NBP

National Bank of Poland

Monetary Policy Council

Warsaw, 27 October 2004

INFORMATION FROM THE MEETING OF THE MONETARY POLICY COUNCIL

Held on 26-27 October 2004

In the period since the last meeting of the Council the appreciation trend of the zloty as well as the low pace of wage growth have been continued while the price effects of Poland's accession to the European Union have been fading away. In consequence, the balance of risks to future inflation points to a rise in the probability of inflation running lower than outlined in the scenario presented in the August *Inflation Report.*

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

- **reference rate 6.5% on an annual basis;**
- **lombard rate 8.8% on an annual basis;**
- **deposit rate 5.0% on an annual basis;**
- **rediscount rate 7.0% on an annual basis.**

The Council maintains its tightening monetary policy bias.

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New economic data which appeared in the period since the previous meeting of the Monetary Policy Council indicates that in 2005-2006 the world economic growth, the euro area included, will be slightly slower than it has been expected to date.

In September and October 2004 the American economy saw a further deterioration of confidence indicators, primarily in response to the rises in crude oil prices in world markets and a lower then expected increase in new jobs. A downturn in sentiment in the enterprise sector was also observed in the euro area. This is especially true of Germany, where pessimistic expectations as to new export orders were reinforced. The hike in the current and forecasted oil prices resulted in a weakening of the outlook for the world economic growth in 2005. Still, there is substantial uncertainty related to the influence of this factor on the economic growth.

So far the growth in oil prices in international markets has not exerted a significant influence on the rise of consumer prices in the major economies. Inflation expectations in the euro area remain broadly consistent with the data presented in the August *Inflation Report*. However, in view of a likely further appreciation of the euro against the dollar, as well as the low dynamics of unit

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labour costs in the euro area, the probability of inflation settling slightly below the projected path has been raised.

The data collected since the last MPC meeting confirms previous expectations that the GDP in Poland will grow annually by 4.5-5.5% in the next two years. According to NBP estimates in 2004 Q3 the growth rate of the GDP amounted to 4.5%. The continually high industrial output dynamics is still being stimulated by high export sales. It can be expected though, that starting from 2005 the role of net exports as a factor contributing to economic growth will be decreasing, while the role of domestic demand in general, and investment demand in particular, will rise.

A slim decrease in the unemployment rate is still being observed, even though LFS data for Q2 may indicate some delay in the expected improvement in the labour market. In September 2004 the wage growth slowed down. The preservation of a moderate pace of wage growth accompanied by a high dynamics in labour productivity will result in making inflation decrease faster than it was presented in the August *Report*. An accurate assessment of the future wage dynamics and the resultant inflationary pressures is made difficult by the considerable uncertainty surrounding the situation in the labour market, especially the difficulties in estimating the natural unemployment rate and the plausible impact that inflation expectations (4.4% in October 2004) may have on wage increases.

The available data as well as NBP survey evidence point to a slower than expected recovery in investments. These signals, however, are inconsistent with reports of the high and still rising level of capacity utilisation. This reveals a rise in uncertainty related to the projected dynamics of economic growth in 2004 and 2006. One source of this uncertainty is also the sluggish progress of structural reforms, particularly those of public finances.

The dynamics of monetary and credit aggregates has not changed to any significant extent.

In September, for the first time this year, a drop in the annual inflation rate (CPI) was recorded from 4.6% to 4.4%. The fall in the current inflation as well as the shrinking gap between CPI and core "net inflation" point to a gradual disappearance of temporary factors which have contributed to inflation growth in the past few months. The zloty has appreciated for the next consecutive month, which was a factor decreasing inflation. Should this tendency be sustained, inflation would run below the path presented in the *Report*.

The possibility of inflation decrease in the first half of 2005 is further supported by the latest food price forecasts, which suggest the diminishing of pro-inflationary shocks in the food market. Current assessment of this year's harvest by the Central Statistical Office (GUS) is more optimistic than the one available at the time the August *Report* was prepared.

A factor of inflationary risk is the persistent rising trend of producer prices in industry (8.0% y/y in September 2004). It is primarily caused by increasing domestic prices, as the appreciation of the zloty brought about a drop in export prices while at the same time it offset the effects of the hike in commodities' prices in world markets. A high and still rising level of capacity utilisation enhances the risk of cost effects translating into the rise of consumer prices.

In this situation the Council estimates that although the probability of inflation settling above the target of 2.5% over the monetary policy transmission horizon has been to some extent reduced, it is still higher than the probability of inflation falling under 2.5%. Considering the above, the Council keeps its tightening monetary policy bias.

The next meeting of the Council will be held on 23-24 November 2004.