

INFORMATION AFTER THE MEETING OF THE MONETARY POLICY COUNCIL

Held on 17-18 July 2003

On July 17-18, 2003, the Monetary Policy Council held a meeting. The Council read materials prepared by NBP and also information and analyses furnished by the Ministry of Finance, banks and research institutes. The Council then discussed the external environment of the Polish economy as well as real trends, trends in payments and social welfare benefits, matters involving the public financial sector, the money supply, loans and interest rates and the structures of pricing and inflationary expectations, as well as the expected rate of inflation.

Decision of the Monetary Policy Council

New economic data that has emerged since the previous meeting of the Monetary Policy Council:

- I. Indicates: that the factors limiting the growth of inflation in the future can still be observed:
 - Inflation remains low; despite the annual CPI of 0.8% in June 2003 against 0.4% in May 2003, June saw a 0.1% reduction in prices compared to May 2003,
 - The salary growth rate in the business sector is kept under stringent control. Between January and June 2003, average monthly salaries in the business sector increased by 2.1% in nominal terms compared to 4.4% observed for the same period in 2002. In real terms, the growth of salaries in the first half of 2003 reached 1.6% and was identical to the growth for the same period in 2002.
 - The annual growth rate of monetary aggregates M3 remains low (at 1.2% in June against 0.3% in May and 0.8% in April),
 - A moderate annual growth rate of dues from households (at 8.4% in June against 7.5% in May and 6.8% in April) and from businesses (at 3.0% in June against 6.5% in May and 7.2% in April),
 - The inflationary expectations of households have steadied at a low level.

- II. Confirms: the signs of a gradual economic revival:
 - In June 2003, industrial production sold grew by 7.8% year on year, including a 9.6% growth in the processing industry, the June results confirmed an upward trend in the total production volume,

- An improvement in the condition of the construction industry has been observed with a 16% growth in the production sold of the construction and assembly sector in June against May, and only 1.2% below the June 2002 ratio.
- June was the third consecutive month witnessing over a twofold growth in construction site production, when measured at the annual level. An accelerated growth rate was observed in companies performing finishing construction work (at 65.3% against nearly 40% in May 2003). Maintaining changes in the sectoral structure of the construction industry promise an improvement in the investment demand.
- A marked improvement in the economic condition ratios in the construction industry parallel positive outlooks on future market trends in the processing industry.

III. Other possible factors creating inflationary pressure include:

- A considerable uncertainty as to the size of the economic deficit in the public finance sector in 2003 coupled by even higher uncertainty regarding the shape of fiscal policy in 2004 and subsequent years,
- Maintaining high growth rate in cash in circulation. In June 2003, the annual growth rate of the aggregate amounted to 14.9% (15.7% in May and 14.9% in April),
- Increasing oil prices. June 2003 saw the average price of a Brent oil barrel at 27.6 USD translating into growth by 1.8 USD when compared to May prices and by 3.5 USD when viewed against prices in June 2002. The forecasted average annual oil prices in 2003 increased from 27.9 USD/barrel in June to 29.04 USD/barrel in July 2003.

Furthermore, the Council took into consideration the size of interest rate cuts performed so far, as they will affect the gradual increase in national demand in the second half of 2003 and in 2004.

The Monetary Policy Council resolved:

To leave the monetary policy parameters unchanged and maintain its neutral approach in respect of monetary policy.

The Council discussed the topic of mandatory reserve of banks.

The discussion will be continued at the next meeting of the Council, which is scheduled for 26-27 August 2003.

I. Assessment of the economic situation

In June and July 2003, evidence of re-established optimism and trust on the international markets were growing stronger. Phenomena giving the strongest indication of these symptoms included: a distinctive increase of global stock exchange indexes, falling prices (from the second half of June) on the T-bond market and the USD markedly gaining against other currencies.

Improvement of investment climate in the USA and Germany

The phenomena were accompanied by the continued increase in trust of business circles. In the USA, the ISM ratio attained 49.8 in June 2003 against 45.4 in April and 49.4 in May. Germany witnessed a similar improvement in the IFO Institute indicator: from 86.6 in April to 87.6 in May and 88.8 in June 2003, while the ZEW index assessing investors' anticipation for the next six months grew from 18.7 in May to 21.3 in June to reach a record 41.9, unseen in the previous 11 months.

Market analysts believe that continuation of these positive trends is conditional to increasing stabilisation in the global political situation in order to consolidate the temporarily volatile consumer trust (in the USA, the Michigan ratio declined in June to 89.7 compared to 92.1 in May).

In June 2003, the rising trend in global oil prices was maintained. This trend dates back to May 2003. The average price of a Brent oil barrel came to USD 27.6 in June 2003, exceeding its May price by USD 1.8 and USD 3.5 year on year.

