

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

On 25-26 March 2003 the meeting of the Monetary Policy Council took place. The MPC read materials prepared by the NBP Management Board and its Departments as well as information and analyses furnished by the Ministry of Finance, banks and research institutes. The MPC discussed the external environment of the Polish economy as well as real trends, trends in wages and salaries and social welfare benefits, in the public finance sector, in money supply, loans and interest rates and in the structures of pricing and inflationary expectations, as well as the anticipated inflation rate.

**Decision of the Monetary Policy Council**

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

- a) confirms the signs of a gradual economic recovery in industry due to increases in exports and to stable growth in retail sales.
  
- b) confirms earlier data that indicated a continuing low growth rate in domestic demand:
  - a continuing low growth rate of wages in the industrial sector,
  - a further declining growth rate in the construction industry,
  - the annual growth rate of monetary aggregates – M3 and loans – is becoming progressively steadier, the cash growth rate has levelled off,

c) shows that the current inflation and inflationary expectations of the general public and bank analysts continue to be low. All base inflation indices have fallen.

d) indicates that the German economy shows no signs of an upturn: both business and consumer optimism have remained low for another month, the German economy growth rate in 2003 is expected to be lower than it had been anticipated.

Factors potentially stimulating inflationary pressure include:

- a steady growth in the sold industrial production index to 2.8% in February 2003,
- a serious weakening of the zloty, which, in the light of internal and external political instability, may persist long enough to result in price increase.
- the risk of escalation in oil prices driven by the military operation in the Persian Gulf,
- a probable over-run in the level of economic deficit in the public finance sector as envisaged in the draft 2003 Budget Act and uncertainty underlying the fiscal policy for 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 6.00% p.a.,**
- **to reduce the lombard rate from 8.00% to 7.75% p.a.,**
- **that the interest rate on term deposits taken by the NBP from banks will be held at 4.25% p.a.,**
- **to reduce the re-discount rate from 6.75% to 6.50% p.a.,**

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

The next meeting of the Monetary Policy Council is scheduled for 23-24 April 2003.

## I. Assessment of the economic situation

Pessimism dominated on international markets in February and March 2003. Increasing political tension in the world caused deterioration in the expectation indicators of all market entities. The USA economy saw the most dramatic drop in consumer confidence with the University of Michigan ratio falling from 82.4 in January 2003 to 79.9 in February, whereas the NAMP indicator (showing the level of business confidence) fell from 53.9 to 50.5 in respective months. Parallel indicators for the Euro-zone also fell, yet at much slower rate. According to the analysts, a temporary increase in the German business confidence indicator in February 2003 (to 88.9 from the level of 87.4 in January 2003) was related to the growth in the industrial order portfolio resulting from the need to replenish stocks during wartime.

**Deterioration in consumer-confidence in the USA and the euro zone.**

The uncertainty which had prevailed on financial markets before the military operation started also resulted in: a downward trend on world stock exchanges, an increasing depreciation of the American dollar against the euro, and an increase in oil prices. Therefore, it was fairly unlikely that the level of demand in regions most important for the global economic condition, particularly the Euro zone, would improve in the near future. This opinion is supported by further negative adjustments to the economic growth forecast for Germany for 2003 (German Institute in Kiel forecasts the growth rate of the German GDP in 2003 to be 0.4%, whereas, according to the OECD, it should be 0.8%.)

**Less optimistic growth forecasts in Germany**

In February 2002, global oil prices continued to rise. The average price of crude oil in February 2003 reached USD 32.8 a barrel and was USD 1.5 higher than in January 2003 and USD 12.5 higher than in February 2002.

The increase in oil prices resulted mainly from growing concerns about the continued supply of oil from the Persian Gulf region and diminishing oil and petroleum products stocks in the USA. This drop was caused by a reduced supply of oil from Venezuela and by an increased demand for petroleum products, heating oil in particular, which resulted from hard winter conditions in the eastern part of the USA.

All in all, despite the relatively lower demand in Western Europe, since December 2002, the level of reserves in the OECD countries has continued to be at a 5 year low.

In February 2002 OPEC increased oil production by 1.5m barrels per day (as agreed in the quotas) as compared with January 2003. The supply level of the cartel members reached the level recorded before the strikes in Venezuela.

Most of the OPEC countries have almost reached their maximum production capacity. This means that in the foreseeable future the OPEC countries will not be able to increase the supply to a level which could compensate for the loss of Iraqi oil. Also, faced by military operations in Iraq, Kuwait may close oilfields located near the Iraqi border.

