

INFORMATION FROM A MEETING OF THE MONETARY POLICY COUNCIL, held on 25-26 November 2003

On 25-26 November 2003, the Monetary Policy Council held a meeting. The Council read materials prepared by the 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

In October 2003, the annual CPI reached 1.3% when compared to 0.9% reported for September 2003. Similarly, a growth was reported by the base inflation rate indicators; however, they remain low within the range from 0.6 to 1.2%.

Other economic data, which emerged since the previous meeting of the Monetary Policy Council indicates:

I Continuous presence of future inflation-limiting factors:

- Continuing strict corporate salary discipline. Between January and October 2003, the average monthly salary in the corporate sector grew by 2.3% in nominal terms comparing to 3.7% on a year-to-year basis. After ten months 2003, a real growth in salaries was equal to 1.6% and was identical to the growth reported for the same period of 2002,
- The supply of the monetary aggregate M3 remains moderate; in October 2003, the annual growth of the aggregate reached 4.7% against 3.1% reported for September 2003,
- A continuous low annual growth rate of corporate credit (at 3.2% in October against 1.6% in September 2003). September witnessed a slight increase in the annual growth in dues from households up to 12.0% from 10.3% in September 2003.

II. Confirms: upward economic trends grow stronger, increasing inflationary pressures gradually. However, the Council does not see as a threat to the attainment of the inflationary goal in 2004.

- October 2003 witnessed a 12.1% growth in the PPI on a year on year basis, including a 13.8% growth in the processing industry. A growth trend in the production grew stronger after October 2003. The annual growth of the trend in the processing industry exceeded 11% and 10% for the industry in total,
- A considerable improvement in the financial results of enterprises was reported for nine months 2003 with net financial result at PLN 15.1 bn i.e. almost a

fivefold growth year on year. Growth in the sales revenue generated on products, goods and materials exceeded a growth in the cost of the revenue,

- Within three quarters 2003, capital expenditures of enterprises grew by 1.2% (against a drop of approx. 2% observed in the first half of 2003). In general, the growth in total expenditures stemmed mainly from investment activity of companies operating in the processing industry,
- Continuing positive opinions on the market climate in the industrial processing sector,
- Continuing high (over a twofold) growth in production reported in October 2003 by the companies preparing construction sites and companies performing finishing construction works (at 74, 5%),
- Continued high growth in the exports, after nine months 2003 at 5.8% in the exports denominated in the euro and a 26.9% in the USD-denominated exports year-on-year (in accordance with the payment statistics),
- A 10.3% growth in retail sales reported in October 2003 (and 9.7% in September 2003).

III. The Council upholds his opinion expressed in the previous information, that another possible factor creating inflationary pressure is:

- uncertainty with respect to the current and future condition of the public finance. Increasing budget disequilibrium, rapid growth of the public debt, deteriorating mid-term public finance perspective may have unfavourable effect on financial market by causing further growth of the yield of treasury securities and depreciation of the zloty exchange rate. There has been a noticeable increase in the yield of treasury bonds since the last meeting of the Council. Fast and effective reforms healing the public finance would erase the uncertainty by eliminating disruptions on financial markets, particularly since other macroeconomic ratios of the Polish economy do not justify a permanent depreciation of the zloty exchange rate.

IV. Other possible factors creating inflationary pressure include:

- depreciation of the zloty exchange rate connected with a difficult condition of the public finance,
- a high and increasing growth rate of cash in circulation. In October 2003, the annual growth rate of the aggregate reached 17.0% (and 16.0% in September).
- A possible increase in the oil prices. Despite a reduction in the annual average oil price in 2004 from 26.6 USD/b to 25.9 USD/b, a continuing high political risk in the Middle East causes oil prices to fluctuate and move them upwards to a high level.

After a discussion, the Monetary Policy Council resolved to leave the monetary policy parameters unchanged **and maintain its neutral approach to monetary policy.**

The next meeting of the Council is scheduled for 2 December 2003 and it will be devoted to the NBP accounting principles and the NBP financial plan for 2004.

I. Assessment of the economic situation

External factors

October 2003 witnessed continuation of improvement in the current activity ratios of the USA economy reflected in a noticeable growth of optimism both among consumers and investors.

Economic revival in the domestic demand of the USA was confirmed by the results of the GDP growth in the 3rd quarter 2003. High growth in investment, a considerable reduction of inventory, accelerated retail sales growth and improvement of the employment market conditions in October, a large influx of orders address to the processing industry combined with favourable conditions of corporate financing allow us to expect a further acceleration of the economic growth rate in the USA economy.

Demand in the economies of the euro system remain low as confirmed by the GDP results in the 3rd quarter 2003 – the annual growth rate reached 0.3% against 0.2% in the 2nd quarter 2003.

