

Warsaw, 28 February 2007

INFORMATION FROM THE MEETING OF THE MONETARY POLICY COUNCIL

held on 27-28 February 2007

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

- **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 2007 the inflation forecasts for 2007 have remained unchanged for the euro area, while the outlook for the United States have been slightly lowered. Similarly, the forecast of economic growth in 2007 in the euro area has stayed unchanged, while the forecast for the United States has been raised. In January the annual inflation in the euro area remained unchanged (at 1.9%), but it fell in the United States (from 2.5% y/y in December 2006 to 2.1%). Since the January meeting of the Council, current price of crude oil has risen by USD 2.9 (i.e. 5.3%), while the prices of this commodity forecast for 2007-2008 have edged down.

GUS (CSO) data for January 2007 on industrial output, construction and assembly production and retail sales point to the continuation of strong economic activity. The rise in industrial output in January 2007 was markedly above the expectations of NBP analysts and external forecasters reaching 15.6% y/y (compared to 5.9% y/y in December), which in seasonally adjusted terms represents 15.5% y/y (compared to 10.5% in December). Also the surge in construction and assembly output proved considerably higher than expected, reaching 60.8% y/y (against 17.9% y/y in December), which in seasonally adjusted terms corresponds to 30.1% y/y (compared to 15.5% in December). This strong increase in the annual growth of construction and assembly output was supported by exceptionally favourable weather conditions in contrast to particularly adverse conditions a year before. January also brought an increase in retail sales growth (to 16.5% y/y in nominal terms, as compared with 13.3% y/y in December).

Since the middle of 2005 growth in consumer loans has been running high (a rise of 22.5% y/y in January). The growth rate of housing loans is still increasing (to 58.3% y/y in January). The significant growth in loans to enterprises has also been sustained (at 13.3% y/y in January). The currently observed growth in corporate lending, combined with substantial own funds of enterprises resulting from their very good financial results in 2006, may indicate that the currently high investment growth will be sustained.

Strong economic growth is accompanied by dynamically growing demand for labour. According to the BAEL (LFS), in 2006 Q4 the number of working persons rose by 3.6% y/y (compared to 3.9% in Q3), while the rate of unemployment slid to 12.2% (compared to 16.7% a year before). The rapid growth in the number of working persons and the concurrent decline in unemployment were accompanied by a dropping number of the economically active (a slide of 1.7% y/y in Q4), a trend noticeable since 2006 Q1. In January the employment in enterprises grew

by 3.8% y/y (compared to 4.1% y/y in December), while the unemployment rate according to labour offices' data amounted to 15.1% (compared to 18.0% one year before).

Economic growth is also accompanied by a fast growth of wages. In 2006 Q4 the wages in the economy rose by 5.3% y/y in nominal terms (against a rise of 5.0% y/y in Q3). In January the growth in nominal wages in enterprises amounted to 7.8% y/y as compared to 8.5% y/y in December. The annual growth of wages in January was affected by shifts in one-off components of wages in some sections. According to the NBP's estimates, adjusting for the impact of these shifts, the rise in wages in January equalled 6.5% y/y compared to 6.2% y/y in December. The data on wages and number of persons working in the economy in 2006 Q4, in combination with the GDP growth as implied by the preliminary GUS data, indicate that Q4 saw a decline in the growth of unit labour cost in the economy (from 3.0% y/y in Q3, down to 2.4% y/y). In industrial enterprises, productivity is still growing faster than wages, which leads to a drop in unit labour costs in this sector (of 3.2% y/y in January). 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 in the conditions of private ownership. This also calls for wage discipline in the public sector.

In January the annual growth of consumer prices increased to 1.7% (from 1.4% in December). In February the inflation expectations of households stood at 1.4% y/y (compared to 1.5% in January). In January the annual growth of producer prices in industry reached 2.9% compared to 2.6% in December (which represented a rise of 0.5% m/m against a drop of 0.5% m/m in December), while in manufacturing it was 2.1% (versus 1.5% in December). In January the nominal effective exchange rate of the zloty remained stable and was close to that recorded one year before.

In the Council's assessment, in the short term CPI inflation will be considerably lower than in the January projection. The core "net" inflation may also prove markedly lower than in the projection.

In the medium term the growth of wages may gradually increase, leading to higher inflation. The Council believes that this increase in inflation will be probably moderate provided that the strong productivity growth and low growth of external prices are sustained, the latter being associated with globalisation and the ensuing increased competition in the market of internationally traded goods and services.

The Council judged that the current level of NBP interest rates makes it possible for inflation to be kept close to the target of 2.5% in the medium term. However, maintaining inflation close to target and thus creating conditions for sustainable long-term economic growth may require monetary policy tightening. Future decisions of the Council will depend, to a large extent, on whether rising economic activity proves more permanent. It will also depend on other economic developments in Poland and in the world and also on their impact on the inflation outlook in Poland.

In the opinion of the Council, the currently observed strong economic growth creates convenient conditions for the implementation of reforms which would permanently reduce 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 constraining of public finance imbalance would be conducive, both *per se* and by creating conditions for the introduction of the euro, to accelerating the long-term economic growth.

The next meeting of the Council will be held on 27-28 March 2007.