

Warsaw, 29 June, 2005

INFORMATION FROM THE MEETING OF THE MONETARY POLICY COUNCIL

Held on 28-29 June, 2005

The Council decided to lower the NBP interest rates by 0.5 percentage point to the following levels:

- **reference rate 5.0% on an annual basis;**
- **lombard rate 6.5 on an annual basis;**
- **deposit rate 3.5% on an annual basis;**
- **rediscount rate 5.5% on an annual basis,**

and to change the monetary policy bias to easing.

Since the last meeting of the Monetary Policy Council the following developments in the external environment of the Polish economy have been observed. The outlook for economic growth in the United States remains positive owing mainly to the sustained high consumption demand growth. The euro area continues to witness stagnation in retail trade and deterioration in consumer confidence indicators. Economic forecasts which have appeared since the last MPC meeting signal a lowering of expected economic growth in the euro area in 2005 and 2006. Most of these forecasts point to a lower than previously expected inflation in the euro area. Oil price increases observed since the Council's last meeting increased the likelihood that high oil prices will persist longer than previously expected.

According to the GUS estimates, the annual GDP growth in Poland in 2005 Q1 was 2.1% significantly less than projected in the May *Inflation Report* and less than envisaged in most other forecasts. A lower than expected economic growth resulted mainly from slower than projected growth of private consumption and a surprising decline in gross fixed capital formation growth. At the same time, May 2005 saw a slower than expected growth of industrial output (0.9% y/y). The marked recovery in construction, which has been evident since mid-2004, has continued. Business confidence signalled in June by enterprises in GUS business surveys has remained broadly unchanged since May. In view of the available GUS data GDP growth in 2005 Q2 has probably not accelerated significantly.

Economic data received since the publication of the May *Inflation Report* suggest that economic growth in 2005 may be significantly lower than expected. The reported slowdown in economic growth is likely to be temporary. Yet, at present it is difficult to assess how long the period of lower growth will last. The data to be released in the coming months should allow a better assessment of the scale of the expected improvement in economic activity and, in consequence, should determine the scale and period of the adjustment in monetary policy.

Available data signal a gradual improvement in the labour market. In May 2005, employment in the corporate sector reported a year-on-year growth of 1.6%, while the unemployment rate decreased to 18.3%, i.e. by 1.2 percentage point y/y. Besides, according to the BAEL surveys (Labour Force Survey) the number of working persons in the economy reported a year-on-year increase of 2.2%. It confirms the upward trend in the number of the working persons observed since 2003.

The gradual improvement in the labour market is accompanied by a moderate wage growth. In May 2005, the nominal wage growth in the enterprise sector stood at 3.0 % y/y (0.5% y/y in real terms). After a year of decline, an increase in real value of the payroll fund in the corporate sector has been reported for three months, due to rising employment and decreasing inflation.

In May 2005, the annual growth of consumer prices decreased to 2.5% y/y against 3.0% recorded in the previous month. This decline in inflation was in line with expectations and it may be expected that inflation in the coming months will fall below the inflation target of 2.5%. A significant drop was also recorded in all core inflation indicators (net inflation amounted to 1.5% y/y as compared with 2.3% recorded in April 2005). Moreover, June 2005 saw a decrease in inflation expectations of households (down to 2.6% from 2.9% in May 2005). The downward trend in producer prices in industry started last year has continued. In May the annual growth of those prices was negative and amounted to -0.5 % y/y (as compared with 0.9% y/y in April 2005).

The zloty exchange rate developments in June 2005 have been broadly consistent with the path accounted for in the *May Inflation Report*. The exchange rate developments may be affected by the situation in the international financial markets and the uncertainty related to the pre-election period.

The MPC decision to lower the interest rates was based on the assessment that the balance of risks for future inflation has changed in the direction of lower inflation.

The Council maintains its opinion expressed in *The Monetary Policy Strategy after 2003* and *The Monetary Policy Guidelines for 2005* that the most favourable for Poland would be to adopt an economic strategy focused on creating conditions that 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 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 26-27 July 2005.