

## **INFORMATION FROM THE MEETING OF THE MONETARY POLICY COUNCIL**

**held on 28 – 29 October 2003**

A meeting of the Monetary Policy Council was held on 28 – 29 October 2003. The Council was provided with the materials prepared by the NBP as well as information and analyses furnished by the Ministry of Finance, banks and research institutes. The Council discussed recent developments in the external environment of the Polish economy and trends in economic performance with regard to payments and social welfare benefits, in the public finance sector, with regard to money supply, credits and interest rates, inflation expectations and price levels as well as inflation prospects.

### **Decision taken by the Monetary Policy Council**

In September 2003, the annual CPI reached 0.9% when compared to 0.7% reported for August and 0.8% reported for July and June 2003. Similarly, the base inflation rate indicators stabilised at a low level.

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

- I. Continuous presence of future inflation-limiting factors:
  - a low growth rate in industrial production prices; at 1.9% in September 2004 as against 1.8% reported in August and 1.9% reported in July 2003;
  - continuing strict corporate salary discipline. Between January and September 2003, the average monthly salary in the corporate sector grew by 2.2% in nominal terms compared to 4.1% on a year-to-year basis. After nine months 2003, a real growth in salaries was equal to 1.6% against 1.9% reported for the same period of 2002,
  - in addition, the annual growth rate of monetary aggregate M3 remains low; September saw the aggregate growing up to 3.1% on an annual basis (compared to 1.7% in August 2003); however, the growth was stimulated chiefly by the zloty losing ground against the euro,
  - a continuous moderate annual growth rate of corporate credit (at 1.6% in September against 1.9% in August and 1.8% in July 2003). September witnessed the annual growth in receivables from households up to 10.2% from 8.5% in August and 7.9% in July 2003; however, the growth can be partly attributed to fall in the value of the zloty,
  - the inflationary expectations remain at a low level.
  
- II. Confirms: strengthening signs of the economic revival; nevertheless, the Council does not see they exert an excessive inflationary pressure:

- September 2003 witnessed an 11.1% growth in PPI on a year-to-year basis, including 12.6% of growth in the processing industry PPI. Net of seasonal factors, the PPI grew by 8.3% and the processing industry PPI grew by 9.6% and was consistent with the trend observed over the recent months,
- continuation of a high, over a two-fold growth in production reported in companies preparing construction sites and performing finishing construction works (at 74.6%),
- continuing positive opinions on the market climate in the industrial processing sector.
- a 4.9% growth in the exports denominated in the euro and a 26.5% growth in the exports denominated in the dollars after eight months 2003 on a year-to-year basis (as reported in the payment statistics),
- a 9.7% growth in retail sales reported in September 2003 against 5.5% on a year-to-year basis.

III. Another possible factor creating inflationary pressure can be:

- uncertainty with respect to the current and future condition of public finances reflected by an increased return on treasury securities and the zloty depreciation against the euro. Difficulties experienced by the government to maintain the liquidity of the budget, increasing public debt in relation to GDP and uncertain prospects of a swift and effective reformation of public finance contributed chiefly to depreciation of the zloty against the euro (compared to PLN/EUR exchange rate as of the last day of August, on 28 October the zloty lost 6.9% to the euro, while it grew by 0.5% against the dollar). However, other macroeconomic ratios of the Polish economy (a higher rate of the economic growth, low inflation, low deficit of the balance of payments, safe relation of the short-term foreign debt to the foreign reserves and a swift increase in the exports) do not justify a permanently weaker zloty. It means that fast and effective reforms to improve Poland's public finance would remove uncertainty, eliminating distortions on financial markets.

IV. Other possible factors creating inflationary pressure include:

- A continuous high growth rate of cash in circulation. In September 2003, the annual growth rate of the aggregate reached 16.0% (15.7% in August 2003 and 13.9% in July 2003),
- Continuing high oil prices. A forecast annual average price of oil in 2004 rose from 26.0 USD/b to 26.6 USD/b.

**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 25-26 November 2003.

## **I. Overview of the economic situation**

In September 2003, positive market trends in the corporate sector continued. The euro zone saw a growth in the ratios, reflecting business confidence. In the USA, the ratios steadied at a high level and the optimism of the business circles was confirmed in PPI exceeding the market expectations (of 0.4% in September against a drop of 0.1% in August).

A gradual increase of consumer optimism could be seen in the euro zone. Due to a marginal improvement in employment trends in the USA, ratios reflecting household confidence remained unstable.

In September 2003, the average price of Brent oil was 27.1 USD/b and was higher by 2.8 USD/b compared to the price reported in August 2003. In October 2003, the OPEC decision to reduce oil production limits sent oil prices up to reach 31.8 USD/b on 10 October 2003. In October, the oil prices forecasts were subject to a verification: forecast for 2003 was brought down to 29.2 USD/b (due to prices in 3Q 2003 remaining below the expected level), while an upward adjustment from 26.0 USD/b to 26.6 USD/b was made for 2004.

