Warsaw, 24 April 2003

INFORMATION FROM A MEETING OF THE MONETARY POLICY COUNCIL, held on 23-24 April 2003

On 23-24 April 2003 the Monetary Policy Council held a meeting. The Council read materials prepared by NBP Management Board and its Departments 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 salaries and wages 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 which has emerged since the previous meeting of the Monetary Policy Council indicates:

a) Decline in global oil prices, falling to below USD 25.00 per barrel and their prospective stabilisation after the end of military operations in Iraq,
b) Tighter salary discipline in the corporate sector resulting in low growth of salaries which, combined with low growth of nominal social benefits sustains the forecast growth rate in consumption demand below the level of the 4th quarter 2002,
c) Low annual growth rate in the M3 monetary aggregate, the cash growth rate has levelled off,
d) Low level of inflationary expectations of individuals and bank analysts,
e) Low base inflation rate,
f) Poor economic growth prospects in the euro zone; it is expected that the economic revival process will be slower than planned,

Factors potentially stimulating inflationary pressure include:

- Systematic growth in the price ratio of the industrial production sold chiefly as a result of zloty devaluation,
- a probable overrun in the level of economic deficit in the public finance sector as envisaged in the draft 2003 Budget Act and uncertainty underlying fiscal policy for 2004,

In addition, the Council took into account the extent of interest rate cuts implemented to date, which, allowing for the normal time lag, will gradually stimulate growth in domestic demand in the second half of 2003 and in 2004,

The Monetary Policy Council resolved:

- **that the National Bank of Poland will conduct open market operations for 14-day maturities with a profitability rate of at least 5.75% p.a.,**
- **to reduce the lombard rate from 7.75% to 7.25% p.a.,**
- **to reduce the re-discount rate from 6.50% to 6.25% p.a.,**
- **that the interest rate on term deposits taken by the NBP from banks will be held at 4.25% p.a.,**

The Council confirms its neutral approach in respect of monetary policy.

The Monetary Policy Council **approves** ***The Annual financial report of the NBP prepared as of 31-12-2002*** **and** ***The Balance of Payments of the Republic of Poland for 2002.***

The next meeting of the Monetary Policy Council is scheduled for 13 May 2003 (its agenda includes adoption of *The Report on the Execution of Monetary Policy Guidelines in 2002* and *The Report on the Inflation Rate in 2002)* and 27-28 May 2003.

I. Assessment of the economic situation

The beginning of war in Iraq trigged international market reactions anticipated by market analysts, including: a drop in the prices of oil and other strategic resources, a decrease in the prices of governmental bonds, rise in share prices and some strengthening of the American dollar. At the moment, in view of the swift completion of the military operation in Iraq, the war has been gradually losing its influential importance and the international market is showing higher stability.

Stabilisation of global oil prices after rapid drops

In the first half of March 2003, the average price of Brent oil was equal to USD 33.9 per barrel and remained above that price in February 2003 by USD 1.2. Directly after the war broke out, the main price-growth factors in the recent month, i.e. fear for the continuity of oil supplies from the Persian Gulf region has rapidly lost its significance. The second half of March 2003 saw a drop in the average oil price to USD 27.1 per barrel. The trend continued in the first half of April 2003 to stabilise at below USD 25.00 per barrel.

Relatively insignificant shortfalls in the global oil supply caused by the war in Iraq were largely compensated by the growth in production of the OPEC countries (on average 26m of barrels a day: unprecedented in the past two years). The production growth stemmed chiefly from the resumption of oil exploitation in Venezuela and a further increase in oil exploitation in Saudi Arabia.

A significant rise in USA imports and increased oil reserves in that country contributed to lessening the pressure towards a price-increase.

Improvement in consumer-confidence in the USA

Similarly, American consumers are showing signs of growing confidence reflected by a distinctive growth in retail sales observed in March 2003 (5.3% growth in turnover against 3.1% in February 2003). This trend is also confirmed by the inception results of April questionnaire research to measure consumer confidence of the USA households. It is anticipated that business circles will share this confidence.

At the moment, no information is available on the reaction of the market entities in the euro zone to the outbreak and positive developments of the Iraqi conflict. March 2003 witnessed a substantial deterioration in consumer and business confidence.