High oil prices on global markets

Primarily, growth in prices stemmed from:

- a continued delay in reestablishment of exports by Iraq,
- a threat of strike in the oil producing sector in Nigeria,
- a distinctive deterioration in oil production in OPEC countries in June 2003. The drop in production is estimated at over 800 000 barrels/day compared to the production in May 2003,
- a continuously low level of oil reserves in developed countries, in particular in the USA., which causes increasing volatility in oil prices.

The high level of oil prices prevailing also in the first days of July 2003 lead to yet another verification of the oil price forecast. The forecasted annual average oil prices in 2003 increased from USD 27.9/barrel in June to USD 29.04/barrel in July 2003.

In June 2003, the industrial production sold grew by 7.8% year on year, including 9.6% growth attributed to the processing industry. At the same time, mining and quarrying production fell (by 5.8%) similarly to the power, gas and water production and to distribution sector (by 1.7%). The slowdown in production growth viewed against May 2003 was caused by a higher base (June 2003 was the first month of distinctive growth in the industrial sector after over a year-long period of falls and stagnation in production) and higher number of working days in May when compared to the previous year.

Increase in the industrial production sold

Results for June 2003 came as a confirmation of an upward trend in the production volume, particularly visible in the processing industry. High annual growth of the trend was maintained with further growth perspective (7.6% in the general industrial sector and 9.1% in the processing sector).

June 2003 saw a decelerating decline in construction industry production. Compared to June 2002 figures, construction and assembly production shrank by 1.2% (annual declines in May and April at 6.9% and 13.5%, respectively). Continuation as from April of changes in the sectoral structure of the construction industry gives promising prospects with respect to investment demand. June was the third consecutive month witnessing over two-fold growth in the production of construction sites, when measured at an annual basis. Accelerated growth rate was observed in companies performing finishing construction work (at 65.3% against nearly 40% in May 2003).

Analysis of economic performance carried out by the Central Statistical Office at the end of June 2003 on a group of nearly 6 thousand companies indicated that positive opinions on the overall economic performance in the construction and processing industry continue to prevail. Seasonally adjusted data indicate even a marked improvement in the perception of economic conditions in the construction sector. Not only has the construction sector seen more optimistic opinions than those expressed in May, but a significant improvement in the assessment of the overall condition was noted in comparison to year on year and June 2003 to the June 2001 assessment.

The processing sector witnessed a slight deterioration of the economic performance, while there is an evident improvement when compared to the assessment noted one and two years ago.

The situation in retail trade was visibly different from the condition of the processing and construction industry. In June, assessment of market performance was very pessimistic and bleaker than the assessment made in May 2003, it was also the most discouraging of all assessments prepared in May for all the years covered by research. The ratio was highly affected by very negative assessment of economic condition of trade units.

Slowdown in declining construction industry production

Marked improvement in assessment of market performance in the construction industry, continuous optimism in the processing sector.

Continued bleak assessment of trade performance

II. Situation of public sector finances

In the first half of 2003, the aggregate state budget revenue exceeded the revenue for the corresponding part of 2002 by PLN 6.8 bn. In nominal terms, i.e. by 10.4% (growth by 3.2% when excluding NBP's dividend). Receipts from personal income tax have increased by 9.5% compared to moderate growth in indirect taxes (2.8%). Corporate income tax receipts remain at a low level. In consequence, within six months of 2003 receipts to the state budget were 15.8% below the receipts from CIT in the preceding year. This chiefly stemmed from: a reduction in the nominal taxation rate, introduction of a 30% depreciation rate to be applied to some fixed assets within their first taxable year, settlement of losses incurred in the prior years by companies.

After June 2003, the annual plan of the state budget revenue was performed in 46.2%. State budget performance has improved considerably when compared to the results of preceding years (when adjusted by the NBP dividend, the planned result was achieved in 43.2% i.e. below last year's figure).

After June 2003, the state budget expenditure amounted to PLN 95.7 bn. i.e. 6.3% over the June 2002 figure to reach 49.2% of the figure stipulated in the budget act. Primarily, the increase in expenditure was connected with higher amounts of subsidies paid to the Social Security Fund and Labour Fund as well as with high costs of servicing the domestic debt. The second quarter of 2003 saw a marked growth in state budget expenditure at 10.8% year to year and at 2.3% in the first quarter of 2003.

In consequence, at the end of June 2003, the state budget deficit reached PLN 23.8 bn. This translates into a budget performance at 61.5% of the annual limit, i.e. at a level comparable to the deficit of preceding years.