Following a temporary deterioration reported in July 2003, August 2003 witnessed an improvement in the balance of current payments. Compared to August 2002, the negative balance of current payments fell by EUR 100 m. and by nearly EUR 2 bn since the beginning of 2003.

Increase in the value of export revenue (by 5.4% against August 2002) exceeded the average reported since January 2003 (4.9%), thus confirming favourable export trends observed in preceding months. At the same time, a considerable growth in import payments reported in July 2003 did not recur in August 2003, when the value of the import payments decreased by 1.1% against the August 2002 figure and by 0.2% when calculated since January 2003.

The favourable trends observed in the foreign trade are confirmed by the Main Statistical Office (GUS) figures, which indicate a reduction of the negative balance of trade payments by EUR 1.2 bn between January – August 2003 against the corresponding period in 2002. Preliminary data indicate a 4.3% growth in the value of exports denominated in euros in eight months of 2003 (and by 3.4% during seven months of 2003) combined with a slighter drop in the value of the imports (by 0.1% against 1.0%). The exports growth to the EU quickened; however, so far, the highest pace of growth was reported in exports to the Central and Eastern European countries.

In September 2003, the total PPI grew by 11.1% including a 12.6% growth in the processing industry year-on-year. The higher PPI growth rate is partially attributed to a higher number of working days as compared to September 2002 (by one day). After seasonal trends, the total PPI growth rate reached 8.3% and the processing industry PPI reached 9.6% and remained in line with the trend observed in recent months. Output growth measured in fixed prices in September 2003 was the highest of the monthly output figures in Poland reported so far both in the production

**Improvement in the investment climate in the USA and the euro system**

**High oil prices on global markets**

**Lower deficit of the balance of payments in August**

**PPI growth of 11.1%**

sector and the processing section, exceeding the level of the average monthly output of 1995 by 74.3% (total production sector) and by 93.7% (processing industry).

Data published on the processing industry structure by sectors do not indicate any changes in existing trends, including a continued highest rate of growth in sales reported by the industries with a high and growing share of exports. Again, the highest growth (by 35.1%) was reported for the motor vehicle, trailers and semi-trailers sector.

Continued high growth is reported by the enterprises preparing construction sites (over a two-fold growth) and enterprises performing finishing construction works (growth by 74.6%), although September saw further deterioration of the total construction and installation output (by 3.8%).

The research into the economic situation published by the Main Statistical Office on 22 October 2003 indicates a sustainment of the positive outlook for the business climate in the processing industry. Opinions are better than those opinions voiced in the same months of previous five years and their level was slightly below the level observed in September 2003. However, the market trend ratio for the construction industry deteriorated against its September figure, while maintaining its negative level. Still, a marginal improvement in the ratio could be observed viewed against October 2002 and October 2001. Assessment of market trends in the retail trade was slightly improved as compared to the assessment for September and October 2001 and 2002. A steady improvement in the market trend in this section has been noticed since March 2003, i.e. the proportion of negative opinions is declining.

A 9.7% growth in retail sales was reported for September 2003 year-on-year (against 5.5% in August and 5.4% in July 2003), stemming from growing sales volumes as well from organisational changes in trading companies resulting in an increasing number of trade units covered by the monthly research, and a change in shopping locations for household purchases.

## **II. Situation of public sector finance**

After 9 months 2003, the total state budget revenue was higher by PLN 4.9 bn in nominal terms when measured on a year-to-year basis (i.e. 4.7% after 9 months 2002). The nominal growth in the budget revenue in 2003 was equally affected by tax and non-tax revenues. After September 2003, 68.6% of the planned tax revenue specified in the budget act was generated i.e. below the level reported in 2002.

After September 2003, budget expenditures amounted to PLN 142.4 bn, i.e. 6.6% more compared to the budget expenditures for the same period of 2002 to reach 73.2% of the figure specified in the budget act.

As at the end of September, the budget deficit reached approx. PLN 33.1 bn, i.e. approx. 85.4% of the annual limit and markedly above the utilisation observed in preceding years. The budget revenue figure reported after 9 months 2003 indicates a possibility of non-achievement of the budget figures planned in the budget act (in 2003 shortage of revenues

**Highest growths  
in the export-  
producing sectors  
of the economy**

**Positive  
assessment of  
market trends in  
the processing and  
construction  
industry**

may reach approx. PLN 5 bn). However, retention of the budget deficit within its statutory limits is not threatened conditional on appropriate adjustments being performed on the expenditure side.

No significant improvement in the financial condition of the remaining units of the public finance sector was observed. Despite high transfers from the state budget and moderate revenues, the Social Security Office has not fully transferred contributions due to the Open Pensions Funds and maintains a considerable debt to the banking system. Since May 2003, the financial condition of the Pension and Invalidity Fund (FER) deteriorated, which operates within the framework of the Agriculture Social Security Fund (KRUS). There is a threat that revenues and expenditures planned for 2003 will not balance. Similarly, the National Health Fund has difficulties in connection with lower-than-expected receipts from health insurance premiums. It will probably result in a further growth in the amounts due and payable by the health sector.

