NBP
National Bank of Poland
Monetary Policy Council

Warsaw, 30 March 2005

INFORMATION FROM THE MEETING OF THE MONETARY POLICY COUNCIL
Held on 29-30 March 2005

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

• reference rate 6.0% on an annual basis;

• lombard rate 7.5% on an annual basis;

• deposit rate 4.5% on an annual basis;

• rediscount rate 6.5% on an annual basis.

The Council maintained an easing monetary policy bias.

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In January and February 2005 economic climate indicators in the euro zone and the United States showed that the discrepancy in the pace of economic recovery in these two areas persisted. International forecasting institutions revised downwards their predictions for economic growth in 2005 in the euro area and in Germany in particular, while the US growth forecasts improved. The recently observed signals of a strengthening inflationary pressure in the United States led to interest rate increases in this market. The interest on American securities increased, which resulted in a decrease in the relative return on portfolio investments in the developing countries and new EU member states alike. This, in turn, contributed to the recently observed outflow of capital from these markets and the depreciation of these countries' currencies. In March 2005 a strong upsurge in crude oil prices was observed in world markets. The forecasts for the next few years now presume that the decrease in oil prices will be significantly smaller than previously expected.

According to GUS data, the GDP growth rate in 2004 Q4 amounted to 3.9%, which is less than it had been estimated on the basis of preliminary data for 2004. The data on the GDP in 2004 Q4 confirmed a recovery in investment demand as well as a reduction in the consumption dynamics. Contrary to previous expectations, the contribution of net exports in the GDP growth in Q4 remained positive.

Upon analysis, the available data indicate that in 2005 Q1 the GDP dynamics will be probably lower than in the previous quarter and also lower than it was accounted for in the February *Inflation Report*. This prediction is supported by, among others, the low industrial output dynamics and by the evident deterioration in the economic sentiment in manufacturing, even though the economic climate is still assessed positively. In seasonally adjusted terms business confidence in construction and trade also worsened to some extent, after a period of significant improvement in this assessment.

The key factor in the assessment of the outlook for economic growth is investment. A considerable improvement in the financial results of enterprises and an evident rise in construction and assembly output create basis for the continuation of the investment recovery. These tendencies, however, might be weakened if the assessments of economic climate continued to deteriorate and if the political risk increased.

The available data signal a gradual improvement of the situation in the labour market. The registered unemployment rate decreased from 19.5% in January to 19.4% in February 2005, and was 1.2 percentage points lower than a year ago. In February, another increase in employment in the enterprise sector was recorded. The positive tendency in the labour market is also confirmed by the BAEL data for 2004 Q4, according to which the number of working persons rose (by 2.5% y/y), while the number of unemployed fell (by 5.9% y/y). The gradual improvement of the situation in the labour market is not accompanied by any acceleration in the wage dynamics. In February 2005 the growth rate of nominal wages in the enterprise sector was still low and stood at 1.4% y/y (representing a real decrease of 2.1% y/y), which confirms a lack of wage pressure in enterprises. If the rate of pay rises continues to be lower than labour productivity dynamics, then it should be possible to sustain the high pace of economic growth, which will be based to the greater extent on the employment growth.

The fact that the GDP dynamics in 2004 Q4 and probably also in 2005 Q1 proved lower than expected raises the probability of inflation in 2005 running lower than it was presented in the February *Inflation Report*.

In February 2005, the dynamics of consumer prices was considerably lower than expected and amounted to 3.6% y/y. This primarily resulted from the application of a new weight structure used in calculating the price index of consumer goods and services (CPI). The use of the new weight structure led to a revision of annual inflation in January 2005 from 4.0% to 3.7%. The drop in inflation in February was mainly triggered by lowering annual food price dynamics. Net inflation in January and February 2005 stood at 2.3% y/y against 2.4% in December 2004. The fall in the current inflation as well as the shrinking gap between inflation measured with the price index of consumer goods and services and core net inflation both confirm the disappearance of transitory factors which contributed to inflation increase in 2004. Additionally, March was another consecutive month when inflation expectations of households were decreased (down to 3.4% from 3.9% in February 2005). The downward trend in the dynamics of producer prices in industry has also been continued since it started last year. In February, the rate of growth of these prices fell even more than expected and amounted to 3.4% y/y (compared with 4.5% y/y in January 2005). The data on inflation in the first months of 2005 and the latest forecasts of food prices both increase the probability of inflation in 2005-2006 running lower than presented in the February *Inflation Report*. This assessment may be changed following commodity price developments in world markets, oil price shifts in particular.

Since the last meeting of the Council the zloty has depreciated. The developments of the exchange rate in 2005 Q1 have been broadly consistent with the path accounted for in the February *Report*. The Council acknowledges the rise in uncertainty surrounding the future course of the exchange rate in view of the situation in international financial markets and the uncertainty related to the pre-election period.

The Council maintains its conviction that the sustainability of the economic growth will hinge upon implementation of reforms that would result in decreasing state expenditure and, consequently, lead to a reduction in public finance sector deficit, and which would remove barriers to employment growth.

The next meeting of the Council will be held on 26-27 of April 2005.