

Warsaw, 28 February 2006

## INFORMATION FROM THE MEETING OF THE MONETARY POLICY COUNCIL

**held on 27-28 February 2006**

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

**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 Council's meeting in January 2006, no significant changes in the outlook for economic growth and inflation in the external environment of the Polish economy have been observed. In January, the annual growth of consumer prices in the euro area increased to 2.4% from 2.2% in December, while in the United States it rose from 3.4% to 4.0%. The price of crude oil decreased between the January meeting of the Council and 24 February 2006 (Brent oil price dropped by USD 4.6 per barrel, i.e. by 7.0%). The average Brent oil price in February was 5.7% lower than in January. Despite that, the average oil price for 2006 forecasted by analysts in the Reuters survey increased from USD 55.2 in January to USD 58.0 in February 2006, i.e. 5.1%. Still, high uncertainty persists as to the effect of the large increase of oil price on economic growth and inflation.

The data published since the Council's previous meeting indicate the continuation of growth tendencies in the Polish economy, which have been observed since 2005 Q2. The upward trend in the annual growth of industrial output observed for the past two quarters points to a recovery in industry. In January 2006 the growth of industrial output was consistent with the expectations of both majority of external forecasters and the NBP, and amounted to 9.5% y/y. At the same time, GUS revised upwards the data on output growth in December 2005 (from 9.2% to 9.6%). In seasonally adjusted terms, growth in the industrial output in January amounted to 7.4% as compared to 13.3% in December 2005. January saw a drop in the output in construction, which resulted mainly from unfavourable weather conditions. The annual growth in the construction and assembly output dropped to -7.8% down from 8.2% recorded in December 2005, i.e. to -3.2% from 10.6% in seasonally adjusted terms. The growth of retail sales exceeded the expectations and amounted to 8.6% y/y in nominal terms (a little lower in real terms) this being the highest growth since July 2005. To some extent this surge resulted from increased sales of fuels, which was due to very low temperatures recorded in January 2006.

2005 Q4 brought a marked acceleration in the growth of wages in the economy. It amounted to 5.1% y/y as compared to 3.4% y/y in 2005 Q3. The data on higher wage growth combined with

the estimated GDP and employment indicate that the growth of unit labour costs in the economy most probably increased in the 2005 Q4

Wage growth in the corporate sector in January was 3.6% y/y. This growth was affected by shifting of bonus payments in mining and quarrying, which significantly lowered wage growth in this sector in January. The employment in the corporate sector has been growing since the beginning of 2005. In January 2006, employment in the corporate sector was 2.6% higher than a year before. The unemployment rate in January rose as a result of seasonal factors to 18.0%, but it decreased by 1.4 percentage point as compared to the corresponding period a year before. It should be emphasised that a necessary condition for a sustained acceleration of economic growth, which should not threaten the achievement of the inflation target is that – in the longer run – the growth in real wages does not outpace the growth in labour productivity.

According to preliminary data, the annual consumer prices growth in January stayed at the previous month's level (0.7% y/y) and was lower than the expectations of both the NBP and market analysts. The annual inflation stabilised despite an increase in the annual growth rate of food, housing and energy prices. The low inflation was driven by higher-than-expected drop in growth of prices of fuels, newspapers, magazines and electronic equipment. At present, it is difficult to assess to what extent this drop will prove permanent. February 2006 saw further decrease in households' inflation expectations (0.6% against 0.9% in the previous month). To a large extent, this development was related to the drop in inflation in December 2005.

January 2006 saw an increase in annual growth of producer prices in industry up to 0.5% y/y as compared to 0.2% in December (0.4% m/m against -0.7% in December). This rise occurred even though the effective exchange rate of the Polish zloty was stronger than a year before.

The developments in the economy after the publication of the January inflation projection, coupled with zloty appreciation and lower than expected inflation, increase the probability of inflation in 2006 running below the level presented in the projection. In the projection horizon, the growth in domestic demand and unit labour costs will be gradually pushing inflation back to the target. Factors that may be decreasing domestic inflation include the growing imports from low costs countries and increasing flexibility of the labour market. In turn, the growing migration of the Polish workforce to EU countries may have the opposite effect. Moreover, if growth of employment was sustained at a larger scale than in the projection, this would lead to inflation running higher than in the projection. Uncertainty factors still include the situation in the oil market and also the impact of a potential increase in budget deficit in relation to that envisaged in the convergence programme.

The Council maintains its belief that implementing an economic strategy focused on creating conditions which ensure introduction of the euro at the earliest possible date would be most favourable for Poland and would contribute to higher long-term economic growth.

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