In October 2003, the average price of a Brent oil barrel rose to USD 29.6 i.e. it showed a growth of USD 2.5 against September 2003. In November 2003, oil prices remained high, exceeding 28 USD/b. After subsequent terrorist attacks, the atmosphere on the oil market is nervous and each coming attack may not only send the oil prices flying to over 30 USD/b for a certain period of time but also leave them at this level.

In November 2003, the Department of State for Energy adjusted downwards the forecasted annual average oil price in 2004 from 26.6 USD/b to 25.9 USD/b

Economic situation in Poland

In September 2003, a surplus on the balance of current payments was reported for the first time since August 1998 (EUR 61 m.) translating into an improvement in the balance of current payments by EUR 590 m. against September 2002, whereas a deficit on the balance of current payments fell by EUR 2.65 bn. to reach EUR 2.72 bn. since the beginning of 2003. The improvement in the balance of current payments stemmed primarily from a reduction in a negative balance of commodity payments and an increase in the surplus of unclassified current payments. The improvement in the balance of commodity payments observed in September 2003 came in consequence of a very high growth of export receipts at 13.4% against September 2002. Since the beginning of 2003, the value of export receipts grew by 5.8% (and by not more than 1.2% on a year-to-year basis). In addition, September 2003 witnessed a rise in the value of disbursements by 0.3% year-on-year. A growth in the value of disbursements for the imports reported for the second time in the 3rd quarter 2003 may indicate a growth tendency arising on the import side.

Preliminary figures published by the Main Statistical Office indicate that the financial condition of corporates within the three quarters 2003 was considerably more favourable than their condition in the same period of 2002, as it is reflected by the improvement in the key effectiveness ratios and an increase in the percentage of net profit reporting companies.

Financial results grew several times over the period; between January and September 2003, an over two-fold growth in the financial result was reported on a

**Improvements
in the market
conditions in the
USA**

**High oil prices
on global
markets**

**A surplus on the
balance of
current
payments in
September**

**Good financial
condition of the
corporate sector**

year-on-year basis and an almost fivefold growth in the net financial result.

Moreover, an improvement in the corporate sector effectiveness ratio on a year-on-year basis was witnessed with the total operating costs reduced by 1.7% due to a more rapid growth in the total operating revenue (a growth of 11.6%) than the operating costs (a growth of 9.7%). An increase of the 1st degree liquidity exceeded the level regarded as safe in terms of cash liquidity. All industry sections reported an improvement in the cost level ratios and net and gross profitability of current operations except for the mining and quarrying section. A particular improvement in the economic and financial standing was experienced by exporters, with key effectiveness ratios more favourable in these corporate groups than in the group of total corporates.

October 2003 was a subsequent month of the PPI remaining below expectation as the total PPI grew by 12.1% against October 2002. Again, over a 40% annual increase was reported in the sales of mechanical vehicles, trailer and semi-trailer production sector. Similarly, a very high growth in the production of machines and equipment, furniture, metal, rubber and plastic goods, electrical machines and devices was maintained. As a result, the industrial processing production in October 2003 exceeded its figure reported in October 2002 by 13.8% and was twice as high as the monthly average in 1995.

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After October 2003, a growing trend in the production industry strengthened. The annual growth of the trend in the processing industry exceeded 11% and 10% in the total industry.

In October 2003, the construction and installation production remained 4.8% below its level generated in October 2002 and the drop was larger than in September 2003 (3.8%). October 2003 witnessed continuation of the growing trend in production in the companies preparing construction sites (over a twofold growth) and companies performing construction and finishing works (by 74.5%).

II. Situation of public sector finance

Unfavourable condition in the public finance sector continues.

After 10 months 2003, the aggregate state budget revenue amounted to PLN 123.4 bn, which translated into a 5.0% growth in nominal terms year-on-year. After October 2003, the execution of the budget act plan reached 79.3% i.e. below the level reported in the preceding years.

After 10 months 2003, budget expenditures amounted to PLN 158.2 bn i.e. grew by 4.4% when compared to the budget expenditures in the same period of 2002. After October 2003, the budget plan realization is comparable with the realization reported in the preceding years and is equal to 81.4%.

After October 2003, the budget deficit reached approx. PLN 34.83 bn, translating into utilization of approx. 89.9% of the annual limit i.e. above the utilization reported in the preceding years.

No significant improvement in the financial condition of the remaining units of the public finance sector was observed. A shortage of funds in the Social Security Fund forecasted in 2003 will be financed with a banking loan and a lower than planned transfer of contributions to the Open Investment Funds. The last months of 2003 will see an increase in the debt of the Labour Fund to the banking system. The condition of the National Health Fund remains very difficult, as funds

The IPP growth of 12.1% and a stronger growth trend of the index

Deficit of the public finance

collected from the health insurance contributions are insufficient to finance medical services rendered by health care units, translating into a continued increase in the amounts due and payable by the health sector.

