

Warsaw, 27 July 2005

## INFORMATION FROM THE MEETING OF THE MONETARY POLICY COUNCIL

Held on 26-27 July 2005

**The Council decided to lower the NBP interest rates by 0.25 percentage point to the following levels:**

- **reference rate 4.75% on an annual basis;**
- **lombard rate 6.25% on an annual basis;**
- **deposit rate 3.25% on an annual basis;**
- **rediscount rate 5.25% on an annual basis;**

**The Council maintains its easing monetary policy bias.**

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The following developments in the external environment of the Polish economy have been observed since the last meeting of the Council. The improvement in the business conditions in the United States, which was to a large extent driven by a strong increase in consumption demand, points to a better outlook for economic growth in this country than it was the case a month ago. The euro area saw a rise in confidence indicators in industry; however still no signs of improvement in consumption demand are visible. The latest forecasts indicate a slight lowering in the expected rate of economic growth in the euro area in 2005 and 2006 as compared to the expectations from June 2005.

The prices of crude oil forecast for 2005-2007 reported further increases. The current forecasts show that starting from 2005 Q3 oil prices will remain at a considerably higher level than it was expected in the May *Inflation Report* and before the previous meeting of the Council in June. This increase in crude oil prices raises the risk of inflation growth and also of a weakening in economic growth in the USA and euro area alike.

The analysis of available data indicates that GDP growth rate in 2005 Q2 proved higher than in the previous quarter, yet lower than anticipated in the May *Report*. According to GUS data, industrial output in June 2005 was growing faster than expected, amounting to 6.8% y/y in real terms. Allowing for seasonal factors (primarily for the larger number of business days this June compared with the previous year), the rise in industrial production according to the GUS stood at 3.9% y/y and was markedly higher than in May (1.5%) and in April 2005 (decrease of 1.6%). Also higher than expected was the nominal growth rate of retail sales, which stood at 10.5% y/y (8.8% y/y in real terms). The visible recovery in construction observed since the mid-2004 has been continued. The annual growth in construction and assembly output in June amounted to 29.9% y/y (according to the GUS – to 24.4% y/y in seasonally adjusted terms) and also outpaced the

expectations. Enterprises' assessments of economic climate as signalled in GUS business tendency surveys are still positive and close to those recorded in June.

Available data may confirm the Council's expectations from June 2005 that the economic growth deceleration in 2005 Q1, signalled by the GUS, is temporary in nature. The data to be released in the coming months should allow for a better assessment of the scale of the expected improvement in economic activity.

There has been a gradual improvement in the labour market. In June 2005 employment in the enterprise sector was 1.7% y/y higher, while the unemployment rate slid to 18% (i.e. by 1.4 percentage points in year-on-year terms).

June 2005 also brought a gradual acceleration in wage growth rate. The pace of the rise in nominal wages in the enterprise sector amounted to 4.5% y/y and 3.0% y/y in real terms, i.e. was at its highest level since March 2004. Even higher rises were recorded in real payroll fund in the enterprise sector, which was supported by the continuing growth in employment in the sector (of 1.7% y/y). At the moment it is difficult to assess whether the increased wage growth rate in June 2005 will be upheld later this year as well. Still, it has to be emphasised that maintaining the present low growth rate of unit labour costs is the necessary condition of sustained acceleration in economic growth based to a larger extent on the rise of employment.

In June 2004 the annual growth rate of consumer prices fell down to 1.4% (compared with 2.5% in the previous month), and so it landed below the lower limit for deviations from the inflation target. This steep slump in the annual inflation index in June was, similarly as in May, anticipated and mainly resulted from the evaporation of the impact of the one-off and transitory increase in prices associated with Poland's EU accession. The rise led to keeping the annual inflation rates at a temporarily higher level. It can be expected that in the months to come inflation will remain low, i.e. markedly below the target of 2.5%. However, there exists a risk of higher inflationary pressure related to increased forecasts of oil and gas prices, even though this may also lead to the dampening of economic growth.

June 2005 also saw a decline in all indices of core inflation (net inflation in June stood at 1.4% y/y compared to 1.5% in May 2005). Additionally, in July 2005 inflation expectations of households decreased (down to 2.2% from 2.6% in June 2005). The growth rate of producer prices in industry has remained low and in June stood at 0.1% y/y.

The developments in zloty exchange rate in June 2005 were broadly consistent with the exchange rate path accounted for in the May *Inflation Report*. The future exchange rate developments may be affected by the situation in international financial markets and also by the uncertainty associated with the pre-election period in Poland.

In the Council's assessment, in spite of the fact that data on economic activity in June 2005 proved better than expected and despite higher forecast prices of fuels, the probability of inflation running below the inflation target in the monetary policy transmission horizon still exceeds the probability of its moving above the target.

The Council maintains its opinion that the most favourable course of action for Poland would be to adopt an economic strategy focused on creating conditions that would guarantee the introduction of the euro at the earliest possible date. Implementation of public finance reforms leading to the meeting of the fiscal convergence criteria is the necessary condition for the euro area membership. However, the numerous legislative proposals passed or put forward in the recent months may cause a widening of the public finance deficit and, in consequence, postpone the compliance with the euro area membership criteria.

The next meeting of the Council will be held on 30-31 August 2005.