

Warsaw, 27 September 2006

INFORMATION FROM THE MEETING OF THE MONETARY POLICY COUNCIL

Held on 26-27 September 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.**

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Since the meeting of the Council in August 2006 the forecasts of economic growth for 2006 have been slightly raised in the euro area, 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 and the United States for 2006-2007 have not changed significantly. The annual growth of consumer prices in the euro area has remained at a heightened level for a longer period (2.3% in August compared with 2.4% in July). In the United States inflation was 3.8% in August (compared with 4.1% recorded in July). Since the August meeting of the Council the current price of crude oil has decreased (by USD 10.1, i.e. 13.7%), while the oil price forecast for 2006-2007 has not changed significantly (according to the analysts polled by the Reuters).

The data for July-August 2006 on industrial output, construction and assembly production and retail sales indicate that high economic growth has continued in 2006 Q3. The rise in industrial output in August 2006 was consistent with the expectations of the NBP and reached 12.5% y/y (compared with 14.3% y/y in July). In seasonally adjusted terms, the growth in industrial output in August amounted to 12.9% y/y (compared to 14.1% y/y in July). In line with expectations, the growth in construction and assembly production returned – after one month of decline – to a high level reaching 15.3% y/y compared with 4.8% y/y in July, and 14.8% y/y compared with 5.7% in seasonally adjusted terms. The rise in retail sales remained high (at 11.5% y/y in nominal terms, compared with 11.0% y/y in July).

Lending to households has continued to rise rapidly: in August the rise in consumer loans amounted to 19.6% y/y (against 19.7% y/y in July) and housing loans rose by 51.2% y/y (compared with 50.4% y/y). Corporate lending growth accelerated (to 8.7% y/y from 7.2% y/y in July). This acceleration of loans to enterprises, which came despite the fact that enterprises held substantial own funds resulting from their very good financial results in the first half of 2006, may point to a further rise in the growth of investment.

Strong economic growth is accompanied by a fast growth of labour demand. Since December 2004 the employment growth in the corporate sector has been accelerating – in August 2006 the growth of employment in enterprises amounted to 3.5% y/y compared with 3.3% y/y in July. According to BAEL (LFS), the rise in the number of people working in the economy in 2006 Q2 exceeded expectations and accelerated to 3.7% y/y (against 2.4% y/y in 2006 Q1). The number of people working outside private farming has been growing fast (by 5.3% compared with 3.2% in 2006 Q1). In 2006 Q2 the unemployment rate according to BAEL fell to 14.1% compared with 18.1% one year before. According to labour office data, in August 2006 the registered unemployment rate slid to 15.5% compared with 17.7% one year before. This rapid growth in the number of working persons and the significant decline in unemployment was accompanied by a drop in the economically active population, which in 2006 Q2 fell in relation to 2005 Q2 by 1.1%.

Economic growth is also accompanied by a high growth of wages. In the enterprise sector, in August 2006 nominal wages rose by 5.3% y/y compared to a rise of 5.6% in July. The growth of unit labour costs in the economy (excluding private farming) stepped up to 4.5% y/y in 2006 Q2 (in comparison to 2.7% in 2006 Q1). In turn, the rise in labour productivity in industry in January-August (10.4%) was still higher than wage growth, which has the result of decreasing unit labour costs in this sector by 5.2% y/y. 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 August the annual growth of consumer prices rose to 1.6% (compared with 1.1% in July) and was higher than expected by external forecasters and the NBP. Thus, inflation was slightly above the lower limit for deviations from the inflation target. The rise in the annual growth of prices in relation to July 2006 was mainly brought about by higher than expected acceleration in the annual growth of prices of food and non-alcoholic beverages, which were affected by the unfavourable weather conditions in July. All measures of core inflation have increased (in August core inflation indicators ranged between 0.7% y/y and 1.4% y/y). September brought a significant rise in inflation expectations of households (1.3% y/y against 0.8% y/y in August). 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 August 2006 the rise in producer prices in industry amounted to 3.4% y/y compared with 3.5% y/y in July (i.e. 0.0% m/m compared with 0.7% m/m in July), while producer prices in manufacturing rose by 1.6% y/y in August. The nominal effective exchange rate of the zloty appreciated by 3.8% in relation to August 2005.

The latest data warrant the assessment that in 2006 Q3 both headline and “net” inflation will be higher than expected in the July inflation projection. In this way, headline inflation will be close to the lower limit for deviations from the inflation target. The released information concerning medium-term factors suggests that inflation in 2007 may prove higher than expected in the July inflation projection. A broader assessment of the inflation outlook will be formed in October 2006 after considering the new inflation projection.

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 and, consequently, the creation of the conditions for the introduction of the euro would contribute to higher long-term economic growth.

NBP

The Council has adopted the *Monetary Policy Guidelines for the year 2007*. This document sets forth the monetary policy strategy, conditions of its implementation and objectives of monetary policy in 2007. The Council has maintained the present understanding of the inflation target and its implementation, including the focus of monetary policy on maintaining inflation as close as possible to the target of 2.5% in the medium term. The Council will strive to make the return of inflation to the target, which is forecast for the beginning of 2007, permanent.

The Council has also adopted the document on the *International Investment Position of Poland in 2005*. The *International Investment Position of Poland* is a specification of foreign assets and liabilities of domestic entities. At the end of 2005, Poland's net international investment position was negative and reached EUR 104.7 billion, which accounted for 43.0% of GDP. Negative international investment position is typical of capital-importing economies. Compared with 2004, Poland's negative international investment position has increased by EUR 11.2 billion, i.e. 12.0% y/y, as a result of foreign liabilities increasing faster than foreign assets. This rise in foreign liabilities was to a large extent the result of the influx of foreign portfolio investment (of EUR 11.8 billion, mainly investment in Treasury bonds issued both in the foreign and domestic markets) and foreign direct investment (of EUR 7.7 billion).

The Council has adopted the *Forecast of the Balance of Payments of the Republic of Poland for the Year 2007*. According to this forecast, in 2007 deterioration may be expected in the trade and service balance of Poland in relation to 2006. Nevertheless, current and capital account deficit will remain at a safe level. Moreover, it will be largely financed by the inflow of foreign capital in the form of direct investment.

The next meeting of the Council will be held on 19 October 2006 and will be devoted to discussing the draft *Inflation Report*. The *Report* will be finally approved at the Council's meeting on 24-25 October 2006.