The start of the Persian Gulf war caused a fall in oil prices. At the moment the prices are fluctuating.

In the nearest future, the war in Iraq constitutes the main source of uncertainty and the cause of fluctuations on global financial markets.

The Central Statistical Office has confirmed the initial outlook, according to which the GDP growth rate in the 4th quarter of 2002 was 2.1%, and over the whole year 2002 - 1.3%.

**Higher production rate, in consistence with the current trend**

Year-to-year growth in total industrial output in February 2003 amounted to 4.1%. The growth in the processing industry might have been influenced, as in January 2003, by imponderables connected with severe weather. This is shown by the relatively high level of sales in the electricity, gas and water production and supply sector, and by a serious decline in output in the non-metallic raw materials manufacturing industry, which is extremely sensitive to weather conditions.

Continuing growth at a level similar to that of January and February confirms the stability of current trends. An increase in growth rates can only be achieved through growing investment demand.

Out of 29 industrial sectors, 22 reported an increase in production and 7 conceded a decline. As in previous months, the highest production growth was observed in industries with a high and increasing share of export sales.

There has been a further decline in construction output. It was 24% lower than in February 2002. The only sector which did not report a decline in production were companies preparing construction sites. As in industrial production, the level of output was influenced by the weather conditions, which this year were much more severe than last winter. Therefore, data concerning construction output in January and February cannot be treated as indicative of a further future decline in the investment demand.

**Further decline in construction output**

According to the Central Statistical Office survey of a sample of six thousand enterprises, conducted at the end of February 2003, the condition of the processing industry has been improving since the beginning of this year. The general marker for this sector has been positive for the second consecutive month. According to the majority of respondents both output and demand increased in February. However, when asked about their financial condition, liabilities or foreign demand, their opinions were still negative, though not as pessimistic as in the same period of the previous year, or two years ago. It should be noted that, compared to January 2003, a substantial over-stock of ready-made goods can be observed in enterprises.

**Significantly better assessment of the condition in processing industry**

Entrepreneurs are very optimistic about the nearest future (with indicators turning positive, except those concerning employment). The foreign demand forecast look particularly promising, so it can be concluded that entrepreneurs associate the increase in production and improvement of their economic situation with exports.

The general situation in trade and in the construction industry is considered to be really difficult, particularly in trade. All specific indicators for February 2003, based on their evaluation by trade and construction companies have again been negative, and, when compared with the data of 2002, they show no signs of discernable improvement.

**Continuous negative assessment of general situation in trade and in construction industry**

Entrepreneurs in all sectors agree that the level of employment will continue to decline.

Entrepreneurs in trade and in the construction industry anticipate a fall in their output prices. Only the processing industry companies expect a price increase.

January 2003 saw another decline by EUR 290m against January 2002 in the current account deficit which amounted to EUR 680m. As in previous months, a drop in the negative balance of the current account results from a decrease in the commodity trading deficit and, as in December 2002, from the growing positive balance of unclassified current account transactions.

**Decrease in the current account deficit**

The commodities trading deficit fell in January 2003 by EUR 170m. This was due to the fact that exports growth rate exceeded (by 8.2%, as compared with January 2002) the imports growth rate (by 1.2%) – a trend that has continued for eleven consecutive months to date. The January data confirms that, since September 2002, exports have increased continuously. The growth in imports, on the other hand, has slowed down as compared with November and December 2002.

**Exports still increase**

## II. Situation of public sector finance

After the first two months of 2003 the nominal and real value of the state budget revenues were higher than in the same period of the previous year, and they constituted 14.3% of the annual plan.

PIT receipts remain at a relatively high level. They rose by 7.8% against the figures for the corresponding months of the previous year, which is not impressive and constitutes mere 14 % of their substantial annual increase of 13% anticipated in the budget for this year.

**The annual plan of state budget revenues and expenditures followed to a very little extent in the first two months of 2003**

CIT receipts are 9.8% lower than after the first two months of 2002. This situation was attributable mainly to the February receipts (annual growth in this category in February equalled 83.9%)

The state budget receipts from indirect taxes in January and February 2003 were 8.3% higher than in the same period of the previous year. Significantly high were receipts in January, which can be attributed to the introduction of settlements on a quarterly basis for small and medium-sized enterprises. The plan resulted in a 15.2% increase - a result slightly worse than in previous years - which stems from the high budget plan for this year.

