

Information on the meeting of the Monetary Policy Council on July 19-20, 2001

The Monetary Policy Council held its meeting on July 19-20th, 2001. The Council was submitted the materials prepared by the Management Board and departments of the NBP and information and analytical materials prepared by Ministry of Finance, research institutes and commercial banks. Before starting the decision-making part of the meeting, the Council members discussed the current economic situation, especially considering factors that influence the future inflation processes.

I. Inflation processes.

1. In June this year, consumer goods and services prices lowered by 0.1% as compared to May this year. It mainly resulted from the drop of foodstuff prices (by 0.6%), especially seasonal drop of fruit prices (by 9.5%) and the drop of fuel prices (by 0.5%) as compared to the previous month. However, it is worth stressing a slight price rise as compared to May this year in the remaining groups that are included into the CPI basket (the price rise within the range 0.1-0.2%).

The twelve-month consumer price index lowered to 6.2% from 6.9% in May this year.

2. In June this year, the base inflation measures looked favorable. All the base inflation indices calculated at the twelve-month scale lowered and amounted from 5.3% to 6.8%.
3. The sold industrial output prices dropped by 0.4% as compared to May this year.

The twelve-month PPI lowered to 0.9% from 2.3% in May this year and 8.9% in June 2000. A relatively low level of this index results from the price drop in the industrial processing section by 0.9% annually (as compared to the rise by 0.6% in May this year and by 8.9% in June last year). It should be stressed, however, that the biggest drop of prices was noted in these industrial-processing sections where a considerable growth was noted last year:

- in the production of coke, petroleum products and derivatives the prices dropped by 11.7% (as compared to the rise by 48.6% a year before),
- in the production of pulp and paper the prices lowered by 4.0% (as compared to the rise by 16.7% in June 2000),
- in the production of motor vehicles the prices dropped by 3.2% (as compared to the 2.5%-rise a year before).

However, in the industrial sections where the market mechanism is limited, the price dynamics is maintained at a high level:

- in the section of production and provision of electric energy, natural gas and water the prices rose by 9.8% annually,
- in mining the prices rose by 5.2%.

The construction and assembling production prices rose by 0.1% as compared to the previous month and as compared to June last year they rose by 3.9%.

4. The inflation rate expected by the bank analysts at the end of the year actually amounts to 6.0% (as compared to 5.9% a month before), i.e. it is the same as the bottom level of the inflation target. The inertia in making inflation expectations by individuals is getting smaller.

Therefore, the earlier forecasts of the Council that the growth of the consumer goods and services prices in the previous two months was a temporary development got confirmed. In June, there was noted a drop of the twelve-month consumer price index, producer price index and all the measures of base inflation. Favorable - for the future inflation - were also inflation expectations.

II. Money supply, loans, interest rates.***

1. In June this year, money supply rose by 0.9% as compared to May this year and it is the lowest indicator for this month within the last six years. The annual growth pace of money supply lowered to 12.3% from 13.5% a month before.
2. Favorable developments in the area of the deposits and lending growth are maintained:
 - In June this year, PLN-denominated deposits placed by individuals rose by PLN 2.5 billion (i.e. by 1.5%) as compared to May this year (in May, the monthly growth pace amounted to 0.7%). Within 6 months of this year the total of PLN-denominated deposits placed by individuals increased by PLN 15.4 billion (i.e. by 10.0%). The dynamics of PLN-denominated deposits placed by individuals calculated at the 12-month scale amounted to 21.4% (as compared to 21% a month before).
 - The lending dynamics lowered again; the total amount of granted loans rose by 10.0% as compared to June last year and by 11.3% in May this year.
 - The twelve-month dynamics of loans dropped both to individuals (to 20.3% from 22.1% a month before) and to businesses (to 7.2% from 8.4% in May this year).
3. Commercial banks quickly reacted to the Monetary Policy Council decision made in June on the cut of the basic interest rates of the NBP by 1.5 percentage point. According to the latest data, the APR for loans and deposits at commercial banks was lowered on average:
 - in case of deposits by 0.4-1.1 percentage point,
 - in case of loans to individuals by 1.1 percentage point,
 - in case of loans to businesses by 1.4-1.6 percentage point.

The favorable tendencies for future inflation processes in the area of monetary developments were enhanced. A strong tendency to save by households is maintained.

III. External conditions.

1. Within the last month, the forecasts of the economic growth in the euro zone were lowered from 2.2% to 2%. The forecast of the economic growth in Germany was lowered to 1.6% from 1.8% a month before. The uncertainty related to the economic growth outlook in the USA is still maintained.
2. Within a month, there were no additional signals inducing to the verification of forecasts concerning fuel prices on the world markets as compared to the previous month.

The current forecasts of external conditions indicate that they do not threaten the achievement of the monetary policy targets. The actual forecasts of growth in the euro zone signal less favorable - than it resulted from the previous forecasts - conditions for the growth of the Polish exports and GDP.