Growth in industrial output

In March 2003, the industry could partially make up for the losses generated in the first two months of 2003. After January and February growth remained at a level lower than expected, March 2003 saw a rise in the total industrial output sold by 5.7% against March 2002, and by 7.2% in processing industry.

Despite an improvement observed in March 2003, in the first quarter 2002, the growth of sales was slower than that in the fourth quarter 2002 (4.4% against 4.6%), chiefly due to a slower growth rate in processing industry (growth by 5.0% against 6.2%).

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Production growth ratios of March and the first quarter 2003 were not affected by the differences in working time. Similarly, the growth trend of the total industrial output volume observed since October 2002, remained below the rate observed between May and September 2002 as well as the stabilising tendency in food processing output volume (at 160% of the 1995 monthly average).

Some symptoms of a rebounding high increase in consumer demand to 2002 level were noticeable despite a continued drop in revenues from hired labour – in March 2003, the salary fund in the corporate sector remained lower by 3.3% from the level observed one year ago and by 2.3% lower over the whole 1st quarter 2003. Exports continuously support production, although the foreign trade turnover figures published by the Central Statistical Office in January and February indicate that the exports volume growth in euro terms was equal to 0.1%. At the same time, the payment figures disclose a growth of exports figures in euro terms by 6.8% over the first two months of 2003.

Downward trend in construction and installation continues

The construction industry showed no signs of upturn, with its output down by 25.3% from the level of March 2002 and by 23.1% below the level observed one year ago. Similarly to January and February trends, the deterioration may be connected with the winter season, with temperatures considerably below the level of 2002.

Seasonally adjusted data with respect to the analysis of economic performance conducted by the Central Statistical Office in the end of March 2003 on a sample of approx. 6 thousand companies indicate that, since the beginning of 2003, we have been facing a general downward trend in the processing and construction industry and in trade.

Positive opinions as to the prospective trends in the processing industry

However, there are many differences in the opinions expressed by the respondents from each of the above-mentioned sections on their economic situation:

- in the processing industry – in most cases, positive opinions and forecasts prevail,
- in the construction industry – pessimistic views prevail, while comments about the future display optimistic tendency,
- in trade - all comments are bleak (both those concerning current situation and the near future), with general market climate ratio the lowest within the whole period covered by the analysis.

No signs of favourable trends in construction and trade

The construction sector shows slightly more optimism with respect to the present and future market situation than the trade sector. In March 2003, both sectors displayed negative values for the majority of market trends; ratios which indicate that most of respondents were pessimistic when expressing their opinion about demand, output and financial standing of companies. They have shown more optimism when forecasting market developments in the next three months than when assessing current market situation.

Research into processing industry points to the positive value of the general consumer confidence index observed for the past three months owing to optimistic forecasts. In March 2003, the majority of respondents agreed that there had been a drop in demand (domestic and foreign) and production, coupled by the deterioration of their overall economic conditions and the potential for on-going settlement of financial liabilities. However, the opinions were not as negative as those expressed 12 and 24 months ago. Entrepreneurs from the industrial processing sectors remained very optimistic about the nearest future (ratios become positive, excluding those related to the employment growth perspectives).

The respondents link growing production and prospective improvement of their economic situation with the optimistic forecast regarding the domestic demand pattern.

What draws attention is the number of companies signalling a deterioration in their financial condition exceeding the number of companies which believe that their financial standing has improved (to some respect, it also applied to the industrial processing companies).

The construction companies anticipate substantial cuts in prices, while processing and trade companies forecast that the prices will grow.

In all sections, entrepreneurs share the same opinion on the prolonging downward trend in employment.

The first figures collected by the Central Statistical Office with respect to April market trends indicate some improvements in the confidence not only in the processing but also in the construction industry. The trade sector remains pessimistic about future developments.

II. Situation of public sector finance

Government revenue in the first quarter of 2003 was higher by 6.6% compared to the same period in 2002. A relatively high growth in the receipts from personal income tax (109.3%) and indirect taxes (106.9%) was observed.

40% of the planned state budget deficit after the 1st quarter 2003

Growth in the revenue from personal income tax can be attributed to additional receipts from the increase in salaries financed from the state and local budgets, pensions and invalidity benefits indexed to the inflation rate as well as from extended tax base in consequence of introducing tax on return on some money capitals. Increased revenues in indirect taxation were attributable to such factors as revenues generated from the excise tax on electricity that was introduced after the first quarter of 2002.

