States and most euro area economies. International forecasting agencies revised upwards oil price forecasts for the coming years. According to their current forecasts, the years 2006 and 2007 will see these prices decrease on a smaller scale than previously expected.

In April the return on American securities fell, increasing the relative profitability of portfolio investments in the developing countries and in the new EU member states.

In March, Poland saw a decline in industrial output dynamics, which was deeper than expected (drop of 3.7% y/y). Negative annual industrial output dynamics was mainly related to the high level of production in March 2004 (then the growth stood at 23.5% y/y) and a smaller number of working days as compared to the previous year. After seasonal adjustment, the production decline reached 1% y/y and 1.6% m/m.

As expected in the February *Inflation Report*, considering moderate consumption dynamics and a probably neutral contribution of net exports to GDP growth, investment is the key factor for the outlook for economic growth and inflation. The investment in enterprises (9.2% y/y increase) was a dynamic factor behind last year's investment growth of 5.1% y/y, with a particularly strong growth recorded in the group of medium-size enterprises. Despite lower output dynamics in the construction and assembly sector, partly due to unfavourable weather conditions, construction site development companies noted a considerable output growth which, combined with positive assessments of investment plans signalled in the business climates surveys of the National Bank of Poland, indicates continuation of investment recovery. However, other business climate surveys suggest that the assessment pointing to stabilisation or deterioration of the current business conditions prevails and they also indicate that expectations of the future economic activity are not unambiguous.

Upon analysis, the available data for 2005 Q1 confirm earlier expectations according to which the GDP growth in 2005 Q1 was lower than in 2004 Q4 and lower than it was accounted for in the February *Inflation Report*.

The available data signal a gradual improvement in the labour market. The registered unemployment rate fell from 19.4% in February to 19.3% in March 2005, and was down by 1.1 percentage point, as compared to the corresponding period last year. In March 2005 the employment in the corporate sector stabilised and was higher by 1.6% y/y. The growth rate of nominal wages in the corporate sector was still low and stood at 2.2% y/y, which means a drop of 1.2% y/y in real terms and confirms a lack of wage pressure in enterprises.

In March 2005, the consumer prices dynamics stood at 3.4% y/y, which was below the upper limit for deviations of the inflation target. March's inflation decline was driven mainly by lower annual food and non-alcoholic beverage price dynamics. A drop was also recorded in most core inflation indicators except for net inflation which increased to 2.4% y/y from 2.3% in February. The fall in the current inflation as well as the shrinking gap between inflation measured with the price index of consumer goods and services and core net inflation both confirm the disappearance of transitory factors which contributed to inflation increase in 2004. Moreover, April 2005 saw a further decrease in households' inflation expectations (down to 3.0% from 3.4% in March 2005). The downward trend in the producer prices in industry started last year has continued. In March, the annual dynamics of those prices amounted to 2.2% y/y (compared with the revised downward 3.2% y/y in February 2005). The data on inflation in 2005 Q1 and the latest food price forecasts suggest the likelihood of inflation rate running lower in the years 2005-2006 than presented in the February *Inflation Report*. This assessment may be adjusted following commodity price developments in the world markets, and oil price movements in particular. At the same time, a further increase in oil prices may additionally weaken GDP growth.

The exchange rate developments in April 2005 have been broadly consistent with the path accounted for in the February *Report*. The developments of the exchange rate may be affected by the situation in the international financial markets and the uncertainty related to the pre-election period.

The Council is concerned about numerous legislative proposals put forward in the recent months which may result in an increase in the general government deficit and, in consequence, a postponement of the fulfilment of the euro area membership criteria. The uncertainty concerning the prospects for public finance reforms and the extent of the implementation of other necessary structural reforms is a significant risk factor for inflation.

In the Council's assessment, the balance of risks for future inflation is more favourable than presented in the February inflation projection. In March the signals of food price dynamics falling faster than expected were confirmed. Compared to March, the likelihood of the GDP growth in 2005 being lower than projected in the February *Report* has increased. Moreover, strong wage discipline in the enterprise sector has continued. In the Council's assessment, starting from 2005 Q3 inflation may stay below the inflation target for a few quarters. At the same time, the Council recognizes the risk of a stronger inflationary pressure in the longer term, related to the revision of the oil price forecasts which are, however, subject to considerable uncertainty.

The next meetings of the Council will be held on 17 May 2005 (when the *Report on monetary policy implementation in 2004* and the *NBP Annual Report for 2004* will be discussed) and on 24-25 May 2005.