Judging from state budget results after June 2003, there are no indications that its size may threaten to exceed the statutory limit of the deficit planned for 2003. However, deficit of the remaining units of the public finance sector will add to economic deficit to reach an estimated 5.2% of GDP.

61.5%
of the planned
state budget
deficit after June
2003

III. Money supply, loans, interest rates, exchange rate

Preliminary data indicate that the M3 money supply rose by PLN 2.8 bn (0.9%) in June 2003 against the end of May 2003. In June, the monetary figures were strongly affected by the FX differences. After elimination of their effect, M3 growth would reach approx. PLN 1.2 Bn. (0.4%). In June 2003, the annual M3 money supply rate was equal to 1.2%.

Slight growth in
money supply in
June

M3 increase stemmed primarily from: growth of cash in circulation and an increase in corporate deposits. Cash grew by PLN 1.3 bn. (2.9%) – the growth of cash in circulation at the end of June is an annually reoccurring phenomenon and results from the start of summer vacation. The annual growth rate of cash has been maintained at a high 14.9%.

Corporate deposits increased by PLN 1.7 bn. (3.2%), and their growth after elimination of FX differences stood at approx. PLN 1.5 bn (2.7%).

PLN 0.2 bn. (0.1%) growth in household deposits observed in June 2003 resulted fully from FX differences. After their elimination, household deposits shrank by approx. PLN 1.1 bn. (-0.6%). At the same time, a considerable inflow of household funds to investment funds is still observed to reach approx. PLN 1.9 bn. in June 2003. In addition, households invested in bank bonds, the phenomenon reflected by PLN 0.4 bn. (11%) increase in the remaining M3 components in June 2003.

The PLN 1.6 bn. growth in total loans (0.6%) observed in June was fully triggered by the zloty depreciation. After elimination of FX differences, the category shrank by PLN 0.1 Bn. (-0.04%). After elimination of FX differences, the amounts due from households plummeted by PLN 0.6 Bn (0.6%), and corporate dues fell by PLN 1 Bn. (-0.7%). The annual growth rate of loans remains moderate (with amounts due from households and corporates increasing by 8.4% and 3.0%, respectively, within the year).

In June 2003, the zloty depreciated both against the euro (by approx. 2.5% when compared to May 2003) and the USD (by 1.3%, respectively). The depreciation of the Polish currency was chiefly affected by such factors as: strong depreciation of the Hungarian forint, which translated into an increase in the currency risk for the currencies of our region, Standard and Poor's lowered rating perspective for Poland as well as a fall in bond prices on the global and Polish market in the wake of the FED's decision on the interest rate reduction below market expectations. In view of discernible appreciation of the USD on the world market, July saw the zloty weakening against the USD and gaining ground against the euro.

Weaker zloty

IV. Prices, inflationary expectations

In June 2003, the twelve-month inflation rate grew to 0.8% against 0.4% in May 2003. The trend arose mainly from a markedly weaker drop in the prices of foodstuffs and non-alcoholic beverages when compared to May 2003 (by 1.9 percentage point). The growth rate of transportation prices slowed (by 1.0 percentage point) with increasing fuel prices (by 2.3 percentage point) as the main growth stimulant. No variations in the group prices of other commodities and services were observed between June and May prices.

The annual growth rate of CPI at 0.8%

In June 2003, "net" inflation totalled 1.1% (0.1 percentage point below the level of May 2003), while the monthly "net" inflation indicator was equal to 0.0%.

May 2003 saw a slight growth of the PPI. Compared to May 2002, producer prices in industry rose by 2.1% (by 2.0% in May). When compared to April 2003, the sold-product prices in the industry increased by 0.4% (0.6% fall in May 2003).

Annual growth rate of PPI at 2.1%

The PPI growth is attributed chiefly to increasing prices in the industrial processing sector as well as in mining and quarrying. June 2003 saw the largest monthly growth in prices in the coke production and oil refining products sector by 2.7%. Rising prices in Poland came as a consequence of growing prices of BRENT crude oil coupled by growing prices of petrol at the Amsterdam exchange (over 3% growth in June 2003), and was additionally affected by the depreciation of the zloty.

In July 2003, the inflationary expectations of households increased to 0.4% i.e. by 0.1 percentage point when compared to the June figure. The inflation rate in June 2004 forecasted by banking analysts amounted to 2.2% i.e. 0.1% below the level indicated a month ago. Since February 2003, the forecast has been showing a steadying tendency within the range of 2% to 2.3%. The end of the 2003 price growth forecast and the annual average price growth forecasted for 2004 decreased when compared to June 2003 by 0.1 percentage point to 1.6% and 2.3%, respectively.

**Steadying
inflationary
expectations**