The present condition of the public finance sector units indicates an economic deficit of the whole public finance sector reaching approx. 5.4% of GDP in 2003, i.e. it grew by 0.3% when compared to the level reported for 2002. .

**Deficit of the public finance sector in 2003 at the level of 5.4% GDP**

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

Figures presented in the accelerated information indicate PLN 1.9 bn (0.6%) growth in the M3 money supply in September 2003 against the end of August 2003. The annual M3 growth rate reached 3.1%, which is the highest figure reported since May 2002; however, the M3 growth was primarily prompted by the zloty losing ground against the euro. After the FX differences, the monthly M3 growth rate amounted to PLN 1.0 bn (0.3%).

**A moderate growth in money supply in September**

The September growth in the M3 aggregate was mainly stimulated by an increase in corporate deposits by PLN 3.2 bn (5.5%) i.e. PLN 2.8 bn (4.9%) when adjusted by FX rate fluctuations. The annual growth rate in corporate deposits reached 20.9% in September 2003, which is the highest figure reported since July 2000. Such a high growth in receivables to the corporate sector is not normal in September.

September 2003 saw a further decrease in household savings deposits by PLN 0.6 bn (i.e.-0.3%). When adjusted by FX rate differences, the total household deposits fell by PLN 1.2 bn (-0.6%). A negative annual growth rate in the receivables to households, prevailing since July 2002, was -6.3% in September 2003. The fall was only slightly associated with households deploying their funds to alternative forms of savings. September witnessed a PLN 0.4 bn growth in the value of investment fund assets held by households and connected with the acquisition of new participation units, i.e. the lowest growth observed for a period longer than one year.

A slight drop in cash in circulation (of -0.1%) was observed in September 2003 compared to the cash in circulation status as at the end of August; however, the annual growth rate of cash in circulation remains high, reaching 16% as at the end of September.

On the money-creation side, there was a growth of PLN 3.6 bn (1.4%) in total receivables in nominal terms, which was entirely due to the zloty FX rate fluctuations. A growth in receivables from households reached PLN 2.6 bn (2.7%) equal to PLN 1.1 bn (1.2%) when adjusted by FX rate differences, resulting in the annual growth rate in this category equal to PLN 10.2%. The growth in receivables from households can be chiefly attributed to the growth in loans financing real estate purchase. Corporate receivables increased by PLN 0.9 bn (0.7%) in nominal terms; however, they deteriorated by PLN 0.9 bn (-0.6%) after the elimination of FX differences. The annual growth rate of loan exposure in corporate sector fell from 1.9% in August 2003 to 1.6% in September 2003.

**Moderate growth in household loans; low growth in corporate loans**

In September 2003, the average exchange rate of the zloty in nominal terms lost ground against the euro and the dollar by 2.3% and 1.6%, respectively.

Within three weeks of October 2003, the average zloty exchange rate against the euro again weakened by 2.4% fixed at PLN 4.57 compared to the average EUR/PLN exchange rate of 4.47 of September 2003. A different trend in the exchange rate of the dollar was observed, which averaged at PLN 3.90 against PLN/USD exchange rate fixed at 3.98 in September 2003, signifying the zloty gaining ground by 2.0%. The zloty exchange rate was markedly affected by the EUR/USD cross-exchange rate averaging at 1.17 for the three weeks of October against 1.13 EUR/USD exchange rate average reported in September 2003.

**Weaker and highly fluctuating zloty**

On 28 October 2003, the zloty weakened against the euro by 6.9% and gained ground against the dollar by 0.5% as compared to the exchange rates quoted on the last day of August 2003.

#### **IV. Prices, inflationary expectations**

In September 2003, the twelve-month CPI reached 0.9% against 0.7% reported in August 2003. A growth in the twelve-month inflation rate is attributable to a rise in fuel prices (of 5.1%), prices of rent and media (by 2.8%) as well as prices of foodstuffs and non-alcoholic beverages (0.5%). At the same time, a drop in the prices of clothes and footwear and prices of alcohol and tobacco was observed. In September 2003, the “net” inflation rate was equal to 0.9% year-on-year, while a monthly net inflation indicator reached 0.1%.

**The annual CPI at the level of 0.9%**

The level of the annual PPI increased by 1.9% on a year-to-year basis (against 1.8% growth reported for August and a 1.9% growth reported for July). A growth in the sold production price index remained at its August level of 0.4%.

**The annual PPI at the level of 1.9%**

In October 2003, the inflation rate forecast by banking analysts for September 2004 reached 2.3% and was identical to the inflation rate forecast for September 2003. The annual average price growth forecast for 2004 totaled 2.0% i.e. by 0.2% below its level reported for September 2003. The inflation rate expected at the end of 2003 fell by 0.1% to 1.3%.

**Low inflationary expectations**

In October 2003, a price-growth rate expected by private individuals over the coming year remained at its September level of 0.7%.