However, revenues from corporate income tax remain low. The amount that entered the state budget within the first three months of 2003 remained by 5.6% below the amount collected in the same period of 2002. Lower nominal value of CIT stems from such factors as lowering the CIT rate by 1 percentage point (to 27%) as at the year beginning and introduction of preferential depreciation rate on newly purchased fixed assets.

In the period covered by the report, high growth of revenues other than from taxes was observed. Their rise of 15% when compared to the same period of 2002 was partially affected by the additional revenues from the restructuring fee.

After three months of 2003, the annual revenue plan of the state budget was executed in 21.4%, remaining below the result achieved in the preceding years.

In the first quarter of 2003, the state budget expenditures reached approx. PLN 48.8bn, i.e. 2.3% above the former year's result. They accounted for 25.1% of the plan included in the Budget Act, i.e. below the level observed in the preceding years.

Deficit in the public finance sector in 2003 may be higher than planned

In consequence, the budget deficit amounted to approx. PLN 15.5bn, translating into 40% utilisation of the annual limit i.e. also below the figure disclosed one year ago.

To summarise, there are no indications in the state budget results after March 2003 that the limit of the deficit defined in the Budget Act will be exceeded. However, the continuing unfavourable situation of the Social Security Fund and the Agricultural Market Agency may aggravate the economic deficit of the public sector finances.

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

March witnessed a fall in money supply

In March 2003, the nominal M3 money supply fell by –0.05% below that of February 2003. Taking substantial changes in exchange rates observed in March 2003 into account, monthly drop of M3 was higher and reached –0.6%. The annual growth rate in M3 reached 0.5% to fall by –0.05% after elimination of exchange rate differences.

The drop in M3 money supply stemmed from the diminishing deposits of households, corporates and non-monetary financial institutions.

The annual growth rate in cash money of 13.8% in March 2003 remains at a level similar to that observed in preceding months.

Low demand for loans

Compared to the end of February result, March 2003 witnesses a substantial rise in total amounts due by 1.3%. However, it stemmed primarily from foreign exchange differences. After elimination of exchange rate differences, monthly rise in this category was as low as 0.1%. Within one month, amounts due from corporations rose by 2%; however, as much as 60% of the rise resulted from weakening of the zloty. After foreign exchange differences, amounts due from coporates grew by 0.8%. Amounts due from households rose by 1.9%; the rise was equal to 0.9% after foreign exchange differences. In general, the March figures confirm a prolonging low demand for loans both in the corporate and household sector.

Zloty weaker in March

March 2003 saw a discernible weakening of the zloty by reason of intensifying political conflicts in Poland. Compared to February, the zloty depreciated by 3.8% against the euro and by 3.6% against the dollar. The nominal effective exchange ratio dropped by 3.5%, while effective actual exchange rate depreciated as follows: exchange rate deflated with the CPI index by 3.3% and with the PPI in industrial processing by 3%, respectively. At the beginning of April 2003, the zloty was gradually gaining ground.

IV. Prices, inflationary expectations

Annual CPI reached 0.6%

In March 2003, the twelve-month CPI rose by 0.1% above the previous two months' figures. The trend was helped by a substantial increase in transport costs, stemming from continued increases in private vehicle fuel prices as well as housing costs and power carriers. Prices of foodstuffs, non-alcoholic and alcoholic beverages and tobacco products as well as articles of clothing and shoes continued to contribute to the drop of the twelve-month CPI.

Continued increase in production costs

March witnessed sustenance of the growing trend in the PPI. Compared to the same month 2002, production costs rose by 3.4%. The rise observed both in March and in the first quarter 2003 are chiefly attributable to zloty depreciation and increase in oil prices on global markets.

Low inflationary expectations of private individuals and bank analysts

In April 2003, the inflation rate expected by bank analysts in the month preceding the same month of next year (i.e. March 2004) rose by 0.1 percentage point to reach 2.2%, whilst the average annual inflation rate projected for 2004 was equal to 2.1% i.e. remained 0.3 percentage point below March 2003 estimations. At the same time, the expected inflation rate as at the end of 2003 amounted to 2.0%, i.e. 0.4 percentage point below March forecast.

Inflationary expectations of private individuals remain unchanged. The individuals expect prices to grow by 0.4% this year i.e. at the level of March 2003.