

Warsaw, 31 August 2005

INFORMATION FROM THE MEETING OF THE MONETARY POLICY COUNCIL

Held on 30-31 August 2005

The Council decided to lower the NBP interest rates by 0.25 percentage point, excluding the rediscount rate which was lowered by 0.50 percentage point, to the following levels:

- **reference rate 4.50% on an annual basis;**
- **lombard rate 6.00% on an annual basis;**
- **deposit rate 3.00% on an annual basis;**
- **rediscount rate 4.75% on an annual basis.**

The Council maintains its easing monetary policy bias.

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Since the last meeting of the Council, the outlook for economic growth and inflation in the euro area and the United States has not changed significantly. However, due to persistently high oil prices in world markets there has been an acceleration in consumer and producer prices in the United States and in producer prices in the euro area. In August crude oil prices reported another significant climb. Moreover, most analytical centres considerably increased their forecasts of oil prices for the coming years. There persists a large uncertainty about the scale of decrease in economic growth as well as about the rise in inflation caused by a considerable accumulated oil price increase.

According to GUS (CSO) estimates, Poland's GDP growth rate in 2005 Q2 was higher than in 2005 Q1 both in year-on-year and quarterly terms allowing for seasonal factors. The annual GDP growth in 2005 Q2 amounted to 2.8% and was consistent with expectations. However, the structure of this growth was significantly different from expectations. Slightly lower than expected was the growth in individual consumption and investments. Considerably lower than anticipated was the contribution of inventories to GDP growth. At the same time, the contribution of net exports proved much higher than expected. Net exports – despite the strong appreciation of the zloty in 2004 and at the beginning of 2005 – were the main demand factor of economic growth in 2005 Q2. It can be expected that economic growth in the second half of 2005 will be gradually increasing.

July 2005 brought a smaller than expected rise in industrial output (of 2.6% y/y), however, allowing for seasonal factors, the rise in industrial output equalled 4.7% y/y and thus was the greatest since the beginning of the year. The recovery in construction, observed since 2004, has been continued. The annual growth in the construction and assembly production in July 2005 amounted to 17.4%. Enterprises' assessments of economic climate as signalled in GUS business tendency surveys remain positive and close to those recorded in July.

The situation in the labour market has been improving. In 2005 Q2 the number of persons working in the economy (in entities with over 9 employees) rose by 1.2% in annual terms. In July 2005 the employment in the enterprise sector rose by 1.8% y/y, while the unemployment rate slid to 17.9%, i.e. by 1.4 percentage point in year-on-year terms. According to NBP business tendency survey the number of enterprises intending to increase their employment in 2005 Q3 surpasses the number of those planning to reduce it, though the net balance of forecasts is slightly lower than one year ago.

In 2005 Q2 the rise in nominal wages in the economy amounted to 3.9% y/y and, in line with expectations, was slightly higher than in the previous quarter (when it was 3.6% y/y). July 2005 saw a continuation of a moderate growth rate in nominal wages in the enterprise sector (3.2% y/y). The acceleration in the annual wage growth in enterprises in June 2005 was primarily connected with the one-off payments of awards and bonuses in the mining industry. In the Council's assessment, a necessary condition for sustained acceleration in economic growth, which would be to a larger extent grounded in the rise of employment, is the preservation of the low growth in unit labour costs.

In line with the expectations of the NBP and external forecasters, in July 2005 the annual growth of consumer prices decreased slightly and amounted to 1.3%. It can be expected that in the coming quarters inflation will remain low, i.e. markedly below the inflation target of 2.5%. However, there is a risk of increased inflationary pressure related to higher forecasts of oil and gas prices, yet this may also dampen economic growth.

July 2005 also brought a decline in most core inflation indices (only net inflation remained at the level from the previous month and was equal to 1.4% y/y). Additionally, August 2005 was another consecutive month which saw a decrease in inflation expectations of households (down to 1.3% from 2.2% in July 2005).

Since the last meeting of the Council, oil prices has recorded a substantial climb - prices of Brent oil increased by USD 8.7 per barrel, i.e. by 15%. However, due to stronger than last year zloty exchange rate against the dollar and a moderate growth in domestic demand, the impact of high oil prices on producer prices in industry has been limited so far. The growth rate of producer prices in industry in July 2005 was equal to 0.0% y/y.

The Council maintains its opinion that the most favourable for Poland would be to adopt an economic strategy focused on creating conditions that would 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 bills passed in July 2005 made the achievement of this goal significantly more difficult in the coming years, which has a negative effect on the economic growth prospects and may postpone Poland's euro area membership.

The NBP inflation projection presented in the August *Inflation Report* was prepared on the basis of data available as of 28 July 2005 and so it does not account for the GUS estimates of GDP in 2005 Q2. The projection indicates that with a 50-percent probability the annual GDP growth should stay at 3.2%-3.5%, 3.9%-5.3% and 3.8%-5.6% in 2005, 2006 and 2007, respectively. In the years 2006-2007, GDP growth should accelerate unless the business conditions in Poland deteriorate or negative shocks occur in the world economy.

According to the August inflation projection, the price growth should be lower than expected in the May *Report*. Assuming unchanged interest rates, there is a 50-percent probability that inflation will stay within the range of 0.9%-1.5% in 2005 Q4 (compared with 1.1%-2.2% in the May *Report*), 1.0%-3.1% in 2006 Q4 (compared with 1.2%-3.8%) and 1.2%-4.1% in 2007 Q4 (compared with 0.7%-4.3%). In line with the projection, inflation will reach a level close to the inflation target in mid-2007.

Still, it has to be emphasised that the inflation projection presented in the *Report* does not account for all sources of uncertainty, such as the unknown economic policy of the government in

the coming years and the effects of worsened outlook for public finance in connection to the bills passed by the Parliament largely impeding the necessary reduction of the public finance deficit and of the pace of public debt growth in the subsequent years. Moreover, the projection does not allow for the latest information which might have a significant bearing on the forecasted price growth. In view of the latest data the most probable path of oil prices for 2005-2007 lies approximately 15% above the path assumed in the August projection. Prices of crude oil running much higher than those accounted for in the projection constitute an important factor of inflationary risk in the monetary policy transmission horizon.

In the Council's assessment, in the monetary policy transmission horizon the probability of inflation running below the inflation target is higher than presented in the August inflation projection, among others, due to possible acceleration in the structural changes ongoing in the Polish economy.

In view of the fact that the interest on required reserve should not exceed the yield on open market operations the Council reduced the spread between the rediscount rate, which serves as the basis for setting the interest on the required reserve of banks, and the reference rate – from 0.5 to 0.25 percent point.

The next meeting of the Council will be held on 27-28 September 2005.