NBP

National Bank of Poland

Monetary Policy Council

Warsaw, 29 September 2004

INFORMATION FROM THE MEETING OF THE MONETARY POLICY COUNCIL

Held on 28-29 September 2004

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

- **reference rate 6.5% on the annual basis;**
- **lombard rate 8.0% on the annual basis;**
- **deposit rate 5.0% on the annual basis;**
- **rediscount rate 7.0% on the annual basis.**

The Council maintains its restrictive monetary policy bias.

Signals appearing after the publication of the August *Inflation Report* confirm the previous forecasts of economic growth. If the appreciation of the zloty visible in Q3 persists, it will be more probable that inflation in the mid-term perspective will be slightly lower than it was presented in the *Report*.

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The developments in the world economy point to the continuation of the tendencies observed since the beginning of the year and corresponding to the expectations presented in the August *Inflation Report*.

Data on the US economy, particularly those on the job market and the activity in the industrial sector, reinforce the optimistic outlook for the growth of the world economy. World demand remains robust and the major economic climate indicators are improving in the euro zone, which allows one to expect that the recovery unfolding in the region will continue. This expectation is reflected in the fact that euro-zone growth forecasts of the main international analytical centres were adjusted upwards. The ECB's September projection indicates that the growth in the euro zone will oscillate within 1.6 and 2.2% in 2004, and 1.8 and 2.8% in 2005.

The gradual improvement in international economic climate, with other factors unchanged, should contribute to an increase in demand for Polish exports.

The high and still increasing prices of crude oil have not yet translated into a significant rise in inflationary pressure in main world economies. Also, the inflation expectations in the euro zone remain consistent with the assumptions of the inflation projection presented in the August *Inflation Report*.

The assessment of economic processes in Poland has not been changed significantly in relation to the August *Inflation Report*. Polish economy is in the phase of dynamic growth. Annual GDP growth rate in 2004 Q2 amounted to 6.1% (in comparison to 6.9% in Q1). Recovery in domestic demand and the fast growing exports were the main factors contributing to the growth. A moderate recovery in investment was also recorded.

August 2004 annual headline inflation remained at the July level of 4.6%. Also, three out of five core inflation measures did not change while the remaining two increased only slightly (by 0.1 percentage point). The difference between the headline inflation and “net inflation” excluding food and fuel prices stabilized in August, which points to a deceleration of price growth in these groups of products. This is consistent with the expectations presented in the August *Inflation Report*. The recent appreciation of the zloty has alleviated the impact of high crude oil prices on the fuel prices in domestic market.

The abating of some of the factors which have contributed to inflation growth in the past few months is also signalled by a deceleration in the growth rate of inflation expectations of individuals in September 2004 (4.6% in the 12-month horizon). Nevertheless, they remain high, which lifts the risk of wage pressure. In the period since the last MPC meeting there have appeared disconcerting signals indicating to wage demand escalation.

The still persisting high growth of producer prices in industry (8.7%) has mainly resulted from the growth of domestic prices, since the appreciation of the zloty has had a breaking effect on the growth of export prices. Considering a very high level of production capacity utilisation in manufacturing, high inflation expectations and recovery in domestic demand, the risk of cost effects pushing the inflation up remains considerable.

Data collected since the last MPC meeting support the August *Report*’s expectations that in the next two years GDP growth rate will stand at 4.5-5.5%. Starting from 2005, net exports will cease to be a factor increasing the rate of economic growth; this role will be taken over by domestic demand, and primarily investment demand.

The expected inflation decrease from the second half of 2005 onwards should be supported by the vanishing of unfavourable supply shocks and some price effects connected with Poland’s entry to the EU. The decrease in inflation in the situation of a high economic growth will be, to a large extent, dependent on the inflation expectations and their influence on wages and prices. Should the currently observed appreciation of the zloty turn out permanent, the probability of lower inflation as compared to the central projection presented in August will increase. However, in view of the diversity of factors influencing the zloty exchange rate and its resultant high volatility, the assessment of the current appreciation's impact on future inflation is subject to a considerable uncertainty.

The moderate level of wage growth at the moment, together with the still relatively high growth of labour productivity as well as a delay (according to GUS data) in investment recovery in relation to what was expected in August, will have some, though limited, influence on the faster than expected rate of inflation drop in the projection horizon.

The next meeting of the Council will be held on 26-27 October 2004.