Present condition of the public finance sector units indicates the economic deficit of the whole public sector in 2003 will reach approx. 5.4% of the GDP i.e. 0.3% above the deficit reported in 2002.

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

Figures presented in the accelerated information indicate PLN 5.4 bn (1.6%) growth in the M3 money supply in October 2003 against the end of September 2003. After exchange rate differences, the M3 aggregate rose by PLN 4.9 bn (1.5%). The annual M3 growth rate reached 4.7%.

The October growth in the M3 aggregate was mainly stimulated by an increase in corporate deposits by PLN 3.0 bn (5%) i.e. PLN 2.9 bn when adjusted by the FX rate differences. In this category, the annual growth rate was equal to 22.8%.

In October, a monthly growth in household deposits reached PLN 0.2 bn (0.1%); however, it resulted from the exchange rate fluctuations. When adjusted by the FX rate, the total household deposits fell by PLN 0.2 bn. The annual growth rate in this category reached -5.2%. Furthermore, October 2003 witnessed an approx. PLN 0.6 bn drop in the value of investment fund assets held by households.

Compared to the cash in circulation status as at the end of September 2003, a growth of PLN 0.5 bn (1.1%) was reported for cash in circulation outside banks, while the annual growth rate of the aggregate reached 17%.

A nominal growth in total dues was equal to PLN 3.2 bn (1.2%) and PLN 2.5 bn (1.0%) after FX rate differences in October 2003. Household loans increased by PLN 1.4 bn (1.4%) i.e. by PLN 1.1. bn (1.2%) after FX rate differences. The annual growth rate in this category reached 12%. Housing loans accounted for over 75% of growth in the household loans. October 2003 saw a PLN 0.9 bn (0.6%) increase in corporate loans i.e. PLN 0.5 bn. (0.3%) after FX rate differences. The annual growth rate in this category was equal to 3.2%.

In October 2003, the monthly average zloty exchange rate weakened against the euro by 2.7% in nominal terms and improved against the dollar by 1.5% in nominal terms. However, within the first three weeks of November 2003, the zloty exchange rate gained ground both against the euro and the dollar by 0.7% and 2.7%, respectively. A stronger appreciation of the zloty against the dollar came as a result of the euro gaining ground against the dollar on the global market (from 1.16 EUR/USD as at the end of October 2003 to approx. 1.19 EUR/USD on 21 November 2003).

In consequence of uncertainty regarding condition of the public finance, an increase in long-term interest rates was observed. Since the latest meeting of the Council, the yield of 2- and 10-year treasury bonds rose by 64 b.p., while an increase in the yield on 5-year bonds was even higher to reach 103 b.p.

IV. Prices, inflationary expectations

In October 2003, the twelve-month CPI reached 1.3% against 0.9% reported in September 2003. A growth in the twelve-month inflation rate stems from a rise in the prices of rent and media (by 3.2%), prices in transport and particularly fuel

sector in 2003 at 5.4% of the GDP

A moderate growth of money supply in October

Moderate growth of household loans; low growth of corporate loans

The zloty stronger in November

The annual CPI at 1.3%

prices (3.0%) and the prices of foodstuffs and non-alcoholic beverages (1.2%). At the same time, the prices of clothes and footwear remained below their October level.

In October 2003, the „net” inflation rate was equal to 1.2% year-on-year, while a monthly net inflation indicator reached 0.3%.

In October 2003, the annual PPI reached 2.7% (compared to 2.1% in September 2003 and 1.8% in August 2003). A particularly high growth in prices was reported by the mining and quarrying section and specifically in the group of metal ore quarrying (iron and copper) with 18.1% of price increase against October 2002. The increase came as an effect of a significant and lasting rise in the global prices of copper. Since April 2003, the copper prices on international markets grew by over 20%. An accelerated growth of prices (by 2.4% year-on-year) was also witnessed in the processing industry.

In consequence of deterioration in the response structure to the questionnaire underlying the analysis of the inflationary expectations of private individuals and an increase in the current inflation rate reported for November 2003, the price growth rate expected by the private individuals in the coming year was equal to 0.9% i.e. exceeded the level reported for the preceding month by 0.2%.

In November 2003, the inflation rate forecast by banking analysts for October 2003 reached 2.3% i.e. was identical to the inflation rate forecast of the two preceding months. However, the inflation rate forecast for the end of 2003 rose by 0.2% to reach 1.5%. The annual average growth of prices forecast for 2003 amounted to 2.2% i.e. remained 0.2% below its October level.

**The annual PPI
at 2.%**

**Less optimistic
inflationary
expectations,
however their
level remains
low**