IV. Balance of payments, exchange rate.

1. In May this year, the current account deficit based on payments amounted to USD 708 million (as compared to USD 519 million in April this year and USD 405 million in May last year). Within the period January-May 2001, the current account deficit amounted to USD 3.397 million and as compared to the same period last year it decreased by USD 1.378 million.
2. Since November 2000 a gradual appreciation of the zloty took place. Within the period November 2000 - June 2001, the zloty appreciated by 16.4% against the dollar and 14.7% against the euro. Since July 6th this year the reversal of this tendency took place and after several days of considerable fluctuations the exchange rate of the zloty is now at the level 4.20-4.30 for a dollar.
3. The latest developments on the currency market resulted from the mix of external and internal factors:
 - The external impulse of the depreciation was the situation in Argentina and Turkey that resulted in the drop of investors' confidence to countries included into the so-called emerging markets.
 - From the group of domestic factors the most important were: unclear situation of the budget, worse than expected data on current account in May and statements of some politicians.
 - The market participants expected the depreciation of the zloty as the current exchange rate - in their opinion - was overvalued.
 - The strengthening of the depreciation was also affected by mechanisms typical to financial markets. The speculation of short-term investors resulted in the fast withdrawal of their capital at the moment of problems in Argentina and Turkey.

In May, there were visible some signs of exports dynamics weakening and current account balance worsening as a result of the zloty appreciation within the last months and the weakening of the external demand dynamics. However, after five months of the year, the situation in the area of external balance was much better than a year before.

Within the last days, there appeared considerable fluctuations of the exchange rate and the depreciation of the zloty that resulted from the joining of external and internal factors.

V. Supply, demand, situation on labor market and income.

1. In June this year, the sold industrial output was lower by 4.8% than a year before. After adjusting the difference of business days, the drop of industrial output amounted to approximately 3%. The construction and assembling output was smaller than in June last year by 10.1%.
2. In June, a further drop of employment in the enterprise sector took place. The number of the employed was smaller by 0.3% than in May this year and by 3.3% as compared to June last year.
3. Average wages in the enterprise sector in June this year were higher by 4.9% than in June last year, and in real terms they lowered by 1.2%. Within the period January-June this year, average wages in the enterprise sector as compared to the same period last year rose by 7.3% in nominal terms (the growth in real terms amounted to 0.6%).

The information on the situation in the real sector and a low dynamics of sold industrial output confirms the lack of demand pressure on the price growth in the nearest months.

VI. Situation in public finance sector.

1. In June this year, due to the payment of the NBP earnings and the payment of the next installment for the third generation cell phone communication license the state budget had a positive balance. As of the end of June this year the level of budget deficit achievement was 91.1% of the amount set forth in the act on the state budget (as compared to 99.3% a month before).
2. The Council of Ministers submitted the Sejm the project of the amendment to the act on the state budget containing the increase of the budget deficit level by maximum PLN 8.6 billion. The Government also forecasts the reduction of budget expenses at the amount of PLN 7.5 billion if the lack of revenues amounts to PLN 17.5 billion.
3. The increase of budget deficit requires an additional issue of treasury securities what will cause pressure on the increase of their profitability. The increase of profitability, in turn, will increase the cost of public debt service and may cause the increase of the market interest rates. The lower revenues from privatization the bigger this pressure.

It should be emphasized that the Government decision is a temporary action and does not solve basic problems of public finance. A thorough reform of the state finance is necessary that would reduce the scale of public expenses mainly by the replacement of the wasteful systems of spending (e.g. system of medication refund) with the more reasonable ones in order to enable the public finance balancing in the next years.

VII. Decision of the Monetary Policy Council.

1. In June this year, according to the earlier forecasts of the Monetary Policy Council, a drop of CPI took place (up to 6.2% annually from 6.9% a month before).
2. Positive tendencies in the area of factors affecting the future inflation were maintained:
 - all measures of base inflation decreased,
 - the producer price index lowered again,
 - inflation expectations of individuals and bank analysts were favorable,
 - positive tendencies in the area of monetary developments were enhanced,
 - the situation in the real sector of the economy indicates a lack of threats to the achievement of inflation target in 2001.
3. At the previous meeting, the Monetary Policy Council forecasted that positive tendencies from the point of view of future inflation processes would be maintained. These forecasts were taken into consideration in making the decision on the interest rates cut by 150 basis points.
4. Threats connected with the situation in public finance sector are maintained. They result from the uncertainty as far as the 2001 budget amendment and the contents of the act on the state budget for 2002 are concerned. Only the firm actions directed towards the public finance improvement (especially the reduction of expenses) will enable the reduction of budget deficit what, in turn, is necessary to enhance macroeconomic bases of the Polish economy development.

Considering the above mentioned conditions, the Monetary Policy Council decided to maintain the basic interest rates of the NBP at the current level and its neutral position in the area of monetary policy.

The next meeting of the Monetary Policy Council will be held on August 21-22nd, 2001.

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****In June last year, there was noted a short-term considerable growth of money supply, loans and deposits due to the sale of the stocks of PKN Orlen and the transfer of funds for the repurchase of bonds made by the state budget to Dom Maklerski Pekao S.A. (brokerage house Pekao S.A.). Due to this reason the annual dynamics of the money supply, loans and deposits are adjusted by the influence of these factors.*