State budget expenditures this February were 4.2% higher than in February 2002. Yet, because of the very low expenditures in January, they constituted only 17.5% of the budget plan, which is considerably below the percentage reported in previous years.



Consequently, the budget deficit amounted to PLN 11.7bn, which equals 30% of the annual limit - much below the result in the previous year.

According to the information available concerning other sectors and institutions in the public finance sector, particularly worrying is the situation of the Social Insurance Institution and the Agricultural Market Agency. Here, deficits may be higher than anticipated.

On the whole, it can be expected that the state budget deficit will not exceed the statutory maximum, although budget revenues are lower than planned. The difficult situation in the Social Insurance Institution and in the Agricultural Market Agency may increase the economic deficit of the public finance sector.

**Economic deficit of the public finance sector in 2003 may be higher than planned.**

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

In February, the M3 money supply rose by PLN 3.3 Bn (1.0%) and the annual growth rate of the M3 aggregate amounted to 1.2%. After elimination of exchange rate differences, the M3 growth amounted to PLN 2.5 Bn. The main source of M3 growth was the increase in the amount of cash in circulation by PLN 1.1 Bn (2.7%) and in the deposits of the local government bodies by PLN 1.3 Bn (14.3%). Other components of the M3 aggregate underwent only slight changes.

**Increase in the amount of money supply in February**

The annual cash in circulation growth rate reached 12.7% in February 2003, similar to the percentages reported in previous months. The annual growth rate in deposits from local government bodies amounted to 9.6% - a level almost unchanged for the last six months, although the deposits by self governing institutions are usually higher in February, due to subsidies received from central government. Deposits from households increased by PLN 1.2 Bn (0.6%). However, when the differences in exchange rates are eliminated, this growth amounted only to PLN 0.4 Bn. Although the total value of growth in household deposits in February was not very high, it should be noted that it was the first growth in this category reported since June 2002.

The low demand for loans, both from companies and from households, continues. The total value of amounts due increased slightly by PLN 0.9 Bn (0.4%) in February, and when the differences in exchange rates were eliminated, the total value of amounts due decreased by 0.4%. Adjusted to exchange rates differences, the annual growth rate of amounts due from households amounted to -0.3% and from corporations to -0.2%.

**Small growth in loans**

In February, a strengthening of the euro against the dollar could be observed on the global markets. The average monthly value of EUR against USD reached a level of 1.08 – the highest since March 1999. The Zloty also strengthened against the dollar. The average exchange rate of EUR against PLN in February equalled 4.16 and was the highest since June 2000.

**Weakening of PLN exchange rate**

The gradual depreciation of the zloty against the dollar and the euro continued in the first half of March. When the war in the Persian Gulf broke out, the exchange rate of the zloty levelled off.

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

The twelve-month consumer commodities and services price growth index was the same in February as in January and amounted to 0.5% (after changes in the weighting system introduced by Central Statistical Office). As in January 2003, the increase in CPI in February 2003 resulted mostly from the rise in rental and energy costs as well as costs of transport, caused mainly by rising fuel prices. The CPI was also reduced by food prices, non-alcoholic drinks, alcohol and tobacco as well as of clothes and footwear.

**The annual  
consumer price  
index at 0.5%**

The sold-product prices in industry increased over the last twelve months by 2.8% (0.2% in the previous year). The growth in sold-product prices resulted from the depreciation of the effective zloty exchange rate and from the rise in oil prices. The actual growth of prices in industrial production was hampered by the adaptive processes in enterprises directed towards lowering individual labour costs (low increase in nominal wages accompanied by rapid growth in efficiency).

**Increase in the  
production prices in  
February**

Most significant was the growth by 6.3% in electricity, gas and water supply and production prices (10.0% in the previous year). Also prices in industrial processing increased by 2.6% (1.7% fall in the previous year).

**Decrease in  
inflationary  
expectations of  
natural persons and  
bank analysts**

In March 2003 the rate of price growth as expected by natural persons in the coming year decreased by 0.3 percentage point against February 2003 and equalled 0.3%. The inflation rate expected by banking analysts in the month preceding the same month of next year (i.e. February 2004) fell by 0.2 percentage point to reach 2.1% whilst the average annual inflation rate for 2004 equalled 2.4% and was 0.1 percentage point below February's forecast. The expected 2003 year-end inflation rate was 2.4% which is 0.1 percentage point higher than in the previous month.