

Warsaw, 30 August 2006

INFORMATION FROM THE MEETING OF THE MONETARY POLICY COUNCIL

Held on 29-30 August 2006

The Council decided to keep the NBP interest rates unchanged:

- **reference rate 4.00% on an annual basis;**
- **lombard rate 5.50% on an annual basis;**
- **deposit rate 2.50% on an annual basis;**
- **rediscount rate 4.25% on an annual basis.**

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Since the Council's meeting in July 2006 there has been no changes in the forecasts of economic growth in the euro area and the United States. They still point to a slight slowdown of economic growth in the euro area in 2007 in relation to 2006. Similarly, according to unchanged forecasts some deceleration of economic growth in 2007 is also expected in the United States. Inflation forecasts for 2006-2007 have not changed in the euro area, while the outlook for inflation in the United States in 2007 has been revised upwards. The annual growth of consumer prices in the euro area has remained at a heightened level for a longer period (2.4% in July compared with 2.5% in June). In July inflation in the United States was 4.1% (compared with 4.3% in June). Since the July meeting of the Council increases have occurred both in the current price of crude oil (rise of USD 1.4, i.e. 1.9%) and in the price forecast for 2006-2007 (according to analysts surveyed by the Reuters the average rise of over USD 2.0, i.e. 3.0%).

The GUS data on GDP in 2006 Q2 confirm the acceleration of economic growth that has been observed since 2005 Q2. The growth of real GDP in 2006 Q2 reached 5.5% y/y (compared with 5.2% in Q1) and was higher than assumed in the July inflation projection. Private consumption rose by 4.9% y/y (as compared with 5.2% in 2006 Q1) and the contribution of net exports to GDP growth was 0.4 percentage point (against 0.7 percentage point in 2006 Q1). Gross fixed capital formation increased by 14.4% y/y (against 7.4% y/y in 2006 Q1) and according to the GUS, contrary to the expectations of the July projection, public consumption declined by 1.0% y/y (against growth of 3.4% y/y in 2006 Q1). The contribution of net exports to GDP growth and the growth of gross fixed capital formation were higher than forecast in the July projection.

The July 2006 data on industrial output and retail sales indicate that high economic growth has continued. The rise in industrial output in July 2006 was consistent with the expectations of the NBP and external forecasters reaching 14.3% y/y (compared with 12.2% y/y in June). In seasonally adjusted terms, the growth in industrial output in July amounted to 14.1% y/y (compared with 13.8% y/y in June). Lower than expected was the rise in construction and assembly output, which was only 4.8% y/y compared with 15.7% y/y in June, which in seasonally adjusted terms represents 5.7% y/y against 10.8% y/y. What has to be borne in mind, however, is that the monthly data on growth in construction and assembly production are subject to considerable volatility. The rise in retail sales remained high (at 11.0% y/y in nominal terms, compared with 10.7% y/y in June).

Lending to households has continued to rise rapidly: in July the rise in consumer loans amounted to 19.7% y/y (against 22.6% y/y in June) and housing loans rose by 50.4% y/y (compared with 53.0% y/y). Corporate lending growth accelerated (to 7.2% y/y from 5.1% y/y in June). The acceleration in corporate lending, which came despite the fact that enterprises are holding substantial own funds resulting from their very good financial results in the first half of 2006, may point to a further rise in investment growth. Net profits of non-financial enterprises in the first half of 2006 were 24.2% higher than in the first half of 2005.

The fast economic growth has been accompanied by growing demand for labour. Since December 2004 the growth of corporate sector employment has been constantly accelerating. In July 2006 the employment in enterprises rose by 3.3% y/y (compared to 3.1% in June), which was the highest increase since the beginning of the 1990s. According to labour office data, in July 2006 the registered unemployment rate slid to 15.7% compared with 17.9% a year before.

Economic growth is also accompanied by a high growth of wages. In 2006 Q2 the rise of nominal wages in the economy was consistent with expectations and, similarly to the previous quarter, amounted to 4.7% y/y. In the enterprise sector, in July 2006 the rise in nominal wages accelerated to 5.6% y/y compared with 4.5% y/y in June (wages in enterprises after adjustment for the impact of shifts in one-off components of wages in certain sections, grew in June, according to NBP estimates, by 4.9% y/y). In industry, in January-July 2006, with employment rising by 1.9% y/y, the growth of labour productivity amounted to 10.4% y/y and was higher than the growth of wages in this sector (5.1% y/y). It will only be possible to assess the growth of unit labour costs in the whole economy in 2006 Q2 once the BAEL data for this period are released. The rise of unit labour costs in the economy (excluding private farming) in 2006 Q1 amounted to 3.3% y/y. It should be emphasised that the high economic growth which would not pose a threat to the achievement of the inflation target can only be sustained on the condition that the growth in wages does not outpace the growth in labour productivity. This requires strong and productivity-oriented corporate governance in enterprises, which is usually more easily attained under private ownership. This also requires wage discipline in the public sector.

The annual growth of consumer prices in July was faster than expected by external forecasters and the NBP, and reached 1.1% (against 0.8% y/y in June). The rise in the annual growth of prices in relation to June 2006 was mainly the result of the acceleration in the annual growth in the prices of food and internet services. The growth of food prices accelerated in connection to the unfavourable weather conditions in July. In turn, the rise in the prices of internet services mainly followed from the expiry of special price reductions offered by one of the providers. All measures of core inflation have increased (in July core inflation indicators ranged between 0.1% y/y and 1.3% y/y). August did not bring any changes to inflation expectations of households (0.8% y/y). According to the GUS business tendency surveys, the expected prices in retail sales, prices of industrial production and construction and assembly output have been gradually increasing since the beginning of 2006.

July 2006 has been another month of a considerable acceleration in the growth of producer prices in industry (rise of 3.5% y/y compared with upwards revised 3.0% y/y in June, i.e. 0.7% m/m against 0.9% m/m in June). The rise in annual PPI growth occurred even though the nominal effective exchange rate of the zloty was 2.3% stronger than a year before.

In the opinion of the Council the analysis of the latest data indicates that the path of future inflation will be similar to that presented in the July projection.

In the opinion of the Council, the currently observed fast economic growth creates favourable conditions for the implementation of reforms which would permanently reduce the public finance imbalance. The Council maintains its belief that it would be the most favourable for Poland to adopt an economic strategy focused on creating conditions that would guarantee the introduction of the euro at the earliest possible date. The reduction of the public finance imbalance

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and, consequently, the creation of the conditions for the introduction of the euro would contribute to higher long-term economic growth.

The next meeting of the Council will be held on 5 September 2006 and will be devoted to discussing the draft *Monetary Policy Guidelines for 2007*. The *Guidelines* will be finally approved at the Council's meeting on 26-27 September 2006.

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